

Cisco Systems(CSCO)

\$47.32 (As of 02/13/20)

Price Target (6-12 Months): **\$49.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/14/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: C

Momentum: A

Summary

Cisco's second-quarter fiscal 2020 results were unimpressive. Revenues climbed marginally on a year-over-year basis due to sluggish performance from enterprise, commercial and service provider end markets. However, Cisco witnessed strong demand for Catalyst 9000 family of switches and Nexus 9K solutions. Data Center revenues decreased due to weakness in servers, partially offset by strong growth in HyperFlex. The company blamed lower customer spending for sluggish results and provided a grim third-quarter outlook. Notably, Cisco's shares have underperformed the industry in the past year. However, solid performance of its security business is expected to aid Cisco's top line in the near term. The company's differentiated end-to-end approach across the network, cloud and endpoints is a major growth driver.

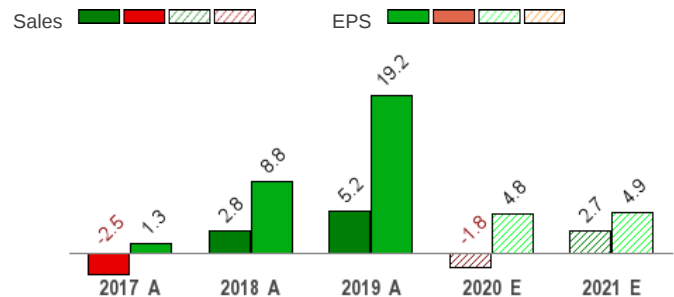
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$58.26 - \$43.40
20 Day Average Volume (sh)	18,637,720
Market Cap	\$200.7 B
YTD Price Change	-1.3%
Beta	1.22
Dividend / Div Yld	\$1.40 / 3.0%
Industry	Computer - Networking
Zacks Industry Rank	Bottom 25% (190 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.3%
Last Sales Surprise	0.2%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/20/2020
Earnings ESP	-1.0%
P/E TTM	14.7
P/E F1	14.6
PEG F1	2.1
P/S TTM	3.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	13,362 E	12,573 E	13,235 E	13,730 E	52,342 E
2020	13,159 A	12,005 A	12,648 E	13,181 E	50,964 E
2019	13,072 A	12,446 A	12,958 A	13,428 A	51,904 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.87 E	\$0.80 E	\$0.85 E	\$0.89 E	\$3.41 E
2020	\$0.84 A	\$0.77 A	\$0.80 E	\$0.84 E	\$3.25 E
2019	\$0.75 A	\$0.73 A	\$0.78 A	\$0.83 A	\$3.10 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/13/2020. The reports text is as of 02/14/2020.

Overview

Headquartered in San Jose, CA and founded in December 1984, Cisco Systems Inc. is an IP-based networking company, which offers other products and services to service providers, companies, commercial users and individuals.

Cisco has seven product categories: Switches aggregate and distribute information, collecting LANs, MANs and WANs filtering, processing and distributing it in the required volume and to the designated locations. They provide connectivity to end users, workstations, IP phones, access points and servers.

Next-Generation Network (NGN) Routers transport data, voice and video information from one IP network to another. Collaboration products integrate voice, video, data and mobile applications on fixed and mobile networks. Key products are Unified Communications and Cisco TelePresence Systems products.

Wireless technology includes networking products: wireless LAN controllers, wireless integrated switches and routers, wireless management software, wireless LAN clients and client software, bridges, antennas and accessories.

Security includes products and services preventing unauthorized access to system resources and protecting from worms, spam, viruses and other malware. The Data Center product category includes Cisco Unified Computing System (UCS) and Server Access Virtualization. It also comprises of The Other products segment and Related Services.

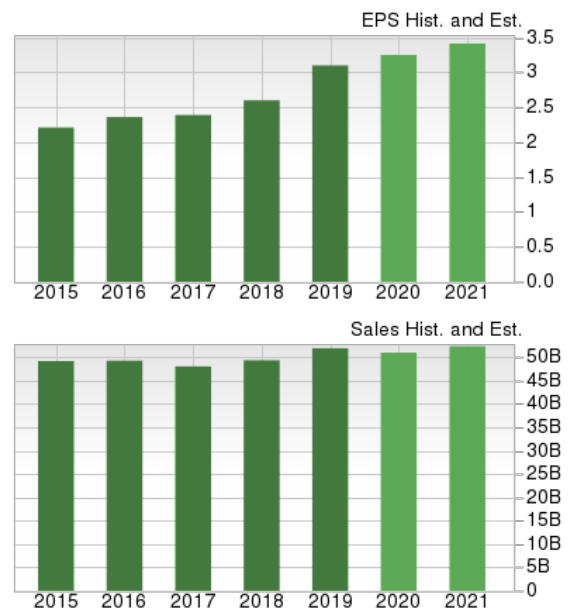
Cisco realigns its reporting segments into four distinct categories – infrastructure platform, applications, security, and other products.

On Oct 28, 2018, Cisco concluded the divestiture of its Service Provider Video Software Solutions (SPVSS) business. SPVSS included digital STBs and media technology products for reception, encoding, transcoding, translating, multiplexing, switching and modulation.

Total revenue was \$51.74 billion in fiscal 2019, up 7% over fiscal 2018 tally, excluding SPVSS business.

In fiscal 2019, the Americas, EMEA and APJC generated 59.6%, 25.2% and 15.2% of total revenue, respectively.

The company competes in the networking and communications equipment markets with companies like Amazon Web Services, Check Point Software Technologies, Dell, F5 Networks, FireEye, Fortinet, Hewlett-Packard Enterprise Company, Juniper Networks and Microsoft Corporation, to name few.



Reasons To Buy:

- ▲ Cisco is the largest player in the networking space. The company has a strong presence in the router and switch market. It also retained a leadership position in WLAN and Ethernet switching. Moreover, expansion into relatively under-penetrated markets is expected to drive growth.
- ▲ Cisco's focus on wireless carriers has increased of late, as evidenced by acquisitions such as Intucell, BroadHop, Cognitive Security, Cariden, ClearAccess and Ubiquisis. With data demand exploding, the wireless carrier segment has grown in importance. Mobile carriers in the U.S. are increasingly looking to make their networks more spectrum-efficient and put their network resources to use without having to materially increase capex expenditure. Also, the proliferation of smartphones has caused mobile data traffic to grow exponentially and the advent of high-speed LTE networks is likely to accelerate that growth. Therefore, networking solutions that allow carriers to manage traffic efficiently are to become increasingly important in the coming years. Cisco intends to tap this market by adding network management solutions to its product portfolio and broadening its relationship with carriers. The increased carrier focus might help Cisco to gain share in the edge routing segment, where its competitors, Juniper and Alcatel Lucent, have substantial market share. Moreover, these acquisitions have diversified Cisco's revenue source. Increasing recurring nature of the top line is a major growth factor.
- ▲ In order to counter the threat of SDN, Cisco has devised a strategy of its own, which it is referring to as Application Centric Infrastructure (ACI). ACI is a comprehensive approach that ties together physical and virtual compute, network and storage by leveraging centralized policies and orchestration. ACI is made up of new hardware in the Nexus 9000 portfolio and software in the shape of an updated NX-OS operating system along with the Application Policy Infrastructure Controller (APIC). The solution streamlines operational processes and reduces operating expenses for power, cooling and cabling. This reduces the total cost of ownership by 75% when compared with software-only network virtualization. The technology ensures the infrastructure is focused on the application. Nexus 9000 Series switches deliver high scalability, performance and energy in a compact form factor and are ideal for data center aggregation- and access-layer deployments in enterprise, service provider, and cloud networks. It is quite encouraging to see that Cisco's ACI technology is gaining significant traction with customers.
- ▲ The company has pioneered a network system, which has been referred to as the Unified Computing System (UCS). This blade server system based on x86 architecture is transforming data centers. The system lowers the cost of ownership by making the entire data center more network-centric, significantly reducing the number of computers/servers required. The UCS is intended to simplify the operation of the data center, improving its flexibility and scalability. For this purpose, the company has tied up with Accenture, BMC, EMC, Intel, Microsoft, NetApp, Novell, Oracle, Red Hat and VMWare. Notably, UCS adoption is increasing owing to the inherent cost advantage and the growing number of data centers across the world. This is working in Cisco's favor. UCS remains a major factor to Cisco's future success as the company builds its Next Generation Data Center stack.
- ▲ Cisco has inked strategic alliances with most of major technology companies globally. These partnerships have increased access to new technology, helped in developing innovative products, facilitated joint sales & marketing programs, and expanded total addressable market (TAM). The company has strategic partnerships with Apple, IBM, Microsoft, Viacom, Telenor, Google and Alibaba, which are expected to aid the company in enhancing business opportunities. We believe partnerships will help Cisco in winning new customers in the long haul.
- ▲ Management execution has been good in recent times. The solid net-cash balance of \$11.07 billion as of Jan 25, 2020, provides the flexibility required to pursue any growth strategy, whether by way of acquisitions or otherwise. Moreover, the strong balance sheet helps Cisco to continue shareholder friendly initiatives of share repurchase and dividend hike. Notably, lower number of outstanding shares helps bottom-line. In the fiscal first quarter, Cisco returned \$2.4 billion to shareholders through share buybacks and dividends. The company has \$11.8 billion remaining under its current share buyback program.

Order growth in new markets of the company remain encouraging and we are positive about the company's market position, innovative prowess, product range, growth initiatives and dividend payouts.

Reasons To Sell:

- ▼ Cisco continues to acquire a large number of companies. While this improves revenue opportunities, it increases integration risks. Moreover, we also note that the large acquisitions negatively impact the balance sheet in the form of high level of goodwill, which totaled \$33.61 billion or 37.2% of total assets as of Jan 25, 2020.
 - ▼ Cisco has been forced to offer discounts and deals in response to actions by peers due to stiff competition from Arista Networks, Juniper, HPE and Huawei, in Ethernet switch and router market. Cisco's competitors are revamping their product lines with faster and power-efficient products. Although the edge business remains strong, the competitive pressure at the core remains intense and is likely to hurt profitability.
 - ▼ One of the primary markets that Cisco serves is federal, state and local governments. Therefore, the company is widely exposed to the stringent budget activities of the U.S. government, which remains a major concern.
 - ▼ Moreover, Cisco generates significant portion of revenues from outside the United States (40.4% of total revenues in fiscal 2019), subjecting the company to exchange rate volatility. Unfavorable movement in exchange rates of foreign currencies like renminbi, euro, pound sterling, Costa Rican colon, and yen related to the U.S. dollar can adversely impact results and undermine its growth potential to some extent. Weakness in service provider business in China, is a headwind. Moreover, imposition of tariffs owing to trade war between the United States and China is anticipated to affect growth prospects. The uncertainty over the recent trade war truce has impacted investors' confidence and is likely to remain an overhang on the company's performance.
 - ▼ We note that the stock currently has a trailing 12 month P/B ratio of 5.67, which compares unfavorably to some extent with what the industry saw over the last year. Hence, valuation looks slightly stretched from P/B perspective.
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Cisco is facing integration risks as well as stiff competition from smaller players.

Last Earnings Report

Cisco Beat Q2 Earnings Estimates, Near Term Outlook Grim

Cisco Systems reported second-quarter fiscal 2020 non-GAAP earnings of 77 cents per share that beat the Zacks Consensus Estimate by 1.3% and grew 5.5% year over year.

However, revenues declined 3.5% year over year to \$12 billion but surpassed the consensus mark by 0.2%.

The company blamed lower customer spending due to several reasons, including macro-economic weakness, for sluggish results and third-quarter outlook.

Quarter Ending **01/2020**

Report Date	Feb 12, 2020
Sales Surprise	0.16%
EPS Surprise	1.32%
Quarterly EPS	0.77
Annual EPS (TTM)	3.22

Top-Line Details

Product revenues (72.2% of total revenues) declined 6.5% on a year-over-year basis to \$8.67 billion.

Service revenues (27.8% of total revenues) increased 5.1% to \$3.33 billion, driven by growth in software and solution services. Software subscriptions represent 72% of Cisco's software revenues.

Region-wise, the Americas, the EMEA and the APJC revenues decreased 4.6%, 2.8% and 0.7% year over year, respectively. Total emerging markets declined 7% and the BRICs plus Mexico fell 20%.

In terms of customer segments, public sector revenues were flat. Commercial, enterprise and service provider revenues were down 4%, 7% and 11%, respectively.

Total product orders were down 6% on a year-over-year basis.

Segment Details

Infrastructure Platforms (54.4% of total revenues) comprise Switching, NGN routing, Wireless and Data Center solutions. Revenues fell 8% year over year to \$6.53 billion.

Routing declined due to weakness in service provider. Switching declined in both campus and data center end markets. However, Cisco witnessed strong demand for Catalyst 9000 family of switches and Nexus 9K solutions.

Additionally, wireless revenues declined overall despite strong growth in Meraki. Data Center revenues decreased due to weakness in servers, partially offset by strong growth in HyperFlex.

Applications (11.2% of total revenues) consist of the Collaboration portfolio of Unified Communications (UC), Conferencing and TelePresence, IoT, and application software businesses such as AppDynamics and Jasper.

Revenues decreased 8% year over year to almost \$1.35 billion due to a decline in UC, partially negated by double-digit growth at AppDynamics.

Security revenues (6.2% of revenues) improved 9% to \$748 million. The growth can be attributed to solid demand witnessed by identity and access, advanced threat, and unified threat management solutions.

Cisco witnessed strong demand for cloud-based solutions, including Duo and Umbrella. The company's differentiated end-to-end approach across the network, cloud and endpoints has helped it expand the clientele. Management stated that 100% of the Fortune 100 are now using one or more of Cisco's security solutions.

Other Products segment contains service provider video, cloud and system management, and various emerging technology offerings. Revenues surged 110% to \$46 million.

Partnership & Product Details

Cisco's integration with Microsoft's Azure Virtual WAN and Office 365, and a deeper partnership with Amazon cloud arm Amazon Web Services have prepared it to deliver highly secure end-to-end connectivity and better application performance. This is likely to help Cisco sell more of its SD-WAN solutions as customers move more applications to the cloud.

Moreover, during the quarter, the company introduced Cisco Silicon One and the Cisco 8000 carrier-class router family built on Silicon One. It also unveiled the iOS XR7 operating system.

Further, Cisco expanded the security portfolio from the cloud to the edge. The company's integrated IoT architecture, which comprises new software-based security solutions Cyber Vision and Edge Intelligence data collection tool, provides enhanced visibility, insights and threat detection across customers' entire environment.

Operating Details

Non-GAAP gross margin expanded 230 bps from the year-ago quarter to 66.4%. On a non-GAAP basis, product gross margin expanded 310 bps but service gross margin was unchanged year over year.

Non-GAAP operating expenses were \$3.93 billion, down 1.1% year over year. As a percentage of revenues, operating expenses increased 80 bps to 32.7%.

Non-GAAP operating margin expanded 150 bps year over year to 33.7%.

Balance Sheet and Cash Flow

As of Jan 25, 2020, Cisco's cash & cash equivalents and investments balance were \$27.06 billion, down from \$28 billion as of Oct 27, 2019.

Total debt, as of Jan 25, was \$15.99 billion compared with \$18.50 billion, as of Oct 27.

Operating cash flow was \$3.8 billion, flat year over year

Remaining performance obligations (RPO) at the end of the reported quarter were \$24.9 billion, up 11%. The metric represents total committed non-cancelable future revenues.

In the fiscal second quarter, Cisco returned \$2.4 billion to shareholders through share buybacks and dividends. The company has \$11.8 billion remaining under its current share buyback program.

Moreover, Cisco announced a penny increase in the dividend to 36 cents per share.

Acquisitions

In early third quarter, Cisco completed its acquisition of Exablaze, a designer and manufacturer of advanced network devices, to reduce latency and improve network performance.

Q3 Guidance

For third-quarter fiscal 2020, revenues are expected to decline 1.5-3.5% on a year-over-year basis.

Non-GAAP gross margin is expected in the range of 64.5-65.5%, while operating margin is anticipated between 32.5% and 33.5% for the quarter.

Non-GAAP earnings are anticipated between 79 cents and 81 cents per share.

Recent News

On Jan 28, 2020, Cisco enhanced Webex Assistant for Webex Meetings with new AI-powered voice intelligence capabilities, facilitated by the recent Voicea acquisition.

On Dec 16, 2019, Cisco announced plans to acquire Exablaze to enhance Nexus switching portfolio with advanced FPGA capabilities

On Dec 11, 2019, Cisco rolled out Silicon One Q100 networking chip with an aim to enhance its network hardware business. The new Silicon One Q100 networking processor functions as both switch and routing chip. It is enabled to transfer data at a faster rate and can be programmed as required.

On Dec 9, 2019, Cisco announced quarterly cash dividend of 35 cents per share to be paid on Jan 22, 2020 to shareholders as on Jan 3, 2020.

On Nov 11, 2019, Cisco secured regulatory approval from the German Federal Cartel Office regarding the acquisition of Acacia Communications. Notably, regulatory clearance has been obtained from the United States and Austria. The buyout is expected to conclude in the second half of Cisco's fiscal 2020.

Valuation

Cisco shares are up 2.3% in the past six-month period but down 4.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 2.7% and 25.9% in the past six-month period. Over the past year, while the Zacks sub-industry is down 4.4%, the sector is up 29.5%, respectively.

The S&P 500 index is up 19.1% in the past six-month period and 20.8% in the past year.

The stock is currently trading at 14.16X forward 12-month earnings, which compares to 16.79X for the Zacks sub-industry, 23.31X for the Zacks sector and 19.41X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.8X and as low as 10.48X, with a 5-year median of 14.91X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$49 price target reflects 14.80X forward 12-month earnings.

The table below shows summary valuation data for CSCO

Valuation Multiples - CSCO					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.16	16.79	23.31	19.41
	5-Year High	19.8	19.21	23.31	19.41
	5-Year Low	10.48	11.26	16.87	15.18
	5-Year Median	14.91	15.18	19.32	17.47
P/S F12M	Current	3.87	3.44	3.80	3.58
	5-Year High	5.19	4.3	3.80	3.58
	5-Year Low	2.28	2.36	2.30	2.54
	5-Year Median	3.45	3.26	3.02	3
EV/Sales TTM	Current	3.65	3.38	4.52	3.11
	5-Year High	4.48	4.03	4.52	3.27
	5-Year Low	1.5	1.46	2.56	2.15
	5-Year Median	2.58	2.43	3.47	2.77

As of 02/13/2019

Industry Analysis Zacks Industry Rank: Bottom 25% (190 out of 255)



Top Peers

Microsoft Corporation (MSFT)	Outperform
Amazon.com, Inc. (AMZN)	Neutral
Check Point Software Technologies Ltd. (CHKP)	Neutral
Juniper Networks, Inc. (JNPR)	Neutral
NVIDIA Corporation (NVDA)	Neutral
VMware, Inc. (VMW)	Neutral
F5 Networks, Inc. (FFIV)	Underperform
Palo Alto Networks, Inc. (PANW)	Underperform

Industry Comparison Industry: Computer - Networking				Industry Peers		
	CSCO Neutral	X Industry	S&P 500	AMZN Neutral	JNPR Neutral	VMW Neutral
VGM Score	B	-	-	B	F	F
Market Cap	200.74 B	132.02 M	24.56 B	1,070.23 B	8.35 B	65.18 B
# of Analysts	12	2	13	13	9	11
Dividend Yield	2.96%	0.00%	1.78%	0.00%	3.05%	0.00%
Value Score	C	-	-	D	C	C
Cash/Price	0.14	0.15	0.04	0.05	0.25	0.03
EV/EBITDA	10.80	8.20	14.00	27.80	10.87	18.32
PEG Ratio	2.06	2.71	2.10	2.89	2.10	1.73
Price/Book (P/B)	5.83	1.70	3.31	17.25	1.81	11.21
Price/Cash Flow (P/CF)	13.75	14.31	13.68	32.06	13.19	24.47
P/E (F1)	14.39	16.65	19.23	77.99	14.23	22.74
Price/Sales (P/S)	3.89	1.68	2.69	3.82	1.88	6.68
Earnings Yield	6.87%	4.79%	5.20%	1.28%	7.02%	4.40%
Debt/Equity	0.42	0.12	0.71	0.38	0.37	0.63
Cash Flow (\$/share)	3.44	0.18	6.92	67.05	1.89	6.50
Growth Score	C	-	-	A	F	F
Hist. EPS Growth (3-5 yrs)	8.00%	-4.53%	10.85%	110.19%	-0.59%	15.51%
Proj. EPS Growth (F1/F0)	4.84%	48.39%	7.17%	19.81%	1.87%	6.36%
Curr. Cash Flow Growth	6.95%	-30.83%	8.56%	31.33%	-8.77%	23.44%
Hist. Cash Flow Growth (3-5 yrs)	3.53%	16.42%	8.36%	49.26%	-15.41%	12.60%
Current Ratio	1.70	2.18	1.23	1.10	2.08	0.58
Debt/Capital	29.63%	14.59%	42.91%	27.39%	26.75%	38.53%
Net Margin	21.44%	-2.19%	11.81%	4.13%	7.76%	67.21%
Return on Equity	36.56%	3.13%	16.86%	21.07%	9.16%	61.67%
Sales/Assets	0.54	0.88	0.54	1.41	0.50	0.54
Proj. Sales Growth (F1/F0)	-1.81%	0.00%	3.85%	19.18%	1.21%	12.61%
Momentum Score	A	-	-	A	F	D
Daily Price Chg	-5.23%	-0.23%	0.00%	-0.47%	2.09%	0.09%
1 Week Price Chg	4.35%	0.79%	2.47%	3.51%	3.57%	5.55%
4 Week Price Chg	-3.53%	-2.86%	0.56%	14.48%	0.16%	4.47%
12 Week Price Chg	5.53%	9.17%	6.96%	23.93%	-1.50%	-4.04%
52 Week Price Chg	-2.23%	-2.23%	16.68%	32.49%	-7.49%	-5.34%
20 Day Average Volume	18,637,720	18,670	2,020,569	4,425,081	4,689,860	966,797
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.05%	5.74%	-2.82%	0.00%
(F1) EPS Est 12 week change	0.00%	0.00%	-0.17%	3.82%	-4.64%	-6.11%
(Q1) EPS Est Mthly Chg	0.95%	0.00%	-0.24%	2.19%	-19.41%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	A
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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