

Estimate change	↔
TP change	↔
Rating change	↔

CMP: INR3,121
TP: INR3,580 (+15%)
Buy
Strong growth and demand outlook key positive in Q2
Stable deal TCV to allay concerns on near-term growth

Bloomberg	TCS IN
Equity Shares (m)	3,752
M.Cap.(INRb)/(USDb)	11420.6 / 138.7
52-Week Range (INR)	4046 / 2926
1, 6, 12 Rel. Per (%)	0/-13/-17
12M Avg Val (INR M)	9475
Free float (%)	27.7

Financials & Valuations (INR b)

Y/E Mar	2022	2023E	2024E
Sales	1,918	2,234	2,478
EBIT Margin (%)	25.3	24.1	24.8
PAT	384	427	492
EPS (INR)	104.0	115.1	132.3
EPS Gr. (%)	19.9	10.7	14.9
BV/Sh. (INR)	242	249	256

Ratios

RoE (%)	43.7	47.0	52.5
RoCE (%)	36.8	39.8	43.9
Payout (%)	97.1	80.0	80.0

Valuations

P/E (x)	30.0	27.1	23.6
P/BV (x)	12.9	12.5	12.2
EV/EBITDA (x)	21.4	19.2	17.0
Div Yield (%)	3.2	3.0	3.4

Shareholding pattern (%)

As On	Jun-22	Mar-22	Jun-21
Promoter	72.3	72.3	72.2
DII	8.4	7.9	8.0
FII	13.5	14.2	15.4
Others	5.8	5.7	4.4

FII Includes depository receipts

- TCS reported revenue of USD6.87b in 2QFY23, up 4.0% QoQ in constant currency (CC) terms, 50bp above our estimates. The company reported deal wins of USD8.1b (up 7% YoY/flat QoQ, book-to-bill ratio at 1.2x), in line with its historical trajectory.

- EBIT improved 90bp QoQ to 24% (vs. our estimate of 23.5%) despite supply pressures. Lower employee expenses, operating leverage, and lower sub-contractor expenses aided margins in 2QFY23. LTM attrition jumped 180bp to 21.5%. The management has indicated that quarterly annualized attrition should moderate starting 3QFY23.

- Management commentary on the demand environment and deal pipeline remained intact with no visible impact of weakening macro environment; however, the management has indicated risks to deal pipeline and conversion in Europe due to uncertainty around energy prices. TCS is seeing some caution for longer term deals and is experiencing some delayed decision making in Europe, but it continues to see a strong spending environment in the US. While the optimistic commentary was on expected lines, we remain concerned on the near-term growth due to macro slowdown. We are factoring in USD revenue growth of 7.5% YoY in FY23, owing to the macro headwinds in the second half of the year along with elevated cross-currency headwinds.

- The margin (up 90bp QoQ) was better than expected on account of lower employee costs, sub-contractor expenses, and operating leverage. The management indicated that attrition has peaked out and quarterly attrition should ease in the coming quarters. The supply situation easing out in 2HFY23 along with benefits from increased fresher additions in the last few quarters and lower sub-contractor costs should aid margins. However, we remain concerned about Q3 margin due to the timelines of cost optimization strategies. We expect the margin to improve in 2HFY23 and hit exit run-rate of ~25%. We expect FY23/24 margin to be at 24.1/24.8%.

- We have slightly tweaked our FY23/FY24 EPS. We expect a USD revenue CAGR of 8.1% over FY22-24 and INR EPS CAGR of 13% during the same period (aided by INR depreciation). Our TP of INR3,580 implies 27x FY24E EPS, with a 15% upside potential. We reiterate our **Buy** rating on the stock.

Good topline growth, margin improvement led by lower employee cost

- Revenue (CC) grew 4.0% QoQ, INR EBIT/ PAT rose 11%/8% YoY in 2QFY23.
- EBIT margin of 24% (up 90bps QoQ) was above our estimate of 23.5%, led by lower employee costs.
- The company added 9.8k associates, the lowest net adds in the last nine quarters.
- TCS announced a dividend of INR8/share.

Key highlights from the management commentary

- TCS is not witnessing any budget cuts or a deferment in client spends, although some European clients have expressed concerns on the macro demand.
- There could be some deal softening in Europe, but the US should remain strong for the company.
- It is exhibiting some caution on its long-term projects. Clients are building various economic models with some downside due to macro-economic concerns and the company is also experiencing delays in decision-making in some, smaller pockets.
- With hiring slowing down in the technology sector and salary expectations moderating, supply side issues should ease off in 2HFY23.
- LTM attrition in IT services was at 21.5% in Q2. The management suggested that attrition has peaked and expects quarterly attrition to moderate in the coming quarters.

Valuation and view

- Increase in interest rates, slow economic growth, and elevated geo-political tensions have adversely impacted the macro environment and raised concerns over IT spends.
- Given TCS's size, order book, and exposure to long duration orders, and portfolio, it is well positioned to withstand the weakening macro environment and ride on the anticipated industry growth.
- Owing to its steadfast market leadership position and best-in-class execution, the company has been able to maintain its industry-leading margin and demonstrate superior return ratios.
- We maintain our positive stance on TCS. Our TP of INR3,580 implies 27x FY24E EPS, with a 15% upside potential. We reiterate our **Buy** rating.

Quarterly performance (IFRS)

Y/E March	FY22				FY23E				FY22	FY23E	(INR b)	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			FY23	Variance
											2QE	(%/bp)
Revenue from IT Services (USD m)	6,154	6,333	6,524	6,696	6,780	6,877	6,909	7,069	25,707	27,636	6,912	-0.5
QoQ (%)	2.8	2.9	3.0	2.6	1.3	1.4	0.5	2.3	15.9	7.5	1.9	-51bp
Overall revenue (INR b)	454	469	489	506	528	553	570	583	1,918	2,234	551	0.4
QoQ (%)	3.9	3.2	4.3	3.5	4.3	4.8	3.1	2.3			4.4	42bp
YoY (%)	18.5	16.8	16.4	15.8	16.2	18.0	16.6	15.3	16.8	16.5	17.5	48bp
GPM (%)	40.4	40.4	40.0	40.1	38.4	39.5	39.7	40.2	40.2	39.5	38.5	100bp
SGA (%)	14.8	14.8	15.0	15.2	15.3	15.5	15.3	15.3	15.0	15.4	15.0	49bp
EBITDA	127	131	134	138	133	144	151	157	530	585	141	2.4
EBITDA Margin (%)	27.9	28.0	27.4	27.4	25.1	26.1	26.4	27.0	27.7	26.2	25.5	51bp
EBIT	116	120	122	126	122	133	139	145	485	539	129	2.6
EBIT Margin (%)	25.5	25.6	25.0	25.0	23.1	24.0	24.4	24.9	25.3	24.1	23.5	51bp
Other Income	6	10	10	7	6	8	9	9	32	32	9	-12.8
PBT	122	130	132	134	128	141	148	155	517	571	139	1.5
ETR (%)	25.8	25.6	25.7	25.5	25.5	25.8	25.0	25.0	25.6	25.3	25.0	76bp
Adj. PAT	90	97	98	100	95	105	111	116	384	427	104	0.5
Exceptional Items	0	0	0	0	0	0	0	0	0	0	0	
Reported PAT	90	97	98	100	95	105	111	116	384	427	104	0.5
QoQ (%)	-2.7	6.9	1.6	1.6	-4.4	9.9	5.8	4.7			9.4	57bp
YoY (%)	28.1	28.6	12.4	7.3	5.4	8.4	12.9	16.5	18.1	10.9	7.9	56bp
EPS (INR)	24.4	26.0	26.4	27.2	26.0	28.1	29.8	31.2	104.0	115.1	28.5	-1.2

Key performance indicators

Y/E March	FY22				FY23E				FY22	FY23E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Revenue (QoQ CC %)	2.4	4.0	3.9	3.2	3.5	4.0			14.3	
Costs (as a percentage of revenue)										
COGS	59.6	59.6	60.0	59.9	61.6	60.5	60.3	59.8	59.8	60.5
SGA	14.8	14.8	15.0	15.2	15.3	15.5	15.3	15.3	15.0	15.4
Margins										
Gross Margin	40.4	40.4	40.0	40.1	38.4	39.5	39.7	40.2	40.2	39.5
EBIT Margin	25.5	25.6	25.0	25.0	23.1	24.0	24.4	24.9	25.3	24.1
Net Margin	19.9	20.6	20.1	19.7	18.0	18.9	19.4	19.9	20.1	19.1
Operating Metrics										
Headcount (k)	509	529	557	592	606	616			509	
Attrition (%)	8.6	11.9	15.3	17.4	19.7	21.5			8.6	
Deal win TCV (USD b)	8.1	7.6	7.6	11.3	8.2	8.1			32.7	
Key verticals (YoY CC %)										
BFSI	19.3	17.0	17.9	12.9	13.9	13.1			16.7	
Retail	21.7	18.4	20.4	22.1	25.1	22.9			20.6	
Key geographies (YoY CC %)										
North America	15.8	17.4	18.0	18.7	19.1	17.6			17.5	
UK	16.3	15.6	12.7	13.0	12.6	14.8			14.3	
Continental Europe	19.7	13.5	17.5	10.1	12.1	14.1			15.1	



Highlights from the management commentary

Performance in 2QFY23 and the demand outlook

- In 2QFY23, TCS reported a revenue growth of 1.4% QoQ and 8.6% YoY in USD terms and 4% QoQ and 15.4% YoY in CC terms.
- All verticals performed well, with Retail and CPG leading with a growth of 22.9% YoY in CC terms.
- TCV stood at USD8.1b in 2QFY23. The BFSI/Retail vertical recorded a TCV of USD2.3b/USD1.6b. Despite macroeconomic concerns in Europe and the UK, the pipeline was stronger in 2Q as compared to 1QFY23.
- The management sees a strong demand environment, with clients maintaining spends in Cloud adoption, operating model transformation, and vendor consolidation.
- TCS, it said, is not witnessing any budget cuts, or a deferment in client spends, although some European clients have expressed concerns on macro demand. There may be some deal softening in Europe, but the US should remain strong for the company.
- The management is seeing some caution from clients on longer-term projects. Clients are building various economic models with some downside due to macroeconomic concerns. It is also seeing a delay in decision making in smaller pockets.
- Technology is at the core both for growth and optimization projects, it stated, that technology spends will be the last ones to be cut by clients in case of a slowdown.
- TCS is seeing an uptick in Travel, Transportation and the Airline vertical. It expects 5G to drive demand in the Telecom vertical. BFSI remains strong for the company on the back of Cloud, data, and customer experience initiatives by clients.
- The seasonality in 3QFY23 is expected to be on normal lines.

Margin performance and outlook

- Operating margin rose 90bp QoQ to 24% in 2QFY23 on fresher additions, operating leverage, better realizations, and lower sub-contractor expenses. Travel and facility expenses and backfilling costs offset some of the margin gains.
- The heat in the technology hiring is easing off and salary expectations are moderating. Supply- side issues should come off in 2HFY23.
- Sub-contractor expenses should trend downwards as visa availability and supply-side issues ease.
- Utilization, operating leverage, better realizations, better execution, and supply headwinds normalization should aid margin going forward.

Other highlights

- The company added 9.8k employees in 2QFY23. It continues to target the hiring of ~40k freshers in FY23.
- LTM attrition in IT Services stood at 21.5% in 2QFY23. The management suggested that attrition has peaked and expects quarterly attrition to moderate in coming quarters.

Exhibit 1: North America continues to register strong growth

Geographies	Contribution to revenue (%)	QoQ growth (%)
North America	54.3	3.5
Latin America	1.7	-4.2
UK	14.5	-1.3
Continental Europe	14.5	-3.2
India	5.1	7.8
Asia Pacific	8.0	-2.2
MEA	1.9	7.1

Source: Company, MOFSL

Exhibit 2: Growth led by Technology

Verticals	Contribution to revenue (%)	QoQ CC growth (%)
BFSI	31.9	0.8
Retail and CPG	15.9	1.4
Communications and Media	6.7	-0.1
Manufacturing	9.9	1.4
Life Sciences and Healthcare	10.2	2.4
Technology and Services	9.0	3.7
Regional Markets and Others	16.4	1.4

Source: Company, MOFSL

Maintain Buy with a TP of INR3,580

- Increase in interest rates, slow economic growth, and elevated geo-political tensions have adversely impacted the macro environment and raised concerns over IT spends.
- Given TCS's size, capabilities, and portfolio, it is well-positioned to withstand the weakening macro environment and ride on the anticipated industry growth.
- Owing to its steadfast market leadership position and best-in-class execution, the company has been able to maintain its industry-leading margin and demonstrate superior return ratios.

- We maintain our positive stance on TCS. Our TP of INR3,580 implies 27x FY24E EPS, with a 15% upside potential. We reiterate our **Buy** rating.

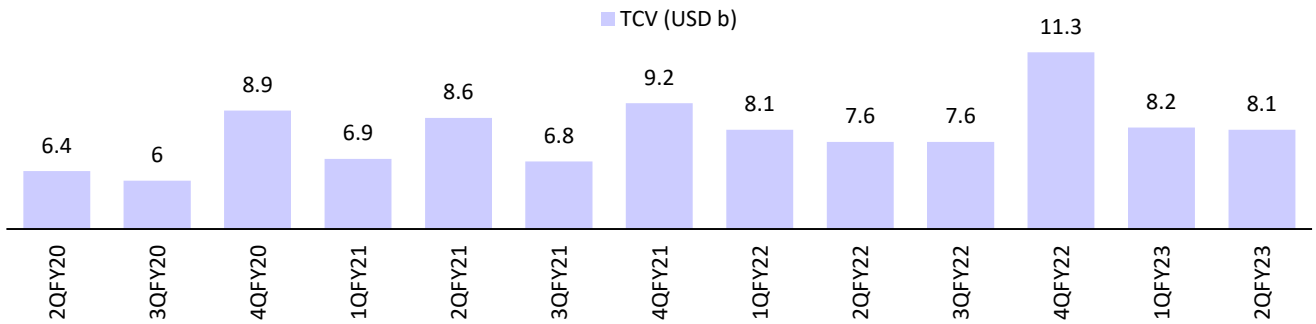
Exhibit 3: Revisions to our estimates

	Revised		Earlier		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
USD:INR	80.8	82.5	80.3	81.8	0.7	0.9
USD revenue (m)	27,636	30,042	27,777	29,464	-0.5	2.0
Growth (%)	7.5	8.7	8.1	6.1	-50bps	260bps
EBIT margin (%)	24.1	24.8	24.0	24.7	20bps	10bps
PAT (INR b)	425	491	425	476.1	0.0	3.1
EPS	115.1	132.3	116.5	130.5	-1.2	1.3

Source: MOFSL

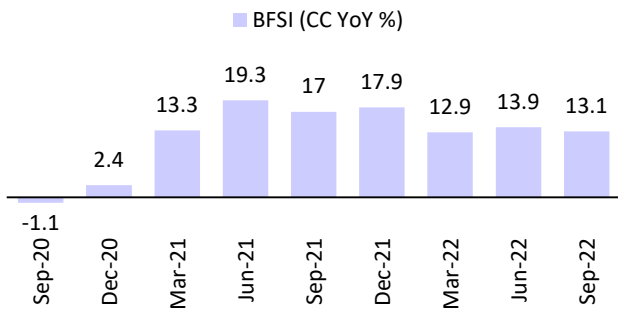
Story in charts

Exhibit 4: TCS reports strong deal wins in 2QFY23



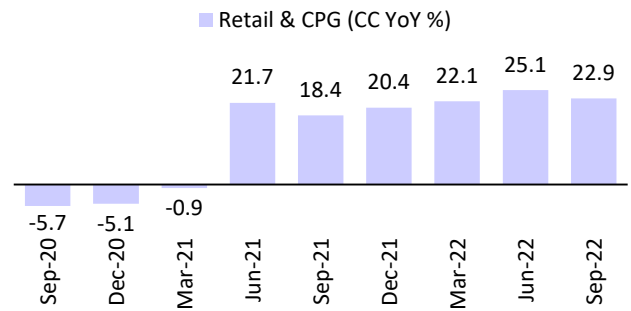
Source: Company, MOFSL

Exhibit 5: Strong growth in BFSI...



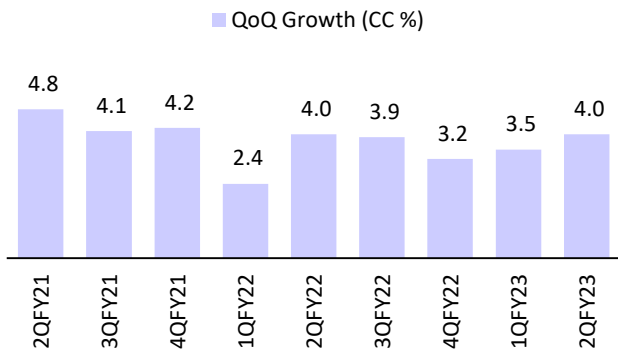
Source: Company, MOFSL

Exhibit 6: ...and in Retail



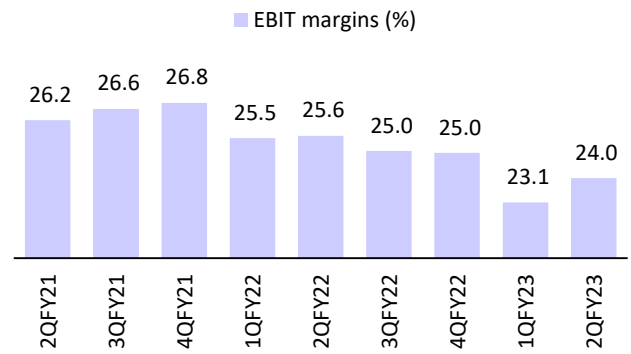
Source: Company, MOFSL

Exhibit 7: TCS delivers strong growth in 2QFY23



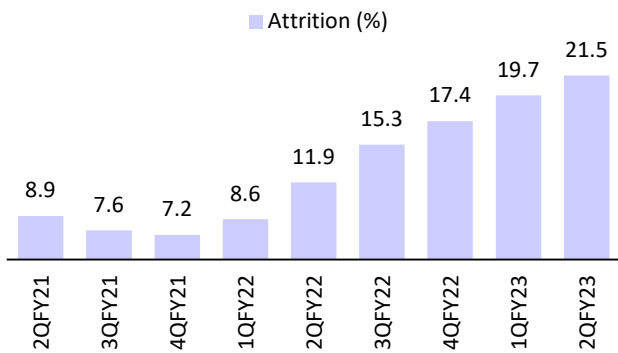
Source: Company, MOFSL

Exhibit 8: Margins see strong recovery



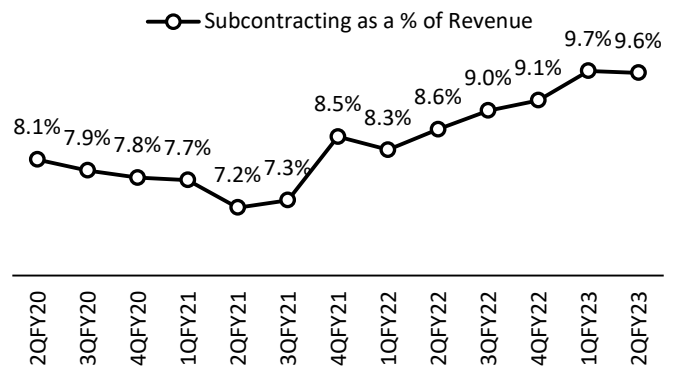
Source: Company, MOFSL

Exhibit 9: Attrition jumps to 21.5%



Source: Company, MOFSL

Exhibit 10: Sub-contracting moderates 10bp QoQ



Source: Company, MOFSL

Operating metrics

Exhibit 11: Operating metrics

	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23
Verticals (%)									
BFSI	31.9	31.3	32.2	32.5	32.4	32.1	31.9	32.1	31.9
Retail and CPG	14.6	14.5	14.5	14.8	15.0	14.5	15.4	15.9	15.9
Communications and Media	6.5	6.6	6.5	6.4	6.5	6.6	6.7	6.8	6.7
Manufacturing	9.4	9.6	9.6	9.8	9.9	9.6	10.0	9.9	9.9
Life Sciences and Healthcare	9.8	9.8	9.7	10.2	10.0	9.8	10.0	10.1	10.2
Technology and Services	8.9	8.6	8.4	8.6	8.8	8.6	8.7	8.8	9.0
Regional markets and others	18.9	19.6	19.1	17.7	17.4	18.8	17.3	16.4	16.4
Geographies (%)									
North America	49.9	49.1	48.6	49.4	50.3	50.7	51.6	53.2	54.3
Latin America	1.7	1.7	1.6	1.6	1.6	1.7	1.7	1.8	1.7
UK	15.5	15.7	16.0	16.3	16.1	15.6	15.6	14.9	14.5
Continental Europe	16.3	16.2	16.8	16.7	15.9	16.0	15.5	15.2	14.5
India	5.0	5.6	5.6	4.6	5.1	5.5	5.1	4.8	5.1
Asia Pacific	9.7	9.7	9.4	9.3	9.0	8.6	8.5	8.3	8.0
MEA	1.9	2	2	2.1	2.0	1.9	2.0	1.8	1.9
QoQ growth (%)									
BFSI	9.3	3.1	8.1	3.7	2.6	2.1	2.0	1.9	0.8
Retail and CPG	11.8	4.4	5.0	4.9	4.3	-0.4	9.0	4.5	1.4
Communications and Media	(1.8)	6.7	3.4	1.2	4.5	4.6	4.2	2.8	-0.1
Manufacturing	3.9	7.4	5.0	4.9	4.0	-0.1	6.9	0.2	1.4
Life Sciences and Healthcare	9.4	5.1	4.0	8.1	0.9	1.0	4.7	2.3	2.4
Technology and Services	4.9	1.6	2.6	5.2	5.3	0.7	3.8	2.4	3.7
Regional markets and others	5.5	9.0	2.4	(4.8)	1.2	11.3	-5.6	-4.0	1.4
North America	4.1	3.4	4.0	4.4	4.8	3.8	4.5	4.4	3.5
Latin America	7.2	5.1	(1.1)	2.8	2.9	9.5	2.6	7.2	-4.2
UK	8.6	6.5	7.0	4.7	1.6	-0.2	2.6	-3.3	-1.3
Continental Europe	12.0	4.5	8.9	2.1	-2.0	3.7	-0.6	-0.7	-3.2
India	24.7	17.7	5.0	(15.6)	14.1	11.1	-4.8	-4.7	7.8
Asia Pacific	6.1	5.1	1.8	1.7	-0.4	-1.6	1.4	-1.1	-2.2
MEA	7.2	10.7	5.0	7.9	-2.0	-2.1	8.0	-8.9	7.1
Total Employees (k)	454	469	489	509	528.7	557.0	592.2	606.3	616.2
Net Additions (k)	10	16	19	20	19.7	28.2	35.2	14.1	9.8
Attrition (LTM %)	8.9	7.6	7.2	8.6	11.9	15.3	17.4	19.7	21.5

Source: Company, MOFSL

Financials and valuations

Income Statement								(INR b)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Sales	1,180	1,231	1,465	1,569	1,642	1,918	2,234	2,478
Change (%)	8.6	4.4	19.0	7.2	4.6	16.8	16.5	10.9
Cost of Services	669	713	852	923	971	1,146	1,352	1,489
SG&A Expenses	208	213	239	260	246	287	343	374
EBITDA	323	325	395	421	465	532	595	677
As a percentage of Net Sales	27.4	26.4	27.0	26.8	28.4	27.8	26.6	27.3
Depreciation	20	20	21	35	41	48	56	62
EBIT	303	305	375	386	425	485	539	615
As a percentage of Net Sales	25.7	24.8	25.6	24.6	25.9	25.3	24.1	24.8
Other Income	42	36	41	37	25	32	32	41
PBT	345	341	416	422	450	517	571	656
Tax	82	82	100	98	115	132	144	164
Rate (%)	23.6	24.1	24.1	23.2	25.5	25.6	25.3	25.0
PAT	264	259	316	324	335	384	427	492
Extraordinary Gains/Losses	0	0	0	0	-10	0	0	0
Adjusted PAT	264	259	316	324	326	384	427	492
Minority Interest	1	1	1	1	1	1	1	1
Reported PAT	263	258	315	323	324	383	425	491
Change (%)	8.6	-1.8	21.9	2.8	0.3	18.2	10.9	15.4

Balance Sheet								(INR b)
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Share capital	2	2	4	4	4	4	4	4
Reserves	860	849	891	838	861	888	915	946
Net Worth	862	851	894	841	864	891	919	950
Minority Interest and Others	25	33	34	97	102	100	113	122
Loans	1	1	0	0	0	0	0	0
Capital Employed	888	885	929	938	966	992	1,031	1,072
Gross Block	247	266	287	408	449	502	556	615
Depreciation	131	151	171	207	247	295	351	413
Net Block	116	115	116	201	201	207	205	202
Intangibles	44	52	44	45	57	55	63	67
Other LT assets	67	84	69	60	56	70	81	90
Current Assets	805	812	921	902	993	1,083	1,122	1,173
Debtors	280	316	325	363	367	418	496	558
Cash and Bank Balance	41	49	72	97	69	125	78	82
Investments	416	380	347	261	316	360	335	310
Other Current Assets	67	67	177	182	241	180	212	223
Current Liab. and Prov.	145	178	221	271	342	424	439	460
Net Current Assets	660	634	700	632	651	660	683	713
Application of Funds	887	885	929	938	966	992	1,031	1,072

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)								
EPS	66.7	67.0	82.3	86.2	86.7	104.0	115.1	132.3
Cash EPS	71.8	72.2	87.6	95.6	97.6	117.0	130.2	149.0
Book Value	218.8	220.9	233.8	224.2	231.1	241.8	248.7	256.2
DPS	27.5	70.7	76.9	71.4	97.2	100.9	92.1	105.8
Payout (%)	41.2	105.6	93.5	82.8	112.1	97.1	80.0	80.0
Valuation (x)								
P/E	46.8	46.6	37.9	36.2	36.0	30.0	27.1	23.6
Cash P/E	43.5	43.2	35.6	32.6	32.0	26.7	24.0	20.9
EV/EBITDA	37.9	36.8	30.0	27.6	24.9	21.4	19.2	17.0
EV/Sales	10.4	9.7	8.1	7.4	7.1	5.9	5.1	4.6
Price/Book Value	14.3	14.1	13.4	13.9	13.5	12.9	12.5	12.2
Dividend Yield (%)	0.9	2.3	2.5	2.3	3.1	3.2	3.0	3.4
Profitability Ratios (%)								
RoE	34.7	30.1	36.1	37.3	38.0	43.7	47.0	52.5
RoCE	29.7	26.1	31.4	31.7	33.2	36.8	39.8	43.9
Turnover Ratios								
Debtors (Days)	87	94	81	84	82	80	81	82
Fixed Asset Turnover (x)	10.1	10.7	12.7	7.8	8.1	9.3	10.9	12.3

Cash Flow Statement

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
(INR b)								
CF from Operations	259	282	308	370	379	427	472	543
Cash for Working Capital	-6	0	-22	-47	9	-28	-103	-56
Net Operating CF	252	282	286	324	388	399	369	487
Net Purchase of FA	-20	-19	-21	-32	-32	-30	-43	-48
Free Cash Flow	232	263	265	291	356	370	326	439
Net Purchase of Invest.	-147	16	36	118	-50	21	25	25
Net Cash from Invest.	-167	-3	16	86	-81	-9	-18	-23
Proceeds from Equity Issues	-1	0	0	0	0	0	0	0
Proceeds from LTB/STB	0	0	-2	-13	-211	-195	0	0
Others	0	0	-2	-9	-6	-7	0	0
Dividend Payments	-110	-268	-275	-377	-109	-134	-398	-459
Cash Flow from Fin.	-110	-268	-279	-399	-326	-336	-398	-459
Net Cash Flow	-27	13	23	14	-18	56	-47	4
Opening Cash Balance	68	41	54	77	91	73	130	83
Add: Net Cash	-27	13	23	14	-18	56	-47	4
Closing Cash Balance	41	54	77	91	73	130	83	87

NOTES

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

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