

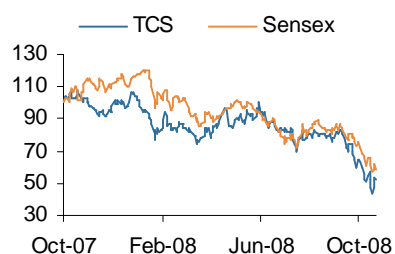
Tata Consultancy Services Ltd (Q2 FY09)

October 23, 2008
Stock data

Sensex:	10,170
CMP (Rs):	547
Target price (Rs):	650
Upside (%):	18.8
52 Week h/l (Rs):	1,125/445
Market cap (Rs cr)	5,3529
6m Avg vol BSE&NSE ('000 nos):	1,746
No of o/s shares (mn):	979
FV (Re):	1
Bloomberg code:	TCS IN
Reuters code:	TCS.BO
BSE code:	532540
NSE code:	TCS

Shareholding pattern

September 2008	(%)
Promoters	76.3
Foreign	11.1
Indian institutions	6.5
Public & others	6.1

Share price trend

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- Dollar revenue growth in-line despite material offshore shift; volumes surprise on upside
- Growth continues to be driven by the non-Top 10 clients; Europe records strong growth
- Broad-based growth across verticals; amongst services, ADM and Engineering drive growth
- OPM expansion of 230 bps qoq was far above expectations; operating profit grew 18.8% qoq
- Huge forex loss and higher depreciation impact net profit growth
- Employee additions were strong; company confident of achieving FY09 hiring guidance
- Rate TCS as BUY with target price Rs650; short-term outperformance likely

Result table

Period to	Q1 FY09	Q2 FY09	QoQ	YoY
(Rs mn)	(3)	(3)	(%)	(%)
Net sales	64107	69534	8.5	23.3
Total Expenditure	(48793)	(51337)	5.2	23.5
Operating Profit	15314	18197	18.8	22.8
OPM (%)	23.9	26.2	-	-
Depreciation	(1167)	(1349)	15.6	(2.3)
Interest	0	0	-	-
Other income	332	(1784)	-	-
PBT	14479	15064	4.0	3.6
Tax	(1947)	(2291)	17.7	12.5
Minority interest	(97)	(151)	-	-
Share of JV/Associates	1	(7)	-	-
Pre-Exceptional PAT	12436	12615	1.4	1.2
Extraordinary items	0	0	-	-
PAT	12436	12615	1.4	1.2
Number of shares (Mn)	979	979	-	-
EPS (Rs) - Quarterly	12.7	12.9	1.4	1.2

Source: Company, India Infoline Research

Dollar revenue growth in-line despite material offshore shift; volumes surprise on upside

TCS reported an in-line 3.2% qoq growth (just above 5% in constant currency) in dollar revenues driven by a strong volume growth of 6% qoq. Pricing improved slightly over previous quarter against our expectations of marginal decline. The effort mix shifted significantly towards offshore and the offshore revenue share increased by 190 bps qoq to 42.8%. This impacted sequential rupee revenue growth by ~100 bps. The sharp rupee depreciation aided growth by over 3% thereby taking the overall growth in rupee revenues to 8.5% qoq. Revenue growth in international business stood ahead of the company at 9.5% qoq.

Growth continues to be driven by the non-Top 10 clients; Europe records strong growth

The Top-5 and Top-10 client brackets continued to grow far behind company for the third consecutive quarter. This has been mainly led by sluggish business flow from few large BFSI customers of the company. The Top 5 clients grew by 3.2% qoq and the Top-10 clients by 4.4% qoq whereas the non-Top 10 clients grew strongly by 10.6% qoq. Regionally, Europe recorded robust growth of 12.5% qoq in revenues while growth in the US region was modest at 6.9% qoq.

Broad-based growth across verticals; amongst services, ADM and Engineering drive growth

Company recorded a broad-based growth across verticals with Manufacturing (11.5% qoq), Retail & Distribution (13.5% qoq), Transportation (16% qoq) and Energy & Utilities (12.2% qoq) registering better than company growth. BFSI revenue growth at 6.9% qoq was healthy given the difficult business backdrop and client-specific issues. Amongst services, ADM (13.8% qoq) and Engineering (16.2% qoq) solely drew growth during the quarter. There was a sequential decline in revenues from Consulting (15% qoq) and Asset Leverage Solutions (3.9% qoq).

OPM expansion of 230 bps qoq was far above expectations; operating profit grew 18.8% qoq

TCS posted a very strong OPM expansion of 230 bps qoq against our expectation of 150 bps. Gross margin improved 365 bps qoq driven by productivity & pricing improvements (~165 bps), rupee depreciation (~140 bps) and offshore shift (~55 bps). As the company invested at the SG&A level and made provisions (worth Rs430mn) with respect to doubtful receivables from some beleaguered BFSI clients, the OPM expansion was restricted to 230 bps qoq. Operating profit increased by robust 18.8% qoq.

Huge forex loss and higher depreciation impact net profit growth

Company reported huge net forex loss of Rs2.61bn on account of significant M-T-M losses on the forex cover. TCS had significantly built-up its hedges during the July-August 2008 period at lower than prevailing Re/US\$ rate. Depreciation was higher 16% qoq on a low base (due to policy change) in the previous quarter. As a result, reported net profit growth stood low at 1.4% qoq.

Employee additions were strong; company confident of achieving FY09 hiring guidance

Net employee addition of 5,328 people, ~4.7% of Q1 FY09 base, was strong for second quarter in row. More importantly, company is confident of achieving the full-year gross hiring guidance of 30,000-35,000 people. This implies that TCS expects a steady growth over the remaining quarters of the year, which is reassuring. Attrition in IT services was 12.4% and BPO was 22.7%.

Rate TCS as BUY with target price Rs650; short-term outperformance likely

TCS has reported the best operational performance for Q2 FY09 in the sector and especially amongst the large companies. More importantly, company's confidence has markedly improved over previous quarter as reflected in relatively positive tone of the management commentary and the strong hiring plans for the remainder of the year. TCS has materially underperformed BSE IT and Infosys since the latter's results, over past 1 month and over past 3 months. A significantly superior operating performance in Q2 FY09 and marginally improved outlook for the company should correct this and lead to stock outperformance in the short-term. We upgrade FY10 EPS estimate of TCS by 2% and rate the stock as BUY with target price Rs650.

Projected financials

Period to	FY06	FY07	FY08	FY09E	FY10E
(Rs mn)	(12)	(12)	(12)	(12)	(12)
Revenues	132,455	186,333	228,137	280,442	303,386
yoy growth (%)	36.2	40.7	22.4	22.9	8.2
Operating Profit	36,625	50,742	59,000	70,574	68,909
OPM (%)	27.7	27.2	25.9	25.2	22.7
Pre-exceptional PAT	29,200	41,406	49,941	53,816	57,210
yoy growth (%)	42.3	41.8	20.6	7.8	6.3
EPS (Rs)	29.5	42.3	51.3	55.0	58.5
P/E (x)	18.6	12.9	10.7	9.9	9.4
P/BV (x)	9.2	6.0	4.4	3.3	2.7
EV/EBITDA (x)	14.4	10.4	8.9	7.2	6.9
ROE (%)	62.1	56.9	47.9	38.4	32.1
ROCE (%)	68.8	61.5	51.7	42.7	36.4

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