

CMP: ₹ 3185

Target: ₹ 3720 (17%)

Target Period: 12 months

April 13, 2023

BUY

Near term pain in US market; growth likely to be back ended

About the stock: Tata Consultancy Services (TCS) is one of the leading IT service providers with a presence in BFSI, communication, manufacturing, retail & hi tech.

- Consistent organic revenue growth and industry leading margins (>25%)
- Stable management, robust return ratios (>RoCE 40%) & payouts (~70%)

Q4FY23 Results: TCS reported weak Q4FY23 numbers.

- Reported CC growth of 0.6% QoQ and 10.7% YoY
- EBIT margin was flat for Q4FY23 at 24.5%
- Reported strong TCW win of US\$10 billion (bn), up 28.2% QoQ

What should investors do? TCS' share price has grown by ~2.2x over the past five years (from ~₹ 1,476 in April 2018 to ~₹ 3,185 levels in April 2023).

- We maintain **BUY** rating on the stock

Target Price and Valuation: We value TCS at ₹ 3,720 i.e. 26x P/E on FY25E EPS

Key triggers for future price performance:

- Smooth & healthy transition to new CEO along with continuance of the strategy planned by the company would ensure growth momentum in the medium to long term
- Increase in outsourcing in Europe, vendor consolidation and deal pipeline leading to rupee revenue CAGR of 7.9% over FY23-25E
- We expect margins to improve from FY24 onwards due to utilisation improvement and moderation of sub-contractor costs. We build in margin expansion of 80 bps over FY23-25E
- Double-digit return ratios, strong cash generation and healthy payout

Alternate Stock Idea: Besides TCS, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 1,730



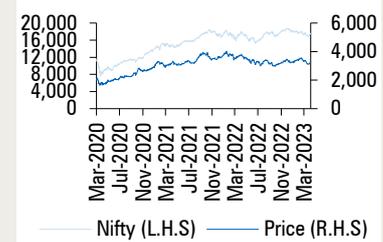
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	11,65,710
Total Debt (₹ Crore)	7,688
Cash and equivalents (₹ Crore)	47,929
EV (₹ Crore)	11,25,469
52 week H/L	3739/ 2926
Equity capital (₹ Crore)	366
Face value	₹ 1

Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoters	72.3	72.3	72.3	72.3
FII	14.1	13.5	13.1	12.9
DII	7.8	8.4	8.6	9.3
Others	5.7	5.8	6.1	5.4

Price Chart



Recent event & key risks

- Appointed K Krithivasan as MD & CEO with effect from June 1, 2023 for five years
- **Key Risk:** i) Lower-than-expected revenue ii) Lower-than-expected margin

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Key Financial Summary

Financials	FY21	FY22	FY23	5 year CAGR (FY18-23)	FY24E	FY25E	2 year CAGR (FY23-25E)
Net Sales	1,64,177	1,91,754	2,25,458	16.3	2,37,968	2,62,389	7.9
EBITDA	46,546	53,057	59,260	16.2	64,013	71,107	9.5
EBITDA Margins (%)	28.4	27.7	26.3		26.9	27.1	
Net Profit	32,430	38,327	42,147	13.0	47,435	52,353	11.5
EPS (₹)	86.7	104.7	115.2	14.3	129.6	143.1	
P/E	36.3	30.4	27.7		24.6	22.3	
RoNW (%)	37.5	43.0	46.6		45.6	43.3	
RoCE (%)	45.9	51.4	56.0		54.6	52.4	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- TCS reported weak revenue growth of 0.6% QoQ & 10.7% YoY in CC terms due to a weaker-than-expected revenue recovery in the US region during the quarter. In dollar terms, the company reported revenue of US\$7,195 mn, up 1.7% QoQ & 7.5% YoY while in rupee terms TCS reported revenue of ₹ 59,162 crore, up 1.6% QoQ & 16.9% YoY
- Geography wise (in CC terms) for Q4, North America (52.4% of mix) reported tepid growth of 9.6% YoY while the UK region reported strong growth of 17% YoY growth. Continental Europe, India & MEA reported growth of 8.4%, 13.4% & 11.3% YoY, respectively
- In CC terms, vertical wise, growth was led by retail & CPG (15.6% of mix) and Lifesciences & Healthcare (12.3% of mix) reporting growth of 13% & 12.3% YoY, respectively, while BFSI (31.4% of mix) reported muted growth of 9.1% YoY due to the deferral of discretionary spending & cautious approach by clients on account of a worsening macro environment. Manufacturing, tech & services and communication also reported muted growth of 9.1%, 9.2% and 5.3% YoY, respectively
- For FY23, in US dollar terms, the company reported revenue of US\$27,927 mn, up 8.6% sequentially while in CC terms it reported growth of 13.7%. North America (53.4% of mix) grew 15.3% while UK & Continental Europe grew 15% & 11%, respectively. Vertical wise, in FY23, all verticals reported double digit growth in CC terms with Retail & CPG (15.8% of mix) reporting growth of 19.7% while BFSI (31.7% of mix) grew 11.8%
- TCS deal wins during the quarter remained strong. It won TCV of US\$10 bn, up 28.2% QoQ, down 11.5% YoY. The company also mentioned that TCV included just one large deal of TCV while a majority of deals are in the deal size range of US\$50-100 mn, which indicates faster TCV to revenue conversion. TCS further said that BFSI TCV during the quarter was US\$3.1 bn & Retail TCV was US\$1.3 bn while geography wise US TCV win was also strong at US\$5 bn. For FY23, TCS reported TCV of US\$34.1 bn. It also won 29 cost optimisation deals during the year compared to 18 deals in FY22
- TCS reported flat margin growth during the quarter with EBIT margin of 24.5%. The company indicated that its benefits from lower subcontractor cost, cost efficiency & currency gains during the quarter were nullified due to higher onsite employee cost. For FY23, TCS reported an EBIT margin decline of 120 bps to 24.1%. The company indicated that the headwinds were as follows: i) wage hikes -160 bps, ii) supply side challenges -140 bps & iii) increase in travel cost -30 bps mitigated by tailwinds of i) better realisations +50 bps, ii) pyramid optimisation by fresher hiring +50 bps and currency benefits +110 bps. The company further indicated it still aspires to achieve the EBIT margin in the range of 26-28% but it is difficult to comment on whether it can be achieved in FY24 itself or not at this moment
- The company indicated that Q4 was weak due to uncertainty on the client side resulting in slower decision making. TCS mentioned that if demand deteriorates further, it cannot rule out further pause in few discretionary spend by clients. The company indicated that there was a softness of demand in North America in Q3, which it was hoping would recover in the subsequent quarter. The demand environment did not pick up in Q4 while it had turned incrementally negative. It mentioned that not only banking but other sectors also contributed to this weakness. In North America, BFSI issues had some impact on decision making while weakness was visible in the manufacturing sector as well. The company indicated that US retail sector was also impacted by a high inflationary environment. The company also mentioned that North America Travel Tourism & hospitality sector are also facing headwinds. The company expects the demand environment to be subdued in the near term while growth is expected to return in the medium term, especially in the BFSI segment as the order book continues to be strong and since it does not contain any large deals, revenue conversion could be faster. The new CEO indicated that leadership change

TCS - ESG Disclosure Score*

Score	FY20	FY21	FY22
Environmental	18.3	18.3	19.7
Social	12.3	12.3	12.3
Governance	91.1	91.1	91.1
Overall ESG Score	40.7	40.7	41.1

Source: Bloomberg, ICICI Direct Research, *Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures

does not mean any strategy change since whatever decisions the earlier CEO had taken were largely collective decisions of a core vertical leadership. He also indicated that he will likely tweak the strategy depending on the demand environment

- The company indicated that the UK market continues to show strong growth, which had positively surprised it considering some of the challenges it had gone through in terms of energy constraints in Q3 and Q4. TCS indicated that UK growth is being driven by both private as well as public sector. From a deal perspective, both transformation and cost take out deals were bringing growth in addition to large telecom vertical deal it won in Q3. The company indicated that in the public sector, a new competitive environment is bringing in growth, especially in utility sector as well as in rail sector, which are betting on data & analytics. The company also indicated that its relationship with one of the largest service providers in this segment is helping it to grow in this region. In Continental Europe, the company indicated that different regions behaved differently to the challenges. It will likely continue, going forward, also and may result in balanced growth
- The company indicated that unlike other industries, IT has been disciplined on pricing. This is unlikely to change even in a subdued demand scenario where clients are likely to pay for outcome-based services that it provides. The company indicated it may not have scope for price increase in the near term but ruled out any pricing pressure for existing as well as new bookings. TCS indicated that it will continue to push pricing up wherever there is an opportunity
- The company indicated that subcontractor costs as percentage of sales for the quarter have come down as the company accelerated onsite hiring. Correspondingly, onsite employee expenses have gone up for the quarter. TCS indicated that it has to keep an onsite employee buffer for any demand changes. In case of a demand pick-up, it likes to serve incremental demand through its own employees rather than taking expensive subcontractors for the same. The company said these costs are sticky in nature, which had an impact on margins for the quarter resulting in flat QoQ margin despite positives in terms of pyramid optimisation, better utilisation and attrition moderation. TCS indicated that historically it was at 5-8% of subcontractor costs as percentage of sales and it is still 25% higher than high end. Hence, there is further scope of optimisation of subcontractor costs
- The company indicated generative AI (ChatGPT) is an interesting technology where it has been working on it. TCS also did some pilots at its end. The company also mentioned that this technology has a potential to change the way it delivers software to clients as it is a tool driven organisation. The company also indicated it has generated certain expertise around this technology and is likely to use for future delivery to clients. The company also mentioned that TCS Cognix platform, which helps enterprises accelerate IT infrastructure transformations, enabling greater operational efficiency has TCV of US\$1.8 bn
- LTM attrition of the company continued to moderate. During the quarter, its LTM attrition declined 120 bps QoQ to 20.1%. The company further mentioned that its quarterly attrition declined by 400 bps. It expects attrition to moderate further to its historical average by H2FY24
- The company's hiring during the quarter was muted as it reported net additions of 821 employees taking its employees strength to 614,875. For FY24, the company's net hiring was 22,600. The company further mentioned it had honoured all offers to freshers & during the year onboarded ~46,000 freshers
- The company, during the quarter, declared a final dividend of ₹ 24 per share taking the total dividend payout for FY23 to ₹ 115 per share

- TCS also announced it has appointed K Krithivasan, its current BFSI head & CEO designate, as its MD & CEO for a term of 5 years with effect from June 1, 2023. The company further informed that its outgoing CEO Rajesh Gopinathan would still available and help in transition process post June till September 2023

Exhibit 1: Variance Analysis

	Q4FY23	Q4FY23E	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	Comments
Revenue (US\$ mn)	7,195	7,217	6,696	7.5	7,075	1.7	In CC terms, revenue grew 0.6% QoQ & 10.7% YoY in CC term
Revenue (₹ crore)	59,162	59,363	50,591	16.9	58,229	1.6	In YoY CC terms; vertical wise, revenue growth was led by Retail & CPG with 13% growth while BFSI grew 9.1% and geography wise UK reported growth of 17% while North America grew 9.6%
Employee expenses	34,427	34,668	29,364	17.2	33,942	1.4	
Gross Margin	24,735	24,695	21,227	16.5	24,287	1.8	
Gross margin (%)	41.8	41.6	42.0	-15 bps	41.7	10 bps	
SG&A expenses	8,962	8,726	7,382	21.4	8,733	2.6	
EBITDA	15,773	15,969	13,845	13.9	15,554	1.4	
EBITDA Margin (%)	26.7	26.9	27.4	-71 bps	26.7	-5 bps	
Depreciation	1,285	1,306	1,217	5.6	1,270	1.2	
EBIT	14,488	14,663	12,628	14.7	14,284	1.4	
EBIT Margin (%)	24.5	24.7	25.0	-47 bps	24.5	-4 bps	EBIT margin was flat QoQ as the tailwinds of lower subcon cost, cost efficiency & currency benefits were offset by the headwinds of lower revenue & higher onsite cost
Other income (less interest)	903	350	736	22.7	360	150.8	
PBT	15,391	15,013	13,364	15.2	14,644	5.1	
Tax paid	3,955	3,753	3,405	16.2	3,761	5.2	
Reported PAT	11,392	10,846	9,926	14.8	10,846	5.0	
Adjusted PAT	11,392	11,224	9,926	14.8	10,846	5.0	

Source: Company, ICICI Direct Research

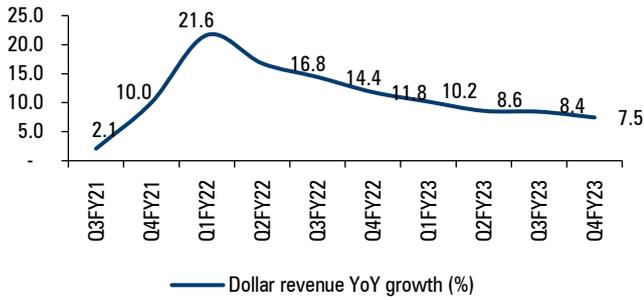
Exhibit 2: Change in estimates

(₹ Crore)	FY24E			FY25E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	2,41,326	2,37,968	-1.4	2,62,389	2,62,389	0.0	We are building up some slowdown as per management commentary while FY25 likely to see some recovery
EBIT	60,573	58,778	-3.0	66,384	65,335	-1.6	
EBIT Margin (%)	25.1	24.7	-40 bps	25.3	24.9	-40 bps	we are building in some impact of increase in on-site expenses
PAT	48,815	47,435	-2.8	53,174	52,353	-1.5	
EPS (₹)	133.4	129.6	-2.8	145.3	143.1	-1.5	

Source: Company, ICICI Direct Research

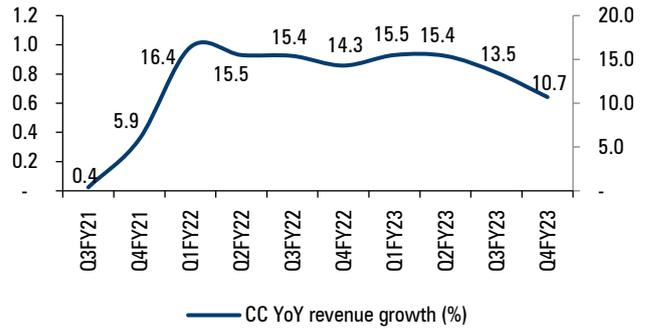
Quarterly highlights

Exhibit 3: North America market impacted Q4



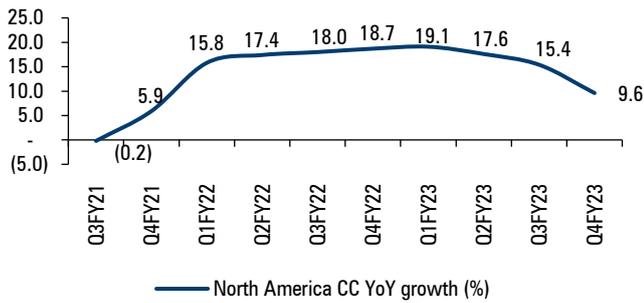
Source: Company, ICICI Direct Research

Exhibit 4: ...resulting in growth moderation



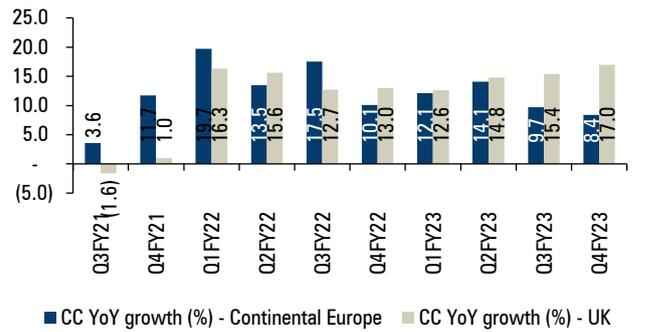
Source: Company, ICICI Direct Research

Exhibit 5: Weak BFSI, Retail impact market



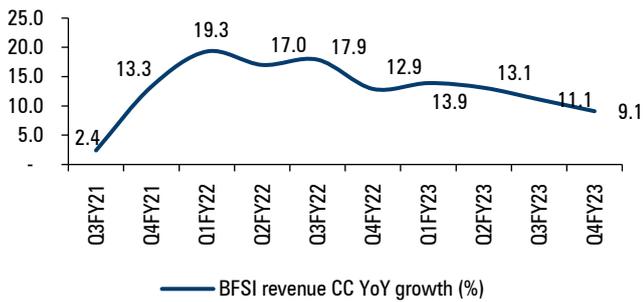
Source: Company, ICICI Direct Research

Exhibit 6: While UK continues to report strong growth



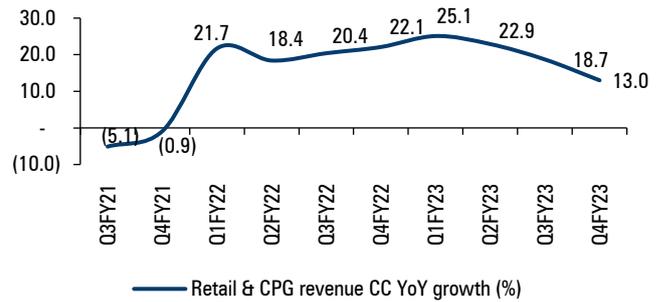
Source: Company, ICICI Direct Research

Exhibit 7: BFSI revenue growth moderating



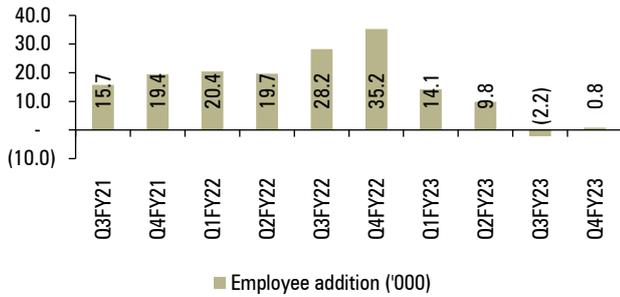
Source: Company, ICICI Direct Research

Exhibit 8: While US market impacts growth



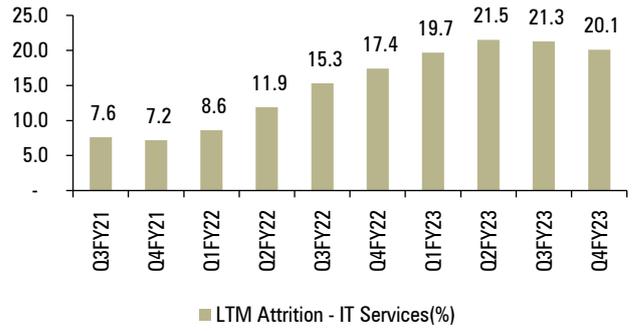
Source: Company, ICICI Direct Research

Exhibit 9: Hiring reflection of demand



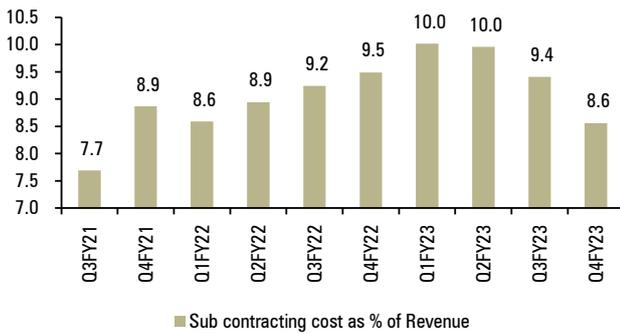
Source: Company, ICICI Direct Research

Exhibit 10: Attrition already peaked out



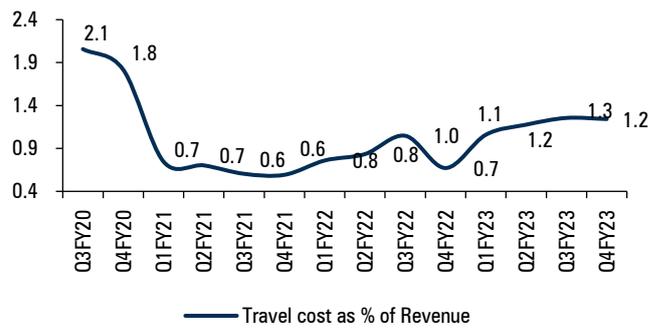
Source: Company, ICICI Direct Research

Exhibit 11: Subcontracting continues to moderate



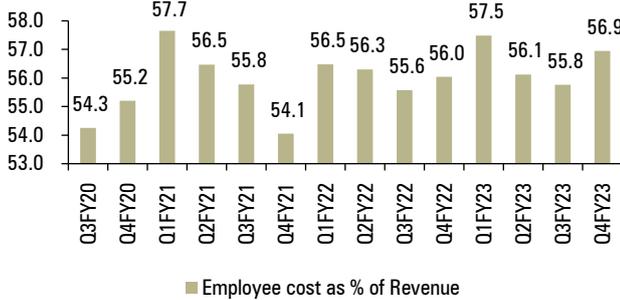
Source: Company, ICICI Direct Research

Exhibit 12: While travel cost is steady



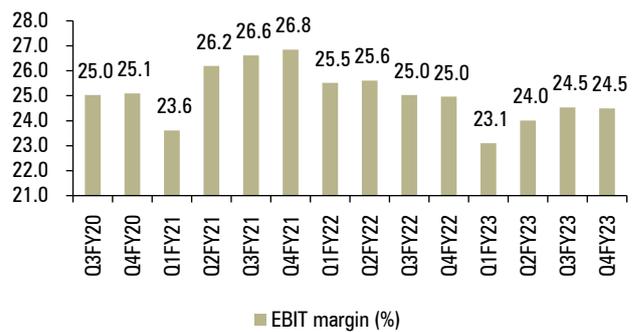
Source: Company, ICICI Direct Research

Exhibit 13: Higher onsite hiring pushes up costs



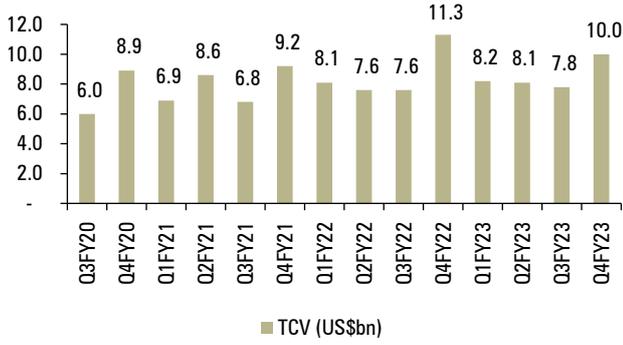
Source: Company, ICICI Direct Research

Exhibit 14: Leading to flattish margins in Q4



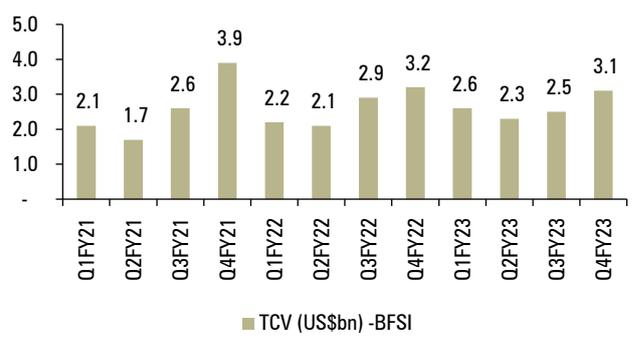
Source: Company, ICICI Direct Research

Exhibit 15: TCV continues to be strong



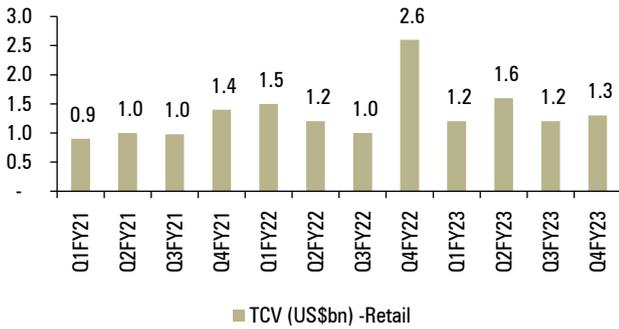
Source: Company, ICICI Direct Research

Exhibit 16: TCV for BFSI



Source: Company, ICICI Direct Research

Exhibit 17: Retail TCV remains steady



Source: Company, ICICI Direct Research

Exhibit 18: While North America TCV remains strong



Source: Company, ICICI Direct Research

Exhibit 19: Adds two clients in US\$100 mn+ bucket YoY



Source: Company, ICICI Direct Research

Exhibit 20: Client addition trend



Source: Company, ICICI Direct Research

Peer comparison

Exhibit 21: Peer Comparison

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
HCL Tech (HCLTEC)	1,095	1,220	BUY	2,97,146	53.6	59.2	63.9	20.4	18.5	17.1	26.2	27.7	29.0	22.2	23.3	23.9
Infosys (INFTEC)	1,428	1,730	BUY	5,97,773	60.7	70.8	75.2	23.5	20.2	19.0	36.2	39.1	39.2	30.1	32.3	32.1
TCS (TCS)	3,185	3,720	BUY	11,65,408	115.2	129.6	143.1	27.7	24.6	22.3	56.0	54.6	52.4	46.6	45.6	43.3
Tech M (TECMAH)	1,110	1,130	HOLD	1,07,983	63.0	74.0	86.3	17.6	15.0	12.9	20.9	21.8	22.9	18.6	19.5	20.2
Wipro (WIPRO)	372	455	BUY	2,03,904	23.3	26.4	28.4	15.9	14.1	13.1	18.9	20.5	21.0	18.7	20.3	21.0

Source: Company, ICICI Direct Research

Financial summary

Exhibit 22: Profit and loss statement ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Total operating Incom	1,91,754	2,25,458	2,37,968	2,62,389
Growth (%)	16.8	17.6	5.5	10.3
COGS (employee expense)	1,11,053	1,32,448	1,40,401	1,54,547
S,G&A expenses	27,644	33,750	33,553	36,734
Total Operating Expenditur	1,38,697	1,66,198	1,73,954	1,91,281
EBITDA	53,057	59,260	64,013	71,107
Growth (%)	14.0	11.7	8.0	11.1
Depreciation	4,604	5,023	5,235	5,773
Other Income less interest	3,234	2,670	4,677	4,677
PBT	51,687	56,907	63,455	70,012
Total Tax	13,238	14,604	15,864	17,503
Minority Interest	122	156	156	156
PAT	38,327	42,147	47,435	52,353
Growth (%)	18.2	10.0	12.5	10.4
EPS (₹)	104.7	115.2	129.6	143.1
PAT	38,327	42,147	47,435	52,353
EPS - Reported (₹)	104.7	115.2	129.6	143.1

Source: Company, ICICI Direct Research

Exhibit 23: Cash flow statement ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Profit before Tax	51,687	56,907	63,455	70,012
Add: Depreciation	4,604	5,022	5,235	5,773
(Inc)/dec in Current Assets	-4,465	-7,455	-5,500	-6,998
Inc/(dec) in CL and Provisions	1,696	3,238	6,501	5,209
Taxes paid	-11,486	-12,966	-15,864	-17,503
CF from operating activiti	39,949	41,965	49,814	52,479
(Inc)/dec in Investments	-640	7	-91	-513
(Inc)/dec in Fixed Assets	-2,961	-3,061	-4,759	-5,248
Others	2,704	3,093	4,014	4,014
CF from investing activiti	-897	39	-837	-1,747
Inc/(dec) in loan funds	-19,566	-5,752	0	0
Dividend paid & dividend tax	-13,317	-41,347	-33,791	-35,423
Others	-698	-779	0	0
CF from financing activiti	-33,581	-47,878	-33,791	-35,423
Net Cash flow	5,471	-5,874	15,186	15,309
Exchange difference	159	509	0	0
Opening Cash	7,705	12,488	7,123	22,309
Closing cash and Bank	12,488	7,123	22,309	37,618

Source: Company, ICICI Direct Research

Exhibit 24: Balance sheet ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Liabilities				
Equity Capital	366	366	366	366
Reserve and Surplus	88,773	90,058	1,03,702	1,20,632
Share Premium	0	0	0	0
Total Shareholders funds	89,139	90,424	1,04,068	1,20,998
Total debt	7,818	7,688	8,076	8,268
Other liabilities & Provisions	2,359	1,892	2,442	2,553
Deferred tax liability(net)	590	792	792	792
Minority Interest / Others	707	782	938	1,094
Total Liabilities	1,00,613	1,01,578	1,16,315	1,33,704
Assets				
Net assets & CWIP	20,716	19,891	19,415	18,890
Goodwill	1,787	2,806	2,806	2,806
Other non current assets	10,501	10,501	10,592	11,105
Debtors	34,219	41,198	43,678	48,160
Loans and Advances	6,456	1,333	11,898	13,119
Other Current Assets	19,352	20,158	12,612	13,907
Current Investments	35,995	40,806	40,806	40,806
Cash	12,488	7,123	22,309	37,618
Trade Payable	8,045	10,515	11,393	12,562
OCL & Provisions	32,856	31,723	36,409	40,145
Application of Funds	1,00,613	1,01,578	1,16,315	1,33,704

Source: Company, ICICI Direct Research

Exhibit 25: Key ratios ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Per share data (₹)				
Adjusted EPS (Diluted)	104.7	115.2	129.6	143.1
BV per share	243.5	247.1	284.3	330.6
DPS	75.8	115.0	92.3	96.8
Cash Per Share	34.1	19.5	61.0	102.8
Operating Ratios (%)				
EBIT margins	25.3	24.1	24.7	24.9
PBT Margins	27.0	25.2	26.7	26.7
PAT Margin	20.0	18.7	19.9	20.0
Debtor days	65	67	67	67
Creditor days	15	17	17	17
Return Ratios (%)				
RoE	43.0	46.6	45.6	43.3
RoCE	51.4	56.0	54.6	52.4
RoIC	92.9	101.1	110.5	118.2
Valuation Ratios (x)				
P/E	30.4	27.6	24.5	22.2
EV / Net Sales	5.9	5.0	4.7	4.2
Market Cap / Sales	6.1	5.2	4.9	4.4
Solvency Ratios				
Debt / EBITDA	0.1	0.1	0.1	0.1
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	1.5	1.5	1.4	1.4
Quick Ratio	1.5	1.5	1.4	1.4

Source: Company, ICICI Direct Research

Exhibit 26: ICICI Direct coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
HCL Tech (HCLTEC)	1,095	1,220	BUY	2,97,146	53.6	59.2	63.9	20.4	18.5	17.1	26.2	27.7	29.0	22.2	23.3	23.9
Infosys (INFTEC)	1,428	1,730	BUY	5,97,773	60.7	70.8	75.2	23.5	20.2	19.0	36.2	39.1	39.2	30.1	32.3	32.1
TCS (TCS)	3,185	3,720	BUY	11,65,408	115.2	129.6	143.1	27.7	24.6	22.3	56.0	54.6	52.4	46.6	45.6	43.3
Tech M (TECMAH)	1,110	1,130	HOLD	1,07,983	63.0	74.0	86.3	17.6	15.0	12.9	20.9	21.8	22.9	18.6	19.5	20.2
Wipro (WIPRO)	372	455	BUY	2,03,904	23.3	26.4	28.4	15.9	14.1	13.1	18.9	20.5	21.0	18.7	20.3	21.0
LTIM (LTINFO)	4,829	5,320	BUY	1,42,840	153.9	181.0	221.7	31.4	26.7	21.8	33.8	34.2	35.9	27.2	27.6	28.9
Coforge (NIIITEC)	4,065	4,870	BUY	24,758	148.9	172.7	194.7	27.3	23.5	20.9	31.8	31.5	30.6	28.5	28.0	26.9
TeamLease (TEASER)	2,191	2,335	HOLD	3,746	73.7	77.5	93.4	29.7	28.3	23.5	15.5	14.3	14.9	15.3	14.0	14.5
Infoedge (INFEDG)	3,859	3,265	HOLD	48,497	52.1	54.6	58.2	74.1	70.7	66.3	6.3	6.3	6.5	4.7	4.8	4.9

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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