

Tata Consultancy Services (TCS) **HOLD**

H2 to be better than H1 led by deal ramp ups

Summary

TCS reported weak set of revenues due to slowdown in discretionary projects especially in North America and project ramp downs. While the macro is uncertain, we believe TCS will continue to win cost optimization, vendor consolidation and integrated operations type of deals. We expect TCS to be a key beneficiary considering the client profile and the recent large deal wins. In addition, we expect H2 to be better than H1 led by ramp up in deal wins and healthy deal pipeline (US\$11.2 bn, book to bill of 1.6x). 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 downgrade the stock from BUY to HOLD while maintaining the same target price of Rs 3,740 (26x FY25E EPS).

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 & Continental Europe 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 91 bps to 25.0% over FY23-FY25E.

TP	Rs3,740
CMP	Rs3,610
Potential upside/downside	4%
Previous Rating	BUY

Price Performance (%)			
	-1m	-3m	-12m
Absolute	3.8	10.3	17.6
Rel to Sensex	4.7	9.0	1.3

V/s Consensus		
EPS (Rs)	FY24E	FY25E
IDBI Capital	128	143
Consensus	128	142
% difference	0.3	0.9

Key Stock Data	
Bloomberg/Reuters	TCS IN/ TCS.BO
Sector	IT Services
Shares o/s (mn)	3,659
Market cap. (Rs mn)	13,209,907
3-m daily avg Trd value (Rs mn)	338.4
52-week high / low	Rs3,680 / 3,053
Sensex / Nifty	66,473 / 19,811

Shareholding Pattern (%)	
Promoters	72.3
FII	12.5
DII	9.3
Public	5.9

Financial snapshot

Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	16,41,770	19,17,540	22,54,580	24,17,691	26,56,785
Change (yoy, %)	5	17	18	7	10
EBITDA	4,65,460	5,30,570	5,92,600	6,38,292	7,14,777
Change (yoy, %)	11	14	12	8	12
EBITDA Margin(%)	28.4	27.7	26.3	26.4	26.9
Adj.PAT	3,32,140	3,83,270	4,21,470	4,62,733	5,16,694
EPS (Rs)	90	105	115	128	143
Change (yoy, %)	4.2	16.6	10.0	11	12
PE(x)	40.2	34.5	31.3	28	25
Dividend Yield (%)	1.0	1.2	3.2	1	2
EV/EBITDA (x)	27.8	24.0	21.5	19.5	17.1
RoE (%)	38.9	43.7	46.9	47	45
RoCE (%)	46.4	51.8	57	57	55

Source: IDBI Capital Research

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Other Key Concall Highlights

- Q2FY24 Dollar revenue came in at \$7,210 mn -0.2%/+4.8% QoQ/YoY; CC growth of 4.8% YoY and -0.3% QoQ. YoY growth in CC terms was led by United Kingdom led with 10.7% YoY growth; North America grew 0.1% YoY and Continental Europe grew 1.3% YoY. In emerging markets, Middle East & Africa grew 15.9% YoY, Latin America grew 13.1% YoY, Asia Pacific grew 4.1% YoY and India grew 3.9% YoY. Segment wise growth was led by Energy, Resources and Utilities vertical which grew 14.8% YoY, Manufacturing which grew 5.8% YoY and Life Sciences and Healthcare which grew 5% YoY, the Consumer Business Group (CBG) grew 1% YoY.
- Company recorded EBIT margin of 24.3%, +110 bps QoQ. The expansion in margin was led by 100 bps improvement led by utilization & sub-contracting, 30 bps led by optimization of discretionary spend offset by investment in Infra
- Order book TCV stood at record high of \$11.2 bn (book to bill of 1.6x) resulting in successive quarter of minimum \$10bn worth TCV. The deal TCV was led by two mega deals BSNL and JLR which were of US\$2 bn each. The company expects BSNL to ramp up over next 12-18 months. Management indicated that deal wins are neutralized by project closure and slowdown in discretionary spend.
- Due to the macro economic challenges, clients across North America and Continental Europe continued to remain cautious while UK is witnessing healthy demand. In terms of industries, all segments of retail are witnessing demand softness. Company informed that clients are focused on executing those projects which provide a faster RoI. This has led to shortening of deals and discretionary spends seeing pause. Consequently, growth challenges are expected to persist in the near term. However, strong order bookings and increase in the number of vendor consolidation deals and cost optimization deals provide growth visibility over longer time period.
- 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.
- In terms of employees the company has not substituted natural attrition and which has led to lower headcount. The company will calibrate headcount based on demand scenario. The company has announced a buyback of Rs 17000 crore at a price of Rs 4,150.

Exhibit 1: Financial snapshot (Rs mn)

Year-end: March	Q2FY24	Q1FY24	QoQ (%)	Q2FY23	YoY (%)
Revenues (US\$ mn)	7,210	7,226	(0.2)	6,877	4.8
Revenues	5,96,920	5,93,810	0.5	5,53,090	7.9
COGS	3,47,980	3,49,730	(0.5)	3,25,260	7.0
Gross profit	2,48,940	2,44,080	2.0	2,27,830	9.3
SG&A	91,490	94,100	(2.8)	82,670	10.7
EBITDA	1,57,450	1,49,980	5.0	1,45,160	8.5
Depreciation & amortization	12,630	12,430	1.6	12,370	2.1
EBIT	1,44,820	1,37,550	5.3	1,32,790	9.1
Other income	8,470	12,340	(31.4)	8,170	3.7
PBT	1,53,290	1,49,890	2.3	1,40,960	8.7
Tax	39,500	38,690	2.1	36,310	8.8
Minority interest	380	460	(17.4)	340	11.8
Adjusted net profit	1,13,410	1,10,740	2.4	1,04,310	8.7
Diluted EPS (Rs)	31.0	30.3	2.4	28.5	8.7
As % of net revenue					
Gross profit	41.7	41.1		41.2	
SG&A	15.3	15.8		14.9	
EBITDA	26.4	25.3		26.2	
EBIT	24.3	23.2		24.0	
Adjusted net profit	19.0	18.6		18.9	
Tax rate	25.8	25.8		25.8	

Source: Company; IDBI Capital Research

Revenue growth of 4.8%, YoY.

EBIT margin was up 110 bps QoQ to 24%.

Exhibit 2: Actual vs. estimates

Year to March	Q2FY24	Q2FY24E	Variance (%)
Revenue (US\$ mn)	7,210	7,269	(0.8)
Revenue (Rs mn)	5,96,920	6,00,812	(0.6)
EBIT (Rs mn)	1,44,820	1,48,540	(2.5)
EBIT margin (%)	24.3%	24.7%	(40)bps
PAT (Rs mn)	1,13,410	1,19,363	(5.0)
PAT margin (%)	19.0%	19.9%	90bps
EPS (Rs)	31.0	32.6	(5.0)

Source: Company; IDBI Capital Research

Exhibit 3: Earnings Revision

Year-end: March	FY24E			FY25E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	29,219	29,524	(1.0)	32,009	32,424	(1.3)
Revenue (Rs bn)	24,17,691	24,26,191	(0.4)	26,56,785	26,68,543	(0.4)
EBIT margin (%)	24.3%	24.9%	-59 bps	25.0%	25%	7.8 bps
EPS (Rs/sh)	127.9	129.8	(1.5)	142.8	142.0	0.5

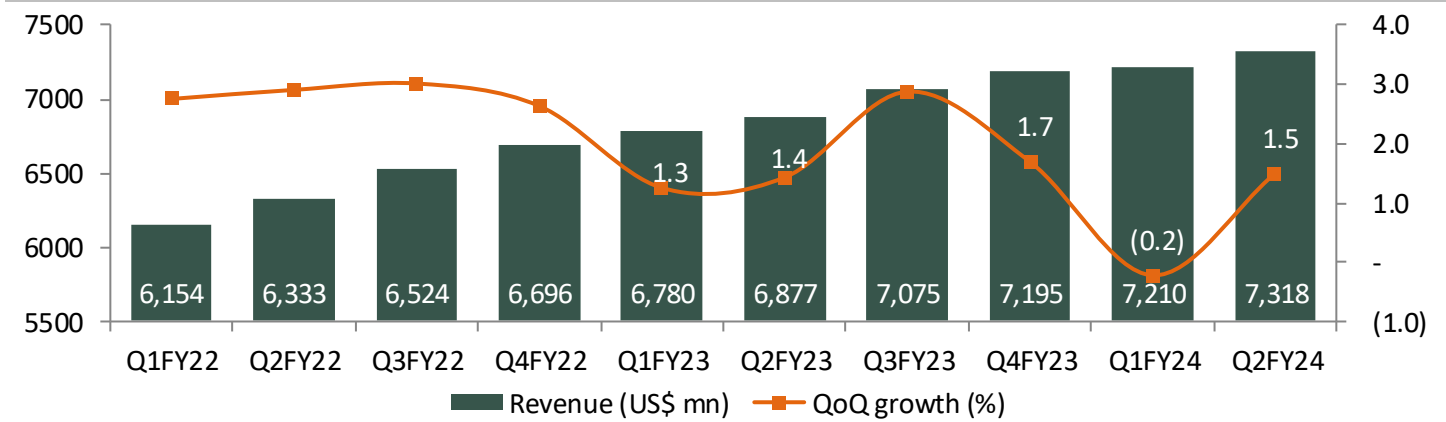
Source: Company; IDBI Capital Research

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

No. of large clients	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
USD1m+	1,118	1,138	1,175	1,182	1,196	1,210	1,217	1,241	1,272
USD5m+	586	609	619	638	650	650	658	665	688
USD10m+	405	417	426	439	446	455	456	461	483
USD20m+	241	247	255	268	272	283	290	291	292
USD50m+	105	114	118	120	124	124	130	133	137
USD100m+	50	54	58	58	59	59	59	60	61

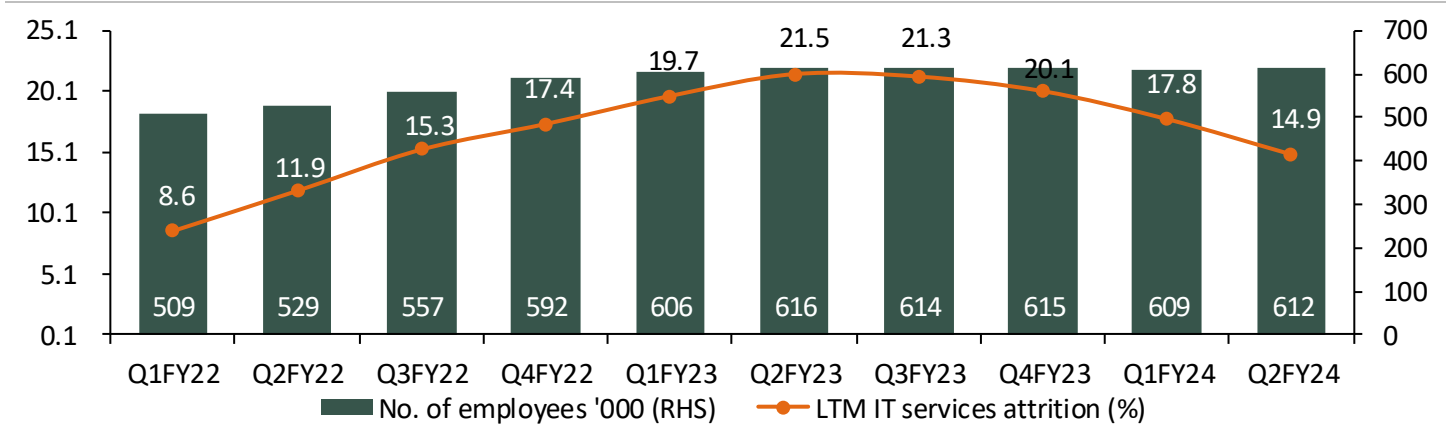
Source: Company; IDBI Capital Research

Exhibit 5: Q2FY24 revenue growth was below consensus estimates



Source: Company; IDBI Capital Research

Exhibit 6: Employee details and IT services attrition trend



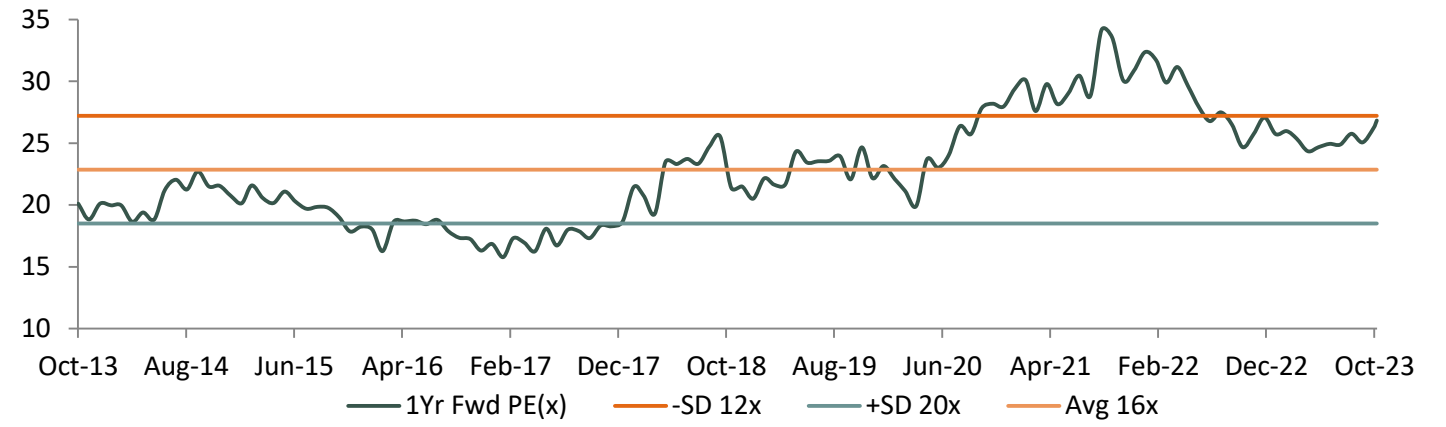
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

	% of revenue (%)	YoY in CC (%)
Total revenue		7%
by geography		
North America	51.7%	2.8%
Latin America	2.0%	27.0%
UK	16.5%	22.8%
Continental Europe	14.9%	10.9%
India	4.9%	3.7%
Asia Pacific	7.8%	5.2%
MEA	2.2%	25.0%
by vertical		
BFSI	32.6%	19.4%
Retail & CPG	15.9%	3.5%
Communication & Media	6.9%	-0.9%
Manufacturing	8.5%	8.7%
Life Sciences & Healthcare	10.9%	6.8%
Technology & Services	8.6%	-0.9%
Regional Markets & Others	11.0%	15.3%

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	FY20	FY21	FY22	FY23	FY24E	FY25E
Net sales	15,69,490	16,41,770	19,17,540	22,54,580	24,17,691	26,56,785
<i>Change (yoy, %)</i>	7.2	5	17	18	7	10
Operating expenses	(11,48,390)	(11,76,310)	(13,86,970)	(16,61,980)	(17,79,399)	(19,42,008)
EBITDA	4,21,100	4,65,460	5,30,570	5,92,600	6,38,292	7,14,777
<i>Change (yoy, %)</i>	6.6	11	14	12	8	12
<i>Margin (%)</i>	26.8	28.4	27.7	26.3	26.4	26.9
Depreciation	(35,300)	(40,650)	(46,040)	(50,230)	(51,250)	(51,607)
EBIT	3,85,800	4,24,810	4,84,530	5,42,370	5,87,041	6,63,170
Interest paid	(9,240)	(6,380)	(7,840)	(7,790)	(7,220)	(8,000)
Other income	45,920	29,610	40,180	34,490	45,274	41,861
Pre-tax profit	4,22,480	4,48,040	5,16,870	5,69,070	6,25,096	6,97,031
Tax	(98,010)	(1,14,580)	(1,32,380)	(1,46,040)	(1,60,922)	(1,79,137)
<i>Effective tax rate (%)</i>	23.2	25.6	25.6	25.7	25.7	25.7
Minority Interest	(1,070.0)	(1,320.0)	(1,220.0)	(1,560.0)	(1,440.0)	(1,200.0)
Net profit	3,23,400	3,32,140	3,83,270	4,21,470	4,62,733	5,16,694
Exceptional items	-	-	-	-	-	-
Adjusted net profit	3,23,400	3,32,140	3,83,270	4,21,470	4,62,733	5,16,694
<i>Change (yoy, %)</i>	2.8	3	15	10	10	12
EPS	86.2	89.8	104.7	115.2	127.9	142.8
DPS	72.0	37.0	43.0	115.0	42.0	85.0
<i>Dividend Payout (%)</i>	101.3	41.2	41.1	100	33	60

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Shareholders' funds	8,41,260	8,64,330	8,91,390	9,04,240	10,45,343	12,54,419
Share capital	3,752	3,699	3,660	3,660	3,619	3,619
Reserves & surplus	8,37,508	8,60,631	8,87,730	9,00,580	10,41,724	12,50,800
Total Debt	-	-	-	-	-	-
Other liabilities	64,160	49,110	52,720	55,260	55,260	55,260
Curr Liab & prov	2,69,060	3,48,090	4,26,880	4,36,120	4,67,672	5,13,921
Current liabilities	1,97,350	2,29,250	2,88,690	2,93,210	3,14,423	3,45,517
Provisions	71,710	1,18,840	1,38,190	1,42,910	1,53,249	1,68,404
Total liabilities	3,33,220	3,97,200	4,79,600	4,91,380	5,22,932	5,69,181
Total equity & liabilities	11,80,710	12,68,280	13,78,060	14,03,440	15,77,535	18,34,060
Net fixed assets	1,38,400	1,43,140	1,48,670	1,41,890	1,15,640	89,033
Investments	2,160	2,130	2,230	2,660	2,660	2,660
Other non-curr assets	1,33,800	1,26,640	1,38,950	1,50,980	1,61,903	1,77,914
Current assets	9,06,350	9,96,370	10,88,210	11,07,910	12,97,332	15,64,453
Inventories	50	80	200	280	280	280
Sundry Debtors	3,66,620	3,69,900	4,20,100	5,03,020	5,39,412	5,92,756
Cash and Bank	3,72,790	3,98,830	4,98,730	4,92,480	6,37,398	8,39,284
Loans and advances	84,750	1,15,010	67,560	14,980	16,064	17,652
Total assets	11,80,710	12,68,280	13,78,060	14,03,440	15,77,535	18,34,060

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Pre-tax profit	4,22,480	4,48,040	5,16,870	5,69,070	6,25,096	6,97,031
Depreciation	14,850	21,420	23,130	30,220	51,250	51,607
Tax paid	(1,02,360)	(1,25,730)	(1,31,920)	(1,40,010)	(1,60,922)	(1,79,137)
Chg in working capital	(4,660)	45,460	75,920	(21,180)	(5,924)	(8,683)
Other operating activities	(47,148)	(1,99,302)	(1,97,021)	1,230	(99,807)	(34,296)
Cash flow from operations (a)	2,83,162	1,89,888	2,86,979	4,39,330	4,09,693	5,26,521
Capital expenditure	(20,720)	(26,160)	(28,660)	(23,440)	(25,000)	(25,000)
Chg in investments	230	30	(100)	(430)	-	-
Other investing activities	-	-	-	-	81,897	7,982
Cash flow from investing (b)	(20,490)	(26,130)	(28,760)	(23,870)	56,897	(17,018)
Equity raised/(repaid)	-	(53)	(39)	-	(1,69,672)	-
Debt raised/(repaid)	-	-	-	-	-	-
Dividend (incl. tax)	(3,27,592)	(1,36,865)	(1,57,380)	(4,20,900)	(1,52,000)	(3,07,618)
Chg in minorities	630	(800)	(900)	(810)	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	(3,26,962)	(1,37,718)	(1,58,319)	(4,21,710)	(3,21,671)	(3,07,618)
Net chg in cash (a+b+c)	(64,290)	26,040	99,900	(6,250)	1,44,919	2,01,885

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	224.2	234	244	247	289	347
Adj EPS (Rs)	86.2	89.8	104.7	115.2	127.9	142.8
Adj EPS growth (%)	2.8	4	17	10	11	12
EBITDA margin (%)	26.8	28.4	27.7	26.3	26.4	26.9
Pre-tax margin (%)	26.9	27.3	27.0	25.2	25.9	26.2
Net Debt/Equity (x)	-0.4	-0.5	-0.6	-0.5	-0.6	-0.7
ROCE (%)	42.8	46	52	57	57	55
ROE (%)	37.3	39	44	47	47	45

DuPont Analysis

Asset turnover (x)	1.4	1.3	1.4	1.6	1.6	1.6
Leverage factor (x)	1.3	1.4	1.5	1.5	1.5	1.5
Net margin (%)	20.6	20.2	20.0	18.7	19.1	19.4

Working Capital & Liquidity ratio

Inventory days	0	0	0	0	0	0
Receivable days	85	82	80	81	81	81
Payable days	21	24	21	23	23	23

Valuations

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
PER (x)	41.9	40.2	34.5	31.3	28.2	25.3
Price/Book value (x)	16.1	15.4	14.8	14.6	12.5	10.4
EV/Net sales (x)	8.4	7.9	6.6	5.6	5.1	4.6
EV/EBITDA (x)	31.3	27.8	24.0	21.5	19.5	17.1
Dividend Yield (%)	2.0	1.0	1.2	3.2	1.2	2.4

Source: Company; IDBI Capital Research



Notes

Dealing

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

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