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Cognizant Technology Solutions Corp.

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Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Cognizant Technology Solutions Third Quarter 2024 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I'd now like to turn the conference over to our host Mr. Tyler Scott, Vice President of Investor Relations. Please go ahead.

Tyler J. Scott

Vice President-Investor Relations, Cognizant Technology Solutions Corp.

Thank you, Operator. And good afternoon, everyone. By now, you should have received a copy of the earnings release and Investor supplement for the company's third quarter 2024 results. If you have not, copies are available on our website, Cognizant.com. Speakers we have on today's call are Ravi Kumar, Chief Executive Officer, and Jatin Dalal, Chief Financial Officer. Before we begin, I would like to remind you that some of the comments made on today's call and some of the responses to your questions may contain forward looking statements.

These statements are subject to the risk and uncertainties as described in the company's earnings release and other filings with the SEC. Additionally, during our call today, we will reference certain non-GAAP financial measures that we believe provide useful information for our investors. Reconciliations of non-GAAP financial

measures, where appropriate, to the corresponding GAAP measures, can be found in the company's earnings release and other filings with the SEC.

With that, I'd now like to turn the call over to Ravi. Please go ahead.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

Thank you, Tyler, and good afternoon, everyone. Thank you for joining the third quarter 2024 earnings call. We are pleased with our third quarter results, which delivered revenue and earnings growth while expanding adjusted margin sequentially and represented strong execution of our strategic priorities to accelerate growth, become an employer of choice in our industry and modernize operations. We are seeing a gradual rebound of spend cycles and gaining wallet share in financial services while our historical strength in health sciences is driving differentiation and growth. Meanwhile, our significant traction with large deals and AI led revenue opportunities, investments in talent and a steadfast focus on operational rigor together led to a strong all round performance.

Let me begin with a quick summary of our results before an update on our strategic priorities. Third quarter revenue was at the high end of our constant currency guidance range. Revenue of \$5 billion grew 3.5% sequentially in constant currency, including approximately 150 basis points of inorganic contribution from our recently completed acquisitions.

Year over year revenue grew by approximately 2.7% in constant currency, including approximately 200 basis points of inorganic contribution. Adjusted operating margin of 15.3% improved sequentially, driven by strong cost discipline despite investments in Belcan, the partial quarter impact from our annual merit cycle. Adjusted EPS grew approximately 7% year over year. Our fourth consecutive quarter of year over year growth, bringing our year to date EPS growth to approximately 5%.

Now, let me provide an update on the progress we made against our strategic priorities. First, accelerating growth. Our improving momentum was driven in the quarter by growth in our two largest segments, Health Sciences and Financial Services, and contribution from our recently completed acquisitions. Health Sciences increased 7.6% year over year in constant currency, backed by our strong, differentiated offerings.

Financial Services returned to year over year growth, driven by strong execution and partial return of discretionary spending, and we maintained our large deal momentum, signing six deals each with a total contract value of \$100 million or more.

Year-to-date, we signed 19 such deals compared to 17 during all of 2023. We are excited about the all-round sustained momentum in large deals across industries and service lines. I am particularly pleased with the traction we are getting in digital engineering, infrastructure and cloud services.

We believe in order to sustain this momentum, we must remain at the forefront of our clients innovation agenda, where today AI is at the top of the list. Our heritage of deep engineering and strong domain expertise, intimate client relationships and flexible operating model has allowed us to quickly respond to this opportunity. We have rapidly developed practical tools to help our clients accelerate AI adoption, while also applying it to ourselves as we aim to significantly accelerate our own productivity.

AI is a profound shift. What I call a double engine transformation because it offers Cognizant the chance to disrupt ourselves as much as it does for our clients. Consistent with our heritage, we spotted the AI opportunity early and in mid-2023, announced plans to invest \$1 billion into AI led initiatives, platforms and capabilities.

Let me share some examples, beginning with our platforms where our clients are co-creating with us. The foundation of our AI strategy is powered by the Cognizant data and Intelligence Toolkit, which we utilize to increase speed, reduce cost, and improve the predictability of our clients' data modernization journeys.

To date, we have over 225 project implementations supporting over 120 clients and our Flowsource platform, which is a developer workbench that is integrating human and AI effort to improve productivity. Today, we are in various phases of testing and adoption with more than 150 clients. Using AI tooling, we are generating 150,000 lines of accepted code per month. That means on an annualized basis, 2 million lines of code are accepted by our developers into the projects to deliver to our clients.

It's a great example of how AI is enabling hyper productivity as we share these productivity gains with clients and lower the cost of technology deployment. Our Neuro IT Ops platform, launched in late 2023, is also supporting 150 clients in various phases of testing and adoption. It enables end-to-end AI-driven automation for IT operations, bringing ops and infrastructure in a single pane of glass. As an example, we are leveraging both our Neuro IT Ops and Flowsource platforms together in a strategic project for DIRECTV to modernize its technology, infrastructure and enhance its operational capabilities.

Neuro IT Ops is helping DIRECTV increase efficiency and resiliency through intelligent detection and automated IT issue resolution. And Flowsource is scaling GenAI across DIRECTV's software development life cycle, promoting innovation through faster time to market, increased collaboration and greater transparency.

We recently introduced two new additions to our Neuro suite. First, our enhanced Neuro AI platform incorporates multi-agent orchestration, aims to help enterprises by simplifying problem identification, data generation and AI model creation and improving decision-making and revenue opportunities. Clients like Gilead Sciences have praised this approach, while others like Bayer have tested several foundational capabilities, now available on the platform. These enhancements aim to help our clients to navigate complex decision-making scenarios effectively.

Second, Cognizant Neuro Cybersecurity offers AI-enabled enterprise security orchestration for enhanced cyber resilience and risk management. This tool is designed to help improve cyber security resilience by integrating and orchestrating point cybersecurity solutions across the enterprise. We have also infused AI through our TriZetto product suite, helping improve end user productivity by at least 30%.

Looking across our enterprise, we now have more than 1,000 GenAI early engagements compared to about 750 at the end of the second quarter. We are seeing significant traction in four categories of use cases starting with tech for tech or applying AI to software development cycles, which had the highest velocity, followed by customer and employee experience, content aggregation and early use cases in content generation.

We see broad-based demand across industries, including fraud detection, credit risk assessment and regulatory compliance in financial services, drug discovery, medical imaging and transcription in health care and design optimization and predictive maintenance in manufacturing. Partnerships and strategic acquisitions are also important levers in our strategy to accelerate growth.

First an update on our partnerships. I'm excited about our recently announced relationship with Palo Alto Networks through which we will deliver AI-driven cybersecurity capabilities and services for enterprises across industries. We see significant opportunities to leverage AI to keep pace with evolving cybersecurity threats and improve overall levels of security. This last week, ServiceNow announced that Cognizant will be the first system

integrator to bring its new workflow data fabric product to market, giving our joint customers the capability to integrate AI agents and real-time data orchestration layers that can be tightly integrated to their digital workflows.

We also announced an expansion of our NVIDIA partnership, bringing together our capabilities with NVIDIA's RAPIDS, part of the NVIDIA AI software platform to enhance their data modernization offering. Together, we aim to help clients transition to GPU-based infrastructure and accelerate the implementation of this exciting new GenAI use cases.

And earlier this week, we strengthened our partnership with Amazon Web Services by signing a strategic collaboration agreement with plans to deliver advanced technology solutions and cloud computing services focused on enhancing smart manufacturing capabilities for global enterprises across multiple industries.

Turning to our strategic acquisitions. Thirdera acquired earlier this year positioned us as one of the world's largest ServiceNow partners and as a leader in AI-driven automation and enterprise workflow solutions. And our acquisition of Belcan has significantly broadened our access to the \$190 billion ER&D services market, which is projected to outpace the legacy IT services market through 2026.

Additionally, it has notably increased our footprint in the aerospace and defense industries with an attractive blue-chip client base. I'm happy to report that our commercial integration is progressing well. We have already seen early pipeline opportunities and identified the potential for new joint offerings in areas such as model-based systems engineering where Belcan has significant expertise.

We believe these actions to accelerate growth are resonating in the market. Let me share a few additional highlights of the value we are bringing to our customers across industries. Within Financial Services, we continue to see traction from the changes in investments we have made over the last 20 months. We are bringing the breadth and depth of our capabilities to every opportunity.

For example, we are supporting Citizen Bank's ongoing cloud transformation journey. We have collaborated with Citizens to revamp their fraud management capabilities with a new in-the-house system. And we are helping Citizens elevate their customer banking experience with a modernized system that streamlines dispute resolution. In the UK, we continued to see success winning in the public sector. During the third quarter, we expanded our relationships with the UK Valuation Office Agency of His Majesty's Revenue and Customs. This was one of a greater than \$100 million contract signed in the quarter. Under the agreement, we'll provide the UK government with property valuations and advice needed to support taxation and benefits. And clients are still looking to drive productivity and underwrite future innovation. For example, we won a significant \$200 million deal in the third quarter with a longstanding global technology client to transform the customer support operations using GenAI. This was a vendor consolidation opportunity where we leveraged GenAI to streamline operations, improve agent productivity and reduce costs. Our differentiated AI-led approach, which included elements of outcome-based pricing allowed us to displace the incumbent.

Now moving on to our next strategic priority of becoming the employer of choice in our industry. We believe our investments in talent are bearing fruit as well. We're adding more access to learning and upskilling, notably through AI in an effort to boost mobility and demonstrate that we are in an organization where our employees can grow. Our grassroots innovation initiative, Bluebolt, continues to build traction with more than 300,000 ideas, of which 40,000 ideas, mostly related to AI are being presented to clients.

Employee engagement scores stayed strong. Trailing 12 months voluntary attrition for tech services is at 14.6%, near multiyear lows. And we are, we were recently named for the second straight year to Forbes list of World's Best Employers.

Our Synapse program, which aims to provide technology training to nearly 1 million people worldwide is another great example of our deep commitment to learning. I was delighted when Fortune named us as the number seven in the world on its prestigious Change the World list while recognizing the impact of Synapse.

Just last week, we were named number 10 on Newsweek's list of America's most reliable companies. This recognition based on the independent survey of more than 1,700 decision-makers highlights our exceptional reliability in delivering services to our clients. We are confident that our expanded breadth of portfolio of services, strengthened by our domain capabilities, talent and partner ecosystem is more resilient and healthier than when I joined Cognizant nearly two years ago. And I believe we are in a strong position to capture the growing and developing AI opportunity for ourselves and our clients.

In closing, a few weeks ago, we brought together over 200 clients to our Americas Discovery event in Austin, Texas, to showcase the strength of our AI platforms, capabilities and offerings. The event's buzz and enthusiasm was incredible. We were excited about the early momentum of large deals with AI-powered productivity and numerous initial products. Our belief is the AI productivity way will evolve from task automation to business process to business model transformation, leading to new products and revenue streams and faster innovation cycles, a flywheel of new opportunities to tap into. I want to thank all our employees globally for their commitment to our clients and the work to strengthen our capabilities for the future.

With that, I will turn the call over to Jatin, who will cover the details of the quarter and progress against our third strategic priority of modernizing operations.

Jatin Pravinchandra Dalal

Chief Financial Officer, Cognizant Technology Solutions Corp.

Thank you, Ravi. Good afternoon, everyone, and thank you for joining us. We delivered a solid third quarter performance with revenue at the high end of our constant currency growth guidance range and a return to organic year-over-year revenue growth for the first time in six quarters.

During the quarter, we continued to focus on modernizing our operations. This helped us increase gross margin by 50 basis points sequentially, driven by improved utilization and increased adoption of automation and AI within delivery. This allowed us to deliver adjusted operating margin of 15.3%, which modestly exceeded our expectation despite headwinds from acquisition related costs and a partial quarter impact from our annual merit cycle that became effective on August 1. Year-to-date, we delivered adjusted operating margin of 15.2%, a 40 basis point increase year-over-year.

Now let's turn to the details. Third quarter revenue was \$5 billion, growing 3.5% sequentially in constant currency, including approximately 150 basis points of inorganic contributions from about five weeks of Belcan. Year-over-year, revenue increased 2.7% in constant currency. This included approximately 200 basis points of growth from recent acquisitions.

From an industry standpoint, Health Sciences was our strongest segment, growing 7.6% year-over-year in constant currency. Growth here was broad-based across payer, provider and life sciences. On the payer and provider side, clients continue to seek our TriZetto platform solution for modern scalable cloud solutions. In

particular, our BPaaS offering has seen healthy demand for its delivery of true end-to-end revenue cycle management, including clearing house services.

On the Life Sciences side, growth has been supported by the ramp-up of recent large deal wins. Our Financial Services segment grew 0.5% year-over-year in constant currency. This performance added to last quarter's momentum and benefited from an uptick in the discretionary demand environment and better execution. Growth was led by banking and financial services clients in North America. In Canada, we have seen strong performance across both banking and insurance customers.

Products and Resources revenue grew 4.6% year-over-year in constant currency, driven primarily by the contribution of Belcan. We have seen pockets of discretionary weakness with clients in manufacturing, logistics, aerospace and automotive industries. We are sharply focused on grid modernization, software defined vehicles and smart manufacturing. This area, we believe will drive significant opportunity in the long run.

CMT declined 4% year-over-year in constant currency, primarily reflecting a continued tight discretionary spending environment across customers in both technology and telecom and media.

Moving on to the details by geography, where all growth rates provided will be year-over-year in constant currency. Growth in the third quarter was led by Americas geography, which increased about 4%. This was driven by the strength in Financial Services and Health Sciences and the contribution from Belcan.

Europe declined about 2% and has been impacted by software discretionary spending. However, recent wins in our largest segments helped support positive sequential growth in Europe. And we are optimistic about the growth opportunity we see in areas like the UK and Ireland, Germany and the Nordics. We delivered healthy growth in our Rest of the World region, which increased about 4%. Performance in this geography was driven by recent large deals, particularly within comms, media and technology and strength in financial services.

Turning to bookings. Third quarter bookings were roughly flat year-over-year, driven in part by the lumpiness of large deals. On a trailing 12-month basis, bookings were \$26.2 billion, down 2% year-over-year and represented a 1.3x book-to-bill. As Ravi mentioned, we signed six deals in the quarter that each had a TCV value of more than \$100 million. This included four deals in Health Sciences, one in financial services and one in CMT.

I am also pleased that two of these six deals were from outside of North America, one each in Europe and Rest of World. We also saw TCV from smaller deals stabilized sequentially. This has led to a modest improvement in our trailing 12-month annual contract value trend from last quarter. We are seeing this reflected in our improved revenue performance this quarter despite muted TCV performance.

Now moving on to margins. In the third quarter, we incurred \$33 million of costs related to NextGen, which negatively impacted our GAAP operating margin by approximately 70 basis points. Adjusted operating margin was 15.3%, an increase of 10 basis points sequentially and a decrease of 20 basis points year-over-year.

Our sequential improvement was driven by gross margin, which expanded approximately 50 basis points quarter-over-quarter. We delivered this through operational rigor, improved utilization and corresponding lower [ph] batch (22:18) costs. We are also making progress in modernizing our operation, increasingly leveraging our AI platforms in delivery to help improve fulfillment and increase productivity with fewer resources.

In Q3, our GAAP tax rate was 22.7%, and adjusted tax rate was 22.2%, reflecting a benefit from the timing of discrete items. Q3 diluted GAAP EPS was \$1.17 and Q3 adjusted EPS was \$1.25. This represented year-over-year growth of 13% and 7%, respectively.

Now turning to the balance sheet. We ended the quarter with cash and short-term investments of \$2 billion or net cash of about \$800 million. This reflects our \$1.3 billion acquisition of Belcan in the third quarter, which was funded primarily through a combination of cash on hand and borrowings under our revolving credit facility. DSO of 81 days was one day up sequentially and increased four days year-over-year driven by our business mix.

Free cash flow of Q3 was \$791 million, bringing year-to-date free cash flow to approximately \$1 billion. There is no change to our full year free cash flow conversion guidance. We continue to expect full year free cash flow to represent about 80% of the net income. This includes previously disclosed negative impact from \$360 million payment made to the Indian tax authorities in relation to our ongoing appeal of our 2016 tax matter in the first quarter.

During the quarter, we returned \$391 million to shareholders, including \$242 million in aggregate through share repurchases and \$149 million to shareholders through our regular dividend. As of September 30, we had \$1.4 billion remaining under our share repurchase authorization.

Year-to-date, we have returned approximately \$900 million to shareholders through share repurchases and dividends. And for the full year, we now expect to return approximately \$1.2 billion. This includes approximately \$100 million of share repurchases to offset the new shares issued as part of the Belcan acquisition.

Turning now to our forward outlook. For the fourth quarter, we expect revenue to increase 4.8% to 6.8% in constant currency. On an as reported basis, this translates to revenue of \$5 billion to \$5.1 billion, representing year-over-year growth of 5.1% to 7.1%. This guidance reflects the benefit of full quarter of Belcan, partially offset by year-end seasonality, including the impact of lower bill days and furloughs. For the full year, we have tightened the revenue range and maintained the midpoint. We now expect revenue to grow 1.4% to 1.9% in constant currency. On and as reported basis, this translates to revenue of \$19.7 billion to \$19.8 billion, representing growth of 1.6% to 2.1%.

Our outlook includes approximately 200 basis points of inorganic contribution, unchanged from our prior assumption. As Ravi mentioned, we closed our acquisition of Belcan in late August. There are no changes to the financial projections we shared at the time of the acquisition announcement in June. We anticipate the transaction will generate over \$100 million in annual revenue synergies within three years and be accretive to EPS starting in full year 2026.

Moving on to adjusted operating margin. We are pleased with our year-to-date performance. We now expect full year adjusted operating margin will be approximately 15.1%, which is the midpoint of our prior range. The fourth quarter adjusted operating margin is expected to be impacted by the full quarter impact of Belcan, including integration related costs, and the impact of non-cash amortization of acquired customer intangibles. It also will include the full quarter impact from our [indiscernible] (27:20) cycle that was effective August 1. We expect these headwinds will be partially offset by continued rigor in operations and the savings associated with our NextGen program.

For the full year, we anticipate net interest income of approximately \$65 million, which compares to \$55 million previously, primarily reflecting the latest cash balance assumptions. Our full year adjusted tax rate guidance of

24% to 25% is unchanged. Our guidance for shares outstanding is also unchanged at approximately \$497 million. Our full year adjusted earnings per share guidance is \$4.63 to \$4.67, which is up from \$4.56 to \$4.64 previously.

With that, we will open the call for your questions.

QUESTION AND ANSWER SECTION

Operator: Great. Thank you. At this time we will be conducting a question-and-answer session [Operator Instructions] Our first question here is from Jason Kupferberg from Bank of America. Please go ahead.

Jason Kupferberg

Analyst, BofA Securities, Inc.

Q

Thank you, guys. So just looking at the midpoint of Q4 guidance, our math suggests organic growth will be right around 2%. So I just wanted to check and see if that's right. And if so, is that a floor we can think about for Cognizant to accelerate off of in 2025, especially since it seems like you are starting to see a turn up in discretionary spending in your largest vertical? Thanks.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yes. So I thought the upper end of the Y-on-Y quarter four was around 2%. So you're right that in quarter four, we are starting to build an organic Y-on-Y positive movement. I mean the midpoint is going to be 1% and the upper end is going to be 2%. So it's a good tail velocity to get into 2025.

Jason Kupferberg

Analyst, BofA Securities, Inc.

Q

Okay, okay. Understood. And then I wanted to come back to some of the comments around sharing savings from the AI-enabled coding efforts with your clients. What would you estimate the productivity improvement has been that you're seeing from those AI-enabled coding efforts? And what are the positive offsets that you're seeing to avoid revenue cannibalization?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Jason, this is a complex, a complicated economic and a complicated – the response is going to be a little, I would say, complicated as well. Let me state how this works. When we have productivity which is non-linear and not labor oriented, and it is new, you have an opportunity to go and tell your clients, if you have time and material business, we can translate that to fixed price business and share the benefits with them.

If you have noticed, I mentioned about 2 million lines of code annually accepted by our developers. So that number is going to keep going up. So our ability to share those benefits with the clients actually makes us more competitive in the market. In fact, many of my clients have actually said, when you share these benefits and the cost of deployment goes down, we can take our backlog down, that's a very positive side. I mean clients are not saying because of productivity, we'll reduce our budgets. They're actually saying we want to do more for less. So that is a very positive indicator. It also gives us an opportunity to consolidate in places where our productivity is higher than our peers. We can actually, we can offer consolidation and, therefore, increase revenue throughput to

us. One of the examples I mentioned in my remarks is about a client where we displaced an incumbent because we actually showed up with a higher productivity.

Now there is a third set, where you could arguably say clients, it will cannibalize our revenue. But those are the times you want to be creative and you go back to clients and say, "Look, the work packet we did, we could do it for less. But you know what, if we consolidate it, we could actually do more for less," which then means you could protect your turf, but you could choose to share the productivity benefits.

Then there is a fourth set, which I would actually say is time and material work, where in some ways, the productivity benefits can generate the value, but you have to work with your clients to move that work to fixed price. So I would actually believe this is a very positive development. There is elasticity in tech spend. So if you can reduce the cost of deployment, clients are actually going to spend more with you. And we believe we are ahead of the curve in comparison to all our peers. And that's why we're winning more large deals and we are able to protect our turf.

Jason Kupferberg

Analyst, BofA Securities, Inc.



Very helpful. Thanks, Ravi.

Operator: Our next question is from Tien-Tsin Huang from JPMorgan. Please go ahead.

Tien-Tsin Huang

Analyst, JPMorgan Securities LLC



Thanks a lot. Good afternoon, here. I wanted to ask on the large deal pipeline, considering you signed quite a bit here year-to-date more than last year, your confidence in being able to replenish the large deal pipeline from here, Ravi.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.



Yes. So last year, we did 17 for the full year, \$100 million deals, more than \$100 million deals. This year, we're already at 19, more than \$100 million deals. I'm very confident that we can sustain the momentum. The way to sustain this is not just look for transformational opportunities where the spend goes up, but also look for cost takeout efficiency and vendor consolidation opportunities. Similar to what I mentioned in my previous response, there's always an opportunity to consolidate using productivity. So we are excited about it.

I think we have to – we are starting to see now large deals in Europe and Asia Pacific. In fact, out of the six deals we did this quarter, one of them was in Asia Pacific, one of them was in Europe, and we had a similar large deal in Asia Pacific last quarter as well. So we can expand. I mean this is also concentrated in a few industries. Now we are stepping up and taking a broader view of other industry. So the expansion will come from more industries. The expansion will come from going beyond Americas, which has already started happening. And the expansion will come from also our services landscape.

Two years ago, a lot of our work was related to tech services and BPO. Now we have tech services, BPO, engineering because of the Belcan acquisition and some of the acquisitions we did before. We are now a top five player in engineering services. And interestingly, we are getting quite a bit of traction on infrastructure services, which we were historically not having those many large deals. So right now, all four capability sets are firing cylinders. So I'm very confident about how we can sustain the large deal momentum.

Tien-Tsin Huang

Analyst, JPMorgan Securities LLC



No, that's great. That's good color. It actually segues nicely into my follow-up question because I know one of your objectives was to diversify. You just mentioned you're doing that geographically and across some of your practices. But healthcare is now your largest vertical looks like, which is so used to seeing BFSI being the biggest recognizant. But where are you in the journey now to expand into some of other under indexed verticals. Is that still a priority? Can we expect that to come? Or is it more work to do on what we discussed before?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.



No, that's a great question. I would say if you look at our revenue mix and the momentum we have, I mean, look at healthcare, we have grown 7.6% Y-on-Y. Both sequentially, we've grown and we have grown Y-on-Y. So we are very excited about the opportunities in healthcare, the differentiation we have and the lead we have in some of the areas is unmatched. So healthcare, we are very confident.

Financial services, we are back on track. I mean, this is the, this quarter, last quarter, we did sequential growth. This quarter, we have done Y-on-Y growth and sequential growth. So again, financial services has a very different muscle. I think we have now stabilized, and we do believe that we are winning the wallet share there.

We now have, I would believe, a unique opportunity in industrial and manufacturing with Belcan in the mix. And that's because they have, we have access to blue-chip clients in aerospace. We have that capability set in engineering, which gives us a chance to go into industrial and manufacturing and automotive. It is a sector where we do believe we are now going to build a muscle to win deals, large deals. And I think we have a breadth of capability all the way from engineering services to tech services.

The vertical comps, which if you have noticed, there has been a lower pace of spend in comps. But as that picks up, I think we have put a good team to get that moving. Where we have to make progress on is energy, oil and gas, where we have a much lower presence. And that's something I'm going to work on.

So the idea of the last two years, what we have essentially done is we've created breadth of capability all the way from engineering, BPO, technology services and infrastructure services. We have created now more expansive opportunities on industries. I have work to do on international markets outside the U.S. But very pleased with the progress we've made so far because this expansive, the strategy of expansion has helped us to keep the sustained momentum on our large deals.

Tien-Tsin Huang

Analyst, JPMorgan Securities LLC



Thank you for the complete answer there. Thank you.

Operator: Next question is from Jim Schneider from Goldman Sachs. Please go ahead.

James Edward Schneider

Analyst, Goldman Sachs & Co. LLC



Good afternoon. Thanks for taking my question. Good to see the momentum in healthcare, you just talked about earlier. So maybe to follow up on last question. Maybe as you think about your backlog of business for 2025.

Obviously, you're not providing guidance now, but can you maybe tell us directionally which verticals do you think might outperform your overall corporate revenue growth in 2025? And then which ones might lag a little bit?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yes. So Jim, as you look at the deal wins and, the momentum that we have built, certainly financial services and healthcare will continue to lead the growth of the company. We have to build back momentum that we had all through 2023 in CMT, Comps Media and Telecom, as we get into next year. And manufacturing has been slow, but one hopes that, that should also come through. So I think that is the order, Jim, for us to look at who would lead the growth as we look at next few quarters.

James Edward Schneider

Analyst, Goldman Sachs & Co. LLC

Q

Thank you. And then maybe as a follow-up. It was good to see the gross margin leverage you delivered in the quarter. You mentioned part of that is utilization, but also part of it was AI, as you mentioned in the quarter. Can you maybe just help us on a go-forward basis into Q4? And then 2025 with sort of the moving pieces of gross margins, how much of those gains are sustainable? And what should we think about in terms of the mix of Belcan in Q4 and beyond in terms of where gross margins should land?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Sure, Jim. So let me start with Belcan because that's easier to get out of the way. I think Belcan will not have a material movement on the gross margin number of the company they operate at a similar sort of range. So we should be okay. There should not be any noise from that.

Now from a classic gross margin standpoint, the levers are utilization, automation and productivity led by AI is another one. Pyramid is the third one and the fourth is really the pricing. So I would say these are the four most or largest [ph] rivers. (41:25) The fifth is offshore mix, but offshore mix, typically tends to be driven more by the requirements of our customer in time and material business. And only in the fixed-price projects, we have more flexibility around offshore. So I would count sort of four big ones and fifth one, which can be leveraged in specific situations.

So, as we look at the performance of this year, certainly utilization has continued to inch up every quarter. And I think we still have some flex left as we enter quarter four. Automation, led by AI is a tremendous opportunity. We have executed well in 2024, and I still feel we'll continue to get additional leverage of that as we build a greater rollout capability, greater absorption capability of that within our delivery, within our spectrum of our delivery.

The Pyramid is certainly an ongoing initiative. We have had, as an organization and as an industry struggle to keep up with the reasons of Pyramid, all through 2020, 2021, 2022 as the industry went through a shock of a sudden drop of demand and then sudden increase in demand I think we are getting back to that rhythm of building Pyramid. So I would say it is not a lever for 2025, but it certainly is a lever as we look at next three years and that we are putting a great internal initiative around.

And finally, pricing. Pricing in the current environment is, I would say, competitive. It's not something that is adding to gross margin today, but it is a factor of the demand environment. So that's how I see it, Jim.

James Edward Schneider

Analyst, Goldman Sachs & Co. LLC

Q

That's great color. Thank you.

Operator: Our next question is from Maggie Nolan from William Blair. Please go ahead.

Maggie Nolan

Analyst, William Blair & Co. LLC

Q

Hi, thank you. Do you view financial services as leading in terms of how IT spend may trend across your business and end markets? Or do you view the dynamics of the financial services performance to be more vertical specific and Cognizant specific at this time?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

We're very pleased with how we have gone about structurally turning around our financial services business. When I came on board, we had both company-specific issues and market-specific issues. I would say the company-specific issues have more or less gone. They were gone at least a few quarters ago. We put a good team on board now, very stable team. We now have compelling offerings, and we are working the corridors of our clients. So we are starting to see the wallet share gain for ourselves.

There is uptick in spending in financial services clients, and we are probably seizing those dollars ahead of some of our peers, and therefore, we are starting to see that. I am very optimistic that financial services will continue to go back to a high discretionary environment at some point in time because it's also one of the most cutting-edge innovative industries. And they all have [ph] retained (45:13) organizations where a lot of technology innovation is done in partnership with companies like ours.

We always had that muscle before. I mean, we were one of the leading financial services players across the world, and it does, I do believe that we have got that mojo back. So depending on how the market turns around in financial services, we will grab those opportunities.

We do not have any specific company-specific challenges which we had in the past. So that gives me the confidence that we have the differentiation, the agility, the team and as the market keeps bouncing back. I mean there is a rebound of discretionary dollars in financial services. And as that continues to go up. We are in a great spot to gain more wallet share.

Maggie Nolan

Analyst, William Blair & Co. LLC

Q

Okay. Thank you. And then any changes that you're seeing in the sales cycle and the conversion rate, both for this quarter that you just reported? And then also your forward expectations just given that continued large deal traction, but also what appears to be the early return of some the smaller discretionary deals and demand?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yes. The smaller discretionary deals are starting to take a little momentum. So, on the large deals, I would say the biggest change I have seen in the last few months is, if we are able to put a proposal on the table where you can

feed into the legacy, make savings, underwrite those savings for innovation. I think clients love that flywheel. So clients are not saying I'm going to spend a ton more. But clients are saying, can you do more for less.

So the AI tooling is helping us to do more for less. And those savings are getting translated to innovation dollars and translated to backlog getting cleared. I think that is a new, it's a new model which is helping us to win those deals. I mean, when we win these large deals, those dollars are not going back elsewhere, they're actually going back to technology. And we are able to put a model where we underwrite those dollars for the innovation. So that's the change. That's what clients are looking for in an industry of this kind where you can do more for less, the spend is elastic. I mean, you can – if you do more for less the spend, you could get more done, and therefore, clients are going to offer you more. That's because the spend is elastic. You get more value, you get more projects to be done.

Maggie Nolan

Analyst, William Blair & Co. LLC

Q

Makes sense. Thank you.

Operator: Our next question is from Jamie Friedman from Susquehanna. Please go ahead.

James E. Friedman

Analyst, Susquehanna Financial Group LLLP

Q

Hi, thank you. So I wanted to ask briefly on your view of the durability of the Health Science recovery. Ravi, the results speak for themselves. It's a very, it's a clear turnaround. But we're getting a lot of questions that the end market seems to be volatile. And if you could unpack that maybe to the Payer and Life Science side, but how do you see the change in the end market, especially on the Payer side potentially impacting the demand for your services?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

That's a great question. There are four segments here, there is Payer, Provider, Pharma Benefit and Life Sciences. Life Sciences clearly is a standout because Life Sciences clients are no longer using technology for enabling their business, they're using technology at the core. And we have some extraordinary capability of partnering with our clients for that core business. This is not enabling the business I mean enabling the business is IT systems, enabling the core is discovery cycle, the drug discovery cycle and the ability to apply technology to support it. We have really some very good capability there, including Life Sciences manufacturing. So I think that's a sector which will continue to invest in technology to reduce the drug development cycle, and we think we have a good opportunity there.

On Payer, as you would have noticed, there's a lot of cost takeout, which is going to happen because the PMPM as I call it, the cost per member per month that is under pressure. So you have to start to think about how do payers reduce their cost and increase the value towards care. So we think technology can be that enabler to reduce cost.

Just to give you an example, on TriZetto, we applied Generative AI. And we are able to take out 30% cost for case managers and end users who are processing claims. The administrative costs in payers is so high that you could use technology and you could use the power of AI to create more, generate more values, more straight through processing.

Our auto adjudication on claims has significantly gone up. I mean we could auto adjudicate claims without human intervention. So there is so much happening on the payer side on technology that it's a cost takeout opportunity rather than anything else. Cost take out is going to lead to transformation of payer.

Provider, there's a very distributed market, and there is consolidation happening on providers. And I think we have, again, a unique opportunity because our TriZetto platform today has a large pool of providers. In fact, we have 200 million members, and we have thousands of providers who are on our platform. We also do Clearing House, which is a combination of payer and provider because the Clearing House actually sits on the gateways between providers and payers.

Pharma benefit companies, very small number and they are themselves going through a transformation. So, is there going to be more consolidation? Is there going to be more change? Is there going to be more transformation in this sector? Yes, but they're all going to be powered by technology. So we think our unique position in healthcare, our unique position in healthcare is going to be a huge benefit for the opportunities which come out there. So I'm excited about the transformation in this entire value chain, which is going to happen in the next few years.

James E. Friedman

Analyst, Susquehanna Financial Group LLLP

Q

Okay. Great answer. I'll drop back in the queue. Thank you.

Operator: The next question is from Bryan Keane from Deutsche Bank. Please go ahead.

Bryan Keane

Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Hey, Ravi, to me, it sounds like you're using GenAI as an advantage to come in and price below some of the peers using your guys' expertise in the technology to replace some incumbents and pass on some productivity gains. Is that fair?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yes. I know Yes. If the engagement model allows us to do that, we could share those benefits with our clients. In the past, it was labor-led, the labor-led cycles are pretty much, I mean, we have really optimized it across the industry. The new cycles are technology-led. And AI-led and automation-led productivity sharing the benefit with our clients, I think, is a mainstream model which we are adapting to win these large deals where we have had sustained momentum.

Bryan Keane

Analyst, Deutsche Bank Securities, Inc.

Q

Yes, because the argument will be that it's a deflationary environment for the overall IT services adds more of the cost saves and productivity gains from GenAI gets passed on, the old time and materials models come under pressure and the yields are lower. The outcomes-based pricing is going to yield a lower outcome for the contracts. So it's got a deflationary impact. So you've got to make it up by volume is the only way you can make faster growth.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yes. So my thesis there is almost every CIO, I have spoken about has actually said, they have a backlog, which they want to clear. And this is our opportunity to clear the backlog. There are CIOs who have actually told us that, look, there is so much technical debt sitting with us. I mean there is a report which talks about \$1 trillion of technical debt in U.S. balance sheets, American Corporation balance sheets. Almost \$400 billion is actually being spent on. Again, another report which talks about spent on servicing that debt. And because of that, a lot of money is being spent on the run versus the build. So this is our opportunity to readjust the run in the build. So, and that's what I was referring to earlier. We were able to reduce the run costs and transfer that to the build, you can actually build more stuff. So technology spend is so elastic that, I mean it will remain elastic because it is such a transformational tool that you could, if you do more for less, you're actually going to get more to do because there is no, the headroom is so high. So I actually believe that the thesis of doing more for less is only going to generate more opportunities for us.

Bryan Keane

Analyst, Deutsche Bank Securities, Inc.

Q

And is it roughly 20% to 40% less or how much more or less is it? You know the pricing.

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Yes, it's a hard to put a number because it depends on the phase of the technology cycle. If it's pure play development, it is much higher. If it's testing, it is much higher. Equally, if you're in a fiercely competitive situation, you probably give it away to – you partially give it away to clients. There's also the maturity of the client, which kind of determines how much you can get productivity.

So there is a compelling proposition to do fixed price and more managed services deals. But there are always companies which have huge [ph] retained (56:59) organizations, and they use companies like us to engage on a time and material or a capacity-base because they have strategically taken a call to build their own tech shop.

In fact, we are actually helping some of those clients to build their tech shop. There are captives being set in India. We are actually a pioneering partner to partner with our clients to set up their captives. That's another opportunity which has kind of evolved in the last one year. And again, I'm excited about it. I don't see that as cannibalization. I see that as an opportunity to stay more relevant with them.

Bryan Keane

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks for taking the questions.

Operator: The last question is from Bryan Bergin from TD Cowen. Please go ahead.

Bryan C. Bergin

Analyst, TD Cowen

Q

Hi, guys. Good afternoon. Thank you. Want to know, I have a follow-up question here on the forward view. If you're targeting kind of an organic exit rate of about 1% of the midpoint, and flattish bookings here when we consider the year ahead, are there puts and takes about the conversion of the multi-year larger deals versus

some of the smaller deals picking up to support the nearer-term growth rate acceleration. Just any thoughts you want to share directionally about growth considerations as we get closer to 2025?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

Sure. So if you see this year, every quarter, we have been able to execute to the growth agenda that we set in the beginning of the quarter. This is the first quarter, quarter three was our first quarter of organic growth in, over the last few quarters. We are exiting with a significantly better velocity than what we had at the end of 2023. So that certainly sets up well. But we will, I think it's, what is critical for us is really focus and execute well to quarter four, and then look at the opportunity that presents us in beginning of 2025 and then guide for 2025. So I would say little early to talk about 2025, but quite happy with the progress that we are making every quarter in, on the trajectory.

Bryan C. Bergin

Analyst, TD Cowen

Q

Okay. Understood. And then when we think about the margin levers, specifically on utilization. Do you have a targeted optimal level for you as you manage the [ph] bench, (59:35) see you've gotten back to 84%. Can you lean on that more until demand recovers? Or is that an upper bound as you think about utilization?

Ravi Kumar Singiseti

Chief Executive Officer & Director, Cognizant Technology Solutions Corp.

A

I do think there is a little more flex left on that, certainly, that I see, but not a lot more.

Bryan C. Bergin

Analyst, TD Cowen

Q

Okay. Thank you.

Operator: Thank you. This concludes the question-and-answer session. This also concludes today's teleconference. You may disconnect your lines at this time. Thank you again for your participation.

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