

EPAM Systems, Inc. (EPAM)

\$226.03 (As of 02/24/20)

Price Target (6-12 Months): **\$260.00**

Long Term: 6-12 Months

Zacks Recommendation: **Outperform**

(Since: 02/23/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: B

Summary

EPAM Systems reported solid fourth-quarter results. The company is benefiting from growth across all industry verticals and geographies. Digital transformation, focus on customer engagement and product development are key catalysts. Moreover, deeper insights into AI, machine learning and analytics are an upside. Increase in demand in the second half of the quarter coupled with stronger performance from a few of its acquired companies drove results. Strong performance of its Financial Services segment, driven by rising demand within FinTech, payments, and insurance, is also a key driver. The company also incurred foreign exchange benefit due to the strengthening of Russian ruble. Shares of the company have outperformed the industry in the past year. However, slowdown in European banking demand is a dampener.

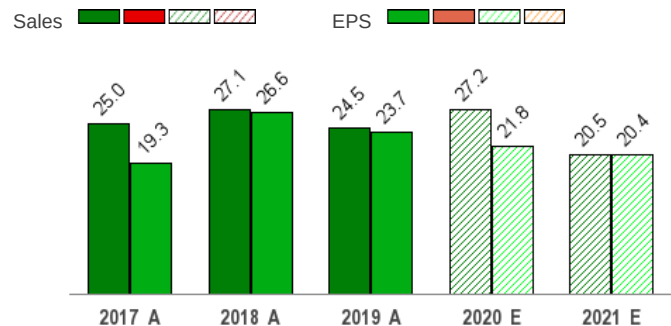
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$248.27 - \$155.30
20 Day Average Volume (sh)	268,611
Market Cap	\$12.4 B
YTD Price Change	6.5%
Beta	1.49
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computers - IT Services
Zacks Industry Rank	Top 21% (54 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.1%
Last Sales Surprise	2.4%
EPS F1 Est- 4 week change	-0.4%
Expected Report Date	05/14/2020
Earnings ESP	-3.5%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	784 E	826 E	872 E	941 E	3,517 E
2020	645 E	680 E	720 E	770 E	2,919 E
2019	521 A	552 A	588 A	633 A	2,294 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.71 E	\$1.79 E	\$1.94 E	\$2.16 E	\$7.95 E
2020	\$1.44 E	\$1.50 E	\$1.65 E	\$1.80 E	\$6.60 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.

P/E TTM	41.9
P/E F1	34.3
PEG F1	1.8
P/S TTM	5.4

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/24/2020. The reports text is as of 02/25/2020.

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.

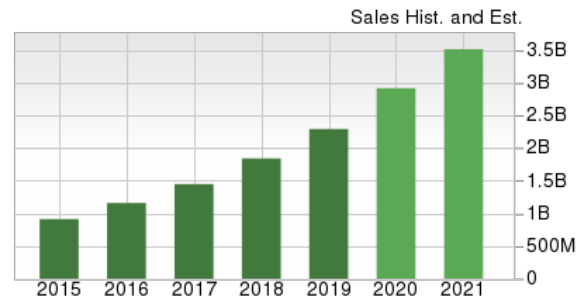
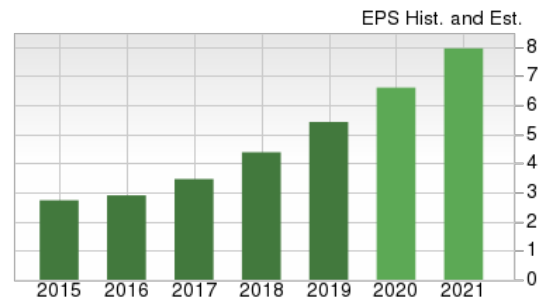
Its software product development services include product research, design and prototyping, product development, component design and integration. EPAM's custom application development services comprise business and technical requirements analysis, solution architecture creation and validation, development, 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.
- ▲ The latest forecast for worldwide IT spending by Gartner buoys optimism for EPAM's growth prospects. Worldwide IT spending is anticipated to be \$3.9 trillion in 2020, an increase of 3.4% from 2019. The research firm expects worldwide spending on IT services to reach \$1.081 trillion in 2020, representing a 5% increase from 2019. We believe EPAM is well-poised to capitalize 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 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 \$936.6 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.

Risks

- 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 49.33. 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 Q4 Earnings & Revenues Surpass Estimates

EPAM Systems' fourth-quarter 2019 non-GAAP earnings per share improved 18.9% year over year to \$1.51 and also beat the Zacks Consensus Estimate by 4.1%.

Additionally, revenues in the reported quarter came in at \$633 million, reflecting a year-over-year rise of 25.3%. The top line also surpassed the Zacks Consensus Estimate of \$618 million. On a constant currency (cc) basis, revenues were up 24.8%.

Increase in demand in the second half of the quarter coupled with stronger performance from a few of its acquired companies drove results. The company also incurred foreign exchange benefit of 0.5% due to the strengthening of Russian ruble.

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

EPAM Systems' largest vertical Financial Services exhibited 21.8% growth on a year-over-year basis. Travel & Consumer improved 15.9%.

Software & Hi-Tech was up nearly 24.5%. Business Information & Media rose 38%.

Life Science & Healthcare rose 20.3%. Exceptionally strong performance in the year-ago quarter resulted in tough year-over-year comparison.

Emerging Verticals improved 36.3%, driven primarily by clients in energy and telecommunications sectors.

Geographically, EPAM Systems generated 60.1% of total revenues from North America, up 20.2% year over year.

Revenues from Europe, contributing 32.7% to total revenues, were up 31.4% (31.7% at cc).

CIS or Commonwealth of Independent States, representing 4.9% of revenues, jumped 39.7% (27.7% at cc).

APAC rose 5.4%, accounting for 2.3% of revenues.

The company's top 20 clients climbed 22.1% year over year in the quarter under review while the rest improved 27.7%.

Margins

EPAM Systems' non-GAAP gross margin contracted 100 basis points (bps) to 36.7%.

The company's non-GAAP operating income improved 15.6% year over year to \$107.6 million while operating margin contracted 140 bps to 17%.

Balance Sheet and Cash Flow

EPAM Systems exited the fourth quarter with cash and cash equivalents of \$936.6 million, up from \$853.2 million at the end of the third quarter.

As of Dec 31, 2019, long-term debt was \$25 million, flat sequentially.

Cash generated from operating activities was \$124.6 million in the quarter compared with \$119 million reported in the previous quarter.

Free cash flow came in at \$77.6 million, compared with \$91.8 million sequentially.

Guidance

For 2020, EPAM Systems expects revenue growth to be at least 22% year over year. The company anticipates foreign currency fluctuations to have no impact on revenues. Inorganic contribution for the full year is expected to be around 1%.

Non-GAAP operating margin is projected in the band of 16-17%. The company anticipates non-GAAP earnings to be \$6.3.

For the fourth quarter, the company forecasts revenues of minimum \$642 million, up 23% (as reported and at cc) year over year.

Non-GAAP earnings per share are expected to be at least at \$1.36. Meanwhile non-GAAP operating margin is predicted between 15% and 16%.

Quarter Ending **12/2019**

Report Date	Feb 20, 2020
Sales Surprise	2.43%
EPS Surprise	4.14%
Quarterly EPS	1.51
Annual EPS (TTM)	5.39

Recent News

On Feb 5, 2020, 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.

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.

Valuation

Shares of EPAM have rallied 22.4% in the past six months and 45% over the trailing 12-month period. Stocks in the Zacks sub-industry improved 12.4% and the Zacks Technology sector are up 21.6% in the past six months. Over the past year, the Zacks sub-industry and sector have gained 12.9% and 24.7%, respectively.

The S&P 500 Index has risen 16.4% in the past six months and 18.6% in the past year.

The stock is currently trading at 33.95X forward 12-month earnings, which compares to 24.1X for the Zacks sub-industry, 22.26X for the Zacks sector and 19.09X 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 32.53X. Our Outperform recommendation indicates that the stock will perform better than the market. Our \$260 price target reflects 39.04X 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	33.95	24.1	22.26	19.09
	5-Year High	48.77	32.37	22.26	19.34
	5-Year Low	24.54	15.6	16.87	15.18
	5-Year Median	32.53	22.29	19.32	17.47
P/S F12M	Current	4.26	5.22	3.7	3.51
	5-Year High	5.21	10.29	3.7	3.51
	5-Year Low	2.27	4.34	2.3	2.54
	5-Year Median	3.25	7.4	3.02	3
EV/EBITDA TTM	Current	33.17	30.31	13.02	12.31
	5-Year High	33.17	32.87	13.02	12.85
	5-Year Low	16.39	20.85	7.68	8.47
	5-Year Median	25.05	27.63	10.54	10.7

As of 02/24/2020

Industry Analysis Zacks Industry Rank: Top 21% (54 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 Outperform	X Industry	S&P 500	ACN Neutral	CTSH Neutral	DXC Neutral
VGM Score	B	-	-	C	B	B
Market Cap	12.43 B	3.03 B	23.50 B	129.91 B	36.99 B	7.14 B
# of Analysts	9	5	13	11	12	6
Dividend Yield	0.00%	0.00%	1.83%	1.57%	1.31%	2.98%
Value Score	D	-	-	D	B	A
Cash/Price	0.07	0.05	0.04	0.04	0.09	0.34
EV/EBITDA	41.04	11.76	13.56	17.69	11.31	3.08
PEG Ratio	1.72	1.98	2.02	2.53	1.50	1.33
Price/Book (P/B)	8.31	5.67	3.20	8.33	3.35	0.79
Price/Cash Flow (P/CF)	47.31	14.83	13.05	22.93	13.39	1.73
P/E (F1)	33.58	21.81	18.56	26.12	16.56	5.22
Price/Sales (P/S)	5.42	1.53	2.60	2.95	2.20	0.36
Earnings Yield	2.92%	2.93%	5.38%	3.83%	6.04%	19.18%
Debt/Equity	0.12	0.26	0.70	0.17	0.13	0.80
Cash Flow (\$/share)	4.78	1.22	7.03	8.91	5.04	16.25
Growth Score	A	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	28.24%	18.65%	10.85%	11.25%	11.62%	21.43%
Proj. EPS Growth (F1/F0)	21.79%	8.12%	6.90%	6.31%	2.07%	-35.29%
Curr. Cash Flow Growth	38.99%	6.89%	6.78%	8.06%	-2.96%	1.14%
Hist. Cash Flow Growth (3-5 yrs)	26.61%	14.92%	8.38%	9.75%	10.46%	21.84%
Current Ratio	4.38	1.31	1.22	1.39	2.55	0.93
Debt/Capital	10.71%	30.69%	42.37%	14.60%	11.59%	44.56%
Net Margin	11.38%	2.36%	11.57%	11.06%	10.98%	-7.98%
Return on Equity	19.21%	12.20%	16.80%	33.35%	20.60%	16.98%
Sales/Assets	1.19	0.81	0.55	1.48	1.05	0.66
Proj. Sales Growth (F1/F0)	26.81%	8.62%	4.03%	6.66%	3.16%	-4.98%
Momentum Score	B	-	-	A	D	D
Daily Price Chg	-2.30%	-2.51%	-2.98%	-3.55%	-3.81%	-3.76%
1 Week Price Chg	-2.28%	-0.69%	-0.94%	-0.23%	2.44%	-5.09%
4 Week Price Chg	-0.36%	-0.13%	-0.94%	-1.06%	9.15%	-16.07%
12 Week Price Chg	10.23%	6.43%	1.75%	2.39%	6.11%	-22.39%
52 Week Price Chg	41.73%	-14.16%	10.97%	26.41%	-6.69%	-57.94%
20 Day Average Volume	268,611	400,279	2,001,782	1,723,187	3,668,797	3,902,312
(F1) EPS Est 1 week change	-0.40%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.40%	0.00%	-0.05%	0.00%	-1.35%	-1.31%
(F1) EPS Est 12 week change	0.13%	0.00%	-0.21%	0.55%	-1.43%	-1.61%
(Q1) EPS Est Mthly Chg	1.16%	0.00%	-0.49%	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	A
Momentum Score	B
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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