SELECTIVE WEALTH MANAGEMENT

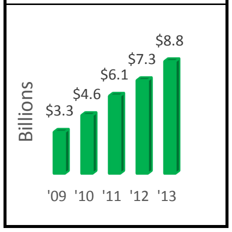
Cognizant Technology Solutions Corp

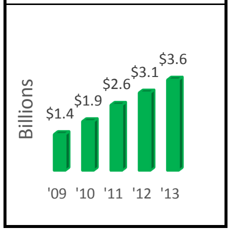
August 6, 2014

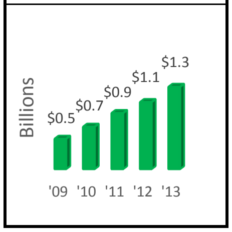
General Overview

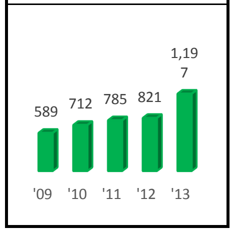
Cognizant Technology Solutions Corp (CTSH) is a leading provider of IT, consulting and business process services. The company was founded as a division of Dun & Bradstreet in 1994 and began serving external clients in 1996. CTSH officially went public in 1998 and has enjoyed tremendous success since that time. Below is a snapshot of key financial data for the last 5 years:

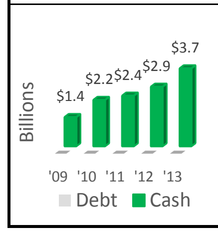
Revenue	Gross Profit	Owner Earnings	Client Relationships	Balance Sheet
$8,843,189,000	$3,577,720,000	$1,295,104,500	1,197	Cash = $3.7 Billion
5-Year CAGR = 28.2%	5-Year CAGR = 25.8%	5-Year CAGR = 28.4%	5-Year CAGR = 19.4%	Debt = $0











The company specializes in helping clients build more efficient businesses. CTSH employs 170,000 software developers located in countries around the globe that are organized into teams based on geography and work seamlessly around the clock to write software programs and develop business processes to save money for their clients. This global delivery model and high value proposition has allowed CTSH to grow rapidly and create tremendous wealth for shareholders.

Purchase Logic

We acquired our stake in CTSH at approximately 14x earnings with an average purchase price of $42.24 per share. This purchase price compares favorably to the current price multiple of 16x earnings for the average S&P 500 constituent. The rationale behind our purchase was simple - we believe we paid a fair price for an outstanding business. CTSH has compounded earnings at a rate of 28.4% for the last five years and has only experienced one year of growth below 20% since its public debut in 1998. In 2014 the business is on pace for 15% growth, the lowest in the company's history, and the momentary deceleration has created a buying opportunity.

Future Expectations

It is our expectation that CTSH will compound earnings at a rate of 15% or more for the next 10 years. During this decade of growth we'd expect to see annual results fluctuate between +5% and +25% depending on macroeconomic conditions and the general spending level of CTSH's client base. We anticipate the growth to be relatively smooth and continually upward due to the highly stable nature of the industry in which CTSH operates. It is very difficult to find businesses of such a high caliber and for that reason we intend to hold the business indefinitely unless a significantly higher price multiple is available at the time of sale.

Financial Highlights

Historical Growth

In the last 5 years CTSH has managed annual top line growth of 28.2% which has translated into a CAGR of 28.4% for owner earnings. The company has increased owner earnings every year – without exception – since their inception in 1994. Below are most relevant performance measures for the business for the last 5 years:

Table 1: Performance Measures

Year	'09	'10	'11	'12	'13	1H2014
Total Revenue	$ 3,278,663,000	$ 4,592,389,000	$ 6,121,156,000	$ 7,346,472,000	$ 8,843,189,000	$4,939,442,000
Gross Profit	$ 1,429,220,000	$ 1,937,820,000	$ 2,582,534,000	$ 3,068,231,000	$ 3,577,720,000	$2,007,536,000
Gross Profit Margin	43.6%	42.2%	42.2%	41.8%	40.5%	40.6%
Owner Earnings	$475,788,750	$665,733,750	$881,787,750	$1,054,507,500	$1,295,104,500	$720,786,000
YOY Earnings Growth	18%	40%	32%	20%	23%	23%
Client Relationships	589	712	785	821	1,197	1,242
Cash	$1,399,332,000	$2,226,388,000	$2,432,264,000	$2,863,758,000	$3,747,473,000	$4,129,221,000
Debt	$0	$0	$0	$0	$0	$0

All trends are favorable with the exception of slight compression in gross profit margins. We anticipate the gross margin level to continue to compress slightly over the years. This issue is addressed in further detail under 'Risks: Wage Increases in India'.

Balance Sheet

CTSH has a simple and impressive balance sheet. In the last 10 years the company has operated with no debt and has consistently increased the cash balance. The company maintains a certain amount of cash for liquidity and operational expenses, but we estimate that of the $4.1 billion in cash equivalents held as of June 30, 2014 that approximately $2 billion is excess and available for acquisitions, dividends, or share repurchases.

Future Performance

The industry conditions, competitive position, and management team that has led to the overwhelming success during the last 25 years remains intact and the total addressable market for CTSH services continues to expand. We are forecasting continued growth of 15% or more for CTSH in the next 10 years. Below is a detailed discussion of why we believe the necessary contributors for growth, namely favorable industry conditions and CTSH position as the industry leader, will continue into the future.

Favorable Industry Conditions

CTSH is one of many third party providers of information technology, consulting, and business process outsourcing (BPO) services. The number of firms competing in this space is large, but the vast majority are extremely profitable. The high profitability of the industry can be attributed to the overall industry having very low capital requirements and the revenue retention rates are typically in excess of 100%. These two factors combined to create an environment for business success.

Low Capital Requirements

The BPO industry is a service industry. The capital requirements to launch a BPO company are low – typically the only expenditures required are office space and computers. Due to small capital outlay expanding a business is limited only by the management team's ability to hire, train, retain, manage, and motivate a competent workforce. CTSH has an outstanding management team that has exceled at building a world class infrastructure to manage and expand the company's workforce. The system continues to scale and the company is able to reinvest nearly 100% of owner earnings back into the business at rates of return in excess of 30%. We see this trend continuing for CTSH and many other industry participants.

High Revenue Retention Rates

We define the revenue retention rate as the amount of revenue generated by clients in the current year divided by the revenue generated by those same clients in the following year.

Example:

2013:	Clients = 100	Revenue Per Client = \$100,000	Total 2013 Revenue = \$10,000,000
2014:	Clients = 98[1]	Revenue Per Client = \$105,000[2]	Total 2014 Revenue = \$10,290,000

Revenue Retention Rate = \$10,290,000 / \$10,000,000 = 102.9%

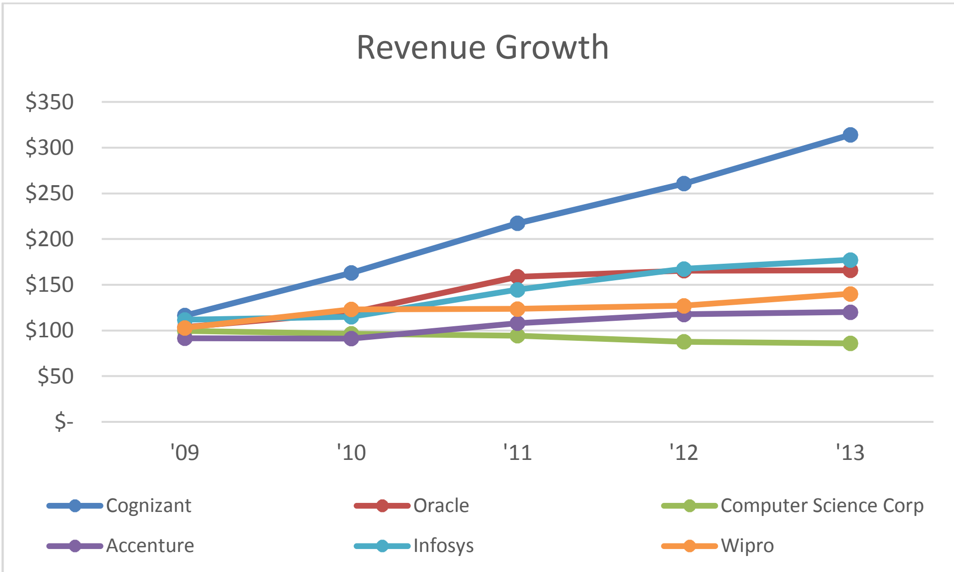
1. This figure does not include new clients added during the time period. In this example we assume that of the 100 clients the company served during 2013 that two went out of business or left to a competitor. The client retention rate in this case is 98%.
2. The revenue per client increased 5% year over year. The 98 clients that remained in 2014 increased their overall spending with CTSH.

The majority of the BPO industry benefits from revenue retention rates in excess of 100%. The outstanding revenue retention rates can be attributed to high switching costs associated with changing a BPO partner. The high switching costs arise from the extreme integration that occurs when a BPO partner, such as CTSH, engages a client on a new project. It takes substantial time and energy for the client to communicate their business model, vision, and needs to the BPO partner. This process often requires teams ranging from 10 to 1,000 communicating together across the two organizations. Once the BPO partner is familiar with how a client operates and begins building custom solutions for that client the two operations begin to integrate. The longer the two partners work together the deeper this integration and the more expensive it is to switch to a competing firm. This gives the BPO partner a considerable pricing advantage when bidding for additional projects with existing clients. As clients expand their project spending on software solutions the incumbent BPO partner typically wins the majority of all work moving forward. Companies such as Oracle, SAP, Accenture, IBM, Infosys, Cognizant, and others have benefited greatly from these high switching costs.

In addition to high switching costs the strong value proposition entices clients to continue to increase their annual spending on BPO development projects. The return on investment for the client is extremely high as BPO projects reduce costs and increase revenue. Clients are able to improve operational performance and increase profitability dramatically for every dollar spent on BPO solutions.

Industry Leader

The BPO industry as a whole benefit from wonderful economics and CTSH is the industry leader. The company has significantly outpaced the growth rate of the competition. The chart below shows the revenue growth of CTSH versus a group of peers. The graph is normalized and assumes initial revenue of $100.



CTSH has achieved large market share gains through superior capital allocation and more efficient operations. The company has operating margins between 19-20% which is a solid 8 to 9 percentage points lower than their peers. The lower operating margin is a byproduct of lower pricing that CTSH offers to clients. While this reduces profits in the short term and lowers returns on capital the decision to undercut the competition has translated into considerable market share gains without comprising profitability.

Additionally, the competition has spent the last decade allocating a portion of earnings to dividends and share repurchases while CTSH continues to invest heavily in the business. The decision to retain 100% of earnings and expand continues to pay off as the returns on invested capital are in excess of 30%. We do not anticipate any share repurchase activity or dividend payments for the foreseeable future.

Risks

We view CTSH as a very low risk investment. All industry participates earn large profits and the nature of the industry protects BPO companies from external competition. CTSH will be highly successful in the next 10 years and in the event the company remains the industry leader the results will be sensational. However, there are a few short-term and long-term risks that could impact the price performance of the stock over short periods of time.

<u>Short-Term Risks</u>

- Reduction in Client Spending. On occasion multiple clients elect to reduce or delay project costs associated with business process development. Historically these reductions or delays are temporary and spending resumes at higher levels once short-term budgeting concerns alleviate. The industry is largely recession proof due to the high value proposition – typically companies continue to cut costs and spend on BPO during difficult times. This was show cased during the 2008 – 2009 financial crisis.
    - Low Risk

- Loss of major customer. As of December 31, 2013 the company provided services to 1,197 clients with the number of ‘strategic partners’ reaching 243. A strategic partner is one offering the potential to generate at least $5 million to $50 million or more in annual revenues. No individual customer exceed 10% of consolidated revenues. The top five customers in 2013 represented a total of 13.2% of revenues. The loss of multiple major customers simultaneously would impact short term results. At the current growth rate it would take approximately 6 to 8 months to replace the revenue lost from the top five customers.
    - Low Risk
- Foreign Exchange Fluctuations between USD and India Rupee. The majority of employees are located in India and are paid in Rupees. The majority of clients are located in North America and Europe and payments made to CTSH are denominated in USD or Euros. Should the Indian Rupee materially appreciate against these two currencies it could impact overall profitability due to higher wage costs.
    - Moderate Risk
- Limit on US H-1B Visas. The majority of CTSH workforce is from the Asia-Pacific region and requires H-1B visas to perform work for corporations in the United States. This has been a political hot spot for several years and reduction in the number of H-1B visas would temporarily impact CTSH business model. The limit on visas would require CTSH to hire more employees from North America and increase costs for the business. This would likely be offset by increasing pricing to maintain gross profits margins and not materially impact the business in the long term.
    - Moderate Risk
- Wage Rate Increases in India. The demand for highly skilled technical labor in India continues to increase and the wages for technically competent employees continues to rise. As wages increase it compresses margins for CTSH. The trend in wages will likely continue upward and be offset slightly by price increases to clients. This will cause margin compression for the business, but the returns on capital would remain significantly above 20%.
    - Moderate Risk

Long-Term Risks

- Technological Obsolescence. More often than not firms that must rapidly adapt to changing technological trends are at risk to technological obsolescence. The opposite is true for CTSH. The firm generates revenue by implementing new technological trends into business processes globally. As technology evolves, from mobile to big data, CTSH has a new greenfield opportunities and new projects to engage with existing clients.
    - No Risk
- Political Changes in India. India is currently exceptionally friendly toward software programming development centers. The government has established an outstanding school system to train software engineers, created tax incentives, and much more to spur development in India. If a new political party is elected with an agenda that makes it difficult to establish foreign businesses in India and utilizes local talent CTSH would suffer. This has the potential to permanently alter the business. We view this political risk as remote.
    - Low Risk

Growth Opportunity

The Indian IT-BPO industry is estimated to grow from $101 billion in FY 2012 to more than $225 billion by 2020.[i] A substantial portion of this growth will come from increased spending from CTSH existing client base – meaning no additional business relationships are required to experience large gains. In addition to increased spending from existing clients CTSH will benefit from the continued addition of new clients during the next 10 years.

Moat

The company's economic moat is protected by the combined effect of the following three contributing factors:

1) High Switching Costs (Industry Specific)

The high switching cost was described previously when outlining the industry conditions for IT BPO firms but will be reemphasized here. When BPO firms partner with clients the integration between the two firms is deep and switching costs are very high. Firms across the entire industry rarely lose clients due to this tight integration and have revenue retention rates in excess of 100%. These high switching costs are industry wide and not CTSH specific.

2) Brand Name & Large Cap Ex (Company & Industry Specific)

When considering a large capital project it is critical to choose the right partner. Companies spend a great deal of time and energy prior to selecting a partner – and having a strong brand name in the industry is crucial during the selection process. CTSH's client base consists of large enterprises with annual budgets for BPO projects ranging from 5 million to 50 million or more. Additionally, CTSH has set itself apart in recent years and continues to win large contract deals from their multi-billion dollar competition. The CTSH brand is exceedingly valuable when bidding for new projects.

3) Low Cost Provider (Company Specific)

CTSH has elected to pursue a business model that is slightly different than its peers – the company charges less and anticipates making up the difference through market share gains. The competitors clients continue to pay higher rates to incumbent firms due to the high switching costs, but new enterprise class companies are consistently choosing CTSH. If CTSH maintains the position as low cost provider the company will succeed mightily in the next decade. In the event they lose this leadership position the business will still grow and experience wonderful results due to the robust client base and high switching costs.

Conclusion

Cognizant Technology Solutions (CTSH) has achieved historical growth rates in excess of 20% for more than 25 years. The industry conditions and competitive position that lead to this success remain intact. As a whole the Indian IT-BPO industry is targeted to grow from $101 billion to more than $225 billion in the next 6 years and we believe that CTSH as an industry leader will benefit from these macroeconomic trends. It is our expectation that CTSH will achieve annual growth in owner earnings of more than 15% for the next 10 years. This forecast is backed by the strong economic moat surrounding the business: high switching costs, a strong brand name, and the position as a low cost provider. We paid approximately 14x earnings to purchase our stake in CTSH and do not intend to sell due to the high probability of robust growth, however, if a significantly higher price multiple is offered we may be inclined to sell.

Works Cited

1) Cognizant Technoly Solutions *Annual Report - SEC Filing 10-K.* EDGAR, 2013.
2) http://www.microsoft.com/mic/mic-about.aspx
3) Infosys IR-Presentation March 2013.

[i] Infosys IR-Presentation March 2013.

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