



Cisco Systems Inc. (CSCO)

Updated February 14th, 2019 by Nathan Parsh

Key Metrics

Current Price:	\$48	5 Year CAGR Estimate:	7.7%	Volatility Percentile:	22.1%
Fair Value Price:	\$45	5 Year Growth Estimate:	6.0%	Momentum Percentile:	75.1%
% Fair Value:	107%	5 Year Valuation Multiple Estimate:	-1.3%	Growth Percentile:	51.5%
Dividend Yield:	3.0%	5 Year Price Target	\$60	Valuation Percentile:	34.1%
Dividend Risk Score:	C	Retirement Suitability Score:	C	Total Return Percentile:	32.9%

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 capitalization of more than \$213 billion. The company generates more than \$49 billion in annual revenues.

Cisco reported financial results for the second quarter of fiscal 2019 on 2/13/2019. The company earned \$0.73 per share, \$0.01 above estimates and a 16% improvement from the previous year. Accounting for the company's divested service provider video business, revenue increased 7% to \$12.5 billion, which was \$30 million above expectations.

Cisco saw growth in almost all product areas, with infrastructure platforms growing 6%. Cisco's switching and wireless business was up double digits as the company's Catalyst 9000 saw increased demand. Applications grew a robust 24% as all business in this category saw growth. Security sales improved 18% due primarily due to higher sales in the areas of identity and access, advanced threat and unified threat. Deferred revenue decreased 8%, mostly due to deferred product revenue declining 23%. Subscription services made up 65% of software revenue during the quarter, a 10% increase from the previous year. All regions showed growth during the quarter, led by 11% growth for the Europe/Middle East/Africa region. Margins for the quarter came in at 64.1%, a slightly decrease from the previous year. Cisco paid \$1.5 billion in dividends and bought back more than \$5 billion worth of stock in the quarter. The company announced a \$15 billion increase to the existing share repurchase authorization, bringing the total authorization to \$24 billion. This is equivalent to 11% of the current market capitalization. Cisco expects revenue in a range of \$12.9 to \$13.2 billion for the third quarter of the fiscal year. Earnings-per-share is expected to be \$0.77. Guidance for both revenue and earnings was above consensus estimates. Shares of Cisco were higher by 2% following the release of results.

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	\$1.38	\$1.85
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% due to a combination of revenue growth and share repurchases.

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 average increase over the past five years is 13%. The most recent raise occurred was announced on 2/13/2019 and resulted in a 6.1% increase for the upcoming April 24th payment. Though the payout ratio is in good shape, we assume dividend growth will equal earnings growth going forward.



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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	16	15.0
Avg. Yld.	---	---	0.6%	1.6%	3.0%	3.1%	2.9%	3.5%	3.5%	3.0%	3.0%	3.1%

Shares of Cisco have gained \$1, or 2.1%, since our November 15th update. The 2009-2010-time frame saw shares of Cisco trade with a well above average price-to-earnings multiple. 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 \$40 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 15% year-to-date.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	7.4%	15.1%	30.1%	35%	36.2%	39.8%	46%	50.1%	46%	46.1%

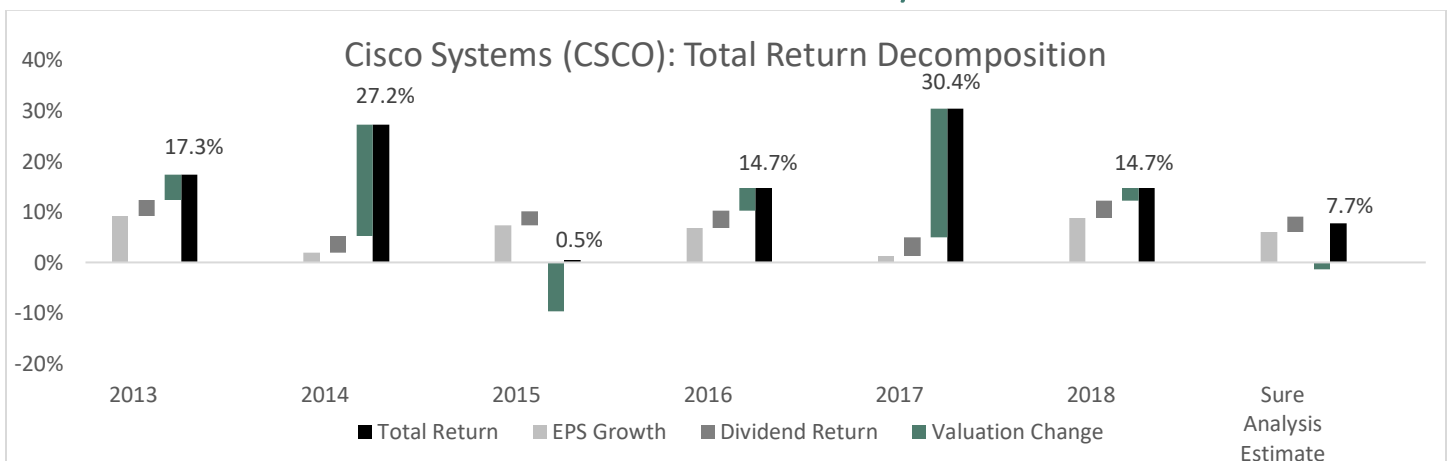
Cisco ended Q3 2018 with \$40.4 billion in cash and equivalents. Given the cash on the company's balance sheet, it is likely that Cisco would be able to continue to pay a dividend even in the event of an extended recession.

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.

Final Thoughts & Recommendation

Cisco saw growth across almost all segments of its business and in every geography that it operates. The company also has a bountiful cash balance and announced a major repurchase authorization. Our total annual return projections have decreased slightly to 7.7% from 8.1% previously due to a higher valuation today. Income investors looking for exposure to the technology sector should find the stock's dividend yield attractive. Investors looking for more growth are encouraged to wait for a pullback before buying shares of the company. We have changed our rating from buy to hold due to lower expected returns. We maintain our 2024 price target of \$60.

Total Return Breakdown by Year



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



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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.

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