Sharekhan
by BNP PARIBAS

Tata Consultancy Services

Mixed bag of a quarter

Sector: IT & ITES
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 1,716**	
Price Target: **Rs. 1,920**	↓

↑ Upgrade ↔ No change ↓ Downgrade

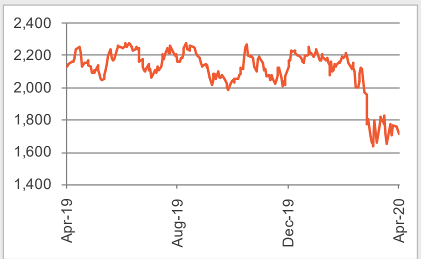
Company details

Market cap:	Rs. 643,759 cr
52-week high/low:	Rs. 2,296 / 1,504
NSE volume: (No of shares)	31.2 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCS
Free float: (No of shares)	104.9 cr

Shareholding (%)

Promoters	72.1
FII	15.5
DII	8.5
Others	3.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.5	-23.4	-16.1	-20.0
Relative to Sensex	3.4	3.7	4.6	1.8

Sharekhan Research, Bloomberg

Tata Consultancy Services (TCS) delivered below-than-expected revenue growth, while margins remained inline with expectations. Constant currency (CC) revenue growth remained at 3.0% y-o-y, significantly moderating from 6.8% y-o-y in Q3FY2020, owing to supply disruptions and deterioration in demand environment due to the Covid-19 outbreak. The financial services vertical was the key drag during the quarter given its inability to get approval for work-from-home (WFH) from large banks due to regulatory complexities. In USD terms, revenue growth was down 2.5% q-o-q [multi-quarter low after the global financial crisis (GFC)] but up by 0.9% y-o-y. EBIT margins improved by 10 bps q-o-q to 25.1%, inline with our expectations. Cost efficiency measures and benefits of rupee depreciation helped TCS to offset margin headwinds from slower revenue growth and lower utilisation. TCS reported strong deal total consideration value (TCV) of $8.9 billion (versus $6.0 billion in Q3FY2020) at the time of tough demand environment. Management expects peak negative revenue impact in Q1FY2021E owing to material deterioration of demand environment, which could be at the similar level (with a deviation of +/- few bps) during global financial crisis (GFC). Though the company reported strong deal wins, we believe the ramp-up of deals will be impacted in the nearterm owing to travel restrictions in many countries. We believe there would be sharp decline in revenues during H1FY2021E followed by gradual improvement in revenues in H2FY2021E.

Key positives

- TCS signed a strong TCV of $8.9 billion in Q4FY2020 (strong book-to-bill of 1.6x)
- Growth in life science and healthcare vertical remains strong

Key negatives

- Growth prospects in BFSI vertical remain tepid owing to supply disruption and low interest rates in key markets
- Expect sharp decline in revenue in Q1FY2021E

Our Call

Valuation –Maintain Buy with a PT of Rs. 1,920: We have slashed our earnings estimates for FY20121E/FY2022E, factoring in weak results in Q4FY2020 and revenue leakage in Q1FY2021 due to supply disruptions. However, we continue to prefer TCS on account of strength in its business model, consistency, solid execution and strong free cash flow (FCF) generation profile.Superior execution, leadership in digital segment, comprehensive set of offerings and a strong complimentary product and platform portfolio make TCS well-positioned to capitalise on opportunities when client technology spending increases. At CMP, the stock is trading at 21x/19x of its FY2021E/ FY2022E earnings, which is a 17% discount to valuations prevalent at the beginning of CY2020. We believe that TCS is an excellent business to own at the right price and the recent correction in the stock price offers investors that opportunity. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 1,920.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/ orconstraint in local talent supply in the USand a stringent visa regime would have an adverse impact on its earnings.

Valuation Rs cr

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Revenue	123,104.0	146,463.0	156,949.0	156,819.3	167,572.1
OPM (%)	26.4	27.0	26.8	25.9	26.4
Adjusted PAT	25,826.0	31,472.0	32,340.0	31,161.9	34,129.1
% YoY growth	-1.8	21.9	2.8	-3.6	9.5
Adjusted EPS (Rs.)	67.1	83.1	86.2	83.0	91.0
P/E (x)	25.6	20.7	19.9	20.7	18.9
P/B (x)	7.5	7.2	7.4	7.5	7.2
EV/EBITDA (x)	10.0	16.0	15.3	15.9	14.6
RoNW (%)	29.6	35.9	36.6	36.0	38.8
RoCE (%)	33.9	41.3	40.9	38.9	41.7

Source: Company; Sharekhan estimates

Revenue missed, margin in-line

Revenue growth was weak in Q4FY2020 and missed consensus estimates. TCS reported constant currency revenue growth of 3.0% y-o-y, a moderation from 6.8% in Q3FY2020. The decline in revenue growth was due to Covid-19 outbreak, which led to revenue leakage. Financial services and regional markets verticals were the key drags, while for remaining verticals revenue was up y-o-y during the quarter. We estimate the sequential revenue decline of 3.4% on CC terms, which is significantly below our expectations. In US Dollar terms, revenue growth was down 2.5% q-o-q [multi-quarter low after the global financial crisis (GFC)] and up 0.9% y-o-y. EBIT margin improved 10BPS q-o-q to 25.1%, in-line with our expectations. Cost efficiency measures and rupee tailwinds helped TCS to offset margin headwinds from slower revenue growth and lower utilisation. Net income came in at Rs. 8,049 crore and was below our estimates, owing to lower-than-expected other income.

Expect sharp revenue decline in Q1FY2021E; deal wins remains strong

TCS' management highlighted that Covid-19 outbreak has caused supply disruption and a material deterioration in the demand environment, which resulted in leakage of revenue in Q4FY2020. It believes that the impact on its revenues from the Covid-19 led crisis would be at par with global financial crisis (GFC). Though the GFC crisis initially impacted the financial vertical and then took a severe toll on the real economy, the Covid-19 crisis, by contrast, has impacted several sectors at a time. Thus, management expects peak negative revenue impact in Q1FY2021E, which would be at the similar level (deviation of +/- few bps) during GFC. During GFC, the company's US Dollar revenues declined 5.8% and 3.4% on sequential basis in Q3FY2009 and Q4FY2009 respectively. The decline in revenue would also be attributed to inability to get the work-from-home (WFH) approvals from large BFSI clients due to regulatory complexity and security reasons. Though TCS reported strong deal wins of $8.9 billion during the quarter, we believe the ramp-up of deals will be impacted in the near-term owing to travel restrictions in major countries. Further, the growth prospects in BFSI vertical remain tepid considering low interest rates across major economies. We believe there would be sharp decline in revenues and margin during H1FY2021E owing to material deterioration in demand environment followed by gradual improvement in revenues in H2FY2021E. We expect normalised growth from FY2022E onward on account of acceleration of investments in technologies by the large clients across the verticals.

Key result highlights from earnings call

- **Large deal wins:** Strong deal wins continued in Q4FY2020, with deal TCVs of $8.9 billion (versus $6 billion in Q3FY2020). Book-to-bill ratio during the quarter increased to 1.63x in Q3FY2020 versus 1.07x in Q3FY2020. TCS signed deals worth $5.3 billion in North America, $2.4 billion in the BFSI vertical and $3.1 billion in the retail vertical.
- **Strong client metrics:** The number of $100-million clients increased by two on a sequential basis, taking total count of such client to 49. The number of $50 million clients increased by three on a q-o-q basis and by six y-o-y. The number of clients under the $20 million client bucket increased by eight sequentially.
- **BFSI vertical outlook:** For the past four consecutive quarters, growth in the BFSI vertical has been decelerating owing to tightening of spends by traditional banks. CC revenue growth declined to 1.3% during the quarter, owing to supply side constraints. The company faced execution challenges during the quarter due to inability of getting approval from large banks on account of security/regulatory complexity. The negative impact on BFSI revenue would continue in Q1FY2021 due to supply disruption.
- **Life sciences and healthcare:** Growth in life sciences had a very strong quarter with a growth of 16.2%. Strong domain knowledge and ability to bring the power of digital technologies across the entire value chain in both these domains has helped the company to win many transformational engagements. Management highlighted life sciences vertical is less impacted owing to Covid-19 outbreak, though there are certain pockets of weakness due to lower utilization of hospitals. Management sees significant opportunities are emerging in this vertical.
- **Negative outlook on communications and media vertical:** The company delivered CC revenue growth of 9.3% y-o-y as against 9.5% in Q3FY2020. Management believes that the technology spends by clients in this vertical would be impacted owing to cancellation of sporting events and closure of studios that would impact the content creation on over-the-top (OTT) platform.
- **Fixed price projects:** The company has not seen any slippages and request for discounts in its fixed price projects. Management confirmed that its fixed price projects are on track.
- **Hiring freeze:** Management cited that there will be no retrenchment of the workforce and will honour all the offers made during the year including the 30,000 odd freshers. However, there is a complete freeze on lateral hiring beyond the offers already made.
- **Work-from-home update:** Around 90% of its employees are now enabled to WFH. The company's could-based monitoring system is tracking progress of all its projects and deliveries.
- **Retail vertical:** Retail & CPG vertical grew 4.2% y-o-y during the quarter despite disruption in businesses of its sub vertical such as travel, transport and hospitality.
- **Post Covid-19 impact:** Management believes that there will a shift in technologies in the areas such as collaboration tools especially in digital technologies migration to cloud will be faster and scope in intelligence and analytics.
- **Strategy to deal Covid-19 crisis:** Management stated that it is working with four themes – (1) operational that focuses on execution quality , (2) feedback from customer, (3) talent model and continued investment on reskilling to prepare employees for rapid shift and (4) financial model

Results Rs cr

Particulars (IFRS)	Q4FY20	Q4FY19	Q3FY20	YoY (%)	QoQ (%)
Revenue ($ mn)	**5,444.0**	**5,397.0**	**5,586.0**	**0.9**	**-2.5**
Revenue in INR (cr)	**39,946.0**	**38,010.0**	**39,854.0**	**5.1**	**0.2**
Direct costs	22,441.0	21,709.0	22,682.0	3.4	-1.1
Gross profit	**17,505.0**	**16,301.0**	**17,172.0**	**7.4**	**1.9**
SG&A	6,529.0	6,228.0	6,301.0	4.8	3.6
EBITDA	**10,976.0**	**10,073.0**	**10,871.0**	**9.0**	**1.0**
Depreciation	951.0	536.0	897.0	77.4	6.0
EBIT	**10,025.0**	**9,537.0**	**9,974.0**	**5.1**	**0.5**
Other income	487.0	1,165.0	595.0	-58.2	-18.2
PBT	10,512.0	10,702.0	10,569.0	-1.8	-0.5
Tax provision	2,419.0	2,549.9	2,426.0	-5.1	-0.3
Net profit	**8,093.0**	**8,152.1**	**8,143.0**	**-0.7**	**-0.6**
Minority interest	44.0	16.1	25.0	174.0	76.0
Adj. Net Profit	8,049.0	8,136.0	8,118.0	-1.1	-0.8
EPS (Rs.)	**21.5**	**21.7**	**21.6**	**-1.1**	**-0.8**
Margin (%)				**BPS**	**BPS**
EBITDA	27.5	26.5	27.3	98	20
EBIT	25.1	25.1	25.0	1	7
NPM	20.1	21.4	20.4	-126	-22

Source: Company; Sharekhan Research

Operating metrics

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%) q-o-q	$ Growth (%) y-o-y	CC growth (%) q-o-q
Revenue ($ mn)	5,444	100	-2.5	0.9	3.0
Geographic mix					
North America	2,738	50.3	-2.2	0.1	0.2
Latin America	98	1.8	-7.7	-9.2	3.9
U.K.	871	16.0	-1.9	1.5	5.4
Continental Europe	827	15.2	-0.6	8.7	11.9
India	299	5.5	-6.0	-4.3	-1.9
APAC	506	9.3	-2.5	-1.3	3.5
MEA	103	1.9	-15.8	-4.2	1.3
Industry verticals					
BFSI	1,617	29.7	-4.8	-2.7	-1.3
Retail & CPG	838	15.4	-1.3	2.9	4.2
Communication & media	392	7.2	0.2	5.3	9.3
Manufacturing	550	10.1	-1.6	6.1	7.0
Life Science and healthcare	479	8.8	3.3	15.3	16.2
Technology & services	474	8.7	0.9	2.0	3.5
Regional markets and others	1,617	29.7	-4.8	-2.7	-1.3

Source: Company; Sharekhan Research

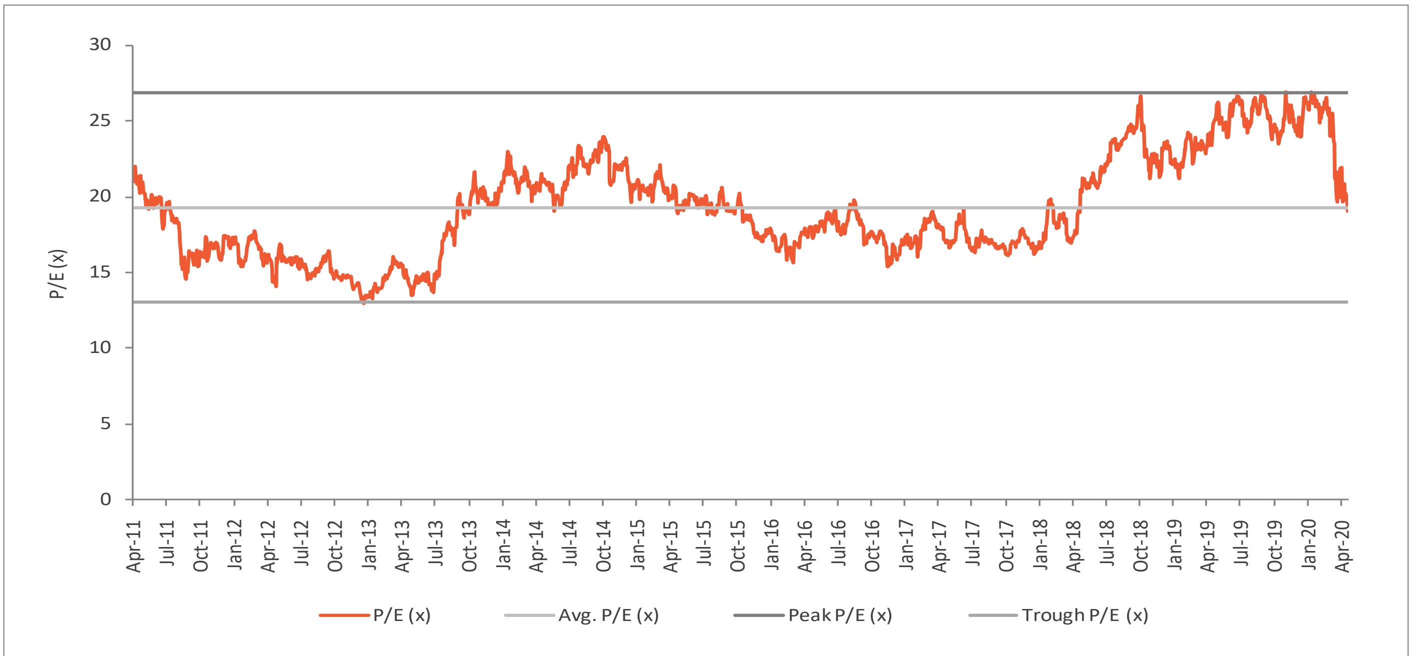
Outlook

The Covid-19 outbreak is causing supply disruption and will lead to material deterioration of demand environment and a cut in discretionary spending, request for rate concession and postponement of large deals wins.Note that TCS provides services to a large number of Fortune 500/ G-500 clients and these have a strong balance sheet and are able to hold on better in economic downturn. Being one of the largest IT services companies worldwide and preferred partners of clients, TCS has the ability to capture a substantial portion of spends ondigital technology and is well-positioned to capitalise on opportunities as and when clients boost their technology spends. Further, the company is well-placed from a competitive perspective, especially in newer technologies. A stable management along with the ability to structure large multi-service deals and resilient margin performance would help TCS to recover its growth once situation normalises. Though tightening of spends by traditional banks in the US and the UK is impacting its growth in the financial services vertical, the company has gained relative market sharein the BFSI space in the past few quarters. Management intends to keep the payout ratio at 80-100% of free cash generated.

Valuation

Maintain Buy with a PT of Rs. 1,920: We have slashed our earnings estimates for FY20121E/FY2022E, factoring inweak results in Q4FY2020 and revenue leakage in Q1FY2021 due to supply disruptions. However, we continue to prefer TCS on account of strength in its business model, consistency, solid execution and strong free cash flow (FCF) generation profile.Superior execution, leadership in digital segment, comprehensive set of offerings and a strong complimentary product and platform portfolio make TCS well-positioned to capitalise on opportunities when client technology spending increases. At CMP, the stock is trading at 21x/19x of its FY2021E/FY2022E earnings, which is a 20% discount to valuations prevalent at the beginning of CY2020. We believe that TCS is an excellent business to own at the right price and the recent correction in the stock price offers investors that opportunity. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 1,920.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About company

TCS is among the pioneers of IT services outsourcing business in India and is the largest ($20,913 million revenue in FY2019) IT services firm in terms of export revenue. Incorporated in 1968,the company provides a comprehensive range of IT services to industries such as BFS, insurance, manufacturing, telecommunications, retail and transportation. TCS is well positioned to benefit from growing demand for offshore IT services, given its solid execution capabilities, long-standing relationships with clients, and stable management team. The companyis a serious contender for winning large deals, as it has better experience compared to peers in implementing large, complex and mission-critical projects. TCS is one of the preferred IT vendors for most Fortune 500/Global 1,000 companies.

Investment theme

TCS is one of the leading IT services companies with a wide-range of capabilities, robust digital competencies, strong platform and stable management.The companyis the preferred partner of large corporates and is increasing its participation in large digital implementation. Hence, we believe TCS would continue to gain market share in digital versus its large peers, given its superior execution capabilities on the digital front. We remain positive on the sustainability of its revenue growth momentum in the medium term, given the acceleration in deal wins with increasing TCVs, broad-based service offerings, higher budgets from clients toward digital technologies and improving sales expertise.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) slackening pace in deal closures, and 3) crunch in local talent supply in the U.S. along with stringent visa regime.

Additional Data

Key management personnel

N. Chandrasekaran	Chairman
Rajesh Gopinathan	Chief Executive Officer
N. GanapathySubramaniam	Chief Operating Officer
V Ramakrishnan	Chief Financial Officer
MilindLakkad	EVP and Global Head

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	3.98
2	BlackRock Inc.	0.91
3	Vanguard Group Inc.	0.89
4	First State Investments ICVC	0.81
5	JPMorgan Chase & Co.	0.81
6	SBI Funds Management Pvt. Ltd.	0.69
7	Invesco Ltd.	0.48
8	Standard Life Aberdeen PLC	0.44
9	Axis Asset Management Co. Ltd.	0.37
10	UTI Asset Management Co Ltd.	0.32

Source: Bloomberg

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