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FIRST LIGHT

17 April 2020

RESEARCH

Tata Consultancy Services | Target: Rs 1,860 | +8% | ADD

Prelude to darker Q1FY21

Oil & Gas | Q4FY20 Preview

Pressure on cyclical earnings

SUMMARY

Tata Consultancy Services

Despite only a partial impact in the last two weeks of March, Covid-19 fuelled 1.2% QoQ CC revenue contraction at TCS in Q4FY20, missing consensus estimates. Resilient margins and record deal wins were the silver lining. Management expects a deeper hit in H1FY21, similar to that during the GFC, and recovery in H2FY21. We cut FY21/FY22 EPS by 14%/13% and pare our target P/E to 20x (vs. 22.5x) on Covid challenges. Retain ADD with a new Mar'21 TP of Rs 1,860 (vs. Rs 2,390). TCS remains our preferred tier-I pick for its resilience in the current climate.

Click here for the full report.

Oil & Gas: Q4FY20 Preview

The oil price crash has been a main feature of Q4FY20 – Brent has plunged 20% QoQ on average, exiting the quarter at <US$ 30/bbl – a stunning 65% below Jan'20 levels. The situation has been exacerbated by demand destruction of ~25mbpd in April due to Covid-19. Fundamentals for cyclicals were mixed in Q4 – Singapore GRMs dropped to US$ 1.2/bbl (–24% QoQ), while petchem cracks have risen by an estimated ~10%. Gas utilities could benefit the most from low LNG prices and the 22% fall in domestic gas price from Apr'20.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	570
Eicher Motors	Buy	25,000
Petronet LNG	Buy	330
Reliance Industries	Buy	1,500

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,870
Greenply Industries	Buy	145
Laurus Labs	Buy	510
Transport Corp	Buy	255
Ashok Leyland	Sell	64

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.63	(12bps)	(21bps)	(184bps)
India 10Y yield (%)	6.43	(7bps)	17bps	(90bps)
USD/INR	76.66	(0.5)	(3.2)	(9.6)
Brent Crude (US$/bbl)	28.50	(3.7)	(12.6)	(58.7)
Dow	23,504	(1.9)	3.3	(9.5)
Shanghai	2,811	(0.6)	(2.1)	(13.1)
Sensex	30,379	(1)	(10.0)	(21.9)
India FII (US$ mn)	**13 Apr**	**MTD**	**CYTD**	**FYTD**
FII-D	(62.7)	(814.5)	(10,574.0)	(814.5)
FII-E	(139.7)	218.3	(6,384.7)	218.3

Source: Bank of Baroda Economics Research

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ADD
TP: Rs 1,860 | ⮝ 8%

TATA CONSULTANCY SERVICES | IT Services | 17 April 2020

Prelude to darker Q1FY21

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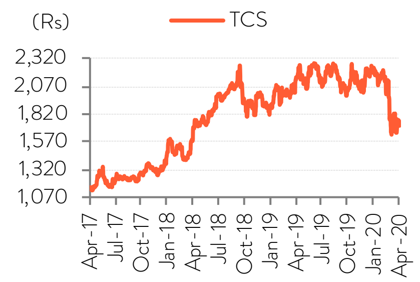
Ticker/Price	TCS IN/Rs 1,716
Market cap	US$ 83.8bn
Shares o/s	3,753mn
3M ADV	US$ 97.5mn
52wk high/low	Rs 2,296/Rs 1,506
Promoter/FPI/DII	72%/17%/11%

Source: NSE

STOCK PERFORMANCE



Source: NSE

Margins resilient but revenues miss the mark: TCS reported a 1.2% QoQ CC revenue decline vs. consensus estimates of 0.3% growth. However, EBIT margins at 25.1% (+10bps QoQ) were resilient despite the weak revenues. Rupee depreciation against the US dollar helped alleviate the negative impact of decreased utilisation. While TCS was able to successfully transition to a borderless workspace model in Q4, its BFSI vertical saw the highest supply hit as regulatory compliance constrained delivery of services from locations outside of designated delivery centres.

Record deal wins: TCS clocked deal TCV worth US$ 8.9bn in Q4, the highest since it started making this disclosure. Contract wins were buoyed by a ~US$ 2bn Phoenix Group deal and a US$ 1.5bn Walgreens Boots Alliance engagement.

Covid-19 guided to hit hardest in Q1FY21: Management expects the peak impact of the pandemic in Q1FY21, likening it to that of the GFC – TCS's revenue had contracted at a 4.6% CQGR in the two quarters following the 2008 financial crisis. Management anticipates recovery in H2FY21 and is hopeful of retracing to Q3FY20 revenue growth levels in Q3-Q4 of FY21 – a tall order in our view. We factor in modest recovery in H2, at a 1.5% CQGR for the last two quarters of FY21.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20A	FY21E	FY22E
Total revenue (Rs mn)	1,231,040	1,464,630	1,569,490	1,555,340	1,688,516
EBITDA (Rs mn)	325,160	395,050	421,100	412,262	465,866
Adj. net profit (Rs mn)	258,260	315,240	323,400	303,607	349,071
Adj. EPS (Rs)	67.1	84.0	86.2	80.9	93.0
Adj. EPS growth (%)	0.6	25.3	2.6	(6.1)	15.0
Adj. ROAE (%)	29.3	35.5	37.0	32.8	31.8
Adj. P/E (x)	25.6	20.4	19.9	21.2	18.5
EV/EBITDA (x)	19.7	16.2	15.2	15.5	13.7

Source: Company, BOBCAPS Research

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OIL & GAS | Q4FY20 Preview | 16 April 2020

Pressure on cyclical earnings

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The oil price crash has been a main feature of Q4FY20 – Brent has plunged 20% QoQ on average, exiting the quarter at <US$ 30/bbl – a stunning 65% below Jan'20 levels. The situation has been exacerbated by demand destruction of ~25mbpd in April due to Covid-19. Fundamentals for cyclicals were mixed in Q4 – Singapore GRMs dropped to US$ 1.2/bbl (–24% QoQ), while petchem cracks have risen by an estimated ~10%. Gas utilities could benefit the most from low LNG prices and the 22% fall in domestic gas price from Apr'20.

Cyclicals to suffer from demand destruction: Oil demand destruction during the pandemic is clearly visible from refining margins – Singapore GRMs continue to decline, averaging at US$ 1.2/bbl for Q4FY20, as spreads for key fuels that serve as a harbinger of economic growth have crashed, viz. diesel (–22.5% QoQ), ATF (–38%) and petrol (–39%). Trends in Q1FY21 may worsen as a further spread of the coronavirus deepens economic disruptions in Europe and the US. While the Chinese economy seems to be limping back towards normalcy, other key oil demand centres in Asia (such as India) are yet to see a resumption in activity.

Expect V-shaped demand recovery in H2FY21: We expect oil consumption to exhibit a V-shaped recovery in Asia by H2FY21, implying GRMs have likely bottomed out (refining margins are not necessarily linked to oil prices given OPEC+ supply disruptions). A similar trend is expected for integrated petrochemicals chain cracks.

LNG prices to align: Spot LNG prices have been muted at <US$ 5/mmbtu in Q4FY20, moving closer to the long-term LNG average of ~US$ 6/mmbtu as falling oil prices have narrowed the gap between the two. We expect both prices to align to ~US$ 3/mmbtu levels by May'20, which could augur well for gas consumption in India from Q2FY21, if economic activity resumes.

Gas utilities to gain; RIL's diversification advantage to pay off: We expect gas utilities to report robust earnings in Q4 led by sequential margin expansion. OMCs' GRMs could be drained by massive inventory losses, albeit somewhat neutralised by a surge in marketing margins QoQ. While RIL's cyclical business earnings could post a steep decline in Q4, earnings expansion in the telecom (RJio) and retail businesses could save the day. RJio earnings could improve further in Q1FY21 as data usage surges post the enforced economic lockdown. Earnings of upstream PSUs are expected to crash given low oil prices.

KEY RECOMMENDATIONS

Ticker	Rating
RIL IN	BUY
IOCL IN	BUY
ONGC IN	BUY
GAIL IN	BUY
PLNG IN	BUY
IGL IN	BUY

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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