Cisco Systems Inc. (CSCO)

Updated February 12th, 2021 by Nathan Parsh

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	9.3%	**Market Cap:**	$199 billion
Fair Value Price:	$48	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	4/5/2021
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.5%	**Dividend Payment Date:**	4/28/2021
Dividend Yield:	3.1%	**5 Year Price Target**	$64	**Years Of Dividend Growth:**	11
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	2.8%

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 $49 billion in annual revenues.

Cisco reported earnings results for the second quarter of fiscal year 2021 on 2/9/2021. Revenue of $12 billion was flat from the previous year, but ahead of the company's guidance and $100 million above analysts' estimates. Adjusted net income of $3.4 billion was a 2% increase from the same quarter a year ago. Adjusted earnings-per-share of $0.79 was 2.6% better than the prior year and $0.04 higher than expected.

Infrastructure Platforms, which is the largest segment within Cisco, experienced a 3% revenue decline, but this was a significant deacceleration from the prior two quarters. COVID-19 remains a headwind as customers have decreased spending on certain products. Demand for the Catalyst 9K remains robust and data center switching was improved. Services sales again grew 2% due to strength in software revenue. Software subscriptions accounted for 76% of total software revenue, an increase of 4% from the previous year. Applications was flat year-over-year, but much improved on a sequential basis. Security sales grew 10%. By region, sales for the Americas declined 0.6%, EMEA grew 2.3% and Asia-Pacific/Japan/China declined 0.4%. By customer category, public sector, service provider and commercial revenues were up 10%, 5% and 1%, respectively while enterprise fell 9%. Total gross margins expanded 50 basis points to 66.9%. Deferred revenue grew 12% to $20.8 billion. Cisco repurchased 19 million shares at an average price of $42.82. Cisco has $9.2 billion, or 4.6% of its current market cap, remaining on its share repurchase authorization. The company also distributed $1.5 billion of dividends during the quarter.

Cisco expects third quarter of fiscal year 2021 adjusted earnings-per-share of $0.80 to $0.82, a 2.65% improvement from the previous year at the midpoint. Revenue is expected to grow 3.5% to 5.5% from the prior year. Analysts expect adjusted EPS of $3.21 for fiscal year 2021, up from $3.12 previously.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.62	$1.85	$2.02	$2.06	$2.21	$2.36	$2.39	$2.60	$3.09	$3.21	***$3.21***	***$4.30***
DPS	$0.12	$0.28	$0.62	$0.72	$0.80	$0.94	$1.10	$1.32	$1.40	$1.44	***$1.48***	***$1.98***
Shares[1]	5435	5298	5389	5107	5085	5029	4983	4670	4307	4243	***4211***	***4000***

Between 2011 and 2020, Cisco's earnings increased at a rate of 7.1% per year. We reaffirm our expected growth rate of 6% due to a combination of improving margins and share repurchases offset by revenue weakness.

Following a 2.8% increase for the 4/28/2021 payment, Cisco has increased its dividend for 11 consecutive years. For much of this time, shareholders have seen impressive dividend growth since the company instituted its dividend, though growth has slowed considerably over the past few years.

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[1] Share count in millions

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	11.9	9.7	10.3	11.3	12.3	11.5	13.3	16.9	15.0	14.7	***14.6***	***15.0***
Avg. Yld.	0.6%	1.6%	3.0%	3.1%	2.9%	3.5%	3.5%	3.0%	3.0%	3.1%	***3.1%***	***3.1%***

Shares of Cisco have increased $6, or 14.6%%, since our 11/15/2020 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 in recent quarters and large cash balance, we maintain our target P/E of 15 for fiscal 2026. If Cisco's stock was to revert to our target multiple by 2026, then valuation would add 0.5% to annual returns over this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	7%	15%	30%	35%	36%	40%	46%	50%	45%	45%	***46%***	***46%***

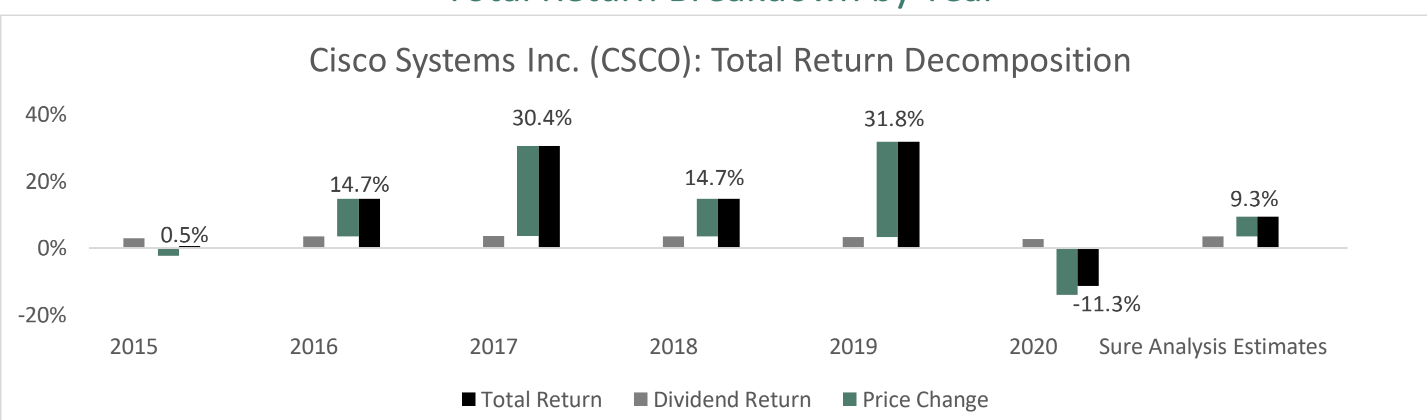
Cisco ended the second quarter of fiscal 2021 with $30.6 billion in cash and equivalents. Given the cash on the balance sheet, it is likely that Cisco would be able to continue to pay a dividend even in the event of an extended recession.

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 9K switch. This switch is twice as fast as competing products and protects data and cloud networks.

Final Thoughts & Recommendation

Cisco Systems is projected to return 9.3% annually over the next five years, down from our prior estimate of 11.7%. Our estimated return stems from a 6% earnings growth rate, 3.1% dividend yield and a slight tailwind from multiple expansion. Cisco saw a return to growth in a number of areas, regions and customer categories during the quarter, something that had been difficult to produce over the prior quarters. The company also expects to see top and bottom-line growth in the current quarter. We have increased our five-year price target $1 due to EPS estimates and note that the stock's projected estimated return sits right below our normal buy rating threshold. Total return investors might prefer to wait for a pullback before purchasing Cisco, but income investors could find the 3%+ yield attractive in a low rate environment.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	43218	46061	48607	47142	49161	49247	48005	49330	51904	49301
Gross Profit	26536	28209	29440	27769	29681	30960	30224	30606	32666	31683
Gross Margin	61.4%	61.2%	60.6%	58.9%	60.4%	62.9%	63.0%	62.0%	62.9%	64.3%
SG&A Exp.	11720	11969	11802	11437	11861	11433	11177	11386	11398	11094
D&A Exp.	2486	2208	2460	2439	2442	2150	2286	2192	1897	1808
Operating Profit	8473	10369	11301	9763	11254	12928	12729	12667	14541	14101
Op. Margin	19.6%	22.5%	23.2%	20.7%	22.9%	26.3%	26.5%	25.7%	28.0%	28.6%
Net Profit	6490	8041	9983	7853	8981	10739	9609	110	11621	11214
Net Margin	15.0%	17.5%	20.5%	16.7%	18.3%	21.8%	20.0%	0.2%	22.4%	22.7%
Free Cash Flow	8905	10365	11734	11057	11325	12424	12912	12832	14922	14656
Income Tax	1335	2118	1244	1862	2220	2181	2678	12929	2950	2756

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets ($B)	87095	91759	101191	105070	113373	121652	129818	108784	97793	94853
Cash & Equivalents	7662	9799	7925	6726	6877	7631	11708	8934	11750	11809
Acc. Receivable	4698	4369	5470	5157	5344	5847	5146	5554	5491	5472
Inventories	1486	1663	1476	1591	1627	1217	1616	1846	1383	1282
Goodwill & Int.	19359	18957	25322	27519	26845	29126	32305	34258	35730	35382
Total Liabilities	39836	40458	42063	48409	53666	58067	63681	65580	64222	56933
Accounts Payable	876	859	1029	1032	1104	1056	1385	1904	2059	2218
Long-Term Debt	16822	16328	16211	20845	25354	28643	33717	25569	24666	14583
Total Equity	47226	51286	59120	56654	59698	63586	66137	43204	33571	37920
D/E Ratio	0.36	0.32	0.27	0.37	0.42	0.45	0.51	0.59	0.73	0.38

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	7.7%	9.0%	10.3%	7.6%	8.2%	9.1%	7.6%	0.1%	11.3%	11.6%
Return on Equity	14.2%	16.3%	18.1%	13.6%	15.4%	17.4%	14.8%	0.2%	30.3%	31.4%
ROIC	10.5%	12.2%	14.0%	10.3%	11.0%	12.1%	10.0%	0.1%	18.3%	20.3%
Shares Out.	5435	5298	5389	5107	5085	5029	4983	4670	4307	4243
Revenue/Share	7.77	8.52	9.03	8.93	9.55	9.68	9.51	10.11	11.66	11.59
FCF/Share	1.60	1.92	2.18	2.09	2.20	2.44	2.56	2.63	3.35	3.45

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