Cisco Systems (CSCO)

Updated May 19th, 2018 by Nate Parsh

Key Metrics

Current Price:	$43	**5 Year CAGR Estimate:**	7.1%	**Quality Percentile:**	N/A
Fair Value Price:	$39	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	N/A
% Fair Value:	110%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Total Return Percentile:**	N/A
Dividend Yield:	3.1%	**5 Year Price Target**	$52	**Valuation Percentile:**	N/A

Overview & Current Events

Cisco Systems is the global leader in high performance computer networking systems. The company's routers and switches allow networks around the world to connect to each other through the internet. Cisco also offers data center, cloud and security products. The company went public on 2/16/1990 at the split adjusted price of $0.06. Today, Cisco employs more than 72,000 people and has a market cap of more than $200 billion.

Cisco reported earnings 3rd quarter of fiscal 2018 on 5/16/2018. The company earned $0.66 per share, $0.01 above estimates and a 74% improvement from Q3 2017. Cisco grew revenues 4.4% to $12.5 billion, $20 million above expectations. The company saw most geographies and divisions grow sales. One area that should interest investors is that the amount of deferred revenue from subscriptions services totaled $5.6 billion in Q3, which is an increase of 29% year over year. While the company posted nice top and bottom line beats, the stock sold off almost 4%, most likely due to Q4 revenue and earnings guidance that was just in line with market expectations. It seems that investors were looking for better guidance from a company whose stock that has increased almost 40% over the past eighteen months.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.31	$1.05	$1.33	$1.62	$1.85	$2.02	$2.06	$2.21	$2.36	$2.39	***$2.59***	***$3.47***
DPS	---	---	---	$0.12	$0.28	$0.62	$0.72	$0.80	$0.94	$1.10	***$1.32***	***$1.77***

Cisco's earnings declined in 2009, but quickly recovered in 2010. The company has managed to increase earnings every year since. Helping EPS totals was a retiring of more than 900 million shares over the past decade. Cisco has seen earnings grow at a rate of more than 6% per year over the past ten years. Based off of this historical growth rate and the company's earnings guidance for 2018, Cisco could earn $3.47 per share in 2023.

With everything from computers to cell phones to buildings to motor vehicles connected today, Cisco is in a prime position to capitalize on the Internet of Things trend. In fact, Cisco is responsible for 80% of all the data moved over the internet in the past 30 years. While Cisco continues to enjoy hardware dominance, the company is attempting to become more of a subscription services company. This should help create more predictable revenue streams. One such example of this effort is the company's Catalyst 9000 switch. This switch is twice as fast as competing products and protects an organization's data and cloud network. The amount of subscription customers for this product increased almost 90% on a year over year basis.

Cisco is one of the youngest dividend payers in our coverage universe, but shareholders have seen impressive dividend growth since the company instituted its dividend. The company has increased its dividend more than 9 fold since 2011. The most recent raise occurred on 4/3/2018 and resulted in a 14% increase. Though the payout ratio is in good shape, we assume dividend growth will equal earnings growth going forward.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	20.6	17.7	17.9	11.9	9.7	10.3	11.3	12.3	11.5	13.3	***16.6***	***15.0***
Avg. Yld.	---	---	---	0.6%	1.6%	3.0%	3.1%	2.9%	3.5%	3.5%	***3.1%***	***3.4%***

The 2008-2010-time frame saw shares of Cisco trade with a well above average price to earnings multiple. Shares have traded with a bellow market P/E for much of the time since. Excluding 2008-2010, shares have an average P/E of 11.5. The market has caught onto Cisco's subscription model and has bid shares up in recent years. Even after the nearly 4% decline after Q3 earnings were announced, shares are up almost 40% since the beginning of 2017. Given the company's growth in subscription services and large cash balance of more than $50 billion, we have a target P/E of 15 for 2023. If Cisco's stock was to revert to our target multiple, shareholders could see the multiple contract by 2% per year through 2023.

Cisco changed from a low yielding stock to a high yielding one almost overnight in 2013. While the current yield is very close to that of the 10-year Treasury Bond, Cisco's yield easily outpaces that of the S&P 500.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	43.2%	33.9%	31.6%	30.5%	30.7%	29.1%	26.4%	26.2%	25.4%	23.3%	***24.6%***	***30%***
Debt/A	41.4%	43.2%	45.4%	45.7%	44.1%	41.6%	46.1%	47.3%	47.7%	49.1%	***48.3%***	***45.2%***
Payout	---	---	---	7.4%	15.1%	30.1%	35%	36.2%	39.8%	46%	***51%***	***51%***
Std. Dev.	33.9%	28.7%	29.7%	25.9%	31.4%	22.6%	18.1%	20.4%	22.7%	16.5%	***18.2%***	***25%***

Cisco ended Q3 2018 with more than $54 billion in cash and equivalents, of which $47.5 billion is located in the United States. Interest from these investments more than offsets interest from debt. Dividend growth has outperformed earnings growth, causing the company's payout ratio to climb to almost 50%. A rising payout ratio isn't a major concern given the cash on the company's balance sheet. Due to this cash level, Cisco would be able to continue to pay a dividend even in the event of an extended recession.

Final Thoughts & Recommendation

The market has taken note of how well Cisco's subscription model has performed in recent years and have driven shares of the company up over the past year and a half. Even after the post earnings price decline, we still feel the stock trades above its fair price to earnings multiple. We believe that Cisco can offer total returns of 7.1% per year through 2023. This annual return is a combination of earnings growth (6%), dividends (3.1%) and multiple reversion (2%). Income investors will probably be satisfied with the yield. Even with the rise in share price, there is still a decent total return available in Cisco. Investors looking for more growth are advised to wait for a better entry point.

Total Return Breakdown by Year