

Tata Consultancy Services

18 October 2011

Reuters: TCS.BO Bloomberg: TCS IN

Results below expectations, maintain Sell

TCS' 2QFY12 dollar revenues were below estimate and pricing fell for the second consecutive quarter, a key concern and an indication that the global turmoil is starting to reflect on the financials. We expect the global turmoil to lead to reduced revenue growth in FY13 and believe consensus estimates are on the higher side. We maintain a Sell rating on the stock with a revised target price of Rs995 (Rs1,019).

Volume growth drives top-line, but pricing pressure a concern: TCS' 2QFY12 revenues grew 4.7% QoQ in dollar terms to US\$2,525mn, below our estimate of US\$2,544mn. This was despite volumes growing 6.25% QoQ (our estimate 5.9% QoQ). The company saw a 0.95% QoQ fall in pricing, the second consecutive quarter of decline, which we believe, is a concern and an indication that the global turmoil is starting to have an impact on the financials. Rupee revenues grew 7.7% QoQ to Rs116.3bn, exactly in line with our estimate and marginally lower than consensus by 0.7%. Constant currency revenues grew 5.2% QoQ.

Margins rise on rupee depreciation, SG&A leverage: TCS reported a 94bps QoQ rise in EBIT margin to 27.1%, lower than our estimate by 92bps and lower than consensus by 37bps. Margin expansion was driven by rupee depreciation and SG&A leverage. Forex losses of Rs910mn led net profit to grow just 2.5% QoQ to Rs24.4bn, below our estimate by 7.7% and below consensus by 3.6%.

Global turmoil likely to impact FY13 outlook, maintain Sell on stock: Given the global economic turmoil, we believe FY13 revenue growth is likely to come in below consensus estimates of 18-20%. Pricing pressure is also visible, with 2QFY12 being the second consecutive quarter of decline, a sign that the global turmoil is starting to impact the financials. At the CMP, the stock trades at 19.1x FY13E EPS. We maintain a Sell rating on the stock with a revised target price of Rs995 (Rs1,019) owing to EPS downgrades of 3.7% and 1.9% for FY12 and FY13, respectively.

SELL

Sector: IT

CMP: Rs1,120

Target Price: Rs995

Downside: 11%

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Key Data

Current Shares O/S (mn)	1,957.2
Mkt Cap (Rsbn/US\$bn)	2,192.6/44.6
52 Wk H / L (Rs)	1,247/902
Daily Vol. (3M NSE Avg.)	2,272,686

Price Performance (%)

	1 M	6 M	1 Yr
TCS	9.0	(2.1)	14.2
Nifty Index	(0.6)	(11.8)	(16.8)

Source: Bloomberg

Y/E March (Rsmn)	2QFY11	1QFY12	2QFY12	QoQ (%)	YoY (%)	1HFY11	1HFY12	Chg (%)
Revenues	92,864	107,970	116,335	7.7	25.3	175,037	224,305	28.1
Cost of revenues	49,956	58,791	62,141	5.7	24.4	94,085	120,932	28.5
Gross profit	42,908	49,179	54,194	10.2	26.3	80,952	103,373	27.7
SG&A expenses	15,133	18,869	20,365	7.9	34.6	29,022	39,234	35.2
EBITDA	27,775	30,310	33,829	11.6	21.8	51,930	64,139	23.5
Depreciation	1,660	2,049	2,286	11.6	37.7	3,235	4,335	34.0
EBIT	26,115	28,261	31,543	11.6	20.8	48,695	59,804	22.8
Other income	443	2,887	997	(65.5)	125.1	1,263	3,884	207.5
Income before income tax	26,558	31,148	32,540	4.5	22.5	49,958	63,688	27.5
Tax	5,001	7,063	7,913	12.0	58.2	9,476	14,976	58.0
Minority interest	294	281	237			586	518	
Net profit	21,263	23,804	24,391	2.5	14.7	39,896	48,194	20.8
Diluted EPS (Rs)	10.9	12.2	12.5	2.5	14.7	20.4	24.6	20.8
Gross profit margin (%)	46.2	45.5	46.6			46.2	46.1	
EBITDA margin (%)	29.9	28.1	29.1			29.7	28.6	
EBIT margin (%)	28.1	26.2	27.1			27.8	26.7	
Net profit margin (%)	22.9	22.0	21.0			22.8	21.5	

Source: Company, Nirmal Bang Institutional Equities Research

(IFRS numbers)

Key financials

Y/E March (Rsmn)	FY09	FY10	FY11	FY12E	FY13E
Revenues	278,129	300,289	373,245	474,712	547,645
YoY (%)	23.0	8.0	24.3	27.2	15.4
EBITDA	71,805	86,800	111,985	139,502	159,578
EBITDA (%)	25.8	28.9	30.0	29.4	29.1
Adj. PAT	51,721	68,895	87,164	102,790	114,586
YoY (%)	3.0	33.2	26.5	17.9	11.5
FDEPS (Rs)	26.4	35.2	44.5	52.5	58.5
RoE (%)	36.9	37.7	37.6	35.8	32.0
RoCE (%)	38.4	36.1	36.1	34.6	30.7
P/E (x)	42.4	31.8	25.1	21.3	19.1
EV/EBITDA (x)	30.2	24.3	19.3	15.2	12.9

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Actuals vs our research estimates, Bloomberg consensus

(2QFY12)	Actuals	NBIE estimates	BBG consensus estimates	% variation from NBIE estimates	% variation from BBG consensus
Revenues (US\$mn)	2,525	2,525		(0.7)	
Revenues (Rsmn)	116,335	116,353	117,166	(0.0)	(0.7)
EBITDA (Rsmn)	33,829	34,764	34,016	(2.7)	(0.5)
EBITDA margins (%)	29.1	29.9	29.0	(80bps)	5bps
EBIT (Rsmn)	31,543	32,613	32,197	(3.3)	(2.0)
EBIT margins (%)	27.1	28.0	27.5	(92bps)	(37bps)
EPS (Rs)	12.46	13.50	12.92	(7.7)	(3.6)

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Key result data points

Volume growth above estimates, but pricing falls for the second straight quarter

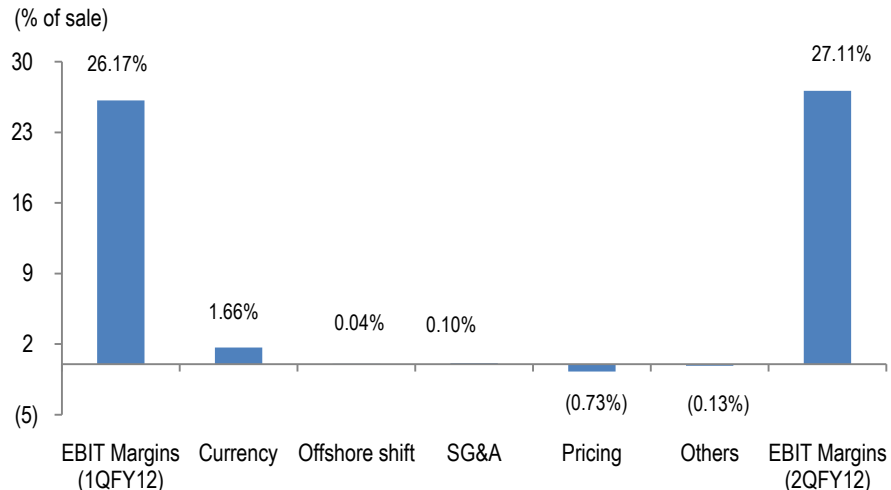
- Volumes up 6.25% QoQ; on-site volumes up 6% QoQ, offshore volumes rise 6.3% QoQ – **this was above our expectations of a 5.9% QoQ volume growth**
- Reported pricing down 0.95% QoQ - **this is a key negative, especially considering that it is the second consecutive quarter of pricing decline after a 0.5% QoQ decline in 1QFY12; we believe this is a clear reflection that in the current global environment characterised by turmoil and uncertainty, pricing is more likely to trend down rather than up in the wake of significant cost pressure being faced by client organisations, a stand we have consistently taken over the past several months**

Exhibit 2: Revenue growth break-up (%) – Volumes and rupee depreciation, key drivers

(A) Constant currency revenue growth		
Volume growth		6.3
Pricing		(1.0)
Productivity		(0.1)
Constant currency revenue growth	(A)	5.2
(B) Cross-currency movement	(B)	(0.5)
(C) Reported dollar revenue growth	(C) = (A) + (B)	4.7
(D) Rupee depreciation	(D)	3.0
(E) Reported rupee revenue growth	(E) = (C) + (D)	7.7

Source: Company

Exhibit 3: EBIT margin break-up – Rupee depreciation, the major tailwind



Source: Company

Vertical split (US\$ terms)

- BFSI grew 5.5% QoQ
- Manufacturing grew 7.2% QoQ
- Retail & Distribution grew 9.1% QoQ
- Telecom de-grew 3.9% QoQ; **this vertical continues to underperform overall company revenues**
- Hi-tech grew 6.5% QoQ
- Energy & Utilities grew 18.5% QoQ; **the stand-out performer in 2QFY12, albeit on a low base (4.3% of 2QFY12 revenues)**
- Life Sciences & Healthcare grew 6.7% QoQ

Service line split (\$ terms)

- **IT solutions and services grew 3.1% QoQ, of which:**
 - ADM grew 1.3% QoQ
 - Business intelligence grew 0.4% QoQ
 - Enterprise solutions grew 7.6% QoQ
 - Assurance services grew 9% QoQ
 - Engineering and industrial services grew 9.3% QoQ
 - Infrastructure services grew 5.8% QoQ
 - Global consulting grew 23.8% QoQ, albeit on a low base (2.6% of 2QFY12 revenues)
 - BPO business grew 4.7% QoQ
 - Asset leveraged solutions (Software products) grew 16.3% QoQ

Geographical split (\$ terms)

- **Americas region grew 5.5% QoQ, of which:**
 - North America grew 5.7% QoQ
 - Latin America grew 1.3% QoQ
- **Europe grew 6.4% QoQ, of which:**
 - UK grew 6.1% QoQ
 - Continental Europe grew 6.8% QoQ
- India revenues declined 6.5% QoQ
- Asia-Pacific grew 7.6% QoQ
- Middle East and Africa (MEA) grew 4.7% QoQ

Employees and utilisation rate

- Gross hires at 20,349 in 2QFY12, net hires at 12,580
- Total employee base at 217,770 at the end of 2QFY12
- Attrition rate at 13.7%, a decline from 14.8% in 1QFY12; **typically, attrition declines during the period of greater economic uncertainty and this, we believe, could be one of the lead indicators of a likely slowdown in growth**
- Utilisation rate, including trainees, at 76.4% (76.2% in 1QFY12)
- Utilisation rate, excluding trainees, at 83.1% (83.2% in 1QFY12)

Valuation

TCS has reported 2QFY12 numbers that are below expectations. While the rupee top-line was in line with estimate, this was helped by rupee depreciation; in dollar terms the IT major reported a performance that was below expectations. Pricing pressure was also visible for the second consecutive quarter, with the IT major reporting a pricing dip, which we believe is an indication that the global economic turmoil is starting to take toll on key operating metrics, given cost pressure faced by client organisations. TCS' management itself has clearly admitted difficulties in achieving price hikes in the current business environment. Volume growth for the quarter was slightly above our estimate at 6.25% QoQ (our estimate 5.9% QoQ), but it has come at the cost of pricing pressure. Margins were below our expectations, with forex losses leading to net profit coming in below estimates, both ours and Bloomberg consensus. We believe the uncertain global economic situation will take a toll on FY13 revenue growth, and currently consensus estimates are on the higher side. Owing to the below-par performance on the EPS front in 2QFY12, we cut our FY12 and FY13 EPS estimates by 3.7% and 1.9%, respectively. At the CMP, the stock trades at 19.1x FY13E EPS. We **maintain our Sell rating on TCS with a revised target price of Rs995 (Rs1,019) owing to EPS reduction.**

Exhibit 4: Earlier, revised estimates

Particulars	Earlier estimates	Revised estimates	% change
FY12E			
Revenues (US\$ mn)	10,324	10,265	(0.6)
Revenues (Rsmn)	476,619	474,712	(0.4)
EBITDA (Rsmn)	140,610	139,502	(0.8)
EPS (Rs)	54.6	52.5	(3.7)
FY13E			
Revenues (US\$ mn)	11,901	11,812	(0.7)
Revenues (Rs mn)	551,778	547,645	(0.7)
EBITDA (Rs mn)	161,685	159,578	(1.3)
EPS (Rs)	59.7	58.5	(1.9)

Source: Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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