

COGNIZANT TECHNOLOGY SOLUTIONS CORP

Form 10-Q

May 08, 2014

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2014

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number 0-24429

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of

13-3728359
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

Glenpointe Centre West

500 Frank W. Burr Blvd.

Teaneck, New Jersey
(Address of Principal Executive Offices)

07666
(Zip Code)

Registrant's telephone number, including area code (201) 801-0233

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No:

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No:

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of May 1, 2014:

Class	Number of Shares
Class A Common Stock, par value \$.01 per share	608,453,905

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited).
COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(in thousands, except per share data)**

	Three Months Ended March 31,	
	2014	2013
Revenues	\$ 2,422,348	\$ 2,020,738
Operating expenses:		
Cost of revenues (exclusive of depreciation and amortization expense shown separately below)	1,432,444	1,199,965
Selling, general and administrative expenses	485,395	413,204
Depreciation and amortization expense	44,473	41,662
Income from operations	460,036	365,907
Other income (expense), net:		
Interest income	13,505	13,247
Foreign currency exchange gains (losses), net	(1,217)	(3,751)
Other, net	864	1,780
Total other income (expense), net	13,152	11,276
Income before provision for income taxes	473,188	377,183
Provision for income taxes	124,310	92,974
Net income	\$ 348,878	\$ 284,209
Basic earnings per share	\$ 0.57	\$ 0.47
Diluted earnings per share	\$ 0.57	\$ 0.47
Weighted average number of common shares outstanding - Basic	607,730	603,708
Dilutive effect of shares issuable under stock-based compensation plans	5,167	6,645
Weighted average number of common shares outstanding - Diluted	612,897	610,353

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands)

	Three Months Ended	
	March 31,	
	2014	2013
Net income	\$ 348,878	\$ 284,209
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	1,472	(19,588)
Change in unrealized losses on cash flow hedges, net of taxes	107,050	51,150
Change in unrealized gains and losses on available-for-sale securities, net of taxes	452	(310)
Other comprehensive income (loss)	108,974	31,252
Comprehensive income	\$ 457,852	\$ 315,461

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

(in thousands, except par values)

	March 31, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,935,991	\$ 2,213,006
Short-term investments	1,928,993	1,534,467
Trade accounts receivable, net of allowances of \$28,475 and \$26,824, respectively	1,703,605	1,648,785
Unbilled accounts receivable	267,349	226,487
Deferred income tax assets, net	200,430	256,230
Other current assets	254,372	268,907
Total current assets	6,290,740	6,147,882
Property and equipment, net of accumulated depreciation of \$740,021 and \$719,336 respectively	1,090,885	1,081,164
Goodwill	445,182	444,236
Intangible assets, net	124,735	131,274
Deferred income tax assets, net	140,568	147,149
Other noncurrent assets	187,189	183,013
Total assets	\$ 8,279,299	\$ 8,134,718
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 176,374	\$ 113,394
Deferred revenue	166,504	182,893
Accrued expenses and other current liabilities	1,159,988	1,478,221
Total current liabilities	1,502,866	1,774,508
Deferred income tax liabilities, net	20,275	21,170
Other noncurrent liabilities	133,201	203,249
Total liabilities	1,656,342	1,998,927
Commitments and contingencies (See Note 7)		
Stockholders Equity:		
Preferred stock, \$.10 par value, 15,000 shares authorized, none issued		
Class A common stock, \$.01 par value, 1,000,000 shares authorized, 608,445 and 607,729 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	6,084	6,077
Additional paid-in capital	572,913	543,606
Retained earnings	6,211,245	5,862,367
Accumulated other comprehensive income (loss)	(167,285)	(276,259)
Total stockholders equity	6,622,957	6,135,791
Total liabilities and stockholders equity	\$ 8,279,299	\$ 8,134,718

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The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	For the Three Months Ended March 31,	
	2014	2013
Cash flows from operating activities:		
Net income	\$ 348,878	\$ 284,209
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	46,680	43,601
Provision for doubtful accounts	1,655	1,729
Deferred income taxes	36,270	23,030
Stock-based compensation expense	35,817	29,093
Excess tax benefits on stock-based compensation plans	(5,853)	(7,490)
Other	(9,835)	1,656
Changes in assets and liabilities:		
Trade accounts receivable	(52,662)	(149,421)
Other current assets	(24,419)	(9,020)
Other noncurrent assets	(3,308)	(20,562)
Accounts payable	65,624	16,269
Other current and noncurrent liabilities	(281,527)	(139,626)
Net cash provided by operating activities	157,320	73,468
Cash flows from investing activities:		
Purchases of property and equipment	(43,256)	(72,185)
Purchases of investments	(779,269)	(348,692)
Proceeds from maturity or sale of investments	390,506	374,279
Business combinations, net of cash acquired	(1,635)	(139,276)
Net cash (used in) investing activities	(433,654)	(185,874)
Cash flows from financing activities:		
Issuance of common stock under stock-based compensation plans	26,677	31,996
Excess tax benefits on stock-based compensation plans	5,853	7,490
Repurchases of common stock	(39,103)	(22,554)
Net cash (used in) provided by financing activities	(6,573)	16,932
Effect of exchange rate changes on cash and cash equivalents	5,892	257
(Decrease) in cash and cash equivalents	(277,015)	(95,217)
Cash and cash equivalents, beginning of year	2,213,006	1,570,077
Cash and cash equivalents, end of period	\$ 1,935,991	\$ 1,474,860

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(dollar amounts in thousands)

Note 1 Interim Condensed Consolidated Financial Statements

The terms Cognizant, we, our, us and company refer to Cognizant Technology Solutions Corporation unless the context indicates otherwise. We have prepared the accompanying unaudited condensed consolidated financial statements included herein in accordance with generally accepted accounting principles in the United States of America, or U.S. GAAP, and Article 10 of Regulation S-X under the Securities Exchange Act of 1934, as amended. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements (and notes thereto) included in our Annual Report on Form 10-K for the year ended December 31, 2013. In our opinion, all adjustments considered necessary for a fair presentation of the accompanying unaudited condensed consolidated financial statements have been included, and all adjustments are of a normal and recurring nature. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire year.

During the three months ended March 31, 2014, we repurchased 600,000 shares of our Class A common stock for \$29,335, inclusive of fees and expenses, under our existing stock repurchase program approved by our Board of Directors. As of March 31, 2014, the remaining available balance under the Board authorization was \$472,778. Additional stock repurchases were made in connection with our stock-based compensation plans, whereby company shares were tendered by employees for payment of applicable statutory tax withholdings. During the first quarter of 2014, such repurchases totaled 194,542 shares at an aggregate cost of \$9,768.

Stock Split

On February 4, 2014, the company's Board of Directors declared a two-for-one stock split of our Class A common stock in the form of a 100% stock dividend, which was paid on March 7, 2014 to stockholders of record as of February 21, 2014. The stock split has been reflected in the accompanying condensed consolidated financial statements, and all applicable references as to the number of outstanding common shares and per share information, except par values, have been retroactively adjusted to reflect the stock split as if it occurred at the beginning of the earliest period presented. Stockholders' equity accounts have been retroactively adjusted to reflect a reclassification of an amount equal to the par value of the increase in issued shares of Class A common stock from the additional paid-in-capital account to the Class A common stock account.

Recently Adopted Accounting Pronouncements.

In July 2013, the Financial Accounting Standard Board issued new guidance which requires the netting of any unrecognized tax benefits against all available same-jurisdiction deferred income tax carryforward assets that would apply if the uncertain tax positions were settled. We adopted this standard on January 1, 2014. As of March 31, 2014, we netted an unrecognized tax benefit of \$79,560 against same-jurisdiction non-current deferred income tax assets. In our December 31, 2013 condensed consolidated statement of financial position, we reclassified \$74,196 from other non-current liabilities to non-current deferred income tax assets, net to conform to current period's presentation. The adoption of this standard had no effect on our condensed consolidated results of operations or stockholders' equity.

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Our short-term investments were as follows:

	March 31, 2014	December 31, 2013
Available-for-sale investment securities:		
U.S. Treasury and agency debt securities	\$ 521,854	\$ 506,285
Corporate and other debt securities	330,199	301,841
Certificates of deposit and commercial paper	494,832	99,959
Asset-backed securities	153,399	160,267
Municipal debt securities	123,316	115,196
Mutual funds	21,343	21,136
Total available-for-sale investment securities	1,644,943	1,204,684
Time deposits	284,050	329,783
Total short-term investments	\$ 1,928,993	\$ 1,534,467

Our available-for-sale investment securities consist of U.S. dollar denominated investments primarily in U.S. Treasury notes, U.S. government agency debt securities, municipal debt securities, non-U.S. government debt securities, U.S. and international corporate bonds, certificates of deposit, commercial paper, debt securities issued by supranational institutions, mutual funds invested in fixed income securities, and asset-backed securities, including Government National Mortgage Association (GNMA) mortgage backed securities and securities backed by auto loans, credit card receivables, and other receivables. Our investment guidelines are to purchase securities which are investment grade at the time of acquisition. We monitor the credit ratings of the securities in our portfolio on an ongoing basis. The carrying value of the time deposits approximated fair value as of March 31, 2014 and December 31, 2013.

Available-for-Sale Investment Securities

The amortized cost, gross unrealized gains and losses and fair value of available-for-sale investment securities at March 31, 2014 were as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury and agency debt securities	\$ 521,619	\$ 622	\$ (387)	\$ 521,854
Corporate and other debt securities	329,194	1,161	(156)	330,199
Certificates of deposit and commercial paper	494,463	382	(13)	494,832
Asset-backed securities	153,426	214	(241)	153,399
Municipal debt securities	122,986	391	(61)	123,316
Mutual funds	22,990	222	(1,869)	21,343
Total available-for-sale investment securities	\$ 1,644,678	\$ 2,992	\$ (2,727)	\$ 1,644,943

The amortized cost, gross unrealized gains and losses and fair value of available-for-sale investment securities at December 31, 2013 were as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Treasury and agency debt securities	\$ 506,094	\$ 544	\$ (353)	\$ 506,285
Corporate and other debt securities	300,994	1,090	(243)	301,841

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Certificates of deposit and commercial paper	99,897	62		99,959
Asset-backed securities	160,559	99	(391)	160,267
Municipal debt securities	114,888	348	(40)	115,196
Mutual funds	22,705	280	(1,849)	21,136
Total available-for-sale investment securities	\$ 1,205,137	\$ 2,423	\$ (2,876)	\$ 1,204,684

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The fair value and related unrealized losses of available-for-sale investment securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer were as follows as of March 31, 2014:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency debt securities	\$ 160,033	\$ (387)	\$	\$	\$ 160,033	\$ (387)
Corporate and other debt securities	101,217	(156)			101,217	(156)
Certificates of deposit and commercial paper	34,989	(13)			34,989	(13)
Asset-backed securities	44,171	(192)	8,185	(49)	52,356	(241)
Municipal debt securities	26,306	(59)	806	(2)	27,112	(61)
Mutual funds			20,343	(1,869)	20,343	(1,869)
Total	\$ 366,716	\$ (807)	\$ 29,334	\$ (1,920)	\$ 396,050	\$ (2,727)

The fair value and related unrealized losses of available-for-sale investment securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer were as follows as of December 31, 2013:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency debt securities	\$ 221,548	\$ (353)	\$	\$	\$ 221,548	\$ (353)
Corporate and other debt securities	106,485	(243)			106,485	(243)
Asset-backed securities	84,051	(333)	5,048	(58)	89,099	(391)
Municipal debt securities	10,702	(34)	1,019	(6)	11,721	(40)
Mutual funds			20,183	(1,849)	20,183	(1,849)
Total	\$ 422,786	\$ (963)	\$ 26,250	\$ (1,913)	\$ 449,036	\$ (2,876)

The unrealized losses for the above securities as of March 31, 2014 and December 31, 2013 are primarily attributable to changes in interest rates. As of March 31, 2014, we do not consider any of the investments to be other-than-temporarily impaired. The gross unrealized gains and losses in the above tables were recorded, net of tax, in accumulated other comprehensive income (loss).

The contractual maturities of our fixed income available-for-sale investment securities as of March 31, 2014 are set forth in the following table:

	Amortized Cost	Fair Value
Due within one year	\$ 650,086	\$ 650,745
Due after one year up to two years	292,940	293,687
Due after two years up to three years	481,426	481,826
Due after three years up to four years	43,810	43,943
Asset-backed securities	153,426	153,399
Fixed income available-for-sale investment securities	\$ 1,621,688	\$ 1,623,600

Asset-backed securities were excluded from the maturity categories because the actual maturities may differ from the contractual maturities since the underlying receivables may be prepaid without penalties. Further, actual maturities of debt securities may differ from those presented above since certain obligations provide the issuer the right to call or prepay the obligation prior to scheduled maturity without penalty.

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Proceeds from sales of available-for-sale investment securities and the gross gains and losses that have been included in earnings as a result of those sales were as follows:

	Three Months Ended March 31,	
	2014	2013
Proceeds from sales of available-for-sale investment securities	\$ 179,035	\$ 161,704
Gross gains	\$ 383	\$ 319
Gross losses	(30)	(5)
Net realized gains on sales of available-for-sale investment securities	\$ 353	\$ 314

Note 3 Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities were as follows:

	March 31, 2014	December 31, 2013
Compensation and benefits	\$ 606,404	\$ 894,986
Income taxes	31,238	24,312
Professional fees	52,439	45,453
Travel and entertainment	28,495	29,645
Customer volume incentives	164,280	170,669
Derivative financial instruments	138,717	191,584
Other	138,415	121,572
Total accrued expenses and other current liabilities	\$ 1,159,988	\$ 1,478,221

Note 4 Income Taxes

Our Indian subsidiaries, collectively referred to as Cognizant India, are primarily export-oriented and are eligible for certain income tax holiday benefits granted by the government of India for export activities conducted within Special Economic Zones, or SEZs, for periods of up to 15 years. Our Indian operations outside of SEZs are subject to corporate income tax at the current rate of 33.99%. In addition, all Indian profits, including those generated within SEZs, are subject to the Minimum Alternative Tax, or MAT, at the current rate of approximately 20.9%, including surcharges. Any MAT paid is creditable against future Indian corporate income tax, subject to limitations.

Our effective income tax rates were as follows:

	Three Months Ended March 31,	
	2014	2013
Effective income tax rate	26.3%	24.6%

For the 2014 and 2013 periods, the principal difference between our effective income tax rates and the U.S. federal statutory rate is the effect of the Indian tax holiday and earnings taxed in countries that have lower rates than the United States. In 2014, our effective income tax rate increased primarily due to changes in the geographic mix of our estimated current year earnings towards countries with higher statutory rates, and a scheduled reduction of certain income tax holiday benefits in India in 2014.

Note 5 Fair Value Measurements

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We measure our cash equivalents, investments and foreign exchange forward contracts at fair value. The authoritative guidance defines fair value as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. The authoritative guidance also establishes a fair value hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions.

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The fair value hierarchy consists of the following three levels:

Level 1 Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.

Level 3 Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable. The following table summarizes our financial assets and (liabilities) measured at fair value on a recurring basis as of March 31, 2014:

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$ 772,010	\$	\$	