Cisco Systems (CSCO)

Updated November 15th, 2018 by Nate Parsh

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	8.1%	**Volatility Percentile:**	35.9%
Fair Value Price:	$45	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	89.8%
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.9%	**Growth Percentile:**	48.3%
Dividend Yield:	3.0%	**5 Year Price Target**	$60	**Valuation Percentile:**	48.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Total Return Percentile:**	43.2%

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 $202 billion.

Cisco reported financial results for the 1st quarter of fiscal 2018 on November 14th. The company earned $0.75 per share, $0.03 above estimates and a 23% improvement year-over-year. Sales improved 7.9% to $13.1 billion, coming in $240 million ahead of estimates. Cisco saw growth in nearly all areas of its business, led by a 9% increase in product revenue. Applications demonstrated strong growth of 18%. Service sales improved 3%. Sales for the Americas region grew 5% while the EMEA and APJC regions saw increases of 11% and 12%, respectively. Gross margins on a GAAP basis improved 1.1% to 62.3%, largely on the strength of product margins. Deferred revenue decreased 9% to $16.8 billion. Cash flow from operation improved 22% to $3.8 billion. Cisco spent $6.5 billion to repurchase almost 110 million shares during the quarter at an average price of $46. The company also paid out $1.5 billion dividends. Following earnings, the average earnings-per-share estimate has increased to $3 from $2.91 previously.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.05	$1.33	$1.62	$1.85	$2.02	$2.06	$2.21	$2.36	$2.39	$2.60	***$3.00***	***$4.01***
DPS	---	---	$0.12	$0.28	$0.62	$0.72	$0.80	$0.94	$1.10	$1.32	***$1.32***	***$1.77***
Shares	5785	5655	5435	5298	5389	5107	5085	5029	4983	4670	***4500***	***4200***

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.

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 younger 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	***15.7***	***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.

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Shares of Cisco have gained $3, or 6.8%, since our August 16th 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 almost $43 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 0.9% per year through 2024. Cisco has returned almost 23% year-to-date and nearly 56% since the beginning of 2017.

Safety, Quality, Competitive Advantage, & Recession Resiliency

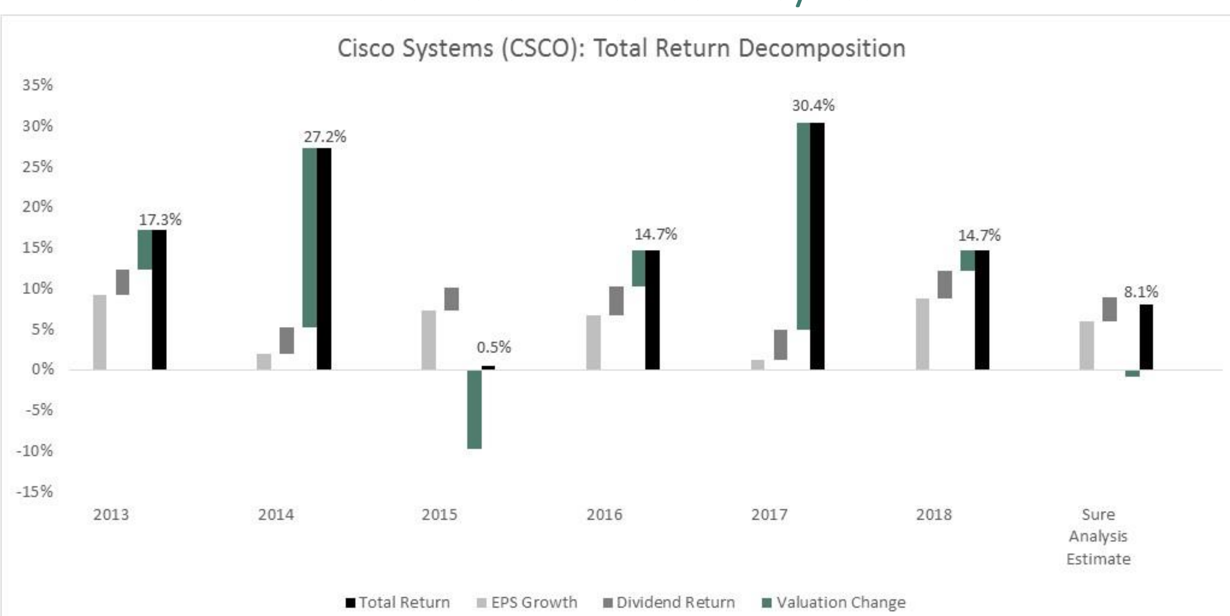
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	33.9%	31.6%	30.5%	30.7%	29.1%	26.4%	26.2%	25.4%	23.3%	24.6%	***25.3%***	***28.2%***
Debt/A	43.2%	45.4%	45.7%	44.1%	41.6%	46.1%	47.3%	47.7%	49.1%	48.3%	***45.4%***	***45.5%***
Payout	---	---	7.4%	15.1%	30.1%	35%	36.2%	39.8%	46%	50.1%	***44.1%***	***44.1%***
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%. Given the cash on the company's balance sheet, it is likely that Cisco would be able to continue to pay a dividend even in the event of an extended recession.

Final Thoughts & Recommendation

Cisco had another solid quarter. While deferred revenue was done from previous year, Cisco showed impressive international growth and almost every product category showed revenue growth. We now forecast that Cisco can offer a total annual return of 8.1% through 2024, down from our previous forecast of 8.9%. This annual return is a combination of earnings growth (6%), dividends (3.0%) and a slight multiple reversion (-0.9%). We maintain our buy rating on Cisco and increase our 2024 price target $2 to $60 due to higher expected earnings-per-share in fiscal 2019.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	36117	40040	43218	46061	48607	47142	49161	49247	48005	49329
Gross Profit	23094	25643	26536	28209	29440	27769	29681	30960	30224	30606
Gross Margin	63.9%	64.0%	61.4%	61.2%	60.6%	58.9%	60.4%	62.9%	63.0%	62.0%
SG&A Exp.	9968	10715	11720	11969	11802	11437	11861	11433	11177	11386
D&A Exp.	1768	2030	2486	2208	2460	2439	2442	2150	2286	2192
Operating Profit	7385	9164	8473	10369	11301	9763	11254	12928	12729	12667
Op. Margin	20.4%	22.9%	19.6%	22.5%	23.2%	20.7%	22.9%	26.3%	26.5%	25.7%
Net Profit	6134	7767	6490	8041	9983	7853	8981	10739	9609	110
Net Margin	17.0%	19.4%	15.0%	17.5%	20.5%	16.7%	18.3%	21.8%	20.0%	0.2%
Free Cash Flow	8892	9165	8905	10365	11734	11057	11325	12424	12912	12832
Income Tax	1559	1648	1335	2118	1244	1862	2220	2181	2678	12929

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	68.13	81.13	87.10	91.76	101.19	105.07	113.37	121.65	129.82	108.78
Cash & Equivalents	5718	4581	7662	9799	7925	6726	6877	7631	11708	8934
Acc. Receivable	3177	4929	4698	4369	5470	5157	5344	5847	5146	5554
Inventories	1074	1327	1486	1663	1476	1591	1627	1217	1616	1846
Goodwill & Int.	14627	19948	19359	18957	25322	27519	26845	29126	32305	34258
Total Liabilities	29451	36845	39836	40458	42063	48409	53666	58067	63681	65580
Accounts Payable	675	895	876	859	1029	1032	1104	1056	1385	1904
Long-Term Debt	10295	15284	16822	16328	16211	20845	25354	28643	33717	25569
Total Equity	38647	44267	47226	51286	59120	56654	59698	63586	66137	43204
D/E Ratio	0.27	0.35	0.36	0.32	0.27	0.37	0.42	0.45	0.51	0.59

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	9.7%	10.4%	7.7%	9.0%	10.3%	7.6%	8.2%	9.1%	7.6%	0.1%
Return on Equity	16.8%	18.7%	14.2%	16.3%	18.1%	13.6%	15.4%	17.4%	14.8%	0.2%
ROIC	13.6%	14.3%	10.5%	12.2%	14.0%	10.3%	11.0%	12.1%	10.0%	0.1%
Shares Out.	5785	5655	5435	5298	5389	5107	5085	5029	4983	4670
Revenue/Share	6.17	6.85	7.77	8.52	9.03	8.93	9.55	9.68	9.51	10.11
FCF/Share	1.52	1.57	1.60	1.92	2.18	2.09	2.20	2.44	2.56	2.63

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.