

Muted 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 2004 | |
| Rating: Hold | Rating: Hold |
| Target: Rs 2144 | Target: Rs 2225 |

(NR-Not Rated)

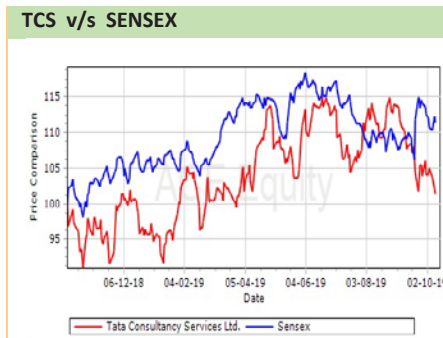
| Stock Info | |
|--------------------------|------------------------|
| INDEX | |
| BSE | 532540 |
| NSE | TCS |
| Bloomberg | TCS IN |
| Reuters | TCS.BO |
| Sector | Information Technology |
| Face Value (Rs) | 1 |
| Equity Capital (Rs Mn) | 3750 |
| Mkt Cap (Rs Mn) | 7,515,000 |
| 52w H/L (Rs) | 2296 /1784 |
| Avg Weekly Vol (BSE+NSE) | 3,935,690 |

| Shareholding Pattern | % |
|--------------------------------|------|
| (As on September, 2019) | |
| Promoters | 72.1 |
| Public & Others | 27.9 |

Source: NSE, Arihant Research

| Stock Performance (%) | 3m | 6m | 12m |
|-----------------------|------|------|------|
| TCS | -4.9 | -1.9 | -1.9 |
| SENSEX | -1.7 | -1.8 | 9.0 |

Source: ACE Equity, Arihant Research



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TCS came out with poor set of numbers in Q2FY20, below ours as well as street estimate. Consolidated revenue stood at Rs 389,770 mn, below our estimate of Rs 393,380 mn, registering +5.8% YoY/+2.1% QoQ growth. Consolidated EBITDA stood at Rs 102,250 mn, below our estimate of Rs 102,780 mn. As far as margin is concerned, EBIT margin contracted 250bps YoY to 24% due to higher employee and depreciation expenses. Consolidated PAT saw a muted growth of 1.8% YoY to Rs 80,420 mn, below our estimate of Rs 84,183 mn. After factoring in muted results we have cut our FY20E estimate and introduced FY21E estimate. 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 revised target price of Rs 2144.

Q2FY20 Performance Highlights

Revenue

- Revenue at Rs 389,770 mn, +5.8% YoY
- Constant Currency revenue growth: +8.4% YoY
- Digital revenue: 33.2% of total, +27.9% YoY
- UK and continental Europe led growth for the quarter at +13.3% YoY and +16% YoY respectively, while India growth was at +7.7% YoY

Margin, PAT and Cash Flow

- Operating Margin, EBIT at 24%; while PAT Margin at 20.6%
- Consolidated PAT at Rs 80,420 mn, +1.8% YoY
- Earnings per Share (EPS) at Rs 21.4, +1.8% YoY
- Net Cash from Operations at Rs 86,860 mn; 108% of PAT

People

- Net addition of 14,097 employees; closing headcount at 450,738
- 322K+ employees trained in digital technologies
- 391K+ employees in Agile methods
- IT Services attrition rate at 11.6% LTM.

Outlook & Valuation

TCS is seeing good traction in digital space despite weakness in BFSI segment. However achieving its aspirational margins of 26-28% will be difficult after its poor Q2 show. 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 2004, TCS is trading at a P/E of 21.5x its FY21E earnings, which is expensive. **Due to limited upside potential and expensive valuation, we maintain our Hold rating on the stock with revised target price of Rs 2144 valuing it at 23x FY21E EPS, giving an upside of 7%.**

Financial Performance

| YE March (Rs Mn) | Net Sales | EBITDA | PAT | EPS (Rs) | EBITDA Margin % | RoE (%) | P/E (x) |
|------------------|-----------|--------|--------|----------|-----------------|---------|---------|
| FY18 | 1231040 | 325160 | 258800 | 67.6 | 26.4 | 30.4 | 29.7 |
| FY19 | 1464630 | 395060 | 315620 | 84.1 | 27.0 | 35.3 | 23.8 |
| FY20E | 1573524 | 416984 | 325197 | 86.6 | 26.5 | 29.6 | 23.1 |
| FY21E | 1723009 | 447982 | 350005 | 93.2 | 26.0 | 24.1 | 21.5 |

Source: Company, Arihant Research

Q2FY20 & H1FY20 Financial Performance

| Rs Mn (Consolidated) | Q2FY20 | Q1FY20 | Q2FY19 | Q-o-Q | Y-o-Y | H1FY20 | H1FY19 | Y-o-Y |
|--------------------------|-----------------|-----------------|-----------------|---------------|----------------|-----------------|-----------------|----------------|
| Net Revenue | 3,89,770 | 3,81,720 | 3,68,540 | 2.1% | 5.8% | 7,71,490 | 7,11,150 | 8.5% |
| Employee Costs | 2,14,700 | 2,08,090 | 1,95,250 | 3.2% | 10.0% | 4,22,790 | 3,80,730 | 11.0% |
| Other Operating Expenses | 72,820 | 73,260 | 70,510 | -0.6% | 3.3% | 1,46,080 | 1,36,930 | 6.7% |
| Depreciation | 8,640 | 8,170 | 5,070 | 5.8% | 70.4% | 16,810 | 10,000 | 68.1% |
| EBIT | 93,610 | 92,200 | 97,710 | 1.5% | -4.2% | 1,85,810 | 1,83,490 | 1.3% |
| EBIT margin % | 24.0% | 24.2% | 26.5% | -14bps | -250bps | 24.1% | 25.8% | -172bps |
| Other Income | 13,610 | 16,750 | 7,300 | -18.7% | 86.4% | 30,360 | 19,550 | 55.3% |
| Finance Costs | 1,930 | 2,570 | 1,370 | -24.9% | 40.9% | 4,500 | 1,540 | 192.2% |
| PBT | 1,05,290 | 1,06,380 | 1,03,640 | -1.0% | 1.6% | 2,11,670 | 2,01,500 | 5.0% |
| Tax Expense | 24,710 | 24,850 | 24,370 | -0.6% | 1.4% | 49,560 | 48,610 | 2.0% |
| Effective Tax Rate % | 23.5% | 23.4% | 23.5% | +11bps | -5bps | 23.4% | 24.1% | -71bps |
| Reported PAT | 80,580 | 81,530 | 79,270 | -1.2% | 1.7% | 1,62,110 | 1,52,890 | 6.0% |
| MI & Associates | -160 | -220 | -260 | | | -380 | -480 | |
| Consolidated PAT | 80,420 | 81,310 | 79,010 | -1.1% | 1.8% | 1,61,730 | 1,52,410 | 6.1% |
| PAT Margin % | 20.6% | 21.3% | 21.4% | -67bps | -81bps | 21.0% | 21.4% | -47bps |
| EPS (Rs) | 21.4 | 21.7 | 21.1 | -1.1% | 1.8% | 43.1 | 40.6 | 6.1% |

Source: Company, Arianth Research

Revision in FY20E estimates, introducing FY21E estimates

| Particulars (Rs Mn) | FY20E | | | FY21E |
|---------------------|------------------|------------------|-------------|--------------|
| | Earlier Estimate | Revised Estimate | % Variation | New Estimate |
| Revenue | 1,573,524 | 1,573,524 | 0.0 | 1,723,009 |
| EBITDA | 440,590 | 416,984 | -5.3 | 447,982 |
| EBITDA Margin (%) | 28.0 | 26.5 | -150 bps | 26.0 |
| PAT | 363,170 | 325,197 | -10.4 | 350,005 |

Post Result Conference Call Highlights

- TCS management believes that 26-28% aspirational EBIT margin is quite achievable despite the fact that Q2FY20 margin was 24% which is 200bps lower than its lower range of aspirational band of 26%.
- Management is hopeful that it can manage its margin profile in subsequent quarters on the back of currency tailwind and operating leverage.
- The weakness in BFSI vertical persisted in Q2FY20 also due to continued pressure in the US banks operating in the capital market industry and overall weakness in European BFSI industry. TCS management maintained its cautious outlook on the BFSI vertical due to the above problem areas. Though insurance continued to witness healthy growth.
- The demand environment continues to remain strong for projects involving digital transformation. Till Q2FY20, TCS has trained 322K+ employees in digital technologies and 391K+ employees in Agile methods.

| Profit and Loss statement | | | | |
|------------------------------|---------------|---------------|---------------|---------------|
| Particulars (Rs Mn) | FY18 | FY19 | FY20E | FY21E |
| Net Revenue | 1231040 | 1464630 | 1573524 | 1723009 |
| Employee costs | 663960 | 782460 | 841836 | 930425 |
| Operation and other expenses | 241920 | 287110 | 314705 | 344602 |
| Total Operating Expenses | 905880 | 1069570 | 1156540 | 1275027 |
| EBIDTA | 325160 | 395060 | 416984 | 447982 |
| EBIDTA Margin | 26.4% | 27.0% | 26.5% | 26.0% |
| Depreciation | 20140 | 20560 | 33988 | 35322 |
| EBIT | 305020 | 374500 | 382996 | 412661 |
| Interest | 520 | 1980 | 7868 | 8615 |
| Other Income | 36420 | 43110 | 47206 | 51690 |
| PBT | 340920 | 415630 | 422334 | 455736 |
| Tax | 82120 | 100010 | 97137 | 105731 |
| PAT | 258800 | 315620 | 325197 | 350005 |
| Growth (%) | -1.8% | 22.0% | 3.0% | 7.6% |
| EPS | 67.6 | 84.1 | 86.6 | 93.2 |

Source: Company, Arianth Research

| Cash Flow Statement | | | | |
|--|----------------|----------------|----------------|----------------|
| Particulars (Rs Mn) | FY18 | FY19 | FY20E | FY21E |
| PAT | 258800 | 315620 | 325197 | 350005 |
| Add:- Depreciation | 20140 | 20560 | 33988 | 35322 |
| Change in Working Capital | 47820 | 55656 | 59794 | 65474 |
| Cash generated from operations | 326760 | 391836 | 418979 | 450801 |
| Taxes paid | -76090 | -100010 | -97137 | -105731 |
| Net cash flow from operating activities | 250670 | 291826 | 321842 | 345071 |
| Purchase of fixed assets | -18620 | -20482 | -22530 | -24783 |
| Others | 47480 | -65860 | 0 | 0 |
| Net cash flow from investing Activities | 28860 | -86342 | -22530 | -24783 |
| Dividend paid, including dividend tax | -107600 | -126248 | -130079 | -140002 |
| Others | -161250 | -160360 | 0 | 0 |
| Net cash flow from financing Activities | -268850 | -286608 | -130079 | -140002 |
| Net Cash Flow | 10680 | 18886 | 266370 | 286016 |
| Opening Cash Balance | 35970 | 48830 | 72240 | 332456 |
| Exchange difference on Forex | 2180 | 4524 | -6154 | 0 |
| Closing Cash Balance | 48830 | 72240 | 332456 | 618472 |

Source: Company, Arianth Research

| Balance Sheet | | | | |
|-------------------------------|----------------|----------------|----------------|----------------|
| Particulars (Rs Mn) | FY18 | FY19 | FY20E | FY21E |
| Shareholder's Funds | | | | |
| Share Capital | 3830 | 3754 | 3754 | 3754 |
| Reserves & Surplus | 847450 | 890710 | 1095818 | 1445823 |
| Net Worth | 851280 | 894464 | 1099572 | 1449577 |
| Minority Interest | 4020 | 4530 | 5030 | 5530 |
| Total Non Current Liabilities | 29380 | 27362 | 26991 | 33992 |
| Total Current Liabilities | 178280 | 220840 | 196219 | 262720 |
| Total Liabilities | 1062960 | 1147196 | 1327812 | 1751819 |
| Net Block | 102160 | 104110 | 157352 | 172301 |
| Capital Work-in-Progress | 15410 | 9630 | 9630 | 9630 |
| Goodwill on consolidation | 17570 | 17000 | 17000 | 17000 |
| Total Non Current Assets | 250720 | 228120 | 250932 | 276025 |
| Cash and bank balance | 48830 | 72240 | 332456 | 618472 |
| Total Current Assets | 812240 | 919080 | 1076876 | 1475791 |
| Total Assets | 1062960 | 1147196 | 1327812 | 1751819 |

Source: Company, Arianth Research

| Key Ratios | | | | |
|-------------------|-------|-------|-------|-------|
| Particulars | FY18 | FY19 | FY20E | FY21E |
| EPS (Rs) | 67.6 | 84.1 | 86.6 | 93.2 |
| Book Value (Rs) | 222 | 238 | 293 | 386 |
| DPS (Rs) | 50 | 50 | 50 | 50 |
| Payout % | 74 | 59 | 58 | 54 |
| Dividend Yield % | 2.5 | 2.5 | 2.5 | 2.5 |
| P/E (x) | 29.7 | 23.8 | 23.1 | 21.5 |
| EBIDTA Margin | 26.4% | 27.0% | 26.5% | 26.0% |
| PBT Margin | 27.7% | 28.4% | 26.8% | 26.5% |
| PAT Margin | 21.0% | 21.5% | 20.7% | 20.3% |
| Debt/Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 |
| Current Ratio (x) | 4.6 | 4.2 | 5.5 | 5.6 |
| ROE | 30.4% | 35.3% | 29.6% | 24.1% |

Source: Company, Arianth Research

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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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