

Raising the bar once again

CMP: Rs 1146
Target Price (TP): Rs 1324
52wk H/L: Rs 1350/ Rs 763

TCS continued to deliver strong numbers above market expectations in Q1FY12 with robust growth across verticals and service lines. Discretionary spend continues to show sustainable trends for TCS.

Yet another impressive quarter

TCS reported strong revenue growth 7.5%QoQ to USD2.41bn (6.3%QoQ to Rs107.9bn) above ours and street expectations, driven by robust volume growth of 7.4%. Although wage hikes impacted EBITDA margin by 230bps to 28.1%, profit was flat at Rs23.8bn (IFRS) coming in way above street estimates.

No let up in discretionary spend; Deal pipeline robust

The company won 10 large deals across verticals, two of them being transformational deals. No delays in decision-making regarding discretionary spend have been witnessed, with a couple of discretionary deals existing in the pipeline. The growth in the Enterprise solutions & consulting service offering (8%QoQ in Q1) continues, growing at a 4Q-CQGR of 10%. Deal pipeline continues to be healthy. We expect the revenue growth momentum to continue.

Margins to bounce back with strong demand

We expect TCS' EBITDA margin to return in the 29-30% range in the next couple of quarters, with revenue growth remaining buoyant. All the verticals (including telecom) have delivered healthy growth. The decline in EBITDA/emp by 2% in Q1, is expected to reverse from Q2.

Key risks: The headcount crossed the two lakh mark and the trend of aggressive hiring is expected to continue. The challenge of acquiring the desired talent at the right cost and managing softer issues of employee satisfaction, and therefore attrition, remain. Risk of consistently meeting the high expectations set, will also remain.

Valuation and Recommendation

We estimate healthy EPS growth of 20% in FY12 to 53.4 followed by 15% growth in FY13 to Rs61.4. The stock trades at 21.5x FY12 and 18.7x FY13 earnings. Given the strong sustainable growth visibility from TCS, we value the stock at 21.5x FY12 earnings, 7-8% premium to Infosys, yielding a target of Rs1324 a 15.5% upside. We rate the stock as 'Buy'.

Stock data

Market Cap (Rs bn)	2,243
Market Cap (USD bn)	50.4
Shares Outstanding (mn)	1957.2
Free Float (%)	26.0
3M avg. daily vol.(mn)	1.7
Bloomberg Code	TCS.IN
Reuters Code	TCS.BO

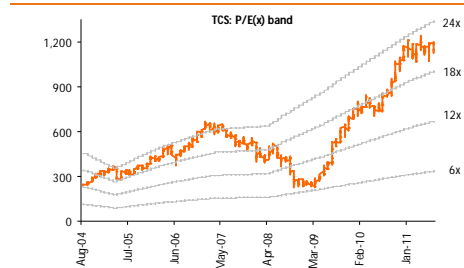
Shareholding Pattern (%)

Promoter	74.0
Institutions	20.8
Public & Others	5.2

Stock Performance

Return (%)	1m	3m	6m	12m
Absolute	(5.3)	(6.9)	0.6	45.3
Relative	(7.0)	(1.4)	1.9	41.5

P/E(x) band



Source: Bloomberg, Almondz Research

Exhibit 1: Quarterly Results

In Rs mn	FY11				FY12E				1QFY12	FY11	FY12E
Parameter	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE	QoQ		
Revenue	82,173	92,864	96,634	101,575	107,970	114,063	119,868	125,349	6.3%	373,245	467,250
Total Expenses	58,018	65,089	67,459	70,695	77,625	80,940	84,458	87,654	9.8%	261,261	330,677
EBITDA	24,155	27,775	29,175	30,880	30,345	33,123	35,410	37,695	-1.7%	111,984	136,573
EBITDA margin (%)	29.4%	29.9%	30.2%	30.4%	28.1%	29.0%	29.5%	30.1%	-230 bps	30.0%	29.2%
Less: Depreciation	1,575	1,660	1,856	2,123	2,049	2,159	2,262	2,332	-3.5%	7,214	8,802
Less: Interest											
PBT (operating)	22,580	26,115	27,319	28,757	28,296	30,964	33,148	35,363	-1.6%	104,770	127,771
Other income (incl. forex, interest costs)	820	443	1,822	2,239	2,886	2,165	2,112	2,047	28.9%	5,324	9,210
PBT	23,400	26,558	29,141	30,996	31,182	33,129	35,260	37,409	0.6%	110,094	136,981
Less: Tax	4,475	5,001	5,491	6,772	7,063	7,620	8,110	8,604	4.3%	21,739	31,397
Eff. tax rate (%)	19.1%	18.8%	18.8%	21.8%	22.7%	23.0%	23.0%	23.0%	3.7%	19.7%	22.9%
PAT	18,925	21,557	23,650	24,224	24,119	25,510	27,150	28,805	-0.4%	88,355	105,584
Prior period items	292	295	189	415	281	310	318	338		1,191	1,247
Ex income/(loss)	0	0	0	0	0	0	0	0		0	0
PAT (after EO)	18,633	21,262	23,461	23,809	23,838	25,200	26,832	28,467	0.1%	87,164	104,337
Basic EPS (Rs)	9.52	10.86	11.99	12.16	12.18	12.88	13.71	14.54	0.1%	44.53	53.31
Dil. EPS (Rs)	9.52	10.86	11.99	12.16	12.18	12.88	13.71	14.54	0.1%	44.53	53.31
Dil. shares (mn)	1,957	1,957	1,957	1,957	1,957	1,957	1,957	1,957		1,957	1,957

Source: Company, Almondz Research

Exhibit 2: Key operating expense ratios

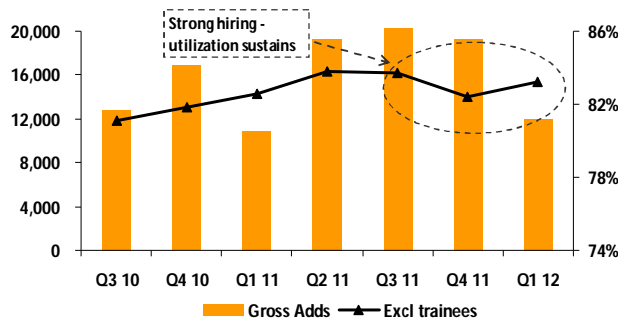
P&L cost % of sales	1Q FY10	2Q FY10	3Q FY10	4Q FY10	1Q FY11	2Q FY11	3Q FY11	4Q FY11	1Q FY12
Cost of revenues	53.0%	52.7%	52.1%	51.7%	53.7%	53.8%	53.3%	53.0%	54.4%
SG&A expenses	19.8%	18.6%	18.2%	18.4%	16.9%	16.3%	16.5%	16.6%	17.5%

Source: Company, Almondz Research

Utilization sustains as hiring picks up

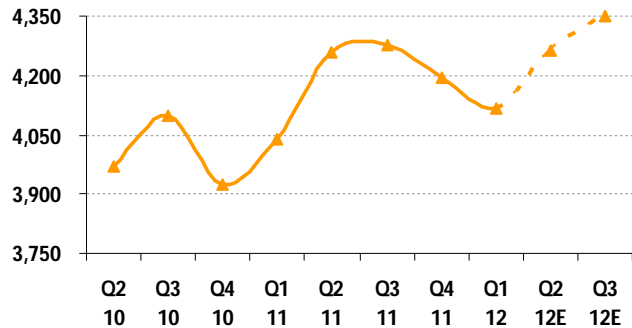
Utilization (excl trainees) has climbed back to over 83% in Q1FY12, with close to 12000 hires in the quarter, of which 3/4th were laterals. With hiring expected to increase further by 17,000-20,000 in Q2FY12 (management guidance), utilization including trainees would drop, but utilization excluding trainees would still be maintained over 82%. This clearly indicates the continued robust demand quarter after quarter. The company is on track to hire 60,000 for FY12.

Exhibit 3: Hiring trend vs. Utilization



Source: Company, Almondz Research

Exhibit 4: EBITDA/employee (\$)



Source: Almondz Research

Where TCS outperforms INFY (Jun-11 qtr):

- Discretionary spend continues to remain buoyant (TCS: 8% vs. INFY: 3.4%)
- Nearly double the volume growth of INFY (TCS: 7.4% vs. INFY: 4%)
- Utilization expected to remain at elevated levels, despite aggressive hiring; (TCS: +80bps vs. INFY: -30bps)
- Telecom springs back to growth vs. further deterioration for INFY (TCS: 14%, INFY: -7%)
- Europe doing much better for TCS (TCS: 6.6%, INFY: 0.5%)

Broad-based vertical growth

Growth in Q1FY12 was witnessed across verticals, including the telecom vertical driven by some discretionary projects. Although telecom can be volatile, other verticals viz. BFSI, retail, life sciences and manufacturing are expected to continue growing.

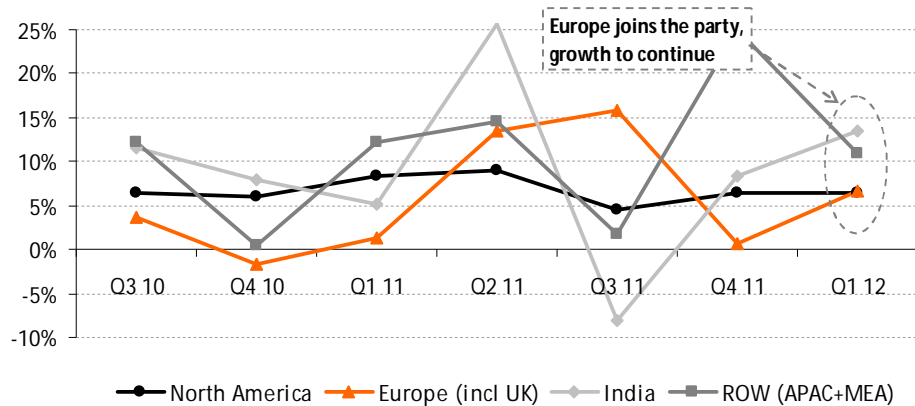
Exhibit 5: Vertical performance

Verticals	QoQ USD Growth						
	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
BFSI	6.3%	3.1%	5.7%	10.0%	8.4%	3.3%	5.7%
Telecom	7.2%	2.6%	12.3%	12.6%	-0.5%	-3.2%	14.3%
Manufacturing	1.5%	-4.4%	2.3%	11.7%	4.1%	9.0%	8.9%
Retail	6.3%	-7.6%	8.8%	10.7%	7.0%	7.6%	11.3%
Hi-tech	10.8%	-10.5%	12.7%	11.7%	16.3%	13.1%	15.4%
Life sciences & Healthcare	4.6%	-10.3%	7.8%	9.6%	9.1%	6.7%	5.4%
Transportation	3.3%	-4.2%	4.5%	15.3%	13.7%	20.1%	1.9%
Energy & Utilities	29.1%	-10.2%	18.6%	45.6%	9.5%	9.4%	-11.2%
Media & Ent	1.5%	-12.8%	13.8%	17.6%	23.0%	4.7%	2.8%
Others	-0.7%	114.4%	11.5%	4.4%	-4.3%	-1.5%	14.2%
Total	6.3%	1.7%	7.8%	11.7%	7.0%	4.7%	7.4%
% Total Revenue							
BFSI	45.0%	45.6%	44.7%	44.0%	44.6%	44.0%	43.3%
Telecom	12.1%	12.2%	12.7%	12.8%	11.9%	11.0%	11.7%
Manufacturing	8.3%	7.8%	7.4%	7.4%	7.2%	7.5%	7.6%
Retail	12.0%	10.9%	11.0%	10.9%	10.9%	11.2%	11.6%
Hi-tech	5.0%	4.4%	4.6%	4.6%	5.0%	5.4%	5.8%
Life sciences & Healthcare	5.9%	5.2%	5.2%	5.1%	5.2%	5.3%	5.2%
Transportation	3.4%	3.2%	3.1%	3.2%	3.4%	3.9%	3.7%
Energy & Utilities	3.4%	3.0%	3.3%	4.3%	4.4%	4.6%	3.8%
Media & Ent	2.1%	1.8%	1.9%	2.0%	2.3%	2.3%	2.2%
Others	2.8%	5.9%	6.1%	5.7%	5.1%	4.8%	5.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Growth across the board; Telecom comes out of slumber

Source: Company, Almondz Research

Exhibit 6: Sequential growth - Geography wise



Source: Company, Almondz Research

Exhibit 7: Horizontal performance

Discretionary spend on the rise

Core ADM – most sustainable growth

Horizontals	QoQ USD Growth						
	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
ADM	5.3%	-0.1%	7.1%	9.1%	2.9%	7.2%	7.7%
Enterprise Solutions	8.4%	-0.8%	3.3%	17.4%	-0.3%	17.8%	7.4%
Business Intelligence	6.3%	-2.3%	6.4%	15.8%	1.2%	-3.2%	7.4%
Engineering services	8.5%	-3.0%	6.4%	14.0%	4.8%	4.7%	3.0%
Infrastructure services	5.0%	8.3%	11.6%	20.7%	19.5%	-9.3%	12.2%
Global Consulting	39.6%	22.7%	-10.6%	11.7%	17.2%	-4.4%	12.6%
Asset Lev Sol (Product)	6.3%	28.9%	-1.6%	2.7%	25.9%	-5.8%	7.4%
BPO	3.6%	3.1%	3.7%	8.7%	11.9%	6.5%	1.0%
Assurance services	8.6%	22.0%	17.4%	15.2%	15.1%	3.2%	12.0%
Total	6.3%	3.1%	6.4%	11.7%	7.0%	4.7%	7.4%
% Total Revenue							
ADM	49.1%	47.6%	47.9%	46.8%	45.0%	46.1%	46.2%
Enterprise Solutions	10.5%	10.1%	9.8%	10.3%	9.6%	10.8%	10.8%
Business Intelligence	5.7%	5.4%	5.4%	5.6%	5.3%	4.9%	4.9%
Engineering services	5.1%	4.8%	4.8%	4.9%	4.8%	4.8%	4.6%
Infrastructure services	7.9%	8.3%	8.7%	9.4%	10.5%	9.1%	9.5%
Global Consulting	2.1%	2.5%	2.1%	2.1%	2.3%	2.1%	2.2%
Asset Lev Sol (Product)	3.2%	4.0%	3.7%	3.4%	4.0%	3.6%	3.6%
BPO	11.5%	11.5%	11.2%	10.9%	11.4%	11.6%	10.9%
Assurance services	4.9%	5.8%	6.4%	6.6%	7.1%	7.0%	7.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company, Almondz Research

Exhibit 8: Other Operating metrics

Utilization rises in strong demand environment

Operating Metrics	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q4 11
Revenue Mix							
Onsite	42.5%	43.6%	43.6%	43.9%	43.7%	44.7%	44.8%
Offshore	51.3%	51.0%	51.2%	51.1%	51.4%	50.3%	50.6%
Gross Adds	12,854	16,851	10,849	19,293	20,219	19,324	11,988
Utilization							
Incl trainees	77.2%	74.3%	74.8%	77.7%	77.1%	75.1%	76.2%
Excl trainees	81.1%	81.8%	82.6%	83.8%	83.8%	82.4%	83.2%
Attrition (LTM)	11.9%	11.8%	13.1%	14.1%	14.4%	14.4%	14.8%
EBITDA/employee (\$)	4,099	3,926	4,040	4,260	4,276	4,194	4,114
Contract Type							
Fixed	48.0%	48.7%	49.1%	49.0%	49.7%	49.5%	49.7%
Time & Material	52.0%	51.3%	50.9%	51.0%	50.3%	50.5%	50.3%
Client Concentration							
Top 1 Client	8.1%	8.2%	8.1%	8.0%	7.7%	7.4%	7.1%
Top 5 Clients	21.5%	21.8%	22.0%	22.1%	21.9%	21.4%	20.7%
Top 10 Clients	29.9%	30.2%	30.5%	30.1%	30.1%	29.6%	28.9%
Active Clients	917	917	930	936	959	969	959
New Clients added	32	39	36	30	35	39	24

Source: Company, Almondz Research

Healthy growth on a larger base

We expect strong USD revenue growth of 28.1% to USD10.49bn to continue in FY12, which factors in a volume growth of 25%. We expect margin to dip slightly to 29.2% and expect an EPS growth of 19.7% to Rs53.31. Our EPS estimate for FY13 is for a growth of 15.3% to Rs61.45.

Financial summary

	(Rs mn)				
Income Statement	FY09	FY10	FY11	FY12E	FY13E
Net sales	278129	300289	373245	467250	548407
Other operating income	0	0	0	0	0
Total operating income	278129	300289	373245	467250	548407
Less: Total operating	206350	213490	261261	330677	387486
Raw materials					
Employee cost	150744	157244	199373	254952	309222
Power & Fuel					
SG&A	55606	56246	61888	75725	78264
Others					
EBITDA	71779	86799	111984	136573	160921
EBITDA margin (%)	25.8%	28.9%	30.0%	29.2%	29.3%
Less: Depreciation	5766	7208	7214	8802	9062
Less: Interest					
PBT (operating)	66013	79591	104770	127771	151859
Add: Other income	(4672)	2255	5324	9210	9099
PBT	61341	81846	110094	136981	160958
Less: Tax	9013	12089	21739	31397	39193
Effective tax rate (%)	14.7%	14.8%	19.7%	22.9%	24.4%
PAT	52328	69757	88355	105584	121765
Add: Share of earnings of	(8)	(10)	0	0	0
Less: Minority interest	605	1018	1191	1247	1280
Net income (before E.O)	51715	68729	87164	104337	120485
Prior period items	0	0	0	0	0
Extraordinary income/(loss)	0	0	0	0	0
Net income (after E.O)	51715	68729	87164	104337	120485

	(Rs mn)				
Balance Sheet	FY09	FY10	FY11	FY12E	FY13E
Equity capital	979	1957	1957	1957	1957
Preference capital	1000	1000	1000	1000	1000
Reserves and surplus	155022	181710	252087	326899	417859
Net worth	157000	184667	255044	329856	420816
Minority interest	2772	3617	3147	3274	3274
Total debt	5632	1033	384	57	57
Deferred tax liability	685	(992)	(47877)	(47896)	(51113)
Total liabilities	166089	188325	210698	285291	373034
Gross block	58439	64195	88185	111185	130185
Less: Acc. depreciation	23597	28975	36189	44991	54052
Net block	34841	35220	51996	66194	76133
CWIP	7055	10174	0	0	0
Goodwill	32614	32160	33791	33845	33845
Investments	16144	36821	18390	20472	20472
Current assets	135236	157891	164856	228265	307769
Inventories	366	178	0	0	0
Debtors	60229	58554	95497	118144	142435
Cash	26981	47186	15539	29639	66773
Loans and advances	32838	39698	39335	62612	79464
Other Current assets	14822	12275	14485	17871	19096
Current liabilities	59802	83939	58335	63485	65184
Creditors	42536	40938	58335	63485	65184
Provisions	17266	43001	0	0	0
Net working capital	75435	73952	106521	164780	242585
Total assets	166089	188327	210698	285291	373034

	(Rs mn)				
Cash Flow Statement	FY09	FY10	FY11	FY12E	FY13E
Net profit	51715	68729	87164	104337	120485
Depreciation	5766	7208	7214	8802	9062
Working capital changes	(91752)	(75220)	(117748)	(226124)	(310953)
Others	87810	70069	81407	173017	212345
Cash from Operations	53539	70787	58036	60032	30938
Capital expenditure	(17534)	(2638)	(34163)	(23000)	(19000)
Increase/Decrease in	(9918)	20677	(18431)	2082	0
Others	(6877)	(51512)	34614	(2082)	(9883)
Cash from investing	(34329)	(33473)	(17980)	(23000)	(28883)
Increase/Decrease in Equity	2000	2979	2000	2000	2000
Change in borrowings	1082	(4600)	(649)	(327)	0
Dividends paid (incl. tax)	(16142)	(19695)	(46087)	(29525)	(29525)
Others	8598	4207	(26968)	4919	62604
Cash from financing	(4462)	(17109)	(71703)	(22933)	35079
Net change in cash	14748	20205	(31647)	14100	37135
Opening cash balance	12234	26981	47186	15539	29639
Closing cash balance	26981	47186	15539	29639	66773

Ratio Analysis	FY09	FY10	FY11	FY12E	FY13E
EPS (Rs.)	26.42	35.12	44.53	53.31	61.56
EPS growth (%)	3.0%	32.9%	26.8%	19.7%	15.5%
Cash EPS (Rs.)	29.4	38.8	48.2	57.8	0.2
BV (Rs.)	80.2	94.4	130.3	168.5	215.0
DPS (Rs.)	14.0	14.0	14.0	15.0	15.0
Payout (%)	53%	40%	31%	28%	24%

Valuation (x)	FY09	FY10	FY11	FY12E	FY13E
P/E (on adjusted FD EPS)	43.4	32.6	25.7	21.5	18.6
P/CEPS	39.0	29.5	23.8	19.8	7404.9
P/BV	14.3	12.1	8.8	6.8	5.3
EV/EBITDA	30.7	24.9	19.7	16.1	13.4
EV/Sales	7.9	7.2	5.9	4.7	3.9
Dividend yield (%)	1.2%	1.2%	1.2%	1.6%	1.6%

Profitability ratios (%)	FY09	FY10	FY11	FY12E	FY13E
RoE	36.9%	40.2%	39.6%	35.7%	32.1%
RoCE	35.3%	39.4%	44.3%	42.6%	37.0%

Turnover ratios	FY09	FY10	FY11	FY12E	FY13E
Debtors (days)	79	71	93	92	95
Inventory (days)	1	0	0	0	0
Creditor (days)	51	50	47	48	48
Net Working capital (days)	29	22	33	30	31
Asset turnover (x)	1.7	1.6	1.8	1.6	1.5

Solvency ratio (x)	FY09	FY10	FY11	FY12E	FY13E
Gross debt / equity	0	0	0	0	0
Net debt / equity	(0.2)	(0.4)	(0.1)	(0.2)	(0.2)
Net debt/ EBITDA	(0.5)	(1.0)	(0.3)	(0.4)	(0.5)
Interest Coverage (EBIT /	230	494	311	605	605

Growth ratios (%)	FY09	FY10	FY11	FY12E	FY13E
Net sales	22%	8%	24%	25%	17%
EBITDA	23%	21%	29%	22%	18%
PAT (before E.O.)	3%	33%	27%	20%	15%
EPS	3%	33%	27%	20%	15%

Operating ratios (%)	FY09	FY10	FY11	FY12E	FY13E
EBITDA margin	26%	29%	30%	29%	29%
EBIT margin	22%	27%	29%	29%	29%
PAT margin	19%	23%	23%	22%	22%
Other income/PBT	-8%	3%	5%	7%	6%
Effective Tax rate	15%	15%	20%	23%	24%

Team Coordinates

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