

COGNIZANT TECHNOLOGY SOLUTIONS CORP

Form 10-Q

May 05, 2011

[Table of Contents](#)

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, 2011

☐ **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)

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

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 April 29, 2011:

Class
Class A Common Stock, par value \$.01 per share

Number of Shares
304,249,849

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

TABLE OF CONTENTS

PART I.	<u>FINANCIAL INFORMATION</u>	Page
		1
Item 1.	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	1
	<u>Condensed Consolidated Statements of Operations (Unaudited) for the Three Months Ended March 31, 2011 and 2010</u>	1
	<u>Condensed Consolidated Statements of Financial Position (Unaudited) as of March 31, 2011 and December 31, 2010</u>	2
	<u>Condensed Consolidated Statements of Cash Flows (Unaudited) for the Three Months Ended March 31, 2011 and 2010</u>	3
	<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	4
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	25
Item 4.	<u>Controls and Procedures</u>	25
	<u>PART II. OTHER INFORMATION</u>	26
Item 1A.	<u>Risk Factors</u>	26
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
Item 6.	<u>Exhibits</u>	42
	<u>SIGNATURES</u>	43

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,	
	2011	2010
Revenues	\$ 1,371,253	\$ 959,720
Operating expenses:		
Cost of revenues (exclusive of depreciation and amortization expense shown separately below)	782,176	555,904
Selling, general and administrative expenses	296,330	194,993
Depreciation and amortization expense	27,382	25,806
Income from operations	265,365	183,017
Other income (expense), net:		
Interest income	8,937	6,054
Other, net	6,198	(10,319)
Total other income (expense), net	15,135	(4,265)
Income before provision for income taxes	280,500	178,752
Provision for income taxes	72,173	27,252
Net income	\$ 208,327	\$ 151,500
Basic earnings per share	\$ 0.69	\$ 0.51
Diluted earnings per share	\$ 0.67	\$ 0.49
Weighted average number of common shares outstanding Basic	304,041	297,885
Dilutive effect of shares issuable under stock-based compensation plans	7,762	8,779
Weighted average number of common shares outstanding Diluted	311,803	306,664

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

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

(in thousands, except par values)

	March 31, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,293,499	\$ 1,540,969
Short-term investments	874,616	685,419
Trade accounts receivable, net of allowances of \$19,851 and \$20,991, respectively	994,948	901,308
Unbilled accounts receivable	128,202	112,960
Deferred income tax assets, net	68,120	96,164
Other current assets	176,415	181,414
Total current assets	3,535,800	3,518,234
Property and equipment, net of accumulated depreciation of \$377,051 and \$352,472, respectively	601,699	570,448
Goodwill	224,009	223,963
Intangible assets, net	81,790	85,136
Deferred income tax assets, net	112,306	109,808
Other noncurrent assets	82,269	75,485
Total assets	\$ 4,637,873	\$ 4,583,074
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 117,595	\$ 75,373
Deferred revenue	82,021	84,590
Accrued expenses and other current liabilities	602,097	770,763
Total current liabilities	801,713	930,726
Deferred income tax liabilities, net	3,870	4,946
Other noncurrent liabilities	68,101	62,971
Total liabilities	873,684	998,643
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, 500,000 shares authorized, 304,210 and 303,941 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	3,042	3,039
Additional paid-in capital	813,962	846,886
Retained earnings	2,907,235	2,698,908
Accumulated other comprehensive income (loss)	39,950	35,598
Total stockholders' equity	3,764,189	3,584,431
Total liabilities and stockholders' equity	\$ 4,637,873	\$ 4,583,074

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

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

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	For the Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 208,327	\$ 151,500
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,964	27,381
Provision for doubtful accounts	(819)	2,658
Deferred income taxes	19,901	23,326
Stock-based compensation expense	16,065	13,945
Excess tax benefit on stock-based compensation plans	(15,792)	(15,753)
Other	240	(10,162)
Changes in assets and liabilities:		
Trade accounts receivable	(89,029)	(92,220)
Other current assets	(7,148)	(46,307)
Other assets	(6,334)	(4,989)
Accounts payable	41,079	36,088
Other current and noncurrent liabilities	(149,825)	(83,139)
Net cash provided by operating activities	45,629	2,328
Cash flows from investing activities:		
Purchases of property and equipment	(55,815)	(24,219)
Purchases of investments	(317,783)	(46,798)
Proceeds from maturity or sale of investments	128,836	13,876
Acquisitions, net of cash acquired	(7,895)	
Net cash used in investing activities	(252,657)	(57,141)
Cash flows from financing activities:		
Issuance of common stock under stock-based compensation plans	23,430	30,103
Excess tax benefit on stock-based compensation plans	15,792	15,753
Repurchases of common stock	(88,266)	(2,315)
Net cash (used in) provided by financing activities	(49,044)	43,541
Effect of currency translation on cash and cash equivalents	8,602	(8,716)
Decrease in cash and cash equivalents	(247,470)	(19,988)
Cash and cash equivalents, beginning of year	1,540,969	1,100,930
Cash and cash equivalents, end of period	\$ 1,293,499	\$ 1,080,942

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

Table of Contents**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 and Article 10 of Regulation S-X under the Securities and 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, 2010. 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.

Note 2 Investments

Investments were as follows:

	March 31, 2011	December 31, 2010
Available-for-sale securities:		
U.S. Treasury and agency debt securities	\$ 383,057	\$ 340,384
Corporate and other debt securities	161,331	122,909
Asset-backed securities	58,289	33,154
Municipal debt securities	40,971	41,655
Foreign government debt securities	9,026	7,926
Total available-for-sale securities	652,674	546,028
Time deposits	221,942	139,391
Total investments	\$ 874,616	\$ 685,419

Our available-for-sale investment securities consist primarily of 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, debt securities issued by supranational institutions and asset-backed securities, including those backed by auto loans, credit card receivables, mortgages loans and other receivables. Our investment guidelines are to purchase securities with a credit rating of A and above 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, 2011 and December 31, 2010.

Available-for-Sale Securities

The amortized cost, gross unrealized gains and losses and fair value of available-for-sale investment securities at March 31, 2011 were as follows:

Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
-------------------	------------------------------	-------------------------------	---------------

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

U.S. Treasury and agency debt securities	\$ 383,505	\$ 641	\$ (1,089)	\$ 383,057
Corporate and other debt securities	160,642	845	(156)	161,331
Asset-backed securities	58,398	35	(144)	58,289
Municipal debt securities	41,094	11	(134)	40,971
Foreign government debt securities	8,944	87	(5)	9,026

Total available-for-sale investment securities	\$ 652,583	\$ 1,619	\$ (1,528)	\$ 652,674
--	------------	----------	------------	------------

The amortized cost, gross unrealized gains and losses and fair value of available-for-sale investment securities at December 31, 2010 were as follows:

Table of Contents

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and agency debt securities	\$ 339,982	\$ 994	\$ (592)	\$ 340,384
Corporate and other debt securities	122,137	835	(63)	122,909
Asset-backed securities	33,258	33	(137)	33,154
Municipal debt securities	41,802	2	(149)	41,655
Foreign government debt securities	7,844	83	(1)	7,926
Total available-for-sale investment securities	\$ 545,023	\$ 1,947	\$ (942)	\$ 546,028

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

	March 31, 2011		December 31, 2010	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency debt securities	\$ 279,119	\$ (1,089)	\$ 200,772	\$ (592)
Corporate and other debt securities	64,327	(156)	16,518	(63)
Asset-backed securities	39,771	(144)	17,791	(137)
Municipal debt securities	20,881	(134)	25,598	(149)
Foreign government debt securities	1,104	(5)	1,203	(1)
Total	\$ 405,202	\$ (1,528)	\$ 261,882	\$ (942)

As of March 31, 2011 and as of December 31, 2010, we did not have any investments in available-for-sale securities that had been in an unrealized loss position for 12 months or longer. The unrealized losses for the above securities are primarily attributable to changes in interest rates. As of March 31, 2011, 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 taxes in accumulated other comprehensive income (loss).

The contractual maturities of available-for-sale investment securities as of March 31, 2011 are set forth in the following table:

	Amortized Cost	Fair Value
Due within one year	\$ 51,127	\$ 51,230
Due after one year through five years	528,685	528,861
Due after five years through ten years	1,070	1,039
Due after ten years	13,303	13,255
Asset-backed securities	58,398	58,289
Total available-for-sale investment securities	\$ 652,583	\$ 652,674

Table of Contents

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.

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 for the three months ended March 31, 2011:

Proceeds from sales of available-for-sale investment securities	\$ 127,527
Gross gains	\$ 482
Gross losses	(133)
Net gains on sales of available-for-sale investment securities	\$ 349

There were no sales of available-for-sale investment securities during the three months ended March 31, 2010.

Note 3 Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities were as follows:

	March 31, 2011	December 31, 2010
Compensation and benefits	\$ 363,143	\$ 533,067
Income taxes	20,338	14,999
Professional fees	36,189	34,121
Travel and entertainment	17,237	16,531
Customer volume incentives	87,597	85,180
Derivative financial instruments	12,283	7,504
Deferred income taxes	1,131	1,134
Other	64,179	78,227
Total accrued expenses and other current liabilities	\$ 602,097	\$ 770,763

Note 4 Income Taxes

Our Indian subsidiaries, collectively referred to as Cognizant India, are primarily export-oriented companies that are eligible for certain income tax holiday benefits granted by the government of India for export activities. These benefits for export activities conducted within Software Technology Parks, or STPs, expired during the first quarter ended March 31, 2011. A significant portion of the earnings of Cognizant India is generated within STPs, and upon expiration of these benefits these earnings are subject to regular corporate income tax at the current rate of 32.4%. In addition to STPs, we have constructed and expect to continue to locate most of our newer development centers in areas designated as Special Economic Zones, or SEZs. Development centers operating in SEZs are entitled to certain income tax incentives for periods up to 15 years. Effective April 1, 2011, all Indian profits, including those generated within SEZs, are subject to the Minimum Alternative Tax, or MAT, at the current rate of 20.0%. Any MAT paid is creditable against future taxable income for a period of up to 10 years.

Our effective income tax rates were as follows for the three months ended March 31:

2011 2010

Effective income tax rate	25.7%	15.2%
---------------------------	-------	-------

For the 2011 and 2010 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.

Note 5 Fair Value Measurements

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.

Table of Contents

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, 2011:

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$ 562,754	\$	\$	\$ 562,754
Time deposits		1,848		1,848
Commercial paper		19,028		19,028
Total cash equivalents	562,754	20,876		583,630
Investments:				
Time deposits		221,942		221,942
Available-for-sale securities current:				
U.S. Treasury and agency debt securities	281,422	101,635		383,057
Corporate and other debt securities		161,331		161,331
Asset-backed debt securities		58,289		58,289
Municipal debt securities		40,971		40,971
Foreign government debt securities		9,026		9,026
Total available-for-sale securities current	281,422	371,252		652,674
Total investments	281,422	593,194		874,616
Derivative financial instruments foreign exchange forward contracts:				
Other current assets		32,418		32,418
Accrued expenses and other current liabilities		(12,283)		(12,283)
Other noncurrent assets		9,989		9,989
Other noncurrent liabilities		(7,867)		(7,867)
Total	\$ 844,176	\$ 636,327	\$	\$ 1,480,503

The following table summarizes our financial assets and (liabilities) measured at fair value on a recurring basis as of December 31, 2010:

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$ 421,424	\$	\$	\$ 421,424

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

Time deposits		67,703	67,703
Total cash equivalents	421,424	67,703	489,127
Investments:			
Time deposits		139,391	139,391
Available-for-sale securities current:			
U.S. Treasury and agency debt securities	268,114	72,270	340,384
Corporate and other debt securities		122,909	122,909
Asset-backed debt securities		33,154	33,154
Municipal debt securities		41,655	41,655
Foreign government debt securities		7,926	7,926
Total available-for-sale securities current	268,114	277,914	546,028
Total investments	268,114	417,305	685,419

Table of Contents

	Level 1	Level 2	Level 3	Total
Derivative financial instruments				
foreign exchange forward contracts:				
Other current assets		30,983		30,983
Accrued expenses and other current liabilities		(7,504)		(7,504)
Other noncurrent assets		8,144		8,144
Other noncurrent liabilities		(6,601)		(6,601)
Total	\$ 689,538	\$ 510,030	\$	\$ 1,199,568

We measure the fair value of money market funds and U.S. Treasury securities based on quoted prices in active markets for identical assets. The fair value of commercial paper, U.S. government agency securities, municipal debt securities, U.S. and international corporate bonds and foreign government debt securities is measured based on relevant trade data, dealer quotes, or model driven valuations using significant inputs derived from or corroborated by observable market data, such as yield curves and credit spreads. We measure the fair value of our asset-backed securities using model driven valuations based on dealer quotes, available trade information, spread data, current market assumptions on prepayment speeds and defaults and historical data on deal collateral performance.

We estimate the fair value of each foreign exchange forward contract by using a present value of expected cash flows model. This model calculates the difference between the current market forward price and the contracted forward price for each foreign exchange contract and applies the difference in the rates to each outstanding contract. The market forward rates included a discount and credit risk factor. The amounts were aggregated by type of contract and maturity.

During the three months ended March 31, 2011 and the year ended December 31, 2010, there were no transfers among Level 1, Level 2, or Level 3 financial assets and liabilities.

Note 6 Derivative Financial Instruments

In the normal course of business, we use foreign exchange forward contracts to manage foreign currency exchange rate risk. The estimated fair value of the foreign exchange forward contracts considers the following items: discount rate, timing and amount of cash flow and counterparty credit risk. Derivatives may give rise to credit risks from the possible non-performance by counterparties. Credit risk is generally limited to the fair value of those contracts that are favorable to us. We have limited our credit risk by entering into derivative transactions only with highly-rated global financial institutions, limiting the amount of credit exposure with any one financial institution and conducting ongoing evaluation of the creditworthiness of the financial institutions with which we do business.

The following table provides information on the location and fair values of derivative financial instruments included in our condensed consolidated statements of financial position as of March 31, 2011:

Designation of Derivatives	Location on Statement of Financial Position	Assets	Liabilities
Cash Flow Hedges	Designated as hedging instruments		
Foreign exchange forward contracts	Other current assets	\$ 32,418	\$
	Other assets	9,989	
	Accrued expenses and other current liabilities		718
	Noncurrent liabilities		7,867
	Total	42,407	8,585
Other Derivatives	Not designated as hedging instruments		
Foreign exchange forward contracts	Accrued expenses and other current liabilities		11,565
	Total		11,565
Total		\$ 42,407	\$ 20,150

Table of Contents

The following table provides information on the location and fair values of derivative financial instruments in our condensed consolidated statements of financial position as of December 31, 2010:

Designation of Derivatives	Location on Statement of Financial Position	Assets	Liabilities
Cash Flow Hedges Designated as hedging instruments			
Foreign exchange forward contracts	Other current assets	\$ 30,983	\$
	Other assets	8,144	
	Accrued expenses and other current liabilities		187
	Noncurrent liabilities		6,601
	Total	39,127	6,788
Other Derivatives Not designated as hedging instruments			
Foreign exchange forward contracts	Accrued expenses and other current liabilities		7,317
	Total		7,317
Total		\$ 39,127	\$ 14,105

Cash Flow Hedges

We have entered into a series of foreign exchange forward contracts that are designated as cash flow hedges of certain salary payments in India. These contracts are intended to partially offset the impact of movement of exchange rates on future operating costs and are scheduled to mature each month during 2011, 2012, 2013, and 2014. Under these contracts, we purchase Indian rupees and sell U.S. dollars. The changes in fair value of these contracts are initially reported in the caption accumulated other comprehensive income (loss) on our accompanying condensed consolidated statements of financial position and are subsequently reclassified to earnings in the same period the hedge contract matures. The notional value of our outstanding contracts by year of maturity and the net unrealized gain included in accumulated other comprehensive income (loss) for such contracts were as follows:

	March 31, 2011	December 31, 2010
2011	\$ 585,000	\$ 780,000
2012	900,000	780,000
2013	840,000	600,000
2014	360,000	
Total notional value of contracts outstanding	\$ 2,685,000	\$ 2,160,000
Net unrealized gain included in accumulated other comprehensive income (loss), net of taxes	\$ 26,781	\$ 30,723

Table of Contents

Upon settlement or maturity of the cash flow hedge contracts, we record the related gain or loss, based on our designation at the commencement of the contract, to salary expense reported within cost of revenues and selling, general and administrative expenses. The following table provides information on the location and amounts of pre-tax gains (losses) on our cash flow hedges for the three months ended March 31, 2011:

	Increase (decrease) in Derivative Gains (Losses) Recognized in Accumulated Other Comprehensive Income (Loss) (effective portion)	Location of Net Derivative Gains (Losses) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (effective portion)	Net Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (effective portion)
Cash Flow Hedges Designated as hedging instruments			
Foreign exchange forward contracts	\$ 13,078	Cost of revenues	\$ 9,562
		Selling, general and administrative expenses	2,033
Total	\$ 13,078		\$ 11,595

The following table provides information on the location and amounts of pre-tax gains (losses) on our cash flow hedges for the three months ended March 31, 2010:

	Increase (decrease) in Derivative Gains (Losses) Recognized in Accumulated Other Comprehensive Income (Loss) (effective portion)	Location of Net Derivative Gains (Losses) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (effective portion)	Net Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (effective portion)
Cash Flow Hedges Designated as hedging instruments			
Foreign exchange forward contracts	\$ 42,024	Cost of revenues	\$ 8,332
		Selling, general and administrative expenses	1,037
Total	\$ 42,024		\$ 9,369

Other Derivatives

We also use foreign exchange forward contracts, which have not been designated as hedges, to hedge our balance sheet exposure to Indian rupee denominated net monetary assets. We entered into a series of foreign exchange forward contracts to purchase U.S. dollars and sell Indian rupees. Realized gains or losses and changes in the estimated fair value of these derivative financial instruments are recorded in Other, net in our condensed consolidated statements of operations.

Additional information related to our outstanding contracts is as follows:

	March 31, 2011	December 31, 2010
Notional value of contracts outstanding	\$ 234,021	\$ 234,021

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

The following table provides information on the location and amounts of realized and unrealized pre-tax gains (losses) on our derivative financial instruments for the three months ended March 31, 2011 and 2010:

		Location of Net Gains / (Losses) on Derivative Instruments	Amount of Net Gains (Losses) on Derivative Instruments	
			2011	2010
Other Derivatives	Not designated as hedging instruments			
Foreign exchange forward contracts		Other, net	\$ (4,248)	\$ (16,095)

The related cash flow impacts of all of our derivative activities are reflected as cash flows from operating activities.

Table of Contents**Note 7 Commitments and Contingencies**

Our current India real estate development program includes planned construction of approximately 8.0 million square feet of new space. The expanded program includes the expenditure of approximately \$500,000 on land acquisition, facilities construction and furnishings to build new, company-owned state-of-the-art development and delivery centers in regions primarily designated as SEZs located in India. As of March 31, 2011, we had outstanding fixed capital commitments of approximately \$125,941 related to our India development center expansion program.

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the outcome of such claims and legal actions, if decided adversely, is not expected to have a material adverse effect on our business, financial condition and results of operations. Additionally, many of our engagements involve projects that are critical to the operations of our customers' business and provide benefits that are difficult to quantify. Any failure in a customer's systems or our failure to meet our contractual obligations to our clients, including any breach involving a customer's confidential information or sensitive data, or our obligations under applicable laws or regulations could result in a claim for substantial damages against us, regardless of our responsibility for such failure. Although we attempt to contractually limit our liability for damages arising from negligent acts, errors, mistakes, or omissions in rendering our services, there can be no assurance that the limitations of liability set forth in our contracts will be enforceable in all instances or will otherwise protect us from liability for damages. Although we have general liability insurance coverage, including coverage for errors or omissions, there can be no assurance that such coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, results of operations and financial condition.

In the normal course of business and in conjunction with certain client engagements, we have entered into contractual arrangements through which we may be obligated to indemnify clients or other parties with whom we conduct business with respect to certain matters. These arrangements can include provisions whereby we agree to hold the indemnified party and certain of their affiliated entities harmless with respect to third-party claims related to such matters as our breach of certain representations or covenants, or out of our intellectual property infringement, our gross negligence or willful misconduct or certain other claims made against certain parties. Payments by us under any of these arrangements are generally conditioned on the client making a claim and providing us with full control over the defense and settlement of such claim. It is not possible to determine the maximum potential amount under these indemnification agreements due to the unique facts and circumstances involved in each particular agreement. Historically, we have not made payments under these indemnification agreements so they have not had any impact on our operating results, financial position, or cash flows. However, if events arise requiring us to make payment for indemnification claims under our indemnification obligations in contracts we have entered, such payments could have material impact on our operating results, financial position, and cash flows.

Note 8 Comprehensive Income

The components of accumulated other comprehensive income (loss) as of March 31, 2011 and December 31, 2010 were as follows:

	March 31, 2011	December 31, 2010
Foreign currency translation adjustments	\$ 13,115	\$ 4,278
Unrealized gain on cash flow hedges, net of taxes	26,781	30,723
Unrealized gain on available-for-sale securities, net of taxes	54	597
Total accumulated other comprehensive income (loss)	\$ 39,950	\$ 35,598

The components of comprehensive income for the three months ended March 31, 2011 and 2010 were as follows:

	2011	2010
Net income	\$ 208,327	\$ 151,500
Foreign currency translation adjustments	8,837	(7,905)
Change in unrealized (loss) gain on cash flow hedges, net of taxes of \$5,425 and \$984, respectively	(3,942)	31,671
Change in unrealized (loss) on available-for-sale securities, net of taxes of (\$371) and \$0, respectively	(543)	

Total comprehensive income	\$ 212,679	\$ 175,266
----------------------------	------------	------------

Table of Contents

Note 9 Segment Information

Our reportable segments are: Financial Services, which includes customers providing banking/transaction processing, capital markets and insurance services; Healthcare, which includes healthcare providers and payers as well as life sciences customers; Manufacturing/Retail/Logistics, which includes manufacturers, retailers, travel and other hospitality customers, as well as customers providing logistics services; and Other, which is an aggregation of industry segments which, individually, are less than 10% of consolidated revenues and segment operating profit. The Other reportable segment includes entertainment, media and information services, communications and high technology operating segments. Our sales managers, account executives, account managers and project teams are aligned in accordance with the specific industries they serve.

Our chief operating decision maker evaluates the Company's performance and allocates resources based on segment revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Generally, operating expenses for each operating segment have similar characteristics and are subject to the same factors, pressures and challenges. However, the economic environment and its effects on industries served by our operating segments may affect revenue and operating expenses to differing degrees. Expenses included in segment operating profit consist principally of direct selling and delivery costs as well as a per seat charge for use of the development and delivery centers. Certain expenses, such as general and administrative, and a portion of depreciation and amortization, are not specifically allocated to specific segments as management does not believe it is practical to allocate such costs to individual segments because they are not directly attributable to any specific segment. Further, stock-based compensation expense is not allocated to individual segments in internal management reports used by the chief operating decision maker. Accordingly, these expenses are separately disclosed as unallocated and adjusted only against our total income from operations. Additionally, management has determined that it is not practical to allocate identifiable assets, by segment, since such assets are used interchangeably among the segments.

Revenues from external customers and segment operating profit, before unallocated expenses, for the Financial Services, Healthcare, Manufacturing/Retail/Logistics, and Other reportable segments were as follows:

	Three Months Ended March 31,	
	2011	2010
Revenues:		
Financial Services	\$ 569,976	\$ 398,687
Healthcare	348,969	252,425
Manufacturing/Retail/Logistics	274,335	173,131
Other	177,973	135,477
Total revenue	\$ 1,371,253	\$ 959,720
Segment Operating Profit:		
Financial Services	\$ 194,498	\$ 128,264
Healthcare	127,566	92,357
Manufacturing/Retail/Logistics	101,450	54,812
Other	56,122	43,186
Total segment operating profit	479,636	318,619
Less: unallocated costs ⁽¹⁾	214,271	135,602
Income from operations	\$ 265,365	\$ 183,017

(1) Includes \$16,065 and \$13,945 of stock-based compensation expense for the three months ended March 31, 2011 and 2010, respectively.

Table of Contents*Geographic Area Information*

Revenue and long-lived assets, by geographic area, are as follows:

	Three Months Ended March 31,	
	2011	2010
Revenues ⁽¹⁾		
North America ⁽²⁾	\$ 1,069,953	\$ 755,690
Europe ⁽³⁾	255,886	173,632
Other ⁽⁴⁾	45,414	30,398
Total	\$ 1,371,253	\$ 959,720

	As of March 31, 2011	As of December 31, 2010
Long-lived Assets ⁽⁵⁾		
North America ⁽²⁾	\$ 12,820	\$ 12,198
Europe	4,103	3,687
Other ⁽⁴⁾⁽⁶⁾	584,776	554,563
Total	\$ 601,699	\$ 570,448

- (1) Revenues are attributed to regions based upon customer location.
- (2) Substantially all relates to operations in the United States.
- (3) Includes revenue from operations in the United Kingdom of \$162,856 and \$106,621 for the three months ended March 31, 2011 and 2010, respectively.
- (4) Includes our operations in Asia Pacific, Middle East and South America.
- (5) Long-lived assets include property and equipment, net of accumulated depreciation and amortization.
- (6) Substantially all of these long-lived assets relate to our operations in India.

Note 10 Recent Accounting Pronouncements

In December 2010, the FASB issued a new accounting standard requiring that Step 2 of the goodwill impairment test be performed for reporting units whose carrying value is zero or negative. We adopted the new guidance effective January 1, 2011. Our adoption of this standard did not have a material effect on our financial condition or consolidated results of operations.

In December 2010, the FASB issued new guidance clarifying some of the disclosure requirements related to business combinations that are material on an individual or aggregate basis. Specifically, the guidance states that, if comparative financial statements are presented, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year occurred as of the beginning of the comparable prior annual reporting period only. Additionally, the new standard expands the supplemental pro forma disclosure required by the authoritative guidance to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination in the reported pro forma revenue and earnings. We adopted the new guidance effective January 1, 2011. Our adoption of this standard did not have a material effect on our financial condition or consolidated results of operations. However, it may result in additional disclosures in the event that we enter into a business combination that is material either on an individual or aggregate basis.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Executive Summary

During the three months ended March 31, 2011, our revenue increased to \$1,371.3 million compared to \$959.7 million during the three months ended March 31, 2010. Net income increased to \$208.3 million, or \$0.67 per diluted share, including stock-based compensation expense, net of tax, equal to \$0.04 per diluted share, during the three months ended March 31, 2011. This is compared to net income of \$151.5 million, or \$0.49 per diluted share, including stock-based compensation expense, net of tax, of \$0.04 per diluted share, during the three months ended March 31, 2010. The key drivers of our revenue growth during the three months ended March 31, 2011 were as follows:

Strong performance across all our business segments with revenue growth ranging from 58.5% for Manufacturing/Retail/Logistics to 31.4% for our Other segment for the quarter as compared to the quarter ended March 31, 2010;

Continued penetration of the European market where we experienced revenue growth of 47.4% for the quarter as compared to the quarter ended March 31, 2010;

Increased customer spending on discretionary development projects;

Expansion of our service offerings, which enabled us to cross-sell new services to our customers and meet the rapidly growing demand for complex large-scale outsourcing solutions;

Increased penetration at existing customers, including strategic customers; and

Continued expansion of the market for global delivery of IT services and business process outsourcing.

We saw a continued increase in demand from our customers for a broad range of IT solutions, including application maintenance, complex systems development engagements, testing, enterprise resource planning, or ERP, infrastructure management, business process outsourcing, or BPO, and business intelligence. We finished the quarter with approximately 714 active clients compared to 597 as of March 31, 2010 and increased the number of strategic clients by seven during the quarter bringing the total number of our strategic clients to 173. We define a strategic client as one offering the potential to generate at least \$5 million to \$50 million or more in annual revenues at maturity. Our top five and top ten customers accounted for approximately 17.0% and 28.8%, respectively, of our total revenues during the quarter ended March 31, 2011 as compared to approximately 17.6% and 30.3%, respectively, for the quarter ended March 31, 2010. As we continue to add new customers and increase our penetration at existing customers, we expect the percentage of revenues from our top five and top ten customers to decline over time.

During the quarter ended March 31, 2011, our revenue from European customers increased by 47.4% to approximately \$255.9 million compared to approximately \$173.6 million in the quarter ended March 31, 2010. For the quarter ended March 31, 2011, revenue from Europe, excluding the UK, increased by approximately \$26.0 million from approximately \$67.0 million in the quarter ended March 31, 2010 to approximately \$93.0 million and revenue from the UK increased by approximately \$56.2 million from approximately \$106.6 million in the quarter ended March 31, 2010 to approximately \$162.9 million. We believe that Europe will continue to be an area of significant investment for us as we see this region as well as the Middle East and the Asia Pacific regions, particularly Japan, India, Australia and Singapore, as growth opportunities for the long term.

Our revenue growth is also attributed to increasing market acceptance of, and strong demand for, offshore IT software and services and business process outsourcing. NASSCOM (India's National Association of Software and Service Companies) reports indicate that India's IT software and services and business process outsourcing sectors are expected to exceed \$88 billion at the end of NASSCOM's fiscal year 2012. This is an expected growth rate of approximately 17% over the prior fiscal year. According to NASSCOM's Perspective 2020: Transform Business, Transform India report, global changes and new megatrends within economic, demographic, business, social and environmental areas are set to expand the outsourcing industry by creating new dynamics and opportunities and are expected to result in export revenues of \$175 billion by 2020.

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

Our operating margin increased to approximately 19.4% for the quarter ended March 31, 2011 compared to 19.1% for the quarter ended March 31, 2010. Excluding stock-based compensation expense of approximately \$16.1 million, operating margin for the quarter ended March 31, 2011 was approximately 20.5%. This was slightly above our historic targeted operating margin range, excluding stock-based compensation expense, of 19% to 20% of total revenues. The increase in operating margin was primarily driven by improvements in pricing and achieving operating efficiencies, largely offset by an increase in compensation costs. Historically, we have invested our profitability above the 19% to 20% operating margin level, which excludes stock-based compensation, back into our business, which we believe is a significant contributing factor to our strong revenue growth. This investment is primarily focused in the areas of: hiring client partners and relationship personnel with specific industry experience or domain expertise; training our technical staff in a broader range of service offerings; strengthening our business analytic capabilities; strengthening and expanding our portfolio of services; continuing to expand our geographic presence for both sales and delivery; and recognizing and rewarding exceptional performance by our employees. In addition, this investment includes maintaining a level of resources, trained in a broad range of service offerings, to be well positioned to respond to our customer requests to take on additional projects. For the year ending December 31, 2011, we expect to continue to invest amounts in excess of our targeted operating margin levels back into the business.

Table of Contents

We finished the first quarter of 2011 with total headcount of approximately 111,200, which is an increase of approximately 25,700 as compared to the total headcount at March 31, 2010. The increase in the number of our technical personnel and the related infrastructure costs, to meet the demand for our services, is the primary driver of the increase in our operating expenses in 2011. Annualized turnover, including both voluntary and involuntary, was approximately 15.1% during the three months ended March 31, 2011. The majority of our turnover occurs in India. As a result, annualized attrition rates on-site at clients are below our global attrition rate. In addition, attrition is weighted towards the more junior members of our staff. We have experienced increases in compensation and benefit costs, including incentive-based compensation costs, in India which may continue in the future; however, historically, this has not had a material impact on our results of operations as we have been able to absorb such cost increases through price increases or cost management strategies such as managing discretionary costs, mix of professional staff and utilization levels and achieving other operating efficiencies.

Our current India real estate development program includes planned construction of an additional 8.0 million square feet of new space. The expanded program includes the expenditure of approximately \$500.0 million between 2011 and the end of 2014 on land acquisition, facilities construction and furnishings to build new company-owned state-of-the-art development and delivery centers in regions primarily designated as Special Economic Zones, or SEZs, located in India. During 2011, we expect to spend approximately \$285 million globally for capital expenditures, a portion of which relates to our India real estate development program.

At March 31, 2011, we had cash and cash equivalents and short-term investments of \$2,168.1 million and working capital of \$2,734.1 million. Accordingly, we do not anticipate any near-term liquidity issues. During the three months ended March 31, 2011, we repurchased \$77.1 million of our Class A common stock under our stock repurchase program. Stock repurchases were funded from working capital.

While several measures have indicated that the economy may be improving, the global economic environment remains fragile. During 2011, we expect the following factors to affect our business and our operating results:

Stabilization of global economic conditions and the financial services sector;

Normalization of customer IT budgets, which may result in spending by customers on discretionary projects, specifically application development projects;

Continued focus by customers on directing IT spending towards cost containment projects, such as application maintenance, infrastructure management and BPO;

Secular changes driven by evolving technologies and regulatory changes;

Foreign currency volatility; and

Increase in our effective income tax rate as a result of the expiration of tax holiday benefits related to our Software Technology Parks, or STPs, in India.

In response to this fragile global economic environment, we plan to:

Continue to invest in our talent base and new service offerings;

Partner with our existing customers to provide innovative solutions resulting in our garnering an increased portion of our customers overall IT spend;

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

Continue our focus on growing our business in Europe, the Middle East and the Asia Pacific region, where we believe there are opportunities to gain market share;

Continue to increase our strategic customer base across all of our business segments;

Opportunistically look for acquisitions that can improve our overall service delivery capabilities;

Continue operating focus and discipline to appropriately manage our cost structure; and

Continue to locate most of our new development center facilities in SEZs to take advantage of SEZ tax incentives.

Critical Accounting Estimates and Risks

Management's discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities, including the recoverability of tangible and intangible assets, disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. On an on-going basis, we evaluate our estimates. The most significant estimates relate to the recognition of revenue and profits based on the percentage of completion method of accounting for certain fixed-bid contracts, the allowance for doubtful accounts, income taxes, valuation of goodwill and other long-lived assets, valuation of investments, assumptions used in valuing stock-based compensation arrangements, contingencies and litigation. We base our estimates on historical experience and on various other

Table of Contents

assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The actual amounts may differ from the estimates used in the preparation of the accompanying unaudited condensed consolidated financial statements. Our significant accounting policies are described in Note 1 to the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010.

We believe the following critical accounting policies require a higher level of management judgments and estimates than others in preparing the consolidated financial statements:

Revenue Recognition. Revenues related to our highly complex information technology application development contracts, which are predominantly fixed-priced contracts, are recognized as the service is performed using the percentage of completion method of accounting. Under this method, total contract revenue during the term of an agreement is recognized on the basis of the percentage that each contract's total labor cost to date bears to the total expected labor cost (cost to cost method). This method is followed where reasonably dependable estimates of revenues and costs can be made. Management reviews total expected labor costs on an ongoing basis. Revisions to our estimates may result in increases or decreases to revenues and income and are reflected in the consolidated financial statements in the periods in which they are first identified. If our estimates indicate that a contract loss will be incurred, a loss provision is recorded in the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which the estimated costs of the contract exceed the estimated total revenues that will be generated by the contract and are included in cost of revenues in our condensed consolidated statement of operations. Contract losses for the periods presented were immaterial.

Stock-Based Compensation. Utilizing the fair value recognition provisions prescribed by the authoritative guidance, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected term over which the stock awards will be outstanding before they are exercised, the expected volatility of our stock and the number of stock-based awards that are expected to be forfeited. In addition, for performance stock units, we are required to estimate the most probable outcome of the performance conditions in order to determine the amount of stock compensation costs to be recorded over the vesting period. If actual results differ significantly from our estimates, stock-based compensation expense and our results of operations could be materially impacted.

Income Taxes. Determining the consolidated provision for income tax expense, deferred income tax assets and liabilities and related valuation allowance, if any, involves judgment. As a global company, we are required to calculate and provide for income taxes in each of the jurisdictions where we operate. Changes in the geographic mix or estimated level of annual pre-tax income can also affect the overall effective income tax rate.

Our provision for income taxes also includes the impact of provisions established for uncertain income tax positions, as well as the related net interest. Tax exposures can involve complex issues and may require an extended period to resolve. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters differs from the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made.

On an on-going basis, we evaluate whether a valuation allowance is needed to reduce our deferred income tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and on-going prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we determine that we will be able to realize deferred income tax assets in the future in excess of the net recorded amount, an adjustment to the deferred income tax asset would increase income in the period such determination was made. Likewise, should we determine that we will not be able to realize all or part of the net deferred income tax asset in the future, an adjustment to the deferred income tax asset would be charged to income in the period such determination was made.

Our Indian subsidiaries, collectively referred to as Cognizant India, are primarily export-oriented companies that are eligible for certain income tax holiday benefits granted by the Indian government for export activities. These benefits for export activities conducted within STPs, expired during the first quarter ended March 31, 2011. A significant portion of the earnings of Cognizant India is generated within STPs, and upon expiration of these benefits these earnings are subject to regular corporate income tax at the current rate of 32.4%. The increase in our effective income tax rate for the three months ended March 31, 2011 is due primarily to the expiration of these STP holidays.

In addition, we have constructed and expect to continue to locate most of our newer development facilities in SEZs, which are entitled to certain income tax incentives for periods up to 15 years.

Table of Contents

Derivative Financial Instruments. Derivative financial instruments are accounted for in accordance with the authoritative guidance which requires that each derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value as of the reporting date. Our derivative financial instruments consist of foreign exchange forward contracts. We estimate the fair value of each foreign exchange forward contract by using a present value of expected cash flows model. This model utilizes various assumptions, including, but not limited to timing and amounts of cash flows, discount rates, and credit risk factors. The use of different assumptions could have a positive or negative effect on our results of operations and financial condition.

Investments. Our investment portfolio is primarily comprised of U.S. dollar denominated corporate bonds, municipal bonds, debt issuances by the U.S. government, U.S. government agencies, foreign governments and supranational entities, asset-backed securities, and bank time deposits. The asset-backed securities include securities backed by auto loans, credit card receivables, mortgage loans and other receivables and are rated AAA/Aaa. The years of issuance of our asset-backed securities fall in the 2004 to 2011 range.

We utilize various inputs to determine the fair value of our investment portfolio. To the extent they exist, unadjusted quoted market prices for identical assets in active markets (Level 1) or quoted prices on similar assets (Level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of quoted prices or liquid markets, valuation techniques would be used to determine fair value of any investments that require inputs that are both significant to the fair value measurement and unobservable (Level 3). Valuation techniques are based on various assumptions, including, but not limited to timing and amounts of cash flows, discount rates, rate of return, and adjustments for nonperformance and liquidity. A significant degree of judgment is involved in valuing investments using Level 3 inputs. The use of different assumptions could have a positive or negative effect on our results of operations and financial condition. See Note 5 for additional information related to our security valuation methodologies.

We periodically evaluate if unrealized losses, as determined based on the security valuation methodologies discussed above, on individual securities classified as available for sale in the investment portfolio are considered to be other-than-temporary. The analysis of other-than-temporary impairment requires the use of various assumptions, including, but not limited to, the length of time an investment's book value is greater than fair value, the severity of the investment's decline, any credit deterioration of the investment, whether management intends to sell the security and whether it is more likely than not that we will be required to sell the security prior to recovery of its amortized cost basis. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is generally recorded to earnings and a new cost basis in the investment is established.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance for doubtful accounts is determined by evaluating the relative credit-worthiness of each customer, historical collections experience and other information, including the aging of the receivables. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Goodwill. We evaluate goodwill for impairment at least annually, or as circumstances warrant. When determining the fair value of our reporting units, we utilize various assumptions, including projections of future cash flows. Any adverse changes in key assumptions about our businesses and their prospects or an adverse change in market conditions may cause a change in the estimation of fair value and could result in an impairment charge. Based upon our most recent evaluation of goodwill, there are no significant risks of impairment. As of March 31, 2011, our goodwill balance was \$224.0 million.

Long-Lived Assets. We review long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In general, we will recognize an impairment loss when the sum of undiscounted expected future cash flows is less than the carrying amount of such asset. The measurement for such an impairment loss is then based on the fair value of the asset. If such assets were determined to be impaired, it could have a material adverse effect on our business, results of operations and financial condition.

Risks. The majority of our development and delivery centers, including a majority of our employees, are located in India. As a result, we may be subject to certain risks associated with international operations, including risks associated with foreign currency exchange rate fluctuations and risks associated with the application and imposition of protective legislation and regulations relating to import and export or otherwise resulting from foreign policy or the variability of foreign economic or political conditions. Additional risks associated with international operations include difficulties in enforcing intellectual property rights, limitations on immigration programs, the burdens of complying with a wide variety of foreign laws, potential geo-political and other risks associated with terrorist activities and local and cross border conflicts, and potentially adverse tax consequences, tariffs, quotas and other barriers. We are also subject to risks associated with our overall compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The inability of our management to ensure the adequacy and effectiveness of our internal control over financial reporting for future year ends could result in adverse consequences to us, including, but not limited to, a loss of investor confidence in the reliability of our financial statements, which could cause the market price of our stock to decline. See Part II, Item 1A. Risk Factors.

Table of Contents**Results of Operations*****Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010***

The following table sets forth, for the periods indicated, certain financial data expressed for the three months ended March 31:

(Dollars in thousands)

	2011	% of Revenues	2010	% of Revenues	Increase / (Decrease) \$	%
Revenues	\$ 1,371,253	100.0	\$ 959,720	100.0	\$ 411,533	42.9
Cost of revenues ⁽¹⁾	782,176	57.0	555,904	57.9	226,272	40.7
Selling, general and administrative expenses ⁽²⁾	296,330	21.6	194,993	20.3	101,337	52.0
Depreciation and amortization expense	27,382	2.0	25,806	2.7	1,576	6.1
Income from operations	265,365	19.4	183,017	19.1	82,348	45.0
Other income (expense), net	15,135		(4,265)		19,400	
Provision for income taxes	72,173		27,252		44,921	164.8
Net income	\$ 208,327	15.2	\$ 151,500	15.8	\$ 56,827	37.5

(1) Includes stock-based compensation expense of \$3,487 in 2011 and \$3,667 in 2010 and is exclusive of depreciation and amortization expense.

(2) Includes stock-based compensation expense of \$12,578 in 2011 and \$10,278 in 2010 and is exclusive of depreciation and amortization expense.

The following table includes non-GAAP income from operations, excluding stock-based compensation, a measure defined by the Securities and Exchange Commission as a non-GAAP financial measure. This non-GAAP financial measure is not based on any comprehensive set of accounting rules or principles and should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP, and may be different from non-GAAP measures used by other companies. In addition, this non-GAAP measure, the financial statements prepared in accordance with GAAP and reconciliations of our GAAP financial statements to such non-GAAP measure should be carefully evaluated.

We seek to manage the company to a targeted operating margin, excluding stock-based compensation expense, of 19% to 20% of revenues. Accordingly, we believe that non-GAAP income from operations, excluding stock-based compensation expense, is a meaningful measure for investors to evaluate our financial performance. For our internal management reporting and budgeting purposes, we use financial statements that do not include stock-based compensation expense for financial and operational decision making, to evaluate period-to-period comparisons and for making comparisons of our operating results to that of our competitors. Moreover, because of varying available valuation methodologies and the variety of award types that companies can use to account for stock-based compensation expense, we believe that providing a non-GAAP financial measure that excludes stock-based compensation expense allows investors to make additional comparisons between our operating results and those of other companies. Accordingly, we believe that the presentation of non-GAAP income from operations when read in conjunction with our reported GAAP income from operations can provide useful supplemental information to our management and to investors regarding financial and business trends relating to our financial condition and results of operations.

A limitation of using non-GAAP income from operations versus income from operations reported in accordance with GAAP is that non-GAAP income from operations excludes stock-based compensation expense, which is recurring. Stock-based compensation expense will continue to be for the foreseeable future a significant recurring expense in our business. In addition, other companies may calculate non-GAAP financial measures differently than us, thereby limiting the usefulness of this non-GAAP financial measure as a comparative tool. We compensate for these limitations by providing specific information regarding the GAAP amounts excluded from non-GAAP income from operations and evaluating such non-GAAP financial measures with financial measures calculated in accordance with GAAP.

Table of Contents

A reconciliation of income from operations as reported and non-GAAP income from operations, excluding stock-based compensation expense, is as follows for the three months ended March 31:

(Dollars in thousands)

	2011	% of Revenues	2010	% of Revenues
Income from operations, as reported	\$ 265,365	19.4	\$ 183,017	19.1
Add: stock-based compensation expense	16,065	1.1	13,945	1.4
Non-GAAP income from operations, excluding stock-based compensation expense	\$ 281,430	20.5	\$ 196,962	20.5

Revenue. Revenue increased 42.9%, or approximately \$411.5 million, from approximately \$959.7 million during the three months ended March 31, 2010 to approximately \$1,371.3 million during the three months ended March 31, 2011. This increase was primarily attributed to greater acceptance of our global delivery model among an increasing number of industries, continued interest in using our global delivery model as a means to reduce overall IT and operations costs, increased customer spending on discretionary development projects, and greater penetration in the European market. Revenue from customers existing as of March 31, 2010 increased by approximately \$354.3 million and revenue from new customers added since March 31, 2010 was approximately \$57.2 million or approximately 13.9% of the period over period revenue increase and 4.2% of total revenues for the three months ended March 31, 2011. In addition, revenue from our North American and European customers for the three months ended March 31, 2011 increased by \$314.3 million and \$82.3 million, respectively, over the comparable 2010 quarter. We had approximately 714 active clients as of March 31, 2011 as compared to 597 active clients as of March 31, 2010. In addition, we experienced strong demand across all of our business segments for an increasingly broad range of services. Our Financial Services and Manufacturing/Retail/Logistics business segments accounted for approximately \$171.3 million and \$101.2 million, respectively, of the approximately \$411.5 million increase in revenue. Additionally, our IT consulting and technology services and IT outsourcing revenues increased by approximately 58.6% and 29.9%, respectively, compared to the three months ended March 31, 2010 and represented approximately 50.1% and 49.9%, respectively, of total revenues for the three months ended March 31, 2011. No customer accounted for sales in excess of 10% of revenues during the three months ended March 31, 2011 and 2010.

Cost of Revenues (Exclusive of Depreciation and Amortization Expense). Our cost of revenues consists primarily of salaries, incentive-based compensation, stock-based compensation expense, payroll taxes, benefits, immigration and project-related travel for technical personnel, subcontracting and sales commissions related to revenues. Our cost of revenues increased by 40.7%, or approximately \$226.3 million, from approximately \$555.9 million during the three months ended March 31, 2010 to approximately \$782.2 million during the three months ended March 31, 2011. The increase was due primarily to an increase in compensation and benefits costs of approximately \$197.3 million, resulting from the increase in the number of our technical personnel and incentive-based compensation, as well as the appreciation of the Indian rupee versus the U.S. dollar offset by continued improvements in operating efficiencies.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of salaries, incentive-based compensation, stock-based compensation expense, payroll taxes, employee benefits, travel, promotion, communications, management, finance, administrative and occupancy costs. Selling, general and administrative expenses, including depreciation and amortization, increased by 46.6%, or approximately \$102.9 million, from approximately \$220.8 million during the three months ended March 31, 2010 to approximately \$323.7 million during the three months ended March 31, 2011, and increased as a percentage of revenue from 23.0% to 23.6%. The increase as a percentage of revenue was due to an increase in compensation and benefit costs, including incentive-based compensation, and the impact of the appreciation of the Indian rupee versus the U.S. dollar, partially offset by economies of scale driven by increased revenues that resulted from our expanded sales and marketing activities in the current year and in prior years that allowed us to leverage our cost structure over a larger organization.

Income from Operations. Income from operations increased 45.0%, or approximately \$82.4 million, from approximately \$183.0 million during the three months ended March 31, 2010 to approximately \$265.4 million during the three months ended March 31, 2011, representing operating margins of 19.4% of revenues in 2011 and 19.1% of revenues in 2010. The increase in operating margin was primarily driven by improvements in pricing and achieving operating efficiencies, largely offset by an increase in compensation costs. Excluding the impact of applicable designated cash flow hedges, the appreciation of the Indian rupee against the U.S. dollar negatively impacted our operating margin by approximately 38 basis points or 0.38 percentage points. Each additional 1.0% change in exchange rate between the Indian rupee and the U.S. dollar will have the effect of moving our operating margin by approximately 26 basis points or 0.26 percentage points. Excluding stock-based compensation expense of \$16.1 million and \$13.9 million for the three months ended March 31, 2011 and March 31, 2010, operating margin was 20.5% for each of the three month periods ended March 31, 2011 and 2010.

Table of Contents

We entered into foreign exchange forward contracts to hedge certain salary payments in India. These hedges are intended to mitigate the volatility of the changes in the exchange rate between the U.S. dollar and the Indian rupee. During the three months ended March 31, 2011, the settlement of certain cash flow hedges favorably impacted our operating margin by approximately 85 basis points or 0.85 percentage points.

Other Income (Expense), Net. Total other income (expense), net consists primarily of foreign currency exchange gains and (losses) and interest income. The following table sets forth total other income (expense), net for the three months ended March 31:

(Dollars in thousands)

	2011	2010	Increase/ (Decrease)
Foreign currency exchange gains	\$ 10,196	\$ 5,635	\$ 4,561
Losses on foreign exchange forward contracts not designated as hedging instruments	(4,248)	(16,095)	11,847
Net foreign currency exchange gains (losses)	5,948	(10,460)	16,408
Interest income	8,937	6,054	2,883
Other, net	250	141	109
Total other income (expense), net	\$ 15,135	\$ (4,265)	\$ 19,400

The foreign currency exchange gains of approximately \$10.2 million were primarily attributed to intercompany transactions between our European subsidiaries and Cognizant India for services performed by Cognizant India on behalf of our European customers and the remeasurement of the Indian rupee net monetary assets on Cognizant India's books to the U.S. dollar functional currency. The \$4.2 million of losses on foreign exchange forward contracts were related to the change in fair value of foreign exchange forward contracts entered into to offset foreign currency exposure to Indian rupee denominated net monetary assets. As of March 31, 2011, the notional value of these undesignated hedges was \$234.0 million. The increase in interest income of \$2.9 million was primarily attributed to higher invested balances.

Provision for Income Taxes. The provision for income taxes increased from approximately \$27.3 million during the three months ended March 31, 2010 to approximately \$72.2 million during the three months ended March 31, 2011. The effective income tax rate increased from 15.2% for the three months ended March 31, 2010 to 25.7% for the three months ended March 31, 2011. The increase in our effective income tax rate was primarily attributed to the expiration of the STP holidays as well as a higher U.S. state effective income tax rate in 2011.

Net Income. Net income increased from approximately \$151.5 million for the three months ended March 31, 2010 to approximately \$208.3 million for the three months ended March 31, 2011, representing 15.8% and 15.2% of revenues, respectively. The decrease in net income as a percentage of revenues was primarily attributed to a higher effective income tax rate in the 2011 period partially offset by a higher operating margin.

Table of Contents**Results by Business Segment**

Our reportable segments are: Financial Services, which includes customers providing banking / transaction processing, capital markets and insurance services; Healthcare, which includes healthcare providers and payers as well as life sciences customers; Manufacturing/Retail/Logistics, which includes manufacturers, retailers, travel and other hospitality customers, as well as customers providing logistics services; and Other, which is an aggregation of industry operating segments which, individually, are less than 10.0% of consolidated revenues and segment operating profit. The Other segment includes entertainment, media and information services, communications, and high technology operating segments. Our sales managers, account executives, account managers and project teams are aligned in accordance with the specific industries they serve.

Our chief operating decision maker evaluates Cognizant's performance and allocates resources based on segment revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Generally, operating expenses for each operating segment have similar characteristics and are subject to the same factors, pressures and challenges. However, the economic environment and its effects on industries served by our operating groups may affect revenue and operating expenses to differing degrees. Expenses included in segment operating profit consist principally of direct selling and delivery costs as well as a per seat charge for use of the development and delivery centers. Certain expenses, such as general and administrative, and a portion of depreciation and amortization, are not specifically allocated to specific segments as management does not believe it is practical to allocate such costs to individual segments because they are not directly attributable to any specific segment. Further, stock-based compensation expense is not allocated to individual segments in internal management reports used by the chief operating decision maker. Accordingly, these expenses are separately disclosed as unallocated and are adjusted only against the total income from operations.

As of March 31, 2011, we had 714 active customers. Accordingly, we provide a significant volume of services to many customers in each of our business segments. Therefore, a loss of a significant customer or a few significant customers in a particular segment could materially reduce revenues for such segment. However, no individual customer exceeded 10% of our consolidated revenues for the three months ended March 31, 2011 and 2010, respectively. In addition, the services we provide to our larger customers are often critical to the operations of such customers and a termination of our services would require an extended transition period with gradual declining revenues.

Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010

Revenues from external customers and segment operating profit, before unallocated expenses, for the Financial Services, Healthcare, Manufacturing/Retail/Logistics and Other segments for the three months ended March 31, 2011 and 2010 are as follows:

(Dollars in thousands)

	2011	2010	Increase / (Decrease) \$	%
Revenues:				
Financial Services	\$ 569,976	\$ 398,687	\$ 171,289	43.0
Healthcare	348,969	252,425	96,544	38.2
Manufacturing/Retail/Logistics	274,335	173,131	101,204	58.5
Other	177,973	135,477	42,496	31.4
Total revenues	\$ 1,371,253	\$ 959,720	\$ 411,533	42.9
Segment Operating Profit:				
Financial Services	\$ 194,498	\$ 128,264	\$ 66,234	51.6
Healthcare	127,566	92,357	35,209	38.1
Manufacturing/Retail/Logistics	101,450	54,812	46,638	85.1
Other	56,122	43,186	12,936	30.0
Total segment operating profit	\$ 479,636	\$ 318,619	\$ 161,017	50.5

Financial Services Segment

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

Revenue. Revenue increased by 43.0%, or approximately \$171.3 million, from approximately \$398.7 million during the three months ended March 31, 2010 to approximately \$570.0 million during the three months ended March 31, 2011. The increase in revenue was primarily driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of March 31, 2010 and customers added during the three months ended March 31, 2011 was approximately \$159.0 million and approximately \$12.3 million, respectively. Within the segment, quarterly revenue from our banking and insurance customers increased approximately \$129.1 million and \$42.2 million, respectively. Overall, the year-over-

Table of Contents

year increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of our global services delivery model and increased customer spending on discretionary development projects.

Segment Operating Profit. Segment operating profit increased 51.6%, or approximately \$66.2 million, from approximately \$128.3 million during the three months ended March 31, 2010 to approximately \$194.5 million during the three months ended March 31, 2011. The increase in segment operating profit was attributable primarily to increased revenues and achieving operating efficiencies, including continued leverage of prior sales and marketing investments, partially offset by additional headcount to support our revenue growth, an increase in compensation and benefit costs, including incentive-based compensation, and the impact of the appreciation of the Indian rupee versus the U.S. dollar.

Healthcare Segment

Revenue. Revenue increased by 38.2%, or approximately \$96.5 million, from approximately \$252.4 million during the three months ended March 31, 2010 to approximately \$348.9 million during the three months ended March 31, 2011. The increase in revenue was primarily driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of March 31, 2010 and customers added during the three months ended March 31, 2011 was approximately \$89.3 million and approximately \$7.2 million, respectively. Within the segment, growth was strong among both our life sciences and healthcare customers, where revenue increased by approximately \$59.4 million and \$37.1 million, respectively. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of our global services delivery model and increased customer spending on discretionary development projects.

Segment Operating Profit. Segment operating profit increased 38.1%, or approximately \$35.2 million, from approximately \$92.3 million during the three months ended March 31, 2010 to approximately \$127.5 million during the three months ended March 31, 2011. The increase in segment operating profit was attributable primarily to increased revenues during the quarter.

Manufacturing/Retail/Logistics Segment

Revenue. Revenue increased by 58.5%, or approximately \$101.2 million, from approximately \$173.1 million during the three months ended March 31, 2010 to approximately \$274.3 million during the three months ended March 31, 2011. The increase in revenue was driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of March 31, 2010 and customers added during the three months ended March 31, 2011 was approximately \$78.2 million and approximately \$23.0 million, respectively. Within the segment, growth was strong among both our retail and hospitality customers and our manufacturing and logistics customers, where revenue during 2011 increased by approximately \$56.4 million and \$44.8 million, respectively. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of our global services delivery model and increased customer spending on discretionary development projects.

Segment Operating Profit. Segment operating profit increased 85.1%, or approximately \$46.6 million, from approximately \$54.8 million during the three months ended March 31, 2010 to approximately \$101.4 million during the three months ended March 31, 2011. The increase in segment operating profit was attributable primarily to increased revenues during the year and achieving operating efficiencies, including continued leverage of prior sales and marketing investments, partially offset by additional headcount to support our revenue growth, an increase in compensation and benefit costs, including incentive-based compensation, and the impact of the appreciation of the Indian rupee versus the U.S. dollar.

Other Segment

Revenue. Revenue increased 31.4%, or approximately \$42.5 million, from approximately \$135.5 million during the three months ended March 31, 2010 to approximately \$178.0 million during the three months ended March 31, 2011. The increase in revenue was driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of March 31, 2010 and customers added during the three months ended March 31, 2011 was approximately \$27.8 million and approximately \$14.7 million, respectively. Within the Other segment, growth was particularly strong among our entertainment, media and information services customers and our telecommunications customers where revenue increased by approximately \$18.8 million and \$15.5 million, respectively. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of our global services delivery model and increased customer spending on discretionary development projects.

Segment Operating Profit. Segment operating profit increased 30.0%, or approximately \$12.9 million, from approximately \$43.2 million during the three months ended March 31, 2010 to approximately \$56.1 million during the three months ended March 31, 2011. The increase in segment operating profit was attributable primarily to increased revenues, partially offset by additional headcount to support our revenue growth,

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

continued investment in sales and marketing, an increase in compensation and benefit costs, including incentive-based compensation, and the impact of the appreciation of the Indian rupee versus the U.S. dollar.

Table of Contents

Liquidity and Capital Resources

At March 31, 2011, we had cash and cash equivalents and short-term investments of \$2,168.1 million. We have used, and plan to use, such cash for expansion of existing operations, including our offshore development and delivery centers; continued development of new service lines; possible acquisitions of related businesses; formation of joint ventures; stock repurchases; and general corporate purposes, including working capital. As of March 31, 2011, we had working capital of approximately \$2,734.1 million, including short-term investments of \$874.6 million. Accordingly, we do not anticipate any near-term liquidity issues.

Net cash provided by operating activities was approximately \$45.6 million during the three months ended March 31, 2011 as compared to approximately \$2.3 million during the three months ended March 31, 2010. The increase was primarily attributed to an increase in net income during the quarter. Trade accounts receivable increased from approximately \$901.3 million at December 31, 2010 to approximately \$995.0 million at March 31, 2011. Unbilled accounts receivable increased from approximately \$113.0 million at December 31, 2010 to approximately \$128.2 million at March 31, 2011. The increase in trade accounts receivable and unbilled receivables as of March 31, 2011 as compared to December 31, 2010 was primarily due to increased revenues and a higher number of days of sales outstanding. We monitor turnover, aging and the collection of accounts receivable through the use of management reports that are prepared on a customer basis and evaluated by our finance staff. At March 31, 2011, our days of sales outstanding, including unbilled receivables, were approximately 74 days as compared to 71 days at December 31, 2010 and 76 days as of March 31, 2010.

Our investing activities used net cash of approximately \$252.7 million during the three months ended March 31, 2011 as compared to approximately \$57.1 million during the three months ended March 31, 2010. The increase in net cash used in investing activities primarily related to an increase in net investments and capital expenditures during the three months ended March 31, 2011.

Our financing activities used net cash of approximately \$49.0 million during the three months ended March 31, 2011 as compared to providing approximately \$43.5 million during the three months ended March 31, 2010. The increase in net cash used in financing activities primarily related to an increase in common stock repurchases during the three months ended March 31, 2011.

Our ability to expand and grow our business in accordance with current plans, to make acquisitions and form joint ventures and to meet our long-term capital requirements beyond a twelve month period will depend on many factors, including the rate, if any, at which our cash flow increases, our ability and willingness to accomplish acquisitions and joint ventures with capital stock, our continued intent not to repatriate foreign earnings, and the availability of public and private debt and equity financing. We cannot be certain that additional financing, if required, will be available on terms favorable to us, if at all. We expect our operating cash flow and cash and cash equivalents to be sufficient to meet our operating requirements for the next twelve months.

Commitments and Contingencies

As of March 31, 2011, we had outstanding fixed capital commitments of approximately \$125.9 million related to our India development center expansion program, which includes expenditures for land acquisition, facilities construction and furnishings to build new state-of-the-art development and delivery centers in regions primarily designated as SEZs located in India.

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the outcome of such claims and legal actions, if decided adversely, is not expected to have a material adverse effect on our quarterly or annual operating results, cash flows, or consolidated financial position. Additionally, many of our engagements involve projects that are critical to the operations of our customers' business and provide benefits that are difficult to quantify. Any failure in a customer's systems or our failure to meet our contractual obligations to our clients, including any breach involving a customer's confidential information or sensitive data, or our obligations under applicable laws or regulations could result in a claim for substantial damages against us, regardless of our responsibility for such failure. Although we attempt to contractually limit our liability for damages arising from negligent acts, errors, mistakes, or omissions in rendering our services, there can be no assurance that the limitations of liability set forth in our contracts will be enforceable in all instances or will otherwise protect us from liability for damages. Although we have general liability insurance coverage, including coverage for errors or omissions, there can be no assurance that such coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our quarterly and annual operating results, financial position and cash flows.

Foreign Currency Risk

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

Overall, we believe that we have limited revenue risk resulting from movement in foreign currency exchange rates as approximately 78.0% of our revenues for the quarter ended March 31, 2011 are generated from customers located in North America. However, a portion of our costs in India, representing approximately 31.6% of our global operating costs for the quarter ended

Table of Contents

March 31, 2011, are denominated in the Indian rupee and are subject to foreign exchange rate fluctuations. These foreign currency exchange rate fluctuations have an impact on our results of operations. In addition, a portion of our balance sheet is exposed to foreign currency exchange rate fluctuations, which may result in non-operating foreign currency gains or losses upon remeasurement. For the quarter ended March 31, 2011, we reported foreign currency exchange gains, exclusive of losses on foreign exchange forward contracts not designated as hedging instruments of approximately \$10.2 million, which were primarily attributed to the remeasurement of intercompany balances between our European subsidiaries and Cognizant India for services performed by Cognizant India on behalf of our European customers and Indian rupee net monetary assets on Cognizant India's books to the U.S. dollar functional currency. On an ongoing basis, we manage a portion of this risk by limiting our net monetary asset exposure to the Indian rupee in our Indian subsidiaries.

We entered into a series of foreign exchange forward contracts that are designated as cash flow hedges of certain salary payments in India. Cognizant India converts U.S. dollar receipts from intercompany billings to Indian rupees to fund local expenses, including salaries. These U.S. dollar / Indian rupee hedges to buy Indian rupees and sell U.S. dollars are intended to partially offset the impact of movement of exchange rates on future operating costs. During the first quarter of 2011, we reported income of \$11.6 million on contracts that settled during the quarter. As of March 31, 2011, we have outstanding contracts with a notional value of \$585.0 million and weighted average forward rate of 48.1 rupees to the U.S. dollar scheduled to mature in 2011, outstanding contracts with a notional value of \$900 million and weighted average forward rate of 48.2 rupees to the U.S. dollar scheduled to mature in 2012, outstanding contracts with a notional value of \$840.0 million and weighted average forward rate of 50.1 rupees to the U.S. dollar scheduled to mature in 2013, and outstanding contracts with a notional value of \$360.0 million and weighted average forward rate of 52.1 rupees to the U.S. dollar scheduled to mature in 2014.

We also use foreign currency forward contracts to hedge balance sheet exposure to our Indian rupee denominated net monetary assets. These contracts are not designated as hedges and are intended to offset the foreign currency exchange rate gains or losses upon the remeasurement of the underlying Indian rupee denominated net monetary assets. During 2010, we entered into a series of foreign exchange forward contracts, scheduled to mature in 2011, to buy U.S. dollars and sell Indian rupees. At March 31, 2011, the notional value of the outstanding contracts was \$234.0 million and the related fair value was a liability of \$11.6 million. During the three months ended March 31, 2011, inclusive of losses of \$4.2 million on these undesignated balance sheet hedges, we reported net foreign currency exchange gains of approximately \$5.9 million.

There were no off-balance sheet transactions, arrangements or other relationships with unconsolidated entities or other persons in 2011 and 2010 that would have affected our liquidity or the availability of or requirements for capital resources.

Recent Accounting Pronouncements

See Note 10 to our condensed consolidated financial statements for additional information.

Effects of Inflation

Our most significant costs are the salaries and related benefits for our professional staff. Competition in India, the United States and Europe for professionals with advanced technical skills necessary to perform our services offered has caused wages to increase at a rate greater than the general rate of inflation. As with other service providers in our industry, we must adequately anticipate wage increases, particularly on our fixed-price contracts. Historically, we have experienced increases in compensation and benefit costs, including incentive-based compensation, in India; however, this has not had a material impact on our results of operations as we have been able to absorb such cost increases through price increases or cost management strategies such as managing discretionary costs, mix of professional staff and utilization levels and achieving other operating efficiencies. There can be no assurance that we will be able to offset such cost increases in the future.

Forward Looking Statements

The statements contained in this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements (within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended) that involve risks and uncertainties. Such forward-looking statements may be identified by, among other things, the use of forward-looking terminology such as believes, expects, may, could, would, plan, intend, estimate, predict, potential, continue, should or anticipates or the negative thereof or other variations thereon or comparable terminology, discussions of strategy that involve risks and uncertainties. From time to time, we or our representatives have made or may make forward-looking statements, orally or in writing.

Such forward-looking statements may be included in various filings made by us with the Securities and Exchange Commission, or press releases or oral statements made by or with the approval of one of our authorized executive officers. These forward-looking statements, such as statements regarding anticipated future revenues or operating margins, contract percentage completions, earnings, capital expenditures and other statements regarding matters that are not historical facts, involve predictions. Our actual results, performance or achievements could differ

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

materially from the results expressed in, or implied by, these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws. There are a number of important factors that could cause our

Table of Contents

results to differ materially from those indicated by such forward-looking statements. These factors include those set forth in Part II, Item 1A. Risk Factors .

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to foreign currency exchange rate risk in the ordinary course of doing business as we transact or hold a portion of our funds in foreign currencies, particularly the Indian rupee. Accordingly, we periodically evaluate the need for hedging strategies, including the use of derivative financial instruments, to mitigate the effect of foreign currency exchange rate fluctuations and expect to continue to use such instruments in the future to reduce foreign currency exposure to appreciation or depreciation in the value of certain foreign currencies. All hedging transactions are authorized and executed pursuant to regularly reviewed policies and procedures.

We have entered into a series of foreign exchange forward contracts that are designated as cash flow hedges of certain salary payments in India. Cognizant India converts U.S. dollar receipts from intercompany billings to Indian rupees to fund local expenses, including salaries. These U.S. dollar / Indian rupee hedges are intended to partially offset the impact of movement of exchange rates on future operating costs. As of March 31, 2011 and December 31, 2010, the notional value of these contracts was \$2,685.0 million and \$2,160.0 million, respectively. The outstanding contracts at March 31, 2011 are scheduled to mature each month during 2011, 2012, 2013 and 2014. At March 31, 2011 and December 31, 2010, the net unrealized gain on our outstanding foreign exchange forward contracts was \$33.8 million and \$32.3 million, respectively. Based upon a sensitivity analysis of our foreign exchange forward contracts at March 31, 2011, which estimates the fair value of the contracts based upon market exchange rate fluctuations, a 10.0% change in the foreign currency exchange rate against the U.S. dollar with all other variables held constant would have resulted in a change in the fair value of approximately \$249.1 million.

We also use foreign exchange forward contracts to hedge balance sheet exposure to our Indian rupee denominated net monetary assets. These contracts are not designated as hedges and are intended to offset the foreign currency exchange rate gains or losses upon the remeasurement of the underlying Indian rupee denominated net monetary assets. We entered into a series of foreign exchange forward contracts, scheduled to mature in 2011, to buy U.S. dollars and sell Indian rupees. At March 31, 2011, the notional value of the outstanding contracts was \$234.0 million and the related fair value was a liability of \$11.6 million. Based upon a sensitivity analysis of our foreign exchange forward contracts at March 31, 2011, which estimates the fair value of the contracts based upon market exchange rate fluctuations, a 10.0% change in the foreign currency exchange rate against the U.S. dollar with all other variables held constant would have resulted in a change in the fair value of approximately \$24.5 million.

There were no off-balance sheet transactions, arrangements or other relationships with unconsolidated entities or other persons in 2011 and 2010 that would have affected our liquidity or the availability of or requirements for capital resources.

We do not believe we are exposed to material direct risks associated with changes in interest rates other than with our cash and cash equivalents and short-term investments. As of March 31, 2011, we had approximately \$2,168.1 million of cash and cash equivalents and short-term investments most of which are impacted almost immediately by changes in short-term interest rates.

We typically invest in highly rated securities and our policy generally limits the amount of credit exposure to any one issuer. Our investment policy requires investments to be investment grade, rated A or better with the objective of minimizing the potential risk of principal loss. We may sell our investments prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. As of March 31, 2011, our short-term investments totaled \$874.6 million. Our investment portfolio is primarily comprised of U.S. dollar denominated corporate bonds, municipal bonds, debt issuances by the U.S. government and U.S. government agencies, debt issuances by foreign governments and supranational entities, asset-backed securities, and bank time deposits.

Item 4. Controls and Procedures. Evaluation of Disclosure Controls and Procedures

Our management under the supervision and with the participation of our chief executive officer and our chief financial officer, evaluated the design and operating effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of March 31, 2011. Based on this evaluation, our chief executive officer and our chief financial officer concluded that, as of March 31, 2011, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our chief executive officer and our

chief financial officer as appropriate to allow timely decisions regarding required disclosure.

Table of Contents

Changes in Internal Control over Financial Reporting

No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors. Factors That May Affect Future Results

In addition to the risks and uncertainties described elsewhere in this Quarterly Report on Form 10-Q, if any of the following risks occur, our business, financial condition, results of operations or prospects could be materially adversely affected. In such case, the trading price of our common stock could decline.

Our global operations are subject to complex risks, some of which might be beyond our control.

We have offices and operations in various countries around the world and provide services to clients globally. During the first quarter of 2011, approximately 78.0% of our revenues were attributable to the North American region, 18.7% were attributable to the European region, and 3.3% were attributable to the rest of the world, primarily the Asia Pacific region. If we are unable to manage the risks of our global operations, including regulatory, economic, political and other uncertainties in India, fluctuations in foreign exchange and inflation rates, international hostilities, terrorism, natural disasters, and multiple legal and regulatory systems, our results of operations could be adversely affected.

A substantial portion of our assets and operations are located in India and we are subject to regulatory, economic, political and other uncertainties in India.

We intend to continue to develop and expand our offshore facilities in India where a majority of our technical professionals are located. While wage costs are lower in India than in the United States and other developed countries for comparably skilled professionals, wages in India have historically increased at a faster rate than in the United States. If this trend continues in the future, it would result in increased costs for our skilled professionals and thereby potentially reduce our operating margins. Also, there is no assurance that, in future periods, competition for skilled professionals will not drive salaries higher in India, thereby resulting in increased costs for our technical professionals and reduced operating margins.

India has also recently experienced civil unrest and terrorism and has been involved in conflicts with neighboring countries. In recent years, there have been military confrontations between India and Pakistan that have occurred in the region of Kashmir and along the India-Pakistan border. The potential for hostilities between the two countries has been high in light of tensions related to recent terrorist incidents in India and the unsettled nature of the regional geopolitical environment, including events in and related to Afghanistan and Iraq. If India becomes engaged in armed hostilities, particularly if these hostilities are protracted or involve the threat of or use of weapons of mass destruction, it is likely that our operations would be materially adversely affected. In addition, companies may decline to contract with us for services in light of international terrorist incidents or armed hostilities, even where India is not involved because of more generalized concerns about relying on a service provider utilizing international resources that may be viewed as less stable than those provided domestically.

In the past, the Indian economy has experienced many of the problems that commonly confront the economies of developing countries, including high inflation, erratic gross domestic product growth and shortages of foreign exchange. The Indian government has exercised, and continues to exercise, significant influence over many aspects of the Indian economy and Indian government actions concerning the economy could have a material adverse effect on private sector entities like us. In the past, the Indian government has provided significant tax incentives and relaxed certain regulatory restrictions in order to encourage foreign investment in specified sectors of the economy, including the software development services industry. Programs that have benefited us include, among others, tax holidays, liberalized import and export duties and preferential rules on foreign investment and repatriation. Notwithstanding these benefits, as noted above, India's central and state governments remain significantly involved in the Indian economy as regulators. In recent years, the Indian government has introduced non-income related taxes, including new service taxes, and income-related taxes, including the Minimum Alternative Tax, or MAT. In addition, a change in government leadership in India or change in policies of the existing government in India that results in the elimination of any of the benefits realized by us from our Indian operations or the imposition of new taxes applicable to such operations could have a material adverse effect on our business, results of operations and financial condition.

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

In addition, the emergence of a widespread health emergency or pandemic, which may be more difficult to prevent or contain in a country like India as compared to more developed countries, could create economic or financial disruption that could negatively affect our revenue and operations or impair our ability to manage our business in certain parts of the world.

Table of Contents

Our international sales and operations are subject to many uncertainties.

Revenues from customers outside North America represented approximately 22.0% of our revenues for the quarter ended March 31, 2011. We anticipate that revenues from customers outside North America will continue to account for a material portion of our revenues in the foreseeable future and may increase as we expand our international presence, particularly in Europe, the Asia Pacific region and the Latin America region. In addition, the majority of our employees, along with our development and delivery centers, are located in India. As a result, we may be subject to risks inherently associated with international operations, including risks associated with foreign currency exchange rate fluctuations, which may cause volatility in our reported income, and risks associated with the application and imposition of protective legislation and regulations relating to import or export or otherwise resulting from foreign policy or the variability of foreign economic conditions. From time to time, we may engage in hedging transactions to mitigate our risks relating to exchange rate fluctuations. The use of hedging contracts is intended to mitigate or reduce transactional level volatility in the results of our foreign operations, but does not completely eliminate volatility and risk. In addition, use of hedging contracts includes the risk of non-performance by the counterparty. Additional risks associated with international operations include difficulties in enforcing intellectual property and/or contractual rights, the burdens of complying with a wide variety of foreign laws, potentially adverse tax consequences, tariffs, quotas and other barriers and potential difficulties in collecting accounts receivable. In addition, we may face competition in other countries from companies that may have more experience with operations in such countries or with international operations. Additionally, such companies may have long-standing or well-established relationships with local officials and/or desired clients, which may put us at a competitive disadvantage. We may also face difficulties integrating new facilities in different countries into our existing operations, as well as integrating employees that we hire in different countries into our existing corporate culture. Our international expansion plans may not be successful and we may not be able to compete effectively in other countries. There can be no assurance that these and other factors will not impede the success of our international expansion plans, limit our ability to compete effectively in other countries or otherwise have a material adverse effect on our business, results of operations and financial condition.

Our operating results may be adversely affected by fluctuations in the Indian rupee and other foreign currency exchange rates and restrictions on the deployment of cash across our global operations.

Although we report our operating results in U.S. dollars, a portion of our revenues and expenses are denominated in currencies other than the U.S. dollar. Fluctuations in foreign currency exchange rates can have a number of adverse effects on us. Because our consolidated financial statements are presented in U.S. dollars, we must translate revenues, expenses and income, as well as assets and liabilities, into U.S. dollars at exchange rates in effect during or at the end of each reporting period. Therefore, changes in the value of the U.S. dollar against other currencies will affect our revenues, income from operations, other income (expense), net and the value of balance sheet items originally denominated in other currencies. There is no guarantee that our financial results will not be adversely affected by currency exchange rate fluctuations or that any efforts by us to engage in currency hedging activities will be effective. In addition, in some countries we could be subject to strict restrictions on the movement of cash and the exchange of foreign currencies, which could limit our ability to use this cash across our global operations. Finally, as we continue to leverage our global delivery model, more of our expenses are incurred in currencies other than those in which we bill for the related services. An increase in the value of certain currencies, such as the Indian rupee, against the U.S. dollar could increase costs for delivery of services at offshore sites by increasing labor and other costs that are denominated in local currency.

Our operating results may be adversely affected by our use of derivative financial instruments.

We have entered into a series of foreign exchange forward contracts that are designated as cash flow hedges of certain salary payments in India. These contracts are intended to partially offset the impact of the movement of the exchange rates on future operating costs. In addition, we also entered into foreign exchange forward contracts in order to mitigate foreign currency risk on Indian rupee denominated net monetary assets. The hedging strategies that we have implemented, or may in the future implement, to mitigate foreign currency exchange rate risks may not reduce or completely offset our exposure to foreign exchange rate fluctuations and may expose our business to unexpected market, operational and counterparty credit risks. Accordingly, we may incur losses from our use of derivative financial instruments that could have a material adverse effect on our business, results of operations and financial condition.

Our global operations expose us to numerous and sometimes conflicting legal and regulatory requirements, and violations of these regulations could harm our business.

Because we provide services to clients throughout the world, we are subject to numerous, and sometimes conflicting, legal rules on matters as diverse as import/export controls, content requirements, trade restrictions, tariffs, taxation, sanctions, government affairs, internal and disclosure control obligations, data privacy and labor relations. Violations of these laws or regulations in the conduct of our business could result in fines, criminal sanctions against us or our officers, prohibitions on doing business, damage to our reputation and other unintended consequences such as liability for monetary damages, fines and/or criminal prosecution, unfavorable publicity, restrictions on our ability to process information and allegations by our clients that we have not performed our contractual

Table of Contents

obligations. Due to the varying degrees of development of the legal systems of the countries in which we operate, local laws might be insufficient to protect our rights. Our failure to comply with applicable legal and regulatory requirements could have a material adverse effect on our business, results of operations and financial condition.

In many parts of the world, including countries in which we operate, practices in the local business community might not conform to international business standards and could violate anti-corruption laws or regulations, including the U.S. Foreign Corrupt Practices Act. Although we have policies and procedures in place that are designed to promote legal and regulatory compliance, our employees, subcontractors and agents could take actions that violate these policies or procedures or applicable anti-corruption laws or regulations. Violations of these laws or regulations could subject us to criminal or civil enforcement actions, including fines and suspension or disqualification from government contracting or contracting with private entities in certain highly regulated industries, any of which could have a material adverse effect on our business.

International hostilities, terrorist activities, other violence or war, natural disasters, pandemics and infrastructure disruptions, could delay or reduce the number of new service orders we receive and impair our ability to service our customers, thereby adversely affecting our business, financial condition and results of operations.

Hostilities involving the United States and acts of terrorism, violence or war, such as the attacks of September 11, 2001 in the United States, the attacks of July 7, 2005 in the United Kingdom, the attacks of November 26, 2008 in Mumbai, India, and the continuing conflict in Iraq and Afghanistan, natural disasters, global health risks or pandemics or the threat or perceived potential for these events could materially adversely affect our operations and our ability to provide services to our customers. Such events may cause customers to delay their decisions on spending for information technology, consulting, and business and knowledge process outsourcing services and give rise to sudden significant changes in regional and global economic conditions and cycles. These events also pose significant risks to our people and to physical facilities and operations around the world, whether the facilities are ours or those of our clients, which could affect our financial results. By disrupting communications and travel, giving rise to travel restrictions, and increasing the difficulty of obtaining and retaining highly-skilled and qualified personnel, these events could make it difficult or impossible for us to deliver services to some or all of our clients. As noted above, the majority of our technical professionals are located in India, and the vast majority of our technical professionals in the United States and Europe are Indian nationals who are able to work in the United States and Europe only because they hold current visas and work permits. Travel restrictions could cause us to incur additional unexpected labor costs and expenses or could restrain our ability to retain the skilled professionals we need for our operations. In addition, any extended disruptions of electricity, other public utilities or network services at our facilities, as well as system failures at, or security breaches in, our facilities or systems, could also adversely affect our ability to serve our clients.

Although we continue to believe that we have a strong competitive position in the United States, we continue to increase our efforts to geographically diversify our clients and revenue. Despite our efforts to diversify, hostilities involving the United States, the United Kingdom, India and other countries in which we provide services to our clients, and other acts of terrorism, violence or war, natural disasters, global health risks or pandemics may reduce the demand for our services and negatively affect our revenues and profitability. While we plan and prepare to defend against each of these occurrences, we might be unable to protect our people, facilities and systems against all such occurrences. If these disruptions prevent us from effectively serving our clients, our operating results could be adversely affected.

Anti-outsourcing legislation, if adopted, and negative perceptions associated with offshore outsourcing could adversely affect our business, financial condition and results of operations and impair our ability to service our customers.

The issue of companies outsourcing services to organizations operating in other countries is a topic of political discussion in many countries, including the United States, which is our largest market. For example, measures aimed at limiting or restricting outsourcing by United States companies are periodically considered in the U.S. Congress and in numerous state legislatures to address concerns over the perceived association between offshore outsourcing and the loss of jobs domestically. On August 13, 2010, President Barack Obama signed Public Law 111-230, which contained provisions to impose additional fees of \$2,000 for certain H-1B petitions and \$2,250 for certain L-1A and L-1B petitions beginning in August 2010 through September 20, 2014. These fees were extended through September 20, 2015 in Public Law 111-347. Given the ongoing debate over this issue, the introduction and consideration of other restrictive legislation is possible. If enacted, such measures may: broaden existing restrictions on outsourcing by federal and state government agencies and on government contracts with firms that outsource services directly or indirectly, or impact private industry with measures that include but are not limited to tax disincentives, fees or penalties, intellectual property transfer restrictions, and new standards that have the effect of restricting the use of certain business and/or work visas. In the event that any of these measures become law, our business, results of operations and financial condition could be adversely affected and our ability to provide services to our customers could be impaired.

In addition, from time to time, there has been publicity about negative experiences associated with offshore outsourcing, such as domestic job loss and theft and misappropriation of sensitive client data, particularly involving service providers in India. Current or

Table of Contents

prospective clients may elect to perform certain services themselves or may be discouraged from utilizing global service delivery providers due to negative perceptions that may be associated with using global service delivery models or firms. Any slowdown or reversal of existing industry trends toward offshore outsourcing would seriously harm our ability to compete effectively with competitors that provide the majority of their services from within the country in which our clients operate.

Existing and future legislative and administrative/regulatory policies restricting the performance of business process services from an offshore location in jurisdictions in Europe, the Asia Pacific, or any other region in which we have clients could also have a material adverse effect on our business, results of operations and financial condition. For example, legislation enacted in the United Kingdom, based on the 1977 EC Acquired Rights Directive, has been adopted in some form by many European Union, or EU, countries, and provides that if a company outsources all or part of its business to a service provider or changes its current service provider, the affected employees of the company or of the previous service provider are entitled to become employees of the new service provider, generally on the same terms and conditions as their original employment. In addition, dismissals of employees who were employed by the company or the previous service provider immediately prior to that transfer are automatically considered unfair dismissals that entitle such employees to compensation. As a result, to avoid unfair dismissal claims we may have to offer, and become liable for, voluntary redundancy payments to the employees of our clients who outsource business to us in the United Kingdom and other EU countries who have adopted similar laws. These types of policies may materially affect our ability to obtain new business from companies in the United Kingdom and EU and to provide outsourced services to companies in the United Kingdom and EU in a cost-effective manner.

Our growth may be hindered by immigration restrictions.

Our future success continues to depend on our ability to attract and retain employees with technical and project management skills from developing countries, especially India. The vast majority of our professionals in the United States and in Europe are Indian nationals. The ability of Indian nationals to work in the United States and Europe depends on their ability and our ability to obtain the necessary visas and work permits.

The H-1B visa classification enables United States employers to hire certain qualified foreign workers in positions that require an education at least equal to a four-year bachelor degree in the United States in specialty occupations such as IT systems engineering and computer systems analysis. The H-1B visa usually permits an individual to work and live in the United States for a period of up to six years. Under certain limited circumstances, H-1B visa extensions after the six-year period may be available. There is a limit on the number of new H-1B petitions that the United States Citizenship and Immigration Services, or CIS, may approve in any federal fiscal year, and in years in which this limit is reached, we may be unable to obtain H-1B visas necessary to bring foreign employees to the United States. Currently, the limit is 65,000 for holders of United States or United States-equivalent bachelor degrees (the general cap), and an additional 20,000 for holders of advanced degrees from United States post-secondary educational institutions. We began filing H-1B petitions with CIS against the fiscal year (FY) 2011 caps beginning April 1, 2010 for work in H-1B status beginning on October 1, 2010. On January 21, 2011 CIS reached its advanced degree cap for FY 2011, and on January 27, 2011, CIS reached its general cap for FY 2011. We plan to begin filing H-1B petitions with CIS against the FY 2012 caps beginning April 1, 2011 for work in H-1B status beginning on October 1, 2011. As part of our advanced planning process, we believe that we have a sufficient number of employees work permit-ready to meet our anticipated business growth in the current year. In addition, there are strict labor regulations associated with the H-1B visa classification. Larger users of the H-1B visa program are often subject to investigations by the Wage and Hour Division of the United States Department of Labor. A finding by the United States Department of Labor of willful or substantial failure to comply with existing regulations on the H-1B classification may result in back-pay liability, substantial fines, and/or a ban on future use of the H-1B program and other immigration benefits.

We also regularly transfer employees from India to the United States to work on projects at client sites using the L-1 visa classification. The L-1 visa allows companies abroad to transfer certain managers, executives, and employees with specialized company knowledge to related United States companies such as a parent, subsidiary, affiliate, joint venture, or branch office. We have an approved Blanket L petition, under which the corporate relationships of our transferring and receiving entities have been pre-approved by CIS, thus enabling individual L-1 visa applications to be presented directly to a visa-issuing United States consular post abroad rather than undergoing a pre-approval process through CIS in the United States. In recent years, both the United States consular posts that review initial L-1 applications and CIS, which adjudicates individual petitions for initial grants and extensions of L-1 status, have become increasingly restrictive with respect to this category. As a result, the rate of refusals of initial individual L-1 petitions and extensions has increased. In addition, even where L-1 visas are ultimately granted and issued, security measures undertaken by United States consular posts around the world have delayed visa issuances. Our inability to bring qualified technical personnel into the United States to staff on-site customer locations would have a material adverse effect on our business, results of operations and financial condition.

Pursuant to the L-1 Visa Reform Act which became effective in June 2005, there are a number of restrictions and requirements that must be met for us to obtain L-1 visas for our personnel. Under one provision of the L-1 Visa Reform Act, all L-1 applicants, including those brought to the United States under a Blanket L Program, must have worked abroad with the related company for one full year in the prior three years. In

addition, L-1B holders (intracompany transferees with specialized company knowledge) may not

Table of Contents

be primarily stationed at the work site of another employer if the L-1B visa holder will be controlled and supervised by an employer other than the petitioning employer. Finally, L-1B status may not be granted where placement of the L-1B visa holder at a third party site is part of an arrangement to provide labor for the third party, rather than placement at the site in connection with the provision of a product or service involving specialized knowledge specific to the petitioning employer.

We do not place L-1B workers at third party sites where they are under the primary supervision of a different employer, nor do we place L-1B workers at third party sites in an arrangement to provide labor for the third party without providing a service involving our specialized knowledge. Since implementation of the L-1 Visa Reform Act, we consistently have established this fact to CIS's satisfaction. However, if CIS and/or the United States Department of State, through its visa-issuing consular posts abroad, decide to interpret these provisions in a very restrictive fashion, this could impair our ability to staff our projects in the United States with resources from our entities abroad. New guidance governing these statutory provisions is being developed by CIS, and if such guidance is restrictive in nature, our ability to staff our projects in the United States with resources from our entities abroad will be impaired.

We also process immigrant visas for lawful permanent residence in the United States for employees to fill positions for which there are an insufficient number of able, willing, and qualified United States workers available to fill the positions. Compliance with existing United States immigration and labor laws, or changes in those laws making it more difficult to hire foreign nationals or limiting our ability to successfully obtain permanent residence for our foreign employees in the United States, could require us to incur additional unexpected labor costs and expenses or could restrain our ability to retain the skilled professionals we need for our operations in the United States. Any of these restrictions or limitations on our hiring practices could have a material adverse effect on our business, results of operations and financial condition.

In addition to immigration restrictions in the United States, there are certain restrictions on transferring employees to work in the United Kingdom, where we have experienced significant growth. The United Kingdom currently requires that all employees who are not nationals of European Union countries (plus nationals of Bulgaria and Romania) or EEA nationals, obtain work permission before obtaining a visa/entry clearance to travel to the United Kingdom. European nations such as Hungary, Poland, Lithuania, Slovakia, and the Czech Republic do not have a work permit requirement but employees need to register to work within 30 days of arrival. The United Kingdom has a points-based system under which certain certificates of sponsorship are issued by licensed employer sponsors, provided the employees they seek to employ in the United Kingdom can accumulate a certain number of points based on certain attributes. Where the employee has not worked for a Cognizant group company outside the United Kingdom for at least 6 months, we must carry out a resident labor market test to confirm that the intended role cannot be filled by an EEA national. We are currently an A-rated sponsor and were allocated certificates of sponsorship which we believe are sufficient to meet our current and expected demand for transfers to the United Kingdom. On November 23, 2010, the United Kingdom announced new restrictions to control annual net migration, but allowed for temporary intra-company transfers of employees from outside the European Economic Area for up to five years as long as the employees meet certain compensation requirements.

Immigration and work permit laws and regulations in the United States, the United Kingdom, the EU, Switzerland and other countries are subject to legislative and administrative changes as well as changes in the application of standards and enforcement. Immigration and work permit laws and regulations can be significantly affected by political forces and levels of economic activity. Our international expansion strategy and our business, results of operations, and financial condition may be materially adversely affected if changes in immigration and work permit laws and regulations or the administration or enforcement of such laws or regulations impair our ability to staff projects with professionals who are not citizens of the country where the work is to be performed.

Our revenues are highly dependent on clients primarily located in the United States and Europe, as well as on clients concentrated in certain industries, including the financial services industry. Continuing or worsening economic conditions or factors that negatively affect the economic health of the United States, Europe or these industries may adversely affect our business.

Approximately 78.0% of our revenues during the quarter ended March 31, 2011 were derived from customers located in North America. In the same period, approximately 18.7% of our revenues were derived from customers located in Europe. If the United States or European economy continues to weaken or slow and conditions in the financial markets continue to deteriorate, pricing for our services may be depressed and our customers may reduce or postpone their technology spending significantly, which may in turn lower the demand for our services and negatively affect our revenues and profitability. Additionally, any prolonged recession in the United States and Europe could have an adverse impact on our revenues because a large portion of our revenues are derived from the United States and Europe. In addition, during the quarter ended March 31, 2011, we earned approximately 41.6% of our revenues from the financial services industry, which includes insurance. A deterioration in the financial services industry and significant consolidation in that industry, or a decrease in growth or consolidation in other industry segments on which we focus, may reduce the demand for our services and negatively affect our revenues and profitability. In addition, if we are unable to successfully anticipate changing economic and political conditions affecting the industries and markets in which we operate, we may be unable to effectively plan for or respond to those changes, and our business could be negatively affected.

Table of Contents

We face intense competition from other service providers.

The intensely competitive information technology, consulting and business process outsourcing professional services markets include a large number of participants and are subject to rapid change. These markets include participants from a variety of market segments, including:

systems integration firms;

contract programming companies;

application software companies;

internet solutions providers;

large or traditional consulting companies;

professional services groups of computer equipment companies; and

infrastructure management and outsourcing companies.

These markets also include numerous smaller local competitors in the various geographic markets in which we operate which may be able to provide services and solutions at lower costs or on terms more attractive to clients than we can. Our direct competitors include, among others, Accenture, Capgemini, Computer Sciences Corporation, HCL Technologies, HP Enterprise (formerly Electronic Data Systems), IBM Global Services, Infosys Technologies, Perot Systems (acquired by Dell Inc.), Tata Consultancy Services and Wipro. Many of our competitors have significantly greater financial, technical and marketing resources and greater name recognition and, therefore, may be better able to compete for new work and skilled professionals. There is a risk that increased competition could put downward pressure on the prices we can charge for our services and on our operating margins. Similarly, if our competitors develop and implement methodologies that yield greater efficiency and productivity, they may be able to offer services similar to ours at lower prices without adversely affecting their profit margins. Even if our offerings address industry and client needs, our competitors may be more successful at selling their services. If we are unable to provide our clients with superior services and solutions at competitive prices or successfully market those services to current and prospective clients, our results of operations may suffer. Further, a client may choose to use its own internal resources rather than engage an outside firm to perform the types of services we provide. We cannot be certain that we will be able to sustain our current levels of profitability or growth in the face of competitive pressures, including competition for skilled technology professionals and pricing pressure from competitors employing an on-site/offshore business model.

In addition, we may face competition from companies that increase in size or scope as the result of strategic mergers or acquisitions. These transactions may include consolidation activity among hardware manufacturers, software companies and vendors, and service providers. The result of any such vertical integration may be greater integration of products and services that were once offered separately by independent vendors. Our access to such products and services may be reduced as a result of such an industry trend, which could adversely affect our competitive position.

We may not be able to sustain our current level of profitability.

For the quarter ended March 31, 2011, we reported an operating margin of 19.4%. Our operating margin may decline if we experience declines in demand and pricing for our services, imposition of new non-income related taxes or due to adverse fluctuations in foreign currency exchange rates. In addition, historically, wages in India have increased at a faster rate than in the United States. Additionally, the number and type of equity-based compensation awards and the assumptions used in valuing equity-based compensation awards may change resulting in increased stock-based compensation expense and lower margins. Although we have historically been able to partially offset wage increases and foreign

currency fluctuations through further leveraging the scale of our operating structure, obtaining price increases, and issuing a lower number of stock-based compensation awards in proportion to our overall headcount, we cannot be sure that we will be able to continue to do so in the future.

Our profitability could suffer if we are not able to control our costs.

Our ability to control our costs and improve our efficiency affects our profitability. If we are unable to control our costs or improve our efficiency, our profitability could be negatively affected.

Our business will suffer if we fail to develop new services and enhance our existing services in order to keep pace with the rapidly evolving technological environment.

The information technology, consulting and business process outsourcing professional services markets are characterized by rapid technological change, evolving industry standards, changing customer preferences and new product and service introductions.

Table of Contents

Our future success will depend on our ability to develop solutions that keep pace with changes in the markets in which we provide services. We cannot be sure that we will be successful in developing new services addressing evolving technologies in a timely or cost-effective manner or, if these services are developed, that we will be successful in the marketplace. In addition, we cannot be sure that products, services or technologies developed by others will not render our services non-competitive or obsolete. Our failure to address the demands of the rapidly evolving technological environment could have a material adverse effect on our business, results of operations and financial condition.

Our ability to remain competitive will also depend on our ability to design and implement, in a timely and cost-effective manner, solutions for customers that both leverage their legacy systems and appropriately utilize newer technologies such as Web 2.0 models, software-as-a-service, and service oriented architectures. Our failure to design and implement solutions in a timely and cost-effective manner could have a material adverse effect on our business, results of operations and financial condition.

We may face difficulties in providing end-to-end business solutions for our clients that could cause clients to discontinue their work with us, which in turn could harm our business.

We have been expanding the nature and scope of our engagements and have added new service offerings, such as IT consulting, business and knowledge process outsourcing, systems integration and outsourcing of entire portions of IT infrastructure. The success of these service offerings is dependent, in part, upon continued demand for such services by our existing, new and prospective clients and our ability to meet this demand in a cost-competitive and effective manner. In addition, our ability to effectively offer a wider breadth of end-to-end business solutions depends on our ability to attract existing or new clients to these service offerings. To obtain engagements for such end-to-end solutions, we also are more likely to compete with large, well-established international consulting firms, resulting in increased competition and marketing costs. Accordingly, we cannot be certain that our new service offerings will effectively meet client needs or that we will be able to attract existing and new clients to these service offerings.

The increased breadth of our service offerings may result in larger and more complex projects with our clients. This will require us to establish closer relationships with our clients and a thorough understanding of their operations. Our ability to establish such relationships will depend on a number of factors, including the proficiency of our professionals and our management personnel. Our failure to understand our client requirements or our failure to deliver services that meet the requirements specified by our clients could result in termination of client contracts, and we could be liable to our clients for significant penalties or damages.

Larger projects may involve multiple engagements or stages, and there is a risk that a client may choose not to retain us for additional stages or may cancel or delay additional planned engagements. These terminations, cancellations or delays may result from factors that have little or nothing to do with the quality of our services, such as the business or financial condition of our clients or the economy generally. Such cancellations or delays make it difficult to plan for project resource requirements, and inaccuracies in such resource planning and allocation may have a negative impact on our profitability.

If our clients are not satisfied with our services, our business could be adversely affected.

Our business model depends in large part on our ability to attract additional work from our base of existing clients. Our business model also depends on relationships our account teams develop with our clients so that we can understand our clients' needs and deliver solutions and services that are tailored to those needs. If a client is not satisfied with the quality of work performed by us, or with the type of services or solutions delivered, then we could incur additional costs to address the situation, the profitability of that work might be impaired, and the client's dissatisfaction with our services could damage our ability to obtain additional work from that client. In particular, clients that are not satisfied might seek to terminate existing contracts prior to their scheduled expiration date and could direct future business to our competitors. In addition, negative publicity related to our client services or relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new contracts with current and prospective clients.

We rely on a few customers for a large portion of our revenues.

Our top five customers generated approximately 17.0% of our revenues for the quarter ended March 31, 2011. The volume of work performed for specific customers is likely to vary from year to year, and a major customer in one year may not use our services in a subsequent year. The loss of one of our large customers could have a material adverse effect on our business, results of operations and financial condition.

We generally do not have long-term contracts with our customers and our results of operations could be adversely affected if our clients terminate their contracts with us on short notice.

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

Consistent with industry practice, we generally do not enter into long-term contracts with our customers. A majority of our contracts can be terminated by our clients with short notice and without significant early termination cost. Terminations may result from factors that are beyond our control and unrelated to our work product or the progress of the project, including the business or

Table of Contents

financial conditions of the client, changes in ownership or management at our clients, changes in client strategies or the economy or markets generally. When contracts are terminated, we lose the anticipated revenues and might not be able to eliminate our associated costs in a timely manner. Consequently, our profit margins in subsequent periods could be lower than expected. If we are unable to replace the lost revenue with other work on terms we find acceptable or effectively eliminate costs, we may not be able to maintain our level of profitability.

Our results of operations may be affected by the rate of growth in the use of technology in business and the type and level of technology spending by our clients.

Our business depends, in part, upon continued growth in the use of technology in business by our clients and prospective clients as well as their customers and suppliers. In challenging economic environments, our clients may reduce or defer their spending on new technologies in order to focus on other priorities. At the same time, many companies have already invested substantial resources in their current means of conducting commerce and exchanging information, and they may be reluctant or slow to adopt new approaches that could disrupt existing personnel, processes and infrastructures. If the growth of technology usage in business, or our clients' spending on technology in business, declines, or if we cannot convince our clients or potential clients to embrace new technological solutions, our results of operations could be adversely affected.

If we are unable to collect our receivables from, or bill our unbilled services to, our clients, our results of operations and cash flows could be adversely affected.

Our business depends on our ability to successfully obtain payment from our clients of the amounts they owe us for work performed. We evaluate the financial condition of our clients and usually bill and collect on relatively short cycles. We maintain allowances against receivables and unbilled services. Actual losses on client balances could differ from those that we currently anticipate and, as a result, we might need to adjust our allowances. There is no guarantee that we will accurately assess the creditworthiness of our clients. Macroeconomic conditions, such as the continued credit crisis and related turmoil in the global financial system, could also result in financial difficulties, including limited access to the credit markets, insolvency or bankruptcy, for our clients, and, as a result, could cause clients to delay payments to us, request modifications to their payment arrangements that could increase our receivables balance, or default on their payment obligations to us. Timely collection of client balances also depends on our ability to complete our contractual commitments and bill and collect our contracted revenues. If we are unable to meet our contractual requirements, we might experience delays in collection of and/or be unable to collect our client balances, and if this occurs, our results of operations and cash flows could be adversely affected. In addition, if we experience an increase in the time to bill and collect for our services, our cash flows could be adversely affected.

We are investing substantial cash in new facilities and physical infrastructure, and our profitability could be reduced if our business does not grow proportionately.

We have made and continue to make significant contractual commitments related to capital expenditures on construction or expansion of our development and delivery centers. We may encounter cost overruns or project delays in connection with new facilities. These expansions will likely increase our fixed costs and if we are unable to grow our business and revenues proportionately, our profitability may be reduced.

Competition for highly-skilled technical personnel is intense and the success of our business depends on our ability to attract and retain highly-skilled professionals.

Our future success will depend to a significant extent on our ability to attract, train and retain highly-skilled professionals so as to keep our supply of skills and resources in balance with client demand. In particular, we must attract, train and retain appropriate numbers of talented people, including project managers, IT engineers and other senior technical personnel, with diverse skills in order to serve client needs and grow our business. We are particularly dependent on retaining our senior executives and other experienced managers with the skill sets required by our business, and if we are unable to do so, our ability to develop new business and effectively lead our current projects could be jeopardized. Similarly, the profitability of our business model depends on our ability to effectively utilize personnel with the right mix of skills and experience to support our projects. The processes and costs associated with recruiting, training and retaining employees place significant demands on our resources.

We believe there is a shortage of, and significant competition for, professionals with the advanced technological skills necessary to perform the services we offer. We have subcontracted to a limited extent in the past, and may do so in the future, with other service providers in order to meet our obligations to our customers. Our ability to maintain and renew existing engagements and obtain new business will depend, in large part, on our ability to attract, train and retain technical personnel with the skills that keep pace with continuing changes in information technology, evolving industry standards and changing customer preferences. Further, we must train and manage our growing work force, requiring an increase in the level of responsibility for both existing and new management personnel. We cannot guarantee that the management skills and systems currently in place will be adequate or that we will be able to

Table of Contents

train and assimilate new employees successfully. Our profits and ability to compete for and manage client engagements could be adversely affected if we cannot manage employee hiring and attrition to achieve a stable and efficient workforce structure.

Our ability to operate and compete effectively could be impaired if we lose key personnel or if we cannot attract additional qualified personnel.

Our future performance depends to a significant degree upon the continued service of the key members of our management team, as well as marketing, sales and technical personnel, and our ability to attract and retain new management and other personnel. We do not maintain key man life insurance on any of our executive officers or significant employees. Competition for personnel is intense, and there can be no assurance that we will be able to retain our key employees or that we will be successful in attracting and retaining new personnel in the future. The loss of any one or more of our key personnel or the failure to attract and retain key personnel could have a material adverse effect on our business, results of operations and financial condition.

Restrictions in non-competition agreements with our executive officers may not be enforceable.

We have entered into non-competition agreements with our executive officers. We cannot be certain, however, that the restrictions in these agreements prohibiting such executive officers from engaging in competitive activities are enforceable. Further, substantially all of our professional non-executive staff are not covered by agreements that would prohibit them from working for our competitors. If any of our key professional personnel leaves our employment and joins one of our competitors, our business could be adversely affected.

Our earnings may be adversely affected if we change our intent not to repatriate earnings in India or if such earnings become subject to U.S. tax on a current basis.

Effective January 1, 2002, and in accordance with authoritative literature, we no longer accrue incremental U.S. taxes on all Indian earnings recognized in 2002 and subsequent periods as these earnings (as well as other foreign earnings for all periods) are considered to be indefinitely reinvested outside of the United States. While we have no plans to do so, events may occur in the future that could effectively force us to change our intent not to repatriate our foreign earnings. If we change our intent and repatriate such earnings, we will have to accrue the applicable amount of taxes associated with such earnings and pay taxes at a substantially higher rate than our effective income tax rate in 2011. These increased taxes could have a material adverse effect on our business, results of operations and financial condition.

Our operating results may be negatively impacted upon the loss of certain tax benefits provided by India to companies in our industry as well as from proposed tax legislation in India.

Cognizant India is primarily export-oriented and is eligible for certain income tax holiday benefits granted by the Indian government for export activities. These benefits for export activities conducted within STPs expired during the first quarter ended March 31, 2011. A significant portion of the earnings of Cognizant India is generated within STPs, and upon expiration of these benefits these earnings are subject to regular corporate income tax at the current rate of 32.4%, resulting in a significant increase in our effective income tax rate for 2011.

In addition to STPs, we have constructed and expect to continue to construct our newer development centers in areas designated as SEZs. Development centers operating in SEZs are entitled to certain income tax incentives for periods up to 15 years. Changes in Indian tax laws that would reduce or deny SEZ tax benefits could have a material adverse effect on our business, results of operations and financial condition. In addition, as part of the Indian government's 2011 budget, effective April 1, 2011, all Indian profits, including those generated within SEZs, are subject to the MAT, at the current rate of 20.0%. Any MAT paid is creditable against future taxable income for a period of up to 10 years. Currently, we anticipate utilizing our existing MAT balances against future taxable income. Whether we will be able to fully realize our MAT related deferred income tax assets will depend on possible changes to the Indian tax laws as well as the future financial results of Cognizant India. The inability to fully realize our deferred income tax assets related to the MAT could have a material adverse effect on our business, results of operations and financial condition.

If our pricing structures are based on inaccurate expectations and assumptions regarding the cost and complexity of performing our work, then our contracts could be unprofitable.

We negotiate pricing terms with our clients utilizing a range of pricing structures and conditions. We predominantly contract to provide services either on a time-and-materials or on a fixed-price basis. Our pricing is highly dependent on our internal forecasts and predictions about our projects and the marketplace, which might be based on limited data and could turn out to be inaccurate. If we do not accurately estimate the costs and timing for completing projects, our contracts could prove unprofitable for us or yield lower profit margins than anticipated. We face a number of risks when pricing our contracts, as many of our projects entail the coordination of operations and workforces in multiple locations

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

and utilizing workforces with different skill sets and competencies across geographically diverse service locations. Our pricing, cost and profit margin estimates for the work that we perform frequently include anticipated long-term cost savings from transformational and other initiatives that we expect to achieve and sustain over the life of the

Table of Contents

contract. There is a risk that we will underprice our projects, fail to accurately estimate the costs of performing the work or fail to accurately assess the risks associated with potential contracts. In particular, any increased or unexpected costs, delays or failures to achieve anticipated cost savings, or unexpected risks we encounter in connection with the performance of this work, including those caused by factors outside our control, could make these contracts less profitable or unprofitable, which could have an adverse effect on our profit margin.

In addition, a significant portion of our projects are on a fixed-price basis, subjecting us to the foregoing risks to an even greater extent. Fixed-price contracts accounted for approximately 31.8% of our revenues for the quarter ended March 31, 2011. We expect that an increasing number of our future projects will be contracted on a fixed-price basis. In addition to the other risks described in the paragraph above, we bear the risk of cost over-runs and operating cost inflation in connection with projects covered by fixed-price contracts. Our failure to estimate accurately the resources and time required for a fixed-price project, or our failure to complete our contractual obligations within the time frame committed, could have a material adverse effect on our business, results of operations and financial condition.

Our profitability could suffer if we are not able to maintain favorable pricing rates.

Our profit margin, and therefore our profitability, is dependent on the rates we are able to recover for our services. If we are not able to maintain favorable pricing for our services, our profit margin and our profitability could suffer. The rates we are able to recover for our services are affected by a number of factors, including:

our clients' perceptions of our ability to add value through our services;

competition;

introduction of new services or products by us or our competitors;

our competitors' pricing policies;

our ability to accurately estimate, attain and sustain contract revenues, margins and cash flows over increasingly longer contract periods;

bid practices of clients and their use of third-party advisors;

the use by our competitors and our clients of offshore resources to provide lower-cost service delivery capabilities;

our ability to charge premium prices when justified by market demand or the type of service; and

general economic and political conditions.

Our profitability could suffer if we are not able to maintain favorable utilization rates.

The cost of providing our services, including the utilization rate of our professionals, affects our profitability. If we are not able to maintain an appropriate utilization rate for our professionals, our profit margin and our profitability may suffer. Our utilization rates are affected by a number of factors, including:

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

our ability to efficiently transition employees from completed projects to new assignments and to hire and assimilate new employees;

our ability to accurately forecast demand for our services and thereby maintain an appropriate headcount in each of our geographies and workforces;

our ability to effectively manage attrition; and

our need to devote time and resources to training, professional development and other non-chargeable activities.

If we do not continue to improve our operational, financial and other internal controls and systems to manage our rapid growth and size or if we are unable to enter, operate and compete effectively in new geographic markets, our business may suffer and the value of our shareholders' investment may be harmed.

Our anticipated growth will continue to place significant demands on our management and other resources. Our growth will require us to continue to develop and improve our operational, financial and other internal controls, both in the United States, India and elsewhere. In particular, our continued growth will increase the challenges involved in:

recruiting, training and retaining technical, finance, marketing and management personnel with the knowledge, skills and experience that our business model requires;

maintaining high levels of client satisfaction;

developing and improving our internal administrative infrastructure, particularly our financial, operational, communications and other internal systems;

Table of Contents

preserving our culture, values and entrepreneurial environment; and

effectively managing our personnel and operations and effectively communicating to our personnel worldwide our core values, strategies and goals.

In addition, the increasing size and scope of our operations increase the possibility that an employee will engage in unlawful or fraudulent activity, or otherwise expose us to unacceptable business risks, despite our efforts to train our people and maintain internal controls to prevent such instances. If we do not continue to develop and implement the right processes and tools to manage our enterprise, our ability to compete successfully and achieve our business objectives could be impaired.

As part of our growth strategy, we plan to continue expanding our operations in Europe, Asia, Middle East, and Latin America. We may not be able to compete effectively in these markets and the cost of entering these markets may be substantially greater than we expect. If we fail to compete effectively in the new markets we enter, or if the cost of entering those markets is substantially greater than we expect, our business, results of operations and financial condition could be adversely affected. In addition, if we cannot compete effectively, we may be required to reconsider our strategy to invest in our international expansion plans and change our intent on the repatriation of our earnings.

Our operating results may experience significant quarterly fluctuations.

Historically, we have experienced significant quarterly fluctuations in our revenues and results of operations and expect these fluctuations to continue. Among the factors causing these variations have been:

the nature, number, timing, scope and contractual terms of the projects in which we are engaged;

delays incurred in the performance of those projects;

the accuracy of estimates of resources and time required to complete ongoing projects; and

general economic conditions.

In addition, our future revenues, operating margins and profitability may fluctuate as a result of:

changes in pricing in response to customer demand and competitive pressures;

changes to the financial condition of our clients;

the mix of on-site and offshore staffing;

the ratio of fixed-price contracts versus time-and-materials contracts;

employee wage levels and utilization rates;

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

changes in foreign exchange rates, including the Indian rupee versus the U.S. dollar;

the timing of collection of accounts receivable;

enactment of new taxes;

changes in domestic and international income tax rates and regulations; and

changes to levels and types of stock-based compensation awards and assumptions used to determine the fair value of such awards. A high percentage of our operating expenses, particularly personnel and rent, are relatively fixed in advance of any particular period. As a result, unanticipated variations in the number and timing of our projects or in employee wage levels and utilization rates may cause significant variations in our operating results in any particular period, and could result in losses. Any significant shortfall of revenues in relation to our expectations, any material reduction in utilization rates for our professional staff or variance in the on-site/offshore staffing mix, an unanticipated termination of a major project, a customer's decision not to pursue a new project or proceed to succeeding stages of a current project or the completion of several major customer projects during a quarter could require us to pay underutilized employees and could therefore have a material adverse effect on our business, results of operations and financial condition.

As a result of these factors, it is possible that in some future periods, our revenues and operating results may be significantly below the expectations of public market analysts and investors. In such an event, the price of our common stock would likely be materially and adversely affected.

We could be held liable for damages or our reputation could be damaged by disclosure of confidential information or personal data or system failures.

We are dependent on information technology networks and systems to process, transmit and store electronic information and to communicate among our locations around the world and with our clients. Security breaches of this infrastructure could lead to

Table of Contents

shutdowns or disruptions of our systems and potential unauthorized disclosure of confidential information. In addition, many of our engagements involve projects that are critical to the operations of our customers' businesses and provide benefits that are difficult to quantify. Any failure in a customer's computer system could result in a claim for substantial damages against us, regardless of our responsibility for the failure. Although we attempt to limit by contract our liability for damages arising from negligent acts, errors, mistakes or omissions in rendering our services, we cannot assure you that any contractual limitations on liability will be enforceable in all instances or will otherwise protect us from liability for damages.

In addition, we often have access to or are required to manage, utilize, collect and store sensitive or confidential client or employee data, including nonpublic personal data. As a result, we are subject to numerous U.S. and foreign jurisdiction laws and regulations designed to protect this information, such as the European Union Directive on Data Protection and various U.S. federal and state laws governing the protection of health or other individually identifiable information. If any person, including any of our employees, negligently disregards or intentionally breaches our established controls with respect to such data or otherwise mismanages or misappropriates that data, we could be subject to significant liability to our clients or our clients' customers for breaching contractual confidentiality provisions or privacy laws as well as liability and penalties in connection with any violation of applicable privacy laws and/or criminal prosecution. Unauthorized disclosure of sensitive or confidential client or employee data, whether through breach of computer systems, systems failure, employee negligence, fraud or misappropriation, or otherwise, could damage our reputation and cause us to lose clients. Similarly, unauthorized access to or through our information systems or those we develop or manage for our clients, whether by our employees or third parties, could result in negative publicity, legal liability and damage to our reputation.

Although we have general liability insurance coverage, including coverage for errors or omissions, there can be no assurance that coverage will continue to be available on reasonable terms or will be sufficient in amount to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, results of operations and financial condition.

Our business could be negatively affected if we incur legal liability, including with respect to our indemnification obligations, in connection with providing our solutions and services.

If we fail to meet our contractual obligations or otherwise breach obligations to our clients, we could be subject to legal liability. We may enter into non-standard agreements because we perceive an important economic opportunity or because our personnel did not adequately adhere to our guidelines. In addition, the contracting practices of our competitors may cause contract terms and conditions that are unfavorable to us to become standard in the marketplace. If we cannot or do not perform our obligations, we could face legal liability and our contracts might not always protect us adequately through limitations on the scope and/or amount of our potential liability. If we cannot, or do not, meet our contractual obligations to provide solutions and services, and if our exposure is not adequately limited through the terms of our agreements, we might face significant legal liability and our business could be adversely affected.

In the normal course of business and in conjunction with certain client engagements, we have entered into contractual arrangements through which we may be obligated to indemnify clients or other parties with whom we conduct business with respect to certain matters. These arrangements can include provisions whereby we agree to hold the indemnified party and certain of their affiliated entities harmless with respect to third-party claims related to such matters as our breach of certain representations or covenants, or out of our intellectual property infringement, our gross negligence or willful misconduct or certain other claims made against certain parties. Payments by us under any of these arrangements are generally conditioned on the client making a claim and providing us with full control over the defense and settlement of such claim. It is not possible to determine the maximum potential amount under these indemnification agreements due to the unique facts and circumstances involved in each particular agreement. Historically, we have not made payments under these indemnification agreements so they have not had any impact on our operating results, financial position, or cash flows. However, if events arise requiring us to make payment for indemnification claims under our indemnification obligations in contracts we have entered, such payments could have material impact on our operating results, financial position, and cash flows.

We could incur liability or our reputation could be damaged if our provision of services and solutions to our clients contributes to our clients' internal control deficiencies.

Our clients may perform audits or require us to perform audits and provide audit reports with respect to the controls and procedures that we use in the performance of services for such clients, especially when we process data belonging to them. Our ability to acquire new clients and retain existing clients may be adversely affected and our reputation could be harmed if we receive a qualified opinion, or if we cannot obtain an unqualified opinion, with respect to our controls and procedures in connection with any such audit in a timely manner. Additionally, we could incur liability if our controls and procedures, or the controls and procedures we

Table of Contents

manage for a client, were to result in internal controls failures or impair our client's ability to comply with its own internal control requirements.

If we are unable to protect our intellectual property rights, our business may be adversely affected.

Our future success will depend, in part, on our ability to protect our proprietary methodologies and other intellectual property. We presently hold no patents or registered copyrights, and rely upon a combination of copyright and trade secret laws, non-disclosure and other contractual arrangements and various security measures to protect our intellectual property rights. Existing laws of some countries in which we provide services or solutions, such as China, might offer only limited protection of our intellectual property rights. India is a member of the Berne Convention, and has agreed to recognize protections on copyrights conferred under the laws of foreign countries, including the laws of the United States. We believe that laws, rules, regulations and treaties in effect in the United States, India and other countries in which we operate are adequate to protect us from misappropriation or unauthorized use of our copyrights and other intellectual property. However, there can be no assurance that these laws will not change and, in particular, that the laws of India or the United States will not change in ways that may prevent or restrict the transfer of software components, libraries and toolsets from India to the United States or from the United States to India. There can be no assurance that the steps we have taken to protect our intellectual property rights will be adequate to deter misappropriation of any of our intellectual property, or that we will be able to detect unauthorized use and take appropriate steps to enforce our rights. Enforcing our rights might also require considerable time, money and oversight. Unauthorized use of our intellectual property may result in development of technology, products or services that compete with our products and services and unauthorized parties may infringe upon or misappropriate our products, services or proprietary information. If we are unable to protect our intellectual property, our business may be adversely affected.

Depending on the circumstances, we might need to grant a specific client greater rights in intellectual property developed or used in connection with a contract than we generally do. In certain situations, we might forego all rights to the use of intellectual property we create and intend to reuse across multiple client engagements, which would limit our ability to reuse that intellectual property for other clients. Any limitation on our ability to provide a service or solution could cause us to lose revenue-generating opportunities and require us to incur additional expenses to develop new or modified solutions for future projects.

Our services or solutions could infringe upon the intellectual property rights of others or we might lose our ability to utilize the intellectual property of others.

We cannot be sure that our services and solutions, or the solutions of others that we offer to our clients, do not infringe on the intellectual property rights of others, and we could have infringement claims asserted against us or against our clients. These claims could harm our reputation, cost us money and prevent us from offering some services or solutions. In a number of our contracts, we have agreed to indemnify our clients for any expenses or liabilities resulting from claimed infringements of the intellectual property rights of third parties. In some instances, the amount of these indemnities could be greater than the revenues we receive from the client. Any claims or litigation in this area, whether we ultimately win or lose, could be time-consuming and costly, injure our reputation or require us to enter into royalty or licensing arrangements. If the latter, we might not be able to enter into these royalty or licensing arrangements on acceptable terms. If a claim of infringement were successful against us or our clients, an injunction might be ordered against our client or our own services or operations, causing further damages. We expect that the risk of infringement claims against us will increase if our competitors are able to obtain patents for software products and processes. Any infringement claim or litigation against us could have a material adverse effect on our business, results of operations and financial condition.

We could lose our ability or be unable to secure the right to utilize the intellectual property of others. Third-party suppliers of software, hardware or other intellectual assets could be unwilling to permit us to use their intellectual property and this could impede or disrupt use of their products or services by us and our clients. If our ability to provide services and solutions to our clients is impaired, our operating results could be adversely affected.

We may be unable to integrate acquired companies or technologies successfully and we may be subject to certain liabilities assumed in connection with our acquisitions that could harm our operating results.

We expect to continue our program of pursuing strategic acquisitions and joint ventures designed to enhance our capabilities, enable us to expand our geographic presence, especially in the European market, enter new technology areas and/or expand our capacity. We cannot be sure that we will successfully identify suitable acquisition candidates, consummate any acquisition or joint venture, integrate any acquired business or joint venture into our operations or achieve desired financial and operating results. Further, acquisitions and joint ventures involve a number of special risks, including diversion of management's attention and failure to retain key personnel. We might need to dedicate additional management and other resources to complete the transactions. Our organizational structure could make it difficult for us to efficiently integrate acquired businesses or technologies into our ongoing operations and assimilate employees of those businesses into our culture and operations. Accordingly, we might fail to realize the expected benefits or strategic objectives of any acquisition we undertake. If we are unable to complete the number and kind of acquisitions for which we

Table of Contents

plan, or if we are inefficient or unsuccessful at integrating any acquired businesses into our operations, we may not be able to achieve our planned rates of growth or improve our market share, profitability or competitive position in specific markets or services. Also, we may finance any future acquisitions with cash, debt financing, the issuance of equity securities or a combination of the foregoing. We cannot assure you that we will be able to arrange adequate financing on acceptable terms. In addition, acquisitions financed with the issuance of our equity securities could be dilutive.

Although we conduct due diligence in connection with each of our acquisitions, there may be liabilities that we fail to discover or that we inadequately assess in our due diligence efforts. In particular, to the extent that any acquired businesses or properties failed to comply with or otherwise violated applicable laws or regulations, or failed to fulfill their contractual obligations to customers, we, as the successor owner, may be financially responsible for these violations and failures and may suffer reputational harm or otherwise be adversely affected. While we generally require the selling party to indemnify us for any and all damages associated with such liabilities, if for any reason the seller does not perform their indemnification obligation, we may be held responsible for such liabilities and have no recourse for resulting damages. In addition, as part of an acquisition, we may assume responsibilities and obligations of the acquired business pursuant to the terms and conditions of services agreements entered by the acquired entity that are not consistent with the terms and conditions that we typically accept and require. Although we attempt to structure acquisitions in such a manner as to minimize the liability that could arise from such contractual commitments, we cannot assure you that any of our efforts to minimize the liability will be effective in all instances or will otherwise protect us from liability for damages under such agreements. The discovery of any material liabilities associated with our acquisitions for which we are unable to receive indemnification could harm our operating results.

System failure or disruptions in communications could disrupt our business and result in lost customers and curtailed operations which would reduce our revenue and profitability.

To deliver our services to our customers, we must maintain a high speed network of satellite, fiber optic and land lines and active voice and data communications twenty-four hours a day between our main operating offices in Chennai, our other development and delivery centers and the offices of our customers worldwide. Although we maintain redundancy facilities and satellite communications links, any systems failure or a significant lapse in our ability to transmit voice and data through satellite and telephone communications could result in lost customers and curtailed operations which would reduce our revenue and profitability.

Consolidation in the industries that we serve could adversely affect our business.

Companies in the industries that we serve may seek to achieve economies of scale and other synergies by combining with or acquiring other companies. If two or more of our current clients merge or consolidate and combine their operations, it may decrease the amount of work that we perform for these clients. If one of our current clients merges or consolidates with a company that relies on another provider for its consulting, systems integration and technology, or outsourcing services, we may lose work from that client or lose the opportunity to gain additional work. The increased market power of larger companies could also increase pricing and competitive pressures on us. Any of these possible results of industry consolidation could adversely affect our business.

Our ability to attract and retain business may depend on our reputation in the marketplace.

Our services are marketed to clients and prospective clients based on a number of factors. Since many of our specific client engagements involve unique services and solutions, our corporate reputation is a significant factor in our clients' evaluation of whether to engage our services. We believe the Cognizant brand name and our reputation are important corporate assets that help distinguish our services from those of our competitors and also contribute to our efforts to recruit and retain talented employees. However, our corporate reputation is potentially susceptible to damage by actions or statements made by current or former clients, competitors, vendors, adversaries in legal proceedings, government regulators, as well as members of the investment community and the media. There is a risk that negative information about our company, even if based on false rumor or misunderstanding, could adversely affect our business. In particular, damage to our reputation could be difficult and time-consuming to repair, could make potential or existing clients reluctant to select us for new engagements, resulting in a loss of business, and could adversely affect our recruitment and retention efforts. Damage to our reputation could also reduce the value and effectiveness of the Cognizant brand name and could reduce investor confidence in us, adversely affecting our share price.

Provisions in our charter, by-laws and stockholders' rights plan and provisions under Delaware law may discourage unsolicited takeover proposals.

Provisions in our charter and by-laws, each as amended, our stockholders' rights plan and Delaware General Corporate Law, or DGCL, may have the effect of deterring unsolicited takeover proposals or delaying or preventing changes in our control or management, including transactions in which stockholders might otherwise receive a premium for their shares over then-current market prices. In addition, these documents and

Edgar Filing: COGNIZANT TECHNOLOGY SOLUTIONS CORP - Form 10-Q

provisions may limit the ability of stockholders to approve transactions that they may deem to be in their best interests. Our board of directors has the authority, without further action by the stockholders, to fix the rights and preferences, and issue shares of preferred stock. Our charter provides for a classified board of directors, which will prevent a

Table of Contents

change of control of our board of directors at a single meeting of stockholders. The prohibition of our stockholders' ability to act by written consent and to call a special meeting will delay stockholder actions until annual meetings or until a special meeting is called by our chairman or chief executive officer or our board of directors. The supermajority-voting requirement for specified amendments to our charter and by-laws allows a minority of our stockholders to block those amendments. The DGCL also contains provisions preventing stockholders from engaging in business combinations with us, subject to certain exceptions. These provisions could also discourage bids for our common stock at a premium as well as create a depressive effect on the market price of the shares of our common stock.

New and changing corporate governance and public disclosure requirements add uncertainty to our compliance policies and increases our costs of compliance.

Changing laws, regulations and standards relating to accounting, corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, other SEC regulations, and the NASDAQ Global Select Market rules, are creating uncertainty for companies like ours. These laws, regulations and standards may lack specificity and are subject to varying interpretations. Their application in practice may evolve over time, as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs of compliance as a result of ongoing revisions to such corporate governance standards.

In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment requires the commitment of significant financial and managerial resources. We consistently assess the adequacy of our internal controls over financial reporting, remediate any control deficiencies that may be identified, and validate through testing that our controls are functioning as documented. While we do not anticipate any material weaknesses, the inability of management and our independent auditor to provide us with an unqualified report as to the adequacy and effectiveness, respectively, of our internal controls over financial reporting for future year ends could result in adverse consequences to us, including, but not limited to, a loss of investor confidence in the reliability of our financial statements, which could cause the market price of our stock to decline.

We are committed to maintaining high standards of corporate governance and public disclosure, and our efforts to comply with evolving laws, regulations and standards in this regard have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In addition, the laws, regulations and standards regarding corporate governance may make it more difficult for us to obtain director and officer liability insurance. Further, our board members, chief executive officer and chief financial officer could face an increased risk of personal liability in connection with their performance of duties. As a result, we may face difficulties attracting and retaining qualified board members and executive officers, which could harm our business. If we fail to comply with new or changed laws, regulations or standards of corporate governance, our business and reputation may be harmed.

Our share price could be adversely affected if we are unable to maintain effective internal controls.

The accuracy of our financial reporting is dependent on the effectiveness of our internal controls. We are required to provide a report from management to our shareholders on our internal control over financial reporting that includes an assessment of the effectiveness of these controls. Internal control over financial reporting has inherent limitations, including human error, the possibility that controls could be circumvented or become inadequate because of changed conditions, and fraud. Because of these inherent limitations, internal control over financial reporting might not prevent or detect all misstatements or fraud. If we cannot maintain and execute adequate internal control over financial reporting or implement required new or improved controls to ensure the reliability of the financial reporting and preparation of our financial statements for external use, we could suffer harm to our reputation, fail to meet our public reporting requirements on a timely basis, or be unable to properly report on our business and the results of our operations, and the market price of our securities could be materially adversely affected.

We are exposed to credit risk and fluctuations in the market values of our investment portfolio.

Recent turmoil in the financial markets has adversely affected economic activity in the United States and other regions of the world in which we do business. We believe that based on our current cash, cash equivalents and investment balances and expected operating cash flows, the current lack of liquidity in the credit markets will not have a material impact on our liquidity, cash flow or financial flexibility. Continued deterioration of the credit and capital markets could result in volatility of our investment earnings and impairments to our investment portfolio, which could negatively impact our financial condition and reported income. The continued decline in economic activity could adversely affect the ability of counterparties to certain financial instruments such as marketable securities and derivatives to meet their obligations to us.

Table of Contents**Our stock price continues to be volatile.**

Our stock has at times experienced substantial price volatility as a result of variations between our actual and anticipated financial results, announcements by us and our competitors, projections or speculation about our business or that of our competitors by the media or investment analysts or uncertainty about current global economic conditions. The stock market, as a whole, also has experienced extreme price and volume fluctuations that have affected the market price of many technology companies in ways that may have been unrelated to these companies operating performance. Furthermore, we believe our stock price should reflect future growth and profitability expectations and, if we fail to meet these expectations, our stock price may significantly decline.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds*Issuer Purchases of Equity Securities*

In December 2010, our Board of Directors authorized up to \$150.0 million in funds for repurchases of Cognizant's outstanding shares of Class A common stock. The \$150.0 million authorization excluded fees and expenses and expires in December 2011. The program authorizes management to repurchase shares in the open market or in private transactions from time to time, depending on market conditions. During the three months ended March 31, 2011, we repurchased \$77.1 million of our Class A common stock under our stock repurchase program. Stock repurchases were funded from working capital.

Month		Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs (in thousands)
January 1, 2011	January 31, 2011				\$ 108,144
February 1, 2011	February 28, 2011	372,450	\$ 74.57	372,450	80,369
March 1, 2011	March 31, 2011	661,750	\$ 74.47	661,750	31,090
Total		1,034,200	\$ 74.51	1,034,200	

Table of Contents

Item 6. Exhibits.

(a) Exhibits.

Exhibit No.	Description
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of principal financial and accounting officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
32.2	Certification of principal financial and accounting officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Cognizant Technology Solutions Corporation

Date: May 5, 2011

By: /s/ Francisco D Souza

Francisco D Souza,
President and Chief Executive Officer
(Principal Executive Officer)

Date: May 5, 2011

By: /s/ Gordon Coburn

Gordon Coburn,
Chief Financial and Operating

Officer and Treasurer
(Principal Financial and Accounting Officer)

Table of Contents

Exhibit Index

Exhibit No.	Description
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of principal financial and accounting officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
32.2	Certification of principal financial and accounting officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document