

Weak quarter due to Covid-19 pandemic but better road ahead

**CMP: Rs 2204**

**Rating: HOLD**

**Target Price: Rs 2339**

**Stock Info**

BSE	532540
NSE	TCS
Bloomberg	TCS IN
Reuters	TCS.BO
Sector	IT
Face Value (Rs)	1
Equity Capital (Rs mn)	3,750
Mkt Cap (Rs mn)	82,69,130
52w H/L (Rs)	2,302/ 1,506
Avg Yearly Vol (in 000')	3,438

**Shareholding Pattern %**

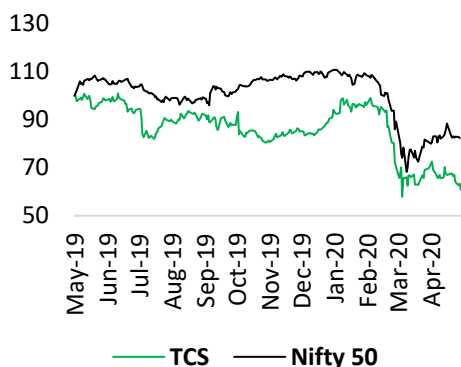
(As on March, 2020)

Promoters	72.05
FII	15.74
DII	8.71
Public & Others	3.50

**Stock Performance (%)**

	3m	6m	12m
TCS	24.8	0.31	4.21
Nifty	19.5	-12.8	-6.52

**TCS Vs Nifty**



*TCS Q1FY21 earnings were below our estimates on all fronts as Covid-19 pandemic disrupted the business performance of the company. Consolidated revenue stood at Rs 3,83,220 mn, below our estimate of Rs 3,95,458 mn, registering +0.4% YoY/-4.1% QoQ. Consolidated EBIT stood at Rs 90,480 mn, down by -1.9% YoY/-9.7% QoQ. On the margins front, EBIT margin contracted by 54bps YoY to 23.6% due to higher employee costs and depreciation expenses. Consolidated PAT saw a decline of 13.8% YoY to Rs 70,090 mn, vs 81,270 mn in Q1FY20 due to lower other income. The board recommended an interim dividend of Rs 5 per equity share of Rs 1 each of the company.*

**Q1FY21 Segment Highlights**

**Industries:** Life Sciences & Healthcare continued to grow strongly at 13.8% YoY. Other than that, all other industry verticals showed declines of varying degrees: BFSI (-4.9%), Retail & CPG (-12.9%), Communications & Media (-3.6%), Manufacturing (-7.1%) and Technology & Services (-4%).

**Markets:** Demand contraction was broad-based by geography. Other than Europe (+2.7%) and Latin America (+0.2%), growth declined in all other markets: North America (-6.1%), UK (-8.5%), India (-27.6%), Asia Pacific (-3.2%), and MEA (-11.7%).

**Services: Consulting & Services Integration:** Strong traction continued in M&A and Location Independent Agile services. Finance and shared services transformation, as well as digital strategy and integration services saw strong traction.

• **Cognitive Business Operations:** Provided uninterrupted services to customers by switching over to the SBWS model. Won several large deals linked to adoption of new operating models that enhance enterprise resilience, accelerate cloud adoption, improve customer experience in a virtual world and improve enterprise agility.

**Outlook & Valuation**

TCS is well positioned to capitalize on opportunities when client technology spending increases. We see the IT services sector as an attractive investment destination due to strong demand for Cloud migration and opportunity for large scale hybrid and public Cloud adoption. We expect shift to Cloud to be the backbone of the upcoming demand. Whereas management expects revenue decline to have bottomed out in Q1. From here on, TCS should see recovery. TCS also expects Q3FY21 INR revenue to be equal to Q3FY20. At CMP of Rs 2204, TCS currently trades at FY20 P/E of 25.5x Factoring in weak Q1FY21 results, we slightly lowered our FY21/FY22 estimates. We value TCS at PE of 25x to its FY22E EPS of Rs 94, which yields a target price of Rs 2339 per share. **We upgrade our rating to Hold from Neutral earlier.**

Particulars (Rs mn)	FY19	FY20	FY21E	FY22E
Net Sales	14,64,630	15,69,490	15,73,598	16,99,951
EBITDA	3,95,060	4,21,090	4,18,577	4,58,987
PAT	3,15,620	3,24,470	3,13,007	3,51,196
EPS (per share)	84	86	83	94
ROE	35.3%	38.6%	27.1%	30.4%
P/E	26.2	25.5	26.4	23.6

Source: Arihant Research, Company Filings, Ace Equity, Bloomberg

## Q1 FY21 - Quarterly Performance (Consolidated)

(in Rs Mn)

Income Statement Rs Mn	Q1FY21	Q4FY20	Q1FY20	Q-o-Q	Y-o-Y
<b>Net Revenue</b>	<b>3,83,220</b>	<b>3,99,460</b>	<b>3,81,720</b>	<b>-4.1%</b>	<b>0.4%</b>
Employee Costs	2,20,930	2,20,510	2,08,090	0.2%	6.2%
Other Operating Expenses	62,050	69,190	73,260	-10.3%	-15.3%
Depreciation	9,760	9,510	8,170	2.6%	19.5%
<b>EBIT</b>	<b>90,480</b>	<b>1,00,250</b>	<b>92,200</b>	<b>-9.7%</b>	<b>-1.9%</b>
<b>EBIT margin %</b>	<b>23.6%</b>	<b>25.1%</b>	<b>24.2%</b>	<b>-149bps</b>	<b>-54bps</b>
Other Income	5,980	7,380	16,750	-19.0%	-64.3%
Finance Costs	1,420	2,510	2,570	-43.4%	-44.7%
<b>PBT</b>	<b>95,040</b>	<b>1,05,120</b>	<b>1,06,380</b>	<b>-9.6%</b>	<b>-10.7%</b>
Tax Expense	24,550	24,190	24,850	1.5%	-1.2%
Effective Tax Rate %	25.8%	23.0%	23.4%	282bps	247bps
<b>Reported PAT</b>	<b>70,490</b>	<b>80,930</b>	<b>81,530</b>	<b>-12.9%</b>	<b>-13.5%</b>
MI & Associates	-410	-440	-260		
<b>Consolidated PAT</b>	<b>70,080</b>	<b>80,490</b>	<b>81,270</b>	<b>-12.9%</b>	<b>-13.8%</b>
<b>PAT Margin %</b>	<b>18.3%</b>	<b>20.1%</b>	<b>21.3%</b>	<b>-186bps</b>	<b>-300bps</b>
<b>EPS (Rs)</b>	<b>18.7</b>	<b>21.5</b>	<b>21.7</b>	<b>-12.9%</b>	<b>-13.8%</b>

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

## Q1 FY21 – Key Concall Highlights

- **COVID-19:** As per management, COVID-19 impact troughed in Q1FY21 (supply side impact: ~1.5% QoQ; India Business: ~1.5% QoQ) and expects recovery from Q2 driven by stabilization of supply-side constraints. Management expects Q3FY21 revenue to be flat YoY in INR terms.
- **Strong deal and pipeline:** TCS' deal wins at USD 6.9 bn were stronger than historical average and grew 21% YoY. Q1 deal wins were polarized, as it had a few large deals on top and number of smaller deals; however, deal pipeline has a good mix of large and small deals. Management sees strong demand for Cloud migration and opportunity for large scale hybrid and public Cloud adoption. Transformation programs that were paused have started resuming. Many customers have fast-tracked some large transformation programs. Digital transformation and Cloud services pipeline is at highest levels in past many quarters
- **Employee management:** The lateral hiring, which was frozen earlier, has been re-started selectively, while fresh on-boarding of 40,000 in FY21E is on track from July.
- **Vertical- commentary: BFSI:** - declined largely due to softness in UK and Canada. Residual impact in supply side impact. Banking and financial services turned out to be more resilient. Supply side is sorted out. Demand side looks better. Banking in Europe was most impacted in April; Now recovery of demand is happening in very quickly.
- **Retail & CPG** – Significant demand reduction in Retail & CPG vertical due to shut down. **Communication & Media** – pulled down by media due to cancellation of sporting events. Not fully anticipated the decline. **Manufacturing** – impacted by production grounding to halt. **Life Sciences & Healthcare** – Medical and Elective surgeries were weak like last quarter. Excluding this, vertical performed well.
- **Geographical:** Management is more optimistic on Europe while being cautiously optimistic on US. Management expects Europe to go back to higher growth trajectory during remaining part of the year. June was better vs earlier months with good traction and positive momentum. US was more impacted (-6.1%YoY) vs Europe, though it is also proving to be most resilient and adaptable in planning or recovery with most innovative ecosystem. TCS' management mentioned multiple instances of clients coming up with innovations to deal with COVID-19 pandemic. **Outlook:** TCS expects increased spending in the areas of cyber security, customer experience transformation and digital transformation in the foreseeable future. TCS reported order bookings of US\$6.9bn (vs. US\$8.9bn QoQ/ US\$5.7bn YoY), however these included a significant mix of very large transformational deals that had been in negotiation over the prior months as well as a number of smaller engagements. TCV of deals signed in BFSI, Retail and North America was \$2.1bn, \$0.9bn and \$3.3bn, respectively.

## Key Financials

Profit and Loss statement				
Particulars (Rs Mn)	FY19	FY20	FY21E	FY22E
<b>Net Revenue</b>	<b>1464630</b>	<b>1569490</b>	<b>1573598</b>	<b>1699951</b>
Employee costs	782460	859520	856037	917974
Operation and other expenses	287110	288880	298984	322991
Total Operating Expenses	1069570	1148400	1155021	1240964
<b>EBIDTA</b>	<b>395060</b>	<b>421090</b>	<b>418577</b>	<b>458987</b>
EBIDTA Margin	27.0%	26.8%	26.6%	27.0%
Depreciation	20560	35290	34619	35699
EBIT	374500	385800	383958	423288
Interest	1980	9240	7868	8500
Other Income	43110	45920	31472	42499
<b>PBT</b>	<b>415630</b>	<b>422480</b>	<b>407562</b>	<b>457287</b>
Tax	100010	98010	94554	106091
<b>PAT</b>	<b>315620</b>	<b>324470</b>	<b>313007</b>	<b>351196</b>
Growth (%)	22.0%	2.8%	-3.5%	12.2%

Balance Sheet				
Particulars (Rs Mn)	FY19	FY20	FY21E	FY22E
Shareholder's Funds				
Share Capital	3754	3754	3754	3754
Reserves & Surplus	890710	837510	1150517	1152802
<b>Net Worth</b>	<b>894464</b>	<b>841260</b>	<b>1154271</b>	<b>1156556</b>
Minority Interest	4530	6230	7080	7830
Total Non Current Liabilities	27366	90900	33316	46268
Total Current Liabilities	220840	270600	231293	254388
<b>Total Liabilities</b>	<b>1147200</b>	<b>1208990</b>	<b>1425960</b>	<b>1465042</b>
Net Block	104110	109410	110152	118997
Capital Work-in-Progress	9630	9060	9000	9500
Goodwill on consolidation	17000	17100	17000	17300
Total Non Current Assets	228120	306620	343414	355433
Cash and bank balance	72240	86460	596573	858211
Total Current Assets	919080	902370	1082546	1109610
<b>Total Assets</b>	<b>1147200</b>	<b>1208990</b>	<b>1425960</b>	<b>1465042</b>

Cash Flow Statement				
Particulars (Rs Mn)	FY19	FY20	FY21E	FY22E
<b>PAT</b>	<b>315620</b>	<b>324470</b>	<b>313007</b>	<b>351196</b>
Add:- Depreciation	20560	35290	34619	35699
Change in Working Capital	55656	59790	59790	59790
Cash generated from operations	391836	418980	418980	418980
Taxes paid	-100010	-97140	-97140	-97140
<b>Net cash flow from operating activities</b>	<b>291826</b>	<b>321840</b>	<b>321840</b>	<b>321840</b>
Purchase of fixed assets	-20482	-22530	-24783	-27262
Others	-65860	0	0	0
<b>Net cash flow from investing Activities</b>	<b>-86342</b>	<b>-22530</b>	<b>-24783</b>	<b>-27262</b>
Dividend paid, including dividend tax	-126248	-130080	-130080	-130080
Others	-160360	0	0	0
<b>Net cash flow from financing Activities</b>	<b>-286608</b>	<b>-130080</b>	<b>-130080</b>	<b>-130080</b>
Net Cash Flow	18886	266370	264117	261638
<b>Opening Cash Balance</b>	<b>48830</b>	<b>72240</b>	<b>332456</b>	<b>596573</b>
Exchange difference on Forex	4524	-6154	0	0
<b>Closing Cash Balance</b>	<b>72240</b>	<b>332456</b>	<b>596573</b>	<b>858211</b>

Key Ratios				
Particulars	FY19	FY20	FY21E	FY22E
EPS (Rs)	84	86	83	94
Book Value (Rs)	238	224	307	308
DPS (Rs)	50	50	50	50
Payout %	59	58	60	53
Dividend Yield %	2.3	2.3	2.8	2.8
P/E (x)	26.2	25.5	26.4	23.6
EBIDTA Margin	27.0%	26.8%	26.6%	27.0%
PBT Margin	28.4%	26.9%	25.9%	26.9%
PAT Margin	21.5%	20.7%	19.9%	20.7%
Debt/Equity (x)	0.0	0.1	0.0	0.0
Current Ratio (x)	4.2	3.3	4.7	4.4
ROE	35.3%	38.6%	27.1%	30.4%

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

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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% to -12%
SELL	<-12%

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