

CMP: ₹ 3965

Target: ₹ 4600 (16%)

Target Period: 12 months

January 14, 2022

BUY

## Margins dip on supply side challenges...

**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%)

**Q3FY22 Results:** TCS reported Q2FY22 results.

- US\$ revenues grew 3% QoQ to \$6,333 million, up 15.4% YoY in CC terms
- EBIT margins declined 60 bps QoQ to 25.0%
- The company's deal pipeline continues to be healthy at US\$7.6 billion

**What should investors do?** TCS' share price has grown by ~3.9x over the past five years (from ~₹ 1,018 in January 2017 to ~₹ 3,965 levels in January 2022).

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

**Target Price and Valuation:** We value TCS at ₹ 4,600 i.e. 34x P/E on FY24E 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 13% over FY21-24E
- We expect margins to be under pressure, at least in FY23E, before stabilising at 25.8% in FY24E, resulting in margin improvement of only 50 bps in FY21-24E
- 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 ₹ 2,300

### Key Financial Summary

Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 year CAGR (FY21-24E)
Net Sales	146,463	156,949	164,177	8.6%	189,446	215,347	236,655	13.0%
EBITDA	39,506	42,110	46,546	8.7%	52,477	60,513	66,263	12.5%
EBITDA Margins (%)	27.0	26.8	28.4		27.7	28.1	28.0	
Net Profit	31,472	32,340	32,430	6.0%	38,468	44,738	49,882	15.4%
EPS (₹)	83.8	86.2	86.7		103.9	120.8	134.7	
P/E	46.3	45.1	44.4		37.5	32.2	28.9	
RoNW (%)	34.4	38.4	37.5		41.4	43.4	41.7	
RoCE (%)	43.8	44.4	45.9		49.0	51.7	49.9	

Source: Company, ICICI Direct Research



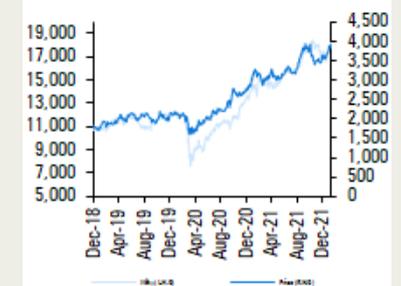
### Particulars

Particular	Amount
Market Capitalization (₹ Crore)	1,467,050.0
Total Debt (₹ Crore)	7,795.0
Cash and equivalents (₹ Crore)	38,489.0
EV (₹ Crore)	1,436,356.0
52 week H/L	3990/ 2701
Equity capital (₹ Crore)	370
Face value	₹ 1

### Shareholding pattern

	Mar-21	Jun-21	Sep-21	Dec-21
Promoters	72.2	72.2	72.2	72.2
FII	15.6	15.4	15.4	15.0
DII	7.8	7.8	7.8	7.8
Others	4.4	4.6	4.7	5.1

### Price Chart



### Recent Event & Key risks

- Announced buyback of ₹18,000 crore and ₹ 7/share interim dividend
- **Key Risk:** (i) higher than expected attrition (ii) Further margin pressure amid supply side challenges

### Research Analyst

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## Key takeaways of recent quarter & conference call highlights

- The company reported 3% QoQ growth to US\$6,524mn while it grew 14.4% on YoY basis. The company recorded 15.4% YoY growth in CC terms
- In terms of revenue by geographies (in CC terms), North America market (52% of mix), grew +18.0% YoY, while UK and Continental Europe reported healthy growth of +12.7% and 17.5% YoY, respectively. Asia Pacific, India and MEA regions grew 4.3%, 15.2% and 6.9% YoY, respectively
- In vertical wise, BFSI, retail & healthcare grew 17.9%, 20.4% and 16.3% YoY, respectively, while manufacturing, technology & services and Media grew 18.3%, 17.7% and 14.4% YoY, respectively
- Attrition was at 15.3% (up from 11.9% in the previous quarter) but the management indicated that quarterly annualised attrition has come down sequentially and they are seeing green shoots of it tapering down in a couple of quarters. The company added 28,238 associates taking the total to 556,986. It is the highest quarterly addition ever
- The company announced a buyback of ₹18,000 crore (4 crore shares at ₹ 4,500 per share). The amount is 12.5% higher than historical buyback. The company also declared an interim dividend of ₹ 7/share (to be paid on February 7, 2022)
- EBIT margin contracted 60 bps QoQ to 25.0%. There was (-70 bps) wage hike impact and (-60 bps) impact due to higher SG&A. It was mitigated by pyramid optimisation (+60 bps), currency tailwind of (+10 bps)
- The company indicated that it hired 43,000 freshers in H1FY22 and 34,000 freshers hired in Q3 itself which were earlier planned to be hired in H2FY22 (i.e. front loading). The company indicated that they will continue freshers hiring in Q4 as well
- The company indicated that the healthcare sector across the globe is going through transformation where there is a rapid need of providing a common access among various stakeholder's is critical i.e. pharma companies, hospitals and pharma retailers, etc
- The company indicated that current digital transformation opportunity has three horizons where horizon 1 pertains to moving your onsite applications to cloud, which is currently playing out. There are further opportunities, which are termed as Horizon 2 (cloud native application development) and Horizon 3 (end to end ecosystem play for sectors such as pharma, manufacturing, etc)
- 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 it to participate in larger deals, going forward
- TCS said it is 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
- Deal TCW was at US\$7.6 billion, flattish on a sequential basis but up 11.7% on a YoY basis. The management said the TCW is largely broad based

## 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)	1,333	1,475	BUY	361,799	45.8	50.6	60.9	29.1	26.3	21.9	23.5	24.1	27.6	20.8	20.5	23.2
Infosys (INFTEC)	1,897	2,300	BUY	806,433	45.5	55.9	63.2	41.7	34.0	30.0	31.7	34.5	36.4	25.2	28.2	29.8
TCS (TCS)	3,965	4,600	BUY	1,467,050	87.6	104.0	120.9	45.2	38.1	32.8	45.9	49.0	51.7	37.5	41.4	43.4
Tech M (TECMAH)	1,719	2,150	BUY	166,107	50.2	64.7	76.8	34.2	26.6	22.4	19.8	22.8	24.4	17.8	20.4	21.4
Wipro (WIPRO)	640	815	BUY	350,528	19.1	21.8	25.6	33.6	29.4	25.0	21.3	22.5	26.2	19.5	21.6	25.4

Source: Company, ICICI Direct Research

**Exhibit 2: Variance Analysis**

	Q3FY22	Q3FY22E	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	Comments
Revenue	48,885	48,383	42,015	16.4	46,867	4.3	Revenue growth was broad based
Employee expenses	28,401	27,723	23,749	19.6	27,048	5.0	
Gross Margin	20,484	20,659	18,266	12.1	19,819	3.4	
Gross margin (%)	41.9	42.7	43.5	-157 bps	42.3	-39 bps	
SG&A expenses	7,051	7,016	6,059	16.4	6,704	5.2	
EBITDA	13,433	13,644	12,207	10.0	13,115	2.4	
EBITDA Margin (%)	27.5	28.2	29.1	-158 bps	28.0	-50 bps	
Depreciation	1,196	1,161	1,023	16.9	1,115	7.3	
EBIT	12,237	12,483	11,184	9.4	12,000	2.0	
EBIT Margin (%)	25.0	25.8	26.6	-159 bps	25.6	-57 bps	EBIT margin contracted 60 bps QoQ as there was wage hike impact (-70 bps) and impact due to higher SG&A (-60 bps). It was mitigated by pyramid optimisation (+60bps), currency tailwind of (+10 bps)
Other income (less interest)	954	900	508	87.8	969	-1.5	
PBT	13,191	13,383	11,692	12.8	12,969	1.7	
Tax paid	3,385	3,413	2,965	14.2	3,316	2.1	
Reported PAT	9,769	9,941	8,701	12.3	9,624	1.5	
Adjusted PAT	9,769	9,941	8,701	12.3	9,624	1.5	PAT was lower due to lower-than-expected operating performance

Source: Company, ICICI Direct Research

**Exhibit 3: Change in estimates**

₹ Crore	FY22E			FY23E			FY24E	Comments
	Old	New	% Change	old	New	% Change	Introduced	
Revenue	189,446	189,446	0.0	220,405	215,347	-2.3	236,655	We revise revenue estimate on 9MFY22 performance
EBIT	51,340	47,930	-6.6	61,273	55,344	-9.7	61,057	
EBIT Margin (%)	27.1	25.3	-180 bps	27.8	25.7	-210 bps	25.8	We trim margins due to supply side pressure visible in Q3FY22 margins as we expect challenges to remain for a few quarters
PAT	41,032	38,468	-6.2	49,196	44,738	-9.1	49,882	
EPS (₹)	110.8	103.9	-6.2	132.9	120.8	-9.1	134.7	

Source: Company, ICICI Direct Research

## Key Metrics

**Exhibit 4: Geography wise break-up**

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
<b>Revenue by geography (%)</b>					
North America	49.1	48.6	49.4	50.3	50.7
Latin America	1.7	1.6	1.6	1.6	1.7
UK	15.7	16.0	16.3	16.1	15.6
Continental Europe	16.2	16.8	16.7	15.9	16.0
India	5.6	5.6	4.6	5.1	5.5
Asia Pacific	9.7	9.4	9.3	9.0	8.6
MEA	2.0	2.0	2.1	2.0	1.9
<b>Growth QoQ (%)</b>					
North America	3.4	4.0	4.4	4.8	3.8
Latin America	5.1	-1.1	2.8	2.9	9.5
UK	6.5	7.0	4.7	1.6	-0.2
Continental Europe	4.5	8.9	2.1	-2.0	3.7
India	17.7	5.0	-15.6	14.1	11.1
Asia Pacific	5.1	1.8	1.7	-0.4	-1.6
MEA	10.7	5.0	7.9	-2.0	-2.1

Source: Company, ICICI Direct Research

*Continental Europe has reported a growth after a blip in the last quarter, while north America growth trajectory continues*

**Exhibit 5: Vertical wise break-up**

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
<b>Revenue by verticals (%)</b>					
BFSI	31.3	32.2	32.5	32.4	32.1
Retail & CPG	14.5	14.5	14.8	15.0	15.1
Communication and Media	6.6	6.5	6.4	6.5	6.5
Manufacturing	9.6	9.7	10.2	9.9	9.9
Life Sciences & Healthcare	9.8	9.6	9.8	10.0	9.9
Technology & services	8.6	8.4	8.6	8.8	8.7
Regional markets & others	19.6	19.1	17.7	17.4	17.8
<b>Growth QoQ (%)</b>					
BFSI	3.1	8.1	3.7	2.6	2.1
Retail & CPG	4.4	5.0	4.9	4.3	3.7
Communication and Media	6.7	3.4	1.2	4.5	3.0
Manufacturing	7.4	6.1	8.1	-0.1	3.0
Life Sciences & Healthcare	5.1	2.9	4.9	5.0	2.0
Technology & services	1.6	2.6	5.2	5.3	1.8
Regional markets & others	9.0	2.4	-4.8	1.2	5.4

Source: Company, ICICI Direct Research

*Broad based growth across verticals*

**Exhibit 6: Client & human resource matrix**

	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
<b>Client metrics</b>					
USD 1 mn+ clients	1077	1096	1118	1138	1175
USD 5 mn+ clients	565	569	586	609	619
USD 10 mn+ clients	386	387	405	417	426
USD 20 mn+ clients	229	228	241	247	255
USD 50 mn+ clients	97	101	105	114	118
USD 100 mn+ clients	48	48	50	54	58
<b>Headcount, Attrition</b>					
Total Employees	469261	488649	509058	528748	556986
Attrition, LTM (IT Services)	7.6	7.2	8.6	11.9	15.3

Source: Company, ICICI Direct Research

*Attrition rose 340 bps QoQ*

## Financial summary

Exhibit 7: Profit and loss statement					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
<b>Total operating Income</b>	<b>164,177</b>	<b>189,446</b>	<b>215,347</b>	<b>236,655</b>	
Growth (%)	4.6	15.4	13.7	9.9	
COGS (employee expenses)	94,053	110,258	124,686	137,023	
S,G&A expenses	23,578	26,712	30,149	33,368	
Total Operating Expenditure	117,631	136,970	154,835	170,392	
<b>EBITDA</b>	<b>46,546</b>	<b>52,477</b>	<b>60,513</b>	<b>66,263</b>	
Growth (%)	10.5	12.7	15.3	9.5	
Depreciation	4,065	4,547	5,168	5,206	
Other Income less interest	2,497	3,400	4,323	5,011	
PBT	44,978	51,330	59,667	66,068	
Total Tax	11,198	12,730	14,797	16,055	
Minority Interest	132	132	132	132	
<b>PAT</b>	<b>32,430</b>	<b>38,468</b>	<b>44,738</b>	<b>49,882</b>	
Growth (%)	0.3	18.6	16.3	11.5	
EPS (₹)	86.7	103.9	120.8	134.7	
<b>PAT</b>	<b>32,430</b>	<b>38,468</b>	<b>44,738</b>	<b>49,882</b>	
EPS - Reported (₹)	86.7	103.9	120.8	134.7	

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
Profit before Tax	44,978	51,330	59,667	66,068	
Add: Depreciation	4,065	4,547	5,168	5,206	
(Inc)/dec in Current Assets	(1,766)	3,047	(3,634)	(6,106)	
Inc/(dec) in CL and Provisions	2,629	3,137	7,894	4,545	
Taxes paid	(2,106)	(12,730)	(14,797)	(16,055)	
<b>CF from operating activities</b>	<b>38,802</b>	<b>46,394</b>	<b>50,437</b>	<b>49,311</b>	
(Inc)/dec in Investments	(7,728)	(531)	(544)	(447)	
(Inc)/dec in Fixed Assets	(3,139)	(3,789)	(4,307)	(4,733)	
Others	2,738	2,937	3,860	4,348	
<b>CF from investing activities</b>	<b>(8,129)</b>	<b>(1,383)</b>	<b>(991)</b>	<b>(832)</b>	
Inc/(dec) in loan funds	0	0	0	0	
Dividend paid & dividend tax	(30,576)	(31,954)	(34,598)	(33,434)	
Others	(722)	0	0	0	
<b>CF from financing activities</b>	<b>(32,634)</b>	<b>(31,954)</b>	<b>(34,598)</b>	<b>(33,434)</b>	
Net Cash flow	(1,961)	13,058	14,849	15,046	
Exchange difference	0	0	0	0	
Opening Cash	9,666	7,705	22,387	37,235	
<b>Closing cash and Bank</b>	<b>7,705</b>	<b>22,387</b>	<b>37,235</b>	<b>52,281</b>	

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
<b>Liabilities</b>					
Equity Capital	370	370	370	370	
Reserve and Surplus	86,063	92,577	102,717	119,166	
Share Premium	0	0	0	0	
Total Shareholders funds	86,433	92,947	103,087	119,536	
Total debt	7,795	7,994	8,198	8,365	
Other liabilities & Provisions	2,226	2,341	2,459	2,557	
Deferred tax liability(net)	767	767	767	767	
Minority Interest / Others	675	807	939	1,071	
<b>Total Liabilities</b>	<b>97,896</b>	<b>104,856</b>	<b>115,451</b>	<b>132,296</b>	
<b>Assets</b>					
Net assets & CWIP	20,149	19,391	18,530	18,057	
Goodwill	1,798	1,798	1,798	1,798	
Other non current assets	9,204	9,735	10,278	10,726	
Debtors	30,134	34,772	39,526	43,437	
Loans and Advances	11,491	13,260	10,767	11,833	
Other Current Assets	19,494	10,041	11,413	12,543	
Current Investments	29,160	29,160	29,160	29,160	
Cash	9,329	22,387	37,235	52,281	
Trade Payable	7,860	9,070	10,310	11,330	
OCL & Provisions	25,003	26,616	32,948	36,208	
<b>Application of Funds</b>	<b>97,896</b>	<b>104,856</b>	<b>115,451</b>	<b>132,296</b>	

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios					₹ crore
(Year-end March)	FY21	FY22E	FY23E	FY24E	
<b>Per share data (₹)</b>					
Adjusted EPS (Diluted)	86.7	103.9	120.8	134.7	
BV per share	233.6	251.2	278.6	323.1	
DPS	21.0	86.3	93.4	0.0	
Cash Per Share	25.2	60.5	100.6	141.3	
<b>Operating Ratios (%)</b>					
EBIT margins	25.9	25.3	25.7	25.8	
PBT Margins	27.4	27.1	27.7	27.9	
PAT Margin	19.8	20.3	20.8	21.1	
Debtor days	67	67	67	67	
Creditor days	17	17	17	17	
<b>Return Ratios (%)</b>					
RoE	37.5	41.4	43.4	41.7	
RoCE	45.9	49.0	51.7	49.9	
RoIC	71.5	89.9	112.8	120.1	
<b>Valuation Ratios (x)</b>					
P/E	45.1	38.1	32.7	29.4	
EV / Net Sales	8.7	7.5	6.5	5.9	
Market Cap / Sales	8.9	7.7	6.8	6.2	
<b>Solvency Ratios</b>					
Debt / EBITDA	0.2	0.2	0.1	0.1	
Debt / Equity	0.1	0.1	0.1	0.1	
Current Ratio	1.9	1.6	1.4	1.4	
Quick Ratio	1.9	1.6	1.4	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)	1,333	1,475	BUY	361,799	45.8	50.6	60.9	29.1	26.3	21.9	23.5	24.1	27.6	20.8	20.5	23.2
Infosys (INFTEC)	1,897	2,300	BUY	806,433	45.5	55.9	63.2	41.7	34.0	30.0	31.7	34.5	36.4	25.2	28.2	29.8
TCS (TCS)	3,965	4,600	BUY	1,467,050	87.6	104.0	120.9	45.2	38.1	32.8	45.9	49.0	51.7	37.5	41.4	43.4
Tech M (TECMAH)	1,719	2,150	BUY	166,107	50.2	64.7	76.8	34.2	26.6	22.4	19.8	22.8	24.4	17.8	20.4	21.4
Wipro (WIPRO)	640	815	BUY	350,528	19.1	21.8	25.6	33.6	29.4	25.0	21.3	22.5	26.2	19.5	21.6	25.4
LTI (LTINFC)	7,100	7,650	BUY	124,646	111.0	137.3	169.9	64.0	51.7	41.8	31.9	33.0	34.0	26.5	27.6	28.5
Mindtree (MINCON)	4,558	4,915	HOLD	75,069	67.4	89.8	109.2	67.6	50.7	41.7	32.5	36.0	36.3	25.7	28.2	28.2
Coforge (NIITEC)	5,726	5,870	BUY	35,595	73.3	115.2	146.7	78.1	49.7	39.0	23.3	28.6	30.9	18.5	25.0	27.1
TeamLease (TEASER)	4,249	4,220	HOLD	7,291	46.5	66.7	101.0	91.4	63.7	42.1	14.2	16.3	19.9	11.6	15.7	18.7
Infoedge (INFEDG)	5,589	6,270	BUY	72,413	20.9	37.1	51.0	267.3	150.7	109.7	7.7	13.1	16.7	6.0	9.9	12.6

Source: Company, ICICI Direct Research

## RATING RATIONALE

ICICI Direct endeavors to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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