

Reduce

Results disappoints; delayed ramp-up deferring path to recovery

- TCS reported revenue decline of 6.9% QoQ in CC terms (DART estm was 5% de-growth) and a OPM decline of 150bps to 23.6% (our estm at 40bps decline) due to weak operating leverage. Reported PAT below estimate at Rs70.1bn. (DE: Rs.77.7Bn). Announced dividend of Rs 5.
- Signed TCV of US\$6.9bn implying 1.31x coverage on TTM basis which is slightly below our expectations. TCV addition is encouraging however, the delayed ramp-up may continue to disappoint going forward as well. Also large contribution from smaller deal in order mix implies constant need for refill to sustain the revenue run rate.
- TCS believes that revenues have bottomed out in Q1 and Q2 will lead growth path also have supply-side tailwinds of about 135bps QoQ. Weaker than expected execution and not-so-confident tone for Q2 would mean the stock may remain under pressure till it delivers.
- Accounting for the deeper-than-anticipated slide in Q1 and softer-than-expected commentary on recovery; we have curtailed our FY22E growth/earnings estimates by 2%/5% respectively and retain our Reduce rating on the stock with TP of Rs2070 valued at 22x FY22E earnings (in-line with its 3 year median PER)

TCV commentary and Digital transformation gives confidence

TCS won TCV of \$6.9bn in Q1FY21 which is in-line compared with 4Qtr average of \$7.0Bn. TCS highlighted that mix of deals include few large deals and a long tail of small deals. Although Pipeline is more fairly represented across deal sizes. We believe large number of smaller deals are culminating out of compulsive need for doing some smaller digital transformation projects by clients (creating/enhancing digital channel; migration related to adoption of WFH transition). However, inertia by large clients to sign large transformation deals at enterprise level still exists; although high intensity for accelerated adoption prevails at smaller scale (Similar views were reciprocated in ISG Q2CY20 Call). Deal wins within product and platform space (Ignio – 8 New Logo, 13 Live, Bancs – 7 Wins, 5 Live) and SBWS driving GTM strategy (with 32 transition in Q1FY21) gives us comfort on digital transformation momentum. Digital largely will have different pace and scale in different verticals (BFSI and Retail are leading).

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue	383,220	381,720	0.4	399,460	(4.1)
Total Expense	282,970	281,350	0.6	289,700	(2.3)
EBITDA	100,250	100,370	(0.1)	109,760	(8.7)
Depreciation	9,770	8,170	19.6	9,510	2.7
EBIT	90,480	92,200	(1.9)	100,250	(9.7)
Other Income	4,560	14,180	(67.8)	4,870	(6.4)
Interest	0	0		0	
EBT	95,040	106,380	(10.7)	105,120	(9.6)
Tax	24,550	24,850	(1.2)	24,190	1.5
RPAT	70,080	81,310	(13.8)	80,490	(12.9)
APAT	70,080	81,310	(13.8)	80,490	(12.9)
			(bps)		(bps)
Gross Margin (%)	41.3	42.1	(78)	43.8	(250)
EBITDA Margin (%)	26.2	26.3	(13)	27.5	(132)
NPM (%)	18.3	21.3	(301)	20.1	(186)
Tax Rate (%)	25.8	23.4	247	23.0	282
EBIT Margin (%)	23.6	24.2	(54)	25.1	(149)

CMP	Rs 2,204
Target / Downside	Rs 2,070 / 6%
BSE Sensex	36,796
NSE Nifty	10,814

Script Details

Equity / FV	Rs 3,745mn / Rs 1
Market Cap	Rs 8,255bn
	US\$ 110bn
52-week High/Low	Rs 2,303/Rs 1,506
Avg. Volume (no)	3,738,830
NSE Symbol	TCS
Bloomberg Code	TCS IN

Shareholding Pattern Jun'20(%)

Promoters	72.1
MF/Banks/FIs	8.0
FII	15.7
Public / Others	4.2

Valuation (x)

	FY20A	FY21E	FY22E
P/E	25.5	26.5	23.5
EV/EBITDA	19.0	18.9	17.0
ROE (%)	36.8	36.3	40.2
RoACE (%)	34.4	32.6	36.1

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	1,569,490	1,593,029	1,756,240
EBITDA	421,100	424,106	471,385
PAT	323,401	304,802	344,421
EPS (Rs.)	86.4	83.2	94.0

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Exhibit 1: Quarterly performance versus estimates

(in Rs mn)	Actual	Estimates		% Variation		Comment
		Dolat	Consensus	Dolat	Consensus	
Revenues (in US\$ mn)	5,059	5,152	5,215	(1.8)	(3.0)	Revenue below estm due to higher than anticipated impact across verticals (supply side 130bps). EBIT below estimate due to adverse operating leverage impact PAT below estimate due to higher ETR (25.8%).
Sales	383,220	388,458	389,278	(1.3)	(1.6)	
EBIT	90,480	95,949	94,021	(5.7)	(3.8)	
EBIT Margin (%)	23.6	24.7	24.2	(110 bps)	(50 bps)	
PAT	70,080	77,778	76,566	(9.9)	(8.5)	

Source: Company, DART

Change in estimates

Given higher-than-expected slide and softer-than-expected tone on recovery we have curtailed our growth estimates by 1%/2% respectively for FY21/22E. Also given the deeper than expected OPM cut in Q1, we have moderated our OPM estimates by 60bps/40bps respectively for FY21/22E. So collectively this has resulted into ~5% cut in earnings estimate for FY21/22E.

Exhibit 2: Change in estimates

(Rs mn)	FY21E			FY22E		
	Old	New	% change	Old	New	% Change
Revenues (US\$ mn)	21,326	21,083	(1.1)	23,668	23,108	(2.4)
YoY growth (%)	(3.2)	(4.3)		11.0	9.6	
Revenues	1,608,010	1,593,029	(0.9)	1,798,746	1,756,240	(2.4)
EBIT	395,562	383,039	(3.2)	444,367	427,273	(3.8)
EBIT Margin (%)	24.6	24.0		24.7	24.3	
Net profits	321,356	304,802	(5.2)	362,058	344,421	(4.9)
EPS (Rs)	87.7	83.2	(5.2)	98.8	94.0	(4.9)

Source: Company, DART

Exhibit 3: Key assumptions in our estimates

Metrics	FY20	FY21E	FY22E
USD Revenue (Mn)	22,032	21,083	23,108
USD Revenue growth (%)	5.4	(4.3)	9.6
USD/INR	71.2	75.6	76.0
INR Revenue growth (%)	7.2	1.5	10.2
EBIT Margins (%)	24.6	24.0	24.3
EPS growth (%)	2.8	(3.7)	13.0

Source: Company, DART

Exhibit 4: Key Revenue growth matrix (% YoY)

YoY Growth	FY20	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21
CC Growth	7.1	10.6	8.4	6.8	3.0	(6.3)
USD Growth	5.4	8.6	5.8	6.4	0.9	(7.8)
INR Growth	7.2	11.4	5.8	6.7	5.1	0.4

Source: Company, DART

Exhibit 5: Quarterly and Full Year Performance Trends

Rs mn	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	YoY (%)	QoQ (%)	FY19	FY20	YoY (%)
Revenues (US\$ Mn)	5,485.0	5,517.0	5,586.0	5,444.0	5,059.0	(7.8)	(7.1)	5,485.0	5,059.0	(7.8)
Revenue (INR Mn)	381,720	389,770	398,540	399,460	383,220	0.4	(4.1)	381,720	383,220	0.4
Operating Expenditure	281,350	287,510	289,830	289,700	282,970	0.6	(2.3)	281,350	282,970	0.6
Cost of revenues	221,020	224,100	226,820	224,410	224,860	1.7	0.2	221,020	224,860	1.7
as % of sales	57.9	57.5	56.9	56.2	58.7			57.9	58.7	
SG&A expenses	60,330	63,410	63,010	65,290	58,110	(3.7)	(11.0)	60,330	58,110	(3.7)
as % of sales	15.8	16.3	15.8	16.3	15.2			15.8	15.2	
EBITDA	100,370	102,260	108,710	109,760	100,250	(0.1)	(8.7)	100,370	100,250	(0.1)
Depreciation	8,170	8,650	8,970	9,510	9,770	19.6	2.7	8,170	9,770	19.6
EBIT	92,200	93,610	99,740	100,250	90,480	(1.9)	(9.7)	92,200	90,480	(1.9)
Other Income	14,180	11,680	5,950	4,870	4,560	(67.8)	(6.4)	14,180	4,560	
PBT	106,380	105,290	105,690	105,120	95,040	(10.7)	(9.6)	106,380	95,040	(10.7)
Total Tax	24,850	24,710	24,260	24,190	24,550	(1.2)	1.5	24,850	24,550	(1.2)
Adjusted PAT	81,530	80,580	81,430	80,930	70,490	(13.5)	(12.9)	81,530	70,490	(13.5)
(Profit)/loss from JV's/Ass/MI	220	160	250	440	410	86.4	(6.8)	220	410	
APAT after MI	81,310	80,420	81,180	80,490	70,080	(13.8)	(12.9)	81,310	70,080	(13.8)
Extra ordinary items	0	0	0	0	0			0	0	
Reported PAT	81,310	80,420	81,180	80,490	70,080	(13.8)	(12.9)	81,310	70,080	(13.8)
Reported EPS	21.7	21.4	21.6	21.5	18.7	(13.8)	(12.9)	21.7	18.7	(13.8)
Margins (%)						(bps)	(bps)			(bps)
EBIDTA	26.3	26.2	27.3	27.5	26.2	(13)	(132)	26.3	26.2	(13)
EBIT	24.2	24.0	25.0	25.1	23.6	(54)	(149)	24.2	23.6	(54)
EBT	27.9	27.0	26.5	26.3	24.8	(307)	(152)	27.9	24.8	(307)
PAT	21.3	20.6	20.4	20.1	18.3	(301)	(186)	21.3	18.3	(301)
Effective Tax rate	23.4	23.5	23.0	23.0	25.8	247	282	23.4	25.8	247

Source: DART, Company

What to expect next Quarter

We expect growth of 3 % CC QoQ in US\$ revenues given led by about 130bps tailwinds from supplyside normalization and recovery of demand given gradual opening of business across Globe. OPM margins should also see some improvement on operating leverage (improved utilization) – we have factored in 40bps gain sequentially.

Exhibit 6: What to expect next Quarter

(Rs Mn)	Q2FY21E	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
Sales (US\$ mn)	5,212	5,059	5,517	3.0%	-5.5%
Sales	393,508	383,220	389,770	2.7%	1.0%
EBIT	94,599	90,480	93,610	4.6%	1.1%
PAT	75,886	70,080	80,420	8.3%	-5.6%
EPS (Rs)	20.2	18.7	21.4	8.3%	-5.6%
EBIT Margin (%)	24.04	23.6	24.0	43 bps	2 bps

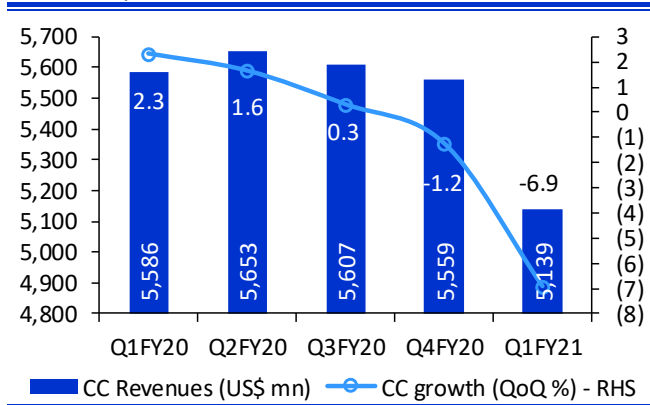
Source: DART, Company

Revenue growth impacted by COVID but strong TCV adds comfort hereon

Revenue de-grew at 6.9% QoQ in CC terms impacted by demand side challenges (80% - ~560bps) and supply side challenges (20% - ~140bps). Total TCV for the quarter stood at \$6.9Bn (up 21% YoY and down 22% QoQ) and TTM TCV stood at \$28.2Bn improving the revenue coverage to 1.3x. Broad based TCV wins across BFSI (\$2.1Bn), Retail (\$0.9Bn) and North America (\$3.3Bn). Decent performance of TCV wins from critical verticals and regions have largely given some re-assurance of recovery.

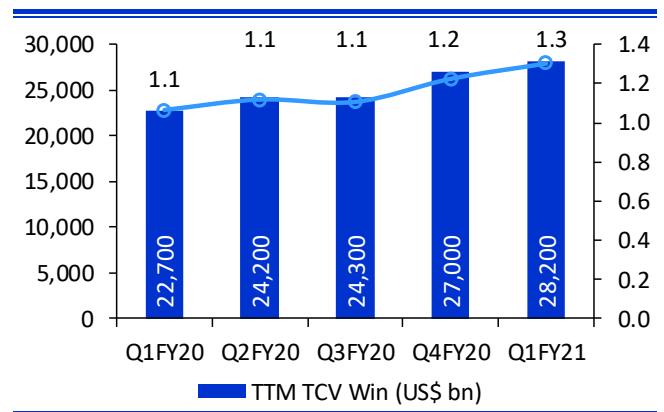
Retail & CPG vertical declined by 12.9% YoY due to impact of weak performance in Travel, transport and hospitality segment and other retail impacted by global lockdown while grocery segment did well. BFSI Vertical de-grew by 4.9% largely due to supply-side restriction. However, BFSI vertical (4.9% YoY) has been performing well in most markets except Canada and Europe. Europe BFSI vertical has largely recovered driven by its initiatives around SBWS. Communication & Media de-grew by 3.6% due to impact in Media segment from cancellation of events. Life Science and Healthcare (up 13.8% YoY) performed well.

Exhibit 7: Revenue de-grew 6.9% CC QoQ due to severe impact across verticals



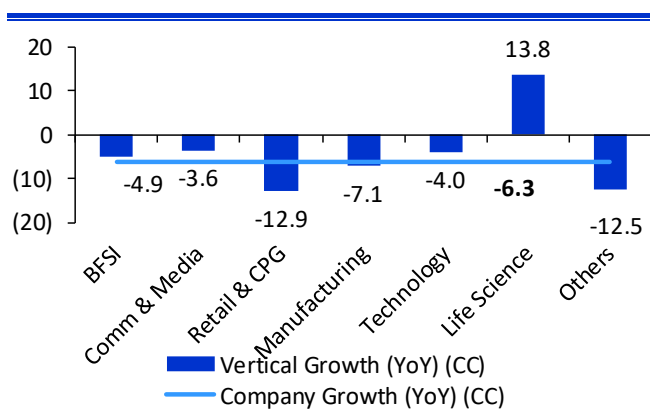
Source: Company, DART

Exhibit 8: TTM TCV wins improved to 1.3x cover



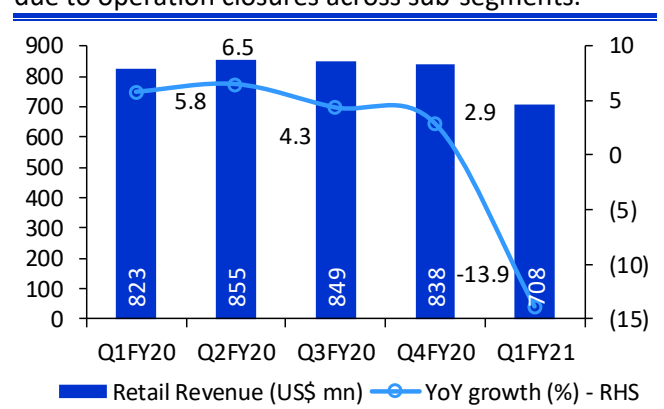
Source: Company, DART

Exhibit 9: Company and each Vertical YoY CC growth



Source: Company, DART

Exhibit 10: Retail & CPG vertical faced severe decline due to operation closures across sub-segments.

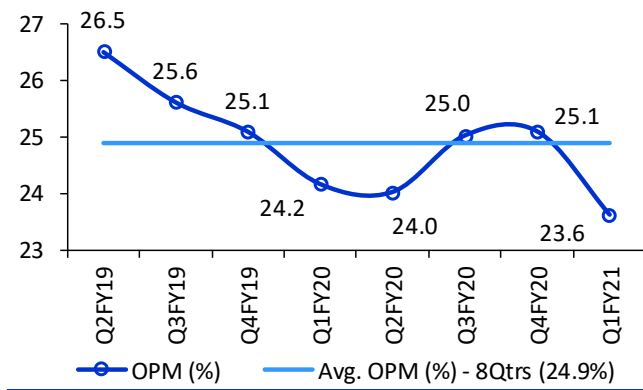


Source: Company, DART

Part of the OPM may prevail, to operate below its aspirational band

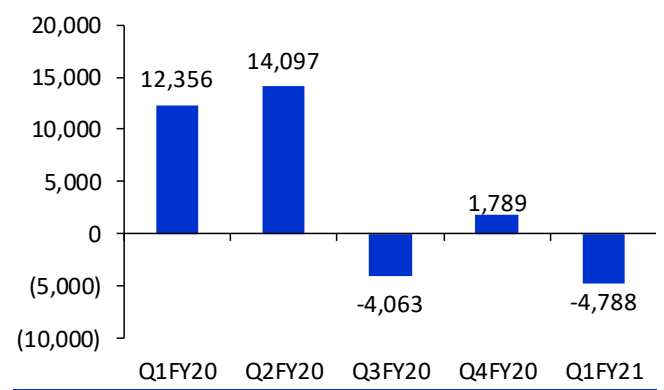
TCS reported margin of 23.6% for Q1FY21 due to weak operating leverage (poor utilization and low attrition). With limited SG&A leverage available (15.2% v/s FY20 16.1%) and similar limited operating cost controls, margin improvement is largely to be driven by sequential revenue growth hereon. TCS is continuously training more employees on digital (18,000 during the current quarter). TCS believes that current degrowth has certain elements of pricing compression and thus some part of this decline may prevail even if demand revives in H2. To account the impact of the same we have curtailed our OPM estimates by about 60bps/40bps for FY21/22E respectively and expect it to operate below its aspirational OPM band of 26-28%.

Exhibit 11: Operating Margin at multi-quarter low



Source: Company, DART

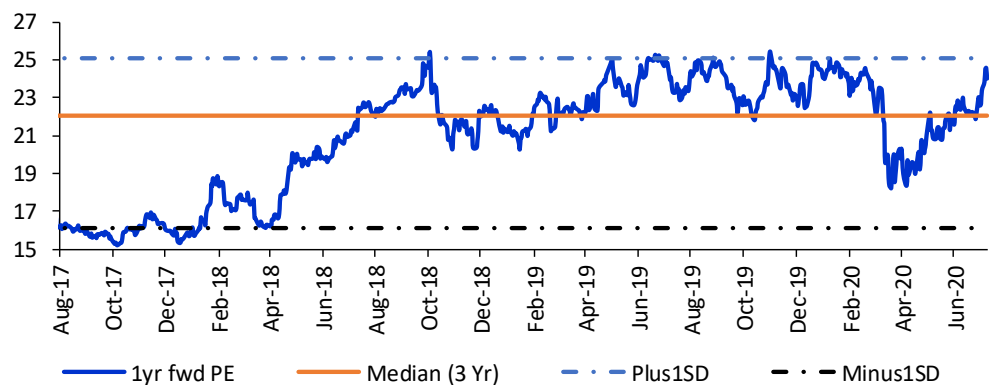
Exhibit 12: Net Hiring trends for last five quarters



Source: Company, DART

PE Performance

Exhibit 13: 1 year Fwd PER Chart - Trading ABOVE with its 3Yr MEDIAN PER of ~22x.



Source: Company, DART

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	1,464,630	1,569,490	1,593,029	1,756,240
Total Expense	1,069,589	1,148,390	1,168,923	1,284,854
COGS	835,099	896,350	922,878	1,010,881
Employees Cost	0	0	0	0
Other expenses	234,490	252,040	246,045	273,973
EBIDTA	395,041	421,100	424,106	471,385
Depreciation	20,550	35,300	41,068	44,113
EBIT	374,491	385,800	383,039	427,273
Interest	0	0	0	0
Other Income	41,130	36,680	21,466	26,177
Exc. / E.O. items	0	0	0	0
EBT	415,621	422,480	404,505	453,449
Tax	100,055	98,009	98,933	108,828
RPAT	314,666	323,401	304,802	344,421
Minority Interest	900	1,070	770	200
Profit/Loss share of associates	0	0	0	0
APAT	314,666	323,401	304,802	344,421

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	3,745	3,745	3,665	3,665
Minority Interest	4,530	6,230	7,000	7,200
Reserves & Surplus	911,810	837,510	834,050	870,628
Net Worth	915,555	841,255	837,715	874,293
Total Debt	29,605	90,900	90,900	90,900
Net Deferred Tax Liability	0	0	0	0
Total Capital Employed	949,690	938,385	935,615	972,393

Applications of Funds

Net Block	156,630	209,280	227,779	250,279
CWIP	10,870	9,060	7,560	6,060
Investments	81,720	88,280	89,474	91,258
Current Assets, Loans & Advances	921,310	902,370	890,154	921,419
Inventories	0	50	50	50
Receivables	325,030	362,640	367,282	404,911
Cash and Bank Balances	126,520	96,660	76,121	63,495
Loans and Advances	178,850	181,620	185,252	191,471
Other Current Assets	0	0	0	0
Less: Current Liabilities & Provisions	220,840	270,605	279,353	296,622
Payables	111,950	141,080	142,285	149,039
Other Current Liabilities	108,890	129,525	137,068	147,583
sub total				
Net Current Assets	700,470	631,765	610,802	624,796
Total Assets	949,690	938,385	935,615	972,393

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	43.0	42.9	42.1	42.4
EBIDTA Margin	27.0	26.8	26.6	26.8
EBIT Margin	25.6	24.6	24.0	24.3
Tax rate	24.1	23.2	24.5	24.0
Net Profit Margin	21.5	20.6	19.1	19.6
(B) As Percentage of Net Sales (%)				
COGS	57.0	57.1	57.9	57.6
Employee	0.0	0.0	0.0	0.0
Other	16.0	16.1	15.4	15.6
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.1	0.1	0.1
Interest Coverage				
Inventory days	0	0	0	0
Debtors days	81	84	84	84
Average Cost of Debt	0.0	0.0	0.0	0.0
Payable days	28	33	33	31
Working Capital days	175	147	140	130
FA T/O	9.4	7.5	7.0	7.0
(D) Measures of Investment				
AEPS (Rs)	84.0	86.4	83.2	94.0
CEPS (Rs)	89.5	95.8	94.4	106.0
DPS (Rs)	30.0	55.0	35.0	70.0
Dividend Payout (%)	35.7	63.7	42.1	74.5
BVPS (Rs)	244.5	224.6	223.7	233.5
RoANW (%)	35.6	36.8	36.3	40.2
RoACE (%)	34.4	34.4	32.6	36.1
RoAIC (%)	45.8	46.3	45.0	48.3
(E) Valuation Ratios				
CMP (Rs)	2204	2204	2204	2204
P/E	26.2	25.5	26.5	23.5
Mcap (Rs Mn)	8,254,850	8,254,850	8,254,850	8,254,850
MCap/ Sales	5.6	5.3	5.2	4.7
EV	7,867,025	7,987,690	8,008,180	8,020,763
EV/Sales	5.4	5.1	5.0	4.6
EV/EBITDA	19.9	19.0	18.9	17.0
P/BV	9.0	9.8	9.9	9.4
Dividend Yield (%)	1.4	2.5	1.6	3.2
(F) Growth Rate (%)				
Revenue	19.0	7.2	1.5	10.2
EBITDA	21.5	6.6	0.7	11.1
EBIT	22.8	3.0	(0.7)	11.5
PBT	21.9	1.7	(4.3)	12.1
APAT	21.8	2.8	(5.8)	13.0
EPS	24.3	2.8	(3.7)	13.0

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	285,930	323,690	351,308	335,980
CFI	15,960	85,650	(37,846)	(40,763)
CFF	(278,970)	(399,150)	(334,002)	(307,843)
FCFF	264,110	292,810	292,406	269,450
Opening Cash	48,830	4,030	86,460	65,921
Closing Cash	72,240	86,460	65,921	53,295

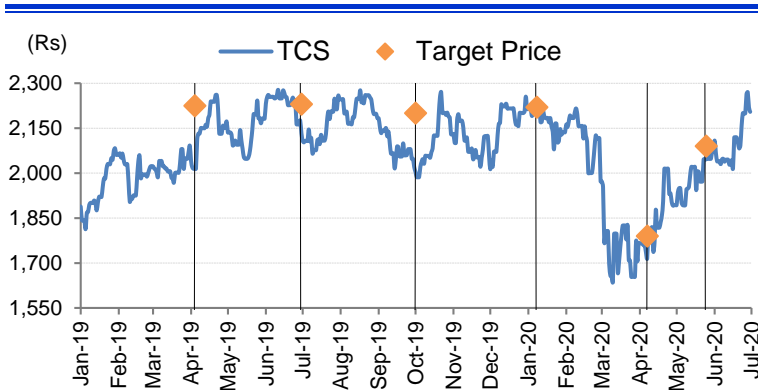
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Apr-19	Accumulate	2,225	2,015
Jul-19	Reduce	2,230	2,133
Oct-19	Accumulate	2,200	2,004
Jan-20	Reduce	2,220	2,219
Apr-20	Accumulate	1,790	1,716
Jun-20	Reduce	2,090	2,046

*Price as on recommendation date

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