Disnat GPS Report

Cisco (CSCO, U$30.07)

Desjardins
Online Brokerage

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Company Description

Cisco is one of the main pillars of the Internet as we know it today.

For some time in the early 2000s, it had the largest market capitalization in the world. It was and continues to be primarily known for its routers and switches, which still account for nearly half of its total revenues.

For many of the company's customers, the name "Cisco" is synonymous with quality products, but also specialized and competent services, enabling the company to diversify its revenue streams (Services account for about 25% of Cisco's total revenues).

In addition to diversifying its activities by offering services that provide stable revenues, the company also appears to want to invest in various areas of technology such as data management, software and cloud computing security.

Disnat GPS Portfolio Strategist Comments

The field of routers and switches which has made Cisco famous is likely to change dramatically over the next few years.

Competition from HP and Juniper Networks continues to be fierce, but other players like Huawei are also hampering Cisco's development, especially in China.

We believe, however, that Cisco's strength lies in its considerable experience which, in our opinion, will enable it to dominate the market in its current businesses and above all, to become a major player in several sectors of the future.

At Disnat GPS, we believe that Cisco's favorable financial position and strong current profitability will enable it to continue to invest, either internally or through acquisitions, in diversification which will prove profitable in the future.

Other Disnat GPS reports available in the GPS section of the Disnat website: Apple, Disney, Nike.

Financial Health

Fiscal Year	2014	2015	2016
Long term debt (in billions of dollars)	20	21	25
Debt/equity ratio	0.36	0.36	0.39

Cisco's financial health is one of the strongest around.

Official figures show a debt of $25 billion and a debt/equity ratio of 0.39. In reality, Cisco's condition is actually much better than what these figures show: at the present time, the company holds cash of about $65 billion!

However, a portion of this cash is held abroad. This is important because if Cisco decides to bring these funds back to the United States, the amount would be taxed as profit made in the United States at a rate of 20% to 35%.

Although there are too many unknowns to allow for a precise calculation, even at a rate of 35% Cisco would benefit from an influx of funds that would still be much greater than its debt.

The only short-term financial risk would be that Cisco would squander this cash on bad investments, which for now does not seem to be likely.

It can therefore be said that Cisco has no net debt and has a very favorable cash position, which should be taken into account during our evaluations.

Growth

Compound Yield	1 year	3 years	5 years	10 years
Earnings	0.2%	0.4%	2.7%	5.6%
Earnings per share	20%	4%	12%	9%

Over the past three years, the company's revenue growth has been less than 1%, which is obviously disappointing.

However, we should remember that Cisco is in the midst of a reorganization and that, with this in mind, the company is concentrating its efforts on increasing its profits rather than its sales.

The company will continue its reorganization and streamlining in 2017, which should continue to affect revenues for some time.

We therefore believe that earnings per share are likely to give a better idea of the company's current situation.

Although earnings per share also experienced some weakness (4% over three years), these were more stable than earnings in recent years.

The relative stability of profits, and above all the 20% increase in earnings per share in 2016, make for an optimistic future.

Growth in the sales of routers and switches may slow further, but we believe that they will continue to perform satisfactorily, pending the emergence of new products and services.

Valuation

Key Ratios	Cisco	Cisco (5 yr avg)	S&P 500
Price/earnings	14.4	14.6	20.3
Forward price/earnings	12.6	n.a.	18.5
Dividend yield	3.5%	2.8%	2.2%

Cisco's evaluation, and more specifically its undervaluation, is one of the main reasons for our interest in the company.

In terms of price/earnings and future price/earnings ratios, it is currently trading at a discount compared to its average of the past five years (even before taking into account any possible adjustments related to its strong cash position).

In addition to trading at a discount to its own average, it also trades at a considerable discount compared to the S&P 500.

At present, the market places a lot less value on a dollar of Cisco earnings than a dollar of earnings from an average S&P 500 company.

We do not agree with the idea that more than 250 companies in the S&P 500 have a better future outlook than Cisco.

At Disnat GPS, we believe that the fears associated with technological changes likely to affect Cisco are real, but we also believe that the positioning and quality of Cisco's products and services will allow it to stand out. Once these fears have faded, there will only remain an undervalued stock!

Governance

Fiscal Year	2012	2013	2014	2015	2016
Earnings per share ($)	1.49	1.86	1.49	1.75	2.11
Dividend ($)	0.28	0.62	0.72	0.80	0.94
Number of shares (millions)	5,347	5,114	5,076	5,020	5,020

Over the past three years, Cisco's dividend has grown an average of more than 15% per year.

The increase in dividends over each of the last six years, since its introduction in 2011, allows us to conclude that this company is serious in its intention to return an increasing portion of its profits to investors.

In addition, the company regularly buys back its shares. Over the past five years, it has repurchased more than 6% of its stock in circulation.

In terms of internal development, Cisco is still ranked among the world's leading research and development companies. For example, Cisco's R & D spending in 2016 totaled $6.3 billion, compared to $4.8 billion for its major competitor, Juniper Networks.

We believe that the steady increase in the dividend, the continuation of the share repurchase program and the fact that Cisco does not appear to be considering any major outlays will ensure that this company continues to manage its growth well while continuing to pay dividends to investors.

Explanatory Notes

Disnat GPS reports contain five separate sections, each followed by comments from the Disnat GPS Portfolio Strategist regarding the following:

1. Company Description

2. Financial Health

3. Growth

4. Valuation

5. Governance

At Disnat GPS, we believe that the topics, ratios and other financial figures presented here are particularly important.

However, for reasons of space, we can not publish all available data. We therefore invite you to read the additional financial information on the Desjardins Online Brokerage website.

Furthermore, this report is an analysis of the condition of a company today, with a medium to long term view. It is in no way an adequate tracking of daily activities of the stock market in general or of this particular company.

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Steve Deschesnes, LL.L, GPC, GSPD, FCSI©
Portfolio Strategist
Disnat GPS