

ADD

TP: Rs 2,320 | ▲ 5%

**TATA CONSULTANCY
SERVICES**

| IT Services

| 10 July 2020

Dull quarter with few bright spots

TCS's Q1FY21 performance was a mixed bag with a miss on operating performance but healthy deal wins. QoQ Growth (-7.1%, USD) was dragged down by drop in the retail, manufacturing and telecom/media businesses while BFSI was relatively resilient. Management believes that the worst is over and expects operational recovery from Q2. We trim FY21 EPS by 3% but keep FY22 earnings largely unchanged. Reiterate ADD with revised TP of Rs 2,320 (Rs 2,160 earlier) as we roll forward to Jun'22 valuations.

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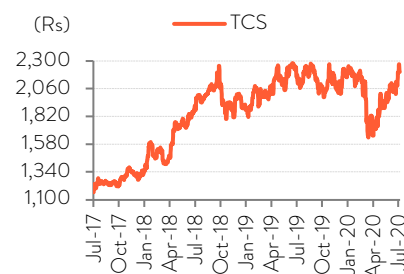
Operating performance below estimates: TCS's Q1FY21 operating performance missed estimates with a 6.9% QoQ CC revenue decline (-5% est.) and 150bps EBIT margin contraction (-90bps est.). The sharp revenue decrease overshadowed operating margin tailwinds from currency movements and non-employee cost rationalisation. Employee expense at Rs 2.5bn was flat (-0.4% QoQ) while non-employee expense at Rs 31.4bn declined 16% QoQ.

Deal wins healthy: Q1 TCV stood at a strong US\$ 6.9bn, increasing 21% YoY despite the downturn and holding above the last four-quarter average of US\$ 6.75bn. QoQ, TCV was down 22.5% from the highest ever US\$ 8.9bn recorded in Q4FY20. New contracts in BFSI and retail totaled US\$ 2.1bn and US\$ 0.9bn respectively. North America deal wins held steady at US\$ 3.3bn. The pipeline was balanced with a few big-ticket engagements and a large number of smaller wins.

Operational recovery in sight: Management believes the Q1 operating performance represents the trough in the current pandemic and expects revenue recovery from Q2FY21. Revenue growth will support operating margin revival as well.

Ticker/Price	TCS IN/Rs 2,204
Market cap	US\$ 110.3bn
Shares o/s	3,753mn
3M ADV	US\$ 98.9mn
52wk high/low	Rs 2,303/Rs 1,506
Promoter/FPI/DII	72%/17%/11%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	14,64,630	15,69,490	15,91,402	18,17,106	20,32,632
EBITDA (Rs mn)	3,95,050	4,21,100	4,24,612	5,11,077	5,71,048
Adj. net profit (Rs mn)	3,15,240	3,23,400	3,04,048	3,83,401	4,27,497
Adj. EPS (Rs)	84.0	86.2	81.0	102.2	113.9
Adj. EPS growth (%)	25.3	2.6	(6.0)	26.1	11.5
Adj. ROAE (%)	35.5	37.0	32.8	34.7	32.5
Adj. P/E (x)	26.2	25.6	27.2	21.6	19.4
EV/EBITDA (x)	20.8	19.5	19.4	16.1	14.1

Source: Company, BOBCAPS Research

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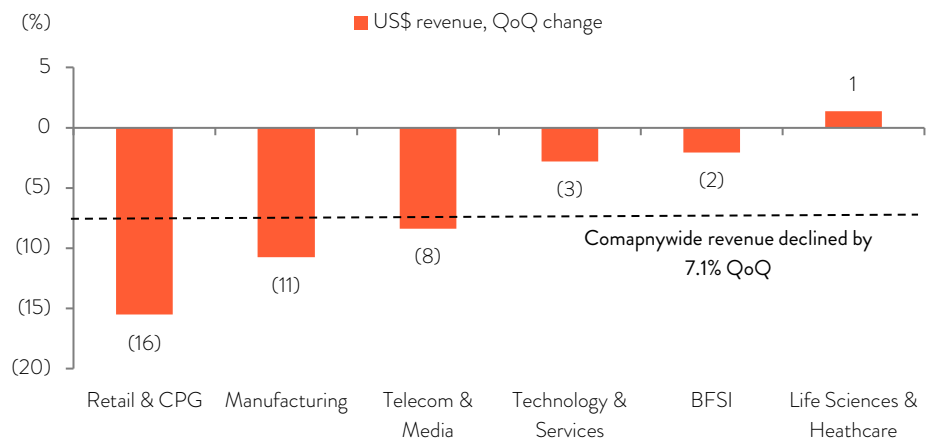


Other highlights

- **BFSI relatively resilient; retail hit hardest:** Revenues declined sequentially across verticals due to widespread financial distress. As expected, retail slumped 15.5% QoQ owing to the shutdown of brick-and-mortar shops amid the pandemic. Communication and media declined 8.4% due to the halting of outdoor and sporting events. Manufacturing fell 10.8%.

Despite management's concerns regarding BFSI, the vertical showed resilience with a decline of just 2.1% QoQ, USD due to pandemic-related issues in the UK and Canada. Other geographies performed better. Life sciences and healthcare was the only vertical to show QoQ growth (1.4%) although some subsegments such as medical devices saw weakness.

- **India- the worst performing market:** India performed the worst among geographies, declining 27% YoY (USD terms). LATAM declined 17% followed by the UK at 11%.
- **Clients reprioritise spending:** Three broad spending themes emerged amid the pandemic: (1) creating smart and secure workspace solutions – rising demand for new solutions to enable employee safety at workspaces, (2) enhancing customer experience – as more enterprises move to online-only mode, especially in BFSI and retail, and (3) core transformation – need to rejig and digitise core processes across enterprises. Hybrid cloud revenues will be a key growth driver going forward. Also, market size for large players will increase due to vendor consolidation.
- **Transition to borderless workspaces:** The SBWS (secure borderless workspaces) model adopted in the wake of Covid is now a significant part of TCS's go-to-market strategy. A total of 32 deal transitions were carried out in Q1. Employees will be returning to office in a staggered manner.
- **Attrition down:** Attrition declined by 100bps QoQ to stand at 11.1%. Employee headcount shrank by 4,788 QoQ. Learning activity increased sharply in Q1 as 353k employees were trained in multiple new technologies.
- **Healthy client adds:** Four clients were added in the US\$ 100mn+ bracket, 11 in the US\$ 20mn+ bracket and 13 in the US\$ 5mn+ band.
- The IGNIO studio was launched in Q1FY21. It is gaining momentum with the number of certified employees doubling this quarter.
- DSO stood at 68 days.

FIG 1 – RETAIL VERTICAL HARDEST HIT

Source: Company, BOBCAPS Research.

FIG 2 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenues (US\$ mn)	5,059	5,485	(7.8)	5,444	(7.1)
Revenue (Rs mn)	3,83,220	3,81,720	0.4	3,99,460	(4.1)
Operating Expenditure	2,82,970	2,81,350	0.6	2,89,700	(2.3)
Cost of revenues	2,24,860	2,21,020	1.7	2,24,410	0.2
as % of sales	58.7	57.9	-	56.2	-
SG&A expenses	58,110	60,330	(3.7)	65,290	(11.0)
as % of sales	15.2	15.8	-	16.3	-
EBITDA	1,00,250	1,00,370	(0.1)	1,09,760	(8.7)
Depreciation	9,770	8,170	19.6	9,510	2.7
EBIT	90,480	92,200	(1.9)	1,00,250	(9.7)
Other Income	4,560	14,180	(67.8)	4,870	(6.4)
PBT	95,040	1,06,380	(10.7)	1,05,120	(9.6)
Total Tax	24,550	24,850	(1.2)	24,190	1.5
Adjusted PAT	70,490	81,530	(13.5)	80,930	(12.9)
(Profit)/loss from JV's/Ass/MI	(410)	(220)	-	(440)	-
APAT after MI	70,080	81,310	(13.8)	80,490	(12.9)
Reported PAT	70,080	81,310	(13.8)	80,490	(12.9)
Reported EPS	18.7	21.7	(13.8)	21.4	(12.9)
Margins (%)			(bps)		(bps)
EBITDA	26.2	26.5	(30)	27.5	(130)
EBIT	23.6	25.1	(150)	25.1	(150)
EBT	24.8	28.2	(340)	26.3	(150)
PAT	18.3	21.4	(310)	20.1	(190)
Effective Tax rate	25.8	23.8	200	23.0	280

Source: Company, BOBCAPS Research

FIG 3 – OPERATING METRICS

(In US\$ terms)	Q1FY21 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Deal win TCV (US\$ mn)	6,900	(22.5)	21.1
Digital revenues	na	na	na
Revenues by Geography			
Americas	51.4	(5.0)	(6.3)
UK	15.3	(11.1)	(10.7)
Europe	15.6	(4.6)	0.6
India	4.3	(27.3)	(33.9)
Asia Pac	9.8	(2.1)	(3.8)
Ibero America	1.7	(16.9)	1.9
MEA	1.9	(7.1)	(2.6)
Revenue by Domain			
BFSI	31.3	(2.1)	(6.3)
Manufacturing	9.7	(10.8)	(8.7)
Telecom & Media	7.1	(8.4)	(3.7)
Life Sciences & Healthcare	9.6	1.4	12.1
Retail & CPG	14.0	(15.5)	(13.9)
Technology & Services	9.1	(2.8)	(4.6)
Regional Markets & Others	19.2	(11.2)	(14.9)
	Q1FY21	Q4FY20	Q1FY20
Attrition (LTM) (%)	11.1	12.1	11.5

Source: Company, BOBCAPS Research

Valuation methodology

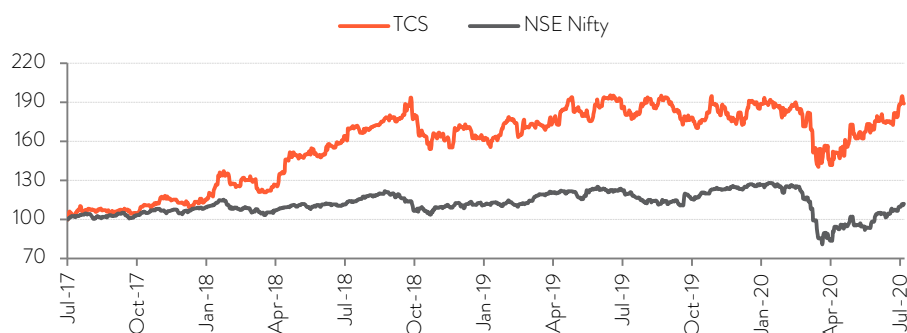
We cut our FY21 EPS estimate by 3% following the Jun'20 quarter performance but keep FY22 earnings largely unchanged. We introduce FY23 EPS at Rs 113.9/sh and forecast 11.9% US dollar revenue growth with 25.9% EBIT margins. Retain ADD as we believe that TCS's strong structural backbone will lend it resilience over peers to weather the current crisis. We roll over to a new Jun'21 target price of Rs 2,320 (vs. Rs 2,160 earlier) based on an unchanged one-year forward P/E multiple of 22x.

FIG 4 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	20,946	20,852	(0.4)	23,229	23,296	0.3	26,059
YoY growth (%)	(4.9)	(5.4)	-	10.9	11.7	-	11.9
Revenues	1,602,350	1,591,402	(0.7)	1,811,871	1,817,106	0.3	2,032,632
EBITDA	424,861	424,612	(0.1)	511,954	511,077	(0.2)	571,048
EBITDA margins (%)	26.5	26.7	-	28.3	28.1	-	28.1
Net profits	313,148	304,048	(2.9)	385,269	383,401	(0.5)	427,497
EPS (Rs)	83.4	81.0	(2.9)	102.7	102.2	(0.5)	113.9

Source: BOBCAPS Research

FIG 5 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates are:

- another wave of Covid-19,
- non-conversion of TCV,
- a sharp decline in IT spending, and
- inability to refresh service offerings amid rapidly changing technologies.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	14,64,630	15,69,490	15,91,402	18,17,106	20,32,632
EBITDA	3,95,050	4,21,100	4,24,612	5,11,077	5,71,048
Depreciation	20,550	35,300	38,377	40,473	43,922
EBIT	3,74,500	3,85,800	3,86,236	4,70,605	5,27,126
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	41,130	36,680	17,446	34,660	36,160
Exceptional items	0	0	0	0	0
EBT	4,15,630	4,22,480	4,03,682	5,05,264	5,63,285
Income taxes	1,00,010	98,010	98,624	1,21,263	1,35,188
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(380)	(1,070)	(1,010)	(600)	(600)
Reported net profit	3,15,240	3,23,400	3,04,048	3,83,401	4,27,497
Adjustments	0	0	0	0	0
Adjusted net profit	3,15,240	3,23,400	3,04,048	3,83,401	4,27,497

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	2,50,000	2,92,440	2,74,680	3,13,638	3,50,838
Provisions	0	0	0	0	0
Debt funds	440	69,060	69,060	69,060	69,060
Other liabilities	0	0	0	0	0
Equity capital	3,750	3,750	3,750	3,750	3,750
Reserves & surplus	0	0	0	0	0
Shareholders' fund	8,98,990	8,47,490	10,06,179	12,05,611	14,27,911
Total liabilities and equities	11,49,430	12,08,990	13,49,919	15,88,308	18,47,808
Cash and cash eq.	72,240	86,460	1,69,007	3,66,700	5,45,031
Accounts receivables	2,73,460	3,05,320	3,48,800	3,48,486	3,89,820
Inventories	0	0	0	0	0
Other current assets	2,43,530	2,39,510	2,61,600	2,98,702	3,34,131
Investments	3,49,540	2,73,760	2,73,760	2,73,760	2,73,760
Net fixed assets	1,13,740	1,98,410	1,91,861	1,87,731	1,84,462
CWIP	0	0	0	0	0
Intangible assets	18,790	19,930	19,930	19,930	19,930
Deferred tax assets, net	26,560	28,280	28,280	28,280	28,280
Other assets	51,570	57,320	56,680	64,719	72,395
Total assets	11,49,430	12,08,990	13,49,920	15,88,309	18,47,809

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	2,36,600	3,59,770	3,43,434	4,24,473	4,72,019
Interest expenses	(25,640)	(36,680)	(17,446)	(34,660)	(36,160)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(21,690)	8,850	(82,691)	(5,869)	(47,238)
Other operating cash flows	96,660	(2,965)	0	0	0
Cash flow from operations	2,85,930	3,28,975	2,43,298	3,83,945	3,88,621
Capital expenditures	(21,320)	(1,19,970)	(31,828)	(36,342)	(40,653)
Change in investments	73,820	(75,780)	0	0	0
Other investing cash flows	(36,050)	36,680	17,446	34,660	36,160
Cash flow from investing	16,450	(1,59,070)	(14,382)	(1,683)	(4,493)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(1,940)	0	0	0	0
Interest expenses	(1,62,310)	0	0	0	0
Dividends paid	(1,14,720)	(1,55,685)	(1,46,369)	(1,84,569)	(2,05,797)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,78,970)	(1,55,685)	(1,46,369)	(1,84,569)	(2,05,797)
Changes in cash and cash eq.	23,410	14,220	82,547	1,97,693	1,78,331
Closing cash and cash eq.	72,240	86,460	1,69,007	3,66,700	5,45,031

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	84.0	86.2	81.0	102.2	113.9
Adjusted EPS	84.0	86.2	81.0	102.2	113.9
Dividend per share	30.0	34.5	32.4	40.9	45.6
Book value per share	239.5	225.8	268.1	321.2	380.5

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	5.6	5.2	5.2	4.5	4.0
EV/EBITDA	20.8	19.5	19.4	16.1	14.1
Adjusted P/E	26.2	25.6	27.2	21.6	19.4
P/BV	9.2	9.8	8.2	6.9	5.8

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	75.8	76.5	75.3	75.9	75.9
Interest burden (PBT/EBIT)	111.0	109.5	104.5	107.4	106.9
EBIT margin (EBIT/Revenue)	25.6	24.6	24.3	25.9	25.9
Asset turnover (Revenue/Avg TA)	131.1	133.1	124.4	123.7	118.3
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.3	1.3
Adjusted ROAE	35.5	37.0	32.8	34.7	32.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	19.0	7.2	1.4	14.2	11.9
EBITDA	21.5	6.6	0.8	20.4	11.7
Adjusted EPS	25.3	2.6	(6.0)	26.1	11.5
Profitability & Return ratios (%)					
EBITDA margin	27.0	26.8	26.7	28.1	28.1
EBIT margin	25.6	24.6	24.3	25.9	25.9
Adjusted profit margin	21.5	20.6	19.1	21.1	21.0
Adjusted ROAE	35.5	37.0	32.8	34.7	32.5
ROCE	34.3	35.8	33.6	39.4	43.1
Working capital days (days)					
Receivables	65	67	75	70	66
Inventory	0	0	0	0	0
Payables	78	86	89	82	83
Ratios (x)					
Gross asset turnover	12.8	10.1	8.2	9.6	10.9
Current ratio	2.6	2.4	3.0	3.4	3.8
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	0.0	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

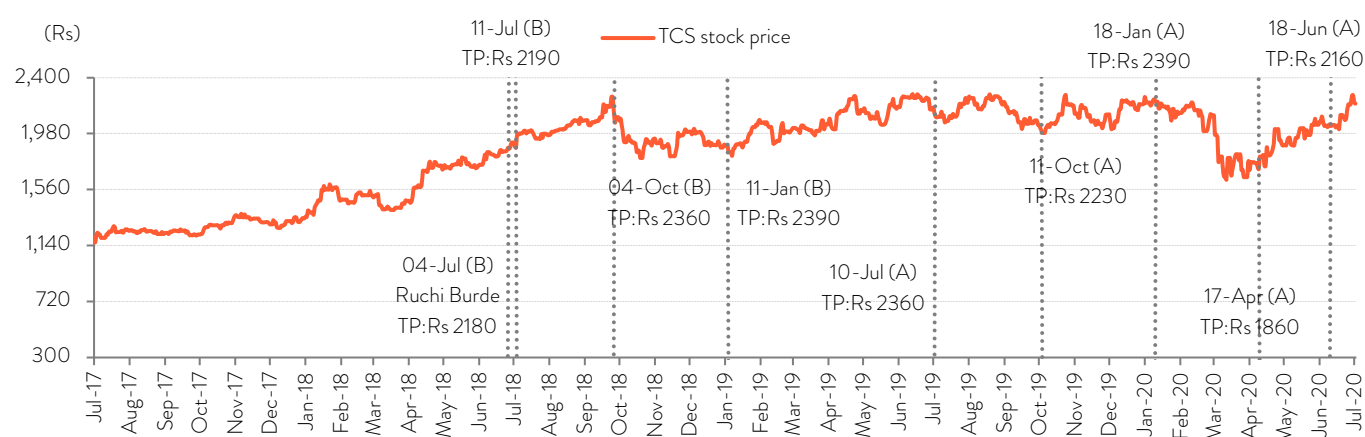
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: TATA CONSULTANCY SERVICES (TCS IN)



B – Buy, A – Add, R – Reduce, S – Sell

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