Feb 07, 2020

Cognizant Technology (CTSH)

$71.42 (As of 02/06/20)

Price Target (6-12 Months): **$75.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 07/01/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:B
	Value: B | Growth: B | Momentum: D	

Summary

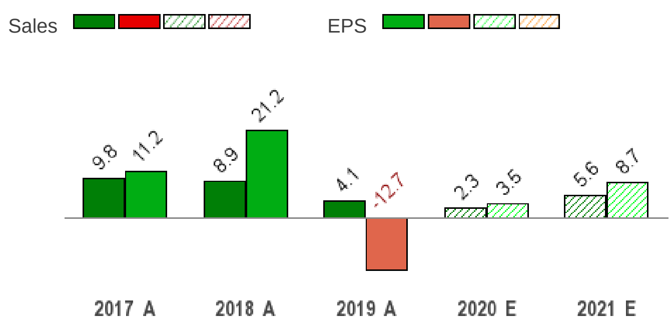
Cognizant's fourth-quarter 2019 results benefited from solid growth in digital revenues driven by strong demand for digital engineering solutions and services. Double-digit growth in Life Sciences and technology and continued momentum in Products and Resources segment drove the top line. Cognizant witnessed continued strength in cloud services, and increased demand for interactive, IoT and analytics solutions. The company's domain expertise and ability to harness the ongoing digital transition continued to drive growth. However, lackluster spending by large banks and ongoing stiff competition in the IT services market are concerns. Sluggishness in technology vertical is also expected to hurt the company's top-line growth in 2020. Notably, shares have underperformed the industry in the past year.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$74.85 - $56.73**
20 Day Average Volume (sh)	**3,218,087**
Market Cap	**$39.1 B**
YTD Price Change	**15.2%**
Beta	**1.06**
Dividend / Div Yld	**$0.80 / 1.1%**
Industry	**Business - Software Services**
Zacks Industry Rank	**Top 11% (28 out of 255)**
Last EPS Surprise	**2.9%**
Last Sales Surprise	**1.5%**
EPS F1 Est- 4 week change	**-0.6%**
Expected Report Date	**05/07/2020**
Earnings ESP	**0.3%**
P/E TTM	**17.9**
P/E F1	**17.3**
PEG F1	**1.7**
P/S TTM	**2.3**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	4,393 E	4,462 E	4,574 E	4,636 E	18,141 E
2020	4,182 E	4,235 E	4,339 E	4,343 E	17,173 E
2019	4,110 A	4,141 A	4,248 A	4,284 A	16,783 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$1.04 E	$1.08 E	$1.15 E	$1.17 E	$4.49 E
2020	$0.96 E	$0.99 E	$1.06 E	$1.07 E	$4.13 E
2019	$0.91 A	$0.94 A	$1.08 A	$1.07 A	$3.99 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/06/2020. The reports text is as of 02/07/2020.

Overview

Headquartered in Teaneck, NJ, Cognizant Technology Solutions Corporation is a leading professional services company. The company was spun off from Dun & Bradstreet in 1996 and went public in 1998.

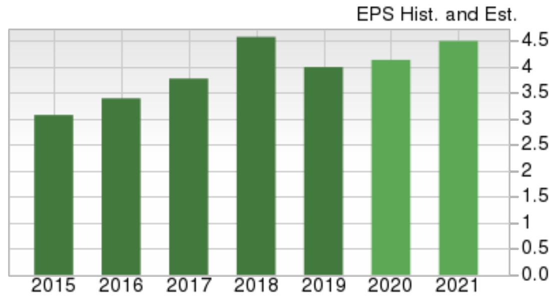
Cognizant's services include digital services and solutions, consulting, application development, systems integration, application testing, application maintenance, infrastructure services, and business process services.

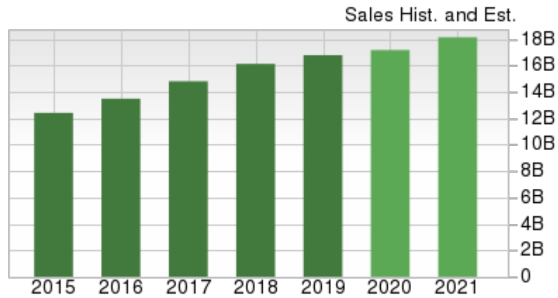
Cognizant reported revenues of $16.78 billion in 2019.

The company primarily serves four domains: Financial Services (Banking and Insurance), Healthcare (Healthcare and Life Sciences), Products & Resources (Manufacturing &Logistics, Retail & Consumer Goods, Travel & Hospitality and Energy & Utilities) and Communications, Media & Technology (Communications & Media and Technology).

In 2019, Financial Services accounted for 35% of revenues. Healthcare, Products &Resources, Communications, and Media & Technology accounted for 28%, 22.4% and 14.6% of revenues, respectively.

At the end of 2019, Cognizant had roughly 292,500 employees.





Cognizant faces significant competition from the likes of Accenture, Atos, Capgemini, Deloitte Digital, DXC Technology, EPAM Systems, Genpact, HCL Technologies, IBM Global Services, Infosys Technologies, Tata Consultancy Services, Wipro and numerous local providers.

Reasons To Buy:

Cognizant benefits from domain expertise, expanding clientele and accretive acquisitions that are strengthening its digital capabilities.

- Cognizant is consistently developing its capabilities to benefit from the ongoing digital transition especially when it comes to integration of the new digital framework with legacy technology platforms. Its Digital Works platform is designed to aid such business transformations. The company's continuing investments to extend its digital capabilities, including the extensive training and re-skilling of its technical teams, is a key catalyst. Cognizant is also expected to continue expansion of its local workforces in the United States and other markets around the world. These efforts are expected to boost organic revenue growth. Moreover, increasing revenue contribution from the higher margin digital services is expected to drive profitability in the long haul.

- Over the past few years, Cognizant outpaced its Tier-1 peers as it has more exposure to the fast-growing verticals, like Financial Services and Healthcare. The company has gained deep industry expertise and knowledge of the domain through partnerships with top firms. This strategy has enabled it to deliver more value to clients and capitalize on new opportunities. Additionally, the new slate of domestic and international regulations, particularly in the financial services and healthcare industries, is a key catalyst.

- Moreover, acquisitions of Bolder Healthcare, Hedera Consulting, Softvision, Advanced Technology Group (ATG), and SaaSfocus are strengthening the company's digital capabilities and clientele. Additionally, these acquisitions have helped the company expand in countries like Belgium, the Netherlands, Romania and Australia. The acquisition of Meritsoft not only strengthens Cognizant's SaaS portfolio but also expands its footprint among financial institutions. Notably, Meritsoft's FINBOS platform for post-trade processing, an automation solution for managing taxes, fees, commissions and cash flows, is popular among financial institutions.

- Cognizant is expected to continue to benefit from strong demand for high quality, lower cost technology services. Based on its global delivery model and expanding capacity in low cost areas in India, Philippines and Latin America, the company remains well-positioned in the outsourcing market. Moreover, its realignment program and other margin enhancement initiatives are expected to boost profitability.

Reasons To Sell:

> Cognizant is exposed to significant geographic, domain concentration risks amid a stiff competition from peers.

- Cognizant is exposed to significant geographic concentration risks. North America contributes most of the revenues. Hence, any slowdown in the region's economic environment will hurt the company's revenue growth. Moreover, Cognizant earns more than 35% of revenues from the financial services industry. Sluggish spending by top banking customers negatively impacted financial services segment growth throughout 2019. As the trend is expected to continue in the near term, Cognizant's top-line growth is anticipated to suffer.

- Competition is intense in the IT services industry. The company's direct competitors, including Infosys Technologies, Tata Consultancy Services and Wipro, utilized an integrated global delivery business model as opposed to the hybrid-model used by Cognizant. The company also competes with large IT service providers with greater resources, such as Accenture, HP Enterprise and IBM Global Services.

- Employees are the primary resource for a company like Cognizant. But there is significant competition for highly skilled and efficient personnel, so the company remains under pressure to raise wages and control the attrition rate. Though Cognizant is investing heavily to retain the best talent around the world, we think employee turnover remains a concern as the offshore staff continues to expand. Though the company has been taking initiatives to retain employees, its attrition rates are still higher than preferred.

- An additional concern for the company relates to the nature of its business, which necessitates bringing employees into the U.S. for on-site application maintenance work. With continuous pressure from the U.S. government under Donald Trump to limit immigration, there has been an increase in the number of H1-B visa application rejections and delays in processing such applications. This doesn't bode well for Cognizant's operations.

Last Earnings Report

Cognizant Q4 Earnings Beat, Revenues Increase Y/Y

Quarter Ending	12/2019
Report Date	Feb 05, 2020
Sales Surprise	1.45%
EPS Surprise	2.88%
Quarterly EPS	1.07
Annual EPS (TTM)	4.00

Cognizant reported fourth-quarter 2019 non-GAAP earnings of $1.07 per share that beat the Zacks Consensus Estimate by 2.9%. Moreover, the figure increased 9.2% from the year-ago quarter.

Revenues of $4.3 billion surpassed the consensus mark by 1.5%. The figure improved 4.2% year over year at constant currency (cc).

Quarter Details

Segment-wise, Financial services (34.3% of revenues) grew 1.5% on a year-over-year basis at cc to $1.47 billion, primarily driven by insurance.

Moreover, growth in banking sector was stable, driven by the partnership with three Finnish financial institutions to transform and operate a shared core banking platform. The growth was partially offset by softness with a few of Cognizant's largest banking and insurance clients.

Healthcare (28.5% of revenues) increased 1.8% year over year at cc to $1.22 billion. The upside was driven by double-digit growth in life sciences, due to robust demand for digital operations, industry-specific platform solutions and the contribution of Zenith Technologies, which was acquired in July 2019.

However, healthcare growth was partially offset by the negative impact of industry consolidation and the movement of work to a captive at a large North American client.

Products and Resources' (22.4% of revenues) momentum continued and improved 8.6% year over year at cc to $963 million, driven by growth in retail and consumer goods, travel and hospitality, and manufacturing, logistics, energy and utilities.

The company stated that demand for core modernization services of enterprise applications and services within digital business drove segment revenues.

Communications, Media and Technology revenues (14.8% of revenues) were $632 million, up 9% from the year-ago quarter at cc, driven by broad-based growth across all industries in this segment.

However, technology revenue growth was hurt by the company's decision to exit certain portions of its content services business.

Digital revenues grew above 20% on a year-over-year basis and accounted for almost 38% of total revenues in the reported quarter.

Further, Consulting & Technology services accounted for 59.9% of revenues. Outsourcing services contributed 40.1% of revenues. Additionally, roughly 37.3% of Cognizant's revenues were from fixed-price contracts.

Region-wise, revenues from North America increased 3.1% year over year at cc and represented 75.7% of total revenues.

Revenues from Europe increased 5.3% from the year-ago quarter at cc and accounted for 17.9% of total revenues. Rest of the World revenues rose 14.5% at cc and represented 6.4% of total revenues.

Operating Details

Selling, general & administrative (SG&A) expenses, as a percentage of revenues, contracted 280 basis points (bps) from the year-ago quarter to 15.8%.

Headcount increased 3.9% year over year. Quarterly annualized attrition was 21%, up 2% year over year but down 3% sequentially.

Cognizant reported non-GAAP operating margin of 17%, which was flat year over year.

Balance Sheet

As of Dec 31, 2019, cash and cash equivalents (and short-term investments) were $3.42 billion, up from $3.08 billion as of Sep 30, 2019.

Cognizant generated $938 million in cash from operations compared with $717 million reported in the previous quarter.

Free cash flow was $845 million compared with $620 million reported in the previous quarter.

Cognizant bought back 2.5 million shares in the fourth quarter.

Guidance

For the first quarter of 2020, Cognizant expects revenues to grow between 2.8% and 3.8% at cc to $4.21-$4.25 billion.

Management expects revenues to have a negative 60 bps impact from the exit of certain content services business.

For 2020, revenues are projected to grow between 2% and 4% year over year at cc.

For 2020, adjusted operating margin is expected to be in the range of 16-17%.

Non-GAAP earnings for 2020 are projected between $3.97 and $4.13 per share.

Per the 2020 Fit for Growth Plan, which was announced in the third quarter, the company expects to complete optimization of its cost structure by 2020. Efforts to streamline cost structure will result in partial funding for investments in sales and marketing, talent re-skilling, acquisitions, and partnerships apart from technology.

For 2020, Cognizant expects total charges toward the low-end of $150-200 million, primarily related to severance and facility exit costs and annualized gross savings of more than $500-550 million in 2021.

Recent News

On Feb 5, 2020, Cognizant entered into negotiations to acquire the French operations of El-Technologies, a Paris-based digital technology consulting firm and Salesforce specialist.

On Feb 3, 2020, Cognizant announced the acquisition of Code Zero Consulting, a provider of consulting and implementation services for cloud-based Configure-Price-Quote (CPQ) and billing solutions to strengthen its cloud solutions portfolio and Salesforce CPQ and billing capabilities.

On Jan 29, 2020, Cognizant was awarded a contract by U.K. based, Network Rail to develop digital capabilities based on AI, IOT, data analytics and mobility technologies that will help improve Network Rail's asset management and overall performance.

On Jan 24, 2020, Cognizant was named a leading Business Process Services provider in the Clinical and Care Management market by Everest Group.

On Jan 9, 2020, Cognizant announced that it has been named a leader in SAP services for mid-size enterprises in a report by Forrester Research.

On Nov 20, 2019, Cognizant was named an Amazon Web Services (AWS) Outpost partner. As a partner, Cognizant experts were trained to re-architect complex workloads to run on AWS operations to deliver customer outcomes.

On Nov 19, 2019, Cognizant announced a partnership between The Cognizant U.S. Foundation, Walmart.org and Microsoft Philanthropies for a collective $3-million investment to deliver industry-informed computer science curriculum at 150 college campuses in the United States.

On Nov 18, 2019, Cognizant announced that The Cognizant U.S. Foundation awarded $1.25 Million to Aspen Institute's Future of Work Initiative in advancing local policy, training, and education to support continuous learning systems in four major cities in the United States.

Valuation

Cognizant shares are up 11.7% in the past six-month period but down 2.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 14.6% and 19.7% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are up 13.6% and 30.1%, respectively.

The S&P 500 index is up 14.4% in the past six-month period and 22.5% in the past year.

The stock is currently trading at 17.14X forward 12-month earnings, which compares to 23.46X for the Zacks sub-industry, 22.88X for the Zacks sector and 19.17X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.27X and as low as 12.76X, with a 5-year median of 18X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $75 price target reflects 18.02X forward 12-month earnings.

The table below shows summary valuation data for CTSH

Valuation Multiples - CTSH

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.14	23.46	22.88	19.17
	5-Year High	23.27	24.54	22.88	19.34
	5-Year Low	12.76	7.29	16.87	15.18
	5-Year Median	18	21.86	19.28	17.46
P/S F12M	Current	2.26	10.66	3.74	3.55
	5-Year High	3.11	10.66	3.74	3.55
	5-Year Low	1.87	6.88	2.3	2.54
	5-Year Median	2.54	8.39	3.02	3
EV/EBITDA TTM	Current	9.67	46.64	12.29	11.95
	5-Year High	17.01	48.89	12.59	12.85
	5-Year Low	7.21	33.64	7.68	8.49
	5-Year Median	11.13	41.05	10.53	10.66

As of 02/06/2020

Industry Analysis **Zacks Industry Rank:** Top 11% (28 out of 255)

Top Peers

Accenture PLC **(ACN)**	Neutral
Automatic Data Processing, Inc. **(ADP)**	Neutral
DXC Technology Company. **(DXC)**	Neutral
EPAM Systems, Inc. **(EPAM)**	Neutral
Genpact Limited **(G)**	Neutral
International Business Machines Corporation **(IBM)**	Neutral
Infosys Limited **(INFY)**	Neutral
Wipro Limited **(WIT)**	Neutral

Industry Comparison Industry: Business - Software Services

Industry Peers

	CTSH Neutral	X Industry	S&P 500	ACN Neutral	INFY Neutral	WIT Neutral
VGM Score	B	-	-	D	B	B
Market Cap	39.11 B	8.51 B	24.40 B	136.14 B	46.46 B	22.54 B
# of Analysts	12	4	13	11	11	3
Dividend Yield	1.12%	0.00%	1.75%	1.49%	1.88%	0.37%
Value Score	B	-	-	D	C	B
Cash/Price	0.09	0.08	0.04	0.04	0.06	0.23
EV/EBITDA	11.28	25.57	14.17	18.55	13.25	8.71
PEG Ratio	1.66	2.79	2.05	2.65	2.09	1.45
Price/Book (P/B)	3.55	4.98	3.31	8.73	5.42	2.97
Price/Cash Flow (P/CF)	14.27	25.16	13.63	24.03	18.24	14.23
P/E (F1)	16.75	31.46	19.08	27.37	19.89	15.63
Price/Sales (P/S)	2.33	3.24	2.67	3.10	3.67	2.62
Earnings Yield	5.78%	3.18%	5.24%	3.65%	5.02%	6.40%
Debt/Equity	0.13	0.24	0.71	0.17	0.00	0.04
Cash Flow ($/share)	5.01	1.99	6.89	8.91	0.60	0.26
Growth Score	B	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	12.48%	19.05%	10.80%	11.25%	5.04%	1.23%
Proj. EPS Growth (F1/F0)	3.47%	10.84%	7.23%	6.31%	2.02%	9.09%
Curr. Cash Flow Growth	-3.63%	14.78%	9.51%	8.06%	1.56%	1.80%
Hist. Cash Flow Growth (3-5 yrs)	14.81%	20.32%	8.55%	9.75%	5.73%	1.27%
Current Ratio	2.55	1.60	1.20	1.39	2.54	2.45
Debt/Capital	11.59%	21.18%	42.90%	14.60%	0.00%	3.95%
Net Margin	10.98%	4.58%	11.76%	11.06%	18.36%	16.38%
Return on Equity	20.60%	9.76%	16.98%	33.35%	26.68%	17.75%
Sales/Assets	1.05	0.73	0.54	1.48	1.04	0.73
Proj. Sales Growth (F1/F0)	2.25%	6.31%	4.15%	6.66%	9.25%	2.62%
Momentum Score	D	-	-	D	A	B
Daily Price Chg	9.93%	0.52%	-0.11%	0.91%	-0.72%	0.27%
1 Week Price Chg	-1.67%	-2.59%	-2.60%	-1.61%	-0.63%	-4.47%
4 Week Price Chg	16.87%	4.75%	1.51%	3.89%	4.58%	-2.60%
12 Week Price Chg	13.17%	8.17%	5.63%	9.13%	11.04%	-2.85%
52 Week Price Chg	-2.15%	20.20%	17.01%	38.01%	1.01%	-11.66%
20 Day Average Volume	3,218,087	410,685	1,961,054	1,958,741	15,174,475	699,245
(F1) EPS Est 1 week change	-0.60%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.64%	0.72%	-0.00%	0.00%	1.34%	1.41%
(F1) EPS Est 12 week change	-1.26%	-1.03%	-0.16%	0.56%	1.08%	-1.03%
(Q1) EPS Est Mthly Chg	0.97%	0.00%	0.00%	0.00%	-1.35%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Value Score	B
Growth Score	B
Momentum Score	D
VGM Score	B

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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