KRChoksey INSTITUTIONAL

Tata Consultancy Services Ltd.

RESULT UPDATE

14th July, 2017

TCS Ltd.

Revenues in line, Margins disappoint

CMP	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 2446	**INR 2675**	**9.5%**	**4678615**	**Accumulate**	**IT**

Result highlights

•In dollar terms, Net Sales in Q1 FY18 stood at $4,591 Mn which was marginally below our estimate of $4,606 Mn and reported a growth of 3.1% qoq and 5.2% yoy

•**By Geography:** Continental Europe led the growth figures with a 5.9% qoq growth, followed by Latin America at 2.8% qoq and India at 1.5% qoq. North America bounced back after a decline in Q4FY17 and grew at 1.7% qoq.

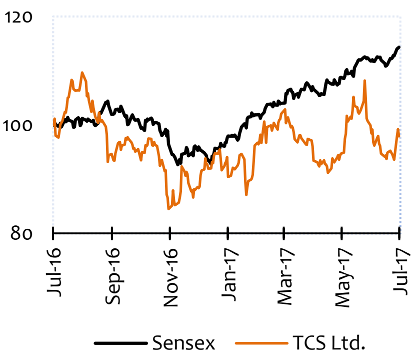
•**By Industry:** Energy and Utilities led the pack with a growth of 7.6% qoq growth, followed by Travel & Hospitality at 7% qoq growth and LifeSciences and Healthcare at 4.7% qoq growth in CC terms.

•Digital revenues stood at 18.9% of overall revenues, registering a 7.6% qoq growth

MARKET DATA

Shares outs (Mn)	1914
EquityCap (INR Mn)	1914
Mkt Cap (INR Mn)	4678615
52 Wk H/L (INR)	2740/2055
Volume Avg (3m K)	1304.5
Face Value (INR)	1
Bloomberg Code	TCS IN

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	32037
NIFTY	9892

KEY FINANCIALS

Particulars (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	9,46,484	10,86,462	11,79,660	12,70,359	14,03,183
EBITDA	2,46,664	3,06,780	3,23,110	3,53,533	3,97,632
PAT	1,96,484	2,41,386	2,61,648	2,82,957	3,19,482
EPS	100.3	122.8	132.8	143.6	162.1
OPM	24.1%	26.5%	25.7%	26.2%	26.9%
NPM	20.8%	22.2%	22.2%	22.3%	22.8%

Source: Company, KRChoksey Research

Another bleak display by BFSI and Retail resonates caution

All segments except BFSI and Retail, grew more than 3.5% qoq, displaying the laggard spending the respective spaces. While Retail segment reported tepid growth after a massive year in FY17, BFSI still found it difficult to bounce-back convincingly. TCS added 2 new verticals to its reporting, namely Technology & Services and Regional Markets in order to differentiate verticals which report volatile earnings. Management is particularly positive on the prospects of Diligenta in the insurance space which is evident from several deal wins in the current quarter.

Re-organization of service lines a huge positive

We are particularly positive of the management's move towards restructuring service lines with separate heads responsible for respective units. The main goal of this restructuring was largely to focus on TCS's digital offerings and is divided into 3 branches – Cognitive Business Operations, Consulting and Service Integration and Digital Transformation Services. We believe that the new structure is definitely a more efficient and effective strategy towards driving growth in key focus areas and achieving targets.

Key Concall Highlights: (i) Several banks' indecisiveness on whether to transform to next-gen systems has bogged down client spend in the BFSI space (ii) Management sees immense traction in products & platform business as iON (Education & Mfg sector) and Chroma (HR platform on cloud and premise) have witnessed heightened interest. Expect Ignio (automation platform) to be a major trigger for revenue growth and improving cost efficiency (iii) Believe TCS Bancs has immense traction as 15% of world population is connected through it and expect client adoption to increase going ahead

Valuation and view

We have **"ACCUMULATE"** rating on the stock and as we assign multiple of 15.5x to its FY19E EPS of INR. 166.7 to arrive at a **price target of INR 2,583.**

SHARE HOLDING PATTERN (%)

Particulars	Mar 17	Dec 16	Sep16
Promoters	73.31	73.33	73.33
FIIs	16.9	16.79	17.02
DIIs	5.36	5.4	5.14
Others	4.43	4.48	4.52
Total	100	100	100

11.6%

Revenue CAGR between FY 17 and FY 19E

15.4%

PAT CAGR between FY 17 and FY 19E

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Q4FY17 Result Snapshot

Exhibit 1: Quarterly Income Statement

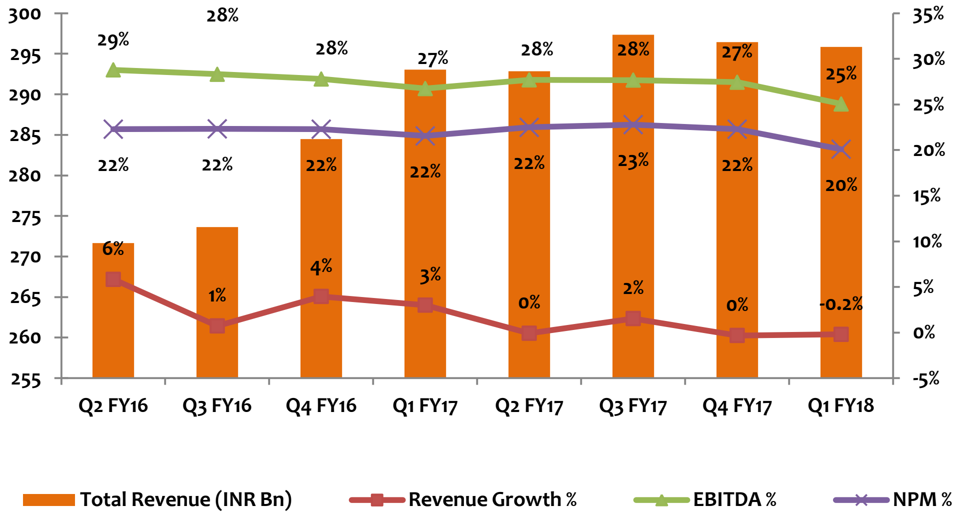
INR Mn	Q1 FY18	Q4 FY17	Q-o-Q change %	Q1 FY17	Y-o-Y change %	Q4 FY17 Est.	Deviation %
Net Sales (US$ Mn)	**4,591**	**4,452**	**3.1%**	**4,362**	**5.2%**	**4,606**	**-0.3%**
Net Sales	**2,95,840**	**2,96,420**	**(0.2%)**	**2,93,050**	**1.0%**	**3,06,688**	**-3.5%**
Less:							
Employees Remuneration & Benefits	1,69,140	1,63,020	3.8%	1,64,430	2.9%	1,73,044	-2.3%
Administrative & Other Expenses	52,580	52,070	1.0%	50,240	4.7%	52,444	0.3%
Total Operating Expenditure	**2,21,720**	**2,15,090**	**3.1%**	**2,14,670**	**3.3%**	**2,25,487**	**-1.7%**
Operating Profit	**74,120**	**81,330**	**(8.9%)**	**78,380**	**(5.4%)**	**81,201**	**-8.7%**
Less: Depreciation	4,980	5,060	(1.6%)	4,910	1.4%	5,079	-1.9%
Add: Other income	**69,140**	**76,270**	**(9.3%)**	**73,470**	**(5.9%)**	**76,122**	**-9.2%**
Profit Before Tax	9,320	9,890	(5.8%)	3,890	139.6%	12,268	
Adjusted Profits	**78,460**	**86,160**	**(8.9%)**	**83,100**	**(5.6%)**	**88,389**	**-11.2%**
Less: Total Tax	18,960	19,940	(4.9%)	19,920	(4.8%)	20,772	-8.7%
PAT	**59,500**	**66,220**	**(10.1%)**	**63,180**	**(5.8%)**	**67,618**	**-12.0%**
Adjusted PAT	50	140	**N.A.**	10	**N.A.**	158	
Reported Diluted EPS (Rs.)	**59,450**	**66,080**	**(10.0%)**	**63,170**	**(5.9%)**	**67,460**	**-11.9%**
Adjusted Diluted EPS (Rs.)	**30.4**	**33.5**	**(10.0%)**	**32.1**	**(5.9%)**	**34.2**	**-11.9%**
No of Shared Diluted (mn)	1,956	1,970		1,970		1,970	
Margin Analysis %			**Change in bps**		**Change in bps**		**Deviation in bps**
EBITDA margin	**25.1%**	**27.4%**	**-238**	**26.7%**	**-169**	**26.5%**	**-142**
Operating Margin	23.4%	25.7%	-236	25.1%	-170	24.8%	-145
NPM	**26.5%**	**29.1%**	**-255**	**28.4%**	**-184**	**28.8%**	**-230**
Adjusted NPM	20.1%	22.3%	-220	21.6%	-146	22.0%	-190
Effective Tax Rate %	**24.2%**	**23.1%**	**102**	**24.0%**	**19**	**23.5%**	**67**
Cost Analysis %			**Change in bps**		**Change in bps**		**Deviation in bps**
Employee Cost/Net Sales	57.2%	55.0%	218	56.1%	106	56.4%	75
SG&A/Net sales	11.9%	11.5%	40	11.7%	15	13.9%	-200

Source: Company, KRChoksey Research

- The Tax rate for the quarter stood 24.2% in Q1 FY18
- Company added 1 client in $100 Mn+ space, 1 in the $50 Mn+ space and 12 in $10 Mn+ space
- Attrition stood at 11.6% in Q1 FY18.
- Cash & Cash equivalents stood at INR 45,250 Mn and Free Cash Flows stood at INR 55,870 Mn.
- Operating Margins were down 236 bps qoq mainly due to 150 bps impact of wage hike and 80 bps impact of currency movements.

TCS Ltd.

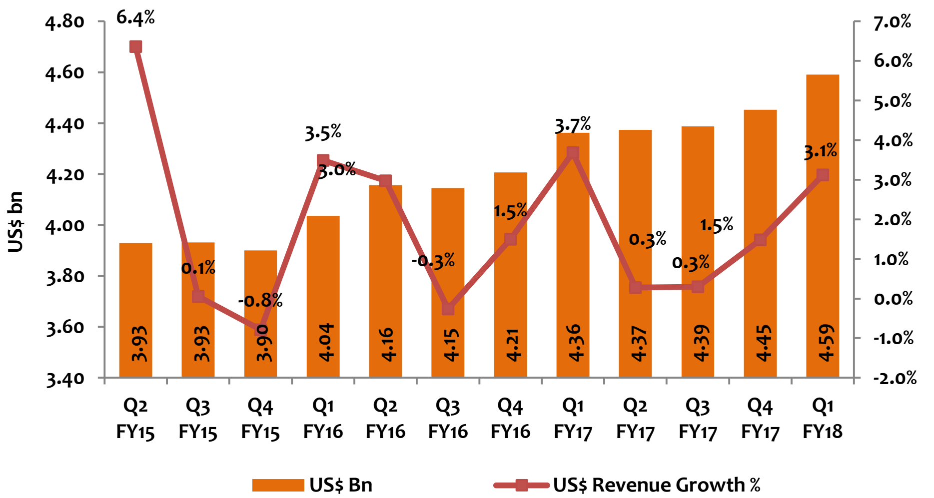
Exhibit 2: Revenues and Margin Movement (INR. Bn)



Source: Company, KRChoksey Research

Revenue in Rupee terms was down by -0.2% qoq at INR 295.8 Bn, and below our estimates of INR 306.6 Bn. Top-line growth was subdued mainly due sharp rupee appreciation against the dollar, which resulted in a INR 6500 Mn loss in reported revenues. Operating Margin was reported at 23.4%, which was below the comfort range of 26-28% mainly due to wage impact and INR appreciation. Company reported a Net Profit Margin of 20.1% which was below our expectations and largely dissapointing.

Exhibit 3: US$ Revenue and Segment Revenue Growth Analysis ($. Mn)



Source: Company, KRChoksey Research

Dollar revenues were recorded at $4,591 Mn in Q1 FY18, up 3.1% qoq, but marginally below our estimate of $3,606 Mn. Growth was largely driven by volume growth of 3.5% and Digital revenue growth of 7.4% qoq. Going ahead, we expect Digital focused revenues to maintain growth momentum. Diligenta also outperformed in Q1 which is evident from several deal wins. However, realizations still remain under pressure. We remain cautious and therefore will continue to monitor the performance of BFSI and Retail segments.

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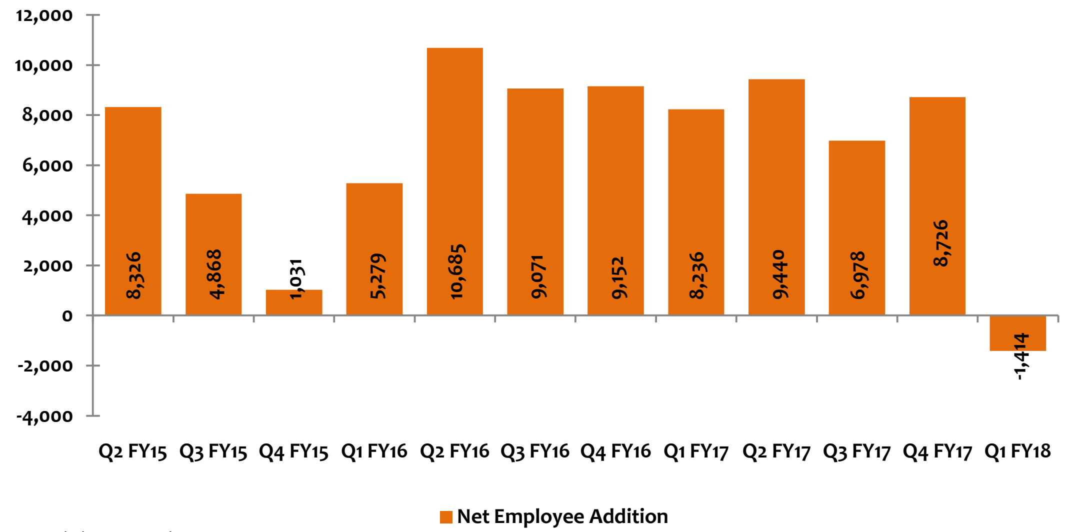
Exhibit 4: Employee Addition and Utilization Trend



Source: Company, KRChoksey Research

This quarter recorded a net employee reduction of -1,414, taking the total headcount to 385,809. We believe that with a higher degree of automation, the hiring rate will reduce at the steady rate.

Exhibit 5: US$ Revenue and Segment Revenue Growth Analysis ($. Mn)

Client Profile	Q4 FY15	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18
$ 1-5 mn	402	413	415	425	400	408	410	426	438	441
$ 5-10 mn	128	123	130	132	148	141	154	154	149	142
$ 10-20 mn	99	96	103	108	108	119	110	114	120	132
$ 20-50 mn	94	103	106	108	100	102	107	106	106	**105**
$ 50-100 mn	39	39	32	31	36	40	42	46	49	49
$ 100 mn +	29	30	33	34	37	37	36	34	35	36

Source: Company, KRChoksey Research

Company added 1 client in $100 Mn+ space, 1 in the $50 Mn+ space and 12 in $10 Mn+ space. We believe that client accession in terms of revenue bucket was strong while management commentary on client involvement and engagement was strong and encouraging.

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Exhibit 6: Q1 FY18 Geography QoQ Growth (%)

Geography	Q1 FY16	Q2 FY16	Q3 FY16	Q4 FY16	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18
North America	4.3%	2.8%	1.2%	2.4%	2.7%	1.2%	2.2%	-1.7%	1.6%
UK	4.8%	4.9%	-3.3%	-4.9%	3.0%	-6.5%	-3.3%	4.5%	4.6%
Europe	2.6%	1.1%	0.7%	4.3%	6.5%	2.9%	-5.7%	7.9%	9.2%
India	0.4%	4.6%	-7.9%	-0.2%	9.0%	-6.2%	8.9%	9.5%	6.2%
Asia Pacific	1.4%	0.8%	-0.3%	3.7%	3.7%	6.5%	-5.6%	2.5%	1.0%
Latin America	-6.4%	-2.4%	16.4%	-3.3%	3.7%	0.3%	10.3%	-3.1%	3.1%
MEA	8.4%	12.3%	-8.6%	10.7%	3.7%	0.3%	4.5%	5.5%	-0.8%

Source: Company, KRChoksey Research

Continental Europe led the growth figures with a 9.2% qoq growth in reported terms, followed by India at 6.2% qoq and UK at 4.6% qoq. North America bounced back after a decline in Q4FY17 and grew at 1.6% qoq.

Exhibit 7: Q1 FY18 Verticals QoQ Growth (%)

Verticals	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18
BFSI	2.4%	0.3%	0.3%	0.2%	3.1%
Manufacturing	3.7%	3.2%	-0.6%	1.5%	4.5%
Telecom	41.2%	1.2%	-6.7%	8.2%	4.6%
Life science & Healthcare	3.7%	4.4%	-2.3%	4.2%	6.1%
Retail & Distribution	2.9%	-4.0%	1.0%	-3.0%	2.3%
Travel & Hospitality	9.3%	0.3%	-2.3%	4.2%	6.2%
Energy & Utilities	6.2%	2.7%	5.0%	1.5%	11.5%
Technology Services	3.7%	-1.0%	1.6%	1.5%	4.4%
Regional Market	3.7%	-1.4%	2.0%	6.7%	-1.4%

Source: Company, KRChoksey Research

TCS restructured its reporting format by separating Regional Market and Technology services to differentiate volatile verticals. In Q1 FY18, Energy & Utilities outperformed with a 11.5% qoq growth, followed by Travel & Hospitality at 6.2% qoq growth and Life Sciences and Healthcare at 6.1% qoq growth.

TCS Ltd.

Exhibit 8: Q1 FY18 Profit & Loss Statement

YE March (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	**946,484**	**1,086,462**	**1,179,660**	**1,270,359**	**1,403,183**
Sales Growth%	*15.7%*	*14.8%*	*8.6%*	*7.7%*	*10.5%*
Total Revenue	**946,484**	**1,086,462**	**1,179,660**	**1,270,359**	**1,403,183**
Less:					
Employees Cost	532,273	595,490	654,300	697,603	768,413
SG&A	167,547	184,193	202,250	219,223	237,138
Total Operating Expenditure	**699,820**	**779,682**	**856,550**	**916,826**	**1,005,551**
EBITDA	**246,664**	**306,780**	**323,110**	**353,533**	**397,632**
EBITDA Growth%	*-1.9%*	*24.4%*	*5.3%*	*9.4%*	*12.5%*
Less: Depreciation	18,699	18,879	19,870	20,216	20,315
Operating Profit	**227,965**	**287,901**	**303,240**	**333,316**	**377,317**
Operating Profit Growh%	*-4.2%*	*26.3%*	*5.3%*	*9.9%*	*13.2%*
Interest Paid	1,135	331	170	0	0
Non-operating Income	32,532	30,833	42,060	40,021	44,205
Profit Before Tax	**259,362**	**318,403**	**345,130**	**373,337**	**421,522**
Tax	60,830	74,825	81,106	87,734	99,058
Minority Interest	2,048	2,192	2,376	2,646	2,983
Net Profit	**196,484**	**241,386**	**261,648**	**282,957**	**319,482**
Adjusted Profit	**196,484**	**241,386**	**261,648**	**282,957**	**319,482**
Reported Diluted EPS Rs	**100.3**	**122.8**	**132.8**	**143.6**	**162.1**
Diluted EPS Growth%	**2.7%**	**22.4%**	**8.2%**	**8.1%**	**12.9%**

Source: Company, KRChoksey Research

TCS Ltd.

Exhibit 9: Q1 FY18 Balance Sheet

YE March(INR Mn)	FY15	FY16	FY17	FY18E	FY19E
Liabilities					
Equity Capital	1,970	1,970	1,970	1,970	1,970
Reserves & Surplus	558,560	708,750	860,170	1,028,135	1,217,782
Equity	**560,530**	**710,720**	**862,140**	**1,030,105**	**1,219,752**
Net Worth	**560,530**	**710,720**	**862,140**	**1,030,105**	**1,219,752**
Minority Interest	2,230	3,550	3,660	6,306	9,289
Net Deferred tax liability/(Asset)	5,400	8,050	9,190	9,190	9,190
Total Loans	3,010	1,960	2,710	3,010	3,010
Other Non Current Liabilities	12,690	11,720	11,310	16,515	18,241
Capital Employed	**583,860**	**736,000**	**889,010**	**1,065,126**	**1,259,483**
Assets					
Gross Block	163,980	193,080	208,910	223,910	238,910
Less:Depreciation	77,570	93,370	108,340	128,556	148,871
Net Block	**86,410**	**99,710**	**100,570**	**95,354**	**90,039**
Capital WIP	27,620	16,700	15,410	27,620	27,620
Investments	**17,540**	**228,220**	**419,800**	**419,800**	**419,800**
Intangible Assets	17,920	18,030	16,440	16,440	16,440
Others-A	106,170	120,960	91,400	114,332	126,287
Current Assets					
Inventories	150	160	210	3,768	4,132
Sundry Debtors	242,670	280,650	280,350	341,083	376,745
Cash and Bank Balance	184,310	66,450	40,020	146,787	308,723
Loans and Advances	14,930	27,430	29,090	5,463	6,034
Other Current Assets	31,940	32,650	39,230	69,870	77,175
Total Current Assets	**474,000**	**407,340**	**388,900**	**566,969**	**772,810**
Less: Current Liabilities & Provisions					
Sundry Creditors	88,320	75,410	62,790	82,891	90,913
Provisions	1,970	1,550	1,050	17,547	19,812
Other Current Liabilities	55,510	78,000	79,670	74,951	82,788
Total Current Liabilities & Provisions	**145,800**	**154,960**	**143,510**	**175,389**	**193,512**
Capital Applied	**583,860**	**736,000**	**889,010**	**1,065,126**	**1,259,483**

Source: Company, KRChoksey Research

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TCS Ltd.

Exhibit 10: Q1 FY18 Ratio Analysis

YE March	FY15	FY16	FY17	FY18E	FY19E
Key Operating Ratios					
EBITDA Margin(%)	26.1%	28.2%	27.4%	27.8%	28.3%
Tax/PBT(%)	23.5%	23.5%	23.5%	23.5%	23.5%
Net Profit Margin(%)	20.8%	22.2%	22.2%	22.3%	22.8%
RoE(%)	30.5%	34.8%	31.2%	28.2%	26.9%
RoCE(%)	29.5%	33.7%	30.2%	27.4%	26.0%
Current Ratio(x)	3.3x	2.6x	2.7x	3.2x	4.0x
Dividend Payout(%)	86.5%	47.5%	40.6%	40.6%	40.6%
Book Value Per Share(Rs.)	286.2	361.5	437.5	522.8	619.0
Financial Leverage Ratios					
Interest/Debt(%)	39.7%	13.3%	5.9%	0.0%	0.0%
GrowthIndicators%					
Growth in Gross Block(%)	25.1%	17.7%	8.2%	7.2%	6.7%
Sales Growth(%)	15.7%	14.8%	8.6%	7.7%	10.5%
EBITDA Growth(%)	(1.9%)	24.4%	5.3%	9.4%	12.5%
Net Profit Growth(%)	2.8%	22.9%	8.4%	8.1%	12.9%
Diluted EPS Growth(%)	2.7%	22.4%	8.2%	8.1%	12.9%
Turnover Ratios					
Debtors (Days of sales)	94	94	87	98	98
Creditors	46	35	27	33	33
Inventory (Days of Optg.Costs)	0.1	0.1	0.1	1.5	1.5

Source: Company, KRChoksey Research

Exhibit 11: Q1 FY18 Free Cash Flow Analysis

YEMarch (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
EBITA	**227,965**	**287,901**	**303,240**	**333,316**	**377,317**
Less:Adjusted Taxes	53,466	67,657	71,261	78,329	88,670
NOPLAT	**174,499**	**220,244**	**231,979**	**254,987**	**288,648**
Plus: Depreciation	18,699	18,879	19,870	20,216	20,315
Less: Increase in Working Capital	(57,591)	38,640	6,334	94,104	27,335
Operating Cashflow	**250,789**	**200,484**	**245,515**	**181,100**	**281,628**
Less: Net Capex	27,709	21,259	19,440	27,210	15,000
Less:Increase in Net Other Assets	45,007	18,100	(17,020)	(37,785)	8,347
FCF From Operation	**178,074**	**161,125**	**243,095**	**191,675**	**258,281**
Less: Inc./(Dec.) in Investment	0	0	0	0	0
FCF after Investment	**178,074**	**161,125**	**243,095**	**191,675**	**258,281**
Plus:Gain/(loss) on Extraordinary Items	(1)	0	0	0	0
Total FCF	**178,073**	**161,125**	**243,095**	**191,675**	**258,281**

Source: Company, KRChoksey Research

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TCS Ltd.

TCS Ltd.				Rating Legend	
Date	**CMP (INR)**	**TP (INR)**	**Recommendation**	**Our Rating**	**Upside**
14-Jul-17	2,446	2,675	ACCUMULATE	**Buy**	More than 15%
19-Apr-17	2,283	2,583	ACCUMULATE	**Accumulate**	5% – 15%
13-Jan-17	2,344	2,490	ACCUMULATE	**Hold**	0 – 5%
19-Oct-16	2,400	2,570	ACCUMULATE	**Reduce**	-5% – 0
				Sell	Less than – 5%

ANALYST CERTIFICATION:

I, Mayank Babla (MCom & BSc Economics & Management), research analyst, and Pritesh Thakkar (MBA, Bcom) , research associate, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities. I also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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