Technology
Communications Equipment

United States of America

Cisco Systems (NASDAQ: CSCO)

New Opportunities Drive Revenue Reacceleration

Investment Summary

Cisco has the most comprehensive set of technologies and products to help enterprises and carriers build secured and converged data networks, in our view. We believe Cisco is a primary beneficiary of the growth in data networks and convergence of services around Internet Protocol.

Initiating Coverage

Rating:	BUY
Price:	$23.23
Price Target:	$30.00
Bloomberg:	**NASDAQ: CSCO**

Market Data

52-Week Range:	$23.47-$16.83
Total Entprs. Value (MM):	$131,396.4
Market Cap. (MM):	$142,878.4
Institutional Ownership:	69.1%
Shares Out. (MM):	6,150.60
Float (%):	98.9%
Avg. Daily Vol.:	57,500,316

Financial Summary

Net Debt (MM):	($11482.00)
Net Debt/Capital:	NM
Long-Term Debt (MM):	$6332.00
Operating Margin:	30.6%

USD	2005A	2006A	2007E	2008E
Rev. (MM)	**24801.0**	**28484.0**	**33507.0**	**37715.0**
EV/Rev.	**5.3x**	**4.6x**	**3.9x**	**3.5x**
EPS				
Oct	0.21	0.25	0.30	0.35
Jan	0.22	0.26	0.31	0.36
Apr	0.23	0.29	0.33	0.38
Jul	0.25	0.30	0.35	0.40
FY Jul	**0.92**	**1.10**	**1.28**	**1.50**
FY P/E	25.2x	21.1x	18.1x	15.5x
Consensus	**—**	**—**	**1.26**	**1.47**

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Event

We are initiating coverage with a Buy rating and $30 price target. We expect revenue growth to reaccelerate toward the high end of its 10%-15% growth target, thanks to a combination of market share gains, penetration of under-networked segments, and increased service provider spending on next-gen data networks.

Key Points

- **One-stop shopping.** As networking technologies mature, customers are looking for more integrated solutions and simpler support capabilities. Cisco benefits from this trend, having the most comprehensive set of technologies and products to help enterprises and carriers build secured and converged data networks. In addition, Cisco is supported by over 30,000 channel partners.

- **Gaining credibility with service providers.** Acquisition of Scientific Atlanta is driving deeper customer engagements on building next-gen networks. We see Cisco as the primary beneficiary of an overall shift in service provider spending toward data networks, as it increasingly deploys services that are data-oriented, like DSL, metro Ethernet, VoIP, and IPTV. Cisco generates 32% of revenue from service providers, including routers and video equipment.

- **Networking for everyone.** While the overall enterprise networking market is mature, Cisco is targeting under-networked groups in commercial (meaning 1,000 employees and fewer) and consumer segments, and in emerging markets. Cisco can also leverage Linksys and Scientific-Atlanta brands to target these market segments.

Valuation/Risks

Cisco Systems is trading at 17x our fiscal 2007 EPS estimate of $1.28. This is below its three-year historical forward P/E multiple of 22x, and in-line with the 15-25x of its peers in the data networking market. We believe CSCO's P/E multiple could expand with core revenue growth rate (excluding Scientific Atlanta) reaccelerating to 13% from 11% last year, and operating margins remaining in the 29-30% range. Our price target of $30 is based on 20x our fiscal 2008 EPS estimate of $1.50. The company has $1.86 per share in net cash and generates about $2 billion in free cash flow per quarter, of which we assume over $1 billion would be used for share repurchases.

Risks include a slowing U.S. economy; the United States represents 60% of total revenue.

Please see important disclosure information on pages 21 - 23 of this report.

Executive Summary

We are initiating coverage of Cisco Systems with a Buy rating and $30 price target. As the dominant supplier of IP-based networking equipment, Cisco has the most comprehensive set of technologies and products to help enterprises and carriers build secured and converged data networks, in our view. We expect the revenue growth rate to reaccelerate to the high-end of its 10%-15% growth target, thanks to a combination of market share gains, penetration of under-networked segments, and increased service provider spending on next-gen data networks.

Back on the offensive. In the past couple of years, Cisco has been fending off encroaching competitors in various market segments: Juniper (JNPR, $16.86, NC) and Alcatel (ALA, $11.92, Hold) in routing; Netgear and D-Link in consumer; HP Procurve in switches. These competitors had a slight to moderate unfavorable impact on Cisco's market share in 2004 and 2005, and, we believe, contributed to underperformance of CSCO's share price during those years. However, we are seeing the market share momentum change in Cisco's favor, and are optimistic that its share price will favorably reflect this development. We believe Cisco is benefiting from various actions it has taken recently:

- refreshed its product line broadly across all major market segments.
- added new capabilities/technologies as modules into switches and routers, adding stickiness to the products.
- revamped its channel strategy, reducing the total number of resellers but expanding their value-add.
- embarked on a significant sales force expansion, adding 2,005 in fiscal 2006, or an 18% increase.

Scientific Atlanta is a critical component of service provider business. At the heart of a heated battle between telcos and cable MSOs is the fight for "household customers," not just "subscribers" of any one particular service (i.e., phone, video, or data). Services are converging around Internet Protocol (IP), enabling one service provider to sell multiple services—with billions of dollars at stake. With the acquisition of Scientific Atlanta in late February 2006, Cisco immediately became a "must-have" vendor partner. While Cisco has strong technology expertise, Scientific Atlanta brings a new level of fundamental understanding on what it takes to support revenue-generating services to millions of customers, and an expertise on delivering end-to-end video services that form a critical component of triple-play bundles. S-A has deployed 25 million set-top boxes and installed over 240 video headends. Video will have a tremendous impact on the service provider networks. Cisco believes that network traffic could grow 200%-500% from current levels when video is deployed in scale. Cisco now has a holistic view on how these next-generation IP networks need to be built, and we believe Cisco will become a strategic partner for service providers as it transitions its networks. In the most recent quarter, Cisco generated 31% of revenue from service providers (incl. 7% from S-A).

Networking for everyone. While the overall enterprise networking market is mature, Cisco is targeting under-networked groups in commercial (meaning 1,000 employees and fewer) and consumer segments, and in emerging markets. In fiscal 4Q06, commercial was 24%, consumer 3%, and emerging markets 8%-9%. We believe the commercial and emerging markets represent significant growth opportunities for Cisco where it can leverage the breadth of its technologies and product line to drive end-user adoption. Cisco has bulked up its sales force to target opportunities in these two areas.

Valuation

Cisco Systems is trading at 17x our forward-four-quarter EPS estimate of $1.28. This is below its three-year average forward P/E multiple of 22x and in-line with the 15-25x of its peers in the data networking market (based on NTM earnings). We believe Cisco's PE multiple could expand as core revenue growth rate reaccelerates to 13% from 11% last year, and as operating margins remain in the 29%-30% range. We believe Cisco warrants a premium valuation as it regains share in primary market segments and aggressively seeks new areas of growth in adjacent markets. Our price target of $30 is based on 20x our fiscal 2008 (ended July) EPS estimate of $1.50. The company has $1.86 per share in net cash and generates about $2 billion in free cash flow per quarter, of which we assume over $1 billion would be used for share repurchases.

Risks

Slowing economy a concern, but Cisco should gain share of spend. With the U.S. economy slowing, investors are naturally concerned about Cisco's exposure to a potential slowdown in IT spending. The U.S. market accounts for 55% of Cisco's product revenue and 60% of total revenue. We share these concerns, but we also expect Cisco to benefit somewhat from flight to quality, as businesses spend more of their budgets with fewer established vendors. Cisco has the most comprehensive set of technologies and products to help enterprise and carriers build secured and converged data networks. Cisco is supported by over 30,000 channel partners. Moreover, Cisco is leveraging its sizable installed base to sell new technologies and capabilities as line-card add-ins to its routing/switching product line. A significant number of new Advanced Technologies categories are emerging from new ways to use the intelligence and flexibility that can be built into Cisco's switches and routers. Cisco targets generating three to four new AT categories a year.

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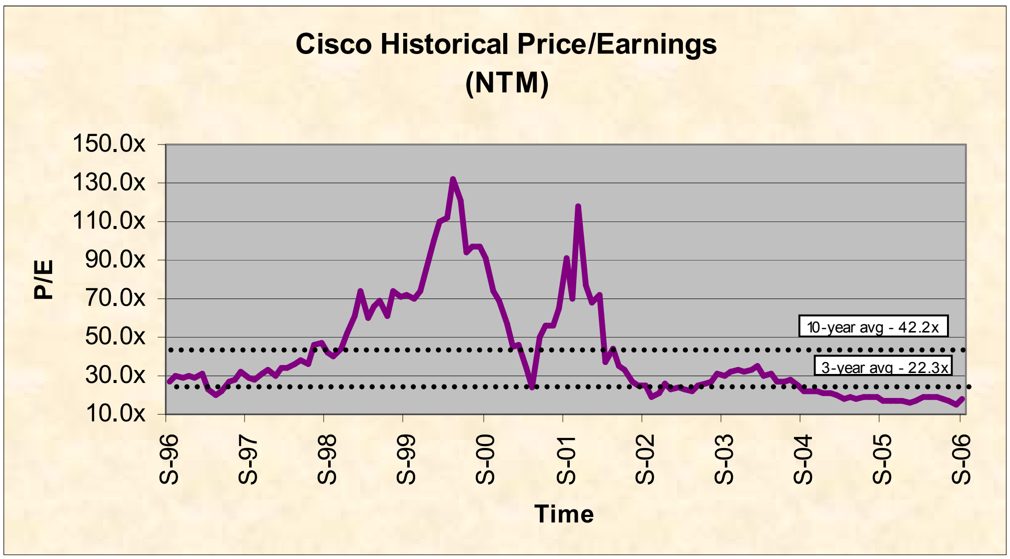
Exhibit 1: Valuation vs. Peer Group

US$m (Except Per Share Information).

Company	Price 9/25/2006	Share Count	Jefferies Rating	Mkt Cap	Ent. Val.	Revenue Est. CY 2006E	Revenue Est. CY 2007E	EPS Est. CY 2006E	EPS Est. CY 2007E	CY06-07 Growth Rev	CY06-07 Growth EPS	P/E Multiple CY2006	P/E Multiple CY2007	Price / Sales CY2006	Price / Sales CY2007	EV/Sales CY2006	EV/Sales CY2007	PEG CY2006	PEG CY2007
CSCO	**$23.23**	6081	**Buy**	**$141,262**	**$129,780**	**$31,470**	**$35,525**	**$1.20**	**$1.39**	**13%**	**16%**	**19.4**	**16.7**	**4.5x**	**4.0x**	**4.1x**	**3.7x**	**120%**	**103%**
ALA	$11.92	1429	Hold	$17,028	$14,588	$17,908	$18,240	$0.72	$0.85	2%	18%	16.6	14.0	1.0x	0.9x	0.8x	0.8x	92%	78%
AV	$11.45	459	Hold	$5,256	$4,434	$5,170	$5,328	$0.48	$0.60	3%	25%	23.7	19.0	1.0x	1.0x	0.9x	0.8x	95%	76%
FFIV	$52.52	40	Buy	$2,118	$1,665	$411	$497	$2.00	$2.42	21%	21%	26.3	21.7	5.2x	4.3x	4.1x	3.3x	126%	104%
JNPR	$16.86	566	NC	$9,539	$8,162	$2,298	$2,603	$0.74	$0.88	13%	19%	22.8	19.2	4.1x	3.7x	3.6x	3.1x	120%	101%
NT	$2.30	4336	Buy	$9,972	$12,619	$11,235	$11,721	-$0.01	$0.11	4%	-1200%	-230.0	20.9	0.9x	0.9x	1.1x	1.1x	19%	-2%

Source: Thomson Baseline and Jefferies & Company, Inc.

Exhibit 2: Historical P/E Valuation Chart



Source: Company data and Jefferies & Company, Inc.

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Company Overview

Cisco Systems manufactures and sells networking communication products to end markets that include enterprises, service providers, and consumers. The San Jose, California-based company was first established in 1984 and has grown to become the leader in the data networking industry, and also one of the leading technology companies worldwide. Cisco has led the development of this industry by marketing, training, and selling the vision of IP-based networks. Cisco's IOS software is the de facto operating system of the public Internet, and its products are used to connect computing devices in and around the corporate networks. With an approximate 66% of the $24 billion switching/routing market globally, Cisco maintains market dominance in the space.

Cisco has historically been able to grow its business from sales within its two core segments: routers and switches. For its fiscal year ended July 31st, the company derived roughly 60% of its revenues from the sale of ***Routers***, or network devices that typically transfer data from one network to another, and ***Switches***, which typically transfer data within a network. This represents a shift from the approximate 70% of total revenues these two product lines made up only three years ago. This change can be attributed to Cisco's entry into adjacent markets, like enterprise telephony, optical transport, and home networking, among others. Product sales into these adjacent markets are included in the Advanced Technologies segment. We note that this simplistic breakout of products by technology does not provide a complete picture of Cisco's dominance in the traditional switches and routers markets. Many of the advanced technologies are sold as line-cards and feature enrichments into its switches and routers. For example, a security module would add VPN firewall capabilities into a Catalyst 6500 switch and be managed by the same network management software. In particular, a meaningful portion of security, applications networking, and optical networking sales are sold as line-cards.

Exhibit 3: Analysis of Cisco's Fiscal 2006 Products and Revenues

% of FY06 Rev		Major Products	Description
21%	**Routers**		
11%	High-end		
		CRS-1	Core of IP/MPLS neworks. 100-200 systems deployed New operating system (IOS XR) partitions control plane.
		GSR 12000, ESR 10000	Over 20,000 GSR systems deployed. Multi-service aggregation with >10 Gbps and 1.2 terabit capacity.
		7200, 7600	Used for service provider Ethernet aggregation, and enterprise head office, WAN, VPN aggregation.
10%	Mid-range and low		
		3800, 2800, 1800, 800	Integrated services router--contains VPN, security, call manager, VoIP in single box.
38%	**Switches**		
20%	Modular		
		Catalyst 6500	Platform for supporting layer 2,3,4-7 switching. Recent into of 8=port 10G. Shipping Sup32, 720 engines.
		Catalyst 4500	
18%	Fixed		
		Catalyst 3750, 3560	Layer 3 Fixed
		Catalyst 2960, 1900, 500	
		ME3400	Used for service provider edge
22%	**Advanced Technologies**		
5%	Security		VPN firewall, IDS/IPS. Also available as line cards into routers and switches.
4%	Unified Comm.	7900 IP phones, call mgr	Contains IP phones, IP-PBX, software
4%	Home networking	Linksys	Linksys routers, Scientific Atlanta cable modems and eMTAs.
3%	Wireless	Aironet	Aironet WiFi access points
3%	Video systems	Set-top boxes, headend	Operates as a wholly owned subsidiary Scientific Atlanta
2%	Optical networking	ONS 15454	Reclassify in FY'07. Optical interconnects moves to Routing segment. Metro Ethernet and SONET pdts in Others
1%	Storage	MDS 9000	SAN switches, blades. Fabric switch and Director-class. Built from Andiamo acqusition.
1%	Applications Ntwg		Load-balancing, applilcation acceleration. As modules and stand-alone applicances. ACE, CSM, WAAS modules
0%	Hosted small-bus.	Linksys One	
3%	**Others**		
		Access	Remote access routers, dialup access servers, DSLAM and CMTS
		Network Mgmt software	
		Miscellaneous parts	Power cable, etc.
16%	**Services**		
		Tech support, maintenance contracts, advanced services program (network architect)	
		Largely includes call center, tech support	

Source: Company reports and Jefferies' estimates

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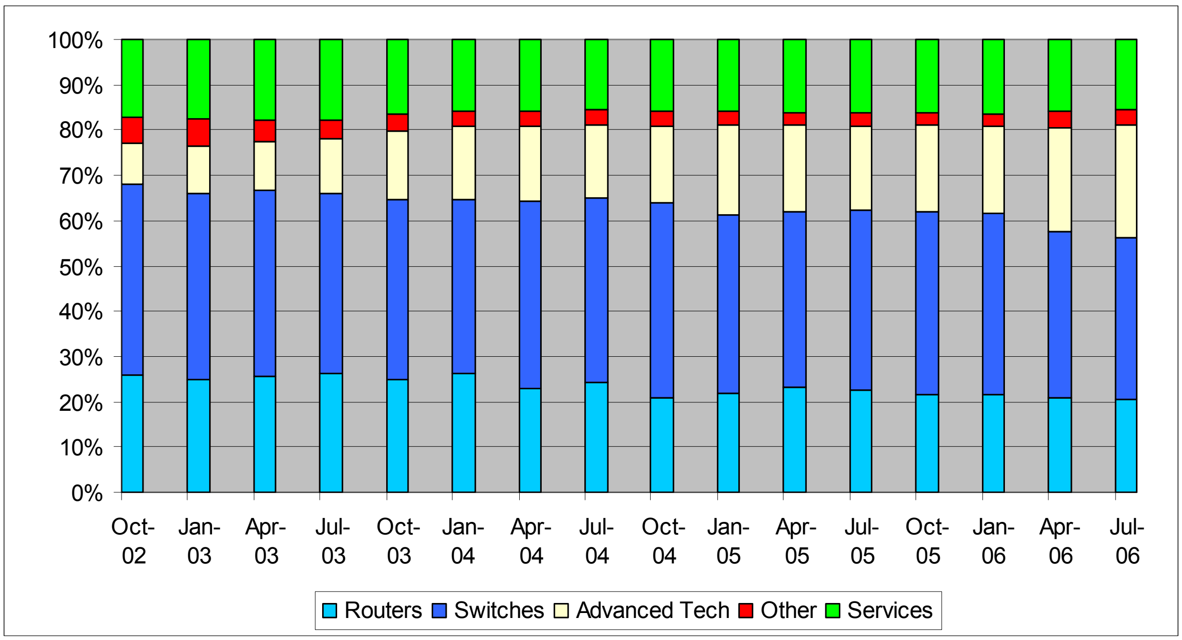
As depicted in Exhibit 4, the ***Advanced Technologies (AT)*** business has now become a much larger percentage of the firm's overall revenues with roughly 22% of sales in FY06. AT is the fastest growing portion of the company's core business, and we believe it should be a significant growth driver for the company in fiscal years 2007 and 2008. This segment consists of Unified Communications (previously Enterprise IP Communications), Home Networking, Optical Networking, Security, Storage Area Networking, and Wireless Technology. Also included in the AT division is the acquired Scientific Atlanta (S-A) business with products such as set-top boxes, video distribution networks, and video system integration. We believe this acquisition by Cisco will be positive for the company as data/video convergence in the network becomes more proliferated. The fiscal 2006 revenue analysis in Exhibit 4 reflects S-A revenues since February 2006. The majority of the Scientific Atlanta business is categorized as Video Networking, with WebStar cable modems grouped in Home Networking, Prisma transport line in Optical Networking.

The remaining 18%-19% of Cisco's FY06 revenue is attributable to its ***Other*** category, which includes access products and network management software, as well as ***Services*** that support each of its product lines.

Exhibit 4: Advanced Technologies Has Been a Growing Product Segment for Cisco



Source: Company data and Jefferies & Company, Inc.

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Scientific Atlanta Is a Critical Component of the Service Provider Business

At the center of a heated battle between telcos and cable MSOs is the fight for “household customers,” not just “subscribers” of any one particular service (i.e., phone, video, data). Services are converging around Internet Protocol (IP), enabling one service provider to sell multiple services—with hundreds of billions of dollars at stake. With the acquisition of Scientific Atlanta in late February 2006, Cisco immediately became a “must-have” vendor partner. Scientific Atlanta brings a new level of fundamental understanding of what it takes to support revenue-generating services to millions of customers, and an expertise on delivering end-to-end video services that form a critical component of the triple play bundle. Scientific-Atlanta is one of only two end-to-end network providers for video services (the other being Motorola [MOT, $25.27, Buy]), supplying headend, transport, and subscriber equipment to the cable MSOs and increasingly to telcos (specifically AT&T for Project Lightspeed). The essential components of the video system are the headend equipment in the network and the set-top box at the customer's home. Scientific Atlanta has deployed over 26 million set-top boxes and installed over 240 video headends. A set-top box is used by cable subscribers to receive TV programming and interactive online services sent by the headend. Set-top boxes are an integral part of the video network. In fact, each element of the set-top box has its parallel in the headend:

Headend		Set-Top Box
Scheduling system provides data on programs	→	Electronic programming guide displays schedule
MPEG encoder compresses video content	→	MPEG decoder processes video content
QAM modulator sends data stream	→	Tuner and demodulator processes the stream
Subscriber management system sets entitlement	→	Conditional access software records entitlement
Conditional access system encrypts content	→	Conditional access software decrypts content

While Scientific Atlanta is run separately as a wholly owned subsidiary, Cisco is working to drive revenue synergies for the longer term. Cisco has formed three internal, co-chaired product/solution integration teams with S-A:

- **IPTV Wireline Team —** focusing on end-to-end capabilities for IPTV deployments worldwide. This group helps to educate customers on IPTV technology and serves as a key team to interface with customers. The Scientific Atlanta team is now able to have major engagements at senior levels with Deutsche Telekom, Belgacom, Telecom Italia, Telefonica, Swisscom, among others in Japan and Latin America where it had difficulty penetrating in the past. As for AT&T’s Project Lightspeed, S-A has made significant progress in the headend buildouts. One of two super headends (SHO) is complete, with seven regional video headends (VHO) completed and 8-10 in process. Recall that AT&T plans to complete 43 VHOs.
- **Next-Generation Network (NGN) Team —** focusing on how to accelerate the velocity of introducing new services on an IP-converged backbone. In addition to S-A, Cisco’s planned purchase of Arroyo adds the capability of doing ad insertion, network attached storage, the ability to stream video from network attached storage sites, and the ability to launch and transport video from all over the country. The team expects to have a five-year plan on how to make the various components work together with an IP converged network.
- **Connected Home Team —** focus on tying together the efforts of Scientific Atlanta, Cisco, and Linksys on coming up with a better solution for home networking with lower risk to the Service Providers. Clearly, Cisco has some choice in using the various brand names it has acquired to appropriately target its goals.

The addition of video will have a significant impact on the service provider networks. Cisco believes that network traffic could grow 200%-500% from current levels when video is deployed in scale. Cisco is the only company to have the holistic view on how next-generation IP networks needs to be built, and we believe Cisco will become a strategic partner for service providers as they transition their networks. It is not surprising to see S-A fall under the supervision of Mike Volpi, head of Cisco’s routing business. In the most recent quarter, Cisco generated 32% of revenue from service providers (including 7% from S-A).

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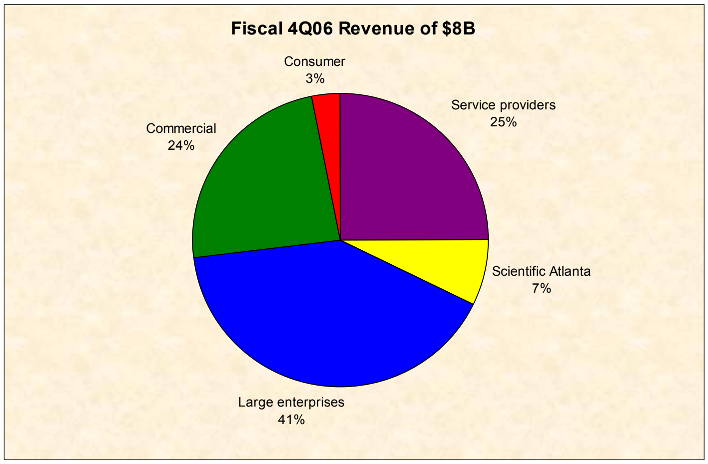
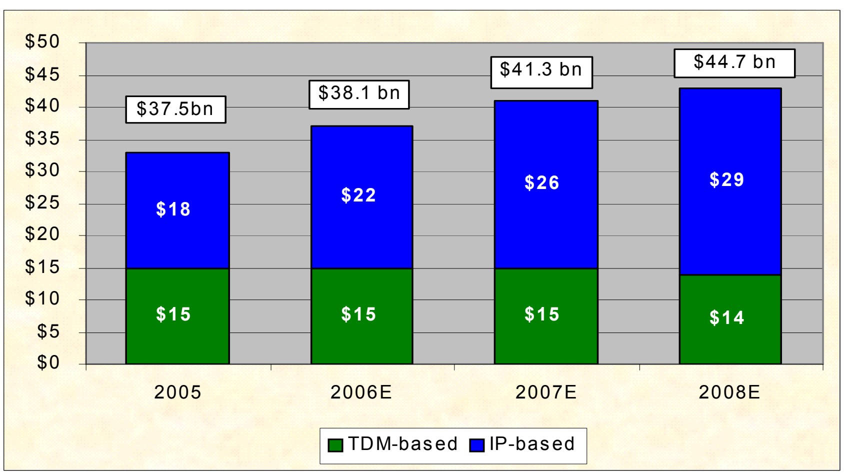
Exhibit 5: Service Providers Contribute 32% of Sales, Including Scientific Atlanta



Source: Company data and Jefferies & Company, Inc.

Cisco is helping carriers build next-generation networks. Service providers are starting to buy routing products to build IP Next-generation Networks (IP NGN). Originally, they bought routers to build their internet backbone, internet peering, or internet access networks. Now, they are building with these same products a single network to run all services—for business or residential, for Internet or Ethernet, for any type of service connection. We view Cisco as the primary beneficiary of a shift in service provider spending toward IP NGN, as it deploys more services that are data-oriented in nature, like consumer broadband, metro Ethernet, VoIP, and IPTV. Exhibit 6 shows an increasing percentage of carrier spend moving toward IP-based network equipment.

Exhibit 6: A Secular Shift in Service Provider Spending Toward IP Networks



Source: Cisco, Synergy Research, and Jefferies & Company, Inc.

Of particular importance, we believe Cisco's position in the $5.4 billion service provider routing market has significantly improved. In May 2004, Cisco introduced the CRS-1, a product purpose-built for carrier-class reliability and performance. It is noteworthy that CRS-1 uses a new operating system, IOS XR (extended release). Among the uniqueness of the IOS XR modular operating system is the ability to partition the control plan of the router to scale, interconnect 76 routers for a total switching capacity of 92 terabits per second, and to enable hot swaps and zero downtime. Cisco has already begun to see some initial traction for the CRS-1 with $80 million of sales and $120 million of orders in 4QFY06. Cisco had invested nearly $500 million to enter the market with the CRS-1 and, as a point of reference, sales for core routing products worldwide were roughly $1.7 billion in 2005. While this is a large investment relative to the size of the end market, management believes that having a high-quality core router in the market will create a "pull-through" effect for its edge routers, names Cisco 7600, 10000, and GSR 12000 routers.

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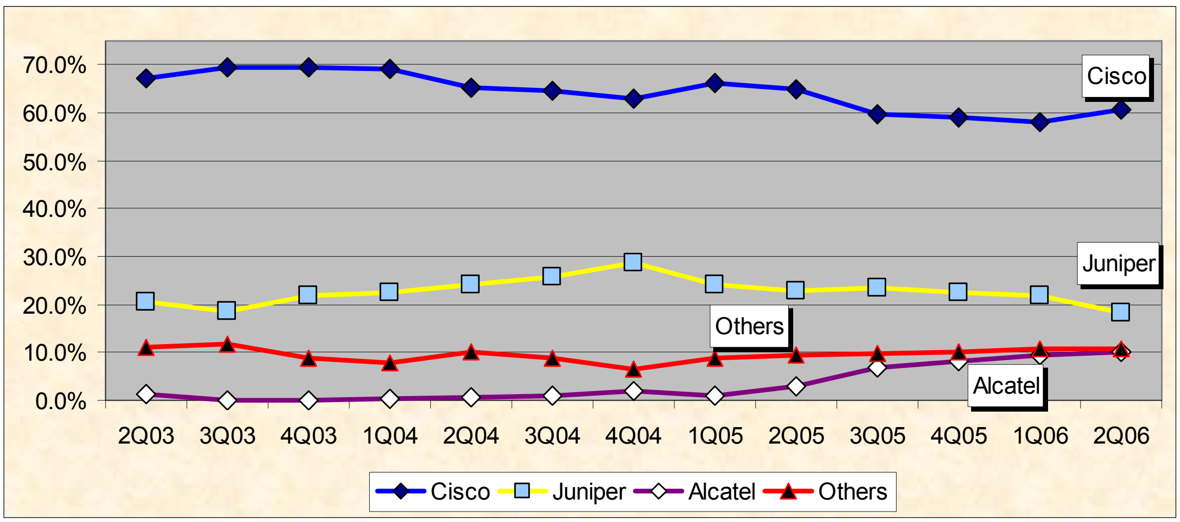
These are all considered high-end routers, where almost 85%-90% of the capex cost is the interfaces that go into the router, rather than the base chassis and common power supplies. Cisco enables the service providers to share modules amongst all four of these routers, which lowers their cost of purchasing individual modules. We believe IOS XR-based CRS-1 and GSR 12000 will be key catalysts for gaining lost ground in the routing market segment.

Cisco had seen some slippage in its service provider routing market share over the last two years from nearly 67% of total revenues in 2Q03 to 61% in 2Q06 (*see Exhibit 7*). As a result, Cisco's total router revenue was range-bound on a quarterly basis at $1.3-$1.5 billion for much of the past three years. Much of the loss came from Juniper gaining share with its T-Series line of core routers that began shipping in April 2002, and from Alcatel with its 7750 edge routers acquired through TiMetra in July 2003. Market share losses raised questions about Cisco's product strength and competitive positioning in this very important market segment. We suspect Cisco took some hit to its prestige as well; to put this into historical perspective, Cisco's success began with its dominance of the routing market. Cisco's leading share in the router market enabled it to expand successfully into larger adjacent markets including switching in the 1990s.

Exhibit 7: Cisco's Market Share in Carrier Routing



Note: We have adjusted 2004 market share estimates to exclude approximate sales of Juniper's M7i and M10i, which are enterprise routers.
Source: Company data and Jefferies & Company, Inc.

Overall, we believe Cisco is now well positioned to gain share across the various market segments. We believe Cisco's position in the service provider routing market has improved with: 1) introduction of IOS XR operating system within CRS-1 core router, 2) additional feature enhancements to 12000, 10000, and 7600 edge routers, and 3) acquisition of Scientific Atlanta and its end-to-end video expertise for IPTV rollouts. We believe Cisco is well positioned to win a piece of Verizon's Service Gateway RFP this month and NTT's IP NGN deployment slated to begin 1H of calendar 2007.

We believe the momentum has already shifted in favor of Cisco, although Alcatel is still growing in edge routing thanks to its presence in AT&T's Lightspeed project and at France Telecom. To compete against Alcatel's cost-effective Ethernet aggregation solution, Cisco will add new line cards to increase the density and speed as well as enhanced functionality into the 7600 routers. The 7600 series routers have native Ethernet switching capabilities built-in, which some service providers prefer in building out its next-gen network. While the Cisco 7600 has been around for six to seven years now, all of the interfaces and control engine are new in the last two to three years.

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Cisco Is Back Playing on the Offense

In the past couple of years, Cisco has been fending off encroaching competitors in various market segments: Juniper and Alcatel in routing; Netgear (NTGR, $21.18, NC) and D-Link in consumer; HP Procurve in switches. While Cisco continues to dominate much of the product markets it serves, smaller, more nimble competitors were able to gain market share against Cisco in certain niche applications and segments. These competitors had a slight to moderate unfavorable impact on Cisco's market share in 2004 and 2005, and, we believe, contributed to underperformance of CSCO share price during those years. However, we are seeing the market share momentum change in Cisco's favor and are optimistic that CSCO's share price will continue to reflect this development. We believe Cisco is benefiting from various actions it has taken in recent periods:

- **Refreshed its product line broadly across all major market segments**, including introduction of integrated service routers (ISRs), higher density interfaces on modular switches, and sweeping upgrades in the unified communications sector. The ISRs, for example, have seen a quick ramp to $1 billion annual revenue level since introduction in mid-2004. ISR contains a call manager and stateful firewall all in one box that helps branch offices simplify deployment and decision making.
- **Added new capabilities/technologies as modules into switches and routers**, adding stickiness to the products. Much of the development here has been in the Advanced Technologies segment, including ACE module for applications networking, WAAS module for WAN optimization, and security module for VPN firewall. Cisco targets generating three to four new AT categories a year. We also point to Cisco's $4 billion R&D budget and a history of using acquisitions (Cisco has completed over 110 acquisitions since 1993—see Appendix 1) to add new technologies.
- **Revamped its channel strategy**, reducing the total number of resellers but expanding their value-add (see further discussion below).
- **Embarked on a significant sales force expansion**, adding 2,005 sales employees in fiscal 2006 or an 18% increase.

Leveraging its dominance in enterprise to sell new products. "You can't go wrong buying Cisco." We believe this is the general mentality in the enterprise segment, where Cisco generates 41% of its revenue. Cisco defines the Enterprise market as customers with 1,000 or more employees, including the U.S. government, healthcare, and education verticals. If we also include the commercial market segment, which Cisco defines as customers with 1,000 or fewer employees, Cisco generates 65% of sales from business customers.

The pace of technology innovation has slowed in the enterprise space (with a shift in innovation picking up on the consumer side) and there hasn't been a great push to try out new technologies or new vendors. Much of the enterprise attention, in our view, has focused on optimization of existing network, better system management capabilities, and return on investment metrics. As Exhibit 8 shows, the enterprise networking market is dominated by just one major vendor, Cisco. In our view, enterprise networking technology is relatively mature and favors the leading vendor. Cisco has the most comprehensive set of technologies and products to help enterprise customers build secured and converged data networks. Cisco is supported by over 30,000 channel partners, far more than 6,500 for Juniper, for example. Moreover, Cisco is leveraging its sizable installed base to sell new technologies and capabilities as line-card add-ins to its routing/switching product line. A significant number of new Advanced Technologies categories are emerging from new ways to use the intelligence and flexibility that can be built into Cisco's switches and routers. Security and Applications Networking capabilities are good examples of once appliance-based markets that are starting to get integrated into the networks. Large customers like this approach because it reduces the complexity of managing multiple devices. Cisco's ability to integrate much of the advanced technologies will, in our view, continue to differentiate its competitive position: customers become more loyal, choosing to buy modules for the chassis instead of buying a competitor's standalone products.

Even when it comes to selling standalone units, Cisco is using its breadth of technologies to beat out competition. Cisco has successfully capitalized on trends for "branch in a box" with its ISR routers, including 800, 1800, 2800, and 3800 models. These boxes are optimized for enterprise remote branch offices and include routing, switching, security, VoIP, WiFi, and now WAN optimization capabilities all in one box. This product line saw a quick ramp to $1 billion annual revenue run-rate since introduction in mid 2004.

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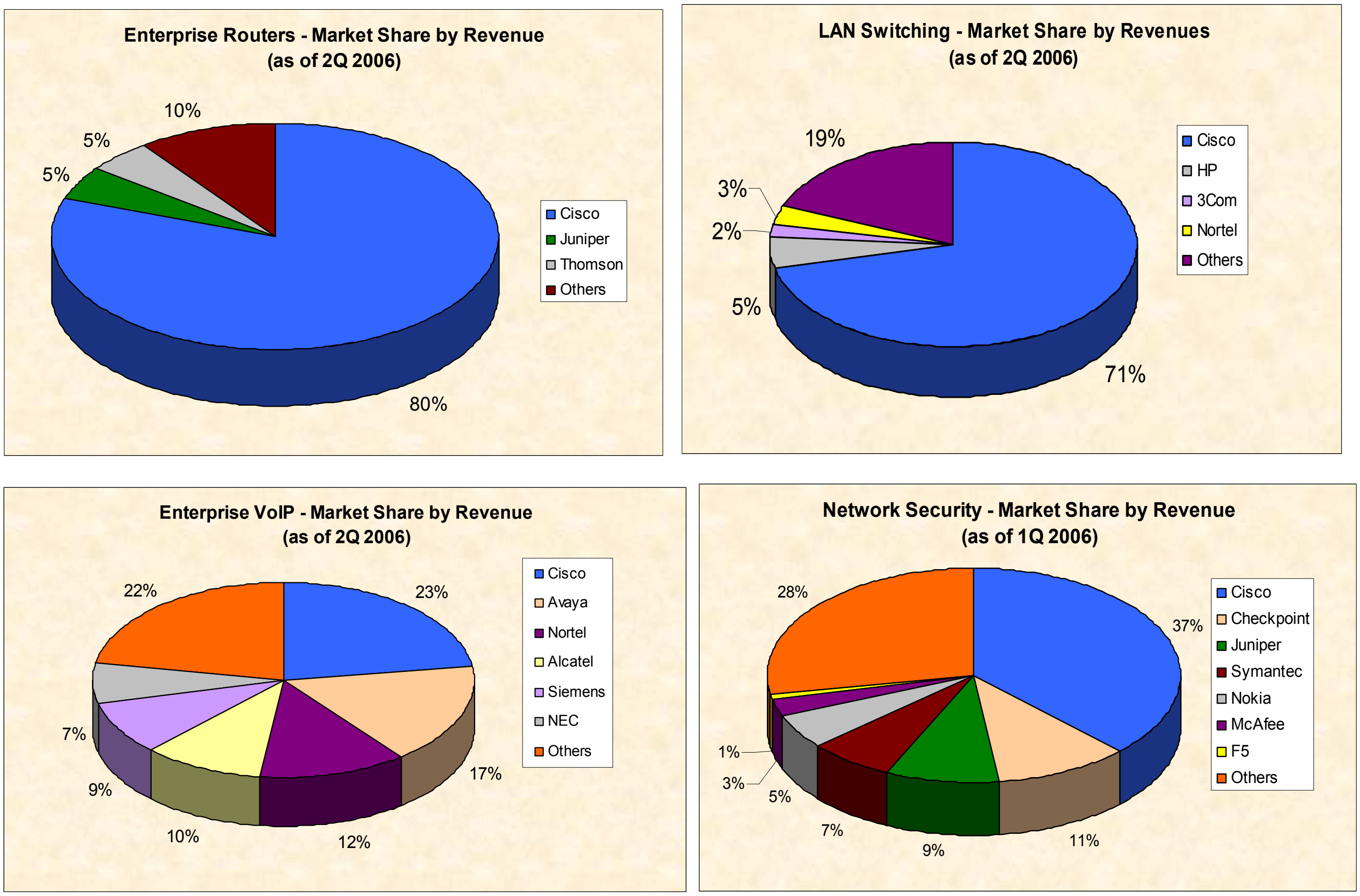
Exhibit 8: Cisco's Market Share in Key Product Segments



Source: Synergy Research and Jefferies & Company, Inc.

Revamped Channel Strategy Proving Successful. While Cisco has a high-touch model to service its largest customers, the company primarily uses the channel to meet broader customer demand. Cisco has its own dedicated sales force of 14,000 employees and channel partners that equate to 200,000 employees. We used to hear complaints in years 2003 and 2004 from the channel about the low margins they get from reselling Cisco products, and how Cisco's volume-based incentives created an unfair advantage toward distributors and service providers that were effectively competing against them. We no longer hear many of these complaints. To reduce the competition between channel partners, Cisco trimmed the number of partners to 30,000 and helped them to specialize and deliver a full solution to a customer. Cisco also improved how it compensated them. Pricing on the products became more aligned and consistent across the partners, to reduce volume-driven pricing differentiations between local resellers and bigger players in the market. Instead, Cisco increased the back-end incentive checks. The OIP (Opportunity Incentive Program) uses a rebate system to compensate the VARs based on various metrics, including customer satisfaction. We believe the improved channel relationships have helped Cisco achieve significant success with two products in particular, ISRs (1800, 2800, 3800 series routers) and unified communications.

We believe a strong channel strategy is essential to driving opportunities in the commercial and emerging markets. While the overall enterprise networking market is fairly mature, there are under-networked groups in commercial (meaning 1,000 employees and fewer) and consumer segments, and in emerging markets. In fiscal 4Q06, commercial was 24%, consumer 3%, and emerging markets 8%-9% of Cisco's total revenue. We believe the commercial and emerging markets represent significant growth opportunities for Cisco where it can leverage the breadth of its technologies and product line. In these markets, we see a significant opportunity to integrate multiple capabilities into one box, like the ISRs, that would meet strong market needs, and to differentiate against lower-cost providers of point solutions, like Adtran (ADTN, $23.51, Buy) or Huawei.

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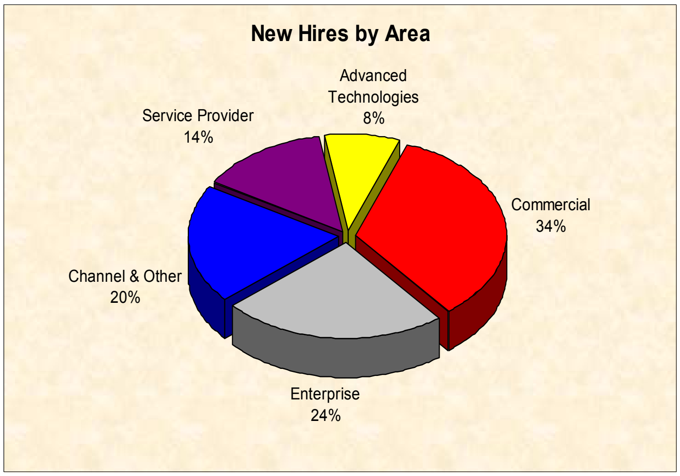
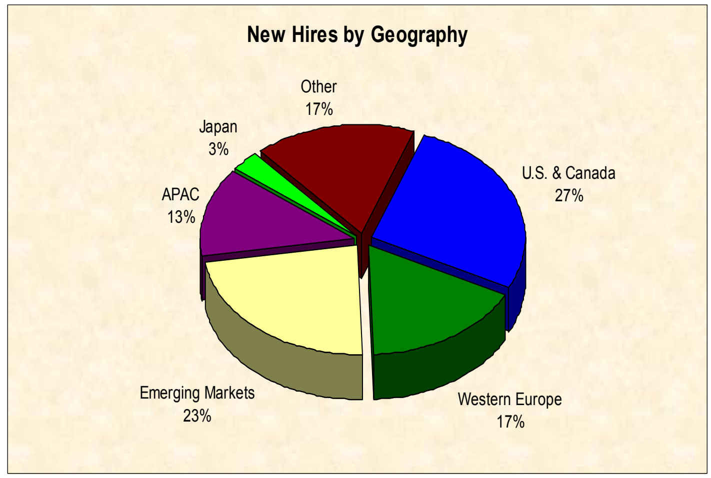
One bullish indication for revenue growth in these under-penetrated sectors has been Cisco's ability to put "more feet on the street." Throughout the 2006 fiscal year, the company has increased its sales headcount by approximately 2,000 employees. Of these additions, 62% were dedicated to the growing businesses such as commercial, advanced technologies, as well as to sales within the channel. Cisco has seen revenues increase commensurate with its investments in headcount, boding well for continued growth in each of these markets. From a geographic perspective, nearly a quarter of the new hires were in emerging markets as this region saw year/year growth in FY2006 of nearly 40% to $2.5 billion. Significant investments were also made in North America, Western Europe, and APAC with 541, 341, and 261 employees hired within each respective region.

Exhibit 9: Fiscal 2006 Headcount Additions



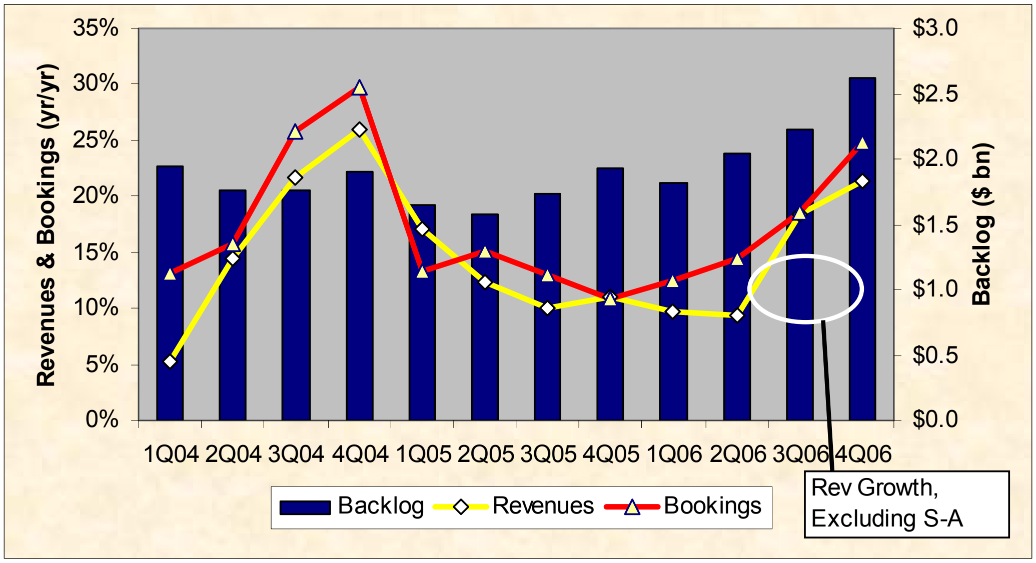


Source: Company data and Jefferies & Company, Inc.

Financial Highlights

We believe Cisco should be able to grow at the high end of its 10%-15% growth target (15%-20% growth including S-A) over the next several years. We point to favorable market share dynamics across all major product segments and a successful strategy of creating new businesses around adjacent markets in the Advanced Technologies segment. Moreover, we believe the Scientific Atlanta acquisition helps address attractive opportunities in traditional digital video market (like HDTV, VOD, switched digital) as well as the emerging opportunities in IPTV and service provider IP NGN networks.

Exhibit 10: Revenue, Bookings and Backlog Growth



Source: Company data and Jefferies & Company, Inc.

We believe investors have been concerned about Cisco's slowing revenue growth rate toward the lower-end of the 10%-15% target (see Exhibit 10). We believe this concern contributed to share price underperformance in 2004 and 2005. Nonetheless, bookings growth excluding the Scientific-Atlanta acquisition has been growing at a faster rate, near the upper end of the 10%-15% range. With backlog now at over $2.6 billion and customer lead-time at comfortable levels, management expects the revenue growth rate to be in line with the bookings growth rate.

We are modeling sales for fiscal 2007 and fiscal 2008 of $33.5 billion and $37.7 billion, respectively. This reflects year/year revenue growth of 18% and 13%, respectively. Revenue comparisons in fiscal 2007 are helped by the acquisition of Scientific-Atlanta, which contributed five months of results to fiscal 2006 revenue. Excluding S-A contribution of $989 million in fiscal 2006 and an expected $2.4 billion in 2007, revenue growth rate in fiscal 2007 would be 13%. We have assumed that gross margins remain around 65% and operating margins near 30%. We note that Cisco has provided the following three- to five-year financial target model:

- Revenue growth of 10%-15%.
- Gross margins of 64%-66%.
- Operating margins of 28%-30%.

In fiscal 2006, gross margins declined 50 bp to 66.7%, largely from the negative impact of integrating Scientific Atlanta, which has gross margins of approximately 37%. Otherwise, gross margins on Cisco standalone were up 60 basis points. Gross margins benefited from higher volumes and cost savings, partially offset by product mix and pricing/discounts.

We see opportunities for Cisco to leverage operating expenses but note continued investment in headcount. Cisco had focused its efforts in expanding its sales force in 2006, and we anticipate this to continue into 2007. As such, we believe sales and marketing expenditures as a percentage of revenue will be roughly in line with 2006 at 19.5%. Over time, we expect additional margin leverage as sales force productivity continues to increase. New employees get to full run-rate typically within four to six quarters, with U.S. hires ramping to full productivity toward the lower end of the range. As long as new work force productivity ramp remains within the targeted range, Cisco will look to add additional

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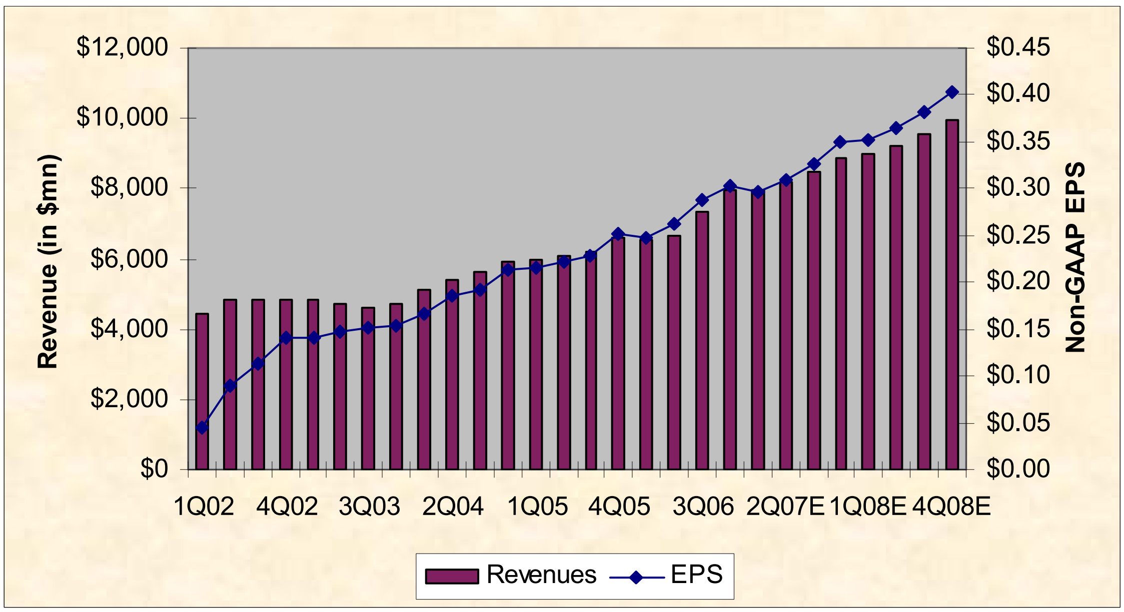
salespeople. As such, we believe management's previous targets for revenue-per-employee metrics are less important. Recall that management originally sought to achieve $700k per employee and, once reached, $1 million per employee.

Our fiscal 2007 and 2008 EPS estimates are $1.28 and $1.50, respectively. Our estimates exclude approximately $0.13-$0.14 per share in stock option expense. We also assume that Cisco will repurchase about 200 million shares a year (for conservatism, this is nearly half the levels purchased in recent years), with 25% of the purchases offsetting share dilution from issuance of employee stock options and restricted shares. Net cash balance of management indicated its preference for share repurchase rather than a dividend, given flexibility to use cash for acquisitions, for example. If share count were to remain unchanged at 4Q06 levels, our estimates would be reduced by $0.01 in FY2007 and $0.05 in FY2008. Our estimates are slightly higher than the consensus estimate of $1.26 for 2007 and $1.47 for 2008.

Exhibit 11: Historical Revenue & EPS Trends



Source: Company data and Jefferies & Company, Inc. Note: July fiscal year end.

Risks

Slowing economy is a concern, but Cisco should gain share of spend. With the U.S. economy slowing, investors are naturally concerned about Cisco's exposure to a potential slowdown in IT spending. The U.S. market accounts for 55% of Cisco's product revenue and 60% of total revenue. While we share these concerns, we expect Cisco to benefit somewhat from flight to quality, as businesses spend more of their budgets with fewer established vendors. Cisco has the most comprehensive set of technologies and products to help enterprise and carriers build secured and converged data networks, in our view. Cisco is supported by over 30,000 channel partners. Moreover, Cisco is leveraging its sizable installed base to sell new technologies and capabilities as line-card add-ins to its routing/switching product line. A significant number of new Advanced Technologies categories are emerging from new ways to use the intelligence and flexibility that can be built into Cisco's switches and routers. Cisco targets generating three to four new AT categories a year.

Other general risks to achieving our price target include:

1. **Level of IT Spend** – Enterprises and Commercial businesses represent nearly 65% of revenues for Cisco. A reallocation of IT expenses on part of these customers can cause a significant shift in the company's revenues and earnings. In addition, IT spending could be negatively affected by macroeconomic slowdown.

2. **Faster than Expected Declines in Margins** – Cisco's gross margins could decline faster than we expect. We note that many of the new, fast-growing advanced technologies businesses have product margins below corporate average. For example, gross margins have declined from 67% to 65% with the acquisition of Scientific Atlanta.

3. **Maintaining Leadership Amongst a High Level of Competition** – Cisco holds the dominant market leadership position in many of the areas in which it competes; most notably within switches and routers. As such, smaller, more nimble competitors could gain market share against Cisco in certain niche applications and segments.

4. **Longer Sales Cycles** – Sales of complex networking products can involve lengthy sales cycles, especially within the service provider market. Moreover, sales to service providers could be lumpy and introduce volatility in the company's quarterly financials. Cisco's service oriented network architecture (SONA) is aimed at increasing the intelligence and usefulness of the network to improve business processes. SONA would require greater collaboration with other major enterprise hardware and software vendors, which could slow the pace of adoption of new networking technologies.

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Appendix 1: Cisco Has Completed More Than 110 Acquisitions Since 1993

Year	Acquisitions	Announced	Market/Technology
1993	Crescendo Communications	9/21/1993	Catalyst 5000 switches for workgroup solutions to desktop
1994	Newport Systems	7/12/1994	Dial Access System for remote network sites
1994	Kalpana, Inc	10/24/1994	Catalyst 3000 Stackable LAN switches
1994	LightStream	12/8/1994	Campus ATM switches
1995	Combinet, Inc.	8/10/1995	Cisco 700, 800 ISDN Access routers
1995	Internet Junction	9/6/1995	Internet/Extranet Enterprise Solutions
1995	Grand Junction Networks	9/27/1995	Catalyst 2900, 1900/2820 LAN Switching Solutions
1995	Network Translation	10/27/1995	PIX Firewall, Web Cache Engine
1996	TGV Software, Inc.	1/23/1996	Security Products
1996	Stratacom, Inc.	4/22/1996	ATM and Frame Relay WAN Switches
1996	Telebit's MICA Tech	7/22/1996	AS5200 Universal Access Servers
1996	Nashoba Networks	8/6/1996	Token Ring LAN Switches
1996	Granite Systems	9/3/1996	Gigabit Ethernet Switches
1996	Netsys Technologies	10/14/1996	Service-Level Management Suite
1996	Metaplex, Inc.	Dec-96	Enterprise SNA Solutions
1997	Telesend	3/26/1997	Cisco 90i IDSL Channel Unit
1997	SkyStone Systems	6/9/1997	SONET/SDH Technologies
1997	Global Internet Software Group	6/24/1997	Windows NT Firewall Solutions
1997	Ardent Communications	6/24/1997	3800 Multiservice Access Platform
1997	Dagaz	7/28/1997	6200 Series DSL Access Multiplexers
1997	LightSpeed International	12/22/1997	Signalling Controller CS2200
1998	WheelGroup Corp.	2/18/1998	NetSonar, NetRanger intrusion detection and security
1998	Net Speed	3/11/1998	605 ADSL Modem, 675 SOHO/Telecommuter
1998	Precept Software	3/11/1998	IPTV client/server application
1998	CLASS Data Systems	5/4/1998	Policy-based Networking Solutions
1998	Summa Four	7/28/1998	Programmable Telephony Switches
1998	American Internet Corp.	8/21/1998	Cisco Network Registrar for IP address mgmt
1998	Clarity Wireless	9/15/1998	Last mile fixed-wireless technology
1998	Selsius Systems	10/14/1998	Network PBX for IP Telephony
1998	Pipelinks	12/2/1998	ISR Products for transporting circuit-switched and routing IP traffic
1999	Fibex Systems	4/8/1999	ATM-based Integrated Access DLC
1999	Sentient Networks	4/8/1999	ATM circuit emulation services gateway
1999	GeoTel Communications	4/13/1999	Network-based call routing for distributed call centers
1999	Amteva Technologies	4/28/1999	IP-based unified communications software
1999	TransMedia Communications	6/17/1999	Media Gateway Technology
1999	StratumOne Communications	6/29/1999	Semiconductor products for Optical interfaces
1999	Calista	8/18/1999	IP Telephony
1999	MaxComm Technologies	8/18/1999	DSL technology
1999	Monterey Networks	8/26/1999	Optical cross connects
1999	Cerent Corp.	8/26/1999	Next-gen SONET ADM
1999	Cocom A/S	9/15/1999	DVB/DAVIC technology for cable modem
1999	WebLine Communications	9/22/1999	Interlligent Contact management for e-commerce
1999	Tasmania Network Systems	10/26/1999	Content-aware network caching for Web Scaling
1999	Aironet Wireless Communications	11/9/1999	Wireless LAN
1999	V-Bits, Inc.	11/11/1999	Digital video processing systems
1999	Worldwide Data Systems	12/16/1999	Consulting and engineering services for converged networks
1999	Internet Engineering Group	12/17/1999	Software for optical internetworking
1999	Pirelli Optical Systems	12/20/1999	OC-192 DWDM equipment
2000	Compatible Systems	1/19/2000	Service provider VPN
2000	Altiga Networks	1/19/2000	Enterprise VPN
2000	Growth Netowrks	2/16/2000	Internet Switching Fabrics
2000	Atlantech Technologies	3/1/2000	Network Element Management Software
2000	JetCell	3/16/2000	In-building Wireless Telephony
2000	infoGear Technology	3/16/2000	Software to manage information appliances
2000	SightPath	3/29/2000	Content Delivery Optimizers
2000	PentaCom	4/11/2000	Metro IP transport networks
2000	Seagull Semiconductor	4/12/2000	High-speed silicon for terabit routers
2000	ArrowPoint Communications	5/5/2000	Content Networking Technology
2000	Qeyton Systems	5/12/2000	Metro DWDM technology
2000	HyNEX	6/5/2000	ATM and IP access complementing Cisco 3800

Source: Company data and Jefferies & Company, Inc.

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Appendix 1 (continued): Cisco Has Completed More Than 110 Acquisitions Since 1993

Year	Acquisitions	Announced	Market/Technology
2000	Netiverse	7/7/2000	Content aware switches
2000	Komodo Technology	7/25/2000	VoIP terminal adapters for analog phones
2000	NuSpeed Internet Systems	7/27/2000	IP-enable SAN technology using iSCSI
2000	IPmobile	8/1/2000	Software systems for 3G wireless networks
2000	PixStream	8/31/2000	Distribute and manage digital video
2000	IPCell Technologies	9/28/2000	Voice and dta integrated access services
2000	Vovida Networks	9/28/2000	VoIP terminal adapters for analog phones
2000	CAIS software solutions	10/20/2000	Broadband service management solutions
2000	Active Voice Coporation	11/10/2000	IP-basesd Unified Messaging solutions
2000	Radiata	11/13/2000	Wireless LAN
2000	ExiO Communications	12/14/2000	In-building wireless telephony networks
2001	AuroraNetics	7/11/2001	Silicon Technology for RFP networks
2001	Allegro Systems	7/27/2001	VPN for high-bandwidth networks
2002	Hammerhead Networks	5/1/2002	IP aggregation for broadband
2002	Navarro Networks	5/1/2002	High-end ASICs for Ethernet switching
2002	AYR Networks	7/25/2002	Cisco IOS enhacements
2002	Andiamo Systems	8/20/2002	Fibre channel SAN
2002	Psionic Software	10/22/2002	Intrusion detection systems
2003	Okena	1/24/2003	Host-based IDS
2003	SignalWorks	3/19/2003	Acoustic echo canceller for IP telephony
2003	Linksys Group	3/20/2003	Consumer/SOHO networking
2003	Latitude Communications	11/12/2003	Enterprise audio and web conferencing
2004	Twingo Systems	3/12/2004	SSL VPN
2004	Riverhead Networks	3/22/2004	DDoS Security products
2004	Procket Network	6/17/2004	Concurrent services routing
2004	Actona Technologies	6/29/2004	Wide area file services software
2004	Parc Technologies	7/8/2004	Traffic engineering solutions
2004	P-Cube	8/23/2004	IP service control platforms
2004	NetSolve	9/9/2004	IT infrastructure management services
2004	dynamicsoft	9/13/2004	SIP technology
2004	Perfigo	10/21/2004	Network admission control
2004	Jahi Networks	11/17/2004	Network management
2004	BCN Systems	12/9/2004	Network software architecture for routing
2004	Protego Networks	12/20/2004	Security Monitoring
2005	Airespace	1/12/2005	WLAN
2005	Topspin Communications	4/14/2005	Server Fabric Switching
2005	Sipura Technology	4/26/2005	Consumer VoIP
2005	Vihana	5/23/2005	ASICs
2005	FineGround Networks	5/26/2005	Application acceleration and security
2005	MI Secure Corporation	6/14/2005	Security
2005	NetSift	6/27/2005	Packet processing capabilities for security
2005	KiSS Technology	7/22/2005	Networked DVD players and recorders for home
2005	Sheer Networks	7/26/2005	Network management for complex networks
2005	Nemo Systems	9/30/2005	Network memory to enhance switching systems
2005	Scientific Atlanta	11/18/2005	End-to-end video distribution network
2005	Intellishield Alert Manager	11/29/2005	Security intelligence service
2005	Digital Fairway		VoIP
2006	SyPixx Networks	3/7/2006	Network-centric video surveillance
2006	Audium	6/8/2006	Automated voice response app development
2006	Metreos	6/8/2006	VoIP application development environment
2006	Meetinghouse Data Comm	7/6/2006	802.1x security software
2006	Arroyo Video Solutions	8/21/2006	On-demand video system for integration into IP-NGN

Source: Company data and Jefferies & Company, Inc.

Cisco Systems
Segment analysis
FYE June

US Millions ($), except EPS	1Q-05 Oct-04	2Q-05 Jan-05	3Q-05 Apr-05	4Q-05 Jul-05	1Q-06 Oct-05	2Q-06 Jan-06	3Q-06 Apr-06	4Q-06 Jul-06	1Q-07E Oct-06	2Q-07E Jan-07	3Q-07E Apr-07	4Q-07E Jul-07	FY2005	FY2006	FY2007E	FY2008E
Routers	1,251	1,329	1,443	1,475	1,417	1,420	1,519	1,649	1,600	1,616	1,696	1,849	5,498	6,005	6,760	7,892
Switches	2,559	2,386	2,385	2,620	2,643	2,665	2,691	2,834	2,834	2,891	2,948	3,037	9,950	10,833	11,710	12,738
Advanced Tech	1,018	1,214	1,189	1,213	1,258	1,277	1,688	2,005	2,085	2,169	2,255	2,346	4,634	6,228	8,855	10,359
Other	205	177	172	217	173	175	257	246	221	224	230	240	771	851	915	827
Services	938	956	998	1,056	1,059	1,091	1,167	1,250	1,250	1,275	1,342	1,400	3,948	4,567	5,267	5,899
Total Revenues*	**5,971**	**6,062**	**6,187**	**6,581**	**6,550**	**6,628**	**7,322**	**7,984**	**7,990**	**8,173**	**8,473**	**8,871**	**24,801**	**28,484**	**33,507**	**37,715**
* of which SFA contribution							407	582	570	605	617	639		989	2,430	
Q/Q Change																
Routers	-12%	6%	9%	2%	-4%	0%	7%	9%	-3%	1%	5%	9%				
Switches	6%	-7%	0%	10%	1%	1%	1%	5%	0%	2%	2%	3%				
Advanced Tech	6%	19%	-2%	2%	4%	2%	32%	19%	4%	4%	4%	4%				
Other	5%	-14%	-3%	26%	-20%	1%	47%	-4%	-10%	1%	3%	4%				
Services	2%	2%	4%	6%	0%	3%	7%	7%	0%	2%	5%	4%				
Y/Y Change																
Routers	-2%	-7%	13%	3%	13%	7%	5%	12%	13%	14%	12%	12%	2%	9%	13%	17%
Switches	26%	16%	2%	8%	3%	12%	13%	8%	7%	8%	10%	7%	13%	9%	8%	9%
Advanced Tech	32%	39%	29%	26%	24%	5%	42%	65%	66%	70%	34%	17%	31%	34%	42%	17%
Other	9%	-10%	-12%	11%	-16%	-1%	49%	13%	28%	28%	-10%	-3%	-1%	10%	8%	-10%
Services	12%	13%	12%	15%	13%	14%	17%	18%	18%	17%	15%	12%	13%	16%	15%	12%
% of total																
Routers	21%	22%	23%	22%	22%	21%	21%	21%	20%	20%	20%	21%	22%	21%	20%	21%
Switches	43%	39%	39%	40%	40%	40%	37%	35%	35%	35%	35%	34%	40%	38%	35%	34%
Advanced Tech	17%	20%	19%	18%	19%	19%	23%	25%	26%	27%	27%	26%	19%	22%	26%	27%
Other	3%	3%	3%	3%	3%	3%	4%	3%	3%	3%	3%	3%	16%	16%	16%	16%
Services	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	16%	3%	3%	3%	2%
Gross Margins																
Product GM	67.3%	67.3%	67.3%	68.4%	68.5%	68.2%	65.3%	65.1%	65.0%	65.0%	65.0%	65.0%	67.6%	66.6%	65.0%	64.8%
Service GM	67.0%	64.4%	64.4%	65.2%	66.5%	67.0%	67.9%	66.3%	66.0%	66.0%	66.0%	66.3%	65.2%	66.9%	66.1%	66.5%
Non-GAAP GM	67.2%	66.9%	66.8%	67.9%	68.1%	68.0%	65.7%	65.3%	65.2%	65.2%	65.2%	65.2%	67.2%	66.7%	65.2%	65.0%
Product COGS	1,646	1,669	1,697	1,746	1,732	1,763	2,136	2,347	2,359	2,414	2,496	2,615	6,758	7,978	9,884	11,207
Service COGS	310	340	355	367	355	360	375	421	425	434	456	472	1,372	1,511	1,787	1,976
Total COGS	**1,956**	**2,009**	**2,052**	**2,113**	**2,087**	**2,123**	**2,511**	**2,768**	**2,784**	**2,848**	**2,952**	**3,087**	**8,130**	**9,489**	**11,671**	**13,183**
Services deferred rev	2,885	3,097	3,322	3,618	3,471	3,765	3,938	4088								
Products deferred rev	1,376	1,550	1,494	1,424	1,323	1,335	1,550	1561								
Total Def. Revenues	4,261	4,647	4,816	5,042	4,794	5,100	5,488	5,649								
Changes in Deferred																
Services deferred rev	(162)	212	225	296	(147)	294	173	150								
Products deferred rev	(79)	174	(56)	(70)	(101)	12	215	11								
Total Def. Revenues	(241)	386	169	226	(248)	306	388	161								

Source: Jefferies & Company, Inc.

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Cisco Systems
Income Statement
FYE June

US Millions ($), except EPS	1Q-05 Oct-04	2Q-05 Jan-05	3Q-05 Apr-05	4Q-05 Jul-05	1Q-06 Oct-05	2Q-06 Jan-06	3Q-06 Apr-06	4Q-06 Jul-06	1Q-07E Oct-06	2Q-07E Jan-07	3Q-07E Apr-07	4Q-07E Jul-07	1Q-08E Oct-07	2Q-08E Jan-08	3Q-08E Apr-08	4Q-08E Jul-08	FY2005	FY2006	FY2007E	FY2008E
Revenues	5,971	6,062	6,187	6,581	6,550	6,628	7,322	7,984	7,990	8,173	8,473	8,871	8,978	9,204	9,572	9,961	24,801	28,484	33,507	37,715
Cost of Sales	1,956	2,009	2,052	2,113	2,087	2,123	2,511	2,768	2,784	2,848	2,952	3,087	3,144	3,216	3,344	3,480	8,130	9,489	11,671	13,183
Gross Profits	4,015	4,053	4,135	4,468	4,463	4,505	4,811	5,216	5,206	5,325	5,521	5,784	5,834	5,989	6,228	6,481	16,671	18,995	21,836	24,532
Research & Development	787	785	790	858	859	850	925	979	999	1,022	1,059	1,109	1,122	1,132	1,177	1,215	3,220	3,613	4,188	4,647
Sales and Marketing	1,102	1,132	1,180	1,257	1,320	1,319	1,431	1,509	1,598	1,610	1,644	1,668	1,706	1,749	1,809	1,873	4,671	5,579	6,520	7,136
General and Admin	225	222	237	250	242	255	268	284	287	290	295	300	305	310	315	320	934	1,049	1,172	1,250
Total Operating Expenses	2,114	2,139	2,207	2,365	2,421	2,424	2,624	2,772	2,884	2,922	2,998	3,077	3,133	3,191	3,301	3,408	8,825	10,241	11,880	13,033
Operating Income	**1,901**	**1,914**	**1,928**	**2,103**	**2,042**	**2,081**	**2,187**	**2,444**	**2,322**	**2,404**	**2,523**	**2,708**	**2,701**	**2,798**	**2,927**	**3,073**	**7,846**	**8,754**	**9,956**	**11,499**
Other Income	117	144	150	156	137	185	159	156	150	155	160	160	160	160	160	160	567	637	625	640
Pretax Income	**2,018**	**2,058**	**2,078**	**2,259**	**2,179**	**2,266**	**2,346**	**2,600**	**2,472**	**2,559**	**2,683**	**2,868**	**2,861**	**2,958**	**3,087**	**3,233**	**8,413**	**9,391**	**10,581**	**12,139**
Income Tax Expense	565	576	582	633	610	634	533	728	643	665	698	746	744	769	803	841	2,356	2,505	2,751	3,156
Net Income	**1,453**	**1,482**	**1,496**	**1,626**	**1,569**	**1,632**	**1,813**	**1,872**	**1,829**	**1,893**	**1,985**	**2,122**	**2,117**	**2,189**	**2,284**	**2,393**	6,057	6,886	7,830	8,983
Goodwill, IPRD, def stock expense	112	98	107	101	101	86	265	237									418	689	0	0
Stock option expense	1	3	3	5	319	264	269	213	280	250	250	250	280	250	250	250	12	1,065	1,030	1,030
Other Charges								4									0	4	0	0
Net (Gains) on Investments	(53)																(53)	0	0	0
Change in Tax Liability	(3)	(19)	(19)	(20)	(112)	(93)	(121)	(126)	(73)	(65)	(65)	(65)	(73)	(65)	(65)	(65)	(61)	-452	-268	-268
Net Income w/ Non-Op	1,396	1,400	1,405	1,540	1,261	1,375	1,400	1,544	1,622	1,708	1,800	1,937	1,910	2,004	2,099	2,208	5,741	5,580	7,068	8,220
EPS, Reported	$0.21	$0.21	$0.21	$0.24	$0.20	$0.22	$0.22	$0.25	$0.26	$0.28	$0.30	$0.32	$0.32	$0.33	$0.35	$0.37	$0.87	$0.89	$1.16	$1.37
Pro-forma EPS	**$0.21**	**$0.22**	**$0.23**	**$0.25**	**$0.25**	**$0.26**	**$0.29**	**$0.30**	**$0.30**	**$0.31**	**$0.33**	**$0.35**	**$0.35**	**$0.36**	**$0.38**	**$0.40**	**$0.92**	**$1.10**	**$1.28**	**$1.50**
Basic Shares (in Mns)	6,635	6,521	6,435	6,366	6,245	6,146	6,160	6,081	6,051	6,021	5,991	5,961	5,931	5,901	5,871	5,841	6,489	6,158	6,006	5,886
Diluted Shares (in Mns)	6,773	6,652	6,541	6,480	6,340	6,233	6,291	6,181	6,151	6,121	6,091	6,061	6,031	6,001	5,971	5,941	6,612	6,261	6,106	5,986
# of shares repurchased	(156)	(140)	(114)	(130)	(194)	(42)	(60)	(139)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(540)	(435)	(200)	(200)
Avg share price of repurchase	$19.24	$19.30	$17.91	$19.14	$18.03	$17.81	$20.34	$20.35									$18.95	$19.07		
Share buyback in $ mns	($3,001)	($2,702)	($2,042)	($2,488)	($3,498)	($748)	($1,220)	($2,829)									($10,233)	($8,295)	$0	$0
Amount remaining	$15,129	$12,427	$10,385	$7,897	$4,399	$3,651	$2,431	$4,602												
% of revenue																				
Gross Margin	**67.2%**	**66.9%**	**66.8%**	**67.9%**	**68.1%**	**68.0%**	**65.7%**	**65.3%**	**65.2%**	**65.2%**	**65.2%**	**65.2%**	**65.0%**	**65.1%**	**65.1%**	**65.1%**	**67.2%**	**66.7%**	**65.2%**	**65.0%**
Research & Development	13.2%	12.9%	12.8%	13.0%	13.1%	12.8%	12.6%	12.3%	12.5%	12.5%	12.5%	12.5%	12.5%	12.3%	12.3%	12.2%	13.0%	12.7%	12.5%	12.3%
Sales and Marketing	18.5%	18.7%	19.1%	19.1%	20.2%	19.9%	19.5%	18.9%	20.0%	19.7%	19.4%	18.8%	19.0%	19.0%	18.9%	18.8%	18.8%	19.6%	19.5%	18.9%
General and Admin	3.8%	3.7%	3.8%	3.8%	3.7%	3.8%	3.7%	3.6%	3.6%	3.5%	3.5%	3.4%	3.4%	3.4%	3.3%	3.2%	3.8%	3.7%	3.5%	3.3%
Operating Expenses	35.4%	35.3%	35.7%	35.9%	37.0%	36.6%	35.8%	34.7%	36.1%	35.7%	35.4%	34.7%	34.9%	34.7%	34.5%	34.2%	35.6%	36.0%	35.5%	34.6%
Operating Margin	**31.8%**	**31.6%**	**31.2%**	**32.0%**	**31.2%**	**31.4%**	**29.9%**	**30.6%**	**29.1%**	**29.4%**	**29.8%**	**30.5%**	**30.1%**	**30.4%**	**30.6%**	**30.9%**	**31.6%**	**30.7%**	**29.7%**	**30.5%**
Taxes	28.0%	28.0%	28.0%	28.0%	28.0%	28.0%	22.7%	28.0%	26.0%	26.0%	26.0%	26.0%	26.0%	26.0%	26.0%	26.0%	28.0%	26.7%	26.0%	26.0%
Net Margin	24.3%	24.4%	24.2%	24.7%	24.0%	24.6%	24.8%	23.4%	22.9%	23.2%	23.4%	23.9%	23.6%	23.8%	23.9%	24.0%	24.4%	24.2%	23.4%	23.8%
Q-to-Q Growth																				
Revenues	1%	2%	2%	6%	0%	1%	10%	9%	0%	2%	4%	5%	1%	3%	4%	4%				
Operating Expenses	-1%	1%	3%	7%	2%	0%	8%	6%	4%	1%	3%	3%	2%	2%	3%	3%				
Operating Income	-1%	1%	1%	9%	-3%	2%	5%	12%	-5%	4%	5%	7%	0%	4%	5%	5%				
Net Income	-2%	2%	1%	9%	-4%	4%	11%	3%	-2%	3%	5%	7%	0%	3%	4%	5%				
Year-to-Year Growth																				
Revenues	17%	12%	10%	11%	10%	9%	18%	21%	22%	23%	16%	11%	12%	13%	13%	12%	13%	15%	18%	13%
Operating Income	26%	16%	12%	9%	7%	9%	13%	16%	14%	16%	15%	11%	16%	16%	16%	14%	15%	12%	14%	15%
Net Income	-2%	2%	1%	9%	-4%	4%	11%	3%	-2%	3%	5%	7%	0%	3%	4%	5%	13%	14%	14%	15%

Source: Jefferies & Company, Inc.

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Cisco Systems
Balance Sheet
Fiscal Year Ends in july

(in millions $ except per share values)	1Q-05 Oct-04	2Q-05 Jan-05	3Q-05 Apr-05	4Q-05 Jul-05	1Q-06 Oct-05	2Q-06 Jan-06	3Q-06 Apr-06	4Q-06 Jul-06	1Q-07E Oct-06	2Q-07E Jan-07	3Q-07E Apr-07	4Q-07E Jul-07	4Q-08E Jul-08
Assets:													
Cash & Equivalents	3,309	2,473	2,641	4,742	1,704	5,151	4,237	3,297	4,442	5,375	6,298	7,263	11,418
Short Term Investments	3,489	3,291	2,397	2,227	11,786	9,838	13,946	14,517	14,517	14,517	14,517	14,517	14,517
Accounts receivable	1,792	2,278	2,241	2,216	2,342	2,537	2,980	3,303	3,152	3,225	3,343	3,500	3,930
Inventories	1,210	1,255	1,280	1,297	1,318	1,345	1,313	1,371	1,392	1,424	1,476	1,543	1,740
Deferred Tax Assets	1,798	1,881	1,537	1,582	1,410	1,476	1,484	1,604	1,604	1,604	1,604	1,604	1,604
Other Current Assets	878	792	867	967	1,193	1,264	1,527	1,584	1,584	1,584	1,584	1,584	1,584
Total Current Assets	**12,476**	**11,970**	**10,963**	**13,031**	**19,753**	**21,611**	**25,487**	**25,676**	**26,692**	**27,729**	**28,821**	**30,011**	**34,792**
Long Term Investments	10,929	10,761	11,111	9,086	-	-	-	-	-	-	-	-	-
Restricted Investments	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Properties, Equipment	3,279	3,302	3,298	3,320	3,335	3,316	3,479	3,440	3,193	2,946	2,699	2,452	1,464
Goodwill and Purchased Intangibles	4,934	5,070	5,522	5,844	5,960	5,932	11,542	11,388	11,388	11,388	11,388	11,388	11,388
Other Assets	2,695	2,722	3,076	2,602	2,707	2,793	2,574	2,811	2,811	2,811	2,811	2,811	2,811
Total Assets	**34,313**	**33,825**	**33,970**	**33,883**	**31,755**	**33,652**	**43,082**	**43,315**	**44,084**	**44,874**	**45,719**	**46,662**	**50,455**
Liabilities & S/H Equity:													
Current Liabilities													
Accounts Payable	680	673	706	735	721	684	837	880	915	936	971	1,015	1,144
Other accrued liabilities	4,655	4,742	4,681	4,922	4,799	4,900	5,293	6,025	6,025	6,025	6,025	6,025	6,025
Deferred revenue	3,291	3,657	3,800	3,854	3,716	3,937	4,300	4,408	4,408	4,408	4,408	4,408	4,408
Total Current Liabilities	**8,626**	**9,072**	**9,187**	**9,511**	**9,236**	**9,521**	**10,430**	**11,313**	**11,348**	**11,369**	**11,404**	**11,448**	**11,577**
Deferred revenue	970	990	1,016	1,188	1,078	1,163	1,188	1,241	1,241	1,241	1,241	1,241	1,241
Long-term Debt	-	-	-	-	-	-	6,346	6,332	6,332	6,332	6,332	6,332	6,332
Other LT Liabilities	-	-	-	-	-	-	495	511	511	511	511	511	511
Total Liabilities	9,596	10,062	10,203	10,699	10,314	10,684	18,459	19,397	19,432	19,453	19,488	19,532	19,661
Minority Interest	128	12	11	10	4	4	8	6	6	6	6	6	6
Shareholder's Equity	24,589	23,751	23,756	23,174	21,437	22,964	24,615	23,912	24,645	25,415	26,226	27,124	30,788
Total Liabilities & S/H Equity	**34,313**	**33,825**	**33,970**	**33,883**	**31,755**	**33,652**	**43,082**	**43,315**	**44,084**	**44,874**	**45,719**	**46,662**	**50,455**
Balance Sheet Ratios													
Cash per share (Cash + ST Investments	$1.00	$0.87	$0.77	$1.08	$2.13	$2.40	$2.89	$2.88	$3.08	$3.25	$3.42	$3.59	$4.37
Net cash	17,727	16,525	16,149	16,055	13,490	14,989	11,837	11,482	12,627	13,560	14,483	15,448	19,603
Net cash per share	$2.62	$2.48	$2.47	$2.48	$2.13	$2.40	$1.88	$1.86	$2.05	$2.22	$2.38	$2.55	$3.30
Book value per share	$3.63	$3.57	$3.63	$3.58	$3.38	$3.68	$3.91	$3.87	$4.01	$4.15	$4.31	$4.48	$5.18
Working Capital	3,850	2,898	1,776	3,520	10,517	12,090	15,057	14,363	15,343	16,360	17,418	18,563	23,215
Current Ratio	1.45	1.32	1.19	1.37	2.14	2.27	2.44	2.27	2.35	2.44	2.53	2.62	3.01
Quick Ratio	1.31	1.18	1.05	1.23	2.00	2.13	2.32	2.15	2.23	2.31	2.40	2.49	2.86
Sales to Total Assets	16.3%	17.1%	17.4%	17.9%	19.4%	18.8%	15.4%	15.9%	16.2%	16.5%	16.6%	16.8%	17.8%
Debt to Capitalization	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	12.7%	12.6%	12.4%	12.2%	12.0%	11.8%	11.1%
Return on Assets*	16.3%	17.1%	17.4%	17.9%	19.4%	18.8%	15.4%	15.9%	16.2%	16.5%	16.6%	16.8%	17.8%
Return on Sales*	24.5%	24.5%	24.5%	24.4%	24.3%	24.4%	24.5%	24.2%	23.9%	23.5%	23.2%	23.4%	23.8%
Return on Equity*	21.6%	23.1%	24.1%	25.4%	26.8%	27.7%	28.8%	29.6%	29.7%	30.1%	30.3%	30.3%	30.6%
A/R Days Sales Outstanding	27	34	33	30	32	34	37	37	36	36	36	36	36
Inventory Turns	6.5	6.4	6.4	6.5	6.3	6.3	7.6	8.1	8.0	8.0	8.0	8.0	8.0
Days of Inventory	56	56	56	55	57	57	47	45	45	45	45	45	45
A/P Days Outstanding	31	30	31	31	31	29	30	29	30	30	30	30	30
Working Capital (no cash)	541	425	(865)	(1,222)	8,813	6,939	10,820	11,066	10,901	10,984	11,120	11,300	11,798
Change in working capital (sequential) : (	1,377	116	1,290	357	(10,035)	1,874	(3,881)	(246)	165	(83)	(136)	(180)	(177)
Change in working capital (YoY)	1,613	2,231	2,715	3,140	(8,272)	(6,514)	(11,685)	(12,288)	(2,088)	(4,045)	(300)	(234)	(497)

* average over four quarters

Source: Jefferies & Company, Inc.

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Cisco Systems
Cash Flow Statement
Fiscal Year Ends in July

US millions $	1Q-05 Oct-04	2Q-05 Jan-05	3Q-05 Apr-05	4Q-05 Jul-05	1Q-06 Oct-05	2Q-06 Jan-06	3Q-06 Apr-06	4Q-06 Jul-06	1Q-07E Oct-06	2Q-07E Jan-07	3Q-07E Apr-07	4Q-07E Jul-07	FY2005	FY2006E	FY2007E
Cash flows from operating activities:															
Net income (loss)	1,396	1,400	1,405	1,540	1,261	1,375	1,400	1,544	1,622	1,708	1,800	1,937	5,741	5,580	7,068
Cumulative effect of acctg change, net	-	-	-	-	-	-	-						0	0	0
Depreciation and amortization	291	296	164	258	258	254	344	437	437	437	437	437	1,009	1,293	1,748
Stock-based comp related to employees	-	-	-	-	317	261	261	211	211	211	211	211	0	1,050	844
Stock-based comp related to acquisitions & investments	-	-	126	39	28	24	23	12					165	87	0
Provision for doubtful accounts	-	-	3	(3)	11	(1)	12	2					0	24	0
Provision for (benefit from) inventory	62	49	50	60	47	23	55	37					221	162	0
Deferred income taxes	74	(115)	257	(161)	125	(124)	(80)	(264)					55	(343)	0
Tax benefits from employee stock option plans	48	78	70	(161)	-	-	-	-					35	0	0
Excess tax benefits from stock-based comp	-	-	-	-	(40)	(85)	(260)	(47)					0	(432)	0
In-process research and development	12	2	6	6	2	-	88	1					26	91	0
Net (gains) losses on investments and provision for losse:	(44)	(30)	(9)	(12)	11	(32)	(53)	(50)					(95)	(124)	0
Other	-	-	-	-	-	-	31	-					0	31	0
Change in operating assets and liabilities:													0	0	0
Accounts receivable	37	(483)	39	34	(135)	(194)	(259)	(325)	151	(72)	(118)	(157)	(373)	(913)	(197)
Inventories	(63)	(94)	(72)	(76)	(65)	(50)	169	(95)	(21)	(32)	(52)	(67)	(305)	(41)	(172)
Prepaid expenses and other current assets	(10)	83	(49)	(82)	(41)	(6)	(181)	(72)					(58)	(300)	0
Lease receivables, net	-	(60)	(63)	(40)	(26)	(34)	(38)	(73)					(163)	(171)	0
Accounts payable	16	(8)	33	21	(14)	(37)	(35)	43	35	21	34	44	62	(43)	135
Income taxes payable	188	236	(147)	670	4	59	210	470					947	743	0
Accrued compensation	(283)	31	39	59	(124)	27	162	85					(154)	150	0
Deferred revenue	(241)	387	169	226	(248)	307	355	161					541	575	0
Other accrued liabilities	28	(35)	(137)	58	31	98	111	240					(86)	480	0
Restructuring liabilities	-	-	-	-	-	-	-	-					0	0	0
Net cash provided by operating activities	$ 1,511	$ 1,737	$ 1,884	$ 2,436	$ 1,402	$ 1,865	$ 2,315	$ 2,317	$ 2,435	$ 2,273	$ 2,312	$ 2,405	7,568	7,899	9,426
Cash flows from investing activities:															
Purchases of short-term investments	(1,735)	(1,090)	(950)	(1,708)	(7,973)	(2,494)	(6,687)	(4,578)					(5,483)	(21,732)	0
Proceeds from sales and maturities of short-term investm	3,535	1,943	2,448	2,539	7,335	4,551	2,653	3,941					10,465	18,480	0
Purchases of investments	(3,437)	(4,104)	(3,772)	(3,518)	-	-	-	-					(14,831)	0	0
Proceeds from sales and maturities of investments	3,002	3,477	2,742	4,944	-	-	-	-					14,165	0	0
Purchases of restricted investments	-	-	-	-	-	-	-	-					0	0	0
Proceeds from sales and maturities of restricted investme	-	-	-	-	-	-	-	-					0	0	0
Acquisition of property and equipment	(159)	(131)	(180)	(222)	(215)	(179)	(201)	(177)	(190)	(190)	(190)	(190)	(692)	(772)	(760)
Acquisition of businesses, net of cash and cash equivaler	(229)	(324)	(58)	(300)	(122)	(28)	(5,197)	(52)					(911)	(5,399)	0
Change in lease receivables, net	(52)	52	-	-	-	-	-	-					0	0	0
Purchases of investments in privately held companies	(48)	(62)	(50)	(11)	(18)	(72)	(68)	(28)					(171)	(186)	0
Lease deposits	-	-	-	-	-	-	-	-					0	0	0
Purchase of minority interest of Cisco Systems, K.K. (Jap	-	-	(9)	(25)	(25)	-	-	-					(34)	(25)	0
Other	70	23	(1)	14	(105)	21	53	21					106	(10)	0
Net cash used in investing activities	947	(216)	170	1,713	(1,123)	1,799	(9,447)	(873)	(190)	(190)	(190)	(190)	2,614	(9,644)	(760)
Cash flows from financing activities:															
Issuance of common stock	96	337	159	495	136	427	719	400					1,087	1,682	0
Repurchase of common stock	(3,001)	(2,705)	(2,037)	(2,492)	(3,500)	(748)	(1,230)	(2,817)	(1,100)	(1,150)	(1,200)	(1,250)	(10,235)	(8,295)	(4,700)
Issuance of debt	-	-	-	-	-	-	6,481	-					0	6,481	0
Other	34	11	(8)	(51)	47	104	248	33					(14)	432	0
Net cash used in financing activities	(2,871)	(2,357)	(1,886)	(2,048)	(3,317)	(217)	6,218	(2,384)	(1,100)	(1,150)	(1,200)	(1,250)	(9,162)	300	(4,700)
Net increase (decrease) in cash and cash equivalents	**(413)**	**(836)**	**168**	**2,101**	**(3,038)**	**3,447**	**(914)**	**(940)**	**1,145**	**933**	**922**	**965**	**1,020**	**(1,445)**	**3,966**
Cash and cash equivalents, beginning of period	3,722	3,309	2,473	2,641	4,742	1,704	5,151	4,237	3,297	4,442	5,375	6,298	3,722	4,742	3,297
Cash and cash equivalents, end of period	3,309	2,473	2,641	4,742	1,704	5,151	4,237	3,297	4,442	5,375	6,298	7,263	4,742	3,297	7,262

Source: Jefferies & Company, Inc.

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Company Description

Cisco Systems, Inc. is the dominant supplier of data networking equipment to enterprise, carrier and government customers. Cisco provides products for transporting and routing data, voice and video within buildings, across campuses and around the world. The company has benefited from the growth in data and Internet traffic as well as from the overall shift in communications technology from circuits to packets. While Cisco has historically held the dominant share of the enterprise data networking market, the company has been expanding its efforts into the service provider market with notable acquisitions of Cerent and Scientific Atlanta as well as into the consumer market with with notable acquisition of Linksys. Acquisition remains an important element of company's growth strategy; Cisco has acquired over 110 companies over the last 13 years.

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I, Bill Choi, CFA, certify that all of the views expressed in this research report accurately reflect my personal views about the subject security(ies) and subject company(ies). I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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Jefferies makes a market in Cisco Systems, Inc.

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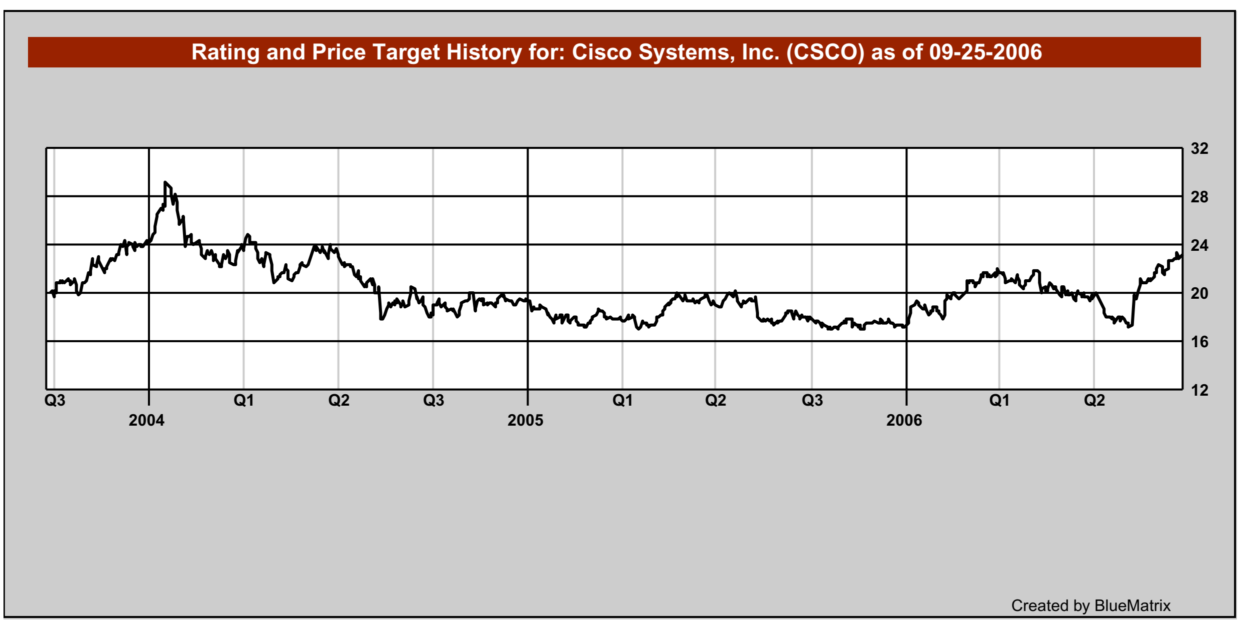

Distribution of Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos. Count	IB Serv./Past 12 Mos. Percent
BUY [BUY/SB]	457	52.71	75	16.41
HOLD [HOLD]	382	44.06	38	9.95
SELL [UNPF/SU]	28	3.23	4	14.29

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