

HOLD
 TP: Rs 4,120 | ▲ 6%

TATA CONSULTANCY SERVICES

Technology & Internet

16 April 2024

Strong deal flow but near-term softness to continue

- TCS gained market share through vendor consolidation/cost optimisation programmes
- Operating margin was strong on a 26% QoQ basis; order book stood at all-time high of US\$ 13.2bn
- Maintain HOLD with a new TP of Rs 4,120 as the discretionary demand climate remains volatile

Saptarshi Mukherjee
 research@bobcaps.in

Emerging market to drive FY25 topline: TCS posted a topline of US\$ 7,363mn, up 1.1% YoY CC, driven by regional markets. The deal with BSNL will likely play a crucial role in driving TCS’s FY25 revenue growth as 80% of the BSNL network of 4G/5G rollout is yet to be completed. TCS’s deal market share comes from several vendor consolidation programmes, mostly due to cost optimisation backed by IaaS. While Accenture has clearly mentioned the impact on its consulting portfolio business, TCS has bagged a large share of new/shorter deal bookings.

Robust deal TCV in Q4FY24: According to TCS, it booked its highest-ever deals in one quarter – US\$ 13.2bn (absolute and book-to-bill terms) – due to solid traction in SAP S/4 HANA, Salesforce, ServiceNow and Oracle cloud platforms. The large delta in FY24 bookings came from Aviva, BSNL (US\$ 1bn+ TCV, Q2) and JLR (US\$ 1bn+ TCV, Q2). TCS witnessed its second highest-ever deal bookings for North America after eight quarters. Europe stayed strong on the back of successful acquisitions in UK/Continental Europe and bagged many deals like Enento Group, Akzo Nobel, Aviva, etc.

Strong execution beats the Street’s estimate: Operating margin expanded by ~100bps on a 190bps improvement from lower subcon cost, improved productivity and better utilisation which was partially offset by 90bps of higher third-party cost and travel expenses. Despite the drop in headcount and lower fresher intake in FY24, the company focused on higher training/higher learning hours which will help recalibrate the employee pyramid.

Maintain HOLD: TCS emphasised its cost optimisation agenda was serving it well compared to its peers with higher consulting exposure in their services portfolios. TCS expects Q4FY24 deal TCVs along with BSNL to drive its growth momentum in FY25. We believe better FCF yield, strong deal wins and better execution will lead to better revenue visibility and demand valuation premium over Tier-I IT companies. TCS is trading at 27.6x/25.4x FY25E/FY26E EPS. We retain our HOLD rating and continue to value the stock at 27x FY26E EPS (in line with its five-year average), for a new TP of Rs 4,120 (old TP of Rs 4,050).

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	TCS IN/Rs 3,873
Market cap	US\$ 170.6bn
Free float	28%
3M ADV	US\$ 122.8mn
52wk high/low	Rs 4,255/Rs 3,070
Promoter/FPI/DII	72%/17%/11%

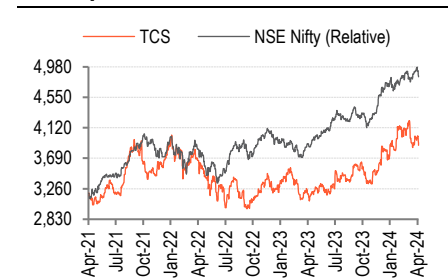
Source: NSE | Price as of 16 Apr 2024

Key financials

Y/E 31 Mar	FY24P	FY25E	FY26E
Total revenue (Rs mn)	24,08,930	25,84,597	28,14,642
EBITDA (Rs mn)	6,53,070	6,99,107	7,61,331
Adj. net profit (Rs mn)	4,72,940	5,08,236	5,52,509
Adj. EPS (Rs)	129.3	140.4	152.6
Consensus EPS (Rs)	129.3	138.1	147.5
Adj. ROAE (%)	51.8	50.1	45.1
Adj. P/E (x)	30.0	27.6	25.4
EV/EBITDA (x)	21.5	20.1	18.4
Adj. EPS growth (%)	9.0	8.6	8.7

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

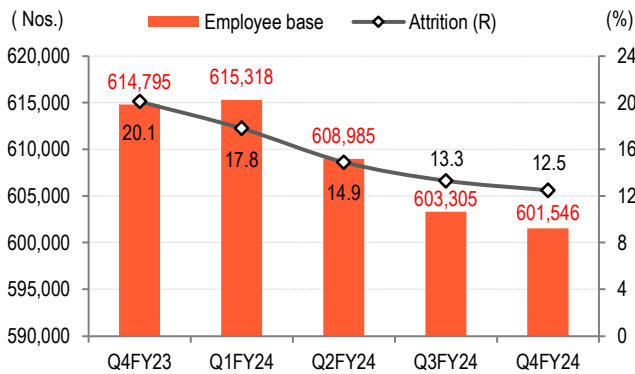


Fig 1 – Quarterly performance

(Rs mn)	Q4FY24	Q3FY23	Q4FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	7,363	7,281	7,195	1.1	2.3	7,395	(0.4)
INR Revenue	612,370	605,830	591,620	1.1	3.5	613,785	(0.2)
EBIT	159,180	151,550	144,880	5.0	9.9	154,674	2.9
PAT	122,400	117,350	113,920	4.3	7.4	121,223	1.0
EBIT Margin (%)	26.0	25.0	24.5	98bps	151bps	25.2	79bps
PAT Margin (%)	20.0	19.4	19.3	62bps	73bps	19.8	24bps

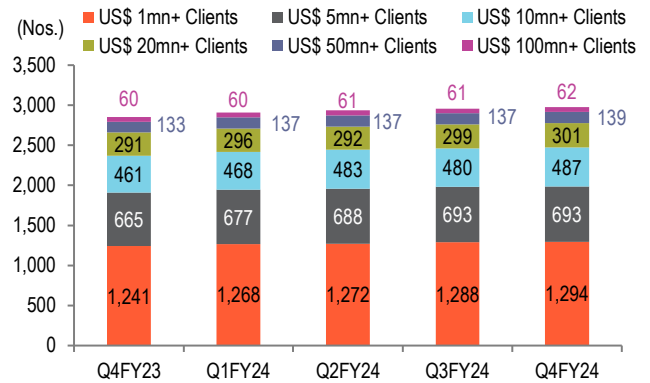
Source: Company, BOBCAPS Research

Fig 2 – Employee base & Attrition



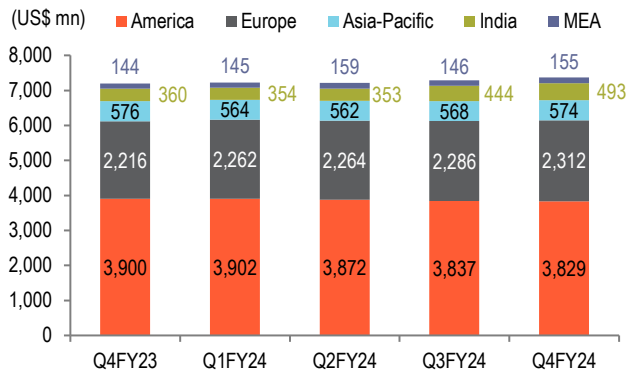
Source: Company, BOBCAPS Research

Fig 3 – Client contribution



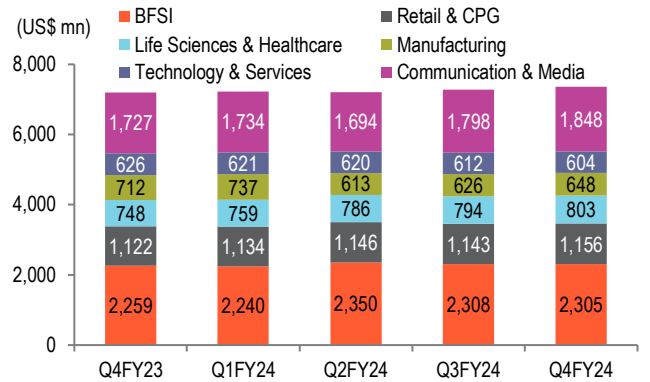
Source: Company, BOBCAPS Research

Fig 4 – Revenue contribution by geography



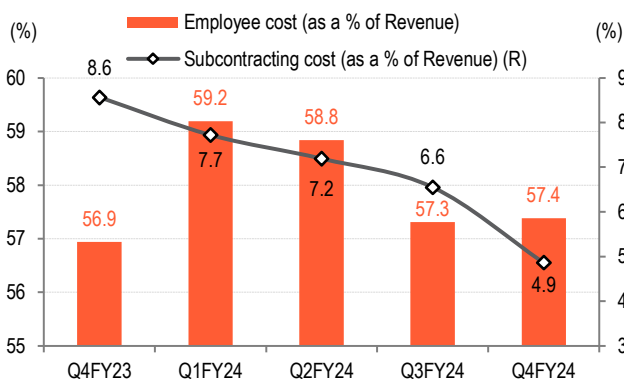
Source: Company, BOBCAPS Research

Fig 5 – Revenue contribution by vertical



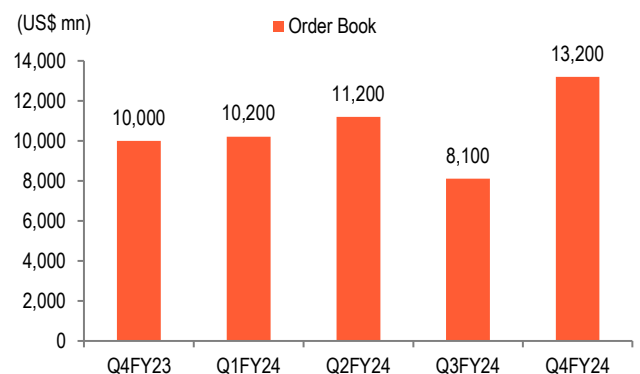
Source: Company, BOBCAPS Research

Fig 6 – Employee cost and Subcontracting cost



Source: Company, BOBCAPS Research

Fig 7 – Order book



Source: Company, BOBCAPS Research

Q4FY24 earnings call highlights

- Despite third-party and travel expenses for Q4FY24, operating margin expanded due to reduced subcontractor costs, improved productivity and better utilisation. TCS's focus continues to be on operational rigor which are already in place.
- Operating margin growth was led by regional markets (up 26% YoY CC). Manufacturing (+9.7% YoY CC), EN&U (+7.3% YoY CC) and Life science/healthcare (+1.7% YoY CC) were the key revenue drivers in Q4.
- Among major markets, the United Kingdom drove growth and was up by 6.2% YoY CC, whereas Continental Europe declined by 2.2% and North America by 2.3%.
- Product portfolio and platforms saw good traction during the quarter. Ignio, a cognitive automation software suite, saw 32 new deal wins and six go-lives. TCS BaNCS, TCS's flagship product specializing in financial services, had eight new wins and seven go-lives during the quarter.
- According to the company, attrition in IT services trended down through the year and company is trying to reach its comfort level ranging from 11% and 13%
- The TCV in Q4 was at a record high of US\$ 13.2bn as each geos/verticals had higher TCV as the clients focus on cost optimisation/ transformational deal wins which includes one mega deal during the quarter. The BFSI TCV was US\$ 4.1bn, and US\$ 1.6bn for the Consumer business. The TCV of deals signed in North America for Q4FY24 stood at US\$ 5.7bn.
- Subcontracting costs has bottomed out as business associate/demand-supply mismatch/macros have already played out – management also believes subcontracting costs will start inching up from this point.
- The company has not changed the plan to hire 40k freshers each year. At this moment, the company is focusing more on recalibrating the employee pyramid. Management has mentioned that the wage hike is likely to range from 4.5% to 7% and top performers will get double-digit wage hikes effective from 1 Apr 2024.
- Due to continuous pressure on discretionary spending, companies are focusing on cost-saving programmes and vendor consolidation, which seems to be a short-term strategy for the IT companies in our coverage universe.
- TCS won >200 engagements in Artificial Intelligence (AI) in FY24; its AI/GenAI (General AI) pipeline has doubled in one year and stands at US\$ 900mn currently.
- The company has proposed a final dividend for FY24 of Rs 28 per share.

Valuation methodology

TCS emphasised its cost optimisation agenda was serving it well compared to its peers with higher consulting exposure in their services portfolios. TCS expects Q4FY24 deal TCVs along with BSNL will drive its growth momentum in FY25. We believe better FCF yield, strong deal wins and better execution will lead to better revenue visibility and demand valuation premium over Tier-I IT companies. TCS is trading at 27.6x/25.4x FY25E/FY26E EPS. We retain our HOLD rating and continue to value the stock at 27x FY26E EPS (in line with its five-year average), for a new TP of Rs 4,120 (old TP of Rs 4,050).

Fig 8 – Revised estimates

	New		Old		Change (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Revenue (US\$ mn)	31,047	33,911	31,335	34,366	(0.9)	(1.3)
Revenue (Rs mn)	2,584,897	2,814,642	2,608,622	2,852,387	(0.9)	(1.3)
EBIT (Rs mn)	647,896	709,537	645,276	711,837	0.4	(0.3)
Margin (%)	25.1	25.2	24.7	24.9	40bps	30bps
EPS (Rs)	140.4	152.6	136.9	150.2	2.6	1.6

Source: BOBCAPS Research

Key Risks

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

Glossary

Glossary of Abbreviations			
AI	Artificial Intelligence	IaaS	Infrastructure as a service
BFSI	Banking, financial services and insurance	IT	Information technology
CC	Constant currency	JLR	Jaguar Land Rover
EN&U	Energy & Utilities	Subcon	Subcontractors
FCF	Free cash flow	TCV	Total contract value

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Total revenue	19,17,540	22,54,580	24,08,930	25,84,597	28,14,642
EBITDA	5,30,570	5,99,740	6,53,070	6,99,107	7,61,331
Depreciation	46,040	50,070	50,260	51,212	51,794
EBIT	4,84,530	5,49,670	6,02,810	6,47,896	7,09,537
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	32,340	19,400	26,740	31,884	29,669
Exceptional items	0	0	0	0	0
EBT	5,16,870	5,69,070	6,29,550	6,79,780	7,39,207
Income taxes	1,32,380	1,46,040	1,58,980	1,73,344	1,88,498
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(1,220)	10,700	2,370	1,800	1,800
Reported net profit	3,83,270	4,33,730	4,72,940	5,08,236	5,52,509
Adjustments	0	0	0	0	0
Adjusted net profit	3,83,270	4,33,730	4,72,940	5,08,236	5,52,509

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Accounts payables	0	0	0	0	0
Other current liabilities	4,23,510	4,35,580	4,61,040	5,31,082	5,78,351
Provisions	0	0	0	0	0
Debt funds	93,170	88,870	90,260	90,260	90,260
Other liabilities	0	0	0	0	0
Equity capital	3,660	3,660	3,620	3,620	3,620
Reserves & surplus	0	0	0	0	0
Shareholders' fund	8,98,460	9,12,060	9,13,190	11,14,684	13,33,888
Total liab. and equities	14,15,140	14,36,510	14,64,490	17,36,026	20,02,499
Cash and cash eq.	1,24,880	71,230	90,160	1,50,841	1,91,069
Accounts receivables	3,40,740	4,10,490	4,44,340	5,31,082	5,78,351
Inventories	0	0	0	0	0
Other current assets	2,47,870	2,04,460	2,32,530	2,54,919	2,77,609
Investments	3,62,180	4,10,720	3,60,320	4,60,320	6,10,320
Net fixed assets	1,96,150	1,90,240	1,88,260	1,82,279	1,79,741
CWIP	0	0	0	0	0
Intangible assets	28,880	27,250	23,420	23,420	23,420
Deferred tax assets, net	37,080	33,070	34,030	34,030	34,030
Other assets	77,360	89,050	91,430	99,135	1,07,959
Total assets	14,15,140	14,36,510	14,64,490	17,36,026	20,02,499

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24P	FY25E	FY26E
Cash flow from operations	3,99,490	4,19,650	4,43,380	4,80,769	5,43,120
Capital expenditures	(29,490)	(28,500)	(26,270)	(45,230)	(49,256)
Change in investments	(15,220)	(70,580)	61,930	(1,00,000)	(1,50,000)
Other investing cash flows	35,740	99,470	24,600	31,884	29,669
Cash flow from investing	(8,970)	390	60,260	(1,13,346)	(1,69,587)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(1,95,080)	(56,890)	(2,26,190)	(1,800)	(1,800)
Interest expenses	(6,980)	(7,790)	(6,990)	0	0
Dividends paid	(1,33,750)	(4,14,100)	(2,52,180)	(3,04,942)	(3,31,505)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(3,35,810)	(4,78,780)	(4,85,360)	(3,06,742)	(3,33,305)
Chg in cash & cash eq.	54,710	(58,740)	18,280	60,681	40,228
Closing cash & cash eq.	1,24,880	71,230	90,160	1,50,841	1,91,069

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24P	FY25E	FY26E
Reported EPS	103.6	118.5	129.3	140.4	152.6
Adjusted EPS	103.6	118.5	129.3	140.4	152.6
Dividend per share	41.4	47.4	51.7	83.3	90.6
Book value per share	242.8	249.3	249.6	304.6	364.5

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24P	FY25E	FY26E
EV/Sales	7.3	6.2	5.8	5.4	5.0
EV/EBITDA	26.2	23.3	21.5	20.1	18.4
Adjusted P/E	37.4	32.7	30.0	27.6	25.4
P/BV	15.9	15.5	15.5	12.7	10.6

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24P	FY25E	FY26E
Tax burden (Net profit/PBT)	74.2	76.2	75.1	74.8	74.7
Interest burden (PBT/EBIT)	106.7	103.5	104.4	104.9	104.2
EBIT margin (EBIT/Revenue)	25.3	24.4	25.0	25.1	25.2
Asset turnover (Rev./Avg TA)	140.9	158.1	166.1	161.5	150.6
Leverage (Avg TA/Avg Equity)	1.5	1.6	1.6	1.6	1.5
Adjusted ROAE	43.3	47.9	51.8	50.1	45.1

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24P	FY25E	FY26E
YoY growth (%)					
Revenue	16.8	17.6	6.8	7.3	8.9
EBITDA	14.0	13.0	8.9	7.0	8.9
Adjusted EPS	13.9	14.4	9.0	8.6	8.7

Profitability & Return ratios (%)

EBITDA margin	27.7	26.6	27.1	27.0	27.0
EBIT margin	25.3	24.4	25.0	25.1	25.2
Adjusted profit margin	20.0	19.2	19.6	19.7	19.6
Adjusted ROAE	43.3	47.9	51.8	50.1	45.1
ROCE	41.6	45.5	48.9	49.1	46.2

Working capital days (days)

Receivables	61	61	65	69	72
Inventory	0	0	0	0	0
Payables	105	95	93	96	99

Ratios (x)

Gross asset turnover	9.8	11.7	12.7	14.0	15.5
Current ratio	1.9	1.8	1.9	2.0	2.0
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	0.0	(0.1)	(0.1)

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

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

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BUY – Expected return >+15%

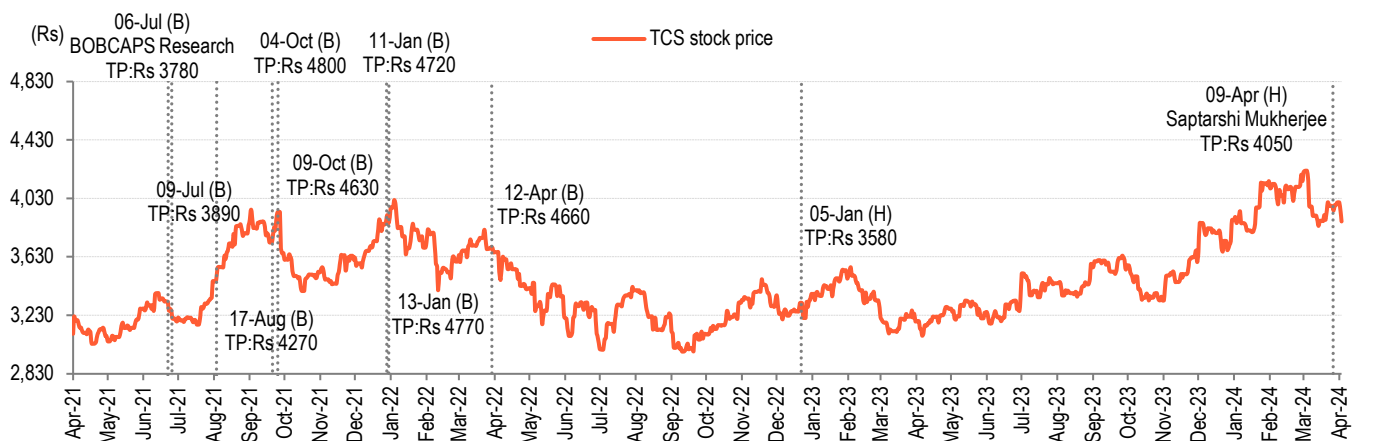
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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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