

Healthy margin expansion despite wage hikes...

Tata Consultancy Services (TCS) reported a healthy set of Q3FY21 numbers that were above our estimates on all fronts. Growth happened across geographies and verticals. The QoQ growth in revenues was led by healthy demand in core transformation services and conversion from earlier deals. US\$ revenues grew 5.1% QoQ to \$5,702 million, above our estimate of 3.6% QoQ growth and \$5,619 million estimate. EBIT margins expanded 42 bps QoQ to 26.6%, above our estimates of 25.1%. TCS has declared an interim dividend of ₹ 6 per share. The company aspires to register double digit revenue growth in FY22E.

Double digit revenue growth expected in coming years

We believe growing virtualisation of business is driving multi-year growth in IT spends. We believe IT companies will be key beneficiaries of this multi-year technology transformation phase. In the current phase, enterprises are building a cloud-based foundation that will serve as a resilient, secure and scalable digital core. In subsequent phases, enterprises will see new age technologies developed around cloud and will lead to new business models & differentiated customer experiences. TCS' investments in building deep expertise on these platforms, in research & development spends and in industry-specific solutions will make it a key beneficiary of this secular demand growth in coming years. This, coupled with increased outsourcing in Europe (especially continental Europe is a sweet spot for TCS), vendor consolidation opportunities, captive carve outs in US will enable a large company like TCS to structure complex deal structure and gain market share from competition. Hence, we expect the company to register dollar growth of 12.3% in FY22E and 11.6% in FY23E.

Margins to remain robust

The company has multiple levers to drive margins like utilisation, productivity improvement, savings due to Secured Borderless Workspace (SBWS), automation and revenue growth. Hence, we expect TCS to register healthy margin improvement of ~270 bps over to 27.3% FY20-23E.

Valuation & Outlook

Going forward, global digital technologies are expected to witness robust growth (~15-20% CAGR in the next five years) led by robust growth in cloud, customer experience and robust growth in cloud native technologies. Considering TCS's digital prowess coupled with market share gains via vendor consolidation, captive carve outs and increase in outsourcing we expect TCS to register robust growth in revenues in coming years. This, coupled with healthy margins and better capital allocation prompt us to be positive on the stock from long term perspective. Hence, we maintain our **BUY** rating on the stock with a revised target price of ₹ 3,600/share (PE of 29x on FY23E EPS) (from an earlier target price of ₹ 3,410).



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	11,70,000.0
Total Debt (₹ Crore)	8,174.0
Cash and equivalents (₹ Crore)	35,939.0
EV (₹ Crore)	11,42,235.0
52 week H/L	3127 / 1504
Equity capital (₹ Crore)	370
Face value	₹ 1

Key Risk

- We assume acceleration in digital technologies will drive revenue growth of IT companies. However, a slower than expected pace of growth in digital technologies will impact TCS' revenue growth
- We believe that in a post Covid world, higher revenue growth, productivity improvement and other cost savings like travel facility cost will not return to normal levels. However, if TCS is unable to realise cost savings or realise benefits of SBWS it will adversely impact its margins

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Key Financial Summary

Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	1,46,463	1,56,949	1,64,517	1,84,742	2,08,434	9.9%
EBITDA	39,506	42,110	47,052	53,760	61,905	13.7%
EBITDA Margins (%)	27.0	26.8	28.6	29.1	29.7	
Net Profit	31,472	32,340	32,902	39,807	45,896	12.4%
EPS (₹)	83.8	86.2	89.0	107.7	124.2	
P/E	37.1	36.1	35.0	28.9	25.1	
RoNW (%)	34.4	37.5	35.7	39.3	40.9	
RoCE (%)	43.8	43.5	44.0	46.9	49.2	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q3FY21	Q3FY21E	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Comments
Revenue	42,015	41,470	39,854	5.4	40,135	4.7	The company's revenues in dollar terms increased 5.1% QoQ led by healthy growth across verticals and geographies
Employee expenses	23,749	23,845	22,682	4.7	22,958	3.4	
Gross Margin	18,266	17,625	17,172	6.4	17,177	6.3	
Gross margin (%)	43.5	42.5	43.1	39 bps	42.8	68 bps	
SG&A expenses	6,059	6,221	6,301	-3.8	5,664	7.0	
EBITDA	12,207	11,404	10,871	12.3	11,513	6.0	
EBITDA Margin (%)	29.1	27.5	27.3	178 bps	28.7	37 bps	
Depreciation	1,023	998	897	14.0	998	2.5	
EBIT	11,184	10,406	9,974	12.1	10,515	6.4	
EBIT Margin (%)	26.6	25.1	25.0	159 bps	26.2	42 bps	Higher utilisation and optimal effort mix drove EBIT margins
Other income (less interest)	508	700	595	-14.6	740	-31.4	
PBT	11,692	11,106	10,569	10.6	11,255	3.9	
Tax paid	2,965	2,499	2,426	22.2	2,533	17.1	
Reported PAT	8,701		8,118	7.2	7,475	16.4	
Adjusted PAT	8,701	8,578	8,118	7.2	8,693	0.1	PAT was above our estimate due to healthy performance at operating level

Key Metrics

Closing employees	446,675	455,738	417,929	6.9	450,738	-0.9	Net reduction of 4063 employees in the quarter post hiring of strong 26,453 employees in H1FY20
Overall attrition (%)	12.2	11.2	11.2	100 bps	11.6	60 bps	Attrition increases 60 bps sequentially
Average \$/₹	71.3	71.2	71.1	0.3	70.6	1.0	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	old	New	% Change	
Revenue	162,403	164,517	1.3	178,581	184,742	3.5	201,986	208,434	3.2	We expect FY22E and FY23E to witness robust growth led by healthy traction in digital technology
EBIT	41,250	43,103	4.5	46,788	49,326	5.4	53,526	56,902	6.3	
EBIT Margin (%)	25.4	26.2	80 bps	26.2	26.7	50 bps	26	27.3	80 bps	Cost rationalisation and improving revenue growth to drive margins
PAT	32,341	32,902	1.7	38,444	39,807	3.5	43,751	45,896	4.9	
EPS (₹)	87.5	89.0	1.7	104.0	107.7	3.5	118	124.2	4.9	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook** – TCS' Q3FY21 revenues were healthy despite a seasonally weak quarter. The QoQ growth in revenues was led by healthy demand in core transformation services and conversion from earlier deals. The company saw healthy ramp up in large deal wins. The company saw demand digital & cloud strategy, enterprise agility, mergers & acquisitions, & supply chain and finance transformation. There was strong demand for hyperscaler cloud services. Key areas included mainframe and legacy modernisations, data modernisation on cloud (MDM, data lakes), augmented analytics for in-context insights, risk regulatory & compliance analytics and use of cloud platforms for collaboration. Cybersecurity continued to be of the highest priority as new work models emerge. Consumer demand for automated and contact-less services led to good growth for TCS Interactive. Growth in IoT was led by remote monitoring and self-optimising plant operations. Going forward, the company believes it will see growth from both transformational and efficiency & productivity led deals. The company believes BFSI has not adopted public cloud on large scale and, hence, has tremendous opportunity, going ahead. Considering opportunities in cloud and ancillary technologies around cloud the company aspires to register double digit growth in FY22E
- **Vertical wise commentary** – The company saw healthy traction in BFSI mainly led by core modernisation and cybersecurity. TCS also saw healthy growth in retail led by optimised fulfilment cost. The company also saw robust growth in life science & healthcare space and expect improved growth going forward. The company expects investment in digital technologies across verticals and expect technology investment in core transformation, customer experience, employee experience and business across verticals
- **Margins** – The company has multiple levers to drive margins like utilisation, productivity improvement, savings due to SBWS, automation and revenue growth. Hence, we expect TCS to register healthy margin improvement in the coming years
- **Deal TCV** - Deal TCV was at US\$6.8 billion, up 13.3% YoY. We believe this was mainly due to ramp up of large deals of previous quarters. Adjusting for large deal in the previous quarter, the company's deal TCV increased 11.4% QoQ. The deal wins are also broad-based participation across verticals and geographies. Of the total TCV, North America accounted for \$4 billion among geographies while vertically \$1 billion was from in retail and healthy deal pipeline in BFSI
- **Client metrics** - The company count in \$20 million+ bucket increased by one while one client was added in the US\$1 million category
- **Employee update** - Attrition in IT services declined 130 bps QoQ to 7.6% (LTM). There was an increase of 15721 employees in this quarter. Employee strength was at 469,261 at the end of Q3FY21

Key Metrics

Exhibit 3: Geography wise break-up

	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Revenue by geography (%)					
North America	50.1	50.3	51.4	49.9	49.1
Latin America	1.9	1.8	1.7	1.7	1.7
UK	15.9	16.0	15.3	15.5	15.7
Continental Europe	14.9	15.2	15.6	16.3	16.2
India	5.7	5.5	4.3	5.0	5.6
Asia Pacific	9.3	9.3	9.8	9.7	9.7
MEA	2.2	1.9	1.9	1.9	2.0
Growth QoQ (%)					
North America	0.3	-2.2	-5.0	4.1	3.4
Latin America	1.3	-7.7	-12.2	7.2	5.1
UK	3.2	-1.9	-11.1	8.6	6.5
Continental Europe	3.3	-0.6	-4.6	12.0	4.5
India	1.3	-6.0	-27.3	24.7	17.7
Asia Pacific	0.2	-2.5	-2.1	6.1	5.1
MEA	1.3	-15.8	-7.1	7.2	10.7

Source: Company, ICICI Direct Research

Growth happened across geographies and was led by Americas, India, MEA and Europe

Exhibit 4: Vertical wise break-up

	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Revenue by verticals (%)					
BFSI	30.4	29.7	31.5	31.9	31.3
Retail & CPG	15.2	15.4	14.0	14.6	14.5
Communication and Media	7.0	7.2	6.9	6.5	6.6
Manufacturing	10.0	10.1	9.7	9.4	9.6
Life Sciences & Healthcare	8.3	8.8	9.6	9.8	9.8
Technology & services	8.4	8.7	9.1	8.9	8.6
Regional markets & others	20.7	20.1	19.2	18.9	19.6
Growth QoQ (%)					
BFSI	-1.7	-4.8	-1.4	8.6	3.1
Retail & CPG	4.0	-1.3	-15.5	11.8	4.4
Communication and Media	2.7	0.2	-10.9	1.0	6.7
Manufacturing	3.3	-1.6	-10.8	3.9	7.4
Life Sciences & Healthcare	3.8	3.3	1.4	9.4	5.1
Technology & services	-2.2	0.9	-2.8	4.9	1.6
Regional markets & others	1.7	-5.4	-11.2	5.5	9.0

Source: Company, ICICI Direct Research

Broad based growth across verticals

Exhibit 5: Client & human resource matrix

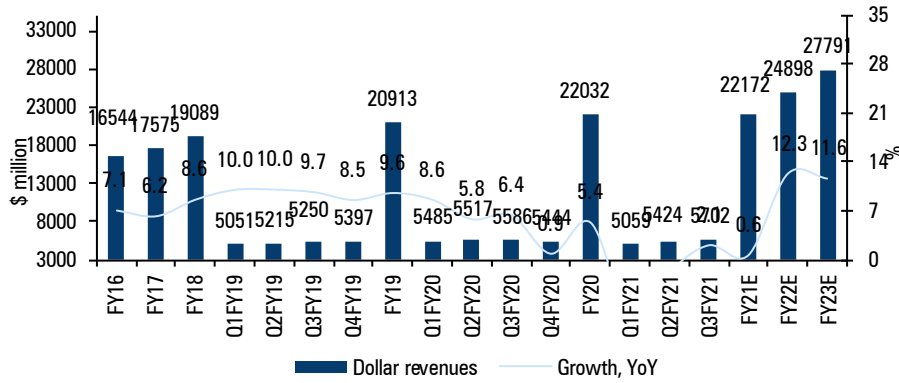
	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Client metrics					
USD 1 mn+ clients	1053	1072	1066	1076	1077
USD 5 mn+ clients	557	565	564	565	565
USD 10 mn+ clients	395	391	382	386	386
USD 20 mn+ clients	232	240	230	228	229
USD 50 mn+ clients	102	105	100	97	97
USD 100 mn+ clients	47	49	48	49	48
Headcount, Attrition					
Total Employees	446675	448646	443676	453540	469261
Attrition, LTM (IT Services)	12.2	12.1	11.1	8.9	7.6

Source: Company, ICICI Direct Research

The company added one client in US\$20 million category and added 15,721 employees in the current quarter. Attrition was lowest in the quarter

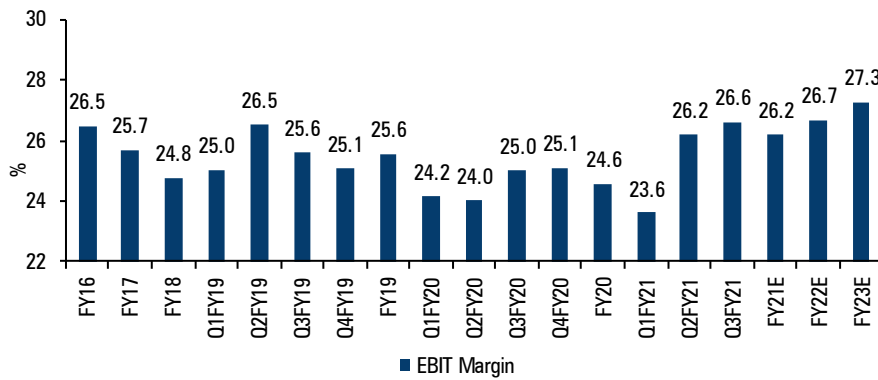
Financial story in charts

Exhibit 6: Dollar revenues may grow at 8% CAGR in FY20-23E



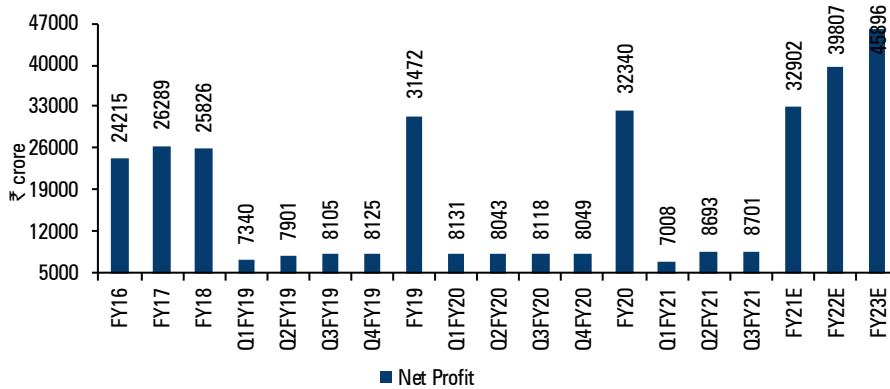
Source: Company, ICICI Direct Research

Exhibit 7: Revision in margin estimates for FY21E, FY22E & FY23E



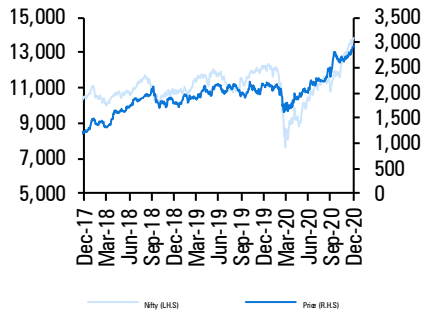
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

Exhibit 9: Three year price chart



Source: Company, ICICI Direct Research

Financial summary

Exhibit 10: Profit and loss statement					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Total operating Income	1,56,949	1,64,517	1,84,742	2,08,434	
Growth (%)	7.2	4.8	12.3	12.8	
COGS (employee expenses)	89,635	93,610	1,04,195	1,16,306	
S,G&A expenses	25,204	23,855	26,788	30,223	
Total Operating Expenditure	1,14,839	1,17,465	1,30,982	1,46,529	
EBITDA	42,110	47,052	53,760	61,905	
Growth (%)	6.6	11.7	14.3	15.2	
Depreciation	3,530	3,948	4,434	5,002	
Other Income less interest	3,668	2,431	3,771	4,292	
PBT	42,248	45,534	53,097	61,194	
Total Tax	9,801	11,293	13,168	15,176	
Minority Interest	107	122	122	122	
PAT	32,340	32,902	39,807	45,896	
Growth (%)	2.8	1.7	21.0	15.3	
EPS (₹)	86.2	89.0	107.7	124.2	
PAT	32,340	32,902	39,807	45,896	
EPS - Reported (₹)	86.2	89.0	107.7	124.2	

Source: Company, ICICI Direct Research

Exhibit 12: Balance sheet					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Liabilities					
Equity Capital	375	370	370	370	
Reserve and Surplus	81,932	87,854	97,021	1,07,983	
Share Premium	3,933	3,933	3,933	3,933	
Total Shareholders funds	86,240	92,156	1,01,324	1,12,286	
Total debt	8,174	8,235	8,399	8,590	
Other liabilities & Provisions	1,405	1,646	1,727	1,822	
Deferred tax liability(net)	779	779	779	779	
Minority Interest / Others	623	745	867	989	
Total Liabilities	97,221	1,03,561	1,13,095	1,24,466	
Assets					
Net assets & CWIP	20,215	19,557	18,818	17,984	
Goodwill	3,850	3,850	3,850	3,850	
Other non current assets	7,965	9,574	10,180	10,891	
Debtors	30,606	30,765	34,547	38,977	
Loans and Advances	10,171	8,226	9,237	10,422	
Other Current Assets	14,267	9,048	9,791	11,047	
Current Investments	26,140	26,140	26,140	26,140	
Cash	9,799	23,210	30,634	39,118	
Trade Payable	6,740	7,065	7,934	8,951	
OCL & Provisions	19,052	19,743	22,169	25,012	
Application of Funds	97,221	1,03,561	1,13,095	1,24,466	

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Profit before Tax	42,248	45,534	53,097	61,194	
Add: Depreciation	3,529	3,948	4,434	5,002	
(Inc)/dec in Current Assets	-7,125	7,005	-5,536	-6,870	
Inc/(dec) in CL and Provisions	2,625	1,319	3,539	4,147	
Taxes paid	-5,846	-11,293	-13,168	-15,176	
CF from operating activities	35,391	42,525	38,912	44,323	
(Inc)/dec in Investments	7,707	-1,609	-607	-711	
(Inc)/dec in Fixed Assets	-3,088	-3,290	-3,695	-4,169	
Others	0	2,771	3,453	3,974	
CF from investing activities	4,619	-2,128	-849	-905	
Inc/(dec) in loan funds	0	0	0	0	
Dividend paid & dividend tax	-37,634	-10,986	-30,639	-34,934	
Others	-295	-16,000	0	0	
CF from financing activities	-38,991	-26,986	-30,639	-34,934	
Net Cash flow	1,019	13,411	7,424	8,483	
Exchange difference	0	0	0	0	
Opening Cash	7,224	9,799	23,210	30,634	
Closing cash and Bank	9,799	23,210	30,634	39,118	

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Per share data (₹)					
Adjusted EPS (Diluted)	86.2	89.0	107.7	124.2	
BV per share	230.0	249.3	274.1	303.7	
DPS	85.0	29.7	82.9	94.5	
Cash Per Share	26.1	62.8	82.9	105.8	
Operating Ratios (%)					
EBIT margins	24.6	26.2	26.7	27.3	
PBT Margins	26.9	27.7	28.7	29.4	
PAT Margin	20.6	20.0	21.5	22.0	
Debtor days	71	68	68	68	
Creditor days	16	16	16	16	
Return Ratios (%)					
RoE	37.5	35.7	39.3	40.9	
RoCE	43.5	44.0	46.9	49.2	
RoIC	63.0	79.5	87.6	96.1	
Valuation Ratios (x)					
P/E	36.1	35.0	28.9	25.1	
EV / Net Sales	7.3	6.9	6.1	5.3	
Market Cap / Sales	7.5	7.1	6.3	5.6	
Solvency Ratios					
Debt / EBITDA	0.2	0.2	0.2	0.1	
Debt / Equity	0.1	0.1	0.1	0.1	
Current Ratio	2.1	1.8	1.8	1.8	
Quick Ratio	2.1	1.8	1.8	1.8	

Source: Company, ICICI Direct Research

Exhibit 14: ICICI Direct coverage universe (IT)

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	EPS (₹)				P/E (x)				RoCE (%)				RoE (%)			
					FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
HCL Tech (HCLTEC)	994	1,105	Buy	2,69,830	40.8	45.6	53.2	61	24	22	19	16	23.0	23.8	24.9	25.3	21.6	20.7	21.0	20.9
Infosys (INFTEC)	1,311	1,450	Buy	5,58,772	38.9	46.3	49.8	57	34	28	26	23	30.8	33.7	33.6	35.6	25.2	27.4	27.2	28.7
TCS (TCS)	3,120	3,600	Buy	11,70,000	86.2	89.0	107.7	124	36	35	29	25	43.5	44.0	46.9	49.2	37.5	35.7	39.3	40.9
Tech M (TECMAH)	1,050	1,105	Buy	1,01,671	45.9	50.0	58.8	69	23	21	18	15	19.1	18.7	19.8	20.9	18.5	18.3	18.9	19.5
Wipro (WIPRO)	430	435	Hold	2,45,845	16.6	18.1	19.7	22	26	24	22	19	19.3	21.0	22.3	24.4	17.4	18.6	19.9	21.8
Mindtree (MINCON)	1,739	1,680	Buy	28,648	38.3	58.8	68.0	76	45	30	26	23	23.0	29.7	30.0	29.6	20.0	25.5	25.4	24.6
LTI (LTINFC)	4,093	3,850	Buy	71,483	86.6	105.9	126.5	149	47	39	32	27	30.7	31.8	31.6	31.3	28.1	28.3	28.3	28.0
Coforge (NIITEC)	2,801	2,690	Hold	16,974	71.4	75.7	94.4	110	39	37	30	25	23.0	25.5	27.0	27.6	18.5	20.1	22.0	22.6
Infoedge (INFEDG)	5,418	4,090	Buy	69,677	26.8	23.8	33.1	39	202	228	164	138	18.0	9.1	11.9	13.3	13.5	6.8	9.0	10.0
Teamlease (TEASER)	2,718	2,840	Buy	4,647	20.5	47.2	64.9	83	133	58	42	33	15.0	13.8	15.9	17.2	6.5	12.7	14.7	15.9

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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