Result Update

Tata Consultancy Services Ltd

October 20, 2009

Ratings			
CMP	609	Recommendation	ADD
Target	660	Risk	MEDIUM

Bloomberg Consensus	
(BUY/HOLD/SELL)	30 / 12 / 6

Sensex	Nifty	BSE IT
17,326	5,142	4,387

Codes

BSE	NSE	Bloomberg	Reuters
532540	TCS	TCS IB	TCS.BO

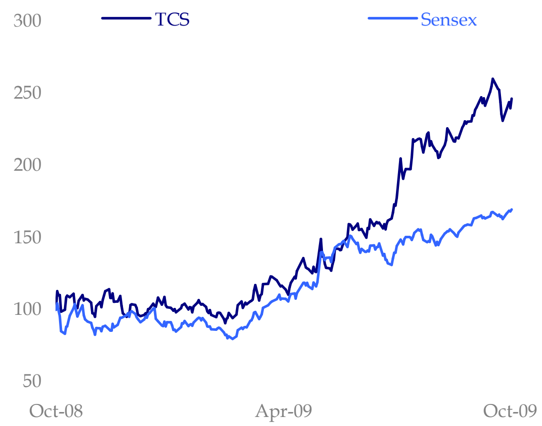
	Sensex	TCS
52 Wk: Hi/Lo	17,196/7,697	648/209
Life High	21,207-Jan 08	699-Jan 07
P/E	22.39	24.99
P/BV	4.18	8.93
Dividend Yield (%)	1.10	1.18
Mkt Cap (INR Mn)	58,675,527	119,125
Equity (INR Mn)	-	19,572

** - TTM standalone basis Capitaline*

Share Holding Pattern %	Mar-09	Jun-09
Foreign	10.00	11.20
Institutions	7.86	7.54
Corporate	0.68	0.73
Promoters	76.21	75.09
Public & Others	5.25	5.44

Returns %	Abs	Relative to	
	Perf	Sensex	BSE IT
1 Month	4.26	0.76	7.97
3 Months	22.21	8.16	5.53
1 Year	150.35	80.87	90.33

Relative Price Performance



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- Strong sequential QoQ volumes growth of 5%
- EBIT margin expansion 144 bps QoQ
- Management expects to hold margins
- Interim dividend of Rs 2 per share

TCS reported revenue of USD 1,538 mn, 3.9% sequential growth, exceeding our expectations of USD ~1,515 mn. Higher volumes, aggressive cost control measures and staggered employee hiring plans resulted into strong operating performance. Net income in rupee terms grew 6.8% sequentially.

TCS management comments remain fairly upbeat about growth going forward, however suggested rate of recovery will be slow. The company committed to honour campus offers made for the year, however joining has been realigned with demand recovery.

M&A and integration related work and recovery in insurance client accounts resulted into strong 6.5% sequential growth in revenues from BFSI. Management believes worst is behind in three troubled verticals namely manufacturing, high-tech and telecom, however demand is likely to remain weak and significant uptick is not expected in near future.

We have revised FY10E and FY11E earning estimates up by ~8% and ~6% respectively after factoring in strong H1, lower tax rate assumptions and better cost control. We maintain ADD with a revised target price of Rs 660 at 18x FY11E earnings.

Consolidated results for the quarter ended September 30, 2009

- ✓ Revenue was Rs 74,350 mn; 6.9% YoY growth
- ✓ Net income was Rs 16,239 mn; 28.7% YoY growth
- ✓ EPS increased to Rs 8.3; 28.7% YoY growth

Financial Summary

Descriptions INR Mn	FY07	FY08	FY09	FY10E	FY11E
Revenue	186,334	226,175	278,129	295,708	337,731
EBIT	46,447	51,212	66,015	75,422	83,757
Profit Before Tax	48,390	58,100	61,343	75,406	87,047
Net Profit	41,316	50,190	51,721	63,149	71,754
EPS (INR)	21.1	25.6	26.4	32.3	36.7
P/E	28.9	23.8	23.1	18.9	16.6

Key Highlights

✓ **Revenue Growth:** TCS reported 3.9% growth in USD revenues sequentially, led by 5% volume growth.

Description (%)	QoQ
Volume Growth	5.0
Pricing Decline	-1.4
Effort Mix Change (Offshore Shift)	-1.4
Foreign Exchange	0.9
Growth in INR	**3.2**

✓ **Margin:** EBIT margin improved by 144 bps sequentially to 26.3% mainly because of lower SG & A expenses (lower bench cost - higher utilization rates including trainees) and offshore shift. Management announced 150% variable pay in 2Q considering better than expected performance. Bad debts & provision for doubtful debts increased by ~20 bps sequentially.

Description (bps)	QoQ
Productivity improvement	81
Promotion and additional variable pay-out	-94
Foreign exchange	20
Offshore shift	16
SG & A efficiencies	121
Net Impact (bps)	**144**

✓ **Clients:** Top client contributed 6.8% of revenues with sequential growth of 23.9% (~35% of incremental revenues). Top 10 clients' contributed 28.9% of the revenues and reported sequential growth of 7.2% in USD terms. USD 1-5, 5-10 and 10-20 mn brackets reported declines of 7, 5 and 5 clients respectively. Number of clients in USD 20-50 mn bracket increased by 3. Total number of clients declined sharply from 933 to 896 despite 30 new client additions during the quarter, loss of 67 clients.

No. of Clients	Q2'07	Q3'07	Q4'07	Q1'08	Q2'08	Q3'08	Q4'08	Q1'09	Q2'09	Q3'09	Q4'09	Q1'10	Q2'10
USD 1-5 mn	169	174	178	196	195	209	215	215	229	229	233	245	238
USD 5-10 mn	35	40	44	41	47	41	43	42	60	54	61	65	60
USD 10-20 mn	38	37	36	40	41	44	44	51	53	53	49	54	49
USD 20-50 mn	17	22	25	27	33	34	37	33	33	36	38	36	39
USD 50-100 mn	13	13	11	12	12	12	12	14	15	16	17	17	17
USD 100+ mn	2	2	3	6	6	7	7	7	7	7	7	6	6
New clients added	58	55	43	62	51	54	53	35	51	41	36	26	30
Active clients	742	754	780	771	814	857	904	885	920	965	985	933	896

✓ **Employee:** Gross addition of 5,530 employees (net addition of 320) during the quarter. The parent company has added 1,820 trainees and 1,189 laterals in India during the quarter. The company has made 24,885 campus offers for FY10 out of which 1,820 joined in Q2 and 8,000 likely to join in Q3. Campus visits in FY10 gets delayed and would start in Q4 when students are in their last semester.

✓ **Attrition:** During the quarter attrition rate decreased by 10 bps to 11.4% on LTM basis. Attrition rate in IT services increased by 10 bps sequentially to 10.8% on LTM basis, and in BPO decreased by 180 bps to 18% on LTM basis.

Positives from the result and management comments

- ✓ 1H numbers are better than market expectations
- ✓ Management commentary turned incrementally positive on business outlook, albeit expect slow recovery
- ✓ Management expects to hold margin at current levels – EBIT improved ~260 bps in last 2 quarters
- ✓ Macro economic indicators shows sign of recovery
- ✓ Cost cutting exercise on full stream
- ✓ Top client grew by 23.9% sequentially, contributed ~35% of total incremental revenues
- ✓ Utilization levels incl. trainees and excl. trainees improved by 230 bps and 30 bps respectively – Fresher hiring in coming quarters would have negative impact
- ✓ Top telecom client bottomed out and likely to stabilize or grow modestly from current levels

Negatives from the results and management comments

- ✓ Manufacturing, hi-tech and Telecom remain under pressure and likely to drag down growth in coming quarters
- ✓ Management guides slow recovery
- ✓ IT spending likely to be tightly controlled and monitored very carefully by clients.
- ✓ Appreciating rupee remains major risk.
- ✓ Net loss on derivative instruments of USD 49.6 mn recognized in accumulated other comprehensive income as of September 30, 2009, is expected to be reclassified into earnings by September 30, 2010.

2QFY10 and 1HFY10 Financial Results

Descriptions (INR Mn)	**Q2FY10 Sept-09**	**Q1FY10 Jun-09**	*% QoQ Growth*	**Q2FY09 Sept-08**	*% YoY Growth*	**H1FY10 Sept-09**	**H1FY09 Sept-08**	*% YoY Growth*
Revenue	**74,351**	**72,070**	*3.2*	**69,534**	*6.9*	**146,421**	**133,641**	*9.6*
Cost of Revenue	40,311	39,238	*2.7*	37,752	*6.8*	79,549	74,899	*6.2*
Gross Margin	**34,040**	**32,832**	*3.7*	**31,782**	*7.1*	**66,872**	**58,742**	*13.8*
GPM (%)	45.8	45.6		45.7		45.7	44.0	
SG & A Expenses	14,509	14,940	*-2.9*	14,934	*-2.8*	29,449	27,747	*6.1*
Operating income	**19,531**	**17,892**	*9.2*	**16,848**	*15.9*	**37,423**	**30,995**	*20.7*
OPM (%)	26.3	24.8		24.2		25.6	23.2	
Other Income (Expense), Net	-144	194		-1,784		50	-1,452	
Income Before Income Taxes	**19,387**	**18,086**	*7.2*	**15,064**	*28.7*	**37,473**	**29,543**	*26.8*
PBITM (%)	26.1	25.1		21.7		25.6	22.1	
Income Taxes	2,909	2,655	*9.5*	2,291	*26.9*	5,564	4,238	*31.3*
Equity in Net Earnings of Affiliates	0	-2		-7		-2	-6	
Income After Income Taxes	**16,478**	**15,429**	*6.8*	**12,766**	*29.1*	**31,907**	**25,300**	*26.1*
PBTM (%)	22.2	21.4		18.4		21.8	18.9	
Minority Interest	240	226	*6.0*	151	*58.7*	466	248	*87.8*
Net Income	**16,239**	**15,203**	*6.8*	**12,615**	*28.7*	**31,442**	**25,052**	*25.5*
PATM (%)	21.8	21.1		18.1		21.5	18.7	
Adj. EPS (INR)	**8.3**	**7.8**	**6.8**	**6.4**	**28.7**	**16.1**	**12.8**	**25.5**

Revenue by Service Line

Strong demand continues for ADM. Pending business decisions by client saw delays in enterprise solutions and product implementation spend.

Descriptions (%)	As % of Revenue Sep-09	Jun-09	Sep-08	*Q-o-Q Growth*	*Y-o-Y Growth*
Application Development & Maintenance	49.6	48.7	49.2	*5.8*	*-1.5*
Business Intelligence	5.7	6.1	8.6	*-2.9*	*-35.3*
Enterprise Solutions	10.3	10.9	12.5	*-1.8*	*-19.5*
Assurance Services	4.8	4.4	4.4	*13.3*	*6.6*
Engineering & Industrial Services	5.0	5.2	6.0	*-0.1*	*-18.6*
Infrastructure Services	8.0	9.3	7.5	*-10.6*	*4.2*
Global Consulting	1.6	1.4	2.9	*18.7*	*-46.1*
Asset Leveraged Solutions	3.2	2.6	3.1	*27.8*	*0.8*
BPO	11.8	11.4	5.8	*7.5*	*98.7*
	100.0	**100.0**	**100.0**	***3.9***	***-2.3***

Revenue by Geographies

Strong market presence helps to capitalize on emerging US recovery. Wins in public sector, energy and retail help mute continued weakness in UK. The challenging economic environment in Europe is putting pressure.

Revenue by Geography	As of Revenues Sep-09	Jun-09	Sep-08	*Q-o-Q Growth*	*Y-o-Y Growth*
North Americas	53.4	52.3	49.7	*6.1*	*5.0*
Ibero America	5.0	4.6	4.7	*12.9*	*3.9*
UK	16.5	16.9	20.2	*1.4*	*-20.2*
Continental Europe	10.6	11.0	10.5	*0.1*	*-1.4*
India	7.3	9.1	7.8	*-16.7*	*-8.6*
Asia Pacific	5.3	4.3	5.3	*28.0*	*-2.3*
MEA	1.9	1.8	1.8	*9.6*	*3.1*
	100.0	**100.0**	**100.0**	***3.9***	***-2.3***

Revenue by Verticals

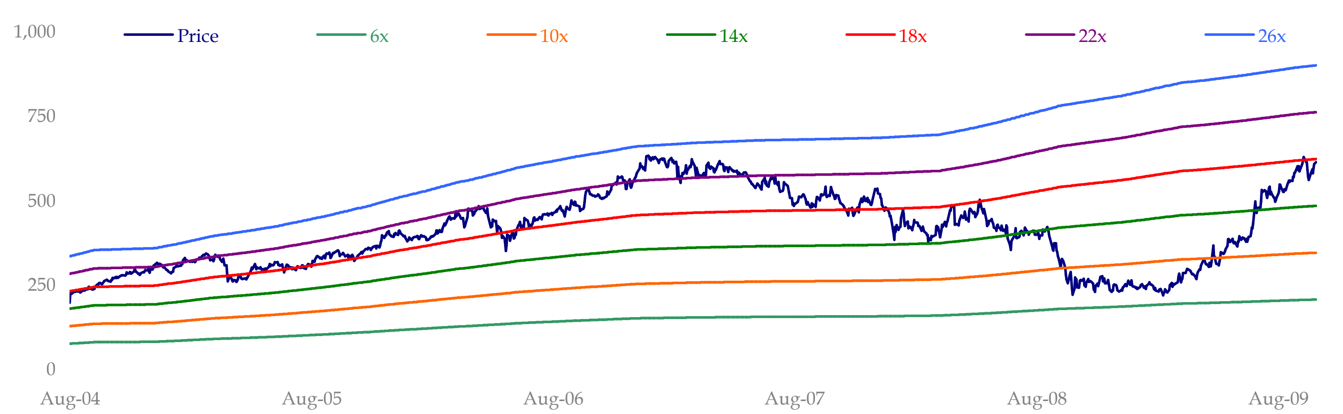
BFSI continues to show good traction largely due to M&A and integration, cost restructuring, and customer recovery. Telecom, Hi-tech and Manufacturing performance remains subdued this quarter also.

Revenue by Verticals	As of Revenues Sep-09	Jun-09	Sep-08	*Q-o-Q Growth*	*Y-o-Y Growth*
BFSI	45.0	43.9	41.9	*6.5*	*4.9*
Telecom	12.0	12.6	15.3	*-1.1*	*-23.4*
Manufacturing	8.7	9.2	11.0	*-1.8*	*-22.7*
Retail & Distribution	12.0	12.2	9.0	*2.2*	*30.3*
Hi-tech	4.8	4.9	6.9	*1.8*	*-32.0*
Life Sciences & Healthcare	6.0	5.7	4.8	*9.3*	*22.1*
Travel & Hospitality	3.5	3.7	4.6	*-1.7*	*-25.7*
Energy & Utilities	2.8	2.7	3.0	*7.7*	*-8.8*
Media & Entertainment	2.2	2.2	1.7	*3.9*	*26.4*
Others	3.0	2.9	1.8	*7.5*	*62.8*
	100.0	**100.0**	**100.0**	***3.9***	***-2.3***

Financial Summary

Description (INR Mn)	FY2006	FY2007	FY2008	FY2009	FY2010E	FY2011E
Income Statement						
Income	132,550	186,334	226,175	278,129	295,708	337,731
Total Expenses	98,349	139,887	212,114	174,963	220,286	253,974
EBIT	34,202	46,447	51,212	66,015	75,422	83,757
PBT	34,459	48,390	58,100	61,343	75,406	87,047
Net Profit	28,968	41,316	50,190	51,721	63,149	71,754
Balance Sheet						
Total Shareholder's Equity	59,972	91,782	126,120	159,644	207,463	259,409
Other Liabilities	1,949	6,906	7,483	5,505	5,457	5,877
	61,920	**98,688**	**133,602**	**165,149**	**212,920**	**265,286**
Net Fixed Assets	15,072	22,912	30,214	37,495	40,500	45,000
Goodwill and Intangibles	8,692	13,978	14,738	34,146	34,124	34,124
Net Working Capital	21,930	30,601	41,396	34,604	44,654	50,605
Other Assets	4,988	6,194	10,399	28,194	17,742	20,264
Cash and Cash Equivalents	11,239	25,002	36,855	30,711	75,900	115,293
	61,920	**98,688**	**133,602**	**165,149**	**212,920**	**265,286**
Key Financial Ratio						
EBIDTAM (%)	27.9	27.2	25.2	25.8	28.0	26.7
EBITM (%)	25.8	24.9	22.7	23.4	25.5	24.8
PBTM (%)	26.0	26.0	25.7	22.1	25.5	25.8
NPM (%)	21.9	22.2	22.2	18.6	21.4	21.2
Adj. EPS (INR)	14.8	21.1	25.6	26.5	32.3	36.7
Adj. BVPS (INR)	29.8	45.8	63.3	80.0	104.4	130.8
Adj. Dividend/Share (INR)	3.4	5.8	7.0	7.0	8.0	8.5
Revenue Growth (%)	36.3	40.6	21.4	23.0	6.3	14.2
NP Growth (%)	41.2	42.6	21.5	3.1	22.0	13.6
EPS Growth (%)	38.5	42.6	21.5	3.2	22.0	13.6

Forward P/E



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KSL Ratings

Target Price refers to one year unless specified; CMP: Last closing price

BUY: Expected return >15%

ADD: Expected return 0-15%

REDUCE: Expected decline 0-15%

SELL: Expected decline >15%

Company Risk is based on the systematic risk of the stock. (1-year Beta)

HIGH: >1.2

MEDIUM: 0.8-1.2

LOW: < 0.8

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