

Industry **IT**  
 Bloomberg **TCS IN**  
 BSE CODE **532540**

## Cost pressure to dent margins in FY20

RATING	NEUTRAL
CMP	2131
Price Target	2203
Potential Upside	3%
Rating Change	↔
Estimate Change	↓
Target Change	↔

STOCK INFO	
52wk Range H/L	2291/1784
Mkt Capital (Rs Cr)	796,781
Free float (%)	26%
Avg. Vol 1M (,000)	2702
No. of Shares (Cr.)	375
Promoters Pledged (Cr)	16903

### 1QFY20 Result Update

- TCS reported mix set of numbers in its 1QFY20 result. Revenue grew 10.6%YoY in cc terms, missing our estimates while margin remained at 24.2% in line with our estimates of 24.6%.
- Although revenue misses estimates, PAT for the quarter came in at Rs8153 which remained flat due higher other income and lower tax rate.
- Demand environment in 1QFY20 remain healthy and broad based across vertical and geographies .TCS won deal TCV of USD5.7billion in 1QFY20, consecutive 4 quarter TCV above 5 billion.
- Vertical wise, Growth during the quarter was led by Life science and Healthcare which grew 18.1%YoY in cc terms .Most of the other vertical reported industry leading growth rates.BFS I grew 9.2%YoY, retail and CPG grew 7.9%YoY in cc terms .Communication grew 8.4% mainly seeing growth in media space.
- Management sees demand outlook very strong to post double digit growth in medium terms however reserve its commentary still 2QFY20 performance for short terms growth due to continued challenges.

### View and Valuation

TCS started the year with the softer than expected revenue growth of 10.6%YoY in cc terms .Even margin declined 90bps due to wage hike and currency headwind. Despite revenue miss, Pat managed to remain flat due to higher other income.

Going forward, continued increase in digital growth (42.2%YoY) and robust TCV wins(Above 5 billion for last 4 quarters ) gives us revenue visibility of double digit growth In fy20.However challenges persists with continued weakness in BFSI segment ( mainly seeing in capital market and European banks).Even despite strong demand for new digital projects, we expect the growth to slow as the strategic discussion of accelerating headcount and training them will result in delay in project implementation in near term .

On margin front, we expect dent in margin to continue due to higher workforce addition and training cost .Even Company's decision to participate aggressively in demand will result in higher subcontracting in near terms.

Amid the management holding back growth commentary still 2QFY20 due to continue challenges, we largely maintain our Neutral rating on stock with the target price of Rs 2203.

### Key Risks to our rating and target

- Slow down in TCV wins.
- Slower than expected growth in digital and weakness in retail vertical.

### RESEARCH ANALYST

**NIHARIKA OJHA**  
 niharika@narnolia.com  
 +91-22-62701230

KEY FINANCIAL/VALUATIONS	FY17	FY18	FY19	FY20E	FY21E
Net Sales	117966	123104	146463	159046	176454
EBITDA	32311	32516	39506	42839	47587
EBIT	30324	30502	37450	39875	44394
PAT	26357	25880	31562	33621	36982
EPS (Rs)	67	68	84	90	99
EPS growth (%)	9%	1%	24%	7%	10%
ROE (%)	34%	30%	36%	34%	32%
ROCE (%)	37%	34%	41%	39%	37%
BV	219	222	238	282	335
P/B (X)	5.6	6.4	8.4	7.6	6.4
P/E (x)	18.2	21.1	23.8	23.8	21.6

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## In line margin performance

### 1QFY20 Results

FINANCIALS	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales	34,261	36,854	37,338	38,010	38,172	11.4%	0.4%	123104	146463	19.0%
Other Income	1,225	730	1,163	1,193	1,675	37%	40%	3,642	4,311	18.4%
Employee Exp	18,548	19,525	19,994	20,179	20,809	12.2%	3.1%	66,396	78,246	17.8%
Other Expenses	6,642	7,049	7,261	7,757	7,326	10.3%	-5.6%	24,192	26,441	9.3%
EBITDA	9,071	10,280	10,083	10,074	10,037	10.6%	-0.4%	32,516	39,506	21.5%
Deprication	493	507	519	537	817	65.7%	52.1%	2,014	2,056	2.1%
EBIT	8,578	9,773	9,564	9,537	9,220	7.5%	-3.3%	30,502	37,450	22.8%
Interest	17	137	16	28	257	14	8	52	198	280.8%
PBT	9,786	10,366	10,711	10,702	10,638	8.7%	-0.6%	34,092	41,563	21.9%
Tax	2,424	2,437	2,590	2,550	2,485	2.5%	-2.5%	8,212	10,001	21.8%
Exceptional	-	-	-	-	-			-	-	
PAT	7,362	7,929	8,121	8,152	8,153	10.7%	0.0%	25,880	31,562	22.0%

### 1QFY20: Revenue misses estimates

- Revenue growth of 2.3% in cc terms were way below our estimates In USD terms , revenue came in at USD5484 million , a growth of 1.6%QoQ and 8.6%YoY.
- In rupee terms, revenue came in at Rs38172 crore , a muted growth of 0.4%QoQ. The slow sequentially growth was impacted by weakness in retail verticals and slow growth in BFSI segment . Cross-currency headwinds during the quarter stood at 70bps.
- Digital revenue grew 42% YoY CC and now contributes 32.2% of revenues (v/s 31% in 4QFY19).

### slow growth continued in BFSI, Retail saw quarter issue

Verticals ( USD Mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ%	cc YoY %
BFSI		1,571	1,627	1,617	1,668	1,689	1.3%	9.2%
Retail and consumers		778	803	814	815	823	1.0%	7.9%
Comm,Media&technology		359	355	362	367	378	3.1%	8.4%
Manufacturing		515	511	515	518	538	3.7%	5.5%
Life sciences		369	391	399	416	433	4.3%	18.1%
Technology &Services		455	464	457	464	483	4.0%	7.8%
Regional market		1,005	1,064	1,087	1,150	1,141	-0.8%	16.9%

### strong growth continued in Europe

Geography(USD Mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ%	cc YoY %
North America	2,496	2,576	2,707	2,688	2,736	2,775	1%	7.7%
Latin america	99	96	115	105	108	99	-9%	6.4%
UK	756	783	730	814	858	867	1%	16.0%
Continetal Europe	706	707	699	740	761	784	3%	15.0%
India	308	293	329	299	313	329	5%	15.9%
Asia Pacific	482	485	511	494	513	516	1%	9.5%
MEA	124	111	125	110	108	115	7%	6.4%

- Vertical wise ,BFSI growth decelerated to 9.2% YoY CC from 11.6% in the previous quarter, led by pockets of weakness in the BFS segment in Europe. While Life Sciences and Healthcare continue growing strongly (+18.1% YoY CC), growth in Retail decelerated sequentially to 7.9% YoY CC from 9.9% in the previous quarter due to account-specific issues (one-off).

## Deal wins lend visibility for FY20

- The company had strong deal closure during the quarter. The total value of contract signed this quarter was USD5.7 billion as compared to USD4.9 billion in 1QFY19 (consecutive 4 quarter of USD5 billion above TCV wins).
- Out of this total, USD2.8 billion was in North America, BFSI contributed to USD 2 billion and Retail was shed over a billion. So the deal continues to be very healthy and well spread across verticals and geographies.

## Margin came in line with the estimates

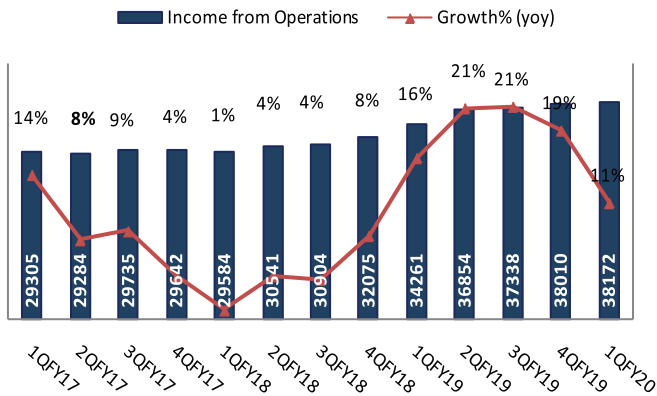
- EBIT margin came at 24.2%, prima-facie driven primarily by increase in subcontractor cost. Sub-con costs were 8.4% of revenues, compared to 8.1% in 4QFY19. Also, this quarter had a wage hike and currency headwind which impacted the margins by 230 bps, however some portion was offset by better operational efficiency.
- Pat for the quarter stood at Rs8132 crore, a flat growth despite revenue miss. The reason was primarily due higher other income which came in Rs1675 vs as compared to Rs1193 last quarter. Even tax rate support the Pat as Tax for quarter stood at 23.4% vs 23.8% last quarter.

## Concall highlights

- **1QFY20 performance:** The company saw Softer than what they expected at the start of the quarter. However Area of strength was similar; as company was expecting growth to be driven by Europe and UK, life science to grow in 1QFY20.
- **Margin performance:** The operational margin stood at 24.2%, a decline of 90 bps primarily led wage revision effective from 1 April and currency headwinds which impact margin by 230 bps however some portion was mitigated by better operational efficiency.
- **Demand for services** continued to be driven through large scale deployment of digital technology which is part of the customers growth and transformation initiatives.
- **Continued growth in digital:** The revenue from digital engagement made up 32.2% in 1QFY20; growing 42.2% YoY. Now digital part of business is at USD 7 billion. The moments is mainly on account of mainstreaming of the digital technologies and central role that they are playing in the customer growth and transformation initiative.
- **Vertical performance:** Growth during the quarter was led by Life science and Healthcare which grew 18.1% YoY in cc terms. Most of the other vertical reported industry leading growth rates. BFSI grew 9.2% YoY, retail and CPG grew 7.9% YoY in cc terms. Communication grew 8.4% mainly seeing growth in media space. The management continue to see some challenges in Capital market in US and European bank in BFSI Segment. Although retail showed softness in 1QFY20 due to quarter issue but management expects to see recovery in 2QFY20.
- **Strong growth seen in Portfolio Product and platform:** Ignio™, company's cognitive automation continues to gain share in the market. Ignio™ on 4th years has doubled its revenue and as well as increased the numbers of customers in 1 Q F Y 2 0 , Ignio™ had 16 new wins, taking the total number of customer to cross 100.
- **Strong uptick in clients bucket:** With deepens clientele focus, the company during the quarter has added 4 more clients in 100+ million dollar band, 3 more clients in 50 million dollar band, 13 clients in 30 million dollar, 29 client in 10 million dollar client and 43 clients in 5 million dollar client.
- **Strategic step to accelerate headcount:** On people front, the company added net addition of 12356, highest addition in last 5 years bring the total headcount to 436641. The company expects to onboard most of the hires by 2QFY20.
- **Attrition inched a bit but still lowest in the industry:** Attrition which is cause of concern for the most of technology, Tcs has managed to remain in lowest band. During the quarter Attrition stood at 11.5% as compared to 11.3%, a marginal rise however not a concern for the company.
- **Outlook for FY20:** The company expects to post double digit growth in FY20 however seeing slight accelerated hiring, the commentary looks more like moderation in outlook for FY20 as compared to accelerated outlook guidance in the beginning of the year. Though company is seeing no new challenges from the last quarter, the company states 2QFY20 to be important quarter to get better clarity on the continued challenges and further comment on company performance for FY20. On subcontracting side, due to company's decision to participate aggressively in demand, the subcontracting is expected to be bit higher.
- **Macro environment:** Demand outlook and overall competitiveness is very strong so the company is confident to post double digit growth in medium terms however reserve its commentary still 2QFY20 performance for short terms growth.

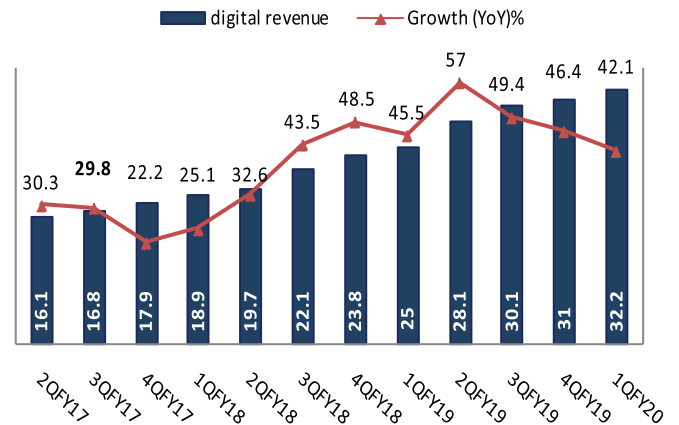
## Exhibit: Revenue trend

Slow start for the year, Manufacturing and Retail dragged the overall revenue growth.



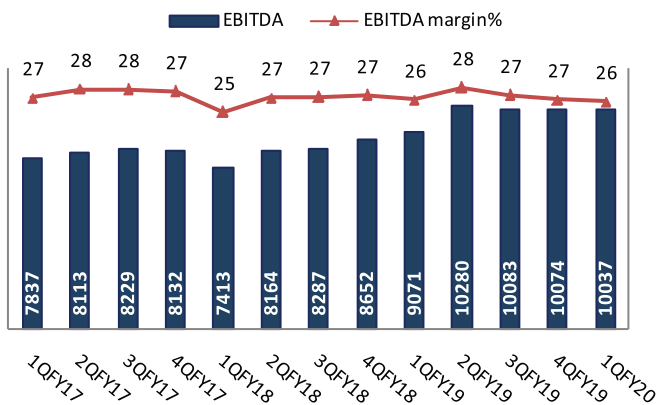
## Exhibit: Digital Revenue

USD 7 billion revenue coming from digital business



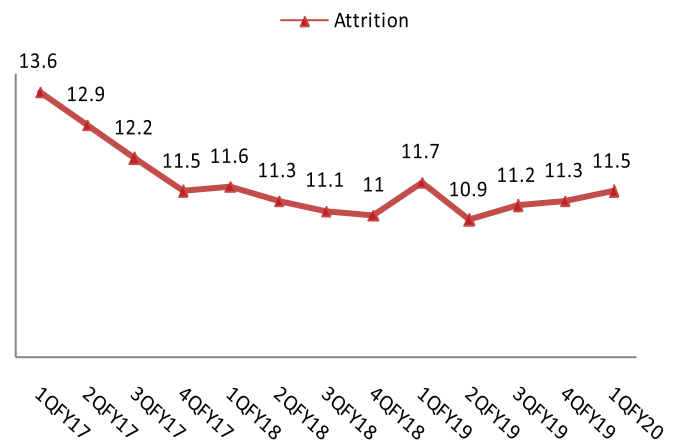
## Exhibit: Margin Trend

Wage hike and currency headwind impacted the margins, management to maintain the margin in FY20.



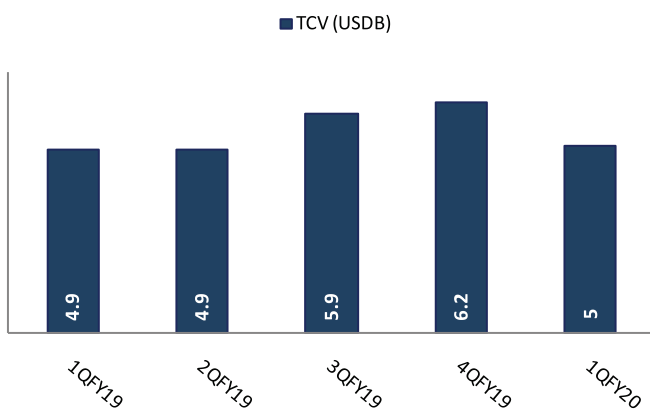
## Exhibit: Attrition

Attrition rate inched up in 1QFY20 but still remained lowest.



## Exhibit: Deal wins

With deal wins backing visibility



## Operational Details

Geography %	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
North America	52.5	51.9	52	50.2	51	51.9	51.2	50.7	50.6
Latin America	2.1	2.2	2.2	2	1.9	2.2	2	2	1.8
UK	13.9	14	14.1	15.2	15.5	14	15.5	15.9	15.8
Continental Europe	12.5	13.4	13.5	14.2	14	13.4	14.1	14.1	14.3
India	7	6.3	6.3	6.2	5.8	6.3	5.7	5.8	6
Asia Pacific	9.5	9.8	9.5	9.7	9.6	9.8	9.4	9.5	9.4
MEA	2.5	2.4	2.4	2.5	2.2	2.4	2.1	2	2.1

Clients Contribution	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
US\$ 1m+ Clients	905	933	941	963	978	989	996	1008	1014
US\$ 5m+ Clients	464	470	485	495	508	513	519	532	551
US\$ 10m+ Clients	322	328	337	350	355	365	370	371	384
US\$ 20m+ Clients	190	196	203	207	206	213	211	215	219
US\$ 50m+ Clients	85	91	94	97	97	98	99	99	100
US\$ 100m+ Clients	36	37	37	38	40	44	45	44	44

IP Revenue (%)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
BFSI					31.1	31.2	30.8	30.9	30.8
Retail & CPG					15.4	15.4	15.5	15.1	15
Communication & Media					7.1	6.8	6.9	6.8	6.9
Manufacturing					10.2	9.8	9.8	9.6	9.8
Life Sciences & Healthcare					7.3	7.5	7.6	7.7	7.9
Technology & Services					9	8.9	8.7	8.6	8.8
Regional Markets & Others					19.9	20.4	20.7	21.3	20.8

Total Employee Base	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Total Employee	385809	389213	390880	394998	400875	411102	417929	424285	436641
Gross Employee	11202	15868	12534						
Net Additions	-1414	3404	1667	4118	5877	10227	6827	6356	12356

Attrition	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
Attrition	11.6	11.3	11.1	11	11.7	10.9	11.2	11.3	11.5

Currency	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20
USD	64.44	64.45	64.56	64.51	67.83	70.67	71.12	70.43	69.6
GBP	82.61	84.83	85.87	90.51	90.95	92.29	90.84	92.37	88.77
EUR	71.78	76.22	76.22	79.74	79.77	82.56	81.31	79.64	78.28

## Financial Details

### Balance Sheet

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	196	196	197	197	191	375	375	375
Reserves	48999	50439	70875	86017	84937	89071	105596	125482
<b>Networth</b>	<b>49195</b>	<b>50635</b>	<b>71072</b>	<b>86214</b>	<b>85128</b>	<b>89446</b>	<b>105971</b>	<b>125857</b>
Debt	254	300	196	271	235	44	44	44
Minority interest	708	1128	355	366	402	453	453	453
Other Non Cur Liab	1437	1466	2017	2089	2884	2916	2916	2916
<b>Total Capital Employed</b>	<b>51595</b>	<b>53528</b>	<b>73640</b>	<b>88940</b>	<b>88649</b>	<b>92860</b>	<b>109384</b>	<b>129270</b>
Net Fixed Assets (incl CWIP)	10444	12311	11775	11645	11506	11553	11003	11344
Non Cur Investments	2275	169	343	344	301	240	240	240
<b>Non Curr Assets</b>	<b>11521</b>	<b>12367</b>	<b>13765</b>	<b>10737</b>	<b>13265</b>	<b>11020</b>	<b>11020</b>	<b>11020</b>
unbilled revenue	4006	3827	3992	5351	6686	5157	5600	6213
Inventory	15	16	16	21	26	10	11	0
Debtors	18230	20438	24073	22684	24943	27346	29695	32946
Cash and bank	14442	18556	6295	3597	4883	7224	11361	19716
Current investment	1158	1493	22479	41636	35707	29091	39537	47290
Short-term loans and advances	4311	4146	2743	2909	3205	8029	8029	8029
Other current asset	735	337	3615	4328	5774	15274	15792	16508
<b>Curr Assets</b>	<b>42898</b>	<b>48813</b>	<b>63213</b>	<b>80526</b>	<b>81224</b>	<b>92131</b>	<b>110025</b>	<b>130702</b>
Trade payables	5536	8831	7541	6279	5094	6292	6833	7580
Provisions	6385.96	7655.16	115	66	240	239	239	239
Other Curr Liab	3621	3647	7800	7967	12313	15553	15831	16215
Curr Liabilities	15543	20133	15456	14312	17647	22084	22902	24035
<b>Net Curr Assets</b>	<b>27354</b>	<b>28680</b>	<b>47757</b>	<b>66214</b>	<b>63577</b>	<b>70047</b>	<b>87122</b>	<b>106667</b>
<b>Total Assets</b>	<b>67138</b>	<b>73661</b>	<b>89096</b>	<b>103252</b>	<b>106296</b>	<b>114944</b>	<b>132287</b>	<b>153305</b>

### Income Statement

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>Revenue from Operation</b>	<b>81809</b>	<b>94648</b>	<b>108646</b>	<b>117966</b>	<b>123104</b>	<b>146463</b>	<b>159045</b>	<b>176453</b>
Change (%)	30%	16%	15%	9%	4%	19%	9%	11%
<b>EBITDA</b>	<b>25,153</b>	<b>24,482</b>	<b>30,590</b>	<b>32,311</b>	<b>32,516</b>	<b>39,506</b>	<b>42,839</b>	<b>47,587</b>
Change (%)	39%	-3%	25%	6%	1%	21%	8%	11%
Margin (%)	31%	26%	28%	27%	26%	27%	27%	27%
Depr & Amor.	1,349	1,799	1,948	1,987	2,014	2,056	2,964	3,193
<b>EBIT</b>	<b>23,804</b>	<b>22,683</b>	<b>28,642</b>	<b>30,324</b>	<b>30,502</b>	<b>37,450</b>	<b>39,875</b>	<b>44,394</b>
Int. & other fin. Cost	39	104	20	32	52	198	1,028	1,028
Other Income	1,637	3,230	3,054	4,221	3,642	4,311	5,301	5,294
<b>EBT</b>	<b>25,402</b>	<b>25,809</b>	<b>31,676</b>	<b>34,513</b>	<b>34,092</b>	<b>41,563</b>	<b>44,148</b>	<b>48,660</b>
Exp Item	-	(490)	-	-	-	-	-	-
Tax	6,070	6,239	7,301	8,156	8,212	10,001	10,527	11,678
Minority Int & P/L share of Ass.	(168)	(208)	83	-	-	-	-	-
<b>Reported PAT</b>	<b>19,164</b>	<b>19,852</b>	<b>24,292</b>	<b>26,357</b>	<b>25,880</b>	<b>31,562</b>	<b>33,621</b>	<b>36,982</b>
<b>Adjusted PAT</b>	<b>19,164</b>	<b>19,852</b>	<b>24,292</b>	<b>26,357</b>	<b>25,880</b>	<b>31,562</b>	<b>33,621</b>	<b>36,982</b>
Change (%)	38%	4%	22%	9%	-2%	22%	7%	10%
Margin(%)	23%	21%	22%	22%	21%	22%	21%	21%

## Financial Details

### Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	43.6%	39.8%	39.9%	33.5%	30.2%	36.2%	34.4%	31.9%
ROCE	51.6%	43.2%	45.0%	37.3%	34.4%	41.3%	39.4%	37.2%
Asset Turnover	9	8	9	10	11	13	14	16
Current Ratio	3	2	4	6	5	4	5	5
Debtor Days	81	79	81	70	74	68	68	68
Book Value Per Share	130	134	180	219	222	238	282	335
Payable Days	25	34	25	19	15	16	16	16
Earnings Per Share	49	51	62	67	68	84	90	99
P/E	22	25	20	18	21	24	24	22
Price / Book Value	8	9	7	6	6	8	8	6
EV/EBITDA	16	20	16	15	17	19	18	16
EV/Sales	5	5	5	4	4	5	5	4
Div Payout%	33%	78%	64%	33%	35%	58%	33%	41%

### Cash Flow Statement

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	25402	26298	31676	26357	25880	31562	44148	48660
(inc)/Dec in Working Capital	-3451	747.22	-4824	-631	-209	-2169	-2493	-3436
Non Cash Op Exp	-156	-195.2	-168	7443	7005	9158	2964.5	3192.7
Int Paid (+)								
Tax Paid	-7044	-7482	-7569	-7946	-7609	-9958	-10527	-11678
others	0	0	0	0	0	0	0	0
<b>CF from Op. Activities</b>	<b>14751</b>	<b>19369</b>	<b>19115</b>	<b>25223</b>	<b>25067</b>	<b>28593</b>	<b>34093</b>	<b>36738</b>
(inc)/Dec in FA & CWIP	-2949	-2047	-1990	-1862	-2053	-2053	-2414	-3534
Free Cashflow	11802	17322	17125	23361	23014	26540	31678	33204
(Pur)/Sale of Inv	0	0	0	-121423	-97473	-96751	-10446	-7753
others	-6541	1247.9	-3162	106681	102221	100351	0	0
<b>CF from Inv. Activities</b>	<b>-9667</b>	<b>-1701</b>	<b>-5209</b>	<b>-16732</b>	<b>2886</b>	<b>1596</b>	<b>-12860</b>	<b>-11287</b>
inc/(dec) in NW	0	0	0	0	0	0	0	0
inc/(dec) in Debt	8.44	43.41	-72.6	87	-43	-181	0	0
Int. Paid	-38.06	-104.98	-20.16	-20	-40	-186	0	0
Div Paid (inc tax)	-5480.07	-17020.46	-9479.19	-10947	-10726	-11424	-17096	-17096
others	-163.55	-85.58	-44.17	-146	0	0	0	0
<b>CF from Fin. Activities</b>	<b>-5673.24</b>	<b>-17167.61</b>	<b>-9616.12</b>	<b>-11026</b>	<b>-10809</b>	<b>-11791</b>	<b>-17096</b>	<b>-17096</b>
<b>Inc(Dec) in Cash</b>	<b>-588.91</b>	<b>499.85</b>	<b>4290.65</b>	<b>-2535</b>	<b>1068</b>	<b>2292</b>	<b>4136.6</b>	<b>8355.4</b>
Add: Opening Balance	2056.77	1362.04	2001.41	6132	3815	4883	7224	11361
<b>Closing Balance</b>	<b>1467.86</b>	<b>1861.89</b>	<b>6292.06</b>	<b>3597</b>	<b>4883</b>	<b>7224</b>	<b>11361</b>	<b>19716</b>

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Correspondence Office Address: Arch Waterfront, 5th Floor, Block GP, Saltlake, Sector 5, Kolkata 700 091; Tel No.: 033-40541700; [www.narnolia.com](http://www.narnolia.com).

Registered Office Address: Marble Arch, Office 201, 2nd Floor, 236B, AJC Bose Road, Kolkata 700 020; Tel No.: 033-4050 1500; [www.narnolia.com](http://www.narnolia.com)

Compliance Officer: Manish Kr Agarwal, Email Id: [mkagarwal@narnolia.com](mailto:mkagarwal@narnolia.com), Contact No.:033-40541700.

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