CISCO SYSTEMS, INC.
Form 10-Q
November 22, 2016
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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FORM 10-Q
(Mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 29, 2016

OR
o 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

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CISCO SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| California | 77-0059951 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

170 West Tasman Drive
San Jose, California 95134
(Address of principal executive office and zip code)
(408) 526-4000
(Registrant's telephone number, including area code)

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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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer x | Accelerated filer o |
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Number of shares of the registrant's common stock outstanding as of November 17, 2016: 5,019,758,934

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Form 10-Q for the Quarter Ended October 29, 2016
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)
CISCO SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(in millions, except par value)
(Unaudited)

| | October 29, 2016 | July 30, 2016 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $8,583 | $7,631 |
| Investments | 62,385 | 58,125 |
| Accounts receivable, net of allowance for doubtful accounts of $247 at October 29, 2016 and $249 at July 30, 2016 | 4,805 | 5,847 |
| Inventories | 1,176 | 1,217 |
| Financing receivables, net | 4,541 | 4,272 |
| Other current assets | 1,651 | 1,627 |
| Total current assets | 83,141 | 78,719 |
| Property and equipment, net | 3,499 | 3,506 |
| Financing receivables, net | 4,784 | 4,158 |
| Goodwill | 26,823 | 26,625 |
| Purchased intangible assets, net | 2,297 | 2,501 |
| Deferred tax assets | 4,057 | 4,299 |
| Other assets | 1,686 | 1,844 |
| TOTAL ASSETS | $126,287 | $121,652 |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Short-term debt | $4,155 | $4,160 |
| Accounts payable | 996 | 1,056 |
| Income taxes payable | 32 | 517 |
| Accrued compensation | 2,619 | 2,951 |
| Deferred revenue | 10,215 | 10,155 |
| Other current liabilities | 5,200 | 6,072 |
| Total current liabilities | 23,217 | 24,911 |
| Long-term debt | 30,634 | 24,483 |
| Income taxes payable | 883 | 925 |
| Deferred revenue | 6,736 | 6,317 |
| Other long-term liabilities | 1,404 | 1,431 |
| Total liabilities | 62,874 | 58,067 |
| Commitments and contingencies (Note 12) | | |
| Equity: | | |
| Cisco 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; 5,024 and 5,029 shares issued and outstanding at October 29, 2016 and July 30, 2016, respectively | 44,236 | 44,516 |
| Retained earnings | 19,694 | 19,396 |
| Accumulated other comprehensive income (loss) | (524) | (326) |
| Total Cisco shareholders’ equity | 63,406 | 63,586 |

| | | |
|---|---|---|
| Noncontrolling interests | 7 | (1 ) |
| Total equity | 63,413 | 63,585 |
| TOTAL LIABILITIES AND EQUITY | $ 126,287 | $ 121,652 |

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per-share amounts)
(Unaudited)

| | Three Months Ended | |
|---|---|---|
| | October 29, 2016 | October 24, 2015 |
| REVENUE: | | |
| Product | $9,302 | $ 9,844 |
| Service | 3,050 | 2,838 |
| Total revenue | 12,352 | 12,682 |
| COST OF SALES: | | |
| Product | 3,403 | 3,853 |
| Service | 1,065 | 997 |
| Total cost of sales | 4,468 | 4,850 |
| GROSS MARGIN | 7,884 | 7,832 |
| OPERATING EXPENSES: | | |
| Research and development | 1,545 | 1,560 |
| Sales and marketing | 2,418 | 2,443 |
| General and administrative | 555 | 539 |
| Amortization of purchased intangible assets | 78 | 69 |
| Restructuring and other charges | 411 | 142 |
| Total operating expenses | 5,007 | 4,753 |
| OPERATING INCOME | 2,877 | 3,079 |
| Interest income | 295 | 225 |
| Interest expense | (198) | (159) |
| Other income (loss), net | (21) | (8) |
| Interest and other income (loss), net | 76 | 58 |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 2,953 | 3,137 |
| Provision for income taxes | 631 | 707 |
| NET INCOME | $2,322 | $ 2,430 |
| | | |
| Net income per share: | | |
| Basic | $0.46 | $ 0.48 |
| Diluted | $0.46 | $ 0.48 |
| Shares used in per-share calculation: | | |
| Basic | 5,027 | 5,080 |
| Diluted | 5,066 | 5,113 |
| | | |
| Cash dividends declared per common share | $0.26 | $ 0.21 |

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions)
(Unaudited)

| | Three Months Ended | |
|---|---|---|
| | October 29, 2016 | October 24, 2015 |
| Net income | $2,322 | $ 2,430 |
| Available-for-sale investments: | | |
| Change in net unrealized gains, net of tax benefit (expense) of $81 and $56 for the three months ended October 29, 2016 and October 24, 2015, respectively | (121 ) | (100 ) |
| Net (gains) losses reclassified into earnings, net of tax (benefit) expense of $5 and $0 for the three months ended October 29, 2016 and October 24, 2015, respectively | (10 ) | 1 |
| | (131 ) | (99 ) |
| Cash flow hedging instruments: | | |
| Change in unrealized gains and losses, net of tax benefit (expense) of $3 for each of the three months ended October 29, 2016 and October 24, 2015, respectively | (43 ) | (1 ) |
| Net (gains) losses reclassified into earnings, net of tax (benefit) expense of $(1) for each of the three months ended October 29, 2016 and October 24, 2015, respectively | 11 | 2 |
| | (32 ) | 1 |
| Net change in cumulative translation adjustment and actuarial gains and losses net of tax benefit (expense) of $(1) and $(39) for the three months ended October 29, 2016, and October 24, 2015, respectively | (27 ) | (216 ) |
| Other comprehensive income (loss) | (190 ) | (314 ) |
| Comprehensive income | 2,132 | 2,116 |
| Comprehensive (income) loss attributable to noncontrolling interests | (8 ) | 1 |
| Comprehensive income attributable to Cisco Systems, Inc. | $2,124 | $ 2,117 |

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(Unaudited)

| | Three Months Ended | |
|---|---|---|
| | October 29, 2016 | October 24, 2015 |
| Cash flows from operating activities: | | |
| Net income | $2,322 | $ 2,430 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, amortization, and other | 599 | 507 |
| Share-based compensation expense | 372 | 376 |
| Provision for receivables | 15 | 7 |
| Deferred income taxes | 158 | 193 |
| Excess tax benefits from share-based compensation | (91) | (73) |
| (Gains) losses on investments and other, net | 32 | (4) |
| Change in operating assets and liabilities, net of effects of acquisitions and divestitures: | | |
| Accounts receivable | 1,049 | 631 |
| Inventories | 44 | 130 |
| Financing receivables | (900) | (206) |
| Other assets | 191 | 129 |
| Accounts payable | (63) | 4 |
| Income taxes, net | (440) | (315) |
| Accrued compensation | (333) | (434) |
| Deferred revenue | 462 | (19) |
| Other liabilities | (687) | (590) |
| Net cash provided by operating activities | 2,730 | 2,766 |
| Cash flows from investing activities: | | |
| Purchases of investments | (18,667) | (10,823) |
| Proceeds from sales of investments | 11,337 | 6,675 |
| Proceeds from maturities of investments | 2,449 | 4,133 |
| Acquisition of businesses, net of cash and cash equivalents acquired | (251) | (614) |
| Purchases of investments in privately held companies | (38) | (78) |
| Return of investments in privately held companies | 24 | 24 |
| Acquisition of property and equipment | (275) | (262) |
| Proceeds from sales of property and equipment | 2 | 6 |
| Other | 23 | (11) |
| Net cash used in investing activities | (5,396) | (950) |
| Cash flows from financing activities: | | |
| Issuances of common stock | 88 | 385 |
| Repurchases of common stock—repurchase program | (1,023) | (1,210) |
| Shares repurchased for tax withholdings on vesting of restricted stock units | (401) | (382) |
| Short-term borrowings, original maturities less than 90 days, net | — | (4) |
| Issuances of debt | 6,232 | — |
| Repayments of debt | (1) | (852) |
| Excess tax benefits from share-based compensation | 91 | 73 |
| Dividends paid | (1,308) | (1,068) |
| Other | (60) | 123 |

| | | |
|---|---|---|
| Net cash provided by (used in) financing activities | 3,618 | (2,935) |
| Net increase (decrease) in cash and cash equivalents | 952 | (1,119) |
| Cash and cash equivalents, beginning of period | 7,631 | 6,877 |
| Cash and cash equivalents, end of period | $8,583 | $ 5,758 |
| | | |
| Supplemental cash flow information: | | |
| Cash paid for interest | $248 | $ 264 |
| Cash paid for income taxes, net | $913 | $ 828 |

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF EQUITY
(in millions, except per-share amounts)
(Unaudited)

| | Shares of Common Stock | Common Stock and Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Cisco Shareholders' Equity | Non-controlling Interests | Total Equity |
|---|---|---|---|---|---|---|---|
| BALANCE AT JULY 30, 2016 | 5,029 | $ 44,516 | $ 19,396 | $ (326) | $ 63,586 | $ (1) | $ 63,585 |
| Net income | | | 2,322 | | 2,322 | | 2,322 |
| Other comprehensive income (loss) | | | | (198) | (198) | 8 | (190) |
| Issuance of common stock | 40 | 88 | | | 88 | | 88 |
| Repurchase of common stock | (32) | (285) | (716) | | (1,001) | | (1,001) |
| Shares repurchased for tax withholdings on vesting of restricted stock units | (13) | (401) | | | (401) | | (401) |
| Cash dividends declared ($0.26 per common share) | | | (1,308) | | (1,308) | | (1,308) |
| Tax effects from employee stock incentive plans | | (60) | | | (60) | | (60) |
| Share-based compensation | | 372 | | | 372 | | 372 |
| Purchase acquisitions and other | | 6 | | | 6 | | 6 |
| BALANCE AT OCTOBER 29, 2016 | 5,024 | $ 44,236 | $ 19,694 | $ (524) | $ 63,406 | $ 7 | $ 63,413 |

| | Shares of Common Stock | Common Stock and Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Cisco Shareholders' Equity | Non-controlling Interests | Total Equity |
|---|---|---|---|---|---|---|---|
| BALANCE AT JULY 25, 2015 | 5,085 | $ 43,592 | $ 16,045 | $ 61 | $ 59,698 | $ 9 | $ 59,707 |
| Net income | | | 2,430 | | 2,430 | | 2,430 |
| Other comprehensive income (loss) | | | | (313) | (313) | (1) | (314) |
| Issuance of common stock | 57 | 385 | | | 385 | | 385 |
| Repurchase of common stock | (45) | (386) | (821) | | (1,207) | | (1,207) |
| Shares repurchased for tax withholdings on vesting of restricted stock units | (15) | (382) | | | (382) | | (382) |
| Cash dividends declared ($0.21 per common share) | | | (1,068) | | (1,068) | | (1,068) |
| Tax effects from employee stock incentive plans | | 39 | | | 39 | | 39 |
| Share-based compensation | | 376 | | | 376 | | 376 |
| Purchase acquisitions and other | | 19 | | | 19 | | 19 |
| BALANCE AT OCTOBER 24, 2015 | 5,082 | $ 43,643 | $ 16,586 | $ (252) | $ 59,977 | $ 8 | $ 59,985 |

Supplemental Information
In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of October 29, 2016, the Company's Board of Directors had authorized an aggregate repurchase of up to $112 billion of common stock

under this program with no termination date. For additional information regarding stock repurchase, see Note 13 to the Consolidated Financial Statements. The stock repurchases since the inception of this program and the related impacts on Cisco shareholders’ equity are summarized in the following table (in millions):

| | Shares of Common Stock | Common Stock and Additional Paid-In Capital | Retained Earnings | Total Cisco Shareholders’ Equity |
|---|---|---|---|---|
| Repurchases of common stock under the repurchase program | 4,623 | $ 24,180 | $ 73,418 | $ 97,598 |

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The fiscal year for Cisco Systems, Inc. (the “Company” or “Cisco”) is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2017 is a 52-week fiscal year, and fiscal 2016 was a 53-week fiscal year. The Consolidated Financial Statements include the accounts of Cisco and its subsidiaries. All intercompany accounts and transactions have been eliminated. The Company conducts business globally and is primarily managed on a geographic basis in the following three geographic segments: the Americas; Europe, Middle East, and Africa (EMEA); and Asia Pacific, Japan, and China (APJC).

The accompanying financial data as of October 29, 2016 and for the three months ended October 29, 2016 and October 24, 2015 has been prepared by the Company, without audit, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. The July 30, 2016 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended July 30, 2016.

The Company consolidates its investments in a venture fund managed by SOFTBANK Corp. and its affiliates (“SOFTBANK”) as this is a variable interest entity and the Company is the primary beneficiary. The noncontrolling interests attributed to SOFTBANK are presented as a separate component from the Company’s equity in the equity section of the Consolidated Balance Sheets. SOFTBANK’s share of the earnings in the venture fund are not presented separately in the Consolidated Statements of Operations as these amounts are not material for any of the fiscal periods presented.

In the opinion of management, all normal recurring adjustments necessary to present fairly the consolidated balance sheet as of October 29, 2016; the results of operations, the statements of comprehensive income, the statements of cash flows and equity for the three months ended October 29, 2016 and October 24, 2015 as applicable, have been made. The results of operations for the three months ended October 29, 2016 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

Certain reclassifications have been made to the amounts in prior periods in order to conform to the current period’s presentation. The Company has evaluated subsequent events through the date that the financial statements were issued.

2. Recent Accounting Pronouncements

(a) New Accounting Updates Recently Adopted

Consolidation of Certain Types of Legal Entities  In February 2015, the FASB issued an accounting standard update that changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The accounting standard update became effective for the Company beginning in the first quarter of fiscal 2017. The application of this accounting standard update did not have any impact on the Company's Consolidated Balance Sheet or Statement of Operations upon adoption, but the Company has provided additional disclosures in Note 8 pursuant to this accounting standard update.

(b) Recent Accounting Standards or Updates Not Yet Effective

Revenue Recognition  In May 2014, the Financial Accounting Standards Board ("FASB") issued an accounting standard update related to revenue from contracts with customers, which, along with amendments issued in 2015 and 2016, will supersede nearly all current U.S. GAAP guidance on this topic and eliminate industry-specific guidance. The underlying principle is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This accounting standard update, as amended, will be effective for the Company beginning in the first quarter of fiscal 2019. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized in retained earnings as of the date of adoption ("modified retrospective basis"). Early adoption is permitted, but no earlier than fiscal 2018. The Company expects to adopt this accounting standard update on a modified retrospective basis in the first quarter of fiscal 2019, and it is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Financial Instruments In January 2016, the FASB issued an accounting standard update that changes the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Leases In February 2016, the FASB issued an accounting standard update related to leases requiring lessees to recognize operating and financing lease liabilities on the balance sheet, as well as corresponding right-of-use assets. The new lease standard also makes some changes to lessor accounting and aligns key aspects of the lessor accounting model with the revenue recognition standard. In addition, disclosures will be required to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2020 on a modified retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Share-Based Compensation In March 2016, the FASB issued an accounting standard update that impacts the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the Consolidated Statements of Cash Flows. The accounting standard will be effective for the Company beginning the first quarter of fiscal 2018, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Credit Losses of Financial Instruments In June 2016, the FASB issued an accounting standard update that requires measurement and recognition of expected credit losses for financial assets held based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2021 on a modified retrospective basis, and early adoption in fiscal 2020 is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Classification of Cash Flow Elements In August 2016, the FASB issued an accounting standard update related to the classification of certain cash receipts and cash payments on the statement of cash flows. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019 on a retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Statements of Cash Flows.

Income Taxes on Intra-Entity Transfers of Assets In October 2016, the FASB issued an accounting standard update that requires recognition of the income tax consequences of intra-entity transfers of assets (other than inventory) at the transaction date. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019 on a modified retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

## 3. Acquisitions and Divestitures

The Company completed three acquisitions during the three months ended October 29, 2016. A summary of the allocation of the total purchase consideration is presented as follows (in millions):

| | Purchase Consideration | Purchased Intangible Assets | Goodwill |
|---|---|---|---|
| CloudLock | $ 249 | $ 36 | $ 213 |
| Others (two in total) | 9 | 5 | 4 |
| Total | $ 258 | $ 41 | $ 217 |

On August 1, 2016, the Company completed its acquisition of privately held CloudLock Inc. ("CloudLock"), a provider of cloud security that specializes in cloud access security broker technology that provides enterprises with visibility and analytics around user behavior and sensitive data in cloud services. Revenue from the CloudLock acquisition has been included in the Company's Security product category.

The total purchase consideration related to the Company’s acquisitions completed during the three months ended October 29, 2016 consisted of cash consideration and vested share-based awards assumed. The total cash and cash equivalents acquired from these acquisitions was approximately $1 million. Total transaction costs related to the Company’s acquisition activities were $1 million and $5 million for the three months ended October 29, 2016 and October 24, 2015, respectively. These transaction costs were expensed as incurred in general and administrative expenses ("G&A") in the Consolidated Statements of Operations.

The Company's purchase price allocation for acquisitions completed during recent periods is preliminary and subject to revision as additional information about fair value of assets and liabilities becomes available. Additional information that existed as of the acquisition date but at that time was unknown to the Company may become known to the Company during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. Adjustments in the purchase price allocation may require a recasting of the amounts allocated to goodwill retroactive to the period in which the acquisition occurred.

The goodwill generated from the Company's acquisitions completed during the three months ended October 29, 2016 is primarily related to expected synergies. The goodwill is generally not deductible for income tax purposes.

The Consolidated Financial Statements include the operating results of each acquisition from the date of acquisition. Pro forma results of operations for the acquisitions completed during the three months ended October 29, 2016 have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to the Company's financial results.

## 4. Goodwill and Purchased Intangible Assets

### (a) Goodwill

The following table presents the goodwill allocated to the Company's reportable segments as of and during the three months ended October 29, 2016 (in millions):

| | Balance at July 30, 2016 | Acquisitions | Other | Balance at October 29, 2016 |
|---|---|---|---|---|
| Americas | $16,529 | $ 132 | $(13) | $ 16,648 |
| EMEA | 6,269 | 62 | (4) | 6,327 |
| APJC | 3,827 | 23 | (2) | 3,848 |
| Total | $26,625 | $ 217 | $(19) | $ 26,823 |

"Other" in the table above primarily consists of foreign currency translation, as well as immaterial purchase accounting adjustments.

### (b) Purchased Intangible Assets

The following table presents details of the Company's intangible assets acquired through acquisitions completed during the three months ended October 29, 2016 (in millions, except years):

| | FINITE LIVES | | | | | | INDEFINITE LIVES | TOTAL |
|---|---|---|---|---|---|---|---|---|
| | TECHNOLOGY | | CUSTOMER RELATIONSHIPS | | OTHER | | IPR&D | |
| | Weighted-Average Useful Life (in Years) | Amount | Weighted-Average Useful Life (in Years) | Amount | Weighted-Average Useful Life (in Years) | Amount | Amount | Amount |
| CloudLock | 6.0 | $ 32 | 4.0 | $ 3 | 1.5 | $ 1 | $ — | $ 36 |
| Others (two in total) | 3.0 | 5 | 0.0 | — | 0.0 | — | — | 5 |
| Total | | $ 37 | | $ 3 | | $ 1 | $ — | $ 41 |

The following tables present details of the Company's purchased intangible assets (in millions):

| October 29, 2016 | Gross | Net |
|---|---|---|

| | | Accumulated Amortization | | |
|---|---|---|---|---|
| Purchased intangible assets with finite lives: | | | | |
| Technology | $2,861 | $ (1,334 | ) | $1,527 |
| Customer relationships | 1,737 | (1,220 | ) | 517 |
| Other | 58 | (21 | ) | 37 |
| Total purchased intangible assets with finite lives | 4,656 | (2,575 | ) | 2,081 |
| In-process research and development, with indefinite lives | 216 | — | | 216 |
| Total | $4,872 | $ (2,575 | ) | $2,297 |

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| July 30, 2016 | Gross | Accumulated Amortization | Net |
|---|---|---|---|
| Purchased intangible assets with finite lives: | | | |
| Technology | $3,038 | $ (1,391) | $1,647 |
| Customer relationships | 1,793 | (1,203) | 590 |
| Other | 85 | (43) | 42 |
| Total purchased intangible assets with finite lives | 4,916 | (2,637) | 2,279 |
| In-process research and development, with indefinite lives | 222 | — | 222 |
| Total | $5,138 | $ (2,637) | $2,501 |

Purchased intangible assets include intangible assets acquired through acquisitions as well as through direct purchases or licenses.

Impairment charges related to purchased intangible assets for the three months ended October 29, 2016 were $42 million. Impairment charges were primarily as a result of declines in estimated fair values of certain purchased intangible assets resulting from the reduction or elimination of expected future cash flows associated with certain of the Company’s technology and IPR&D intangible assets. Of these impairment charges, $38 million was recorded to restructuring and other charges upon the Company's decision to exit certain product lines, and the corresponding elimination of future associated cash flows. There were no impairment charges related to purchased intangible assets for the corresponding period in fiscal 2016.

The following table presents the amortization of purchased intangible assets including impairment charges related to purchased intangible assets (in millions):

| | Three Months Ended | |
|---|---|---|
| | October 29, 2016 | October 24, 2015 |
| Amortization of purchased intangible assets: | | |
| Cost of sales | $129 | $ 146 |
| Operating expenses | | |
| Amortization of purchased intangible assets | 78 | 69 |
| Restructuring and other charges | 38 | — |
| Total | $245 | $ 215 |

The estimated future amortization expense of purchased intangible assets with finite lives as of October 29, 2016 is as follows (in millions):

| Fiscal Year | Amount |
|---|---|
| 2017 (remaining nine months) | $ 524 |
| 2018 | 579 |
| 2019 | 493 |
| 2020 | 281 |
| 2021 | 137 |
| Thereafter | 67 |
| Total | $ 2,081 |

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CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

5. Restructuring and Other Charges

In August 2016, the Company announced a restructuring plan (the "Fiscal 2017 Plan") that will impact up to 5,500 employees, representing approximately 7% of its global workforce. The Company's aggregate pretax estimated charges pursuant to the restructuring plan are expected to be up to $700 million, consisting primarily of severance and other one-time termination benefits, and other associated costs. These charges are primarily cash-based, and the Company expects the Fiscal 2017 Plan to be substantially completed by the end of fiscal 2017.

In connection with a restructuring action announced in August 2014 (the "Fiscal 2015 Plan"), the Company incurred cumulative charges of approximately $756 million. The Company completed the Fiscal 2015 Plan in fiscal 2016.

The following tables summarize the activities related to the restructuring and other charges (in millions):

| | FISCAL 2015 AND PRIOR PLANS | | FISCAL 2017 PLAN | | |
|---|---|---|---|---|---|
| | Employee Severance | Other | Employee Severance | Other | Total |
| Liability as of July 30, 2016 | $21 | $24 | $— | $ — | $45 |
| Charges | — | — | 369 | 42 | 411 |
| Cash payments | (12) | — | (257) | (1) | (270) |
| Non-cash items | (4) | (2) | — | (41) | (47) |
| Liability as of October 29, 2016 | $5 | $22 | $112 | $ — | $139 |

| | FISCAL 2015 AND PRIOR PLANS | | |
|---|---|---|---|
| | Employee Severance | Other | Total |
| Liability as of July 25, 2015 | $60 | $29 | $89 |
| Charges | 125 | 17 | 142 |
| Cash payments | (123) | (6) | (129) |
| Non-cash items | — | (16) | (16) |
| Liability as of October 24, 2015 | $62 | $24 | $86 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

6. Balance Sheet Details
The following tables provide details of selected balance sheet items (in millions):

| | October 29, 2016 | July 30, 2016 |
|---|---|---|
| Inventories: | | |
| Raw materials | $ 111 | $ 91 |
| Finished goods: | | |
| Distributor inventory and deferred cost of sales | 481 | 457 |
| Manufactured finished goods | 328 | 415 |
| Total finished goods | 809 | 872 |
| Service-related spares | 237 | 236 |
| Demonstration systems | 19 | 18 |
| Total | $ 1,176 | $ 1,217 |

| | | |
|---|---|---|
| Property and equipment, net: | | |
| Gross property and equipment: | | |
| Land, buildings, and building and leasehold improvements | $ 4,819 | $ 4,778 |
| Computer equipment and related software | 1,292 | 1,288 |
| Production, engineering, and other equipment | 5,708 | 5,658 |
| Operating lease assets | 301 | 296 |
| Furniture and fixtures | 548 | 543 |
| Total gross property and equipment | 12,668 | 12,563 |
| Less: accumulated depreciation and amortization | (9,169 ) | (9,057 ) |
| Total | $ 3,499 | $ 3,506 |

| | | |
|---|---|---|
| Deferred revenue: | | |
| Service | $ 10,424 | $ 10,621 |
| Product: | | |
| Deferred revenue related to recurring software and subscription businesses | 3,801 | 3,308 |
| Deferred revenue related to two-tier distributors | 439 | 377 |
| Other product deferred revenue | 2,287 | 2,166 |
| Total product deferred revenue | 6,527 | 5,851 |
| Total | $ 16,951 | $ 16,472 |
| Reported as: | | |
| Current | $ 10,215 | $ 10,155 |
| Noncurrent | 6,736 | 6,317 |
| Total | $ 16,951 | $ 16,472 |

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CISCO SYSTEMS, INC.
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## 7. Financing Receivables and Operating Leases

### (a) Financing Receivables

Financing receivables primarily consist of lease receivables, loan receivables, and financed service contracts and other. Lease receivables represent sales-type and direct-financing leases resulting from the sale of the Company’s and complementary third-party products and are typically collateralized by a security interest in the underlying assets. Loan receivables represent financing arrangements related to the sale of the Company’s products and services, which may include additional funding for other costs associated with network installation and integration of the Company’s products and services. Lease receivables consist of arrangements with terms of four years on average, while loan receivables generally have terms of up to three years. The financed service contracts and other category includes financing receivables related to technical support and advanced services, software, and receivables related to financing of certain indirect costs associated with leases. Revenue related to the technical support services is typically deferred and included in deferred service revenue and is recognized ratably over the period during which the related services are to be performed, which typically ranges from one to three years.

A summary of the Company's financing receivables is presented as follows (in millions):

| October 29, 2016 | Lease Receivables | Loan Receivables | Financed Service Contracts and Other | Total |
|---|---|---|---|---|
| Gross | $ 3,202 | $ 2,236 | $ 4,239 | $9,677 |
| Residual value | 197 | — | — | 197 |
| Unearned income | (163) | — | — | (163) |
| Allowance for credit loss | (227) | (111) | (48) | (386) |
| Total, net | $ 3,009 | $ 2,125 | $ 4,191 | $9,325 |
| Reported as: | | | | |
| Current | $ 1,504 | $ 1,021 | $ 2,016 | $4,541 |
| Noncurrent | 1,505 | 1,104 | 2,175 | 4,784 |
| Total, net | $ 3,009 | $ 2,125 | $ 4,191 | $9,325 |

| July 30, 2016 | Lease Receivables | Loan Receivables | Financed Service Contracts and Other | Total |
|---|---|---|---|---|
| Gross | $ 3,272 | $ 2,135 | $ 3,370 | $ 8,777 |
| Residual value | 202 | — | — | 202 |
| Unearned income | (174) | — | — | (174) |
| Allowance for credit loss | (230) | (97) | (48) | (375) |
| Total, net | $ 3,070 | $ 2,038 | $ 3,322 | $ 8,430 |
| Reported as: | | | | |
| Current | $ 1,490 | $ 988 | $ 1,794 | $ 4,272 |
| Noncurrent | 1,580 | 1,050 | 1,528 | 4,158 |
| Total, net | $ 3,070 | $ 2,038 | $ 3,322 | $ 8,430 |

As of October 29, 2016 and July 30, 2016, the deferred service revenue related to "Financed Service Contracts and Other" was $2,371 million and $1,716 million, respectively.

Future minimum lease payments to the Company on lease receivables as of October 29, 2016 are summarized as follows (in millions):

| Fiscal Year | Amount |
|---|---|
| 2017 (remaining nine months) | $ 1,222 |
| 2018 | 1,066 |

| | |
|---|---|
| 2019 | 587 |
| 2020 | 260 |
| 2021 | 65 |
| Thereafter | 2 |
| Total | $ 3,202 |

Actual cash collections may differ from the contractual maturities due to early customer buyouts, refinancings, or defaults.

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(b) Credit Quality of Financing Receivables

Gross receivables, excluding residual value, less unearned income categorized by the Company's internal credit risk rating as of October 29, 2016 and July 30, 2016 are summarized as follows (in millions):

| | INTERNAL CREDIT RISK RATING | | | |
|---|---|---|---|---|
| October 29, 2016 | 1 to 4 | 5 to 6 | 7 and Higher | Total |
| Lease receivables | $1,652 | $1,293 | $ 94 | $3,039 |
| Loan receivables | 1,081 | 976 | 179 | 2,236 |
| Financed service contracts and other | 2,898 | 1,313 | 28 | 4,239 |
| Total | $5,631 | $3,582 | $ 301 | $9,514 |

| | INTERNAL CREDIT RISK RATING | | | |
|---|---|---|---|---|
| July 30, 2016 | 1 to 4 | 5 to 6 | 7 and Higher | Total |
| Lease receivables | $1,703 | $1,294 | $ 101 | $3,098 |
| Loan receivables | 986 | 967 | 182 | 2,135 |
| Financed service contracts and other | 2,077 | 1,271 | 22 | 3,370 |
| Total | $4,766 | $3,532 | $ 305 | $8,603 |

The Company determines the adequacy of its allowance for credit loss by assessing the risks and losses inherent in its financing receivables by portfolio segment. The portfolio segment is based on the types of financing offered by the Company to its customers, which consist of the following: lease receivables, loan receivables, and financed service contracts and other.

The Company's internal credit risk ratings of 1 through 4 correspond to investment-grade ratings, while credit risk ratings of 5 and 6 correspond to non-investment grade ratings. Credit risk ratings of 7 and higher correspond to substandard ratings.

In circumstances when collectibility is not deemed reasonably assured, the associated revenue is deferred in accordance with the Company's revenue recognition policies, and the related allowance for credit loss, if any, is included in deferred revenue. The Company also records deferred revenue associated with financing receivables when there are remaining performance obligations, as it does for financed service contracts. Total allowances for credit loss and deferred revenue as of October 29, 2016 and July 30, 2016 were $2,779 million and $2,112 million, respectively, and they were associated with total financing receivables before allowance for credit loss of $9,711 million and $8,805 million as of their respective period ends.

The following tables present the aging analysis of gross receivables, excluding residual value and less unearned income as of October 29, 2016 and July 30, 2016 (in millions):

| | DAYS PAST DUE (INCLUDES BILLED AND UNBILLED) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| October 29, 2016 | 31-60 | 61-90 | 91+ | Total Past Due | Current | Total | Nonaccrual Financing Receivables | Impaired Financing Receivables |
| Lease receivables | $86 | $ 70 | $249 | $ 405 | $2,634 | $3,039 | $ 55 | $ 55 |
| Loan receivables | 25 | 23 | 95 | 143 | 2,093 | 2,236 | 42 | 42 |
| Financed service contracts and other | 317 | 338 | 367 | 1,022 | 3,217 | 4,239 | 29 | 9 |
| Total | $428 | $ 431 | $711 | $ 1,570 | $7,944 | $9,514 | $ 126 | $ 106 |

DAYS PAST DUE
(INCLUDES BILLED AND
UNBILLED)

| July 30, 2016 | 31-60 | 61-90 | 91+ | Total Past Due | Current | Total | Nonaccrual Financing Receivables | Impaired Financing Receivables |
|---|---|---|---|---|---|---|---|---|
| Lease receivables | $111 | $ 25 | $251 | $ 387 | $2,711 | $3,098 | $ 60 | $ 60 |
| Loan receivables | 30 | 9 | 37 | 76 | 2,059 | 2,135 | 42 | 42 |
| Financed service contracts and other | 213 | 152 | 565 | 930 | 2,440 | 3,370 | 30 | 10 |
| Total | $354 | $ 186 | $853 | $ 1,393 | $7,210 | $8,603 | $ 132 | $ 112 |

Past due financing receivables are those that are 31 days or more past due according to their contractual payment terms. The data in the preceding tables is presented by contract, and the aging classification of each contract is based on the oldest outstanding receivable, and therefore past due amounts also include unbilled and current receivables within the same contract. The balances of either unbilled or current financing receivables included in the category of 91 days plus past due for financing receivables were $436 million and $670 million as of October 29, 2016 and July 30, 2016, respectively.

As of October 29, 2016, the Company had financing receivables of $236 million, net of unbilled or current receivables, that were in the category of 91 days plus past due but remained on accrual status as they are well secured and in the process of collection. Such balance was $144 million as of July 30, 2016.

(c) Allowance for Credit Loss Rollforward

The allowances for credit loss and the related financing receivables are summarized as follows (in millions):

| | CREDIT LOSS ALLOWANCES | | | |
|---|---|---|---|---|
| | Lease Receivables | Loan Receivables | Financed Service Contracts and Other | Total |
| Allowance for credit loss as of July 30, 2016 | $230 | $ 97 | $ 48 | $375 |
| Provisions | (4) | 12 | — | 8 |
| Foreign exchange and other | 1 | 2 | — | 3 |
| Allowance for credit loss as of October 29, 2016 | $227 | $ 111 | $ 48 | $386 |

| | CREDIT LOSS ALLOWANCES | | | |
|---|---|---|---|---|
| | Lease Receivables | Loan Receivables | Financed Service Contracts and Other | Total |
| Allowance for credit loss as of July 25, 2015 | $259 | $ 87 | $ 36 | $382 |
| Provisions | — | 4 | — | 4 |
| Recoveries (write-offs), net | (4) | — | (3) | (7) |
| Foreign exchange and other | — | (1) | — | (1) |
| Allowance for credit loss as of October 24, 2015 | $255 | $ 90 | $ 33 | $378 |

The Company assesses the allowance for credit loss related to financing receivables on either an individual or a collective basis. The Company considers various factors in evaluating lease and loan receivables and the earned portion of financed service contracts for possible impairment on an individual basis. These factors include the Company's historical experience, credit quality and age of the receivable balances, and economic conditions that may affect a customer's ability to pay. When the evaluation indicates that it is probable that all amounts due pursuant to the contractual terms of the financing agreement, including scheduled interest payments, are unable to be collected, the financing receivable is considered impaired. All such outstanding amounts, including any accrued interest, will be assessed and fully reserved at the customer level. The Company's internal credit risk ratings are categorized as 1 through 10, with the lowest credit risk rating representing the highest quality financing receivables.

Typically, the Company also considers receivables with a risk rating of 8 or higher to be impaired and will include them in the individual assessment for allowance. These balances, as of October 29, 2016 and July 30, 2016, are presented under "(b) Credit Quality of Financing Receivables" above.

The Company evaluates the remainder of its financing receivables portfolio for impairment on a collective basis and records an allowance for credit loss at the portfolio segment level. When evaluating the financing receivables on a collective basis, the Company uses expected default frequency rates published by a major third-party credit-rating agency as well as its own historical loss rate in the event of default, while also systematically giving effect to economic conditions, concentration of risk, and correlation.

(d) Operating Leases

The Company provides financing of certain equipment through operating leases, and the amounts are included in property and equipment in the Consolidated Balance Sheets. Amounts relating to equipment on operating lease assets and the associated accumulated depreciation are summarized as follows (in millions):

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| | October 29, 2016 | July 30, 2016 |
|---|---|---|
| Operating lease assets | $ 301 | $ 296 |
| Accumulated depreciation | (168 ) | (161 ) |
| Operating lease assets, net | $ 133 | $ 135 |

Minimum future rentals on noncancelable operating leases as of October 29, 2016 are summarized as follows (in millions):

| Fiscal Year | Amount |
|---|---|
| 2017 (remaining nine months) | $ 179 |
| 2018 | 142 |
| 2019 | 53 |
| 2020 | 8 |
| 2021 | 4 |
| Thereafter | 1 |
| Total | $ 387 |

8. Investments

(a) Summary of Available-for-Sale Investments

The following tables summarize the Company's available-for-sale investments (in millions):

| October 29, 2016 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Fixed income securities: | | | | |
| U.S. government securities | $ 25,905 | $ 24 | $ (33 ) | $25,896 |
| U.S. government agency securities | 2,619 | 4 | (1 ) | 2,622 |
| Non-U.S. government and agency securities | 1,104 | 1 | (1 ) | 1,104 |
| Corporate debt securities | 29,046 | 177 | (60 ) | 29,163 |
| U.S. agency mortgage-backed securities | 2,069 | 16 | (2 ) | 2,083 |
| Total fixed income securities | 60,743 | 222 | (97 ) | 60,868 |
| Publicly traded equity securities | 1,225 | 346 | (54 ) | 1,517 |
| Total (1) | $ 61,968 | $ 568 | $ (151 ) | $62,385 |

| July 30, 2016 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Fixed income securities: | | | | |
| U.S. government securities | $ 26,473 | $ 73 | $ (2 ) | $26,544 |
| U.S. government agency securities | 2,809 | 8 | — | 2,817 |
| Non-U.S. government and agency securities | 1,096 | 4 | — | 1,100 |
| Corporate debt securities | 24,044 | 263 | (15 ) | 24,292 |
| U.S. agency mortgage-backed securities | 1,846 | 22 | — | 1,868 |
| Total fixed income securities | 56,268 | 370 | (17 ) | 56,621 |
| Publicly traded equity securities | 1,211 | 333 | (40 ) | 1,504 |
| Total (1) | $ 57,479 | $ 703 | $ (57 ) | $58,125 |

(1) Includes investments that were pending settlement as of the respective fiscal years. The net unsettled investment purchases were $328 million and $654 million as of October 29, 2016 and July 30, 2016, respectively.

Non-U.S. government and agency securities include agency and corporate debt securities that are guaranteed by non-U.S. governments.

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(b) Gains and Losses on Available-for-Sale Investments

The following table presents the gross realized gains and gross realized losses related to the Company's available-for-sale investments (in millions):

| | Three Months Ended | |
|---|---|---|
| | October 29, 2016 | October 24, 2015 |
| Gross realized gains | $30 | $ 35 |
| Gross realized losses | (15 ) | (36 ) |
| Total | $15 | $ (1 ) |

The following table presents the realized net gains (losses) related to the Company's available-for-sale investments by security type (in millions):

| | Three Months Ended | |
|---|---|---|
| | October 29, 2016 | October 24, 2015 |
| Net gains/(losses) on investments in publicly traded equity securities | $ 5 | $ (9 ) |
| Net gains/(losses) on investments in fixed income securities | 10 | 8 |
| Total | $ 15 | $ (1 ) |

The following tables present the breakdown of the available-for-sale investments with gross unrealized losses and the duration that those losses had been unrealized at October 29, 2016 and July 30, 2016 (in millions):

| | UNREALIZED LOSSES LESS THAN 12 MONTHS | | UNREALIZED LOSSES 12 MONTHS OR GREATER | | TOTAL | |
|---|---|---|---|---|---|---|
| October 29, 2016 | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fixed income securities: | | | | | | |
| U.S. government securities | $ 11,766 | $ (33 ) | $ 100 | $ — | $11,866 | $ (33 ) |
| U.S. government agency securities | 596 | (1 ) | — | — | 596 | (1 ) |
| Non-U.S. government and agency securities | 498 | (1 ) | — | — | 498 | (1 ) |
| Corporate debt securities | 9,013 | (57 ) | 572 | (3 ) | 9,585 | (60 ) |
| U.S. agency mortgage-backed securities | 594 | (2 ) | — | — | 594 | (2 ) |
| Total fixed income securities | 22,467 | (94 ) | 672 | (3 ) | 23,139 | (97 ) |
| Publicly traded equity securities | 291 | (53 ) | 3 | (1 ) | 294 | (54 ) |
| Total | $ 22,758 | $ (147 ) | $ 675 | $ (4 ) | $23,433 | $ (151 ) |

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| | UNREALIZED LOSSES LESS THAN 12 MONTHS | | UNREALIZED LOSSES 12 MONTHS OR GREATER | | TOTAL | |
|---|---|---|---|---|---|---|
| July 30, 2016 | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fixed income securities: | | | | | | |
| U.S. government securities | $ 2,414 | $ (2) | $ — | $ — | $2,414 | $ (2) |
| U.S. government agency securities | 144 | — | — | — | 144 | — |
| Non-U.S. government and agency securities | 61 | — | — | — | 61 | — |
| Corporate debt securities | 2,499 | (7) | 1,208 | (8) | 3,707 | (15) |
| U.S. agency mortgage-backed securities | 174 | — | — | — | 174 | — |
| Total fixed income securities | 5,292 | (9) | 1,208 | (8) | 6,500 | (17) |
| Publicly traded equity securities | 188 | (40) | — | — | 188 | (40) |
| Total | $ 5,480 | $ (49) | $ 1,208 | $ (8) | $6,688 | $ (57) |

As of October 29, 2016, for fixed income securities that were in unrealized loss positions, the Company has determined that (i) it does not have the intent to sell any of these investments and (ii) it is not more likely than not that it will be required to sell any of these investments before recovery of the entire amortized cost basis. In addition, as of October 29, 2016, the Company anticipates that it will recover the entire amortized cost basis of such fixed income securities and has determined that no other-than-temporary impairments associated with credit losses were required to be recognized during the three months ended October 29, 2016.

The Company has evaluated its publicly traded equity securities as of October 29, 2016 and has determined that there was no indication of other-than-temporary impairments in the respective categories of unrealized losses. This determination was based on several factors, which 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 issuer, and the Company’s intent and ability to hold the publicly traded equity securities for a period of time sufficient to allow for any anticipated recovery in market value.

(c) Maturities of Fixed Income Securities

The following table summarizes the maturities of the Company’s fixed income securities as of October 29, 2016 (in millions):

| | Amortized Cost | Fair Value |
|---|---|---|
| Less than 1 year | $ 12,967 | $ 12,977 |
| Due in 1 to 2 years | 17,042 | 17,071 |
| Due in 2 to 5 years | 25,125 | 25,230 |
| Due after 5 years | 3,540 | 3,507 |
| Mortgage-backed securities with no single maturity | 2,069 | 2,083 |
| Total | $ 60,743 | $ 60,868 |

Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay certain obligations. The remaining contractual principal maturities for mortgage-backed securities were allocated assuming no prepayments.

(d) Securities Lending

The Company periodically engages in securities lending activities with certain of its available for sale investments. These transactions are accounted for as a secured lending of the securities, and the securities are typically loaned only on an overnight basis. The average daily balance of securities lending for the three months ended October 29, 2016 and October 24, 2015 was $1.5 billion and $0.5 billion, respectively. The Company requires collateral equal to at least 102% of the fair market value of the loaned security and that the collateral be in the form of cash or liquid, high-quality assets. The Company engages in these secured lending transactions only with highly creditworthy counterparties, and the associated portfolio custodian has agreed to indemnify the Company against collateral losses. The Company did not experience any losses in connection with the secured lending of securities during the periods presented. As of October 29, 2016 and July 30, 2016, the Company had no outstanding securities lending transactions.

(e) Investments in Privately Held Companies

The carrying value of the Company’s investments in privately held companies was included in other assets. For such investments that were accounted for under the equity and cost method as of October 29, 2016 and July 30, 2016, the amounts are summarized in the following table (in millions):

| | October 29, 2016 | July 30, 2016 |
|---|---|---|
| Equity method investments | $ 162 | $ 174 |
| Cost method investments | 829 | 829 |
| Total | $ 991 | $ 1,003 |

For additional information on impairment charges related to investments in privately held companies, see Note 9.

Variable Interest Entities In the ordinary course of business, the Company has investments in privately held companies and provides financing to certain customers. These privately held companies and customers may be considered to be variable interest entities. The Company evaluates on an ongoing basis its investments in these privately held companies and its customer financings, and has determined that as of October 29, 2016, except as disclosed in Note 1, there were no significant variable interest entities required to be consolidated in the Company’s Consolidated Financial Statements.

As discussed in Note 2, during the first quarter of fiscal 2017, the Company adopted a new accounting standard update related to the consolidation of certain types of legal entities. As of October 29, 2016, the carrying value of the Company's investments in privately held companies was $991 million, of which $609 million of such investments are considered to be in variable interest entities which are unconsolidated. In addition, the Company has additional funding commitments of $189 million related to these investments, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The carrying value of these investments and the additional funding commitments collectively represent the Company's maximum exposure related to these variable interest entities.

## 9. Fair Value

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be either recorded or disclosed at fair value, the Company considers the principal or most advantageous market in which it would transact, and it also considers assumptions that market participants would use when pricing the asset or liability.

(a) Fair Value Hierarchy

The accounting guidance for fair value measurement requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard establishes a fair value hierarchy based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument’s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is as follows:

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices that are observable for the asset or liability, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

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(b) Assets and Liabilities Measured at Fair Value on a Recurring Basis
Assets and liabilities measured at fair value on a recurring basis as of October 29, 2016 and July 30, 2016 were as follows (in millions):

| | OCTOBER 29, 2016 FAIR VALUE MEASUREMENTS | | | | JULY 30, 2016 FAIR VALUE MEASUREMENTS | | | |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Balance | Level 1 | Level 2 | Level 3 | Total Balance |
| Assets: | | | | | | | | |
| Cash equivalents: | | | | | | | | |
| Money market funds | $6,749 | $— | $ — | $6,749 | $6,049 | $— | $ — | $6,049 |
| Corporate debt securities | — | — | — | — | — | 43 | — | 43 |
| Available-for-sale investments: | | | | | | | | |
| U.S. government securities | — | 25,896 | — | 25,896 | — | 26,544 | — | 26,544 |
| U.S. government agency securities | — | 2,622 | — | 2,622 | — | 2,817 | — | 2,817 |
| Non-U.S. government and agency securities | — | 1,104 | — | 1,104 | — | 1,100 | — | 1,100 |
| Corporate debt securities | — | 29,163 | — | 29,163 | — | 24,292 | — | 24,292 |
| U.S. agency mortgage-backed securities | — | 2,083 | — | 2,083 | — | 1,868 | — | 1,868 |
| Publicly traded equity securities | 1,517 | — | — | 1,517 | 1,504 | — | — | 1,504 |
| Derivative assets | — | 292 | — | 292 | — | 384 | 1 | 385 |
| Total | $8,266 | $61,160 | $ — | $69,426 | $7,553 | $57,048 | $ 1 | $64,602 |
| Liabilities: | | | | | | | | |
| Derivative liabilities | $— | $85 | $ — | $85 | $— | $54 | $ — | $54 |
| Total | $— | $85 | $ — | $85 | $— | $54 | $ — | $54 |

Level 1 publicly traded equity securities are determined by using quoted prices in active markets for identical assets. Level 2 fixed income securities are priced using quoted market prices for similar instruments or nonbinding market prices that are corroborated by observable market data. The Company uses inputs such as actual trade data, benchmark yields, broker/dealer quotes, and other similar data, which are obtained from quoted market prices, independent pricing vendors, or other sources, to determine the ultimate fair value of these assets and liabilities. The Company uses such pricing data as the primary input to make its assessments and determinations as to the ultimate valuation of its investment portfolio and has not made, during the periods presented, any material adjustments to such inputs. The Company is ultimately responsible for the financial statements and underlying estimates. The Company's derivative instruments are primarily classified as Level 2, as they are not actively traded and are valued using pricing models that use observable market inputs. The Company did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.
Level 3 assets include certain derivative instruments, the values of which are determined based on discounted cash flow models using inputs that the Company could not corroborate with market data.
(c) Assets Measured at Fair Value on a Nonrecurring Basis
The following table presents the Company's assets that were measured at fair value on a nonrecurring basis during the indicated periods and the related recognized gains and losses for the periods indicated (in millions):

TOTAL
GAINS
(LOSSES)
FOR THE
THREE
MONTHS

| | ENDED October 29, 2016 | October 24, 2015 |
|---|---|---|
| Investments in privately held companies (impaired) | $ (47 ) | $ (17 ) |
| Purchased intangible assets (impaired) | (42 ) | — |
| Total gains (losses) for nonrecurring measurements | $ (89 ) | $ (17 ) |

These assets were measured at fair value due to events or circumstances the Company identified as having significant impact on their fair value during the respective periods. To arrive at the valuation of these assets, the Company considers any significant

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changes in the financial metrics and economic variables and also uses third-party valuation reports to assist in the valuation as necessary.
The fair value measurement of the impaired investments was classified as Level 3 because significant unobservable inputs were used in the valuation due to the absence of quoted market prices and inherent lack of liquidity. Significant unobservable inputs, which included financial metrics of comparable private and public companies, financial condition and near-term prospects of the investees, recent financing activities of the investees, and the investees' capital structure as well as other economic variables, reflected the assumptions market participants would use in pricing these assets. The impairment charges, representing the difference between the net book value and the fair value as a result of the evaluation, were recorded to other income (loss), net. The remaining carrying value of the investments that were impaired was $46 million and $6 million as of October 29, 2016 and October 24, 2015, respectively.
The fair value for purchased intangible assets measured at fair value on a nonrecurring basis was categorized as Level 3 due to the use of significant unobservable inputs in the valuation. Significant unobservable inputs that were used included expected revenues and net income related to the assets and the expected life of the assets. The difference between the estimated fair value and the carrying value of the assets was recorded as an impairment charge, which was included in product cost of sales and operating expenses as applicable. See Note 4. The remaining carrying value of the specific purchased intangible assets that were impaired was $11 million and zero as of October 29, 2016 and October 24, 2015.

(d) Other Fair Value Disclosures
The carrying value of the Company's investments in privately held companies that were accounted for under the cost method was $829 million as of each of October 29, 2016 and July 30, 2016. It was not practicable to estimate the fair value of this portfolio.
The fair value of the Company's short-term loan receivables and financed service contracts approximates their carrying value due to their short duration. The aggregate carrying value of the Company's long-term loan receivables and financed service contracts and other as of October 29, 2016 and July 30, 2016 was $3.3 billion and $2.6 billion, respectively. The estimated fair value of the Company's long-term loan receivables and financed service contracts and other approximates their carrying value. The Company uses significant unobservable inputs in determining discounted cash flows to estimate the fair value of its long-term loan receivables and financed service contracts, and therefore they are categorized as Level 3.
As of October 29, 2016, the estimated fair value of the short-term debt approximates its carrying value due to the short maturities. As of October 29, 2016, the fair value of the Company's senior notes and other long-term debt was $36.5 billion with a carrying amount of $34.8 billion. This compares to a fair value of $30.9 billion and a carrying amount of $28.6 billion as of July 30, 2016. The fair value of the senior notes and other long-term debt was determined based on observable market prices in a less active market and was categorized as Level 2 in the fair value hierarchy.

10. Borrowings
(a) Short-Term Debt
The following table summarizes the Company's short-term debt (in millions, except percentages):

| | October 29, 2016 | | July 30, 2016 | |
|---|---|---|---|---|
| | Amount | Effective Rate | Amount | Effective Rate |
| Current portion of long-term debt | $ | | | |