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Result Update-Q2FY18
TCS LTD.

Robust Volume Growth

13th October 2017

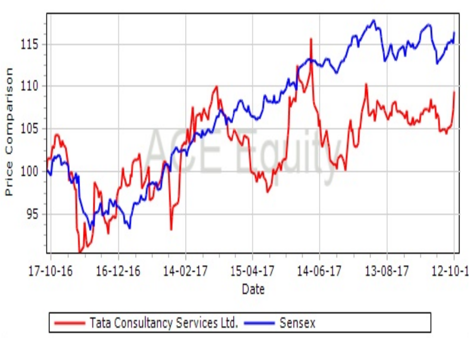
CMP:	**Rs.2,548**
Target Price:	**Rs.2,652**
Recommendation:	**HOLD**

Stock Info	
BSE Group	A
BSE Code	532540
NSE Symbol	TCS
Bloomberg	TCS.IN
Reuters	TCS.BO
BSE Sensex	32,182
NSE Nifty	10,096

Market Info	
Market Capital	Rs.488,554Cr
Equity Capital	Rs.191.0cr
6MAvg. Trading Vol.	1,137,769
52 Wk High/ Low	2708/2051
Face Value	Rs.1

Shareholding Pattern (%)	Sep (2017)
Promoters	73.6
Domestic Institutions	5.5
Foreign Institutions	16.7
Public & Others	4.2

Price VS Sensex Chart



Strong volume growth of 3.2% qoq and increase in earnings by 8.6% QoQ:
On a year-on-year basis, TCS grew 7.1% in constant currency, 8.3% in USD terms and 4.3% in INR, representing an acceleration over the last quarter.
On a sequential basis, 3.2% volume growth translated into 3.2% revenue growth in both USD as well as INR terms. And revenue growth was accompanied by good profitability, staged impressive margin recovery only partially aided by currency .Operating margin at 25.1% vs 23.4% QoQ, and the net margin at 21.15% vs 20.11% QoQ.

Segmental commentary:
On a year-on-year basis, with the exception of BFSI and Retail, all other industry verticals showed revenue growth upwards of 9.5% and four of them growing in double-digits. Two of the verticals, Energy & Utilities and Travel & Hospitality grew 20% plus. On a sequential basis, other than CMI, and Retail and CPG, all other verticals grew above the company average in Q2. Growth was led by Travel & Hospitality, which grew 8%, Energy & Utilities, which grew 7.2%, Life Sciences & Healthcare at 3.6% and Technology & Services at 3.4%. BFSI and Manufacturing grew at 1.9% each. BFSI grew by 2% in June and 1.9% sequentially in September.

Key Wins:
TCS had a strong set of new deals in Q2, total 11 deals in all. Of the 11 key wins, we had 3 each in BFSI and CMI, 2 in Retail and 1 in Life Sciences, Manufacturing and Travel.

Geography Perspective:
Strong 5.3% Q-on-Q growth in Continental Europe and a 5.7% growth in Latin America. North America continued to grow below company average, primarily due to the softness in BFSI and Retail. UK and APAC grew at 2.5% and 3% respectively. Japan, which went through a volatile patch, has shown modest growth in Q2 and we expect that to sustain going forward. India was volatile declining 6.9% reflecting the project centric nature of the business. Of the 11 key wins in Q2, 5 in North America, 3 in APAC, 2 in Europe and 1 in UK.

Human Resources:
Total employee strength at the end of Q2 stood at 389,213 on a consolidated basis, with gross addition of 15,868 employees and net addition of 3,404 employees during the quarter. Overseas recruitment continues with 3,725 employees recruited outside India, bringing the total to 6,979 in the first half of the fiscal year.
The company continues to enjoy best in class employee retention rates. The IT attrition rate (LTM) fell by 0.3% in Q2 to **11.3%**, while the total attrition rate (including BPS) fell to **12.1%**. The percentage of women in TCS continues to rise, hitting **35%** in Q2. The total number of nationalities represented in the workforce stood at 133.

Source: Company data, Arihant Research

Key Takeaways:

- In Retail, many of the larger customers getting their strategy together, moving beyond just e-commerce and omni-channel and embarking on a Business 4.0 transformational journey.Investing in interconnected channels that will help them leverage the ecosystem, make data-driven decisions and provide a differentiated experience to their end customers. Investments are the use of augmented reality, virtual reality and AI powered chat bots.
- Most banks have completed the first wave of digital investments. In the journey to Business 4.0, they're looking to transform their core systems and exploring the most appropriate architectures and delivery models to achieve that.
- TCS is partnering each of them in arriving at the right model that's best suited for them. But it is somewhat difficult to predict at this point when these efforts will ramp up sufficiently to move the BFSI growth. The next logical point to revisit this is at the end of the next quarter.
- In Q2, TCS was ranked as a leader in nine digital related assessments in areas like IoT, mobile application development, testing, digital workplace services, cloud services, and finance and accounting as a service. At an overall level, company is placed in the winner's circle in an assessment around digital technology strategy and consulting services, validating our Business 4.0 centric consulting led approach to digital transformation.
- Business 4.0 transformational opportunities is also resulting in strong client metrics.
- During the quarter, TCS added one client in the $100 million-plus revenue band, bringing that total to 37. In addition, it added six clients each in $50 million-plus, $20 million, $10 million and $5 million bands.
- TCS BaNCS, flagship product suite leads the field with 14 new wins and 19 go-lives in Q2.
- TCS finally breaks the multi-year drought in deals that Diligenta suffered. Pipeline there looks good with other large deals lined up.
- TCS actively scouting other markets outside United Kingdom for platform-based opportunities in the life and pension space.
- In the life sciences area, the highly successful TCS Advanced Drug Discovery platform suite added two new large life sciences companies as customers in Q2.

Outlook:

Q2 was a strong quarter, marked by robust volumes and an uptrend in our revenue trajectory and an impressive margin recovery. With the exception of BFSI and Retail, all verticals grew upwards of 9.5% year-over-year and management believe they have bottomed out in Retail and expect a good growth in the quarters ahead. Business 4.0 offerings followed by pioneering location-independent agile methodologies are resulting in good growth in the Digital revenue and strong client metrics with good client additions across all revenue bands.TCS had excellent deal signings in Q2 and the highlight being the deals signed by Diligenta after a long break. Investments in research and innovation and in products and platforms are giving significant market success .With all the developments and improvement in margins, we value the Stock at P/E of 17x FY19E EPS of Rs 156 and arrived at Target price of Rs 2652 with a **HOLD** rating on the Stock.

Source: Company data, Arihant Research

Financials:

Y/E March (Rs. In Crore)	FY17	FY18E	FY19E
Net Revenue	117966	126224	137584
Growth %	9%	7%	9%
EBIDTA	32311	34080	37148
EBIDTA Margin	27.4%	27%	27%
Net Profit	26357	27480	29847
Growth %	9%	4%	9%
EPS	134	144	156
P/E	16.9	17.8	16.3
ROE	30.6	27.6	25.8

Quarterly Results:

Particulars (Rs. Cr)	Q2FY18	Q1 FY18	QoQ%	Q2FY17	YoY%
Information technology and consultancy services	30541	29584	3.2%	29284	4.3%
Total Income	30541	29584	3.2%	29284	4.3%
Employee cost	16572	16183	2.4%	15280	8.5%
Gross Profit	13969	13401	4.2%	14004	-0.2%
Gross Margin%	45.7%	45.3%	1.0%	47.8%	-4.4%
Other expenses	5805	5988	-3.1%	5891	-1.5%
EBITDA	8164	7413	10.1%	8113	0.6%
EBITDA Margin	26.7%	25.1%	6.7%	27.7%	-3.5%
Depreciation	504	499	1.0%	496	1.6%
EBIT	7660	6914	10.8%	7617	0.6%
EBIT Margin	25.08%	23.37%	7.3%	26.01%	-3.6%
Interest	7	27	-74.1%	5	40.0%
Other Income	819	959	-14.6%	1057	-22.5%
PBT	8472	7846	8.0%	8669	-2.3%
Tax paid	2012	1896	6.1%	2066	-2.6%
Effective tax rate%	24%	24%	-1.7%	24%	-0.3%
Net Profit	6460	5950	8.6%	6603	-2.2%
EPS	33.70	30.40	10.8%	33.51	0.6%

Source: Company data, Arihant Research

Profit and Loss statement			
Particulars (Rs. In Crore)	**FY17**	**FY18E**	**FY19E**
Information technology services	117966	126224	137584
Total	**117966**	**126224**	**137584**
Employee costs	61621	65636	71544
Operation and other expenses	24034	26507	28893
Total Operating Expenses	85655	92143	100436
EBIDTA	**32311**	**34080**	**37148**
EBIDTA Margin	27.4%	27.0%	27.0%
Depreciation	1987	2146	2477
EBIT	30324	31935	34671
Interest	32	33	36
Other Income	4221	3787	4128
PBT	**34513**	35688	38763
Tax	8156	8208	8915
PAT	**26357**	27480	29847
Growth (%)	8.5%	4.3%	8.6%
EPS	**134**	144	156

Cash Flow Statement			
Particulars (Rs. In Crore)	**FY17**	**FY18E**	**FY18E**
Profit After taxes	26357	27480	29847
Add:- Depreciation	1987	2146	2477
Change in Working Capital	4825	3860	3088
Cash generated from operations	33169	33486	35412
Taxes paid	-7946	-8208	-8915
Net cash flow from operating activities	25223	25278	26496
Purchase of fixed assets	-1989	-2586	-3361
Others	-14743	-16217	-17839
Net cash flow from investing activities	-16732	-18803	-21200
Dividend paid, including dividend tax	-10947	-14000	-14000
Other	-79	-76	-76
Net cash used in financing activities	-11026	-14076	-14076
Net Cash Flow	-2535	607	135
Opening Cash balance	6295	3760	4367
Exchange Difference on transaction of Foreign Currency	-163	-163	-163
Closing Cash balance	3597	4367	4502

Balance Sheet			
Particulars (Rs. In Crore)	**FY17**	**FY18E**	**FY19E**
Shareholder's funds			
Share Capital	197	191	191
Reserves & Surplus	86017	99497	115345
Total	**86214**	99688	115536
Minority Interest	366	350	350
Total Non Current Liabilities	2160	2494	2811
Total Current Liabilities	14512	18941	21952
Total Liabilities	**103252**	**121473**	**140648**
Net Block	10057	12622	13758
Capital Work-in-Progress	1541	4984	5777
Goodwill on consolidation	1597	1994	2311
Total Non Current Assets	22726	24999	27829
Cash and bank balance	3597	4367	4502
Total Current Assets	80526	96474	112818
Total Assets	**103252**	**121473**	**140648**

Key Ratios			
Particulars	**FY17**	**FY18E**	**FY19E**
EPS	133.8	143.9	156.3
Book Value	440.5	508.9	589.8
DPS	52	52	52
Payout %	39	36	33
Dividend Yield %	2.1	2.1	2.1
P/E	16.9	17.8	16.3
EBIDTA Margin	27%	27%	27%
PBT Margin	29%	28%	28%
PAT Margin	22%	22%	22%
Debt/Equity	0.0	0.0	0.0
Current Ratio	5.55	5.09	5.14
ROE	30.6	27.6	25.8

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Stock Rating Scale

	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

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