The Cisco bid: To branch out while others retrench

April 5 2009, By RACHEL METZ , AP Technology Writer

(AP) -- On the surface, there doesn't seem to be much of a connection between the servers that run corporate data centers and a handheld video camera you use to film family vacations. Yet both have somehow become part of the master plan at Cisco Systems Inc.

After growing into one of Silicon Valley's most prominent companies by selling behind-the-scenes computing products, Cisco is now expanding aggressively, using its hefty financial resources to go on the attack while other companies are just trying to survive.

In recent weeks, Cisco said it will start selling servers, opening a new rivalry with longtime partners like Hewlett-Packard Co. and IBM Corp. Cisco also agreed to pay about $590 million in stock to pick up Pure Digital Technologies, which makes the popular Flip camcorders.

Cisco has not been spared by the recession. Its profit declined 27 percent in its last quarter, which ended in late January, and it reported flat earnings in the previous period. It is slashing more than $1 billion in expenses, partly by cutting back on travel and freezing hiring.

Yet it also has $29.5 billion in cash and investments, a solid reputation, a network of product resellers and thousands of sales employees - assets that the company hopes to exploit.

One challenge will be whether Cisco can maintain focus. By the company's own count, it has 28 overall priorities, running the gamut

from computer networks in space to "virtual health care."

Even if Cisco doesn't stumble, Cisco's rivals will try to use the breadth of its goals against it.

Mike Banic, vice president of marketing for the switches business at Juniper Networks Inc., a Cisco competitor, said it appears Cisco is focusing more on moving into adjacent markets and less on innovations in its core business.

"Based on what customers are telling us, we are seeing they're becoming a bit distracted," Banic said.

Even so, Banic said Juniper remains wary of Cisco. "We never underestimate them," he said.

Since its founding in 1984, San Jose-based Cisco has become the largest provider of the routers and switches that companies use to send data on the Internet and internal networks. This has been incredibly profitable, and briefly made Cisco the most valuable company in the world in 2000, when its market capitalization topped $500 billion. It hasn't come close to this peak since the tech bubble burst shortly thereafter, and today the company's market value is about $100 billion.

The end of dot-com mania erased almost a third of Cisco's business, as many customers simply went out of business. Back then, the vast majority of Cisco's business involved data-networking equipment.

In this downturn, Cisco is unlikely to find itself so exposed, according to Marthin De Beer, head of Cisco's emerging technologies group. The company has spent most of this decade diversifying into multiple aspects of computing and consumer electronics.

Between 2002 and 2008, Cisco bought 59 companies for more than $13.4 billion. Among the biggest forays, the company acquired Linksys, a maker of home Wi-Fi routers and other networking products, for $480 million in stock in 2003, and Scientific-Atlanta, which makes TV set-top boxes, for $7.1 billion in 2006. It grabbed online conference provider WebEx for $3 billion in 2007.

Cisco is seeking more ways to capture revenue from the data zipping across networks. Rather than just being in the middle, with its routers and switches, now Cisco wants to sell products at more places on the chain.

This accounts for the plan to sell servers, which is part of Cisco's larger strategy for "Unified Computing" - a combination of networking, data storage and "virtualization" technology that makes servers operate more efficiently.

This thinking also explains the deal for Pure Digital, the maker of the Flip cameras. Cisco wants a piece of the action as people make and share videos on social Web sites - "visual networking" in the words of Cisco's vice president of consumer marketing, Ken Wirt.

"There is a method to the madness here," said Brent Bracelin, an analyst with Pacific Crest Securities, who thinks both moves will drive network traffic and, ultimately, demand for Cisco's networking equipment.

Wirt said Cisco looks for times of disruption. One such instance, he said, is coming from the rise of devices that can connect to each other - to transfer photos or videos from your computer to your TV, for example - and to the Internet. Meanwhile, broadband adoption has soared in recent years, with 57 percent of American adults now having high-speed Internet access at home, according to the Pew Internet and American Life Project.

Cisco is trying to capitalize on this shift with new products it unveiled in January at the International Consumer Electronics Show, including a media hub that can synchronize, store and stream content from several computers and devices.

The current economy is not likely a boon to sales, but Wirt said Cisco is willing to spend the recession building its brand in the consumer market.

"The way we approach these downturns is to prepare for the upturn," Wirt said.

While Cisco's expansion has come largely through acquisitions, Cisco also is developing internal startups under De Beer's emerging-technologies group that began 2 1/2 years ago. One such product is the high-definition videoconferencing Cisco dubs "TelePresence."

Chief Financial Officer Frank Calderoni said Cisco is able to take on so much because of a collaborative management structure that began in 2001. Under this structure, Cisco forms a council around each of the company's priorities, but one leader gets some decision-making abilities.

One such group oversaw the rise of "StadiumVision" - Cisco's video and digital content technology for sporting venues. It began in 2007, when Cisco's CEO, John Chambers, was at a basketball game and saw kids text-messaging on their phones. Chambers decided that Cisco needed to take advantage of digital shifts in sports. He put four executives, including De Beer, in charge of building the company's sports and entertainment board. These executives gathered people and funds from their own departments, and within a year StadiumVision became a $100 million-plus business for Cisco.

Bracelin said he'll be looking closely for signs Cisco is losing focus. One indicator would be financial results that lag the performance of Cisco's

peers. But it will be hard to gauge how Cisco is doing for at least the next two quarters, because its core business is being hurt by the tough economy, he said.

Mark McKechnie, a Broadpoint AmTech analyst, sees another challenge for Cisco - the potential to spark conflict with its partners by moving onto their turf.

This could happen with Cisco's entrance into the server market, where it will compete against Hewlett-Packard and IBM. Those companies have long resold Cisco's networking equipment to go along with their servers and computers, but may not be as keen to do so now. HP is already pushing its own networking equipment to customers.

Jim Ganthier, vice president of marketing for enterprise servers and storage at HP, was dismissive of some of Cisco's plans. He said Cisco's Unified Computing idea is "promising a vision tomorrow that we're actually delivering today" through a set of products HP calls "Adaptive Infrastructure."

Ganthier cautioned Cisco to make sure it wants to be in servers for the long haul.

"This is not a market for the faint of heart," he said.