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

Please click here for complete GAAP reconciliation information between our GAAP financial results and our non-GAAP financial results.

Cisco Systems, Inc.
Q3 FY07 Financial Results Conference Call
Tuesday, May 8, 2007
1:30 p.m. PT

Introduction

Hello participants.

Welcome to Cisco Systems third quarter fiscal year 2007 financial results conference call. At the request of Cisco Systems today's conference is being recorded. If you have any objection you must disconnect at this time. Now I would like to introduce Ms. Blair Christie, Vice President of Corporation Communications for Cisco Systems. Ma'am, you may begin.

Thank you, Martee. Good afternoon, everyone and welcome to our 69th quarterly conference call.

This is Blair Christie and I'm joined by John Chambers, our Chairman and CEO; Dennis Powell, Chief Financial Officer; Rick Justice, Senior Vice President of Worldwide Operations and Business Development; Charlie Giancarlo, Chief Development Officer; and Jim McDonald, Chief Executive Officer of Scientific Atlanta.

The Q3 fiscal year 2007 press release is on First Call, Full National Market Wire and the European Financial and Technology Wire, as well as on the Cisco website at www.cisco.com. If you would like a fax of the press release, please call 408-526-8890 and follow the instructions.

A corresponding webcast with slides and downloadable information regarding Cisco's financial statements can be found on our website in the Investor Relations section. Additionally, a replay of this call will be available via telephone at 866-357-4205 or 203-369-0122 for international callers.

Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results. Please note that we have provided a reconciliation of GAAP to non-GAAP information in the slides accompanying this webcast. We have also posted full reconciliation information along with all of our financial statements to our website. Please go to the financial section in the Investor Relations website for further details.

Throughout our call today, we will provide both Cisco and Scientific Atlanta financial information, in order to illustrate the impact of the acquisition on our overall Q3 fiscal year 2007 results. Where we refer to Cisco standalone, the financial information represents Cisco's performance excluding the results of this acquisition.

The financial results in the press release are unaudited. And of course, the matters we will be discussing today include forward-looking statements and as such, are subject to the risks and uncertainties that we discuss in detail in our documents filed with the SEC, specifically the most recent report on forms 10-K and 10-Q and any applicable amendments, which identify important risk factors that could cause actual results to differ materially from those contained in the forward-looking statements.

Unauthorized recording of this conference call is not permitted.

And I will now turn it over to John for his commentary on the quarter. John?

Opening Remarks

Blair, thank you very much.

Based on your constructive feedback, we will continue to reduce the time for the narrative part of this call and increase the time for Q&A as we have done in each of the last several conference calls.

The opening comments of the conference call will focus on what I view to be the key takeaways for the quarter, as well as the revenue guidance for the next quarter. The opening comments will also include a brief discussion about what I believe will be the next wave driving growth of both the Internet and IT sales. It will be built around collaboration and Web 2.0 capabilities.

This discussion will be followed by a detailed discussion of the financials by Dennis. The third section of the call will focus on general business momentum and strategy on a geographic, product, and customer segment basis.

Dennis will then provide additional financial parameters around our guidance for Q4 and then I will wrap it up with some comments in terms of Cisco's momentum going into Q4 of fiscal 2007.

And finally, our Q&A session. Again, this briefer format will be supplemented with more detailed information in the slides accompanying the webcast.

Now on to the discussion of Q3.

This quarter was once again another very strong record quarter from a revenue, non-GAAP, net income and non-GAAP earnings per share perspective. To put these record results in perspective, I will summarize the quarterly highlights.

First, from a key financial perspective; second, from a product and services perspective; third, by customer segment; and fourth, from a geographic point of view. Per many of your requests, in this discussion and in future quarterly conference calls we will discuss product growth and other financials primarily from a revenue perspective and use order growth rates to add color and momentum to the discussion. The customer segment and geographic discussion will be primarily in order growth numbers, as this is now how we run our business.

The key financial highlights for Q3 include the following. Record revenue of approximately $8.9 billion, a 21% year-over-year increase which was slightly above our guidance of 19 to 20% provided in the Q2 conference call. The Cisco stand-alone revenue increase was approximately 17%, which was at the high end of our stand-alone guidance of 15 to 17% provided in the Q2 conference call. This continues to be one of the fastest stand-alone year-over-year revenue growth rates we have seen in several years.

As a reminder, our long-term revenue guidance is for growth in the 10 to 15% range. We are obviously pleased with both the growth on the top and bottom lines, as well as the market share gains.

Order growth continued to be very solid, with product book-to-bill of greater than 1. Product order growth from a Cisco stand-alone perspective, that is not including Scientific Atlanta, grew in the mid-teens. Revenue growth from Scientific Atlanta was approximately 30% year-over-year, aligned to conform to Cisco's fiscal quarters.

Non-GAAP net income was $2.1 billion, an increase year-over-year of approximately 16%. GAAP net income was $1.9 billion, representing a 34% increase year-over-year. Non-GAAP earnings per share were a record $0.34 and GAAP earnings per share were $0.30, which were increases of 17% and 36% respectively year-over-year.

Cash generated from operations was $2.4 billion. We repurchased $1.5 billion of common stock and we exited the quarter with $22.3 billion in cash, cash equivalents, and investments, which increased approximately $1.7 billion over Q2. Revenue growth from our key products and services was very strong across all categories.

In terms of my view of our momentum from product and services perspective this quarter, I will analyze the results in the following five categories; routing, switching, advanced technologies, Scientific Atlanta, and customer advocacy services. Routing revenue grew year-over-year by 16%. Switching revenue grew year-over-year by 15%. And advanced technologies revenues grew year-over-year by approximately 24%, not including Scientific Atlanta.

Scientific Atlanta's revenue grew by approximately 30% year-over-year, as I said earlier. The advanced technologies revenues are now becoming larger in terms of their total contribution to our top line than routing. This again speaks to Cisco's constant evolution, moving into new markets and product adjacencies.

All but one of the first wave of advanced technologies grew year-over-year in double-digits; led by storage, unified communications, security and wireless. Although competition remains robust, we believe we are gaining market share versus almost all of our major competitors, but we also believe we are getting a larger share of our customers' total spend on communications and IT.

To add additional information regarding the balance of our orders across product lines and potential future momentum, we now have approximately 14 product families/technologies that have an annualized order run rate of approximately $1 billion to $4 billion, with a catalyst 6K family being our largest contributor at approximately $4 billion.

Our customer advocacy service revenue now represents approximately 16% of our total revenue. In Q3, our revenues for services grew year-over-year by approximately 19% and our non-GAAP gross margins remained extremely strong at approximately 63%.

In future calls, we'll be sharing more of our service and support strategies, as well as the revenue and profitability models of our customer services group. With the expanding services model and our movement of our Chief Globalization Officer, Wim Elfrink, to India, we fully intend to dramatically differentiate Cisco, both in customer satisfaction, as well as service revenues and profit growth.

Our customer satisfaction numbers remain very high in Q3 and continue to lead the industry in almost all major CIO categories. To the best of our knowledge, no other large high-tech company is achieving these types of both balance and growth results from such a broad product portfolio, as well as a strong services portfolio.

From a Cisco standalone geographic perspective, momentum was strong from an orders perspective and balance was good across our large theaters during Q3. Despite the slower growth for many of our technology peers in the most recent quarter, our business remained strong.

As anticipated, we saw very strong order growth from the emerging markets theater of approximately 40% year-over-year. We continue to see solid order growth momentum in our European operations. The improvement we saw in the last three quarters continued in Q3, with very solid year-over-year order growth in the low teens.

In the US, order growth grew year-over-year in the mid teens. Asia Pacific achieved solid order growth of approximately 20%. From a Cisco stand-alone customer segment perspective, we saw continued strength in the commercial market with orders growth continuing at approximately 20% year-over-year.

The service provider business remained very strong in what has traditionally been our strongest service provider quarter. Stand-alone orders grew over a very strong Q3 of fiscal year '06, by approximately 17%. As we said earlier, Scientific Atlanta was above the high end of our expectations, with year-over-year revenue growth of approximately 30%.

Video continues to drive network demand and is the potential killer application for loading and bringing value to the network. We were very pleased with the accelerating momentum from video applications. Consumer video and broadband build-out are driving much of the service provider investments.

From an enterprise and a commercial perspective, video applications such as TelePresence and unified communications will continue to load networks and require upgrades to existing networks. Forecasts are for consumer IP traffic to surpass business IP traffic for the first time this calendar year.

Our high-end CRS1 routers remained on a tear, with orders of almost $250 million in the quarter. That is an annualized run rate of approximately $1 billion. This is especially powerful when you compare it to prior quarters, which have averaged a yearly run rate of approximately $400 million.

The global enterprise business including public sector was solid, with growth of approximately 14%, up from Q2's growth of approximately 12%. US enterprise orders remained at the same pace as Q2 with growth in the mid single-digits.

From a commentary perspective, we executed as we outlined in our Q1 and Q2 calls. We will always try to share some with our shareholders in a very transparent way, both our reasons for optimism and occasional caution. Going into Q4 of last fiscal year and Q2 of this fiscal year, we did share some caution and these concerns turned out to be appropriate, at least on a macro and general technology spending level in those quarters.

In comparison going into Q1, we were a little more optimistic than some of the prevailing views in early August and it appears that these balanced views in the last three quarters were accurate. Using the quarters' results as the proof-point from a Cisco perspective, they key takeaway for Q3 is that momentum remains very strong.

These record results for Q3 continue to be due to the momentum being created by the successful implementation of our strategy. We laid the cornerstones of this strategy three, five, and seven years ago. Many of the market transitions we anticipated are converging today, as more and more communications and IT capability are moving into the network.

Our architectural approach based on intelligence in the network and tightly coupled products, has been increasing the total available market to Cisco and our share of our total customer spend in our areas.

You could characterize Cisco's position this way. We believe that the network is becoming the platform for all forms of communication in IT. The expanding role of the network builds on the end-to-end architecture we have been investing in for more than a decade.

In simple terms, our belief that the network will enable almost all forms of communication and IT appears to be occurring. As a result, our architectural approach, based on intelligence moving into the network and tightly coupled products is increasing the total available market to Cisco and our share of our customer spend as we said earlier.

As the network becomes the platform, we believe that Cisco is uniquely positioned to lead and to grow with this market transition of the Internet. As this transition occurs, we believe there is one potentially huge inflection point that will define this opportunity for Cisco and for our customers.

For end-users or customers alike, the network becomes the foundation for applications and/or services. It enables new business models for business process. This evolution is what we believe will be the second major phase of the Internet, resulting from networking-enabled personal and business process changes.

Collaboration will be fueled by Web 2.0 technologies, which is why our customers are so interested in these network-enabled capabilities, driving innovation into their companies.

As we did in the first phase of the Internet growth over a decade ago, Cisco led not just the high-tech peers, but all businesses in both the internal applications and associated productivity tied to the effective implementation of network technologies, while at the same time leading our customers in the implementation and innovation of this technology in their own environment.

We have spent the last six years preparing for the next wave of collaboration enabled by Web 2.0. In our terms, Web 2.0 is simply the technologies that enable user collaboration. These technologies include web services, Unified Communications, TelePresence, blogs, wikis, peer-to-peer networks, podcasts, mash-ups, etc.

I do not think we are being overly optimistic when we say that this second phase of the Internet, that is, collaboration enabled by Web 2.0 will drive the industry for the next decade from an innovation, productivity, personalization and process change perspective.

As most of you know, Q3 marked the one-year anniversary of our acquisition of Scientific Atlanta, and while for the last year we have been talking about Cisco stand-alone growth rates and adjusting to draw comparisons for the effect of Scientific Atlanta's contribution, it is now with a great deal of pleasure that going forward we can now provide guidance and comparisons simply on a year-over-year basis on the combined numbers beginning in Q4.

Therefore, our revenue guidance for Q4 fiscal 2007, including our usual caveats as discussed in prior calls and financial reports, is for year-over-year revenue growth of 15 to 16%. This guidance is obviously at or above the high end of our guidance that we had provided in many recent quarters.

Given that our long-term revenue guidance remains in the 10 to 15% range for growth, we are obviously very pleased with our expectations of stand-alone growth to again be in the mid teens as we outlined in last quarter's conference call.

At this time I would like to turn it over to Dennis for further discussion of the financial highlights. Dennis, to you.

Financial Overview

Thanks, John.

We were very pleased that the financial results for both Cisco stand-alone and Scientific Atlanta exceeded our expectations this quarter for revenue, operating income, and earnings per share.

Total revenue for the third quarter was $8.9 billion, an increase of 21% year-over-year. Fiscal Q3 stand-alone revenue was $8.1 billion, or 17% growth year-over-year. Scientific Atlanta Q3 revenue was $752 million or 32% growth year-over-year for the comparable period, aligned to conform to Cisco's fiscal quarters.

As a reminder, Q3 fiscal year '06 reflected only two months of Scientific Atlanta financial results, versus the three months for Q3 FY '07.

Record revenue for Scientific Atlanta was driven by several factors, including the impact of Regulation 707, a shift in the installed base to HD set-top-boxes, network upgrades and international expansion.

Routing revenue totaled $1.8 billion, up 16% year-over-year due to continued growth in our high-end router portfolio, particularly the GSR, the 7600 and the CRS-1. Switching revenue was $3.1 billion, an increase of 15% year-over-year due to strength in our fixed and modular switching portfolio.

Advanced technologies revenue totaled $2.1 billion, including $589 million of Scientific Atlanta sales, representing an increase of 36% year-over-year on a combined basis. Advanced technologies revenue not including Scientific Atlanta, grew 24% year-over-year.

Other product revenue totaled $554 million, an increase of 33% year-over-year on a combined basis and an increase of 16% year-over-year not including Scientific Atlanta. Total service revenue was $1.4 billion, up approximately 19% year-over-year on a combined basis.

Q3 total non-GAAP gross margin was 64.5%, down from 64.8% last quarter. For product only, non-GAAP gross margin for the third quarter was also 64.7%, down slightly from 64.8% last quarter, primarily due to the increased discounts and the as-expected impacts of higher Scientific Atlanta revenue, offset by volume and cost savings.

Our non-GAAP service margins on a combined basis for the third quarter were 63.2%, down from 64.4% last quarter, due primarily to investments in headcount and advanced services making up a higher proportion of our service revenue. Continued growth in advanced services has been driven by our momentum this year in service provider and emerging markets, as well as in advanced technologies.

Non-GAAP operating expenses as a percentage of revenue were approximately 35% in Q3 FY '07, down from approximately 36% in Q3 FY '06.

Our Q3 FY '07 non-GAAP tax provision was 25%. Non-GAAP net income for the third quarter of fiscal 2007 was $2.1 billion compared to $1.8 billion in the third quarter of fiscal year 2006, representing a 16% increase year-over-year.

Non-GAAP earnings per share on a fully diluted basis for the third quarter were $0.34, up from $0.29 in the third quarter of fiscal year 2006, representing a 17% increase year-over-year. GAAP net income for the third quarter was $1.9 billion as compared to $1.4 billion in the third quarter of fiscal year 2006, representing a 34% increase year-over-year.

GAAP earnings per share on a fully diluted basis for the third quarter were $0.30, up from $0.22 in the same quarter of fiscal year 2006, representing a 36% increase year-over-year.

Moving on to the balance sheet

The total of cash, cash equivalents and investments at the end of Q3 was $22.3 billion, up from $20.7 billion last quarter. During Q3 we generated $2.4 billion in cash from operations and $940 million in proceeds from stock option exercises.

We used $1.5 billion to repurchase 56 million shares of our stock at an average price of $26.85. Our cash and cash equivalents and investments balance has increased in anticipation of the acquisitions of WebEx and IronPort, both expected to close in Q4.

Moving on to accounts receivable

We ended the quarter at $3.2 billion, up from $2.9 billion at the end of Q2. At the end of Q3 FY '07, DSO, or days sales outstanding, was 33 days, up from 31 days in Q2.

Total inventory for Q3 was $1.3 billion, down from $1.6 billion last quarter. Non-GAAP inventory turns were 8.6 times, up from 7.6 times last quarter. The increase in inventory turns and reduction in inventory in Q3 was driven by our lean implementation.

Our inventory purchase commitments at the end of Q3 were $2.6 billion as compared with $2.5 billion at the end of Q2, reflecting increased sales volume. Deferred revenue increased from $6.1 billion in Q2 FY '07 to $6.3 billion in Q3, an increase of $278 million. Deferred product revenue increased by $115 million and deferred service revenue increased by $163 million from the previous quarter.

At the end of Q3 our headcount totaled 56,790, an increase of 2,227 from Q2. The new headcount was concentrated in sales, engineering, services, and our Scientific Atlanta Juarez manufacturing facility.

Summary

In conclusion, we are very pleased with our performance for the third quarter of the fiscal year.

The consistency of Cisco's performance can be attributed to our balanced approach across geographies, products and customer segments. We believe our strategy is working as we continue to effectively balance investing for the future while executing in the present.

I'll now turn it over to John.

Geographic, Customer Segment, Product and Strategy Review

Dennis, nice job and thank you.

In this section of the call, we will cover our geographies, customer segments, and product review for Q3 in more detail. Unless specifically indicated, all comments in this section are for Cisco stand-alone only.

Geographic

From a geographic point of view, there were a number of positives from our four largest theaters. First discussing the emerging markets, with growth year-over-year of approximately 40%, our business and technology architectural strategy for the emerging markets is obviously working extremely well. While this business, by definition will be lumpy, and based in part upon large orders, we have been pleased with the consistent performance. This model appears to have legs for the next decade.

Balance was very good across the four emerging markets operations. Eastern Europe, for example, led the way with growth above 50%, followed by the Middle East and Africa operations with growth in the mid-40s.

Russia and CIS achieved growth in the mid-30s and Latin America achieved growth in the mid-20s. While there are many caveats and it's obviously too early to say for sure in this process, it is very possible that we can maintain the growth in these markets in the 35 to 45% range for the foreseeable future. It also may be of interest to some of you that the emerging markets have now become our third largest theater behind the US and Europe in terms of orders.

Europe - After a slow last fiscal year, the momentum that we saw in Q1 and Q2 continued to be very solid in Q3 in Europe. Year-over-year order growth continued in the low teens. Balance was very good across all regions, with seven of the nine European operations achieving growth in double-digits.

From the US perspective, the service provider market segment continued to lead the way with growth in the high 20s year-over-year. Balance was again very good across all four US service provider areas. Just a real nice job by Rob's team, Rick's team. Rick, congratulations on that.

The commercial market continued its very strong pace with growth of approximately 20% in the US. Again, there was very good balance across four of our commercial areas. The enterprise business, after a very strong Q1, with growth above 20%, grew in the mid-single digits in Q3, which was approximately the same growth rate as the US enterprise grew in Q2.

Asia Pacific - The Asia Pacific theater continued its solid momentum with growth accelerating from the low double-digits in Q2 to approximately 20% in Q3. Balance was unusually good, with all five major areas achieving growth in double digits. This quarter India led the way with growth of approximately 50% followed by Korea with growth in the mid-40s. China's growth was in the low teens. Overall momentum in Asia Pacific feels pretty good.

In addition, we are starting to see some very positive early results of our new globalization strategy with Wim Elfrink, again, our Chief Globalization Officer moving to Bangalore with a number of our other key executives. We believe that this should have a very positive benefit throughout the region.

Japan was down slightly in terms of year-over-year growth and Rick, that's not a surprise to us until we see the next generation build-out of the IP networks in the service provider marketplace. So pretty much what we expected.

Moving on to the customer segment discussion

As we said earlier, the commercial market segment continued its solid momentum with year-over-year order growth on a global basis of approximately 20%. The commercial customer segment also achieved the best balance across our four largest theaters, with order growth again as we experienced in Q2, with each of the theaters growing comfortably in double-digits.

Growth in the service provider market segment continued to be very solid with Cisco stand-alone growth of approximately 17% and revenue growth from Scientific Atlanta, as we said earlier, of approximately 30%. To put this in perspective, Scientific Atlanta now represents approximately 10% of our total product revenue. We again continue to gain market share versus almost all of our peers in the service provider market.

Jim, once again, thanks to your team. Well done.

Growth in the enterprise, which includes the public sector, was mixed. We continue to see strong enterprise and public sector growth in Europe and the emerging markets. The US, however, remained relatively stable and steady compared to Q2 with growth in mid single-digits.

We have now had 13 quarters in a row of order growth in the 12 to 19% growth range as a total company, year-over-year on a stand-alone basis. It is this balance across products, services, geographies and customer segments in our business, that is resulting in the consistent results. For example, this quarter, very similar to the Q2 quarter, the product balance was very strong across all our areas. Our customer segments were solid with commercial again leading the way.

One of the key takeaways of this quarter is clearly the expanding role of our service provider customers. Our technology and business architecture strategy is moving Cisco from a tactical or strategic technology partner for our service providers, to a strategic business partner relationship with many of our accounts.

And as we discussed in prior conference calls, while it is too early to say for sure, I would parallel this progress to a very similar evolution that Cisco achieved in the enterprise markets in the mid-1990s. All of us understand the business results and strategic positioning in the enterprise customers and what that has enabled us in terms of business results since that time.

Moving next to the product discussion

As a reminder, in this discussion and in the future quarterly conference call product discussions, we will cover the product families primarily from a revenue perspective and use orders to add color or illustrate momentum trends.

Revenue balance was once again very good across our core routing, switching, and advanced technologies.

Again, the most effective way to understand this breadth relates to the comments that we made at the opening of the call. In Q3 we had 14 product families/technologies that had a product annualized order run rate of approximately $1 billion or above. Revenues for routing grew 16% and switching grew 15% year-over-year. Advanced technologies in total from a revenue perspective grew approximately 24% standalone.

From a standalone advanced technology perspective, storage led the way with approximately 50% growth. Unified communication was second with growth in the high 30s, followed by security with growth in the mid-20s, wireless growth in the mid teens and the network home relatively flat.

In terms of our second wave of advanced technologies, video was extremely strong, but we also saw growth in our application networking services in mid-40s year-over-year and optical, even though we did not count it as part of our advanced technologies, continued to grow very well with growth in the mid-20s.

While three of our current emerging technologies, which include telepresence, physical security and the third being digital media and signage, are still in the early development stages. Charlie, I was amazed. They grew quarter-over-quarter in Q3 by approximately 100% growth rate. This indicates a very positive momentum that even the fastest growing startups would like to have. While we are still at a relatively small quarterly run rate, our ability to move into new market adjacencies in the networking industry is continuing to achieve the desired results.

It is very difficult to single out unique products in Q3, because candidly, almost all of our top products did very well. Our top 20 products account for approximately 80% of our stand-alone product revenue and 19 of these 20 products grew in terms of year-over-year growth in revenue, at least in double-digits.

To put this in the proper position in terms of the unique balance, Q2 as we all know is a very strong quarter for us and the net quarter 16 of the top 20 products achieved this double-digit growth from a revenue perspective year-over-year. We are not aware of any other company in the IT and communications industry that is even close to these type of growth numbers and market share gains across such a broad array of products.

Our technology architecture play, with the convergence of layers 1 through 7 of the OSI stack, continues to gain traction and mind share. For example, customers understand the leadership, total cost of ownership, flexibility, and investment protection advantages they receive when they install a Cisco switch, which allows them easily and cost effectively add market-leading routing, voice, data, security, wireless, video, and other capabilities to the existing Cisco products, with the confidence that we're committed to industry-wide interoperability.

This is a very powerful differentiator compared to our competitors, who are usually present in only one or two product categories and often do not loosely, much less tightly integrate their products from an architectural perspective.

Vision, Strategy, Execution

In summary, our vision of how this industry was going to evolve appears to be playing out very much as we expected. We believe our differentiated strategy is also achieving the benefits to both Cisco and to our customers that we thought were possible.

And finally, our execution is on target in terms of results as measured by our customer partnership perspective, market share and share of our total customers' spend on communications and IT, as the network truly becomes the platform for delivering these capabilities.

It is now my pleasure to turn the call back over to Dennis for a detailed discussion of the financials regarding guidance. Dennis, back to you.

Financial Guidance

Thanks, John.

Let me remind you again that our comments include forward-looking statements. You should review our recent SEC filings that identify important risk factors and understand that actual results could materially differ from those contained in the forward-looking statements. The guidance we are providing guidance is on a non-GAAP basis with reconciliation to GAAP and also includes the effect of Scientific Atlanta.

We anticipate total revenue for the fourth quarter to be in the range of $9.2 billion to $9.3 billion, representing a 15 to 16% growth year-over-year. As we've said in the past, forecasting gross margin has always been challenging due to various factors such as volume, product mix, variable component cost, customer and channel mix and competitive pricing pressures.

That being said, we believe total gross margin will remain at approximately 64.5% due to the continuing strength in Scientific Atlanta's business, which has a lower gross margin than Cisco's stand-alone portfolio of products.

We believe Q4 operating expenses will be slightly below or above 35.5% of revenue. And we expect interest and other income to be approximately $200 million in the fourth quarter. Our tax rate provision is expected to be approximately 25%.

Please note that the above guidance does not include the acquisitions of WebEx or IronPort. Assuming that these acquisitions close halfway through the quarter, the incremental revenue would be approximately $50 million with no impact to non-GAAP earnings per share.

While we expect to continue our share repurchase program, it is difficult to predict the exact weighted average shares outstanding. We are modeling the share count to be flat to up approximately 40 million shares in weighted average shares outstanding for EPS purposes. In this estimate of share count we are not taking into consideration any further change in our stock price that could occur in the fourth quarter of FY '07. And as a point of reference, a $1.00 increase in our average stock price would increase the calculated shares outstanding for purposes of determining earnings per share by 20 to 25 million shares.

Regarding cash flow from operations we would expect to generate $500 to $700 million per month at these revenues.

For our Q4 FY '07 GAAP earnings, we anticipate that Q4 GAAP EPS will be $0.03 to $0.05 per share lower than non-GAAP EPS, primarily due to acquisition-related charges and stock option expense. Please see the slides that accompany this webcast for more detail.

Other than those items noted above, there are no other significant differences between GAAP and our non-GAAP guidance. This guidance assumes no additional acquisitions, asset impairments, restructuring, or other events which may or may not be significant.

I'll now turn the call back over to John. John?

Summary

Dennis, thank you very much. Well done.

The following is a summary of my view of Cisco's momentum and opportunities entering the fourth quarter of fiscal 2007. In areas that Cisco can control or influence, our momentum continues to be even stronger than it was a year ago. Balance continues to be very good across our geographies, products, services and customer segments.

In the US, our strategic value to our service providers is increasing, both from technology and business architecture perspective, and as we said last quarter, has the potential to continue to expand Cisco's added value to our service provider customers as we move forward. As we said last quarter, the progress of Scientific Atlanta is actually ahead of what we would have anticipated to be at this point in time.

While success is still dependent upon solid execution, our role with Scientific Atlanta in service providers has the unique potential to continue to expand throughout fiscal 2007 and into 2008. We will have a unique revenue benefit from the 7/07 security requirements that we talked about in the last conference call, both in the quarter we just finished, as well as in Q4.

The commercial market remains very solid and very well-balanced on a global basis. Our European results continue to show solid improvement with good balance across almost all countries. Asia-Pacific continues to remain very solid, again with good balance across all five of the major operations.

Our architectural strategy in the emerging markets is working extremely well. Barring some major economic or political surprises across many of these emerging countries, I would expect this theater to have the potential to grow over twice the average growth rates of the other four theaters, if we execute effectively.

While the US remains very solid, both in order momentum in total and strength in both the service provider and commercial markets, the US enterprise remains relatively sluggish with growth in the mid single-digits.

To put this balance in proper perspective, as we summarized in the Q2 conference call and are repeating at this time with almost identical commentary in this call, from our customer segments to geographic theaters and products and technology markets, we are focusing on approximately 20 different areas. It is extremely unusual to overachieve on almost all of our focus areas as we did in Q1 and Q2. Even in very strong quarters such as this one, we would expect to have at least one or two of our focus areas to be in the low to mid single-digits or even negative.

Q3 was indeed a very strong quarter.

The vast majority of our advanced technologies, emerging markets, European operations, Asia-Pacific operations, US service provider group, commercial operations, global service provider customer segment, global enterprises and public sectors and Scientific Atlanta all achieved growth in double-digits, with only the US enterprise and Japan being below this level.

Our balanced product momentum across our core technologies and advanced technologies continues to be the best that I've seen in many years. But again, it is this loosely and then tightly coupled product strategy for these technologies that dramatically differentiates Cisco from our peers as it regards our customers both in flexibility and the ability to add new market adjacency products.

Our pipeline of potential new core routing and switching products looks to be very good. Our continued evolution of our first wave of our advanced technologies and the emergence of a second wave of advanced technologies is on schedule and evolving as we expected. At the same time we're beginning to plant a potential third wave with our early stage emerging technologies.

And Charlie, I think you all have done just an amazing job. Congratulations to you and Marthin and the entire group.

In summary, our product pipeline is in excellent shape and looks really exciting. Having said that, obviously the proof is in the results. I was especially pleased with our balanced product growth across all of our product areas, given the challenges that many of our peers continue to experience.

We see the same challenges and uncertainties from an economic and a capital spending concern that many of you continue to witness. At the risk of stating the obvious, Cisco will always be affected by major economic changes, capital spending patterns, new and existing competitors, and our ability to execute or not on our strategies. Having said that, Q1, Q2 and Q3 were unusually strong quarters.

With the usual caveats, our Q4 guidance of 15 to 16% year-over-year in what is traditionally our strongest quarter growth is obviously above our traditional guidance of 10 to 15% and continues to be at the very high end of our guidance that we have provided in a number of years.

This aggressive guidance obviously indicates a high degree of confidence in our strategy and business momentum, once again with the usual caveats. In addition, I would not underestimate the potential that collaboration enabled by Web 2.0 technologies could have on Cisco's and the entire IT and communications industry's growth over the next five to 10 years. We will discuss these topics in more details in future conference calls.

We will focus on what we can control and influence and attempt to position Cisco to gain momentum in market transitions, whether they are industry consolidation, product transitions, or economic. In summary, for those areas that we can control or influence, we believe that our vision, strategy, and execution are in great shape and producing the desired results.

As always, I want to thank our shareholders, customers, employees and partners for their support and continued confidence in our ability to execute during rapid industry consolidation, market transitions, and changing economic times.

Blair, let me turn it back over to you.

Closing Remarks

Okay. Thank you, John.

Now we're going to open up the call to our Q&A session. As we have before, and I will remind you, we do request that sell-side analysts please ask only one question. So Martee, let's go ahead and open up for questions.