

Sector: IT & ITES
Results update

	Change
Reco: Buy	↔
CMP: Rs. 2,131	
Price Target: Rs. 2,300	↓

↑ Upgrade ↔ No change ↓ Downgrade

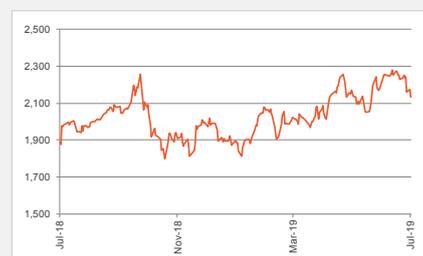
Company details

Market cap:	Rs. 799,802 cr
52-week high/low:	Rs. 2,290/1,784
NSE volume: (No of shares)	29.5 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCS
Free float: (No of shares)	104.9 cr

Shareholding (%)

Promoters	72.1
FII	15.8
DII	8.1
Others	4.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.3	5.9	16.1	15.4
Relative to Sensex	1.8	5.4	7.2	5.0

Sharekhan Research, Bloomberg

Tata Consultancy Services (TCS) delivered lower-than-expected revenue growth, with 10.6% y-o-y on constant currency (CC) terms. The softer-than-expected revenue growth can be attributed to slower growth in the BFSI and communication vertical, while CC growth in life science and healthcare and regional markets remained strong. EBIT margin declined by 94 BPS q-o-q to 24.2%, a tad below our expectations, owing to 230 BPS q-o-q impact from both wage revision and rupee appreciation, partially offset by operational efficiencies. Digital, with an annual run rate of \$7 billion+, continues to grow strong at over 40% y-o-y for the past several quarters. TCS signed strong deal wins worth \$5.7 billion (versus \$4.9 billion in Q1FY2019) during the quarter. Management remains optimistic on the medium-to-long-term demand outlook despite macro challenges. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 2,300.

Strong digital growth, management remains confident on medium-term outlook

Digital revenue (32.2% of total revenue) continued to show strong growth momentum, growing by 42.1% y-o-y on CC basis. Growth in digital revenue continued at an elevated level, given its differentiated capabilities and end-to-end transformative solutions to customers. Management remains optimistic on the medium-to-long-term demand outlook, but it highlighted that the near term could remain volatile. Further, management believes that Q2 would be an important quarter to achieve double-digit revenue growth in FY2020E, as Q1 revenue growth was softer than expected. Further, strong deal wins in recent quarters along with a healthy deal pipeline and traction for its product and platform business will help the company to achieve the growth trajectory.

Our Call

Valuation – Maintain Buy with a PT of Rs. 2,300: We have fine-tuned our earnings estimates for FY2020E/FY2021E, factoring lower-than-expected Q1FY2020 and reset of USD/INR rates. We continue to remain positive on the revenue growth momentum of TCS in FY2020E, given acceleration in deal wins with increasing TCVs, strong digital growth and good execution. At the CMP, the stock is trading at 24x/22x its FY2020E/FY2021E EPS, which commands an industry-leading PE multiple, given its consistency and leadership position. Therefore, we maintain our Buy rating with a revised PT of Rs. 2,300.

Key Risks:

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the U.S. along with stringent visa regime would have an adverse impact on its earnings.

Valuation (standalone)

Particulars	Rs cr				
	FY17	FY18	FY19	FY20E	FY21E
Revenues	1,17,966.0	1,23,104.0	1,46,463.0	1,58,740.8	1,74,864.3
OPM (%)	27.4	26.4	27.0	26.8	26.7
Adjusted PAT	26,289.0	25,826.0	31,472.0	33,735.7	37,045.8
% YoY growth	8.6	-1.8	21.9	7.2	9.8
Adjusted EPS (Rs.)	70.1	67.1	83.1	89.9	98.7
P/E (x)	30.4	31.8	25.7	23.7	21.6
P/B (x)	9.0	9.4	8.9	8.0	7.3
EV/EBITDA (x)	12.9	12.4	20.0	18.4	16.7
RoNW (%)	32.4	29.6	35.9	35.6	35.4
RoCE (%)	36.4	33.9	41.3	40.1	40.0

Source: Company; Sharekhan estimates

Revenue miss, margins a tad below expectations

TCS delivered lower-than-expected revenue growth for Q1FY2020, with 10.6% y-o-y on CC basis (did not report q-o-q growth on CC terms). In USD terms, revenue was at 1.6% q-o-q/8.6% y-o-y versus our expectations of 2.6% q-o-q/9.7% y-o-y. EBIT margin during the quarter declined by 94 BPS q-o-q to 24.2%, a tad below our expectations, owing to 230 BPS q-o-q impact because of both salary increment and rupee appreciation, partially offset by operational efficiencies. Excluding non-recurring expense of Rs. 220 crore pertaining to contribution to electoral trust, adjusted EBIT margin contracted by 150 BPS q-o-q in Q1FY2020. Lower profitability was offset by higher other income (21.7% q-o-q), resulting in flat growth in net income at Rs. 8,131 crore.

Strong digital, healthy momentum of deals, slower growth in BFSI and retail

Digital revenue (32.2% of total revenue) continued to show strong growth momentum, growing by 42.1% y-o-y on CC basis. Digital now contributes around one-third to the revenue, with an annual run-rate of \$7 billion+ and has been growing over 40% y-o-y for the past seven consecutive quarters. Strong deal wins continued in Q1FY2020, with deal TCVs of \$5.7 billion (versus \$4.9 billion in Q1FY2019), an increase of around 20% y-o-y. TCS signed deals worth \$2.8 billion in North America, \$2 billion in BFSI (book-to-bill ratio remains strong) and \$1 billion in retail. BFSI CC revenue growth slowed down to 9.2 y-o-y in Q1FY2020, compared to 11.6% y-o-y in Q4FY2019. Retail and CPG, communication and media and manufacturing CC revenue growth also decelerated to 7.9%, 8.4% and 5.5%, respectively, during the quarter. Lifescience and healthcare and regional markets continued their double-digit growth of 18.1% and 16.9%, respectively, during the quarter. U.K. and Continental Europe continued to report strong CC growth of 16% y-o-y and 15% y-o-y in Q1FY2020, respectively, while U.S. CC revenue growth remained at 7.7% y-o-y versus 9.9% y-o-y in Q4FY2019. TCS added one client on a sequential basis under the \$50 million client bucket during the quarter.

Management remains positive on the medium to long-term demand outlook

Management remains optimistic on the medium-to-long-term demand outlook despite macro challenges, while it believes the near term could remain volatile. Though management maintains its confidence on double-digit growth in FY2020E, Q2 would remain key as Q1, which used to be a seasonally strong quarter, was softer than expected. Strong deal wins along with a healthy deal pipeline, participation in clients' digital journey and traction for its product and platform business give comfort to the company's growth trajectory. Further, pick-up in hiring (net addition of 12,356 employees, highest in the past five years) during the quarter is the reflection of the medium-term demand outlook. Management expects the retail vertical growth would to recover in Q2FY2020E, while the weakness in BFSI is more pronounced (U.S.-centric capital market and European banks remains soft).

Products and platforms gaining scale

The products and platforms of TCS are gaining traction among customers. Ignio continues to gain market share, doubling its revenue and customer on a y-o-y basis. It has 16 new wins during the quarter, taking total number of customers to over 100. TCS BANCS also continues to gain traction in the U.S. and Europe, with seven new wins and five go-lives in Q1FY2020. The company is on track to launch this product in the U.S. The company had two wins in Quartz and Optumera each during Q1FY2020.

Results

Particulars	Rs cr				
	Q1FY20	Q1FY20	Q4FY19	YoY (%)	QoQ (%)
Revenue (\$ mn)	5,485.0	5,051.0	5,397.0	8.6	1.6
Revenue in INR (cr)	38,172.0	34,261.0	38,010.0	11.4	0.4
Direct costs	22,102.0	19,685.0	21,709.0	12.3	1.8
Gross profit	16,070.0	14,576.0	16,301.0	10.2	-1.4
SG&A	6,033.0	5,505.0	6,228.0	9.6	-3.1
EBITDA	10,037.0	9,071.0	10,073.0	10.6	-0.4
Depreciation	817.0	493.0	536.0	65.7	52.4
EBIT	9,220.0	8,578.0	9,537.0	7.5	-3.3
Other income	1,418.0	1,208.0	1,165.0	17.4	21.7
PBT	10,638.0	9,786.0	10,702.0	8.7	-0.6
Tax provision	2,485.0	2,424.0	2,549.9	2.5	-2.5
Net profit	8,153.0	7,362.0	8,152.1	10.7	0.0
Minority interest	22.0	22.0	26.1	0.0	-15.7
Adj. Net Profit	8,131.0	7,340.0	8,126.0	10.8	0.1
EPS (Rs.)	21.7	19.6	21.7	10.8	0.1
Margin (%)				BPS	BPS
EBITDA	26.3	26.5	26.5	-18	-21
EBIT	24.2	25.0	25.1	-88	-94
NPM	21.3	21.4	21.4	-12	-8

Source: Company; Sharekhan estimates

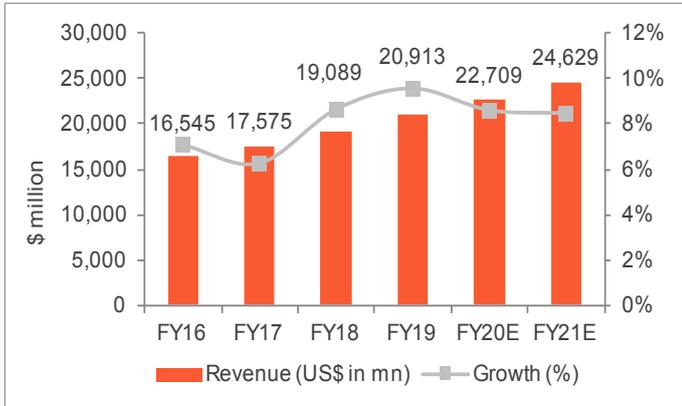
Operating metrics

Particulars	Revenue		Contribution		\$ Growth (%)		CC growth (%)	
	(\$ mn)	(%)	(%)	(%)	q-o-q	y-o-y	y-o-y	y-o-y
Revenue (\$ mn)	5,485	100			1.6	8.6		10.6
Geographic mix								
North America	2,775	50.6			1.4	7.7		7.7
Latin America	99	1.8			-8.5	2.9		6.4
U.K.	867	15.8			1.0	10.7		16.0
Continental Europe	784	14.3			3.1	10.9		15.0
India	329	6.0			5.1	12.3		15.9
APAC	516	9.4			0.6	6.3		9.5
MEA	115	2.1			6.7	3.7		6.4
Industry verticals								
BFSI	1,689	30.8			1.6	7.5		9.2
Retail & CPG	823	15.0			1.0	5.8		7.9
Communication & media	378	6.9			1.6	5.5		8.4
Manufacturing	538	9.8			3.7	4.3		5.5
Life Science and healthcare	433	7.9			4.3	17.5		18.1
Technology & services	483	8.8			4.0	6.2		7.8
Regional markets and others	1,141	20.8			-0.8	13.5		16.9
Digital	1,766	32.2			5.6	39.9		42.1
Core	3,719	67.8			-0.1	-1.8		NA

Source: Company; Sharekhan estimates

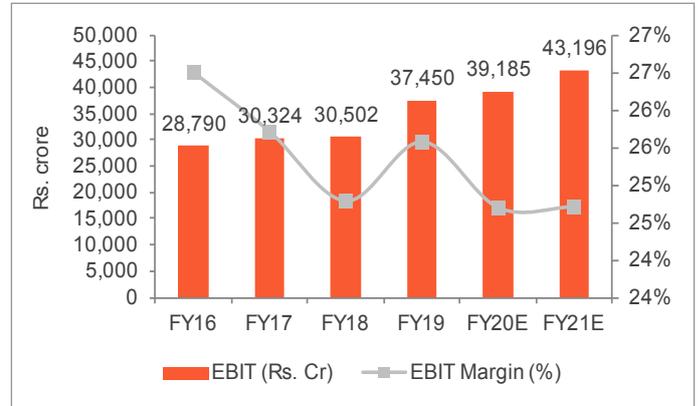
Financials in charts

Revenue in US\$ (mn) and growth (%)



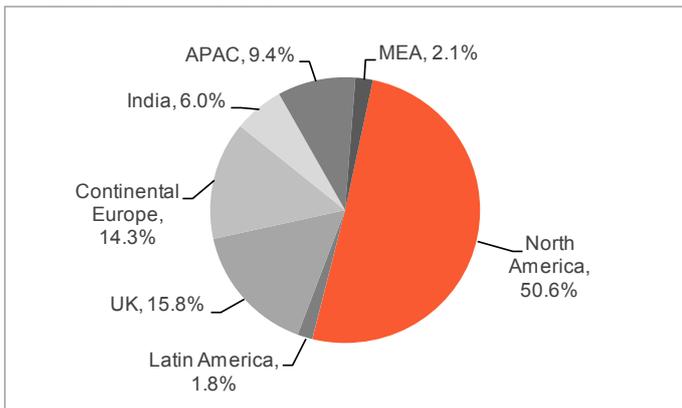
Source: Company; Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



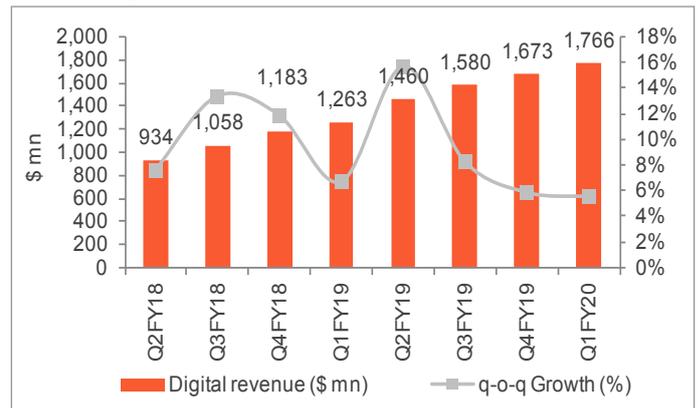
Source: Company; Sharekhan Research

Geography break-up (%)



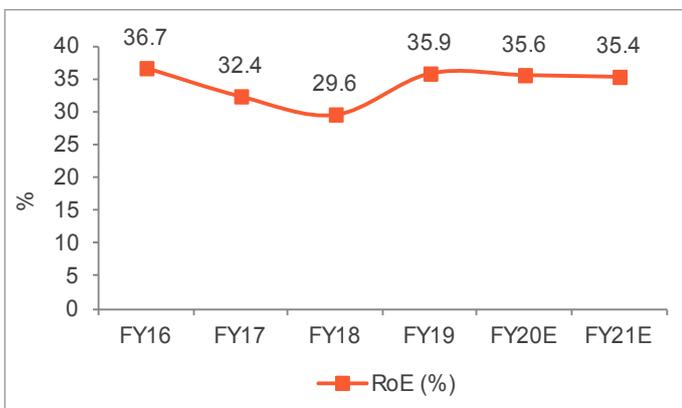
Source: Company; Sharekhan Research

Trend in digital revenue



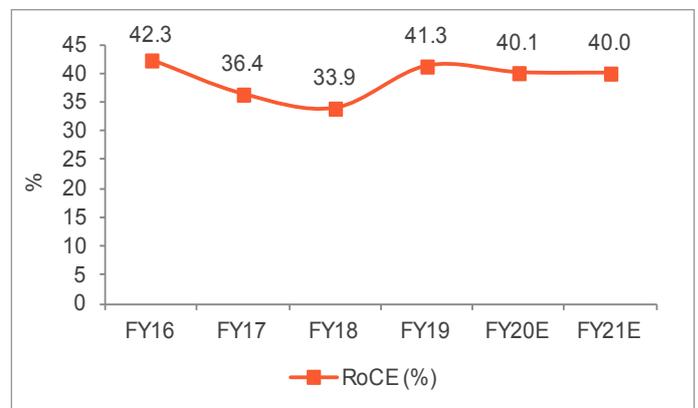
Source: Company; Sharekhan Research

RoE trend



Source: Company; Sharekhan Research

RoCE trend



Source: Company; Sharekhan Research

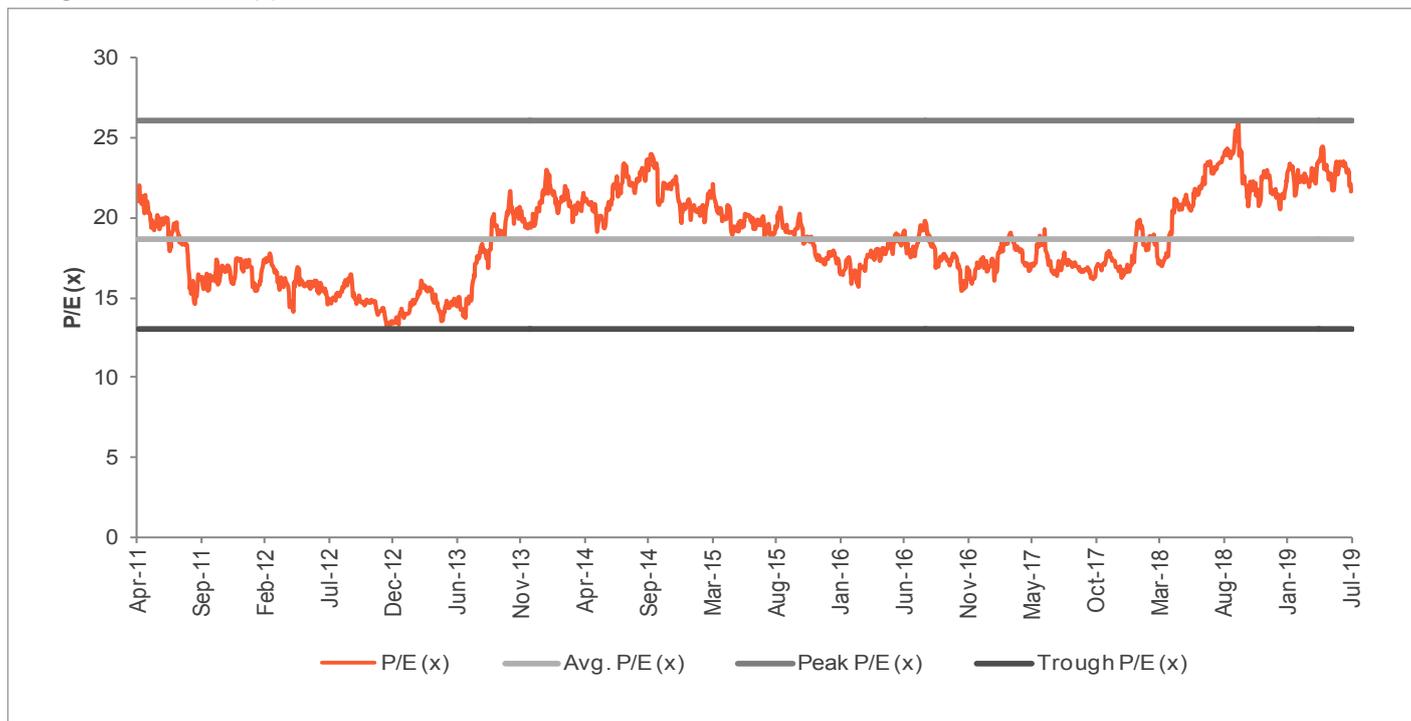
Outlook

Being the larger IT services company in India, TCS is well positioned to benefit from the growing demand for digital technology. 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 maintain its growth trajectory in the long term. While there are macro uncertainties in major markets, TCS's management indicated that client discussions do not indicate any lowering of spending yet. Management intends to keep the payout ratio at 80-100% of free cash generated.

Valuation

We have fine-tuned our earnings estimates for FY2020E/FY2021E, factoring lower-than-expected Q1FY2020 and reset of USD/INR rates. We continue to remain positive on the revenue growth momentum of TCS in FY2020E, given acceleration in deal wins with increasing TCVs, strong digital growth and good execution. At the CMP, the stock is trading at 24x/22x its FY2020E/FY2021E EPS, which commands an industry-leading PE multiple, given its consistency and leadership position. Therefore, we maintain our Buy rating on the stock with a revised PT of Rs. 2,300.

One-year forward P/E (x) band



Source: Company; Sharekhan Research

Peer valuation

Particulars	CMP	O/S	M cap	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
	Rs/share	Cr	Rs cr	FY20E	FY21E	FY20E	FY21E	FY20E	FY21	FY20E	FY21
HCL Tech	1,021	136	1,38,530	13.0	11.6	8.8	7.9	3.0	2.7	24.4	24.2
Infosys	715	436	3,12,038	18.2	16.2	13.1	11.5	2.7	2.6	27.2	31.3
Wipro	265	603	1,60,141	15.9	14.3	10.5	9.3	2.2	2.0	17.4	17.5
TCS	2,131	375	7,99,802	23.7	21.6	17.8	16.0	8.0	7.3	35.6	35.4

Source: 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 customers, 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 broad-range of capabilities, strong digital competencies, strong platform and stable management. The company is a 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 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Tata Sons Pvt Ltd	72.0
2	Life Insurance Corp of India	4.1
3	Commonwealth Bank of Australia	1.1
4	BlackRock Inc	1.0
5	Vanguard Group Inc	0.9
6	JPMorgan Chase & Co	0.7
7	SBI Funds Management Pvt Ltd	0.6
8	Invesco Ltd	0.5
9	Standard Life Aberdeen PLC	0.4
10	Axis Asset Management Co Ltd	0.4

Source: Bloomberg

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