Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update | Result Update

Tata Consultancy Services Ltd

In-line quarter; uncertainty persists

IT & ITES	Sharekhan code: TCS
Reco/View: Buy ↔	CMP: Rs. 3,260	Price Target: Rs. 3,650 ↔

↑ 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 11.42

Updated Jul 08, 2023

Low Risk

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

Source: Morningstar

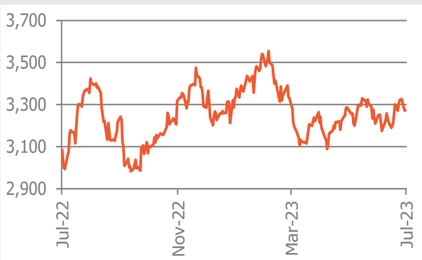
Company details

Market cap:	Rs. 11,92,924 cr
52-week high/low:	Rs. 3575/2,926
NSE volume: (No of shares)	18.5 lakh
BSE code:	532540
NSE code:	TCS
Free float: (No of shares)	101.4 cr

Shareholding (%)

Promoters	72.3
FII	12.7
DII	9.6
Others	5.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.4	0.6	(2.2)	5.7
Relative to Sensex	(3.9)	(7.7)	(11.3)	(15.7)

Sharekhan Research, Bloomberg

Summary

- Revenue growth was flat q-o-q and rose 7% y-o-y in CC terms in line with our estimates led by Lifesciences, Healthcare Manufacturing verticals. EBIT margins dipped to 23.2%, down ~130 bps, missing our estimates by 40 bps largely due to wage hike.
- Company reported robust order book TCV of $10.2 billion with Book -to-bill ratio of 1.4x. Deal TCV was broad based with TCVs from North America at $5.2 billion, BFSI at $3.0 billion and Retail at 1.2 billion.
- The management highlighted that clients are reprioritising and causing softness in revenue, but the company is not witnessing any major cancellations or ramp downs. Projects with low ROI are being paused.
- Despite soft demand environment, we believe TCS is well placed to capture opportunities arising from vendor consolidation, transformational deals, cloud services and new technologies like generative AI. Hence, we maintain Buy rating on TCS with an unchanged PT of Rs. 3,650. At the CMP, the stock trades at 26.6x/24.7x FY24/25E Eps.

TCS reported in-line revenues at $7226 million, up 0.4% q-o-q but flat in constant currency (CC) terms in line with our expectations led by Lifesciences, Healthcare and Manufacturing verticals. The company reported revenue at Rs 59,381 crore, up 0.4% q-o-q/ 12.6% y-o-y. EBIT margin dipped, 130 bps to 23.2% q-o-q largely due to wage hike on expected lines but was tad lower than our estimates of 23.6%. Net profit stood at Rs 11,074 crore, up 16.8% y-o-y. The company continued to report healthy deal win TCVs of $10.2 billion, up ~24% y-o-y. Book-to-bill stood at 1.4x. Net additions continued to remain muted at 523 taking total headcount to 615,318. LTM attrition dipped 230 bps to 17.8% from 20.1% in Q4FY23. Robust order book and transformational deals provides revenue growth visibility for FY24. Clients are reprioritising and causing softness in revenue, but the company is not witnessing any major cancellations or ramp downs. Projects with low ROI are being paused. Persisting macro uncertainty and softness in Technology and Communication verticals are likely to remain an overhang in the near term. Despite the softness in the demand environment and likely challenges due to CEO transition, we believe TCS is well placed to capture opportunities arising from vendor consolidation, transformation deals and cloud services. Hence, we maintain Buy rating on TCS with an unchanged PT of Rs. 3,650. At the CMP, the stock trades at 26.6x/24.7x FY24/25E EPS.

Key positives

- Robust Order book of $10.2 billion vs $10 billion in Q4FY23 with a book-to-bill ratio of 1.4x
- LTM attrition dipped 230 bps to 17.8% from 20.1% in Q4FY23.

Key negatives

- EBIT margin dipped to 23.2%, down ~130 bps, missing estimates by 40 bps.
- Net headcount additions continued to remain muted with 523 additions in Q1FY24 vs 821 in Q4FY23

Management Commentary

- The management highlighted that clients are reprioritising and causing softness in revenue, but they are not witnessing any major cancellations or ramp downs. Projects with low ROI are being paused. However, TCV continues to grow due to new incremental projects.
- The management cited that the deal conversion in Europe is taking longer than expected. They are not witnessing any pricing pressure and they are not seeing clients asking for discounts.

Revision in estimates – We have fine-tuned our estimates for FY24/25E factoring the muted Q1FY24 performance and persistent macro-overhang.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 3,650: Although the demand environment continues to remain soft, the robust order book and transformational deal wins provided decent revenue visibility for the year ahead. We expect 6.1%/7.1% Sales and PAT CAGR over FY23-25E. Despite the softness in the demand environment and likely challenges due to CEO transition, we believe TCS is well placed to capture opportunities arising from vendor consolidation, transformation deals and cloud services. Hence, we maintain Buy rating on TCS with an unchanged PT of Rs. 3,650. At CMP the stock trades at 26.6x/24.7x FY24/25E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and a possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY2022	FY2023	FY2024E	FY2025E
Revenue	1,91,754.0	2,25,458.0	2,36,935.9	2,53,862.8
OPM (%)	27.7	26.3	26.1	26.3
Adjusted PAT	38,327.0	42,147.0	44,809.2	48,324.4
% y-o-y growth	14.8	10.0	6.3	7.8
Adjusted EPS (Rs.)	103.6	115.2	122.4	132.0
P/E (x)	31.5	28.3	26.6	24.7
P/B (x)	13.4	13.1	11.4	11.1
EV/EBITDA	21.7	19.4	18.5	17.2
ROE %	43.3	46.6	45.8	45.7
ROCE %	49.6	54.8	50.5	53.4

Source: Company; Sharekhan estimates

Key highlights of Management Commentary

- **Strong and broad-based TCV deals:** The company continued to report robust deal TCVs at $10.2 billion in Q1FY24,up by 24% y-o-y. TCV was broad based with TCVs from North America at $5.2 billion, BFSI at $3.0 bn and Retail at 1.2 bn. Book to bill stood at 1.4x. Deal conversion in Europe is taking longer than usual. The company is pleased with the pipeline and sees opportunities for vendor consolidation, transformation deals, and cloud services. Smaller and short-term deals are gaining popularity due to recessionary trends.
- **EBIT margin performance:** EBIT margins declined by ~130 bps to 23.2 % largely due to impact of wage hike taken in Q1FY24 and muted revenue growth. EBIT margin impact due to wage hike was partially offset by improved efficiencies.
- **Verticals wise Performance:** On a y-o-y basis, growth was led by Life Sciences and Healthcare, which grew 10.1% and the Manufacturing vertical which grew 9.4%. BFSI grew 3%, Retail and CPG grew 5.3%, Technology & Services grew 4.4% while Communications & Media grew 0.5%.
- **Geography-wise performance:** On a y-o-y basis, the UK led with 16.1% growth; North America grew 4.6% and Continental Europe grew 3.4%. In emerging markets, Middle East & Africa grew 15.2%, India grew 14%, Latin America grew 13.5%, and Asia Pacific grew 4.7%.
- **Headcount & attrition:** Net headcount additions were muted at 523 in Q1FY24 vs 821 in Q4FY23 taking total headcount to 615,318. Attrition continued to ease as LTM attrition rate dipped 230 bps to 17.8% from 20.1% in Q4FY23. The company maintained its target of hiring 40,000 freshers in FY24 but cited that the spread across quarters is uncertain.
- **Healthy client metrics:** The number of clients in $50/20/10/5 million+ increased by 1, 4, 2, and 5 taking the total count to 137, 296, 468 and 677, respectively.
- **Strong cash flow from operations:** Cash flow from operations at Rs. 11,353 crore was up by 9.2% y-o-y. Cash flow from operations was strong at 102.5% of net profit. DSO remained stable at 65.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	Q4FY23	% YoY	% QoQ
Revenues In USD (mn)	**7,226.0**	**6,780.0**	**7,195.0**	**6.6**	**0.4**
Revenues In INR	**59,381.0**	**52,758.0**	**59,162.0**	**12.6**	**0.4**
Direct Costs	34,973.0	31,553.0	34,427.0	10.8	1.6
Gross Profit	**24,408.0**	**21,205.0**	**24,735.0**	**15.1**	**-1.3**
SG&A	9,410.0	7,788.0	8,962.0	20.8	5.0
EBITDA	**14,998.0**	**13,417.0**	**15,773.0**	**11.8**	**-4.9**
Depr & amort.	1,243.0	1,231.0	1,285.0	1.0	-3.3
EBIT	**13,755.0**	**12,186.0**	**14,488.0**	**12.9**	**-5.1**
Other Income	1,234.0	590.0	903.0	109.2	36.7
PBT	**14,989.0**	**12,776.0**	**15,391.0**	**17.3**	**-2.6**
Tax Provision	3,869.0	3,257.0	3,955.0	18.8	-2.2
PAT	**11,120.0**	**9,519.0**	**11,436.0**	**16.8**	**-2.8**
Minority interest/Share of associates	46.0	41.0	44.0	12.2	4.5
Adj. Net Profit	**11,074.0**	**9,478.0**	**11,392.0**	**16.8**	**-2.8**
EPS (Rs)	**30.3**	**25.9**	**31.1**	**16.8**	**-2.8**
Margin (%)					
GPM	41.1	40.2	41.8	91.1	-70.5
EBITDA	25.3	25.4	26.7	-17	-140
EBIT	23.2	23.1	24.5	7	-132
NPM	18.6	18.0	19.3	68	-61
Tax rate	25.8	25.5	25.7	32	12

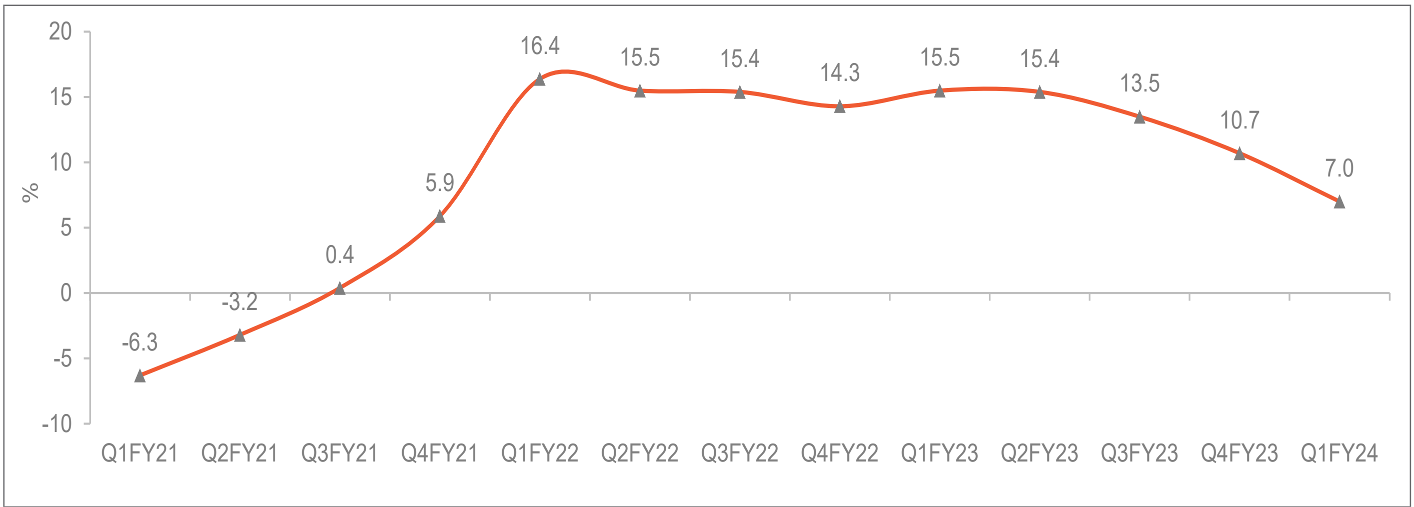
Source: Company; Sharekhan Research

Operating metrics

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%)		CC growth (%)
			Q-o-Q %	Y-o-Y %	Y-o-Y %
Revenues ($ mn)	7,226	100	0.4	6.6	7.0
Geographic mix					
North America	3,758	52.0	-0.3	4.2	4.6
Latin America	145	2.0	11.6	18.4	13.5
UK	1,185	16.4	4.9	17.3	16.1
Continental Europe	1,077	14.9	-0.9	4.5	3.4
India	354	4.9	-1.6	8.8	14.0
APAC	564	7.8	-2.1	0.2	4.7
MEA	145	2.0	0.4	18.4	15.2
Industry verticals					
BFSI	2,240	31.0	-0.8	2.9	3.0
Retail & CPG	1,134	15.7	1.1	5.2	5.3
Communication & media	462	6.4	-1.1	0.3	0.5
Manufacturing	737	10.2	3.5	9.8	9.4
Life Science and healthcare	759	10.5	1.4	10.8	10.1
Technology & services	621	8.6	-0.7	4.2	4.4
Regional markets and others	1,272	17.6	1.0	14.4	16.9

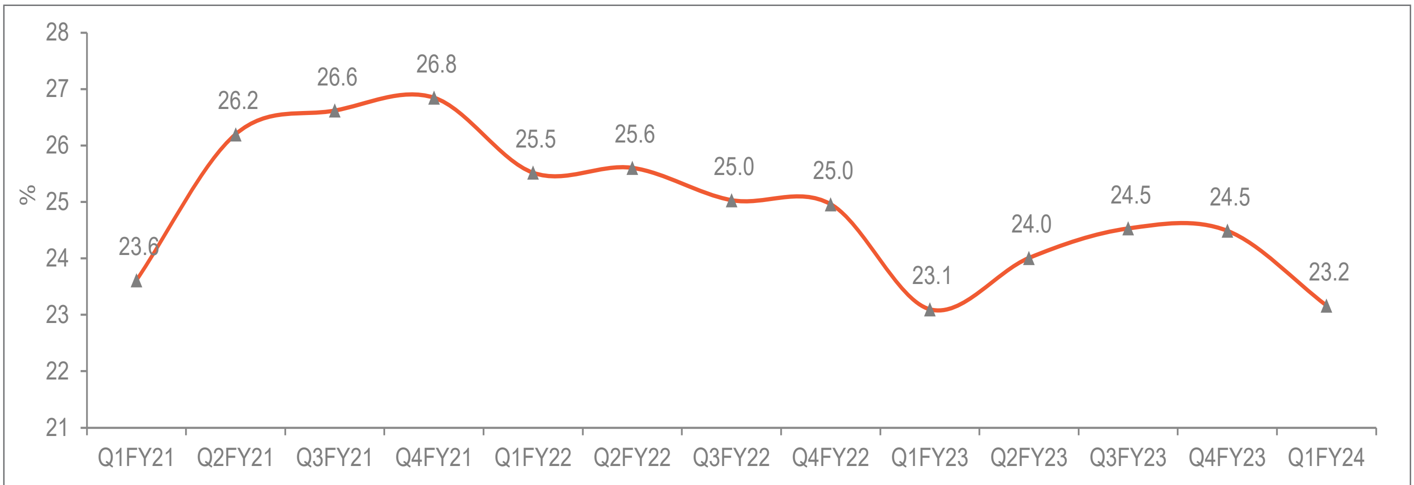
Source: Company; Sharekhan Research

TCS' constant-currency revenue growth (y-o-y) trend



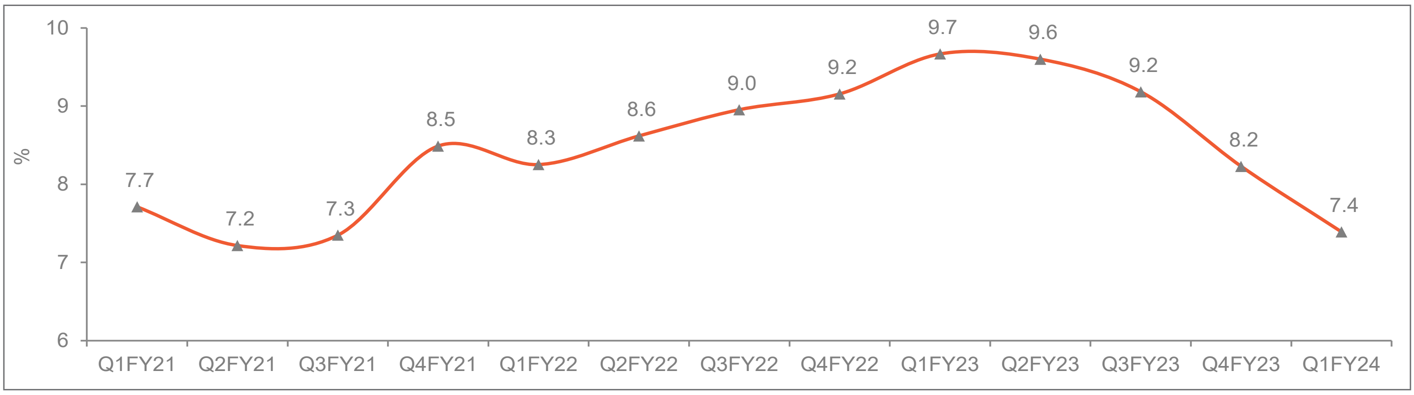
Source: Company; Sharekhan Research

EBIT margin Trend



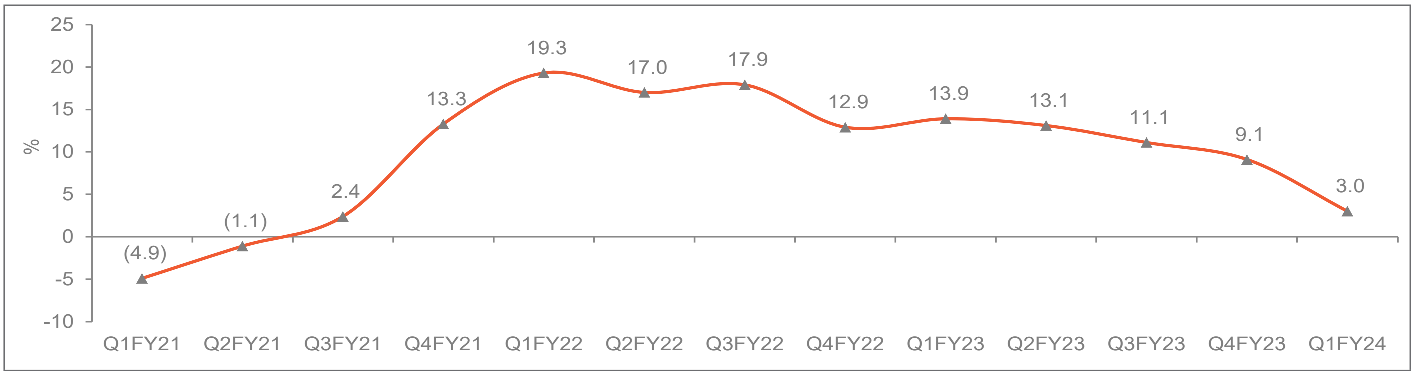
Source: Company; Sharekhan Research

Subcontracting costs as % of revenue



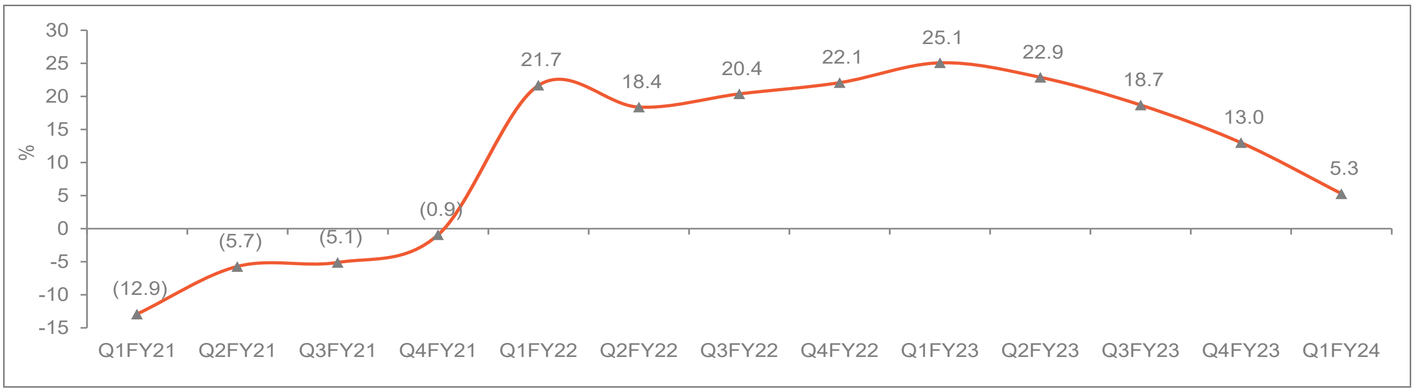
Source: Company; Sharekhan Research

BFSI revenue growth trend



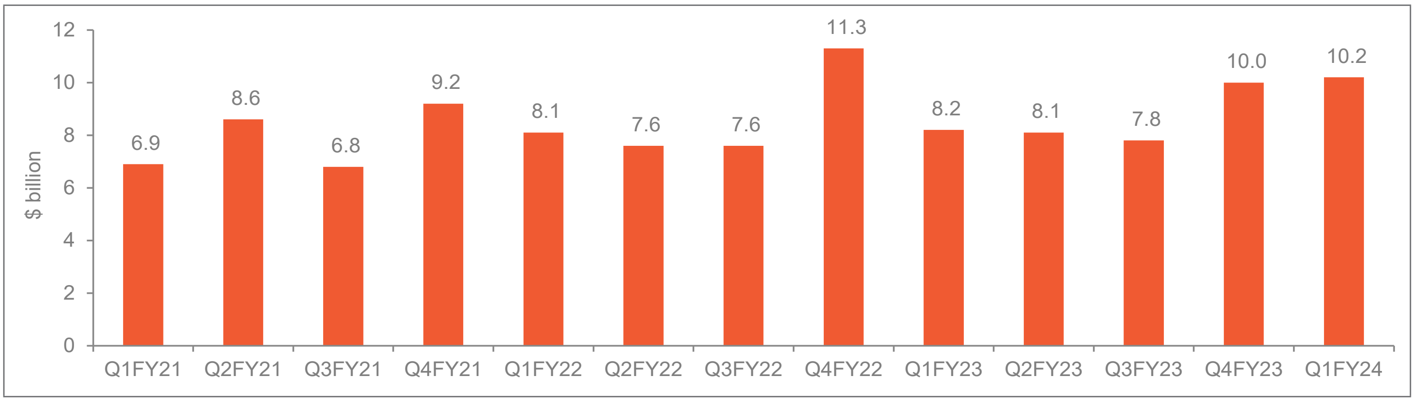
Source: Company; Sharekhan Research

Retail vertical trend



Source: Company; Sharekhan Research

Healthy deal TCVs



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds, the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence concerns relating to macroeconomic headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

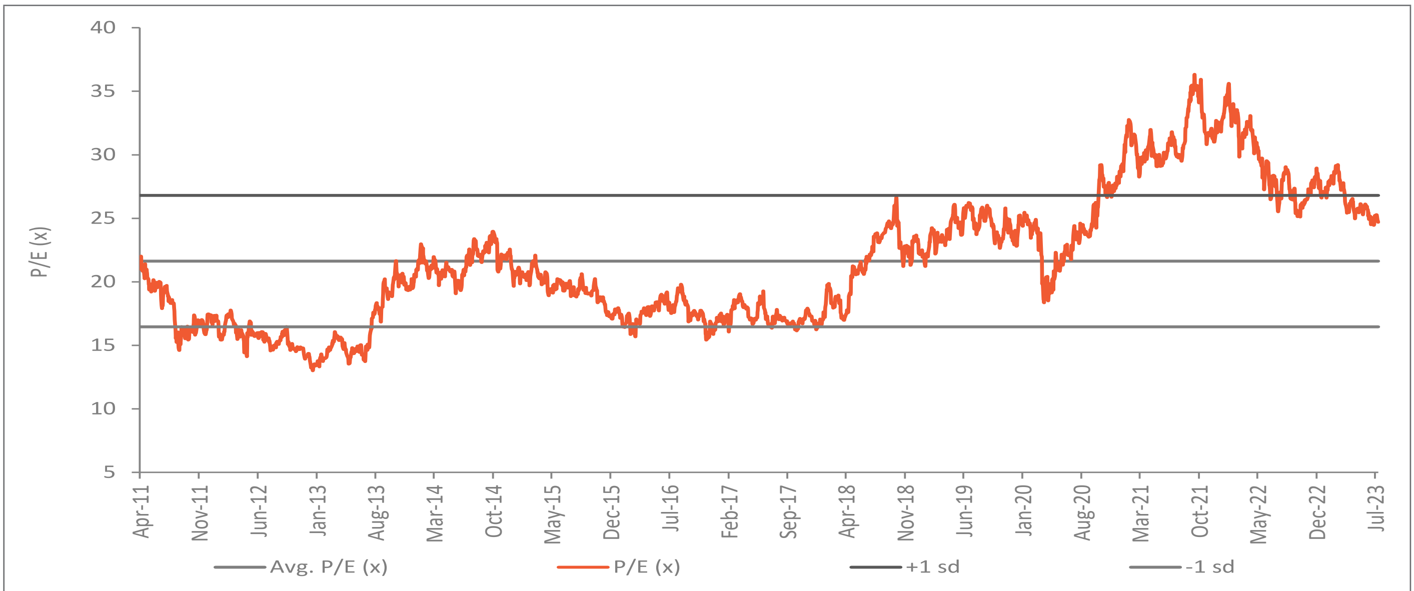
■ Company Outlook – Staying ahead of the race

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 unchanged PT of Rs. 3,650

Although the demand environment continues to remain soft, the robust order book and transformational deal wins provided decent revenue visibility for the year ahead. We expect 6.1%/7.1% Sales and PAT CAGR over FY23-25E. Despite the softness in the demand environment and likely challenges due to CEO transition, we believe TCS is well placed to capture opportunities arising from vendor consolidation, transformation deals and cloud services. Hence, we maintain Buy rating on TCS with an unchanged PT of Rs. 3,650. At the CMP, the stock trades at 26.6x/24.7x FY24/25E eps

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
HCL Tech	1,110	271	3,01,230	19.7	17.6	12.3	10.6	4.4	4.1	22.7	23.9
Infosys	1,333	415	5,53,148	24.0	23.0	16.1	15.4	3.8	3.9	29.3	30.7
TCS	3,260	366	11,92,685	26.6	24.7	18.5	17.2	11.4	11.1	45.8	45.7

Source: Company, Sharekhan estimates

About the 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 an IT services, consulting and business solutions organization that has been partnering with many of the world's largest businesses in their transformation journeys for over 50 years. 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) Contagion effect of banking crisis and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

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

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.5
2	SBI Funds Management Ltd	1.0
3	BlackRock Inc	0.9
4	Vanguard Group Inc	0.9
5	Invesco Ltd	0.9
6	JPMorgan Chase & Co	0.6
7	Axis Asset Management Co Ltd	0.5
8	UTI Asset Management Co Ltd	0.4
9	First State Investments ICVC	0.3
10	Norges Bank	0.3

Source: Bloomberg

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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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