

Tata Consultancy Services (TCS)

Performance highlights

(` cr)	1QFY18	4QFY17	% chg (qoq)	1QFY17	% chg (yoy)
Net revenue	29,584	29,642	(0.2)	29,305	1.0
Adj. EBITDA	7,065	8,147	(13.3)	7,971	(11.4)
Adj. EBITDA margin (%)	25.1	27.5	(243.1)	27.2	(168.9)
Adj. PAT	5,945	6,608	(10.0)	6,317	(5.9)

Source: Company, Angel Research

For 1QFY2018, TCS posted below expectation results on the EBIT and net profit fronts. The company posted 3.1% sequential growth in USD revenues to US\$4,591mn v/s. US\$4,585mn expected, mostly volume lead (3.5% qoq growth). On Constant Currency terms, the company posted a 2.0% qoq growth. On profitability, the EBIT margins came in at 23.4% v/s. 24.2% expected, posting a qoq dip of 236bps. Impact of wage hikes and visa expenses, apart from rupee appreciation were the major drags on profitability. Consequently, PAT came in at `5,945cr v/s. `6,275cr expected, de-growth of 10.0% qoq.

We maintain our Accumulate rating with a target price of `2,651.

Quarterly highlights: Company posted 3.1% sequential growth in USD revenues to US\$4,591mn v/s. US\$4,585mn expected, mostly volume lead (3.5% qoq growth). On Constant Currency terms, the company posted a 2.0% qoq growth. In terms of geography, Latin America and Continental Europe posted a qoq growth of 2.8% and 5.9% respectively. Its key market USA posted a qoq growth of 1.7%. India and Asia Pacific posted a qoq growth of 1.5% and 1.2% respectively. On profitability, the EBIT margins came in at 23.4% v/s. 24.2% expected, posting a qoq dip of 236bps. Impact of wage hikes and visa expenses, apart from rupee appreciation were the major drags on profitability. Consequently, PAT came in at `5,945 v/s. `6,275cr expected, de-growth of 10.0% qoq. On operational front, the LTM attrition was at 11.6% in IT Services.

Outlook and valuation: The Company has been cautiously optimistic regarding its outlook for FY2018, with key verticals like BFSI and Hi-Tech expected to post a recovery. Also, on the EBIT front the company is confident of managing the EBIT margins in the range of 26-28%. We expect TCS to post revenue CAGR of 8.5% in USD as well as INR terms over FY2017-19E. **Hence, maintain our Accumulate recommendation.**

Key financials (Consolidated, IFRS)

Y/E March (` cr)	FY2016	FY2017	FY2018E	FY2019E
Net sales	1,08,646	1,17,966	1,27,403	1,38,870
% chg	14.8	8.6	8.0	9.0
Net profit	24,215	26,289	28,272	30,524
% chg	11.6	8.6	7.5	8.0
EBITDA margin (%)	28.3	27.5	27.6	27.6
EPS (`)	123.7	134.3	144.5	156.0
P/E (x)	19.4	17.9	16.6	15.4
P/BV (x)	6.4	5.3	4.9	4.6
RoE (%)	33.1	29.8	29.7	29.8
RoCE (%)	31.6	28.8	28.9	29.2
EV/Sales (x)	4.0	3.6	3.3	3.0
EV/EBITDA (x)	14.3	13.0	12.1	10.9

Source: Company, Angel Research; Note: CMP as of July 14, 2017

ACCUMULATE

CMP	₹2,399
Target Price	₹2,651

Investment Period 12 Months

Stock Info

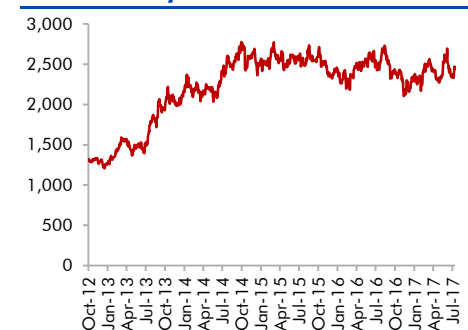
Sector	IT
Market Cap (₹ cr)	4,58,606
Net Debt (₹ cr)	-45,288
Beta	0.6
52 Week High / Low	2,834/2,055
Avg. Daily Volume	1,10,516
Face Value (₹)	1
BSE Sensex	32,021
Nifty	9,886
Reuters Code	TCS.BO
Bloomberg Code	TCS@IN

Shareholding Pattern (%)

Promoters	73.6
MF / Banks / Indian Fls	5.5
FII / NRIs / OCBs	17.0
Indian Public / Others	4.0

Abs.(%)	3m	1yr	3yr
Sensex	28.0	14.6	29.0
TCS	(1.1)	(4.8)	4.1

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 1QFY2018 performance (Consolidated, IFRS)

(` cr)	1QFY2018	4QFY2017	% chg (qoq)	1QFY2017	% chg (yoy)	FY2017	FY2016	% chg(yoy)
Net revenue	29,584	29,642	(0.2)	29,305	1.0	1,17,966	1,08,646	8.6
Cost of revenue	16,792	16,153	4.0	16,312	2.9	65,402	59,459	10.0
Gross profit	12,792	13,489	(5.2)	12,993	(1.5)	52,564	49,187	6.9
SG&A expense	5,379	5,342	0.7	5,156	4.3	20,755	18,956	9.5
EBITDA	7,413	8,147	(9.0)	7,837	(5.4)	31,809	30,231	5.2
Dep. and amortisation	499	520	(4.0)	490	1.8	1,485	1,441	3.1
EBIT	6,914	7,627	(9.3)	7,347	(5.9)	30,324	28,790	5.3
Other income	932	989	(5.8)	963	(3.2)	4,189	3,050	37.3
PBT	7,846	8,616	(8.9)	8,310	(5.6)	34,513	31,840	8.4
Income tax	1,896	1,994	(4.9)	1,992	(4.8)	8,156	7,503	8.7
PAT	5,950	6,622	(10.1)	6,318	(5.8)	26,357	24,337	8.3
Earnings in affiliates	-	-	-	-	-	-	-	-
Minority interest	5	14	-	1	-	68	123	-
Reported PAT	5,945	6,608	(10.0)	6,317	(5.9)	26,289	24,215	8.6
Adj. PAT	5,945	6,608	(10.0)	6,317	(5.9)	26,289	24,215	8.6
EPS	30.4	33.7	(10.0)	32.3	(5.9)	133.4	123.2	8.3
Gross margin (%)	43.2	45.5	(227)bp	44.3	(110)bp	44.6	45.3	(71)bp
EBITDA margin (%)	25.1	27.5	(243)bp	26.7	(169)bp	27.0	27.8	(86)bp
EBIT margin (%)	23.4	25.7	(236)bp	25.1	(170)bp	25.7	26.5	(79)bp

Source: Company, Angel Research

Exhibit 2: Actual v/s Angel estimates

(` cr)	Actual	Estimate	Var. (%)
Net revenue	29,584	29,600	(0.1)
EBIT margin (%)	23.4	24.2	(88)bps
Adj. PAT	5,945	6,275	(5.3)

Source: Company, Angel Research

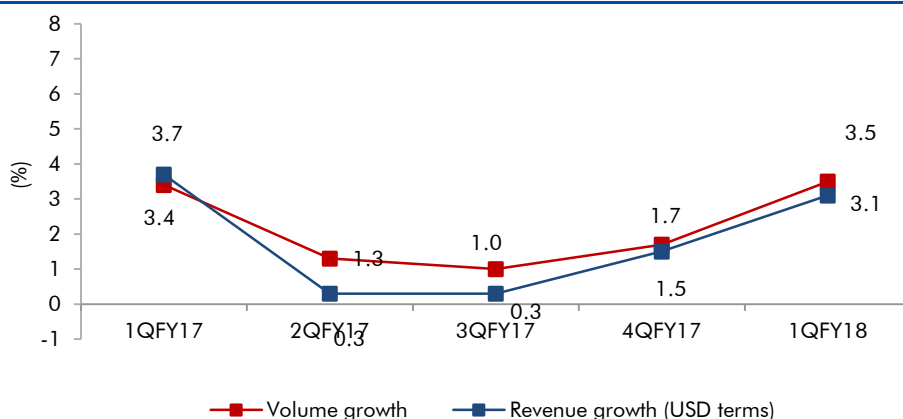
Numbers just in-line with expectations

TCS' results were below expectations on the EBIT and net profit fronts. The company posted 3.1% sequential growth in USD revenues to US\$4,591mn v/s. US\$4,585mn expected, mostly volume lead (3.5% qoq growth). On Constant Currency terms, the company posted a 2.0% qoq growth. In Rupee terms, revenues are expected to come in at `29,548cr v/s. `29,600cr expected, down 0.2% qoq.

In terms of verticals, on CC basis, the growth registered by the company in respective segments was, BFSI (2.3% qoq), Retail & CPG (2.0% qoq), Communication & Media (3.9% qoq), Manufacturing (3.8% qoq), Life Sciences & Healthcare (4.7% qoq), Hi-Tech (3.7% qoq), Energy Utilities (7.6% qoq), Travel & Hospitality (7.0% qoq).

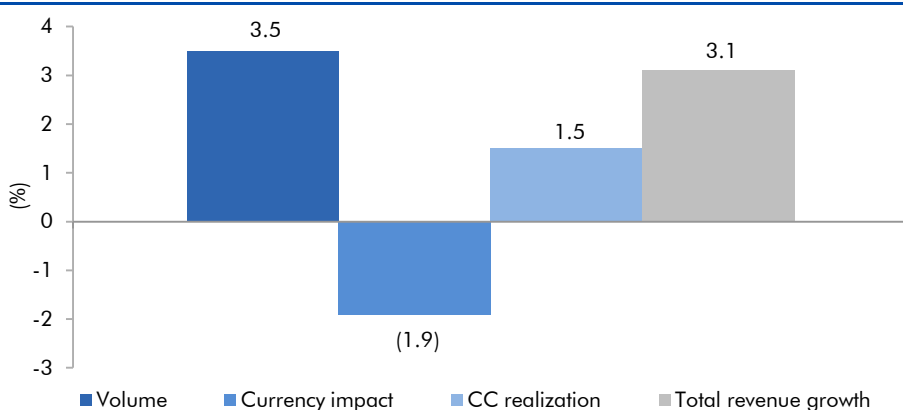
In terms of geography, on CC basis, qoq growth was North America (1.7% qoq), Latin America (2.8% qoq), UK (0.7% qoq), Continental Europe (5.9% qoq), India (1.5% qoq), Asia Pacific (1.2% qoq), MEA (0.7% qoq).

Exhibit 3: Trend in volume and revenue growth (qoq)



Source: Company, Angel Research

Exhibit 4: Revenue drivers for 1QFY2018



Source: Company, Angel Research

In Communication, weakness was seen in UK, Europe and Asia Pacific, while in Healthcare, US slowed down. However, both these factors are one-offs. Revenue from Digital grew by 7.6% qoq, and it now constitutes to 17.9% of total revenue.

Exhibit 5: Revenue growth (Industry wise on CC basis)

	% to revenue	% chg (CC qoq)	% chg (yoy)
BFSI	32.9	2.3	5.1
Manufacturing	7.5	3.8	10.2
Communication & Media	7.3	3.9	11.6
Life sciences and healthcare	7.1	4.7	10.7
Retail and CPG	12.2	2.0	(3.4)
Transportation & Hospitality	3.5	3.7	16.5
Energy and utilities	4.0	4.0	20.3
Technology & Services	7.9	3.7	8.2
Regional Markets & Others	17.6	(3.6)	5.5

Source: Company, Angel Research

Geography wise growth in INR sales in key geographies was as follows: USA (1.7% qoq on CC basis), Latin America (2.8% qoq on CC basis), UK (0.7% qoq on CC basis), India (1.5% qoq on CC basis), and MEA (0.7% qoq on CC basis). However, Continental Europe and Asia Pacific posted growth of 5.9% qoq and 1.2% qoq on CC basis respectively.

Exhibit 6: Revenue growth (Geography wise in INR terms)

	% of revenue	% chg (CC qoq)	% chg (yoy)
U.S.	52.5	1.7	3.5
Latin America	2.1	2.8	8.0
U.K.	13.9	0.7	6.3
Continental Europe	12.5	5.9	16.5
India	7.0	1.5	13.3
Asia Pacific	9.5	1.2	4.7
MEA	2.5	0.7	8.9

Source: Company, Angel Research

Attrition rate appreciates

In 1QFY2018, TCS witnessed a gross addition of 11,202 employees and net addition of (1,414) employees, taking its total employee base to 3,85,809. During the quarter, the attrition rate (last twelve month [LTM] basis) for the company increased to 12.5% from 11.5% in 4QFY2017.

Exhibit 7: Hiring and attrition trend

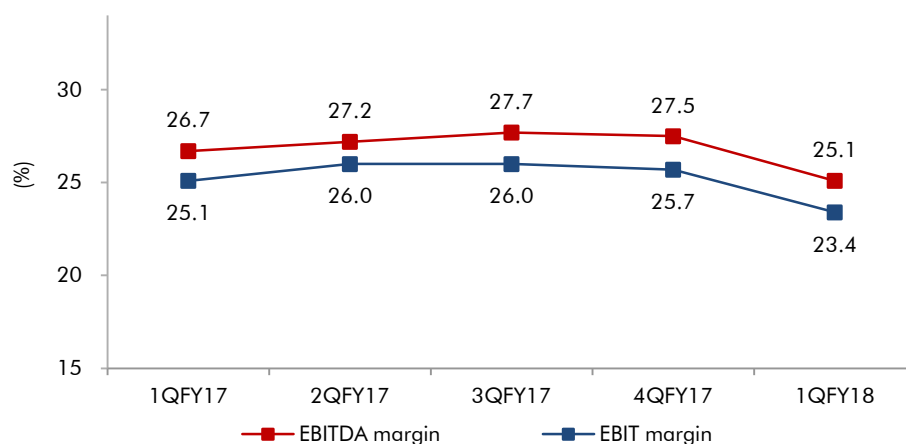
Particulars	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Gross addition	17,792	22,665	18,362	20,093	11,202
Net addition	8,236	9,440	6,978	8,726	(1,414)
Total employee base	3,62,079	3,71,519	3,78,497	3,87,223	3,85,809
Attrition (%) - LTM basis	13.6	12.9	12.2	11.5	12.4

Source: Company, Angel Research

Margin dips

On the operating front, the company reported EBITDA and EBIT margins at 25.1% and 23.4%, i.e. a contraction of 243bps and 236bps qoq respectively. The break up across cost items is – Employee costs (200bps), Rent expenses (30bps) and Visas and consultants (30bps). However, for FY2018, the company has guided the EBIT margins to be in the range of 26-28%.

Exhibit 8: Adj. Margin profile



Source: Company, Angel Research

Client metrics

The client pyramid during the quarter witnessed a qualitative improvement with client additions seen in the higher revenue brackets. The clients in US\$100mn+ revenue band increased by 1 and in US\$10mn+ revenue band increased by 12. TCS won four large deals in BFSI in 1QFY2018, but cited that the pipeline remains short. The pipeline for Insurance is strong, which can result in a stronger 2HFY2018.

Exhibit 9: Client pyramid

	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
US\$1mn–5mn	408	410	426	438	441
US\$5mn–10mn	141	154	154	149	142
US\$10mn–20mn	119	110	114	120	132
US\$20mn–50mn	102	107	106	106	105
US\$50mn–100mn	40	42	46	49	49
US\$100mn plus	37	36	34	35	36

Source: Company, Angel Research

Investment Argument

Guidance – Cautious optimism: The management refrained from giving any guidance for FY2018, however it expects a bounce back of the key verticals like BFSI, Communications and Hi-Tech. Digital also continues to see a good traction. On EBIT front, the company expects to manage its margins in 26-28% range. We expect the company to post a US\$ revenue CAGR of 8.5% over FY2017-19E.

Management Reggie: With Mr. Natarajan Chandrasekaran being the Chairman of Tata Sons since February 21, 2017, CFO Mr. Rajesh Gopinathan has taken charge as the CEO of the company. He started his professional career with TCS in 2001 and was appointed as the CFO in February 2013. TCS also announced N G Subramanian as the COO of the company. Thus, the new targets under the new CEO will have a bearing on the performance of the company.

Growth fundamentals intact: Despite the near term uncertainty arising out of Brexit and new macro dynamics in US, TCS remains optimistic to make a comeback after current cyclical headwinds are behind. Long term drivers of tech spending will remain intact and new growth areas are emerging. Strength in Digital bounced back after seeing some weakness in 2QFY2017. Revenue from Digital grew by 7.6% qoq and it now constitutes to 17.9% of total revenue. Thus, the company has invested well to reap the benefits over long term.

Outlook and valuation

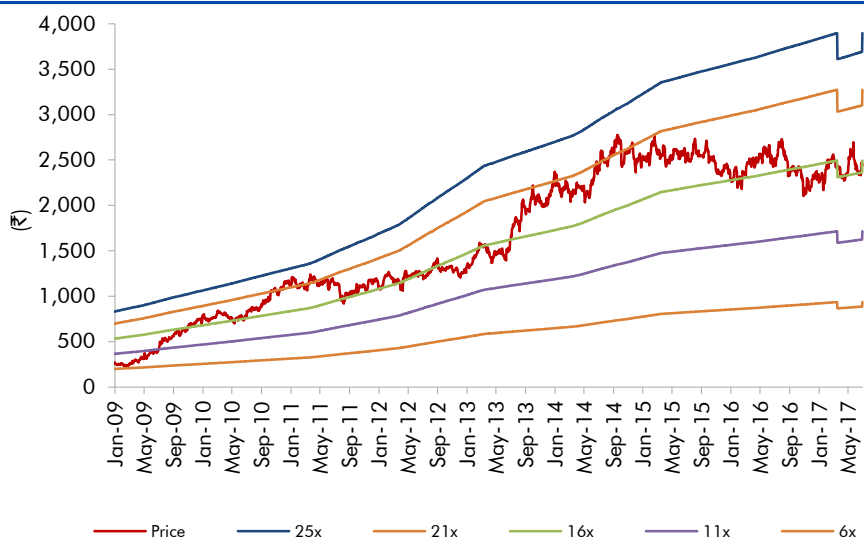
Over FY2017-19E, we expect TCS to post revenue CAGR of 8.5% in USD and INR terms. The company highlighted that it stands comfortable of sustaining the EBIT margin in the range of 26-28%. On the EBIT and PAT fronts, we expect the company to post 8.7% and 7.8% CAGR over FY2017-19E respectively. The stock is trading at 15.4x FY2019E EPS of ₹156. **We maintain our Accumulate recommendation.**

Exhibit 10: Key assumptions

	FY2018E	FY2019E
Revenue growth (USD)	8.0	9.0
USD-INR rate (realized)	67.1	67.1
Revenue growth (₹)	8.0	9.0
EBITDA margin (%)	27.6	27.6
Tax rate (%)	23.5	23.5
EPS growth (%)	7.5	8.0

Source: Company, Angel Research

Exhibit 11: One-year forward PE chart



Source: Company, Angel Research

Exhibit 12: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	Upside (%)	FY2019E EBITDA (%)	FY2019E P/E (x)	FY2017-19E EPS CAGR (%)	FY2019E EV/Sales (x)	FY2019E RoE (%)
HCL Tech	Buy	851	1,014	19.1	20.9	12.6	6.2	1.8	20.6
Infosys	Buy	972	1,179	21.3	26.0	14.0	5.3	2.2	19.6
TCS	Accumulate	2,399	2,651	10.5	27.6	15.4	7.8	3.0	29.8
Tech Mahindra	Buy	388	533	37.5	15.0	10.2	8.6	1.0	16.3
Wipro	Accumulate	260	280	7.9	20.3	13.6	4.4	1.2	13.4

Source: Company, Angel Research

Company background

TCS is Asia's largest IT services provider and is amongst the top 10 technology firms in the world. The company has a global footprint with an employee base of over 3lakh professionals, offering services to more than 1,000 clients across various industry segments. The company has one of the widest portfolios of service offerings, spanning across the entire IT service value chain – from traditional application development and maintenance to consulting and package implementation to products and platforms.

Profit & Loss statement (Consolidated, IFRS)

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Net sales	94,648	1,08,646	1,17,966	1,27,403	1,38,870
Cost of revenue	50,599	58,952	64,764	68,798	74,990
Gross profit	44,049	49,695	53,202	58,606	63,880
% of net sales	46.5	45.7	45.1	46.0	46.0
SGA expenses	17,353	18,956	20,755	23,442	25,552
% of net sales	18.3	17.4	17.6	18.4	18.4
EBITDA	26,696	30,738	32,447	35,163	38,328
% of net sales	28.2	28.3	27.5	27.6	27.6
Dep. and amortization	1272	1948	2123	2293	2500
% of net sales	1.3	1.8	1.8	1.8	1.8
EBIT	25,424	28,790	30,324	32,870	35,828
% of net sales	26.9	26.5	25.7	25.8	25.8
Other income, net	3140	3050	4189	4189	4189
Profit before tax	28,564	31,840	34,513	37,059	40,017
Provision for tax	6,083	7,503	8,156	8,709	9,404
% of PBT	21.3	23.6	23.6	23.5	23.5
PAT	22,481	24,338	26,357	28,350	30,613
Minority interest	205	123	68	78	89
Extra-ordinary (Exp.)/ Inc.	-2627.9				
Reported PAT	19,648	24,215	26,289	28,272	30,524
Adj. PAT	21,696	24,215	26,289	28,272	30,524
Diluted EPS (₹)	110.9	123.7	134.3	144.5	156.0

Balance sheet (Consolidated, IFRS)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Assets					
Cash and cash equivalents	1,862	1,862	3,597.0	4,500.0	5,000.0
Other current financial assets	16,383	4,833	-	-	-
Accounts receivable	20,440	24,073	22,684	31,694	31,695
Unbilled revenues	3,827	3,992	5,351	5,348	5,349
Other current assets	6,414	5,975	7,258	7,258	7,258
Property and equipment	11,572	11,790	11,741	12,741	13,741
Intangible assets and goodwill	3,931	3,946	3,768	3,768	3,768
Investments	9,619	22,822	41,980	39,267	46,761
Other non current assets	906	11,919	8,974	8,974	8,974
Total assets	74,954	91,212	1,05,353	1,13,550	1,22,545
Liabilities					
Current liabilities	14,428	15,407	14,294	15,288	16,664
Short term borrowings	243	162	218	218	218
Redeemable preference shares	-	(0)	-	1	2
Long term debt	114	83	71	71	71
Other non current liabilities	1,778	2,017	2,089	2,442	2,662
Minority interest	914	354	366	444	533
Shareholders funds	57,477	73,190	88,315	95,086	1,02,397
Total liabilities	74,954	91,212	1,05,353	1,13,550	1,22,545

Cash flow statement (Consolidated, IFRS)

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Pre-tax profit from oper.	22,481	24,338	26,357	28,350	30,613
Depreciation	1,272	1,948	2,123	2,293	2,500
Exp. (deferred)/written off	160	174	-	-	-
Pre tax cash from oper	23,913	26,460	28,480	30,643	33,113
Other inc./prior period ad	1,272	1,948	2,123	2,293	2,500
Net cash from operations	25,185	28,408	30,604	32,937	35,613
Tax	6,083	7,503	8,156	8,709	9,404
Cash profits	19,102	20,905	22,448	24,228	26,209
(Inc)/dec in acc. recv.	(2,210)	(3,633)	1,389	(9,010)	(1)
(Inc)/dec in unbilled rev.	179	(165)	(1,359)	3	(1)
(Inc)/dec in oth. current asst.	(6,414)	439	(1,283)	-	-
Inc/(dec) in current liab.	(1,207)	(218)	49	(1,000)	(1,000)
Net trade working capital	(9,652)	(3,577)	(1,204)	(10,007)	(1,002)
Cash flow from oper. actv.	9,450	17,328	21,243	14,221	25,207
(Inc)/dec in fixed assets	(1,207)	(218)	49	(1,000)	(1,000)
(Inc)/dec in investments	(4,446)	(1,653)	(14,325)	2,713	(7,494)
(Inc)/dec in intangible asst.	(226)	16	(178)	-	-
(Inc)/dec in non-cur.asst.	(906)	(11,013)	2,945	-	-
Cash flow from invt. actv.	(6,786)	(12,869)	(11,509)	1,713	(8,494)
Inc/(dec) in debt	61	(113)	44	-	-
Inc/(dec) in equity	223	(559)	12	78	89
Inc/(dec) in minority int.	(19,923)	(18,415)	(19,993)	(21,501)	(23,213)
Dividends	16,976	14,629	10,202	5,489	6,411
Cash flow from finan. actv.	(2,664)	(4,459)	(9,735)	(15,934)	(16,713)
Cash generated/(utilized)	393	-	1,735	903	500
Cash at start of the year	1,469	1,862	1,862	3,597	4,500
Cash at end of the year	1,862	1,862	3,597	4,500	5,000

Key ratios

Y/E March	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation ratio(x)					
P/E (on FDEPS)	21.6	19.4	17.9	16.6	15.4
P/CEPS	22.5	18.0	16.5	15.4	14.2
P/BVPS	8.2	6.4	5.3	4.9	4.6
Dividend yield (%)	1.8	1.7	1.8	2.0	2.1
EV/Sales	4.6	4.0	3.6	3.3	3.0
EV/EBITDA	16.5	14.3	13.0	12.1	10.9
EV/Total assets	5.9	4.8	4.0	3.7	3.4
Per share data (₹)					
EPS	110.9	123.7	134.3	144.5	156.0
Cash EPS	106.8	133.6	145.1	156.0	168.6
Dividend	43.5	40.2	43.6	46.9	50.6
Book value	294	374	451	486	523
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.8	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.1	1.1	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.3	0.3	0.3	0.3	0.3
Asset turnover ratio (Sales/Assets)	1.3	1.2	1.1	1.1	1.1
Leverage ratio (Assets/Equity)	1.3	1.2	1.2	1.2	1.2
Operating ROE	39.1	33.3	29.8	29.8	29.9
Return ratios (%)					
RoCE (pre-tax)	33.9	31.6	28.8	28.9	29.2
Angel RoIC	54.0	46.7	50.7	47.1	50.6
RoE	34.2	33.1	29.8	29.7	29.8
Turnover ratios(x)					
Asset turnover (fixed assets)	8.2	9.2	10.0	10.0	10.1
Receivables days	79	81	70	91	83

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	TCS
1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)