



John T. Chambers
President and Chief Executive Officer

Fiscal 2002 was a very challenging year for the entire industry, and the most difficult environment Cisco Systems has ever faced. In a tough market, we focused on the four elements that we could influence and control—profit contribution, cash flow from operations, available market, and productivity. And although we all wish the market conditions had been different, we were pleased with our progress in each of these areas.

One area where we set aggressive stretch goals was our focus on the available market, with our goal being to grow 10 percent faster than our top ten North American competitors. We achieved this goal consistently throughout the year. And in Q4 fiscal 2002, for example, the delta was impressive when our fourth quarter revenues from 2001 to 2002 increased 12 percent, while the revenue of our top ten competitors shrunk by 44 percent in their most recently reported quarters, compared with the prior year.

During challenging market transitions, successful companies usually get surprised by the downturn, they determine how long it will last and how deep it will be, and then they get ready for the upturn. We mapped these three stages to our business strategy, the first being aligned with our breakaway opportunity, the second being aligned with our six-point plan, and the third stage focusing on the four elements that we could influence or control, as mentioned above. In each of our quarterly result announcements for fiscal 2002, we attempted to cover our progress in this way, and I will summarize the entire year on this basis.

Our Results

For fiscal 2002 we showed consistent quarterly improvement in almost all categories of our operational and financial results. We adjusted to a very tough economic market and attempted to position the company for where we want to be three to five years after the recovery. I was pleased with our execution at a time when many of our peers continuously adjusted their business strategies and were slow in dealing with the economic environment. While we all wish our revenue could have been higher, our fiscal 2002 revenue of \$18.9 billion resulted in major market-share gains compared to most of our competitors. Fiscal 2002 net income, according to generally accepted accounting principles (GAAP), was \$1.9 billion and earnings per share were \$0.25, as compared to fiscal 2001 loss of \$1.0 billion and a loss per share of \$0.14. Pro forma net income for the same time period was \$2.9 billion, with earnings per share of \$0.39 as compared to pro forma net income of \$3.1 billion and earnings per share of \$0.41 in fiscal 2001.

For fiscal 2002 we showed consistent quarterly improvement in almost all categories of our operational and financial results.

Our positive cash flow from operations continues to average between \$300 million and \$500 million per month. And while this will vary from quarter to quarter based on large cash outlays such as tax payments and end-of-year compensation payments, we were pleased with our average positive cash flow for the year from operations of \$1.5 billion per quarter. Our total cash and investment position has improved from \$18.5 billion in last fiscal year's Q4 to \$21.5 billion in Q4 this year. In terms of quarterly profit improvement for the same time period, pro forma net income grew from \$163 million to \$1.039 billion, making Q4 fiscal 2002 the fourth best quarter in company history. As a percentage of revenue, it increased from 3.8 percent in Q4 2001 to 21.5 percent in Q4 2002, the best we've done since 1998.

Our productivity, as measured by annualized revenue per employee, has moved from \$442,000 per employee in last fiscal year's Q4 to \$540,000 per employee in Q4 this year. This productivity increase of 22 percent has helped Cisco achieve a \$1.9 billion productivity benefit for the company this year.

We were especially pleased with our pro forma gross margins, which improved from 52.3 percent in last fiscal year's Q4 to 67.7 percent in Q4 this year, overachieving our target goal of 60 percent gross margin. And for the same time period, inventory turns improved from 4.6 to 7.1, in line with our targeted goal of seven to eight turns.

Another area in which we have consistently overachieved our goals has been in our yearly global customer satisfaction survey. And this year, despite the challenges in the marketplace, is no different. In fiscal 2002, we achieved our highest global customer satisfaction rating ever, 4.63, as measured on a five-point scale. Customers are obviously satisfied with the service and support that Cisco provides and are now clearly seeing the productivity benefits associated with Internet business solutions.

Productivity

When people ask why we believe in the future of our company and our industry, the answer is not based on technology alone, but on what we hear from business and government leaders around the world. They clearly understand the productivity opportunities and the associated standard of living implications that Internet business solutions provide. In fact, they are now truly associating Cisco, and our solutions, with productivity. There are two reasons for this: first, because of how we use the network ourselves to gain productivity, and second, because we help our partners and customers utilize the network and its associated Internet business solutions to increase their own productivity.



In a recent study designed by top economists at the University of California, Berkeley and the Brookings Institution, U.S. companies indicated that almost half of their expected productivity increases would come through Internet business solutions. In short, it's the productivity gains—including increasing operational efficiencies and cutting costs—that are allowing companies to drive profits in this challenging economy.

Customers clearly understand the productivity opportunities and the associated standard of living implications that Internet business solutions provide.

Innovation

As dramatic changes occurred in the marketplace, we restructured our engineering team to focus on where the market is going, not where it has been. We believe in the concept of Network of Networks, in which service provider networks, our customer networks, the Internet, wireless, cable, and other environments are seamlessly implemented. CIOs and technologists will decide on which type of infrastructure they implement, and Cisco will be the company to deliver the networks that provide the greatest productivity gains, regardless of network type. While we are truly excited about growth markets, we have organized our engineering team to focus on our core technology markets today and the growth markets of the future. In very simple terms, we are concentrating on core routing and switching, and new growth markets. In conceptual terms, we are creating an end-to-end shared, common architecture for both hardware and software. This is unique to Cisco.

People and Giving Back

As always, our employees continue to be our strongest asset, and we are very pleased that even during the tough times Cisco continues to be voted one of the best places to work in America and also in our industry. One of Cisco's core values is employee ownership, and in a very tough environment our employee base feels empowered in terms of company success, which historically has allowed us to achieve success relative to our peers. It is this ownership that we truly believe helped our employees to drive toward success, despite the challenges of this year.

It is also our view that the most successful companies give back to their communities, and we continue to expand our corporate-giving focus. This year we sponsored the NetAid World Schoolhouse, helping thousands of children worldwide have a better chance in life through education. In October 2002, the



Cisco Networking Academy™ Program will celebrate its five-year anniversary. Today, this program includes 9,900 Academies worldwide, with more than 263,000 students learning to build the networks that ultimately will make greater opportunities possible. Through another endeavor, the Cisco Community Fellows Program, Cisco

provided employees with opportunities to work for nonprofit organizations, and it has been a roaring success. More than 21 organizations worldwide have benefited from the addition of these employees, including Second Harvest Food Bank, which estimates it would have taken the organization five to seven years to realize all of the improvements made to its operations by the fellowship program in just this past year alone.

Moving to a discussion of our senior management team, we used this challenging time as a chance to position our leadership organization for the future. In the last two years we evolved our team both through internal promotions and external hiring, adding 50 percent new senior vice presidents



John P. Morgridge
Chairman of the Board



Donald T. Valentine
Vice Chairman of the Board

and vice presidents. And, although we were not able to add large numbers of people company-wide, we viewed this as an opportunity to add major leadership talent to our senior management team, and you will continue to see us position ourselves for the next decade.

Also this past year, Cisco received an important award that meant a great deal to us. *Barron's* and *Investor Relations* magazines awarded Cisco “Best Investor Relations Officer” and “Best Investor Relations by a CEO,” in what was a very challenging year. We want to thank shareholders for your confidence, and we will continue to do everything possible to reward that confidence.

In many ways, fiscal 2002 was about constant focus and execution. With that in mind, we are very optimistic about our future opportunities. However, we must balance this calm confidence with a healthy dose of paranoia. How well we do will depend on how well we execute, how quickly the industry adopts the inevitable convergence of data, voice, and video, and ultimately on when the economy and capital expenditures pick up. But in the areas that we can control and influence, we believe we are well positioned for greater future success.

We are dedicated to doing the best possible job for our shareholders, customers, partners, and employees as we continue to prepare ourselves for the upturn. We want to thank you for your continued patience and your confidence.

John T. Chambers
President and Chief Executive Officer

John P. Morgridge
Chairman of the Board

Donald T. Valentine
Vice Chairman of the Board