AXIS SECURITIES

Results Update
12th Oct 2023

Tata Consultancy Services
IT Services Sector

HOLD
Target Price
3,790

Near-term Challenges Persists; Outlook Remains Cautious

Est. Vs. Actual for Q2FY24: Revenue – MISS ; EBITDA Margin – BEAT ; PAT – INLINE; Deal Wins – BEAT

Change in Estimates post Q2FY24 (Abs.)

FY24E/FY25E: Revenue 1%/ 2%; EBITDA 1%/ 2%; PAT 1%/ 2%

Recommendation Rationale

- BFSI and Retail verticals reported sluggish growth which may indicate a softening of demand.
- TCV was within the typical quarterly range at $11.2 Bn (vs. $10.1 Bn QoQ).
- While the management is sceptical about the demand scenario, the medium to long-term outlook remains healthy.

Sector Outlook: Cautiously positive

Company Outlook & Guidance: The growth rate may slow down in FY24 due to uncertainties in the world's largest economies. However, supply-side constraints are easing up, which will help the company gain some margin expansion in the near term. H2FY24 may see some revision on the demand side. The industry's and the company's long-term outlook remain robust.

Current Valuation: 25x FY25E P/E; Earlier Valuation: 24x FY25E

Current TP: 3,790/share (Earlier TP: Rs 3,350/share)

Recommendation: With a strong deal pipeline and increasing demand for newer technologies, we believe TCS will demonstrate quicker recovery in FY25E. Hence, we **maintain** our **HOLD** rating on the stock.

Financial Performance

In Q2FY24, Tata Consultancy Services Ltd. (TCS) reported revenue of Rs 59,692 Cr, up only 0.5% on a QoQ basis (in rupee terms). On a YoY basis, it posted weaker revenue growth of 8%, owing to weakness in discretionary spending. The company reported operating profits of Rs 14,483 Cr and operating margins of 24.3%, reporting an expansion of 120bps QoQ. This was on account of better execution, strong volume growth, and reduced sub-con cost. Attrition levels dropped by 290bps to 14.9%, but it continues to loom concerns over the company's execution efficiency in the future. The management commentary on the verticals such as BFSI, Hi-tech Media, Life Sciences, and Retail was cautious. Furthermore, it expects the company to report moderate growth in the near term. On a brighter note, deal-wins for the quarter continued strong and remained high. Moreover, deal wins were spread across verticals and across geographies and stood at $11.2 Bn (BFSI TCV at $3 Bn; Consumer Business TCV at $1.4 Bn). However, TCS expects technology spending to remain resilient and expects the secular tailwinds to drive healthy growth over the medium term to long term.

Outlook: From a long-term perspective, we believe TCS has built a resilient business model by securing multiple long-term contracts with the world's leading brands. It has also established robust capabilities that will enable it to gain market share moving ahead. However, prevailing uncertainties in large economies continue to pose short-term headwinds to the growth prospects of the company. We believe discretionary spending will gradually increase with newer technologies.

Valuation & Recommendation

We recommend a **HOLD** rating on the stock and assign a 25x P/E multiple to its FY25E earnings of Rs 148.8/share to arrive at a TP of Rs 3,790/share, implying an upside of 5% from the CMP.

Key Financials (Consolidated)

(Rs Cr)	Q2FY24	QoQ (%)	YoY (%)	Axis Est.	Variance
Net Sales	59,692	1.6	16.7	60,270	-1%
EBITDA	14,483	1.5	2	14446	0%
EBITDA Margin	24%	-	100 bps	24	50 bps
Net Profit	11,342	1.4	14.7	11500	-1%
EPS (Rs)	28.51	1.4	14.7	31.4	-9%

Source: Company, Axis Research

(CMP as of 11 Oct 2023)

CMP (Rs)	3,610
Upside /Downside (%)	5%
High/Low (Rs)	3,680/3,053
Market cap (Cr)	13,20,290
Avg. daily vol. (6m)Shrs.	18,39,129
No. of shares (Cr)	366

Shareholding (%)

	Dec-22	Mar-23	Jun-23
Promoter	72.3	72.3	72.3
FIIs	12.9	12.7	12.5
MFs / UTI	3.3	3.5	3.5
Banks / FIs	0.1	0.1	0.1
Others	11.4	11.5	11.7

Financial & Valuations

Y/E Mar (Rs Cr)	FY23	FY24E	FY25E
Net Sales	2,25,458	2,28,658	2,58,510
EBITDA	73,046	61,280	69,281
Net Profit	58,454	46,521	54,970
EPS (Rs)	115.4	126.0	148.8
PER (x)	20.5	25.8	21.8
P/BV (x)	16	19	15
EV/EBITDA (x)	9	7	5
ROE (%)	49%	30%	28%

Change in Estimates (%)

Y/E Mar	FY23E	FY24E	FY25E
Sales		1%	2%
EBITDA		1%	2%
PAT		1%	2%

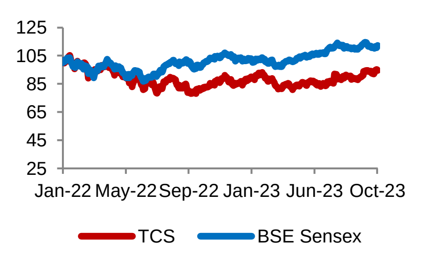
ESG disclosure Score**

Environmental Disclosure	51.5
Social Disclosure Score	34.1
Governance Disclosure	91.1
Total ESG Disclosure Score	59.0
Sector Average	**46.0**

Source: Bloomberg, Scale: 0.1-100

**Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

Relative performance



Source: Capitaline, Axis Securities

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Recommendation Rationale & Key Highlights

- **Management is confident of continuing strength in demand environment in the medium term to long term:** The US is relatively weaker in terms of demand. The UK is seeing higher cost optimization deals (with faster decision-making), although the European market will continue to be impacted in the near term. As the macro environment stabilizes, the company expects a pick-up in decision-making around IT spends. Demand for newer technologies such as Generative AI, Machine learning, Digital Transformations, Cloud Transformations, etc. remains resilient even during challenging times.

- **Broad-based vertical growth:** TCS delivered broad-based growth in the majority of the verticals during the quarter. Growth in Q2 was led by Life Sciences and Healthcare (+5% YoY), while Manufacturing grew by 5.8% YoY. Energy Resources & Utilities grew by 14.8% YoY, Regional markets and other verticals grew by 11.3% YoY, and Consumer business grew by 1%. Technology & Services de-grew by 1.1%. On the other hand, BFSI reported a de-growth of 0.5% while Communications & Media de-grew by 2.1%.

- **Better geographical performance:** On a geographical front, North America (51.7% of revenue) posted a marginal growth of 0.1% YoY, Latin America grew by 13.1%, the UK (16.5%) grew by 10.7% YoY, Continental Europe (14.9% of revenue) grew by 1.3% YoY, and India's business grew by 4.9% YoY.

- **TCS announces Buyback**: TCS announces the buyback with a total size of Rs 17,000 Cr. The buyback price will be Rs 4,150/ share. Based on our analysis, the investor should participate in the buyback via the tender route.

- **TCS announces Rs 9/share as interim dividend**

Key Risks to our Estimates and TP

- The demand environment is uncertain because of the potential threat of recession from the world's largest economies.

- The rising subcontracting cost and cross-currency headwinds may impact operating margins negatively.

Revenue Distribution by Geography - New Classification

	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1 FY24	Q2 FY24
Americas	53%	55%	56%	56%	54%	52%	52%
North America	52%	53%	54%	54%	52%	52%	52%
Latin America *	2%	2%	2%	2%	2%	2%	2%
Europe	31%	30%	29%	30%	31%	16%	0%
UK	16%	15%	15%	15%	16%	16%	17%
Continental Europe	16%	15%	15%	15%	15%	16%	15%
India	5%	5%	5%	5%	5%	5%	5%
Asia Pacific	9%	8%	8%	8%	8%	8%	8%
MEA	2%	2%	2%	2%	2%	2%	2%

Source: Company, Axis Research

Revenue Distribution by Industry Domain

	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1 FY24	Q2 FY24
BFSI	32%	32%	32%	32%	31%	31%	33%
Retail & CPG	15%	16%	16%	16%	16%	16%	16%
Communication & Media	7%	7%	7%	7%	7%	6%	7%
Manufacturing	10%	10%	10%	10%	10%	10%	9%
Life Science & Healthcare	10%	10%	10%	10%	10%	11%	11%
Technology & Services	9%	9%	9%	9%	9%	9%	9%
Regional Markets & Others	17%	16%	16%	17%	18%	18%	11%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Company, Axis Research

Average Realized Rates in INR

	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1 FY24	Q2 FY24
USD	75.6	77.8	80.4	82.3	82.4	82.4	82.4
GBP	100.5	96.7	92.5	98.1	98.4	98.4	98.4
EUR	84.3	82.4	79.9	85.1	85.3	85.3	85.3

Source: Company, Axis Research

Client Parameters

	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1 FY24	Q2 FY24
USD 1 Mn clients *	1,182	1,196	1,210	1,217	1,241	1,268	1,272
USD 5 Mn clients *	638	650	650	658	665	677	688
USD 10 Mn clients *	439	446	455	456	461	468	483
USD 20 Mn clients *	268	272	283	290	291	296	292
USD 50 Mn clients *	120	124	124	130	133	137	137
USD 100 Mn clients *	58	59	59	59	60	60	61

Source: Company, Axis Research

Client Parameters

	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1 FY24	Q2 FY24
Total Headcount	5,92,195	6,06,331	6,16,171	6,13,974	6,14,795	6,15,318	6,08,905
Net Addition	35,209	14,136	9,840	(2,197)	821	523	(6,413)
Attrition (%)	17%	20%	22%	21%	20%	18%	14.90%

Source: Company, Axis Research

Results Review **(Rs Cr)**

In Crs.	Q2 FY24	Q1 FY24	Q2 FY23	% change (YoY)	% change (QoQ)
Total Revenue	**59,692**	**59,381**	**55,309**	**8%**	**0.52%**
Cost of revenue	35,762	35,916	33,462		
Gross Margin	23,930	23,465	20,304		
SG&A Expenses	9,447	9,710	8,568		
Operating Income	**14,483**	**13,755**	**13,279**	**9%**	**5%**
Margin(%)	24.3%	23%	24%	25	110
Total Other Income/(Expense)	847	1,234	817		
Income Before Income Taxes	**15,330**	**14,989**	**14,096**		
Total Taxes	3,950	3,869	3,631		
ETR (%)	26%	26%	26%	1	-5
Net Profit After Taxes	**11,380**	**11,120**	**10,465**	9%	2%
Non Controlling Interest	38	46	34		
Net Income After Extraordinary Items	**11,342**	**11,074**	**10,431**	9%	2%
Margin(%)	19%	19%	19%	14	35
EPS	**28.51**	**30.26**	**31.00**	-8%	-6%

Source: Company, Axis Securities

Financials (consolidated)

Profit & Loss

(Rs Cr)

Y/E March	FY22	FY23	FY24E	FY25E
Net sales	**1,91,754**	**2,25,458**	**2,28,658**	**2,58,510**
Other operating income	0	0	0	0
Total income	**1,91,754**	**2,25,458**	**2,28,658**	**2,58,510**
Employee Cost	1,07,554	1,16,837	1,29,649	1,46,575
Fees to External Consultants	*17,410*	*19,702*	*21,037*	*23,783*
Cost of Equipment and Software Licenses	*1,298*	*991*	*1,143*	*1,293*
Travel	*1,588*	*2,077*	*1,829*	*2,068*
Communication	*2,051*	*2,011*	*1,143*	*1,293*
Facility Expenses	*2,139*	*2,127*	*2,287*	*2,585*
Other Costs	*6,657*	*8,668*	*10,290*	*11,633*
EBITDA	**53,057**	**73,046**	**61,280**	**69,281**
Other income	3,234	2,462	3,430	3,878
PBIDT	**56,291**	**75,508**	**64,710**	**73,158**
Depreciation	4,604	4,266	4,573	4,573
Interest & Fin Chg.	2	0	0	0
E/o income / (Expense)	0	0	0	0
Pre-tax profit	**51,685**	**71,242**	**60,137**	**68,585**
Tax provision	13,238	12,642	13,549	13,549
(-) Minority Interests	-122	-146	-67	-67
Associates	0	0	0	0
Profit after Tax	**38,325**	**58,454**	**46,521**	**54,970**
Other Comprehensive Income	0.0	0.0	0.0	0.0
PAT after Comprehensive Income	**38,325**	**58,454**	**46,521**	**54,970**

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Total assets	**1,02,514**	**1,43,260**	**1,79,988**	**2,40,617**
Net Block	12,080.0	12,135.0	12,080.0	0.0
CWIP	5,167.0	5,856.6	6,753.1	4,555.3
Investments	19,309.0	20,336.2	21,484.8	19,553.4
Wkg. cap. (excl cash)	53,471	67,015	70,203	40,887
Cash / Bank balance	12,488.0	37,918.5	69,468.3	######
Misc. Assets	(1.0)	(1.0)	(1.0)	(1.0)
Capital employed	**1,02,514**	**1,43,260**	**1,79,988**	**2,40,617**
Equity capital	366.0	366.0	366.0	366.0
Reserves	90,894	1,32,250	1,65,164	2,20,133
Minority Interests	707.0	707.0	707.0	707.0
Borrowings	7,617	7,617	7,617	1,249
Def tax Liabilities	590.0	590.0	590.0	590.0

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Sources	**11,339**	**46,849**	**38,730**	**54,523**
Cash profit	43,053	62,866	51,162	59,610
(-) Dividends	11,210	17,098	13,608	0
Retained earnings	31,843	45,769	37,554	59,610
Issue of equity	(4.0)	0.0	0.0	0.0
Change in Oth. Reserves	2,578.0	1,080.2	1,176.2	1,281.1
Borrowings	157	0	0	-6,368
Others	-23,235	0	0	0
Applications	**11,339**	**46,849**	**38,730**	**54,523**
Capital expenditure	8,731.0	8,126.9	4,369.6	6,418.0
Investments	1,774.0	751.3	563.7	597.0
Net current assets	(4,796.0)	12,540.1	2,247.0	(18,310.5)
Change in cash	5,630.0	25,430.5	31,549.8	1,06,153.4
Closing cash	6,858	6,858	6,858	6,858

Source: Company, Axis Securities

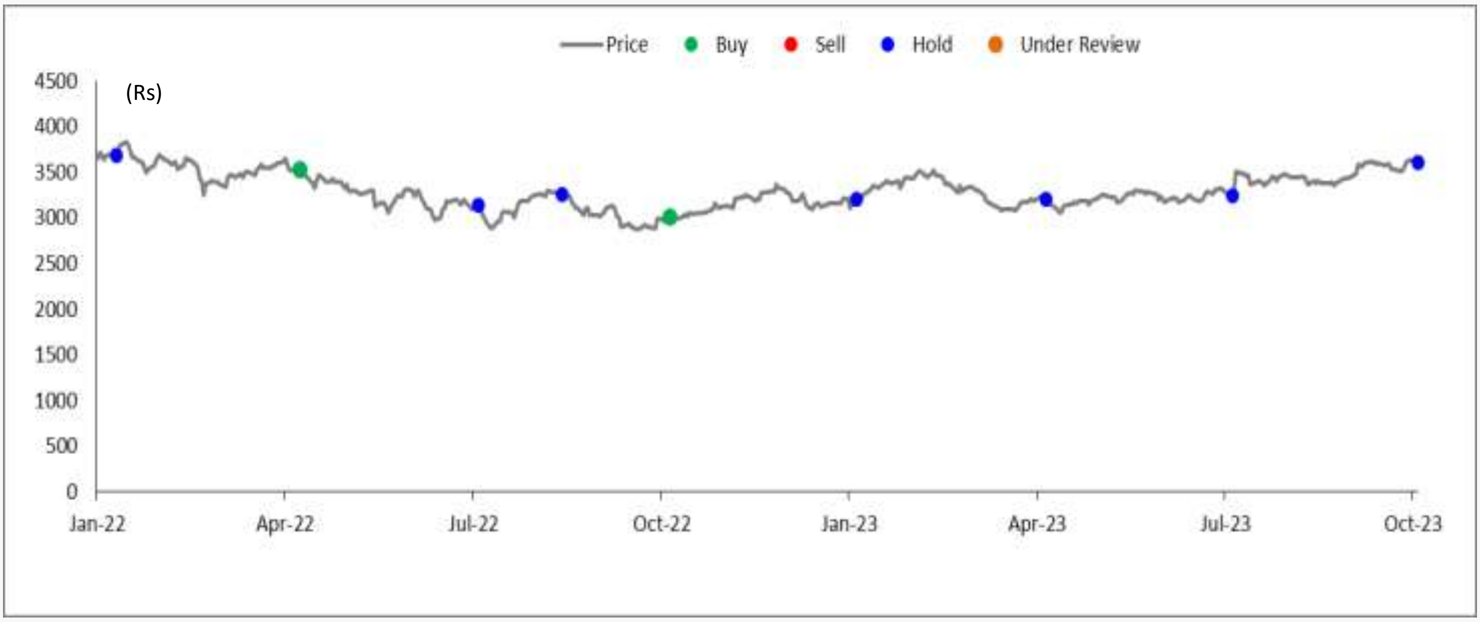
Ratio Analysis

(%)

Y/E March	FY22A	FY23E	FY24E	FY25E
Sales growth	**16.8**	**17.6**	**1.4**	**13.1**
OPM	**27.7**	**32.4**	**26.8**	**26.8**
Oper. profit growth	14.0	37.7	(16.1)	13.1
COGS / Net sales	56.1	51.8	56.7	56.7
Depreciation / G. block	(6,306.8)	7,757.2	(8,314.8)	(37.9)
Effective interest rate (%)	0.0	0.0	0.0	0.0
Net wkg.cap / Net sales	0.31	0.28	0.32	0.23
Net sales / Gr block (x)	43.7	46.5	42.8	47.9
RoCE	**52%**	**58%**	**38%**	**34%**
Debt / equity (x)	0.08	0.05	0.04	0.00
Effective tax rate	25.6	17.7	22.5	19.8
RoE	**40%**	**49%**	**30%**	**28%**
Payout ratio (Div/NP)	25.0	25.0	25.0	0.0
EPS (Rs.)	**103.9**	**115.4**	**126.0**	**148.8**
EPS Growth	16.0	52.4	(20.5)	18.1
CEPS (Rs.)	116.1	169.6	138.1	161.0
DPS (Rs.)	25.9	39.5	31.4	0.0

Source: Company, Axis Securities

Tata Consultancy Services Price Chart and Recommendation History



Date	Reco	TP	Research
13-Jan-22	HOLD	4,200	Result Update
12-Apr-22	BUY	4,200	Result Update
11-Jul-22	HOLD	3,460	Result Update
19-Aug-22	HOLD	3,650	AAA
11-Oct-22	BUY	3,460	Result Update
10-Jan-23	HOLD	3,650	Result Update
13-Apr-23	HOLD	3,350	Result Update
13-Jul-23	HOLD	3,350	Result Update
12-Oct-23	HOLD	3,790	Result Update

Source: Axis Securities

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