

EPAM Systems, Inc. (EPAM)

\$236.75 (As of 02/14/20)

Price Target (6-12 Months): **\$249.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/20/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: D

Growth: B

Momentum: B

Summary

EPAM Systems is benefiting from broad-based growth across the company's industry verticals and geographies. Digital transformation, focus on customer engagement and product development are key drivers. Moreover, deeper insights into AI, machine learning and analytics are an upside. Strong performance of its Financial Services segment, driven by rising demand for asset management and payment processing offerings, is also a key driver. Additionally, acquisitions have been a key catalyst, which enabled the company to penetrate new markets plus diversify and broaden its product portfolio. Nonetheless, slowdown within certain consumer clients in Europe and lower growth for few North American clients are an overhang. Further, adverse foreign currency volatility persists as a major concern.

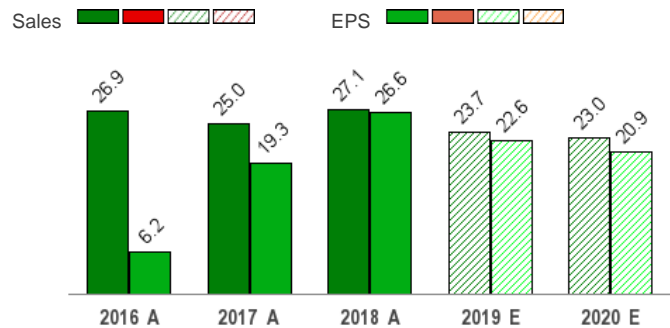
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$242.09 - \$150.97
20 Day Average Volume (sh)	227,580
Market Cap	\$13.0 B
YTD Price Change	11.6%
Beta	1.49
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Top 35% (90 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.7%
Last Sales Surprise	1.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/20/2020
Earnings ESP	0.0%
P/E TTM	46.0
P/E F1	36.5
PEG F1	1.9
P/S TTM	6.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	640 E	677 E	719 E	763 E	2,805 E
2019	521 A	552 A	588 A	618 E	2,280 E
2018	424 A	446 A	468 A	505 A	1,843 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.47 E	\$1.50 E	\$1.65 E	\$1.79 E	\$6.49 E
2019	\$1.21 A	\$1.28 A	\$1.39 A	\$1.45 E	\$5.37 E
2018	\$0.93 A	\$1.01 A	\$1.17 A	\$1.27 A	\$4.38 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 02/14/2020. The reports text is as of 02/17/2020.

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.

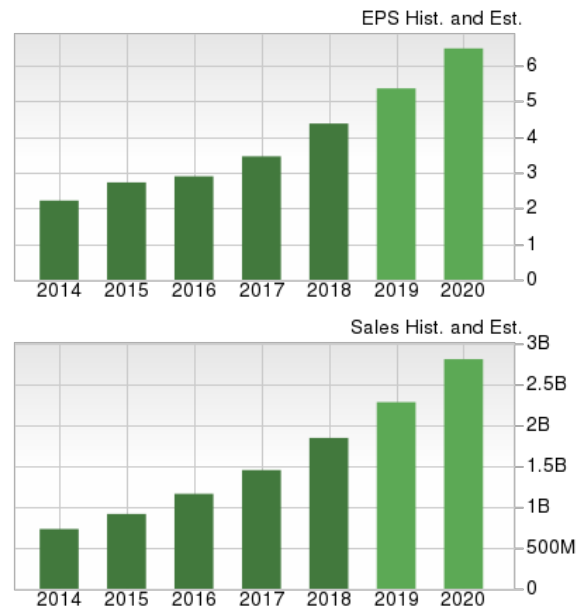
Its software product development services include product research, design and prototyping, product development, component design and integration. EPAM's custom application development services comprise business and technical requirements analysis, solution architecture creation and validation, development,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

The company has six operating verticals — Financial Services (23% of FY18 revenues), Travel and Consumer (21%), Software & Hi-Tech (19%), Business Information & Media (18%), Life Sciences & Healthcare (9%) and Emerging Verticals (10%). EPAM had generated total revenues of \$1.84 billion in 2018.

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 2018, the company generated 60% of its revenues from North America, 33% from Europe, 4% from CIS and 3% 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 more than 25% over the last six 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.
- ▲ The latest forecast for worldwide IT spending by Gartner buoys optimism for EPAM's growth prospects. The research firm expects worldwide spending on IT services to reach \$1.088 trillion in 2020, representing a 5.5% increase from 2019. We believe EPAM is well-poised to capitalise on this growth opportunity.
- ▲ 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 witness a compounded annual growth rate (CAGR) of 18.4% during the 2018-2021 period, reaching \$302.54 billion by 2021 end. 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 \$853.2 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 \$25 million of long-term debt, the cash is available for pursuing strategic acquisitions and investment in growth initiatives.

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:

- ▼ 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.
- ▼ 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 53.93. 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 Q3 Earnings & Revenues Surpass Estimates

EPAM Systems' third-quarter 2019 non-GAAP earnings per share improved 18.8% year over year to \$1.39 and also beat the Zacks Consensus Estimate by 3.7%.

Additionally, revenues in the reported quarter came in at \$588.1 million, reflecting a year-over-year rise of 25.6%. The top line also surpassed the Zacks Consensus Estimate of \$580 million. On constant currency (cc) basis, revenues were up 27.2%. During the quarter, inorganic contribution to revenue growth was approximately 1.5%.

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

Top-Line Details

Revenue Break Up by Verticals

EPAM Systems' largest vertical Financial Services (representing 22.1% of total revenues) exhibited 24.4% growth on a year-over-year basis to \$130.3 million. Growing demand for asset management, insurance and payment processing offerings is a key catalyst.

Travel and Consumer (19.1%) improved 11.2% (8.2% in cc) to \$112.4 million. An uptick in demand for replatforming, e-commerce, retail and data engineering services aided performance. However, ongoing slowdown within certain consumer clients limited growth.

Software & Hi-Tech (18.4%) was up nearly 22.9% to \$108.4 million on strong adoption of product engineering services.

Business Information & Media (18%) rose 29.3% to \$105.8 million on robust traction witnessed by data and analytics services.

Life Science & Healthcare (11.4%) surged 49.7% to 66.8 million, backed by improving demand for R&D IT services and other applications.

Emerging Verticals (11%) improved 35.1% to \$64.4 million, driven primarily by clients in energy and telecommunications sectors.

Revenue Break Up by Geography

Geographically, EPAM Systems generated 60.9% of total revenues from North America, up 26.2% year over year (26.5% at cc) to \$358.4 million.

Revenues from Europe, contributing 32.2% to total revenues, were up 24.4% (28.4% at cc) to \$189.3 million.

CIS or Commonwealth of Independent States, representing 4.5% of revenues, jumped 43% (42.9% at cc), to \$26.5 million.

APAC rose 4.1% (5.5% at cc), accounting for 2.4% of revenues, to \$13.9 million.

Revenue Break Up by Customer Concentration

The company's top 20 clients, contributing 40.8% to total revenues, climbed 17% year over year in the quarter under review while the rest (representing 59.2% of total revenues) improved 32%.

Margins

EPAM Systems' non-GAAP gross margin contracted 20 bps to 37.1%.

The company's non-GAAP operating income improved 21.6% year over year to \$99.7 million while the operating margin contracted 50 bps to 17%.

Balance Sheet and Cash Flow

EPAM Systems exited the third quarter with cash and cash equivalents of \$853.2 million, up from \$777.4 million at the end of the second quarter.

As of Sep 30, 2019, long-term debt came in at \$25 million, flat when compared with the second quarter.

Cash generated from operating activities was \$119 million in the quarter compared with \$44 million reported in the previous quarter.

Free cash flow came in at \$91.8 million, compared with \$32.4 million in the second quarter.

Guidance

For 2019, EPAM Systems expects revenue growth to be at least 23% year over year. At cc, the metric is expected to be 24%. The company anticipates foreign currency fluctuations to have an adverse impact of 1% on revenues.

Non-GAAP operating margin is now projected in the band of 16.5-17.5%, compared with the earlier predicted range of 16-17%. The company now anticipates non-GAAP earnings to be \$5.35, up from \$5.25 predicted earlier, reflecting anticipated improvement in profitability.

For the fourth quarter, the company forecasts revenues at minimum \$616 million, up 22% (as reported and at cc) year over year.

Quarter Ending **09/2019**

Report Date	Nov 07, 2019
Sales Surprise	1.41%
EPS Surprise	3.73%
Quarterly EPS	1.39
Annual EPS (TTM)	5.15

Non-GAAP earnings per share are expected to be at least at \$1.43. Meanwhile non-GAAP operating margin is predicted between 16.5% and 17.5%.

Recent News

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

On Nov 5, 2019, EPAM Systems announced the acquisition of NAYA Technologies. The acquisition will enhance EPAM's data management and cloud servicing capabilities by combining NAYA Technologies' expertise in big data, software development and cloud migration.

On Jul 2, 2019, EPAM Systems acquired educational content services company, Competentum, and its learning platform, ShareKnowledge, for an undisclosed amount.

Valuation

Shares of EPAM have rallied 24.2% in the last six months and 53% over the trailing 12-month period. Stocks in the Zacks sub-industry improved 15% and the Zacks Technology sector are up 22.5% in the past six months. Over the past year, the Zacks sub-industry and sector have gained 16.9% and 29.8%, respectively.

The S&P 500 Index has risen 16.2% in the past six months and 21% in the past year.

The stock is currently trading at 35.57X forward 12-month earnings, which compares to 24.79X for the Zacks sub-industry, 23.19X for the Zacks sector and 19.36X 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 32.48X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$249 price target reflects 37.34X 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	41.85	23.28	22.84	18.96
	5-Year High	48.77	32.37	22.84	19.34
	5-Year Low	22.68	15.6	16.87	15.17
	5-Year Median	32.14	22.18	19.24	17.44
P/S F12M	Current	4.45	5.14	3.59	3.5
	5-Year High	5.21	10.29	3.59	3.5
	5-Year Low	2.27	4.34	2.3	2.54
	5-Year Median	3.23	7.46	3.01	3
EV/EBITDA TTM	Current	33.59	28.34	12.41	12.12
	5-Year High	33.59	32.87	12.6	12.86
	5-Year Low	16.39	20.85	7.68	8.48
	5-Year Median	24.93	27.64	10.52	10.67

As of 01/14/2020

Industry Analysis Zacks Industry Rank: Top 35% (90 out of 255)



Top Peers

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

Industry Comparison Industry: Computers - It Services				Industry Peers		
	EPAM Neutral	X Industry	S&P 500	ACN Neutral	CTSH Neutral	DXC Neutral
VGM Score	C	-	-	D	B	B
Market Cap	13.02 B	3.37 B	24.61 B	135.00 B	37.46 B	7.82 B
# of Analysts	9	5	13	11	12	6
Dividend Yield	0.00%	0.00%	1.78%	1.51%	1.17%	2.73%
Value Score	D	-	-	D	B	A
Cash/Price	0.07	0.06	0.04	0.04	0.09	0.31
EV/EBITDA	43.10	12.14	14.06	18.40	10.68	3.26
PEG Ratio	1.86	2.03	2.09	2.63	1.52	1.46
Price/Book (P/B)	8.70	5.44	3.29	8.65	3.40	0.86
Price/Cash Flow (P/CF)	49.56	15.16	13.65	23.83	13.67	1.90
P/E (F1)	36.48	21.99	19.21	27.14	16.71	5.71
Price/Sales (P/S)	6.01	1.60	2.70	3.07	2.23	0.39
Earnings Yield	2.74%	2.69%	5.19%	3.68%	5.98%	17.52%
Debt/Equity	0.12	0.23	0.71	0.17	0.13	0.80
Cash Flow (\$/share)	4.78	1.39	6.92	8.91	5.01	16.25
Growth Score	B	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	26.81%	18.65%	10.85%	11.25%	11.62%	21.43%
Proj. EPS Growth (F1/F0)	20.89%	7.73%	7.17%	6.31%	2.61%	-35.29%
Curr. Cash Flow Growth	38.99%	10.90%	8.56%	8.06%	-3.63%	1.14%
Hist. Cash Flow Growth (3-5 yrs)	26.61%	18.94%	8.36%	9.75%	10.30%	21.84%
Current Ratio	4.38	1.33	1.23	1.39	2.55	0.93
Debt/Capital	10.71%	33.63%	42.91%	14.60%	11.59%	44.56%
Net Margin	11.38%	2.36%	11.81%	11.06%	10.98%	-7.98%
Return on Equity	18.44%	11.38%	16.86%	33.35%	20.60%	16.98%
Sales/Assets	1.17	0.81	0.54	1.48	1.05	0.66
Proj. Sales Growth (F1/F0)	23.04%	8.24%	3.85%	6.66%	3.16%	-4.98%
Momentum Score	B	-	-	B	D	C
Daily Price Chg	1.63%	0.00%	0.06%	-0.01%	-1.71%	0.59%
1 Week Price Chg	2.14%	2.30%	2.47%	3.10%	13.38%	2.57%
4 Week Price Chg	1.30%	-0.97%	0.59%	1.62%	9.56%	-12.79%
12 Week Price Chg	15.20%	8.45%	6.98%	7.92%	7.92%	-13.45%
52 Week Price Chg	53.64%	-2.75%	16.62%	34.54%	-6.43%	-52.80%
20 Day Average Volume	227,580	330,606	2,020,569	1,796,744	3,490,203	3,670,561
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-0.34%	-1.04%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.05%	0.00%	-0.83%	-1.31%
(F1) EPS Est 12 week change	0.59%	0.00%	-0.17%	0.56%	-1.11%	-1.61%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.24%	0.00%	0.52%	-17.07%

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	B
Momentum Score	B
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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