

Cloud SMB offering: An exciting inflexion

Launch of Cloud-based SAAS offering for SMBs a landmark

TCS launches its Cloud SMB offering tomorrow. It is initially aimed at the India market, which is currently estimated at USD12bn and forecast to grow at over a 40% CAGR over the next 4 years. Globally, it is a USD1.04trn market. As in [our recent theme piece on cloud](#), cloud solutions are potentially margin accretive once it acquires scale. It will be marketed through a network of 80 value-added resellers across 21 cities that will be compensated on commission basis over a period of time.

Layered cloud-based IT service offering

TCS started investing in Apr08, all of which has been expensed, and has 100 pilot customers. The product offers hardware, connectivity, common office applications, business applications and core vertical ERP solutions for manufacturing, retail, wellness and education. It also provides an extranet for clients to connect to its customers and suppliers, and also enables business analytics. TCS believes there is no comparable product in the market, given its comprehensive nature.

Attractive value proposition

Key advantages of the product are: a) TCS takes complete accountability for hardware, network, software & services, b) it is on demand, c) it is opex-based, d) it incorporates business process knowledge, e.g., procure to pay, order to cash, and e) embeds compliance processes. Hence, it enhances productivity, growth and saves from risk of obsolescence. As per the company, it cuts the total cost of ownership by 40%.

2011 likely another strong year; One of our top picks

Overall, we believe demand pick-up is broad-based with discretionary IT spending increasing and an upward bias to pricing. TCS hopes to maintain a 27% EBIT margin next year as well, barring any significant currency volatility. One of the key levers going forward is non-linear initiatives, such as the Cloud-Based SMB offering and investments in solutions/geographies beginning pay off. We remain confident of our FY11-13e USD-terms rev growth of ~30% CAGR and Re-terms rev growth of 25%, and EPS growth of 22%. TCS remains one of our top picks.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	51,720	68,728	86,154	103,102	124,079
EPS	26.43	35.12	44.02	52.68	63.40
EPS Change (YoY)	3.6%	32.9%	25.4%	19.7%	20.3%
Dividend / Share	7.00	20.00	13.21	15.80	19.02
Free Cash Flow / Share	22.45	33.00	35.95	40.39	51.95

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	42.09x	31.68x	25.27x	21.12x	17.55x
Dividend Yield	0.629%	1.80%	1.19%	1.42%	1.71%
EV / EBITDA*	28.88x	23.88x	18.60x	14.85x	12.40x
Free Cash Flow Yield*	2.02%	2.97%	3.23%	3.63%	4.67%

* For full definitions of *iQmethod*SM measures, see page 5.

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Bank of America Merrill Lynch

Mitali Ghosh >>	+91 22 6632 8661
Research Analyst DSP Merrill Lynch (India) mitali.b.ghosh@baml.com	
Pratish Krishnan >>	+91 22 6632 8679
Research Analyst DSP Merrill Lynch (India) pratish.krishnan@baml.com	
Kunal Tayal >>	+91 22 6632 8663
Research Analyst DSP Merrill Lynch (India) kunal.tayal@baml.com	

Stock Data

Price	Rs1,112
Price Objective	Rs1,400
Date Established	4-Jan-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs676.48-Rs1,221
Mrkt Val / Shares Out (mn)	US\$47,653 / 1,957.2
Average Daily Volume	1,998,392
BofAML Ticker / Exchange	TACSF / BSE
Bloomberg / Reuters	TCS IN / TCS.BO
ROE (2011E)	36.2%
Net Dbt to Eqty (Mar-2010A)	-37.0%
Est. 5-Yr EPS / DPS Growth	20.0% / 10.0%
Free Float	13.3%

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11020530

iQprofileSM Tata Consultancy

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	278,129	300,289	373,925	477,443	585,789
Gross Profit	127,354	143,047	175,068	223,176	271,684
Sell General & Admin Expense	(55,144)	(55,396)	(62,625)	(82,136)	(101,538)
Operating Profit	66,015	79,591	103,560	129,489	154,723
Net Interest & Other Income	(4,673)	2,255	3,909	5,818	7,799
Associates	NA	NA	NA	NA	NA
Pretax Income	61,342	81,846	107,469	135,307	162,522
Tax (expense) / Benefit	(9,012)	(12,088)	(20,200)	(31,121)	(37,380)
Net Income (Adjusted)	51,720	68,728	86,154	103,102	124,079
Average Fully Diluted Shares Outstanding	1,957	1,957	1,957	1,957	1,957

Key Cash Flow Statement Data

Net Income	51,720	68,728	86,154	103,102	124,079
Depreciation & Amortization	5,764	7,209	7,900	10,119	12,494
Change in Working Capital	1,802	4,431	(2,135)	(9,084)	(7,563)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(4,387)	(5,499)	(3,620)	(5,089)	(5,326)
Cash Flow from Operations	54,898	74,869	88,299	99,048	123,683
Capital Expenditure	(10,960)	(10,274)	(17,936)	(20,000)	(22,000)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other Cash Inflow / (Outflow)	(23,780)	(44,887)	0	0	0
Cash Flow from Investing	(34,739)	(55,161)	(17,936)	(20,000)	(22,000)
Shares Issue / (Repurchase)	0	0	108	0	0
Cost of Dividends Paid	(16,121)	(19,594)	(29,465)	(35,261)	(42,435)
Cash Flow from Financing	(16,696)	(23,500)	(30,515)	(34,176)	(41,372)
Free Cash Flow	43,938	64,595	70,364	79,048	101,683
Net Debt	(36,299)	(78,902)	(118,736)	(163,609)	(223,920)
Change in Net Debt	(4,077)	(168)	(42,119)	(44,872)	(60,312)

Key Balance Sheet Data

Property, Plant & Equipment	37,490	41,706	51,991	61,873	71,379
Other Non-Current Assets	51,077	54,920	60,184	67,937	76,050
Trade Receivables	61,532	58,098	82,263	105,037	128,874
Cash & Equivalents	43,219	81,319	121,168	166,041	226,352
Other Current Assets	35,484	38,502	47,943	61,216	75,108
Total Assets	228,802	274,546	363,551	462,103	577,763
Long-Term Debt	1,762	2,383	113	113	113
Other Non-Current Liabilities	10,048	7,727	9,622	12,285	15,073
Short-Term Debt	5,158	34	2,319	2,319	2,319
Other Current Liabilities	52,157	50,962	80,149	107,112	137,277
Total Liabilities	69,124	61,106	92,203	121,829	154,782
Total Equity	159,678	213,439	271,348	340,274	422,981
Total Equity & Liabilities	228,802	274,546	363,551	462,103	577,763

iQmethodSM - Bus Performance*

Return On Capital Employed	37.6%	34.8%	34.2%	32.3%	31.1%
Return On Equity	36.9%	37.6%	36.2%	34.4%	33.1%
Operating Margin	23.7%	26.5%	27.7%	27.1%	26.4%
EBITDA Margin	25.8%	28.9%	29.8%	29.2%	28.5%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.1x	1.1x	1.0x	1.0x	1.0x
Asset Replacement Ratio	1.9x	1.4x	2.3x	2.0x	1.8x
Tax Rate (Reported)	14.7%	14.8%	18.8%	23.0%	23.0%
Net Debt-to-Equity Ratio	-22.7%	-37.0%	-43.8%	-48.1%	-52.9%
Interest Cover	NM	NM	NM	NM	NM

Key Metrics

* For full definitions of iQmethodSM measures, see page 5.

Company Description

Set up in 1968, TCS pioneered IT services exports & is India's largest exporter (FY10 rev: US\$6.3bn, 160,429 people). Strengths: Scale, end-to-end services, depth of vertically focused IP, project mgmt depth, fixed-bid pricing capability & ability to deliver large/complex projects. Besides US & Europe it focuses on India too & has the widest global low-cost delivery centers (eg, China).

Investment Thesis

TCS should be a key beneficiary of the uptrend in discretionary IT spending and increased global sourcing, particularly in the banking, financial services and insurance vertical. We also like TCS for its strong competitive position across service lines, including high-growth areas like Infrastructure Management Services. We expect pricing, productivity and revenue mix focus to largely offset wage pressures.

Stock Data

Price to Book Value 8.2x

Figure 1: Cloud SMB offering by TCS addresses all IT layers – hardware to analytics



Source: TCS

Price objective basis & risk

Tata Consultancy (TACSF)

Our Price Objective of Rs1,400 is based on a target FY12 EV/EBITDA-to-2-year EBITDA growth of 0.85x, in line with Infosys. This implies a target FY13e PE of 22x, in line with the current 1-year forward (FY12e) PE. Downside risks to our estimates stem from macro-led delays in IT spending or a sharp appreciation of the Rupee.

Link to Definitions

Technology

Click [here](#) for definitions of commonly used terms.

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Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

Tel : +91 22 6632 8000

India - Software & IT Services Coverage Cluster

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	Educomp Solu	EUSOF	EDSL IN	Pratish Krishnan
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	HCL	XHCLF	HCLT IN	Mitali Ghosh
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
	Jagran Prakashan Ltd	JGRPF	JAGP IN	Pratish Krishnan
	Persistent Systems	XPSYF	PSYS IN	Kunal Tayal
	Rollta India	RLTAF	RLTA IN	Pratish Krishnan
	Rollta India-GDR	XLROF	RTI LI	Pratish Krishnan
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	Zee Entertainment	XZETF	Z IN	Pratish Krishnan
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	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh
UNDERPERFORM				
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	Mastek	MSKDF	MAST IN	Pratish Krishnan
	Mphasis Ltd	MPSSF	MPHL IN	Pratish Krishnan
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	$\text{Market Cap.} = \text{Current Share Price} * \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

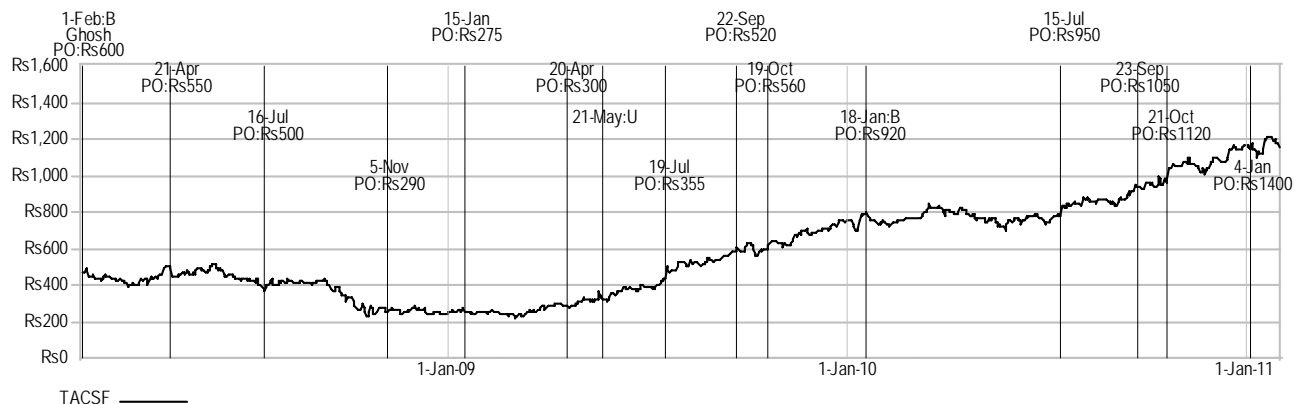
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Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2011 or such later date as indicated.

Investment Rating Distribution: Technology Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	128	54.01%	Buy	53	46.49%
Neutral	48	20.25%	Neutral	21	46.67%
Sell	61	25.74%	Sell	16	27.59%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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