INDUSTRY TIMELINESS: 53 (of 98)

The Computer Software & Services Industry has been divided into two separate groups; Computer Software and IT Services. The IT Services Industry (reviewed here) consists of 18 stocks and includes companies that provide offshore outsourcing, consulting, electronic payment processing, payroll, and a host of other information technology services to businesses of all sizes. The Computer Software Industry (found elsewhere in this issue) covers 25 equities and mainly consists of software manufacturers.

The majority of the stocks in the IT Services Industry have performed relatively well since our November review. This is partly owing to the upward momentum in the broader markets since that time. Higher technology spending by many businesses appears to have also helped spark investor interest. Overall, the stocks of 15 out of the 18 companies in this industry have risen in the past three months. Most notable, are the shares of *DealerTrack Holdings* and *SEI Investments*, which both climbed over 15%. Still, only the shares of *Fair Isaac*, *Fiserv*, and *CACI International* are ranked to outperform the year-ahead market. On the downside, *Computer Sciences* stock was the worst performer, falling around 20% in price.

Our Outlook on Technology Spending

Even though spending on information technology services has improved over the last year, we are beginning to witness a slowdown in some areas. In North America we expect modest declines from financial services, telecommunications, and healthcare companies in the coming months. By the second half, though, prospects ought to brighten, buoyed by further economic improvement. However, demand from Asia should remain healthy, as the emerging economies in that region experience ongoing gains. The near-term prospects for Europe, though, are a bit mixed given the uncertainties in some of the economies on that continent. All told, any economic downturns, either domestically or abroad, have the potential to dampen corporate profits and lead to a tightening in technology outlays by customers.

A Look Offshore

We think offshore outsourcing providers like *Accenture*, *Cognizant*, and *Infosys* will be negatively impacted by customer delays for purchases of higher-margined services, such as consulting, over the next couple of months. What's more, economic concerns in Europe have the potential to limit the profitability of these companies, since they derive a sizable portion of business from the Continent. Even so, the need for clients to trim expenses and streamline their operations will probably keep global customers knocking on the doors of these firms, thereby helping them to report top- and bottom-line gains this year.

Competition and Consolidation

Many of these companies have been actively purchasing smaller businesses over the past year. Acquisitions are a good way to gain or maintain a competitive advantage and expand the product portfolio. Specifically, we think *Automatic Data Processing* and *Jack Henry & Associates* will seek to further satiate their appetites for smaller entities in the next few years. Meanwhile, consolidation helps firms increase market share especially for those operating in a similar space. Providers of technology services to the government sector, including *ManTech* and *CACI International* will likely try to acquire companies that will boost their ability to win contracts in this arena. Furthermore, takeovers can help firms broaden their geographic footprint. As time progresses, we expect more of these businesses to widen their presence in Asia, Europe, and Latin America. Finally, the technology giants are always on the prowl for attractive deals. Indeed, Microsoft, IBM, Oracle, Intel, and a couple of other large names have hefty war chests and are constantly searching for opportunities to gain a firmer grip on the technology sector.

Conclusion

As mentioned above, there are only three timely stocks in the IT Services Industry, thereby limiting the choices of those interested in the short term. Risk-averse, income-oriented portfolios may find the shares of *Paychex* appealing, given their solid dividend yield (4.1%), low Beta, and high Price Stability rating. Meanwhile, investors looking for above-average appreciation potential over the 3- to 5-year horizon may want to take a second look at the reports on *Amdocs Limited*, *Cognizant Technology*, *Infosys*, and *SEI Investments*. We advise investors to peruse all the pages of the companies in this industry carefully, though, before making any commitments.

Randy Shrikishun

Composite Statistics: IT SERVICES

2007	2008	2009	2010	2011	2012		14-16
70181	79066	76108	79749	***89500***	***97000***	Revenues ($mill)	***116000***
18.9%	19.0%	19.5%	19.0%	***19.0%***	***20.0%***	Operating Margin	***21.0%***
2906.4	3057.4	3036.4	2997.5	***3180***	***3420***	Depreciation ($mill)	***4400***
6814.2	7594.3	7852.1	8337.3	***9300***	***11000***	Net Profit ($mill)	***14500***
30.9%	29.5%	28.1%	29.8%	***30.0%***	***32.0%***	Income Tax Rate	***32.0%***
9.7%	9.6%	10.3%	10.5%	***10.4%***	***11.3%***	Net Profit Margin	***12.5%***
9941.3	14220	17815	18720	***19500***	***21000***	Working Cap'l ($mill)	***26000***
9148.4	11381	9336.9	8364.1	***8500***	***10000***	Long-Term Debt ($mill)	***10000***
30448	30189	35884	39702	***41500***	***52000***	Shr. Equity ($mill)	***60000***
17.7%	19.1%	18.0%	17.8%	***20.0%***	***18.0%***	Return on Total Cap'l	***21.0%***
22.4%	25.2%	21.9%	21.0%	***22.5%***	***21.0%***	Return on Shr. Equity	***24.0%***
18.1%	19.9%	16.9%	14.9%	***19.5%***	***18.5%***	Retained to Com Eq	***21.0%***
19%	21%	23%	29%	***25%***	***25%***	All Div'ds to Net Prof	***22%***
16.7	15.1	17.7	17.3	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	***17.0***
1.01	1.01	1.13	1.11			Relative P/E Ratio	***1.15***
1.2%	1.5%	1.6%	1.5%			Avg Ann'l Div'd Yield	***1.5%***