Prabhudas Lilladher

Tata Consultancy Services

Some turbulence ahead

Event Update

February 13, 2008

Rating	**Market Performer**
Price	Rs869
Target Price	Rs1,076
Implied Upside	23.9%
Sensex	16,949

(Prices as on January 13, 2008)

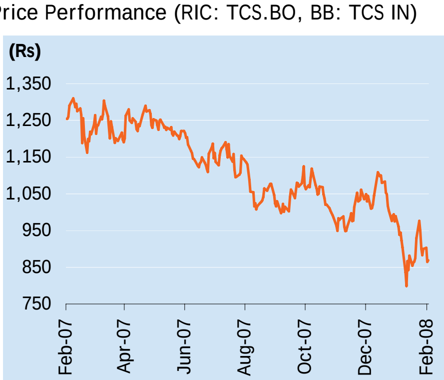
Trading Data	
Market Cap. (Rs bn)	850.4
Shares o/s (m)	978.6
Free Float	20.7%
Avg. Daily Vol ('000)	192.1
Avg. Daily Value (Rs m)	189.1

Major Shareholders	
Promoters	77.8%
Foreign	10.7%
Domestic Inst.	6.2%
Public & Others	5.4%

Stock Performance

(%)	1M	6M	12M
Absolute	(12.1)	(23.4)	(30.7)
Relative	6.5	(36.3)	(51.0)

Price Performance (RIC: TCS.BO, BB: TCS IN)



Source: Bloomberg

We had an opportunity to interact with the senior management of TCS at their 'Analyst Day' event held at Yantra Park in Thane, Mumbai.

Following are the key takeaways from the meet:

- BFS & retail slowdown anticipated
- The positives: deal pipeline remains strong
- New organisation structure announced
- Future growth engines
- Initiatives for Non Linear growth

BFS & retail slowdown anticipated

TCS management has indicated a slowdown in IT budgets of BFS and retail clients.

- In particular, **two** Wall Street clients have indicated a cut back in IT spending for FY08.
- Both clients are among TCS' top15 clients (but not among its top10 clients).
- Further, change in top management of BFS clients could also lead to delay in projects.

Key financials (Y/e March)	FY07	FY08E	FY09E	FY10E
Revenue (Rs m)	186,332	231,260	310,358	396,209
Growth (%)	*40.7*	*24.1*	*34.2*	*27.7*
EBITDA (Rs m)	50,740	60,188	78,621	103,063
PAT (Rs m)	41,271	51,298	65,822	80,898
EPS (Rs)	42.2	52.4	67.3	82.7
Growth (%)	*43.3*	*24.2*	*28.3*	*22.9*
Net DPS (Rs)	11.5	15.0	17.0	18.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	*27.2*	*26.0*	*25.3*	*26.0*
RoE (%)	*55.8*	*47.9*	*44.5*	*40.1*
RoCE (%)	*52.3*	*44.7*	*42.0*	*38.3*
EV / sales (x)	4.5	3.6	2.7	2.1
EV / EBITDA (x)	16.7	14.0	10.7	8.0
PE (x)	20.6	16.6	12.9	10.5
P / BV (x)	9.5	6.8	5.0	3.7
Net dividend yield (%)	*1.3*	*1.7*	*2.0*	*2.1*

Source: Company Data; PL Research

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Our take: With 49% revenue derived from North America, and 44% revenue from BFSI vertical, TCS is vulnerable to developments in the US financial services sector. We are not surprised that TCS has warned of short-term pressures in BFSI/retail - two segments that are highly exposed to any slowdown/recession in the US economy.

However, greater offshoring component (even within the truncated client IT budgets) and a conscious move up the value chain ought to provide some cushion to TCS, in an otherwise challenging environment going forward.

The positives

- **Deal pipeline remains strong:** The management has indicated a healthy pipeline, with 30 large deals (US$50m+) being pursued currently, indicating relatively healthy demand environment.

Deal Pipeline ($50mn+ deals being pursued)

Current	Q3' 08	Q3 '07
30	25	19

- Qualified Pipeline Value (overall) as of December 2007 is 2.5 times December 2006 value, which gives a degree of comfort.

- Wage inflation is expected to moderate to 10% (as against 14% historically).

- Notwithstanding the macro environment, TCS forecasts billing rate hikes in the region of 3% going forward.

- **Vendor consolidation:** The management indicates that global clients have shown an interest in consolidating their IT vendors to low single digits. In our view, should such consolidation materialise, a major full services player like TCS offering end-to-end services and offshoring capabilities is likely to benefit from the development.

Our take: Moderation in wage inflation would serve to take some pressure off margins and provide marginal relief, while vendor consolidation would be beneficial for a full services player like TCS.

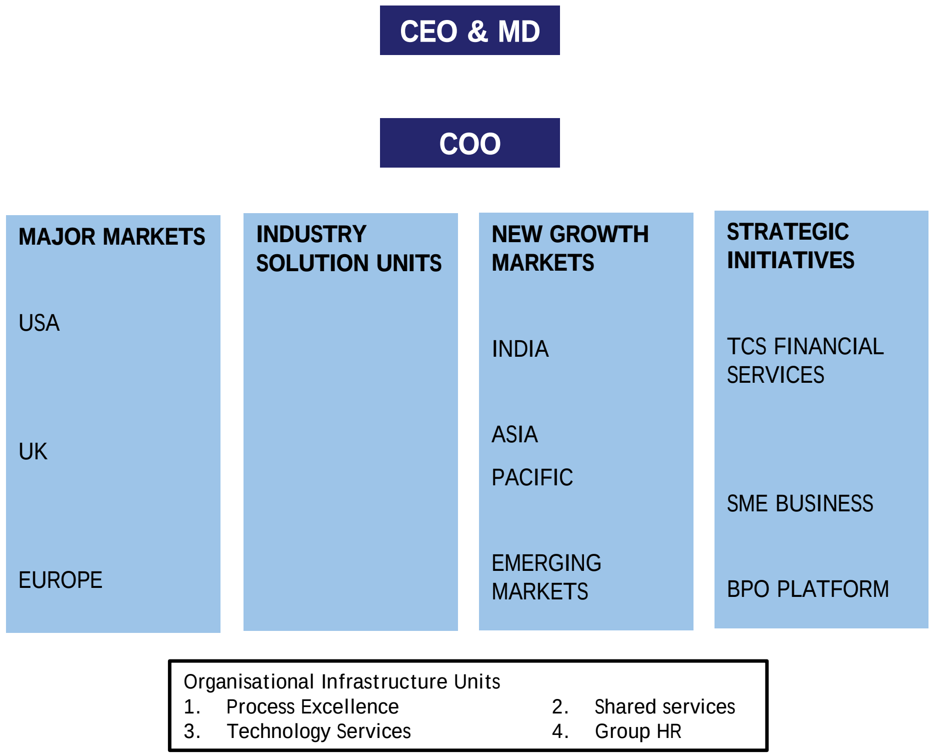
New organisation structure: Organising for the future

TCS announced a new organisation and reporting structure across the entire company.

- The new structure will comprise customer clusters aligned to major verticals like BFSI, retail, manufacturing, etc. collectively grouped as Industry Solution Units.
- Each cluster will have a limited size and critical mass.
- Each cluster will have its own cluster head, HR head, accounts head and support function head, making it an independent and self contained unit.
- Most importantly, each cluster will have complete P&L responsibility.
- Thus, Strategic Initiatives block will focus on new initiatives like TCS Financial Services and SME business.
- There will be an Organisational Infrastructure Unit comprising heads of support service functions. It will be thinly staffed with experts who will be involved with group wide policy making.

Our take: The new structure announced aims to impose greater accountability and client centricity even as it focuses on leadership development and employee empowerment.

The new organisation structure



Source: Company Data; PL Research

Future growth engines

- Management expects offshoring to grow at 40% YoY, thereby offsetting some part of slowdown on account of IT spend cuts.
- Non US regions viz. Latam, China and Rest of Asia is expected to witness robust growth.
- Global Network Delivery Model – scaling up non India centres and simultaneously focusing on local (home country) markets to drive growth.

Our take: Revenue from non US/Europe geographies (viz. Latam, India, AsiaPac, Others) accounts for about 20% revenue, and on an average has grown above company averages for the last couple of quarters. While they cannot compensate for sluggish growth in major markets like US/Europe, we expect them to provide a cushioning effect thereby providing some resistance to any fall in revenue/margins.

Initiatives for Non Linear growth

In order to spur non linear growth, TCS management has embarked upon the following initiatives:

- Platform based BPO solutions (as against traditional transaction based models)
- Enhanced focus on products business - TCS Financial Solutions business unit to contribute to growth
- Formation of Small & Medium Enterprises (SME) SBU as a strategic move to tap the fast growing SME segment, which has uniquely different needs and capabilities (has signed up 11 customers)
- Technical Centres of Excellence (Innovation Labs) to capture emerging opportunities

Our take: We expect platform-based BPO offerings to witness good growth in view of the value proposition they offer clients. However, with most vendors already pitching the same model, TCS can no longer claim to be a differentiated/unique service offering.

As far as other new initiatives are concerned, these are made with an eye on the future, although they may not have any material impact/payoffs in the near/medium term.

Conclusion

The management was candid enough to acknowledge the possibility of short term pressures going forward, but appeared to be confident of managing the same. In view of the emerging challenges in the macro environment, we expect muted growth in US/BFSI revenue segments in the short to medium term. However, newer service lines and emerging markets are expected to provide some support and relief. On the other hand, we expect margins to remain flattish resting on support from lower wage inflation and SG&A leverage.

At the CMP of Rs869, TCS quotes at 12.9x FY09E earnings. We maintain Market Performer rating with a target price of Rs1,076 (16x FY09E earnings).

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PL's Recommendation Nomenclature

BUY	:	> 15% Outperformance to BSE Sensex	**Outperformer** (OP)	:	5 to 15% Outperformance to Sensex
Market Performer (MP)	:	-5 to 5% of Sensex Movement	**Underperformer** (UP)	:	-5 to -15% of Underperformace to Sensex
Sell	:	<-15% Relative to Sensex			
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly