

# Tata Consultancy Services Ltd

TCS IN; TCS NS

October 17, 2011

IT | India

**2Q/F12 result review**
**ADD**
**Another strong quarter; maintain ADD**

Current price	Rs	1,120
Target price	Rs	1,140
Upside/(downside)	%	2
Earning estimate		Revised

**Market data**

Mkt capitalisation	Rs bn	2192.6
Average daily vol	'000	3843.5
52-week h/w	Rs	1247 / 902
Shares O/S	mn	1957.2
Free float	mn	507.5
Promotor holding	%	74.1
Foreign holding	%	12.8
Face value	Rs	1.0

**Price performance (%)**

	3m	6m	1yr	2yr
Nifty (abs)	0.7	(8.3)	(12.1)	(15.6)
Stock (abs)	9.0	(2.3)	(6.0)	17.9
Relative to Index	8.3	6.0	6.2	33.5

**Performance**


Source: Bloomberg, SSL

TCS reported US\$2,525mn revenues with a 4.7% QoQ growth (cc ~5.2% QoQ), below SSLe of ~US\$2,559mn. Volume grew 6.25%, while pricing declined by 0.95%. In rupee terms, revenues grew 7.7% QoQ. EBIT margin improved by 94bps to 27.1%, largely due to currency movement. Net income grew 2.5% QoQ to Rs24,390mn, lower than SSLe of Rs25,435mn, largely due to higher income taxes (ETR of 24.3% against SSLe ETR of 23%) and forex losses of ~Rs910mn.

**Broad-based growth:** Growth was across verticals, service lines and geographies. North America, UK, Continental Europe and Asia-pacific reported high growth rates of 5.7%, 6.1%, 6.8% and 7.6%, respectively, although revenues from India de-grew 6.5% QoQ. Energy & Utilities and Retail & Distribution registered strong growth rates of 18.5% and 9.2% QoQ, as did Enterprise Solutions, Assurance Services and Engg. & Industrial Services, which posted strong growth rates of 7.6%, 9% and 9.3%, respectively. On the other hand, in keeping with management's subdued expectations, the Telecom vertical de-grew 4.2% QoQ.

**Management remains fairly upbeat about growth momentum:** The management remains fairly upbeat about growth going forward; however, it has advised caution considering uncertainty in the macroeconomic environment. The management expects clients to execute their plan in a stable manner. The company has signed 10 large deals during the quarter and hinted healthy pipeline. The company has maintained its hiring plans for 2HF12 on the back of 32,337 gross additions in 1HF12, which suggests no deterioration in demand visibility.

**Outlook and valuation:** We are revising our EPS estimate for F12/F13 by 0.8%/(1.4)% to Rs53.1/61.6, respectively owing to: a) 1HF12 results, b) lowering US dollar revenue expectations for F12 and F13, c) weaker rupee assumptions (avg. exchange rate of Rs47/45.4 for 2HF12/F13) and d) higher tax rate assumption (ETR of 24% in 2HF12 and F13). Considering recent price performance, macroeconomic challenges and clarity over C12 IT budgets, which will emerge only by early C12, we see limited upside in the near-term. The stock currently trades at ~21.1x F12e earnings, ~7% premium to Infosys. We maintain an **ADD** recommendation with a revised target price of **Rs1,140** at 17x Sept'13e earnings.

**Financial summary**

Y/E March (Rs mn)	F 10	F 11	F 12e	F 13e
Sales	300,289	373,245	477,326	557,182
Growth YoY (%)	8.0	24.3	27.9	16.7
EBIDTA margin (%)	28.9	30.0	29.1	29.0
Net profit (mn)	68,894	87,167	103,867	120,549
EPS (Rs)	35.2	44.5	53.1	61.6
Growth YoY (%)	33.2	26.5	19.2	16.1
P/E (x)	31.8	25.1	21.1	18.2
EV/EBIDTA (x)	24.7	19.3	15.4	13.1
Dividend yield (%)	1.8	1.3	1.5	1.8
RoE (%)	37.4	37.6	36.3	33.9

Source: Company, SSLe

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## Earnings call takeaways

- TCS registered a revenue growth of 7.7% led volume growth of 6.25%.

### Revenue growth

Factors	QoQ (%)
Volume growth	6.3
Realisation	(1.0)
Effort mix	(0.1)
Foreign exchange	2.5
<b>Growth in rupee revenues</b>	<b>7.7</b>

Source: Company

- EBIT margin saw an improvement of 94bps led by a weaker rupee.

### Margin movement

Factors	QoQ (bps)
Rate productivity impact	(73)
Offshore shift	4
Currency movement	166
SG & A efficiency, provisioning for bad debts	10
Others	(13)
<b>Impact on operating margins</b>	<b>94</b>

Source: Company

- The management reiterated that they have not heard any incremental negative news from clients. Deal pipeline remains robust and deal signings are also happening at usual pace.
- The macro environment continues to be concerning and nervous, but yet not impacted demand.
- Comfortable with utilisation levels of 82-84%
- Hiring plan on track ~60,000 for F12, made ~35,000 campus offers till date for next year
- Variable payout 100% in 2QF12
- The company expects ETR of ~24% for F12.
- DSO 82 days
- The company has delivered an LTM attrition of 12.5% in IT Services and an industry leading utilisation of 83.1% ex-trainees

**2Q/F12 results update**

Volumes grew by 6.3% in 2QF12, on the back of 7.4% growth in 1QF12

Operating margins improved 94bps to 27.1%, largely due to weaker rupee

Particular (Rs mn)	2Q/F12	1Q/F12	QoQ (%)	2Q/F11	YoY (%)	2Q/F12e	Var. (%)
Revenue (US\$ mn)	2,525	2,412	4.7	2,004	26.0	2,559	(1.3)
Revenue	116,335	107,970	7.7	92,864	25.3	117,140	(0.7)
Cost of revenue	63,716	60,175	5.9	51,107	24.7	64,779	(1.6)
Gross margin	52,619	47,795	10.1	41,757	26.0	52,362	0.5
GPM (%)	45.2	44.3		45.0		44.7	
SG & A expenses	21,076	19,534	7.9	15,642	34.7	20,500	2.8
Operating income	31,542	28,261	11.6	26,115	20.8	31,862	(1.0)
OPM (%)	27.1	26.2		28.1		27.2	
Other income (exp), net	997	2,887	(65.5)	443	125.1	1,557	(35.9)
Income before income taxes	32,540	31,147	4.5	26,558	22.5	33,419	(2.6)
PBTM (%)	28.0	28.8		28.6		28.5	
Income taxes	7,913	7,063	12.0	5,001	58.2	7,686	2.9
Income after income taxes	24,627	24,084	2.3	21,557	14.2	25,732	(4.3)
PATM (%)	21.2	22.3		23.2		22.0	
Minority interest	237	281	(15.6)	295	(19.6)	298	(20.3)
Net Income	24,390	23,803	2.5	21,262	14.7	25,435	(4.1)
NPM (%)	21.0	22.0		22.9		21.7	
Adj. EPS (Rs)	12.5	12.2	2.5	10.9	14.7	13.0	(4.1)

Source: Company, SSL

**Revenue by service line**

Particulars	As % of revenues			QoQ (%)	YoY (%)
	2Q/F12	1Q/F12	2Q/F11		
ADM	44.7	46.2	46.8	1.3	20.3
Business Intelligence	4.7	4.9	5.6	0.4	5.8
Enterprise Solutions	11.1	10.8	10.3	7.6	35.8
Assurance Services	7.6	7.3	6.6	9.0	45.1
Engg. & Industrial Services	4.8	4.6	4.9	9.3	23.4
Infrastructure Services	9.6	9.5	9.4	5.8	28.7
Global Consulting	2.6	2.2	2.1	23.8	56.0
Asset Leveraged Solutions	4.0	3.6	3.4	16.3	48.2
BPO	10.9	10.9	10.9	4.7	26.0
	100.0	100.0	100.0	4.7	26.0

Source: Company, SSL

**Revenue by geography**

Particulars	As % of revenues			QoQ (%)	YoY (%)
	2Q/F12	1Q/F12	2Q/F11		
North Americas	53.4	52.9	53.7	5.7	25.3
Latin America	3.0	3.1	3.9	1.3	(3.1)
UK	15.5	15.3	15.3	6.1	27.6
Continental Europe	10.1	9.9	9.1	6.8	39.8
India	8.3	9.3	9.9	(6.5)	5.6
Asia Pacific	7.5	7.3	6.2	7.6	52.4
MEA	2.2	2.2	1.9	4.7	45.9
	100.0	100.0	100.0	4.7	26.0

Source: Company, SSL

### Revenue by verticals

Particulars	As % of revenues			QoQ (%)	YoY (%)
	2Q/F12	1Q/F12	2Q/F11		
BFSI	43.5	43.3	44.0	5.2	24.6
Telecom	10.7	11.7	12.8	(4.2)	5.3
Retail & Distribution	12.1	11.6	10.9	9.2	39.9
Manufacturing	7.8	7.6	7.4	7.5	32.8
Life Sciences & Healthcare	5.3	5.2	5.1	6.7	30.9
Hi-tech	5.9	5.8	4.6	6.5	61.6
Travel & Hospitality	3.8	3.7	3.2	7.5	49.6
Energy & Utilities	4.3	3.8	4.3	18.5	26.0
Media & Entertainment	2.1	2.2	2.0	(0.0)	32.3
Others	4.5	5.1	5.7	(7.6)	(0.5)
	100.0	100.0	100.0	4.7	26.0

Source: Company, SSL

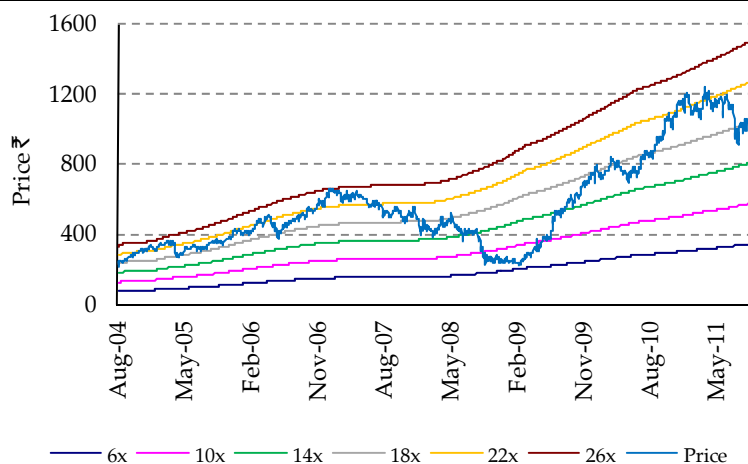
### Client contribution (LTM)

No. of clients	4Q/F10	1Q/F11	2Q/F11	3Q/F11	4Q/F11	1Q/F12	2Q/F12
US\$1 mn+	409	409	420	434	458	473	495
US\$5 mn+	183	191	192	200	208	219	230
US\$10mn+	118	122	131	139	143	148	155
US\$20mn+	63	65	66	76	81	91	94
US\$50mn+	23	24	25	25	27	33	36
US\$100mn+	7	7	8	9	8	10	12

Number of US\$100mn+ clients increased by 2 QoQ to 12 at the end of 2QF12

Source: Company

### Forward P/E chart



Source: Company, SSL

## Financials

### Income statement

Y/E March (Rs mn)	F 10	F 11	F 12e	F 13e
<b>Revenue</b>	<b>300,289</b>	<b>373,245</b>	<b>477,326</b>	<b>557,182</b>
YoY (%)	8.0	24.3	27.9	16.7
<b>EBITDA</b>	<b>86,881</b>	<b>111,987</b>	<b>139,120</b>	<b>161,410</b>
YoY (%)	21.0	28.9	24.2	16.0
Depreciation & Amortisation	7,291	7,214	9,142	10,586
<b>EBIT</b>	<b>79,590</b>	<b>104,773</b>	<b>129,977</b>	<b>150,823</b>
YoY (%)	20.6	31.6	24.1	16.0
Other income	2,255	5,324	7,754	9,280
<b>PBT</b>	<b>81,845</b>	<b>110,097</b>	<b>137,731</b>	<b>160,103</b>
Less: Provision for Taxation	12,202	21,739	32,746	38,425
Effective tax rate (%)	14.9	19.7	23.8	24.0
<b>PAT</b>	<b>69,633</b>	<b>88,358</b>	<b>104,985</b>	<b>121,679</b>
YoY (%)	33.1	26.9	18.8	15.9
No-controlling interest	739	1,191	1,118	1,130
<b>Net Profit</b>	<b>68,894</b>	<b>87,167</b>	<b>103,867</b>	<b>120,549</b>
YoY (%)	33.2	26.5	19.2	16.1

### Balance sheet

Y/E March (Rs mn)	F 10	F 11	F 12e	F 13e
Net Fixed Assets	41,706	52,340	65,000	78,000
Intangible assets and goodwill	32,415	32,455	30,997	29,897
Investments	74,364	50,714	60,000	70,000
Cash & Bank balance	10,249	15,078	28,504	57,941
Accounts receivables	58,098	81,990	105,012	122,580
Unbilled revenues	12,011	13,489	16,706	19,501
Other current assets	21,267	29,068	38,663	45,132
Other non-current assets	26,103	57,474	71,599	83,577
<b>Total Assets</b>	<b>276,213</b>	<b>332,608</b>	<b>416,482</b>	<b>506,629</b>
Shareholder's equity	213,172	257,053	321,992	396,744
Current liabilities	54,819	63,837	82,949	96,587
Non-current liabilities	8,221	11,718	11,541	13,298
<b>Total Liabilities</b>	<b>276,213</b>	<b>332,608</b>	<b>416,482</b>	<b>506,629</b>

### Financial ratios (Y/E March)

Y/E March	F 10	F 11	F 12e	F 13e
<b>Profitability and Return Ratio(%)</b>				
EBITDAM	28.9	30.0	29.1	29.0
EBITM	26.5	28.1	27.2	27.1
NPM	22.9	23.4	21.8	21.6
RoCE	32.4	36.2	36.8	34.7
RoE	37.4	37.6	36.3	33.9
<b>Per Share Data (Rs)</b>				
EPS	35.2	44.5	53.1	61.6
CEPS	38.9	48.2	57.7	67.0
BV	108.9	131.3	164.5	202.7
DPS	10.0	7.0	8.5	10.0
<b>Valuation Ratios</b>				
PE (x)	31.8	25.1	21.1	18.2
P/BV (x)	10.3	8.5	6.8	5.5
P/S (x)	7.3	5.9	4.6	3.9
EV/EBITDA (x)	24.7	19.3	15.4	13.1
EV/Sales (x)	7.1	5.8	4.5	3.8
<b>Turnover Ratios</b>				
DSO (days)	69.7	79.1	79.2	79.2

### Cash flow statement

Y/E March (Rs mn)	F 10	F 11	F 12e	F 13e
Net income	68,894	87,167	103,867	120,549
Dep & Amor.	7,291	7,214	9,142	10,586
Others	(3,844)	(17)	-	-
Change in WC	2,609	(52,151)	(31,024)	(23,414)
<b>Operating CF</b>	<b>74,951</b>	<b>69,148</b>	<b>81,985</b>	<b>107,721</b>
Purchase of Fixed Assets	(10,225)	(16,834)	(21,802)	(23,586)
Purchase of Investments	(45,320)	(1,378)	(9,286)	(10,000)
Purchase of subsidiaries & business	253	(391)	1,457	1,100
Other investing activities	26	-	-	-
<b>Investing CF</b>	<b>(55,266)</b>	<b>(18,663)</b>	<b>(29,631)</b>	<b>(32,486)</b>
Issuance of shares	54	-	-	-
Proceeds from borrowings	(3,960)	(310)	-	-
Dividend paid	(19,594)	(45,832)	(38,927)	(45,797)
<b>Financing CF</b>	<b>(23,500)</b>	<b>(46,142)</b>	<b>(38,927)</b>	<b>(45,797)</b>
Inc/(Dec) in Cash & Bank bal.	(3,815)	4,342	13,426	29,437
Effect of forex on cash flows	(529)	487	-	-
<b>Opening Cash &amp; Bank bal.</b>	<b>14,593</b>	<b>10,249</b>	<b>15,078</b>	<b>28,504</b>
<b>Closing Cash &amp; Bank bal.</b>	<b>10,249</b>	<b>15,078</b>	<b>28,504</b>	<b>57,941</b>

Source: Company, SSL

## SBICAP Securities Limited

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Guide to the expected return over the next 12 months. **1=BUY** (expected to give absolute returns of 20 or more percentage points); **2=ACCUMULATE/ADD** (expected to give absolute returns between 10 to 20 percentage points); **3=REDUCE** (expected to give absolute returns between 0 to 10 percentage points); **4=SELL** (expected to give absolute negative returns)

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