Tata Consultancy Services (TCS)

CMP: ₹ 4,190 | Target: ₹ 4,400 (5%) | Target Period: 12 months

HOLD

July 12, 2024

Decent show; demand uncertainty persists...

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 >60%) & payouts (~70%)

Q1FY25 Performance: TCS reported revenue of US$ 7,505 mn up 1.9% QoQ & 3.9% YoY (in CC terms up 2.2%QoQ/4.4% YoY), driven by strong ramp up on BSNL orders. EBIT margin came at 24.7%, down ~133 bps QoQ, with wage impact. The PAT margin stood at 19.3%, down ~110 bps QoQ. The company reported TCV wins of US$ 8.2 bn, down 37% QoQ & 18% YoY during the quarter.

Investment Rationale:

- **Retains cautious outlook; albeit FY25 to be better than FY25**: Management reiterated that FY25 would be better than FY24. However, it indicated no change in the demand environment from the previous quarter, thus maintaining a cautious outlook considering that clients still continue to pause/reassess projects on short notice, amid focus more on cost optimisation. **We believe that the growth will be back ended and expect dollar revenue to grow by 6.4% & 10.8% in FY25E & FY26E respectively. We, thus, believe that revenue would grow at CAGR of 8.6% between FY24-26E compared to CAGR of 8.8% between FY19-24**.
- **Strong momentum in AI/GenAI deals**: The company is engaged in 270 AI/GenAI projects and reported a healthy AI/GenAI pipeline of US$ 1.5 bn compared to US $900 mn in Q4FY24. It also informed that Many Gen-AI deals have moved from Proof of Concept to actual contracts, albeit, the deal sizes continue to remain small barring one large deal.
- **Margins witnesses wage hike impact; to improve ahead:** While margins faced headwinds from wage hikes (~170 bps), it was mitigated by operating efficiencies including better productivity, improved utilisation and reduced subcon costs. The key levers in the short term to aid margin growth would be pyramid, utilisation and productivity while in the medium to long term pricing and growth acceleration would be key. **We bake in EBIT margins of 25.4%/26.4% in FY25/FY26.**

Rating and Target Price

- TCS is well placed among the large peers to support its medium and long-term growth momentum driven by strong execution and increased AI/GenAI deal pipeline. Nonetheless, the company has maintained near term growth uncertainty.
- We maintain HOLD, and value it at a **target price of ₹4,400; at 27x P/E on FY26E EPS.**

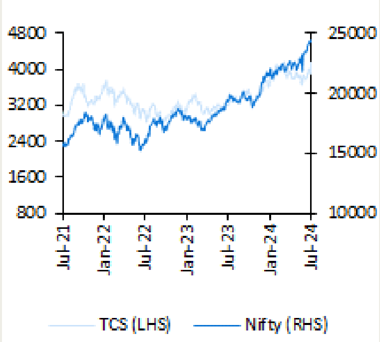
Particulars

Particular	Amount
Market Cap (₹ Crore)	15,16,780
Total Debt (₹ Crore)	8,021
Cash & equiv. (₹ Crore)	40,497
EV (₹ Crore)	14,84,304
52 week H/L	4254/ 3250
Equity capital (₹ Crore)	362
Face value	1.0

Shareholding pattern

	Jun-23	Sep-23	Dec-23	Mar-24
Promoters	72.3	72.3	72.4	71.8
FII	12.5	12.5	12.5	12.7
DII	9.9	10.1	10.1	10.7
Others	5.4	5.2	5.0	4.9

Price Chart



Key risks

- Delay in recovery from US market;
- Lower than expected AI/GenAI contribution to revenue

Research Analyst

Bhupendra Tiwary, CFA
bhupendra.tiwary@icicisecurities.com

CA Anjini Sharma
Anjini.sharma@icicisecurities.com

Key Financial Summary

₹ crore	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	2 year CAGR (FY24-26E)
Net Sales	1,91,754	2,25,458	2,40,893	10.5	2,58,050	2,87,621	9.3
EBITDA	53,057	59,260	63,337	9.9	70,513	81,541	13.5
EBITDA Margins (%)	27.7	26.3	26.3		27.3	28.4	
Net Profit	38,327	42,147	45,908	7.8	50,695	58,863	13.2
EPS (₹)	104.7	115.2	125.9		140.1	162.7	
P/E	40.0	36.4	33.0		29.9	25.8	
RoNW (%)	43.0	46.6	50.7		48.2	47.4	
RoCE (%)	51.4	56.0	60.9		58.3	57.9	

Source: Company, ICICI Direct Research

Performance highlights and outlook

- **Revenue performance**: TCS in Q1 reported revenue of US$ 7,505 mn up 1.9% QoQ & 3.9% YoY (in CC terms up 2.2%QoQ/4.4% YoY). In rupee terms it reported revenue of ₹62,613 crore up 2.2% QoQ & 5.4% YoY. 50% incremental revenues were from the ramp up in BSNL deal.
- **Geography performance**: Geography wise the growth was led by India (7.5% of mix), MEA (2% of mix), Asia (7.8% of mix) & UK (16.9% of mix) which reported YoY CC growth of 61.8%, 8.5%, 7.6% & 6% respectively while US region (49.5% of mix) declined by 1.1%. However, on a sequential basis almost all geographies grew positively and North America reported sequential growth for the first time in the last four quarters.
- **Segment performance:** Segment wise in CC terms on YoY basis growth was led by Regional Markets (14% of mix), Manufacturing (8.8% of mix) and Lifesciences (11% of mix) which grew by 37.7%, 9.4% & 4% YoY in CC terms while Communication (6.2% of mix), BFSI (30.9% of mix) & Retail (15.4% of mix) declined by 7.4%, 0.9% & 0.3% respectively. **On a QoQ basis growth was led by Regional Markets, Lifesciences, Manufacturing and BFSI which grew by 10.6%, 2.9%, 1.9%, 0.6% respectively while Retail was flat and Communication de-grew by 4.2%. It is pertinent to note that BFSI returned to growth sequentially after few stressed quarters**. **The communication vertical is expected to recover once the interest rates are lowered (similar to BFSI vertical), while Lifesciences being non-cyclical in nature continues to witness secular growth**.
- **Margin performance**: TCS reported decent margin growth despite absorbing the impact of wage hikes. The company's EBIT margin came at 24.7%, down ~133 bps QoQ due to headwinds from wage hikes (~170 bps) and higher third-party expenses mitigated by operating efficiencies including better productivity, improved utilisation and reduced subcon costs. The PAT margin stood at 19.3%, down ~110 bps QoQ.
- **Deal Wins**: The company during the quarter won TCV of US$ 8.2 bn (down 37.1% QoQ/18.6% YoY) with BFSI, Retail & US reporting TCV of US$ 2.7bn, 1.1 bn & 4.6 bn respectively. The company reported lower than average but within its comfort range of US$ 7-9bn. Lower TCV wins was attributed to delay in closure of certain deals which are now expected to close in Q2.
- **Demand Outlook:** On the demand front, the company saw no change in the market sentiment from the previous quarter. However, the management reiterated that growth in FY25 will be better than FY24 by ~4%, driven by broad based sequential recovery across verticals. Regional markets of India, APAC & MEA continue to grow at faster pace compared to other markets.
- **AI/GenAI Outlook**: On the GenAI front, TCS is currently engaged in 270 AI/GeAI projects and reported an AI/GenAI pipeline of US$1.5bn vs US$900 mn last quarter. It is seeing a positive response for its newly launched GenAI platform "WisdomNext" which integrates multiple GenAI services into a single interface, enabling rapid AI adoption, cost reduction, and compliance. However, the deal sizes continue to remain small barring one large deal.
- **Margin Guidance/ Aspiration**: Management indicated the key levers in the short term to aid margin growth would be pyramid, utilisation and productivity while in the medium to long term pricing and growth acceleration would be key. Recall, management has indicated 26-28% aspirational margin band.
- **Attrition and employee addition:** Attrition further declined by 40 bps QoQ to 12.1% while on YoY basis it declined by 570 bps. The company net employees during the quarter increased by 5,452 bringing the total employee strength to 606,998. The company has cleared its backlog from the last year and any additions going ahead will be from the coming year. Further, the company onboarded 11,000 trainees in the quarter.
- **Dividend:** The company in Q1FY25 declared an interim dividend of ₹10 per share which is in line with its practice of returning 80-100% of FCFs back to shareholders.

Exhibit 1: Quarter Performance

	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)	Comments
Revenue (US$ mn)	7,505	7,226	3.9	7,363	1.9	In CC terms Revenue grew 2.2% QoQ & 4.4% YoY
Revenue (₹ crore)	62,613	59,381	5.4	61,237	2.2	In YoY CC terms; vertical wise, revenue growth was led by Manufacturing & Regional markets reporting growth of 9.4% & 37% while geography wise the growth was led by India region reporting growth of 61.8%
Employee expenses	36,721	34,973	5.0	35,084	4.7	
Gross Margin	25,892	24,408	6.1	26,153	-1.0	
Gross margin (%)	41.4	41.1	25 bps	42.7	-136 bps	
SG&A expenses	9,230	9,410	-1.9	8,989	2.7	
EBITDA	16,662	14,998	11.1	17,164	-2.9	
EBITDA Margin (%)	26.6	25.3	135 bps	28.0	-142 bps	
Depreciation	1,220	1,243	-1.9	1,246	-2.1	
EBIT	15,442	13,755	12.3	15,918	-3.0	
EBIT Margin (%)	24.7	23.2	150 bps	26.0	-133 bps	EBIT margin contracted by 133 bps QoQ due to the headwinds from wage hikes (170 bps) and higher 3rd party expenses mitigated by operating efficiencies including better productivity, improved utilisation and reduced subcon costs
Other income (less interest)	789	1,234	-36.1	931	-15.3	
PBT	16,231	14,989	8.3	15,891	2.1	
Tax paid	4,126	3,869	6.6	4,347	-5.1	
Reported PAT	12,040	11,074	8.7	12,434	-3.2	
Adjusted PAT	12,040	11,074	8.7	12,434	-3.2	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Total operating Income	2,25,458	2,40,893	2,58,050	2,87,621
Growth (%)	17.6	6.8	7.1	11.5
COGS (employee expenses)	1,32,448	1,39,775	1,49,382	1,63,369
S,G&A expenses	33,750	37,781	38,155	42,712
Total Operating Expenditure	1,66,198	1,77,556	1,87,537	2,06,081
EBITDA	59,260	63,337	70,513	81,541
Growth (%)	11.7	6.9	11.3	15.6
Depreciation	5,023	4,984	5,064	5,609
Other Income less interest	2,670	3,644	2,930	3,428
PBT	56,907	61,997	68,379	79,360
Total Tax	14,604	15,898	17,424	20,237
Minority Interest	156	191	260	260
PAT	42,147	45,908	50,695	58,863
Growth (%)	10.0	8.9	10.4	16.1
EPS (₹)	115.2	125.9	140.1	162.7
PAT	42,147	45,908	50,695	58,863
EPS - Reported (₹)	115.2	125.9	140.1	162.7

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Profit before Tax	56,907	61,997	68,379	79,360
Add: Depreciation	5,022	4,985	5,064	5,609
(Inc)/dec in Current Assets	-7,455	-6,793	-5,163	-8,898
Inc/(dec) in CL and Provisions	3,238	-89	3,676	5,783
Taxes paid	-12,966	-12,489	-17,424	-20,237
CF from operating activities	41,965	44,338	51,603	58,189
(Inc)/dec in Investments	7	5,657	-2,787	-878
(Inc)/dec in Fixed Assets	-3,061	-2,647	-3,871	-4,314
Others	3,093	3,016	2,930	3,428
CF from investing activities	39	6,026	-3,728	-1,764
Inc/(dec) in loan funds	-5,752	-1,614	0	0
Dividend paid & dividend tax	-41,347	-25,137	-35,990	-39,759
Others	-779	-21,785	0	0
CF from financing activities	-47,878	-48,536	-35,990	-39,759
Net Cash flow	-5,874	1,828	11,885	16,666
Exchange difference	509	65	0	0
Opening Cash	12,488	7,123	9,016	20,901
Closing cash and Bank	7,123	9,016	20,901	37,567

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet ₹crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Liabilities				
Equity Capital	366	362	362	362
Reserve and Surplus	90,058	90,127	1,04,832	1,23,937
Share Premium	0	0	0	0
Total Shareholders funds	90,424	90,489	1,05,194	1,24,299
Total debt	7,688	8,021	8,128	8,313
Other liabilities & Provisions	1,892	1,533	1,925	2,049
Deferred tax liability(net)	792	977	977	977
Minority Interest / Others	782	830	1,090	1,350
Total Liabilities	1,01,578	1,01,850	1,17,315	1,36,987
Assets				
Net assets & CWIP	19,891	19,336	18,143	16,848
Goodwill	2,806	1,832	1,832	1,832
Other non current assets	10,501	12,297	15,084	15,962
Debtors	41,198	44,434	47,599	53,053
Loans and Advances	1,333	642	688	767
Other Current Assets	20,158	27,411	29,363	32,728
Current Investments	40,806	31,481	31,481	31,481
Cash	7,123	9,016	20,901	37,567
Trade Payable	10,515	9,981	10,692	11,917
OCL & Provisions	31,723	34,618	37,084	41,333
Application of Funds	1,01,578	1,01,850	1,17,315	1,36,987

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E
Per share data				
Adjusted EPS (Diluted)	115.2	125.9	140.1	162.7
BV per share	247.1	250.0	290.6	343.4
DPS	115.0	73.0	99.5	109.9
Cash Per Share	19.5	24.9	57.7	103.8
Operating Ratios (%)				
EBIT margins	24.1	24.2	25.4	26.4
PBT Margins	25.2	25.7	26.5	27.6
PAT Margin	18.7	19.1	19.6	20.5
Debtor days	67	67	67	67
Creditor days	17	15	15	15
Return Ratios (%)				
RoE	46.6	50.7	48.2	47.4
RoCE	56.0	60.9	58.3	57.9
RoIC	101.1	95.1	100.8	111.8
Valuation Ratios (x)				
P/E	36.3	33.0	29.9	25.7
EV / Net Sales	6.5	6.2	5.7	5.1
Market Cap / Sales	6.7	6.3	5.9	5.3
Solvency Ratios				
Debt / EBITDA	0.1	0.1	0.1	0.1
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	1.5	1.6	1.6	1.6
Quick Ratio	1.5	1.6	1.6	1.6

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

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Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
Third Floor, Brillanto House,
Road No 13, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal

Contact number: 022-40701000 E-mail Address: complianceofficer@icicisecurities.com

For any queries or grievances: Mr. Bhavesh Soni Email address: headservicequality@icicidirect.com Contact Number: 18601231122

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