

# Tata Consultancy Services

Rs1,280  
**OUTPERFORMER**

## RESULT NOTE

Mkt Cap: Rs1,253bn; US \$28.6bn

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**Result:** Q4FY07

**Comment:** Disappointing quarter; maintains positive stance on demand environment

**Last report:** 04 April 2007 (Price Rs1200; Recommendation: Outperformer)

## Key financials

Year end 31 March (Rs mn)	Net Sales	% Change yoy	Net Profits	Diluted EPS	% Change yoy	PER(x)
2006	132,454	36.2	28,831	29.7	21.0	43.1
2007	186,334	40.7	41,315	42.2	42.0	30.3
2008E	240,709	29.2	52,297	53.4	26.6	24.0
2009E	307,816	27.9	64,918	66.3	24.1	19.3

TCS results were lackluster given the fact that expectations were high based on the management commentary over the last couple of quarters. While the top client continued to fire growing by 20.6% qoq, it was disappointing to note that pricing remained stable (Infosys' billing rates continued to grow) and volume growth was modest at 5.2% qoq. While hiring continued to be strong, the lack of data on pricing and volume not only poses a risk on the upside but also on the downside. The increase in attrition rate at the experienced level also creates some nervousness. We are cutting our above-consensus estimates due to marginally lower volume growth and using an exchange rate of Rs42/US\$. We are lowering our earnings forecast by 6.1% in FY08E and 4.7% in FY09E due to lower revenue and margin expectations. It is trading at 24x FY08E and 19.3x FY09E earnings (which is same as Infosys' valuation). We maintain Out performer but retain Infosys as our top pick in the sector.

### □ Revenue growth of 7.8% qoq in dollar terms

TCS's international revenues (90.6% of the total) grew 6% qoq in \$ terms and 4.1% qoq in rupee terms to Rs46.6bn. Total revenues grew 7.8%qoq in \$ terms and 5.9%qoq in rupee terms aided by volume growth of 6.42% qoq (5.2% in international business), improvement in blended billing rate of 89bp qoq on Time & Material contracts, productivity improvement in fixed price contract (44bp), despite rupee appreciation (-187bp). TCS reiterated that it is experiencing 3-5% increase in prices on contract renewals (partly coming from productivity gains) with existing customers and 5-9% higher prices for new contracts as it has mentioned earlier.

### □ EBITDA margin were flat sequentially – declined 66bp yoy

TCS' gross margin expanded 130bp despite rupee appreciation, as the employee cost declined 200bp sequentially as a % of revenue. TCS witnessed attrition in the experienced employees which resulting in lower employee cost in COR. However, a part of the vacant positions were replaced by trainees. SG&A increased 130bp as % of revenue mainly due to higher trainee level employee cost (-40bp impact on margins), higher provision of bad debts (-30bp), and higher other costs (-90bp). Overall, EBITDA margins remained flat against our expectations of 90bp qoq improvement.

### □ Top client grew fast

TCS has experienced strong growth rates from its top client. We note that its top client grew 20.6% qoq in Q4FY07 following the 21.6% qoq, 35.7% qoq, and 26.8% qoq growth in the first three quarters respectively. Thus, the quarterly run-rate from the top client has increased 2.5x to Rs3b during FY07. Its top5 customers excluding the top client grew at a slower pace of 5.9% qoq. But the bottom five clients in the top 10 category grew at just 2.1% qoq. The growth in revenues from the non-top10 clients for TCS was lower at 2.8% qoq compared to 8% qoq in the previous quarter.

### □ Net profit grew 6.6% qoq

TCS' EBITDA grew 5.9% qoq to Rs 14.6bn. Net profit grew 6.2% qoq to Rs11.7bn. Other income was higher at Rs898m on account of Rs663m of profit from sale of Sitel. The tax rate was higher at 15.6% during the quarter due to higher other income.

### □ Management continues its bullish stance on overall prospects

TCS hired 5,827 employees (net) in Q4FY07 and 8,613 (gross) aggregating about 32,462 gross employee addition in FY07 – net addition was 22,750. The company refrained from guiding for employee addition for FY08, but maintained that the employee addition would be higher than FY07.

TCS remains confident of reporting further billing rate increases and getting productivity gains from fixed price contracts and maintained its positive stance on billing rate environment. It announced two \$50m+ deals and one \$35m+ deal during the quarter.

Management informed that it would be effecting 12-15% salary hike on offshore and 3-5% onsite during Q1FY08.

### □ Other key metrics

- Good client mining continued in the quarter as reflected in the 90bp qoq increase in contribution from top customer to 6.6%.
- The company added 43 new clients. The number of active clients increased to 780 from 754 in the previous quarter.
- Attrition increased to 11.3% (LTM basis) from 10.6% in previous quarter.
- ADM declined 220bp qoq to 51.3% of revenues, while Enterprise solutions/PI and Asset leverage solutions rose by 50bp and 30bp to 12.3% and 3.1% of revenues, respectively .
- BFSI's contribution to revenues declined by 220bp qoq to 41.3%
- Revenues from North America were lower at 51.1% of total revenues from 51.9% in the previous quarter. Continental Europe remained flat as % of total revenues at 8.5%. Contribution of UK and India increased 40bp qoq and 150bp qoq as % of total revenues to 20.5% and 9.4%, respectively.
- Fixed price projects declined to 40.2% of revenues from 41% in last quarter.
- Offshore proportion of revenues declined marginally to 41.3% of revenue (-30bp qoq), while GDC revenues increased 50bpb qoq as % of total revenues to 4.6%.
- Utilization rates (including trainees) declined marginally to 74.72%.
- TCS added 2 more clients to the US\$20m revenue bucket. It now has 39 clients billing an annual US\$20m. Clients with \$50m+ run rate declined to 14 from 15 in the last quarter.

## Valuations and view

TCS results were lackluster given the fact that expectations were high based on the management commentary over the last couple of quarters. While the top client continued to fire growing by 20.6% qoq, it was disappointing to note that pricing remained stable (Infosys' billing rates continued to grow) and volume growth was modest at 5.2% qoq. While hiring continued to be strong, the lack of data on pricing and volume not only poses a risk on the upside but also on the downside. The increase in attrition rate at the experienced level also creates some nervousness. We are cutting our above-consensus estimates due to marginally lower volume growth and using an exchange rate of Rs42/US\$. We are lowering our earnings forecast by 6.1% in FY08E and 4.7% in FY09E due to lower revenues and margins. It is trading at 24x FY08E and 19.3x FY09E earnings (which is in line with Infosys' valuation). We maintain Out performer but retain Infosys as our top pick in the sector.

	Old		New	
	FY08	FY09	FY08	FY09
Exchange rate	44	43	42	41
Revenue (Rs b)	254	321	241	308
% revision			(5.4)	(4.1)
EPS (Rs)	56.9	69.6	53.4	66.3
% revision			(6.1)	(4.7)

## Quarterly results

Year ending March 31, Rs.m	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	FY06	FY07E	FY08E
<b>Total revenues</b>	<b>34,526</b>	<b>37,234</b>	<b>41,443</b>	<b>44,822</b>	<b>48,605</b>	<b>51,464</b>	<b>132,454</b>	<b>186,334</b>	<b>240,709</b>
Cost of revenues	18,059	19,799	22,989	23,880	26,294	27,177	69,684	100,339	130,380
<b>Gross Profit</b>	<b>16,466</b>	<b>17,434</b>	<b>18,455</b>	<b>20,942</b>	<b>22,311</b>	<b>24,287</b>	<b>62,770</b>	<b>85,995</b>	<b>110,329</b>
Other operating expenditure	6,694	7,373	8,327	8,648	8,559	9,720	25,824	35,253	45,794
EBITDA	9,773	10,062	10,128	12,294	13,752	14,568	36,946	50,742	64,536
<b>Net income</b>	<b>7,505</b>	<b>8,190</b>	<b>8,626</b>	<b>9,915</b>	<b>11,047</b>	<b>11,728</b>	<b>29,074</b>	<b>41,315</b>	<b>52,297</b>
<b>Ratios</b>									
Gross Profit Margin (%)	47.7	46.8	44.5	46.7	45.9	47.2	47.4	46.2	45.8
EBITDA Margin (%)	28.3	27.0	24.4	27.4	28.3	28.3	27.9	27.2	26.8
Net profit Margin (%)	21.7	22.0	20.8	22.1	22.7	22.8	22.0	22.2	21.7
<b>QoQ growth</b>									
Revenues	9.4	7.8	11.3	8.2	8.4	5.9			
EBITDA	11.1	3.0	0.7	21.4	11.9	5.9			
Net profits	8.7	9.3	5.3	14.6	11.8	6.6			
<b>YoY growth</b>									
Revenues	33.9	44.1	42.3	42.0	40.8	38.2	36.2	40.7	29.2
EBITDA	26.3	37.5	21.8	39.8	40.7	44.8	29.6	37.3	27.2
Net profits	6.2	48.5	32.3	43.4	47.5	43.9	24.2	42.1	26.4

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2. Neutral: Within 0-10% to Index
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