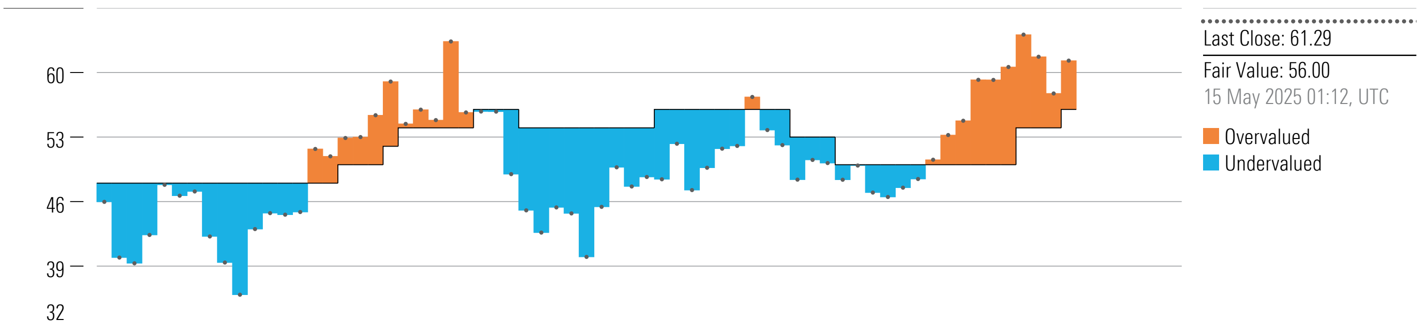
Morningstar Equity Analyst Report | Report as of 15 May 2025 23:16, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

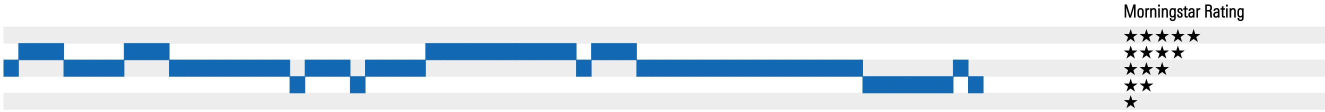
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.29 USD 14 May 2025	56.00 USD 15 May 2025 01:12, UTC	1.09	255.65 USD Bil 15 May 2025	Wide	Large Value	Medium	Exemplary	7 May 2025 05:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD	
	0.93	1.17	0.88	0.95	1.18	1.09	Price/Fair Value
	-3.71	44.89	-22.44	9.30	20.33	4.90	Total Return %

Morningstar Rating



Total Return % as of 14 May 2025. Last Close as of 14 May 2025. Fair Value as of 15 May 2025 01:12, UTC.

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The primary analyst covering this company does not own its stock.

[1] The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

Cisco Earnings: We Like Core Networking Strength and Raise Our Valuation to $56 From $54

Analyst Note William Kerwin, CFA, Senior Equity Analyst, 15 May 2025

Cisco Systems' April-quarter results beat management guidance. Sales rose 11% year over year and 1% sequentially to $14.1 billion, while non-GAAP operating margin was 34.5%. July-quarter guidance includes sequential sales growth to a midpoint of $14.6 billion and tariff-driven margin compression.

Why it matters: Cisco's good growth and profitability continue to show strong demand for its networking portfolio. We particularly like high order growth for campus offerings, which are the firm's largest driver. Artificial intelligence order growth is also promising, but remains a small piece of total Cisco.

- Management didn't see material revenue pull-in—an investor concern with a looming end to the 90-day pause on many US import tariffs—in the quarter. We see this as a positive indicator on current healthy demand, but would still expect weaker orders if tariffs remain in effect in the long term.
- This was the last quarter with inorganic growth from the 2024 Splunk acquisition, which effectively doubled Cisco's security portfolio. We remain positive on the acquisition, given competitive concerns on Cisco's legacy security offerings.

The bottom line: We raised our fair value estimate for wide-moat Cisco to $56 per share, from $54, after raising our medium-term growth forecast for campus networking revenue to reflect a better upcoming refresh cycle. Shares look moderately overvalued to us.

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Sector	Industry
Technology	Communication Equipment

Business Description

Cisco Systems is the largest provider of networking equipment in the world and one of the largest software companies in the world. Its largest businesses are selling networking hardware and software (where it has leading market shares) and cybersecurity software such as firewalls. It also has collaboration products, like its Webex suite, and observability tools. It primarily outsources its manufacturing to third parties and has a large sales and marketing staff—25,000 strong across 90 countries. Overall, Cisco employs 80,000 people and sells its products globally.

- We still think that the financial impact of Cisco's AI portfolio is being overestimated in the market. We expect well over $1 billion in AI revenue in fiscal 2026, compared with a $59 billion top line. AI is gently elevating Cisco's networking growth, but we remain focused on enterprise customers.
- We remain constructive on Cisco's total networking portfolio, which is extensive, highly profitable, and deeply entrenched in customers. In our view, the combination of networking and security sets Cisco up well for long-term growth and customer retention, informing our wide moat rating.

Business Strategy & Outlook William Kerwin, CFA, Senior Equity Analyst, 14 Aug 2024

We view Cisco Systems as the dominant force in enterprise networking and expect it to retain its strength in both legacy and future networks. Cisco holds leading market shares across switching, routing, and wireless access, with strong complementary positions in security and collaboration. We believe Cisco’s portfolio is appropriately positioned to benefit from trends toward hybrid work and hybrid cloud environments. It offers the most comprehensive suite of capabilities across converging networking and security markets, and we deem its intertwined products as sticky and worthy of a wide economic moat.

For years, the emergence of the public cloud has been interpreted as the demise of Cisco, with a weaker market share position in cloud customers. Nevertheless, we credit Cisco for appropriately evolving its networking products from a campus focus to include strong software and high-speed public cloud capabilities. Though Cisco faces greater competition in new models of networking, we expect it to retain its broad leadership as enterprises adopt hybrid and multi-cloud environments with new technologies like software-defined wide-area networking, or SD-WAN. We expect it to retain dominance of campus and on-premises environments. We also positively view its shift toward a greater mix of software and subscription sales, which should increase its customer switching costs.

We believe Cisco’s core markets offer slow, but steady, growth with upside from newer software and cloud businesses. We expect Cisco to continue investing both organically and inorganically to push the cutting edge of its markets and maintain growth. We also anticipate it to continue modestly raising its profit margins as it retains hefty pricing power in networking and pushes deeper into a software- and subscription-based model. In our view, Cisco’s shareholder return policies are superb. The firm has a resolute balance sheet and generates immense cash flow. It dedicates well over half of this cash flow to its dividend and repurchases, which we view favorably. Cisco’s dividend yield and total shareholder return, inclusive of buybacks, should be attractive to long-term investors.

Bulls Say William Kerwin, CFA, Senior Equity Analyst, 15 May 2025

- Cisco holds dominant market shares across networking, and leading shares in areas like switching software and software-defined wide-area networking, or SD-WAN, bode well for its position in the next era.

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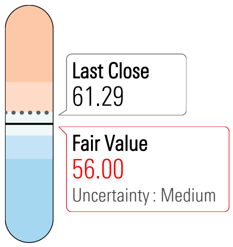
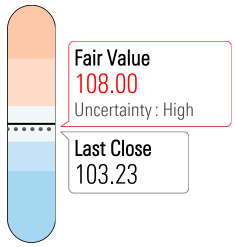
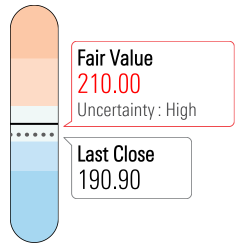
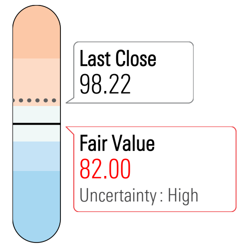
Competitors









	Cisco Systems Inc CSCO	Fortinet Inc FTNT	Palo Alto Networks Inc PANW	Arista Networks Inc ANET
Economic Moat	Wide	Wide	Wide	Wide
Currency	USD	USD	USD	USD
Fair Value	56.00 15 May 2025 01:12, UTC	108.00 7 Feb 2025 04:07, UTC	210.00 14 Feb 2025 02:55, UTC	82.00 19 Feb 2025 01:25, UTC
1-Star Price	75.60	167.40	325.50	127.10
5-Star Price	39.20	64.80	126.00	49.20
Assessment	Overvalued 15 May 2025	Fairly Valued 15 May 2025	Fairly Valued 15 May 2025	Overvalued 15 May 2025
Morningstar Rating	★★15 May 2025 21:25, UTC	★★★15 May 2025 21:30, UTC	★★★15 May 2025 21:34, UTC	★★15 May 2025 21:37, UTC
Analyst	William Kerwin, Senior Equity Analyst	Malik Ahmed Khan, Equity Analyst	Malik Ahmed Khan, Equity Analyst	William Kerwin, Senior Equity Analyst
Capital Allocation	Exemplary	Standard	Exemplary	Exemplary
Price/Fair Value	1.09	0.95	0.92	1.17
Price/Sales	4.42	13.00	15.79	16.92
Price/Book	5.31	40.45	19.77	12.20
Price/Earning	23.80	44.62	107.56	41.44
Dividend Yield	2.63%	0.00%	0.00%	0.00%
Market Cap	255.65 Bil	78.49 Bil	127.72 Bil	120.66 Bil
52-Week Range	44.50—66.50	54.57—114.82	142.01—208.39	59.43—396.90
Investment Style	Large Value	Large Growth	Large Growth	Large Growth

- We view Cisco's shift toward a higher mix of software and subscription-based consumption models as positive.
- Cisco's balance sheet is strong and it generates impressive free cash flow. It is shareholder-friendly and sends most of its free cash flow back to shareholders.

Bears Say William Kerwin, CFA, Senior Equity Analyst, 15 May 2025

- Cisco's core markets of networking don't offer robust growth opportunities, and it has to seek top-line upside from nascent corners or other markets where it is less competitively advantaged.
- Cisco has been losing market share across networking and security over the last decade and will need to redouble its efforts against the likes of Arista Networks or cybersecurity platform providers.
- In high-speed, public cloud applications, Cisco lags Arista Networks in market share, which could hamper its growth as these applications grow in mix in the market.

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Economic Moat William Kerwin, CFA, Senior Equity Analyst, 14 Aug 2024

We assign Cisco Systems a wide economic moat rating stemming from customer switching costs. We think Cisco's offerings for networking and cybersecurity are comprehensive and intertwined, with integrated software, hardware, and services creating a sticky overall solution and leading to pricing power. These competitive advantages give us confidence in Cisco earning economic profits, more likely than not, over the next 20 years.

Cisco is the dominant force in enterprise networking and the only provider we see with a complete end-to-end portfolio for both on-premises and the cloud. Cisco's switches, wireless access points, routers, and networking software allow enterprises to create local networks and give those local networks access to private clouds, public clouds, and the internet. Cisco holds the top market share position in nearly every subsection of the enterprise networking market, including campus and data center switching, networking software, routing, software-defined wide-area networking, or SD-WAN, and wireless access.

Once Cisco is embedded in a business, we believe it becomes increasingly hard to rip Cisco out. Data center hardware refresh cycles happen a couple of times a decade. Campus refreshes can be even more spaced out. Upon each refresh, we believe that enterprises are more likely to stay with a well-performing incumbent networking vendor. Refreshing networking hardware is a headache regardless, but it is even more fraught when switching vendors. Refreshing hardware can lead to partial network and application downtime, and costs time, money, and effort on part of an IT department to ensure new hardware and software fit in seamlessly. When a business switches vendors, it has to transfer the whole network to a new architecture, including differently specified hardware and completely new software. This leads to longer and more costly implementation, at best. At worst, it risks losing critical data or functionality of portions of the network and applications.

Cisco is building upon the existing stickiness of its networking equipment by integrating its software and hardware. In our view, software is just as critical as hardware to an enterprise's networking needs, if not more so. Cisco's software gives IT departments a broad dashboard with visibility throughout the network. This can show malfunctioning hardware, show traffic between all endpoints, and even provide artificial-intelligence-powered suggestions to solve problems. Highly integrated software augments switching costs, given IT departments take time to develop workflows specific to their vendor.

We believe Cisco solidifies its switching costs with an expansive ecosystem of technologist certifications and a large training pipeline. It offers close to 20 specialized certifications across four levels of expertise (novice to expert), with tens of thousands of learning partners globally. Cisco certifications are a bellwether for competence in the IT industry, and provide an added switching cost for firms using Cisco hardware. With Cisco being the large incumbent in networking, aspiring IT professionals seek out Cisco certifications to bolster a resume. For a hiring manager, IT professionals with Cisco certifications reduce onboarding friction, and switching vendors would require certifying the whole IT department on new standards.

Cisco's switching costs provide it with pricing power for its networking products. Cisco customers readily pay a premium for its equipment, resulting in steady gross margins in the mid-60% range that are matched only by high-speed networking provider Arista Networks. As one example, China-based competitor Huawei actually ships the most 10-gigabit and 25-gigabit switches globally, but Cisco's revenue triples that of Huawei for these products.

Cisco also offers a comprehensive platform for cybersecurity. Cisco is a strong incumbent vendor for network firewalls but has a rounded portfolio, including identity access management, cloud security, endpoint security, zero trust, and threat intelligence. We see cybersecurity software as eliciting switching costs, resulting from the depth by which it is embedded in enterprise networks. To change a cybersecurity vendor, a customer incurs the time and expense of getting up to speed on a new system, along with the expense of running both systems concurrently during the transition. Finally, the customer risks breaches during the vulnerable transition.

Though we don't view Cisco as offering best-of-breed capabilities in any point solution for security (though it comes closest for firewalls), we view the ability to offer robust capabilities across the spectrum of security as a competitive advantage. We believe IT departments want to consolidate their cybersecurity vendor lists—some reports estimate enterprises averaging close to 50 vendors. A high quantity of vendors can lead to overlapping capabilities and inundated IT departments that are less familiar with each individual vendor and less effective at resolving individual threats. We don't foresee any IT department locking itself into a single vendor, but the ability to consolidate a few functions with one strong vendor is attractive. This not only drives demand for Cisco's security platform but leads to stickier customers. The more points of Cisco's platform a customer uses, the more integrated it becomes in the organization, and it becomes even harder to replace. We see its budding observability portfolio's (though not moaty in isolation) integration with its security platform as a further adhesive for customers.

We believe that security and networking are converging, especially as multi-cloud and hybrid cloud environments become the norm. Every network and connection needs to be secure. Cisco, as a pre-eminent provider of both, is in an advantaged position to win new customers and cross-sell within existing customers. Many of Cisco's sales feature a combination of networking hardware, networking software, and security software. We view a direct relationship between the number of products a customer adopts and Cisco's stickiness within that customer. It may be easier, more cost-efficient, and less risky for an existing Cisco customer pursuing a new security product to up its subscription rather than sourcing from a whole new vendor. It would also be difficult to replace a point offering from Cisco, given its integration with networking software and other security offerings.

Finally, we see Cisco's services providing an additional layer of stickiness. Cisco's services range from basic troubleshooting to high-level optimization. Professional services can help to optimize the way an IT department builds and operates a network and offer improvements over the lifecycle of the equipment. Cisco also has a renowned cyber threat intelligence team, Talos, that feeds information on new and emerging threats into customer security products. These help to further embed Cisco's products into the workflows of a customer and make them harder to rip out.

We think concerns over the public cloud for Cisco are overestimated. We do see Cisco's position in public cloud providers as weaker than in the rest of the market. Cisco trails Arista Networks in high-speed switching market share, and we believe hyperscalers offer lower switching costs to providers by consuming hardware, software, and chips in a disaggregated model. Still, we expect hybrid cloud environments to be the long-term favored option for enterprises, which should maintain demand for Cisco's campus and data center offerings. An average enterprise uses more than two public and two private clouds in its network, per Faction. Furthermore, we see these environments as being a boon for Cisco's SD-WAN and networking software offerings. We also note Cisco maintains a strong second-place market share in high-speed switching and sells its software and chips à la carte to public cloud providers.

In our view, Cisco's collaboration segment, composed of its Webex suite for meetings as well as a unified communications as a service, or UCaaS, solution, also exhibits switching costs. Though we see steep competition with Zoom and Microsoft Teams, we view these three leaders as technologically neck-and-neck. Cisco's ability to service a customer's telephony along with feature-rich meeting software and a suite of peripheral hardware (phones, headsets, desk hubs, conference room equipment) embeds it in a customer's workflows. A customer using Cisco's meeting or UCaaS solution may find it easier to adopt the complementary solution rather than sourcing from a new vendor. A customer would also find it difficult to rip out either solution, given employee familiarity with hardware and software interfaces and the requisite transition period of utilizing two solutions.

Cisco's sticky products embed themselves in customers and give the firm pricing power that leads to strong margins and returns on invested capital. Even against robust competition and a rapidly evolving technological landscape, Cisco has done well to gently expand its margins with software. We see the push toward subscription-based offerings as solidifying the firm's stickiness. Even as competitive threats persist, we are confident in Cisco's ability to generate excess returns above its cost of capital, more likely than not, over the next 20 years.

Fair Value and Profit Drivers William Kerwin, CFA, Senior Equity Analyst, 15 May 2025

Our fair value estimate for Cisco Systems is $56 per share. Our valuation implies a fiscal 2025 adjusted price/ earnings of 15 times, fiscal 2025 enterprise value to sales of 4 times, a free cash flow yield of 6%,

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and a next-12- months dividend yield of 3%. Our biggest drivers to Cisco's valuation are growth of its core networking business and ability to maintain and improve both gross and operating margins.

We forecast 5% compound annual growth for Cisco through fiscal 2029. We project a return to normalized growth in fiscal 2025 after tumultuous overordering and subsequent customer inventory digestion over the two preceding years. Long term, we think 3% to 5% growth is a durable growth rate for Cisco. We think its largest, core networking business, including services, will grow in the low-single digits at midcycle, largely in line with the underlying market. We assume Cisco can maintain its market share in campus networking, and expect strength from its newer product families with more software and subscription-based consumption models, as well as from AI infrastructure buildouts. We believe AI orders will augment Cisco's core growth, but don't expect it to become a material driver in the medium term against a much larger enterprise networking business.

We expect more rapid growth from Cisco's security business organically with Splunk in the fold long-term. Though security has lagged peers in recent history, we think it can begin to slow market share losses with a more streamlined, feature-rich, cloud-based platform and more observability integration. Splunk's portfolio should help here.

Cisco has reinvigorated its investment in its collaboration products, and we think its Webex suite of both meeting solutions and unified communications as a service, or UCaaS, can compete with the likes of Zoom and Microsoft. However, we're observing market share losses to these competitors, and expect submarket growth for collaboration going forward.

Non-GAAP gross margins in our model stay steady in the 67%-68% range. We expect slight margin expansion to come via a greater software product mix as well as subscription-based sales leading to stickier customers and maintained pricing power for Cisco. We forecast the firm to maintain steady investment in operating expenses and for non-GAAP operating margins to remain in the 33%-35% range over our forecast.

Risk and Uncertainty William Kerwin, CFA, Senior Equity Analyst, 14 Aug 2024

We assign Cisco Systems a Medium Morningstar Uncertainty Rating. Cisco can experience some mild cyclicality in customer IT spending and is under constant competitive threat across its broad portfolio. We've seen high, concentrated investment from more focused competitors like Arista Networks or Palo Alto Networks and Fortinet lead to market share gains at Cisco's expense. In the face of such competition, Cisco commits steady organic investment into research and development and sales and marketing in order to compete on the cutting edge and maintain its sticky foothold in existing customers. In addition, Cisco's service provider customer base can offer lumpy spending habits, which could lead to some swings in sales and profits.

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We believe Cisco can face risk from its outsourced manufacturing model, which can augment supply constraints like the firm saw in fiscal 2021 and fiscal 2022. Supply constraints can lead to lower sales in the short term, and if Cisco built up excess inventory to insure against short supply, it may have to discount it or write it down, hampering margins. Cisco is also a serial acquirer, and its acquisition strategy could pose a risk if the firm began to reach for overvalued assets or poor strategic fits that began to destroy shareholder value.

Finally, we foresee modest environmental, social, and governance, or ESG, risk for Cisco. ESG risk in our view would primarily come via the risk of cyber breaches to its security equipment and software, which could cause serious customer harm and tarnish Cisco's reputation. We also see high human capital demand as making it difficult for Cisco to attract and retain top engineers.

Capital Allocation William Kerwin, CFA, Senior Equity Analyst, 14 Aug 2024

We rate Cisco Systems' capital allocation as Exemplary, primarily based on its excellent shareholder return program. Cisco's strong balance sheet gives it the flexibility for these returns, and we rate management's investments overall as fair. Overall, we see Cisco as adequately defending its competitive position while being extremely shareholder-friendly.

Cisco's capital allocation priorities, in order, are organic investment, inorganic investment, maintaining its dividend, and buying back stock. Cisco maintains a large cash position and relatively low debt, with consistently robust annual free cash flow. It targets more than 50% of free cash flow to go back to shareholders. Even after significant organic investment, Cisco maintains a growing dividend at a high payout ratio and sends extra cash toward repurchases. Cisco has well exceeded its 50% target in the past, and we expect this to continue. We model more than 75% of free cash flow over the next five years going back to shareholders.

We think Cisco has been prudent to keep its recent acquisitions on the smaller end, and they have gone toward adjacent markets or capabilities to help it defend against competition. We also see Cisco's balance sheet as accommodating for a larger deal if it were to prove attractive. We think Cisco's primary organic investments in research and development and sales and marketing help fortress its large existing install base and allow it to renew at customers with new, cutting-edge equipment.

Analyst Notes Archive

Cisco Earnings: Healthy Demand Lifts Our Forecast and Valuation, but Shares Remain Overpriced

William Kerwin, CFA,Senior Equity Analyst,13 Feb 2025

Cisco Systems' January-quarter revenue rose 9% year over year and 1% sequentially to $14 billion. Revenue and profitability came in above management's guidance ranges. April-quarter guidance implies flat revenue growth sequentially, and a slight tick down in profitability resulting from tariffs.Why it

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matters: We liked Cisco's results and outlook and see it showing healthy underlying demand after a choppy period since 2022 of customers overordering and then underordering to manage inventory. Full-year guidance beat our model and implies a better July quarter than we expected. Cisco notched $700 million in artificial intelligence infrastructure orders in the past two quarters, and we expect strong AI revenue growth ahead. Even so, this level is a small minority of Cisco's $28 billion in revenue over the same period, and we see non-AI networking as the business' primary driver. High security growth reflected continued inorganic contribution from the 2024 acquisition of Splunk. Organic security growth was 4% year over year, but we expect an acceleration from these levels as Splunk integrates with Cisco's portfolio over the next two years. The bottom line: We raise our fair value estimate for shares of wide-moat Cisco to $54 from $50, behind a higher medium-term networking growth forecast. Shares look overvalued to us and, in our view, reflect excess optimism for an AI business that remains a small minority of sales. We increased our growth forecast for Cisco's AI infrastructure sales, which we expect to exceed $1 billion in fiscal 2026. While this should add to the growth of the firm's networking business, even $1 billion in revenue would be 2% of Cisco's revenue and remains a small driver to us. We expect the integration of Splunk to raise Cisco's organic security growth profile close to 10% over the next five years, more in line with peers. The deal still looks favorable to us, and we believe it should stem Cisco's share losses in its second-largest segment.

Cisco Earnings: We See Healthy Demand in Fiscal 2025, but Shares Reflect Aggressive AI Expectations William Kerwin, CFA,Senior Equity Analyst,14 Nov 2024

We keep our $50 per share fair value estimate for wide-moat Cisco Systems, as we leave our long-term forecasts intact after October-quarter results. We believe Cisco is solidly back in a normal demand environment after two years of choppy results that stemmed from overordering and subsequent inventory digestion at customers. We still like the acquisition and integration of Splunk, but view this as a minority driver relative to the larger networking business. We also like Cisco’s emerging growth from artificial intelligence networking infrastructure, but we don’t expect this to be a massive driver, nor do we expect Cisco to hold a strong market share in AI networks. Shares look overvalued to us after rising more than 25% since Cisco’s last earnings release in August. We believe current levels overestimate the firm’s long-term growth opportunity, likely due to some overexuberance around the firm’s AI exposure.October-quarter sales rose 2% sequentially but fell 6% year over year to $13.8 billion. We expect the year-over-year decline to be the last for Cisco this fiscal year, which results from overordering dynamics that lasted through the October quarter last year. We see sequential growth reflecting healthier and more stable demand currently. Overordering a year ago was concentrated in networking, and these sales fell more than 20% year over year this quarter. Security sales rose 100% year over year, resulting from the inorganic contribution from Splunk. We see 13% sequential security growth positively and as mostly organic in the second full quarter with Splunk.Cisco raised its fiscal year 2025 guidance in line with our forecast for 4% sales growth. The January-quarter sales outlook of $13.85 billion at the midpoint also agreed with our model and implied 8% year-over-year growth over depressed demand last year. We believe Cisco can grow sequentially through fiscal 2025, under more normalized networking demand and continued strong momentum for security sales.

Cisco Earnings: Growth Guidance for Fiscal 2025 is Positive, and Shares Look Fairly Valued William Kerwin, CFA,Senior Equity Analyst,14 Aug 2024

We maintain our $50 per share fair value estimate of wide-moat Cisco Systems, as our long-term thesis is intact after the firm reported fiscal fourth-quarter results. Cisco's fiscal year 2025 guidance was a little light compared with our model, but we continue to see a return to growth in fiscal 2025 favorably. Long term, we see Cisco as a low- to mid-single-digit revenue growth story, with ongoing strength in its core campus and enterprise networking markets. We don't expect the firm to be a major winner from AI investment, but see a modest position growing over time. We like the integration with Splunk, which should bolster Cisco's ecosystem of joined networking, security, and observability. Fiscal fourth quarter results and fiscal first quarter guidance were largely in line with our expectations. Shares are up 6% after-hours on growth guidance for fiscal 2025, and we see the stock as fairly valued.July quarter sales beat the top end of guidance and rose 7% sequentially to $13.6 billion. Cisco is facing harsh year-over-year comparisons after a period of customer overordering in calendar 2023, particularly for its networking equipment. We expect the October quarter to be the last quarter of year over year revenue declines against these prior quarters of overordering. Cisco's software rose nicely in the quarter organically, and high reported growth included inorganic contribution from Splunk. We expect the inclusion of Splunk to drive better organic growth for Cisco's security sales over the medium term.October quarter guidance was in line with our expectations. A midpoint of $13.75 billion in sales implies 1% sequential growth. Fiscal 2025 sales guidance of $55.6 billion at the midpoint implies 3% growth, even inclusive of a harsh comparison against the first fiscal quarter of 2024 that included customer overordering. We believe Cisco's fiscal 2025 will show a return to more typical customer ordering, and we see 3% growth as durable for the firm in the long run.

Cisco: 2024 Investor Day Aligns With Our Long-Term Thesis and $50 Valuation William Kerwin, CFA,Senior Equity Analyst,5 Jun 2024

We keep our $50 per share fair value estimate for wide-moat Cisco Systems after a positive investor day aligned with our long-term thesis. We continue to like Cisco's core portfolio between networking and security, which elicits strong switching costs for customers and generates strong profitability. We also like the prospects for the Splunk integration to accelerate Cisco's software revenue growth. Management provided longer-term financial targets, all of which fit with our model. We see shares as slightly undervalued.Cisco largely reiterated its existing strategy, which we view favorably. Management highlighted artificial intelligence, both in terms of Cisco's ability to sell networking equipment into generative AI clusters and its ability to integrate AI into its security and observability software. We think Cisco has a moderate opportunity in generative AI networking infrastructure, but believe it will remain a minority of its overall networking business. We are optimistic that integrating Splunk and more AI functionality into Cisco's existing security and observability businesses can positively inflect growth and stave off further market share losses.Longer-term growth targets through fiscal 2027 aligned with our model. Cisco specifically guided for growth rates in fiscal 2026 and 2027 in light of choppy results in fiscal 2024 and strong inorganic contribution from Splunk in fiscal 2025. Our model is toward the low end of management's 4%-6% top-line growth target in these outer years, as we retain some skepticism over its target for midteens security software growth. We do believe in Splunk driving better security revenue growth than Cisco has earned prior to the deal. We agree with management's target to increase profitability faster than revenue with expanding margins. Cisco also maintained its capital allocation targets, which we like. We believe the firm's impressive cash flow and dividend are among its most attractive investment characteristics.

Cisco Earnings: Positive Guidance and Splunk's Inclusion Align With Our Long-Term Thesis William Kerwin, CFA,Senior Equity Analyst,16 May 2024

We maintained our $50 fair value estimate for shares of wide-moat Cisco Systems after its fiscal third-quarter results aligned with our expectations, and we integrated the acquisition of Splunk into our model. Cisco continues to see weak networking demand, stemming from overordering at customers in 2022 and 2023. Splunk (closed in March) added some inorganic revenue, and management raised its full-year guide to include the acquisition. Shares rose about 5% after-hours, which we believe is due to a raised fiscal year guide and positive commentary around networking demand returning. We'd already forecast a recovery in fiscal 2025 and view the guidance raise as entirely inorganic. We reiterate our belief that the Splunk deal is value-neutral. We continue to see shares as fairly valued.Fiscal third-quarter sales dropped 13% year over year and 1% sequentially to $12.7 billion, including the inorganic contribution from about half a quarter of Splunk. Organically, sales fell about 3% more than that. Cisco's primary networking business continues to see slower orders and declined 27% year over year. Security and observability revenue rose double digits with Splunk included, but both rose organically too, which we see as positive and consistent with prior quarters. Gross and operating margins rose about 100 basis points sequentially with benefits from Splunk, but management expects these to come back down in the next quarter with some higher integration costs.Fiscal fourth-quarter guidance was in line with our model, and we view it positively, with an implied return to sequential growth both with Splunk and organically. Management raised its fiscal year guidance to account for Splunk's inclusion, which implies consistent full-year guidance organically. At the midpoint, fiscal fourth-quarter sales of $13.5 billion imply 6% sequential growth (roughly 2% organically.)

Cisco Earnings: We Trim Our Valuation 6% to $50 Behind Management's Lowered Outlook William Kerwin, CFA,Senior Equity Analyst,15 Feb 2024

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Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.29 USD 14 May 2025	56.00 USD 15 May 2025 01:12, UTC	1.09	255.65 USD Bil 15 May 2025	Wide	Large Value	Medium	Exemplary	7 May 2025 05:00, UTC

We trim our fair value estimate for wide-moat Cisco Systems to $50 per share, from $53, as weak guidance for the rest of fiscal 2024 leads us to reduce our short-term forecasts. Cisco continues to see lower demand as its large customers work through inventory stockpiles following two years of overordering. While we'd previously seen management's expectations for a short-lived correction as rosy, new fiscal 2024 guidance is still well below our prior forecast. We remain fans of Cisco's long-term position, with heady profits, cash flow, and a good dividend. The short term, however, looks weak. With a market selloff after the release commensurate with our valuation cut, we continue to see shares as close to fair value.January-quarter sales dropped 6% year over year and 13% sequentially to $12.8 billion. Networking sales shepherded weak results, declining 12% year over year and 20% sequentially. Cisco is seeing weakness mostly in its large enterprise, cloud, and service provider customers within networking. Security and collaboration sales continue to underperform as well, with both declining sequentially.Guidance for the April quarter missed our model and the company reduced its fiscal 2024 guidance for the second quarter in a row. A sales midpoint of $12.2 billion in the April quarter is 8% lower than we expected, and the fiscal 2024 sales midpoint of $52 billion is 4% lower than our prior forecast. In our view, this reflects longer and deeper inventory digestion at Cisco's largest customers, but doesn't give us long-term concern. We believe Cisco will return to growth when inventory at customers gets digested and orders better reflect underlying demand. We see supernormally high growth in fiscal 2023 and declines in fiscal 2024 exhibiting short-term cyclicality but not long-term demand destruction.

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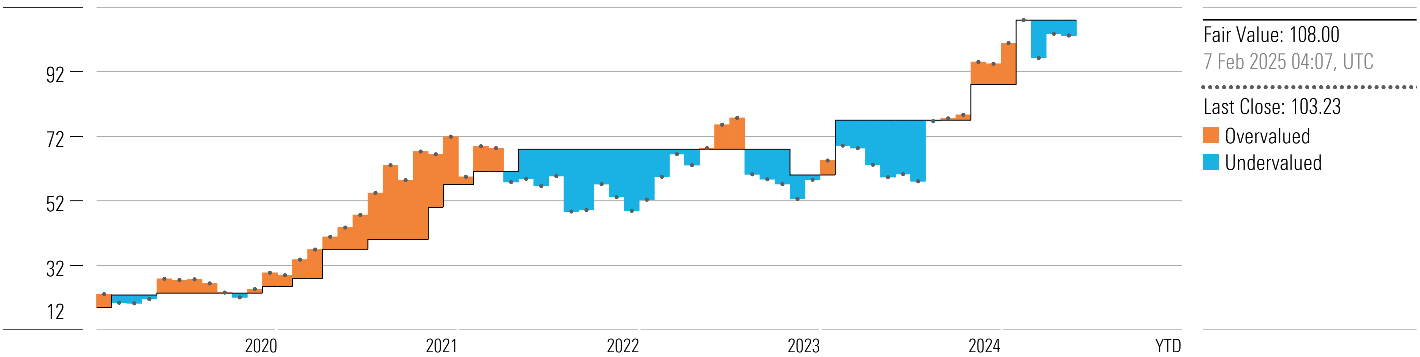
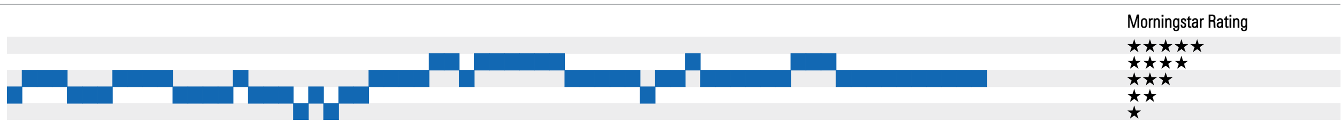
Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

Competitors Price vs. Fair Value

Fortinet Inc FTNT

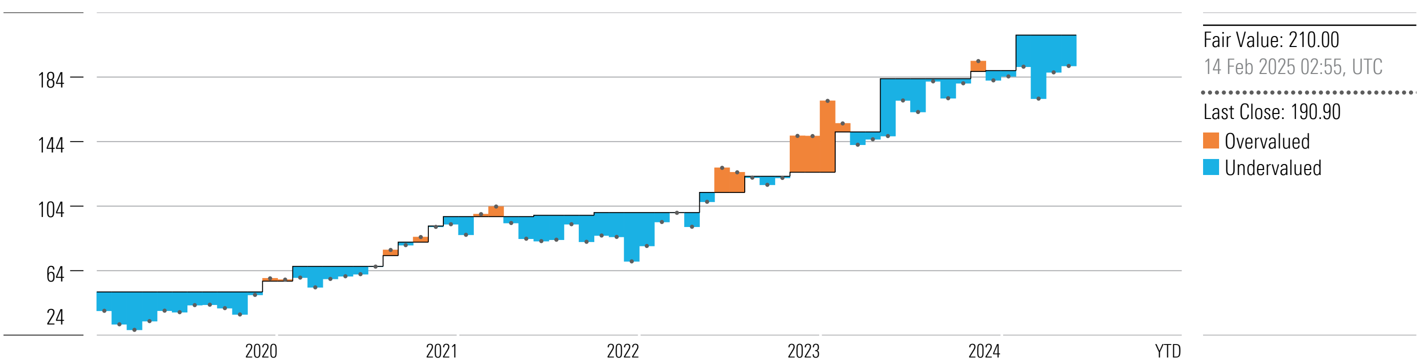


2020	2021	2022	2023	2024	YTD	
1.17	1.26	0.72	0.98	1.07	0.95	Price/Fair Value
39.13	141.97	-31.98	19.72	61.42	9.26	Total Return %

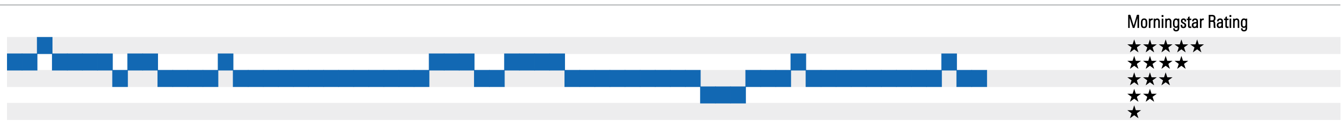


Total Return % as of 14 May 2025. Last Close as of 14 May 2025. Fair Value as of 7 Feb 2025 04:07, UTC.

Palo Alto Networks Inc PANW



2020	2021	2022	2023	2024	YTD	
1.03	0.95	0.70	1.18	0.97	0.92	Price/Fair Value
53.68	56.66	-24.81	111.32	23.41	4.91	Total Return %



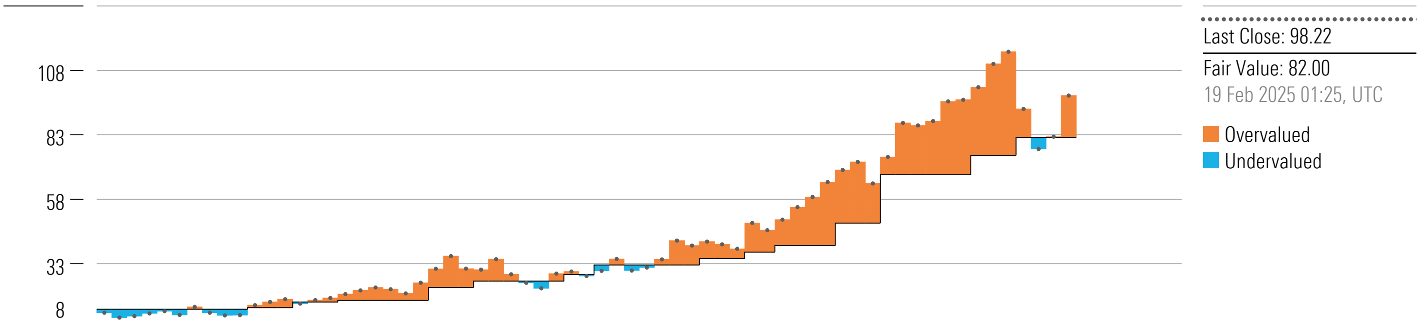
Total Return % as of 14 May 2025. Last Close as of 14 May 2025. Fair Value as of 14 Feb 2025 02:55, UTC.

Morningstar Equity Analyst Report | Report as of 15 May 2025 23:16, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS

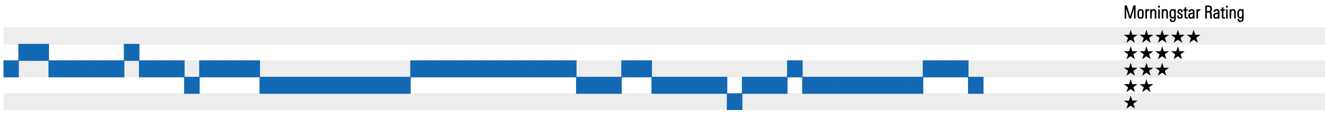
Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

Competitors Price vs. Fair Value

Arista Networks Inc ANET



	2020	2021	2022	2023	2024	YTD	
	1.14	1.51	0.93	1.47	1.47	1.17	Price/Fair Value
	42.86	97.89	-15.58	94.07	87.73	-11.14	Total Return %



Total Return % as of 14 May 2025. Last Close as of 14 May 2025. Fair Value as of 19 Feb 2025 01:25, UTC.

Morningstar Equity Analyst Report | Report as of 15 May 2025 23:16, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NASDAQ - ALL MARKETS Page 15 of 24

Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.29 USD 14 May 2025	56.00 USD 15 May 2025 01:12, UTC	1.09	255.65 USD Bil 15 May 2025	Wide	Large Value	Medium	Exemplary	7 May 2025 05:00, UTC

Morningstar Valuation Model Summary

Financials as of 14 May 2025	Actual			Forecast				
Fiscal Year, ends 31 Jul	2022	2023	2024	2025	2026	2027	2028	2029
Revenue (USD Mil)	51,557	56,998	53,803	56,618	59,459	62,098	64,815	67,642
Operating Income (USD Mil)	13,975	15,562	12,970	12,705	13,305	14,522	15,829	16,921
EBITDA (USD Mil)	15,926	16,757	14,688	14,974	16,005	17,023	18,361	19,471
Adjusted EBITDA (USD Mil)	19,302	20,797	20,884	22,423	22,760	23,642	24,929	26,031
Net Income (USD Mil)	11,812	12,613	10,320	10,210	10,387	11,555	12,751	13,658
Adjusted Net Income (USD Mil)	14,094	15,979	15,150	15,139	15,542	16,724	17,869	18,767
Free Cash Flow To The Firm (USD Mil)	10,532	18,239	-16,021	12,939	12,393	13,628	14,662	15,509
Weighted Average Diluted Shares Outstanding (Mil)	4,192	4,105	4,062	3,982	3,912	3,868	3,812	3,748
Earnings Per Share (Diluted) (USD)	2.82	3.07	2.54	2.56	2.66	2.99	3.35	3.64
Adjusted Earnings Per Share (Diluted) (USD)	3.36	3.89	3.73	3.80	3.97	4.32	4.69	5.01
Dividends Per Share (USD)	1.50	1.54	1.58	1.62	1.64	1.68	1.72	1.76

Margins & Returns as of 14 May 2025		Actual			Forecast					
	3 Year Avg	2022	2023	2024	2025	2026	2027	2028	2029	5 Year Avg
Operating Margin %	25.4	27.1	27.3	24.1	22.4	22.4	23.4	24.4	25.0	23.3
EBITDA Margin %	—	30.9	29.4	27.3	26.5	26.9	27.4	28.3	28.8	—
Adjusted EBITDA Margin %	—	37.4	36.5	38.8	39.6	38.3	38.1	38.5	38.5	38.6
Net Margin %	21.4	22.9	22.1	19.2	18.0	17.5	18.6	19.7	20.2	18.8
Adjusted Net Margin %	27.8	27.3	28.0	28.2	26.7	26.1	26.9	27.6	27.7	27.0
Free Cash Flow To The Firm Margin %	7.6	20.4	32.0	-29.8	22.9	20.8	22.0	22.6	22.9	22.2

Growth & Ratios as of 14 May 2025		Actual			Forecast					
	3 Year CAGR	2022	2023	2024	2025	2026	2027	2028	2029	5 Year CAGR
Revenue Growth %	2.6	3.5	10.5	-5.6	5.2	5.0	4.4	4.4	4.4	4.7
Operating Income Growth %	-1.8	1.9	11.4	-16.7	-2.0	4.7	9.2	9.0	6.9	5.5
EBITDA Growth %	0.4	8.4	5.2	-12.4	1.9	6.9	6.4	7.9	6.1	5.8
Adjusted EBITDA Growth %	4.0	4.0	7.8	0.4	7.4	1.5	3.9	5.4	4.4	4.5
Earnings Per Share Growth %	0.5	12.7	9.0	-17.3	0.9	3.6	12.5	12.0	8.9	7.5
Adjusted Earnings Per Share Growth %	0.5	4.4	15.8	-4.2	1.9	4.5	8.8	8.4	6.8	7.5

Valuation as of 14 May 2025	Actual			Forecast				
	2022	2023	2024	2025	2026	2027	2028	2029
Price/Earning	13.5	13.4	13.0	16.9	16.2	14.9	13.7	12.8
Price/Sales	3.6	3.7	3.6	4.5	4.3	4.1	3.9	3.8
Price/Book	4.8	4.8	4.3	5.9	5.6	5.3	5.0	4.7
Price/Cash Flow	—	—	—	—	—	—	—	—
EV/EBITDA	9.2	9.5	9.9	12.0	11.8	11.4	10.8	10.3
EV/EBIT	12.7	12.6	16.0	21.2	20.2	18.5	17.0	15.9
Dividend Yield %	3.3	3.0	3.3	2.5	2.6	2.6	2.7	2.7
Dividend Payout %	44.6	39.6	42.4	42.6	41.3	38.9	36.7	35.2
Free Cash Flow Yield %	—	—	—	—	—	—	—	—

Operating Performance / Profitability as of 14 May 2025	Actual			Forecast				
Fiscal Year, ends 31 Jul	2022	2023	2024	2025	2026	2027	2028	2029
ROA %	12.6	12.4	8.3	8.7	8.9	9.9	10.5	11.1
ROE %	29.7	28.4	22.7	23.6	23.0	24.7	26.0	26.7
ROIC %	18.9	22.3	15.5	13.7	14.2	15.0	15.5	15.8

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Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.29 USD 14 May 2025	56.00 USD 15 May 2025 01:12, UTC	1.09	255.65 USD Bil 15 May 2025	Wide	Large Value	Medium	Exemplary	7 May 2025 05:00, UTC

Financial Leverage (Reporting Currency)	Actual			Forecast				
Fiscal Year, ends 31 Jul	2022	2023	2024	2025	2026	2027	2028	2029
Debt/Capital %	4.8	3.8	13.7	11.5	9.6	8.0	7.6	6.5
Assets/Equity	2.4	2.3	2.7	2.7	2.6	2.5	2.5	2.4
Net Debt/EBITDA	-0.6	-1.1	0.9	1.6	1.2	0.9	0.6	0.4
Total Debt/EBITDA	0.5	0.4	1.5	1.3	1.1	0.9	0.9	0.7
EBITDA/ Net Interest Expense	-38.0	-72.5	-394.0	28.9	25.3	39.4	53.5	55.8

Forecast Revisions as of 14 May 2025	2025		2026		2027	
Prior data as of 12 Feb 2025	Current	Prior	Current	Prior	Current	Prior
Fair Value Estimate Change (Trading Currency)	56.00	53.75	—	—	—	—
Revenue (USD Mil)	56,618	56,218	59,459	58,823	62,098	61,638
Operating Income (USD Mil)	12,705	12,073	13,305	13,148	14,522	14,626
EBITDA (USD Mil)	22,423	22,020	22,760	22,651	23,642	23,766
Net Income (USD Mil)	15,139	14,739	15,542	15,158	16,724	16,303
Earnings Per Share (Diluted) (USD)	2.56	2.46	2.66	2.71	2.99	3.11
Adjusted Earnings Per Share (Diluted) (USD)	3.80	3.70	3.97	3.92	4.32	4.32
Dividends Per Share (USD)	1.62	1.62	1.64	1.66	1.68	1.70

Key Valuation Drivers as of 14 May 2025	
Cost of Equity %	9.0
Pre-Tax Cost of Debt %	5.8
Weighted Average Cost of Capital %	8.5
Long-Run Tax Rate %	17.0
Stage II EBI Growth Rate %	5.0
Stage II Investment Rate %	10.0
Perpetuity Year	20

Additional estimates and scenarios available for download at https://pitchbook.com/.

Discounted Cash Flow Valuation as of 14 May 2025	USD Mil
Present Value Stage I	48,072
Present Value Stage II	107,272
Present Value Stage III	77,811
Total Firm Value	**233,155**
Cash and Equivalents	7,508
Debt	30,962
Other Adjustments	0
Equity Value	**209,701**
Projected Diluted Shares	3,929
Fair Value per Share (USD)	**56.00**

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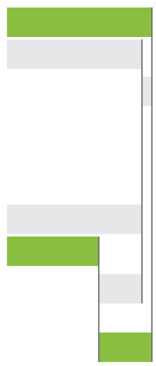
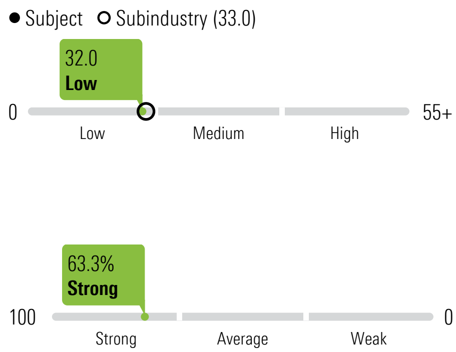
Cisco Systems Inc CSCO ★★ 15 May 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
61.29 USD 14 May 2025	56.00 USD 15 May 2025 01:12, UTC	1.09	255.65 USD Bil 15 May 2025	Wide	Large Value	Medium	Exemplary	7 May 2025 05:00, UTC

ESG Risk Rating Breakdown

Exposure		
Company Exposure[1]	32.0	
– Manageable Risk	29.8	
Unmanageable Risk[2]	**2.1**	
Management		
Manageable Risk	29.8	
– Managed Risk[3]	18.9	
Management Gap[4]	**11.0**	
Overall Unmanaged Risk	**13.1**	





- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- Management measures a company's ability to manage ESG risks through its commitments and actions
- Management assesses a company's efficiency on ESG programs, practices, and policies
- Management score ranges from 0-100% showing how much manageable risk a company is managing

ESG Risk Rating

ESG Risk Ratings measure the degree to which a company's value is impacted by environmental, social, and governance risks, by evaluating the company's ability to manage the ESG risks it faces.

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 63.3% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

ESG Risk Rating Assessment[5]

ESG Risk Rating is of May 07, 2025. Highest Controversy Level is as of May 08, 2025. Sustainalytics Subindustry: Communications Equipment. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: sustainalytics.com/esg-ratings/.

Peer Analysis 07 May 2025

Peers are selected from the company's Sustainalytics-defined Subindustry and are displayed based on the closest market cap values

Company Name	Exposure			Management			ESG Risk Rating		
Cisco Systems Inc	32.0 | Low	0	55+	63.3 | Strong	100	0	13.1 | Low	0	40+
Fortinet Inc	33.4 | Low	0	55+	56.2 | Strong	100	0	16.0 | Low	0	40+
Palo Alto Networks Inc	31.0 | Low	0	55+	62.3 | Strong	100	0	12.9 | Low	0	40+
Arista Networks Inc	31.2 | Low	0	55+	50.8 | Strong	100	0	16.5 | Low	0	40+
Hewlett Packard Enterprise Co	34.2 | Low	0	55+	70.5 | Strong	100	0	11.7 | Low	0	40+

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Appendix
Historical Morningstar Rating

Cisco Systems Inc CSCO 15 May 2025 21:23, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	—	★★	★★★	★★	★★	★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★	★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★	★★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★★	★★★	★★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★

Fortinet Inc FTNT 15 May 2025 21:30, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
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Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★	★★★	★★★★	★★★	★★★	★★	★★★	★★★	★★★	★★★	★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★★	★★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★	★	★★	★	★★	★★	★★	★★★	★★	★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★	★★★	★★★	★★★	★★★	★★	★★	★★	★★★	★★★	★★★	★★

Palo Alto Networks Inc PANW 15 May 2025 21:34, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
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Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★	★★★	★★★	★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★	★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★	★★★★	★★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★	★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★★	★★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★★★	★★★★	★★★★

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Arista Networks Inc ANET 15 May 2025 21:37, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	—	★★	★★★	★★★	★★★	★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★	★★	★★	★★	★★	★★	★★	★★★	★★	★★	★★	★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★	★★	★★	★★	★★	★★★	★★★	★★	★★	★★	★★★	★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★	★★	★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★	★★	★★	★★	★★	★★	★★	★★★	★★★	★★★	★★★	★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★	★★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★

Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

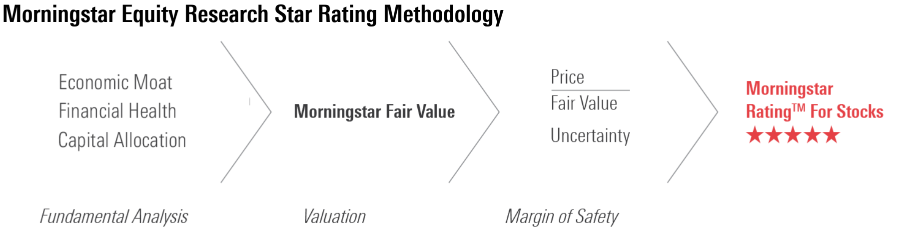
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future outcomes for the intrinsic value of a company, and any-

Morningstar Equity Research Star Rating Methodology



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thing that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the Uncertainty Rating provides guidance in portfolio construction based on risk tolerance.

Our Uncertainty Ratings are: Low, Medium, High, Very High, and Extreme.

	Margin of Safety	
Qualitative Analysis Uncertainty Ratings	★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly, when a stock hits 1 star, we expect there is a 75% chance that the intrinsic value of that stock lies below the current market price.

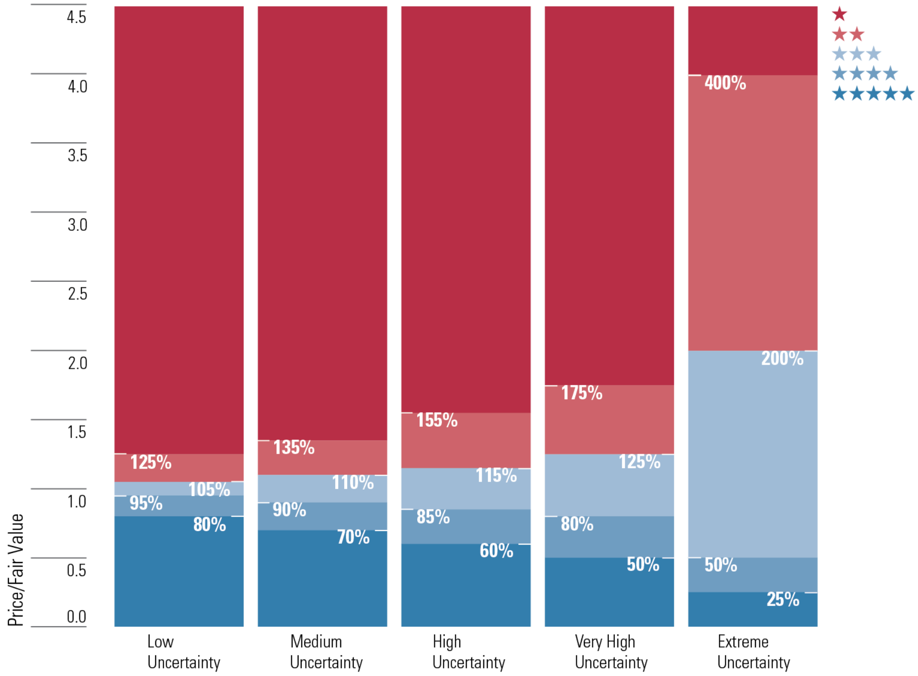
4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com

Morningstar Star Rating for Stocks

Morningstar Equity Research Star Rating Methodology



Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider compan-

Research Methodology for Valuing Companies

ies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

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Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit sustainalytics.com/esg-ratings/

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