

BUY

TP: Rs 3,710 | ▲ 19%

**TATA CONSULTANCY
SERVICES**

| IT Services

| 08 January 2021

Strongest Q3 in nine years – growth and margins outperform

TCS's QoQ dollar revenue growth of 5.1% beat street estimates (~3.1%) in a seasonally weak quarter. Growth was broad-based across verticals and geographies. Adj. EBIT margin stood at 26.6%, up 40bps QoQ despite salary hikes. TCV was strong at US\$ 6.8bn. We raise our target P/E to 27.4x from 24.2x backed by strong demand growth and stable margins. On rollover, we have a revised Dec'22 TP of Rs 3,710 (Rs 3,180 earlier). Being the industry leader, TCS will be the prime beneficiary of vendor consolidation. **BUY.**

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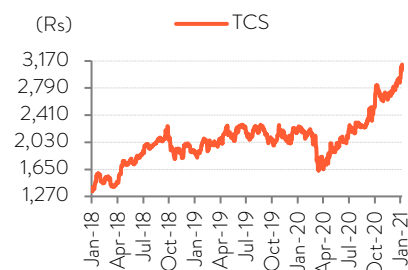
Stellar Q3 performance: TCS reported QoQ revenue growth of 4.1% CC/ 5.1% USD, beating our optimistic estimates of 2.6% CC/3% USD and setting the tone for a strong Q3 for Indian IT despite seasonality. At 2.1%, YoY growth was positive for the first time since pandemic onset. Demand is robust as indicated by TCV of US\$ 6.8bn (excluding Postbank acquisition), up 13% YoY. Geographically, India grew the highest at 18.1% QoQ CC. North America was strong at 3.3% CC, followed by Europe at 2.5%. Vertical-wise, life sciences/ manufacturing posted stellar growth of 5.2%/7.1% CC. BFSI/retail-CPG increased 2%/3.1% QoQ. The strong all-round showing indicates the beginning of a multi-year demand growth cycle wherein TCS will be the prime beneficiary.

Margins surprise: Adj. EBIT margin at 26.6% expanded 40bps QoQ (est. 24.7%), entering TCS's target band of 26-28% and recovering from a trough of 23.6% in Q1. Management expects to maintain margins, aided by accelerated growth.

Strong BFSI TCV growth: BFSI is gaining momentum with TCV at an all-time high of US\$ 2.6bn (+44% YoY), excluding Postbank. Growth was aided by closure of the Prudential deal in December. TCS is beginning to invest more in Europe as it sees opportunity there. However, UK banking remains stressed.

Ticker/Price	TCS IN/Rs 3,121
Market cap	US\$ 159.9bn
Shares o/s	3,753mn
3M ADV	US\$ 132.8mn
52wk high/low	Rs 3,128/Rs 1,506
Promoter/FPI/DII	72%/17%/11%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	1,464,630	1,569,490	1,662,306	2,106,950	2,489,786
EBITDA (Rs mn)	395,050	421,100	467,862	603,187	702,831
Adj. net profit (Rs mn)	315,240	323,400	337,873	444,595	518,335
Adj. EPS (Rs)	84.0	86.2	91.3	120.2	140.1
Adj. EPS growth (%)	25.3	2.6	6.0	31.6	16.6
Adj. ROAE (%)	35.5	37.0	37.7	43.6	42.1
Adj. P/E (x)	37.2	36.2	34.2	26.0	22.3
EV/EBITDA (x)	29.5	27.7	24.9	19.4	16.6

Source: Company, BOBCAPS Research

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Other highlights

- TCS is confident of achieving strong double-digit growth in FY22, backed by an uptick in cloud, products & platforms and revenue from captive acquisitions. Management is positive on BFSI momentum despite a high base. (see our report [Deep Dive 3: Swift BFSI recovery ahead; raise TCS to BUY](#)).
- Ignio (cognitive automation product) has acquired eight new logos and seven customer go-lives in Q3. TCS also launched Cognix – its AI-driven human-machine collaboration suite in Q3FY21.
- Attrition at 7.6% during the quarter was at its lowest ever, despite net addition of 15,721 employees.
- The board has declared a third interim dividend of Rs 6/sh.
- Cash conversion stood strong at 137% of net profit.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenues (US\$ mn)	5,702	5,586	2.1	5,424	5.1
Revenue (Rs mn)	420,150	398,540	5.4	401,350	4.7
Operating Expenditure	298,080	289,830	2.8	286,220	4.1
Cost of revenues	237,490	226,820	4.7	229,580	3.4
as % of sales	56.5	56.9	-	57.2	-
SG&A expenses	60,590	63,010	(3.8)	56,640	7.0
as % of sales	14.4	15.8	-	14.1	-
EBITDA	122,070	108,710	12.3	115,130	6.0
Depreciation	10,230	8,970	14.0	9,980	2.5
EBIT	111,840	99,740	12.1	105,150	6.4
Other Income	5,080	5,950	(14.6)	7,400	(31.4)
PBT	116,920	105,690	10.6	112,550	3.9
Total Tax	29,650	24,260	22.2	25,330	17.1
Adjusted PAT	87,270	81,430	7.2	87,220	0.1
(Profit)/loss from JV's/Ass/MI	(260)	(250)	-	(290)	-
APAT after MI	87,010	81,180	7.2	86,930	0.1
Reported PAT	87,010	81,180	7.2	86,930	0.1
Reported EPS	23.2	21.6	7.3	23.2	0.2
Margins (%)			(bps)		(bps)
EBITDA	29.1	27.3	180	28.7	40
EBIT	26.6	25.0	160	26.2	40
EBT	27.8	26.5	130	28.0	(20)
PAT	20.7	20.4	30	21.7	(100)
Effective Tax rate	25.4	23.0	240	22.5	290

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

(in US\$ mn)	Q3FY21 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Deal win TCV (US\$ mn)	6,800	(20.9)	13.3
Revenue by Geography			
Americas	49.1	3.4	0.0
UK	15.7	6.5	0.8
Europe	16.2	4.5	11.0
India	5.6	17.7	0.3
Asia Pac	9.7	5.1	6.5
Ibero America	1.7	5.1	2.0
MEA	2.0	10.7	(7.2)
Revenue by Domain			
BFSI	31.3	3.1	5.1
Manufacturing	9.6	7.4	(2.0)
Telecom & Media	6.6	6.7	(3.8)
Life Sciences & Healthcare	9.8	5.1	20.5
Retail & CPG	14.5	4.4	(2.6)
Technology & Services	8.6	1.6	4.5
Regional Markets & Others	19.6	9.0	(3.3)
	Q3FY21	Q2FY21	Q3FY20
Attrition (LTM) (%)	7.6	8.9	12.2

Source: BOBCAPS Research

Valuation methodology

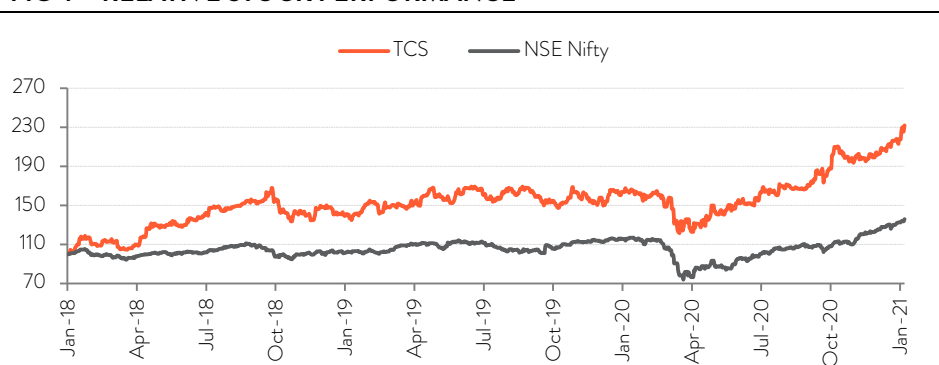
Following a strong Dec'20 quarter on all counts, we roll over to a new Dec'22 target price of Rs 3,710 (Rs 3,180 earlier) based on an upgraded one-year forward P/E multiple of 27.4x (24.2x earlier) which is +2sd above the last five-year mean P/E of 21x. We keep FY22/FY23 EPS estimates largely unchanged. The P/E upgrade is justified by TCS's industry-leading position which makes it the prime beneficiary of the upcoming technology upcycle, growing cloud migration demand and vendor consolidation. Reiterate BUY.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	22,215	22,286	0.3	27,382	27,534	0.6	31,889	31,920	0.1
YoY growth (%)	0.8	0.8	-	23.3	23.5	-	16.5	15.9	-
Revenues	1,673,534	1,662,306	(0.7)	2,135,763	2,106,950	(1.3)	2,487,379	2,489,786	0.1
EBITDA	454,419	467,862	3.0	611,431	603,187	(1.3)	702,151	702,831	0.1
EBITDA margins (%)	27.2	28.1	-	28.6	28.6	-	28.2	28.2	-
Net profits	327,360	337,873	3.2	450,338	444,595	(1.3)	517,277	518,335	0.2
EPS (Rs)	88.5	91.3	3.2	121.7	120.2	(1.3)	139.8	140.1	0.2

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates are:

- non-conversion of TCV, and
- another wave of Covid-19.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	1,464,630	1,569,490	1,662,306	2,106,950	2,489,786
EBITDA	395,050	421,100	467,862	603,187	702,831
Depreciation	20,550	35,300	39,533	40,859	44,978
EBIT	374,500	385,800	428,329	562,327	657,853
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	41,130	36,680	19,935	23,456	24,956
Exceptional items	0	0	0	0	0
EBT	415,630	422,480	448,264	585,783	682,809
Income taxes	100,010	98,010	109,231	140,588	163,874
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(380)	(1,070)	(1,160)	(600)	(600)
Reported net profit	315,240	323,400	337,873	444,595	518,335
Adjustments	0	0	0	0	0
Adjusted net profit	315,240	323,400	337,873	444,595	518,335

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	250,000	292,440	286,918	363,665	429,744
Provisions	0	0	0	0	0
Debt funds	440	69,060	69,060	69,060	69,060
Other liabilities	0	0	0	0	0
Equity capital	3,750	3,750	3,750	3,750	3,750
Reserves & surplus	0	0	0	0	0
Shareholders' fund	898,990	847,490	943,871	1,095,038	1,364,446
Total liabilities and equities	1,149,430	1,208,990	1,299,850	1,527,763	1,863,250
Cash and cash eq.	72,240	86,460	88,955	186,928	367,609
Accounts receivables	273,460	305,320	364,341	404,073	477,493
Inventories	0	0	0	0	0
Other current assets	243,530	239,510	273,256	346,348	409,280
Investments	349,540	273,760	273,760	273,760	273,760
Net fixed assets	113,740	198,410	192,123	193,403	198,221
CWIP	0	0	0	0	0
Intangible assets	18,790	19,930	19,930	19,930	19,930
Deferred tax assets, net	26,560	28,280	28,280	28,280	28,280
Other assets	51,570	57,320	59,205	75,042	88,677
Total assets	1,149,430	1,208,990	1,299,850	1,527,764	1,863,251

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	236,600	359,770	378,566	486,054	563,913
Interest expenses	(25,640)	(36,680)	(19,935)	(23,456)	(24,956)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(21,690)	8,850	(100,174)	(51,914)	(83,909)
Other operating cash flows	96,660	(2,965)	0	0	0
Cash flow from operations	285,930	328,975	258,457	410,685	455,047
Capital expenditures	(21,320)	(119,970)	(33,246)	(42,139)	(49,796)
Change in investments	73,820	(75,780)	0	0	0
Other investing cash flows	(36,050)	36,680	19,935	23,456	24,956
Cash flow from investing	16,450	(159,070)	(13,311)	(18,683)	(24,840)
Equities issued/Others	0	0	(80,000)	(80,000)	0
Debt raised/repaid	(1,940)	0	0	0	0
Interest expenses	(162,310)	0	0	0	0
Dividends paid	(114,720)	(155,685)	(162,652)	(214,028)	(249,526)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(278,970)	(155,685)	(242,652)	(294,028)	(249,526)
Changes in cash and cash eq.	23,410	14,220	2,494	97,974	180,681
Closing cash and cash eq.	72,240	86,460	88,955	186,928	367,609

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	84.0	86.2	91.3	120.2	140.1
Adjusted EPS	84.0	86.2	91.3	120.2	140.1
Dividend per share	30.0	34.5	36.5	48.1	56.0
Book value per share	239.5	225.8	255.1	296.0	368.8

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	8.0	7.4	7.0	5.6	4.7
EV/EBITDA	29.5	27.7	24.9	19.4	16.6
Adjusted P/E	37.2	36.2	34.2	26.0	22.3
P/BV	13.0	13.8	12.2	10.5	8.5

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	75.8	76.5	75.4	75.9	75.9
Interest burden (PBT/EBIT)	111.0	109.5	104.7	104.2	103.8
EBIT margin (EBIT/Revenue)	25.6	24.6	25.8	26.7	26.4
Asset turnover (Revenue/Avg TA)	131.1	133.1	132.5	149.0	146.8
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.4	1.4
Adjusted ROAE	35.5	37.0	37.7	43.6	42.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	19.0	7.2	5.9	26.7	18.2
EBITDA	21.5	6.6	11.1	28.9	16.5
Adjusted EPS	25.3	2.6	6.0	31.6	16.6
Profitability & Return ratios (%)					
EBITDA margin	27.0	26.8	28.1	28.6	28.2
EBIT margin	25.6	24.6	25.8	26.7	26.4
Adjusted profit margin	21.5	20.6	20.3	21.1	20.8
Adjusted ROAE	35.5	37.0	37.7	43.6	42.1
ROCE	34.3	35.8	36.9	45.0	48.9
Working capital days (days)					
Receivables	65	67	74	67	65
Inventory	0	0	0	0	0
Payables	78	86	89	79	81
Ratios (x)					
Gross asset turnover	12.8	10.1	8.5	10.9	12.7
Current ratio	2.6	2.4	2.7	2.8	3.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	0.0	0.0	(0.1)	(0.2)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

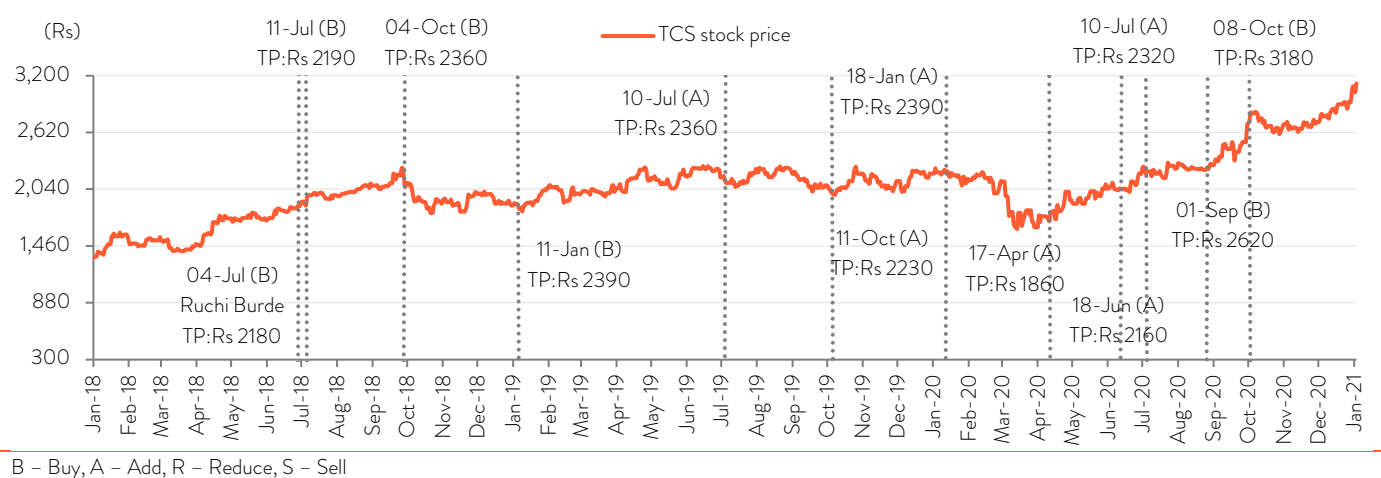
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): TATA CONSULTANCY SERVICES (TCS IN)



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