



# CISCO SYSTEMS, INC.

(Ticker: CSCO)



Stock Price: \$61.86 (01/13/2022)	Company Size: \$263B	Author: Madhu Chaudhary
Company Rank: -	Sector: Information Technology	Industry: Communications Equipment

*Cisco is a global tech company that specializes in networking hardware, telecommunications equipment as well as software.*

## IN THIS FIRST FOCUS WE'LL COVER:

### ► Summary of the Business

Cisco Systems is one of the largest suppliers of networking devices globally. The company's products include routers, switches as well as other wireless and data center products.

### ► Recent Developments

The company reported 8% growth in revenue in the most recent quarter driven by digital transformation led spending by enterprises and governments globally.

### ► Competitive Environment

In its core networking equipment category, Cisco faces competition from several large players such as Juniper Networks, Arista, Huawei, HP, etc. It also faces competition from Palo Alto, Fortinet in cybersecurity segments.

### ► Conclusions/Recommendations

While we like the company's strong market positioning in its core segments, we are not completely sold on the company's ability to drive faster growth in its focus areas and its current premium valuation relative to its own history makes the risk-reward less attractive.



**Grab-and-Go™**  
**THESIS**

*An investment in Cisco is a play on increased demand for networking as well as cybersecurity software and hardware solutions. Cisco is a global market leader in its core networking devices segment. The company's success going forward depends on its ability to successfully transition itself into a new age software integrated, faster growth profile business.*

Data as of 01/13/22 unless specified

Enterprise Value:	\$250.4B	Market Cap:	\$263.1B	Revenue Fwd (TTM):	53.5B (\$50.78B)
YTD Return:	39.3%	Fwd (TTM) Price/Sales:	4.91x (5.18x)	RSI:	55.94
Adj. EBIT Margin TTM	33.65%	Revenue Growth (TTM, YoY):	5.65%	ROIC (TTM):	49%
52-Week High:	\$64.29	52-Week Low	\$43.89	200-day Moving Avg.	\$55.17
Adj. Net Income TTM	\$13.9B	CFO	\$14.78B	FCF	\$14.14B

**Insider Transactions: In 2021, Chuck Robbins (CEO) sold 3,5M shares, Gerri Elliott (EVP and Chief Customer and Partner Officer) sold 266K shares, Maria Martinez (Executive Vice President and Chief Operating Officer) sold 3,8M shares, Prat Bhatt (SVP and Chief Accounting officer) sold 1.2M shares.**

## SUMMARY OF BUSINESS

Incorporated in 1987, Cisco Systems has grown over the years to become the largest supplier of networking devices globally. Its products include several categories of routers, switches as well as other wireless and data center products that facilitate transfer and storage of data through networks. The company also offers software-oriented offerings that sit on top of its infrastructure platforms such as video conferencing solutions (Webex), IoT software, analytics software, etc. Besides, the company also provides cybersecurity solutions including firewalls, endpoint protection, email security, etc.

From Q1 FY22, Cisco has replaced its three product segments (infrastructure platforms, applications, and security) with 6 new segments as listed below: -

**Secure, Agile Networks:** This segment comprises of Cisco's core networking solutions which include hardware products such as switches, routers and other wireless devices as well as software defined network solutions. This is

company's primary segment and contributes 46% of the overall revenue.

**Hybrid Work:** This segment comprises of Cisco's calling, meetings and contact center offerings which include video calling and other CPaaS services as well as hardware products such as telephones. The segment contributed 9% of company's overall top-line in Q1 FY22.

**End-to-End Security:** This segment includes cybersecurity solutions offered by the company such as Firewalls, SASE, EDR, and other application security services. The segment contributes 7% of Cisco's revenue.

**Internet for the Future:** This segment comprises of technologically advanced and highspeed optical networking products offered by the company primarily catering to public telecommunication service providers and other web scale companies that transfer significant amount of data and require large bandwidths across their network. This is Cisco's fastest growing segment mainly driven by increased data usage during the

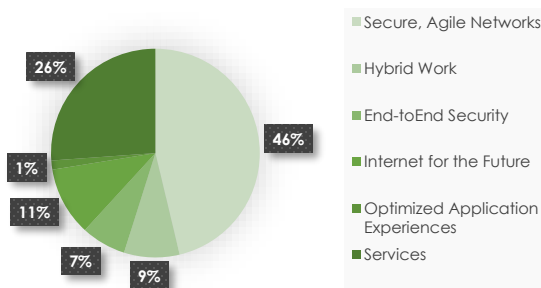
pandemic and growth of cloud computing. The segment contributed 11% of company's revenue in the most recent quarter.

**Optimized Application Experiences:** This segment includes company's software offerings that helps customers to track, manage and optimize their network performance. This is a very small segment and contributes 1% of company's revenue.

**Services:** Besides products, Cisco also provides technical support services to its customers. Please note that this segment is not a cost centre, in fact it is a major revenue and profit generating segment contributing 26% of company's revenue with a gross margin of 65%.

Being a mature tech company with over 45% market share in the networking equipment market, Cisco has been lately struggling to find new avenues of growth and has delivered a tepid top-line CAGR of just of 0.4% in the last 3 years. While its cybersecurity peers Palo Alto Networks and Fortinet have been consistently delivering double digit growth. As such, the management has been transitioning the company beyond switches and routers and focusing on software-centric subscription-based solutions through internal development and inorganic acquisitions to generate more recurring revenue and fuel growth. Subscriptions now constitute 43% of the company's overall top-line and Cisco is targeting to get this up to 50% by 2025.

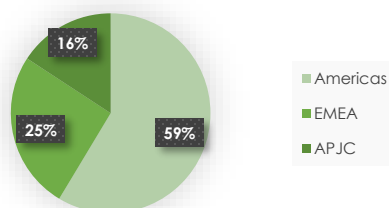
Revenue Mix - Q1 2022



Source: 10-Q

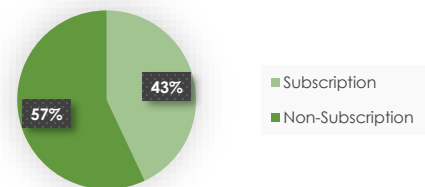
Cisco has a well-diversified customer base spanning across all industry verticals such as financial services, retail, government, automotive, and several others. Besides, its top-line is diversified across all geographies.

Revenue Mix - Q1 2022



Source: 10-Q

Revenue Mix - Q1 2022



Source:10-Q



**LB • LOGIC** While a successful transition to a subscription-based business model will be beneficial for the company ensuring stability and predictability in cash flows, investors must note that the said transition will be a slow and gradual process. In fact, subscription revenue grew just 7% on a YoY basis in the recent quarter as compared to overall top-line growth of 8%.

 **RECENT DEVELOPMENTS**

In Q2 FY22, Cisco reported total revenue of \$12.9B which represents a growth of 8% on a YoY basis. Secure, Agile Networks which is company's core segment contributing 46% of the total revenue reported a strong YoY revenue increase of 10% to \$6B. This was primarily driven by robust demand across all campus, data center and Edge networking switches, routers and wireless hardware segments. Hybrid work segment reported a 7% decline in revenue due to soft demand for its Calling, Meetings and Contact Center offerings. Cisco's end-to-end security segment reported a 4% YoY growth driven by expansion in its software offerings which was offset by slow demand for on-premise hardware products. The Internet for the Future segment reported a 46% YoY growth in revenue largely driven by the recent \$4.5B acquisition of Acacia Communications. Lastly, Optimized Application Experiences segment reported around 18% growth in top-line driven by increased demand for AppDynamics and ThousandEyes which Cisco acquired in 2017 and 2020 respectively.

also reflected in 31% and 33% product order growth that Cisco achieved in the last 2 quarters. On being asked about the same during the [earnings call](#), management said that they were also surprised by the significant growth in orders as compared to the previous year, however, it is difficult to quantify the extent of pull forward in demand. Although Cisco's remaining performance obligations (RPO) are currently at all time high, the growth may slow in coming quarters due to the above phenomenon.

Cisco expects its revenue to grow at a CAGR of 5-6% for the next 5 years which will be a significant improvement from less than 1% annual growth that the company has delivered in recent years. Besides, the company expects its subscription revenue to contribute 50% of overall revenue by 2025 which translated into a subscriptions CAGR of over 15%. While being the largest networking communications company, Cisco has the ability to achieve these targets, it is also worth noting that subscriptions growth will need to see a pick up from its ~7% growth range in the recent quarter to achieve those targets.

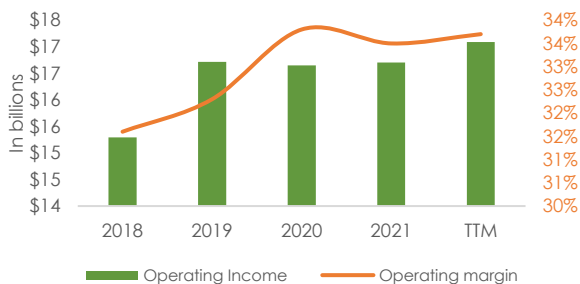
Cisco's operating margin has grown from 30.7% in FY16 to 33.5% in FY21 due to increasing share of high margin software and subscription income in the overall revenue mix. Operating income stood at \$4.3B in Q1 FY22, up by 10% driven by higher software revenue and improving efficiencies, partially offset by supply chain challenges which the industry as a whole is facing. With software revenue growth slowing down, Cisco expects to continue to maintain its current level of operating margins going forward. Besides it expects to grow its EPS at a CAGR of 5-7% until 2025, which is in line with its expected top-line growth.



Source: [10-q](#), [10-k](#)

Please note that Cisco has announced a price increase for its hardware offerings starting October 2021. As a result, some customers would have advanced their procurement timelines in the recent quarters to prevent higher costs. This is

### Operating Income Trend



Source: [10-q](#), [10-k](#)

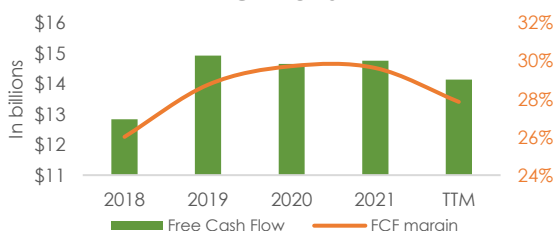
Cisco is a cash-rich company and consistently generates high levels of free cash flows. It ended the recent quarter with over \$24B of cash and short-term investments on its balance sheet. With outstanding debt of \$9.5B, company's financial position remains robust with a net debt position of -\$14.5B. For the first quarter of FY22, company reported operating cash flows of \$3.4B as compared to \$4B in the same quarter previous year. Free cash flow also decreased from \$3.9B in Q1 FY21 to \$3.3B in Q2 FY22. This decline was mainly because of unfavorable working capital changes.

Cisco has a history of consistently growing its dividend level each year since 2011. In fact, its quarterly dividends have grown at a CAGR of 5% in the last 5 years. Besides, the company has bought back 21% of its total outstanding shares in the past decade. Cisco expects to return at least 50% of its free cash flows to shareholders in the form of dividends or share repurchases. With enough liquidity on the balance sheet, it will not face any difficulty meeting its targets even if it expands its software business through acquisitions.



**LB • LOGIC** With top-line growth decelerating, share buybacks and dividends have been the primary drivers of Cisco stock price growth in recent years. Going forward, rejuvenated demand and a successful transition to a subscription-based business model, if they were to occur, may provide additional support to Cisco's stock price.

### FCF Trend



Source: [10-q](#), [10-k](#)

## COMPANY MANAGEMENT

[Chuck Robbins](#) is the company's Chairman and CEO. He has been at Cisco for nearly two decades in primarily sales leadership-oriented roles. He was named the CEO in 2015. Prior to Cisco, he was at Bay Networks and Ascend Communications. He holds a bachelor's degree in

mathematics with a focus on computer science from the University of North Carolina.

[Scott Herren](#) is the company's CFO. He has spent most of his career in Tech in senior finance roles. He joined Cisco in 2020. Prior to Cisco, he was the



CFO at Autodesk. He also held senior level strategy and finance positions in Citrix Systems, FedEx and IBM. He holds a Bachelor of Industrial Engineering from Georgia Institute of Technology and has an MBA in Finance from Columbia University.

**LB•LOGIC** The company's leadership is in seasoned hands and the company is headed by industry veterans who have seen multiple tech cycles.

## INDUSTRY AND COMPETITION

Cisco has been a major beneficiary of the covid pandemic which has significantly accelerated the digitization of global businesses. Increasing need for interconnected devices has increased demand for networking equipment such as routers and switches for which Cisco is an industry leader. Besides, demand for its adjacent software services such as cybersecurity and teleconferencing has also increased. As per company analysis, its total addressable market stands at \$260B and is expected to grow to \$400B by 2025 as Cisco expands into new market segments.

remain the market leader holding over 50% of the market share, significantly ahead of its nearest peers. For its cybersecurity offerings, company competes with specialized firewall and SD-WAN players such as Fortinet, Palo Alto Networks, Checkpoint etc. as well as EDR players such as CrowdStrike, whereas in teleconferencing space there are several well-established players including Zoom Communications and Falcon9.

Cisco is now targeting an upcoming segment called "Hybrid Cloud" which the company believes will be the future of cloud networks where users would be able to seamlessly integrate their private cloud network with public cloud as per requirement thereby improving efficiency and lowering IT related costs. As per [Statista](#), hybrid cloud market was valued at \$52B in 2020 and is expected to reach \$145B by 2026, thereby growing at a CAGR of almost 20%. Adoption of a hybrid cloud environment by global enterprises will lead to increased demand for networking equipment creating an interesting opportunity for Cisco in the long-run.



Source: [Investor Day presentation](#).

Cisco faces tough competition across all its product categories. In its core networking equipment category, Cisco faces competition from several large players such as Juniper Networks, Arista, Huawei, HP, etc. Having said that, Cisco being the early entrant continues to



**LB•LOGIC** While Cisco competes with several companies across its different categories, it is the only one-stop solution provider for all networking needs of customers. This is why it continues to hold an industry-leading position. If the company is able to successfully integrate its new software products and offer them to customers as a bundled service with hardware, Cisco will continue to retain its market position despite growing competition.

### **TREND ANALYSIS: VALUATION**

While Cisco trades at a reasonable valuation multiple relative to industry peers, it is worth noting that Cisco's forward earnings multiple

at over 18 times is at a large premium relative to its own history (~12.5 times average PE).

Company name	Revenue Growth FWD	EBITDA Margin TTM	Net Income Margin TTM	Price-to-Earnings FWD	EV-to-Sales FWD
Palo Alto	26.6%	-1.89%	-11.2%	73.5	9.7
Juniper Networks	5.2%	14.6%	3.2%	20.4	2.6
Arista Networks	29.1%	32.6%	28.3%	47.8	12.9
Cisco	5.9%	31.2%	22.4%	18.2	4.8

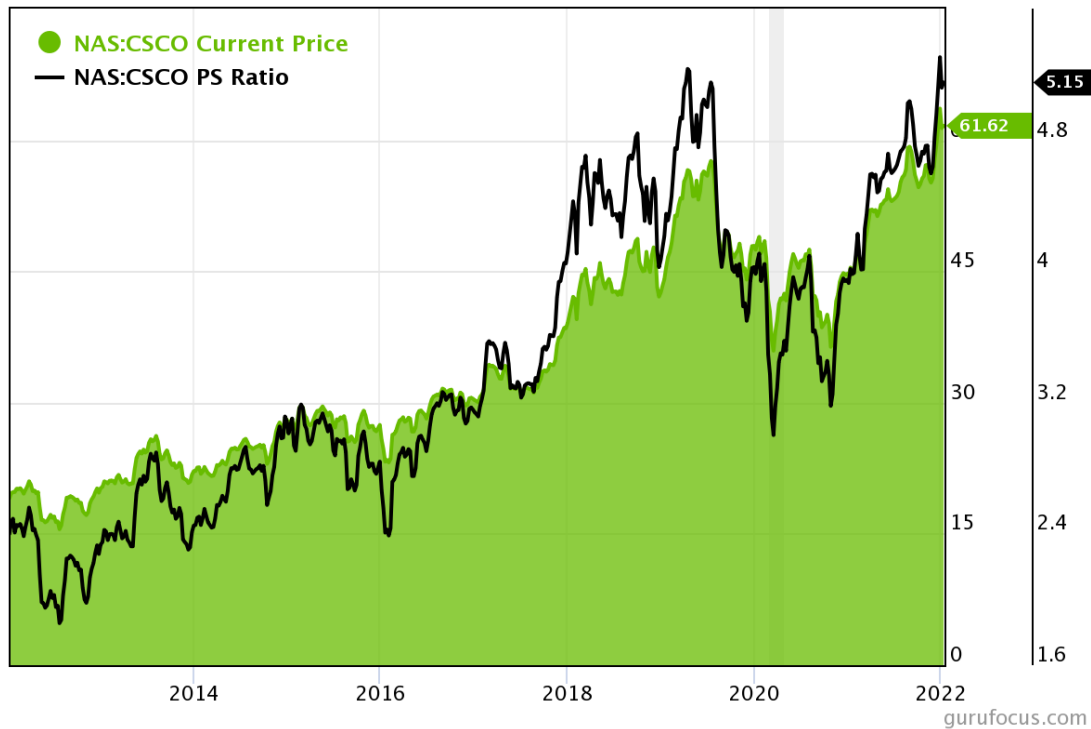
Source: Seeking Alpha

### **CONCLUSION / RECOMMENDATION**

While Cisco is an industry behemoth with dominant market share in its core segments, the company's growth going forward is going to be mediocre despite the company's effort at transitioning into a new age subscription and software integrated company. Given the fact that the company is trading at a premium to its own past valuation, we believe the risk-reward

is not attractive currently and rate Cisco as a **"YELLOW LIGHT"**.

Stock Chart for Cisco Systems, Inc (CSCO)



Performance Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
RETURN ON INVESTED CAPITAL (%)	48.83%	42.29%	22.01%	55.06%	60.19%	49.61%
ADJ. EBIT MARGIN (%)	30.68%	31.60%	31.00%	32.21%	33.77%	33.53%
ADJ. NET EARNINGS (BILLIONS USD)	12.022	12.067	12.65	13.787	13.658	13.636
YoY Earnings Growth (%)	5.88%	0.37%	4.83%	8.99%	-0.94%	-0.16%
NET REVENUE (BILLIONS USD)	49.25	48.01	49.33	51.90	49.30	49.82
YoY Revenue Growth (%)	7.90%	35.20%	2.80%	7.40%	4.50%	16.00%

Valuation Data

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
SHARE PRICE (USD)	30.53	31.52	42.57	56.93	46.71	55.07
SHARES OUTSTANDING (MILLIONS)	5,029	4,983	4,614	4,250	4,237	4,217
MARKET CAP (BILLIONS USD)	153.5	157.1	196.4	242.0	197.9	232.2
PRICE/SALES RATIO	3.1X	3.3X	4.0X	4.7X	4.0X	4.7X



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