

Company

27 August 2009 | 6 pages

Tata Consultancy Services (TCS.BO)

Equity

Buy: Call with BFS Head – Key Takeaways

- Visible Signs of Recovery** — Pace of decision making has picked up and ramp ups are happening. Projects started getting approved in Mar/Apr timeframe (leading to ~5% qoq growth in Q1) and this continues into Q2 – we believe this should drive decent growth in this segment (BFSI is ~44% of overall revenues). New deals with existing customers are fructifying faster than those with new customers altogether, a sign of TCS' entrenched relationships.
- Segmental Demand Scenario** — Retail and Capital Market segments are witnessing good traction. Application development, BPO and Infrastructure Services are doing well. ADM has a lot of integration related work which typically spans 9-18 months. Clients are showing interest in Products – a sign that discretionary spend could improve. Ramp ups are happening as per plans while the company doesn't see large scale ramp downs (as in the past).
- US leading the way** — In terms of decision making, US is moving faster while UK is doing ok. Continental Europe is slower – which is not unusual going by the past. Management continues to expect that the Rest of the World would grow much faster (on a smaller base).
- Pricing Stable** — Negotiations were largely over in Q4. Competition has been rational as even if they reduced prices, it did not mean that demand migrated to them (most customers are conscious of the capabilities of vendors).
- Remains our top pick** — Management indicated that there is pent up demand – which could fructify if things improve. TCS trades at 18.6x FY10E EPS, ~8% premium to the Indian market for EPS growth of ~13% yoy (vis-à-vis ~3% for the market). It remains our top pick in the Indian IT Services space.

Buy/Low Risk	1L
Price (27 Aug 09)	Rs553.60
Target price	Rs630.00
Expected share price return	13.8%
Expected dividend yield	1.6%
Expected total return	15.4%
Market Cap	Rs1,083,518M US\$22,156M

Price Performance (RIC: TCS.BO, BB: TCS IN)



Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2008A	50,191	25.64	21.5	21.6	8.8	47.3	1.3
2009A	51,721	26.42	3.0	21.0	6.9	37.0	1.3
2010E	58,335	29.80	12.8	18.6	5.5	33.2	1.6
2011E	64,975	33.19	11.4	16.7	4.5	29.7	1.6
2012E	70,961	36.25	9.2	15.3	3.7	26.3	1.6

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

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Tata Consultancy Services

Company description

TCS is the largest and among the oldest IT companies in India. It is part of the diversified Tata Group, one of the largest corporate groups in Asia, with more than 140,000 employees, including subsidiaries. It provides a comprehensive range of IT services to industries such as banking & financial services, insurance, manufacturing, telecom, retail and transportation. It has more than 900 active clients. The company started with data processing work in 1968, and was the first to provide offshore services in 1974. Over the past three decades, it has come a long way with deep technical and project management expertise in handling complex client projects and strong offshore processes.

Investment strategy

We rate TCS Buy/Low Risk (1L). Management is taking significant measures to sustain margins in FY10: (1) Offshoring is a big initiative - 1Q saw a ~270bp shift; (2) Lateral hiring is frozen and involuntary attrition is an option; (3) Campus hires will start joining in the latter part of 2Q, as a result utilization is likely to continue at present levels; and (4) cross-currency movements should help. The valuation discount is clearly attractive. Some stability in business could drive significant outperformance.

Valuation

Our target price of Rs630 is based on 19x FY11E EPS. Given that businesses are bottoming and we estimate TCS' earnings to grow at an ~11% CAGR over FY09-12E, we believe the stock should trade slightly higher than the mid-point of its historical three-year trading range of 8-27x 12-month forward earnings. We believe P/E remains the most appropriate valuation measure given TCS' past profitability and future earnings visibility.

Risks

We rate TCS Low Risk despite our quantitative risk-rating system suggesting High Risk. The company has significant scale, enjoys a good brand name and continues to generate significant FCF. Key downside risks that could cause the shares to be lower than our target price are: (1) any significant appreciation of the rupee against the USD/EUR/GBP; (2) a prolonged recession in the US; and (3) any margin dilutive acquisition.

Appendix A-1

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Tata Consultancy Services (TCS.BO)

Ratings and Target Price History Fundamental Research

Analyst: Surendra Goyal, CFA
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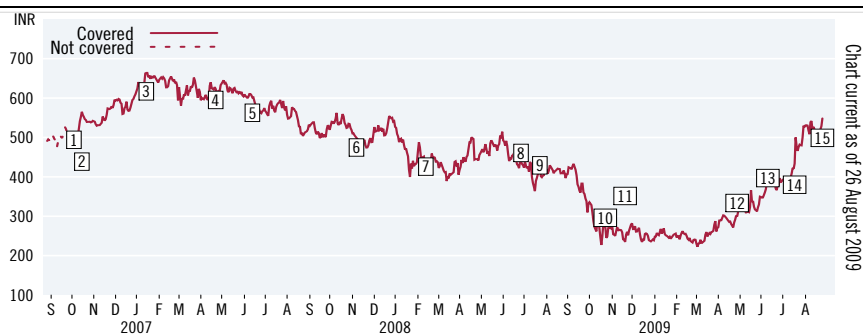


Chart current as of 26 August 2009

	Date	Rating	Target Price	Closing Price
1	4-Oct-06	1L	*592.50	494.05
2	16-Oct-06	1L	*650.00	565.23
3	15-Jan-07	1L	*780.00	663.95
4	23-Apr-07	1L	*775.00	623.05
5	13-Jun-07	1L	*730.00	601.40

	Date	Rating	Target Price	Closing Price
6	7-Nov-07	1L	*645.00	499.13
7	13-Feb-08	*1M	*582.50	434.48
8	26-Jun-08	1M	*587.50	438.43
9	23-Jul-08	*2M	*462.50	429.25
10	23-Oct-08	2M	*312.50	273.73

	Date	Rating	Target Price	Closing Price
11	20-Nov-08	*2H	*280.00	234.75
12	28-Apr-09	*3M	*307.50	299.30
13	10-Jun-09	*1L	*465.00	390.88
14	17-Jul-09	1L	*525.00	433.60
15	26-Aug-09	1L	*630.00	548.30

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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