

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 companies in the IT Services Industry have performed relatively well over the past year, especially compared to 2009 when they faced a slowdown in business. Indeed, it appears that there is a resurgence in information technology spending by businesses. Still, the recent volatility in the broader markets, and in some cases cloudier outlooks for some of the companies covered here, have led to price declines in all of the equities in this industry over the past three months. There are a number of stocks, though, that are ranked favorably for Timeliness.

The Outlook For Technology Spending

Customers have increased their outlays for information technology services over the past few quarters in order to streamline their operations, lower operating costs, and widen market share. Technology spending in North America, particularly from financial services, telecommunications, and healthcare companies, should rebound in the years head. We expect business in Asia to pick up as well, as the economies in that region experience further growth. The near-term prospects for Europe, though, are a bit cloudy given the uneven recovery in some of the economies on that continent. Any further economic softness, either domestically or abroad, may dampen corporate profits and lead to a tightening in technology spending.

Competition Should Remain Fierce

The offshore outsourcing sector, in particular, is crowded with names such as *Infosys*, *Accenture*, *Cognizant*, and many other players all vying for the technology, consulting, and systems management services of global corporations. What's more, behemoths such as

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IBM and Oracle are widening their presence in this sector. *Automatic Data Processing* holds a solid share of the payroll processing market, and we think it can keep rivals such as *Paychex* at bay in the coming years. Nonetheless, threats to its position as a provider of human resources and tax filing services have the potential to limit the company's prospects. Meanwhile, providers of technology services to the government sector, which include *CACI International* and *ManTech International*, ought to perform well over the 3- to 5-year horizon as governments upgrade their legacy systems, security architecture, and communications networks.

Takeovers Will Likely Continue to Fuel Growth

Automatic Data Processing, *DealerTrack*, *DST Systems*, and *Jack Henry* have been purchasing smaller entities to expand their offerings. *Infosys* has expressed interest in enlarging its footprint in Europe and Asia through small purchases, too. Then there is the looming specter of Microsoft, IBM, Oracle, and Intel, among a few other large names, that seem to be always on the lookout to take over companies that can give them a firmer grip on the technology sector. Overall, as time progresses and the global economic landscape brightens, we expect to see an uptick in consolidations.

Conclusion

There are five stocks in the IT Services Industry that are ranked to outperform the broader markets in the year ahead. These are *ManTech International*, *CACI International*, *Accenture*, *Manhattan Associates*, and *Fiserv*. Income-oriented investors with a long-term perspective may want to look at *Paychex* and *ManTech*, both of which possess dividend yields that are more than double the *Value Line* average. The recent pullback in the prices of many of these shares has also created better entry points, especially for those stocks that we believe have attractive appreciation potential over the coming 3 to 5 years. Still, we advise investors to peruse all the pages of the companies in this industry carefully before making any commitments.

Randy Shrikishun

Composite Statistics: IT SERVICES							
2007	2008	2009	2010	2011	2012		14-16
71450	80573	77649	88676	90000	97000	Revenues (\$mill)	116000
18.7%	18.8%	19.3%	19.0%	19.0%	20.0%	Operating Margin	21.0%
2927.6	3082.7	3066.4	3236.1	3280	3520	Depreciation (\$mill)	4400
6877.7	7667.6	7910.1	9544.9	9500	11000	Net Profit (\$mill)	14500
31.0%	29.6%	28.2%	30.0%	30.0%	32.0%	Income Tax Rate	32.0%
9.6%	9.5%	10.2%	10.8%	10.6%	11.3%	Net Profit Margin	12.5%
10238	14593	18039	20350	22500	24000	Working Cap'l (\$mill)	28000
9148.4	11531	9411.9	8479.9	8500	10000	Long-Term Debt (\$mill)	10000
31073	30882	36626	45275	44000	52000	Shr. Equity (\$mill)	60000
17.6%	18.9%	17.8%	17.5%	19.0%	18.0%	Return on Total Cap'l	21.0%
22.1%	24.8%	21.6%	21.1%	21.5%	21.0%	Return on Shr. Equity	24.0%
17.9%	19.7%	16.7%	17.0%	18.5%	18.5%	Retained to Com Eq	20.0%
19%	21%	23%	38%	25%	25%	All Div'ds to Net Prof	25%
22.3	16.7	15.1	17.3	Bold figures are Value Line estimates		Avg Ann'l P/E Ratio	18.0
1.18	1.01	1.01	1.11			Relative P/E Ratio	1.20
1.5%	1.2%	1.5%	1.5%			Avg Ann'l Div'd Yield	1.2%

