ANNEX BULLETIN

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A CONFIDENTIAL Client Edition

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IT SERVICES

Updated 5/31/06, 10:50PM PDT, adds Competitors Chart

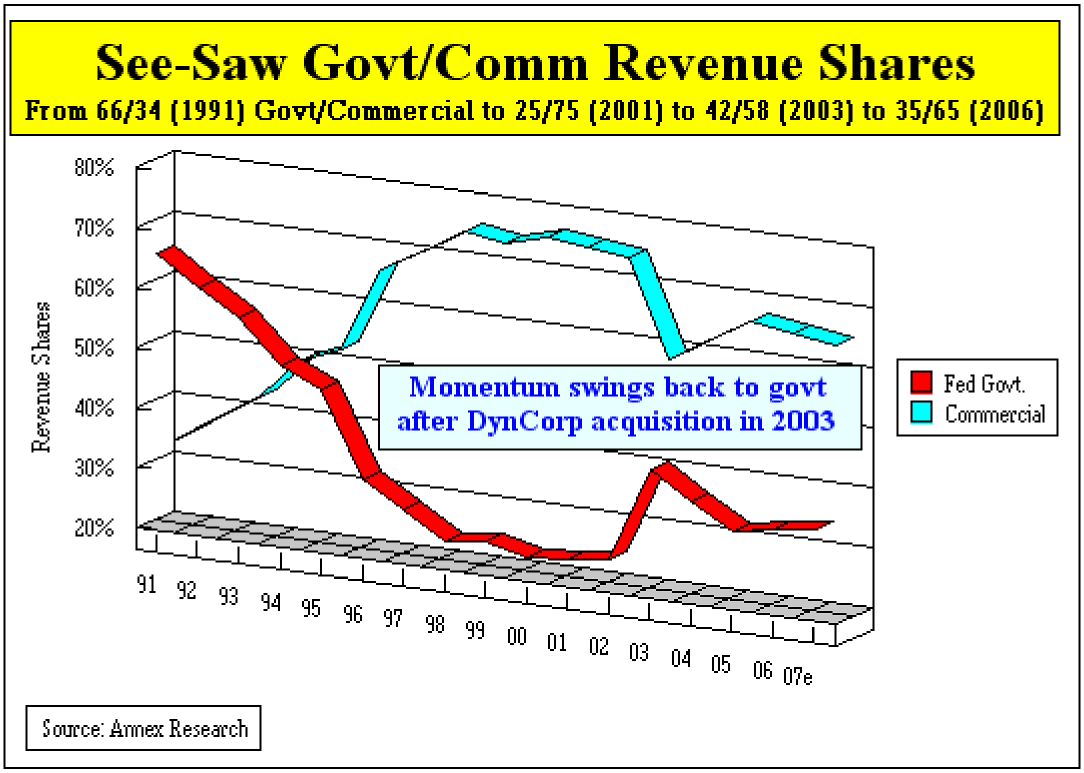
Analysis of Computer Sciences' FY2006 Business Results

Up for Grabs

Those Who Can Do; Those Who Can't Sell Out; Or Buy Back Own Shares; Time for Change at Helm?

ST. PETERSBURG, Russia, May 25 - "Those who can do; those who can't teach," goes an old proverb. Applied to Computer Sciences Corp. (CSC) latest results, the modified saying would be "those who can do; those who can't sell out; or buy back own shares."

After the disappointing fourth quarter results (flat revenues; halved profits); that capped a flaccid year (FY06; ended Mar 31 - revenues up only 2%; profits down 15%), sharply contrasted by stellar results of its major competitors, CSC management's recipes for the turnaround seem to be "look for a buyer" and/or "buy back shares." They might as well have put up a sign "gone fishing," or "see you at 19th green."

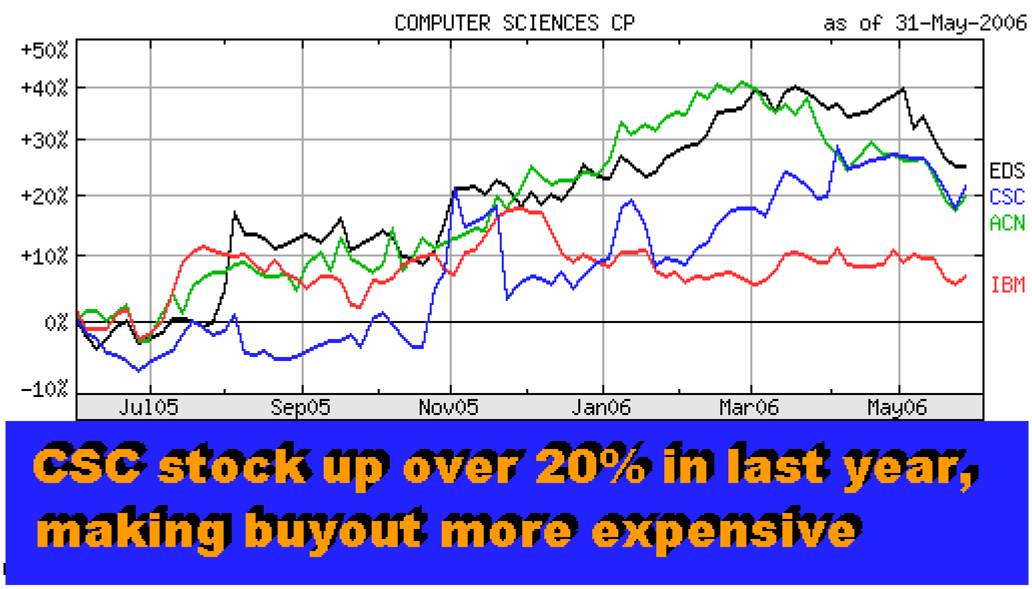


And who can blame Van Honeycutt, the CEO, or Leon Level, the CFO, for thinking that way at their ages (61 and 64 respectively). They've been doing their part for years, and now it's somebody else's turn. Alas, there is no "Mark Hurd" in sight that would resuscitate CSC back to life. In fact, the real Mark Hurd and his much younger HP executive team may be some of the would-be buyers who may help Honeycutt and Level get to the golf course faster.

During the post-release call, Honeycutt said the company is going through a "strategic review" to evaluate its options. They include, the possibility of acquiring another company or being acquired or buyback shares, "depending on what is best for shareholders."

"The first priority is to pick the option that most enhances shareholder value," Honeycutt said. "When we have done that, we will report fully to you. And that's just all I have to say about that."

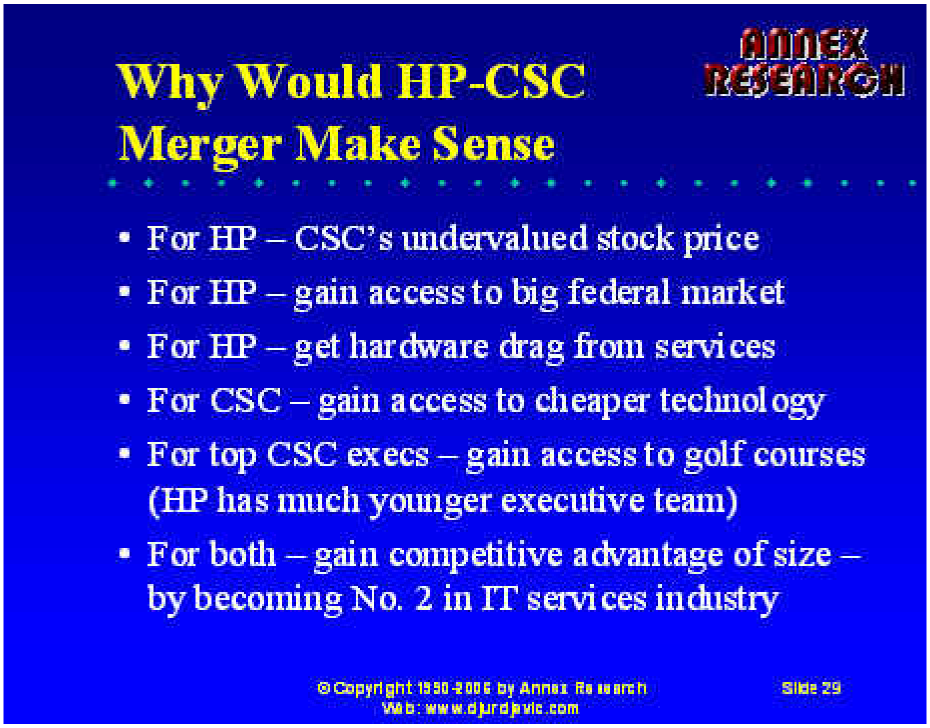
Wall Street got the hint, though. The CSC stock initially gave up as much as 4.2% to $52.41 in the wake of the results and forecast, issued after the close of trading Tuesday (May 23). The shares have since bounced back into the $56-range, probably buoyed by the possibility that an eventual suitor would pay a premium price for the company.



HP-CSC Merger?

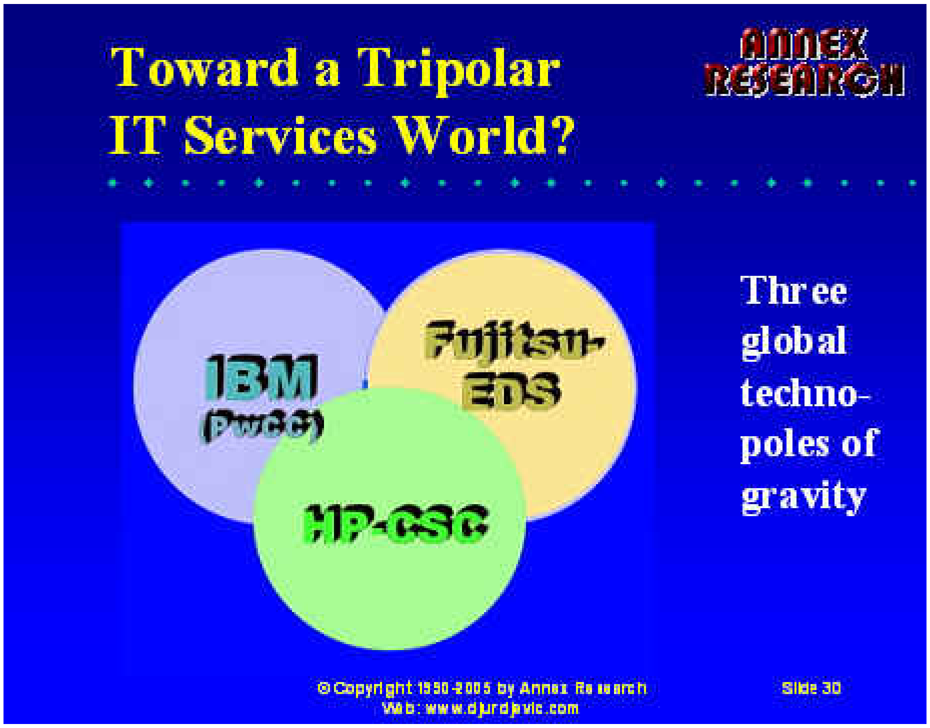
Ironically, such increases mitigate *against* a CSC buyout by making the target company more expensive for a potential suitor. As you can see from the above chart, CSC stock has already appreciated over 20% since a year ago, about the same as Accenture's, for example, even though the two companies' fundamentals are vastly different (see "Accenture Wins 'Gold'," Apr 2006).

One possible CSC suitor that's been mentioned was HP, a company whose stock has experienced one of the industry's most dramatic turnarounds since Mark Hurd took over in April 2005. Would an HP-CSC merger make sense? That's a question we have been asked by our clients and the media ever since the rumor started in early January.



It might (make sense). For reasons why, see the above chart. But it would depend on the price. The way the stock market has been pushing the CSC stock upward despite its tepid business results, would only mitigate *against* it. So out No. 1 reason for such a merger is getting less and less compelling. That's the irony we had mentioned before.

Toward a Tripolar World?



Should such an HP-CSC merger ever take place, it would push the IT services industry in the direction of a tripolar world. IBM, Fujitsu and HP - the three leading conglomerates and technological foundries - would be at the center of gravity in each of the three techno-universes (see above chart).

And where would that leave the "pure" consulting companies, such as Accenture or Capgemini or BearingPoint, for example? Guess looking to build arms-length alliances on a deal-by-deal basis, as they have been doing till now. Or putting themselves up for adoption by one of the three "solar systems." Either way, the declining growth in the global IT services industry seems to be pointing toward stratification and higher concentration at the top of the industry's food chain.

Business Results

Meanwhile, back to CSC's latest results, the company reported net earnings of $199.4 million, or $1.05 a share, for the quarter. A year ago, the IT services company had $411.8 million, or $2.13 a share. Last year's number included $245.2 million in income from discontinued operations.

The fourth-quarter results actually beat the Street's expectations, but the CSC executives' guidance for the current quarter sent the shares lower in after-hours trading. CSC said EPS would be in the mid-60-cent range, excluding options, and sales will range from $3.4 billion to $3.5 billion. Analysts had anticipated that the company would earn 69 cents a share on sales of $3.71 billion.

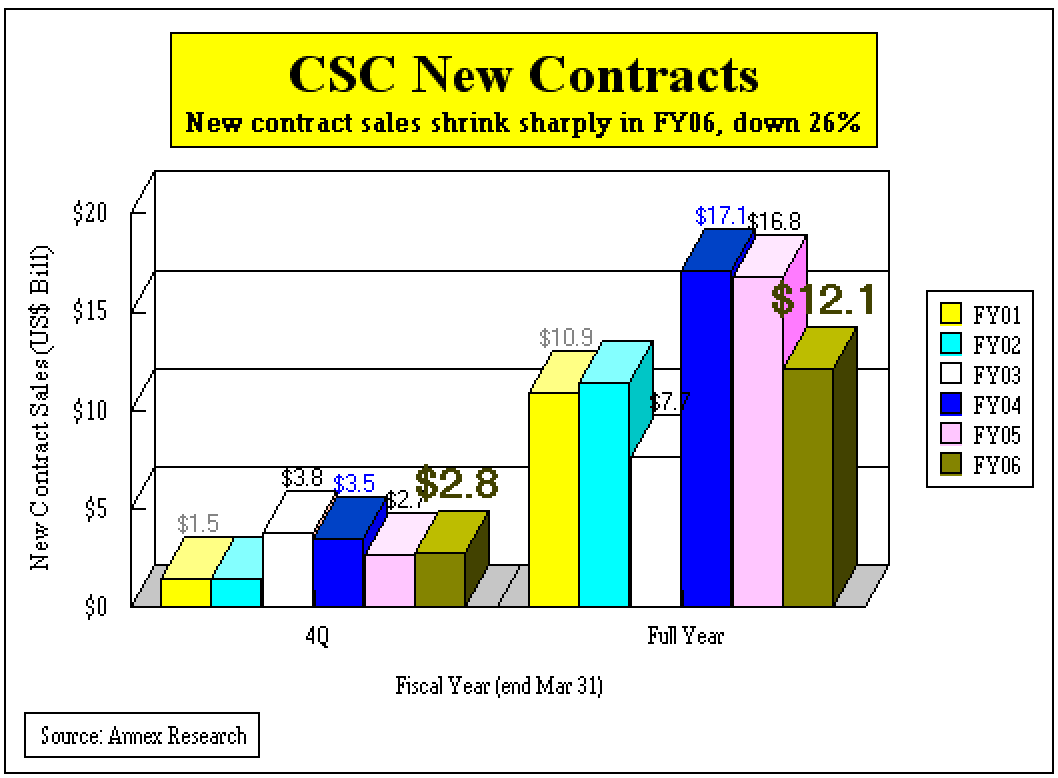
Excluding certain items, the company earned $218.9 million, or $1.16 a share in the fourth quarter, up from $185 million, or 96 cents a share a year ago. On that basis, the company beat consensus numbers from Thomson First Call analysts, who were looking for $1.13 a share.

Revenue for the quarter was $3.88 billion, level with that a year-ago. Wall Street had predicted the company would earn $3.86 billion in revenue.

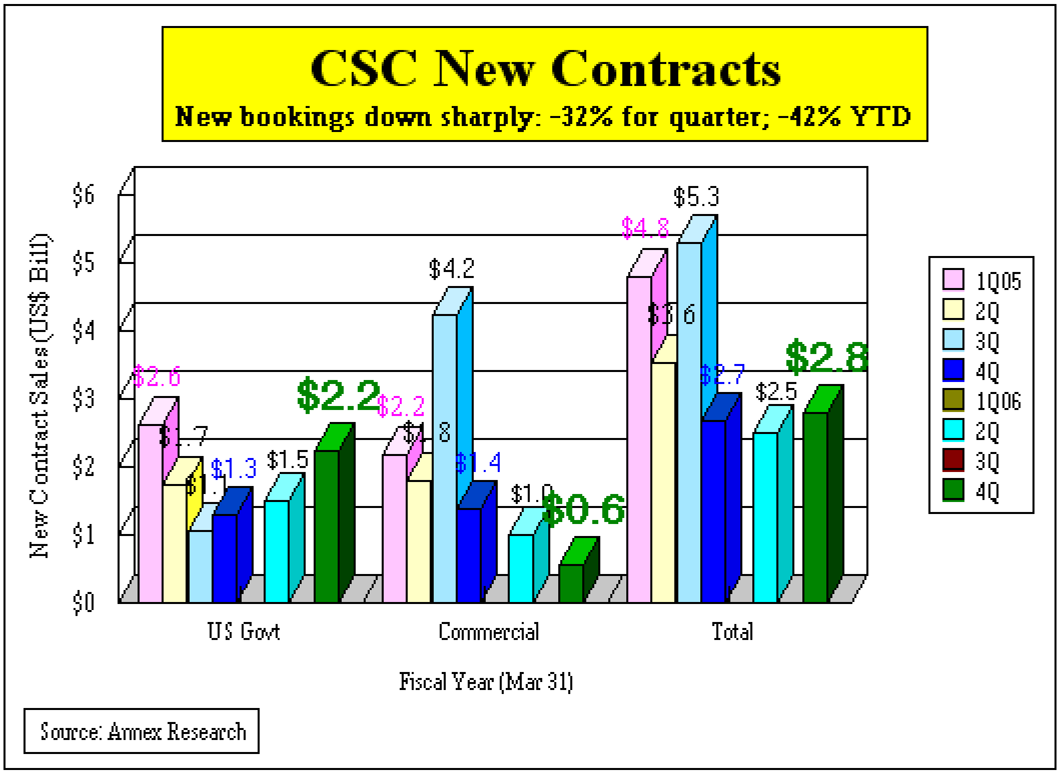
For full fiscal 2007, CSC said EPS would be between $3.61 and $3.71, including options. Wall Street had predicted $3.62 a share. The company said revenue would be up 2% to 3% for the year, suggesting revenue of $14.9 billion to $15.1 billion. Analysts were calling for $15.4 billion at the top line.

New Contracts Down Sharply

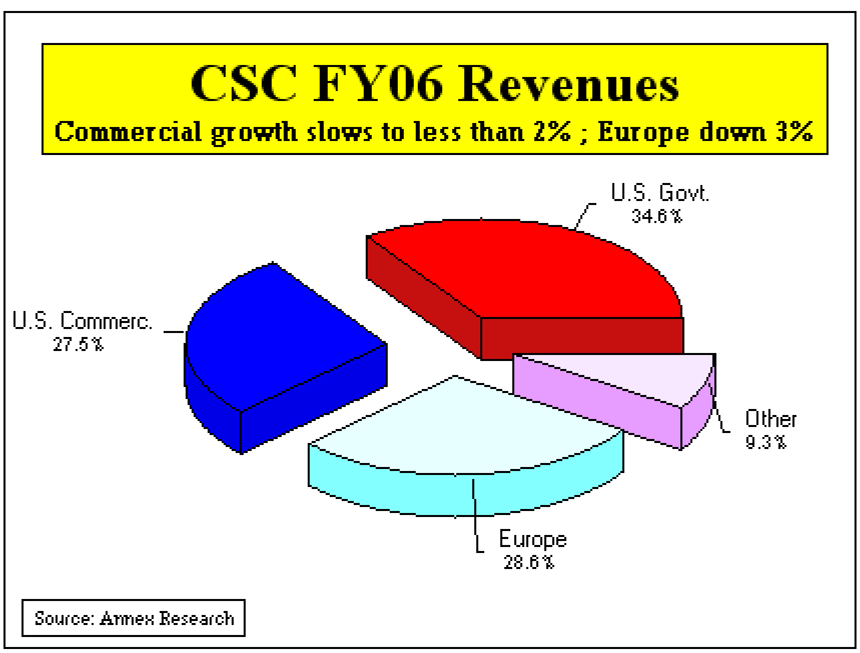
One reason for the downcast outlook and meager growth in FY07 is a sharp decline in the new contract signings that the company experiences in FY06, especially in the commercial sector. For the full year, new bookings totaled $12.1 billion, down 26% from the previous year's total (from continuing operations - see the chart).



The company tried to bury this bit of negative news in its release, and to cover it up by hailing the $12.1 billion as "the third-highest announced annual award total in the company's history." But it also happens to be the second consecutive *decline* in CSC's new contract sales (see the chart), and just a tad higher than the company's sales performance four and five years ago (FY01 and FY02).



Furthermore, commercial sector new business awards had all but dried up in the fourth quarter (about $600 million). As a result, they accounted for only 41% of the total for the full fiscal year. And that should be a cause for alarm, not self-congratulations, such as the above news release statement.

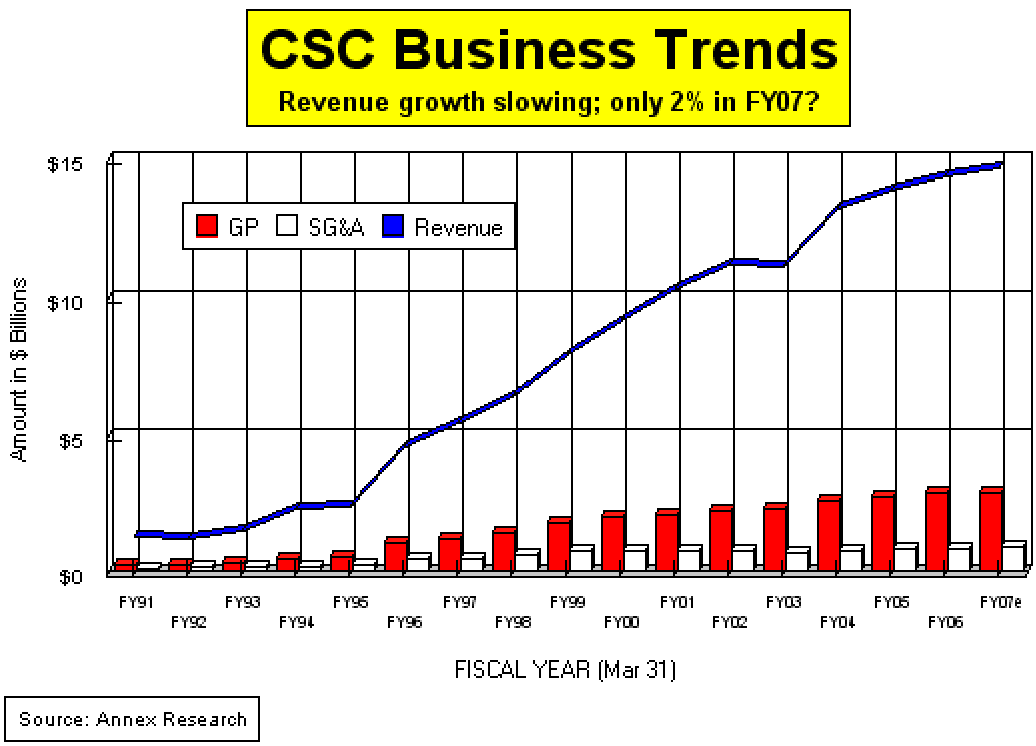


Furthermore, CSC seems to be running out of steam in Europe, a $4.2 billion-CSC unit, bigger than the U.S. commercial ($4 billion). That's the market in which the company showed strong growth the year before. In the latest fiscal year, however, its European revenues declined 3%, from $4.33 billion to $4.18 billion.

Another Passenger on Crowded Ship to India

And what is CSC doing about it? Nothing that we heard. CSC executives also told the analysts that they are planning to reduce headcount by 4,300 employees in 2007, and by 700 in 2008. Pretax restructuring charges will total $375 million. The company said it also plans to relocate 2,000 jobs to India.

Now that's an "original" thought! (Most of CSC competitors already have tens of thousands of people in India). Another passenger on a ship to India. And that's going to boost the growth and the new contract sales?



Hm... CSC leaders sure sound tired and devoid of new ideas. Maybe it is time for someone else to take a turn at the helm, try to shake things and re-energize the company? Ever heard of Hurd? Then you know he is nobody's fool. So the CSC stock would probably have to drop quite a bit before that happens. If at all.

For detailed tables, click on CSC FY06 P&L, and CSC Worldwide Results

Happy bargain hunting

Bob Djurdjevic

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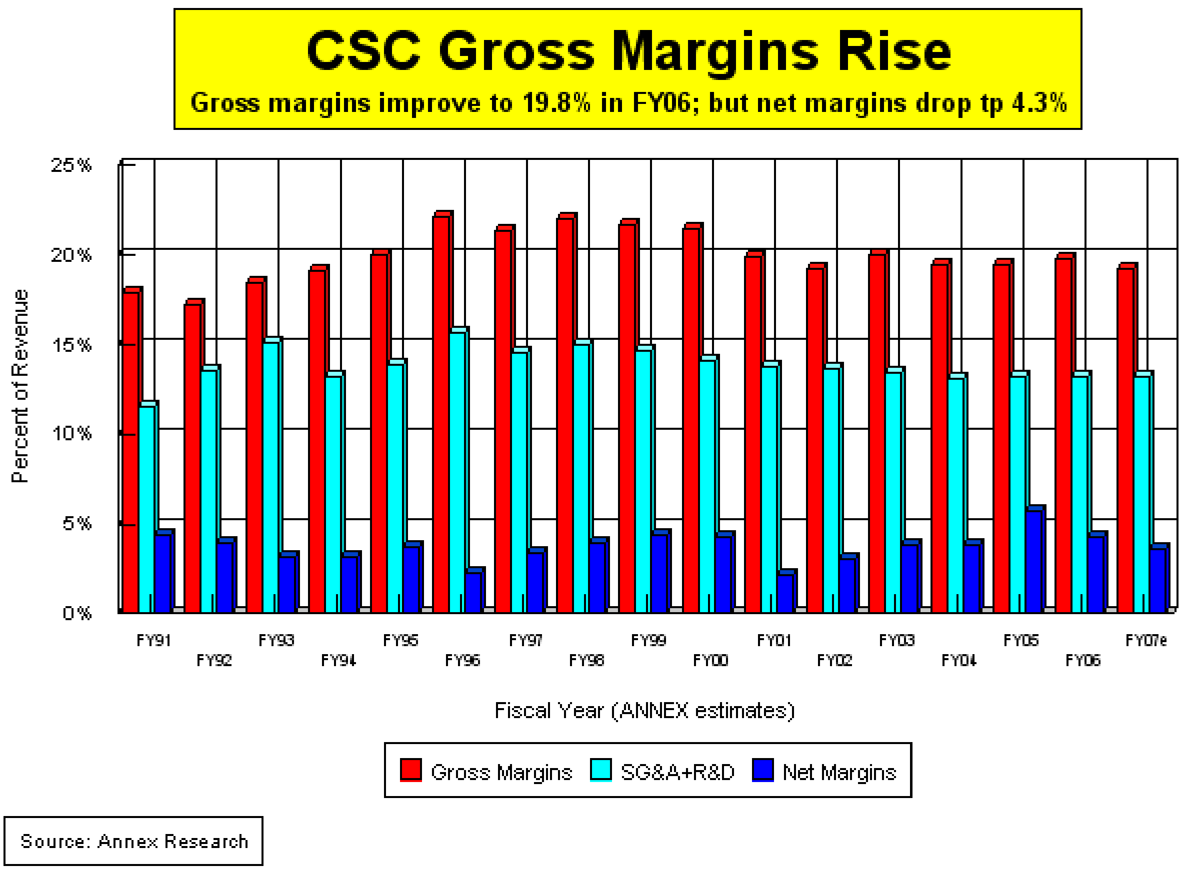

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