

**SELECTED FINANCIAL DATA<sup>(1)</sup>**

Five Years Ended July 29, 2000 (In millions, except per-share amounts)

	July 29, 2000	July 31, 1999	July 25, 1998	July 26, 1997	July 28, 1996
Net sales	<b>\$18,928</b>	\$12,173	\$8,489	\$6,452	\$4,101
Net income	<b>\$ 2,668<sup>(2)</sup></b>	\$ 2,023 <sup>(3)</sup>	\$1,331 <sup>(4)</sup>	\$1,047 <sup>(5)</sup>	\$ 915 <sup>(6)</sup>
Net income per common share—basic	<b>\$ 0.39</b>	\$ 0.30	\$ 0.21	\$ 0.17	\$ 0.16
Net income per common share—diluted	<b>\$ 0.36<sup>(2)</sup></b>	\$ 0.29 <sup>(3)</sup>	\$ 0.20 <sup>(4)</sup>	\$ 0.17 <sup>(5)</sup>	\$ 0.15 <sup>(6)</sup>
Shares used in per-common share calculation—basic*	<b>6,917</b>	6,646	6,312	6,007	5,758
Shares used in per-common share calculation—diluted*	<b>7,438</b>	7,062	6,658	6,287	6,008
Total assets	<b>\$32,870</b>	\$14,893	\$9,043	\$5,504	\$3,647

\* Reflects the two-for-one stock split effective March 2000.

<sup>(1)</sup> All historical financial information has been restated to reflect the acquisitions that were accounted for as poolings of interests (see Note 3 to the Consolidated Financial Statements).<sup>(2)</sup> Net income and net income per common share include in-process research and development expenses of \$1.37 billion, amortization of goodwill and purchased intangible assets of \$291 million, acquisition-related costs of \$62 million, payroll tax on stock option exercises of \$51 million, and net gains realized on minority investments of \$531 million. Pro forma net income and diluted net income per common share, excluding these items net of tax of \$0, were \$3.91 billion and \$0.53, respectively.<sup>(3)</sup> Net income and net income per common share include in-process research and development expenses of \$471 million, amortization of goodwill and purchased intangible assets of \$61 million, and acquisition-related costs of \$16 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$54 million, were \$2.52 billion and \$0.36, respectively.<sup>(4)</sup> Net income and net income per common share include in-process research and development expenses of \$594 million, amortization of goodwill and purchased intangible assets of \$23 million, and net gains realized on minority investments of \$5 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$67 million, were \$1.88 billion and \$0.28, respectively.<sup>(5)</sup> Net income and net income per common share include in-process research and development expenses of \$508 million, amortization of goodwill and purchased intangible assets of \$11 million, and net gains realized on minority investments of \$152 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$7 million, were \$1.42 billion and \$0.23, respectively.<sup>(6)</sup> Net income and net income per common share include amortization of goodwill and purchased intangible assets of \$14 million. Pro forma net income and diluted net income per common share, excluding this item net of a tax benefit of \$2 million, were \$927 million and \$0.15, respectively.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

All historical financial information has been restated to reflect the acquisitions that were accounted for as poolings of interests (see Note 3 to the Consolidated Financial Statements).

### FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report, including, without limitation, statements containing the words "believes," "anticipates," "estimates," "expects," "projections," and words of similar import, constitute "forward-looking statements." You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including risks faced by us described in the Risk Factors sections, among others, included in the documents we file with the Securities and Exchange Commission ("SEC"), including our most recent reports on Form 10-K, Form 8-K, and Form 10-Q, and amendments thereto.

### COMPARISON OF FISCAL 2000 AND FISCAL 1999

Net sales in fiscal 2000 were \$18.93 billion, compared with \$12.17 billion in fiscal 1999, an increase of 55.5%. The increase in net sales was primarily a result of increased unit sales of switch, router, and access products; growth in the sales of add-on boards that provide increased functionality; optical transport products; and maintenance, service, and support sales (see Note 12 to the Consolidated Financial Statements).

We manage our business on four geographic theaters: the Americas; Europe, the Middle East, and Africa ("EMEA"); Asia Pacific; and Japan. Summarized financial information by theater for fiscal 2000 and 1999 is presented in the following table (in millions):

Years Ended	Amount		Percentage of Net Sales	
	July 29, 2000	July 31, 1999	July 29, 2000	July 31, 1999
Net sales:				
Americas	<b>\$12,924</b>	\$ 8,088	<b>68.3%</b>	66.4%
EMEA	<b>4,770</b>	3,216	<b>25.2</b>	26.4
Asia Pacific	<b>1,705</b>	825	<b>9.0</b>	6.8
Japan	<b>935</b>	566	<b>4.9</b>	4.7
Sales adjustments	<b>(1,406)</b>	(522)	<b>(7.4)</b>	(4.3)
<b>Total</b>	<b>\$18,928</b>	\$12,173	<b>100.0%</b>	100.0%

The revenue growth for each theater was primarily driven by market demand and the deployment of Internet technologies and business solutions.

Gross margin in fiscal 2000 was 64.4%, compared with 65.0% in fiscal 1999. The following table shows the standard margins for each theater:

Years Ended	July 29, 2000	July 31, 1999
Standard margins:		
Americas	<b>72.8%</b>	72.2%
EMEA	<b>75.1%</b>	74.0%
Asia Pacific	<b>71.3%</b>	71.0%
Japan	<b>78.8%</b>	77.0%

The net sales and standard margins by geographic theater differ from the amounts recognized under generally accepted accounting principles because we do not allocate certain sales adjustments, production overhead, and manufacturing variances and other related costs to the theaters. Sales adjustments relate to revenue deferrals and reserves, credit memos, returns, and other timing differences.

Standard margins increased for all geographic theaters as compared with fiscal 1999. The decrease in the overall gross margin was primarily due to shifts in product mix, introduction of new products, which generally have lower margins when first released, higher production-related costs, the continued pricing pressure seen from competitors in certain product areas, and the above-mentioned sales adjustments, which were not included in the standard margins.

We expect gross margin may be adversely affected by increases in material or labor costs, heightened price competition, increasing levels of services, higher inventory balances, introduction of new products for new high-growth markets, and changes in channels of distribution or in the mix of products sold. We believe gross margin may additionally be impacted due to constraints relating to certain component shortages that currently exist in the supply chain. We may also experience a lower gross margin as the product mix for access and optical product volume grows.

We have recently introduced several new products, with additional new products scheduled to be released in the future. Increase in demand would result in increased manufacturing capacity, which in turn would result in higher inventory balances. In addition, our vendor base is capacity-constrained, and this could result in increased cost pressure on certain components. If product or related warranty costs associated with these new products are greater than we have experienced, gross margin may be adversely affected. Our gross margin may also be impacted by geographic mix, as well as the mix of configurations within each product group. We continue to expand into third-party or indirect-distribution channels, which generally results in a lower gross margin. In addition, increasing third-party and indirect-distribution channels generally results in greater difficulty in forecasting the mix of our product, and to a certain degree, the timing of orders from our customers. Downward pressures on our gross margin may be further impacted by other factors, such as increased percentage of revenue from service provider markets, which may have lower margins or an increase in product costs, which could adversely affect our future operating results.

Research and development (“R&D”) expenses in fiscal 2000 were \$2.70 billion, compared with \$1.66 billion in fiscal 1999, an increase of 62.6%. R&D expenses, as a percentage of net sales, increased to 14.3% in fiscal 2000, compared with 13.7% in fiscal 1999. The increase reflected our ongoing R&D efforts in a wide variety of areas such as data, voice, and video integration, digital subscriber line (“DSL”) technologies, cable modem technology, wireless access, dial access, enterprise switching, optical transport, security, network management, and high-end routing technologies, among others. A significant portion of the increase was due to the addition of new personnel, partly through acquisitions, as well as higher expenditures on prototypes and depreciation on additional lab equipment. We also continued to purchase technology in order to bring a broad range of products to the market in a timely fashion. If we believe that we are unable to enter a particular market in a timely manner with internally developed products, we may license technology from other businesses or acquire businesses as an alternative to internal R&D. All of our R&D costs are expensed as incurred. We currently expect that R&D expenses will continue to increase in absolute dollars as we continue to invest in technology to address potential market opportunities.

Sales and marketing expenses in fiscal 2000 were \$3.95 billion, compared with \$2.46 billion in fiscal 1999, an increase of 60.1%. Sales and marketing expenses, as a percentage of net sales, increased to 20.8% in fiscal 2000, compared with 20.2% in fiscal 1999. The increase was principally due to an increase in the size of our direct sales force and related commissions, additional marketing and advertising investments associated with the introduction of new products, the expansion of distribution channels, and general corporate branding. The increase also reflected our efforts to invest in certain key areas, such as expansion of our end-to-end networking strategy and service provider coverage, in order to be positioned to take advantage of future market opportunities. We currently expect that sales and marketing expenses will continue to increase in absolute dollars.

General and administrative (“G&A”) expenses in fiscal 2000 were \$633 million, compared with \$381 million in fiscal 1999, an increase of 66.1%. G&A expenses, as a percentage of net sales, increased to 3.3% in fiscal 2000, compared with 3.1% in fiscal 1999. G&A expenses for fiscal 2000 and 1999 included acquisition-related costs of approximately \$62 million and \$16 million, respectively. Excluding the acquisition-related costs, the increase in G&A expenses was primarily related to the addition of new personnel and investments in infrastructure. We intend to keep G&A expenses relatively constant as a percentage of net sales; however, this depends on the level of acquisition activity and our growth, among other factors.

Amortization of goodwill and purchased intangible assets included in operating expenses was \$291 million in fiscal 2000, compared with \$61 million in fiscal 1999. Amortization of goodwill and purchased intangible assets primarily relates to various purchase acquisitions (see Note 3 and Note 4 to the Consolidated Financial Statements). Amortization of goodwill and purchased intangible assets will continue to increase as we acquire companies and technologies.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The amount expensed to in-process research and development ("in-process R&D") arose from the purchase acquisitions completed in fiscal 2000 (see Note 3 to the Consolidated Financial Statements).

The fair values of the existing products and patents, as well as the technology currently under development, were determined using the income approach, which discounts expected future cash flows to present value. The discount rates used in the present value calculations were typically derived from a weighted-average cost of capital analysis and venture capital surveys, adjusted upward to reflect additional risks inherent in the development life cycle. These risk factors have increased the overall discount rate for acquisitions in the current year. We consider the pricing model for products related to these acquisitions to be standard within the high-technology communications equipment industry. However, we do not expect to achieve a material amount of expense reductions or synergies as a result of integrating the acquired in-process technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

The development of these technologies remains a significant risk due to the remaining effort to achieve technical viability, rapidly changing customer markets, uncertain standards for new products, and significant competitive threats from numerous companies. The nature of the efforts to develop the acquired technologies into commercially viable products consists principally of planning, designing, and testing activities necessary to determine that the products can meet market expectations, including functionality and technical requirements. Failure to bring these products to market in a timely manner could result in a loss of market share or a lost opportunity to capitalize on emerging markets and could have a material adverse impact on our business and operating results.

The following table summarizes the significant assumptions underlying the valuations for our significant purchase acquisitions completed in fiscal 2000 and 1999 (in millions, except percentages):

Acquired Company	Acquisition Assumptions	
	Estimated Cost to Complete Technology at Time of Acquisition	Risk-Adjusted Discount Rate for In-Process R&D
<b>FISCAL 2000</b>		
Monterey Networks, Inc.	\$ 4	30.0%
The optical systems business of Pirelli S.p.A.	\$ 5	20.0%
Aironet Wireless Communications, Inc.	\$ 3	23.5%
Atlantech Technologies	\$ 6	37.5%
JetCell, Inc.	\$ 7	30.5%
PentaCom, Ltd.	\$13	30.0%
Qeyton Systems	\$ 6	35.0%
<b>FISCAL 1999</b>		
Summa Four, Inc.	\$ 5	25.0%
Clarity Wireless, Inc.	\$42	32.0%
Selsius Systems, Inc.	\$15	31.0%
PipeLinks, Inc.	\$ 5	31.0%
Amteva Technologies	\$ 4	35.0%

Regarding our purchase acquisitions completed in fiscal 2000 and 1999, actual results to date have been consistent, in all material respects, with our assumptions at the time of the acquisitions. The assumptions primarily consist of an expected completion date for the in-process projects, estimated costs to complete the projects, and revenue and expense projections once the products have entered the market. Shipment volumes of products from the above-acquired technologies are not material to our overall financial results at the present time. Therefore, it is difficult to determine the accuracy of overall revenue projections early in the technology or product life cycle. Failure to achieve the expected levels of revenue and net income from these products will negatively impact the return on investment expected at the time that the acquisitions were completed and potentially result in impairment of any other assets related to the development activities.

Interest and other income, net, was \$577 million in fiscal 2000, compared with \$330 million in fiscal 1999. The increase was primarily due to interest income related to the general increase in cash and investments, which was generated from our operations. Net gains realized on minority investments were \$531 million in fiscal 2000. The net gains realized on minority investments were not material in fiscal 1999.

Our pro forma effective tax rate for fiscal 2000 was 30.0%. The actual effective tax rate was 38.6%, which included the impact of nondeductible in-process R&D and acquisition-related costs. Our future effective tax rates could be adversely affected if earnings are lower than anticipated in countries where we have lower effective rates or by unfavorable changes in tax laws and regulations. Additionally, we have provided a valuation allowance on certain of our deferred tax assets because of uncertainty regarding their realizability due to expectation of future employee stock option exercises (see Note 11 to the Consolidated Financial Statements).

#### COMPARISON OF FISCAL 1999 AND FISCAL 1998

Net sales in fiscal 1999 were \$12.17 billion, compared with \$8.49 billion in fiscal 1998, an increase of 43.4%. The increase in net sales was primarily a result of increased unit sales of LAN switching products, access servers, high-performance WAN switching and routing products, and maintenance service contracts.

Gross margin in fiscal 1999 was 65.0%, compared with 65.6% in fiscal 1998. The decrease in the overall gross margin was primarily due to our continued shift in revenue mix toward our lower-margin products and the continued pricing pressure seen from competitors in certain product areas.

R&D expenses in fiscal 1999 were \$1.66 billion, compared with \$1.05 billion in fiscal 1998, an increase of 58.1%. R&D expenses, as a percentage of net sales, increased to 13.7% in fiscal 1999, compared with 12.4% in fiscal 1998. The increase reflected our ongoing R&D efforts in a wide variety of areas such as data, voice, and video integration, DSL technologies, cable modem technology, wireless access, dial access, enterprise switching, security, network management, and high-end routing technologies, among others. A significant portion of the increase was due to the addition of new personnel, partly through acquisitions, as well as higher expenditures on prototypes and depreciation on additional lab equipment.

Sales and marketing expenses in fiscal 1999 were \$2.46 billion, compared with \$1.58 billion in fiscal 1998, an increase of 56.1%. Sales and marketing expenses, as a percentage of net sales, increased to 20.2% in fiscal 1999, compared with 18.6% in fiscal 1998. The increase was principally due to an increase in the size of our direct sales force and related commissions, television advertising campaigns to build brand awareness, additional marketing and advertising costs associated with the introduction of new products, and the expansion of distribution channels. The increase also reflected our efforts to invest in certain key areas, such as expansion of our end-to-end networking strategy and service provider coverage, in order to be positioned to take advantage of future market opportunities.

G&A expenses in fiscal 1999 were \$381 million, compared with \$247 million in fiscal 1998, an increase of 54.3%. G&A expenses, as a percentage of net sales, increased to 3.1% in fiscal 1999, compared with 2.9% in fiscal 1998. The increase was primarily related to additional personnel and acquisition-related costs of \$16 million.

Amortization of goodwill and purchased intangible assets included in operating expenses was \$61 million in fiscal 1999, compared with \$23 million in fiscal 1998. Amortization of goodwill and purchased intangible assets increased as we acquired companies and technologies.

Interest and other income, net, in fiscal 1999 was \$330 million, compared with \$196 million in fiscal 1998. Interest income rose primarily as a result of additional investment income on our increased investment balances.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments and hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. We do not expect the initial adoption of SFAS 133 to have a material effect on our operations or financial position. We are required to adopt SFAS 133 in the first quarter of fiscal 2001.

In September 1999, the FASB issued Emerging Issues Task Force Topic No. D-83, "Accounting for Payroll Taxes Associated with Stock Option Exercises" ("EITF D-83"). EITF D-83 requires that payroll tax paid on the difference between the exercise price and the fair value of acquired stock in association with an employee's exercise of stock options be recorded as operating expenses. Payroll tax on stock option exercises of \$51 million was expensed in fiscal 2000.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101, as amended, summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements. At this time, we do not expect the adoption of SAB 101 to have a material effect on our operations or financial position; however, the SEC's final guidance for implementation has not been released to date. We are required to adopt SAB 101 in the fourth quarter of fiscal 2001.

### LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents, short-term investments, and investments were \$20.50 billion at July 29, 2000, an increase of \$10.28 billion from July 31, 1999. The increase was primarily a result of \$5.00 billion of net unrealized gains on publicly held investments and \$7.70 billion of cash generated by operating and financing activities partially offset by investing activities, including net capital expenditures of \$1.09 billion, purchases of technology licenses of \$444 million, and investments in lease receivables of \$535 million.

Accounts receivable increased 83.9% during fiscal 2000. Days sales outstanding in receivables increased to 37 days for fiscal 2000, from 32 days for fiscal 1999. The increase in accounts receivable and days sales outstanding was due, in part, to growth in total net sales combined with conditions in a number of markets, resulting in longer payment terms.

Inventories increased 87.2% during fiscal 2000; however, inventory turns remained constant at 7.8 times. The increase in inventory levels reflected new product introductions, continued growth in our two-tier distribution system, and increased purchases to secure the supply of certain components. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times with the risk of inventory obsolescence due to rapidly changing technology and customer requirements.

At July 29, 2000, we had a line of credit totaling \$500 million, which expires in July 2002. There have been no borrowings under this agreement (see Note 7 to the Consolidated Financial Statements).

We have entered into several agreements to lease 448 acres of land located in San Jose, California, where our headquarters operations are established, and 759 acres of land located in Boxborough, Massachusetts; Salem, New Hampshire; Richardson, Texas; and Research Triangle Park, North Carolina, where we have expanded certain R&D and customer-support activities. In connection with these transactions, we have pledged \$1.29 billion of our investments as collateral for certain obligations of the leases. We anticipate that we will occupy more leased property in the future that will require similar pledged securities; however, we do not expect the impact of this activity to be material to our liquidity position (see Note 8 to the Consolidated Financial Statements).

We believe that our current cash and cash equivalents, short-term investments, line of credit, and cash generated from operations will satisfy our expected working capital, capital expenditure, and investment requirements through at least the next 12 months.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We maintain an investment portfolio of various holdings, types, and maturities. These securities are generally classified as available for sale and, consequently, are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of tax. Part of this portfolio includes minority equity investments in several publicly traded companies, the values of which are subject to market price volatility. For example, as a result of recent market price volatility of our publicly traded equity investments, we experienced a \$111 million after-tax unrealized loss during the third quarter of fiscal 2000 and a \$1.83 billion after-tax unrealized gain during the fourth quarter of fiscal 2000 on these investments. We have also invested in numerous privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire initial investment in these companies. We also have certain real estate lease commitments with payments tied to short-term interest rates. At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our investment portfolio while increasing the costs associated with our lease commitments. Conversely, declines in interest rates could have a material impact on interest earnings for our investment portfolio. We do not currently hedge these interest rate exposures.

### INVESTMENTS

The following table presents the hypothetical changes in fair values in the financial instruments held at July 29, 2000 that are sensitive to changes in interest rates. These instruments are not leveraged and are held for purposes other than trading. The modeling technique used measures the change in fair values arising from selected potential changes in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ("BPS"), 100 BPS, and 150 BPS over a 12-month horizon. Beginning fair values represent the principal plus accrued interest and dividends of the interest rate-sensitive financial instruments at July 29, 2000. Ending fair values are the market principal plus accrued interest, dividends, and reinvestment income at a 12-month horizon. The following table estimates the fair value of the portfolio at a 12-month horizon (in millions):

Issuer	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of July 29, 2000	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)		50 BPS	100 BPS	150 BPS
U.S. government notes and bonds	\$2,350	\$2,329	\$2,307	\$2,285	\$2,262	\$2,240	\$2,218
State, municipal, and county government notes and bonds	3,666	3,632	3,598	3,564	3,529	3,494	3,459
Corporate notes and bonds	3,296	3,266	3,235	3,204	3,173	3,141	3,110
Total	\$9,312	\$9,227	\$9,140	\$9,053	\$8,964	\$8,875	\$8,787

A 50 BPS move in the Federal Funds Rate has occurred in nine of the last 10 years; a 100 BPS move in the Federal Funds Rate has occurred in six of the last 10 years; and a 150 BPS move in the Federal Funds Rate has occurred in four of the last 10 years.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following analysis presents the hypothetical changes in fair values of public equity investments that are sensitive to changes in the stock market. These equity securities are held for purposes other than trading. The modeling technique used measures the hypothetical change in fair values arising from selected hypothetical changes in each stock's price. Stock price fluctuations of plus or minus 15%, plus or minus 35%, and plus or minus 50% were selected based on the probability of their occurrence. The following table estimates the fair value of the publicly traded corporate equities at a 12-month horizon (in millions):

	Valuation of Securities Given X% Decrease in Each Stock's Price			Fair Value as of July 29, 2000	Valuation of Securities Given X% Increase in Each Stock's Price		
	(50%)	(35%)	(15%)		15%	35%	50%
Corporate equities	\$3,112	\$4,046	\$5,291	\$6,225	\$7,159	\$8,404	\$9,337

Our equity portfolio consists of securities with characteristics that most closely match the S&P Index or companies traded on the NASDAQ National Market. The NASDAQ Composite Index has shown a 15% movement in each of the last three years and a 35% and 50% movement in at least one of the last three years.

We also have an investment in KPMG Consulting, Inc. in the principal amount of \$1.05 billion of Series A Mandatorily Redeemable Convertible Preferred Stock, which carries a 6% dividend rate on the original issue price until converted to common stock. Conversion is at our option upon or after the completion of an initial public offering of KPMG Consulting, Inc. We have not included the investment in the above sensitivity analyses due to the nature of this investment.

### LEASES

We are exposed to interest rate risk associated with leases on our facilities where payments are tied to the London Interbank Offered Rate ("LIBOR"). We have evaluated the hypothetical change in lease obligations held at July 29, 2000 due to changes in the LIBOR. The modeling technique used measures hypothetical changes in lease obligations arising from selected hypothetical changes in the LIBOR. The hypothetical market changes reflected immediate parallel shifts in the LIBOR curve of plus or minus 50 BPS, 100 BPS, and 150 BPS over a 12-month period. The results of this analysis were not material in comparison to our financial results.

### FOREIGN EXCHANGE FORWARD AND OPTION CONTRACTS

We enter into foreign exchange forward contracts to offset the impact of currency fluctuations on certain nonfunctional currency assets and liabilities, primarily denominated in Australian, Canadian, Japanese, Korean, and several European currencies, primarily the euro and British pound. We also periodically hedge anticipated transactions with purchased currency options.

The foreign exchange forward and option contracts we enter into generally have original maturities ranging from one to three months. We do not enter into foreign exchange forward and option contracts for trading purposes. We do not expect gains or losses on these contracts to have a material impact on our financial results (see Note 8 to the Consolidated Financial Statements).

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per-share amounts)

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
<b>NET SALES</b>	<b>\$18,928</b>	\$12,173	\$8,489
Cost of sales	<b>6,746</b>	4,259	2,924
<b>GROSS MARGIN</b>	<b>12,182</b>	7,914	5,565
Operating expenses:			
Research and development	<b>2,704</b>	1,663	1,052
Sales and marketing	<b>3,946</b>	2,465	1,579
General and administrative	<b>633</b>	381	247
Amortization of goodwill and purchased intangible assets	<b>291</b>	61	23
In-process research and development	<b>1,373</b>	471	594
Total operating expenses	<b>8,947</b>	5,041	3,495
<b>OPERATING INCOME</b>	<b>3,235</b>	2,873	2,070
Net gains realized on minority investments	<b>531</b>	-	5
Interest and other income, net	<b>577</b>	330	196
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>4,343</b>	3,203	2,271
Provision for income taxes	<b>1,675</b>	1,180	940
<b>NET INCOME</b>	<b>\$ 2,668</b>	\$ 2,023	\$1,331
Net income per common share—basic	<b>\$ 0.39</b>	\$ 0.30	\$ 0.21
Net income per common share—diluted	<b>\$ 0.36</b>	\$ 0.29	\$ 0.20
Shares used in per-common share calculation—basic	<b>6,917</b>	6,646	6,312
Shares used in per-common share calculation—diluted	<b>7,438</b>	7,062	6,658

See Notes to Consolidated Financial Statements.

## CONSOLIDATED BALANCE SHEETS

(In millions, except par value)

July 29, 2000      July 31, 1999

### ASSETS

#### Current assets:

Cash and cash equivalents	\$ 4,234	\$ 913
Short-term investments	1,291	1,189
Accounts receivable, net of allowances for doubtful accounts of \$43 at 2000 and \$27 at 1999	2,299	1,250
Inventories, net	1,232	658
Deferred tax assets	1,091	580
Prepaid expenses and other current assets	963	171
<b>Total current assets</b>	<b>11,110</b>	<b>4,761</b>
Investments	13,688	7,032
Restricted investments	1,286	1,080
Property and equipment, net	1,426	825
Goodwill and purchased intangible assets, net	4,087	460
Lease receivables	527	500
Other assets	746	235
<b>TOTAL ASSETS</b>	<b>\$32,870</b>	<b>\$14,893</b>

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current liabilities:

Accounts payable	\$ 739	\$ 374
Income taxes payable	233	630
Accrued compensation	1,317	679
Deferred revenue	1,386	724
Other accrued liabilities	1,521	631
<b>Total current liabilities</b>	<b>5,196</b>	<b>3,038</b>
Commitments and contingencies (Note 8)		
Deferred tax liabilities	1,132	-
Minority interest	45	44
Shareholders' equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding	-	-
Common stock and additional paid-in capital, \$0.001 par value: 20,000 shares authorized; 7,138 and 6,821 shares issued and outstanding at 2000 and 1999, respectively	14,609	5,731
Retained earnings	8,358	5,782
Accumulated other comprehensive income	3,530	298
<b>Total shareholders' equity</b>	<b>26,497</b>	<b>11,811</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$32,870</b>	<b>\$14,893</b>

See Notes to Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
<b>Cash flows from operating activities:</b>			
Net income	\$ 2,668	\$ 2,023	\$ 1,331
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	863	489	329
Provision for doubtful accounts	40	19	43
Provision for inventory allowances	339	151	161
Deferred income taxes	(782)	(247)	(76)
Tax benefits from employee stock option plans	2,495	837	422
Adjustment to conform fiscal year ends of pooled acquisitions	(18)	1	–
In-process research and development	1,279	379	436
Gains on minority investments	(92)	–	–
Change in operating assets and liabilities:			
Accounts receivable	(1,043)	45	(166)
Inventories	(887)	(443)	(267)
Prepaid expenses and other current assets	(249)	(101)	21
Accounts payable	286	111	32
Income taxes payable	(365)	217	155
Accrued compensation	576	285	123
Deferred revenue	662	385	156
Other accrued liabilities	369	174	165
Net cash provided by operating activities	<b>6,141</b>	4,325	2,865
<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	(2,473)	(1,250)	(1,611)
Proceeds from sales and maturities of short-term investments	2,481	1,660	1,751
Purchases of investments	(14,778)	(5,632)	(3,561)
Proceeds from sales and maturities of investments	13,240	1,994	1,107
Purchases of restricted investments	(458)	(1,101)	(527)
Proceeds from sales and maturities of restricted investments	206	560	337
Acquisition of property and equipment	(1,086)	(602)	(429)
Purchases of technology licenses	(444)	(95)	–
Acquisition of businesses, net of cash and cash equivalents	24	(19)	–
Net investment in lease receivables	(535)	(310)	(171)
Other	(554)	(190)	1
Net cash used in investing activities	<b>(4,377)</b>	(4,985)	(3,103)
<b>Cash flows from financing activities:</b>			
Issuance of common stock	1,564	947	555
Other	(7)	7	(7)
Net cash provided by financing activities	<b>1,557</b>	954	548
Net increase in cash and cash equivalents	<b>3,321</b>	294	310
Cash and cash equivalents, beginning of fiscal year	<b>913</b>	619	309
Cash and cash equivalents, end of fiscal year	<b>\$ 4,234</b>	\$ 913	\$ 619

See Notes to Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions)

	Common Stock Number of Shares	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
BALANCE AT JULY 26, 1997	6,163	\$ 1,814	\$2,478	\$ 40	\$ 4,332
Net income	-	-	1,331	-	1,331
Change in net unrealized gains on investments	-	-	-	28	28
Translation adjustments	-	-	-	(10)	(10)
Comprehensive income	-	-	-	-	1,349
Issuance of common stock	280	555	-	-	555
Tax benefits from employee stock option plans	-	422	-	-	422
Pooling of interests acquisitions	6	12	(9)	-	3
Purchase acquisitions	42	536	-	-	536
BALANCE AT JULY 25, 1998	6,491	3,339	3,800	58	7,197
Net income	-	-	2,023	-	2,023
Change in net unrealized gains on investments	-	-	-	234	234
Translation adjustments	-	-	-	6	6
Comprehensive income	-	-	-	-	2,263
Issuance of common stock	300	947	-	-	947
Tax benefits from employee stock option plans	-	837	-	-	837
Pooling of interests acquisitions	4	38	(42)	-	(4)
Purchase acquisitions	26	570	-	-	570
Adjustment to conform fiscal year ends of pooled acquisitions	-	-	1	-	1
BALANCE AT JULY 31, 1999	6,821	5,731	5,782	298	11,811
Net income	-	-	2,668	-	2,668
Change in net unrealized gains on investments	-	-	-	3,240	3,240
Translation adjustments	-	-	-	(8)	(8)
Comprehensive income	-	-	-	-	5,900
Issuance of common stock	219	1,564	-	-	1,564
Tax benefits from employee stock option plans	-	3,077	-	-	3,077
Pooling of interests acquisitions	20	75	(74)	-	1
Purchase acquisitions	78	4,162	-	-	4,162
Adjustment to conform fiscal year ends of pooled acquisitions	-	-	(18)	-	(18)
<b>BALANCE AT JULY 29, 2000</b>	<b>7,138</b>	<b>\$14,609</b>	<b>\$8,358</b>	<b>\$3,530</b>	<b>\$26,497</b>

See Notes to Consolidated Financial Statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. DESCRIPTION OF BUSINESS

Cisco Systems, Inc. and its subsidiaries (“Cisco” or the “Company”) is the worldwide leader in networking for the Internet. Cisco hardware, software, and service offerings are used to create Internet solutions so that individuals, companies, and countries have seamless access to information—regardless of differences in time and place. Cisco solutions provide competitive advantage to our customers through more efficient and timely exchange of information, which in turn leads to cost savings, process efficiencies, and closer relationships with their customers, prospects, business partners, suppliers, and employees. These solutions form the networking foundation for companies, universities, utilities, and government agencies worldwide.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year The Company’s fiscal year is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2000, 1999, and 1998 were 52-week, 53-week, and 52-week fiscal years, respectively.

Principles of Consolidation The Consolidated Financial Statements include the accounts of Cisco Systems, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents The Company considers all highly liquid investments purchased with an original or remaining maturity of less than three months at the date of purchase to be cash equivalents. Substantially all cash and cash equivalents are custodied with three major financial institutions.

Investments The Company’s investments comprise U.S., state, and municipal government obligations; corporate debt securities; and public corporate equity securities. Investments with maturities of less than one year are considered short-term and are carried at fair value. All investments are primarily held in the Company’s name and custodied with two major financial institutions. The specific identification method is used to determine the cost of securities disposed. At July 29, 2000 and July 31, 1999, substantially all of the Company’s investments were classified as available for sale. Unrealized gains and losses on these investments are included as a separate component of shareholders’ equity, net of any related tax effect.

The Company also has certain other minority investments in nonpublicly traded companies. These investments are included in other assets on the Company’s balance sheet and are generally carried at cost. The Company monitors these investments for impairment and makes appropriate reductions in carrying values when necessary.

Inventories Inventories are stated at the lower of cost or market. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis.

Restricted Investments Restricted investments consist of U.S. government obligations with maturities of more than one year. These investments are carried at fair value and are restricted as to withdrawal. Restricted investments are held in the Company’s name and custodied with two major financial institutions.

Fair Value of Financial Instruments Carrying amounts of certain of the Company’s financial instruments, including cash and cash equivalents, accrued compensation, and other accrued liabilities, approximate fair value because of their short maturities. The fair values of investments are determined using quoted market prices for those securities or similar financial instruments.

Concentrations Cash and cash equivalents are primarily maintained with three major financial institutions in the United States. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and, therefore, bear minimal risk.

The Company performs ongoing credit evaluations of its customers and, with the exception of certain financing transactions, does not require collateral from its customers.

The Company receives certain of its components from sole suppliers. Additionally, the Company relies on a limited number of hardware manufacturers. The inability of any supplier or manufacturer to fulfill supply requirements of the Company could materially impact future operating results.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Revenue Recognition** The Company generally recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, fee is fixed or determinable, and collectibility is probable. Revenue from service obligations is deferred and generally recognized ratably over the period of the obligation. The Company makes certain sales to partners in two-tier distribution channels. These partners are generally given privileges to return a portion of inventory and participate in various cooperative marketing programs. The Company recognizes revenue to two-tier distributors based on estimates which approximate the point products have been sold by the distributors and also maintains accruals and allowances for all cooperative marketing and other programs. The Company accrues for warranty costs, sales returns, and other allowances based on its experience.

**Lease Receivables** Cisco provides a variety of lease financing services to its customers to build, maintain, and upgrade their networks. Lease receivables represent the principal balance remaining in sales-type and direct-financing leases under these programs. These leases typically have two to three year terms and are collateralized by a security interest in the underlying assets.

**Advertising Costs** The Company expenses all advertising costs as incurred.

**Software Development Costs** Software development costs, which are required to be capitalized pursuant to Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," have not been material to date.

**Depreciation and Amortization** Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of 24 to 30 months are used on computer equipment and related software and production and engineering equipment and five years for office equipment, furniture, and fixtures. Depreciation and amortization of leasehold improvements is computed using the shorter of the remaining lease term or five years.

**Goodwill and Purchased Intangible Assets** Goodwill and purchased intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the economic lives of the respective assets, generally three to five years.

**Income Taxes** Income tax expense is based on pre-tax financial accounting income. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts.

**Computation of Net Income per Common Share** Basic net income per common share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per common share is computed using the weighted-average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options. Share and per-common share data for all periods presented reflect the two-for-one stock split effective March 2000.

**Foreign Currency Translation** Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment are translated to U.S. dollars at exchange rates in effect at the balance sheet date with the resulting translation adjustments recorded directly to a separate component of shareholders' equity. Income and expense accounts are translated at average exchange rates during the year. Where the U.S. dollar is the functional currency, translation adjustments are recorded in income.

**Derivatives** The Company enters into foreign exchange forward contracts to minimize the short-term impact of foreign currency fluctuations on assets and liabilities denominated in currencies other than the functional currency of the reporting entity. All foreign exchange forward contracts are highly inversely correlated to the hedged items and are designated as, and considered effective as, hedges of the underlying assets or liabilities. Gains and losses on the contracts are included in interest and other income, net, and offset foreign exchange gains or losses from the revaluation of intercompany balances or other current assets and liabilities denominated in currencies other than the functional currency of the reporting entity. Fair values of foreign exchange forward contracts are determined using published rates. If a derivative contract terminates prior to maturity, the investment is shown at its fair value with the resulting gain or loss reflected in interest and other income, net. The Company periodically hedges anticipated transactions with purchased currency options. The premium paid is amortized over the life of the option while any intrinsic value is recognized in income during the same period as the hedged transaction.

**Minority Interest** Minority interest represents the preferred stockholders' proportionate share of the equity of Cisco Systems, K.K. (Japan). At July 29, 2000, the Company owned all issued and outstanding common stock amounting to 73.2% of the voting rights. Each share of preferred stock is convertible into one share of common stock at any time at the option of the holder.

Use of Estimates The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory allowances, depreciation and amortization, sales returns, warranty costs, taxes, and contingencies. Actual results could differ from these estimates.

Impairment of Long-Lived Assets Long-lived assets and certain identifiable intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use are based on the fair value of the asset. Long-lived assets and certain identifiable intangible assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

Recent Accounting Pronouncements In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments and hedging activities. It requires an entity to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. Management does not expect the initial adoption of SFAS 133 to have a material effect on the Company's operations or financial position. The Company is required to adopt SFAS 133 in the first quarter of fiscal 2001.

In September 1999, the FASB issued Emerging Issues Task Force Topic No. D-83, "Accounting for Payroll Taxes Associated with Stock Option Exercises" ("EITF D-83"). EITF D-83 requires that payroll tax paid on the difference between the exercise price and the fair value of acquired stock in association with an employee's exercise of stock options be recorded as operating expenses. Payroll tax on stock option exercises of \$51 million was expensed in fiscal 2000.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101, as amended, summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements. At this time, management does not expect the adoption of SAB 101 to have a material effect on the Company's operations or financial position; however, the SEC's final guidance for implementation has not been released to date. The Company is required to adopt SAB 101 in the fourth quarter of fiscal 2001.

Reclassifications Certain reclassifications have been made to prior year balances in order to conform to the current year presentation.

### 3. BUSINESS COMBINATIONS

#### Pooling of Interests Combinations

In fiscal 2000, the Company acquired StratumOne Communications, Inc. ("StratumOne"); TransMedia Communications, Inc. ("TransMedia"); Cerent Corporation ("Cerent"); WebLine Communications Corporation ("WebLine"); SightPath, Inc. ("SightPath"); InfoGear Technology Corporation ("InfoGear"); and ArrowPoint Communications, Inc. ("ArrowPoint"), which were accounted for as poolings of interests. All historical financial information has been restated to reflect these acquisitions. In addition, the historical financial information has been restated to reflect the acquisition of Fibex Systems ("Fibex"), which was completed in the fourth quarter of fiscal 1999 and accounted for as a pooling of interests. These transactions are summarized as follows (in millions):

Acquisition Date	Acquired Company	Shares of Cisco Stock Issued, Including Options Assumed	Fair Value of Acquisition
May 1999	Fibex	11.5	\$ 314
September 1999	StratumOne	13.3	\$ 435
September 1999	TransMedia	13.9	\$ 407
November 1999	Cerent	200.0	\$6,900
November 1999	WebLine	8.6	\$ 325
May 2000	SightPath	11.4	\$ 800
June 2000	InfoGear	4.7	\$ 301
June 2000	ArrowPoint	90.2	\$5,700

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All of these acquired companies used a calendar year end. In order for all companies to operate on the same fiscal year, operations for the one-month period ending July 31, 1999, which were not significant to the Company, have been reflected as an adjustment to retained earnings in fiscal 2000. No significant adjustments were necessary to conform accounting policies. However, the companies' historical results have been adjusted to reflect the elimination of previously provided valuation allowances on deferred tax assets. There were no intercompany transactions requiring elimination in any period presented. The following table shows the historical results for the periods prior to the mergers of these entities (in millions):

	Nine Months Ended	Years Ended	
	April 29, 2000	July 31, 1999	July 25, 1998
Net sales:			
Cisco	<b>\$13,147</b>	\$12,154	\$8,488
Fibex	-	3	-
StratumOne	-	-	-
TransMedia	-	-	-
Cerent	<b>35</b>	10	-
WebLine	<b>1</b>	3	1
SightPath	-	-	-
InfoGear	-	-	-
ArrowPoint	<b>25</b>	3	-
Total	<b>\$13,208</b>	\$12,173	\$8,489
Net income (loss):			
Cisco	<b>\$ 1,932</b>	\$ 2,096	\$1,355
Fibex	-	(13)	(3)
StratumOne	<b>(3)</b>	(6)	(1)
TransMedia	<b>(4)</b>	(7)	-
Cerent	<b>(15)</b>	(31)	(9)
WebLine	<b>(3)</b>	(4)	(2)
SightPath	<b>(8)</b>	(2)	-
InfoGear	<b>(15)</b>	(5)	(5)
ArrowPoint	<b>(12)</b>	(5)	(4)
Total	<b>\$ 1,872</b>	\$ 2,023	\$1,331

In fiscal 1999, the Company acquired GeoTel Communications Corporation and approximately 68 million shares of common stock were exchanged and options were assumed for a fair value of \$2 billion. The transaction was accounted for as a pooling of interests and all periods presented prior to fiscal 1999 were restated.

### Other Pooling of Interests Combinations Completed as of July 29, 2000

The Company has also completed a number of other pooling transactions during the three years ended July 29, 2000. The historical operations of these entities were not material to the Company's consolidated operations on either an individual or aggregate basis; therefore, prior period financial statements have not been restated for these acquisitions. These transactions are summarized as follows (in millions):

Fiscal Year	Acquired Company	Shares of Cisco Stock Issued, Including Options Assumed	Fair Value of Acquisition
1998	Precept Software, Inc.	6.0	\$ 84
1999	Sentient Networks, Inc.	4.0	\$131
<b>2000</b>	Cocom A/S	<b>1.9</b>	<b>\$ 66</b>
<b>2000</b>	V-Bits, Inc.	<b>2.8</b>	<b>\$128</b>
<b>2000</b>	Growth Networks, Inc.	<b>5.6</b>	<b>\$355</b>
<b>2000</b>	Altiga Networks, Inc.	<b>6.3</b>	<b>\$335</b>
<b>2000</b>	Compatible Systems Corporation	<b>3.8</b>	<b>\$232</b>

### Purchase Combinations

During the three years ended July 29, 2000, the Company completed a number of purchase acquisitions. The Consolidated Financial Statements include the operating results of each business from the date of acquisition. Pro forma results of operations have not been presented because the effects of these acquisitions were not material on either an individual or an aggregate basis.

The amounts allocated to in-process research and development (“in-process R&D”) were determined through established valuation techniques in the high-technology communications equipment industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed. Amounts allocated to goodwill and purchased intangible assets are amortized on a straight-line basis over periods not exceeding five years. A summary of purchase transactions is outlined as follows (in millions):

Acquired Company	Consideration	In-Process R&D Expense	Form of Consideration and Other Notes to Acquisition
<b>FISCAL 2000</b>			
Monterey Networks, Inc.	\$ 517	\$354	Common stock and options assumed; \$14 in liabilities assumed; goodwill and other intangibles recorded of \$154
The optical systems business of Pirelli S.p.A.	\$2,018	\$245	Common stock; \$362 in liabilities assumed; goodwill and other intangibles recorded of \$1,717
Aironet Wireless Communications, Inc.	\$ 835	\$243	Common stock and options assumed; \$34 in liabilities assumed; goodwill and other intangibles recorded of \$589
Atlantech Technologies	\$ 179	\$ 63	Cash of \$92; common stock and options assumed; \$1 in liabilities assumed; goodwill and other intangibles recorded of \$140
JetCell, Inc.	\$ 203	\$ 88	Cash of \$5; common stock and options assumed; \$2 in liabilities assumed; goodwill and other intangibles recorded of \$137
PentaCom, Ltd.	\$ 102	\$ 49	Cash of \$26; common stock and options assumed; goodwill and other intangibles recorded of \$40
Qeyton Systems	\$ 887	\$260	Common stock; goodwill and other intangibles recorded of \$567
Other	\$ 228	\$ 71	Cash of \$31; common stock and options assumed; \$5 in liabilities assumed; goodwill and other intangibles recorded of \$155
<b>FISCAL 1999</b>			
Summa Four, Inc.	\$ 129	\$ 64	Common stock and options assumed; \$16 in liabilities assumed; goodwill and other intangibles recorded of \$29
Clarity Wireless, Inc.	\$ 153	\$ 94	Common stock and options assumed; goodwill and other intangibles recorded of \$73
Selsius Systems, Inc.	\$ 134	\$ 92	Cash of \$111; options assumed; goodwill and other intangibles recorded of \$41
PipeLinks, Inc.	\$ 118	\$ 99	Common stock and options assumed; goodwill and other intangibles recorded of \$11
Amteva Technologies, Inc.	\$ 159	\$ 81	Common stock and options assumed; \$9 in liabilities assumed; goodwill and other intangibles recorded of \$85
Other	\$ 58	\$ 41	Common stock and options assumed; goodwill and other intangibles recorded of \$18
<b>FISCAL 1998</b>			
Dagaz Technologies, Inc.	\$ 130	\$127	Cash of \$108; \$18 in common stock; liabilities assumed of \$4
LightSpeed International, Inc.	\$ 161	\$143	Common stock and options assumed; other intangibles recorded of \$15
WheelGroup Corporation	\$ 124	\$ 97	Common stock and options assumed; goodwill and other intangibles recorded of \$38
NetSpeed International, Inc.	\$ 252	\$179	Cash of \$12; common stock and options assumed; liabilities assumed of \$18; goodwill and other intangibles recorded of \$76
Other	\$ 51	\$ 48	Cash of \$38 and options assumed

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Other Purchase Combinations Completed as of July 29, 2000

In fiscal 2000, the Company acquired Maxcomm Technologies, Inc.; Calista, Inc.; Tasmania Network Systems, Inc.; Internet Engineering Group, LLC; Worldwide Data Systems, Inc.; and Seagull Networks, Ltd. for a total purchase price of \$228 million, paid in common stock and cash. Total in-process R&D related to these acquisitions amounted to \$71 million.

Total in-process R&D expense in fiscal 2000, 1999, and 1998 was \$1.37 billion, \$471 million, and \$594 million, respectively. The in-process R&D expense that was attributable to stock consideration for the same periods was \$1.28 billion, \$379 million, and \$436 million, respectively.

### 4. BALANCE SHEET DETAIL

The following tables provide details of selected balance sheet items (in millions):

	July 29, 2000	July 31, 1999
<b>INVENTORIES, NET:</b>		
Raw materials	\$ 145	\$ 143
Work in process	472	198
Finished goods	496	282
Demonstration systems	119	35
Total	<b>\$1,232</b>	\$ 658
<b>PROPERTY AND EQUIPMENT, NET:</b>		
Leasehold improvements	\$ 607	\$ 289
Computer equipment and related software	908	639
Production and engineering equipment	407	238
Office equipment, furniture, and fixtures	1,083	685
	<b>3,005</b>	1,851
Less, accumulated depreciation and amortization	<b>(1,579)</b>	(1,026)
Total	<b>\$1,426</b>	\$ 825
<b>GOODWILL AND PURCHASED INTANGIBLE ASSETS, NET:</b>		
Goodwill	\$2,937	\$ 157
Purchased intangible assets	1,558	395
	<b>4,495</b>	552
Less, accumulated amortization	<b>(408)</b>	(92)
Total	<b>\$4,087</b>	\$ 460

The following table presents the details of the amortization of goodwill and purchased intangible assets as reported in the Consolidated Statements of Operations:

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Reported as:			
Cost of sales	\$ 25	\$ 1	\$ -
Operating expenses	291	61	23
Total	<b>\$316</b>	\$62	\$23

## 5. LEASE RECEIVABLES

Lease receivables represent sales-type and direct-financing leases resulting from the sale of the Company's and complementary third-party products and services. These lease arrangements typically have terms from two to three years and are usually collateralized by a security interest in the underlying assets. The net lease receivables are summarized as follows (in millions):

	July 29, 2000	July 31, 1999
Gross lease receivables	<b>\$1,310</b>	\$663
Unearned income and other reserves	<b>(195)</b>	(83)
Total	<b>1,115</b>	580
Less, current portion	<b>(588)</b>	(80)
Long-term lease receivables, net	<b>\$ 527</b>	\$500

Contractual maturities of the gross lease receivables at July 29, 2000 were \$588 million in fiscal 2001, \$354 million in fiscal 2002, \$337 million in fiscal 2003, \$29 million in fiscal 2004, and \$2 million in fiscal 2005. Actual cash collections may differ from the contractual maturities due to early customer buyouts or refinancings. The current portion of lease receivables is included in prepaid expenses and other current assets.

## 6. INVESTMENTS

The following tables summarize the Company's investments in securities (in millions):

JULY 29, 2000	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government notes and bonds	<b>\$ 2,317</b>	\$ -	\$ (32)	<b>\$ 2,285</b>
State, municipal, and county government notes and bonds	<b>3,592</b>	<b>13</b>	<b>(41)</b>	<b>3,564</b>
Corporate notes and bonds	<b>3,222</b>	<b>1</b>	<b>(19)</b>	<b>3,204</b>
Corporate equity securities	<b>641</b>	<b>5,621</b>	<b>(37)</b>	<b>6,225</b>
Mandatorily redeemable convertible preferred stock	<b>987</b>	-	-	<b>987</b>
Total	<b>\$10,759</b>	<b>\$5,635</b>	<b>\$(129)</b>	<b>\$16,265</b>
Reported as:				
Short-term investments				<b>\$ 1,291</b>
Investments				<b>13,688</b>
Restricted investments				<b>1,286</b>
Total				<b>\$16,265</b>
JULY 31, 1999				
U.S. government notes and bonds	\$ 2,187	\$ -	\$ (29)	\$ 2,158
State, municipal, and county government notes and bonds	5,177	5	(44)	5,138
Corporate notes and bonds	1,145	-	(17)	1,128
Corporate equity securities	288	615	(26)	877
Total	\$ 8,797	\$ 620	\$(116)	\$ 9,301
Reported as:				
Short-term investments				\$ 1,189
Investments				7,032
Restricted investments				1,080
Total				\$ 9,301

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Net gains realized on minority investments were \$531 million in fiscal 2000. The net gains realized on minority investments that were attributable to noncash activity were \$92 million in fiscal 2000. The net gains realized on minority investments were not material in fiscal 1999 and were \$5 million in fiscal 1998.

The following table summarizes debt investment and mandatorily redeemable convertible preferred stock maturities (including restricted investments) at July 29, 2000 (in millions):

	Amortized Cost	Fair Value
Less than one year	\$ 1,753	\$ 1,744
Due in 1-2 years	1,930	1,922
Due in 2-5 years	4,218	4,161
Due after 5 years	2,217	2,213
Total	\$10,118	\$10,040

### 7. LINE OF CREDIT

At July 29, 2000, the Company had a syndicated credit agreement under the terms of which a group of banks committed a maximum of \$500 million on an unsecured, revolving basis for borrowings of various maturities. The commitments made under this agreement expire on July 1, 2002. Under the terms of the agreement, borrowings bear interest at a spread over the London Interbank Offered Rate based on certain financial criteria and third-party rating assessments. As of July 29, 2000, this spread was 17.5 basis points. From this spread, a commitment fee of 5.5 basis points is assessed against any undrawn amounts. The agreement includes a single financial covenant that places a variable floor on tangible net worth, as defined, if certain leverage ratios are exceeded. There have been no borrowings under this agreement to date.

### 8. COMMITMENTS AND CONTINGENCIES

#### Leases

The Company has entered into several agreements to lease 448 acres of land located in San Jose, California, where it has established its headquarters operations, and 759 acres of land located in Boxborough, Massachusetts; Salem, New Hampshire; Richardson, Texas; and Research Triangle Park, North Carolina, where it has expanded certain research and development and customer-support activities.

All of the leases have initial terms of five to seven years and options to renew for an additional three to five years, subject to certain conditions. At any time during the terms of these leases, the Company may purchase the land. If the Company elects not to purchase the land at the end of each of the leases, the Company has guaranteed a residual value of \$624 million.

The Company has also entered into agreements to lease certain buildings standing or to be constructed on the land described above. The lessors of the buildings have committed to fund up to a maximum of \$1.40 billion (subject to reductions based on certain conditions in the respective leases) for the construction of the buildings, with the portion of the committed amount actually used to be determined by the Company. Rent obligations for the buildings commenced on various dates and will expire at the same time as the land leases.

The Company has options to renew the building leases for an additional three to five years, subject to certain conditions. The Company may, at its option, purchase the buildings during or at the end of the terms of the leases at approximately the amount expended by the lessors to construct the buildings. If the Company does not exercise the purchase options by the end of the leases, the Company will guarantee a residual value of the buildings as determined at the lease inception date of each agreement (approximately \$748 million at July 29, 2000).

As part of the above lease transactions, the Company restricted \$1.29 billion of its investment securities as collateral for specified obligations of the lessors under the leases. These investment securities are restricted as to withdrawal and are managed by a third party subject to certain limitations under the Company's investment policy. In addition, the Company must maintain a minimum consolidated tangible net worth, as defined.

The Company also leases office space in Santa Clara, California; Chelmsford, Massachusetts; and for its various U.S. and international sales offices.

Future annual minimum lease payments under all noncancelable operating leases as of July 29, 2000 are as follows (in millions):

Fiscal Year	
2001	\$ 302
2002	299
2003	310
2004	251
2005	237
Thereafter	1,506
<b>Total</b>	<b>\$2,905</b>

Rent expense totaled \$229 million, \$123 million, and \$90 million for fiscal 2000, 1999, and 1998, respectively.

#### Foreign Exchange Forward and Option Contracts

The Company conducts business on a global basis in several major currencies. As such, it is exposed to adverse movements in foreign currency exchange rates. The Company enters into foreign exchange forward contracts to reduce the impact of certain currency exposures. These contracts hedge exposures associated with nonfunctional currency assets and liabilities denominated in Australian, Canadian, Japanese, Korean, and several European currencies, primarily the euro and British pound.

The Company does not enter into foreign exchange forward contracts for trading purposes. Gains and losses on the contracts are included in interest and other income, net, and offset foreign exchange gains or losses from the revaluation of intercompany balances or other current assets and liabilities denominated in currencies other than the functional currency of the reporting entity. The Company's foreign exchange forward contracts generally range from one to three months in original maturity.

The Company periodically hedges anticipated transactions with purchased currency options. A purchased currency option's premium is amortized over the life of the option while any intrinsic value is recognized in income during the same period as the hedged transaction. The deferred premium and intrinsic value from hedging anticipated transactions were not material at July 29, 2000. In the unlikely event that the underlying transaction terminates or becomes improbable, the remaining premium or deferred intrinsic value will be recorded in the Consolidated Statements of Operations. The Company does not purchase currency options for trading purposes. Foreign exchange forward and option contracts as of July 29, 2000 are summarized as follows (in millions):

	Notional Amount	Carrying Value	Fair Value
Forward contracts:			
Assets	\$1,377	\$ (5)	\$ (15)
Liabilities	\$1,500	\$ 12	\$ 37
Option contracts:			
Assets	\$ 561	\$ 12	\$ 14

The Company's foreign exchange forward and option contracts contain credit risk to the extent that its bank counterparties may be unable to meet the terms of the agreements. The Company minimizes such risk by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one party resulting from this type of credit risk is monitored. Management does not expect any material losses as a result of default by other parties.

#### Legal Proceedings

The Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 9. SHAREHOLDERS' EQUITY

#### Authorized Shares

On November 10, 1999, the shareholders of the Company approved an increase to the authorized number of shares of common stock from 5.40 billion to 10 billion shares. On March 20, 2000, the Board of Directors of the Company approved an increase to the authorized number of shares of common stock from 10 billion to 20 billion shares relating to the two-for-one stock split distributed on March 22, 2000.

#### Stock Split

The Board of Directors authorized the splitting of the Company's common stock on a two-for-one basis for shareholders of record on February 22, 2000 and the resulting shares from the split were distributed on March 22, 2000. All references to share and per-share data for all periods presented have been adjusted to give effect to this two-for-one stock split.

#### Shareholders' Rights Plan

In June 1998, the Board of Directors approved a Shareholders' Rights Plan ("Rights Plan"). The Rights Plan is intended to protect shareholders' rights in the event of an unsolicited takeover attempt. It is not intended to prevent a takeover of the Company on terms that are favorable and fair to all shareholders and will not interfere with a merger approved by the Board of Directors. Each right entitles shareholders to buy a unit equal to a portion of a new share of Series A Preferred Stock of the Company. The rights will be exercisable only if a person or a group acquires or announces a tender or exchange offer to acquire 15% or more of the Company's common stock.

In the event the rights become exercisable, the Rights Plan allows for Cisco shareholders to acquire, at an exercise price of \$108 per right owned, stock of the surviving corporation having a market value of \$217, whether or not Cisco is the surviving corporation. The rights, which expire in June 2008, are redeemable for \$0.00017 per right at the approval of the Board of Directors.

#### Preferred Stock

Under the terms of the Company's Articles of Incorporation, the Board of Directors may determine the rights, preferences, and terms of the Company's authorized but unissued shares of preferred stock.

#### Comprehensive Income

The components of comprehensive income, net of tax, are as follows (in millions):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Net income	\$2,668	\$2,023	\$1,331
Other comprehensive income (loss):			
Change in net unrealized gains on investments, net of tax of \$1,762, \$144, and \$17 in fiscal 2000, 1999, and 1998, respectively	3,240	234	25
Reclassification for net unrealized gains previously included in net income, net of tax of \$2 in fiscal 1998	-	-	3
Net unrealized gains	3,240	234	28
Change in accumulated translation adjustments	(8)	6	(10)
Total	\$5,900	\$2,263	\$1,349

### 10. EMPLOYEE BENEFIT PLANS

#### Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan (the "Purchase Plan") under which 222 million shares of common stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of the Company's common stock at 85% of the market value at certain plan-defined dates. The Purchase Plan terminates on January 3, 2005. In fiscal 2000, 1999, and 1998, seven million, 10 million, and 14 million shares, respectively, were issued under the Purchase Plan. At July 29, 2000, 123 million shares were available for issuance under the Purchase Plan.

### Employee Stock Option Plans

The Company has two main stock option plans: the 1987 Stock Option Plan (the "Predecessor Plan") and the 1996 Stock Incentive Plan (the "1996 Plan"). The Predecessor Plan was terminated in 1996. All outstanding options under the Predecessor Plan were transferred to the 1996 Plan. However, all outstanding options under the Predecessor Plan continue to be governed by the terms and conditions of the existing option agreements for those grants.

The maximum number of shares under the 1996 Plan was initially limited to the 620 million shares transferred from the Predecessor Plan. However, under the terms of the 1996 Plan, the share reserve increased each December for the three fiscal years beginning with fiscal 1997, by an amount equal to 4.75% of the outstanding shares on the last trading day of the immediately preceding November. In fiscal 1999, the Company's shareholders approved the extension of the automatic share increase provision of the 1996 Plan for an additional three-year period.

Although the Board of Directors has the authority to set other terms, the options are generally 20% or 25% exercisable one year from the date of grant and then ratably over the following 48 or 36 months, respectively. Options issued under the Predecessor Plan generally had terms of four years. New options granted under the 1996 Plan expire no later than nine years from the grant date. A summary of option activity follows (in millions, except per-share amounts):

	Options Available for Grant	Options Outstanding	
		Options	Weighted-Average Exercise Price per Share
BALANCE AT JULY 26, 1997	96	810	\$ 4.05
Granted and assumed	(282)	282	10.00
Exercised	-	(168)	2.40
Canceled	48	(48)	4.59
Additional shares reserved	314	-	-
BALANCE AT JULY 25, 1998	176	876	6.25
Granted and assumed	(245)	245	22.22
Exercised	-	(210)	3.09
Canceled	22	(22)	10.85
Additional shares reserved	359	-	-
BALANCE AT JULY 31, 1999	312	889	11.22
Granted and assumed	(295)	295	52.10
Exercised	-	(176)	5.75
Canceled	37	(37)	22.70
Additional shares reserved	339	-	-
<b>BALANCE AT JULY 29, 2000</b>	<b>393</b>	<b>971</b>	<b>\$24.19</b>

The Company has, in connection with the acquisitions of various companies, assumed the stock option plans of each acquired company. During fiscal 2000, a total of approximately 31 million shares of the Company's common stock have been reserved for issuance under the assumed plans and the related options are included in the preceding table.

In 1997, the Company adopted a Supplemental Stock Incentive Plan (the "Supplemental Plan") under which options can be granted or shares can be directly issued to eligible employees. Officers and members of the Company's Board of Directors are not eligible to participate in the Supplemental Plan. Nine million shares have been reserved for issuance under the Supplemental Plan, of which 9,000 shares are subject to outstanding options and 66,600 shares have been issued in fiscal 2000.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information concerning outstanding and exercisable options at July 29, 2000 (in millions, except number of years and per-share amounts):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price per Share	Number Exercisable	Weighted-Average Exercise Price per Share
\$ 0.01 – 5.56	229	5.20	\$ 5.23	188	\$ 4.44
5.57 – 12.27	258	6.16	9.56	162	8.95
12.28 – 28.61	194	7.49	23.59	63	22.47
28.62 – 54.53	241	8.34	49.91	5	31.02
54.54 – 72.56	49	8.64	65.65	–	–
Total	971	6.87	\$ 24.19	418	\$ 9.22

At July 31, 1999 and July 25, 1998, approximately 370 million and 312 million outstanding options, respectively, were exercisable. The weighted-average exercise prices for outstanding options were \$5.75 and \$3.64 at July 31, 1999 and July 25, 1998, respectively.

The Company is required under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), to disclose pro forma information regarding option grants made to its employees based on specified valuation techniques that produce estimated compensation charges. These amounts have not been reflected in the Company's Consolidated Statements of Operations because no compensation charge arises when the price of the employees' stock options equals the market value of the underlying stock at the grant date, as in the case of options granted to the Company's employees. Pro forma information under SFAS 123 is as follows (in millions, except per-share amounts):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Net income—as reported	<b>\$2,668</b>	\$2,023	\$1,331
Net income—pro forma	<b>\$1,549</b>	\$1,487	\$1,074
Basic net income per common share—as reported	<b>\$ 0.39</b>	\$ 0.30	\$ 0.21
Diluted net income per common share—as reported	<b>\$ 0.36</b>	\$ 0.29	\$ 0.20
Basic net income per common share—pro forma	<b>\$ 0.22</b>	\$ 0.22	\$ 0.17
Diluted net income per common share—pro forma	<b>\$ 0.21</b>	\$ 0.21	\$ 0.16

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Employee Stock Option Plans			Employee Stock Purchase Plan		
	July 29, 2000	July 31, 1999	July 25, 1998	July 29, 2000	July 31, 1999	July 25, 1998
Expected dividend yield	<b>0.0%</b>	0.0%	0.0%	<b>0.0%</b>	0.0%	0.0%
Risk-free interest rate	<b>6.4%</b>	5.1%	5.7%	<b>5.3%</b>	4.9%	5.4%
Expected volatility	<b>33.9%</b>	40.2%	35.6%	<b>43.3%</b>	47.2%	44.8%
Expected life (in years)	<b>3.1</b>	3.1	3.1	<b>0.5</b>	0.5	0.5

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions including the expected stock price volatility. The Company uses projected volatility rates which are based upon historical volatility rates trended into future years. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's options. The weighted-average estimated fair values of employee stock options granted during fiscal 2000, 1999, and 1998 were \$19.44, \$8.40, and \$3.57 per share, respectively.

The above pro forma disclosures under SFAS 123 are also not likely to be representative of the effects on net income and net income per common share in future years, because they do not take into consideration pro forma compensation expense related to grants made prior to fiscal 1996.

#### Employee 401(k) Plans

The Company sponsors the Cisco Systems, Inc. 401(k) Plan (the "Plan") to provide retirement benefits for its employees. As allowed under Section 401(k) of the Internal Revenue Code, the Plan provides tax-deferred salary deductions for eligible employees. The Company also has other 401(k) plans that it sponsors. These plans arose from acquisitions of other companies and are not material to the Company on either an individual or aggregate basis.

Employees may contribute from 1% to 15% of their annual compensation to the Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. The Company matches employee contributions dollar for dollar up to a maximum of \$1,500 per year per person. All matching contributions vest immediately. In addition, the Plan provides for discretionary contributions as determined by the Board of Directors. Such contributions to the Plan are allocated among eligible participants in the proportion of their salaries to the total salaries of all participants. The Company's matching contributions to the Plan totaled \$34 million, \$20 million, and \$15 million in fiscal 2000, 1999, and 1998, respectively. No discretionary contributions were made in fiscal 2000, 1999, or 1998.

#### 11. INCOME TAXES

The provision for (benefit from) income taxes consisted of (in millions):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Federal:			
Current	\$1,843	\$ 1,164	\$855
Deferred	(652)	(221)	(54)
	<b>1,191</b>	943	801
State:			
Current	282	112	87
Deferred	(118)	(24)	(8)
	<b>164</b>	88	79
Foreign:			
Current	332	151	74
Deferred	(12)	(2)	(14)
	<b>320</b>	149	60
Total provision for income taxes	<b>\$1,675</b>	\$ 1,180	\$940

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company paid income taxes of \$327 million, \$301 million, and \$440 million in fiscal 2000, 1999, and 1998, respectively. Income before provision for income taxes consisted of (in millions):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
United States	<b>\$2,544</b>	\$2,092	\$1,950
International	<b>1,799</b>	1,111	321
	<b>\$4,343</b>	\$3,203	\$2,271

The items accounting for the difference between income taxes computed at the federal statutory rate and the provision for income taxes consisted of:

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Federal statutory rate	<b>35.0%</b>	35.0%	35.0%
Effect of:			
State taxes, net of federal tax benefit	<b>1.9</b>	2.2	2.2
Foreign sales corporation	<b>(1.9)</b>	(1.6)	(2.4)
Foreign income at other than U.S. rates	<b>(1.6)</b>	(1.0)	–
Nondeductible in-process R&D	<b>8.1</b>	3.9	6.4
Tax-exempt interest	<b>(1.8)</b>	(1.9)	(1.6)
Tax credits	<b>(1.6)</b>	(1.2)	(1.4)
Other, net	<b>0.5</b>	1.5	3.2
Total	<b>38.6%</b>	36.9%	41.4%

U.S. income taxes and foreign withholding taxes were not provided for on a cumulative total of approximately \$411 million of undistributed earnings for certain non-U.S. subsidiaries. The Company intends to reinvest these earnings indefinitely in operations outside the United States. The components of the deferred tax assets (liabilities) follow (in millions):

	July 29, 2000	July 31, 1999
<b>ASSETS</b>		
Allowance for doubtful accounts and returns	<b>\$ 418</b>	\$ 185
In-process R&D	<b>265</b>	163
Inventory allowances and capitalization	<b>94</b>	57
Accrued state franchise tax	<b>–</b>	32
Depreciation	<b>41</b>	28
Deferred revenue	<b>177</b>	65
Credits and net operating loss carryforwards	<b>1,023</b>	–
Other	<b>451</b>	256
Gross deferred tax assets	<b>2,469</b>	786
Valuation allowance	<b>(299)</b>	–
Total deferred tax assets	<b>2,170</b>	786
<b>LIABILITIES</b>		
Purchased intangible assets	<b>(257)</b>	(88)
Unrealized gain on investments	<b>(1,954)</b>	(192)
Total deferred tax liabilities	<b>(2,211)</b>	(280)
Total	<b>\$ (41)</b>	\$ 506

The noncurrent portion of the deferred tax liabilities, which totaled \$74 million at July 31, 1999, is included in other assets.

The Company has provided a valuation allowance on certain of its deferred tax assets because of uncertainty regarding their realizability due to expectation of future employee stock option exercises. Deferred tax assets of approximately \$963 million at July 29, 2000 pertain to certain tax credits and net operating loss carryforwards resulting from the exercise of employee stock options. When recognized, the tax benefit of these credits and losses will be accounted for as a credit to shareholders' equity rather than as a reduction of the income tax provision.

As of July 29, 2000, the Company's federal and state net operating loss carryforwards for income tax purposes were approximately \$496 million and \$865 million, respectively. If not utilized, the federal net operating loss carryforwards will begin to expire in fiscal 2020, and the state net operating loss carryforwards will begin to expire in fiscal 2005. As of July 29, 2000, the Company's federal and state tax credit carryforwards for income tax purposes were approximately \$678 million and \$197 million, respectively. If not utilized, the federal and state tax credit carryforwards will begin to expire in fiscal 2005.

The Company's income taxes payable for federal, state, and foreign purposes have been reduced, and the deferred tax assets increased, by the tax benefits associated with dispositions of employee stock options. The Company receives an income tax benefit calculated as the difference between the fair market value of the stock issued at the time of exercise and the option price, tax effected. These benefits were credited directly to shareholders' equity and amounted to \$3.08 billion, \$837 million, and \$422 million for fiscal 2000, 1999, and 1998, respectively. Benefits reducing taxes payable amounted to \$2.49 billion, \$837 million, and \$422 million for fiscal 2000, 1999, and 1998, respectively. Benefits increasing gross deferred tax assets amounted to \$582 million in fiscal 2000.

#### **12. SEGMENT INFORMATION AND MAJOR CUSTOMERS**

The Company's operations involve the design, development, manufacture, marketing, and technical support of networking products and services. The Company offers end-to-end networking solutions for its customers. Cisco products include routers, LAN and ATM switches, dial-up access servers, and network-management software. These products, integrated by the Cisco IOS® software, link geographically dispersed LANs, WANs, and IBM networks.

The Company conducts business globally and is managed geographically. The Company's management relies on an internal management system that provides sales and standard cost information by geographic theater. Sales are attributed to a theater based on the ordering location of the customer. The Company's management makes financial decisions and allocates resources based on the information it receives from this internal management system. The Company does not allocate research and development, sales and marketing, or general and administrative expenses to its geographic theaters as management does not use this information to measure the performance of the operating segments. Management does not believe that allocating these expenses is material in evaluating a geographic theater's performance. Information from this internal management system differs from the amounts reported under generally accepted accounting principles due to certain corporate level adjustments not included in the internal management system. These corporate level adjustments are primarily sales adjustments relating to revenue deferrals and reserves, credit memos, returns, and other timing differences. Based on established criteria, the Company has four reportable segments: the Americas; Europe, the Middle East, and Africa ("EMEA"); Asia Pacific; and Japan.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Summarized financial information by theater for fiscal 2000, 1999, and 1998, as taken from the internal management system discussed previously, is as follows (in millions):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
<b>Net sales:</b>			
Americas	<b>\$12,924</b>	\$ 8,088	\$5,732
EMEA	<b>4,770</b>	3,216	2,114
Asia Pacific	<b>1,705</b>	825	535
Japan	<b>935</b>	566	459
Sales adjustments	<b>(1,406)</b>	(522)	(351)
<b>Total</b>	<b>\$18,928</b>	\$12,173	\$8,489
<b>Gross margin:</b>			
Americas	<b>\$ 9,412</b>	\$ 5,836	\$4,261
EMEA	<b>3,581</b>	2,380	1,565
Asia Pacific	<b>1,215</b>	586	395
Japan	<b>737</b>	436	340
Standard margins	<b>14,945</b>	9,238	6,561
Sales adjustments	<b>(1,406)</b>	(522)	(351)
Production overhead	<b>(455)</b>	(255)	(207)
Manufacturing variances and other related costs	<b>(902)</b>	(547)	(438)
<b>Total</b>	<b>\$12,182</b>	\$ 7,914	\$5,565

The standard margins by geographic theater differ from the amounts recognized under generally accepted accounting principles because the Company does not allocate certain sales adjustments, production overhead, and manufacturing variances and other related costs to the theaters. The above table reconciles the net sales and standard margins by geographic theater to net sales and gross margin as reported in the Consolidated Statements of Operations by including such adjustments.

Enterprise-wide information provided on geographic sales is based on the ordering location of the customer. Property and equipment information is based on the physical location of the assets. The following table presents net sales and property and equipment information for geographic areas (in millions):

	July 29, 2000	July 31, 1999	July 25, 1998
<b>Net sales:</b>			
United States	<b>\$ 12,013</b>	\$ 7,454	\$5,232
International	<b>8,321</b>	5,241	3,608
Sales adjustments	<b>(1,406)</b>	(522)	(351)
<b>Total</b>	<b>\$ 18,928</b>	\$12,173	\$8,489
<b>Property and equipment, net:</b>			
United States	<b>\$ 1,242</b>	\$ 711	\$ 537
International	<b>184</b>	114	72
<b>Total</b>	<b>\$ 1,426</b>	\$ 825	\$ 609

The following table presents net sales for groups of similar products and services (in millions):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Net sales:			
Routers	\$ 7,611	\$ 5,196	\$3,856
Switches	7,509	5,167	3,613
Access	2,396	1,127	630
Other	2,818	1,205	741
Sales adjustments	(1,406)	(522)	(351)
Total	\$18,928	\$12,173	\$8,489

Substantially all of the Company's assets at July 29, 2000 and July 31, 1999 were attributable to U.S. operations. In fiscal 2000, 1999, and 1998, no single customer accounted for 10% or more of the Company's net sales.

### 13. NET INCOME PER COMMON SHARE

The following table presents the calculation of basic and diluted net income per common share (in millions, except per-share amounts):

Years Ended	July 29, 2000	July 31, 1999	July 25, 1998
Net income	\$2,668	\$2,023	\$1,331
Weighted-average shares—basic	6,917	6,646	6,312
Effect of dilutive securities:			
Employee stock options	521	416	346
Weighted-average shares—diluted	7,438	7,062	6,658
Net income per common share—basic	\$ 0.39	\$ 0.30	\$ 0.21
Net income per common share—diluted	\$ 0.36	\$ 0.29	\$ 0.20

### 14. SUBSEQUENT EVENTS (UNAUDITED)

#### Pending Business Combinations

The Company announced definitive agreements to acquire HyNEX, Ltd.; Netiverse, Inc.; Komodo Technology, Inc.; NuSpeed Internet Systems, Inc.; IPmobile, Inc.; and PixStream Incorporated for a total purchase price of approximately \$1.76 billion, payable in common stock and cash. These acquisitions will be accounted for as purchases and are expected to close in the first quarter of fiscal 2001.

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## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of Cisco Systems, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Cisco Systems, Inc. and its subsidiaries at July 29, 2000 and July 31, 1999, and the results of their operations and their cash flows for each of the three years in the period ended July 29, 2000, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

*PricewaterhouseCoopers LLP*

San Jose, California  
August 8, 2000

## SUPPLEMENTARY FINANCIAL DATA<sup>(1)</sup> (Unaudited)

(In millions, except per-share amounts)

	July 29, 2000	April 29, 2000	Jan. 29, 2000	Oct. 30, 1999	July 31, 1999	May 1, 1999	Jan. 23, 1999	Oct. 24, 1998
Net sales	\$5,720	\$4,933	\$4,357	\$3,918	\$3,558	\$3,172	\$2,845	\$2,598
Gross margin	\$3,662	\$3,172	\$2,818	\$2,530	\$2,297	\$2,059	\$1,857	\$1,701
Net income	\$ 796 <sup>(2)</sup>	\$ 641 <sup>(3)</sup>	\$ 816 <sup>(4)</sup>	\$ 415 <sup>(5)</sup>	\$ 605 <sup>(6)</sup>	\$ 632 <sup>(7)</sup>	\$ 279 <sup>(8)</sup>	\$ 507 <sup>(9)</sup>
Net income per common share—basic*	\$ 0.11	\$ 0.09	\$ 0.12	\$ 0.06	\$ 0.09	\$ 0.09	\$ 0.04	\$ 0.08
Net income per common share—diluted*	\$ 0.11 <sup>(2)</sup>	\$ 0.08 <sup>(3)</sup>	\$ 0.11 <sup>(4)</sup>	\$ 0.06 <sup>(5)</sup>	\$ 0.08 <sup>(6)</sup>	\$ 0.09 <sup>(7)</sup>	\$ 0.04 <sup>(8)</sup>	\$ 0.07 <sup>(9)</sup>

\* Reflects the two-for-one stock split effective March 2000.

(1) All historical financial information has been restated to reflect the acquisitions that were accounted for as poolings of interests (see Note 3 to the Consolidated Financial Statements).

(2) Net income and net income per common share include in-process research and development expenses of \$461 million, payroll tax on stock option exercises of \$26 million, amortization of goodwill and purchased intangible assets of \$169 million, acquisition-related costs of \$37 million, and net gains realized on minority investments of \$344 million. Pro forma net income and diluted net income per common share, excluding these items net of tax of \$53 million, were \$1.20 billion and \$0.16, respectively.

(3) Net income and net income per common share include in-process research and development expenses of \$488 million, payroll tax on stock option exercises of \$25 million, amortization of goodwill and purchased intangible assets of \$51 million, and net gains realized on minority investments of \$156 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$44 million, were \$1.01 billion and \$0.13, respectively.

(4) Net income and net income per common share include in-process research and development expenses of \$43 million, amortization of goodwill and purchased intangible assets of \$47 million, acquisition-related costs of \$25 million, and net gains realized on minority investments of \$31 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$3 million, were \$897 million and \$0.12, respectively.

(5) Net income and net income per common share include in-process research and development expenses of \$381 million and amortization of goodwill and purchased intangible assets of \$24 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$6 million, were \$814 million and \$0.11, respectively.

(6) Net income and net income per common share include in-process research and development expenses of \$81 million, amortization of goodwill and purchased intangible assets of \$19 million, and acquisition-related costs of \$16 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$11 million, were \$710 million and \$0.10, respectively.

(7) Net income and net income per common share include amortization of goodwill and purchased intangible assets of \$19 million. Pro forma net income and diluted net income per common share, excluding this item net of a tax benefit of \$6 million, were \$645 million and \$0.09, respectively.

(8) Net income and net income per common share include in-process research and development expenses of \$349 million and amortization of goodwill and purchased intangible assets of \$12 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$34 million, were \$606 million and \$0.09, respectively.

(9) Net income and net income per common share include in-process research and development expenses of \$41 million and amortization of goodwill and purchased intangible assets of \$11 million. Pro forma net income and diluted net income per common share, excluding these items net of tax benefits of \$3 million, were \$556 million and \$0.08, respectively.

## STOCK MARKET INFORMATION

Cisco common stock (NASDAQ symbol CSCO) is traded on the NASDAQ National Market. The following table sets forth the range of high and low closing prices for each period indicated, adjusted to reflect the two-for-one split effective March 2000:

	2000		1999		1998	
	High	Low	High	Low	High	Low
First quarter	\$37.00	\$29.38	\$17.32	\$10.97	\$ 9.37	\$ 7.75
Second quarter	\$57.63	\$35.00	\$26.67	\$15.19	\$10.05	\$ 8.10
Third quarter	\$80.06	\$54.75	\$29.69	\$23.78	\$12.31	\$ 9.44
Fourth quarter	\$71.44	\$50.55	\$33.53	\$26.09	\$17.20	\$11.74

The Company has never paid cash dividends on its common stock and has no present plans to do so. There were approximately 60,150 shareholders of record at July 29, 2000.

## SHAREHOLDER INFORMATION

### DIRECTORS AND OFFICERS

#### Directors

Carol A. Bartz <sup>(2) (4) (5) (6) (8)</sup>  
Chairman and Chief Executive Officer  
Autodesk, Inc.

Larry R. Carter  
Senior Vice President, Finance and Administration  
Chief Financial Officer and Secretary  
Cisco Systems, Inc.

John T. Chambers <sup>(1) (4) (5) (6) (8)</sup>  
President and Chief Executive Officer  
Cisco Systems, Inc.

Mary Cirillo <sup>(3) (7)</sup>  
Chairman and Chief Executive Officer  
OPCENTER, LLC

James F. Gibbons, Ph.D. <sup>(2) (4)</sup>  
Reid Weaver Dennis Professor of Electrical Engineering and  
Special Consul to the President for Industrial Relations  
Stanford University

Edward R. Kozel <sup>(7) (8)</sup>  
Managing Member  
Open Range Ventures

James C. Morgan <sup>(2)</sup>  
Chairman and Chief Executive Officer  
Applied Materials, Inc.

John P. Morgridge <sup>(1) (5) (6) (7)</sup>  
Chairman of the Board  
Cisco Systems, Inc.

Arun Sarin <sup>(3) (5)</sup>  
Chief Executive Officer  
InfoSpace, Inc.

Donald T. Valentine <sup>(1) (5) (7)</sup>  
General Partner  
Sequoia Capital

Steven M. West <sup>(3)</sup>  
President and Chief Executive Officer  
Entera, Inc.

Jerry Yang  
Cofounder and Chief Yahoo!  
Yahoo!

- (1) Member of the Executive Committee  
(2) Member of the Compensation/Stock Option Committee  
(3) Member of the Audit Committee  
(4) Member of the Nomination Committee  
(5) Member of the Acquisition Committee  
(6) Member of the Special Stock Option Committee  
(7) Member of the Investment/Finance Committee  
(8) Member of the Special Acquisition Committee

#### Officers

Larry R. Carter  
Senior Vice President, Finance and Administration  
Chief Financial Officer and Secretary

John T. Chambers  
President and Chief Executive Officer

Gary J. Daichendt  
Executive Vice President  
Worldwide Operations

Charles H. Giancarlo  
Senior Vice President  
Small/Medium Business Line of Business  
Consumer Line of Business

Richard J. Justice  
Senior Vice President  
Worldwide Field Operations

Carl Redfield  
Senior Vice President, Manufacturing and  
Worldwide Logistics

James Richardson  
Senior Vice President, Enterprise Line of Business and  
Internet Communications Software Group

Michelangelo Volpi  
Senior Vice President, Chief Strategy Officer

#### OTHER SENIOR VICE PRESIDENTS

Douglas C. Allred  
Senior Vice President, Customer Advocacy

Vernon E. Altman  
Senior Vice President, Strategic Business Partnerships

Barbara Beck  
Senior Vice President, Human Resources

Susan L. Bostrom  
Senior Vice President, Internet Business Solutions Group

Howard S. Charney  
Senior Vice President, Office of the President

William G. Conlon  
Senior Vice President  
Customer Advocacy Global Support Operations

Doug Dennerline  
Senior Vice President  
U.S. Enterprise and Federal Sales

Kevin A. DeNuccio  
Senior Vice President  
Worldwide Service Provider Field Operations

Richard Freemantle  
Senior Vice President, Asia Pacific

Kevin J. Kennedy  
Senior Vice President  
Service Provider Line of Business and  
Cisco IOS® Technologies Division

David Kirk  
Senior Vice President  
Internet Communications Software Group

Mario Mazzola  
Senior Vice President, New Business Ventures

William R. Nuti  
Senior Vice President, EMEA Operations

Randy Pond  
Senior Vice President, Operations

Daniel Scheinman  
Senior Vice President, Corporate Affairs

Cas Skrzypczak  
Senior Vice President  
Customer Advocacy for Service Provider and  
Consumer Lines of Business

Peter Solvik  
Senior Vice President, Chief Information Officer

### SHAREHOLDER INFORMATION

#### Online Annual Report

We invite you to visit our online interactive report at [www.cisco.com/annualreport/2000](http://www.cisco.com/annualreport/2000). In this version you will find our shareholders' letter in multiple languages, a financial section, and additional company and product information. This Web-based report complements our printed report, giving you a comprehensive understanding of Cisco Systems.



Cisco recently introduced the iQ Web site and *iQ* magazine with additional information to help business executives implement effective Internet business solutions. *iQ* magazine is the senior executive's atlas to the Internet economy. Using the successful models of Cisco and its customers, the site and magazine detail how businesses can harness the power of the Internet to gain a competitive advantage and increase profitability. Visit the site at [www.cisco.com/go/iqmagazine](http://www.cisco.com/go/iqmagazine).

#### Investor Relations

For further information on the Company, additional copies of this report, Form 10-K, or other financial information, contact:

Investor Relations  
Cisco Systems, Inc.  
170 West Tasman Drive  
San Jose, CA 95134-1706  
(408) 227-CSCO (2726)

You may also contact us by sending an e-mail to [investor-relations@cisco.com](mailto:investor-relations@cisco.com) or by visiting the Investor Relations section on the Company's Web site at [www.cisco.com](http://www.cisco.com).

#### Transfer Agent and Registrar

Fleet National Bank  
(f/k/a BankBoston, N.A.)  
c/o EquiServe Limited Partnership  
P.O. Box 8040  
Boston, MA 02266-8040  
[www.equiserve.com](http://www.equiserve.com)  
(800) 730-6001

#### Independent Accountants

PricewaterhouseCoopers LLP  
San Jose, CA

#### Legal Counsel

Brobeck, Phleger & Harrison LLP  
Palo Alto, CA

#### Notice of Annual Meeting

Paramount's Great America  
Paramount Theater  
1 Great America Parkway  
Santa Clara, CA  
November 14, 2000  
10 a.m. Pacific Standard Time