

Tata Consultancy Services (TCS)

Performance highlights

(` cr)	3QFY19	2QFY19	% chg (QoQ)	3QFY18	% chg (yoy)
Net revenue	37,338	36,854	1.3	30,904	20.8
Adj. EBITDA	7,065	10,364	(31.8)	8,287	(14.7)
Adj. EBITDA margin (%)	27.2	28.1	(92)bp	26.8	39bp
Adj. PAT	8,105	7,901	2.6	6,531	24.1

Source: Company, Angel Research

TCS posted a 0.7% sequential growth in USD revenues to US\$5,250mn v/s US\$5,215mn in 2QFY2019. In rupee terms, revenues came in at `37,338cr V/s `36,854cr, up 1.3% QoQ. In Constant Currency (CC) terms, the company posted a 1.8% QoQ growth. On profitability front, EBIT margin showed a dip of ~90bps QoQ to 25.6%. Consequently, PAT came in at 8,105cr v/s `7,901cr in 2QFY2019, up of 2.6% QoQ. **We recommend a neutral rating on the stock.**

Quarterly highlights: TCS posted a 0.7% sequential growth in USD revenues to US\$5,250mn v/s US\$5,215mn in 2QFY2019. In Constant Currency (CC) terms, the company posted a 1.8% QoQ growth. Geography wise, the growth was broadly well spread. In terms of verticals, key verticals BFSI, Retail & CPG & Communication & Media registered a yoy CC growth of 8.6%, 10.5% and 10.8% respectively. Other verticals like Manufacturing & Technology Services posted yoy growth of 6.7% and 5.8% on CC terms. On profitability front, EBIT margin showed a dip of ~90bps QoQ to 25.6%. Consequently, PAT came in at 8,105cr V/s `7,901cr in 2QFY2019, up 2.6% QoQ.

Outlook and valuation: Over FY2018-21E, we expect TCS to post revenue CAGR of 9.5% & 13.1% in USD & INR terms respectively. The company highlighted that it stands comfortable in sustaining the EBIT margin in the range of 26-28%. On the EBIT and PAT fronts, we expect the company to post 13.4% and 11.7% CAGR over FY2018-21E respectively. The stock is trading at 21.3x FY2020E EPS of `88.7. **Valuations already discount a robust medium growth & favorable operating environment and valuations are higher than its P/E averages. However, given the good cash yield we recommend a Neutral.**

Key financials (Consolidated, IFRS)

Y/E March (` cr)	FY2018	FY2019	FY2020E	FY2021E
Net sales	123,104	149,085	163,248	177,941
% chg	4.4	21.1	9.5	9.0
Net profit	25,826	31,194	33,284	36,030
% chg	(1.8)	20.8	6.7	8.3
EBITDA margin (%)	26.6	27.2	26.7	26.7
EPS (`)	67.5	83.1	88.7	96.0
P/E (x)	28.0	22.7	21.3	19.7
P/BV (x)	8.2	8.4	7.5	6.7
RoE (%)	29.5	36.9	35.2	34.2
RoCE (%)	28.0	35.1	33.8	33.1
EV/Sales (x)	5.3	4.4	3.9	3.6
EV/EBITDA (x)	19.8	16.1	14.7	13.3

Source: Company, Angel Research; Note: CMP as of January 10, 2018

NEUTRAL

CMP `1,889

Target Price

Investment Period 12 Months

Stock Info

Sector	IT
Market Cap (` cr)	708,507
Net Debt (` cr)	(45,288)
Beta	0.3
52 Week High / Low	2,273/1,349
Avg. Daily Volume	192,405
Face Value (`)	1
BSE Sensex	36,107
Nifty	10,822
Reuters Code	TCS.BO
Bloomberg Code	TCS@IN

Shareholding Pattern (%)

Promoters	72.1
MF / Banks / Indian FIs	7.8
FII / NRIs / OCBs	16.1
Indian Public / Others	4.1

Abs.(%)	3m	1yr	3yr
Sensex	2.7	4.9	45.4
TCS	(1.1)	34.5	59.8

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2019 performance (Consolidated, IFRS)

(` cr)	3QFY2019	2QFY2019	% chg (QoQ)	3QFY2018	% chg (yoy)	9MFY2019	9MFY2018	% chg(yoy)
Net revenue	37,338	36,854	1.3	30,904	20.8	1,08,453	91,029	19.1
Cost of revenue	21,142	20,607	2.6	17,356	21.8	61,434	51,255	19.9
Gross profit	16,196	16,247	(0.3)	13,548	19.5	47,019	39,774	18.2
SG&A expense	6,039	5,883	2.7	5,261	14.8	17,522	15,910	10.1
EBITDA	10,157	10,364	(2.0)	8,287	22.6	29,497	23,864	23.6
Dep. and Amortization	593	593	-	506	17.2	1,584	1,509	5.0
EBIT	9,564	9,771	(2.1)	7,781	22.9	27,913	22,355	24.9
Other income	1,147	593	93.4	864	32.8	2,948	2,608	13.0
PBT	10,711	10,364	3.3	8,645	23.9	30,861	24,963	23.6
Income tax	2,590	2,437	6.3	2,100	23.3	7,451	6,008	24.0
PAT	8,121	7,927	2.4	6,545	24.1	23,410	18,955	23.5
Earnings in affiliates	-	-	-	-	-	-	-	-
Minority interest	16	26	-	14	-	-	33	-
Reported PAT	8,105	7,901	2.6	6,531	24.1	23,410	18,922	23.7
Adj. PAT	8,105	7,901	2.6	6,531	24.1	23,410	18,922	23.7
EPS	21.6	20.7	4.5	16.8	28.3	62.4	49.5	26.1
Gross margin (%)	43.4	44.1	(71)bps	43.8	(46)bps	43.4	43.7	(34)bps
EBITDA margin (%)	27.2	28.1	(92)bps	26.8	39bps	27.2	26.2	98bps
EBIT margin (%)	25.6	26.5	(90)bps	25.2	44bps	25.7	24.6	118bps

Source: Company, Angel Research

Key geographies & verticals doing well

TCS posted a 3.2% sequential growth in USD revenues to US\$5,250mn v/s US\$5,215mn in 2QFY2019. In Constant Currency (CC) terms, the company posted a 1.8% QoQ growth.

Geography wise, the growth was broadly well spread. USA - North America & Latin America registered a yoy CC growth of 8.2% and 7.6% respectively. In Europe- UK & Continental Europe registered a yoy CC growth of 25.1% and 17.6% respectively. India & Asia Pacific registered a yoy CC growth of 9.7% and 12.6% respectively.

In terms of verticals, BFSI, Retail & CPG & Communication & Media registered a yoy CC growth of 8.6%, 10.5% and 10.8% respectively. Other verticals like Manufacturing & Technology Services posted yoy growth of 6.7% and 5.8% on CC terms. Growth in Digital was 52.7% yoy in CC terms and it now constitutes to 30.1% of total revenue. Digital was around 22.1% of sales in 3QFY2018. TCS pipeline expanded across segments and geographies. Total TCV of deals in 3QFY2019 amounted to US\$ 5.9bn.

Exhibit 2: Revenue growth (Industry wise on CC basis)

	% to revenue	% chg (yoy)
BFSI	30.8	8.6
Manufacturing	7.2	6.7
Communication & Media	6.9	10.8
Life sciences and healthcare	7.6	15.7
Retail and CPG	16.5	10.5
Energy and utilities	4.7	18.1
Technology & Services	7.6	5.8
Regional Markets & Others	18.7	22.6

Source: Company, Angel Research

Exhibit 3: Revenue growth (Geography wise in INR terms)

	% of revenue	% chg (yoy)
U.S.	51.2	8.2
Latin America	2.0	7.6
U.K.	15.5	25.1
Continental Europe	14.1	17.6
India	5.7	9.7
Asia Pacific	9.4	12.6
MEA	2.1	(3.3)

Source: Company, Angel Research

Attrition rate inches up

In 3QFY2019, TCS witnessed a gross addition of 12,534 employees and net addition of 6,827 employees, taking its total employee base to 4,17,929. During the quarter, the attrition rate (last twelve-month [LTM] basis) for the company increased to 11.2% from 10.9% in 2QFY2019.

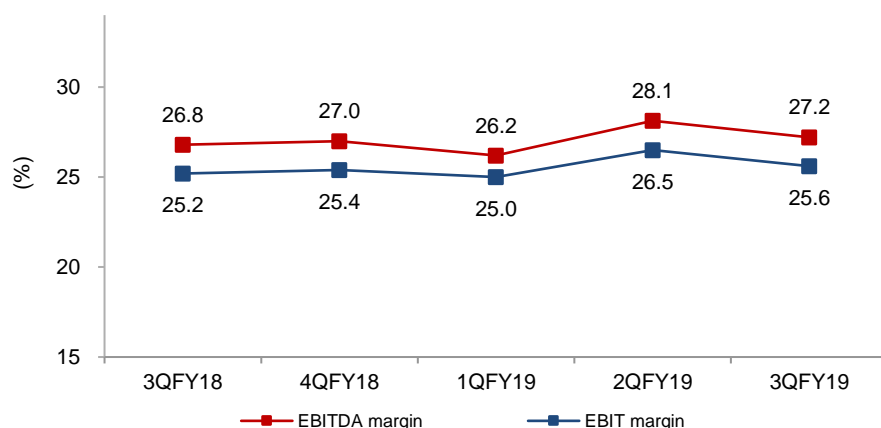
Exhibit 4: Hiring & attrition trend

Particulars	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
Net addition	3,404	1,667	4,118	5,877	6,827
Total employee base	3,90,880	3,94,998	4,00,875	4,11,102	4,17,929
Attrition (%) - LTM basis	11.9	11.8	11.7	10.9	11.2

Source: Company, Angel Research

Margin dips; mainly driven by subcontracting costs

On the operating front, the company reported EBITDA and EBIT margins at 27.2% and 25.6%, i.e. a dip of 92ps and 90bps QoQ respectively. A major part of the dip was on back of subcontracting costs. Sub-con costs were 7.9% of revenues (the highest in recent history) compared to 7.2% in 2QFY2019. The company has maintained an EBIT margin target of 26-28%.

Exhibit 5: Adj. Margin profile (%)


Source: Company, Angel Research

Client metrics

The client pyramid during the quarter witnessed a qualitative improvement with client additions seen in the higher revenue brackets. The clients in US\$10mn+ revenue band increased by 7 and in US\$100mn+ revenue band increased by 1.

Exhibit 6: Client pyramid

	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19
US\$1mn–5mn	456	468	470	476	477
US\$5mn–10mn	148	145	153	148	149
US\$10mn–20mn	134	143	149	152	159
US\$20mn–50mn	109	110	109	115	112
US\$50mn–100mn	57	59	57	54	54
US\$100mn plus	37	38	40	44	45

Source: Company, Angel Research

Outlook & Valuations

Over FY2018-21E, we expect TCS to post revenue CAGR of 9.5% & 13.1% in USD & INR terms respectively. The company highlighted that it stands comfortable in sustaining the EBIT margin in the range of 26-28%. On the EBIT and PAT fronts, we expect the company to post 13.4% and 11.7% CAGR over FY2018-21E respectively. The stock is trading at 21.3x FY2020E EPS of ₹88.7. **Valuations already discount a robust medium growth and favorable operating environment and is at slight premium to its long-term P/E averages. However, given the cash yield we recommend a Neutral.**

Exhibit 7: Key assumptions

	FY2020E	FY2021E
Revenue growth (USD)	9.5	9.0
USD-INR rate (realized)	71.0	71.0
Revenue growth (%)	9.5	9.0
EBITDA margin (%)	26.7	26.7
Tax rate (%)	25.0	25.0
EPS growth (%)	6.7	8.3

Source: Company, Angel Research

Company background

TCS is Asia's largest IT services provider and is amongst the top 10 technology firms in the world. The company has a global footprint with an employee base of over 4lakh professionals, offering services to more than 1,000 clients across various industry segments. The company has one of the widest portfolios of service offerings, spanning across the entire IT service value chain – from traditional application development and maintenance to consulting and package implementation to products and platforms.

Profit & Loss statement (Consolidated, IFRS)

Y/E March (₹ cr)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Net sales	117,966	123,104	149,085	163,248	177,941
Cost of revenue	64,764	69,072	82,444	90,276	98,401
Gross profit	53,202	54,032	66,641	72,972	79,539
<i>% of net sales</i>	45.1	43.9	44.7	44.7	44.7
SGA expenses	20,755	21,314	26,090	29,385	32,029
<i>% of net sales</i>	17.6	17.3	17.5	18.0	18.0
EBITDA	32,447	32,718	40,551	43,587	47,510
<i>% of net sales</i>	27.5	26.6	27.2	26.7	26.7
Dep. and amortization	2123	2216	2534	2775	3025
<i>% of net sales</i>	1.8	1.8	1.7	1.7	1.7
EBIT	30,324	30,502	38,017	40,812	44,485
<i>% of net sales</i>	25.7	24.8	25.5	25.0	25.0
Other income, net	4189	3590	3700	3700	3700
Profit before tax	34,513	34,092	41,717	44,512	48,185
Provision for tax	8,156	8,212	10,429	11,128	12,046
<i>% of PBT</i>	23.6	24.1	25.0	25.0	25.0
PAT	26,357	25,880	31,288	33,384	36,139
Minority interest	68	54	94	100	108
Extra-ordinary (Exp.)/ Inc.					
Reported PAT	26,289	25,826	31,194	33,284	36,030
Adj. PAT	26,289	25,826	31,194	33,284	36,030
Diluted EPS (₹)	68.7	67.5	83.1	88.7	96.0

Balance sheet (Consolidated, IFRS)

Y/E March (` cr)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Assets					
Cash and cash equivalents	3,597.0	4,883.0	5,240.4	5,326.2	4,782.0
Other current financial assets	-	6,395	6,395	6,395	6,395
Accounts receivable	22,684	24,943	27,437	30,181	33,199
Unbilled revenues	5,351	6,686	8,097	8,866	9,664
Other current assets	7,258	2,610	2,610	2,610	2,611
Property and equipment	11,741	11,600	11,700	11,800	11,900
Intangible assets and goodwill	3,768	3,896	3,896	3,896	3,896
Investments	41,980	36,008	30,908	39,747	50,074
Other non-current assets	8,974	12,034	12,034	12,034	12,034
Total assets	105,353	109,055	108,318	120,856	134,555
Liabilities					
Current liabilities	14,294	17,828	20,146	22,765	25,724
Short term borrowings	218	193	193	193	194
Redeemable preference shares	-	-	-	-	-
Long term debt	71	54	54	54	55
Other non-current liabilities	2,089	2,935	2,935	2,935	2,935
Minority interest	366	402	402	402	403
Shareholders' funds	88,315	87,643	84,588	94,507	105,244
Total liabilities	105,353	109,055	108,318	120,856	134,555

Cash flow statement (Consolidated, IFRS)

Y/E March (` cr)	FY2017	FY2018	FY2019	FY2020E	FY2021E
Pre-tax profit from oper.	26,357	25,880	31,288	33,384	36,139
Depreciation	2,123	2,216	2,534	2,775	3,025
Exp. (deferred)/written off	-	-	-	-	-
Pretax cash from oper	28,480	28,096	33,822	36,159	39,164
Other inc./prior period ad	2,123	2,216	2,534	2,775	3,025
Net cash from operations	30,604	30,312	36,356	38,934	42,189
Tax	8,156	8,212	10,429	11,128	12,046
Cash profits	22,448	22,100	25,927	27,806	30,143
(Inc)/dec in acc. recv.	1,389	(2,259)	(2,494)	(2,744)	(3,018)
(Inc)/dec in unbilled rev.	(1,359)	(1,335)	(1,411)	(769)	(798)
(Inc)/dec in oth. current asst.	(1,283)	4,648	-	-	(1)
Inc/(dec) in current liab.	49	141	(100)	(100)	(100)
Net trade working capital	(1,204)	1,195	(4,005)	(3,613)	(3,917)
Cash flow from opert. actv.	21,243	23,295	21,922	24,194	26,225
(Inc)/dec in fixed assets	49	141	(100)	(100)	(100)
(Inc)/dec in investments	(14,325)	(423)	5,100	(8,839)	(10,327)
(Inc)/dec in intangible asst.	(178)	128	-	-	-
(Inc)/dec in non-cur.asst.	2,945	(3,060)	-	-	-
Cash flow from invt. actv.	(11,509)	(3,214)	5,000	(8,939)	(10,427)
Inc/(dec) in debt	44	(42)	-	-	-
Inc/(dec) in minority int.	12	36	-	-	-
Dividends	(19,993)	(11,258)	(18,248)	(23,365)	(25,293)
Others	10,202	(8,816)	(8,673)	8,111	9,494
Cash flow from finan. actv.	(9,735)	(20,080)	(26,921)	(15,254)	(15,799)
Cash generated/(utilized)	1,735	1,286	357	86	(544)
Cash at start of the year	1,862	3,597	4,883	5,240	5,326
Cash at end of the year	3,597	4,883	5,240	5,326	4,782

Key ratios

Y/E March	FY2017	FY2018	FY2019	FY2020E	FY2021E
Valuation ratio(x)					
P/E (on FDEPS)	27.5	28.0	22.7	21.3	19.7
P/CEPS	25.4	25.8	21.0	19.7	18.1
P/BVPS	8.2	8.2	8.4	7.5	6.7
Dividend yield (%)	1.2	1.3	2.2	2.8	3.1
EV/Sales	5.5	5.3	4.4	3.9	3.6
EV/EBITDA	20.0	19.8	16.1	14.7	13.3
EV/Total assets	6.2	5.9	6.0	5.3	4.7
Per share data (₹)					
EPS	68.7	67.5	83.1	88.7	96.0
Cash EPS	74.3	73.3	89.9	96.1	104.1
Dividend	23.5	25.0	41.6	53.2	57.6
Book value	231	229	225	252	280
DuPont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.8	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.1	1.1	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.3	0.2	0.3	0.3	0.3
Asset turnover ratio (Sales/Assets)	1.1	1.1	1.4	1.4	1.3
Leverage ratio (Assets/Equity)	1.2	1.2	1.3	1.3	1.3
Operating ROE	29.8	29.5	37.0	35.3	34.3
Return ratios (%)					
RoCE (pre-tax)	28.8	28.0	35.1	33.8	33.1
Angel RoIC	50.7	49.4	57.8	58.8	60.7
RoE	29.8	29.5	36.9	35.2	34.2
Turnover ratios(x)					
Asset turnover (fixed assets)	10.0	10.6	12.7	13.8	15.0
Receivables days	70	74	67	67	68

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1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)

Neutral (-5 to 5%)

Reduce (-5% to -15%)

Sell (< -15)