

**HOLD**

TP: Rs 3,580 | ▲ 10%

**TATA CONSULTANCY SERVICES**

Technology & Internet

13 June 2023

## Annual report analysis: Macro headwinds cloud outlook

- Key spending areas for FY23 included AI/ML, data & network services, cloud and managed security services
- Pause on discretionary spend and deferral of non-critical projects dampened margins; pressure to ease in the medium term
- Demand environment volatile; maintain HOLD with an unchanged TP of Rs 3,580, set at 25x FY25E EPS

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**Resilient demand with strong order book:** TCS reported revenue growth of 13.7% YoY CC in FY23, backed by retail & CPG (+22% YoY), communication, media and technology (18% YoY), and life science/healthcare (+20% YoY). The company saw traction in North America (+24% YoY) and the UK (11% YoY). Order book TCV stood at US\$ 10bn, of which North America contributed US\$ 5bn. Vertical-wise, BFSI/retail contributed US\$ 3bn/US\$1.3bn TCV. The board recommended final dividend of Rs 24/sh, bringing the payout for the year to Rs 115/sh (108% of FCF).

**Margin under pressure but likely to improve:** Operating margin declined 120bps YoY to 24.1% in FY23 primarily due to supply-side challenges, higher compensation cost (up ~1.6%) and higher travel/ visa cost (up 0.3%). Most of the margin dilution came from the manufacturing vertical which clocked a 260bps YoY drop in EBIT margin to 27.5%, followed by retail and life science which were down 200bps YoY each at 25.7% and 28% respectively. We expect margins to hover in the range of 24.5-25% in the medium term.

**Other key metrics supported growth:** TCS exited FY23 with 60 clients in the US\$ 100mn+ band (adding 2 YoY), 133 in the US\$ 50mn+ band (+13) and 291 in the US\$ 20mn+ band (+23). Net employee addition during the year stood at ~22,600 for a total staff strength of 615,000. Cash conversion remained strong – while pre-tax OCF/EBITDA came in at 94.5%, FCF/PAT stood at 92.2%. The company generated ROE and ROCE of 47% and 41% in FY23 vs. 44% and 37% respectively in FY22.

**Reskilling/upskilling helped drive digital businesses:** Per the annual report, employees logged ~48.3mn learning hours and acquired ~6mn competencies in FY23. In addition, 53,000 employees acquired hyperscaler cloud skill certifications.

**Maintain HOLD:** The stock is trading at 24.7x/22.7x FY24E/FY25E EPS. We believe TCS is well positioned to deliver industry-leading growth and margins in the long run. However, considering the current volatile macro environment, poor quality of deal wins and delays in client decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS for an unchanged TP of Rs 3,580.

### Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	TCS IN/Rs 3,247
Market cap	US\$ 144.6bn
Free float	28%
3M ADV	US\$ 80.0mn
52wk high/low	Rs 3,575/Rs 2,926
Promoter/FPI/DII	72%/17%/11%

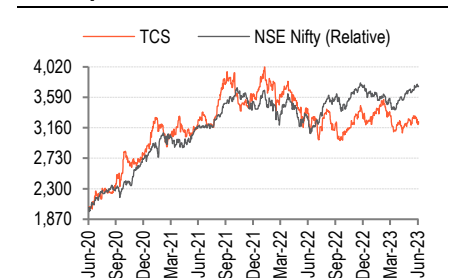
Source: NSE | Price as of 12 Jun 2023

### Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	22,23,757	24,76,435	27,26,137
EBITDA (Rs mn)	5,82,248	6,66,207	7,37,388
Adj. net profit (Rs mn)	4,16,294	4,80,791	5,24,296
Adj. EPS (Rs)	113.8	131.4	143.3
Consensus EPS (Rs)	113.8	128.3	142.5
Adj. ROAE (%)	43.5	44.5	43.4
Adj. P/E (x)	28.5	24.7	22.7
EV/EBITDA (x)	20.3	17.7	15.9
Adj. EPS growth (%)	9.8	15.5	9.0

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



## Annual report takeaways

### Key spending areas

- TCS continued to invest in its employees during FY23 by collaborating with Ivy League business schools to create tailored leadership programmes, in turn aiding lower attrition.
- Client spends amid the challenging macro environment have been focused on cost optimisation, vendor consolidation and automation initiatives. Clients continued to increase investments in cloud by leveraging AI/machine learning (ML), data, and cloud native on a hybrid cloud foundation. In addition, the company is concentrating on cyber defence as it sees traction in managed security services, identity and access management (IAM) and governance, risk and compliance services.
- TCS Cognix has emerged as a key tool for operations transformation, improving throughput, accuracy and user experience. Cognix led to multiple large wins in FY23. Growth the last year was led by end-to-end infrastructure & network services, digital finance & accounting (F&A), enterprise resource planning, and machine first delivery models (MFDm).

### ESG and carbon neutrality

- TCS launched its ESG Integration Solution on AWS to help financial institutions more easily and accurately measure the impact of environmental, social, and governance (ESG) factors in their investment analysis.
- TCS has achieved carbon neutrality across Scope 1 and Scope 2 in the Asia Pacific, Europe, North America, UK & Ireland, Latin America, Middle East and Africa regions during FY23. This entailed a ~71% reduction in absolute emission when compared to the base year of FY16, thereby achieving the 2025 target of 70% reduction ahead of time.

### Management change

- Rajesh Gopinathan has stepped down as CEO & MD of TCS, handing the baton over to K Krithivasan.

## Valuation methodology

TCS is trading at 24.7x/22.6x FY24E/FY25E EPS. We believe the company is well positioned to deliver industry-leading growth and margins in the long run, given its size, steadfast market leadership, best-in-asset class execution and robust order book (especially its exposure to longer duration contracts). However, considering the current volatile macro environment, poor quality of deal wins and delays in decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS for an unchanged TP of Rs 3,580.

## Key risks

- Multiple digital deal wins, including in the domestic market, represent an upside risk to our estimates.
- A further rise in interest rate would be a key downside risk.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.3	1,017	1,110	BUY
Coforge	COFORGE IN	3.4	4,506	4,830	BUY
HCL Technologies	HCLT IN	37.6	1,140	1,240	BUY
Infosys	INFO IN	66.1	1,292	1,760	BUY
Mphasis	MPHL IN	4.3	1,890	2,541	BUY
Persistent Systems	PSYS IN	4.9	4,984	5,330	BUY
Tata Consultancy Services	TCS IN	144.6	3,247	3,580	HOLD
Tech Mahindra	TECHM IN	11.4	1,075	1,130	HOLD
Wipro	WPRO IN	26.4	396	420	HOLD

Source: BOBCAPS Research, NSE | Price as of 12 Jun 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Total revenue</b>	<b>16,41,770</b>	<b>19,17,540</b>	<b>22,23,757</b>	<b>24,76,435</b>	<b>27,26,137</b>
EBITDA	4,65,460	5,30,570	5,82,248	6,66,207	7,37,388
Depreciation	40,650	46,404	50,377	55,894	61,731
EBIT	4,24,810	4,84,530	5,31,871	6,10,313	6,75,658
Net interest inc./(exp.)	0	0	0	0	1
Other inc./(exp.)	24,970	32,340	29,203	39,021	34,471
Exceptional items	0	0	0	0	0
EBT	4,49,780	5,16,870	5,61,074	6,49,333	7,10,128
Income taxes	1,11,980	1,32,380	1,43,430	1,67,342	1,84,633
Extraordinary items	0	0	0	0	1
Min. int./Inc. from assoc.	(1,320)	(1,220)	(1,350)	(1,200)	(1,200)
<b>Reported net profit</b>	<b>3,36,480</b>	<b>3,83,270</b>	<b>4,16,294</b>	<b>4,80,791</b>	<b>5,24,295</b>
Adjustments	0	0	0	0	1
<b>Adjusted net profit</b>	<b>3,36,480</b>	<b>3,83,270</b>	<b>4,16,294</b>	<b>4,80,791</b>	<b>5,24,296</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	3,71,480	4,53,000	5,17,861	5,08,857	5,60,165
Provisions	0	0	0	0	0
Debt funds	65,030	63,680	63,680	63,680	63,680
Other liabilities	0	0	0	0	0
Equity capital	3,700	3,660	3,660	3,660	3,660
Reserves & surplus	0	0	0	0	0
Shareholders' fund	8,71,080	8,98,460	10,15,700	11,46,238	12,69,338
<b>Total liab. and equities</b>	<b>13,07,590</b>	<b>14,15,140</b>	<b>15,97,241</b>	<b>17,18,775</b>	<b>18,93,183</b>
Cash and cash eq.	68,580	1,24,880	1,87,896	2,55,510	3,10,158
Accounts receivables	3,00,790	3,40,740	3,96,011	4,07,085	4,48,132
Inventories	0	0	0	0	0
Other current assets	2,95,170	2,47,870	3,04,624	3,39,238	3,73,443
Investments	3,18,440	3,62,180	3,62,180	3,62,180	3,62,180
Net fixed assets	1,96,690	1,96,150	2,01,367	2,07,384	2,13,807
CWIP	0	0	0	0	0
Intangible assets	22,780	28,880	28,880	28,880	28,880
Deferred tax assets, net	39,310	37,080	37,080	37,080	37,080
Other assets	65,830	77,360	79,202	81,417	1,19,502
<b>Total assets</b>	<b>13,07,590</b>	<b>14,15,140</b>	<b>15,97,241</b>	<b>17,18,775</b>	<b>18,93,183</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Cash flow from operations</b>	<b>3,72,880</b>	<b>5,30,710</b>	<b>3,89,811</b>	<b>4,41,958</b>	<b>4,90,727</b>
Capital expenditures	(38,930)	(29,490)	(55,594)	(61,911)	(68,153)
Change in investments	44,680	(15,220)	(1,00,000)	(1,20,000)	(1,50,000)
Other investing cash flows	24,970	27,000	29,203	39,021	34,471
<b>Cash flow from investing</b>	<b>30,720</b>	<b>(17,710)</b>	<b>(1,26,391)</b>	<b>(1,42,890)</b>	<b>(1,83,683)</b>
Equities issued/Others	(2,59,499)	0	0	0	0
Debt raised/repaid	0	(14,170)	0	0	0
Interest expenses	0	(6,980)	0	0	0
Dividends paid	(1,61,981)	(1,33,170)	(2,00,404)	(2,31,453)	(2,52,396)
Other financing cash flows	0	0	0	0	1
<b>Cash flow from financing</b>	<b>(4,21,480)</b>	<b>(1,54,320)</b>	<b>(2,00,404)</b>	<b>(2,31,453)</b>	<b>(2,52,395)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(17,880)</b>	<b>3,58,680</b>	<b>63,016</b>	<b>67,615</b>	<b>54,650</b>
<b>Closing cash &amp; cash eq.</b>	<b>68,580</b>	<b>1,24,880</b>	<b>1,87,896</b>	<b>2,55,510</b>	<b>3,10,158</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	90.9	103.6	113.8	131.4	143.3
Adjusted EPS	90.9	103.6	113.8	131.4	143.3
Dividend per share	36.4	41.4	45.5	52.6	57.3
Book value per share	235.4	242.8	277.6	313.3	346.9

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	7.2	6.2	5.3	4.8	4.3
EV/EBITDA	25.4	22.4	20.3	17.7	15.9
Adjusted P/E	35.7	31.3	28.5	24.7	22.7
P/BV	13.8	13.4	11.7	10.4	9.4

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	74.8	74.2	74.2	74.0	73.8
Interest burden (PBT/EBIT)	105.9	106.7	105.5	106.4	105.1
EBIT margin (EBIT/Revenue)	25.9	25.3	23.9	24.6	24.8
Asset turnover (Rev./Avg TA)	130.5	140.9	147.6	149.4	151.0
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.6	1.5	1.5
Adjusted ROAE	39.2	43.3	43.5	44.5	43.4

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	4.6	16.8	16.0	11.4	10.1
EBITDA	10.5	14.0	9.7	14.4	10.7
Adjusted EPS	5.5	13.9	9.8	15.5	9.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	28.4	27.7	26.2	26.9	27.0
EBIT margin	25.9	25.3	23.9	24.6	24.8
Adjusted profit margin	20.5	20.0	18.7	19.4	19.2
Adjusted ROAE	39.2	43.3	43.5	44.5	43.4
ROCE	37.6	42.3	45.8	49.1	50.6
<b>Working capital days (days)</b>					
Receivables	67	61	60	59	57
Inventory	0	0	0	0	0
Payables	103	108	108	104	98
<b>Ratios (x)</b>					
Gross asset turnover	8.3	9.8	11.2	12.1	12.9
Current ratio	2.0	1.7	1.9	2.1	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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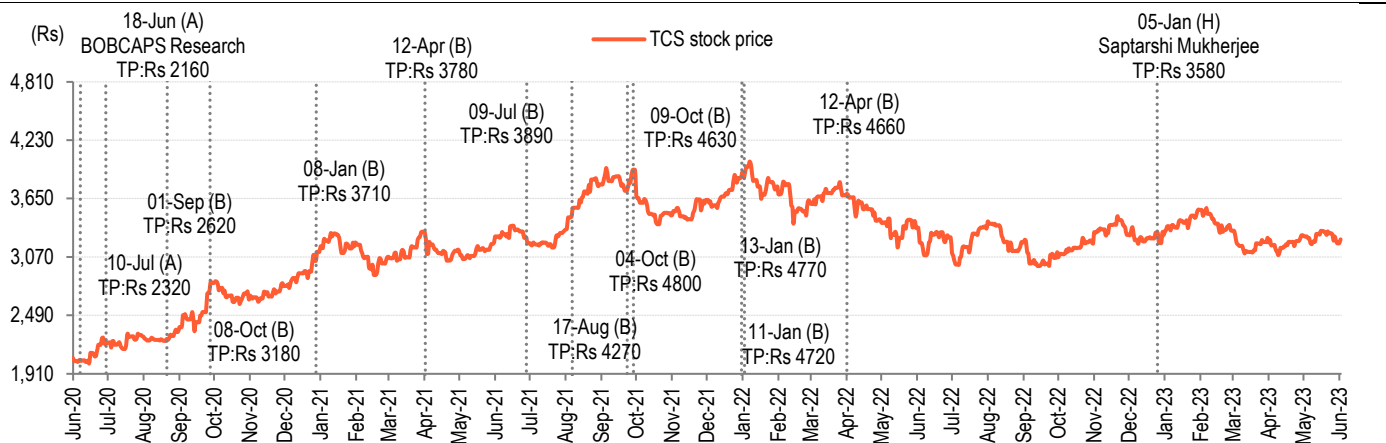
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

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B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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