

Mixed set of numbers, robust digital growth and strong deal pipeline provide comfort, though margin pressure and high valuation will limit upside - Maintain HOLD

Current	Previous
CMP: Rs 2133	
Rating: Hold	Rating: Hold
Target: Rs 2225	Target: Rs 2225

(NR-Not Rated)

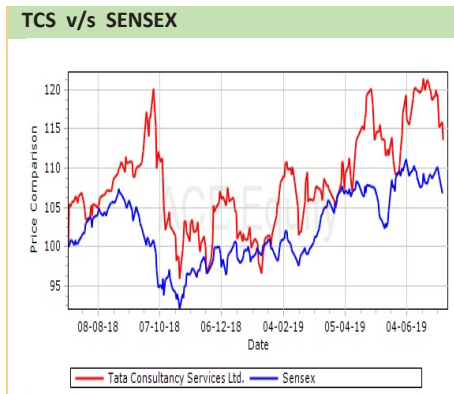
Stock Info	
INDEX	
BSE	532540
NSE	TCS
Bloomberg	TCS IN
Reuters	TCS.BO
Sector	Information Technology
Face Value (Rs)	1
Equity Capital (Rs Cr)	375
Mkt Cap (Rs Cr)	799,875
52w H/L (Rs)	2292 /1784
Avg Weekly Vol (BSE+NSE)	3,935,690

Shareholding Pattern	%
(As on March, 2019)	
Promoters	72.1
Public & Others	27.9

Source: NSE, Arihant Research

Stock Performance (%)	3m	6m	12m
TCS	2.1	12.9	12.9
SENSEX	-0.5	6.9	7.8

Source: ACE Equity, Arihant Research



Source: ACE Equity, Arihant Research

TCS came out with mixed set of numbers in Q1FY20, revenue and EBIT margin were slightly below our as well as street estimate; however PAT for the quarter was ahead of our estimate owing to higher other income. Digital business continued to show traction, though BFSI vertical remained on a weak footing. We are positive on the stock from longer term perspective, however in the near term we see limited upside due to expensive valuation and tepid management commentary. We maintain our HOLD rating on the stock with a target price of Rs 2225 (unchanged).

Q1FY20 Performance Highlights

Revenue

- Revenue at ~8,172 crore, +11.4% YoY
- Constant Currency revenue growth: +10.6% YoY
- Digital revenue: 32.2% of total, +42.1% YoY
- UK, Europe and India lead growth: +16% YoY, +15% YoY and +15.9% YoY respectively

Operating Margin & PAT

- Operating Margin at 24.2%; Net Margin at 21.3%
- Net Income at ~,131 crore, +10.5% YoY
- Earnings Per Share at Rs 21.67, +13.0% YoY
- Net Cash from Operations at Rs 8,446 crore; 103.9% of Net Income

People

- Net addition of 12,356 employees: highest in 5 years
- 315K+ employees trained in digital technologies
- 361K+ employees in Agile methods
- IT Services attrition rate at 11.5% LTM.

Outlook & Valuation

TCS is seeing good traction in digital space despite weakness in BFSI segment and the management is confident of continuing its medium term growth path on the back of a strong deal pipeline. However achieving its aspirational margins of 26-28% will be difficult at current exchange rate and company will strive to better its margin in subsequent quarters. We believe TCS can deliver industry-leading growth and have positive view on the stock, however acknowledge the fact that margins will be tepid due to industry wide supply side pressure. At CMP of Rs 2133, TCS is trading at a P/E of 22x its FY20E earnings, which is expensive. **Due to limited upside potential and expensive valuation, we maintain our Hold rating on the stock with unchanged target price of Rs 2225 valuing it at 23x FY20E EPS, giving an upside of 4.3%.**

Financial Performance

YE March (Rs Cr)	Net Sales	EBITDA	PAT	EPS (Rs)	EBITDA Margin %	RoE (%)	P/E (x)
FY18	123104	32516	25880	67.6	26.4	30.4	31.6
FY19	146463	39506	31562	84.1	27.0	35.3	25.4
FY20E	157352	44059	36317	96.7	28.0	32.4	22.0

Source: Company, Arihant Research

Q1FY20 Financial Performance

Rs Cr (Consolidated)	Q1FY20	Q4FY19	Q1FY19	Q-o-Q	Y-o-Y
Net Revenue	38,172	38,010	34,261	0.4%	11.4%
Employee Costs	20,809	20,179	18,548	3.1%	12.2%
Other Operating Expenses	7,326	7,757	6,642	-5.6%	10.3%
Depreciation	817	537	493	52.1%	65.7%
EBIT	9,220	9,537	8,578	-3.3%	7.5%
EBIT margin %	24.2%	25.1%	25.0%	-90bps	-80bps
Other Income	1,675	1,193	1,225	40.4%	36.7%
Finance Costs	257	28	17	817.9%	1411.8%
PBT	10,638	10,702	9,786	-0.6%	8.7%
Tax Expense	2,485	2,550	2,424	-2.5%	2.5%
Effective Tax Rate %	23.4%	23.8%	24.8%		
Reported PAT	8,153	8,152	7,362	0.0%	10.7%
MI & Associates	-22	-26	-22		
Consolidated PAT	8,131	8,126	7,340	0.1%	10.8%
<i>PAT Margin %</i>	<i>21.3%</i>	<i>21.4%</i>	<i>21.4%</i>	<i>-10bps</i>	<i>0bps</i>
EPS (Rs)	21.7	21.7	19.2	0.1%	13.1%

Source: Company, Arianth Research

Post Result Conference Call Highlights

- In Q1FY20, UK/Europe led growth with 15/16% CC YoY growth, while North America grew 7.7% YoY. BFSI vertical reported weak growth while volatility in retail segment impacted overall growth for Q1FY20.
- The weakness in BFSI vertical was more pronounced than anticipated as US banks operating in the capital market industry and overall European BFSI industry continued to be pressure points.
- TCS management still hopeful of double-digit growth due to strong deal pipeline, however agreed that the above aspirational growth is contingent upon a strong show in Q2FY20.
- Decline of EBIT margin by 90bps QoQ to 24.2% was mainly on account of negative headwinds from wage hikes and rupee appreciation.
- PAT margin was stable at 21.3% due to higher other income.
- TCS management expressed confidence in its medium term growth prospects as deal pipeline remains robust, especially in digital space. Digital constituted 32.8% of sales and grew 42% YoY in CC terms.
- Attrition rate remained under control at 11.5%.
- In Q1FY20, TCS declared an interim dividend of Rs 5/share, and the management said that they remain committed to return 80-100% of its free cash flow (FCF) to shareholders, despite the recent setback faced in budget of imposition of dividend distribution tax on share buybacks.

Profit and Loss statement (consolidated)			
Particulars (Rs. In Crore)	FY18	FY19	FY20E
Information technology services	123104	146463	157352
Total	123104	146463	157352
Employee costs	66396	78246	83397
Operation and other expenses	24192	28711	29897
Total Operating Expenses	90588	106957	113294
EBIDTA	32516	39506	44059
EBIDTA Margin	26.4%	27.0%	28.0%
Depreciation	2014	2056	2518
EBIT	30502	37450	41541
Interest	52	198	41
Other Income	3642	4311	5665
PBT	34092	41563	47165
Tax	8212	10001	10848
PAT	25880	31562	36317
Growth (%)	-1.8%	22.0%	15.1%
EPS	68	84	97

Balance Sheet (consolidated)			
Particulars (Rs. In Crore)	FY18	FY19	FY20E
Shareholder's funds			
Share Capital	383	375	375
Reserves & Surplus	84745	89071	111860
Total	85128	89446	112236
Minority Interest	402	453	350
Total Non Current Liabilities	2938	2736	2745
Total Current Liabilities	17828	22084	20055
Total Liabilities	106296	114720	135385
Net Block	10216	10411	15735
Capital Work-in-Progress	1541	963	6734
Goodwill on consolidation	1757	1700	2245
Total Non Current Assets	25072	22812	25093
Cash and bank balance	4883	7224	16712
Total Current Assets	81224	91908	110290
Total Assets	106296	114720	135385

Cash Flow Statement (consolidated)			
Particulars (Rs. In Crore)	FY18	FY19	FY20E
Profit After taxes	25880	31562	36317
Add:- Depreciation	2014	2056	2518
Change in Working Capital	4782	5566	5979
Cash generated from operations	32676	39184	44814
Taxes paid	-7609	-10001	-10848
Net cash flow from operating Activities	25067	29183	33966
Purchase of fixed assets	-1862	-2048	-2253
Others	4748	-6586	-17692
Net cash flow from investing ADivities	2886	-8634	-19945
Dividend paid, including dividend tax	-10760	-12625	-14527
Other	-16125	-16036	-76
Net cash used in financing Activities	-26885	-28661	-14603
Net Cash Flow	1068	1889	10267
Opening Cash balance	3597	4883	6609
Exchange rate difference	218	452	-163
Closing Cash balance	4883	7224	16712

Key Ratios (consolidated)			
Particulars	FY18	FY19	FY20E
EPS	67.6	84.1	96.7
Book Value	435	457	573
DPS	50	50	50
Payout %	74	59	52
Dividend Yield %	2.3	2.3	2.3
P/E	31.6	25.4	22.0
EBIDTA Margin	26%	27%	28%
PBT Margin	28%	28%	30%
PAT Margin	21%	22%	23%
Debt/Equity	0.0	0.0	0.0
Current Ratio	4.56	4.16	5.50
ROE	30.4	35.3	32.4

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Stock Rating Scale

	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

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