Wonderful things are happening. Cisco is changing the way we work, live, play, and learn. We believe the network is the source for experiencing this change. And it isn’t just a network of computers, it’s a network of people. A network full of potential; a gateway to new life experiences. A network of human connections. Because we believe we are more powerful together than we ever could be apart. Welcome to the human network.
Welcome home. Now view, read, or listen to anything you want—on any device you choose. Watch spy flicks on your cell phone. Listen to Don Giovanni over wireless speakers while you’re in the shower. Keep an eye on that share price on a wireless PDA. The Cisco connected home coordinates all the connections. So whether you take the cliffhanger, the arias, and the numbers with you or enjoy them at home, the experiences are endless.

Cartoons on the phone. Mozart in the shower. Stock ticker in the kitchen.
Teachers often say that as soon as a textbook is printed, it’s out of date. With accountability standards increasing, it makes no sense to invest in yesterday’s materials. Some innovative school districts are spending their education dollars on laptop computers instead of textbooks. Students use a Cisco IP network to access curriculum online and tap into a universe of up-to-date resources on the Internet. Homework is done right on the laptop. And children have connections to other classrooms—and to experiences from around the world.
Now just say, "hello." Reach a live person instead of their voicemail. However you choose to connect online—instant messaging, wireless, or desktop IP phone—you’ll do less tagging and more talking. Cisco Unified Communications delivers a rich experience of voice, video, and data communications for businesses of all sizes, reducing frustration and boosting productivity. And that sounds good in any language.

More Guten Tag, less phone tag.
The eyebrow is now an advanced digital business communications tool.

Same with the hand. And the shoulder. And everything else that speaks body language. Cisco TelePresence is the closest thing to teleporting. Life-size screens display clear images, with no delay or fuzziness. So you can bring customers, associates, and suppliers from around the world into your conference room—with no jet lag. And once you see and hear each other, TelePresence communicates with more than just words. Because sometimes, even the smallest gesture can speak volumes.
When disaster strikes and conventional communications are knocked out, seconds count. Accurate information is critical. Removing barriers of time and space is paramount. Cisco’s response: instant communications in a mobile emergency kit. Connecting to a satellite, this integrated solution delivers highly secure Internet access, a wireless hotspot, mobile radio, video, and more. It’s portable and sets up in minutes to open the channels of communication and connect the lifeline.
Vision: Product Innovation

We believe Cisco's leadership is dependent upon three major factors. First, a vision of how the industry will evolve. Second, the strategy Cisco will employ to gain leadership, based upon that vision. And third, our effectiveness in executing on this strategy, as measured by such factors as product leadership, market share gains, and leadership in our customer segments.

To Cisco, vision means the ability to broadly anticipate how the communications and IT market will evolve and understand how the network drives this evolution. We believe the network will change the way the world works, lives, plays, and learns, and that the network will have intelligence distributed throughout it. We see, as the market plays out, that the network will literally become the platform for all of life's experiences by delivering applications and services to our customers and by enabling greater productivity, new business models, and expanded forms of entertainment.

Internet traffic continues to grow, driven in part by the rapid expansion of video traffic over the network. Our successful acquisition of Scientific Atlanta provided Cisco with the technology, capabilities, and talent that help to complete the "quad play" offering of data, voice, and video, with mobility. Today, we address the growing demand for networked video with expertise and a unique understanding of the functionality requirements of the underlying network, which we believe are unmatched by our competitors. In fiscal 2006, we enhanced our position as a strategic business partner for service provider, enterprise, and commercial businesses of all sizes, as well as consumer customers. Cisco has the vision and tools to integrate the business and technology architectural approaches for these networks.

Our technology architectural play with the convergence of Layers 1 through 7 of the OSI stack continues to gain traction and mindshare. For example, customers understand the leadership, total cost of ownership, flexibility, and investment protection advantages they receive when they install a Cisco switch, which is designed to allow them to easily and cost-effectively add market-leading voice, data, security, wireless, and other capabilities to their existing Cisco networks. This innovation strategy is a powerful differentiator versus our competitors, who are usually present in only one or two product categories or customer segments, and often do not integrate their products from an architectural perspective.

Balanced Strategy: Customer Market Segments and Geographies

Cisco's strategy is built around four basic principles. First, our ability to identify market transitions and position Cisco for those transitions based upon feedback primarily from our customers. Second, our unique approach to this market, taking an architectural perspective, as opposed to just thinking about individual products. Third, our balanced business and technology implementation. And fourth, careful collaboration and teamwork as we execute across what we define as a multiple-dimension chess game, including innovation, products, customer segments, and geographies, enabled by services.

Our balanced approach to the industry in terms of our four customer segments (enterprise, service provider, commercial, and consumer), core and advanced technologies, and our five key geographic theaters continues to work very well. With the acquisition of Scientific Atlanta, we gained systems integration expertise that allowed us to service a segment of the global service provider market that we hadn't been able to fully reach before. The acquisition also brought us an expanded consumer offering. Scientific Atlanta is a leading provider of high-end set-top boxes to view high-definition digital video in addition to standard programming. We believe these devices drive increased demand for bandwidth on service provider networks, making this a win for Cisco in both the service provider and consumer segments of the market.

In fiscal 2006, we also saw previously unmatched acceptance of our products in the commercial market segment, making it our fastest-growing market segment. We define a commercial business as generally one with less than 1,000 employees. Small to medium-sized businesses and retail chains are some examples of this type of market segment. It is exciting to watch this segment begin to embrace networking and unlock the power and efficiency of their business network investment. Again, we believe that Cisco will be a long-term, trusted partner for this segment, and we look forward to helping these businesses grow to their fullest potential.

Cisco's business is made up of five distinct theaters, or geographical regions. These include the United States and Canada, European Markets, Emerging Markets, Asia Pacific, and Japan. For fiscal 2006, we reorganized our sales theaters and added the Emerging Markets theater in order to take advantage of the growth potential of these theaters. We met with government leaders around the world in countries such as India, China, Germany, Saudi Arabia, and Russia. Our conversations centered around how Cisco could help their countries develop a stronger economy through Internet access to education, healthcare, and business opportunities. As these countries begin to deploy Internet solutions, they look to Cisco as a partner and resource vital to their success. As a result, product revenue in Cisco's Emerging Markets theater grew 38 percent on a year-over-year basis—the highest growth percentage of all five theaters. Growth in Emerging Markets is the truest example of the power of the network now.

John T. Chambers, President and Chief Executive Officer
In fiscal 2006, Cisco achieved outstanding financial results. Total revenue for fiscal 2006 was a record $28.5 billion, an increase of approximately 15 percent over fiscal 2005 revenue of $24.8 billion. We believe our revenue growth was the result of market share gains in many product categories, as well as the addition of Scientific Atlanta. Of total revenue, $23.9 billion was related to product revenue and $4.6 billion was related to service revenue.

To address the growth in new markets, we added approximately 11,500 employees on a net basis throughout the year, including approximately 8,000 as a result of the acquisition of Scientific Atlanta. Cisco continued its tradition of striving for profitable growth. Despite the added headcount expense, we continued to hold margins within our plan. Total gross margin for fiscal 2006 was over 65 percent. Fiscal year operating margin was approximately 25 percent, making Cisco one of the most profitable companies in the technology networking sector.

Net income was $5.6 billion or approximately 20 percent of revenue. Earnings per share on a fully diluted basis for fiscal 2006 were $0.89. If we had included the newly required Statement of Financial Accounting Standards No. 123, or SFAS123, expense previously disclosed in our footnotes, fiscal 2005 EPS would have been $0.71, representing a 25 percent increase over the prior year had the expense been required then. Cisco generated $7.9 billion of cash from operations and used $8.3 billion to repurchase 435 million shares of stock.

We diversified our capital base with the issuance of $6.2 billion of long-term debt. Our inaugural debt issuance was rated favorably by the ratings agencies and overwhelmingly received by the market. We believe this can be attributed to the underlying strength of Cisco as a whole. Proceeds from the debt issuance were used to purchase Scientific Atlanta and for other general corporate purposes. We believe this was a sound financing decision for Cisco.

We are proud of Cisco's consistency and transparency in financial reporting and execution in operations. We also continue to pursue success and trust as a corporate citizen. Cisco's products promote collaboration and communication of information that is used not only to power businesses, but to modernize governments, support education, and foster economic development as well. We partner with Lawrence Berkeley National Laboratory to research innovations in product design that enhance energy efficiency. Our product design and manufacturing teams seek ways to cut emissions and increase the recyclable nature of our products. Global connections via the Internet remind us that we all inhabit one world. We believe in protecting it as best we can.

Cisco is also committed to education. Our company supports Networking Academy programs in more than 160 countries, with approximately 10,000 academies and over 430,000 students. Students in high schools, technical schools, colleges, and community organizations learn hands-on networking skills to prepare for the workforce of today and the future. The Jordan Education Initiative, spearheaded by Cisco in partnership with the World Economic Forum and several other organizations, continued its momentum of expanding its interactive e-curriculum-based education programs by moving into new geographic areas such as Egypt and India. The education initiatives in the Mississippi and Louisiana school systems after Hurricane Katrina are rebuilding schools for the 21st century. These are all examples of how technology has the power to change the way people work, live, play, and learn. More importantly, it can actually improve lives.

Looking Back
Looking at all that was achieved in fiscal 2006, it is hard to imagine the humble beginnings of Cisco. When John Morgridge became president and CEO in 1984, Cisco's annual revenues were $5 million, less than 0.02 percent of our annual revenues today. We were a competitor in the single product category of routing, and our entire corporation employed only 29 employees. At the time, we were thrilled to have a customer, any customer, visit our modest offices in Menlo Park.

Today, we are a global company with a strong and diverse product line and annual revenues approaching $30 billion. We are proud of our position as the number 1 or number 2 competitor in almost every technology segment in which we compete. In the last year, our San Jose headquarters was visited by hundreds of business, government, and technology leaders, including U.S. President George Bush and Britain's Prime Minister Tony Blair. Cisco's operations on a global basis now reach geographies that we considered previously unreachable. We employ approximately 50,000 of the best and brightest talent in the world. We continue to grow our technological capabilities to meet new challenges and state-of-the-art applications.

At this year's annual meeting in November 2006, John Morgridge will step down from his day-to-day responsibilities as chairman of the board. We thank John for his many years of service to Cisco, and for his invaluable contributions to our business as well as the fundamental nature of our culture. When you look at Cisco's success, John Morgridge has played a key role in making that happen, including the business results, management evolution, and the development of a distinctive corporate culture. He will continue to serve as chairman emeritus and lead the Cisco Systems Foundation.

Looking Back
Reports of Management

Statement of Management’s Responsibility
Cisco's management has always assumed full accountability for maintaining compliance with our established financial accounting policies and for reporting our results with objectivity and the highest degree of integrity. It is critical for investors and other users of the Consolidated Financial Statements to have confidence that the financial information that we provide is timely, complete, relevant, and accurate. Management is responsible for the fair presentation of Cisco’s Consolidated Financial Statements, prepared in accordance with generally accepted accounting principles (GAAP), and has full responsibility for their integrity and accuracy.

Management, with oversight by Cisco’s Board of Directors, has established and maintains a strong ethical climate so that our affairs are conducted to the highest standards of personal and corporate conduct. Management also has established an effective system of internal control over financial reporting. Cisco’s policies and practices reflect corporate governance initiatives that are compliant with the listing requirements of NASDAQ and the corporate governance requirements of the Sarbanes-Oxley Act of 2002.

We are committed to enhancing shareholder value and fully understand and embrace our fiduciary oversight responsibilities. We are dedicated to ensuring that our high standards of financial accounting and reporting as well as our underlying system of internal controls are maintained. Our culture demands integrity and we have the highest confidence in our processes, our internal controls, and our people, who are objective in their responsibilities and who operate under the highest level of ethical standards.

Management’s Report on Internal Control Over Financial Reporting
Management is responsible for establishing and maintaining adequate internal control over financial reporting for Cisco. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management (with the participation of the principal executive officer and principal financial officer) conducted an evaluation of the effectiveness of Cisco’s internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that Cisco’s internal control over financial reporting was effective as of July 2, 2006. Management’s assessment of the effectiveness of Cisco’s internal control over financial reporting as of July 29, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

John T. Chambers
President and Chief Executive Officer
September 15, 2006

Dennis D. Powell
Senior Vice President and Chief Financial Officer
September 15, 2006