



3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	■	✓	■

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

Reco/View

Reco: Buy	↔
CMP: Rs. 3,120	
Price Target: Rs. 3,590	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

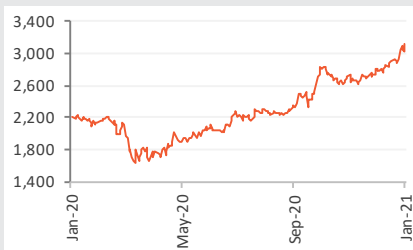
Company details

Market cap:	Rs. 11,70,875 cr
52-week high/low:	Rs. 3,127 / 1,504
NSE volume: (No of shares)	42.5 lakh
BSE code:	532540
NSE code:	TCS
Free float: (No of shares)	102.9 cr

Shareholding (%)

Promoters	72.2
FII	15.9
DII	8.2
Others	3.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.1	10.8	41.6	40.8
Relative to Sensex	5.2	(9.6)	8.8	23.1

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy on TCS with a revised PT of Rs. 3,590, given its differentiated positioning and deep relationships with large global enterprises.
- Q3FY21 was the second consecutive quarter of strong all-round performance, led by robust demand, market share gains and deal ramp-ups. FCF generation, deal win TCVs and net employee addition remained strong.
- Owing to end-to-end capabilities, deep domain expertise, contextual knowledge and excellent product and platform offerings, TCS is well-placed to tackle competition.
- TCS' revenue and earnings to clock a 11%/15% CAGR over FY2021-23E; we prefer TCS on account of its full-service business model, preferred partner for clients' transformation journey and higher payout policy.

For TCS, Q3FY21 was the second consecutive quarter of strong all-round performance, led by a strong demand environment, market share gains and quick revenue conversion from deals won earlier. The company reported better-than-expected revenue growth of 4.1% q-o-q on constant currency (CC) in a seasonally weak quarter, which is the strongest in the December quarter in the last nine years. On a y-o-y basis, the company came back to positive growth trajectory with a CC growth of 0.4%. EBIT margins improved 42 bps q-o-q to 26.6% despite wage revision (-160 bps), ahead of our estimates, supported by strong revenue growth, operational efficiencies through secure borderless workspace (SBWS) operating model and currency tailwinds. Net income stood at Rs. 8,701 crore (up 3.2% q-o-q/7.2% y-o-y), beating our estimates, led by strong revenue growth and higher-than-expected margin expansion. In addition, the company reported strongest cash conversion, best deal wins in the BFSI vertical (even excluding the Postbank Systems deal, which was completed on January 1, 2021), highest-ever quarterly net employee addition (including 1,500 employees of Pramerica Systems) and all-time low attrition rate during the quarter. Deal win TCVs increased 11.5% q-o-q (excluding the Phoenix deal TCV from Q2FY2021) and 13.3% y-o-y, which provides strong revenue visibility going ahead. TCS' management indicated that cloud transformation is a multi-year opportunity. Further, the management believes that BFSI vertical would drive growth in the medium-to-long term given 1) low cloud penetration levels among banks, 2) significant investments in products in the wealth management space and 3) adoption of cloud among insurance clients. In addition, the management indicated that the sector's growth would be driven by the investments in the areas of (1) growth and transformation where enterprises adopts new business models and reimagine customer experience and (2) drive efficiency and greater productivity. Given its end-to-end capabilities, deep domain expertise, contextual knowledge and excellent product and platform offerings, we believe TCS is well placed from a competitive perspective. Hence, management remains confident that the company would return to double digit growth in FY2022E.

Key positives

- EBIT margins improved despite wage revision, a way above our and street's expectations
- TCVs in BFSI vertical stood at \$2.6 billion, strongest in its history
- Cash conversion remained strong with FCF/EBITDA at 92%

Key negatives

- Client addition was flat and would remain soft in the next couple of quarters

Our Call

**Valuation – Maintain Buy with a PT of Rs. 3,590:** We upgraded our earnings estimates for FY2021E/FY2022E/FY2023E, given that both revenue and operating margin exceeded estimates, continued strong deal wins and resilience in IT spending of clients. We continue to prefer TCS on account of a strong business model, stable management, solid execution and strong free cash flows (FCF) generation. As TCS is well-positioned to capitalise on ensuing opportunities created by COVID-19, we expect TCS' USD revenue and earnings would clock an 11%/15% CAGR over FY2021-23E. At CMP, the stock is trading at 30x/26x of its FY2022E/FY2023E earnings, which is justified given potential strong earnings growth, preferred partner for clients' transformation journey and a strong payout policy. Hence, we maintain a Buy rating on TCS with a revised PT of Rs. 3,590.

Key risk

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US and a stringent visa regime would affect earnings.

Valuation

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	146,463.0	156,949.0	164,153.6	185,475.6	206,751.3
OPM (%)	27.0	26.8	28.3	28.5	28.3
Adjusted PAT	31,472.0	32,340.0	33,356.4	38,716.0	44,285.8
% y-o-y growth	21.9	2.8	3.1	16.1	14.4
Adjusted EPS (Rs.)	83.1	86.2	90.2	104.7	119.7
P/E (x)	37.6	36.2	34.6	29.8	26.1
P/B (x)	13.0	13.8	13.0	12.0	10.5
EV/EBITDA (x)	28.2	26.6	24.0	20.8	18.7
RoNW (%)	35.9	37.0	38.4	41.8	43.0
RoCE (%)	41.3	41.0	43.6	47.1	47.5

Source: Company; Sharekhan estimates

## Exceeding hopes on all fronts

TCS impressed with stronger-than-expected performance on all financial parameters in a seasonally weak quarter (strongest performance in Q3 in last nine years). In addition, large deal TCVs and cash conversion remained strong. The company reported constant currency (CC) revenue growth of 4.1% q-o-q and 0.4% y-o-y (back to positive growth trajectory), higher than ours as well as consensus estimates, led by strong demand environment, market share gains and deal ramp-ups won earlier. In US Dollar terms, revenue grew by 5.1% q-o-q to \$5,702 million, beating our estimates. EBIT margin improved 42bps q-o-q to 26.6% despite wage revision (-160 bps) in Q3FY2021. The impact of wage revision was mitigated by strong revenue growth, operational efficiencies through the company's SBWS operating model and currency tailwinds. Net income stood at Rs. 8,701 crore (3.2% q-o-q/7.2% y-o-y) and was ahead of our estimates, led by a strong revenue growth and higher-than-expected margin expansion. Cash conversion remained strong with operating cash flow (OCF) to net income at 137.4%.

## Demand recovery faster than expectations; target to report double-digit revenue growth in FY2022

In Q1FY2021, the management had indicated that company may report flat CC revenue growth y-o-y by March 2021. However, strong demand environment, market share gains and rapid revenue conversion from deals won earlier helped TCS to exceed its own expectation with one quarter by achieving positive CC growth (of 0.4% y-o-y) in Q3FY2021 (against the expectation in Q4FY2021 that was originally expected at the start of the pandemic). TCS' management indicated that cloud transformation is a multi-year opportunity. Hence, the company has created new dedicated business units, which would focus on the three leading hyperscaler platforms separately. The management highlighted that company has won 200+ customers in cloud engagements in Q3FY2021 and pipeline remains strong. Further, management believes that BFSI clients would continue to provide huge opportunity for growth given 1) low cloud penetration levels, 2) significant investments in wealth management products and 3) adoption of cloud among insurance clients. In addition, management indicated growth would be driven by investments in the areas of (1) growth and transformation where enterprises adopts new business models and reimagine customer experience and (2) drive efficiency and greater productivity. Given its end-to-end capabilities, strong contextual knowledge and excellent product and platform offerings, we believe TCS is well-placed from a competitive perspective. Hence, the management remains confident that the company would return to double-digit growth in FY2022E.

## Key result highlights from earnings call

- ♦ **Best quarterly performance on many parameters:** Strong demand for core transformation services, market share gains and quick revenue conversion from all the deals helped the company to maintain its strong growth momentum in a seasonally weak quarter. CC growth of 4.1% q-o-q was the strongest growth for a December quarter in the last nine years. In addition, the company reported highest EBIT margin (26.6% in Q3FY2021) in last five years, strongest cash conversion, best deal wins in BFSI vertical (excluding the Postbank Systems deal, which was completed on January 1, 2021), highest ever quarterly net employee addition and all-time low attrition rate.
- ♦ **Broad-based growth across verticals:** All verticals reported growth on a sequential basis, led by manufacturing (+7.1% CC), BFSI (+2% CC), life-sciences and healthcare (+5.2% CC), communications & media (+5.5% CC) and retail and CPG (+3.1% CC). The company's largest verticals i.e BFSI and retail & CPG reported decent sequential growth in a seasonally weak quarter. On a y-o-y, life-sciences and healthcare continued to grow in double-digits at 18.2% on CC. While manufacturing CC revenue growth recovered strongly to 18.2% y-o-y from a decline of 7.3% y-o-y in Q2FY2021, BFSI (+2.4% y-o-y) and technology and services (+2.4% y-o-y) returned to positive growth trajectory.

- ◆ **Well-rounded growth across markets:** North America/UK/Continental Europe clocked a growth of 3.3%/4.5%/2.5% q-o-q in CC terms. Among the emerging markets, India grew 18.1% q-o-q on CC terms.
- ◆ **Strong product and platform portfolio:** The company continued to witness strong traction in its product and platform portfolio. Ignio, a cognitive automation solution platform, acquired 8 (versus 10 in Q2FY21) new logos during the quarter and 7 (versus 12 in Q2FY21) customers' 'go-lives' on the product. TCS BaNCS, its flagship product in financial domain, has five new wins (two in digital banking platform, two wealth management solution and one for payment) during the quarter and six 'go-lives' on the product. Quartz had four new wins and one go-live during Q2FY2021. TCS HOBBS has three new wins during the quarter and four 'go-lives' on the product. There were eight new wins for Mastercraft in Q3FY2021.
- ◆ **Client metrics remained flattish:** The number of '\$100-million' clients increased by one y-o-y but declined by one q-o-q, taking total count of such clients to 48. The number of '\$50 million' clients dropped by five on a y-o-y basis (flat on q-o-q basis), taking total count of such client to 97. The number of clients under the '\$20 million' bucket dropped by three on y-o-y, but increased by one sequentially, taking count of such client to 229. The number of '\$5 million' clients increased by eight on a y-o-y basis but remained flat on a sequential basis, taking total count of such clients to 565. TCS management expects the client metrics could remain soft for another couple of quarters until the June quarter.
- ◆ **Strong headcount addition:** The company's staff count stood at 4,69,261, a net addition of 15,721 employees q-o-q (highest ever in the quarter). The company's net employee addition remained strong during the quarter. This includes around 1,500 employees of Pramerica Systems Ireland Limited and 12,000 trainees. Attrition rate remained industry leading at 7.6% during the quarter, which is all-time low in its history.
- ◆ **Cash generation remained strong:** The company had cash flow of Rs. 11,952 crore from operations, which was 137.4% to the net profit. Company's free cash flow (FCF) stood at Rs. 11,229 crore, up 28.6% y-o-y. Cash conversion remained stood strong with FCF/EBITDA at 92%. Total cash and investments stood at Rs. 65,377 crore during the quarter. The Board has recommended an interim dividend of Rs. 6 per share.
- ◆ **Secure Borderless Workspaces (SBWS) model helped in margin expansion:** TCS had adopted the SBWS model during Q4FY2020. This location-independent execution model brings in the resources just in time, efficient execution, and machine-led delivery governance, which augurs well to progress its 25x25 future of work vision. Management highlighted that the operational benefits from its SBWS model helped the company to report the highest operating margin in Q3FY2021 over the last five years.
- ◆ **Large deal wins continued to remain strong:** Strong deal wins continued in Q3FY2021, with TCVs of \$6.8 billion (excluding Postbank Systems deal as it was closed on January 1, 2021). Deal wins TCVs increased by 11.5% q-o-q (excluding Phoenix deal TCV from Q2FY2021, deal wins TCV was \$6.1 billion) and 13.3% y-o-y. Deal wins TCVs remained higher as compared to average \$6.4 billion of past ten quarters. The book-to-bill ratio during the quarter remained at 1.19x in Q3FY2021 versus 1.12x in Q2FY2021. TCS signed deals worth \$4 billion in North America, \$2.6 billion in the BFSI vertical and \$0.98 billion in the retail vertical. Though management highlighted that the bookings in Q2FY2021 was included higher number small deals, the bookings during the quarter was back to its historic trends with high volume of large deals.
- ◆ **Retail vertical grew despite holiday season:** Retail vertical grew 3.1% q-o-q on a CC basis despite the seasonal softness of the holiday season and continued weakness in discretionary retail, CPG and the travel and hospitality sub-verticals. The US retail segment witnessed a good recovery followed by Europe. UK Retailers continued to spend on initiatives to enhance customer experience, reimagine customer journeys by providing a seamless experience across channels, optimising fulfillment costs and find ways to leverage the physical store to provide value-added services and experiences.

Results						Rs cr
Particulars	Q3FY21	Q3FY20	Q2FY21	y-o-y (%)	q-o-q (%)	
Revenue (\$ mn)	5,702.0	5,586.0	5,424.0	2.1	5.1	
Revenue in INR (cr)	42,015.0	39,854.0	40,135.0	5.4	4.7	
Direct costs	23,749.0	22,682.0	22,958.0	4.7	3.4	
Gross profit	18,266.0	17,172.0	17,177.0	6.4	6.3	
SG&A	6,059.0	6,301.0	5,664.0	-3.8	7.0	
<b>EBITDA</b>	<b>12,207.0</b>	<b>10,871.0</b>	<b>11,513.0</b>	<b>12.3</b>	<b>6.0</b>	
Depreciation	1,023.0	897.0	998.0	14.0	2.5	
<b>EBIT</b>	<b>11,184.0</b>	<b>9,974.0</b>	<b>10,515.0</b>	<b>12.1</b>	<b>6.4</b>	
Other income	508.0	595.0	740.0	-14.6	-31.4	
PBT	11,692.0	10,569.0	11,255.0	10.6	3.9	
Tax provision	2,965.0	2,426.0	2,793.0	22.2	6.2	
<b>Net profit</b>	<b>8,727.0</b>	<b>8,143.0</b>	<b>8,462.0</b>	<b>7.2</b>	<b>3.1</b>	
Minority interest	26.0	25.0	29.0	4.0	-10.3	
<b>Adj. Net Profit</b>	<b>8,701.0</b>	<b>8,118.0</b>	<b>8,433.0</b>	<b>7.2</b>	<b>3.2</b>	
<b>EPS (Rs.)</b>	<b>23.2</b>	<b>21.6</b>	<b>22.5</b>	<b>7.2</b>	<b>3.2</b>	
<b>Margin (%)</b>						
EBITDA	2.1	27.3	28.7	178	37	
EBIT	26.6	25.0	26.2	159	42	
NPM	20.7	20.4	21.0	34	-30	

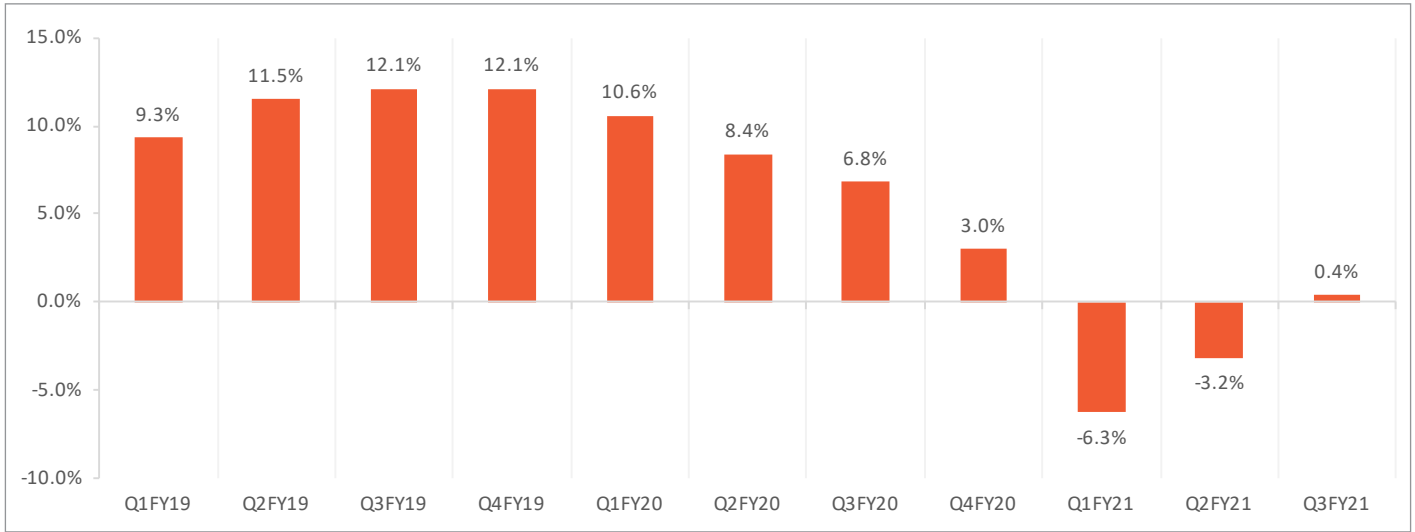
Source: Company; Sharekhan Research

#### Operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y	q-o-q	y-o-y
Revenue (\$ mn)	5,702	100	5.1	2.1	4.1	0.4
<b>Geographic mix</b>						
North America	2,857	50.1	5.5	2.1	3.3	-0.2
Latin America	108	1.9	17.5	2.1	3.1	-3.8
U.K.	907	15.9	7.8	2.1	4.5	-1.6
Continental Europe	850	14.9	-3.9	2.1	2.5	3.6
India	325	5.7	19.8	2.1	18.1	4.1
APAC	530	9.3	0.8	2.1	2.6	1.3
MEA	125	2.2	21.7	2.1	6.7	-3.8
<b>Industry verticals</b>						
BFSI	1,751	30.7	1.2	3.1	2.0	2.4
Retail & CPG	867	15.2	9.4	2.1	3.1	-5.1
Communication & media	393	6.9	11.6	0.6	5.5	-4.8
Manufacturing	570	10.0	11.8	2.1	7.1	18.2
Life Science and healthcare	473	8.3	-11.0	2.1	5.2	18.2
Technology & services	479	8.4	-0.8	2.1	0.8	2.4
Regional markets and others	1,169	20.5	14.0	1.1	7.3	-2.9

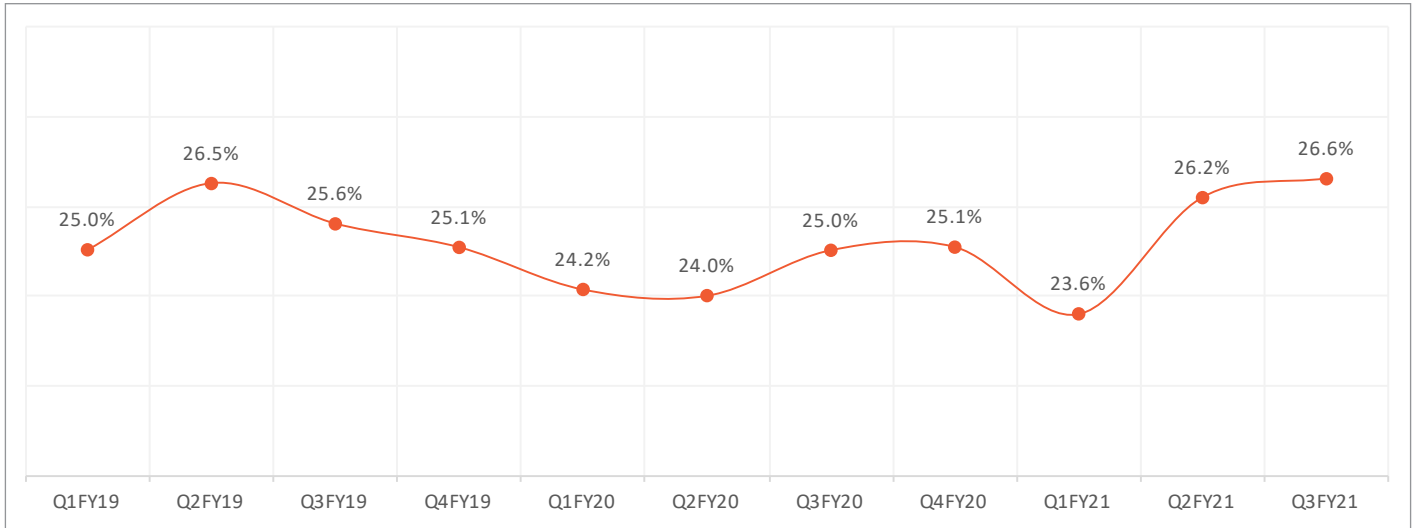
Source: Company; Sharekhan Research

**TCS' constant-currency revenue growth trend (y-o-y)**



Source: Sharekhan Research

**EBIT margin expanded by 40 bps q-o-q despite wage revision**



Source: Sharekhan Research

## Outlook and Valuation

### ■ Sector View – Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimate that IT services spending would grow by 5-8% over CY2021-24E as compared to an average of 4.2% achieved in CY2010-19. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients and increase in online adoption across verticals. Implications of the COVID-19 outbreak have accelerated digital activities among large global enterprises, leading to an increase in spending on workplace transformation and collaboration tools, cyber-security and higher cloud migration. We believe that the variable cost structure of companies combined with cost-efficiency measures would help the IT companies to absorb pricing pressure and increase in administrative expenses (post normalcy) to some extent.

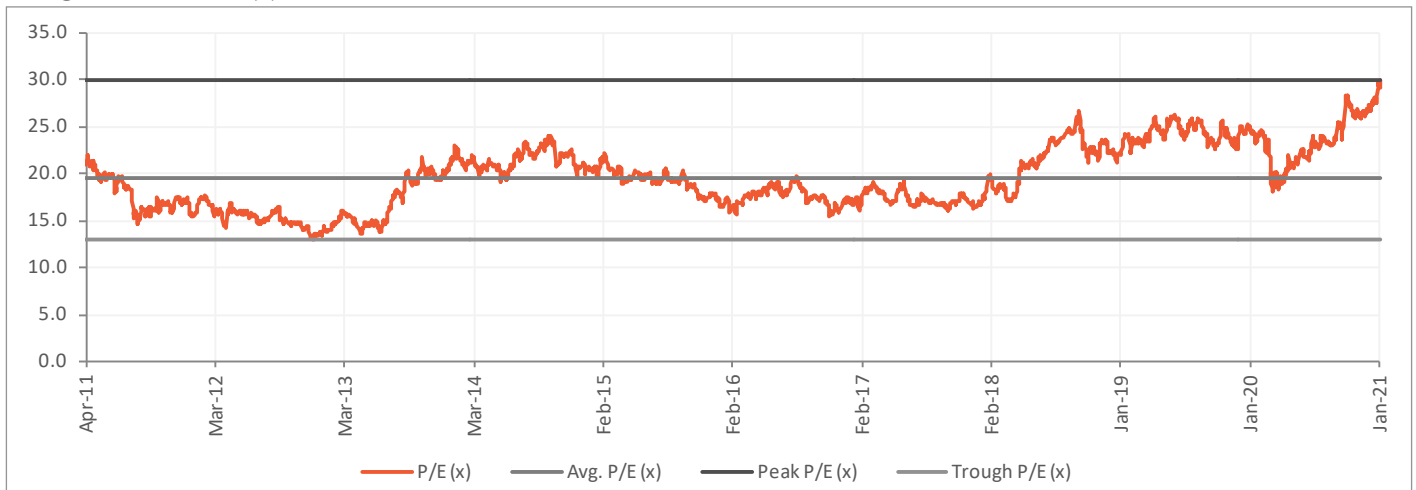
### ■ Company Outlook – a dominant position

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 on digital technology and is well-positioned to capitalise on opportunities as and when clients boost technology expenditure. Further, the company is well-placed from a competitive perspective, especially in newer technologies. A stable management and the ability to structure large multi-service deals would help TCS recover once the situation normalises. The management intends to keep the payout ratio at 80-100% of free cash generated.

### ■ Valuation – Cross-cycle champion

**Valuation – Maintain Buy with a PT of Rs. 3,590:** We upgraded our earnings estimates for FY2021E/FY2022E/FY2023E, given that both revenue and operating margin exceeded estimates, continued strong deal wins and resilience in IT spending of clients. We continue to prefer TCS on account of a strong business model, stable management, solid execution and strong free cash flows (FCF) generation. As TCS is well-positioned to capitalise on ensuing opportunities created by COVID-19, we expect TCS' USD revenue and earnings would clock an 11%/15% CAGR over FY2021-23E. At CMP, the stock is trading at 30x/26x of its FY2022E/FY2023E earnings, which is justified given potential strong earnings growth, preferred partner for clients' transformation journey and a strong payout policy. Hence, we maintain a Buy rating on TCS with a revised PT of Rs. 3,590.

### One-year forward P/E (x) band



Source: Sharekhan Research

### Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HCL Tech	994	271	269,860	21.9	20.1	13.9	13.0	4.7	4.2	22.7	22.1
Infosys	1,312	426	558,773	30.0	27.0	19.9	18.1	4.1	3.7	26.7	26.6
Wipro	430	572	245,845	24.7	23.3	17.1	15.8	4.3	3.9	15.7	15.8
TCS	3,120	375	1,170,875	34.6	29.8	24.0	20.8	13.0	12.0	38.4	41.8

Source: Company, Sharekhan Research

## About company

TCS is among the pioneers of IT services outsourcing business in India and is the largest (\$22,032 million revenue in FY2020) 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 company is 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 company is 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. Ganapathy Subramaniam	Chief Operating Officer
V Ramakrishnan	Chief Financial Officer
Milind Lakkad	EVP and Global Head

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	3.93
2	JPMorgan Chase & Co.	1.07
3	Vanguard Group Inc.	0.92
4	Invesco Ltd.	0.81
5	BlackRock Inc.	0.80
6	SBI Funds Management Pvt. Ltd.	0.75
7	First State Investments ICVC	0.72
8	Axis Asset Management Co. Ltd.	0.50
9	Standard Life Aberdeen PLC	0.37
10	First Sentier Global Umbrella Fund P	0.37

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.



## Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research



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