



Cisco Systems Inc. (CSCO)

Updated May 15th, 2020 by Nathan Parsh

Key Metrics

Current Price:	\$44	5 Year CAGR Estimate:	10.8%	Market Cap:	\$186 billion
Fair Value Price:	\$49	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	7/3/2020 ¹
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	2.0%	Dividend Payment Date:	7/24/2020 ²
Dividend Yield:	3.3%	5 Year Price Target	\$65	Years Of Dividend Growth:	10
Dividend Risk Score:	B	Retirement Suitability Score:	C	Last Dividend Increase:	2.9%

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 generates about \$50 billion in annual revenues.

Cisco reported earnings results for the third quarter of fiscal 2020 on 5/13/2020. Adjusted earnings-per-share increased \$0.01, or 1.3%, to \$0.79, which was \$0.08 higher than anticipated by the analyst community. Revenue declined 7.5% to \$12 billion, though this was \$134 million above estimates.

Revenues for Infrastructure Platforms, which is the largest segment within Cisco, declined 15% as supply chains were interrupted by the COVID-19 pandemic. Switching revenue was lower at in both campus and data center. On the plus side, the company's Cat 9K switch continues to gain momentum. Services had sales growth of 5% due gains in software and solution support. Software subscriptions accounted for 74% of total software revenue, up 9% from the prior year. Revenues for Applications were down 5% due to weakness in unified communication. Security sales improved 6% on gains made in unified front management, identity and access and advanced threat. Total product orders were lower by 6%, led by a 22% decrease in the Asia-Pacific/Japan/China region. The Americas region was flat. Public Sector sales improved 1% with all other customer groups declining year-over-year. Total gross margins improved 200 bps to 66.6%. Deferred revenue increased 6.8% to \$18.7 billion. Cisco repurchased \$981 million worth of stock in the quarter and has \$10.8 billion, or 5.7% of its current market capitalization, remaining on its share repurchase authorization. Cisco expects fourth quarter adjusted earnings-per-share of \$0.72 to \$0.74, above consensus estimates. Revenue is expected to decline 8.5% to 11.5% year-over-year to a range of \$11.89 billion to \$12.29 billion, though this is above consensus estimates as well.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.33	\$1.62	\$1.85	\$2.02	\$2.06	\$2.21	\$2.36	\$2.39	\$2.60	\$3.09	\$3.24	\$4.34
DPS	---	\$0.12	\$0.28	\$0.62	\$0.72	\$0.80	\$0.94	\$1.10	\$1.32	\$1.40	\$1.44	\$1.93
Shares³	5655	5435	5298	5389	5107	5085	5029	4983	4670	4307	4243	4000

Between 2010 and 2019, Cisco's earnings increased at a rate of 8.8% per year. We reaffirm our expected growth rate of 6% due to a combination of improving margins and share repurchases offset by revenue weakness.

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 was announced on 2/12/2020 and resulted in a 2.9% increase for the 4/22/2020 payment. Though the payout ratio is in good shape, we assume dividend growth will equal earnings growth going forward.

¹ Estimated ex-dividend date

² Estimated dividend payment date

³ Share count in millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.9	11.9	9.7	10.3	11.3	12.3	11.5	13.3	16.9	15.0	13.6	15.0
Avg. Yld.	---	0.6%	1.6%	3.0%	3.1%	2.9%	3.5%	3.5%	3.0%	3.0%	3.3%	3.0%

Shares of Cisco have decreased \$6, or 12%, since our 2/13/2020 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. Given the company's growth in subscription services and large cash balance, we maintain our target P/E of 15 for fiscal 2025. If Cisco's stock was to revert to our target multiple by 2025, then valuation would be a 2% tailwind to annual returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	7%	15%	30%	35%	36%	40%	46%	50%	45%	44%	44%

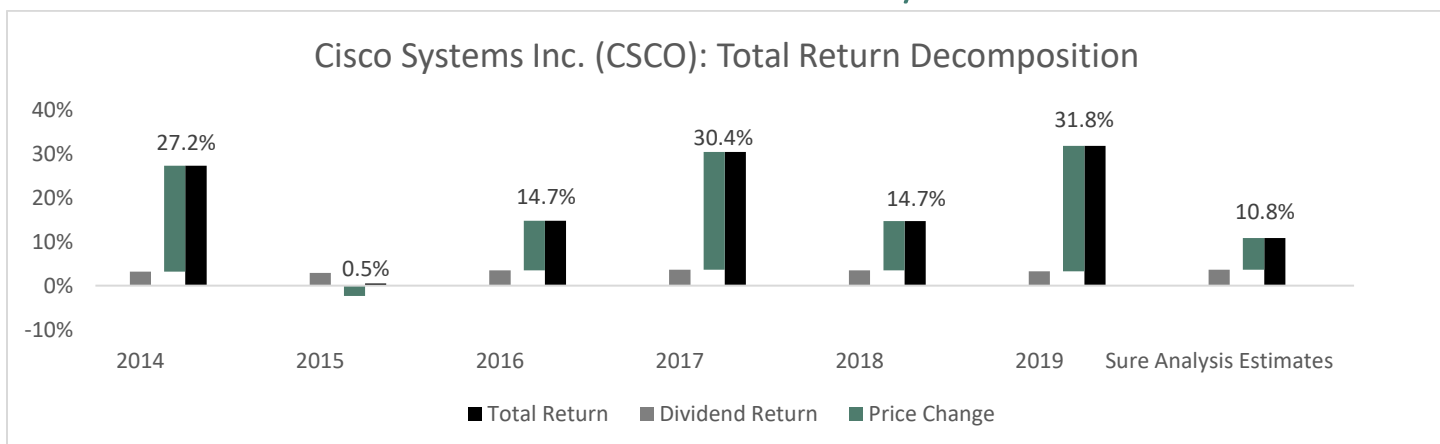
Cisco ended third quarter of fiscal 2020 with \$33.4 billion in cash and equivalents. Given the cash on the balance sheet, it is likely that Cisco would be able to continue to pay a dividend even in the event of an extended recession.

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

After reviewing third quarter results, Cisco Systems is projected to return 10.8% annually through 2025, up from our previous estimate of 8.1%. Cisco performed better on the top and bottom-lines than had been expected, though the COVID-19 pandemic did have some impact on the company's results. Supply chain issues led to a significant decline in revenue for the Infrastructure Platforms. Still, Cisco is the leader in its sector and should enjoy the benefits of such positioning for years to come. The company also has a massive cash position and a well-covered dividend. We raise our rating on the stock to buy from hold due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	40040	43218	46061	48607	47142	49161	49247	48005	49330	51904
Gross Profit	25643	26536	28209	29440	27769	29681	30960	30224	30606	32666
Gross Margin	64.0%	61.4%	61.2%	60.6%	58.9%	60.4%	62.9%	63.0%	62.0%	62.9%
SG&A Exp.	10715	11720	11969	11802	11437	11861	11433	11177	11386	11398
D&A Exp.	2030	2486	2208	2460	2439	2442	2150	2286	2192	1897
Operating Profit	9164	8473	10369	11301	9763	11254	12928	12729	12667	14541
Op. Margin	22.9%	19.6%	22.5%	23.2%	20.7%	22.9%	26.3%	26.5%	25.7%	28.0%
Net Profit	7767	6490	8041	9983	7853	8981	10739	9609	110	11621
Net Margin	19.4%	15.0%	17.5%	20.5%	16.7%	18.3%	21.8%	20.0%	0.2%	22.4%
Free Cash Flow	9165	8905	10365	11734	11057	11325	12424	12912	12832	14922
Income Tax	1648	1335	2118	1244	1862	2220	2181	2678	12929	2950

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets (\$B)	81	87	92	101	105	113	122	130	109	98
Cash & Equivalents	4581	7662	9799	7925	6726	6877	7631	11708	8934	11750
Acc. Receivable	4929	4698	4369	5470	5157	5344	5847	5146	5554	5491
Inventories	1327	1486	1663	1476	1591	1627	1217	1616	1846	1383
Goodwill & Int.	19948	19359	18957	25322	27519	26845	29126	32305	34258	35730
Total Liabilities	36845	39836	40458	42063	48409	53666	58067	63681	65580	64222
Accounts Payable	895	876	859	1029	1032	1104	1056	1385	1904	2059
Long-Term Debt	15284	16822	16328	16211	20845	25354	28643	33717	25569	24666
Total Equity	44267	47226	51286	59120	56654	59698	63586	66137	43204	33571
D/E Ratio	0.35	0.36	0.32	0.27	0.37	0.42	0.45	0.51	0.59	0.73

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	10.4%	7.7%	9.0%	10.3%	7.6%	8.2%	9.1%	7.6%	0.1%	11.3%
Return on Equity	18.7%	14.2%	16.3%	18.1%	13.6%	15.4%	17.4%	14.8%	0.2%	30.3%
ROIC	14.3%	10.5%	12.2%	14.0%	10.3%	11.0%	12.1%	10.0%	0.1%	18.3%
Shares Out.	5655	5435	5298	5389	5107	5085	5029	4983	4670	4307
Revenue/Share	6.85	7.77	8.52	9.03	8.93	9.55	9.68	9.51	10.11	11.66
FCF/Share	1.57	1.60	1.92	2.18	2.09	2.20	2.44	2.56	2.63	3.35

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

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