# Prabhudas Lilladher

# Tata Consultancy Services

## Positioned to Sustain Leadership

Analyst Meet Update

**March 18, 2016**

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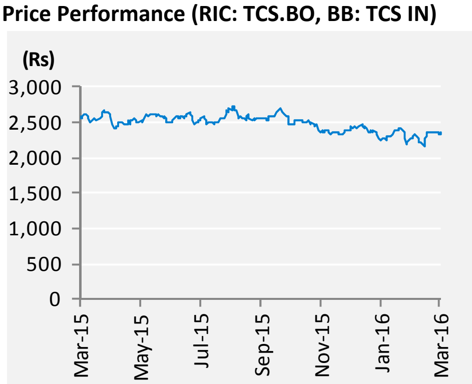
| | |
|---|---|
| Rating | **BUY** |
| Price | Rs2,352 |
| Target Price | Rs2,600 |
| Implied Upside | 10.5% |
| Sensex | 24,677 |
| Nifty | 7,513 |

***(Prices as on March 17, 2016)***

| **Trading data** | | | |
|---|---|---|---|
| Market Cap. (Rs bn) | | | 4,603.4 |
| Shares o/s (m) | | | 1,957.2 |
| 3M Avg. Daily value (Rs m) | | | 2421.3 |
| **Major shareholders** | | | |
| Promoters | | | 73.90% |
| Foreign | | | 16.95% |
| Domestic Inst. | | | 4.69% |
| Public & Other | | | 4.46% |
| **Stock Performance** | | | |
| **(%)** | **1M** | **6M** | **12M** |
| Absolute | 3.4 | (7.8) | (9.0) |
| Relative | (2.2) | (2.8) | 5.2 |
| **How we differ from Consensus** | | | |
| **EPS (Rs)** | **PL** | **Cons.** | ***% Diff.*** |
| 2017 | 135.7 | 134.8 | *0.7* |
| 2018 | 147.1 | 151.1 | *-2.7* |

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




*Source: Bloomberg*

***TCS showcased its digital expertise across verticals in the analyst meet. Management believes that digital is becoming mainstream and now contributes ~13% of CY15 revenues. Company continues to make significant investments in new technologies, automation etc to stay relevant to customers. Management sees tremendous growth opportunities in the medium term driven by increased market penetration (which is still <3% in their largest market). In the near term, management indicated that Diligenta business will bottom out in 4QFY16 and hence growth is likely to improve in CY16 in our view. The commentary indicated confidence to sustain the growth and maintain margins. Retain ''BUY''.***

- **Verticals positioned to accelerate growth***:* CY15 saw healthy growth with all verticals (barring Insurance and Telecom) growing at or above 15%. **a) Retail:** TCS recently created a real time enterprise supply change for a large retailer. The growth drivers in retail are digitalization and creating real time enterprises. Retail has a huge opportunity and management was confident about being well poised to address it. **b) Life sciences & Healthcare:** TCS is a trusted partner for top global pharma and medical devices companies. Drivers for growth are cloud adoption, gaining insights on R&D and consolidation of technology. LS &HC are expected to increase adoption of digital technologies leading to holistic growth. **c) BFS:** TCS is partner to top 34 banks out of 50 across the globe. Growth drivers are Digital adoption, Risk management & regulatory compliance and simplification Management in confident of sustaining leadership position in this vertical. **d) Manufacturing:** TCS partnered with an OEM to build their premium in car experience platform. Growth drivers: infrastructure transformation, enterprise transformation and outsourcing R&D. Management feels they are well positioned for robust growth across manufacturing.

*Contd...2*

| **Key financials (Y/e March)** | **2015** | **2016E** | **2017E** | **2018E** |
|---|---|---|---|---|
| Revenues (Rs m) | 946,484 | 1,079,527 | 1,206,771 | 1,346,813 |
| *Growth (%)* | *15.7* | *14.1* | *11.8* | *11.6* |
| EBITDA (Rs m) | 246,664 | 310,514 | 344,608 | 382,440 |
| PAT (Rs m) | 216,600 | 238,487 | 265,823 | 288,143 |
| EPS (Rs) | 110.6 | 121.8 | 135.7 | 147.1 |
| *Growth (%)* | *13.3* | *10.1* | *11.5* | *8.4* |
| Net DPS (Rs) | 78.0 | 38.2 | 43.3 | 43.3 |

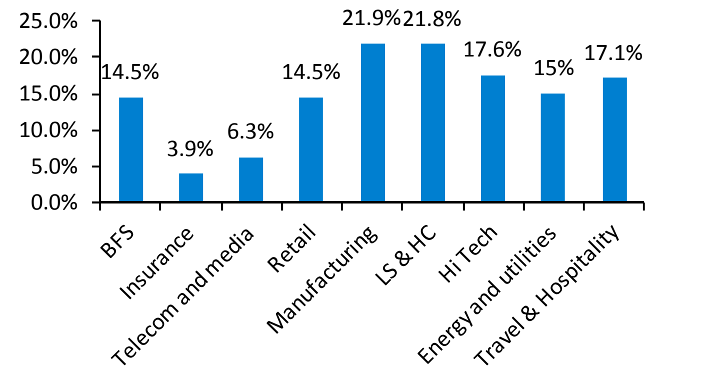
| **Profitability & Valuation** | **2015** | **2016E** | **2017E** | **2018E** |
|---|---|---|---|---|
| *EBITDA margin (%)* | *26.1* | *28.8* | *28.6* | *28.4* |
| *RoE (%)* | *38.4* | *36.3* | *31.9* | *28.0* |
| *RoCE (%)* | *36.8* | *34.7* | *30.8* | *27.2* |
| EV / sales (x) | 4.7 | 4.0 | 3.5 | 3.0 |
| EV / EBITDA (x) | 17.9 | 14.1 | 12.3 | 10.7 |
| PE (x) | 21.3 | 19.3 | 17.3 | 16.0 |
| P / BV (x) | 8.0 | 6.2 | 5.0 | 4.1 |
| *Net dividend yield (%)* | *3.3* | *1.6* | *1.8* | *1.8* |

*Source: Company Data; PL Research*

- **Investments in digital likely to sustain:** Management indicated significant investments in digital where the core is to connect everything through digital reimagination. Digital revenues for CY15 accounted for $2 billion (13% of the total revenues) and this number is further expected to accelerate.

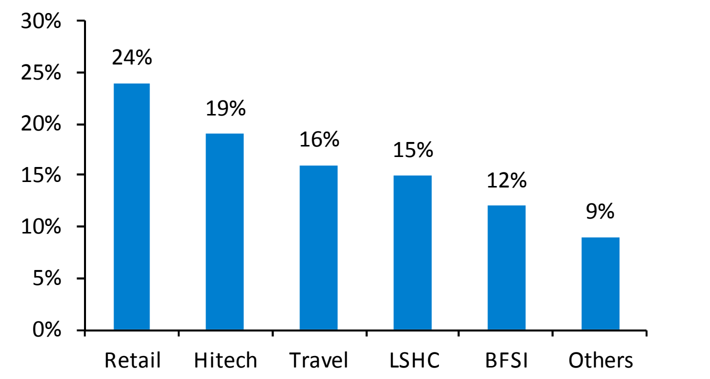
- **Strong customer traction and future growth drivers:** Strong customer traction is seen across the board with significant increase in number of clients across different customer buckets. Management feels they are extremely well positioned to retain current customers and add new customers because of the well distributed footprint across the globe.

**Exhibit 1: Core business performance (CY15 CC terms)**



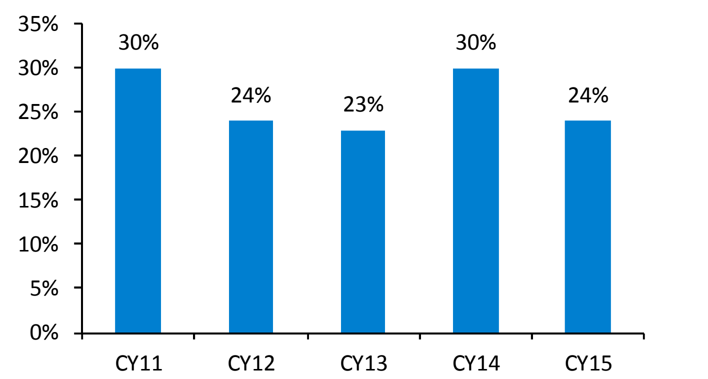

*Source: Company Data, PL Research*

**Exhibit 2: Contribution of Digital across verticals (CY15)**



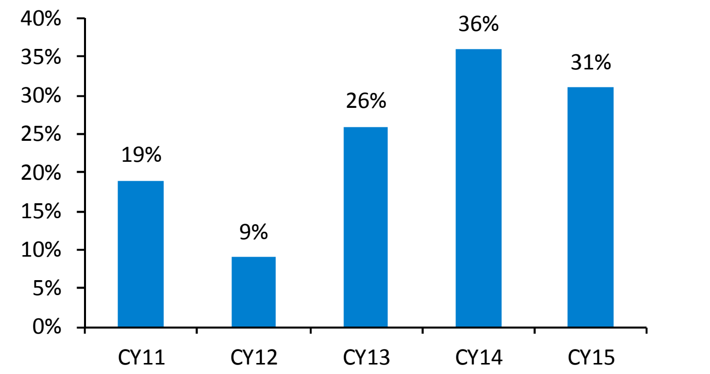

*Source: Company Data, PL Research*

**Exhibit 3: Manufacturing- Retain global leadership position (YoY rev growth in cc)**




*Source: Company Data, PL Research*

**Exhibit 4: Pharmaceuticals & Biotechnology( YoY rev growth in cc)**




*Source: Company Data, PL Research*

- **Valuation & Recommendation:** We retain BUY on TCS with TP of Rs2,600 based on 18x 12 month forward EPS. TCS' revenue growth moderated in FY16 due to headwinds in insurance vertical, South America and telecom vertical. As per management most of the headwinds in Insurance business and South America business has already bottomed out or likely to bottom out in 4QFY16. This should aid growth in FY17. Stock is trading at 16x FY18E EPS which is reasonable in our view.

**Income Statement (Rs m)**

| Y/e March | 2015 | 2016E | 2017E | 2018E |
|---|---|---|---|---|
| **Net Revenue** | **946,484** | **1,079,527** | **1,206,771** | **1,346,813** |
| Raw Material Expenses | 544,993 | 595,997 | 672,501 | 756,163 |
| Gross Profit | 401,492 | 483,530 | 534,270 | 590,651 |
| Employee Cost | — | — | — | — |
| Other Expenses | 154,828 | 173,015 | 189,662 | 208,211 |
| **EBITDA** | **246,664** | **310,514** | **344,608** | **382,440** |
| Depr. & Amortization | 18,699 | 19,062 | 23,862 | 28,441 |
| Net Interest | (15,247) | (12,743) | (18,290) | (14,801) |
| Other Income | 32,532 | 26,966 | 34,013 | 30,525 |
| **Profit before Tax** | **259,361** | **317,196** | **353,535** | **383,300** |
| Total Tax | 60,830 | 76,127 | 84,849 | 91,992 |
| **Profit after Tax** | **198,532** | **241,069** | **268,687** | **291,308** |
| Ex-Od items / Min. Int. | (22,163) | (2,582) | (2,864) | (3,164) |
| **Adj. PAT** | **216,600** | **238,487** | **265,823** | **288,143** |
| **Avg. Shares O/S (m)** | **1,958.7** | **1,958.7** | **1,958.7** | **1,958.7** |
| **EPS (Rs.)** | **110.6** | **121.8** | **135.7** | **147.1** |

**Cash Flow Abstract (Rs m)**

| Y/e March | 2015 | 2016E | 2017E | 2018E |
|---|---|---|---|---|
| C/F from Operations | 212,055 | 180,741 | 265,357 | 289,822 |
| C/F from Investing | (35,778) | (43,181) | (48,271) | (53,873) |
| C/F from Financing | (171,285) | (74,876) | (84,728) | (84,728) |
| Inc. / Dec. in Cash | 4,992 | 62,683 | 132,358 | 151,221 |
| Opening Cash | 14,688 | 18,622 | 81,305 | 213,663 |
| Closing Cash | 18,622 | 81,305 | 213,663 | 364,885 |
| FCFF | 224,371 | 134,977 | 214,223 | 232,785 |
| FCFE | 224,241 | 134,977 | 214,223 | 232,785 |

**Key Financial Metrics**

| Y/e March | 2015 | 2016E | 2017E | 2018E |
|---|---|---|---|---|
| **Growth** | | | | |
| Revenue (%) | 15.7 | 14.1 | 11.8 | 11.6 |
| EBITDA (%) | (2.0) | 25.9 | 11.0 | 11.0 |
| PAT (%) | 13.3 | 10.1 | 11.5 | 8.4 |
| EPS (%) | 13.3 | 10.1 | 11.5 | 8.4 |
| **Profitability** | | | | |
| EBITDA Margin (%) | 26.1 | 28.8 | 28.6 | 28.4 |
| PAT Margin (%) | 22.9 | 22.1 | 22.0 | 21.4 |
| RoCE (%) | 36.8 | 34.7 | 30.8 | 27.2 |
| RoE (%) | 38.4 | 36.3 | 31.9 | 28.0 |
| **Balance Sheet** | | | | |
| Net Debt : Equity | (0.3) | (0.3) | (0.4) | (0.5) |
| Net Wrkng Cap. (days) | — | — | — | — |
| **Valuation** | | | | |
| PER (x) | 21.3 | 19.3 | 17.3 | 16.0 |
| P / B (x) | 8.0 | 6.2 | 5.0 | 4.1 |
| EV / EBITDA (x) | 17.9 | 14.1 | 12.3 | 10.7 |
| EV / Sales (x) | 4.7 | 4.0 | 3.5 | 3.0 |
| **Earnings Quality** | | | | |
| Eff. Tax Rate | 23.5 | 24.0 | 24.0 | 24.0 |
| Other Inc / PBT | 12.5 | 8.5 | 9.6 | 8.0 |
| Eff. Depr. Rate (%) | 9.9 | 8.2 | 8.5 | 8.5 |
| FCFE / PAT | 103.5 | 56.6 | 80.6 | 80.8 |

*Source: Company Data, PL Research.*

**Balance Sheet Abstract (Rs m)**

| Y/e March | 2015 | 2016E | 2017E | 2018E |
|---|---|---|---|---|
| Shareholder's Funds | 574,767 | 740,960 | 924,918 | 1,131,498 |
| Total Debt | 1,143 | 1,143 | 1,143 | 1,143 |
| Other Liabilities | 28,243 | 28,243 | 28,243 | 28,243 |
| **Total Liabilities** | **604,153** | **770,345** | **954,304** | **1,160,883** |
| Net Fixed Assets | 115,716 | 139,835 | 164,244 | 189,675 |
| Goodwill | 39,308 | 39,308 | 39,308 | 39,308 |
| Investments | 22,544 | 22,544 | 22,544 | 22,544 |
| Net Current Assets | 327,286 | 469,359 | 628,909 | 810,057 |
| *Cash & Equivalents* | *182,451* | *245,134* | *377,493* | *528,714* |
| *Other Current Assets* | *291,551* | *385,761* | *427,944* | *474,369* |
| *Current Liabilities* | *146,716* | *161,537* | *176,527* | *193,025* |
| Other Assets | 99,300 | 99,300 | 99,300 | 99,300 |
| **Total Assets** | **604,153** | **770,345** | **954,304** | **1,160,883** |

**Quarterly Financials (Rs m)**

| Y/e March | Q4FY15 | Q1FY16 | Q2FY16 | Q3FY16 |
|---|---|---|---|---|
| **Net Revenue** | **242,198** | **256,681** | **271,655** | **273,640** |
| **EBITDA** | **44,375** | **72,019** | **78,223** | **77,469** |
| *% of revenue* | *18.3* | *28.1* | *28.8* | *28.3* |
| Depr. & Amortization | 4,743 | 4,535 | 4,688 | 4,707 |
| Net Interest | (3,257) | (4,482) | (4,108) | (4,202) |
| Other Income | 11,432 | 7,784 | 6,827 | 7,074 |
| **Profit before Tax** | **50,923** | **75,195** | **80,286** | **79,753** |
| Total Tax | 12,018 | 17,468 | 19,356 | 18,501 |
| **Profit after Tax** | **38,582** | **57,089** | **60,552** | **61,095** |
| **Adj. PAT** | **58,698** | **57,089** | **60,552** | **61,095** |

**Key Operating Metrics**

| Y/e March | 2015 | 2016E | 2017E | 2018E |
|---|---|---|---|---|
| Revenue (US$ m) | 15,454 | 16,608 | 18,566 | 20,720 |

*Source: Company Data, PL Research.*

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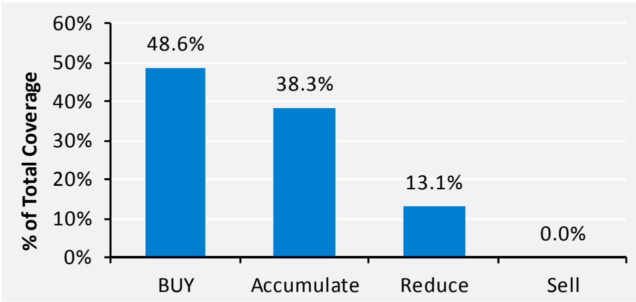


### PL's Recommendation Nomenclature

| | | |
|---|---|---|
| **BUY** | : | Over 15% Outperformance to Sensex over 12-months |
| **Accumulate** | : | Outperformance to Sensex over 12-months |
| **Reduce** | : | Underperformance to Sensex over 12-months |
| **Sell** | : | Over 15% underperformance to Sensex over 12-months |
| **Trading Buy** | : | Over 10% absolute upside in 1-month |
| **Trading Sell** | : | Over 10% absolute decline in 1-month |
| **Not Rated (NR)** | : | No specific call on the stock |
| **Under Review (UR)** | : | Rating likely to change shortly |

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