

APRIL 19, 2010
RESULT

Coverage view: **Attractive**

Price (Rs): **812**

Target price (Rs): **900**

BSE-30: **17,401**
Margin resilience and forex gains drive net income beat despite revenue miss.

Another strong quarter of margin performance and forex gains aided an 8% net income outperformance even as revenue growth fell short of expectations. Weaker-than-expected volume growth in 4QFY10 notwithstanding, we continue to expect FY2011E to be a strong year of revenue growth for the Tier-I companies. We make modest changes to our FY2011-12E estimates and retain BUY. TP unchanged at Rs900.

Company data and valuation summary

TCS

Stock data

52-week range (Rs) (high,low)	846-264
Market Cap. (Rs bn)	1,589.1

Shareholding pattern (%)

Promoters	74.1
FIs	12.3
MFs	2.6

Price performance (%)

	1M	3M	12M
Absolute	(1.1)	4.0	183.4
Rel. to BSE-30	(0.1)	4.5	79.5

Forecasts/Valuations

	2010	2011E	2012E
EPS (Rs)	35.1	41.1	46.3
EPS growth (%)	32.8	16.9	12.8
P/E (X)	23.1	19.8	17.5
Sales (Rs bn)	300.3	353.9	425.8
Net profits (Rs bn)	68.7	80.4	90.7
EBITDA (Rs bn)	86.8	102.8	120.9
EV/EBITDA (X)	17.8	14.5	12.0
ROE (%)	37.6	34.8	32.8
Div. Yield (%)	2.5	2.0	2.3

A weaker-than-expected quarter on revenues; margins pick up the slack

TCS reported a net income of Rs19.3 bn (+7.4% qoq, +47% yoy) for 4QFY10, higher than our estimate of Rs17.9 bn. Net income beat was driven by strong margin outperformance and higher forex gains, even as revenues missed expectations. Revenues of US\$1,686 mn were 1.6% lower than our estimated US\$1,713 mn, while EBITDA margins at 29.9% (+20 bps qoq, +370 bps yoy) were 120 bps higher than our expectations.

Not too perturbed with the revenue miss; expect momentum to pick up starting 1QFY11E

We would not read too much into TCS' relatively weaker quarter on volume growth (at 4% qoq, lower than Infosys' 5.2%), and the revenue miss versus expectations. March is a seasonally weak quarter and we expect volume momentum to pick up starting June 2010 quarter. We believe that the underlying business momentum remains strong for the Tier-I players and we continue to expect mid-20s US\$ revenue growth yoy for the Tier-I names in FY2011E. We believe that the lagging verticals (telecom, manufacturing) should gain traction in 2HFY11E, even as strong volume momentum sustains in BFSI, Retain, Life Sciences and Energy/Utilities verticals.

Management earnings commentary, strong hiring lend weight to our thesis

TCS management commentary on strong deal flow (improving pipeline), deal conversions (10 large deals announced in March 2010 quarter), strong hiring in 4QFY10 (net employee additions of 10,775 highest ever in absolute terms), and a robust hiring guidance for FY2011E are all positive indicators of the strength of business momentum. TCS also reported improvement in client metrics — number of US\$100 mn accounts (ttm) increased to 7 from 6 in the previous quarter, new client addition was robust and growth was uniform across client size buckets.

Modest changes to earnings estimates; maintain BUY

We have broadly maintained our revenue and EPS estimates for FY2011/12E. We retain our BUY rating on the stock with an unchanged 12-month forward target price of Rs900/share. Our target price implies a PE of 21.9X FY2011E and 19.4X FY2012E EPS, a 5% discount to our implied FY2012E target multiple for Infosys.

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Margins—headwinds ahead, but strong volume growth should aid sustenance in FY2011E

TCS increased EBITDA margins further to 29.9% in 4QFY10, a qoq increase of 21 bps and yoy increase of 370 bps. We believe that TCS has utilized a bulk of its margin levers (offshore mix, utilization rate, G&A rationalization) and expect sequential margin pressure ahead, especially in the wake of (1) appreciation of the rupee and (2) announced wage hikes—13% offshore and 2-4% onsite.

Our model builds in margin of safety on this account. We forecast EBITDA margin of 29% for FY2011E and 28.4% for FY2012E, down from 29.9% reported in 4QFY10.

Other metrics—BFSI slows down sequentially, improvement in collection cycle continues

After a string of strong sequential growth quarters, BFSI vertical grew a modest 0.9% qoq in 4QFY10, though still a very impressive 21% yoy. Growth was led by healthcare, retail, and travel/transportation verticals, while manufacturing (down 1.3% yoy), and telecom remained subdued. DSO (including unbilled revenues) came down further to 82 days (down 3.5 days qoq, and 13 days yoy), impressive in our view.

The company announced a final dividend of Rs4/share and a special dividend of Rs10/share, taking the total dividend to Rs20/share (~55% payout ratio) for FY2010.

TCS: key changes to FY2010E-12E estimates

Rs mn	New		Old		Change (%)	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
Revenues	353,939	425,783	360,707	428,816	(1.9)	(0.7)
EBIT	93,250	109,136	93,250	109,136	-	-
Net Profit	80,373	90,698	80,338	89,805	0.0	1.0
EPS (Rs/ share)	41.1	46.3	41.0	45.9	0.0	1.0
Revenues (US\$ mn)	7,861	9,408	7,837	9,318	0.3	1.0
Revenue growth (%)	23.3	19.7	22.9	18.9		
Re/\$ rate	45.0	45.3	46.0	46.0	(2.2)	(1.7)
EBIT margin	26.3	25.6	25.9	25.5		

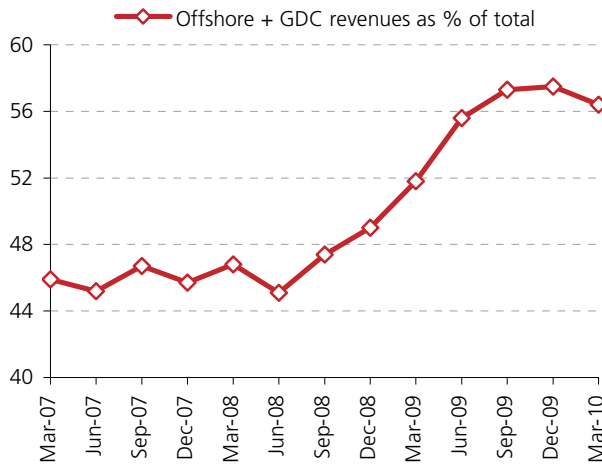
Source: Kotak Institutional Equities estimates

Comments: TCS Interim Results (consolidated, US GAAP)

Rs mn	4QFY09	3QFY10	4QFY10	% chg.		4QFY10E	% dev.	Comments
				qoq	yoy			
Revenues	71,718	76,503	77,365	1.1	7.9	78,601	(1.6)	Revenues up 3.1% qoq in US\$ terms to US\$1,689 mn, missing our estimated 4.8% qoq revenue growth. Volume growth was a reasonable 4%.
Cost of revenues	(39,217)	(40,959)	(41,121)	0.4	4.9	(42,755)	(3.8)	
Gross profit	32,501	35,544	36,244	2.0	11.5	35,847	1.1	
SG&A expenses	(15,501)	(14,656)	(14,964)	2.1	(3.5)	(15,243)	(1.8)	
EBIT	17,000	20,888	21,280	1.9	25.2	20,604	3.3	EBIT margin expansion of 20 bps qoq versus our expectation of a 110 bps decline
Other Income	(1,374)	569	1,636	187.5	(219)	803	103.8	Other income includes forex gain of Rs420 mn versus a loss of Rs350 mn in the previous quarter; our expectation was a loss of Rs200 mn.
Profit Before Tax	15,626	21,457	22,916	6.8	46.7	21,406	7.1	
Provision for Tax	(2,293)	(3,241)	(3,284)	1.3	43.2	(3,307)	(0.7)	
Net income before minority int	13,333	18,216	19,632	7.8	47.2	18,099	8.5	
Income from affiliates	(1)	-	(8)			1		
Minority Interest	(189)	(241)	(312)	29.5	65.1	(210)	48.6	
Net income	13,143	17,975	19,312	7.4	46.9	17,890	7.9	
Extraordinary items	—	—	—			—		
Net income	13,143	17,975	19,312	7.4	46.9	17,890	7.9	Net income 8% ahead of expectations on account margin outperformance, forex gains, and lower-than-expected ETR.
EPS (Rs/ share)	6.7	9.2	9.9	7.4	46.9	9.1	7.9	
No of shares outstanding (mn)	1,957.2	1,957.2	1,957.2	—	—	1,957.2	-	
As % of revenues								
Gross Profit Margin (%)	45.3	46.5	46.8			45.6		
Operating Margin (EBIT)	23.7	27.3	27.5			26.2		
EBITDA (%)	26.2	29.7	29.9			28.7		
SG&A Expenses (%)	21.6	19.2	19.3			19.4		
Tax Rate	14.7	15.1	14.3			15.5		
Revenue Mix (%)								
Onsite	48.2	42.5	43.6					
Offshore	51.8	57.5	56.4					
Revenues (Rs mn)								
Onsite	31,729	29,761	30,728	3.3	(3.2)			
Offshore	34,098	40,264	39,750	(1.3)	16.6			
International Revenues	65,827	70,025	70,478	0.6	7.1			
Domestic Revenues	5,891	6,478	6,887	6.3	16.9			

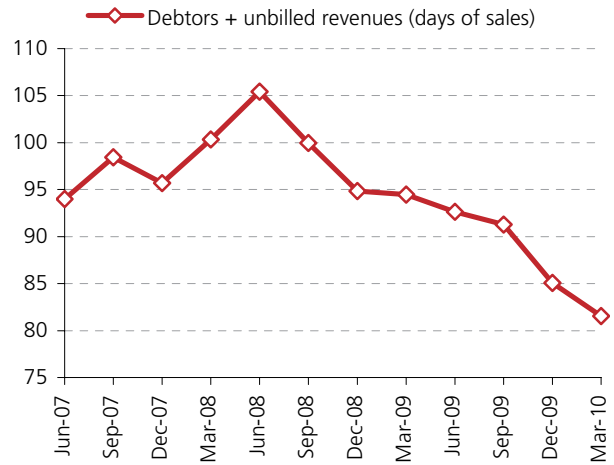
Source: Company estimates, Kotak Institutional Equities estimates

Offshore shift in revenues has been a major margin driver for TCS



Source: Company

Improvement in receivables management impressive; still a lot of scope for improvement, though



Source: Company

TCS has outperformed Infosys for the past four quarters

	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
yoy US\$ revenue growth (%)									
TCS	29	20	13	(0)	(6)	(3)	(2)	10	18
Infosys	32	25	19	8	(2)	(3)	(5)	5	15
yoy Rupee net income growth (%)									
TCS	7	5	1	2	5	22	29	33	47
Infosys	21	24	30	34	30	20	8	0	(2)
yoy Rupee EBITDA growth (%)									
TCS	4	20	27	28	24	28	17	17	23
Infosys	23	36	40	46	28	26	8	0	7

Source: Company, Kotak Institutional Equities

Strong sequential revenue performance driven by BFSI, Telecom, Healthcare, and Energy & Utilities verticals

Vertical-wise break-down of TCS' organic international revenues

	4QFY09	3QFY10	4QFY10	qoq (%)	yoy (%)
Revenues (US\$ mn)					
BFSI	554	664	670	0.9	21.0
Manufacturing	127	122	125	2.2	(1.3)
Telecom	197	210	214	2.2	8.9
Healthcare	74	87	92	5.7	24.8
Retail & Distribution	155	177	186	4.8	19.5
Transportation	49	50	53	5.3	7.4
Energy & Utilities	35	50	50	(0.8)	42.5
Others	104	115	119	3.6	15.1
Total	1,294	1,476	1,509	2.2	16.6
% of revenues					
BFSI	42.8	45.0	44.4		
Manufacturing	9.8	8.3	8.3		
Telecom	15.2	14.2	14.2		
Healthcare	5.7	5.9	6.1		
Retail & Distribution	12.0	12.0	12.3		
Transportation	3.8	3.4	3.5		
Energy & Utilities	2.7	3.4	3.3		
Others	8.0	7.8	7.9		
Total	100.0	100.0	100.0		

Source: Company, Kotak Institutional Equities estimates

Key assumptions driving TCS earnings model, 2009-2012E, March fiscal year-ends

	2009	2010	2011E	2012E
Key assumptions				
Revenue growth (US\$ terms) (%)	6.1	5.4	24.0	19.7
Volume growth yoy (%)	15.8	22.1	26.5	21.2
Pricing change yoy (%)				
Onsite	(7.8)	(7.8)	(0.4)	(0.0)
Offshore	(3.7)	(7.6)	(1.6)	—
Blended	(6.8)	(14.4)	(1.7)	(0.8)
Total employees (#)	143,761	160,429	191,811	225,459
Employee additions	32,313	16,318	35,482	33,648
Utilization rate (%)	72.5	74.2	76.6	77.6
SG&A expense as % of revenues	20.0	18.7	18.1	18.2
Re/US\$ rate	46.3	47.4	45.0	45.3

Source: Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of TCS, 2008-2012E, March fiscal year-ends (Rs mn)

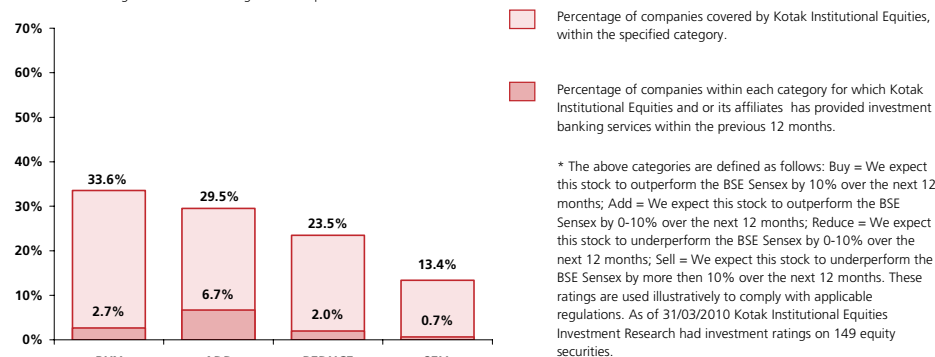
	2008	2009	2010	2011E	2012E
Profit model					
Revenues	228,614	278,129	300,289	353,939	425,783
Cost of sales	(126,194)	(154,420)	(161,629)	(192,238)	(233,790)
SG&A expenses	(48,769)	(57,694)	(59,069)	(67,288)	(81,085)
EBIT	53,651	66,015	79,591	94,414	110,908
Other income	4,450	(4,673)	2,255	5,207	6,623
Pre-tax profits	58,101	61,342	81,846	99,621	117,531
Provision for tax	(7,494)	(9,012)	(12,089)	(18,066)	(25,813)
Recurring net income	50,607	52,330	69,757	81,554	91,718
Equity in earnings of affiliates	8	(8)	(10)	—	—
Minority Interest	(424)	(569)	(1,018)	(1,182)	(1,019)
Reported net income	50,183	51,761	68,739	80,373	90,698
EPS (Rs)	25.6	26.4	35.1	41.1	46.3
Balance Sheet					
Shareholders funds	123,820	156,545	209,512	252,272	300,525
Borrowings	6,727	2,762	3,383	—	—
Minority interest	2,300	3,098	4,056	5,238	6,257
Other non-current liabilities	756	2,744	6,727	3,492	4,201
Total liabilities	133,602	165,149	223,678	261,001	310,983
Net fixed assets	30,214	37,494	41,706	57,591	67,953
Goodwill	11,105	25,913	24,183	24,183	24,183
Intangibles	3,633	8,232	8,232	8,232	8,232
Investments	26,475	17,271	37,817	37,817	37,817
Other non-current assets	10,427	17,370	22,488	22,488	22,488
Cash and bank balances	10,352	24,742	10,249	65,397	99,982
Net current assets excluding cash	41,396	34,127	79,003	45,293	50,327
Total assets	133,602	165,149	223,678	261,001	310,983

Source: Company, Kotak Institutional Equities estimates

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As of March 31, 2010

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ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

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