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FIRST LIGHT

14 July 2023

RESEARCH

TATA CONSULTANCY SERVICES | TARGET: Rs 3,580 | +10% | HOLD

Strong deal flow but near-term softness to continue

HCL TECHNOLOGIES | TARGET: Rs 1,240 | +12% | HOLD

Weak Q1 but full-year guidance retained – a tall order

CONSUMER STAPLES

Volume-led growth; margin expansion to continue

SUMMARY

TATA CONSULTANCY SERVICES

- 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

Click here for the full report.

HCL TECHNOLOGIES

- Q1 revenue missed estimates largely due to a slowdown in ER&D services and the telecom & media vertical
- Full-year guidance remains intact but implied 2.8-4% CQGR ask rate looks optimistic in an uncertain macro environment
- Upside capped post recent stock runup; maintain HOLD and TP of Rs 1,240, set at 18.7x FY25E EPS

Click here for the full report.

Daily macro indicators

Ticker	11-Jul	12-Jul	Chg (%)
US 10Y yield (%)	3.97	3.86	(11bps)
India 10Y yield (%)	7.09	7.12	2bps
USD/INR	82.37	82.25	0.1
Brent Crude (US$/bbl)	79.4	80.1	0.9
Dow	34,261	34,347	0.3
Hang Seng	18,660	18,861	1.1
Sensex	65,618	65,394	(0.3)
India FII (US$ mn)	**10-Jul**	**11-Jul**	**Chg ($ mn)**
FII-D	(118.0)	39.1	157.1
FII-E	128.2	178.4	50.2

Source: Bank of Baroda Economics Research

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CONSUMER STAPLES

- Demand environment held steady in Q1; divergence between pricing and volumes has narrowed
- Rural recovery continues, albeit at a slow pace; margin expansion should support double-digit earnings growth
- We expect volume-led growth and margin accretion in FY24; prefer BRIT, NEST, ITC, DABUR and TCPL

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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**
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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*APOS*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 *ENDASH**ENDASH* 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%

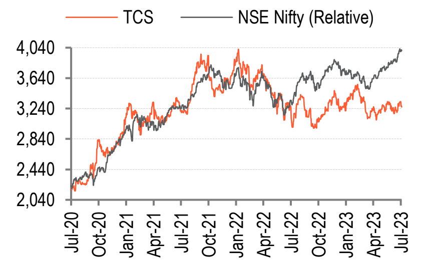
Source: NSE | Price as of 12 Jul 2023

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

RESULT REVIEW

HOLD

TP: Rs 1,240 | ⮝ 12%

HCL TECHNOLOGIES | Technology & Internet | 13 July 2023

Weak Q1 but full-year guidance retained – a tall order

- **Q1 revenue missed estimates largely due to a slowdown in ER&D services and the telecom & media vertical**
- **Full-year guidance remains intact but implied 2.8-4% CQGR ask rate looks optimistic in an uncertain macro environment**
- **Upside capped post recent stock runup; maintain HOLD and TP of Rs 1,240, set at 18.7x FY25E EPS**

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Weak performance: HCLT posted Q1FY24 revenue of US$ 3.2bn (-1.3% QoQ CC, +6.3% YoY CC) vs. US$ 3.3bn estimated as IT and business services (ITBS: 75% of revenue) declined 0.1% QoQ CC, engineering and R&D (ER&D) services fell 5.2% and software business was down 3.1%. Services revenue (ITBS + ER&D) dipped 1% QoQ CC owing to a sharp decline in the technology (-7.8%) and telecom (-14.4%) verticals. Among the other verticals, financial services grew 5.1% QoQ CC, manufacturing was up 3.6%, and retail & consumer packaged goods (CPG) was largely flat. Lifesciences and healthcare fell 1.3% QoQ CC.

Dichotomy between net new deal TCV and order pipeline: Net new deal TCV stood at US$ 1.6bn in Q1FY24 as compared to a quarterly average of US$ 2.2bn in FY23. In contrast, the deal pipeline continues to grow, rising 18% QoQ and 26% YoY. HCLT signed 18 large deals in Q1, 7 in services (vs. 10 the previous quarter) and 11 in software. Net new deal value has contracted due to a slowdown in the telecom and technology verticals and in the Europe and RoW geographies. Average contract value has also shrunk 21% YoY in Q1 and while management expects to close a few large deals over the next 45 days, this hardly inspires confidence.

Operating margin disappoints but FY24 guidance retained: EBIT margin declined 120bps QoQ to 17% (17.9% est.), impacted by a margin drop in ER&D whereas the software segment was stable. Nevertheless, the company maintained its margin guidance for FY24 at 18-19%, factoring in a sequential drop in revenue and lower utilisation. Revenue growth guidance for the year was maintained at 6-8% CC (including services revenue at 6.5-8.5% CC). This implies a 2.8-4% CQGR which we find rather optimistic against the backdrop of an uncertain macro climate.

Maintain HOLD: HCLT is trading at 18.5x/16.8x FY24E/FY25E EPS. Despite muted first-quarter results, management has stuck to its full-year guidance, which looks difficult to achieve at this stage. Following the recent run-up in stock price, upside potential also looks capped. We maintain HOLD and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	HCLT IN/Rs 1,109
Market cap	US$ 36.6bn
Free float	38%
3M ADV	US$ 33.4mn
52wk high/low	Rs 1,203/Rs 877
Promoter/FPI/DII	61%/17%/22%

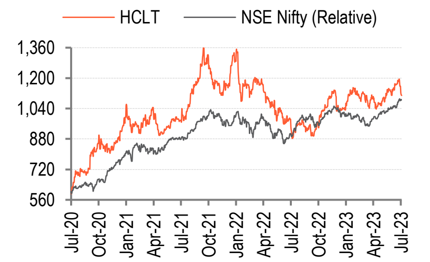
Source: NSE | Price as of 13 Jul 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	10,14,355	11,31,246	12,36,314
EBITDA (Rs mn)	2,24,451	2,59,888	2,82,793
Adj. net profit (Rs mn)	1,41,181	1,62,773	1,79,498
Adj. EPS (Rs)	52.0	60.0	66.1
Consensus EPS (Rs)	52.0	63.5	64.5
Adj. ROAE (%)	21.7	22.3	21.9
Adj. P/E (x)	21.3	18.5	16.8
EV/EBITDA (x)	13.3	11.4	10.4
Adj. EPS growth (%)	4.6	15.3	10.3

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

Stock performance



Source: NSE

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CONSUMER STAPLES | Q1FY24 Preview | 13 July 2023

Volume-led growth; margin expansion to continue

- **Demand environment held steady in Q1; divergence between pricing and volumes has narrowed**
- **Rural recovery continues, albeit at a slow pace; margin expansion should support double-digit earnings growth**
- **We expect volume-led growth and margin accretion in FY24; prefer BRIT, NEST, ITC, DABUR and TCPL**

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Growth visibility improves with volume recovery: The demand environment held steady during Q1FY24 and most consumer companies saw volume recovery. Early commentary from key players, including DABUR, GCPL and AWL, indicates a heathy performance with volumes ticking up in urban as well as rural markets. We expect consumer staples players to deliver near-double-digit topline growth as the divergence between price and volumes has narrowed during the quarter. Volume growth is likely to be in the mid-single digits.

Rural markets continue to pick up with lower inflation: Rural markets witnessed budding signs of recovery during Q4FY23 and the momentum continued during Q1FY24, though the pace of growth remains slow. The softness in rural markets appears to be bottoming out, but progress of the monsoon and its impact on agricultural output remains a key monitorable. Our rural channel checks suggest sustained growth traction in staples and food products along with volume revival in the soap, detergent, and dental portfolios. Urban centres remain steady and continue to grow ahead of rural markets.

Lower input cost to aid margin expansion: Gross margins for most consumer companies are likely to improve meaningfully YoY due to price correction in key commodities during the quarter. The benefits of gross margins will not fully reflect at the operating level as most companies have stepped up their advertisement and promotion spend to bolster volumes.

Sector outlook remains positive: We expect consumer companies to register strong growth in the April-June quarter backed by higher volumes amid a steady demand environment. Innovation and premiumisation will continue to fuel growth in the near-to-medium term. Margins are forecast to improve YoY, likely resulting in double-digit earnings growth for staples players. We prefer BRIT (TP Rs 5,844, BUY), NEST (TP Rs 26,430, BUY), ITC (TP Rs 523, BUY), DABUR (TP Rs 669, BUY) and TCPL (TP Rs 994, BUY).

Recommendation snapshot

Ticker	Price	Target	Rating
BRIT IN	5,074	5,844	BUY
DABUR IN	583	669	BUY
GCPL IN	1,068	1,159	BUY
HUVR IN	2,674	3,069	BUY
ITC IN	472	523	BUY
MRCO IN	538	629	BUY
NEST IN	23,060	26,430	BUY
TATACONS IN	843	994	BUY
ZYWL IN	1,471	1,631	HOLD

Price & Target in Rupees | Price as of 12 Jul 2023
TATACONS = TCPL

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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

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