



## COMPANY UPDATE | COMMENT

MARCH 9, 2010

## Cisco Systems, Inc. (NASDAQ: CSCO)

### The Big Bad Core

### Outperform Above Average Risk

|                          |         |                         |         |
|--------------------------|---------|-------------------------|---------|
| Price:                   | 26.13   | Price Target:           | 30.00   |
|                          |         | Implied All-In Return:  | 15%     |
| Shares O/S (MM):         | 5,862.0 | Market Cap (MM):        | 153,174 |
| Dividend:                | 0.00    | Avg. Daily Volume (MM): | 47.23   |
| Float (MM):              | 5,780.0 | 3-Yr. Est. EPS Growth:  | 10.00%  |
| Debt to Cap:             | 22%     |                         |         |
| Institutional Ownership: | 74%     |                         |         |

Priced at market close March 9, 2010 ET.

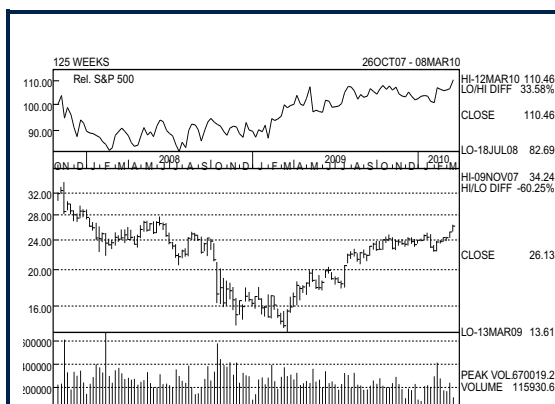
### Event: Scaling the Internet from the Middle

### Investment Opinion

- **Cisco unveiled its major new CRS-3 carrier routing system touted as the foundation for the next-generation Internet.** The CRS-3 is currently in trials with Cisco's partner AT&T who recently completed a successful 100 gig Ethernet field trial. Cisco expects the CRS-3 to be available in C3Q10. Pricing will start at \$90,000 and will range into the multi-millions for a fully configured system.
- **The Core Router market is one of the most strategic markets since it's considered the heart of the network and it's how most carriers build and branch out their service provider access layers.** According to our estimates, the core router market is about \$3B, is expected to grow at 10-15% over the next 5 years and is largely a duopoly with Cisco and Juniper controlling the bulk of the market. And in our view, the Core Router market is set to rebound in 2010 as major carriers resume their Capex spending to upgrade IP networks. With the growth in data traffic largely ignoring the recession, Cisco's new CRS-3 router will likely benefit as the carriers resume their network expansion at the core.
- **The CRS-3 is expected to support the accelerating growth in bandwidth demands for several years to come which will enable Cisco to benefit from its \$1.6B investment in the CRS family.** The new CRS-3 provides significant cost savings as it is both backward and forward compatible with CRS-1 line cards, can be placed in existing CRS-1 chassis and utilizes cooling and power designed for the CRS-1.
- **Cisco's speed to market and CRS-3's offering of 12x the capacity of its peers provides the company with a competitive advantage.** Key customers include service providers around the globe including AT&T as they work to boost the speeds of the Internet backbone.
- **Overall routers are 16% of Cisco's revenues at the moment but in the past we've seen this amount reach the low 20% range driven by a product cycle.** Routers also typically carry higher than normal gross margins for Cisco. The Cisco CRS-3 will soon be featured in our upcoming 2010 RBC core router guide.

Priced as of prior trading day's market close, EST (unless otherwise noted).

For Required Conflicts Disclosures, see Page 4.



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| FY Jul        | 2008A     | 2009A    | 2010E     | 2011E     |
|---------------|-----------|----------|-----------|-----------|
| EPS (Op) - FD | 1.53      | 1.35     | 1.59      | 1.61      |
| P/E           | 17.1x     | 19.4x    | 16.4x     | 16.2x     |
| Revenue (MM)  | 39,540.0  | 36,117.0 | 39,398.0  | 42,669.0  |
| EPS (Op) - FD | Q1        | Q2       | Q3        | Q4        |
| 2008          | 0.37A     | 0.38A    | 0.38A     | 0.40A     |
| 2009          | 0.42A     | 0.32A    | 0.30A     | 0.31A     |
| 2010          | 0.36A     | 0.40A    | 0.38E     | 0.40E     |
| Revenue (MM)  |           |          |           |           |
| 2008          | 9,554.0A  | 9,831.0A | 9,791.0A  | 10,364.0A |
| 2009          | 10,331.0A | 9,089.0A | 8,162.0A  | 8,535.0A  |
| 2010          | 9,021.0A  | 9,815.0A | 10,162.0E | 10,400.0E |

All values in USD unless otherwise noted.

## Details

The CRS-3 with up to 322 Tbps on a 72 line card chassis system triples the capacity and offers 2x the services of Cisco's predecessor, CRS-1 which clocked in at up to 92 Tbps. Putting these speeds into perspective the new CRS-3 can transfer all of the books housed in the library of congress in just over 1 second. The CRS-3 is powered by Cisco's new internally developed Cisco QuantumFlow Array Processor.

## Valuation

Cisco's stock currently trades at 3.1x our CY10 revenue estimate net cash and 17x our CY10 earnings estimate, which does not reflect option expensing. Our 12-month price target of \$30 is 19x our CY10 EPS estimate, which is above the current mean of 16x. Target multiple is closer to 16x blended CY10/CY11 EPS net cash of \$4.17/share. We believe CSCO deserves a premium multiple because of its strong cashflow, balance sheet and industry position.

## Price Target Impediment

Impediments to reaching our price target include competitive pressures, a prolonged IT spending recovery period, and geo-political risks.

## Company Description

Headquartered in San Jose, CA, Cisco Systems is a leading networking equipment provider. Its end-to-end product portfolio helps service providers and enterprise customers communicate in a globally interconnected economy. Cisco sells its products in more than 115 countries via a direct sales force, distributors, value-added resellers and system consultants. The company has made numerous acquisitions as part of its growth strategy. Calendar 2009 sales were \$28.2 billion vs. just \$69 million in 1990, the year Cisco went public.



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| Period Ending<br>(in \$Million) | Oct-08<br>1Q  | Jan-09<br>2Q  | Apr-09<br>3Q  | Jul-09<br>4Q  | Oct-09<br>1Q  | Jan-10<br>2Q  | Apr-10<br>3QE | Jul-10<br>4QE | Oct-10<br>1QE | Jan-11<br>2QE | Apr-11<br>3QE | Jul-11<br>4QE | Jul-08<br>FY  | Jul-09<br>FY  | Jul-10<br>FYE | Jul-11<br>FYE | Dec-08<br>CY  | Dec-09<br>CY  | Dec-10<br>CYE | Dec-11<br>CYE |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>Income Stmt (Pro-Forma)</b>  |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |
| Product Revenue                 | 8,635         | 7,347         | 6,420         | 6,729         | 7,200         | 7,976         | 8,212         | 8,400         | 8,300         | 8,580         | 8,650         | 8,800         | 33,099        | 29,131        | 31,788        | 34,330        | 33,120        | 28,115        | 33,291        | 34,960        |
| Services Revenue                | 1,696         | 1,742         | 1,742         | 1,806         | 1,821         | 1,839         | 1,950         | 2,000         | 1,989         | 2,050         | 2,100         | 2,200         | 6,441         | 6,986         | 7,610         | 8,339         | 6,702         | 7,176         | 7,919         | 8,712         |
| <b>Revenue</b>                  | <b>10,331</b> | <b>9,089</b>  | <b>8,162</b>  | <b>8,535</b>  | <b>9,021</b>  | <b>9,815</b>  | <b>10,162</b> | <b>10,400</b> | <b>10,289</b> | <b>10,630</b> | <b>10,750</b> | <b>11,000</b> | <b>39,540</b> | <b>36,117</b> | <b>39,398</b> | <b>42,669</b> | <b>39,822</b> | <b>35,291</b> | <b>41,209</b> | <b>43,672</b> |
| Y/Y % Chg                       | 8%            | -8%           | -17%          | -18%          | -13%          | 8%            | 25%           | 22%           | 14%           | 8%            | 6%            | 6%            | 13%           | -9%           | 9%            | 8%            | 7%            | -11%          | 17%           | 6%            |
| Q/Q % Chg                       | 0%            | -12%          | -10%          | 5%            | 6%            | 9%            | 4%            | 2%            | -1%           | 3%            | 1%            | 2%            | -             | -             | -             | -             | -             | -             | -             | -             |
| Cost of Products                | 2,916         | 2,673         | 2,272         | 2,373         | 2,430         | 2,746         | 2,874         | 2,940         | 2,905         | 3,003         | 3,028         | 3,080         | 11,358        | 10,234        | 10,990        | 12,016        | 11,430        | 9,797         | 11,637        | 12,236        |
| Cost of Services                | 638           | 597           | 575           | 587           | 614           | 627           | 677           | 686           | 680           | 697           | 714           | 737           | 2,317         | 2,397         | 2,604         | 2,828         | 2,432         | 2,393         | 2,717         | 2,946         |
| <b>Total Cost of Sales</b>      | <b>3,554</b>  | <b>3,270</b>  | <b>2,847</b>  | <b>2,960</b>  | <b>3,044</b>  | <b>3,373</b>  | <b>3,551</b>  | <b>3,626</b>  | <b>3,585</b>  | <b>3,700</b>  | <b>3,742</b>  | <b>3,817</b>  | <b>13,675</b> | <b>12,631</b> | <b>13,594</b> | <b>14,844</b> | <b>13,862</b> | <b>12,190</b> | <b>14,353</b> | <b>15,182</b> |
| <b>Product Gross Profit</b>     | <b>5,719</b>  | <b>4,674</b>  | <b>4,148</b>  | <b>4,356</b>  | <b>4,770</b>  | <b>5,230</b>  | <b>5,338</b>  | <b>5,460</b>  | <b>5,395</b>  | <b>5,577</b>  | <b>5,623</b>  | <b>5,720</b>  | <b>21,741</b> | <b>18,897</b> | <b>20,798</b> | <b>22,315</b> | <b>21,691</b> | <b>18,319</b> | <b>21,654</b> | <b>22,724</b> |
| <b>Services Gross Profit</b>    | <b>1,058</b>  | <b>1,145</b>  | <b>1,167</b>  | <b>1,219</b>  | <b>1,207</b>  | <b>1,212</b>  | <b>1,273</b>  | <b>1,314</b>  | <b>1,309</b>  | <b>1,353</b>  | <b>1,386</b>  | <b>1,463</b>  | <b>4,124</b>  | <b>4,589</b>  | <b>5,006</b>  | <b>5,511</b>  | <b>4,270</b>  | <b>4,783</b>  | <b>5,202</b>  | <b>5,766</b>  |
| <b>Gross Profit</b>             | <b>6,777</b>  | <b>5,819</b>  | <b>5,315</b>  | <b>5,575</b>  | <b>5,977</b>  | <b>6,442</b>  | <b>6,611</b>  | <b>6,774</b>  | <b>6,704</b>  | <b>6,930</b>  | <b>7,009</b>  | <b>7,183</b>  | <b>25,865</b> | <b>23,486</b> | <b>25,804</b> | <b>27,825</b> | <b>25,961</b> | <b>23,101</b> | <b>26,856</b> | <b>28,490</b> |
| Res & Dev                       | 1,200         | 1,152         | 1,067         | 1,090         | 1,097         | 1,109         | 1,260         | 1,300         | 1,307         | 1,329         | 1,312         | 1,375         | 4,508         | 4,509         | 4,406         | 5,322         | 4,633         | 4,377         | 5,122         | 5,434         |
| Sales & Marketing               | 2,167         | 2,048         | 1,839         | 1,854         | 1,879         | 1,977         | 2,134         | 2,132         | 2,161         | 2,232         | 2,258         | 2,365         | 7,888         | 7,908         | 8,122         | 9,015         | 8,219         | 7,573         | 8,574         | 9,281         |
| Gen & Admin                     | 332           | 321           | 241           | 405           | 361           | 380           | 396           | 395           | 391           | 393           | 398           | 407           | 1,818         | 1,299         | 1,533         | 1,589         | 1,602         | 1,367         | 1,571         | 1,608         |
| <b>Operating Expenses</b>       | <b>3,699</b>  | <b>3,521</b>  | <b>3,147</b>  | <b>3,349</b>  | <b>3,337</b>  | <b>3,466</b>  | <b>3,790</b>  | <b>3,827</b>  | <b>3,858</b>  | <b>3,954</b>  | <b>3,967</b>  | <b>4,147</b>  | <b>14,213</b> | <b>13,716</b> | <b>14,061</b> | <b>15,926</b> | <b>14,454</b> | <b>13,317</b> | <b>15,268</b> | <b>16,323</b> |
| <b>Operating Income</b>         | <b>3,078</b>  | <b>2,298</b>  | <b>2,168</b>  | <b>2,226</b>  | <b>2,640</b>  | <b>2,976</b>  | <b>2,821</b>  | <b>2,947</b>  | <b>2,845</b>  | <b>2,976</b>  | <b>3,042</b>  | <b>3,036</b>  | <b>11,652</b> | <b>9,770</b>  | <b>11,744</b> | <b>11,899</b> | <b>11,506</b> | <b>9,784</b>  | <b>11,589</b> | <b>12,167</b> |
| Other Inc (Exp)                 | 123           | 95            | 80            | 73            | 73            | 23            | 15            | 20            | 20            | 25            | 30            | 40            | 813           | 371           | 131           | 115           | 589           | 273           | 79            | 168           |
| <b>Pre-Tax Income</b>           | <b>3,201</b>  | <b>2,393</b>  | <b>2,248</b>  | <b>2,299</b>  | <b>2,713</b>  | <b>2,999</b>  | <b>2,836</b>  | <b>2,967</b>  | <b>2,865</b>  | <b>3,001</b>  | <b>3,072</b>  | <b>3,076</b>  | <b>12,465</b> | <b>10,141</b> | <b>11,875</b> | <b>12,014</b> | <b>12,096</b> | <b>10,057</b> | <b>11,668</b> | <b>12,335</b> |
| Taxes                           | 704           | 526           | 495           | 460           | 597           | 664           | 624           | 653           | 630           | 660           | 676           | 677           | 3,042         | 2,185         | 2,538         | 2,643         | 2,857         | 2,170         | 2,568         | 2,714         |
| <b>Net Income</b>               | <b>2,497</b>  | <b>1,867</b>  | <b>1,753</b>  | <b>1,839</b>  | <b>2,116</b>  | <b>2,335</b>  | <b>2,212</b>  | <b>2,314</b>  | <b>2,235</b>  | <b>2,340</b>  | <b>2,396</b>  | <b>2,399</b>  | <b>9,423</b>  | <b>7,956</b>  | <b>9,337</b>  | <b>9,371</b>  | <b>9,239</b>  | <b>7,887</b>  | <b>9,100</b>  | <b>9,622</b>  |
| <b>EPS</b>                      | <b>\$0.42</b> | <b>\$0.32</b> | <b>\$0.30</b> | <b>\$0.31</b> | <b>\$0.36</b> | <b>\$0.40</b> | <b>\$0.38</b> | <b>\$0.40</b> | <b>\$0.38</b> | <b>\$0.40</b> | <b>\$0.41</b> | <b>\$0.41</b> | <b>\$1.53</b> | <b>\$1.35</b> | <b>\$1.59</b> | <b>\$1.61</b> | <b>\$1.54</b> | <b>\$1.35</b> | <b>\$1.56</b> | <b>\$1.65</b> |
| Y/Y % Chg                       | 13%           | -17%          | -21%          | -21%          | -14%          | 26%           | 26%           | 26%           | 7%            | 1%            | 8%            | 4%            | 14%           | -12%          | 18%           | 1%            | 7%            | -12%          | 16%           | 6%            |
| Q/Q % Chg                       | 5%            | -24%          | -5%           | 5%            | 14%           | 11%           | -5%           | 5%            | -3%           | 5%            | 2%            | 0%            | -             | -             | -             | -             | -             | -             | -             | -             |
| <b>GAAP EPS</b>                 | <b>\$0.37</b> | <b>\$0.26</b> | <b>\$0.23</b> | <b>\$0.19</b> | <b>\$0.30</b> | <b>\$0.32</b> |               |               |               |               |               |               |               |               |               |               |               |               |               |               |
| Shares O/S                      | 5,979         | 5,885         | 5,840         | 5,840         | 5,880         | 5,862         | 5,837         | 5,837         | 5,830         | 5,830         | 5,830         | 5,830         | 6,146         | 5,886         | 5,854         | 5,830         | 6,010         | 5,857         | 5,836         | 5,830         |
| <b>Percentage of Sales:</b>     |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |               |
| Gross Profit                    | 65.6%         | 64.0%         | 65.1%         | 65.3%         | 66.3%         | 65.6%         | 65.1%         | 65.1%         | 65.2%         | 65.2%         | 65.2%         | 65.3%         | 65.4%         | 65.0%         | 65.5%         | 65.2%         | 65.2%         | 65.5%         | 65.2%         | 65.2%         |
| Product Gross Profit            | 66.2%         | 63.6%         | 64.6%         | 64.7%         | 66.3%         | 65.6%         | 65.0%         | 65.0%         | 65.0%         | 65.0%         | 65.0%         | 65.0%         | 65.7%         | 64.9%         | 65.4%         | 65.0%         | 65.5%         | 65.2%         | 65.0%         | 65.0%         |
| Services Gross Profit           | 62.4%         | 65.7%         | 67.0%         | 67.5%         | 66.3%         | 65.9%         | 65.3%         | 65.7%         | 65.8%         | 66.0%         | 66.0%         | 66.5%         | 64.0%         | 65.7%         | 65.8%         | 66.1%         | 63.7%         | 66.7%         | 65.7%         | 66.2%         |
| Operating Income                | 29.8%         | 25.3%         | 26.6%         | 26.1%         | 29.3%         | 30.3%         | 27.8%         | 28.3%         | 27.7%         | 28.0%         | 28.3%         | 27.6%         | 29.5%         | 27.1%         | 29.8%         | 27.9%         | 28.9%         | 27.7%         | 28.1%         | 27.9%         |
| Pre-Tax Income                  | 31.0%         | 26.3%         | 27.5%         | 26.9%         | 30.1%         | 30.6%         | 27.9%         | 28.5%         | 27.8%         | 28.2%         | 28.6%         | 28.0%         | 31.5%         | 28.1%         | 30.1%         | 28.2%         | 30.4%         | 28.5%         | 28.3%         | 28.2%         |
| Net Income                      | 24.2%         | 20.5%         | 21.5%         | 21.5%         | 23.5%         | 23.8%         | 21.8%         | 22.3%         | 21.7%         | 22.0%         | 22.3%         | 21.8%         | 23.8%         | 22.0%         | 23.7%         | 22.0%         | 23.2%         | 22.3%         | 22.1%         | 22.0%         |
| Res & Dev                       | 11.6%         | 12.7%         | 13.1%         | 12.8%         | 12.2%         | 11.3%         | 12.4%         | 12.5%         | 12.7%         | 12.5%         | 12.2%         | 12.5%         | 11.4%         | 12.5%         | 11.2%         | 12.5%         | 11.6%         | 12.4%         | 12.4%         | 12.4%         |
| Sales & Marketing               | 21.0%         | 22.5%         | 22.5%         | 21.7%         | 20.8%         | 20.1%         | 21.0%         | 20.5%         | 21.0%         | 21.0%         | 21.0%         | 21.5%         | 19.9%         | 21.9%         | 20.6%         | 21.1%         | 20.6%         | 21.5%         | 20.8%         | 21.3%         |
| Gen & Admin                     | 3.2%          | 3.5%          | 3.0%          | 4.7%          | 4.0%          | 3.9%          | 3.9%          | 3.8%          | 3.8%          | 3.7%          | 3.7%          | 3.7%          | 4.6%          | 3.6%          | 3.9%          | 3.7%          | 4.0%          | 3.9%          | 3.8%          | 3.7%          |
| Operating Expenses              | 35.8%         | 38.7%         | 38.6%         | 39.2%         | 37.0%         | 35.3%         | 37.3%         | 36.8%         | 37.5%         | 37.2%         | 36.9%         | 37.7%         | 35.9%         | 38.0%         | 35.7%         | 37.3%         | 36.3%         | 37.7%         | 37.0%         | 37.4%         |
| Tax Rate                        | 22.0%         | 22.0%         | 22.0%         | 20.0%         | 22.0%         | 22.1%         | 22.0%         | 22.0%         | 22.0%         | 22.0%         | 22.0%         | 22.0%         | 24.4%         | 21.5%         | 21.4%         | 22.0%         | 23.6%         | 21.6%         | 22.0%         | 22.0%         |

Source: Company Reports, RBC Capital Markets Estimates



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## Required Disclosures

### Conflicts Disclosures

The analyst(s) responsible for preparing this research report received compensation that is based upon various factors, including total revenues of the member companies of RBC Capital Markets and its affiliates, a portion of which are or have been generated by investment banking activities of the member companies of RBC Capital Markets and its affiliates.

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### Explanation of RBC Capital Markets Equity Rating System

An analyst's 'sector' is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector average.

#### Ratings

**Top Pick (TP):** Represents best in Outperform category; analyst's best ideas; expected to significantly outperform the sector over 12 months; provides best risk-reward ratio; approximately 10% of analyst's recommendations.

**Outperform (O):** Expected to materially outperform sector average over 12 months.

**Sector Perform (SP):** Returns expected to be in line with sector average over 12 months.

**Underperform (U):** Returns expected to be materially below sector average over 12 months.

#### Risk Qualifiers (any of the following criteria may be present):

**Average Risk (Avg):** Volatility and risk expected to be comparable to sector; average revenue and earnings predictability; no significant cash flow/financing concerns over coming 12-24 months; fairly liquid.

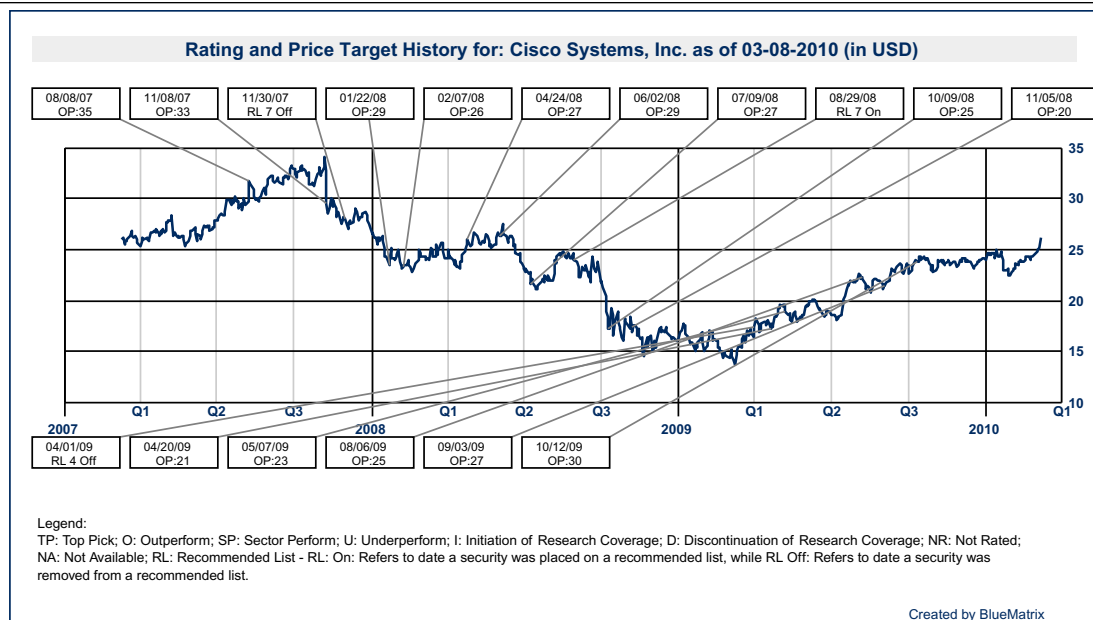
**Above Average Risk (AA):** Volatility and risk expected to be above sector; below average revenue and earnings predictability; may not be suitable for a significant class of individual equity investors; may have negative cash flow; low market cap or float.

**Speculative (Spec):** Risk consistent with venture capital; low public float; potential balance sheet concerns; risk of being delisted.

### Distribution of Ratings

For the purpose of ratings distributions, regulatory rules require member firms to assign ratings to one of three rating categories - Buy, Hold/Neutral, or Sell - regardless of a firm's own rating categories. Although RBC Capital Markets' ratings of Top Pick/Outperform, Sector Perform and Underperform most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis (as described above).

| Distribution of Ratings<br>RBC Capital Markets, Equity Research |       |         |  |         |
|---|-------|---------|--|---------|
| Rating  | Count | Percent | Investment Banking<br>Serv./Past 12 Mos. |         |
|   |       |         | Count                                    | Percent |
| BUY[TP/O]   | 598   | 49.90   | 184                                      | 30.77   |
| HOLD[SP]  | 538   | 44.90   | 124                                      | 23.05   |
| SELL[U]   | 62    | 5.20    | 6  | 9.68    |



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