

Supply side competition suppressing margins during industry headwinds

CMP: Rs 2,220

Rating: HOLD

Target Price: Rs 2,331

Stock Info

BSE	532540
NSE	TCS
Bloomberg	TCS IN
Reuters	TCS.BO
Sector	IT
Face Value (Rs)	1
Equity Capital (Rs mn)	3,754
Mkt Cap (Rs mn)	8,380,000
52w H/L (Rs)	1,847 / 2,296
Avg Yearly Vol (in 000')	3,000

Shareholding Pattern %

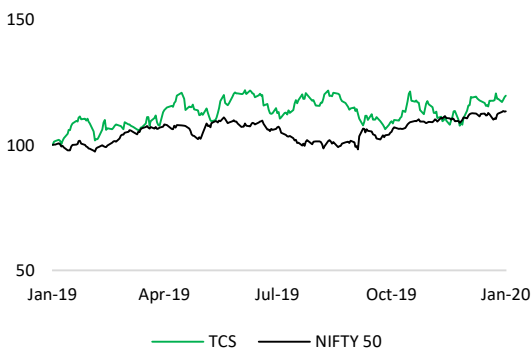
(As on Dec, 2019)

Promoters	72.05
FII	15.52
DII	8.26
Public & Others	4.17

Stock Performance (%)

	3m	6m	12m
TCS	9.4	6.3	19.7
Nifty	7.8	5.9	13.5

TCS Vs Nifty



TCS came out with reasonable set of numbers in Q3FY20, missing our estimates marginally. Consolidated revenue stood at Rs 398,540 mn, just below our estimate of Rs 401,017 mn, registering +6.7% YoY/+2.3% QoQ growth. Consolidated EBIT stood at Rs 99,740 mn, below our estimate of Rs 104,264 mn increasing by +4.3% YoY/+6.5% QoQ. As far as margin is concerned, EBIT margin contracted 59bps YoY to 25% due to higher employee costs and depreciation expenses. Consolidated PAT saw a muted growth of 0.2% YoY to Rs 81,180 mn, below our estimate of Rs 82,209 mn. Factoring the satisfactory results, we maintain our Hold rating on the stock, with a Target Price of Rs 2,331 considering the company's steady state performance despite global headwinds and trade tensions while a buoyant US market will be very helpful when it finds windows for expansion.

Q3FY20 Performance Highlights

Revenue

Revenue at Rs 398,540 mn, +6.7% YoY
Constant Currency revenue growth: +6.8% YoY
Continental Europe led revenue growth increasing by 15.9% YoY

Margin, PAT and Cash Flow

Operating Margin (EBIT) at 25%; while PAT Margin at 20.4%
Consolidated PAT stood at Rs 81,180 mn, +0.2% YoY
Earnings per Share (EPS) at Rs 21.63, +0.2% YoY
Net Cash from Operations at Rs 94,510 mn; 116% of PAT

People

Net addition of 22,390 employees in 9MFY20; headcount at 446,675
327,000 employees trained in digital technologies
404,000 employees in Agile methods

Outlook & Valuation

TCS had good traction in Q3FY20 despite a seasonal weakness in BFSI segment during the quarter. The attrition rates have risen in the quarter to 12.2% in the last 12 months which is still lower than the industry. The company had registered healthy growth in the Life sciences & health care space. While business in other segments had been stable for the quarter. Going forward, we believe TCS can deliver industry-leading growth and have positive view on the stock, however acknowledging the fact that margins will be tepid due to industry wide supply side pressure. At CMP of Rs 2220, TCS is trading at a P/E of 23.8x its FY21E earnings. **We maintain our Hold rating on the stock with revised target price of Rs 2,331 valuing it at 25x FY21E EPS, with an upside of 5%.**

Particulars (Rs mn)	FY18	FY19	FY20E	FY21E
Net Sales	12,31,040	14,64,630	15,73,524	17,23,009
EBITDA	3,25,160	3,95,060	4,16,984	4,47,982
PAT	2,58,800	3,15,620	3,25,197	3,50,005
EPS (per share)	67.6	84.1	86.6	93.2
ROE	30.4%	35.3%	29.6%	24.1%
P/E	32.9	26.4	25.6	23.8

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

Q3 FY20 - Quarterly Performance (Standalone)

(in Rs Mn)

Profit & Loss Statement	Q3FY20	Q2FY20	Q3FY19	Q-o-Q	Y-o-Y	9MFY20	9MFY19	Y-o-Y
Net Revenue	3,98,540	3,89,770	3,73,380	2.3%	6.7%	11,70,030	10,84,530	7.9%
Employee Costs	2,16,220	2,14,700	1,99,940	0.7%	8.1%	6,39,010	5,80,670	10.0%
Other Operating Expenses	73,610	72,820	72,610	1.1%	1.4%	2,19,690	2,09,540	4.8%
Depreciation	8,970	8,640	5,190	3.8%	72.8%	25,780	15,190	69.7%
EBIT	99,740	93,610	95,640	6.5%	4.3%	2,85,550	2,79,130	2.3%
EBIT margin %	25.0%	24.0%	25.6%	101bps	-59bps	24.4%	25.7%	-133bps
Other Income	8,180	13,610	11,630	-39.9%	-29.7%	38,540	31,180	23.6%
Finance Costs	2,230	1,930	160	15.5%	1293.8%	6,730	1,700	295.9%
PBT	1,05,690	1,05,290	1,07,110	0.4%	-1.3%	3,17,360	3,08,610	2.8%
Tax Expense	24,260	24,710	25,900	-1.8%	-6.3%	73,820	74,510	-0.9%
Effective Tax Rate %	23.0%	23.5%	24.2%	-51bps	-123bps	23.3%	24.1%	-88bps
Reported PAT	81,430	80,580	81,210	1.1%	0.3%	2,43,540	2,34,100	4.0%
MI & Associates	-250	-160	-160			-630	-640	
Consolidated PAT	81,180	80,420	81,050	0.9%	0.2%	2,42,910	2,33,460	4.0%
PAT Margin %	20.4%	20.6%	21.7%	-26bps	-134bps	20.8%	21.5%	-77bps
EPS (Rs)	21.6	21.4	21.6	0.9%	0.2%	64.8	62.3	4.0%

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

Q3 FY20 – Key Concall Highlights

- The management mentioned of seasonal weakness in BFSI segment revenues on account of holidays and winters. However, the IT major won USD 1.8 bn of TCV deals in the quarter from BFSI segment only with healthy demand across geographies, specially from continental Europe, Asia-Pacific, Japan and Australia.
- Overall, the company won new contracts worth USD 3.3 bn in the quarter across globe with majority from continental Europe.
- New client additions: The company added 2 clients with USD +100 mn, while total clients worth USD +1 mn stood at 1,053.
- The company has deployed 93% of the 30K freshers hired in H1FY20 on projects while another 39,000 freshers are rolled out offers and expected to join by next year.
- The management removed the metrics on digital and non-digital work since it gets difficult to distinguish between the two.
- The management maintained their aspirations of achieving a 26-28% operating (EBIT) margins.
- The management provided a weak guidance of Q4FY20 with announcement of Rs 5 as interim dividend.

Key Financials

Profit & 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

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

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

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 %	2.3	2.3	2.3	2.3
P/E (x)	32.9	26.4	25.6	23.8
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: 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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