

CMP: ₹ 3121

Target: ₹ 3630 (16%)

Target Period: 12 months

October 11, 2022

BUY

## Strong Q2 numbers...

**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%)

**Q2FY23 Results:** TCS reported strong revenue & margin growth for Q2.

- Reported CC growth of 4% QoQ & 15.4% YoY, respectively
- EBIT margins improved 90 bps QoQ to 24% for the quarter
- TCV remained steady at US\$8.1 billion (bn)

**What should investors do?** TCS' share price has grown by ~2.5x over the past five years (from ~₹ 1,227 in October 2017 to ~₹ 3,121 levels in October 2022).

- We maintain **BUY** rating on the stock

**Target Price and Valuation:** We value TCS at ₹ 3,630 i.e. 26x P/E on FY25E EPS

**Key triggers for future price performance:**

- New organisation structure, which is aimed at increasing customer stickiness, is expected to enhance market share gains
- Increase in outsourcing in Europe, vendor consolidation and deal pipeline leading to rupee revenue CAGR of 9.4% over FY22-25E
- We expect margins to improve from FY23 onwards due to utilisation improvement, moderation of sub-contractor costs. We build in margin expansion of 130 bps over FY23-25E
- Double-digit return ratios, strong cash generation and healthy payout

**Alternate Stock Idea:** Besides TCS, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 1,760



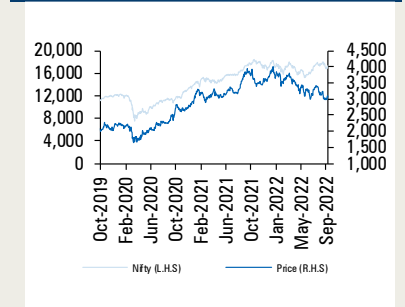
### Particulars

Particular	Amount
Market Capitalization (₹ Crore)	11,41,554.0
Total Debt (₹ Crore)	7,818.0
Cash and equivalents (₹ Crore)	48,483.0
EV (₹ Crore)	11,10,860.0
52 week H/L	4043/ 2927
Equity capital (₹ Crore)	366
Face value	₹ 1

### Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoters	72.2	72.2	72.3	72.3
FII	15.4	15.0	14.2	13.5
DII	7.8	7.8	7.9	8.4
Others	4.7	5.1	5.7	5.8

### Price Chart



### Recent event & key risks

- Declared interim dividend of ₹ 8 per share
- **Key Risk:** i) Higher-than-expected attrition, ii) Deteriorating TCV

### Research Analyst

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### Key Financial Summary

Financials	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 year CAGR (FY22-25E)
Net Sales	1,64,177	1,91,754	12.9	2,18,226	2,35,293	2,51,410	9.4
EBITDA	46,546	53,057	13.2	58,048	64,235	69,138	9.2
EBITDA Margins (%)	28.4	27.7		26.6	27.3	27.5	
Net Profit	32,430	38,327	9.9	42,335	47,680	51,091	10.1
EPS (₹)	86.7	104.7	9.9	115.7	130.3	139.6	
P/E	35.5	29.8		27.0	23.9	22.3	
RoNW (%)	37.5	43.0		42.0	41.0	38.6	
RoCE (%)	45.9	51.4		49.3	48.7	46.3	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter & conference call highlights

- TCS reported 4% QoQ, 15.4% YoY CC revenue growth for the quarter. Dollar revenues were up 1.4% QoQ and 8.6% YoY to US\$6,877 million (mn), implying 260 bps cross currency headwinds for the quarter
- In terms of revenue by geographies (in CC terms), the North America market (54% of mix), grew 17.6% YoY while UK and Continental Europe reported growth of 14.8% and 14.1% YoY, respectively. India, Asia Pacific and MEA regions grew 16.7%, 7.0% and 8.2% YoY, respectively. Vertical wise, growth was aided by retail, BFSI, media & comm and healthcare, which grew 22.9%, 13.1%, 18.7% and 14.5% YoY, respectively
- LTM attrition continued to inch up to 21.5% (up from 19.7% in the previous quarter). The management in Q1FY23 earnings call had indicated that LTM attrition is likely to be at an elevated level in H2 and is expected to moderate in H2. In continuance of its commentary, the company mentioned that LTM attrition in Q2 could be at a peak and is expected to moderate from here onwards. The management also indicated it is also a function of job market demand supply mismatch, which is now cooling off for tech talent
- The company added 9,840 net associates in Q2, taking the total to 616,171. TCS also indicated that it hired around 20,000 freshers in Q2
- On a reported basis, TCV for the quarter was at US\$8.1 bn, which was largely constant for two consecutive quarters (it reported US\$8.2 bn TCV in Q1). The company continued to maintain that steady state deal win number for the quarter could be in the range of US\$7-9 bn in the foreseeable future. TCS also indicated that the deal win number was also impacted by currency movement
- EBIT margin for the quarter was up 90 bps QoQ at 24%. There was a positive impact of currency (rupee depreciation against dollar) as well as utilisation improvement. Margin headwinds for the quarter were normalisation of travelling and facility expenses as well as increase in backfilling costs due to high LTM attrition. The company maintained its earlier guidance of exit margins of 25% in Q4FY23
- TCS indicated that it has hired 35,000 freshers in H1FY23 (15,000 in Q1 and 20,000 in Q2) and maintained guidance of 40,000 fresher additions in FY23, which implies that pace of fresher additions is likely to come down in H2. The company also indicated that fresher hiring is being done keeping an eye on long term demand outlook and there could be some variation in quarterly trends. TCS clarified that it is honouring all fresher's offers. It has also indicated that 70% of employees have been paid 100% variable payout while rest 30% of employees would be paid on the basis of performance
- TCS indicated that demand for the US market continued to robust, which is a function of continued strong deal execution. It also indicated that near term outlook also looks strong with healthy TCV of US\$2 bn+ for the market. The company indicated that it has not picked up any sign of growth moderation in the region as well as change in spending pattern across clients. TCS is also not seeing any deal cancellation or delay in the project execution in the region. The company expects normal seasonality in the US market for the December quarter
- Regarding Europe region, the company continued to see robust numbers as it indicates that Europe is going through a strong tech cycle where technology is a key driver in both revenue and cost reduction programmes. TCS believes that it is playing that cycle well and continues to gain market share there, which is also a reflection of its continued strong growth of 14%+ on a YoY basis in Q2. However, the company indicated that the near term outlook for the Europe region is cautious due to continued geopolitical risks and volatility in the upcoming winter regarding energy requirements. The order book in Q2FY23 grew 33% QoQ for Europe

- The management indicated that it expects a margin improvement, going forward. Some margin tailwinds are i) rupee depreciation, ii) pricing increase, iii) utilisation improvement (as fresher hiring is likely come down), iv) moderation of subcontractor costs, which is likely to mitigate normalisation of travel expenses and facility expenses. Subcontractor costs as percentage of revenue dipped marginally to 9.9% of sales in Q2FY23 vs. 7.6% it achieved few quarters back. Facility expenses as a percentage of sales is currently at 1.2%, up from the Covid quarter low of 0.6% of sales

**Exhibit 1: Variance Analysis**

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue (US\$ mn)	6,877	6,882	6,333	8.6	6,780	1.4	Revenue grew 4% QoQ in CC term driven by continued growth momentum in BFSI, retail, manufacturing, etc
Revenue (₹ crore)	55,309	54,916	46,867	18.0	52,758	4.8	Revenue growth was aided by the North America region, which grew 17.6% YoY in CC terms while vertical wise retail, BFSI, media & healthcare grew 22.9%, 13.1%, 18.7% & 14.5% YoY, respectively, in CC terms
Employee expenses	32,526	32,675	27,048	20.3	31,553	3.1	
Gross Margin	22,783	22,241	19,819	15.0	21,205	7.4	
Gross margin (%)	41.2	40.5	42.3	-110 bps	40.2	100 bps	
SG&A expenses	8,267	8,018	6,704	23.3	7,788	6.2	
EBITDA	14,516	14,223	13,115	10.7	13,417	8.2	
EBITDA Margin (%)	26.2	25.9	28.0	-174 bps	25.4	81 bps	
Depreciation	1,237	1,263	1,115	10.9	1,231	0.5	
EBIT	13,279	12,960	12,000	10.7	12,186	9.0	
EBIT Margin (%)	24.0	23.6	25.6	-160 bps	23.1	91 bps	EBIT margin expanded due to currency depreciation & utilisation related benefits, which was mitigated, to some extent, due to normalisation of travel & facility expenses as well as increase in backfilling costs amid high attrition
Other income (less interest)	817	600	969	-15.7	590	38.5	
PBT	14,096	13,560	12,969	8.7	12,776	10.3	
Tax paid	3,631	3,458	3,316	9.5	3,257	11.5	
Reported PAT	10,431	10,062	9,624	8.4	9,478	10.1	
Adjusted PAT	10,431	10,062	9,624	8.4	9,478	10.1	

Source: Company, ICICI Direct Research

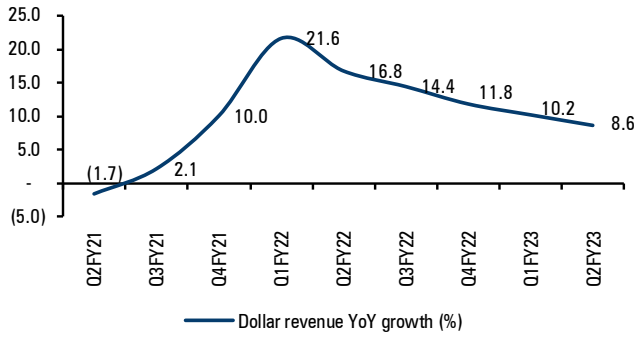
**Exhibit 2: Change in estimates**

	FY23E			FY24E			FY25E	Comments
	old	New	% Change	Old	New	% Change	Introduced	
(₹ Crore)								
Revenue	214,348	218,226	1.8	236,378	235,293	-0.5	251,410	
EBIT	52,515	52,811	0.6	59,095	59,059	-0.1	63,607	
EBIT Margin (%)	24.5	24.2	-30 bps	25.0	25.1	10 bps	25.3	We build in margin expansion from FY23 onwards
PAT	42,115	42,335	0.5	47,707	47,680	-0.1	51,091	
EPS (₹)	115.1	115.7	0.5	130.4	130.3	-0.1	139.6	

Source: Company, ICICI Direct Research

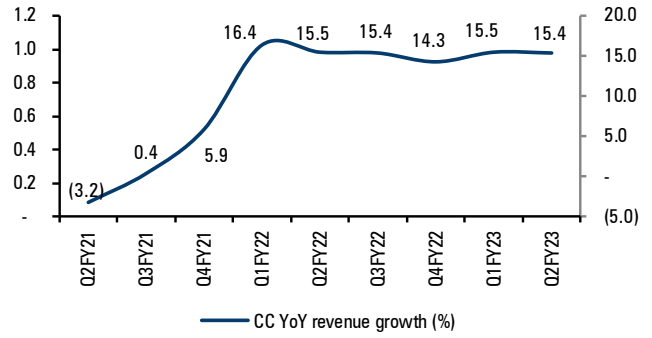
### Quarterly highlights

**Exhibit 3: Dollar growth hit by cross currency headwinds**



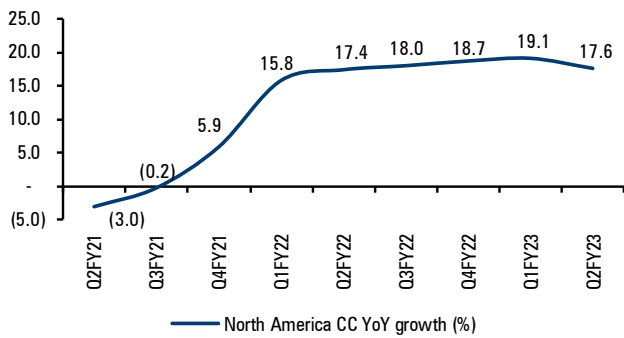
Source: Company, ICICI Direct Research

**Exhibit 4: CC YoY revenue growth has been steady**



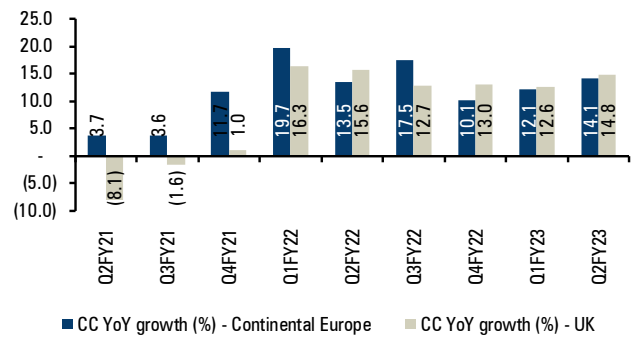
Source: Company, ICICI Direct Research

**Exhibit 5: Steady growth in North America market**



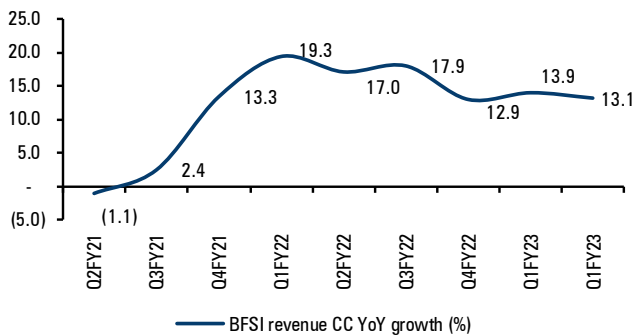
Source: Company, ICICI Direct Research

**Exhibit 6: UK & Continental Europe growth pick up in Q2**



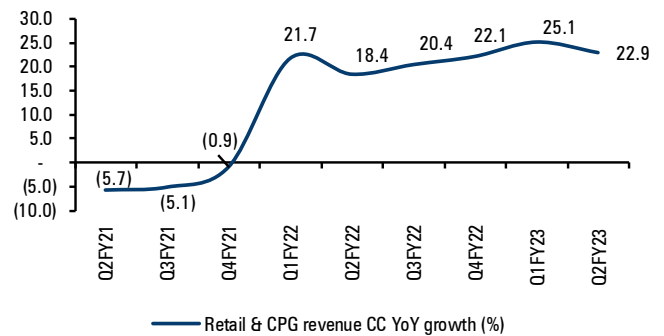
Source: Company, ICICI Direct Research

**Exhibit 7: BFSI revenue remains stable**



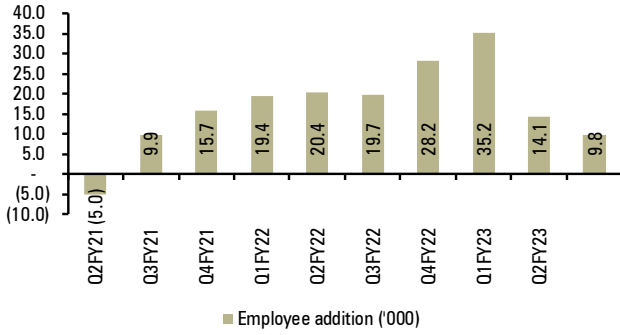
Source: Company, ICICI Direct Research

**Exhibit 8: Retail revenues continue to be strong**



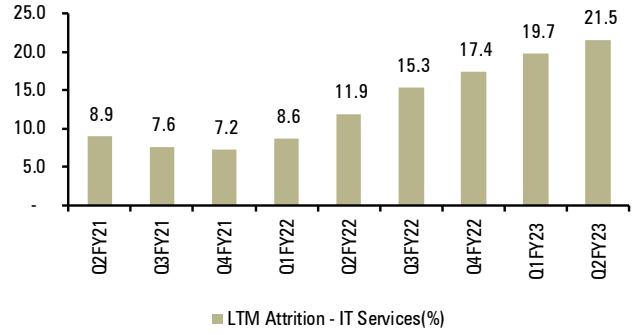
Source: Company, ICICI Direct Research

**Exhibit 9: Employee additions moderating**



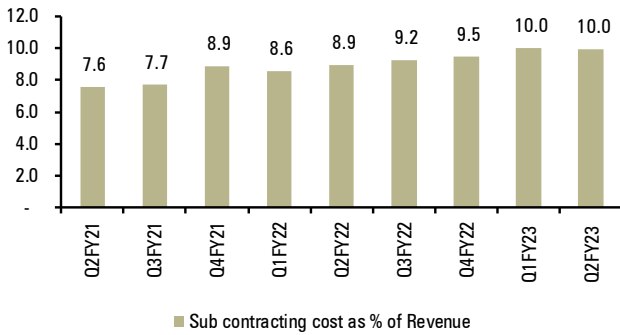
Source: Company, ICICI Direct Research

**Exhibit 10: LTM attrition at elevated level**



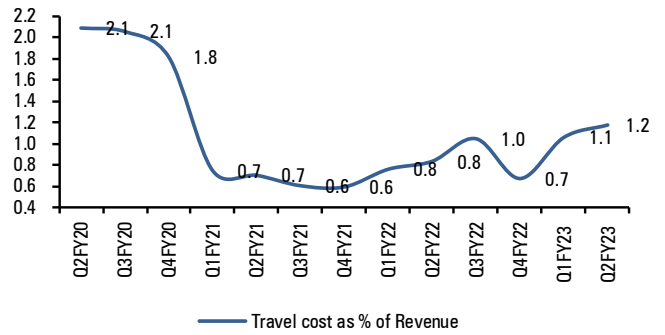
Source: Company, ICICI Direct Research

**Exhibit 11: Sub-contracting costs largely stable**



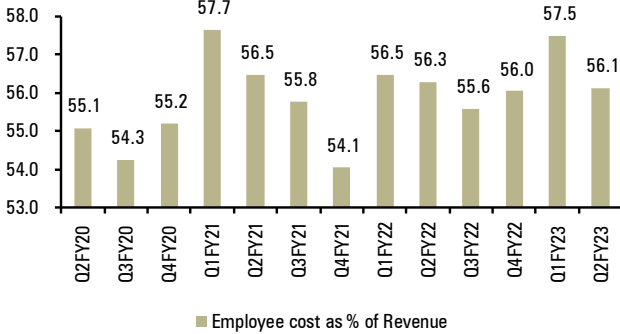
Source: Company, ICICI Direct Research

**Exhibit 12: Travel cost continues to inch up**



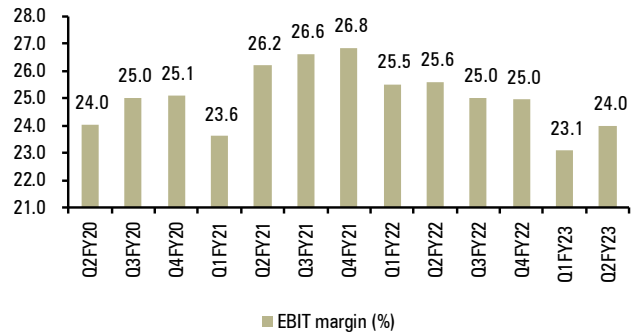
Source: Company, ICICI Direct Research

**Exhibit 13: Employee costs cool off after Q1 wage hike**



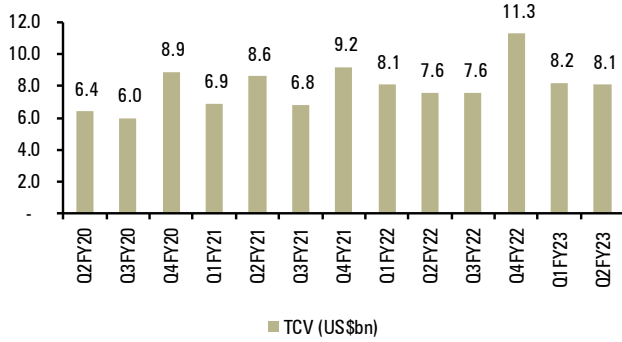
Source: Company, ICICI Direct Research

**Exhibit 14: Margins on up move**



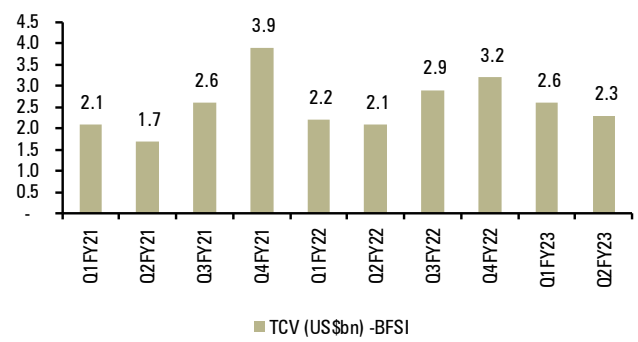
Source: Company, ICICI Direct Research

Exhibit 15: TCV remains steady



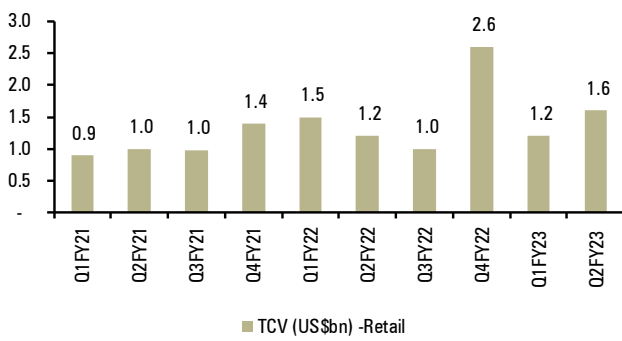
Source: Company, ICICI Direct Research

Exhibit 16: TCV trend for BFSI



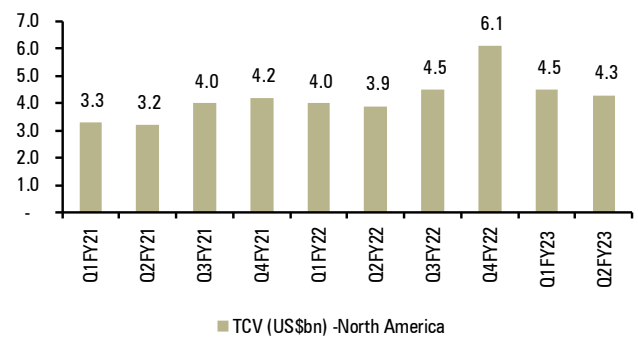
Source: Company, ICICI Direct Research

Exhibit 17: TCV trend for retail



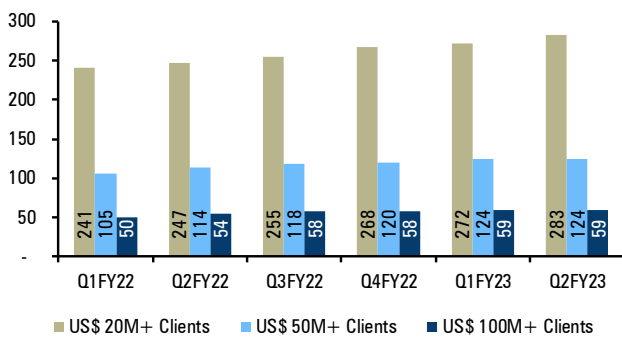
Source: Company, ICICI Direct Research

Exhibit 18: TCV trend for North America



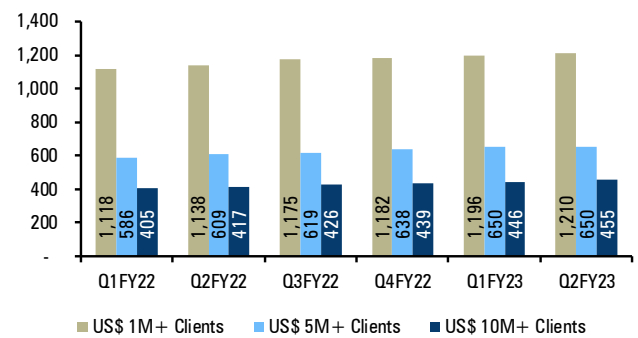
Source: Company, ICICI Direct Research

Exhibit 19: Adds five clients in US\$100 mn+ on YoY basis



Source: Company, ICICI Direct Research

Exhibit 20: Client addition trend



Source: Company, ICICI Direct Research

## Peer comparison

### Exhibit 21: Peer Comparison

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HCL Tech (HCLTEC)	962	1,050	HOLD	2,61,055	49.8	50.5	55.2	19.3	19.1	17.4	24.2	24.8	26.0	21.8	21.0	21.9
Infosys (INFTEC)	1,463	1,760	BUY	6,15,575	52.1	58.1	67.5	28.1	25.2	21.7	36.0	35.0	37.7	29.2	29.1	31.1
TCS (TCS)	3,119	3,630	BUY	11,41,258	104.7	115.1	130.4	29.8	27.1	23.9	51.4	49.2	48.7	43.0	41.9	41.0
Tech M (TECMAH)	1,030	1,170	BUY	1,00,200	63.1	66.2	77.9	16.3	15.6	13.2	22.5	21.8	22.7	20.7	19.4	20.3
Wipro (WIPRO)	411	460	HOLD	2,25,281	22.3	23.3	27.1	18.5	17.7	15.2	18.8	18.9	21.0	19.6	18.7	20.8

Source: Company, ICICI Direct Research



## Financial summary

Exhibit 22: Profit and loss statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
<b>Total operating Income</b>	<b>1,91,754</b>	<b>2,18,226</b>	<b>2,35,293</b>	<b>2,51,410</b>
Growth (%)	16.8	13.8	7.8	6.8
COGS (employee expenses)	1,11,053	1,29,626	1,37,882	1,47,075
S,G&A expenses	27,644	30,552	33,176	35,197
Total Operating Expenditure	1,38,697	1,60,178	1,71,058	1,82,273
<b>EBITDA</b>	<b>53,057</b>	<b>58,048</b>	<b>64,235</b>	<b>69,138</b>
Growth (%)	14.0	9.4	10.7	7.6
Depreciation	4,604	5,237	5,176	5,531
Other Income less interest	3,234	4,026	4,677	4,677
PBT	51,687	56,837	63,735	68,284
Total Tax	13,238	14,380	15,934	17,071
Minority Interest	122	122	122	122
<b>PAT</b>	<b>38,327</b>	<b>42,335</b>	<b>47,680</b>	<b>51,091</b>
Growth (%)	18.2	10.5	12.6	7.2
EPS (₹)	104.7	115.7	130.3	139.6
<b>PAT</b>	<b>38,327</b>	<b>42,335</b>	<b>47,680</b>	<b>51,091</b>
EPS - Reported (₹)	104.7	115.7	130.3	139.6

Source: Company, ICICI Direct Research

Exhibit 23: Cash flow statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Profit before Tax	51,687	56,837	63,735	68,284
Add: Depreciation	4,604	5,237	5,176	5,531
(Inc)/dec in Current Assets	1,092	-2,505	-4,891	-4,618
Inc/(dec) in CL and Provisions	8,124	3,521	3,641	3,438
Taxes paid	-13,238	-14,380	-15,934	-17,071
<b>CF from operating activities</b>	<b>49,332</b>	<b>45,148</b>	<b>47,714</b>	<b>51,550</b>
(Inc)/dec in Investments	-1,100	-35	-358	-338
(Inc)/dec in Fixed Assets	-3,835	-4,365	-4,706	-5,028
Others	2,937	3,563	4,014	4,014
<b>CF from investing activities</b>	<b>-1,998</b>	<b>-836</b>	<b>-1,050</b>	<b>-1,353</b>
Inc/(dec) in loan funds	0	0	0	0
Dividend paid & dividend tax	-34,123	-30,587	-32,256	-34,891
Others	-1,498	0	0	0
<b>CF from financing activities</b>	<b>-35,621</b>	<b>-30,587</b>	<b>-32,256</b>	<b>-34,891</b>
Net Cash flow	11,713	13,724	14,408	15,306
Exchange difference	0	0	0	0
Opening Cash	7,705	21,042	34,766	49,174
<b>Closing cash and Bank</b>	<b>21,042</b>	<b>34,766</b>	<b>49,174</b>	<b>64,480</b>

Source: Company, ICICI Direct Research

Exhibit 24: Balance sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
<b>Liabilities</b>				
Equity Capital	366	366	366	366
Reserve and Surplus	88,773	1,00,521	1,15,944	1,32,144
Share Premium	0	0	0	0
Total Shareholders funds	89,139	1,00,887	1,16,310	1,32,510
Total debt	7,818	10,229	10,364	10,490
Other liabilities & Provisions	2,359	2,678	2,755	2,829
Deferred tax liability(net)	590	590	590	590
Minority Interest / Others	707	829	951	1,073
<b>Total Liabilities</b>	<b>1,00,613</b>	<b>1,15,213</b>	<b>1,30,970</b>	<b>1,47,492</b>
<b>Assets</b>				
Net assets & CWIP	20,716	19,167	18,696	18,193
Goodwill	1,787	1,787	1,787	1,787
Other non current assets	10,501	10,536	10,894	11,233
Debtors	34,219	40,054	43,187	46,145
Loans and Advances	6,456	10,911	11,765	12,571
Other Current Assets	19,352	11,566	12,471	13,325
Current Investments	30,262	30,262	30,262	30,262
Cash	18,221	34,766	49,174	64,480
Trade Payable	8,045	10,448	11,265	12,036
OCL & Provisions	32,856	33,389	36,000	38,466
<b>Application of Funds</b>	<b>1,00,613</b>	<b>1,15,213</b>	<b>1,30,971</b>	<b>1,47,493</b>

Source: Company, ICICI Direct Research

Exhibit 25: Key ratios				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
<b>Per share data (₹)</b>				
Adjusted EPS (Diluted)	104.7	115.7	130.3	139.6
BV per share	243.5	275.6	317.8	362.0
DPS	93.3	83.6	88.2	95.4
Cash Per Share	49.8	95.0	134.4	176.2
<b>Operating Ratios (%)</b>				
EBIT margins	25.3	24.2	25.1	25.3
PBT Margins	27.0	26.0	27.1	27.2
PAT Margin	20.0	19.4	20.3	20.3
Debtor days	65	67	67	67
Creditor days	15	17	17	17
<b>Return Ratios (%)</b>				
RoE	43.0	42.0	41.0	38.6
RoCE	51.4	49.3	48.7	46.3
RoIC	92.9	105.2	114.6	120.6
<b>Valuation Ratios (x)</b>				
P/E	29.7	26.9	23.9	22.3
EV / Net Sales	5.7	5.0	4.6	4.2
Market Cap / Sales	6.0	5.2	4.9	4.5
<b>Solvency Ratios</b>				
Debt / EBITDA	0.1	0.2	0.2	0.2
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	1.5	1.4	1.4	1.4
Quick Ratio	1.5	1.4	1.4	1.4

Source: Company, ICICI Direct Research

Exhibit 26: ICICI Direct coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HCL Tech (HCLTEC)	962	1,050	HOLD	2,61,055	49.8	50.5	55.2	19.3	19.1	17.4	24.2	24.8	26.0	21.8	21.0	21.9
Infosys (INFTEC)	1,463	1,760	BUY	6,15,575	52.1	58.1	67.5	28.1	25.2	21.7	36.0	35.0	37.7	29.2	29.1	31.1
TCS (TCS)	3,119	3,630	BUY	11,41,258	104.7	115.1	130.4	29.8	27.1	23.9	51.4	49.2	48.7	43.0	41.9	41.0
Tech M (TECMAH)	1,030	1,170	BUY	1,00,200	63.1	66.2	77.9	16.3	15.6	13.2	22.5	21.8	22.7	20.7	19.4	20.3
Wipro (WIPRO)	411	460	HOLD	2,25,281	22.3	23.3	27.1	18.5	17.7	15.2	18.8	18.9	21.0	19.6	18.7	20.8
LTI (LTINFC)	4,700	4,480	HOLD	82,355	130.8	140.3	165.9	35.9	33.5	28.3	32.3	29.0	29.6	26.1	24.1	24.4
Mindtree (MINCON)	3,348	3,320	BUY	55,177	100.3	109.8	127.9	33.4	30.5	26.2	38.0	35.4	34.5	30.2	27.4	26.6
Coforge (NIITEC)	3,639	4,375	BUY	22,163	106.5	147.8	175.0	34.2	24.6	20.8	25.6	31.5	31.8	24.2	28.4	28.3
TeamLease (TEASER)	3,069	4,240	BUY	5,247	22.5	85.6	124.6	136.5	35.8	24.6	15.4	17.6	20.8	(4.7)	17.4	20.4
Infoedge (INFEDG)	3,817	5,230	BUY	47,969	35.8	47.8	54.2	106.7	79.9	70.4	4.2	5.7	6.3	3.2	4.3	4.7

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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