Update

SECTOR: INFORMATION TECHNOLOGY

Tata Consultancy Services

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,344	TCS IN
	REUTERS CODE
S&P CNX: 2,617	TCS.BO

Equity Shares (m)	978.6
52-Week Range	1,054/418
1,6,12 Rel. Perf. (%)	4/-1/6
M.Cap. (Rs b)	465.1
M.Cap. (US$ b)	9.0

12 March 2009 **Buy**

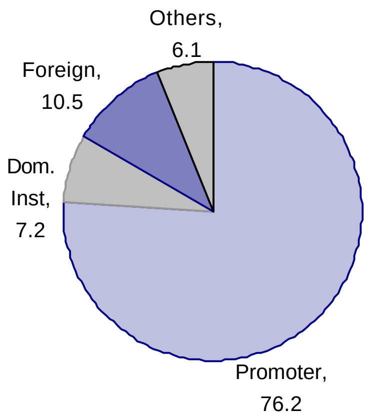
Previous Recommendation: Buy Rs475

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/07A	186,334	41,316	41.7	39.6	11.4	5.2	55.1	50.3	2.4	8.8
3/08A	228,614	50,484	51.3	23.1	9.3	3.8	47.0	43.0	1.9	7.3
3/09E	282,425	52,137	53.3	3.9	8.9	2.9	36.7	34.3	1.5	5.7
3/10E	306,634	51,766	52.9	-0.7	9.0	2.4	29.0	27.4	1.3	5.5

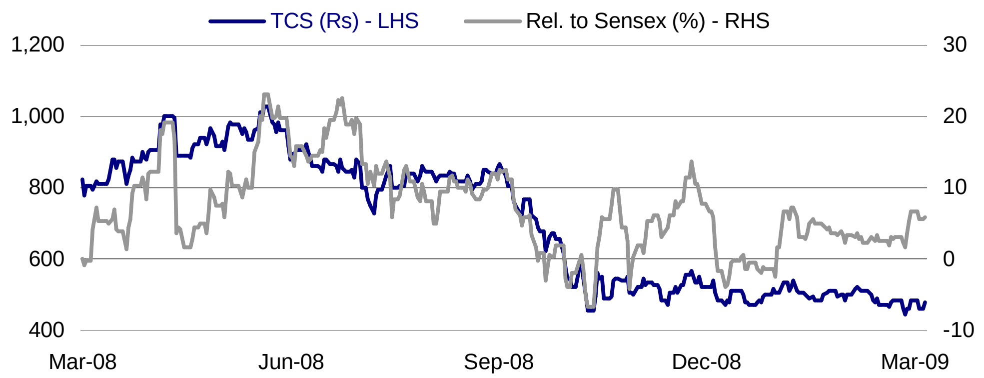
We met with TCS management for an update on 4QFY09 performance and FY10 outlook. Key highlights:

- **4QFY09 revenues impacted materially by project cancellations, GBP depreciation:** TCS has been witnessing project cancellations since December 2008 as a result of clients' failure to finalize IT budgets for CY09. This coupled with GBP depreciation (of ~8%) v/s the US$, will together have an adverse impact on 4QFY09 revenues. However, the company has been able to hold on to pricing in 4QFY09. We expect 4QFY09 revenues to decline by ~2% organically.
- **FY10 revenue outlook positive – single-digit organic volume growth and only marginal negative pricing:** Customers are increasingly seeking overall cost optimization with lower IT spend for FY10 and are willing to consider increasing offshoring services. This makes TCS optimistic of a single-digit, positive, organic volume growth for FY10 (without factoring CGSL revenues). TCS claims to have succeeded in maintaining pricing discipline and management is hopeful of restricting the price decline to 2-3% in constant currency.
- **Margins to be protected due to wage freeze, lower variable pay, longer working hours:** With revenue growth slowing down, margin management will play a key role in maintaining earnings. Management is hopeful of maintaining FY10 EBITDA margins: (1) zero wage hike in FY10, this is expected to boost margins by 200-250bp; (2) variable salaries are ~20% of offshore salary cost, TCS can utilize about ~400bp for margin leverage; (3) likely increase in working hours from 40 to 45 hours/ week effective April 2009; could provide 10-12% efficiency gain; and (4) rationalization of COGS and SG&A is expected to yield an additional 150-200bp of margin leverage.
- **Cutting FY10 estimates; valuation at 9x FY10 P/E; maintain Buy:** We have revised our estimates to factor in project cancellations, adverse cross currency impact and revised INR/US$ assumptions. Our INR/US$ assumptions for FY10 have changed from Rs45.6 to Rs49.6. We model 3% volume growth and 6% pricing decline for TCS in FY10. US$ revenues including CGSL are expected to rise 0.7% in FY10 (down 2.4% ex-CGSL). We cut our FY10 EPS by 6.3% to Rs52.9 (from Rs56.5 earlier). Stock trades at 9x FY10E earnings. Maintain **Buy** with a target price of Rs550 (upside of 16%).

SHAREHOLDING PATTERN % (DEC.08)



STOCK PERFORMANCE (1 YEAR)



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We met with TCS management for an update on 4QFY09 performance and FY10 outlook. Key highlights:

4QFY09 revenues impacted materially by project cancellations and GBP depreciation

TCS has been witnessing project cancellations since December 2008 as a result of client's failure to finalize IT budgets for CY09. The pace of cancellations reached unprecedented proportions in January 2009 due to the continuous uncertain business conditions and the higher BFSI exposure of ~42% of revenues. This, coupled with GBP depreciation against the US$ of 8% (average basis until date), will collectively have a significant adverse impact on 4QFY09 revenues. However, on the pricing front, TCS has been able to successfully hold on to pricing for a few of the existing contracts that were renewed in 4QFY09. We expect 4QFY09 revenues to decline by ~2% organically and grow ~3% QoQ after factoring CGSL revenues.

FY10 revenue outlook positive – single-digit organic volume growth and only marginal negative pricing

Customers are increasingly seeking overall cost optimization with lower IT spend for FY10 and are willing to consider increasing offshoring services. This makes TCS optimistic of a single-digit, positive, organic volume growth in FY10 (without factoring CGSL revenues). Despite downward pressure on pricing, TCS claims to have succeeded in maintaining strong pricing discipline. This is likely to result in stable pricing in 4QFY09, in line with the 3QFY09 trend (when constant currency pricing was flat). Even in FY10, management is hopeful of restricting pricing decline to 2-3% in constant currency. This is at a divergence from widespread expectation of a 5-10% fall in pricing.

FY10 margins to be protected by wage freeze, lower variable pay, higher working hours

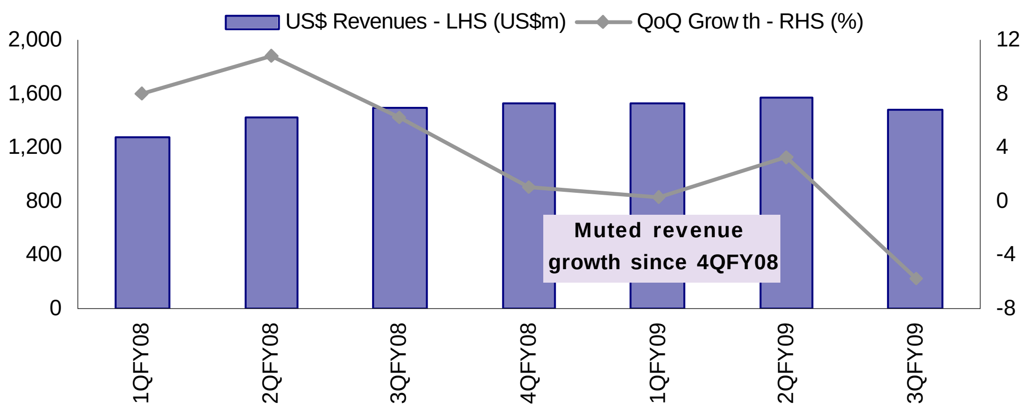
With revenue growth slowing down, margin management will play a key role in maintaining earnings. TCS' management is hopeful of maintaining FY10 EBITDA margin:

1) Zero wage hike in FY10 versus 10-15% for offshore and 3-5% for onsite salaries in the past 2-3 years. This will boost margins by 200-250 bp.
2) Variable salaries are ~20% of offshore salary cost and ~8% of revenues. However, TCS can utilize only about ~400bp for margin leverage out of the 800bp owing to commission-based cost structure for some employees, individual performance incentives etc.
3) A possible extension of working hours from 40 hours to 45 hours per week effective April 2009. This move provides a 10-12% efficiency gain, which could yield additional revenues from clients without a corresponding cost increase.
4) Rationalization of COGS and SG&A with measures like rationalization of sales and marketing teams, lowering tolerance levels for onsite bench, reducing travel costs etc. This is expected to yield an additional 150-200bp of margin leverage.

Client budgets mostly finalized – overall budgets lower, offshoring higher

A majority of TCS' clients have already finalized their budgets while the remaining clients will finalize budgets by late March. The budgets forecast lower IT spend in CY09 although offshoring will rise. Offshore revenue contribution of TCS at ~44% is lower than peers. Besides, TCS expects specific opportunities in terms of integration, consolidation, infrastructure optimization and business transformation. Management believes that annual IT budgets will be reviewed as clarity on business outlook emerges.

TREND IN REVENUE GROWTH

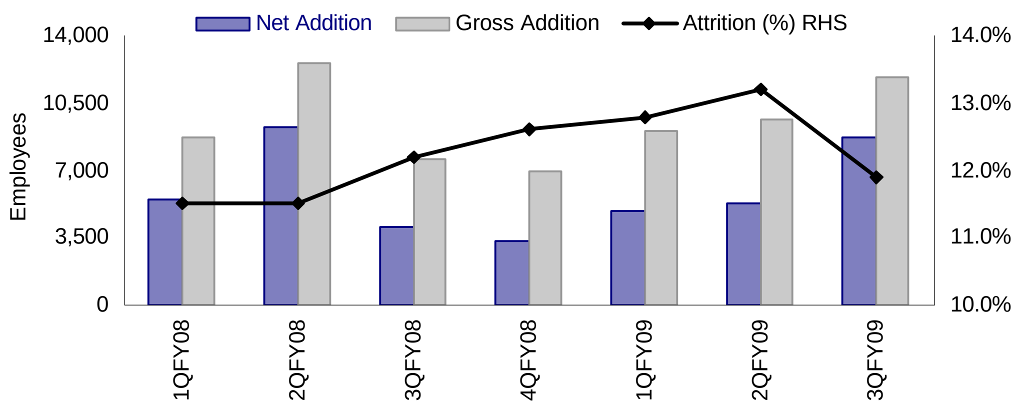


Source: Company/MOSL

FY10 manpower addition - will honor campus offers resulting in lower utilization rate

TCS has made 24,800 campus offers for FY10 and would honor all of them. However, TCS would defer the joining date by two quarters, resulting in marginal increase in FY10 employee cost. About 6,000 of the 24,800 campus joiners would become billable in FY10. Further, TCS has added 30,400 (gross) employees in 9MFY09 and is likely to add another 5,000 employees in 4QFY09, which would be billable in FY10. This, combined with falling attrition (higher single digit in 4QFY09 v/s 11.9% in 3QFY09), will pull FY10 utilization down (utilization including trainees fell 290bp QoQ in 3QFY09.

TREND IN MANPOWER ADDITION



Source: Company/MOSL

Cutting FY10 estimates; valuation at 9x FY10 P/E; maintain Buy

We have revised our estimates to factor in project cancellations, adverse cross currency impact and revised INR/US$ assumptions. Our INR/US$ assumptions for FY10 have changed from Rs45.6 to Rs49.6. We model 3% volume growth and 6% pricing decline for TCS for FY10. US$ revenues including CGSL are expected to rise 0.7% in FY10 (down 2.8% ex-CGSL). We cut our FY10E EPS by 6.3% to Rs52.9 (from Rs56.5 earlier), implying a YoY decline of 0.7%. The stock trades at 9x FY10E earnings. We value TCS at 10.4x FY10 EPS (20% discount to the P/E multiple implied by our target price for Infosys). Maintain **Buy** with a target price of Rs550, upside of 16%.

ASSUMPTIONS FOR FY10

	OLD	REVISED	EPS IMPACT (RS)
Average RS/US$ Rate	45.6	49.6	14.0
Volume Growth - % YoY	8.1	3.0	-3.6
Pricing - % YoY	-4.0	-6.0	-10.9
Utilization (Incl Trainees) %	75.0	73.0	-1.8
Other Inc (Incl Forex loss) - Rs M	741.0	-300.0	-1.0
Tax Rate - % to PBT	15.4	16.0	-0.3
EPS	**56.5**	**52.9**	**-3.6**

Source: MOSL

INCOME STATEMENT (Rs Million)

Y/E MARCH	2007	2008	2009E	2010E	2011E
Sales	**186,334**	**228,614**	**282,425**	**306,634**	**301,805**
Change (%)	*40.6*	*22.7*	*23.5*	*8.6*	*-1.6*
Cost of Services	100,339	122,344	155,704	177,353	177,335
SG&A Expenses	35,253	46,873	54,960	57,254	57,371
EBITDA	**50,742**	**59,397**	**71,761**	**72,028**	**67,099**
% of Net Sales	*27.2*	*26.0*	*25.4*	*23.5*	*22.2*
Depreciation	4,296	5,746	5,671	6,864	5,579
Other Income	1,280	4,450	-4,199	-2,679	4,360
PBT	**47,726**	**58,101**	**61,891**	**62,484**	**65,880**
Tax	6,568	7,494	9,161	9,983	14,849
Rate (%)	*13.8*	*12.9*	*14.8*	*16.0*	*22.5*
Equity in net earnings of affi	44	8	-4	5	7
Minority Interest	417	424	589	740	847
PAT	**40,786**	**50,191**	**52,137**	**51,766**	**50,191**
Extraordinary	530	293	0	0	0
Net Income	**41,316**	**50,484**	**52,137**	**51,766**	**50,191**
Change (%)	*42.6*	*22.2*	*3.3*	*-0.7*	*-3.0*

BALANCE SHEET (Rs Million)

Y/E MARCH	2007	2008	2009E	2010E	2011E
Share Capital	979	979	979	979	979
Reserves	88,682	122,841	158,948	195,830	231,136
Net Worth	**89,661**	**123,820**	**159,927**	**196,808**	**232,114**
Minority Interest	2,121	2,300	2,889	3,629	3,629
Loans	6,626	7,098	6,395	6,075	5,772
Capital Employed	**99,291**	**134,031**	**170,023**	**207,325**	**242,328**
Gross Block	25,669	38,449	53,449	66,449	81,449
Less : Depreciation	9,895	14,322	19,993	26,857	32,435
Net Block	**15,774**	**24,128**	**33,457**	**39,593**	**49,014**
CWIP	7,140	6,088	3,002	3,002	5,002
Other LT Assets	20,222	23,801	21,547	26,383	21,257
Investments	12,661	26,475	10,760	40,000	50,000
Curr. Assets	**74,853**	**96,141**	**143,815**	**147,221**	**158,606**
Debtors	43,090	53,899	65,262	75,874	66,346
Cash & Bank Balance	12,291	11,164	48,627	34,121	59,166
Other Current Assets	19,471	31,078	29,926	37,227	33,094
Current Liab. & Prov	**31,358**	**42,602**	**42,558**	**48,874**	**41,552**
Creditors	6,701	11,004	7,566	12,596	7,249
Other liabilites	24,657	31,596	34,989	36,276	34,301
Net Current Assets	**43,494**	**53,539**	**101,257**	**98,348**	**117,054**
Application of Funds	**99,291**	**134,031**	**170,023**	**207,325**	**242,328**

E: MOSL Estimates

RATIOS *

Y/E MARCH	2007	2008	2009E	2010E	2011E
Basic (Rs)					
EPS	**41.7**	**51.3**	**53.3**	**52.9**	**51.3**
Cash EPS	46.1	57.2	59.1	59.9	57.0
Book Value	91.6	126.5	163.4	201.1	237.2
DPS	11.5	14.0	14.0	13.0	13.0
Payout %	27.6	27.3	26.3	24.6	25.3
Valuation (x)					
P/E	11.4	9.3	8.9	9.0	9.3
Cash P/E	10.3	8.3	8.0	7.9	8.3
EV/EBITDA	8.8	7.3	5.7	5.5	5.4
EV/Sales	2.4	1.9	1.5	1.3	1.2
Price/Book Value	5.2	3.8	2.9	2.4	2.0
Dividend Yield (%)	2.4	2.9	2.9	2.7	2.7
Profitability Ratios (%)					
RoE	55.1	47.0	36.7	29.0	23.4
RoCE	50.3	43.0	34.3	27.4	22.3
Turnover Ratios					
Debtors (Days)	74	77	77	84	86
Fixed Asset Turnover (x)	13.2	11.5	9.8	8.4	6.8
Leverage Ratio					
Debt/Equity Ratio(x)	0.1	0.1	0.0	0.0	0.0

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

CASH FLOW STATEMENT (Rs Million)

Y/E MARCH	2007	2008	2009E	2010E	2011E
CF from Operations	46,169	56,409	58,396	59,370	55,769
Cash for Working Capital	-8,287	-11,173	-10,256	-11,597	6,338
Net Operating CF	**37,882**	**45,236**	**48,141**	**47,774**	**62,108**
Net Purchase of FA	-18,491	-16,626	-9,660	-17,836	-11,874
Net Purchase of Invest.	-5,574	-13,815	15,715	-29,240	-10,000
Net Cash from Invest.	**-24,065**	**-30,440**	**6,055**	**-47,076**	**-21,874**
Proceeds from equity issue	2,896	-281	0	0	0
Proceeds from LTB/STB	4,573	402	-703	-320	-304
Dividend Payments	-12,959	-16,043	-16,030	-14,885	-14,885
Cash Flow from Fin.	**-5,490**	**-15,923**	**-16,733**	**-15,204**	**-15,188**
Free Cash Flow	19,391	28,610	38,481	29,938	50,234
Net Cash Flow	**8,326**	**-1,127**	**37,463**	**-14,506**	**25,045**
Opening Cash Bal.	**3,965**	**12,291**	**11,164**	**48,627**	**34,121**
Add: Net Cash	8,326	-1,127	37,463	-14,506	25,045
Closing Cash Bal.	**12,291**	**11,164**	**48,627**	**34,121**	**59,166**

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Disclosure of Interest Statement	Tata Consultancy Services
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No