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Global

Global IT Services

Industry Reboot: M&A, Capital Return the Next Potential Catalysts

- **Capital allocation to gain prominence:** IT services firms globally could focus on improving capital allocation through such moves as M&A (moving beyond tuck-in deals), given their large/increasing cash piles. For India-heritage firms, improved cash return (buyback, div) over the next 12-24 months, in addition to M&A, could help sustain multiples as growth matures (*Industry Reboot*: Potential and Perils).
  - **Capital return to support Indian IT P/Es:** Vendors could see growth slow vs. the last decade as traditional markets are penetrated and the law of large numbers kicks in. Better capital return should sustain current multiples; e.g. ACN's robust cash return supports higher multiples than growth alone may warrant.
  - **Mature firms could explore optimization:** Vendors farther ahead on the curve (US/EU firms with mature growth and established buyback/div programs) seem more likely to use M&A, optimize B/S (refinance debt, address pension concerns, if any) or crystallize value from under-appreciated/non-core assets (divestitures).
  - ***Most likely* developments:** On our analysis of industry trends, B/S strength and history, the larger stocks are likely to be consolidators in the next 12-24 months. BPO firms and smaller geography-focused players appear better acquisition targets (*see table below*). Indian tier-one firms are also likely to focus on dividend.
- **Sub-sector capital intensity to trend down:** Capex for organic growth has been a leading use of cash (~32% of allocation over the last 5 years), but should trend down due to scale (larger companies operate at higher utilizations), slower growth and newer models (non-linear models, digital and managed services).
- **M&A could accelerate:** (1) Financial factors (low interest rates, solid B/S) in place for long; (2) Slower organic rev growth due to structural factors (cloud, SaaS, ERP slowdown, traditional services penetration, high base) an impetus for inorganic growth; (3) Need to expand new areas due to geographical/functional diversification, new (non-CIO) buyers, regulation. M&A may be seen as *buying growth*, but, if disciplined, sustaining higher growth with low-return B/S cash is a positive.
- **Structural vs. cyclical:** While growth rates could come off in the medium term with a higher penetration/base, cyclical trends cannot be ignored. We expect robust demand trends to continue and improve in CY14. ***Wipro, CTSH*** are our top picks.

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Global IT Services: "Most Likely" Developments Over Next 12-24 Months

Most Likely a Material Acquirer	Most Desirable Acquisition Candidates	Most Likely to Make Big Dividend News
Accenture, AtoS, Capgemini, Cognizant, IBM, TCS, Wipro, Xerox	Amdocs, EPAM, EXL Service, Genpact, Mindtree, WNS	HCL Tech, TCS, Infosys

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Portfolio Manager Summary

The global IT services sector remains an attractive investment choice for a number of good reasons, including (i) multiple secular trends, e.g., outsourcing growth, that support top-line growth, (ii) the ability to advise on, and influence the direction of, corporate investments, through consulting relationships, and (iii) attractive financial metrics, such as margins, cash flow, and healthy balance sheets. Relatively stable unit pricing and capable management teams round out the bullish outlook. Citi's recent Global Theme Machine report supports this view.

However, any multi-year view of the sector should consider the challenges associated with continuing growth at a high level (law of large numbers) as well as emerging opportunities (e.g., Mobility) and risks (e.g., cloud / SaaS).

Our view is that as growth inevitably decelerates (and this is likely a multi-year process due to a near-term cyclical uptick), the companies in the sector could pay especially close attention to *capital allocation*, including both increased M&A and a greater return of capital to shareholders through dividends and buybacks.

Capital allocation should gain prominence

Expect capital allocation to gain prominence in IT services – for Indian-heritage firms and larger global peers

- ***Most Likely* developments in the medium term** — IT services companies will gravitate to a more optimal capital allocation, in our opinion. We look for the pace and magnitude of sector M&A to pick up materially and also for more sustained cash return in the form of share repurchases and dividends. Most of our covered companies have the ability to do both. Figure 1 below shows our company-specific outlook.

Figure 1. IT Services "Most Likely" Developments Over Next 12-24 Months

Most Likely a Material Acquirer	Most Desirable Acquisition Candidates	Most Likely to Make Big Dividend News
Accenture, AtoS, Capgemini, Cognizant, IBM, TCS, Wipro, Xerox	Amdocs, EPAM, EXL Service, Genpact, Mindtree, WNS	HCL Tech, TCS, Infosys

Source: Citi Research

- **Macro stability** — Following almost half a decade of volatility, many economists are predicting steadier times in developed economies, which should promote a less risk-averse corporate attitude. While the recent EM currency volatility has tempered the optimism in the markets, end-demand in developed countries is expected to remain strong (Budget Spending Improves Globally).

Robust balance sheets offer enough room to improve capital allocation

- **Available balance sheet capacity (Figure 2, below)** — IT services vendors' balance sheets are increasingly robust and cash-flow generation remains quite healthy. Interest rates remain low, which can help with large deals, but many of the larger companies can comfortably fund good-sized acquisitions using cash on hand and their available credit lines.

Figure 2. Our Covered IT Vendors have Strong and Generally Improving Balance Sheet Health; Sustainable Free Cash Flows

Net Cash / Share in USD

	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013E	Most Recent Quarter	Net Cash as Percent of Market Cap
Accenture	4.40	5.79	6.31	7.68	9.14	7.87	6.45	7.9%
Amdocs	3.61	5.65	6.04	4.95	5.42	6.91	7.49	17.0%
AtoS	-6.10	-2.68	-2.45	-2.08	3.17	8.28	6.94	7.4%
Capgemini	7.45	11.56	7.81	3.46	6.55	4.00	4.62	6.2%
Cognizant	2.55	4.65	7.20	7.84	9.36	12.29	12.27	12.2%
CSC	-16.01	-12.69	-6.25	-4.83	-10.85	-4.44	-3.48	N/A
EXLService	3.84	4.50	3.66	2.48	3.03	4.60	3.85	15.2%
Genpact	0.92	1.60	2.03	0.23	-1.15	-0.37	-0.36	N/A
HCL Tech	0.84	-0.33	-0.07	0.04	0.16	1.02	1.22	5.1%
IBM	-15.54	-9.08	-13.46	-16.40	-18.47	-26.87	-26.87	N/A
Infosys	3.03	3.34	4.12	6.61	7.21	7.60	7.07	12.0%
TCS	0.10	0.06	0.51	0.62	0.73	1.07	1.30	3.7%
WNS	2.58	-3.63	-2.30	-1.77	-0.29	-0.43	0.66	3.1%
Xerox	-8.14	-3.91	-5.33	-5.55	-5.56	-5.10	-5.07	N/A

WNS steadily better after 2009 Aviva deal

Genpact cash position improving after Headstrong, Special Dividend

Capgemini balance sheet optimization

Free Cash Flow / Share in USD

	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013E
Accenture	3.02	3.71	3.72	4.09	5.35	4.11
Amdocs	1.60	2.10	2.93	2.28	2.31	3.46
AtoS	-2.10	2.60	2.34	3.82	3.28	3.44
Capgemini	3.89	3.34	2.61	1.55	3.95	0.80
Cognizant	0.87	1.98	1.87	1.89	2.74	3.47
CSC	0.75	6.28	4.66	3.90	1.32	3.14
EXLService	0.67	0.83	0.55	1.17	1.42	1.70
Genpact	0.65	0.48	0.48	1.02	0.99	1.11
HCL Tech	0.41	0.42	0.37	0.25	0.48	1.04
IBM	10.60	12.82	12.24	12.93	13.40	12.86
Infosys	1.11	1.43	1.78	1.65	1.58	1.21
TCS	0.18	0.72	0.67	0.65	0.66	0.87
WNS	0.30	0.93	0.90	0.46	0.80	0.84
Xerox	0.83	1.51	1.72	1.13	1.70	1.68

Source: Citi Research

- **Lower capital intensity frees up capital** — In addition to the above-mentioned point on the health of IT services corporate balance sheets, we also believe that the capital intensity of these businesses should decline due to a variety of factors including available scale and the lower capital requirements in faster-growing newer businesses such as digital technologies. Further, capital-heavy mega-deals that involve a large-scale transfer of assets and people are no longer in vogue.

Capital intensity should also trend down, with lower capex requirements: (1) pick-up in non-linear initiatives; (2) growth slows down on a higher base; (3) long-term mega deals go out of vogue

- **Slowing industry growth** — IT vendors no longer have the luxury of fast-growing traditional markets such as datacenter outsourcing (impact of cloud) and ERP / enterprise software deployments (impact of SaaS). Although India-heritage companies continue to outpace overall industry growth, they also have to face up to the impact of “the law of large numbers” and higher client penetration of traditional services in legacy markets.

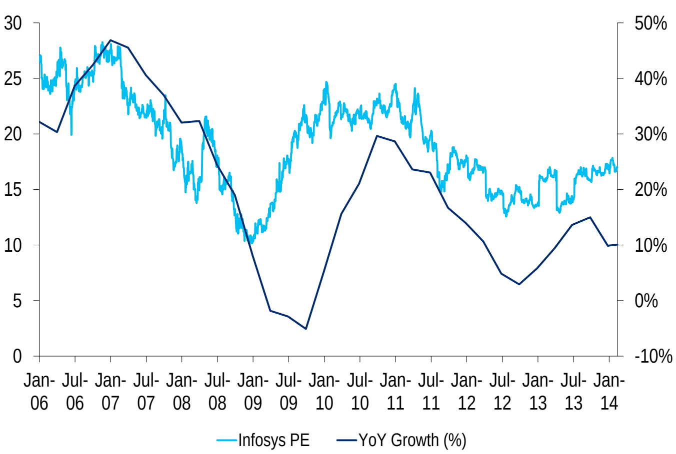
- **New strategic mandates with a high premium on growth** — Material new centers of IT spending other than the CIO have emerged. These new spenders – for example, business unit leaders or Chief Marketing Officers – look for transformational changes within their own businesses through better use of newer technologies that exploit the growth of Social Networks, Mobile Devices and Big Data. Allocating capital resources to these areas, possibly through inorganic means to improve time-to-market, is crucial.

Capital return to support Indian IT P/Es

Growth has been coming off over the last decade, as the industry has scaled up

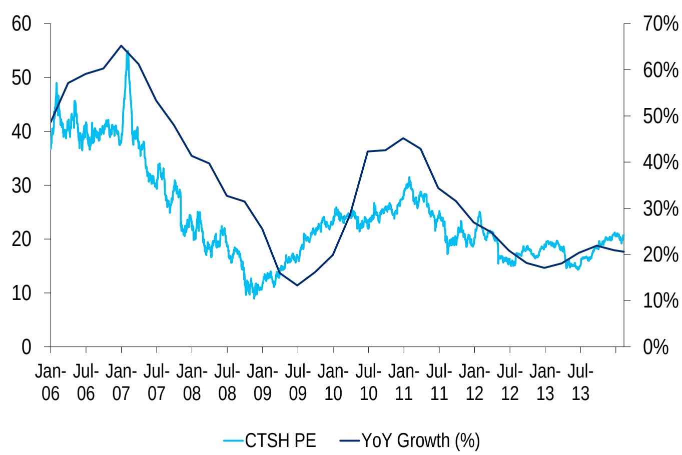
- **Indian IT growth rates settling at healthy mid-to-high teens** — Indian-heritage IT services has been a growth industry (a ~27% revenue CAGR over the last decade). However, during this period, growth has slowed; US$-revenue CAGR was ~35% in FY02-06, ~25% over FY07-10 and ~17% over FY11-13.
  - **Not surprising at this base:** This drop in growth is largely attributable to the higher scale/maturity of the industry (Infosys FY13 revenues were ~18x FY01 revenues and for CTSH, this number is a whopping 50x off a lower base) and given that offshore has become mainstream. Business models converging with global peers on scale/offshore mix has also partly contributed, stemming from the higher competitive intensity.
  - **Too big to grow? We think not!:** In Changing Face of IT Services - Industry Reboot – The Potential and the Perils, we discussed some medium-term demand themes that we expect to play out in the sector and how IT services firms could continue with low-to-mid teens growth rates.
- **Valuations have broadly kept pace with growth** — Traditionally, valuations in the sector have been closely correlated with US$-revenue growth (see Figures 3 and 4). The average P/Es of Infy/Wipro have trended down from ~23x (FY06-08) to ~19/16x (FY09-11) and ~16/15x (FY12-now), keeping pace with growth. This has led investors to wonder if ~15-20x multiples are sustainable if growth levels were to come off.

Figure 3. Infosys – Valuations correlated with US$-revenue growth



Source: Citi Research

Figure 4. Cognizant – Valuations correlated with US$-revenue growth

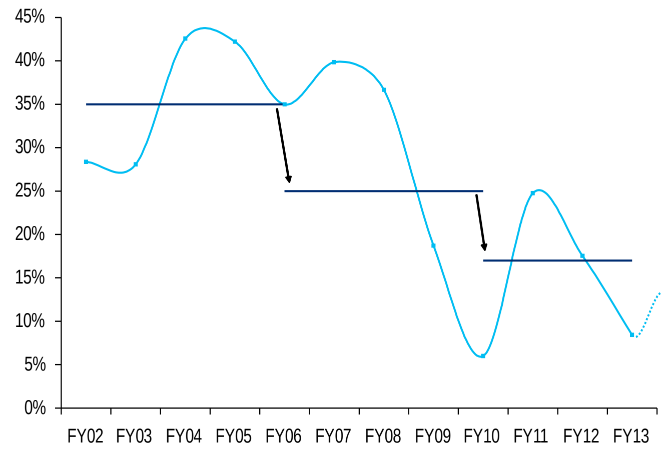


Source: Citi Research

Better capital allocation could emerge as the next catalyst and support medium-term multiples for Indian IT services

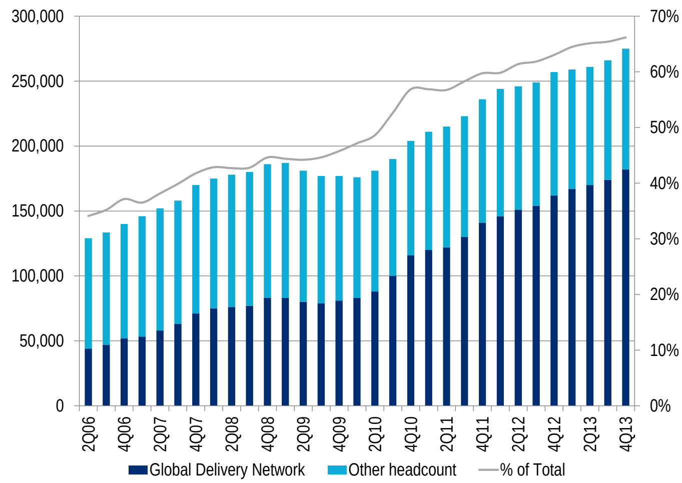
- **Capital allocation could emerge as the next catalyst** — With growth coming off, better capital allocation could emerge as the next catalyst for the sector and support multiples in the medium term. In Capital Allocation – Better Cash Usage Can Help Multiples, we discussed how Indian IT companies could add returns to shareholders with better cash distribution (dividends/buybacks). In addition, companies need to step up their focus on other modes of cash usage (like M&A).

Figure 5. Industry Revenue Growth has Stepped Down Over Time



Source: Company Reports, Citi Research; Indian IT Revenues calculated as sum of the top 4 companies

Figure 6. Accenture's Offshore Presence Has Increased to ~65%



Source: Company Reports, Citi Research

Key capital allocation actions to watch out for

- **Priorities could differ** — Indian vendors could step up capital return (buyback/ dividend), while also accelerating their pace of M&A. Vendors farther ahead on the curve (primarily US and EU heritage firms with more mature growth profiles and well-established buyback/dividend programs) seem more likely to use M&A, optimize their balance sheets (refinance debt, address pension concerns if any) or crystallize value from under-appreciated / non-core assets (divestitures).

Anecdotal Evidence Exists that a Well-Executed Cash Return Strategy Can Aid Valuation Multiples. This can also be seen in the "share shrinkers" basket created by our Global Strategy team

- **Cash return to shareholders to become more sustained** — We have clearly seen anecdotal evidence that companies that have instituted a sustained program of capital return to shareholders (via dividends and buyback) have benefited. All else being equal, better capital return can help a stock's multiple in addition to technical benefits that include attracting a wider range of investors and providing downside support for the stock in the event of a negative move.

- **Pace and magnitude of IT services sector M&A to pick up** — Historically, these companies have tended to make tuck-in acquisitions at a measured pace. But the confluence of the factors mentioned below should lead to an accelerated deal-making pace with possible larger deals thrown in, in our view. While some may view heightened M&A negatively ("buying growth"), disciplined and opportunistic (e.g., to fill in a portfolio gap) moves to help sustain a higher growth rate using low-return balance sheet cash is positive, in our view.

- **However, risks to M&A-led growth remain, including investor concerns over valuation paid and execution** — Also, "culture" remains quite important for these people-based companies; this risk is more about incompatible operating philosophy or approach rather than a geographical risk since most of these companies have a significant presence and experience in operating in multiple countries. So far, the sector has had a decent track record of assimilating the (mostly smaller) acquisitions that have occurred.

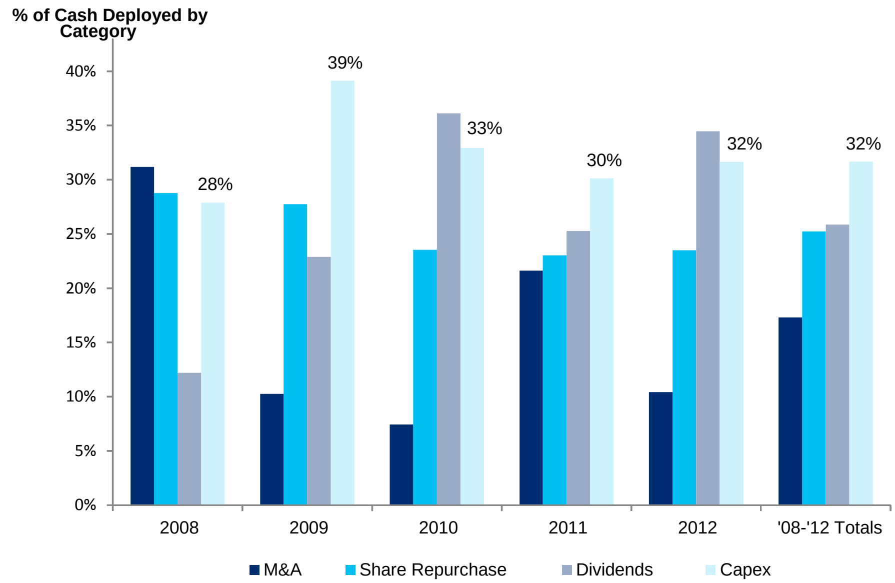
Changing Trends in Capital Allocation

The trend so far: Capex > M&A

Growth-related capex has been the biggest single use of cash generation in 2008-12. As CY13 results come in, we note that our conclusion would not change materially

Historical growth rates and patterns led to higher capital intensity for IT services vendors in the past. This meant that cash generated by the business was reliably re-directed towards capital expenditures to sustain that growth. The chart below shows that capex was the leading "use of cash" category over the last 5 years.

Figure 7. Capital Allocation Trends for IT Services: Capex was the Leading Spend Category



Source: Company Reports, Citi Research

We expect capex to gradually diminish in relative importance. The chart below qualitatively explains the reasons for our belief.

Figure 8. Some Reasons Why Capex Led "Use of Cash" In the Past, But May Not in the Future

Past Trend	Past Impact	Prognosis
Emergence of India heritage vendors (we estimate ~27% revenue CAGR over the last decade for the top 4 companies)	Significant capex investment to build and kit out campuses and centers to support this growth.	Scale; Slower growth at vendors; Emergence of models that depend less on FTE growth - these factors imply slower capex growth.
Competitive Response to Offshore - Significant ramp of global delivery infrastructure (organic as well as inorganic) by Traditional / Western vendors such as IBM, ACN, CAPP, etc.	Significant capex investment to build and kit out campuses and centers to support this growth; M&A by IBM, Capgemini to buy offshore capacity	Traditional Tier 1 vendors are "at scale" in terms of global delivery, which implies slower capex growth.
Asset-heavy and long duration multi-year outsourcing mega-deals	Capex associated with purchasing deal-related assets	Mega-deals have been on decline for many years now.

Source: Citi Research

- **M&A has been tempered in recent times** — While the relatively fragmented nature of the IT services sub-sector has meant that M&A has been an ever-present theme, the level of activity has been tempered in recent times (2008-12), with a focus on occasional tuck-in deals – this continued in late 2013 also. There were larger deals in the space, but were mostly IT Hardware (IBM, HP, Dell, Xerox) and Defense (Lockheed, Raytheon, BAE) companies buying IT services

assets due to the attractiveness of the business model. The tempered level of activity is broadly in line with the trend witnessed within the wider tech sector and to a large degree a function of the prevailing macro uncertainty, in our view.

- **Capital return selective** — We note that many of the firms with more mature growth profiles (primarily US and EU heritage firms) have steadier dividend payout ratios. These companies have also tended to use share repurchases in a steady manner to cull the share base to support EPS growth. India-heritage firms have tended to be more opportunistic in this regard.

- **Other actions affecting the balance sheet** — Firms with more mature growth profiles have made strategic divestitures to streamline their assets and optimize their balance sheets. CSC has divested 6 businesses in the recent past, in line with the new management's focus. AtoS plans to do a partial IPO of its payments business in 2014. IBM too has a very successful track record of divestitures.

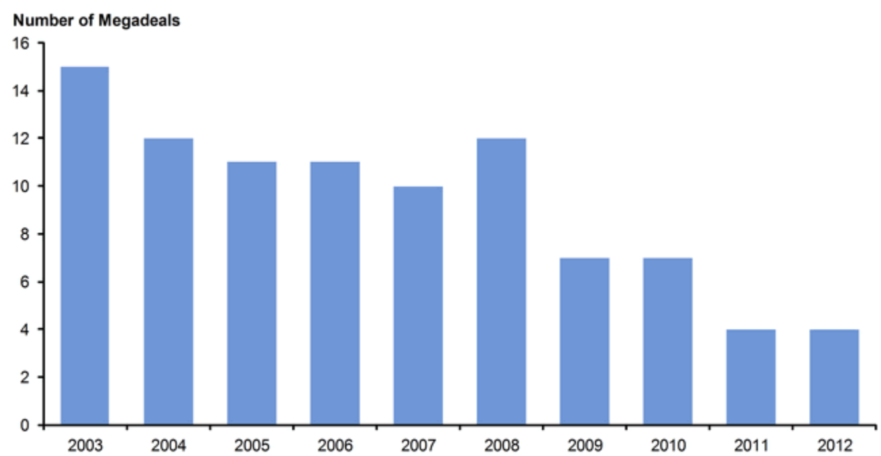
We see capex trending down

- **Moderating growth and increasing scale for Indian IT players** — For the top 4 companies, growth has been decelerating; US$-revenue CAGR was ~35% in FY02-06, ~25% over FY07-10 and ~17% over FY11-13. Of course, these are large companies now, safely within the top 25 global IT services companies.

- **New engagement models are emerging** — All major IT services firms have been trying to solve the "non-linear growth" conundrum for some time now and some of the newer lines of business are less dependent on FTE (full-time employee) growth. For example, the growth of Remote Infrastructure Management helps this cause. While there is initial investment required in hardware, software tools and network operations, once the solution is set up, it scales quite well with limited headcount additions. To a smaller extent, outcome-based contracts and platform-based BPO contracts also help in terms of growing with lower levels of capex. Lastly, while consulting is still FTE-based, it does bring in higher revenue/employee at a much lower capital investment.

As per ISG, mega-relationships were down ~38% year/year in 2013 and the number of deals in this segment was down ~30% year/year

Figure 9. Outsourcing Megadeals (TCV >US$1bn), Publicly Reported (2003-2012)



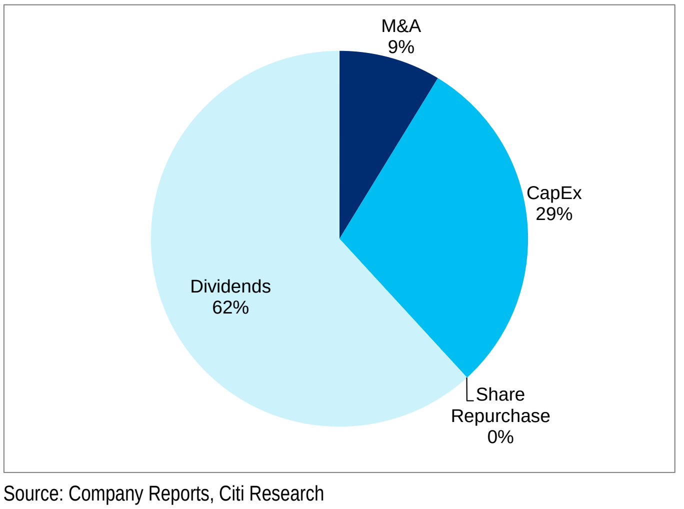
Source: Gartner (Outsourcing Trends, 2013: Balance Business Goals with Cost Focus in Outsourcing Contracting Practices Jan 2013), Citi Research

- **Reduced customer preference for large deals —** There has been a steady decline in the number of reported outsourcing megadeals signed over the years; according to Gartner, those with a total contract value (TCV) exceeding US$1bn

declined from a high of 15 megadeals signed in 2003 to 4 in 2012. We believe this is primarily due to market and buyer maturity as customers emphasize smaller deals to ensure more control, less risk and ease of approval in light of tighter budgetary constraints.

- **Deliberate effort to reduce exposure to asset-heavy deals** — To some degree there may be a deliberate effort on behalf of some vendors (such as Capgemini) to reduce exposure to asset-heavy deals in a bid to mitigate potential balance-sheet risks. Anecdotal evidence also seems to suggest that asset-heavy multi-year deals (many of which are now close to maturity / renewal after being signed 6-10 years) haven't necessarily translated into the returns/profitability that the vendors had hoped for when the deals were signed.

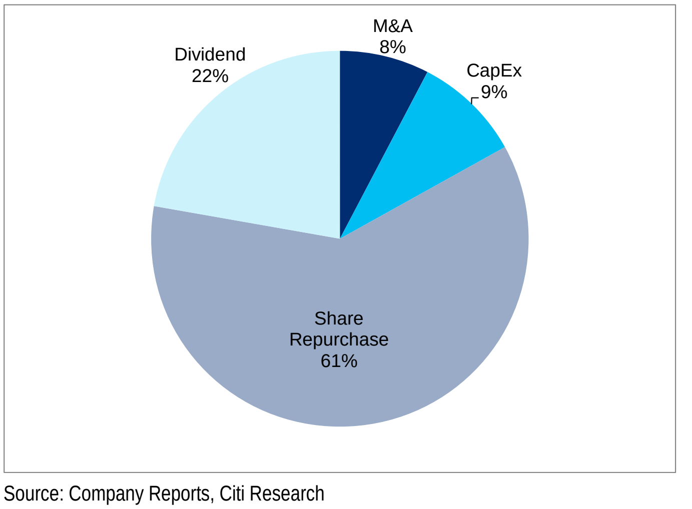
Figure 10. TCS: Leading Spend Categories (FY09-13)



Source: Company Reports, Citi Research

Note – TCS spent ~74% of its cash flow from operations during this time frame

Figure 11. ACN: Leading Spend Categories (FY09-13)



Source: Company Reports, Citi Research

M&A: Rationale and Key Players

Why should pace of M&A accelerate?

We look for an accelerated M&A pace, based on the following factors:

1. New strategic client mandate for transformational change and growth;

2. Slowing industry growth;

3. Available balance-sheet capacity;

4. Macro stability; and

5. Takeout as a potential catalyst (for the smaller firms).

(1) Strategic mandate for transformation

Several factors constitute the use of M&A as a strategic tool at this point.

- Meaningful non-traditional sources of demand are emerging
- Need for geographical diversification
- Regulatory dynamics (long-term impact of immigration reform)

Meaningful non-traditional sources of demand emerging

Many of the available growth opportunities within IT services are not in traditional growth areas like datacenter outsourcing or ERP deployment. These growth opportunities stem from business transformation that clients are engaged in. Many clients are looking to accelerate their own growth by focusing on new channels, geographies and innovation, while at the same time widening their cost-control initiatives. We described the evolving demand environment for IT services vendors in a couple of our reports in 2013, specifically (pages 1-10 of) our North American 2013 IT/BPO Preview and our global piece on the Changing Face of IT Services.

See our recent report Mobility Unchained: From Mobile Commerce to the Internet of Things for more detail on the mobility opportunity. This particular opportunity is both widespread and fast-growing and companies must react fast, in our view

An example of this growth opportunity is the transformational impact of Mobility on various industries – there can be impact not just in the obvious markets like Banking, Telecoms and Retail but also in industries as widespread as Utilities, Lodging, Quick-Service Restaurants and Agriculture. Another impact, mostly felt in consumer-facing industries, is the impact of the growth of Social Media and Networking. These diverse businesses need to adapt to these technology-based changes and obviously it drives demand for services.

What is different about this demand is that: (i) the buyer is often not the CIO or CTO who might have purchased traditional IT services – he may be the Chief Marketing Officer or the head of a business unit; (ii) the buyer likely speaks a “different language” and has more business-oriented rather than technology outcomes in mind; (iii) these are transformational projects from the business standpoint; (iv) the underlying business transformation is happening at a very fast pace and so the demand is for agile solutions and services; (v) there are continuing productivity initiatives at clients but they often involve BPO rather than IT – typically the CIOs do not “own” the BPO process and so they tend not to control the procurement either; (vi) Even when the CIO/CTO are involved in transformation it tends to be a multi-year cloud- or SaaS-related transformation, which requires a non-traditional approach to doing business.

The above-mentioned factors imply that many IT services vendors do not readily have the skills needed to help their clients with these new requirements. Moreover, their sales and marketing infrastructure is often more suited to building a traditional

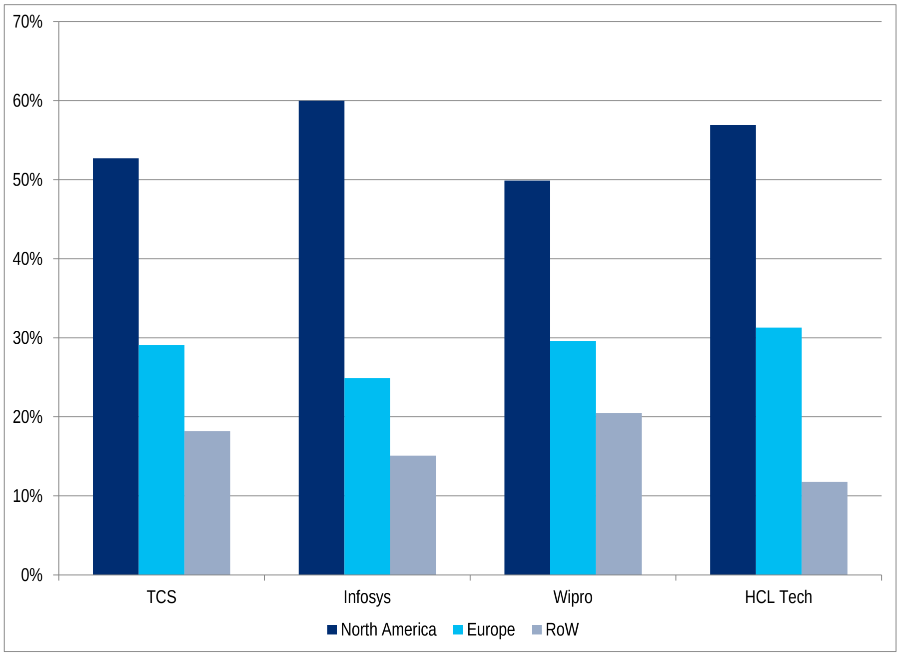
IT business. Combined with the speed of change, our contention is that IT services vendors are increasingly likely to choose “Buy” because the “Build” option may not get them market-ready in time.

Companies are looking to diversify to other geographies besides US

Need for geographical diversification

With the majority of our companies traditionally biased towards either the US/UK or Europe, we find that each of them is looking towards the other geographies in a bid to reap the corresponding strategic/financial benefits as well as the obvious de-risking that accompanies improved diversification. In addition, companies can also look to acquire diversified businesses to add scale and achieve operational efficiencies.

Figure 12. Most India-heritage IT Services Vendors Are Over-focused on the US



Source: Company Reports; Figure shows share of revenues from each geography

Local acquisitions could help mitigate medium-term risks of immigration reform, by helping build a sizeable local presence in quick time

Regulatory dynamics (immigration reform)

In mid-2013, Indian IT services stocks suffered due to the heightened level of regulatory risk related to prospective U.S. Immigration Reform. Currently, this has become less of an issue from an investor perspective since the current Congress is unlikely to address the matter in a timely fashion.

Our view is that immigration remains a problem that Congress must try to resolve and so we would expect the legislative risk to re-emerge on a 3-year timeframe. Some of the IT companies are addressing this risk – for example, Cognizant has stepped up its support for STEM initiatives and has announced an intention to hire more U.S. citizens and continue to apply for green cards at a rapid pace.

Still, on a longer-term timeframe, this is a concern that can be mitigated through the acquisition of local U.S. assets, among other possible steps. Indian IT services companies are looking at adapting by stepping up local hiring, setting up near-shore delivery centers (in locations like Latin America), moving some part of the work offshore and acquisition of US companies.

(2) Slowing industry growth

India-heritage IT services has been a growth industry (a ~27% revenue CAGR over the last decade). However during this period, growth has been slowing down; US$-revenue CAGR was ~35% in FY02-06, ~25% over FY07-10 and ~17% over FY11-13. Similarly, US and European company growth has slowed to the low-single digits – admittedly part of this is a cyclical impact but the “law of large numbers” plays into this, as does the slowing of traditional growth drivers such as enterprise software deployment.

A stable macro environment in the developed markets and strong balance sheet capacity offer favorable financial conditions for an uptick in M&A activity

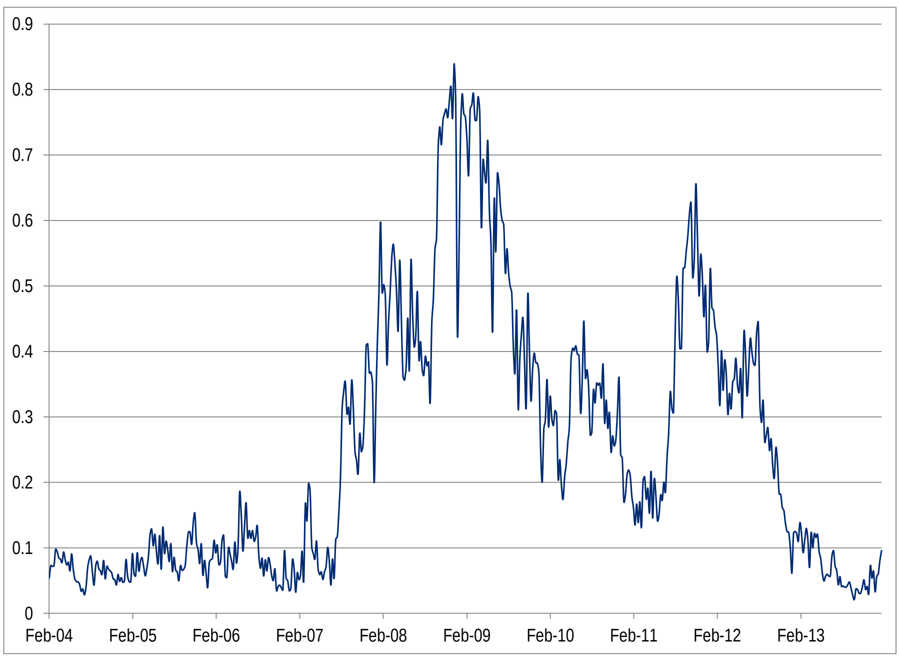
(3) Available balance-sheet capacity

We illustrated this in Figure 2 earlier in this report, but it bears repeating that companies in the sector, on average, have strong cash-rich balance sheets and relatively healthy cash generation.

(4) Macro stability

- Many broader economic indicators point towards incrementally improved macro stability. Figure 13 shows the ECB’s composite indicator of systemic stress to represent the level of macro risk in Europe. There is also evidence of normalization (relative to recent years) reflected in global PMIs, private sector debt, EU banks capital and US fiscal deficit.

Figure 13. ECB Composite Indicator of Systemic Stress



Source: Citi Research, Bloomberg; EASSCOMP Index

- **Low interest rate environment should persist** — Citi’s economists anticipate that monetary policy is likely to remain loose across advanced economies, and expect further loosening in 2014 from the BoJ and ECB.

Figure 14. Currency and Interest Rate Forecasts, as of 22 January

	22-Jan-14	1Q14F	2Q14F	3Q14F	4Q14F	1Q15F	2Q15F
United States: Federal Funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10-Yr. Treasuries (Period Ave.)	2.84	2.85	2.95	3.15	3.25	3.40	3.50
Euro Area: US$/€	1.36	1.37	1.39	1.40	1.40	1.40	1.41
Euro Repo Rate	0.25	0.25	0.00	0.00	0.00	0.00	0.00
10-Yr. Bunds (Period Ave.)	1.75	1.75	1.70	1.70	1.80	1.90	1.90
Japan: Yen/US$	104	105	106	107	108	110	111
Call Money	0.10	0.10	0.10	0.10	0.10	0.10	0.10
10-Yr. JGB (Period Ave.)	0.67	0.65	0.55	0.70	0.85	0.95	1.05

Source: Citi Research; F: Forecast. Note: All forecasts are for end of period, unless specified.

(5) Takeout as a potential catalyst

IT services, particularly in the traditional offshore service lines, can benefit from scale. This brings in several efficiencies in operations – ability to operate at higher utilizations, better sales coverage, and ability to bid for and win larger ticket deals among others. With greater maturity of offshoring, it has arguably become tougher for new/emerging entrants to break into client accounts currently serviced by larger, more established offshore players.

Why have companies acquired in the past?

IT services vendors have gone the M&A route before (just not at the pace or magnitude required now). We believe it is instructive to look at prior examples to get an idea of future M&A. The reasons why companies have looked to acquire in the past remain relevant, and possibly more so, even in today's environment.

1. Pursuit of new functional areas / service offerings;
2. Pursuit of new verticals;
3. Pursuit of a wider geographic presence;
4. Pursuit of scale; and
5. Regulatory reasons.

(1) Pursuit of new functional areas / service offerings

Emergence of new services necessitates quick investments as companies try to ramp and take advantage of demand in these areas

- *What?* — Newer service areas like Cloud, Mobility, Digital Marketing and Analytics are rapidly becoming mainstream services, necessitating quick investments (i.e., a "Buy" decision). These projects are highly strategic and the buyer tends to be different from the CIO, and so these new areas continue to see good demand even though budgets are constrained in the traditional CIO base.

- *How?* — IT companies are stepping up investments in these services either through direct acquisitions or through deep partnerships. Valuations are high relative to traditional services acquisitions – some were in the 6x-9x trailing sales – but other SaaS stocks trade at much higher multiples.

  A few examples are listed below and in the table that follows.

  – IBM's decision to acquire SoftLayer Technologies, which specializes in public clouds, was aimed at ramping up its ability to offer businesses and governments computing services hosted in the internet "cloud".

– Accenture's acquisitions of avVenta, Acquity and FjordNet were directed at building expertise in digital marketing while Procurement helped in Procurement BPO.

– EPAM's 2012 acquisition of Empathy Lab gave it digital commerce expertise.

– In the cloud arena, CSC's interesting relationship with AT&T and AtoS' strategic alliance with EMC and VMWare offer an interesting approach.

– HCL Tech's Axon acquisition in Dec 2008, while not ground-breaking relative to the broader space, was still interesting in that it demonstrated that India-heritage companies can actually "spend big" on an asset that grows a particular skill set – in this case, SAP skills and relationships that HCL had lower exposure to.

Figure 15. Representative Acquisitions to Augment Service Offerings

Date	Acquirer	Target	Value (USD in millions)	Description
Jul-13	IBM	SoftLayer Technologies	NA	Cloud computing infrastructure provider, which will enhance IBM's ability to integrate public and private clouds for clients. Headquarted in Dalls, Texas with 21,000 customers and 13 data centers across the U.S , Asia, and Europe.
Nov-13	Towers Watson	Liazon	$215	Provider of health insurance to small and mid-sized employers through a combination of direct sales and partnerships with over 400 brokers. Liazon is expected to insure ~40k employees in 2014.
May-13	Accenture	Acquity Group	$316	Provides e-commerce and digital marketing services.Acquisition expanded Accenture's digital marketing and e-commerce capabilities. Advisors were Goldman Sachs, The Blackstone Group, Shearman & Sterling, Sullivan & Cromwell, and Kirkland & Ellis
May-13	Accenture	Fjordnet	NA	Engaged in the provision of digital design consultancy services for mobile convergence markets. Fjordnet Ltd has 200 employees. The transaction will enhance digital and marketing capabilities of Accenture Plc, and also expand its technology and marketing operations services offered through Accenture Interactive.
Dec-12	EPAM	Empathy Lab	NA	Based in Pennsylvania, Empathy Lab LLC provides digital strategy and multichannel experience design services. Clients include USA Netowork, Rogers Communications, the American Red Cross and Liberty Global.
Oct-12	Accenture	avVenta Worldwide	NA	Digital marketing production company specializing in Digital Production, Marketing Operations and Platform Support for over 130 of the world's Fortune 500 companies. The acquisition strengthens the broad range of marketing services Accenture provides to chief marketing officers, from the development of marketing strategy to the management of marketing systems and campaigns.
May-12	Towers Watson	Extend Health	$431	Provider of health benefit managment services and operator of largest private Medicare exchange. Extend Health will operate as a new busienss segment called Exchange Solutions within TW.
Dec-08	HCL Tech	Axon	$785	Focused niche vendor active in SAP consultancy and implementation work with a market leadership position in the UK. The acquisition took the employee count in the practice to ~4,500 consultants.

Source: Company Reports, Media Reports, Citi Research

(2) Pursuit of new verticals

- *What?* — A few verticals figure prominently in every vendor's revenue mix – Financial Services, Telecom, Life Sciences / Healthcare, Manufacturing, Retail. However, different vendors have relative strengths, e.g., Accenture, TCS and Cognizant are strong in (different parts of) Financial Services; Cognizant has strong offerings in Life Sciences; Infosys in Manufacturing; CSC in Public Sector and Accenture in Process Industries. This strength in a particular vertical gives them an edge in terms of pipeline generation.

Adding/strengthening verticals and gaining new customers will continue to be one of the key reasons to acquire

- *How?* — Companies can acquire in their core vertical or try to quickly build scale in other verticals.

  – Tech Mahindra acquired Hutchison Global Services (Acquisition to Add Telco/Call Center Exposure) and also a 51% stake in Comviva (Comviva Acquisition – More Telco?) as it doubled down on its already strong telecom exposure.

– Wipro acquired SAIC's global oil and gas IT services business to enhance its position in its Energy, Natural Resources and Utilities SBU by augmenting domain capabilities in consulting, system integration and outsourcing services.

– EXLService acquired Landacorp in 2012 to enter the healthcare market.

– While slightly older, TCS' acquisition of E-Serve is an example of a company acquiring functional expertise (BPO) to strengthen an already strong vertical (Financial Services).

Figure 16. Key Acquisitions to Augment Customer Base and Vertical Presence

Date	Acquirer	Target	Value (USD in millions)	Description
Dec-13	Accenture	Procurian	$375	Procurian is one of the leading procurement BPO providers globally. Procurian focuses on delivering strategic sourcing business services to the Global 2000. Procurian is a subsidiary of ICG Group.
Feb-13	Genpact	JAWOOD	$51	Enhanced G's services for the healthcare payer market which is a strategic industry and growth area for G. Over 420 JAWOOD and Felix Software employees joined G, in this separate but related transaction.
Oct-12	EXLS	Landacorp	NA	Leading provider of healthcare solutions and technology with 50 million+ members under management on its platforms. Landacorp services and technology solutions provide clinical data and analytics to payers, providers, plan participants and accountable care organizaitions.
Sep-12	Infosys	Marsh BPO	NA	The captive BPO unit of US-based insurance brokerage Marsh & McLennan Companies, the company provided back-office services in the area of group life insurance business, and had 87 employees. The transaction would have added at least seven group life insurance clients for Infosys BPO.
May-12	Genpact	Atyati Technologies	$34	Provides information technology solutions for the banking industry. Acquisition allowed Genpact Ltd to expand its banking business in the rural areas of India. Payment was$ 19.4 mil cash, up to $ 14.4 mil earn-out payments, and undisclosed amount of deferred payment. 60 employees joined G.
Apr-12	Genpact	Accounting Plaza	$39	Provides finance and accounting services. Acquisition enhanced the operations of Genpact Ltd in the retail industry as well as expands its geographic coverage in the Netherlands.
Apr-11	Wipro	SAIC (Portion of IT business)	$150	The purchase covers the IT business of the firm's oil and gas vertical which provides consulting, system integration and outsourcing services to oil majors. ~1,450 employees moved to Wipro as part of the deal.
Oct-08	TCS	Citigroup Global Services (eServe)	$505	TCS purchased all of Citigroup's interest in Citigroup Global Services, an India-based captive business process outsourcing for Citigroup. In addition to the sale, Citi signed an agreement for TCS to provide process outsourcing services to Citi and its affliates in an aggregate amount of $2.5 billion over a period of 9.5 years.

Source: Company Reports, Media Reports, Citi Research

(3) Pursuit of a wider geographic presence

- *What?* — Based on the maturity level of IT usage and outsourcing usage, we consider three broad geographies – 1) the US and UK characterized by highest levels of offshoring, 2) Continental Europe where the current macro environment has triggered an increasing acceptance towards greater offshoring, and 3) Rest of the world / emerging economies characterized by stronger overall macro growth.

The India-heritage players have traditionally focused on the US and most of their "Europe" exposure consists of UK business. Obviously, Atos and Capgemini are very strong in their core markets in Europe. With most of our companies traditionally biased towards either the US/UK or Europe, we find that each of them is looking towards the other geographies in a bid to reap the corresponding strategic/financial benefits as well as the obvious de-risking that accompanies improved diversification.

India-heritage players could focus on Continental Europe while EU centric players focus on US/UK

– Offshoring has been highest in the US/UK, where early/easy market share gains seem to be behind us. Therefore for firms biased towards these markets (including all the Indian heritage vendors), the next leg of opportunity seems to be continental Europe. It has been a traditionally difficult market due to language / labor barriers. With the current macro environment exerting pressure on several European companies with a high cost structure, there seems to be an increasing acceptance towards greater offshoring – particularly in Nordics, Germany, Benelux and France.

– For EU-centric firms on the other hand, increasing exposure to US/UK drives group margin expansion (due to higher acceptance offshoring component). Capgemini aims to increase contribution from North America from 20% of revenues in 2012 to more than 25%.

Companies should focus on emerging markets given structurally higher growth

– Finally, most developed world companies across sectors are targeting M&A in emerging economies to benefit from the structural stronger overall macro growth, and IT services firms are no exception. However, meaningful targets in emerging economies remain few and far between. Still we have seen some deals in recent years such as Capgemini's acquisition of CPM-Braxis in Brazil and AtoS' move for Venture Infotek in India, both in 2010.

- *How?* — Clients in continental Europe need a near-shore centre to get more comfort, necessitating companies to invest much more than before. However, we understand that these near-shore centres are 20-30% more expensive than in India and availability of talent, particularly within the context of rapidly scaling up operations, remains a challenge.

  – In Sept 2012, Infosys acquired Lodestone Holding for an EV of ~US$350mn (~1.6x trailing sales). A management consultancy firm in Zurich, it provided (1) scale in Europe – Lodestone has ~83% revenues from Europe. (2) Access to clients – Lodestone had >200 clients, with very minimal overlap with Infosys. (3) Strengthening business transformation consulting offerings – Lodestone helped Infosys increase CSI revenues by ~10%. Please refer Lodestone Acquisition – Inorganic Strategy at Work for details.

  – In Dec 2012, Cognizant announced its acquisition of six companies of the C1 Group, an independent consulting and IT services firm based in Hamburg, Germany.

  – In July 2013, TCS acquired Alti SA, a system integrator of SAP solutions in France for ~€75mn (~0.6x trailing sales). TCS had been operating in France since 1992 and had over 50 clients in the country – Alti's team of ~1,200 employees helped to further scale up its operations in France, Belgium and Switzerland.

Figure 17. Key Acquisitions to Augment Geographic Presence

Date	Acquirer	Target	Value (USD in millions)	Description
Jan-14	Convergys	Stream Global Services	$820	Stream Global Services provides customer management services. The acquisition is expected to expand and strengthen CVG's US and European presence in outsourced customer management services within the technology industry. Clients include AOL, British Gas and Vodafone.
Oct-13	Cognizant	Equinox Consulting	NA	Consulting firm based in France providing services across financial services firms such as investment banking, asset management, retail banking, insurance.
Jul-13	TCS	Alti SA	$75	Formed in 1992, Alti is a system integrator of SAP solutions in France. It has ~1,200 employees and has operations primarily in France, Belgium and Switzerland.
Dec-12	Cognizant	C1 Group	$137	Acquisition expanded CTSH's expertise in enterprise application services and high-end testing services. 500 employees joined CTSH. The acquisition helped CTSH to expand its presence in Europe, Germany and in Switzerland.
Sep-12	Infosys	Lodestone Holdings	$350	A management consultancy firm headquartered in Zurich with an employee base of ~850 and >200 clients. Lodestone had ~83% revenues from Europe (largely Switzerland and Germany).
Dec-11	Infosys	Portland Group	$37	Portland Group, an Australia-based sourcing and category management services firm, had over 100 employees.
Jul-09	CSC	Bearingpoint - Brazil	NA	BearingPoint's Brazilian operation specializes in consulting and systems integration services. Bearingpoint had 550 employees. Acquisition supports CSC's growth plan by expanding presence in Brazil.

Source: Company Reports, Media Reports, Citi Research

(4) Pursuit of scale

- *What?* — Companies can also look to acquire diversified businesses to add scale. This brings in several efficiencies in operations – usually a more diversified revenue mix, ability to operate at higher utilizations, better sales coverage, and ability to bid for and win larger ticket deals among others.

iGate's acquisition of Patni (which was more than double its size) is a good example of why companies could pursue scale inorganically

- *How?* — A good example is iGate's acquisition of Patni. At the time, iGate (~US$300mn revenues) acquired Patni (~US$700mn revenues) which was more than double its size.
  - In Dec 2010, Atos Origin announced its intent to acquire Siemens IT Services business (SIS) for €850m (consisting of €186m cash, €250m convertible and 12.5m shares in the combined entity). Prior to this, in CY2009, Atos Origin had worldwide revenues of €5.1bn and Siemens SIS €4.1bn. Post closure in 1H11, the combined entity ('AtoS') posted revenue of €6.8bn in 2011 and €8.8bn in 2012. The deal saw Atos gain scale, in terms of service offerings (e.g. Managed services revenue rose from €1.7bn in 2010 to €4.1bn in 2012), geographic presence (e.g. Germany revenue increased from €377m in 2010 to €1.7bn in 2012) and vertical exposure (e.g. manufacturing, retail and transport contribution up from €1.5bn in 2010 to €2.9bn in 2012). In addition, the resultant cost synergies imply that the combined entity ('AtoS') is on track to post an EPS increase of ~50% over a two-year period (2011-2013) compared to standalone AtoS Origin. This enhanced fundamental positioning has been appreciated by investors, and since the deal was announced, the stock has outperformed the broader European market by more than 55% (as of Feb 17, 2014).
  - In terms of service offerings, the deal saw AtoS add substantial scale across all its disciplines, and in particular within managed services (€1.7bn in 2010 to €4.1bn in 2012).

(5) Regulatory reasons

- *What?* — Acquisitions could also be driven by regulatory reasons, like the US immigration bill for example. With the senate clearing the US Immigration Reforms Bill, concerns around its provision remain a big overhang on the sector. Investors are particularly concerned about the "Outplacement" clause, which could have a significant impact on the business model of the IT companies.

- *How?* — Depending on the final shape in which the regulation kicks in, Indian IT companies could need to hire locally in big numbers, and quickly. They could look at M&A as an option to build scale quickly and protect their existing contracts, especially if the "outplacement" clause were to be implemented. Anticipation of M&A activity could drive up valuations of small and midsized tech companies in the US. However, such acquisitions are likely to be margin dilutive but may not necessarily be EPS dilutive given that most companies are sitting on a lot of cash, which earns low returns.

Buyers and sellers

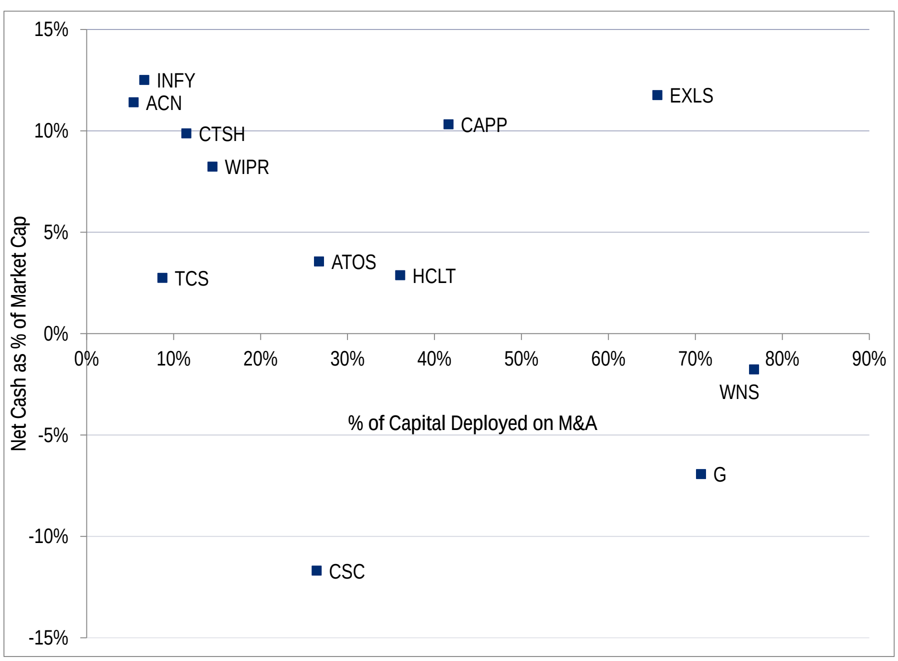
We believe our largest covered companies are likely to be consolidators rather than consolidated. Based on our analysis, it would appear that BPO companies and smaller regional players could be potential acquisition candidates.

Candidates set up for acquisitions

Accenture, CTSH, INFY, TCS and Wipro are interestingly high on ability to acquire but low on intent to acquire (based on last 5 years data)

Next we look at companies on two parameters – ability to acquire (function of balance-sheet strength and intent to acquire (based on historical track record). Interestingly, all the BPO names (Genpact, EXLS, WNS) have been aggressive acquirers deploying a significant part of their capital employed towards M&A over the past 5 years. The large Indian and US services names like Accenture, Cognizant, Infosys, TCS and Wipro have spent a very small part of their capital employed towards M&A over the past 5 years.

Figure 18. Acquisitions — Ability and Willingness



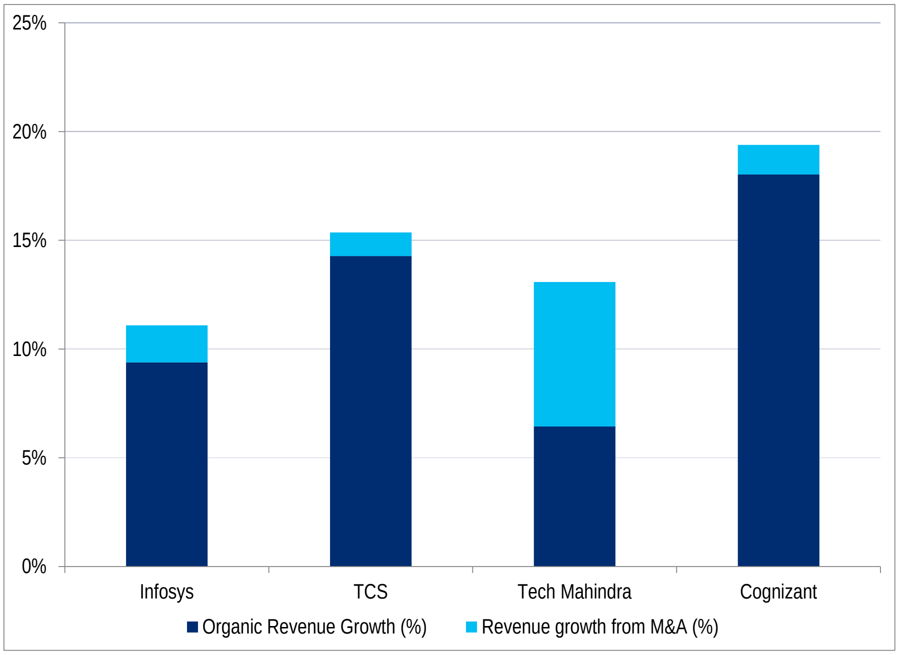
Source: Company Reports, Citi Research; Figure shows % of capital deployed on M&A over 2008-12

Impact of acquisitions

Given that most companies discontinue separate reporting post the integration of the acquired entity, we have used our assumptions for this exercise. Tech Mahindra has used acquisitions aggressively – the larger one being Satyam and following up with multiple smaller acquisitions.

Tech Mahindra has almost doubled its revenues on the back of the large Satyam acquisition and following that up with multiple smaller acquisitions

Figure 19. How Acquisitions Have Helped Add to US$-rev Growth in Most Recent Fiscal Year



Source: Company Reports, Citi Research

"Most Likely" to acquire

- **AtoS** — At AtoS's analyst day last year, management outlined its 2016 ambitions. AtoS IT is expected to deliver c.5% revenue CAGR over 2014-16. Of the implied increase at least half (~€700-900m) would be external. With a) many firms aiming to divest non-core assets, b) continental EU opening up to outsourcing (and offshoring) and c) AtoS's M&A discipline – captives (similar to SIS) seem the most likely targets to us. Further on the payments side (Worldline), strategic M&A – either transformational (to raise scale with focus primarily on EU) or focused-led (new regions / offerings) remains a priority. Given the scarcity of appropriate targets (particularly transformational) and the nature of the payments market (where we note that organic growth is relatively challenging due to high barriers to entry), we believe that for the 'right' deal' management would be open to doing M&A before the IPO of Worldline, its e-payments business (planned for some time in 2014), or even at the expense of slightly delaying the IPO.

- **Accenture** — While Accenture's acquisitions have been tuck-in ones directed to gaining functional expertise and customer scale so far, we note that some of the recent deals are actually reasonable-sized (Acquity for US$316m and Procurian for US$375m). If it found a deal that helped it dramatically gain scale (say, in BPO) or grow delivery in a new location – without diluting its culture – we believe Accenture certainly has the capability to pull the trigger.

- **Cognizant** — Cognizant is clearly a company that recognizes the need for urgency in terms of reinventing itself. While it has also been careful due to cultural factors, we believe there are actually a larger number of suitable candidates for them than for Accenture – geographical and functional diversification would be at the top of their list, in our view. This would also be helped by the desire of many companies in the industry (including reasonable-sized public companies) to "be like Cognizant", given their track record to-date.

- **Capgemini** — M&A remains firmly on the company's agenda but will be disciplined and primarily DCF-driven (vs. multiple-based approach) with some room for strategic premium. Management's preference in terms of regions remains North America (enables Capgemini to utilize DTAs worth ~US$1bn) and Emerging Markets (EM). Admittedly, targets in North America (NA) will likely not be inexpensive (due to tougher competitive dynamics as Indian vendors look to ramp up local presence and Japanese buyers benefit from improved liquidity) while eligible deals in EM are few and far between. Although management hasn't indicated a strong bias in terms of verticals, we are inclined to look towards the gaps in its portfolio in Oil & Gas and Healthcare, particularly in North America.

- **TCS** — Among India-heritage companies, TCS has been amongst the most open to pursuing M&A opportunities. In the past, the company has been unafraid to venture into larger acquisitions (like the "e-Serve" deal in 2008) and continues to do tuck-in acquisitions (like "Alti" recently) to deepen its access to specific geographies, service capabilities or verticals. The company also has a fair track record in integrating these acquisitions.

- **Wipro** — In the past, Wipro has made multiple acquisitions with its 'string of pearls' strategy including the acquisition of Spectramind, which gave it an early mover advantage in the BPO space. However, there have been fewer acquisitions in the past few years as the company has focused on (a) client mining and (b) creating large deal/hunting sales teams to accelerate organic growth. However, with some of these initiatives starting to play out, we believe Wipro will start focusing on opportunistically looking at acquisitions – recent acquisition of Opus CMC is a case in point.

Figure 20. "Most Likely a Material Acquirer" – Key Areas of Interest

Accenture	Digital Marketing	BPO	Scale in certain geographies
AtoS	Cloud	Payments	Presence in North America, Emerging Markets
Capgemini	Energy/Healthcare	Presence in North America	Presence in Emerging Markets, BPO
Cognizant	SMAC	Non-India Offshore Delivery	Onshore Relationships
IBM	Cloud/SaaS	BPO (Non-Call-Center)	Mobility
TCS	Presence in Europe	Consulting	Newer technologies
Xerox	Global Expansion(Asia, Brazil, Europe)	Data Analytics	Expansion of capabilities within Transportation, Healthcare, Customer Care & Finance & Accounting

Source: Citi Research

Most desirable acquisition candidates

IT services is undeniably a scale business – companies can operate at higher utilizations on a bigger employee base, have a wider sales presence (small companies may not be able to spread their sales force thin, given the cost implications) and see a relatively steady business performance (a single contract or deal win is not likely to have a material impact on a larger scale). For these reasons, the industry should tend to remain concentrated in the long run, in our view.

- **Genpact, WNS and EXL Service** — Is there a place in the industry for three successful pure-play BPO companies? Can each of these benefit from the freedom to invest and grow their businesses out of the public eye (as part of a larger company, perhaps)? Is the level of competition in BPO increasing given the secular trend towards BPO? We believe the answer to all three is "yes" and so we would posit that this list shrinks over the next 12-18 months.

- **EPAM** — Non-India delivery is fast-becoming a necessity from a client's risk management viewpoint. At the same time, scale is difficult to come by in LatAm and there are myriad of concerns in China as well. Eastern Europe offers a robust alternative and EPAM is the market leader in this respect.

- **Mindtree** — Among mid-cap India-heritage IT services companies, Mindtree is perhaps the closest to larger peers in terms of its business mix – well diversified across verticals and service lines. However, given its smaller scale and relatively higher exposure to discretionary spend, the company has tended to see more volatility in its performance – revenue growth in the past 20 quarters has varied from -9% to +10% qoq. Being a part of a larger company should help in a steady performance. The company is professionally run, and management has broadly exhibited good corporate governance. In this context, while so far there have been no indications of a willingness to be acquired, we believe a shareholder-friendly proposal could be given consideration. Ownership is also relatively concentrated with 3 shareholders accounting for a ~26% stake (12 holders account for ~50%).

- **Amdocs** — What might Amdocs bring to the table for an acquirer? Market leadership and focused vertical expertise in the telecom vertical; above-telecom-market growth rate; good client base; healthy margin and cash flow profile. In other words, Amdocs could make a good target for the right acquirer.

The dark side – What are the risks?

Post-deal integration is usually the key risk. In this context, "culture" risk should be lower given fairly diversified presence

While pursuing an inorganic growth strategy has its advantages, companies also remain cognizant of the key risks:

- Post-deal integration is often cited as the single greatest cause of concern in achieving a successful M&A transaction. In this context, "culture" risks associated with geography are relatively lower given that most of these companies have a significantly diversified presence and experience of operating in multiple countries. But "culture" risks associated with possibly incompatible operating philosophy is still important, in our view. So far, companies in the sector have had a decent track record of assimilating acquisitions.

- Other risks include pre-deal risks like insufficient due diligence (especially in emerging/frontier economies with less transparent/stringent accounting norms) and consequent inaccuracies in the valuation process.

- Changing regulatory and legislative environment presents another key area of risk. However, given the wide geographic presence of IT services companies, they are already exposed to the same, in some measure.

Distributions: Dividends & Buybacks

Most of our covered companies would, in our view, step up their M&A if the right opportunity came along. However, by its very nature, M&A tends to be sporadic and less predictable.

Our Global Strategists believe that their buyback theme (and their related basket of "share shrinkers") should continue to be an outperformer

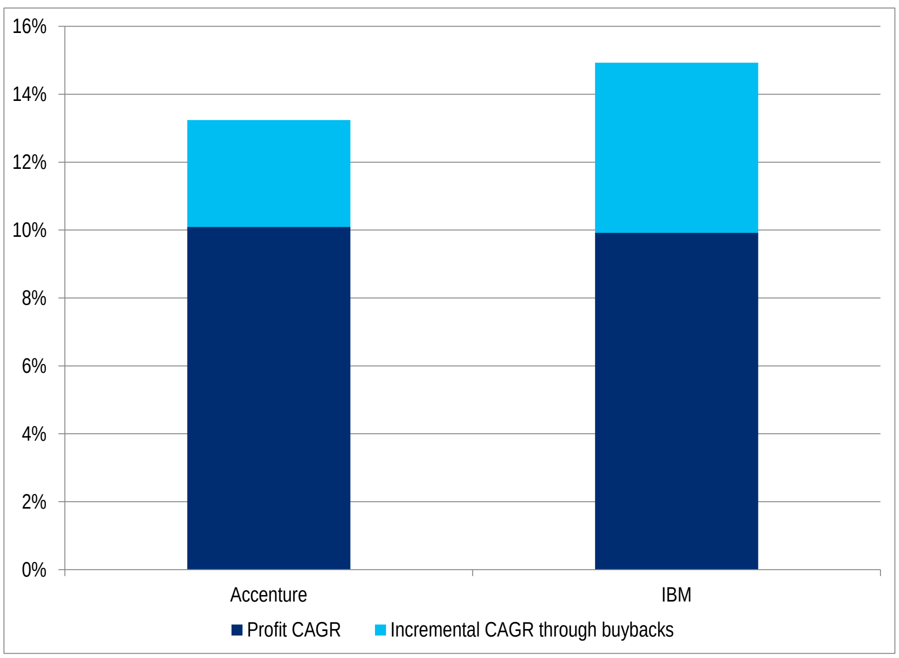
Other cash uses – dividends and buybacks – can be more predictable and help shareholder returns. Our view is that most of our covered companies can take on multiple cash uses simultaneously. This can also make the companies more relevant for a different set of investors – for example, the offshore names are currently a focus for growth or GARP investors – a good yield (more than twice the benchmark or more) could result in interest from value investors as well.

– **Enough room to take up distributions** — Indian IT companies have enough room to take up distributions via dividends/buybacks; Infosys/TCS have distributed ~35/45% of the operating cash flow generated in the five years over FY08-12. Share buyback or higher dividends would increase the return ratios of the companies and should make Indian IT more attractive to long-term holders.

IBM/Accenture have demonstrated how an organized buyback program can be successful in generating additional returns to shareholders

– **Buybacks: IBM/Accenture are great examples** — IBM/Accenture have, over the last 5 years, demonstrated how an organized buyback program can be successful in generating additional returns to shareholders, adding ~3-5% CAGR to their profit growth.

Figure 21. IBM/Accenture Have Added ~3-5% to EPS CAGR in Last 5 Years Through Buybacks



Source: Company Reports, Citi Research

– **Accenture is a classic case in point** — Over FY09-13, Accenture has distributed ~85% of its OCF through dividends/buybacks. In fact, Accenture's buyback has helped its EPS CAGR by ~3%. This has played a part in supporting valuations; over the past five years, Accenture has commanded an average PE of ~14.5x.

Figure 22. Accenture – Share Repurchases Over the Past Few Years

	FY09	FY10	FY11	FY12	FY13
Shares repurchased/redeemed (million)	58.0	52.0	42.8	36.6	34.4
Average Price (USD)	32.0	40.0	50.8	57.3	74.1
Average Stock Price during the FY (USD)	31.8	39.9	51.2	58.2	72.9

Source: Company Reports, IBES

Over 2000-12, IBM has reduced its share count by >35%

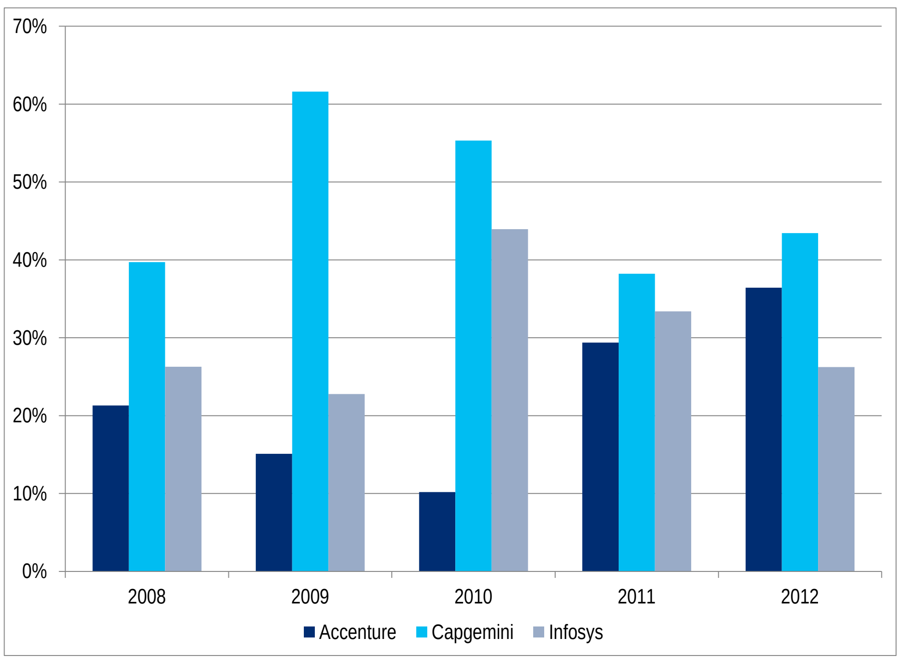
– **IBM also has an active road map for repurchases** — Over 2000-12, IBM has returned ~US$150bn to shareholders and has reduced the share count by >35%. This buyback program has helped IBM add an incremental return of ~5% over CY07-12 to its profit CAGR of ~10%. In 2013, the company made share repurchases worth ~$14bn.

– **Apple is another notable example in the tech sector** — Apple has the largest cash pile of any US company. In April, the company announced a plan to return an incremental US$50bn through share repurchases by Dec 2015. In the recent quarter, Apple utilized a total of US$16bn on share repurchases. Our US analyst's view is discussed in Buyback in Rearview Mirror, where he pegs the benefit to EPS at 2.6%-5%.

Significant room to step up dividends across the sector

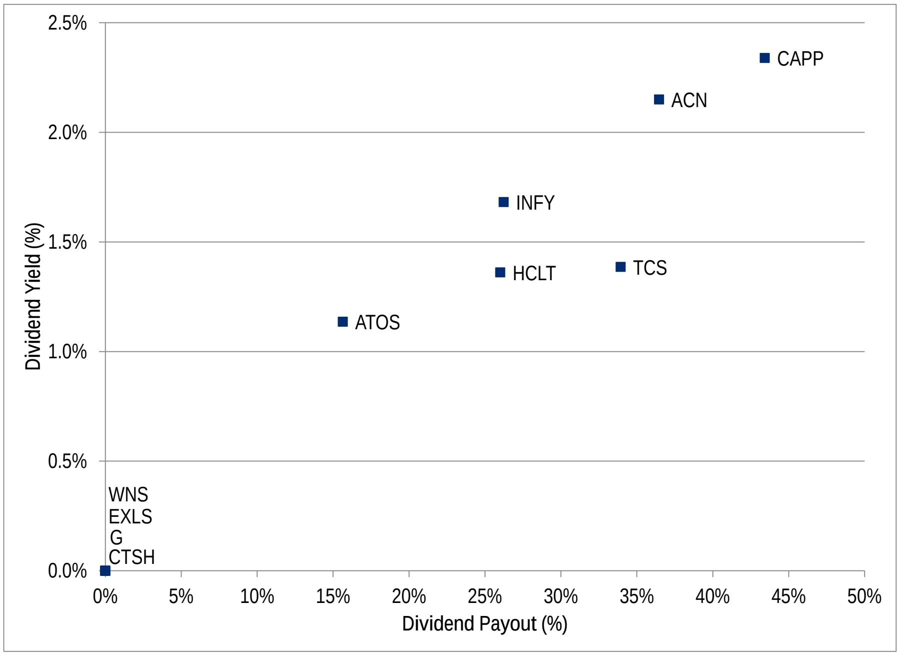
- **Dividends: Accenture/Capgemini for inspiration** — Companies like Accenture and Capgemini demonstrate that there is enough room for dividends in the sector to go up from current levels of distribution. Increasing the payout could further add ~2% to shareholder returns.

Figure 23. IT Services – Dividend Payout Over the Years



Source: Company Reports

Figure 24. IT Services – Dividend Distribution of Key Companies



Source: Company Reports, Citi Research

Infosys (high cash balances) and HCLT (lowest payout ratios; historical payout ratio has been much higher) are key candidates to watch out for higher dividends

- **Ability/willingness to increase payout** — Infosys (cash at ~58% of balance sheet) and HCLT (>50% payout before Axon acquisition; now at ~25%) are key candidates to watch out for:
  - Infosys has had the leeway to increase payout for a while, but management has been reluctant citing aspirations to pursue acquisitions. This is perplexing in our view, given that acquisitions can be funded by cash generation and if required, interim debt, which can be wound down given cash generation in the business.
  - HCL Tech had a high payout (50%+) prior to the Axon acquisition – with the company becoming net cash again, it will be interesting to watch out for the payout strategy – there is room for a significant increase.

Divestitures and Other Optimization Steps

In our view, those farther ahead along the curve (primarily US/EU heritage firms with more mature growth profiles and well-established buyback/dividend programs) seem more likely beneficiaries of additional steps aimed at optimizing balance sheet (eg: refinancing debt and addressing pension concerns if any) and crystallizing value from under-appreciated/non-core assets (partial/complete divestitures).

- **Divestitures help free up cash** — Divestitures of lower-margin or non-core businesses lead to a better cash generation profile, streamline portfolios, and also enable companies to increase their focus on their core businesses. Valuation arbitrage is also usually supportive in a demerger.

Divestitures could also help free up cash and help companies invest in strategic priorities – for example CSC has divested 6 businesses in the recent past

  – CSC has divested 6 businesses in the recent past in line with the new management's focus; the cash generated can be used to align the business in line with new strategic priorities.

  – AtoS has announced the carve-out of its payments and transactional activities into a separate company, Worldline, and plans to have a partial IPO for this business in 2014. With most investors now increasingly factoring in sum-of-the-parts (SOTP) analysis to value the investment thesis on the stock, we anticipate supportive valuation arbitrage to come into play.

  – IBM has a very successful track record of divestitures. A good example is its deal to divest its worldwide customer care services business (SNX's Acquisition of IBM's CRM BPO Business Represents a Win-Win) which demonstrates its continued intention to focus on higher value/ higher margin service offerings.

- **Releases management bandwidth** — Spinning off non-core or unrelated businesses (which could have been a part of the company for legacy reasons) also helps free up management bandwidth to focus on the core business.

  – Wipro undertook a demerger of its consumer business in Nov 2012, along with Wipro Infrastructure Engineering (Hydraulics & Water businesses), and Medical Diagnostic Product & Services business (through its strategic JV), into a separate company. Put together, these formed ~14% of revenues. The demerger was done to facilitate pursuit of separate growth strategies by both entities. It also helped allay any investor concerns about cash generation in the IT business being used to finance growth plans of the consumer business.

- **Other optimization steps** — Although not strictly coming under the ambit of capital allocation, we highlight for the sake of completeness that we also see mature firms evaluating other optimization steps (such as refinancing of debt and addressing pension concerns) in an attempt to improve FCF generation and reduce existing balance sheet risk, thereby facilitating an increased level of M&A.

  – In 2013, Capgemini announced a series of steps to optimize its balance sheet – a) allocation of €400m to partially buy back the dilution of the 2014 convertible bond (OCEANEs due 2014), b) one-off pension-related cash contribution of €235m – this is expected to enable the firm to increase annual FCF starting 2014 by €30m as well as drives a €9m reduction in financial expenses in 2014/2015, and c) new €400m offering of convertible bonds (ORNANEs due 2019) to partially finance the purchase of OCEANE 2014.

  – At AtoS's analyst day last year, management too outlined a series of steps – a) Defined benefit (DB) pensions plan in Netherlands (NL) converted to defined contribution (DC) - €155m settlement in €40m cash and €115m stock, b) new €230m share buyback to offset performance shares and NL pension dilution, c) early redemption of OCEANE 2011 converts.

Structural vs. Cyclical

Secular growth step-down; cyclicality a near-term positive

Medium-term growth rates could come off with high base

- **Secular slowdown** — Just to be clear, while we argue for growth rates to slow down, we are referring to secular longer-term growth rates. IT vendors no longer have the luxury of fast-growing traditional markets such as datacenter outsourcing (hurt by cloud) and ERP / enterprise software deployments (hurt by SaaS). India-heritage companies continue to outpace overall industry growth for now, but they also have to face up to the impact of "the law of large numbers" and higher client penetration of traditional services in legacy markets.

We expect the good demand trends seen in CY13 to continue into CY14

- **However, positive cyclical impact coexists** — As we have indicated in our recent 2014 preview (Looking Ahead at CY14 – Make Hay While the Sun Shines!), we believe the positive cyclical trends that we experienced in 2013 (see Déjà Vu - Will CY13 Be a Repeat of CY09?) should repeat this year.

Top picks are Wipro, CTSH

- **Buy Wipro in Indian IT** — Among the Indian heritage companies, we prefer Wipro. The recent quarter saw Wipro's best sequential growth in the past 9 quarters which coupled with reassuring guidance/commentary suggests a directional pickup in growth. Our quarterly Citi CIO survey of 260 CIOs (Budget Spending Improves Globally) also suggests a pickup in wallet share (21% now and 25% in 3Q13 from 13% in 2Q13 and declines last year). Margin trajectory is encouraging, and valuations at ~14.5x FY15E still offer good upsides ahead.

- **Buy Cognizant in US IT services** — Among the US IT/BPO companies we cover, our top pick is CTSH. Offshore outsourcing continues to be a strong market (mega-deal renewals; financial services and healthcare strength; outsourcing in Europe picking up) and our research shows CTSH as a steady wallet-share gainer. It is also making ongoing investments to grow consulting services and SMAC (social, mobile, analytics and cloud) revenues. Moreover, we believe it should sustain stable margins, so its upper-teens revenue growth translates well to net income growth. Its 3-year net income CAGR of ~17% and strong balance sheet with ~12/share in cash make the current valuation attractive, in our view. We particularly like the set-up for 2014 for CTSH.

Figure 25. IT Services — Valuation Comparables (standardized for Dec year-ending)

		Mkt Cap	Price				P/E (x)		P/B (x)	
Company	Ticker	US$ (M)	Ccy	Current	Target	Rating	2014	2015	2014	2015
Accenture	ACN.N	56,189	US$	82.59	96.00	1	17.7	15.9	6.9	5.3
Amdocs Ltd	DOX.O	7,069	US$	44.29	52.00	1	13.7	12.5	2.0	1.8
Atos	ATOS.PA	9,378	€	69.44	74.00	1	14.0	12.5	2.2	1.9
CAP Gemini	CAPP.PA	11,869	€	53.81	53.00	1	15.6	14.3	1.8	1.7
Cognizant	CTSH.O	30,409	US$	100.07	115.00	1	19.6	16.7	4.2	3.4
Comp Science	CSC.N	9,161	US$	62.88	60.00	2H	14.7	13.3	2.0	1.8
EPAM	EPAM.N	2,075	US$	44.62	46.00	1	23.2	20.1	4.6	3.8
ExlService	EXLS.O	856	US$	26.00	31.00	1	13.7	11.9	2.0	1.8
Genpact	G.N	3,494	US$	15.11	-	2	14.9	13.3	2.3	2.1
HCL Techno	HCLT.BO	16,752	Rs	1,489.70	1,540.00	1	16.1	13.8	4.6	3.6
Infosys	INFY.BO	33,817	Rs	3,680.00	4,050.00	1	17.1	14.9	4.0	3.4
IBM	IBM.N	198,918	US$	183.19	235.00	1	10.2	9.1	9.0	6.7
Mindtree	MINT.BO	1,088	Rs	1,625.05	1,740.00	1	12.6	NA	3.4	NA
Tata Consult	TCS.BO	68,236	Rs	2,166.15	2,350.00	2	19.3	16.8	6.4	5.1
Wipro	WIPR.BO	21,956	Rs	557.05	650.00	1	15.3	13.3	3.5	2.9
WNS Hldg	WNS.N	1,087	US$	21.24	26.00	1	14.8	13.1	3.3	2.8
Xerox Corp	XRX.N	12,739	US$	10.72	13.00	1	9.4	8.3	0.9	0.9

Source: Citi Research estimates and dataCentral. (19 Feb 2014)

Appendix 1 – M&A Database

Figure 26. Notable M&A Transactions

Date	Acquirer	Target	Value (USD in millions)	Description
Jan-14	Accenture	ClientHouse	NA	Based in Germany, provides salesforce.com and Veeva Systems. Expected to expand ACN's salesforce in Europe, and strengthen ACN's Salesforce implementation services
Jan-14	Convergys	Stream Global Services	$820	Stream Global Services provides customer management services. The acquisition is expected to expand and strengthen CVG's US and European presence in outsourced customer management services within the technology industry. Clients include AOL, British Gas and Vodafone.
Dec-13	IBM	Aspera	NA	Provides software for transferring large amounts of data across a WAN (Wide Area Network).
Dec-13	IBM	Fiberlink Communications	NA	Mobile management and security company through cloud-based technologies.
Dec-13	IBM	Associated Dexia Technology Services SA	NA	Provider of IT services to financial institutions and subsidiary of Belgium firm Dexia. IBM purchased a controlling stake and will rename it Innovative Solutions for Finance.
Dec-13	Accenture	Procurian	$375	Procurian is one of the leading procurement BPO providers globally. Procurian focuses on delivering strategic sourcing business services to the Global 2000. Procurian is a subsidiary of ICG Group.
Dec-13	Wipro	Opus CMC	$75	US-based provider of mortgage due diligence and risk management services with >490 employees spread across 5 centers.
Nov-13	Tech Mahindra	Mahindra Engineering Services Ltd	NA	Engineering consultant catering to automotive, aerospace, defense & manufacturing industries with >1,300 employees, founded in 2003.
Nov-13	Accenture	Businesses from Evopro Group	NA	Acquisition of industrial and embedded software development and services business with operations in Germany, Hungary, Romania and Turkey.
Nov-13	IBM	Xtify, Inc.	NA	Provider of cloud-based mobile messaging platform for CRM and marketing. Clients include Stables, Disney Stores, Ritz Carlton and WebMD.
Oct-13	Accenture	PCO Innovation France	NA	Located in Paris, France, provides international consulting and systems integration services, delivering PLM software technologies. PCO Innovation works with gloval clients in the French and North American markets.
Oct-13	CSC	ServiceMesh Inc.	NA	Provides enterprise cloud management platform.
Oct-13	Cognizant	Valuesource NV	NA	Valuesource provides information and communications technology services focusing on the financial and insurance verticals
Oct-13	IBM	The Now Factory Ltd.	NA	Provider of analytics software that helps communications service providers analyze network and business data. Headquarted in Dublin, Ireland.
Oct-13	Cognizant	Equinox consulting	NA	Consulting firm based in France providing services across financial services firms such as investment banking, asset management, retail banking, insurance
Oct-13	CSC	Benchmark Technology Group	NA	Benchmark Technology Group's bank sofrtware business develops software applications for financial institutions
Oct-13	IBM	Daeja Image Systems Ltd.	NA	Provider of document and image viewing solutions for Enterprise Content Management, baed in Milton Keynes, UK.
Sep-13	Accenture	OP-Pohjola	NA	OP-Pohjola group provides banking, investment and insurance services. The OP-Pohjola Group has approximately 200 member banks, with Pohjola Bank being the largest.
Sep-13	IBM	Trusteer, Inc.	NA	Provider of software that helps protect organizations against fraud and advanced security threats, including network and endpoint antimalware solutions.
Sep-13	Accenture	Vivere Brasil	NA	A leading mortgage-processing technology company. ACN will use Vivere Brasil's capabilities to expand ACN's mortgage-process technology and services to help Brazilian Banks increase their efficiencies for process Brazilian mortgage loans.
Sep-13	Amdocs	Actix International	$120	The acquisition will expand the customer experience offerings of Amdocs Ltd. The transaction is subject to customary closing conditions and is expected to close by the end of September 2013. Actix International Ltd is located in London, United Kingdom and provides mobile network analytics and optimization services. Summit Partners LP previously acquired Actix Ltd in March 2005.
Aug-13	IBM	CSL International	NA	Virtulization management solution provider for IBM z/VM and Linux on System z, headquarted in Herzliya Pituach, Israel.
Aug-13	Accenture	PRION GmbH	NA	Provides product lifecycle management software services. PRION has about 330 employees, transaction subject to customary closing conditions. Transaction would enhance Accenture's product lifecycle management.
Aug-13	CSC	Infochimps, Inc.	NA	Provides data indexing services. Acquisition was in line with the bidder's strategy of expanding its big data solutions business.
Aug-13	Cognizant	SourceNet	NA	SourceNet Solutions - a division of BNY Mellon's Treasury Services Group which does accounts payable outsourcing.

Source: FactSet, Company Reports, Citi Research

Figure 27. Notable M&A Transactions Continued

Date	Acquirer	Target	Value (USD in millions)	Description
Jul-13	Accenture	ASM Research, Inc.	NA	Information technology company offering their services to the government. Subject to regulatory review and other customary closing conditions. If closed, employees of ASM Research Inc will join Accenture Federal Services LLC. The acquisition expands Accenture's portfolio of information solutions to Defense and Federal Health Bu
Jul-13	TCS	Alti SA	$75	Formed in 1992, Alti is a system integrator of SAP solutions in France. It has ~1,200 employees and has operations primarily in France, Belgium and Switzerland.
Jul-13	Atos	WindowLogic	NA	WindowLogic provides management and consulting services. The Company offers solutions including business process and engineering information management, enterprise applications and security, and strategic consulting. WindowLogic markets to clients throughout Australia.
Jul-13	Accenture	Mortgage Cadence	NA	Provides enterprise technological software solutions. The transaction enhances Accenture's portfolio of mortgage business process outsourcing services.
Jul-13	IBM	SoftLayer Technologies, Inc.	NA	Cloud computing infrastructure provider, which will enhance IBM's ability to integrate public and private clouds for clients. Headquarted in Dalls, Texas with 21,000 customers and 13 data centers across the U.S , Asia, and Europe.
Jun-13	IBM	UniCredit Business Integrated Solutions SCPA	NA	Joint Venture between UniCredit Business Integrated Solutions - the global service company of UniCredit - and IBM, which will market and deliver IT infrastructure services to other companies besides UniCredit.
May-13	IBM	UrbanCode, Inc.	NA	UrbanCode offers capabilities for application release automation, which will enhance IBM's DevOps solutions enabliing clients to more rapidly deliver mobile, cloud, big data analytics applications.
May-13	Accenture	Acquity Group Ltd.	NA	Provides e-commerce and digital marketing services.Acquisition expanded Accenture's digital marketing and e-commerce capabilities. Advisors were Goldman Sachs, The Blackstone Group, Shearman & Sterling, Sullivan&Cromwell, and Kirkland&Ellis
May-13	Accenture	Fjordnet Ltd.	NA	Engaged in the provision of digital design consultancy services for mobile convergence markets. Fjordnet Ltd has 200 employees. The transaction will enhance digital and marketing capabilities of Accenture Plc, and also expand its technology and marketing operations services offered through Accenture Interactive.
Apr-13	Convergys	Datacom Group Ltd	$21	CVG acquired Datacom Group's Asian Contact Center Operations, which provides outsource billing and management solutions
Apr-13	Accenture	ChangeTrack Research Pty	NA	Provides database measurement and tracking analytics services. ChangeTrach's ChangeTracking® collects data on people and processes associated with implementations of change programs (on time, budget, etc)
Mar-13	Genpact	NGEN Media Services Pvt Ltd.	$0	Located in Delhi, India and provides news, current affairs and entertainment television services. G acquired the remaining 50% stake in NGEN Media Services (South Asian broadcaster New Delhi Television (NDTV), and the acquisition made NGEN G's wholly-owned subsidiary. Previously, G accounted for its 50% interest in NGEN as an equity method investment.
Mar-13	IBM	Star Analytics, Inc.	NA	Provider of business analytics and reporting tools that can integrate different applications and business analytics tools across enterprises.
Mar-13	Amdocs	Certen	$64	Amdocs Ltd acquired Certen Inc from BCE Inc for CDN$89 million (US$62.8 million) in a move to simplify their business relationship between Amdocs and Bell Canada International, a subsidiary of BCE. Under the terms of the agreement, Amdocs and Bell Canada would also extend their billing operations outsourcing agreement by three years to December, 2010. Bell Canada would assume from Certen the project management and business analysis roles related to billing systems modernization and development. Amdocs would assume more operational role and would continue to develop an integrated billing platform for Bell Canada and Certen.
Feb-13	Genpact	JAWOOD Business Process Solutions	$51	Enhanced G's services for the healthcare payer market which is a strategic industry and growth area for G. Over 420 JAWOOD and Felix Software employees joined G, in this separate but related transaction.
Feb-13	Genpact	Felix Software Solutions	$0	Strengthened G's service offerings in the healthcare payer market. Over 420 JAWOOD and Felix Software employees joined G, in this separate but related transaction, integrating into G's healthcare and IT service businesses.
Feb-13	IBM	StoredIQ Inc.	NA	Provider of software to manage unstructured data with applications in Data Intelligence, eDiscovery and Information Governance. Big Data tools.
Dec-12	Cognizant	C1 Group /Subsidiaries (6)/	$137	Acquisition expanded CTSH's expertise in enterprise application services and high-end testing services. 500 employees joined CTSH. Acquisition let CTSH expand its presence in Europe, Germany and in Switzerland.
Dec-12	IBM	Butterfly Software Ltd.	NA	Privately held data analysis and migration softare company located in Maidenhead, England. Offers storage planning softare and storage migration tools.
Dec-12	EPAM	Empathy Lab LLC	NA	Based in Pennsylvania, Empathy Lab LLC provides digital strategy and multichannel experience design services. Clients include USA Netowork, Rogers Communications, the American Red Cross and Liberty Global.
Nov-12	Cognizant	Medicall	NA	Provides clinical management support services. Services Medicall provides are Medical Management Services, Worker's Compensation Services, and Pharmacy Support Services.

Source: FactSet, Company Reports, Citi Research

Figure 28. Notable M&A Transactions Continued

Date	Acquirer	Target	Value (USD in millions)	Description
Oct-12	EXLS	Landacorp, Inc.	NA	Leading provider of healthcare solutions and technology with 50 million+ members under management on its platforms. Landacorp services and technology solutions provide clinical data and analytics to payers, providers, plan participants and accountable care organizaitions.
Oct-12	Accenture	avVenta Worldwide	NA	Digital marketing production company specializing in Digital Production, Marketing Operations and Platform Support for over 130 of the world's Fortune 500 companies. The acquisition strengthens the broad range of marketing services Accenture provides to chief marketing officers, from the development of marketing strategy to the management of marketing systems and campaigns.
Oct-12	CSC	42six Solutions LLC	NA	Software development company specializing in big data processing and advanced applications support for the U.S. Government Intelligence Community (IC) and the Department of Defense (DoD). CSC planned to offer customers greater value through big data expertise and intellectual property by recruiting some of the most highly capable developers in the intelligence field.
Oct-12	Accenture	Nokia Siemens Networks Internet Protocol television (IPTV)	NA	IPTV software was integrated with Accenture Video Solution, a product that enables companies to launch new over-the-top TV and services. This will give end users the ability to control their viewing experience (ex. accessing content a tablet, pausing, resume, etc – on a TV, a laptop computer, smart phone, or tablet.
Sep-12	IBM	Kenexa Corp.	$1,300	Leading provider of recruiting and talent management solutions, with a combination of cloud-based solutions and consulting services. Kenexa supports 8900+ customers across FS, pharma, retail and consumer verticals.
Sep-12	Tech Mahindra	Comviva	$47	Acquired 51% stake. Formed in 1999, Comviva is a provider of mobile solutions with an employee base of ~1,500. The company had a client roster of ~130 including Aircel, Uninor, MTN, Vodafone, Videocon, and Idea.
Sep-12	Infosys	Marsh BPO	NA	The captive BPO unit of US-based insurance brokerage Marsh & McLennan Companies, the company provided back-office services in the area of group life insurance business, and had 87 employees. The transaction would have added at least seven group life insurance clients for Infosys BPO.
Sep-12	Infosys	Lodestone Holdings	$350	A management consultancy firm headquartered in Zurich with an employee base of ~850 and >200 clients. Lodestone had ~83% revenues from Europe (largely Switzerland and Germany).
Sep-12	Tech Mahindra	Hutchison Global Services	$87	HGS, with its ~11,500 employees, provides customer lifecycle operations in a combination of voice, email and chat services. The company derived its revenues primarily across UK (~60%), Australia (~35%) and Ireland (~5%). The deal came with a 5-year contractual revenue commitment of $845mn at guaranteed margins.
Aug-12	Accenture	NewsPage Pte Ltd	NA	Distributor management and mobility software for the consumer goods industry in emerging markets. Approximately 128 NewsPage employees will join ACN.
Aug-12	IBM	Texas Memory Systems, Inc.	NA	Designs and sells solid state memory solutions as the RamSan family of shared rackmount systems and Peripheral Component Interconnect Express (PCIe) cards. (Flash storage).
Aug-12	IBM	TeaLeaf Technology, Inc.	NA	Leading provider of digital customer experience management and customer behavior analysis solutions. Software helps CMOs to analyze customer engagement between mobile and company websites.
Aug-12	Accenture	Octagon Research Solutions	NA	Provider of clinical and regulatory information management solutions and software for the pharmaceutical industry. Accenture will extend its BPO services portfolio targeting the pharmaceutical industry. Octagon has a staff of 380. The company is the fifth largest user of the U.S. Food and Drug Administration's (FDA) electronic submission gateway.
Jul-12	Genpact	Triumph Engineering Corp.	$4	Enhanced G's services for the infrastructure and manufacturing sectors by combining Triumph's expertise in aircraft/engine, electrical, and aerospace system design and integration and energy with G. 90 employees joined G's Infrastructure, Manufacturing and Services (IMS) vertical, which provides leading finance and accounting, supply chain management, procurement, and aftermarket services.
Jun-12	WNS	Fusion Outsourcing Services	$16	Provides business outsourcing services, such as contact center, customer care, and business continuity services. Had 1,500 employees. Acquisition expanded WNS' global footprint, tapping into emerging markets (South Africa)
Jun-12	Atos	Quality Equipment Benelux BV	NA	Quality Equipment Benelux B.V. was founded in 2007. The company's line of business includes the wholesale distribution of electrical apparatus and equipment wiring supplies.
May-12	Genpact	Atyati Technologies Pvt Ltd.	$34	Provides information technology solutions for the banking industry. Acquisition allowed Genpact Ltd to expand its banking business in the rural areas of India. Payment was$ 19.4 mil cash, up to $ 14.4 mil earn-out payments, and undisclosed amount of deferred payment. 60 employees joined G.
May-12	IBM	Vivisimo, Inc.	NA	Leading provider of federated discovery and navigation software that helps organizations access and analyze big data across the enterprise. Based in Pittsburgh, PA.
May-12	EPAM	Thoughtcorp	$17	Founded in 1995, it is a premier IT Consultancy and Software Solution Provider based in Toronto.

Source: FactSet, Company Reports, Citi Research

Figure 29. Notable M&A Transactions Continued

Date	Acquirer	Target	Value (USD in millions)	Description
Apr-12	IBM	Varicent Software, Inc.	NA	Leading provider of analytics software for compensation and sales performance management. Variecent has 180+ customers including Starwood Hotels, Covidien, Hertz, Office Depot and Farmers and 200 employees.
Apr-12	Genpact	Accounting Plaza BV	$39	Provides finance and accounting services. Acquisition enhanced the operations of Genpact Ltd in the retail industry as well as expands its geographic coverage in the Netherlands.
Apr-12	IBM	SIX Automacao	NA	Part of a strategic agreement, where IBM will acquire 20% of SIX Automacao, part of the EBX Group. SIX Automacao provides software and services in sectors including oil and gas, mining, naval constructuion and naval ports.
Apr-12	IBM	WorkLight Ltd.	NA	Provider of mobile application management software for smartphones and tablets, including HTML5 and native applications with clients all across retail, FS, technology, travel and hospitality and manufacturing verticals.
Apr-12	Wipro	Promax Applications Group	$35	Founded in 1989, it had 71 employees and offered solutions in predictive analytics for trade promotions, among others, to 45 clients incl Heinz, Loreal, Kraft, and Henkel.
Mar-12	EPAM	Instant Information	NA	Located in New York, Instant Information provides information management and collaboration solutions to the financial industry
Mar-12	WSTC	HyperCube	$77	Interconnects communications traffic to all carriers, including wireless, wire-line, cable telephony and Voice over Internet Protocol (VoIP) companies
Feb-12	Atos	EMC Corp/MA	NA	AtoS, EMC Corp/MA and VMware Inc announced a Joint Venture named Canopy located in U.S.
Jan-12	IBM	Green Hat Software Ltd.	NA	Green Hat offers capabilities that use virtualization to create cost effective 24x7 test environments, enabling clients to test earlier and more frequently throughout the development lifecycle.
Jan-12	Accenture	Neo Metrics Analytics S.L.	NA	Consulting firm specializing in optimization and predictive analytics based in Madrid, Spain. ACN also gains new social network analysis capabilities such as the ability to identify hierarchies within online customer communities.
Jan-12	Atos	MSL Group/UK	NA	AtoS announced the acquisition of a minority stake in MSL Group/UK. The transaction was announced on 01/09/2012 and is expected to be completed by 03/31/2012. Financial terms of the transaction are undisclosed. MSL Group/UK provides information technology (IT) products and services. The Company specializes in real-time computerized results and information systems for major sports events. MSL Group provides these services to support medium and large sporting events worldwide from the Tennis Master Series to the Olympic games.
Jan-12	IBM	Emptoris, Inc.	NA	Leading provider of cloud and on-premise analytics software that brings more intelligence to procurement and supply chain operations with spend, supplier and contract management for Smarter Commerce. Emptoris has over 725 employees around the world.
Dec-11	Infosys	Portland Group	$37	Portland Group, an Australia-based sourcing and category management services firm, had over 100 employees.
Dec-11	IBM	DemandTec, Inc.	$440	DemandTec delivers cloud-based analytics software that enables businesses to examine different customer buying scenarios, both online and in-store. DemandTec has ~450 customers worldwide in retail, consumer products and other industries with 31 patents in the areas of pricing, response analysis and promotion analysis.
Dec-11	IBM	Curam Software Ltd.	NA	Provider of social program software solutions used in HR, health and human services and social security in more than 80 government projects across the world.
Dec-11	IBM	Platform Computing, Inc.	NA	Leading provider of cluster, grid and cloud management software for distributed computing environments.
Nov-11	Cap Gemini	Vengroff Williams & Associates	NA	Capgemini acquires Order to Cash Business: from US-based privately-held firm Vengroff, Williams & Associates (VWA).
Nov-11	Atos	Yonyou Software Co Ltd	NA	AtoS and Yonyou Software Co Ltd announced a Joint Venture named YUNANO located in France. The transaction was completed on 11/08/2011. Financial terms of the transaction are undisclosed.
Nov-11	WNS	WNS Philippines, Inc.	$2	WNS Philippines provides BPO services. WNS Global Services Netherlands Cooperative, a subsidiary of WNS Holdings, entered into an agreement to acquire the remaining 35% in WNS Philippines from Paxys
Oct-11	Accenture	Itaca Service SpA	NA	Provides IT services to the Banco Popolare Group's leasing companies and to Alba Leasing. 33 employees will join ACN.
Oct-11	IBM	Q1 Labs, Inc.	NA	Provides advanced analytics to detect and flag suspicious or abnormal events. Q1 Labs' advanced analytics and correlation capabilities can help detect and flag actions that deviate from prescribed policies and typical behavior with a view across an organization's network, applications, user activity, mobile endpoints, and physical security devices.
Oct-11	Accenture	eCONNEX AG	NA	Provides information technology solutions and consulting services. Strengthens its Microsoft Dynamics CRM capabilities for its European operations and also expand Avanade Inc's service offerings.
Oct-11	IBM	Algorithmics, Inc. from Fimalac SA	$380	Provides software and services for improved business insights at banks and investment and insurance organizations to assess risk and address regulatory challenges
Oct-11	EXLS	Trumbull Services LLC	NA	Provides offshore business process outsourcing solutions to the insurance industry. Acquisition strengthened EXLS' portfolio of healthcare services. After acquisition Landacorp changed name to EXL Landa. Landacorp had more than 50 million members under management on its platforms.

Source: FactSet, Company Reports, Citi Research

Figure 30. Notable M&A Transactions Continued

Date	Acquirer	Target	Value (USD in millions)	Description
Sep-11	Cognizant	Zaffera LLC	NA	Provides strategic consulting and software development company specializing in SAP solutions, with expertise in retail, apparel, footwear, and consumer products. Zaffera has about 100 employees. Acquisition significantly expanded CTSH's ability to provide industry-focused SAP consulting and software solutions to help major retailers gain better insights into their business, streamline operations, enhance customer.
Sep-11	CSC	AppLabs Technologies Pvt Ltd.	NA	Provides software testing and development services. All 2,500 employees will be retained after acquisition. Acquisition increased CSC's product and service offerings in the application testing services market.
Sep-11	Genpact	EmPower Research LLC	$25	Integrated media and business research company who helps their clients understand their stakeholder perception and needs. Acquisition enabled G to profit from EmPower Research's business practices in social media research and media monitoring and measurement.
Sep-11	CSC	Maricom Systems, Inc.	NA	Provider of business intelligence and data management solutions that support mission-critical health information technology within the U.S. Department of Health and Human Services. About 200 employees will join CSC. Acquisition let CSC implement IT improvements in the Patient Protection and Affordable Care Act. Maricom strengthened CSC's healthcare informatics and data management.
Sep-11	IBM	i2, Inc. from i2 Holdings Ltd.	NA	A leading provider of intelligence analytics for crime and fraud prevention based in Cambridge, UK with U.S. headquarters in McLean, Va. i2's clients span multiple sectors globally such as banking, defense, health care, insurance, law enforcement, national security and retail, in 150 countries.
Aug-11	IBM	TRIRIGA, Inc.	NA	Leading provider of facility and real estate managment software solutions, which will be integrated into IBM Software and IBM Global Business Services. Products include Real Estate Portfolio Management, Capital Project Management, and Energy and Environmental Sustainability.
Aug-11	Genpact	High Performance Partners LLC	$16	Provides supply chain consulting management solutions. G acquired the remaining 73% stake in High Performance Partners. G planned to use High Performance Partners' Quantum software platform to support its Mortgage Business Process as a Service (BPaaS) offering.
Aug-11	Accenture	Zenta	NA	Provider of residential and commercial mortgage processing services in the United States. Approximately 3,700 employees in the United States, India and the Philippines joined ACN.
Aug-11	WSTC	Pivotpoint Solutions	$23	Telecommunications operation of PivotPoint Solutions provides wireless location accuracy compliance reporting, analysis and optimization.
Jul-11	Cognizant	CoreLogic Global Services	$50	Provides and combines public, contributory and proprietary data to develop decision analytics to businesses and government. Transaction was expected to allow CoreLogic to increase their global reach and technological capabilities to better deliver integrated workflow solutions to their customers.
Jul-11	Accenture	Duck Creek Technologies	NA	Software solutions for the property and casualty (P&C) insurance industry. 370 Duck Creek employees based in the US and the UK joined ACN.
Jul-11	Genpact	Nissan Human Information Services	$2	Provides human resource services to Nissan group. G took over the human resource center operations for the Nissan Group of companies, which was then renamed Genpact Japan Service. It provides payroll, benefits, staffing, training, and other HR services to 54,000+ employees of the Nissan group of companies.
Jun-11	Cap Gemini	Praxis Technology	NA	Provider of IT and consulting services to the Chinese utility market, including Enterprise Resource Planning implementations, business management consulting, and application and software development services for the Chinese energy industry. 2010 revenues of over 5m euros and over 110 employees.
Jun-11	Cap Gemini	Prosodie SA	$552	Capgemini announced plans to buy Prosodie, a French internet and telecoms services company from Apax Partners, for €382m ($552m) in cash.
Jun-11	Accenture	Nokia (Symbian Software Development and Support Services Outsourcing Agreement)	NA	ACN will provide Symbian-based software development and support services to Nokia at least until 2016 and also become the preferred supplier for Nokia in its transition to Windows Phone. Approximately 2,300 employees from China, Finland, India, the UK, and the US transferred from Nokia to ACN.
Jun-11	WSTC	Contact One	$8	Based in Austin, Texas, provides geographic mapping information system
Jun-11	Infosys	Gen-I (software solutions division)	$5	Gen-i was the corporate information and communication technology (ICT) arm of Telecom New Zealand, the largest telecom services provider in New Zealand. The acquisition helped add ~110 people.
Jun-11	Accenture	Al Faisaliah Group (Middle East JV)	NA	Accenture acquired a majority stake in the IT Services business Al Faisaliah Business & Technology Company (FBTC), a subsidiary of the Saudi Arabia-based Al Faisaliah Group. Al Faisaliah operates in four core sectors: Agriculture & Food, Medical & Healthcare, Consumer Electronics, and Technology Infrastructure. It employs >5,000 people, serving customers in 11 countries across the Middle East.
Jun-11	CSC	VIXIA Consultoria e Tecnolo...	NA	Based in Sao Paulo, Brazil, and provides business consulting and IT services. Acquistion will strength Computer Science Corp's position in the Latin American market.
Jun-11	WSTC	Smoothstone IP Communications	$120	Provides cloud-based communications solutions

Source: FactSet, Company Reports, Citi Research

Figure 31. Notable M&A Transactions Continued

Date	Acquirer	Target	Value (USD in millions)	Description
Jun-11	Amdocs	Bridgewater Systems	$129	The acquisition will enhance Amdocs Ltd's Customer Experience Systems portfolio. Based in Ottawa, Ontario, Canada, Bridgewater Systems Corp provides mobile data services, content and commerce.
May-11	Cap Gemini	BI Consulting Group LLC	NA	Minneapolis-based, provider of consulting, technology and outsourcing servicse specifically within Oracle Busienss Intelligence and Enterprise Performance Management technologies. 2010 revenues of $18.7 million and 85 employees.
May-11	EXLS	Outsource Partners International	$91	Provides finance and accounting outsourcing services. All employees remained with the company. Acquisition strengthened EXLS' position in the insurance industry.
Apr-11	Genpact	Headstrong Corp.	$550	Provides information technology consulting services with its 3,700 employees and 7 countries. Acquisition provided G with a complementary business, as well as an expanded geographic reach and services. G's president predicted the technology expertise from the acquisition combined with G's business process management (BPM) and Smart Decision Servic
Apr-11	Cap Gemini	ARTESYS,Avantias	$57	Artesys - provider of IT infrastructure solutions in France. In 2010 Artesys had revenues of 25 million euros, with 131 employees. Avantias, also in France, is a provider of ECM - Enterprise Content Management. In 2010, Avantias had revenues of 13.6 million euros with 120 employees and focuses on the banking, insurance, telecommunications and public sectors.
Apr-11	CSC	iSOFT Group Ltd.	NA	Develops software and provides IT solutions for the healthcare industry. Acquisition strengthened CSC's software products, healthcare integration, services portfolio, and its healthcare research and development capabilities.
Apr-11	Wipro	SAIC (Portion of IT business)	$150	The purchase covers the IT business of the firm's oil and gas vertical which provides consulting, system integration and outsourcing services to oil majors. ~1,450 employees moved to Wipro as part of the deal.
Mar-11	IBM	Clarity Systems Ltd. (Canada)	NA	Clarity Systems delivers financial governance software that enables organizations to automate the process of collecting, preparing, certifying and controlling financial statements for electronic filing, in support of mandates by the SEC and other financial regulatory agencies. Clarity Systems has 600 global clients across multipe industry segments.
Mar-11	Genpact	Akritiv Technologies, Inc.	$3	Provides software as a service solutions for Working Capital Management. Acquisition would increase the range of products offered by G
Mar-11	WSTC	Unisfair	$20	Provides virtual events and business environments by allowing companies to create branded virtual environments
Feb-11	WSTC	Preferred One Stop Technologies	$24	Based in North Yorkshire, UK, provides components, systems, professional services and hosted services for Unified Communications (UC) in Europe
Feb-11	WSTC	Twenty First Century Communications	$41	Headquartered in Ohio, provides automated alerts and notification solutions to the electric utilities industry, government, public safety and corporate markets

Source: FactSet, Company Reports, Citi Research

Appendix A-1

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