

## Tata Consultancy Services (TCS IN)

Rating: **1**

### Slight downward revision to our US Dollar revenue forecast

Software: India

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Target price: **Rs1,350.00 → Rs1,300.00**

<b>Price (18 Mar)</b>	<b>Rs1,082.75</b>
Reuters code	TCS.NS
ADR/GDR code	n.a.
Shares per ADR/GDR	n.a.

<b>Market data</b>	
SENSEX Index	17,878.81
Market cap	(US\$bn) 46.96
EV	(US\$bn: 11E) 45.57
3-mth avg daily T/O	(US\$) 46.18
Shares outstanding	(m) 1,957
Free float	(%) 26.0
Major shareholder	Tata group (74.1%)
Exchange rate	Rs/US\$ 45.126

<b>Performance (%)</b>	<b>1M</b>	<b>3M</b>	<b>6M</b>
Absolute	(0.6)	(5.1)	18.5
Relative	1.2	4.9	27.3

Source: Daiwa  
Note: \*Relative to SENSEX Index

#### Investment indicators

	2011E	2012E	2013E
PER (x)	24.4	20.2	17.2
PCFR (x)	29.3	21.3	17.6
EV/EBITDA (x)	18.3	14.4	11.6
PBR (x)	8.7	6.7	5.3
Dividend yield (%)	1.4	1.6	1.8
ROE (%)	40.4	37.5	34.5
ROA (%)	28.5	27.4	25.7
Net debt equity (%)	net cash	net cash	net cash
Relative to peers			In line
Relative to history			In line

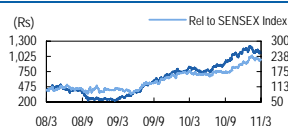
Source: Daiwa forecasts

#### Income summary (Rs m)

Yr to 31 Mar	2010	2011E	2012E	2013E
Revenue	300,291	374,101	467,574	565,578
YoY (%)	8.0	24.6	25.0	21.0
EBITDA	86,801	112,499	139,805	169,108
YoY (%)	20.9	29.6	24.3	21.0
Net profit	68,729	87,023	104,868	123,461
YoY (%)	32.9	26.6	20.5	17.7
EPS (Rs)	35.116	44.463	53.580	63.080
YoY (%)	32.9	26.6	20.5	17.7
CFPS (Rs)	43,512	37,005	50,756	61,517
DPS (Rs)	19,913	15,000	17,000	20,000

Source: Company, Daiwa forecasts

#### Price and relative performance



Source: Bloomberg, Daiwa

#### Forecasts revisions (%)

	FY11E	FY12E	FY13E
Revenue change	(0.5)	(4.3)	(3.5)
Net profit change	(0.5)	(3.8)	(4.2)
EPS change	(0.5)	(3.8)	(4.2)

Source: Daiwa forecasts

#### Fair value

Valuation (Rs/shr)	1,300.00
Methodology	24x FY12 EPS
Key assumption	24x FY12 EPS

Source: Daiwa forecasts

### What has changed?

- After meeting with the management, we have revised down our US Dollar revenue forecasts by 4.3% and 3.5% for FY12 and FY13, respectively.

### Impact

- We learned from the management that there was unlikely to be any big turnaround in orders from the sectors that were seeing slow revenue growth, such as Manufacturing and Telecoms. Given this, we now forecast US Dollar revenue to rise by 29.8% YoY for FY12 (34.5% previously) and by 26% YoY for FY13 (25% YoY previously). As our US\$:Rupee forecasts are unchanged, we also have revised down our Rupee revenue forecasts by 4.3% for FY12 and 3.5% for FY13.
- We forecast US Dollar revenue for FY11 to rise by 29.3% YoY, and given the reasonably strong demand Tata Consultancy Service (TCS) is experiencing in sectors such as Energy, Utilities, Retail, High-technology, and Banks, Financial Services and Insurance (BFSI), our new revenue forecast for FY12 is unlikely to be threatened. For the BFSI Sector (which we forecast to account for 44.5% of FY11 revenue), we expect the demand in FY12 to be strong, as a result of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, which requires new software to be written to identify systemic risks in advance.
- In addition, compliance with the *Basel II/III* standards and *Credit Card Accountability, Responsibility and Disclosure Act* should keep new deals flowing in. Cost-cutting initiatives are ongoing and have been the focus of EU-based corporations. We understand that the existing service providers and in-house/captive customers will be substituted by India vendors, and believe TCS is well-positioned to win some of this new business. However, the blended billing rate may not see a large increase for FY12.
- As there are no plans for any major shift in terms of onsite or offshore in the revenue mix, or to time and material contracts versus fixed-priced project revenue mix in FY12, nor any significant rise in non-linear revenue, we expect the EBITDA margin to remain at about the current level for FY12, as TCS has indicated there are ways for it to improve revenue productivity. As a result of the downward revisions to our revenue forecasts, we have revised down our net-profit forecasts by 3.8% for FY12 and 4.2% for FY13, after making suitable adjustments to our tax-rate assumptions.

### Valuation

- We have lowered our six-month target price to Rs1,300, from Rs1,350, after revising down our FY12 earnings forecast by 3.8%. We continue to value the stock at a PER of 24x on our FY12 EPS forecast. Given the current 20% upside potential from the current level, we maintain our **1 (Buy)** rating.

### Catalysts and action

- We have revised down our US Dollar revenue forecasts as the revenue visibility for the company is for no more than a rise of 20% for FY12. The risks to our target price include a slower-than-expected improvement in the orders from laggard sectors, and a depreciation in the Rupee against the US Dollar.

### Company background

TCS is a leader in the technology services business. It has adopted a global delivery model, for providing software solutions that span the entire life cycle of a project, encompassing, consulting, design, development, re-engineering, systems integration, package implementation, business process outsourcing and remote infrastructure management - for global corporations across industries in many countries worldwide. Between FY05 and FY10, its US-dollar revenues and profit almost tripled.

## Tata Consultancy Services – financial summary

### Profit and loss (Rs m)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Application development	139,145	146,366	175,898	222,098	264,691
Application maintenance	0	0	0	0	0
Others	138,984	153,925	198,203	245,477	300,887
<b>Total revenue</b>	<b>278,129</b>	<b>300,291</b>	<b>374,101</b>	<b>467,574</b>	<b>565,578</b>
Other income	0	0	0	0	0
	(150,77)	(157,24)	(198,69)	(248,75)	(300,32)
COGS	4)	4)	5)	0)	2)
SG&A	(55,574)	(56,246)	(62,907)	(79,020)	(96,148)
Other op. expenses	(5,768)	(7,208)	(7,783)	(9,083)	(10,183)
<b>EBIT</b>	<b>66,013</b>	<b>79,593</b>	<b>104,716</b>	<b>130,722</b>	<b>158,925</b>
Net-interest inc./(exp.)	1,996	2,255	3,745	5,070	8,150
Assoc/forex/extraord./others	(6,669)	0	0	0	0
<b>Pre-tax profit</b>	<b>61,340</b>	<b>81,848</b>	<b>108,461</b>	<b>135,792</b>	<b>167,075</b>
Tax	(9,010)	(12,089)	(20,355)	(29,874)	(42,604)
Min. int./pref. div./others	(613)	(1,030)	(1,082)	(1,050)	(1,010)
<b>Net profit (reported)</b>	<b>51,717</b>	<b>68,729</b>	<b>87,023</b>	<b>104,868</b>	<b>123,461</b>
<b>Net profit (adj.)</b>	<b>51,717</b>	<b>68,729</b>	<b>87,023</b>	<b>104,868</b>	<b>123,461</b>
<b>EPS (reported) (Rs)</b>	<b>26.424</b>	<b>35.116</b>	<b>44.463</b>	<b>53.580</b>	<b>63.080</b>
<b>EPS (adj.) (Rs)</b>	<b>26.424</b>	<b>35.116</b>	<b>44.463</b>	<b>53.580</b>	<b>63.080</b>
<b>DPS (Rs)</b>	<b>5.810</b>	<b>19.913</b>	<b>15.000</b>	<b>17.000</b>	<b>20.000</b>
<b>EBIT (adj.)</b>	<b>66,013</b>	<b>79,593</b>	<b>104,716</b>	<b>130,722</b>	<b>158,925</b>
<b>EBITDA (adj.)</b>	<b>71,781</b>	<b>86,801</b>	<b>112,499</b>	<b>139,805</b>	<b>169,108</b>

### Balance sheet (Rs m)

As at 31 Mar	2009	2010	2011E	2012E	2013E
Cash & short-term investment	26,981	47,186	69,054	108,941	162,158
Inventory	366	178	220	280	350
Accounts receivable	75,043	70,566	88,454	108,659	127,569
Other current assets	32,846	39,698	45,200	52,500	58,900
<b>Total current assets</b>	<b>135,236</b>	<b>157,627</b>	<b>202,929</b>	<b>270,381</b>	<b>348,977</b>
Fixed assets	41,896	45,394	51,637	59,854	68,871
Goodwill & intangibles	32,614	32,160	32,160	32,160	32,160
Other non-current assets	17,420	38,096	50,096	65,096	83,096
<b>Total assets</b>	<b>227,166</b>	<b>273,277</b>	<b>336,822</b>	<b>427,491</b>	<b>533,104</b>
Short-term debt	5,632	1,033	1,383	1,883	2,633
Accounts payable	21,144	29,775	32,200	35,200	38,200
Other current liabilities	38,658	50,798	52,820	67,343	83,880
<b>Total current liabilities</b>	<b>65,434</b>	<b>81,605</b>	<b>86,402</b>	<b>104,426</b>	<b>124,713</b>
Long-term debt	0	0	0	0	0
Other non-current liabilities	1,961	687	687	687	687
<b>Total liabilities</b>	<b>67,394</b>	<b>82,291</b>	<b>87,089</b>	<b>105,113</b>	<b>125,399</b>
Share capital	1,979	2,957	2,957	2,957	2,957
Reserves/R.E./others	155,021	184,412	242,077	313,672	397,989
<b>Shareholders' equity</b>	<b>157,000</b>	<b>187,369</b>	<b>245,034</b>	<b>316,629</b>	<b>400,946</b>
Minority interests	2,772	3,617	4,699	5,749	6,759
<b>Total equity &amp; liabilities</b>	<b>227,166</b>	<b>273,277</b>	<b>336,822</b>	<b>427,491</b>	<b>533,104</b>
				(107,059)	(159,525)
<b>Net debt/(cash)</b>	<b>(21,349)</b>	<b>(46,153)</b>	<b>(67,672)</b>	<b>)</b>	<b>)</b>

### Cash flow (Rs m)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Profit before tax	61,340	81,848	108,461	135,792	167,075
Depreciation and amortisation	5,768	7,208	7,783	9,083	10,183
Tax paid	(9,623)	(13,119)	(21,437)	(30,924)	(43,614)
Change in working capital	(6,096)	11,479	(18,635)	(9,541)	(5,094)
Other operational CF items	(1,996)	(2,255)	(3,745)	(5,070)	(8,150)
<b>Cash flow from operations</b>	<b>49,393</b>	<b>85,162</b>	<b>72,426</b>	<b>99,339</b>	<b>120,400</b>
Capex	(33,471)	(8,421)	(14,026)	(17,300)	(19,200)
Net (acquisitions)/disposal	9,918	(20,677)	(12,000)	(15,000)	(18,000)
Other investing CF items	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(23,554)</b>	<b>(29,098)</b>	<b>(26,026)</b>	<b>(32,300)</b>	<b>(37,200)</b>
Change in debt	0	0	0	0	0
Net share issues/(repurchases)	0	0	0	0	0
Dividends paid	(13,700)	(39,144)	(29,358)	(33,272)	(39,144)
Other financing CF items	(4,673)	2,255	3,745	5,070	8,150
<b>Cash flow from financing</b>	<b>(18,373)</b>	<b>(36,889)</b>	<b>(25,613)</b>	<b>(28,202)</b>	<b>(30,994)</b>
Forex effect/others	0	0	0	0	0
<b>Change in cash</b>	<b>7,466</b>	<b>19,175</b>	<b>20,786</b>	<b>38,837</b>	<b>52,206</b>

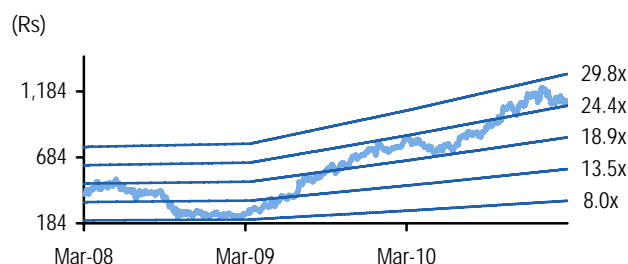
### Key assumptions

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Offshore based engineers (No.)	60,649	67,313	75,274	85,861	95,056
Onsite based engineers (No.)	36,390	39,533	43,268	47,257	52,318
Offshore revenues (US\$ m)	2,700	3,285	4,173	5,630	7,193
Onsite revenues (US\$ m)	2,876	2,508	3,254	4,077	4,999
Offshore rev productivity (US\$ m)					

### Key ratios

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Sales – YoY %	21.7	8.0	24.6	25.0	21.0
EBITDA (adj.) – YoY %	20.9	20.9	29.6	24.3	21.0
Net profit (adj.) – YoY %	3.0	32.9	26.6	20.5	17.7
EPS (adj.) – YoY %	3.0	32.9	26.6	20.5	17.7
EBITDA margin % (adj.)	25.8	28.9	30.1	29.9	29.9
EBIT margin % (adj.)	23.7	26.5	28.0	28.0	28.1
Net-profit margin % (adj.)	18.6	22.9	23.3	22.4	21.8
ROAE (%)	37.2	40.1	40.4	37.5	34.5
ROAA (%)	25.7	27.5	28.5	27.4	25.7
ROCE (%)	44.7	44.5	47.3	45.4	43.3
ROIC (%)	22.3	24.1	26.1	25.7	25.6
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Effective tax rate (%)	14.7	14.8	18.8	22.0	25.5
Accounts receivable (days)	93.4	88.5	77.6	76.9	76.2
Payables (days)	26.3	30.9	30.2	26.3	23.7
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout (%)	22.0	56.7	33.7	31.7	31.7

### PER bands



Source: Company, Daiwa forecasts

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