

Industry Flash

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Indian IT Services and Software

"Buy vs. Make": CSC to Acquire Covansys

- **CSC to acquire Covansys** — Computer Sciences Corporation and Covansys Corporation announced that they have entered into an agreement under which CSC will acquire Covansys for \$34.00 per share in an all-cash transaction. The transaction values Covansys at \$1.3 billion. Covansys had CY06 revenues of \$455.5 m (+4.9% yoy) and income from operations of \$48.3m (+5.2% yoy).
- **Offshore mainstream; race to expand** — The deal doubles CSC's India headcount to 14,000. For MNCs, a strong offshore presence is becoming a strong imperative. With a large number of deals nearing restructuring, MNCs need to beef up their offshore presence to offer a better value proposition to retain the customer.
- **Buy vs. Make** — MNCs have taken different routes – while Accenture has used the organic route to aggressively expand its offshore presence, others like IBM Global Services (acquired Daksh in 2004), Cap Gemini (acquired Kanbay), and EDS (acquired majority stake in Mphasis BFL), took the inorganic route to accelerate offshore presence.
- **Premium valuations for faster offshore ramp up** — CSC has clearly paid a premium valuation for faster offshore ramp up. The deal price was at ~27% premium to the latest closing price of Covansys. On consensus EPS (source: Bloomberg EPS GAAP), this values Covansys at 27.5x CY07E and 22.7x CY08E earnings, which is clearly a premium to Indian companies of similar size.
- **Implications for Indian IT Services** — The consensus valuation is clearly at a significant premium to the valuations that Indian mid caps trade at. Premium valuations highlight the importance of global/offshore delivery in outsourcing.

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Appendix A-1

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