

TCS posted modest results for Q4 FY07 with revenues and earnings growing 5.9% and 6.6% respectively. The operational performance was far below expectations with decline in operating margin by 50 bps qoq. If not for the higher other income from forex cover and stake sale in JV company, PBT would have grown by just 3.9% qoq. Management has indicated continuation of revenue growth momentum and stable OPM for FY08.

Key highlights of the quarter

Financials

Period	03/07	12/06	Growth (%)	03/06	Growth (%)	03/07	03/06	Growth (%)	03/08E	Growth (%)
Rs mn	(3)	(3)	qoq	(3)	yoy	(12)	(12)	yoy	(12)	yoy
Sales	51,464	48,605	5.9	37,234	38.2	186,332	132,454	40.7	245,098	31.5
Operating Profit	13,173	12,673	3.9	8,965	46.9	46,444	33,894	37.0	60,303	29.8
OPM (%)	25.6	26.1	-	24.1	-	24.9	25.6	-	24.6	-
PAT	11,771	11,047	6.6	8,012	46.9	41,315	28,831	43.3	52,563	27.2
NPM (%)	22.9	22.7	-	21.5	-	22.2	21.8	-	21.4	-
EPS (Rs)										
Annualized	48.1	45.2	-	32.7	-	42.2	29.5	-	53.7	-
P/E (x) at CMP										
Rs1253	26.0	-	-	-	-	29.7	-	-	23.3	-

- ✓ The 5.9% sequential growth in the quarter was a combination of 6.4% volume growth, 0.9% growth from pricing improvements, 0.4% growth from productivity improvements and negative 1.9% growth impact of Rupee appreciation. Revenues from international business grew 4.1% qoq while that from India business grew strong 26.2% qoq in line with seasonal pattern. For the full year FY08, revenues were higher by robust 40.7% yoy.
- ✓ Company continued to win better than industry average price hikes from both existing clients (in case of contracts which came up for renewal) and new clients in the range of 3-5% and 5-10% respectively.
- ✓ The key clients of the company grew at far higher than company rate. Growth in Top, Top 5 and Top 10 clients was 22.6%, 12.6% and 9.3% respectively on sequential basis. Further, these client brackets have grown faster than company in full year FY07i also. New business was higher at 5.1% of revenues against 3.9% in the previous quarter.
- ✓ The onsite:offshore ratio shifted towards the former by 30bps qoq to 58.7:41.3. Company has indicated towards resumption of offshore movement in coming quarters. UK & Europe witnessed good growth of 7.4% qoq while the America region witnessed modest growth of 3.6% on sequential basis. For FY08, revenues from America crossed US\$2bn and from UK& Europe crossed US\$1bn.
- ✓ Amongst the service lines, non-ADM services led growth in the quarter with ADM revenues growing just 1.5% qoq. Within non-ADM services, Infrastructure, ALS and Assurance services grew by >15% qoq and Enterprise Services, BI, Consulting and BPO grew by >9% qoq. The newer services comprising BI, Infrastructure, ALS, Assurance, Consulting and BPO grew by exceptional 95.9% yoy in FY07 increasing their revenue share to 35.6% from 28% in FY06.
- ✓ In terms of verticals, Telecom, Retail & Distribution and Transportation grew by 10.9%, 21.2% and 16.8% respectively on sequential basis. Flattish growth of 0.5% qoq was witnessed in the major vertical of BFSI.
- ✓ OPM declined qoq by 50bps to 25.6% mainly impacted by the sharp Rupee appreciation. For FY08 OPM stood at 24.9% lower 70 bps yoy thereby missing company's guidance of stable margin.
- ✓ For the full year, company re-iterated its guidance of maintaining stable OPM on yoy basis ie near 25.8% level of FY06. Management expects further sequential margin improvements (but quantum to be lower than Q2 FY07) in the remaining two quarters led by pricing upticks, continued offshore shift and cost leverage (mainly SG&A).

- ✓ Other income stood significantly higher at Rs898mn against Rs300mn in the previous quarter driven by higher net forex gains and profit of ~Rs580mn on stake sale in JV company Sitel Corp. The tax rate was higher at 15.6% compared to 14.1% in Q3 FY07.
- ✓ Company added gross 8,613 people (including 3,843 trainees) and net 5,827 people in the quarter. Attrition rate inched downward to 10.6%. In FY07, gross and net addition stood at 32,462 and 22,750 respectively. The net additions represent 36.2% growth over FY06 manpower base.
- ✓ The management has indicated strong demand environment and continuance of revenue growth momentum for FY08. Further, OPM level is expected to be sustained and gross manpower additions are likely to be much higher in FY08. As per the company, offshore shift, pricing upticks, SG&A leverage and productivity improvements will help offset any margin pressures from salary hike (expected 12-15% offshore & 3-5% onsite) and exchange rate volatility. It anticipates a Re/\$ rate of Rs43.50-43.60 average for FY08.

Outlook

We are revising our FY08 EPS forecast marginally downwards by 0.9% to Rs53.7 mainly to factor underachievement of our expectations in Q4 FY07. We maintain BUY rating with a one-year target price of Rs1,558 representing 24.3% upside from current levels.

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