

BUY

TP: Rs 3,890 | ▲ 19%

TATA CONSULTANCY SERVICES

| IT Services

| 09 July 2021

India contraction plays spoilsport; core market growth intact

- TCS reported 2.4% QoQ cc growth (vs. est. of 3.5%), impacted by contraction in India geography. Core market growth was intact at 4.1%.
- TCV remained robust at US\$8.1bn, highest ever TCV for first quarter. BFSI led the TCV pack with deal wins worth US\$2.2bn
- We tweak FY22/FY23 EPS lower by 5-6%, retain BUY with revised Jun'22 TP of Rs3,890 set at updated target P/E to 29.6x

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Core market growth intact: TCS reported QoQ revenue growth of 2.4% CC/2.7% USD, underperforming our (3.5% CC/4% USD) and street's estimates on soft India and emerging geography performance. Core markets grew 4.1% QoQ cc, which was more in-line with markets and our estimates. However, overall demand is robust, as indicated by its highest-ever first quarter TCV of US\$ 8.1bn, up 17%YoY on a strong base of US\$ 6.9bn in Q1FY21. BFSI was leading with US\$2.2bn TCV, followed by retail which achieved its highest TCV ever of US\$1.5bn.

Covid impacted verticals recover: Vertical-wise, BFSI posted robust growth of 3.7% QoQ USD. Covid impacted verticals such as: manufacturing and RCPG both recovered by ~5% USD each and life sciences was leading at 8%. Geographically, UK, North America and Europe grew the most at 2-4.7% QoQ USD. India- hit by second wave, contracted 15.6% USD, QoQ. The robust secular showing in core markets indicates the strong demand from the multiyear demand growth cycle wherein we expect TCS to be the prime beneficiary.

Record hiring: With a highest ever net hiring of 20,409, TCS crossed the 500,000 employees milestone. TCS plans to hire more than 40,000 freshers in FY22 (similar to last year). In an environment where digital talent is in short supply, having a cushion of adequate digital talent will help TCS be prepared for a rise in demand.

Stable margin: EBIT margin stood at 25.5%, down 130bps QoQ, almost in-line with our estimate of 25.9%. The 130bps QoQ impact was due to mix of annual wage hike and few pre-pandemic costs rising up. We are optimistic of TCS maintaining its margin in the aspirational range of 26-28% in the upcoming quarters as it will showcase the best talent retention among peers.

Retain BUY: The subdued growth this quarter has been the result of adversely impacted India geography. However, this India business is not lost, it has simply been deferred. Also, we expect TCS to have the best margin defence against rising pre-covid costs and a supply pressures. Maintain BUY with a new TP of Rs3,890.

Key changes

Target	Rating
▲	◀ ▶

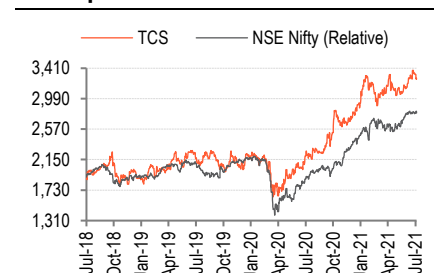
Ticker/Price	TCS IN/Rs 3,259
Market cap	US\$ 163.7bn
Free float	28%
3M ADV	US\$ 99.7mn
52wk high/low	Rs 3,400/Rs 2,125
Promoter/FPI/DII	72%/17%/11%

Source: NSE | Price as of 8 Jul 2021

Key financials

Y/E 31 Mar	FY20A	FY21A	FY22E
Total revenue (Rs mn)	1,569,490	1,641,770	2,026,582
EBITDA (Rs mn)	421,100	465,460	590,316
Adj. net profit (Rs mn)	323,400	336,480	435,024
Adj. EPS (Rs)	86.2	90.9	117.6
Consensus EPS (Rs)			
Adj. ROAE (%)	37.0	39.2	44.2
Adj. P/E (x)	38.0	36.0	27.9
EV/EBITDA (x)	29.0	26.3	20.8
Adj. EPS growth (%)	2.6	5.5	29.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance

Source: NSE



Fig 1 – Quarterly performance

Rs mn	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenues (US\$ mn)	6,154	5,059	21.6	5,989	2.7	22,626	22,032	2.7
Revenue (Rs mn)	454,110	383,220	18.5	437,050	3.9	1,675,730	1,569,490	6.8
Operating Expenditure	327,470	282,970	15.7	309,040	6.0	1,205,700	1,148,390	5.0
Cost of revenues	262,400	224,860	16.7	248,600	5.6	965,440	896,350	7.7
as % of sales	57.8	58.7		56.9		57.6	57.1	
SG&A expenses	65,070	58,110	12.0	60,440	7.7	240,260	252,040	(4.7)
as % of sales	14.3	15.2		13.8		14.3	16.1	
EBITDA	126,640	100,250	26.3	128,010	(1.1)	470,030	421,100	11.6
Depreciation	10,760	9,770	10.1	10,670	0.8	41,180	35,300	16.7
EBIT	115,880	90,480	28.1	117,340	(1.2)	428,850	385,800	11.2
Other Income	5,750	4,560	26.1	7,930	(27.5)	25,640	36,680	
PBT	121,630	95,040	28.0	125,270	(2.9)	454,490	422,480	7.6
Total Tax	31,320	24,550	27.6	32,450	(3.5)	113,650	98,010	16.0
Adjusted PAT	90,310	70,490	28.1	92,820	(2.7)	340,840	324,470	5.0
(Profit)/loss from JV's/Ass/MI	(230)	(410)		(360)		(1,290)	(1,070)	
APAT after MI	90,080	70,080	28.5	92,460	(2.6)	339,550	323,400	5.0
Reported PAT	90,080	70,080	28.5	92,460	(2.6)	339,550	323,400	5.0
Reported EPS	24.3	18.7	30.4	25.0	(2.6)	91	86	5.8
Margins (%)			(bps)		(bps)			(bps)
EBIDTA	27.9	26.2	170	29.3	(140)	28.0	26.8	(120)
EBIT	25.5	23.6	190	26.8	(130)	25.6	24.6	(100)
EBT	26.8	24.8	200	28.7	(190)	27.1	26.9	(20)
PAT	19.8	18.3	150	21.2	(130)	20.3	20.6	30
Effective Tax rate	25.8	25.8	(10)	25.9	(20)	25.0	23.2	(180)

Source: BOBCAPS Research, Company

Fig 2 – Operating metrics

(in US\$ terms)	Q1FY22 (% Contri to Revenue)	QoQ (%)	YoY (%)
Deal win TCV (US\$ mn)	8100	(12.0)	17.4
Revenues by Geography			
Americas	49.4	4.4	16.9
UK	16.3	4.7	29.6
Europe	16.7	2.1	30.2
India	4.6	(15.6)	30.1
Asia Pac	9.3	1.7	15.4
Ibero America	1.6	2.8	2.1
MEA	2.1	7.9	34.4
Revenue breakup by Domain			
BFSI	32.5	3.7	25.5
Manufacturing	9.8	4.9	22.9
Telecom & Media	6.4	1.2	9.7
Life Sciences & Healthcare	10.2	8.1	29.2
Retail & CPG	14.8	4.9	28.6
Technology & Services	8.6	5.2	15.0
Regional Markets & Others	17.7	(4.8)	12.1
	Q1FY22	Q4FY21	Q1FY21
Attrition(LTM) (%)	8.6	7.2	11.1

Source: BOBCAPS Research, Company

Valuation methodology

Factoring in Jun'21 quarter, we adjust FY22/FY23 EPS estimates by –5.4%/–5.9%. We roll over to a new Jun'22 target price of Rs 3,890 (Rs 3,780 earlier) based on an updated one-year forward P/E multiple of 29.6x (28x earlier) which is +2sd above the last five-year mean P/E of 21.8x. The P/E is justified by TCS's industry-leading position which makes it the prime beneficiary of the upcoming technology upcycle, growing cloud migration demand and vendor consolidation. Its industry low attrition levels will help it defend margins better than its peers in the light of rising talent costs. Reiterate BUY.

Fig 3 – Change in estimates

(Rs mn)	FY22E			FY23E			FY24E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	26,476	25,936	(2.0)	30,447	29,367	(3.5)	32,678
YoY Growth (%)	19.4	17.0		15.0	13.2		11.3
Revenues	2,015,976	1,970,943	(2.2)	2,382,736	2,298,179	(3.5)	2,557,177
EBITDA	583,070	559,932	(4.0)	678,273	648,748	(4.4)	721,830
EBITDA mgns (%)	28.9	28.4		28.5	28.2		28.2
Net profits	429,589	406,326	(5.4)	499,254	469,730	(5.9)	538,108
EPS (Rs)	116.1	109.8	(5.4)	134.9	127.0	(5.9)	145.4

Source: BOBCAPS Research, Company

Key risks

Key downside risks to our estimates are:

- non-conversion of TCV, and
- prolonged impact from the second Covid-19 wave in India.

Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	35	975	1,190	BUY
Info Edge	INFOE IN	9	5,333	2,880	SELL
L&T Infotech	LTI IN	10	4,035	4,710	BUY
Mphasis	MPHL IN	5	2,174	1,580	SELL
Persistent Systems	PSYS IN	3	2,813	1,340	SELL
Tata Consultancy Services	TCS IN	165	3,259	3,890	BUY

Source: BOBCAPS Research, NSE | Price as of 8 Jul 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21A	FY22E	FY23E
Total revenue	1,464,630	1,569,490	1,641,770	2,026,582	2,383,493
EBITDA	395,050	421,100	465,460	590,316	678,489
Depreciation	20,550	35,300	40,650	41,297	45,248
EBIT	374,500	385,800	424,810	549,019	633,241
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	41,130	36,680	24,970	31,039	32,539
Exceptional items	0	0	0	0	0
EBT	415,630	422,480	449,780	580,058	665,780
Income taxes	100,010	98,010	111,980	144,435	165,779
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(380)	(1,070)	(1,320)	(600)	(600)
Reported net profit	315,240	323,400	336,480	435,024	499,401
Adjustments	0	0	0	0	0
Adjusted net profit	315,240	323,400	336,480	435,024	499,401

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21A	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	250,000	292,440	371,480	349,794	411,397
Provisions	0	0	0	0	0
Debt funds	440	69,060	65,030	65,030	65,030
Other liabilities	0	0	0	0	0
Equity capital	3,750	3,750	3,700	3,700	3,700
Reserves & surplus	0	0	0	0	0
Shareholders' fund	898,990	847,490	871,080	1,097,283	1,356,873
Total liab. and equities	1,149,430	1,208,990	1,307,590	1,512,107	1,833,300
Cash and cash eq.	72,240	86,460	68,580	141,676	320,616
Accounts receivables	273,460	305,320	300,790	388,660	457,108
Inventories	0	0	0	0	0
Other current assets	243,530	239,510	295,170	333,137	391,807
Investments	349,540	273,760	318,440	318,440	318,440
Net fixed assets	113,740	198,410	196,690	195,925	198,347
CWIP	0	0	0	0	0
Intangible assets	18,790	19,930	22,780	22,780	22,780
Deferred tax assets, net	26,560	28,280	39,310	39,310	39,310
Other assets	51,570	57,320	65,830	72,180	84,892
Total assets	1,149,430	1,208,990	1,307,590	1,512,107	1,833,300

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21A	FY22E	FY23E
Cash flow from operations	285,930	328,975	372,880	292,009	434,482
Capital expenditures	(21,320)	(119,970)	(38,930)	(40,532)	(47,670)
Change in investments	73,820	(75,780)	44,680	0	0
Other investing cash flows	(36,050)	36,680	24,970	31,039	32,539
Cash flow from investing	16,450	(159,070)	30,720	(9,492)	(15,131)
Equities issued/Others	0	0	(259,499)	0	0
Debt raised/repaid	(1,940)	0	0	0	0
Interest expenses	(162,310)	0	0	0	0
Dividends paid	(114,720)	(155,685)	(161,981)	(209,420)	(240,412)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(278,970)	(155,685)	(421,480)	(209,420)	(240,412)
Chg in cash & cash eq.	23,410	14,220	(17,880)	73,096	178,940
Closing cash & cash eq.	72,240	86,460	68,580	141,676	320,616

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21A	FY22E	FY23E
Reported EPS	84.0	86.2	90.9	117.6	135.0
Adjusted EPS	84.0	86.2	90.9	117.6	135.0
Dividend per share	30.0	34.5	36.4	47.0	54.0
Book value per share	239.5	225.8	235.4	296.6	366.7

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21A	FY22E	FY23E
EV/Sales	8.4	7.8	7.5	6.1	5.1
EV/EBITDA	31.0	29.0	26.3	20.8	18.1
Adjusted P/E	39.0	38.0	36.0	27.9	24.3
P/BV	13.7	14.5	13.9	11.0	8.9

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21A	FY22E	FY23E
Tax burden (Net profit/PBT)	75.8	76.5	74.8	75.0	75.0
Interest burden (PBT/EBIT)	111.0	109.5	105.9	105.7	105.1
EBIT margin (EBIT/Revenue)	25.6	24.6	25.9	27.1	26.6
Asset turnover (Rev./Avg TA)	131.1	133.1	130.5	143.7	142.5
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.5	1.4	1.4
Adjusted ROAE	35.5	37.0	39.2	44.2	40.7

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21A	FY22E	FY23E
YoY growth (%)					
Revenue	19.0	7.2	4.6	23.4	17.6
EBITDA	21.5	6.6	10.5	26.8	14.9
Adjusted EPS	25.3	2.6	5.5	29.3	14.8
Profitability & Return ratios (%)					
EBITDA margin	27.0	26.8	28.4	29.1	28.5
EBIT margin	25.6	24.6	25.9	27.1	26.6
Adjusted profit margin	21.5	20.6	20.5	21.5	21.0
Adjusted ROAE	35.5	37.0	39.2	44.2	40.7
ROCE	34.3	35.8	37.6	43.7	44.8
Working capital days (days)					
Receivables	65	67	67	62	65
Inventory	0	0	0	0	0
Payables	78	86	103	92	81
Ratios (x)					
Gross asset turnover	12.8	10.1	8.3	10.3	12.1
Current ratio	2.6	2.4	2.0	2.7	3.0
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	0.0	0.0	(0.1)	(0.2)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

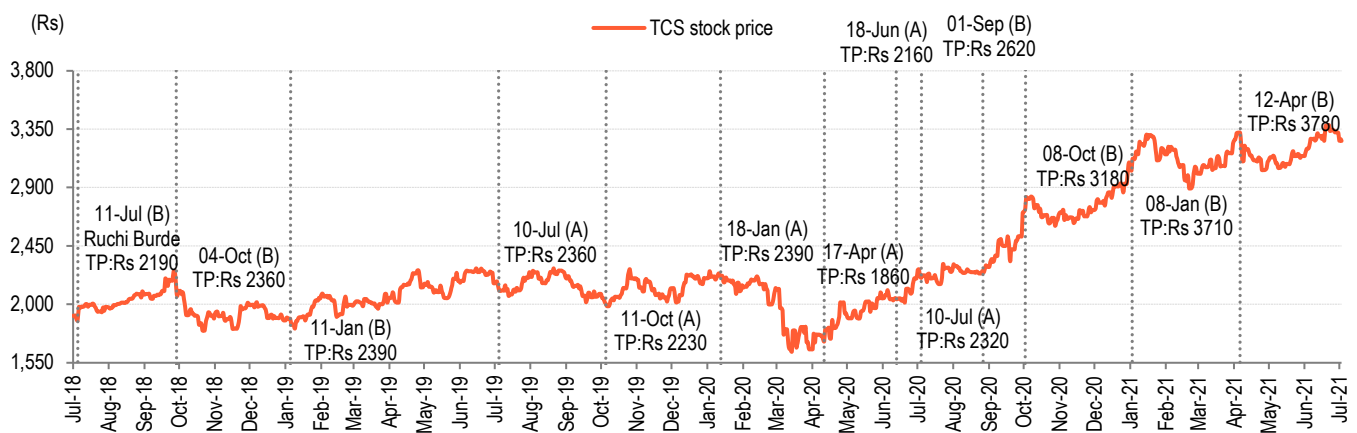
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): TATA CONSULTANCY SERVICES (TCS IN)



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

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