

Telecoms, Media & Technology
IT Services
 Equity – India

Overweight

Target price (INR)	1300.00
Share price (INR)	1120.15
Potential return (%)	16.1

Performance	1M	3M	12M
Absolute (%)	-1.8	17.9	43.4
Relative ^A (%)	3.4	25.8	33.4

Index ^A	BOMBAY SE IDX
RIC	TCS.BO
Bloomberg	TCS IN

Market cap (USDm)	48,290
Market cap (INRm)	2,192,381
Enterprise value (INRm)	2157596
Free float (%)	15

Note: (V) = volatile (please see disclosure appendix)

18 January 2011

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TCS

OW: 3QFY11 – top-line in line, margins surprise positively

- ▶ **A better than expected margin performance, complemented by robust 5.7% volume growth q-o-q**
- ▶ **Strong hiring and deal wins suggest strong demand outlook**
- ▶ **We remain OW with a target price of INR1,300**

TCS reported another strong quarter as revenues grew 7% q-o-q (in USD terms) and EBITDA margins were flat q-o-q. While top-line growth (including volume growth of 5.7%) was in line with our expectation of 7.2% q-o-q growth, EBITDA margins were much better than our expectation of an 80bps decline q-o-q. Hedging gains further surprised positively, resulting in a net profit increase of 11% q-o-q vs our expectation of 2% growth.

Growth broad-based: While India and Latin America reported a decline in revenues (reflecting seasonal factors), growth was broad-based in the primarily geographies of the US and Europe. In terms of service lines, strong growth in testing, products, BPO and Infrastructure services offset the weakness in the applications market (see table 1 for details).

Other than telecoms, all vertical markets reported strong growth. Management expects telecom growth to improve in 2011, but remain slower than overall group growth. The company added 12,500 employees (net) in the quarter and expects this robust hiring to continue in 4Q.

EBITDA margins surprised positively again and remained flat q-o-q, despite a 112bps q-o-q headwind from INR appreciation, offset by an offshore leverage of 23bps and productivity gain of 97bps (decline in sub-contracting costs, software and hardware purchases and provisions for bad debts). We expect FY12 EBITDA margins to remain flat y-o-y.

Valuation: We reiterate our OW rating on TCS, valuing the company on a PE of 22x our CY12e earnings (in line with Infosys), yielding a target price of INR1,300. **Risks:** Wage inflation and a macro-economic slowdown are the primary risks to our rating for TCS.

TCS: 3QFY11

	Actual	HSBCE	Consensus	3QFY10	2QFY11	Variance (%)		YoY	QoQ
						Vs. HSBCE	Vs. Consensus		
Revenues (USD)	2,144	2,148	2,135	1,635	2,004	-0.2%	0.4%	31%	7.0%
EBITDA (INRm)	96,634	96,579	96,072	76,503	92,864	0.1%	0.6%	26%	4.1%
EBITDA margin	30.3%	29.4%	29.6%	29.7%	30.2%	88bps	66bps	57bps	7bps
Net Profit	23,302	21,397	21,936	17,975	21,065	8.9%	6.2%	29.6%	10.6%
EPS	11.9	10.9	11.2	9.2	10.8	8.9%	6.4%	29.6%	10.6%

Source: Company, HSBC estimates

Financials & valuation

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	300,289	374,102	468,155	560,383
EBITDA	86,839	112,127	138,579	161,608
Depreciation & amortisation	7,248	8,203	10,299	12,328
Operating profit/EBIT	79,591	103,923	128,280	149,280
Net interest	1,561	3,115	4,504	5,383
PBT	81,846	108,266	133,476	154,663
HSBC PBT	81,846	108,266	133,476	154,663
Taxation	-12,202	-20,468	-31,324	-36,708
Net profit	68,895	86,713	101,067	116,870
HSBC net profit	68,895	86,713	101,067	116,870

Cash flow summary (INRm)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Cash flow from operations	74,919	91,092	107,738	125,985
Capex	-10,358	-23,568	-23,408	-28,019
Cash flow from investment	-55,266	-31,005	-23,408	-28,019
Dividends	-19,464	-58,969	-70,157	-80,103
Change in net debt	-25,177	9,571	-14,173	-17,863
FCF equity	33,835	-3,245	88,352	102,264

Balance sheet summary (INRm)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Intangible fixed assets	7,082	6,832	6,832	6,832
Tangible fixed assets	41,706	57,071	70,180	85,870
Current assets	138,149	149,104	185,180	224,521
Cash & others	46,773	37,217	51,390	69,253
Total assets	276,213	322,576	371,760	426,792
Operating liabilities	109,029	142,219	176,599	210,957
Gross debt	2,418	2,432	2,432	2,432
Net debt	-44,356	-34,785	-48,958	-66,821
Shareholders funds	209,404	238,207	269,117	305,883
Invested capital	174,620	213,090	230,911	250,900

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	8.0	24.6	25.1	19.7
EBITDA	20.9	29.1	23.6	16.6
Operating profit	20.6	30.6	23.4	16.4
PBT	33.4	32.3	23.3	15.9
HSBC EPS	33.2	25.9	16.6	15.6

Ratios (%)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Revenue/IC (x)	1.9	1.9	2.1	2.3
ROIC	38.8	39.5	42.5	45.4
ROE	37.7	38.7	39.8	40.7
ROA	27.8	29.5	29.5	29.5
EBITDA margin	28.9	30.0	29.6	28.8
Operating profit margin	26.5	27.8	27.4	26.6
EBITDA/net interest (x)				
Net debt/equity	-20.8	-14.4	-17.9	-21.4
Net debt/EBITDA (x)	-0.5	-0.3	-0.4	-0.4
CF from operations/net debt				

Per share data (INR)

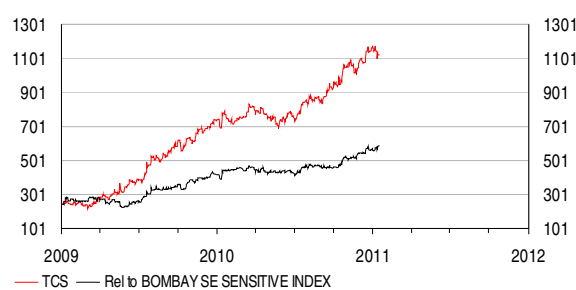
Year to	03/2010a	03/2011e	03/2012e	03/2013e
EPS reported (fully diluted)	35.20	44.30	51.64	59.71
HSBC EPS (fully diluted)	35.20	44.30	51.64	59.71
DPS	20.00	25.75	30.64	34.98
Book value	106.99	121.71	137.50	156.28

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	7.2	5.8	4.6	3.8
EV/EBITDA	24.7	19.2	15.5	13.2
EV/IC	12.3	10.1	9.3	8.5
PE*	31.8	25.3	21.7	18.8
P/Book value	10.5	9.2	8.1	7.2
FCF yield (%)	1.5	-0.1	4.0	4.7
Dividend yield (%)	1.8	2.3	2.7	3.1

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 14 Jan 2011

3QFY11 highlights

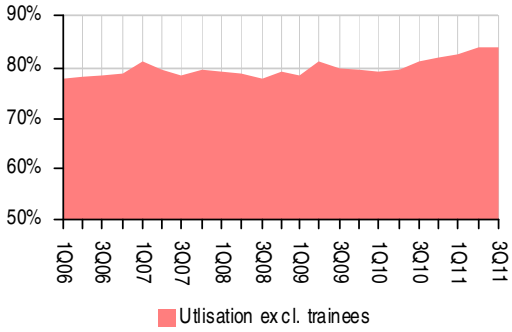
Table 1: TCS revenue mix

Revenue Mix	Proportion	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11
Geography												
NA	53.5%	12.0%	5.5%	9.9%	-1.1%	0.3%	5.3%	1.2%	4.0%	8.2%	10.3%	3.7%
Ibero A	3.1%	-11.0%	30.7%	13.6%	-7.2%	-3.7%	12.1%	0.8%	-9.2%	3.8%	2.5%	-17.3%
UK	16.0%	16.3%	5.8%	-4.2%	-4.6%	-5.1%	0.7%	-0.2%	-3.9%	5.5%	14.5%	8.8%
Con Eur	9.3%	-4.8%	32.4%	6.6%	-0.5%	2.4%	-0.6%	1.0%	-2.8%	-5.5%	15.6%	6.3%
India	9.2%	6.0%	-6.0%	-8.8%	18.8%	11.5%	-17.2%	19.8%	5.9%	5.0%	27.1%	-3.3%
APAC	6.9%	9.6%	12.7%	-1.3%	-23.1%	10.8%	27.2%	8.7%	1.1%	11.9%	18.8%	15.8%
MEA	2.0%	25.2%	22.0%	-1.2%	15.9%	-9.6%	8.9%	13.7%	-8.5%	11.8%	7.4%	9.5%
Total	100.0%	9.6%	8.5%	4.7%	-1.4%	0.5%	3.2%	2.9%	1.1%	6.2%	13.0%	4.1%
Vertical Breakdown												
BFSI	44.6%	7.8%	5.4%	4.7%	0.7%	-6.3%	7.8%	1.5%	12.0%	4.1%	0.2%	6.3%
Telecom	11.9%	15.1%	0.0%	-5.6%	-6.4%	-11.9%	0.0%	2.4%	11.4%	10.6%	2.6%	-2.5%
Manufacturing	7.2%	11.8%	19.3%	0.8%	-8.9%	-14.2%	-0.5%	-3.1%	3.9%	0.8%	1.8%	2.0%
Retail & Distribution	10.9%	6.9%	22.0%	30.2%	5.6%	-7.1%	3.5%	1.6%	0.4%	7.2%	0.9%	4.9%
Hi-Tech	5.0%	-13.6%	33.6%	1.6%	-19.1%	-18.6%	3.1%	5.8%	-2.7%	11.0%	1.8%	14.0%
Life Sciences & Healthcare	5.2%	31.1%	-14.7%	13.4%	8.0%	-8.7%	10.7%	-0.1%	-2.6%	6.2%	-0.1%	6.9%
Transportation	3.4%	6.9%	24.7%	-15.8%	1.2%	-11.1%	-0.5%	-1.3%	4.0%	2.9%	5.1%	11.4%
Energy & Utilities	4.4%	-6.1%	35.6%	-9.3%	2.3%	-8.7%	9.1%	23.3%	-2.5%	16.8%	32.7%	7.3%
Media and Entertainment	2.3%	9.6%	22.9%	23.1%	3.5%	-4.3%	5.2%	-3.1%	-5.3%	12.1%	7.2%	20.6%
Others	5.1%	64.4%	-27.7%	33.7%	7.1%	6.0%	8.8%	-5.2%	132.9%	9.8%	-4.9%	-6.2%
Total	100.0%	-0.3%	9.9%	5.8%	-2.9%	-0.5%	5.2%	1.6%	10.5%	-3.1%	11.6%	4.1%
Horizontal Breakdown												
IT Solutions & Services												
Application Development & Maintenance	45.0%	11.1%	5.0%	5.4%	-3.7%	-0.3%	7.2%	0.5%	7.1%	-2.5%	9.1%	0.8%
BI	5.3%	-1.3%	-1.6%	-0.4%	-18.5%	-10.7%	-1.7%	1.6%	4.7%	-3.1%	15.8%	-0.8%
ES	9.6%	-9.8%	10.8%	6.6%	-9.1%	-8.1%	-0.6%	3.5%	6.3%	-6.0%	17.3%	-2.3%
Assurance Services	7.1%	-21.7%	46.5%	1.0%	-12.2%	15.2%	14.8%	7.9%	25.7%	6.9%	15.1%	12.8%
Engineering & Industrial Services	4.8%	-0.3%	24.4%	11.1%	-10.6%	-10.8%	1.2%	-0.5%	8.3%	-3.1%	14.0%	2.7%
Infrastructure Services	10.5%	-15.2%	44.6%	17.1%	-2.9%	11.5%	-9.5%	0.3%	16.1%	1.5%	20.6%	17.1%
Global Sourcing	2.3%	-16.9%	6.2%	-8.8%	-34.0%	-18.1%	20.2%	33.3%	31.6%	-18.6%	11.6%	14.9%
Asset Leverage Solutions	4.0%	-23.5%	3.2%	9.2%	-36.3%	23.2%	29.5%	1.6%	38.2%	-10.4%	2.6%	23.4%
BPO	11.4%	-6.6%	8.0%	5.8%	85.8%	2.2%	8.9%	-1.0%	10.5%	-5.7%	8.7%	9.7%
Total	100.0%	-0.3%	9.9%	5.8%	-2.9%	-0.5%	5.2%	1.6%	10.5%	-3.1%	11.6%	4.1%

Source: Company, HSBC

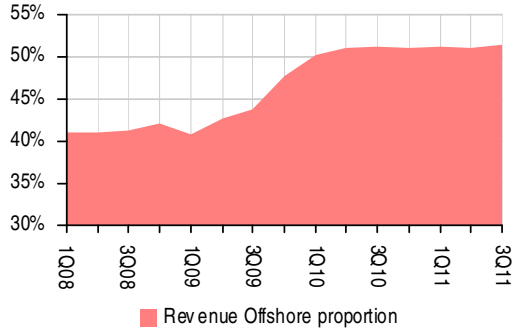
Margin levers

Chart 1. Utilisation (excluding trainees)



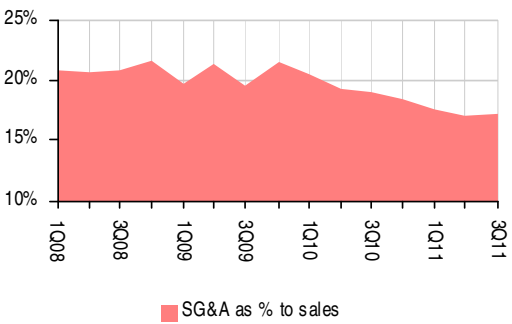
Source: TCS, HSBC

Chart 2. Offshore percentage of revenues



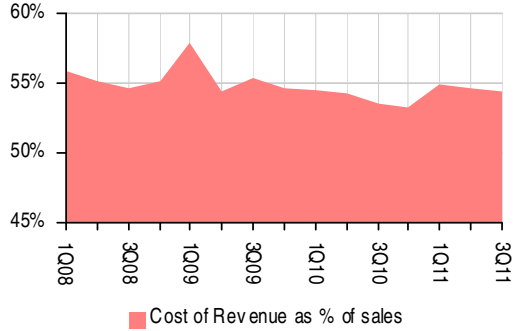
Source: TCS, HSBC

Chart 3. SG&A expenses as % of sales



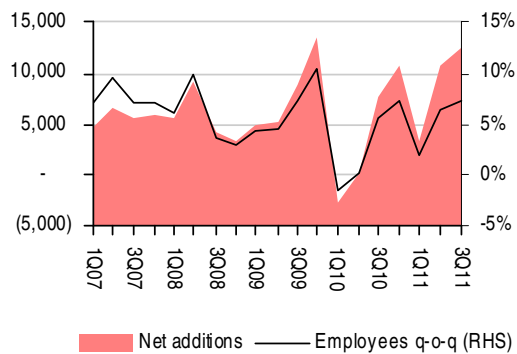
Source: TCS, HSBC

Chart 4. Cost of revenues as % of sales



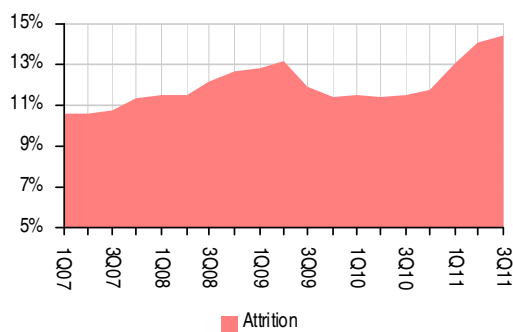
Source: TCS, HSBC

Chart 5. Net additions



Source: TCS, HSBC

Chart 6. Attrition



Source: TCS, HSBC

TCS

P&L Summary (INRm)	FY10	FY11E	FY12E	FY13E
Total Revenues	300,289	374,102	468,155	560,383
Total Cost of Revenues	161,667	204,255	254,449	304,613
Gross profit	138,621	169,847	213,706	255,770
Selling, general and administrative expenses	58,180	64,999	84,268	105,100
Research & Development	851	924	1,158	1,390
Total Operating Expenses	59,031	65,924	85,426	106,490
Operating Income	79,591	103,923	128,280	149,280
Net income	68,895	86,713	101,067	116,870
EPS	35.2	44.3	51.6	59.7
Margin Ratios				
Gross Margin	46.2%	45.4%	45.6%	45.6%
Operating Margin	26.5%	27.8%	27.4%	26.6%
Net Margin	22.9%	23.2%	21.6%	20.9%
Y-o-Y Growth				
Revenues	8.0%	24.6%	25.1%	19.7%
Operating Income	20.6%	30.6%	23.4%	16.4%
EPS	33.2%	25.9%	16.6%	15.6%
Balance Sheet Summary	FY10	FY11E	FY12E	FY13E
Cash & Cash Equivalents	10,249	11,451	25,624	43,487
Bank Deposits	36,525	25,766	25,766	25,766
Accounts Receivables	58,098	73,013	94,915	116,393
Total Current Assets	138,149	149,104	185,180	224,521
Investments	37,822	56,270	56,270	56,270
Total Assets	276,213	322,576	371,760	426,792
Liabilities				
Accrued expenses and other current liabilities	46,899	69,950	87,140	104,319
Unearned and deferred revenues	7,311	7,978	7,978	7,978
Short term debt	610	2,319	2,319	2,319
Total Current Liabilities	54,819	72,269	89,459	106,638
Long term debt	1,808	113	113	113
Total Liabilities	63,040	80,360	97,550	114,729
Minority Interests	3,768	4,061	5,147	6,232
Shareholders' Equity:				
Equity Shares	1,957	1,957	1,957	1,957
Total shareholders' equity	209,404	238,207	269,117	305,883
Total liabilities and equity	276,213	322,629	371,813	426,845
Cash Flow Summary	FY10	FY11E	FY12E	FY13E
Net Income	69,634	87,798	102,152	117,955
Depreciation and amortization	7,248	8,203	10,299	12,328
Changes in current assets and liabilities	2,619	(4,910)	(4,713)	(4,298)
Net cash from Operating activities	74,919	91,092	107,738	125,985
Purchase of Fixed Assets	(10,358)	(23,568)	(23,408)	(28,019)
Net cash from Investing activities	(55,266)	(31,005)	(23,408)	(28,019)
Dividends paid	(19,464)	(58,969)	(70,157)	(80,103)
Net cash from financing activities	(23,500)	(59,099)	(70,157)	(80,103)
Change in cash	(4,377)	988	14,173	17,863
Opening Cash	14,839	10,462	11,451	25,624
Closing Cash	10,462	11,451	25,624	43,487

Source: Company, HSBC estimates

Valuations: We remain OW on TCS, valuing the company on an unchanged PE of 22x our CY12e earnings (in line with Infosys (INFO IN, OW, INR3,204.30)); this yields a target price of INR1,300.

Risks: In our view, wage inflation and a macro-economic slowdown represent the primary downside risks to our Overweight rating on TCS.

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Yogesh Aggarwal.

Important disclosures

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

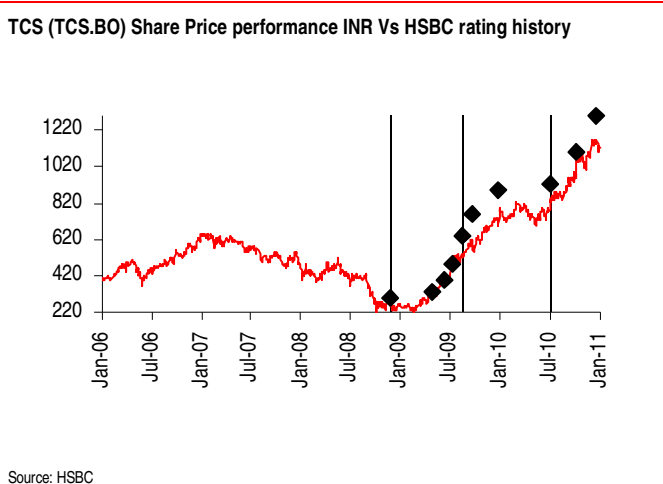
stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 17 January 2011, the distribution of all ratings published is as follows:

Overweight (Buy)	47%	(23% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(19% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(22% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
N/A	Neutral (V)	10 December 2008
Neutral (V)	Overweight (V)	01 September 2009
Overweight (V)	Overweight	15 July 2010
Target Price	Value	Date
Price 1	300.00	10 December 2008
Price 2	335.00	12 May 2009
Price 3	400.00	25 June 2009
Price 4	480.00	20 July 2009
Price 5	640.00	01 September 2009
Price 6	755.00	07 October 2009
Price 7	890.00	07 January 2010
Price 8	925.00	15 July 2010
Price 9	1100.00	22 October 2010
Price 10	1300.00	02 January 2011

Source: HSBC

HSBC & Analyst disclosures

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- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 31 December 2010 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
- 5 As of 30 November 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
- 6 As of 30 November 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking-securities related services.
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