

12 October 2023

India | Equity Research | Q2FY24 result update

Tata Consultancy Services

Technology

No signs of demand recovery despite strong orderbook; downgrade to HOLD

TCS has reported muted growth of 0.1% QoQ in CC terms and a decline of 0.2% QoQ in USD terms in Q2FY24, much weaker than our and street's growth expectations of 1.2% and 1.1% QoQ USD, respectively. It reported sequential revenue decline (after a gap of three years due to covid), despite a strong orderbook of USD 11.2bn (+10% QoQ and 38% YoY), implying a book-to-bill ratio of 1.6x, because of continued rationalisation of spends in older projects and a cut in discretionary spends. EBIT margin at 24.3%, +110bps QoQ, was ahead of our and street's estimates of 23.7% and 23.9%, respectively, led by an improvement in utilisation, better productivity and a reduction in sub-con costs. There is continued uncertainty around the timeline of revival in overall tech spending. The company has announced buyback of INR 170bn, at a share price of INR 4,150, which could provide some technical support until the buyback closure date (yet to be announced) (Refer Exhibit 3).

What to do with the stock

TCS' sequential revenue growth of 0.1% / 2.8% YoY in CC was much weaker than our and street's expectations, despite a strong orderbook (at USD 11.2bn, +10% QoQ and 38% YoY and implying book:bill of 1.6x). Key industry verticals (BFSI, retail, comm/media and technologies - these four together contribute 64% of revenue) and geographies (Americas and Continental EU - these two contribute to 68% of revenues) continue to be soft on the back of a cut in discretionary spending and higher scrutiny of older projects. We believe trends around optimising cloud spend and overall rationalisation of tech budgets post two years of very strong tech spending, are leading to high leakage of base business which is offsetting the ramp-up of large deals. TCS has taken multiple steps around scaling-up Gen-AI practice (training 100K associates, announcing multiple partnerships and incorporating Gen-AI tools in each of its SaaS offerings across industry verticals) but did guide that in the current challenging macro environment, major investments by clients around Gen AI will be funded by cost savings in other areas of tech spending, hence, keeping overall tech budgets under check. This, in our view, also corroborates with muted organic revenue growth guidance of 0-3% by Accenture for the year ending Aug'24 with more relevant pie for TCS - IT outsourcing/ managed services business could grow in mid-high single digits.

Financial Summary

Y/E March (INR mn)	FY23A	FY24E	FY25E	FY26E
Net Revenue	22,54,580	24,23,471	26,31,302	29,41,610
EBITDA	5,92,590	6,34,394	7,00,465	7,99,550
EBITDA Margin (%)	26.3	26.2	26.6	27.2
Net Profit	4,23,030	4,60,182	5,05,764	5,75,237
EPS (Rs)	115.6	125.8	138.2	157.2
EPS % Chg YoY	10.0	8.8	9.9	13.7
P/E (x)	31.2	28.7	26.1	23.0
EV/EBITDA (x)	22.2	20.7	18.8	16.4
RoCE (%)	44.0	45.1	47.1	50.5
RoE (%)	46.0	47.7	49.6	52.9

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Market Data

Market Cap (INR)	13,209bn
Market Cap (USD)	1,58,787mn
Bloomberg Code	TCS IN
Reuters Code	TCS.BO
52-week Range (INR)	3,680 /2,992
Free Float (%)	28.0
ADTV-3M (mn) (USD)	87.7

Price Performance (%)	3m	6m	12m
Absolute	10.6	13.5	21.8
Relative to Sensex	1.6	11.6	17.8

ESG Disclosure	2021	2022	Change
ESG score	58.9	59.0	0.1
Environment	49.8	51.5	1.7
Social	35.7	34.1	(1.6)
Governance	91.1	91.1	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Earnings Revisions (%)	FY24E	FY25E
Revenue USD	(0.9)	(2.8)
EBIT	(1.3)	(4.2)
EPS	(3.0)	(4.9)

Previous Reports

13-07-2023: [Q1FY24 result review](#)

13-04-2023: [Q4FY23 result review](#)

Given the above backdrop of muted overall tech spending outlook in near-medium term, we are cutting our TCS USD revenue growth forecast for FY24-26E by 1-3%. We are now projecting FY24E/25E/26E CC revenue growth of 4.7%/8.9%/11.8%, implying FY24-26E USD revenue/ EBIT/EPS CAGR of 9%/11%/11%, respectively.

TCS' buyback plan of INR 170bn with stock price of INR 4,150 could provide certain technical support until the closure date (yet to be announced) and **help TCS outperform NIFTY IT by 2-4% (our estimate is based on the performance in the previous such buyback periods)** (refer Exhibit 3). Due to cut in our revenue growth assumptions, we cut our FY24-26E EPS estimates by 3-5% and lower our 12-month target price to INR 3,708 (vs prior INR 3,869), implying 3% potential upside. Hence, we **downgrade the stock to HOLD** (from Add) and foresee time correction in TCS's stock price pending broader macro recovery, signs of which remain elusive at least over the next 6-9 months.

Key takeaways from Q2FY24 earnings call

- **Discretionary demand has not yet picked up:** Revenue growth continues to be muted despite strong deal TCV of USD 10bn+ for three consecutive quarters due to rationalisation of discretionary spends in existing projects and completion of certain large transformation projects. The conversion of recent new deal wins to revenue is proceeding as per the plan.
- Revival in overall spending is contingent on improving macro outlook. Clients are waiting for definitive signs of macro recovery.
- Deal TCV continues to be strong, led by large cost optimisation, vendor consolidation and operating model transformation deals. Many large deals won this quarter involved clients who were outsourcing the work for the first time. Clients continue to proceed with cloud migration work as per earlier planned timelines.
- Strong deal TCV of USD 11.2bn included two mega deals – 1) USD 1bn TCV BSNL deal involving rollout of 4G and 5G networks across India and 2) USD 855mn deal with JLR. Deal TCV was strong across – 1) BFSI at USD 3bn, 2) retail at USD 1.44bn and 3) North America at USD 4.5bn. Pipeline continues to be strong despite strong deal conversion to pipeline to TCV in Q2FY24.
- BFSI, retail & CPG, communication and technology verticals continue to report muted revenue growth. Management mentioned even essential retail, which was relatively resilient so far, reported weak growth this quarter.
- EBIT margin came in at 24.3%, considerable improvement of +110bps QoQ despite muted revenue growth led by margin tailwinds of 100bps, benefitting from improvement in utilisation, productivity and reduction in sub-con expenses and 10bps from reduction in discretionary spends.
- Management mentioned there is scope to further improve utilisation, productivity and reduce sub-con costs. Margins are likely to increase in Q3 and Q4, as per the management.
- TCS has trained 100K employees in Gen AI and is working on several Gen AI use cases with clients, but it is yet to contribute materially to revenue. Management is seeing progressive increase in Gen AI use cases from knowledge discovery and customer support chat boxes to more advanced use cases of AI-led molecule discovery, AI-led advisory in wealth management etc. However, due to current challenging macro environment, major investments by clients around Gen AI will be funded by cost savings in other areas of tech spending, believes management.

Exhibit 1: Q2FY24 actuals vs estimates

(INR bn)	Q2FY24	Q1FY24	QoQ	Q2FY23	YoY	Q2FY24E-ISEC	vs our estimates	Cons	vs Cons
CC growth	0.1%	0.0%		4.0%		1.2%	-111 bps		
Sales (\$ m)	7,210	7,226	-0.2%	6,877	4.8%	7,313	-1.4%	7,290	-1.10%
USD/INR	82.8	82.2	0.7%	80.4	2.9%	82.6	0.2%	82.8	
Sales (Rs bn)	597	594	0.5%	553	7.9%	604	-1.2%	604	-1.10%
EBIT	145	138	5.3%	133	9.1%	143	1.2%	144	0.34%
EBIT Margin	24.3%	23.2%	110 bps	24.0%	25 bps	23.7%	56 bps	23.9%	35 bps
Reported PAT	113	111	2.4%	104	8.7%	114	-0.5%	114	-0.59%
EPS	31.0	30.3	2.4%	28.5	8.7%	31.2	-0.5%	31.2	-0.59%

Source: I-Sec research, Company data

Exhibit 2: TCS – change in estimates

	New			Old			New vs Old		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenues (USD mn)	29,299	31,726	35,467	29,574	32,640	36,553	-0.9%	-2.8%	-3.0%
Revenue growth YoY CC	4.7%	8.9%	11.8%	5.4%	10.9%	12.0%	-70bps	-200bps	-20bps
Revenue growth YoY US\$	4.9%	8.3%	11.8%	5.9%	10.4%	12.0%	-100bps	-210bps	-20bps
INR bn									
Revenues	2,423	2,631	2,942	2,445	2,707	3,032	-0.9%	-2.8%	-3.0%
EBIT	582	643	735	590	671	761	-1.3%	-4.2%	-3.4%
EBIT margin	24.0%	24.4%	25.0%	24.1%	24.8%	25.1%	-10bps	-40bps	-10bps
EPS (Rs/share)	125.3	137.8	156.8	129.1	144.9	163.7	-3.0%	-4.9%	-4.2%

Source: I-Sec research, Company data

Exhibit 3: TCS has outperformed NIFTY IT by 2-4% in 3 out of 4 previous buyback periods

Buyback	Buyback announcement date	Buyback record date	Buyback opening date	Buyback closure date	Buyback Size (INR mn)	Buyback size as % of Market cap	Buyback share price (INR)	Buyback share price premium over average price in last three months preceding announcement date
Buyback 2022	07-Jan-22	23-Feb-22	09-Mar-22	23-Mar-22	1,80,000	1.3%	4,500	23-25%
Buyback 2020	04-Oct-20	28-Nov-20	18-Dec-20	01-Jan-21	1,60,000	1.7%	3,000	29%
Buyback 2018	12-Jun-18	18-Aug-18	06-Sep-18	21-Sep-18	1,60,000	2.4%	2,100	31-32%
Buyback 2017	15-Feb-17	08-May-17	18-May-17	31-May-17	1,60,000	3.4%	2,850	25-26%

Buyback	TCS stock price movement				Outperformance of TCS price movement over NIFTY IT			
	From date of announcement to record date	From record date to buyback opening date	From buyback opening date to closing date	From buyback announcement to closure date	From date of announcement to record date	From record date to buyback opening date	From buyback opening date to closing date	From buyback announcement to closure date
Buyback 2022	-8%	2%	2%	-4%	3%	-2%	0%	2%
Buyback 2020	6%	7%	2%	16%	-2%	0%	-3%	-6%
Buyback 2018	13%	3%	1%	18%	4%	-3%	3%	4%
Buyback 2017	-3%	8%	0%	6%	-1%	5%	0%	4%

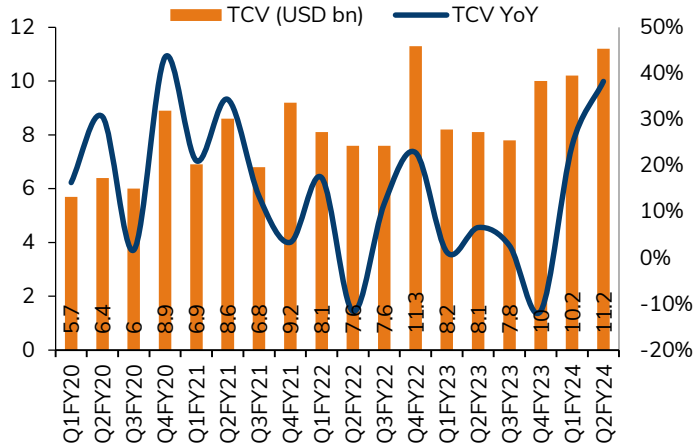
Source: Company data, I-Sec research

Exhibit 4: Decrease in sub-con costs by 56bps QoQ and employee costs (led by utilisation and productivity gains) contributed to 110bps QoQ margin increase despite muted revenue growth

Cost line items as % of revenue	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
COGS										
Employee costs	44.39%	44.00%	43.29%	43.87%	44.89%	43.51%	43.27%	44.29%	45.97%	45.85%
Fees to External Consultants	8.25%	8.62%	8.95%	9.16%	9.67%	9.63%	9.18%	8.23%	7.39%	6.83%
Travel	0.61%	0.65%	0.94%	0.50%	0.81%	0.86%	0.78%	0.77%	0.83%	0.85%
Other costs	6.38%	6.31%	6.82%	6.35%	6.21%	6.50%	6.72%	6.56%	6.29%	6.38%
SG&A costs										
Employee costs	12.09%	12.29%	12.29%	12.18%	12.59%	12.61%	12.49%	12.65%	13.22%	12.99%
Fees to External Consultants	0.34%	0.32%	0.29%	0.33%	0.35%	0.33%	0.23%	0.33%	0.33%	0.36%
Travel	0.15%	0.18%	0.10%	0.17%	0.25%	0.32%	0.47%	0.47%	0.51%	0.30%
Other costs	2.27%	2.02%	2.28%	2.49%	2.14%	2.23%	2.33%	2.21%	2.30%	2.18%

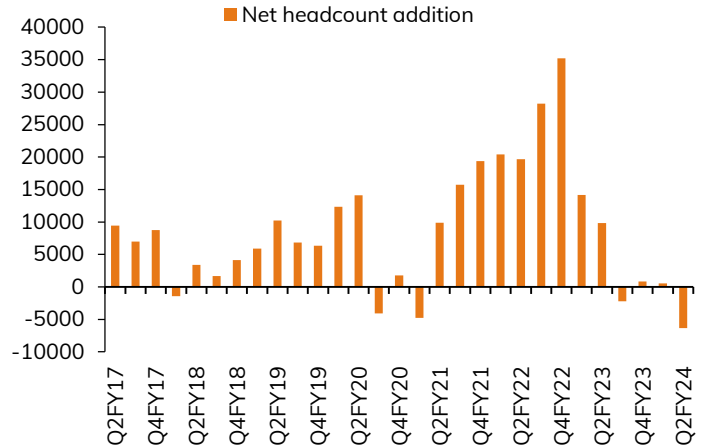
Source: I-Sec research, Company data

Exhibit 5: Strong deal TCV for three consecutive quarters



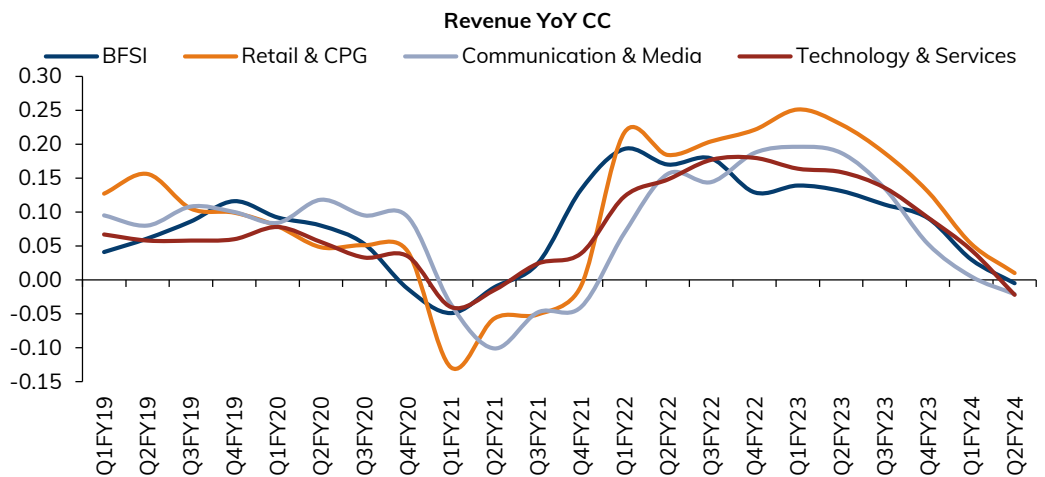
Source: I-Sec research, Company data

Exhibit 6: Sharp decline in headcount due to lower gross hiring and lower backfilling of attrition in order to improve utilization



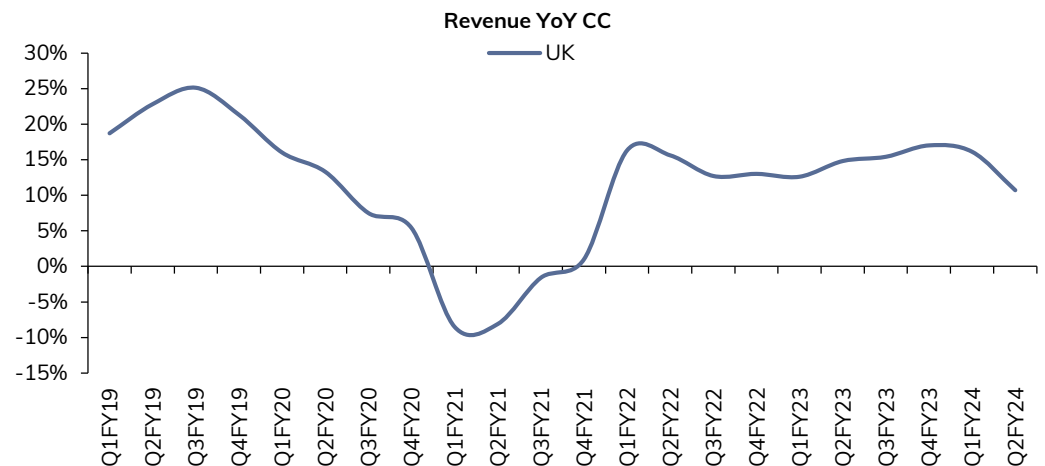
Source: I-Sec research, Company data

Exhibit 7: Revenue growth has been slowing down for verticals impacted by macro slowdown – BFSI, Retail & CPG, Communication and Technology services



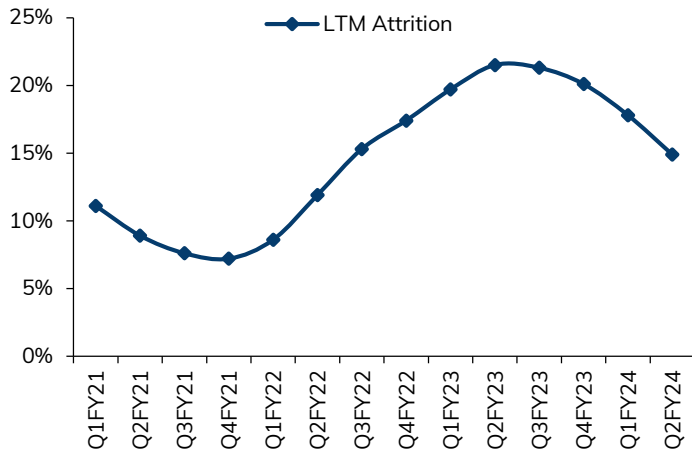
Source: I-Sec research, Company data

Exhibit 8: Revenue growth is more resilient in UK



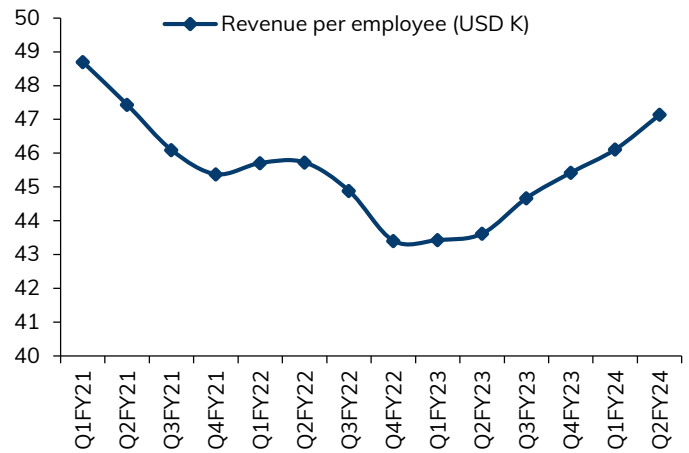
Source: I-Sec research, Company data

Exhibit 9: Attrition inching towards normalized pre-covid levels



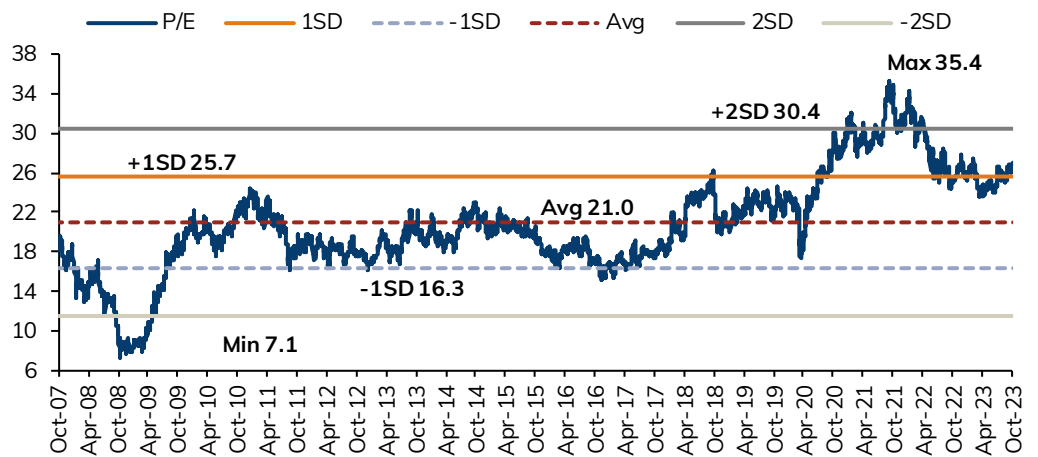
Source: I-Sec research, Company data

Exhibit 10: Revenue per employee consistently improving led by increase in utilization and has scope to improve further



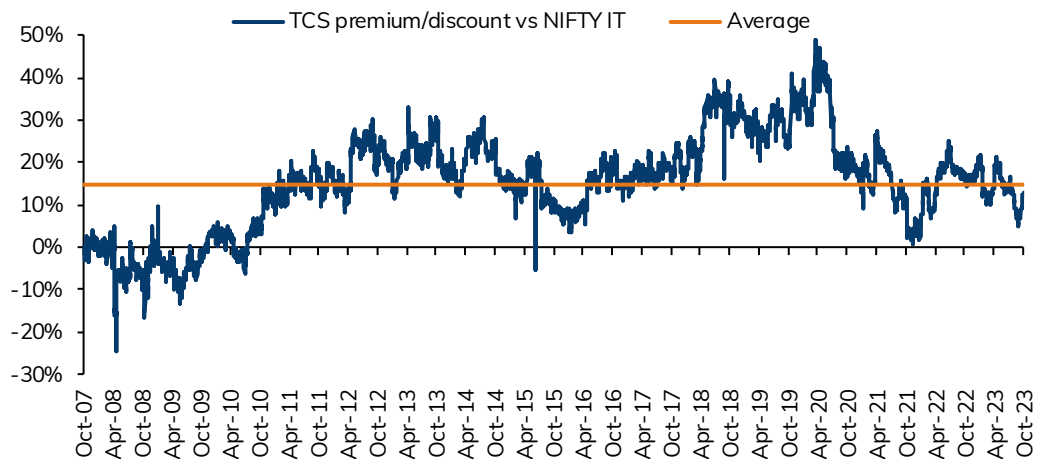
Source: I-Sec research, Company data

Exhibit 11: TCS (1yr forward P/E) is trading at 27x, closer to average+1SD of ~26x



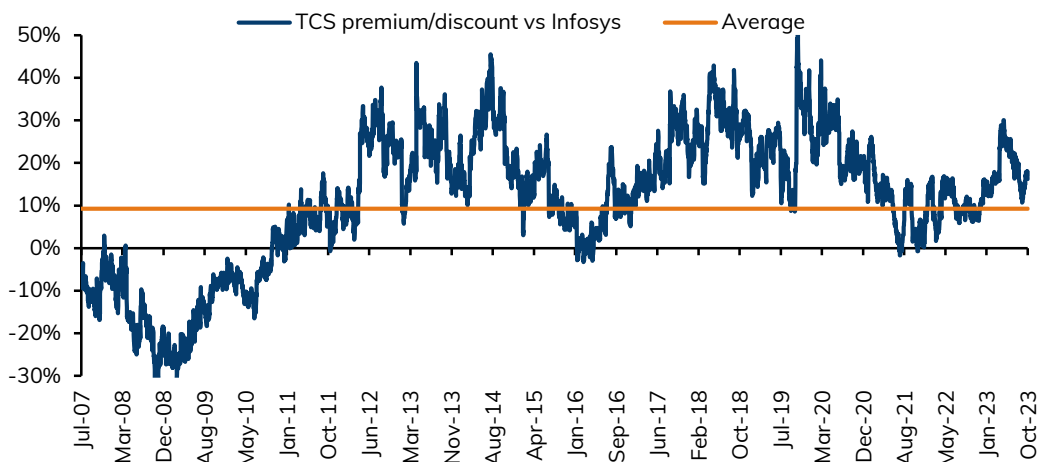
Source: I-Sec research, Company data, Bloomberg

Exhibit 12: TCS is trading at ~12% premium to NIFTY IT vs long term average premium of ~15%



Source: I-Sec research, Company data, Bloomberg

Exhibit 13: TCS is trading at ~16% premium to Infosys vs long term average premium of ~9%



Source: I-Sec research, Company data, Bloomberg

Exhibit 14: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	72.3	72.3	72.3
Institutional investors	22.2	22.4	21.8
MFs and others	3.3	3.5	3.5
FIs/Banks	0.0	0.0	0.1
Insurance	5.4	5.6	5.7
FIIIs	13.5	13.3	12.5
Others	5.5	5.3	5.9

Source: Bloomberg

Exhibit 15: Price chart



Source: Bloomberg

Financial Summary

Exhibit 16: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Net Sales (US\$ mn)	27,927	29,299	31,726	35,467
Net Sales (INR mn)	22,54,580	24,23,471	26,31,302	29,41,610
Operating Expense	17,12,210	18,41,248	19,88,725	22,06,775
EBITDA	5,92,590	6,34,394	7,00,465	7,99,550
EBITDA Margin (%)	26.3	26.2	26.6	27.2
Depreciation & Amortization	50,220	52,170	57,889	64,715
EBIT	5,42,370	5,82,223	6,42,577	7,34,835
Interest expenditure	-	-	-	-
Other Non-operating Income	26,700	36,647	36,301	37,295
Recurring PBT	5,69,070	6,18,870	6,78,878	7,72,130
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	1,46,040	1,58,689	1,73,114	1,96,893
PAT	4,23,030	4,60,182	5,05,764	5,75,237
Less: Minority Interest	(1,560)	(1,600)	(1,520)	(1,520)
Net Income (Reported)	4,23,030	4,60,182	5,05,764	5,75,237
Extraordinaries (Net)	-	-	-	-
Recurring Net Income	4,21,470	4,58,582	5,04,244	5,73,717

Source Company data, I-Sec research

Exhibit 17: Balance sheet

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Total Current Assets	11,02,700	11,83,396	12,55,631	13,60,849
of which cash & cash eqv.	71,230	62,915	70,841	92,539
Total Current Liabilities & Provisions	4,35,580	4,66,067	4,88,007	5,15,903
Net Current Assets	6,67,120	7,17,329	7,67,624	8,44,946
Investments	2,660	2,880	2,880	2,880
Net Fixed Assets	1,15,950	1,12,620	1,16,620	1,20,620
ROU Assets	75,600	76,350	76,350	76,350
Capital Work-in-Progress	-	-	-	-
Goodwill	40,060	39,640	39,640	39,640
Other assets	1,12,050	1,19,470	1,19,470	1,19,470
Deferred Tax assets	-	-	-	-
Total Assets	10,22,110	10,74,799	11,29,094	12,10,416
Liabilities				
Borrowings	-	-	-	-
Deferred Tax Liability provisions	7,920	9,390	9,390	9,390
other Liabilities	18,920	14,320	14,320	14,320
Minority Interest	7,820	8,070	9,590	11,110
Equity Share Capital	3,660	3,660	3,660	3,660
Reserves & Surplus*	9,21,760	9,76,829	10,29,604	11,09,406
Total Net Worth	9,25,420	9,80,489	10,33,264	11,13,066
Total Liabilities	10,22,110	10,74,799	11,29,094	12,10,416

Source Company data, I-Sec research

Exhibit 18: Quarterly trend

(INR mn, year ending March)

	Dec-22	Mar-23	Jun-23	Sep-23
Net Sales	4,88,850	5,05,910	5,27,580	5,53,090
% growth (YOY)	16.4	15.8	16.2	18.0
EBITDA	1,34,330	1,38,450	1,34,160	1,45,160
Margin %	27.5	27.4	25.4	26.2
Other Income	9,540	7,360	5,900	8,170
Extraordinaries	0	0	0	0
Adjusted Net Profit	97,690	99,260	94,780	1,04,310

Source Company data, I-Sec research

Exhibit 19: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
CFO before WC changes	5,92,590	6,32,794	6,98,945	7,98,030
CFO after WC changes	5,49,310	6,18,759	6,47,709	7,30,891
Capital Commitments	(31,000)	(47,010)	(61,889)	(68,715)
Free Cashflow	4,50,650	5,07,081	5,36,484	6,02,713
Other investing cashflow	31,390	(15,483)	36,301	37,295
Cashflow from Investing Activities	390	(62,493)	(25,587)	(31,421)
Issue of Share Capital	-	(2,21,895)	1,520	1,520
Interest Cost	(7,790)	-	-	-
Inc (Dec) in Borrowings	-	(2,630)	8,868	11,516
Cash flow from Financing Activities	(4,78,780)	(4,05,892)	(4,41,082)	(4,80,878)
Dividend paid	(4,13,470)	(1,81,368)	(4,51,469)	(4,93,915)
Others	(15,600)	-	-	-
Chg. in Cash & Bank balance	(53,650)	(8,315)	7,926	21,699
Closing cash & balance	71,230	62,915	70,841	92,539

Source Company data, I-Sec research

Exhibit 20: Key ratios

(Year ending March)

	FY23A	FY24E	FY25E	FY26E
Per Share Data (INR)				
Reported EPS	115.6	125.8	138.2	157.2
Diluted EPS	115.6	125.8	138.2	157.2
Cash EPS	128.9	139.6	153.6	174.5
Dividend per share (DPS)	115.0	47.0	117.0	128.0
Book Value per share (BV)	252.9	268.0	282.4	304.2
Dividend Payout (%)	99.5	37.4	84.6	81.4
Growth (%)				
Net Sales	17.6	7.5	8.6	11.8
EBITDA	11.7	7.1	10.4	14.1
EPS	10.0	8.8	9.9	13.7
Valuation Ratios (x)				
P/E	31.2	28.7	26.1	23.0
P/CEPS	28.0	25.9	23.5	20.7
P/BV	14.3	13.5	12.8	11.9
EV / EBITDA	22.2	20.7	18.8	16.4
P/S	5.9	5.5	5.0	4.5
Dividend Yield (%)	3.2	1.3	3.2	3.5
Operating Ratios				
EBITDA Margins (%)	26.3	26.2	26.6	27.2
EBIT Margins (%)	24.1	24.0	24.4	25.0
Effective Tax Rate (%)	25.7	25.6	25.5	25.5
Net Profit Margins (%)	18.8	19.0	19.2	19.6
Inventory Turnover Days	-	-	-	-
Fixed Asset Turnover (x)	19.1	21.2	23.0	24.8
Receivables Days	61	63	63	62
Payables Days	15	16	16	16
Working Capital Days	92	94	94	90
Net Debt / EBITDA (x)	(1.4)	(1.2)	(1.2)	(1.4)
Profitability Ratios				
RoCE (%)	44.0	45.1	47.1	50.5
RoC (%)	53.0	53.2	55.7	59.6
RoNW (%)	46.0	47.7	49.6	52.9

Source Company data, I-Sec research

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