

## Equities

17 October 2011 | 11 pages

# Tata Consultancy Services (TCS.BO)

## Inline Q2FY12 Result

- Revenue growth of 4.7% qoq** — TCS reported a steady quarter with 4.7% qoq revenue growth to \$2525m (our exp: \$2540m). Growth in constant currency was ~5.3% qoq with ~6.3% volume growth and some pricing decline due to mix (as per TCS management).
- Net profit in line with consensus** — EBIT margins expanded by ~94bps qoq (CIRA exp: + 80bps) with currency benefits being partly offset by rate/productivity. Forex loss was lower than our expectations at Rs. 910m. Net profit at Rs. 24.4b was in line with our and consensus expectations (CIRA exp: Rs. 24.5b).
- Key takeaways from the earnings call** — (a) 6.3% volume growth in the quarter (b) 10 deals in the quarter in the range of \$100m or more (c) Pipeline looks healthy and there is no negative news from customers at this point (d) Maintained its target of hiring ~60k employees for FY12 (e) Pricing outlook stable (f) TCS has made ~35k campus offers for next year so far – campus wages flat yoy (g) Q3 to see some impact of holiday season and shutdowns in manufacturing and hi-tech industries.
- Takeaways from Infosys/TCS results and commentary** — (a) Both companies reported ~4.5%-4.7% growth in the seasonally strongest quarter (b) TCS had better volume growth while Infosys delivered better reported pricing (c) Both companies maintained reasonably positive outlook with stable pricing (d) While Infosys expects growth to be equally distributed across quarters this year, TCS does expect some impact of the holiday season on Q3 performance.
- Trades at ~20x 1-yr forward; maintain Neutral** — TCS had a steady Q2 – however, lack of positive surprises (which the street seemed to factor in) could be a little disappointing to some investors. Inline results and uncertain macro are unlikely to drive any upgrades to consensus. The stock already trades at ~20x 1-year forward – we maintain our Neutral rating on the stock.

### Statistical Abstract

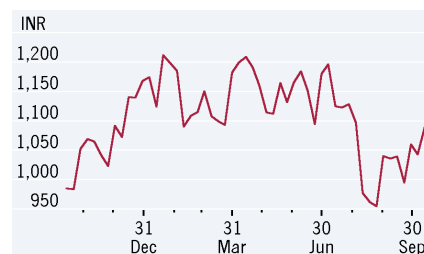
Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	68,729	35.11	32.9	31.9	10.5	37.6	1.8
2011A	87,167	44.53	26.8	25.1	8.6	37.5	1.3
2012E	106,259	54.28	21.9	20.6	6.6	36.2	1.3
2013E	117,190	59.87	10.3	18.7	5.2	31.2	1.3
2014E	132,653	67.77	13.2	16.5	4.2	28.1	1.3

Source: Powered by dataCentral

### Company Update

<b>Neutral</b>	<b>2</b>
Price (17 Oct 11)	Rs1,119.80
Target price	Rs1,140.00
Expected share price return	1.8%
Expected dividend yield	1.3%
<b>Expected total return</b>	<b>3.1%</b>
Market Cap	Rs2,191,696M
	US\$44,710M

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



### Surendra Goyal, CFA

 +91-22-6631-9870  
 surendra.goyal@citi.com

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
<b>Valuation Ratios</b>					
P/E adjusted (x)	31.9	25.1	20.6	18.7	16.5
EV/EBITDA adjusted (x)	24.7	18.9	14.8	13.3	11.7
P/BV (x)	10.5	8.6	6.6	5.2	4.2
Dividend yield (%)	1.8	1.3	1.3	1.3	1.3
<b>Per Share Data (Rs)</b>					
EPS adjusted	35.11	44.53	54.28	59.87	67.77
EPS reported	35.11	44.53	54.28	59.87	67.77
BVPS	106.97	130.29	169.56	214.43	267.19
DPS	20.00	14.00	14.00	15.00	15.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	300,289	373,245	483,296	539,650	603,223
Operating expenses	-220,698	-268,472	-349,915	-395,646	-445,237
<b>EBIT</b>	<b>79,591</b>	<b>104,773</b>	<b>133,381</b>	<b>144,003</b>	<b>157,985</b>
Net interest expense	2,255	5,324	6,523	8,609	14,109
Non-operating/exceptionals	-10	0	0	0	0
<b>Pre-tax profit</b>	<b>81,836</b>	<b>110,097</b>	<b>139,903</b>	<b>152,612</b>	<b>172,094</b>
Tax	-12,089	-21,739	-32,520	-34,298	-38,317
Extraord./Min.Int./Pref.div.	-1,018	-1,191	-1,124	-1,124	-1,124
<b>Reported net income</b>	<b>68,729</b>	<b>87,167</b>	<b>106,259</b>	<b>117,190</b>	<b>132,653</b>
Adjusted earnings	68,729	87,167	106,259	117,190	132,653
Adjusted EBITDA	86,800	111,987	142,561	154,257	169,447
<b>Growth Rates (%)</b>					
Sales	8.0	24.3	29.5	11.7	11.8
EBIT adjusted	20.6	31.6	27.3	8.0	9.7
EBITDA adjusted	20.9	29.0	27.3	8.2	9.8
EPS adjusted	32.9	26.8	21.9	10.3	13.2
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>73,128</b>	<b>75,108</b>	<b>81,459</b>	<b>113,302</b>	<b>120,895</b>
Depreciation/amortization	7,209	7,214	9,180	10,253	11,461
Net working capital	-1,573	-15,140	-28,581	-6,656	-10,235
<b>Investing cash flow</b>	<b>-53,920</b>	<b>13,887</b>	<b>-36,995</b>	<b>-28,734</b>	<b>-24,080</b>
Capital expenditure	-11,421	-17,504	-26,824	-22,675	-25,849
Acquisitions/disposals	-16,404	25,135	8,327	8,309	13,809
<b>Financing cash flow</b>	<b>-17,851</b>	<b>-42,203</b>	<b>-29,440</b>	<b>-29,363</b>	<b>-29,363</b>
Borrowings	-2,651	-55	-56	0	0
Dividends paid	-39,151	-27,405	-27,405	-29,363	-29,363
<b>Change in cash</b>	<b>1,357</b>	<b>46,792</b>	<b>15,024</b>	<b>55,206</b>	<b>67,452</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>276,213</b>	<b>327,883</b>	<b>428,527</b>	<b>525,934</b>	<b>640,032</b>
Cash & cash equivalent	46,774	54,875	85,469	154,217	232,885
Accounts receivable	58,098	82,007	106,325	116,025	129,693
Net fixed assets	41,706	51,996	69,640	82,062	96,449
<b>Total liabilities</b>	<b>63,041</b>	<b>69,692</b>	<b>93,461</b>	<b>103,041</b>	<b>113,849</b>
Accounts payable	0	0	0	0	0
Total Debt	2,418	384	328	328	328
<b>Shareholders' funds</b>	<b>213,172</b>	<b>258,191</b>	<b>335,066</b>	<b>422,893</b>	<b>526,183</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	28.9	30.0	29.5	28.6	28.1
ROE adjusted	37.6	37.5	36.2	31.2	28.1
ROIC adjusted	48.5	49.6	46.0	43.5	43.7
Net debt to equity	-20.8	-21.1	-25.4	-36.4	-44.2
Total debt to capital	1.1	0.1	0.1	0.1	0.1

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## Key Highlights

- Volume growth was 6.3% qoq while pricing declined on reported basis, resulting in constant currency growth of ~5.3% qoq.
- India business witnessed a decline while LATAM was muted – all other geographies witnessed decent growth trends. Both North America and Europe delivered above company average growth.
- In terms of service lines, application development and maintenance was slow while growth was led by enterprise solutions, infrastructure services, assurance services, engineering services and products.
- Growth was good across verticals except telecom, which witnessed a qoq decline. BFSI growth was largely in line with company average.
- Currency had a positive impact of +166bps on margins while rate/productivity impacted margins by 73 bps. These along with other smaller factors, resulted in margin expansion of ~94 bps qoq.
- DSOs came down from 84 days to 82 days qoq.
- Hedges outstanding at the end of the quarter were ~\$1.2b.
- Losses in other comprehensive line of balance sheet at the end of the quarter were ~ Rs. 5.3b.
- Utilization is expected to continue between 82 and 84%.
- Variable payout in the quarter was 100% - more or less the same as the prior quarter.
- FY12 tax rate is expected to be ~24%.

## Result Tables

Figure 1. Key Financials

Rs m	2Q11	1Q12	2Q12	QoQ	YoY
Revenue (\$ m)	2,004	2,412	2,525	4.7%	26.0%
<b>Revenue</b>	<b>92,864</b>	<b>107,970</b>	<b>116,335</b>	<b>7.7%</b>	<b>25.3%</b>
Cost of revenue	51,107	60,175	63,716	5.9%	24.7%
Gross profit	41,757	47,795	52,619	10.1%	26.0%
Gross margin	45.0%	44.3%	45.2%	96bp	26bp
Operating expenses	15,644	19,534	21,076	7.9%	34.7%
<b>EBIT</b>	<b>26,113</b>	<b>28,261</b>	<b>31,543</b>	<b>11.6%</b>	<b>20.8%</b>
<b>EBIT margin</b>	<b>28.1%</b>	<b>26.2%</b>	<b>27.1%</b>	<b>94bp</b>	<b>-101bp</b>
Depreciation & amortization	1,660	2,049	2,286	11.6%	37.7%
<b>EBITDA</b>	<b>27,773</b>	<b>30,310</b>	<b>33,829</b>	<b>11.6%</b>	<b>21.8%</b>
<b>EBITDA margin</b>	<b>29.9%</b>	<b>28.1%</b>	<b>29.1%</b>	<b>101bp</b>	<b>-83bp</b>
Other income	861	2,090	997	-52.3%	15.8%
Profit before tax	26,556	31,147	32,540	4.5%	22.5%
Income tax expense	-5,001	-7,063	-7,913	12.0%	58.2%
Income from operations	21,555	24,084	24,627	2.3%	14.3%
Affiliates/Minority	-295	-281	-237	-15.7%	-19.7%
Net profit	21,260	23,803	24,390	2.5%	14.7%
<b>EPS - basic &amp; diluted</b>	<b>10.86</b>	<b>12.16</b>	<b>12.46</b>	<b>2.5%</b>	<b>14.7%</b>

Source: Company Reports

Figure 2. Key Client Metrics

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12
Total active clients	930	936	959	969	959	1,010
New clients	36	30	35	39	24	35
<b>Client relationships</b>						
>\$1 m	409	420	434	458	473	495
>\$5 m	191	192	200	208	219	230
>\$10 m	122	131	139	143	148	155
>\$20 m	65	66	76	81	91	94
>\$50 m	24	25	25	27	33	36
<b>Client concentration</b>						
Top client	8.1%	8.0%	7.7%	7.4%	7.1%	6.9%
Top 5 clients	22.0%	22.1%	21.9%	21.4%	20.7%	20.0%
Top 10 clients	30.5%	30.1%	30.1%	29.6%	28.9%	28.3%

Source: Company Reports

Figure 3. Revenue Mix

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12
<b>Geographic Mix</b>						
Americas	59.3%	57.6%	56.6%	56.6%	56.0%	56.4%
Europe	24.0%	24.4%	25.3%	25.4%	25.2%	25.6%
India	8.8%	9.9%	9.2%	8.8%	9.3%	8.3%
Others	7.9%	8.1%	8.9%	9.2%	9.5%	9.7%
<b>Service Mix</b>						
ADM & engineering services	58.1%	57.3%	55.1%	55.8%	55.7%	54.2%
Enterprise solutions & PI	20.6%	21.8%	22.4%	22.0%	22.5%	23.3%
Asset leverages solutions	3.7%	3.4%	4.0%	3.6%	3.6%	4.0%
Others	17.6%	17.5%	18.5%	18.6%	18.2%	18.5%
<b>Vertical Mix</b>						
BFSI	44.7%	44.0%	44.6%	44.0%	43.3%	43.5%
Manufacturing	7.4%	7.4%	7.2%	7.5%	7.6%	7.8%
Telecommunications	12.7%	12.8%	11.9%	11.0%	11.7%	10.7%
Life sciences & healthcare	5.2%	5.1%	5.2%	5.3%	5.2%	5.3%
Retail & distribution	11.0%	10.9%	10.9%	11.2%	11.6%	12.1%
Travel & Hospitality	3.1%	3.2%	3.4%	3.9%	3.7%	3.8%
Energy & utilities	3.3%	4.3%	4.4%	4.6%	3.8%	4.3%
Others	12.6%	12.3%	12.4%	12.5%	13.1%	12.5%

Source: Company Reports

Figure 4. Key Execution Metrics

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12
TCS (Consolidated) headcount	163,700	174,417	186,914	198,614	202,190	214,770
<b>Execution matrices</b>						
Attrition rate (%)	13.1%	14.1%	14.4%	14.4%	14.8%	13.7%
<b>Utilization rate</b>						
Including trainees	74.8%	77.7%	77.1%	75.1%	76.2%	76.4%
Excluding trainees	82.6%	83.8%	83.8%	82.4%	83.2%	83.1%

Source: Company Reports

## Tata Consultancy Services

### Company description

TCS is the largest and among the oldest IT companies in India. It is a part of the diversified Tata Group, one of the largest corporate groups in Asia, with more than 200,000 employees (including subsidiaries). It provides a comprehensive range of IT Services to industries such as Banking and Financial Services, Insurance, Manufacturing, Telecom, Retail and Transportation. It has more than 950 active clients. The company started with data processing work in 1968, and was the first to provide offshore services in 1974. Over the past three decades or so, it has come a long way with deep technical and project management expertise in handling complex client projects and strong offshore processes.

### Investment strategy

We rate TCS as Neutral (2). The company has benefitted significantly from the return of spends in the BFSI segment; however, things could change given the global macro concerns. We have seen good growth in FY11 due to pent-up demand, however, we are concerned that expectations are running ahead of reality. Its earlier valuation discount vis-à-vis Infosys has now turned into a premium.

### Valuation

Our target price of Rs1,140 is based on ~20x Sep'12E EPS. We estimate TCS' earnings will grow at a ~16% CAGR over FY11-13E, and believe the stock should trade closer to the higher end of its historical three-year trading range of 7-24x 12-month forward earnings. We believe PE remains the most appropriate valuation measure, given TCS' past profitability and future earnings visibility.

### Risks

The key downside risks to our investment thesis on TCS are: (1) any significant appreciation of the rupee against the USD/EUR/GBP; (2) a prolonged recession in the US; and (3) any margin-dilutive acquisition. Key upside risks that could cause the shares to be higher than our target price are: (1) any significant depreciation of the rupee against the USD/EUR/GBP; (2) aggressive pent-up demand from corporates in the US; and (3) any margin-accretive acquisition.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our target price.

## Appendix A-1

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Analyst: Surendra Goyal, CFA

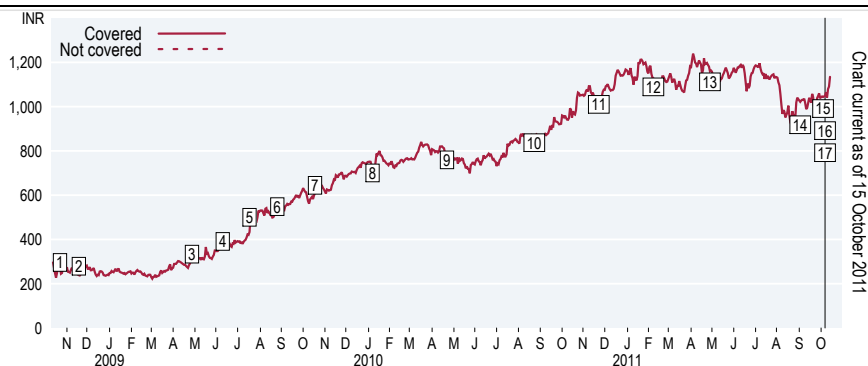


Chart current as of 15 October 2011

Date	Rating	Target Price	Closing Price
1 23-Oct-08	2M	*312.50	273.73
2 19-Nov-08	*2H	*280.00	240.43
3 28-Apr-09	*3M	*307.50	299.30
4 10-Jun-09	*1L	*465.00	390.88
5 17-Jul-09	1L	*525.00	433.60
6 26-Aug-09	1L	*630.00	548.30

\* Indicates change

Date	Rating	Target Price	Closing Price
7 19-Oct-09	1L	*695.00	599.00
8 7-Jan-10	1L	*855.00	714.65
9 22-Apr-10	*2L	855.00	785.30
10 24-Aug-10	2L	*930.00	868.90
11 23-Nov-10	2L	*1,080.00	1,032.20
12 8-Feb-11	2L	*1,185.00	1,128.45

Date	Rating	Target Price	Closing Price
13 28-Apr-11	2L	*1,260.00	1,160.05
14 2-Sep-11	2L	*1,110.00	1,021.65
15 5-Oct-11	2L	*1,140.00	1,043.50
16 7-Oct-11	Stock rating system changed		
17 7-Oct-11	*2	1,140.00	1,048.70

Rating/target price changes above reflect Eastern Standard Time

### Tata Consultancy Services (TCS.BO)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Surendra Goyal, CFA

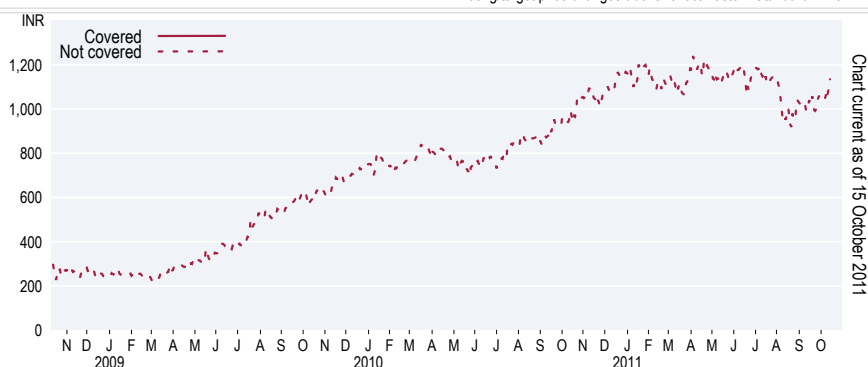


Chart current as of 15 October 2011

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