

**HOLD**  
 TP: Rs 3,580 | ▲ 10%

**TATA CONSULTANCY SERVICES**

| Technology & Internet | 13 July 2023

**Strong deal flow but near-term softness to continue**

- Management echoed Accenture’s commentary on temporary weakness due to project delays in the near term
- Despite this, TCS won US\$ 10.2bn of deal bookings (ex-BSNL) in Q1, up 24% YoY
- Maintain HOLD with an unchanged TP of Rs 3,580 as the demand climate remains volatile

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**Q1 in line:** TCS reported Q1FY24 revenue of US\$ 7.2bn, up 0.1% QoQ CC and 0.4% QoQ USD, in line with our estimate. Growth was led by the UK (+4.8% QoQ USD) while the US (-0.4%) and EU (-1%) were a drag. Among verticals, manufacturing (+3.5% QoQ USD) was strong whereas BFSI (-0.9%) and communication & media (-1.1%) lagged. Key positives for the quarter were strong deal bookings, demand for full-stack services, continued momentum in UK business, improved utilisation and pricing, as well as lower attrition

**Deal trajectory to remain stable:** Management indicated that the demand slowdown due to macro concerns is leading to reprioritisation of deals and hence pauses and deferrals of non-critical projects. Even so, TCS won projects worth US\$ 10.2bn TCV in Q1 (ex-BSNL), up 24% YoY and crossing the US\$ 10bn mark for the second consecutive quarter. These include TCV of US\$ 5.2bn from North America, US\$ 3bn from the BFSI vertical, and US\$ 1.2bn from the retail & consumer packaged goods (CPG) vertical. Management also indicated that it is engaged in 50 proofs of concept on generative AI and has 100 such deals in the pipeline.

**Operating margin a miss:** EBIT margin at 23.2% (vs. 24.8% expected) declined 130bps QoQ due to wage hikes (-200bps impact), offset by efficiencies (+80bps) from lower subcontracting cost. Margins were sequentially lower across verticals with the exception of manufacturing. Attrition in the IT services business moderated to 17.8% for the last 12 months vs. 20.1% in Q4FY23, and management expects a return to pre-pandemic levels of ~11.5-13% by H2FY24. The company’s fresher hiring target for FY24 remains intact at ~40,000 to be spread through the quarters.

**Maintain HOLD:** The stock is trading at 24.8x/22.8x FY24E/FY25E EPS. We believe TCS is well positioned to deliver industry-leading growth and margins in the long run. However, considering the current volatile macro environment, poor quality of deal wins and delays in client decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS — for an unchanged TP of Rs 3,580.

**Key changes**

Target	Rating
◀▶	◀▶

Ticker/Price	TCS IN/Rs 3,260
Market cap	US\$ 145.2bn
Free float	28%
3M ADV	US\$ 75.1mn
52wk high/low	Rs 3,575/Rs 2,926
Promoter/FPI/DII	72%/17%/11%

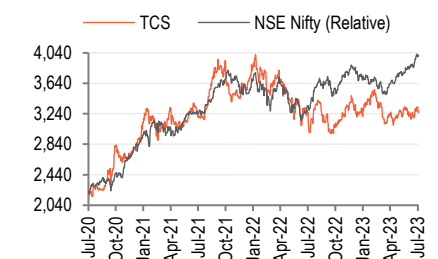
Source: NSE | Price as of 12 Jul 2023

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	22,23,757	24,76,435	27,26,137
EBITDA (Rs mn)	5,82,248	6,66,207	7,37,388
Adj. net profit (Rs mn)	4,16,294	4,80,791	5,24,296
Adj. EPS (Rs)	113.8	131.4	143.3
Consensus EPS (Rs)	113.8	128.3	142.5
Adj. ROAE (%)	43.5	44.5	43.4
Adj. P/E (x)	28.7	24.8	22.8
EV/EBITDA (x)	20.4	17.8	16.0
Adj. EPS growth (%)	9.8	15.5	9.0

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE

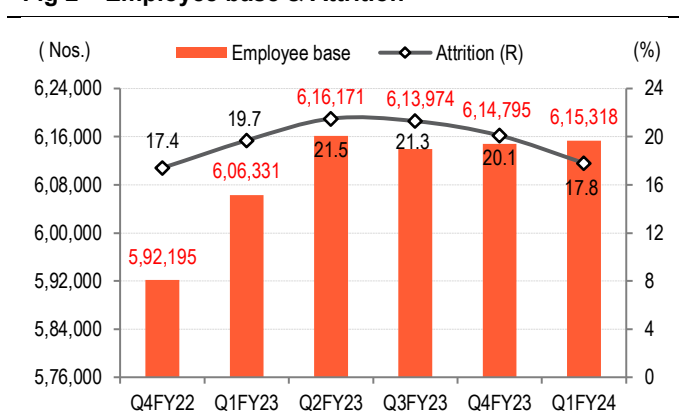


**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue (US\$ mn)	7,226	7,195	6,780	0.4	6.6	7,229	0.0
Revenue (Rs mn)	5,93,810	5,91,620	5,27,508	0.4	12.6	5,94,224	(0.1)
EBIT	1,37,550	1,44,880	1,21,788	(5.1)	12.9	1,47,378	(6.7)
PAT	1,11,074	1,13,920	94,708	(2.5)	17.3	1,14,364	(2.9)
EBIT Margin (%)	23.2	24.5	23.1	(132bps)	8bps	24.8	(164bps)
PAT Margin (%)	18.7	19.3	18.0	(55bps)	75bps	19.2	(54bps)

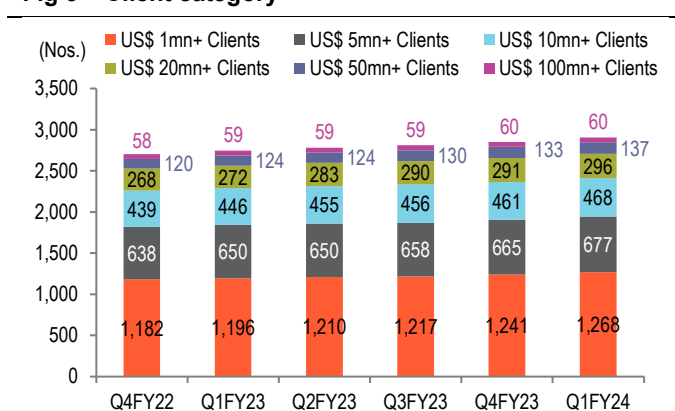
Source: Company, BOBCAPS Research

**Fig 2 – Employee base & Attrition**



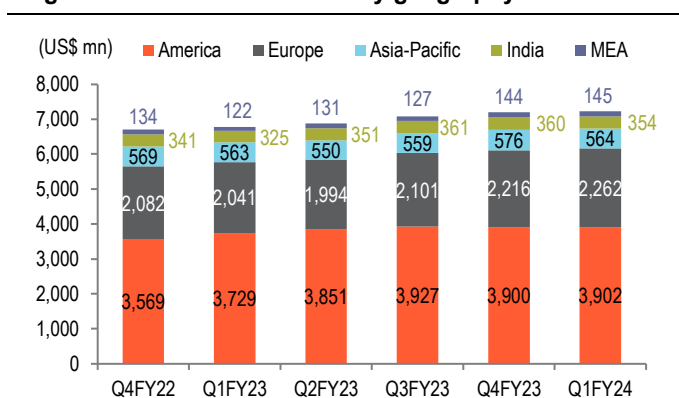
Source: Company, BOBCAPS Research

**Fig 3 – Client category**



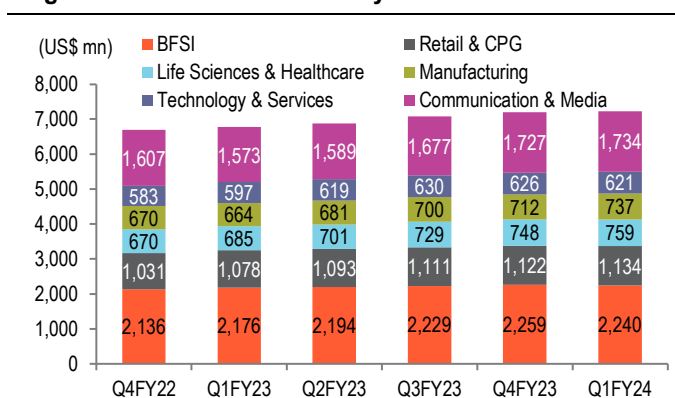
Source: Company, BOBCAPS Research

**Fig 4 – Revenue contribution by geography**



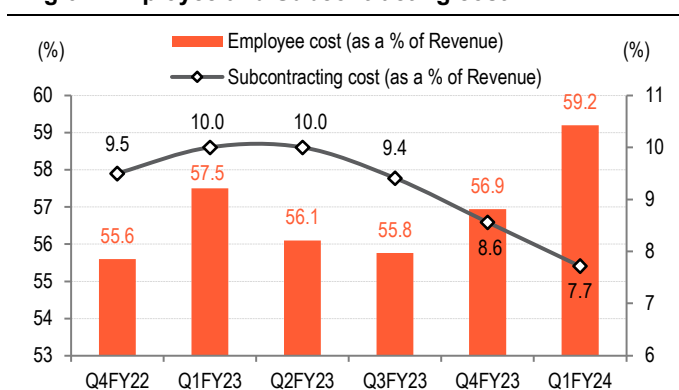
Source: Company, BOBCAPS Research

**Fig 5 – Revenue contribution by vertical**



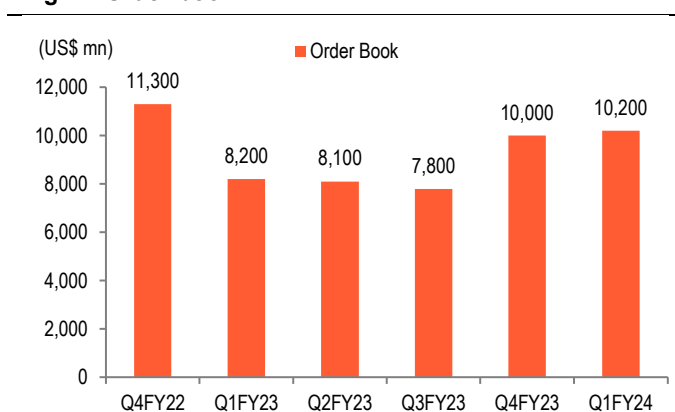
Source: Company, BOBCAPS Research

**Fig 6 – Employee and Subcontracting cost**



Source: BOBCAPS Research, Company

**Fig 7 – Order book**



Source: BOBCAPS Research, Company

## Earnings call highlights

- Per management, clients are taking a month-to-month approach, limiting their future spending visibility.
- Large transformation and business-critical projects are on track, whereas discretionary and low-ROI projects are coming under greater scrutiny. Demand was soft across multiple pockets in Q1FY24 as clients continued to reprioritise projects with higher ROA, creating near-term revenue leakages.
- TCS's deal pipeline remained strong with healthy TCV of US\$ 10.2bn (book-to-bill ratio at 1.4x) in Q1, marked by a balanced mix of vendor consolidation, transformation and integration projects. However, small and medium-size deals in the range of US\$ 50mn-60mn form a major proportion of the pipeline.
- Management mentioned that it was business as usual with large banks while the mortgage and capital market segments were weak. The property & casualty (P&C) insurance segment was also tepid but life insurance was strong.
- Salary hikes with effect from Apr'23 had a 200bps adverse impact on EBIT margin, though lower subcontractor cost and other efficiencies helped the company mitigate some of the pressure.

## Valuation methodology

The stock is trading at 24.8x/22.8x FY24E/FY25E EPS. We believe TCS is well positioned to deliver industry-leading growth and margins in the long run. However, considering the current volatile macro environment, poor quality of deal wins and delays in client decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS for an unchanged TP of Rs 3,580.

## Key risks

- Better-than-expected improvement in the BFSI, retail and hi-tech verticals in developed economies represents an upside risk to our estimates.
- Further reduction in IT-related spends by target clients is a key downside risk.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.3	1,057	1,110	HOLD
Coforge	COFORGE IN	3.5	4,650	4,830	HOLD
eClerx Services	ECLX IN	0.8	1,743	3,790	BUY
HCL Technologies	HCLT IN	36.7	1,111	1,240	HOLD
IndiaMart InterMesh	INMART IN	1.0	2,789	7,660	BUY
Info Edge	INFOE IN	7.0	4,461	6,780	BUY
Infosys	INFO IN	68.2	1,333	1,760	BUY
Just Dial	JUST IN	0.6	778	990	BUY
LTIMindtree	LTI IN	10.3	4,816	8,140	BUY
Mphasis	MPHL IN	4.3	1,904	2,541	BUY
Persistent Systems	PSYS IN	4.6	4,695	5,330	HOLD
Tata Consultancy Services	TCS IN	145.2	3,260	3,580	HOLD
Tech Mahindra	TECHM IN	12.3	1,159	1,130	HOLD
Wipro	WPRO IN	26.2	392	420	HOLD

Source: BOBCAPS Research, NSE | Price as of 12 Jul 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Total revenue</b>	<b>16,41,770</b>	<b>19,17,540</b>	<b>22,23,757</b>	<b>24,76,435</b>	<b>27,26,137</b>
EBITDA	4,65,460	5,30,570	5,82,248	6,66,207	7,37,388
Depreciation	40,650	46,404	50,377	55,894	61,731
EBIT	4,24,810	4,84,530	5,31,871	6,10,313	6,75,658
Net interest inc./(exp.)	0	0	0	0	1
Other inc./(exp.)	24,970	32,340	29,203	39,021	34,471
Exceptional items	0	0	0	0	0
EBT	4,49,780	5,16,870	5,61,074	6,49,333	7,10,128
Income taxes	1,11,980	1,32,380	1,43,430	1,67,342	1,84,633
Extraordinary items	0	0	0	0	1
Min. int./Inc. from assoc.	(1,320)	(1,220)	(1,350)	(1,200)	(1,200)
<b>Reported net profit</b>	<b>3,36,480</b>	<b>3,83,270</b>	<b>4,16,294</b>	<b>4,80,791</b>	<b>5,24,295</b>
Adjustments	0	0	0	0	1
<b>Adjusted net profit</b>	<b>3,36,480</b>	<b>3,83,270</b>	<b>4,16,294</b>	<b>4,80,791</b>	<b>5,24,296</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	3,71,480	4,53,000	5,17,861	5,08,857	5,60,165
Provisions	0	0	0	0	0
Debt funds	65,030	63,680	63,680	63,680	63,680
Other liabilities	0	0	0	0	0
Equity capital	3,700	3,660	3,660	3,660	3,660
Reserves & surplus	0	0	0	0	0
Shareholders' fund	8,71,080	8,98,460	10,15,700	11,46,238	12,69,338
<b>Total liab. and equities</b>	<b>13,07,590</b>	<b>14,15,140</b>	<b>15,97,241</b>	<b>17,18,775</b>	<b>18,93,183</b>
Cash and cash eq.	68,580	1,24,880	1,87,896	2,55,510	3,10,158
Accounts receivables	3,00,790	3,40,740	3,96,011	4,07,085	4,48,132
Inventories	0	0	0	0	0
Other current assets	2,95,170	2,47,870	3,04,624	3,39,238	3,73,443
Investments	3,18,440	3,62,180	3,62,180	3,62,180	3,62,180
Net fixed assets	1,96,690	1,96,150	2,01,367	2,07,384	2,13,807
CWIP	0	0	0	0	0
Intangible assets	22,780	28,880	28,880	28,880	28,880
Deferred tax assets, net	39,310	37,080	37,080	37,080	37,080
Other assets	65,830	77,360	79,202	81,417	1,19,502
<b>Total assets</b>	<b>13,07,590</b>	<b>14,15,140</b>	<b>15,97,241</b>	<b>17,18,775</b>	<b>18,93,183</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Cash flow from operations</b>	<b>3,72,880</b>	<b>5,30,710</b>	<b>3,89,811</b>	<b>4,41,958</b>	<b>4,90,727</b>
Capital expenditures	(38,930)	(29,490)	(55,594)	(61,911)	(68,153)
Change in investments	44,680	(15,220)	(1,00,000)	(1,20,000)	(1,50,000)
Other investing cash flows	24,970	27,000	29,203	39,021	34,471
<b>Cash flow from investing</b>	<b>30,720</b>	<b>(17,710)</b>	<b>(1,26,391)</b>	<b>(1,42,890)</b>	<b>(1,83,683)</b>
Equities issued/Others	(2,59,499)	0	0	0	0
Debt raised/repaid	0	(14,170)	0	0	0
Interest expenses	0	(6,980)	0	0	0
Dividends paid	(1,61,981)	(1,33,170)	(2,00,404)	(2,31,453)	(2,52,396)
Other financing cash flows	0	0	0	0	1
<b>Cash flow from financing</b>	<b>(4,21,480)</b>	<b>(1,54,320)</b>	<b>(2,00,404)</b>	<b>(2,31,453)</b>	<b>(2,52,395)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(17,880)</b>	<b>3,58,680</b>	<b>63,016</b>	<b>67,615</b>	<b>54,650</b>
<b>Closing cash &amp; cash eq.</b>	<b>68,580</b>	<b>1,24,880</b>	<b>1,87,896</b>	<b>2,55,510</b>	<b>3,10,158</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	90.9	103.6	113.8	131.4	143.3
Adjusted EPS	90.9	103.6	113.8	131.4	143.3
Dividend per share	36.4	41.4	45.5	52.6	57.3
Book value per share	235.4	242.8	277.6	313.3	346.9

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	7.2	6.2	5.3	4.8	4.3
EV/EBITDA	25.5	22.5	20.4	17.8	16.0
Adjusted P/E	35.8	31.5	28.7	24.8	22.8
P/BV	13.8	13.4	11.7	10.4	9.4

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	74.8	74.2	74.2	74.0	73.8
Interest burden (PBT/EBIT)	105.9	106.7	105.5	106.4	105.1
EBIT margin (EBIT/Revenue)	25.9	25.3	23.9	24.6	24.8
Asset turnover (Rev./Avg TA)	130.5	140.9	147.6	149.4	151.0
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.6	1.5	1.5
Adjusted ROAE	39.2	43.3	43.5	44.5	43.4

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	4.6	16.8	16.0	11.4	10.1
EBITDA	10.5	14.0	9.7	14.4	10.7
Adjusted EPS	5.5	13.9	9.8	15.5	9.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	28.4	27.7	26.2	26.9	27.0
EBIT margin	25.9	25.3	23.9	24.6	24.8
Adjusted profit margin	20.5	20.0	18.7	19.4	19.2
Adjusted ROAE	39.2	43.3	43.5	44.5	43.4
ROCE	37.6	42.3	45.8	49.1	50.6
<b>Working capital days (days)</b>					
Receivables	67	61	60	59	57
Inventory	0	0	0	0	0
Payables	103	108	108	104	98
<b>Ratios (x)</b>					
Gross asset turnover	8.3	9.8	11.2	12.1	12.9
Current ratio	2.0	1.7	1.9	2.1	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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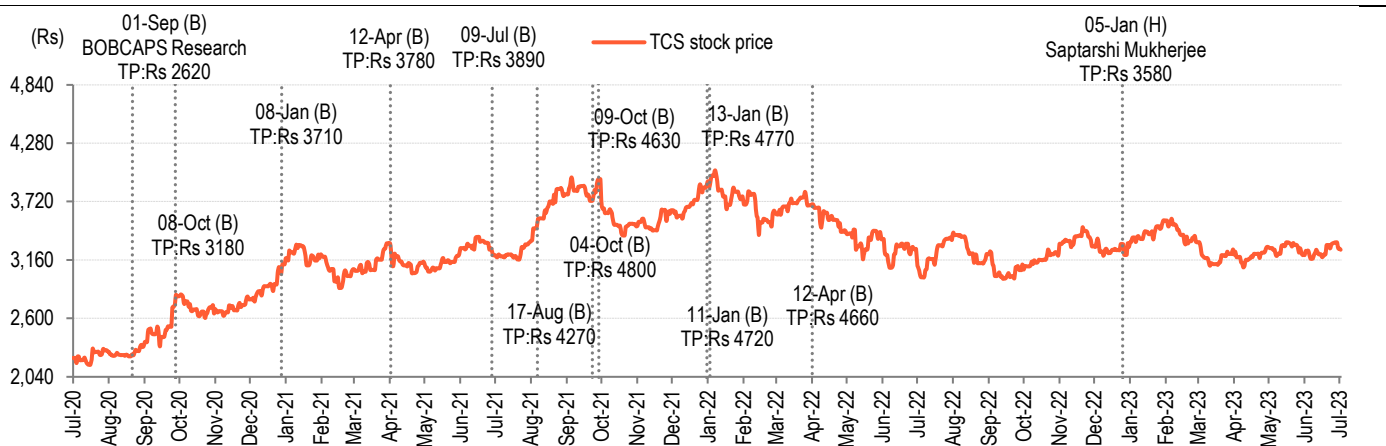
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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### Ratings and Target Price (3-year history): TATA CONSULTANCY SERVICES (TCS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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