9 December 2021

Company Update | Sector: Technology

TCS

BSE SENSEX	S&P CNX
58,807	17,517

Bloomberg	TCS IN
Equity Shares (m)	3,752
M.Cap.(INRb)/(USDb)	13329.9 / 176.5
52-Week Range (INR)	3990 / 2701
1, 6, 12 Rel. Per (%)	6/-1/1
12M Avg Val (INR M)	9810
Free float (%)	27.8

Financials & Valuations (INR b)

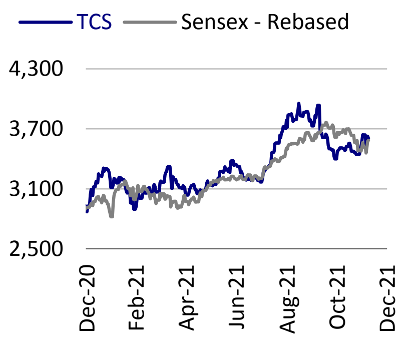
Y/E Mar	2022E	2023E	2024E
Sales	1,910	2,186	2,458
EBIT Margin (%)	25.9	26.1	26.5
PAT	394	458	522
EPS (INR)	106.2	123.5	140.8
EPS Gr. (%)	22.5	16.3	14.0
BV/Sh. (INR)	247	262	279
Ratios			
RoE (%)	44.2	48.6	52.1
RoCE (%)	37.0	40.1	42.8
Payout (%)	75.0	75.0	75.0
Valuations			
P/E (x)	33.9	29.1	25.6
P/BV (x)	14.6	13.8	12.9
EV/EBITDA (x)	24.4	21.2	18.6
Div Yield (%)	2.2	2.6	2.9

Shareholding pattern (%)

As On	Sep-21	Jun-21	Sep-20
Promoter	72.2	72.2	72.1
DII	7.9	8.0	7.9
FII	15.4	15.4	16.0
Others	4.5	4.4	4.0

FII Includes depository receipts

Stock performance (one-year)



CMP: INR3,604 TP: INR4,220 (+17%) Upgrade to Buy

Structural levers intact; growth to support valuations

- IT services companies should see acceleration in structural growth over the medium term as corporates embark on a multi-year cloud-led upgrade cycle. This shift in the business model should lead to a substantial increase (5% revenue v/s 3% historically) in the tech budgets of enterprise clients, adding 5–6% incremental growth for the industry.
- Growth in the cloud would anchor this phase of technology spending, which would see a mid to high teen growth rate. Along with continued double-digit growth in digital services, this should more than compensate for the decline in traditional services.
- In our view, TCS is among the best positioned companies to benefit from this structural spending uptick, and hence are upgrading the stock to Buy rating.
- We expect TCS to benefit from the sustained growth given its 1) strong organic capabilities, 2) diverse vertical and geographic presence, 3) deal win momentum, and 4) strong headcount additions.
- With the industry seeing supply-side challenges, TCS has been the industry bellwether in managing these challenges over multiple business cycles. We see this as a key factor for TCS to be able to post sustainable growth.
- While TCS has delivered good returns in the last year (up 30%, in line with the Nifty), it has underperformed its Tier 1 peers (by 30%, on average) as well as its Tier 2 IT services peers (20% valuation discount for the first time in history). We expect this underperformance to reverse as peer growth starts to normalize owing to the base effect as well as the impact of increased aggression from TCS to increase its market share.
- We expect TCS to benefit from demand tailwinds and deliver a ~14% revenue CAGR over FY21–24E, ~650bp higher than that seen over FY15–20. Growth could improve further as a greater acceptance of offshoring and inorganic opportunities from captive monetization could trigger incremental market share gains.
- While the current sector valuation is ahead of historical levels, the strong growth environment and increased visibility should more than justify it. We see current valuations at 26x FY24E as reasonable given its 1) sustained growth, 2) industry-high margins and return ratio profile, and 3) strong track record of supply-side management.
- We have taken up our FY22-23 estimates by 1-2% and are introducing FY24 estimates in this report. We are also rolling forward our target multiple to FY24E, leading to new target price of INR4,220 on 30x our FY24 EPS. We upgrade TCS to Buy with 17% upside from current level.

Technology spends to grow faster; expect TCS to see 14% CAGR

- COVID-19 has structurally accelerated the growth profile of the IT Services industry as corporates are embarking on a multi-year upgrade cycle.
- Enterprise technology budgets should increase to 5% of revenue by CY30 (from 3%). This should add 5–6% of incremental growth from normalized growth levels based on the global corporate performance.

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- This is also reflected in the commentaries of industry advisors such as Gartner. It expects IT services spending to see a 9.1% CAGR over CY20–25E (v/s a history of 3–5% over the last decade).

Cloud migration a multi-year theme

- We are seeing cloud usher in a new cycle of technology spending – similar in potential to the ERP wave of the 2000s – creating significant growth opportunities for IT services companies. Cloud adoption/migration is a USD300–350b opportunity for IT services providers.
- Within cloud infrastructure, hybrid and multi-cloud would continue to gain scale, providing large opportunities for IT services providers on increased complexities. We believe cloud migration and adjacent services would be the key growth contributors to the growth performance of Indian IT services.
- TCS' management sees increased technology intensity from enterprise customers and expects the demand momentum to continue over the medium term. Cloud adoption is at the initial stages, with only 20–30% of workloads having been moved to the cloud.
- Given TCS' strong organic capabilities and diversified vertical and geographical presence, it stands to be one of the key beneficiaries of the cloud migration demand.

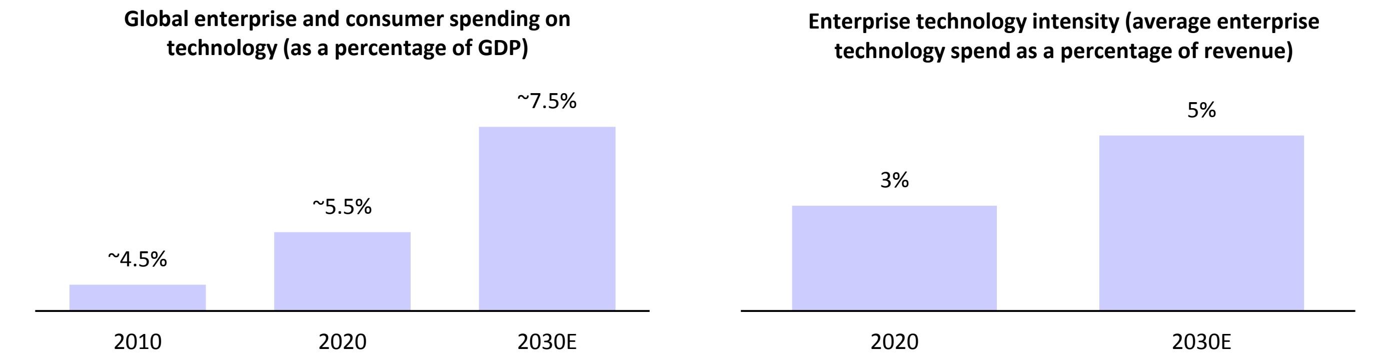
Margins to remain range-bound despite supply-side pressure

- While IT services companies have ramped up hiring, we expect attrition to remain elevated in 2HFY22 and stabilize gradually in FY23E. Moreover, we see the current intensity of supply-side challenges as transient and expect normalization over the medium term. TCS is the industry bellwether in managing supply-side challenges.
- TCS' LTM attrition is trending at 11.9% (an industry low). Moreover, the company has had strong net additions, including those of ~43k freshers in 1HFY22. On the other hand, the management has indicated the number of supply-side challenges would remain high for the next 2–3 quarters before normalizing.
- Despite the shortage of key skills leading to increased costs, we expect the company to have sufficient levers around 1) increasing offshoring, 2) cost optimization, and 3) operating leverage to keep margins range-bound.

Valuation and view

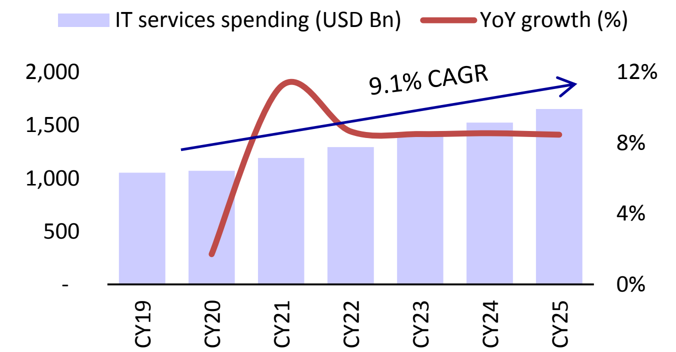
- IT Services has entered a technology upcycle, with cloud migration and digital transformation led deals coming to the market. Given TCS' size, capability, and portfolio stretch, it is rightly positioned to leverage the expected industry growth.
- The company has consistently maintained its market leadership and shown best-in-class execution. This gives the company continued room to maintain its industry-leading margins and demonstrate industry-leading return ratios.
- We are turning positive on the company given the strong growth potential. Our TP of INR4,220 implies 30x FY24E EPS. We upgrade our rating to **Buy**.

Exhibit 1: Enterprises' technology intensity to amplify



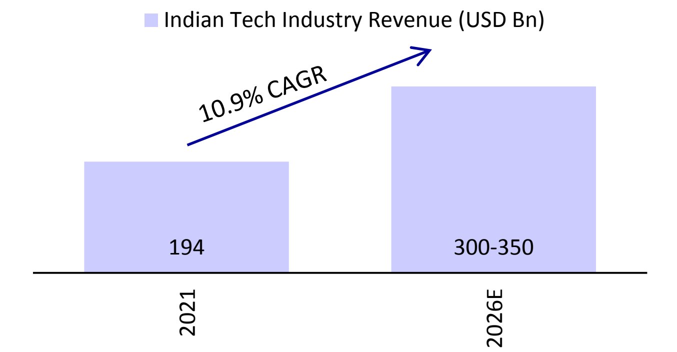
Source: Nasscom, McKinsey study

Exhibit 2: Gartner expects global IT spends to see 9% CAGR



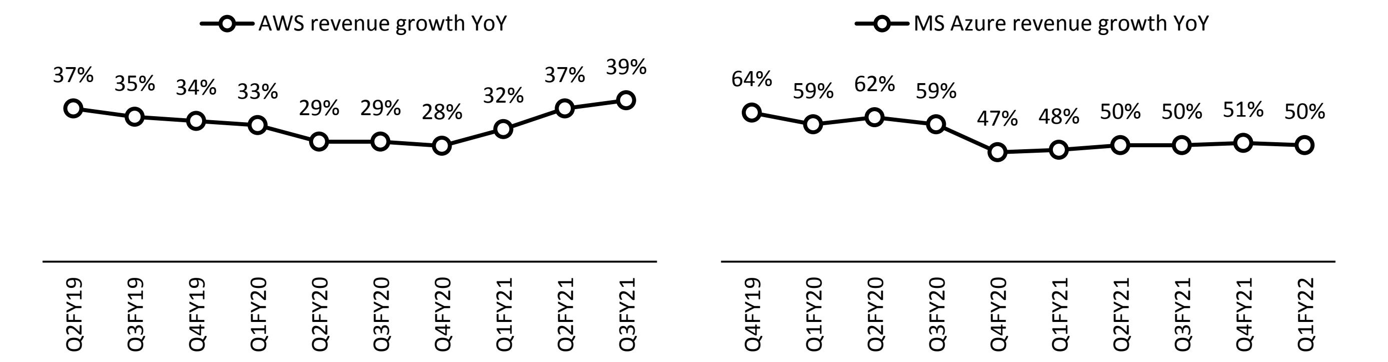
Source: Gartner

Exhibit 3: NASSCOM expects higher-than-market CAGR of ~11% for Indian IT



Source: NASSCOM

Exhibit 4: Sustained and strong growth among Hyperscalers despite increasing base effect



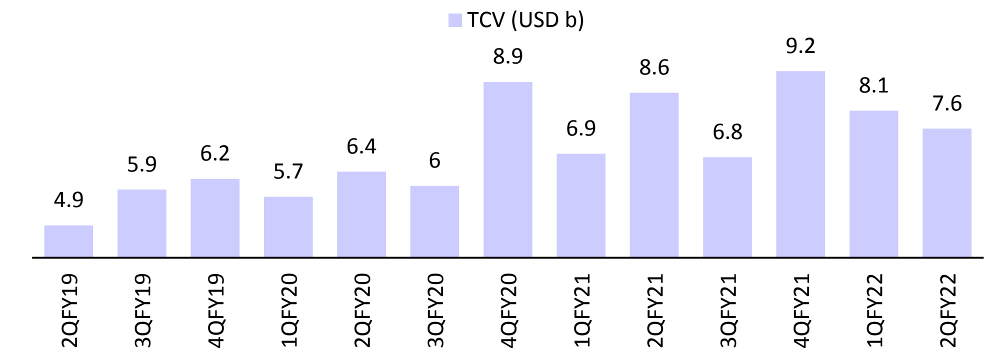
Source: Company, MOFSL

Exhibit 5: Strong commentaries by large hyperscalers

Company	Commentary
AWS	❖ We have seen a reacceleration of revenue growth as customers have expanded their commitment to the cloud and selected AWS as their cloud partner. Customers of all sizes and across all industries are using AWS as their preferred cloud provider for machine learning services.
MS Azure	❖ Azure and other cloud services grew 50% and 48% in constant currency, ahead of expectations, driven by consumption-based services. Seventy-eight percent of the Fortune 500 use our hybrid offerings. And with Azure Arc, customers like Nokia, Royal Bank of Canada, and SKF can deploy and run applications at the edge or in multicloud environments. Organizations also prefer our cloud to power the mission-critical apps they rely on every day.
Oracle	❖ We remain highly confident that our revenue growth will accelerate because of fast-growing cloud business which is becoming a larger portion of our total revenue.
SAP	❖ Our S/4HANA Current Cloud Backlog grew by 58% to EUR1.3 billion, building a strong foundation for future cloud revenue. We see a number of important supporting drivers that make us confident that in 2022, we will actually see a further continued acceleration of their cloud business.
Workday	❖ We have proposed acquisition of VNDLY, a leading next-generation cloud-based vendor management solution platform. Workday and VNDLY together will deliver a comprehensive total workforce optimization solution that brings an integrated approach to managing all types of workers.

Source: Company. MOFSL

Exhibit 6: TCS' deal wins continue at elevated levels



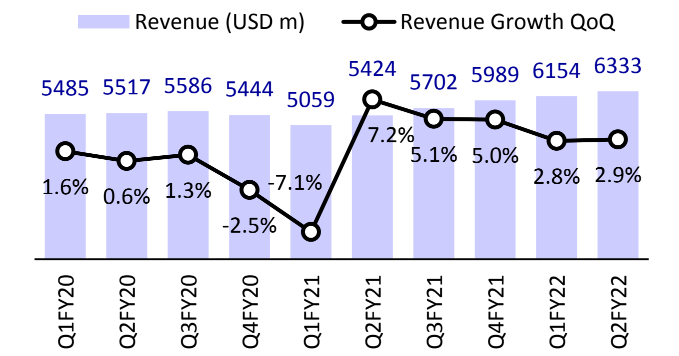
Source: Company, MOFSL

Exhibit 7: Tier 1 IT's select deal wins over October and November 2021

Company	Client	Vertical	Geography	Type
TCS	**SBI**	**BFSI**	**APAC**	**Customer experience**
TCS	**Scotland Gov.**	**Public Services**	**EMEA**	**Digital Transformation**
TCS	**Cainz**	**Retail**	**APAC**	**Business transformation**
TCS	**Heritage Life Insurance Company**	**BFSI**	**USA**	**Customer experience**
TCS	**Celcom**	**Communications & Media**	**APAC**	**Core platform transformation**
TCS	**Royal Academy of Engineering**	**Education**	**EMEA**	**Education Transformation**
TCS	**Juniper**	**Technology**	**USA**	**Customer experience**
TCS	**Zebra Technologies**	**Technology**	**USA**	**IT Transformation**
TCS	**Swiss Re**	**BFSI**	**EMEA**	**Digital Workspace**
TCS	**South32**	**Energy & Utilities**	**EMEA**	**IT operating model**
Infosys	ATP	Communications & Media	EMEA	Digital Transformation
Infosys	Bloomberg Media	Communications & Media	USA	AI Driven content
Wipro	National Grid	Energy & Utilities	USA	Cloud Architecture
Wipro	Aggreko	Energy & Utilities	EMEA	Procurement function transformation
HCL Tech	Proximus	Communication & Media	EMEA	Customer experience
HCL Tech	Innovaccer	Healthcare & Life Sciences	USA	Digital Health Transformation
HCL Tech	Euroclear	Capital Markets	EMEA	Automation, User experience
Tech M	Tanesco	Energy & Utilities	EMEA	IT infrastructure/network
Tech M	Cogniac	Technology	USA	AI based Visual data solutions
LTI	PIH Group	Healthcare	USA	SAP Integration

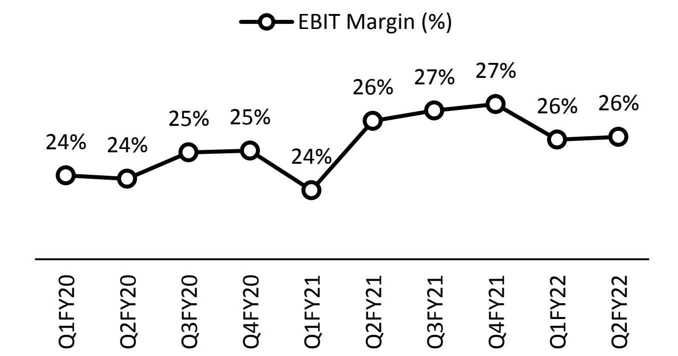
Source: Company. MOFSL

Exhibit 8: Strong revenue growth should sustain



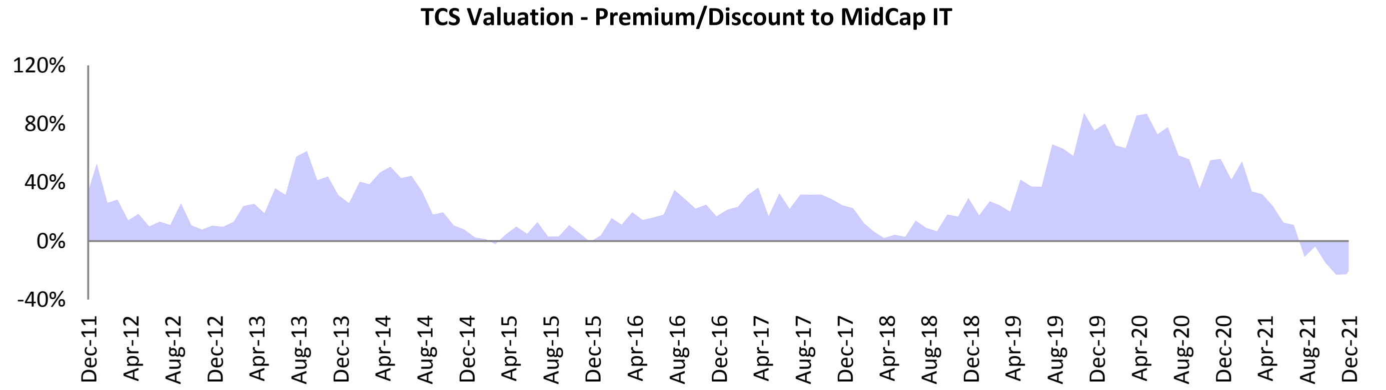
Source: MOFSL, Company

Exhibit 9: TCS is able to maintain stable margins over time



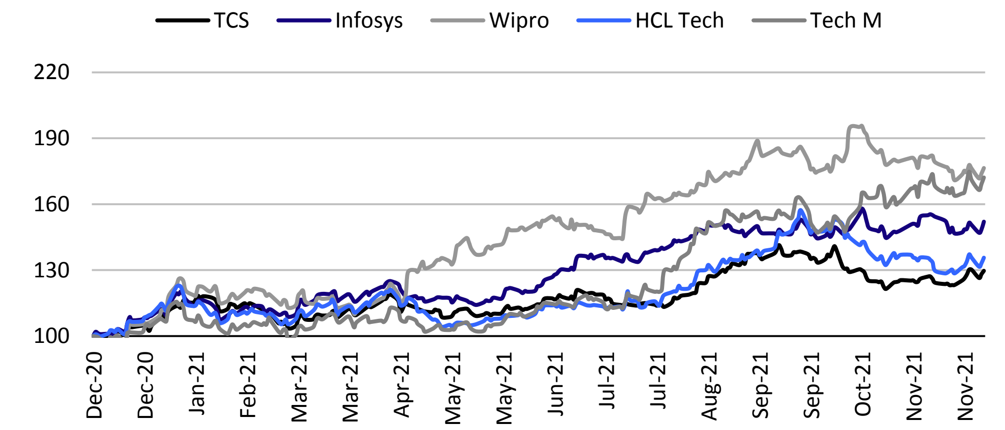
Source: MOFSL, Company

Exhibit 10: TCS trades at 20% discount to Midcap IT v/s 87% premium in Oct'19



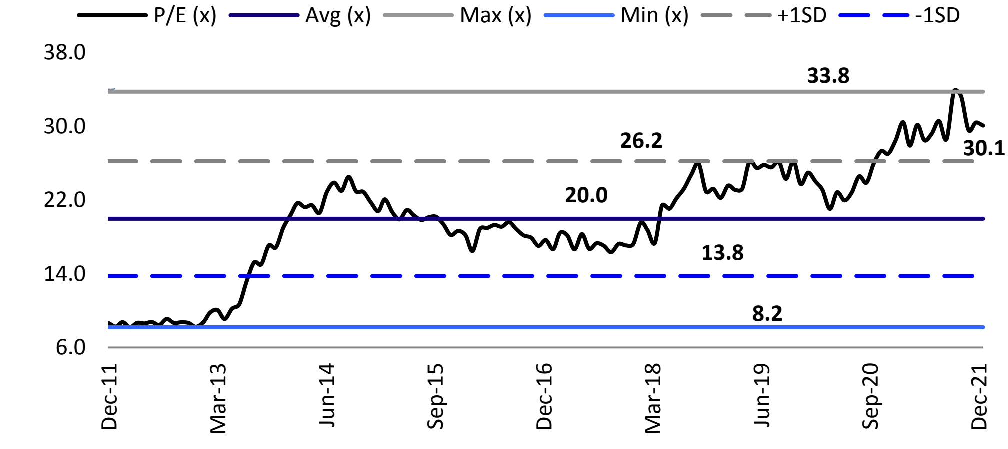
Source: MOFSL, Bloomberg

Exhibit 11: TCS underperforms peers by 30%



Source: MOFSL, Bloomberg

Exhibit 12: Valuation elevated, but growth visibility to lead to further performance



Source: Bloomberg, MOFSL

Exhibit 13: Peer comparison

Company	Rating	Price (INR)	P/E (x)			EV/EBIT (x)			Rev growth (%) (USD)			EBIT Margin (%)			PEG
			FY21	FY22e	FY23e	FY21	FY22e	FY23e	FY21	FY22e	FY23e	FY21	FY22e	FY23e	FY21-23
TCS	Buy	3,604	41.8	34.1	29.1	23.7	20.0	17.3	0.6	15.7	13.6	25.9	25.9	26.2	1.5
Infosys	Buy	1,763	38.5	33.2	26.9	18.4	16.2	13.3	6.1	18.9	16.4	24.5	23.6	24.2	1.4
Wipro	Neutral	643	34.2	28.9	25.3	14.0	11.5	9.8	-0.7	26.3	15.6	19.8	17.8	17.6	1.6
HCL Tech	Buy	1,169	26.8	23.9	20.5	14.8	13.8	11.6	2.4	11.7	14.5	20.4	19.4	20.0	1.4
Tech M	Neutral	1,611	31.1	24.8	21.5	12.9	10.0	8.4	-1.4	16.6	14.6	14.2	15.2	15.0	1.1

Source: MOFSL, Company

Exhibit 14: Current v/s previous v/s consensus estimate

	Revenues			Operating Margins			EPS		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Current Estimates (INR b)	1,910	2,186	2,458	25.9%	26.1%	26.5%	106.2	123.5	140.8
YoY Change	16.4%	14.4%	12.4%	1 bps	21 bps	38 bps	22.5%	16.3%	14.0%
Previous Estimates (INR b)	1895	2159	NA	25.9%	26.1%	NA	105.4	121.6	NA
YoY Change	15.4%	13.9%	NA	0 bps	20 bps	NA	21.6%	15.4%	NA
Current vs Previous	**0.8%**	**1.2%**	NA	**-0.1%**	**0.0%**	NA	**0.8%**	**1.6%**	NA
Consensus	1901	2147	2394	25.6%	25.4%	25.7%	104.8	118.8	132.5
YoY Change	15.8%	12.9%	11.5%	-30 bps	-19 bps	37 bps	20.9%	13.4%	11.4%
MOFSL vs Consensus	**0.5%**	**1.8%**	**2.7%**	**1.2%**	**2.8%**	**2.8%**	**1.4%**	**3.9%**	**6.3%**

Source: MOFSL, Bloomberg, Company

Financials and valuations

Income statement								(INR b)
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Sales	**1,180**	**1,231**	**1,465**	**1,569**	**1,642**	**1,910**	**2,186**	**2,458**
Change (%)	8.6	4.4	19.0	7.2	4.6	16.4	14.4	12.4
Cost of Services	669	713	852	923	971	1,133	1,296	1,443
SG&A Expenses	208	213	239	260	246	283	320	364
EBITDA	**323**	**325**	**395**	**421**	**465**	**542**	**625**	**712**
% of Net Sales	27.4	26.4	27.0	26.8	28.4	28.4	28.6	29.0
Depreciation	20	20	21	35	41	48	55	61
EBIT	**303**	**305**	**375**	**386**	**425**	**494**	**570**	**651**
% of Net Sales	25.7	24.8	25.6	24.6	25.9	25.9	26.1	26.5
Other Income	42	36	41	37	25	33	40	45
PBT	**345**	**341**	**416**	**422**	**450**	**528**	**611**	**696**
Tax	82	82	100	98	115	134	153	174
Rate (%)	23.6	24.1	24.1	23.2	25.5	25.3	25.0	25.0
PAT	**264**	**259**	**316**	**324**	**335**	**394**	**458**	**522**
Extraordinary gains/loss	0	0	0	0	-10	0	0	0
Adjusted PAT	**264**	**259**	**316**	**324**	**326**	**394**	**458**	**522**
Minority Interest	1	1	1	1	1	1	1	1
Reported PAT	**263**	**258**	**315**	**323**	**324**	**393**	**457**	**521**
Change (%)	8.6	-1.8	21.9	2.8	0.3	21.2	16.3	14.0

Balance Sheet								(INR b)
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Share capital	2	2	4	4	4	4	4	4
Reserves	860	849	891	838	861	909	965	1,029
Net Worth	**862**	**851**	**894**	**841**	**864**	**912**	**968**	**1,032**
Minority Interest & Others	25	33	34	97	102	117	133	149
Loans	1	1	0	0	0	0	0	0
Capital Employed	**888**	**885**	**929**	**938**	**966**	**1,030**	**1,102**	**1,181**
Gross Block	247	266	287	408	449	492	542	600
Depreciation	131	151	171	207	247	295	350	411
Net Block	**116**	**115**	**116**	**201**	**201**	**197**	**193**	**189**
Intangibles	44	52	44	45	57	62	66	72
Other LT assets	67	84	69	60	56	65	74	83
Curr. Assets	**805**	**812**	**921**	**902**	**993**	**1,100**	**1,215**	**1,333**
Debtors	280	316	325	363	367	425	486	546
Cash & Bank Balance	41	49	72	97	69	70	74	83
Investments	416	380	347	261	316	331	341	351
Other Current Assets	67	67	177	182	241	274	314	353
Current Liab. & Prov	**145**	**178**	**221**	**271**	**342**	**394**	**446**	**496**
Net Current Assets	**660**	**634**	**700**	**632**	**651**	**706**	**769**	**838**
Application of Funds	**887**	**885**	**929**	**938**	**966**	**1,030**	**1,102**	**1,181**

Financials and valuations

Ratios								
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Basic (INR)								
EPS	**66.7**	**67.0**	**82.3**	**86.2**	**86.7**	**106.2**	**123.5**	**140.8**
Cash EPS	71.8	72.2	87.6	95.6	97.6	119.1	138.3	157.4
Book Value	218.8	220.9	233.8	224.2	231.1	246.7	261.8	279.1
DPS	27.5	70.7	76.9	71.4	97.2	79.7	92.7	105.6
Payout %	41.2	105.6	93.5	82.8	112.1	75.0	75.0	75.0
Valuation (x)								
P/E	54.0	53.7	43.8	41.8	41.5	33.9	29.1	25.6
Cash P/E	50.2	49.9	41.1	37.7	36.9	30.2	26.0	22.9
EV/EBITDA	43.8	42.5	34.7	31.9	28.8	24.4	21.2	18.6
EV/Sales	12.0	11.2	9.4	8.5	8.2	6.9	6.1	5.4
Price/Book Value	16.5	16.3	15.4	16.1	15.6	14.6	13.8	12.9
Dividend Yield (%)	0.8	2.0	2.1	2.0	2.7	2.2	2.6	2.9
Profitability Ratios (%)								
RoE	34.7	30.1	36.1	37.3	38.0	44.2	48.6	52.1
RoCE	29.7	26.1	31.4	31.7	33.2	37.0	40.1	42.8
Turnover Ratios								
Debtors (Days)	87	94	81	84	82	81	81	81
Fixed Asset Turnover (x)	10.1	10.7	12.7	7.8	8.1	9.7	11.3	13.0

Cash Flow Statement								(INR b)
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
CF from Operations	259	282	308	370	379	436	505	574
Cash for Working Capital	-6	0	-22	-47	9	-37	-47	-51
Net Operating CF	**252**	**282**	**286**	**324**	**388**	**398**	**458**	**523**
Net Purchase of FA	-20	-19	-21	-32	-32	-37	-42	-48
Free Cash Flow	**232**	**263**	**265**	**291**	**356**	**361**	**415**	**476**
Net Purchase of Invest.	-147	16	36	118	-50	-15	-10	-10
Net Cash from Invest.	**-167**	**-3**	**16**	**86**	**-81**	**-52**	**-52**	**-58**
Proc. from equity issues	-1	0	0	0	0	0	0	0
Proceeds from LTB/STB	0	0	-2	-13	-211	0	0	0
Others	0	0	-2	-9	-6	0	0	0
Dividend Payments	-110	-268	-275	-377	-109	-345	-401	-457
Cash Flow from Fin.	**-110**	**-268**	**-279**	**-399**	**-326**	**-345**	**-401**	**-457**
Net Cash Flow	**-27**	**13**	**23**	**14**	**-18**	**2**	**4**	**8**
Opening Cash Bal.	**68**	**41**	**54**	**77**	**91**	**73**	**75**	**79**
Add: Net Cash	-27	13	23	14	-18	2	4	8
Closing Cash Bal.	**41**	**54**	**77**	**91**	**73**	**75**	**79**	**88**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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