

CMP: ₹ 3260

Target: ₹ 3780 (16%)

Target Period: 12 months

January 10, 2023

BUY

Steady performance in seasonally weak quarter...

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%)

Q3FY23 Results: TCS reported decent numbers in a seasonally weak quarter.

- Reported CC growth of 2.2% QoQ and 13.5% YoY, respectively
- EBIT margins improved 50 bps QoQ to 24.5% for the quarter
- Reported TCV of US\$7.8 billion (bn), down 3.7% QoQ

What should investors do? TCS' share price has grown by ~2.5x over the past five years (from ~₹ 1,323 in January 2018 to ~₹ 3,260 levels in January 2023).

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

Target Price and Valuation: We value TCS at ₹ 3,780 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 11.0% 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 110 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 ₹ 1,670



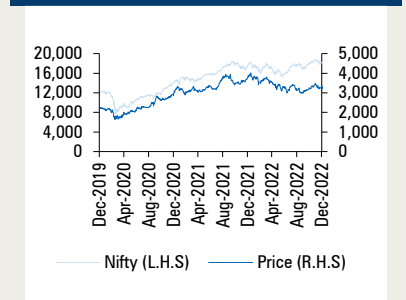
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	11,89,500
Total Debt (₹ Crore)	7,818
Cash and equivalents (₹ Crore)	48,483
EV (₹ Crore)	11,58,806
52 week H/L	4043/ 2927
Equity capital (₹ Crore)	366
Face value	₹ 1

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	72.2	72.3	72.3	72.3
FII	15.0	14.1	13.5	13.1
DII	7.9	7.8	8.4	8.6
Others	4.9	5.7	5.8	6.1

Price Chart



Recent event & key risks

- Declared interim dividend of ₹ 75 per share including ₹ 67 per share special dividend
- **Key Risk:** i) Lower-than-expected profit, ii) Deteriorating TCV

Research Analyst

Sameer Pardikar
sameer.pardikar@icicisecurities.com

Sujay Chavan
sujay.chavan@icicisecurities.com

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	2,23,822	2,41,326	2,62,389	11.0
EBITDA	46,546	53,057	13.2	59,089	65,882	72,157	10.8
EBITDA Margins (%)	28.4	27.7		26.4	27.3	27.5	
Net Profit	32,430	38,327	9.9	43,347	48,815	53,174	11.5
EPS (₹)	86.7	104.7	9.9	118.5	133.4	145.3	
P/E	37.0	31.0		27.4	24.4	22.4	
RoNW (%)	37.5	43.0		42.6	41.5	39.5	
RoCE (%)	45.9	51.4		50.1	49.3	47.5	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- TCS reported 2.2% QoQ, 13.5% YoY CC revenue growth in the furlough impacted quarter. The company indicated that the impact of furlough was comparable to the previous year and did not experience higher than expected furlough impact. In dollar terms, the company reported revenues of US\$7,075 million (mn), up 2.9% QoQ and 8.4% YoY. In rupee terms, TCS reported revenue of ₹ 58,229 crore, up 5.3% QoQ and 19.1% YoY
- In terms of revenue by geographies (in CC terms), growth was led by North America (54% of revenue mix) & UK (15% of revenue mix) reporting growth of 15.4% YoY each while Continental Europe, which was impacted by geopolitical crisis, grew 9.7% YoY. India, Asia Pacific and MEA regions grew 9.1%, 9.5% and 8.6% YoY, respectively
- In CC terms, vertical wise, all verticals reported double digit growth with Retail & CPG reporting growth of 18.7% YoY while its largest vertical BFSI (32% of revenue mix) reported growth of 11.1% YoY. Retail & CPG growth was aided by strong retail sales in the holiday season and rebound of travel & hospitality sub-vertical, which is included in Retail & CPG vertical
- EBIT margin for the quarter improved ~50 bps QoQ to 24.5% while EBIT increased 7.6% QoQ to ₹ 14,284 crore. The company indicated tailwinds for the margin improvement were currency benefit (+70 bps), (+30 bps) came in due to improved utilisation & lower sub-contractor cost while headwinds included ~50 bps increase in third party cost for hardware & software and increase in travel & facility expenses on account of normalisation of expenses
- TCS has maintained its exit EBIT margin guidance of 25% for Q4FY23. The company indicated that the margin improvement for the medium term would be driven by improved utilisation, moderation of sub-contractor costs & moderation of attrition. The company also indicated that pricing is one of the levers for margin improvement but acknowledged that it will be challenging to get price increases in the current environment
- The company indicated that revenue growth for the quarter was moderated due to seasonality. It mentioned that revenue growth in CY23 is expected to normalise after strong growth in CY21 and CY22. TCS also mentioned that deal TCv and deal pipeline, continue to be skewed towards cost take out deals and it continues to win such deals. The company won 20 such deals in Q3 this year vs. 16 in the same period last year. TCS is also witnessing vendor consolidation on the client side. The company says it is looking to enhance wallet share among customers
- The company indicated that cloud transformation continues to be one of the key areas of investments for clients across industries. Hence, it continues to be one of the key growth drivers from a medium to long term perspective. It mentioned that cloud transformation has a long runway for growth and reiterated that tech spending is the last area of cut in the case of weak macros as it is not discretionary in nature
- As far as deal structures in key markets are concerned, the company indicated that all key markets for them are moving in different directions currently. As per the company, the UK market is seeing much more strategic long term cost take out deals while the Europe market is going through a rough patch. Hence, clarity on the same is expected to emerge only when geopolitical issues ease out there. The company also indicated that the US market is seen fairly constructive on deals and it is witnessing a good balance of cost take out as well as transformation deals in the market

- TCS indicated that the retail vertical is expected to continue its growth momentum in the near to medium term. The company mentioned that they club retail, CPG, travel & hospitality in their vertical breakup. TCS indicated that it is seeing a strong rebound in travel & hospitality sector globally and TCS being one of the largest tech providers in the industry is likely to benefit from the same. CPG is also going through multiple levels of transformation, channel strategy seeing an area of investment where the company is participating. TCS also said grocery as a sub-category is doing well in the retail vertical. The company also mentioned that US retail is still growing strong even adjusting for inflation. TCS said profitability for many retailers has been under challenge recently. Hence, it is creating more opportunity for cost takeout deals where it is looking to increase market share
- LTM attrition of the company declined marginally by 20 bps QoQ to 21.3%. However, the company indicated that its quarterly annualised attrition declined by 600 bps and the impact of the same would be visible in subsequent quarters
- The company reported a net decline of 2,197 employee taking total employee strength to 613,974 employees. TCS indicated that it had hired 7,000 freshers in the quarter taking the total fresher hiring to 42,000 till FY23 YTD. The company indicated that net hiring should be seen in the context of strong hiring in the last six quarters and decline in the same is NOT an indication of demand slowdown. The company guided for 125,000-150,000 gross employee addition for FY24
- The company declared an interim dividend of ₹ 75/share including special dividend of ₹ 67/share. It also mentioned that it is committed to give 80-100% of free cash flow to shareholders

Exhibit 1: Variance Analysis

	Q3FY23	Q3FY23E	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
Revenue (US\$ mn)	7,075	6,960	6,524	8.4	6,877	2.9	Revenue grew 2.2% QoQ & 13.5% YoY in CC term
Revenue (₹ crore)	58,229	57,221	48,885	19.1	55,309	5.3	In CC terms; vertical wise, revenue growth was led by Retail & CPG with 18.7% YoY CC growth while geography wise North America & UK reported growth of 15.4% YoY
Employee expenses	33,942	33,818	28,401	19.5	32,526	4.4	
Gross Margin	24,287	23,403	20,484	18.6	22,783	6.6	
Gross margin (%)	41.7	40.9	41.9	-19 bps	41.2	52 bps	
SG&A expenses	8,733	8,354	7,051	23.9	8,267	5.6	
EBITDA	15,554	15,049	13,433	15.8	14,516	7.2	
EBITDA Margin (%)	26.7	26.3	27.5	-77 bps	26.2	47 bps	
Depreciation	1,270	1,202	1,196	6.2	1,237	2.7	
EBIT	14,284	13,848	12,237	16.7	13,279	7.6	
EBIT Margin (%)	24.5	24.2	25.0	-50 bps	24.0	52 bps	EBIT margin improved on account of the following tailwinds: i) 70 bps of currency depreciation benefit & ii) 30 bps benefit of improved utilisation & lower sub-contractor cost mitigated by the 50 bps impact of increase in external third party cost and increase in expenses due to return to normalcy
Other income (less interest)	360	600	954	-62.3	817	-55.9	
PBT	14,644	14,448	13,191	11.0	14,096	3.9	
Tax paid	3,761	3,684	3,385	11.1	3,631	3.6	
Reported PAT	10,846	10,723	9,769	11.0	10,431	4.0	
Adjusted PAT	10,846	10,723	9,769	11.0	10,431	4.0	

Source: Company, ICICI Direct Research

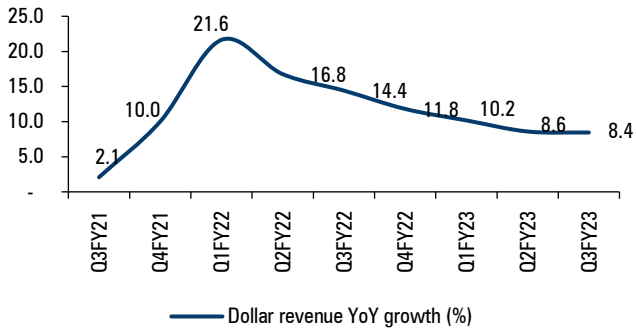
Exhibit 2: Change in estimates

	FY23E			FY24E			FY25E			Comments
	old	New	% Change	Old	New	% Change	Old	New	% Change	
(₹ Crore)										
Revenue	218,226	223,822	2.6	235,293	241,326	2.6	251,410	262,389	4.4	We are revising growth upward on higher rupee dollar realisation and steady growth in US market
EBIT	52,811	54,165	2.6	59,059	60,573	2.6	63,607	66,384	4.4	
EBIT Margin (%)	24.2	24.2	0 bps	25.1	25.1	0 bps	25.3	25.3	0 bps	
PAT	42,335	43,347	2.4	47,680	48,815	2.4	51,091	53,174	4.1	
EPS (₹)	115.7	118.5	2.4	130.3	133.4	2.4	139.6	145.3	4.1	

Source: Company, ICICI Direct Research

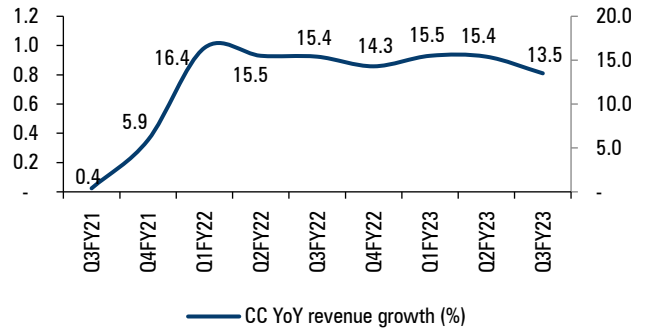
Quarterly highlights

Exhibit 3: Dollar growth steady in a seasonally weak quarter



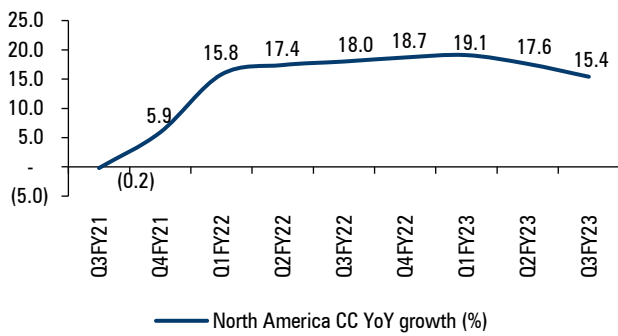
Source: Company, ICICI Direct Research

Exhibit 4: CC YoY revenue growth declines marginally



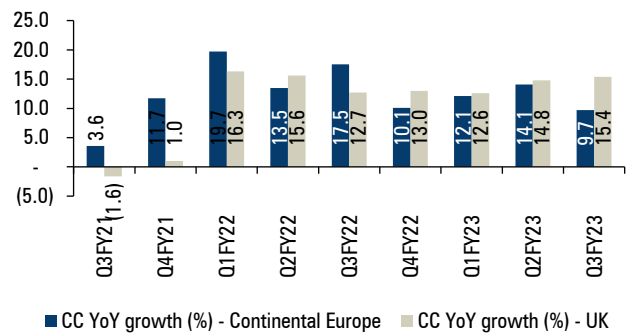
Source: Company, ICICI Direct Research

Exhibit 5: Steady growth in North America market



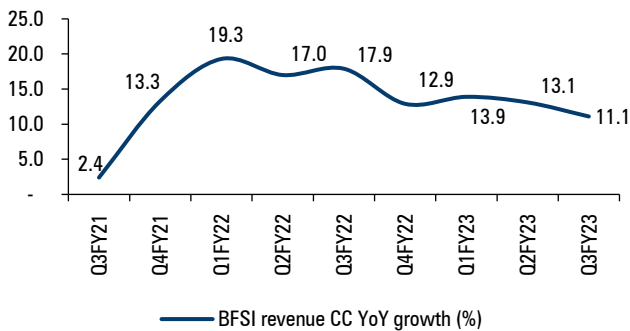
Source: Company, ICICI Direct Research

Exhibit 6: Geopolitical issues impact Continental Europe



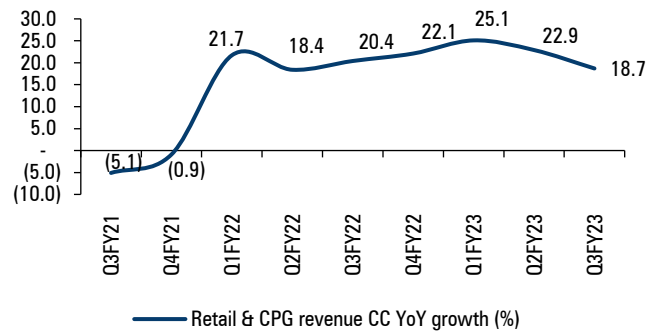
Source: Company, ICICI Direct Research

Exhibit 7: BFSI revenue remains stable



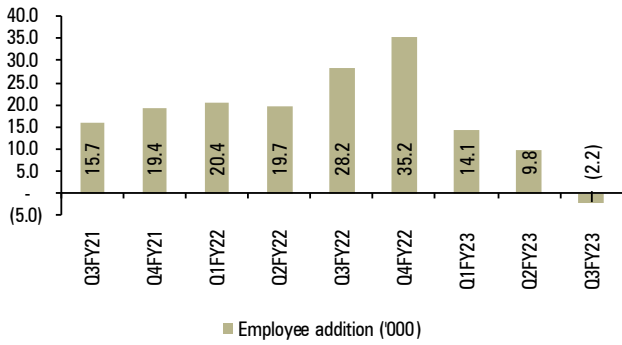
Source: Company, ICICI Direct Research

Exhibit 8: Retail revenues continue to be strong



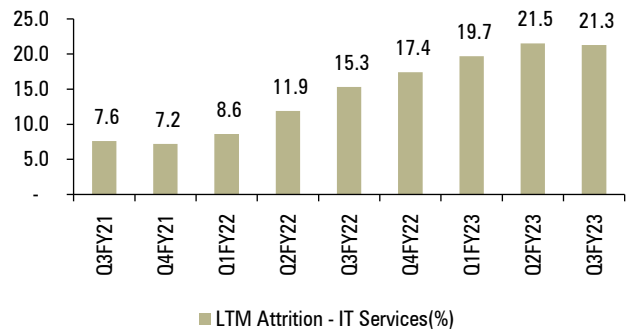
Source: Company, ICICI Direct Research

Exhibit 9: Stronger hiring in last six quarters led to decline



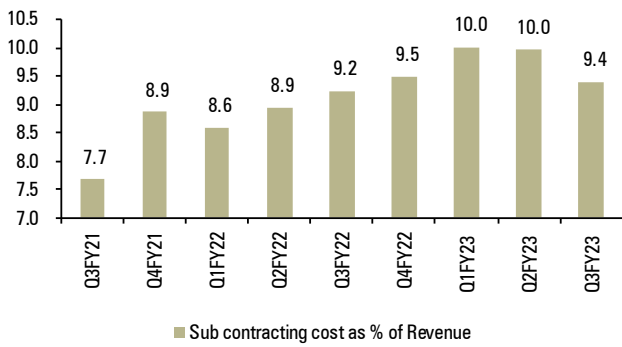
Source: Company, ICICI Direct Research

Exhibit 10: LTM attrition moderating



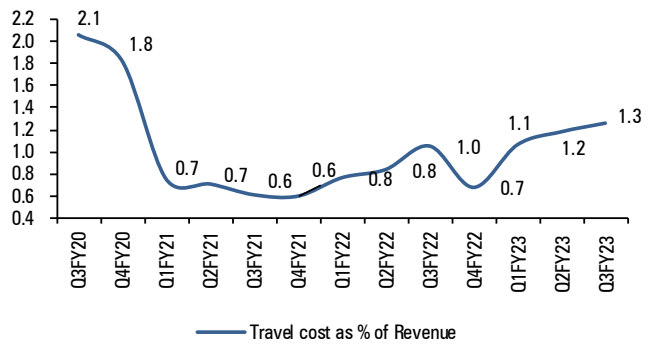
Source: Company, ICICI Direct Research

Exhibit 11: Sub-contracting costs coming down



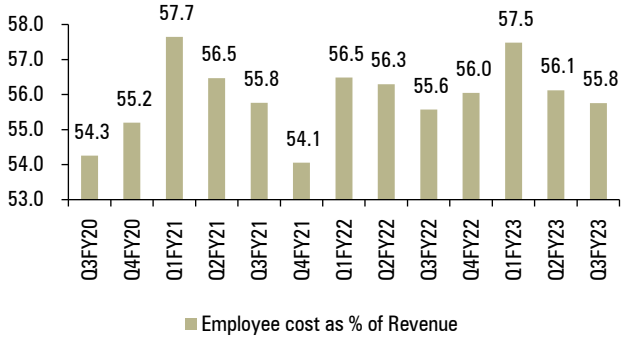
Source: Company, ICICI Direct Research

Exhibit 12: Travel cost coming back



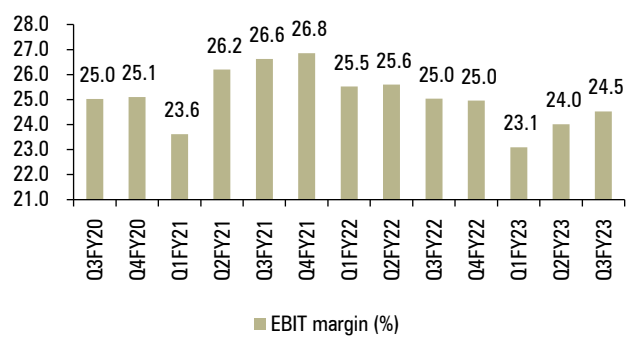
Source: Company, ICICI Direct Research

Exhibit 13: Employee costs cool off after Q1 wage hike



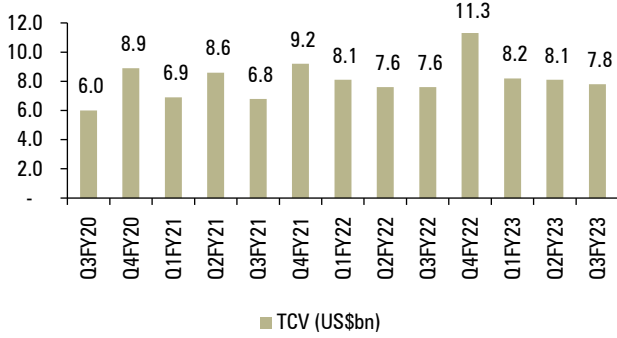
Source: Company, ICICI Direct Research

Exhibit 14: Sequential margin improvement continues



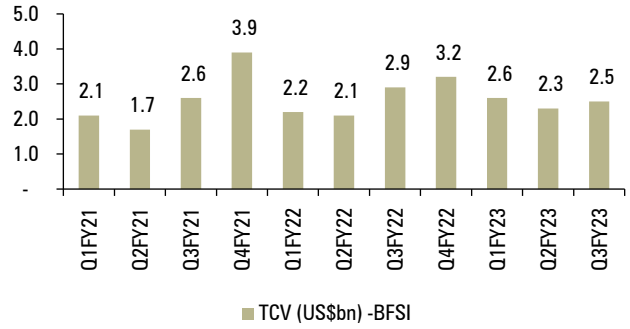
Source: Company, ICICI Direct Research

Exhibit 15: TCV down in Q3 but in guided range



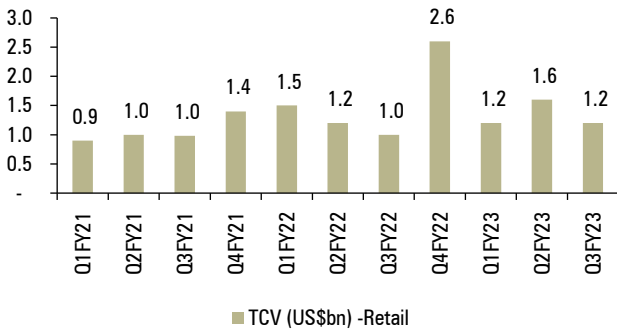
Source: Company, ICICI Direct Research

Exhibit 16: TCV trend for BFSI



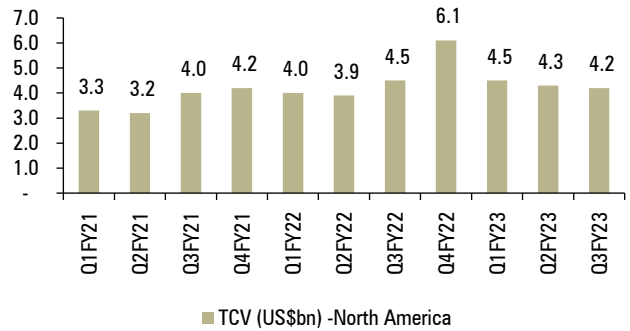
Source: Company, ICICI Direct Research

Exhibit 17: TCV trend for retail seen some impact of Europe



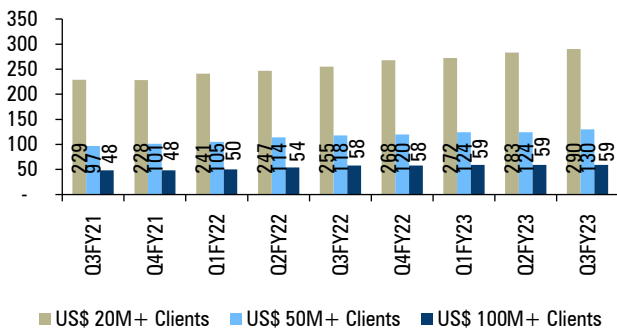
Source: Company, ICICI Direct Research

Exhibit 18: TCV trend for North America is steady



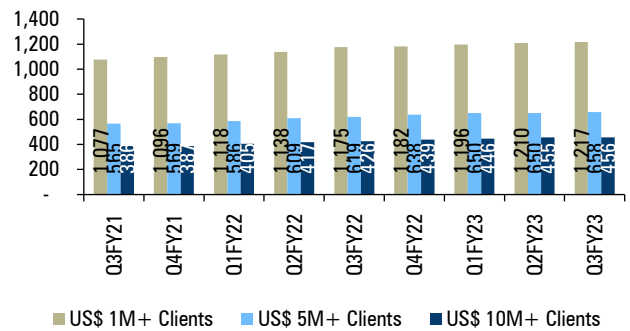
Source: Company, ICICI Direct Research

Exhibit 19: Client addition trend



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)	1,068	1,115	BUY	2,89,819	49.8	52.8	58.3	21.4	20.2	18.3	24.2	25.8	27.4	21.8	21.9	23.0
Infosys (INFTEC)	1,485	1,670	BUY	6,24,832	52.1	59.7	68.7	28.5	24.9	21.6	36.0	35.8	38.3	29.2	29.7	31.6
TCS (TCS)	3,260	3,780	BUY	11,92,851	104.7	118.5	133.4	31.1	27.5	24.4	51.4	50.1	49.3	43.0	42.6	41.5
Tech M (TECMAH)	1,015	1,240	BUY	98,741	63.1	65.2	80.0	16.1	15.6	12.7	22.5	21.5	23.2	20.7	19.1	20.8
Wipro (WIPRO)	392	420	HOLD	2,14,866	23.5	23.1	26.1	16.7	17.0	15.0	18.8	18.7	20.3	19.6	18.5	20.1

Source: Company, ICICI Direct Research

Financial summary

Exhibit 22: Profit and loss statement					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Total operating Incom	1,91,754	2,23,822	2,41,326	2,62,389	
Growth (%)	16.8	16.7	7.8	8.7	
COGS (employee expense:	1,11,053	1,31,607	1,41,417	1,53,497	
S,G&A expenses	27,644	33,126	34,027	36,734	
Total Operating Expenditur	1,38,697	1,64,733	1,75,444	1,90,232	
EBITDA	53,057	59,089	65,882	72,157	
Growth (%)	14.0	11.4	11.5	9.5	
Depreciation	4,604	4,924	5,309	5,773	
Other Income less interest	3,234	4,026	4,677	4,677	
PBT	51,687	58,191	65,250	71,061	
Total Tax	13,238	14,722	16,312	17,765	
Minority Interest	122	122	122	122	
PAT	38,327	43,347	48,815	53,174	
Growth (%)	18.2	13.1	12.6	8.9	
EPS (₹)	104.7	118.5	133.4	145.3	
PAT	38,327	43,347	48,815	53,174	
EPS - Reported (₹)	104.7	118.5	133.4	145.3	

Source: Company, ICICI Direct Research

Exhibit 23: Cash flow statement					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Profit before Tax	51,687	58,191	65,250	71,061	
Add: Depreciation	4,604	4,924	5,309	5,773	
(Inc)/dec in Current Assets	1,092	-4,108	-5,016	-6,035	
Inc/(dec) in CL and Provisions	8,124	4,715	3,734	4,493	
Taxes paid	-13,238	-14,722	-16,312	-17,765	
CF from operating activiti	49,332	45,436	48,951	53,512	
(Inc)/dec in Investments	-1,100	-152	-368	-442	
(Inc)/dec in Fixed Assets	-3,835	-4,476	-4,827	-5,248	
Others	2,937	3,563	4,014	4,014	
CF from investing activiti	-1,998	-1,066	-1,180	-1,676	
Inc/(dec) in loan funds	0	0	0	0	
Dividend paid & dividend tax	-34,123	-30,720	-33,093	-36,198	
Others	-1,498	0	0	0	
CF from financing activiti	-35,621	-30,720	-33,093	-36,198	
Net Cash flow	11,713	13,651	14,677	15,638	
Exchange difference	0	0	0	0	
Opening Cash	7,705	21,042	34,693	49,370	
Closing cash and Bank	21,042	34,693	49,370	65,008	

Source: Company, ICICI Direct Research

Exhibit 24: Balance sheet					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Liabilities					
Equity Capital	366	366	366	366	
Reserve and Surplus	88,773	1,01,400	1,17,122	1,34,098	
Share Premium	0	0	0	0	
Total Shareholders funds	89,139	1,01,766	1,17,488	1,34,464	
Total debt	7,818	10,273	10,411	10,577	
Other liabilities & Provision	2,359	2,703	2,783	2,879	
Deferred tax liability(net)	590	590	590	590	
Minority Interest / Others	707	829	951	1,073	
Total Liabilities	1,00,613	1,16,161	1,32,223	1,49,583	
Assets					
Net assets & CWIP	20,716	19,592	19,109	18,584	
Goodwill	1,787	1,787	1,787	1,787	
Other non current assets	10,501	10,653	11,021	11,463	
Debtors	34,219	41,082	44,294	48,160	
Loans and Advances	6,456	11,191	12,066	13,119	
Other Current Assets	19,352	11,863	12,790	13,907	
Current Investments	30,262	30,262	30,262	30,262	
Cash	18,221	34,693	49,370	65,008	
Trade Payable	8,045	10,715	11,554	12,562	
OCL & Provisions	32,856	34,245	36,923	40,145	
Application of Funds	1,00,613	1,16,162	1,32,224	1,49,583	

Source: Company, ICICI Direct Research

Exhibit 25: Key ratios					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Per share data (₹)					
Adjusted EPS (Diluted)	104.7	118.5	133.4	145.3	
BV per share	243.5	278.0	321.0	367.4	
DPS	93.3	84.0	90.4	98.9	
Cash Per Share	49.8	94.8	134.9	177.6	
Operating Ratios (%)					
EBIT margins	25.3	24.2	25.1	25.3	
PBT Margins	27.0	26.0	27.0	27.1	
PAT Margin	20.0	19.4	20.2	20.3	
Debtor days	65	67	67	67	
Creditor days	15	17	17	17	
Return Ratios (%)					
RoE	43.0	42.6	41.5	39.5	
RoCE	51.4	50.1	49.3	47.5	
RoIC	92.9	105.8	115.2	122.2	
Valuation Ratios (x)					
P/E	31.0	27.4	24.3	22.3	
EV / Net Sales	6.0	5.1	4.6	4.2	
Market Cap / Sales	6.2	5.3	4.9	4.5	
Solvency Ratios					
Debt / EBITDA	0.1	0.2	0.2	0.1	
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)	1,068	1,115	BUY	2,89,819	49.8	52.8	58.3	21.4	20.2	18.3	24.2	25.8	27.4	21.8	21.9	23.0
Infosys (INFTEC)	1,485	1,670	BUY	6,24,832	52.1	59.7	68.7	28.5	24.9	21.6	36.0	35.8	38.3	29.2	29.7	31.6
TCS (TCS)	3,260	3,780	BUY	11,92,851	104.7	118.5	133.4	31.1	27.5	24.4	51.4	50.1	49.3	43.0	42.6	41.5
Tech M (TECMAH)	1,015	1,240	BUY	98,741	63.1	65.2	80.0	16.1	15.6	12.7	22.5	21.5	23.2	20.7	19.1	20.8
Wipro (WIPRO)	392	420	HOLD	2,14,866	23.5	23.1	26.1	16.7	17.0	15.0	18.8	18.7	20.3	19.6	18.5	20.1
LTIM (LTINFO)	4,300	UR	UR	1,27,192	130.8	155.9*	186.2*	32.9	27.3*	22.9*	32.3	-	-	26.1	-	-
Coforge (NIITEC)	4,010	4,570	BUY	24,423	106.5	147.8	170.8	37.6	27.1	23.5	25.6	31.6	31.2	24.2	28.4	27.8
TeamLease (TEASER)	2,484	2,540	HOLD	4,247	22.5	72.9	88.0	110.5	34.1	28.2	15.4	15.4	16.0	(4.7)	15.1	15.6
Infoedge (INFEDG)	3,671	4,590	HOLD	46,135	35.8	45.5	51.7	102.6	80.7	71.0	4.2	5.4	6.0	3.2	4.1	4.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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