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Price: \$17.26
52 Week High: \$55.69
52 Week Low: \$10.09

The stock fell because of the concern of questionable hedging activity; therefore, if the SEC does find wrongdoing, the stock could crash even more.

Day Sales outstanding is about 25% greater than the industry, and almost twice that of a comparable.

We wouldn't touch some of their clients stock with a ten foot pole; yet they have well over \$1B in contracts with them. There is an increased risk that the contracts may not pay out.

Company Description
EDS is a professional services firm which offers services within the categories of systems and technology services, business process management, management consulting and electronic business.

Key Statistics	
Price	17.16
EPS Est. 2003	1.61
P/E (2003)	11
LT Growth (5yr)	4.65
PEG	2.37
Shs. Outstg (M)	477.2
Market Cap (B)	8.2

Source: Multex

EDS: Ross Left and We're Leaving Too!

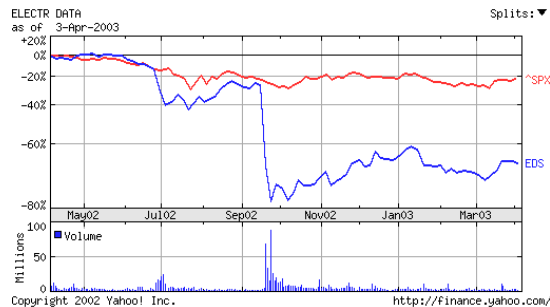
Highlights:

SEC Investigations. The stock plummeted on September 18, 2002 when investors learned of a questionable purchase of forward contracts in company's common stock. Presently, the SEC is probing their purchase of the \$225 million forward contracts.

Questions on Diversification. EDS relies heavily on big name, headlining contracts. These deals require huge initial capital outlay, and don't generate cash until well into the project. Case in point is their Days Sales Outstanding. Although these contracts do show reliable income, they can also increase risk because they can be renegotiated longer down the road.

Poor performing contracts. EDS has a high exposure to airline industry, with a \$500MM contract with American Airlines, a \$200MM contract with US Airways and a contract with United Airlines. Other companies outside the airline industry include Xerox, BellSouth and WorldCom.

Red Flags the Size of Russia. EDS & Chairman Richard "Dick" Brown "mutually agreed" to part ways amid performance concerns and SEC controversy, allowing new CEO Michael Jordan to step on the court March 20. In addition, the company also saw once CFO Jim Daley step aside and accept a smaller role, allowing new CFO Robert Swan to step in and make sense of the company's finances in January.



Industry Overview:

Our outlook of IT Consulting remains positive. For the long term, we remain positive for this industry because the services offered by the industry helps cut costs and increase productivity. Areas for future growth include business process outsourcing, which is, performing various back-office functions and data processing for customers; and the government marketplace, as politicians look for new ways to control expenses and promote efficiency. Computer services should continue to benefit from an increasingly global economy, an IT labor shortage, and e-business opportunities. Companies are increasingly turning to computer services concerns to help ease their transition to the e-business medium. Internet projects are becoming more sophisticated and complex, leading to a need for different skills for programmers, designers, and business strategists. Computer services can provide an array of services, including applications development, strategy consulting, and Web page creation.

Year to date through March 14, the S&P IT Consulting & Services Index fell 16.5%, versus 5.6% decline for the S&P 1500. In 2002, the Index fell 45.5%, versus a 22.5% drop for the S&P 1500. The group's poor performance has been exacerbated by a recent EPS shortfall and guarded near-term outlook at ElectronicData Systems, the largest independent IT services company.

Source: Hoovers

Looking Back: the Writing's on the Wall

As mentioned above, the problems facing EDS are mounting. Former CEO Dick Brown was unable to bring the mega-deals that made him famous his first three years with EDS. Coupled with an SEC investigation, probing the legality of \$225 million expense made to cover the cost of an arrogant and overly optimistic bet on its own stock, it seemed inevitable that Brown would "mutually agree" to walk. While shareholders welcome the reign of new CEO Michael Jordan, many question whether Brown's severance package, an estimated \$34.7 million is a bit excessive. Indeed, the turmoil has triggered an expected shake-up in management, but the incoming crew warrants speculation about EDS' time horizon. Two new executives are coming out of retirement to help the company and many wonder how long they will stay given the situation.

The past few quarters have been rough on EDS. In the third quarter of 2002, the company stunned the market when it said earnings would be 80% below expectations after CEO Brown said they would meet their initial estimate. Recently, Moody's cut EDS' rating for the second time in three months. James Cramer of the TheStreet.com writes, "This is a troubled company that has done its level best to confuse those who are trying to figure out how bad things really are. 'You need a darned accountant to figure out how bad it really is' said one friend of mine who is neither long nor short the stock" While former CEO Brown was renown for his mega-deals, the terms of such deals presented serious cash flow issues. In order to lure such mammoth agreements, EDS agreed to eat up front investments required for the engagement as witnessed by the recent multi-billion dollar Navy deal.

Moreover, economic downturn has troubled many of EDS' clients. We see the renegotiation and trimming of current contracts to be a major problem. A recent class action lawsuit, faults among other complaints, that the contract structure of EDS allows current clients to renegotiate terms at will. Intuitively, we feel this is a necessary evil of the business. Why would a company engage in a multi-million dollar contract spread over several years without an exit door or parachute? Rather than lose customers all together, EDS allows for contract flexibility to retain the client given a capricious market. But what if those company's go bankrupt? Bankruptcy allows companies to void most outstanding contracts, possibly resulting in earnings restatements. EDS has a track record of picking true winners: United Airlines, American Airlines, US Airways, Xerox, and WorldCom.

Info Source: CBS Marketwatch, Yahoo Finance

Comparative Analysis

Comparable Valuation				
	EDS	INFY	Industry*	<i>Market</i>
P/S	0.38	12.08	0.61	1.09
P/E	7.57	44.75	16.81	44.15
P/CF	3.22	36.11	6.1	13.05
P/B	1.17	14.46	1.66	2.14

* Information Technology Services

Comparables				
	EDS	INFY	Industry*	Market
Day Sales Outstanding	107.74	54.41	88.06	60.21
Gross Profit Margin	24.19	51.01	30.09	47.67
Pre-tax Profit Margin	7.09	32.71	5.28	5.3
Net Profit Margin	5.19	27.17	3.67	2.44
ROE	15.9	32.6	10	4.8
ROA	5.9	29	4.2	0.8
Return of Invested Capital	10	32.6	7.1	2.3

* Information Technology Services

Source: Hoovers

In a unique and calculated way, we examined EDS as compared to the industry as well as a future play we will soon present, Infosys Technologies, an IT consulting gem out of India. While the valuation numbers for EDS appear astoundingly cheap relative to the market and certainly Infosys, we caveat by directing attention to the fact that EDS' stock price has taken a beating as of late.

Going forward EDS will rely on outsourcing contracts to help turn things around as miscalculated mega-deals find direction. But what does the competitive landscape hold for EDS? Industry leader IBM Client Services feels that it crush EDS when it comes to securing large multi-million dollar contracts without resorting to shouldering initial investments, a tactic that lead EDS to where it is now. EDS will be forced to reaffirm its niche as an outsourcing leader. But even the outsourcing market has left EDS scrambling. Companies such as Infosys and Wipro, both provide outsourcing out of India for substantially less than EDS and many other domestic outfits. Given the current market climate, global companies are turning to outsourcing to cut costs and accordingly select those that make the best offer. This has helped Infosys realize tremendous success in recent years. Relative to Infosys, it takes EDS almost twice as long to collect on sales. In addition, their gross margins are significantly smaller than that of Infosys, while they remain in-line with the industry.

Valuation Analysis

Implied price at S&P 500 PEG		
at E	1.61	\$19.78
at Growth	4.65	
at S &P PEG	2.64	

Firm	EDS				
source	Price		17.16	P/E(03)	11.00
Multex	E(03) projected		1.61		
Multex	LT Growth (projected)		4.65	PEG	2.37

Firm	INFY				
source	Price		61.75	P/E(03)	45.07
Multex	E(03) projected		1.37		
Multex	LT Growth (projected)		69.5	PEG	0.65

Firm	S&P 500				
source	Price		841	P/E(03)	15.85
S&P	E(03) projected		53.05		
S&P	LT Growth (projected)		6	PEG	2.64

Source: Dr. Thompson, Hoovers

Time 0 FCF= $2246 + (347 \cdot .66) - 1080 = 1395.02$

EDS Corp.

Cash Flows:	0	1	2	3	4	5	Terminal Value
	2002	2003	2004	2005	2006	2007	
CF Est.	1395.02	1534.5	1687.95	1766.4	1792.9	1876.3	24416.1
		1429.0	1463.9	1426.6	1348.5	1314.2	17101.5

Discount rate and growth analysis			
r	0.015	5% yr growth	0.0465
p	0.065	terminal growth	0.015
beta	1.2	LT WACC	0.0738
(stock)	0.093		
(debt)	0.07		
vs	0.59		
vd	0.41		
tax rate	0.34		
WACC	0.073812		

PV of Cash Flows & Valuation	
Firm value	24083.74
Existing Debt	5387
Implied Equity	18696.7
No. of Shares	477.2
Value/share	39.18

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Again, the fundamental valuation numbers show that there is potential for EDS. Our recommendation, however, does not place as much emphasis upon such calculations. We feel that many large outstanding deals (i.e. American) still have legitimate potential to sour resulting in a possible restatement of earnings.

Furthermore, one Warburg analyst remarked, "Percentage-of-completion accounting, which EDS uses to account for some contracts, provides great discretion as to when revenue is recognized. This makes it easy for the company to 'manage' its earnings." We are rightfully leery of such creative accounting schemes.

Source: CBS MarketWatch

Summary

EDS has fallen on hard times. Shares of late have tanked as a result of slumping new business bookings, contract renegotiations, and an ongoing formal SEC probe. The company has taken sufficient steps to address these issues, most notably shuffling management, but we remain apprehensive. There are too many red-flags not to take action at this point. The SEC probe, as well as other fuzzy accounting schemes, remains a serious concern. All of this comes at a time when the competition is turning up the heat. IBM, the industry leader, continues to steal multi-million dollar deals. Outsourcing threats from India are leaving EDS scrambling for direction. The Airline Industry, where EDS has considerable stake, is a powder-keg of problems. Indeed, it is a perfect storm of issues. While the valuation numbers look enticing, we feel that our interest and our client's money is best placed elsewhere within the industry.

INCOME STATEMENT

Period Ending:	Dec 31, 2002	Sep 30, 2002	Jun 30, 2002	Mar 31, 2002
Total Revenue	\$5,281,000,000	\$5,405,000,000	\$5,475,000,000	\$5,341,000,000
Cost Of Revenue	\$4,336,000,000	\$4,638,000,000	\$4,484,000,000	\$4,286,000,000
Gross Profit	\$945,000,000	\$767,000,000	\$991,000,000	\$1,055,000,000
Operating Expenses				
Research And Development	N/A	N/A	N/A	N/A
Selling General And Administrative Expenses	\$461,000,000	\$523,000,000	\$452,000,000	\$453,000,000
Non Recurring	(\$3,000,000)	N/A	N/A	N/A
Other Operating Expenses	N/A	N/A	N/A	N/A
Operating Income	\$487,000,000	\$244,000,000	\$539,000,000	\$602,000,000
Total Other Income And Expenses Net	(\$89,000,000)	(\$4,000,000)	\$5,000,000	(\$1,000,000)
Earnings Before Interest And Taxes	\$398,000,000	\$240,000,000	\$544,000,000	\$601,000,000
Interest Expense	\$17,000,000	\$111,000,000	\$66,000,000	\$64,000,000
Income Before Tax	\$381,000,000	\$129,000,000	\$478,000,000	\$537,000,000
Income Tax Expense	\$129,000,000	\$44,000,000	\$162,000,000	\$183,000,000
Equity Earnings Or Loss Unconsolidated Subsidiary	N/A	N/A	N/A	N/A
Minority Interest	N/A	N/A	N/A	N/A
Net Income From Continuing Operations	\$252,000,000	\$85,000,000	\$316,000,000	\$354,000,000
Nonrecurring Events				
Discontinued Operations	\$109,000,000	N/A	N/A	N/A
Extraordinary Items	N/A	N/A	N/A	N/A
Effect Of Accounting Changes	N/A	N/A	N/A	N/A
Other Items	N/A	N/A	N/A	N/A
Net Income	\$361,000,000	\$85,000,000	\$316,000,000	\$354,000,000
Preferred Stock And Other Adjustments	N/A	N/A	N/A	N/A

Net Income Applicable To Common Shares	\$361,000,000	\$85,000,000	\$316,000,000	\$354,000,000
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BALANCE SHEET

Period Ending	Dec 31, 2002	Sep 30, 2002	Jun 30, 2002	Mar 31, 2002
Current Assets				
Cash And Cash Equivalents	\$1,642,000,000	\$343,000,000	\$275,000,000	\$171,000,000
Short Term Investments	\$248,000,000	\$271,000,000	\$299,000,000	\$309,000,000
Net Receivables	\$6,435,000,000	\$6,426,000,000	\$6,230,000,000	\$5,866,000,000
Inventory	N/A	N/A	N/A	N/A
Other Current Assets	\$1,060,000,000	\$1,062,000,000	\$1,003,000,000	\$981,000,000
Total Current Assets	\$9,385,000,000	\$8,102,000,000	\$7,807,000,000	\$7,327,000,000
Long Term Assets				
Long Term Investments	\$276,000,000	\$954,000,000	\$954,000,000	\$935,000,000
Property Plant And Equipment	\$3,023,000,000	\$3,188,000,000	\$3,150,000,000	\$3,077,000,000
Goodwill	\$4,077,000,000	\$4,036,000,000	\$3,981,000,000	\$3,799,000,000
Intangible Assets	\$1,409,000,000	\$1,417,000,000	\$1,391,000,000	\$1,287,000,000
Accumulated Amortization	N/A	N/A	N/A	N/A
Other Assets	\$392,000,000	N/A	N/A	N/A
Deferred Long Term Asset Charges	\$318,000,000	N/A	N/A	N/A
Total Assets	\$18,880,000,000	\$17,697,000,000	\$17,283,000,000	\$16,425,000,000
Current Liabilities				
Payables And Accrued Expense ;	\$4,060,000,000	\$4,089,000,000	\$3,914,000,000	\$3,820,000,000
Short Term And Current Long Term Debt	\$1,239,000,000	\$50,000,000	\$12,000,000	\$37,000,000
Other Current Liabilities	\$830,000,000	\$681,000,000	\$693,000,000	\$500,000,000
Total Current Liabilities	\$6,129,000,000	\$4,820,000,000	\$4,619,000,000	\$4,357,000,000
Long Term Debt	\$4,148,000,000	\$5,141,000,000	\$4,613,000,000	\$4,586,000,000
Other Liabilities	\$1,113,000,000	N/A	N/A	N/A
Deferred Long Term Liability Charges	\$51,000,000	\$163,000,000	\$204,000,000	\$199,000,000
Minority Interest	\$417,000,000	N/A	N/A	N/A
Negative Goodwill	N/A	N/A	N/A	N/A
Total Liabilities	\$11,858,000,000	\$10,124,000,000	\$9,436,000,000	\$9,142,000,000
Stock Holders Equity				
Misc Stocks Options Warrants	N/A	N/A	N/A	N/A
Redeemable Preferred Stock	N/A	\$567,000,000	\$550,000,000	\$461,000,000
Preferred Stock	N/A	N/A	N/A	N/A

Common Stock	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000
Retained Earnings	\$7,951,000,000	\$7,662,000,000	\$7,647,000,000	\$7,404,000,000
Treasury Stock	(\$1,146,000,000)	(\$1,188,000,000)	(\$919,000,000)	(\$909,000,000)
Capital Surplus	\$901,000,000	\$918,000,000	\$946,000,000	\$927,000,000
Other Stockholder Equity	(\$689,000,000)	(\$391,000,000)	(\$382,000,000)	(\$605,000,000)
Total Stockholder Equity	\$7,022,000,000	\$7,006,000,000	\$7,297,000,000	\$6,822,000,000
Net Tangible Assets	\$1,536,000,000	\$1,553,000,000	\$1,925,000,000	\$1,736,000,000

CASH FLOW STATEMENT

Period Ending:	Dec 31, 2002	Sep 30, 2002	Jun 30, 2002	Mar 31, 2002
Net Income	\$361,000,000	\$85,000,000	\$316,000,000	\$354,000,000
Cash Flow Operating Activities				
Depreciation	\$384,000,000	\$370,000,000	\$350,000,000	\$339,000,000
Adjustments To Net Income	(\$96,000,000)	\$84,000,000	\$41,000,000	\$4,000,000
Changes in Operating Activities				
Changes In Accounts Receivables	\$38,000,000	(\$192,000,000)	(\$255,000,000)	(\$270,000,000)
Changes In Liabilities	\$347,000,000	\$78,000,000	\$92,000,000	\$32,000,000
Changes In Inventories	N/A	N/A	N/A	N/A
Changes In Other Operating Activities	\$18,000,000	\$10,000,000	(\$6,000,000)	(\$238,000,000)
Cash Flows From Operating Activities	\$1,052,000,000	\$435,000,000	\$538,000,000	\$221,000,000
Cash Flow Investing Activities				
Capital Expenditures	(\$183,000,000)	(\$196,000,000)	(\$312,000,000)	(\$282,000,000)
Investments	\$117,000,000	(\$75,000,000)	\$162,000,000	(\$122,000,000)
Other Cashflows From Investing Activities	\$193,000,000	(\$106,000,000)	(\$181,000,000)	(\$12,000,000)
Cash Flows From Investing Activities	\$127,000,000	(\$377,000,000)	(\$331,000,000)	(\$416,000,000)
Cash Flow Financing Activities				
Dividends Paid	(\$72,000,000)	(\$70,000,000)	(\$73,000,000)	(\$72,000,000)
Sale Purchase Of Stock	\$6,000,000	(\$308,000,000)	(\$18,000,000)	\$29,000,000
Net Borrowings	\$161,000,000	\$401,000,000	(\$8,000,000)	(\$117,000,000)
Other Cashflows From Financing Activities	(\$8,000,000)	(\$14,000,000)	(\$4,000,000)	\$1,000,000
Cash Flows From Financing Activities	\$87,000,000	\$9,000,000	(\$103,000,000)	(\$159,000,000)

Effect Of Exchange Rate	\$33,000,000	\$1,000,000	N/A	\$4,000,000
Change In Cash And Cash Equivalents	\$1,299,000,000	\$68,000,000	\$104,000,000	(\$350,000,000)

Source: YahooFinance