

BUY

TP: Rs 4,630 | ▲ 18%

TATA CONSULTANCY SERVICES

| Technology & Internet

| 09 October 2021

Management confident of strong medium-term demand

- Q2 revenue grew 2.9% QoQ USD, in line with our estimate of 3%; TCV was healthy at US\$ 7.6bn
- EBIT margin at 25.6% came in below estimates due to supply pressure, higher subcontracting costs and increased depreciation
- We lower FY22/FY23 EPS by 3%/4% post Q2 and revise our Sep'22 TP to Rs 4,630 (vs. Rs 4,800); retain BUY

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In-line revenue: TCS's Q2FY22 revenue grew 2.9% USD/4% CC, in line with our estimate of 3% USD/4% CC. Growth was backed by a pickup in the technology & services (+5.3% QoQ USD), telecom (+4.5%), retail (+4.3%) and manufacturing (+4%) verticals. The hi-tech vertical growth was driven by the NXP Semiconductor deal. Geography-wise, North America and Latin America grew the most. India grew 14.1% QoQ USD, recovering from the 15.6% QoQ decline in Q1FY22.

Miss on margins: EBIT margin stood at 25.6% (+10bps QoQ), below our estimate of 26.3% due to expensive backfilling costs from increased attrition amid a widespread supply crunch. Employee cost and SG&A were stable QoQ as a percentage of revenue, but depreciation increased 3.6% QoQ (in INR terms). Subcontracting costs rose 30bps QoQ (8.6% of revenue). Net margin was at 20.5%.

Deal pipeline robust; more small-to-midsized wins: Deal win TCV at US\$ 7.6bn declined 7% QoQ (-12% YoY) and consisted entirely of small-to-midsized contracts, per management. In contrast, Q2FY21 had a US\$ 2.6bn deal – excluding this large deal from the base quarter, TCV was up 25% YoY. The pipeline is healthy and has a similar mix of small and midsized engagements. BFSI/retail TCV were at US\$ 2.1bn/1.2bn. MFDM and TCS Cognix powered five large deal wins for digital transformation of operations. Q2 had several wins in the area of cloud transformation as well.

Strong, sustainable demand ahead: Management emphasised that growth visibility remains strong in the medium term and looks sustainable over an extended period. The three broad demand themes are increasing outsourcing, digitising/transforming operating models, and growth & transformation agendas. Cloud migration is another key demand driver.

Reiterate BUY: We lower FY22/FY23/FY24 EPS by 3%/4%/4% to factor in the Q2 margin miss and a continued tight supply environment for the next couple of quarters. Our Sep'22 TP stands revised to Rs 4,630 (vs. Rs 4,800), based on an unchanged one-year forward P/E of 36.5x. Reiterate BUY based on the Q2 revenue pickup, robust TCV and management's optimism on demand.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	TCS IN/Rs 3,936
Market cap	US\$ 197.0bn
Free float	28%
3M ADV	US\$ 113.9mn
52wk high/low	Rs 3,990/Rs 2,600
Promoter/FPI/DII	72%/17%/11%

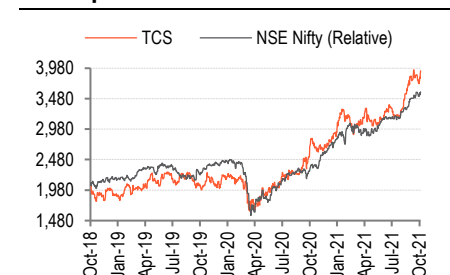
Source: NSE | Price as of 8 Oct 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	1,641,770	1,897,907	2,181,215
EBITDA (Rs mn)	465,460	528,904	615,714
Adj. net profit (Rs mn)	336,480	382,624	442,959
Adj. EPS (Rs)	90.9	103.4	119.7
Consensus EPS (Rs)	90.9	107.2	119.2
Adj. ROAE (%)	39.2	39.4	37.4
Adj. P/E (x)	43.3	38.1	32.9
EV/EBITDA (x)	31.6	27.9	23.9
Adj. EPS growth (%)	5.5	13.7	15.8

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- Amidst a lack of digital talent, TCS remained on a hiring spree, adding ~19.7k employees in Q2FY22 vs. 20.4k in Q1. In line with the sector-wide trend, attrition climbed higher, reaching a 20-quarter peak of 11.9% (+330bps QoQ), albeit still at manageable levels. Offshoring in Europe has been ramped up because of the talent crunch. Management expects supply challenges to persist for the next three quarters.
- The BFSI vertical crossed a milestone US\$ 2bn quarterly run-rate. Combined with platform and product revenues, TCS is one of the largest providers of IT consulting services and solutions in the BFSI industry globally.
- TCS's cognitive automation software Ignio signed 22 new customers and had 8 go-lives in Q2. BaNCS, the company's leading product suite for financial services, signed five new wins and had three go-lives. Quartz, TCS's blockchain platform had two new wins and one go-live.
- North America TCV stood at US\$ 3.9bn.
- TCS is planning to bring employees back to office by the end of the year.
- The board declared an interim dividend of Rs 7/sh.

Fig 1 – Quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenues (US\$ mn)	6,333	5,424	16.8	6,154	2.9	12,487	10,483	19.1
Revenue	468,670	401,350	16.8	454,110	3.2	922,780	784,570	17.6
Operating Expenditure	337,520	286,220	17.9	327,470	3.1	664,990	569,190	16.8
Cost of revenues	270,480	229,580	17.8	262,400	3.1	532,880	454,440	17.3
as % of sales	57.7	57.2	-	57.8	-	57.7	57.9	-
SG&A expenses	67,040	56,640	18.4	65,070	3.0	132,110	114,750	15.1
as % of sales	14.3	14.1	-	14.3	-	14.3	14.6	-
EBITDA	131,150	115,130	13.9	126,640	3.6	257,790	215,380	19.7
Depreciation	11,150	9,980	11.7	10,760	3.6	21,910	19,750	10.9
EBIT	120,000	105,150	14.1	115,880	3.6	235,880	195,630	20.6
Other Income	9,690	7,400	30.9	5,750	68.5	15,440	11,960	-
PBT	129,690	112,550	15.2	121,630	6.6	251,320	207,590	21.1
Total Tax	33,160	25,330	30.9	31,320	5.9	64,480	49,880	29.3
Adjusted PAT	96,530	87,220	10.7	90,310	6.9	186,840	157,710	18.5
(Profit)/loss from JV's/Ass/MI	(290)	(290)	-	(230)	-	(520)	(700)	-
APAT after MI	96,240	86,930	10.7	90,080	6.8	186,320	157,010	18.7
Reported PAT	96,240	86,930	10.7	90,080	6.8	186,320	157,010	18.7
Reported EPS	26.0	23.2	12.3	24.3	6.8	50.4	41.8	20.4
Margins (%)			(bps)		(bps)			(bps)
EBITDA	28.0	28.7	(70)	27.9	10	27.9	27.5	(50)
EBIT	25.6	26.2	(60)	25.5	10	25.6	24.9	(60)
EBT	27.7	28.0	(40)	26.8	90	27.2	26.5	(80)
PAT	20.5	21.7	(110)	19.8	70	20.2	20.0	(20)
Effective Tax rate	25.6	22.5	310	25.8	(20)	25.7	24.0	(160)

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

(in US\$ terms)	Q2FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Deal win TCV (US\$ mn)	7,600	(7.3)	(11.6)
Revenue by Geography			
Americas	50.3	4.8	17.7
UK	16.1	1.6	21.3
Europe	15.9	(2.0)	13.9
India	5.1	14.1	19.1
Asia Pac	9.0	(0.4)	8.3
Ibero America	1.6	2.9	2.0
MEA	2.0	(2.0)	22.9
Revenue by Domain			
BFSI	32.4	2.6	18.6
Manufacturing	9.9	4.0	23.0
Telecom & Media	6.5	4.5	16.8
Life Sciences & Healthcare	10.0	0.9	19.1
Retail & CPG	15.0	4.3	20.0
Technology & Services	8.8	5.3	15.4
Regional Markets & Others	17.4	1.2	7.5
	Q2FY22	Q1FY22	Q2FY21
Attrition (LTM) (%)	11.9	8.6	8.9

Source: Company, BOBCAPS Research

Valuation methodology

Factoring in the Q2FY22 results, we pare our FY22/FY23/FY24 EPS estimates by 2.8%/3.8%/3.5% and revise our Sep'22 TP to Rs 4,630 (from Rs 4,800), based on an unchanged one-year forward P/E multiple of 36.5x. Our target multiple is justified by TCS's industry-leading position which makes it the prime beneficiary of the current technology upcycle, growing cloud migration demand and vendor consolidation. Industry-low attrition levels will help the company defend margins better than peers in light of rising talent costs. Reiterate BUY given a robust demand visibility.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	25,664	28,700	31,556	25,738	28,855	31725.9	(0.3)	(0.5)	(0.5)
YoY growth (%)	15.7	11.8	10.0	16.1	12.1	10.0	-	-	-
Revenues	1,897,907	2,181,215	2,398,265	1,915,973	2,258,040	2482686	(0.9)	(3.4)	(3.4)
EBITDA	528,904	615,714	676,968	544,229	637,405	700803	(2.8)	(3.4)	(3.4)
EBITDA margin (%)	27.9	28.2	28.2	28.4	28.2	28.2	-	-	-
EBIT margin (%)	25.5	26.0	26.6	26.2	26.1	26.7	(60 bps)	(10 bps)	(10 bps)
Net profits	382,624	442,959	503,170	393,542	460,237	521454	(2.8)	(3.8)	(3.5)
EPS (Rs)	103.4	119.7	136.0	106.4	124.4	140.9	(2.8)	(3.8)	(3.5)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Revenue (US\$ mn)	22,174	25,664	28,700	31,556
YoY growth (%)	0.6	15.7	11.8	10.0
EBIT margin (%)	25.9	25.5	26.0	26.6

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Ticker	Rating	Target Price (Rs)	US\$ Revenue CAGR FY21-23E (%)	EPS (Rs)		RoE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS IN	BUY	4,630	13.8	103.4	119.7	39.4	37.4	36.5
INFO IN	BUY	2,020	13.3	53.4	60.1	29.3	31.0	32.0
WPRO IN	HOLD	630	17.5	23.3	26.9	21.0	21.6	22.5
HCLT IN	BUY	1,530	11.6	52.1	59.5	21.5	21.9	24.6
TECHM IN	BUY	1,660	14.1	66.8	78.1	21.9	22.7	27.8
LTI IN	BUY	6,780	19.3	132.1	159.7	29.1	29.6	39.5
MPHL IN	HOLD	3,530	16.0	79.7	93.2	21.9	23.7	35.0
MTCL IN	SELL	3,210	18.1	90.3	97.9	31.8	29.4	30.0
PSYS IN	HOLD	3,560	21.0	74.0	91.5	19.9	21.5	35.0
COFORGE IN	BUY	6,930	26.8	130.9	176.8	29.5	33.4	35.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- non-conversion of TCV, and
- prolonged impact from the second Covid-19 wave in India.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,154	6,200	BUY
Coforge	COFORGE IN	4.7	5,646	6,930	BUY
eClerx Services	ECLX IN	1.1	2,261	2,880	BUY
HCL Technologies	HCLT IN	47.8	1,322	1,530	BUY
IndiaMart InterMesh	INMART IN	3.6	8,806	7,200	HOLD
Infosys	INFO IN	97.9	1,724	2,020	BUY
Just Dial	JUST IN	0.8	1,000	1,330	BUY
L&T Infotech	LTI IN	14.0	5,984	6,780	BUY
Mindtree	MTCL IN	9.8	4,455	3,210	SELL
Mphasis	MPHL IN	8.1	3,248	3,530	HOLD
Persistent Systems	PSYS IN	4.3	4,013	3,560	HOLD
Tata Consultancy Services	TCS IN	197.0	3,936	4,630	BUY
Tech Mahindra	TECHM IN	16.8	1,440	1,660	BUY
Wipro	WPRO IN	48.7	661	630	HOLD

Source: BOBCAPS Research, NSE | Price as of 8 Oct 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	1,569,490	1,641,770	1,897,907	2,181,215	2,398,265
EBITDA	421,100	465,460	528,904	615,714	676,968
Depreciation	35,300	40,650	44,155	48,439	39,654
EBIT	385,800	424,810	484,749	567,275	637,314
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	36,680	24,970	28,710	28,106	38,888
Exceptional items	0	0	0	0	0
EBT	422,480	449,780	513,458	595,381	676,202
Income taxes	98,010	111,980	130,015	151,822	172,431
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(1,070)	(1,320)	(820)	(600)	(600)
Reported net profit	323,400	336,480	382,624	442,959	503,170
Adjustments	0	0	0	0	0
Adjusted net profit	323,400	336,480	382,624	442,959	503,170

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	292,440	371,480	327,584	376,484	413,947
Provisions	0	0	0	0	0
Debt funds	69,060	65,030	65,030	65,030	65,030
Other liabilities	0	0	0	0	0
Equity capital	3,750	3,700	3,700	3,700	3,700
Reserves & surplus	0	0	0	0	0
Shareholders' fund	847,490	871,080	1,070,329	1,300,647	1,562,191
Total liab. and equities	1,208,990	1,307,590	1,462,943	1,742,161	2,041,168
Cash and cash eq.	86,460	68,580	148,356	321,394	527,054
Accounts receivables	305,320	300,790	363,982	418,315	459,941
Inventories	0	0	0	0	0
Other current assets	239,510	295,170	311,985	358,556	394,235
Investments	273,760	318,440	318,440	318,440	318,440
Net fixed assets	198,410	196,690	190,493	185,678	193,989
CWIP	0	0	0	0	0
Intangible assets	19,930	22,780	22,780	22,780	22,780
Deferred tax assets, net	28,280	39,310	39,310	39,310	39,310
Other assets	57,320	65,830	67,597	77,687	85,418
Total assets	1,208,990	1,307,590	1,462,942	1,742,160	2,041,168

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	328,975	372,880	273,220	401,797	456,963
Capital expenditures	(119,970)	(38,930)	(37,958)	(43,624)	(47,965)
Change in investments	(75,780)	44,680	0	0	0
Other investing cash flows	36,680	24,970	28,710	28,106	38,888
Cash flow from investing	(159,070)	30,720	(9,248)	(15,518)	(9,077)
Equities issued/Others	0	(259,499)	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(155,685)	(161,981)	(184,195)	(213,240)	(242,226)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(155,685)	(421,480)	(184,195)	(213,240)	(242,226)
Chg in cash & cash eq.	14,220	(17,880)	79,776	173,038	205,660
Closing cash & cash eq.	86,460	68,580	148,356	321,394	527,054

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	86.2	90.9	103.4	119.7	136.0
Adjusted EPS	86.2	90.9	103.4	119.7	136.0
Dividend per share	34.5	36.4	41.4	47.9	54.4
Book value per share	225.8	235.4	289.3	351.5	422.2

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	9.4	9.0	7.8	6.8	6.1
EV/EBITDA	34.9	31.6	27.9	23.9	21.6
Adjusted P/E	45.7	43.3	38.1	32.9	28.9
P/BV	17.4	16.7	13.6	11.2	9.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	76.5	74.8	74.5	74.4	74.4
Interest burden (PBT/EBIT)	109.5	105.9	105.9	105.0	106.1
EBIT margin (EBIT/Revenue)	24.6	25.9	25.5	26.0	26.6
Asset turnover (Rev./Avg TA)	133.1	130.5	137.0	136.1	126.8
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.4	1.4	1.3
Adjusted ROAE	37.0	39.2	39.4	37.4	35.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	7.2	4.6	15.6	14.9	10.0
EBITDA	6.6	10.5	13.6	16.4	9.9
Adjusted EPS	2.6	5.5	13.7	15.8	13.6
Profitability & Return ratios (%)					
EBITDA margin	26.8	28.4	27.9	28.2	28.2
EBIT margin	24.6	25.9	25.5	26.0	26.6
Adjusted profit margin	20.6	20.5	20.2	20.3	21.0
Adjusted ROAE	37.0	39.2	39.4	37.4	35.2
ROCE	35.8	37.6	39.0	41.6	44.3
Working capital days (days)					
Receivables	67	67	64	65	67
Inventory	0	0	0	0	0
Payables	86	103	93	82	84
Ratios (x)					
Gross asset turnover	10.1	8.3	9.8	11.6	12.6
Current ratio	2.4	2.0	2.7	3.1	3.5
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.1)	(0.2)	(0.3)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

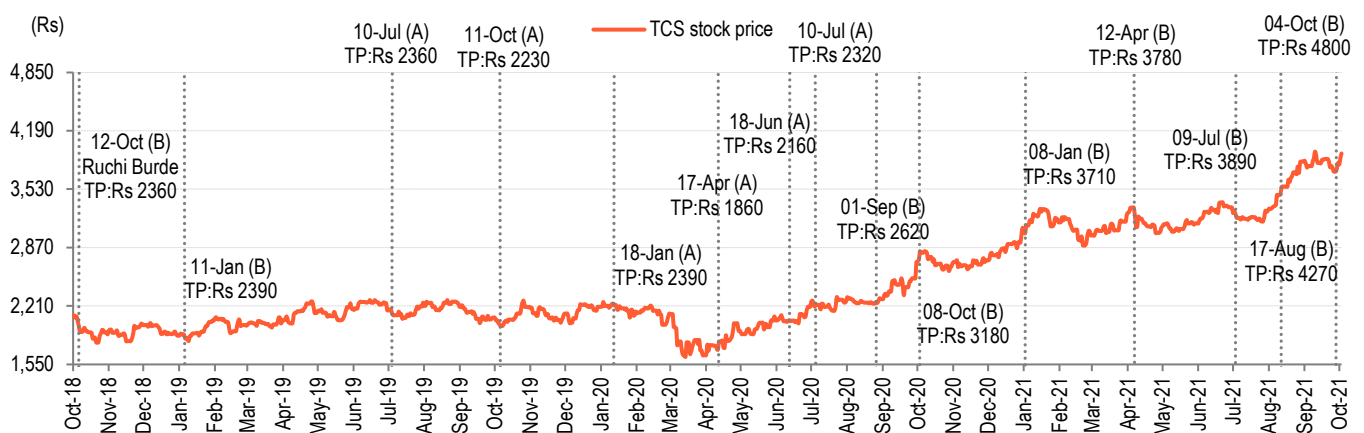
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): TATA CONSULTANCY SERVICES (TCS IN)



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

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