

Tata Consultancy Services (TCS) **HOLD**

Macro uncertainty expected to reduce in medium term

Summary

TCS Q3FY24 numbers were above consensus estimates. While the macro is uncertain, TCS continues to win cost optimization, vendor consolidation and growth & transformation deal. The company is also expecting improvement in BFSI. Apart from BFSI, E&U, lifescience & retail are witnessing strong tailwind. In addition we believe that with receding macro headwinds and robust deal wins, the company could see tailwinds in revenue and margins. This coupled with company's focus on technologies like 5G, IoT, generative AI, virtual reality /metaverse, digital twin will drive long term growth. However, considering the recent run up in price we maintain HOLD rating on the stock. We have introduced FY26E estimates and now value the company at 25x FY26E EPS leading to target price of Rs 4,000.

Key Highlights and Investment Rationale

- Cloud, generative AI, Data key drivers of long term growth:** The IT industry is witnessing macro challenges especially in North America leading to project ramp downs, slowdown in discretionary spend and elongation of deal tenure. We believe these are short term demand pangs and longer term tech spend trajectory remains robust led by cloud, AI, data and generative AI. Further, TCS will be a key beneficiary in challenging as well as robust macro considering its client profile, ability to win large deals and robust demand pipeline. The company is also seeing strong traction in generative AI which could be a major driver of multi-year tech spend.
- Margins to improve:** Improvement in utilisation, higher realisation, automation lower sub con cost and decelerating supply side pressure will drive margins. Hence, we expect margins to expand by 160 bps to 25.7% over FY23-FY26E.

TP	Rs4,000
CMP	Rs3,736
Potential upside/downside	7%
Previous Rating	HOLD

Price Performance (%)			
	-1m	-3m	-12m
Absolute	2.6	3.5	12.2
Rel to Sensex	0.0	(4.4)	(7.1)

V/s Consensus			
EPS (Rs)	FY24E	FY25E	FY26E
IDBI Capital	127	144	160
Consensus	127	140	156
% difference	0.3	2.6	2.8

Key Stock Data	
Bloomberg/Reuters	TCS IN/ TCS.BO
Sector	IT Services
Shares o/s (mn)	3,618
Market cap. (Rs mn)	13,517,899
3-m daily avg Trd value (Rs mn)	432.0
52-week high / low	Rs3,929 / 3,070
Sensex / Nifty	71,721 / 21,647

Shareholding Pattern (%)	
Promoters	72.3
FII	12.5
DII	9.5
Public	5.7

Financial snapshot

Year	FY22	FY23	FY24E	FY25E	FY26E
Revenue	19,17,540	22,54,580	24,12,969	26,16,877	28,70,497
Change (yoy, %)	17	18	7	8	10
EBITDA	5,30,570	5,92,600	6,32,068	7,19,939	7,90,990
Change (yoy, %)	14	12	7	14	10
EBITDA Margin(%)	27.7	26.3	26.2	27.5	27.6
Adj.PAT	3,83,270	4,21,470	4,57,966	5,20,529	5,77,720
EPS (Rs)	105	115	127	144	160
Change (yoy, %)	16.6	10.0	9.9	14	11
PE(x)	35.7	32.4	29.5	26	23
Dividend Yield (%)	1.2	3.1	1.1	2	3
EV/EBITDA (x)	24.8	22.2	20.4	17.6	15.8
RoE (%)	43.7	46.9	47.1	45	39
RoCE (%)	51.8	56.5	56	55	48

Source: IDBI Capital Research

Devang Bhatt

devang.bhatt@idbicapital.com
+91-22-2217 1846

Other Key Concall Highlights

- Q2FY24 Dollar revenue came in at \$7,281 mn +1%/+2.9% QoQ/YoY; CC growth of 1.7% YoY. Growth in CC terms was led by United Kingdom led with 8.1% YoY growth; Continental Europe grew 0.5% YoY and North America degrew by 3.0% YoY. In emerging markets, India grew 23.4% YoY, Middle East & Africa grew 16% YoY, Latin America grew 13.2% YoY, Asia Pacific grew 3.9% YoY. Segment wise growth was led by Energy, Resources and Utilities vertical which grew 11.8% YoY, Manufacturing which grew 7% QoQ and Life Sciences and Healthcare which grew 3.1% QoQ, the Consumer Business Group (CBG) degrew 0.3% QoQ.
- The expansion in margin was led by 60 bps by efficiency improvements, 70bps by reduction in contract & subcontracting cost and 25bps by currency gains which was offset by 80 bps led by seasonal furloughs and higher third party expenses.
- Order book TCV stood at \$8.1 bn (book to bill of 1.1x).It grew by 11.3% YoY. The company expects BSNL to ramp up over next 4-6 quarters. Management stated that new large deal wins were led by vendor consolidation and operating model transformation.
- **Demand environment:** 1) BFSI segment would see growth in next few quarters (medium-long term), Insurance is doing well in the segment 2) Pressure on discretionary spends will continue as clients are focusing on projects with higher ROI. 3) Healthy order book pipeline 4) Growth drivers - digital transformation, cloud migration, sustainability and Gen AI across sectors. 5) Hyper personalisation in trend.
- Macro economic challenges, geopolitical uncertainty and higher inflation created lower demand than expected in deals. AI, Cloud, Cyber Security and Cognitive Business Operations led the growth amongst service lines.
- On the margins front, TCS believes it has levers like improvement in utilization, lower sub-contracting cost and optimization of discretionary spends which can aid in margin expansion going forward.
- Total headcount for the quarter stood at 6,03,305 employees net addition of (-5680) with attrition rate at 13.3%. Management indicated on hiring employees organically.

Exhibit 1: Financial snapshot (Rs mn)

Year-end: March	Q3FY24	Q2FY24	QoQ (%)	Q3FY23	YoY (%)
Revenues (US\$ mn)	7,281	7,210	1.0	7,075	2.9
Revenues	6,05,830	5,96,920	1.5	5,82,290	4.0
COGS	3,49,200	3,47,980	0.4	3,39,420	2.9
Gross profit	2,56,630	2,48,940	3.1	2,42,870	5.7
SG&A	1,02,330	91,490	11.8	87,330	17.2
EBITDA	1,54,300	1,57,450	(2.0)	1,55,540	(0.8)
Depreciation & amortization	12,330	12,630	(2.4)	12,700	(2.9)
EBIT	1,41,970	1,44,820	(2.0)	1,42,840	(0.6)
Other income	6,320	8,470	(25.4)	3,600	75.6
PBT	1,48,290	1,53,290	(3.3)	1,46,440	1.3
Tax	37,320	39,500	(5.5)	37,610	(0.8)
Minority interest	390	380	2.6	370	5.4
Net profit	1,10,580	1,13,410	(2.5)	1,08,460	2.0
Diluted EPS (Rs)	1,17,350	1,13,410	3.5	1,08,460	8.2

Revenue growth of 2.9%, YoY.

As % of net revenue

Gross profit	42.4	41.7		41.7
SG&A	16.9	15.3		15.0
EBITDA	25.5	26.4		26.7
EBIT	23.4	24.3		24.5
Net profit	18.3	19.0		18.6
Tax rate	25.2	25.8		25.7

Source: Company; IDBI Capital Research

Exhibit 2: Actual vs. estimates

Year to March	Q3FY24	Q3FY24E	Variance (%)
Revenue (US\$ mn)	7,281	7,181	1.4
Revenue (Rs mn)	6,05,830	5,98,191	1.3
EBIT (Rs mn)	1,41,970	1,42,150	(0.1)
EBIT margin (%)	23.4%	23.8%	(33)bps
PAT (Rs mn)	1,10,580	1,11,912	(1.2)
PAT margin (%)	18.3%	18.7%	(46bps)
EPS (Rs)	30.2	30.9	(2.3)

Source: Company; IDBI Capital Research

Exhibit 3: Earnings Revision

Year-end: March	FY24E			FY25E			FY26E
	New	Old	Chg (%)	New	Old	Chg (%)	(Introduced)
Revenue (US\$ mn)	29,144	29219	(0.3)	31,529	32,009	(1.5)	34,584
Revenue (Rs bn)	24,12,969	24,17,691	(0.2)	26,16,877	26,56,785	(1.5)	28,70,497
EBIT margin (%)	24.11%	24.3%	(19bps)	25.5%	25%	50 bps	25.7%
EPS (Rs/sh)	126.5	127.9	(1.1)	143.8	142.8	0.7	159.6

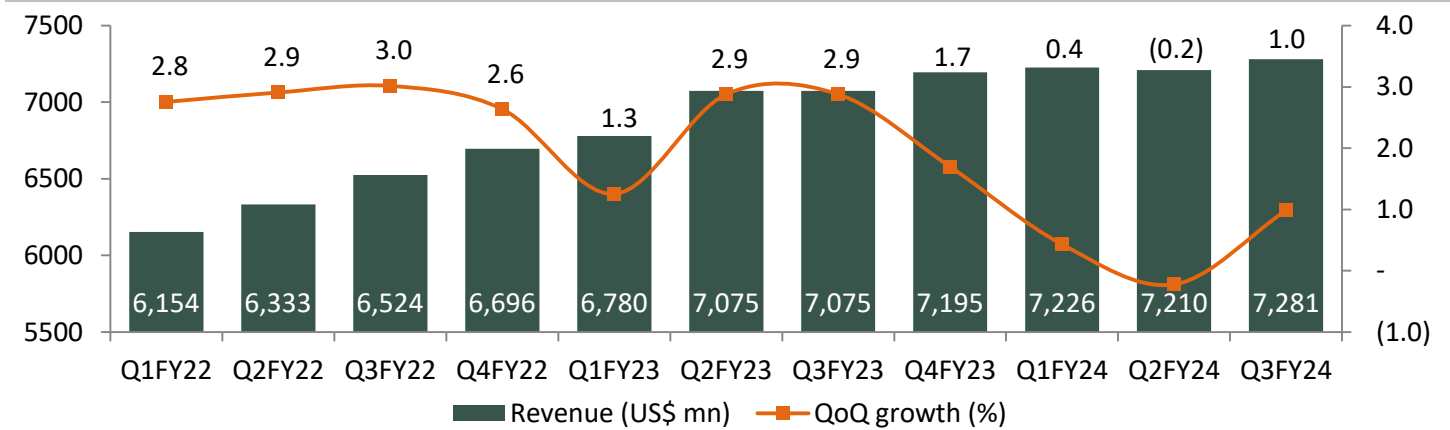
Source: Company; IDBI Capital Research

Exhibit 4: QoQ increase in number of clients across all sizes

No. of large clients	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24
USD1m+	1175	1182	1196	1217	1217	1241	1196	1272	1288
USD5m+	619	638	650	658	658	665	650	688	693
USD10m+	426	439	446	456	456	461	446	483	480
USD20m+	255	268	272	290	290	291	272	292	299
USD50m+	118	120	124	130	130	133	124	137	137
USD100m+	58	58	59	59	59	60	59	61	61

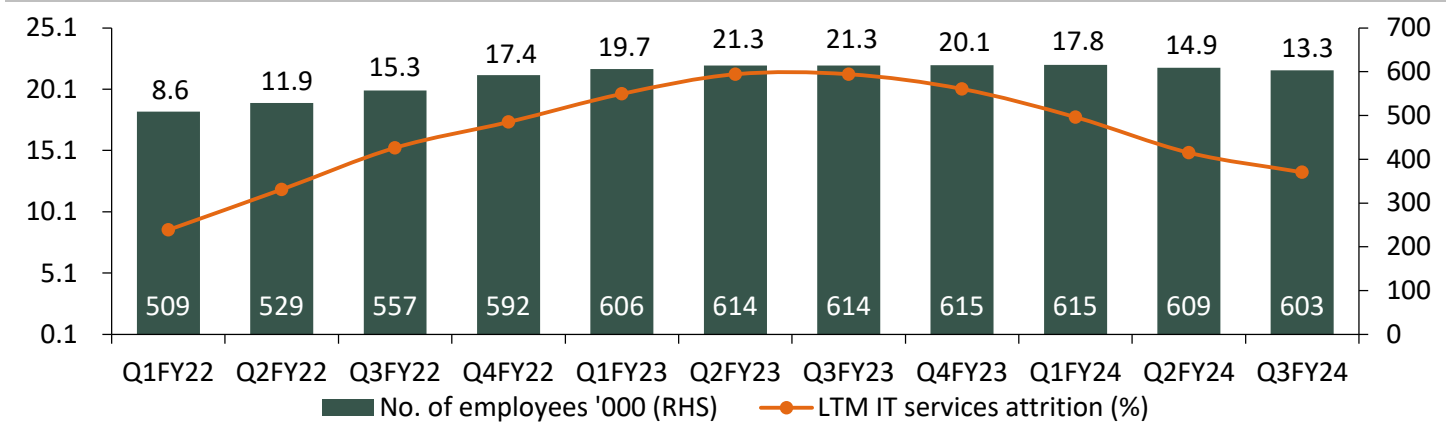
Source: Company; IDBI Capital Research

Exhibit 5: Q3FY24 revenue growth was above consensus estimates



Source: Company; IDBI Capital Research

Exhibit 6: Employee details and IT services attrition trend



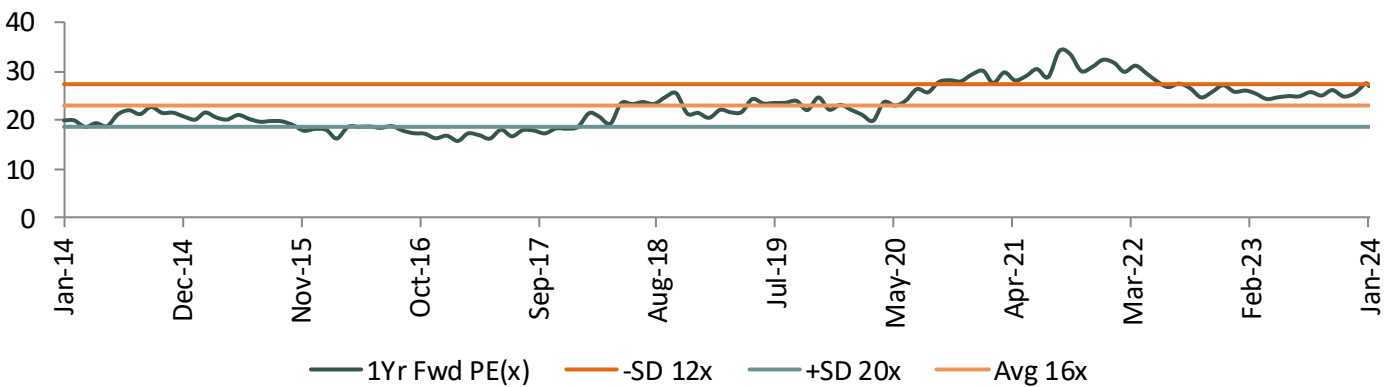
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

	% of revenue (%)	YoY in CC (%)
Total revenue		1.7%
by geography		
North America	50.6%	-3.0%
Latin America	2.1%	13.2%
UK	16.4%	8.1%
Continental Europe	15.0%	0.5%
India	6.1%	23.4%
Asia Pacific	7.8%	3.9%
MEA	2.0%	16.0%
by vertical		
BFSI	31.7%	-3.0%
Retail & CPG	15.7%	-0.3%
Communication & Media	6.7%	-4.9%
Manufacturing	8.6%	7.0%
Life Sciences & Healthcare	10.9%	3.1%
Technology & Services	8.4%	-5.0%
Regional Markets & Others	12.3%	19.2%

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	FY21	FY22	FY23	FY24E	FY25E	FY26E
Net sales	16,41,770	19,17,540	22,54,580	24,12,969	26,16,877	28,70,497
<i>Change (yoy, %)</i>	5	17	18	7	8	10
Operating expenses	(11,76,310)	(13,86,970)	(16,61,980)	(17,80,902)	(18,96,938)	(20,79,507)
EBITDA	4,65,460	5,30,570	5,92,600	6,32,068	7,19,939	7,90,990
<i>Change (yoy, %)</i>	11	14	12	7	14	10
<i>Margin (%)</i>	28.4	27.7	26.3	26.2	27.5	27.6
Depreciation	(40,650)	(46,040)	(50,230)	(50,240)	(51,607)	(54,421)
EBIT	4,24,810	4,84,530	5,42,370	5,81,828	6,68,332	7,36,569
Interest paid	(6,380)	(7,840)	(7,790)	(7,520)	(8,000)	(8,000)
Other income	29,610	40,180	34,490	43,429	41,861	50,596
Pre-tax profit	4,48,040	5,16,870	5,69,070	6,17,737	7,02,193	7,79,166
Tax	(1,14,580)	(1,32,380)	(1,46,040)	(1,58,241)	(1,80,463)	(2,00,246)
<i>Effective tax rate (%)</i>	25.6	25.6	25.7	25.6	25.7	25.7
Minority Interest	(1,320.0)	(1,220.0)	(1,560.0)	(1,530.0)	(1,200.0)	(1,200.0)
Net profit	3,32,140	3,83,270	4,21,470	4,57,966	5,20,529	5,77,720
Exceptional items	-	-	-	-	-	-
Adjusted net profit	3,32,140	3,83,270	4,21,470	4,57,966	5,20,529	5,77,720
<i>Change (yoy, %)</i>	3	15	10	9	14	11
EPS	89.8	104.7	115.2	126.5	143.8	159.6
DPS	37.0	43.0	115.0	42.0	85.0	100.0
<i>Dividend Payout (%)</i>	41.2	41.1	99.9	33	59	63

Balance Sheet

(Rs mn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Shareholders' funds	8,64,330	8,91,390	9,04,240	10,40,576	12,53,487	14,69,303
Share capital	3,699	3,660	3,660	3,619	3,619	3,619
Reserves & surplus	8,60,631	8,87,730	9,00,580	10,36,957	12,49,868	14,65,684
Total Debt	-	-	-	-	-	-
Other liabilities	49,110	52,720	55,260	55,260	55,260	55,260
Curr Liab & prov	3,48,090	4,26,880	4,36,120	4,66,758	5,06,202	5,51,148
Current liabilities	2,29,250	2,88,690	2,93,210	3,13,809	3,40,327	3,69,197
Provisions	1,18,840	1,38,190	1,42,910	1,52,950	1,65,875	1,81,951
Total liabilities	3,97,200	4,79,600	4,91,380	5,22,018	5,61,462	6,06,408
Total equity & liabilities	12,68,280	13,78,060	14,03,440	15,71,944	18,25,498	20,87,462
Net fixed assets	1,43,140	1,48,670	1,41,890	1,16,650	90,043	60,623
Investments	2,130	2,230	2,660	2,660	2,660	2,660
Other non-curr assets	1,26,640	1,38,950	1,50,980	1,61,587	1,75,242	1,92,225
Current assets	9,96,370	10,88,210	11,07,910	12,91,048	15,57,554	18,31,954
Inventories	80	200	280	280	280	280
Sundry Debtors	3,69,900	4,20,100	5,03,020	5,38,358	5,83,852	6,40,438
Cash and Bank	3,98,830	4,98,730	4,92,480	6,32,402	8,43,273	10,48,474
Loans and advances	1,15,010	67,560	14,980	16,032	17,387	19,072
Total assets	12,68,280	13,78,060	14,03,440	15,71,944	18,25,498	20,87,462

Cash Flow Statement

(Rs mn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	4,48,040	5,16,870	5,69,070	6,17,737	7,02,193	7,79,166
Depreciation	21,420	23,130	30,220	50,240	51,607	54,421
Tax paid	(1,25,730)	(1,31,920)	(1,40,010)	(1,58,241)	(1,80,463)	(2,00,246)
Chg in working capital	45,460	75,920	(21,180)	(5,752)	(7,405)	(13,324)
Other operating activities	(1,99,302)	(1,97,021)	1,230	(17,391)	(22,441)	(27,912)
Cash flow from operations (a)	1,89,888	2,86,979	4,39,330	4,86,593	5,43,490	5,92,105
Capital expenditure	(26,160)	(28,660)	(23,440)	(25,000)	(25,000)	(25,000)
Chg in investments	30	(100)	(430)	-	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(26,130)	(28,760)	(23,870)	(25,000)	(25,000)	(25,000)
Equity raised/(repaid)	(53)	(39)	-	(1,69,672)	-	-
Debt raised/(repaid)	-	-	-	-	-	-
Dividend (incl. tax)	(1,36,865)	(1,57,380)	(4,20,900)	(1,52,000)	(3,07,618)	(3,61,904)
Chg in minorities	(800)	(900)	(810)	-	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(1,37,718)	(1,58,319)	(4,21,710)	(3,21,671)	(3,07,618)	(3,61,904)
Net chg in cash (a+b+c)	26,040	99,900	(6,250)	1,39,922	2,10,871	2,05,201

Financial Ratios

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Book Value (Rs)	233.7	244	247	288	346	406
Adj EPS (Rs)	89.8	104.7	115.2	126.5	143.8	159.6
Adj EPS growth (%)	4.2	17	10	10	14	11
EBITDA margin (%)	28.4	27.7	26.3	26.2	27.5	27.6
Pre-tax margin (%)	27.3	27.0	25.2	25.6	26.8	27.1
Net Debt/Equity (x)	-0.5	-0.6	-0.5	-0.6	-0.7	-0.7
ROCE (%)	46.4	52	57	56	55	48
ROE (%)	38.9	44	47	47	45	39

DuPont Analysis

Asset turnover (x)	1.3	1.4	1.6	1.6	1.5	1.4
Leverage factor (x)	1.4	1.5	1.5	1.5	1.5	1.4
Net margin (%)	20.2	20.0	18.7	19.0	19.9	20.1

Working Capital & Liquidity ratio

Inventory days	0	0	0	0	0	0
Receivable days	82	80	81	81	81	81
Payable days	24	21	23	23	23	23

Valuations

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
PER (x)	42	36	32	30	26	23
Price/Book value (x)	16.0	15.3	15.1	13.0	10.8	9.2
EV/Net sales (x)	8.2	6.9	5.8	5.3	4.8	4.3
EV/EBITDA (x)	29	25	22	20	18	16
Dividend Yield (%)	1.0	1.2	3.1	1.1	2.3	2.7

Source: Company; IDBI Capital Research



Notes

Dealing

(91-22) 6836 1111

dealing@idbicapital.com

Key to Ratings Stocks:**BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

6th Floor, IDBI Tower, WTC Complex, Cuffe Parade, Colaba, Mumbai – 400 005. Phones: (91-22) 2217 1700; Fax: (91-22) 2215 1787; Email: info@idbicapital.com

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