

# TATA CONSULTANCY SERVICES

## BFSI and retail not firing as yet

India Equity Research | IT

Key highlights of our recent interaction with Tata Consultancy Services' (TCS) management are: 1) sustained softness in BFSI and retail stemming from lower discretionary spending by large banks and online transition by large retailers, respectively; and 2) strong growth in rest of business (RoB) spearheaded by broad-based spending. We believe, given substantial contribution of BFSI and retail segments (32.9% & 12.2%) to TCS' revenue, overall growth in Q2FY18 is likely to remain subdued. Moreover, by virtue of traditionally being a first half revenue-driven company, overall FY18 growth too is likely to be muted. The anticipated soft revenue coupled with INR strengthening is likely to lead to muted earnings growth in spite of strong execution and offerings. Maintain 'HOLD' with TP of INR2,315.

### Tepid BFSI & retail to steal rest of business' strong show

Management expects BFSI and retail, which contribute 32.9% and 12.2%, respectively, to TCS' revenue, to continue to be soft in an otherwise seasonally strong quarter. While it attributed the softness in BFSI to absence of pick up in discretionary spending by large banks, retail weakness has been due to transition to online channels by large retailers. A weak Q2FY18 (seasonally strong quarter) will imply muted growth in FY18 as well as TCS' growth has traditionally been led by H1. Management expects strong growth in RoB led by digital and other services. While the above is a concern for TCS in the near term, it also implies muted growth for the entire sector as BFSI and retail segments contribute >50% to Indian IT industry's revenue.

### Outlook and valuations: Key segments tepid; maintain 'HOLD'

The absence of pick up in spending in BFSI is surprising given the rise in interest rates in the North American market and improving profits, particularly in the BFSI space. Stagnant new spends imply further delay in decision making and awarding of new deals. We believe, this coupled with continued pain in retail (although temporary) implies lower growth for the sector and in particular for TCS, Infosys and Wipro, which draw substantial portion of revenue from these segments. We will keenly monitor quarterly earnings & commentary and maintain that TCS is a dividend play until margin stabilises and demand environment improves in spite of its best-in-class execution. We maintain 'HOLD/SP' with target price of INR2,315 (16x FY19E EPS). The stock is currently trading at 18.7x and 17.3x FY18E and FY19E EPS, respectively.

#### Financials

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	1,086,416	1,181,606	1,235,098	1,335,853
EBITDA	306,734	325,046	329,013	355,334
Adjusted Profit	242,102	264,836	257,408	276,875
Adjusted diluted EPS (INR)	123.2	134.8	133.8	144.6
Diluted P/E (x)	20.3	18.5	18.7	17.3
EV/EBITDA (x)	15.1	13.7	13.5	12.2
ROAE (%)	36.9	32.7	30.0	30.5

#### EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

#### MARKET DATA (R: TCS.BO, B: TCS IN)

CMP	: INR 2,499
Target Price	: INR 2,315
52-week range (INR)	: 2,709 / 2,052
Share in issue (mn)	: 1,970.4
M cap (INR bn/USD mn)	: 4,924 / 77,058
Avg. Daily Vol.BSE/NSE('000)	: 1,265.8

#### SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	73.6	73.3	73.3
MF's, FI's & BK's	5.5	5.4	5.4
FII's	16.7	16.9	16.8
Others	4.2	4.4	4.4
* Promoters pledged shares (% of share in issue)	:		11.3

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	(0.6)	3.2	0.3
3 months	4.1	5.9	2.3
12 months	5.8	15.6	(2.1)

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## Company Description

TCS is India's largest and one of its oldest IT companies. It commenced operations in 1968 and provides a comprehensive range of IT services to industries such as banking and financial services, insurance, manufacturing, telecommunications, retail, and transportation. With a presence in 42 countries, TCS is positioned to deliver its services seamlessly. TCS has a large diversified client base, TCS' employee force stands at 385,809 (including subsidiaries) and its revenues for the last twelve months (TTM) stood at INR1,182bn (USD17.8bn).

## Investment Theme

As India's largest and most-experienced IT services firm, TCS is well-positioned to benefit from the growing demand for offshore IT services. It is a serious contender for winning large deals, as it has more experience than peers in implementing large, complex, and mission-critical projects. End-to-end full services offerings, traction in emerging markets, ability to roll up large acquisitions, improving sales and marketing prowess and willingness to take multiple big bets (different go-to-market models) are among the key rationales for TCS to sustain its long term hi-growth trajectory.

## Key Risks

Key risks to our investment theme include – (1) double dip recession in major market US and prolonged slowdown in Europe, (2) sharp cross currency movements and appreciation of rupee against USD, Euro and GBP, (3) pricing pressure, (4) a reduction in margins and (5) Adverse impact of US Immigration bill.

## Financial Statements

### Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
<b>Macro</b>				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
<b>Company</b>				
Average attrition	17.0	12.5	13.1	13.4
<b>Efforts</b>				
Onsite (%)	28.0	28.0	28.0	28.0
Offshore (%)	72.0	72.0	72.0	72.0
<b>Utilisation</b>				
Onsite (%)	98.0	98.3	96.5	94.0
Offshore (%)	91.5	93.0	90.0	89.3
Pricing change	0.1	0.1	0.1	-
Onsite (%)	(3.0)	(3.9)	1.5	(0.5)
Offshore (%)	(5.9)	(5.2)	4.6	(0.5)
<b>Cost of sales</b>				
Employees cost	38.6	39.1	40.2	40.6
Travelling cost	1.5	1.5	1.6	1.7
Other costs	16.0	16.0	15.9	14.9
<b>SGA cost</b>				
Employees cost	12.4	13.1	13.4	13.5
Other cost	5.1	4.5	3.9	4.2
<b>Financial assumptions</b>				
Depreciation	1.7	1.7	1.6	1.5
Cash yield (%)	10.3	9.1	7.8	5.7
Tax rate as % of PBT	23.6	23.6	24.0	24.0
Capex (INR mn)	19,673	19,530	22,267	54,650
Debtor days	88	87	93	97
Payable days	98	89	93	100
Cash conversion cycle	(10)	(2)	-	(3)

### Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	1,086,416	1,181,606	1,235,098	1,335,853
Cost of revenues	595,489	649,010	695,823	747,542
Gross profit	490,927	532,596	539,274	588,312
Total SG&A expenses	184,193	207,550	210,262	232,978
EBITDA	306,734	325,046	329,013	355,334
Depreciation	18,879	19,860	20,329	20,038
EBIT	287,855	305,186	308,684	335,296
Add: Other income	30,503.00	41,890.00	30,640.55	29,539.97
Profit Before Tax	318,358	347,076	339,324	364,836
Less: Provision for Tax	75,027	81,560	81,566	87,561
Less: Minority Interest	1,229	680	350	400
Reported Profit	242,102	264,836	257,408	276,875
Adjusted Profit	242,102	264,836	257,408	276,875
Shares o /s (mn)	1,965	1,965	1,924	1,914
Adjusted Basic EPS	123.2	134.8	133.8	144.6
Diluted shares o/s (mn)	1,965	1,965	1,924	1,914
Adjusted Diluted EPS	123.2	134.8	133.8	144.6
Adjusted Cash EPS	132.8	144.9	144.3	155.1
Dividend per share (DPS)	43.5	46.5	49.6	52.5
Dividend Payout Ratio(%)	41.3	40.4	43.4	42.5

### Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Cost of revenues	54.8	54.9	56.3	56.0
Gross margin	45.2	45.1	43.7	44.0
S&M expenses	17.0	17.6	17.0	17.4
SG&A expenses	17.0	17.6	17.0	17.4
EBITDA margins	28.2	27.5	26.6	26.6
EBIT margins	26.5	25.8	25.0	25.1
Net Profit margins	22.4	22.5	20.9	20.8

### Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	14.8	8.8	4.5	8.2
EBITDA	24.4	6.0	1.2	8.0
PBT	22.8	9.0	(2.2)	7.5
Adjusted Profit	23.2	9.4	(2.8)	7.6
EPS	22.8	9.4	(0.8)	8.1

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,970	1,970	1,910	1,910	
Reserves & Surplus	729,929	881,180	823,554	982,850	
Shareholders' funds	731,899	883,150	825,464	984,760	
Minority Interest	3,542	3,660	3,440	3,440	
Long term borrowings	2,448	2,890	830	830	
Total Borrowings	2,448	2,890	830	830	
Def. Tax Liability (net)	(65,726)	(67,010)	(64,760)	(64,760)	
<b>Sources of funds</b>	<b>672,164</b>	<b>822,690</b>	<b>764,974</b>	<b>924,270</b>	
Net Block	119,243	117,880	121,508	156,120	
Intangible Assets	38,120	37,210	37,700	37,700	
Total Fixed Assets	157,363	155,090	159,208	193,820	
Non current investments	3,681	3,440	33,450	73,450	
Cash and Equivalents	292,021	456,630	361,467	442,874	
Sundry Debtors	280,646	280,350	348,794	363,509	
Loans & Advances	92,723	76,360	45,790	45,790	
Other Current Assets	7,767	5,460	15,620	15,620	
Current Assets (ex cash)	381,136	362,170	410,204	424,919	
Trade payable	162,037	154,640	199,354	210,794	
Total Current Liab	162,037	154,640	199,354	210,794	
Net Curr Assets-ex cash	219,099	207,530	210,850	214,126	
<b>Uses of funds</b>	<b>672,164</b>	<b>822,690</b>	<b>764,974</b>	<b>924,270</b>	
BVPS (INR)	372.5	449.5	429.0	514.4	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	242,102	264,836	257,408	276,875	
Add: Depreciation	18,879	19,860	20,329	20,038	
Others	51,724	(26,345)	(44,785)	(29,140)	
Less: Changes in WC	103,541	(11,569)	3,320	3,275	
Operating cash flow	209,164	269,920	229,632	264,498	
Less: Capex	19,673	19,530	22,267	54,650	
<b>Free Cash Flow</b>	<b>189,492</b>	<b>250,390</b>	<b>207,365</b>	<b>209,847</b>	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		209,164	269,920	229,632	264,498
Investing cash flow		(65,766)	(185,210)	139,164	(65,110)
Financing cash flow		(96,462)	(110,060)	(319,289)	(117,980)
Net cash Flow		46,936	(25,350)	49,507	81,407
Capex		(19,673)	(19,530)	(22,267)	(54,650)
Dividend paid		(95,148)	(110,270)	(156,809)	(117,980)

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)		36.9	32.7	30.0	30.5
ROACE (%)		48.0	42.6	39.5	40.1
Debtors Days		88	87	93	97
Payable Days		98	89	93	100
Cash Conversion Cycle		(10)	(2)	-	(3)
Current Ratio		4.2	5.3	3.9	4.1

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover		1.8	1.6	1.6	1.6
Fixed Asset Turnover		7.0	7.6	7.9	7.6
Equity Turnover		1.6	1.5	1.4	1.5

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)		123.2	134.8	133.8	144.6
Y-o-Y growth (%)		22.8	9.4	(0.8)	8.1
Adjusted Cash EPS (INR)		132.8	144.9	144.3	155.1
Diluted P/E (x)		20.3	18.5	18.7	17.3
P/B (x)		6.7	5.6	5.8	4.9
EV / Sales (x)		4.2	3.7	3.5	3.2
EV / EBITDA (x)		15.1	13.7	13.5	12.2
Dividend Yield (%)		1.7	1.9	2.0	2.1

#### Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Tata Consultancy Services	77,058	18.7	17.3	13.5	12.2	30.0	30.5
Cyient	881	13.6	12.0	8.4	6.8	18.5	18.4
ECLERX SERVICES	729	13.1	11.8	7.8	6.4	26.5	24.8
HCL Technologies	19,753	13.9	12.7	10.9	9.7	25.2	24.3
Hexaware Technologies	1,312	-	-	(0.7)	(0.7)	27.4	27.3
Infosys	32,556	13.8	12.6	8.8	7.7	21.8	22.8
Persistent Systems	787	14.4	12.3	8.3	6.7	17.4	18.0
Tata Consultancy Services	77,058	18.7	17.3	13.5	12.2	30.0	30.5
Tech Mahindra	6,765	13.0	11.4	8.6	6.9	17.2	17.6
Wipro	21,701	16.0	14.0	12.5	10.8	16.9	17.2
Median	-	13.8	12.4	8.7	7.3	23.5	23.6
AVERAGE	-	13.5	12.1	9.2	7.9	23.1	23.1

Source: Edelweiss research

## Additional Data

### Directors Data

N Chandrasekaran	CEO and MD	Aman Mehta	Director
V Thyagarajan	Director	Prof. Clayton M Christensen	Director
Dr. Ron Sommer	Director	Dr. Vijay Kelkar	Director
Ishaat Hussain	Director	O. P. Bhatt	Director
Cyrus Mistry	Chairman		

Auditors - Deloitte Haskins & Sells

### Holding - Top10

	Perc. Holding		Perc. Holding
Life Insurance Corp. of India	3.77	Commonwealth Bank of Australia	1.33
Blackrock	0.89	Vanguard Group	0.84
JP Morgan Chase	0.84	Lazard	0.76
Aberdeen Asset Management	0.64	Oppenheimer	0.50
Vontobel Asset Management	0.26	HDFC Asset Management	0.24

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

*\*in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Cyient	BUY	SP	H	ECLERX SERVICES	HOLD	SP	M
HCL Technologies	BUY	SP	H	Hexaware Technologies	HOLD	SP	M
Info Edge	BUY	SP	M	Infosys	HOLD	SP	L
Just Dial	REDUCE	SU	M	Persistent Systems	BUY	SP	L
Tata Consultancy Services	HOLD	SP	L	Tech Mahindra	BUY	SP	M
Wipro	BUY	SP	L				

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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### Coverage group(s) of stocks by primary analyst(s): IT

Cyient, ECLERX SERVICES, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Just Dial, Persistent Systems, Tata Consultancy Services, Tech Mahindra, Wipro

#### Recent Research

Date	Company	Title	Price (INR)	Recos
07-Sep-17	Info Edge	Near-term pain; strong moat; Visit Note	960	Buy
28-Aug-17	Infosys	Nandan Nilekani 2.0: Stability the priority; Company Update	912	Hold
22-Aug-17	EPAM Systems and Luxoft	Central & Eastern European companies; Holding (Global Result Excerpts Pulse)		Not Rated

#### Distribution of Ratings / Market Cap

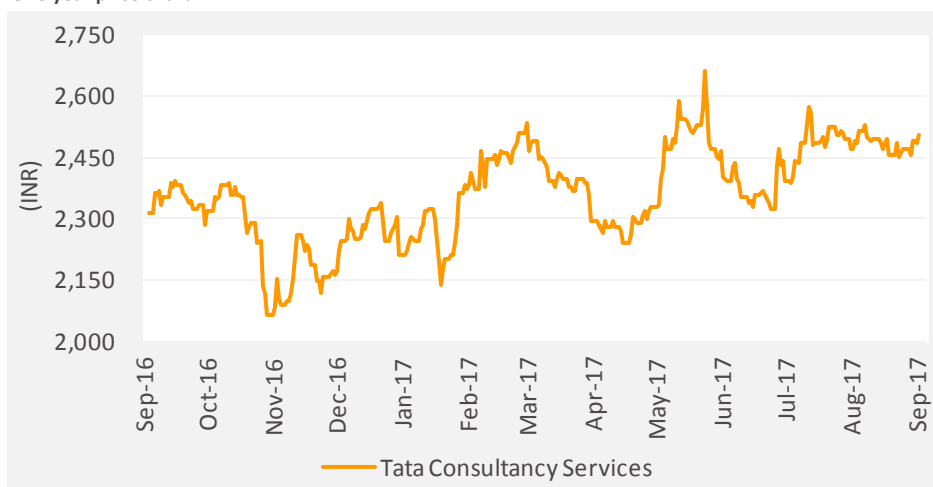
##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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