Tata Consultancy Services

BSE SENSEX	S&P CNX
16,466	4,967
Bloomberg	TCS IN
Equity Shares (m)	1,957.2
52-Week Range (INR)	1,247/903
1,6,12 Rel. Perf. (%)	-10/9/10
M.Cap. (INR b)	2,160.8
M.Cap. (USD b)	42.6

CMP: INR1,104 TP: INR1,268 Neutral

Year End	Net Sales (INR M)	PAT (INR M)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ Sales	EV/ EBITDA
3/10A	300,289	68,729	35.1	33.8	-	-	37.4	41.0	-	-
3/11A	373,245	86,826	44.4	26.3	24.9	8.5	37.4	42.2	5.6	18.8
3/12E	494,357	106,457	54.4	22.6	20.3	6.5	36.5	44.7	4.2	14.1
3/13E	574,305	124,086	63.4	16.6	17.4	5.3	33.7	39.1	3.5	12.4

- TCS' reported revenue in 3QFY12 was in line with estimates (USD2,586m v/s est. of USD2,592m). However, excluding equipment sales, revenue growth in USD terms was 1.7% QoQ v/s our estimate of ex-equipment sales growth of 2.9% QoQ.
- Volume growth of 3.2% (v/s 3.1% for Infosys) was the lowest since 4QFY11. TCS added incremental revenues of a meager USD61m in 3QFY12 v/s USD140m (on a much smaller base) in 3QFY11. This is the second consecutive quarter of convergence in USD revenue growth with Infosys.
- However, realizations improved 198bp QoQ after three consecutive quarters of declines due to a change in portfolio mix, with higher growth in GDCs being a significant contributor.
- PAT beat our estimates by 3.7%, helped by lower-than-expected effective tax rate (22.6% v/s est. of 24%) and greater-than-expected currency benefit (realized INR51.1/USD v/s expectation of INR50.5/USD).
- Management commentary has been toned down v/s previous quarters, with the company indicating that it was seeing a delay in decision making for 50% of its discretionary projects; commentary on pricing continues to be flat with no upward or downward bias.
- We lower our FY13 revenue growth estimates to 12.8% (14.5% earlier). Considering two consecutive quarters of similar revenue growth and a widening gap in EBIT margins v/s Infosys, it is difficult to justify a valuation premium for the stock. Moreover, with 4Q being traditionally weaker than 3Q, and management commentary being toned down, the stock is unlikely to perform in the near term.
- We reiterate a **Neutral** rating with a price target of INR1,268, which discounts our FY13E EPS of INR63.4 by 20x.

TCS Quarterly Performance (IFRS) (INR Million)

Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Revenues	82,173	92,864	96,634	101,575	107,970	116,335	132,040	138,012	373,245	494,357
Q-o-Q Change (%)	6.2	13.0	4.1	5.1	6.3	7.7	13.5	4.5	24.3	32.4
EBITDA	24,088	27,894	29,173	30,738	30,310	33,829	40,921	42,308	111,892	147,368
Margins (%)	29.3	30.0	30.2	30.3	28.1	29.1	31.0	30.7	30.0	29.8
Other Income	831	337	1,817	2,259	2,887	997	-920	-1,238	5,243	1,726
PAT	18,442	21,064	23,301	24,018	23,804	24,390	28,866	29,397	86,826	106,457
Q-o-Q Change (%)	-4.5	14.2	10.6	3.1	-0.9	2.5	18.3	1.8	26.3	22.6
Diluted EPS	9.4	10.8	11.9	12.3	12.2	12.5	14.7	15.0	44.4	54.4
US$ Revenues	1,794	2,004	2,144	2,245	2,412	2,525	2,586	2,654	8,187	10,177
Q-o-Q Change (%)	6.4	11.7	7.0	4.7	7.5	4.7	2.4	2.6	29.1	24.3
Operating Metrics										
Gross Margin (%)	46.5	46.8	47.0	46.9	45.5	46.6	48.0	47.6	46.8	47.0
SGA (%)	17.2	16.7	16.8	16.7	17.5	17.5	17.1	17.0	16.8	17.2
Tax rate (%)	19.1	18.9	18.6	20.8	22.7	24.3	22.6	22.6	19.4	23.0
Net Employee additions	3,271	10,717	12,497	11,700	3,576	12,580	11,981	8,197	38,185	36,334
Utilization - excluding trainees (%)	82.6	83.8	83.8	82.4	83.2	83.1	82.0	81	83.1	82.3
Q-o-Q Volume Growth (%)	8.1	11.2	5.7	2.9	7.5	6.3	3.2	3.3	29.7	20.0
Q-o-Q Realization change (%)	-0.3	-0.3	1.2	0.8	-0.5	-1.0	-1.3	0.1	-0.3	3.8

E: MOSL Estimates

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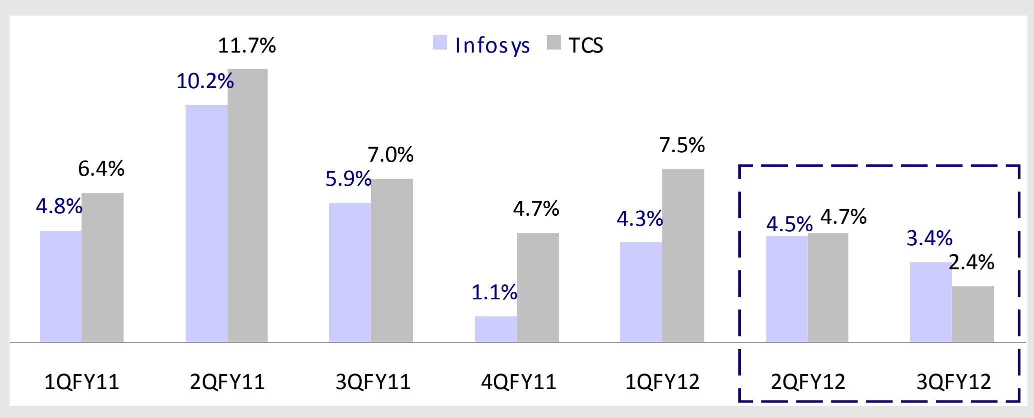
Delay in decision making is no longer an Infosys specific issue

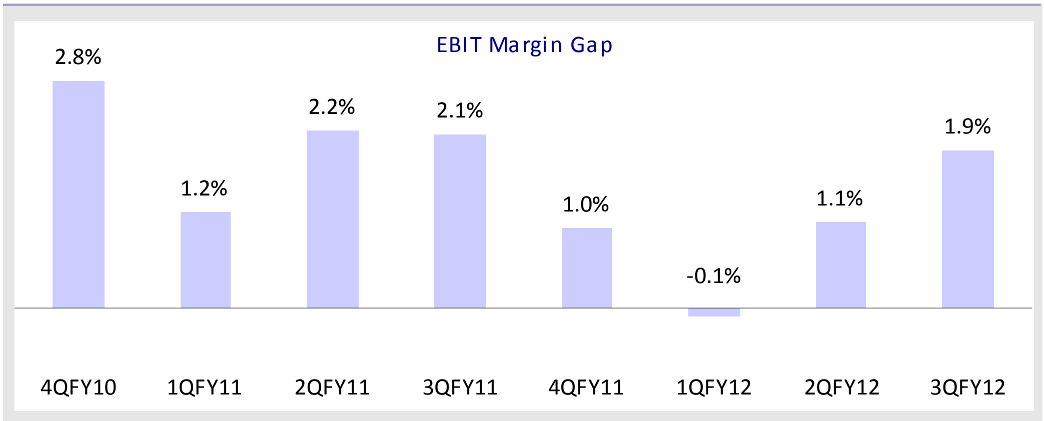
Post 3QFY12, delay in decision making is no longer an Infosys specific issue. TCS, too, is now seeing similar headwinds within its portfolio for discretionary spends. The management indicated that 20-25% of its portfolio was discretionary in nature.

We note that this is the second consecutive quarter of convergence in revenue growth with Infosys and divergence in EBIT margins.

TCS failed to outgrow INFY for the second consecutive quarter



TCS v/s Infosys - EBIT margins are now diverging



Source: Company/MOSL

Reported revenues were in line with est.; the 3.7% PAT outperformance was driven by currency and lower-than-expected effective tax rates

TCS reported revenues of USD2,586m v/s our estimate of USD2,592m, led by stronger-than-estimated growth in hardware sales. The company benefited from a weaker rupee which was 1.2% below our estimates (realized rate of INR51.1 v/s estimates of INR50.5). SG&A expenses, 20bps below our estimates, and the weaker rupee helped drive a 1.5% outperformance on EBIT.

Forex losses at INR2.8b were lower than our estimate of INR3b. Effective tax rate of 22.6% was also below our estimate of 24%.

TCS - Variance analysis (INR m)

	3QFY12A	2QFY12	QoQ %	3QFY11	YoY %	3QFY12E	Var. %
Revenue - USD m	**2,586**	**2,525**	**2.4**	**2,144**	**20.6**	**2,592**	**-0.2**
Revenue - INR m	**132,040**	**116,335**	**13.5**	**96,634**	**36.6**	**130,889**	**0.9**
Cost of revenue	68,604	62,141	10.4	51,186	34.0	67,763	1.2
SG&A	22,515	20,365	10.6	16,275	38.3	22,546	-0.1
EBIT	**38,618**	**31,543**	**22.4**	**27,132**	**42.3**	**38,032**	**1.5**
EBIT %	29.2	27.1	213bp	28.1	117bp	29.1	19bp
Other income	(920)	997	-192.3	1,817	-150.6	(1,095)	-16.0
PBT	37,698	32,540	15.9	28,948	30.2	36,937	2.1
Tax	8,538	7,913	7.9	5,385	58.6	8,865	-3.7
ETR %	22.6	24.3	-167bp	18.6	405bp	24.0	-135bp
Minority Interest	(294)	(237)	24.1	-262.2	12.1	(237)	24.1
PAT	**28,866**	**24,390**	**18.3**	**23,564**	**22.5**	**27,835**	**3.7**

Source: Company/MOSL

Key drivers for INR revenue and EBIT margins

INR Revenue impacts	%	EBIT Margin impacts (IFRS)	(bp)
Cross Currency impact	-2.10	Currency	282
Volume	3.20	GDC	-10
Realization	1.98	Rate/Productivity	-94
Offshore	-0.64	Bad Debts	-10
Currency	11.0	Others	45
Total	**13.4**	**Total**	**213.0**

Source: Company/MOSL

3QFY12 growth drivers: IMS; broad-based growth across verticals

- TCS added incremental revenues of a meager USD61m in 3QFY12 v/s USD140m (on a much smaller base) in 3QFY11.
- IMS alone accounted for 52% of incremental revenues of USD61m added during the quarter.
- From a vertical perspective, growth was broad-based across verticals, with telecom and E&U dragging results to some extent.
- BFSI, Retail and others were key contributors to growth during the quarter.
- North America and Europe together accounted for 76% of incremental revenues during the quarter.
- 97% of incremental revenues were contributed by non-top 10 clients.

Incremental revenue

	3QFY12 (USDm)	Contrib to inc Rev %
BFSI	21	35
Telecom	-12	-19
Manufacturing	5	8
Retail & Distribution	13	21
Life science & Health Care	3	5
Transportation	2	4
Energy & Utility	-3	-4
Others	23	38
Hi-Tech	4	6
Media & Entertainment	4	6
Total	**61**	**100**

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Revising estimates to factor in the delay in discretionary spends and a weaker INR

We revise our INR assumptions to INR50/USD for FY13 v/s INR47.9/USD and INR48.6/USD for FY12 v/s INR47.9 earlier. We reduce our USD revenue growth estimates by 2pp to 12.8% to factor in the delay in discretionary spends and a weakening management commentary. The change in tone by TCS indicates a deteriorating business environment. Our revised EPS estimates are INR54.4 for FY12 and INR63.4 for FY13, up 2% and 1%, respectively, due to changes in INR assumptions.

Change in Estimates

	Revised		Earlier		Change (%)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
INR/USD	48.6	50.0	47.9	47.9	1.4	4.5
USD Revenue (m)	10,177	11,477	10,203	11,720	-0.2	-2.1
EBIT Margin (%)	27.9	26.4	27.9	26.7	0bp	-35bp
EPS (INR)	54.4	63.4	53.2	62.7	2.2	1.0

Source: MOSL

Other result highlights

- TCS won 9 large deals during the quarter.
- The company added 40 new clients during the quarter (v/s 49 additions at Infosys). TCS ended the quarter with 1,003 active clients v/s 1,010 at the end of 2QFY12.
- DSO days were 81 v/s 82 in 2QFY12.
- Utilization excluding trainees declined 1pp QoQ to 82% (v/s 83.1% in 2Q). Utilization including trainees slid further (2.4pp QoQ) to 74% (v/s 76.4% in 2Q).
- Gross employee additions during the quarter were 18,907 while net additions stood at 11,981, taking the total employee count to 226,751.
- Attrition rate was 12.8% (v/s 14.4% in 2QFY12).
- Contribution from Fixed Price contracts declined 40bp QoQ to 46.4%, the lowest in 12 quarters.

QoQ growth (%)

	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12
Service Lines										
ADM	5.8	5.2	0.0	7.1	9.2	2.9	7.3	7.7	1.3	0.8
Business Intelligence	-2.9	6.3	-2.3	6.4	15.9	1.	-3.2	7.5	0.4	-4.1
Engineering & Industrial Services	-0.1	8.4	-2.9	6.4	14.0	4.8	4.7	3.0	9.2	-1.9
Infrastructure Services	-10.6	5.0	8.3	11.5	20.7	19.5	-9.3	12.2	5.8	13.1
Enterprise Solutions	-1.8	8.4	-0.8	3.2	17.4	-0.3	17.8	7.5	7.6	5.2
Global Consulting	18.8	39.5	22.8	-10.6	11.7	17.2	-4.4	12.6	23.7	10.3
Asset Leverage Solutions	27.9	6.3	28.9	-1.6	2.7	25.9	-5.8	7.5	16.3	-2.7
Assurance Services	13.4	13.0	17.3	17.4	15.2	15.1	3.2	12.1	9.0	2.4
BPO	7.6	3.6	3.1	3.6	8.7	11.9	6.5	1.0	4.7	1.5
Industry Verticals										
BFSI	7.5	5.6	4.5	4.3	10.0	8.4	3.3	5.7	5.2	1.9
Manufacturing	-2.1	-0.2	4.5	0.9	11.7	4.1	9.1	8.3	8.0	2.4
Telecom	-1.6	8.0	-0.9	10.8	12.6	-0.5	-3.2	14.3	-4.3	-4.3
Life Sciences & Healthcare	8.2	6.3	5.1	6.4	9.6	9.1	6.7	5.4	6.7	2.4
Retail & Distribution	2.0	7.3	7.0	7.4	10.7	7.0	7.6	11.3	9.2	4.1
Transportation	-2.4	9.7	3.1	3.1	15.3	13.7	20.1	1.9	7.5	2.4
Energy and Utilities	12.2	33.9	-9.0	17.0	45.6	9.5	9.5	-11.2	18.5	-2.3
Media & Entertainment	3.9	6.3	-2.3	12.3	17.6	23.0	4.7	2.8	-0.1	7.3
Hi-Tech	-0.9	6.3	10.7	11.2	11.7	16.3	13.1	15.4	6.5	2.4
Others	2.4	4.7	-6.4	10.0	4.4	-4.3	-1.5	14.2	-7.6	20.6
Client growth										
Top Client	24.0	26.6	4.4	5.1	10.3	3.0	0.6	3.1	1.7	2.4
Top 5	9.8	11.5	4.6	7.4	12.2	6.0	2.3	3.9	1.1	0.4
Top 10	7.3	10.0	4.2	7.5	10.3	7.0	3.0	4.9	2.5	0.2
Non top 10 Clients	2.6	4.8	2.7	5.9	12.4	7.0	5.4	8.5	5.6	3.3
Geographies										
America	6.1	4.5	6.1	8.4	9.1	6.6	4.5	6.5	5.7	2.2
UK	1.5	3.1	-2.0	5.7	13.2	11.9	1.4	6.1	6.1	-0.9
Rest of Europe	0.1	4.3	-0.8	-5.3	14.2	9.3	11.4	7.5	6.8	6.5
Europe	0.9	3.6	-1.6	1.3	13.6	10.9	5.1	6.6	6.3	2.0
India	-16.6	23.8	8.0	5.2	25.7	-0.6	0.1	13.6	-6.6	3.6
APAC	28.1	12.3	3.1	12.1	17.4	19.1	9.2	9.0	7.6	3.8
Ibero America	13.0	4.2	-7.4	4.0	1.3	-15.0	8.1	4.1	1.3	5.8
MEA	9.7	17.5	-6.7	12.0	6.1	12.6	4.7	18.2	4.7	-2.2
Others	18.5	9.8	-2.6	9.1	9.9	7.0	8.2	9.2	5.5	3.2
Offshore	7.5	5.3	2.0	6.9	11.1	7.4	3.0	7.5	6.5	1.5
Onsite	2.0	4.4	5.3	6.5	12.1	6.3	7.7	7.1	6.8	1.9
GDC	26.4	4.9	-10.6	2.6	7.1	4.6	7.4	-1.7	-10.3	18.0
Overall International business	6.0	4.9	2.6	6.5	11.3	6.7	5.3	6.9	5.8	2.3
Domestic Business	-17.2	24.1	8.4	5.2	15.5	9.3	-0.9	13.6	-6.6	3.6

Source: Company/MOSL

Tata Consultancy Services: an investment profile

Company description

TCS is the largest IT services company in India, with (LTM) revenues of over USD9.3b. It employs more than 226,000 people and provides IT and BPO services to over 900 global clients. It is one of the preferred IT vendors for most Fortune 500/Global 1,000 companies.

Key investment arguments

- Despite the prevailing macroeconomic headwinds, TCS' stance remains bullish, and the company is set to beat its earlier FY12 gross hiring guidance of 60,000 despite attrition rates staying in control.
- Traction for the company has been broad-based; the company bagged 10 large deals across industries.
- TCS is one of the largest players in IMS, the key growth driver for the industry.

Key investment risks

- The appreciation of the rupee and continued attrition could hamper profitability.
- Slowdown in BFSI due to the prevailing threat of a sovereign default in Europe.
- Supply side pressures could also affect deliveries.

Recent developments

- TCS closed 10 large deals across various verticals in 3QFY12.
- TCS' cloud-based non-linear platform for Life and Pensions industry has been adopted by a large insurance provider in the UK in a multi-billion dollar engagement.

Valuation and view

- We expect TCS to report revenue CAGR of 18.4% over FY11-13 and EPS CAGR of 19.5% over this period.
- Valuations at 20.3x FY12E earnings and 17.4x FY13E; we maintain our **Neutral** rating with a target price of INR1,268, based on 20x FY13E earnings.

Sector view

- In the last few months, increasingly weak macro economic data have been emanating from both the US and Europe, which implies deceleration in growth for Indian IT services.
- Initial commentary on CY12 budgets indicates a moderation in growth across the sector, resulting from a possible 3-4% cut in budgets as in 2003 (v/s 6-8% in CY08).
- We reckon frontline Indian IT companies would be better placed to sail through the near-term challenges mentioned above. Niche IT/ITeS services companies with strong business models are also likely to be better placed to face uncertainties in the near term.

Comparative valuations

		TCS	Infosys	Wipro
P/E (x)	FY12E	20.3	19.1	16.1
	FY13E	17.4	17.3	14.7
P/BV (x)	FY12E	6.5	4.8	3.1
	FY13E	5.3	4.2	2.6
EV/Sales (x)	FY12E	4.2	4.0	2.2
	FY13E	3.5	3.5	1.9
EV/EBITDA (x)	FY12E	14.1	12.9	11.3
	FY13E	12.4	11.2	9.9

Shareholding pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	74.1	74.1	74.0
Domestic Inst	8.1	8.1	8.1
Foreign	12.8	12.8	12.4
Others	5.0	5.0	5.4

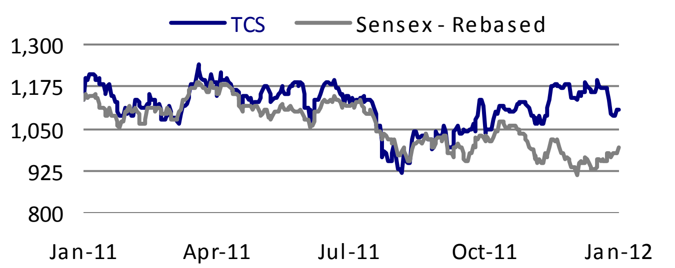
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	54.4	54.7	-0.5
FY13	63.4	63.6	-0.4

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
1,104	1,268	14.9	Neutral

Stock performance (1 year)



Financials and Valuations

Income statement					(INR Million)
Y/E March	2009	2010	2011	2012E	2013E
Sales	278,129	300,289	373,245	494,357	574,305
Change (%)	21.7	8.0	24.3	32.4	16.2
Cost of Services	150,745	157,243	198,505	261,808	312,545
SG&A Expenses	55,606	56,246	62,848	85,181	99,155
EBITDA	71,778	86,800	111,892	147,368	162,605
% of Net Sales	25.8	28.9	30.0	29.8	28.3
Depreciation	5,765	7,209	7,990	9,323	11,154
Other Income	-4,673	2,255	5,243	1,726	11,227
PBT	61,340	81,846	109,145	139,771	162,679
Tax	9,362	12,088	21,203	32,208	37,416
Rate (%)	15.3	14.8	19.4	23.0	23.0
Eq. in earnings of af	-7	-10	0	0	0
Minority Interest	604	1,019	1,116	1,106	1,176
PAT	51,367	68,729	86,826	106,457	124,086
Extraordinary	350	0	0	0	0
Net Income	51,717	68,729	86,826	106,457	124,086
Change (%)	3.0	32.9	26.3	22.6	16.6

Balance Sheet					(INR Million)
Y/E March	2009	2010	2011	2012E	2013E
Share Capital	979	1,957	1,957	1,957	1,957
Reserves	155,567	207,427	250,432	327,170	404,314
Net Worth	156,545	209,384	252,389	329,127	406,271
Preference shares	1,000	1,000	1,000	1,000	1,000
Minority Interest	3,098	4,056	4,663	3,274	3,274
Loans	4,505	9,110	10,718	14,912	15,814
Capital Employed	165,149	223,549	268,771	348,312	426,360
Gross Block	57,959	69,379	88,003	100,353	104,288
Less : Depreciation	20,464	27,673	35,663	35,663	35,663
Net Block	37,495	41,706	52,340	64,690	68,625
Other LT Assets	62,353	54,920	89,929	92,323	97,126
Investments	17,257	37,799	18,390	12,173	12,173
Curr. Assets	109,753	140,120	171,948	257,458	334,321
Debtors	75,276	70,109	95,479	141,825	150,428
Cash & Bank Balanc	13,440	10,249	47,401	89,225	155,882
Loans & Advances					
Other Current Assets	21,037	59,762	29,068	26,409	28,011
Current Liab. & Prov	61,709	50,996	63,837	78,332	85,886
Current Liabilities	61,709	50,996	63,837	78,332	85,886
Net Current Assets	48,044	89,124	108,111	179,126	248,435
Misc Expenses	2	2	2	2	2
Application of Funds	165,149	223,549	268,771	348,312	426,360

E: MOSL Estimates

Ratios *					
Y/E March	2009	2010	2011	2012E	2013E
Basic (Rs)					
EPS	26.2	35.1	44.4	54.4	63.4
Cash EPS	29.2	38.8	48.4	59.2	69.1
Book Value	80.5	107.5	129.5	168.7	208.1
DPS	7.0	20.0	14.0	17.0	20.5
Payout %	26.7	57.0	31.6	31.3	32.3
Valuation (x)					
P/E			24.9	20.3	17.4
Cash P/E			22.8	18.7	16.0
EV/EBITDA			18.8	14.1	12.4
EV/Sales			5.6	4.2	3.5
Price/Book Value			8.5	6.5	5.3
Dividend Yield (%)			1.3	1.5	1.9
Profitability Ratios (%)					
RoE	36.4	37.4	37.4	36.5	33.7
RoCE	44.2	41.0	42.2	44.7	39.1
Turnover Ratios					
Debtors (Days)	94	88	81	88	93
Fixed Asset Turnove	8.2	7.6	7.9	8.4	8.6

* 1:1 bonus in FY07, accordingly ratios are adjusted

Cash Flow Statement					(INR Million)
Y/E March	2009	2010	2011	2012E	2013E
CF from Operations	57,132	75,856	94,816	115,780	135,240
Cash for Working Ca	6,792	-44,271	18,165	-29,192	-2,651
Net Operating CF	63,925	31,585	112,981	86,588	132,589
Net Purchase of FA	-50,234	-3,987	-53,633	-24,066	-19,892
Net Purchase of Inve	9,568	-20,461	19,409	6,217	0
Net Cash from Invest.	-40,666	-24,448	-34,224	-17,849	-19,892
Proc from equity iss	-2,164	30,864	-11,154	7,818	0
Proceeds from LTB/S	-1,978	4,605	1,608	4,194	903
Net Cash Withdrawn by Tata Sons					
Dividend Payments	-16,029	-45,797	-32,058	-38,927	-46,942
Cash Flow from Fin.	-20,171	-10,328	-41,604	-26,916	-46,039
Free Cash Flow	13,691	27,598	59,348	62,522	112,696
Net Cash Flow	3,088	-3,191	37,153	41,823	66,657
Opening Cash Bal.	10,352	13,440	10,249	47,401	89,225
Add: Net Cash	3,088	-3,191	37,153	41,823	66,657
Closing Cash Bal.	13,440	10,249	47,401	89,225	155,882

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