

October 17, 2011

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Rating	BUY
Price	Rs1,120
Target Price	Rs1,140
Implied Upside	1.8%
Sensex	17,025

(Prices as on October 17, 2011)

Trading data

Market Cap. (Rs bn)	2,192.6
Shares o/s (m)	1,957.2
3M Avg. Daily value (Rs m)	2679.2

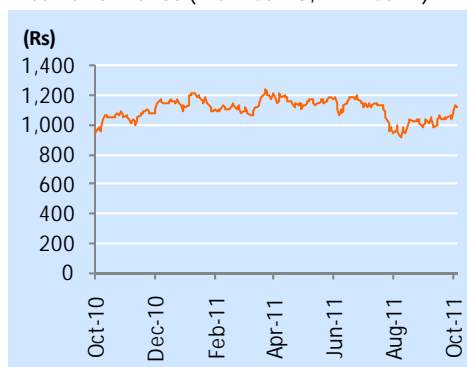
Major shareholders

Promoters	74.08%
Foreign	12.80%
Domestic Inst.	8.10%
Public & Other	5.02%

Stock Performance

(%)	1M	6M	12M
Absolute	9.0	(6.0)	17.9
Relative	8.5	6.2	33.3

Price Performance (RIC: TCS.BO, BB: TCS IN)



Source: Bloomberg

Tata Consultancy Services (TCS) reported Q2FY12 results in line with our expectations, but lower than consensus estimates. Below expectation performance is due to slower growth in Lat-Am and de-growth in India. Moreover, we continue to believe that the company has fully utilized its operating leverage to deliver strong growth in FY10-11. We reiterate our **'BUY'** rating, with a TP of **Rs1,140**.

- In-line quarter - lacks any positive surprise:** TCS reported Q2FY12 results reported lower than consensus expectation. Revenue grew by 7.7% QoQ to Rs116.53bn (PLe: Rs117.11bn Cons: Rs117.17bn) and 4.7% QoQ in USD terms, led by better-than-expected volume growth of 6.25% QoQ (PLe: 5.8%). EBIT margins expanded by 94bps (PLe: 87bps, Cons: 110bps) to 27.1%. EPS grew by 2.5% QoQ to Rs12.46 (PLe: Rs12.59, Cons: Rs12.95).
- Margin levers looks stretched, growth from top clients peaking out:** TCS' top 10 clients grew faster since FY10 (TCS: 6.7%, INFO: 4.9%, WPRO: 3.2%, HCLT: 3.8%) till Q1FY12. We believe that the growth from top 10 clients has peaked as the top client mining has reached its peak. In Q2FY12, top 10 clients grew by 2.55 QoQ. As in our previous note ("**Strong performance, but margin concerns persist**", July 14, 2011) we highlighted that *FY11 growth was more predictable (existing clients), helping them to operate at high utilization. We believe that onsite would increase as growth would come from new clients; hence, impacting margins in-line with our hypothesis.* Despite favourable currency, margin improvement was 94bps and we expect margin pressures to mount as growth comes back.
- Revising FY11 and FY12 estimates:** We revise our FY12 and FY13 USD revenue estimates downward, but upward revision in currency estimates.
- Valuation & Recommendation:** We expect 26% volume growth, with positive pricing bias in FY12. However, we continue to expect margin headwinds to dampen EPS growth. However, we reiterate **'BUY'** rating, with a TP of **Rs1,140**, 19x FY13e earnings estimate.

Key financials (Y/e March)	2010	2011	2012E	2013E
Revenues (Rs m)	300,289	373,245	476,080	591,062
Growth (%)	8.0	24.3	27.6	24.2
EBITDA (Rs m)	86,799	111,984	135,819	164,455
PAT (Rs m)	68,729	82,936	100,111	118,307
EPS (Rs)	35.1	42.4	51.1	60.4
Growth (%)	(33.5)	20.7	20.7	18.2
Net DPS (Rs)	9.9	23.3	9.5	12.0

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	28.9	30.0	28.5	27.8
RoE (%)	37.6	35.9	34.0	30.7
RoCE (%)	34.4	34.5	31.7	29.0
EV / sales (x)	7.1	5.7	4.5	3.5
EV / EBITDA (x)	24.7	19.2	15.7	12.6
PE (x)	31.9	26.4	21.9	18.5
P / BV (x)	10.5	8.7	6.5	5.1
Net dividend yield (%)	0.9	2.1	0.8	1.1

Source: Company Data; PL Research

Exhibit 1: Q2FY12 Results – below par performance

	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY	PLe	Cons.	PL v/s Act
Consolidated Sales (USD m)	2,525	2,412	4.7%	2,004	26.0%	2,557	na	-1.3%
Consolidated Sales (Rs m)	116,335	107,970	7.7%	92,864	25.5%	117,111	117,166	-0.5%
Operating Profit (Rs m)	31,543	28,261	11.6%	26,115	20.8%	31,676	31,922	-0.4%
<i>OPM</i>	<i>27.1%</i>	<i>26.2%</i>	<i>94 bps</i>	<i>28.1%</i>	<i>-101 bps</i>	<i>27.0%</i>	<i>27.2%</i>	<i>7 bps</i>
PBT	32,540	31,147	4.5%	26,558	22.5%	32,430	33,701	0.3%
PAT (Rs m)	24,390	23,803	2.5%	21,262	14.7%	24,634	25,290	-1.0%
<i>PAT Margin</i>	<i>20.9%</i>	<i>22.0%</i>	<i>-112 bps</i>	<i>22.9%</i>	<i>-197 bps</i>	<i>21.0%</i>	<i>21.6%</i>	<i>-11 bps</i>
EPS (Rs)	12.46	12.16	2.5%	10.86	14.7%	12.59	12.95	-1.0%

Source: Company Data, Bloomberg, PL Research

Lowering volume and margin estimates as levers look stretched

We have revised our volume growth downwards by 150bps to 26%. Moreover, we have also lowered our margin forecast by 41bps due to impact of lower utilization and lateral additions for FY12. However, for FY13, we have left our volume and pricing unchanged for FY13.

Exhibit 2: Margin Drivers (QoQ)

Currency	+166bps
Offshore	+4bps
Rate Productivity	-73bps
SG&A and Bad Debt	+10bps
Others	-13bps
Total	+94bps

Source: Company Data, PL Research

Exhibit 3: Revising FY12 & FY13 estimates upward on account of higher volume growth

	NEW		OLD		REVISED	
	FY12	FY13	FY12	FY13	FY12	FY13
Volume Growth (YoY)	26.0%	25.0%	27.5%	25.0%	-150 bps	0 bps
Pricing Growth (YoY)	1.0%	2.0%	2.0%	2.0%	-100 bps	0 bps
Revenue (US\$ m)	10,418	13,282	10,646	13,574	-2.1%	-2.1%
Revenue (Rs m)	476,080	591,062	462,135	589,743	3.0%	0.2%
EBIT (Rs m)	126,565	153,581	124,770	157,048	1.4%	-2.2%
<i>EBIT Margin</i>	<i>26.6%</i>	<i>26.0%</i>	<i>27.0%</i>	<i>26.6%</i>	<i>-41 bps</i>	<i>-65 bps</i>
EPS (Rs)	51.15	60.45	50.19	60.94	1.9%	-0.8%

Source: Company Data, PL Research

Conference call highlights

1) The management indicated no signs of worry from client IT budget for both, CY11 and CY12 **2)** Ten large deals (Q1FY12: 15) in pipeline (Four each in US, UK & Europe, Two in EM) (BFSI -4, Telecom-2, Utility-1, Retail-1, Manufacturing -1, Hitech-1) **3)** Ten large deals won, Two strategic large deals **4)** Comfortable with 82-84% utilization level **5)** Top 10 clients grew only 2.5% QoQ **6)** Pricing for the quarter declined by 0.95% QoQ, but according to management, there is no pricing pressure, the impact was more due to business mix **7)** The management indicated good ramp-up likely in telecom vertical **8)** Strength in Europe is also from first time outsourcers.

Exhibit 4: Growth Drivers (QoQ)

Volume Growth	+6.25%
Exchange	+2.49%
Pricing	-0.95%
Effort Mix	-0.50%
Total	+7.74%

Source: Company Data, PL Research

Exhibit 5: Growth across geographies, except India and Lat-Am

Revenue By Geography (USD m)	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
America	1,424	1,351	5.4%	1,154	23.4%
North America	1,348	1,276	5.7%	1,076	25.3%
Ibero America	76	75	1.3%	78	-3.1%
Europe	646	608	6.3%	489	32.2%
UK	391	369	6.1%	307	27.6%
Continental Europe	255	239	6.8%	182	39.8%
India	210	224	-6.6%	198	5.6%
Asia Pacific	189	176	7.6%	124	52.4%
MEA	56	53	4.7%	38	45.9%
% of Total					
America					
North America	56.4%	56.0%	40 bps	57.6%	-120 bps
Ibero America	53.4%	52.9%	50 bps	53.7%	-30 bps
Europe	3.0%	3.1%	-10 bps	3.9%	-90 bps
UK	25.6%	25.2%	40 bps	24.4%	120 bps
Continental Europe	15.5%	15.3%	20 bps	15.3%	20 bps
India	10.1%	9.9%	20 bps	9.1%	100 bps
Asia Pacific	8.3%	9.3%	-100 bps	9.9%	-160 bps
MEA	7.5%	7.3%	20 bps	6.2%	130 bps

Source: Company Data, PL Research

Exhibit 6: Sudden drop in FPP because of few large projects got completed

Contract Type Analysis	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
Time & Material	53.2%	50.3%	290 bps	51.0%	220 bps
Fixed Price & Project	46.8%	49.7%	-290 bps	49.0%	-220 bps
Contract Type Revenue (USD m)					
Time & Material	1,343	1,213	10.7%	1,022	31.4%
Fixed Price & Project	1,182	1,199	-1.4%	982	20.3%

Source: Company Data, PL Research

Exhibit 7: Net client addition steady

	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
Active Clients	1010	959	5.3%	936	7.9%
New Clients Added	35	24	45.8%	30	16.7%
Repeat Business Revenue	99.3%	99.8%	-50 bps	98.3%	100 bps
New Business Revenue	0.7%	0.2%	50 bps	1.7%	-100 bps

Source: Company Data, PL Research

Exhibit 8: Telecom vertical seeing signs of weakness, BFSI continues to look strong

Revenue By Verticals (USD m)	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
BFSI	1,098	1,044	5.2%	907	21.1%
Telecom	270	282	-4.3%	250	7.9%
Retail & Distribution	306	280	9.2%	209	45.9%
Manufacturing	197	183	7.4%	165	19.6%
Life Sciences & Healthcare	134	140	-4.3%	102	30.7%
Hi-tech	149	125	18.8%	83	80.1%
Transportation	96	89	7.5%	63	53.4%
Energy & Utilities	109	92	18.5%	54	101.7%
Media & Entertainment	53	53	-0.1%	39	36.4%
Others	114	123	-7.6%	132	-14.1%
% of Total					
BFSI	43.5%	43.3%	20 bps	45.3%	-175 bps
Telecom	10.7%	11.7%	-100 bps	12.5%	-180 bps
Retail & Distribution	12.1%	11.6%	50 bps	10.4%	165 bps
Manufacturing	7.8%	7.6%	20 bps	8.2%	-42 bps
Life Sciences & Healthcare	5.3%	5.8%	-50 bps	5.1%	19 bps
Hi-Tech	5.9%	5.2%	70 bps	4.1%	177 bps
Transportation	3.8%	3.7%	10 bps	3.1%	68 bps
Energy & Utilities	4.3%	3.8%	50 bps	2.7%	161 bps
Media & Entertainment	2.1%	2.2%	-10 bps	1.9%	16 bps
Others	4.5%	5.1%	-60 bps	6.6%	-210 bps

Source: Company Data, PL Research

Exhibit 9: Onsite starts inching forward as pent-up demand from existing clients are over

Revenue Delivery Location	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
Offshore	50.9%	50.6%	30 bps	51.1%	-20 bps
Onsite	45.2%	44.8%	40 bps	43.9%	130 bps
GDC/RDC	3.9%	4.6%	-70 bps	5.0%	-110 bps
Rs m					
Offshore	1,285	1,220	5.3%	1,024	25.5%
Onsite	1,141	1,081	5.6%	880	29.7%
GDC/RDC	98	111	-11.2%	100	-1.7%

Source: Company Data, PL Research

Exhibit 10: Growth coming from non-top 10 clients

Client Contribution	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
as % of Revenue					
Top 1 Client	6.9%	7.1%	-20 bps	8.0%	-110 bps
Top 5 Clients	20.0%	20.7%	-70 bps	22.1%	-210 bps
Top 10 Clients	28.3%	28.9%	-60 bps	30.1%	-180 bps
Non-Top 10 Clients	71.7%	71.1%	60 bps	69.9%	180 bps
Total Revenue (USD m)					
Top 1 Client	174	171	1.7%	160	8.7%
Top 5 Clients	505	499	1.1%	443	14.0%
Top 2-5 Clients	331	328	0.8%	283	17.1%
Top 10 Clients	715	697	2.5%	603	18.5%
Top 6-10 Clients	210	198	6.0%	160	30.7%
Non Top 10 Clients	1,810	1,715	5.6%	1,401	29.2%
USD 1m clients	495	473	4.7%	420	17.9%
USD 5m clients	230	219	5.0%	192	19.8%
USD 10m clients	155	148	4.7%	131	18.3%
USD 20m clients	94	91	3.3%	66	42.4%
USD 50m clients	36	33	9.1%	25	44.0%
USD 100m clients	12	10	20.0%	8	50.0%

Source: Company Data, PL Research

Exhibit 11: Guidance kept at 60k hiring for FY12

Headcount	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
Including Indian Subsidiaries	214,770	202,190	6.2%	174,417	23.1%
Gross Addition	20,349	11,988	69.7%	17,121	18.9%
Laterals (India)	8,125	7,752	4.8%	19,293	-57.9%
Net Addition	12,580	3,576	251.8%	10,717	17.4%
Attrition rate	12.5%	13.6%	-105 bps	13.1%	-56 bps
Offshore Utilisation (Incl. Trainees)	76.4%	76.2%	20 bps	77.7%	-130 bps
Offshore Utilisation (Excl. Trainees)	83.1%	83.2%	-10 bps	83.8%	-70 bps

Source: Company Data, PL Research

Exhibit 12: Steady growth across the service line

By Service Line (USD m)	Q2FY12	Q1FY12	QoQ	Q4FY11	YoY
IT Solutions & Services	1,720	1,669	3.0%	1,389	23.8%
Application Dev & Maint.	1,129	1,114	1.3%	938	20.3%
Business Intelligence	119	118	0.4%	112	5.7%
Enterprise Solutions	280	260	7.6%	206	35.8%
Assurance Services	192	176	9.0%	132	45.1%
Engineering & Industrial Services	121	111	9.2%	98	23.4%
Infrastructure Services	242	229	5.8%	188	28.7%
Global Consulting	66	53	23.7%	42	56.0%
Asset Leverage Solutions	101	87	16.3%	68	48.2%
Business Process Outsourcing	275	263	4.7%	218	26.0%
% of Total Revenue					
IT Solutions & Services	68.1%	69.2%	-110 bps	69.3%	-120 bps
Application Dev & Maint.	44.7%	46.2%	-150 bps	46.8%	-210 bps
Business Intelligence	4.7%	4.9%	-20 bps	5.6%	-90 bps
Enterprise Solutions	11.1%	10.8%	30 bps	10.3%	80 bps
Assurance Services	7.6%	7.3%	30 bps	6.6%	100 bps
Engineering & Industrial Services	4.8%	4.6%	20 bps	4.9%	-10 bps
Infrastructure Services	9.6%	9.5%	10 bps	9.4%	20 bps
Global Consulting	2.6%	2.2%	40 bps	2.1%	50 bps
Asset Leverage Solutions	4.0%	3.6%	40 bps	3.4%	60 bps
Business Process Outsourcing	10.9%	10.9%	0 bps	10.9%	0 bps

Source: Company Data, PL Research



Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	300,289	373,245	476,080	591,062
Raw Material Expenses	161,628	204,296	266,933	338,770
Gross Profit	138,661	168,949	209,147	252,292
Employee Cost	—	—	—	—
Other Expenses	51,862	56,965	73,329	87,837
EBITDA	86,799	111,984	135,819	164,455
Depr. & Amortization	7,208	7,214	9,254	10,874
Net Interest	(1,551)	4,229	—	—
Other Income	694	5,324	7,133	7,736
Profit before Tax	81,836	105,865	133,697	161,317
Total Tax	12,088	21,739	32,087	41,136
Profit after Tax	69,748	84,126	101,610	120,181
Ex-Od items / Min. Int.	(1,019)	(1,190)	(1,499)	(1,874)
Adj. PAT	68,729	82,936	100,111	118,307
Avg. Shares O/S (m)	1,957.2	1,957.2	1,957.2	1,957.2
EPS (Rs.)	35.1	42.4	51.1	60.4

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	74,869	—	56,010	98,286
C/F from Investing	(51,361)	(18,663)	(19,043)	(22,165)
C/F from Financing	(28,098)	(13,332)	(18,593)	(23,486)
Inc. / Dec. in Cash	(4,591)	(31,996)	18,374	52,635
Opening Cash	14,839	10,249	47,401	65,775
Closing Cash	10,249	47,401	65,775	118,409
FCFF	75,070	48,603	35,468	74,247
FCFE	73,419	48,532	35,468	74,247

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	8.0	24.3	27.6	24.2
EBITDA (%)	20.9	29.0	21.3	21.1
PAT (%)	32.9	20.7	20.7	18.2
EPS (%)	(33.5)	20.7	20.7	18.2
Profitability				
EBITDA Margin (%)	28.9	30.0	28.5	27.8
PAT Margin (%)	22.9	22.2	21.0	20.0
RoCE (%)	34.4	34.5	31.7	29.0
RoE (%)	37.6	35.9	34.0	30.7

Balance Sheet

Net Debt : Equity	(0.2)	(0.2)	(0.2)	(0.3)
Net Wrkng Cap. (days)	66	76	73	73

Valuation

PER (x)	31.9	26.4	21.9	18.5
P / B (x)	10.5	8.7	6.5	5.1
EV / EBITDA (x)	24.7	19.2	15.7	12.6
EV / Sales (x)	7.1	5.7	4.5	3.5

Earnings Quality

Eff. Tax Rate	14.8	20.5	24.0	25.5
Other Inc / PBT	0.8	5.0	5.3	4.8
Eff. Depr. Rate (%)	10.3	8.3	8.8	8.5
FCFE / PAT	106.8	58.5	35.4	62.8

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	209,404	252,389	336,776	433,470
Total Debt	111	40	40	40
Other Liabilities	11,501	16,341	16,341	16,341
Total Liabilities	221,015	268,771	353,157	449,852
Net Fixed Assets	44,685	54,486	64,275	75,566
Goodwill	32,415	32,455	32,455	32,455
Investments	37,839	18,390	18,390	18,390
Net Current Assets	82,952	108,111	181,338	266,742
<i>Cash & Equivalents</i>	<i>46,773</i>	<i>47,401</i>	<i>65,775</i>	<i>118,409</i>
<i>Other Current Assets</i>	<i>91,376</i>	<i>124,547</i>	<i>183,389</i>	<i>227,680</i>
<i>Current Liabilities</i>	<i>55,197</i>	<i>63,837</i>	<i>67,825</i>	<i>79,348</i>
Other Assets	26,103	57,474	57,474	57,474
Total Assets	223,994	270,916	353,933	450,628

Quarterly Financials (Rs m)

Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	96,634	101,575	107,970	116,335
EBITDA	29,175	30,880	30,310	33,399
<i>% of revenue</i>	<i>30.2</i>	<i>30.4</i>	<i>28.1</i>	<i>28.7</i>
Depr. & Amortization	1,856	2,123	2,049	1,856
Net Interest	—	—	—	—
Other Income	1,822	2,239	2,886	997
Profit before Tax	29,141	30,996	31,147	32,540
Total Tax	5,491	6,772	7,063	7,913
Profit after Tax	23,461	23,809	23,803	24,390
Adj. PAT	23,461	23,809	23,803	24,390

Key Operating Metrics

Y/e March	2010	2011	2012E	2013E
Volume (persons month)	1,216,218	1,588,419	2,001,408	2,501,760
Pricing (US\$ / Hr)	33.5	33.5	33.8	34.5
Currency (USDINR)	47.4	45.6	45.7	44.5
SW Devp. Cost (% of Sales)	53.8	54.7	56.1	57.3
SG&A (% of Sales)	17.0	15.3	15.2	14.7
Revenue (US\$ m)	6,339	8,186	10,418	13,282
EBITDAM Expansion/(Erosion) (bps)	309	110	(147)	(70)
Tax Rate (%)	14.8	19.0	24.0	25.5

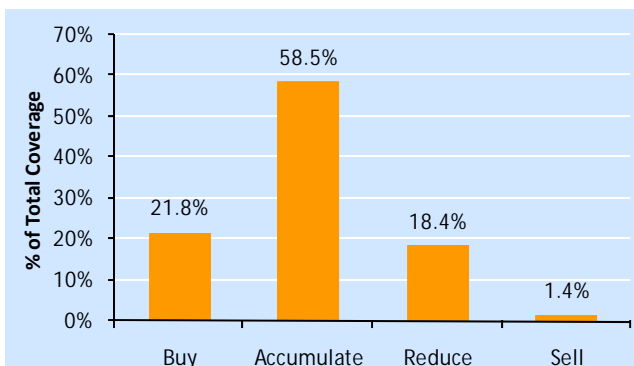
Source: Company Data, PL Research.

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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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