

Tata Consultancy Services (TCS) HOLD

TCS in a sweet spot to maneuver macros

Summary

TCS reported healthy set of numbers despite a seasonally weak quarter. We expect the impact of macro's will be felt post 2 quarters. However, we expect macro impact to be varying across regions with US & UK better placed than Europe. We believe TCS is well poised to manoeuvre through the macro challenges due to scale, taking advantage of vendor consolidation and cost take out opportunities. Hence, post factoring lower growth in FY24E (7.6% YoY) we now expect revenues to grow at a CAGR of 9% over FY22-FY25E. In addition, we expect margins to improve in coming quarters and expect margins to surpass 26% in FY25E. We have rolled forward our numbers to FY25E. Hence we now revise our target price upwards to Rs 3615 while maintain our multiple of 25x on FY25E eps. We maintain our hold rating on the stock with upside of 9%.

Key Highlights and Investment Rationale

- Cost take out opportunities to drive growth:** TCS is witnessing disparate macro situation across regions and segment. While UK is witnessing healthy demand, US is seeing slowdown in decision making and Europe is witnessing adverse macro. Similarly BFSI, travel and CPG is witnessing health growth. We believe TCS will be key beneficiary of the slowdown due to its ability to win cost take out opportunities, vendor consolidation opportunities and scale benefit. We believe cloud, AI, ML and core transformation will drive company's long term growth.
- Margins have bottomed out:** The company saw an improvement in margins led by rupee depreciation, utilization, decline in supply side challenges and operational efficiencies. We expect long term margins to improve due to higher utilization and lower attrition. Hence, we expect near term margins to be at 26% for FY24E & FY25E from 24% in FY23E.

TP	Rs3,615
CMP	Rs3,320
Potential upside/downside	9%
Previous Rating	HOLD

Price Performance (%)			
	-1m	-3m	-12m
Absolute	(3.5)	8.3	(13.9)
Rel to Sensex	(0.1)	3.9	(15.5)

V/s Consensus			
EPS (Rs)	FY23E	FY24E	FY25E
IDBI Capital	118	137	151
Consensus	116	131	144
% difference	1.9	4.9	4.7

Key Stock Data	
Bloomberg/Reuters	TCS IN/ TCS.BO
Sector	IT Services
Shares o/s (mn)	3,659
Market cap. (Rs mn)	12,146,953
3-m daily avg Trd value (Rs mn)	647.0
52-week high / low	Rs4,046 / 2,926
Sensex / Nifty	60,747 / 18,101

Shareholding Pattern (%)	
Promoters	72.3
FII	13.1
DII	8.5
Public	6.1

Financial snapshot

Year	FY21	FY22	FY23E	FY24E	FY25E
Revenue	1,641,770	1,917,540	2,262,136	2,481,098	2,732,163
Change (yoy, %)	5	17	18	10	10
EBITDA	4,65,460	5,30,570	6,00,433	7,00,914	7,66,538
Change (yoy, %)	11	14	13	17	9
EBITDA Margin(%)	28.4	27.7	26.5	28.3	28.1
Adj.PAT	3,32,140	3,83,270	4,25,536	4,96,002	5,44,826
EPS (Rs)	90	105	118	137	151
Change (yoy, %)	4	17	12	17	10
PE(x)	37	32	28	24	22
Dividend Yield (%)	1	1	3	4	4
EV/EBITDA (x)	26	22	20	17	15
RoE (%)	39	44	51	62	64
RoCE (%)	46	52	62	75	77

Source: IDBI Capital Research

Other Key Concall Highlights

- Q3 being a seasonally weak quarter saw some moderation in sequential revenue growth. Rupee & Dollar revenue grew 5.3%/2.9% qoq respectively (v/s 4.8%/1.4% in previous quarter). Revenue in CC terms expanded by 13.5% YoY (v/s 15.4% in previous quarter). Cloud continues to see healthy traction.
- YoY growth in CC terms was led by North America & UK (+15.4%), followed by LATAM (+14.6%), Europe (+9.7%), APAC (+9.5%), India (+9.1%) & MEA (+8.6%). In terms of verticals, YoY CC growth was led by Retail & CPG (+18.7%) as travel& hospitality saw robust demand, followed by Life Sciences (+14.4%), Tech (+13.6%), Communication (+13.5%), Manufacturing (+12.5%) & BFSI (+11.1%).
- EBIT margin improved by 58 bps QoQ to 24.5%. Favorable impact of Currency fluctuation (+70 bps) and improved utilization (+30 bps) was offset by costs related to returning to normalcy to the tune of 50 bps. Going forward, management expects SG&A costs to increase as normalcy returns & utilization to improve.
- Company stated that the macro challenges have resulted in clients being cautious, delay in decision making and focus on cost optimization. However, TCS is benefitting from vendor consolidation opportunities in verticals like BFSI, Healthcare & Telecom. In terms of geography, Europe is witnessing slowdown in decision making, UK is observing increased interest in long term cost optimization deals and the scenario in USA will become clear in a couple of quarters.
- Order book TCV stood at \$7.8bn (v/s 8 bn is prev. quarter) taking the average TCV of past 4 quarters to \$7.9 bn. Sequential decline in TCV is due to delayed decision making. Order book mix - BFSI at \$2.5 bn, Retail at \$1.2 bn and North America at \$4.2 bn. Book to bill ratio was at 1.1 (v/s 1.2 in prev. quarter).
- Employee headcount at 613,974; QoQ reduction of 2,197 (v/s addition of 9,840 in Q2FY23). Freshers added during the quarter stood at 7,000 (20,000 in Q2FY23). Company stated that reduction in headcount is due to higher intake during the past few quarters & management's focus on improving utilization.
- LTM Attrition stayed at elevated levels of 21.3%, reduction of 20 bps QoQ. However, the quarterly attrition saw a decline to the tune of 6%. Company expects attrition to further moderate going forward.
- Dividend of Rs. 75 per share declared, including special dividend of Rs. 67. 110% of FCF paid to shareholders in FY23. DSO days at 66 days (+4 days QoQ). FCF of Rs. 102.15 bn (Rs. 100.62 bn in Q2FY23).

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q3FY23	Q2FY23	QoQ (%)	Q3FY22	YoY (%)
Revenues (US\$ mn)	7,075	6,877	2.9	6,524	8.4
Revenues	582,290	553,090	5.3	488,850	19.1
COGS	339,420	325,260	4.4	284,010	19.5
Gross profit	242,870	227,830	6.6	204,840	18.6
SG&A	87,330	82,670	5.6	70,510	23.9
EBITDA	155,540	145,160	7.2	134,330	15.8
Depreciation & amortization	12,700	12,690	0.1	11,960	6.2
EBIT	142,840	132,470	7.8	122,370	16.7
Other income	3,600	8,170	(55.9)	9,540	(62.3)
PBT	146,440	140,640	4.1	131,910	11.0
Tax	37,610	36,310	3.6	33,850	11.1
Minority interest	370	340	8.8	370	0.0
Adjusted net profit	108,460	103,990	4.3	97,690	11.0
Diluted EPS (Rs)	29.6	28.5	4.0	26.4	12.3
As % of net revenue					
Gross profit	41.7	41.2		41.9	
SG&A	15.0	14.9		14.4	
EBITDA	26.7	26.2		27.5	
EBIT	24.5	24.0		25.0	
Adjusted net profit	18.6	18.8		20.0	
Tax rate	25.7	25.8		25.7	

Source: Company; IDBI Capital Research

Revenue growth of 13.5%, YoY in CC terms.

EBIT margin improved QoQ to 24.5%

Exhibit 2: Actual vs. estimates

Year to March	Q3FY23	Q3FY23E	Variance (%)
Revenue (US\$ mn)	7,075	6,932	2.1
Revenue (Rs mn)	582,290	569,812	2.2
EBIT (Rs mn)	142,840	138,626	3.0
EBIT margin (%)	24.5%	24.3%	17bps
PAT (Rs mn)	108,460	107,292	1.1
PAT margin (%)	18.6%	18.8%	(55)bps
EPS (Rs)	29.6	29.3	1.1

Source: Company; IDBI Capital Research

Exhibit 3: Earnings Revision

Year-end: March	FY23E			FY24E			FY25F
	New	Old	Chg (%)	New	Old	Chg (%)	Introduced
Revenue (US\$ mn)	28,012	27,792	0.8	30,146	29883	0.9	33,197
Revenue (Rs bn)	2,262,136	2,217,477	2.0	2,481,098	2403372	3.2	2,732,163
EBIT margin (%)	24.3%	24.8%	(50) bps	26.0%	26.0%	8 bps	26.0%
EPS (Rs/sh)	117.6	119.1	(1.3)	137.0	134.0	2.2	150.5

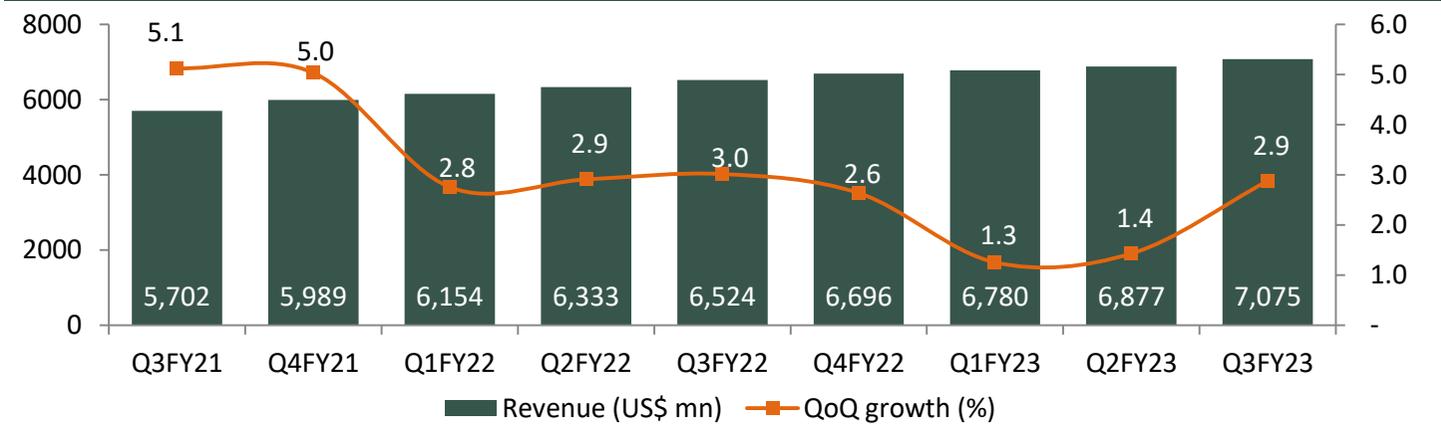
Source: Company; IDBI Capital Research

Exhibit 4: US\$20 mn clients +7 QoQ to 290

No. of large clients	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
USD1m+	1077	1096	1118	1138	1175	1182	1196	1210	1217
USD5m+	565	569	586	609	619	638	650	650	658
USD10m+	386	387	405	417	426	439	446	455	456
USD20m+	229	228	241	247	255	268	272	283	290
USD50m+	97	101	105	114	118	120	124	124	130
USD100m+	48	48	50	54	58	58	59	59	59

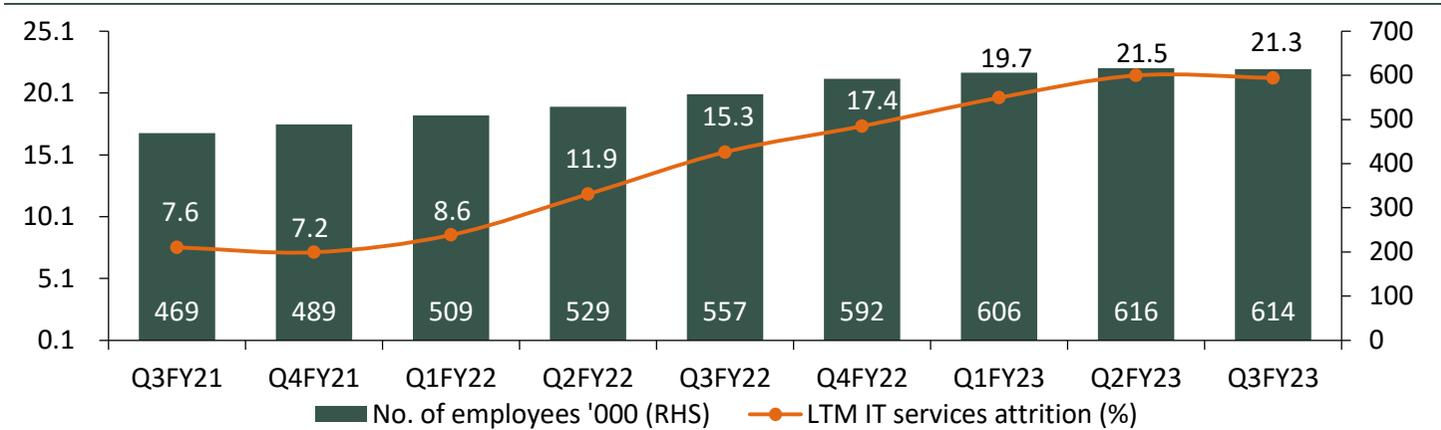
Source: Company; IDBI Capital Research

Exhibit 5: Q3FY23 revenue growth was above our estimates



Source: Company; IDBI Capital Research

Exhibit 6: Employee details and IT services attrition trend



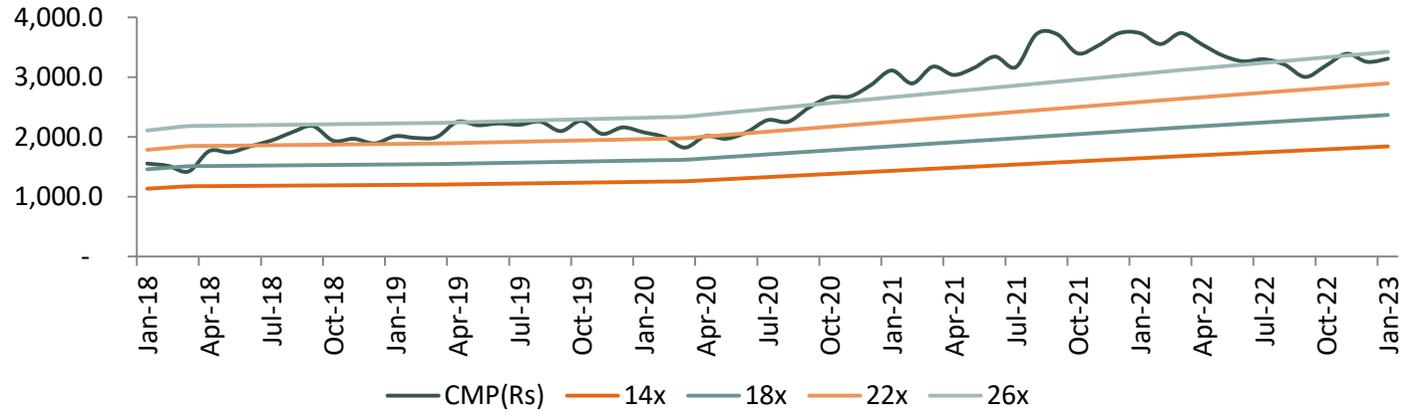
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

	% of revenue (%)	YoY in CC (%)
Total revenue		13.5%
by geography		
North America	53.7%	26.2%
Latin America	1.8%	26.1%
UK	14.9%	13.8%
Continental Europe	14.8%	10.2%
India	5.1%	10.5%
Asia Pacific	7.9%	9.4%
MEA	1.8%	12.8%
by vertical		
BFSI	31.5%	6.4%
Retail & CPG	15.7%	12.8%
Communication & Media	6.6%	10.1%
Manufacturing	9.9%	8.4%
Life Sciences & Healthcare	10.3%	12.8%
Technology & Services	8.9%	10.9%
Regional Markets & Others	17.1%	4.2%

Source: Company; IDBI Capital Research

Exhibit 8: One-year forward PER trend



Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Net sales	1,569,490	1,641,770	1,917,540	2,262,136	2,481,098	2,732,163
<i>Change (yoy, %)</i>	7	5	12	18	10	10
Operating expenses	(1,148,390)	(1,176,310)	(1,386,970)	(1,661,704)	(1,780,184)	(1,965,625)
EBITDA	421,100	465,460	530,570	600,433	700,914	766,538
<i>Change (yoy, %)</i>	7	11	14	13	17	9
<i>Margin (%)</i>	26.8	28.4	27.7	26.5	28.3	28.1
Depreciation	(35,300)	(40,650)	(46,040)	(50,383)	(54,936)	(54,936)
EBIT	385,800	424,810	484,530	550,049	645,978	711,602
Interest paid	(9,240)	(6,380)	(7,840)	(6,670)	(6,400)	(6,400)
Other income	45,920	29,610	40,180	30,877	28,704	28,704
Pre-tax profit	422,480	448,040	516,870	574,256	668,282	733,906
Tax	(98,010)	(114,580)	(132,380)	(147,301)	(171,080)	(187,880)
<i>Effective tax rate (%)</i>	23	26	26	26	26	26
Minority Interest	(1,070)	(1,320)	(1,220)	(1,420)	(1,200)	(1,200)
Net profit	323,400	332,140	383,270	425,536	496,002	544,826
Exceptional items	-	-	-	-	-	-
Adjusted net profit	323,400	332,140	383,270	425,536	496,002	544,826
<i>Change (yoy, %)</i>	3	3	15	11	17	10
EPS	86.2	89.8	104.7	117.6	137.0	150.5
DPS	72	37	43	103	120	134
<i>Dividend Payout (%)</i>	101	41	41	88	88	89

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Shareholders' funds	841,260	864,330	891,390	764,066	825,667	885,414
Share capital	3,752	3,699	3,660	3,620	3,620	3,620
Reserves & surplus	837,508	860,631	887,730	760,446	822,047	881,794
Total Debt	-	-	-	-	-	-
Other liabilities	64,160	49,110	52,720	52,720	52,720	52,720
Curr Liab & prov	269,060	348,090	426,880	503,510	552,247	608,129
Current liabilities	197,350	229,250	288,690	340,486	373,443	411,232
Provisions	71,710	118,840	138,190	163,024	178,804	196,897
Total liabilities	333,220	397,200	479,600	556,230	604,967	660,849
Total equity & liabilities	1,180,710	1,268,280	1,378,060	1,328,786	1,440,324	1,557,153
Net fixed assets	138,400	143,140	148,670	148,287	138,351	128,415
Investments	2,160	2,130	2,230	2,230	2,230	2,230
Other non-curr assets	133,800	126,640	138,950	169,660	186,082	204,912
Current assets	906,350	996,370	1,088,210	1,008,609	1,113,661	1,221,596
Inventories	50	80	200	200	200	200
Sundry Debtors	366,620	369,900	420,100	495,811	543,802	598,830
Cash and Bank	372,790	398,830	498,730	196,519	222,985	240,811
Loans and advances	84,750	115,010	67,560	161,138	176,736	194,620
Total assets	1,180,710	1,268,280	1,378,060	1,328,786	1,440,324	1,557,153

Source: Company; IDBI Capital Research

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Pre-tax profit	422,480	448,040	516,870	574,256	668,282	733,906
Depreciation	14,850	21,420	23,130	50,383	54,936	54,936
Tax paid	(102,360)	(125,730)	(131,920)	(147,301)	(171,080)	(187,880)
Chg in working capital	(4,660)	45,460	75,920	(92,659)	(14,852)	(17,030)
Other operating activities	(47,148)	(199,302)	(197,021)	(95,588)	(32,548)	(482,339)
Cash flow from operations (a)	283,162	189,888	286,979	289,092	504,737	101,594
Capital expenditure	(20,720)	(26,160)	(28,660)	(50,000)	(45,000)	(45,000)
Chg in investments	230	30	(100)	-	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(20,490)	(26,130)	(28,760)	(50,000)	(45,000)	(45,000)
Equity raised/(repaid)	-	(53)	(39)	(40)	-	-
Debt raised/(repaid)	-	-	-	-	-	-
Dividend (incl. tax)	(327,592)	(136,865)	(157,380)	(372,860)	(434,400)	(485,080)
Chg in minorities	630	(800)	(900)	-	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(326,962)	(137,718)	(158,319)	(532,900)	(434,400)	(485,080)
Net chg in cash (a+b+c)	(64,290)	26,040	99,900	(293,808)	25,337	(428,486)

Source: Company; IDBI Capital Research

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Book Value (Rs)	224	234	244	211	228	245
Adj EPS (Rs)	86	90	105	118	137	151
Adj EPS growth (%)	3	4	17	12	17	10
EBITDA margin (%)	27	28	28	27	28	28
Pre-tax margin (%)	27	27	27	25	27	27
Net Debt/Equity (x)	-0.4	-0.5	-0.6	-0.3	-0.3	-0.3
ROCE (%)	43	46	52	62	75	77
ROE (%)	37	39	44	51	62	64

DuPont Analysis

Asset turnover (x)	1.4	1.3	1.4	1.7	1.8	1.8
Leverage factor (x)	1.3	1.4	1.5	1.6	1.7	1.8
Net margin (%)	20.6	20.2	20.0	18.8	20.0	19.9

Working Capital & Liquidity ratio

Inventory days	0	0	0	0	0	0
Receivable days	85	82	80	80	80	80
Payable days	21	24	21	21	21	21

Valuations

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
PER (x)	38.5	37.0	31.7	28.2	24.2	22.1
Price/Book value (x)	14.8	14.2	13.6	15.7	14.6	13.6
EV/Net sales (x)	7.7	7.2	6.1	5.2	4.8	4.3
EV/EBITDA (x)	29	26	22	20	17	15
Dividend Yield (%)	2	1	1	3	4	4

Source: Company; IDBI Capital Research



Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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