

# Stock Update

In-line quarter, strong acceleration in digital continues

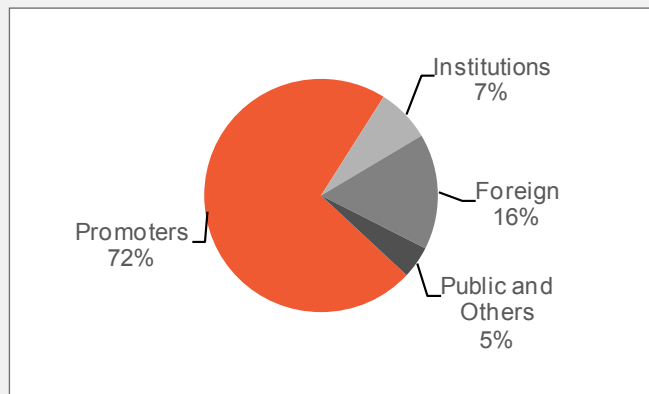
## Tata Consultancy Services

Reco: Buy | CMP: Rs1,980

### Company details

Price target:	Rs2,400
Market cap:	Rs742,878 cr
52-week high/low:	Rs2,273 / 1,228
NSE volume: (No of shares)	26.7 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCS
Free float: (No of shares)	104.9 cr

### Shareholding pattern



### Price chart



### Price performance

(%)	1m	3m	6m	12m
Absolute	-1.8	9.2	40.6	68.8
Relative to Sensex	7.1	13.5	35.9	53.2

### Key points

- In-line quarter:** During Q2FY2019, Tata Consultancy Services (TCS) delivered broadly in-line revenue performance, with constant currency (CC) revenue growth of 3.7% q-o-q and 11.5% y-o-y. The return of double-digit y-o-y revenue growth trajectory after couple of years was supported by acceleration of revenue from digital business (60% y-o-y) and strong growth in BFSI (6.1% y-o-y) and retail and CPG (15.6% y-o-y). On a reported basis, revenue increased by 3.2% q-o-q to \$5,215 million, above our estimates, owing to 50 BPS q-o-q cross-currency headwinds. EBIT margin improved by 150 BPS q-o-q to 26.5% (a tad ahead of our estimates), led by operational efficiencies (30 BPS), rupee tailwind (120 BPS) and absence of wage revision. Lower-than-expected other income growth (down 50.9% q-o-q) owing to FX impact resulted in marginal miss in net income. Net income during the quarter increased by 7.6% q-o-q to Rs. 7,901 crore.
- Strong acceleration in digital; BFSI and retail continue to perform well:** CC revenue growth from digital business accelerated to 16.5 q-o-q/60% y-o-y in Q2FY2019 compared to 9.1 q-o-q/45% y-o-y in Q1FY2019. Effectively, the digital segment contributed 28% to the total revenue (vs. 25% in Q1FY2019) in Q2FY2019. However, revenue from the core business declined by 0.9% q-o-q against flat growth in Q1FY2019. Management highlighted that it sees large enterprises, especially in the U.S. and U.K., currently taking digital into core, which would continue to drive demand for the digital business going ahead. CC revenue growth of BFSI and retail stood at 3.5% and 3.4% q-o-q, respectively, below the company's overall growth rate for Q2FY2019. Regional markets continued to grow strongly at 19.8% y-o-y, led by ramp-up of deal wins in the platform business. Growth in regions was broad based - North America grew by 2.6% q-o-q, led by healthy growth in BFSI and retail, while growth in Europe stood at 4.1% q-o-q. APAC growth momentum accelerated to 4.5% q-o-q in Q2FY2019 on account of strong growth in Australia. Client addition metrics remained strong, with addition of four new clients in \$100 million+ revenue bucket during the quarter. Net headcount addition was 10,227, highest in the past 12 quarters. Deal TCVs remained strong at \$4.9 billion in Q2FY2019, similar to deal TCVs of Q1FY2019.
- Optimistic to deliver sustainable growth momentum going ahead:** Contrary to the usual trend, management has provided double-digit y-o-y CC revenue growth guidance for H2FY2019 and FY2019. Management has

cited that TCS is well positioned to achieve double-digit growth in FY2019 despite weak seasonality in 2HFY2019, driven by recovery in BFSI and retail, pick-up in outsourcing demand environment in Europe, strong recent deal wins and healthy deal pipeline. The structural shift in demand among financial clients (especially in North America) would be driven by lifting up the regulatory overhang and reduction in corporate tax rate, which should drive the investments in technologies. Further, the acceleration in digital investments is expected in the areas of wealth management, commercial banking and consumer facing businesses. Though retail is not structurally out of woods yet, management expects growth to continue as traditional retailers could embrace digital to face stiff competition from online retail players. Management stated that its early investments in Europe (Germany and France) have started yielding results. Further, management expects healthy growth in Europe to continue going ahead owing to the conversion of global sourcing models as European companies are actively looking to participate in leveraging technology.

We believe growth momentum would continue in FY2020E, given increasing digital deal sizes, acceleration of deal wins, superior digital execution capabilities and increasing traction in North America.

- ♦ **Valuation: Maintain Buy with a PT of Rs. 2,400:** We have fine-tuned our earnings estimates for FY2019E/FY2020E, factoring in lower-than-expected other income. TCS is well positioned from a competitive perspective, given its differentiated capabilities along with its ability to structure large-scale multi-dimensional projects, which are helping TCS to gain market share in the digital space. The stock has corrected around 12% in the past one week and is currently trading at 21x its FY2020E EPS estimates. We believe the stock of TCS would continue to trade at a healthy premium to its peers, given its superior execution capabilities in digital, best-in-class organic revenue growth among large peers and healthy traction in digital momentum. Therefore, we maintain our Buy rating on the stock with a price target (PT) of Rs. 2,400.

#### Valuation

Particulars	Rs cr			
	FY18	FY19E	FY20E	FY21E
Total revenue	1,23,104.0	1,47,221.9	1,63,442.8	1,78,046.3
EBIT margin (%)	24.8	26.3	26.4	26.4
Net profit	25,826.0	31,545.9	34,922.9	37,944.2
EPS (Rs.)	68.8	84.1	93.1	101.1
P/E (x)	28.8	23.5	21.3	19.6
EV/EBITDA	11.5	9.0	8.1	7.4
ROE (%)	29.5	34.2	34.1	34.5
ROCE (%)	37.6	43.8	44.1	44.7

#### Results

Particulars	Rs cr				
	Q2FY19	Q2FY18	Q1FY19	YoY (%)	QoQ (%)
Revenues (\$ mn)	5,215.0	4,739.0	5,051.0	10.0	3.2
Revenues in INR (Cr)	36,854.0	30,541.0	34,261.0	20.7	7.6
Direct costs	20,795.0	17,218.0	19,685.0	20.8	5.6
Gross profit	16,059.0	13,323.0	14,576.0	20.5	10.2
SG&A	5,781.0	5,159.0	5,505.0	12.1	5.0
EBITDA	10,278.0	8,164.0	9,071.0	25.9	13.3
Depreciation	507.0	504.0	493.0	0.6	2.8
EBIT	9,771.0	7,660.0	8,578.0	27.6	13.9
Other income	593.0	812.0	1,208.0	-27.0	-50.9
PBT	10,364.0	8,472.0	9,786.0	22.3	5.9
Tax provision	2,437.0	2,012.0	2,424.0	21.1	0.5
Net profit	7,927.0	6,460.0	7,362.0	22.7	7.7
Minority interest	26.0	14.0	22.0	85.7	18.2
Adj. Net Profit	7,901.0	6,446.0	7,340.0	22.6	7.6
EPS (Rs)	21.1	17.2	19.6	22.6	7.6
Margin (%)					
EBITDA	27.9	26.7	26.5	116	141
EBIT	26.5	25.1	25.0	143	148
NPM	21.4	21.1	21.4	33	1

## Operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y	q-o-q	y-o-y
Revenues (\$ mn)	5,215	100	3.2	10.0	3.7	11.5
<b>Geographic mix</b>						
North America	2,665	51.1	3.4	8.3	2.6	8.1
Latin America	104	2.0	8.7	0.0	7.1	6.8
UK	814	15.6	3.9	22.6	6.0	22.8
Continental Europe	730	14.0	3.2	15.0	4.1	17.4
India	292	5.6	-0.3	-2.2	5.0	7.4
APAC	501	9.6	3.2	7.8	4.5	12.5
MEA	110	2.1	-1.4	-3.7	0.3	-4.4
<b>Industry verticals</b>						
BFSI	1,627	31.2	3.6	5.3	3.5	6.1
Retail & CPG	866	16.6	3.2	14.9	3.4	15.6
Communication & media	360	6.9	0.3	6.9	0.0	8.0
Manufacturing	375	7.2	1.8	7.1	1.6	6.9
Energy & utilities	240	4.6	-1.1	20.5	0.0	22.2
Technology & services	396	7.6	1.9	4.5	2.3	5.8
Regional markets and others	960	18.4	5.0	15.0	7.3	19.8
Digital	1,460	28.0	15.6	56.4	16.5	59.8
Core	3,755	72.0	-0.9	0.0	NA	NA

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