

October 12, 2017

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Rating	Accumulate
Price	Rs2,549
Target Price	Rs2,600
Implied Upside	2.0%
Sensex	32,182
Nifty	10,096

(Prices as on October 12, 2017)

Trading data

Market Cap. (Rs bn)	4,988.0
Shares o/s (m)	1,957.2
3M Avg. Daily value (Rs m)	2411.3

Major shareholders

Promoters	73.38%
Foreign	16.79%
Domestic Inst.	5.40%
Public & Other	4.43%

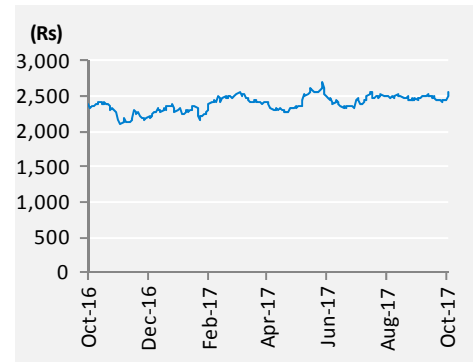
Stock Performance

(%)	1M	6M	12M
Absolute	2.5	6.4	7.1
Relative	2.4	(2.1)	(7.5)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2018	136.6	133.7	2.2
2019	148.5	148.1	0.2

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



Source: Bloomberg

TCS 2QFY18 results were marginally below our estimates on USD revenues but beat our estimates on EBIDTA margin and PAT. PAT was 2% above our estimate led by margin beat. Constant currency revenue growth for 2QFY18 came at 1.7% QoQ (vs. our estimate of 2.3%). Tepid cc revenue growth in a seasonally strong quarter is a concern. We note select large segments appear to be showing signs of softness. Revenues from North America (~52% of total revenues) for 2QFY18 were up 1.4% QoQ and a modest 3.6% YoY in constant currency. Softer traction in the core geographies is a concern. Lack of acceleration in BFSI (33% of total revenues) is another turnoff. BFSI vertical revenues grew by 1.9% QoQ and 4.7% YoY in constant currency. Retail vertical (~12% of total revenues) remains a pain point down 0.9% QoQ and 1.4% YoY. While TCS sounded confident of recovery in demand from Retail vertical from 3Q onwards, it remained cautious on BFSI vertical demand outlook.

Aided by cross currency tailwinds, we model TCS USD revenue growth at 8.4/9.3% for FY18E/FY19E (vs. 8.1/8.5% modelled earlier). However, TCS constant currency growth would be only 6.3% for FY18 which is lower than FY17 (8.3% cc revenue growth delivered in FY17). 2Q margin beat is negated by currency reset (USD vs INR) to lower levels which leads us to retain our EBIT margin assumption are retained at 24.9/24.5% for FY18/FY19E. Our EPS estimates are retained at FY18/FY19E to Rs136/148/sh. Raise TP by 2% to Rs 2600/sh (17x Sep 19E EPS vs 17x June19E EPS earlier). Maintain Accumulate.

Global peers Accenture (Annual Revenues at USD34.8bn for FY17) has guided for 5-8% YoY revenue growth for FY18 (2.5-5.5% 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. Hence, TCS revenue growth momentum has shown a deceleration and is now at par with global peers Accenture. (vs historic performance of growing at much higher pace as compared to Accenture).

Key financials (Y/e March)

	2016	2017	2018E	2019E
Revenues (Rs m)	1,086,462	1,179,660	1,238,295	1,375,260
Growth (%)	14.8	8.6	5.0	11.1
EBITDA (Rs m)	306,776	323,110	329,036	354,239
PAT (Rs m)	242,147	262,890	261,458	284,104
EPS (Rs)	122.9	133.4	136.0	148.0
Growth (%)	30.7	8.6	2.4	8.7
Net DPS (Rs)	38.0	46.7	50.6	54.9

Profitability & Valuation

	2016	2017	2018E	2019E
EBITDA margin (%)	28.2	27.4	26.6	25.8
RoE (%)	36.7	32.4	29.7	29.8
RoCE (%)	35.7	31.8	29.1	29.3
EV / sales (x)	4.4	3.9	3.6	3.1
EV / EBITDA (x)	15.4	14.1	13.5	12.2
PE (x)	20.7	19.1	18.7	17.2
P / BV (x)	6.8	5.7	5.6	4.7
Net dividend yield (%)	1.5	1.8	2.0	2.2

Source: Company Data; PL Research

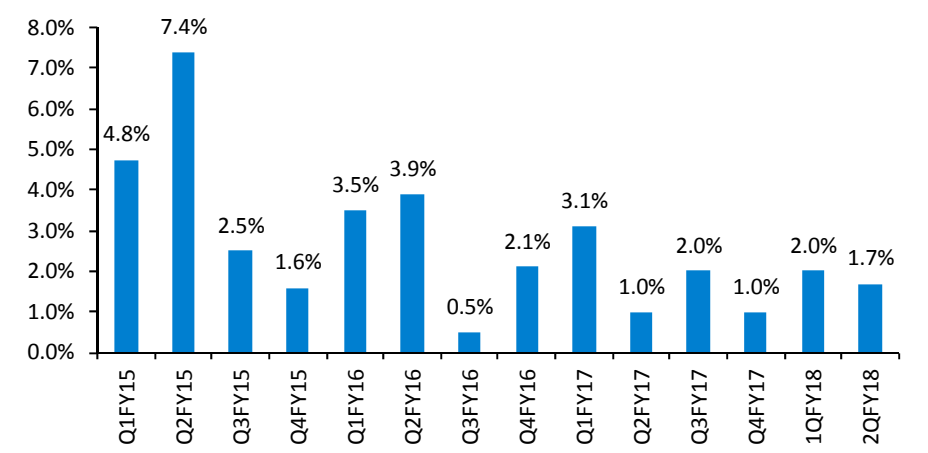
Exhibit 1: Q2FY18: Consolidated P&L- Revenues broadly in line, Margins beat expectations

(Rs m)	2QFY18	1QFY18	QoQ Growth	2QFY17	YoY Growth	PL Estimates	Variance(PL VS ACTUAL)
Total Operating Income (USD m)	4,739	4,591	3.2%	4,374	8.3%	4,761	-0.5%
Total Operating Income	305,410	295,840	3.2%	292,840	4.3%	307,076	-0.5%
EBITDA	81,630	74,130	10.1%	81,110	0.6%	79,840	2.2%
<i>EBITDA Margins</i>	<i>26.7%</i>	<i>25.1%</i>	<i>167 bps</i>	<i>27.7%</i>	<i>-97 bps</i>	<i>26.0%</i>	
Pre -Tax Income	84,720	78,460	8.0%	86,690	-2.3%	83,273	1.7%
Tax	20,120	18,960	6.1%	20,660	-2.6%	19,986	0.7%
<i>Tax- Rate</i>	<i>23.7%</i>	<i>24.2%</i>	<i>-42 bps</i>	<i>23.8%</i>	<i>-8 bps</i>	<i>24.0%</i>	
PAT	64,460	59,495	8.3%	65,860	-2.1%	63,207	2.0%
EPS	33.7	30.4	10.8%	33.4	0.7%	33.0	2.0%

Source: Company Data, PL Research

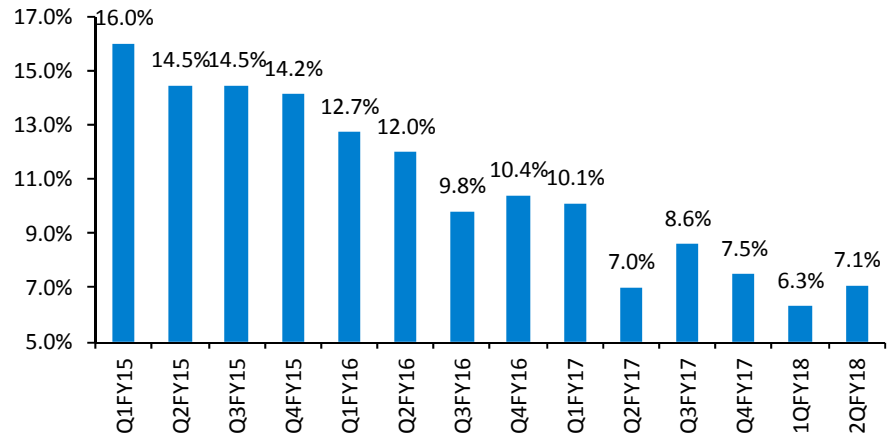
- Revenue in line with estimates:** Revenues were at US\$4,739mn, up 3.2% QoQ and were broadly in line with estimates (US\$4,761mn). Constant currency growth for the quarter stood at 1.7% and below our estimates (PLe: 2.3%). Volume growth for the quarter came at 3.2% QoQ. **Digital revenues stood at USD934mn up 7.5% QoQ and 35% YoY. Traditional Business (Revenues–Ex Digital) growth remained modest and grew by 3.7% YoY for 2QFY18.**
- Traction in BFSI vertical remained soft, while Retail vertical continued to remain tepid.** Owing to the weak performance in 1HFY18, we believe that TCS might be able to deliver ~6.3% constant currency growth for FY18E (vs. 8.3% constant currency growth delivered in FY17). We believe that TCS could also be struggling on the growth front owing to a base effect (Revenues at USD19bn for FY18 and Headcount at 389,213 employees as on 2QFY18).
- Travel & hospitality (up 8% QoQ in cc), Life sciences &Healthcare (up 3.6% QoQ in cc) energy (up 7.2% in cc) and technology & services (up 3.4% QoQ in cc) drove growth for the quarter.

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

Exhibit 2: Revenue Growth in Constant Currency (QoQ)


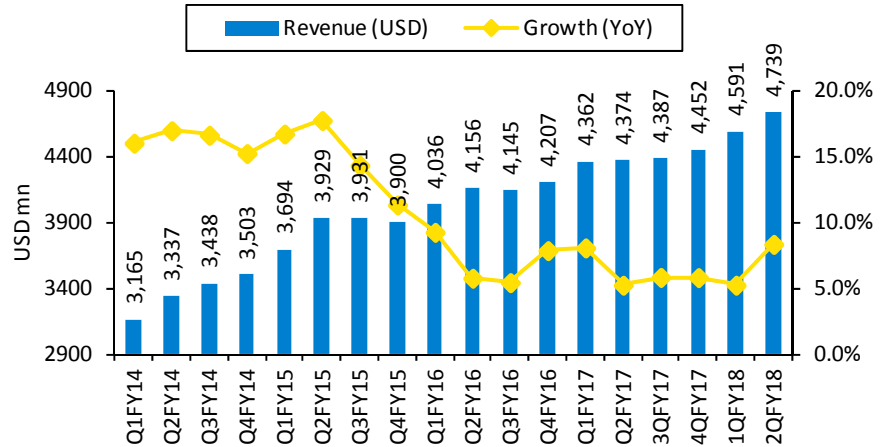
Source: Company Data, PL Research* 2QFY15 Organic constant currency growth is 4.6% QoQ.

Exhibit 3: Revenue growth in CC (YoY)



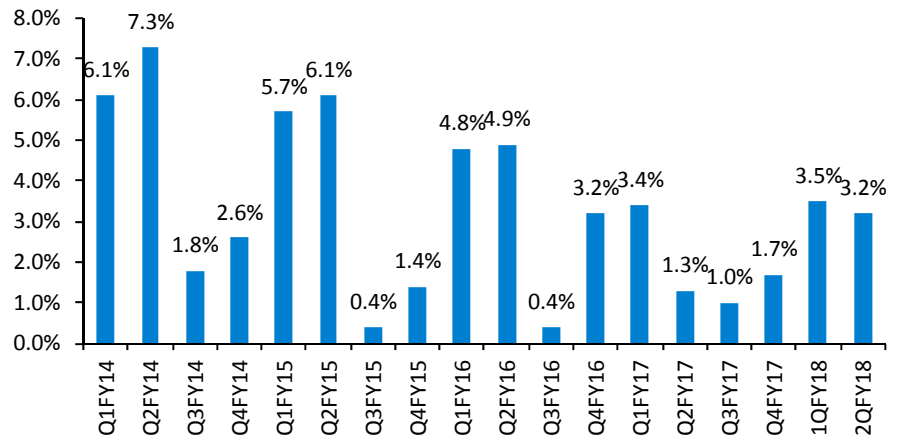
Source: Company Data, PL Research

Exhibit 4: USD revenue growth (YoY)



Source: Company Data, PL Research

Exhibit 5: Volume Growth (QoQ)

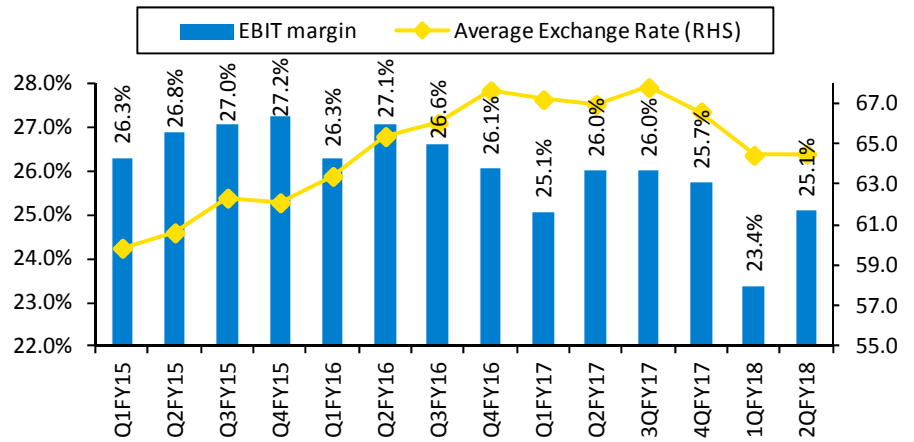


Source: Company Data, PL Research

- Margin delivers strong beat** : EBITDA margins increased by 170bps for the quarter and came in at 26.7%, and above our estimates (PLe: 26.0%). EBIT margin for the quarter stood at 25.1%, up 170 bps QoQ and above our estimates (PLe: 24.4%). EBIT Margins for the quarter were positively impacted by currency tailwind (impacted by +50 bps) and operating efficiencies (impacted by +120bps). **We believe margin expansion is being driven by softer Headcount additions. Total headcount at 389,213 employees which is up 0.9% QoQ and 4.8% 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

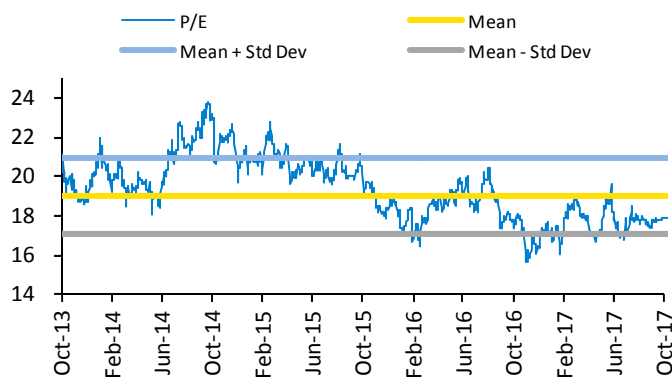
	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Headcount	324,935	335,620	344,691	353,843	362,079	371,519	378,497	387,223	385,809	389,213
QoQ growth (%)	1.7%	3.3%	2.7%	2.7%	2.3%	2.6%	1.9%	2.3%	-0.4%	0.9%
Net additions	5279	10685	9071	9152	8236	9440	6978	8726	(1,414)	3404

Source: Company Data, PL Research

Valuations

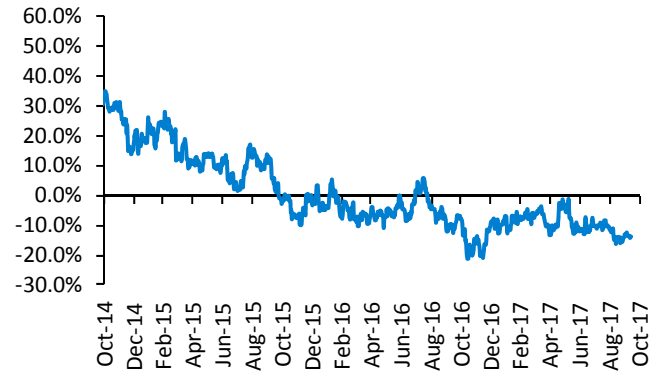
TCS has moderated substantially on the valuation front over the past few quarters. TCS trades at 17.8x one-year forward earnings (v/s 17.1/20.5x traded one year and two years ago respectively). TCS currently trades at 14% discount to Accenture on one year forward P/E basis. Moderating Revenue growth 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 %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
North America	53.5	54	53.5	54	55	53	52.5	51.9
Latin America	2.1	2.0	2.0	2.0	2.2	2.1	2.1	2.2
UK	15.9	14.9	14.8	13.8	13.3	13.7	13.9	14
Continental Europe	10.9	11.2	11.5	11.8	11.1	11.8	12.5	13.4
India	6.0	5.9	6.2	5.8	6.3	6.8	7	6.3
APAC	9.4	9.6	9.6	10.2	9.6	9.7	9.5	9.8
MEA	2.2	2.4	2.4	2.4	2.5	2.6	2.5	2.4

Source: Company Data, PL Research

Among geographies most of the incremental growth was driven by Continental Europe (up 5.3% QoQ in cc) and Latin America (up 5.7% 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	51.9%	1.4%	3.6%
Latin America	2.2%	5.7%	13.6%
UK	14.0%	2.5%	9.2%
Continental Europe	13.4%	5.3%	18.2%
India	6.3%	-6.8%	14.3%
Asia	9.8%	3.0%	4.1%
MEA	2.4%	1.0%	7.6%
Total	100.0%	1.7%	7.1%

Source: Company Data, PL Research

Energy and utility vertical (up 7.2%QoQ in CC QoQ) and travel (up 8% QoQ in cc) delivered most of the incremental revenue growth.

Exhibit 12: Revenue contribution by vertical and constant currency growth in verticals

Verticals (CC Growth)	Revenue contribution (%)	QoQ (CC Growth)	YoY (CC Growth)
BFSI	33.0%	1.9%	4.7%
Retail & CPG	11.9%	-0.9%	-1.4%
Communication & Media	7.3%	1.4%	9.5%
Manufacturing	7.5%	1.9%	9.6%
Life Sciences & Healthcare	7.2%	3.6%	10.3%
Energy & Utilities	4.2%	7.2%	22.7%
Travel & Hospitality	3.8%	8.0%	23.2%
Technology and services	8.1%	3.4%	10.1%
Regional markets and others	17.0%	-0.6%	6.9%
Total	100.0%	2.0%	6.3%

Source: Company Data, PL Research

Exhibit 13: Employee Details

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

Source: Company Data, PL Research

Exhibit 14: Client Details

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

Source: Company Data, PL Research

Financial Summary

Exhibit 15: Financial Snapshot of TCS

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E
Revenues- USD mn	11,568	13,443	15,454	16,544	17,575	19,056	20,837
Growth (%)	13.7%	16.2%	15.0%	7.1%	6.2%	8.4%	9.3%
Average exchange rate (USD vs INR)	54.5	60.8	61.2	65.6	67.1	65.0	66.0
Consolidated revenues (Rs mn)	629,884	818,093	946,484	1,086,462	1,179,660	1,238,295	1,375,260
Growth (%)	28.8%	29.9%	15.7%	14.8%	8.6%	5.0%	11.1%
EBITDA (Rs mn)	180,391	251,533	272,941	306,776	323,110	329,036	354,239
EBIT (Rs mn)	169,593	238,031	254,243	287,901	303,240	308,824	333,610
PAT (Rs mn)	139,168	191,546	216,961	242,147	262,890	261,458	284,104
EBITDA Margins (%)	28.6%	30.7%	28.8%	28.2%	27.4%	26.6%	25.8%
EBIT Margins (%)	26.9%	29.1%	26.9%	26.5%	25.7%	24.9%	24.3%
NPM (%)	22.1%	23.4%	22.4%	22.3%	22.3%	21.1%	20.7%
EPS	71.1	97.8	108.8	123.2	133.4	135.9	148.4
Growth (%)	33.6%	37.5%	11.2%	13.2%	8.3%	1.9%	9.2%
P/E	34.4	25.0	23.0	20.7	19.1	18.7	17.2
EV/EBITDA	25.7	18.2	17.5	15.3	14.1	13.5	12.2
ROE	40.8%	43.6%	38.5%	37.1%	32.6%	29.9%	30.0%
Consolidated balance sheet (Rs mn)							
Net cash on balance sheet (Rs mn)	404,245	514,674	749,537	912,128	1,053,530	1,060,185	1,232,778
Net cash per share	147,129	201,255	204,995	299,852	460,070	436,976	566,980
Net cash per share/ Stock price	72.6	98.3	99.5	149.4	231.3	219.4	285.7
Net cash per share/ Stock price	3.0%	4.0%	4.1%	6.1%	9.5%	9.0%	11.4%
Consolidated cash flows (Rs mn)							
Cash flow from operations	123,227	159,221	212,055	209,164	269,920	274,594	277,746
Capex + Acquisitions	(27,644)	(35,344)	(31,518)	(19,894)	(19,890)	(22,000)	(22,000)
Free cash flows	95,583	123,876	180,537	189,270	250,030	252,594	255,746
FCF Yield	2.0%	2.5%	3.7%	3.9%	5.1%	5.2%	5.2%

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2016	2017	2018E	2019E
Net Revenue	1,086,462	1,179,660	1,238,295	1,375,260
Cost of Software Dev.	595,493	650,320	676,914	770,146
Gross Profit	490,969	529,340	561,381	605,115
Other Expenses	184,193	206,230	232,344	250,876
EBITDA	306,776	323,110	329,036	354,239
Depr. & Amortization	18,875	19,870	20,213	20,629
Other Income	30,502	41,890	35,940	41,000
Profit before Tax	318,403	345,130	344,764	374,610
Total Tax	75,027	81,560	82,660	89,906
Profit after Tax	243,376	263,570	262,103	284,704
Ex-Od items / Min. Int.	(1,229)	(680)	(645)	(600)
Adj. PAT	242,147	262,890	261,458	284,104
Avg. Shares O/S (m)	1,970.4	1,970.0	1,913.5	1,913.5
EPS (Rs.)	122.9	133.4	136.0	148.0

Cash Flow Abstract (Rs m)

Y/e March	2016	2017	2018E	2019E
C/F from Operations	210,673	265,720	274,594	277,746
C/F from Investing	(65,766)	(189,220)	(22,000)	(22,000)
C/F from Financing	(95,863)	(109,400)	(275,688)	(125,742)
Inc. / Dec. in Cash	49,044	(32,900)	(23,094)	130,004

Key Financial Metrics

Y/e March	2016	2017	2018E	2019E
Growth				
Revenue (%)	14.8	8.6	5.0	11.1
EBITDA (%)	12.4	5.3	1.8	7.7
PAT (%)	31.5	8.6	(0.5)	8.7
EPS (%)	30.7	8.6	2.4	8.7
Profitability				
EBITDA Margin (%)	28.2	27.4	26.6	25.8
PAT Margin (%)	22.3	22.3	21.1	20.7
RoCE (%)	35.7	31.8	29.1	29.3
RoE (%)	36.7	32.4	29.7	29.8
Balance Sheet				
Net Debt : Equity	(0.4)	(0.5)	(0.5)	(0.5)
Valuation				
PER (x)	20.7	19.1	18.7	17.2
P / B (x)	6.8	5.7	5.6	4.7
EV / EBITDA (x)	15.4	14.1	13.5	12.2
EV / Sales (x)	4.4	3.9	3.6	3.1
Earnings Quality				
Eff. Tax Rate	23.6	23.6	24.0	24.0
Other Inc / PBT	9.6	12.1	10.4	10.9

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2016	2017	2018E	2019E
Shareholder's Funds	735,442	886,810	872,826	1,031,388
Total Debt	2,448	2,890	2,890	2,890
Other Liabilities	20,169	20,890	22,190	23,490
Total Liabilities	758,059	910,590	897,906	1,057,768
Net Fixed Assets	119,242	117,880	119,667	121,038
Goodwill	38,120	37,210	37,210	37,210
Investments	—	—	—	—
Net Current Assets	481,503	665,760	646,289	799,779
<i>Cash & Equivalents</i>	<i>295,174</i>	<i>455,770</i>	<i>432,676</i>	<i>562,680</i>
<i>Other Current Assets</i>	<i>340,397</i>	<i>352,930</i>	<i>375,892</i>	<i>412,109</i>
<i>Current Liabilities</i>	<i>154,068</i>	<i>142,940</i>	<i>162,280</i>	<i>175,010</i>
Other Assets	119,194	89,740	94,740	99,740
Total Assets	758,059	910,590	897,906	1,057,768

Quarterly Financials (Rs m)

Y/e March	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Net Revenue	297,350	296,420	295,840	305,410
EBITDA	82,290	81,330	74,130	81,630
<i>% of revenue</i>	<i>27.7</i>	<i>27.4</i>	<i>25.1</i>	<i>26.7</i>
Depr. & Amortization	4,960	5,060	4,990	5,030
Other Income	11,850	9,890	9,320	8,120
Profit before Tax	89,180	86,160	78,460	84,720
Total Tax	21,040	19,940	18,960	20,120
Profit after Tax	67,780	66,080	59,495	64,460
Adj. PAT	67,780	66,080	59,495	64,460

Key Operating Metrics

Y/e March	2016	2017	2018E	2019E
Revenue (US\$ m)	16,544	17,575	19,056	20,837
Growth (%)	7.1	6.2	8.4	9.3
Average Rupee Dollar rate	66	67	65	66

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>39.8%</td> </tr> <tr> <td>Accumulate</td> <td>43.8%</td> </tr> <tr> <td>Reduce</td> <td>16.4%</td> </tr> <tr> <td>Sell</td> <td>0.0%</td> </tr> </tbody> </table>	Rating	% of Total Coverage	BUY	39.8%	Accumulate	43.8%	Reduce	16.4%	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	39.8%										
Accumulate	43.8%										
Reduce	16.4%										
Sell	0.0%										

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