

# Tata Consultancy Services

 BSE code: 532540  
 NSE code: TCS

**CMP: Rs 1,074**
**Target: Rs 1,193** ↓

**BUY**

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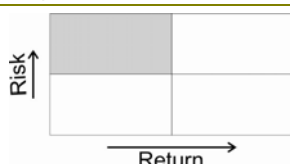
## Company data

Particulars	
Market cap (Rs bn / US\$ bn)	1,051 / 26.7
Outstanding equity shares (mn)	978.6
52-week high/low (Rs)	1,399 / 978
2-month average daily volume	281,451

## Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs bn)	186.3	225.7	271.8
Growth (%)	40.6	21.1	20.4
Adj net profit (Rs bn)	41.3	50.5	58.4
Growth (%)	42.6	22.2	15.6
FDEPS (Rs)	43.1	51.6	59.7
Growth (%)	42.0	19.9	15.6
P/E (x)	24.9	20.8	18.0
ROE (%)	46.1	39.8	33.0

## Risk-return profile



## Shareholding pattern

(%)	Sep-07	Jun-07
Promoters	79.8	80.1
FIs	8.1	7.7
Banks & FIs	2.1	5.6
Public	10.0	6.6

## Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
TCS	1,074	6.1	(4.6)	(14.1)
Sensex	19,059	22.1	24.5	39.2
BSE IT	4,712	5.9	(2.8)	(7.1)

 Company website: [www.tcs.com](http://www.tcs.com)

## No surprises; estimates downgraded

Tata Consultancy Services' (TCS) Q2FY08 results were on par with expectations. Revenue and EBITDA grew by 8.4% and 11.7% QoQ respectively as against our estimates of 6.7% and 10.9% growth respectively. Higher other income shored up net income by 5.2% QoQ, ahead of our expectation of flattish growth. International IT services clocked 9% QoQ growth in volumes. Improved pricing, higher offshoring and forex gains allowed the company to expand its EBITDA margin by 79bps QoQ to 26.3%.

In line with our revised foreign exchange estimate of Rs 39/US\$ for FY09, we are decreasing our FY09 revenue and EPS estimates for TCS by 2.5% and 3.8% respectively. We are also decreasing our one-year target price for the stock from Rs 1,354 earlier to Rs 1,193. Our target price is based on 20x FY09E earnings of Rs 59.7 (a discount of 10% to Infosys' target multiple). Considering the 11% upside from current levels, we maintain our Buy recommendation on the stock.

## Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	56,398.4	55,523.4	1.6
EBIDTA	14,820.6	14,706.0	0.8
PAT	12,469.5	11,912.4	4.7
EPS (Rs)	12.7	12.2	4.7

Source: Company, Religare Research

## Quarterly results

(Rs mn)	Q2FY08	Q1FY08	% Chg QoQ	Q2FY07	% Chg YoY
Revenue	56,398.4	52,028.2	8.4	44,821.8	25.8
Cost of revenue	30,152.3	28,221.2	6.8	23,880.1	26.3
<b>Gross profit</b>	<b>26,246.1</b>	<b>23,807.0</b>	<b>10.2</b>	<b>20,941.6</b>	<b>25.3</b>
SG&A expenses	11,425.5	10,543.1	-	8,647.6	
<b>EBITDA</b>	<b>14,820.6</b>	<b>13,263.9</b>	<b>11.7</b>	<b>12,294.1</b>	<b>20.6</b>
Depreciation	1,381.3	1,264.6	-	957.9	-
EBIT	13,439.3	11,999.3	12.0	11,336.2	18.6
Other income	1,104.7	1,516.3	-	77.3	-
PBT	14,544.0	13,515.6	7.6	11,413.5	27.4
Income taxes	2,036.6	1,523.0	-	1,446.8	-
Earnings from affiliates	4.1	2.4	-	7.7	-
<b>Reported net income</b>	<b>12,469.5</b>	<b>11,855.1</b>	<b>5.2</b>	<b>9,915.1</b>	<b>25.8</b>
EPS	12.7	12.1	5.2	10.1	25.8

Source: Company, Religare Research

Q1FY08 Performance highlights

Parameters	Comments
<b>Volume growth</b>	Volumes in international IT services grew at 9% QoQ while revenues from the Indian business declined by 0.7% QoQ due to seasonal reasons.
<b>Pricing</b>	Blended pricing improved by 85bps QoQ which is in line with our expectations. The management maintains a stable outlook on pricing. However, in some deals we are seeing resistance to price hikes, particularly in the BFSI space. Pricing improvement was an important contributor to the 79bps EBITDA margin expansion witnessed by the company during the quarter.
<b>Onsite – GDC – Offshore mix</b>	Offshoring is another lever employed by TCS to maintain profit margins. The share of offshore revenues increased to 43% during the quarter as compared to 41.1% in Q1FY08 and 41% in Q2FY07. The offshoring leverage contributed 36bps to the EBITDA margin expansion. The share of onsite revenues decreased from 54.8% in Q1FY08 to 53.3% in Q2FY08.
<b>Employee addition</b>	A total of 12,523 employees were added during the quarter (gross) of which 5,899 were trainees and 5,658 were lateral recruits. The management has maintained its FY08 guidance of recruiting more than 30,000 employees at the gross level. The overall headcount in TCS crossed the 100,000 milestone during the quarter. The company has 104,347 employees with 3,748 in GDC and 8,900 in overseas subsidiaries.
<b>Attrition rate</b>	A total of 3,255 employees left the company during the quarter, representing an attrition rate of 11.5% on LTM basis. Attrition in the BPO business rose from 16.7% in Q1FY08 to 17.9% in Q2FY08, while that in IT services remained stable at 10.9% (LTM).
<b>Salary hikes</b>	The company typically awards promotions to employees during the July–September quarter. The rise in salaries due to these promotions had a negative impact of 117bps on the EBITDA margin. We do not expect any further salary hikes during the fiscal.
<b>Clients metrics</b>	Momentum in client addition continues with 51 clients added during the quarter, and growth witnessed across revenue brackets. The number of clients contributing more than US\$ 20mn in annual revenues increased from 69 to 75 during the quarter.
<b>Geographical mix</b>	Despite concerns over the US economy, the North American geography grew at 11% QoQ, faster than the overall company growth rate. Revenue contribution from Europe declined by 100bps in the quarter to 28.3%. The management continues to focus on diversifying geographical risks by increasing revenues from Europe and other non-US geographies.
<b>Utilisation levels</b>	Utilisation including trainees was at 73.7%, a decrease of 230bps from Q1FY08 due to higher trainee employee additions during the quarter. However, the net utilisation (excluding trainees) remained stable at 78.9% as compared to Q1FY08.
<b>Client growth</b>	Growth was witnessed across all clients in rupee terms. However, revenues from the top client expanded faster than the overall company growth at 11.6% sequentially. Client growth excluding the top–10 accounts was at 11% QoQ, and contributed 72.4% of total revenues.
<b>Services metrics</b>	The contribution of ADM in overall revenues fell to 48.6% during the quarter as against 52.1% in Q2FY07 as newer services like infrastructure management, enterprise solutions and asset leveraged solutions continued to ramp up.
<b>Vertical metrics</b>	Despite US subprime issues, the BFSI vertical continued to grow faster than the overall company at 8.9% QoQ. Transportation, telecom and manufacturing also posted brisk growth due to strong deal inflow.

Source: Company, Religare Research

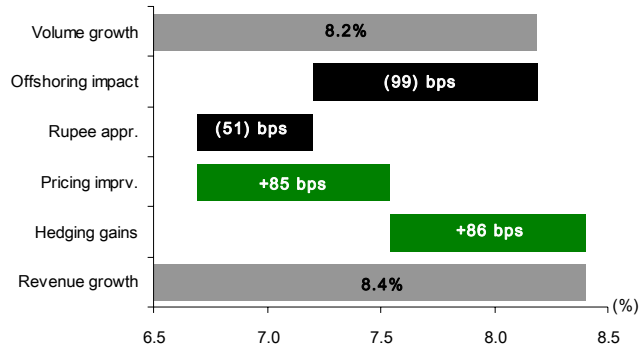
## Result highlights

**Overall dollar revenues grew at 10.8% QoQ with rupee revenues rising 8.4%**

### Strong volume growth propels revenues

The quarter witnessed strong volume growth of more than 9% in the international IT services business, propelling dollar revenue growth to 11.7% QoQ. Overall volumes grew at a slower rate of 8.2% due to the flattish volumes witnessed in the Indian IT services business stemming from the seasonal effect. Overall revenues in dollar terms grew at 10.8% sequentially. Rupee revenues witnessed lower growth at 8.4% QoQ due to the impact of higher offshoring and rupee appreciation.

### Q2FY08 revenue growth profile



Source: Company, Religare Research

**Slower rupee appreciation, improved pricing and higher offshoring expanded margins**

### Profit margins expand

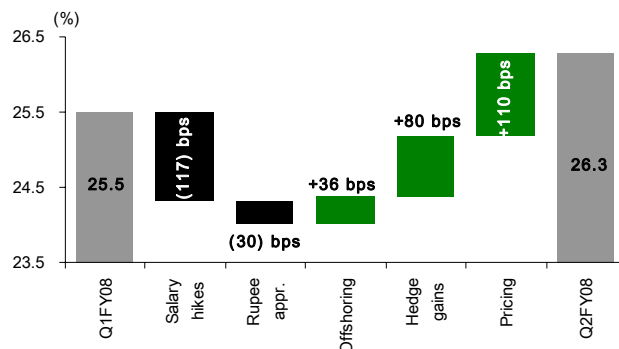
Operating profit increased 11.7% over Q1FY08 in the absence of the steep rupee appreciation that was witnessed in Q1FY08. Besides slower rupee appreciation, an 85bps improvement in pricing as well as higher offshoring also bolstered profit margins. However, the EBITDA margin expansion at 100bps has been marginally lower than our estimate of 79bps.

### Profit margin trend

(%)	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08
Gross profit margin	46.7	47.0	47.2	45.8	46.5
EBITDA margin	27.4	28.3	28.3	25.5	26.3
EBIT margin	25.3	26.1	25.6	23.1	23.8
Net profit margin	22.1	22.7	22.8	22.8	22.1

Source: Company, Religare Research

### QoQ EBITDA margin expansion



Source: Company, Religare Research

### Impressive deal inflows especially from non-US geographies

#### Deal flow remains strong

Despite concerns over the demand environment in the industry, TCS has managed to record impressive deal inflows during the quarter. A considerable portion of the deals are from non-US geographies, primarily Europe and Latin America. Services like infrastructure management, consulting and asset leveraged solutions are witnessing an increase in deal size and duration.

### Future outlook

#### Estimates reduced to factor in new exchange rate assumption

We are realigning our FY09 estimates for Indian IT services companies to an exchange rate of Rs 39/US\$ as against our earlier assumption of Rs 40.5/US\$. Considering this, our FY09 revenue and EPS estimates for TCS stand reduced by 2.5% and 3.8% respectively. We now expect EPS growth to be at 15.6% in FY09 as against 20.2% projected earlier.

#### Revised estimates

(Rs mn)	FY07			FY08E		
	Earlier	Revised	Chg (%)	Earlier	Revised	Chg (%)
Revenue	225,662.1	225,662.1	-	278,724.0	271,767.4	(2.5)
EBITDA	60,653.7	60,653.7	-	73,732.6	71,624.7	(2.9)
Net profit	50,498.7	50,498.7	-	60,712.0	58,390.7	(3.8)
EPS (Rs)	51.6	51.6	-	62.0	59.7	(3.8)

Source: Religare Research

### We lower our target price to Rs 1,193 but maintain Buy considering the 11% upside

#### We decrease our target price to Rs 1,193; maintain Buy

Considering the expected growth deceleration we are also decreasing our target multiple for the stock from 22x to 20x, which is a 10% discount to our target multiple of 22x for Infosys. At the current price of Rs 1,074, the stock is trading at 20.8x and 18x its expected FY08 and FY09 earnings of Rs 51.6 and Rs 59.7 respectively. This is a discount of 12.9% and 12.2% to the current FY08 and FY09 valuation of Infosys respectively.

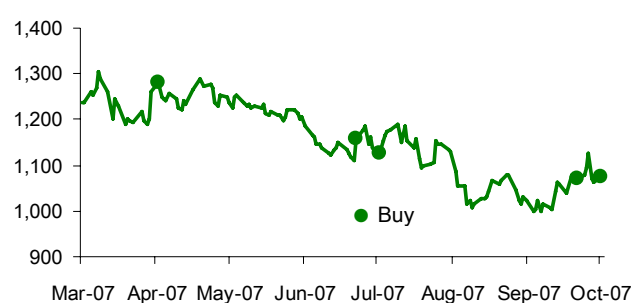
Our one-year target price for TCS now stands revised to Rs 1,193 as against Rs 1,354 earlier. We maintain our cautious view on Indian IT services companies considering the appreciating rupee and uncertain demand environment in FY09. However, considering the potential 11% upside to the TCS stock price from current levels, we maintain our Buy recommendation.

#### Recommendation history

Date	Event	Reco price	Tgt price	Reco
17-Apr-07	Results Update	1,280	1,530	Buy
09-Jul-07	Sector Update	1,159	1,448	Buy
17-Jul-07	Results Update	1,128	1,415	Buy
05-Oct-07	Quarterly Preview	1,078	1,354	Buy
16-Oct-07	Results Update	1,074	1,193	Buy

Source: Religare Research

#### Stock performance



Source: Religare Research

## Consolidated financials

### Profit and Loss statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Revenues	132.6	186.3	225.7	271.8
Growth (%)	36.3	40.6	21.1	20.4
EBITDA	37.0	50.6	60.7	71.6
Growth (%)	29.8	36.8	19.8	18.1
Depreciation	2.8	4.2	5.7	6.6
EBIT	34.2	46.4	54.9	65.1
Growth (%)	27.0	35.8	18.3	18.4
Interest	0.3	1.9	3.8	3.5
Other income	34.5	48.4	58.7	68.6
EBT	5.0	6.7	7.9	9.8
Growth (%)	14.5	13.8	13.5	14.3
Tax	0.3	0.4	0.4	0.4
Effective tax rate	0.2	0.0	0.0	0.0
Adj net income	29.0	41.3	50.5	58.4
Growth (%)	41.2	42.6	22.2	15.6
Shares outstanding (mn)	489.3	978.6	978.6	978.6
FDEPS (Rs)	30.3	43.1	51.6	59.7
DPS (Rs)	16.3	11.5	12.0	13.0
CEPS (Rs)	64.9	46.5	57.4	66.4

Source: Company, Religare Research

### Cash flow statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Net income	29.0	41.3	50.5	58.4
Depreciation	2.8	4.2	5.7	6.6
Other adjustments	-	-	-	-
Changes in WC	(6.8)	(8.1)	(4.7)	(5.7)
Operating cash flow	25.0	37.4	51.5	59.2
Capital expenditure	(5.9)	(16.2)	(11.7)	(11.0)
Investments	-	-	-	-
Other investing inc/(exp)	(8.7)	(5.4)	(6.4)	(9.5)
Investing cash flow	(14.6)	(21.7)	(18.1)	(20.5)
Free cash flow	10.4	15.8	33.4	38.7
Issue of equity	0.1	-	-	-
Issue/repay debt	(1.2)	4.1	-	-
Dividends paid	(8.0)	(12.7)	(13.2)	(14.3)
Others	-	-	-	-
Financing cash flow	(9.1)	(8.6)	(13.2)	(14.3)
Beg. cash & cash eq	2.6	4.0	11.1	31.4
Chg in cash & cash eq	1.3	7.2	20.2	24.4
Closing cash & cash eq	4.0	11.1	31.4	55.7

Source: Company, Religare Research

### Balance sheet

(Rs bn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	4.0	11.1	31.4	55.7
Accounts receivable	37.5	50.9	60.6	71.5
Inventories	0.8	1.0	1.2	1.5
Others current assets	7.3	10.6	12.8	15.3
Current assets	49.6	73.7	105.9	144.0
LT investments	7.3	12.7	19.1	28.6
Net fixed assets	19.1	37.1	42.8	53.0
CWIP	9.6	7.1	7.1	7.1
Total assets	85.6	130.6	174.9	232.7
Payables	17.4	23.9	29.7	35.7
Others	5.3	7.7	9.3	11.2
Current liabilities	22.7	31.6	38.9	46.9
LT debt	1.0	5.0	5.0	5.0
Other liabilities	3.5	4.3	4.3	4.3
Equity capital	0.5	1.0	1.0	1.0
Reserves	57.9	88.7	126.0	170.0
Net worth	58.4	89.7	126.9	176.9
Total liabilities	85.6	130.6	174.9	232.7
BVPS (Rs)	175.0	133.4	178.7	237.8

Source: Company, Religare Research

### Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	27.9	27.2	26.9	26.4
EBIT margin (%)	25.8	24.9	24.3	23.9
Net profit margin (%)	21.9	22.2	22.4	21.5
FDEPS growth (%)	36.6	42.0	19.9	15.6
Receivables (days)	103.3	99.8	98.0	96.0
Inventory (days)	2.2	2.0	2.0	2.0
Payables (days)	47.9	48.0	48.0	48.0
Current ratio (x)	2.2	2.3	2.7	3.1
Interest coverage (x)	-	-	-	-
Debt/equity ratio (x)	0.0	0.1	0.0	0.0
ROE (%)	49.6	46.1	39.8	33.0
ROCE (%)	54.4	46.9	40.4	35.0
ROAE (%)	39.9	35.6	31.4	28.0
EV/Sales (x)	7.9	5.6	4.6	3.8
EV/EBITDA (x)	28.2	20.6	17.2	14.6
P/E (x)	35.4	24.9	20.8	18.0
P/BV (x)	6.1	8.0	6.0	4.5
P/CEPS (x)	16.5	23.1	18.7	16.2

Source: Company, Religare Research

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**Recommendation parameters**

<b>Large-caps*</b>	> 10%	< - 5%	<b>Returns</b>	<b>Absolute</b>
	BUY	SELL		
<b>Mid-caps**</b>	> 25%	< 10%		

*\*Market cap over US\$ 1bn \*\*Market cap less than US\$ 1bn*

**Religare Securities**

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