MOTILAL OSWAL
FINANCIAL SERVICES

13 July 2023
1QFY24 Results Update | Sector: Technology

TCS

Estimate change	⟷
TP change	⟷
Rating change	⟷

Bloomberg	TCS IN
Equity Shares (m)	3752
M.Cap.(INRb)/(USDb)	11929.2 / 145
52-Week Range (INR)	3575 / 2868
1, 6, 12 Rel. Per (%)	-4/-11/-15
12M Avg Val (INR M)	6591
Free float (%)	27.7

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	2,255	2,445	2,756
EBIT Margin (%)	24.1	24.1	25.4
PAT	423	471	557
EPS (INR)	115.3	128.2	151.6
EPS Gr. (%)	10.9	11.3	18.2
BV/Sh. (INR)	247	240	232
Ratios			
RoE (%)	46.9	52.6	64.2
RoCE (%)	40.5	43.8	52.5
Payout (%)	99.8	90.0	90.0
Valuations			
P/E (x)	28.3	25.4	21.5
P/BV (x)	13.2	13.6	14.0
EV/EBITDA (x)	19.8	18.2	15.4
Div Yield (%)	3.5	3.5	4.2

Shareholding pattern (%)

As On	Mar-23	Dec-22	Mar-22
Promoter	72.3	72.3	72.3
DII	9.6	9.3	7.9
FII	12.7	12.9	14.2
Others	5.4	5.5	5.7

FII Includes depository receipts

CMP: INR3,260 TP: INR3,790 (+16%) Buy

Strong deal flow to compensate for low near-term visibility

Margin recovery to add to earnings growth; reiterate BUY

- TCS reported in-line revenue of USD7.2b in 1QFY24, flat QoQ in constant currency (CC) and a tad below our estimate of 0.3% CC. Revenue growth was affected by broad-based demand weakness across key verticals (BFSI) and geographies (US). The management indicated that a demand slowdown due to macro concerns is leading to reprioritization of deals, which is resulting in pauses and deferrals in non-critical projects. While the deal pipeline and deal wins (Q1 deal TCV of USD10.2b, book-to-bill at 1.4x) are good, smaller discretionary projects are getting impacted.
- 1Q EBIT margin declined by 130bp (to 23.2%) due to seasonal wage hikes and was in line with our estimate. The management expects margins to improve gradually over the next three quarters, in line with past trends.
- TCS remains cautious about near-term demand amid adverse macros, while it is quite optimistic about the secular long-term trend. The weakness persists in verticals like BFS, Communication and Retail due to a slowdown in discretionary spending, while the focus is shifting to efficiency-driven projects. The management also indicated that the small deals are getting scrutinized and taking more time to ramp up. However, the company was able to maintain its deal TCV at USD10.2b in 1Q, which we see as a key positive and differentiator for TCS.
- While we have trimmed our estimates for FY24, we continue to expect TCS to deliver superior growth in the near term among our Tier 1 coverage on account of its leadership in cost efficiency, which has resulted in strong inflows for the last two quarters. We expect the trend to continue, providing better visibility for FY25 revenue growth despite an uncertain demand environment. We factor in a USD revenue CAGR of 10.7% over FY23-25E.
- With in-line Q1 EBIT margin performance, TCS should benefit from its scale and ability to manage talent to control costs in the near to medium term. This is especially visible in the fact that it has given timely increments despite growth concerns, which we expect to pay out over the medium term through easing attrition. This should allow it to deliver a 14.8% PAT CAGR over FY23-25E.
- We have largely maintained our FY24/FY25 EPS estimates. Our TP of INR3,790 implies 25x FY25E EPS (16% upside). Reiterate **BUY** on the stock.

In-line revenue and margin

- Revenue growth (CC) was flat QoQ. INR EBIT/PAT rose 13%/17% YoY.
- EBIT margin of 23.2% (down 130 QoQ) was in line with our expectation. Margin was affected by wage hikes, offset by the improvement in subcon.
- The net headcount moderated further, with the addition of 523 associates vs. a net addition of 821 in 4Q.
- TCS announced an interim dividend of INR9/share in 1QFY24, with an overall payout of INR33b.
- The cash conversion was strong at 76% OCF/EBITDA, while FCF/PAT stood at 99% in 1Q.

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Key highlights from management commentary

- The demand softness was broad-based across multiple pockets as clients continued to reprioritize projects with higher ROA, hence creating near-term revenue leakages
- The deal pipeline remained strong with healthy booking of USD10.2b (BTB 1.4x), with a balanced mix of vendor consolidation, transformation and integration projects. However, small and medium size deals form the major proportion of the pipeline in the range of USD50-60m.
- The current environment is making enterprises cautious, which is leading to pauses and deferrals in non-critical projects. It expects the transformation projects to gain strength once the macro headwinds start to ease.
- Small deals are getting scrutinized more and ramping up slowly. However, there are no instances of deal cancellations or a meaningful ramp-down in projects.

Valuation and view

- Given its size, order book and exposure to long-duration orders and portfolio, TCS 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 INR3,790 implies 25x FY25E EPS, with a 16% upside potential. We reiterate our **BUY** rating.

Quarterly performance (IFRS) (INR b)

Y/E March	FY23				FY24E				FY23	FY24E	FY24	Variance
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			1QFY24E	(% / bp)
Revenue from IT Services (USD m)	**6,780**	**6,877**	**7,075**	**7,195**	**7,226**	**7,364**	**7,500**	**7,716**	**27,927**	**29,806**	**7,246**	**-0.3**
QoQ (%)	1.3	1.4	2.9	1.7	0.4	1.9	1.8	2.9	8.6	6.7	0.7	-28bp
Overall revenue (INR b)	**528**	**553**	**582**	**592**	**594**	**604**	**615**	**633**	**2,255**	**2,445**	**596**	**-0.3**
QoQ (%)	4.3	4.8	5.3	1.6	0.4	1.7	1.8	2.9			0.7	-30bp
YoY (%)	16.2	18.0	19.1	16.9	12.6	9.2	5.6	6.9	17.6	8.5	12.9	-34bp
GPM (%)	**38.4**	**39.5**	**40.1**	**40.1**	**39.5**	**39.9**	**40.3**	**40.6**	**39.6**	**40.1**	**38.7**	**82bp**
SGA (%)	15.3	15.5	15.5	15.7	16.4	16.0	15.9	15.7	15.5	16.0	15.6	75bp
EBITDA	**134**	**145**	**156**	**157**	**150**	**157**	**163**	**170**	**591**	**639**	**150**	**0.0**
EBITDA Margin (%)	25.3	26.2	26.8	26.5	25.2	25.9	26.4	26.9	26.2	26.1	25.1	7bp
EBIT	**122**	**133**	**143**	**145**	**138**	**144**	**150**	**158**	**542**	**590**	**138**	**0.0**
EBIT Margin (%)	23.1	24.0	24.5	24.5	23.2	23.9	24.4	24.9	24.1	24.1	23.1	6bp
Other Income	6	8	4	9	12	10	10	11	27	44	9	38.1
PBT	**128**	**141**	**146**	**154**	**150**	**155**	**161**	**168**	**569**	**633**	**147**	**2.3**
ETR (%)	25.5	25.8	25.7	25.7	25.8	25.5	25.5	25.5	25.7	25.6	25.5	31bp
Adj. PAT	**95**	**105**	**109**	**114**	**111**	**115**	**120**	**125**	**423**	**471**	**109**	**1.9**
Exceptional Items	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	
Reported PAT	**95**	**105**	**109**	**114**	**111**	**115**	**120**	**125**	**423**	**471**	**109**	**1.9**
QoQ (%)	-4.4	9.9	4.0	5.1	-2.8	3.6	3.8	4.9			-4.6	179bp
YoY (%)	5.4	8.4	11.0	14.8	16.8	10.1	9.9	9.6	10.0	11.4	14.7	215bp
EPS (INR)	26.0	28.5	29.6	31.1	30.3	31.3	32.5	34.1	115.3	128.2	29.7	1.8

Key performance indicators

Y/E March	FY23				FY24E	FY23
	1Q	2Q	3Q	4Q	1Q	
Revenue (QoQ CC %)	3.5	4.0	2.2	0.6	0.0	14.3
Costs (as a percentage of revenue)						
COGS	61.6	60.5	59.9	59.9	60.5	60.4
SGA	15.3	15.5	15.5	15.7	16.4	15.5
Margins						
Gross Margin	38.4	39.5	40.1	40.1	39.5	39.6
EBIT Margin	23.1	24.0	24.5	24.5	23.2	24.1
Net Margin	18.0	18.9	18.7	19.3	18.7	18.8
Operating Metrics						
Headcount (k)	606	616	614	615	615	615
Attrition (%)	19.7	21.5	21.3	20.1	17.8	20.1
Deal win TCV (USD b)	8.2	8.1	7.8	10	10.2	34.1
Key verticals (YoY CC %)						
BFSI	13.9	13.1	11.1	9.1	3.0	11.8
Retail	25.1	22.9	18.7	13.0	5.3	19.7
Key geographies (YoY CC %)						
North America	19.1	17.6	15.4	9.6	4.6	15.3
UK	12.6	14.8	15.4	17.0	16.1	15.0
Continental Europe	12.1	14.1	9.7	8.4	3.4	11.0

CONFERENCE CALL

Highlights from management commentary

1QFY24 performance and demand outlook

- TCS reported revenue growth of 7% YoY and flat QoQ CC. The demand softness was broad based across multiple pockets as clients continued to reprioritize projects with higher ROA, hence creating near-term revenue leakages.
- For BFS, large banks are driving growth; however, there is some softness in the Mortgage, Capital Markets and P&C (Insurance) segments.
- In Manufacturing, demand is led by Automotive in the area of improving supply chain. The company is also gaining market share in the space.
- Retail is witnessing signs of bottoming out. Essential retail remains healthy, while luxury and speciality have been impacted by the structural softness in consumer spending.
- In CME, revenue profiles of Telcos are weak as the earlier investments in 5G have not played out meaningfully, hence clients have moved to the cost optimization phase.
- The deal pipeline remained strong with healthy booking of USD10.2b (BTB 1.4x), with a balanced mix of vendor consolidation, transformation and integration projects. However, small and medium size deals form the major proportion of the pipeline in the range of USD50-60m.
- The current environment is making enterprises cautious, which is leading to pauses and deferrals in non-critical projects. It expects transformation projects to gain strength once the macro headwinds start to ease.
- Small deals are getting scrutinized more and ramping up slowly. However, there are no instances of deal cancellations or a meaningful ramp-down in projects.
- Despite having a healthy deal pipeline, the management is seeking more visibility in the current environment to see any further uptick in demand for H2.

Margin performance and outlook

- The management sees further scope of improvement in utilization, productivity, discretionary spending and pricing, which are some of the levers to play out in improving margins.
- 100% variable pay is given to 70% of employees in 1Q, while the rest 30% would be evaluated on the BUs' performance in Q2.
- It is confident to take margin to 25% in FY24.

Exhibit 1: Growth was muted across key geographies

Geographies	Contribution to revenue (%)	QoQ growth (%)
North America	52.0	-0.3
Latin America	2.0	11.6
UK	16.4	4.9
Continental Europe	14.9	-0.9
India	4.9	-1.6
Asia Pacific	7.8	-2.1
MEA	2.0	0.4

Source: Company, MOFSL

Exhibit 2: Softness was prominent in key verticals

Verticals	Contribution to revenue (%)	QoQ growth (%)
BFSI	31.0	-0.8
Retail and CPG	15.7	1.1
Communications and Media	6.4	-1.1
Manufacturing	10.2	3.5
Life Sciences and Healthcare	10.5	1.4
Technology and Services	8.6	-0.7
Regional Markets and Others	17.6	1.0

Source: Company, MOFSL

Maintain BUY with a TP of INR3,790

- Given its size, order book and exposure to long-duration orders and portfolio, TCS 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 INR3,790 implies 25x FY25E EPS, with a 16% upside potential. We reiterate our **BUY** rating.

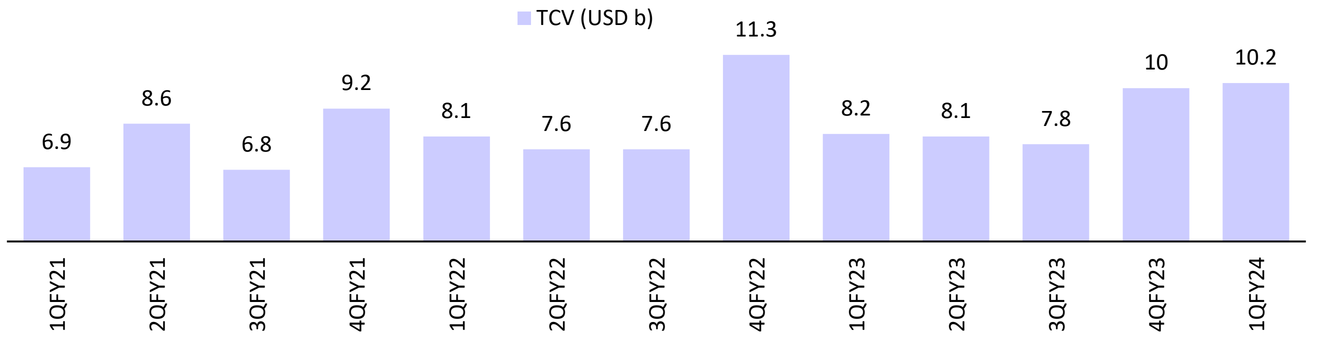
Exhibit 3: Revisions to our estimates

	Revised		Earlier		Change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
USD:INR	82.0	82.2	82.1	82.2	0.0%	0.0%
USD revenue (m)	29,806	33,540	29,980	33,694	-0.6%	-0.5%
Growth (%)	6.7	12.5	7.4	12.4	-60bps	10bps
EBIT margin (%)	24.1	25.4	24.4	25.4	-30bps	0bps
PAT (INR b)	469	555	475	555.9	-1.1%	-0.2%
EPS	128.2	151.6	129.7	151.9	-1.1%	-0.2%

Source: MOFSL

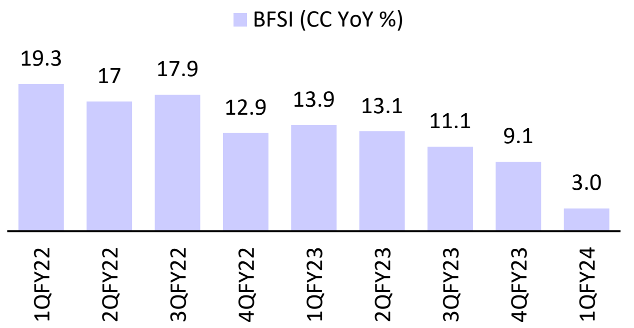
Story in charts

Exhibit 4: Deal wins remain stable in 1QFY24



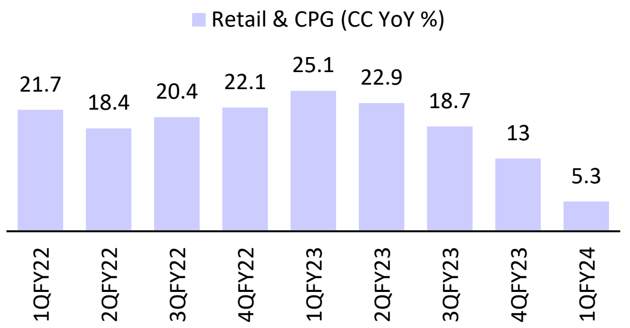
Source: Company, MOFSL

Exhibit 5: Softness continues in BFSI



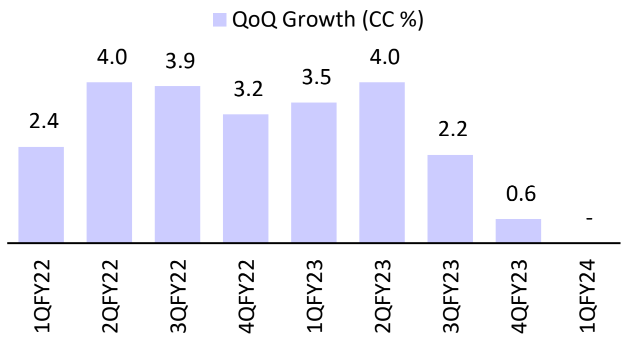
Source: Company, MOFSL

Exhibit 6: Muted growth in retail



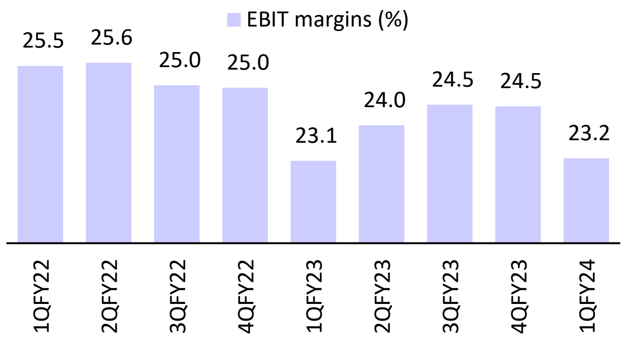
Source: Company, MOFSL

Exhibit 7: Flat CC growth in Q1 led by deteriorating macros



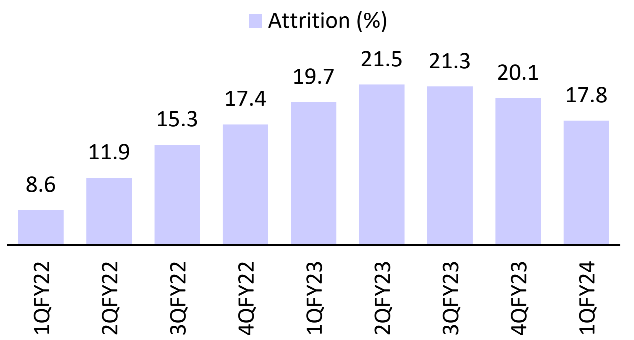
Source: Company, MOFSL

Exhibit 8: Margins moderated due to wage hike



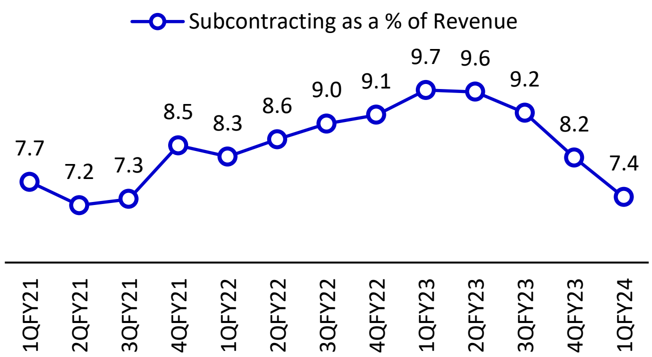
Source: Company, MOFSL

Exhibit 9: LTM attrition cooled off further



Source: Company, MOFSL

Exhibit 10: Sub-contracting moderates meaningfully



Source: Company, MOFSL

Operating metrics

Exhibit 11: Operating metrics

	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24
Verticals (%)									
BFSI	32.5	32.4	32.1	31.9	32.1	31.9	31.5	31.4	31.4
Retail and CPG	14.8	15.0	14.5	15.4	15.9	15.9	15.7	15.6	15.6
Communications and Media	6.4	6.5	6.6	6.7	6.8	6.7	6.6	6.5	6.5
Manufacturing	9.8	9.9	9.6	10.0	9.9	9.9	9.9	9.9	9.9
Life Sciences and Healthcare	10.2	10.0	9.8	10.0	10.1	10.2	10.3	10.4	10.4
Technology and Services	8.6	8.8	8.6	8.7	8.8	9.0	8.9	8.7	8.7
Regional markets and others	17.7	17.4	18.8	17.3	16.4	16.4	17.1	17.5	17.5
Geographies (%)									
North America	49.4	50.3	50.7	51.6	53.2	54.3	53.7	52.4	52.4
Latin America	1.6	1.6	1.7	1.7	1.8	1.7	1.8	1.8	1.8
UK	16.3	16.1	15.6	15.6	14.9	14.5	14.9	15.7	15.7
Continental Europe	16.7	15.9	16.0	15.5	15.2	14.5	14.8	15.1	15.1
India	4.6	5.1	5.5	5.1	4.8	5.1	5.1	5.0	5.0
Asia Pacific	9.3	9.0	8.6	8.5	8.3	8.0	7.9	8.0	8.0
MEA	2.1	2.0	1.9	2.0	1.8	1.9	1.8	2.0	2.0
QoQ growth (%)									
BFSI	3.7	2.6	2.1	2.0	1.9	0.8	1.6	1.4	1.4
Retail and CPG	4.9	4.3	-0.4	9.0	4.5	1.4	1.6	1.0	1.0
Communications and Media	1.2	4.5	4.6	4.2	2.8	-0.1	1.3	0.2	0.2
Manufacturing	4.9	4.0	-0.1	6.9	0.2	1.4	2.9	1.7	1.7
Life Sciences and Healthcare	8.1	0.9	1.0	4.7	2.3	2.4	3.9	2.7	2.7
Technology and Services	5.2	5.3	0.7	3.8	2.4	3.7	1.7	-0.6	-0.6
Regional markets and others	(4.8)	1.2	11.3	-5.6	-4.0	1.4	7.3	4.1	4.1
North America	4.4	4.8	3.8	4.5	4.4	3.5	1.7	-0.8	-0.8
Latin America	2.8	2.9	9.5	2.6	7.2	-4.2	8.9	1.7	1.7
UK	4.7	1.6	-0.2	2.6	-3.3	-1.3	5.7	7.2	7.2
Continental Europe	2.1	-2.0	3.7	-0.6	-0.7	-3.2	5.0	3.8	3.8
India	(15.6)	14.1	11.1	-4.8	-4.7	7.8	2.9	-0.3	-0.3
Asia Pacific	1.7	-0.4	-1.6	1.4	-1.1	-2.2	1.6	3.0	3.0
MEA	7.9	-2.0	-2.1	8.0	-8.9	7.1	-2.5	13.0	13.0
Total Employees (k)	**509**	**528.7**	**557.0**	**592.2**	**606.3**	**616.2**	**614.0**	**614.8**	**614.8**
Net Additions (k)	**20**	**19.7**	**28.2**	**35.2**	**14.1**	**9.8**	**-2.2**	**0.8**	**0.8**
Attrition (LTM %)	**8.6**	**11.9**	**15.3**	**17.4**	**19.7**	**21.5**	**21.3**	**20.1**	**20.1**

Source: Company, MOFSL

Financials and valuations

Income Statement								(INR b)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Sales	**1,231**	**1,465**	**1,569**	**1,642**	**1,918**	**2,255**	**2,445**	**2,756**
Change (%)	4.4	19.0	7.2	4.6	16.8	17.6	8.5	12.7
Cost of Services	713	852	923	971	1,146	1,363	1,465	1,614
SG&A Expenses	213	239	260	246	287	350	391	441
EBITDA	**325**	**395**	**421**	**465**	**532**	**599**	**651**	**770**
As a percentage of Net Sales	26.4	27.0	26.8	28.4	27.8	26.6	26.6	27.9
Depreciation	20	21	35	41	48	56	61	69
EBIT	**305**	**375**	**386**	**425**	**485**	**542**	**590**	**701**
As a percentage of Net Sales	24.8	25.6	24.6	25.9	25.3	24.1	24.1	25.4
Other Income	36	41	37	25	32	27	44	47
PBT	**341**	**416**	**422**	**450**	**517**	**569**	**633**	**748**
Tax	82	100	98	115	132	146	162	191
Rate (%)	24.1	24.1	23.2	25.5	25.6	25.7	25.6	25.5
PAT	**259**	**316**	**324**	**335**	**384**	**423**	**471**	**557**
Extraordinary Gains/Losses	0	0	0	-10	0	0	0	0
Adjusted PAT	**259**	**316**	**324**	**326**	**384**	**423**	**471**	**557**
Minority Interest	1	1	1	1	1	2	2	2
Reported PAT	**258**	**315**	**323**	**324**	**383**	**421**	**469**	**555**
Change (%)	-1.8	21.9	2.8	0.3	18.2	10.0	11.4	18.2

Balance Sheet								(INR b)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Share capital	2	4	4	4	4	4	4	4
Reserves	849	891	838	861	888	901	876	846
Net Worth	**851**	**894**	**841**	**864**	**891**	**904**	**879**	**850**
Minority Interest and Others	33	34	97	102	100	97	122	137
Loans	1	0	0	0	0	0	0	0
Capital Employed	**885**	**929**	**938**	**966**	**992**	**1,001**	**1,002**	**987**
Gross Block	266	287	408	449	502	550	609	676
Depreciation	151	171	207	247	295	351	413	482
Net Block	**115**	**116**	**201**	**201**	**207**	**199**	**197**	**195**
Intangibles	52	44	45	57	55	52	55	52
Other LT assets	84	69	60	56	70	83	97	100
Current Assets	**812**	**921**	**902**	**993**	**1,083**	**1,103**	**1,107**	**1,123**
Debtors	316	325	363	367	418	500	537	597
Cash and Bank Balance	49	72	97	69	125	71	80	71
Investments	380	347	261	316	360	401	356	311
Other Current Assets	67	177	182	241	180	131	134	143
Current Liab. and Prov.	**178**	**221**	**271**	**342**	**424**	**436**	**454**	**482**
Net Current Assets	**634**	**700**	**632**	**651**	**660**	**667**	**653**	**641**
Application of Funds	**885**	**929**	**938**	**966**	**992**	**1,001**	**1,002**	**987**

Financials and valuations

Ratios								
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Basic (INR)								
EPS	**67.0**	**82.3**	**86.2**	**86.7**	**104.0**	**115.3**	**128.2**	**151.6**
Cash EPS	72.2	87.6	95.6	97.6	117.0	130.7	144.9	170.5
Book Value	220.9	233.8	224.2	231.1	241.8	247.3	240.3	232.2
DPS	70.7	76.9	71.4	97.2	100.9	115.1	115.4	136.5
Payout (%)	105.6	93.5	82.8	112.1	97.1	99.8	90.0	90.0
Valuation (x)								
P/E	48.7	39.6	37.8	37.6	31.4	28.3	25.4	21.5
Cash P/E	45.1	37.2	34.1	33.4	27.9	24.9	22.5	19.1
EV/EBITDA	38.5	31.4	28.8	26.0	22.3	19.8	18.2	15.4
EV/Sales	10.2	8.5	7.7	7.4	6.2	5.3	4.8	4.3
Price/Book Value	14.8	13.9	14.5	14.1	13.5	13.2	13.6	14.0
Dividend Yield (%)	2.2	2.4	2.2	3.0	3.1	3.5	3.5	4.2
Profitability Ratios (%)								
RoE	30.1	36.1	37.3	38.0	43.7	46.9	52.6	64.2
RoCE	26.1	31.4	31.7	33.2	36.8	40.5	43.8	52.5
Turnover Ratios								
Debtors (Days)	94	81	84	82	80	81	80	79
Fixed Asset Turnover (x)	10.7	12.7	7.8	8.1	9.3	11.3	12.4	14.2

Cash Flow Statement								(INR b)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
CF from Operations	282	308	370	379	427	462	521	612
Cash for Working Capital	0	-22	-47	9	-28	-42	-16	-28
Net Operating CF	**282**	**286**	**324**	**388**	**399**	**420**	**505**	**584**
Net Purchase of FA	-19	-21	-32	-32	-30	-31	-47	-53
Free Cash Flow	**263**	**265**	**291**	**356**	**370**	**389**	**458**	**531**
Net Purchase of Invest.	16	36	118	-50	21	31	45	45
Net Cash from Invest.	**-3**	**16**	**86**	**-81**	**-9**	**0**	**-2**	**-8**
Proceeds from Equity Issues	0	0	0	0	0	0	0	0
Proceeds from LTB/STB	0	-2	-13	-211	-195	-57	0	0
Others	0	-2	-9	-6	-7	-8	0	0
Dividend Payments	-268	-275	-377	-109	-134	-414	-494	-584
Cash Flow from Fin.	**-268**	**-279**	**-399**	**-326**	**-336**	**-479**	**-494**	**-584**
Net Cash Flow	**13**	**23**	**14**	**-18**	**56**	**-54**	**8**	**-9**
Opening Cash Balance	**41**	**54**	**77**	**91**	**73**	**130**	**76**	**84**
Add: Net Cash	13	23	14	-18	56	-54	8	-9
Closing Cash Balance	**54**	**77**	**91**	**73**	**130**	**76**	**84**	**76**

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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