

EPAM Systems, Inc. (EPAM)

\$298.73 (As of 08/10/20)

Price Target (6-12 Months): **\$314.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/24/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: D

Growth: A

Momentum: F

Summary

EPAM Systems is benefiting from broad-based growth across its industry verticals and geographies as reflected by second-quarter 2020 results. Digital transformation, focus on customer engagement and product development are key drivers. 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 is a major concern. Shares have underperformed the industry year to date.

Data Overview

52 Week High-Low	\$306.41 - \$151.97
20 Day Average Volume (sh)	291,706
Market Cap	\$16.7 B
YTD Price Change	40.8%
Beta	1.34
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Top 49% (124 out of 253)

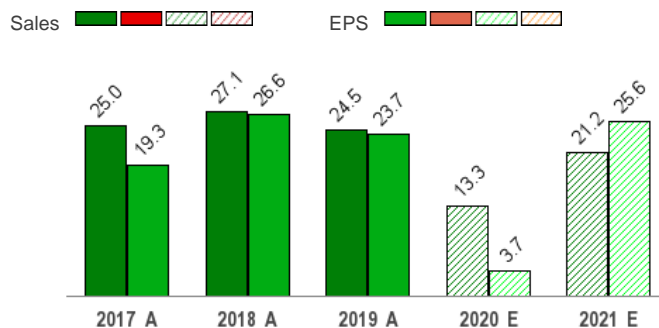
Last EPS Surprise	21.7%
Last Sales Surprise	5.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	11/05/2020
Earnings ESP	9.6%

P/E TTM	51.6
P/E F1	53.2
PEG F1	2.7
P/S TTM	6.7

Price, Consensus & Surprise



Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	717 E	747 E	796 E	846 E	3,150 E
2020	651 A	632 A	640 E	680 E	2,599 E
2019	521 A	552 A	588 A	633 A	2,294 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.54 E	\$1.60 E	\$1.74 E	\$1.91 E	\$7.06 E
2020	\$1.43 A	\$1.46 A	\$1.33 E	\$1.47 E	\$5.62 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 08/10/2020. The reports text is as of 08/11/2020.

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.

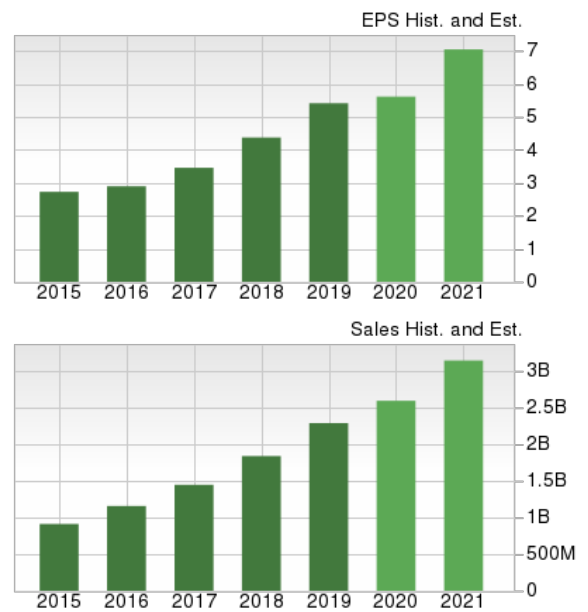
Its software product development services include product research, design and prototyping, product development, component design and integration. EPAM's custom application development services comprise business and technical requirements analysis, solution architecture creation and validation, development,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

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.

▲ 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 \$1.05 billion at the end of the second 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 \$25 million of long-term debt, the excess cash is available for pursuing strategic acquisitions and investment in growth initiatives.

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.

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Last Earnings Report

EPAM Systems Q2 Earnings & Revenues Beat Estimates

EPAM Systems' reported second-quarter 2020 non-GAAP earnings of \$1.46 per share beat the Zacks Consensus Estimate by 21.7% and grew 14.1% year over year.

Revenues came in at \$632.4 million, reflecting a year-over-year rise of 14.6%. The top line also surpassed the consensus mark by 5.8%. On a constant currency (cc) basis, revenues were up 15.5%.

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

Quarter Ending **06/2020**

Report Date	Aug 06, 2020
Sales Surprise	5.78%
EPS Surprise	21.67%
Quarterly EPS	1.46
Annual EPS (TTM)	5.79

Quarterly Details

EPAM Systems' largest vertical, Business Information & Media, surged 42.9% year over year to \$140.2 million and accounted for 22.2% of revenues.

Financial Services grew 6.3% on a year-over-year basis to \$128 million and accounted for 20.2% of revenues.

While Software & Hi-Tech was up 13.2% to \$119.5 million, Travel & Consumer climbed 0.1% to \$107.3 million. Software & Hi-Tech, and Travel & Consumer accounted for 18.9% and 17% of revenues, respectively.

Life Science & Healthcare increased 16.4% year over year to \$68.9 million and accounted for 10.9% of revenues.

Emerging Verticals improved 10.8% year over year to \$68.5 million and contributed 11.9% of revenues.

Geographically, EPAM Systems generated 60.4% of total revenues from North America, up 14.1% year over year to \$381.9 million.

Revenues from Europe, contributing 33.4% to total revenues, were up 19% to \$211.1 million.

CIS, representing 4% of revenues, fell 12% to \$22.1 million.

APAC was up 20.5% to \$17.3 million and accounted for 2.7% of revenues.

Meanwhile, selling, general and administrative expenses as a percentage of revenues decreased 250 basis points (bps) year over year to 16%.

EPAM Systems' non-GAAP operating income improved 16.9% year over year to \$108.2 million. Operating margin expanded 30 bps to 17.1%.

Balance Sheet and Cash Flow

As of Jun 30, 2020, EPAM Systems had cash and cash equivalents of \$1.05 billion, up from \$916.3 million as of Mar 31, 2020.

As of Jun 30, 2020, long-term debt was \$25 million, flat sequentially.

EPAM Systems generated cash flow from operating activities of \$134.7 million compared with \$32.4 million in the year-ago quarter.

Outlook

Citing the uncertainty regarding the coronavirus pandemic which is impacting the global business and consumer activities, EPAM Systems didn't provide full-year 2020 outlook.

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

EPAM Systems expects revenues between \$633 million and \$643 million, suggesting year-over-year growth of 8.5% at the mid-point of the range.

The company anticipates non-GAAP operating margin in the 16.5-17.5% range. Non-GAAP earnings are expected to be in the \$1.40-\$1.49 per share band.

Recent News

On Jul 9, EPAM collaborated with UNICEF ECARO to develop an information app —HealthBuddy COVID-19— to protect children, families and communities across Europe and Central Asia.

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.

Valuation

Shares of EPAM have increased 39.1% year-to-date (YTD) and 58.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have gained 19.5% and 19.9%, respectively, YTD. Over the past year, the Zacks sub-industry and the sector increased 23.6% and 36.7%, respectively.

The S&P 500 Index has increased 4.2% YTD while it has gained 16.7% in the past year.

The stock is currently trading at 45.96X forward 12-month earnings, which compares to 30.8X for the Zacks sub-industry, 26.19X for the Zacks sector and 22.75X for the S&P 500 index.

Over the past five years, the stock has traded as high as 56.64X and as low as 24.54X with a 5-year median of 33.03X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$314 price target reflects 48.26X 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	45.96	30.8	26.19	22.75
	5-Year High	56.64	32.37	26.31	22.75
	5-Year Low	24.54	15.46	16.72	15.25
	5-Year Median	33.03	22.32	19.61	17.58
P/S F12M	Current	5.69	5.81	1.25	3.66
	5-Year High	5.7	10.11	1.25	3.66
	5-Year Low	2.27	3.91	0.82	2.53
	5-Year Median	3.26	6.98	0.97	3.05
EV/EBITDA TTM	Current	39.98	32.56	13.31	12.62
	5-Year High	39.98	33.18	13.51	12.84
	5-Year Low	16.18	19.83	7.59	8.24
	5-Year Median	25.42	27.44	10.9	10.9

As of 08/10/2020

Industry Analysis Zacks Industry Rank: Top 49% (124 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Accenture PLC (ACN)	Neutral	3
Cognizant Technology Solutions Corporation (CTSH)	Neutral	3
Amdocs Limited (DOX)	Neutral	3
DXC Technology Company. (DXC)	Neutral	4
Genpact Limited (G)	Neutral	3
International Business Machines Corporation (IBM)	Neutral	4
Infosys Limited (INFY)	Neutral	3
Hewlett Packard Enterprise Company (HPE)	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	Neutral
Zacks Rank (Short Term)	2	-	-	3	3	4
VGM Score	C	-	-	B	A	B
Market Cap	16.68 B	2.86 B	23.56 B	146.68 B	36.39 B	5.15 B
# of Analysts	10	5	14	11	10	5
Dividend Yield	0.00%	0.00%	1.71%	1.39%	1.31%	0.00%
Value Score	D	-	-	C	A	A
Cash/Price	0.06	0.06	0.07	0.04	0.13	1.09
EV/EBITDA	45.93	10.02	13.39	19.95	11.32	2.55
PEG Ratio	2.71	2.36	2.92	3.02	1.73	NA
Price/Book (P/B)	9.48	5.82	3.18	8.90	3.32	1.04
Price/Cash Flow (P/CF)	49.95	13.07	12.69	25.84	13.32	0.50
P/E (F1)	53.07	36.40	22.16	30.19	18.98	9.06
Price/Sales (P/S)	6.66	2.66	2.55	3.29	2.17	0.27
Earnings Yield	1.88%	2.27%	4.33%	3.31%	5.27%	11.06%
Debt/Equity	0.12	0.24	0.77	0.17	0.29	2.09
Cash Flow (\$/share)	5.98	1.07	6.94	8.91	5.04	40.21
Growth Score	A	-	-	A	A	C
Hist. EPS Growth (3-5 yrs)	29.12%	17.84%	10.41%	11.11%	9.68%	17.98%
Proj. EPS Growth (F1/F0)	3.73%	-3.34%	-6.51%	3.67%	-11.40%	-59.93%
Curr. Cash Flow Growth	27.45%	15.98%	5.26%	8.06%	-2.96%	133.97%
Hist. Cash Flow Growth (3-5 yrs)	26.53%	15.72%	8.55%	9.75%	10.46%	44.41%
Current Ratio	4.37	1.47	1.34	1.37	2.66	1.29
Debt/Capital	10.55%	32.71%	44.59%	14.36%	22.70%	67.65%
Net Margin	11.73%	3.26%	10.13%	11.11%	9.67%	-29.90%
Return on Equity	18.45%	9.12%	14.59%	31.51%	19.87%	14.79%
Sales/Assets	1.12	0.76	0.51	1.35	0.99	0.68
Proj. Sales Growth (F1/F0)	13.32%	0.68%	-1.54%	2.52%	-1.32%	-11.76%
Momentum Score	F	-	-	C	B	F
Daily Price Chg	0.24%	0.13%	0.91%	-0.53%	-0.55%	1.81%
1 Week Price Chg	2.73%	2.73%	2.30%	3.02%	-1.23%	11.11%
4 Week Price Chg	18.29%	10.02%	8.54%	6.77%	18.86%	30.63%
12 Week Price Chg	34.61%	20.34%	13.68%	19.50%	26.29%	21.10%
52 Week Price Chg	59.97%	13.43%	3.71%	21.23%	9.71%	-40.27%
20 Day Average Volume	291,706	503,180	2,015,804	1,504,666	3,246,768	3,157,249
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-5.78%
(F1) EPS Est 4 week change	0.00%	0.00%	1.67%	0.00%	6.34%	-5.78%
(F1) EPS Est 12 week change	-0.06%	1.31%	2.27%	0.77%	3.42%	-52.23%
(Q1) EPS Est Mthly Chg	6.94%	0.00%	0.67%	0.00%	8.53%	-28.89%

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	D
Growth Score	A
Momentum Score	F
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.

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