TATA CONSULTANCY SERVICES

INR 1,250

Big, and looking even bigger

BUY

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Tata Consultancy Services' (TCS) Q4FY07 results were in line with our expectations. Revenues came in at INR 51.5 bn, up 5.9% Q-o-Q, and net profit was at INR 11.7 bn, up 6.2% Q-o-Q. On Y-o-Y basis, revenue and net profit growth stood at 37.9% and 44.9%, respectively.

TCS closed FY07 with revenues of USD 4.3 bn and net income of USD 950 mn, a growth of 41% and 43%, respectively, in USD terms. The company crossed the USD 2 bn and USD 1 bn revenue mark from North America and Europe, respectively, attesting to its scale and geographic spread. TCS' existing realizations have room for expansion.

Recent services such as business intelligence, remote infrastructure management, BPO, and assurance services are seeing strong traction. We expect these services to continue to lead healthy growth in FY08E. We believe that TCS has sufficient levers to sustain margins in FY08E given the continuing trend towards offshore and improving realizations on account of pricing and productivity gains.

Our EPS forecasts of INR 55.4 in FY08 and INR 69.7 in FY09 imply an EPS CAGR of 28.4% over 2007-09. At the CMP of INR 1,250 the stock trades at a P/E of 22.6x and 17.9x for our FY08E and FY09E earnings respectively. We reiterate our 'BUY' recommendation on the stock.

Reuters	:	TCS.BO
Bloomberg	:	TCS IN

Market Data

52-week range (INR)	:	2,099 / 900
Share in issue (mn)	:	978.6
M cap (INR bn/USD mn)	:	1,223 / 29,197
Avg. Daily Vol. BSE/NSE ('000)	:	1,342.1

Share Holding Pattern (%)

Promoters	:	81.7
MFs, FIs & Banks	:	2.9
FIIs	:	7.1
Others	:	8.3

Key Highlights

Q4FY07 Result Highlights

- Revenues were reported at INR 51.5 bn, up 5.9% Q-o-Q and 37.9% Y-o-Y, and net profits stood at INR 11.7 bn, up 6.2% Q-o-Q and 44.9% Y-o-Y.
- Gross margins were up 20bps Q-o-Q and 40bps Y-o-Y to 47.2%. The increase in the margin is attributed to the improvement in the utilization level and improved realizations.
- EBITDA for the quarter stood at INR 14.6 bn, up 5.9% Q-o-Q and 43.7% Y-o-Y. EBITDA margins remained stable at 28.3% Q-o-Q, but were up 110bps Y-o-Y.
- The employee headcount increase continued to remain strong. In the current quarter the company added gross 8,613 employees and net 5,991 employees. The company's total headcount now stands at 89,491.

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	51,464	48,605	*5.9*	37,328	*37.9*	245,591	317,507
EBITDA (INR mn)	14,568	13,753	*5.9*	10,137	*43.7*	69,020	88,922
Net profit (INR mn)	11,728	11,047	*6.2*	8,094	*44.9*	54,213	68,198
EPS (INR)	12.0	11.3	*6.1*	8.3	*44.9*	55.4	69.7
P/E (x)						22.6	17.9
EV/EBITDA (x)						17.4	13.3
Mkt. cap/ Rev.						5.0	3.9

- Attrition for the quarter stood at 11.3%, up from 10.8% in the previous quarter. However, the attrition in IT-services remained low at 10.6%, which is the best in the sector. BPO attrition stood at 20.2%.
- Utilization rate (excluding trainees) improved during the quarter to 79.6% from 78.2% in Q3FY07. Including trainees, utilization for the company stood at 74.7% during the current quarter compared to 75.0% in Q3FY07.
- During the current quarter the company added 43 new clients and the active client count now stands at 780, compared to 754 in the previous quarter. TCS has 297 customers contributing revenues of USD 1 mn plus, against 288 in Q3FY07 and 256 in Q4FY06. Clients with revenue contribution of over USD 50 mn have grown from nine in Q4FY06 to 14 in Q4FY07, which is particularly impressive.
- Offshore revenue contribution (41.3%) remained mainly in line with the previous quarter (41.6%).

Highlights of FY07

- TCS closed FY07 with revenues of USD 4.3 bn and net income of USD 950 mn, a growth of 41% and 43%, respectively, in USD terms.
- North American revenues crossed USD 2 bn and those from Europe crossed the USD 1 bn revenue mark.
- The company closed 12 deals of value USD 50 mn and above during the year.
- Customer addition for the year stood at 218, headcount increased by 34.6% to reach 89,500.

Confident and optimistic outlook

We sensed the management's optimism and confidence in its commentary on the current demand environment and on the traction for the company's full-service model. Muted growth seen in the current quarter with regard to North America and revenues from ADM were put down to being a quarterly phenomenon only, as momentum continues to be strong all around.

Bigger deals increasingly becoming the mainstay

TCS has closed 12 deals of over USD 50 mn in FY07. It is currently pursuing 10 deals of above USD 50 mn. The company also indicated that at least five among them are upwards of USD 100 mn in size. We believe that large-size deals will be the mainstay going forward for the company given its full-services model.

The company has indicated that it has won a follow-up order from ABN Amro Bank which is in excess of USD 50 mn.

Levers for sustaining operating margins in FY08 exist

We believe that TCS will sustain its margins on the back of:

(a) Improved overall pricing

Headroom exists to derive even greater price hikes (5-10%) from new clients. We believe that there is a meaningful differential between TCS and Infosys pricing and headroom to narrow this gap exists.

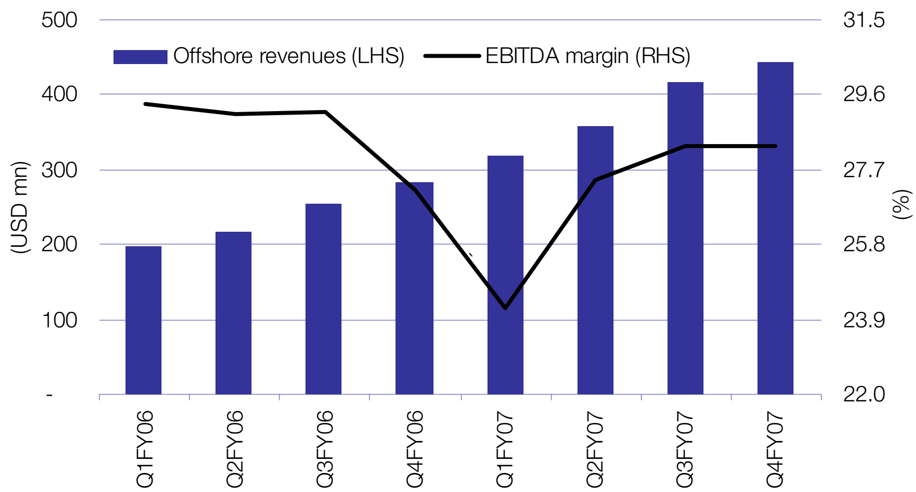
(b) Productivity improvements

TCS draws on its significant repository of project knowledge and frameworks spanning verticals and services to deliver accelerated solutions. In our view, this is an additional margin accretive factor and potentially provides a further upside of between 50bps and 60bps in FY08E.

(c) Continuing shift towards offshore

As traction builds in infrastructure management, assurance, and BPO and momentum is maintained in the traditional application maintenance offering, we believe that there will be a slight sequential marginal shift towards offshore that should support margins. EBITDA margins have shown an upward trend through FY07 supported by increasing offshore revenues (see chart 1).

Chart 1: Offshore revenues and EBITDA margins through FY07



Source: Company, Edelweiss research

(d) Incremental growth in products in banking products business

TCS has indicated that it has recorded banking product revenues of about USD 120 mn in FY07 with 51 client wins during the fiscal. The outlook for the banking products business seems buoyant. The company has bagged a significant order from the Bank of China and a significant portion of that project is product-related revenues. Our estimates show that decent growth in banking products could offer between 50bps and 100bps leverage in operating margins.

These factors should help offset margin pressures that arise on account of wage inflation (12-15% offshore and 3-5% onsite) and sustain margins.

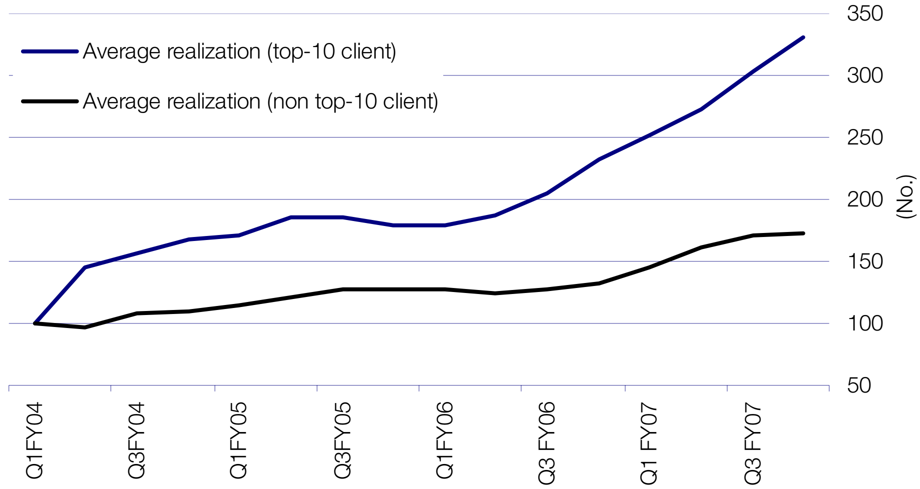
Continued appreciation of INR versus the USD beyond a range could have a dampening impact on margins.

Making large accounts even larger with cross selling

TCS is continuously increasing its contribution from service lines such as business intelligence, infrastructure services, assurance services, and BPO which contributed nearly 25% of revenues in Q4FY07, significantly up from 15.8% in FY06. This growing revenue stream enables the company to further cross sell into existing customers, thus making big customers even bigger. The company has marked out remote infrastructure management as an offering that is driving new client acquisition as well as large deal pipeline.

TCS' initiatives in further consolidating its share of revenues from its major clients can be seen from chart 2 that maps out the growth of the average realization per client in the top-10 category versus that for the non-top 10 clients. The size is indexed to Q1FY04 levels for purposes of comparison.

Chart 2: Progress of average size of the client through FY04-07 (indexed to FY04)



Source: Company, Edelweiss research

Growth broad-based across verticals and services

Tables 1 and 2 show how various service lines and verticals have fared through FY04-07. The BFSI vertical has garnered 44% of incremental revenues from 2004 maintaining its traditional dominance, while telecom and retail are the new growth verticals. We believe that growth in these verticals is powered by an array of services such as BI, infrastructure management, assurance services, and BPO, which we have mentioned earlier (see table 2).

Table 1: Revenue CAGR progress over 2004-07 from verticals in INR mn

	FY04	FY07	FY04-07 (CAGR)	% share of incremental rev.
BFSI	28,491	78,611	40.3	43.5
Manufacturing	14,245	28,648	26.2	12.5
Telecom	11,396	31,502	40.3	17.5
Life Sciences & Heathcare	2,422	8,098	49.5	4.9
Retail & Distribution	4,772	13,154	40.2	7.3
Transportation	3,134	6,072	24.7	2.6
Energy & Utility	1,994	4,541	31.6	2.2
Others	4,772	15,708	48.8	9.5
Total	71,227	186,334	37.8	100.0

Source: Company, Edelweiss research

Table 2: Several services demonstrate healthy growth in recent quarters

(INR mn)	Q1FY06	Q4FY07	CQGR (%)
Application dev. & maint.	17,649	26,401	6.9
Business intelligence	2,214	5,043	14.7
Engineering and industrial services	2,007	2,779	5.6
Inftrastructure services	1,210	3,088	16.9
Enterprise solutions	4,161	6,330	7.2
Global consulting	738	1,801	16.0
Asset leveraged solutions	797	1,595	12.3
Assurance services	354	1,338	24.8
Business process outsourcing	384	3,088	41.6
Total	29,513	51,464	9.7

Source: Company, Edelweiss research

Valuations

We forecast TCS to post healthy EPS growth of 28.4% over FY07-09E. Our FY08 EPS forecast of INR 55.4 requires an EPS CQGR of 5.8% through FY08, relatively undemanding in our view.

At the CMP of INR 1,250 the stock trades at a P/E of 22.6x and 17.9x for our FY08E and FY09E earnings, respectively. We reiterate our **'BUY'** recommendation on the stock.

Financial snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	51,464	48,605	*5.9*	37,328	*37.9*	186,334	245,591	317,507
Cost of revenues	27,177	25,758	*5.5*	19,850	*36.9*	99,886	128,097	167,124
Gross profit	24,287	22,847	*6.3*	17,479	*39.0*	86,447	117,494	150,383
SG&A	9,587	8,989	*6.6*	7,234	*32.5*	35,385	47,264	59,711
R&D	133	105	*26.8*	107	*23.5*	432	1,210	1,750
EBITDA	14,568	13,753	*5.9*	10,137	*43.7*	50,630	69,020	88,922
Depreciation and amortization	1,395	1,080	*29.2*	861	*62.0*	4,184	6,030	7,007
EBIT	13,173	12,673	*3.9*	9,276	*42.0*	46,446	62,990	81,916
Other income	898	300	*199.5*	16	*5,351.7*	1,943	720	1,080
PBT	14,070	12,972	*8.5*	9,293	*51.4*	48,389	63,710	82,996
Tax	2,188	1,828	*19.7*	896	*144.2*	6,700	8,975	14,109
Adjusted net profit	11,882	11,144	*6.6*	8,397	*41.5*	41,688	54,735	68,886
Minority interest	(158)	(115)	*37.9*	(103)	*53.3*	(417)	(522)	(689)
Equity in net earnings of affiliates	4	17	*(79.1)*	33	*(89.2)*	44	-	-
Extraordinary income/expense	-	-		(232)		-	-	-
Reported net profit	11,728	11,047	*6.2*	8,094	*44.9*	41,315	54,213	68,198
EPS - basic	12.0	11.3	*6.1*	8.3	*44.9*	42.2	55.4	69.7
as % of net revenues								
Gross profit	47.2	47.0		46.8		46.4	47.8	47.4
SG&A	18.6	18.5		19.4		19.0	19.2	18.8
EBITDA	28.3	28.3		27.2		27.2	28.1	28.0
Adjusted net profit	23.1	22.9		22.5		22.4	22.3	21.7
Reported net profit	22.8	22.7		21.7		22.2	22.1	21.5
Tax rate	15.6	14.1		9.6		13.8	14.1	17.0

Company Description

TCS is India's largest and among the oldest IT companies which commenced operations in 1968. It provides a comprehensive range of IT services to industries such as banking and financial services, insurance, manufacturing, telecommunications, retail and transportation. With presence in 34 countries, TCS is positioned to deliver its services seamlessly. TCS has a large diversified client base (780 active clients) which includes seven of the Fortune Top 10 companies. TCS' employee force stands at 89,491 and its revenues for the last twelve months (TTM) stood at INR 186.3 bn (USD 4.3 bn).

Investment Theme

As India's largest and most experienced IT services firm, TCS is well positioned to benefit from the growing demand for offshore IT services. TCS is a serious contender for winning large deals as it has more experience than any of its peers in implementing large, complex, mission critical projects. TCS has multiple margin levers at its disposal, which we believe, will sustain its margins, shielding it from continued pressures on account of wage increases across the industry. These drivers include transition to offshore, leveraging fixed price business, and higher client mining.

Key Risks

Key risks to our investment theme include – a) sustained slowdown in US, b) maintaining the margins while pursuing large deals, c) Significant increase in the salary hikes and attrition rate creating cost pressures, and d) Any substantial appreciation of rupee against US dollar, Euro and GBP.

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Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
Vishal Goyal, CFA	-	2286 4370	Banking & Finance
Revathi Myneni	-	2286 4413	Cement
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Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom
Hitesh Zaveri	-	2286 4424	Information Technology
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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period