

January 11, 2018

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Rating	Accumulate
Price	Rs2,788
Target Price	Rs2,770
Implied Upside	-0.5%
Sensex	34,503
Nifty	10,651

(Prices as on January 11, 2018)

Trading data

Market Cap. (Rs bn)	5,457.5
Shares o/s (m)	1,957.2
3M Avg. Daily value (Rs m)	2564.5

Major shareholders

Promoters	73.57%
Foreign	16.26%
Domestic Inst.	6.07%
Public & Other	4.10%

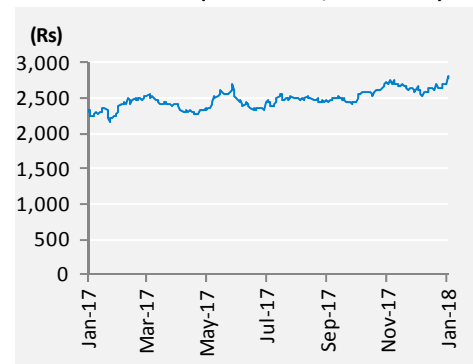
Stock Performance

(%)	1M	6M	12M
Absolute	5.0	12.8	20.0
Relative	1.9	4.1	(7.1)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	146.7	148.2	(1.0)
2020	157.9	161.5	(2.2)

Price Performance (RIC: TCS.BO, BB: TCS IN)



Source: Bloomberg

TCS' 3QFY18 results were in-line with our estimates on constant currency revenue growth, EBIT margin as well as PAT. Constant currency revenue growth for 3QFY18 came at 1.3% QoQ (vs. our estimate of 1.4%). BFSI vertical (32% of total revenues) continues to remain tepid with revenues from this vertical down 1.5% QoQ and up only 0.2% YoY in constant currency. Management expects volatility to continue in the BFSI vertical over medium term. Lack of uptick in BFSI vertical comes as a surprise to us especially considering that Accenture is delivering steady traction in this vertical. We believe In-sourcing to captives by select BFSI accounts could also have been a headwind for tepid performance at TCS in the BFSI vertical. Retail vertical (~12.5% of total revenues) has bounced back after prolonged weakness and grew by 6.4% QoQ. Management expects Retail vertical revenue growth to be back on track in CY18. Digital now accounts to 22.1% of total revenues of the company. Digital revenues were up 13.9% QoQ and 39.6% YoY in constant currency for 3QFY18. Management expects Digital deals to grow larger and remain the key driver for incremental revenue growth.

TCS showed yet another strong margin execution which we believe is predominantly aided by tepid hiring. Net employee additions for 9MFY18 stood at 3,650 employees (vs 24,650 employees added for 9MFY17). EBIT margin for 3QFY18 came at 25.2% up 10bps QoQ and in-line with our estimates. PAT came at Rs65.3bn in-line with our estimates. Led by 3Q USD revenue miss, we marginally downgrade TCS' USD revenue growth assumption to 8.1/9.3% for FY18E/FY19E (vs. 8.4/9.3% modelled earlier). TCS constant currency growth would be 6.3% for FY18 which is lower than FY17 (8.3% cc revenue growth delivered in FY17). We marginally trim EBIT margin to 24.7/24.4% for FY18/FY19E (vs 24.9/24.5% modelled earlier). We retain our EPS estimates at Rs134/147/158/sh for FY18E/FY19E/FY20E. Stock trades at 19x FY19E EPS and 17.7x FY20E EPS. TCS trades at 26% premium to Infosys (despite similar revenue growth and margin profile). Led by rollover FY20E earnings, we raise TP by 6% to Rs2770/sh (17.5x FY20E EPS vs 17x Sep19E EPS earlier). Maintain Accumulate.

Key financials (Y/e March)

	2017	2018E	2019E	2020E
Revenues (Rs m)	1,179,660	1,227,979	1,350,944	1,477,092
Growth (%)	8.6	4.1	10.0	9.3
EBITDA (Rs m)	323,110	323,781	349,612	376,741
PAT (Rs m)	262,890	256,799	280,741	302,225
EPS (Rs)	133.4	134.2	146.7	157.9
Growth (%)	8.6	0.6	9.3	7.7
Net DPS (Rs)	46.7	49.7	54.3	58.4

Profitability & Valuation

	2017	2018E	2019E	2020E
EBITDA margin (%)	27.4	26.4	25.9	25.5
RoE (%)	32.4	29.2	29.6	27.2
RoCE (%)	31.8	28.7	29.0	26.7
EV / sales (x)	4.3	4.0	3.5	3.1
EV / EBITDA (x)	15.6	15.2	13.7	12.3
PE (x)	20.9	20.8	19.0	17.7
P / BV (x)	6.2	6.1	5.2	4.5
Net dividend yield (%)	1.7	1.8	1.9	2.1

Source: Company Data; PL Research

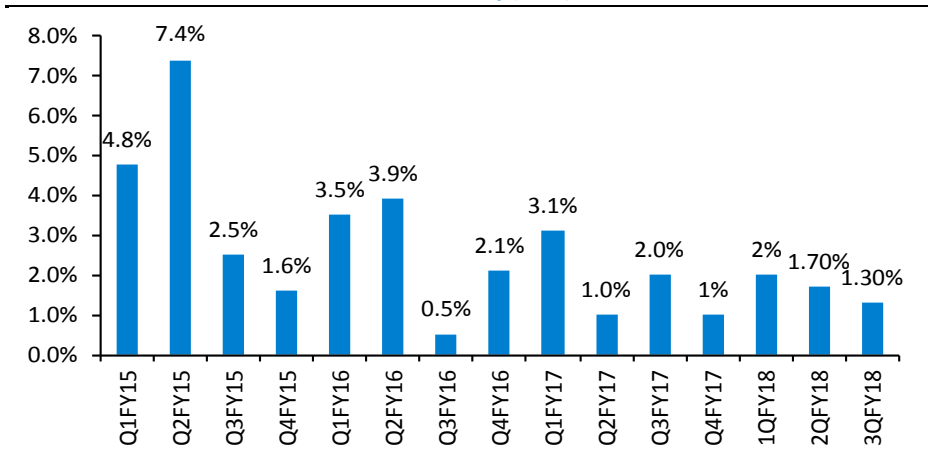
Exhibit 1: Q3FY18: Consolidated P&L

(Rs m)	3QFY18	2QFY18	QoQ Growth	3QFY17	YoY Growth	PI Estimates	Variance(PL VS ACTUAL)
Total Operating Income (USD m)	4,787	4,739	1.0%	4,387	9.1%	4,801	-0.3%
Total Operating Income	309,040	305,410	1.2%	297,350	3.9%	309,159	0.0%
EBITDA	82,880	81,630	1.5%	82,290	0.7%	82,855	0.0%
<i>EBITDA Margins</i>	<i>26.8%</i>	<i>26.7%</i>	<i>9 bps</i>	<i>27.7%</i>	<i>-86 bps</i>	<i>26.8%</i>	
Pre -Tax Income	86,450	84,720	2.0%	89,180	-3.1%	86,284	0.2%
Tax	21,000	20,120	4.4%	21,040	-0.2%	20,708	1.4%
<i>Tax- Rate</i>	<i>24.3%</i>	<i>23.7%</i>	<i>54 bps</i>	<i>23.6%</i>	<i>70 bps</i>	<i>24.0%</i>	
PAT	65,310	64,460	1.3%	67,780	-3.6%	65,326	0.0%
EPS (Rs)	34.1	33.7	1.3%	34.4	-0.8%	34.1	0.1%

Source: Company Data, PL Research

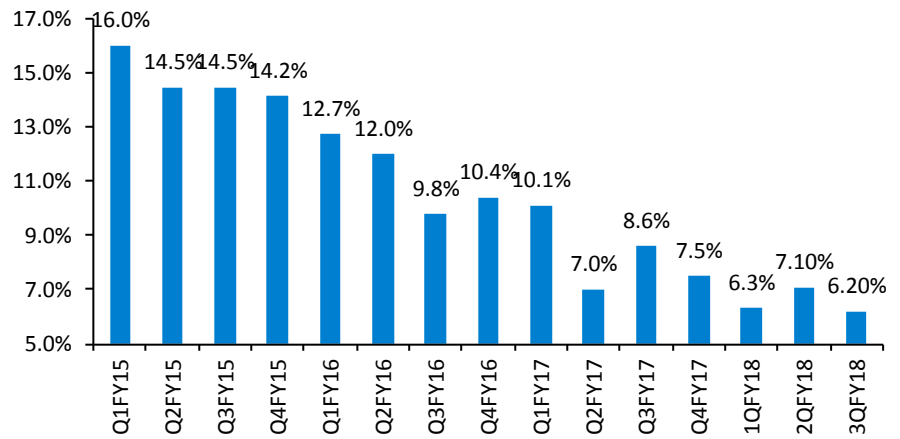
- Revenues marginally miss estimates:** Revenues were at US\$4,787mn, up 1% QoQ and were below our estimates (US\$4,801mn). Constant currency growth for the quarter stood at 1.3% and in-line with our estimates (PLe: 1.3%). Volume growth for the quarter came at 1.6% QoQ. Digital revenues stood at USD1058mn up 13.3% QoQ and 43% YoY in USD. Traditional Business (Revenues–Ex Digital) revenue came at USD3729mn down 2.2% QoQ and up a modest 2% YoY. Hence, Digital remains the key driver for incremental growth.
- Traction in BFSI vertical remained soft, while Retail vertical showed a strong bounce back. Management expects Retail vertical to deliver double digit growth in CY18E. TCS continues to remain cautious on the BFSI vertical over the medium. **We note that peer Accenture has delivered BFSI revenues of USD2059mn for 1QFY18(Accenture has August 31 Year ending) up 11% in constant currency. TCS BFSI vertical revenues for 3QFY18 came at USD1537mn up 0.2% YoY in constant currency. Hence, TCS BFSI vertical traction has seen substantial moderation (vs Accenture) which is a concern.**

Constant currency revenue growth remained modest for TCS over the past few quarters led by slower traction in North America and core verticals (BFSI)

Exhibit 2: Revenue Growth in Constant Currency (QoQ)


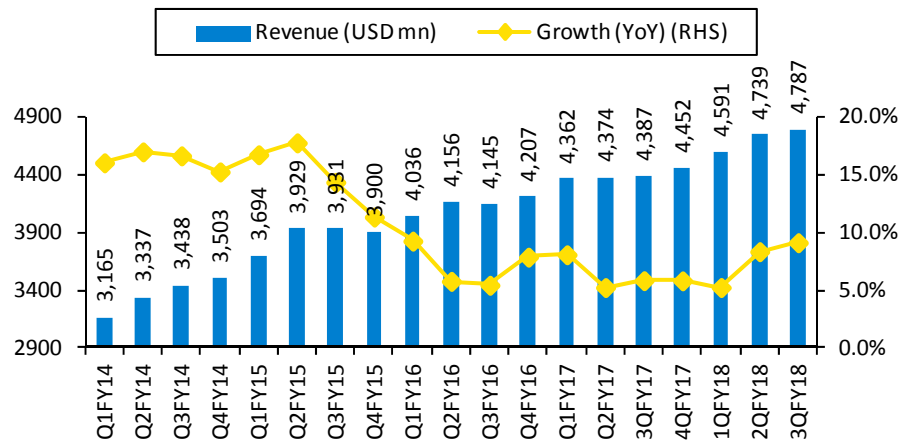
Source: Company Data, PL Research* 2QFY15 Organic constant currency growth is 4.6% QoQ.

Exhibit 3: Revenue growth in CC (YoY)



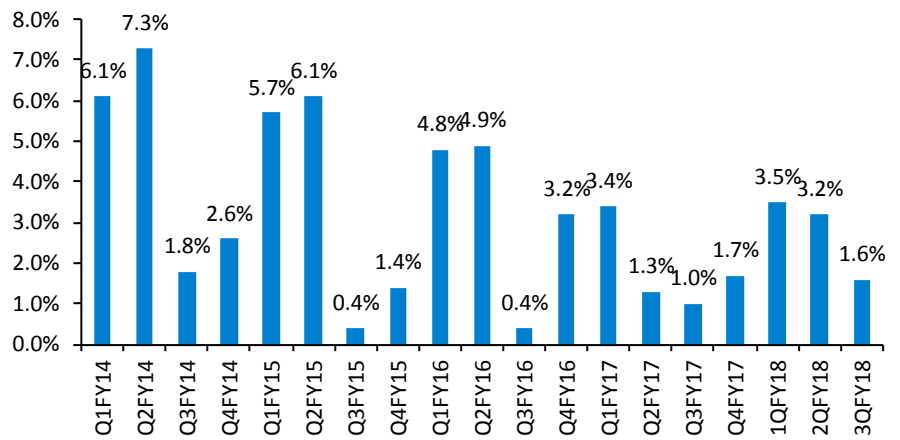
Source: Company Data, PL Research

Exhibit 4: USD revenue growth (YoY)



Source: Company Data, PL Research

Exhibit 5: Volume Growth (QoQ)

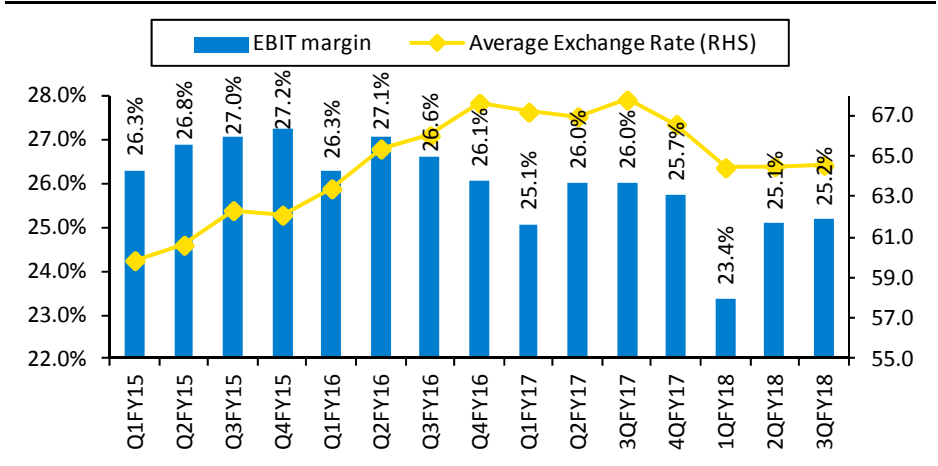


Source: Company Data, PL Research

- Margin inline with estimates:** EBITDA margins increased by 10bps for the quarter and came in at 26.8%, and inline with our estimates (PLe: 26.8%). EBIT margin for the quarter stood at 25.2%, up 10 bps QoQ and inline with our estimates (PLe: 25.2%). **We believe margin expansion is being driven by tepid Headcount additions.** Total headcount at 390,880 employees which is up 0.4% QoQ and 3.2% YoY.

TCS has shown a strong improvement in EBIT margin performance which is positive. However, we believe that company might have to step up investments as revenue growth trajectory appears to be softening

Exhibit 6: EBIT Margins vs. Average exchange rate



Source: Company Data, PL Research

Exhibit 7: Headcount details

	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Headcount	324,935	335,620	344,691	353,843	362,079	371,519	378,497	387,223	385,809	389,213	390,880
QoQ growth (%)	1.7%	3.3%	2.7%	2.7%	2.3%	2.6%	1.9%	2.3%	-0.4%	0.9%	0.4%
Net additions	5279	10685	9071	9152	8236	9440	6978	8726	(1,414)	3404	1667

Source: Company Data, PL Research

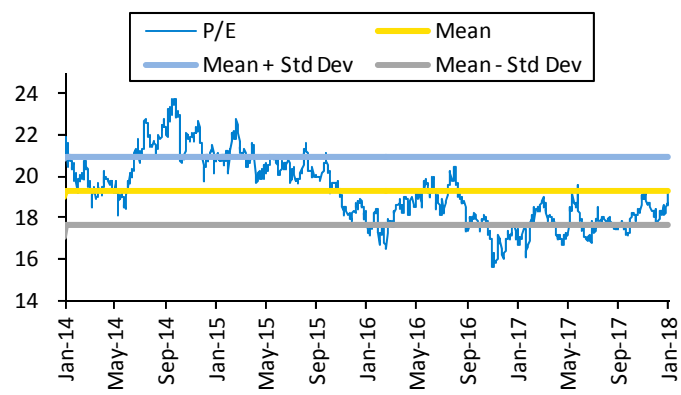
Valuations

Global peers Accenture (Annual Revenues at USD35bn for FY17) has guided for 6-8% YoY revenue growth for FY18 (3-5% organic growth). Accenture has been delivering stable EBIT margin (~14.8% for FY17) and also showing strong headcount addition in global delivery centres.

We expect TCS (annual revenues of USD19bn for FY18E) to grow by 6.3% YoY in constant currency for FY18E. **While TCS used to grow 2-3x the pace of Accenture over FY12-FY15, the current scenario shows that revenue growth differential has substantially narrowed.** Also note that Accenture revenue base is at USD35bn which is almost twice that of TCS. Hence, TCS narrowing on revenue growth differential with Accenture has led to some de-rating for the stock over the past two years.

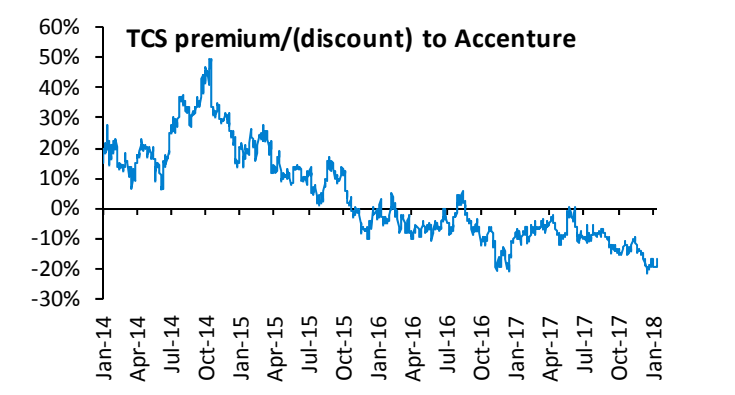
TCS has moderated substantially on the valuation front over the past few quarters. TCS trades at 19.3x one-year forward earnings. **TCS currently trades at 20% discount to Accenture on one year forward P/E basis.** Moderating Revenue growth has led to P/E multiple erosion for TCS.

Exhibit 8: TCS one-year forward P/E Chart



Source: Company Data, PL Research

Exhibit 9: TCS vs. Accenture one-year forward P/E discount/premium



Source: Company Data, PL Research

Key Metrics

Exhibit 10: Geography Mix of revenues

Geographical mix (in %)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
North America	54	53.5	54	55	53	52.5	51.9	52.0
Latin America	2.0	2.0	2.0	2.2	2.1	2.1	2.2	2.2
UK	14.9	14.8	13.8	13.3	13.7	13.9	14	14.1
Continental Europe	11.2	11.5	11.8	11.1	11.8	12.5	13.4	13.5
India	5.9	6.2	5.8	6.3	6.8	7	6.3	6.3
APAC	9.6	9.6	10.2	9.6	9.7	9.5	9.8	9.5
MEA	2.4	2.4	2.4	2.5	2.6	2.5	2.4	2.4

Source: Company Data, PL Research

Among geographies most of the incremental growth was driven by Continental Europe (up 2.6% QoQ in cc) and Latin America (up 5% QoQ in cc)

Exhibit 11: Revenue contribution by Geography and CC growth in geographies

Geography (CC Growth)	Revenue Contribution (%)	QoQ (CC growth)	YoY (CC Growth)
North America	52.0	1.5	2.8
Latin America	2.2	5.0	5.4
UK	14.1	0.8	8.2
Continental Europe	13.5	2.6	22.3
India	6.3	0.5	4.1
Asia	9.5	0.0	6.2
MEA	2.4	(0.2)	3.7
Total	100.0	1.3	6.2

Source: Company Data, PL Research

Energy and utility vertical (up 8.2%QoQ) and Retail (up 6% QoQ) delivered strong revenue growth.

Exhibit 12: Revenues by vertical and growth (QoQ and YoY)

Verticals (CC Growth)	Revenues(USD mn)	QoQ Growth (%)	YoY Growth(%)
BFSI	1537	-1.7%	3.3%
Retail & CPG	598	6.1%	4.9%
Communication & Media	354	2.4%	20.5%
Manufacturing	364	2.4%	12.1%
Life Sciences & Healthcare	349	2.4%	15.4%
Energy & Utilities	215	8.2%	36.4%
Travel & Hospitality	182	1.0%	29.6%
Technology and services	383	-0.2%	11.9%
Regional markets and others	804	-0.2%	4.8%
Total	4787	1.0%	9.1%

Source: Company Data, PL Research

Exhibit 13: Employee Details

Employee Details	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Total number of employee's	344,691	353,843	362,079	371,519	378,497	387,223	385,809	389,213	390,880
Gross additions	22,118	22,576	17,792	22,655	18,362	20,093	11,202	15,868	12534
Net additions	9,071	9,152	8,236	9,440	6,978	8,726	(1,414)	3,404	1667
Attrition	15.3%	14.7%	13.6%	12.9%	11.3%	11.3%	11.6%	11.3%	11.1%

Source: Company Data, PL Research

Exhibit 14: Client Details

Client Bucket	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
USD 1mn	791	804	819	838	829	847	859	880	897	905	933	941
USD 5mn	389	391	404	413	429	439	449	454	459	464	470	485
USD10 mn	261	268	274	281	298	298	295	300	310	322	328	337
USD20 mn	162	172	171	173	173	179	185	186	190	190	196	203
USD50 mn	68	69	65	65	73	77	78	80	84	85	91	94
USD100 mn	29	30	33	34	37	37	36	34	35	36	37	37

Source: Company Data, PL Research

Financial Summary

Exhibit 15: Consolidated Financial Snapshot of TCS

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenues- USD mn	11,568	13,443	15,454	16,544	17,575	19,005	20,784	22,724
<i>Growth (%)</i>	13.7%	16.2%	15.0%	7.1%	6.2%	8.1%	9.4%	9.3%
Average exchange rate (USD vs INR)	54.5	60.8	61.2	65.6	67.1	64.6	65.0	65.0
Consolidated revenues (Rs mn)	629,884	818,093	946,484	1,086,462	1,179,660	1,227,979	1,350,944	1,477,092
<i>Growth (%)</i>	28.8%	29.9%	15.7%	14.8%	8.6%	4.1%	10.0%	9.3%
EBITDA (Rs mn)	180,391	251,533	272,941	306,776	323,110	323,781	349,612	376,741
EBIT (Rs mn)	169,593	238,031	254,243	287,901	303,240	303,608	329,185	355,959
PAT (Rs mn)	139,168	191,546	216,961	242,147	262,890	256,799	280,741	302,225
<i>EBITDA Margins (%)</i>	28.6%	30.7%	28.8%	28.2%	27.4%	26.4%	25.9%	25.5%
<i>EBIT Margins (%)</i>	26.9%	29.1%	26.9%	26.5%	25.7%	24.7%	24.4%	24.1%
<i>NPM (%)</i>	22.1%	23.4%	22.4%	22.3%	22.3%	20.9%	20.8%	20.5%
EPS	71.1	97.8	108.8	123.2	133.4	133.5	146.7	157.9
<i>Growth (%)</i>	33.6%	37.5%	11.2%	13.2%	8.3%	0.0%	9.9%	7.7%
P/E	34.4	25.0	23.0	20.7	19.1	20.8	19.0	17.7
EV/EBITDA	25.7	18.2	17.5	15.3	14.1	15.2	13.7	12.3
ROE	40.8%	43.6%	38.5%	37.1%	32.6%	29.4%	29.8%	27.3%
Consolidated balance sheet (Rs mn)								
Net cash on balance sheet (Rs mn)	147,129	201,255	204,995	299,852	460,070	435,702	565,837	707,680
Net cash per share	72.6	98.3	99.5	149.4	231.3	223.5	291.4	365.4
Net cash per share/ Stock price	3.0%	3.5%	3.6%	5.4%	8.3%	8.0%	10.4%	13.1%
Consolidated cash flows (Rs mn)								
Cash flow from operations	123,227	159,221	212,055	209,164	269,920	271,536	276,695	297,966
Capex + Acquisitions	(27,644)	(35,344)	(31,518)	(19,894)	(19,890)	(22,000)	(22,000)	(22,000)
Free cash flows	95,583	123,876	180,537	189,270	250,030	249,536	254,695	275,966
FCF Yield (%)	1.8%	2.3%	3.4%	3.5%	4.7%	4.7%	4.8%	5.2%

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2017	2018E	2019E	2020E
Net Revenue	1,179,660	1,227,979	1,350,944	1,477,092
Software development	650,320	687,014	754,896	827,172
Gross Profit	529,340	540,965	596,048	649,921
RM Cost	—	—	—	—
Other Expenses	206,230	217,184	246,436	273,180
EBITDA	323,110	323,781	349,612	376,741
Depr. & Amortization	19,870	20,173	20,427	20,782
Other Income	41,890	35,080	41,000	42,500
Profit before Tax	345,130	338,688	370,185	398,459
Total Tax	81,560	81,454	88,844	95,630
Profit after Tax	263,570	257,234	281,341	302,829
Ex-Od items / Min. Int.	(680)	(435)	(600)	(604)
Adj. PAT	262,890	256,799	280,741	302,225
Avg. Shares O/S (m)	1,970.0	1,913.5	1,913.5	1,913.5
EPS (Rs.)	133.4	134.2	146.7	157.9

Cash Flow Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
C/F from Operations	265,720	271,536	276,695	297,966
C/F from Investing	(189,220)	(22,000)	(22,000)	(22,000)
C/F from Financing	(109,400)	(273,904)	(124,560)	(134,123)
Inc. / Dec. in Cash	(32,900)	(24,368)	130,135	141,843
Opening Cash	62,950	35,970	11,602	141,737
Closing Cash	35,970	11,602	141,737	283,580

Key Financial Metrics

Y/e March	2017	2018E	2019E	2020E
Growth				
Revenue (%)	8.6	4.1	10.0	9.3
EBITDA (%)	5.3	0.2	8.0	7.8
PAT (%)	8.6	(2.3)	9.3	7.7
EPS (%)	8.6	0.6	9.3	7.7
Profitability				
EBITDA Margin (%)	27.4	26.4	25.9	25.5
PAT Margin (%)	22.3	20.9	20.8	20.5
RoCE (%)	31.8	28.7	29.0	26.7
RoE (%)	32.4	29.2	29.6	27.2
Balance Sheet				
Net Debt : Equity	(0.5)	(0.5)	(0.5)	(0.6)
Valuation				
PER (x)	20.9	20.8	19.0	17.7
P / B (x)	6.2	6.1	5.2	4.5
EV / EBITDA (x)	15.6	15.2	13.7	12.3
EV / Sales (x)	4.3	4.0	3.5	3.1
Earnings Quality				
Eff. Tax Rate	23.6	24.0	24.0	24.0
Other Inc / PBT	12.1	10.4	11.1	10.7

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
Shareholder's Funds	886,810	869,741	1,026,121	1,194,426
Total Debt	2,890	2,890	2,890	2,890
Other Liabilities	20,890	22,190	23,490	24,790
Total Liabilities	910,590	894,821	1,052,501	1,222,106
Net Fixed Assets	117,880	119,707	121,280	122,498
Goodwill	37,210	37,210	37,210	37,210
Investments	—	—	—	—
Net Current Assets	665,760	643,163	794,271	957,658
Cash & Equivalents	455,770	431,402	561,537	703,380
Other Current Assets	352,930	373,390	406,212	439,805
Current Liabilities	142,940	161,630	173,478	185,527
Other Assets	89,740	94,740	99,740	104,740
Total Assets	910,590	894,820	1,052,500	1,222,106

Quarterly Financials (Rs m)

Y/e March	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Net Revenue	296,420	295,840	305,410	309,040
EBITDA	81,330	74,130	81,630	82,880
% of revenue	27.4	25.1	26.7	26.8
Depr. & Amortization	5,060	4,990	5,030	5,070
Net Interest	(9,890)	(9,320)	(8,120)	(8,640)
Other Income	9,890	9,320	8,120	8,640
Profit before Tax	86,160	78,460	84,720	86,450
Total Tax	19,940	18,960	20,120	21,000
Profit after Tax	66,080	59,495	64,460	65,310
Adj. PAT	66,080	59,495	64,460	65,310

Source: Company Data, PL Research.

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Rating Distribution of Research Coverage	PL's Recommendation Nomenclature										
<table border="1"> <caption>Rating Distribution of Research Coverage</caption> <thead> <tr> <th>Rating</th> <th>% of Total Coverage</th> </tr> </thead> <tbody> <tr> <td>BUY</td> <td>43.8%</td> </tr> <tr> <td>Accumulate</td> <td>43.0%</td> </tr> <tr> <td>Reduce</td> <td>13.3%</td> </tr> <tr> <td>Sell</td> <td>0.0%</td> </tr> </tbody> </table>	Rating	% of Total Coverage	BUY	43.8%	Accumulate	43.0%	Reduce	13.3%	Sell	0.0%	<p>BUY : Over 15% Outperformance to Sensex over 12-months</p> <p>Accumulate : Outperformance to Sensex over 12-months</p> <p>Reduce : Underperformance to Sensex over 12-months</p> <p>Sell : Over 15% underperformance to Sensex over 12-months</p> <p>Trading Buy : Over 10% absolute upside in 1-month</p> <p>Trading Sell : Over 10% absolute decline in 1-month</p> <p>Not Rated (NR) : No specific call on the stock</p> <p>Under Review (UR) : Rating likely to change shortly</p>
Rating	% of Total Coverage										
BUY	43.8%										
Accumulate	43.0%										
Reduce	13.3%										
Sell	0.0%										

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