



Tata Consultancy Services

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,696	TCS IN
S&P CNX: 4,013	REUTERS CODE
	TCS.BO

16 April 2007

Buy

Previous Recommendation: Buy

Rs1,280

Equity Shares (m)	978.6
52-Week Range	1,399/728
1,6,12 Rel. Perf. (%)	-7/7/16
M.Cap. (Rs b)	1,252.7
M.Cap. (US\$ b)	28.8

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
3/07E	186,334	41,316	41.7	39.6	30.7	14.0	54.5	59.0	6.6	24.3
3/08E	241,484	51,984	53.1	27.5	24.1	9.9	47.0	52.1	5.0	18.4
3/09E	301,462	63,253	64.6	21.7	19.8	7.3	41.6	47.2	3.9	14.8

- International revenue and margins disappoint in 4QFY07:** 4QFY07 results were lower than our expectations with international business growing at 6% (in dollar terms) versus our estimate of 7.7%. EBITDA margin stayed flat at 28.3% due to rupee appreciation and decline in offshore contribution. Adjusted PAT grew slower at 1.4%.
- BFSI, ADM slow down during the quarter:** BFSI grew marginally at 2.3% in dollar terms (Infosys also reported low growth at 0.8% QoQ), while ADM revenue grew 3.4%. While the management has stated these to be a quarterly aberration, we would observe these to discern any visible trend in demand.
- Management confident of robust growth in FY08; hopes to top FY07 hiring:** The management expects to witness sustained volume growth in FY08, with strong demand 'across geographies and verticals'. In FY08, TCS expects to exceed the ~32,000 gross additions which it clocked in FY07. Despite pressure on margins through wage inflation and rupee appreciation, management is confident of sustaining margins in FY08.
- Outlook and view:** Both Infosys and TCS have reaffirmed their faith in a secular volume growth trend in FY08 and do not foresee any decline in spending in FY08. Following expectation of higher rupee appreciation in FY08 and lower volume growth in 4QFY07, we have downgraded our EPS to Rs53.1 and Rs64.6 for FY08 and FY09 respectively. At CMP, the stock is trading at 24.1x FY08E and 19.8x FY09E, However, the rupee has appreciated beyond our rupee-dollar estimates of 43.1 and 42 for FY08 and FY09 respectively. Any appreciation on a full year basis beyond our estimated rates could impact EPS growth negatively. We reiterate **Buy** with a price target of Rs1,490.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07*				FY06*	FY07*
	1Q	2Q	3Q*	4Q*	1Q*	2Q*	3Q*	4Q*		
Revenues	27,094	29,513	34,527	37,234	41,443	44,822	48,605	51,464	132,550	186,334
Q-o-Q Change (%)	4.8	8.9	17.0	7.8	11.3	8.2	8.4	5.9	36.3	40.6
Direct Expenses	13,621	15,428	18,064	19,897	22,989	23,880	26,294	27,177	69,746	100,339
Sales, General & Admin. Expenses	5,515	5,573	6,696	7,507	8,327	8,648	8,559	9,720	25,797	35,253
Operating Profit	7,958	8,513	9,767	9,830	10,128	12,294	13,753	14,568	37,008	50,742
Margins (%)	29.4	28.8	28.3	26.4	24.4	27.4	28.3	28.3	27.9	27.2
Other Income	98	170	-154	-40	668	77	300	235	257	1,280
Depreciation	540	592	738	865	863	958	1,080	1,395	2,806	4,296
PBT bef. Extra-ordinary	7,517	8,091	8,875	8,919	9,932	11,414	12,973	13,408	34,459	47,726
Provision for Tax	1,247	1,317	1,319	898	1,238	1,447	1,828	2,056	4,984	6,568
Rate (%)	16.6	16.3	14.9	10.1	12.5	12.7	14.1	15.3	14.5	13.8
Minority Interest	83	43	45	70	69	52	98	155	280	373
Net Income bef. Extra-ordinary	6,187	6,731	7,511	7,951	8,626	9,915	11,047	11,198	29,211	40,786
Q-o-Q Change (%)	9.0	8.8	11.6	5.9	8.5	14.9	11.4	1.4	29.6	39.6
PAT aft Extra-ordinary	6,187	6,731	7,511	7,725	8,626	9,915	11,047	11,728	28,968	41,316

*Consolidated numbers that include Tata Infotech

International revenue and margins disappoint in 4QFY07

4QFY07 results were lower than our expectations with international business (~90% of revenue) growing at 6% QoQ (in dollar terms) versus our estimate 7.7%. However on a consolidated basis, TCS registered 7.8% growth in revenue (dollar terms) versus our estimate of 7.4%. This was due to higher growth of 26.2% QoQ (in rupee terms) in revenues from India. Volumes grew 6.4% QoQ, while billing rates improved by 89bp. TCS also witnessed 44bp improvement in revenue through productivity gains in fixed price projects. However, there was negative impact of 1.87% on revenue growth due to rupee appreciation. Volume growth in international business at 5.24% was lower than absolute growth of 6% in dollar terms despite management citing more offshoring in international business. This was due to slower growth in BFSI, where some large projects got completed during the quarter.

Despite pricing and productivity gains, EBITDA margin stayed flat at 28.3% against our expectation of 50bp improvement. This was due to rupee appreciation, lower offshoring and lower utilisation rates. Offshore revenue contribution has declined to 41.3% vs. 41.6% in 3QFY07.

The quarter saw non recurring other income accruing from the sale of stake in Sitel JV, which resulted in 6.2% QoQ increase in reported net profit to Rs11.7b. Adjusted PAT (assuming tax rate of 20% on profit on sale of investment), grew slower at 1.4%, which is lower than our estimate of 7.9% growth.

BFSI, ADM slow down during the quarter

Growth in international business revenue was largely led by growth in top client, which grew at a robust rate of 24.8% QoQ. International revenue growth excluding top 10 clients slowed down to 4.8% QoQ (lowest in the last 5 quarters). Given the recent concerns over slowdown in non top clients for Infosys and TCS, we would closely watch this metric over the next few quarters.

Other operational metrics were also below expectations – BFSI grew marginally at 2.3% QoQ in dollar terms (Infosys also reported low growth at 0.8% QoQ, despite BFSI being the highest contributor to revenue for both the vendors),

while ADM revenue grew 3.4% QoQ. While the management has stated these to be a quarterly aberration, we would observe these to discern any visible trend in demand.

NON TOP CLIENT SLOWDOWN IN 4QFY07 (US\$M)

	MAR-06	JUN-06	SEP-06	DEC-06	MAR-07
Top Client Revenue	31.0	36.0	47.8	62.6	78.1
Growth (%)	9.1	16.3	32.7	31.0	24.8
Top 10 Clients Revenue	230.0	241.2	261.4	302.0	336.2
Growth (%)	8.7	4.9	8.4	15.5	11.3
Int'l Rev. Excl. Top Client	710.7	768.9	845.9	949.2	994.6
Growth (%)	9.8	8.2	10.0	12.2	4.8

BFSI STAYS FLAT DURING THE QUARTER (IN RUPEE TERMS)

VERTICALS (RS M)	JUN-06	SEP-06	DEC-06	MAR-07
BFSI	17,075	19,139	21,143	21,255
Growth (%)	9.7	12.1	10.5	0.5
Manufacturing	6,631	6,858	7,388	7,771
Growth (%)	8.6	3.4	7.7	5.2
Telecom	6,838	7,440	8,166	9,058
Growth (%)	28.4	8.8	9.7	10.9
Life Sciences and Healthcare	1,699	1,793	2,187	2,419
Growth (%)	1.4	5.5	22.0	10.6
Retail and Distribution	2,777	2,958	3,354	4,066
Growth (%)	16.5	6.5	13.4	21.2
Transportation	1,492	1,524	1,410	1,647
Growth (%)	8.3	2.1	-7.5	16.8
Energy and Utilities	1,078	1,210	1,069	1,184
Growth (%)	-3.5	12.3	-11.6	10.7
Others	3,854	3,899	3,888	4,066
Growth (%)	4.6	1.2	-0.3	4.6

ADM REV. SLOWEST DURING THE QUARTER (IN RUPEE TERMS) (RS M)

REVENUE BY SERVICE OFFERING	JUN-06	SEP-06	DEC-06	MAR-07
ADM	21,551	23,352	26,004	26,401
Growth % QoQ		8.4	11.4	1.5
BI	3,606	4,303	4,617	5,043
Growth % QoQ		19.3	7.3	9.2
Engg. & Industrial Services	2,569	2,734	2,625	2,779
Growth % QoQ		6.4	-4.0	5.9
Infrastructure Services	2,818	2,689	2,673	3,088
Growth % QoQ		-4.6	-0.6	15.5
Enterprise Solutions	5,388	5,379	5,735	6,330
Growth % QoQ		-0.2	6.6	10.4
Global Consulting	1,326	1,569	1,653	1,801
Growth % QoQ		18.3	5.3	9.0
Asset Leveraged Solutions	1,078	1,121	1,361	1,595
Growth % QoQ		4.0	21.5	17.2
Assurance Services	746	1,076	1,118	1,338
Growth % QoQ		44.2	3.9	19.7
BPO	2,362	2,600	2,819	3,088
Growth % QoQ		10.0	8.4	9.5

Source: Company/ Motilal Oswal Securities

Management expects margins to stay flat in FY08, despite rupee appreciation and wage inflation

Salary hikes are expected to be 3-5% onsite and 12-15% offshore (akin to FY07). Besides wage inflation, the rupee still continues to appreciate (Rs41.9 against the US\$ on 16 April 2007; Infosys has budgeted 150-160bp margin impact at a full year rate of 43.1 for FY08). Further appreciation in the rupee would have a negative impact on margins. However, TCS' over US\$1b hedge at an average rate of US\$43.5-44, which will cushion this impact to some extent. Despite wage inflation and continuing rupee appreciation, management is expecting operating margins to remain flat in FY08 (FY07 EBITDA margin at 27.2%; EBIT margins 24.9%; missed FY07 guidance of flat margins).

On pricing front, TCS continues to claim to be getting 5-10% higher realization for new contracts and 3-5% higher pricing for renewals, which could aid margins going forward. Since most of the contract renegotiations have come in post September 2006, we expect full year impact of the same to boost realization in FY08. We anticipate improvement in price realizations to also accrue on account of better service mix due to faster growth in high margin services and continued improvement in service mix of Tata Infotech and CMC.

Offshore contribution, currently at 41.3%, offers scope for improvement, which could also result in some margin improvement during the year. The management also expect SG&A leverage and profitability improvements in subsidiaries (Diligenta, centers in Latin America and China) to help maintain margins on a YoY basis.

However we believe that maintaining margins in FY08 will be an optimistic target and therefore estimate 30bp decline in margins.

Management confident of volume growth in FY08, hopes to top FY07 hiring

The management expects to witness sustained volume growth in FY08, with strong demand 'across geographies and verticals'. Following 4QFY07 lackluster performance

in BFSI, the management is confident of ramp up in BFSI in FY08 on back of nearly 50% growth in FY07. There is currently no downturn witnessed in terms of client spending across the board. In terms on manpower recruitment for the year, for FY08, TCS expects to exceed the ~32,000 gross additions which it clocked in FY07, indicating robust volume growth.

Large deal pipeline continues to be strong, with TCS currently participating in 10 deals of +US\$50m of which some are more than US\$100m. It expects robust deal pipeline with leverage from integrated service and global delivery model. (In FY07, TCS has won 12 large deals of +US\$50m, including 2 large deals of +US\$100m). This is in line with its large deal strategy, which could contribute significantly to volume growth over the coming year.

Outlook and view

Both Infosys and TCS have reaffirmed their faith in a secular volume growth trend in FY08 and do not foresee any decline in spending in FY08. While we would continue to watch BFSI and ADM revenue growth across the sector, we believe the long term trend in offshore spending is intact and offshoring could increase in case of IT budget cuts. The indication of higher recruitment numbers for TCS in FY08 gives us comfort on volume growth in FY08.

Following expectation of higher rupee appreciation in FY08 (than our earlier estimates) and lower volume growth in 4QFY07, we have downgraded our EPS by 3.5% and 2.9% to Rs53.1 and Rs64.6 for FY08 and FY09 respectively. At CMP, the stock is trading at 24.1x FY08E and 19.8x FY09E. We continue to be bullish on the demand scenario for the Indian IT sector given the continued offshoring momentum. However, the rupee has appreciated beyond our rupee-dollar rates of 43.1 and 42 for FY08 and FY09 respectively. Any appreciation on a full year basis beyond our estimated rates could impact EPS growth negatively. We reiterate **Buy** with a price target of Rs1,490 (revised downward from earlier target of Rs1,535) based on 23x FY09E EPS (upside of 16%).

Tata Consultancy Services: an investment profile

Company description

TCS is the largest IT services company in India, with revenue of US\$4.2b in FY07. It employs nearly 90,000 people, and provides IT as well as BPO services to 780 clients. It is a preferred vendor for a majority of the Fortune 500/Global 1000 companies. Its top clients include GE, Prudential, AIG, Target, P&O Nedlloyd, ABN Amro and Standard Chartered.

Key investment arguments

- ✎ Experience of handling multi-million dollar contracts places it suitably against global players.
- ✎ Client diversification, leading to narrowing gap in growth differential compared to peers.
- ✎ Has considerable near shore presence, which could give an edge in bagging clients new to offshoring.

Key investment risks

- ✎ Lowering of experience profile could impact quality, as TCS is used to delivering services with more experienced people.
- ✎ Inclination to accept large complete IT outsourcing deals could impact profitability and return ratios.

Recent developments

- ✎ Sold 50% holding in JV to Sitel Corporation for US\$22.2 million.
- ✎ Positioned by Gartner Inc in the leaders quadrant in the 'Magic Quadrant for Business Intelligence Services, North America, 2007' report.

Valuation and view

- ✎ Revenue CAGR of 27.2% and EPS CAGR of 24.5% over FY07-09.
- ✎ Valuations at 19.8x FY09E earnings offers room for upside, given strong growth and likely expansion in margins.
- ✎ Maintain **Buy** with a target price of Rs1,490.

Sector view

- ✎ Various CIO surveys indicate increasing share of offshore spending in IT budgets.
- ✎ Indian offshore vendors gaining market share from MNCs.
- ✎ Prefer large companies, as bulk of volumes going to them; niche players benefit due to lack of offshore competition.

COMPARATIVE VALUATIONS

		TCS	INFOSYS	WIPRO
P/E (x)	FY08E	24.1	25.2	22.8
	FY09E	19.8	21.0	19.2
P/BV (x)	FY08E	9.9	8.0	6.2
	FY09E	7.3	6.1	4.9
EV/Sales (x)	FY08E	5.0	6.1	3.9
	FY09E	3.9	4.7	3.0
EV/EBITDA (x)	FY08E	18.4	19.8	17.2
	FY09E	14.8	15.5	13.5

SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	81.7	82.5	83.7
Domestic Inst	4.9	4.4	3.3
Foreign	7.1	7.0	7.5
Others	6.3	6.1	5.5

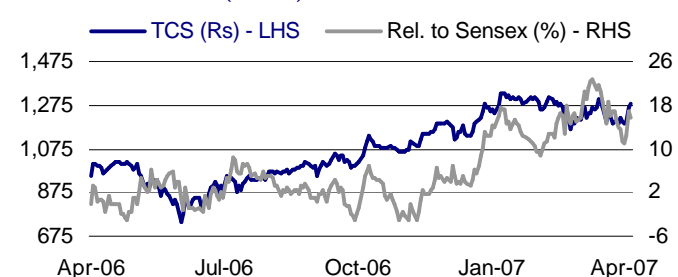
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	53.1	55.4	-4.2
FY09	64.6	67.5	-4.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,280	1,490	16.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Sales	97,272	132,550	186,334	241,484	301,462
Change (%)	36.6	36.3	40.6	29.6	24.8
Cost of Services	51,105	69,746	100,339	132,004	168,299
SG&A Expenses	17,662	25,797	35,253	44,588	54,254
EBITDA	28,505	37,008	50,742	64,892	78,908
% of Net Sales	29.3	27.9	27.2	26.9	26.2
Depreciation	1,577	2,806	4,296	5,916	7,235
Interest	0	0	0	266	266
Other Income	757	257	1,280	2,550	3,613
PBT	27,685	34,459	47,726	61,260	75,020
Tax	4,065	4,984	6,568	8,586	10,917
Rate (%)	14.7	14.5	13.8	14.0	14.6
Equity in net earnings of aff	18	16	44	70	120
Minority Interest	79	280	417	760	972
PAT	23,559	29,211	40,786	51,984	63,253
Extraordinary	-3,038	-243	530	0	0
Net Income	20,521	28,968	41,316	51,984	63,253
Change (%)	25.4	41.2	42.6	25.8	21.7

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	480	489	979	979	979
Share Premium	0	0	0	0	0
Reserves	31,497	57,919	88,682	125,461	170,212
Net Worth	31,977	58,408	89,661	126,439	171,190
Minority Interest	1,323	1,564	2,121	2,881	3,853
Loans	1,928	979	5,032	4,679	4,429
Capital Employed	35,712	62,900	98,984	136,170	181,642
Gross Block	15,261	22,320	35,160	50,160	66,160
Less : Depreciation	5,360	9,951	14,247	20,164	27,399
Net Block	9,902	12,369	20,912	29,996	38,761
CWIP	968	2,703	2,001	3,001	3,001
Other LT Assets	3,164	13,868	21,258	20,318	24,556
Investments	4,183	7,086	12,711	30,000	50,000
Curr. Assets	30,692	49,600	73,707	106,587	133,496
Debtors	20,343	32,790	43,090	54,826	65,758
Cash & Bank Balance	2,633	3,965	11,120	30,687	41,179
Loans & Advances	0	0	0	0	0
Other Current Assets	7,717	12,845	19,496	21,073	26,558
Current Liab. & Prov	13,197	22,726	31,605	53,734	68,173
Creditors	2,727	4,308	5,596	7,636	8,882
Other liabilities	10,469	18,418	26,008	46,095	59,288
Net Current Assets	17,495	26,874	42,102	52,853	65,323
Application of Funds	35,712	62,900	98,984	136,169	181,641

E: MOST Estimates

RATIOS *					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	24.6	29.8	41.7	53.1	64.6
Cash EPS	26.2	32.5	46.6	59.2	72.0
Book Value	33.3	59.7	91.6	129.2	174.9
DPS	4.2	6.8	11.5	13.3	16.2
Payout%(Incl.Div.Taxes)	20.0	22.8	27.2	25.0	25.0
Valuation (x)					
P/E		42.9	30.7	24.1	19.8
Cash P/E		39.4	27.5	21.6	17.8
EV/EBITDA		33.6	24.3	18.4	14.8
EV/Sales		9.4	6.6	5.0	3.9
Price/Book Value		21.4	14.0	9.9	7.3
Dividend Yield (%)		0.5	0.9	1.0	1.3
Profitability Ratios (%)					
RoE	80.4	62.1	54.5	47.0	41.6
RoCE	90.2	69.9	59.0	52.1	47.2
Turnover Ratios					
Debtors (Days)	76	90	84	83	80
Fixed Asset Turnover (x)	6.4	5.9	5.3	4.8	4.6
Leverage Ratio					
Debt/Equity Ratio(x)	0.1	0.0	0.1	0.0	0.0

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

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
CF from Operations	24,046	31,953	46,631	56,526	68,497
Cash for Working Capital	-3,772	-7,098	-18,268	9,643	-6,549
Net Operating CF	20,274	24,855	28,363	66,169	61,948
Net Purchase of FA	-3,909	-12,511	-12,138	-16,000	-16,000
Net Purchase of Invest.	-2,033	-2,074	-5,625	-17,289	-20,000
Net Cash from Invest.	-5,942	-14,585	-17,763	-33,289	-36,000
Inc./(Dec) in Equity & other	18,921	71	0	0	0
Proceeds from LTB/STB	-5,563	-1,193	4,053	-353	-250
Net Cash Withdrawn by Tat	-23,000	0	0	0	0
Dividend Payments	-3,624	-7,960	-7,498	-12,959	-15,205
Cash Flow from Fin.	-13,265	-9,083	-3,446	-13,312	-15,455
Free Cash Flow	16,365	12,344	16,225	50,169	45,948
Net Cash Flow	1,067	1,187	7,155	19,567	10,493
Opening Cash Bal.	1,566	2,778	3,965	11,120	30,687
Add: Net Cash	1,067	1,187	7,155	19,567	10,493
Closing Cash Bal.	2,633	3,965	11,120	30,687	41,180



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Tata Consultancy Services

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2. Group/Directors ownership of the stock	No
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