

Industry	TECHNOLOGY
Bloomberg	TCS IN
BSE CODE	532540

Medium term more reassuring while near term remains challenging

RATING	NEUTRAL
CMP	2004
Price Target	2201
Potential Upside	9.8%

Rating Change	
Estimate Change	
Target Change	

Stock Info

52wk Range H/L	2296/1784
Mkt Capital (Rs Cr)	752128
Free float (%)	26%
Avg. Vol 1M (000)	108
No. of Shares (Crs)	375
Promoters Pledged (Crs)	15956

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2QFY20 Result update

- ❑ TCS reported below expectation performance in 2QFY20 result. Revenue grew 5.8%YoY missing our estimates of 8%YoY While PAT improved by 1.6%YoY to Rs 8058 crore (declining 1.2%QoQ) mainly coming from higher other income .
- ❑ EBIT for the quarter came in at Rs 9361crore , a de growth of 4.2%YoY. The margin declined 20bps to 24% mainly owing to lower revenue growth and continued investment in people addition.
- ❑ Vertical wise, Life Sciences & Healthcare continues to outperform the industry by growing 16%YoY in cc terms. Even Communications & Media grew by double digit (11.8%YoY growth in cc terms). However BFSI and retail continued to see challenges and grew 8%YoY and 4.8%YoY in cc terms.
- ❑ Demand environment in 2QFY20 remain healthy and broad based across vertical and geographies .TCS won deal TCV of USD6.4billion in 2QFY20, highest in the last six quarters.
- ❑ Management sees demand outlook very strong for medium to long term perspective however for near terms , the management sees H2 not relatively very strong.

View and Valuation

TCS posted a disappointing performance in 2QFY20 result .Both Revenue (grew 5.8%YoY) and margin (declined 20bps) missed the estimates despite 2Q being strong quarter. Digital revenue grew 27.9% which is lower than its usual growth of 40% range due to volatile environment. Going ahead , Growth in digital, momentum in deal wins (won USD6.4billion in 2QFY20, highest in the last six quarters) and strong hiring trend gives medium to long term visibility however in near term challenges in BFSI (mainly seeing in capital market and European banks) will continue to drag revenue. Even H2 will continue to remain soft due to furlough .Thus we see TCS unlikely to reach double digit growth in FY20. Even Margin for FY20 will remain lower than last year as structural initiative taken like rationalizing the employee pyramid will take time to play out.

Amid the weak 2Q and near terms challenges we have cut down our revenue and PAT estimates for FY20/21 by 2%/4% and 2.8%/3.5%. Thus we maintain our Neutral stance on the stock with reduced target price from Rs2279 to Rs2201.

Key Risks to our rating and target

- ❑ Slow down in TCV wins
- ❑ Slower than expected growth TCS 80 in digital and weakness in retail vertical.

Fig in Rs cr

KEY FINANCIAL/VALUATIONS	FY17	FY18	FY19	FY20E	FY21E
Net Sales	117966	123104	146463	156761	170655
EBITDA	32311	32516	39506	41683	46336
EBIT	30324	30502	37450	38296	42825
PAT	26357	25880	31562	32776	35919
EPS (Rs)	67	68	84	87	96
EPS growth (%)	9%	1%	24%	4%	10%
ROE (%)	34%	30%	36%	34%	33%
ROCE (%)	37%	34%	41%	39%	38%
BV	219	222	238	269	307
P/B (X)	5.6	6.4	8.4	7.5	6.5
P/E (x)	18.2	21.1	23.8	23.0	20.9

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2QFY20 Results**Weak quarter**

Financials	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	YoY %	QoQ%	FY18	FY19	Fig in Rs cr
										YoY %
Net Sales	36,854	37,338	38,010	38,172	38,977	5.8%	2.1%	123104	146463	19.0%
Other Income	730	1,163	1,193	1,675	1,361	86.4%	-18.7%	3,642	4,311	216.8%
Employee Exp	19,525	19,994	20,179	20,809	21,470	10.0%	3.2%	66,396	78,246	17.8%
Other Expenses	7,049	7,261	7,757	7,326	7,282	3.3%	-0.6%	24,192	26,441	9.3%
EBITDA	10,280	10,083	10,074	10,037	10,225	-0.5%	1.9%	32516	39506	21.5%
Deprication	507	519	537	817	864	70.4%	5.8%	2,014	2,056	2.1%
EBIT	9,773	9,564	9,537	9,220	9,361	-4.2%	1.5%	30,502	37,450	22.8%
Interest	137	16	28	257	193	40.9%	-24.9%	52	198	280.8%
PBT	10,366	10,711	10,702	10,638	10,529	1.6%	-1.0%	34,092	41,563	21.9%
Tax	2,437	2,590	2,550	2,485	2,471	1.4%	-0.6%	8,212	10,001	21.8%
PAT	7,929	8,121	8,152	8,153	8,058	1.6%	-1.2%	25,880	31,562	22.0%

2QFY20 performance: Weak performance

- Revenue grew 8.4% YoY in cc terms which was way below our estimates. In USD terms, revenue came in at USD5517 million, a growth of 0.6%QoQ and 5.8%YoY.
- In rupee terms, revenue came in at Rs38977 crore, a moderate growth of 2.1%QoQ. Sequentially slow growth was mainly attributed by weakness in retail verticals and slow growth in BFSI segment. Cross-currency headwinds during the quarter stood at 260bps.
- Digital revenue grew 27.9% YoY CC and now contributes 33.1% of revenues (v/s 32.2% in 1QFY20).

Slow growth continued in BFSI and retail

Verticals (USD Mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	QoQ%	YoY%
BFSI	1,546	1,571	1,627	1,617	1,668	1,689	1,710	1.2%	5.1%
Retail and consumers	825	778	803	814	815	823	817	-0.8%	1.7%
Comm,Media&technology	353	359	355	362	367	378	386	2.0%	8.9%
Manufacturing	368	515	511	515	518	538	541	0.6%	5.8%
Life sciences	358	369	391	399	416	433	447	3.1%	14.3%
Technology &Services	388	455	464	457	464	483	480	-0.6%	3.4%
Regional market	895	1,005	1,064	1,087	1,150	1,141	1,137	-0.4%	6.8%

- Vertical wise, Life Sciences & Healthcare continues to outperform the industry by growing 16%YoY in cc terms .Even Communications & Media grew double digit (11.8%YoY growth in cc terms).However BFSI and retail continued to see challenges and grew 8%YoY and 4.8%YoY in cc terms.

Barring Europe, all other geographies remained volatile

Geography(USD Mn)	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	QoQ%	YoY%
North America	2,496	2,576	2,707	2,688	2,736	2,775	2,792	1%	3.1%
Latin america	99	96	115	105	108	99	105	6%	-8.6%
UK	756	783	730	814	858	867	861	-1%	17.9%
Continetal Europe	706	707	699	740	761	784	805	3%	15.3%
India	308	293	329	299	313	329	314	-4%	-4.3%
Asia Pacific	482	485	511	494	513	516	519	1%	1.5%
MEA	124	111	125	110	108	115	121	5%	-3.0%

Deal wins remained solid but still not seen in revenues

- The company had strong deal closure during the quarter (highest in last 6 quarter). The total value of contract signed this quarter was USD6.4billion as compared to USD5 billion in 1QFY20 (consecutive 4 quarter of USD5 billion above TCV wins).
- Out of this total, USD3.4 billion was in North America, BFSI contributed to USD 2 billion and Retail was shed over a USD830million .So the deal continues to be very healthy and well spread across verticals and geographies .

Concall Highlights

- **Slow growth in Digital:** Due to volatile situation, the revenue from digital contributed 33.1%, growing 27.9% which is lower than its usual growth of 40% range.
- **Geography wise performance:** UK and Europe continued to outperform by growing 13.3%YoY and 16%YoY in cc terms respectively. North America decelerated further growing 5.8%YoY While Asia pacific grew by 6.5%YoY in cc terms. Emerging market largely under performed with India growing 7.7%YoY, Middle East and Africa growing 7.3%YoY and Latin America growing 7.3%YoY in cc terms.
- **Vertical performance:**
 - **BFSI:** Insurance vertical continued to grow well however there was continued volatility particularly in Europe which was mitigated to some extent by ramping up of new business during the quarter. Overall growth was 8%YoY in BFSI. Going forward, the company states of positive momentum however it is seeing incrementally QoQ variation. It is the trends that are weaker .The management remains uncertain about the large bank in Europe and capital market in US.
 - **Retail:** Soft growth of 4.8%YoY was seen in 2Q.The management was surprise by continued weakness in pockets which brought down the overall growth .The weakness was mainly broad based across markets and the company saw slow down due to decisions making. Going ahead, the management is hopeful to see ramp up deal in 3QFY20 which got delayed in 2QFY20.
- **Demand environment:** Despite negative news flows and industry volatility, the structural aspects of the demand services are well in their place and customer spending has not slowed down .Though there is some amount of caution on economy and geopolitical change by customers, however management states that there transformative initiatives are on track which was reflected in deal closures. The company is also seeing expansion in deal sizes and deal tenure.
- **Solid order Book:** Despite challenges, the company signed TCV of USD 6.54Bbillion which is highest in last 6 quarters. Out of total TCV, North America accounted for USD 3.4billion of that. BFSI order book was also very strong USD2.2billion higher than last quarter. Retail TCV was USD830million.The Company has remained 1 to 1.2times of book to bill .
- **Higher addition:** For gearing up for growth, the net addition during the quarter was 14097 employees which is highest ever employees on boarded in a quarter. The total headcount now stands at 4, 50,738 employees.
- **Capital allocation:** The Company continued to return most of its free cash flow to shareholders. The board has recommended and interim dividend of Rs 5per share and a special dividend of Rs 40 per share which amounts to Rs 22000 crore returning to the shareholder as so far.
- **Margin performance:** The Company reported 24% EBIT margin during the quarter. The margin declined 20bps mainly attributed by lower revenue growth and continued investment in people addition. The volatility that is been YoY is also coming from currency market .Going forward , rationalizing the employee pyramid will be levers for medium to long term which is steadily progressing .Also the company is working on external consultant cost under control that will also improve steadily .
- **Outlook for FY20:** The company is participating well in the demand .Order book and deal pipeline is well distributed among geographies and verticals which gives TCS a confidence of growth for medium to long term perspective .However for H2FY20,right now the management sees H2 not very relatively strong.

Exhibit: Revenue trend

Continued challenges in BFS and Retail dragged the overall revenue.

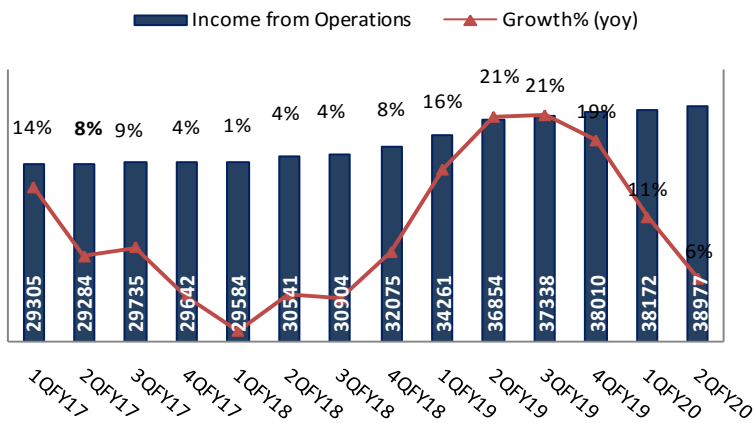


Exhibit: Digital Revenue

Digital revenue below its 40% YoY growth.

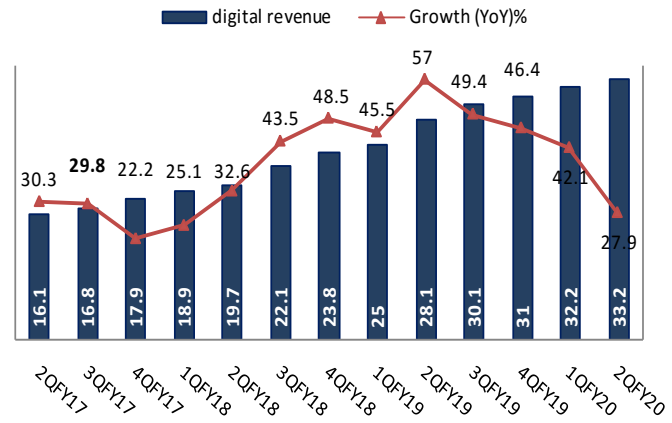


Exhibit: Margin Trend

Margins declined due to continued investment, FY20 Margins to be below aspirational range of 26% to 28%.

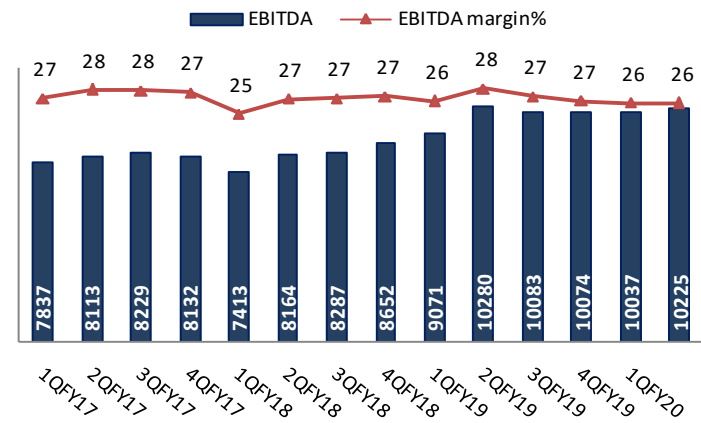


Exhibit: Attrition Trend

Attrition still remain under control.

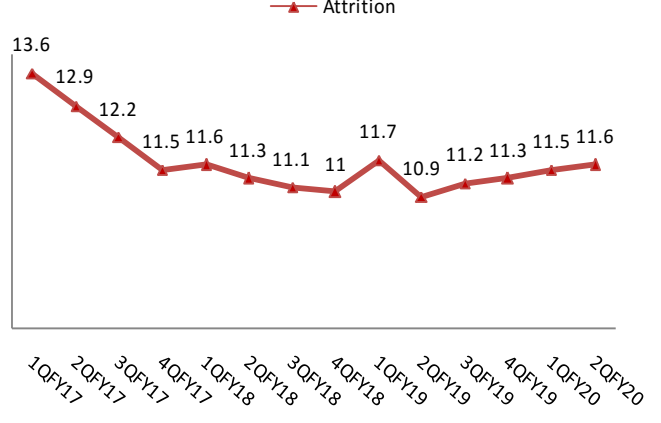
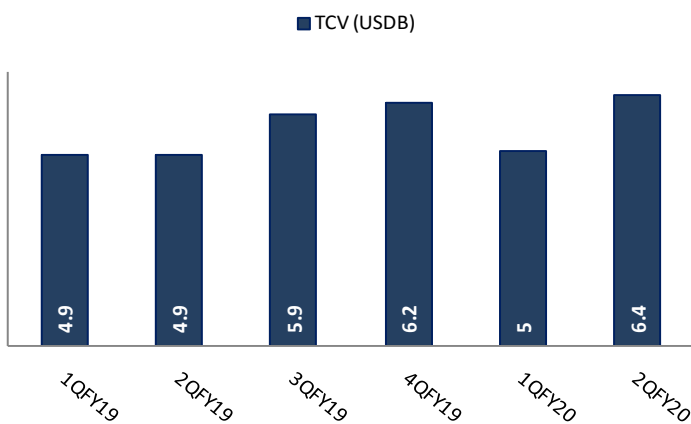


Exhibit: Deal wins

Highest ever deal TCV.



Operational Details

Geography %	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
North America	52	50.2	51	51.9	51.2	50.7	50.6	50.6
Latin America	2.2	2	1.9	2.2	2	2	1.8	1.9
UK	14.1	15.2	15.5	14	15.5	15.9	15.8	15.6
Continental Europe	13.5	14.2	14	13.4	14.1	14.1	14.3	14.6
India	6.3	6.2	5.8	6.3	5.7	5.8	6	5.7
Asia Pacific	9.5	9.7	9.6	9.8	9.4	9.5	9.4	9.4
MEA	2.4	2.5	2.2	2.4	2.1	2	2.1	2.2

Clients Contribution	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
US\$ 1m+ Clients	941	963	978	989	996	1008	1014	1032
US\$ 5m+ Clients	485	495	508	513	519	532	551	554
US\$ 10m+ Clients	337	350	355	365	370	371	384	398
US\$ 20m+ Clients	203	207	206	213	211	215	219	225
US\$ 50m+ Clients	94	97	97	98	99	99	100	101
US\$ 100m+ Clients	37	38	40	44	45	44	44	47

IP Revenue (%)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
BFSI	31.6	31.1	31.1	31.2	30.8	30.9	30.8	31
Retail & CPG	16.7	16.6	15.4	15.4	15.5	15.1	15	14.8
Communication & Media	7.1	7.1	7.1	6.8	6.9	6.8	6.9	7
Manufacturing	7.5	7.4	10.2	9.8	9.8	9.6	9.8	9.8
Life Sciences & Healthcare	7.3	7.2	7.3	7.5	7.6	7.7	7.9	8.1
Technology & Services	7.9	7.8	9	8.9	8.7	8.6	8.8	8.7
Regional Markets & Others	17.4	18	19.9	20.4	20.7	21.3	20.8	20.6

Total Employee Base	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Total Employee	390880	394998	400875	411102	417929	424285	436641	450738
Gross Employee	12534							
Net Additions	1667	4118	5877	10227	6827	6356	12356	14097

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

Currency	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
USD	64.56	64.51	67.83	70.67	71.12	70.43	69.6	70.65
GBP	85.87	90.51	90.95	92.29	90.84	92.37	88.77	86.3
GBP	76.22	79.74	79.77	82.56	81.31	79.64	78.28	78.07

Financial Details

Balance Sheet

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	195.87	195.87	197	197	191	375.2856	375.2856	375.2856
Reserves	48998.89	50438.89	70875	86017	84937	89071	100477.3	115026.3
Networth	49194.76	50634.76	71072	86214	85128	89446.29	100852.6	115401.6
Debt	254.35	299.83	196	271	235	44	44	44
Minority interest	707.99	1127.76	355	366	402	453	453	453
Other Non Current Liab	1437	1466	2017	2089	2884	2916	2916	2916
Total Capital Employed	51594.56	53528.2	73640	88940	88649	92859.58	104265.9	118814.8
Net Fixed Assets (incl CWIP)	10444.03	12311.32	11775	11645	11506	11553	10545.78	10480.81
Non Current Investments	2275.27	169.18	343	344	301	239.58	239.58	239.58
Non Current Assets	11520.79	12367.38	13765	10737	13265	11020	11020	11020
unbilled revenue	4005.61	3827.08	3992	5351	6686	5157	5519.605	6008.81
Inventory	15.21	16.07	16	21	26	10	10.70313	0
Debtors	18230.4	20437.94	24073	22684	24943	27346	29268.78	31862.89
Cash & Bank	14441.84	18556.04	6295	3597	4883	7224	7151.455	11271.71
Current investments	1158.47	1492.6	22479	41636	35707	29091	39537	47290
Short-term loans and advances	4310.8	4146.45	2743	2909	3205	8029	8029	8029
Other Curr Assets	735.36	336.82	3615	4328	5774	15274	15697.85	16269.68
Current Assets	42897.69	48813	63213	80526	81224	92131	105214.4	120732.1
Creditors	5536.02	8830.93	7541	6279	5094	6292	6734.411	7331.284
Provisions	6385.96	7655.16	115	66	240	239	239	239
Other Curr Liab	3621.24	3646.59	7800	7967	12313	15553	15780.46	16087.34
Curr Liabilities	15543.22	20132.68	15456	14312	17647	22084	22753.87	23657.63
Net Current Assets	27354.47	28680.32	47757	66214	63577	70047	82460.52	97074.46
Total Assets	67137.78	73660.88	89096	103252	106296	114943.6	127019.8	142472.5

Income Statement

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	81809.36	94648.41	108646.2	117966	123104	146463	156761.3	170655.1
Change (%)	30%	16%	15%	9%	4%	19%	7%	9%
EBITDA	25,153	24,482	30,590	32,311	32,516	39,506	41,683	46,336
Change (%)	39%	-3%	25%	6%	1%	21%	6%	11%
Margin (%)	31%	26%	28%	27%	26%	27%	27%	27%
Depr & Amor.	1,349	1,799	1,948	1,987	2,014	2,056	3,387	3,511
EBIT	23,804	22,683	28,642	30,324	30,502	37,450	38,296	42,825
Int. & other fin. Cost	39	104	20	32	52	198	836	772
Other Income	1,637	3,230	3,054	4,221	3,642	4,311	5,503	5,208
EBT	25,402	25,809	31,676	34,513	34,092	41,563	42,963	47,262
Exp Item	-	(490)	-	-	-	-	-	-
Tax	6,070	6,239	7,301	8,156	8,212	10,001	10,187	11,343
Minority Int & P/L share of Ass.	(168)	(208)	83	-	-	-	-	-
Reported PAT	19,164	19,852	24,292	26,357	25,880	31,562	32,776	35,919
Adjusted PAT	19,164	19,852	24,292	26,357	25,880	31,562	32,776	35,919
Change (%)	0	0	0	0	(0)	0	0	0
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	44%	40%	40%	34%	30%	36%	34%	33%
ROCE	52%	43%	45%	37%	34%	41%	39%	38%
Asset Turnover	9	8	9	10	11	13	14	16
Current Ratio	3	2	4.1	5.6	4.6	4.2	4.6	5.1
Debtor Days	81	79	81	70	74	68	68	68
Book Value Per Share	130	134	180	219	222	238	269	307
Payable Days	25	34	25	19	15	16	16	16
Earnings Per Share	49	51	62	67	68	84	87	96
P/E	22	25	20	18	21	24	23	21
Price / Book Value	8	9	7	6	6	8	7	7
EV/EBITDA	16	20	16	15	17	19	18	16
EV/Sales	5	5	5	4	4	5	5	4

Cash Flow Statement

Fig in Rs cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	25401.9	26298.5	31675.9	26357	25880	31562	42963.2	47261.6
(inc)/Dec in Working Capital	-3450.79	747.22	-4823.58	-631	-209	-2169	-2040.07	-2740.68
Non Cash Op Exp	-156.03	-195.17	-167.97	7443	7005	9158	3386.79	3511.12
Int Paid (+)								
Tax Paid	-7043.63	-7481.76	-7568.88	-7946	-7609	-9958	-10187.1	-11342.8
others	0	0	0	0	0	0	0	0
CF from Op. Activities	14751.4	19368.8	19115.4	25223	25067	28593	34122.9	36689.2
(inc)/Dec in FA & CWIP	-2949.2	-2046.52	-1990	-1862	-2053	-2053	-2379.57	-3446.14
Free Cashflow	11802.2	17322.3	17125.4	23361	23014	26540	31743.3	33243.1
(Pur)/Sale of Inv	0	0	0	-121423	-97473	-96751	-10446	-7753
others	-6540.93	1247.88	-3162.15	106681	102221	100351	0	0
CF from Inv. Activities	-9667.08	-1701.32	-5208.67	-16732	2886	1596	-12825.6	-11199.1
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	-17020.5	-9479.19	-10947	-10726	-11424	-21369.8	-21369.8
others	-163.55	-85.58	-44.17	-146	0	0	0	0
CF from Fin. Activities	-5673.24	-17167.6	-9616.12	-11026	-10809	-11791	-21369.8	-21369.8
Inc(Dec) in Cash	-588.91	499.85	4290.65	-2535	1068	2292	-72.5407	4120.26
Add: Opening Balance	2056.77	1362.04	2001.41	6132	3815	4883	7224	7151.45
Closing Balance	1467.86	1861.89	6292.06	3597	4883	7224	7151.46	11271.7

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