

## Tata Consultancy Services

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,047	TCS IN
	REUTERS CODE
S&P CNX: 2,737	TCS.BO

15 January 2009

Buy

Previous Recommendation: Buy

Rs510

Equity Shares (m)	978.6
52-Week Range	1,054/418
1,6,12 Rel. Perf. (%)	17/-3/8
M.Cap. (Rs b)	499.1
M.Cap. (US\$ b)	10.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	186,334	41,316	41.7	39.6	12.2	5.6	55.1	50.3	2.6	9.5
3/08A	228,614	50,484	51.3	23.1	9.9	4.0	47.0	43.0	2.0	7.9
3/09E	286,090	55,285	56.5	10.1	9.0	3.1	38.9	36.3	1.5	5.9
3/10E	305,556	54,970	56.2	-0.6	9.1	2.6	30.9	29.2	1.3	5.4

1:1 bonus in FY07, accordingly ratios are adjusted

- US\$ revenues below expectation, EBIT margin expands 53bp:** 3QFY09 US\$ revenues declined 5.8% QoQ to US\$1,483m (up 1.2% in constant currency), below our expectation of US\$1,520m. Rupee revenues at Rs72.8b grew 4.7% QoQ (23% YoY). EBIT margin at 24.8% is marginally above estimates (23.9%) and is up 53bp QoQ. SGA is down 3.5% QoQ, with SGA salary costs declining marginally QoQ. PAT at Rs13.5b grew 7.2% QoQ but below our estimates due to higher-than-expected forex losses of Rs2.5b.
- Pricing stable on increased 'billing rate discipline', to come under pressure:** Constant currency pricing was largely stable, having declined marginally by 0.1% QoQ. Management claimed to follow a high level of discipline on pricing currently but acknowledged that the pricing environment was increasingly becoming tougher.
- Hiring plans on track, guidance unchanged:** TCS hired 11,773 employees on a gross basis and 8,692 employees on a net basis excluding subsidiaries. Total headcount, including subsidiaries, rose to 130,343 (excluding 12,459 employees of Citigroup Global Services, CGSL) with 8,733 net hires. The number of employees in 9MFY09 has touched 30,437 — crossing the lower end of the guidance of 30,000-35,000 gross hires for FY09.
- Valuation and view:** In 3Q, both TCS and Infosys have grown ~1% QoQ (in constant currency). Although TCS' realization has been flat QoQ, we believe accommodative billing rates are close to reality and pricing will be key going forward. We have marginally reduced our FY10 EPS to Rs56.2 (from Rs57 earlier), while keeping our FY09 assumptions largely unchanged, in order to factor in likely strained margins resulting from rising pricing concerns. We expect FY10 US\$ consolidated revenue to grow at 7.4% for TCS (4% excl. CGSL). The stock is trading at 9.1x FY10E earnings. We value TCS at 10.4x FY10 EPS (a 20% discount to the P/E multiple implied by Infosys' target price). Maintain **Buy** with a target price of Rs584.

### QUARTERLY PERFORMANCE (US GAAP)

Y/E MARCH	(RS MILLION)									
	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
<b>Revenues</b>	<b>52,029</b>	<b>56,398</b>	<b>59,241</b>	<b>60,947</b>	<b>64,107</b>	<b>69,534</b>	<b>72,770</b>	<b>79,679</b>	<b>228,615</b>	<b>286,090</b>
Q-o-Q Change (%)	1.1	8.4	5.0	2.9	5.2	8.5	4.7	9.5	22.7	25.1
Direct Expenses	28,221	30,152	31,384	32,587	36,427	36,879	39,348	44,449	122,344	157,103
Sales, General & Admin. Expenses	10,543	11,426	12,068	12,836	12,366	14,458	13,948	14,121	46,873	54,893
<b>Operating Profit</b>	<b>13,265</b>	<b>14,820</b>	<b>15,789</b>	<b>15,524</b>	<b>15,314</b>	<b>18,197</b>	<b>19,474</b>	<b>21,109</b>	<b>59,398</b>	<b>74,094</b>
Margins (%)	25.5	26.3	26.7	25.5	23.9	26.2	26.8	26.5	26.0	25.9
Other Income	1,516	1,105	1,048	781	332	-1,784	-1,847	303	4,450	-2,996
Depreciation	1,265	1,381	1,475	1,625	1,167	1,349	1,454	1,761	5,746	5,731
<b>PBT bef. Extra-ordinary</b>	<b>13,516</b>	<b>14,543</b>	<b>15,362</b>	<b>14,681</b>	<b>14,479</b>	<b>15,064</b>	<b>16,173</b>	<b>19,652</b>	<b>58,102</b>	<b>65,368</b>
Provision for Tax	1,523	2,037	1,947	1,988	1,947	2,291	2,481	2,771	7,494	9,490
Rate (%)	11.3	14.0	12.7	13.5	13.4	15.2	15.3	14.1	12.9	14.5
Minority Interest	138	38	107	134	96	158	167	172	416	593
<b>Net Income after. Extra-ordinary</b>	<b>11,856</b>	<b>12,469</b>	<b>13,308</b>	<b>12,559</b>	<b>12,436</b>	<b>12,615</b>	<b>13,525</b>	<b>16,709</b>	<b>50,192</b>	<b>55,285</b>
Q-o-Q Change (%)	5.9	5.2	6.7	-5.6	-1.0	1.4	7.2	23.5	23.1	10.1

E: MOSL Estimates

### US\$ revenues below expectation, EBIT margin expands 53bp

3QFY09 US\$ revenues declined 5.8% QoQ to US\$1,483m (up 1.2% in constant currency) below our expectation of US\$1,520m. Rupee revenues at Rs72.8b grew 4.7% QoQ (23% YoY). Broken down, the rupee revenue growth would comprise the following: (1) 2.4 % growth in volumes; (2) 0.1% decline in pricing; (3) 1.06% negative impact due to higher offshoring; and (4) 3.4% due to rupee depreciation.

EBIT margin at 24.8% is marginally above estimates (23.9%) and is up 53bp QoQ on account of lower SGA (+166bp); rupee depreciation (+130bp), higher offshoring (+25bp) and lower productivity (-269bp). SGA was down 3.5% QoQ, with SGA salary costs declining marginally QoQ. PAT at Rs13.5b grew 7.2% QoQ, below our estimates due to higher-than-expected forex loss of Rs2.5b.

### Pricing stable on increased 'billing rate discipline', to come under pressure

Constant currency pricing was largely stable, having declined marginally by 0.1% QoQ. Management of TCS claims to follow a high level of discipline on pricing currently, but acknowledged that the pricing environment was increasingly becoming tougher. Management expects pricing to come under pressure in the next few quarters.

### Hiring plans on track, guidance unchanged

TCS hired 11,773 employees on a gross basis and 8,692 employees on a net basis in 3Q; this excludes the subsidiaries. Total headcount, including subsidiaries, went up to 130,343 (excluding 12,459 employees of CGSL) with 8,733 net hires. With the headcount addition in the current quarter, employee addition in 9MFY09 has touched 30,437 employees — crossing the lower end of the guidance of 30,000-35,000 gross hires for FY09. The company has made more than 24,800 campus offers for FY10. Management has kept the hiring guidance unchanged.

#### HIGH EMPLOYEE ADDITIONS CASTS STRAIN ON UTILIZATION

	DEC.07	SEP.08	DEC.08
<b>Utilization (%)</b>			
Including Trainees	72.6	74.7	71.8
Excluding Trainees	77.7	81.1	79.9
<b>Employees</b>			
Total Employees	108,229	121,610	130,343
Gross Addition	7,522	9,682	11,773
Net Addition	4,037	5,328	8,692
Attrition % (LTM)	12.2	13.2	11.9

Source: Company/MOSL

### Signed 6 large deals, 5 in North America

TCS has signed six large deals in 3Q, 2 in Retail and one each in Utilities, Hi-tech, Pharma and the BFSI space. Five out of the six deals are from North America, indicating initial signs of stability in the geography. The stated basket includes a US\$100m deal and a US\$250m deal. Management expects Retail, Pharma and the Utilities verticals to fare better versus others in the years ahead.

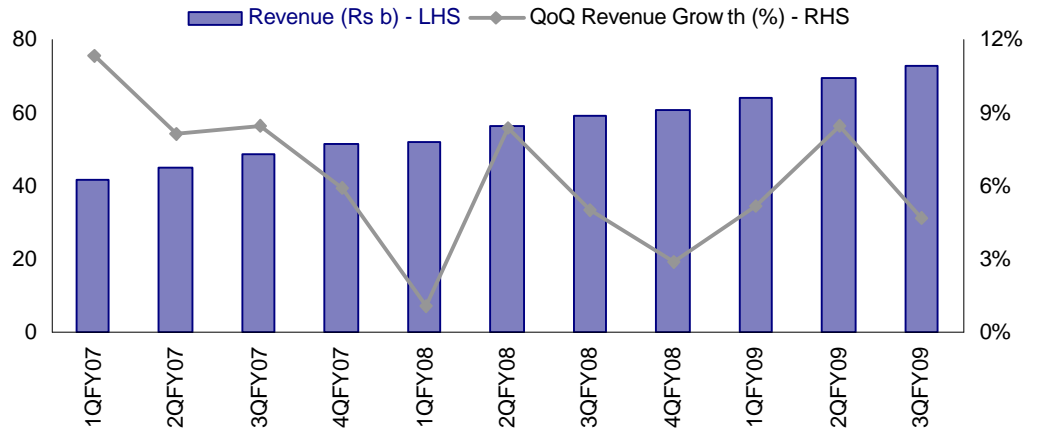
### Other operating highlights

- ✂ International business grew 5.9% at Rs64.8b while the domestic business declined 9.5% to Rs4.9b.
- ✂ Active clients grew from 920 in 2Q to 965 in 3Q. TCS added 41 new clients in 3Q.
- ✂ Utilization excluding trainees declined to 79.9% v/s 81.1% in 2Q. Utilization including trainees declined to 71.8% v/s 74.7% in 2Q.
- ✂ Infrastructure services has been the key growth driver with 4.3% QoQ growth contributing 8.3% in 3Q v/s 7.5% in 2Q.
- ✂ Contribution from fixed price projects at 45.5% is up 210bp QoQ, having grown in the second consecutive quarter.
- ✂ Revenues from top clients declined 18.6% in reported currency.
- ✂ TCS has not replenished the hedges it utilized in 3Q; this would lower company's hedging position from US\$1.25b to US\$0.77b (US\$190m hedges for 4QFY09). The company's losses in OCI stood at Rs7.5, marginally up from Rs6.7b in 2QFY09.
- ✂ Billing from Nortel was less than US\$40m.

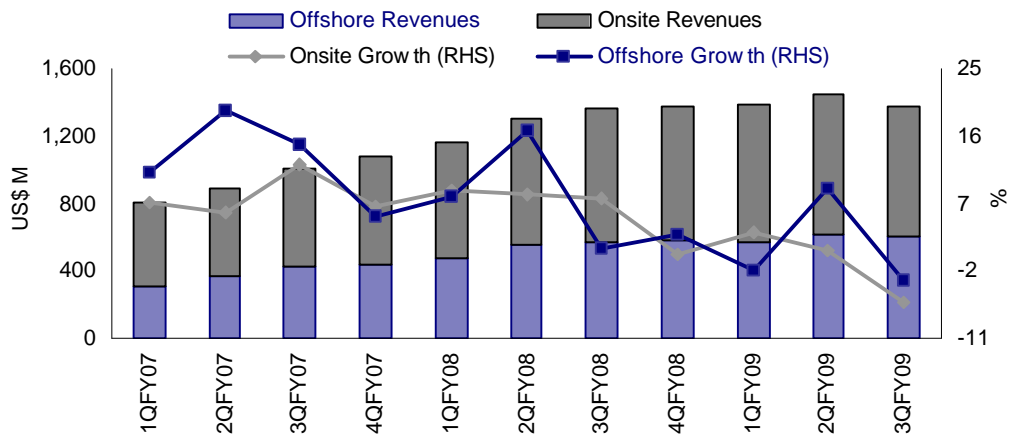
### Valuation and view

Both TCS and Infosys have grown ~1%QoQ (in constant currency) in 3Q. But while Infosys reported a 1.8% decline in realization in constant currency that of TCS is flat QoQ. Both managements have however accepted that pricing will come under considerable strain going forward. We believe that accommodative billing rates are fast approaching reality and pricing will be the key subject of client discussion going forward. Our estimates factor in declining realization for all the companies under our coverage in FY10. We have marginally reduced our FY10 EPS to Rs56.2 (from Rs57 earlier), while keeping our FY09 assumptions largely unchanged, in order to factor in likely strained margins resulting from rising pricing concerns. We expect FY10 US\$ consolidated revenue growth at 7.4% for TCS (4% excl. CGSL). The stock is trading at 9.1x FY10E earnings. We value TCS at 10.4x FY10 EPS (a 20% discount to the P/E multiple implied by Infosys' target price). Maintain **Buy** with a target price of Rs584.

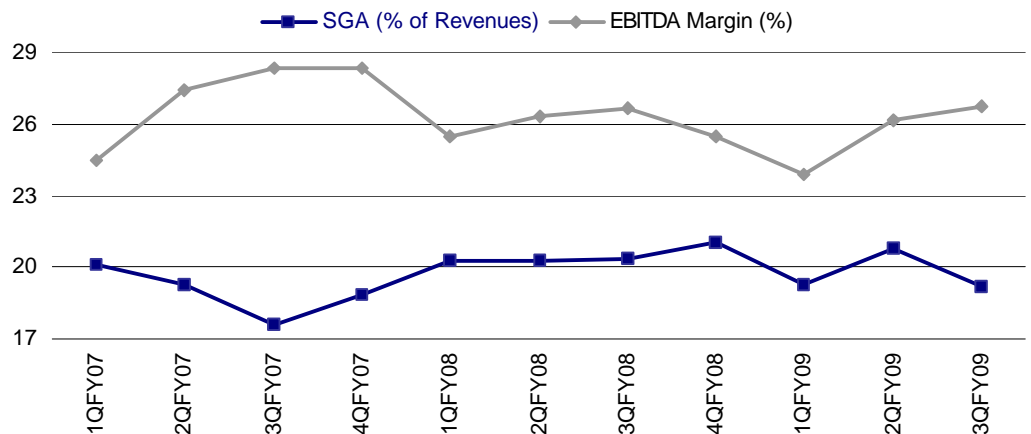
INR REVENUE BOOSTED BY RUPEE DEPRECIATION



HIGHER OFFSHORING LEADS TO CHANGE IN ONSITE/OFFSHORE REVENUE MIX

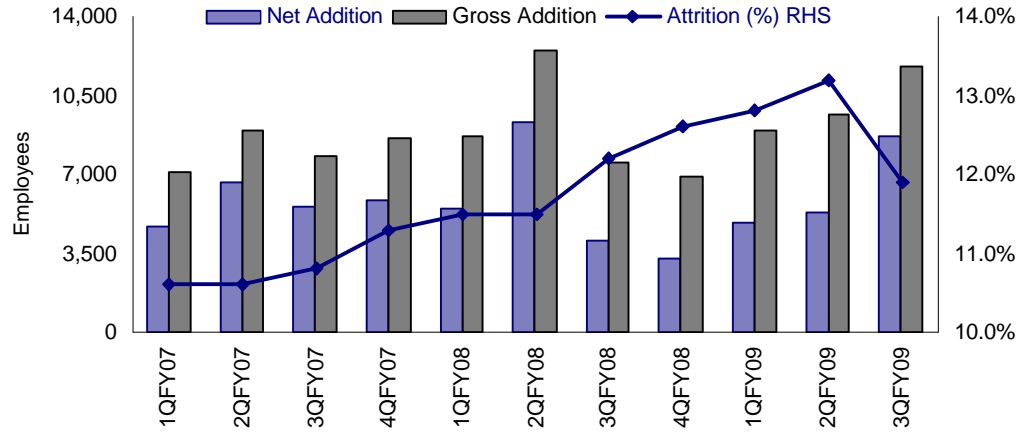


SGA LEVERAGE HELPS EBITDA MARGIN BY 166BP

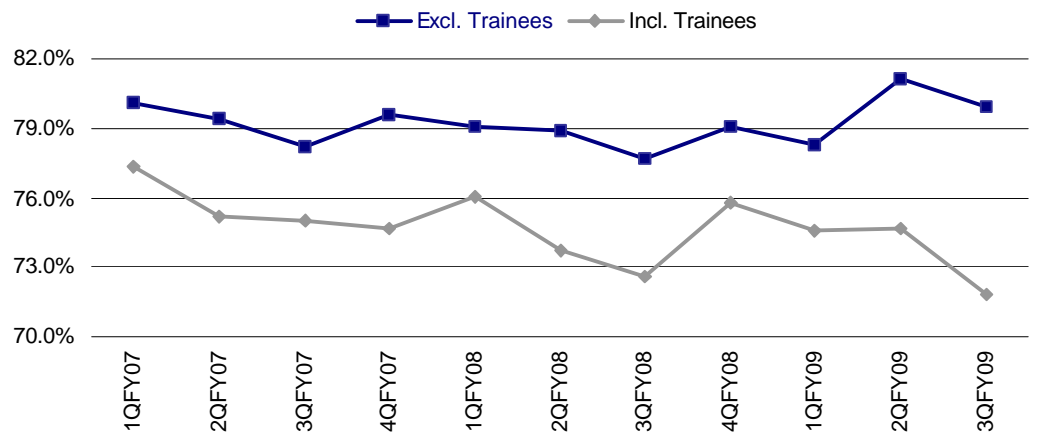


Source: Company/MOSL

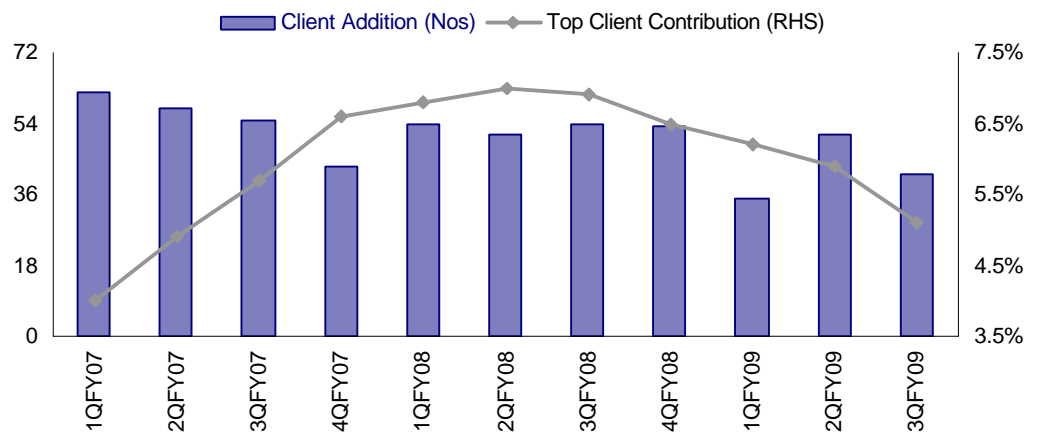
HIGH GROSS & NET HIRING; ATTRITION DECLINES CONSIDERABLY



HIGH EMPLOYEE ADDITION PULLS DOWN UTILIZATION



LOW CLIENT ADDITION, TOP CLIENT DECLINES QOQ



Source: Company/MOSL

## Tata Consultancy Services: an investment profile

### Company description

TCS is the largest IT services company in India, with (LTM) revenue of US\$6.1b as on 31 December 2008. It employs over 140,000 staff and provides IT as well as BPO services to over 985 clients globally. It is a preferred IT vendor for a majority of the Fortune 500/Global 1,000 companies.

### Key investment arguments

- ✎ Most diversified range of offerings with less than 50% ADM business and other 50% spread to Enterprise Solutions, Business Intelligence, Consulting Infrastructure management and BPO.
- ✎ Widest global reach, operates in 50 countries with 175 offices, US revenue share ~52%; UK ~19%; Europe ~11%; India ~7% and the rest in APAC, Middle East.
- ✎ Lowest attrition in industry (December 2008: 11.9%) Out of 140,000 employees, 9.1% are foreigners, 30% are women and 52% have 3+ years experience.
- ✎ Leadership in emerging services like Infra, BPO and Enterprise Solutions; and focus on Consulting.

### Key investment risks

- ✎ Globally challenging IT-spend environment in view of the ongoing recession in the US and most of Europe.
- ✎ Rising concerns on pricing declines with competition intensifying on lower IT-spend.

#### COMPARATIVE VALUATIONS

		TCS	INFOSYS	WIPRO
P/E (x)	FY09E	9.0	12.4	9.6
	FY10E	9.1	12.2	9.5
P/BV (x)	FY09E	3.1	4.1	2.2
	FY10E	2.6	3.4	1.8
EV/Sales (x)	FY09E	1.5	2.9	1.1
	FY10E	1.3	2.7	0.9
EV/EBITDA (x)	FY09E	5.9	8.9	5.2
	FY10E	5.4	8.7	4.9

#### SHAREHOLDING PATTERN (%)

	SEP-08	JUN-08	SEP-07
Promoter	76.4	76.4	79.8
Domestic Inst	6.5	6.4	5.4
Foreign	11.1	11.2	8.1
Others	6.1	6.1	6.7

### Recent developments

- ✎ TCS acquires Citigroup Global Services (India-based captive BPO arm of Citigroup) for US\$505m.
- ✎ Largest retirement fund administrator in Australia signs up TCS as leading technology partner for business transformation program worth ~AUD70m over 1 year.

### Valuation and view

- ✎ Revenue CAGR of 16% and EPS CAGR of 5% over FY08-10E.
- ✎ Valuations at 9x FY09E earnings and 9.1x FY10E. Maintain **Buy** with a target price of Rs584.

### Sector view

- ✎ Indian offshoring has been vindicated with the Global Clients and Service providers making India as their base for IT Enabled Solutions. India still has less than 5% of the Global IT markets. We are positive on the sector from a long term perspective.
- ✎ Developed economies slowing down, sub prime crises and sharper currency appreciation remain key concerns.
- ✎ We reckon frontline Indian IT companies would be better placed to sail through the near term adversities mentioned above. Niche IT/ITeS services companies with strong business models are also likely to be better placed to face uncertainties ahead.

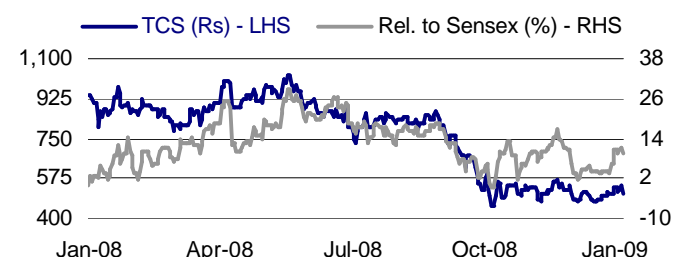
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	56.5	56.5	-0.1
FY10	56.2	60.9	-7.7

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
510	584	14.5	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2007	2008	2009E	2010E	2011E
<b>Sales</b>	<b>186,334</b>	<b>228,614</b>	<b>286,090</b>	<b>305,556</b>	<b>316,353</b>
Change (%)	40.6	22.7	25.1	6.8	3.5
Cost of Services	100,339	122,344	157,103	176,570	189,102
SG&A Expenses	35,253	46,873	54,893	57,078	57,348
<b>EBITDA</b>	<b>50,742</b>	<b>59,397</b>	<b>74,094</b>	<b>71,909</b>	<b>69,902</b>
% of Net Sales	27.2	26.0	25.9	23.5	22.1
Depreciation	4,296	5,746	5,731	6,796	5,849
Other Income	1,280	4,450	-2,996	741	931
<b>PBT</b>	<b>47,726</b>	<b>58,101</b>	<b>65,368</b>	<b>65,853</b>	<b>64,984</b>
Tax	6,568	7,494	9,490	10,148	13,012
Rate (%)	13.8	12.9	14.5	15.4	20.0
Equity in net earnings of affi	44	8	-4	5	7
Minority Interest	417	424	589	740	847
<b>PAT</b>	<b>40,786</b>	<b>50,191</b>	<b>55,285</b>	<b>54,970</b>	<b>51,131</b>
Extraordinary	530	293	0	0	0
<b>Net Income</b>	<b>41,316</b>	<b>50,484</b>	<b>55,285</b>	<b>54,970</b>	<b>51,131</b>
Change (%)	42.6	22.2	9.5	-0.6	-7.0

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2007	2008	2009E	2010E	2011E
Share Capital	979	979	979	979	979
Reserves	88,682	122,841	159,807	194,168	222,399
<b>Net Worth</b>	<b>89,661</b>	<b>123,820</b>	<b>160,785</b>	<b>195,146</b>	<b>223,378</b>
Minority Interest	2,121	2,300	2,889	3,629	3,629
Loans	6,626	7,098	6,395	6,075	5,772
<b>Capital Employed</b>	<b>99,291</b>	<b>134,031</b>	<b>170,882</b>	<b>205,663</b>	<b>233,591</b>
Gross Block	25,669	38,449	53,449	68,449	83,449
Less : Depreciation	9,895	14,322	20,052	26,848	32,698
<b>Net Block</b>	<b>15,774</b>	<b>24,128</b>	<b>33,397</b>	<b>41,601</b>	<b>50,752</b>
CWIP	7,140	6,088	3,002	3,002	5,002
Other LT Assets	20,222	23,801	21,752	26,113	22,400
Investments	12,661	26,475	10,760	40,000	50,000
<b>Curr. Assets</b>	<b>74,853</b>	<b>96,141</b>	<b>150,102</b>	<b>174,701</b>	<b>186,847</b>
Debtors	43,090	53,899	66,808	60,437	71,304
Cash & Bank Balance	12,291	11,164	56,009	78,909	86,045
Other Current Assets	19,471	31,078	27,285	35,354	29,498
<b>Current Liab. &amp; Prov</b>	<b>31,358</b>	<b>42,602</b>	<b>48,131</b>	<b>79,754</b>	<b>81,410</b>
Creditors	6,701	11,004	7,807	12,284	8,517
Other liabilities	24,657	31,596	40,322	67,468	72,890
<b>Net Current Assets</b>	<b>43,494</b>	<b>53,539</b>	<b>101,971</b>	<b>94,947</b>	<b>105,438</b>
<b>Application of Funds</b>	<b>99,291</b>	<b>134,031</b>	<b>170,882</b>	<b>205,663</b>	<b>233,591</b>

E: MOSL Estimates

RATIOS *					
Y/E MARCH	2007	2008	2009E	2010E	2011E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>41.7</b>	<b>51.3</b>	<b>56.5</b>	<b>56.2</b>	<b>52.2</b>
Cash EPS	46.1	57.2	62.3	63.1	58.2
Book Value	916	126.5	164.3	199.4	228.3
DPS	11.5	14.0	16.0	18.0	20.0
Payout %	27.6	27.3	28.3	32.0	38.3
<b>Valuation (x)</b>					
P/E	12.2	9.9	9.0	9.1	9.8
Cash P/E	11.1	8.9	8.2	8.1	8.8
EV/EBITDA	9.5	7.9	5.9	5.4	5.3
EV/Sales	2.6	2.0	1.5	1.3	1.2
Price/Book Value	5.6	4.0	3.1	2.6	2.2
Dividend Yield (%)	2.3	2.7	3.1	3.5	3.9
<b>Profitability Ratios (%)</b>					
RoE	55.1	47.0	38.9	30.9	24.4
RoCE	50.3	43.0	36.3	29.2	23.3
<b>Turnover Ratios</b>					
Debtors (Days)	74	77	77	76	76
Fixed Asset Turnover (x)	13.2	11.5	9.9	8.1	6.9
<b>Leverage Ratio</b>					
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	61,605	62,507	56,981
Cash for Working Capital	-8,287	-11,173	-3,587	29,924	-3,355
<b>Net Operating CF</b>	<b>37,882</b>	<b>45,236</b>	<b>58,018</b>	<b>92,431</b>	<b>53,626</b>
Net Purchase of FA	-18,491	-16,626	-9,865	-19,361	-13,287
Net Purchase of Invest.	-5,574	-13,815	15,715	-29,240	-10,000
<b>Net Cash from Invest.</b>	<b>-24,065</b>	<b>-30,440</b>	<b>5,850</b>	<b>-48,601</b>	<b>-23,287</b>
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	-18,320	-20,610	-22,899
<b>Cash Flow from Fin.</b>	<b>-5,490</b>	<b>-15,923</b>	<b>-19,023</b>	<b>-20,929</b>	<b>-23,203</b>
Free Cash Flow	19,391	28,610	48,152	73,070	40,339
<b>Net Cash Flow</b>	<b>8,326</b>	<b>-1,127</b>	<b>44,845</b>	<b>22,900</b>	<b>7,136</b>
<b>Opening Cash Bal.</b>	<b>3,965</b>	<b>12,291</b>	<b>11,164</b>	<b>56,009</b>	<b>78,909</b>
Add: Net Cash	8,326	-1,127	44,845	22,900	7,136
<b>Closing Cash Bal.</b>	<b>12,291</b>	<b>11,164</b>	<b>56,009</b>	<b>78,909</b>	<b>86,045</b>



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilalosal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

1. Analyst ownership of the stock
2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

**Tata Consultancy Services**

No  
No  
No  
No

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.