

Tata Consultancy Services (TCS IN)

Rating: HOLD | CMP: Rs2,219 | TP: Rs2,106

January 18, 2020

Q3FY20 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY21E	FY22E	FY21E	FY22E
Rating	HOLD		HOLD	
Target Price	2,106		2,102	
Sales (Rs. m)	1,726,499	1,846,771	1,705,094	1,832,638
% Chng.	1.3	0.8		
EBITDA (Rs. m)	456,431	497,490	450,821	493,668
% Chng.	1.2	0.8		
EPS (Rs.)	94.0	101.9	93.7	101.9
% Chng.	0.4	-		

Key Financials - Standalone

Y/e Mar	FY19	FY20E	FY21E	FY22E
Sales (Rs. bn)	1,465	1,587	1,726	1,847
EBITDA (Rs. bn)	395	425	456	497
Margin (%)	27.0	26.8	26.4	26.9
PAT (Rs. bn)	315	330	356	386
EPS (Rs.)	83.0	87.0	94.0	101.9
Gr. (%)	23.8	4.8	8.0	8.3
DPS (Rs.)	30.0	86.5	54.0	54.0
Yield (%)	1.4	3.9	2.4	2.4
RoE (%)	36.1	36.8	36.6	33.9
RoCE (%)	42.8	43.6	44.1	41.1
EV/Sales (x)	5.5	5.1	4.6	4.2
EV/EBITDA (x)	20.2	19.1	17.5	15.8
PE (x)	26.7	25.5	23.6	21.8
P/BV (x)	9.4	9.4	8.0	6.8

Key Data

TCS.BO | TCS IN

52-W High / Low	Rs.2,286 / Rs.1,833
Sensex / Nifty	41,945 / 12,352
Market Cap	Rs.8,327bn/ \$ 117,213m
Shares Outstanding	3,752m
3M Avg. Daily Value	Rs.15151.07m

Shareholding Pattern (%)

Promoter's	72.05
Foreign	15.90
Domestic Institution	8.04
Public & Others	4.00
Promoter Pledge (Rs bn)	176.56

Stock Performance (%)

	1M	6M	12M
Absolute	2.5	6.9	19.5
Relative	1.1	(0.1)	3.6

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On expected lines...

TCS revenue growth continued to get dragged on account of headwinds in major segments like BFSI & Retail & US geography. TCS posted a weak 0.3% QoQ CC growth lower than our & street estimates of 0.9% QoQ CC. However, TCS positively surprised street in margins, increasing 100bps due to operational efficiency & currency tailwinds at 25%(Ple:24.9%, Cons:24.5%) in Q3FY20. Decrease in headcount (-4,063 employees QoQ) might have led to increase in utilization rates. The company stopped sharing digital revenues from the quarter.

BFSI & Retail contributes to 46% of the total revenues and are showing signs of weakness. TCS expects potentially weak demand trend to continue in Q4FY20E also. Management mentioned that challenges faced in BFSI vertical are primarily from select large banks in US & UK in traditional business.

Despite of strong order booking of US\$6.0bn, TCS management remained pessimistic about growth in Q4FY20E. With soft Q3 and uncertain outlook on sub segments of BFS and Retail, FY20E growth for TCS will likely be in high single digits (FY19 at 11.4% YoY in CC) lower than Infy (9%) & HCLT (11%) organic revenue growth in FY20E.

We maintain our cautious outlook on financial services & don't expect recovery soon. We believe conversion of backlog into revenues is happening slower than expected as clients try to optimize their run spends in an uncertain macro & upcoming elections.

TCS is a pioneer in IT services globally with strong execution across geographies, strong delivery team, consistent strategy which helps them to win wallet shares gains & helps them to deliver cross selling services in tight pricing environment. TCS is a fundamentally superior stock, but expensive valuations with moderating growth restrict us to stick with our HOLD rating. We expect TCS to deliver 7.5% revenue CAGR & EPS CAGR of 8.2% over FY20E-22E. We maintain our estimates & arrive at target price of Rs. 2106(earlier Rs.2102) (valued at 21.5x) Sep-21 earnings. TCS is currently trading at 21.9x/20.2x at FY21E/22E multiple.

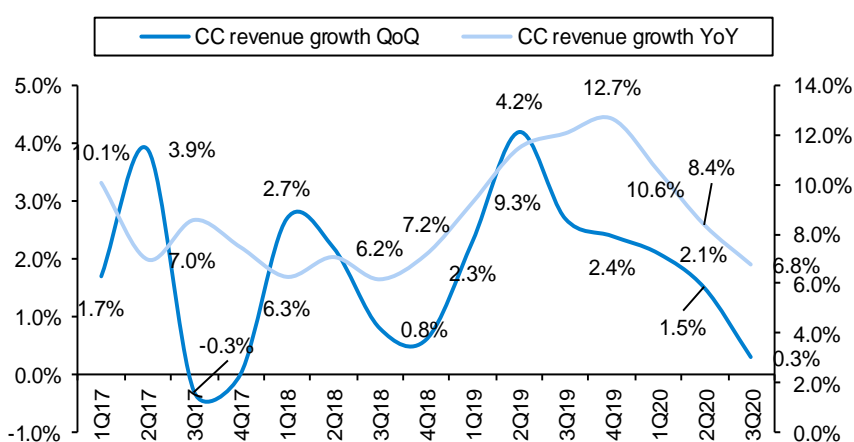
- **Tepid revenue acceleration, weak margin performance:** TCS posted a muted revenue growth of 1.3% QoQ USD, 0.3% QoQ CC inline with street estimates. However, TCS positively surprised street in margins, increasing 100bps due to operational efficiency & currency tailwinds at 25%(Ple:24.9%, Cons:24.5%) in Q3FY20. Decrease in headcount (-4,063 employees QoQ) might have led to increase in utilization rates. EPS of Rs21.6 (+0.1% YoY, -1.3% QoQ) was marginally lower due to FX loss and higher-than-expected interest cost. The company stopped sharing digital revenues from the quarter.
- **No signs of macro environment on deal wins:** TCS reported TCV of deal wins at US\$6 bn in the quarter. The TCV number does not include the mega deal announced with the Phoenix Group in November 2019. The quarterly book-to-bill ratio is within management comfort band of 1-1.2X.

Exhibit 1: Q3FY20 Result Overview (Rs mn)

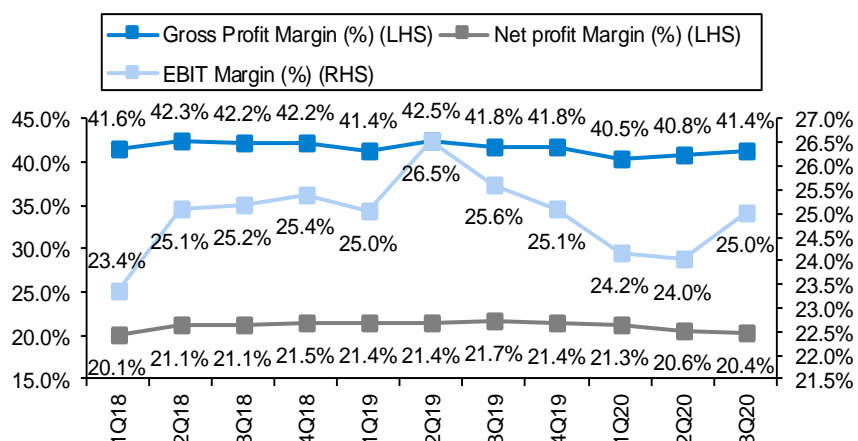
Y/e March	3Q20	2Q20	QoQ gr.	3Q19	YoY gr.	Ple	Ple vs Act
Revenues (US\$mn)	5,586	5,517	1.3%	5,250	6.4%	5,595	-0.2%
Revenues	3,98,540	3,89,770	2.3%	3,73,380	6.7%	3,98,504	0.0%
EBITDA	1,10,810	1,02,260	8.4%	1,00,830	9.9%	1,05,125	5.4%
EBITDA Margin	27.8%	26.2%	157 bps	27.0%	80 bps	26%	142 bps
EBIT	99,740	93,610	6.5%	95,640	4.3%	99,207	0.5%
EBIT Margin	25.0%	24.0%	101 bps	25.6%	-59 bps	24.9%	13 bps
Adjusted PAT	81,180	80,420	0.9%	81,050	0.2%	84,290	-3.7%
EPS (Rs)	21.6	21.4	0.9%	21.1	2.8%	22.48	-3.7%

Source: Company, PL

TCS posted weak revenue growth in the quarter, inline with estimates and below street expectations.

Exhibit 2: Revenue growth weaker than expectations


Source: Company, PL

Exhibit 3: Net Profit margin eroding below 21%


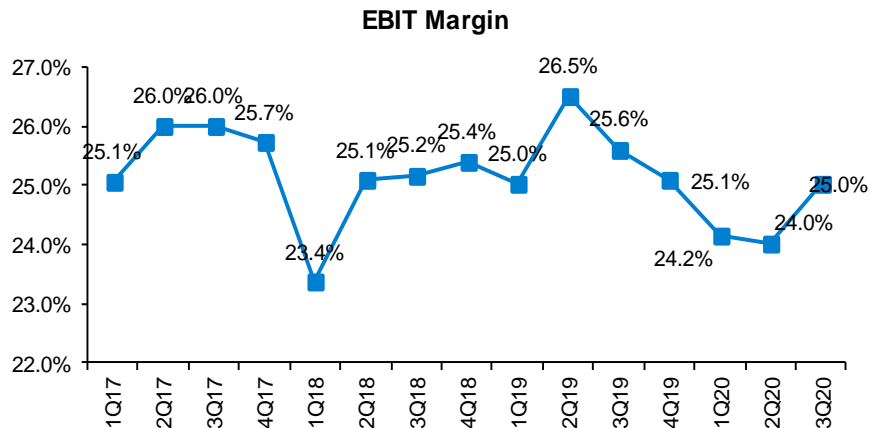
Source: Company, PL

TCS positively surprised street in margins, increasing 100bps due to operational efficiency & currency tailwinds at 25%(Pl:24.9%, Cons:24.5%) in Q3FY20.

TCS is planning to maintain SGA Expenses despite headwinds such as onsite hiring, localization, higher sub-contracting cost.

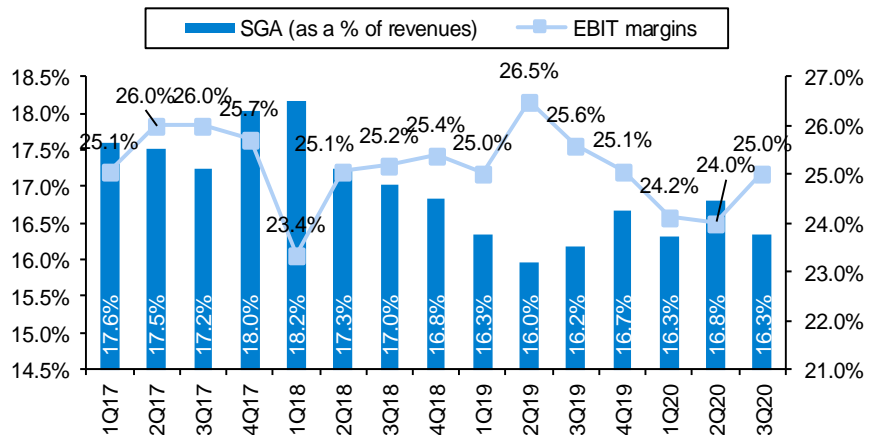
Higher Sub-contracting cost reflecting headwinds from onsite hiring, localization which are ultimately putting pressure on margins.

Exhibit 4: Strong margin performance



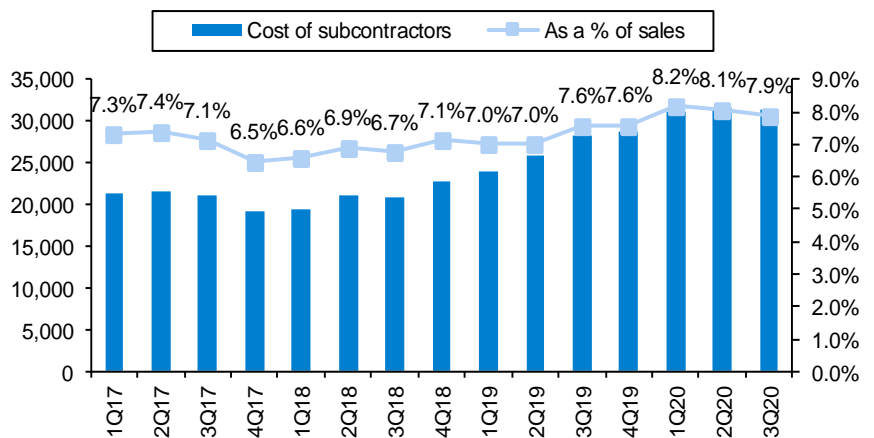
Source: Company, PL

Exhibit 5: Tailwind from decreasing SG&A expenses



Source: Company, PL

Exhibit 6: Sub-Contracting building new normal level

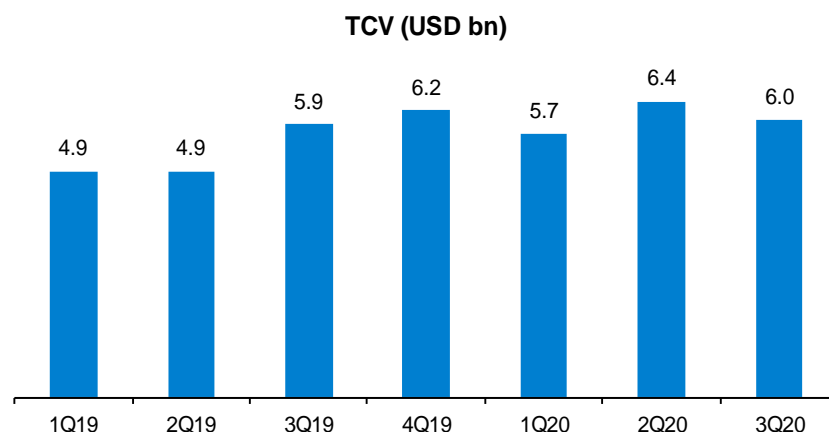


Source: Company, PL

TCS reported TCV of deal wins at US\$6 bn in the quarter. The TCV number does not include the mega deal announced with the Phoenix Group in November 2019.

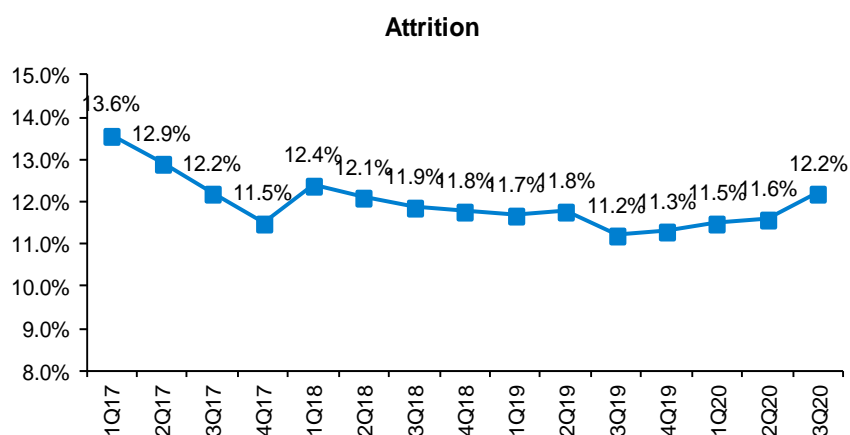
Attrition rate at 12.2%, up by 60bps QoQ

Exhibit 7: TCV Deal Pipeline continues to remain strong



Source: Company, PL

Exhibit 8: Attrition rate inched up during quarter



Source: Company, PL

Valuations

TCS is the most expensive stock (~23.3x one year forward P/E) under our coverage but because of its sector leading FCF generation & disciplined policy of returning all of that to shareholders' via dividend/buyback, TCS's FCF yield stands at 3-4%. TCS's predictable cash flow generation, strong revenue momentum, maintaining stable margin, tight balance sheet, stickiness of clients will help them **earlier** to maintain its premium valuations. We are seeing pricing pressure in TCS & supply side constraints are creating headwinds for the margins.

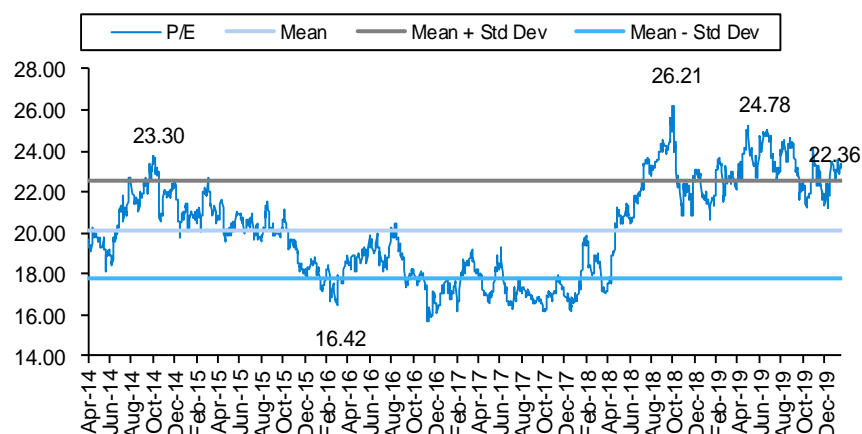
We continue to like the best in class resilience in business model of TCS. TCS is ahead of peers on all key attributes of success viz., 1) asset/IP creation through home grown platforms, both horizontal and vertical specific, 2) most expansive non-CIO centric go-to-market, and 3) scaled digital capabilities with early investments in reskilling reflected in high available capacity for digital and agile capabilities. **But now there are headwinds such as furloughs, US elections which leaves very limited space for any trigger for stock to react positively. Moderating revenue growth could lead to a derating.**

TCS is a fundamentally superior stock, but expensive valuations with moderating growth restrict us to stick with our HOLD rating. We expect TCS to deliver 7.5% revenue CAGR & EPS CAGR of 8.2% over FY20E-22E. We maintain our estimates & arrive at target price of Rs. 2106(earlier Rs.2102) (valued at 21.5x) Sep-21 earnings. TCS is currently trading at 21.9x/20.2x at FY21E/22E multiple.

Exhibit 9: Change in Estimates

Y/e March	FY20E	FY21E	FY22E
USD revenues (US\$ m)			
- New	22,499	24,317	26,011
- Old	22,357	24,015	25,812
<i>Change (%)</i>	<i>0.6%</i>	<i>1.3%</i>	<i>0.8%</i>
<i>USD Revenue growth YoY</i>	<i>7.6%</i>	<i>8.1%</i>	<i>7.0%</i>
EBIT Margin			
- New	24.6%	24.9%	25.4%
- Old	24.6%	24.9%	25.4%
<i>Change (%)</i>	<i>4 bps</i>	<i>-1 bps</i>	<i>0 bps</i>
Recurring EPS - Fully diluted (Rs)			
- New	87.0	94.0	101.9
- Old	87.3	93.7	101.9
<i>Change (%)</i>	<i>-0.3%</i>	<i>0.4%</i>	<i>0.0%</i>

Source: PL

Exhibit 10: One year forward PE chart of TCS


Source: Bloomberg, Company, PL

Exhibit 11: Geography-wise revenues

(US\$ m)	3Q20	2Q20	QoQ gr.	3Q19	YoY gr.	YoY (CC)
America	2,910	2,896	0.5%	2,793	4.2%	
North America	2,799	2,792	0.3%	2,688	4.1%	4.1%
Ibero America	112	105	6.6%	105	6.4%	6.2%
Europe	1,720	1,666	3.3%	1,554	10.7%	
UK	888	861	3.2%	814	9.1%	7.5%
Continental Europe	832	805	3.3%	740	12.4%	15.9%
India	318	314	1.3%	299	6.4%	6.4%
Asia Pacific	519	519	0.2%	494	5.3%	5.7%
MEA	123	121	1.3%	110	11.5%	10.8%
% of Total						
America	52.1%	52.5%	-40 bps	53.2%	-110 bps	
North America	50.1%	50.6%	-50 bps	51.2%	-110 bps	
Ibero America	2.0%	1.9%	10 bps	2.0%	0 bps	
Europe	30.8%	30.2%	60 bps	29.6%	120 bps	
UK	15.9%	15.6%	30 bps	15.5%	40 bps	
Continental Europe	14.9%	14.6%	30 bps	14.1%	80 bps	
India	5.7%	5.7%	0 bps	5.7%	0 bps	
Asia Pacific	9.3%	9.4%	-10 bps	9.4%	-10 bps	
MEA	2.2%	2.2%	0 bps	2.1%	10 bps	

Source: Company, PL

Exhibit 12: Vertical-wise revenues

(US\$ m)	3Q20	2Q20	QoQ gr.	3Q19	YoY gr.	YoY (CC)
BFSI	1,698	1,710	-0.7%	1,617	5.0%	5.3%
Retail & CPG	849	817	4.0%	814	4.3%	5.1%
Comm & media	391	386	1.3%	362	7.9%	9.5%
Mfg	559	541	3.3%	515	8.6%	9.2%
Life Sc & Healthcare	464	447	3.8%	399	16.2%	17.1%
Tech Services	469	480	-2.2%	457	2.7%	3.3%
Regional Markets & Others	1,156	1,137	1.7%	1,087	6.4%	5.7%
Total	5,586	5,517	1.3%	5,250	6.4%	6.8%
% of Total						
BFSI	30.4%	31.0%	-60 bps	30.8%	-40 bps	
Retail & CPG	15.2%	14.8%	40 bps	15.5%	-30 bps	
Comm & media	7.0%	7.0%	0 bps	6.9%	10 bps	
Mfg	10.0%	9.8%	20 bps	9.8%	20 bps	
Life Sc & Healthcare	8.3%	8.1%	20 bps	7.6%	70 bps	
Tech Services	8.4%	8.7%	-30 bps	8.7%	-30 bps	
Regional Markets & Others	20.7%	20.6%	10 bps	20.7%	0 bps	
Digital Revenue	33.2%	33.2%	0 bps	30.1%	310 bps	

Source: Company, PL

Exhibit 13: Client Metrics

	3Q20	2Q20	QoQ gr.	3Q19	YoY gr.
US\$ 1mn clients	1,053	1,032	21	996	57
US\$ 5mn clients	557	554	3	519	38
US\$ 10mn clients	395	398	-3	370	25
US\$ 20mn clients	232	225	7	211	21
US\$ 50mn clients	102	101	1	99	3
US\$ 100mn clients	47	47	0	45	2

Source: Company, PL

Exhibit 14: Headcount Metrics

Headcount Metrics	3Q20	2Q20	QoQ gr.	3Q19	YoY gr.
Headcount	4,46,675	4,50,738	-0.9%	4,17,929	6.9%
Net Addition (Consolidated)	-4,063	14,097	-128.8%	6,827	-159.5%
Overall Attrition	12.2%	11.6%	60 bps	11.2%	100 bps

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Net Revenues	1,464,630	1,586,785	1,726,499	1,846,771
YoY gr. (%)	19.0	8.3	8.8	7.0
Employee Cost	835,090	906,140	974,134	1,032,761
Gross Profit	629,540	680,645	752,365	814,010
Margin (%)	43.0	42.9	43.6	44.1
SG&A Expenses	-	-	-	-
Other Expenses	-	-	-	-
EBITDA	395,050	424,630	456,431	497,490
YoY gr. (%)	21.5	7.5	7.5	9.0
Margin (%)	27.0	26.8	26.4	26.9
Depreciation and Amortization	20,550	34,061	27,156	29,054
EBIT	374,500	390,569	429,276	468,436
Margin (%)	25.6	24.6	24.9	25.4
Net Interest	-	-	-	-
Other Income	41,130	41,310	41,740	43,264
Profit Before Tax	415,630	431,879	471,016	511,699
Margin (%)	28.4	27.2	27.3	27.7
Total Tax	100,010	101,195	114,375	125,354
Effective tax rate (%)	24.1	23.4	24.3	24.5
Profit after tax	315,620	330,684	356,642	386,345
Minority interest	900	790	300	300
Share Profit from Associate	-	-	-	-
Adjusted PAT	314,720	329,894	356,342	386,045
YoY gr. (%)	21.9	4.8	8.0	8.3
Margin (%)	21.5	20.8	20.6	20.9
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	314,720	329,894	356,342	386,045
YoY gr. (%)	21.9	4.8	8.0	8.3
Margin (%)	21.5	20.8	20.6	20.9
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	314,720	329,894	356,342	386,045
Equity Shares O/s (m)	3,790	3,790	3,790	3,790
EPS (Rs)	83.0	87.0	94.0	101.9

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Non-Current Assets				
Gross Block	156,630	295,035	307,971	319,107
Tangibles	116,500	254,905	267,841	278,977
Intangibles	40,130	40,130	40,130	40,130
Acc: Dep / Amortization	-	-	-	-
Tangibles	-	-	-	-
Intangibles	-	-	-	-
Net fixed assets	156,630	295,035	307,971	319,107
Tangibles	116,500	254,905	267,841	278,977
Intangibles	40,130	40,130	40,130	40,130
Capital Work In Progress	-	-	-	-
Goodwill	-	-	-	-
Non-Current Investments	2,390	2,390	2,390	2,390
Net Deferred tax assets	-	-	-	-
Other Non-Current Assets	69,100	69,100	69,100	69,100
Current Assets				
Investments	-	-	-	-
Inventories	-	-	-	-
Trade receivables	325,030	399,870	435,078	465,386
Cash & Bank Balance	419,390	307,087	423,212	573,991
Other Current Assets	176,890	63,471	69,060	73,871
Total Assets	1,149,430	1,136,953	1,306,811	1,503,845
Equity				
Equity Share Capital	3,750	3,750	3,750	3,750
Other Equity	890,710	892,791	1,044,486	1,225,885
Total Network	894,460	896,541	1,048,236	1,229,635
Non-Current Liabilities				
Long Term borrowings	-	-	-	-
Provisions	-	-	-	-
Other non current liabilities	34,130	34,130	34,130	34,130
Current Liabilities				
ST Debt / Current of LT Debt	440	-	-	-
Trade payables	-	-	-	-
Other current liabilities	220,400	206,282	224,445	240,080
Total Equity & Liabilities	1,149,430	1,136,953	1,306,811	1,503,845

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
PBT	415,630	431,879	471,016	511,699
Add. Depreciation	20,550	34,061	27,156	29,054
Add. Interest	-	-	-	-
Less Financial Other Income	41,130	41,310	41,740	43,264
Add. Other	-	-	-	-
Op. profit before WC changes	436,180	465,940	498,172	540,754
Net Changes-WC	(49,510)	24,461	(22,634)	(19,484)
Direct tax	(100,010)	(101,195)	(114,375)	(125,354)
Net cash from Op. activities	286,660	389,206	361,163	395,916
Capital expenditures	(22,220)	(172,465)	(40,092)	(40,191)
Interest / Dividend Income	-	-	-	-
Others	620	-	-	-
Net Cash from Invst. activities	(21,600)	(172,465)	(40,092)	(40,191)
Issue of share cap. / premium	1,840	-	-	-
Debt changes	(1,910)	(440)	-	-
Dividend paid	(113,692)	(327,813)	(204,646)	(204,646)
Interest paid	-	-	-	-
Others	(160,588)	(790)	(300)	(300)
Net cash from Fin. activities	(274,350)	(329,043)	(204,946)	(204,946)
Net change in cash	(9,290)	(112,303)	116,125	150,779
Free Cash Flow	264,440	216,741	321,071	355,725

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY19	FY20E	FY21E	FY22E
Per Share(Rs)				
EPS	83.0	87.0	94.0	101.9
CEPS	88.5	96.0	101.2	109.5
BVPS	236.0	236.6	276.6	324.5
FCF	69.8	57.2	84.7	93.9
DPS	30.0	86.5	54.0	54.0
Return Ratio(%)				
RoCE	42.8	43.6	44.1	41.1
ROIC	36.3	36.5	36.3	33.3
RoE	36.1	36.8	36.6	33.9
Balance Sheet				
Net Debt : Equity (x)	(0.5)	(0.3)	(0.4)	(0.5)
Debtor (Days)	81	92	92	92
Valuation(x)				
PER	26.7	25.5	23.6	21.8
P/B	9.4	9.4	8.0	6.8
P/CEPS	25.1	23.1	21.9	20.3
EV/EBITDA	20.2	19.1	17.5	15.8
EV/Sales	5.5	5.1	4.6	4.2
Dividend Yield (%)	1.4	3.9	2.4	2.4

Source: Company Data, PL Research

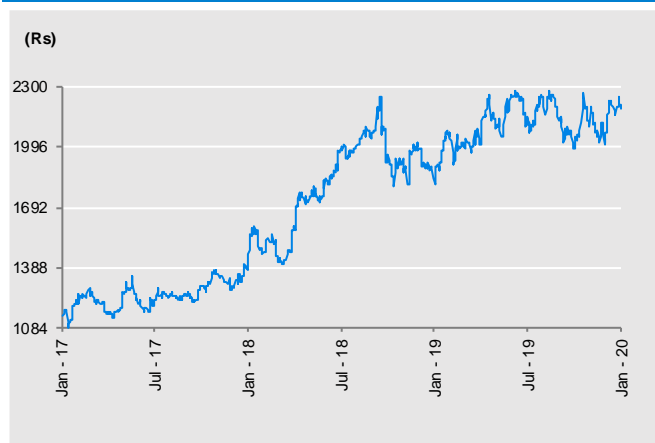
Quarterly Financials (Rs m)

Y/e Mar	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Net Revenue	380,100	381,720	389,770	398,540
YoY gr. (%)	18.5	11.4	5.8	6.7
Raw Material Expenses	217,090	221,020	224,100	224,720
Gross Profit	163,010	160,700	165,670	173,820
Margin (%)	42.9	42.1	42.5	43.6
EBITDA	100,730	100,370	102,260	110,810
YoY gr. (%)	16.4	10.6	(0.5)	9.9
Margin (%)	26.5	26.3	26.2	27.8
Depreciation / Depletion	5,360	8,170	8,650	11,070
EBIT	95,370	92,200	93,610	99,740
Margin (%)	25.1	24.2	24.0	25.0
Net Interest	-	-	-	-
Other Income	11,650	14,180	11,680	5,950
Profit before Tax	107,020	106,380	105,290	105,690
Margin (%)	28.2	27.9	27.0	26.5
Total Tax	25,500	24,850	24,710	24,260
Effective tax rate (%)	23.8	23.4	23.5	23.0
Profit after Tax	81,520	81,530	80,580	81,430
Minority interest	260	220	160	250
Share Profit from Associates	-	-	-	-
Adjusted PAT	81,260	81,310	80,420	81,180
YoY gr. (%)	17.7	10.8	1.8	0.2
Margin (%)	21.4	21.3	20.6	20.4
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	81,260	81,310	80,420	81,180
YoY gr. (%)	17.7	10.8	1.8	0.2
Margin (%)	21.4	21.3	20.6	20.4
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	81,260	81,310	80,420	81,180
Avg. Shares O/s (m)	3,750	3,750	3,750	3,750
EPS (Rs)	21.7	21.7	21.4	21.6

Source: Company Data, PL Research

Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	3-Jan-20	Hold	2,102	2,201
2	17-Dec-19	Hold	2,106	2,127
3	11-Oct-19	Hold	1,985	2,004
4	3-Oct-19	BUY	2,273	2,060
5	10-Jul-19	BUY	2,291	2,133
6	4-Jul-19	BUY	2,291	2,243
7	10-Jun-19	BUY	2,312	2,182
8	15-Apr-19	BUY	2,312	2,013
9	5-Apr-19	BUY	2,265	2,048

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	Hold	450	437
2	HCL Technologies	BUY	628	585
3	Hexaware Technologies	Hold	349	336
4	Infosys	BUY	820	738
5	L&T Technology Services	Hold	1,437	1,511
6	Larsen & Toubro Infotech	BUY	2,119	1,925
7	Mindtree	Reduce	808	863
8	Mphasis	Accumulate	1,010	884
9	NIIT Technologies	Accumulate	1,551	1,631
10	Persistent Systems	Hold	616	695
11	Redington (India)	BUY	114	117
12	Sonata Software	Accumulate	400	313
13	Tata Consultancy Services	Hold	2,102	2,201
14	TeamLease Services	Hold	3,203	2,487
15	Tech Mahindra	Reduce	656	775
16	Wipro	Hold	253	256
17	Zensar Technologies	Accumulate	246	191

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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