

CMP: ₹ 3935

Target: ₹ 4530 (15%)

Target Period: 12 months

October 10, 2021

BUY

Margin expansion QoQ a positive surprise...

About the stock: Tata Consultancy Services (TCS) is one of the leading IT service providers with a presence in BFSI, communication, manufacturing, retail & hi tech.

- Consistent organic revenue growth and industry leading margins (>25%)
- Stable management, robust return ratios (>RoCE 40%) & payouts (~70%)

Q2FY22 Results: TCS reported Q2FY22 results.

- US\$ revenues grew 2.9% QoQ to \$6,333 million, 4% QoQ CC growth
- EBIT margins improved 10 bps QoQ to 25.6%
- The company's deal pipeline continues to be healthy at US\$7.6 billion

What should investors do? TCS' share price has grown by ~3.6x over the past five years (from ~₹ 1,077 in October 2016 to ~₹ 3,976 levels in October 2021).

- We continue to remain positive and retain our BUY rating on the stock

Target Price and Valuation: We value TCS at ₹ 4,530 i.e. 34x P/E on FY23E EPS

Key triggers for future price performance:

- TCS is key beneficiary of multi-year growth (15-20%) in digital technologies
- Increase in outsourcing in Europe, vendor consolidation and deal pipeline leading to revenue CAGR of 15.9% over FY21-23E
- Industry leading margins to continue; expect margins to improve 190 bps over FY21-23E
- Double-digit return ratios, strong cash generation and healthy payout

Alternate Stock Idea: Apart from TCS, in our IT coverage we also like Infosys.

- Improving revenue growth, narrowing margins with industry leader and healthy payout
- BUY with a target price of ₹ 1,930



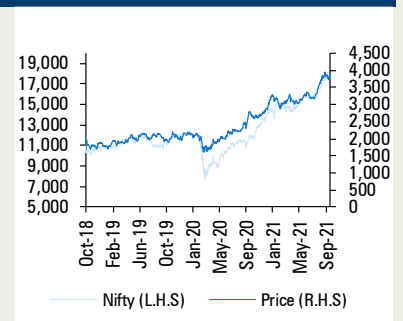
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	1,455,950.0
Total Debt (₹ Crore)	7,795.0
Cash and equivalents (₹ Crore)	38,489.0
EV (₹ Crore)	1,425,256.0
52 week H/L	3990/2600
Equity capital (₹ Crore)	370
Face value	₹ 1

Shareholding pattern

	Sep-20	Dec-20	Mar-21	Jun-21
Promoters	72.05	72.1	72.2	72.2
F II	16	15.9	15.6	15.4
D II	7.85	7.71	7.83	7.82
Others	4.10	4.36	4.36	4.58

Price Chart



Recent Event & Key risks

- Deal pipeline up 25% YoY.
- **Key Risk:** (i) higher than expected attrition (ii) Margin pressure on high subcontractor costs.

Research Analyst

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Key Financial Summary

Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Sales	146,463	156,949	164,177	8.6%	189,446	220,405	15.9%
EBITDA	39,506	42,110	46,546	8.7%	55,887	66,562	19.6%
EBITDA Margins (%)	27.0	26.8	28.4		29.5	30.2	
Net Profit	31,472	32,340	32,430	6.0%	41,032	49,196	23.2%
EPS (₹)	83.8	86.2	86.7		110.8	132.9	
P/E	46.8	45.5	44.8		35.4	29.6	
RoNW (%)	34.4	38.4	37.5		43.8	46.8	
RoCE (%)	43.8	44.4	45.9		51.9	55.8	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q2FY22 Results: Supply side challenges could be short term

- In the current quarter, revenue growth was broad based across verticals and geographies
- Demand in core transformation services and traction in digital tech like cloud, supply chain, M&A & customer experience other key drivers
- The company added 19,690 employees during the quarter, one of the highest quarterly hirings
- Of the total TCV, North America accounted for US\$3.5 billion among geographies while vertically US\$1.5 billion in retail
- The company is seeing healthy traction in manufacturing, retail and outsourcing in Europe

Q1FY22 Earnings Conference Call highlights

- The company believes it is making investments in the areas of future technologies i.e. contactless payments, battery management software for electric vehicles, etc, which will help them to participate in larger deals, going forward
- TCS said they are not witnessing a slower pace of transformation deals on account of return of normalcy
- The company is seeing a multi-year opportunity led by technology refresh, vendor consolidation, transformational projects and higher outsourcing
- Considering opportunities in cloud and ancillary technologies around cloud the company could register double digit growth in FY22E
- The management maintained that margin expanded 10 bps QoQ despite supply side challenges and currency headwinds. They maintained that these challenges are short-term in nature and their cost structure is well placed to tide over this
- Deal TCV was at US\$7.6 billion, up 25% YoY (adjusted to one-off large deal of US\$2.5 billion in the UK, in the base quarter). The management said the TCV is largely broad based
- The management said attrition challenge may continue for the next two to three quarters. The company hired 43,000 freshers in H1. They are being trained with emerging technologies to able to cater to the demand. They also said they are planning to increase the velocity of hiring keeping in mind the demand scenario

Peer comparison

Exhibit 1: Peer Comparison

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
HCL Tech (HCLTEC)	1,322	1,475	BUY	358,747	45.8	50.6	60.9	28.9	26.1	21.7	23.5	24.1	25.7	20.8	20.5	21.4
Infosys (INFTEC)	1,723	1,930	BUY	732,464	45.5	54.8	64.3	37.9	31.4	26.8	31.7	34.0	37.0	25.2	27.8	30.3
TCS (TCS)	3,935	4,530	BUY	1,455,950	87.6	110.9	133.0	44.9	35.5	29.6	45.9	51.9	55.8	37.5	43.8	46.8
Tech M (TECMAH)	1,440	1,611	BUY	139,147	50.2	64.7	74.6	28.7	22.2	19.3	19.8	22.8	23.7	17.8	20.4	20.8
Wipro (WIPRO)	661	743	BUY	362,301	19.1	21.3	25.6	34.6	31.0	25.9	21.3	23.0	27.3	19.5	21.8	26.1

Source: Company, ICICI Direct Research

We believe TCS deserves premium valuation (trades at >1.4x its large cap peers) due to its far superior return ratios with RoCE at ~45% vs. ~20-30% at its peers

Exhibit 2: Variance Analysis

	Q2FY22	Q2FY22E	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	Comments
Revenue	46,867	46,800	40,135	16.8	45,411	3.2	Revenue growth of 4% QoQ in CC terms was broad based
Employee expenses	27,048	26,910	22,958	17.8	26,240	3.1	
Gross Margin	19,819	19,890	17,177	15.4	19,171	3.4	
Gross margin (%)	42.3	42.5	42.8	-51 bps	42.2	7 bps	
SG&A expenses	6,704	7,020	5,664	18.4	6,507	3.0	
EBITDA	13,115	12,870	11,513	13.9	12,664	3.6	
EBITDA Margin (%)	28.0	27.5	28.7	-70 bps	27.9	10 bps	
Depreciation	1,115	1,076	998	11.7	1,076	3.6	
EBIT	12,000	11,794	10,515	14.1	11,588	3.6	
EBIT Margin (%)	25.6	25.2	26.2	-59 bps	25.5	9 bps	Operating margins for the quarter expanded due to lower SG&A expenses
Other income (less interest)	969	700	740	30.9	575	68.5	
PBT	12,969	12,348	11,255	15.2	12,163	6.6	
Tax paid	3,316	3,186	2,533	30.9	3,132	5.9	
Reported PAT	9,624	9,136	8,693	10.7	9,008	6.8	
Adjusted PAT	9,624	9,136	8,693	10.7	9,008	6.8	PAT was higher due to strong operating performance and higher other income

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	old	New	% Change	
Revenue	1,87,669	1,89,446	0.9	2,14,157	2,20,405	2.9	We revise FY22E and FY23E revenue estimates upwards factoring in strong revenue growth in H1
EBIT	50,108	51,340	2.5	58,465	61,273	4.8	
EBIT Margin (%)	26.7	27.1	40 bps	27.3	27.8	50 bps	We expect margins to improve ~190 bps over FY21-23E due to cost optimisation and some pricing discipline may kick in gradually
PAT	40,106	41,032	2.3	47,085	49,196	4.5	
EPS (₹)	108.3	110.8	2.3	127.2	132.9	4.5	

Source: Company, ICICI Direct Research

Key Metrics

Exhibit 4: Geography wise break-up

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Revenue by geography (%)					
North America	49.9	49.1	48.6	49.8	49.4
Latin America	1.7	1.7	1.6	1.7	1.6
UK	15.5	15.7	16.0	15.6	16.3
Continental Europe	16.3	16.2	16.8	16.2	16.7
India	5.0	5.6	5.6	5.1	4.6
Asia Pacific	9.7	9.7	9.4	9.7	9.3
MEA	1.9	2.0	2.0	2.0	2.1
Growth QoQ (%)					
North America	4.1	3.4	4.0	4.4	4.8
Latin America	7.2	5.1	-1.1	2.8	2.9
UK	8.6	6.5	7.0	4.7	1.6
Continental Europe	12.0	4.5	8.9	2.1	-2.0
India	24.7	17.7	5.0	-15.6	14.1
Asia Pacific	6.1	5.1	1.8	1.7	-0.4
MEA	7.2	10.7	5.0	7.9	-2.0

Source: Company, ICICI Direct Research

India bounced back after a blip in Q1 but continental Europe and MEA witnessed weakness

Exhibit 5: Vertical wise break-up

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Revenue by verticals (%)					
BFSI	31.9	31.3	32.2	31.7	32.5
Retail & CPG	14.6	14.5	14.5	14.4	14.8
Communication and Media	6.5	6.6	6.5	6.6	6.4
Manufacturing	9.4	9.6	9.7	9.6	10.2
Life Sciences & Healthcare	9.8	9.8	9.6	9.7	9.8
Technology & services	8.9	8.6	8.4	8.8	8.6
Regional markets & others	18.9	19.6	19.1	19.2	17.7
Growth QoQ (%)					
BFSI	8.6	3.1	8.1	3.7	2.6
Retail & CPG	11.8	4.4	5.0	4.9	4.3
Communication and Media	1.0	6.7	3.4	1.2	4.5
Manufacturing	3.9	7.4	6.1	8.1	-0.1
Life Sciences & Healthcare	9.4	5.1	2.9	4.9	5.0
Technology & services	4.9	1.6	2.6	5.2	5.3
Regional markets & others	5.5	9.0	2.4	-4.8	1.2

Source: Company, ICICI Direct Research

Broad based growth across verticals except manufacturing

Exhibit 6: Client & human resource matrix

	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22
Client metrics					
USD 1 mn+ clients	1076	1077	1096	1118	1138
USD 5 mn+ clients	565	565	569	586	609
USD 10 mn+ clients	386	386	387	405	417
USD 20 mn+ clients	228	229	228	241	247
USD 50 mn+ clients	97	97	101	105	114
USD 100 mn+ clients	49	48	48	50	54
Headcount, Attrition					
Total Employees	453540	469261	488649	509058	528748
Attrition, LTM (IT Services)	8.9	7.6	7.2	8.6	11.9

Source: Company, ICICI Direct Research

Attrition witnessed an increase in the quarter

Financial summary

Exhibit 7: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Total operating Income	156,949	164,177	189,446	220,405
Growth (%)	7.2	4.6	15.4	16.3
COGS (employee expenses)	89,635	94,053	106,848	122,986
S,G&A expenses	25,204	23,578	26,712	30,857
Total Operating Expenditure	114,839	117,631	133,560	153,842
EBITDA	42,110	46,546	55,887	66,562
Growth (%)	6.6	10.5	20.1	19.1
Depreciation	3,530	4,065	4,547	5,290
Other Income less interest	3,668	2,497	3,400	4,323
PBT	42,248	44,978	54,740	65,596
Total Tax	9,801	11,198	13,575	16,268
Minority Interest	107	132	132	132
PAT	32,340	32,430	41,032	49,196
Growth (%)	2.8	0.3	26.5	19.9
EPS (₹)	86.2	86.7	110.8	132.9
PAT	32,340	32,430	41,032	49,196
EPS - Reported (₹)	86.2	86.7	110.8	132.9

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Profit before Tax	42,248	44,978	54,740	65,596
Add: Depreciation	3,529	4,065	4,547	5,290
(Inc)/dec in Current Assets	(7,125)	(1,766)	3,047	(5,084)
Inc/(dec) in CL and Provisions	2,625	2,629	3,137	8,973
Taxes paid	3,955	(2,106)	(13,575)	(16,268)
CF from operating activities	32,369	38,802	48,958	54,646
(Inc)/dec in Investments	7,916	(7,728)	(531)	(650)
(Inc)/dec in Fixed Assets	(3,088)	(3,139)	(3,789)	(4,408)
Others	3,737	2,738	2,937	3,860
CF from investing activities	8,565	(8,129)	(1,383)	(1,198)
Inc/(dec) in loan funds	0	0	0	0
Dividend paid & dividend tax	(37,634)	(30,576)	(33,877)	(37,679)
Others	(1,219)	(722)	0	0
CF from financing activities	(39,915)	(32,634)	(33,877)	(37,679)
Net Cash flow	1,019	(1,961)	13,699	15,770
Exchange difference	0	0	0	0
Opening Cash	7,224	9,666	7,705	23,028
Closing cash and Bank	9,666	7,705	23,028	38,797

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Liabilities				
Equity Capital	375	370	370	370
Reserve and Surplus	83,751	86,063	93,218	104,736
Share Premium	0	0	0	0
Total Shareholders funds	84,126	86,433	93,588	105,106
Total debt	8,174	7,795	7,994	8,237
Other liabilities & Provisions	1,405	2,226	2,341	2,483
Deferred tax liability(net)	779	767	767	767
Minority Interest / Others	623	675	807	939
Total Liabilities	95,107	97,896	105,498	117,532
Assets				
Net assets & CWIP	20,124	20,149	19,391	18,510
Goodwill	1,710	1,798	1,798	1,798
Other non current assets	8,430	9,204	9,735	10,385
Debtors	30,606	30,134	34,772	40,454
Loans and Advances	8,483	11,491	13,260	11,020
Other Current Assets	15,740	19,494	10,041	11,681
Current Investments	26,140	29,160	29,160	29,160
Cash	9,666	9,329	23,028	38,797
Trade Payable	6,740	7,860	9,070	10,552
OCL & Provisions	19,052	25,003	26,616	33,722
Application of Funds	95,107	97,896	105,498	117,532

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Per share data (₹)				
Adjusted EPS (Diluted)	86.2	86.7	110.8	132.9
BV per share	224.3	233.6	252.9	284.1
DPS	85.0	21.0	91.5	101.8
Cash Per Share	25.8	25.2	62.2	104.9
Operating Ratios (%)				
EBIT margins	24.6	25.9	27.1	27.8
PBT Margins	26.9	27.4	28.9	29.8
PAT Margin	20.6	19.8	21.7	22.3
Debtor days	71	67	67	67
Creditor days	16	17	17	17
Return Ratios (%)				
RoE	38.4	37.5	43.8	46.8
RoCE	44.4	45.9	51.9	55.8
RoIC	65.1	71.5	96.3	123.6
Valuation Ratios (x)				
P/E	45.5	44.8	35.4	29.6
EV / Net Sales	9.1	8.7	7.5	6.3
Market Cap / Sales	9.3	8.9	7.7	6.6
Solvency Ratios				
Debt / EBITDA	0.2	0.2	0.1	0.1
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	2.1	1.9	1.6	1.4
Quick Ratio	2.1	1.9	1.6	1.4

Source: Company, ICICI Direct Research

Exhibit 11: ICICI Direct coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
HCL Tech (HCLTEC)	1,322	1,475	BUY	358,747	45.8	50.6	60.9	28.9	26.1	21.7	23.5	24.1	25.7	20.8	20.5	21.4
Infosys (INFTEC)	1,723	1,930	BUY	732,464	45.5	54.8	64.3	37.9	31.4	26.8	31.7	34.0	37.0	25.2	27.8	30.3
TCS (TCS)	3,935	4,530	BUY	1,455,950	87.6	110.9	133.0	44.9	35.5	29.6	45.9	51.9	55.8	37.5	43.8	46.8
Tech M (TECMAH)	1,440	1,611	BUY	139,147	50.2	64.7	74.6	28.7	22.2	19.3	19.8	22.8	23.7	17.8	20.4	20.8
Wipro (WIPRO)	661	743	BUY	362,301	19.1	21.3	25.6	34.6	31.0	25.9	21.3	23.0	27.3	19.5	21.8	26.1
Larsen & Toubro Infotech Ltd	5,981	6,599	BUY	104,776	111.0	126.2	146.4	53.9	47.4	40.8	31.9	30.9	30.6	26.5	25.7	25.4
Mindtree Ltd	4,455	4,314	HOLD	73,433	67.4	81.1	95.8	66.1	54.9	46.5	32.5	33.1	33.1	25.7	25.9	25.7
Coforge Limited	5,644	6,139	BUY	34,217	73.3	106.3	139.1	77.0	53.1	40.6	23.3	26.8	29.8	18.5	23.4	26.2
TeamLease Services	4,847	4,550	BUY	8,287	46.5	67.5	100.3	104.3	71.9	48.3	14.2	16.4	19.8	11.6	15.8	18.6
InfoEdge	6,669	6,270	BUY	85,888	20.9	37.1	51.0	318.9	179.8	130.9	7.7	13.1	16.7	6.0	9.9	12.6

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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