

EPAM Systems, Inc. (EPAM)

\$235.00 (As of 06/09/20)

Price Target (6-12 Months): **\$247.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/24/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: F

Growth: A

Momentum: C

Summary

EPAM Systems is benefiting from broad-based growth across its industry verticals and geographies. Digital transformation, focus on customer engagement and product development are key drivers. Besides, deeper insights into AI, ML and analytics are an upside. Strong performance of the Financial Services segment, driven by the rising demand for asset management and payment processing offerings, is also a key driver. Also, acquisitions have been a key catalyst, which enabled the company to penetrate new markets and diversify and broaden its product portfolio. However, anticipating an uncertainty regarding the potential impacts of coronavirus, EPAM withdrew its 2020 guidance. Slowdown within certain consumer clients in Europe and North America is an overhang. Further, adverse foreign currency volatility persists as a major concern.

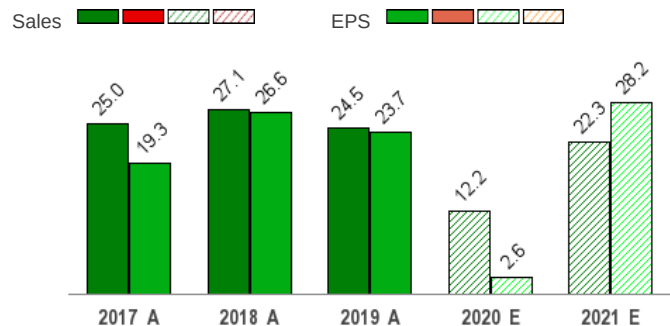
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$248.27 - \$151.97
20 Day Average Volume (sh)	361,805
Market Cap	\$13.1 B
YTD Price Change	10.8%
Beta	1.31
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Bottom 42% (146 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.1%
Last Sales Surprise	-0.0%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	08/13/2020
Earnings ESP	0.3%
P/E TTM	41.9
P/E F1	42.3
PEG F1	2.2
P/S TTM	5.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	742 E	737 E	781 E	834 E	3,149 E
2020	651 A	598 E	622 E	685 E	2,574 E
2019	521 A	552 A	588 A	633 A	2,294 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.57 E	\$1.61 E	\$1.75 E	\$1.92 E	\$7.13 E
2020	\$1.43 A	\$1.20 E	\$1.32 E	\$1.50 E	\$5.56 E
2019	\$1.21 A	\$1.28 A	\$1.39 A	\$1.51 A	\$5.42 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 06/09/2020. The reports text is as of 06/10/2020.

Overview

Headquartered at Newtown, PA, EPAM Systems, Inc. is well known for its software engineering and IT consulting services.

The company is engaged in providing software product development services, custom application development services, application testing services, application maintenance and support services, infrastructure management services and enterprise information management services.

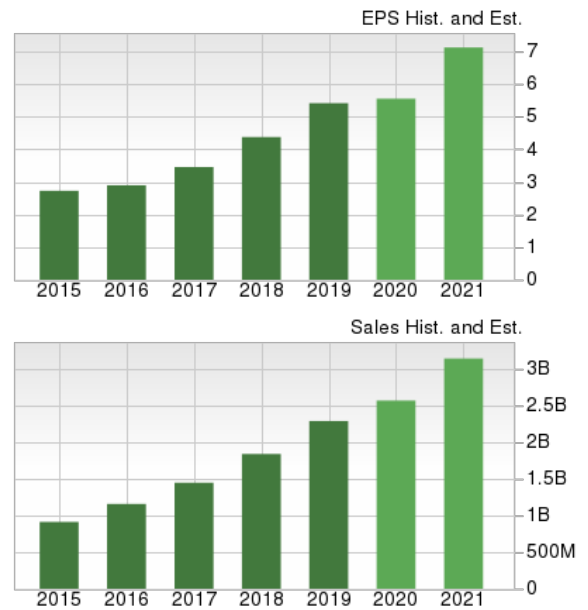
Its software product development services include product research, design and prototyping, product development, component design and integration. EPAM's custom application development services comprise business and technical requirements analysis, solution architecture creation and validation, development, component design and integration.

Under the application testing services, the company offers software application testing, testing for enterprise IT, and consulting services. Further, it provides services like incident management, fault investigation diagnosis, work-around provision, application bug fixes, release management, application enhancements, and third-party maintenance under the application maintenance and support services.

EPAM's infrastructure management services include applications, database, network, server, storage, and systems operations management, as well as incident notification and resolutions. Through its enterprise information management services, the company helps organizations in improving business processes, thereby achieving greater operational excellence.

EPAM generated total revenues of \$2.29 billion in 2019. The company has six operating verticals — Financial Services (22% of FY19 revenues), Travel and Consumer (19%), Software & Hi-Tech (19%), Business Information & Media (18%), Life Sciences & Healthcare (10%) and Emerging Verticals (10%).

The company has a huge client base, which includes majority of Forbes Global 2000 corporations operating across North America, Europe, CIS (Commonwealth of Independent States) and APAC (Asia including India and Australia). In 2019, the company generated 61% of its revenues from North America, 33% from Europe, 4% from CIS and 2% from APAC.



Reasons To Buy:

- ▲ EPAM mainly serves to the fastest growing areas of IT services which include mobile applications, and their testing, cognitive computing, software development and advanced analytics. The benefits of operating in these key IT services areas can better be understood with the fact that EPAM's revenues have witnessed a compounded annual growth rate (CAGR) of around 25% over the last five years. The demand for these key areas are likely to continue for the next several years as more and more organizations are trying to take advantage of cloud computing and data analytics in order to make greater use of their IT infrastructure. With its world-class capabilities in empowering digital technologies, EPAM is well positioned to grab the growing opportunities in the aforementioned IT services space.
- ▲ Acquisitions have been one of the key growth strategies for EPAM. Since its stock exchange listing, the company has acquired 10 businesses. Acquisitions have enabled EPAM to enter new markets, diversify and broaden its product portfolio. Moving ahead, such acquisitions are expected to contribute significantly to the company's revenue stream. Most recently in Mar 2020, EPAM acquired Deltix, which provides software and services for quantitative research in the financial sector. The acquisition would help EPAM enhance its capabilities and offerings in the FinTech space. With Deltix, EPAM is developing a real-time computing lab that will focus on creating real-time event processing and analytics products for capital marketing trading, risk and market data, as well as crypto trading, IoT and real-time signal processing. Furthermore, EPAM plans to leverage Deltix's technology and expertise across various industries including travel and hospitality, automotive, healthcare, insurance, retail, media and entertainment.
- ▲ EPAM's strategy of enhancing its cloud capabilities through acquisitions and partnerships with the likes of Amazon Web Services and Google Cloud is a step in the right direction, as evident from the recent forecast provided by several independent research firms. The research firm — Gartner — predicts that the public cloud services market will grow 17% in 2020 and reach \$266.4 billion, up from \$227.8 billion in 2019. Exponential growth in the amount of data, complexity of data formats and the need to scale resources at regular intervals compelled several companies to turn to cloud-computing vendors. Therefore, considering the rising need for cloud-based applications and software, we expect EPAM's investments in this space to propel long-term growth.
- ▲ EPAM has a strong balance sheet with ample liquidity position and meagre debt obligations. Cash and cash equivalents were \$916 million as of the last reported quarter. It should be noted that the company has been able to regularly increase its cash and cash equivalents balance and cash from operations. The increasing liquidity and cash flow trend reflect that the company is making investments in the right direction. Moreover, since it carries just \$274 million of long-term debt, the excess cash is available for pursuing strategic acquisitions and investment in growth initiatives. Additionally, EPAM's total debt to total capital ratio of 0.14 is significantly lower than the industry average of 0.46.

EPAM mainly serves to the fastest growing areas of IT services. Acquisitions have been a key driving factor which has enabled it entering new markets, diversify and broaden product portfolio.

Reasons To Sell:

- ▼ We believe the coronavirus outbreak will affect EPAM's near-term financial performance. The novel virus has hit the business community hard and therefore, majority of EPAM clients might adjust their planned IT services investments. Nonetheless, the impact is anticipated to be limited as investment in IT Services work streams remain essential and hence, the industry would be the softest hit in comparison to others. Furthermore, anticipating an uncertainty regarding the potential impacts of the coronavirus pandemic on its full-year results, EPAM withdrew its 2020 guidance. It expects its business operations to remain affected throughout the year, which makes us anxious about the company's near-term prospects.
- ▼ As EPAM's majority of its delivery centers are located in Central and Eastern Europe, the company's prospects are currently prone to a massive geopolitical risk due to the ongoing conflict between Russia and Ukraine. Notably, the company's largest delivery centers are located in Belarus, Russia and Ukraine. Any escalation in the ongoing conflict is likely to disrupt the company's overall business operations and therefore, hurt its revenues and profitability.
- ▼ EPAM's market share and revenues necessarily depend on client relationships and the number of contracts it secures. This, along with the limited scope for product differentiation, makes renegotiation of large contracts extremely important. As a result, competition from companies like Accenture and Infosys is a constant pressure. Competition is particularly tough in the case of resurgent regions like Europe, since all the major players are fighting for business. This naturally also increases pricing pressures.
- ▼ The latest forecast for worldwide IT spending by Gartner might dampen EPAM's growth prospects. The worldwide IT spending is anticipated to be \$3.4 trillion in 2020, suggesting a decrease of 8% from 2019. The research firm expects worldwide spending on IT services to decline 7.7% year over year to \$1.032 trillion this year. Gartner noted that companies are prioritizing technology spending that are mission-critical instead of on growth and transformation initiatives amid the ongoing coronavirus crisis and the global economic recession.
- ▼ Anticipation of a controlled spending from select clients is making investors wary. Soft spending by the European banking clients and sluggish demand in the consumer and retail space, primarily in Europe, are nagging woes. Brexit-related uncertainty and revenue recognition from various financial services clients in Russia are also a dampener.
- ▼ We note that the stock currently has a trailing 12 month P/E ratio of 47.9. This compares unfavorably to some extent with what the industry witnessed during the same time frame. Hence, valuation looks slightly stretched from a P/E perspective.

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Last Earnings Report

EPAM Systems' Q1 Earnings & Revenues Beat Estimates

EPAM Systems' first-quarter 2020 non-GAAP earnings per share improved 14.4% year over year to \$1.43 and also beat the Zacks Consensus Estimate by 2.1%.

Additionally, revenues in the reported quarter came in at \$651.4 million, reflecting a year-over-year rise of 24.9%. The top line also surpassed the Zacks Consensus Estimate of \$649 million. On a constant currency (cc) basis, revenues were up 26%.

The company is benefiting from growth across all industry verticals and geographies. Digital transformation, focus on customer engagement and product development are key catalysts.

Quarter Ending **03/2020**

Report Date	May 07, 2020
Sales Surprise	-0.01%
EPS Surprise	2.14%
Quarterly EPS	1.43
Annual EPS (TTM)	5.61

Quarterly Details

EPAM Systems' largest vertical, Financial Services, displayed 16.2% growth on a year-over-year basis. Travel & Consumer improved 14.6%.

Software & Hi-Tech was up 21.9%. Business Information & Media climbed 46%.

Life Science & Healthcare rose 26.4%. Emerging Verticals improved 30.3%, driven primarily by clients in energy and telecommunications sectors.

Geographically, EPAM Systems generated 59.9% of total revenues from North America, up 23.1% year over year.

Revenues from Europe, contributing 34.2% to total revenues, were up 28.6%.

CIS or Commonwealth of Independent States, representing 3.8% of revenues, jumped 36.8%.

APAC was up 4.7%, accounting for 2.1% of revenues.

EPAM Systems' non-GAAP operating income improved 18.1% year over year to \$105.3 million, while operating margin contracted 90 basis points (bps) to 16.2%.

Balance Sheet and Cash Flow

EPAM Systems exited the first quarter with cash and cash equivalents of \$916.3 million, up from \$936.6 million witnessed at the end of the prior quarter.

As of Mar 31, 2020, long-term debt was \$25 million, flat sequentially.

During the March-end quarter, the company generated operating cash flow of \$63.3 million

Outlook

Citing the uncertainty regarding the coronavirus pandemic, which is impacting the global business and consumer activities, EPAM didn't issue the full-year outlook.

Nonetheless, the company has issued its guidance for the second quarter.

For the ongoing quarter, the company forecasts revenues between \$590 million and \$605 million, suggesting year-over-year growth of 7.5%-10.2%. The company anticipates non-GAAP operating margins in the 14-16% range. Non-GAAP earnings per share are expected to be in the \$1.12-\$1.31 band.

Recent News

On Jun 10, EPAM revealed that it has partnered with EIS Group to help insurers accelerate digital transformation initiatives in the UK.

On May 27, EPAM announced a partnership with Fnality International to deliver payment-on-chain to support future wholesale banking requirements.

On Apr 9, EPAM Systems raised its view for the first quarter of 2020. However, anticipating an uncertainty regarding the potential impacts of the coronavirus pandemic on its second-quarter and full-year results, EPAM withdrew its 2020 guidance.

On Apr 2, EPAM Systems partnered with telemedicine and text-messaging platform, Curogram, to develop a solution to simplify COVID-19 crisis response for healthcare systems.

On Mar 27, EPAM Systems launched an open source solution — GENTL Mask — designed by EPAM Continuum. The solution will help manufacturers meet the supply shortage of protective masks for medical professionals in the wake of the coronavirus outbreak.

On Mar 20, EPAM Systems acquired Deltix. The acquisition will help EPAM develop a computing lab for industry-leading real-time event processing and analytics, focusing on areas such as capital marketing trading, risk and market data, as well as crypto trading, IoT and real-time signal processing.

On Feb 5, EPAM Systems partnered with Contentstack to deliver a full microservices, API, cloud-native and headless (MACH) solution for global customers.

On Dec 9, 2019, EPAM Systems announced that it has expanded its crowdtesting software solutions to enable user story testing.

Valuation

Shares of EPAM have increased 10.8% so far this year and 32.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Technology sector have increased 3.7% and 9.1%, respectively, in the year to date period. Over the past year, while the Zacks sub-industry increased 6.5%, the sector grew 24.6%.

The S&P 500 Index has plunged 0.5% year to date, while has gained 11.1% in the past year.

The stock is currently trading at 37.6X forward 12-month earnings, which compares to 28.44X for the Zacks sub-industry, 25.36X for the Zacks sector and 23.18X for the S&P 500 index.

Over the past five years, the stock has traded as high as 48.77X and as low as 24.54X with a 5-year median of 33.02X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$247 price target reflects 39.48X forward 12-month earnings.

The table below shows summary valuation data for EPAM

Valuation Multiples - EPAM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	37.60	28.44	25.36	23.18
	5-Year High	48.77	32.37	25.36	23.18
	5-Year Low	24.54	15.46	16.72	15.23
	5-Year Median	33.02	22.29	19.28	17.49
P/S F12M	Current	4.63	5.20	3.86	3.60
	5-Year High	5.21	10.11	3.86	3.60
	5-Year Low	2.27	3.86	2.32	2.53
	5-Year Median	3.26	7.17	3.11	3.02
EV/EBITDA TTM	Current	33.23	28.41	12.44	11.88
	5-Year High	34.84	33.18	12.72	12.85
	5-Year Low	16.18	19.79	7.57	8.25
	5-Year Median	25.42	27.43	10.74	10.81

As of 06/09/2020

Industry Analysis Zacks Industry Rank: Bottom 42% (146 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Accenture PLC (ACN)	Neutral	3
Cognizant Technology Solutions Corporation (CTSH)	Neutral	4
Amdocs Limited (DOX)	Neutral	3
Genpact Limited (G)	Neutral	3
Hewlett Packard Enterprise Company (HPE)	Neutral	3
International Business Machines Corporation (IBM)	Neutral	3
Infosys Limited (INFY)	Neutral	3
DXC Technology Company. (DXC)	Underperform	5

Industry Comparison Industry: Computers - It Services				Industry Peers		
	EPAM	X Industry	S&P 500	ACN	CTSH	DXC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	4	-	-	3	4	5
VGM Score	C	-	-	A	B	C
Market Cap	13.08 B	2.94 B	22.74 B	131.80 B	30.92 B	4.60 B
# of Analysts	10	5	14	11	10	6
Dividend Yield	0.00%	0.00%	1.81%	1.54%	1.54%	4.63%
Value Score	F	-	-	B	B	A
Cash/Price	0.07	0.07	0.06	0.04	0.14	0.81
EV/EBITDA	35.88	10.58	13.04	18.00	9.63	2.46
PEG Ratio	2.19	2.07	3.12	2.74	1.53	NA
Price/Book (P/B)	7.93	4.49	3.14	8.28	2.92	0.90
Price/Cash Flow (P/CF)	39.29	12.99	12.32	23.26	11.35	0.45
P/E (F1)	42.81	31.32	22.61	27.38	16.78	7.49
Price/Sales (P/S)	5.39	2.14	2.46	2.95	1.83	0.24
Earnings Yield	2.37%	2.34%	4.26%	3.65%	5.96%	13.34%
Debt/Equity	0.13	0.29	0.76	0.17	0.30	1.69
Cash Flow (\$/share)	5.98	1.07	7.01	8.91	5.04	40.21
Growth Score	A	-	-	A	A	C
Hist. EPS Growth (3-5 yrs)	28.92%	18.58%	10.87%	11.33%	10.74%	20.80%
Proj. EPS Growth (F1/F0)	2.55%	-6.29%	-10.76%	2.90%	-14.59%	-56.60%
Curr. Cash Flow Growth	27.45%	12.63%	5.48%	8.06%	-2.96%	133.97%
Hist. Cash Flow Growth (3-5 yrs)	26.53%	16.03%	8.55%	9.75%	10.46%	44.41%
Current Ratio	3.87	1.44	1.29	1.38	2.90	1.14
Debt/Capital	11.51%	34.09%	44.75%	14.34%	22.97%	62.84%
Net Margin	11.79%	2.14%	10.54%	11.13%	10.46%	-27.43%
Return on Equity	18.45%	9.36%	16.08%	32.87%	20.90%	16.91%
Sales/Assets	1.14	0.76	0.55	1.43	1.04	0.67
Proj. Sales Growth (F1/F0)	12.20%	0.00%	-2.59%	2.81%	-4.44%	-13.12%
Momentum Score	C	-	-	A	F	F
Daily Price Chg	-1.25%	-1.01%	-2.13%	-1.86%	-2.37%	-7.26%
1 Week Price Chg	3.21%	3.45%	7.51%	3.41%	9.09%	26.67%
4 Week Price Chg	6.21%	13.06%	16.33%	11.64%	7.48%	14.66%
12 Week Price Chg	27.66%	34.92%	28.71%	31.47%	14.15%	81.40%
52 Week Price Chg	32.43%	4.10%	1.59%	13.07%	-9.75%	-64.24%
20 Day Average Volume	361,805	415,744	2,644,123	2,048,200	3,532,832	6,391,597
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.06%	0.00%	0.00%	0.02%	-1.84%	-49.30%
(F1) EPS Est 12 week change	-16.24%	-11.41%	-15.96%	-2.95%	-16.11%	-55.00%
(Q1) EPS Est Mthly Chg	0.27%	0.00%	0.00%	-0.05%	-4.67%	-92.44%

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	F
Growth Score	A
Momentum Score	C
VGM Score	C

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.

Disclosures

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