

These prepared remarks should be viewed solely in conjunction with the related quarter's conference call webcast and press release, which can be found [here](#). The webcast includes the prepared remarks as well as a question and answer session.

Please [click here](#) for complete GAAP reconciliation information between our GAAP financial results and our non-GAAP financial results.

Cisco Systems, Incorporated [CSCO]  
Q1FY23 Earnings Results Conference Call  
Wednesday, November 16, 2022

### Introduction

Welcome, everyone to Cisco's first quarter fiscal year 2023 quarterly earnings conference call. This is Marilyn Mora, Head of Investor Relations and I'm joined by Chuck Robbins, our Chair and CEO; and Scott Herren, our CFO.

By now you should have seen our earnings press release. A corresponding webcast with slides, including supplemental information, will be made available on our website in the Investor Relations section following the call.

As is customary in Q1, we have made certain reclassifications to prior period amounts to conform to the current period's presentation. Income statements, full GAAP to non-GAAP reconciliation information, balance sheets, cash flow statements and other financial information can also be found in the Financial Information section of our Investor Relations website.

Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results. And we'll discuss product results in terms of revenue and geographic and customer results in terms of product orders unless stated otherwise. All comparisons made throughout this call will be done on a year-over-year basis.

The matters we will be discussing today include forward-looking statements, including the guidance we will be providing for the second quarter and full year of fiscal 2023. They are subject to the risks and uncertainties that we discuss in detail in our documents filed with the SEC, specifically the most recent report on Form 10-K, which identify important risk factors that could cause actual results to differ materially from those contained in the forward-looking statements. With respect to guidance, please also see the slides and press release that accompany this call for further details. Cisco will not comment on its financial guidance during the quarter unless it is done through an explicit public disclosure.

With that, I'll now turn it over to Chuck.

### Opening Remarks

Thank you, Marilyn, and thank you all for joining us today.

We are off to a good start in fiscal 2023, delivering strong results, exceeding the top end of our guidance range for both revenue and non-GAAP EPS.

We delivered the largest quarterly revenue in our history driven by excellent execution and the actions our team took to remediate our supply challenges. Given these results along with the strength of our orders, our visibility and easing supply constraints, we are raising our full year outlook, which Scott will cover later.

While we are proactively managing through an evolving and complex market environment, we remain intensely focused on executing on our strategy, including our transition to more software and subscription-based recurring revenue. We achieved software revenue growth of 5% year-over-year and software subscription revenue grew 11%. The easing of supply constraints and our ability to deliver hardware is now releasing software subscriptions that were sitting in backlog connected to unshipped hardware.

Our success is also reflected in our ARR, which exceeded \$23 billion, increasing 7%, with product ARR growing 12%. We also ended the quarter with RPO of nearly \$31 billion, up 3% year-over-year with product RPO up 5%. Over \$16 billion of the RPO will be recognized as revenue over the next 12 months, with a backlog that remains elevated at near-record levels.

These metrics give us increased visibility and predictability and provide additional confidence in our ability to perform through the current market cycle. It also underscores our unique position, helping customers become more agile and resilient as they continue to navigate a complex set of challenges.

As I've done in the past, I'd like to provide an update on supply chain before discussing our Q1 results. Like you've heard from others in the industry, we are encouraged by what we are seeing with modest improvement in certain component availability as shortages continue to ease from last quarter. The redesign of many of our products has also helped bring supply stability and more resiliency.

Over the last few quarters, you've heard me talk about the actions we've taken to navigate supply constraints. These actions are paying off and are contributing to our results. We now have greater visibility in the ramp of our customer product deliveries, which in turn gives us greater confidence in our fiscal 2023 outlook.

Now moving to performance highlights in the quarter. We delivered revenues of \$13.6 billion, up 6%. And non-GAAP EPS came in at \$0.86, our second highest quarterly non-GAAP EPS in the history of the company. We also generated \$4 billion in operating cash flow and returned over \$2 billion to our shareholders.

These metrics show we remain committed to operating discipline and our balanced capital allocation priorities. We are continuing to invest in our long-term growth opportunities while also returning capital to shareholders.

In terms of our product orders in the quarter, it's important to note that the year-over-year comparison is against an unusually strong period of 34% growth in Q1 of fiscal year '22.

From a geographic perspective, we saw some emerging cautiousness in Europe. This is driven by a dramatic increase in energy costs and market volatility, which is leading customers to assess their overall spend. However, this also presents an opportunity for us as our technologies like IoT, Silicon One and power over ethernet, drive a significant reduction in power consumption.

To provide a normalized perspective, our Q4 to Q1 sequential growth was just slightly below the normal range over the last six years. It's also important to note that this was the second highest Q1 orders in the history of the company.

We have strong product revenue momentum in key parts of our business, including Secure Agile Networks, Security and Optimized Application Experiences. We also saw record performance from a number of products, including the Catalyst 9000 family, Cisco 8000, Wireless, Meraki, ThousandEyes and Duo.

Networking is becoming increasingly critical to every organization, led by digital transformation, hybrid cloud, AI and ML workloads. This is driving demand for our technologies. As we've discussed, there are also tailwinds for our business such as hybrid work, 400G and beyond, 5G, WiFi 6, security and full stack observability. We believe these broader technology transitions will require every customer to rearchitect their network infrastructure and in turn fuel long-term growth across our portfolio.

As I speak with customers, they tell me that while they are closely watching the economy, they remain focused on making the right investments across their business to increase their agility and drive greater innovation and productivity.

In our Webscale business, demand remains solid, driven by their growing investments with Cisco to build out AI fabric and massively scalable cloud networks.

Once again, we saw strong momentum with our Silicon One-based Cisco 8000 routers. We are experiencing robust demand for our 400G products and now have nearly 1,200 customers. On a trailing 12-month basis, webscale orders were up double digits or greater for the eighth consecutive quarter.

Network capacity demand continues to increase, driven by 5G, IoT, pervasive video and other technology trends I've mentioned earlier. With our commitment to powering next-generation networks while also driving sustainability, we launched new 800 gig switching platforms built on our Silicon One G100 chip to help meet customers' demand for more programmability, bandwidth and energy efficiency.

Let me now touch on our innovation as I'm incredibly proud of how our teams have come together to deliver market leading solutions for our customers.

Security and hybrid work are now more critical than ever. We continue to extend our capabilities to enable customers to work more securely anywhere while reducing cost and complexity. In Security, we introduced new data loss prevention, firewall and zero trust capabilities across our portfolio. And in Collaboration, we announced more than 40 new innovations to power hybrid work and deliver exceptional customer experiences.

We're also committed to giving our customers more choice. An example of this is our partnership with Microsoft to bring Microsoft Teams to Cisco meeting room devices. By doing this, we are driving interoperability and demonstrating our openness to meet our customers' need and provide greater flexibility.

To wrap up, we delivered another strong quarter of revenue and non-GAAP earnings growth. The strength of orders, increased visibility and easing supply situation provides us with enhanced visibility and predictability, which underpins the confidence we have in our business and our increased outlook for the year.

Our performance this quarter is a testament to our innovation and execution to support our customers during these complex times. Additionally, it reinforces Cisco's strength, durability and discipline in how we manage the business while investing to capture the multi-year growth opportunities ahead.

Our portfolio is in great shape and our business model is resilient with 43% of our revenue now recurring, which is very important as we navigate the current macro environment. The hard work and dedicated commitment of our leadership team and employees over the last few years to transform our business model is reflected in the performance we delivered this quarter. Combined with the strength of our balance sheet and our position in the market, we have an excellent foundation for delivering long-term results.

I will now turn it over to Scott.

### Financial Overview

Thanks, Chuck.

We started the fiscal year with a strong Q1, reflecting solid execution and disciplined management. We had record total revenue of \$13.6 billion, exceeding the high end of our guidance range, driven by product shipment levels above our expectations, and continued improvements in component supply.

Non-GAAP operating margin was 31.8%, down 150 basis points in line with our guidance range, primarily driven by higher component costs as well as logistics costs related to supply constraints. Non-GAAP net income was \$3.5 billion, up 2%; and non-GAAP EPS was \$0.86, up 5%, exceeding the high end of our guidance range.

Looking at our Q1 revenue in more detail:

Total product revenue was \$10.2 billion, up 8%. And service revenue was flat at \$3.4 billion.

Within product revenue, Secure Agile Networks performed well, up 12%. Switching revenue grew with double-digit growth in campus switching, driven by growth in our Catalyst 9000 and Meraki offerings. While data center switching modestly declined, we saw solid growth in our Nexus 9000 offering. Enterprise routing declined primarily from the product transition to our Catalyst 8000 series routers along with constrained supply. Wireless had very strong double-digit growth driven, primarily by our WiFi 6 products and Meraki wireless offerings.

Internet for the Future was down 5%, driven by declines in Cable, Optical and Edge. We saw growth in our Cisco 8000 offering and strong double-digit growth in webscale.

Collaboration was down 2%, driven by a decline in meetings, partially offset by growth in calling.

End-to-end security was up 9%, driven by unified threat management and Zero Trust offerings. Our Zero Trust portfolio continues to perform well, driven by strong performance in our Duo offering.

Optimized Application Experiences was up 7%, driven by double-digit growth in our SaaS-based offering, ThousandEyes.

We continue to make progress on our transformation metrics as we shift our business to more software and subscriptions.

We saw strong performance in our ARR of \$23.2 billion, which increased 7% with product ARR growth of 12%.

Total software revenue was \$3.9 billion, an increase of 5%, with software subscription revenue up 11%. 85% of the software revenue was subscription based, which is up 5 percentage points year-over-year. We continue to have over \$2 billion of software orders in our product backlog.

Total subscription revenue was \$5.9 billion, an increase of 6%. Total subscription revenue represented 43% of Cisco's total revenue.

And RPO was \$30.9 billion, up 3%. Product RPO increased 5%, and service RPO increased 1%. Total short-term RPO grew to \$16.4 billion.

In terms of orders in Q1, we had the second highest Q1 orders in our history. Although product orders were down 14% for the quarter, it's important to keep in mind that they compare against 34% growth from a year ago. We continue to have low cancellation rates, which remain below pre-pandemic levels. Looking at our geographic segments year-on-year, the Americas was down 10%, EMEA was down 23% and APJC down 10%. In our customer markets, Service Provider was down 23%, Commercial was down 14%, Enterprise was down 13% and Public Sector was down 7%.

Total non-GAAP gross margin came in within our guidance range at 63%, down 150 basis points

year-over-year. Product gross margin was 61%, down 280 basis points. And service gross margin was 68.8%, up 230 basis points. In our product gross margin, the decrease was primarily driven by both component costs, as well as higher freight and logistics costs related to supply constraints. This was partially offset by strong positive pricing impact as a result of the actions we took in the prior year as well as some benefit from product mix.

Backlog levels for both our hardware and software continue to far exceed historical levels. As we navigated a complex supply environment, we were able to increase our shipments this quarter, resulting in about a 10% decrease in total backlog sequentially, which remains at the second highest level we've seen. Just a reminder, backlog is not included as part of our \$30.9 billion in remaining performance obligations. Combined, our significant backlog and RPO continued to provide great visibility to our top line.

Shifting to the balance sheet, we ended Q1 with total cash, cash equivalents and investments of \$19.8 billion. Operating cash flow for the quarter was \$4 billion, up 16% year-over-year.

In capital allocation, we returned \$2.1 billion to shareholders during the quarter. That was comprised of \$1.6 billion for our quarterly cash dividend and approximately \$500 million of share repurchases. All of this is in line with our long-term objective of returning a minimum of 50% of free cash flow annually to our shareholders. We also ended the quarter with \$14.7 billion in stock repurchase authorization.

To summarize, we executed well in Q1 in a highly complex environment, delivering better than expected top line growth and non-GAAP profitability. We continue to make progress on our business model shift to more recurring revenue while making strategic investments in innovation to capitalize on our significant growth opportunities. Consistent with that objective, we announced some restructuring actions focused on prioritizing our investments across our highest growth opportunities and rightsizing our real estate footprint to help maximize long-term value for our shareholders.

## Guidance

Turning to our financial guidance for Q2:

We expect revenue growth to be in the range of 4.5% to 6.5%.

We anticipate non-GAAP gross margins to be in the range of 63% to 64%.

Our non-GAAP operating margin is expected to be in the range of 31.5% to 32.5%. And non-GAAP earnings per share is expected to range from \$0.84 to \$0.86.

For fiscal year '23, our guidance is:

We are raising our expectations for revenue growth to be in the range of 4.5% to 6.5% year-on-year. This is up from the prior range of 4% to 6% growth.

Non-GAAP earnings per share guidance is expected to range from \$3.51 to \$3.58, also up 4.5%

to 6.5% year-on-year.

In both our Q2 and full year guidance, we're assuming a non-GAAP effective tax rate of 19%.

Our Q2 guidance reflects the increased visibility we have from our significant backlog and the RPO we have built up with our business model transformation as well as the easing of supply constraints. The full year guidance rolls forward our Q1 overperformance with a prudent view of the remainder of the year.

### Summary Comments

Thank you all for joining us today. I just want to reiterate, we feel like we had a very strong quarter, largest quarterly revenue in history. As I said earlier, the orders, the visibility, the easing of supply chain gives us the confidence to raise the year, obviously.

We're very focused. We're managing the business for growth. We are going to go through this process of reinvesting into strategic areas. And the people impact is difficult. And I just want our employees who are listening in today to know that this afternoon and tomorrow, we'll be communicating about how we're going to go about this. It's always a difficult decision, but we have a lot of opportunity. I'm very optimistic about the future. I'm proud of the teams and what they have accomplished and really excited about the visibility and the confidence that we have in the near term.

So thanks for joining us, and we look forward to next time.

### Closing

Thanks, Chuck. Cisco's next quarterly earnings conference call, which will reflect our fiscal year 2023 second quarter results, will be on Wednesday, February 15, 2023 at 1:30 p.m. Pacific Time, 4:30 p.m. Eastern Time.

This concludes today's call. If you have any further questions, feel free to contact the Cisco Investor Relations group. We thank you very much for joining today's call.

The prepared remarks set forth above and the related conference call may be deemed to contain forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among other things, statements regarding future events (such as the relevance of our strategy, our differentiated innovation, our ability to help our customers become more resilient, our continued progress on our business model transformation, and the visibility and predictability provided by backlog, RPO, easing of the supply situation and the growth of annualized recurring revenue) and the future financial performance of Cisco (including the guidance for Q2 FY 2023 and full year FY 2023) that involve risks and uncertainties. Readers are cautioned that these forward-looking statements are only predictions and may differ materially from actual future events or results due to a variety of factors, including: the impact of the COVID-19 pandemic and related public health measures; business and economic conditions and growth trends in the networking industry, our

customer markets and various geographic regions; global economic conditions and uncertainties in the geopolitical environment; overall information technology spending; the growth and evolution of the Internet and levels of capital spending on Internet-based systems; variations in customer demand for products and services, including sales to the service provider market and other customer markets; the return on our investments in certain priorities, key growth areas, and in certain geographical locations, as well as maintaining leadership in Secure, Agile Networks and services; the timing of orders and manufacturing and customer lead times; significant supply constraints; changes in customer order patterns or customer mix; insufficient, excess or obsolete inventory; variability of component costs; variations in sales channels, product costs or mix of products sold; our ability to successfully acquire businesses and technologies and to successfully integrate and operate these acquired businesses and technologies; our ability to achieve expected benefits of our partnerships; increased competition in our product and service markets, including the data center market; dependence on the introduction and market acceptance of new product offerings and standards; rapid technological and market change; manufacturing and sourcing risks; product defects and returns; litigation involving patents, other intellectual property, antitrust, stockholder and other matters, and governmental investigations; our ability to achieve the benefits of restructurings and possible changes in the size and timing of related charges; cyber-attacks, data breaches or malware; vulnerabilities and critical security defects; terrorism; natural catastrophic events (including as a result of global climate change); any other pandemic or epidemic; our ability to achieve the benefits anticipated from our investments in sales, engineering, service, marketing and manufacturing activities; our ability to recruit and retain key personnel; our ability to manage financial risk, and to manage expenses during economic downturns; risks related to the global nature of our operations, including our operations in emerging markets; currency fluctuations and other international factors; changes in provision for income taxes, including changes in tax laws and regulations or adverse outcomes resulting from examinations of our income tax returns; potential volatility in operating results; and other factors listed in Cisco's most recent report on Form 10-K filed on September 8, 2022. The financial information contained in the prepared remarks and the related conference call should be read in conjunction with the consolidated financial statements and notes thereto included in Cisco's most recent report on Form 10-K as it may be amended from time to time. Cisco's results of operations for the three months ended October 29, 2022 are not necessarily indicative of Cisco's operating results for any future periods. Any projections in the prepared remarks and the related conference call are based on limited information currently available to Cisco, which is subject to change. Although any such projections and the factors influencing them will likely change, Cisco will not necessarily update the information, since Cisco will only provide guidance at certain points during the year. Such information speaks only as of the date of the prepared remarks and the related conference call.