

CISCO FQ2 2024 EARNINGS

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CONTEXT

Cisco Systems, Inc., this week [announced](#) its financial results for the second quarter of its fiscal year 2024,

In an environment marked by increasing uncertainty and complex market dynamics, Cisco's latest earnings call, led by Chairman and CEO Chuck Robbins and CFO Scott Herren, provided a comprehensive overview of the company's financial health, strategic initiatives, and forward-looking perspectives.

This Research Note delves into the critical financial achievements, strategic milestones, and challenges addressed during the call, offering insights into how Cisco navigates the intricate landscape of today's tech industry.

QUARTER'S PERFORMANCE

During Cisco's second quarter of the fiscal year 2024, the company reported a performance that met the high end of its guidance despite facing a challenging macroeconomic environment.

Q2 FY 2024 Revenue and Total Gross Margin

\$M (except percentages)

	Revenue			Total Gross Margin %		
	Q2 FY'23	Q1 FY'24	Q2 FY'24	Q2 FY'23	Q1 FY'24	Q2 FY'24
Americas	\$7,825	\$9,022	\$7,510	62.9%	66.2%	65.7%
EMEA	3,728	3,664	3,484	66.2%	69.5%	68.1%
APJC	2,039	1,982	1,798	63.6%	67.0%	68.2%
Geographic Total	\$13,592	\$14,668	\$12,791	63.9%	67.1%	66.7%

Q2 FY 2024 Revenue Highlights

Product Category	\$M	Y/Y
Networking	\$7,081	(12%)
Security	973	3%
Collaboration	989	3%
Observability	188	16%
Services	3,559	4%
Total Cisco	\$12,791	(6%)

Here are the key financial details from the quarter:

- **Revenue:** Cisco's total revenue for the quarter was \$12.8 billion, marking a 6% decrease from the previous year.
- **Net Income:** Non-GAAP net income was \$3.5 billion, a decrease of 3% year-over-year.
- **Earnings Per Share (EPS):** Non-GAAP EPS was \$0.87, above their guidance range, but still represented a 1% decline from the prior year.
- **Product and Service Revenue:** Product revenue decreased 9% to \$9.2 billion, while service revenue increased by 4% to \$3.6 billion.
- **Shareholder Returns:** The company returned \$2.8 billion to shareholders through dividends and share repurchases during the quarter.
- **Dividend Increase:** Cisco also announced an increase in its dividend payout rate, reflecting its commitment to shareholder returns.
- **Annual Recurring Revenue (ARR):** ARR grew by 6% to \$24.7 billion, with product ARR increasing by 9%.
- **Software Revenue:** Software revenue remained flat at \$4.2 billion, with subscription-based software revenue up by 5%.
- **Total Subscription Revenue:** Subscription revenue, which now represents 50% of total revenue, increased by 6% to \$6.4 billion.

The company's results reflect solid operational execution with strong margins and operating leverage despite a drop in total revenue. Cisco continues to navigate through global economic challenges by adjusting its strategies, focusing on software and subscription services, and maintaining a commitment to returning value to shareholders.

QUARTER HIGHLIGHTS

During the quarter, Cisco achieved several notable highlights, reflecting its strategic business efforts and continued transformation towards software and subscription-based offerings. The key highlights include:

- **Financial Performance:** Revenue was at the high end of their guidance, and earnings per share exceeded expectations due to substantial operating leverage.
- **Shareholder Returns:** Cisco returned \$2.8 billion to shareholders through dividends and share repurchases, indicating their commitment to shareholder value.
- **Dividend Increase:** The company announced an increase in its dividend payout rate, continuing its practice of significant capital returns to shareholders.
- **Transformation Progress:** Cisco's strategic transformation towards driving more software subscriptions and annualized recurring revenue (ARR) shows positive results, with both metrics experiencing growth during the quarter.
- **Splunk Acquisition:** The pending acquisition of Splunk is set to support Cisco's transformation strategy, which is expected to contribute approximately \$4 billion in additional ARR and position Cisco among the largest software companies globally.
- **Operational Execution:** Despite macroeconomic uncertainties and customer inventory absorption taking longer than expected, Cisco's operational execution remained strong, with solid margins and increased operating leverage.
- **Product Innovation:** The company announced new capabilities in networking, security, collaboration, and observability at Cisco Live EMEA and continued to capitalize on the AI infrastructure opportunity.
- **Partnership with NVIDIA:** Cisco revealed the next phase in its collaboration with NVIDIA to provide cloud-based and on-premise AI infrastructure solutions, showcasing Cisco's role in AI adoption.

These highlights demonstrate Cisco's focus on strategic growth areas, financial discipline, and innovation, which are expected to drive long-term shareholder value and customer success in a transformative technology landscape.

OUTLOOK

The current market and economic environment, as detailed in Cisco's earnings call, reflects several key factors:

- **Macro Uncertainty:** Cisco observed a greater degree of caution in the market due to high levels of uncertainty. This has led to increased scrutiny of deals and a more cautious approach to forecasting and expectations.
- **Inventory Absorption:** Customers are taking longer than expected to deploy the elevated levels of products shipped to them in recent quarters, affecting new order flows.
- **Service Provider Weakness:** Cisco specifically mentioned weakness in the demand from the telecommunications and cable service provider sector in its earnings call, highlighting significant pressure has led to adjustments in deployment phasing and is impacting Cisco's business outlook.
- **Expense and Investment Adjustments:** Cisco is adjusting its expenses and investments to reflect the current cautious market environment, aiming to align its operations more closely with existing conditions.
- **Steady Progress in Cloud Implementations:** Although progress is being made, Cisco anticipates it may still be a few quarters away from fully implementing customer inventories.
- **Stable Win Rates and Market Share:** Despite near-term challenges, Cisco's win rates remain stable, and market share has stayed steady in most of its largest markets.

Overall, the environment is characterized by a heightened level of prudence among customers, slower deployment rates, and sector-specific demand challenges, all influencing Cisco's strategic and operational decisions.

Cisco's guidance and outlook for the upcoming periods, as detailed in their earnings call, include the following key points:

1. **Q3 Fiscal Year 2024 Guidance:**

- **Revenue:** Expected to be in the range of \$12.1 billion to \$12.3 billion.
- **Non-GAAP Gross Margin:** Anticipated to be between 66% and 67%.
- **Non-GAAP Operating Margin:** Projected to be in the range of 33.5% to 34.5%.
- **Non-GAAP Earnings Per Share:** Forecasted between \$0.84 and \$0.86.
- **Non-GAAP Effective Tax Rate:** Assumed to be around 19%.

2. **Full Fiscal Year 2024 Guidance:**

- **Revenue:** Expected to be between \$51.5 billion and \$52.5 billion.
- **Non-GAAP Earnings Per Share:** Anticipated to range from \$3.68 to \$3.74.

3. **Overall Outlook:**

- The guidance reflects a reset of expectations for the second half of the fiscal year, accounting for macroeconomic uncertainties, ongoing absorption of product shipments by customers, and weakness in the service provider market.
- Cisco's strategic focus remains on transitioning to more recurring revenue-based offerings, with ongoing investment in innovation to capitalize on growth opportunities.
- The company emphasizes a commitment to delivering long-term shareholder value while managing the current challenges and market dynamics.

This outlook indicates that Cisco is taking a cautious yet strategically focused approach, considering the prevailing economic conditions and specific market challenges. They are balancing the need to adapt to short-term market realities while maintaining a clear vision for long-term growth and shareholder value.

ANALYSIS

Cisco is navigating a complex and challenging market environment with a strategic focus and disciplined approach. Cisco's performance in the second quarter of fiscal year 2024 highlights its resilience amidst global economic uncertainties. The company reported revenue at the higher end of its guidance, reflecting solid execution, especially considering the broader technology sector's struggles. However, a year-over-year decline in revenue underscores the impact of cautious customer spending and macroeconomic headwinds.

Cisco's guidance for Q3 and the full fiscal year 2024 suggests a cautious yet realistic approach in the face of ongoing challenges, including macroeconomic uncertainty and the absorption of product shipments by customers.

As part of its mitigation against continuing challenges, Cisco intends to eliminate approximately 5% of its global workforce. The company estimates this will produce roughly \$800 million pretax charges. This restructuring is part of Cisco's broader strategy to realign its investments and expenses to reflect the current market environment and maximize long-term value for its shareholders.

A significant aspect of Cisco's strategy is its focus on transitioning to more recurring revenue models, emphasizing software subscriptions and annualized recurring revenue. This shift aligns well with broader industry trends towards service-oriented models and indicates Cisco's commitment to long-term sustainability and growth in the face of short-term market volatility.

The company's increased emphasis on areas like AI, Security, and Observability, coupled with strategic acquisitions like Splunk, is poised to strengthen its portfolio

and market position. This is particularly relevant as businesses increasingly seek comprehensive, integrated solutions for digital transformation.

Cisco's current outlook reflects a company cautiously navigating short-term challenges while strategically investing in areas that promise long-term growth. Its commitment to shareholder value and strategic investments in high-growth areas position it well to emerge stronger as market conditions evolve.



RESEARCH NOTE

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