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IT SERVICES

Updated 2/08/08, 2:30PM

Analysis of EDS's Fourth Quarter Business Results

Profit Drops, Stock Follows

Yet Strong Fourth Quarter Sales Signal Better Times Ahead

SCOTTSDALE, Feb 8 – Electronic Data Systems Corp. (EDS) shares fell almost 9% Thursday after the computer services and consulting giant reported a 13% drop in its fourth-quarter earnings, and offered lower-than-expected forecasts for its first quarter and full-year 2008 outlook. EDS said fourth quarter revenues rose 2% to \$5.83 billion from \$5.7 billion in the same quarter a year ago. But net income fell to \$189 million, or 36 cents per share, from \$217 million, or 40 cents per share, in 2006.

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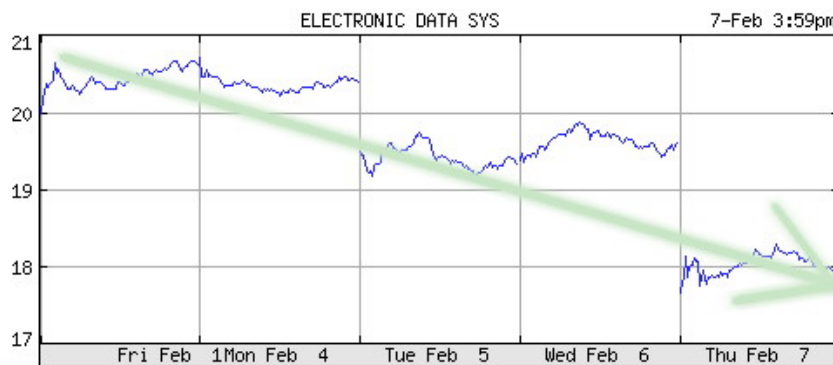
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A sinking feeling... EDS stock drops sharply after 4Q release

As a result, EDS shares sank Thursday for a third day in a row, closing at at \$17.90. And the stock continued to slide today (Feb 8), losing another four points of market value to \$17.15 as of the time of this report. The stock has now lost more than 40% of its market value since Michael Jordan stepped down as CEO last summer.

During his four years-plus as CEO, Jordan had become Wall Street's darling by cutting costs and transferring contract



fulfillment jobs to India. Except in his last full year as CEO (2006), however, Jordan has done little to inspire investors' confidence in the company's ability to grow sales and develop new markets. Ironically, that's exactly what the new CEO, Ron Rittenmeyer, has been trying to do during the time the stock has been slumping.

Strong New Bookings

For example, EDS signed \$6.1 billion in new contracts in the fourth quarter 2007, including seven with values greater than \$100 million. The 2H07 total contract value was \$11.8 billion, the best second-half sales performance since 2001. The overall 2008 sales pipeline is up 10% from a year-ago, the company said.



Full-year 2007 total contract value was \$19.5 billion, down 26% from \$26.5 billion the prior year, which included some exceptionally large deals. Excluding the multibillion dollar contract renewals with General Motors and the U.S. Navy in 2006, total contract value increased 2% year-over-year. In 2007, EDS signed 28 mega-deals (contract values greater than \$100 million) versus 26 such deals in 2006. New logos accounted for \$3.5 billion of total contract value in 2007.



"We are pleased with recent booking trends," Rittenmeyer said during the teleconference with analysts. He also noted that a number of large contracts for which EDS was "down-selected to one" slipped from the fourth quarter of 2007 into 2008. "Our people did a good job, and I feel good about it," he added in an interview with the Dallas Morning News.



Fickle Wall Street

But Wall Street seemed preoccupied with its own minutia... which in EDS's case meant coming short of its 57 cents per share earnings analysts had been expecting on overall revenue of \$5.88 billion. And so, the stock continued its southward slide. Losses related to restructuring charges may have contributed to it.

EDS said an early retirement offer for U.S. employees accounted for a decline in its fourth-quarter earnings. EDS executives said in post-earnings conference call there's no sign that a cooling economy is hurting the company. The fourth quarter 2007 early retirement offer cost the company \$154 million, or \$0.18 per share.

The company also had net after-tax losses associated with discontinued operations of \$13 million, and pre-tax items as follows: a write-off of acquired in-process research and development of \$6 million, and a reversal of previously recognized restructuring expenses of \$4 million.

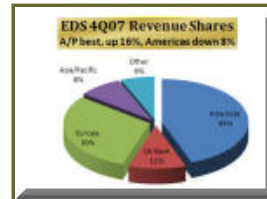
But EDS sounded optimistic about the general business climate in which it was operating.

"The economic slowdown that everybody is concerned about, we do believe it is important, and it is something we are watching, but we also feel we are in a pretty good position," Ron Rittenmeyer, EDS chairman, president and chief executive, said in a conference call.

For the full year, EDS revenues rose to \$22.1 billion from \$21.3 billion in 2006. Profit jumped to \$716 million, or \$1.40 per share, from \$470 million, or 91 cents per share.

Business Segment Analysis

Americas: Fourth quarter revenue was \$2.6 billion, down 8% compared to the prior-year period. Operating profit was \$394 million, down 28% from 2006, driven primarily by the Verizon contract termination.



U.S. Government: Fourth quarter revenue was \$624 million, flat compared to the prior-year period. Operating profit was \$92 million, down 34%, due primarily to contractual price reductions.

Europe: Fourth quarter revenue was \$1.8 billion, up 3% from a year ago. Operating profit was \$352 million, up 15% from 4Q06.

Asia/Pacific: Fourth quarter revenue was \$478 million, up 16 percent compared to the prior-year period. Operating profit was \$71 million, up 41 percent from \$50 million in the prior-year period, driven primarily by MphasIS and improved contract performance in the region.

Outlook

For 2008, EDS expects revenue of more than \$22.5 billion and adjusted earnings per share of about \$1.35, and hopes to sign new contracts worth more than \$20 billion. The company also expects free cash flow of about \$900 million.

So 2007 was by no means a barn-burning year for EDS. But it was a year of solid sales growth and of repositioning of the company's strategies to take advantage of the higher margin deals in the marketplace (see "[Moving Up the Stack](#)," Feb 2007).

As a result, we think that Wall Street's pessimism about the EDS future under Ron Rittenmeyer is exaggerated, just like its ebullience may have been overstated in the early years of the Michael Jordan era.

Annex Clients: [CLICK HERE](#) for detailed EDS P&L tables & charts

Happy bargain hunting!

Bob Djurdjevic

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