

CMP: ₹ 4,150

Target: ₹ 4,500 (8%)

Target Period: 12 months

HOLD

October 11, 2024

## Mixed bag show; Margin recovery likely from Q4...

**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%)

**Q2FY25 Performance:** TCS reported revenue of US\$ 7,670 mn, up 2.2% QoQ & 6.4% YoY (in CC terms up 5.5% YoY), driven by strong ramp up in BSNL deal. EBIT margin came at 24.1%, down ~60 bps QoQ impacted by BSNL project ramp up (~60 bps) and incremental investments in talent and infrastructure (~70 bps), offset by currency tailwinds. TCV was at US\$ 8.6 bn, up 3.6% QoQ & down 23.2% YoY.

### Investment Rationale:

- **BSNL deal and Client issues strains margins; management optimistic on recovery:** The margins were strained owing to the BSNL deal ramp up (margin dilutive) as well as certain client specific issues in the Lifesciences (scope reduction) and Manufacturing (supply chain and labour issues) vertical. However, the margins are expected to recover once the BSNL deal which is at its peak right now, tapers off in Q4. The management remains committed to a margin band of 26-28%, and expects to exit Q4 with an EBIT margin of 26%, after a likely seasonally weak Q3. **We build in our estimates for FY27 as well and bake in EBIT margins of 24.6%/26%/26.2% in FY25E/FY26E/FY27E.**
- **Demand environment remains soft with potential recovery in FY26:** The demand environment remains same as Q1 with clients focusing on cost optimisation and ROI driven deals. However, management remains optimistic on discretionary spends recovery aided by lower inflation, interest rate cuts, modernization backlog at enterprises and increasing consumer experience spends. **We expect dollar revenue to grow by 5.5%, 9% & 10% in FY25E, FY26E & FY27E respectively implying CAGR of 8.2% between FY24-27E compared to CAGR of 8.8% between FY19-24.**
- **Strong momentum in BFSI vertical and AI/GenAI deals:** The BFSI vertical continued to stay healthy in Q2 (up +1.9% QoQ). On the AI/GenAI front, TCS is seeing its pipeline doubling every quarter which has now started to translate to revenue as 86 engagements move into production from the proof of concept (PoC) stage (vs. 8 in Q1).

### Rating and Target Price

- Expanding GenAI demand visibility and BFSI recovery are positive signs amid challenges such as margin pain & challenges in non-BFSI segment.
- We maintain HOLD, and assign a **target price of ₹4,500 at 26x P/E on average of FY26E and FY27E EPS (vs ₹4,400 earlier at 27x FY26E P/E).**

### Key Financial Summary

₹ crore	FY22	FY23	FY24	5 year CAGR (FY19-24)	FY25E	FY26E	FY27E	3 year CAGR (FY24-27E)
Net Sales	1,91,754	2,25,458	2,40,893	10.5	2,56,678	2,81,806	3,11,960	9.0
EBITDA	53,057	59,260	63,337	9.9	68,351	78,906	87,973	11.6
EBITDA Margins (%)	27.7	26.3	26.3		26.6	28.0	28.2	
Net Profit	38,327	42,147	45,908	7.8	48,911	56,772	63,769	11.6
EPS (₹)	104.7	115.2	125.9		135.2	156.9	176.3	
P/E	39.6	36.0	32.7		30.7	26.5	23.6	
RoNW (%)	43.0	46.6	50.7		46.9	46.4	44.6	
RoCE (%)	51.4	56.0	60.9		56.5	56.6	55.0	

Source: Company, ICICI Direct Research



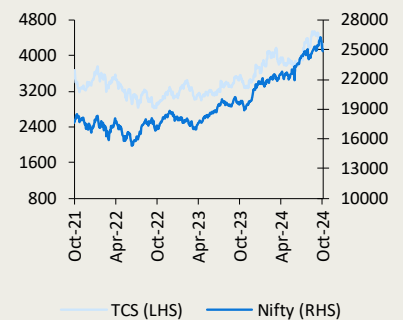
### Particulars

Particular	Amount
Market Cap (₹ Crore)	15,02,300
Total Debt (₹ Crore)	8,021
Cash & equiv. (₹ Crore)	40,497
EV (₹ Crore)	14,69,824
52 week H/L	4592/ 3311
Equity capital (₹ Crore)	362
Face value	1.0

### Shareholding pattern

	Sep-23	Dec-23	Mar-24	Jun-24
Promoters	72.3	72.4	71.8	71.8
FII	12.5	12.5	12.7	12.4
DII	10.1	10.1	10.7	11.1
Others	5.2	5.0	4.9	4.8

### Price Chart



### Key risks

- Continued weakening of the demand environment;
- Lower than expected AI/GenAI contribution to revenue

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## Performance highlights and outlook

- Revenue performance:** TCS in Q1 reported revenue of US\$ 7,670 mn, up 2.2% QoQ & 6.4% YoY (in CC terms up 1.1% QoQ & 5.5% YoY). In rupee terms it reported revenue of ₹64,259 crore up 2.6% QoQ & 7.7% YoY. This was primarily driven by the ramp up in the BSNL deal.
- Geography performance:** Geography wise the growth was led by India (8.9% of mix), MEA (2.2% of mix), Asia (7.8% of mix) & UK (16.5% of mix) which reported YoY CC growth of 95.2%, 7.9%, 7.5% & 4.6% respectively while US region (47.6% of mix) declined by 2.1%. **However, on a sequential basis almost all geographies grew positively barring the America's region which declined by 1.8%. The growth in India region was fuelled by the BSNL deal ramp up.**
- Segment performance:** Segment wise in CC terms on YoY basis the growth was led by Regional Markets (15.5% of mix), Energy, Resources and Utilities (5.7% of mix) and Manufacturing (8.6% of mix) which grew by 50.4%, 7% & 5.3% respectively and BFSI (30.8% of the mix), Retail (15.9% of the mix), Lifesciences (10.4% of the mix) growing by 0.1% each, while Communications (5.9% of mix), Technology & Services (8% of the mix) declined by 10.3% and 1.9% respectively. On a QoQ basis growth was led by Regional Markets, ERU and BFSI which grew by 13%, 4% and 1.9% respectively while Retail and Tech Services improved marginally by 0.2% and 0.9% respectively. **Owing to labour & supply chain issues in the manufacturing segment along with reduction in the scope of a deal in the healthcare segment, both these segments have declined 0.1% and 3.4% respectively.**
- Margin performance:** EBIT margin came at 24.1%, down ~60 bps QoQ due to headwinds from higher third-party expenses on account of BSNL project (~60 bps) and incremental investments in talent and infrastructure (~70 bps), offset by currency tailwinds and non-recurring one-offs from Q1. The PAT margin stood at 18.6%, down ~70 bps QoQ.
- Deal Wins:** The company during the quarter won TCV of US\$ 8.6 bn (up 3.61% QoQ/down 23.2% YoY) with BFSI, Retail & US reporting TCV of US\$ 2.9bn, 1.2 bn & 4.2 bn respectively. The company reported TCV wins within its comfort range of US\$ 7-9bn, although there were no mega deal wins added during the quarter. TCV wins also warrants a mega deal win to offset a risk of lower order inflows in FY25 vs FY24, in our view.
- Demand Outlook:** The company saw **no change in the demand environment from the previous quarter** other than a few clients' specific issues in the Lifesciences and Manufacturing vertical which are expected to stabilise in Q3, as **clients still keep their focus on cost optimisation and ROI driven deals.** However, **management remains optimistic on discretionary spends recovery driven by reduced inflation, interest rate cuts, modernization backlog at enterprises and increasing spend on consumer experience.**
- AI/GenAI Outlook:** On the GenAI front, the company is doubling its TCV every quarter. This quarter it reported that it is engaged in 600 engagements versus 275 in the last quarter. Additionally, this quarter **86 engagements went into production from the PoC stage as compared with 8 last quarter.** However, the deal sizes continue to remain small.
- Margin Guidance/ Aspiration:** The management remains committed to a margin band of 26-28%, and expects to exit Q4 with an EBIT margin of 26%, after a likely seasonally weak Q3.
- Attrition and employee addition:** Attrition expanded by 20 bps QoQ to 12.3% while on YoY basis it declined by 260 bps. The company net employees during the quarter increased by 5,726 bringing the total employee strength to 612,724.
- Dividend:** The company in Q2FY25 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**

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
Revenue (US\$ mn)	7,670	7,210	6.4	7,505	2.2	In CC terms Revenue grew 1.1% QoQ & 5.5% YoY
Revenue (₹ crore)	64,259	59,692	7.7	62,613	2.6	On a QoQ basis growth was led by Regional Markets, ERU and BFSI which grew by 13%, 4% and 1.9% respectively while Retail and Tech Services improved marginally by 0.2% and 0.9% respectively.
Employee expenses	38,734	34,798	11.3	36,721	5.5	
Gross Margin	25,525	24,894	2.5	25,892	-1.4	
Gross margin (%)	39.7	41.7	-198 bps	41.4	-163 bps	
SG&A expenses	8,793	9,149	-3.9	9,230	-4.7	
EBITDA	16,732	15,745	6.3	16,662	0.4	
EBITDA Margin (%)	26.0	26.4	-34 bps	26.6	-57 bps	
Depreciation	1,267	1,262	0.4	1,220	3.9	
EBIT	15,465	14,483	6.8	15,442	0.1	
EBIT Margin (%)	24.1	24.3	-20 bps	24.7	-60 bps	EBIT margin contracted by 60 bps QoQ due to the headwinds from higher third-party expenses on account of BSNL project (~60 bps) and incremental investments in talent and infrastructure (~70 bps), offset by currency tailwinds and non-recurring one-offs from Q1.
Other income (less interest)	567	847	-33.1	789	-28.1	
PBT	16,032	15,330	4.6	15,273	5.0	
Tax paid	4,077	3,950	3.2	4,126	-1.2	
Reported PAT	11,909	11,342	5.0	12,040	-1.1	
Adjusted PAT	11,909	11,342	5.0	12,040	-1.1	

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 2: Profit and loss statement		₹ crore			
(Year-end March)	FY24	FY25E	FY26E	FY27E	
Total operating Income	2,40,893	2,56,678	2,81,806	3,11,960	
Growth (%)	6.8	6.6	9.8	10.7	
COGS (employee expenses)	1,39,775	1,51,610	1,60,911	1,77,505	
S,G&A expenses	37,781	36,718	41,989	46,482	
Total Operating Expenditure	1,77,556	1,88,327	2,02,900	2,23,987	
EBITDA	63,337	68,351	78,906	87,973	
Growth (%)	6.9	7.9	15.4	11.5	
Depreciation	4,984	5,083	5,636	6,239	
Other Income less interest	3,644	2,579	3,127	4,097	
PBT	61,997	65,847	76,396	85,830	
Total Tax	15,898	16,733	19,405	21,801	
Minority Interest	191	203	220	260	
PAT	45,908	48,911	56,772	63,769	
Growth (%)	8.9	6.5	16.1	12.3	
EPS (₹)	125.9	135.2	156.9	176.3	
PAT	45,908	48,911	56,772	63,769	
EPS - Reported (₹)	125.9	135.2	156.9	176.3	

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement		₹ crore			
(Year-end March)	FY24	FY25E	FY26E	FY27E	
Profit before Tax	61,997	65,847	76,396	85,830	
Add: Depreciation	4,985	5,083	5,636	6,239	
(Inc)/dec in Current Assets	-6,793	-4,750	-7,561	-9,073	
Inc/(dec) in CL and Provisions	-89	3,408	4,914	5,897	
Taxes paid	-12,489	-16,733	-19,405	-21,801	
CF from operating activities	44,338	50,275	56,854	62,995	
(Inc)/dec in Investments	5,657	-2,746	-746	-895	
(Inc)/dec in Fixed Assets	-2,647	-3,850	-4,227	-4,679	
Others	3,016	2,579	3,127	4,097	
CF from investing activities	6,026	-4,017	-1,846	-1,478	
Inc/(dec) in loan funds	-1,614	0	0	0	
Dividend paid & dividend tax	-25,137	-35,005	-38,839	-43,037	
Others	-21,785	0	0	0	
CF from financing activities	-48,536	-35,005	-38,839	-43,037	
Net Cash flow	1,828	11,254	16,169	18,480	
Exchange difference	65	0	0	0	
Opening Cash	7,123	9,016	20,270	36,439	
Closing cash and Bank	9,016	20,270	36,439	54,919	

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet		₹ crore			
(Year-end March)	FY24	FY25E	FY26E	FY27E	
<b>Liabilities</b>					
Equity Capital	362	362	362	362	
Reserve and Surplus	90,127	1,04,033	1,21,966	1,42,699	
Share Premium	0	0	0	0	
Total Shareholders funds	90,489	1,04,395	1,22,328	1,43,061	
Total debt	8,021	8,120	8,277	8,465	
Other liabilities & Provisions	1,533	1,920	2,025	2,150	
Deferred tax liability(net)	977	977	977	977	
Minority Interest / Others	830	1,033	1,253	1,513	
Total Liabilities	1,01,850	1,16,444	1,34,859	1,56,166	
<b>Assets</b>					
Net assets & CWIP	19,336	18,103	16,694	15,134	
Goodwill	1,832	1,832	1,832	1,832	
Other non current assets	12,297	15,043	15,789	16,684	
Debtors	44,434	47,346	51,981	57,543	
Loans and Advances	642	684	751	831	
Other Current Assets	27,411	29,207	32,066	35,498	
Current Investments	31,481	31,481	31,481	31,481	
Cash	9,016	20,270	36,439	54,919	
Trade Payable	9,981	10,635	11,676	12,926	
OCL & Provisions	34,618	36,886	40,498	44,831	
Application of Funds	1,01,850	1,16,444	1,34,859	1,56,166	

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios					
(Year-end March)	FY24	FY25E	FY26E	FY27E	
<b>Per share data</b>					
Adjusted EPS (Diluted)	125.9	135.2	156.9	176.3	
BV per share	250.0	288.4	337.9	395.2	
DPS	73.0	96.8	107.4	119.0	
Cash Per Share	24.9	56.0	100.7	151.7	
<b>Operating Ratios (%)</b>					
EBIT margins	24.2	24.6	26.0	26.2	
PBT Margins	25.7	25.7	27.1	27.5	
PAT Margin	19.1	19.1	20.1	20.4	
Debtor days	67	67	67	67	
Creditor days	15	15	15	15	
<b>Return Ratios (%)</b>					
RoE	50.7	46.9	46.4	44.6	
RoCE	60.9	56.5	56.6	55.0	
RoIC	95.1	97.8	109.5	117.2	
<b>Valuation Ratios (x)</b>					
P/E	32.7	30.7	26.4	23.5	
EV / Net Sales	6.1	5.7	5.1	4.6	
Market Cap / Sales	6.2	5.9	5.3	4.8	
<b>Solvency Ratios</b>					
Debt / EBITDA	0.1	0.1	0.1	0.1	
Debt / Equity	0.1	0.1	0.1	0.1	
Current Ratio	1.6	1.6	1.6	1.6	
Quick Ratio	1.6	1.6	1.6	1.6	

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%



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