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August 26, 1999

Cisco to Acquire Cerent For \$6.9 Billion in Stock

Networking-Equipment Maker Also Sets Pact to Buy Monterey

By SCOTT THURM
Staff Reporter of THE WALL STREET JOURNAL

Cisco Systems Inc., in what is believed to be the highest price ever paid for a closely technology company, has agreed to acquire networking start-up Cerent Corp. for about \$6.9 billion in stock.

The purchase, Cisco's costliest to date, is the latest sign of the Internet's mind-boggling on corporate valuations. Cerent, a Petaluma, Calif., company making devices that route telephone calls and Internet traffic on and off fiber-optic lines, commanded the extra price even though it has posted only \$10 million in sales in 2 1/2 years in business and has never turned a profit.

"This is unbelievable, and unprecedented," said Greg Rossmann, a managing director of the technology investment banking firm Broadview International. "It is truly reflective of the expectations for how the Internet infrastructure is going to be forced to evolve to support the demands of e-commerce."

Vinod Khosla, Cerent's chairman and a prominent Silicon Valley venture capitalist, said the deal appears to be the largest ever involving a private technology concern. And for the investors who had put about \$85 million into the company, it is a huge payday.

Mr. Khosla's venture-capital firm, Kleiner Perkins Caufield & Byers, for example, invested about \$8 million for what is now a 30.8% stake with an indicated value of \$2.1 billion.

Acer and Cisco
Agreement to
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Company Profile
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shares. Carl Russo, Cerent's chief executive, owns a 5% stake valued at \$342 million had already held about 8.2% of Cerent through a \$13 million investment last fall. Other investors include computer magnate Michael Dell, who bought \$30 million of convertible just last month.

Cisco, San Jose, Calif. formally announced the acquisition Thursday, along with a deal for Monterey Networks Inc., a Richardson, Texas, networking concern, for about \$450 million of stock. Executives from Cisco and the target companies briefed employees Wednesday.

Quest to Become Leader

Speaking with Cerent employees, John Chambers, Cisco's chief executive, said his company is determined to be the leader in optical networking technology. "We don't think this can be done by one company without combining skills," he said.

Cisco began by making the routing devices that direct traffic on the Internet. Since then it has built a broad-line networking business by using the purchasing power of its lucrative services which created a market capitalization that stands at more than \$220 billion. Cisco's stock closed Wednesday at \$68.625, up \$2.25, on the Nasdaq Stock Market.

Cerent at a Glance

Figures are for the first six months of 1999:

Headquarters	Petaluma, Calif.
Founded	January 1997
Employees	210
Revenue	\$9.9 million
Net loss	\$29.3 million
Key investors	Cisco Systems, Kleiner Perkins Caufield & Byers, Michael Dell
Major customers	Qwest Communications, Frontier, Williams Communications, PSINet
Business	Produces routers designed to switch telephone calls and computer traffic on and off fiber-optic lines.

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The latest two purchases are Cisco's 39th and 40th acquisitions. Its deal for Cerent t \$4.6 billion it paid for StrataCom Inc. in 1996. But those companies could hardly be different.

StrataCom was a profitable, publicly traded company with annual sales of \$330 milli 1,000 employees. Cerent has just 266 employees and has accumulated \$60 million in its brief history. It had filed recently to go public in an initial offering expected to rais million.

Of course, Cisco is a lot bigger today than at the time of the StrataCom deal. Its fisca sales of \$12 billion are roughly three times 1996 levels, and its stock-market value h roughly eightfold.

Moreover, Cerent is widely perceived to have a head start in an exploding market. Its equipment serves as a bridge between long-haul communications lines and the local t and data network, helping to reduce congestion and allow phone companies to move types of data faster.

Attracting Customers

The company has attracted more than 100 customers since it began shipping product including [Frontier](#) Corp., Williams Communications Group Inc. and [Qwest Commu International](#) Inc. Those companies are attracted by Cerent's ability to handle both tel calls and computer traffic, while working seamlessly with existing telephone networ

Cisco executives explained that the Cerent deal was so expensive because the impend Cerent IPO required them to peg the valuation to the IPOs of other young networking companies whose stocks have soared since going public earlier this year. For examp [Networks](#) Inc., Mountain View, Calif., is valued at nearly \$11 billion and [Redback N](#) Inc., Sunnyvale, Calif., at nearly \$6 billion, less than three months after going publi

"The word was, this was going to be as big as Juniper," said Ammar Hanafi, Cisco' of business development.

Shares in these companies have soared, even as other Internet issues have sagged, be telecommunications firms are expected to spend hundreds of billions of dollars in co to rewire the globe to accommodate the explosion of computer traffic generated by th

Cisco hopes the acquisitions of Cerent and Monterey will boost sales to the telecom companies, the fastest-growing part of Cisco's business. Both Cerent and Monterey expertise in routing traffic very rapidly across fiber-optic lines, which are becoming t primary component of large communications networks but operate differently than th corporate networks at which Cisco is expert. Cerent's first product, for example, can 240 gigabits of data a second, the equivalent of 3.8 million phone calls or 160,000 h T-1 lines.

Initial Surprise

Mr. Chambers said he initially blanched when he heard the deal price but began to se in the amount. Though Cerent had less than \$10 million in revenue in the six months June 30, it is increasing product shipments so quickly that it is now on an annualized exceeding \$100 million, he said. Cisco expects revenue to swell to about \$300 millio year, making the purchase price about 23 times sales, a multiple in keeping with Cis financial structure, he said.

Mr. Chambers also compared Cerent with Crescendo Communications Inc., which had roughly \$10 million in annual sales when Cisco acquired it for \$92 million in 1993. Crescendo's products are at the core of a Cisco unit with annual sales of \$4.5 billion

But Mr. Rossmann of Broadview, which wasn't involved in the transaction, said the increase in Cerent's market value could remain controversial. "This is not a cure for cancer or a silver bullet; it is an evolutionary technology that appears to solve some telephone-carrier problems," he said. "The real question is how can a Cisco shareholder believe that this dramatic expenditure of equity is going to yield a return."

Cisco expects to close both acquisitions in its fiscal first quarter, ending in October. The deal will be accounted for as a pooling of interests.

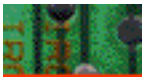
The Monterey deal will be accounted for as a purchase. Cisco said it expects to take a charge of approximately seven cents to 11 cents a share in the fiscal first quarter for purchased research-and-development costs connected to the Monterey acquisition. Cisco also has a minority stake in Monterey.

--Don Clark contributed to this article.



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