

**ADD**

TP: Rs 1,860 | ▲ 8%

**TATA CONSULTANCY  
SERVICES**

| IT Services

| 17 April 2020

**Prelude to darker Q1FY21**

**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.**

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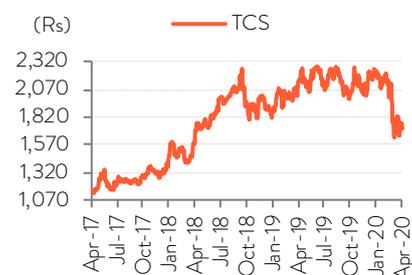
**Margins resilient but revenues miss the mark:** TCS reported a 1.2% QoQ CC revenue decline vs. consensus estimates of 0.3% growth. However, EBIT margins at 25.1% (+10bps QoQ) were resilient despite the weak revenues. Rupee depreciation against the US dollar helped alleviate the negative impact of decreased 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.

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

**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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## Earnings call highlights

### Covid-19 impact

- As per management, the impact of Covid-19 on the company will be similar to that of the GFC and will spill over to the next couple of quarters. In Q4FY20, the revenue impact due to the outbreak was two-thirds from the supply side and a third from the demand side. In Q1FY21, the company expects 80% of the revenue impact to come from demand headwinds.
- The revival of manufacturing is critical to recovery. TCS's efforts will be directed towards retracing to Q3FY20 revenue growth and optimising costs.
- The company has been able to successfully transition from a location-independent, agile model to a SBWS (secure borderless workspace) model. About 90% of employees have been transitioned to the SBWS model.
- The focus has been on building resilience and on ensuring service delivery. Support to mission-critical service providers continued seamlessly, per management, and the company has received encouraging feedback from clients on its quick response to the crisis which is translating to market share gains.
- TCS is seeing accelerated migration to cloud and new-age location-agnostic digital workspaces as a result of the change in working environment.
- All new hiring has been frozen. However, more than 30,000 offers which are outstanding will be honoured. Onboarding will take place in Q2 and Q3FY21.

**FIG 1 – MAR'20 QUARTER PERFORMANCE**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>5,444</b>	<b>5,397</b>	<b>0.9</b>	<b>5,586</b>	<b>(2.5)</b>	<b>22,032</b>	<b>20,913</b>	<b>5.4</b>
<b>Revenue (Rs mn)</b>	<b>3,99,460</b>	<b>3,80,100</b>	<b>5.1</b>	<b>3,98,540</b>	<b>0.2</b>	<b>15,69,490</b>	<b>14,64,630</b>	<b>7.2</b>
Operating Expenditure	2,89,700	2,79,370	3.7	2,89,830	(0.0)	11,48,390	10,69,580	7.4
Cost of revenues	2,24,410	2,17,090	3.4	2,26,820	(1.1)	8,96,350	8,35,090	7.3
as % of sales	56.2	57.1	-	56.9	-	57.1	57.0	-
SG&A expenses	65,290	62,280	4.8	63,010	3.6	2,52,040	2,34,490	7.5
as % of sales	16.3	16.4	-	15.8	-	16.1	16.0	-
<b>EBITDA</b>	<b>1,09,760</b>	<b>1,00,730</b>	<b>9.0</b>	<b>1,08,710</b>	<b>1.0</b>	<b>4,21,100</b>	<b>3,95,050</b>	<b>6.6</b>
Depreciation	9,510	5,360	77.4	8,970	6.0	35,300	20,550	71.8
<b>EBIT</b>	<b>1,00,250</b>	<b>95,370</b>	<b>5.1</b>	<b>99,740</b>	<b>0.5</b>	<b>3,85,800</b>	<b>3,74,500</b>	<b>3.0</b>
Other Income	4,870	11,650	(58.2)	5,950	(18.2)	36,680	41,130	(10.8)
PBT	1,05,120	1,07,020	(1.8)	1,05,690	(0.5)	4,22,480	4,15,630	1.6
Total Tax	24,190	25,500	(5.1)	24,260	(0.3)	98,010	1,00,010	(2.0)
Adjusted PAT	80,930	81,520	(0.7)	81,430	(0.6)	3,24,470	3,15,620	2.8
(Profit)/loss from JV's/Ass/MI	(440)	(260)	-	(250)	-	(1,070)	(380)	-
APAT after MI	80,490	81,260	(0.9)	81,180	(0.8)	3,23,400	3,15,240	2.6

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Reported PAT</b>	<b>80,490</b>	<b>81,260</b>	<b>(0.9)</b>	<b>81,180</b>	<b>(0.8)</b>	<b>3,23,400</b>	<b>3,15,240</b>	<b>2.6</b>
Reported EPS	21.4	21.7	(0.9)	21.6	(0.8)	86	83	3.7
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	27.5	26.5	100	27.3	20	26.8	27.0	(10)
EBIT	25.1	25.1	-	25.0	10	24.6	25.6	(100)
EBT	26.3	28.2	(180)	26.5	(20)	26.9	28.4	(150)
PAT	20.1	21.4	(120)	20.4	(20)	20.6	21.5	(90)
Effective Tax rate	23.0	23.8	(80)	23.0	10	23.2	24.1	(90)

Source: Company, BOBCAPS Research

**Contract wins were buoyed  
~US\$ 2bn Phoenix Group  
deal and US\$ 1.5bn  
Walgreens Boots Alliance deal**

**BFSI had highest supply hit as  
regulatory compliance/  
approvals constrained delivery**

**Attrition stayed rangebound –  
we highlight TCS's  
commitment to avoiding  
retrenchment during the crisis**

**FIG 2 – MAR'20 OPERATING PERFORMANCE**

(In US\$ terms)	Q4FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Deal win TCV (US\$ mn)	8,900	48.3	43.5
Digital revenues	na	na	na
<b>Revenue by Geography</b>			
Americas	50.3	(2.2)	0.1
UK	16.0	(1.9)	1.5
Europe	15.2	(0.6)	8.7
India	5.5	(6.0)	(4.3)
Asia Pac	9.3	(2.5)	(1.3)
Ibero America	1.9	(2.5)	1.9
MEA	1.9	(15.8)	(4.2)
<b>Revenue by Domain</b>			
BFSI	29.7	(4.8)	(3.0)
Manufacturing	10.1	(1.6)	6.1
Telecom	7.2	0.2	6.8
Life Sciences & Healthcare	8.8	3.3	15.3
Retail & Distribution	15.4	(1.3)	2.9
Technology & Services	8.7	0.9	2.0
Regional Markets & Others	20.1	(5.4)	(4.8)

	Q4FY20	Q3FY20	Q4FY19
Attrition (LTM) (%)	12.1	12.2	11.3

Source: Company, BOBCAPS Research

## Valuation methodology

We cut FY21/FY22 EPS estimates by 14%/13% and pare our target FY22E P/E multiple to 20x from 22.5x earlier to accommodate Covid-19 risks. This translates to a revised Mar'21 target price of Rs 1,860 (vs. Rs 2,390). Retain ADD as we believe that TCS's strong structural backbone will lend it resilience over peers to weather the current crisis.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	23,968	20,738	(13.5)	26,374	22,514	(14.6)
YoY growth (%)	7.7	(5.9)		10.0	8.6	
Revenues	16,77,784	15,55,340	(7.3)	18,46,210	16,88,516	(8.5)
EBITDA	4,56,066	4,12,262	(9.6)	5,09,411	4,65,866	(8.5)
EBITDA margins (%)	27.2	26.5		27.6	27.6	
Net profits	3,53,803	3,03,607	(14.2)	3,99,265	3,49,071	(12.6)
EPS (Rs)	94.3	80.9	(14.2)	106.4	93.0	(12.6)

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Key downside risks to our estimates are:

- a sharp decline in IT spending,
- adverse currency movements,
- inability to refresh service offerings amid rapidly changing technologies, and
- execution risk in bundled deals.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20A	FY21E	FY22E
<b>Total revenue</b>	<b>1,231,040</b>	<b>1,464,630</b>	<b>1,569,490</b>	<b>1,555,340</b>	<b>1,688,516</b>
EBITDA	325,160	395,050	421,100	412,262	465,866
Depreciation	20,140	20,550	35,300	38,107	40,293
EBIT	305,020	374,500	385,800	374,155	425,574
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	35,900	41,130	36,680	26,381	34,783
Exceptional items	0	0	0	0	0
EBT	340,920	415,630	422,480	400,536	460,357
Income taxes	82,120	100,010	98,010	96,129	110,486
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(540)	(380)	(1,070)	(800)	(800)
<b>Reported net profit</b>	<b>258,260</b>	<b>315,240</b>	<b>323,400</b>	<b>303,607</b>	<b>349,071</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>258,260</b>	<b>315,240</b>	<b>323,400</b>	<b>303,607</b>	<b>349,071</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20A	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	205,190	250,000	292,440	268,456	291,442
Provisions	0	0	0	0	0
Debt funds	2,470	440	69,060	69,060	69,060
Other liabilities	0	0	0	0	0
Equity capital	1,910	3,750	3,750	3,750	3,750
Reserves & surplus	0	0	0	0	0
Shareholders' fund	876,430	898,990	847,490	1,005,741	1,187,569
<b>Total liabilities and equities</b>	<b>1,084,090</b>	<b>1,149,430</b>	<b>1,208,990</b>	<b>1,343,257</b>	<b>1,548,072</b>
Cash and cash eq.	48,830	72,240	86,460	177,912	379,686
Accounts receivables	249,430	273,460	305,320	340,897	323,825
Inventories	0	0	0	0	0
Other current assets	122,470	243,530	239,510	255,672	277,564
Investments	407,310	349,540	273,760	273,760	273,760
Net fixed assets	116,000	113,740	198,410	191,410	184,888
CWIP	0	0	0	0	0
Intangible assets	38,960	18,790	19,930	19,930	19,930
Deferred tax assets, net	34,230	26,560	28,280	28,280	28,280
Other assets	66,860	51,570	57,320	55,396	60,139
<b>Total assets</b>	<b>1,084,090</b>	<b>1,149,430</b>	<b>1,208,990</b>	<b>1,343,257</b>	<b>1,548,072</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20A	FY21E	FY22E
Net income + Depreciation	202,850	236,600	359,770	342,514	390,164
Interest expenses	(23,930)	(25,640)	(36,680)	(26,381)	(34,783)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(2,090)	(21,690)	8,850	(73,799)	13,423
Other operating cash flows	73,840	96,660	(2,965)	0	0
<b>Cash flow from operations</b>	<b>250,670</b>	<b>285,930</b>	<b>328,975</b>	<b>242,334</b>	<b>368,804</b>
Capital expenditures	(18,040)	(21,320)	(119,970)	(31,107)	(33,770)
Change in investments	60,090	73,820	(75,780)	0	0
Other investing cash flows	(11,010)	(36,050)	36,680	26,381	34,783
<b>Cash flow from investing</b>	<b>31,040</b>	<b>16,450</b>	<b>(159,070)</b>	<b>(4,726)</b>	<b>1,013</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(430)	(1,940)	0	0	0
Interest expenses	(160,820)	(162,310)	0	0	0
Dividends paid	(107,600)	(114,720)	(155,685)	(146,157)	(168,043)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(268,850)</b>	<b>(278,970)</b>	<b>(155,685)</b>	<b>(146,157)</b>	<b>(168,043)</b>
<b>Changes in cash and cash eq.</b>	<b>12,860</b>	<b>23,410</b>	<b>14,220</b>	<b>91,452</b>	<b>201,774</b>
<b>Closing cash and cash eq.</b>	<b>48,830</b>	<b>72,240</b>	<b>86,460</b>	<b>177,912</b>	<b>379,686</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20A	FY21E	FY22E
Reported EPS	67.1	84.0	86.2	80.9	93.0
Adjusted EPS	67.1	84.0	86.2	80.9	93.0
Dividend per share	24.1	30.0	34.5	32.4	37.2
Book value per share	227.6	239.5	225.8	268.0	316.4

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20A	FY21E	FY22E
EV/Sales	5.2	4.4	4.1	4.1	3.8
EV/EBITDA	19.7	16.2	15.2	15.5	13.7
Adjusted P/E	25.6	20.4	19.9	21.2	18.5
P/BV	7.5	7.2	7.6	6.4	5.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20A	FY21E	FY22E
Tax burden (Net profit/PBT)	75.8	75.8	76.5	75.8	75.8
Interest burden (PBT/EBIT)	111.8	111.0	109.5	107.1	108.2
EBIT margin (EBIT/Revenue)	24.8	25.6	24.6	24.1	25.2
Asset turnover (Revenue/Avg TA)	115.2	131.1	133.1	121.9	116.8
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.4	1.4	1.3
Adjusted ROAE	29.3	35.5	37.0	32.8	31.8

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20A	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	4.4	19.0	7.2	(0.9)	8.6
EBITDA	0.6	21.5	6.6	(2.1)	13.0
Adjusted EPS	0.6	25.3	2.6	(6.1)	15.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	26.4	27.0	26.8	26.5	27.6
EBIT margin	24.8	25.6	24.6	24.1	25.2
Adjusted profit margin	21.0	21.5	20.6	19.5	20.7
Adjusted ROAE	29.3	35.5	37.0	32.8	31.8
ROCE	27.5	34.3	35.8	32.9	36.5
<b>Working capital days (days)</b>					
Receivables	71	65	67	76	72
Inventory	0	0	0	0	0
Payables	74	78	86	90	84
<b>Ratios (x)</b>					
Gross asset turnover	10.5	12.8	10.1	8.0	9.0
Current ratio	2.4	2.6	2.4	3.1	3.6
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	0.0	(0.1)	(0.3)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

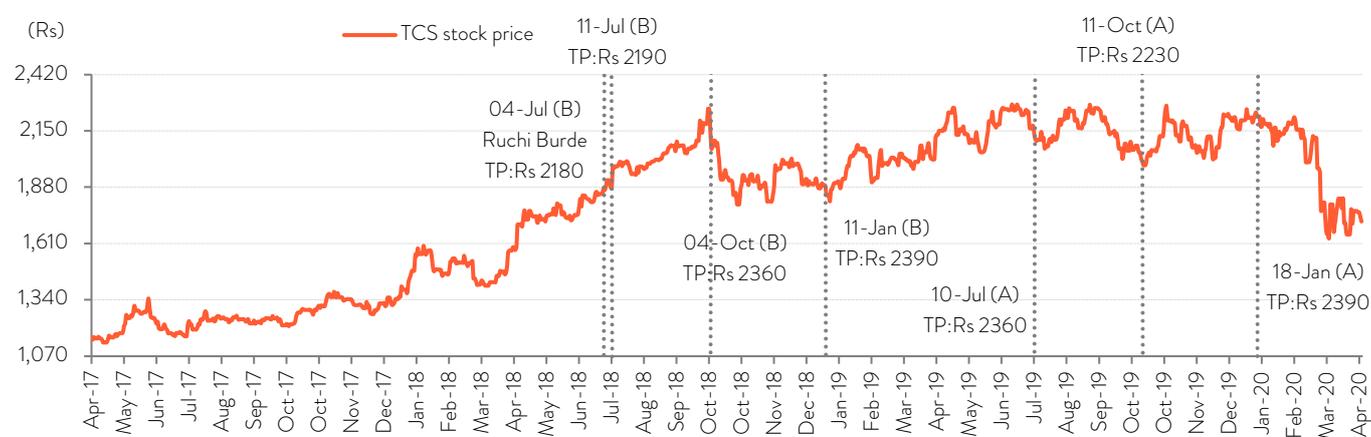
**ADD** – Expected return from >+5% to +15%

**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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