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## ANALYST QUICK NOTES

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**Cisco Systems Inc. (NGS: CSCO: BUY)**

**Target Price: \$41**

**Jim Kelleher, CFA**

**5/17/2017**

### Thesis

- While many legacy hardware companies are struggling, Cisco's innovation, execution at scale, and operating discipline set it apart.
- Cisco is investing in itself with niche asset purchases and bigger share buyback.

### YTD Performance

- CSCO shares are up 13% YTD.
- Comm. equipment peer group up 13%.
  - Subset of cloud & social companies up 14%.
- S&P 500 up 7%.

### 3Q17 Expectations

- Street: \$11.9 billion, non-GAAP EPS \$0.58.
- Argus: \$11.9 billion, non-GAAP EPS \$0.60.
  - Guidance of \$11.76-\$12.00 billion and \$0.57-\$0.59.
- Revenue \$12.00 billion a year ago.
  - Non-GAAP EPS \$0.57 a year ago.
- Our revenue estimate assumes 2% y/y decline.
- Our EPS estimate assumes 5% y/y growth.

### What We'll Be Watching

- 3Q17 will be first quarter w/o SPV impacting comparisons.
- Core of Routing, Switching, Services = 71% of revenue.
  - Core products down mid-singles, as legacy data center loss not fully offset by cloud wins and next gen data center.
  - Services rising: up about 2% as next gen requires more customer interaction, even as products become more autonomous.
- Double-digit growth in Security, Other (optical).
- Single digit in Collaboration, Wireless, Data Center, maybe switching.
- Declines in SVP, routing.

### **What The Street Wants In 4Q17 Guidance**

- Seasonally solid quarter, ends in July.
  - Looking for revenue of \$12.52 billion.
  - Looking for EPS of \$0.62.
- Argus for 4Q17:
  - Looking for revenue of \$12.35 billion.
  - Looking for EPS of \$0.62.

### **Capital Allocation**

- Pioneer in share buybacks.
- In February (2Q17):
  - Hiked Q dividend by 12%, to \$0.24; now yielding 3.5%.
  - Returned \$4.6 billion to shareholders in 1H17.
- Dividend not a strain (2.3-times CFO/dividend coverage).

### **Valuation & Conclusion**

- Trading at 13.8-times vs. trailing 5-yr P/E 10.8, but...
  - 2-yr forward relative P/E of 0.78, vs. 5-yr 0.71.
  - DFCF value in the high \$50s.
  - Trading below peer group on P/Es, P/S, PEG, and price/book.
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