CEO SPOTLIGHT

John Chambers: The Once and Future King of Tech

On the state of technology, and Chambers' plan to put Cisco back on top.

By DYAN MACHAN
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John and Elaine Chambers were recently watching a movie in their living room when the show on their 152-inch screen was interrupted. A couple of Cisco engineers unwittingly popped onto the screen. They were tweaking one of his two Cisco Systems TelePresence video-conferencing systems off premises and hit a wrong button.

After 40 years of marriage, Elaine knows her husband's nonstop work ethic as well as anyone. She understands that he is in touch with CEOs and world leaders at all hours, and that on weekends he makes calls to Cisco employees of all ranks, lending support, she says, to those "whose family members are experiencing life-threatening illnesses."

Chambers had been angling for a third TelePresence system in their San Jose, Calif., home, this time in the bedroom. When the engineers popped onto their TV screen, Elaine made a decision: "You know, John, there is a limit."

Humbling experience: "Our P/E ratio went from 120 to 12 now. You can do the math in your head." *Photo: Martin Klimeck for Barron's*

Chambers' over-the-top work ethic is a part of his legend, as much as his high-speed talking and West Virginia twang. As his administrative assistant, Debbie Gross, says, "He's like a 2-year-old after sugar."

Chambers' exuberance helped build Cisco (ticker: CSCO) into a tech behemoth. When he became CEO in 1995, Cisco had revenue of $1.2 billion. Last year, sales hit $48.6 billion; profits are up nearly 20-fold, to $10 billion. But Cisco's enormous success during the dot-com boom is now something of an albatross around its neck with investors.

In 2000, Cisco was the most valuable company in the world, with a market value of over $500 billion. Then it ran headlong into the law of large numbers—a lesson today's investors in highflying Internet companies would do well to remember. Earnings, which had gone nowhere but up for a decade, turned negative in the fiscal year that ended in July 2001, and revenue fell for two years straight. How bad did it get? "Our P/E ratio went from 120 to 12 now," Chambers says. "You can do the math in your head."

At a recent price of $23—down from $77 at its peak—the stock has a market value of $120 billion. And in an admission that its high-growth days are behind it, Cisco initiated a cash dividend three years ago. The stock yields 3.3%.

The global leader in integrated hardware and software for computer networks—switches, routers, and the like—Cisco is facing a new challenge as computing moves out of data centers and into the cloud. New software-defined networks will allow enterprises to purchase hardware and software on an à la carte basis, lowering costs and increasing flexibility. And that could threaten Cisco's rich gross profit margins, which range as high as 70%.

Chambers, 64, professes to be unfazed. "The whole IT [information technology] industry is in a period of disruption," he says. "We see this as a chance to lead."

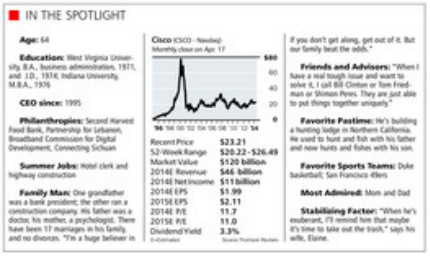
Besides, he says, he has been here before. On a warm spring afternoon at the company's 53-building headquarters complex in San Jose, he explains that software- defined networks are part of normal market transitions that occur every three to five years in technology. Citing the move from routing into switching, and the onset of video streaming and IP telephony, he notes that in the past Cisco initially lagged but eventually come out on top. "People said we couldn't spell telephony, and that might have been true," he says. "But we knew how to get 65% market share."

CHAMBERS KNOWS SOMETHING about coming from behind, having suffered from severe dyslexia as a child. Growing up in a prosperous household of doctors near Charleston, W.Va., he says he learned by example how to think long term. His father was an obstetrician who delivered 6,000 babies and later became an investor and real estate developer. "Dad taught me to see things coming five, 10, and 15 years ahead of time and to understand the business implications," he says.

His mother was a psychologist who "taught me emotional IQ." And a compassionate grade-school teacher taught him how to adapt, or at least to neutralize his learning disability, when others gave up. "My teachers didn't think I would go to college," he says.

Even today, he struggles with reading. "If you are dyslexic, you read from right to left," he says. His staff has learned to communicate with him via calls and texting, not e-mail. He gives speeches from colored graphics rather than a script.

Chambers met his wife, who attended a rival West Virginia high school, just after his graduation. She showed up, he recalls, when the first girl his friends had arranged for him to meet couldn't be found. He soon went off to West Virginia University, where he earned business and law degrees, and assumed that Elaine, who was a year behind him in school, would join him when she finished at Memphis State. But when she told him over the phone that she was taking a job in California, he spontaneously popped the question. If he hadn't, he says, "I could have lost her."



After adding an M.B.A. from Indiana University, Chambers accepted a job in 1976 selling mainframe computers at IBM (IBM) in Indianapolis. He was No. 1 in sales the first year, but became disillusioned with Big Blue, which was making its mini computers as complex as its mainframes. "You could get in trouble for saying what was wrong," Chambers says, "It was getting too far away from the customers."

From there, he went to the Lowell, Mass.-based computer firm Wang Laboratories to head up Asian sales in 1982. Though Wang was highflying when Chambers joined up, it became infamous for missing the move to desktop computing. "I learned about missing transitions when we went from 37,000 people to zero," he says.

Ultimately, Chambers spent too much of his time planning layoffs, and quit. "It was humbling," he says, but within three months, he had networked his way to seven job offers, one being from Cisco, which he joined in 1991 as head of sales, with the understanding that he would be the next CEO.

CHAMBERS FOCUSED THE company on customer satisfaction and getting various business units to work together. If Cisco wasn't ahead of the curve in a product or innovation, it was mostly masterful at acquiring what it needed. When it bought Crescendo Communications for $95 million in 1993, executives rolled their eyes at Chambers' insistence that its networking equipment would become a billion-dollar business. That business has revenue of more

than $10 billion today.

Less successful was the 2009 acquisition, for $590 million, of Flip Video, a concept that was undone by camera-equipped smartphones. Of the 163 acquisitions since he joined Cisco, Chambers says, "We occasionally miss one and get knocked on our butt, but we get right back up and execute pretty well."

Cisco's current challenge is from software-defined networks, which handle traffic at Internet data centers on inexpensive, so-called white-box servers. There is also a threat from upstart competitors, the most prominent of which is Arista Networks, headed by Jayshree Ullal, a 15-year Cisco veteran who had joined Cisco with the Crescendo acquisition.

Cisco has responded with what it calls Application Centric Infrastructure, separate software programs that sit above the switch itself and direct data like an omniscient traffic cop. "In effect, Cisco's pitch is, 'We've got a broader vision than just a better network. So if you just want a better network, go ahead and use SDN, and build it on our switches,'" says Jeff Kvaal, an analyst at Northland Securities in Minneapolis. "The advantage Cisco has is that no IT manager wants to throw away a switch. It's not done lightly."

Chambers promises to outsell Arista. "I give us very good odds we'll blow right pass Arista in the next four quarters," he says.

Arista's Ullal declined to comment, citing a quiet period in advance of the company's initial public offering. But last fall, she told *Barron's*, "Traditional networking software has too much unneeded bloat and lacks programmability." Arista's switches, by contrast, run Linux, which can be more easily programmed than a Cisco box ("Building the Cloud: Who Wins, Who Loses," Oct. 14, 2013).

ISI Group's Brian Marshall, who has met with Arista multiple times in recent years—and who has a Hold rating on Cisco shares—says, "at the end of the day, Cisco can be as aggressive as they want to be. They could even give away the product for free, but people are still going to buy Arista because it offers things Cisco doesn't offer."

Chambers has similarly challenged Hewlett-Packard (HPQ) in blade and rack servers. "We are the No. 2 player, and we will probably go past HP in blade servers in the next four to five quarters," Chambers says.

And last month, Cisco announced that it was entering cloud-computing services, a brash foray into a crowded space that has lately been rife with price-cutting. Competitors include Google (GOOGL), Amazon.com (AMZN), and Microsoft (MSFT). Cisco will spend more than $1 billion over two years to build a global network of cloud—the so-called intercloud—with a group of partners including Telstra (TLSYY), an Australian telecom-services provider, and Allstream, a Canadian wireless operator.

Cisco Cloud Systems reflects Chambers' ardent conviction that Cisco will be an instrumental player in the coming "Internet of Everything," now with its own acronym, IoE. It is predicted to dwarf the current Internet with billions of connected devices and, according to a Cisco study, generate $4.6 trillion in value for public-sector organizations over the next decade.

For example, at the World Economic Forum this year, Chambers predicted that humans will soon wear four to five devices for personal computing, GPS, and data collection on health, fitness, and injury prevention, among other things.

"It comes down to who gets the trends right," he says. "The trends are cloud, mobility, social, SDN, and software as a service, and Cisco's track record has been good on these trends. We're in the right spot, and we are trying not to mess it up."

WITH HIS RETIREMENT scheduled for late 2016, Chambers has an immodest goal: to push Cisco to the top spot in the IT world. Right now, it is No. 3 in revenue, behind IBM and Microsoft. But he thinks the field is wide open. "The whole IT industry is under a period of major disruption, and you see that in stocks," he says. "You see it where IBM, HP, Microsoft, Oracle [ORCL], and others are struggling. That's what gives us a chance to become the No. 1 IT

player."

Brash? Perhaps. But as his wife will attest with the home TelePresence systems, it's hard for John Chambers to see limits.

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