

Q3FY07 result

Tata Consultancy Services

BUY

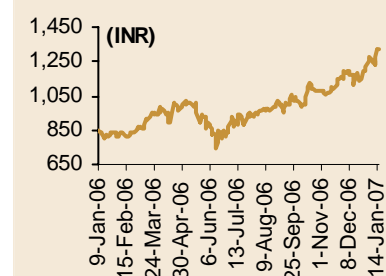
Bloomberg: TCS IN
Reuters: TCS.NS
Mkt cap: INR 1,299.5bn/USD 29.4bn

Current price: INR 1,328
Target price: INR 1,650*
Strong quarter

We upgrade earnings and move to March08 price target

**Revised from INR 1,495. Horizon: 31 March 2008*
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Stock performance


(%)	Absolute	Relative to	
		Sensex	Sector
3 months	22.6	8.8	6.1
6 months	42.2	9.3	6.8
12 months	60.9	6.7	10.0

Expected performance relative to Sensex **OUTPERFORM**
Beta relative to Sensex **0.92**
Key financials

Y/E 31 Mar	FY07E	FY08E	FY09E
Net sales (INR m)	186,877	247,502	318,996
Net profit (INR m)	41,399	52,931	66,162
Adj EPS (INR)	42.3	54.1	67.6
PER (x)	31.4	24.5	19.6
PCE (x)	28.7	22.5	18.0
EV/Core			
EBITDA (x)	24.8	18.7	14.1
Price/Book (x)	12.8	8.4	5.9
ROE (%)	51.3	41.4	35.3
ROCE (%)	58.1	46.8	40.5
Consensus EPS (INR) *		52.8	

** Bloomberg*

TCS reported a QoQ growth of 8.4% in revenues, 11.9% in EBIDTA and 11.4% in net profit. This is against our estimates of QoQ growth of 6.0% in revenues, 4.3% in EBIDTA and 4.8% in net profit. The 90bp expansion in the EBIDTA margin has taken us by surprise, especially as the rupee appreciated by 3.8% against the USD and 1.9% against the Euro.

In view of the positive margin surprise in Q3, we have raised our EPS estimate for FY07 by 2.4% to INR 42.3, for FY08 by 2.5% to INR 54.1, and for FY09 by 2.4% to INR 67.6.

TCS's stock has been one of best-performing stocks in the Sensex in the recent past, having risen by 8.8% YTD in January 2007, as against the index's return of 2%. We expect TCS to maintain its 20-25% premium to the Sensex, as the earnings momentum continues to be strong. We impute a multiple of 24.4 to the company's FY09E EPS to arrive at our March 2008 price target of INR 1,650 (as against our previous December 2007 target of INR 1,495)

Figure 1: Quarterly result US GAAP figures (INR m)

	Q3FY06	Q2FY07	Q3FY07
Revenues	31,566.5	44,821.8	48,604.8
Cost of services	16,837.6	23,880.1	25,758.2
Gross Profits	14,728.9	20,941.6	22,846.5
SG&A Expenses	5,935.1	8,647.6	9,094.0
EBIDTA	8,793.8	12,294.1	13,752.5
Depreciation	625.3	957.9	1,079.9
Other Income	252.0	77.3	299.8
PBT	8,420.5	11,413.5	12,972.4
Income-tax expense	1,468.5	1,446.8	1,828.0
Tax rate (%)	17.4	12.7	14.1
Minority interest	(43.2)	(59.3)	(114.7)
Earnings of affiliates	(5.4)	7.7	17.1
PAT	6,903.4	9,915.1	11,046.8
Extraordinary item	(3.1)	-	-
PAT after ext.	7,502.0	9,915.1	11,046.8
EPS	7.7	10.1	11.7
Gross margins (%)	47.7	46.7	47.0
EBIDTA margins (%)	28.3	27.4	28.3
Net margins (%)	21.7	22.1	22.7

Source: Company, BRICS Research
Revenues up 8.4% QoQ, earnings up 11.4%

TCS reported a QoQ growth of 8.4% in revenues and 11.4% in net profit. The revenue growth was driven by 7.9% volume growth in international business, price increases, and an increase in offshoring.

Figure 2: Growth rates

	Q3FY06	Q2FY07	Q3FY07
QoQ growth (%)			
Revenues	9.4	8.2	8.4
Gross Profits	11.8	14.0	9.1
EBIDTA	11.1	22.7	11.9
PAT	8.7	14.9	11.4
YoY growth (%)			
Revenues	33.9	42.0	40.8
Gross Profits	31.3	42.2	38.7
EBIDTA	25.8	39.8	40.7
PAT	5.8	43.6	47.2

Figure 3: Contributors to revenue growth (%)

Volume growth	7.87
Billing rate (T&M)	2.00
Pricing & productivity (turnkey projects)	2.59
Rupee depreciation effect	-2.46
Off-shoring impact	-1.56
Total effect	8.44

Source: Company

Steady Improvement in EBIDTA margins

TCS's EBIDTA margins have expanded by almost 90bp in the quarter, despite a 137bp adverse impact of rupee appreciation.

Figure 4: Contributors to margin expansion (%)

Offshoring	.28
Pricing	1.74
Cost Efficiency	.14
Rupee depreciation	-1.37
Total effect	.79

Source: Company

Strong growth in Q2

Strong growth in traditional service lines resulted in robust overall growth as ADM revenues went up 11.4% during the quarter. Similarly, new service offerings such as business intelligence (up 7.3%) and BPO (up 8.4%) did well.

The most significant growth was recorded by asset-leveraged solutions, which grew by 21.5% during the quarter.

BFSI, Life Sciences and Healthcare, Telecommunications and Retail & Distribution verticals witnessed QoQ growth of 10.5%, 22%, 9.7% and 13.4%, respectively.

Figure 5: Growth profile - QoQ growth (%)

	Q3FY06	Q2FY07	Q3FY07
By Geography			
North America	8.1	8.8	5.2
Ibero America	75.0	30.5	42.5
UK	11.6	12.5	5.3
Continental Europe	30.9	8.2	18.2
India	-5.7	-14.3	2.0
Asia-Pacific	12.1	27.6	32.0
MEA	15.1	-4.6	1.2
By Industry Vertical/Domain			
Banking, Financial Services & Insurance	12.1	9.9	10.5
Manufacturing	8.2	12.5	7.7
Telecommunications	10.1	8.2	9.7
Life Sciences and Healthcare	12.0	11.3	22.0
Retail & Distribution	1.2	-14.3	13.4
Transportation	-8.4	27.6	-7.5
Energy and Utilities	0.6	-4.6	-11.6

Source: Company, BRICS Research

Figure 6: Growth profile - QoQ growth

Service Offering	QoQ growth (%)	
	Q2FY07	Q3FY07
Application Development & Maintenance	8.4	11.4
Business Intelligence	19.3	7.3
Engineering & Industrial Services	6.4	-4.0
Infrastructure Services	-4.6	-0.6
Enterprise Solutions	-0.2	6.6
Global Consulting	18.3	5.3
Asset Leveraged Solutions	4.0	21.5
Assurance Services	44.2	3.9
BPO	10.0	8.4

Source: Company, Brics Research

In terms of geography, Ibero America, Continental Europe and Asia-Pacific were outperformers, growing by 42.5%, 18.2% and 32%, respectively, during the quarter.

Other income went up by INR 222.5m during Q2FY07 to INR 299.8 m during the quarter. The net forex gain went up to INR 35.9m during Q3FY07 from a loss of INR 5.1 m during the previous quarter.

Figure 7: Other income

	Other income (INR m)	
	Q2FY07	Q3FY07
Interest Income	35.5	55.3
Interest (Expense)	-90.7	-64.5
Foreign exchange (loss)/gain, net	-5.1	35.9
Dividend Income	65.8	105.6
Others, net	71.8	167.5
Other income, net	77.3	299.8

Source: Company

Attrition rates down

On a QoQ basis, attrition rates seem to have gone down from 12.7% in Q2FY07 to 11.8% in Q3FY07.

Figure 8: Attrition

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Total no. of employees excluding subsidiaries	48,337	53,042	59,216	62,832	67,530	74,193	79,755
Gross addition	8,814	5,788	7,521	5,954	7,095	8,919	7,835
Net addition	7,345	4,238	5,986	4,271	4,698	6,663	5,562
Attrition	1469	1550	1535	1683	2,397	2,256	2,273
Annualised attrition as % of average staff strength of quarter	13.2	12.2	10.9	11.0	14.7	12.7	11.8
Attrition rate reported by the company (%)	8.2	8.7	8.7	9.9	10.6	10.6	10.8

Source: Companies, Brics Research

Other highlights

- The utilisation (excluding trainees) went down from 79.4% to 78.2% during the quarter.
- The company added 7,835 employees during the quarter on gross basis.

- The contribution of fixed-price contracts went up from 40.9% to 41% of revenues.

We raise FY07, FY08 and FY09 estimates, and revise price target upward

We have revised our revenue and earnings estimates upwards to factor in robust growth and margin improvement in Q3FY07 (see table below). Our FY07, FY08 and FY09 EPS estimates now stand at INR 42.3, INR 54.1, and INR 67.6, respectively.

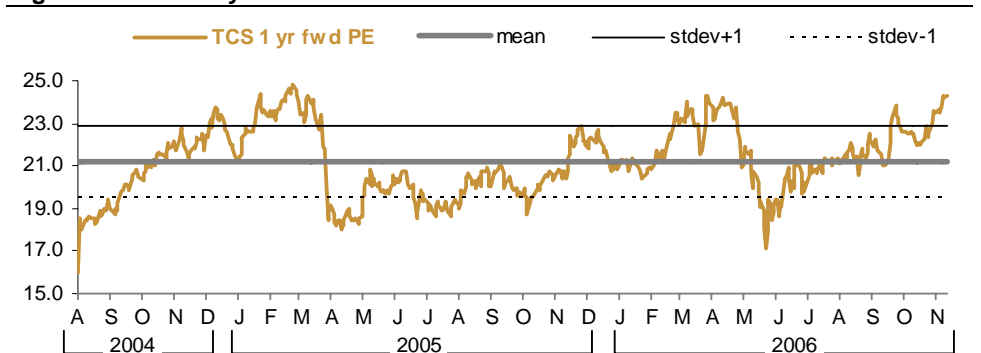
Figure 9: Our revision of estimates

	Earlier estimates			Revised estimates		
	FY07	FY08	FY09	FY07	FY08	FY09
Revenues (INR m)	284,613	241,933	311,818	186,877	247,502	318,996
EPS (INR)	41	52.8	66.0	42.3	54.1	67.6

Source: BRICS Research

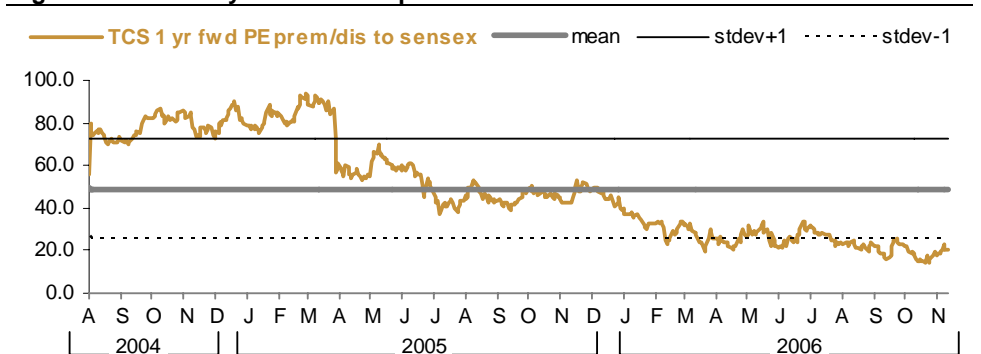
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Figure 10: TCS's 1-yr-forward P/E



Source: Brics Research

Figure 11: TCS's 1-yr-forward P/E premium/discount to Sensex



Source: Brics Research

Key metrics

Figure 12: Revenue mix by geography (%)

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
North America	57.9	58.1	57.4	55.1	53.2	53.5	51.9
Ibero America	0.9	1.5	2.4	2.9	2.9	3.5	4.6
UK	15.5	14.6	14.9	16.9	19.9	20.7	20.1
Continental Europe	6.6	6.1	7.3	7.4	7.8	7.8	8.5
India	13.3	13.8	11.9	11.5	10.6	8.4	7.9
Asia-Pacific	4.3	4	4.1	4	3.9	4.6	5.6
MEA	1.5	1.9	2	2.2	1.7	1.5	1.4

Source: Company

Figure 13: Revenue mix by service practice (%)

	FY07		
	Q1	Q2	Q3
Application Development & Maintenance	52.0	52.1	53.5
Business Intelligence	8.7	9.6	9.5
Engineering & Industrial Services	6.2	6.1	5.4
Infrastructure Services	6.8	6.0	5.5
Enterprise Solutions	13.0	12.0	11.8
Global Consulting	3.2	3.5	3.4
Asset Leveraged Solutions	2.6	2.5	2.8
Assurance Services	1.8	2.4	2.3
BPO	5.7	5.8	5.8

Source: Company

Figure 14: Revenue mix by industry practice (%)

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
BFSI	40.1	40.8	41.8	41.8	41.2	42.7	43.5
Manufacturing	16.7	17.9	17.7	16.4	16.0	15.3	15.2
Telecommunications	15.3	15.3	15.4	14.3	16.5	16.6	16.8
Life Sciences and Healthcare	5.5	4.2	4.3	4.5	4.1	4.0	4.5
Retail & Distribution	7.1	6.7	6.2	6.4	6.7	6.6	6.9
Transportation	3.9	3.7	3.1	3.7	3.6	3.4	2.9
Energy and Utilities	2.2	2.5	2.3	3.0	2.6	2.7	2.2
Others	9.2	8.9	9.2	9.9	9.3	8.7	8

Source: Company

Figure 15: Revenue mix by pricing model (%)

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Time & Materials basis	49.3	48.4	49.4	51.7	56.4	59.1	59
Fixed price, fixed time basis	50.7	51.6	50.6	48.3	43.6	40.9	41

Source: Company

Figure 16: Client concentration

Revenue Contribution (%)	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Top client	4.7	3.8	3.7	3.7	4.0	49.0	5.7
Top 5 clients	19.4	18.1	17.0	17.0	16.7	16.8	17.4
Top 10 clients	30.7	29.0	27.6	27.5	26.8	26.8	27.5
GE Group	12.5	11.6	10.8	10.3	9.0	8.2	

Source: Company

Figure 17: Client mix

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Active clients	671	759	766	748	764	742	754
New clients	72	81	88	89	62	58	55
Revenues from new clients	1.5%	3.3%	5.1%	8.1%	1.2%	2.1%	96.1
Revenues from repeat business	98.5%	96.7%	94.9%	91.9%	9.0%	8.2%	3.9

Source: Company

Figure 18: Revenue mix by delivery model

(%)

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Offshore	37.1	37.3	38.6	37.3	38.1	41.0	41.6
Onsite	62.9	62.7	61.4	59.0	58.7	56.0	54.3
GDC/RDC				3.7	3.2	3.0	4.1

Source: Company

Figure 19: Utilization Rate

(%)

	FY06				FY07		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Including Trainees	74.8	74.9	75.5	75.8	77.3	75.2	75
Excluding Trainees	77.7	78.0	78.3	78.9	80.1	79.4	78.2

Source: Company

Income statement						INR m
Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E	
Net sales	97,272	132,454	186,877	247,502	318,996	
<i>growth (%)</i>	36.6	36.2	41.1	32.4	28.9	
Operating expenses	(68,789)	(95,508)	(135,993)	(182,231)	(236,308)	
Core EBITDA	28,483	36,946	50,884	65,272	82,688	
Other income	757	190	1,205	740	740	
EBITDA	29,240	37,137	52,089	66,012	83,428	
Depreciation	(1,555)	(2,810)	(3,899)	(4,780)	(6,100)	
EBIT	27,685	34,327	48,190	61,232	77,328	
Associates	18	16	50	40	40	
Non-recurring items (net of taxes)	(3,038)	(243)	0	0	0	
Pre-tax profit	24,665	34,100	48,241	61,272	77,368	
Tax (current + deferred)	(4,065)	(4,989)	(6,468)	(7,960)	(10,826)	
Profit after tax	20,600	29,110	41,772	53,311	66,542	
Minority interests	(79)	(279)	(374)	(380)	(380)	
Net profit	20,521	28,831	41,399	52,931	66,162	
<i>Adjusted net profit</i>	<i>23,559</i>	<i>29,074</i>	<i>41,399</i>	<i>52,931</i>	<i>66,162</i>	
<i>growth (%)</i>	46.1	23.4	42.4	27.9	25.0	

Balance sheet						INR m
Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E	
Current assets	30,374	49,600	95,391	153,181	224,867	
Investments	4,192	7,274	7,274	7,274	7,274	
Fixed assets	11,400	23,764	27,365	31,585	35,635	
Other assets	2,943	4,988	7,038	9,321	12,013	
Total assets	48,908	85,626	137,067	201,360	279,789	
Current liabilities	15,124	23,706	33,043	43,445	55,712	
Other liabilities	484	1,949	2,654	3,613	3,613	
Total liabilities	15,608	25,655	35,697	47,059	59,326	
Paid-up capital	480	58,408	99,806	152,738	218,900	
Reserves & surplus	31,497	0	0	0	0	
Shareholders' funds	33,300	59,972	101,370	154,302	220,464	
Minorities	1,323	1,564	1,564	1,564	1,564	
Total equity & liabilities	48,908	85,626	137,067	201,360	279,789	

Cash-flow						INR m
Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E	
Pre-tax profit	24,665	34,100	48,241	61,272	77,368	
Depreciation	1,555	2,810	3,899	4,780	6,100	
Tax paid	-5,459	-4,989	-6,468	-7,960	-10,826	
Chg in working capital	-5,909	-9,306	-526	-7,602	-8,965	
Other operating activities	-1,482	-580	-1,345	-1,323	-2,692	
Cash flow from operations (a)	13,371	22,034	43,801	49,166	60,984	
Capital expenditure	-3,289	-15,174	-7,500	-9,000	-10,150	
Chg in investments	-3,393	-3,082	0	0	0	
Chg in associates	18	16	50	40	40	
Other investing activities	-16,251	-95	-46	-40	0	
Cash flow from investing (b)	-22,915	-18,335	-7,496	-9,000	-10,110	
Free cash flow (a+b)	-9,545	3,699	36,305	40,166	50,874	
Equity raised/(repaid)	2,770	36,344	41,399	52,931	60,062	
Chg in minorities	-21	-39	-374	-380	-380	
Debt raised/(repaid)	-2,878	0	0	0	0	
Dividend (incl. tax)	11,042	0	0	0	0	
Cash flow from financing (c)	10,913	36,305	41,025	52,551	59,682	
Net chg in cash (a+b+c)	1,369	40,004	77,330	92,717	110,557	

Key ratios

Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
Adjusted EPS (Rs)	24.5	29.7	42.3	54.1	67.6
Adjusted EPS growth (%)	45.6	21.1	42.4	27.9	25.0
Core EBITDA growth (%)	46.6	29.7	37.7	28.3	26.7
Core EBITDA margin (%)	29.3	27.9	27.2	26.4	25.9
Pre-tax margin (%)	25.4	25.7	25.8	24.8	24.3
ROE (%)	102.0	62.3	51.3	41.4	35.3
ROCE (%)	108.3	71.7	58.1	46.8	40.5
Net debt/Equity (%)	(7.9)	(6.6)	(39.4)	(51.6)	(59.0)

Valuation parameters

Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
PER (x)	54.1	44.7	31.4	24.5	19.6
PCE (x)	50.8	40.8	28.7	22.5	18.0
Price/Book (x)	38.3	21.7	12.8	8.4	5.9
Yield (%)	(0.9)	0.0	0.0	0.0	0.0
EV/Net sales (x)	13.3	9.8	6.7	4.9	3.7
EV/Core EBITDA (x)	45.5	35.1	24.8	18.7	14.1

TCS: Recommendation history

Date	Stock price (Rs)	Recommendation	Price target (Rs)	Report
5-Oct-06	988	BUY	1229	Thriving on good delivery execution
17-Oct-06	1130	BUY	1314	Q2FY07 result: Strong quarter
7-Dec-06	1196	BUY	1495	Positive long term, however - Margin movements to drive short term stock performance
15-Jan-07	1328	BUY	1650	Q3FY07 result: Strong quarter - We upgrade earnings and move to March08 price target

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