

## Tata Consultancy Services (TCS)

### Performance highlights

(` cr)	2QFY19	1QFY19	% chg (QoQ)	2QFY18	% chg (yoy)
<b>Net revenue</b>	<b>36,854</b>	<b>34,261</b>	<b>7.6</b>	<b>30,541</b>	<b>20.7</b>
Adj. EBITDA	7,065	8,976	(21.3)	8,307	(14.9)
Adj. EBITDA margin (%)	28.1	26.2		27.2	
<b>Adj. PAT</b>	<b>7,901</b>	<b>7,340</b>	<b>7.6</b>	<b>6,446</b>	<b>22.6</b>

Source: Company, Angel Research

TCS posted a 3.2% sequential growth in USD revenues to US\$5,215mn v/s US\$5,051mn in 1QFY2019. In rupee terms, revenues came in at `36,854cr V/s `34,261cr, up 7.6% QoQ. In Constant Currency (CC) terms, the company posted a 3.7% QoQ growth. On profitability front, EBIT margin showed an upside of ~148bps QoQ to 26.5%. Consequently, PAT came in at 7,901cr v/s `7,340cr expected, up of 7.6% QoQ.

**We recommend a reduce rating on the stock.**

**Quarterly highlights:** TCS posted a 3.2% sequential growth in USD revenues to US\$5,215mn v/s US\$5,051mn in 1QFY2019. In Constant Currency (CC) terms, the company posted a 3.7% QoQ growth. Geography wise, the growth was broadly well spread. In terms of verticals, Life Sciences & Healthcare posted 5.7% a QoQ CC growth, Retail & CPG & BSFI came in next registering a QoQ CC growth of 3.4% and 3.5% respectively. Other verticals like Energy & Utility & communication posted no growth QoQ on CC terms. On profitability front, EBIT margin showed an upside of ~148bps QoQ to 26.5%. Consequently, PAT came in at 7,901cr V/s `7,340cr expected, up 7.6% QoQ.

**Outlook and valuation:** Management expects to maintain a double-digit yoy growth trajectory over the next two quarters and hopes to exit 4QFY2019 at a better run-rate than 4QY2018. We maintain our 9.7% USD revenue CAGR in FY2018-20E. The stock is trading at 21.3x FY2020E EPS of `89.9. **Valuations already discount a robust medium growth & favorable operating environment and valuations are higher than its P/E averages. However, given the good cash yield we recommend a Reduce.**

### Key financials (Consolidated, IFRS)

Y/E March (` cr)	FY2017	FY2018	FY2019E	FY2020E
<b>Net sales</b>	<b>117,966</b>	<b>123,104</b>	<b>148,455</b>	<b>162,558</b>
% chg	8.6	4.4	20.6	9.5
<b>Net profit</b>	<b>26,289</b>	<b>25,826</b>	<b>31,851</b>	<b>34,370</b>
% chg	8.6	(1.8)	23.3	7.9
EBITDA margin (%)	27.5	26.6	27.6	27.4
<b>EPS (`)</b>	<b>68.7</b>	<b>67.5</b>	<b>83.3</b>	<b>89.9</b>
P/E (x)	27.9	28.4	23.0	21.3
P/BV (x)	8.3	8.4	7.3	6.4
RoE (%)	29.8	29.5	31.6	29.9
RoCE (%)	28.8	28.0	31.2	29.9
EV/Sales (x)	5.7	5.5	4.5	4.0
EV/EBITDA (x)	20.8	20.6	16.1	14.5

Source: Company, Angel Research; Note: CMP as of October 12, 2018

## REDUCE

CMP `1,918

Target Price `1,800

**Investment Period 12 Months**

### Stock Info

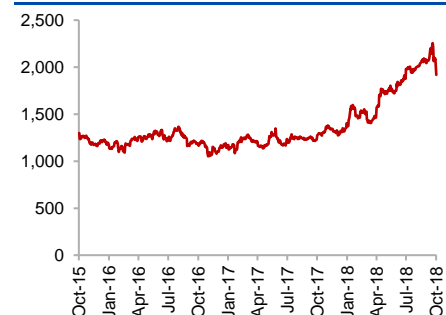
Sector	IT
Market Cap (` cr)	719,858
Net Debt (` cr)	(45,288)
Beta	0.3
52 Week High / Low	2,273/1,214
Avg. Daily Volume	79,800
Face Value (`)	1
BSE Sensex	34,734
Nifty	10,473
Reuters Code	TCS.BO
Bloomberg Code	TCS@IN

### Shareholding Pattern (%)

Promoters	72.1
MF / Banks / Indian FIs	7.5
FII / NRIs / OCBs	16.1
Indian Public / Others	4.4

Abs. (%)	3m	1yr	3yr
Sensex	(5.0)	7.9	29.1
TCS	(2.7)	50.5	48.0

### 3-Year Daily Price Chart



Source: Company, Angel Research

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**Exhibit 1: 2QFY2019 performance (Consolidated, IFRS)**

(` cr)	2QFY2019	1QFY2019	% chg (QoQ)	2QFY2018	% chg (yoy)	1HFY2019	1HFY2018	% chg(yoy)
<b>Net revenue</b>	<b>36,854</b>	<b>34,261</b>	<b>7.6</b>	<b>30,541</b>	<b>20.7</b>	<b>71,115</b>	<b>60,125</b>	<b>18.3</b>
Cost of revenue	20,607	19,685	4.7	17,218	19.7	40,292	32,755	23.0
Gross profit	16,247	14,576	11.5	13,323	21.9	30,823	27,370	12.6
SG&A expense	5,883	5,600	5.1	5,270	11.6	11,483	11,793	(2.6)
<b>EBITDA</b>	<b>10,364</b>	<b>8,976</b>	<b>15.5</b>	<b>8,053</b>	<b>28.7</b>	<b>19,340</b>	<b>15,577</b>	<b>24.2</b>
Dep. and Amortization	593	398	49.0	393	50.9	991	1,003	(1.2)
EBIT	9,771	8,578	13.9	7,660	27.6	18,349	14,574	25.9
Other income	593	1,208	(50.9)	812	(27.0)	1,801	1,744	3.3
PBT	10,364	9,786	5.9	8,472	22.3	20,150	16,318	23.5
Income tax	2,437	2,424	0.5	2,012	21.1	4,861	3,908	24.4
<b>PAT</b>	<b>7,927</b>	<b>7,362</b>	<b>7.7</b>	<b>6,460</b>	<b>22.7</b>	<b>15,289</b>	<b>12,410</b>	<b>23.2</b>
Earnings in affiliates	-	-	-	-	-	-	-	-
Minority interest	26	22	-	14	-	-	-	-
<b>Reported PAT</b>	<b>7,901</b>	<b>7,340</b>	<b>7.6</b>	<b>6,446</b>	<b>22.6</b>	<b>15,289</b>	<b>12,410</b>	<b>23.2</b>
<b>Adj. PAT</b>	<b>7,901</b>	<b>7,340</b>	<b>7.6</b>	<b>6,446</b>	<b>22.6</b>	<b>15,289</b>	<b>12,410</b>	<b>23.2</b>
<b>EPS</b>	<b>20.7</b>	<b>19.2</b>	<b>7.8</b>	<b>16.8</b>	<b>22.7</b>	<b>40.0</b>	<b>32.4</b>	<b>23.2</b>
Gross margin (%)	44.1	42.5	154bp	43.6	46bp	43.3	45.5	(218)bp
EBITDA margin (%)	28.1	26.2	192bp	26.4	175bp	27.2	25.9	129bp
EBIT margin (%)	26.5	25.0	148bp	25.1	143bp	25.8	24.2	156bp

Source: Company, Angel Research

### Key geographies & verticals doing well

TCS posted a 3.2% sequential growth in USD revenues to US\$5,215mn v/s US\$5,051mn in 1QFY2019. In Constant Currency (CC) terms, the company posted a 3.7% QoQ growth.

Geography wise, the growth was broadly well spread. USA - North America & Latin America registered a QoQ CC growth of 2.6% and 7.1% respectively. In Europe- UK & Continental Europe registered a QoQ CC growth of 6.0% and 4.1% respectively. India & Asia Pacific registered a QoQ CC growth of 5.0% and 4.5% respectively.

In terms of verticals, Life Sciences & Healthcare posted 5.7% a QoQ CC growth, Retail & CPG & BSFI came in next registering a QoQ CC growth of 3.4% and 3.5% respectively. Other verticals like Energy & Utility & communication posted no growth QoQ on CC terms. Manufacturing posted a decent QoQ Cc growth of 1.6%, while Technology services posted a QoQ Cc growth of 2.3%. Growth in Digital was 16.5% QoQ in CC terms and it now constitutes to 28.1% of total revenue. On a YoY basis, Digital revenue grew by 59.8% in CC terms.

**Exhibit 2: Revenue growth (Industry wise on CC basis)**

	% to revenue	% chg (CC QoQ)	% chg (yoy)
BFSI	31.2	3.5	6.1
Manufacturing	7.2	1.6	6.9
Communication & Media	6.9	0.0	8.0
Life sciences and healthcare	7.5	5.7	14.7
Retail and CPG	16.6	3.4	15.6
Energy and utilities	4.6	0.0	22.2
Technology & Services	7.6	2.3	5.8
Regional Markets & Others	18.4	7.3	19.8

Source: Company, Angel Research

**Exhibit 3: Revenue growth (Geography wise in INR terms)**

	% of revenue	% chg (CC QoQ)	% chg (yoy)
U.S.	51.1	2.6	8.1
Latin America	2.0	7.1	6.8
U.K.	15.6	6.0	22.8
Continental Europe	14.0	4.1	17.4
India	5.6	5.0	7.4
Asia Pacific	9.6	4.5	12.5
MEA	2.1	0.3	(4.4)

Source: Company, Angel Research

**Attrition rate dips**

In 2QFY2019, TCS witnessed a gross addition of 12,534 employees and net addition of 5,877 employees, taking its total employee base to 4,11,102. During the quarter, the attrition rate (last twelve-month [LTM] basis) for the company decreased to 10.9% from 11.7% in 1QFY2019.

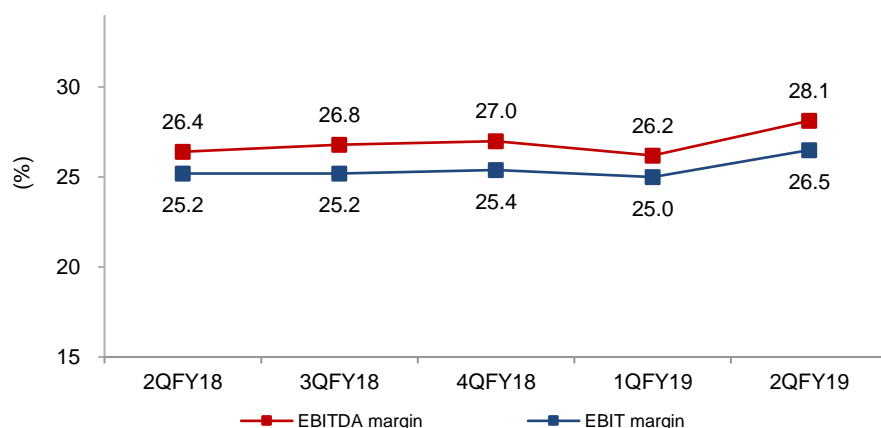
**Exhibit 4: Hiring & attrition trend**

Particulars	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
Gross addition	15,868	12,534	11,202	15,868	12,534
Net addition	(1,414)	3,404	1,667	4,118	5,877
<b>Total employee base</b>	<b>3,89,213</b>	<b>3,90,880</b>	<b>3,94,998</b>	<b>4,00,875</b>	<b>4,11,102</b>
Attrition (%) - LTM basis	12.1	11.9	11.8	11.7	10.9

Source: Company, Angel Research

**Margin expands; mainly driven by exchange gains**

On the operating front, the company reported EBITDA and EBIT margins at 28.1% and 26.5%, i.e. an expansion of 192ps and 148bps QoQ respectively. A major part of the expansion was exchange gains (120bps), operational efficiency (30bps). The company has maintained an EBIT margin target of 26-28%.

**Exhibit 5: 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\$20mn+ revenue band increased by 6 and in US\$100mn+ revenue band increased by 4.

**Exhibit 6: Client pyramid**

	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19
US\$1mn–5mn	463	456	468	470	476
US\$5mn–10mn	142	148	145	153	148
US\$10mn–20mn	132	134	143	149	152
US\$20mn–50mn	105	109	110	109	115
US\$50mn–100mn	54	57	59	57	54
US\$100mn plus	37	37	38	40	44

Source: Company, Angel Research

## Outlook & Valuations

Management expects to maintain a double-digit yoy growth trajectory over the next two quarters and hopes to exit 4QFY2019 at a better run-rate than 4QY2018. We maintain our 9.7% USD revenue CAGR in FY2018-20E. Over FY2018-20E, we expect TCS to post revenue CAGR of 9.7% & 14.9% in USD & INR terms respectively. The company highlighted that it stands comfortable in sustaining the EBIT margin in the range of 26-28%. On the EBIT and PAT fronts, we expect the company to post 17.7% and 15.4% CAGR over FY2018-20E respectively. The stock is trading at 21.3x FY2020E EPS of `89.9. **Valuations already discount a robust medium growth and favorable operating environment and is at slight premium to its long-term P/E averages. However, given the cash yield we recommend a reduce.**

**Exhibit 7: Key assumptions**

	<b>FY2019E</b>	<b>FY2020E</b>
Revenue growth (USD)	10.0	9.5
USD-INR rate (realized)	70.7	70.7
Revenue growth (%)	20.6	9.5
EBITDA margin (%)	27.6	27.4
Tax rate (%)	25.0	25.0
EPS growth (%)	23.3	7.9

*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 4lakh 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)	FY2016	FY2017	FY2018	FY2019E	FY2020E
<b>Net sales</b>	<b>108,646</b>	<b>117,966</b>	<b>123,104</b>	<b>148,455</b>	<b>162,558</b>
Cost of revenue	58,952	64,764	69,072	82,986	90,870
<b>Gross profit</b>	<b>49,695</b>	<b>53,202</b>	<b>54,032</b>	<b>65,469</b>	<b>71,688</b>
% of net sales	45.7	45.1	43.9	44.1	44.1
SGA expenses	18,956	20,755	21,314	24,495	27,147
% of net sales	17.4	17.6	17.3	16.5	16.7
<b>EBITDA</b>	<b>30,738</b>	<b>32,447</b>	<b>32,718</b>	<b>40,974</b>	<b>44,541</b>
% of net sales	28.3	27.5	26.6	27.6	27.4
Dep. and amortization	1948	2123	2216	2078	2276
% of net sales	1.8	1.8	1.8	1.4	1.4
<b>EBIT</b>	<b>28,790</b>	<b>30,324</b>	<b>30,502</b>	<b>38,895</b>	<b>42,265</b>
% of net sales	26.5	25.7	24.8	26.2	26.0
Other income, net	3050	4189	3590	3700	3700
Profit before tax	31,840	34,513	34,092	42,595	45,965
Provision for tax	7,503	8,156	8,212	10,649	11,491
% of PBT	23.6	23.6	24.1	25.0	25.0
<b>PAT</b>	<b>24,338</b>	<b>26,357</b>	<b>25,880</b>	<b>31,946</b>	<b>34,474</b>
Minority interest	123	68	54	96	103
Extra-ordinary (Exp.)/ Inc.					
Reported PAT	24,215	26,289	25,826	31,851	34,370
<b>Adj. PAT</b>	<b>24,215</b>	<b>26,289</b>	<b>25,826</b>	<b>31,851</b>	<b>34,370</b>
<b>Diluted EPS (₹)</b>	<b>63.3</b>	<b>68.7</b>	<b>67.5</b>	<b>83.3</b>	<b>89.9</b>

**Balance sheet (Consolidated, IFRS)**

Y/E March (` cr)	FY2016	FY2017	FY2018	FY2019E	FY2020E
<b>Assets</b>					
Cash and cash equivalents	1,862	3,597.0	4,883.0	5,240.4	5,326.2
Other current financial assets	4,833	-	6,395	6,395	6,395
Accounts receivable	24,073	22,684	24,943	27,437	30,181
Unbilled revenues	3,992	5,351	6,686	8,063	8,829
Other current assets	5,975	7,258	2,610	2,610	2,610
Property and equipment	11,790	11,741	11,600	11,700	11,800
Intangible assets and goodwill	3,946	3,768	3,896	3,896	3,896
Investments	22,822	41,980	36,008	47,215	60,402
Other non-current assets	11,919	8,974	12,034	12,034	12,034
<b>Total assets</b>	<b>91,212</b>	<b>1,05,353</b>	<b>1,09,055</b>	<b>1,24,591</b>	<b>1,41,473</b>
<b>Liabilities</b>					
Current liabilities	15,407	14,294	17,828	20,146	22,765
Short term borrowings	162	218	193	193	193
Redeemable preference shares	(0)	-	-	-	-
Long term debt	83	71	54	54	54
Other non-current liabilities	2,017	2,089	2,935	2,935	2,935
Minority interest	354	366	402	402	402
Shareholders' funds	73,190	88,315	87,643	100,861	115,125
<b>Total liabilities</b>	<b>91,212</b>	<b>1,05,353</b>	<b>1,09,055</b>	<b>1,24,591</b>	<b>1,41,473</b>

**Cash flow statement (Consolidated, IFRS)**

Y/E March (` cr)	FY2016	FY2017	FY2018	FY2019E	FY2020E
Pre-tax profit from oper.	24,338	26,357	25,880	31,946	34,474
Depreciation	1,948	2,123	2,216	2,078	2,276
Exp. (deferred)/written off	174	-	-	-	-
Pretax cash from oper	26,460	28,480	28,096	34,025	36,750
Other inc./prior period ad	1,948	2,123	2,216	2,078	2,276
Net cash from operations	28,408	30,604	30,312	36,103	39,026
Tax	7,503	8,156	8,212	10,649	11,491
<b>Cash profits</b>	<b>20,905</b>	<b>22,448</b>	<b>22,100</b>	<b>25,454</b>	<b>27,534</b>
(Inc)/dec in acc. rev.	(3,633)	1,389	(2,259)	(2,494)	(2,744)
(Inc)/dec in unbilled rev.	(165)	(1,359)	(1,335)	(1,377)	(766)
(Inc)/dec in oth. current asst.	439	(1,283)	4,648	-	-
Inc/(dec) in current liab.	(218)	49	141	(100)	(100)
Net trade working capital	(3,577)	(1,204)	1,195	(3,971)	(3,610)
<b>Cash flow from oper. activ.</b>	<b>17,328</b>	<b>21,243</b>	<b>23,295</b>	<b>21,483</b>	<b>23,925</b>
(Inc)/dec in fixed assets	(218)	49	141	(100)	(100)
(Inc)/dec in investments	(1,653)	(14,325)	(423)	(11,207)	(13,187)
(Inc)/dec in intangible asst.	16	(178)	128	-	-
(Inc)/dec in non-cur.asst.	(11,013)	2,945	(3,060)	-	-
<b>Cash flow from invt. activ.</b>	<b>(12,869)</b>	<b>(11,509)</b>	<b>(3,214)</b>	<b>(11,307)</b>	<b>(13,287)</b>
Inc/(dec) in debt	(113)	44	(42)	-	-
Inc/(dec) in minority int.	(559)	12	36	-	-
Dividends	(18,415)	(19,993)	(11,258)	(18,633)	(20,107)
Others	14,629	10,202	(8,816)	8,456	9,469
<b>Cash flow from finan. activ.</b>	<b>(4,459)</b>	<b>(9,735)</b>	<b>(20,080)</b>	<b>(10,177)</b>	<b>(10,638)</b>
<b>Cash generated/(utilized)</b>	<b>-</b>	<b>1,735</b>	<b>1,286</b>	<b>357</b>	<b>86</b>
<b>Cash at start of the year</b>	<b>1,862</b>	<b>1,862</b>	<b>3,597</b>	<b>4,883</b>	<b>5,240</b>
<b>Cash at end of the year</b>	<b>1,862</b>	<b>3,597</b>	<b>4,883</b>	<b>5,240</b>	<b>5,326</b>



### Key ratios

Y/E March	FY2016	FY2017	FY2018	FY2019E	FY2020E
<b>Valuation ratio(x)</b>					
P/E (on FDEPS)	30.3	27.9	28.4	23.0	21.3
P/CEPS	28.0	25.8	26.2	21.6	20.0
P/BVPS	10.0	8.3	8.4	7.3	6.4
Dividend yield (%)	2.1	2.3	1.3	2.1	2.3
EV/Sales	6.4	5.7	5.5	4.5	4.0
EV/EBITDA	22.5	20.8	20.6	16.1	14.5
EV/Total assets	7.6	6.4	6.2	5.3	4.6
<b>Per share data (₹)</b>					
EPS	63.3	68.7	67.5	83.3	89.9
Cash EPS	68.4	74.3	73.3	88.7	95.8
Dividend	40.2	43.6	24.6	40.6	43.9
Book value	191	231	229	263	301
<b>DuPont analysis</b>					
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	0.2	0.3	0.3
Asset turnover ratio (Sales/Assets)	1.2	1.1	1.1	1.2	1.1
Leverage ratio (Assets/Equity)	1.2	1.2	1.2	1.2	1.2
Operating ROE	33.3	29.8	29.5	31.7	29.9
<b>Return ratios (%)</b>					
RoCE (pre-tax)	31.6	28.8	28.0	31.2	29.9
Angel RoIC	46.7	50.7	49.4	59.2	60.9
RoE	33.1	29.8	29.5	31.6	29.9
<b>Turnover ratios(x)</b>					
Asset turnover (fixed assets)	9.2	10.0	10.6	12.7	13.8
Receivables days	81	70	74	67	68

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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%)

Neutral (-5 to 5%)

Reduce (-5% to -15%)

Sell (< -15%)