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Company Update | IT

September 10, 2013

TCS

Analyst Meet Update

NEUTRAL	
CMP	₹1,984
Target Price	-
Investment Period	-

Stock Info	
Sector	IT
Market Cap (₹ cr)	389,003
Net debt (₹ cr)	(16,694)
Beta	0.5
52 Week High / Low	2,076/1,198
Avg. Daily Volume	120,601
Face Value (₹)	1
BSE Sensex	19,270
Nifty	5,680
Reuters Code	TCS.BO
Bloomberg Code	TCS@IN

Shareholding Pattern (%)	
Promoters	74.0
MF / Banks / Indian FIs	5.9
FII / NRIs / OCBs	15.7
Indian Public / Others	4.5

Abs. (%)	3m	1yr	3yr
Sensex	(1.3)	11.1	3.8
TCS	35.0	44.4	133.0

Tata Consultancy Services (TCS) hosted an analyst briefing. Following are the key takeaways:

Strong demand environment, broadcasted growth: TCS' Management indicated that the overall demand remains good and in line with its expectations, and that 1HFY2014 should see positive seasonal tailwinds. While core markets (the US and Europe) are tracking overall trends, emerging markets would remain lumpy. In the US geography, the Management indicated that growth is more broad-based. Demand is predominantly from existing customers on new technology and new IT spends. The projects are smaller in size, but clients are taking decisions around discretionary IT spending as well. Growth is likely to be dominated by market penetration in the European geography and new client addition. The deals are more of large total outsourcing deals, a trend witnessed by Indian IT vendors in the early part of last decade. As far as emerging markets are concerned, India continues to be volatile.

Growth is likely to be robust across industry verticals barring telecom, which as per the Management, is going through structural difficulties. However, recent deal wins in this space will assist revenue growth. Growth is expected to be strong across service lines, especially in discretionary services. TCS indicated that discretionary spending was improving in the US across verticals with clients spending more on revamping their front-end systems.

2Q growth to be strong: For 2QFY2014, the Management indicated that USD revenue growth is expected to be strong as suggested at the beginning of the year. Seasonality for the full year is playing as expected (2Q is the strongest quarter seasonally for Indian IT companies), with growth in 1H expected to be stronger than that in the second half of the financial year FY2014. Pricing is expected to remain stable and growth is expected to be driven by volumes in the quarter. We model in a USD revenue growth of 5.0% qoq for 2QFY2014, taking into account the negative cross currency impact. Full quarter revenue from ALTI (the recent acquisition done by TCS), expected at ~EUR30mn, will compound growth during the quarter (will contribute ~1.1% to growth).

Operating margin expected to increase sharply: In the current quarter, TCS' operating margin has faced marginal headwinds from promotion-linked impacts and integration of ALTI whose margins are lower. However, excluding the impact of currency fluctuation, the company expects margins to be comparable to that in the last quarter, aided by healthy revenue growth. Depreciation in INR is expected to provide a margin tailwind benefit of ~275-350bp qoq. We are currently modeling in a qoq EBIT margin expansion of 280bp to 29.9% for 2QFY2014.

Forex losses on hedge positions: TCS' Management indicated that during 2QFY2014, the company is expected to incur forex losses to the tune of ₹550-650cr, largely on account of range forward options, assuming Re/USD range of 65-68. It be noted that 50% of TCS' hedges are in the form of options, a fair portion of which could be range forward options.

Ankita Somani
+91 22 39357800 Ext: 6819
ankita.somani@angelbroking.com

The Management indicated that range forwards were used since they are cheaper. In addition, TCS will likely carry forward losses of between ₹300-700cr in the balance sheet and the same will flow into the P&L in the subsequent quarters. Our PAT estimate for the quarter stands at ₹4,560cr, up 20% qoq.

TCS to wait for stability before reinvestment of Rupee benefit: TCS will continue to seek opportunities to invest in emerging markets and service lines. The big issue is to move into the non-English speaking geographies. The domestic currency, at current levels, gives an additional degree of flexibility. The pace of Rupee depreciation has been so sharp that the company has not yet invested the Rupee gains in the near term. If the Rupee remains at current levels, TCS will reinvest the benefits into the business over the medium term. The Management indicated that it reinvested Rupee gains in the business in the past as opposed to offering discounts/passing on Rupee benefits to clients. Instead of passing the benefits to clients, the approach is more towards reinvesting in newer segments. Having said that, these are extreme situations, and so the Management will also keep a watch on competition.

Outlook and Valuation: We expect TCS to grow its USD revenues at a CAGR of 15% over FY2013-15 and EPS at a CAGR of 20% during this period. We believe TCS will continue to lead industry growth while maintaining its profitability. TCS has executed well over the past many quarters and currently trades at 21.6x FY2014E and 19.3x FY2015E EPS. After the sharp upmove YTD, we believe that TCS' valuations are rich and build in a relatively strong operational performance. **Keeping that in notice, we maintain Neutral rating on the stock with target price being ₹2,065.**

Exhibit 1: Key Financials (Consolidated)

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014E	FY2015E
Net sales	**37,324**	**48,891**	**62,988**	**82,186**	**91,561**
% chg	*24.3*	*31.0*	*28.8*	*30.5*	*11.4*
Net profit	**8,715**	**10,636**	**13,942**	**18,042**	**20,203**
% chg	*26.8*	*22.0*	*31.1*	*29.4*	*12.0*
EBITDA (%)	30.0	29.5	28.7	30.4	30.0
EPS (₹)	**44.5**	**54.3**	**71.2**	**92.2**	**103.2**
P/E (x)	44.6	36.6	27.9	21.6	19.3
P/BV (x)	15.3	12.0	9.5	7.0	5.7
RoE (%)	34.3	32.7	34.0	32.5	29.5
RoCE (%)	32.0	32.8	32.7	34.1	30.7
EV/Sales (x)	10.2	7.8	5.9	4.5	4.0
EV/EBITDA (x)	34.1	26.3	20.7	14.8	13.3

Source: Company, Angel Research; Note: CMP as of Sept. 6, 2013

Exhibit 2: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	*Upside (%)*	FY2015E EBITDA (%)	FY2015E P/E (x)	FY2012-15E EPS CAGR (%)	FY2015E EV/Sales (x)	FY2015E RoE (%)
HCL Tech	Accumulate	1,016	1070	*5.3*	22.6	13.7	27.1	1.7	23.7
Hexaware	Neutral	125	-	-	21.5	9.4	14.5	1.2	24.0
Infosys	Neutral	3,021	-	-	27.1	15.1	11.2	2.5	20.0
Infotech Enterprises	Neutral	188	-	-	17.6	8.1	16.9	0.5	14.3
KPIT Cummins	Buy	132	155	*17.1*	17.8	8.0	27.5	0.6	19.5
Mindtree	Neutral	1,035	-	-	20.7	9.3	27.5	1.0	21.2
Mphasis	Neutral	419	-	-	17.2	9.6	4.9	0.6	14.0
NIIT	Neutral	20	-	-	9.1	3.8	(7.1)	0.0	11.9
Persistent	Neutral	569	-	-	23.8	10.0	17.1	0.8	16.2
TCS	Neutral	1,988	-	-	30.0	19.3	23.8	4.0	29.5
Tech Mahindra	Accumulate	1,359	1,485	*9.3*	21.0	11.9	13.5	0.5	22.8
Wipro	Neutral	468	-	-	22.2	14.2	13.3	1.9	20.1

Source: Company, Angel Research

Research Team Tel: 022 - 39357800 E-mail: research@angelbroking.com Website: www.angelbroking.com

DISCLAIMER

Disclosure of Interest Statement	TCS
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to -15%)	*Sell (< -15%)*	

6th Floor, Ackruti Star, Central Road, MIDC, Andheri (E), Mumbai- 400 093. Tel: (022) 39357800

Research Team

Fundamental:

Sarabjit Kour Nangra	VP-Research, Pharmaceutical	sarabjit@angelbroking.com
Vaibhav Agrawal	VP-Research, Banking	vaibhav.agrawal@angelbroking.com
Bhavesh Chauhan	Sr. Analyst (Metals & Mining)	bhaveshu.chauhan@angelbroking.com
Viral Shah	Sr. Analyst (Infrastructure)	viralk.shah@angelbroking.com
V Srinivasan	Analyst (Cement, FMCG)	v.srinivasan@angelbroking.com
Yaresh Kothari	Analyst (Automobile)	yareshb.kothari@angelbroking.com
Ankita Somani	Analyst (IT, Telecom)	ankita.somani@angelbroking.com
Sourabh Taparia	Analyst (Banking)	sourabh.taparia@angelbroking.com
Bhupali Gursale	Economist	bhupali.gursale@angelbroking.com
Vinay Rachh	Research Associate	vinay.rachh@angelbroking.com
Amit Patil	Research Associate	amit.patil@angelbroking.com
Twinkle Gosar	Research Associate	gosar.twinkle@angelbroking.com
Tejashwini Kumari	Research Associate	tejashwini.kumari@angelbroking.com
Akshay Narang	Research Associate	akshay.narang@angelbroking.com
Harshal Patkar	Research Associate	harshal.patkar@angelbroking.com
Nishant Sharma	Research Associate	nishantj.sharma@angelbroking.com

Technicals:

Shardul Kulkarni	Sr. Technical Analyst	shardul.kulkarni@angelbroking.com
Sameet Chavan	Technical Analyst	sameet.chavan@angelbroking.com
Sacchitanand Uttekar	Technical Analyst	sacchitanand.uttekar@angelbroking.com

Derivatives:

Siddarth Bhamre	Head - Derivatives	siddarth.bhamre@angelbroking.com

Institutional Sales Team:

Mayuresh Joshi	VP - Institutional Sales	mayuresh.joshi@angelbroking.com
Meenakshi Chavan	Dealer	meenakshis.chavan@angelbroking.com
Gaurang Tisani	Dealer	gaurangp.tisani@angelbroking.com
Akshay Shah	Sr. Executive	akshayr.shah@angelbroking.com

Production Team:

Tejas Vahalia	Research Editor	tejas.vahalia@angelbroking.com
Dilip Patel	Production Incharge	dilipm.patel@angelbroking.com