

DELTA OUTCOMES GLOBAL LEADERS / INVESTMENT STORY

Why We Own Cisco: Making AI Networks More Efficient

Inside World Wide Technology's Advanced Technology Center, as many as 200 paid customer engagements can be running at once. Increasingly, they involve artificial intelligence. The practical constraint is not only computing power. It is whether the network can move enormous flows of data reliably without consuming the electricity and cooling capacity the processors need.

That is where Cisco fits. The company is best known for the equipment that connects organisations, but the investment case is broader. Cisco combines networking silicon, switches, optics, security, observability and support. As AI moves from experiments into everyday operations, the network becomes part of the critical infrastructure. It must be fast, secure, available and increasingly efficient.

Where Cisco fits

Cisco sits primarily within Delta's Climate Action theme because more efficient networking can reduce the equipment and electricity required for each unit of data moved. The overlap matters: secure digital access also supports Human Advancement, while longer-lived, repairable and recyclable hardware supports Nature Innovation. We retain one primary classification to keep the portfolio understandable.

The problem is becoming physical

AI is often described as software, but its growth depends on very physical systems: data centres, electricity networks, cooling equipment and high-capacity connections. The International Energy Agency expects global data-centre electricity use to rise from about 485 terawatt-hours in 2025 to roughly 950 terawatt-hours in 2030. Electricity use from AI-focused data centres is expected to more than triple.

The answer is not to stop useful computing. It is to get more useful work from every unit of equipment, electricity and water, while being honest that efficiency alone will not prevent total demand from rising.

Networks matter because every AI task moves data: between processors, storage systems, data centres and users. A slow or unreliable network leaves expensive processors idle. An inefficient network consumes power and cooling capacity that could have supported more useful computing. In other words, better networking can improve both the economics and the resource intensity of AI infrastructure.

Cisco's advantage is the whole system

Cisco does not depend on one product. Its Silicon One chips, switches and optics move data. Its security products protect users and infrastructure. Its observability tools help customers

see what is failing or slowing down. Its global support organisation helps large companies run systems that cannot simply be switched off.

This breadth is useful because customers do not experience infrastructure as a collection of isolated components. They experience whether the system works. A supplier that can connect performance, security, visibility and support may reduce integration risk and shorten the time needed to deploy new capacity.

There are signs that the underlying technology is becoming more efficient. Cisco says its 400G optics can use up to 70% less power than multiple 10G optics delivering similar bandwidth, while newer power supplies can exceed 95% efficiency. In February, Cisco said its new Silicon One G300 systems and optics could improve efficiency by nearly 70% in the relevant system design.

These are company-reported product claims, not proof of lower emissions across a customer's whole data centre. Even so, they point to the right engineering problem: moving more data with less equipment and energy per unit of work.

The commercial evidence has strengthened

Cisco's full-year 2026 results showed how quickly this market is moving. Revenue rose 12% to \$63.3 billion and non-GAAP earnings per share reached \$4.33. AI-infrastructure orders totalled \$9.3 billion for the year, while the company delivered about \$4 billion of AI-infrastructure revenue. It expects that revenue to reach \$7.5 billion in the 2027 financial year.

Product orders rose 35% in the final quarter and networking orders rose 40% - the eighth consecutive quarter of double-digit growth. This is the earnings mechanism in plain English: customers need more network capacity; Cisco sells the chips, systems and software that provide it; and security, observability, service and support can deepen the relationship over time.

The figures also contain a warning. Non-GAAP gross margin fell to 66.3% in the fourth quarter from 68.4% a year earlier, as a richer mix of AI-related hardware and higher memory input costs weighed on margins. Strong demand can still produce a less attractive mix when hardware, memory and supply-chain costs rise. Orders are not cash, market growth is not automatically profitable growth, and a forecast is not an accomplished result.

A financially strong business, not just a good story

A compelling theme only matters if the company behind it can fund it, year after year. Before getting swept up in the AI networking story, we ask a simpler question: is Cisco a genuinely well-run, profitable business? The recent record is mixed, and the honest answer is that the company has been working through a period of margin and return pressure tied to a large acquisition - but the direction has clearly turned, and independent analyst forecasts expect that turn to continue.

Profitability — the case ahead. Cisco's return on shareholders' equity - essentially, how much profit it generates for every dollar shareholders have invested - fell from around 28% in

fiscal 2024 to roughly 22% in fiscal 2026, as the \$28 billion acquisition of Splunk added debt and diluted returns on a larger capital base. Operating margins moved similarly, dipping to just over 22% in fiscal 2025 before recovering to 25.4% in fiscal 2026, with the most recent quarter's non-GAAP operating margin reaching 35.9%, up from 34.3% a year earlier. This is not a story we gloss over. It is, however, a story with a credible forward path: independent analyst forecasts expect Cisco's return on equity to recover to over 26% in fiscal 2027 and rise past 47% by 2031, as acquisition-related debt is paid down and operating margins move toward the mid-30s, helped by AI-related networking demand that requires minimal incremental cost to serve.

Earnings growth — re-accelerating. Diluted earnings per share fell 17% in fiscal 2024 and were roughly flat in fiscal 2025, before growth resumed sharply: fiscal 2026 diluted earnings per share grew 31%, and the most recent quarter alone delivered non-GAAP earnings-per-share growth of 23% year-on-year, beating consensus expectations. Management's own guidance for fiscal 2027 - revenue growth of around 15% and non-GAAP earnings growth of around 17% at the midpoint - was issued above prior Street estimates, and independent analyst forecasts point to further earnings growth of around 27% in fiscal 2027 and mid-teens growth in the years after, comfortably ahead of revenue growth - the signature of a business becoming more, not less, profitable as it scales.

Shareholder returns — a genuine strength, not a promise. Unlike profitability, Cisco's shareholder returns have not needed a forward-looking defence. Total shareholder return - share price growth plus dividends - compounded at roughly 14% a year over the five years to the end of 2025, despite a sharp 22% decline in 2022 during the broader technology sell-off, and that run has continued: shares delivered a further 48% total return in the year to date in 2026. Cisco has raised its dividend for 15 consecutive years and returned \$12.7 billion to shareholders in fiscal 2026 alone - 99% of free cash flow, comfortably above its own target of returning more than half of free cash flow - funded by a balance sheet that has converted more than 100% of net income into free cash flow over the past five years.

Together, this gives us a credible, evidenced path to the returns this thesis needs - one that is not yet proven in the fiscal 2024-2026 numbers on profitability, but is already visible in Cisco's cash generation and shareholder distributions, and is backed by a forward earnings and margin trajectory that independent analysts now expect to continue.

Leadership we can trust

Cisco's governance shows real strengths alongside areas we continue to watch. All directors stand for re-election every year, giving shareholders a regular say over who governs the company. There is only one class of common stock, with equal voting rights, so no shareholder carries outsized power over the rest. The audit, remuneration and nominating committees are each populated by a majority - and in most cases the entirety - of independent non-executive directors, keeping oversight of pay and financial reporting away from executive influence. The board has also refreshed itself meaningfully: around seven in ten directors have joined within the last five years, bringing a dynamic mix of relevant expertise in technology, cybersecurity and finance, while a smaller group of longer-serving directors preserves institutional memory. Executive pay is structured so that the large majority is performance-based and tied to multi-

year outcomes, consistent with the alignment we look for between management and shareholders.

Two structural points are areas we watch rather than settled strengths. The Chief Executive also chairs the board, a combination Cisco addresses through a Lead Independent Director rather than an independent chair; and overall board independence sits just below the two-thirds threshold we look for, at six of ten directors. The board does conduct an annual review of its own effectiveness, though the detailed findings are not yet made public - a level of disclosure we would welcome seeing extended over time. None of this outweighs the structural strengths above, but it is why we continue to monitor how the board oversees capital allocation as Cisco funds AI investment, further acquisitions, and shareholder returns side by side.

Taken together, this gives us reasonable confidence that Cisco's leadership is accountable to shareholders and is allocating capital with discipline, while leaving genuine questions about board independence and disclosure that we will keep testing over time.

What real-world evidence looks like

The strongest outcome evidence comes from customers, measured against a clear baseline. In a recent trial, Colt Technology Services reported that Cisco 800G coherent optics doubled the capacity of a network link and reduced power consumption by 33.3% compared with its previous 400G build. This is a useful, customer-reported result from a defined comparison. It is not a claim that Cisco reduces the electricity use of every network by one-third.

Cisco also reports that 100% of new products and packaging released in its 2025 financial year met its circular-design criteria, and that its own Scope 1 and 2 emissions were 89.7% below the 2019 base year. Those measures show operational progress and better design discipline. They do not measure the emissions avoided by customers, and they do not solve the rebound problem: when computing becomes cheaper and more efficient, organisations may use much more of it.

For Delta Outcomes, that distinction matters. We want companies whose products help customers use resources more intelligently. We also want evidence that is specific, bounded and repeatable. Product efficiency is part of an impact thesis; it is not impact by itself.

Why the holding still has to earn its place

Cisco has an installed base, long customer relationships, a large support network and an increasingly broad technology platform. Those advantages matter when infrastructure is mission-critical. They can also create complacency.

Competition is intense. Specialist chipmakers, cloud providers and lower-cost equipment vendors all want a larger part of the AI network. Some of Cisco's biggest potential customers can design their own systems. Customers may resist higher licence or support costs. Security failures could damage trust across the platform. Cisco's September IOS XR security release addressed multiple critical vulnerabilities across affected releases; Cisco said they were found internally and were not known to be actively exploited, but also said there were no

workarounds. Export restrictions, component shortages and geopolitical concentration can disrupt supply. Rapid hardware growth can weaken margins. Organisational restructuring can save money while also damaging the expertise and relationships that support customers.

Governance deserves scrutiny as well. Cisco combines the chair and chief-executive roles, with a lead independent director intended to provide a counterweight. Delta Outcomes must judge whether that oversight is strong enough, particularly as the company allocates capital across AI investment, acquisitions, shareholder returns and restructuring.

Value, decision, and tension

We own Cisco because three things are starting to line up: a durable, structural source of demand as AI networks turn efficient data movement into a hard engineering constraint; a business whose profitability and cash generation are inflecting upward after a period of acquisition-related pressure, with shareholder returns that have already been genuinely strong; and a board and management team that show real structural strengths, even as we continue to test the areas of governance we do not yet consider fully resolved.

We do not own it on the assumption that AI infrastructure spending is guaranteed to continue at its current pace, that margins will recover exactly as analysts model, or that governance gaps will close on our timetable. The central tension is that markets have already priced in much of this recovery: Cisco shares trade at a forward price/earnings multiple of around 20 times estimated fiscal 2027 earnings, falling only gradually toward 18 times by fiscal 2028 as earnings catch up - a valuation that already assumes AI-driven networking growth continues and that margins keep expanding broadly as guided. Sell-side price targets sit above the current share price, but the durability of AI infrastructure spending - the single biggest swing factor in the entire thesis - remains unproven, not assumed. Valuation discipline, not enthusiasm for AI, is what should govern position sizing.

What could break the chain

A number of things could weaken this thesis, and we watch for all of them:

- AI infrastructure orders have grown rapidly - \$9.3 billion in fiscal 2026, roughly 4.5 times the prior year - but orders from hyperscale customers can be lumpy, and a slowdown in AI infrastructure capital spending would remove the single largest driver of the forward earnings recovery described above.
- The \$28 billion Splunk acquisition remains a source of financial leverage, and further large deals - a stated part of Cisco's capital allocation priorities - would need to earn back what they cost rather than dilute the returns recovery already underway.
- The margin and return recovery modelled by independent analysts is a forecast, not a result: non-GAAP gross margin has already compressed as the mix shifts toward AI-related hardware, and further compression, or a weaker cycle in core campus and enterprise networking, would delay or blunt the improvement the thesis depends on.
- The combined Chair and Chief Executive role, and a board independence ratio just below two-thirds, mean that oversight rests more heavily on the Lead Independent

Director and committee structures than we would ideally prefer; any weakening of that counterweight would be a genuine governance concern, not a technicality.

- The efficiency case for Cisco's networking equipment can fail on its own terms even if the commercial case succeeds: the company's own product-efficiency claims are not independently verified end-to-end, and more efficient networks could simply enable more total computing and electricity use rather than reducing it - the rebound problem this story already flags.

The thesis would weaken materially if AI order growth failed to convert into revenue and cash as guided, if margins compressed further without a cyclical explanation, if a large acquisition destroyed rather than created value, or if governance oversight proved less robust than the structures above suggest. It would also weaken if the shares' current valuation - already reflecting much of the expected recovery - left no margin of safety for any of these risks to materialise together.

Our ownership test

Cisco is held in the Delta Outcomes Global Leaders portfolio. That fact does not remove the need for price discipline.

The investment case strengthens if Cisco converts AI orders into profitable revenue and free cash flow, maintains its position across networking, security and observability, sustains the margin and return recovery now underway, and produces customer evidence showing that higher capacity can be delivered with lower resource intensity per unit of work. It weakens if growth depends on a narrow group of buyers, margins remain under structural pressure rather than recovering as guided, customers lose trust, board oversight proves less robust than its structural strengths suggest, or efficiency claims fail to translate beyond controlled product comparisons.

This is why we own Cisco: not because every new data centre is automatically good, not because AI demand guarantees attractive returns, and not because a recovering set of financial metrics is the same as a proven one. We own it because better networks can make essential digital infrastructure more capable, secure and efficient; because the business behind that case is turning a period of acquisition-driven pressure into a credible, analyst-backed recovery in profitability, funded by genuinely strong cash generation and shareholder returns; and because its board, while not without governance questions we continue to test, shows real structural accountability to shareholders. Cisco must keep proving all three - impact, financial quality and governance - profitably, responsibly, and at a valuation that leaves room for disappointment.

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