

NOT RATED**TATA CONSULTANCY SERVICES**

| IT Services

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BSNL margin pain pops up

- 1.1% CC QoQ revenue growth was in line. Margin pain of BSNL order, not visible thus far, showed up
- Lack of mega deals has meant a 20% drop in TCV in 1HFY25. Pressure builds in 2H for TCV to support consensus revenue estimate for FY26
- Client-specific rescoping impacted international revenue growth. This has lasted for longer than expected. Re-initiating coverage soon

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BSNL order props up growth again despite international softness: Against the backdrop of client-specific issues in healthcare and life sciences in North America and in the UK, peak revenue has been hit in its BSNL order which helped deliver growth in 2QFY25.

Margin hit due to third-party items. Trajectory different from the one guided for three months ago: The margin pain from the BSNL order which was not visible thus far to everyone's surprise (for three quarters now) has suddenly popped up. But the hit of ~420bps in YoY terms has been softened by the dramatic decline in Subcontractor (~250bps) and SGA costs (~170bps). The margin trajectory is quite different from the one guided three months back.

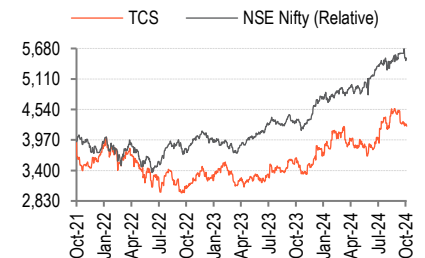
TCV addition must perk up in 2H: 1HFY25 TCV was down ~20% YoY. TCS indicated that the base had a few mega deals which were absent in 1HFY25. With the BSNL deal coming to an end in FY25 (unless there is a follow-on deal immediately) current consensus expectations on growth for FY26 requires a strong 2H on the TCV front. Not sure whether the lack of mega deals is an industry problem or a TCS specific one. TCS also talked about elongation of deal closure timelines. Maybe this is 'wait and watch' in the evolving political situation in the US.

Multiple quarters of compression of book of business: TCS has seen significant revenue leakage for multiple quarters now with instances of clients ramping down or rescoping continuing to impact international revenue growth. That probably explains the cautious commentary of management three months ago when TCS seemingly delivered a decent 1QFY25. TCS is holding out hope that after a weakish 3Q due to normal furloughs, revenue growth should pick up in 4Q.

Hoping for better discretionary spend and capex by customers: TCS was of the view that with inflation moving down globally, and the first fed fund rate cut done, it expects discretionary spend and capital investments to make a comeback driving growth. However currently the demand situation on growth remains very much like what it was in the last few quarters with a big focus on cost take out.

Ticker/Price	TCS IN/Rs 4,227
Market cap	US\$ 182.2bn
Free float	28%
3M ADV	US\$ 129.3mn
52wk high/low	Rs 4,592/Rs 3,311
Promoter/FPI/DII	72%/12%/11%

Source: NSE | Price as of 10 Oct 2024

Stock performance

Source: NSE



Other key points

Cross currency tailwind and BSNL helped.

- Revenue grew 1.1% in constant currency (CC) QoQ terms in line with our estimate. However cross currency tailwind at 110bps was higher than our estimate of 70bps.
- In terms of revenue, just as in 1QFY25, a very large part of growth in 2Q has come from the BSNL order with very weak contribution from international.
- TCS says that the BSNL order execution hit a peak in 2Q and will remain at this level for one more quarter before it ends in 4QFY25 after which it will go into maintenance mode.
- What is less certain is if the margins which were a big negative surprise in 2QFY25 will continue in 3QFY25 and then improve dramatically in 4Q once the BSNL order winds down.

Margin hit

- The biggest surprise in 2QFY25 was on margins where instead of rising on a QoQ basis – as was indicated post 1Q – it fell 60bps QoQ to 24.1%. This was largely because of higher third-party items which hit QoQ by 60bps. This has to do with the BSNL order that it has been executing. Investment in talent and infrastructure hit margins by another 70bps. Not sure what that means – could include costs associated with lateral hires or higher talent retention costs as attrition seems to have picked up a bit QoQ. Currency tailwind helped set off 70bps of the margin pain.
- TCS had indicated a smoother and upwardly trending margin trajectory post 1QFY25. It had talked about mimicking the trajectory of FY24 (which saw ~100bps increase for each of the last three quarters). TCS is now indicating that it hopes to exit FY25 at the same margin level as in FY24 – at 26% – as the BSNL order would wind down and third-party items in its cost structure fall with other lowered costs not flaring up.

Demand outlook

- The demand outlook remains cautious as seen in the last few quarters.
- Key business themes seen across industries were cost optimization, vendor consolidation, customer experience transformation, supply chain modernization, risk and resiliency.
- Globally, clients continue to prioritize efficiency through cost transformation programmes and demand for discretionary deals is low.
- BFSI institutions in the US are looking at sustaining growth momentum with the Fed's first rate cut.
- The gradual easing of inflation in the major markets and expectations of a good holiday season make TCS optimistic around the prospect of improved discretionary spend and capital investments by its customers in the not-too-distant future.

- Barring instances which are client specific, the environment has been quite like that of previous quarters.
- 3Q is expected to be a seasonally weak quarter, but in 4Q TCS believes that demand pressures should ease.
- The company said that the pipeline remains strong, and it sees large transformational deals in the BFSI sector.
- Retail sector – Customers are taking a cautious approach due to the macroeconomic and geopolitical situation.
 - Consumer spending during the coming holiday season will play a crucial role in determining budgets towards transformation initiatives. Retailers are likely to wait and watch for these parameters and factor these into their planning for the next fiscal.
 - Supply chain transformation continues to be a key priority, attracting investments from customers in addition to customer experience.
- Manufacturing – The company is seeing some pressure in the near term. Labor and supply-side constraints are impacting the industry. However, barring these areas of concern, manufacturing continues to see a strong demand environment.
- The tech, software, and services vertical saw sequential growth for the second consecutive quarter. Cost and efficiency remain the top priorities.
- Telecom and media firms are keeping a focus on bottom-line impact – doing more with less.
- Service lines – This quarter was driven by cybersecurity, AI Cloud, and TCS Interactive.
- TCS sees good growth in legacy modernization, data platform modernization, and technology landscape simplification.
- **On AI and generative-AI**
 - Companies have moved past the point of experimentation through proof-of-concept and are increasingly viewing AI and generative-AI as strategic, while integrating them into the entire value chain.
 - No specific numbers on order inflow, revenue and pipeline were discussed unlike that by Accenture in its recent results.
- **Long-term strategy on growth markets**
 - TCS is investing significantly to create a large footprint in emerging growth markets. These include India, APAC, Latin America, and Middle East and Africa.
 - The company believes these markets are likely to turn into a sustainable driver of long-term growth. A scalable presence in these markets is likely to provide the muscle for growth in TCS's overall business over the next couple of decades.

▪ **Outlook on verticals**

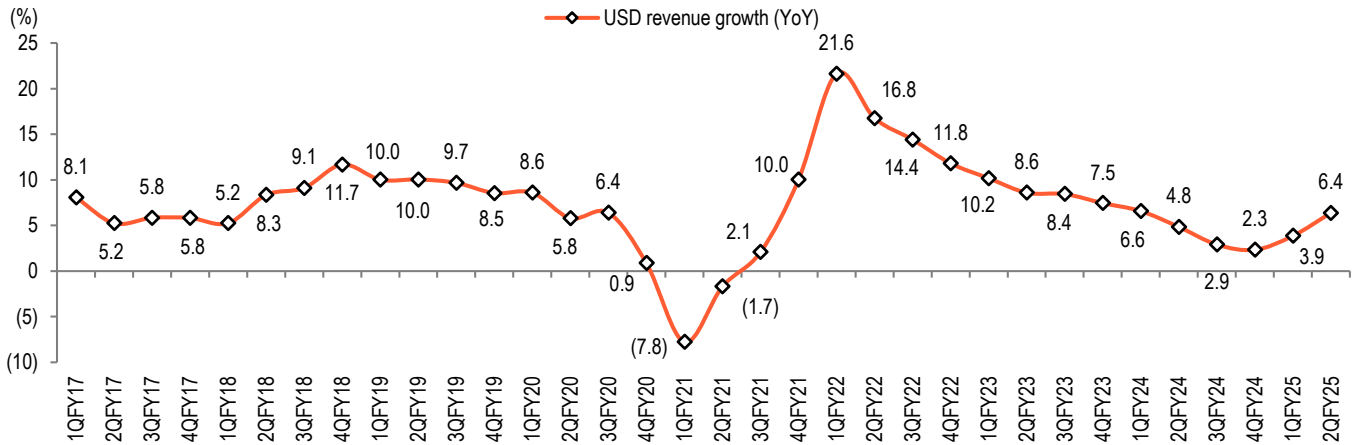
- Both North America and Europe, especially the UK, TCS sees good growth in banking.
- Capital markets have been weak. Insurance, regulations and risk and compliance have grown in banking.
- Europe is seeing a very similar trend.
- UK, capital markets has been a problem. The UK is probably a more customer-specific situation than the overall trend.
- In manufacturing, there is an overall supply chain issue which is impacting demand. But TCS believes it is a short-term problem.

Fig 1 – Quarterly results: Comparison of actuals with estimates

Y/E Mar (Rs mn)	2QFY24	1QFY25	2QFY25	YoY(%)	QoQ (%)	2QFY25E	Deviation (%)
Net Sales (USD mn)	7,210	7,505	7,670	6.4	2.2	7,633	0.5
Net Sales	5,96,920	6,26,130	6,42,590	7.7	2.6	6,39,655	0.5
Software Expenses	3,57,620	3,76,610	3,97,200	11.1	5.5	3,80,376	4.4
% of Sales	59.9	60.1	61.8			59.5	
Gross Margin	2,39,300	2,49,520	2,45,390	2.5	(1.7)	2,59,279	(5.4)
% of Sales	40.1	39.9	38.2			40.5	
Operating Expenses	94,470	95,100	90,740	(3.9)	(4.6)	96,051	(5.5)
% of Sales	15.8	15.2	14.1			15.0	
EBIT	1,44,830	1,54,420	1,54,650	6.8	0.1	1,63,228	(5.3)
EBIT Margin (%)	24.3	24.7	24.1			25.5	
Other Income	8,470	7,890	5,670	(33.1)	(28.1)	7,467	(24.1)
PBT	1,53,300	1,62,310	1,60,320	4.6	(1.2)	1,70,695	(6.1)
Provision for Tax	39,500	41,260	40,770	3.2	(1.2)	43,391	(6.0)
Effective Tax Rate	25.8	25.4	25.4			25.4	
Minority share in Profit / Loss	380	650	460	21.1	(29.2)	650	(29.2)
Reported PAT	1,13,420	1,20,400	1,19,090	5.0	(1.1)	1,26,653	(6.0)
PAT Adjusted	1,13,420	1,20,400	1,19,090	5.0	(1.1)	1,26,653	(6.0)
NPM (%)	19.0	19.2	18.5			19.8	

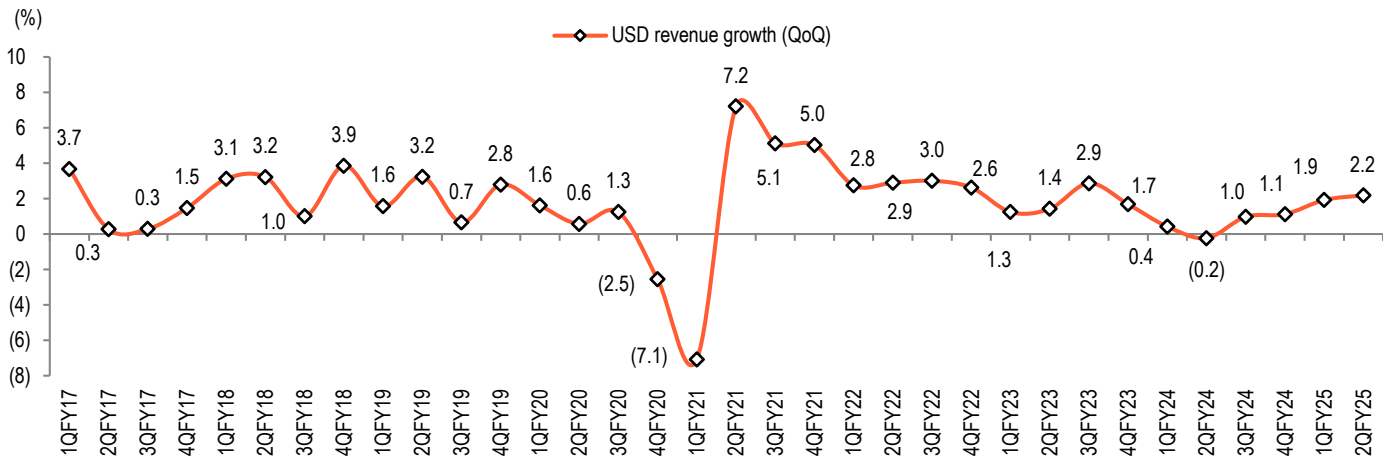
Source: Company, BOBCAPS Research

Fig 2 – US\$ revenue growth rate (YoY)



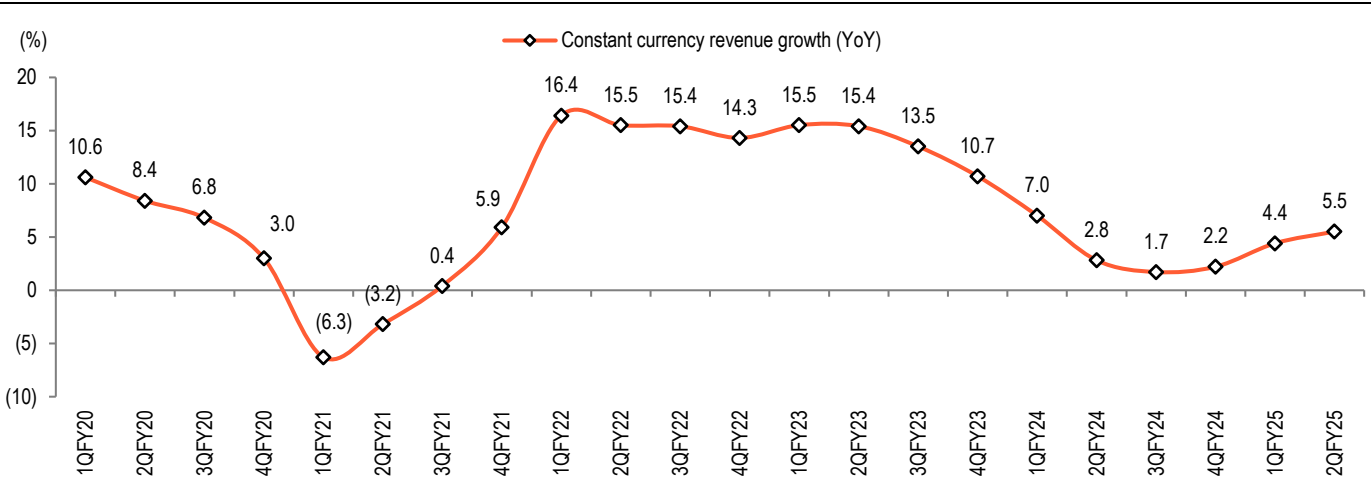
Source: Company, BOBCAPS Research

Fig 3 – US\$ revenue growth rate (QoQ)



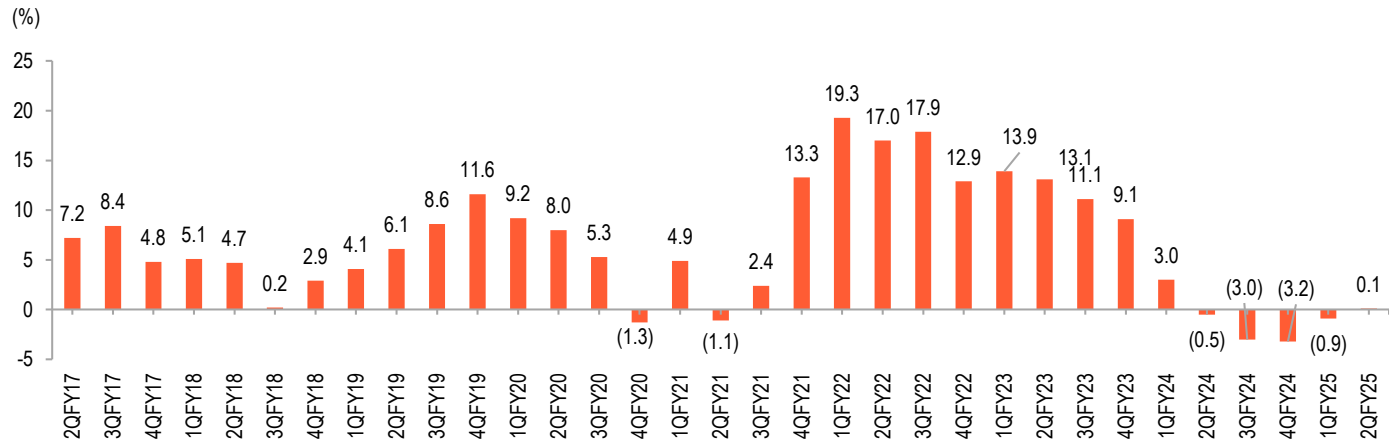
Source: Company, BOBCAPS Research

Fig 4 – CC YoY revenue



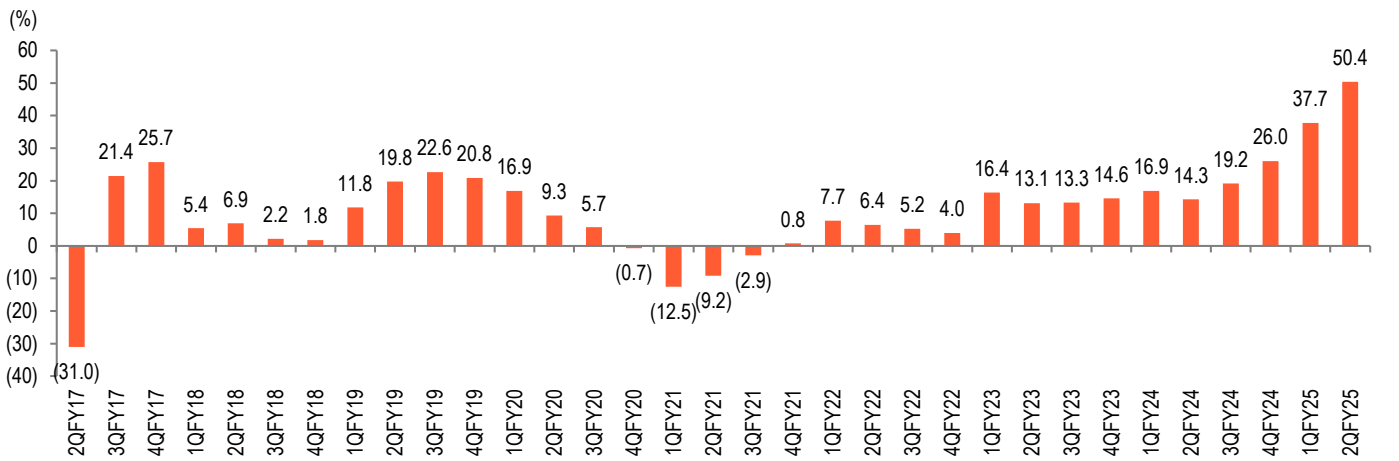
Source: Company, BOBCAPS Research

Fig 5 – CC YoY BFSI vertical



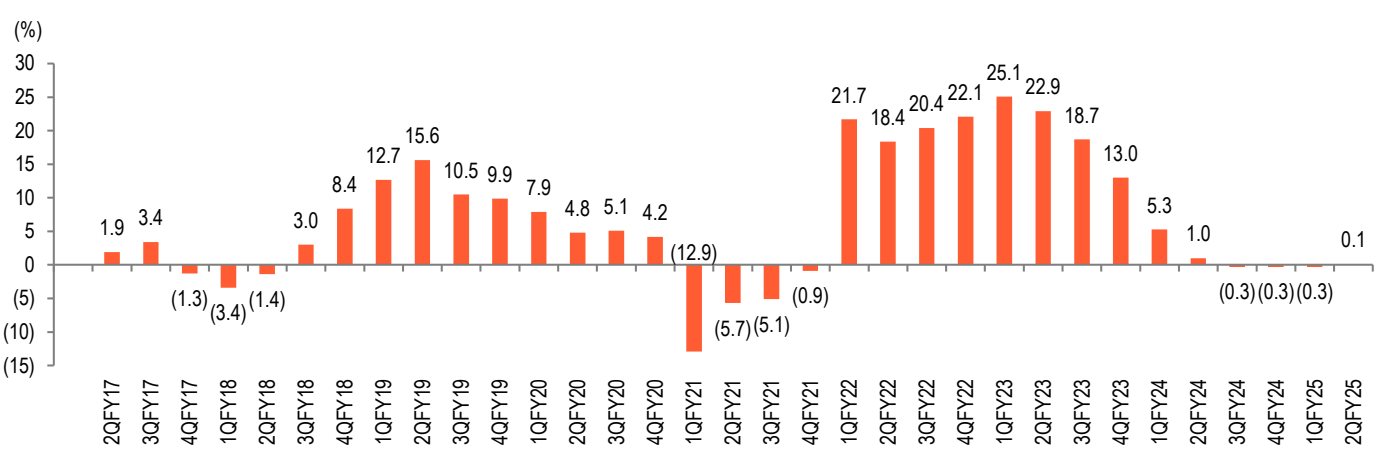
Source: Company, BOBCAPS Research

Fig 6 – CC YoY in regional markets and others



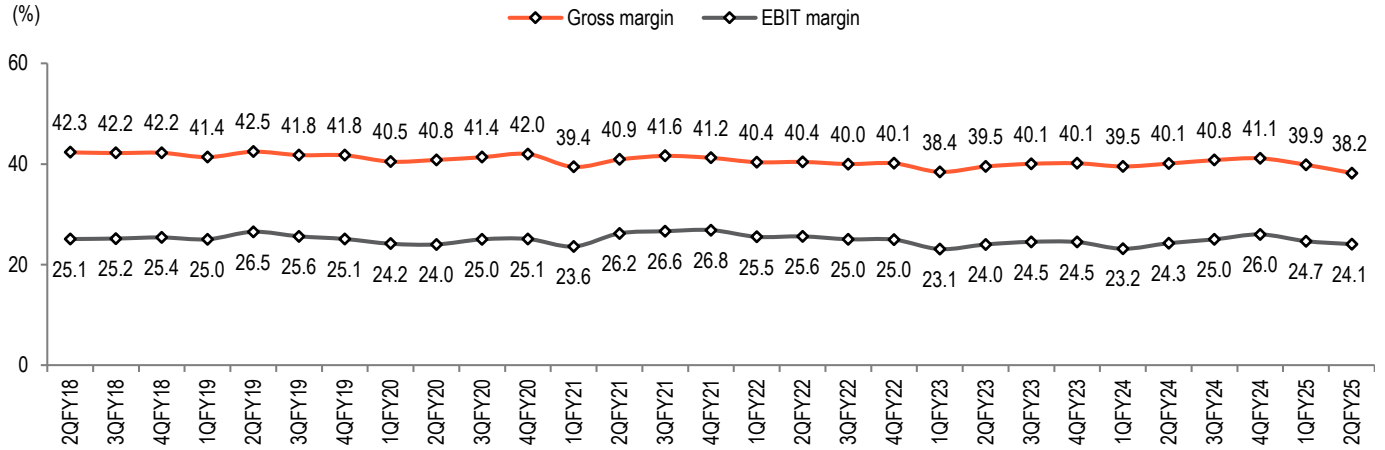
Source: Company, BOBCAPS Research

Fig 7 – CC YoY Retail and CPG vertical



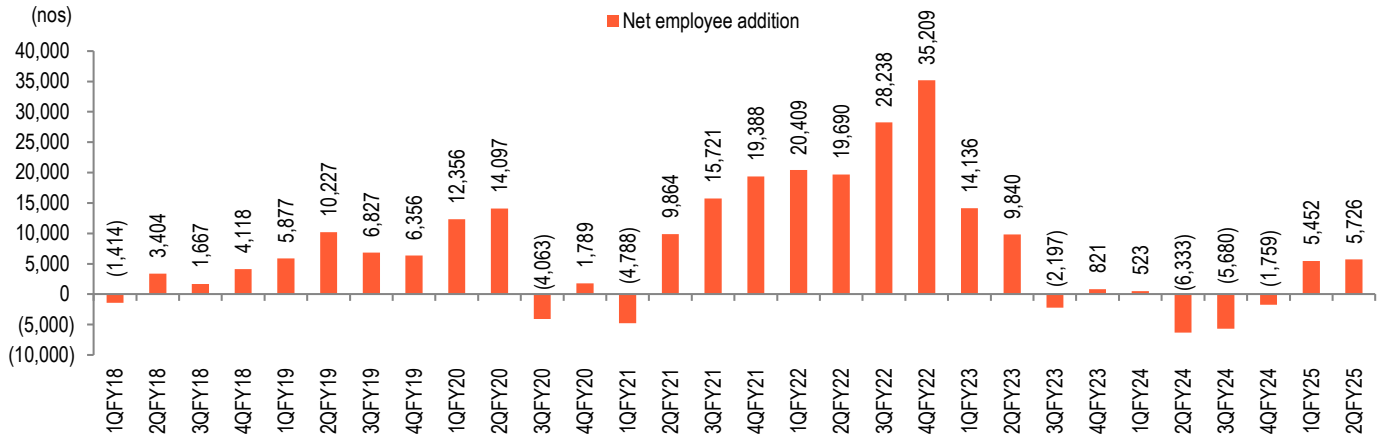
Source: Company, BOBCAPS Research

Fig 8 – Gross and EBIT margin picture



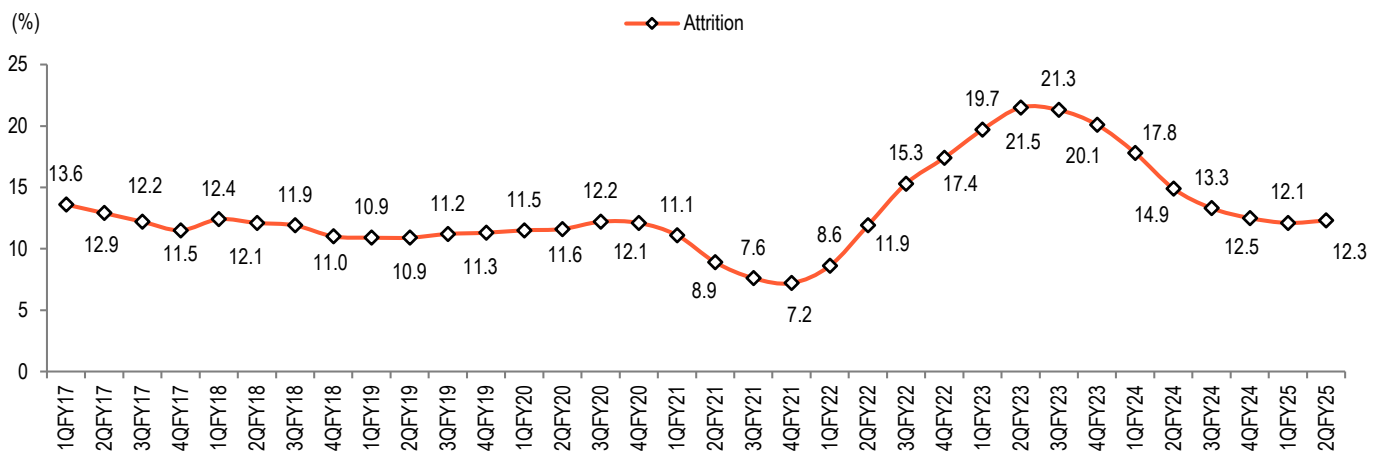
Source: Company, BOBCAPS Research

Fig 9 – Net employee addition (nos)



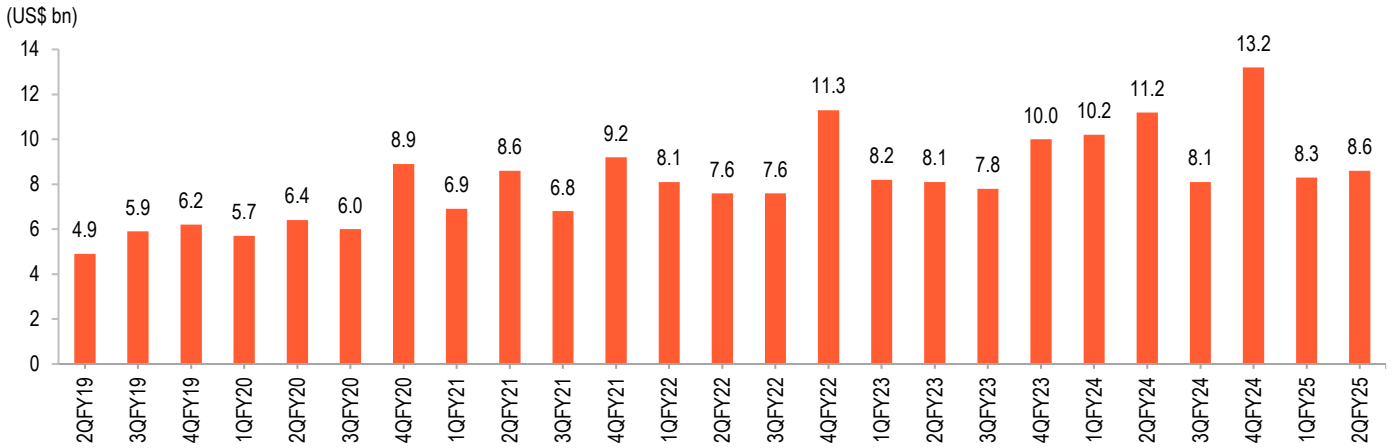
Source: Company, BOBCAPS Research

Fig 10 – LTM attrition rate



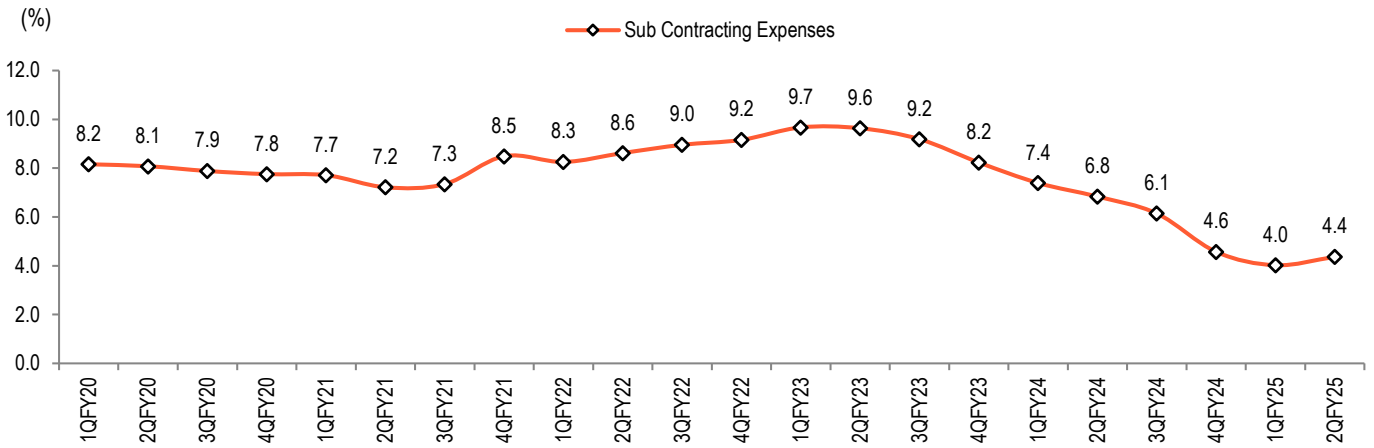
Source: Company, BOBCAPS Research | LTM: Last 12 months

Fig 11 – Quarterly TCV picture



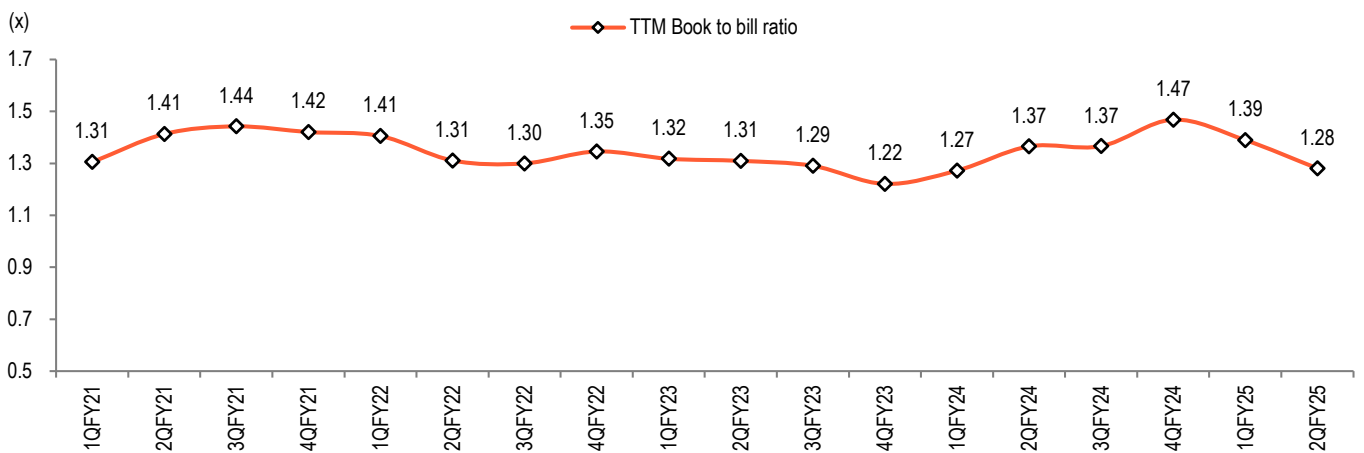
Source: Company, BOBCAPS Research

Fig 12 – Subcontractor charges (% of revenue)



Source: Company, BOBCAPS Research

Fig 13 – TTM Book/ Bill Ratio



Source: Company, BOBCAPS Research

Fig 14 – Key Metrics

P and L (Rs mn)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
Revenue	527,580	553,090	582,290	591,620	593,810	596,920	605,830	612,370	626,130	642,590
EBITDA	121,860	132,790	142,840	144,880	137,550	144,830	151,550	159,180	154,420	154,650
PAT	94,780	104,310	108,460	113,920	110,740	113,420	117,350	124,340	120,400	119,090
Vertical Mix (%)										
BFSI	32.1	33.6	33.1	32.9	32.5	32.6	31.7	31.3	30.9	30.8
Manufacturing	9.9	8.2	8.2	8.2	8.3	8.6	8.6	8.8	8.8	8.6
Communication and Media	6.8	7.3	7.2	7.1	7.0	6.9	6.7	6.6	6.2	5.9
Life Sciences	10.1	10.7	10.8	10.9	11.0	10.9	10.9	10.9	11.0	10.4
Retail & Distribution	15.9	16.1	16.0	16.0	16.1	15.9	15.7	15.7	15.4	15.1
Hi-Tech	8.8	9.1	9.0	8.9	8.7	8.6	8.4	8.2	8.1	8.0
Others	16.4	10.0	10.5	10.6	10.9	10.9	12.3	12.9	14.0	15.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Geographic Mix (%)										
North America	53.2	54.3	53.7	52.4	52.0	51.7	50.6	50.0	49.5	47.6
UK	14.9	14.5	14.9	15.7	16.4	16.5	16.4	16.8	16.9	17.0
Europe	15.2	14.5	14.8	15.1	14.9	14.9	15.0	14.6	14.4	14.6
India	4.8	5.1	5.1	5.0	4.9	4.9	6.1	6.7	7.5	8.9
APAC	8.3	8.0	7.9	8.0	7.8	7.8	7.8	7.8	7.8	8.0
Ibero America	1.8	1.7	1.8	1.8	2.0	2.0	2.1	2.0	1.9	1.8
MEA	1.8	1.9	1.8	2.0	2.0	2.2	2.0	2.1	2.0	2.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Number of Client										
US\$ 100mn +	59	59	59	60	60	61	61	62	63	66
US\$ 50mn +	124	124	130	133	137	137	137	139	140	136
Employee Number	606,331	616,171	613,974	614,795	615,318	608,985	603,305	601,546	606,998	612,724
Net Addition	14,136	9,840	(2,197)	821	523	(6,333)	(5,680)	(1,759)	5,452	5,726
Attrition (%)	19.7	21.5	21.3	20.1	17.8	14.9	13.3	12.5	12.1	12.3
Net Employee Growth (YoY %)	19	17	10	4	1	(1)	(2)	(2)	(1)	1

Source: Company, BOBCAPS Research

Fig 15 – OoQ and YoY metrics

(in US\$)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
QoQ Growth (%)										
Revenue	1.3	1.4	2.9	1.7	0.4	(0.2)	1.0	1.1	1.9	2.2
Geographical Data										
Americas	4.4	3.5	1.7	(0.8)	(0.3)	(0.8)	(1.2)	(0.1)	0.9	(1.7)
UK	(3.3)	(1.3)	5.7	7.2	4.9	0.4	0.4	3.6	2.5	2.8
Europe	(0.7)	(3.2)	5.0	3.8	(0.9)	(0.2)	1.7	(1.6)	0.5	3.6
India	(4.7)	7.8	2.9	(0.3)	(1.6)	(0.2)	25.7	11.1	14.1	21.3
APAC	(1.1)	(2.2)	1.6	3.0	(2.1)	(0.2)	1.0	1.1	1.9	4.8
Ibero America	7.2	(4.2)	8.9	1.7	11.6	(0.2)	6.0	(3.7)	(3.2)	(3.2)
MEA	(8.9)	7.1	(2.5)	13.0	0.4	9.8	(8.2)	6.2	(2.9)	7.3
Verticals										
BFSI	1.9	6.2	1.3	1.1	(0.8)	0.1	(1.8)	(0.1)	0.6	1.9
Manufacturing	0.2	(16.0)	2.9	1.7	1.7	3.4	1.0	3.5	1.9	(0.1)
Communication and Media	2.8	8.9	1.5	0.3	(1.0)	(1.6)	(1.9)	(0.4)	(4.2)	(2.7)
Life Science & Healthcare	2.3	7.5	3.8	2.6	1.4	(1.1)	1.0	1.1	2.9	(3.4)

(in US\$)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
Retail and distribution	4.5	2.7	2.2	1.7	1.1	(1.5)	(0.3)	1.1	(0.0)	0.2
Hi-Tech (Now Technology Services)	2.4	4.9	1.7	0.6	(1.8)	(1.4)	(1.4)	(1.3)	0.7	0.9
Energy and Utilities	0.0	0.0	7.0	5.6	2.3	1.6	2.8	(0.6)	1.9	4.0
Regional Market & Others	(4.0)	(38.2)	8.0	2.7	3.3	(0.2)	14.0	6.1	10.6	13.1
YoY Growth (%)										
Revenue	10.2	8.6	8.4	7.5	6.6	4.8	2.9	2.3	3.9	6.4
Geographical Data										
Americas	18.6	17.2	14.9	9.1	4.2	(0.2)	(3.0)	(2.4)	(1.1)	(2.1)
UK	0.7	(2.2)	3.6	8.1	17.3	19.3	13.3	9.5	7.0	9.6
Europe	0.3	(1.0)	0.3	4.7	4.5	7.7	4.3	(1.1)	0.4	4.2
India	15.0	8.6	0.6	5.3	8.8	0.7	23.1	37.1	59.0	93.2
APAC	(1.7)	(3.5)	(0.4)	1.1	0.2	2.2	1.6	(0.2)	3.9	9.1
Ibero America	23.9	15.4	14.8	13.8	18.4	23.3	20.1	13.7	(1.3)	(4.3)
MEA	(5.6)	3.2	2.7	7.5	18.4	21.4	14.3	7.5	3.9	1.5
Verticals										
BFSI	8.8	12.6	11.8	10.8	7.9	1.7	(1.4)	(2.6)	(1.3)	0.5
Manufacturing	11.3	(10.1)	(10.2)	(11.9)	(10.6)	10.0	7.9	9.8	10.1	6.4
Communication and Media	17.1	22.0	20.1	13.9	9.7	(0.9)	(4.2)	(4.9)	(8.0)	(9.0)
Life Science & Healthcare	9.1	16.2	18.3	17.1	16.1	6.8	3.9	2.3	3.9	1.5
Retail and distribution	18.4	16.6	14.9	11.6	7.9	3.5	1.0	0.4	(0.7)	1.0
Hi-Tech	12.7	12.3	12.2	9.9	5.4	(0.9)	(3.9)	(5.7)	(3.3)	(1.0)
Energy and Utilities	0.0	0.0	0.0	0.0	0.0	17.4	12.8	6.1	5.7	8.3
Regional Market & Others	2.1	(37.6)	(36.0)	(34.2)	(29.2)	14.3	20.6	24.5	33.4	51.3

Source: Company, BOBCAPS Research

Fig 16 – Verticals picture

Verticals	Contribution to Revenue (%)	Growth - QoQ (%)	Growth -YoY (%)	Growth -YoY (%) in CC
BFSI	30.8	1.9	0.5	0.1
Manufacturing	8.6	(0.1)	6.4	5.3
Communication and Media	5.9	(2.7)	(9.0)	(10.3)
Life Science and Healthcare	10.4	(3.4)	1.5	0.1
Retail and CPG	15.1	0.2	1.0	0.1
Technology and Services	8.0	0.9	(1.0)	(1.9)
Energy and Utilities	5.7	4.0	8.3	7.0
Regional Market & Others	15.5	13.1	51.3	50.4
Total	100.00	2.2	6.4	5.5

Source: Company, BOBCAPS Research

Fig 17 – Geographic picture

Geographies	Contribution to Revenue (%)	Growth-QoQ(%)	Growth-YoY(%)	Growth-YoY(%) in CC
North America	47.6	(1.7)	(2.1)	(2.1)
Latin America	1.8	(3.2)	(4.3)	6.8
UK	17.0	2.8	9.6	4.6
Europe	14.6	3.6	4.2	1.8
India	8.9	21.3	93.2	95.2
APAC	8.0	4.8	9.1	7.5
MEA	2.1	7.3	1.5	7.9
Total	100.0	2.2	6.4	5.5

Source: Company, BOBCAPS Research

Fig 18 – Quarterly picture

Year to 31 March	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
INR/US\$	77.8	80.4	82.3	82.2	82.2	82.8	83.2	83.2	83.4	83.8
Revenue (in US\$ bn)	6.8	6.9	7.1	7.2	7.2	7.2	7.3	7.4	7.5	7.7
(Rs bn)										
Revenue	527.6	553.1	582.3	591.6	593.8	596.9	605.8	612.4	626.1	642.6
Gross margin	202.7	218.5	233.2	237.5	234.7	239.3	247.1	251.9	249.5	245.4
EBIT	121.9	132.8	142.8	144.9	137.6	144.8	151.6	159.2	154.4	154.7
Other income	5.9	8.2	3.6	9.0	12.3	8.5	7.2	9.3	7.9	5.7
PBT	127.8	141.0	146.4	153.9	149.9	153.3	158.7	168.5	162.3	160.3
Tax	32.6	36.3	37.6	39.6	38.7	39.5	41.0	43.5	41.3	40.8
PAT	94.8	104.3	108.5	113.9	110.7	113.4	117.4	124.3	120.4	119.1
Number of shares	3,659	3,659	3,659	3,658	3,660	3,659	3,610	3,618	3,618	3,618
EPS (Rs)	25.9	28.5	29.6	31.1	30.3	31.0	32.5	34.4	33.3	32.9
YoY Growth (%)										
US\$ Revenue	10.2	8.6	8.4	7.5	6.6	4.8	2.9	2.3	3.9	6.4
INR Revenues	16.2	18.0	19.1	16.9	12.6	7.9	4.0	3.5	5.4	7.7
Gross profit	10.6	15.3	19.3	17.0	15.8	9.5	6.0	6.1	6.3	2.5
EBIT	5.2	10.7	16.7	14.7	12.9	9.1	6.1	9.9	12.3	6.8
Net profit	5.2	8.4	11.0	14.8	16.8	8.7	8.2	9.1	8.7	5.0
QoQ Growth (%)										
USD Revenues	1.25	1.4	2.9	1.70	0.43	(0.22)	1.0	1.1	1.93	2.20
INR Revenues	4.3	4.8	5.3	1.6	0.4	0.5	1.5	1.1	2.2	2.6
EBIT	(3.5)	9.0	7.6	1.4	(5.1)	5.3	4.6	5.0	(3.0)	0.1
Net profit	(4.5)	10.1	4.0	5.0	(2.8)	2.4	3.5	6.0	(3.2)	(1.1)
Margins (%)										
Gross margin	38.4	39.5	40.1	40.1	39.5	40.1	40.8	41.1	39.9	38.2
EBIT	23.1	24.0	24.5	24.5	23.2	24.3	25.0	26.0	24.7	24.1
PAT	18.0	18.9	18.6	19.3	18.6	19.0	19.4	20.3	19.2	18.5
SGA	15.3	15.5	15.5	15.7	16.4	15.8	15.8	15.1	15.2	14.1

Source: Company, BOBCAPS Research

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