

Cognizant Technology (CTSH)

\$62.60 (As of 01/28/20)

Price Target (6-12 Months): **\$66.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/01/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: D

Summary

Cognizant's domain expertise and ability to harness the ongoing digital transition are key catalysts. The company is witnessing strength in cloud and digital engineering services, and increased demand for interactive, IoT and analytics solutions. Moreover, acquisitions have strengthened the company's digital capabilities, clientele and international prospects. Meanwhile, estimates have been stable lately ahead of the company's fourth-quarter earnings release. Cognizant has mixed record of earnings surprises in recent quarters. However, lackluster spending by large banks and 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 the near term. Shares have underperformed the industry in a year's time.

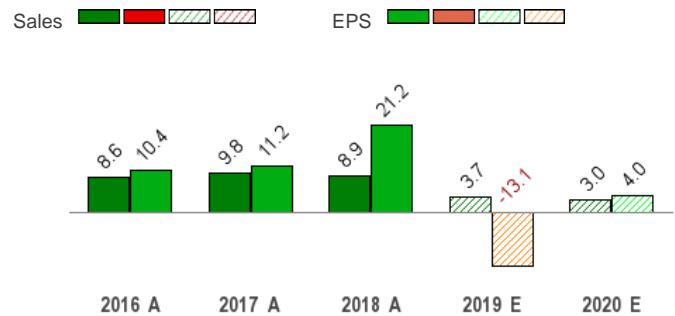
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$74.85 - \$56.73
20 Day Average Volume (sh)	2,741,634
Market Cap	\$34.3 B
YTD Price Change	0.9%
Beta	1.02
Dividend / Div Yld	\$0.80 / 1.3%
Industry	Business - Software Services
Zacks Industry Rank	Top 14% (36 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.9%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	02/05/2020
Earnings ESP	0.0%
P/E TTM	15.4
P/E F1	15.2
PEG F1	1.5
P/S TTM	2.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	4,187 E	4,244 E	4,353 E	4,361 E	17,224 E
2019	4,110 A	4,141 A	4,248 A	4,223 E	16,722 E
2018	3,912 A	4,006 A	4,078 A	4,129 A	16,125 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.96 E	\$1.00 E	\$1.07 E	\$1.09 E	\$4.13 E
2019	\$0.91 A	\$0.94 A	\$1.08 A	\$1.04 E	\$3.97 E
2018	\$1.06 A	\$1.19 A	\$1.19 A	\$1.13 A	\$4.57 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 01/28/2020. The reports text is as of 01/29/2020.

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.

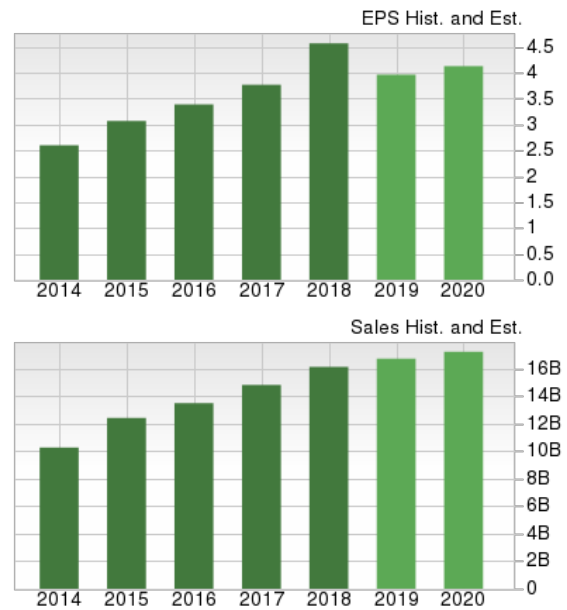
Cognizant reported revenues of \$16.13 billion in 2018.

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 2018, Financial Services accounted for 36.2% of revenues. Healthcare, Products & Resources, Communications, and Media & Technology accounted for 28.9%, 21.2% and 13.6% of revenues, respectively.

At the end of 2018, Cognizant had roughly 281,600 employees, with almost 50,000 in North America, roughly 18,300 in Europe and approximately 213,300 in various other locations across the Rest of the World, including nearly 194,700 in India.

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 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.

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

Reasons To Sell:

- ▼ 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 2018. 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.

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

Last Earnings Report

Cognizant Q3 Earnings Top Estimates, Revenues Up Y/Y

Cognizant Technology Solutions reported third-quarter 2019 non-GAAP earnings of \$1.08 per share that beat the Zacks Consensus Estimate by 3 cents. However, the figure decreased 1.8% from the year-ago quarter.

Revenues of \$4.25 billion also surpassed the consensus mark of \$4.21 billion. The figure improved 5.1% at constant currency (cc) year over year.

Quarter Ending **09/2019**

Report Date	Oct 30, 2019
Sales Surprise	0.91%
EPS Surprise	2.86%
Quarterly EPS	1.08
Annual EPS (TTM)	4.06

Quarter Details

Segment-wise, Financial services (35.1% of revenues), which includes insurance, banking and transaction processing, grew 3% on a year-over-year basis at cc to \$1.49 billion. Growth was driven by improvement in project-based work related to insurance and contribution from the previously-announced partnership with three Finnish financial institutions to transform and operate a shared core banking platform. However, softness continued with the company's largest banking clients.

Healthcare (27.7% of revenues) declined 0.9% year over year at cc to \$1.18 billion. The downside resulted from a contract dispute with a customer and the ongoing industry consolidation, which reduced spending and sped up the shift of work to a captive at a large North American client.

However, Life Sciences delivered double-digit growth, driven by large enterprise deals. The company witnessed good traction with digital operation services, momentum in the shared investigator portal for clinical trials and contribution from Zenith Technologies.

Notably, in July 2019, Cognizant completed the acquisition of Zenith Technologies, thus expanding its IoT portfolio. This will enable the company to become a single-source provider of end-to-end smart factory capabilities.

Products and Resources' (22.7% of revenues) momentum continued and improved 13.4% year over year at cc to \$966 million, driven by growth in retail and consumer goods, travel and hospitality, and manufacturing, logistics, energy and utilities.

Cognizant stated that continued strength in cloud and digital engineering services, and increased demand for interactive, IoT and analytics solutions drove segment revenues.

Communications, Media and Technology revenues (14.5% of revenues) were \$615 million, up 10.6% from the year-ago quarter at cc, led by growth in technology. This growth was driven by revenues from recent acquisitions and demand for digital engineering services. However, lower spending by a few large clients hurt the segment's top-line growth.

Digital revenues grew in the mid-20% range on a year-over-year basis and accounted for almost 35% of total revenues in the reported quarter.

Further, Consulting & Technology services accounted for 59.6% of revenues. Outsourcing services contributed 40.4% of revenues. Additionally, roughly 36.3% of Cognizant's revenues were from fixed-price contracts.

Region-wise, revenues from North America increased 3.7% year over year at cc and represented 75.9% of total revenues.

Revenues from Europe increased 8.8% from the year-ago quarter at cc and accounted for 17.8% of total revenues. Revenues from the U.K. increased 4.5% at cc. Rest of Europe revenues increased 12.3% at cc.

Rest of the World revenues rose 11.1% at cc and represented 6.4% of total revenues

Operating Details

Selling, general & administrative (SG&A) expenses, as a percentage of revenues, contracted 20 basis points (bps) from the year-ago quarter to 18.1%.

Headcount increased 5.7% year over year. Quarterly annualized attrition was 24%, up 2% year over year and 1% sequentially.

Cognizant reported non-GAAP operating margin of 17.3%, which shrank 160 bps from the year-ago quarter.

Balance Sheet

As of Sep 30, 2019, cash and cash equivalents (and short-term investments) were \$3.08 billion, up from \$3 billion as of Jun 30, 2019.

Cognizant generated \$717 million in cash from operations compared with \$575 million reported in the previous quarter.

Free cash flow was \$620 million compared with \$479 million reported in the previous quarter.

Cognizant bought back 3.6 million shares in the third quarter. It has \$519 million remaining under its current share repurchase authorization.

Cognizant declared a quarterly cash dividend of 20 cents per share to be paid out on Nov 19, 2019.

Guidance

For the fourth quarter of 2019, Cognizant expects revenues to grow between 2.1% and 3.1% at cc to \$4.23-\$4.27 billion.

Management expects overall spending in banking to remain sluggish for the rest of the year due to weakness in capital markets and weak macro factors.

Moreover, Cognizant expects that it might lose revenues between \$240 million to \$270 million on an annual basis from the Communications, Media and Technology segment.

For 2019, revenues are projected to grow between 4.6% and 4.9% year over year at cc (revised from the earlier guidance of 3.9-4.9% year-over-year growth at cc).

For 2019, adjusted operating margin is expected to be in the range of 16.5-17.0%. The company expects to align the cost structure with revised revenue expectations.

Moreover, steps taken toward simplification of organization structure in the second and third quarters are expected to result in \$100 million of annualized savings. Approximately half of that is anticipated to be realized in the remainder of 2019.

Non-GAAP earnings for 2019 are projected between \$3.95 and \$3.98 per share (up from the previous guidance of \$3.92-\$3.98).

Cognizant also announced a 2020 Fit to Growth Plan. The company plans to focus on optimizing its core portfolio while investing in four areas, namely Data, Digital Engineering, Cloud, and IoT.

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, the company expects total charges of approximately \$150-200 million, primarily related to severance and facility exit costs and annualized gross savings of over \$500-550 million in 2021.

Recent News

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.

On Oct 16, 2019, Cognizant announced that it has inked an agreement to acquire Contino, a privately-held technology consulting firm. London-based Contino has approximately 350 employees worldwide with operations in the U.K., the United States and Australia.

On Sep 24, 2019, Cognizant unveiled an AI-powered software platform that provides property insurers the ability to process large number of claims resulting from natural disasters or other catastrophic events in record time.

Valuation

Cognizant shares are down 4.2% in the six months period and 10.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 5% and 11.9% in the six months period, respectively. Over the past year, the Zacks sub-industry and sector are up 10.9% and 28.3%, respectively.

The S&P 500 index is up 8.1% in the six months period and 20.2% in the past year.

The stock is currently trading at 15.05X forward 12-month earnings, which compares to 21.85X for the Zacks sub-industry, 22.37X for the Zacks sector and 18.62X 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 18.03X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$66 price target reflects 15.90X forward 12-month earnings.

The table below shows summary valuation data for CTS

Valuation Multiples - CTS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.05	21.85	22.37	18.62
	5-Year High	23.27	24.54	22.37	19.34
	5-Year Low	12.76	7.29	16.87	15.18
	5-Year Median	18.03	21.85	19.24	17.45
P/S F12M	Current	1.98	9.92	3.63	3.46
	5-Year High	3.11	9.92	3.63	3.46
	5-Year Low	1.87	6.88	2.3	2.54
	5-Year Median	2.54	8.38	3.01	3
EV/EBITDA TTM	Current	10.34	46.87	12.68	12.25
	5-Year High	17.01	48.89	12.68	12.86
	5-Year Low	7.21	33.69	7.68	8.48
	5-Year Median	11.21	40.82	10.52	10.68

As of 01/28/2020

Industry Analysis Zacks Industry Rank: Top 14% (36 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	C	C
Market Cap	34.28 B	8.16 B	23.90 B	133.64 B	47.06 B	22.60 B
# of Analysts	12	4	13	11	11	3
Dividend Yield	1.28%	0.00%	1.8%	1.52%	1.86%	0.38%
Value Score	B	-	-	D	C	B
Cash/Price	0.09	0.08	0.04	0.04	0.06	0.22
EV/EBITDA	9.83	24.49	14.05	18.21	13.43	8.74
PEG Ratio	1.51	2.65	2.00	2.60	2.12	1.46
Price/Book (P/B)	3.22	4.83	3.28	8.57	5.49	2.98
Price/Cash Flow (P/CF)	12.70	24.58	13.57	23.59	18.47	14.27
P/E (F1)	15.27	30.56	18.76	26.87	20.15	15.67
Price/Sales (P/S)	2.06	3.38	2.63	3.04	3.72	2.62
Earnings Yield	6.60%	3.28%	5.33%	3.72%	4.95%	6.38%
Debt/Equity	0.13	0.24	0.72	0.17	0.00	0.04
Cash Flow (\$/share)	4.93	1.99	6.89	8.91	0.60	0.26
Growth Score	C	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	12.48%	19.05%	10.68%	11.25%	5.04%	1.23%
Proj. EPS Growth (F1/F0)	4.14%	6.90%	7.63%	6.31%	2.02%	9.09%
Curr. Cash Flow Growth	11.93%	22.81%	13.04%	8.06%	1.56%	1.80%
Hist. Cash Flow Growth (3-5 yrs)	14.81%	21.71%	8.78%	9.75%	5.73%	1.27%
Current Ratio	2.53	1.59	1.24	1.39	2.54	2.45
Debt/Capital	11.88%	21.18%	42.99%	14.60%	0.00%	3.95%
Net Margin	12.60%	4.52%	11.47%	11.06%	18.36%	16.38%
Return on Equity	20.23%	9.76%	17.21%	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)	3.03%	6.20%	4.10%	6.66%	9.25%	2.62%
Momentum Score	D	-	-	F	C	C
Daily Price Chg	1.34%	0.53%	0.90%	1.79%	1.00%	0.53%
1 Week Price Chg	-0.56%	0.00%	-1.09%	-0.30%	1.38%	-0.78%
4 Week Price Chg	0.94%	1.93%	0.46%	-0.16%	7.56%	0.27%
12 Week Price Chg	1.10%	6.54%	4.15%	12.50%	14.20%	-5.05%
52 Week Price Chg	-8.83%	22.30%	18.27%	38.30%	5.92%	-8.85%
20 Day Average Volume	2,741,634	261,898	1,730,811	2,057,683	13,901,523	710,297
(F1) EPS Est 1 week change	0.02%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.08%	0.00%	0.00%	0.00%	1.34%	0.00%
(F1) EPS Est 12 week change	-3.52%	-1.03%	-0.13%	0.56%	1.08%	-1.03%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-1.35%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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.

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.

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

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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