Cisco Systems (CSCO)

Updated August 16th, 2018 by Nate Parsh

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	8.9%	**Volatility Percentile:**	44.2%
Fair Value Price:	$44	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	88.5%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	-0.1%	**Valuation Percentile:**	36.1%
Dividend Yield:	3.0%	**5 Year Price Target**	$58	**Total Return Percentile:**	36.4%

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 recently reported (8/15/18) earnings results for the 4th quarter of fiscal 2018. The company earned $0.70 per share, $0.01 above estimates and a 14.8% improvement year over year. Sales improved 5.9% to $12.85 billion, $80 million above estimates.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2018	2023
EPS	$1.05	$1.33	$1.62	$1.85	$2.02	$2.06	$2.21	$2.36	$2.39	$2.60	***$2.91***	***$3.89***
DPS	---	---	$0.12	$0.28	$0.62	$0.72	$0.80	$0.94	$1.10	$1.32	***$1.32***	***$1.77***

Between 2009 and 2018, Cisco's earnings increased at a rate of 9.5% per year, above the 2008-2017 growth rate of 6%. We reaffirm our expected growth rate of 6% as earnings had troughed in 2009 in the depths of the last recession. If Cisco shows more aggressive growth in the coming quarters, we may raise our expected earnings growth rate slightly.

Cisco's reoccurring revenues from its subscription services increased 1% (as a percent of total revenues) to 32% in the 4th quarter. Deferred product revenue from software and subscriptions improved 23% to $6.1 billion. All geographies experienced revenue growth, led by Asia with a 12% increase. Gross margins were 61.7%, a 0.5% decline from the 4th quarter of fiscal 2017. Still, Cisco generated a lot of cash and returned nearly $24 billion of it to shareholders during the year. Three-fourths of this capital was spent on buybacks during fiscal 2018. At the midpoint, Cisco forecasts revenue to grow 6% in the 1st quarter of FY 2019 to $12.86. The midpoint for EPS for the current quarter is expected to be $0.71. Both midpoints are above what analysts were expecting. The average earnings-per-share estimate for 2019 is $2.91.

With everything from computers to cell phones to buildings connected today, Cisco is in a prime position to capitalize on the Internet of Things. 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 Catalyst 9000 switch. This switch is twice as fast as competing products and protects data and cloud networks.

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 April 3rd 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	17.7	17.9	11.9	9.7	10.3	11.3	12.3	11.5	13.3	16.9	***15.1***	***15.0***
Avg. Yld.	---	---	0.6%	1.6%	3.0%	3.1%	2.9%	3.5%	3.5%	3.0%	***3.0%***	***3.1%***

Disclosure: This analyst has a long position in the security discussed in this research report

Shares of Cisco have gained $1, or 2.3%, since our May 19th update. The 2009-2010 time frame saw shares of Cisco trade with a well above average price-to-earnings multiple. Shares have traded with a bellow market price-to-earnings for much of the time since. Excluding 2009-2010, shares have an average P/E of 12.2. The market has caught onto Cisco's subscription model and has bid shares up in recent years. Given the company's growth in subscription services and large cash balance of more than $50 billion, we maintain our target P/E of 15 for 2024. If Cisco's stock was to revert to our target multiple, shareholders could see the multiple contract by just 0.1% per year through 2024. After 4th quarter earnings, Cisco has returned more than 43% since the beginning of 2017.

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

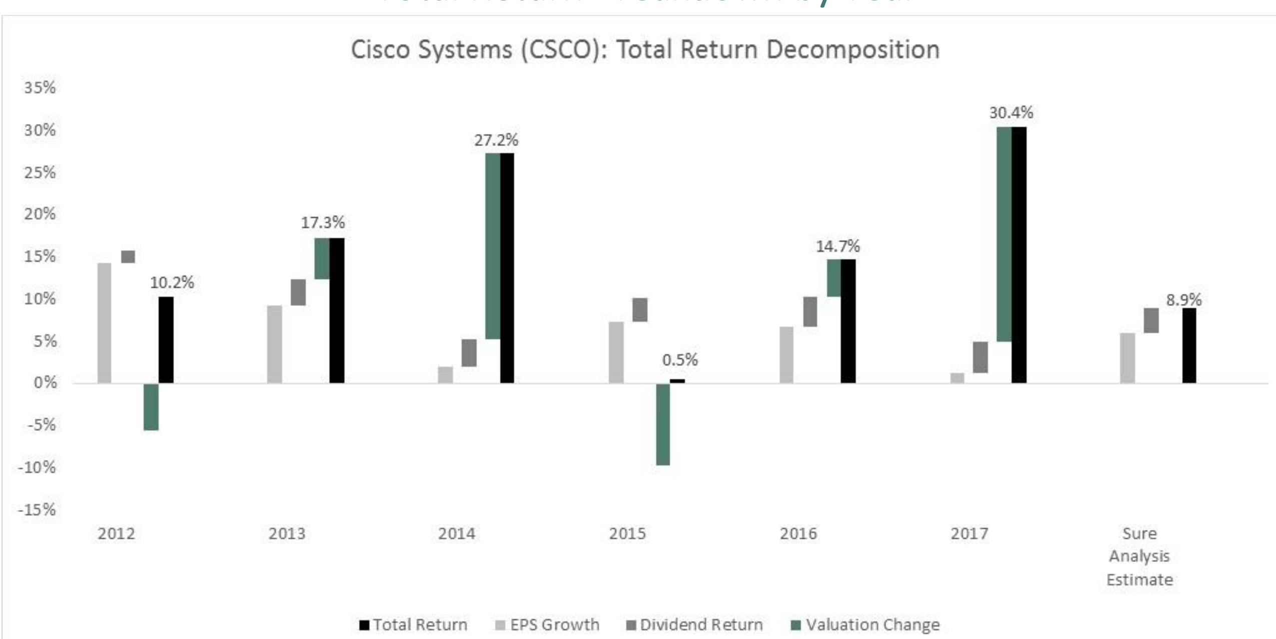
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
GP/A	33.9%	31.6%	30.5%	30.7%	29.1%	26.4%	26.2%	25.4%	23.3%	24.6%	***25.3%***	***28.2%***
Debt/A	43.2%	45.4%	45.7%	44.1%	41.6%	46.1%	47.3%	47.7%	49.1%	48.3%	***45.4%***	***45.5%***
Payout	---	---	7.4%	15.1%	30.1%	35%	36.2%	39.8%	46%	50.1%	***X%***	***X%***
Std. Dev.	28.7%	29.7%	25.9%	31.4%	22.6%	18.1%	20.4%	22.7%	16.5%	18.2%	***19.2%***	***23.4%***

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 outpaced earnings growth, causing the company's payout ratio to climb to almost 50%. A rising payout ratio is not 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

Based on guidance for 2019 and the recent share price increase, we now estimate that Cisco can offer total returns of 8.9% through 2024, up from our prior forecast of 7.1%. This annual return is a combination of earnings growth (6%), dividends (3.0%) and a slight multiple reversion (0.1%). Reoccurring and deferred revenues were up slightly during the 4th quarter. Cisco's stock spiked more than 6% following earnings, but even after this sharp gain, shares still offer solid upside from current levels. Very few technology stocks offer earnings growth and a yield higher than the 10-year treasury bond. We change our rating to buy from hold and increase our 2024 price target $6 to $58 due to higher earnings per share forecasts. Shares are now trading at what we consider to be fair value.

Total Return Breakdown by Year



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