

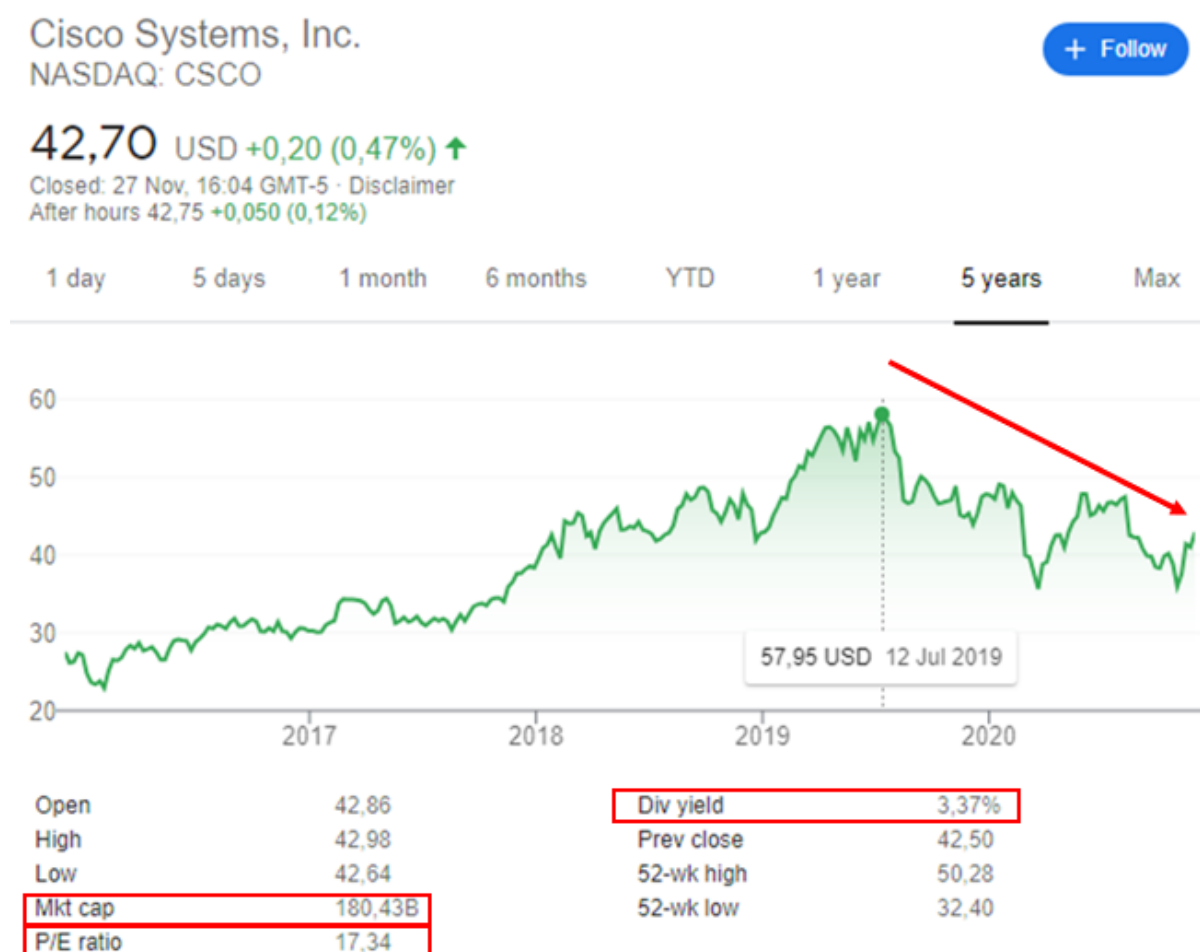
Cisco Stock Analysis – Bargain Bin Value Hunting

Cisco (NASDAQ: CSCO) stock analysis content:

- CSCO stock price overview (Long-Term Compounder)
- Cisco business analysis (Behemoth)
- Conference calls quick notes (reality)
- Cisco fundamentals (Cisco Dividend)
- CSCO valuation (good for good business)
- Risk and reward investment conclusion (good business at fair price)

CSCO stock price overview

CSCO stock peaked in July 2019 and since then it has only seen lower highs and lower lows; the trend is clearly negative. CSCO stock is down 26% while the market (S&P500) is up 30% over the same period. That is some staggering underperformance.



CSCO stock price 5-year chart

However, the dividend yield is double and the price to earnings valuation is half of what the S&P offers. If the reason for the underperformance is just negative sentiment, then we might be looking at an opportunity to pick up a great business at a fair price.

The two main reasons behind the negative sentiment and CSCO stock dropping is the 9% revenue decline which is mostly due to COVID-19 related softer demand and the fear

([according to Needham](#)) that Cisco is losing market share to companies like Arista Networks (NYSE:ANET), Extreme Networks (NASDAQ:EXTR) and Juniper Networks (NYSE:JNPR).

Cisco has always been a compounder that rewarded shareholders in the past, paid a good dividend and buying below intrinsic value when the sentiment was negative, was usually a very good investment. Let's look deep into CSCO stock to see whether we are in a similar situation.



CSCO stock price historical performance and buy levels

Cisco business overview

Cisco is a networking equipment behemoth selling hardware and software solutions. I think we all know that.

The screenshot shows the Cisco website's navigation menu on the left, with 'Products Home' highlighted. The main content area is divided into sections: NETWORKING, TOP PRODUCTS, and SUPPORT BUSINESS RESILIENCY WITH YOUR NETWORK.

Products Home

- Networking
- Software
- Internet of Things (IoT)
- Mobility & Wireless
- Security
- Collaboration
- Data Center
- Cloud & Computing
- Small & Midsize Business
- Service Provider
- By Industry
- Customer Experience

NETWORKING

- Network Architecture - Cisco DNA
- Network Architecture - Cisco ACI
- Secure Network Access
- SD-WAN
- Switches
- Wireless
- Routers
- Intent-Based Networking
- Enterprise Network Security

TOP PRODUCTS

- Catalyst 8000 Series Edge Platforms
- Catalyst 9100 Access Points
- Catalyst 9600 Series Switches
- Catalyst 9800 Series Wireless Controllers
- Cisco DNA Center
- Nexus 9000 Series Switches
- Nexus Dashboard

SUPPORT BUSINESS RESILIENCY WITH YOUR NETWORK

Help secure your remote workforce and provide a trusted workplace experience with Cisco solutions.

[Start now >](#)

Cisco products overview – Source: [Cisco](#)

They are managing to increase the share of software and service driven revenues which is now at 50%.

Q1 FY 2021 Highlights

- Off to a solid start in FY 2021: teams executing with excellence; making steady progress on our **shift to a software and subscription-driven model**; encouraged by signs of improvement in our business
- Remain closely aligned with customers to provide them with the mission critical technology they need; many are compressing years of work into just a few months
- Focused on building innovation that helps our customers – and Cisco – thrive in a hybrid cloud world
- Ongoing success of Catalyst 9K and strong growth in Webex, security solutions and business resiliency offers
- Introduced new technology solutions that help our customers adapt, accelerate and simplify their operations through new, agile automation platforms
- Focused on growing our business, guided by our purpose to power an inclusive future for all

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CSCO stock analysis – Source: [Q1 2021 Investor presentation](#)

I don't really agree with Needham's worry that Cisco is 'hemorrhaging' market share to competitors like Arista Networks (NYSE:ANET), Extreme Networks (NASDAQ:EXTR) and Juniper Networks (NYSE:JNPR). Arista has also seen a [7% decline](#) in revenues with total revenues for the last 4 quarter at \$2.1 billion. Extreme Networks with its cloud-based focus has a \$1 billion yearly revenue target while Juniper's revenue, mentioned only after 35th presentation slide about how good their products are, just surpasses \$4 billion per year and has actually been declining.

Quarterly Trended Results

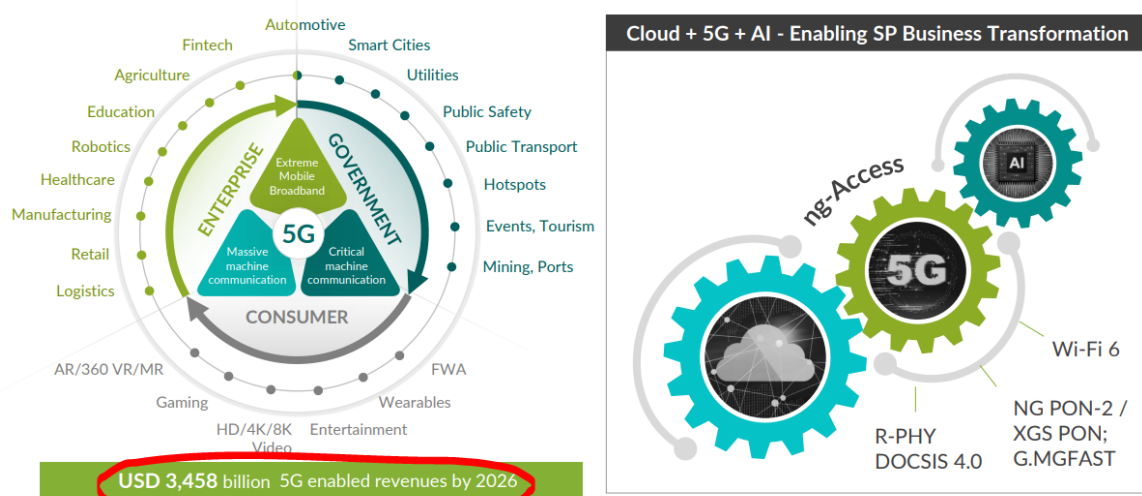


Juniper’s revenue – after 35 slides of how wonderful their products are – Source: [Juniper](#)

So, the 3 competitors have total yearly revenues of \$7 billion which is what Cisco makes in two months. It is normal that there is competition as networks are a fast-growing sector but calling it life threatening is a bit too much for my taste.

All in all, with \$3.5 trillion of revenues enabled by 5G by 2026, I have a feeling there will be a place for CSCO, its network solutions and most likely the \$50 billion in revenues will stay or grow. Wi-Fi, 5G, cloud, AI, VR, security and all that will come, will also require many of Cisco’s products on both the software and hardware side.

‘CLOUD + 5G + AI’ Era has begun, opening new growth opportunities and enabling holistic business transformation for SPs



Market expectations - Source: [Juniper](#)

Within data center networks, Cisco is still the leader according to Gartner on both ability to execute and completeness of vision.

• 2020 Magic Quadrant for Data Center Networking



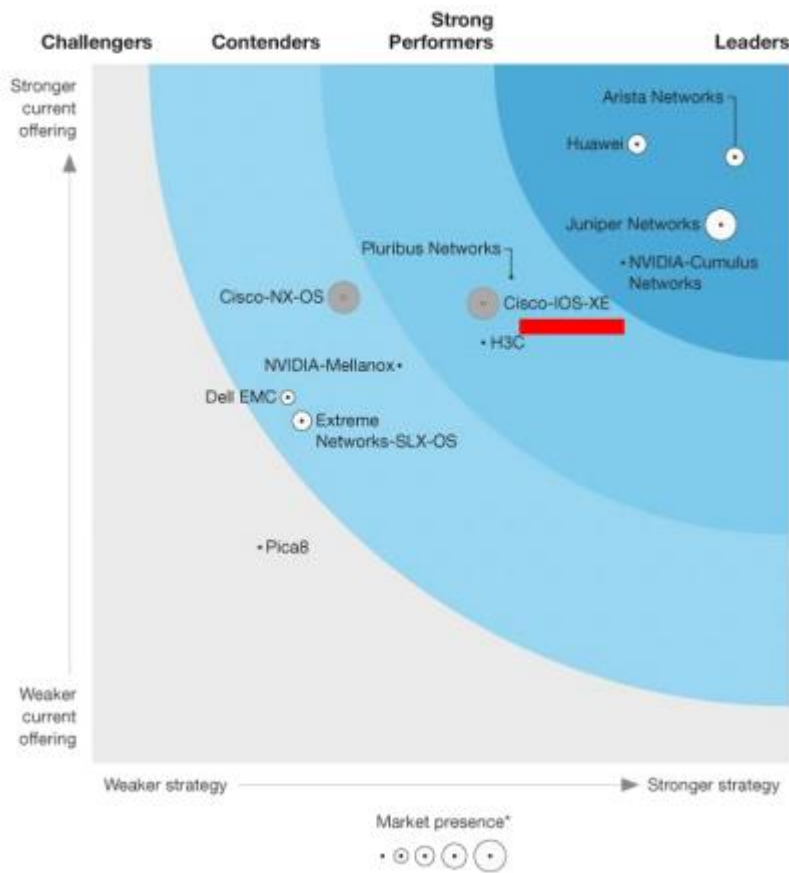
Data center networking - Source: [Juniper](#)

CSCO is a strong performer within the open, programmable switches for business wide software defined networks.

THE FORRESTER WAVE™

Open, Programmable Switches For A Businesswide SDN

Q3 2020



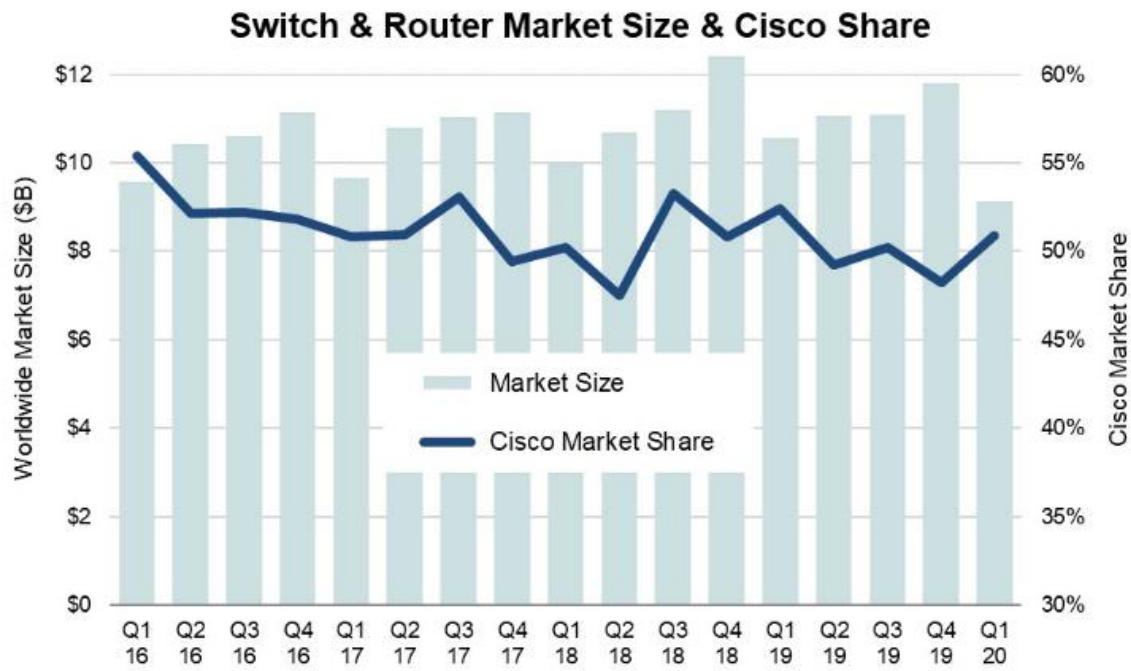
*A gray bubble indicates a nonparticipating vendor.

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Source: Forrester Research, Inc. Unauthorized reproduction, citation, or distribution prohibited.

Cisco's SDN positioning - Source: [Juniper](#)

The switch and router market share looks stable.



Source: Synergy Research Group

CSCO stock analysis – market share – Source: [Synergy Research](#)

Further, Cisco is not really standing still. The company is practically acquiring one company per quarter in order to keep providing and enlarging its product offering (200 acquisitions made in 36 year history). Acquiring smaller companies with differentiated products is very smart when you are as big as Cisco because you can immediately scale by offering the product to your large client base.

Acquisitions by Year

View by Company Name

- **Banzai Cloud** (*intent to acquire*) - November 16, 2020
Banzai Cloud has demonstrated experience with complete end-to-end cloud-native application development, deployment, runtime and security workflows. They have built and deployed software tools that solve critical real-world pain points and are active participants in the open-source community as sponsors, contributors and maintainers of several open-source projects.
- **Portshift** - October 1, 2020
Portshift is focused on building application security solutions that span a large portion of the lifecycle of cloud-native applications, from development and policy enforcement to vulnerability management and runtime protection. Portshift's team brings cloud-native application security capabilities and expertise for containers and service meshes for Kubernetes environments to Cisco, allowing us to move toward the delivery of security for all phases of the application development lifecycle.
- **BabbleLabs, Inc.** - August 25, 2020
BabbleLabs uses advanced AI (Artificial Intelligence) techniques to distinguish human speech from unwanted noise, enhancing the quality of communications and conferencing applications. With the addition of BabbleLabs, Cisco will bring native noise removal capability to its entire Collaboration portfolio. Initially, Cisco will focus on integrating BabbleLabs to deliver a best-in-class audio experience to Webex Meetings users - wherever they are and however they connect via the Webex application (whether via a conference room or mobile device).
- **Modcam** - July 31, 2020
Modcam is a privately held, video analytics company. In acquiring Modcam, Cisco is investing in a team of highly talented engineers who bring a wealth of expertise in machine learning, computer vision and cloud-managed cameras. Modcam has developed a solution that enables cameras to become even smarter. Cisco Meraki MV smart camera capabilities include motion detection and machine learning-based object detection, all of which run at the edge, in-camera. Today, these analytics are constrained to a single camera's view of the world. With Modcam's technology, this micro-level information can be stitched together, enabling multiple cameras to provide a macro-level view of the real world.

Cisco's latest acquisitions – Source: [Cisco](#)

Cisco's competitors are actually [many](#): Amazon Web Services LLC; Arista Networks, Inc.; Broadcom Inc.; CommScope Holding Company, Inc.; Check Point Software Technologies Ltd.; Dell Technologies Inc.; Dynatrace; F5 Networks, Inc.; FireEye, Inc.; Fortinet, Inc.; Hewlett-Packard Enterprise Company; Huawei Technologies Co., Ltd.; Juniper Networks, Inc.; Lenovo Group Limited; LogMeIn, Inc.; Microsoft Corporation; New Relic, Inc.; Nokia Corporation; Nutanix, Inc.; Palo Alto Networks, Inc.; RingCentral, Inc.; Slack Technologies, Inc.; Ubiquiti Networks; VMware, Inc.; Zoom Video Communications, Inc.; and Zscaler, Inc.; among others.

The key competitive factors include:

- The ability to sell successful business outcomes (integrated offers – CSCO Yes)
- The ability to provide a broad range of networking and communications products and services (integrated offers – CSCO Yes)
- Product performance (medium)
- Price (medium – hard to compete with those that lose money on purpose)
- The ability to introduce new products, including providing continuous new customer value and products with price performance advantages (takeovers - yes)
- The ability to reduce production costs (scale – yes)

- The ability to provide value-added features such as security, reliability, and investment protection (takeovers and integrated offer)
- Conformance to standards
- Market presence (strong – easy to scale on existing eco-system)
- The ability to provide financing (cash loaded)
- Disruptive technology shifts and new business models (hm...)

Given the position, the expected growth in the market thanks to 5G and all the other things expected to happen, I would argue Cisco is going to be around 5, 10 and even more years down the road. This gives me a business margin of safety as a growth tailwind lowers the probability of making mistakes, both on my investing side and CSCO's business side while CSCO's current market position and integration reassures me of its future position. I don't expect linearity, which is what the market always expects, it is a cyclical business and the best time to buy is when the sentiment is negative.

Whenever analyzing a business a bit more in depth, it is always good to listen to the last few conference calls, especially at the analysts' questions because those will immediately give you an indication of the main concerns in order to better understand the management's intention and strategy.

CSCO conference calls quick notes

Q1 2021 – November 2020 Cisco conference call

Question - Oppenheimer: Enterprise orders are down – will it reverse?

Answer CEO: improvement last quarter, good on SMB and positive outlook

Let's take a look at how is the business reflected in the fundamentals.

Question – Cowen & Co: How will working from home impact Cisco?

Answer CEO: “there was this belief that we were going to shut down every headquarters building in the world” but it is most likely going to be more of both, thus high definition video in every office and more security needs etc.

Question – Bank of America: Why are you down more than Arista and Juniper on infrastructure platforms?

Answer CEO: decline driven by compute which none of the competitors have and lower compute pricing. Plus, data centers and DRAM pricing – something others don't have.

Question – JPMorgan: Organic or M&A for growth? Hardware as a service?

M&A strategy stays same, unlikely big acquisitions but mostly a combination of internal organic development and small M&A. Hardware as a service will come of the coming quarters.

Question – Piper Sandler: Core 5G spending, when do you see it?

Answer CEO: probably just starting middle next year (2021) and then developing over the coming few years.

Several analysts mentioned how the management was downbeat in the previous call, so let's see what was the case in Q4 2020.

Q4 2020 – July 2020 Cisco conference call

I've gone through the call and it was mostly about uncertainty based on two down quarters impacted by COVID-19. The most important topic from my perspective is the expensiveness of acquisition targets and consequently Cisco being patient on acquisitions as paying too much doesn't make much sense, despite the growth.

Cisco stock fundamentals

Revenue (1) has been growing slowly over the last 10 years but gross margins (2) have improved significantly, followed by operating income (3) and operating margin (4) improvements. If you can increase your margins, then you are not in a bad market position.

Cisco Systems Inc CSCO | ★★★★★

Financials

	2011-07	2012-07	2013-07	2014-07	2015-07	2016-07	2017-07	2018-07	2019-07	2020-07	TTM
Revenue USD Mil	43,218	46,061	48,607	47,142	49,161	49,247	48,005	49,330	51,904	49,301	48,071
Gross Margin %	61.4	61.2	60.6	58.9	60.4	62.9	63.0	62.0	62.9	64.3	64.1
Operating Income USD Mil	8,473	10,369	11,301	9,763	11,254	12,928	12,729	12,667	14,541	14,101	13,510
Operating Margin %	19.6	22.5	23.2	20.7	22.9	26.3	26.5	25.7	28.0	28.6	28.1
Net Income USD Mil	6,490	8,041	9,983	7,853	8,981	10,739	9,609	110	11,621	11,214	10,462
Earnings Per Share USD	1.17	1.49	1.86	1.49	1.75	2.11	1.90	0.02	2.61	2.64	2.47
Dividends USD	0.12	0.28	0.62	0.72	0.80	0.94	1.10	1.24	1.36	1.42	1.43
Payout Ratio % *	4.7	18.8	29.4	47.3	45.4	44.1	54.3	—	46.6	55.7	57.9
Shares Mil	5,563	5,404	5,380	5,281	5,146	5,088	5,049	4,881	4,453	4,254	4,247
Book Value Per Share * USD	8.68	9.68	10.54	10.92	11.57	12.40	13.12	10.11	8.66	8.43	9.03
Operating Cash Flow USD Mil	10,079	11,491	12,894	12,332	12,552	13,570	13,876	13,666	15,831	15,426	15,935
Cap Spending USD Mil	-1,174	-1,126	-1,160	-1,275	-1,227	-1,146	-964	-834	-909	-770	-739
Free Cash Flow USD Mil	8,905	10,365	11,734	11,057	11,325	12,424	12,912	12,832	14,922	14,656	15,196
Free Cash Flow Per Share * USD	1.64	1.91	2.03	2.14	2.09	2.49	2.50	2.59	3.28	3.47	—
Working Capital USD Mil	39,725	44,202	43,329	47,305	52,660	53,808	56,120	34,802	16,043	18,242	—

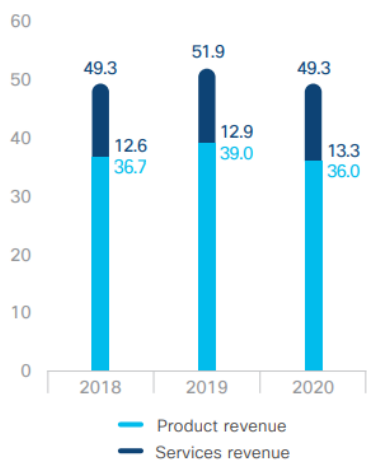
* Indicates calendar year-end data information

CSCO stock fundamentals – Source: [CSCO stock financials - key factors](#)

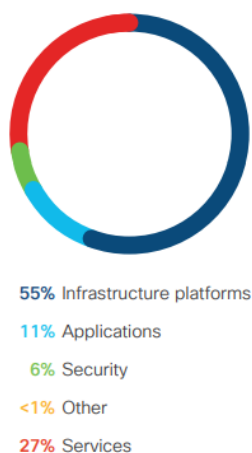
Net income (5) has increased alongside the margin expansion and revenue growth while earnings per share have more than doubled thanks to the strong buybacks (7). Dividends (6) have been growing too while the company even managed to lower capital spending over time and increase free cash flows (11).

Prior to the COVID-19 crisis the revenue trend had been positive while infrastructure applications keep dominating revenues.

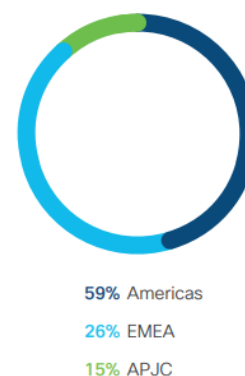
Revenue Trend
(\$B)



Revenue
by product category and services*



Revenue
by geographical segment

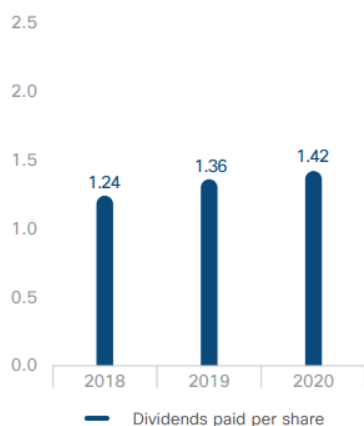


CSCO stock analysis – Source: [2020 Annual report](#)

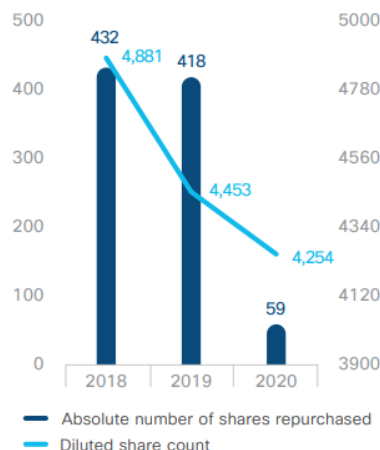
When it comes to capital allocation, the focus has been on debt repayment, followed by dividends and buybacks. There is still \$10 billion remaining under the current buyback program.

Capital allocation

Dividends paid per share
(\$)



Share repurchases
and diluted share count
(M)



Primary uses of cash



CSCO stock analysis – capital allocation – Source: [2020 Annual report](#)

The debt reduction program has been staggering and there is only \$14 billion of debt left. At the current debt repayment rate Cisco could eliminate the debt in two years. I don't think that is something smart to do given the currently low interest rates so they might push for higher rewards to shareholders in the form of higher dividends and higher buybacks.

	July 25, 2020	July 27, 2019	July 28, 2018	July 29, 2017	July 30, 2016
Cash and cash equivalents and investments	\$ 29,419	\$ 33,413	\$ 46,548	\$ 70,492	\$ 65,756
Total assets	\$ 94,853	\$ 97,793	\$ 108,784	\$ 129,818	\$ 121,652
Debt	\$ 14,583	\$ 24,666	\$ 25,569	\$ 33,717	\$ 28,643
Deferred revenue	\$ 20,446	\$ 18,467	\$ 19,685	\$ 18,494	\$ 16,472

CSCO selected financial data - Source: [2020 Annual report](#)

If they decide to increase the dividend and push buybacks higher the stock will most likely go up. According to the [inelastic market hypothesis](#), if they do \$20 billion of buybacks over the next two years, that should push the market capitalization up by \$100 billion or 50%.

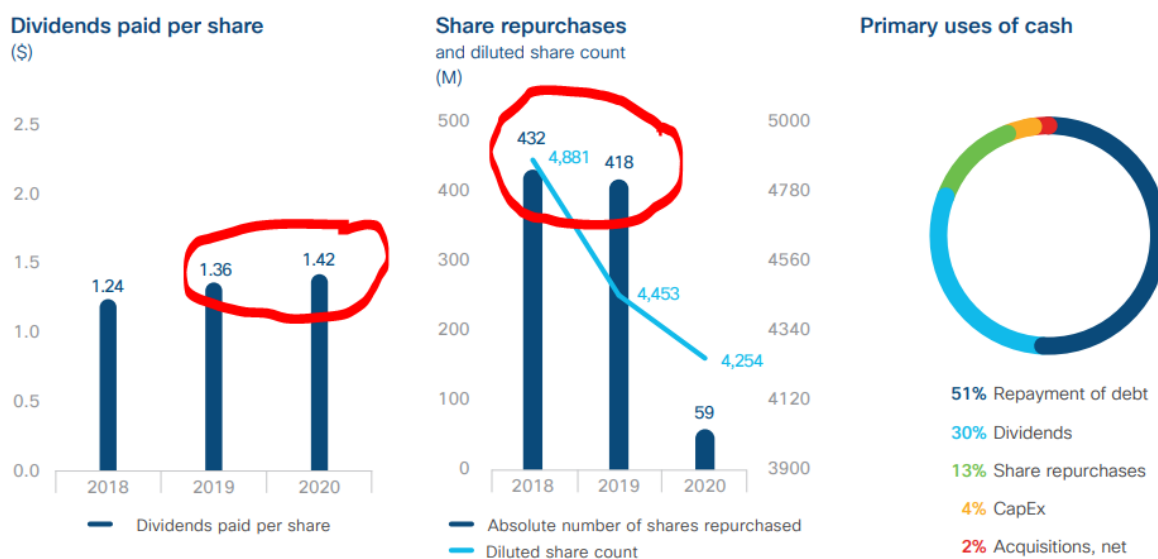
Given that the number of shares has been already significantly lowered, perhaps CSCO stock elasticity could be even lower than the market’s average which could push the market cap even higher. Something we have witnessed with [Apple stock](#) (AAPL).

Let’s take a deeper look at Cisco’s dividend and buyback potential.

Cisco dividend and buyback yield

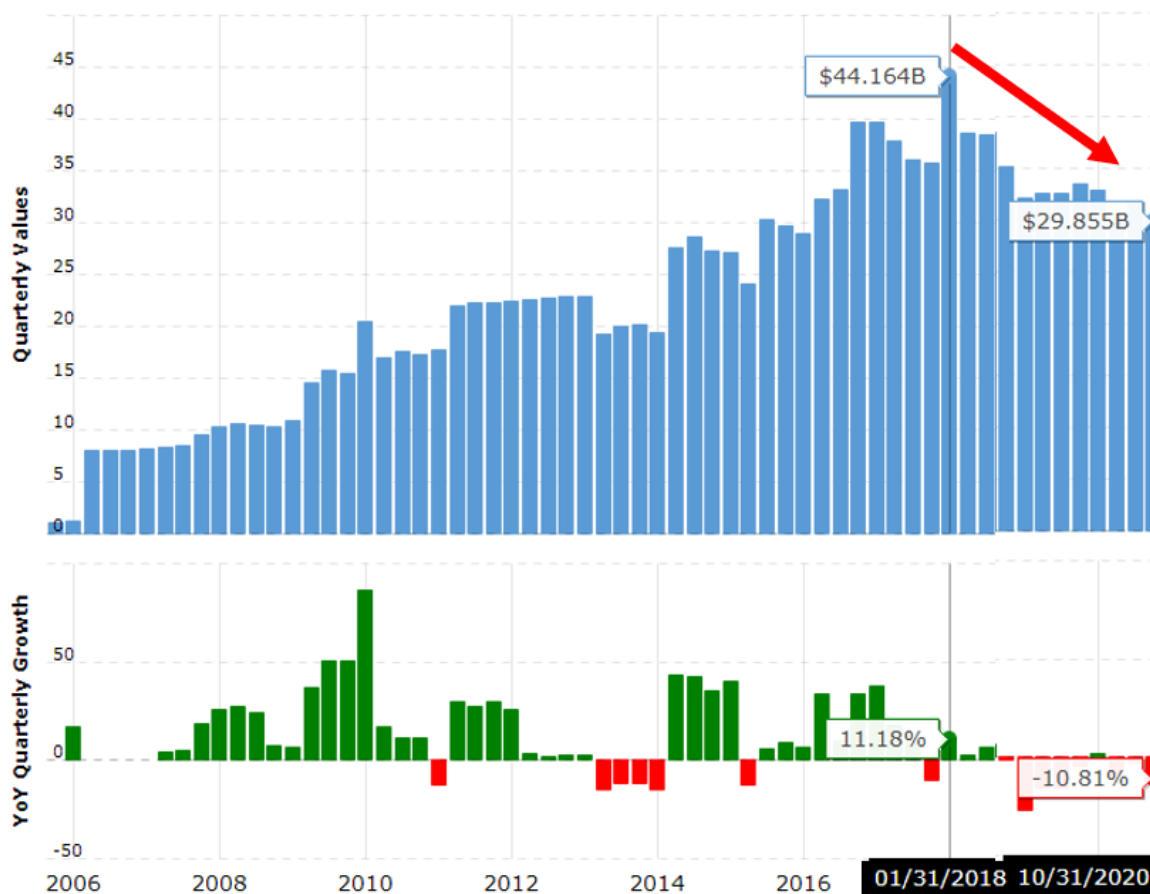
The company manages to make \$15 billion in free cash flow per year where the capital expenditures are just 4% of that as they mostly grow through small acquisitions for complementary technologies.

Capital allocation



CSCO stock analysis – dividend and buybacks – Source: [2020 Annual report](#)

I must say I am surprised to see such a strong focus on debt repayment, especially as the debt to cash flow ratio was just 3, even at a long-term debt level of \$44 billion.



Cisco stock analysis – debt levels – Source: [Macrotrends](#)

The cost of debt isn't high so I feel CSCO could stop repaying the debt and perhaps take on new debt. This would allow for 90% of the cash flows to be returned to shareholders.

Borrowings

Senior Notes The following table summarizes the principal amount of our senior notes (in millions):

	<u>Maturity Date</u>	<u>July 25, 2020</u>	<u>July 27, 2019</u>
Senior notes:			
Floating-rate notes:			
Three-month LIBOR plus 0.34%	September 20, 2019	\$ —	\$ 500
Fixed-rate notes:			
1.40%	September 20, 2019	—	1,500
4.45%	January 15, 2020	—	2,500
2.45%	June 15, 2020	—	1,500
2.20%	February 28, 2021	2,500	2,500
2.90%	March 4, 2021	500	500
1.85%	September 20, 2021	2,000	2,000
3.00%	June 15, 2022	500	500
2.60%	February 28, 2023	500	500
2.20%	September 20, 2023	750	750
3.625%	March 4, 2024	1,000	1,000
3.50%	June 15, 2025	500	500
2.95%	February 28, 2026	750	750
2.50%	September 20, 2026	1,500	1,500
5.90%	February 15, 2039	2,000	2,000
5.50%	January 15, 2040	2,000	2,000
Total		<u>\$ 14,500</u>	<u>\$ 20,500</u>

Cisco stock analysis – debt cost - Source: [2020 Annual report](#)

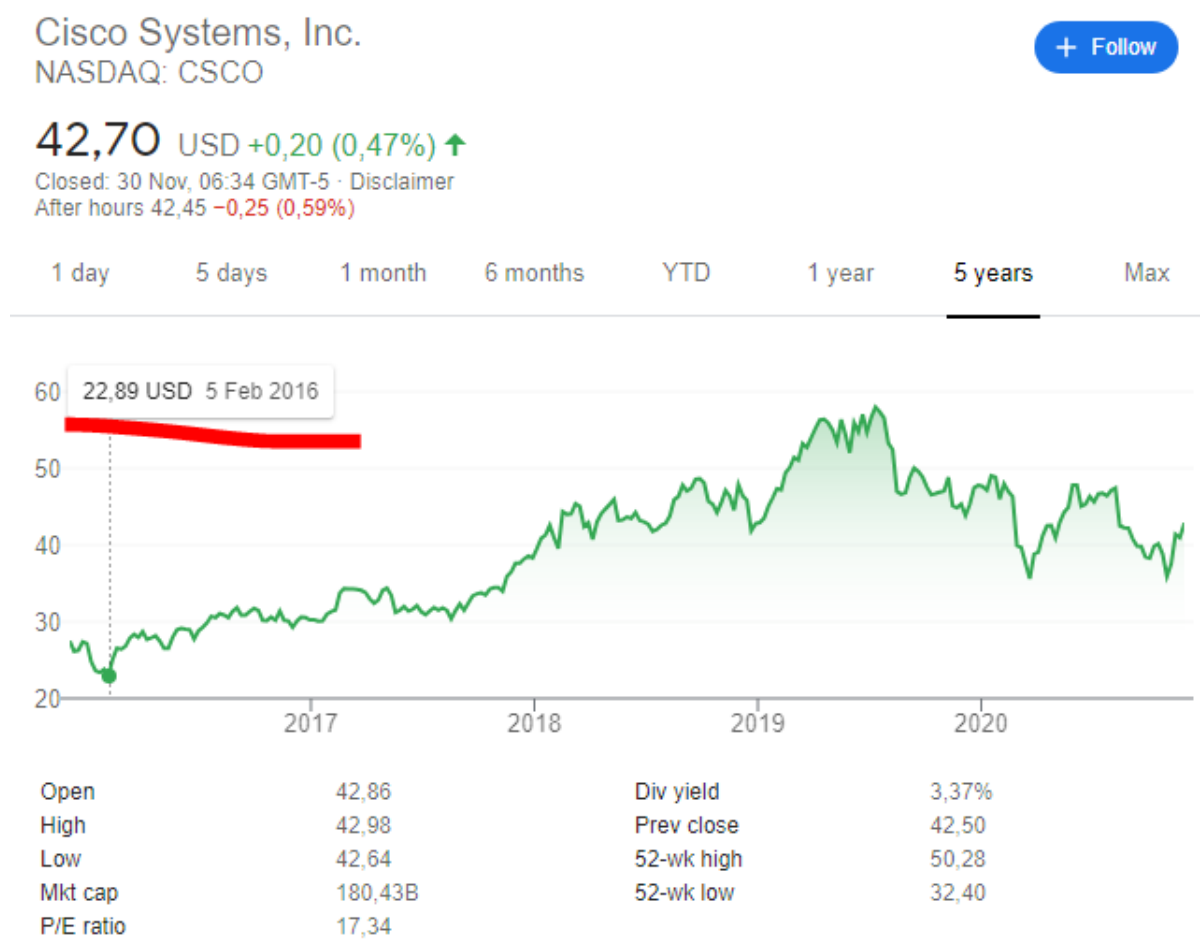
If that would happen, the likely free cash on business being stable, would be around \$15 billion. Spending 40% of that on dividends would allow for a dividend increase, something always loved by the markets, while spending 60% of that on buybacks would give a significant support to the stock price. Before discussing the stock price investing outlook, let's make first a cash flow valuation from a purely business perspective.

CSCO stock valuation – Cash flow basis

This valuation is pretty simple, with \$15 billion of free cash flows and with a conservative expectation that in the most likely scenario those cash flows will remain stable, it is up to you to decide how much would you be willing to pay for the free cash flows.

My favorite situation would be to get to a 15% business yield when owning a business. For that CSCO's market capitalization should be at \$100 billion or there should be something two to three years down the road that is going to increase cash flows by 50% but isn't yet accounted for by the market (I'll follow CSCO to see if something like that emerges).

In 2016, CSCO's market cap was close to \$100 billion but when I multiply the \$22.89 stock price with 5.1 billion shares outstanding, even in 2016 the market capitalization didn't go below \$116 billion, and above a 10% free cash flow yield (\$12 billion 2016 FCF on \$116 market capitalization).



CSCO stock price – unlikely to go much lower

For a big company like CSCO, you have to pay for quality, so at current market levels, we are looking at a free cash flow yield of 8.3%. That is not bad for the quality offered and the 3.37% dividend yield with great dividend coverage, where the dividend can even be increased.

CSCO stock price and investment analysis

Given the free cash flows that will be available in 2021, the \$29 billion cash position, I feel buybacks and dividends can be increased easily even if there is no immediate revenue growth. Alongside no disaster earnings reports, we could easily see \$60 in the next 12 months. I give a 60% chance for this scenario.



Cisco stock price forecast

In case there are some issues during earnings like delays in 5G implementation or increased competition, then the stock will probably trade in the current range between \$40 and \$50 giving you a good yield while you wait for better times. I give a 30% chance for such a scenario.

If we have a bad recession again in 2021, stimulus doesn't work and who knows what negative happens, then we could see it in the low thirties or high twenties. I give a 10% chance to that.

$$0.6 * \$60 + 0.3 * \$45 + 0.1 * 30 = \$52.5$$

Probabilistically, the current value of CSCO should be around \$52.5 giving a 30% upside.

If I assume the stock will hit \$60 over the next 5 years, that would give a 7% return that increases to 10% when you add the dividend. Not bad for a company like CSCO. If it happens earlier, even better.

Now, you can never know what scenario will develop, so one must have a strategy on what to do if the bad scenarios happen, compare the risk and reward with other investment opportunities and see how the above fits one's portfolio. I'll cover CSCO and see how it evolves over the next few years. I will specialize much more into these cash flow cows that nobody seems to like, I am sure there will be some fat value investing pitches down the road.