

## Weaker than expected performance...

TCS reported a weaker-than-expected performance this quarter in terms of revenue growth. The lower-than-expected dollar revenue was due to weakness in the European banking & retail segment. The key driver of revenues in the quarter was digital revenues, which increased 40% YoY and 5.6% sequentially in dollar terms. In terms of EBIT margins, the company reported a decline of 93 bps QoQ mainly due to wage hikes and higher subcontracting cost. After adjusting for gains due to new lease accounting and one off in previous quarter the dip in EBIT margin was 150 bps.

## Uphill task to achieve double digit revenue growth in FY20E

The growth in banking & financial services tapered mainly due to weakness in capital markets and European banks. This trend is expected to continue, which will be a key drag for revenue growth in the near term. In addition, 8.1% QoQ dip in deal TCV at US\$5.7 billion does not augur well for the revenue growth trajectory. Further, a weak revenue performance in a seasonally strong Q1 will make it an uphill task for the company to achieve double digit growth rate in FY20E. To achieve double digit growth in FY20E, we believe Q2FY20E becomes an important quarter to be seen from a perspective of growth, deal wins and segment outlook.

## Digital still primary growth driver

Digital was the primary driver of growth in the quarter with 5.6% QoQ growth in sequential terms. Traditional was flat QoQ. Digital revenue share in overall pie continue to rise now forming 32.2% to revenues (vs. 25% in Q1FY19). With digital moving towards core modernisation, we believe TCS would be the biggest beneficiary taking into account its strength in traditional areas and acceleration in digital growth.

## In line margin, pressure on margins to continue

In Q1FY20E, the decline in margins was mainly on account of currency and wage hike (together -230 bps impact) partly offset by operational efficiency. Going forward, sub-contractor costs and no major benefit from currency could keep margins well below the internal target range of 26-28%. Addition of ~30000 freshers in H1FY20E could provide a cushion to margins through employee pyramid optimisation. Consequently, we expect EBIT margin estimates of 25%, 25.3% in FY20E and FY21E, respectively.

## Valuation & Outlook

Weaker than expected Q1FY20E, weakness in BFSI and fully priced valuations prompt us to main our **HOLD** recommendation on the stock. We value the stock at ~21x FY21E EPS with a revised target price of ₹ 2080.



### Particulars

Particular	Amount
Market Capitalization (₹ Crore)	790,125.0
Total Debt (₹ Crore)	62.0
Cash and equivalents (₹ Crore)	41,743.0
EV (₹ Crore)	747,726.0
52 week H/L	2290 / 1784
Equity capital (₹ Crore)	375
Face value	₹ 1

### Key Highlights

- Weak revenue performance in seasonally strong Q1, softness in BFSI makes it difficult to attain double digit growth in FY20E
- Digital with growth of 40% YoY, primary driver for growth
- Margins could remain in pressure on account of subcontracting costs and assuming no currency benefit
- Maintain our **HOLD** recommendation with a revised target price of ₹ 2080

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### Key Financial Summary

Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	117,966	123,104	146,463	158,770	173,076	8.7%
EBITDA	32,311	32,516	39,506	43,027	47,423	9.6%
EBITDA Margins (%)	27.4	26.4	27.0	27.1	27.4	
Net Profit	26,289	25,826	31,472	33,316	37,159	8.7%
EPS (₹)	66.7	67.4	83.8	88.8	99.0	
P/E	31.6	31.2	25.0	23.7	21.2	
RoNW (%)	29.8	29.6	34.4	33.9	35.1	
RoCE (%)	37.9	37.6	43.8	43.2	44.7	

Source: Company, ICICI Direct Research

**Exhibit 1: Variance Analysis**

	Q1FY20	Q1FY20E	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Comments
Revenue	38,172	38,689	34,261	11.4	38,010	0.4	Revenues grew 1.6% QoQ in dollar terms, much lower than our expectations
Employee expenses	22,102	22,478	19,685	12.3	21,709	1.8	
Gross Margin	16,070	16,211	14,576	10.2	16,301	-1.4	
Gross margin (%)	42.1	41.9	42.5	-45 bps	42.9	-79 bps	
SG&A expenses	6,033	6,384	5,505	9.6	6,228	-3.1	
EBITDA	10,037	9,827	9,071	10.6	10,073	-0.4	
EBITDA Margin (%)	26.3	25.4	26.5	-18 bps	26.5	-21 bps	
Depreciation	817	542	493	65.7	537	52.1	
EBIT	9,220	9,285	8,578	7.5	9,536	-3.3	
EBIT Margin (%)	24.2	24.0	25.0	-88 bps	25.1	-93 bps	EBIT margins witnessed a decline due to wage hike and currency impact of 230 bps
Other income (less interest)	1,418	998	1,208	17.4	1,165	21.7	
PBT	10,638	10,283	9,786	8.7	10,701	-0.6	
Tax paid	2,485	2,468	2,424	2.5	2,550	-2.5	
PAT	8,131	7,789	7,340	10.8	8,125	0.1	Reported PAT was above our expectation due to higher other income

**Key Metrics**

Closing employees	436,641	429,285	400,875	8.9	424,285	2.9	Strong net hiring of 12356 employees in Q1FY20
Overall attrition (%)	11.5	11.2	10.9	60 bps	11.3	20 bps	Attrition increased 20 bps sequentially
Average \$/₹	69.6	69.5	67.8	2.6	70.4	-1.2	

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

	FY19		FY20E		FY21E			Comments
(₹ Crore)	Current	Old	New	% Change	Old	New	% Change	
Revenue	146,463	161,001	158,770	-1.4	176,255	173,076	-1.8	Change in rupee revenue due to downward revision in dollar revenue growth estimates
EBIT	37,450	40,733	39,693	-2.6	44,945	43,788	-2.6	
EBIT Margin (%)	25.6	25.3	25.0	-30 bps	25.5	25.3	-20 bps	
PAT	31,472	33,267	33,316	0.1	36,933	37,159	0.6	
EPS (₹)	83.8	88.7	88.8	0.1	98.4	99.0	0.6	Marginal rise in EPS due to higher other income estimates

Source: Company, ICICI Direct Research

## Conference Call Highlights

- **Revenue outlook** - TCS clocked 10.6% YoY growth in constant currency terms and 8.6% YoY in dollar terms in Q1FY20. Considering weaker Q1FY20 revenue growth, we believe it will be difficult for TCS to maintain double digit revenue growth in FY20E
- **Vertical reclassification** – The company has reclassified its vertical break-up of revenue to reflect recent changes in the organisation structure
- **BFSI** - Banking and financial services grew 1.3% QoQ in the quarter. Regarding the future outlook of the sector, the management commentary largely remain unchanged with softness in capital markets and European banks
- **Retail & communication segments** – Retail grew at a slow 1% QoQ while communication growth was healthy at 3.1% QoQ. The management anticipates the growth in retail (15% of revenue) to strike back from subsequent quarters. Communication (6.9% of revenue) continues to be volatile. We would be in wait and watch mode as it is too early to comment on 5G shaping up
- **Digital business** - Digital revenue continue to accelerate with now contributing 32.2% to revenues (vs. 25% in Q1FY19) with strong growth of 40% YoY and 5.6% sequentially in dollar terms. Digital moving from point wise implementation to enterprise wise adoption, would act as an opportunity for TCS taking its scale and digital scaling up
- **Deal TCV** - Deal TCV was at US\$5.7 billion, down 8.1% QoQ and 16.3% YoY. Of this TCV, North America accounted for \$2.8 billion among geography while among verticals, BFSI accounted for \$2 billion and retail \$1 billion
- **Client metrics** - Client count remained constant in \$100 million+ bucket at 44. One client transitioned to US\$50 million+, 13 clients transitioned to US\$10 million+ category while six clients were added QoQ in the US\$1 million+ revenue bucket taking the total to 1014
- **Employee update** - Attrition in IT services increased 20 bps QoQ to 11.5% (LTM). There was net addition of 12,356 employees in the quarter (highest in many years) leading to employee strength of 436,641 at end of Q1FY20. Further, the company has issued joining letters to ~30,000 freshers, of which remaining 18,000 would be on boarded in Q2FY20E

## Key Metrics

### Exhibit 3: Geography wise split up

	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
<b><u>Revenue by geography (%)</u></b>						
North America	50.2	51.0	51.1	51.2	50.7	50.6
Latin America	2.0	1.9	2.0	2.0	2.0	1.8
UK	15.2	15.5	15.6	15.5	15.9	15.8
Continental Europe	14.2	14.0	14.0	14.1	14.1	14.3
India	6.2	5.8	5.6	5.7	5.8	6.0
Asia Pacific	9.7	9.6	9.6	9.4	9.5	9.4
MEA	2.5	2.2	2.1	2.1	2.0	2.1
<b><u>Growth QoQ (%)</u></b>						
North America	0.3	3.2	3.4	0.9	1.8	1.4
Latin America	-5.6	-3.5	8.7	0.7	2.8	-8.5
UK	12.0	3.6	3.9	0.0	5.5	1.0
Continental Europe	9.3	0.2	3.2	1.4	2.8	3.1
India	2.2	-5.0	-0.3	2.5	4.6	5.1
Asia Pacific	6.1	0.5	3.2	-1.4	3.9	0.6
MEA	8.2	-10.6	-1.4	0.7	-2.1	6.7

Source: Company, ICICI Direct Research

Among geography, growth was led by Continental Europe and North America

### Exhibit 4: Vertical wise split up

	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
<b><u>Revenue by verticals (%)</u></b>						
BFSI	31.1	31.1	31.2	30.8	30.9	30.8
Retail & CPG	16.6	15.4	15.4	15.5	15.1	15.0
Communication and Media	7.1	7.1	6.8	6.9	6.8	6.9
Manufacturing	7.4	10.2	9.8	9.8	9.6	9.8
Life Sciences & Healthcare	7.2	7.3	7.5	7.6	7.7	7.9
Technology & services	7.8	9.0	8.9	8.7	8.6	8.8
Regional markets & others	18.0	19.9	20.4	20.7	21.3	20.8
<b><u>Growth QoQ (%)</u></b>						
BFSI	2.2	1.6	3.6	-0.6	3.1	1.3
Retail & CPG	3.2	-5.8	3.2	1.3	0.1	1.0
Communication and Media	3.9	1.6	-1.1	2.2	1.3	3.1
Manufacturing	2.5	40.0	-0.8	0.7	0.7	3.7
Life Sciences & Healthcare	2.4	3.0	6.1	2.0	4.2	4.3
Technology & services	2.5	17.2	2.1	-1.6	1.6	4.0
Regional markets & others	7.4	12.3	5.8	2.2	5.8	-0.8

Source: Company, ICICI Direct Research

Lifesciences & healthcare led the growth followed by communication and manufacturing. BFS may remain under pressure while retail could strike back to growth from Q2FY20E

### Exhibit 5: Client & human resource matrix

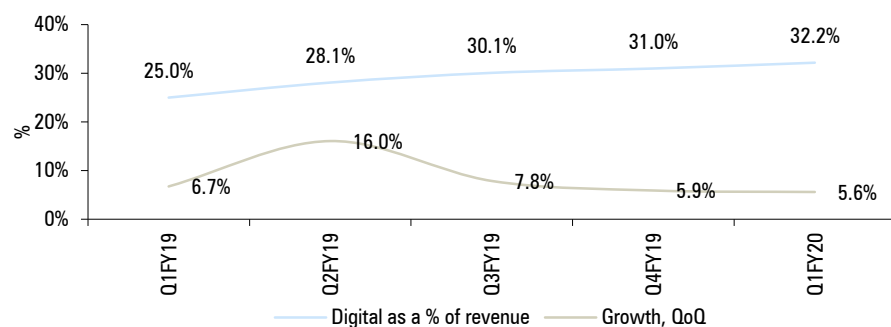
	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
<b><u>Client metrics</u></b>						
USD 1 mn+ clients	963	978	989	996	1008	1014
USD 5 mn+ clients	495	508	513	519	532	551
USD 10 mn+ clients	350	355	365	370	371	384
USD 20 mn+ clients	207	206	213	211	215	219
USD 50 mn+ clients	97	97	98	99	99	100
USD 100 mn+ clients	38	40	44	45	44	44
<b><u>Headcount, Attrition</u></b>						
Total Employees	394998	400875	411102	417929	424285	436641
Attrition, LTM (IT Services)	11.0	10.9	10.9	11.2	11.3	11.5

Source: Company, ICICI Direct Research

One client added in US\$50 mn+ category taking the count to 100

## Financial story in charts

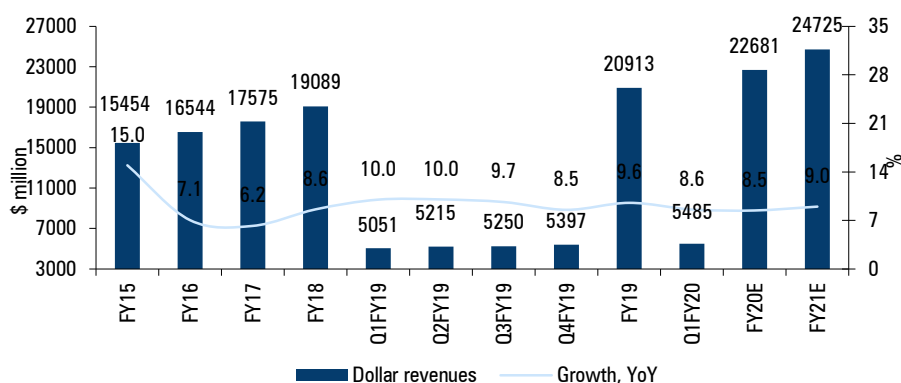
**Exhibit 6: Digital grew strong at 40% YoY in Q1FY20**



Digital business continues to ride on upward trajectory and constituted 32.2% of revenue (vs. 25% in Q1FY19) and grew 40% YoY in Q1FY20

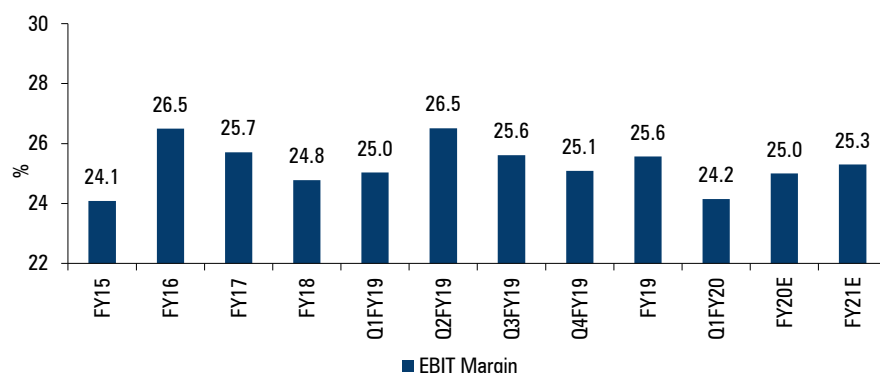
Source: Company, ICICI Direct Research

**Exhibit 7: Dollar revenues may grow at 8.7% CAGR in FY19-21E**



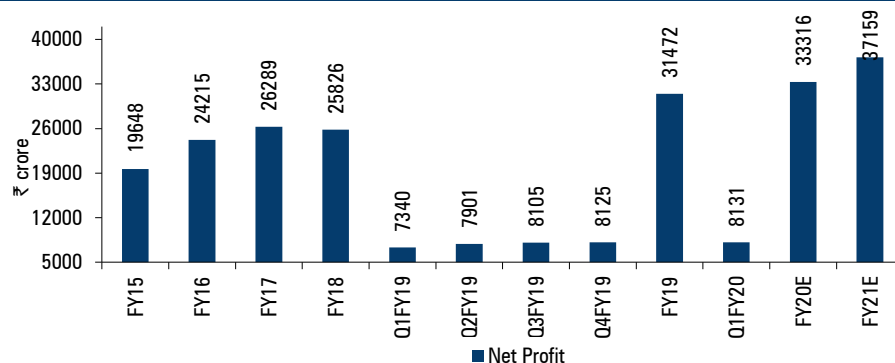
Source: Company, ICICI Direct Research

**Exhibit 8: Change in margin estimates for next two years**

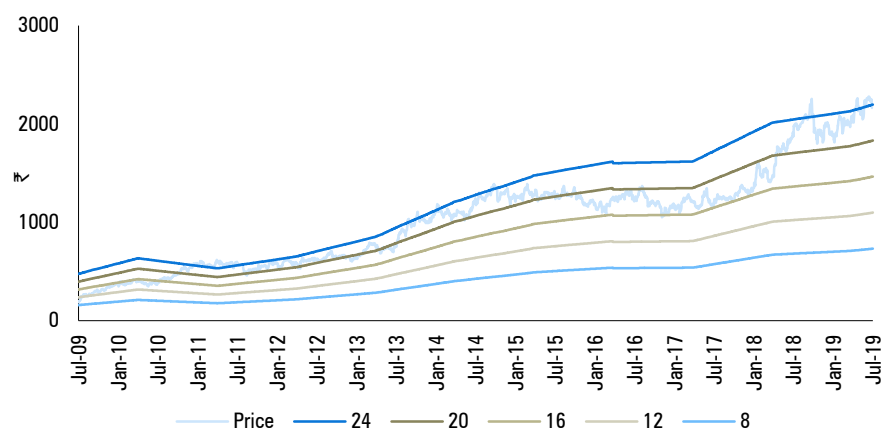


Source: Company, ICICI Direct Research

**Exhibit 9: PAT trend**



Source: Company, ICICI Direct Research

**Exhibit 10: One year forward rolling PE**


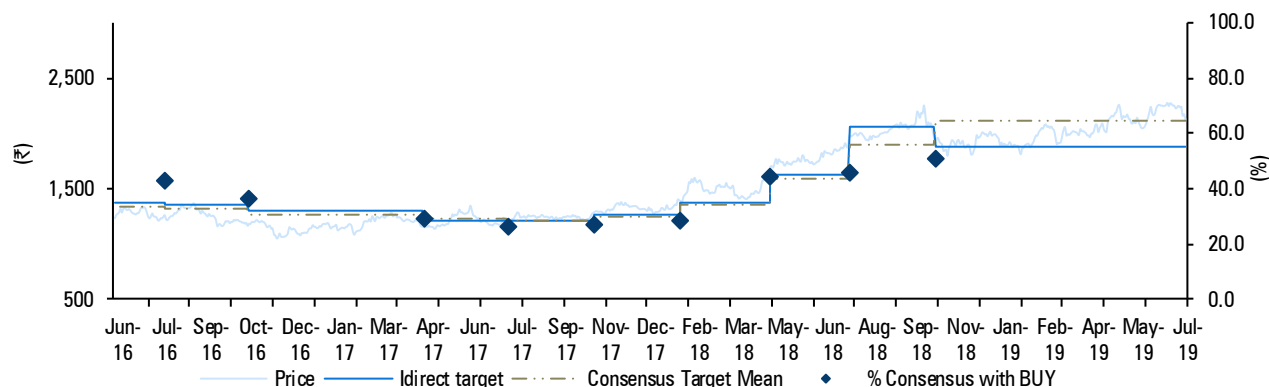
Source: Company, ICICI Direct Research

**Exhibit 11: Valuation**

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	117,966	8.6	66.7	8.5	31.6	23.0	29.8	37.9
FY18	123,104	4.4	67.4	1.1	31.2	23.0	29.6	37.6
FY19	146,463	19.0	83.8	24.3	25.0	18.9	34.4	43.8
FY20E	158,770	8.4	88.8	5.9	23.7	17.2	33.9	43.2
FY21E	173,076	9.0	99.0	11.5	21.2	15.3	35.1	44.7

Source: Company, ICICI Direct Research

**Exhibit 12: Recommendation History vs. Consensus**



Source: Bloomberg, Company, ICICI Direct Research

**Exhibit 13: Top 10 Shareholders**

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Tata Group of Companies	31-Mar-19	72.0%	2,702.5	0.0
2	Life Insurance Corporation of India	31-Mar-19	4.1%	152.5	0.0
3	The Vanguard Group, Inc.	31-May-19	0.9%	33.0	0.4
4	Stewart Investors	31-May-19	0.8%	29.2	-0.1
5	BlackRock Institutional Trust Company, N.A.	30-Jun-19	0.8%	29.0	0.0
6	SBI Funds Management Pvt. Ltd.	31-May-19	0.6%	20.9	-0.7
7	OppenheimerFunds, Inc.	31-May-19	0.5%	18.2	0.0
8	JPMorgan Asset Management U.K. Limited	30-Jun-19	0.5%	18.0	0.0
9	Axis Asset Management Company Limited	31-May-19	0.4%	15.7	-0.6
10	Vontobel Asset Management, Inc.	31-May-19	0.4%	13.3	0.1

Source: Reuters, ICICI Direct Research

**Exhibit 14: Recent Activity**

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
First State Investments (Singapore)	138.5m	4.4m	First State Investments (U.K.) Ltd	-138.5m	-4.4m
Harding Loevner LP	72.3m	2.5m	Fidelity International	-123.3m	-3.9m
FIL Investment Management (Hong Kong) Limited	62.6m	1.9m	Colonial First State Global Asset Management	-30.6m	-0.9m
Caisse de Depot et Placement du Quebec	44.4m	1.6m	Ivy Investment Management Company	-20.1m	-0.7m
Mirae Asset Global Investments (India) Pvt. Ltd.	30.6m	1.0m	SBI Funds Management Pvt. Ltd.	-20.9m	-0.7m

Source: Reuters, ICICI Direct Research

**Exhibit 15: Shareholding Pattern**

(in %)	Sep-18	Dec-18	Mar-19
Promoter	72.05	72.05	72.05
Public	27.95	27.95	27.95
Others	--	--	--
Total	100.00	100.00	100.00

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 16: Profit and loss statement ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
Total operating Income	123,104	146,463	158,770	173,076
Growth (%)	4.4	19.0	8.4	9.0
COGS (employee expenses)	69,274	83,102	90,658	98,653
S,G&A expenses	21,314	23,855	25,086	27,000
Total Operating Expenditure	90,588	106,957	115,744	125,653
EBITDA	32,516	39,506	43,027	47,423
Growth (%)	0.6	21.5	8.9	10.2
Depreciation	2,014	2,056	3,334	3,635
Other Income less interest	3,590	4,113	4,263	5,224
PBT	34,092	41,563	43,956	49,012
Total Tax	8,212	10,001	10,549	11,763
Minority Interest	54	90	90	90
Exceptional Item	0	0	0	0
PAT before exceptional item	25,826	31,472	33,316	37,159
Growth (%)	-1.8	21.9	5.9	11.5
EPS (₹)	67.4	83.8	88.8	99.0
PAT after exceptional item	25,826	31,472	33,316	37,159
EPS - Reported (₹)	67.4	83.8	88.8	99.0

Source: Company, ICICI Direct Research

Exhibit 17: Cash flow statement ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit before Tax	34,092	41,563	43,956	49,012
Add: Depreciation	2,014	2,056	3,334	3,635
(Inc)/dec in Current Assets	(3,172)	(5,910)	487	652
Inc/(dec) in CL and Provisions	3,141	3,598	1,928	2,193
Taxes paid	(7,609)	(9,958)	(10,549)	(11,763)
<b>CF from operating activities</b>	<b>28,166</b>	<b>31,667</b>	<b>35,660</b>	<b>39,429</b>
(Inc)/dec in Investments	1,646	474	(405)	27
(Inc)/dec in Fixed Assets	(1,804)	(2,132)	(2,382)	(2,596)
Others	0	(50)	3,496	4,300
<b>CF from investing activities</b>	<b>(253)</b>	<b>(1,664)</b>	<b>710</b>	<b>1,732</b>
Inc/(dec) in loan funds	(19)	(181)	0	0
Dividend paid & dividend tax	(10,726)	(11,424)	(26,622)	(29,467)
Others	(16,076)	(16,093)	0	0
<b>CF from financing activities</b>	<b>(26,845)</b>	<b>(27,711)</b>	<b>(26,622)</b>	<b>(29,467)</b>
Net Cash flow	1,068	2,292	9,747	11,694
Exchange difference	218	49	0	0
Opening Cash	4,027	6,939	12,652	22,399
<b>Closing Cash</b>	<b>6,939</b>	<b>12,652</b>	<b>22,399</b>	<b>34,094</b>

Source: Company, ICICI Direct Research

Exhibit 18: Balance sheet ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
<b>Liabilities</b>				
Equity Capital	191	375	375	375
Reserve and Surplus	84,254	88,615	95,309	103,002
Share Premium	2,796	2,566	2,566	2,566
Total Shareholders funds	87,241	91,556	98,250	105,943
Total debt	247	62	64	65
Other liabilities & Provisions	1,714	1,874	1,902	1,934
Deferred tax liability(net)	1,170	1,042	1,042	1,042
Minority Interest / Others	402	453	543	633
<b>Total Liabilities</b>	<b>90,774</b>	<b>94,987</b>	<b>101,800</b>	<b>109,617</b>
<b>Assets</b>				
Net assets & CWIP	11,612	11,829	10,876	9,838
Goodwill	3,884	3,834	3,834	3,834
Other non current assets	11,368	8,773	9,178	9,150
Debtors	25,037	27,441	29,747	32,427
Loans and Advances	4,339	11,847	11,908	7,788
Other Current Assets	9,523	11,586	8,732	9,519
Current Investments	35,707	29,091	29,091	29,091
Cash	6,939	12,652	22,399	34,094
Trade Payable	7,731	6,292	6,821	7,435
OCL & Provisions	9,904	15,774	17,144	18,689
<b>Application of Funds</b>	<b>90,774</b>	<b>94,987</b>	<b>101,800</b>	<b>109,617</b>

Source: Company, ICICI Direct Research

Exhibit 19: Key ratios ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
<b>Per share data (₹)</b>				
Adjusted EPS (Diluted)	67.4	83.8	88.8	99.0
BV per share	227.8	244.1	261.8	282.3
DPS	50.0	30.0	58.9	65.2
Cash Per Share	18.1	33.7	59.7	90.9
<b>Operating Ratios (%)</b>				
EBIT margins	24.8	25.6	25.0	25.3
PBT Margins	27.7	28.4	27.7	28.3
PAT Margin	21.0	21.5	21.0	21.5
Debtor days	74	68	68	68
Creditor days	23	16	16	16
<b>Return Ratios (%)</b>				
RoE	29.6	34.4	33.9	35.1
RoCE	37.6	43.8	43.2	44.7
RoIC	63.4	70.3	78.9	94.3
<b>Valuation Ratios (x)</b>				
P/E	31.2	25.0	23.7	21.2
EV / Net Sales	6.1	5.1	4.7	4.2
Market Cap / Sales	6.4	5.4	5.0	4.6
<b>Solvency Ratios</b>				
Debt / EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.2	2.3	2.1	1.9
Quick Ratio	2.2	2.3	2.1	1.9

Source: Company, ICICI Direct Research



**Exhibit 20: ICICI Direct coverage universe (IT)**

Sector / Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY18	FY19	FY20E	FY18	FY19	FY20E	FY18	FY19	FY20E	FY18	FY19	FY20E	FY18	FY19	FY20E
Cyient (INFENT)	540	620	Hold	6,530	36.0	42.4	46.6	16.1	13.7	12.4	10.3	9.1	7.5	21.4	21.4	20.7	17.3	18.7	18.1
Eclerx (ECLSER)	675	860	Reduce	3,532	72.9	60.0	63.1	12.7	15.5	14.7	8.0	9.1	9.2	28.2	21.5	24.8	24.1	16.5	18.9
Firstsource (FIRSOU)	51	60	Buy	3,502	4.8	5.4	5.9	10.7	9.4	8.6	8.8	7.2	6.2	13.0	14.0	15.7	13.9	13.9	13.8
HCL Tech (HCLTEC)	1,017	1,190	Hold	146,833	62.6	74.7	76.7	17.3	14.5	14.1	12.5	10.1	9.1	27.4	26.5	26.0	23.8	24.5	22.5
Infosys (INFTEC)	719	805	Buy	314,663	32.3	35.4	39.5	22.4	20.4	18.3	15.2	13.8	12.3	30.9	32.9	32.9	22.5	23.7	24.4
L&T Intotech (LTINFO)	1,570	1,940	Buy	29,148	64.7	87.3	94.6	26.0	19.2	17.7	23.2	14.3	12.3	36.0	40.4	36.4	28.8	31.0	27.8
NIIT Tech (NIITEC)	1,302	1,395	Hold	7,677	45.6	65.7	76.1	27.8	19.0	16.7	13.8	10.4	8.9	19.4	24.2	24.3	15.8	19.9	20.2
Persistent (PSYS)	613	650	Hold	5,119	40.5	44.0	48.7	15.8	14.6	13.2	9.1	7.1	6.4	19.8	20.5	20.5	15.2	15.0	14.9
TCS (TCS)	2,107	2,080	Hold	790,125	67.4	83.8	88.8	31.2	25.0	23.7	23.0	18.9	17.2	37.6	43.8	43.2	29.6	34.4	33.9
Tech M (TECMAH)	674	845	Hold	67,723	42.8	47.7	51.4	17.6	15.8	14.6	13.4	9.5	8.2	21.5	23.6	23.2	20.2	21.2	19.8
Wipro (WIPRO)	268	315	Buy	171,636	12.7	14.9	17.3	22.5	19.1	16.4	14.8	12.0	10.2	16.9	17.8	18.1	16.6	15.8	16.7

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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