

CISCO SYSTEMS, INC.

FORM 10-K (Annual Report)

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended July 31, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-18225

CISCO SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

77-0059951
(IRS Employer
Identification No.)

170 West Tasman Drive
San Jose, California
(Address of principal executive offices)

95134-1706
(Zip Code)

Registrant's telephone number, including area code: (408) 526-4000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.001 par value
Preferred Stock Purchase Rights

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

Aggregate market value of registrant's common stock held by non-affiliates of the registrant, based upon the closing price of a share of the registrant's common stock on January 23, 2004 as reported by the Nasdaq National Market on that date: \$184,093,506,531

Number of shares of the registrant's common stock outstanding as of September 9, 2004: 6,650,438,687

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the registrant's Annual Report to Shareholders for its fiscal year ended July 31, 2004 are incorporated by reference into Part I and Part II of this Annual Report on Form 10-K where indicated.

(2) Portions of the registrant's Proxy Statement relating to the registrant's 2004 Annual Meeting of Shareholders, to be held on November 18, 2004, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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This Annual Report on Form 10-K, including the “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which is incorporated by reference from our 2004 Annual Report to Shareholders, contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as “expects,” “anticipates,” “targets,” “goals,” “projects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “continues,” “may,” variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses (including the potential growth of Advanced Technologies), and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under “Risk Factors,” and elsewhere herein and in the 2004 Annual Report to Shareholders. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

PART I

ITEM 1. Business

General

We manufacture and sell networking and communications products and provide services associated with that equipment and its use. Our products are installed at corporations, public institutions, telecommunication companies, and commercial businesses and are also found in personal residences. We provide a broad line of products for transporting data, voice, and video within buildings, across campuses, and around the world. We conduct our business globally and are managed geographically in four segments: the Americas; Europe, the Middle East, and Africa (“EMEA”); Asia Pacific; and Japan. For revenue and other information regarding these segments, see Note 12 to the Consolidated Financial Statements in our 2004 Annual Report to Shareholders, which is incorporated into this report by reference.

We were incorporated in California in December 1984, and our headquarters are in San Jose. The mailing address of our headquarters is 170 West Tasman Drive, San Jose, California 95134-1706, and our telephone number at that location is (408) 526-4000. Our Website is www.cisco.com. Through a link on the Investor Relations section of our Website, we make available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission (“SEC”): our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. All such filings are available free of charge.

Products and Services

We sell scalable, standards-based networking products that address a wide range of customers’ business needs, including improving productivity, reducing costs, and gaining a competitive advantage. Our corresponding technology focus is on delivering networking products and systems that simplify customers’ infrastructures, offer integrated services, and are highly secure. Our products and services help customers build their own network infrastructures while providing tools to allow them to communicate with key stakeholders, including customers, prospects, business partners, suppliers, and employees.

Our products are used individually or in combination to connect computing devices to networks or computer networks with each other—whether they are within a building, across a campus, or around the world. Our breadth of product and service offerings enables us to offer a wide range of products and services to meet customer requirements. We also provide products and services that allow customers to transition their various networks to a single multiservice data, voice, and video network.

We refer to some of our products and technologies as Advanced Technologies, and we believe some of these Advanced Technologies may grow over time to become material contributors to our overall business. Each of these Advanced Technologies and our core switching and routing businesses builds upon our existing competencies. We have currently identified six Advanced Technologies for particular focus: home networking, IP telephony, optical networking, security, storage area networking, and wireless technology. We may identify additional Advanced Technologies for focus and investment in the future, and our investments in some presently identified Advanced Technologies may be curtailed or eliminated depending on market developments.

Over time, we believe that the Internet and the various networks associated with it, including corporate intranets, cable, broadband and dialup networks, and voice and video networks, will evolve to include embedded resources and the virtualization of applications and services to produce an integrated, intelligent system or, as we refer to it, an Intelligent Information Network. This is our vision for the

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evolution of networking from connectivity products to intelligent systems. In this evolving environment, we believe successful vendors will be capable of providing a broad spectrum of products aimed not at a particular technology platform but at solutions to networking problems that span all segments. As such, many of our strategic initiatives and investments are aimed at meeting the requirements that an Intelligent Information Network would demand. For a discussion of the risks associated with that strategy, please see the section of this report entitled "Risk Factors," including the risk factor entitled "We depend upon the development of new products and enhancements to existing products, and if we fail to predict and respond to emerging technological trends and customers' changing needs, our operating results and market share may suffer." For information regarding sales of our major products and services, see Note 12 to the Consolidated Financial Statements in our 2004 Annual Report to Shareholders, which is incorporated into this report by reference.

Our offerings fall into several categories:

Routing

Routing technology is the foundation of a computer network. Routers interconnect computer networks, moving information (data, voice, and video) from one network to another. Our routing products offer features designed to increase the intelligence, security, reliability, and level of performance in the transmission of information. We offer a broad range of routers, from core backbone infrastructure at service providers to home network deployments.

Switching

Switching is another integral networking technology that is used in buildings and campuses to build local-area networks (LANs), across cities to build metropolitan-area networks (MANs), and across great distances to build wide-area networks (WANs). Our switching systems offer many forms of connectivity to end users, workstations, and servers and function as aggregators on LANs, MANs, and WANs. Our systems employ several widely used technologies including Ethernet, Gigabit Ethernet, 10 Gigabit Ethernet, Asynchronous Transfer Mode, and Packet over SONET.

Advanced Technologies

Home Networking

Home networking products connect, in a wired or wireless format, different devices in the household, allowing users to share Internet access, printers, music, movies, and games throughout the home. Our products include routers, network cards, media adapters, video cameras, USB adapters, and other products that enable customers to deploy networking in their homes or small office environments.

IP Telephony

We provide IP telephony products for transmitting voice communications over a network using an open, standards-based Internet Protocol (IP). Our IP telephony products use a single network infrastructure for the transmission of data, voice, and video traffic to deliver IP voice and fully integrated communications. IP telephony products provide a migration path to full IP communications by interoperating with existing systems.

Optical Networking

We provide optical networking products for both the enterprise and service provider markets. Our optical networking products provide an evolutionary path for telecommunications carriers from their existing infrastructures as well as giving newer carriers and enterprises the foundation and capability to offer and deploy cost-effective, multiservice networks that can support data, voice, and video. We support optical technologies such as Synchronous Optical Network/Synchronous Digital Hierarchy (SONET/SDH), Dense Wave Division Multiplexing (DWDM), and Coarse Wave Division Multiplexing (CWDM), which are used to scale optical bandwidth as high-bandwidth applications, such as Gigabit Ethernet and storage, become more commonplace.

Security

We provide a wide range of network security products and services that offer protection to critical information systems from unauthorized use, that defend against attack, and that minimize the effect of Internet-borne worms and viruses. As part of our Self-Defending Network strategy, we offer numerous network security technologies within our family of routers and switches, in standalone security appliances, and as host-based software agents with central management and analysis. Our network security product and service offerings are designed to help ensure the integrity of the information network, simplify operations, and lower total cost of ownership.

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Storage Area Networking

We provide storage networking products that deliver standards-based connectivity between servers and storage systems, which can include products such as arrays and tape drives. Our products incorporate intelligent network features, such as advanced security, traffic management, virtualization, and tools that are designed to help make storing, retrieving, and protecting critical data across widely distributed environments more efficient.

Wireless Technology

We offer a broad variety of in-building wireless LAN and outdoor wireless bridging products. These products include access points, an integrated wireless and wireline switching system, wireless LAN client adapters, bridges, antennas, and accessories. Our wireless networking products are designed to provide high-performance, highly secure, manageable, and highly reliable wireless LANs that enable mobility and increase productivity.

Other Products

Our other products comprise primarily of access and network management software products as follows:

Access

Our access products give remotely located groups and individuals similar levels of connectivity and information access to achieve seamless connections for users whether they are located at a company's head office, at home, or traveling. Asynchronous and Integrated Services Digital Network (ISDN) remote-access routers, dialup access servers, wireless solutions, digital subscriber line (DSL) technologies, and cable universal broadband routers provide telecommuters, mobile workers, students, and other users with remote network access.

Network Management Software

Our enterprise and service provider customers depend on our network management products to provide continuous system operation, security, configuration, monitoring, network optimization, and end-user management. Utilizing our embedded instrumentation, interfaces, and application services and a portfolio of carrier-class, large-scale management products, we offer network management solutions across our product lines. We aim to bring state-of-the-art management capabilities to a converged network management solution covering all our network technologies and services with a high level of inherent security, network intelligence, and high availability. Our network management products include developer kits, application programming interfaces, and services to support customer integration into legacy systems and the integration of third party products that complement our network management product portfolio.

Service

In addition to our product offerings, we provide a broad range of service offerings, including technical support services and advanced services. Technical support services are designed to help ensure that our products operate efficiently, remain highly available, and benefit from the most up-to-date system software. These services help customers to protect their network investments and minimize downtime for systems running mission-critical applications. Advanced services is a comprehensive program that provides responsive, preventive, and consultative support of our technologies for specific networking needs. The advanced services program supports networking devices, applications, and complete infrastructures.

Customers and Markets

Our customers' networking needs are influenced by numerous factors, including the size of the organization, number and types of computer systems, geographic location, and the applications requiring communications. Our customer base is not concentrated in any particular industry. In each of the past three fiscal years, no single customer has accounted for 10 percent or more of our net sales. Our customers are primarily in the following markets:

Large Enterprise Businesses

We define large enterprise businesses generally as regional, national, or global organizations with 1,000 or more employees in multiple locations or branch offices. They have complex IT infrastructure and networking needs within a multivendor environment. Our large enterprise customers include government, education, and healthcare organizations and retail, finance, manufacturing, and transportation enterprises. Cisco creates and delivers solutions in collaboration with third-party application and hardware vendors and channel partners taking advantage of Cisco's products and advanced technology solutions such as enterprise routing, switching, security, IP telephony, mobility, and storage. We also offer a wide variety of services, including service and support packages, financing, and managed service offerings through our service provider partners.

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Service Providers

Service providers offer data, voice, and video communication services to businesses, governments, utilities, and consumers. They include regional, national, and international telecommunications carriers, as well as Internet, cable, and wireless service providers. Service providers use a variety of our routing, switching, optical, storage, security, and network management products in their own core networks. Compared to other end-user customers, service provider customers are more likely to require network design, deployment, and support services. Additionally, many service providers offer managed services incorporating our products into solutions for their residential, enterprise, and commercial customers.

Commercial

We define commercial customers primarily as small and medium-sized businesses having fewer than 1,000 employees and a need for networks of their own, as well as connection to the Internet and to business partners. However, these customers generally have limited resources and expertise in networking technology. Therefore, we attempt to provide products that are affordable and easy to install and use. The commercial market remains an area of potential growth for network adoption and deployment of intelligent network solutions.

Consumer

Consumer customers, primarily individuals and small office/home office (SOHO) businesses, have infrastructure and networking needs on a smaller scale. We offer products to consumers through our Linksys division.

Sales Overview

As of the end of fiscal 2004, our worldwide sales and marketing organization consisted of approximately 13,000 individuals, including managers, sales representatives, and technical support personnel. We have field sales offices in more than 60 countries and sell our products and services both directly and through a variety of channels with support from our sales force. A substantial portion of our products and services is sold through our channel partners and the remainder is sold through direct sales. Our channel partners include system integrators, service providers, other resellers, distributors, and retail partners.

System integrators and service providers typically sell directly to end users and often provide system installation, technical support, professional services, and other support services in addition to network equipment sales. System integrators also typically integrate our products into an overall solution and a number of service providers are also system integrators.

Distributors stock inventory and typically sell to system integrators, service providers, and other resellers. In addition, with the acquisition of the Linksys business, home networking products are generally sold through distributors and retail partners. We refer to sales through distributors and retail partners as our two-tier system of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. These distributors and retail partners are generally given business terms which allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs.

For information regarding risks related to our channels, please see the section of this report entitled "Risk Factors," including the risk factors entitled "Disruption of or changes in our distribution model or customer base could harm our sales and margins" and "Our inventory management relating to our sales to our two-tier distribution channel is complex, and excess inventory may harm our gross margins."

Our service offerings complement our products via a range of consulting, technical, project, quality, and maintenance services, including 24-hour online and telephone support through technical assistance centers.

Cisco Systems Capital Corporation facilitates and provides lease and other financing to certain qualified customers for the purchase of equipment and other needs. For additional information regarding Cisco Systems Capital Corporation's financing activities, see Note 6 to the Consolidated Financial Statements in our 2004 Annual Report to Shareholders, which is incorporated into this report by reference.

Acquisitions, Investments, and Alliances

The markets in which we compete require a wide variety of technologies, products, and capabilities. The combination of technological

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complexity and rapid change within our markets makes it difficult for a single company to develop all technological solutions that it desires to offer within its family of products and services. Through acquisitions, investments, and alliances we are able to deliver a broader range of products and services to customers in target markets.

We employ the following strategies to address the need for new or enhanced networking products and solutions: we develop new technologies and products internally; we enter into joint-development efforts with other companies; we resell other companies' products; and we acquire all or parts of other companies.

Acquisitions

We have acquired many companies, and we expect to make future acquisitions. Mergers and acquisitions of high-technology companies are inherently risky, especially if the acquired company has yet to ship a product. No assurance can be given that our previous or future acquisitions will be successful or will not materially adversely affect our financial condition or operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products and technologies to an inability to do so. The risks associated with acquisitions are more fully discussed in the section of this report entitled "Risk Factors," including the risk factor entitled "We have made and expect to continue to make acquisitions that could disrupt our operations and harm our operating results."

Investments in Privately Held Companies

In addition to passive portfolio investments, we make minority investments in privately held companies that develop technology or provide services that are complementary to our products or provide strategic value. The risks associated with these investments are more fully discussed in the section of the report entitled "Risk Factors," including the risk factor entitled "We are exposed to fluctuations in the market values of our portfolio investments and in interest rates; impairment of our investments could harm our earnings."

Strategic Alliances

We pursue strategic alliances with other companies in areas where collaboration can produce industry advancement and acceleration of new markets. The objectives and goals for a strategic alliance can include one or more of the following: technology exchange, product and solution development, joint sales and marketing, or new-market creation. Currently, we have strategic alliances with AT&T Corp.; BearingPoint, Inc.; Bell South Corporation; Cap Gemini S.A.; Electronic Data Systems Corporation; Hewlett-Packard Company; Intel Corporation; International Business Machines Corporation; Italtel SpA; Microsoft Corporation; Motorola, Inc.; SBC Communications, Inc.; and Sprint Corporation; among others.

Backlog

Our backlog at July 31, 2004, the last day of our 2004 fiscal year, was approximately \$1.9 billion, compared with backlog of approximately \$2.0 billion at July 26, 2003, the last day of our 2003 fiscal year. Backlog includes orders confirmed with a purchase order for products scheduled to be shipped within 90 days to customers with approved credit status. Because of the generally short cycle between order and shipment and occasional customer changes in delivery schedules or cancellation of orders (which are made without significant penalty), we do not believe that our backlog, as of any particular date, is necessarily indicative of actual net sales for any future period.

Competition

We compete in the networking and communications equipment markets, providing products and services for transporting data, voice, and video traffic across intranets, extranets, and the Internet. These markets are characterized by rapid change, converging technologies, and a migration to networking solutions that offer superior advantages. These market factors represent both an opportunity and a competitive threat to us. We compete with numerous vendors in each product category. The overall number of our competitors providing niche product solutions may increase. Also, the identity and composition of competitors may change as we increase our activity in our Advanced Technology markets. As we continue to expand our sales globally, we may see new competitors in different geographic regions, especially Asia.

Our competitors include 3Com; Alcatel; Avaya; Avici Systems; Brocade Communications Systems, Inc.; Check Point Software Technologies; Ciena; D-Link Systems, Inc.; Dell; Enterasys Networks; Extreme Networks; Force10 Networks, Inc.; Foundry Networks; Fujitsu; Hewlett-Packard Company; Huawei Technologies; Juniper Networks; Lucent; McDATA Corporation; NETGEAR, Inc.; Nokia; Nortel Networks; Redback Networks; Siemens AG; and Sycamore Networks; among others.

Some of these companies compete across many of our product lines, while others are primarily focused in a specific product area.

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Barriers to entry are relatively low, and new ventures to create products that do or could compete with our products are regularly formed. In addition, some of our competitors may have greater resources, including technical and engineering resources, than we do. As we expand into new markets, we will face competition not only from our existing competitors but from other competitors, including existing companies with strong technological, marketing, and sales positions in those markets. We also sometimes face competition from resellers and distributors of our products.

The principal competitive factors in the markets in which we presently compete and may compete in the future include:

- The ability to provide a broad range of networking products and services
- Product performance
- Price
- The ability to introduce new products with price/performance advantages
- The ability to provide value-added features such as security, reliability, and investment protection
- Conformance to standards
- Market presence
- The ability to provide financing

We also face competition from customers to whom we license or supply technology and suppliers from whom we transfer technology. The inherent nature of networking requires interoperability. As such, we must cooperate and at the same time compete with many companies. Any inability to effectively manage these complicated relationships with customers and suppliers could have a material adverse effect on our business, operating results, and financial condition and accordingly affect our chances of success.

Research and Development

We regularly seek to introduce new products and features in areas including, routers, switches, Advanced Technologies, and other product technologies.

The industry in which we compete is subject to rapid technological developments, evolving industry standards, changes in customer requirements, and new product introductions and enhancements. As a result, our success, in part, depends upon our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products that improve performance and reduce total cost of ownership. In order to achieve these objectives, our management and engineering personnel work with customers to identify and respond to customer needs, as well as with other innovators of internetworking products, including universities, laboratories, and corporations. We also expect to continue to make acquisitions and investments where appropriate to provide us with access to new technologies. We intend to continue developing products that meet key industry standards and to support important protocol standards as they emerge. Still, there can be no assurance that we will be able to successfully develop products to address new customer requirements and technological changes or that such products will achieve market acceptance.

Our research and development expenditures were \$3.2 billion, \$3.1 billion, and \$3.4 billion in fiscal 2004, 2003, and 2002, respectively. All of our expenditures for research and development costs, as well as in-process research and development of \$3 million, \$4 million, and \$65 million in fiscal 2004, 2003, and 2002, respectively, have been expensed as incurred.

Manufacturing

We primarily employ an outsourced manufacturing strategy that relies on contract manufacturers for manufacturing services. Our manufacturing operations primarily consist of quality assurance of materials and components, subassemblies, final assembly, and testing of products. We presently use a variety of independent third-party companies to provide services related to printed circuit board assembly, in-circuit test, and product repair as well as product assembly. Proprietary software on electronically programmable memory chips is installed in our systems in order to configure products to customer needs and to maintain quality control and security. The manufacturing process enables us to configure the hardware and software in unique combinations to meet a wide variety of individual customer requirements. We also use automated testing equipment and burn-in procedures, as well as comprehensive inspection, testing, and statistical process controls that are designed to help ensure the quality and reliability of our products. The manufacturing processes and procedures are generally ISO 9001 or ISO 9003 certified.

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Our arrangements with contract manufacturers generally provide for quality, cost, and delivery requirements, as well as manufacturing process terms, such as continuity of supply, inventory management, flexibility regarding capacity, quality and cost management, oversight of manufacturing, and conditions for use of our intellectual property. We have not entered into any significant long-term contracts with any manufacturing service provider. We generally have the option to renew arrangements on an as-needed basis, primarily annually. These arrangements generally do not commit us to purchase any particular amount or any quantities beyond certain amounts covered by orders or forecasts that we submit covering discrete periods of time.

Patents, Intellectual Property, and Licensing

We seek to establish and maintain our proprietary rights in our technology and products through the use of patents, copyrights, trademarks, and trade secret laws. We have a program to file applications for and obtain patents, copyrights, and trademarks in the United States and in selected foreign countries where we believe filing for such protection is appropriate. We also seek to maintain our trade secrets and confidential information by nondisclosure policies and through the use of appropriate confidentiality agreements. We have obtained a substantial number of patents and trademarks in the United States and in other countries. There can be no assurance, however, that the rights thereby obtained can be successfully enforced against competitive products in every jurisdiction. Although we believe the protection afforded by our patents, copyrights, trademarks, and trade secrets has value, the rapidly changing technology in the networking industry and uncertainties in the legal process make our future success dependent primarily on the innovative skills, technological expertise, and management abilities of our employees rather than on the protection afforded by patent, copyright, trademark, and trade secret laws.

Many of our products are designed to include software or other intellectual property licensed from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, we believe, based upon past experience and standard industry practice, that such licenses generally could be obtained on commercially reasonable terms. Nonetheless, there can be no assurance that the necessary licenses would be available on acceptable terms, if at all. Our inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis can limit our ability to protect our proprietary rights in our products.

The industry in which we compete is characterized by rapidly changing technology, a large number of patents, and frequent claims and related litigation regarding patent and other intellectual property rights. There can be no assurance that our patents and other proprietary rights will not be challenged, invalidated, or circumvented; that others will not assert intellectual property rights to technologies that are relevant to us; or that our rights will give us a competitive advantage. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as the laws of the United States. The risks associated with patents and intellectual property are more fully discussed in the section of this report entitled "Risk Factors," including the risk factors entitled "Our proprietary rights may prove difficult to enforce," "We may be found to infringe on intellectual property rights of others," and "We rely on the availability of third party licenses."

Employees

As of July 31, 2004, we employed more than 34,000 employees, including approximately 6,000 in manufacturing and service, approximately 12,000 in engineering, approximately 13,000 in sales and marketing, and approximately 3,000 in finance and administration. Approximately 9,600 employees are in locations outside the United States. We consider the relationships with our employees to be positive. Competition for technical personnel in the industry in which we compete is intense. We believe that our future success depends in part on our continued ability to hire, assimilate, and retain qualified personnel. To date, we believe that we have been successful in recruiting qualified employees, but there is no assurance that we will continue to be successful in the future.

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Risk Factors

Set forth below and elsewhere in this report and in other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this report.

OUR OPERATING RESULTS MAY FLUCTUATE IN FUTURE PERIODS, WHICH MAY ADVERSELY AFFECT OUR STOCK PRICE

Our operating results have been in the past, and will continue to be, subject to quarterly and annual fluctuations as a result of numerous factors. These factors include:

- Fluctuations in demand for our products and services, especially with respect to Internet businesses and telecommunications service providers
- Changes in sales and implementation cycles for our products and reduced visibility into our customers' spending plans and associated revenue
- Our ability to maintain appropriate inventory levels and purchase commitments
- Price and product competition in the communications and networking industries, which can change rapidly due to technological innovation
- The overall movement toward industry consolidation among both our competitors and our customers
- The introduction and market acceptance of new technologies and products and our success in new markets, as well as the adoption of new networking standards
- Variations in sales channels, product costs, or mix of products sold
- The timing, size, and mix of orders from customers
- Manufacturing lead times
- Fluctuations in our gross margins, and the factors that contribute to this as described below
- Our ability to achieve targeted cost reductions
- The ability of our customers, channel partners, and suppliers to obtain financing or to fund capital expenditures
- The timing and amount of employer payroll tax to be paid on employees' gains on stock options exercised
- Actual events, circumstances, outcomes, and amounts differing from judgments, assumptions, and estimates used in determining the values of certain assets (including the amounts of related valuation allowances), liabilities, and other items reflected in our Consolidated Financial Statements

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- How well we execute on our strategy and operating plans
- Changes in accounting rules, such as recording expenses for employee stock option grants

As a consequence, operating results for a particular future period are difficult to predict, and, therefore, prior results are not necessarily indicative of results to be expected in future periods. Any of the foregoing factors, or any other factors discussed elsewhere herein, could have a material adverse effect on our business, results of operations, and financial condition that could adversely affect our stock price.

OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED BY THE UNCERTAIN GEOPOLITICAL ENVIRONMENT AND UNFAVORABLE ECONOMIC AND MARKET CONDITIONS

Economic conditions worldwide have contributed to recent slowdowns in the communications and networking industries and may continue to impact our business, resulting in:

- Reduced demand for our products as a result of continued constraints on information technology-related capital spending by our customers, particularly service providers
- Increased price competition for our products, not only from our competitors but also as a consequence of customers disposing of unutilized products
- Risk of excess and obsolete inventories
- Excess facilities and manufacturing capacity
- Higher overhead costs as a percentage of revenues

Recent turmoil in the geopolitical environment in many parts of the world, including terrorist activities and military actions, particularly the continuing tension in and surrounding Iraq, may continue to put pressure on global economic conditions. If the economic and market conditions in the United States and globally do not improve, or if they deteriorate, we may experience material impacts on our business, operating results, and financial condition.

OUR REVENUES FOR A PARTICULAR PERIOD ARE DIFFICULT TO PREDICT, AND A SHORTFALL IN REVENUES MAY HARM OUR OPERATING RESULTS

As a result of a variety of factors discussed in this report, our revenues for a particular quarter are difficult to predict. Our net sales may grow at a slower rate than in past periods and may decline. Our ability to meet financial expectations could also be adversely affected if the nonlinear sales pattern seen in some of our past quarters recurs in future periods. We have experienced periods of time during which shipments have exceeded net bookings or manufacturing issues have delayed shipments, leading to nonlinearity in shipping patterns. In addition to making it difficult to predict revenues for a particular period, nonlinearity in shipping can increase costs, as irregular shipment patterns result in periods of underutilized capacity and periods when overtime expenses may be incurred, as well as leading to additional costs arising out of inventory management. In addition, to the extent that manufacturing issues and any related component shortages result in delayed shipments in the future, and particularly in periods when we and our contract manufacturers are operating at higher levels of capacity, it is possible that revenues for a quarter could be adversely affected if such matters are not remediated within the same quarter.

In addition, to improve customer satisfaction, we continue to attempt to improve our manufacturing lead time performance, which may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter net sales and operating results. Long manufacturing lead times have caused our customers in the past to place the same order multiple times within our various sales channels and to cancel the duplicative orders upon receipt of the product or to place orders with other vendors with shorter manufacturing lead times. Such multiple ordering (along with other factors) may cause difficulty in predicting our sales and, as a result, could impair our ability to manage parts inventory effectively.

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We plan our operating expense levels based primarily on forecasted revenue levels. These expenses and the impact of long-term commitments are relatively fixed in the short term. A shortfall in revenue could lead to operating results being below expectations as we may not be able to quickly reduce these fixed expenses in response to short term business changes.

Any of the above factors could have a material adverse impact on our operations and financial results.

WE EXPECT GROSS MARGIN TO VARY OVER TIME AND OUR RECENT LEVEL OF PRODUCT GROSS MARGIN MAY NOT BE SUSTAINABLE

Our recent level of product gross margins may not be sustainable and may be adversely affected in the future by numerous factors, including:

- Changes in customer, geographic, or product mix, including mix of configurations within each product group
- Increases in material or labor costs
- Excess inventory
- Obsolescence charges
- Changes in shipment volume
- Loss of cost savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand
- Increased price competition
- Changes in distribution channels
- Increased warranty costs
- How well we execute on our strategy and operating plans
- Introduction of new products or entering new markets and different pricing and cost structures of new markets

Changes in service gross margin may result from various factors such as changes in the mix between technical support services and advanced services, as well as the timing of technical support service contract initiations and renewals.

DISRUPTION OF OR CHANGES IN OUR DISTRIBUTION MODEL OR CUSTOMER BASE COULD HARM OUR SALES AND MARGINS

If we fail to manage distribution of our products and services properly, or if our distributors' financial condition or operations weaken, our revenues and gross margins could be adversely affected. Furthermore, a change in the mix of our customers between service provider and enterprise, or a change in the mix of direct and indirect sales, could adversely affect our revenues and gross margins.

A substantial portion of our products and services is sold through our channel partners and the remainder is sold through direct sales. Our channel partners include system integrators, service providers, other resellers, distributors, and retail partners. System integrators and service providers typically sell directly to end users and often provide system installation, technical support, professional services, and other support services in addition to network equipment sales. System integrators also typically integrate our products into an

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overall solution, and a number of service providers are also system integrators. Distributors stock inventory and typically sell to system integrators, service providers, and other resellers. In addition, with the acquisition of the Linksys business, home networking products are generally sold through distributors and retail partners. We refer to sales through distributors and retail partners as our two-tier system of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. These distributors and retail partners are generally given business terms, which allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. If sales through indirect channels increase, this may lead to greater difficulty in forecasting the mix of our products and, to a certain degree, the timing of orders from our customers.

Historically, we have seen fluctuations in our gross margins based on changes in the balance of our distribution channels. Although variability to date has not been significant, there can be no assurance that changes in the balance of our distribution model in future periods would not have an adverse effect on our gross margins and profitability.

Some factors could result in disruption of or changes in our distribution model or customer base, which could harm our sales and margins, including the following:

- We compete with some of our channel partners through our direct sales, which may lead these channel partners to use other suppliers that do not directly sell their own products
- Some of our channel partners may demand that we absorb a greater share of the risks that their customers may ask them to bear
- Some of our channel partners may have insufficient financial resources and may not be able to withstand changes in business conditions
- As we develop more solution-oriented products, enterprise customers may demand rigorous acceptance testing or prime contracting similar to the requirements of our service provider customers

OUR INVENTORY MANAGEMENT RELATING TO OUR SALES TO OUR TWO-TIER DISTRIBUTION CHANNEL IS COMPLEX, AND EXCESS INVENTORY MAY HARM OUR GROSS MARGINS

We must manage our inventory relating to sales to our distributors and retail partners effectively, because inventory held by them could affect our results of operations. Our distributors and retail partners may increase orders during periods of product shortages, cancel orders if their inventory is too high, or delay orders in anticipation of new products. They also may adjust their orders in response to the supply of our products and the products of our competitors that are available to them and in response to seasonal fluctuations in end user demand. Revenue to our distributors and retail partners is recognized based on a sell-through method using information provided by them, and they are generally given business terms that allow them to return a portion of inventory, receive credits for changes in selling price, and participate in various cooperative marketing programs. In addition, due to the expansion of our product line breadth and continued need for higher inventory levels of certain subassemblies of high-demand products in order to manage customer lead times, our inventory levels have increased in recent periods. We may continue to see these higher inventories in the shorter term. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times against the risk of inventory obsolescence because of rapidly changing technology and customer requirements. If we ultimately determine that we have excess inventory, we may have to reduce our prices and write-down inventory, which in turn could result in lower gross margins.

SALES TO THE SERVICE PROVIDER MARKET ARE ESPECIALLY VOLATILE, AND CONTINUED DECLINES OR DELAYS IN SALES ORDERS FROM THIS INDUSTRY MAY HARM OUR OPERATING RESULTS AND FINANCIAL CONDITION

Sales to the service provider market have been characterized by large and often sporadic purchases with longer sales cycles. We have experienced significant decreases in sales to service providers as market conditions have changed. Sales activity in this industry depends upon the stage of completion of expanding network infrastructures; the availability of funding; and the extent that service providers are affected by regulatory, economic, and business conditions in the country of operations. Although some service providers may be increasing capital expenditures over the depressed levels that have prevailed over the last few years, continued declines or delays in orders from this industry could have a material adverse effect on our business, operating results, and financial condition. The recent slowdown in the general economy, overcapacity, changes in the service provider market, and constraints on capital availability

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have had a material adverse effect on many of our service provider customers, with many of such customers going out of business or substantially reducing their expansion plans. These conditions have materially harmed our business and operating results, and we expect that some or all of these conditions may continue for the foreseeable future. Finally, service provider customers typically have longer implementation cycles; require a broader range of service including design services; demand that vendors take on a larger share of risks; often require acceptance provisions, which can lead to a delay in revenue recognition; and expect financing from vendors. All these factors can add further risk to business conducted with service providers.

A SHORTAGE OF ADEQUATE COMPONENT SUPPLY OR MANUFACTURING CAPACITY COULD INCREASE OUR COSTS OR CAUSE A DELAY IN OUR ABILITY TO FULFILL ORDERS, AND OUR FAILURE TO ESTIMATE CUSTOMER DEMAND PROPERLY MAY RESULT IN EXCESS OR OBSOLETE COMPONENT SUPPLY, WHICH COULD ADVERSELY AFFECT OUR GROSS MARGINS

Our growth and ability to meet customer demands depend in part on our ability to obtain timely deliveries of parts from our suppliers and contract manufacturers. We have experienced component shortages in the past, including shortages caused by manufacturing process issues, which have affected our operations. We may in the future experience a shortage of certain component parts as a result of our own manufacturing process issues, manufacturing process issues at our suppliers or contract manufacturers, capacity problems experienced by our suppliers or contract manufacturers, or strong demand in the industry for those parts, especially if the economy grows. Growth in the economy is likely to create greater pressures on us and our suppliers to accurately project overall component demand and component demands within specific product categories and to establish optimal component levels. If shortages or delays persist, the price of these components may increase, or the components may not be available at all, and we may also encounter shortages if we do not accurately anticipate our needs. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner in the quantities or configurations needed. Accordingly, our revenues and gross margins could suffer until other sources can be developed. Our operating results would also be adversely affected if, anticipating greater demand than actually develops, we commit to the purchase of more components than we need. There can be no assurance that we will not encounter these problems in the future. Although in many cases we use standard parts and components for our products, certain components are presently available only from a single source or limited sources. We may not be able to diversify sources in a timely manner, which could harm our ability to deliver products to customers and seriously impact present and future sales.

We believe that we may be faced with the following challenges in the future:

- New markets in which we participate may grow quickly, which may make it difficult to quickly obtain significant component capacity
- As we acquire companies and new technologies, we are dependent, at least initially, on unfamiliar supply chains or relatively small supply partners
- We face competition for certain components, which are supply constrained, from existing competitors and companies in other markets

Manufacturing capacity and component supply constraints could be significant issues for us. We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, in order to improve manufacturing lead time performance and to help assure adequate component supply, we enter into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by us or that establish the parameters defining our requirements. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed. If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete components that could adversely affect our gross margins. For additional information regarding our purchase commitments, see Note 8 to the Consolidated Financial Statements in our 2004 Annual Report to Shareholders. A reduction or interruption in supply; a significant increase in the price of one or more components; a failure to adequately authorize procurement of inventory by our contract manufacturers; a failure to appropriately cancel, reschedule, or adjust our requirements based on our business needs; or a decrease in demand for products could materially adversely affect our business, operating results, and financial condition and could materially damage customer relationships. Furthermore, as a result of binding price or purchase commitments with suppliers, we may be obligated to purchase components at prices that are higher than those available in the current market. In the event that we become committed to purchase components at prices in excess of the current market price when the components are actually used, our gross margins could decrease.

The fact that we do not own the bulk of our manufacturing facilities could have an adverse impact on the supply of our products and on operating results. Financial problems of contract manufacturers on whom we rely, or reservation of manufacturing capacity by other companies, inside or outside of our industry, could either limit supply or increase costs.

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THE MARKETS IN WHICH WE COMPETE ARE INTENSELY COMPETITIVE, WHICH COULD ADVERSELY AFFECT OUR REVENUE GROWTH

For information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled “Competition” contained in Item 1 of this report.

WE DEPEND UPON THE DEVELOPMENT OF NEW PRODUCTS AND ENHANCEMENTS TO EXISTING PRODUCTS, AND IF WE FAIL TO PREDICT AND RESPOND TO EMERGING TECHNOLOGICAL TRENDS AND CUSTOMERS’ CHANGING NEEDS, OUR OPERATING RESULTS AND MARKET SHARE MAY SUFFER

The markets for our products are characterized by rapidly changing technology, evolving industry standards, new product introductions, and evolving methods of building and operating networks. Our operating results depend on our ability to develop and introduce new products into existing and emerging markets and to reduce the production costs of existing products. We believe that the Internet and the various networks associated with it, including corporate intranets, cable, broadband and dialup networks, voice and video networks, will evolve to include embedded resources and the virtualization of applications and services to produce an integrated, intelligent system, or as we refer to it, an Intelligent Information Network. This is our vision for the evolution of networking from connectivity products to intelligent systems. As such, many of our strategic initiatives and investments are aimed at meeting the requirements that an Intelligent Information Network would demand. The process of developing new technology is complex and uncertain, and if we fail to accurately predict customers’ changing needs and emerging technological trends, our business could be harmed. We must commit significant resources to developing new products before knowing whether our investments will result in products the market will accept. In particular, if our model of the evolution of networking from connectivity products to intelligent systems does not emerge as we believe it will, many of our strategic initiatives and investments may be of no or limited value. Furthermore, we may not execute successfully on that vision because of errors in product planning or timing, technical hurdles that we fail to overcome in a timely fashion, or a lack of appropriate resources. This could result in competitors providing those solutions before we do and loss of market share, revenues, and earnings. The success of new products is dependent on several factors, including proper new product definition, component costs, timely completion and introduction of these products, differentiation of new products from those of our competitors, and market acceptance of these products. There can be no assurance that we will successfully identify new product opportunities, develop and bring new products to market in a timely manner, or achieve market acceptance of our products or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive. Specifically, the products and technologies that we have identified as “Advanced Technologies” may not prove to have the market success we anticipate, and we may not successfully identify and invest in other advanced technologies.

OUR BUSINESS SUBSTANTIALLY DEPENDS UPON THE CONTINUED GROWTH OF THE INTERNET AND INTERNET-BASED SYSTEMS

A substantial portion of our business and revenue depends on growth of the Internet and on the deployment of our products by customers who depend on the continued growth of the Internet. As a result of the recent economic slowdown and reduction in capital spending, which have particularly affected telecommunications service providers, spending on Internet infrastructure declined, which has materially harmed our business. To the extent that the economic slowdown and reduction in capital spending continue to adversely affect spending on Internet infrastructure, we could continue to experience material harm to our business, operating results, and financial condition.

Because of the rapid introduction of new products and changing customer requirements related to matters such as cost-effectiveness and security, we believe that there could be certain performance problems with Internet communications in the future, which could receive a high degree of publicity and visibility. As we are a large supplier of networking products, our business, operating results, and financial condition may be materially adversely affected, regardless of whether or not these problems are due to the performance of our own products. Such an event could also result in a material adverse effect on the market price of our common stock independent of direct effects on our business.

CHANGES IN INDUSTRY STRUCTURE AND MARKET CONDITIONS COULD LEAD TO CHARGES RELATED TO DISCONTINUANCES OF CERTAIN OF OUR PRODUCTS OR BUSINESSES AND ASSET IMPAIRMENTS

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Further, our estimates relating to the liabilities for excess

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facilities are affected by changes in real estate market conditions. Additionally, we are required to perform goodwill impairment tests on an annual basis and between annual tests in certain circumstances. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

WE HAVE MADE AND EXPECT TO CONTINUE TO MAKE ACQUISITIONS THAT COULD DISRUPT OUR OPERATIONS AND HARM OUR OPERATING RESULTS

Our growth is dependent upon market growth, our ability to enhance our existing products, and our ability to introduce new products on a timely basis. We intend to continue to address the need to develop new products and enhance existing products through acquisitions of other companies, product lines, technologies, and personnel. Acquisitions involve numerous risks, including the following:

- Difficulties in integrating the operations, technologies, products, and personnel of the acquired companies
- Diversion of management's attention from normal daily operations of the business
- Potential difficulties in completing projects associated with in-process research and development
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions
- Initial dependence on unfamiliar supply chains or relatively small supply partners
- Insufficient revenues to offset increased expenses associated with acquisitions
- The potential loss of key employees of the acquired companies

Acquisitions may also cause us to:

- Issue common stock that would dilute our current shareholders' percentage ownership
- Assume liabilities
- Record goodwill and nonamortizable intangible assets that will be subject to impairment testing on a regular basis and potential periodic impairment charges
- Incur amortization expenses related to certain intangible assets
- Incur large and immediate write-offs and restructuring and other related expenses
- Become subject to intellectual property or other litigation

Mergers and acquisitions of high-technology companies are inherently risky, and no assurance can be given that our previous or future acquisitions will be successful and will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could materially harm our business and operating results. Prior acquisitions have

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resulted in a wide range of outcomes, from successful introduction of new products and technologies to an inability to do so. Even when an acquired company has already developed and marketed products, there can be no assurance that product enhancements will be made in a timely fashion or that preacquisition due diligence will have identified all possible issues that might arise with respect to such products.

From time to time, we have made acquisitions that result in in-process research and development expenses being charged in an individual quarter. These charges may occur in any particular quarter, resulting in variability in our quarterly earnings.

Risks related to new product development also apply to acquisitions. Please see the risk factor above entitled “We depend upon the development of new products and enhancements to existing products, and if we fail to predict and respond to emerging technological trends and customers’ changing needs, our operating results and market share may suffer” for additional information.

ENTRANCE INTO NEW OR DEVELOPING MARKETS EXPOSES US TO ADDITIONAL COMPETITION AND WILL LIKELY INCREASE DEMANDS ON OUR SERVICE AND SUPPORT OPERATIONS

As we focus on new market opportunities—for example, storage; wireless; security; and transporting data, voice, and video traffic across the same network—we will increasingly compete with large telecommunications equipment suppliers as well as startup companies. Several of our competitors may have greater resources, including technical and engineering resources, than we do. Additionally, as customers in these markets complete infrastructure deployments, they may require greater levels of service, support, and financing than we have provided in the past. Demand for these types of service or financing contracts may increase in the future. There can be no assurance that we can provide products, service, support, and financing to effectively compete for these market opportunities. Further, provision of greater levels of services by us may result in a delay in the timing of revenue recognition. In addition, entry into other markets, including our recent entry into the consumer market, has subjected and will subject us to additional risks, particularly to those markets, including the effects of general market conditions and reduced consumer confidence.

PRODUCT QUALITY PROBLEMS COULD LEAD TO REDUCED REVENUES, GROSS MARGINS, AND NET INCOME

We produce highly complex products that incorporate leading-edge technology, including both hardware and software. Software typically contains bugs that can unexpectedly interfere with expected operations. There can be no assurance that our preshipment testing programs will be adequate to detect all defects, either ones in individual products or ones that could affect numerous shipments, which might interfere with customer satisfaction, reduce sales opportunities, or affect gross margins. In the past, we have had to replace certain components and provide remediation in response to the discovery of defects or bugs in products that we had shipped. While the cost of such remediation has not been material in the past, there can be no assurance that such a remediation, depending on the product involved, would not have a material impact. An inability to cure a product defect could result in the failure of a product line, temporary or permanent withdrawal from a product or market, damage to our reputation, inventory costs, or product reengineering expenses, any of which could have a material impact on revenues, margins, and net income.

INDUSTRY CONSOLIDATION MAY LEAD TO INCREASED COMPETITION AND MAY HARM OUR OPERATING RESULTS

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in operating results and could have a material adverse effect on our business, operating results, and financial condition. Furthermore, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants.

DUE TO THE GLOBAL NATURE OF OUR OPERATIONS, POLITICAL OR ECONOMIC CHANGES OR OTHER FACTORS IN A SPECIFIC COUNTRY OR REGION COULD HARM OUR COSTS, EXPENSES, AND FINANCIAL CONDITION

We conduct significant sales and customer support operations in countries outside of the United States and also depend on non-U.S. operations of our contract manufacturers and our distribution partners. For fiscal 2004, we derived 49.3% of our revenues from sales outside the United States. Accordingly, our future results could be materially adversely affected by a variety of uncontrollable and changing factors, including, among others, foreign currency exchange rates; political or social unrest or economic instability in a specific country or region; trade protection measures and other regulatory requirements, which may affect our ability to import or export our products from various countries; political considerations that affect service provider and government spending patterns; health or similar issues, such as the outbreak of Severe Acute Respiratory Syndrome (SARS) in Asia; difficulties in staffing and managing international operations; and adverse tax consequences, including imposition of withholding or other taxes on payments by subsidiaries. Any or all of these factors could have a material adverse impact on our costs, expenses, and financial condition.

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WE ARE EXPOSED TO FLUCTUATIONS IN CURRENCY EXCHANGE RATES THAT COULD NEGATIVELY IMPACT OUR FINANCIAL RESULTS AND CASH FLOWS

Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results and cash flows. Historically, our primary exposures have related to nondollar-denominated sales in Japan, Canada, and Australia and certain nondollar-denominated operating expenses in Europe, Latin America, and Asia, where we sell primarily in U.S. dollars. Additionally, we have exposures to emerging market currencies, which can have extreme currency volatility. An increase in the value of the dollar could increase the real cost to our customers of our products in those markets outside the United States where we sell in dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent we must purchase components in foreign currencies.

Currently, we enter into foreign exchange forward contracts to minimize the short-term impact of foreign currency fluctuations on certain foreign currency receivables, investments, and payables. In addition, we periodically hedge anticipated foreign currency cash flows. Our attempts to hedge against these risks may not be successful, resulting in an adverse impact on our net income.

WE ARE EXPOSED TO THE CREDIT RISK OF SOME OF OUR CUSTOMERS AND TO CREDIT EXPOSURES IN WEAKENED MARKETS, WHICH COULD RESULT IN MATERIAL LOSSES

Most of our sales are on an open credit basis, with typical payment terms of 30 days in the United States and, because of local customs or conditions, longer in some markets outside the United States. We monitor individual customer payment capability in granting such open credit arrangements, seek to limit such open credit to amounts we believe the customers can pay, and maintain reserves we believe are adequate to cover exposure for doubtful accounts. Beyond our open credit arrangements, we have also experienced demands for customer financing and facilitation of leasing arrangements. We expect demand for customer financing to continue. We believe customer financing is a competitive factor in obtaining business, particularly in supplying customers involved in significant infrastructure projects. Our loan financing arrangements may include not only financing the acquisition of our products and services but also providing additional funds for other costs associated with network installation and integration of our products and services and for working capital purposes. We do not recognize revenue on structured loan financing arrangements until cash payments are received.

Because of the recent slowdown in the global economy, our exposure to the credit risks relating to our financing activities described above may increase. Although we have programs in place that are designed to monitor and mitigate the associated risk, including monitoring of particular risks in certain geographic areas, there can be no assurance that such programs will be effective in reducing our credit risks. There have been significant bankruptcies among customers both on open credit and with loan or lease financing arrangements, particularly among Internet businesses and service providers, causing us to incur economic or financial losses. There can be no assurance that additional losses will not be incurred. Although these losses have not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition.

A portion of our sales is derived through our distributors and retail partners. These distributors and retail partners are generally given business terms which allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. We maintain estimated accruals and allowances for such business terms. However, distributors tend to have more limited financial resources than other resellers and end-user customers and therefore represent potential sources of increased credit risk because they may be more likely to lack the reserve resources to meet payment obligations.

OUR PROPRIETARY RIGHTS MAY PROVE DIFFICULT TO ENFORCE

We generally rely on patents, copyrights, trademarks, and trade secret laws to establish and maintain proprietary rights in our technology and products. While we have been issued numerous patents, and other patent applications are currently pending, there can be no assurance that any of these patents or other proprietary rights will not be challenged, invalidated, or circumvented or that our rights will in fact provide competitive advantages to us. Furthermore, many key aspects of networking technology are governed by industry-wide standards, which are usable by all market entrants. In addition, there can be no assurance that patents will be issued from pending applications or that claims allowed on any patents will be sufficiently broad to protect our technology. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as do the laws of the United States. The outcome of any actions taken in these foreign countries may be different than if such actions were determined under the laws of the United States. While we are not dependent on any individual patents or group of patents for particular segments of the business for which we compete, if we are unable to protect our proprietary rights to the totality of the features (including aspects of products protected other than by patent rights) in a market, we may find ourselves at a competitive disadvantage to others who need not incur the substantial expense, time, and effort required to create the innovative products that have enabled us to be successful.

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WE MAY BE FOUND TO INFRINGE ON INTELLECTUAL PROPERTY RIGHTS OF OTHERS

Third parties, including customers, have in the past and may in the future assert claims or initiate litigation related to exclusive patent, copyright, trademark, and other intellectual property rights to technologies and related standards that are relevant to us. These assertions have increased over time as a result of our growth and the general increase in the pace of patent claims assertions, particularly in the United States. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents, and the rapid rate of issuance of new patents, it is not economically practical or even possible to determine in advance whether a product or any of its components infringes or will infringe the patent rights of others. The asserted claims and/or initiated litigation can include claims against us or our manufacturers, suppliers, or customers, alleging infringement of their proprietary rights with respect to our existing or future products or components of those products. Regardless of the merit of these claims, they can be time-consuming, result in costly litigation and diversion of technical and management personnel, or require us to develop a noninfringing technology or enter into license agreements. Where claims are made by customers, resistance even to unmeritorious claims could damage customer relationships. There can be no assurance that licenses will be available on acceptable terms and conditions, if at all, or that our indemnification by our suppliers will be adequate to cover our costs if a claim were brought directly against us or our customers. Furthermore, because of the potential for high court awards that are not necessarily predictable, it is not unusual to find even arguably unmeritorious claims settled for significant amounts. If any infringement or other intellectual property claim made against us by any third party is successful, or if we fail to develop noninfringing technology or license the proprietary rights on commercially reasonable terms and conditions, our business, operating results, and financial condition could be materially and adversely affected.

Our exposure to risks associated with the use of intellectual property may be increased as a result of acquisitions, as we have a lower level of visibility into the development process with respect to such technology or the care taken to safeguard against infringement risks. Further, in the past, third parties have made infringement and similar claims after we have acquired technology that had not been asserted prior to our acquisition.

WE RELY ON THE AVAILABILITY OF THIRD-PARTY LICENSES

Many of our products are designed to include software or other intellectual property licensed from third parties. It may be necessary in the future to seek or renew licenses relating to various aspects of these products. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to protect our proprietary rights in our products.

OUR OPERATING RESULTS AND FUTURE PROSPECTS COULD BE MATERIALLY HARMED BY UNCERTAINTIES OF REGULATION OF THE INTERNET

Currently, few laws or regulations apply directly to access or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as voice over the Internet or using IP, encryption technology, sales taxes on Internet product sales, and access charges for Internet service providers. The adoption of regulation of the Internet and Internet commerce could decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material adverse effect on our business, operating results, and financial condition.

CHANGES IN TELECOMMUNICATIONS REGULATION AND TARIFFS COULD HARM OUR PROSPECTS AND FUTURE SALES

Changes in telecommunications requirements in the United States or other countries could affect the sales of our products. In particular, we believe that there may be future changes in U.S. telecommunications regulations that could slow the expansion of the service providers' network infrastructures and materially adversely affect our business, operating results, and financial condition. Future changes in tariffs by regulatory agencies or application of tariff requirements to currently untariffed services could affect the sales of our products for certain classes of customers. Additionally, in the United States, our products must comply with various Federal Communications Commission requirements and regulations. In countries outside of the United States, our products must meet various requirements of local telecommunications authorities. Changes in tariffs or failure by us to obtain timely approval of products could have a material adverse effect on our business, operating results, and financial condition.

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FAILURE TO RETAIN AND RECRUIT KEY PERSONNEL WOULD HARM OUR ABILITY TO MEET KEY OBJECTIVES

Our success has always depended in large part on our ability to attract and retain highly skilled technical, managerial, sales, and marketing personnel. In spite of the recent economic slowdown, competition for these personnel is intense, especially in the Silicon Valley area of Northern California. Volatility or lack of positive performance in our stock price may also adversely affect our ability to retain key employees, virtually all of whom have been granted stock options. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future, or delays in hiring required personnel, particularly engineering and sales personnel, could make it difficult to meet key objectives, such as timely and effective product introductions. In addition, companies in the networking industry whose employees accept positions with competitors frequently claim that competitors have engaged in improper hiring practices. We have received these claims in the past and may receive additional claims to this effect in the future.

ADVERSE RESOLUTION OF LITIGATION MAY HARM OUR OPERATING RESULTS OR FINANCIAL CONDITION

We are a party to lawsuits in the normal course of our business. Litigation can be expensive, lengthy, and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition. For additional information regarding certain of the lawsuits in which we are involved, see Item 3, "Legal Proceedings," contained in Part I of this report.

CHANGES IN EFFECTIVE TAX RATES OR ADVERSE OUTCOMES RESULTING FROM EXAMINATION OF OUR INCOME TAX RETURNS COULD ADVERSELY AFFECT OUR RESULTS

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

OUR BUSINESS AND OPERATIONS ARE ESPECIALLY SUBJECT TO THE RISKS OF EARTHQUAKES, FLOODS, AND OTHER NATURAL CATASTROPHIC EVENTS

Our corporate headquarters, including certain of our research and development operations and our manufacturing facilities, are located in the Silicon Valley area of Northern California, a region known for seismic activity. Additionally, a certain number of our facilities, including one of our manufacturing facilities, are located near rivers that have experienced flooding in the past. A significant natural disaster, such as an earthquake or a flood, could have a material adverse impact on our business, operating results, and financial condition.

MANMADE PROBLEMS SUCH AS COMPUTER VIRUSES OR TERRORISM MAY DISRUPT OUR OPERATIONS AND HARM OUR OPERATING RESULTS

Despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems. Any such event could have a material adverse effect on our business, operating results, and financial condition. In addition, the continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the U.S. and other countries and create further uncertainties or otherwise materially harm our business, operating results, and financial condition. Similarly, events such as the blackouts in the eastern United States, and recurrences of these blackouts, could have similar negative impacts. To the extent that such disruptions or uncertainties result in delays or cancellations of customer orders or the manufacture or shipment of our products, our business, operating results, and financial condition could be materially and adversely affected.

WE ARE EXPOSED TO FLUCTUATIONS IN THE MARKET VALUES OF OUR PORTFOLIO INVESTMENTS AND IN INTEREST RATES; IMPAIRMENT OF OUR INVESTMENTS COULD HARM OUR EARNINGS

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 Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax. Part of this portfolio includes equity investments in publicly traded companies, the values of which are subject to market price volatility. The recent economic downturn and other factors have adversely affected the public equities market, and general economic conditions may worsen. As a result, we may recognize in earnings the decline in fair value of our publicly traded equity investments below the cost basis when the decline is judged to be other-than-temporary. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, refer to the section titled "Quantitative and Qualitative Disclosures About Market Risk" in our 2004 Annual Report to

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Shareholders, which is incorporated by reference in Item 7A of this report. Our investments in private companies are subject to risk of loss of investment capital. These investments are inherently risky, as the markets for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire investment in these companies.

IF WE DO NOT SUCCESSFULLY MANAGE OUR STRATEGIC ALLIANCES, WE MAY EXPERIENCE INCREASED COMPETITION OR DELAYS IN PRODUCT DEVELOPMENT

We have several strategic alliances with large and complex organizations and other companies with whom we work to offer complementary products and services. These arrangements are generally limited to specific projects, the goal of which is generally to facilitate product compatibility and adoption of industry standards. If successful, these relationships may be mutually beneficial and result in industry growth. However, these alliances carry an element of risk because, in most cases, we must compete in some business areas with a company with which we have a strategic alliance and, at the same time, cooperate with that company in other business areas. Also, if these companies fail to perform or if these relationships fail to materialize as expected, we could suffer delays in product development or other operational difficulties.

OUR STOCK PRICE MAY CONTINUE TO BE VOLATILE

Our common stock has experienced substantial price volatility, particularly as a result of variations between our actual financial results and the published expectations of analysts and as a result of announcements by our competitors and us. Furthermore, speculation in the press or investment community about our strategic position, financial condition, results of operations, business, or significant transactions can cause changes in our stock price. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, in particular, and that have often been unrelated to the operating performance of these companies. These factors, as well as general economic and political conditions, may materially adversely affect the market price of our common stock in the future. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom are compensated in part based on the performance of our stock price.

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Executive Officers of the Registrant

The following table shows the name, age and position of each of our executive officers as of August 31, 2004:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Larry R. Carter	61	<u>Senior Vice President, Office of the President, and Director</u> Mr. Carter has been a member of the Board of Directors since July 2000. He joined Cisco in January 1995 as Vice President of Finance and Administration, Chief Financial Officer, and Secretary. In July 1997, he was promoted to Senior Vice President of Finance and Administration, Chief Financial Officer, and Secretary. In May 2003, upon his retirement as Chief Financial Officer and Secretary, he was appointed to his current position. Before joining Cisco, he was employed by Advanced Micro Devices, Inc. as Vice President and Corporate Controller. Mr. Carter currently serves on the board of directors of QLogic Corporation.
John T. Chambers	55	<u>President, Chief Executive Officer, and Director</u> Mr. Chambers has been a member of the Board of Directors since November 1993. He joined Cisco as Senior Vice President in January 1991 and was promoted to Executive Vice President in June 1994. Mr. Chambers was promoted to his current position as of January 31, 1995. Before joining Cisco, he was employed by Wang Laboratories, Inc. for eight years, where, in his last role, he was the Senior Vice President of U.S. Operations.
Mark Chandler	48	<u>Vice President, Legal Services, General Counsel and Secretary</u> Mr. Chandler joined Cisco in July 1996, as Cisco's Managing Attorney for Europe, the Middle East, and Africa, and was promoted to Vice President, Worldwide Legal Services in February 2001. In October 2001, he was promoted to Vice President, Legal Services and General Counsel. In May 2003, he was appointed to his current position. Before joining Cisco, he was General Counsel of Stratacom, Inc. Stratacom was acquired by Cisco in July 1996. Before joining Stratacom, he served as Vice President, Corporate Development and General Counsel of Maxtor Corporation.
Charles H. Giancarlo	46	<u>Senior Vice President and Chief Technology Officer</u> Mr. Giancarlo joined Cisco in December 1994 as Director of Business Development. He was promoted to Vice President in September 1995. He was Vice President of Global Alliances from April 1997 to April 1999 and promoted to Senior Vice President in April 1998. In April 1999, he was promoted to Senior Vice President, Commercial Line of Business. In August 2001, he was promoted to Senior Vice President and General Manager of the Access, Aggregation, Ethernet Switching, and Wireless Groups. In May 2002, he was promoted to Senior Vice President of the Switching, Voice and Storage Groups. In June 2003, he also became the President of Cisco-Linksys LLC. As of August 2004, he was promoted to his current position, holds the senior leadership roles for the Global Government Solutions Group and Voice Technology Group, and continues to serve as President of Cisco-Linksys LLC. Before joining Cisco, he served as Vice President of Marketing with Kalpana Corporation from July 1993 until Kalpana was acquired by Cisco in December 1994.

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Richard J. Justice	54	<u>Senior Vice President, Worldwide Field Operations</u> Mr. Justice joined Cisco in December 1996 as Senior Vice President of the Americas. In February 2000, he was promoted to his current position. Before joining Cisco, Mr. Justice spent 22 years at Hewlett-Packard Company where, in his last role, he was responsible for Worldwide Enterprise Sales and Marketing.
Mario Mazzola	57	<u>Senior Vice President, Chief Development Officer</u> Mr. Mazzola joined Cisco in September 1993 as Vice President and General Manager of the Workgroup Business Unit. He was promoted to Senior Vice President of the Enterprise Line of Business in April 1997. In June 2000, Mr. Mazzola took on the leadership of Cisco's new technology development efforts as Senior Vice President of New Business Ventures. In August 2001, he was promoted to his current position. Before joining Cisco, he served as President and Chief Executive Officer of Crescendo Communications, Inc. from 1990 until Crescendo was acquired by Cisco in September 1993.
Randy Pond	50	<u>Senior Vice President, Operations, Systems, and Processes</u> Mr. Pond joined Cisco in September 1993. In 1994, Mr. Pond assumed leadership of Cisco's Supply/Demand group. In 1994, he was appointed Director of Manufacturing Operations. He was promoted to Vice President of Manufacturing in 1995. In January 2000, Mr. Pond was promoted to Senior Vice President of West Coast and Asia operations. He was promoted to Senior Vice President, Worldwide Manufacturing Operations and Logistics in June 2001. In August 2003, he was promoted to his current position. Before joining Cisco, Mr. Pond held the position of Vice President Finance, Chief Financial Officer and Vice President of Operations at Crescendo Communications, Inc. until Crescendo was acquired by Cisco in September 1993.
Dennis D. Powell	56	<u>Senior Vice President and Chief Financial Officer</u> Mr. Powell joined Cisco in January 1997 as Vice President, Corporate Controller. In June 2002, he was promoted to Senior Vice President, Corporate Finance. Mr. Powell was promoted to Senior Vice President and Chief Financial Officer in May 2003. Before joining Cisco, Mr. Powell was employed by Coopers & Lybrand LLP for 26 years, most recently as a senior partner. Mr. Powell currently serves on the board of directors of Intuit Inc.
Betsy Rafael	43	<u>Vice President, Corporate Controller and Principal Accounting Officer</u> Ms. Rafael joined Cisco in April 2002 as Vice President, Corporate Controller. In July 2003 she was also named to the role of Principal Accounting Officer. Before joining Cisco, from December 2000 until March 2002, Ms. Rafael was employed by Aspect Communications Corporation, most recently as Executive Vice President, Finance, Chief Financial Officer and Chief Administrative Officer. From May 2000 until November 2000, she was employed by Escalate Corporation as Senior Vice President and Chief Financial Officer. From November 1994 until May 2000, she was employed by Silicon Graphics, Inc., most recently as Senior Vice President and Chief Financial Officer. Ms. Rafael currently serves on the board of directors of PalmSource, Inc.
James Richardson	47	<u>Senior Vice President, Chief Marketing Officer</u> Mr. Richardson joined Cisco in May 1990, founded Cisco's Canadian operations, and was promoted to Vice President of Intercontinental Operations in June 1992. Mr. Richardson was promoted to Vice President of North American Operations in June 1994. He was promoted to President of EMEA and Senior Vice President in August 1996. In September 1999, he was promoted to Senior Vice President, Office of the President. In January 2000, he was promoted to Senior Vice President of the Enterprise Line of Business and Internet Communications Software Group. In August 2001, Mr. Richardson was promoted to his current position.

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ITEM 2. Properties

Our headquarters are located on an owned site in San Jose, California. In addition to this site, we own certain sites in the United States, which include facilities in the surrounding areas of San Jose, California; Boxborough, Massachusetts; Salem, New Hampshire; Richardson, Texas; and Research Triangle Park, North Carolina. We also own land for expansion in some of these locations. In addition, we also lease office space in several U.S. locations.

Outside the United States, we have operations, primarily in leased sites, in the Americas, EMEA, Asia Pacific, and Japan. Larger site locations include the United Kingdom, France, Belgium, the Netherlands, Singapore, Hong Kong, Australia, Japan, and India. We own and lease manufacturing facilities, which are primarily test and assembly operations, in two locations in the United States and none internationally. We believe that our existing properties, including both owned and leased sites, are in good condition and suitable for the conduct of our business.

For additional information regarding obligations under leases, see Note 8 to the Consolidated Financial Statements in our 2004 Annual Report to Shareholders, which is incorporated by reference herein. For additional information regarding properties by operating segment, see Note 12 to the Consolidated Financial Statements in our 2004 Annual Report to Shareholders, which is incorporated by reference herein.

ITEM 3. Legal Proceedings

Beginning on April 20, 2001, a number of purported shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against us and certain of our officers and directors. The lawsuits have been consolidated, and the consolidated action is purportedly brought on behalf of those who purchased our publicly traded securities between August 10, 1999 and February 6, 2001. Plaintiffs allege that defendants made false and misleading statements, purport to assert claims for violations of the federal securities laws, and seek unspecified compensatory damages and other relief. We believe the claims are without merit and intend to defend the actions vigorously.

In addition, beginning on April 23, 2001, a number of purported shareholder derivative lawsuits were filed in the Superior Court of California, County of Santa Clara, and in the Superior Court of California, County of San Mateo. There is a procedure in place for the coordination of such actions (one of which has been dismissed and is currently on appeal). Two purported derivative suits were filed in the United States District Court for the Northern District of California, and those federal court actions have been consolidated. The consolidated federal court derivative action was dismissed by the court, and plaintiffs have appealed from that decision. The complaints in the various derivative actions include claims for breach of fiduciary duty, waste of corporate assets, mismanagement, unjust enrichment, and violations of the California Corporations Code; seek compensatory and other damages, disgorgement, and other relief; and are based on essentially the same allegations as the class actions.

In addition, we are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

(a) The information required by this item is incorporated by reference to page 67 of our 2004 Annual Report to Shareholders.

(b) None.

(c) Issuer Purchases of Equity Securities

(In millions, except per-share amounts)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares	Approximate Dollar Value of Shares That May
			Purchased as Part of Publicly Announced Plans or Programs (1)	Yet Be Purchased under the Plans or Programs (1)
May 2, 2004 to May 29, 2004	41	\$ 21.59	41	\$ 9,208
May 30, 2004 to June 26, 2004	28	\$ 23.29	28	\$ 8,564
June 27, 2004 to July 31, 2004	21	\$ 22.63	21	\$ 8,085
Total	90	\$ 22.36	90	

(1) In September 2001, our Board of Directors authorized a stock repurchase program. As of July 31, 2004, our Board of Directors has authorized the repurchase of up to \$25 billion of common stock under this program. During fiscal 2004, we repurchased and retired 408 million shares of our common stock at an average price of \$22.30 per share for an aggregate purchase price of \$9.1 billion. As of July 31, 2004, we had repurchased and retired 956 million shares of our common stock at an average price of \$17.70 per share for an aggregate purchase price of \$16.9 billion since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was \$8.1 billion with no termination date.

ITEM 6. Selected Financial Data

The information required by this item is incorporated by reference to page 17 of our 2004 Annual Report to Shareholders.

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information required by this item is incorporated by reference to pages 18 to 35 of our 2004 Annual Report to Shareholders.

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

The information required by this item is incorporated by reference to pages 36 to 37 of our 2004 Annual Report to Shareholders.

ITEM 8. Financial Statements and Supplementary Data

The information required by this item is incorporated by reference to pages 38 to 67 of our 2004 Annual Report to Shareholders.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

ITEM 9A. Controls and Procedures

Evaluation of disclosure controls and procedures. Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

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Changes in internal control over financial reporting. There was no change in our internal control over financial reporting during our fourth quarter of fiscal 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors and Executive Officers of the Registrant

The information required by this item relating to our directors and nominees, and compliance with Section 16(a) of the Securities Act of 1934, is included under the captions “Proposal No. 1: Election of Directors” and “Ownership of Securities—Section 16(a) Beneficial Ownership Reporting Compliance” in our Proxy Statement related to the 2004 Annual Meeting of Shareholders and is incorporated herein by reference.

The information required by this item relating to our executive officers is included under the caption “Executive Officers of the Registrant” in Part I of this report and is incorporated by reference into this section.

We have adopted a code of ethics that applies to our principal executive officer and all members of our finance department, including the principal financial officer and principal accounting officer. This code of ethics, which consists of the “Special Ethics Obligations for Employees with Financial Reporting Responsibilities” section of our Code of Business Conduct that applies to employees generally, is posted on our Website. The Internet address for our Website is www.cisco.com, and the code of ethics may be found as follows:

1. From our main Web page, first click on “About Cisco” and then on “Corporate Governance” under “Investor Relations.”
2. Next, click on “Code of Business Conduct.”
3. Finally, click on “Special Ethics Obligations for Employees with Financial Reporting Responsibilities.”

We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of this code of ethics by posting such information on our Website, at the address and location specified above.

ITEM 11. Executive Compensation

The information required by this item is included under the captions “Proposal No. 1: Election of Directors—Director Compensation” and “Executive Compensation and Related Information” in our Proxy Statement related to the 2004 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item relating to security ownership of certain beneficial owners and management, and securities authorized for issuance under equity compensation plans, is included under the caption “Ownership of Securities” in our Proxy Statement related to the 2004 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. Certain Relationships and Related Transactions

None.

ITEM 14. Principal Accountant Fees and Services

The information required by this item is included under the captions “Proposal No. 2: Ratification of Independent Registered Public Accounting Firm—Principal Accountant Fees and Services” and “Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm” in our Proxy Statement related to the 2004 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a) 1. Financial Statements

The Index to Financial Statements and Financial Statement Schedule on page 26 is incorporated herein by reference as the list of financial statements required as part of this report.

2. Financial Statement Schedule

The Index to Financial Statements and Financial Statement Schedule on page 26 is incorporated herein by reference as the list of financial statement schedules required as part of this report.

3. Exhibits

The exhibit list in the Index to Exhibits is incorporated herein by reference as the list of exhibits required as part of this report.

**INDEX TO FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULE**

Item 15(a)

	Page	
	Form 10-K	2004 Annual Report to Shareholders
Consolidated Statements of Operations for each of the three years in the period ended July 31, 2004		38
Consolidated Balance Sheets at July 31, 2004 and July 26, 2003		39
Consolidated Statements of Cash Flows for each of the three years in the period ended July 31, 2004		40
Consolidated Statements of Shareholders' Equity for each of the three years in the period ended July 31, 2004		41
Notes to Consolidated Financial Statements		42 – 65
Report of Independent Registered Public Accounting Firm		66
Supplementary Financial Data (Unaudited) and Stock Market Information:		
Fiscal 2004 and 2003 by Quarter		67
Financial Statement Schedule:		
Schedule II Valuation and Qualifying Accounts	27	
Report of Independent Registered Public Accounting Firm	28	

SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS
(in millions)

	<u>Allowance for Doubtful Accounts</u>	<u>Allowance for Inventory</u>	<u>Liability for Purchase Commitments</u>
Year ended July 27, 2002:			
Balance at beginning of fiscal year	\$ 288	\$ 1,682	\$ 597
Charged to expenses or other accounts	91	131	18
Deductions	(44)	(1,587)	(377)
Balance at end of fiscal year	\$ 335	\$ 226	\$ 238
Year ended July 26, 2003:			
Balance at beginning of fiscal year	\$ 335	\$ 226	\$ 238
Charged (credited) to expenses or other accounts	(59)	70	3
Deductions	(93)	(174)	(142)
Balance at end of fiscal year	\$ 183	\$ 122	\$ 99
Year ended July 31, 2004:			
Balance at beginning of fiscal year	\$ 183	\$ 122	\$ 99
Charged to expenses or other accounts	19	205	46
Deductions	(23)	(188)	(4)
Balance at end of fiscal year	\$ 179	\$ 139	\$ 141

The liability for purchase commitments is reported as other accrued liabilities on the Consolidated Balance Sheets.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENT SCHEDULE

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

Our audits of the consolidated financial statements referred to in our report dated September 16, 2004 appearing in the 2004 Annual Report to Shareholders of Cisco Systems, Inc. (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in Item 15(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PRICEWATERHOUSECOOPERS LLP

San Jose, California

September 16, 2004

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

September 17, 2004

CISCO SYSTEMS, INC.

/s/ JOHN T. C HAMBERS

John T. Chambers
(President and Chief Executive Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John T. Chambers and Dennis D. Powell, jointly and severally, his attorney-in-fact, each with the full power of substitution, for such person, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might do or could do in person hereby ratifying and confirming all that each of said attorneys-in-fact and agents, or his substitute, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report on Form 10-K has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ JOHN T. C HAMBERS</u> John T. Chambers	President and Chief Executive Officer and Director (Principal Executive Officer)	September 17, 2004
<u>/s/ DENNIS D. POWELL</u> Dennis D. Powell	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	September 17, 2004
<u>/s/ BETSY RAFAEL</u> Betsy Rafael	Vice President, Corporate Controller, and Principal Accounting Officer (Principal Accounting Officer)	September 17, 2004

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<hr/> <p>/s/ J O H N P. M O R G R I D G E</p> <hr/> <p>John P. Morgridge</p> <hr/>	Chairman of the Board and Director	September 17, 2004
<hr/> <p>Donald T. Valentine</p> <hr/> <p>/s/ C A R O L A. B A R T Z</p> <hr/> <p>Carol A. Bartz</p> <hr/>	Vice Chairman of the Board and Director	
<hr/> <p>/s/ M. M I C H E L E B U R N S</p> <hr/> <p>M. Michele Burns</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ L A R R Y R. C A R T E R</p> <hr/> <p>Larry R. Carter</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ D R. J A M E S F. G I B B O N S</p> <hr/> <p>Dr. James F. Gibbons</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ D R. J O H N L. H E N N E S S Y</p> <hr/> <p>Dr. John L. Hennessy</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ R O D E R I C K C. M C G E A R Y</p> <hr/> <p>Roderick C. McGeary</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ J A M E S C. M O R G A N</p> <hr/> <p>James C. Morgan</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ S T E V E N M. W E S T</p> <hr/> <p>Steven M. West</p> <hr/>	Director	September 17, 2004
<hr/> <p>/s/ J E R R Y Y A N G</p> <hr/> <p>Jerry Yang</p> <hr/>	Director	September 17, 2004

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Index to Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Restated Articles of Incorporation of Cisco Systems, Inc., as currently in effect	S-3	333-56004	4.1	2/21/2001	
3.2	Amended and Restated Bylaws of Cisco Systems, Inc., as currently in effect	10-Q	000-18225	3.2	11/17/2003	
4.1	Rights Agreement dated as of June 10, 1998 between Cisco Systems, Inc. and Bank Boston, N.A.	10-K	000-18225	4.1	9/10/2003	
4.2	First Amendment to the Rights Agreement and Certification of Compliance with Section 27 Thereof between Cisco Systems, Inc. and Fleet National Bank (f/k/a Bank Boston, N.A.)	10-K	000-18225	4.2	9/29/2000	
4.3	Second Amendment to the Rights Agreement and Certification of Compliance with Section 27 Thereof by and among Cisco Systems, Inc., Fleet National Bank (f/k/a Bank Boston, N.A.), and EquiServe Trust Company, N.A.	10-Q	000-18225	4.1	12/10/2001	
10.1*	Cisco Systems, Inc. Amended and Restated 1996 Stock Incentive Plan (including related form agreements)					X
10.2*	1997 Supplemental Stock Incentive Plan (including related form agreements)	10-K	000-18225	10.2	9/10/2003	
10.3*	Professional and Leadership Incentive Plan—Fiscal Year 2004	10-Q	000-18225	10.3	5/27/2004	
10.4*	Professional and Leadership Incentive Plan—Fiscal Year 2005					X
10.5*	Cisco Systems, Inc. Employee Stock Purchase Plan (including Sub-plan, the International Employee Stock Purchase Plan)	10-Q	000-18225	10.4	11/17/2003	
10.6*	Notice of Grant of Stock Option and Stock Option Agreement between John T. Chambers and Cisco Systems, Inc.					X
10.7*	Form of Officer Indemnification Agreement					X
10.8*	Form of Director Indemnification Agreement					X
13.1	Pages 17 to 67 of the Registrant's 2004 Annual Report to Shareholders					X
21.1	Subsidiaries of the Registrant					X
23.1	Consent of Independent Registered Public Accounting Firm					X
24.1	Power of Attorney (included on page 29 of this Annual Report on Form 10-K)					X
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer					X
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer					X
32.1	Section 1350 Certification of Principal Executive Officer					X
32.2	Section 1350 Certification of Principal Financial Officer					X

* Indicates a management contract or compensatory plan or arrangement.

**CISCO SYSTEMS, INC.
1996 STOCK INCENTIVE PLAN**

As Amended and Restated Effective March 18, 2003

ARTICLE ONE

GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This 1996 Stock Incentive Plan is intended to promote the interests of Cisco Systems, Inc., a California corporation, by providing eligible persons with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the Corporation as an incentive for them to remain in the service of the Corporation.

Capitalized terms shall have the meanings assigned to such terms in the attached Appendix.

All share numbers in this March 18, 2003 restatement reflect all splits of the Common Stock effected through March 22, 2000, including (i) the three (3)-for-two (2) split of Common Stock effected on December 16, 1997, (ii) the three (3)-for-two (2) split of Common Stock effected on September 15, 1998, (iii) the two (2)-for-one (1) split of Common Stock effected on June 21, 1999, and (iv) the two (2)-for-one (1) split of Common Stock effected on March 22, 2000.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into three separate equity programs:

(i) the Discretionary Option Grant Program under which eligible persons may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock,

(ii) the Automatic Option Grant Program under which eligible non-employee Board members shall automatically receive option grants at periodic intervals to purchase shares of Common Stock, and

(iii) the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary) or the attainment of designated performance goals.

B. The provisions of Articles One and Five shall apply to all equity programs under the Plan and shall govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. The Primary Committee shall have sole and exclusive authority to administer the Discretionary Option Grant Program with respect to Section 16 Insiders.

B. Administration of the Discretionary Option Grant Program with respect to all other persons eligible to participate in that program may, at the Board's discretion, be vested in the Primary Committee or a Secondary Committee, or the Board may retain the power to administer that program with respect to all such persons. The members of the Secondary Committee may be Board members who are Employees eligible to receive discretionary option grants under the Plan or any other stock option, stock appreciation, stock bonus or other stock plan of the Corporation (or any Parent or Subsidiary). Administration of the Stock Issuance Program shall be vested in the Primary Committee, except to the extent the Board delegates administrative authority under the Stock Issuance Program to a Secondary Committee or retains such authority for itself.

C. Members of the Primary Committee or any Secondary Committee shall serve for such period of time as the Board may determine and may be removed by the Board at any time. The Board may also at any time terminate the functions of any Secondary Committee and reassume all powers and authority previously delegated to such committee.

D. Each Plan Administrator shall, within the scope of its administrative functions under the Plan, have full power and authority (subject to the provisions of the Plan) to establish such rules and regulations as it may deem appropriate for proper administration of the Discretionary Option Grant and Stock Issuance Programs and to make such determinations under, and issue such interpretations of, the provisions of such programs and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan Administrator within the scope of its administrative functions under the Plan shall be final and binding on all parties who have an interest in the Discretionary Option Grant or Stock Issuance Program under its jurisdiction or any option or stock issuance thereunder.

E. Service on the Primary Committee or the Secondary Committee shall constitute service as a Board member, and members of each such committee shall accordingly be entitled to full indemnification and reimbursement as Board members for their service on such committee. No member of the Primary Committee or the Secondary Committee shall be liable for any act or omission made in good faith with respect to the Plan or any option grants under the Plan.

F. Administration of the Automatic Option Grant Program shall be self-executing in accordance with the terms of that program, and no Plan Administrator shall exercise any discretionary functions with respect to any option grants made under that program.

IV. ELIGIBILITY

A. The persons eligible to participate in the Discretionary Option Grant Program are as follows:

- (i) Employees,
- (ii) non-employee members of the Board or the board of directors of any Parent or Subsidiary, and
- (iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. The persons eligible to participate in the Stock Issuance Program shall be limited to those individuals who render services to the Corporation (or any Parent or Subsidiary) in the capacity of independent, non-employee consultants and who are not otherwise Section 16 Insiders at the time of issuance.

C. Each Plan Administrator shall, within the scope of its administrative jurisdiction under the Plan, have full authority to determine (i) with respect to the Discretionary Option Grant Program, which eligible persons are to receive option grants, the time or times when such option grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times when each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding and (ii) with respect to stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when such issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration for such shares..

D. The individuals who shall be eligible to participate in the Automatic Option Grant Program shall be limited to (i) those individuals serving as non-employee Board members on the Plan Effective Date, (ii) those individuals who first become non-employee Board members on or after the Plan Effective Date, whether through appointment by the Board or election by the Corporation's shareholders, and (iii) those individuals who continue to serve as non-employee Board members at one or more Annual Shareholders Meetings held after the Plan Effective Date. A non-employee Board member who has previously been in the employ of the Corporation (or any Parent or Subsidiary) shall not be eligible to receive an option grant under the Automatic Option Grant Program at the time he or she first becomes a non-employee Board member, but shall be eligible to receive periodic option grants under the Automatic Option Grant Program while he or she continues to serve as a non-employee Board member.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock, including shares repurchased by the Corporation on the open market. The maximum number of shares of Common Stock reserved for issuance over the term of the Plan shall not exceed 2,504,006,600 shares, subject to the automatic share increases described in Paragraph V.B. below. Such share reserve consists of the number of shares of Common Stock transferred from the Predecessor Plan, as of the Plan Effective Date (619,524,900), plus the number of shares added to the reserve pursuant to the automatic share increases effected in December 1996, December 1997, December 1998, December 1999, December 2000 and December 2001 (1,884,481,700 shares in the aggregate).

B. The number of shares of Common Stock available for issuance under the Plan shall automatically increase on the first trading day of fiscal December each calendar year, beginning with fiscal December in calendar year 1996 and continuing through fiscal December in calendar year 2001, by a number of shares equal to four and three-quarters percent (4.75%) of the total number of shares of Common Stock outstanding on the last trading day in the immediately preceding fiscal November, but in no event shall any such annual increase exceed 480,000,000 shares.

C. No one person participating in the Plan may receive stock options, separately exercisable stock appreciation rights or direct stock issuances for more than 18,000,000 shares of Common Stock in the aggregate per calendar year.

D. Shares of Common Stock subject to outstanding options (including options incorporated into this Plan from the Predecessor Plan) shall be available for subsequent issuance under the Plan to the extent those options expire or terminate for any reason prior to exercise in full. Unvested shares issued under the Plan and subsequently cancelled or repurchased by the Corporation, at the original issue price paid per share, pursuant to the Corporation's repurchase rights under the Plan shall be added back to the number of shares of Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants under the Plan. However, should the exercise price of an option under the Plan be paid with shares of Common Stock or should shares of Common Stock otherwise issuable under the Plan be withheld by the Corporation in satisfaction of the withholding taxes incurred in connection with the exercise of an option or the vesting of a stock issuance under the Plan, then the number of shares of Common Stock available for issuance under the Plan shall be reduced by the gross number of shares for which the option is exercised or which vest under the stock issuance, and not by the net number of shares of Common Stock issued to the holder of such option or stock issuance. Shares of Common Stock underlying one or more stock appreciation rights exercised under Section IV of Article Two of the Plan shall **not** be available for subsequent issuance under the Plan.

E. If any change is made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of

securities issuable under the Plan, (ii) the maximum number and/or class of securities for which any one person may be granted stock options, separately exercisable stock appreciation rights and direct stock issuances in the aggregate under the Plan per calendar year, (iii) the maximum number and/or class of securities issuable under the Stock Issuance Program, (iv) the number and/or class of securities for which grants are subsequently to be made under the Automatic Option Grant Program to new and continuing non-employee Board members, unless the Plan Administrator determines otherwise, (v) the number and/or class of securities and the exercise price per share in effect under each outstanding option under the Plan and (vi) the number and/or class of securities and price per share in effect under each outstanding option incorporated into this Plan from the Predecessor Plan. Such adjustments to the outstanding options are to be effected in a manner which shall preclude the enlargement or dilution of rights and benefits under such options. The adjustments determined by the Plan Administrator shall be final, binding and conclusive.

ARTICLE TWO

DISCRETIONARY OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. Exercise Price.

1. The exercise price per share shall be fixed by the Plan Administrator but shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Four and the documents evidencing the option, be payable in one or more of the forms specified below:

(i) cash or check made payable to the Corporation,

(ii) shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or

(iii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable instructions to (a) a brokerage firm (reasonably acceptable to the Corporation for purposes of administering such procedure in compliance with the Corporation's pre-notification policy for sales of Common Stock) to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (b) the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. Exercise and Term of Options . Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan Administrator and set forth in the documents evidencing the option. However, no option shall have a term in excess of nine (9) years measured from the option grant date.

C. Effect of Termination of Service .

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:

(i) Any option outstanding at the time of the Optionee's cessation of Service for any reason shall remain exercisable for such period of time thereafter as shall be determined by the Plan Administrator and set forth in the documents evidencing the option, but no such option shall be exercisable after the expiration of the option term.

(ii) Any option exercisable in whole or in part by the Optionee at the time of death may be subsequently exercised by the personal representative of the Optionee's estate or by the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution.

(iii) Should the Optionee's Service be terminated for Misconduct, then all outstanding options held by the Optionee shall terminate immediately and cease to be outstanding.

(iv) During the applicable post-Service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

D. The Plan Administrator shall have complete discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following the Optionee's cessation of Service from the limited exercise period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable post-Service exercise period, not only with respect to the number of vested shares of Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also with respect to one or more additional installments in which the Optionee would have vested had the Optionee continued in Service.

E. **Shareholder Rights**. The holder of an option shall have no shareholder rights with respect to the shares subject to the option until such person shall have exercised the option, paid the exercise price and become a holder of record of the purchased shares.

F. **Repurchase Rights**. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right.

G. **Limited Transferability of Options**. During the lifetime of the Optionee, Incentive Options shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of inheritance following the Optionee's death. However, a Non-Statutory Option may be assigned in whole or in part during the Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established exclusively for one or more such family members or to one or more individuals, to the extent such assignment is in connection with the Optionee's estate plan or pursuant to a domestic relations order. The assigned portion may only be exercised by the person or persons who acquire a proprietary interest in the option pursuant to the assignment. The terms applicable to the assigned portion shall be the same as those in effect for the option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Plan Administrator may deem appropriate.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of Articles One, Two and Four shall be applicable to Incentive Options. Options designated as Non-Statutory Options when issued under the Plan shall not be subject to the terms of this Section II.

A. **Eligibility**. Incentive Options may only be granted to Employees.

B. **Dollar Limitation**. The aggregate Fair Market Value of the shares of Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one calendar year shall not exceed the sum of One Hundred Thousand Dollars (\$100,000). To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

C. **10% Shareholder**. If any Employee to whom an Incentive Option is granted is a 10% Shareholder, then the exercise price per share shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the option grant date, and the option term shall not exceed five (5) years measured from the option grant date.

III. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. In the event of any Corporate Transaction, each outstanding option shall automatically accelerate so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. However, an outstanding option shall not so accelerate if and to the extent: (i) such option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation (or parent thereof) or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation (or parent thereof), (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested option shares at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to those option shares or (iii) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant. The determination of option comparability under clause (i) above shall be made by the Plan Administrator, and its determination shall be final, binding and conclusive.

B. All outstanding repurchase rights shall also terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are to be assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. Immediately following the consummation of the Corporate Transaction, all outstanding options shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments to reflect such Corporate Transaction shall also be made to (i) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same, (ii) the maximum number and/or class of securities available for issuance over the remaining term of the Plan, (iii) the maximum number and/or class of securities for which any one person may be granted stock options, separately exercisable stock appreciation rights and direct stock issuances under the Plan per calendar year and (iv) . the maximum number and/or class of securities available for issuance under the Stock Issuance Program.

E. The Plan Administrator shall have full power and authority to grant options under the Discretionary Option Grant Program which will automatically accelerate in the event the Optionee's Service subsequently terminates by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those options are assumed or replaced and do not otherwise accelerate. Any options so accelerated shall remain exercisable for fully-vested shares until the expiration or sooner termination of the option term. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights with respect to shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate, and the shares subject to those terminated repurchase rights shall accordingly vest in full.

F. The Plan Administrator shall have full power and authority to grant options under the Discretionary Option Grant Program which will automatically accelerate in the event the Optionee's Service subsequently terminates by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Change in Control. Each option so accelerated shall remain exercisable for fully-vested shares until the expiration or sooner termination of the option term. In addition, the Plan Administrator may provide that one or more of the Corporation's outstanding repurchase rights with respect to shares held by the Optionee at the time of such Involuntary Termination shall immediately terminate, and the shares subject to those terminated repurchase rights shall accordingly vest in full.

G. The portion of any Incentive Option accelerated in connection with a Corporate Transaction or Change in Control shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar limitation is not exceeded. To the extent such dollar limitation is exceeded, the accelerated portion of such option shall be exercisable as a Non-Statutory Option under the Federal tax laws.

H. The outstanding options shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. STOCK APPRECIATION RIGHTS

A. The Plan Administrator shall have full power and authority, exercisable in its sole discretion, to grant to selected Optionees or other individuals eligible to receive option grants under the Discretionary Option Grant Program stock appreciation rights.

B. Three types of stock appreciation rights shall be authorized for issuance under the Plan: (i) tandem stock appreciation rights (“Tandem Rights”), (ii) stand-alone stock appreciation rights (“Stand-alone Rights”) and (iii) limited stock appreciation rights (“Limited Rights”).

C. The following terms and conditions shall govern the grant and exercise of Tandem Rights under this Article Two.

1. One or more Optionees may be granted a Tandem Right, exercisable upon such terms and conditions as the Plan Administrator may establish, to elect between the exercise of the underlying Article Two stock option for shares of Common Stock or the surrender of that option in exchange for a distribution from the Corporation in an amount equal to the excess of (i) the Fair Market Value (on the option surrender date) of the number of shares in which the Optionee is at the time vested under the surrendered option (or surrendered portion thereof) over (ii) the aggregate exercise price payable for such vested shares.

2. No such option surrender shall be effective unless it is approved by the Plan Administrator, either at the time of the actual option surrender or at any earlier time. If the surrender is so approved, then the distribution to which the Optionee shall accordingly become entitled under this Section V may be made in shares of Common Stock valued at Fair Market Value on the option surrender date, in cash, or partly in shares and partly in cash, as the Plan Administrator shall in its sole discretion deem appropriate.

3. If the surrender of an option is not approved by the Plan Administrator, then the Optionee shall retain whatever rights the Optionee had under the surrendered option (or surrendered portion thereof) on the option surrender date and may exercise such rights at any time prior to the later of (i) five (5) business days after the receipt of the rejection notice or (ii) the last day on which the option is otherwise exercisable in accordance with the terms of the instrument evidencing such option, but in no event may such rights be exercised more than nine (9) years after the date of the option grant.

D. The following terms and conditions shall govern the grant and exercise of Stand-alone Rights under this Article Two:

1. One or more individuals eligible to participate in the Discretionary Option Grant Program may be granted a Stand-alone Right not tied to any underlying option under this Discretionary Option Grant Program. The Stand-alone Right shall cover a specified number of underlying shares of Common Stock and shall be exercisable upon such terms and conditions as the Plan Administrator may establish. Upon exercise of the Stand-alone Right, the holder shall be entitled to receive a distribution from the Corporation in an amount equal to the excess of (i) the aggregate Fair Market Value (on the exercise date) of the shares of Common Stock underlying the exercised right over (ii) the aggregate base price in effect for those shares.

2. The number of shares of Common Stock underlying each Stand-alone Right and the base price in effect for those shares shall be determined by the Plan Administrator in its sole discretion at the time the Stand-alone Right is granted. In no event, however, may the base price per share be less than the Fair Market Value per underlying share of Common Stock on the grant date.

3. The distribution with respect to an exercised Stand-alone Right may be made in shares of Common Stock valued at Fair Market Value on the exercise date, in cash, or partly in shares and partly in cash, as the Plan Administrator shall in its sole discretion deem appropriate.

E. The following terms and conditions shall govern the grant and exercise of Limited Rights under this Article Two:

1. One or more Section 16 Insiders may, in the Plan Administrator's sole discretion, be granted Limited Rights with respect to their outstanding options under this Article Two.

2. Upon the occurrence of a Hostile Take-Over, the Section 16 Insider shall have the unconditional right (exercisable for a thirty (30)-day period following such Hostile Take-Over) to surrender each option with such a Limited Right to the Corporation, to the extent the option is at the time exercisable for fully vested shares of Common Stock. The Section 16 Insider shall in return be entitled to a cash distribution from the Corporation in an amount equal to the excess of (i) the Take-Over Price of the vested shares of Common Stock at the time subject to each surrendered option (or surrendered portion of such option) over (ii) the aggregate exercise price payable for such vested shares. Such cash distribution shall be made within five (5) days following the option surrender date.

3. The Plan Administrator shall pre-approve, at the time such Limited Right is granted, the subsequent exercise of that right in accordance with the terms of the grant and the provisions of this Section IV. No additional approval of the Plan Administrator or the Board shall be required at the time of the actual option surrender and cash distribution. Any unsurrendered portion of the option shall continue to remain outstanding and become exercisable in accordance with the terms of the instrument evidencing such grant.

F. The shares of Common Stock underlying any stock appreciation rights exercised under this Section IV shall **not** be available for subsequent issuance under the Plan.

ARTICLE THREE

AUTOMATIC OPTION GRANT PROGRAM

The following terms and provisions reflect the amendment to the Automatic Option Grant Program authorized by the Board on July 8, 1999 and approved by the shareholders at the 1999 Annual Shareholder Meeting on November 10, 1999.

I. OPTION TERMS

A. **Grant Dates.** Option grants under this Article Three shall be made on the dates specified below:

1. Each individual who is first elected or appointed as a non-employee Board member on or after November 10, 1999 shall automatically be granted, on the date of such initial election or appointment, a Non-Statutory Option to purchase 30,000 shares of Common Stock,¹ provided that individual has not previously been in the employ of the Corporation or any Parent or Subsidiary.

2. On the date of each Annual Shareholders Meeting, beginning with the 1999 Annual Shareholders Meeting, each individual who is re-elected to serve as an Eligible Director shall automatically be granted a Non-Statutory Option to purchase 15,000 shares of Common Stock², provided such individual has served as a non-employee Board member for at least six (6) months. There shall be no limit on the number of such 15,000-share option grants any one Eligible Director may receive over his or her period of Board service, and non-employee Board members who have previously been in the employ of the Corporation (or any Parent or Subsidiary) shall be eligible to receive one or more such annual option grants over their period of continued Board service.

B. **Exercise Price.**

1. The exercise price per share shall be equal to one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

¹ Prior to the July 8, 1999 restatement, the number of shares of Common Stock for which an initial option grant was to be made to each newly elected or appointed non-employee Board member was set at 20,000 shares (before taking into account any splits of the Common Stock effected after that date).

² Prior to the July 8, 1999 restatement, the number of shares of Common Stock for which a continuing non-employee Board member was to be granted an option at each annual shareholders meeting at which he or she was re-elected to the Board was set at 10,000 shares (before taking into account any splits of the Common Stock effected after that date).

2. The exercise price shall be payable in one or more of the alternative forms authorized under the Discretionary Option Grant Program. Except to the extent the sale and remittance procedure specified thereunder is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

C. **Option Term** . Each option shall have a maximum term equal to the lesser of (i) nine (9) years measured from the option grant date or (ii) twelve (12) months following termination of Board service.

D. **Exercise and Vesting of Options** . Each option shall be immediately exercisable for any or all of the option shares. However, any shares purchased under the option shall be subject to repurchase by the Corporation, at the exercise price paid per share, upon the Optionee's cessation of Board service prior to vesting in those shares. Each initial 30,000-share grant shall vest, and the Corporation's repurchase right with respect to those shares shall lapse, in four (4) successive equal annual installments over the Optionee's period of Board service, with the first such installment to vest upon the completion of one (1) year of Board service measured from the automatic grant date. Each annual 15,000-share grant shall vest, and the Corporation's repurchase right with respect to those shares shall lapse, in two (2) successive equal annual installments over the optionee's period of Board service measured from the automatic grant date.

E. **Termination of Board Service** . The following provisions shall govern the exercise of any options held by the Optionee upon his or her cessation of Board service:

(i) The Optionee (or, in the event of Optionee's death, the personal representative of the Optionee's estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or the laws of inheritance) shall have a twelve (12)-month period following the date of such cessation of Board service in which to exercise each such option.

(ii) During the twelve (12)-month exercise period, the option may not be exercised in the aggregate for more than the number of vested shares of Common Stock for which the option is exercisable at the time of the Optionee's cessation of Board service.

(iii) Should the Optionee cease to serve as a Board member by reason of death or Permanent Disability, then all shares at the time subject to the option shall immediately vest so that such option may, during the twelve (12)-month exercise period following such cessation of Board service, be exercised for all or any portion of those shares as fully-vested shares of Common Stock.

(iv) In no event shall the option remain exercisable after the expiration of the option term. Upon the expiration of the twelve (12)-month exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the

Optionee's cessation of Board service for any reason other than death or Permanent Disability, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL/HOSTILE TAKE-OVER

A. In the event of any Corporate Transaction, the shares of Common Stock at the time subject to each outstanding option but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. Immediately following the consummation of the Corporate Transaction, each automatic option grant shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

B. In connection with any Change in Control, the shares of Common Stock at the time subject to each outstanding option but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Change in Control, become exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. Each such option shall remain exercisable for such fully-vested option shares until the expiration or sooner termination of the option term or the surrender of the option in connection with a Hostile Take-Over.

C. Upon the occurrence of a Hostile Take-Over, the Optionee shall have a thirty (30)-day period in which to surrender to the Corporation each of his or her outstanding automatic option grants. The Optionee shall in return be entitled to a cash distribution from the Corporation in an amount equal to the excess of (i) the Take-Over Price of the shares of Common Stock at the time subject to each surrendered option (whether or not the Optionee is otherwise at the time vested in those shares) over (ii) the aggregate exercise price payable for such shares. Such cash distribution shall be paid within five (5) days following the surrender of the option to the Corporation. At the 1999 Annual Meeting on November 10, 1999, shareholder approval of a proposal amending the 1996 Stock Incentive Plan created an automatic pre-approval of each option grant with such a cash surrender right made under the Automatic Option Grant Program on or after this date and the subsequent exercise of that right in accordance with the provisions of this Section II.C, and no additional approval of the Board or any Plan Administrator shall accordingly be required at the time of the actual option surrender and cash distribution.

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation

of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

E. The grant of options under the Automatic Option Grant Program shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

III. REMAINING TERMS

The remaining terms of each option granted under the Automatic Option Grant Program shall be the same as the terms in effect for option grants made under the Discretionary Option Grant Program.

ARTICLE FOUR

STOCK ISSUANCE PROGRAM

Shares of Common Stock reserved for issuance under the Plan may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Only person who render services to the Corporation (or any Parent or Subsidiary) in the capacity of an independent, non-employee consultant and who are not otherwise Section 16 Insiders at the time of issuance may receive a stock issuance under the Program. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below. Shares of Common Stock may also be issued under the Stock Issuance Program pursuant to share right awards which entitle the recipients to receive those shares upon the attainment of designated performance goals. In no event may more than One Million (1,000,000) shares of Common Stock reserved for issuance under the Plan be issued pursuant to the provisions of the Stock Issuance Program.

A. Purchase Price .

1. The purchase price per share of Common Stock subject to direct issuance shall be fixed by the Plan Administrator, but shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the issuance date.

2. Shares of Common Stock may be issued under the Stock Issuance Program for any of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:

- (i) cash or check made payable to the Corporation, or
- (ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. Vesting/Issuance Provisions .

1. Shares of Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives. Alternatively, the Plan Administrator may issue share right awards under the Stock Issuance Program which shall entitle the recipient to receive a specified number of shares of Common Stock upon the attainment of one or more performance goals established by the Plan Administrator or the completion of a specified period of Service designated by the Plan Administrator. Upon the attainment of such performance goals or the completion of such Service requirement, fully-vested shares of Common Stock shall be issued in satisfaction of those share right awards.

2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive with respect to his or her unvested shares of Common Stock by reason of any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights with respect to any shares of Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained with respect to one or more such unvested shares of Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation, and the Participant shall have no further stockholder rights with respect to those shares. To the extent the surrendered shares were previously issued to the Participant for cash consideration, the Corporation shall repay that consideration to the Participant at the time the shares are surrendered.

5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Common Stock (or other assets attributable thereto) which would otherwise occur upon the cessation of the Participant's Service or the non-attainment of the performance objectives applicable to those shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares of Common Stock as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

6. Outstanding share right awards under the Stock Issuance Program shall automatically terminate, and no shares of Common Stock shall actually be issued in satisfaction of those awards, if the performance goals or Service requirement established for such awards are not attained. The Plan Administrator, however, shall have the discretionary authority to issue shares of Common Stock under one or more outstanding share right awards as to which the designated performance goals or Service requirement have not been attained.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. All of the Corporation's outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and all the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent those repurchase rights are to be assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction.

B. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights remain outstanding under the Stock Issuance Program, to provide that those rights shall automatically terminate in whole or in part, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should subsequently terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Corporate Transaction in which those repurchase rights are assigned to the successor corporation (or parent thereof).

C. The Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights remain outstanding under the Stock Issuance Program, to provide that those rights shall automatically terminate in whole or in part, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event the Participant's Service should subsequently terminate by reason of an Involuntary Termination within a designated period (not to exceed eighteen (18) months) following the effective date of any Change in Control.

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

ARTICLE FIVE

MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee (other than a Section 16 Insider) to pay the option exercise price under the Discretionary Option Grant Program by delivering a full-recourse, interest bearing promissory note payable in one or more installments. The terms of any such promissory note (including the interest rate and the terms of repayment) shall be established by the Plan Administrator in its sole discretion. In no event may the maximum credit available to the Optionee exceed the sum of (i) the aggregate option exercise price payable for the purchased shares plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee in connection with the option exercise or share purchase.

II. TAX WITHHOLDING

A. The Corporation's obligation to deliver shares of Common Stock upon the exercise of options under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

B. The Plan Administrator may, in its discretion, provide any or all holders of Non-Statutory Options under the Discretionary Option Grant Program or unvested shares of Common Stock under the Stock Issuance Program with the right to use shares of Common Stock in satisfaction of all or part of the Withholding Taxes to which such holders may become subject in connection with the exercise of their options or the vesting of their shares. Such right may be provided to any such holder in either or both of the following formats:

Stock Withholding : The election to have the Corporation withhold, from the shares of Common Stock otherwise issuable upon the exercise of such Non-Statutory Option or the vesting of such shares, a portion of those shares with an aggregate Fair Market Value equal to the percentage of the Withholding Taxes (not to exceed one hundred percent (100%)) designated by the holder.

Stock Delivery : The election to deliver to the Corporation, at the time the Non-Statutory Option is exercised or the issued shares vest, one or more shares of Common Stock previously acquired by such holder (other than in connection with the option exercise or stock vesting which triggers the Withholding Taxes) with an aggregate Fair Market Value equal to the percentage of the Withholding Taxes (not to exceed one hundred percent (100%)) designated by the holder.

III. EFFECTIVE DATE AND TERM OF THE PLAN

A. The Plan and each of the equity incentive programs thereunder shall become effective immediately upon the approval of the Corporation's shareholders at the 1996 Annual Meeting. Options may be granted under the Plan at any time on or after the date of such shareholder approval. If such shareholder approval is not obtained, then this Plan shall not become effective, and no options shall be granted and no shares shall be issued under the Plan.

B. The Plan shall serve as the successor to the Predecessor Plan, and no further option grants shall be made under the Predecessor Plan after this Plan is approved by the shareholders at the 1996 Annual Meeting. All options outstanding under the Predecessor Plan at the time of such shareholder approval shall be incorporated into the Plan at that time and shall be treated as outstanding options under the Plan. However, each outstanding option so incorporated shall continue to be governed solely by the terms of the documents evidencing such option, and no provision of the Plan shall be deemed to affect or otherwise modify the rights or obligations of the holders of such incorporated options with respect to their acquisition of shares of Common Stock.

C. One or more provisions of the Plan, including (without limitation) the option/vesting acceleration provisions of Article Two relating to Corporate Transactions and Changes in Control, may, in the Plan Administrator's discretion, be extended to one or more options incorporated from the Predecessor Plan which do not otherwise contain such provisions.

D. The Plan shall terminate upon the earliest of (i) December 31, 2006, (ii) the date on which all shares available for issuance under the Plan shall have been issued as fully-vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. Upon such plan termination, all outstanding option grants shall thereafter continue to have force and effect in accordance with the provisions of the documents evidencing such grants.

IV. AMENDMENT OF THE PLAN

A. The Board shall have complete power and authority to amend or modify the Plan in any or all respects but may delegate such authority in whole or in part to the Primary Committee, as the Board deems appropriate. However, no such amendment or modification shall adversely affect the rights and obligations with respect to stock options at the time outstanding under the Plan unless the Optionee consents to such amendment or modification. In addition, certain amendments may require shareholder approval in accordance with applicable laws and regulations.

B. The Plan was amended by the Board on July 29, 1998 and approved by the Shareholders at the 1998 Annual Shareholders Meeting, in order to extend the automatic share increase provisions of the Plan for an additional three (3)-year through fiscal December in calendar year 2001. The Automatic Option Grant Program in effect under the Plan was amended by the Board on July 8, 1999 and approved by the shareholders at the 1999 Annual Shareholder Meeting, in order to increase the number of shares of Common Stock for which newly elected or

appointed non-employee Board members and continuing non-employee Board members may be granted stock options under such program. The Plan was amended on January 9, 2001 to allow the Board to delegate, in whole or in part, its authority to amend the Plan to the Primary Committee as it deems appropriate. The Plan was amended on March 18, 2003 to implement the Stock Issuance Program pursuant to which up to One Million (1,000,000) shares of Common Stock reserved for issuance under the Plan may be issued pursuant to direct stock issuances under the Stock Issuance Program.

C. Options to purchase shares of Common Stock may be granted under the Discretionary Option Grant Program that are in excess of the number of shares then available for issuance under the Plan, provided any excess shares actually issued under that program shall be held in escrow until there is obtained shareholder approval of an amendment sufficiently increasing the number of shares of Common Stock available for issuance under the Plan. If such shareholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

V. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Common Stock under the Plan shall be used for general corporate purposes.

VI. REGULATORY APPROVALS

A. The implementation of the Plan, the granting of any stock option under the Plan and the issuance of any shares of Common Stock under the Plan shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the stock options granted under it and the shares of Common Stock issued pursuant to it.

B. No shares of Common Stock or other assets shall be issued or delivered under the Plan unless and until there shall have been compliance with all applicable requirements of Federal and state securities laws, including the filing and effectiveness of the Form S-8 registration statement for the shares of Common Stock issuable under the Plan, and all applicable listing requirements of any stock exchange (or the Nasdaq National Market, if applicable) on which Common Stock is then listed for trading.

VII. NO EMPLOYMENT/SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee, which rights are hereby expressly reserved by each, to terminate such person's Service at any time for any reason, with or without cause.

APPENDIX

The following definitions shall be in effect under the Plan:

A. **Automatic Option Grant Program** shall mean the automatic option grant program in effect under Article Three of the Plan.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Change in Control** shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty-five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

D. **Code** shall mean the Internal Revenue Code of 1986, as amended.

E. **Common Stock** shall mean the Corporation's common stock.

F. **Corporate Transaction** shall mean either of the following shareholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

G. **Corporation** shall mean Cisco Systems, Inc., a California corporation, and its successors.

H. **Discretionary Option Grant Program** shall mean the discretionary option grant program in effect under Article Two of the Plan.

I. **Eligible Director** shall mean a non-employee Board member eligible to participate in the Automatic Option Grant Program in accordance with the eligibility provisions of Article One.

J. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

K. **Exercise Date** shall mean the date on which the Corporation shall have received written notice of the option exercise.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be deemed equal to the closing selling price per share of Common Stock on the date in question, as such price is reported on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be deemed equal to the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

M. **Hostile Take-Over** shall mean the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty-five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept.

N. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

O. **Involuntary Termination** shall mean the termination of the Service of any individual which occurs by reason of:

(i) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(ii) such individual's voluntary resignation following (A) a change in his or her position with the Corporation which materially reduces his or her level of responsibility, (B) a reduction in his or her level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs) by more than fifteen percent (15%) or (C) a relocation of such individual's place of employment by more than fifty (50) miles, provided and only if such change, reduction or relocation is effected without the individual's consent.

P. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by the Optionee, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee or other person in the Service of the Corporation (or any Parent or Subsidiary).

Q. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

R. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

S. **Optionee** shall mean any person to whom an option is granted under the Discretionary Option Grant or Automatic Option Grant Program.

T. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

U. **Participant** shall mean any person who is issued shares of Common Stock under the Stock Issuance Program.

V. **Permanent Disability or Permanently Disabled** shall mean the inability of the Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more. However, solely for purposes of the Automatic Option Grant Program, Permanent Disability or Permanently Disabled shall mean the inability of the non-employee Board member to perform his or her usual duties as a Board member by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more.

W. **Plan** shall mean the Corporation's 1996 Stock Incentive Plan, as set forth in this document.

X. **Plan Administrator** shall mean the particular entity, whether the Primary Committee, the Board or the Secondary Committee, which is authorized to administer the Discretionary Option Grant Program with respect to one or more classes of eligible persons, to the extent such entity is carrying out its administrative functions under those programs with respect to the persons under its jurisdiction.

Y. **Predecessor Plan** shall mean the Corporation's pre-existing 1987 Stock Option Plan in effect immediately prior to the Plan Effective Date hereunder.

Z. **Primary Committee** shall mean the committee of two (2) or more non-employee Board members appointed by the Board to administer the Discretionary Option Grant Program with respect to Section 16 Insiders.

AA. **Secondary Committee** shall mean a committee of two (2) or more Board members appointed by the Board to administer the Discretionary Option Grant Program with respect to eligible persons other than Section 16 Insiders.

BB. **Section 16 Insider** shall mean an officer or director of the Corporation subject to the short-swing profit liabilities of Section 16 of the 1934 Act.

CC. **Service** shall mean the performance of services for the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant or stock issuance.

DD. **Stock Exchange** shall mean either the American Stock Exchange or the New York Stock Exchange.

EE. **Stock Issuance Agreement** shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares to such person under the Stock Issuance Program.

FF. **Stock Issuance Program** shall mean the stock issuance program in effect under Article Four of the Plan.

GG. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

HH. **Take-Over Price** shall mean the greater of (i) the Fair Market Value per share of Common Stock on the date the option is surrendered to the Corporation in connection with a Hostile Take-Over or (ii) the highest reported price per share of Common Stock paid by the tender offeror in effecting such Hostile Take-Over. However, if the surrendered option is an Incentive Option, the Take-Over Price shall not exceed the clause (i) price per share.

II. **10% Shareholder** shall mean the owner of stock (as determined under Code Section 424(d)) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

JJ. **Withholding Taxes** shall mean the Federal, state and local income and employment withholding taxes to which the holder of Non-Statutory Options or unvested shares of Common Stock may become subject in connection with the exercise of those options or the vesting of those shares.

STOCK OPTION AGREEMENT

Recitals

A. The Board has adopted the Plan for the purpose of retaining the services of selected Employees, non-employee members of the Board or of the board of directors of any Parent or Subsidiary and consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. Optionee is to render valuable services to the Corporation (or a Parent or Subsidiary), and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of an option to Optionee.

C. All capitalized terms in this Agreement shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE, it is hereby agreed as follows:

1. **Grant of Option**. The Corporation hereby grants to Optionee, as of the Grant Date, an option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price.

2. **Option Term**. This option shall have a maximum term of nine (9) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5 or 6.

3. **Limited Transferability**. This option may, in connection with the Optionee's estate plan, be assigned in whole or in part during Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established for the exclusive benefit of one or more such family members. The assigned portion shall be exercisable only by the person or persons who acquire a proprietary interest in the option pursuant to such assignment. The terms applicable to the assigned portion shall be the same as those in effect for this option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Corporation may deem appropriate. Should the Optionee die while holding this option, then this option shall be transferred in accordance with Optionee's will or the laws of descent and distribution.

4. **Dates of Exercise**. This option shall become exercisable for the Option Shares in one or more installments as specified in the Grant Notice. As the option becomes exercisable for such installments, those installments shall accumulate and the option shall remain exercisable for the accumulated installments until the Expiration Date or sooner termination of the option term under Paragraph 5 or 6. As an administrative matter, the exercisable portion of this option may only be exercised until the close of the Nasdaq National Market on the last trading day before the Expiration Date or earlier date of termination of the option term under

Paragraph 5. Any later attempt to exercise this option will not be honored. For example, if Optionee ceases to remain in Service as provided in Paragraph 5(i) and the date three (3) months from the date of cessation is Monday, July 4 (a holiday on which the Nasdaq National Market is closed), Optionee must exercise the exercisable portion of this option by 4 pm Eastern Daylight Time on Friday, July 1.

5. **Cessation of Service**. The option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date should any of the following provisions become applicable:

(i) Should Optionee cease to remain in Service for any reason (other than death, Permanent Disability or Misconduct) while this option is outstanding, then Optionee shall have a period of three (3) months (commencing with the date of such cessation of Service) during which to exercise this option, but in no event shall this option be exercisable at any time after the Expiration Date.

(ii) If Optionee dies while this option is outstanding, then the personal representative of Optionee's estate or the person or persons to whom the option is transferred pursuant to Optionee's will or in accordance with the laws of descent and distribution shall have the right to exercise this option. Such right shall lapse, and this option shall cease to be outstanding, upon the earlier of (A) the expiration of the twelve (12)- month period measured from the date of Optionee's death or (B) the Expiration Date.

(iii) Should Optionee cease Service by reason of Permanent Disability while this option is outstanding, then Optionee shall have a period of twelve (12) months (commencing with the date of such cessation of Service) during which to exercise this option. In no event shall this option be exercisable at any time after the Expiration Date.

(iv) For purposes of this Agreement, Optionee's period of Service shall not include any period of notice of termination of employment, whether expressed or implied. Optionee's date of cessation of Service shall mean the date upon which Optionee ceases active performance of services for the Corporation following the provision of such notification of termination or resignation from Service and shall be determined solely by this Agreement and without reference to any other agreement, written or oral, including Optionee's contract of employment.

(v) During the limited period of post-Service exercisability, this option may not be exercised in the aggregate for more than the number of vested Option Shares for which the option is exercisable at the time of Optionee's cessation of Service. Upon the expiration of such limited exercise period or (if earlier) upon the Expiration Date, this option shall terminate and cease to be outstanding for any vested Option Shares for which the option has not

been exercised. However, this option shall, immediately upon Optionee's cessation of Service for any reason, terminate and cease to be outstanding with respect to any Option Shares in which Optionee is not otherwise at that time vested or for which this option is not otherwise at that time exercisable.

(vi) Should Optionee's Service be terminated for Misconduct or should Optionee otherwise engage in Misconduct while this option is outstanding, then this option shall terminate immediately and cease to remain outstanding.

6. Special Acceleration of Option

(a) This option, to the extent outstanding at the time of a Corporate Transaction but not otherwise fully exercisable, shall automatically accelerate so that this option shall, immediately prior to the effective date of the Corporate Transaction, become exercisable for all of the Option Shares at the time subject to this option and may be exercised for any or all of those Option Shares as fully-vested shares of Common Stock. No such acceleration of this option, however, shall occur if and to the extent: (i) this option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation (or parent thereof) or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation (or parent thereof) or (ii) this option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested Option Shares at the time of the Corporate Transaction (the excess of the Fair Market Value of those Option Shares over the aggregate Exercise Price payable for such shares) and provides for subsequent pay-out in accordance with the same option exercise/vesting schedule set forth in the Grant Notice. The determination of option comparability under clause (i) shall be made by the Plan Administrator, and such determination shall be final, binding and conclusive.

(b) Immediately following the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) in connection with the Corporate Transaction.

(c) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

(d) This option, to the extent outstanding at the time of a Change in Control but not otherwise fully exercisable, shall automatically accelerate so that this option shall, immediately prior to the effective date of the Change in Control, become exercisable for all of the Option Shares at the time subject to this option and may be exercised for any or all of those Option Shares as fully-vested shares of Common Stock. This option shall remain so exercisable until the Expiration Date or sooner termination of the option term.

(e) This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

7. **Adjustment in Option Shares**. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the total number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder.

8. **Shareholder Rights**. The holder of this option shall not have any shareholder rights with respect to the Option Shares until such person shall have exercised the option, paid the Exercise Price and become a holder of record of the purchased shares.

9. **Manner of Exercising Option**.

(a) In order to exercise this option with respect to all or any part of the Option Shares for which this option is at the time exercisable, Optionee (or any other person or persons exercising the option) must take the following actions:

(i) Pay the aggregate Exercise Price for the purchased shares in one or more of the following forms:

(A) cash or check made payable to the Corporation;

(B) to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee (or any other person or persons exercising the option) shall concurrently provide irrevocable written instructions (I) to a Corporation-designated brokerage firm (or in the case of an Executive Officer or Board member of the Corporation, an Optionee-designated brokerage firm) to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for the purchased shares plus all applicable taxes required to be withheld by the Corporation by reason of such exercise and (II) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale transaction;

(C) a promissory note payable to the Corporation, but only to the extent authorized by the Plan Administrator in accordance with Paragraph 13; and

(D) shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date.

(ii) Furnish to the Corporation appropriate documentation that the person or persons exercising the option (if other than Optionee) have the right to exercise this option.

(iii) Make appropriate arrangements with the Corporation (or Parent or Subsidiary employing or retaining Optionee) for the satisfaction of all tax withholding requirements applicable to the option exercise.

(b) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate for the purchased Option Shares, with the appropriate legends affixed thereto.

(c) In no event may this option be exercised for any fractional shares.

(d) Notwithstanding any other provisions of the Plan, this Agreement or any other agreement to the contrary, if at the time this option is exercised, Optionee is indebted to the Corporation (or any Parent or Subsidiary) for any reason, the following actions shall be taken, as deemed appropriate by the Plan Administrator:

(i) any shares of Common Stock to be issued upon such exercise shall automatically be pledged against Optionee's outstanding indebtedness; and

(ii) if this option is exercised in accordance with subparagraph 9(a)(i)(B) above, the after tax proceeds of the sale of Optionee's stock shall automatically be applied to the outstanding balance of Optionee's indebtedness.

10. Compliance with Laws and Regulations.

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability with respect to the non-issuance or sale of the Common Stock as to which such

approval shall not have been obtained. The Corporation, however, shall use its best efforts to obtain all such approvals.

11. **Successors and Assigns** . Except to the extent otherwise provided in Paragraphs 3 and 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

12. **Notices** . Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

13. **Financing** . The Plan Administrator may, in its absolute discretion and without any obligation to do so, permit Optionee to pay the Exercise Price for the purchased Option Shares by delivering a full-recourse promissory note payable to the Corporation. The terms of any such promissory note (including the interest rate, the requirements for collateral and the terms of repayment) shall be established by the Plan Administrator in its sole discretion.

14. **Construction** . This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator with respect to any question or issue arising under the Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

15. **Governing Law** . The interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

16. **Excess Shares** . If the Option Shares covered by this Agreement exceed, as of the Grant Date, the number of shares of Common Stock which may without shareholder approval be issued under the Plan, then this option shall be void with respect to those excess shares, unless shareholder approval of an amendment sufficiently increasing the number of shares of Common Stock issuable under the Plan is obtained in accordance with the provisions of the Plan.

17. **Additional Terms Applicable to an Incentive Option** . In the event this option is designated an Incentive Option in the Grant Notice, the following terms and conditions shall also apply to the grant:

(a) This option shall cease to qualify for favorable tax treatment as an Incentive Option if (and to the extent) this option is exercised for one or more Option Shares: (A) more than three (3) months after the date Optionee ceases to be an Employee for any reason other than death or Permanent Disability or (B) more than twelve (12) months after the date Optionee ceases to be an Employee by reason of Permanent Disability.

(b) No installment under this option shall qualify for favorable tax treatment as an Incentive Option if (and to the extent) the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which such installment first becomes exercisable hereunder would, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock or other securities for which this option or any other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars (\$100,000) in the aggregate. Should such One Hundred Thousand Dollar (\$100,000) limitation be exceeded in any calendar year, this option shall nevertheless become exercisable for the excess shares in such calendar year as a Non-Statutory Option.

(c) Should the exercisability of this option be accelerated upon a Corporate Transaction or Change in Control, then this option shall qualify for favorable tax treatment as an Incentive Option only to the extent the aggregate Fair Market Value (determined at the Grant Date) of the Common Stock for which this option first becomes exercisable in the calendar year in which the Corporate Transaction or Change in Control occurs does not, when added to the aggregate value (determined as of the respective date or dates of grant) of the Common Stock or other securities for which this option or one or more other Incentive Options granted to Optionee prior to the Grant Date (whether under the Plan or any other option plan of the Corporation or any Parent or Subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars (\$100,000) in the aggregate. Should the applicable One Hundred Thousand Dollar (\$100,000) limitation be exceeded in the calendar year of such Corporate Transaction or Change in Control, the option may nevertheless be exercised for the excess shares in such calendar year as a Non-Statutory Option.

(d) Should Optionee hold, in addition to this option, one or more other options to purchase Common Stock which become exercisable for the first time in the same calendar year as this option, then the foregoing limitations on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

18. **Leave of Absence.** The following provisions shall apply upon the Optionee's commencement of an authorized leave of absence:

(a) The exercise schedule in effect under the Grant Notice shall be frozen as of the first day of the authorized leave, and this option shall not become exercisable for any additional installments of the Option Shares during the period Optionee remains on such leave.

(b) If the option is designated as an Incentive Option in the Grant Notice, then the following additional provision shall apply:

If the leave of absence continues for more than ninety (90) days, then this option shall automatically convert to a Non-Statutory Option under the Federal tax laws at the end of the three (3)-month period measured from the ninety-first (91st) day of such leave, unless the Optionee's reemployment rights are guaranteed by statute or by written agreement. Following any such

conversion of the option, all subsequent exercises of such option, whether effected before or after Optionee's return to active Employee status, shall result in an immediate taxable event, and the Corporation shall be required to collect from Optionee all withholding taxes applicable to such exercise.

(c) In no event shall this option become exercisable for any additional Option Shares or otherwise remain outstanding if Optionee does not resume Employee status prior to the Expiration Date of the option term.

19. **Further Instruments**. The parties agree to execute such further instruments and to take such further action as may be reasonably necessary to carry out the purposes and intent of this Agreement.

20. **Authorization to Release Necessary Personal Information**.

(a) Optionee hereby authorizes and directs Optionee's employer to collect, use and transfer in electronic or other form, any personal information (the "Data") regarding Optionee's employment, the nature and amount of Optionee's compensation and the fact and conditions of Optionee's participation in the Plan (including, but not limited to, Optionee's name, home address, telephone number, date of birth, social security number (or any other social or national identification number), salary, nationality, job title, number of shares of Common Stock held and the details of all options or any other entitlement to shares of Common Stock awarded, cancelled, exercised, vested, unvested or outstanding) for the purpose of implementing, administering and managing Optionee's participation in the Plan. Optionee understands that the Data may be transferred to the Corporation or any of its Subsidiaries, or to any third parties assisting in the implementation, administration and management of the Plan, including any requisite transfer to a broker or other third party assisting with the exercise of Options under the Plan or with whom shares of Common Stock acquired upon exercise of this option or cash from the sale of such shares may be deposited. Optionee acknowledges that recipients of the Data may be located in different countries, and those countries may have data privacy laws and protections different from those in the country of Optionee's residence. Furthermore, Optionee acknowledges and understands that the transfer of the Data to the Corporation or any of its Subsidiaries, or to any third parties is necessary for Optionee's participation in the Plan.

(b) Optionee may at any time withdraw the consents herein, by contacting Optionee's local human resources representative in writing. Optionee further acknowledges that withdrawal of consent may affect Optionee's ability to exercise or realize benefits from the option, and Optionee's ability to participate in the Plan.

21. **No Entitlement or Claims for Compensation**.

(a) The grant of options under the Plan is made at the discretion of the Plan Administrator, and the Plan may be suspended or terminated by the Corporation at any time. The grant of an option in one year or at one time does not in any way entitle Optionee to an option grant in the future. The Plan is wholly discretionary in nature and is not to be considered part of Optionee's normal or expected compensation subject to severance, resignation,

redundancy or similar compensation. The value of the option is an extraordinary item of compensation which is outside the scope of Optionee's employment contract (if any).

(b) Optionee shall have no rights to compensation or damages as a result of Optionee's cessation of Service for any reason whatsoever, whether or not in breach of contract, insofar as those rights arise or may arise from Optionee's ceasing to have rights under or be entitled to exercise this option as a result of such cessation or from the loss or diminution in value of such rights. If Optionee did acquire any such rights, Optionee is deemed to have waived them irrevocably by accepting the option.

Appendix

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Change in Control** shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty-five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

D. **Code** shall mean the Internal Revenue Code of 1986, as amended.

E. **Common Stock** shall mean the Corporation's common stock.

F. **Corporate Transaction** shall mean either of the following shareholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

G. **Corporation** shall mean Cisco Systems, Inc., a California corporation.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 9 of the Agreement.

J. **Exercise Price** shall mean the exercise price per share as specified in the Grant Notice.

K. **Expiration Date** shall mean the date on which the option expires as specified in the Grant Notice.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported by the National Association of Securities Dealers on the Nasdaq National Market or any successor system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

M. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

N. **Grant Notice** shall mean the Notice of Grant of Stock Option accompanying the Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

O. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

P. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other

intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

Q. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

R. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

S. **Option Shares** shall mean the number of shares of Common Stock subject to the option as specified in the Grant Notice.

T. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

U. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

V. **Permanent Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

W. **Plan** shall mean the Corporation's 1996 Stock Incentive Plan.

X. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its administrative capacity under the Plan.

Y. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor.

Z. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

AA. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

CISCO SYSTEMS, INC.
NOTICE OF GRANT OF NON-EMPLOYEE DIRECTOR
AUTOMATIC STOCK OPTION

Notice is hereby given of the following option grant (the "Option") to purchase shares of the Common Stock of Cisco Systems, Inc. (the "Corporation"):

Optionee : _____

Grant Date : _____

Exercise Price : \$ _____ per share

Number of Option Shares : _____ shares

Expiration Date : _____

Type of Option : Non-Statutory Stock Option

Date Exercisable : Immediately Exercisable

Vesting Schedule: The Option Shares shall initially be unvested and subject to repurchase by the Corporation at the Exercise Price paid per share. Optionee shall acquire a vested interest in, and the Corporation's repurchase right shall accordingly lapse with respect to, the Option Shares in a series of four (4) successive equal annual installments upon the Optionee's completion of each year of service as a member of the Corporation's Board of Directors (the "Board") over the four (4)-year period measured from the Grant Date. In no event shall any additional Option Shares vest after Optionee's cessation of Board service.

Optionee understands and agrees that the Option is granted subject to and in accordance with the terms of the automatic option grant program under the Cisco Systems, Inc. 1996 Stock Incentive Plan (the "Plan"). Optionee further agrees to be bound by the terms of the Plan and the terms of the Option as set forth in the Automatic Stock Option Agreement attached hereto as Exhibit A.

Optionee hereby acknowledges receipt of a copy of the official prospectus for the Plan in the form attached hereto as Exhibit B. A copy of the Plan is available upon request made to the Corporate Secretary at the Corporation's principal offices.

REPURCHASE RIGHT . OPTIONEE HEREBY AGREES THAT ALL UNVESTED OPTION SHARES ACQUIRED UPON THE EXERCISE OF THE OPTION SHALL NOT BE TRANSFERABLE AND SHALL BE SUBJECT TO REPURCHASE BY THE CORPORATION, AT THE EXERCISE PRICE PAID PER SHARE, UPON OPTIONEE'S TERMINATION OF SERVICE AS A MEMBER OF THE CORPORATION'S BOARD OF DIRECTORS PRIOR TO VESTING IN THOSE SHARES. THE TERMS AND CONDITIONS OF SUCH REPURCHASE RIGHT SHALL BE SPECIFIED IN A STOCK PURCHASE AGREEMENT, IN FORM AND SUBSTANCE SATISFACTORY TO THE CORPORATION, EXECUTED BY OPTIONEE AT THE TIME OF THE OPTION EXERCISE.

No Impairment of Rights . Nothing in this Notice or in the attached Automatic Stock Option Agreement or the Plan shall interfere with or otherwise restrict in any way the rights of the Corporation or the Corporation's shareholders to remove Optionee from the Board at any time in accordance with the provisions of applicable law.

Definitions . All capitalized terms in this Notice shall have the meaning assigned to them in this Notice or in the attached Automatic Stock Option Agreement.

DATED: _____, ____

CISCO SYSTEMS, INC.

By: _____

Title: _____

OPTIONEE

Address: _____

ATTACHMENTS

Exhibit A - Automatic Stock Option Agreement

Exhibit B - Plan Summary and Prospectus

**CISCO SYSTEMS, INC.
NOTICE OF GRANT OF NON-EMPLOYEE DIRECTOR
AUTOMATIC STOCK OPTION**

Notice is hereby given of the following option grant (the "Option") to purchase shares of the Common Stock of Cisco Systems, Inc. (the "Corporation"):

Optionee : _____

Grant Date : _____

Exercise Price : \$ _____ per share

Number of Option Shares : _____ shares

Expiration Date : _____

Type of Option : Non-Statutory Stock Option

Date Exercisable : Immediately Exercisable

Vesting Schedule : The Option Shares shall initially be unvested and subject to repurchase by the Corporation at the Exercise Price paid per share. Optionee shall acquire a vested interest in, and the Corporation's repurchase right shall accordingly lapse with respect to, the Option Shares in a series of two (2) successive equal annual installments upon Optionee's completion of each year of service as a member of the Corporation's Board of Directors (the "Board") over the two (2)-year period measured from the Grant Date. In no event shall any additional Option Shares vest after Optionee's cessation of Board service.

Optionee understands and agrees that the Option is granted subject to and in accordance with the terms of the automatic option grant program under the Cisco Systems, Inc. 1996 Stock Incentive Plan (the "Plan"). Optionee further agrees to be bound by the terms of the Plan and the terms of the Option as set forth in the Automatic Stock Option Agreement attached hereto as Exhibit A.

Optionee hereby acknowledges receipt of a copy of the official prospectus for the Plan in the form attached hereto as Exhibit B. A copy of the Plan is available upon request made to the Corporate Secretary at the Corporation's principal offices.

REPURCHASE RIGHT. OPTIONEE HEREBY AGREES THAT ALL UNVESTED OPTION SHARES ACQUIRED UPON THE EXERCISE OF THE OPTION SHALL NOT BE TRANSFERABLE AND SHALL BE SUBJECT TO REPURCHASE BY THE CORPORATION, AT THE EXERCISE PRICE PAID PER SHARE, UPON OPTIONEE'S TERMINATION OF SERVICE AS A MEMBER OF THE

CORPORATION'S BOARD OF DIRECTORS PRIOR TO VESTING IN THOSE SHARES. THE TERMS AND CONDITIONS OF SUCH REPURCHASE RIGHT SHALL BE SPECIFIED IN A STOCK PURCHASE AGREEMENT, IN FORM AND SUBSTANCE SATISFACTORY TO THE CORPORATION, EXECUTED BY OPTIONEE AT THE TIME OF THE OPTION EXERCISE.

No Impairment of Rights. Nothing in this Notice or in the attached Automatic Stock Option Agreement or the Plan shall interfere with or otherwise restrict in any way the rights of the Corporation or the Corporation's shareholders to remove Optionee from the Board at any time in accordance with the provisions of applicable law.

Definitions. All capitalized terms in this Notice shall have the meaning assigned to them in this Notice or in the attached Automatic Stock Option Agreement.

DATED: _____, ____

CISCO SYSTEMS, INC.

By: _____

Title: _____

OPTIONEE

Address: _____

ATTACHMENTS

- Exhibit A - Automatic Stock Option Agreement
- Exhibit B - Plan Summary and Prospectus

CISCO SYSTEMS, INC.
AUTOMATIC STOCK OPTION AGREEMENT

RECITALS

A. The Corporation has implemented an automatic option grant program under the Corporation's 1996 Stock Incentive Plan pursuant to which eligible non-employee members of the Board will automatically receive special option grants at designated intervals over their period of Board service in order to provide such individuals with a meaningful incentive to continue to serve as a member of the Board.

B. Optionee is an eligible non-employee Board member, and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the automatic grant of a stock option to purchase shares of the Corporation's Common Stock under the Plan.

C. The granted option is intended to be a non-statutory option which does not meet the requirements of Section 422 of the Internal Revenue Code.

D. All capitalized terms in this Agreement, to the extent not otherwise defined in the Agreement, shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE , it is hereby agreed as follows:

1. **Grant of Option** . The Corporation hereby grants to Optionee, as of the Grant Date, a Non-Statutory Option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price.

2. **Option Term** . This option shall have a maximum term of nine (9) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5, 6 or 7.

3. **Limited Transferability** . This option may, in connection with the Optionee's estate plan, be assigned in whole or in part during Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established for the exclusive benefit of one or more such family members. The assigned portion shall be exercisable only by the person or persons who acquire a proprietary interest in the option pursuant to such assignment. The terms applicable to the assigned portion shall be the same as those in effect for this option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Corporation may deem appropriate. Should the Optionee die while holding this option, then this option shall be transferred in accordance with Optionee's will or the laws of descent and distribution.

4. **Exercisability/Vesting**.

(a) This option shall be immediately exercisable for any or all of the Option Shares, whether or not the Option Shares are vested in accordance with the Vesting Schedule set forth in the Grant Notice, and shall remain so exercisable until the Expiration Date or the sooner termination of the option term under Paragraph 5, 6 or 7.

(b) Optionee shall, in accordance with the Vesting Schedule set forth in the Grant Notice, vest in the Option Shares in a series of installments over his or her period of Board service. Vesting in the Option Shares may be accelerated pursuant to the provisions of Paragraph 5, 6 or 7. In no event, however, shall any additional Option Shares vest following Optionee's cessation of service as a Board member.

5. **Cessation of Board Service**. Should Optionee's service as a Board member cease while this option remains outstanding, then the option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date in accordance with the following provisions:

(i) Should Optionee cease to serve as a Board member for any reason (other than death or Permanent Disability) while this option is outstanding, then the period for exercising this option shall be reduced to a twelve (12)-month period commencing with the date of such cessation of Board service, but in no event shall this option be exercisable at any time after the Expiration Date. During such limited period of exercisability, this option may not be exercised in the aggregate for more than the number of Option Shares (if any) in which Optionee is vested on the date of his or her cessation of Board service. Upon the earlier of (i) the expiration of such twelve (12)-month period or (ii) the specified Expiration Date, the option shall terminate and cease to be exercisable with respect to any vested Option Shares for which the option has not been exercised.

(ii) Should Optionee die during the twelve (12)-month period following his or her cessation of Board service and hold this option at the time of his or her death, then the personal representative of Optionee's estate or the person or persons to whom the option is transferred pursuant to Optionee's will or in accordance with the laws of descent and distribution shall have the right to exercise this option for any or all of the Option Shares in which Optionee is vested at the time of Optionee's cessation of Board service (less any Option Shares purchased by Optionee after such cessation of Board service but prior to death). Such right of exercise shall terminate, and this option shall accordingly cease to be exercisable for such vested Option Shares, upon the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's cessation of Board service or (ii) the specified Expiration Date of the option term. Should this option be transferred during Optionee's lifetime in accordance with the provisions of Paragraph 3, then the transferee(s) shall have the same limited time period in which to exercise this option for any or all of those vested Option Shares.

(iii) Should Optionee cease service as a Board member by reason of death or Permanent Disability, then all Option Shares at the time subject to this option but not otherwise vested shall immediately vest in full so that Optionee (or the personal representative of Optionee's estate or the person or persons to whom the option is transferred upon Optionee's death or to whom the option is transferred during Optionee's lifetime in accordance with the provisions of Paragraph 3) shall have the right to exercise this option for any or all of the Option Shares as fully-vested shares of Common Stock at any time prior to the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's cessation of Board service or (ii) the specified Expiration Date.

(iv) Upon Optionee's cessation of Board service for any reason other than death or Permanent Disability, this option shall immediately terminate and cease to be outstanding with respect to any and all Option Shares in which Optionee is not otherwise at that time vested in accordance with the normal Vesting Schedule set forth in the Grant Notice or the special vesting acceleration provisions of Paragraph 6 or 7 below.

6. Corporate Transaction

(a) In the event of a Corporate Transaction, all Option Shares at the time subject to this option but not otherwise vested shall automatically vest so that this option shall, immediately prior to the specified effective date for the Corporate Transaction, become fully exercisable for all of the Option Shares at the time subject to this option and may be exercised for all or any portion of such shares as fully-vested shares of Common Stock. Immediately following the consummation of the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation or its parent company.

(b) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

7. Change in Control/Hostile Take-Over

(a) All Option Shares subject to this option at the time of a Change in Control but not otherwise vested shall automatically vest so that this option shall, immediately prior to the effective date of such Change in Control, become fully exercisable for all of the Option Shares at the time subject to this option and may be exercised for all or any portion of such shares as fully-vested shares of Common Stock. This option shall remain exercisable for such fully-vested Option Shares until the earliest to occur of (i) the specified Expiration Date, (ii) the sooner termination of this option in accordance with Paragraph 5 or 6 or (iii) the surrender of this option under Paragraph 7(b).

(b) Optionee shall have an unconditional right (exercisable during the thirty (30)-day period immediately following the consummation of a Hostile Take-Over) to surrender this option to the Corporation in exchange for a cash distribution from the Corporation in an amount equal to the excess of (i) the Take-Over Price of the Option Shares at the time subject to the surrendered option (whether or not those Option Shares are otherwise at the time vested) over (ii) the aggregate Exercise Price payable for such shares. This Paragraph 7(b) limited stock appreciation right shall in all events terminate upon the expiration or sooner termination of the option term and may not be assigned or transferred by Optionee.

(c) To exercise the Paragraph 7(b) limited stock appreciation right, Optionee must, during the applicable thirty (30)-day exercise period, provide the Corporation with written notice of the option surrender in which there is specified the number of Option Shares as to which the option is being surrendered. Such notice must be accompanied by the return of Optionee's copy of this Agreement, together with any written amendments to such Agreement. The cash distribution shall be paid to Optionee within five (5) business days following such delivery date. Such option surrender and cash distribution has been pre-approved by the Corporation's shareholders in connection with their approval of the Plan, and no additional approval of the Plan Administrator or the Board shall be required at the time of the actual option surrender and cash distribution. Upon receipt of such cash distribution, this option shall be cancelled with respect to the shares subject to the surrendered option (or the surrendered portion), and Optionee shall cease to have any further right to acquire those Option Shares under this Agreement. The option shall, however, remain outstanding for the balance of the Option Shares (if any) in accordance with the terms and provisions of this Agreement, and the Corporation shall accordingly issue a new stock option agreement (substantially in the same form as this Agreement) for those remaining Option Shares.

8. **Adjustment in Option Shares** . Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder; provided, however, that the aggregate Exercise Price shall remain the same.

9. **Shareholder Rights** . The holder of this option shall not have any shareholder rights with respect to the Option Shares until such person shall have exercised the option, paid the Exercise Price and become a holder of record of the purchased shares.

10. **Manner of Exercising Option** .

(a) In order to exercise this option for all or any part of the Option Shares for which the option is at the time exercisable, Optionee or, in the case of exercise after Optionee's death, Optionee's executor, administrator, heir or legatee, as the case may be, must take the following actions:

(i) To the extent the option is exercised for vested Option Shares, the Secretary of the Corporation shall be provided with written notice of the option exercise (the "Exercise Notice") in substantially the form of Exhibit I attached hereto, in which there is specified the number of vested Option Shares to be purchased under the exercised option. To the extent that the option is exercised for one or more unvested Option Shares, Optionee (or other person exercising the option) shall deliver to the Secretary of the Corporation a Purchase Agreement for those unvested Option Shares.

(ii) The Exercise Price for the purchased shares shall be paid in one or more of the following alternative forms:

- cash or check made payable to the Corporation's order; or
- shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or
- to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee shall provide irrevocable written instructions (A) to a Optionee-designated brokerage firm to effect the immediate sale of the vested shares purchased under the option and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for those shares plus the applicable Federal, state and local income taxes required to be withheld by the Corporation by reason of such exercise and (B) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

(iii) Appropriate documentation evidencing the right to exercise this option shall be furnished the Corporation if the person or persons exercising the option is other than Optionee.

(iv) Appropriate arrangement must be made with the Corporation for the satisfaction of all Federal, state and local income tax withholding requirements applicable to the option exercise.

(b) Except to the extent the sale and remittance procedure specified above is utilized in connection with the exercise of the option for vested Option Shares, payment of the Exercise Price for the purchased shares must accompany the Exercise Notice or Purchase Agreement delivered to the Corporation in connection with the option exercise.

(c) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate or certificates representing the purchased Option Shares. To the extent any such Option Shares are unvested, the certificates for those Option Shares shall be endorsed with an appropriate legend evidencing the Corporation's repurchase rights and may be held in escrow with the Corporation until such shares vest.

(d) In no event may this option be exercised for fractional shares.

11. **No Impairment of Rights**. This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets. In addition, nothing in this Agreement shall in any way be construed or interpreted so as to affect adversely or otherwise impair the right of the Corporation or the shareholders to remove Optionee from the Board at any time in accordance with the provisions of applicable law.

12. **Compliance with Laws and Regulations**.

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability with respect to the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. However, the Corporation shall use its best efforts to obtain all such applicable approvals.

13. **Successors and Assigns**. Except to the extent otherwise provided in Paragraph 3 or 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

14. **Construction/Governing Law**. This Agreement and the option evidenced hereby are made and granted pursuant to the automatic option grant program in effect under the Plan and are in all respects limited by and subject to the express terms and provisions of that program. The interpretation, performance, and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

15. **Notices**. Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

EXHIBIT I
NOTICE OF EXERCISE

I hereby notify Cisco Systems, Inc. (the "Corporation") that I elect to purchase _____ shares of the Corporation's Common Stock (the "Purchased Shares") at the option exercise price of \$ _____ per share (the "Exercise Price") pursuant to that certain option (the "Option") granted to me pursuant to the automatic option grant program under the Corporation's 1996 Stock Incentive Plan on _____, _____.

Concurrently with the delivery of this Exercise Notice to the Secretary of the Corporation, I shall hereby pay to the Corporation the Exercise Price for the Purchased Shares in accordance with the provisions of my agreement with the Corporation evidencing the Option and shall deliver whatever additional documents may be required by such agreement as a condition for exercise. Alternatively, I may utilize the special broker/dealer sale and remittance procedure specified in my agreement to effect payment of the Exercise Price for any Purchased Shares in which I am vested at the time of exercise.

_____, _____
Date

Optionee

Address:

Print name in exact manner
it is to appear on the
stock certificate:

Address to which certificate
is to be sent, if different
from address above:

Social Security Number:

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Automatic Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Change in Control** shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty-five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

D. **Code** shall mean the Internal Revenue Code of 1986, as amended.

E. **Common Stock** shall mean the Corporation's common stock.

F. **Corporate Transaction** shall mean either of the following shareholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

G. **Corporation** shall mean Cisco Systems, Inc., a California corporation.

H. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 10 of the Agreement.

I. **Exercise Price** shall mean the exercise price payable per share as specified in the Grant Notice.

J. **Expiration Date** shall mean the date on which the option term expires as specified in the Grant Notice.

K. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

L. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

M. **Grant Notice** shall mean the Notice of Grant of Automatic Stock Option accompanying this Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

N. **Hostile Take-Over** shall mean the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept.

O. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

P. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

Q. **Option Shares** shall mean the number of shares of Common Stock subject to the option.

R. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

S. **Permanent Disability** shall mean the inability of Optionee to perform his or her usual duties as a Board member by reason of any medically determinable physical or mental impairment which is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

T. **Plan** shall mean the Corporation's 1996 Stock Incentive Plan.

U. **Purchase Agreement** shall mean the stock purchase agreement (in form and substance satisfactory to the Corporation) which must be executed at the time the option is exercised for unvested Option Shares and which will accordingly (i) grant the Corporation the right to repurchase, at the Exercise Price, any and all of those Option Shares in which Optionee is not otherwise vested at the time of his or her cessation of service as a Board member and (ii) preclude the sale, transfer or other disposition of any of the Option Shares purchased under such agreement while those Option Shares remain subject to the repurchase right.

V. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

W. **Take-Over Price** shall mean the greater of (i) the Fair Market Value per share of Common Stock on the date the option is surrendered to the Corporation in connection with a Hostile Take-Over or (ii) the highest reported price per share of Common Stock paid by the tender offeror in effecting the Hostile Take-Over.

X. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice, pursuant to which Optionee will vest in the Option Shares in one or more installments over his or her period of Board service, subject to acceleration in accordance with the provisions of the Agreement.

CISCO SYSTEMS, INC.
NOTICE OF GRANT OF NON-EMPLOYEE DIRECTOR
DISCRETIONARY STOCK OPTION

Notice is hereby given of the following option grant (the "Option") to purchase shares of the Common Stock of Cisco Systems, Inc. (the "Corporation"):

Optionee : _____

Grant Date : _____

Exercise Price : \$ _____ per share

Number of Option Shares : _____ shares

Expiration Date : _____

Type of Option : Non-Statutory Stock Option

Date Exercisable : Immediately Exercisable

Vesting Schedule : The Option Shares shall initially be unvested and subject to repurchase by the Corporation at the Exercise Price paid per share. Optionee shall acquire a vested interest in, and the Corporation's repurchase right shall accordingly lapse with respect to, the Option Shares in a series of four (4) successive equal annual installments upon the Optionee's completion of each year of service as a member of the Corporation's Board of Directors (the "Board") over the four (4)-year period measured from the Grant Date. In no event shall any additional Option Shares vest after Optionee's cessation of Board service.

Optionee understands and agrees that the Option is granted subject to and in accordance with the terms of the Cisco Systems, Inc. 1996 Stock Incentive Plan (the "Plan"). Optionee further agrees to be bound by the terms of the Plan and the terms of the Option as set forth in the Discretionary Stock Option Agreement attached hereto as Exhibit A.

Optionee hereby acknowledges receipt of a copy of the official prospectus for the Plan in the form attached hereto as Exhibit B. A copy of the Plan is available upon request made to the Corporate Secretary at the Corporation's principal offices.

REPURCHASE RIGHT . OPTIONEE HEREBY AGREES THAT ALL UNVESTED OPTION SHARES ACQUIRED UPON THE EXERCISE OF THE OPTION SHALL NOT BE TRANSFERABLE AND SHALL BE SUBJECT TO REPURCHASE BY THE CORPORATION, AT THE EXERCISE PRICE PAID PER SHARE, UPON OPTIONEE'S TERMINATION OF SERVICE AS A MEMBER OF THE CORPORATION'S BOARD OF DIRECTORS PRIOR TO VESTING IN THOSE SHARES. THE TERMS AND CONDITIONS OF SUCH REPURCHASE RIGHT SHALL BE SPECIFIED IN A STOCK PURCHASE AGREEMENT, IN FORM AND SUBSTANCE SATISFACTORY TO THE CORPORATION, EXECUTED BY OPTIONEE AT THE TIME OF THE OPTION EXERCISE.

No Impairment of Rights . Nothing in this Notice or in the attached Discretionary Stock Option Agreement or the Plan shall interfere with or otherwise restrict in any way the rights of the Corporation or the Corporation's shareholders to remove Optionee from the Board at any time in accordance with the provisions of applicable law.

Definitions . All capitalized terms in this Notice shall have the meaning assigned to them in this Notice or in the attached Discretionary Stock Option Agreement.

DATED: _____, _____

CISCO SYSTEMS, INC.

By: _____

Title: _____

OPTIONEE

Address: _____

ATTACHMENTS

Exhibit A – Discretionary Stock Option Agreement
Exhibit B- Plan Summary and Prospectus

**CISCO SYSTEMS, INC.
NOTICE OF GRANT OF NON-EMPLOYEE DIRECTOR
DISCRETIONARY STOCK OPTION**

Notice is hereby given of the following option grant (the "Option") to purchase shares of the Common Stock of Cisco Systems, Inc. (the "Corporation"):

Optionee : _____

Grant Date : _____

Exercise Price : \$ _____ per share

Number of Option Shares : _____ shares

Expiration Date : _____

Type of Option : Non-Statutory Stock Option

Date Exercisable : Immediately Exercisable

Vesting Schedule : The Option Shares shall initially be unvested and subject to repurchase by the Corporation at the Exercise Price paid per share. Optionee shall acquire a vested interest in, and the Corporation's repurchase right shall accordingly lapse with respect to, the Option Shares in a series of two (2) successive equal annual installments upon Optionee's completion of each year of service as a member of the Corporation's Board of Directors (the "Board") over the two (2)-year period measured from the Grant Date. In no event shall any additional Option Shares vest after Optionee's cessation of Board service.

Optionee understands and agrees that the Option is granted subject to and in accordance with the terms of the Cisco Systems, Inc. 1996 Stock Incentive Plan (the "Plan"). Optionee further agrees to be bound by the terms of the Plan and the terms of the Option as set forth in the Discretionary Stock Option Agreement attached hereto as Exhibit A.

Optionee hereby acknowledges receipt of a copy of the official prospectus for the Plan in the form attached hereto as Exhibit B. A copy of the Plan is available upon request made to the Corporate Secretary at the Corporation's principal offices.

REPURCHASE RIGHT. OPTIONEE HEREBY AGREES THAT ALL UNVESTED OPTION SHARES ACQUIRED UPON THE EXERCISE OF THE OPTION SHALL NOT BE TRANSFERABLE AND SHALL BE SUBJECT TO REPURCHASE BY THE CORPORATION, AT THE EXERCISE PRICE PAID PER SHARE, UPON OPTIONEE'S TERMINATION OF SERVICE AS A MEMBER OF THE CORPORATION'S BOARD OF DIRECTORS PRIOR TO VESTING IN THOSE

SHARES. THE TERMS AND CONDITIONS OF SUCH REPURCHASE RIGHT SHALL BE SPECIFIED IN A STOCK PURCHASE AGREEMENT, IN FORM AND SUBSTANCE SATISFACTORY TO THE CORPORATION, EXECUTED BY OPTIONEE AT THE TIME OF THE OPTION EXERCISE.

No Impairment of Rights. Nothing in this Notice or in the attached Discretionary Stock Option Agreement or the Plan shall interfere with or otherwise restrict in any way the rights of the Corporation or the Corporation's shareholders to remove Optionee from the Board at any time in accordance with the provisions of applicable law.

Definitions. All capitalized terms in this Notice shall have the meaning assigned to them in this Notice or in the attached Discretionary Stock Option Agreement.

DATED: _____, ____

CISCO SYSTEMS, INC.

By: _____

Title: _____

OPTIONEE

Address: _____

ATTACHMENTS

- Exhibit A – Discretionary Stock Option Agreement
- Exhibit B - Plan Summary and Prospectus

CISCO SYSTEMS, INC.
DISCRETIONARY STOCK OPTION AGREEMENT

RECITALS

A. The Board has adopted the Plan for the purpose of retaining the services of selected employees, non-employee members of the Board or of the board of directors of any Parent or Subsidiary and consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. Optionee is an eligible non-employee Board member, and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of a stock option to purchase shares of the Corporation's Common Stock under the Plan.

C. The granted option is intended to be a non-statutory option which does not meet the requirements of Section 422 of the Internal Revenue Code.

D. All capitalized terms in this Agreement, to the extent not otherwise defined in the Agreement, shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE , it is hereby agreed as follows:

1. **Grant of Option** . The Corporation hereby grants to Optionee, as of the Grant Date, a Non-Statutory Option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price.

2. **Option Term** . This option shall have a maximum term of nine (9) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5, 6 or 7.

3. **Limited Transferability** . This option may, in connection with the Optionee's estate plan, be assigned in whole or in part during Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established for the exclusive benefit of one or more such family members. The assigned portion shall be exercisable only by the person or persons who acquire a proprietary interest in the option pursuant to such assignment. The terms applicable to the assigned portion shall be the same as those in effect for this option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Corporation may deem appropriate. Should the Optionee die while holding this option, then this option shall be transferred in accordance with Optionee's will or the laws of descent and distribution.

4. **Exercisability/Vesting** .

- (a) This option shall be immediately exercisable for any or all of the Option Shares, whether or not the Option Shares are vested in

accordance with the Vesting Schedule set forth in the Grant Notice, and shall remain so exercisable until the Expiration Date or the sooner termination of the option term under Paragraph 5, 6 or 7.

- (b) Optionee shall, in accordance with the Vesting Schedule set forth in the Grant Notice, vest in the Option Shares in a series of installments over his or her period of Board service. Vesting in the Option Shares may be accelerated pursuant to the provisions of Paragraph 5, 6 or 7. In no event, however, shall any additional Option Shares vest following Optionee's cessation of service as a Board member.

5. **Cessation of Board Service**. Should Optionee's service as a Board member cease while this option remains outstanding, then the option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date in accordance with the following provisions:

(i) Should Optionee cease to serve as a Board member for any reason (other than death, Permanent Disability or Misconduct) while this option is outstanding, then the period for exercising this option shall be reduced to a twelve (12)-month period commencing with the date of such cessation of Board service, but in no event shall this option be exercisable at any time after the Expiration Date. During such limited period of exercisability, this option may not be exercised in the aggregate for more than the number of Option Shares (if any) in which Optionee is vested on the date of his or her cessation of Board service. Upon the earlier of (i) the expiration of such twelve (12)-month period or (ii) the specified Expiration Date, the option shall terminate and cease to be exercisable with respect to any vested Option Shares for which the option has not been exercised.

(ii) Should Optionee die during the twelve (12)-month period following his or her cessation of Board service and hold this option at the time of his or her death, then the personal representative of Optionee's estate or the person or persons to whom the option is transferred pursuant to Optionee's will or in accordance with the laws of descent and distribution shall have the right to exercise this option for any or all of the Option Shares in which Optionee is vested at the time of Optionee's cessation of Board service (less any Option Shares purchased by Optionee after such cessation of Board service but prior to death). Such right of exercise shall terminate, and this option shall accordingly cease to be exercisable for such vested Option Shares, upon the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's cessation of Board service or (ii) the specified Expiration Date of the option term. Should this option be transferred during Optionee's lifetime in accordance with the provisions of Paragraph 3, then the transferee(s) shall have the same limited time period in which to exercise this option for any or all of those vested Option Shares.

(iii) Should Optionee cease service as a Board member by reason of death or Permanent Disability, then all Option Shares at the time subject to this option but not otherwise vested shall immediately vest in full so that Optionee (or the personal representative of Optionee's estate or the person or persons to whom the option is transferred upon Optionee's death or to whom the option is transferred during Optionee's lifetime in accordance with the provisions of Paragraph 3) shall have the right to exercise this option for any or all of the Option Shares as fully-vested shares of Common Stock at any time prior to the earlier of (i) the expiration of the twelve (12)-month period measured from the date of Optionee's cessation of Board service or (ii) the specified Expiration Date.

(iv) Upon Optionee's cessation of Board service for any reason other than death or Permanent Disability, this option shall immediately terminate and cease to be outstanding with respect to any and all Option Shares in which Optionee is not otherwise at that time vested in accordance with the normal Vesting Schedule set forth in the Grant Notice or the special vesting acceleration provisions of Paragraph 6 or 7 below.

(v) Should Optionee cease service as a Board member by reason of Misconduct, then this option shall terminate immediately and cease to remain outstanding.

6. Corporate Transaction

(a) In the event of a Corporate Transaction, all Option Shares at the time subject to this option but not otherwise vested shall automatically vest so that this option shall, immediately prior to the specified effective date for the Corporate Transaction, become fully-exercisable for all of the Option Shares at the time subject to this option and may be exercised for all or any portion of such shares as fully-vested shares of Common Stock. No such acceleration of this option, however, shall occur if and to the extent: (i) this option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation (or parent thereof) or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation (or parent thereof) or (ii) this option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested Option Shares at the time of the Corporate Transaction (the excess of the Fair Market Value of those Option Shares over the aggregate Exercise Price payable for such shares) and provides for subsequent pay-out in accordance with the same option Vesting Schedule set forth in the Grant Notice. The determination of option comparability under clause (i) shall be made by the Plan Administrator, and such determination shall be final, binding and conclusive.

(b) Immediately following the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) in connection with the Corporate Transaction.

(c) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to

Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

7. Change in Control/Hostile Take-Over.

(a) All Option Shares subject to this option at the time of a Change in Control but not otherwise vested shall automatically vest so that this option shall, immediately prior to the effective date of such Change in Control, become fully exercisable for all of the Option Shares at the time subject to this option and may be exercised for all or any portion of such shares as fully-vested shares of Common Stock. This option shall remain exercisable for such fully-vested Option Shares until the earliest to occur of (i) the specified Expiration Date, (ii) the sooner termination of this option in accordance with Paragraph 5 or 6 or (iii) the surrender of this option under Paragraph 7(b).

(b) Optionee shall have an unconditional right (exercisable during the thirty (30)-day period immediately following the consummation of a Hostile Take-Over) to surrender this option to the Corporation in exchange for a cash distribution from the Corporation in an amount equal to the excess of (i) the Take-Over Price of the Option Shares at the time subject to the surrendered option (whether or not those Option Shares are otherwise at the time vested) over (ii) the aggregate Exercise Price payable for such shares. This Paragraph 7(b) limited stock appreciation right shall in all events terminate upon the expiration or sooner termination of the option term and may not be assigned or transferred by Optionee.

(c) To exercise the Paragraph 7(b) limited stock appreciation right, Optionee must, during the applicable thirty (30)-day exercise period, provide the Corporation with written notice of the option surrender in which there is specified the number of Option Shares as to which the option is being surrendered. Such notice must be accompanied by the return of Optionee's copy of this Agreement, together with any written amendments to such Agreement. The cash distribution shall be paid to Optionee within five (5) business days following such delivery date. Upon receipt of such cash distribution, this option shall be cancelled with respect to the shares subject to the surrendered option (or the surrendered portion), and Optionee shall cease to have any further right to acquire those Option Shares under this Agreement. The option shall, however, remain outstanding for the balance of the Option Shares (if any) in accordance with the terms and provisions of this Agreement, and the Corporation shall accordingly issue a new stock option agreement (substantially in the same form as this Agreement) for those remaining Option Shares.

8. Adjustment in Option Shares. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder; provided, however, that the aggregate Exercise Price shall remain the same.

9. **Shareholder Rights**. The holder of this option shall not have any shareholder rights with respect to the Option Shares until such person shall have exercised the option, paid the Exercise Price and become a holder of record of the purchased shares.

10. **Manner of Exercising Option**.

(a) In order to exercise this option for all or any part of the Option Shares for which the option is at the time exercisable, Optionee or, in the case of exercise after Optionee's death, Optionee's executor, administrator, heir or legatee, as the case may be, must take the following actions:

(i) To the extent the option is exercised for vested Option Shares, the Secretary of the Corporation shall be provided with written notice of the option exercise (the "Exercise Notice") in substantially the form of Exhibit I attached hereto, in which there is specified the number of vested Option Shares to be purchased under the exercised option. To the extent that the option is exercised for one or more unvested Option Shares, Optionee (or other person exercising the option) shall deliver to the Secretary of the Corporation a Purchase Agreement for those unvested Option Shares.

(ii) The Exercise Price for the purchased shares shall be paid in one or more of the following alternative forms:

- cash or check made payable to the Corporation's order; or
- shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date; or
- to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee shall provide irrevocable written instructions (A) to a Optionee-designated brokerage firm to effect the immediate sale of the vested shares purchased under the option and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for those shares plus the applicable Federal, state and local income taxes required to be withheld by the Corporation by reason of such exercise and (B) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

(iii) Appropriate documentation evidencing the right to exercise this option shall be furnished to the Corporation if the person or persons exercising the option is other than Optionee.

(iv) Appropriate arrangements must be made with the Corporation for the satisfaction of all Federal, state and local income tax withholding requirements applicable to the option exercise.

(b) Except to the extent the sale and remittance procedure specified above is utilized in connection with the exercise of the option for vested Option Shares, payment of the Exercise Price for the purchased shares must accompany the Exercise Notice or Purchase Agreement delivered to the Corporation in connection with the option exercise.

(c) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate or certificates representing the purchased Option Shares. To the extent any such Option Shares are unvested, the certificates for those Option Shares shall be endorsed with an appropriate legend evidencing the Corporation's repurchase rights and may be held in escrow with the Corporation until such shares vest.

(d) In no event may this option be exercised for fractional shares.

11. **No Impairment of Rights**. This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets. In addition, nothing in this Agreement shall in any way be construed or interpreted so as to affect adversely or otherwise impair the right of the Corporation or the shareholders to remove Optionee from the Board at any time in accordance with the provisions of applicable law.

12. **Compliance with Laws and Regulations**.

(a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.

(b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability with respect to the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. However, the Corporation shall use its best efforts to obtain all such applicable approvals.

13. **Successors and Assigns**. Except to the extent otherwise provided in Paragraph 3 or 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

14. **Construction/Governing Law**. This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. The interpretation, performance, and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

15. **Notices**. Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

EXHIBIT I

NOTICE OF EXERCISE

I hereby notify Cisco Systems, Inc. (the "Corporation") that I elect to purchase _____ shares of the Corporation's Common Stock (the "Purchased Shares") at the option exercise price of \$ _____ per share (the "Exercise Price") pursuant to that certain option (the "Option") granted to me under the Corporation's 1996 Stock Incentive Plan on _____, 20 ____.

Concurrently with the delivery of this Exercise Notice to the Secretary of the Corporation, I shall hereby pay to the Corporation the Exercise Price for the Purchased Shares in accordance with the provisions of my agreement with the Corporation evidencing the Option and shall deliver whatever additional documents may be required by such agreement as a condition for exercise. Alternatively, I may utilize the special broker/dealer sale and remittance procedure specified in my agreement to effect payment of the Exercise Price for any Purchased Shares in which I am vested at the time of exercise.

_____, _____
Date

Optionee

Address: _____

Print name in exact manner
it is to appear on the
stock certificate:

Address to which certificate
is to be sent, if different
from address above:

Social Security Number:

APPENDIX

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Discretionary Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Change in Control** shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty-five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

D. **Code** shall mean the Internal Revenue Code of 1986, as amended.

E. **Common Stock** shall mean the Corporation's common stock.

F. **Corporate Transaction** shall mean either of the following shareholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

G. **Corporation** shall mean Cisco Systems, Inc., a California corporation.

H. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 10 of the Agreement.

I. **Exercise Price** shall mean the exercise price payable per share as specified in the Grant Notice.

J. **Expiration Date** shall mean the date on which the option term expires as specified in the Grant Notice.

K. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

L. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

M. **Grant Notice** shall mean the Notice of Grant of Discretionary Stock Option accompanying this Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

N. **Hostile Take-Over** shall mean the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept.

O. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation

(or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the service of the Corporation (or any Parent or Subsidiary).

P. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

Q. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

R. **Option Shares** shall mean the number of shares of Common Stock subject to the option.

S. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

T. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

U. **Permanent Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

V. **Plan** shall mean the Corporation's 1996 Stock Incentive Plan.

W. **Purchase Agreement** shall mean the stock purchase agreement (in form and substance satisfactory to the Corporation) which must be executed at the time the option is exercised for unvested Option Shares and which will accordingly (i) grant the Corporation the right to repurchase, at the Exercise Price, any and all of those Option Shares in which Optionee is not otherwise vested at the time of his or her cessation of service as a Board member and (ii) preclude the sale, transfer or other disposition of any of the Option Shares purchased under such agreement while those Option Shares remain subject to the repurchase right.

X. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

Y. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Z. **Take-Over Price** shall mean the greater of (i) the Fair Market Value per share of Common Stock on the date the option is surrendered to the Corporation in connection with a

Hostile Take-Over or (ii) the highest reported price per share of Common Stock paid by the tender offeror in effecting the Hostile Take-Over.

AA. **Vesting Schedule** shall mean the vesting schedule specified in the Grant Notice, pursuant to which Optionee will vest in the Option Shares in one or more installments over his or her period of Board service, subject to acceleration in accordance with the provisions of the Agreement.

**CISCO SYSTEMS, INC.
STOCK ISSUANCE AGREEMENT**

RECITALS

This stock issuance agreement (this "Stock Issuance Agreement") is made and entered into as of _____ by and between Cisco Systems, Inc., a California corporation having a principal place of business at 170 West Tasman Drive, San Jose, California (the "Corporation") and _____, an individual having a principal place of business at _____ ("Consultant").

A. Capitalized terms not defined in this Stock Issuance Agreement shall have the meanings assigned to such terms in the Corporation's 1996 Stock Incentive Plan (the "Plan").

B. The Board has adopted the Plan for the purpose of retaining the services of selected employees, non-employee members of the Board or of the board of directors of any Parent or Subsidiary and consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

C. Consultant is to render valuable services to the Corporation pursuant to the consulting agreement by and between the Corporation and Consultant executed on _____ (the "Consulting Agreement"), and this Stock Issuance Agreement is executed pursuant to Article _____ of, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of a share right award to Consultant.

NOW, THEREFORE, it is hereby agreed as follows:

1. **GRANT OF SHARE RIGHT AWARD**. In full satisfaction of its obligation under Section _____ of the Consulting Agreement, the Corporation hereby grants to Consultant a share right award which entitles Consultant to receive _____ shares of Common Stock as soon as practicable following each Issuance Date, in each case subject to Consultant having provided continuous service to the Corporation pursuant to the Consulting Agreement through each such date. In no event will Consultant be issued any shares of Common Stock following Consultant's termination of service pursuant to the Consulting Agreement. For purposes of this Stock Issuance Agreement, "Issuance Date" shall mean _____.

2. **NON-TRANSFERABILITY**. This share right award shall be neither transferable or assignable by Consultant.

3. **ADJUSTMENT IN SHARE RIGHT AWARD SHARES**. If any change is made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's or its successor's receipt of consideration, appropriate adjustments shall be made to the number and/or class of securities in effect under the share right award made hereunder. Such adjustments are to be effected in a manner which shall preclude the enlargement or dilution of rights and benefits under such share right award.

4. **STOCKHOLDER RIGHTS** . Consultant shall have full stockholder rights with respect to any shares of Common Stock issued to Consultant hereunder. Accordingly, Consultant have the right to vote such shares and to receive any regular cash dividends paid on such shares.

5. **CONSTRUCTION** . This Stock Issuance Agreement and the share right award evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator with respect to any question or issue arising under the Plan or this Stock Issuance Agreement shall be conclusive and binding on all persons having an interest in this share right award.

IN WITNESS WHEREOF , the parties have entered into this Stock Issuance Agreement as of the date first written above.

Corporation:

CISCO SYSTEMS, INC.

By: _____

Consultant:

CISCO SYSTEMS, INC.
PROFESSIONAL AND LEADERSHIP INCENTIVE PLAN
FY 2005

I. INTRODUCTION

- A. **The Objective of the Professional and Leadership Incentive (P&LI) Plan (the “Plan”)** is to provide eligible employees of Cisco Systems, Inc. (“Cisco”) and its subsidiaries (as defined in Paragraph III.C. below), with the opportunity to receive a payment for their contributions to the success and profitability of Cisco. Participation in the Plan and the payment of any sums hereunder shall be at the sole and absolute discretion of Cisco. “Cisco and its subsidiaries” are referred to herein as “the Company.”
- B. **Participants:** This Plan, as determined by Cisco on a fully discretionary basis, applies solely to regular employees of Cisco Systems, Inc. and its subsidiaries (as defined in Paragraph III.C. below) in salary grades 1 through 14, 083, 084, 090, 150, 200, and 888 (“Plan Participants”), who Cisco determines meet the eligibility requirements set forth in Section II. For purposes of this Plan and unless otherwise prohibited by applicable law, the term “regular employee” means an individual who is deemed by Cisco to be both an employee of the Company and employed for an unspecified or indefinite period of time.
- C. **Effective Date:** This Plan is only effective for Cisco’s fiscal year 2005 beginning August 1, 2004, through July 30, 2005 (the “Fiscal Year”). This Plan is limited in time and will expire automatically on July 30, 2005 (“Expiration Date”). This Plan also supersedes all prior bonus and incentive plans, whether with Cisco Systems, Inc. or a subsidiary or affiliate thereof, as well as any written and/or oral representations regarding the subject matter of this Plan.
- D. **Changes in Plan:** Cisco reserves the right to modify or terminate the Plan in total or in part, at any time. Any such modification or termination must be approved in writing by either (i) the President/CEO or Senior Vice President of Human Resources of Cisco Systems, Inc. or (ii) resolution of the Cisco Systems Inc. Compensation Committee. Any modification must expressly provide that it is modifying this Plan.
- E. **Cisco Authority:** Cisco reserves the right to interpret this Plan document on a fully discretionary basis, which authority includes but is not limited to the right to determine employee eligibility for participation in the Plan; to determine the amount, if any, to be paid under the Plan; to terminate, amend, or modify the Plan; and to take any other action in relation to administration of the Plan. Nothing in this Plan is intended to create an entitlement to any employee for any incentive payment hereunder except as Cisco may determine in its discretion.

- F. **Entire Agreement:** This Plan, as it may be modified in accordance with the foregoing, is the entire writing regarding the subject matter of this Plan and supersedes all prior bonus and commission incentive plans, employment contracts whether with any holding company, subsidiary, or affiliate thereof (including Cisco Systems, Inc.) and any written and/or oral representations regarding the subject matter of this Plan, unless superseded by local law. All payments under this Plan are fully discretionary payments. Participation in this Plan during the Fiscal Year will not convey any entitlement to participate in this or future plans or to the same or similar cash incentive benefits. Payments under this Plan are an extraordinary item of compensation that are outside the normal or expected compensation for the purpose of calculating any of the following payments: termination, severance, redundancy, end-of-service premiums, bonuses, long-term service awards, overtime premiums, pension or retirement benefits, and any other similar payments and extra benefits.

II. ELIGIBILITY AND INCENTIVE PLAN ELEMENTS

- A. **Eligibility:** Assuming all other conditions of the Plan are met and that Cisco determines in its discretion to make payments under the Plan, to be considered for a discretionary incentive payment hereunder, a Plan Participant must satisfy each of the following eligibility requirements:
1. The employee must be deemed by Cisco to be employed by the Company as a regular employee in an incentive-eligible position on or before the first working day of the last fiscal quarter of the Fiscal Year, and must be employed as a regular employee in an incentive-eligible position on the last working day of the Fiscal Year;
 2. The employee must not be providing services to Cisco as a temporary employee, intern or as an independent contractor, consultant, or agent under a written or oral contract, or purchase order, and must not be classified by Cisco as a temporary employee, independent contractor, consultant, or agent (whether or not such classification is upheld upon review by a governmental, judicial or other agency);
 3. At both the time of calculation of the incentive award and at the time of payment, the employee:

- a. must not be concurrently on a sales incentive or commission plan;
- b. cannot have entered into an employment termination agreement (including, but not limited to, any agreement, other than an employment agreement or offer letter, in respect of an employee's termination of employment);
- c. must not be on a Performance Improvement Plan, letter of concern, work plan, etc.;
- d. must not be rated as N in his/her most recent performance evaluation; and
- e. must not be deemed by Cisco to have violated the business conduct requirements described below in the section entitled Miscellaneous (Section III.C.).

All payments under the Plan rest within the sole and absolute discretion of Cisco and, in particular, any payment for employees ranked in the bottom 5% of their organization and/or for employees who have been offered (but not accepted) an employment termination agreement (including, but not limited to, any agreement, other than an employment agreement or offer letter, in respect of termination of employment) is at manager's discretion and requires approval from Human Resources.

Employees meeting all eligibility requirements of the Plan who have less than one year of service will be eligible to receive a discretionary incentive that is pro-rated from the effective date of participation in the Plan up to and including the Expiration Date. Unless otherwise required by law, in no event will an employee be eligible to receive an incentive under this Plan unless he/she is employed on the last working day of the Fiscal Year.

B. Elements of Calculation:

Incentives under this Plan are calculated on a fully discretionary basis, in accordance with the following formula:

$$\begin{array}{ccccccccc}
 \text{Base Salary} & \times & \text{Incentive Target Percentage} & \times & \text{Individual Performance Factor} & \times & \text{Customer Satisfaction Factor} & \times & \text{Company Performance Factor} & \times \\
 & & \text{Teamwork and Collaboration Factor} & & \times & \text{Pro-ration Factor} & = & \text{Total Annual Incentive} & &
 \end{array}$$

1. **Base Salary** shall mean the annual base salary in effect (i) at the end of Q2 for the purposes of calculating midyear advances, if any (as described below in section II.F.); and (ii) at the end of Q4 of the Fiscal Year for year-end payments, if any. If the employee's salary currency changes during the Fiscal Year, the salary currency in effect before the change will be used as the basis for the incentive calculation for the period in which

that currency was in effect. The post-change currency will be the basis for the incentive calculation on a pro-rated basis for the period in which it was in effect. These two pro-rated incentive award amounts will be added together to determine the total annual incentive award amount. Incentive payments will be made in the employee's salary currency in effect at the end of Q2 for midyear advances, if any, and at the end of Q4 for year-end payments, if any. Base Salary shall not include variable forms of compensation including, but not limited to, overtime, on-call pay, lead premiums, shift differentials, bonuses, incentive compensation, commissions, stock options, expense allowances, or reimbursements.

2. **Incentive Target** is a percentage of base salary determined by the participant's grade level and may be changed at the discretion of Cisco at any time during the Fiscal Year. If the target is modified, impacted employees will be notified.

<u>Grades</u>	<u>Incentive Target</u>
1-4	7%
5-7	10%
8 and 9	14%
10 and 11	17%
12	30%
013, 014, 083, 084, and 090	40%
200 and 888	50%
150	60%

3. **Individual Performance Factor (IPF)** is based upon the manager's evaluation of a participant's performance and contribution for the Fiscal Year.
4. **Teamwork and Collaboration Factor (T&C)** is based upon the manager's evaluation of a participant's ability to work as a team player and collaborate with others across the company, suppliers, partners and/or customers.
5. **Company Performance Factor** is based upon Cisco's financial performance, as determined by Cisco in its sole and absolute discretion.
6. **Customer Satisfaction Factor** is based upon a blend of Primary and Secondary customer satisfaction surveys drawn from Cisco worldwide.
7. **Pro-ration Factor** accounts for the number of calendar days or hours within the day during the Fiscal Year that an employee was in an incentive-eligible position under this Plan. For example, the Pro-ration Factor for an employee who has been in the Plan the entire year will be 1.00. For an employee who has been in the Plan for 6 months, this factor

will be 0.50. Unless otherwise required by law, employees in the following situations will have a Pro-ration Factor of less than 1.00:

- Employees in the Plan who transfer to a new position not covered by the Plan.
- Employees who transfer from one incentive-eligible position to another incentive-eligible position. Employees in this situation will have their eligibility under the Plan prorated based on length of time in each position.
- Employees who have been in the Plan less than 12 months (such as a New Hire, or an employee who transfers from a non-incentive eligible position into an incentive eligible position).
- Employees who have been on a leave of absence of any duration during the fiscal quarter with the exception of Emergency Call-up Military Leave.
- Employees working less than the applicable full-time standard work week. Such employees will have a Pro-ration Factor that reflects the average number of hours of worked.

Any modification to the Pro-ration Factor must be approved by the next-level Manager and the Director of Compensation in advance of the year-end close date.

- C. **Total Annual Incentive** shall be the product of the foregoing seven factors and shall be less any advances, including, but not limited to, midyear advances and unearned commission advances, draws, other outstanding debts and appropriate withholdings.
- D. **Transfers and Terminations:** A participant in the Plan who transfers to a new position within Cisco not governed by this Plan will be eligible to receive payments under the Plan on a pro-rata basis. Such employee's Pro-ration Factor will reflect the percentage of time the employee was an eligible participant in the Plan. Employees who transfer into the Plan from another plan will be subject to pro-ration as well, and will be eligible to receive payments under the Plan in accordance with the Pro-ration Factors described above. A participant must be employed on the last working day of the Fiscal Year to be eligible for the year-end payment. A participant must be employed on the day of distribution to receive a partial midyear advance payment under paragraph II.F. Unless otherwise required by law, if an employee terminates prior to the applicable date, the employee will not be eligible for such incentive or partial payment.

- E. **Incentive Formula and Calculation Example:** Assuming a base salary of \$95,000, Incentive Target of 14%, Individual Performance Factor of 1.00, a Customer Satisfaction Factor of 1.05, Company Performance Factor of 1.00, Teamwork and Collaboration Factor of 1.0, and a Pro-ration Factor of 1.00, the Total Annual Incentive for an employee meeting all eligibility requirements, would be calculated as follows:

Sample Calculation

Base Salary		Incentive Target Percentage		Individual Performance Factor		Customer Satisfaction Factor		Company Performance Factor	
\$95,000	X	0.14	X	1.0	X	1.05	X	1.0	X
			Teamwork and Collaboration Factor						
			1.0	X	Pro-ration Factor				
					1.0	=	Total Annual Incentive		
							\$13,965.00*		

*less any advances, including, but not limited to, midyear advances and unearned commission advances, draws, other outstanding debts, and appropriate withholdings.

In this example, the total incentive equals 14.7% of base salary.

- F. **Midyear Advance of Year-End Incentive Payment:** If, at the midpoint of the Fiscal Year, Cisco determines, in its sole discretion, that the Company Performance Factor is at a minimum of 1.00, Cisco may elect to make an advance of incentive payments at that time. Any such payment will be treated as an advance, and will not be more than 50% of the incentive target times base salary, reduced by any advances, including, but not limited to, unearned commission advances, draws, other outstanding debts, and appropriate withholdings. This advance will be deducted from the Total Annual Incentive year-end payment, if any. Only Plan Participants who have met job expectations, were hired in an incentive eligible position under this Plan on or before the first working day of the second quarter of the Fiscal Year and are actively employed by Cisco on the day of distribution will be eligible to receive a midyear advance. In no event, however, will any eligible participant receive such a partial payment unless that individual is employed by Cisco Systems, Inc. or a participating Cisco subsidiary on the distribution date.

If Cisco determines, in its sole and absolute discretion, that the Company Performance Factor is not at a minimum of 1.00 at the midpoint of the Fiscal Year, but is at least .80, then a partial payment may, at the sole discretion of Cisco's President/CEO, be distributed at that time. Such distribution may be made to all employees eligible to receive an incentive under the Plan, or to only some of the employees eligible to receive an incentive under the Plan, as determined by the President/CEO. Such discretionary payment, if any, will be

subject to the same terms and conditions set forth above for a midyear advance based on a 1.00 Company Performance Factor, except that the maximum amount paid will be 25% of the incentive target.

- G. **Year-End Discretionary Incentive Payment:** If Cisco Performance Factor is 0, so that no year-end incentive payment becomes payable under the Plan, then the President/CEO may, at his or her sole discretion, authorize a year-end payment in an amount up to 25% of the applicable incentive target to all or a portion of employees eligible to receive an incentive under the Plan. In no event will an individual be eligible for such a discretionary payment unless he or she is employed on the last day of the Fiscal Year. All payments are subject to reduction for any advances, including but not limited to midyear advances, unearned commission advances, draws, other outstanding debts and appropriate withholding.

III. MISCELLANEOUS

- A. **Business Conduct:** It is the established policy of Cisco Systems, Inc. and all of its subsidiaries to conduct business with the highest standards of business ethics. Employees may not offer, give, solicit or receive any payment that could appear to be a bribe, kickback or other irregular type of payment from anyone involved in any way with an actual or potential business transaction.
- B. **Employment at Will (US Only):** The Company is an at-will employer, which means that an employee's employment can be terminated by the employee or the Company at any time with or without cause. The Company reserves the right to modify an employee's duties, title or other terms and conditions of employment with or without cause. This Plan cannot and should not be interpreted to alter the at-will nature of the employment relationship between the Company and any Plan Participant. The at-will nature of the employment relationship cannot be modified except in a written document signed by Cisco's CEO or Senior Vice President of Human Resources. In addition, none of the terms and conditions applicable to incentive compensation supersedes or modifies in any way the terms set forth in the Plan Participant's Proprietary Information and Inventions Agreement.
- C. **Subsidiaries:** This Plan applies to employees of all Cisco subsidiaries, except where the employees of a subsidiary are expressly eligible for participation in a bonus or incentive plan established by the subsidiary by which they are employed, and/or where employees of a Cisco subsidiary are expressly informed in writing that they are not eligible for participation in this Plan. Employees of Cisco-Linksys LLC are not eligible for participation in this Plan.

It is not Cisco's intention that employees of Cisco or its subsidiaries be eligible for more than one bonus or incentive plan, unless expressly stated to the contrary.

- D. **Dispute Resolution:** Plan Participants and the Company acknowledge and agree that any and all disputes or claims arising from or relating to a Plan Participant's

recruitment to or employment with the Company (including but not limited to disputes or claims arising from or relating to the Cisco Systems, Inc. Professional and Leadership Incentive Plan), or the termination of the Plan Participant's employment, will be resolved solely and exclusively pursuant to final and binding arbitration in lieu of any evidentiary hearing before a government agency and/or a court trial before a judge or jury, pursuant to the terms of Cisco's Arbitration Agreement and Policy, a copy of which can be found at http://www.in.cisco.com/HR/employee/proprietary_info/agreement2arbitrate.html. The parties' agreement to arbitrate means that both Cisco and the Plan Participant have expressly waived any and all rights to a trial before a court or a jury.

NOTICE OF GRANT OF STOCK OPTION

Notice is hereby given of the following option grant (the "Option") to purchase shares of the Common Stock of Cisco Systems, Inc. (the "Corporation"):

Optionee : John Chambers

Grant Date : August 23, 2004

Exercise Price : \$ 19.18 per share

Number of Option Shares : 1,500,000 shares

Expiration Date : August 23, 2013

Type of Option : Non-Statutory Stock Option

Exercise Schedule

The Option shall become exercisable with respect to all of the Option Shares upon the earlier of: (i) the Optionee's completion of seven (7) years of Service measured from the above option grant date or (ii) three (3) years after the Optionee ceases to serve as the Corporation's President and Chief Executive Officer subject to the requirements that (A) this option can not become exercisable due to this subsection (ii) any earlier than the fifth anniversary of the above option grant date and (B) Optionee must continue to render Service during the period after Optionee is no longer President and Chief Executive Officer or (iii) the Optionee's death or Permanent Disability. In no event shall the Option become exercisable for any additional Option Shares after Optionee's cessation of Service.

Optionee understands and agrees that the Option is offered subject to and in accordance with the terms of the Cisco Systems, Inc. 1996 Stock Incentive Plan (the "Plan"). Optionee further agrees to be bound by the terms of the Plan and the terms of the Option as set forth in the Stock Option Agreement attached hereto.

No Employment or Service Contract. Nothing in this Notice or in the attached Stock Option Agreement or in the Plan shall confer upon Optionee any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining Optionee) or of Optionee, which rights are hereby expressly reserved by each, to terminate Optionee's Service at any time for any reason, with or without cause.

Definitions. All capitalized terms in this Notice shall have the meaning assigned to them in this Notice or in the attached Stock Option Agreement.

STOCK OPTION AGREEMENT

Recitals

A. The Board has adopted the Plan for the purpose of retaining the services of selected Employees, non-employee members of the Board or of the board of directors of any Parent or Subsidiary and consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

B. Optionee is to render valuable services to the Corporation (or a Parent or Subsidiary), and this Agreement is executed pursuant to, and is intended to carry out the purposes of, the Plan in connection with the Corporation's grant of an option to Optionee.

C. All capitalized terms in this Agreement shall have the meaning assigned to them in the attached Appendix.

NOW, THEREFORE, it is hereby agreed as follows:

1. **Grant of Option.** The Corporation hereby grants to Optionee, as of the Grant Date, an option to purchase up to the number of Option Shares specified in the Grant Notice. The Option Shares shall be purchasable from time to time during the option term specified in Paragraph 2 at the Exercise Price.

2. **Option Term.** This option shall have a maximum term of nine (9) years measured from the Grant Date and shall accordingly expire at the close of business on the Expiration Date, unless sooner terminated in accordance with Paragraph 5 or 6 .

3. **Limited Transferability.** This option may, in connection with the Optionee's estate plan, be assigned in whole or in part during Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established for the exclusive benefit of one or more such family members. The assigned portion shall be exercisable only by the person or persons who acquire a proprietary interest in the option pursuant to such assignment. The terms applicable to the assigned portion shall be the same as those in effect for this option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Corporation may deem appropriate. Should the Optionee die while holding this option, then this option shall be transferred in accordance with Optionee's will or the laws of descent and distribution.

4. **Dates of Exercise.** This option shall become exercisable for the Option Shares in one or more installments as specified in the Grant Notice. As the option becomes exercisable for such installments, those installments shall accumulate and the option shall remain exercisable for the accumulated installments until the Expiration Date or sooner termination of the option term under Paragraph 5 or 6. As an administrative matter, the exercisable portion of this option may only be exercised until the close of the Nasdaq National Market (or Stock Exchange on which the Common Stock is primarily traded if applicable) (4:00 p.m. ET) on the last trading day before the Expiration Date or earlier date of termination of the option term under Paragraph 5. Any later attempt to exercise this option will not be honored due to the expiration of this option.

For example, if the Expiration Date is Monday, July 30, Optionee must exercise the exercisable portion of this option by 4:00 p.m. Eastern Time on Friday, July 27. Another example would be if Optionee ceases to remain in Service as provided in Paragraph 5(i) and the date three (3) months from the date of cessation is Monday, July 7, Optionee must exercise the exercisable portion of this option by 4:00 p.m. Eastern Time on Thursday, July 3. This is because Friday, July 4 is a holiday on which the Nasdaq National Market is closed for trading.

5. **Cessation of Service.** The option term specified in Paragraph 2 shall terminate (and this option shall cease to be outstanding) prior to the Expiration Date: (i) should Optionee's Service be terminated for Misconduct or (ii) should Optionee otherwise engage in Misconduct while this option is outstanding or (iii) should Optionee become an employee of (or render services to) any business enterprise which is then a current competitor of the Corporation (or a Parent or Subsidiary).

6. **Special Acceleration of Option**

(a) This option, to the extent outstanding at the time of a Corporate Transaction but not otherwise fully exercisable, shall automatically accelerate so that this option shall, immediately prior to the effective date of the Corporate Transaction, become exercisable for all of the Option Shares at the time subject to this option and may be exercised for any or all of those Option Shares as fully-vested shares of Common Stock. No such acceleration of this option, however, shall occur if and to the extent: (i) this option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation (or parent thereof) or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation (or parent thereof) or (ii) this option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested Option Shares at the time of the Corporate Transaction (the excess of the Fair Market Value of those Option Shares over the aggregate Exercise Price payable for such shares) and provides for subsequent pay-out in accordance with the same option exercise/vesting schedule set forth in the Grant Notice. The determination of option comparability under clause (i) shall be made by the Plan Administrator, and such determination shall be final, binding and conclusive.

(b) Immediately following the Corporate Transaction, this option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof) in connection with the Corporate Transaction.

(c) If this option is assumed in connection with a Corporate Transaction, then this option shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction, and appropriate adjustments shall also be made to the Exercise Price, provided the aggregate Exercise Price shall remain the same.

(d) This option, to the extent outstanding at the time of a Change in Control but not otherwise fully exercisable, shall automatically accelerate so that this option shall, immediately prior to the effective date of the Change in Control, become exercisable for all of the Option Shares at the

time subject to this option and may be exercised for any or all of those Option Shares as fully-vested shares of Common Stock. This option shall remain so exercisable until the Expiration Date or sooner termination of the option term.

(e) This Agreement shall not in any way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

7. **Adjustment in Option Shares.** Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the total number and/or class of securities subject to this option and (ii) the Exercise Price in order to reflect such change and thereby preclude a dilution or enlargement of benefits hereunder.

8. **Shareholder Rights.** The holder of this option shall not have any shareholder rights with respect to the Option Shares until such person shall have exercised the option, paid the Exercise Price and become a holder of record of the purchased shares.

9. **Manner of Exercising Option.**

(a) In order to exercise this option with respect to all or any part of the Option Shares for which this option is at the time exercisable, Optionee (or any other person or persons exercising the option) must take the following actions:

(i) Pay the aggregate Exercise Price for the purchased shares in one or more of the following forms:

(A) cash or check made payable to the Corporation;

(B) to the extent the option is exercised for vested Option Shares, through a special sale and remittance procedure pursuant to which Optionee (or any other person or persons exercising the option) shall concurrently provide irrevocable written instructions (I) to a Optionee-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate Exercise Price payable for the purchased shares plus all applicable taxes required to be withheld by the Corporation by reason of such exercise and (II) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale transaction;

(C) a promissory note payable to the Corporation, but only to the extent authorized by the Plan Administrator in accordance with Paragraph 13; and

(D) shares of Common Stock held by Optionee (or any other person or persons exercising the option) for the requisite period necessary to avoid a charge to the Corporation's

earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date.

- (ii) Furnish to the Corporation appropriate documentation that the person or persons exercising the option (if other than Optionee) have the right to exercise this option.
- (iii) Make appropriate arrangements with the Corporation (or Parent or Subsidiary employing or retaining Optionee) for the satisfaction of all tax withholding requirements applicable to the option exercise.
- (b) As soon as practical after the Exercise Date, the Corporation shall issue to or on behalf of Optionee (or any other person or persons exercising this option) a certificate for the purchased Option Shares, with the appropriate legends affixed thereto.
- (c) In no event may this option be exercised for any fractional shares.
- (d) Notwithstanding any other provisions of the Plan, this Agreement or any other agreement to the contrary, if at the time this option is exercised, Optionee is indebted to the Corporation (or any Parent or Subsidiary) for any reason, the following actions shall be taken, as deemed appropriate by the Plan Administrator:
 - (i) any shares of Common Stock to be issued upon such exercise shall automatically be pledged against Optionee's outstanding indebtedness; and
 - (ii) if this option is exercised in accordance with subparagraph 9(a)(i)(B) above, the after tax proceeds of the sale of Optionee's stock shall automatically be applied to the outstanding balance of Optionee's indebtedness.

10. Compliance with Laws and Regulations.

- (a) The exercise of this option and the issuance of the Option Shares upon such exercise shall be subject to compliance by the Corporation and Optionee with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange (or the Nasdaq National Market, if applicable) on which the Common Stock may be listed for trading at the time of such exercise and issuance.
- (b) The inability of the Corporation to obtain approval from any regulatory body having authority deemed by the Corporation to be necessary to the lawful issuance and sale of any Common Stock pursuant to this option shall relieve the Corporation of any liability with respect to the non-issuance or sale of the Common Stock as to which such approval shall not have been obtained. The Corporation, however, shall use its best efforts to obtain all such approvals.

11. Successors and Assigns. Except to the extent otherwise provided in Paragraphs 3 and 6, the provisions of this Agreement shall inure to the benefit of, and be binding upon, the Corporation and its successors and assigns and Optionee, Optionee's assigns and the legal representatives, heirs and legatees of Optionee's estate.

12. **Notices.** Any notice required to be given or delivered to the Corporation under the terms of this Agreement shall be in writing and addressed to the Corporation at its principal corporate offices. Any notice required to be given or delivered to Optionee shall be in writing and addressed to Optionee at the address indicated below Optionee's signature line on the Grant Notice. All notices shall be deemed effective upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

13. **Financing.** The Plan Administrator may, in its absolute discretion and without any obligation to do so, permit Optionee to pay the Exercise Price for the purchased Option Shares by delivering a full-recourse promissory note payable to the Corporation. The terms of any such promissory note (including the interest rate, the requirements for collateral and the terms of repayment) shall be established by the Plan Administrator in its sole discretion.

14. **Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the terms of the Plan. All decisions of the Plan Administrator with respect to any question or issue arising under the Plan or this Agreement shall be conclusive and binding on all persons having an interest in this option.

15. **Governing Law.** The interpretation, performance and enforcement of this Agreement shall be governed by the laws of the State of California without resort to that State's conflict-of-laws rules.

16. **Excess Shares.** If the Option Shares covered by this Agreement exceed, as of the Grant Date, the number of shares of Common Stock which may without shareholder approval be issued under the Plan, then this option shall be void with respect to those excess shares, unless shareholder approval of an amendment sufficiently increasing the number of shares of Common Stock issuable under the Plan is obtained in accordance with the provisions of the Plan.

17. **Further Instruments.** The parties agree to execute such further instruments and to take such further action as may be reasonably necessary to carry out the purposes and intent of this Agreement.

18. **Authorization to Release Necessary Personal Information.**

(a) Optionee hereby authorizes and directs Optionee's employer to collect, use and transfer in electronic or other form, any personal information (the "Data") regarding Optionee's employment, the nature and amount of Optionee's compensation and the fact and conditions of Optionee's participation in the Plan (including, but not limited to, Optionee's name, home address, telephone number, date of birth, social security number (or any other social or national identification number), salary, nationality, job title, number of shares of Common Stock held and the details of all options or any other entitlement to shares of Common Stock awarded, cancelled, exercised, vested, unvested or outstanding) for the purpose of implementing, administering and managing Optionee's participation in the Plan. Optionee understands that the Data may be transferred to the Corporation or any of its Subsidiaries, or to any third parties assisting in the

implementation, administration and management of the Plan, including any requisite transfer to a broker or other third party assisting with the exercise of Options under the Plan or with whom shares of Common Stock acquired upon exercise of this option or cash from the sale of such shares may be deposited. Optionee acknowledges that recipients of the Data may be located in different countries, and those countries may have data privacy laws and protections different from those in the country of Optionee's residence. Furthermore, Optionee acknowledges and understands that the transfer of the Data to the Corporation or any of its Subsidiaries, or to any third parties is necessary for Optionee's participation in the Plan.

(b) Optionee may at any time withdraw the consents herein, by contacting Optionee's local human resources representative in writing. Optionee further acknowledges that withdrawal of consent may affect Optionee's ability to exercise or realize benefits from the option, and Optionee's ability to participate in the Plan.

19. No Entitlement or Claims for Compensation.

(a) The grant of options under the Plan is made at the discretion of the Plan Administrator, and the Plan may be suspended or terminated by the Corporation at any time. The grant of an option in one year or at one time does not in any way entitle Optionee to an option grant in the future. The Plan is wholly discretionary in nature and is not to be considered part of Optionee's normal or expected compensation subject to severance, resignation, redundancy or similar compensation. The value of the option is an extraordinary item of compensation which is outside the scope of Optionee's employment contract (if any).

(b) Optionee shall have no rights to compensation or damages as a result of Optionee's cessation of Service for any reason whatsoever, whether or not in breach of contract, insofar as those rights arise or may arise from Optionee's ceasing to have rights under or be entitled to exercise this option as a result of such cessation or from the loss or diminution in value of such rights. If Optionee did acquire any such rights, Optionee is deemed to have waived them irrevocably by accepting the option.

Appendix

The following definitions shall be in effect under the Agreement:

A. **Agreement** shall mean this Stock Option Agreement.

B. **Board** shall mean the Corporation's Board of Directors.

C. **Change in Control** shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than thirty-five percent (35%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's shareholders which the Board does not recommend such shareholders to accept, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

D. **Code** shall mean the Internal Revenue Code of 1986, as amended.

E. **Common Stock** shall mean the Corporation's common stock.

F. **Corporate Transaction** shall mean either of the following shareholder-approved transactions to which the Corporation is a party:

(i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction, or

(ii) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

G. **Corporation** shall mean Cisco Systems, Inc., a California corporation.

H. **Employee** shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

I. **Exercise Date** shall mean the date on which the option shall have been exercised in accordance with Paragraph 9 of the Agreement.

J. **Exercise Price** shall mean the exercise price per share as specified in the Grant Notice.

K. **Expiration Date** shall mean the date on which the option expires as specified in the Grant Notice.

L. **Fair Market Value** per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(i) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as the price is reported by the National Association of Securities Dealers on the Nasdaq National Market or any successor system. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(ii) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

M. **Grant Date** shall mean the date of grant of the option as specified in the Grant Notice.

N. **Grant Notice** shall mean the Notice of Grant of Stock Option accompanying the Agreement, pursuant to which Optionee has been informed of the basic terms of the option evidenced hereby.

O. **Incentive Option** shall mean an option which satisfies the requirements of Code Section 422.

P. **Misconduct** shall mean the commission of any act of fraud, embezzlement or dishonesty by Optionee, any unauthorized use or disclosure by Optionee of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by Optionee adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of Optionee or any other individual in the Service of the Corporation (or any Parent or Subsidiary).

Q. **1934 Act** shall mean the Securities Exchange Act of 1934, as amended.

R. **Non-Statutory Option** shall mean an option not intended to satisfy the requirements of Code Section 422.

S. **Option Shares** shall mean the number of shares of Common Stock subject to the option as specified in the Grant Notice.

T. **Optionee** shall mean the person to whom the option is granted as specified in the Grant Notice.

U. **Parent** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

V. **Permanent Disability** shall mean the inability of Optionee to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which is expected to result in death or has lasted or can be expected to last for a continuous period of twelve (12) months or more.

W. **Plan** shall mean the Corporation's 1996 Stock Incentive Plan.

X. **Plan Administrator** shall mean either the Board or a committee of the Board acting in its administrative capacity under the Plan.

Y. **Service** shall mean the Optionee's performance of services for the Corporation (or any Parent or Subsidiary) in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor. For purposes of this option, Service shall not be considered terminated if Optionee is rendering services only to an accredited institution of higher education and/or a federal, state or local government agency or entity, in each case whose conflict of interest rules prevent Optionee from continuing to render services to the Corporation (or any Parent or Subsidiary).

Z. **Stock Exchange** shall mean the American Stock Exchange or the New York Stock Exchange.

AA. **Subsidiary** shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

INDEMNIFICATION AGREEMENT

THIS AGREEMENT, made and entered into as of _____ day of _____ between Cisco Systems, Inc., a California corporation (“Corporation”), and _____ (“Officer”),

WITNESSETH THAT:

WHEREAS, Officer is an executive officer of Corporation, and in such capacity performs a valuable service for Corporation; and

WHEREAS, in accordance with the authorization provided by Section 204(a)(11) of the California General Corporation Code, as amended (“Code”), Article V of the Restated Articles of Incorporation, as amended (the “Articles”), authorizes Corporation to provide indemnification to its officers through agreements with such officers in excess of the indemnification otherwise permitted by Section 317 of the Code; and

WHEREAS, Corporation recognizes that the indemnification provided by this Agreement is of great importance in attracting highly qualified individuals, such as Officer, to serve as executive officers of Corporation; and

WHEREAS, in order to induce Officer to continue to serve as an executive officer of Corporation, Corporation has determined and agreed to enter into this Agreement with Officer for the purpose of fully implementing the provisions of Sections 204(a)(11) and 317 of the Code and Article V of the Articles;

NOW, THEREFORE, in consideration of Officer’s continued service as a Officer after the date hereof, the parties hereto agree as follows:

1. Indemnity of Officer. Corporation hereby agrees to hold harmless and indemnify Officer to the fullest extent authorized by the provisions of Section 317 of the Code, as it may be amended from time to time.

2. Additional Indemnity. Subject only to the limitations set forth in Section 3 hereof, Corporation hereby further agrees to hold harmless and indemnify Officer:

(a) against any and all expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by Officer in connection with any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (including an action by or in the right of Corporation) to which Officer is, was or at any time becomes a party, or is threatened to be made a party, by reason of the fact that Officer is, was or at any time becomes an officer, employee or agent of Corporation, or is or was serving or at any time serves at the request of Corporation as an officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise; and

(b) otherwise to the fullest extent as indemnification may be provided to Officer by Corporation under the provisions of Article V of the Articles and Sections 204(a)(11) and 317 of the Code.

3. Limitations on Additional Indemnity.

(a) No indemnification pursuant to Section 2 hereof shall be paid by Corporation for any of the following:

(i) to the extent that Officer is or has been indemnified or reimbursed pursuant to Section 1 hereof or any Directors and Officers Liability Insurance (“D & O Insurance”) purchased and maintained by Corporation;

(ii) with respect to remuneration paid to Officer if it shall be determined by a final judgment or other final adjudication that such remuneration was in violation of law;

(iii) on account of any suit pursuant to the provisions of Section 16(b) of the Securities Exchange Act of 1934, as amended, and amendments thereto or similar provisions of any federal, state or local statutory law in which judgment is rendered against Officer for an accounting of profits made from the purchase or sale by Officer of securities of Corporation;

(iv) if a final decision by a court having jurisdiction in the matter shall determine that such indemnification is not lawful; or

(v) on account of any action, suit or proceeding (other than a proceeding referred to in Section 8(b) hereof) commenced by the Officer against Corporation or against any director, officer or shareholder of Corporation unless authorized in the specific case by action of the Board of Directors;

(b) In addition to those limitations set forth above in paragraph (a) of this Section 3, no indemnification pursuant to Section 2 hereof in an action brought by or in the right of Corporation for breach of the Officer’s duties to Corporation and its shareholders shall be paid by Corporation for any of the following:

(i) on account of Officer’s acts or omissions that involve intentional misconduct or a knowing and culpable violation of law;

(ii) on account of acts or omissions that Officer believes to be contrary to the best interests of Corporation or its shareholders or that involve the absence of good faith on the part of Officer;

(iii) with respect to any transaction from which Officer derived an improper personal benefit;

(iv) on account of acts or omissions that show a reckless disregard for Officer’s duty to Corporation or its shareholders in circumstances in which Officer was aware, or should have been aware, in the ordinary course of performing a Officer’s duties, of a risk of serious injury to Corporation or its shareholders;

(v) on account of acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of Officer's duty to Corporation or its shareholders;

(vi) to the extent prohibited by Section 310 of the Code (contracts in which a director has material financial interest), if applicable;

(vii) to the extent prohibited by Section 316 of the Code (corporate actions subjecting directors to joint and several liability for prohibited distributions, loans and guarantees), if applicable; or,

(viii) in any circumstances in which indemnity is expressly prohibited by Section 317 of the Code.

4. Contribution. If the indemnification provided in Sections 1 and 2 is unavailable and may not be paid to Officer for any reason other than those set forth in Section 3 (excluding subsections 3(b)(viii)), then in respect of any threatened, pending or completed action, suit or proceeding in which Corporation is jointly liable with Officer (or would be if joined in such action, suit or proceeding), Corporation shall contribute to the amount of expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred and paid or payable by Officer in such proportion as is appropriate to reflect (i) the relative benefits received by Corporation on the one hand and Officer on the other hand from the transaction from which such action, suit or proceeding arose, and (ii) the relative fault of Corporation on the one hand and of Officer on the other in connection with the events which resulted in such expenses, judgments, fines or settlement amounts, as well as any other relevant equitable considerations. The relative fault of Corporation on the one hand and of Officer on the other shall be determined by reference to, among other things, the parties' relative intent, knowledge, access to information and opportunity to correct or prevent the circumstances resulting in such expenses, judgments, fines or settlement amounts. Corporation agrees that it would not be just and equitable if contribution pursuant to this Section 4 were determined by pro rata allocation or any other method of allocation that does not take account of the foregoing equitable considerations.

5. Continuation of Obligations. All agreements and obligations of Corporation contained herein shall continue during the period Officer is a director, officer, employee or agent of Corporation (or is or was serving at the request of Corporation as an officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise) and shall continue thereafter so long as Officer shall be subject to any possible claim or threatened, pending or completed action, suit or proceeding, whether civil, criminal or investigative, by reason of the fact that Officer was an officer of Corporation or serving in any other capacity referred to herein.

6. Notification and Defense of Claim. Promptly after receipt by Officer of notice of the commencement of any action, suit or proceeding, Officer will, if a claim in respect thereof is to be made against Corporation under this Agreement, notify Corporation of the commencement thereof; but the omission so to notify Corporation will not relieve it from any liability which it may have to Officer otherwise than under this Agreement. With respect to any

such action, suit or proceeding as to which Officer notifies Corporation of the commencement thereof:

(a) Corporation will be entitled to participate therein at its own expense;

(b) Except as otherwise provided below, to the extent that it may wish, Corporation jointly with any other indemnifying party similarly notified will be entitled to assume the defense thereof, with counsel satisfactory to Officer (such consent not to be unreasonably withheld). After notice from Corporation to Officer of its election to assume the defense thereof, Corporation will not be liable to Officer under this Agreement for any legal or other expenses subsequently incurred by Officer in connection with the defense thereof other than reasonable costs of investigation or as otherwise provided below. Officer shall have the right to employ counsel in such action, suit or proceeding but the fees and expenses of such counsel incurred after notice from Corporation of its assumption of the defense thereof shall be at the expense of Officer unless (i) the employment of counsel by Officer has been authorized by Corporation, (ii) Officer shall have reasonably concluded that there may be a conflict of interest between Corporation and Officer in the conduct of the defense of such action, or (iii) Corporation shall not in fact have employed counsel to assume the defense of such action, in each of which cases the fees and expenses of counsel shall be at the expense of Corporation. Corporation shall not be entitled to assume the defense of any action, suit or proceeding brought by or on behalf of Corporation or as to which Officer shall have made the conclusion provided for in (ii) above; and

(c) Corporation shall not be liable to indemnify Officer under this Agreement for any amounts paid in settlement of any action or claim effected without its written consent. Corporation shall not settle any action or claim in any manner that would impose any penalty or limitation on Officer without Officer's written consent. Neither Corporation nor Officer will unreasonably withhold its consent to any proposed settlement.

7. Advancement and Repayment of Expenses.

(a) In the event that Officer employs his or her own counsel pursuant to Section 6(b)(i) through (iii) above, Corporation shall advance to Officer, prior to any final disposition of any threatened or pending action, suit or proceeding, whether civil, criminal, administrative or investigative, any and all reasonable expenses (including legal fees and expenses) incurred in investigating or defending any such action, suit or proceeding within ten (10) days after receiving copies of invoices presented to Officer for such expenses; and

(b) Officer agrees that Officer will reimburse Corporation for all reasonable expenses paid by Corporation in defending any civil or criminal action, suit or proceeding against Officer in the event and only to the extent it shall be ultimately determined by a final judicial decision (from which there is no right of appeal) that Officer is not entitled, under applicable law, the Articles or Bylaws, this Agreement or otherwise, to be indemnified by Corporation for such expenses.

8. Enforcement.

(a) Corporation expressly confirms and agrees that it has entered into this Agreement and assumed the obligations imposed on Corporation hereby in order to induce Officer to serve as a Officer of Corporation, and acknowledges that Officer is relying upon this Agreement in serving in such capacity.

(b) In the event Officer is required to bring any action to enforce rights or to collect moneys due under this Agreement and is successful in such action, Corporation shall reimburse Officer for all of Officer's reasonable fees and expenses in bringing and pursuing such action.

9. Separability. Each of the provisions of this Agreement is a separate and distinct agreement and independent of the others, so that if any provision hereof shall be held to be invalid or unenforceable for any reason, such invalidity or unenforceability shall not affect the validity or enforceability of the other provisions hereof.

10. Governing Law. This Agreement shall be interpreted and enforced in accordance with the laws of the State of California.

11. Binding Effect. This Agreement shall be binding upon Officer and upon Corporation, and their respective successors and assigns, and shall inure to the benefit of Officer, his or her heirs, personal representatives and assigns and to the benefit of Corporation, its successors and assigns.

12. Amendment and Termination. No amendment, modification, termination or cancellation of this Agreement shall be effective unless in writing signed by both parties hereto.

13. Subrogation. In the event of payment under this Agreement, Corporation shall be subrogated to the extent of such payment to any right Officer may have for recovery of the amounts so paid from any third party. Officer agrees to execute all documents required and do all other acts necessary to effect the foregoing provisions and permit Corporation to enforce the rights so subrogated.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

CISCO SYSTEMS, INC.

By: _____

OFFICER

INDEMNIFICATION AGREEMENT

THIS AGREEMENT, made and entered into as of ____ day of _____ between Cisco Systems, Inc., a California corporation (“Corporation”), and _____ (“Director”),

WITNESSETH THAT:

WHEREAS, Director is a member of the Board of Directors of Corporation, and in such capacity performs a valuable service for Corporation; and

WHEREAS, in accordance with the authorization provided by subsections (a)(10) and (a)(11) of Section 204 of the California General Corporation Code, as amended (“Code”), Article V of the Restated Articles of Incorporation, as amended (the “Articles”), provides that the liability of Directors of Corporation for monetary damages shall be eliminated to the fullest extent permissible under California law and authorizes Corporation to provide indemnification to members of its Board of Directors through agreements with such members in excess of the indemnification otherwise permitted by Section 317 of the Code; and

WHEREAS, Corporation recognizes that the indemnification provided by this Agreement is of great importance in attracting highly qualified individuals, such as Director, to serve as members of its Board of Directors; and

WHEREAS, in order to induce Director to continue to serve as a member of the Board of Directors of Corporation, Corporation has determined and agreed to enter into this Agreement with Director for the purpose of fully implementing the provisions of Section 204 and Section 317 of the Code and Article V of the Articles;

NOW, THEREFORE, in consideration of Director’s continued service as a director after the date hereof, the parties hereto agree as follows:

1. Indemnity of Director. Corporation hereby agrees to hold harmless and indemnify Director to the fullest extent authorized by the provisions of Section 317 of the Code, as it may be amended from time to time.

2. Additional Indemnity. Subject only to the limitations set forth in Section 3 hereof, Corporation hereby further agrees to hold harmless and indemnify Director:

(a) against any and all expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by Director in connection with any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (including an action by or in the right of Corporation) to which Director is, was or at any time becomes a party, or is threatened to be made a party, by reason of the fact that Director is, was or at any time becomes a director, officer, employee or agent of Corporation, or is or was serving or at any time serves at the request of Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise; and

(b) otherwise to the fullest extent as indemnification may be provided to Director by Corporation under the provisions of Article V of the Articles and Sections 204(a)(11) and 317 of the Code.

3. Limitations on Additional Indemnity.

(a) No indemnification pursuant to Section 2 hereof shall be paid by Corporation for any of the following:

(i) to the extent that Director is or has been indemnified or reimbursed pursuant to Section 1 hereof or any Directors and Officers Liability Insurance (“D & O Insurance”) purchased and maintained by Corporation;

(ii) with respect to remuneration paid to Director if it shall be determined by a final judgment or other final adjudication that such remuneration was in violation of law;

(iii) on account of any suit pursuant to the provisions of Section 16(b) of the Securities Exchange Act of 1934, as amended, and amendments thereto or similar provisions of any federal, state or local statutory law in which judgment is rendered against Director for an accounting of profits made from the purchase or sale by Director of securities of Corporation;

(iv) if a final decision by a court having jurisdiction in the matter shall determine that such indemnification is not lawful; or

(v) on account of any action, suit or proceeding (other than a proceeding referred to in Section 8(b) hereof) commenced by the Director against Corporation or against any officer, director or shareholder of Corporation unless authorized in the specific case by action of the Board of Directors;

(b) In addition to those limitations set forth above in paragraph (a) of this Section 3, no indemnification pursuant to Section 2 hereof in an action brought by or in the right of Corporation for breach of the Directors duties to Corporation and its shareholders shall be paid by Corporation for any of the following:

(i) on account of Director’s acts or omissions that involve intentional misconduct or a knowing and culpable violation of law;

(ii) on account of acts or omissions that Director believes to be contrary to the best interests of Corporation or its shareholders or that involve the absence of good faith on the part of Director;

(iii) with respect to any transaction from which Director derived an improper personal benefit;

(iv) on account of acts or omissions that show a reckless disregard for Director’s duty to Corporation or its shareholders in circumstances in which Director was

aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to Corporation or its shareholders;

(v) on account of acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of Director's duty to Corporation or its shareholders;

(vi) to the extent prohibited by Section 310 of the Code (contracts in which a director has material financial interest);

(vii) to the extent prohibited by Section 316 of the Code (corporate actions subjecting directors to joint and several liability for prohibited distributions, loans and guarantees); or,

(viii) in any circumstances in which indemnity is expressly prohibited by Section 317 of the Code.

4. Contribution. If the indemnification provided in Sections 1 and 2 is unavailable and may not be paid to Director for any reason other than those set forth in Section 3 (excluding subsections 3(b)(viii)), then in respect of any threatened, pending or completed action, suit or proceeding in which Corporation is jointly liable with Director (or would be if joined in such action, suit or proceeding), Corporation shall contribute to the amount of expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred and paid or payable by Director in such proportion as is appropriate to reflect (i) the relative benefits received by Corporation on the one hand and Director on the other hand from the transaction from which such action, suit or proceeding arose, and (ii) the relative fault of Corporation on the one hand and of Director on the other in connection with the events which resulted in such expenses, judgments, fines or settlement amounts, as well as any other relevant equitable considerations. The relative fault of Corporation on the one hand and of Director on the other shall be determined by reference to, among other things, the parties' relative intent, knowledge, access to information and opportunity to correct or prevent the circumstances resulting in such expenses, judgments, fines or settlement amounts. Corporation agrees that it would not be just and equitable if contribution pursuant to this Section 4 were determined by pro rata allocation or any other method of allocation that does not take account of the foregoing equitable considerations.

5. Continuation of Obligations. All agreements and obligations of Corporation contained herein shall continue during the period Director is a director, officer, employee or agent of Corporation (or is or was serving at the request of Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise) and shall continue thereafter so long as Director shall be subject to any possible claim or threatened, pending or completed action, suit or proceeding, whether civil, criminal or investigative, by reason of the fact that Director was a director of Corporation or serving in any other capacity referred to herein.

6. Notification and Defense of Claim. Promptly after receipt by Director of notice of the commencement of any action, suit or proceeding, Director will, if a claim in respect

thereof is to be made against Corporation under this Agreement, notify Corporation of the commencement thereof; but the omission so to notify Corporation will not relieve it from any liability which it may have to Director otherwise than under this Agreement. With respect to any such action, suit or proceeding as to which Director notifies Corporation of the commencement thereof:

(a) Corporation will be entitled to participate therein at its own expense;

(b) Except as otherwise provided below, to the extent that it may wish, Corporation jointly with any other indemnifying party similarly notified will be entitled to assume the defense thereof, with counsel satisfactory to Director (such consent not to be unreasonably withheld). After notice from Corporation to Director of its election to assume the defense thereof, Corporation will not be liable to Director under this Agreement for any legal or other expenses subsequently incurred by Director in connection with the defense thereof other than reasonable costs of investigation or as otherwise provided below. Director shall have the right to employ counsel in such action, suit or proceeding but the fees and expenses of such counsel incurred after notice from Corporation of its assumption of the defense thereof shall be at the expense of Director unless (i) the employment of counsel by Director has been authorized by Corporation, (ii) Director shall have reasonably concluded that there may be a conflict of interest between Corporation and Director in the conduct of the defense of such action, or (iii) Corporation shall not in fact have employed counsel to assume the defense of such action, in each of which cases the fees and expenses of counsel shall be at the expense of Corporation. Corporation shall not be entitled to assume the defense of any action, suit or proceeding brought by or on behalf of Corporation or as to which Director shall have made the conclusion provided for in (ii) above; and

(c) Corporation shall not be liable to indemnify Director under this Agreement for any amounts paid in settlement of any action or claim effected without its written consent. Corporation shall not settle any action or claim in any manner that would impose any penalty or limitation on Director without Director's written consent. Neither Corporation nor Director will unreasonably withhold its consent to any proposed settlement.

7. Advancement and Repayment of Expenses .

(a) In the event that Director employs his or her own counsel pursuant to Section 6(b)(i) through (iii) above, Corporation shall advance to Director, prior to any final disposition of any threatened or pending action, suit or proceeding, whether civil, criminal, administrative or investigative, any and all reasonable expenses (including legal fees and expenses) incurred in investigating or defending any such action, suit or proceeding within ten (10) days after receiving copies of invoices presented to Director for such expenses; and

(b) Director agrees that Director will reimburse Corporation for all reasonable expenses paid by Corporation in defending any civil or criminal action, suit or proceeding against Director in the event and only to the extent it shall be ultimately determined by a final judicial decision (from which there is no right of appeal) that Director is not entitled, under applicable law, the Articles or Bylaws, this Agreement or otherwise, to be indemnified by Corporation for such expenses.

8. Enforcement.

(a) Corporation expressly confirms and agrees that it has entered into this Agreement and assumed the obligations imposed on Corporation hereby in order to induce Director to serve as a director of Corporation, and acknowledges that Director is relying upon this Agreement in serving in such capacity.

(b) In the event Director is required to bring any action to enforce rights or to collect moneys due under this Agreement and is successful in such action, Corporation shall reimburse Director for all of Director's reasonable fees and expenses in bringing and pursuing such action.

9. Separability. Each of the provisions of this Agreement is a separate and distinct agreement and independent of the others, so that if any provision hereof shall be held to be invalid or unenforceable for any reason, such invalidity or unenforceability shall not affect the validity or enforceability of the other provisions hereof.

10. Governing Law. This Agreement shall be interpreted and enforced in accordance with the laws of the State of California.

11. Binding Effect. This Agreement shall be binding upon Director and upon Corporation, and their respective successors and assigns, and shall inure to the benefit of Director, his or her heirs, personal representatives and assigns and to the benefit of Corporation, its successors and assigns.

12. Amendment and Termination. No amendment, modification, termination or cancellation of this Agreement shall be effective unless in writing signed by both parties hereto.

13. Subrogation. In the event of payment under this Agreement, Corporation shall be subrogated to the extent of such payment to any right Director may have for recovery of the amounts so paid from any third party. Director agrees to execute all documents required and do all other acts necessary to effect the foregoing provisions and permit Corporation to enforce the rights so subrogated.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

CISCO SYSTEMS, INC.

By: _____

DIRECTOR

SELECTED FINANCIAL DATA

Five Years Ended July 31, 2004 (in millions, except per-share amounts)

The following selected financial data should be read in conjunction with the Consolidated Financial Statements and related notes:

	<u>July 31, 2004</u>	<u>July 26, 2003</u>	<u>July 27, 2002</u>	<u>July 28, 2001</u>	<u>July 29, 2000</u>
Net sales	\$ 22,045	\$ 18,878	\$ 18,915	\$ 22,293	\$ 18,928
Net income (loss)	\$ 4,401 ⁽²⁾	\$ 3,578	\$ 1,893	\$ (1,014) ⁽³⁾	\$ 2,668
Net income (loss) per share — basic	\$ 0.64	\$ 0.50	\$ 0.26	\$ (0.14)	\$ 0.39
Net income (loss) per share — diluted ⁽¹⁾	\$ 0.62	\$ 0.50	\$ 0.25	\$ (0.14)	\$ 0.36
Shares used in per-share calculation — basic	6,840	7,124	7,301	7,196	6,917
Shares used in per-share calculation — diluted ⁽¹⁾	7,057	7,223	7,447	7,196	7,438
Cash and cash equivalents and total investments	\$ 19,267	\$ 20,652	\$ 21,456	\$ 18,517	\$ 20,499
Total assets	\$ 35,594	\$ 37,107	\$ 37,795	\$ 35,238	\$ 32,870

Note 1: Diluted net income per share is computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and excludes dilutive potential common shares, as their effect is antidilutive. The weighted-average dilutive potential common shares, which were antidilutive for fiscal 2001, amounted to 348 million shares.

Note 2: Net income for fiscal 2004 included a noncash charge for the cumulative effect of accounting change relating to a stock compensation charge of \$567 million, net of tax. See Note 3 to the Consolidated Financial Statements.

Note 3: Net loss for fiscal 2001 included restructuring costs and other special charges of \$1.2 billion. See Note 4 to the Consolidated Financial Statements. In addition, net loss for fiscal 2001 included an additional excess inventory charge of \$2.2 billion recorded in the third quarter period.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," "continues," "may," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses (including the potential growth of Advanced Technologies), and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, as well as on the inside back cover of this Annual Report to Shareholders and under "Risk Factors," and elsewhere in our Annual Report on Form 10-K. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

OVERVIEW

We sell scalable, standards-based networking products that address a wide range of customers' business needs, including improving productivity, reducing costs, and gaining a competitive advantage. Our corresponding technology focus is on delivering networking products and systems that simplify customers' infrastructures, offer integrated services, and are highly secure. Our products and services help customers build their own network infrastructures while providing tools to allow them to communicate with key stakeholders, including customers, prospects, business partners, suppliers, and employees. Our product offerings fall into several categories: our core technologies, routing and switching; Advanced Technologies (home networking, IP telephony, optical networking, security, storage area networking, and wireless technology); and other products, including our access products and network management software. Our customer base spans virtually all types of public and private agencies and enterprises, comprising enterprise customers, service provider customers, and commercial customers. We also have customers in the consumer market through our Linksys division.

As we entered fiscal 2004, we articulated three long-term financial priorities:

- Seeking profitable growth opportunities while supporting our profitability targets;
- Continuing to improve productivity; and
- Maintaining our healthy balance sheet.

Our results for fiscal 2004 indicate that we made substantial progress toward these goals. Net sales were \$22.0 billion, compared with \$18.9 billion in fiscal 2003. Net income was \$4.4 billion, compared with \$3.6 billion in fiscal 2003. Diluted earnings per share was \$0.62, compared with \$0.50 in fiscal 2003. Cash flows from operations were \$7.1 billion, compared with \$5.2 billion for fiscal 2003.

All of our geographic segments contributed to our revenue growth in fiscal 2004 as general economic conditions around the world began to improve from the recent economic downturn. We also improved our productivity, as operating expenses as a percentage of sales improved by 4% from fiscal 2003. With regard to our balance sheet, at the end of fiscal 2004, cash and cash equivalents and investments totaled \$19.3 billion, days sales outstanding (DSO) were 28 days, and annualized inventory turns were 6.4. During the fiscal year, we repurchased \$9.1 billion or 408 million shares of our common stock at an average price of \$22.30.

Our technology vision is based on an architectural evolution of networking from simple connectivity of products to intelligent systems, or as we refer to it, the Intelligent Information Network. As such, many of our strategic initiatives and investments are aimed at meeting the requirements of an Intelligent Information Network. If networking evolves the way we think it will, we believe we have positioned ourselves well versus our key competitors, but if it does not, our initiatives and investments in this area may be of no or limited value. In general, our markets are very competitive, and, in addition to positioning Cisco in relation to our traditional competitors, we are also positioning ourselves to address new competitors, especially from Asia.

We rely on internal innovation along with strategic alliances and acquisitions to provide innovative products to enhance our competitive position. Our ability to innovate internally requires us to attract and retain top talent in a very competitive industry. We have made plans to hire up to 1,000 new employees in fiscal 2005, primarily for engineering and sales positions. In addition, we believe our acquisitions have the potential to bring both talent and technology to Cisco, and we expect to continue to make strategic acquisitions.

As we evaluate our growth prospects and manage our operations for the future, we continue to believe that the leading indicator of our growth will be the gross domestic product, or GDP, of the countries into which we sell our products. We regard the willingness to take good business risk as part of our strategy, and we intend to be aggressive in this respect. For example, during fiscal 2004, we steadily decreased product lead times for our customers. While these shortened lead times potentially increase our exposure to changes in economic conditions, we believe this investment increases customer satisfaction.

In fiscal 2005, we will continue to focus on our three major growth areas of core routing and switching, service provider, and Advanced Technologies, as well as our expectation of network architecture evolution, while maintaining our focus on profit contribution. Among the key external factors that will influence our fiscal 2005 performance are the continued improvement of the global economy and our customers' perspective regarding the prospects for improving conditions.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions, and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 2 to the Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. We consider the accounting policies described below to be affected by critical accounting estimates. Such accounting policies are impacted significantly by judgments, assumptions, and estimates used in the preparation of the Consolidated Financial Statements, and actual results could differ materially from the amounts reported based on these policies.

Revenue Recognition

Our networking and communications products are integrated with software that is essential to the functionality of the equipment. We provide unspecified software upgrades and enhancements related to the equipment through our maintenance contracts. Accordingly, we account for revenue in accordance with Statement No. 97-2, "Software Revenue Recognition," and all related interpretations. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is reasonably assured. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Our total deferred revenue for products was \$1.5 billion and \$1.4 billion as of July 31, 2004 and July 26, 2003, respectively. Service revenue is generally deferred and, in most cases, recognized ratably over the period during which the services are to be performed, which is typically from one to three years. Our total deferred revenue for services was \$3.0 billion and \$2.5 billion as of July 31, 2004 and July 26, 2003, respectively.

Contracts, Internet commerce agreements, and customer purchase orders are generally used to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history.

When a sale involves multiple elements, such as sales of products that include services, the entire fee from the arrangement is allocated to each respective element based on its relative fair value and recognized when revenue recognition criteria for each element are met. The amount of product and service revenue recognized is impacted by our judgments as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence of fair value exists for those elements. Changes to the elements in an arrangement and our ability to establish vendor-specific objective evidence for those elements could affect the timing of the revenue recognition.

We make sales to distributors and retail partners and recognize revenue based on a sell-through method using information provided by them. Our distributors and retail partners participate in various cooperative marketing and other programs, and we maintain estimated accruals and allowances for these programs. If actual credits received by our distributors and retail partners for these programs were to deviate significantly from our estimates, which are based on historical experience, our revenue could be adversely affected.

Allowance for Doubtful Accounts and Sales Returns

Our accounts receivable balance, net of allowance for doubtful accounts, was \$1.8 billion as of July 31, 2004, compared with \$1.4 billion as of July 26, 2003. The allowance for doubtful accounts as of July 31, 2004 was \$179 million, compared with \$183 million as of July 26, 2003. The allowance is based on our assessment of the collectibility of customer accounts. We regularly review the allowance by considering factors such as historical experience, credit quality, age of the accounts receivable balances, and current economic conditions that may affect a customer's ability to pay.

Our provision (credit) for doubtful accounts was \$19 million, (\$59) million, and \$91 million for fiscal 2004, 2003, and 2002, respectively. In fiscal 2003, we recorded a credit for doubtful accounts as a result of the improvement in the collectibility of specific customer accounts due to increased credit quality and resolution of disputes. If a major customer's creditworthiness deteriorates, or if actual defaults are higher than our historical experience, or if other circumstances arise, our estimates of the recoverability of amounts due to us could be overstated, and additional allowances could be required, which could have an adverse impact on our revenue.

A reserve for sales returns is established based on historical trends in product return rates. The reserve for sales returns as of July 31, 2004 and July 26, 2003 included \$74 million and \$73 million, respectively, for estimated future returns that were recorded as a reduction of our accounts receivable. If the actual future returns were to deviate from the historical data on which the reserve had been established, our revenue could be adversely affected.

Allowance for Inventory

Our inventory balance was \$1.2 billion as of July 31, 2004, compared with \$873 million as of July 26, 2003. Our inventory allowances as of July 31, 2004 were \$139 million, compared with \$122 million as of July 26, 2003. We provide inventory allowances based on excess and obsolete inventories determined primarily by future demand forecasts. The allowance is measured as the difference between the cost of the inventory and market based upon assumptions about future demand and is charged to the provision for inventory, which is a component of our cost of sales. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

Our provision for inventory was \$205 million, \$70 million, and \$131 million for fiscal 2004, 2003, and 2002, respectively. If there were to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements, we could be required to increase our inventory allowances, and our gross margin could be adversely affected. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times compared with the risk of inventory obsolescence.

Warranty Costs

The liability for product warranties, included in other accrued liabilities, was \$239 million as of July 31, 2004, compared with \$246 million as of July 26, 2003. See Note 8 to the Consolidated Financial Statements. Our products sold are generally covered by a warranty for periods ranging from 90 days to five years, and for some products we provide a limited lifetime warranty. We accrue for warranty costs as part of our cost of sales based on associated material costs, technical support labor costs, and associated overhead. Material cost is estimated based primarily upon historical trends in the volume of product returns within the warranty period and the cost to repair or replace the equipment. Technical support labor cost is estimated based primarily upon historical trends in the rate of customer cases and the cost to support the customer cases within the warranty period. Overhead cost is applied based on estimated time to support warranty activities.

The provision for product warranties issued during fiscal 2004 and 2003 was \$333 million and \$342 million, respectively. If we experience an increase in warranty claims compared with our historical experience, or if the cost of servicing warranty claims is greater than the expectations on which the accrual has been based, our gross margin could be adversely affected.

Investment Impairments

Our publicly traded equity securities are reflected in the Consolidated Balance Sheets at a fair value of \$1.1 billion as of July 31, 2004, compared with \$745 million as of July 26, 2003. See Note 7 to the Consolidated Financial Statements. We recognize an impairment charge when the declines in the fair values of our publicly traded equity securities below their cost basis are judged to be other-than-temporary. The ultimate value realized on these equity securities is subject to market price volatility until they are sold. We consider various factors in determining whether we should recognize an impairment charge, including the length of time and extent to which the fair value has been less than our cost basis, the financial condition and near-term prospects of the investee, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. Our ongoing consideration of these factors could result in additional impairment charges in the future, which could adversely affect our net income. There was no impairment charge of publicly traded equity securities recorded during fiscal 2004. During fiscal 2003 and 2002, we recognized charges of \$412 million and \$858 million, respectively, attributable to the impairment of certain publicly traded equity securities.

We also have investments in privately held companies, some of which are in the startup or development stages. As of July 31, 2004, our investments in privately held companies were \$354 million, compared with \$516 million as of July 26, 2003, and were included in other assets. See Note 5 to the Consolidated Financial Statements. We monitor these investments for impairment and make appropriate reductions in carrying values if we determine an impairment charge is required, based primarily on the financial condition and near-term prospects of these companies. These investments are inherently risky, as the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. Our impairment charges on investments in privately held companies were \$112 million, \$281 million, and \$420 million during fiscal 2004, 2003, and 2002, respectively.

Goodwill Impairments

Our methodology for allocating the purchase price relating to purchase acquisitions is determined through established valuation techniques in the high-technology communications equipment industry. Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. We perform goodwill impairment tests on an annual basis and between annual tests in certain circumstances for each reporting unit. The goodwill recorded in the Consolidated Balance Sheets as of July 31, 2004 and July 26, 2003 was \$4.2 billion and \$4.0 billion, respectively. In response to changes in industry and market conditions, we could be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill. Based on impairment tests performed, there was no impairment of goodwill in fiscal 2004, 2003, and 2002.

Income Taxes

We are subject to income taxes in both the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes and interest will be due. These reserves are established when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are likely to be challenged and may not be sustained on review by tax authorities. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

Our effective tax rates differ from the statutory rate primarily due to acquisition-related costs, research and experimentation tax credits, state taxes, and the tax impact of foreign operations. The effective tax rate was 28.9%, 28.6%, and 30.1% for fiscal 2004, 2003, and 2002, respectively. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted and whether new accruals are required.

FINANCIAL DATA FOR FISCAL 2004, 2003, AND 2002

Net Sales

We manage our business based on four geographic theaters: the Americas; Europe, the Middle East, and Africa (“EMEA”); Asia Pacific; and Japan. Net sales, which include product and service revenue, for each theater are summarized in the following table (in millions, except percentages):

Years Ended	July 31, 2004	July 26, 2003	Variance in Dollars	Variance in Percent	July 26, 2003	July 27, 2002	Variance in Dollars	Variance in Percent
Net sales:								
Americas	\$ 12,233	\$ 10,544	\$ 1,689	16.0%	\$ 10,544	\$ 10,654	\$ (110)	(1.0)%
<i>Percentage of net sales</i>	<i>55.5 %</i>	<i>55.8 %</i>			<i>55.8 %</i>	<i>56.4 %</i>		
EMEA	6,126	5,202	924	17.8%	5,202	5,126	76	1.5%
<i>Percentage of net sales</i>	<i>27.8 %</i>	<i>27.6 %</i>			<i>27.6 %</i>	<i>27.1 %</i>		
Asia Pacific	2,230	1,860	370	19.9%	1,860	1,765	95	5.4%
<i>Percentage of net sales</i>	<i>10.1 %</i>	<i>9.9 %</i>			<i>9.9 %</i>	<i>9.3 %</i>		
Japan	1,456	1,272	184	14.5%	1,272	1,370	(98)	(7.2)%
<i>Percentage of net sales</i>	<i>6.6 %</i>	<i>6.7 %</i>			<i>6.7 %</i>	<i>7.2 %</i>		
Total	\$ 22,045	\$ 18,878	\$ 3,167	16.8%	\$ 18,878	\$ 18,915	\$ (37)	(0.2)%

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

The following table is a breakdown of net sales between product and service revenue (in millions, except percentages):

Years Ended	July 31, 2004	July 26, 2003	Variance in Dollars	Variance in Percent	July 26, 2003	July 27, 2002	Variance in Dollars	Variance in Percent
Net sales:								
<i>Product</i>	\$ 18,550	\$ 15,565	\$ 2,985	19.2%	\$ 15,565	\$ 15,669	\$ (104)	(0.7)%
<i>Percentage of net sales</i>	84.1 %	82.5 %			82.5 %	82.8 %		
<i>Service</i>	3,495	3,313	182	5.5%	3,313	3,246	67	2.1%
<i>Percentage of net sales</i>	15.9 %	17.5 %			17.5 %	17.2 %		
Total	\$ 22,045	\$ 18,878	\$ 3,167	16.8%	\$ 18,878	\$ 18,915	\$ (37)	(0.2)%

Net Product Sales by Theater

The following table is a breakdown of net product sales by theater (in millions, except percentages):

Years Ended	July 31, 2004	July 26, 2003	Variance in Dollars	Variance in Percent	July 26, 2003	July 27, 2002	Variance in Dollars	Variance in Percent
Net product sales:								
Americas	\$ 9,662	\$ 8,109	\$ 1,553	19.2%	\$ 8,109	\$ 8,277	\$ (168)	(2.0)%
<i>Percentage of net product sales</i>	52.1 %	52.1 %			52.1 %	52.7 %		
EMEA	5,504	4,609	895	19.4%	4,609	4,537	72	1.6%
<i>Percentage of net product sales</i>	29.7 %	29.6 %			29.6 %	29.0 %		
Asia Pacific	2,039	1,687	352	20.9%	1,687	1,593	94	5.9%
<i>Percentage of net product sales</i>	11.0 %	10.8 %			10.8 %	10.2 %		
Japan	1,345	1,160	185	15.9%	1,160	1,262	(102)	(8.1)%
<i>Percentage of net product sales</i>	7.2 %	7.5 %			7.5 %	8.1 %		
Total	\$ 18,550	\$ 15,565	\$ 2,985	19.2%	\$ 15,565	\$ 15,669	\$ (104)	(0.7)%

Net Product Sales by Groups of Similar Products

The following table presents net sales for groups of similar products (in millions, except percentages):

Years Ended	July 31, 2004	July 26, 2003	Variance in Dollars	Variance in Percent	July 26, 2003	July 27, 2002	Variance in Dollars	Variance in Percent
Net product sales:								
Routers	\$ 5,406	\$ 4,859	\$ 547	11.3%	\$ 4,859	\$ 5,487	\$ (628)	(11.4)%
<i>Percentage of net product sales</i>	29.1 %	31.2 %			31.2 %	35.0 %		
Switches	8,881	7,721	1,160	15.0%	7,721	7,651	70	0.9%
<i>Percentage of net product sales</i>	47.9 %	49.6 %			49.6 %	48.8 %		
Advanced Technologies	3,435	2,004	1,431	71.4%	2,004	1,556	448	28.8%
<i>Percentage of net product sales</i>	18.5 %	12.9 %			12.9 %	10.0 %		
Other	828	981	(153)	(15.6)%	981	975	6	0.6%
<i>Percentage of net product sales</i>	4.5 %	6.3 %			6.3 %	6.2 %		
Total	\$ 18,550	\$ 15,565	\$ 2,985	19.2%	\$ 15,565	\$ 15,669	\$ (104)	(0.7)%

Gross Margin

The following table shows the gross margin for each theater (in millions, except percentages):

Years Ended	AMOUNT			PERCENTAGE		
	July 31, 2004	July 26, 2003	July 27, 2002	July 31, 2004	July 26, 2003	July 27, 2002
Gross margin:						
Americas	\$ 8,274	\$ 7,340	\$ 6,733	67.6%	69.6%	63.2%
EMEA	4,244	3,659	3,269	69.3%	70.3%	63.8%
Asia Pacific	1,532	1,313	1,121	68.7%	70.6%	63.5%
Japan	1,076	921	890	73.9%	72.4%	65.0%
Total	\$ 15,126	\$ 13,233	\$ 12,013	68.6%	70.1%	63.5%

The following table shows the gross margin for products and services (in millions, except percentages):

Years Ended	AMOUNT			PERCENTAGE		
	July 31, 2004	July 26, 2003	July 27, 2002	July 31, 2004	July 26, 2003	July 27, 2002
Gross margin:						
Product	\$ 12,784	\$ 10,971	\$ 9,755	68.9%	70.5%	62.3%
Service	2,342	2,262	2,258	67.0%	68.3%	69.6%
Total	\$ 15,126	\$ 13,233	\$ 12,013	68.6%	70.1%	63.5%

Research and Development, Sales and Marketing, and General and Administrative Expenses

Research and development ("R&D"), sales and marketing, and general and administrative ("G&A") expenses are summarized in the following table (in millions, except percentages):

Years Ended	July 31, 2004	July 26, 2003	Variance		July 26, 2003	July 27, 2002	Variance	
			in Dollars	in Percent			in Dollars	in Percent
Research and development	\$ 3,192	\$ 3,135	\$ 57	1.8%	\$ 3,135	\$ 3,448	\$ (313)	(9.1)%
<i>Percentage of net sales</i>	<i>14.5 %</i>	<i>16.6 %</i>			<i>16.6 %</i>	<i>18.2 %</i>		
Sales and marketing	4,530	4,116	414	10.1%	4,116	4,264	(148)	(3.5)%
<i>Percentage of net sales</i>	<i>20.6 %</i>	<i>21.8 %</i>			<i>21.8 %</i>	<i>22.5 %</i>		
General and administrative	867	702	165	23.5%	702	618	84	13.6%
<i>Percentage of net sales</i>	<i>3.9 %</i>	<i>3.7 %</i>			<i>3.7 %</i>	<i>3.3 %</i>		
Total	\$ 8,589	\$ 7,953	\$ 636	8.0%	\$ 7,953	\$ 8,330	\$ (377)	(4.5)%
<i>Percentage of net sales</i>	<i>39.0 %</i>	<i>42.1 %</i>			<i>42.1 %</i>	<i>44.0 %</i>		

Interest and Other Income (Loss), Net

Interest and other income (loss), net were as follows (in millions):

Years Ended	July 31, 2004	July 26, 2003	Variance		July 26, 2003	July 27, 2002	Variance	
			in Dollars	in Dollars			in Dollars	in Dollars
Interest income	\$ 512	\$ 660	\$ (148)		\$ 660	\$ 895	\$ (235)	
Other income (loss), net	188	(529)	717		(529)	(1,104)	575	
Total	\$ 700	\$ 131	\$ 569		\$ 131	\$ (209)	\$ 340	

DISCUSSION OF FISCAL 2004 AND 2003

The following discussion of fiscal 2004 compared with fiscal 2003 should be read in conjunction with the section of this report entitled "Financial Data for Fiscal 2004, 2003, and 2002."

Net Sales

The increase in net product sales was due to the impact of a gradual recovery in the global economic environment coupled with increased information technology-related capital spending in our enterprise, service provider, commercial, and consumer markets. The increase in net product sales occurred across all geographic theaters with the Americas and EMEA theaters, contributing approximately 82.0% of the total increase. The majority of the increase in net product sales was related to higher sales of Advanced Technology products, which contributed approximately 47.9% of the total increase, and higher sales of switches, which contributed approximately 38.9% of the total increase. The increase in service revenue was primarily due to increased technical support service contract initiations and renewals associated with product sales.

Fiscal 2004 had 53 weeks, compared with 52 weeks in fiscal 2003, and we believe that this extra week may have had a positive impact on our sales in fiscal 2004. However, we are not able to quantify the effect of the slightly longer year on our revenue.

Net Product Sales by Theater

Net product sales in the Americas theater consist of net product sales in the United States and Americas International, which includes Canada, Mexico, and Latin America. Net product sales in the Americas theater increased due to sales of home networking products increasing by approximately \$513 million as a result of our acquisition of the Linksys business in the fourth quarter of fiscal 2003. The remainder of the increase in net product sales in the Americas theater was primarily due to an increase in net product sales to enterprise customers and the United States federal government. The increase in net product sales to enterprise customers was due to the impact of a gradual recovery in the economic environment coupled with increased information technology-related capital spending. Net product sales to the United States federal government increased by approximately 20% due to higher program capital spending in the defense sector.

Net product sales in the EMEA theater increased primarily as a result of continued product deployment by service providers and growth in enterprise markets, especially in the public sector. The increase in net product sales in the EMEA theater occurred primarily in the United Kingdom, Germany, the Netherlands, and Russia.

In Asia Pacific, net product sales increased primarily as a result of infrastructure builds, broadband acceleration, and investments by Asian telecom carriers. The growth was primarily in the service provider and enterprise markets in China, Korea, and India. Net product sales in the Japan theater increased primarily as a result of growth in the service provider market.

Net Product Sales by Groups of Similar Products

Routers The increase in net product sales related to routers was attributable to sales of high-end routers, which increased by \$556 million primarily as a result of higher spending by service providers, partially offset by a decline in sales of midrange routers and low-end routers, which decreased by \$47 million. The decrease in midrange and low-end routers was primarily due to the increased size of the default memory in our basic configurations, which resulted in fewer customers needing to purchase lower-end routers to augment their memory.

Switches The increase in net product sales related to switches was primarily due to sales of LAN modular switches, which increased by \$632 million, and LAN fixed switches, which increased by \$618 million, partially offset by sales of WAN switches, which decreased by \$90 million. The increase in sales of LAN switches was a result of new technologies being implemented by our customers, which resulted in higher sales of our modular switches, Cisco Catalyst 6500 and Catalyst 4500 platforms and fixed configuration switches, including the Cisco Catalyst 3750 platform, introduced in the fourth quarter of fiscal 2003, and the Cisco Catalyst 3550 platform. The decline in sales of WAN switches was due to the continued technology migration away from Asynchronous Transfer Mode (ATM) to Internet Protocol (IP).

Advanced Technologies The increase in net product sales related to Advanced Technologies was primarily due to sales of products in all six of our Advanced Technology markets. Sales of our home networking products, which increased \$605 million, were related to our acquisition of the Linksys business in the fourth quarter of fiscal 2003. An increase of \$252 million in sales of security products was primarily due to module and line card sales related to our routers and switches as customers continued to emphasize network security in light of continuing, well-publicized worms, viruses, and other attacks. Sales of IP telephony products increased \$219 million primarily due to sales of IP phones and associated software related to the transition from analog to IP-based infrastructure. Our wireless technology product sales increased \$157 million due to sales of our access points as we gained new customers and continued deployments with existing customers. Sales of storage area networking products, which increased \$113 million, were related to our acquisition of Andiamo Systems, Inc. (“Andiamo”) in the third quarter of fiscal 2004. See Note 3 to the Consolidated Financial Statements. The increase of \$85 million in sales of optical products was due to an increase in the sales of the Cisco ONS 15454 platform.

Factors That May Impact Net Product Sales Net product sales may be adversely affected in the future by changes in the geopolitical environment and global economic conditions; sales cycles and implementation cycles of our products; changes in the mix of our customers between service provider and enterprise markets; changes in the mix of direct sales and indirect sales; variations in sales channels; and final acceptance criteria of the product, system, or solution as specified by the customer. Service provider customers typically have longer implementation cycles, require a broader range of services, including design services, and often have acceptance provisions, which can lead to a delay in revenue recognition. To improve customer satisfaction, we continue to focus on managing our manufacturing lead time performance, which may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter net sales and operating results. Net product sales may also be adversely affected by fluctuations in demand for our products, especially with respect to Internet businesses and telecommunications service providers, price and product competition in the communications and networking industries, introduction and market acceptance of new technologies and products, adoption of new networking standards, and financial difficulties experienced by our customers. We may, from time to time, experience manufacturing issues that create a delay in our suppliers’ ability to provide specific components, resulting in delayed shipments. To the extent that manufacturing issues and any related component shortages result in delayed shipments in the future, and particularly in periods when we and our suppliers are operating at higher levels of capacity, it is possible that revenue for a quarter could be adversely affected if such matters are not remediated within the same quarter.

Our distributors and retail partners participate in various cooperative marketing and other programs. In addition, increasing sales to our distributors and retail partners generally results in greater difficulty in forecasting the mix of our products and, to a certain degree, the timing of orders from our customers. We recognize revenue to our distributors and retail partners based on a sell-through method using information provided by them, and we maintain estimated accruals and allowances for all cooperative marketing and other programs.

Net Service Revenue

The increase in net service revenue was primarily due to increased technical support service contract initiations and renewals associated with higher product sales that have resulted in a larger installed base of equipment being serviced and revenue from advanced services, which relates to consulting support services of our technologies for specific networking needs. Net service revenue is generally deferred and, in most cases, recognized ratably over the service period, which is typically one to three years.

Product Gross Margin

Product gross margin decreased by 1.6% due to the following factors. Changes in the mix of products sold decreased product gross margin by approximately 3% due to increased sales of home networking products related to our acquisition of the Linksys business and new product introductions within our switching business. Product pricing reductions and sales discounts decreased product gross margin by approximately 1%, and higher provision for inventory decreased product gross margin by 0.6%. However, lower manufacturing costs related to lower component costs and value engineering and other manufacturing related costs increased product gross margin by approximately 1.5%. Value engineering is the process by which the production costs are reduced through component redesign, board configuration, test processes, and transformation processes. Higher shipment volume also increased product gross margin by approximately 1.5%.

Product gross margin may be adversely affected in the future by changes in the mix of products sold, including further periods of increased growth of some of our lower-margin products, changes in distribution channels, price competition, sales discounts, increases in material or labor costs, excess inventory and obsolescence charges, changes in shipment volume, loss of cost savings due to changes in component pricing, impact of value engineering, inventory holding charges, introduction of new products or entering new markets, and different pricing and cost structures of new markets. If warranty costs associated with our products are greater than we have experienced, product gross margin may also be adversely affected. Product gross margin may also be affected by geographic mix, as well as the mix of configurations within each product group.

Service Gross Margin

Service gross margin decreased by 1.3% but increased \$80 million in absolute dollars. Service gross margin will typically experience some variability over time due to various factors such as the change in mix between technical support services and advanced services, as well as the timing of technical support service contract initiations and renewals. Our revenue from advanced services may increase to a higher proportion of total service revenue due to our continued focus on providing comprehensive support to our customers' networking devices, applications, and infrastructures.

Research and Development, Sales and Marketing, and General and Administrative Expenses

R&D expenses increased primarily due to higher discretionary spending of \$87 million, primarily related to higher prototype expenses and due to an additional week of headcount-related expense of \$28 million. The increase in R&D expenses was partially offset by lower depreciation expense of \$61 million. The increase in R&D expenses reflect our continued investment in R&D efforts in routers, switches, Advanced Technologies, and other product technologies. We have also continued to purchase or license technology in order to bring a broad range of products to 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 have been expensed as incurred. In May 2004, we announced plans to hire additional engineers, and we expect to incur additional R&D expenses in connection with such new hires.

Sales and marketing expenses increased primarily due to increases in sales expenses of \$270 million and marketing expenses of \$144 million. The increase in sales expenses was primarily due to the effect of foreign currency fluctuations, net of hedging, of approximately \$120 million, and an increase in sales commissions of approximately \$110 million partially offset by a decrease in sales program expenses of \$86 million. The remaining increase was primarily due to higher discretionary spending. The increase in marketing expenses was primarily related to an increase of \$66 million in our integrated marketing campaign. The increase in marketing expenses was also attributable to additional expenses of \$33 million related to our acquisition of the Linksys business in the fourth quarter of fiscal 2003. In May 2004, we announced plans to increase the size of our sales force, and we expect to incur additional sales expenses in connection with such new hires.

G&A expenses increased primarily due to higher amortization of deferred stock-based compensation of \$52 million attributable to our acquisitions, expenses related to investments in internal information technology systems and related program spending of \$42 million, and the effect of foreign currency fluctuations, net of hedging, of approximately \$30 million.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets included in operating expenses was \$242 million in fiscal 2004, compared with \$394 million in fiscal 2003. The decrease in the amortization of purchased intangible assets was due to the amortization of certain technology and patent intangibles in the prior year period that were fully amortized as of the end of fiscal 2003. For additional information regarding purchased intangible assets, see Note 3 to the Consolidated Financial Statements.

In-Process Research and Development

Our methodology for allocating the purchase price relating to purchase acquisitions to in-process R&D is determined through established valuation techniques in the high-technology communications equipment industry. In-process R&D expense in fiscal 2004 was \$3 million, compared with \$4 million in fiscal 2003. See Note 3 to the Consolidated Financial Statements for additional information regarding the acquisitions completed in fiscal 2004 and fiscal 2003 and the in-process R&D recorded for each acquisition. In-process R&D was expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed.

The fair value of the existing purchased technology and patents, as well as the technology under development, is determined using the income approach, which discounts expected future cash flows to present value. The discount rates used in the present value calculations are 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. 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 as a result of integrating the acquired in-process technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

For purchase acquisitions completed to date, the development of these technologies remains a significant risk due to the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for new products, and significant competitive threats from several companies. The nature of the efforts to develop these technologies into commercially viable products consists primarily of planning, designing, experimenting, and testing activities necessary to determine that the technologies 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 key assumptions underlying the valuation for our purchase acquisitions completed in fiscal 2004 and fiscal 2003, for which in-process R&D was recorded (in millions, except percentages):

Acquisition	In-Process R&D Expense	Estimated Cost to Complete Technology at Time of Acquisition	Risk-Adjusted Discount Rate for In-Process R&D
FISCAL 2004			
Latitude Communications, Inc.	\$ 1	\$ 1	16.5%
Riverhead Networks, Inc.	\$ 2	\$ —	23.0%
FISCAL 2003			
Okena, Inc.	\$ 3	\$ 1	22.0%
SignalWorks, Inc.	\$ 1	\$ 1	24.0%

The key assumptions primarily consist of an expected completion date for the in-process projects; estimated costs to complete the projects; revenue and expense projections, assuming the products have entered the market; and discount rates based on the risks associated with the development life cycle of the in-process technology acquired. 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 may result in impairment charges. Actual results from the purchase acquisitions to date did not have a material adverse impact on our business and operating results, except for certain purchase acquisitions where the purchased intangible assets were impaired and written down as reflected in the Consolidated Statements of Operations.

Interest Income

The decrease in interest income was primarily due to lower average interest rates on our portfolio of fixed income securities.

Other Income (Loss), Net

The components of other income (loss), net, are as follows (in millions):

Years Ended	July 31, 2004	July 26, 2003
Net gains on investments in fixed income and publicly traded equity securities	\$ 206	\$ 161
Impairment charges on publicly traded equity securities	—	(412)
Net gains on investments in privately held companies	61	12
Impairment charges on investments in privately held companies	(112)	(281)
Net gains (losses) and impairment charges on investments	155	(520)
Other	33	(9)
Total	\$ 188	\$ (529)

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

The impairment charges on publicly traded equity securities of \$412 million, pretax, during fiscal 2003 were due to the declines in the fair values of certain publicly traded equity securities below their cost basis that were judged to be other-than-temporary. For additional information regarding our net gains (losses) and impairment charges on investments, see the section of this report entitled "Quantitative and Qualitative Disclosures About Market Risk."

Provision for Income Taxes

The effective tax rate was 28.9% for fiscal 2004 and 28.6% for fiscal 2003. The effective tax rate differs from the statutory rate primarily due to acquisition-related costs, research and experimentation tax credits, state taxes, and the tax impact of foreign operations.

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Cumulative Effect of Accounting Change, Net of Tax

In April 2001, we entered into a commitment to provide convertible debt funding of approximately \$84 million to Andiamo, a privately held storage switch developer. This debt was convertible into approximately 44% of the equity of Andiamo. In connection with this investment, we obtained a call option that provided us the right to purchase Andiamo. The purchase price under the call option was based on a valuation of Andiamo using a negotiated formula. On August 19, 2002, we entered into a definitive agreement to acquire Andiamo, which represented the exercise of our rights under the call option. We also entered into a commitment to provide nonconvertible debt funding to Andiamo of approximately \$100 million through the close of the acquisition. Substantially all of the convertible debt funding of \$84 million and nonconvertible debt funding of \$100 million had been expensed as research and development costs.

We adopted Financial Accounting Standards Board ("FASB") Interpretation No. 46(R), "Consolidation of Variable Interest Entities" ("FIN 46(R)"), effective January 24, 2004. We evaluated our debt investment in Andiamo and determined that Andiamo was a variable interest entity under FIN 46(R). We concluded that we were the primary beneficiary as defined by FIN 46(R) and, therefore, accounted for Andiamo as if we had consolidated Andiamo since our initial investment in April 2001. The consolidation of Andiamo from the date of our initial investment required accounting for the call option as a repurchase right. Under FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation," and related interpretations, variable accounting was required for substantially all Andiamo employee stock and options because the ending purchase price was primarily derived from a revenue-based formula.

Effective January 24, 2004, the last day of the second quarter of fiscal 2004, we recorded a noncash cumulative stock compensation charge of \$567 million, net of tax (representing the amount of variable compensation from April 2001 through January 2004). This charge was reported as a separate line item in the Consolidated Statements of Operations as a cumulative effect of accounting change, net of tax. The charge was based on the value of the Andiamo employee stock and options and their vesting from the adoption of FIN 46(R) pursuant to the formula-based valuation.

On February 19, 2004, we completed the acquisition of Andiamo, exchanging approximately 23 million shares of our common stock for Andiamo shares not owned by us and assuming approximately 6 million stock options, for a total estimated value of \$750 million, primarily derived from the revenue-based formula, which after stock price related adjustments resulted in a total amount recorded of \$722 million as summarized in the table below.

Subsequent to the adoption of FIN 46(R), changes to the value of Andiamo and the continued vesting of the employee stock and options resulted in an adjustment to the noncash stock compensation charge. We recorded a noncash variable stock compensation adjustment of \$58 million in the third quarter of fiscal 2004 to the cumulative stock compensation charge recorded in the second quarter of fiscal 2004 to account for the additional vesting of the Andiamo employee stock and options and changes in the formula-based valuation from January 24, 2004 until February 19, 2004. This noncash adjustment was reported as research and development expense of \$52 million and sales and marketing expense of \$6 million in the Consolidated Statements of Operations, as amortization of deferred stock-based compensation in the Consolidated Statements of Cash Flows, and as an increase to additional paid-in capital in the Consolidated Statements of Shareholders' Equity. In addition, upon completion of the acquisition, deferred stock-based compensation of \$90 million was recorded to reflect the unvested portion of the formula-based valuation of the Andiamo employee stock and options. See Note 3 to the Consolidated Financial Statements. The amount of deferred stock-based compensation was fixed at the date of acquisition and will be amortized over the remaining vesting period of the Andiamo employee stock and options of approximately two years.

A summary of the accounting of the consolidation under FIN 46(R) and the subsequent purchase of Andiamo, after stock price related adjustments, is as follows (in millions):

	Amount
Cumulative effect of accounting change, net of tax benefit of \$5	\$ 567
Variable stock-based compensation	58
Deferred stock-based compensation	90
Net assets	7
Total	\$ 722

DISCUSSION OF FISCAL 2003 AND 2002

The following discussion of fiscal 2003 compared with fiscal 2002 should be read in conjunction with the section of this report entitled "Financial Data for Fiscal 2004, 2003, and 2002."

Net Sales

The decrease in net product sales was due to the impact of a combination of a challenging global economic environment, geopolitical issues, and constraints on information technology-related capital spending, particularly with respect to our service provider customers. The increase in service revenue was primarily due to increased technical support service contract initiations and renewals associated with product sales.

Net Product Sales by Theater

Net product sales in the United States were \$7.4 billion in fiscal 2003, compared with \$7.4 billion in fiscal 2002, a decrease of \$69 million or 0.9%. Net product sales in Americas International in fiscal 2003 were \$759 million, compared with \$858 million in fiscal 2002, a decrease of \$99 million or 11.5%. The decrease in net product sales reflected the slowdown in the United States and other economies, overcapacity, and constraints on information technology-related capital spending, which have continued to affect both enterprise and service provider customers, especially service provider customers. This decrease was partially offset by growth in our net product sales to the United States federal government, which increased by approximately 20%.

Net product sales in the EMEA theater increased as incumbent service providers began deploying products and some enterprise markets experienced modest growth. In Asia Pacific, net product sales increased due to infrastructure builds, broadband acceleration, and investments by Asian telecom carriers. Net product sales in the Japan theater decreased due to ongoing economic challenges in the theater.

Net Product Sales by Groups of Similar Products

Net product sales related to routers decreased due to decreases in sales of midrange and low-end routers. Net product sales related to switches increased due to increases in sales of fixed LAN and WAN switches partially offset by a decrease in sales of modular LAN switches. Net product sales related to Advanced Technology products increased primarily due to sales of security products, which increased \$160 million; sales of IP telephony products, which increased \$148 million; and sales of wireless LAN products, which increased \$95 million.

Net Service Revenue

Net service revenue increased due to increased technical support service contract initiations and renewals associated with product sales that have resulted in a higher installed base of equipment being serviced and revenue from advanced services, which relates to consulting support services of our technologies for specific networking needs.

Product Gross Margin

The increase in product gross margin of 8.2% was primarily due to lower manufacturing costs related to lower component costs and value engineering partially offset by the impact of product pricing reductions and changes in the mix of products sold, which increased product gross margin by 3.5%, and the reduction of production overhead and other manufacturing costs, which increased product gross margin by 4.7%. The decrease in production overhead related to lower labor costs, depreciation on equipment, and facilities charges associated with manufacturing activities. The decrease in manufacturing and other related costs was due to lower warranty, provision for inventory, and other nonstandard costs. The provision for inventory in fiscal 2002 included an excess inventory benefit of \$422 million related to inventory previously written off that was utilized in production and sold.

Service Gross Margin

Service gross margin decreased by 1.3% but increased \$4 million in absolute dollars. Service gross margin will typically experience some variability over time due to various factors such as the change in mix between technical support services and advanced services, as well as the timing of technical support service contract initiations and renewals.

Research and Development, Sales and Marketing, and General and Administrative Expenses

R&D expenses decreased primarily due to a decrease in expenditures on prototypes of approximately \$120 million due, in part, to our ongoing cost control measures. The decrease in R&D expenses was also due to lower depreciation on lab equipment and other reduced discretionary spending. Sales and marketing expenses decreased due to a decrease in sales expenses of \$176 million partially offset by an increase in marketing expenses of \$28 million. The decrease in sales expenses was due to lower expenses related to our sales programs and other reduced discretionary spending. In addition, we experienced a decrease in the size of our sales force during fiscal 2003. Our marketing expenses increased as we have continued to invest in both our new growth market opportunities and our branding strategy. During fiscal 2003, we invested approximately \$98 million in a new marketing campaign. G&A expenses increased primarily due to real estate allocations.

In the third quarter of fiscal 2001, we announced a restructuring program to prioritize our initiatives around a focus on profit contribution, high-growth areas of our business, reduction of expenses, and improved efficiency. This restructuring program included a worldwide workforce reduction, consolidation of excess facilities, and restructuring of certain business functions. For additional information regarding the restructuring program, see Note 4 to the Consolidated Financial Statements. During fiscal 2003, we increased the restructuring liabilities related to the consolidation of excess facilities and other charges by \$45 million, which was recorded during the first quarter and fourth quarter of fiscal 2003, due to changes in real estate market conditions. The increase in restructuring liabilities was recorded as expenses related to R&D (\$18 million), sales and marketing (\$18 million), G&A (\$4 million), and cost of sales (\$5 million). During fiscal 2002, we increased the restructuring liabilities related to the consolidation of excess facilities and other charges by \$93 million, which was recorded in the third quarter of fiscal 2002, due to changes in real estate market conditions. The increase in restructuring liabilities was recorded as expenses related to R&D (\$39 million), sales and marketing (\$42 million), G&A (\$8 million), and cost of sales (\$4 million). There can be no assurance that future changes in real estate market conditions will not result in additional real estate liabilities.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets included in operating expenses was \$394 million in fiscal 2003, compared with \$699 million in fiscal 2002. The decrease in the amortization of purchased intangible assets was primarily due to the accelerated amortization for certain technology and patent intangibles in the fiscal 2002 period and a decrease in the write-down of certain technology and patent intangibles. The write-down of certain technology and patent intangibles in fiscal 2003 was \$49 million, compared with \$159 million in fiscal 2002. The write-downs of certain technology and patent intangibles were related to a decrease in the expected future cash flows for these purchased intangible assets. For additional information regarding purchased intangible assets, see Note 3 to the Consolidated Financial Statements.

In-Process Research and Development

In-process R&D expense in fiscal 2003 was \$4 million, compared with \$65 million in fiscal 2002. See Note 3 to the Consolidated Financial Statements for additional information regarding the acquisitions completed in fiscal 2003 and 2002 and the in-process R&D recorded for each acquisition. The amounts expensed to in-process R&D were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed.

The following table summarizes the key assumptions underlying the valuation for our purchase acquisitions completed in fiscal 2003 and 2002, for which in-process R&D was recorded (in millions, except percentages):

Acquisition	In-Process R&D Expense	Estimated Cost to Complete Technology at Time of Acquisition	Risk-Adjusted Discount Rate for In-Process R&D
FISCAL 2003			
Okena, Inc.	\$ 3	\$ 1	22.0%
SignalWorks, Inc.	\$ 1	\$ 1	24.0%
FISCAL 2002			
Allegro Systems, Inc.	\$ 28	\$ 5	52.5%
AuroraNetics, Inc.	\$ 9	\$ 2	35.0%
Hammerhead Networks, Inc.	\$ 27	\$ 2	23.0%
Navarro Networks, Inc.	\$ 1	\$ 1	23.0%

Interest Income

The decrease in interest income was primarily due to lower average interest rates on our portfolio of fixed income securities.

Other Income (Loss), Net

The components of other income (loss), net, are as follows (in millions):

Years Ended	July 26, 2003	July 27, 2002
Net gains on investments in fixed income and publicly traded equity securities	\$ 161	\$ 151
Impairment charges on publicly traded equity securities	(412)	(858)
Net gains on investments in privately held companies	12	—
Impairment charges on investments in privately held companies	(281)	(420)
Net gains (losses) and impairment charges on investments	(520)	(1,127)
Other	(9)	23
Total	\$ (529)	\$ (1,104)

The net losses relating to investments in securities in fiscal 2003 and 2002 included charges of \$412 million and \$858 million, respectively, related to the impairment of certain publicly traded equity securities. The impairment charges were due to declines in the fair values of certain publicly traded equity investments below their cost basis that were judged to be other-than-temporary.

Provision for Income Taxes

The effective tax rate was 28.6% for fiscal 2003 and 30.1% for fiscal 2002. The effective tax rate differs from the statutory rate primarily due to the impact of nondeductible in-process R&D, acquisition-related costs, research and experimentation tax credits, state taxes, and the tax impact of foreign operations.

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

LIQUIDITY AND CAPITAL RESOURCES

The following sections discuss the effects of changes in our balance sheet and cash flows, contractual obligations, other commitments, and the stock repurchase program on our liquidity and capital resources.

Balance Sheet and Cash Flows

Cash and Cash Equivalents and Total Investments The following table summarizes our cash and cash equivalents and total investments (in millions):

	July 31, 2004	July 26, 2003	Increase (Decrease)
Cash and cash equivalents	\$ 3,722	\$ 3,925	\$ (203)
Fixed income securities	14,411	15,982	(1,571)
Publicly traded equity securities	1,134	745	389
Total	\$19,267	\$20,652	\$ (1,385)

The decrease in cash and cash equivalents and total investments was primarily a result of cash used for the repurchase of common stock of \$9.1 billion and capital expenditures of \$613 million, partially offset by cash provided by operating activities of \$7.1 billion and cash provided by the issuance of common stock of \$1.3 billion related to employee stock option exercises and employee stock purchases.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, shipment linearity, accounts receivable collections, inventory management, and the timing of tax and other payments. Shipment linearity is a measure of the level of shipments throughout a particular quarter. For additional discussion, see the section entitled "Risk Factors" in our Annual Report on Form 10-K.

Accounts Receivable, Net The following table summarizes our accounts receivable, net (in millions):

	July 31, 2004	July 26, 2003	Increase (Decrease)
Accounts receivable, net	\$1,825	\$1,351	\$ 474

Days sales outstanding ("DSO") in receivables as of July 31, 2004 and July 26, 2003 were 28 days and 26 days, respectively. Our accounts receivable and DSO are primarily impacted by shipment linearity and collections performance. A steady level of shipments and good collections performance will result in reduced DSO compared with a higher level of shipments toward the end of a quarter, which will result in a shorter amount of time to collect the related accounts receivable and increased DSO.

Inventories The following table summarizes our inventories (in millions):

	July 31, 2004	July 26, 2003	Increase (Decrease)
Raw materials	\$ 58	\$ 38	\$ 20
Work in process	459	291	168
Finished goods:			
Distributor inventory and deferred cost of sales	316	283	33
Manufacturing finished goods	206	160	46
Service-related spares	134	72	62
Total finished goods	656	515	141
Demonstration systems	34	29	5
Total	\$1,207	\$ 873	\$ 334

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

The overall increase in inventory was due to the impact of managing targeted lead times, changes in anticipated customer demands and other customer-specific requirements, and the increase in our total revenue. Work-in-process increased due to increased inventory levels of subassemblies needed to manage targeted lead times on certain high-demand products. Our finished goods increased primarily due to higher service-related spares and higher inventories related to our home networking products in order to meet anticipated customer demands, and other customer-specific requirements. Distributor inventory and deferred cost of sales are related to unrecognized revenue on shipments to distributors and retail partners and shipments to enterprise and service provider customers. Manufacturing finished goods consist primarily of build-to-order and build-to-stock products, including home networking products. Service-related spares consist of reusable equipment related to our technical support and warranty activities. All inventories are accounted for at the lower of cost or market.

Annualized inventory turns were 6.4 in the fourth quarter of fiscal 2004, compared with 6.8 in the fourth quarter of fiscal 2003. We may continue to see these higher levels of inventories in the short term due to the expansion of our product lines and continued need for higher inventory levels of subassemblies of certain high-demand products in order to manage customer lead times. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times against the risk of inventory obsolescence because of rapidly changing technology and customer requirements.

Deferred Revenue The breakdown of deferred revenue at July 31, 2004 and July 26, 2003 was as follows (in millions):

Deferred revenue:	July 31, 2004	July 26, 2003	Increase (Decrease)
Service	\$3,047	\$2,451	\$ 596
Product	1,455	1,357	98
Total	\$4,502	\$3,808	\$ 694
Reported as:			
Current	\$3,527	\$3,034	\$ 493
Noncurrent	975	774	201
Total	\$4,502	\$3,808	\$ 694

The increase in deferred service revenue reflects a higher volume of technical support contract initiations and renewals, including higher volume of multiyear contracts, in excess of the amortization of deferred service revenue during the fiscal year.

Contractual Obligations

Our cash flows from operations are dependent on a number of factors, including fluctuations in our operating results, shipment linearity, accounts receivable collections, inventory management, and the timing of tax and other payments. As a result, the impact of contractual obligations on our liquidity and capital resources in future periods should be analyzed in conjunction with such factors. In addition, we plan for and measure our liquidity and capital resources through an annual budgeting process.

The following table summarizes our contractual obligations at July 31, 2004 and excludes amounts recorded in our Consolidated Balance Sheets (in millions):

	PAYMENTS DUE BY PERIOD				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases	\$1,356	\$ 231	\$306	\$187	\$ 632
Purchase commitments with contract manufacturers and suppliers	951	951	—	—	—
Purchase obligations	1,121	631	343	147	—
Total	\$3,428	\$ 1,813	\$649	\$334	\$ 632

Operating Leases We lease office space in several U.S. locations, as well as locations elsewhere in the Americas, EMEA, Asia Pacific, and Japan. Operating lease amounts include future minimum lease payments under all our noncancelable operating leases with an initial term in excess of one year as of July 31, 2004.

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

Purchase Commitments with Contract Manufacturers and Suppliers We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, in order to manage manufacturing lead times and to help assure adequate component supply, we enter into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by us or that establish the parameters defining our requirements. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed. Consequently, only a portion of our reported purchase commitments arising from these agreements are firm, noncancelable, and unconditional commitments. The purchase commitments for inventory are expected to be fulfilled within one year.

In addition to the above, we record a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of our future demand forecasts consistent with our allowance for inventory. As of July 31, 2004, the liability for our firm, noncancelable, and unconditional purchase commitments was \$141 million, compared with \$99 million as of July 26, 2003. These amounts are included in other accrued liabilities in our Consolidated Balance Sheets at July 31, 2004 and July 26, 2003, and are not included in the preceding table.

Purchase Obligations Purchase obligations represent an estimate of all open purchase orders and contractual obligations in the ordinary course of business, other than commitments with contract manufacturers and suppliers, for which we have not received the goods or services as of July 31, 2004. Although open purchase orders are considered enforceable and legally binding, the terms generally allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to the delivery of goods or performance of services.

Other Commitments

In fiscal 2001, we entered into an agreement to invest approximately \$1.0 billion in venture funds managed by SOFTBANK Corp. and its affiliates ("SOFTBANK"), which are required to be funded on demand. In fiscal 2003, this agreement was amended to reduce the amount of our commitment to \$800 million, of which up to \$550 million is to be invested in venture funds under terms similar to the original agreement and \$250 million invested as senior debt with entities as directed by SOFTBANK. Our commitment to fund the senior debt is contingent upon the achievement of certain agreed-upon milestones. As of July 31, 2004, we have invested \$290 million in the venture funds and \$49 million in the senior debt, of which \$19 million has been repaid, and both were recorded as investments in privately held companies in our Consolidated Balance Sheets. We had invested \$247 million in the venture funds and \$49 million in the senior debt as of July 26, 2003.

We provide structured financing to certain qualified customers for the purchase of equipment and other needs through our wholly owned subsidiary, Cisco Systems Capital Corporation. These loan commitments may be funded over a two- to three-year period, provided that these customers achieve specific business milestones and satisfy certain financial covenants. As of July 31, 2004, our outstanding loan commitments were approximately \$61 million, of which approximately \$22 million was eligible for draw-down. As of July 26, 2003, our outstanding loan commitments were approximately \$97 million, of which approximately \$38 million was eligible for draw-down.

As of July 31, 2004 and July 26, 2003, we had a commitment of approximately \$59 million and \$130 million, respectively, to purchase the remaining portion of the minority interest of Cisco Systems, K.K. (Japan), and the payment under this commitment is based on a put option held by the minority shareholders.

We also have certain other funding commitments related to our privately held investments that are based on the achievement of certain agreed-upon milestones. The funding commitments were approximately \$67 million as of July 31, 2004, compared with approximately \$95 million as of July 26, 2003.

Off-Balance Sheet Arrangements

We consider our investments in unconsolidated variable interest entities to be off-balance sheet arrangements. In the ordinary course of business, we have investments in privately held companies and provide structured financing to certain customers through our wholly owned subsidiary, Cisco Systems Capital Corporation, which may be considered to be variable interest entities. We have evaluated our investments in these privately held companies and structured financings and have determined that there were no significant unconsolidated variable interest entities as of July 31, 2004.

Certain events can require a reassessment of our investments in privately held companies or structured financings to determine if they are variable interest entities and which of the stakeholders will be the primary beneficiaries. As a result of such events, we may be required to make additional disclosures or consolidate these entities. As we may not control these entities, we may not have the ability to influence these events.

Stock Repurchase Program

In September 2001, our Board of Directors authorized a stock repurchase program. As of July 31, 2004, our Board of Directors has authorized the repurchase of up to \$25 billion of common stock under this program. During fiscal 2004, we repurchased and retired 408 million shares of our common stock at an average price of \$22.30 per share for an aggregate purchase price of \$9.1 billion. As of July 31, 2004, we have repurchased and retired 956 million shares of our common stock at an average price of \$17.70 per share for an aggregate purchase price of \$16.9 billion since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was \$8.1 billion with no termination date.

The purchase price for the shares of our common stock repurchased was reflected as a reduction to shareholders' equity. In accordance with Accounting Principles Board Opinion No. 6, "Status of Accounting Research Bulletins," we are required to allocate the purchase price of the repurchased shares as a reduction to retained earnings and common stock and additional paid-in capital. Issuance of common stock and the tax benefit related to employee stock option plans are recorded as an increase to common stock and additional paid-in capital. As a result of future repurchases, we may be required to report an accumulated deficit included in shareholders' equity in our Consolidated Balance Sheets.

Liquidity and Capital Resource Requirements

Based on past performance and current expectations, we believe our cash and cash equivalents, short-term investments, and cash generated from operations will satisfy our working capital needs, capital expenditures, investment requirements, stock repurchases, contractual obligations, commitments (see Note 8 to the Consolidated Financial Statements), future customer financings, and other liquidity requirements associated with our operations through at least the next 12 months. We believe that the most strategic uses of our cash resources include repurchase of shares, strategic investments to gain access to new technologies, acquisitions, financing activities, and working capital. There are no transactions, arrangements, and other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of our requirements for capital resources.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INVESTMENTS

We maintain an investment portfolio of various holdings, types, and maturities. See Note 7 to the Consolidated Financial Statements. These securities are generally classified as available-for-sale and consequently are recorded in the Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of tax.

Fixed Income Securities

At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our investment portfolio. 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. These instruments are not leveraged as of July 31, 2004, and are held for purposes other than trading. The modeling technique used measures the change in fair value 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. The following tables present the hypothetical changes in fair value in investment securities held at July 31, 2004 and July 26, 2003 that are sensitive to changes in interest rates (in millions):

	VALUATION OF SECURITIES GIVEN AN INTEREST RATE DECREASE OF X BASIS POINTS			FAIR VALUE AS OF JULY 31, 2004	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	\$ 4,517	\$ 4,477		\$ 4,437	\$ 4,397	\$ 4,357
Corporate and municipal notes and bonds and asset-backed securities	10,214	10,147	10,080	10,014	9,946	9,879	9,812
Total	\$14,731	\$14,624	\$14,517	\$ 14,411	\$14,303	\$14,196	\$14,089

	VALUATION OF SECURITIES GIVEN AN INTEREST RATE DECREASE OF X BASIS POINTS			FAIR VALUE AS OF JULY 26, 2003	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	\$ 5,505	\$ 5,450		\$ 5,395	\$ 5,340	\$ 5,285
Corporate and municipal notes and bonds and asset-backed securities	10,832	10,768	10,704	10,642	10,578	10,514	10,450
Total	\$16,337	\$16,218	\$16,099	\$ 15,982	\$15,863	\$15,744	\$15,625

Publicly Traded Equity Securities

The values of our equity investments in several publicly traded companies are subject to market price volatility. The following tables present the hypothetical changes in fair value of publicly traded equity securities held at July 31, 2004 and July 26, 2003 that are sensitive to changes in market price (in millions):

	VALUATION OF SECURITIES GIVEN AN X% DECREASE IN EACH STOCK'S PRICE			FAIR VALUE AS OF JULY 31, 2004	VALUATION OF SECURITIES GIVEN AN X% INCREASE IN EACH STOCK'S PRICE		
	(75%)	(50%)	(25%)		25%	50%	75%
	Publicly traded equity securities	\$ 284	\$ 567		\$ 851	\$ 1,134	\$1,418

	VALUATION OF SECURITIES GIVEN AN X% DECREASE IN EACH STOCK'S PRICE			FAIR VALUE AS OF JULY 26, 2003	VALUATION OF SECURITIES GIVEN AN X% INCREASE IN EACH STOCK'S PRICE		
	(75%)	(50%)	(25%)		25%	50%	75%
	Publicly traded equity securities	\$ 186	\$ 373		\$ 559	\$ 745	\$ 931

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our equity portfolio consists of securities with characteristics that most closely match the Standard & Poor's 500 Index or Nasdaq Composite Index. These equity securities are held for purposes other than trading. The modeling technique used measures the change in fair values arising from selected hypothetical changes in each stock's price. Stock price fluctuations of plus or minus 25%, 50%, and 75% were selected based on the probability of their occurrence. During fiscal 2003 and 2002, we recognized charges of \$412 million and \$858 million, respectively, attributable to the impairment of certain publicly traded equity securities. The impairment charges were related to the declines in the fair values of certain publicly traded equity securities below their cost basis that were judged to be other-than-temporary. There was no impairment charge recorded in fiscal 2004.

INVESTMENTS IN PRIVATELY HELD COMPANIES

We have invested in privately held companies, some of which are in the startup or development stages. These investments are inherently risky, as the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. We could lose our entire initial investment in these companies. These investments are primarily carried at cost, which as of July 31, 2004 was \$354 million, compared with \$516 million at July 26, 2003, and are recorded in other assets in the Consolidated Balance Sheets. Our impairment charges on investments in privately held companies were \$112 million, \$281 million, and \$420 million during fiscal 2004, 2003, and 2002, respectively.

Our evaluation of equity investments in private and public companies is based on the fundamentals of the businesses, including, among other factors, the nature of their technologies and potential for financial return to us.

DERIVATIVE INSTRUMENTS

We enter into foreign exchange forward contracts to minimize the short-term impact of foreign currency fluctuations on receivables, investments, and payables, primarily denominated in Australian, Canadian, Japanese, and several European currencies, including the euro and British pound. Our market risks associated with our foreign currency receivables, investments, and payables relate primarily to variances from our forecasted foreign currency transactions and balances.

Approximately 75% of our operating expenses are U.S.-dollar denominated. In order to reduce variability in operating expenses caused by the remaining non-U.S.-dollar-denominated operating expenses, we periodically hedge certain foreign currency forecasted transactions with currency options with maturities up to 18 months. These hedging programs are not designed to provide foreign currency protection over longer time horizons. In designing a specific hedging approach, we consider several factors, including offsetting exposures, significance of exposures, costs associated with entering into a particular hedge instrument, and potential effectiveness of the hedge. The gains and losses on foreign exchange contracts mitigate the variability in operating expenses associated with currency movements. Due primarily to our limited currency exposure to date, the impact of foreign currency fluctuations has not been material to our Consolidated Financial Statements. In fiscal 2004, the effects of foreign currency fluctuations, net of hedging, increased total research and development, sales and marketing, and general and administrative expenses by approximately 2.5%, compared with fiscal 2003 and by approximately 1% in fiscal 2003, compared with fiscal 2002. The impact of foreign currency fluctuations on sales has not been material because our sales are primarily denominated in U.S. dollars.

Foreign exchange forward and option contracts as of July 31, 2004 are summarized as follows (in millions):

	Notional Amount	Fair Value
Forward contracts:		
Purchased	\$ 862	\$ (3)
Sold	\$ 583	\$ (2)
Option contracts:		
Purchased	\$ 389	\$ 6
Sold	\$ 431	\$ (1)

Our foreign exchange forward contracts related to current assets and liabilities generally range from one to three months in original maturity. Additionally, we have entered into foreign exchange forward contracts related to long-term financings with maturities of up to two years. The foreign exchange forward contracts related to investments generally have maturities of less than one year. Currency option contracts generally have maturities of less than 18 months. We do not enter into foreign exchange forward and option contracts for trading purposes. We do not expect gains or losses on these derivative instruments 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 31, 2004	July 26, 2003	July 27, 2002
NET SALES:			
Product	\$ 18,550	\$ 15,565	\$ 15,669
Service	3,495	3,313	3,246
Total net sales	<u>22,045</u>	<u>18,878</u>	<u>18,915</u>
COST OF SALES:			
Product	5,766	4,594	5,914
Service	1,153	1,051	988
Total cost of sales	<u>6,919</u>	<u>5,645</u>	<u>6,902</u>
GROSS MARGIN	15,126	13,233	12,013
OPERATING EXPENSES:			
Research and development	3,192	3,135	3,448
Sales and marketing	4,530	4,116	4,264
General and administrative	867	702	618
Amortization of purchased intangible assets	242	394	699
In-process research and development	3	4	65
Total operating expenses	<u>8,834</u>	<u>8,351</u>	<u>9,094</u>
OPERATING INCOME	6,292	4,882	2,919
Interest income	512	660	895
Other income (loss), net	188	(529)	(1,104)
Interest and other income (loss), net	<u>700</u>	<u>131</u>	<u>(209)</u>
INCOME BEFORE PROVISION FOR INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	6,992	5,013	2,710
Provision for income taxes	2,024	1,435	817
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	4,968	3,578	1,893
Cumulative effect of accounting change, net of tax	(567)	—	—
NET INCOME	\$ 4,401	\$ 3,578	\$ 1,893
Income per share before cumulative effect of accounting change—basic	<u>\$ 0.73</u>	<u>\$ 0.50</u>	<u>\$ 0.26</u>
Income per share before cumulative effect of accounting change—diluted	<u>\$ 0.70</u>	<u>\$ 0.50</u>	<u>\$ 0.25</u>
Net income per share—basic	<u>\$ 0.64</u>	<u>\$ 0.50</u>	<u>\$ 0.26</u>
Net income per share—diluted	<u>\$ 0.62</u>	<u>\$ 0.50</u>	<u>\$ 0.25</u>
Shares used in per-share calculation—basic	<u>6,840</u>	<u>7,124</u>	<u>7,301</u>
Shares used in per-share calculation—diluted	<u>7,057</u>	<u>7,223</u>	<u>7,447</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS
(in millions, except par value)

	July 31, 2004	July 26, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,722	\$ 3,925
Short-term investments	4,947	4,560
Accounts receivable, net of allowance for doubtful accounts of \$179 at July 31, 2004 and \$183 at July 26, 2003	1,825	1,351
Inventories	1,207	873
Deferred tax assets	1,827	1,975
Prepaid expenses and other current assets	815	753
Total current assets	14,343	13,437
Investments	10,598	12,167
Property and equipment, net	3,290	3,643
Goodwill	4,198	4,043
Purchased intangible assets, net	325	556
Other assets	2,840	3,261
TOTAL ASSETS	\$ 35,594	\$ 37,107
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 657	\$ 594
Income taxes payable	963	739
Accrued compensation	1,466	1,470
Deferred revenue	3,527	3,034
Other accrued liabilities	2,090	2,457
Total current liabilities	8,703	8,294
Deferred revenue	975	774
Total liabilities	9,678	9,068
Commitments and contingencies (Note 8)		
Minority interest	90	10
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; 6,735 and 6,998 shares issued and outstanding at July 31, 2004 and July 26, 2003, respectively	22,450	21,116
Retained earnings	3,164	6,559
Accumulated other comprehensive income	212	354
Total shareholders' equity	25,826	28,029
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 35,594	\$ 37,107

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Cash flows from operating activities:			
Net income	\$ 4,401	\$ 3,578	\$ 1,893
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change, net of tax	567	—	—
Depreciation and amortization	1,443	1,591	1,957
Provision for doubtful accounts	19	(59)	91
Provision for inventory	205	70	131
Deferred income taxes	552	(14)	(573)
Tax benefits from employee stock option plans	537	132	61
In-process research and development	3	4	53
Net (gains) losses and impairment charges on investments	(155)	520	1,127
Change in operating assets and liabilities:			
Accounts receivable	(488)	(125)	270
Inventories	(538)	(17)	673
Prepaid expenses and other current assets	(42)	(61)	(28)
Accounts payable	54	35	(174)
Income taxes payable	260	(125)	389
Accrued compensation	(7)	104	307
Deferred revenue	688	(84)	678
Other accrued liabilities	(378)	(309)	(268)
Net cash provided by operating activities	<u>7,121</u>	<u>5,240</u>	<u>6,587</u>
Cash flows from investing activities:			
Purchases of short-term investments	(12,206)	(9,396)	(5,473)
Proceeds from sales and maturities of short-term investments	13,570	10,319	5,868
Purchases of investments	(20,848)	(18,063)	(15,760)
Proceeds from sales and maturities of investments	20,757	12,497	15,317
Purchases of restricted investments	—	—	(291)
Proceeds from sales and maturities of restricted investments	—	—	1,471
Acquisition of property and equipment	(613)	(717)	(2,641)
Acquisition of businesses, net of cash and cash equivalents	(104)	33	16
Change in lease receivables, net	(159)	79	380
Change in investments in privately held companies	(13)	(223)	(58)
Lease deposits	—	—	320
Purchase of minority interest of Cisco Systems, K.K. (Japan)	(71)	(59)	(115)
Other	153	94	159
Net cash provided by (used in) investing activities	<u>466</u>	<u>(5,436)</u>	<u>(807)</u>
Cash flows from financing activities:			
Issuance of common stock	1,257	578	655
Repurchase of common stock	(9,080)	(5,984)	(1,854)
Other	33	43	30
Net cash used in financing activities	<u>(7,790)</u>	<u>(5,363)</u>	<u>(1,169)</u>
Net (decrease) increase in cash and cash equivalents	(203)	(5,559)	4,611
Cash and cash equivalents, beginning of fiscal year	3,925	9,484	4,873
Cash and cash equivalents, end of fiscal year	<u>\$ 3,722</u>	<u>\$ 3,925</u>	<u>\$ 9,484</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in millions)

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
BALANCE AT JULY 28, 2001	7,324	\$ 20,051	\$ 7,344	\$ (275)	\$ 27,120
Net income	—	—	1,893	—	1,893
Change in unrealized gains and losses on investments, net of tax	—	—	—	224	224
Other	—	—	—	24	24
Comprehensive income					2,141
Issuance of common stock	76	655	—	—	655
Repurchase of common stock	(124)	(350)	(1,504)	—	(1,854)
Tax benefits from employee stock option plans	—	61	—	—	61
Purchase acquisitions	27	346	—	—	346
Amortization of deferred stock-based compensation	—	187	—	—	187
BALANCE AT JULY 27, 2002	7,303	\$ 20,950	\$ 7,733	\$ (27)	\$ 28,656
Net income	—	—	3,578	—	3,578
Change in unrealized gains and losses on investments, net of tax	—	—	—	352	352
Other	—	—	—	29	29
Comprehensive income					3,959
Issuance of common stock	68	578	—	—	578
Repurchase of common stock	(424)	(1,232)	(4,752)	—	(5,984)
Tax benefits from employee stock option plans	—	132	—	—	132
Purchase acquisitions	51	557	—	—	557
Amortization of deferred stock-based compensation	—	131	—	—	131
BALANCE AT JULY 26, 2003	6,998	\$ 21,116	\$ 6,559	\$ 354	\$ 28,029
Net income	—	—	4,401	—	4,401
Change in unrealized gains and losses on investments, net of tax	—	—	—	(161)	(161)
Other	—	—	—	19	19
Comprehensive income					4,259
Issuance of common stock	122	1,257	—	—	1,257
Repurchase of common stock	(408)	(1,284)	(7,796)	—	(9,080)
Tax benefits from employee stock option plans	—	537	—	—	537
Purchase acquisitions	—	6	—	—	6
Amortization of deferred stock-based compensation	—	186	—	—	186
Variable stock-based compensation	—	58	—	—	58
Cumulative effect of accounting change, net of tax	—	567	—	—	567
Acquisition of Andiamo Systems, Inc.	23	7	—	—	7
BALANCE AT JULY 31, 2004	6,735	\$ 22,450	\$ 3,164	\$ 212	\$ 25,826

Supplemental Information

In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of July 31, 2004, the Company's Board of Directors has authorized the repurchase of up to \$25 billion of common stock under this program. For additional information regarding stock repurchases, see Note 9 to the Consolidated Financial Statements. The purchase price of shares of common stock repurchased was reflected as a reduction to retained earnings and common stock and additional paid-in capital. Issuance of common stock and the tax benefit related to employee stock option plans are recorded as an increase to common stock and additional paid-in capital. The stock repurchases pursuant to this program are summarized in the table below (in millions):

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Repurchases of common stock	956	\$ 2,866	\$14,052	\$ —	\$ 16,918

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Cisco Systems, Inc. (the "Company" or "Cisco") manufactures and sells networking and communications products and provides services associated with that equipment and its use. The Company's products are installed at corporations, public institutions, telecommunication companies, and commercial businesses and are also found in personal residences. Cisco provides a broad line of products for transporting data, voice, and video within buildings, across campuses, and around the world.

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 2004 was a 53-week fiscal year, and fiscal 2003 and 2002 were 52-week fiscal years.

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. Cash and cash equivalents are maintained with various financial institutions.

Investments The Company's investments comprise U.S. government notes and bonds; corporate notes, bonds, and asset-backed securities; municipal notes and bonds; and publicly traded equity securities. Investments with original or remaining maturities of more than three months and less than one year are considered to be short-term. These investments are held in the custody of a major financial institution. The specific identification method is used to determine the cost basis of fixed income securities disposed of. The weighted-average method is used to determine the cost basis of publicly traded equity securities disposed of. At July 31, 2004 and July 26, 2003, the Company's investments were classified as available-for-sale. These investments are recorded in the Consolidated Balance Sheets at fair value. Unrealized gains and losses on these investments are included as a separate component of accumulated other comprehensive income, net of tax.

The Company recognizes an impairment charge when the declines in the fair values of its investments below the cost basis are judged to be other-than-temporary. The Company considers various factors in determining whether to recognize an impairment charge, including the length of time and extent to which the fair value has been less than the Company's cost basis, the financial condition and near-term prospects of the investee, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

The Company also has investments in privately held companies. These investments are included in other assets in the Consolidated Balance Sheets and are primarily carried at cost. The Company monitors these investments for impairment and makes appropriate reductions in carrying values if the Company determines that an impairment charge is required based primarily on the financial condition and near-term prospects of these companies.

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. The Company provides inventory allowances based on excess and obsolete inventories determined primarily by future demand forecasts. The allowance is measured as the difference between the cost of the inventory and market based upon assumptions about future demand and charged to the provision for inventory, which is a component of cost of sales. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

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

Concentrations of Risk Cash and cash equivalents are maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and therefore bear minimal credit 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's customers are primarily in the service provider and enterprise markets. The Company receives certain of its components from sole suppliers. Additionally, the Company relies on a limited number of contract manufacturers and suppliers to provide manufacturing services for its products. The inability of a contract manufacturer or supplier to fulfill supply requirements of the Company could materially impact future operating results.

Revenue Recognition The Company's networking and communications products are integrated with software that is essential to the functionality of the equipment. Additionally, the Company provides unspecified software upgrades and enhancements related to the equipment through its maintenance contracts. Accordingly, the Company accounts for revenue in accordance with Statement of Position No. 97-2, "Software Revenue Recognition," and all related interpretations.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is reasonably assured. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Service revenue is generally deferred and, in most cases, recognized ratably over the period during which the services are to be performed, which is typically from one to three years.

When a sale involves multiple elements, such as sales of products that include services, the entire fee from the arrangement is allocated to each respective element based on its relative fair value and recognized when revenue recognition criteria for each element are met. Fair value for each element is established based on the sales price charged when the same element is sold separately.

The Company uses distributors that stock inventory and typically sell to system integrators, service providers, and other resellers. In addition, certain products are sold through retail partners. The Company refers to these sales through distributors and retail partners as its two-tier system of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. Distributors and retail partners participate in various cooperative marketing and other programs, and the Company maintains estimated accruals and allowances for these programs. The Company accrues for warranty costs, sales returns, and other allowances based on its historical experience.

Allowance for Doubtful Accounts The allowance for doubtful accounts is based on the Company's assessment of the collectibility of customer accounts. The Company regularly reviews the allowance by considering factors such as historical experience, credit quality, age of the accounts receivable balances, and current economic conditions that may affect a customer's ability to pay.

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

Advertising Costs The Company expenses all advertising costs as incurred, and the amounts were not material for all periods presented.

Software Development Costs Software development costs 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. Software development costs for internal use required to be capitalized pursuant to Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," have also not been material to date.

Depreciation and Amortization Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of 25 years are used for buildings. Estimated useful lives of 30 to 36 months are used for computer equipment and related software and five years for furniture and fixtures. Estimated useful lives of up to five years are used for production, engineering, and other equipment. Depreciation of operating lease assets is computed based on the respective lease terms, which range up to three years. Depreciation and amortization of leasehold improvements are computed using the shorter of the remaining lease terms or five years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Goodwill and Purchased Intangible Assets Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), requires goodwill to be tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired. Based on the impairment tests performed, there was no impairment of goodwill in fiscal 2004, 2003, and 2002. Furthermore, SFAS 142 requires purchased intangible assets other than goodwill to be amortized over their useful lives unless these lives are determined to be indefinite. Purchased intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets, generally two to five years.

Income Taxes Income tax expense is based on pretax 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 Share Basic net income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and excludes dilutive potential common shares outstanding, as their effect is antidilutive. Dilutive potential common shares primarily consist of employee stock options and restricted common stock.

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 directly recorded to a separate component of accumulated other comprehensive income. 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 other income (loss), net.

Derivative Instruments The Company recognizes derivative instruments as either assets or liabilities in the Consolidated Balance Sheets and measures those instruments at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For a derivative instrument designated as a fair value hedge, the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributed to the risk being hedged. For a derivative instrument designated as a cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately.

Certain forecasted transactions and foreign currency assets and liabilities expose the Company to foreign currency risk. The Company purchases currency options and designates these currency options as cash flow hedges of foreign currency forecasted transactions related to certain operating expenses. The Company enters into foreign exchange forward contracts to minimize the short-term impact of currency fluctuations on certain foreign currency receivables, investments, and payables. The foreign exchange forward contracts are not designated as accounting hedges, and all changes in fair value are recognized in earnings in the period of change.

The fair value of derivative instruments as of July 31, 2004 and changes in fair value during fiscal 2004 were not material. During fiscal 2004, there were no significant gains or losses recognized in earnings for hedge ineffectiveness. The Company did not discontinue any hedges because it was probable that the original forecasted transactions would not occur.

Consolidation of Variable Interest Entities Financial Accounting Standards Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), was issued in January 2003. FIN 46 requires that if an entity is the primary beneficiary of a variable interest entity, the assets, liabilities, and results of operations of the variable interest entity should be included in the consolidated financial statements of the entity. FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities" ("FIN 46(R)"), was issued in December 2003. The Company adopted FIN 46(R) effective January 24, 2004, and recorded a noncash cumulative stock compensation charge of \$567 million, net of tax, relating to the consolidation of Andiamo Systems, Inc. ("Andiamo"). For additional information regarding Andiamo, see Note 3 to these Consolidated Financial Statements. For additional information regarding variable interest entities, see Note 8 to these Consolidated Financial Statements.

Minority Interest The Company consolidated its investment in a venture fund managed by SOFTBANK Corp. and its affiliates (“SOFTBANK”). As of July 31, 2004, minority interest of \$84 million represents SOFTBANK’s share of the venture fund. The remaining minority interest of \$6 million represents the preferred stockholders’ proportionate share of the equity of Cisco Systems, K.K. (Japan). At July 31, 2004, the Company owned all issued and outstanding common stock, amounting to 97.6% of the aggregate voting rights of Cisco Systems, K.K. (Japan). Each share of preferred stock is convertible into one share of common stock of Cisco Systems, K.K. (Japan) 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 U.S. requires management to make estimates and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Estimates are used for revenue recognition, allowance for doubtful accounts and sales returns, allowance for inventory, warranty costs, investment impairments, goodwill impairments, income taxes, and loss contingencies, among others. The actual results experienced by the Company may differ materially from management’s 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 of long-lived assets 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 is 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.

Employee Stock Benefit Plans The Company accounts for stock-based awards to employees and directors using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”). Under the intrinsic value method, because the exercise price of the Company’s employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized in the Company’s Consolidated Statements of Operations.

Pro forma information regarding option grants made to the Company’s employees and directors and common stock issued pursuant to the Employee Stock Purchase Plan is based on specified valuation techniques that produce estimated compensation charges. The following table reflects the pro forma information (in millions, except per-share amounts):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Net income — as reported	\$ 4,401	\$ 3,578	\$ 1,893
Compensation expense, net of tax	(1,215)	(1,259)	(1,520)
Net income — pro forma	\$ 3,186	\$ 2,319	\$ 373
Basic net income per share — as reported	\$ 0.64	\$ 0.50	\$ 0.26
Diluted net income per share — as reported	\$ 0.62	\$ 0.50	\$ 0.25
Basic net income per share — pro forma	\$ 0.47	\$ 0.33	\$ 0.05
Diluted net income per share — pro forma	\$ 0.45	\$ 0.32	\$ 0.05

The value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and are fully transferable. 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 estimate, in management’s opinion, the existing valuation models do not provide a reliable measure of the fair value of the Company’s employee stock options. For additional information regarding this pro forma information, see Note 10 to the Consolidated Financial Statements.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. BUSINESS COMBINATIONS

Purchase Acquisitions

During the second quarter of fiscal 2004, the Company completed the acquisition of Latitude Communications, Inc. (“Latitude”) to add rich-media conferencing that combines voice, video, and Web conferencing to its IP communications. During the third quarter of fiscal 2004, the Company completed the acquisition of Riverhead Networks, Inc. to add to its portfolio of security solutions that help customers defend against Distributed Denial of Service (DDoS) attacks and other security threats. In addition, during the third quarter of fiscal 2004, the Company completed the acquisition of Twingo Systems, Inc. to add desktop security features for Secure Sockets Layer (SSL) virtual private networks (VPNs) to its networking products. A summary of the acquisitions is as follows (in millions):

Acquisition	Cash Purchase Consideration	Assumed Liabilities	In-Process R&D Expense	Goodwill	Purchased Intangible Assets
Latitude Communications, Inc.	\$ 86	\$ 29	\$ 1	\$ 60	\$ 16
Riverhead Networks, Inc.	36	6	2	25	7
Twingo Systems, Inc.	5	1	—	5	1
Total	\$ 127	\$ 36	\$ 3	\$ 90	\$ 24

The purchase consideration for the Company’s acquisitions is also allocated to tangible assets and deferred stock-based compensation. Deferred stock-based compensation represents the intrinsic value of the unvested portion of any restricted shares exchanged, options assumed, or options canceled and replaced with the Company’s options and is amortized as compensation expense over the remaining respective future vesting periods. The balance for deferred stock-based compensation is reflected as a reduction to additional paid-in capital in the Consolidated Statements of Shareholders’ Equity. The following table presents the activity of deferred stock-based compensation, including the deferred stock-based compensation relating to the acquisition of Andiamo of \$90 million (in millions):

	July 31, 2004	July 26, 2003	July 27, 2002
Balance at beginning of fiscal year	\$ 262	\$ 182	\$ 293
Purchase acquisitions	94	227	91
Amortization	(186)	(131)	(187)
Canceled unvested options	(17)	(16)	(15)
Balance at end of fiscal year	\$ 153	\$ 262	\$ 182

The Company’s methodology for allocating the purchase price to purchase acquisitions and to in-process research and development (“in-process R&D”) is determined through established valuation techniques in the high-technology communications equipment industry. In-process R&D is expensed upon acquisition because technological feasibility has not been established and no future alternative uses exist. Total in-process R&D expense in fiscal 2004, 2003, and 2002 was \$3 million, \$4 million, and \$65 million, respectively. The in-process R&D expense that was attributable to stock consideration for the same periods was \$0, \$4 million, and \$53 million, respectively.

A summary of the purchase transactions completed in fiscal 2003 and 2002 is as follows (in millions):

Acquisition	Shares	Purchase Consideration	Assumed Liabilities	In-Process R&D Expense	Goodwill	Purchased
	Issued					Intangible Assets
FISCAL 2003						
AYR Networks, Inc.	9	\$ 96	\$ 1	\$ —	\$ 59	\$ —
Okena, Inc.	9	152	8	3	96	45
Psionic Software, Inc.	1	11	2	—	8	5
SignalWorks, Inc.	1	16	2	1	9	4
The Linksys Group, Inc.	29	480	111	—	221	114
Total	49	\$ 755	\$ 124	\$ 4	\$ 393	\$ 168
FISCAL 2002						
Allegro Systems, Inc.	8	\$ 161	\$ 3	\$ 28	\$ 19	\$ 105
AuroraNetics, Inc.	3	43	8	9	16	14
Hammerhead Networks, Inc.	10	171	4	27	105	—
Navarro Networks, Inc.	6	83	2	1	73	—
Total	27	\$ 458	\$ 17	\$ 65	\$ 213	\$ 119

The Company acquired AuroraNetics, Inc. in the first quarter of fiscal 2002. During fiscal 2003, the Company issued approximately 2.7 million shares of common stock with a value of \$39 million to the former stockholders of AuroraNetics, Inc., as a result of the achievement of certain agreed-upon milestones. Such amounts were allocated to goodwill and deferred stock-based compensation totaling \$31 million and \$8 million, respectively.

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 to the Company's results.

Purchased Intangible Assets

The following table presents details of the purchased intangible assets acquired during fiscal 2004 and 2003 (in millions, except number of years):

	TECHNOLOGY		TRADE NAMES		CUSTOMER RELATIONSHIPS		Total
	Estimated Useful Life	Amount	Estimated Useful Life	Amount	Estimated Useful Life	Amount	
	(in Years)		(in Years)		(in Years)		
FISCAL 2004							
Latitude Communications, Inc.	4.5	\$ 4	7.0	\$ 1	4.0	\$ 11	\$ 16
Riverhead Networks, Inc.	4.5	5	—	—	3.5	2	7
Twingo Systems, Inc.	3.5	1	—	—	—	—	1
Total		\$ 10		\$ 1		\$ 13	\$ 24
FISCAL 2003							
Okena, Inc.	4.5	\$ 38	—	\$ —	2.5	\$ 7	\$ 45
Psionic Software, Inc.	3.0	5	—	—	—	—	5
SignalWorks, Inc.	4.5	4	—	—	—	—	4
The Linksys Group, Inc.	—	—	4.5	47	4.5	67	114
Total		\$ 47		\$ 47		\$ 74	\$ 168

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present details of the Company's total purchased intangible assets (in millions):

<u>July 31, 2004</u>	Accumulated		
	Gross	Amortization	Net
Technology	\$ 627	\$ (452)	\$175
Technology licenses	252	(239)	13
Customer relationships	88	(20)	68
Trade names	90	(43)	47
Other	131	(109)	22
Total	<u>\$1,188</u>	<u>\$ (863)</u>	<u>\$325</u>
<u>July 26, 2003</u>			
Technology	\$ 639	\$ (349)	\$290
Technology licenses	523	(447)	76
Customer relationships	75	(1)	74
Trade names	89	(24)	65
Other	160	(109)	51
Total	<u>\$1,486</u>	<u>\$ (930)</u>	<u>\$556</u>

The following table presents details of the amortization expense of purchased intangible assets as reported in the Consolidated Statements of Operations (in millions):

<u>Years Ended</u>	<u>July 31,</u>	July 26,	July 27,
	2004	2003	2002
<u>Reported as:</u>			
Cost of sales	\$ 13	\$ 15	\$ 22
Operating expenses	242	394	699
Total	<u>\$ 255</u>	<u>\$ 409</u>	<u>\$ 721</u>

The estimated future amortization expense of purchased intangible assets as of July 31, 2004, is as follows (in millions):

<u>Fiscal Year</u>	<u>Amount</u>
2005	\$ 185
2006	82
2007	40
2008	18
Total	<u>\$ 325</u>

Goodwill

The following tables present the changes in goodwill allocated to the Company's reportable segments during fiscal 2004 and 2003 (in millions):

	Balance at July 26, 2003	Acquired	Balance at July 31, 2004
Americas	\$ 2,642	\$ 74	\$ 2,716
EMEA	668	10	678
Asia Pacific	167	4	171
Japan	566	67	633
Total	\$ 4,043	\$ 155	\$ 4,198

	Balance at July 27, 2002	Acquired	Balance at July 26, 2003
Americas	\$ 2,335	\$ 307	\$ 2,642
EMEA	593	75	668
Asia Pacific	140	27	167
Japan	497	69	566
Total	\$ 3,565	\$ 478	\$ 4,043

In fiscal 2004, the Company purchased a portion of the minority interest of Cisco Systems, K.K. (Japan). As a result, the Company increased its ownership from 94.8% to 97.6% of the voting rights of Cisco Systems, K.K. (Japan) and recorded goodwill of \$65 million, which was included in the preceding table.

Acquisition of Andiamo Systems, Inc.

In April 2001, the Company entered into a commitment to provide convertible debt funding of approximately \$84 million to Andiamo, a privately held storage switch developer. This debt was convertible into approximately 44% of the equity of Andiamo. In connection with this investment, the Company obtained a call option that provided the Company the right to purchase Andiamo. The purchase price under the call option was based on a valuation of Andiamo using a negotiated formula. On August 19, 2002, the Company entered into a definitive agreement to acquire Andiamo, which represented the exercise of its rights under the call option. The Company also entered into a commitment to provide nonconvertible debt funding to Andiamo of approximately \$100 million through the close of the acquisition. Substantially all of the convertible debt funding of \$84 million and nonconvertible debt funding of \$100 million has been expensed as research and development costs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company adopted FIN 46(R) effective January 24, 2004. The Company evaluated its debt investment in Andiamo and determined that Andiamo was a variable interest entity under FIN 46(R). The Company concluded that the Company was the primary beneficiary as defined by FIN 46(R) and, therefore, accounted for Andiamo as if the Company had consolidated Andiamo since the Company's initial investment in April 2001. The consolidation of Andiamo from the date of the Company's initial investment required accounting for the call option as a repurchase right. Under FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation," and related interpretations, variable accounting was required for substantially all Andiamo employee stock and options because the ending purchase price was primarily derived from a revenue-based formula.

Effective January 24, 2004, the last day of the second quarter of fiscal 2004, the Company recorded a noncash cumulative stock compensation charge of \$567 million, net of tax (representing the amount of variable compensation from April 2001 through January 2004). This charge was reported as a separate line item in the Consolidated Statements of Operations as a cumulative effect of accounting change, net of tax. The charge was based on the value of the Andiamo employee stock and options and their vesting from the adoption of FIN 46(R) pursuant to the formula-based valuation.

On February 19, 2004, the Company completed the acquisition of Andiamo, exchanging approximately 23 million shares of the Company's common stock for Andiamo shares not owned by the Company and assuming approximately 6 million stock options, for a total estimated value of \$750 million, primarily derived from the revenue-based formula, which after stock price related adjustments resulted in a total amount recorded of \$722 million, as summarized in the table below.

Subsequent to the adoption of FIN 46(R), changes to the value of Andiamo and the continued vesting of the employee stock and options resulted in an adjustment to the noncash stock compensation charge. The Company recorded a noncash variable stock compensation adjustment of \$58 million in the third quarter of fiscal 2004 to the cumulative stock compensation charge recorded in the second quarter of fiscal 2004 to account for the additional vesting of the Andiamo employee stock and options and changes in the formula-based valuation from January 24, 2004 until February 19, 2004. This noncash adjustment was reported as operating expense in the Consolidated Statements of Operations, as amortization of deferred stock-based compensation in the Consolidated Statements of Cash Flows, and as an increase to additional paid-in capital in the Consolidated Statements of Shareholders' Equity. In addition, upon completion of the acquisition, deferred stock-based compensation of \$90 million was recorded in the Consolidated Balance Sheets to reflect the unvested portion of the formula-based valuation of the Andiamo employee stock and options. The amount of deferred stock-based compensation was fixed at the date of acquisition and will be amortized over the remaining vesting period of Andiamo employee stock and options of approximately two years.

A summary of the accounting of the consolidation under FIN 46(R) and the subsequent purchase of Andiamo, after stock price related adjustments, is as follows (in millions):

	Amount
Cumulative effect of accounting change, net of tax benefit of \$5	\$ 567
Variable stock-based compensation	58
Deferred stock-based compensation	90
Net assets	7
Total	\$ 722

4. RESTRUCTURING COSTS AND OTHER SPECIAL CHARGES

On April 16, 2001, the Company announced a restructuring program, which included a worldwide workforce reduction, consolidation of excess facilities, and restructuring of certain business functions. The liability for restructuring costs is recorded in other accrued liabilities in the Consolidated Balance Sheets. The following table summarizes the activity related to the liability for restructuring costs and other special charges as of July 31, 2004 (in millions):

	<u>Workforce Reduction</u>	<u>Consolidation of Excess Facilities and Other Charges</u>	<u>Impairment of Goodwill and Purchased Intangible Assets</u>	<u>Total</u>
Initial charge in the third quarter of fiscal 2001	\$ 397	\$ 484	\$ 289	\$1,170
Noncash charges	(71)	(141)	(289)	(501)
Cash payments	(265)	(18)	—	(283)
Balance at July 28, 2001	61	325	—	386
Adjustments ⁽¹⁾	(35)	128	—	93
Cash payments	(26)	(131)	—	(157)
Balance at July 27, 2002	—	322	—	322
Adjustments ⁽²⁾	—	45	—	45
Cash payments	—	(72)	—	(72)
Balance at July 26, 2003	—	295	—	295
Cash payments ⁽³⁾	—	(230)	—	(230)
Balance at July 31, 2004	\$ —	\$ 65	\$ —	\$ 65

Note 1: Due to changes in previous estimates, in fiscal 2002, the Company reclassified \$35 million of restructuring liabilities related to the workforce reduction charges to consolidation of excess facilities and other charges. The initial estimated workforce reduction was approximately 6,000 regular employees. Approximately 5,400 regular employees were terminated, and the liability was paid. In addition, during fiscal 2002, the Company increased the restructuring liabilities related to the consolidation of excess facilities and other charges by \$93 million, which was recorded during the third quarter of fiscal 2002, due to changes in real estate market conditions. The increase in restructuring liabilities was recorded as expenses related to research and development (\$39 million), sales and marketing (\$42 million), general and administrative (\$8 million), and cost of sales (\$4 million) in the Consolidated Statements of Operations.

Note 2: During fiscal 2003, the Company increased the restructuring liabilities related to the consolidation of excess facilities and other charges by a total of \$45 million, which was recorded during the first quarter and fourth quarter of fiscal 2003, due to changes in real estate market conditions. The increase in restructuring liabilities was recorded as expenses related to research and development (\$18 million), sales and marketing (\$18 million), general and administrative (\$4 million), and cost of sales (\$5 million) in the Consolidated Statements of Operations.

Note 3: Cash payments include payments of approximately \$204 million on lease obligations that were terminated.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. BALANCE SHEET DETAILS

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

	July 31, 2004	July 26, 2003
Inventories:		
Raw materials	\$ 58	\$ 38
Work in process	459	291
Finished goods	656	515
Demonstration systems	34	29
Total	\$ 1,207	\$ 873
Property and equipment, net:		
Land, buildings, and leasehold improvements	\$ 3,429	\$ 3,411
Computer equipment and related software	1,120	1,147
Production, engineering, and other equipment	2,643	2,410
Operating lease assets	94	356
Furniture and fixtures	356	350
	7,642	7,674
Less accumulated depreciation and amortization	(4,352)	(4,031)
Total	\$ 3,290	\$ 3,643
Other assets:		
Deferred tax assets	\$ 1,130	\$ 1,476
Investments in privately held companies	354	516
Income tax receivable	690	727
Lease receivables, net	231	158
Other	435	384
Total	\$ 2,840	\$ 3,261
Deferred revenue:		
Service	\$ 3,047	\$ 2,451
Product	1,455	1,357
Total	\$ 4,502	\$ 3,808
Reported as:		
Current	\$ 3,527	\$ 3,034
Noncurrent	975	774
Total	\$ 4,502	\$ 3,808

6. LEASE RECEIVABLES, NET

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 current portion of lease receivables, net, is recorded in prepaid expenses and other current assets, and the noncurrent portion is recorded in other assets in the Consolidated Balance Sheets. The net lease receivables are summarized as follows (in millions):

	July 31, 2004	July 26, 2003
Gross lease receivables	\$ 616	\$ 840
Unearned income and other allowances	(170)	(553)
Total	\$ 446	\$ 287
Reported as:		
Current	\$ 215	\$ 129
Noncurrent	231	158

Total

\$ 446

\$ 287

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Contractual maturities of the gross lease receivables at July 31, 2004 were \$307 million in fiscal 2005, \$166 million in fiscal 2006, \$84 million in fiscal 2007, \$44 million in fiscal 2008, and \$15 million in fiscal 2009. Actual cash collections may differ from the contractual maturities due to early customer buyouts, refinancings, or customer defaults.

7. INVESTMENTS

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

<u>July 31, 2004</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Fixed income securities:				
U.S. government notes and bonds	\$ 4,408	\$ 9	\$ (20)	\$ 4,397
Corporate notes, bonds, and asset-backed securities	9,333	14	(42)	9,305
Municipal notes and bonds	710	—	(1)	709
Total fixed income securities	14,451	23	(63)	14,411
Publicly traded equity securities	755	387	(8)	1,134
Total	\$ 15,206	\$ 410	\$ (71)	\$15,545
Reported as:				
Short-term investments				\$ 4,947
Investments				10,598
Total				\$15,545

<u>July 26, 2003</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Fixed income securities:				
U.S. government notes and bonds	\$ 5,302	\$ 68	\$ (30)	\$ 5,340
Corporate notes, bonds, and asset-backed securities	9,978	152	(10)	10,120
Municipal notes and bonds	522	—	—	522
Total fixed income securities	15,802	220	(40)	15,982
Publicly traded equity securities	467	278	—	745
Total	\$ 16,269	\$ 498	\$ (40)	\$16,727
Reported as:				
Short-term investments				\$ 4,560
Investments				12,167
Total				\$16,727

The following table provides gross realized gains and losses related to the Company's investments (in millions):

<u>Years Ended</u>	<u>July 31, 2004</u>	<u>July 26, 2003</u>	<u>July 27, 2002</u>
Gross realized gains	\$ 208	\$ 339	\$ 422
Gross realized losses	(2)	(590)	(1,129)
Total	\$ 206	\$ (251)	\$ (707)

The gross realized losses in fiscal 2004, 2003, and 2002 included charges of \$0, \$412 million, and \$858 million, respectively, related to the impairment of certain publicly traded equity securities. The impairment charges were due to the declines in the fair values of the investments below their cost basis that were judged to be other-than-temporary. The specific identification method is used to determine the cost basis of fixed income securities disposed of. The weighted-average method is used to determine the cost basis of publicly traded equity securities disposed of.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table provides the breakdown of the investments with unrealized losses at July 31, 2004 (in millions):

	LESS THAN 12 MONTHS		12 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government notes and bonds	\$ 2,859	\$ (18)	\$ 84	\$ (2)	\$ 2,943	\$ (20)
Corporate notes, bonds, and asset-backed securities	3,883	(38)	189	(4)	4,072	(42)
Municipal notes and bonds	176	(1)	—	—	176	(1)
Publicly traded equity securities	83	(8)	—	—	83	(8)
Total	\$ 7,001	\$ (65)	\$ 273	\$ (6)	\$ 7,274	\$ (71)

The gross unrealized losses related to fixed income securities were due to changes in interest rates. The gross unrealized losses related to publicly traded equity securities were due to changes in market prices. The Company's management has determined that the gross unrealized losses on its investment securities at July 31, 2004 are temporary in nature. The Company reviews its investments to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. Substantially all of the Company's fixed income securities are rated investment grade or better.

The following table summarizes the maturities of the Company's fixed income securities at July 31, 2004 (in millions):

	Amortized Cost	Fair Value
Less than one year	\$ 4,951	\$ 4,947
Due in 1-2 years	3,138	3,130
Due in 2-5 years	4,088	4,064
Due after 5 years	2,274	2,270
Total	\$ 14,451	\$ 14,411

8. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases office space in several U.S. locations, as well as locations elsewhere in the Americas; Europe, the Middle East, and Africa ("EMEA"); Asia Pacific; and Japan. Rent expense totaled \$191 million, \$196 million, and \$265 million in fiscal 2004, 2003, and 2002, respectively. Future annual minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of July 31, 2004 were as follows (in millions):

Fiscal Year	Amount
2005	\$ 231
2006	176
2007	130
2008	104
2009	83
Thereafter	632
Total	\$1,356

Purchase Commitments with Contract Manufacturers and Suppliers

The Company purchases components from a variety of suppliers and uses several contract manufacturers to provide manufacturing services for its products. During the normal course of business, in order to manage manufacturing lead times and help assure adequate component supply, the Company enters into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by the Company or that establish the parameters defining the Company's requirements. In certain instances, these agreements allow the Company the option to cancel, reschedule, and adjust the Company's requirements based on its business needs prior to firm orders being placed. Consequently, only a portion of the Company's reported purchase commitments arising from these agreements are firm, noncancelable, and unconditional commitments. As of July 31, 2004, the Company had total purchase commitments for inventory of approximately \$951 million, compared with \$718 million as of July 26, 2003.

In addition to the above, the Company records a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of its future demand forecasts consistent with the Company's allowance for inventory. As of July 31, 2004, the liability for these firm, noncancelable, and unconditional purchase commitments was \$141 million, compared with \$99 million as of July 26, 2003 and was included in other accrued liabilities.

Other Commitments

In fiscal 2001, the Company entered into an agreement to invest approximately \$1.0 billion in venture funds managed by SOFTBANK which are required to be funded on demand. In fiscal 2003, this agreement was amended to reduce the amount of the Company's commitment to \$800 million, of which up to \$550 million is to be invested in venture funds under terms similar to the original agreement and \$250 million invested as senior debt with entities as directed by SOFTBANK. The Company's commitment to fund the senior debt is contingent upon the achievement of certain agreed-upon milestones. As of July 31, 2004, the Company had invested \$290 million in the venture funds, compared with \$247 million as of July 26, 2003. In addition, as of July 31, 2004 and July 26, 2003, the Company has invested \$49 million in the senior debt, of which \$19 million has been repaid.

The Company provides structured financing to certain qualified customers for the purchase of equipment and other needs through its wholly owned subsidiary, Cisco Systems Capital Corporation. These loan commitments may be funded over a two- to three-year period, provided that these customers achieve specific business milestones and satisfy certain financial covenants. As of July 31, 2004, the outstanding loan commitments were approximately \$61 million, of which approximately \$22 million was eligible for draw-down. As of July 26, 2003, the outstanding loan commitments were approximately \$97 million, of which approximately \$38 million was eligible for draw-down.

As of July 31, 2004, the Company has a commitment of approximately \$59 million to purchase the remaining minority interest of Cisco Systems, K.K. (Japan), compared with approximately \$130 million as of July 26, 2003.

The Company also has certain other funding commitments related to its privately held investments that are based on the achievement of certain agreed-upon milestones. The funding commitments were approximately \$67 million as of July 31, 2004, compared with approximately \$95 million as of July 26, 2003.

Variable Interest Entities

In the ordinary course of business, the Company has investments in privately held companies and provides structured financing to certain customers through its wholly owned subsidiary, Cisco Systems Capital Corporation, which are considered to be variable interest entities. The Company has evaluated its investments in privately held companies and structured financings and determined that there were no significant unconsolidated variable interest entities as of July 31, 2004.

Guarantees and Product Warranties

FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee.

The requirements of FIN 45 are applicable to the Company's product warranty liability and certain guarantees. The Company's guarantees issued subject to the recognition and disclosure requirements of FIN 45 as of July 31, 2004 and July 26, 2003 were not material. As of July 31, 2004 and July 26, 2003, the Company's product warranty liability recorded in other accrued liabilities was \$239 million and \$246 million, respectively. The following table summarizes the activity related to the product warranty liability during fiscal 2004 and 2003 (in millions):

	July 31, 2004	July 26, 2003
Balance at beginning of fiscal year	\$ 246	\$ 242
Provision for warranties issued	333	342
Payments	(340)	(338)
Balance at end of fiscal year	\$ 239	\$ 246

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company accrues for warranty costs as part of its cost of sales based on associated material product costs, technical support labor costs, and associated overhead. The products sold are generally covered by a warranty for periods ranging from 90 days to five years, and for some products, the Company provides a limited lifetime warranty.

In the normal course of business to facilitate sales of its products, the Company indemnifies other parties, including customers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, the Company has entered into indemnification agreements with its officers and directors, and the Company's bylaws contain similar indemnification obligations to the Company's agents.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material impact on the Company's operating results, financial position, or cash flows.

Derivative Instruments

The Company uses derivative instruments to manage exposures to foreign currency. The Company's objective in holding derivatives is to minimize the volatility of earnings and cash flows associated with changes in foreign currency.

The Company conducts business on a global basis in several currencies. As such, it is exposed to adverse movements in foreign currency exchange rates. The Company enters into foreign exchange forward contracts to minimize the short-term impact of foreign currency fluctuations on certain foreign currency receivables, investments, and payables. The gains and losses on the foreign exchange forward contracts offset the transaction gains and losses on certain foreign currency receivables, investments, and payables recognized in earnings.

The Company does not enter into foreign exchange forward contracts for trading purposes. Gains and losses on the contracts are included in other income (loss), net, in the Consolidated Statements of Operations and offset foreign exchange gains or losses from the revaluation of intercompany balances or other current assets, investments, and liabilities denominated in currencies other than the functional currency of the reporting entity. The Company's foreign exchange forward contracts related to current assets and liabilities generally range from one to three months in original maturity. Additionally, the Company has entered into foreign exchange forward contracts with maturities of up to two years related to long-term customer financings. The foreign exchange contracts related to investments generally have maturities of less than one year.

The Company periodically hedges certain foreign currency forecasted transactions related to certain operating expenses with currency options. These transactions are designated as cash flow hedges. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately. These currency option contracts generally have maturities of less than 18 months. The Company does not purchase currency options for trading purposes. Foreign exchange forward and option contracts as of July 31, 2004 are summarized as follows (in millions):

	<u>Notional Amount</u>	<u>Fair Value</u>
Forward contracts:		
Purchased	\$ 862	\$ (3)
Sold	\$ 583	\$ (2)
Option contracts:		
Purchased	\$ 389	\$ 6
Sold	\$ 431	\$ (1)

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

Legal Proceedings

Beginning on April 20, 2001, a number of purported shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against Cisco and certain of its officers and directors. The lawsuits have been consolidated, and the consolidated action is purportedly brought on behalf of those who purchased the Company's publicly traded securities between August 10, 1999 and February 6, 2001. Plaintiffs allege that defendants made false and misleading statements, purport to assert claims for violations of the federal securities laws, and seek unspecified compensatory damages and other relief. Cisco believes the claims are without merit and intends to defend the actions vigorously.

In addition, beginning on April 23, 2001, a number of purported shareholder derivative lawsuits were filed in the Superior Court of California, County of Santa Clara, and in the Superior Court of California, County of San Mateo. There is a procedure in place for the coordination of such actions (one of which has been dismissed and is currently on appeal). Two purported derivative suits were filed in the United States District Court for the Northern District of California, and those federal court actions have been consolidated. The consolidated federal court derivative action was dismissed by the court, and plaintiffs have appealed from that decision. The complaints in the various derivative actions include claims for breach of fiduciary duty, waste of corporate assets, mismanagement, unjust enrichment, and violations of the California Corporations Code; seek compensatory and other damages, disgorgement, and other relief; and are based on essentially the same allegations as the class actions.

With respect to the above-described shareholder litigation, Cisco believes there is no legal basis for liability. However, due to the uncertainty surrounding the litigation process, Cisco is unable to reasonably estimate a range of loss, if any, at this time. In addition, 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, the Company 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.

9. SHAREHOLDERS' EQUITY

Stock Repurchase Program

In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of July 31, 2004, the Company's Board of Directors has authorized the repurchase of up to \$25 billion of common stock under this program. During fiscal 2004, the Company repurchased and retired 408 million shares of Cisco common stock at an average price of \$22.30 per share for an aggregate purchase price of \$9.1 billion. As of July 31, 2004, the Company has repurchased and retired 956 million shares of Cisco common stock for an average price of \$17.70 per share for an aggregate purchase price of \$16.9 billion since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was \$8.1 billion with no termination date.

The purchase price for the shares of the Company's common stock repurchased was reflected as a reduction to shareholders' equity. In accordance with Accounting Principles Board Opinion No. 6, "Status of Accounting Research Bulletins," the Company is required to allocate the purchase price of the repurchased shares as a reduction to retained earnings and common stock and additional paid-in capital.

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 are as follows (in millions):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Net income	\$4,401	\$3,578	\$1,893
Other comprehensive income:			
Change in unrealized gains and losses on investments, net of tax benefit (expense) of \$42, \$(150), and \$9 in fiscal 2004, 2003, and 2002, respectively	(77)	352	224
Other	19	29	24
Other comprehensive income before minority interest	4,343	3,959	2,141
Less minority interest	(84)	—	—
Total	\$4,259	\$3,959	\$2,141

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The change in unrealized gains and losses on investments, net of tax, during fiscal 2004, 2003, and 2002 included the effects of the recognition of charges in the Consolidated Statements of Operations of \$0, \$412 million, and \$858 million, pretax, respectively, attributable to the impairment of certain publicly traded equity securities. The impairment charges were related to the declines in the fair values of certain publicly traded equity investments below their cost basis that were judged to be other-than-temporary.

10. EMPLOYEE BENEFIT PLANS

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan, which includes its subplan, the International Employee Stock Purchase Plan (together the "Purchase Plan"), under which 321.4 million shares of the Company's common stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of the Company's common stock at a discount of up to 15% of the market value at certain plan-defined dates. The Purchase Plan terminates on January 3, 2010. In fiscal 2004, 2003, and 2002, the shares issued under the Purchase Plan were 26 million, 23 million, and 22 million shares, respectively. At July 31, 2004, 138.6 million shares were available for issuance under the Purchase Plan.

Employee Stock Option Plans

Stock Option Program Description The Company has two plans under which it grants options: the 1996 Stock Incentive Plan (the "1996 Plan") and the 1997 Supplemental Stock Incentive Plan (the "Supplemental Plan").

Stock option grants are designed to reward employees for their long-term contributions to the Company and provide incentives for them to remain with the Company. The number and frequency of stock option grants are based on competitive practices, operating results of the Company, and government regulations.

The maximum number of shares issuable over the term of the 1996 Plan is limited to 2.5 billion shares. Options granted under the 1996 Plan have an exercise price equal to the fair market value of the underlying stock on the grant date and expire no later than nine years from the grant date. The options will generally become exercisable for 20% or 25% of the option shares one year from the date of grant and then ratably over the following 48 or 36 months, respectively. Certain other grants have utilized a 60-month ratable vesting schedule. In addition, the Board of Directors, or other committee administering the plan, has the discretion to use a different vesting schedule and has done so from time to time. Since the inception of the 1996 Plan, the Company has granted options to virtually all employees, and the majority have been granted to employees below the vice president level.

In 1997, the Company adopted 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 3 million options were granted. All option grants have an exercise price equal to the fair market value of the underlying stock on the grant date.

Distribution and Dilutive Effect of Options The following table illustrates the grant dilution and exercise dilution (in millions, except percentages):

Years Ended	July 31, 2004	July 26, 2003
Shares of common stock outstanding	6,735	6,998
Granted and assumed	195	199
Canceled	(52)	(57)
Net options granted	143	142
Grant dilution ⁽¹⁾	2.1%	2.0%
Exercised	96	45
Exercise dilution ⁽²⁾	1.4%	0.6%

Note 1: The percentage for grant dilution is computed based on net options granted as a percentage of shares of common stock outstanding.

Note 2: The percentage for exercise dilution is computed based on options exercised as a percentage of shares of common stock outstanding.

Basic and diluted shares outstanding for the year ended July 31, 2004 were 6.8 billion shares and 7.1 billion shares, respectively. Diluted shares outstanding include the dilutive impact of in-the-money options, which is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the tax-effected proceeds that would be hypothetically received from the exercise of all in-the-money options are assumed to be used to repurchase shares. In fiscal 2004, the dilutive impact of in-the-money employee stock options was approximately 209 million shares or 3.1% of the basic shares outstanding based on Cisco's average share price of \$22.39.

The following table summarizes the options granted to the Named Executive Officers during the periods indicated. The Named Executive Officers represent the Company's Chief Executive Officer and the four other most highly paid executive officers whose salary and bonus for the fiscal year ended July 31, 2004 and July 26, 2003 were in excess of \$100,000.

Years Ended	July 31, 2004	July 26, 2003
Options granted to the Named Executive Officers	2 million	6 million
Options granted to the Named Executive Officers as a % of net options granted	1.6%	4.2%
Options granted to the Named Executive Officers as a % of outstanding shares	0.03%	0.09%
Cumulative options held by Named Executive Officers as a % of total options outstanding	4.0%	4.6%

General Option Information A summary of option activity follows (in millions, except per-share amounts). The Company has, in connection with the acquisitions of various companies, assumed the stock option plans of the acquired companies or issued replacement options.

	Options Available for Grant	OPTIONS OUTSTANDING	
		Number Outstanding	Weighted- Average Exercise Price per Share
BALANCE AT JULY 28, 2001	522	1,060	\$ 29.41
Granted and assumed	(282)	282	17.72
Exercised	—	(54)	6.99
Canceled	82	(82)	36.94
Additional shares reserved	342	—	—
	664	1,206	27.17
BALANCE AT JULY 27, 2002	664	1,206	27.17
Granted and assumed	(199)	199	12.01
Exercised	—	(45)	7.14
Canceled	57	(57)	33.03
Additional shares reserved	4	—	—
	526	1,303	25.29
BALANCE AT JULY 26, 2003	526	1,303	25.29
Granted and assumed	(195)	195	20.00
Exercised	—	(96)	10.03
Canceled	52	(52)	32.33
Additional shares reserved	7	—	—
	390	1,350	\$ 25.34
BALANCE AT JULY 31, 2004	390	1,350	\$ 25.34

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes significant ranges of outstanding and exercisable options as of July 31, 2004 (shares and aggregate intrinsic value in millions, except 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	Aggregate Intrinsic Value	Number Exercisable	Weighted-Average Exercise Price per Share	Aggregate Intrinsic Value
\$ 0.01 – 9.75	210	3.61	\$ 7.13	\$ 2,896	159	\$ 6.57	\$ 2,282
9.76 – 13.04	156	5.20	12.52	1,310	97	12.28	838
13.05 – 16.15	180	6.25	15.61	956	89	15.68	466
16.16 – 18.57	96	6.12	18.19	262	51	18.21	138
18.58 – 19.59	144	7.91	19.56	196	5	19.19	9
19.60 – 26.42	185	5.78	22.95	31	109	24.37	15
26.43 – 50.38	184	4.93	43.30	—	145	42.46	—
50.39 – 64.38	160	4.57	55.12	—	140	55.09	—
64.39 – 72.56	35	4.86	67.28	—	28	69.17	—
Total	1,350	5.41	\$ 25.34	\$ 5,651	823	\$ 28.09	\$ 3,748

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value based on Cisco's closing stock price of \$20.92 as of July 30, 2004, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable as of July 31, 2004 was 436 million. As of July 26, 2003, 748 million outstanding options were exercisable, and the weighted average exercise price was \$26.12. As of July 27, 2002, 634 million outstanding options were exercisable, and the weighted average exercise price was \$23.51.

The following table presents the option exercises for the year ended July 31, 2004, and option values as of that date for the Named Executive Officers (in millions):

	Number of Shares		NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT JULY 31, 2004		INTRINSIC VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT JULY 31, 2004	
	Acquired on Exercise	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Named Executive Officers	4	\$ 71	41	13	\$ 257	\$ 44

Pro forma Information Pro forma information regarding option grants made to the Company's employees and directors and common stock relating to the Employee Stock Purchase Plan is based on specified valuation techniques that produce estimated compensation charges. The following table reflects the pro forma information (in millions, except per-share amounts):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Net income — as reported	\$ 4,401	\$ 3,578	\$ 1,893
Compensation expense, net of tax	(1,215)	(1,259)	(1,520)
Net income — pro forma	\$ 3,186	\$ 2,319	\$ 373
Basic net income per share — as reported	\$ 0.64	\$ 0.50	\$ 0.26
Diluted net income per share — as reported	\$ 0.62	\$ 0.50	\$ 0.25
Basic net income per share — pro forma	\$ 0.47	\$ 0.33	\$ 0.05
Diluted net income per share — pro forma	\$ 0.45	\$ 0.32	\$ 0.05

The 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 31, 2004	July 26, 2003	July 27, 2002	July 31, 2004	July 26, 2003	July 27, 2002
Expected dividend	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	3.9%	3.2%	4.7%	2.8%	1.1%	3.1%
Expected volatility	40.0%	45.7%	47.5%	43.2%	45.7%	58.1%
Expected life (in years)	5.6	5.8	5.5	1.9	0.5	0.5

The Black-Scholes option pricing model was developed for use in estimating the 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 and expected life. The Company uses projected data for expected volatility and expected life of its stock options based upon historical and other economic data 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 estimate, in management's opinion, the existing valuation models do not provide a reliable measure of the fair value of the Company's employee stock options. Under the Black-Scholes option pricing model, the weighted-average estimated values of employee stock options granted during fiscal 2004, 2003, and 2002 were \$8.77, \$5.67, and \$8.60, respectively.

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 contributions 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 can contribute from 1% to 25% of their annual compensation to the Plan. Employee contributions are limited to a maximum annual amount as set periodically by the Internal Revenue Service. Through December 31, 2002, the Company matched employee contributions dollar for dollar up to a maximum of \$1,500 per person per year. Effective January 1, 2003, the new matching structure is 50% of the first 6% of eligible earnings that are contributed by employees. Therefore, the maximum matching contribution that the Company may allocate to each participant's account will not exceed \$6,150 for the 2004 calendar year due to the \$205,000 annual limit on eligible earnings imposed by the Internal Revenue Code. All matching contributions vest immediately. The Company's matching contributions to the Plan totaled \$81 million, \$40 million, and \$35 million in fiscal 2004, 2003, and 2002, respectively.

Effective January 1, 2004, employees who meet the age requirements and reach the Plan contribution limits can make a catch-up contribution not to exceed the lesser of 50% of their eligible compensation or the limit of \$3,000 set forth in the Internal Revenue Code for the 2004 calendar year. The catch-up contributions are not eligible for matching contributions.

In addition, the Plan provides for discretionary profit-sharing 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. There were no discretionary profit-sharing contributions made in fiscal 2004, 2003, or 2002. In fiscal 2002, the Plan provided for a one-time discretionary matching contribution of \$11 million, based on \$500 per eligible employee.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. INCOME TAXES

The provision for income taxes consisted of the following (in millions):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Federal:			
Current	\$ 968	\$1,041	\$ 929
Deferred	469	6	(480)
	<u>1,437</u>	<u>1,047</u>	<u>449</u>
State:			
Current	230	138	117
Deferred	(19)	2	(68)
	<u>211</u>	<u>140</u>	<u>49</u>
Foreign:			
Current	274	270	344
Deferred	102	(22)	(25)
	<u>376</u>	<u>248</u>	<u>319</u>
Total	<u>\$2,024</u>	<u>\$1,435</u>	<u>\$ 817</u>

The Company paid income taxes of \$644 million, \$1.4 billion, and \$909 million in fiscal 2004, 2003, and 2002, respectively. Income before provision for income taxes consisted of the following (in millions):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
United States	\$2,743	\$3,325	\$1,550
International	4,249	1,688	1,160
Total	<u>\$6,992</u>	<u>\$5,013</u>	<u>\$2,710</u>

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

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Federal statutory rate	35.0%	35.0%	35.0%
Effect of:			
State taxes, net of federal tax benefit	1.8	1.8	1.8
Export sales benefit	(0.4)	(0.2)	(1.5)
Foreign income at other than U.S. rates	(8.3)	(8.9)	(4.9)
Nondeductible in-process R&D	—	—	0.9
Nondeductible deferred stock-based compensation	1.2	0.8	1.9
Tax credits	(0.4)	—	(3.4)
Other, net	—	0.1	0.3
Total	<u>28.9%</u>	<u>28.6%</u>	<u>30.1%</u>

U.S. income taxes and foreign withholding taxes were not provided for on a cumulative total of \$4.3 billion of undistributed earnings for certain foreign subsidiaries. The Company intends to reinvest these earnings indefinitely in its foreign subsidiaries. If these earnings were distributed to the U.S. in the form of dividends or otherwise, or if the shares of the relevant foreign subsidiaries were sold or otherwise transferred, the Company would be subject to additional U.S. income taxes (subject to an adjustment for foreign tax credits) and foreign withholding taxes. Determination of the amount of unrecognized deferred income tax liability related to these earnings is not practicable.

The components of the deferred tax assets (liabilities) are as follows (in millions):

	July 31, 2004	July 26, 2003
ASSETS		
Allowance for doubtful accounts and returns	\$ 231	\$ 228
Sales-type and direct-financing leases	270	297
Loan reserves	86	123
Inventory allowances and capitalization	228	247
Investment provisions	385	654
In-process R&D, goodwill, and purchased intangible assets	469	375
Deferred revenue	1,170	899
Credits and net operating loss carryforwards	339	261
Other	541	562
	<u>3,719</u>	<u>3,646</u>
LIABILITIES		
Unremitted earnings of foreign subsidiaries	(450)	—
Unrealized gains on investments	(100)	(142)
Other	(212)	(53)
	<u>(762)</u>	<u>(195)</u>
Total	<u>\$2,957</u>	<u>\$3,451</u>

Reclassifications have been made to the fiscal 2003 balances for certain components of deferred tax assets and liabilities in order to conform to the current year's presentation.

The following table presents the breakdown between current and noncurrent net deferred tax assets (in millions):

	July 31, 2004	July 26, 2003
Current	\$1,827	\$1,975
Noncurrent	1,130	1,476
	<u>\$2,957</u>	<u>\$3,451</u>
Total	<u>\$2,957</u>	<u>\$3,451</u>

The noncurrent portion of the deferred tax assets is included in other assets.

As of July 31, 2004, the Company's federal and state net operating loss carryforwards for income tax purposes were \$234 million and \$17 million, respectively. If not utilized, the federal net operating loss carryforwards will begin to expire in fiscal 2010, and the state net operating loss carryforwards will begin to expire in fiscal 2005. As of July 31, 2004, the Company's federal and state tax credit carryforwards for income tax purposes were \$21 million and \$362 million, respectively. If not utilized, the federal tax credit carryforwards will begin to expire in fiscal 2008, 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 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 \$537 million, \$132 million, and \$61 million for fiscal 2004, 2003, and 2002, respectively.

The Company's federal income tax returns for fiscal years ended July 25, 1998 through July 28, 2001 are under examination, and the Internal Revenue Service has proposed certain adjustments. The Company believes that adequate amounts have been reserved for any adjustments that may ultimately result from these examinations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. SEGMENT INFORMATION AND MAJOR CUSTOMERS

The Company's operations involve the design, development, manufacturing, marketing, and technical support of networking and communications products and services. Cisco products include routers, switches, Advanced Technologies, and other networking equipment. These products, primarily integrated by Cisco IOS Software, link geographically dispersed LANs and WANs.

The Company conducts business globally and is managed geographically. The Company's management makes financial decisions and allocates resources based on the information it receives from its internal management system. Prior to fiscal 2004, the Company's management relied on the internal management system to provide sales and standard cost information by geographic theater. Beginning in fiscal 2004, production overhead and manufacturing variances and other related costs in the cost of sales information are attributed to each geographic theater in the internal management system. As a result, effective in fiscal 2004, the Company's management uses gross margin by geographic theater, and prior period information has been reclassified to conform to the current period's presentation.

Sales are attributed to a geographic theater based on the ordering location of the customer. The Company does not allocate research and development, sales and marketing, or general and administrative expenses to its geographic theaters in this internal management system, as management does not currently use the information to measure the performance of the operating segments. Based on established criteria, the Company has four reportable segments: the Americas, EMEA, Asia Pacific, and Japan.

Summarized financial information by theater for fiscal 2004, 2003, and 2002, as taken from the internal management system previously discussed, is as follows (in millions):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Net sales:			
Americas	\$ 12,233	\$ 10,544	\$ 10,654
EMEA	6,126	5,202	5,126
Asia Pacific	2,230	1,860	1,765
Japan	1,456	1,272	1,370
Total	\$ 22,045	\$ 18,878	\$ 18,915
Gross margin:			
Americas	\$ 8,274	\$ 7,340	\$ 6,733
EMEA	4,244	3,659	3,269
Asia Pacific	1,532	1,313	1,121
Japan	1,076	921	890
Total	\$ 15,126	\$ 13,233	\$ 12,013

The Americas theater included non-U.S. net sales of \$1.1 billion, \$888 million, and \$988 million for fiscal 2004, 2003, and 2002, respectively. The following table presents net sales for groups of similar products and services (in millions):

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Net sales:			
Routers	\$ 5,406	\$ 4,859	\$ 5,487
Switches	8,881	7,721	7,651
Advanced Technologies	3,435	2,004	1,556
Other	828	981	975
Product	18,550	15,565	15,669
Service	3,495	3,313	3,246
Total	\$ 22,045	\$ 18,878	\$ 18,915

The Company reclassified net sales for groups of similar products in fiscal 2003 and 2002 to conform to the current year's presentation. The reclassification was related to the separate classification of net sales of Advanced Technology products, which were previously included in the "Access" and "Other" product categories, and the elimination of the separate classification of net sales of Access products.

The Company refers to some of its products and technologies as Advanced Technologies. The Company has currently identified six Advanced Technologies for particular focus: home networking, IP telephony, optical networking, security, storage area networking, and wireless technology. The Company may identify additional Advanced Technologies for focus and investment in the future, and the Company's investments in some previously identified Advanced Technologies may be curtailed or eliminated depending on market developments.

The majority of the Company's assets as of July 31, 2004 and July 26, 2003 were attributable to its U.S. operations. In fiscal 2004, 2003, and 2002, no single customer accounted for 10% or more of the Company's net sales.

Property and equipment information is based on the physical location of the assets. The following table presents property and equipment information for geographic areas (in millions):

	July 31, 2004	July 26, 2003	July 27, 2002
Property and equipment, net:			
United States	\$ 2,919	\$ 3,186	\$ 3,555
International	371	457	547
Total	<u>\$ 3,290</u>	<u>\$ 3,643</u>	<u>\$ 4,102</u>

13. NET INCOME PER SHARE

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

Years Ended	July 31, 2004	July 26, 2003	July 27, 2002
Income before cumulative effect of accounting change	\$ 4,968	\$ 3,578	\$ 1,893
Cumulative effect of accounting change, net of tax	(567)	—	—
Net income	<u>\$ 4,401</u>	<u>\$ 3,578</u>	<u>\$ 1,893</u>
Weighted-average shares — basic	6,840	7,124	7,301
Effect of dilutive potential common shares	217	99	146
Weighted-average shares — diluted	<u>7,057</u>	<u>7,223</u>	<u>7,447</u>
Income per share before cumulative effect of accounting change:			
Basic	<u>\$ 0.73</u>	<u>\$ 0.50</u>	<u>\$ 0.26</u>
Diluted	<u>\$ 0.70</u>	<u>\$ 0.50</u>	<u>\$ 0.25</u>
Per-share amount of cumulative effect of accounting change:			
Basic	<u>\$ 0.09</u>	<u>\$ —</u>	<u>\$ —</u>
Diluted	<u>\$ 0.08</u>	<u>\$ —</u>	<u>\$ —</u>
Net income per share:			
Basic	<u>\$ 0.64</u>	<u>\$ 0.50</u>	<u>\$ 0.26</u>
Diluted	<u>\$ 0.62</u>	<u>\$ 0.50</u>	<u>\$ 0.25</u>

Dilutive potential common shares consist of employee stock options and restricted common stock. Employee stock options to purchase approximately 469 million, 838 million, and 712 million shares in fiscal 2004, 2003, and 2002, respectively, were outstanding, but were not included in the computation of diluted earnings per share because the exercise price of the stock options was greater than the average share price of the common shares, and, therefore, the effect would have been antidilutive.

14. PENDING BUSINESS COMBINATIONS

As of July 31, 2004, the Company announced a definitive agreement to acquire the intellectual property and select other assets, and the hiring of a majority of the engineering team, from privately held Procket Networks, Inc. The Company also announced definitive agreements to acquire privately held Actona Technologies, Inc. and Parc Technologies, Ltd. The aggregate announced purchase price for these acquisitions was approximately \$180 million in cash. These acquisitions closed in the first quarter of fiscal 2005.

In addition, as of July 31, 2004, the Company has made an investment in BCN Systems, Inc. ("BCN"). The Company has the right, but not the obligation, to acquire the portion of BCN it does not own, with such purchase dependent upon the Company's sole determination as to whether certain technical conditions have been met. The aggregate total purchase value of BCN could range from approximately \$45 million to approximately \$195 million depending upon the achievement of certain milestones including those which would be determinable only after closing.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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 31, 2004 and July 26, 2003, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2004 in conformity with accounting principles generally accepted in the United States of America. 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 of the Public Company Accounting Oversight Board (United States). Those standards 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 our opinion.

As discussed in Notes 2 and 3 to the Consolidated Financial Statements, effective January 24, 2004, the Company adopted Financial Accounting Standards Board Interpretation No. 46(R), "Consolidation of Variable Interest Entities."

/s/ PricewaterhouseCoopers LLP

San Jose, California
September 16, 2004

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SUPPLEMENTARY FINANCIAL DATA (UNAUDITED)

(In millions, except per-share amounts)

Quarters ended	July 31, 2004	May 1, 2004	Jan. 24, 2004	Oct. 25, 2003	July 26, 2003	April 26, 2003	Jan. 25, 2003	Oct. 26, 2002
Net sales	\$ 5,926	\$ 5,620	\$ 5,398	\$ 5,101	\$ 4,702	\$ 4,618	\$ 4,713	\$ 4,845
Gross margin	\$ 4,055	\$ 3,867	\$ 3,698	\$ 3,506	\$ 3,289	\$ 3,269	\$ 3,317	\$ 3,358
Income before cumulative effect of accounting change	\$ 1,380	\$ 1,211	\$ 1,291	\$ 1,086	\$ 982	\$ 987	\$ 991	\$ 618
Income per share before cumulative effect of accounting change—basic	\$ 0.20	\$ 0.18	\$ 0.19	\$ 0.16	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.09
Income per share before cumulative effect of accounting change—diluted	\$ 0.20	\$ 0.17	\$ 0.18	\$ 0.15	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.08
Net income	\$ 1,380	\$ 1,211	\$ 724	\$ 1,086	\$ 982	\$ 987	\$ 991	\$ 618
Net income per share—basic	\$ 0.20	\$ 0.18	\$ 0.11	\$ 0.16	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.09
Net income per share—diluted	\$ 0.20	\$ 0.17	\$ 0.10	\$ 0.15	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.08
Cash and cash equivalents and total investments	\$19,267	\$18,946	\$19,834	\$19,688	\$20,652	\$20,316	\$21,197	\$21,188

STOCK MARKET INFORMATION

Cisco common stock is traded on the Nasdaq National Market under the symbol CSCO. The following table lists the high and low sales prices for each period indicated:

Fiscal	2004		2003	
	High	Low	High	Low
First quarter	\$21.56	\$17.42	\$15.29	\$ 8.12
Second quarter	\$29.39	\$19.81	\$15.63	\$10.14
Third quarter	\$28.50	\$20.82	\$14.78	\$12.33
Fourth quarter	\$24.20	\$20.07	\$19.55	\$14.40

The Company has never paid cash dividends on its common stock and has no present plans to do so. There were 84,686 registered shareholders as of September 9, 2004.

Subsidiaries of the Registrant

Subsidiaries	State or Other Jurisdiction of Incorporation or Organization
3010081 Nova Scotia Company	Canada
3045848 Nova Scotia Company	Canada
3048504 Nova Scotia Company	Canada
3801110 Canada Inc.	Canada
Andiamo Software Systems Private Limited	India
Cisco Acquisition I, Inc.	Delaware
Cisco Acquisition II, Inc.	Delaware
Cisco Acquisition III, Inc.	Delaware
Cisco Cable Products And Solutions A/S	Denmark
Cisco do Brasil Ltda.	Brazil
Cisco Managed Solutions, Inc.	Delaware
Cisco Optical Transport Germany GmbH	Germany
Cisco Photonics Italy S.r.l.	Italy
Cisco SBAIF III, Inc.	Delaware
Cisco Systems (Argentina) S.A.	Argentina
Cisco Systems (Asia) Services B.V.	Netherlands
Cisco Systems (Bermuda) Holdings Ltd.	Bermuda
Cisco Systems (Bermuda) International IP Management Ltd.	Bermuda
Cisco Systems (Bermuda) IP Holdings, Ltd.	Bermuda
Cisco Systems (Bermuda) Ltd.	Bermuda
Cisco Systems (China) Networking Technology Co., Ltd.	China
Cisco Systems (Colombia) Limitada	Colombia
Cisco Systems (Czech Republic) s.r.o.	Czech Republic
Cisco Systems (HK) Limited	Hong Kong
Cisco Systems (India) Ltd.	Delaware
Cisco Systems (India) Private Limited	India
Cisco Systems (Italy) S.r.l.	Italy
Cisco Systems (Korea) Limited	Korea
Cisco Systems (Malaysia) Sdn Bhd	Malaysia
Cisco Systems (Nigeria) Limited	Nigeria
Cisco Systems (Puerto Rico) Corp.	Delaware
Cisco Systems (Scotland) Limited	Scotland
Cisco Systems (South Africa) (Proprietary) Limited	South Africa
Cisco Systems (Spain) S.L.	Spain
Cisco Systems (Sweden) AB	Sweden
Cisco Systems (Switzerland) GmbH	Switzerland
Cisco Systems (Thailand) Limited	Thailand
Cisco Systems (USA) Pte. Ltd.	Singapore
Cisco Systems Australia Pty. Limited	Australia
Cisco Systems Austria GmbH	Austria
Cisco Systems Belgium S.P.R.L.	Belgium
Cisco Systems Bulgaria EOOD	Bulgaria
Cisco Systems Canada Co./Les Systemes Cisco Canada Cie	Canada
Cisco Systems Capital (Australia) Pty. Limited	Australia
Cisco Systems Capital (Korea) Limited	Korea

Cisco Systems Capital Asia Pte. Ltd.	Singapore
Cisco Systems Capital Canada Co./Les Systemes Cisco Capital Canada Cie	Canada
Cisco Systems Capital Corporation	Nevada
Cisco Systems Capital France SAS	France
Cisco Systems Capital Funding, LLC	Delaware
Cisco Systems Capital GmbH	Germany
Cisco Systems Capital Italy S.r.l.	Italy
Cisco Systems Capital K.K.	Japan
Cisco Systems Capital Netherlands B.V.	Netherlands
Cisco Systems Capital Spain, S.L.	Spain
Cisco Systems Chile S.A.	Chile
Cisco Systems Co.	Canada
Cisco Systems Costa Rica, Sociedad Anonima	Costa Rica
Cisco Systems Croatia Ltd. For Trade	Croatia
Cisco Systems Cyprus Ltd.	Cyprus
Cisco Systems Danmark ApS	Denmark
Cisco Systems De Mexico, S.A. de C.V.	Mexico
Cisco Systems Dominicana, S.A.	Dominican Republic
Cisco Systems Egypt Ltd.	Egypt
Cisco Systems Finance International	Ireland
Cisco Systems Finance International Holdings I Limited	Ireland
Cisco Systems Finance International Holdings II Limited	Ireland
Cisco Systems Finance International Holdings III Limited	Ireland
Cisco Systems Finance International Holdings IV Limited	Ireland
Cisco Systems Finance International Holdings V Limited	Ireland
Cisco Systems Finance International Holdings VI Limited	Ireland
Cisco Systems Finance, Inc.	California
Cisco Systems Finland Oy	Finland
Cisco Systems France Sarl	France
Cisco Systems GmbH	GERMANY
Cisco Systems Holding GmbH & Co. KG	Germany
Cisco Systems Holding, Inc.	Delaware
Cisco Systems Holdings I, Inc.	California
Cisco Systems Hungary Ltd. / Cisco Systems Hungary Servicing And Trading Limited Liability Company	Hungary
Cisco Systems Insurance Services Ltd.	Bermuda
Cisco Systems International B.V.	Netherlands
Cisco Systems International Holdings Ltd.	Bermuda
Cisco Systems Internetworking (Ireland) Limited	Ireland
Cisco Systems Internetworking Hellas S.A.	Greece
Cisco Systems Internetworking Iletisim Hizmetleri Limited Sirketi	Turkey
Cisco Systems Israel Ltd.	Israel
Cisco Systems K.K.	Japan
Cisco Systems Limited	Nevada
Cisco Systems Limited	United Kingdom
Cisco Systems Luxembourg International S.a.r.l.	Luxembourg
Cisco Systems Luxembourg S.a.r.l.	Luxembourg
Cisco Systems Management B.V.	Netherlands
Cisco Systems Management GmbH	Germany
Cisco Systems Management LLC	Delaware
Cisco Systems Management Ltd.	Bermuda
Cisco Systems Netherlands Holdings B.V.	Netherlands

Cisco Systems New Zealand Limited	New Zealand
Cisco Systems Norway AS	Norway
Cisco Systems O.I.A. (1998) Ltd.	Israel
Cisco Systems Pakistan (Private) Limited	Pakistan
Cisco Systems Panama S. de R.L.	Panama
Cisco Systems Peru S.A.	Peru
Cisco Systems Poland Sp. Z.o.o.	Poland
Cisco Systems Portugal—Sistemas Informáticos, Sociedade Unipessoal, Limitada	Portugal
Cisco Systems Romania S.R.L.	Romania
Cisco Systems Slovakia, spol. S.r.o.	Slovakia
Cisco Systems Taiwan Ltd.	Taiwan
Cisco Systems Venezuela, C.A.	Venezuela
Cisco Systems Vietnam Limited	Vietnam
Cisco Systems Wireless Networking (Australia) Pty. Limited	Australia
Cisco Systems-Linksys (Asia) Pte. Ltd.	Singapore
Cisco Technology, Inc.	California
Cisco-Latitude (UK) Limited	United Kingdom
Cisco-Linksys (Chengdu) Networking Technology Co., Ltd.	China
Cisco-Linksys (HK) Limited	Hong Kong
Cisco-Linksys K.K.	Japan
Cisco-Linksys LLC	California
Latitude Communications Pte. Ltd.	Singapore
PT Cisco Systems Indonesia	Indonesia
Radiata, Inc.	Delaware
SB Asia Infrastructure Fund III	Delaware
Twingo Systems, Inc.	Delaware

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO
EXCHANGE ACT RULE 13a-14(a)/15d-14(a)
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, John T. Chambers, President and Chief Executive Officer of Cisco Systems, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of Cisco Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 17, 2004

/s/ JOHN T. CHAMBERS

John T. Chambers
President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO
EXCHANGE ACT RULE 13a-14(a)/15d-14(a)
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Dennis D. Powell, Senior Vice President and Chief Financial Officer of Cisco Systems, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of Cisco Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 17, 2004

/s/ DENNIS D. POWELL

Dennis D. Powell
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

I, John T. Chambers, President and Chief Executive Officer of Cisco Systems, Inc. (the "Company"), do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- the Annual Report on Form 10-K of the Company for the fiscal year ended July 31, 2004, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 17, 2004

/s/ JOHN T. CHAMBERS

John T. Chambers
President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

I, Dennis D. Powell, Senior Vice President and Chief Financial Officer of Cisco Systems, Inc. (the "Company"), do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- the Annual Report on Form 10-K of the Company for the fiscal year ended July 31, 2004, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 17, 2004

/s/ DENNIS D. POWELL

Dennis D. Powell
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)