31 January 2023

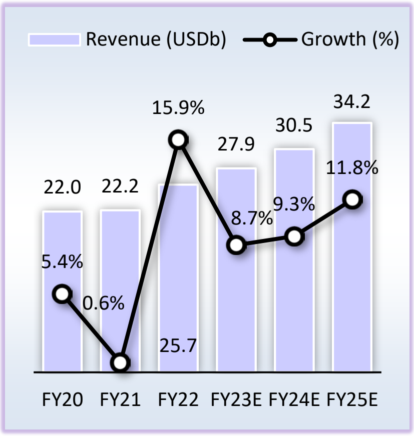
Company Update | Sector: Technology

TCS

BSE SENSEX	S&P CNX
59,550	17,662

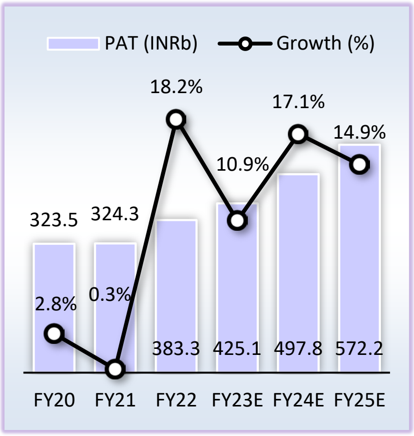
Bloomberg	TCS IN
Equity Shares (m)	3752
M.Cap.(INRb)/(USDb)	12285.1 / 150
52-Week Range (INR)	3806 / 2868
1, 6, 12 Rel. Per (%)	5/-1/-12
12M Avg Val (INR M)	8005
Free float (%)	27.7

Revenue growth to remain strong



Source: MOFSL, Company

Robust revenue growth and margin recovery will lead to strong PAT growth



Source: MOFSL, Company

CMP: INR3,357 TP: INR3,950 (+18%) Buy

Defensive giant to outshine peers in 2023

Superior cost-focused capabilities to drive performance

We believe TCS, among our IT services coverage, is best positioned to ride out the near-term moderation in technology spending, on account of macroeconomic stress in developed economies. With tech spending shifting toward cost efficiency (vs focus on transformation over the last two years), TCS revenue growth is expected to outperform its peers (FY24 at 9.2% YoY CC in USD vs large cap coverage median of 8.5% YoY) on account of its industry leadership in cost optimization and strong order book. Further, its better operational efficiencies is expected to drive up its profitability, leading to 20% YoY INR PAT growth in a tough year. We reiterate our Buy rating with a TP of INR3,950 (29xFY24/25xFY25).

TCS will be a key beneficiary of shift in focus to cost efficiency

- Amid the weak macro environment, enterprises are increasing their focus on cost efficient projects and cutting out some of their discretionary spends.
- Commentary across IT services space suggests caution in discretionary spending and increased the amount of cost optimization mandates in the deal pipeline.
- TCS has underperformed its IT services peers over the last two years due to a larger proportion of work focused on short duration projects with a focus on growth acceleration. This trend should reverse in FY24, as cost efficiency capabilities and project execution skills of TCS would drive revenue growth.
- We estimate TCS to deliver FY24 USD CC revenue growth of 9.2% YoY, the second best among our large cap coverage (after HCLT). TCS has been able to maintain strong traction in deal wins despite weakening macro (1.3x LTM book to bill), which should support the near-term growth. Hence, we believe TCS is best positioned to deliver stock return in a constrained demand environment.

Margin pickup to drive earnings growth

- With easing supply-side pressure and front loading of cost, we expect TCS to improve its EBIT margin by 135bp over FY23-25 after declining 170bp over the previous two years.
- While cost efficiency project usually command lower pricing, TCS should benefit from the addition of a large pool of freshers (155k over the last 1.5 years, 30% of FY21 workforce), improved utilization and strong operating leverage. More importantly, it has best in class track record of managing cost efficiency work and strong execution capabilities, which should help the company generate better profitability. We expect the company to register FY24/FY25 EBIT margin of 24.8/25.6%, respectively.
- We expect high single-digit revenue growth and good margin recovery to help TCS deliver FY23-25 PAT CAGR of 16%.

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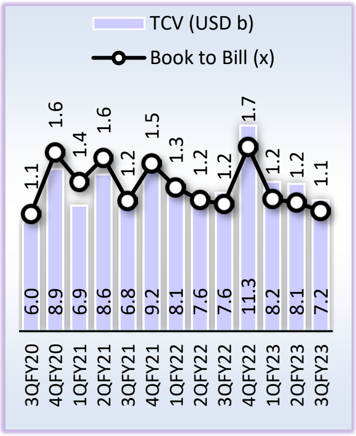
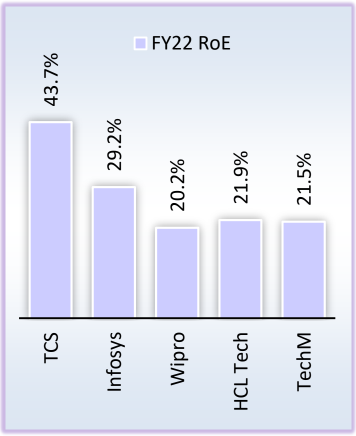
TCS' deal wins continue to remain strong despite macro concerns



Source: Company, MOFSL

TCS has a superior RoE profile compared to its peers



Source: Company, MOFSL

Longer term demand for IT services intact

- The longer term demand for IT services remains intact despite near-term pain due to weakening macro.
- Since IT spends are largely non-discretionary in nature, the clients are unlikely to cut spends in case of a macro slowdown apart from some cuts in discretionary spending.
- Cloud transformation is a multi-year tailwind and IT services companies should continue to get benefited from the same. Gartner expects IT services spends to grow 5.5% YoY CC in CY23 despite weakening macro.
- The IT service spends should see an uptick once the concerns around macro subside. We expect a gradual recovery from 2HFY24 for technology spends across key end markets.

High Europe exposure could dampen the performance

- Given the macro concerns, the situation in Europe remains more troublesome compared to the US. Energy crisis is expected to further worsen the situation in Europe. We remain watchful of TCS's comparatively high exposure to Europe (29%), which could negatively impact the revenue.
- The UK remains in a better position than Continental Europe. TCS's decent share from the UK (50% of Europe as of 3QFY23) should moderate some of the possible impact from Europe.

Valuation and view – TCS is our Top idea

- Increase in interest rates, slow economic growth, and elevated geo-political tensions have adversely impacted the macro environment and increased the concerns over IT services spends.
- Given TCS's size, order book, and exposure to long duration orders, it is well positioned to withstand the weakening macro environment and ride on the anticipated industry growth.
- Owing to its 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 INR3,950 implies 29x FY24E/25xFY25 EPS, with a 18% upside potential. We reiterate our **Buy** rating.

Clear shift in focus to optimize cost; TCS top beneficiary

Rising interest rates, slowdown in GDP growth, and elevated inflation create a lot of macro uncertainties and raise concerns over a possible slowdown in the US and Europe. With weakening macro environment, clients have started cutting on discretionary spends with increased focus on cost optimization. In general, cost optimization deals are of longer duration and larger in size. Automation and cost optimization are seen as deflationary forces in an environment where inflation continues to remain elevated. Clients continue to focus on projects with high ROIs and where the benefits can be realized faster.

Exhibit 1: Recent commentaries hint toward increasing focus to optimize costs

Salesforce	❖ '...elongated sales cycles, **additional deal approval layers**, and deal compression, particularly in enterprise.' ❖ '...our customers need to **quickly get the benefits of their technology investments**.' ❖ '...ensuring these digital transformation projects **drive cost savings.**'
Microsoft	❖ '...as we help customers **optimize current workloads** while they prioritize new workloads.' ❖ '...proactively helping them (customers) **optimize their spend.**'
Google	❖ '...we'll continue to make important trade-offs where needed and **are focused on moderating operating expense growth.**'
Nutanix	❖ 'we have **started to see some anecdotal evidence of increased inspection on deals…**'
Crowdstrike	❖ '...**increased levels of required approvals** on some deals as companies evaluated investment priorities, which can extend the time it takes to close deals.'

Source: MOFSL, Company

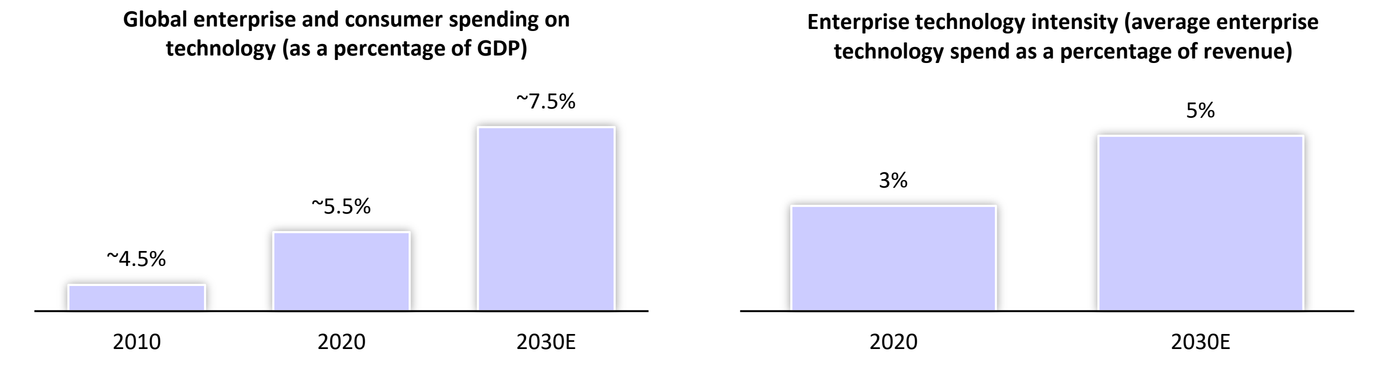
TCS has one of the best automation and cost optimization capabilities across the globe, and therefore, would be one of the top beneficiaries in the demand constraint environment, where there is increased focus toward cost optimization. This also aligns with FY13 'Taper Tantrum' where the constraint demand environment worked in favor of TCS as enterprises started focusing on saving costs.

Also, TCS is one of the most diversified companies across verticals. Its exposure to larger, longer duration projects and best-in-class execution capabilities will further help TCS to withstand any slowdown in the macro.

IT spends to remain resilient; demand tailwinds intact

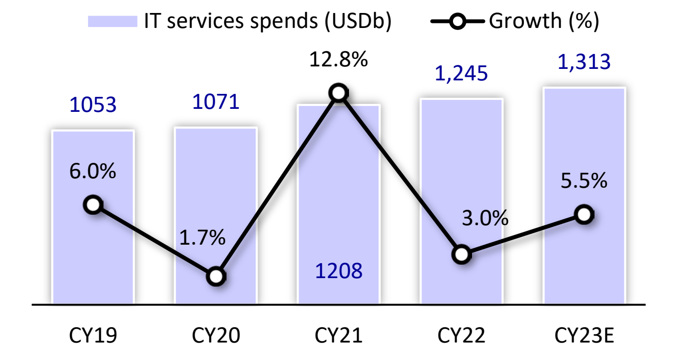
The longer term demand for IT services remains intact despite near-term pain due to weakening macro. As IT spends are largely non-discretionary in nature, the spend cut is unlikely in case of a macro-economic backdrop, apart from some cuts in discretionary spending. Cloud transformation is a multi-year tailwind and IT services companies should continue to get benefited from the same. With only 30-40% workloads on cloud, there is a long runway for growth. Gartner expects IT services spends to grow by 5.5% YoY CC in CY23 despite wakening macro (Exhibit-3). We expect gradual recovery from 2HFY24 as the macro concerns subside.

Exhibit 2: Enterprises' technology intensity to amplify



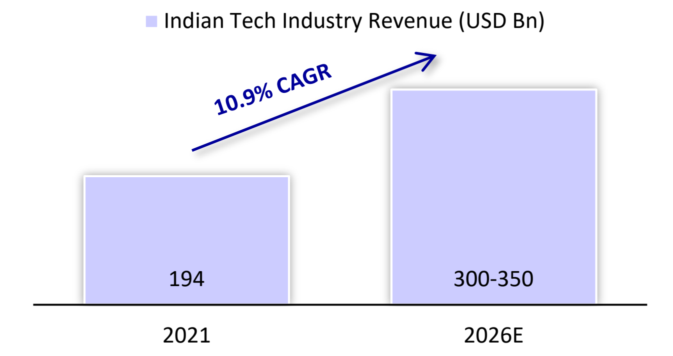
Source: Nasscom, McKinsey study

Exhibit 3: IT spends to grow 5.5% YoY CC in CY23 as per Gartner



Source: Gartner

Exhibit 4: NASSCOM expects ~11% CAGR for Indian IT

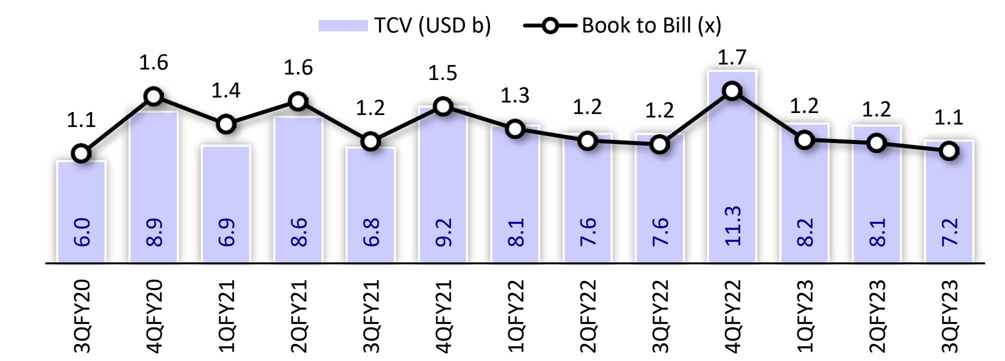


Source: NASSCOM

Strong Deal wins and improved margin will help TCS to weather the storm

Though the macro environment remains weak, the deal wins have not tumbled for the IT Services space. The deal pipeline is tilting toward cost optimization. TCS has been able to maintain strong traction in deal wins despite weakening macro (1.3x LTM book to bill), which should support the near-term growth.

Exhibit 5: TCS' deal wins continue to remain strong despite macro concerns

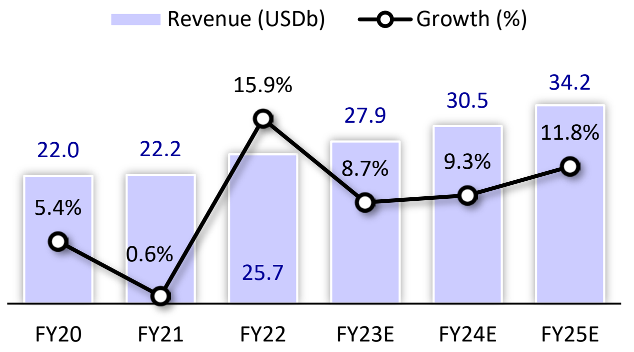


Source: Company, MOFSL

With a strong deal pipeline, we expect revenue growth to remain resilient in the near term. As demand tailwinds remain intact, the growth should pick up in medium term as the macro-economic environment stabilizes. We expect TCS to deliver ~11% revenue CAGR over FY23-25.

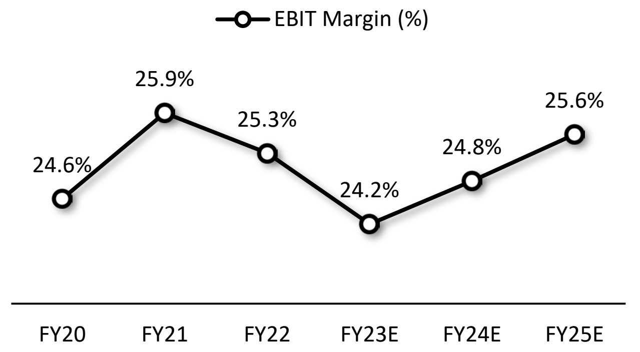
Attrition has peaked and has started to ease. Salary expectations of the employees have started to cool off. Easing supply, a large pool of freshers turning billable, improved utilization, and strong operating leverage should translate to strong recovery in margin. We expect FY24E/FY25 EBIT margin for TCS to be 24.8/25.6%. Robust growth and strong margin recovery should help TCS deliver FY23-25 PAT CAGR of ~16%

Exhibit 6: Revenue growth to remain strong



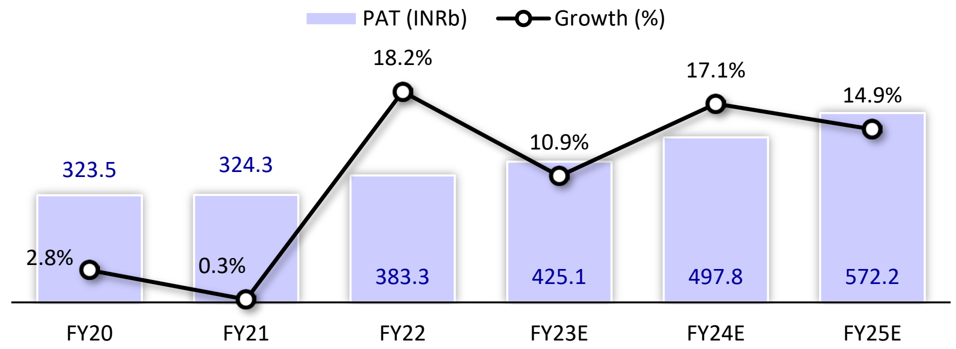
Source: MOFSL, Company

Exhibit 7: Supply easing; expect strong recovery in margins



Source: MOFSL, Company

Exhibit 8: Robust revenue growth and margin recovery will lead to strong PAT growth

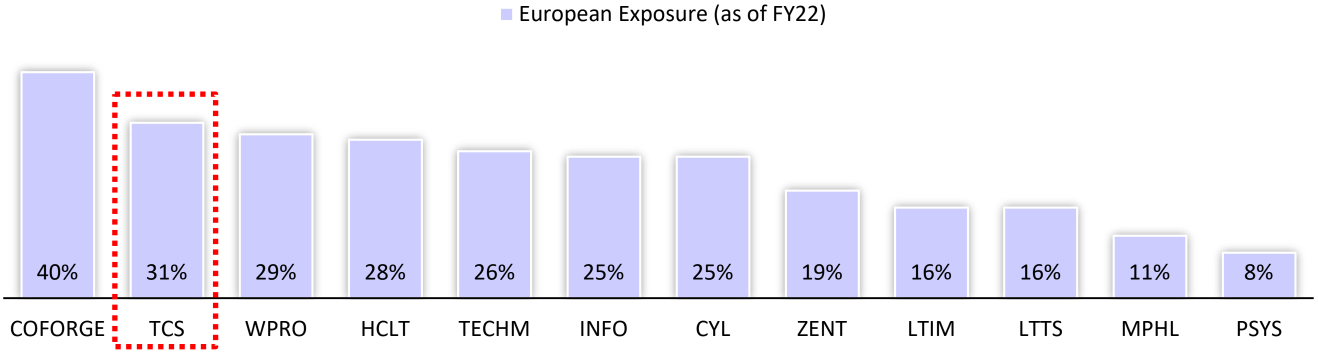


Source: MOFSL, Company

Relatively high exposure to Europe to be watched

Given the macro concerns, the situation in Europe remains more troublesome compared to the US. Energy crisis is expected to worsen the situation in Europe. We remain watchful of TCS's comparatively high exposure to Europe (29%), which could negatively impact the revenue. The UK continues to be in a better position than Continental Europe. TCS's decent share from the UK (50% of Europe as of 3QFY23) should moderate some of the possible impact from Europe.

Exhibit 9: TCS has relatively high exposure to Europe

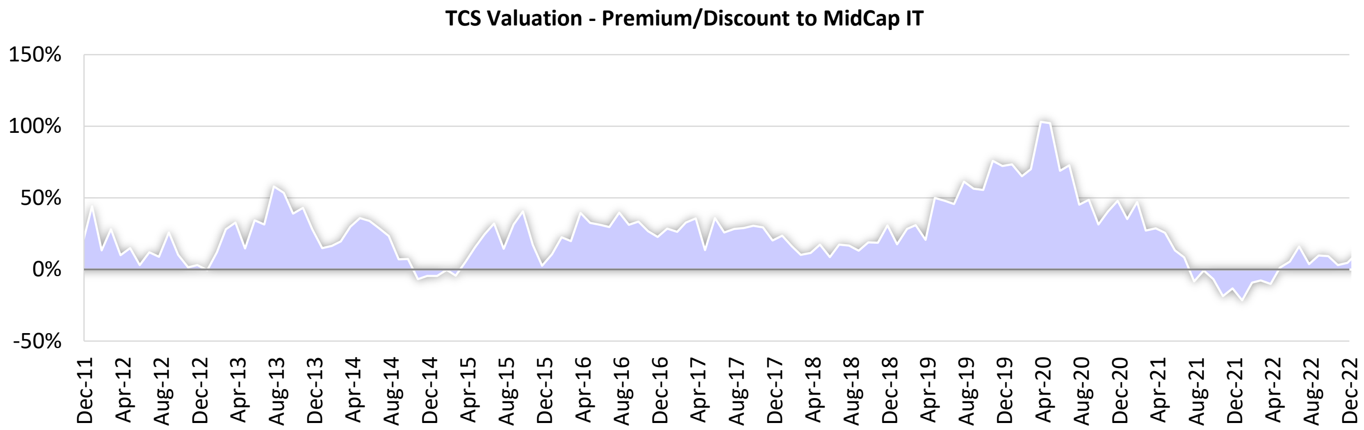


Source: MOFSL, Company

Valuation and view – TCS is our Top Pick

- Increase in interest rates, slow economic growth, and elevated geo-political tensions have adversely impacted the macro environment and raised concerns over IT services spend.
- 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 INR3,950 implies 29x FY24E/25xFY25 EPS, with a 18% upside potential. We reiterate our **Buy** rating on the stock.

Exhibit 10: TCS is not trading at a significant premium to Mid-Cap IT unlike in the past



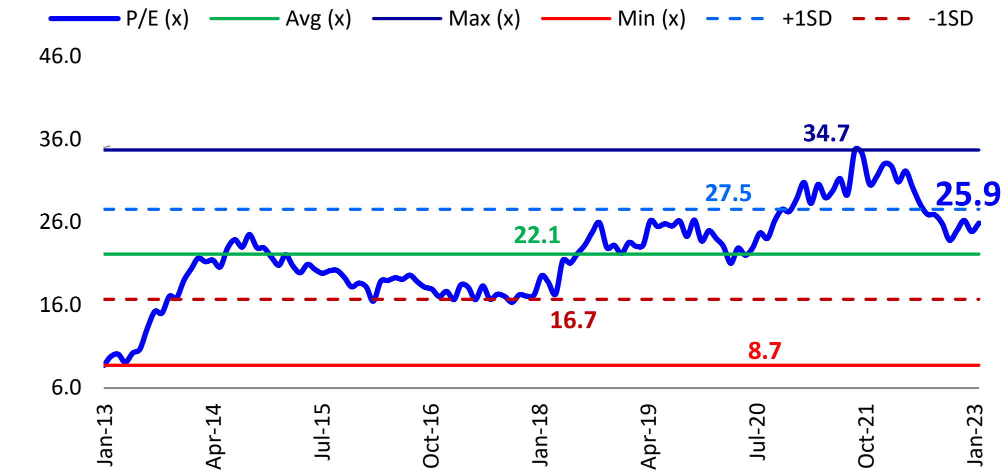
Source: MOFSL, Bloomberg

Exhibit 11: MOFSL vs Consensus

MOFSL vs Consensus	Revenues (INRb)			Operating Margins			EPS (INR)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
MOSL Estimates	2,258	2,520	2,818	24.2%	24.8%	25.6%	116.3	136.1	156.4
YoY Change	17.8%	11.6%	11.8%	-107 bps	65 bps	70 bps	11.8%	17.0%	14.9%
Consensus	2251	2483	2725	24.3%	24.9%	25.2%	115.8	132.0	146.0
YoY Change	17.4%	10.3%	9.8%	-100 bps	62 bps	31 bps	11.3%	14.0%	10.6%
MOSL vs Consensus	**0.3%**	**1.5%**	**3.4%**	**-0.3%**	**-0.1%**	**1.4%**	**0.4%**	**3.1%**	**7.1%**

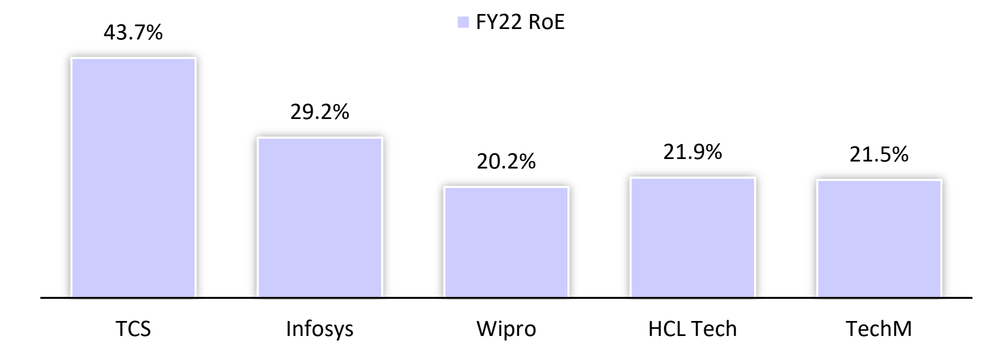
Source: MOFSL, Company

Exhibit 12: Valuations have corrected meaningfully from the top



Source: Bloomberg, MOFSL

Exhibit 13: TCS has a superior RoE profile compared to its peers



Source: MOFSL, Company

Exhibit 14: Peer comparison

Company	Rating	Price (INR)	Target Price (INR)	Upside/ Downside	P/E (x)			Rev growth (%) (CC USD)		
					FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
TCS	**Buy**	**3,357**	**3,950**	**18%**	**28.9**	**24.7**	**21.5**	**12.4**	**8.9**	**12.3**
Infosys	Buy	1,533	1,760	15%	26.0	22.6	19.9	15.8	8.5	11.4
Wipro	Neutral	399	380	-5%	19.1	16.7	14.8	8.4	5.9	10.2
HCL Tech	Buy	1,015	1,270	25%	18.6	16.0	14.1	13.3	10.2	12.3
TechM	Neutral	1,051	1,020	-3%	18.0	15.4	13.2	13.6	7.5	10.1

Source: MOFSL, Company

Financials and valuations

Income statement (INR b)

Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
Sales	**1,231**	**1,465**	**1,569**	**1,642**	**1,918**	**2,258**	**2,520**	**2,818**
Change (%)	4.4	19.0	7.2	4.6	16.8	17.8	11.6	11.8
Cost of Services	713	852	923	971	1,146	1,362	1,505	1,667
SG&A Expenses	213	239	260	246	287	350	389	431
EBITDA	**325**	**395**	**421**	**465**	**532**	**603**	**689**	**790**
% of Net Sales	26.4	27.0	26.8	28.4	27.8	26.7	27.3	28.1
Depreciation	20	21	35	41	48	56	63	70
EBIT	**305**	**375**	**386**	**425**	**485**	**546**	**626**	**720**
% of Net Sales	24.8	25.6	24.6	25.9	25.3	24.2	24.8	25.6
Other Income	36	41	37	25	32	26	40	45
PBT	**341**	**416**	**422**	**450**	**517**	**572**	**666**	**765**
Tax	82	100	98	115	132	146	166	191
Rate (%)	24.1	24.1	23.2	25.5	25.6	25.5	25.0	25.0
PAT	**259**	**316**	**324**	**335**	**384**	**427**	**499**	**574**
Extraordinary gains/loss	0	0	0	-10	0	0	0	0
Adjusted PAT	**259**	**316**	**324**	**326**	**384**	**427**	**499**	**574**
Minority Interest	1	1	1	1	1	2	2	2
Reported PAT	**258**	**315**	**323**	**324**	**383**	**425**	**498**	**572**
Change (%)	-1.8	21.9	2.8	0.3	18.2	10.9	17.1	14.9

Balance Sheet (INR b)

Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
Share capital	2	4	4	4	4	4	4	4
Reserves	849	891	838	861	888	890	893	896
Net Worth	**851**	**894**	**841**	**864**	**891**	**894**	**896**	**900**
Minority Interest & Others	33	34	97	102	100	114	124	138
Loans	1	0	0	0	0	0	0	0
Capital Employed	**885**	**929**	**938**	**966**	**992**	**1,008**	**1,020**	**1,037**
Gross Block	266	287	408	449	502	557	617	685
Depreciation	151	171	207	247	295	352	415	485
Net Block	**115**	**116**	**201**	**201**	**207**	**205**	**203**	**200**
Intangibles	52	44	45	57	55	63	68	74
Other LT assets	84	69	60	56	70	82	91	102
Curr. Assets	**812**	**921**	**902**	**993**	**1,083**	**1,101**	**1,126**	**1,155**
Debtors	316	325	363	367	418	502	567	642
Cash & Bank Balance	49	72	97	69	125	49	22	-25
Investments	380	347	261	316	360	335	310	285
Other Current Assets	67	177	182	241	180	215	227	254
Current Liab. & Prov	**178**	**221**	**271**	**342**	**424**	**443**	**467**	**494**
Net Current Assets	**634**	**700**	**632**	**651**	**660**	**657**	**658**	**661**
Application of Funds	**885**	**929**	**938**	**966**	**992**	**1,008**	**1,020**	**1,037**

Financials and valuations

Ratios

Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
Basic (INR)								
EPS	**67.0**	**82.3**	**86.2**	**86.7**	**104.0**	**116.3**	**136.1**	**156.4**
Cash EPS	72.2	87.6	95.6	97.6	117.0	131.7	153.3	175.6
Book Value	220.9	233.8	224.2	231.1	241.8	244.4	245.0	245.9
DPS	70.7	76.9	71.4	97.2	100.9	98.8	115.6	132.9
Payout %	105.6	93.5	82.8	112.1	97.1	85.0	85.0	85.0
Valuation (x)								
P/E	50.1	40.8	38.9	38.7	32.3	28.9	24.7	21.5
Cash P/E	46.5	38.3	35.1	34.4	28.7	25.5	21.9	19.1
EV/EBITDA	39.6	32.3	29.7	26.8	23.0	20.3	17.8	15.6
EV/Sales	10.5	8.7	8.0	7.6	6.4	5.4	4.9	4.4
Price/Book Value	15.2	14.4	15.0	14.5	13.9	13.7	13.7	13.7
Dividend Yield (%)	2.1	2.3	2.1	2.9	3.0	2.9	3.4	4.0
Profitability Ratios (%)								
RoE	30.1	36.1	37.3	38.0	43.7	47.6	55.6	63.7
RoCE	26.1	31.4	31.7	33.2	36.8	40.7	46.3	52.5
Turnover Ratios								
Debtors (Days)	94	81	84	82	80	81	82	83
Fixed Asset Turnover (x)	10.7	12.7	7.8	8.1	9.3	11.0	12.4	14.1

Cash Flow Statement **(INR b)**

Y/E March	2018	2019	2020	2021	2022	2023E	2024E	2025E
CF from Operations	282	308	370	379	427	472	551	631
Cash for Working Capital	0	-22	-47	9	-28	-107	-59	-79
Net Operating CF	**282**	**286**	**324**	**388**	**399**	**366**	**491**	**552**
Net Purchase of FA	-19	-21	-32	-32	-30	-44	-49	-55
Free Cash Flow	**263**	**265**	**291**	**356**	**370**	**322**	**443**	**497**
Net Purchase of Invest.	16	36	118	-50	21	25	25	25
Net Cash from Invest.	**-3**	**16**	**86**	**-81**	**-9**	**-19**	**-24**	**-30**
Proc. from equity issues	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	0	-2	-13	-211	-195	0	0	0
Others	0	-2	-9	-6	-7	0	0	0
Dividend Payments	-268	-275	-377	-109	-134	-423	-495	-569
Cash Flow from Fin.	**-268**	**-279**	**-399**	**-326**	**-336**	**-423**	**-495**	**-569**
Net Cash Flow	**13**	**23**	**14**	**-18**	**56**	**-76**	**-28**	**-47**
Opening Cash Bal.	**41**	**54**	**77**	**91**	**73**	**130**	**54**	**26**
Add: Net Cash	13	23	14	-18	56	-76	-28	-47
Closing Cash Bal.	**54**	**77**	**91**	**73**	**130**	**54**	**26**	**-21**

N O T E S

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 be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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