

HOLD
 TP: Rs 3,580 | ▲ 8%

TATA CONSULTANCY SERVICES

| Technology & Internet

| 09 January 2023

Demand drivers intact with some pockets of slowdown

- Q3 revenue growth of 2.9% QoQ CC beat consensus and came in higher than our estimate
- EBIT margin held strong at 24.5%, marginally below our forecast; order book was stable at US\$ 7.8bn
- Maintain HOLD and TP of Rs 3,580, set at 25x FY25E EPS

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Broad-based revenue growth: Despite a seasonally weak quarter, TCS reported above-estimated Q3FY23 revenue of US\$ 7.1bn, up 2.9%/13.5% QoQ/YoY CC. Q3 saw a broad-based uptick across services, led by cloud, consulting & service integration, cognitive business operations and enterprise application services. Revenue growth was driven by North America and the UK (+15.4% YoY), along with market share gains through vendor consolidation. All the verticals grew sequentially with strong growth in retail & CPG (+ 18.7% YoY) and life sciences & healthcare (+14.4%).

Stable deal wins to drive growth: TCS registered deal bookings worth US\$ 7.8bn in Q3, with a book-to-bill ratio of 1.1x (vs. 1.2x in Q2FY23), below the average deal TCv of US\$ 8.4bn in the last eight quarters. Deal win numbers are partly impacted by currency movements. Wins included US\$ 2.5bn in BFSI and US\$ 1.2bn in retail & CPG, with US\$ 4bn coming from North America. TCS saw positive traction in cost takeout and transformation projects.

Net negative hiring led to higher utilisation: Net hiring was a negative ~2.2k and pushed up utilisation during the quarter. Attrition decreased to 21.3% LTM (-20bps QoQ) and management expects it to taper down further in H2FY23.

Margin to stabilize at 25% near term: EBIT margin expanded by ~50bps QoQ to 24.5%, aided by easing supply challenges, improved productivity, higher utilization and currency tailwinds (partly offset by higher third-party and travel expenses). The improvement will show up prominently from Q1FY24 on the back of a more efficient employee pyramid, lower subcontracting costs and productivity improvement based on the hypothesis that the high costs towards backfilling attrition, wage revision, subcontracting and capacity building have peaked out last quarter.

Maintain HOLD: The stock is trading at 25.3x/23.2x 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 decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS, similar to Accenture, translating to a TP of Rs 3,580.

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	TCS IN/Rs 3,320
Market cap	US\$ 147.4bn
Free float	28%
3M ADV	US\$ 66.8mn
52wk high/low	Rs 4,043/Rs 2,926
Promoter/FPI/DII	72%/17%/11%

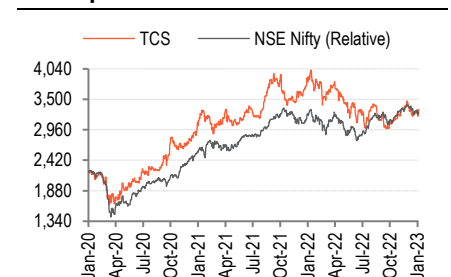
Source: NSE | Price as of 9 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	19,17,540	22,23,757	24,76,435
EBITDA (Rs mn)	5,30,570	5,82,248	6,66,207
Adj. net profit (Rs mn)	3,83,270	4,16,294	4,80,791
Adj. EPS (Rs)	103.6	113.8	131.4
Consensus EPS (Rs)	107.2	119.2	130.1
Adj. ROAE (%)	43.3	41.3	38.7
Adj. P/E (x)	32.0	29.2	25.3
EV/EBITDA (x)	22.9	20.8	18.1
Adj. EPS growth (%)	13.9	9.8	15.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

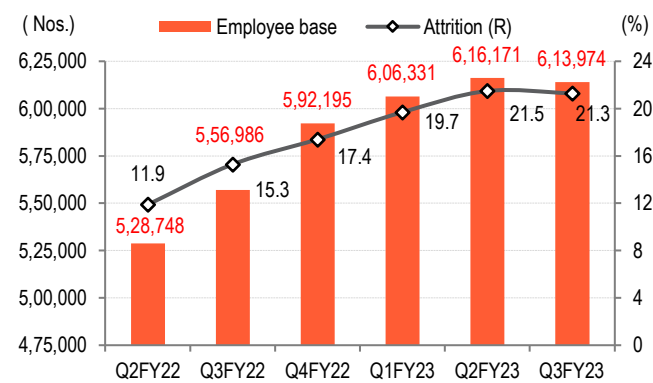


Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q2FY23	Q3FY22	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	7,075	6,877	6,333	2.9	11.7	6,987	1.3
INR Revenue	5,82,290	5,53,090	4,68,670	5.3	24.2	5,75,737	1.1
EBIT	1,42,840	1,32,790	1,20,000	7.6	19	1,42,783	0.0
PAT	1,08,830	1,04,310	96,240	4.3	13.1	1,12,654	(3.4)
EBIT Margin (%)	24.5	24.0	25.6	52bps	(107bps)	24.8	(27bps)
PAT Margin (%)	18.7	18.9	20.5	(16bps)	(184bps)	19.6	(88bps)

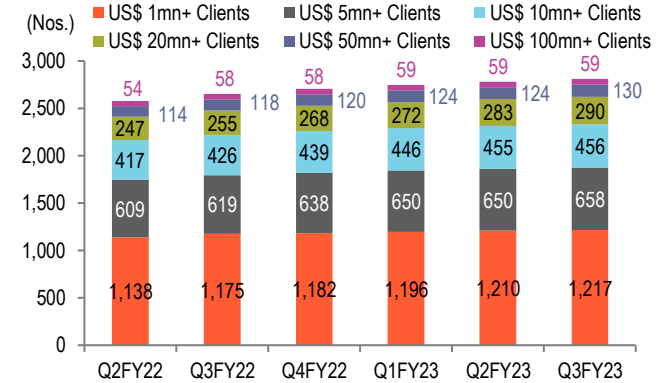
Source: Company, BOBCAPS Research

Fig 2 – Employee base & Attrition



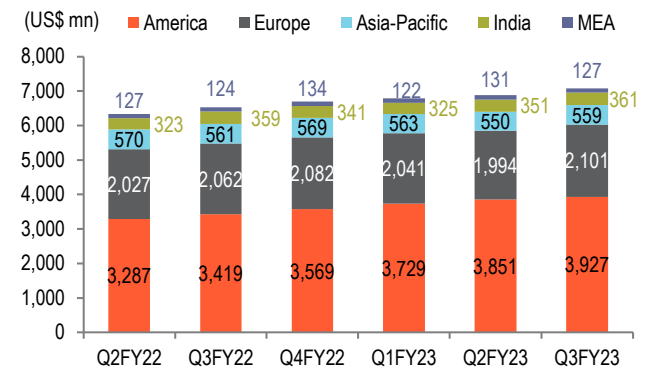
Source: Company, BOBCAPS Research

Fig 3 – Client contribution



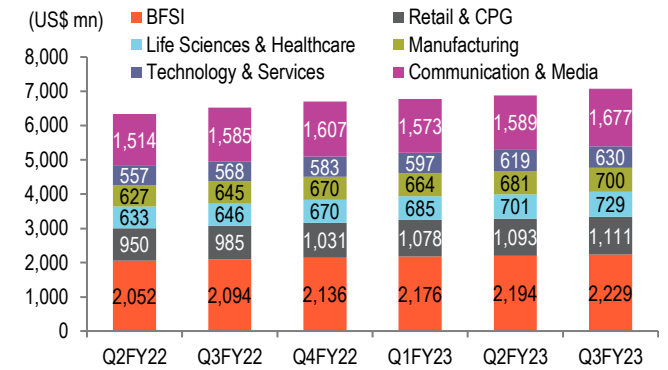
Source: Company, BOBCAPS Research

Fig 4 – Revenue contribution by geography



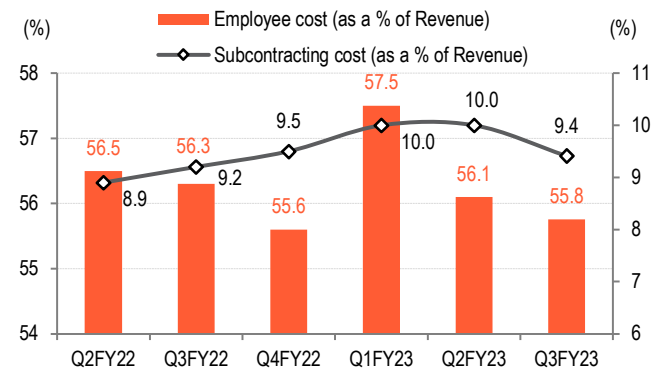
Source: Company, BOBCAPS Research

Fig 5 – Revenue contribution by vertical



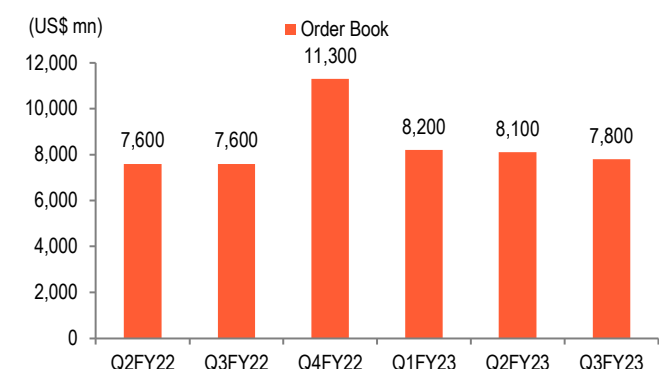
Source: Company, BOBCAPS Research

Fig 6 – Employee cost and Subcontracting cost



Source: Company, BOBCAPS Research

Fig 7 – Order book



Source: Company, BOBCAPS Research

Earnings call highlights

- Despite macro concerns, TCS is not seeing any further weakness in terms of budget cuts or deferral in clients spends.
- Management anticipates softening of deals in Europe but indicated that the US remains strong.
- The focus on long-term projects will continue as clients are building various economic models with downside risk factors based on recent macroeconomic events, which may delay decision-making in smaller pockets.
- With the hiring slowdown in the technology sector and salary expectations moderating, supply-side issues should ease in H2FY23.
- Management suggested that attrition has peaked and expects quarterly attrition to slow in the coming quarters
- The plan to hire 40k+ freshers in FY23 has already been achieved (~42k YTD).
- Easing of supply/onsite travel restrictions led to lower subcontracting cost at 9.4% of revenue, which TCS expects will reduce further, aiding positive margin traction.
- Retail and CPG growth was led by higher spending on channel strategy transformation by retailers (mostly regional), along with an uptick in travel and hospitality. BFSI growth was powered by strong spending on cloud, data, analytics and CX (customer experience) (except for mortgage, insurance).
- TCS announced a dividend of Rs 75/sh, including a special dividend of Rs 67/sh.

Valuation methodology

The stock is trading at 25.3x/23.2x FY24E/FY25E EPS. We believe TCS 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, similar to Accenture, translating to a TP of Rs 3,580.

Fig 8 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY23-25E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
TCS	TCS IN	HOLD	3580	10.7	131.4	143.3	41.3	38.7	25
Infosys	INFO IN	BUY	1760	14.9	58.7	73	30.6	33.5	20.5
HCL Tech	HCLT IN	BUY	1240	10.4	52	59.8	21.7	22.3	18.7
Wipro	WPRO IN	HOLD	440	9.9	20.1	23.9	16.7	19.5	16
Tech Mahindra	TECHM IN	HOLD	1160	12.4	60.5	77.9	18.4	21.4	12.5

Source: BOBCAPS Research

Key risks

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

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	35.2	1,067	1,240	BUY
Infosys	INFO IN	75.8	1,484	1,760	BUY
Tata Consultancy Services	TCS IN	147.4	3,320	3,580	HOLD
Tech Mahindra	TECHM IN	10.8	1,015	1,160	HOLD
Wipro	WPRO IN	26.1	392	440	HOLD

Source: BOBCAPS Research, NSE | Price as of 9 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	16,41,770	19,17,540	22,23,757	24,76,435	27,26,137
EBITDA	4,65,460	5,30,570	5,82,248	6,66,207	7,37,388
Depreciation	40,650	46,400	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)
Reported net profit	3,36,480	3,83,270	4,16,294	4,80,791	5,24,295
Adjustments	0	0	0	0	1
Adjusted net profit	3,36,480	3,83,270	4,16,294	4,80,791	5,24,296

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	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	11,15,700	13,66,238	16,39,338
Total liab. and equities	13,07,590	14,15,140	16,97,241	19,38,775	22,63,183
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
Total assets	13,07,590	14,15,140	15,97,241	17,18,775	18,93,183

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	3,72,880	5,30,710	3,89,811	4,41,958	4,90,727
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
Cash flow from investing	30,720	(17,710)	(1,26,391)	(1,42,890)	(1,83,683)
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
Cash flow from financing	(4,21,480)	(1,54,320)	(2,00,404)	(2,31,453)	(2,52,395)
Chg in cash & cash eq.	(17,880)	3,58,680	63,016	67,615	54,650
Closing cash & cash eq.	68,580	1,24,880	1,87,896	2,55,510	3,10,158

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	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	304.9	373.4	448.0

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	7.4	6.3	5.4	4.9	4.4
EV/EBITDA	26.0	22.9	20.8	18.1	16.3
Adjusted P/E	36.5	32.0	29.2	25.3	23.2
P/BV	14.1	13.7	10.9	8.9	7.4

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	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	1.5	1.3	1.2
Adjusted ROAE	39.2	43.3	41.3	38.7	34.9

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
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
Profitability & Return ratios (%)					
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	41.3	38.7	34.9
ROCE	37.6	42.3	43.3	41.8	39.0
Working capital days (days)					
Receivables	67	61	60	59	57
Inventory	0	0	0	0	0
Payables	103	108	108	104	98
Ratios (x)					
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)	(0.1)	(0.2)

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

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

BUY – Expected return >+15%

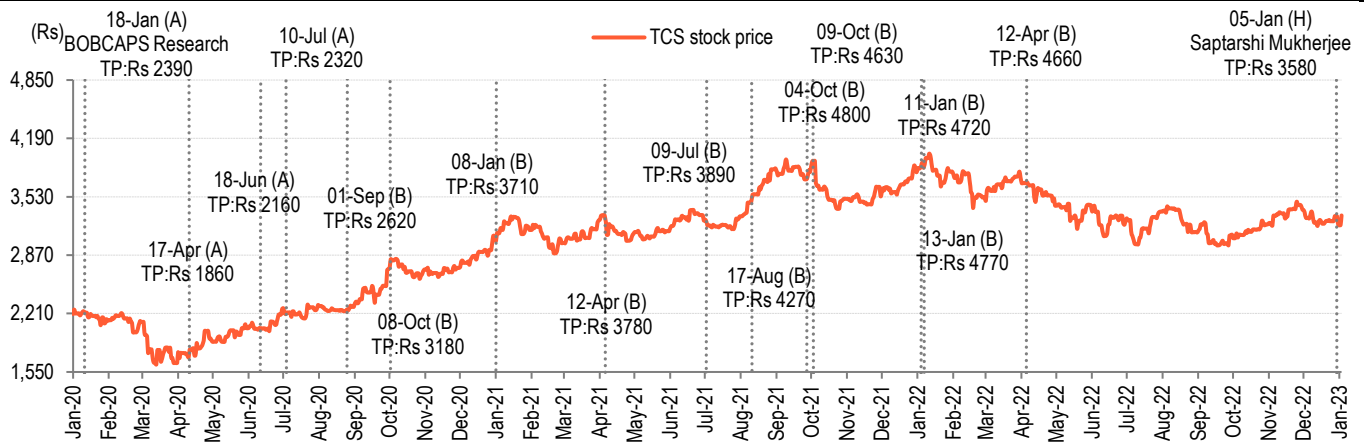
HOLD – Expected return from -6% to +15%

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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