

Tata Consultancy Services (TCS)

HOLD

While deal wins were robust, we are cautious on Europe

Summary

TCS reported decent revenue growth in Q4FY22 and was broadly in line with our estimates (up 2.6% QoQ/11.8% YoY). We believe the demand continues to be robust led by cloud migration and ancillary technologies. In addition, the company is seeing healthy deal wins (US\$11.3 bn with 2 US\$1 bn deal wins) and higher deal TCV (US\$ 6.5 bn average to US\$8 bn). However, geopolitical tensions in Europe prompt us to revise our revenue estimates downwards. We now expect revenue CAGR of 10.8% over FY22-FY24. Further, in terms of margins we expect supply side challenges, wage hikes, higher travel and facility cost to impact near term margins (FY23E). Hence, we maintain our HOLD rating on the stock with a revised target price of Rs 4035 (based on PER of 30x on FY24E EPS).

Key Highlights and Investment Rationale

- Tech spend to be driven by cloud:** TCS has witnessed healthy revenue growth in Q4FY22 led by broad based growth in geographies and verticals. In addition, client mining remains healthy. Geographically North America (+5.3%) and UK (+3.5%) drove QoQ revenues while vertically Retail (+4.7%), Manufacturing (+3.7%) and Healthcare (+3.7%) drove growth. Going forward, Cloud, Cyber Security, Enterprise Application Services and IoT & Digital Engineering are expected to drive growth. However, geopolitical challenges in Europe will impact client budgets and revenues in the near term.
- Margins to be under pressure in near terms:** Wage hikes, higher travel & discretionary cost and shift to onsite will impact the company's margins in the near term partially offset by tapering of attrition & utilization. Hence, while the company aspires to achieve 26-28% margins in longer run. We expect near term margins to be below aspiration levels (i.e 25% for FY23E & 25.6% for FY24E).

TP	Rs4,035
CMP	Rs3,696
Potential upside/downside	9%
Previous Rating	HOLD

Price Performance (%)			
	-1m	-3m	-12m
Absolute	2.7	(5.6)	11.3
Rel to Sensex	(3.5)	(2.9)	(7.6)

V/s Consensus			
EPS (Rs)	FY22E	FY23E	FY24E
IDBI Capital	103.6	118.9	132.6
Consensus	104.5	119.6	134.7
% difference	(0.9)	(0.6)	(1.6)

Key Stock Data	
Bloomberg/Reuters	TCS IN/ TCS.BO
Sector	IT Services
Shares o/s (mn)	3,659
Market cap. (Rs mn)	13,525,317
3-m daily avg Trd value (Rs mn)	627.8
52-week high / low	Rs4,046 / 3,005
Sensex / Nifty	58,965 / 17,675

Shareholding Pattern (%)	
Promoters	72.2
FII	15.0
DII	7.8
Public	5.0

Financial snapshot

(Rs mn)

Year	FY20	FY21	FY22	FY23E	FY24E
Revenue	15,69,490	16,41,770	19,17,540	21,47,344	23,98,839
Change (yoy, %)	7	5	17	12	12
EBITDA	4,21,100	4,65,460	5,30,570	5,88,846	6,74,580
Change (yoy, %)	7	11	14	11	15
EBITDA Margin(%)	26.8	28.4	27.7	27.4	28.1
Adj.PAT	3,23,400	3,32,140	3,83,270	4,35,131	4,85,365
EPS (Rs)	86.2	89.8	103.6	118.9	132.6
Change (yoy, %)	3	4	15	15	12
PE(x)	43	41	36	31	28
Dividend Yield (%)	2	1	1	3	4
EV/EBITDA (x)	32	29	25	22	20
RoE (%)	37	39	40	43	52
RoCE (%)	43	46	47	49	60

Source: IDBI Capital Research

Other Key Concall Highlights

- The new operating structure will focus on investing in the right talent and improving the customer relationship as the Company would aim to become a strategic vendor.
- Operating margins were flat QoQ at 25% as supply side challenges had a 90 bps impact which was partially offset to the tune of 10 bps by cross currency impact.
- Management expects the margins to remain volatile in the near term until supply side constraints cool.
- Utilization levels have declined QoQ due to increased hiring of fresh talent. However, in the coming quarters expects productivity to improve and thus have a positive impact on utilization.
- Attrition inched upwards to 17.4% during the quarter, but remained flat on a sequential basis.
- With increased hiring of freshers, the supply side issues are expected to begin tapering down by the mid FY23 as the company plans to hire 40,000 freshers in FY23.
- Employee headcount stood at 592,195 as the Company added 35,209 employees.
- Travel expenses are expected to increase in the near future on the back of normalization of activities.
- Company stated that the demand momentum is expected to be better as increased off shoring and cloud adoption continue to drive growth across all the verticals.
- Management informed that the demand in the European region has not been impacted. However, would cautiously invest in Europe due to the ongoing geo political and macro-economic challenges.
- While the renewed deals did see an uptick in pricing and introduction of COLA clauses, new deals pricing was mainly governed by the competition intensity, nature and size.
- During the quarter, Company signed two large deals worth around \$1 Bn each. These deals are expected to span over 7-10 years.
- Company proposed final dividend of Rs 22 per share.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q4FY22	Q3FY22	QoQ (%)	Q4FY21	YoY (%)
Revenues (US\$ mn)	6,696	6,524	2.6	5,989	11.8
Revenues	5,05,910	4,88,850	3.5	4,37,050	15.8
COGS	2,93,640	2,84,010	3.4	2,48,600	18.1
Gross profit	2,12,270	2,04,840	3.6	1,88,450	12.6
SG&A	73,820	70,510	4.7	60,440	22.1
EBITDA	1,38,450	1,34,330	3.1	1,28,010	8.2
Depreciation & amortization	12,170	11,960	1.8	10,670	14.1
EBIT	1,26,280	1,22,370	3.2	1,17,340	7.6
Other income	7,360	9,540	(22.9)	7,930	(7.2)
PBT	1,33,640	1,31,910	1.3	1,25,270	6.7
Tax	34,050	33,850	0.6	32,450	4.9
Minority interest	330	370	(10.8)	360	(8.3)
Adjusted net profit	99,260	97,690	1.6	92,460	7.4
Diluted EPS (Rs)	27.0	26.4	2.5	25.0	8.3
As % of net revenue					
Gross profit	42.0	41.9		43.1	
SG&A	14.6	14.4		13.8	
EBITDA	27.4	27.5		29.3	
EBIT	25.0	25.0		26.8	
Adjusted net profit	19.6	20.0		21.2	
Tax rate	25.5	25.7		25.9	

Source: Company; IDBI Capital Research

Revenue growth of 14.3%, YoY in CC terms.

EBIT margin was flat QoQ at 25%.

Exhibit 2: Actual vs. estimates

Year to March	Q4FY22	Q4FY22E	Variance (%)
Revenue (US\$ mn)	6,696	6,720	(0.4)
Revenue (Rs mn)	5,05,910	5,03,979	0.4
EBIT (Rs mn)	1,26,280	1,26,449	(0.1)
EBIT margin (%)	25.0%	25.1%	(97)bps
PAT (Rs mn)	99,260	1,01,570	(2.3)
PAT margin (%)	19.6%	20.2%	(104)bps
EPS (Rs)	27.0	27.4	(1.4)

Source: Company; IDBI Capital Research

Exhibit 3: Earnings Revision

Year-end: March	FY23F			FY24E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	28,631	29,227	(2.0)	31,564	33,221	(5.0)
Revenue (Rs bn)	21,47,344	22,11,806	(2.9)	23,98,839	24,91,557	(3.7)
EBIT margin (%)	25.0%	25.3%	(32)bps	25.6%	25.90%	(28)bps
EPS (Rs/sh)	118.9	123.8	(3.9)	132.6	138.7	(4.4)

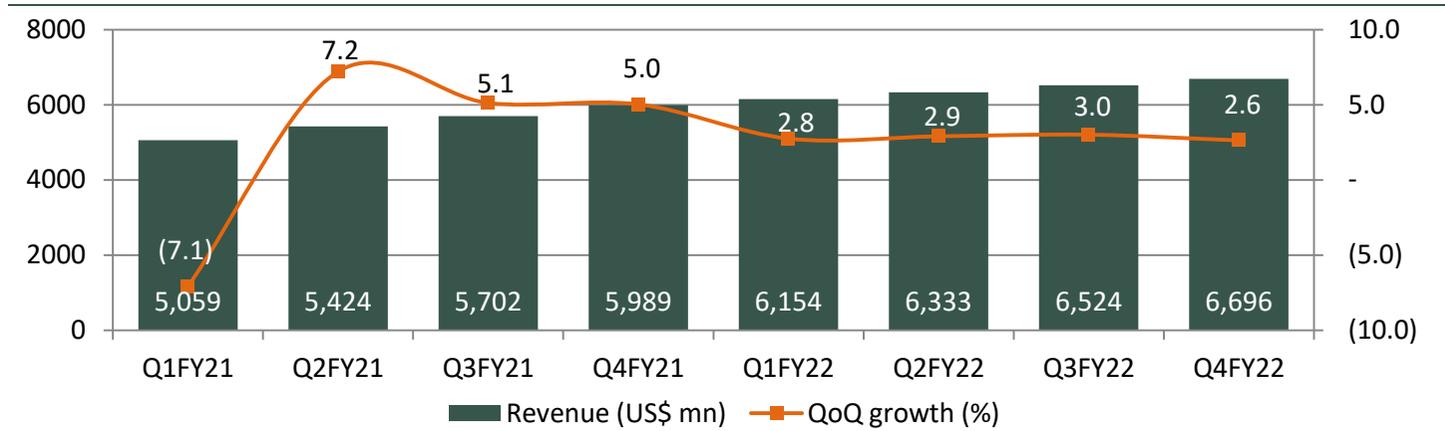
Source: Company; IDBI Capital Research

Exhibit 4: US\$20 mn clients +13 QoQ to 268

No. of large clients	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
USD1m+	1,066	1,076	1,077	1,096	1,118	1,138	1,175	1,182
USD5m+	564	565	565	569	586	609	619	638
USD10m+	382	386	386	387	405	417	426	439
USD20m+	230	228	229	228	241	247	255	268
USD50m+	100	97	97	101	105	114	118	120
USD100m+	48	49	48	48	50	54	58	58

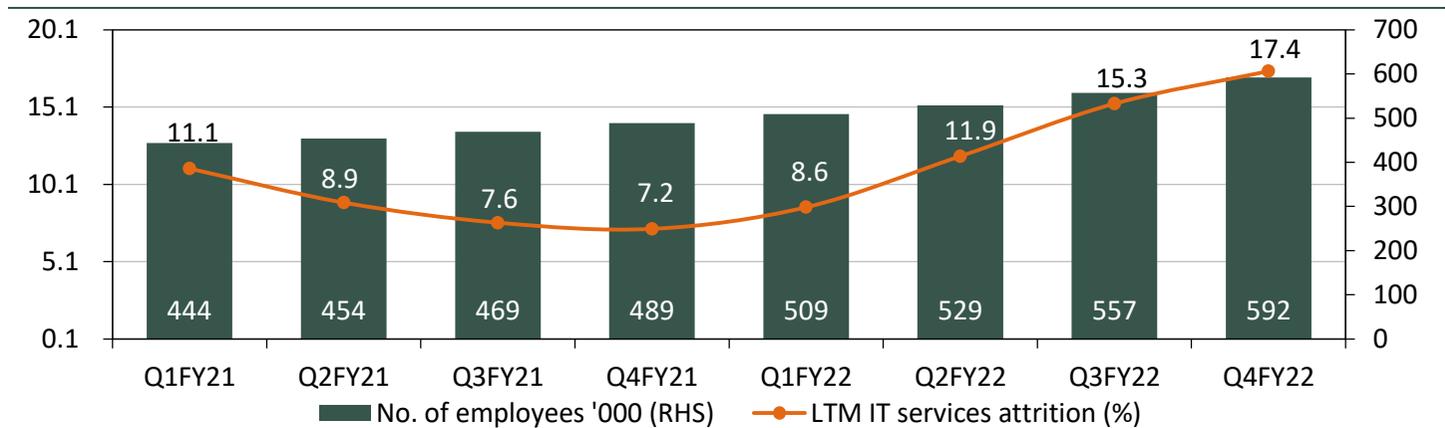
Source: Company; IDBI Capital Research

Exhibit 5: Q4FY22 revenue growth was in line with our expectation



Source: Company; IDBI Capital Research

Exhibit 6: Employee details and IT services attrition trend



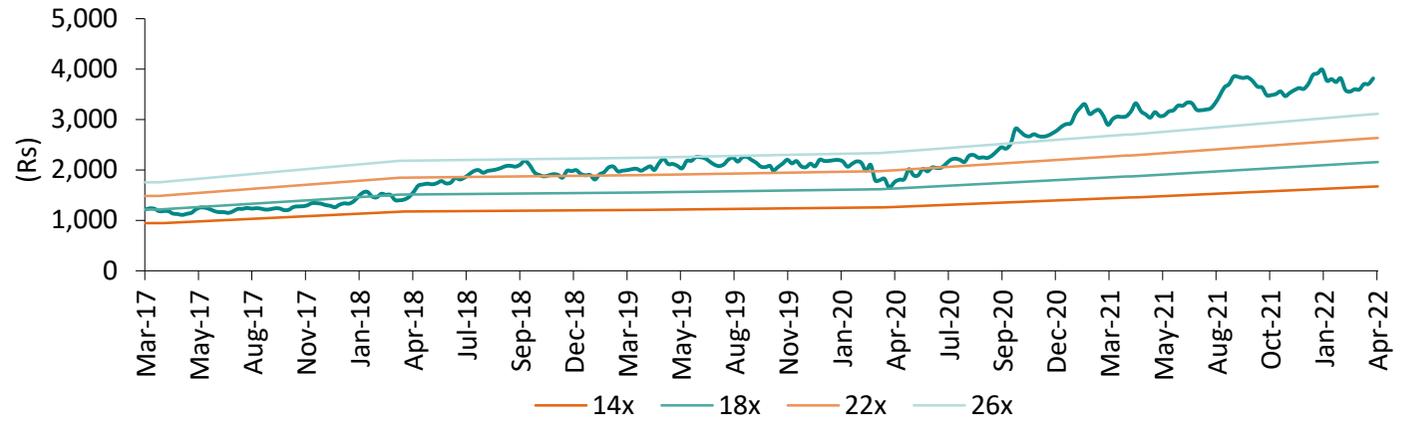
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

	% of revenue (%)	YoY in CC (%)
Total revenue		15.4%
by geography		
North America	51.6%	22.9%
Latin America	1.7%	23.0%
UK	15.6%	12.9%
Continental Europe	15.5%	6.8%
India	5.1%	5.4%
Asia Pacific	8.5%	4.7%
MEA	2.0%	15.8%
by vertical		
BFSI	31.9%	10.8%
Retail & CPG	15.4%	18.7%
Communication & Media	6.7%	15.2%
Manufacturing	10.0%	16.5%
Life Sciences & Healthcare	10.0%	15.3%
Technology & Services	8.7%	15.8%
Regional Markets & Others	17.3%	1.3%

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	FY19	FY20	FY21	FY22	FY23E	FY24E
Net sales	14,64,630	15,69,490	16,41,770	19,17,540	21,47,344	23,98,839
<i>Change (yoy, %)</i>	19	7	12	17	12	12
Operating expenses	(10,69,580)	(11,48,390)	(11,76,310)	(13,86,970)	(15,58,498)	(17,24,258)
EBITDA	3,95,050	4,21,100	4,65,460	5,30,570	5,88,846	6,74,580
<i>Change (yoy, %)</i>	21	7	11	14	11	15
<i>Margin (%)</i>	27.0	26.8	28.4	27.7	27.4	28.1
Depreciation	(20,550)	(35,300)	(40,650)	(46,040)	(52,468)	(60,058)
EBIT	3,74,500	3,85,800	4,24,810	4,84,530	5,36,379	6,14,523
Interest paid	(1,980)	(9,240)	(6,380)	(7,840)	(5,600)	(5,600)
Other income	43,110	45,920	29,610	40,180	51,773	40,697
Pre-tax profit	4,15,630	4,22,480	4,48,040	5,16,870	5,82,552	6,49,620
Tax	(1,00,010)	(98,010)	(1,14,580)	(1,32,380)	(1,46,220)	(1,63,055)
<i>Effective tax rate (%)</i>	24	23	26	26	25	25
Minority Interest	(900)	(1,070)	(1,320)	(1,220)	(1,200)	(1,200)
Net profit	3,14,720	3,23,400	3,32,140	3,83,270	4,35,131	4,85,365
Exceptional items	-	-	-	-	-	-
Adjusted net profit	3,14,720	3,23,400	3,32,140	3,83,270	4,35,131	4,85,365
<i>Change (yoy, %)</i>	22	3	3	15	14	12
EPS	83.9	86.2	89.8	103.6	118.9	132.6
DPS	30	72	37	43	103	138
<i>Dividend Payout (%)</i>	43	101	41	42	86	104

Balance Sheet

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E*	FY23E	FY24E
Shareholders' funds	8,94,460	8,41,260	8,64,330	10,88,541	9,67,829	9,49,415
Share capital	3,752	3,752	3,699	3,699	3,659	3,659
Reserves & surplus	8,90,708	8,37,508	8,60,631	10,84,842	9,64,170	9,45,756
Total Debt	-	-	-	-	-	-
Other liabilities	(8,700)	64,160	49,110	49,110	49,110	49,110
Curr Liab & prov	2,32,580	2,69,060	3,48,090	4,06,693	4,52,491	4,98,914
Current liabilities	1,76,660	1,97,350	2,29,250	2,67,892	2,97,055	3,25,274
Provisions	55,920	71,710	1,18,840	1,38,802	1,55,436	1,73,641
Total liabilities	2,23,880	3,33,220	3,97,200	4,55,803	5,01,601	5,48,024
Total equity & liabilities	11,22,870	11,80,710	12,68,280	15,52,314	14,78,600	15,07,810
Net fixed assets	1,32,530	1,38,400	1,43,140	1,32,100	1,29,632	1,24,575
Investments	2,390	2,160	2,130	2,130	2,130	2,130
Other non-curr assets	61,780	1,33,800	1,26,640	1,43,816	1,61,051	1,79,913
Current assets	9,26,170	9,06,350	9,96,370	12,74,269	11,85,787	12,01,192
Inventories	100	50	80	80	80	80
Sundry Debtors	3,29,890	3,66,620	3,69,900	4,30,790	4,82,417	5,38,917
Cash and Bank	4,37,080	3,72,790	3,98,830	5,75,469	4,03,250	3,27,015
Loans and advances	80,290	84,750	1,15,010	1,36,592	1,52,961	1,70,876
Total assets	11,22,870	11,80,710	12,68,280	15,52,314	14,78,600	15,07,810

Note: *Awaiting Annual Report

Cash Flow Statement

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E*	FY23E	FY24E
Pre-tax profit	4,15,630	4,22,480	4,48,040	5,16,870	5,83,939	6,51,183
Depreciation	12,730	14,850	21,420	46,040	52,468	60,058
Tax paid	(93,360)	(1,02,360)	(1,25,730)	(1,32,380)	(1,46,569)	(1,63,447)
Chg in working capital	17,390	(4,660)	45,460	(23,868)	(22,199)	(27,992)
Other operating activities	(1,93,958)	(47,148)	(1,99,302)	1,24,271	(39,627)	(35,132)
Cash flow from operations (a)	1,58,432	2,83,162	1,89,888	5,30,932	4,28,012	4,84,669
Capital expenditure	(12,750)	(20,720)	(26,160)	(35,000)	(50,000)	(55,000)
Chg in investments	(1,140)	230	30	-	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	(13,890)	(20,490)	(26,130)	(35,000)	(50,000)	(55,000)
Equity raised/(repaid)	(76)	-	(53)	(1,59,947)	(1,80,000)	-
Debt raised/(repaid)	(2,350)	-	-	-	-	-
Dividend (incl. tax)	(1,35,086)	(3,27,592)	(1,36,865)	(1,59,059)	(3,76,882)	(5,04,949)
Chg in minorities	(390)	630	(800)	-	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(1,37,902)	(3,26,962)	(1,37,718)	(3,19,059)	(3,76,922)	(5,04,949)
Net chg in cash (a+b+c)	6,640	(64,290)	26,040	1,76,873	1,090	(75,280)

Note: *Awaiting Annual Report

Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	238	224	234	294	265	259
Adj EPS (Rs)	84	86	90	104	119	133
Adj EPS growth (%)	24	3	4	15	15	12
EBITDA margin (%)	27	27	28	28	27	28
Pre-tax margin (%)	28	27	27	27	27	27
Net Debt/Equity (x)	-0.5	-0.4	-0.5	-0.5	-0.4	-0.3
ROCE (%)	43	43	46	47	49	60
ROE (%)	36	37	39	39	42	51
DuPont Analysis						
Asset turnover (x)	1.4	1.4	1.3	1.4	1.4	1.6
Leverage factor (x)	1.2	1.3	1.4	1.4	1.5	1.6
Net margin (%)	21.5	20.6	20.2	20.0	20.3	20.3
Working Capital & Liquidity ratio						
Inventory days	0	0	0	0	0	0
Receivable days	82	85	82	82	82	82
Payable days	21	21	24	24	23	22

Valuations

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
PER (x)	44.1	42.9	41.2	35.7	31.0	27.8
Price/Book value (x)	15.5	16.5	15.8	12.8	14.0	14.2
EV/Net sales (x)	9.2	8.6	8.1	6.8	6.1	5.5
EV/EBITDA (x)	34	32	29	25	22	20
Dividend Yield (%)	1	2	1	1	3	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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