

## Cisco Systems

## 2Q24 preview: Networking segment continues to be under pressure

Maintain Rating: NEUTRAL | PO: 55.00 USD | Price: 50.13 USD

## Networking to remain pressured, driving down growth

We expect the networking market to remain under pressure and believe the weakness would be more visible on Cisco's results, given lack of remaining backlog support. About 80% of product revenue is generated by the Networking segment, and of that ~70% was attributed to switches and routers in f1Q24. Cisco's switching and routing revenue grew ~1% per year on average in the 15-year period from c2005 to c2020, yet grew 15% YoY in c2022 and 32% in c9M23 (see c3Q23 [Switching Trends](#) and [Routing Trends](#)). With backlog largely depleted, and product orders down 20% YoY in f1Q, we model a 9% and 7% product revenue decline in f2Q24 and FY24, respectively, led by Service Provider spending slowdown, Cloud Providers digesting previous purchases, and Enterprises responding to the economic cycle. We maintain our Neutral rating and \$55 PO.

## Depleted backlog levels offer limited support

Product orders came down 20% YoY in f1Q24, while backlog depleted by ~\$4.5bn, returning to normal, historical levels. We believe backlog drawdown of \$4bn-\$6bn supported the growth of the Networking segment in FY23, driving the \$5.1bn YoY increase in product revenue to \$43.1bn. With backlog drawdown now offering limited support post-1Q, coupled with weak underlying spending initiatives, we believe growth will go through a steep correction in FY24 and model product revenue to decline 9%, 13% and 12% YoY in the next three quarters, respectively.

## Product trends and headcount reduction imply weakness

Street estimates call for \$41bn and \$42bn of product revenue in FY24 and FY25, respectively, but we believe product revenue should re-base at around \$40bn-\$41bn (ex-Splunk), suggesting additional downside risk to consensus estimates to the tune of \$1bn-\$2bn. Additionally, Cisco is expected to reduce its headcount "by the thousands", per press reports, following a smaller headcount reduction in c2023. We believe the move is driven by Cisco's desire to preserve margins in FY24, in light of the weakening demand environment. Management previously called for margin improvement in FY24, supported by the easing of supply chain and software revenue mix, with 2024 Street GM and OM estimates improving ~170bps and 90bps YoY to 66.2% and 34.4%, respectively.

## Peer results signal negative implications for Cisco

The underlying trends across networking peers remain weak, as evidenced by recent quarter results across [Juniper](#), [F5](#), (see links to quarter review notes), Extreme Networks, and Calix. Enterprise, Service Providers, and Tier-2 Cloud demand remains pressured, as these customer verticals are going through a period of lower spending and inventory digestion, coupled with the high interest rate environment also putting a pause on investments. We expect the weakness to linger throughout c2024, especially in c1H24. Overall, we model f2Q24 total revenue to be down -6.5% YoY and EPS declining 6% YoY to 83c, largely in-line with Street estimates. On the positive side, Cisco's valuation of ~11x 2025E EV/FCF is relatively unassuming, and the 3.1% dividend yield and 8.6% FCF yield should continue to provide some support for the stock.

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## Stock Data

Price	50.13 USD
Price Objective	55.00 USD
Date Established	16-Nov-2023
Investment Opinion	B-2-7
52-Week Range	45.56 USD - 58.19 USD
Mrkt Val (mn) / Shares Out (mn)	212,651 USD / 4,242.0
Free Float	91.5%
Average Daily Value (mn)	884.71 USD
BofA Ticker / Exchange	CSCO / NAS
Bloomberg / Reuters	CSCO US / CSCO.OQ
ROE (2024E)	33.9%
Net Dbt to Eqty (Jul-2023A)	-3.9%
ESGMeter™	High

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# Financial Highlights

## Exhibit 1: BofA Estimates vs. Street Estimates (US\$ Millions except for per share items)

BofA estimates for 2Q24 fall slightly under Street estimates

	2Q24E					FY24E					FY25E				
	BofA	Bloomberg	%Diff	Visible Alpha	%Diff	BofA	Bloomberg	%Diff	Visible Alpha	%Diff	BofA	Bloomberg	%Diff	Visible Alpha	%Diff
Product revenue	\$9,198.7	\$9,516.6	-3.3%	\$9,257.1	-0.6%	\$40,253.8	\$40,949.3	-1.7%	\$40,320.9	-0.2%	\$40,414.1	\$41,962.3	-3.7%	\$41,496.8	-2.6%
Service revenue	\$3,507.8	\$3,458.7	1.4%	\$3,447.0	1.8%	\$14,151.0	\$14,070.5	0.6%	\$14,038.0	0.8%	\$14,467.7	\$14,376.2	0.6%	\$14,336.9	0.9%
Total revenue	\$12,706.5	\$12,710.7	0.0%	\$12,707.6	0.0%	\$54,404.8	\$54,353.2	0.1%	\$54,376.0	0.1%	\$54,881.8	\$55,908.3	-1.8%	\$55,839.5	-1.7%
Cost of sales	\$8,326.0	\$8,347.1	-0.3%	\$8,335.6	-0.1%	\$35,922.8	\$35,952.9	-0.1%	\$35,932.6	0.0%	\$36,082.0	\$36,914.8	-2.3%	\$36,823.6	-2.0%
Operating expenses	\$4,068.0	\$4,083.2	-0.4%	\$4,042.5	0.6%	\$18,650.8	\$18,708.6	-0.3%	\$18,577.2	0.4%	\$18,750.0	\$19,278.6	-2.7%	\$19,008.5	-1.4%
Net income	\$3,384.2	\$3,408.1	-0.7%	\$3,410.3	-0.8%	\$15,835.7	\$15,682.5	1.0%	\$15,704.3	0.8%	\$15,964.7	\$16,035.0	-0.4%	\$16,034.0	-0.4%
EPS	\$0.83	\$0.84	-0.8%	\$0.84	-0.8%	\$3.90	\$3.87	0.7%	\$3.87	0.7%	\$3.97	\$4.01	-0.9%	\$4.00	-0.7%

Source: BofA Global Research estimates, Bloomberg, Visible Alpha

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## Price objective basis & risk

### Cisco Systems (CSCO)

Our \$55 PO is based on roughly 12x EV/FCF using our CY2025 estimate, in-line with tech peers at 9-20x (appropriate given Cisco's stability and high 3.0%+ dividend yield). We also focus on FCF to better capture software revenue growth and the shift to subscription models.

Downside risks to our price objective are: (1) deterioration in the spending environment, (2) lack of growth in public spending, a vertical that Cisco dominates, (3) downside risk to gross margin stemming from pricing and competitive pressures, (4) technological changes that would adversely impact high profit switching and routing segments, (5) inability to drive technological innovation in its core and new growth segments through organic innovation and acquisitions, and (6) change in customer behavior that would result in revenue pressure in services and other key areas.

Upside risks to our price objective are: (1) higher than expected growth in key markets, particularly switching and routing, and (2) solid market share gains in security and observability.

## Analyst Certification

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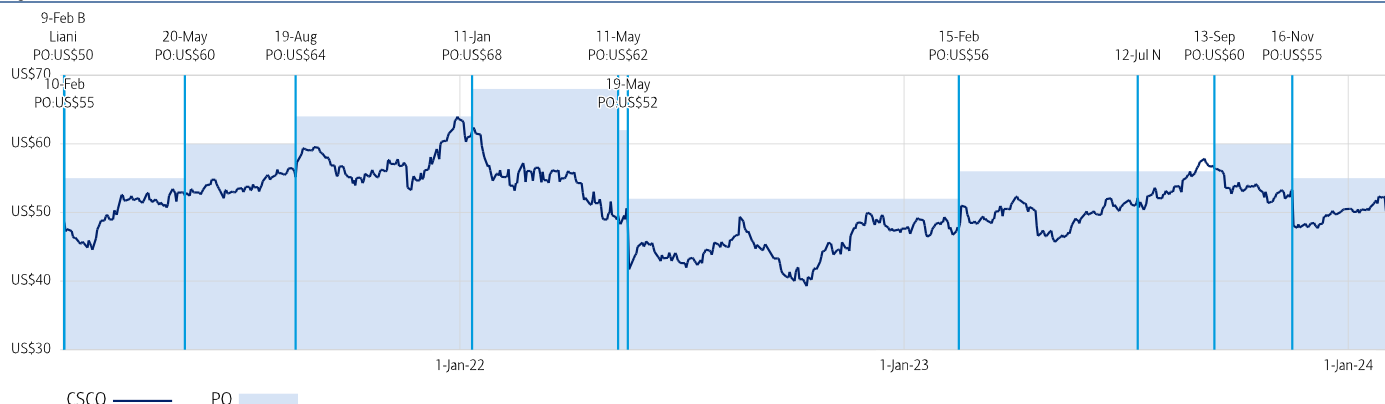
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### Cisco Systems (CSCO) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	57	51.82%	Buy	43	75.44%
Hold	27	24.55%	Hold	17	62.96%
Sell	26	23.64%	Sell	12	46.15%

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Sell	807	22.84%	Sell	383	47.46%

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