



INDIA

TCS IN Outperform
Price 19 Apr 10 Rs811.95

12-month target Rs 925.00
Upside/Downside % 13.9
Valuation Rs 925.00

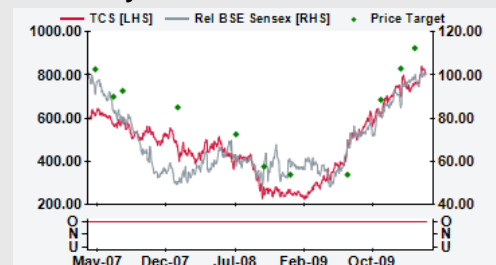
- DCF (WACC 12.5%)

GICS sector Software & Services
Market cap Rsbn 1,589
30-day avg turnover US\$m 39.9
Market cap US\$m 35,989
Number shares on issue m 1,957

Investment fundamentals

Year end 31 Mar		2009A	2010E	2011E	2012E
Total revenue	bn	278.1	301.1	344.3	408.5
EBITDA	bn	71.8	85.5	94.3	110.5
EBITDA growth	%	26.0	19.1	10.3	17.2
Adjusted profit	bn	51.7	66.1	72.4	82.4
EPS adj	Rs	26.42	33.75	36.98	42.09
EPS adj growth	%	3.0	27.7	9.6	13.8
PER adj	x	30.7	24.1	22.0	19.3
ROA	%	32.8	31.0	27.6	26.5
ROE	%	36.9	36.2	30.8	28.3
EV/EBITDA	x	22.0	18.5	16.8	14.3
Net debt/equity	%	-5.0	-8.9	-20.0	-30.9
P/BV	x	10.2	7.6	6.1	5.0

TCS IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, March 2010
(all figures in INR unless noted)

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20 April 2010

Tata Consultancy Services

4Q: Strong results delivered again

Event

- TCS reported solid 4Q FY3/10 results that were in-line with our and street expectations on the top-line, but ahead of estimates on the bottom-line due to able margin execution and treasury gains. These results once again support our above-consensus revenue growth forecast of 25% for sector leaders in FY3/11E. Retain TCS as our favoured large cap pick in the sector. (See Figure 1 and 2 for the detailed quarterly P&L and deviation from estimates).

Impact

- Another strong quarter driven by broad-based growth.** 3Q marked the beginning of all-round recovery across verticals and geographies. Trends emerging from the 4Q results of sector leaders – TCS and Infosys – cement the argument of a broader demand recovery playing out. We specifically highlight growth in Retail, Life Sciences and Manufacturing verticals. (See Figure 4).
- Good 4Q:** TCS posted revenues of Rs77.4bn (up 1.1% QoQ and 7.9% YoY), EBITDA of Rs23.1bn (up 1.8% QoQ and 23% YoY), and PAT of Rs19.3bn (up 7.4% QoQ and 47% YoY). In US\$ terms, TCS reported 3% QoQ revenue growth (vs. 5.2% at Infosys). The biggest positive surprise in the quarter was 20bp QoQ margin expansion to 29.9% driven largely by productivity initiatives.
- 20K campus offers made, strong pick up in lateral hiring.** TCS maintained its full-year gross employee addition target of 30K in FY3/11E. The company has already made 20K campus offers up till now and expects to meet its hiring target by lateral hiring and/or follow on fresher hiring later in the year. We view the robust hiring pattern (~5.2K laterals added in 4Q) as a leading indicator of a revenue rebound that will play out in FY3/11E and FY3/12E.
- Wage hikes announced – no negative surprises.** TCS has given 13% offshore wage hikes and 2-4% onsite increments. This is in-line with our expectations and similar to the increments announced by Infosys last week.
- Large deals are back.** TCS won 10 large deals in the quarter and the company detailed four multi-year, multi-million dollar deals won during the quarter. Management noted that they have won sizeable deals in the Infrastructure offering – this has a positive read through for Wipro and HCLT.
- TCS announces a special dividend of Rs10, full-year FY3/10 DPS of Rs20.**

Earnings and target price revision

- No change. We will review our earnings and TP post 4Q results season.

Price catalyst

- 12-month price target: Rs925.00 based on a DCF methodology.
- Catalyst: Large deal wins and an uptick in discretionary spend.

Action and recommendation

- Reiterate TCS as our top pick in the sector.** We retain our upbeat outlook on the Indian IT sector and prefer TCS over Infosys in the large caps.

4Q FY3/10 Results review and Analysis – Actuals vs expectations

Fig 1 4Q FY3/10 results – P&L: YoY growth, QoQ growth and deviation from our expectations

(Amount in Rsm)	Mar-09 4Q FY09	Jun-09 1Q FY10	Sep-09 2Q FY10	Dec-09 3Q FY10	Mar-10 4Q FY10	(% Chg YoY)	(% Chg QoQ)	Mar-10E	Deviation (%)
Revenues									
Information technology and consultancy services	69,538	69,424	72,175	74,285	74,968	7.8%	0.9%	75,941	-1.3%
Sale of equipment and software licenses	2,180	2,646	2,176	2,218	2,398	10.0%	8.1%	2,267	5.7%
Total revenues	71,718	72,070	74,351	76,503	77,365	7.9%	1.1%	78,208	-1.1%
Cost of revenues									
Cost of information technology and consultancy services	37,394	36,628	38,419	39,137	39,326	5.2%	0.5%	40,628	-3.2%
Cost of equipment and software licenses	1,822	2,610	1,892	1,822	1,794	-1.5%	-1.5%	2,041	-12.1%
Total cost of revenues	39,216	39,238	40,311	40,959	41,121	4.9%	0.4%	42,669	-3.6%
Gross profit	32,501	32,832	34,040	35,544	36,244	11.5%	2.0%	35,539	2.0%
Gross profit margin (%)	45.3%	45.6%	45.8%	46.5%	46.8%			45.4%	3.1%
Operating expenses									
SG&A expenses	15,402	14,830	14,408	14,568	14,413	-6.4%	-1.1%	15,251	-5.5%
R&D	99	109	101	89	552	456.6%	522.6%	108	410.4%
Total operating expenses	15,501	14,940	14,509	14,657	14,965	-3.5%	2.1%	15,359	-2.6%
EBITDA	18,796	19,620	21,342	22,717	23,120	23.0%	1.8%	22,140	4.4%
EBITDA margin (%)	26.2%	27.2%	28.7%	29.7%	29.9%			28.3%	
Depreciation included above in operating expense	1,796	1,727	1,811	1,829	1,841	2.5%	0.7%	1,959	-6.0%
Operating income	17,000	17,893	19,531	20,888	21,279	25.2%	1.9%	20,181	5.4%
Operating margin (%)	23.7%	24.8%	26.3%	27.3%	27.5%			25.8%	6.6%
Other income/(expense)									
Interest income	352	388	402	484	822	133.5%	69.8%	356	131.1%
Interest expense	(169)	(84)	(84)	(84)	(284)	67.9%	240.0%	(85)	234.4%
Other non operating income, net	(1,569)	(110)	(463)	169	1,098	nmf	nmf	(105)	nmf
Other income, net	(1,386)	194	(144)	570	1,635	nmf	nmf	166	nmf
Income before income taxes and minority interests	15,614	18,087	19,387	21,457	22,915	46.8%	6.8%	20,346	12.6%
Income tax expense	2,293	2,655	2,909	3,241	3,284	43.2%	1.3%	3,052	7.6%
Income before minority interests	13,321	15,432	16,478	18,216	19,631	47.1%	7.4%	17,294	13.4%
Minority interests	(189)	(226)	(240)	(242)	(312)	65.1%	28.9%	(266)	17.2%
Equity in net earnings of affiliates	(1)	(2)	-	-	(8)	nmf	nmf	(2)	nmf
Net income	13,132	15,203	16,239	17,975	19,311	47.1%	7.4%	17,026	13.4%
Basic and Diluted EPS	6.71	7.77	8.30	9.18	9.87	47.1%	7.4%	8.70	13.4%
Weighted average no. of shares	1,957	1,957	1,957	1,957	1,957			1,957	

Source: Company data, Macquarie Research, April 2010

- 4Q results vs. street expectation:** Revenue of Rs77.4bn (up 1.1% QoQ and 7.9% YoY) was 1% below our and the street's estimate. EBITDA of Rs23.1bn (up 1.8% QoQ and 23% YoY) was 4.5% above our estimate and 2.6% above consensus. PAT of Rs19.3bn (up 7.4% QoQ and 47% YoY) came in 13.5% above our and 7.8% above consensus expectations.
- Sequential margin expansion – key positive surprise in the quarter.** EBITDA margins in the quarter have expanded to 29.9% (up 20 bp QoQ vs. INFO down 150 bp QoQ). The key moving parts for margin movement this quarter were: (192bp) due to FX, +16bp due to offshore movement, (59bp) due to bad debt provisioning and +247bp due to productivity and efficiency in project management. We note that utilization (ex-trainees) for TCS is now at all time high of 81.8% (vs. 81.1% last quarter and 77.3% at INFO). TCS's CFO indicated that they can maintain EBIT margins at ~27%, if INR:US\$ remains at 46. We are currently building in FY3/11E margins to dip to 24.8% and see upside risks to our estimates.

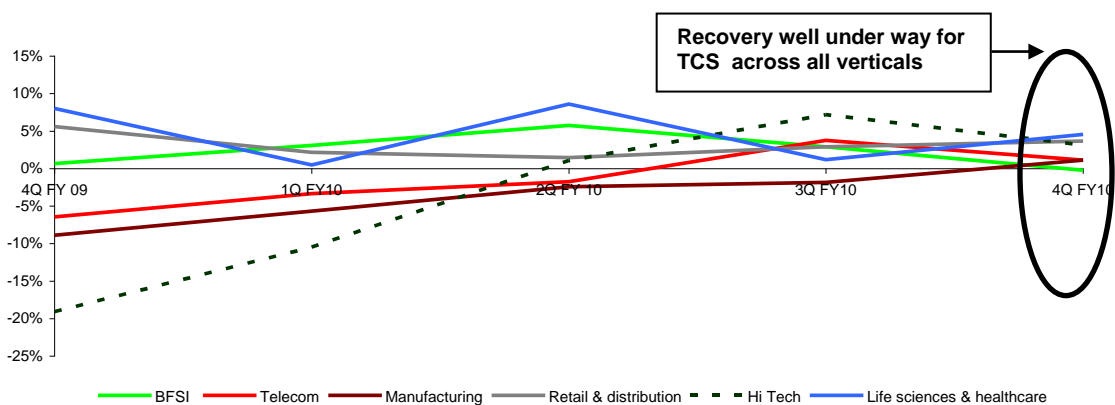
Fig 2 TCS 4Q Operating Metrics: YoY growth, QoQ growth

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	(% Chg YoY)	(% Chg QoQ)
Operating Metrics							
Employee Metrics							
Total employees (including subs.)	143,761	141,642	141,962	149,654	160,429	11.6%	7.2%
Gross addition (excluding subs.)	3,522	1,154	3,836	11,377	16,851	378.4%	48.1%
Net addition (excluding subs.)	521	(2,746)	(312)	7,417	10,110	na	na
Trainees added	2,227	316	1,820	8,239	8,429	278.5%	2.3%
Experienced Professionals added	522	384	1,189	2,249	5,230	901.9%	132.5%
Overseas subsidiaries and Branches added	773	454	827	889	981	26.9%	10.3%
Utilization Rate							
- Including trainees	69.4%	71.3%	73.6%	77.2%	74.3%	7.1%	-3.8%
- Excluding trainees	79.7%	79.2%	79.5%	81.1%	81.8%	2.6%	0.9%
Client Concentration							
Top client	4.7%	5.7%	6.8%	8.1%	8.2%	74.5%	1.2%
Top 5 clients	18.6%	19.4%	20.5%	21.5%	21.8%	17.2%	1.4%
Top 10 clients	26.9%	28.0%	28.9%	29.9%	30.2%	12.3%	1.0%
US\$1m - US\$5m	405	423	409	419	409	1.0%	-2.4%
US\$5m - US\$10m	172	178	171	178	183	6.4%	2.8%
US\$10m - US\$20m	111	113	111	112	118	6.3%	5.4%
US\$20m - US\$50m	62	59	62	61	63	1.6%	3.3%
US\$50m - US\$100m	24	23	23	23	23	-4.2%	0.0%
US\$100m+	7	6	6	6	7	0.0%	16.7%
Active clients	985	933	896	917	917	-6.9%	0.0%
Clients added during the quarter	36	26	30	32	39	8.3%	21.9%

Source: Company data, Macquarie Research, April 2010

- Volume growth tad lower than Infosys, stable pricing in the quarter. TCS reported 4% QoQ volume growth this quarter (vs. 5.2% at Infosys). Pricing in 4Q was stable and management hinted at a potential pricing uptick later in FY3/11E. Price changes are contingent on healthy volume growth in the future.

Fig 3 Broad based Demand Recovery across verticals 4QFY09 - 4QFY10



Source: Company Data, Macquarie Research, April 2010

Fig 4 Infosys 4Q Operating metrics: YoY growth, QoQ growth

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	YoY (%)	QoQ (%)
	4Q FY09	1Q FY10	2Q FY10	3Q FY10	4Q FY10		
Operating Metrics							
Employee Metrics							
Employees, period end							
Total Employees (Consolidated)	104,850	103,905	105,453	109,882	113,796	8.5%	3.6%
Gross additions	4,935	3,538	6,069	8,719	9,313	88.7%	6.8%
Net additions	1,772	(945)	1,548	4,429	3,914	120.9%	-11.6%
Laterals hired	659	390	1,064	1,420	2,041	209.7%	43.7%
Effort (IT Services and Consulting)							
Onsite-Offshore Effort Split							
Onsite	30%	29%	29%	29%	29%		
Offshore	70%	71%	71%	71%	71%		
Utilization measures (IT Services and Consulting + Product)							
Including trainees	66.9%	66.2%	66.5%	68.0%	69.2%		
Excluding trainees	74.3%	70.1%	73.0%	76.2%	77.3%		
Client metrics							
Top client contribution to revenues	6%	5%	5%	5%	5%		
Top 5 client contribution to revenues	17%	16%	17%	18%	16%		
Top 10 client contribution to revenues	27%	26%	26%	28%	26%		
Number of active clients	579	569	571	568	575		
New clients added in the period	37	27	35	32	47		
Effort and Utilization (IT Services and Consulting)							
Effort - Person-months							
Onsite	45,169	44,231	44,435	46,686	49,183	8.9%	5.3%
Offshore	106,399	105,730	108,953	116,069	122,049	14.7%	5.2%
Billed	151,568	149,961	153,388	162,755	171,232	13.0%	5.2%
Non-billed	56,706	69,465	61,739	55,208	54,574	-3.8%	-1.1%
Training	24,246	13,921	22,285	27,931	28,309	16.8%	1.4%
Total professionals	232,520	233,347	237,411	245,894	254,114	9.3%	3.3%
Support	14,590	14,798	14,486	13,958	13,920	-4.6%	-0.3%
Total	247,109	248,145	251,898	259,852	268,034	8.5%	3.1%
Per-capita productivity (IT Services and Consulting) - Reported							
Onsite	137,033	140,612	142,438	145,290	144,452	5.4%	-0.6%
Offshore	55,621	55,654	55,974	56,387	54,903	-1.3%	-2.6%
Blended	79,883	80,713	81,021	81,889	80,624	0.9%	-1.5%
QoQ change in per capita productivity - constant currency							
Onsite	-1.0%	0.6%	-0.2%	1.2%	0.2%		
Offshore	-3.1%	-1.9%	-0.9%	-0.1%	-1.7%		
Blended	-2.1%	-0.9%	-1.1%	0.2%	-0.7%		
Avg USD-INR rate							
Period end USD-INR rate	50.24	48.82	48.39	46.62	45.91	-8.6%	-1.5%
Period end USD-INR rate	50.72	47.91	48.11	46.53	44.90	-11.5%	-3.5%

Source: Company data, Macquarie Research, April 2010

Fig 5 Valuation Comp Sheet – Indian IT Services

Company name	Bloomberg Ticker	Reco	Market Cap (US\$ m)	Current Price (lcy)	Target Price (lcy)	Up/Down side(%)	EPS FY10	EPS FY11	EPS FY12	PER (x) FY10	PER (x) FY11	RoE (FY10)	EPS CAGR (FY10-12E)
Large Cap - Indian IT Services													
Infosys	INFO IN	OP	34,328	2752	2980	8%	108.5	117.1	134.1	25.4	23.5	30.6	11.2%
TCS	TCS IN	OP	34,547	812	925	14%	35.1	37.0	42.1	23.1	22.0	37.6	9.5%
Wipro	WPRO IN	OP	22,473	704	800	14%	31.1	33.7	36.3	22.7	20.9	27.1	8.1%
HCL Tech	HCLT IN	OP	5,128	349	435	25%	18.2	24.4	28.9	19.2	14.3	20.3	26.1%
Oracle Financial Services	OFSS IN	NR	4,011	2200	NR	NR	101.0	119.3	121.2	21.8	18.4	23.4	9.5%
Mahindra Satyam	SCS IN	NR	2,346	92	NR	NR	10.6	4.4	8.5	8.7	20.8	26.0	-10.5%
Tech Mahindra	TECHM IN	NR	2,203	829	NR	NR	50.5	61.2	72.0	16.4	13.5	63.4	19.4%
Mphasis	MPLH IN	NR	2,954	648	NR	NR	49.0	52.5	57.8	13.2	12.3	51.9	8.6%
Accenture	ACN US	NR	30,839	42	NR	NR	2.6	3.0	3.4	16.1	14.1	58.6	13.1%
Amdocs	DOX US	NR	6,224	30	NR	NR	2.2	2.4	2.5	13.7	12.7	10.8	5.9%
Cap Gemini	CAP FP	NR	6,102	39	NR	NR	1.8	2.4	2.9	22.1	16.1	4.4	27.5%
Cognizant	CTSH US	NR	15,442	52	NR	NR	2.1	2.4	2.8	24.2	21.9	23.2	13.7%
Convergys	CVG US	NR	1,604	13	NR	NR	1.1	1.2	1.3	12.0	10.7	-6.6	9.6%
CSC	CSC US	NR	8,367	54	NR	NR	5.0	5.2	5.6	10.9	10.4	20.3	5.3%
Logica PLC	LOG LN	NR	2,245	140	NR	NR	0.1	0.1	0.1	1158.7	1062.1	2.0	9.5%
Paxys	PAX PM	NR	2,458	2	NR	NR	na	na	na	na	na	na	na
IBM GS	IBM US	NR	170,662	131	NR	NR	11.1	12.2	12.9	11.8	10.8	74.4	7.5%
Aptech	APTR IN	NR	170	168	NR	NR	na	na	na	na	na	21.7	na
Educomp	EDSL IN	NR	1,448	701	NR	NR	28.9	37.1	46.5	24.2	18.9	37.9	26.8%
Everonn	ESIL IN	NR	126	382	NR	NR	26.0	35.9	50.8	14.7	10.7	14.3	39.6%
Hexaware	HEXW IN	NR	234	75	NR	NR	9.3	8.1	9.7	8.0	9.2	17.7	1.9%
Mindtree	MTCL IN	NR	545	632	NR	NR	50.0	51.1	58.0	12.6	12.4	9.6	7.6%
NIIT	NIIT IN	NR	248	69	NR	NR	na	na	na	na	na	na	na
NIIT Tech	NITEC IN	NR	221	173	NR	NR	23.5	24.4	28.3	7.4	7.1	27.7	9.8%
Patni	PATNI IN	NR	1,619	576	NR	NR	40.2	42.1	44.2	14.3	13.7	15.7	4.9%
Polaris	POL IN	NR	371	172	NR	NR	15.2	19.7	21.5	11.3	8.8	13.5	18.8%
Rolta	RLTA IN	NR	643	184	NR	NR	na	na	na	na	na	na	na
EXL Service	EXLS US	NR	505	17	NR	NR	0.7	0.8	1.0	26.1	22.0	8.3	-26.8%
Firstsource	FSOL IN	NR	286	31	NR	NR	2.4	3.2	na	12.6	9.6	2.9	na
Genpact	G US	NR	3,876	17	NR	NR	0.8	0.9	0.9	22.0	19.1	12.5	-41.9%
WNS	WNS US	NR	535	13	NR	NR	1.2	1.4	1.6	10.9	9.0	3.9	-30.3%

Note: Share price data as of 13 April 2010. Data for Not rated companies are based on Bloomberg consensus estimates. Fiscal year end June for HCLT.

Source: Bloomberg, Macquarie Research, April 2010

Stocks mentioned in the report

- Infosys: (INFO IN, Rs2,752, OP, TP: Rs2,980, Upside: 8%)
- Wipro: (WPRO IN, Rs704, OP, TP: Rs800, Upside: 14%)
- HCLT: (HCLT IN, Rs349, OP, TP: Rs435, Upside: 25%)

Important disclosures:

Recommendation definitions**Macquarie - Australia/New Zealand**

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie First South - South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ/Canada stocks only

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2009

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	47.94%	60.52%	37.50%	43.42%	65.26%	41.60%	(for US coverage by MCUSA, 3.76% of stocks covered are investment banking clients)
Neutral	35.58%	18.70%	53.13%	49.06%	29.11%	36.80%	(for US coverage by MCUSA, 4.51% of stocks covered are investment banking clients)
Underperform	16.48%	20.79%	9.38%	7.52%	5.63%	21.60%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

Company Specific Disclosures:

The analyst and/or associated parties own or have other interests in securities issued by Tata Consultancy Services Ltd.

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