

Stock Update

Good quarter, Digital is scaling up

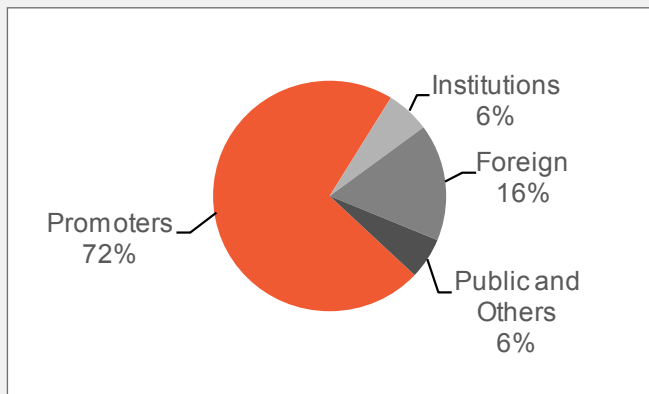
Tata Consultancy Services

Reco: Buy | CMP: Rs3,191

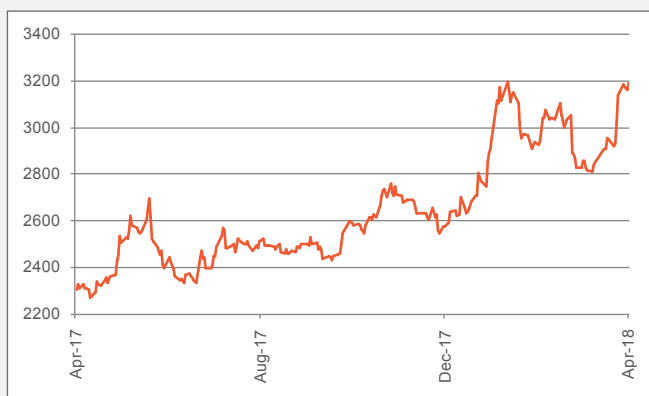
Company details

Price target:	Rs3,500
Market cap:	Rs610,782 cr
52-week high/low:	Rs3,254/2,255
NSE volume: (No of shares)	15.5 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCS
Free float: (No of shares)	53.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.8	8.5	22.7	39.4
Relative to Sensex	8.0	11.2	16.1	17.6

Key points

- Good exit in Q4:** During Q4FY2018, Tata Consultancy Services (TCS) delivered the highest incremental dollar revenue (\$185 million) on sequential basis in the history of Q4, despite seasonality issues. Revenue growth was driven by strong performance in verticals such as energy & utilities and travel & hospitality along with geographies in Europe and APAC (Japan grew in double digits). TCS reported a higher-than-expected constant currency (CC) revenue growth of 2% QoQ in Q4FY18, led by volume growth of 2% QoQ. On a reported basis, revenues were up by 3.9%QoQ at \$4,972 million. EBIT margins improved by 22bps QoQ to 25.4% (below our estimates) despite higher bonus payouts to employees, driven by currency benefits (40 bps). Net income during the quarter increased by 5.7% QoQ to Rs.6,904 crore. In FY2018, the revenue increased by 6.7% YoY on CC basis and 8.6% YoY on reported basis. EBIT margin contracted ~90bps YoY at 24.8% in FY2018, owing to wage hikes above industry standards, localisation and structuring innovative deals.
- Strong digital momentum continued, healthy progression of customers:** The digital segment has delivered yet another quarter of robust performance, revving up 11.9% QoQ and 42.8% YoY on CC terms. The digital segment thus made a higher contribution to the revenues at 23.8% (vs 22.1% in Q3FY18) in Q4FY18. The annual digital revenue for FY18 remained above \$4 billion and grew by 35% YoY. Regionally, continental Europe continued to perform well with a CC growth of 6.3% QoQ in Q4FY2018 while North America reported muted CC revenue growth. APAC delivered strong CC revenue growth of 4.0% QoQ. Baring BFSI and retail, all other verticals have grown over above company average. During Q4FY2018, customer additions remained strong – with \$100mn+ up by one, \$50mn+ up by three; \$20mn+ up by four, \$10mn+ up by 13.
- Hopeful for double digit growth in FY19, retained the targeted margin band:** The TCS management remained optimistic for the double digit revenue growth in FY2019 on the back of healthy deal wins and deal closures in recent past, strong deal pipelines, traction for its digital offerings and anticipation of cross-currency

tailwinds. Further, the management believes that retail vertical would continue its growth momentum in FY19, given the recent spate of deals. Though the management maintained its cautious stand on BFSI growth, some green shoot in this space are visible in North America and expect uptick by Q1 led by 1) de-growth in large accounts have stabilized, 2) demand emerging for digital technologies, 3) visibility of spends in coming quarters post interaction with the clients. Europe is expected to sustain its growth momentum in FY2019. On the margins front, maintained margins guidance target band of 26-28% for FY19E, was led by revenues recovery coupled with accelerated growth in the digital segment.

- ♦ **Valuation: upgrade to Buy with a revised price target of Rs.3,500:** We have revised our earnings estimates for FY2019E/FY2020E on account of management's positive demand outlook for FY19 and re-set of USD/INR rate to Rs. 66 from Rs. 64.5. Given a low base of revenue growth (CC) of 6.7% in FY18, large deal closures during 2HFY18 and strong growth momentum in retail and Europe, we expect acceleration in organic revenue in FY2019E/FY2020E. Further, with favorable capital allocation policy for investors (80-100% of annual FCF), we expect TCS to continue to trade at a premium to its peers. Hence, we upgrade our rating on the stock to Buy from Hold with a revised price target (PT) of Rs. 3,500.

Valuations

Particulars	Rs cr			
	FY17	FY18E	FY19E	FY20E
Total revenue	1,17,966.0	1,23,104.0	1,38,629.8	1,53,252.8
EBIT margin (%)	25.7	24.4	25.2	25.4
Net profit	26,289.0	25,384.0	28,755.9	31,878.1
EPS (Rs)	137.3	134.9	150.2	166.5
P/E (x)	23.2	23.6	21.2	19.2
EV/EBITDA	19.4	18.9	16.1	14.3
ROE (%)	29.6	29.0	27.4	27.1
ROCE (%)	37.9	37.1	35.3	35.0

Results

Particulars	Rs cr				
	Q4FY18	Q4FY17	Q3FY18	YoY (%)	QoQ (%)
Revenues (\$ mn)	4,972.0	4,452.0	4,787.0	11.7	3.9
Revenues in INR (Cr)	32,075.0	29,642.0	30,904.0	8.2	3.8
Direct costs	18,122.0	16,302.0	17,461.0	11.2	3.8
Gross profit	13,953.0	13,340.0	13,443.0	4.6	3.8
SG&A	5,301.0	5,207.0	5,155.0	1.8	2.8
EBITDA	8,652.0	8,133.0	8,288.0	6.4	4.4
Depreciation	505.0	506.0	507.0	-0.2	-0.4
EBIT	8,147.0	7,627.0	7,781.0	6.8	4.7
Other income	982.0	989.0	864.0	-0.7	13.7
PBT	9,129.0	8,616.0	8,645.0	6.0	5.6
Tax provision	2,204.0	1,994.0	2,100.0	10.5	5.0
Net profit	6,925.0	6,622.0	6,545.0	4.6	5.8
Minority interest	21.0	14.0	14.0	50.0	50.0
Adj. Net Profit	6,904.0	6,608.0	6,531.0	4.5	5.7
EPS (Rs)	36.1	34.5	34.1	4.5	5.7
Margin (%)					
EBITDA	27.0	27.4	26.8	-46	16
EBIT	25.4	25.7	25.2	-33	22
NPM	21.5	22.3	21.1	-77	39

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