

**NOT RATED****TATA CONSULTANCY SERVICES**

| IT Services

| 12 July 2024

**Modest growth improvement in FY25 over FY24 likely**

- Results were better than expected, more so on margins. Broad-based growth seen. However, international growth was much weaker
- While TCS reiterated that FY25 growth is going to be better, it refused to say that the quarter's momentum would sustain on customer behaviour
- A mid-single digit EPS upgrade for FY25 is likely because of a margin upgrade. Will be initiating coverage on the sector and TCS shortly

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**Client behavior has not seen change:** TCS refuses to say that a sustained uptick is on the cards, though it insists that FY25 is going to be a better year. A mid-single digit EPS upgrade is likely for FY25 largely due to better margins. TCS is uncertain whether the 2.2% CC QoQ growth (better than our estimate of 1.5%) seen in 1QFY25 will sustain. This is due to clients who take decisions at short notice based on the evolving macro environment. Even in 1QFY25 TCS saw clients ramping down programmes or re-evaluating programmes at very short notice where the ROI did not meet expectations. It stated that customer sentiment remains like what it was in past quarters.

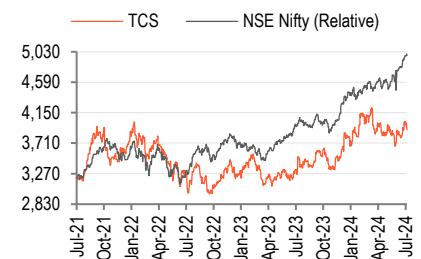
**Growth in line with company expectations:** The 2.2% growth number was in line with internal expectations at the beginning of the quarter. The lack of confidence in growth probably also stems from the fact that international business (ex India) revenue growth in USD terms on a QoQ basis fell to 1%. India growth we believe was largely driven by the BSNL order. While BFSI in North America has picked up, TCS refused to conclusively state that a bottom had been reached. Growth in the quarter was quite broad-based with only the communications and media sector not participating.

**EBIT margin jumps:** The biggest surprise was on the EBIT margin front where it came in at 24.7% (our estimate 24%), despite taking a hit of 170bps due to a compensation increase (QoQ) and higher pass-through costs QoQ (~90bps, again likely due to the BSNL order). The compensation hit was partly offset by better productivity and higher utilisation. Productivity could mean higher offshoring, span of control, and higher automation (including probable use of Gen AI).

**Ambitious exit rate of margin unlikely:** The CFO alluded to the 100bps/quarter clawback in FY24 from 1Q to 4Q and hinted at a similar trajectory in FY25. We think that may be ambitious in the context of the levers of Subcontracting being completely used up and utilisation being higher than it was in previous quarters. The bulk of the improvement will have to be driven by pyramid and higher automation. Consensus EBIT margin of 25.3% (BBG consensus) will likely move up.

Ticker/Price	TCS IN/Rs 3,902
Market cap	US\$ 172.2bn
Free float	28%
3M ADV	US\$ 112.0mn
52wk high/low	Rs 4,255/Rs 3,250
Promoter/FPI/DII	72%/17%/11%

Source: NSE | Price as of 11 Jul 2024

**Stock performance**

Source: NSE



We are not sure the TCS margin expansion trajectory can be repeated by its peers in the market so one should not extrapolate this performance to other companies.

The total contract value (TCV) was lower by 37% QoQ/18% YoY, but management said one should not read too much into it as deals got pushed out by customers by a few months. It indicated that the order pipeline is at its best levels.

The better-than-expected numbers could induce an EPS upgrade for TCS for FY25 by up to mid-single digits. We think the upgrade will be driven more by an upgrade on margins more than on revenue.

Pricing at the portfolio level was indicated to be stable.

Gen AI projects are picking up and now are at a US\$1.5bn pipeline. However, TCS did not get into any discussion around order inflow and revenue on the Gen AI side compared to Accenture (which put out those numbers). It also stated that Gen AI is not coming in the way of growth.

We are in the process of re-initiating coverage on the Indian IT Services sector. We have currently no rating on TCS.

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