Sharekhan by BNP PARIBAS

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Stock Update

Company Update

Tata Consultancy Services Ltd

Large deal ramp-ups to fuel growth

IT & ITES	Sharekhan code: TCS
Reco/View: Buy ↔	CMP: Rs. 4,207
	Price Target: Rs. 4,750 ↑

↑ 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		↔	

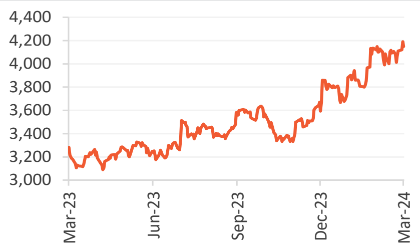
Company details

Market cap:	Rs. 15,22,184 cr
52-week high/low:	Rs. 4241/3070
NSE volume: (No of shares)	20.5 lakh
BSE code:	532540
NSE code:	TCS
Free float: (No of shares)	99.8 cr

Shareholding (%)

Promoters	72.4
FII	12.5
DII	10.0
Others	5.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.6	14.7	18.2	30.8
Relative to Sensex	0.8	11.1	9.9	4.5

Sharekhan Research, Bloomberg

Summary

- We maintain BUY on TCS with revised PT of Rs. 4,750 (the increase in PT reflects rollover of valuation multiple to FY26E EPS), as the company's strong domain expertise, geographical presence, and ability to cross-sell make it well placed to grab opportunities across cost optimisation, digital transformation, and newer technology services. At CMP, the stock trades at 29.1/24.8x its FY25/26E EPS.
- TCS's resilient revenue profile is likely to see an uptick with the ramp-up of large deals from JLR, Nest, BSNL, and Aviva. Deal win TCV over 9MFY24 is robust at USD29.5 billion.
- EBIT margin improvement is expected to steadily continue in FY25 aided by revenue growth, automation, pyramid restructuring, optimisation of subcon costs, and increased utilisation.
- Opportunities arising from the SAP migration cycle, demand improvement in certain industry verticals including BFSI, and gradually receding headwinds should aid growth momentum. Gartner forecasts spending on IT services to grow 8.7% in 2024 from 5.8% growth in 2023.

TCS's resilient revenue growth over the last several quarters is expected to pick up, given the ramp-up of large deal wins over FY25/26 in addition to demand recovery across key verticals, including BFSI, led by mitigating headwinds in CY24 and growing opportunities across newer technology services. The ramp-up of JLR, Nest, BSNL and Aviva deals are likely to fuel revenue growth in the medium to long term. TCS is witnessing a margin uptick aided by moderating attrition and declining subcon costs. Margin improvement is expected to steadily continue in FY25, aided by revenue growth, further moderation in LTM attrition, subcon cost optimization, and improving utilisation. TCS's strong domain expertise, geographical presence, and ability to cross-sell make it well placed to tap into significant opportunities for growth in the tech sector owing to demand recovery along with cost takeouts as well as digital-transformation programs and vendor consolidation in addition to the demand for newer technology services. Hence, we maintain BUY on TCS with revised price target (PT) of Rs. 4,750. At the CMP, the stock trades at 29.1x/24.8x its FY25/26E EPS.

- **Ramp-up of large deal wins to drive growth:** TCS has reported a resilient revenue growth profile during LTM despite macro headwinds compared to its Tier-1 peers. Among its Tier-1 peers (ex-HCL Tech), TCS leads the CQGR in constant currency terms with 0.89% growth. The CQGR of Infosys, Wipro, and Tech Mahindra stood at 0.03%, -1.34%, and -1.07%, respectively. The CQGR of HCL Tech stood at 1.38%, largely aided by seasonally strong Q3FY24. The company is witnessing strong deal momentum across verticals. Despite a seasonally soft Q3 and persisting headwinds, deal win TCV for TCS remained robust at USD8.1 billion, up 4% y-o-y compared to y-o-y degrowth for other Tier-1 peers. Despite the elongated deal cycle due to the macro-overhang, the deal TCV over 9MFY24 is robust at USD29.5 billion. We believe the ramp-ups of deals with JLR, BSNL, Nest, and Aviva should contribute strongly to the company's revenue growth recovery in FY25.
- **Margin mprovement:** The company is steadily improving its margins aided by moderating attrition and a declining trend in sub-con costs. EBIT margin has improved by ~185 bps post Q1FY24. LTM attrition has steadily moderated after peaking to 21.5% in Q2FY23 with the current LTM attrition at 13.3% for Q3FY24 owing to easing supply-side pressure. Subcon cost as a percentage of revenue is also witnessing a declining trend after peaking out in Q1FY2023 at 9.7%. For Q3FY24 subcon costs as a percentage of revenue stood at 6.1%, down ~70 q-o-q/300 y-o-y. We expect margin improvement to steadily continue in FY25 with margin levers being revenue growth, automation, cost efficiencies from pyramid restructuring, optimisation of subcon cost, increased utilisation, and favorable pricing with receding macro headwinds.
- **Opportunities amid gradually receding headwinds:** The company is well placed to leverage significant growth opportunities in the tech sector, given the increasing demand for technological advancements across industries. Management expects a better FY25 compared to the current fiscal, based on early signs of improvement in certain industry verticals, including the key BFSI vertical. As per the latest forecast by Gartner, worldwide IT spending is expected to total USD5 trillion in 2024, an increase of 6.8% from 2023. As per the report, IT services are expected to see increased growth in 2024, becoming the largest segment of IT spending for the first time. Spending on IT services is expected to grow 8.7% in 2024, reaching USD1.5 trillion. Further, SAP's intention to end the mainstream support of its ERP Central Component (ECC) version by 2027 is likely to present growth opportunities for Indian IT services companies. Along with other Tier 1companies, TCS could benefit from the SAP migration cycle owing to a significant portion of its SAP revenue coming from implementation services. As demand for newer technology services such as generative AI, machine learning, IoT, and cloud transformations remain stable, we believe opportunities across new technologies are likely to recover more quickly as macro headwinds recede.

Our Call

Valuation – Maintain BUY with a revised PT of Rs. 4,750: TCS's resilient revenue growth profile and improving margin trajectory are expected to witness an uptick with the ramp-up of large deals and improvement in certain industry verticals, including BFSI along with opportunities across newer technology services. The company's strong domain expertise, geographical presence, and ability to cross-sell make it well-placed to grab opportunities across cost optimisation, digital transformation, and newer technology services. We expect 10.9%/15.4% sales and PAT CAGR over FY24-26E At the CMP, the stock trades at 29.1x/24.8x its FY25/26E EPS.

Key Risks

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

Valuation Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Revenue	2,25,458.0	2,42,002.7	2,66,550.0	2,97,580.8
OPM (%)	26.3	26.7	27.9	28.9
Adjusted PAT	42,147.0	46,609.5	52,833.5	62,075.9
% y-o-y growth	10.0	10.6	13.4	17.5
Adjusted EPS (Rs.)	115.2	127.4	144.4	169.6
P/E (x)	36.5	33.0	29.1	24.8
P/B (x)	16.9	14.6	14.3	13.9
EV/EBITDA	25.3	23.1	20.1	17.9
ROE (%)	46.6	47.5	49.6	56.8
ROCE (%)	54.8	52.6	59.3	67.3

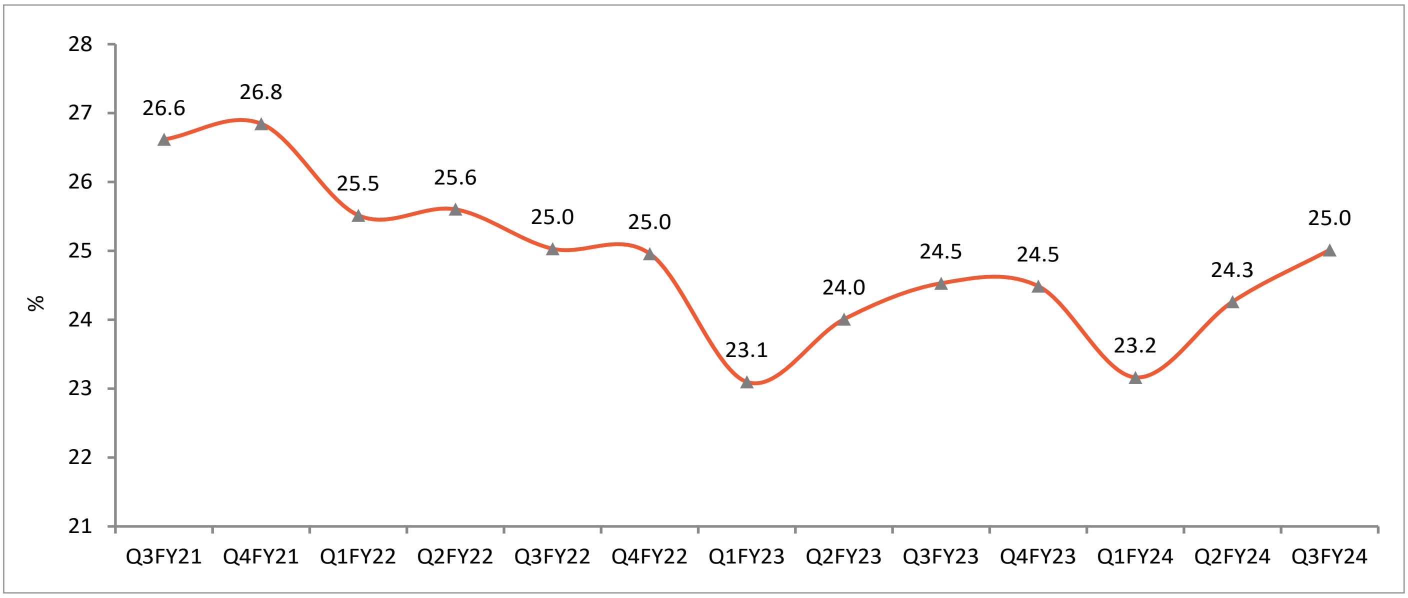
Source: Company; Sharekhan estimates

Resilient constant-currency revenue growth (q-o-q) trend for TCS

Tier 1 IT Company	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	CQGR
TCS	2.2%	0.6%	0.0%	-0.1%	1.0%	0.9%
Infosys	2.4%	-3.2%	1.0%	2.3%	-1.0%	0.0%
HCL Tech	5.0%	-1.2%	-1.3%	1.0%	6.0%	1.4%
Wipro	0.6%	-0.6%	-2.8%	-2.0%	-1.7%	-1.3%
Tech Mahindra	0.2%	0.3%	-4.1%	-2.4%	1.1%	-1.1%

Source: Company; Sharekhan Research

EBIT margin(%) trend



Source: Company, Sharekhan Research

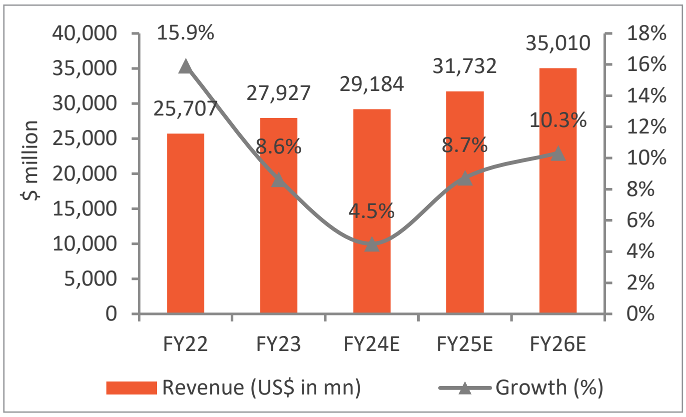
Worldwide IT Spending Forecast (USD million)

Particulars	2023 Spending	2023 Growth (%)	2024 Spending	2024 Growth (%)
Data Centre Systems	2,43,063	7.1	2,61,332	7.5
Devices	6,99,791	-8.7	7,32,287	4.6
Software	9,13,334	12.4	10,29,421	12.7
IT Services	13,81,832	5.8	15,01,365	8.7
Communications Services	14,40,827	1.5	14,73,314	2.3
Overall IT	**46,78,847**	**3.3**	**49,97,718**	**6.8**

Source : Gartner (January 2024)

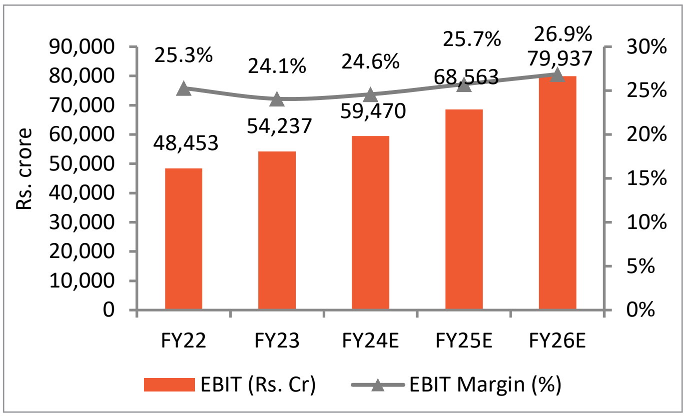
Financials in charts

Revenue (USD mn)



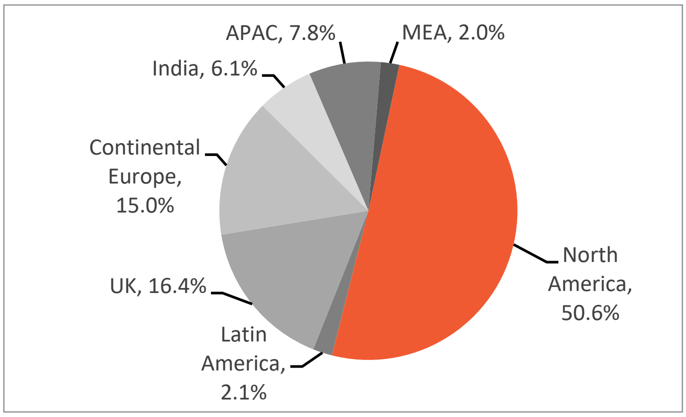
Source: Company, Sharekhan Research

EBIT & EBIT Margin



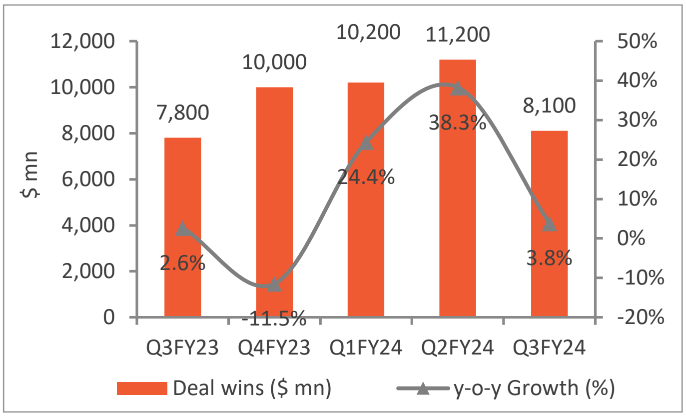
Source: Company, Sharekhan Research

Q3FY24 Geographical break-up (%)



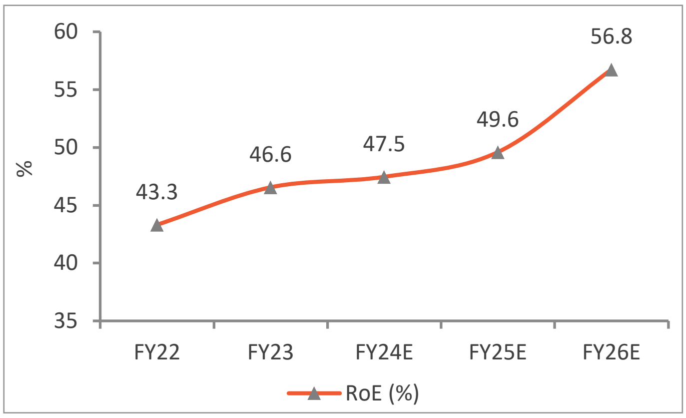
Source: Company, Sharekhan Research

Deal wins (USD mn)



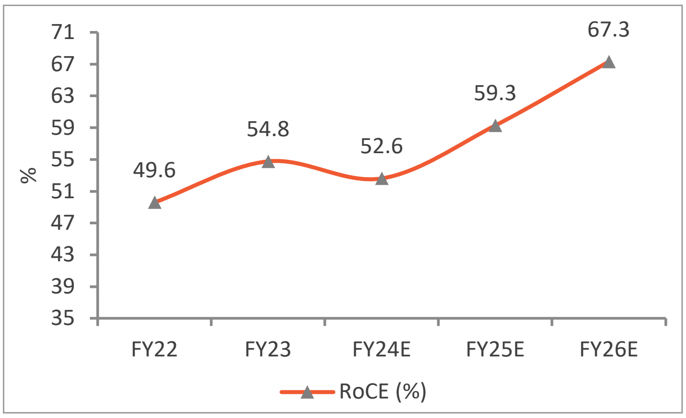
Source: Company, Sharekhan Research

RoE (%)



Source: Company, Sharekhan Research

RoCE (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Macro headwinds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25, aided by a lower base coupled with easing sector headwinds. Although the IT sector has already outperformed Nifty last year, we expect overall outperformance in CY24 as well, driven by receding headwinds and better earnings visibility.

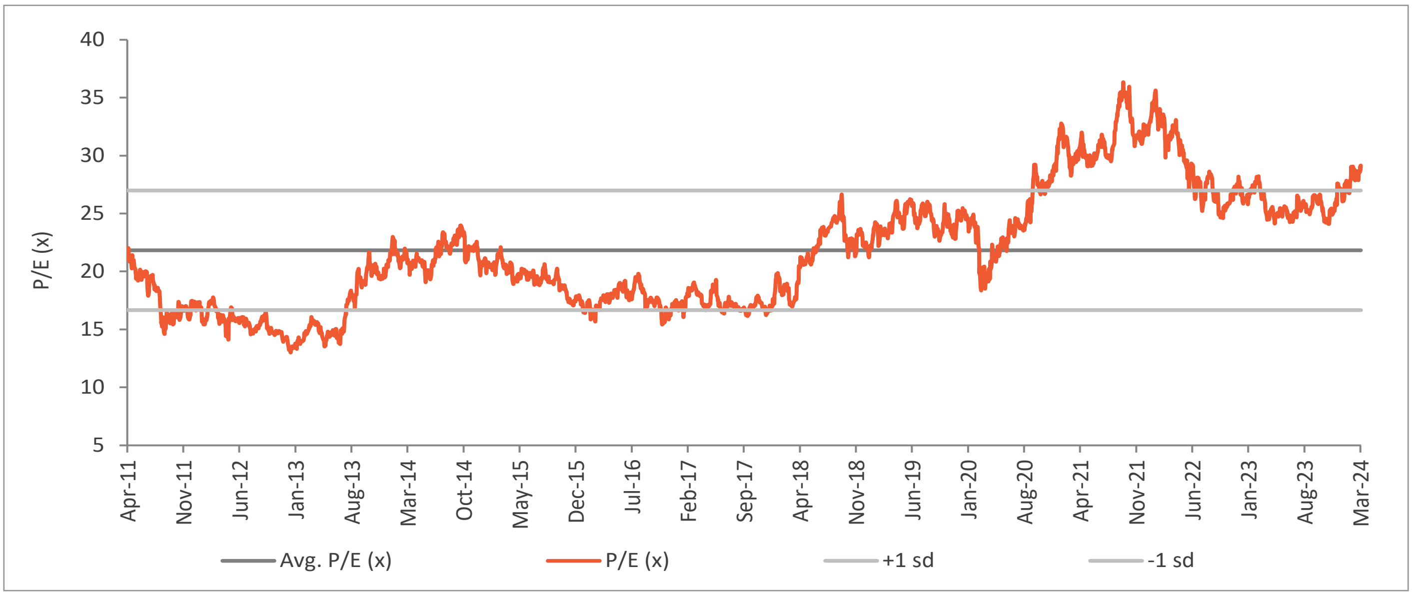
■ Company outlook - Staying ahead of the race

Being one of the largest IT services companies worldwide and having preferred partners as clients, TCS can capture a fair share of spending 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. Management intends to keep the payout ratio at 80-100% of free cash generated.

■ Valuation - Maintain Buy revised PT of Rs. 4,750

TCS's resilient revenue growth profile and improving margin trajectory are expected to witness an uptick with the ramp-up of large deals and improvement in certain industry verticals, including BFSI along with opportunities across newer technology services. The company's strong domain expertise, geographical presence, and ability to cross-sell make it well-placed to grab opportunities across cost optimisation, digital transformation, and newer technology services. We expect 10.9%/15.4% sales and PAT CAGR over FY24-26E At the CMP, the stock trades at 29.1x/24.8x its FY25/26E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

TCS is among the pioneers of IT services outsourcing businesses in India and is the largest (USD27,927 million revenue in FY2023) 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 organisation 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 spending on digital technologies, and best-in-class execution.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) Contagion effect of the banking crisis, and 3) Macro headwinds and recession in the U.S. 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	4.8
2	Vanguard Group Inc	1.1
3	SBI Funds Management Ltd	1.0
4	BlackRock Inc	1.0
5	Invesco Ltd	0.6
6	Axis Asset Management Co Ltd	0.4
7	JPMorgan Chase & Co	0.4
8	UTI Asset Management Co Ltd	0.4
9	ICICI Prudential Asset Management	0.3
10	First Sentier Investors ICVC	0.3

Source: Bloomberg

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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