

Industry IT
Bloomberg TCS IN
BSE CODE 532540

Margin moving towards lower end of the guidance (26% to 28%) in FY19

RATING Neutral

CMP 1888

Price Target 2013

Potential Upside 7%

Rating Change ↔

Estimate Change ↓

Target Change ↔

Stock Info

52wk Range H/L 2273/1348
Mkt Capital (Rs Cr) 708507
Free float (%) 26%
Avg. Vol 1M (,000) 2667
No. of Shares (Cr) 375
Promoters Pledged (Cr) 15031

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Key Highlights-

- ❑ TCS reported a mixed performance in 3QFY19 where revenue grew 1.8%QoQ in CC terms whereas margin missed the expectation and decline 90 bps due to higher employee cost.
- ❑ The company posted the highest ever order book of \$5.9bn during the quarter. Out of total TCv, \$2bn came from BFSI and \$800mn came from Retail. The management is confident of momentum to continue going forward.
- ❑ Communications segment (which includes communication, media and technology) which largely remained flat in 3QFY19 is expected to continue to be soft for few more quarters as the industry is going through massive change and management is not seeing 5G to immediately result in benefit to this segment. Thus expecting sector to remain volatile for foreseeable future.
- ❑ Strong order book and deal pipeline will ensure double-digit growth in constant currency in FY19. However EBIT margin expected to be in the lower end of the guidance (26- 28%).

3Q FY19 Result Update

Company posted mixed set of numbers in 3QFY19 where the revenue grew 1.8% QoQ in cc term to Rs37338 crore led by growth in digital and segment like Life Sciences & Healthcare, Energy & Utilities and Retail. However currency headwind of 50bps impacted the revenue growth in INR term (growth of 1.3%QoQ). Digital revenue grew 52.7% YoY growth in CC in 3QFY19. Thus contributing 30.1% of the overall revenue. EBIT for the quarter stood at Rs9564 (decline of 2.1% QoQ). Margin missed our estimates and decline 90 bps led by higher employee cost, currency headwind and increase in the cost of the business. Despite decline in margins overall PAT grew 2.4%QoQ supported by higher other income.

View and Valuation

Going forward we expect TCS to post double digit revenue growth in cc term for FY19 led by continued recovery in BFSI Segment (grew 6.1%YoY in cc term,) strong order book that is increasing every quarter (grew 20% QoQ) and continued acceleration in building of digital core.

Although order intake increasing to \$5.9 billion in 3QFY19 (almost 20% growth in QoQ) and continued digital traction (growing 52.6%YoY) is giving a strong revenue visibility for FY19, weakness in communication segment (~16% of the overall revenues) will continue to impact the growth in FY19. On margin front, we have reduced our margins for FY19 by 60 bps post the miss in 3QFY19 result. We expect the margin to continue to taper for FY19 as the management is investing in employee addition to aggressively capture the larger demand and also due to higher subcontracting cost which will likely to continue until the employees are re skilled to meet the required demand.

We expect TCS to post revenue/Pat growth of 16%/17% CAGR over FY18-20. We see revenue growth in FY19 however PAT will likely to be impacted by tapered margin in FY19. **Thus, we are Neutral on the stock with 1 year forward target price of Rs2013 (21x FY20EPS).**

Key Risks to our rating and target

- ❑ Slower growth in deal wins.
- ❑ Weakness in BFSI and retail segment.

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
Net Sales	108646	117966	123104	146990	165591
EBITDA	30590	32311	32516	40186	44674
EBIT	28642	30324	30502	38167	42649
PAT	24292	26357	25880	32070	35989
EPS (Rs)	62	67	68	85	96
EPS growth (%)	22	9	1	26	12
ROE (%)	40	34	30	36	35
ROCE (%)	45	37	34	42	40
BV	180	219	222	242	308
P/B (X)	7	6	6	8	6
P/E (x)	20	18	21	22	20

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3QFY19 Results

Margin below estimates

Financials	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	YoY %	QoQ%	FY17	FY18	YoY %
Net Sales /	30,904	32,075	34,261	36,854	37,338	20.8%	1.3%	117966	123104	4.4%
Other Income	870	994	1,225	730	1,163	34%	59%	4,221	3,642	-14%
Employee	16,458	17,183	18,548	19,525	19,994	21%	2%	61,621	66,396	8%
Other Exp	6,159	6,240	6,642	7,049	7,261	18%	3%	24,034	24,192	0.7%
EBITDA	8,287	8,652	9,071	10,280	10,083	22%	-2%	32,311	32,516	0.6%
Dep and	506	505	493	507	519	3%	2%	1,987	2,014	1.4%
EBIT	7,781	8,147	8,578	9,773	9,564	23%	-2%	30,324	30,502	0.6%
Interest	6	12	17	137	16	167%	-88%	32	52	62.5%
PBT	8,645	9,129	9,786	10,366	10,711	24%	3%	34,513	34,092	-1.2%
Tax	2,100	2,204	2,424	2,437	2,590	23%	6%	8,156	8,212	0.7%
Exceptional	-	-	-	-	-					
PAT	6,545	6,925	7,362	7,929	8,121	24%	2%	26,357	25,880	-1.8%

3QFY19 revenue in line with the expectation

Revenue for the quarter at Rs37338 crore a growth of 1.3% QoQ led by strong growth in digital and segment like Life Sciences & Healthcare, Energy & Utilities and Retail. Digital revenue grew 52.7% YoY growth in CC in 3QFY19. Thus contributing 30.1% of the overall revenue.

Retail and Regional segment showed strong growth in 3QFY19

Segments (in crore)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	YoY %
BFSI	11789	12229	11970	12430	13464	14648	14722	1%	23%
Manufacturing	3182	3288	3315	3576	3746	3919	3958	1%	19%
Retail and Consumer	4996	5109	5383	5567	5906	6348	6449	2%	20%
CMI	5041	5269	5370	5451	5730	6009	6090	1%	13%
Others	4576	4646	4866	5051	5415	5930	6119	3%	26%

Softness seen in north America

Segments (in crore)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	QoQ%	YoY %
North America	15532	15851	16070	16102	17473	19127	19117	0%	19%
Latin America	621	672	680	642	651	811	747	-8%	10%
UK	4112	4276	4357	4875	5310	5160	5787	12%	33%
Continental Europe	3698	4092	4172	4555	4797	4938	5265	7%	26%
India	2071	1924	1947	1989	1987	2322	2128	-8%	9%
Asia Pacific	2810	2993	2936	3111	3289	3612	3510	-3%	20%
MEA	740	733	742	802	754	884	784	-11%	6%

Higher employee cost resulted in miss in margins

EBIT for the quarter stood at Rs9564 crore a decline of 2.1 QoQ. Margin contracted by 90 bps led by higher employee addition, currency headwind (50 bps) and higher subcontracting cost (40bps). pat for the quarter was at Rs8121 crore a growth of 2.4 % QoQ led by higher other income which grew 59%QoQ.

Concall Highlights

- ❑ Strong order continued in 3QFY19: Order book of US\$5.9 bn was won during the quarter across all verticals as compared to .US\$4.9 bn QoQ last quarter. Out of total TCv of US\$5.9bn, BFSI at \$2 bn+ and Retail at \$800mn+.
- ❑ Subcontracting issue: As the demand is spiking up ,in short term the management expect subcontracting to be volatile. However as it is costlier fair, management will work on its employee optimization to rationalize the impact in long term.
- ❑ Verticals:
 - Growth in 3QFY18 led by Energy & utilities grew 18.1 YoY in cc terms, life science grew 15.7%YoY in cc term, communication and media grew 10.8%YoY and retail cluster grew 10.5YoY.
 - Continued to see recovery in BFSI. In Banking strong traction coming from US, insurance is good in UK and Europe.
 - Communication continues to face challenges going forward
 - Retail: Retailer continuing to invest in online offline retail, Thus resulting in heavy investment in this segment. Management is heavily participating in large transformation deals and expects strong traction from retail.

Operational Metrics

<i>By Geography (%)</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>	<i>2QFY19</i>	<i>3QFY19</i>
North America	55.0	53.3	52.5	51.9	52.0	50.2	51.0	51.9	51.2
Latin America	2.2	2.1	2.1	2.2	2.2	2.0	1.9	2.2	2.0
UK	13.3	13.7	13.9	14.0	14.1	15.2	15.5	14.0	15.5
Europe	11.1	11.8	12.5	13.4	13.5	14.2	14.0	13.4	14.1
India	6.3	6.8	7.0	6.3	6.3	6.2	5.8	6.3	5.7
Asia Pacific	9.6	9.7	9.5	9.8	9.5	9.7	9.6	9.8	9.4
MEA	2.5	2.6	2.5	2.4	2.4	2.5	2.2	2.4	2.1

<i>Clients Contribution</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>	<i>2QFY19</i>	<i>3QFY19</i>
US\$ 1m+ Clients	880	897	905	933	941	963	978	989	996
US\$ 5m+ Clients	454	459	464	470	485	495	508	513	519
US\$ 10m+ Clients	300	310	322	328	337	350	355	365	370
US\$ 20m+ Clients	186	190	190	196	203	207	206	213	211
US\$ 50m+ Clients	80	84	85	91	94	97	97	98	99
US\$ 100m+ Clients	34	35	36	37	37	38	40	44	45

<i>Verticals(%)</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>	<i>2QFY19</i>	<i>3QFY19</i>
BFSI	33.9	32.9	32.5	32.6	31.6	31.1	31.1	31.2	30.8
Retail & CPG	13	12.3	16	15.9	16.7	16.6	16.6	16.6	16.5
Communication	6.7	7.2	7.1	7.1	7.1	7.1	7.1	6.9	6.9
Manufacturing	7.4	7.4	7.4	7.4	7.5	7.4	7.3	7.2	7.2
Life Sciences	6.9	6.9	7.1	7.2	7.3	7.2	7.3	7.5	7.6
Energy & Utilities	3.6	3.7	4	4.2	4.5	4.8	4.8	4.6	4.7
Travel & Hospitality	3.2	3.4						0	0
Technology & Serv	7.8	7.8	7.9	8	7.9	7.8	7.7	7.6	7.6
Regional Market	17.5	18.4	18	17.6	17.4	18	18.1	18.4	18.7

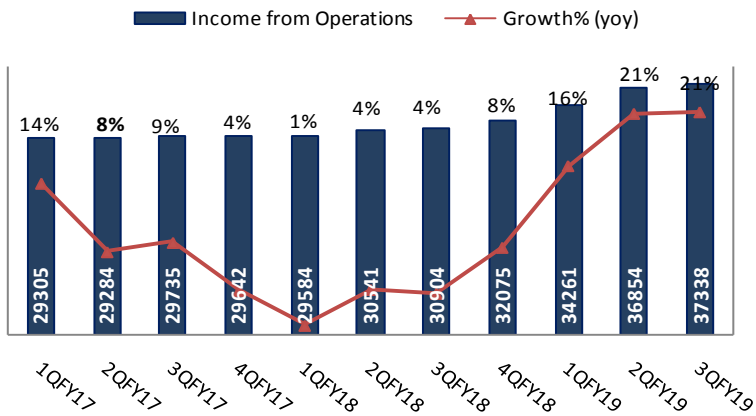
<i>Total Employee Base</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>	<i>2QFY19</i>	<i>3QFY19</i>
Total Employee	378497	387223	385809	389213	390880	394998	400875	411102	417929
Gross Additions	18362	20093	11202	15868	12534	n/a	n/a	n/a	n/a

<i>Attrition(%)</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>	<i>2QFY19</i>	<i>3QFY19</i>
Attrition	12.2	11.5	11.6	11.3	11.1	11	11.7	10.9	11.2

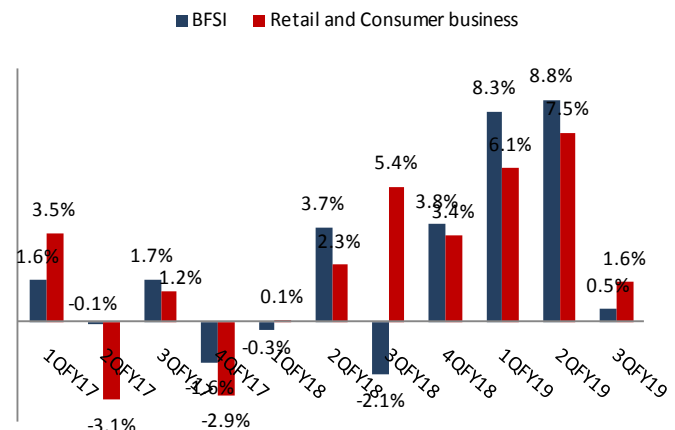
<i>Currency</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>	<i>2QFY19</i>	<i>3QFY19</i>
USD	67.8	66.6	64.4	64.5	64.6	64.5	67.8	70.7	71.12
GBP	83.8	82.9	82.6	84.8	85.9	90.5	91.0	92.3	90.84
EUR	72.2	71.1	71.8	76.2	76.2	79.7	79.8	82.6	81.31

Exhibit: Revenue trend

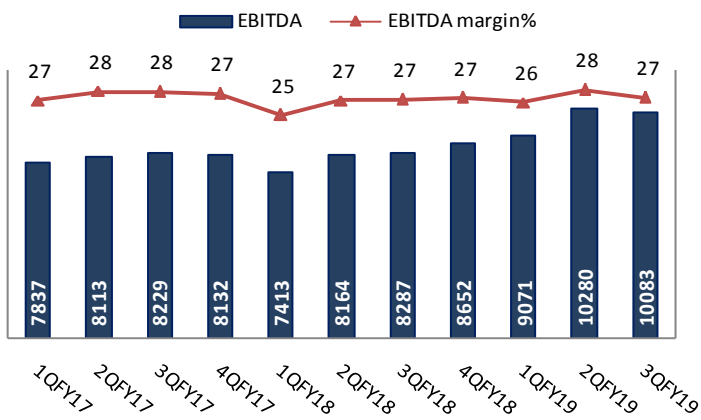
Life Sciences & Healthcare, Energy & Utilities and retail led growth in 3QFY19.

**Exhibit: BFSI and Retail growth**

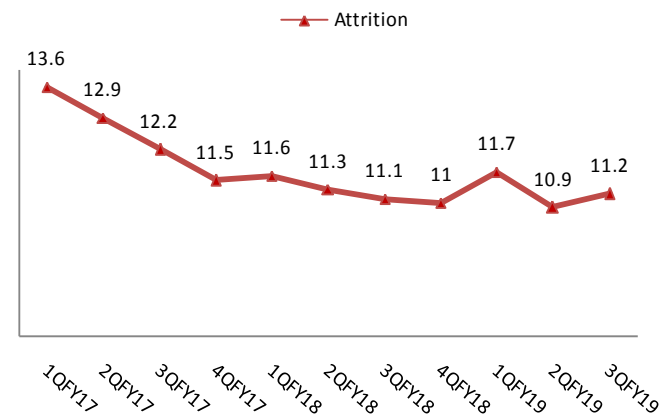
Seasonality in BFSI, retail continued to post steady growth.

**Exhibit: EBITDA and EBITDA margin**

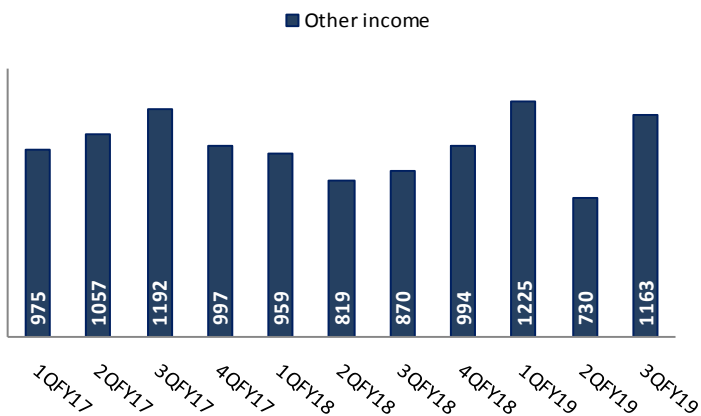
Higher employee cost resulted in miss in margins.

**Exhibit: Attrition Rate**

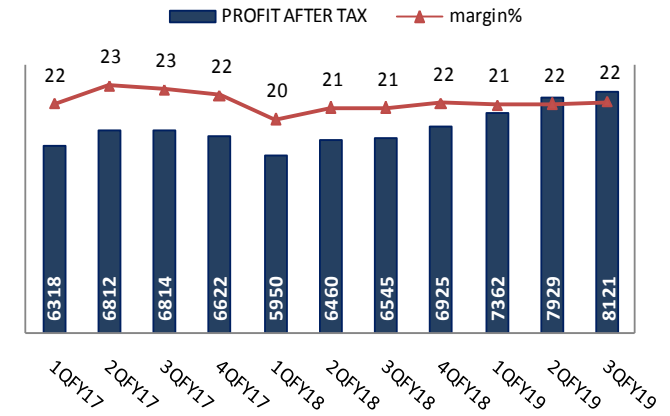
Attrition itched up after being lowest in last quarter.

**Exhibit: Other Income**

Higher than expected growth in 3QFY19.

**Exhibit: PAT and PAT Margin**

Higher Other income (growth of 59% QoQ) supported the PAT growth.



Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	296	196	196	197	197	191	375	375
Reserves	38350	48998.9	50438.9	70875	86017	84937	90479.2	115498
Networth	38645.7	49194.8	50634.8	71072	86214	85128	90854.6	115873
Debt	211	254	300	196	271	235	235	235
Minority interest	695	708	1,128	355	366	402	402	402
Other Non Current Liab	1,031	1,437	1,466	2,017	2,089	2,884	2,884	2,884
Total Capital Employed	40583.2	51594.6	53528.2	73640	88940	88649	94375.6	119394
Net Fixed Assets (incl CWIP)	8141.87	10444	12311.3	11775	11645	11506	12694.4	13973
Non Current Investments	968	2,275	169	343	344	301	301	301
Non Current Assets	11659.2	11520.8	12367.4	13765	10737	13265	13265	13265
Unbilled revenue	3,141	4,006	3,827	3,992	5,351	6,686	6,686	6,686
Inventory	21	15	16	16	21	26	31	35
Debtors	14,096	18,230	20,438	24,073	22,684	24,943	29,783	33,552
Cash & Bank	6,769	14,442	18,556	6,295	3,597	4,883	2,912	13,306
Current investments	929	1,158	1,493	22479	41636	35707	38427	48822
Short-term loans and advances	5,643	4,311	4,146	2,743	2,909	3,205	3,205	3,205
Other Current Assets	799	735	337	3,615	4,328	5,774	6,275	6,666
Current Assets	31398.5	42897.7	48813	63213	80526	81224	87318.9	112271
Creditors	4,270	5,536	8,831	7,541	6,279	5,094	6,082	6,852
Provisions	4,233	6,386	7,655	115	66	240	240	240
Other Current Liabilities	3,082	3,621	3,647	7,800	7,967	12313	12881.3	13323.9
Curr Liabilities	11584.7	15543.2	20132.7	15456	14312	17647	19203.7	20416
Net Current Assets	19813.8	27354.5	28680.3	47757	66214	63577	68115.2	91855
Total Assets	52167.9	67137.8	73660.9	89096	103252	106296	113579	139810

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	62989.5	81809.4	94648.4	108646	117966	123104	146990	165591
Change (%)	29%	30%	16%	15%	9%	4%	19%	10%
	-	-	-	-	-	-	-	-
EBITDA	18,040	25,153	24,482	30,590	32,311	32,516	40,186	44,674
Change (%)	25%	39%	-3%	25%	6%	1%	24%	11%
Margin (%)	29%	31%	26%	28%	27%	26%	27%	27%
Depr & Amor.	1,080	1,349	1,799	1,948	1,987	2,014	2,019	2,026
EBIT	16,960	23,804	22,683	28,642	30,324	30,502	38,167	42,649
Int. & other fin. Cost	48	39	104	20	32	52	186	64
Other Income	1,178	1,637	3,230	3,054	4,221	3,642	4,274	4,769
EBT	18,090	25,402	25,809	31,676	34,513	34,092	42,255	47,353
Exp Item	-	-	(490)	-	-	-	-	-
Tax	4,014	6,070	6,239	7,301	8,156	8,212	10,185	11,365
Minority Int & P/L share of Ass.	(158)	(168)	(208)	83	-	-	-	-
Reported PAT	13,917	19,164	19,852	24,292	26,357	25,880	32,070	35,989
Adjusted PAT	13,917	19,164	19,852	24,292	26,357	25,880	32,070	35,989
Change (%)	34%	38%	4%	22%	9%	-2%	24%	12%
Margin(%)	22%	23%	21%	22%	22%	21%	22%	22%

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
ROE	41%	44%	40%	40%	34%	30%	36%	35%
ROCE	47%	52%	43%	45%	37%	34%	42%	40%
Asset Turnover	9	9	8	9	10	11	12	12
Debtor Days	82	81	79	81	70	74	74	74
BV	98	126	129	180	219	222	242	308
Payable Days	25	25	34	25	19	15	15	15
Earnings Per Share	36	49	51	62	67	68	85	96
P/E	22	22	25	20	18	21	22	20
Price / Book Value	8	8	10	7	6	6	8	6
EV/EBITDA	17	16	20	16	15	17	18	16
EV/Sales	5	5	5	5	4	4	5	4

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	18,090	25,402	26,298	31,676	26,357	25,880	42,255	47,353
Depreciation	(1,767)	(3,451)	747	(4,824)	(631)	(209)	(3,789)	(2,951)
Int Paid (+)	114	(156)	(195)	(168)	7,443	7,005	2,019	2,026
Non Cash Op Exp								
Tax Paid	(4,822)	(7,044)	(7,482)	(7,569)	(7,946)	(7,609)	-10185.2	-11364.8
(inc)/Dec in Working Capital	-	-	-	-	-	-	-	-
CF from Op. Activities	11,615	14,751	19,369	19,115	25,223	25,067	30,299	35,063
(inc)/Dec in FA & CWIP	(3,126)	(2,949)	(2,047)	(1,990)	(1,862)	(3,207)	(3,207)	(3,304)
Free Cashflow	8,489	11,802	17,322	17,125	23,361	21,860	27,092	31,759
(Pur)/Sale of Inv	-	-	-	-	-121423	-97473	-2720	-10395
others	(3,448)	(6,541)	1,248	(3,162)	106681	102221	-	-
CF from Inv. Activities	(6,086)	(9,667)	(1,701)	(5,209)	-16732	2886	-5927.05	-13699.4
inc/(dec) in NW	-	-	-	-	-	-	-	-
inc/(dec) in Debt	82	8	43	(73)	87	(43)	-	-
Int. Paid	(48)	(38)	(105)	(20)	(20)	(40)	-	-
Div Paid (inc tax)	(5,703)	(5,480)	-17020.5	-9479.19	-10947	-10726	-10534	-10970.2
others	(60)	(164)	(86)	(44)	(146)	-	-	-
CF from Fin. Activities	(5,729)	(5,673)	-17167.6	-9616.12	-11026	-10809	-10534	-10970.2
Inc(Dec) in Cash	(200)	(589)	500	4,291	(2,535)	1,068	(1,971)	10,394
Add: Opening Balance	2,042	2,057	1,362	2,001	6,132	3,815	4,883	2,912
Closing Balance	1,841	1,468	1,862	6,292	3,597	4,883	2,912	13,306

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Analyst's ownership of the stocks mentioned in the Report	NIL
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