

## TATA CONSULTANCY SERVICES

### Earnings miss: Industry issue or company problems?

**Miss in earnings for FY2Q12:** TCS's earnings miss for the quarter ended September 2011 (actual EPS of Rs12.5 vs our estimate of Rs13.3) raises the issue of headwinds facing the industry in the current weak environment. However, a closer look suggests that this could be a reflection of weak company performance rather than an industry issue. Revenue performance was in line at 5.3% q/q constant currency growth (Infosys was at 5% q/q) while the earnings miss was largely due to a weak EBIT margin performance (reported 27.1% vs our estimate of 28.4%).

**Management's commentary in the earnings call raises further concerns:** While peer Infosys is guiding for stronger growth in FY2H12, TCS indicated that FY2H12 suffers from seasonality and, hence, could be weaker than FY1H12. This could signal a change in the industry leader scoreboard in favour of Infosys, in our opinion. Post the quarterly results, we reduce our earnings estimates by 3.4% for FY2012 and 4.1% for FY2013.

**TCS currently trades at a 5% P/E premium to Infosys vs a discount of 7% for its entire listed history:** TCS's weak performance for FY2Q12 could lead to a mean reversal of this P/E premium. This, coupled with a realignment of consensus EPS expectations, should lead to a stock price correction near term. However, we maintain our 12-month price target of Rs1,150 and our 2-EW rating on TCS. We continue to prefer Infosys (1-OW; PT Rs3,050) over TCS.

#### TCS.NS: Quarterly and Annual EPS (INR)

FY Mar	2011		2012		2013			Change y/y	
	Actual	Old	New	Cons	Old	New	Cons	2012	2013
Q1	9.42A	12.16A	12.16A	N/A	14.01E	13.48E	N/A	29%	11%
Q2	10.76A	13.29E	12.46A	N/A	14.83E	14.50E	N/A	16%	16%
Q3	11.91A	15.07E	13.60E	N/A	15.60E	14.82E	N/A	14%	9%
Q4	12.13A	13.64E	14.09E	N/A	16.36E	15.48E	N/A	16%	10%
Year	44.22A	54.15E	52.31E	N/A	60.80E	58.29E	N/A	18%	11%
P/E	25.3		21.4			19.2			

Source: Barclays Capital  
Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST(S) CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 7.

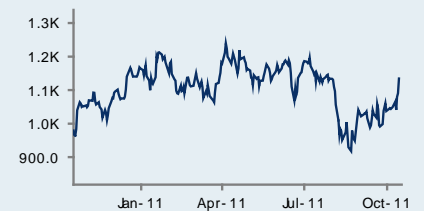
Stock Rating	2-EQUAL WEIGHT Unchanged
Sector View	2-NEUTRAL Unchanged
Price Target	INR 1150.00 Unchanged

Price (17-Oct-2011)	INR 1119.80
Potential Upside/Downside	+3%
Tickers	TCS IN / TCS.NS

Market Cap (INR mn)	2191696
Shares Outstanding (mn)	2957.22
Free Float (%)	26.20
52 Wk Avg Daily Volume (mn)	0.2
Dividend Yield (%)	1.2
Return on Equity TTM (%)	N/A
Current BVPS (INR)	N/A

Source: FactSet Fundamentals

Price Performance	Exchange-BSE
52 Week range	INR 1247.00-902.90



[Link to Barclays Capital Live for interactive charting](#)

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## FY2Q12 results

TCS's results for FY2Q12 (quarter ended September) missed our earnings estimates on weaker margins (EBIT margin of 27.1% vs our expectation of 28.4%). Revenue rose 4.6% in USD terms, lower than our estimate and almost in line with the 4.5% q/q growth delivered by Infosys a couple of days ago. Constant currency revenue growth was 5.3% compared with 5% delivered by Infosys.

**Figure 1: TCS – summary profit and loss statement in INR**

INR m	Sep-10	Jun-11	Sep-11 act	QQ	YY	Sep-11 est	Diff
Revenue	92,864	107,970	116,335	7.7%	25.3%	116,284	0.0%
Gross profit	42,133	47,795	52,619	10.1%	24.9%	51,762	1.7%
EBITDA	27,894	30,310	33,829	11.6%	21.3%	35,393	-4.4%
EBIT	26,008	28,261	31,542	11.6%	21.3%	33,067	-4.6%
Net profit	21,065	23,803	24,388	2.5%	15.8%	26,003	-6.2%
EPS (INR)	10.8	12.2	12.5	2.5%	15.8%	13.3	
Gross margin	45.4%	44.3%	45.2%			44.5%	
EBIT margin	28.0%	26.2%	27.1%			28.4%	
Net margin	22.7%	22.0%	21.0%			22.4%	
INR/US\$	46.3	44.7	46.1			45.8	

Source: Company reports, Barclays Capital

**Figure 2: TCS – summary profit and loss statement in USD**

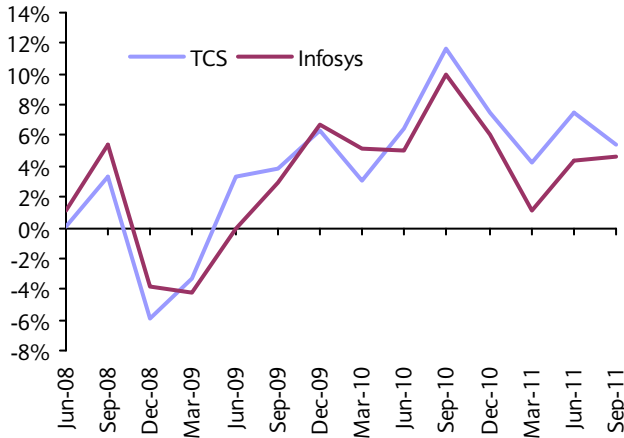
USD m	Sep-10	Jun-11	Sep-11 act	QQ	YY	Sep-11 est	Diff
Revenue	2,004.20	2,413.19	2,525.30	4.6%	26.0%	2,541.72	-0.7%
Gross profit	909.32	1,068.25	1,142.21	6.9%	25.6%	1,131.41	1.0%
EBITDA	602.02	677.44	734.33	8.4%	22.0%	773.62	-5.1%
EBIT	561.31	631.64	684.69	8.4%	22.0%	722.78	-5.3%
Net profit	454.62	532.01	528.39	-0.7%	16.2%	568.38	-7.0%
EPS (USD)	0.23	0.27	0.27			0.29	

Source: Company reports, Barclays Capital

### Relative performance between TCS and Infosys

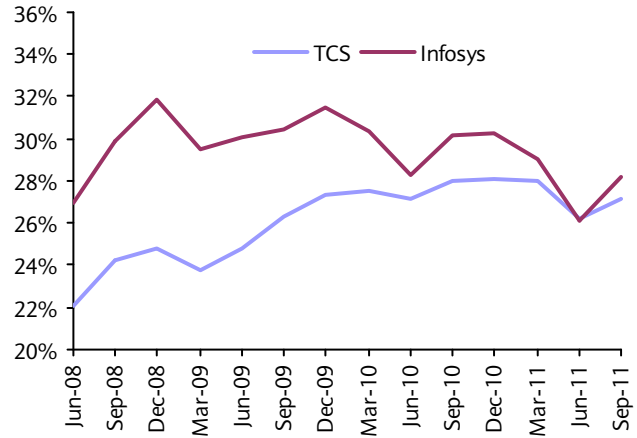
TCS has outperformed Infosys on revenue growth for the past five quarters in addition to closing the margin gap. However, FY2Q12 saw both a convergence of growth profiles and an expansion of the margin gaps in favour of Infosys.

Figure 3: TCS vs Infosys – q/q revenue growth in US\$ terms



Source: Company reports, Barclays Capital

Figure 4: TCS vs Infosys – EBIT margins through the quarters



Source: Company reports, Barclays Capital

Figure 5: Infosys vs TCS – earnings and operating performances

	Infosys	TCS
Revenue growth (constant currency)	5%	5.3%
Volume growth	2.90%	6.25%
Pricing growth	+53bps	-100bps
Margin expansion	+210bps	+94bps
Attrition	15.6%	13.7%
Hiring as % of workforce	6.2%	6.2%
Change in utilization	+100bps	+20bps

Source: Barclays Capital

### Operating metrics

A look at the revenue breakdown by service offering reveals that application development and maintenance and business intelligence both showed sub par growth (+4.4% and +3.6% q/q respectively). Among the verticals, telecom showed a 1.7% q/q decline while media and entertainment showed a lower growth of 1.9% q/q as compared with other industries. Energy and utilities, manufacturing and retail all showed double-digit sequential growth. Lastly, among the geographical regions, growth was fairly uniform except India, which showed a q/q sequential decline of 4.3%.

Figure 6: TCS – Revenue breakdown by service offering

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
ADM and Engg Services	46.9%	49.2%	49.0%	48.6%	48.7%	49.6%	49.1%	47.6%	47.9%	46.8%	45.0%	46.1%	46.2%	44.7%
Business intelligence	9.0%	8.6%	8.1%	6.8%	6.1%	5.7%	5.7%	5.4%	5.4%	5.6%	5.3%	4.9%	4.9%	4.7%
Enterprise solutions	13.0%	12.5%	12.6%	11.8%	10.9%	10.3%	10.5%	10.1%	9.8%	10.3%	9.6%	10.8%	10.8%	11.1%
Assurance services	4.5%	4.4%	4.2%	3.8%	4.4%	4.8%	5.1%	5.8%	6.4%	6.6%	7.1%	7.0%	7.3%	7.6%
Engineering and Industrial services	5.6%	6.0%	6.3%	5.8%	5.2%	5.0%	4.9%	4.8%	4.8%	4.9%	4.8%	4.8%	4.6%	4.8%
Infrastructure services	7.7%	7.5%	8.3%	8.3%	9.3%	8.0%	7.9%	8.3%	8.7%	9.4%	10.5%	9.1%	9.5%	9.6%
Global consulting	3.7%	2.9%	2.5%	1.7%	1.4%	1.6%	2.1%	2.5%	2.1%	2.1%	2.3%	2.1%	2.2%	2.6%
Asset leveraged solutions	3.5%	3.1%	3.2%	2.1%	2.6%	3.2%	3.2%	4.0%	3.7%	3.4%	4.0%	3.6%	3.6%	4.0%
BPO	6.1%	5.8%	5.8%	11.1%	11.4%	11.8%	11.5%	11.5%	11.2%	10.9%	11.4%	11.6%	10.9%	10.9%

Source: Company data

Figure 7: TCS – Revenue breakdown by industry vertical

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Financial Services	42.5%	41.9%	41.9%	42.8%	43.9%	45.0%	45.0%	44.4%	44.7%	44.0%	44.6%	44.0%	43.3%	43.5%
Manufacturing	10.7%	11.0%	10.6%	9.8%	9.2%	8.7%	8.3%	8.3%	7.4%	7.4%	7.2%	7.5%	7.6%	7.8%
Telecom	15.5%	15.3%	13.8%	13.1%	12.6%	12.0%	12.1%	12.1%	12.7%	12.8%	11.9%	11.0%	11.7%	10.7%
Retail and distribution	8.6%	9.0%	11.2%	12.0%	12.2%	12.0%	12.0%	12.3%	11.0%	10.9%	10.9%	11.2%	11.6%	12.1%
Hi Tech	7.0%	6.9%	6.7%	5.5%	4.9%	4.8%	5.0%	5.1%	4.6%	4.6%	5.0%	5.4%	5.8%	5.9%
Life Sciences and Health Care	5.3%	4.8%	5.2%	5.7%	5.7%	6.0%	5.9%	6.1%	5.2%	5.1%	5.2%	5.3%	5.2%	5.3%
Transportation	4.3%	4.6%	3.7%	3.8%	3.7%	3.5%	3.4%	3.5%	3.1%	3.2%	3.4%	3.9%	3.7%	3.8%
Energy and utilities	2.9%	3.0%	2.6%	2.7%	2.7%	2.8%	3.4%	3.3%	3.3%	4.3%	4.4%	4.6%	3.8%	4.3%
Media and entertainment	1.7%	1.7%	2.0%	2.1%	2.2%	2.2%	2.1%	2.1%	1.9%	2.0%	2.3%	2.3%	2.2%	2.1%
Others	1.5%	1.8%	2.3%	2.5%	2.9%	3.0%	2.8%	2.8%	6.1%	5.7%	5.1%	4.8%	5.1%	4.5%

Source: Company data

Figure 8: TCS – Revenue breakdown by geography

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Americas	51.1%	49.7%	52.2%	52.4%	52.3%	53.4%	52.5%	54.0%	55.0%	53.7%	53.5%	53.4%	52.9%	53.4%
Ibero America	4.1%	4.7%	5.1%	4.8%	4.6%	5.0%	4.9%	4.4%	4.3%	3.9%	3.1%	3.2%	3.1%	3.0%
UK	19.5%	20.2%	18.5%	17.9%	16.9%	16.5%	16.0%	15.2%	15.1%	15.3%	16.0%	15.5%	15.3%	15.5%
Europe	10.1%	10.5%	10.7%	10.8%	11.0%	10.6%	10.4%	10.0%	8.9%	9.1%	9.3%	9.9%	9.9%	10.1%
India	8.7%	7.8%	6.8%	8.2%	9.1%	7.3%	8.5%	8.9%	8.8%	9.9%	9.2%	8.8%	9.3%	8.3%
Asia Pacific	4.9%	5.3%	5.0%	3.9%	4.3%	5.3%	5.6%	5.6%	5.9%	6.2%	6.9%	7.2%	7.3%	7.5%
MEA	1.6%	1.8%	1.7%	2.0%	1.8%	1.9%	2.1%	1.9%	2.0%	1.9%	2.0%	2.0%	2.2%	2.2%

Source: Barclays Capital

### Volume trends favourable, pricing shows a decline

In line with its peer Infosys, TCS continued to show impressive volume growth of 6.25% sequentially even though it has now shown two consecutive quarters of pricing decline (-100bps in Sep-11 quarter) due to realizations (-95 bps) and effort mix (-5 bps). However, management expects pricing to remain steady going forward.

### Hiring robust

With overall IT services outsourcing demand remaining strong, TCS continued to hire aggressively, having hired 12.6K people in the quarter (6% of the current workforce) and ended the quarter at 215K people.

Figure 9: TCS – employee metrics

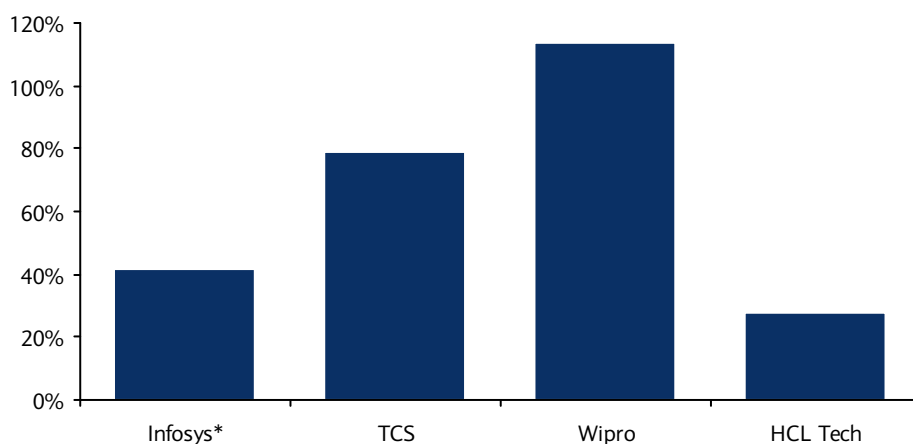
	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Total employees (including Indian subsidiaries)	130,343	143,761	141,642	141,962	149,654	160,429	163,700	174,417	186,914	198,614	202,190	214,770
Gross addition	11,773	3,522	2,828	5,530	11,377	14,640	8,464	17,121	16,847	19,324	11,988	20,349
Net addition	8,692	521	2,119	320	7,417	10,110	2,320	10,229	10,827	11,700	3,576	12,580
Attrition	11.9%	11.4%	11.5%	11.4%	11.5%	11.8%	13.1%	14.1%	14.4%	14.4%	14.8%	13.7%

Source: Company reports

### Currency trends

TCS has a much larger percentage of revenues hedged vs Infosys (80% of revenue vs 40% for Infosys) thereby limiting any gain in a depreciating Indian rupee scenario and potentially exposing it to mark-to-market losses. Even in FY2Q12, foreign currency related losses at Rs0.91bn – though lesser than expectations – were still significant.

Figure 10: TCS – foreign exchange cover as a percentage of revenue vs peers

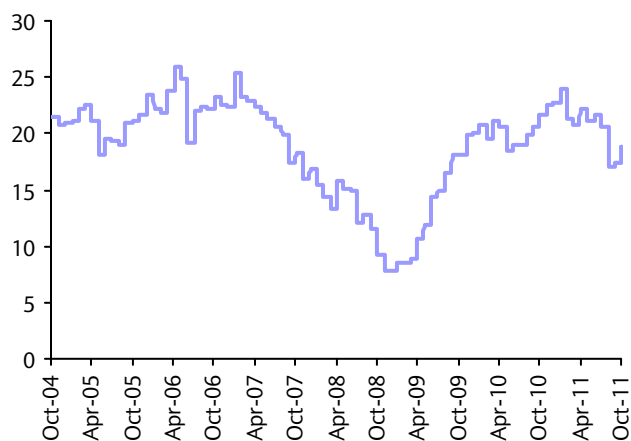


Source: Barclays Capital

## Valuations

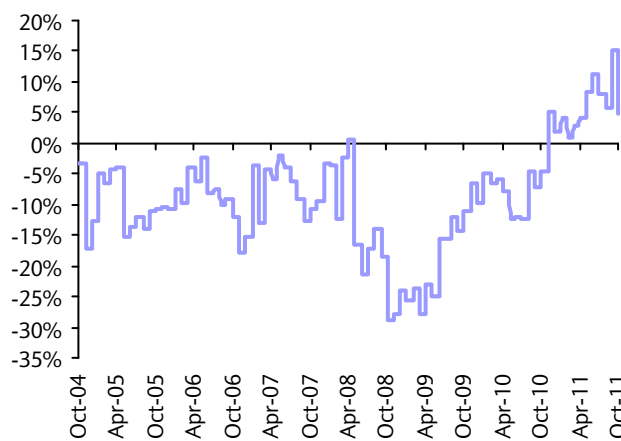
Despite the recent relative underperformance vs Infosys, TCS still trades at a 5% premium on 12-month forward P/E. With slowing growth and the widening of margin gap vs Infosys, this valuation gap should converge and potentially even reverse.

Figure 11: TCS – 12 month forward P/Es



Source: Datastream

Figure 12: TCS – 12 month forward P/Es relative to Infosys, still at a premium



Source: Datastream

## Estimate changes

Post the earnings miss for the quarter, we streamline our model, resulting in 3-5% EPS declines for next three years. With TCS's valuation being the highest among its peers, we retain our 2-Equal Weight rating and a 12-month price target of Rs1,150.

Figure 13: TCS – Changes to Barclays Capital estimates

Rs mn	Earlier			Revised			% change vs. earlier		
	FY3/12E	FY3/13E	FY3/14E	FY3/12E	FY3/13E	FY3/14E	FY3/12E	FY3/13E	FY3/14E
Rs/US\$	45.7	44.5	44.5	45.8	44.5	44.5	0.2%	0.0%	0.0%
Revenues (Rs mn)	476,158	561,405	667,322	471,872	540,401	637,848	-0.9%	-3.7%	-4.4%
Revenues (\$ mn)	10,408	12,616	14,996	10,297	12,144	14,334	-1.1%	-3.7%	-4.4%
YoY growth (\$)	27.1%	21.2%	18.9%	25.7%	17.9%	18.0%			
EBIT (Rs mn)	132,690	150,653	177,205	129,072	141,982	166,086	-2.7%	-5.8%	-6.3%
EBIT margins	27.9%	26.8%	26.6%	27.4%	26.3%	26.0%			
EBITDA	142,074	162,096	190,548	138,409	153,411	179,416	-2.6%	-5.4%	-5.8%
EBITDA margins	29.8%	28.9%	28.6%	29.3%	28.4%	28.1%			
PBT	138,539	156,573	186,533	134,486	150,088	177,736	-2.9%	-4.1%	-4.7%
PAT	107,239	120,443	145,216	103,542	115,406	137,454	-3.4%	-4.2%	-5.3%
Adjusted PAT	105,988	119,005	143,562	102,387	114,077	135,926	-3.4%	-4.1%	-5.3%
Net margins	22.3%	21.2%	21.5%	21.7%	21.1%	21.3%			
EPS (Rs/share)	54.15	60.80	73.35	52.31	58.29	69.45			

Source: Barclays Capital estimates

## ANALYST(S) CERTIFICATION(S)

I, Bhuvnesh Singh, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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### Primary Stocks (Ticker, Date, Price)

Tata Consultancy Services (TCS.NS, 17-Oct-2011, INR 1119.80), 2-Equal Weight/2-Neutral

### Materially Mentioned Stocks (Ticker, Date, Price)

Infosys Ltd. (INFY.NS, 17-Oct-2011, INR 2747.25), 1-Overweight/2-Neutral

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In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

### Stock Rating

**1-Overweight** - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

**2-Equal Weight** - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

**3-Underweight** - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

**RS-Rating Suspended** - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including when Barclays Capital is acting in an advisory capacity in a merger or strategic transaction involving the company.

### Sector View

**1-Positive** - sector coverage universe fundamentals/valuations are improving.

**2-Neutral** - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

**3-Negative** - sector coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "sector coverage universe":

Asia Ex-Japan Software & IT Services

HCL Technologies (HCLT.NS)

Infosys Ltd. (INFY.NS)

Tata Consultancy Services (TCS.NS)

Wipro Limited (WIPR.NS)

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44% have been assigned a 1-Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 58% of companies with this rating are investment banking clients of the Firm.

## IMPORTANT DISCLOSURES CONTINUED

41% have been assigned a 2-Equal Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 51% of companies with this rating are investment banking clients of the Firm.

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### Guide to the Barclays Capital Price Target:

Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent potential upside/potential downside to each analyst's price target over the same 12-month period.

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IMPORTANT DISCLOSURES CONTINUED

**Tata Consultancy Services (TCS IN / TCS.NS)**  
**INR 1119.80 (17-Oct-2011)**

Stock Rating

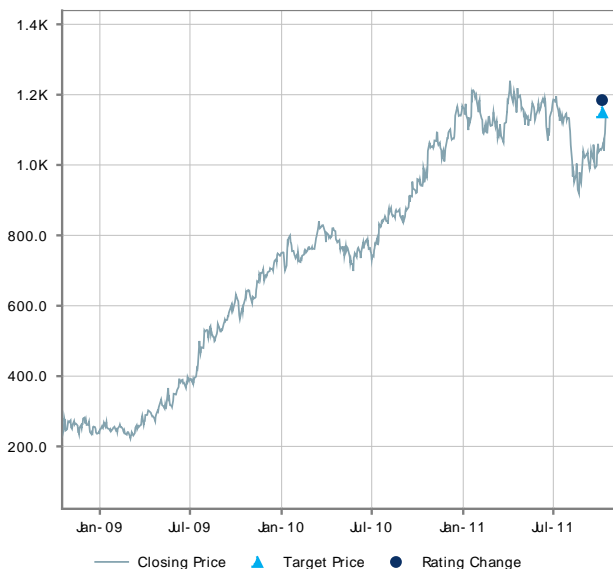
Sector View

**2-EQUAL WEIGHT**

**2-NEUTRAL**

Rating and Price Target Chart - INR (as of 17-Oct-2011)

Currency=INR



Date	Closing Price	Rating	Price Target
07-Oct-2011	1043.50	2-Equal Weight	1150.00

[Link to Barclays Capital Live for interactive charting](#)

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**Valuation Methodology:** Our 12-month target price of INR1,150 for TCS is based on a P/E of 17.5x, which we apply to the average of our EPS estimates for FY2013 and FY2014, or INR67. For TCS, we apply the same target multiple we use for Infosys given that we estimate that TCS's operating profit will grow in line with Infosys, although its EPS growth could be slower. Our target multiple for Infosys is in line with Infosys's past five-year average.

**Risks which May Impede the Achievement of the Price Target:** The key risks to the downside that could keep our price target from being achieved, in our view, are a weak macroeconomic backdrop and market weakness that would cause earnings forecast downgrades and multiple contraction. TCS trades at the highest multiple amongst the Indian IT services peers. On the other hand, a stronger-than-expected rebound in the macroeconomic situation poses an upside risk. TCS's high exposure to the Financial Services vertical means that an uptick in banks' discretionary spending in such a situation could mean disproportionately high gains for the company.

IMPORTANT DISCLOSURES CONTINUED

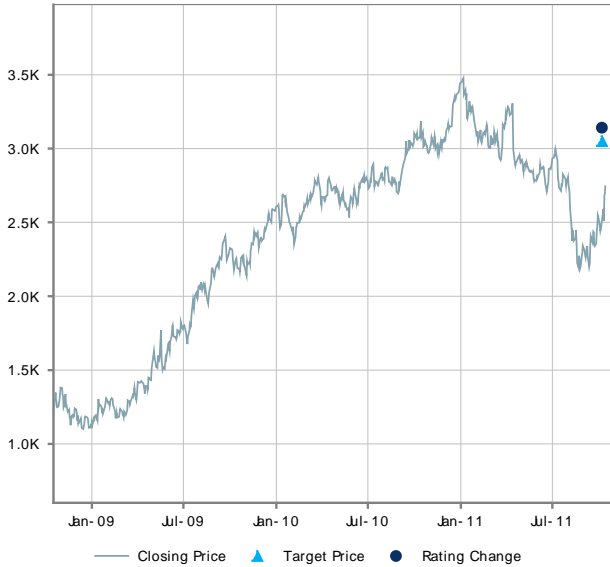
**Infosys Ltd. (INFO IN / INFY.NS)**  
**INR 2747.25 (17-Oct-2011)**

Stock Rating  
**1-OVERWEIGHT**

Sector View  
**2-NEUTRAL**

Rating and Price Target Chart - INR (as of 17-Oct-2011)

Currency=INR



Date	Closing Price	Rating	Price Target
07-Oct-2011	2454.30	1-Overweight	3050.00

[Link to Barclays Capital Live for interactive charting](#)

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**Valuation Methodology:** Our 12-month target price of INR3,050 for Infosys is based on a P/E of 17.5x, which we apply to the average of our EPS estimates for FY2013 and FY2014, which is INR171. Our target multiple for Infosys is in line with Infosys's past five-year average.

**Risks which May Impede the Achievement of the Price Target:** The risks that could keep our price target from being achieved, in our view, include the following: 1) a weaker global macroeconomic scenario could slow down the process of incremental business from new and existing customers; 2) management changes over the past couple of years have caused some overhang, with any further shuffle in top management being a risk; and 3) demand unevenness has caused some issues in management of staffing levels that has had a margin impact and should be monitored.

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