



Tata Consultancy Services

STOCK INFO.	BLOOMBERG
BSE Sensex: 16,784	TCS IN
	REUTERS CODE
S&P CNX: 5,049	TCS.BO

22 April 2008

Buy

Previous Recommendation: Buy

Rs887

Equity Shares (m)	978.6
52-Week Range	1,330/725
1,6,12 Rel. Perf. (%)	-3/-16/-49
M.Cap. (Rs b)	868.2
M.Cap. (US\$ b)	21.7

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	186,334	41,316	41.7	39.6	21.3	9.7	54.5	58.8	4.6	16.7
3/08A	228,614	50,191	51.3	23.1	17.3	7.0	46.1	49.8	3.7	14.1
3/09E	276,395	57,987	59.3	15.5	15.0	5.3	39.6	44.5	2.9	11.4
3/10E	334,761	65,284	66.7	12.6	13.3	4.2	34.5	43.2	2.4	9.1

1:1 bonus in FY07, accordingly ratios are adjusted

- TCS reported revenues of Rs60.95b in 4QFY08 (v/s our estimate of Rs61.85b), a growth of 2.9% QoQ (v/s our estimate of 4.4%). EBITDA was at Rs15.52b v/s our estimate of Rs16.53b, a decline of 118bp QoQ on account of increased manpower and other costs as a percentage of revenues. A few of TCS' key US-based BFSI clients that were supposed to ramp up during the quarter, postponed their IT budgets to the next quarter. Net profit was at Rs12.56b v/s our estimate of Rs13.57b, down 5.6% QoQ and up 12% YoY.
- For FY08, revenues grew 22.7% to Rs228.6b while US\$ revenues grew 37% to US\$5.7b. EBITDA margins declined 125bp to 26% in FY08, resulting in net profit growth of 23% to Rs50.19b.
- On business outlook, TCS management has indicated no cuts in IT budgets or any slowing down in its clients' IT spend, save one Brazilian client (revenue ~ US\$70m). It continues to build capability and capacity, as it expects favorable pipeline and deal flows; it plans to add 30,000-35,000 employees in FY09 and has given 22,450 campus offers (no sign of slowing down capability building).
- We believe that 4QFY08's below-expected result is one-off and unlikely to recur. Manpower hiring plans and deal pipeline gives us the confidence that TCS will continue to outgrow industry in this challenging environment. Maintain **Buy** with a revised target price of Rs1,100 (P/E of 18.5x FY09E EPS), an upside of 24%.

QUARTERLY PERFORMANCE (US GAAP)

(RS MILLION)

Y/E MARCH	FY07				FY08				FY07	FY08
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenues	41,443	44,822	48,605	51,464	52,029	56,398	59,241	60,947	186,334	228,615
Q-o-Q Change (%)	11.3	8.2	8.4	5.9	1.1	8.4	5.0	2.9	40.6	22.7
Direct Expenses	22,989	23,880	26,294	27,177	28,221	30,152	31,384	32,587	100,339	122,344
Sales, General & Admin. Expenses	8,327	8,648	8,559	9,720	10,543	11,426	12,068	12,836	35,253	46,873
Operating Profit	10,128	12,294	13,753	14,568	13,265	14,820	15,789	15,524	50,742	59,398
Margins (%)	24.4	27.4	28.3	28.3	25.5	26.3	26.65	25.47	27.2	26.0
Other Income	668	77	300	235	1,516	1,105	1,048	781	1,280	4,450
Depreciation	863	958	1,080	1,395	1,265	1,381	1,475	1,625	4,296	5,746
PBT bef. Extra-ordinary	9,932	11,414	12,973	13,408	13,516	14,543	15,362	14,681	47,726	58,102
Provision for Tax	1,238	1,447	1,828	2,056	1,523	2,037	1,947	1,988	6,568	7,494
Rate (%)	12.5	12.7	14.1	15.3	11.3	14.0	12.7	13.5	13.8	12.9
Minority Interest	69	52	98	155	138	38	107	134	373	416
Net Income bef. Extra-ordinary	8,626	9,915	11,047	11,198	11,856	12,469	13,308	12,559	40,786	50,192
Q-o-Q Change (%)	8.5	14.9	11.4	1.4	5.9	5.2	6.7	-5.6	39.6	23.1
PAT aft Extra-ordinary	8,626	9,915	11,047	11,728	12,149	12,469	13,308	12,559	41,316	50,192

E: M0St Estimates

Numbers below expectation; revenue growth muted; EBITDA margins fall QoQ

TCS reported revenues of Rs60.95b in 4QFY08 (v/s our estimate of Rs61.85b), a growth of 2.9% QoQ (v/s our estimate of 4.4%). EBITDA stood at Rs15.52b v/s our estimate of Rs16.53b, a decline of 118bp QoQ on account of increased manpower and other costs to revenues due to postponement of IT budgets to next quarter by a few of TCS' key US-based BFSI clients (hit by sub prime crisis) that were supposed to ramp up during quarter. Net profit was at Rs12.56b v/s our estimate of Rs13.57b, down by 5.6% QoQ and up 12% YoY. Though management had indicated the impact of postponement of IT budgets by a few of its key clients in its recent analyst meet, we did not expect profits to decline in the quarter, as management had indicated its cautionary stance early in the quarter, offering the company adequate flexibility to manage its costs.

4Q witnessed pricing decline though volume growth was strong

The composition of 2.9% QoQ revenue growth is as follows — volume growth 4.8%, exchange rate (rupee depreciation) helped by 1.1%, but pricing declined by 1.6% while effort mix (in favor of offshore) was hit by 1.4% QoQ.

Metrics weaken in 4QFY08

Surprisingly, US revenue share went up to 50.4% in 4QFY08 compared with 49.5% in 3QFY08 and share of UK and Continental Europe was flat at 19.4% and 9.7% respectively. TCS witnessed a fall in growth in its Top/Top 10 clients and flat growth in Top 5 clients. As expected, the BFSI vertical registered flat growth and contributed 43.8% to revenues in 4QFY08 (44% in 3QFY08) while the manufacturing and retail verticals grew above the company average growth rate, contributing 13% (12.5% in 3QFY08.) and 8.2% (7.2% in 3QFY08)

Continued capability and capacity additions, indicate high business confidence

TCS added a healthy 6,921 employees taking total employee strength to 1,11,407 in 4QFY08; at gross levels its added over 35,672 people in FY08 (21,988 net addition). Company has made 22,450 campus offers for FY09 with no plans to delay joining dates. Attrition rate continues to remain one of the lowest in industry at 12.6% on an employee base of over 1,00,000.

Business outlook remains positive; management cautiously optimistic

On business outlook, TCS management has indicated no cuts in IT budgets or any slowing down in its clients' IT spend, save one Brazilian client who has cancelled IT spend of approx. US\$70m and IT spend postponement (not cut) by a couple of its BFSI clients to 1QFY09. TCS continues to build capability and capacity in FY08 as it expects a favorable pipeline and deal flows; it plans to add 30,000-35,000 employees in FY09 and has given 22,450 campus offers (no sign of slowing down in capability building); it has signed deals over US\$600m in 4QFY08, over and above US\$1.8b signed during 3QFY08. Finally, management reiterated a healthy deal pipeline and demand environment, but has maintained a cautionary stance considering the macro environment in the US; and not on account of its own clients' IT spend visibility. Management indicated that its objective is to always strive to maintain margins.

TCS announced a lower-than-average wage hike of 10% for offshore and 2-4% for onsite employees given the business environment.

No fundamental shift in business outlook noticed as on date

We are revising our earnings estimates for FY09 and FY10. For FY09 we expect net sales of Rs276.4b (Rs228.6b) and PAT of Rs.57.98b (Rs50.19b). Our revised EPS for FY09

is Rs59.3 (v/s Rs59.8 earlier), +15.5% YoY. For FY10, we expect PAT of Rs.65.28b (Rs57.98b). Our revised FY10 EPS is Rs66.7 (v/s Rs67.1 earlier), +12.6% YoY.

At the CMP of Rs887, the stock is trading at 15x FY09E EPS of Rs59.3. We believe the below-expected 4QFY08 result is one-off and unlikely to recur. Manpower hiring plans and deal pipeline give us the confidence that TCS will continue to outgrow industry in this challenging environment. Maintain **Buy** with a revised target price of Rs1,100 (P/E of 18.5x FY09 EPS), an upside of 24%.

Few positive indicators for TCS

- ✍ TCS has been able to hold on to its net margins levels at 22% for the past three years, highlighting the company's forex management in the light of all kinds of currency environments – appreciating, depreciating and volatile exchange environment, that too in multiple currencies.
- ✍ TCS' EBITDA decline was only 120bp in spite of 11% rupee appreciation during year, key BFSI clients going slow and the standard headwind of wage inflation.
- ✍ Company's capacity and capability plans on track with no slowing down, reflecting stronger business visibility. Management's guidance for hiring 30,000 to 35,000 employees (gross level) and over 22,000 campus offers made supports this.
- ✍ TCS continues to witness a strong pipeline of deal flows, during 4QFY08 it signed total deals worth US\$600m (closed 6 deals of US\$50m+ in Q4) in addition to the US\$1.8b signed in 3QFY08. In the last two quarters, one of the weakest for IT industry, TCS signed deals worth US\$2.2b (40% of FY08 revenues) indicates its winning ability and strong business model.
- ✍ Even BFSI for TCS has grown 42% YoY, though growth was flattish in 4QFY08. Management has already indicated some pick-up in ramp-up by these clients in 1QFY09 and some to come in 2QFY09. We believe the worst may be behind.
- ✍ Stronger growth of 54% YoY coming from Continental Europe (crosses US\$500m). Over 50% growth in APAC and South American revenues each posting above US\$250m in revenues in FY08.
- ✍ US\$100m customers increase to 7 in FY08 from 3 in FY07, further 20 deals of US\$50m+ closed in FY08. New-growth services (BPO, Assurance, Infra and Consulting) up US\$52 to US\$1.1b. TCS is doing things right with expanding and delivering stronger growth in emerging markets and emerging services.
- ✍ Dividend of 1,400%, a payout ratio of 27%.
- ✍ One of lowest attrition of 12.6% on manpower base of 1,00,000.

Tata Consultancy Services: an investment profile

Company description

TCS is the largest IT services company in India, with (LTM) revenue of US\$5.7b as of 31 March 08. It employs over 110,000 people, and provides IT as well as BPO services to over 904 clients globally. It is the one of preferred IT vendor for a majority of the Fortune 500/Global 1,000 companies.

Key investment arguments

- ✎ Most diversified range of offerings with less than 50% ADM business and other 50% spread to Enterprise Solutions, Business Intelligence, Consulting Infrastructure management and BPO.
- ✎ Lowest attrition amongst industry (March 2008-12.6%): most preferred employer for past 3 years, of 1,11,407 employees, 9.1% are foreign, 28% are women and 50% have 3+ years experience.
- ✎ Leadership in emerging services like Infra, BPO and Enterprise Solutions and focus on Consulting.

Key investment risks

- ✎ Macro IT spend environment in the light of US slowdown and credit crisis in the US worsening.
- ✎ Sharper appreciation of the Indian rupee v/s major currencies like US\$, GBP, Euro.

Recent developments

- ✎ TCS subsidiary, Diligenta wins £100m BPO contract from Sun Life Financials of Canada.
- ✎ TCS launches development of new 20,000-seat campus in Pune to be completed by 2010.
- ✎ Signed a multi-year contract with Chrysler Llc. to provide a comprehensive portfolio of IT services.

Valuation and view

- ✎ Revenue CAGR of 22% and profit CAGR of 17% over FY07-10. Valuations at 15x FY09E earnings offers room for upside. Maintain **Buy** with a target price of Rs1,100 and upside of 24%.

Sector view

- ✎ Indian offshoring has been vindicated with global clients and service providers making India their base for IT enabled solutions. India still has less than 5% of global IT markets.
- ✎ US economy slowdown, sub prime crisis and sharper currency appreciation remain key concerns.
- ✎ We reckon frontline Indian IT companies would be better placed to sail through the near term adversities mentioned above. Niche IT/ITeS services companies with strong business models are also likely to be better placed to face uncertainties in the near term.

COMPARATIVE VALUATIONS

		TCS	INFOSYS	WIPRO
P/E (x)	FY08E	17.3	18.6	20.3
	FY09E	15.0	16.0	17.0
P/BV (x)	FY08E	7.0	6.3	5.1
	FY09E	5.3	4.8	4.1
EV/Sales (x)	FY08E	3.7	4.6	3.2
	FY09E	2.9	3.6	2.6
EV/EBITDA (x)	FY08E	14.1	14.8	15.7
	FY09E	11.4	11.6	13.1

SHAREHOLDING PATTERN (%)

	MAR-08	DEC-07	MAR-07
Promoter	77.6	77.8	81.7
Domestic Inst	5.4	5.4	4.9
Foreign	10.8	10.7	7.1
Others	6.3	6.2	6.4

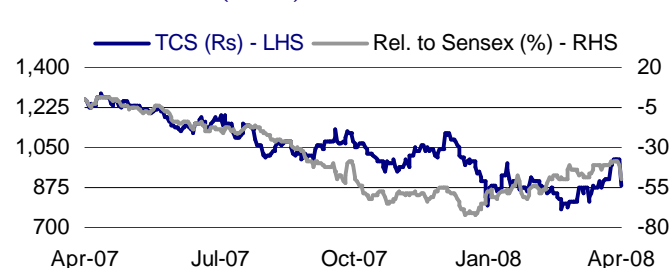
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VIATION (%)
FY09	59.3	61.7	-3.9
FY10	66.7	68.5	-2.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
887	1,100	24.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Sales	132,550	186,334	228,614	276,395	334,761
Change (%)	36.3	40.6	22.7	20.9	21.1
Cost of Services	69,746	100,339	122,344	152,509	186,557
SG&A Expenses	25,797	35,253	46,873	54,370	61,763
EBITDA	37,008	50,742	59,397	69,516	86,440
% of Net Sales	27.9	27.2	26.0	25.2	25.8
Depreciation	2,806	4,296	5,746	6,495	8,034
Other Income	257	1,280	4,450	5,361	6,586
PBT	34,459	47,726	58,101	68,382	84,752
Tax	4,984	6,568	7,494	9,748	18,646
Rate (%)	14.5	13.8	12.9	14.3	22.0
Equity in net earnings of affi	16	44	8	-6	-8
Minority Interest	280	47	424	641	814
PAT	29,211	40,786	50,191	57,987	65,284
Extraordinary	-243	530	0	0	0
Net Income	28,968	41,316	50,191	57,987	65,284
Change (%)	41.2	42.6	21.5	15.5	12.6

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	489	979	979	979	979
Reserves	57,919	88,682	122,841	162,509	207,183
Net Worth	58,408	89,661	123,820	163,487	208,162
Minority Interest	1,564	2,121	2,300	2,941	3,755
Loans	2,415	6,626	7,098	6,395	6,075
Capital Employed	62,908	99,291	134,031	173,636	218,805
Gross Block	20,739	25,669	38,449	53,449	68,449
Less : Depreciation	8,370	9,895	14,322	20,817	28,851
Net Block	12,369	15,774	24,128	32,632	39,598
CWIP	2,703	7,140	6,088	3,002	3,002
Other LT Assets	13,868	20,222	23,801	21,209	28,408
Investments	7,086	12,661	26,475	35,000	50,000
Curr. Assets	49,600	74,853	96,141	127,134	157,193
Debtors	32,790	43,090	53,899	62,718	76,690
Cash & Bank Balance	3,965	12,291	11,164	44,637	35,004
Other Current Assets	12,845	19,471	31,078	19,779	45,499
Current Liab. & Prov	22,719	31,358	42,602	45,341	59,396
Creditors	5,233	6,701	11,004	7,170	14,842
Other liabilities	17,485	24,657	31,596	38,170	44,553
Net Current Assets	26,882	43,494	53,539	81,792	97,797
Application of Funds	62,908	99,291	134,031	173,636	218,805

E: MOST Estimates

RATIOS *					
Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)					
EPS	29.8	41.7	51.3	59.3	66.7
Cash EPS	32.5	46.6	57.2	65.9	74.9
Book Value	59.7	91.6	126.5	167.1	212.7
DPS	6.8	11.5	14.0	16.0	18.0
Payout %(Incl.Div.Taxes)	22.8	27.2	-27.3	-27.0	-27.0
Valuation (x)					
P/E		21.3	17.3	15.0	13.3
Cash P/E		19.0	15.5	13.5	11.8
EV/EBITDA		16.7	14.1	11.4	9.1
EV/Sales		4.6	3.7	2.9	2.4
Price/Book Value		9.7	7.0	5.3	4.2
Dividend Yield (%)		13	16	18	2.0
Profitability Ratios (%)					
RoE	62.1	54.5	46.1	39.6	34.5
RoCE	69.9	58.8	49.8	44.5	43.2
Turnover Ratios					
Debtors (Days)	90	84	86	83	84
Fixed Asset Turnover (x)	6.4	7.3	5.9	5.2	4.9
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.1	0.1	0.0	0.0

* 1:1 bonus in FY07, accordingly ratios are adjusted

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
CF from Operations	31,953	45,271	56,361	65,124	71,050
Cash for Working Capital	-7,098	-11,603	-2,587	7,811	-29,753
Net Operating CF	24,855	33,669	53,773	72,935	41,297
Net Purchase of FA	-12,511	-14,055	-25,529	-11,914	-15,000
Net Purchase of Invest.	-2,074	-4,526	-13,815	-8,525	-15,000
Net Cash from Invest.	-14,585	-18,581	-39,344	-20,439	-30,000
Inc./(Dec) in Equity & other r	71	211	0	0	0
Proceeds from LTB/STB	-1,193	3,949	473	-703	-320
Net Cash Withdrawn by Tata	0	0	0	0	0
Dividend Payments	-7,960	-10,922	-16,030	-18,320	-20,610
Cash Flow from Fin.	-9,083	-6,761	-15,557	-19,023	-20,929
Free Cash Flow	12,344	19,613	28,244	61,021	26,297
Net Cash Flow	1,187	8,326	-1,127	33,473	-9,633
Opening Cash Bal.	2,778	3,965	12,291	11,164	44,637
Add: Net Cash	1,187	8,326	-1,127	33,473	-9,633
Closing Cash Bal.	3,965	12,291	11,164	44,637	35,005



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1. Analyst ownership of the stock
2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

Tata Consultancy Services

No
No
No
No

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