Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Annual Report Review

Tata Consultancy Services Ltd

Poised to tide over uncertainty

IT & ITES	Sharekhan code: TCS

Reco/View: Buy	↔	CMP: Rs. 3,142	Price Target: Rs. 3,800	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 14.25

Updated Apr 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

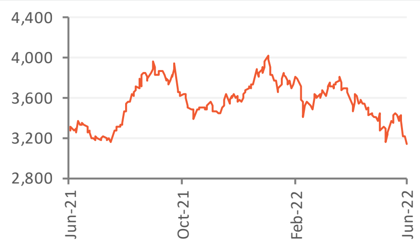
Company details

Market cap:	Rs. 11,49,802 cr
52-week high/low:	Rs. 4,045 / 3,133
NSE volume: (No of shares)	26.1 lakh
BSE code:	532540
NSE code:	TCS
Free float: (No of shares)	101.4 cr

Shareholding (%)

Promoters	72.3
FII	14.3
DII	8.2
Others	5.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.0	-14.5	-12.0	-4.1
Relative to Sensex	-3.8	-3.5	-1.1	-2.2

Sharekhan Research, Bloomberg

Summary

- Demand stayed robust led by higher spending on growth & transformation (G&T) initiatives, technologies and operations. G&T initiatives are likely to offer TCS huge growth opportunities given its robust contextual knowledge and full service model.
- TCS has a proven track record of gaining market share in the fragmented IT industry across cycles. Hence, we believe TCS will be considered as a preferred partner for any strategic vendor consolidation exercise in an inflationary environment.
- Margin levers such operating leverage, pyramid balancing, improved realisations and currency tailwinds are expected to offset the margin headwinds to a large extent in FY2023. COLA and better pricing would drive margin gradually.
- We continue to prefer TCS led by its robust business model, healthy order intake, excellent payout ratios and a strong client base. Hence, we maintain a Buy on the stock with a revised PT of Rs. 3,800.

TCS's FY2022 annual report reiterated that demand continues to remain robust on the back of higher spending on (a) growth and transformation (G&T) initiatives, (b) technologies (Cloud, data modernisation, 5G/Edge adoption, etc) and (c) IT infrastructure for leaner operating model. TCS is well placed to leverage the opportunity in G&T area given its full service model, strong contextual understanding of clients' operation, and excellent product and platform offerings. However, the recent geopolitical tensions in Europe, higher inflationary environment and the possibilities of recession in the US could moderate the pace of technology spends in FY2023E. TCS has a good track record of gaining market share in the fragmented IT industry even after events like GFC, Eurozone crisis, Brexit, pandemic, etc. Hence, we believe TCS will be at the forefront in driving clients' G&T program given its strong digital capabilities.

Well-placed to capture G&T opportunities: Clients who have moved the critical portion of workloads to Cloud will start shifting their IT spends to G&T themes (mostly business innovations). The key areas of G&T initiatives are (a) customer experience, (b) product innovation, (c) sustainability, and (d) M&A, supply chain modernization, collaborative ecosystem, etc. TCS has been investing in building a comprehensive offering in G&T space by leveraging its deep expertise in IoT, advanced analytics, and machine learning. The Horizon-2 and Horizon-3 initiatives are expected to offer huge growth opportunities to TCS given its strong presence across technologies and verticals.

Likely to get benefit from vendor consolidation: Vendor consolidation usually happens when customers eye cost savings in an inflationary environment or a strong strategic service provider. When cost savings would become a prime focus area for clients during the recessionary period, the large deals would start flowing in terms of vendor consolidation, re-badging of employees as part of integrated outsourcing deal and captive acquisitions. We believe TCS will be considered as a preferred partner for any cost take out led large deals in a challenging environment.

Expect sustainable margin performance in FY2023E: Margin headwinds such as higher wage revision, supply-side challenges, and return of travel and facility expenses are likely to weigh on margin performance though the course of FY2023E. We believe margin levers such operating leverage from strong revenue growth, pyramid balancing, improved realisations, lower sub-contractor costs and currency tailwinds are expected to negate the headwinds to a large extent. The management indicated that COLA (Cost of living adjustments) and better pricing during renewals would drive margin improvement gradually.

Our Call

Valuation – Maintain Buy with a PT of Rs. 3,800: We have reduced our earnings estimates for FY23-25E by 2-4% to factor in moderation in USD revenue growth owing to adverse currency movements and anticipation of moderation in technology spending due to increasing macro risks and possibilities of US recession. However, we believe that TCS has a robust business model which would leverage the G&T opportunities most given its strong digital competencies and solid execution capabilities. We expect the company's US Dollar revenues and earnings to clock a 10.5%/12% CAGR over FY2022-24E. At CMP, the stock trades at valuation of 27x/24x its FY2023E/FY2024E earnings. We have lowered out target multiples considering higher interest rates and lower growth assumptions owing to increasing concerns around US slowdown/ recession. Given a better supply-management capability than its peers, strong margin profile and excellent payout ratios, we maintain a Buy on TCS with an unchanged PT of Rs. 3,800.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would have an adverse impact on its earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	1,91,754.0	2,20,130.8	2,43,440.3	2,70,047.4
OPM (%)	27.7	27.3	27.6	27.6
Adjusted PAT	38,327.0	42,903.2	48,072.6	53,290.0
% y-o-y growth	*14.8*	*11.9*	*12.0*	*10.9*
Adjusted EPS (Rs.)	103.6	117.3	131.4	145.6
P/E (x)	30.3	26.8	23.9	21.6
P/B (x)	12.9	11.7	10.2	10.0
EV/EBITDA (x)	20.9	18.4	16.3	14.7
RoNW (%)	43.3	45.6	45.5	46.7
RoCE (%)	49.6	51.9	51.3	55.7

Source: Company; Sharekhan estimates

Key takeaways

TCS's FY2022 annual report highlighted demand themes such as (1) growth and transformation (G&T), (2) spending on technologies and (3) IT infrastructure for a leaner operating model, that would drive IT services spending in FY2023E. Though demand environment continues to remain strong, the recent geo-political tensions, higher inflationary environment and possibilities of a recession in the US could moderate the pace of technology spends in FY2023E as compared to FY2022. However, the growth in IT services spend would continue going ahead as enterprises would continue to make a steady progress towards their transformation journey in order to survive and adapt in tough times. In addition, enterprises may reprioritize their tech budget based on shifting objectives or towards programs that will deliver ROI in the near-term. TCS has been through multiple disruptive macroeconomic event (GFC, taper tantrums, Eurozone crisis, Brexit, pandemic, war, etc) in the past 15 years and has always emerged as a stronger than ever by gaining market shares in the fragmented IT industry.

Strong execution track record in tough times

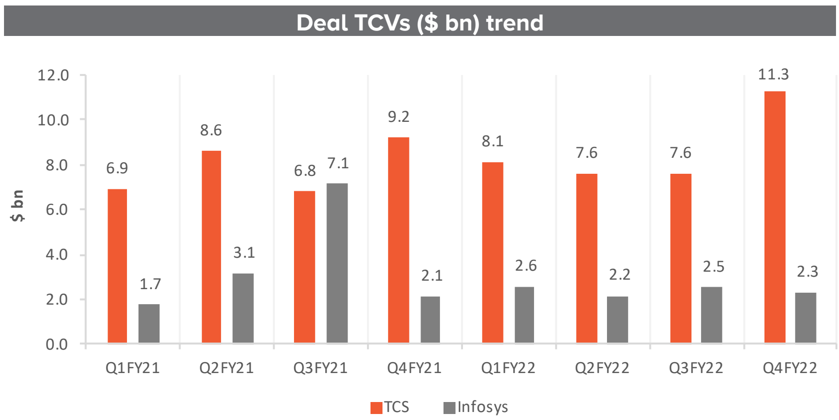
TCS has a good track record of staying relevant to the customers even after multiple technology changes and the catastrophic events like the global financial crisis or the pandemic, supported by full-service model, deep domain expertise, mature set of products and platforms and best-in class execution. It is expected that the recent geopolitical tensions in Europe, higher inflationary environment and the possibilities of recession in the US would moderate the pace of tech spends going ahead. However, we believe that growth of IT spends would continue as the enterprises can't stop their transformation initiatives in the middle or pullback programs that will deliver strong ROIs on an immediate basis. Based on recent demand trends, TCS will continue to focus on G&T opportunity and addition of new clients to drive its growth going ahead. Further, the company's newly purpose-designed organisational structure and investments in building newer capabilities, next generation delivery models and assets would help it to expand its addressable market and gain market share. Given its end-to-end capabilities, strong contextual understanding of clients' operation, and excellent product and platform offerings, we believe that TCS will be at the forefront of driving clients' growth and transformation initiatives and will benefit from vendor consolidation deal in an inflationary environment.

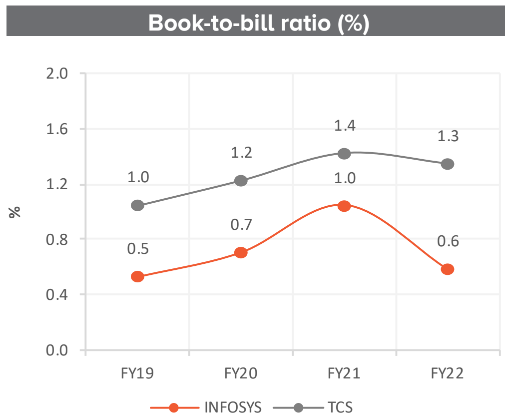
G&T initiatives likely to accelerate; TCS is well-placed to capture opportunities

Cloud adoption trends were strong in FY2022 as more clients embarked on multi-horizon Cloud transformation journeys. Henceforth, the demand would be driven by three themes (1) growth and transformation (G&T), (2) emerging technologies and (3) operations. Clients who have moved the critical portion of workloads to Cloud (Horizon-1 program) will start shifting their IT spends to Horizon-2 (development of Cloud native applications) and Horizon-3 (integration across ecosystem) initiatives. In the last two phases of cloud transformation journey, the focus of enterprises would be more on G&T themes. The key areas of G&T initiatives are (a) customer experience – strengthening customer relationships through digital channels, device agnostic experiences and hyper-personalization, (b) product innovation – accelerated spending on servitisation to provide a connected experience, (c) sustainability – developing new products and services aligned to sustainability, and (d) spending on employee experience, M&A, supply chain modernization, collaborative ecosystem, smart manufacturing and digital twins, etc. TCS has been investing in building a comprehensive offering and service in G&T space by leveraging its deep expertise in IoT, advanced analytics, and machine learning. We believe TCS is better positioned to participate in accelerated G&T initiatives given its strong digital capabilities, contextual knowledge, full service model and collaborative approach.

Strong deal win momentum likely to continue

In FY2022, the spending on digital and cloud transformation programs remained strong led by three factors such as (1) increasing focus on G&T initiatives, (2) supply-side issues and (3) need for resilient IT infrastructure. Given its depth of consulting expertise, presence across technology and domain areas and strong portfolio of products and platforms, TCS was able to win large deal through the year from the Horizon-1 initiatives (cloud migration). Deal TCVs signed in the first three quarters averaged $7-8 billion per quarter, while it touched all-time high order book of $11.3 billion in the fourth quarter. The company's deal TCVs remained at $34.6 billion, representing a book to bill ratio of 1.3x. We believe the company's deal win momentum would continue in the medium-term as TCS is actively engaged with its customers in Cloud assessment, business case preparation, roadmap creation, ERP consolidation and migration, application and data modernization and cloud migration.





Source: Company; Sharekhan Research

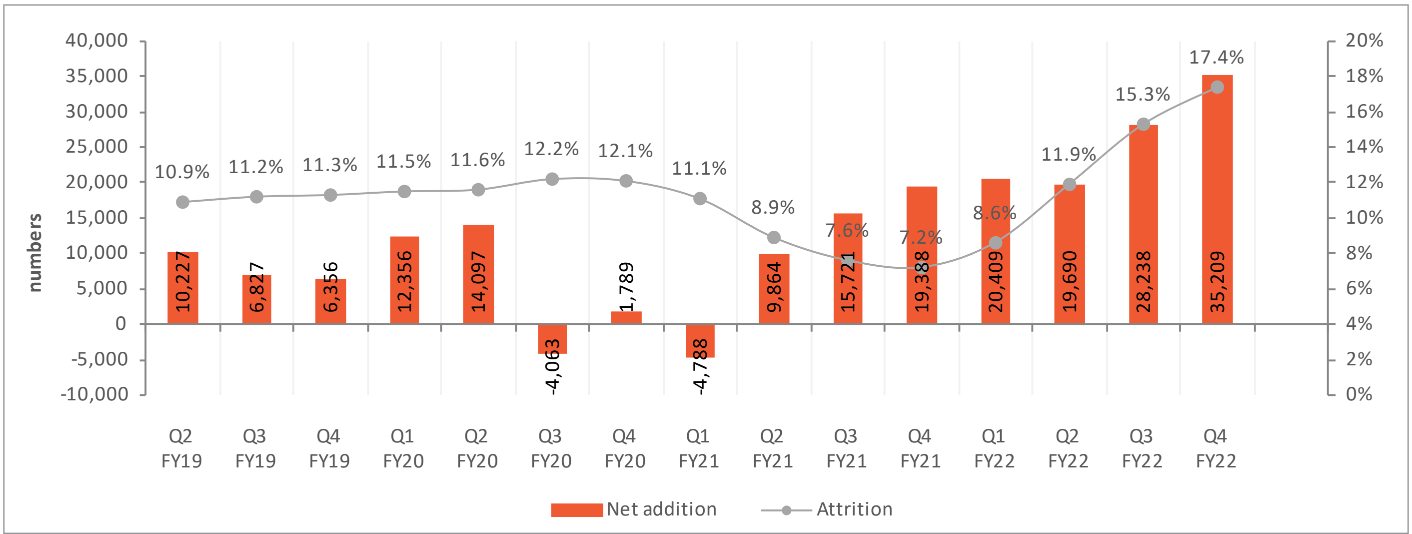
Vendor consolidation looks more eminent in a recessionary environment

Vendor consolidation happens when customers look for cost savings in an inflationary environment or an alternative strategic provider with strong capabilities and robust global delivery models. Though large IT service companies have won a few deals during the first two years of pandemic, we believe the activity of vendor consolidations during the last two years was weak because of higher focus on business continuity in the first year of pandemic and increasing spends on Cloud transformation in the second year of pandemic. Further, IT services vendors had constraints in terms of talent supply and capability. As cost savings remain a prime focus area for clients during the recessionary period, the large deals would start flowing in in terms of vendor consolidation, rebadging of employees as part of large integrated outsourcing deal and captive center acquisitions. We believe TCS will be considered as a preferred partner for any strategic cost take-out led large deals in a challenging environment given its end-to-end capabilities, presence across technologies and strong execution track record.

Strong net addition of employees; lowest attrition in the industry

The company's total headcount increased to 592,195 in FY2022, a record net addition of 103,546 employees. Hiring activity increased sharply during FY2022 due to sharp uptick in demand, lack of digital talents and travel restrictions. Hence, companies undertook several tactical measures to deal with the supply-side challenges through promotions, retention bonuses and increased use of sub-contractors. TCS indicated that the attrition is plateauing on a quarterly annualised basis, though LTM attrition is expected to inch up further over next couple of quarters before its starts tapering. Further, rising layoff in start-ups, hiring freeze and strong industry-wide fresher hiring would further reduce the attrition across the industry. Though the attrition rate (on an LTM basis) of TCS increased to 17.4% in FY2022, it remained the lowest attrition in the industry, which reflects the company's strong talent management policy among large peers. TCS hired 118,000 freshers in FY2022, which would benefit in terms of margin improvement and pyramid rationalisation as they become billable.

Strong net employee addition continued; attrition remained lowest in industry

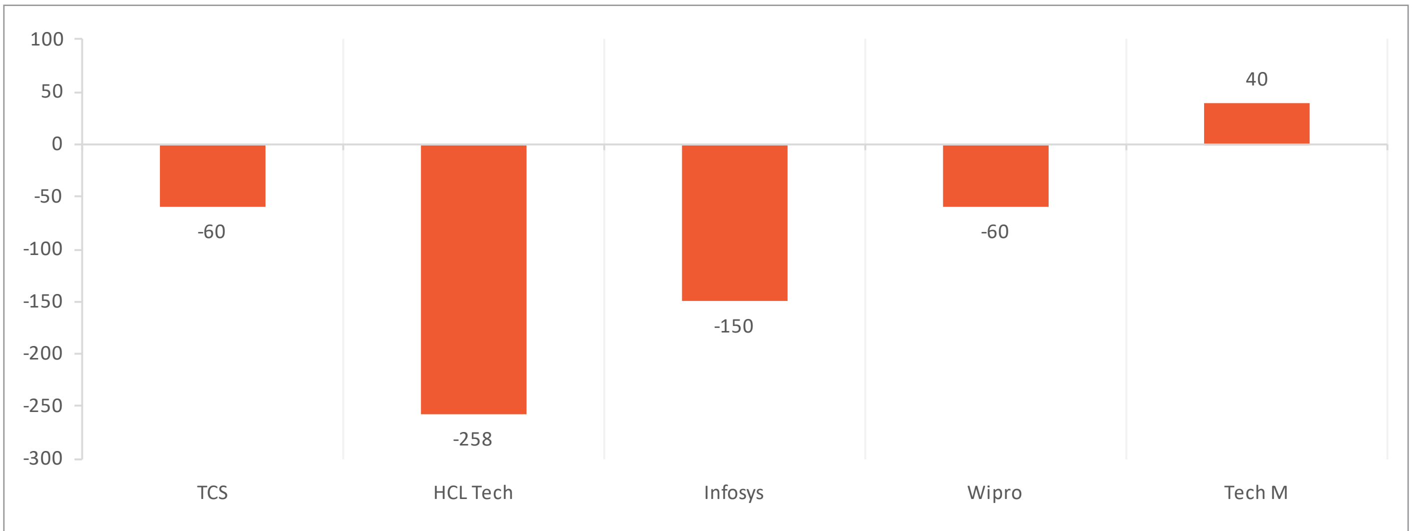


Source: Company, Sharekhan Research

Enough levers to sustain margin performance in FY2023E

Margin headwinds such as higher wage revision, supply-side challenges, and return of travel and facility expenses are likely to weigh on margin performance in FY2023E. The wage revision is expected to remain high compared to previous years owing to higher inflationary environment in key markets, while attrition is expected to slow down due to significant fresher hires across the industry and rising layoff in start-ups. We believe margin levers such operating leverage from strong revenue growth, pyramid balancing, improved realizations, lower sub-contractor costs and currency tailwinds are expected to negate the headwinds to a large extent.

Change in EBIT margin on y-o-y in FY2022



Source: Company, Sharekhan Research

Product and platform business is progressing well

TCS has been organically building a strong complementary product and platform portfolio, which has been helping the company for new revenue streams, providing competitive advantage and expansion of addressable markets. The company's four dimensions for the development of IPs are – (1) innovation in core business, (2) technology-led innovation (emerging technologies), (3) business and ecosystem led innovation (leveraging domain expertise) and, 4) blue sky innovation (futuristic areas of research).

- TCS is now enabling more of its IP based products and platforms to be available on hyperscaler cloud platforms. In FY2022, TCS added TCS Omnistore, TCS MasterCraft, 5G Edge Suite, TwinX and its suite of sustainability solutions (namely TCS Clever Energy, TCS IP2 and TCS Envirozone) on the cloud.
- TCS also launched Google Cloud Garages for co-innovation leveraging analytics and AI on the cloud, at its Pace Ports in Amsterdam, New York and Tokyo.
- TCS launched ESG Integration solution suite on all three hyperscaler platforms and across all relevant business verticals covering EU taxonomy, Sustainable IT, Green Mortgage, Carbon Bank and Cal-C (Carbon Calculator).
- The company launched Cyber Defense Suite – a comprehensive suite of modular, quickly adoptable cyber security services on a single platform – to provide enterprises with a unified 360-degree visibility and predictive intelligence to proactively defend and respond against evolving risks.

Products and platforms

Year/ Name	TCS BaNCS	Ignio	TCS Ion	TCS Optumera	TCS TwinX	TCS OmniStore	Mastercraft	Quartz	TCS ADD	TCS HOBS	Jile
FY2019	18	44		5	NA	2	22	NA	7	6	11
FY2020	23	54		4	2	4	29	NA	9	5	8
FY2021	19	50	307	1	7	1	25	10	NA	13	14,000+ active users
FY2022	22	100	125	1	20	3	27	7	3	2	13,000+ active users

Source: Company, Sharekhan Research

ESG goals remain a priority

- **Environment:** TCS has plans to achieve net zero emissions by 2030 and have 70% reduction of Scope 1 + 2 emissions by 2025 (vs base year 2016). It made a big leap on the latter front, with use of renewable energy across TCS' global operations growing to 37.2% of the total (15.6% in FY2021). Other initiatives range around reduction in freshwater consumption, waste generation and increasing recycling of waste and conservation of natural resources on campuses.
- **Social:** TCS has a highly diverse workforce, with over 153 nationalities represented with the number of women in the workforce exceeding 200,000 and accounting for 35.6% of workforce.

- **Governance:** On the diversity, equity and inclusion (DEI) front, TCS has carried out various initiatives- iExcel: TCS' flagship executive leadership development program for women, which has benefited 1,290 women leaders. TCS management has mentioned its intention to assist clients with their ESG goals by means of the ESG Integration solution suite on all three hyperscaler platforms covering EU taxonomy, sustainable IT, green mortgage, carbon bank and Cal-C (Carbon Calculator).

New organisation structure: Focused on the customer

TCS's key pillar of its strategy is customer-centric. The company's investments in new capabilities and intellectual property, delivery models and contracting structures have been designed based on its clients' requirements. With a larger component of G&T revenues, improving realisations, and rising IP-linked revenues, the company is well-positioned to its double revenues without adding employees at similar pace.

With a focus on doubling revenues, the management has decided on a new organisation structure that is more customer-centric and will enable curated experiences to its customers based on what stage they are at in their relationship journey with TCS. The company added a fourth dimension i.e. customer relationship stage to the existing three dimensions of TCS' organization structure: geography, industry vertical and service line. Customers have now been segmented by relationship stage.

- ***Relationship Incubation Group*** to manage new relationships which require a higher level of hand holding and a differentiated, high touch delivery;
- ***Enterprise Growth Group*** to manage relationships which are in the high growth phase;
- ***Business Transformation Group*** to manage large and mature relationships

Sharper customer focus enabled by the new structure and the resultant curated customer experiences are expected to enhance customer intimacy, facilitate cross-selling and up-selling, expand share of wallet and prepare the company for the journey ahead.

Industry overview

Demand stays robust

With a strong recovery in economy, global technology spending reached to $1.7 trillion in 2021 from $1.4 trillion in 2020. Strong growth in technology spends were led by higher digital and cloud transformation program. Growth was also supported by higher focus on G&T initiatives by clients those had already moved their most critical workloads to the cloud and increased outsourcing for cost efficiencies. Within overall technology spends IT services grew by 6.2% y-o-y to $899 billion, while BPM grew by 5% y-o-y to $211 billion.

TCS has outperformed the market by growing significantly higher than market growth over the last decade. The company market share has increased to 2.3% in FY2022 from 1.3% in FY2012. The company highlighted that it has shown market share growth in the fragmented IT industry where the large IT service provider has a mid-single digit market share. We believe the company's market share gain in the fragmented IT industry is led by its customer-centric strategy and organization structure, strong capabilities, robust execution and expanding participation in customers' growth and transformation spends.

Business overview

Banking, Financial Services and Insurance (BFSI): BFSI the largest industry vertical for TCS surpassed $10 billion revenue milestone this year, which contributed 39.2% of its revenue in FY2022. BFSI was the slowest growing industry vertical with revenue growth of 14.5% y-o-y in FY2022. The segment's margin declined to 26.9% in FY2022 from 28.5% in FY2021.

- Demand in this segment was led by trends such as customer journey transformation, ecosystem strategies for new products & services, and fintech adoption.
- Demand was also fueled by regulatory requirements, particularly new credit risk and operational risk mandates, controls management, consent order management and strategic framework for risk and finance management.

Communication, Media and Technology (CMT): The vertical's revenue picked up in the second half of FY2022. Segment revenue for the year stood at $1,671 million in FY2022, an increase of 14.2% y-o-y. The segment margin stood at an improved 29.9% for FY2022 as compared to 29.6% in FY2021.

- Major spending areas were 5G and fiber rollout, network virtualization. Further, the spending areas in this segment are data and analytics, cloud enhancement, product and platform engineering.
- Margins improved due to cost optimisation.

Retail and consumer business: The spending in retails improved as the pandemic resided with focus on customer experience and digitisation. The vertical saw one of the fastest growth amongst the verticals for TCS with 21.6% y-o-y revenue growth at $3,882 million. The segment's margins however remained stable at 27.8% in FY2022 (27.9% in FY2021).

- The growth was driven by technology spends in seamless and unified customer experience across channels, hyper personalization, last-mile delivery, marketplace, payments.
- Enterprises are focusing on supply chain transformation for speed and visibility.
- Enterprises are also focusing on employee experience, automation, application and data modernization, cloud migration, cost optimization.

Manufacturing: Manufacturing was one of the most affected sectors during the pandemic and that led to less spending by customers on discretionary spends. The vertical saw a strong recovery post the normalization of the situation. The vertical posted revenue growth of 19.6% to $2,545 million. Vertical margin improved by 200 bps y-o-y to 30.1% in FY2022.

- Demand in this segment is driven by IT infrastructure modernization, cloud enablement, cybersecurity, plant safety, remote asset management, energy efficiency and decarbonisation, supply chain resilience and process resilience.
- Utilities invested in connected ecosystems, smart-grids and front-end digital investments to enhance customer experience.

Life sciences and healthcare (LSH): Contrary to other verticals, this vertical saw an improved impetus in spending since the onset of COVID-19. The industry witnessed higher spending in connected labs, clinical trials, connected instruments, digital surgery and health. The LSH vertical reported revenue growth of 19.5% y-o-y to $2,571 million for FY2022 while margin for FY2022 stood at 30.0% (versus 31% in FY2021).

Others: The others segment includes energy, resources and utilities, Public Services etc. The vertical revenue increased by 15.5% y-o-y in FY2022, while the vertical's margins stood at 20.6% (vs 22.9% in FY2021).

- Demand is led by higher technology spending in digital marketing and analytics, mergers, acquisitions and divestitures, digital workplace transformation, ERP modernisation, cloud transformation, intelligent automation, data democratization, analytics and insights, cyber security.

Added highest-ever incremental revenue in FY2022E

TCS reported strong revenue growth of 15.9% y-o-y to $25,707 million in FY2022, when incremental revenues hit all-time high of $3,533 million. The growth was primarily led by BFSI, retail and CPG and life sciences and healthcare, which contributed 66% of the total incremental revenue in FY2022. Similarly, the incremental revenue from US accounted for 56% of the total incremental revenue in FY2022. TCS reported industry-leading EBIT margins of 25.3% despite supply-side challenges, tactical interventions, annual increment and a rise in sub-contractor usages. Net profit increased by 14.8% y-o-y to Rs. 38,327 crore.

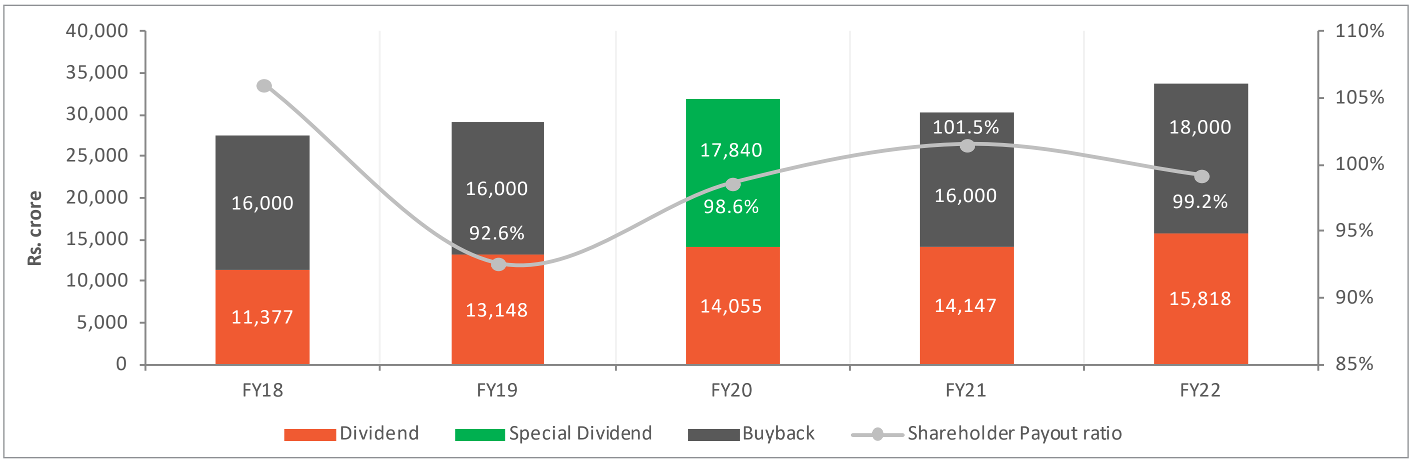
Balance sheet analysis

- Total investments and cash & cash equivalents increased by 11.2% y-o-y to Rs. 56,053 crore in FY2022 (cash balance was Rs. 50,430 crore). Cash per share stood at Rs. 152.
- Total cash and cash equivalents remained at 55.7% of total assets and 4.9% of current market capitalisation.
- Current ratio for FY2022 stood good at 1.46x but down from 1.85x in FY2021.
- PPE increased by 5.7% y-o-y to Rs. 30,300 crore, while the capex for PPE declined by 8.6% y-o-y to Rs. 2,345 crore (8% of the opening PPE).
- Intangible assets remained at Rs. 1,818 crore, which was 2% of total networth.
- Receivable days (billed + unbilled) remained stable y-o-y at 65 days in FY2022 compared to 67 days in FY2021. Working capital cycle increased by 3 days to 44 days in FY2022.
- Current liability increased by 24% y-o-y to Rs. 42,351 crore in FY2022 from Rs. 34,155 crore in FY2021.
- RoE and RoCE stood at 43.3% and 49.6% in FY2022 versus 38.9% and 44.8% in FY2021.

Cash flow analysis

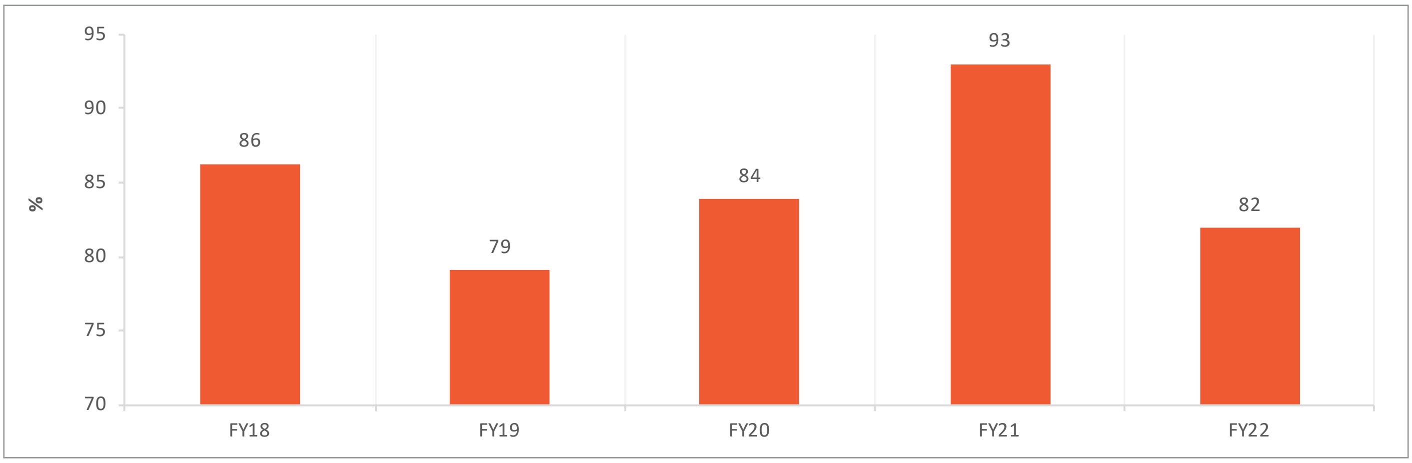
- OCF before change in working capital increased by 15.3% y-o-y to Rs. 54,204 crore, while OCF increased by just 3% y-o-y to Rs. 39,949 crore in FY2022 from Rs. 38,802 crore in FY2021.
- FCF increased 3% y-o-y to Rs. 3,9701 crore in FY2022 from Rs. 38,530 cores in FY2021. FCF to EBITDA ratio fell to 74.8% in FY2022 from 82.8% in FY2021.
- The company declared a dividend per share of Rs. 43 in FY2022 compared to Rs. 38 per share) in FY2021. The payout ratio stood at 41.5% of total net profit (43.8% of net profit in FY2021). Further, the company completed its buyback to the tune of Rs. 18,000 crore in FY2022. Total payout ratio (including buyback tax) stood at 102.8% of the FCF and 99.2% of net profit in FY2022. Management intends to keep the payout ratio at 80-100% of free cash generated.

Shareholder payouts (%)



Source: Company, Sharekhan Research

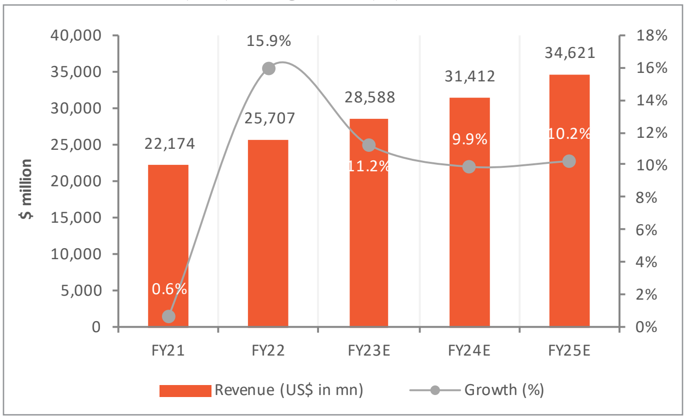
FCF/EBITDA ratio (%)



Source: Company, Sharekhan Research

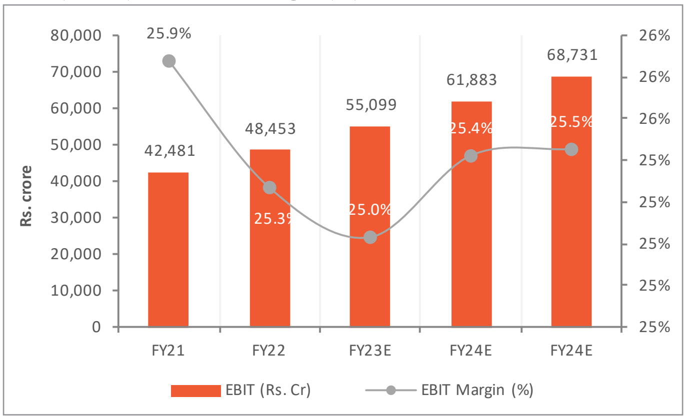
Financials in charts

Revenue in US$ (mn) and growth (%)



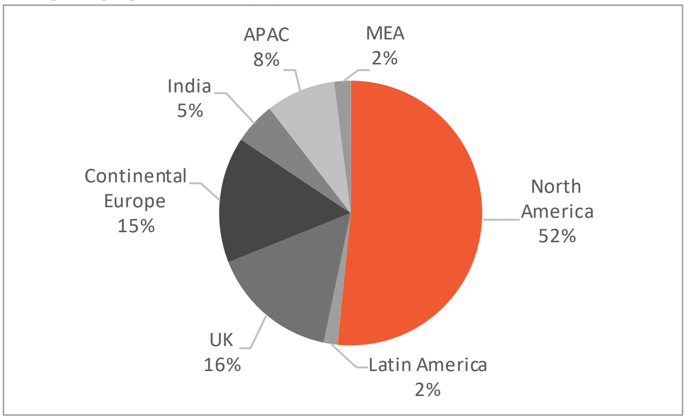
Source: Company, Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



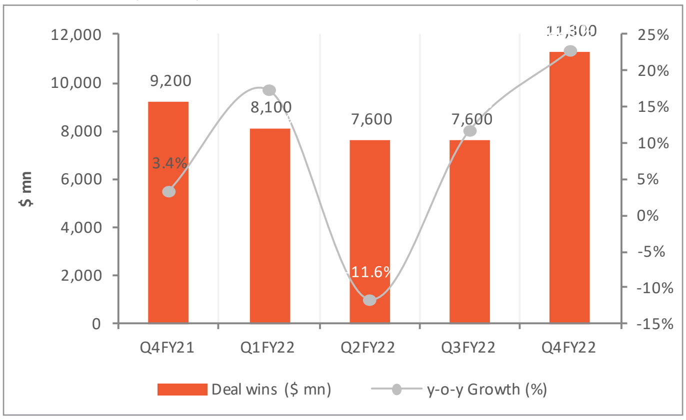
Source: Company, Sharekhan Research

Geograpghy break-up (%)



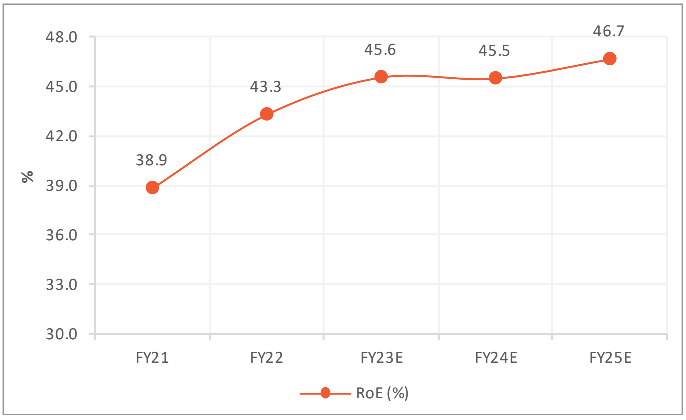
Source: Company, Sharekhan Research

Order book ($ mn)



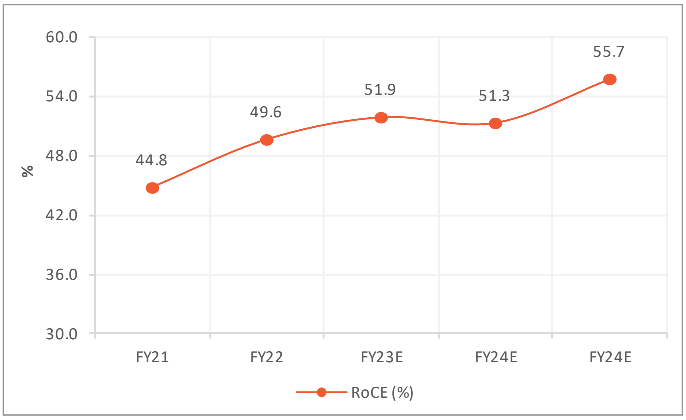
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimate that IT services spending would grow by 8-8.5% in the next four years as compared to the average of 4.3% achieved over 2011-20. Consulting (+11%) and application implementation and managed services (up 9%) are expected to grow faster than BPO (+7%) and infra implementation and managed services (up 4%) in CY2022E. Forecasts indicate higher demand for Cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals.

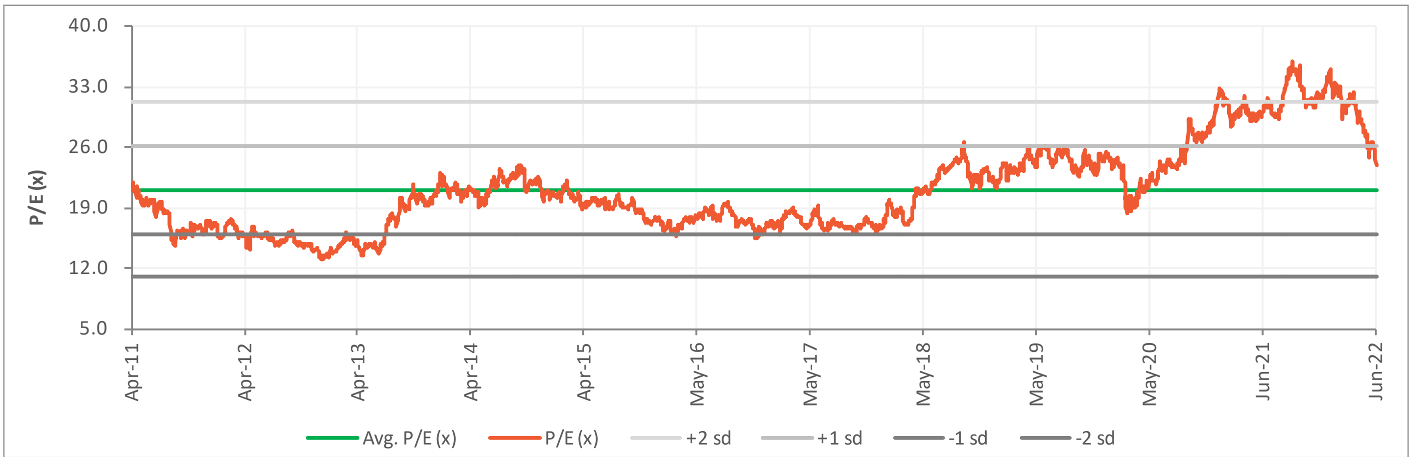
Company Outlook – Staying ahead of the race

Being one of the largest IT services companies worldwide and having preferred partners as clients, TCS can capture a fair share of spends on digital and Cloud transformation initiatives and is well-positioned to participate in clients' transformation journeys. Further, the company is well-placed from a competitive perspective, especially in newer technologies. A stable management, full-service capabilities, the ability to structure large multi-service deals and multi-horizon transformation demand would help TCS to deliver strong revenue growth in the next three years. The management intends to keep the payout ratio at 80-100% of free cash generated.

Valuation – Maintain Buy with a revised PT of Rs. 3,800

We have reduced our earnings estimates for FY23-25E by 2-4% to factor in moderation in USD revenue growth owing to adverse currency movements and anticipation of moderation in technology spending due to increasing macro risks and possibilities of US recession. However, we believe that TCS has a robust business model which would leverage the G&T opportunities most given its strong digital competencies and solid execution capabilities. We expect the company's US Dollar revenues and earnings to clock a 10.5%/12% CAGR over FY2022-24E. At CMP, the stock trades at valuation of 27x/24x its FY2023E/FY2024E earnings. We have lowered out target multiples considering higher interest rates and lower growth assumptions owing to increasing concerns around US slowdown/recession. Given a better supply-management capability than its peers, strong margin profile and excellent payout ratios, we maintain a Buy on TCS with an unchanged PT of Rs. 3,800.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
HCL Tech	965	271	2,61,896	17.4	15.0	12.0	10.4	3.9	3.7	24.8	26.9
Infosys	1,397	421	5,87,843	23.4	20.5	15.8	13.6	3.9	3.6	30.9	31.9
TCS	3,142	366	11,49,802	26.8	23.9	18.4	16.3	11.7	10.2	45.6	45.5

Source: Company, Sharekhan Research

About company

TCS is among the pioneers of IT services outsourcing business in India and is the largest ($25,707 million revenue in FY2022) IT services firm in terms of export revenue. Incorporated in 1968, the company provides a comprehensive range of IT services to industries such as BFS, insurance, manufacturing, telecommunications, retail and transportation. TCS is well positioned to benefit from growing demand for offshore IT services, given its solid execution capabilities, long-standing relationships with clients, and stable management team. The company is a serious contender for winning large deals, as it has better experience compared to peers in implementing large, complex and mission-critical projects. TCS is one of the preferred IT vendors for most Fortune 500/Global 1,000 companies.

Investment theme

TCS is one of the leading IT services companies with a wide-range of capabilities, robust digital competencies, strong platform and stable management. The company is the preferred partner of large corporates and is increasing its participation in large digital implementation. Hence, we believe TCS would continue to gain market share in digital versus its large peers, given its superior execution capabilities on the digital front. We remain positive on the sustainability of its revenue growth momentum in the medium term, given strong deal wins, broad-based service offerings, higher spend on digital technologies and best-in-class execution.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) slackening pace in deal closures, and 3) crunch in local talent supply in the U.S. along with stringent visa regime.

Additional Data

Key management personnel

N. Chandrasekaran	Chairman
Rajesh Gopinathan	Chief Executive Officer
N. Ganapathy Subramaniam	Chief Operating Officer
Samir Seksaria	Chief Financial Officer
Milind Lakkad	EVP and Global Head, HR

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	3.65
2	Vanguard Group Inc.	0.94
3	BlackRock Inc.	0.88
4	Invesco Ltd.	0.86
5	SBI Funds Management Pvt. Ltd.	0.85
6	JPMorgan Chase & Co.	0.72
7	Axis Asset Management Co. Ltd.	0.63
8	First State Investments ICVC	0.41
9	FMR LLC	0.32
10	UTI Asset Management	0.31

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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