



**CDW  
CORPORATION  
(CDW)  
OVERWEIGHT**

**GAINING MARKET SHARE; HIGHER OP  
MARGINS; INITIATE BUY & TARGET 131**

09/28/2020

# CDW CORPORATION (CDW) OVERWEIGHT

**GAINING MARKET SHARE; HIGHER OP MARGINS; INITIATE BUY & TARGET 131**

## THESIS

We are initiating a buy rating following CDW's strong Q2 earnings results. We value it at 18x P/E with a target price of \$131, representing a 16% upside as of September 27th, 2020. We are confident that CDW would continue to gain market share in the cloud service sector given its strong competitive advantage, while its improving strength in the balance sheet also sets up perfect opportunities for potential acquisitions. Meanwhile, its public segment will remain resilient as people continue to work from home, and we also expect a higher operating margin for the next two quarters due to an improving product mix.

## KEY DRIVERS

**Gain market share amid market consolidation.** CDW currently has a 5% market share in the cloud solutions sector that has a \$360 billion total addressable market. Over the past 10 years, CDW's net sales recorded a 9.7% CAGR, while overall IT spending in the US had a 5.3% CAGR. CDW was able to consistently outperform the sector due to the long-term relationships it has established with fast-growing cloud service vendors and customers such as Apple, Amazon, NVidia, Intel, Zoom, and Zscaler. We expect CDW to continue to gain market share as its customers and vendors rely more on its resilience and market-leading scale amid rising market uncertainty.

**Improving leverage ratio** to support future acquisitions. Over the past 10 years, CDW's debt-to-EBITDA level has declined almost every year from 7.57 in 2010 to 1.98 in its most recent quarter. Its operating cash flow also grew more than 5 times during the same period. In 2019, CDW acquired Aprtris and Scalar Decisions that helped solidify its market leadership in the cloud service sector. We expect CDW to continue to acquire small, innovative players in the cloud service sector while its debt level edges lower every year.

**Stronger revenue growth** in the public segment due to increase in government spending, structural shift to virtual educational environment, and stronger demand for healthcare. CDW's public sector saw the most revenue growth in the past two quarters as Covid-19 has forced employees to stay at home, and thus the demand for home laptops and desktops increased drastically. Although the pandemic is gradually recovering, we continue to see strong demand for this segment as we see a large-scale ongoing structural shift from working in office to working from home. In particular, we see rising demand in laptops, desktops, network communication products (VPN and stronger wifi), and cloud storage for people who choose to work from home.

**Growing operating margin** in the public and small businesses segments. In Q2 2020, CDW reported higher operating margins in all its segments, including corporate, public and small businesses (as shown in chart). We expect its operating margin to continue to rise in the next two quarters due to higher ASP for its service products. We see a 5-10% upside in ASP and 10-15% volume growth in their cloud service products.

PRICE:  
**US \$112.74**  
(Reflects price on 9/26/20)

TARGET:  
**US \$131.00**

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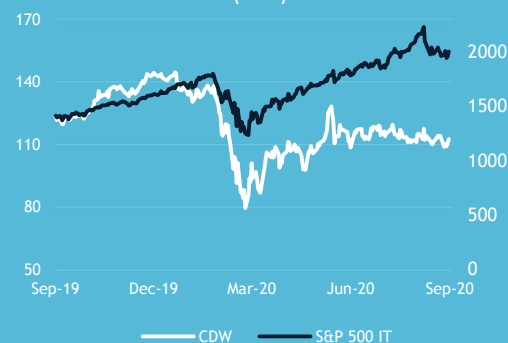
### Rohan Sanjay

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## SUMMARY

Rating	Buy
Price Target	US \$131.00
FY20E Rev (mil)	US \$17,545.2
FY20E EPS	US \$5.59
52-Week High/Low	US \$73.39 / US \$146.09
Shares Out (mil)	142.67
Market cap. (mil)	US \$16,085.00
Net Cash/Share	9.17
Price/Earnings	24.2
Price/Book	16.7
Price/Sales	1.0
Price/Cash Flow	15.8
EV/EBITDA	14.2
Quick ratio	1.3
Current ratio	1.5
Dividend	1.2%

## CDW STOCK PERFORMANCE (1Y)



## COMPANY OVERVIEW

CDW offers 100,000-plus information technology products, including notebook and desktop computers, software, printers, servers, storage devices, networking tools, and accessories under more than 1,000 brands. CDW's solutions are delivered in physical, virtual and cloud-based environments to 250,000 business, government, education and healthcare customers in the US, UK, and Canada. The company was founded in 1984 by Michael P. Krasny and it is headquartered in Lincolnshire, IL.

## COVID-19 IMPACT ON THE CLOUD SOLUTIONS SECTOR

CDW is part of the information technology services industries. The main players are International Business Machines Corporation, Cisco Systems, Inc., Accenture, CDW, Cognizant Technology Solutions, Leidos Holdings, VMware, Inc., SHI International, SAP America, and Insight Enterprises. The industry has a P/E ratio of 22.5. Performance is currently -2.9% over the past month, 10.1% over the past 3 months, 29.6% over the past 3 months, and 11.9% YTD. 2020 sales growth is at 1.4%, net margin is at 12.0%, and EPS growth is at -3.0%.

The COVID-19 pandemic has affected most technology companies, and it is impossible to predict when the crisis will end and what the impact will be. Nonetheless, cloud services are at the highest rates of demand along with videoconferencing and remote collaboration tools. The industry as a whole is expected to have a market boom from \$131 Billion in 2020 to \$295 Billion by 2025. Especially with COVID-19, people are recognizing the vital role that technology companies play in streamlining communication and many other necessities of daily life. As such, despite losses suffered from the pandemic, the outlook for the information technology services industry as a whole is positioning industries for a stronger future.

## RESILIENCE SHOWN IN Q2 RESULTS

CDW announced its 2020 Q2 earnings on August 5th, 2020, and results varied due to impacts of the COVID-19 pandemic. The firm reported \$1.56 EPS for the quarter, which beat estimates of \$1.38 by \$0.18. It earned \$4.37 billion during the quarter, right

around expectations of \$4.36 billion. Current price-to-earnings ratio is 21.8, and the company has generated \$6.02 earnings per share over the last year.

Quarterly results indicated that Net sales decreased \$264 million from Q2 2019 to \$4,366 million, down 5.7% on a reported and average daily sales ("ADS") basis and 5.3% on an ADS constant currency basis. Operating income decreased 5.6% to \$283 million and net income decreased 3.8% to \$189 million. Year to date, net sales increased \$167 million from Q2 2019 to \$8,755 million, up 1.9% on a reported basis, 1.1% on an ADS basis, and 1.5% on an ADS constant currency basis. Operating income remained flat at \$529 million and net income increased 2.2% to \$357 million.

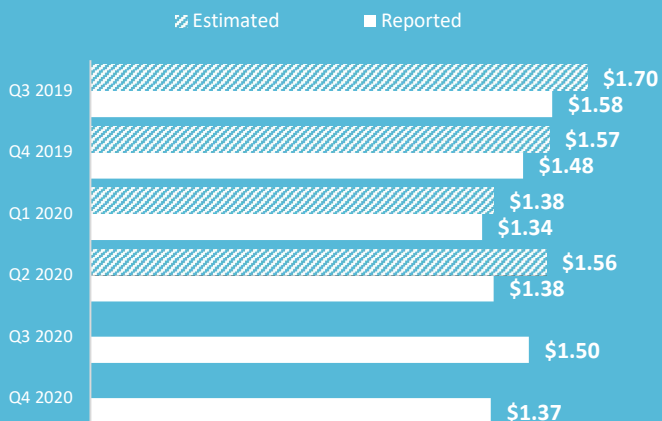
As shown in the chart below, CDW has consistently outperformed its EPS expectation for the past four quarters. On average, it reported earnings that are 7.34% above market consensus. We expect its EPS to be \$1.50 and \$1.37 for the two upcoming quarters, representing a -5.1% and -7.4% YoY decline respectively.

The company followed a combined power of business model and strategy, which included a balanced portfolio of customer end-markets, diverse product and solutions portfolio, and a three-part strategy for growth. The three steps of the three-part growth strategy are to capture, share and acquire new customers, enhance capabilities in high-growth solutions areas, and expand services capabilities.

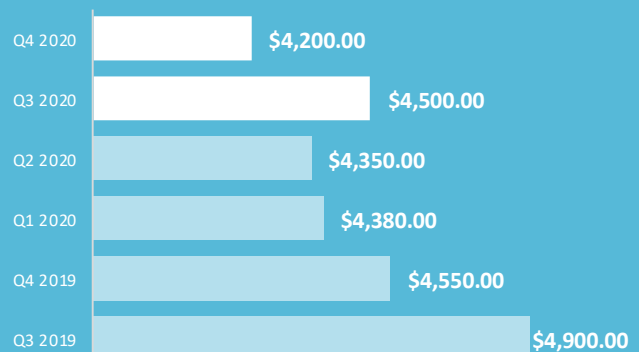
In response to COVID-19, the company has worked to safeguard the health and well-being of our coworkers, serve the mission-driven needs of our customers, and support its communities, including efforts to contain and slow the virus.

The capital allocation priorities are to increase dividends annually, maintain net leverage ratio, supplement organic growth with M&A, and return excess free cash flow after dividends and M&A through share repurchases. Objectives include target ~25% payout of Non-GAAP net income, grow in-line with earnings, maintain ~2.5 to 3.0 times Net leverage ratio, expand CDW's strategic capabilities, and offset to incentive plan dilution and to supplement EPS growth. Thus far in 2020, CDW has declared Q2'20 dividend on August 5th, maintained net leverage ratio currently at 2.0x, prioritized liquidity but will remain opportunistic (IGNW acquisition announced July 1st), and suspended share repurchase program

### ESTIMATED VS REPORTED



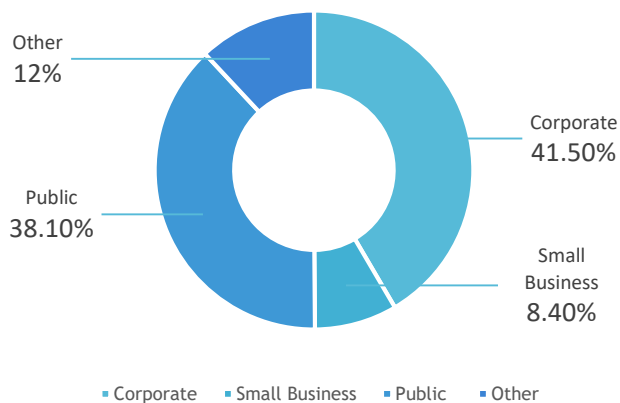
### REVENUE (IN MILLIONS)



## BALANCED REVENUE MIX

For the full year of 2019, CDW saw revenue increase around 11% with strong growth seen in all four of their product segments but most notably in their public product segment. CDW's main segments include Corporate, Small Business, Other, and Public solutions that include products and services provided for and sold to various organizations. The Corporate business segment that also encompasses their small business segment, represents a combined 50% of total revenue and saw modest growth in 2019. This segment includes IT hardware, software, and IT security solutions that large corporations rely on to conduct business. Like their corporate segment, their public revenue segment, which makes up about 38% of sales, is broken down further and represents hardware and software sales to education, healthcare, and government organizations. The final revenue segment of CDW is their other revenue segment, which makes up 12% of total revenue and represents their shift towards consulting services in the IT management sector with modest growth seen in this segment over the last few years.

### REVENUE MIX



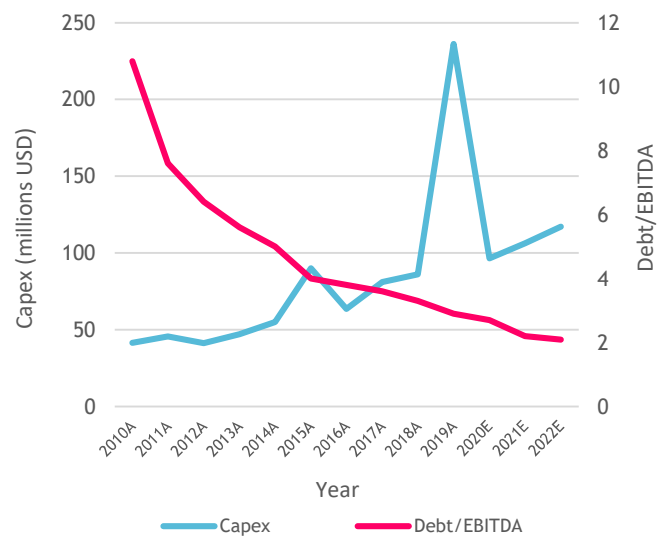
Looking forward to 2020, due to the recent business disruption that has faced many businesses, including CDW, our topline projections for the first year reflect management's guidance of a decrease in revenue growth of around 2%. Although management is expecting a steep drop in its corporate revenue segment, management has noted some bright spots and acceleration in their education and healthcare revenue segments in particular. Management has guided for revenue growth YoY in these two segments to increase by 12% and 2% respectively. With the drop in revenue that we have seen so far in the first two quarters and managements upbeat guidance, we expect a strong bounce back in revenue growth in the back half of 2020 and continuing into 2021.

## RISING CAPITAL EXPENDITURES

As shown in the chart, CDW's net leverage ratio has been declining almost every year since 2010, from above 10.0 in 2010 to below 2.0 in 2021. During the same period, CDW's capital expenditure has been rising slowly, with a spike in 2019 due to the acquisitions of Aprtris and Scalar Decisions. We expect CDW to continue to raise its capital expenditure in the next two years with more acquisitions to come as the sector consolidates and CDW's balance sheet strengthens. CDW should see a 10-15%

market share gain from acquisitions of smaller cloud solutions players within the next two years.

### CAPEX VS NET LEVERAGE RATIO

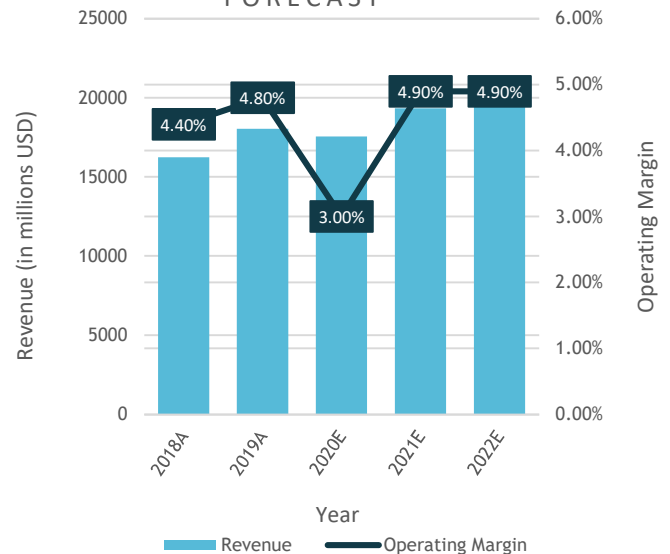


## DCF MODEL BREAKDOWN

### Margin Expansion

Similar to our revenue projections we expect short term pressure on operating margins as the Coronavirus weighs on the different segments of CDW. Despite these near term challenges and drop in operating margin in 2020 our group kept operating margins relatively stable moving forward. While we do see opportunity for CDW to continue growing their market share within the fragmented IT segment, we expect to see CDW take on more of an acquisition based approach to growth to continue increasing market share at a similar rate to their historical average. This shift towards an acquisition based growth combined with an increase in advertising spend is why we expect a small increase in EBIT margins from 4.8% to 4.9% from 2019 to 2025.

### REVENUE AND OP MARGIN FORECAST



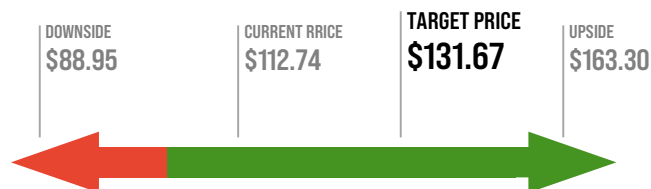
## WACC AND LONG-TERM GROWTH RATE

For our valuation, we discounted cash flows at a weighted average cost of capital using 7.61%. Our group referenced Factset data regarding the company's equity and debt percent of financing and the cost of each to arrive at our weighted average cost of capital. Given the predictable nature of CDW's business model, stable revenue growth, and high returns on capital that they have exhibited we feel comfortable with our WACC calculation. With CDW's calculated ROIC of around 15% and weighted average cost of capital at 7.61% CDW is earning sustainable economic profits. Our long term growth rate of 2.5% is consistent with our belief that CDW will at a minimum grow in line with U.S. GDP in perpetuity.

		VALUE					
		DISCOUNT RATE					
TERMINAL GROWTH RATE		\$130.53	7.11%	7.36%	7.61%	7.86%	8.11%
	2.00%	\$136.18	\$128.02	\$120.59	\$113.80	\$107.58	
	2.25%	\$142.18	\$133.34	\$125.34	\$118.07	\$111.42	
	2.50%	\$148.82	\$139.22	\$130.57	\$122.73	\$115.60	
	2.75%	\$156.22	\$145.73	\$136.32	\$127.85	\$120.17	
	3.00%	\$164.53	\$152.99	\$142.71	\$133.49	\$125.18	

## TAX RATE

Given the passage of the Tax Cut and Jobs Act of 2017 the effective corporate tax rate was lowered from 35% to 21% and this change is therefore reflected in our model. With 90% of CDW's revenue coming from the United States and given the political uncertainty moving forward we feel comfortable holding our projected tax rate for CDW at 24% slightly above CDW's past 3y average tax rate of 22%. Although CDW's historical tax rates have remained consistent this higher tax rate of 24% reflects our conservatism and provides us with room for error should any one-time impairment or tax rate change happen in the future.



## A VALUE-DRIVEN APPROACH

To arrive at our base case valuation for CDW, our group used a 10-year discounted cash flow model. After projecting revenue and expense growth over our five-year horizon we arrived at a price to value of 0.85 and an intrinsic value per share of \$131 based on a 7.61% WACC and a 2.5% Long term growth rate.

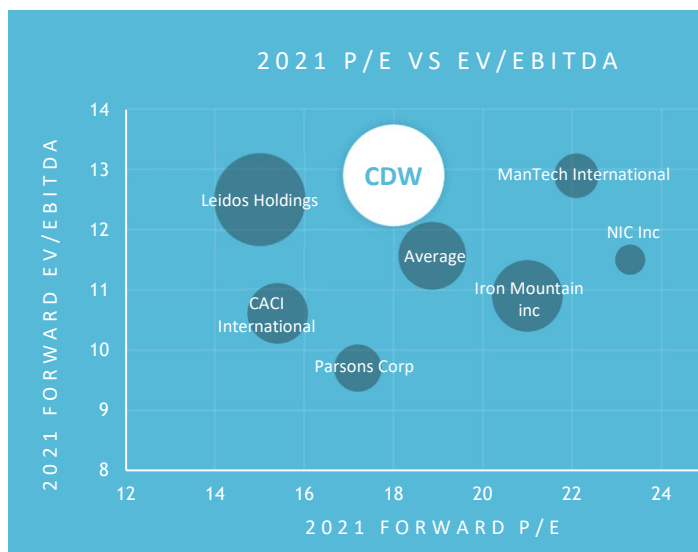
Our upside valuation case of \$163 is based on a strong acceleration in revenue growth specifically in the government, education and healthcare segments as a result of a potential for increased demand. This upside valuation reflects a belief that a second wave of infections is not realized and that CDW is able to manage costs effectively while capitalizing fully on work from home trends.

Our downside valuation of \$89 reflects greater than anticipated slowdown in revenue across the board as a result of the coronavirus. With the potential for a second wave of coronavirus infections as a possibility CDW could see further downside resulting in decreased demand in certain revenue segments like corporate and small business solutions. Although second wave infections remain a possibility CDW has navigated this crisis well and is well positioned to capitalize on the tailwinds of this new work from home environment moving forward.

Given CDW's long history of consistent and sustainable growth coupled with management's proven ability to execute, moving forward we feel confident that CDW can reach our projected price target of \$131 which represents upside of around 18% at current levels. With a TTM EPS of 5.11 our implied TTM PE for CDW stands around 25.62 up from their current PE of 21.51.

## PEER COMPARISON

CDW's main competitors include CACI International, ManTech International, Leidos Holdings and Iron Mountain. We gave CDW a forward P/E and EV/EBITDA of 18x and 12.9x for 2021 respectively, which is slightly around the sector average of 18.9 and 11.6. We believe the company could potentially trade above the sector average at a premium given its market leadership in the hardware market and its strong growth in its cloud solutions segment.



## **RISK FACTORS**

The over-crowdedness in the software and cloud sector poses the greatest risk to CDW. CDW faces competition from software resellers, manufacturers, large service providers and system integrators, communications service providers, cloud providers, e-tailers. However, we believe that CDW has the ability to outperform its peers due to its steady position in the market and its healthy product mix.

Covid-19 also poses serious risk to the business as it may disrupt their supply chain, reduce their customer base with more small businesses closing down, or interrupt their operations with more employees falling ill.

Other risks include breaches of data security, failure of third-party service providers to provide high-quality service to their customers, account receivable risk, and foreign currency risk.

