



3R MATRIX

	+	=	-
Right Sector (RS)	Green	✓	Red
Right Quality (RQ)	✓	Grey	Red
Right Valuation (RV)	Green	✓	Red

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Grey	↔	Grey

ESG Disclosure Score

NEW

ESG RISK RATING

Updated Mar 08, 2023

11.42

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

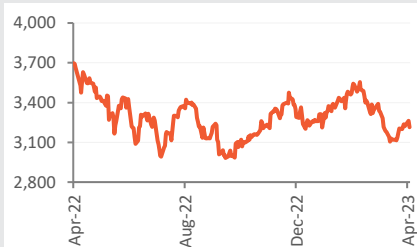
Company details

Market cap:	Rs. 11,86,301 cr
52-week high/low:	Rs. 3,739 / 2,926
NSE volume: (No of shares)	17.2 lakh
BSE code:	532540
NSE code:	TCS
Free float: (No of shares)	101.4 cr

Shareholding (%)

Promoters	72.3
FII	12.9
DII	9.3
Others	5.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.7	-2.8	4.6	-12.2
Relative to Sensex	-4.8	-3.5	-0.2	-15.3

Sharekhan Research, Bloomberg

Tata Consultancy Services Ltd

Soft quarter; Hazy near-term outlook

IT & ITES

Sharekhan code: TCS

Reco/View: Buy



CMP: Rs. 3,242

Price Target: Rs. 3,650



Upgrade



Maintain



Downgrade

Summary

- TCS reported a revenue growth of 0.6% q-o-q and 10.7% y-o-y in CC terms missing our estimates of 1.1% q-o-q CC growth in a seasonally weak quarter primarily due to weakness in North America. EBIT margin at 24.5% remained flat missing estimates on muted revenue and higher onsite costs offsetting the effect of currency tailwinds during the quarter.
- The company reported robust deal TCV wins with order book TCV of \$10 billion versus \$7.8 billion in Q3FY23 and a book to bill ratio of 1.4x recording all-time high number of large deals.
- The management expressed that they are seeing weakness not only in BFSI but also across other sectors in North America. Despite the strong deal wins and robust deal pipeline, which offers decent revenue visibility the management highlighted that they are being watchful over the next quarter on account of near term uncertainties due to recent macro developments.
- We believe near-term outperformance would be restricted for TCS owing to uncertain earnings outlook, CEO transition and global macro headwinds. Thus, we advise investors to adopt a staggered buying approach for long-term investment. We maintain our Buy rating on TCS with an unchanged PT of Rs. 3,650.

TCS reported revenue growth of 0.6% q-o-q and 10.7% y-o-y in CC terms missing our estimates of 1.1% q-o-q CC growth in a seasonally weak quarter primarily due to weakness in North America. In USD terms, revenues were up by 1.7% q-o-q aided by a currency tailwind of 110 bps. EBIT margin at 24.5% remained flat missing estimates on account of muted revenue and higher onsite costs offsetting the effect of currency tailwinds during the quarter. In terms of verticals, growth in Q4FY23 was led by Retail & CPG and Life Sciences and Healthcare growing 13% and 12.1% y-o-y in cc terms respectively while in terms of geography UK led with 17% y-o-y growth in cc terms. The company reported a headcount addition of 821 employees during the quarter. Attrition rate (on an LTM basis) dipped 120 bps to 20.1%. The company reported robust Deal TCV wins with order book TCV at \$10 Bn vs \$7.8 billion in Q3FY23 and a book to bill ratio of 1.4x recording all-time high number of large deals during the quarter. The deals were broad based with one mega deal of ~\$750 million. On the demand environment, the management expressed that they are seeing weakness not only in BFSI but also across other sectors in North America. However, they cited that the deal velocity has accelerated especially in Europe where the sentiment is turning positive. Despite the strong deal wins and robust deal pipeline which offers decent revenue visibility the management highlighted that they are being watchful over the next quarter. Further with change in the top management, CEO transition would be another area to watch out for in the near term. We believe near-term outperformance would be restricted for TCS owing to uncertain earnings outlook, CEO transition and global macro headwinds. Thus, we advise investors to adopt a staggered buying approach for long term investment. We maintain our Buy rating on TCS with an unchanged PT of Rs. 3,650.

Key positives

- Order book TCV at \$10 Bn vs \$7.8 billion in Q3FY23 with a book to bill ratio of 1.4x, all-time high number of large deals.
- LTM attrition dipped 120 bps to 20.1% from 21.3% in Q3FY23.
- Strong Client addition q-o-q -1new client in \$100Mn+ category and added 3 new clients in \$50Mn+ category.

Key negatives

- EBIT margin was flat at 24.5%, missing estimates by ~ 60 basis points.
- Net addition was a meagre 821 employees during the quarter, closing headcount at 614,795.

Management Commentary

- The management highlighted that after a soft Q3FY23 which was a result of caution on client's part, they were anticipating a strong recovery in Q4FY23. However, it has turned more negative following developments on the Banking side. Further management commented that they are seeing weakness not just out of BFSI but across sectors in North America.
- The management cited that the deal velocity has not reduced but has accelerated especially in Europe. The decision making in Europe has increased with sentiment turning positive both on the overall economic front and having dealt with the winter positively with receding fears on energy crisis and increasing optimism on China scenario. They said that they have closed more deals in Europe in the quarter in comparison to the first three quarters.

Revision in estimates – We have fine-tuned our estimates for FY24/25 owing to macro-overhang.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 3,650: We believe near-term outperformance would be restricted for TCS owing to uncertain earnings outlook, CEO transition and global macro headwinds. Thus, we advise investors to adopt a staggered buying approach for long term investment. We maintain our Buy rating on TCS with an unchanged PT of Rs. 3,650.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and a possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated)

Particulars	FY2022	FY2023	FY2024E	FY2025E
Revenue	1,91,754.0	2,25,458.0	2,35,979.3	2,52,772.0
OPM (%)	27.7	26.3	26.7	26.6
Adjusted PAT	38,327.0	42,147.0	45,342.2	48,750.3
% y-o-y growth	14.8	10.0	7.6	7.5
Adjusted EPS (Rs.)	103.6	115.2	123.9	133.3
P/E (x)	31.3	28.1	26.2	24.3
P/B (x)	13.3	13.0	11.3	11.1
EV/EBITDA	21.6	19.3	18.0	16.9
ROE %	43.3	46.6	46.3	46.0
ROCE %	49.6	54.8	51.6	53.9

Source: Company; Sharekhan estimates

Key highlights of Management Commentary

- ♦ **Strong and broad-based TCV deals:** Robust TCVs at \$10bn in Q4 were up by 28% q-o-q with a mega deal win of \$750 mn from UK Insurance player, Phoenix Group. TCV growth was also broad based with TCVs from North America at \$5 bn, BFSI at \$3.1 bn and Retail at 1.3 bn. Company is confident of \$7-9 billion worth of TCVs on a quarterly basis. FY23 TCV came at \$34.1 bn. Strong TCV metrics has made the management confident despite short-term demand uncertainty.
- ♦ **EBIT margin performance:** EBIT margins for Q4 remained flat at 24.5% as the benefits of lower subcontractor cost, currency gains and other efficiencies were offset by higher on-site costs. FY23 EBIT at 24.1% was down by 120 bps y-o-y. Increase in wage costs by 160 bps, supply side costs by 140 bps and travel costs by 30 bps were partially offset by 50 bps of realization improvement, 50 bps of employee pyramid optimisation and 110 bps of currency benefit. The contingent workforce is still high due to supply side challenges and company is working to bring its contingent labour to 5% to 8% of the total workforce.
- ♦ **Commentary on verticals:** Growth in Q4 was led by 13% and 12.1% y-o-y in cc terms for Retail & CPG and the lifesciences and Healthcare, verticals, respectively. Other verticals grew in the single digits below the overall company growth rate of 10.7% y-o-y in cc. Technology & Services grew 9.2%, BFSI grew 9.1%, Manufacturing grew 9.1% and Communications & Media grew 5.3%.
- ♦ **Geography-wise performance:** Q4 y-o-y growth in cc was led by UK which grew by 17%. North America grew 9.6% while Continental Europe grew 8.4%. Among emerging markets, Latin America grew 15.1%, India grew 13.4%, Middle East & Africa grew 11.3% and Asia Pacific grew 7.5%. Deal velocity accelerated in Europe with company signing more large deals in Q4 alone than 9MFY23. However, challenges persist for Continental Europe going forward. North America has underperformed across all sectors and the growth has been slower than expected.
- ♦ **Headcount & attrition:** Headcount stood at 6, 14,795 as of March 31, 2023 increased by 821 q-o-q. LTM attrition rate at 20.1% was down by 120 bps q-o-q but is still high due to the unprecedented churn levels in the previous quarters. Quarterly annualized attrition, on the other hand, decreased by over 400 bps q-o-q and by close to 1000 bps from peak levels seen in Q2. Management expects LTM attrition to come to pre-pandemic levels in H2FY24.
- ♦ **Healthy client metrics:** The number of clients in 100/50/20/10/5 increased by 1, 3, 1, 5 & 7 taking the total count to 60, 133, 291, 461 & 665, respectively. The company has not seen large scale project cancellation or budget cuts but only deferment of discretionary projects as clients' focus is to now spend wisely.
- ♦ **Strong cash flow from operations:** Cash flow from operations at INR 118.64 Bn was up by 6.37% q-o-q. Cash flow from operations was strong at 104.1% of net profit.

Results (Consolidated)

Particulars	Rs cr				
	Q4FY23	Q4FY22	Q3FY23	Y-o-Y %	Q-o-Q %
Revenues In USD (mn)	7,195.0	6,696.0	7,075.0	7.5	1.7
Revenues In INR	59,162.0	50,591.0	58,229.0	16.9	1.6
Direct Costs	34,427.0	29,364.0	33,942.0	17.2	1.4
Gross Profit	24,735.0	21,227.0	24,287.0	16.5	1.8
SG&A	8,962.0	7,382.0	8,733.0	21.4	2.6
EBITDA	15,773.0	13,845.0	15,554.0	13.9	1.4
Depr & amort.	1,285.0	1,217.0	1,270.0	5.6	1.2
EBIT	14,488.0	12,628.0	14,284.0	14.7	1.4
Other Income	903.0	736.0	360.0	22.7	150.8
PBT	15,391.0	13,364.0	14,644.0	15.2	5.1
Tax Provision	3,955.0	3,405.0	3,761.0	16.2	5.2
PAT	11,436.0	9,959.0	10,883.0	14.8	5.1
Minority interest/Share of associates	44.0	33.0	37.0	33.3	18.9
Adj. Net Profit	11,392.0	9,926.0	10,846.0	14.8	5.0
EPS (Rs.)	31.1	26.9	29.6	16.0	5.1
Margin (%)					
GPM	41.8	42.0	41.7	-14.9	9.9
EBITDA	26.7	27.4	26.7	-71	-5
EBIT	24.5	25.0	24.5	-47	-4
NPM	19.3	19.6	18.6	-36	63
Tax rate	25.7	25.5	25.7	22	1

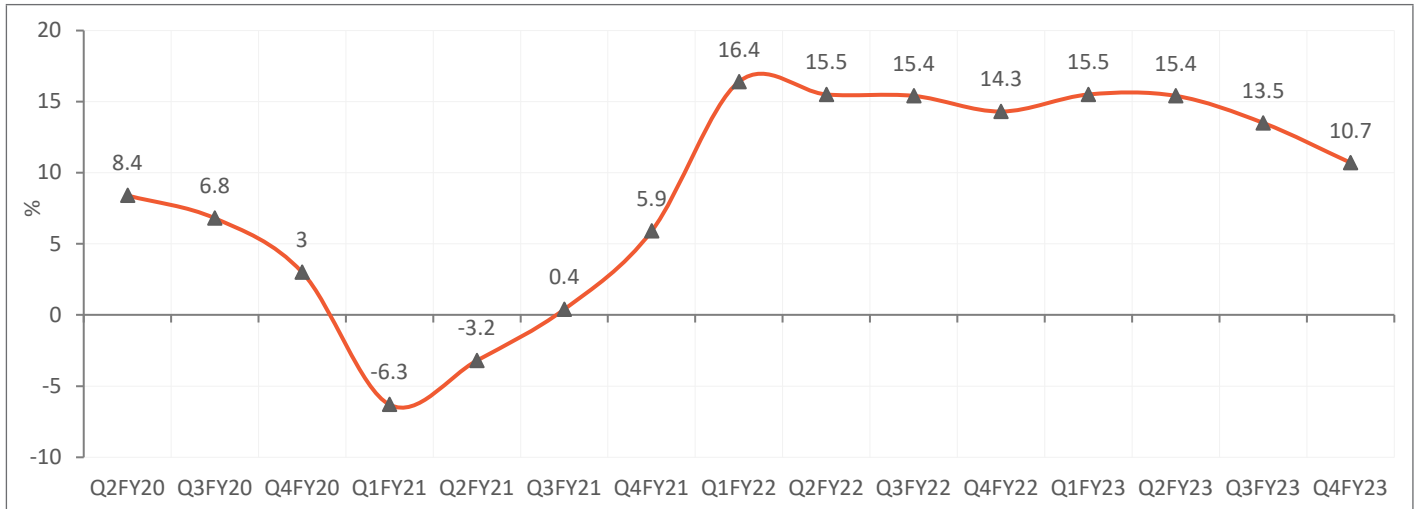
Source: Company; Sharekhan Research

Operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)
	(\$ mn)	(%)	Q-o-Q %	Y-o-Y %	Y-o-Y %
Revenues (\$ mn)	7,195	100	1.7	7.5	10.7
Geographic mix					
North America	3,770	52.4	-0.8	9.1	9.6
Latin America	130	1.8	1.7	13.8	15.1
UK	1,130	15.7	7.2	8.1	17.0
Continental Europe	1,086	15.1	3.8	4.7	8.4
India	360	5.0	-0.3	5.3	13.4
APAC	576	8.0	3.0	1.1	7.5
MEA	144	2.0	13.0	7.5	11.3
Industry verticals					
BFSI	2,259	31.4	1.4	5.8	9.1
Retail & CPG	1,122	15.6	1.0	8.8	13.0
Communication & media	468	6.5	0.2	4.2	5.3
Manufacturing	712	9.9	1.7	6.4	9.1
Life Science and healthcare	748	10.4	2.7	11.8	12.3
Technology & services	626	8.7	-0.6	7.5	9.2
Regional markets and others	1,259	17.5	4.1	8.7	14.6

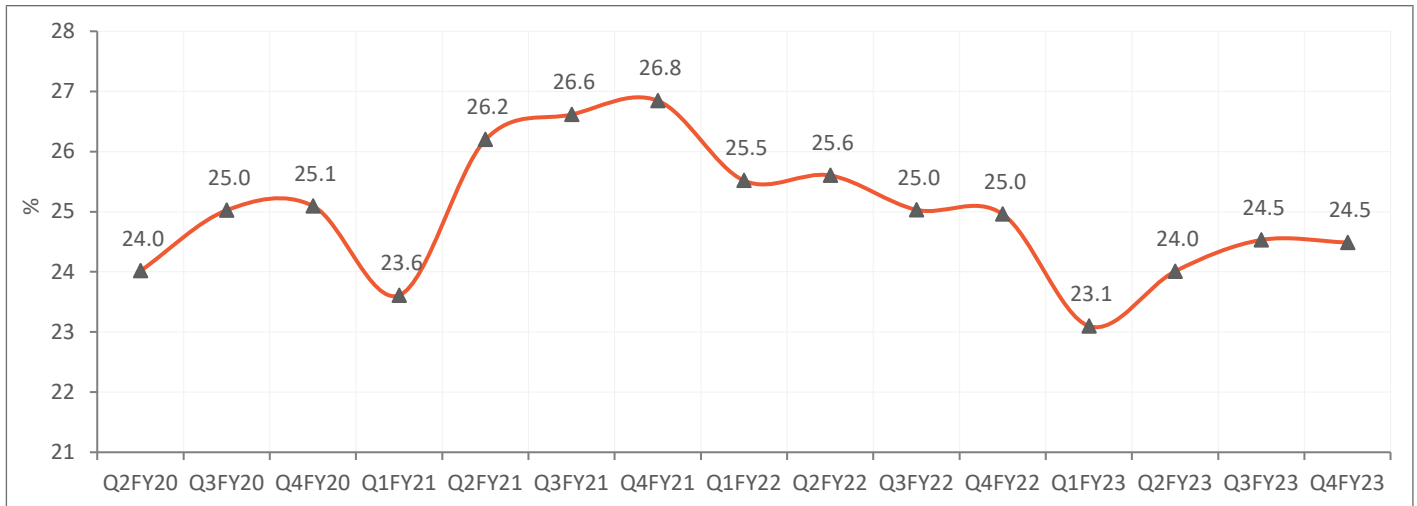
Source: Company; Sharekhan Research

TCS' constant-currency revenue growth (y-o-y) trend



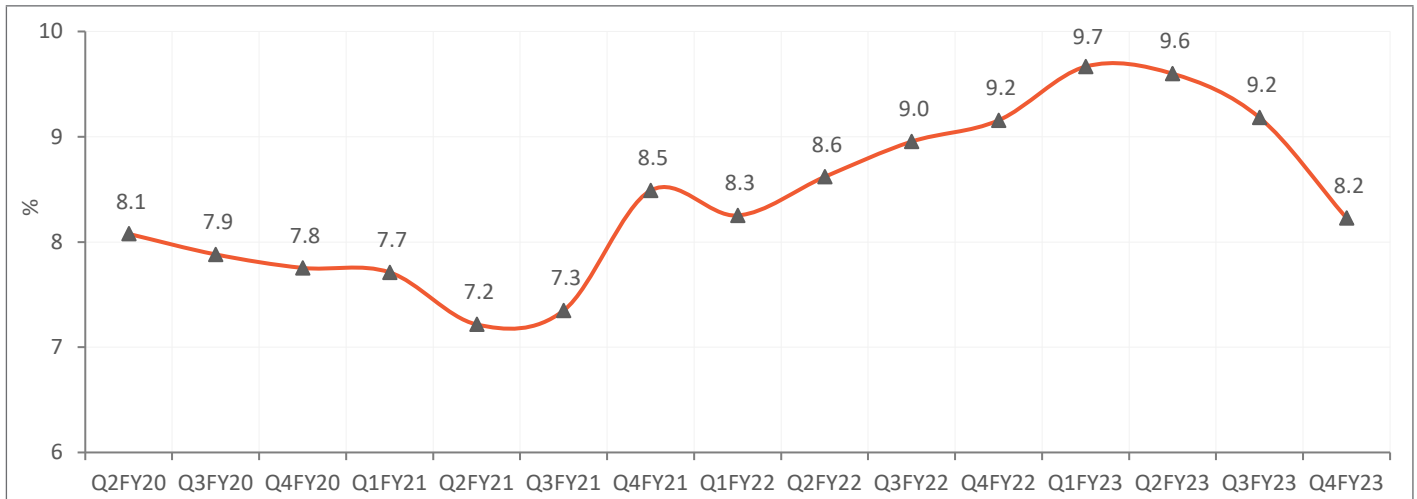
Source: Sharekhan Research

EBIT margin Trend



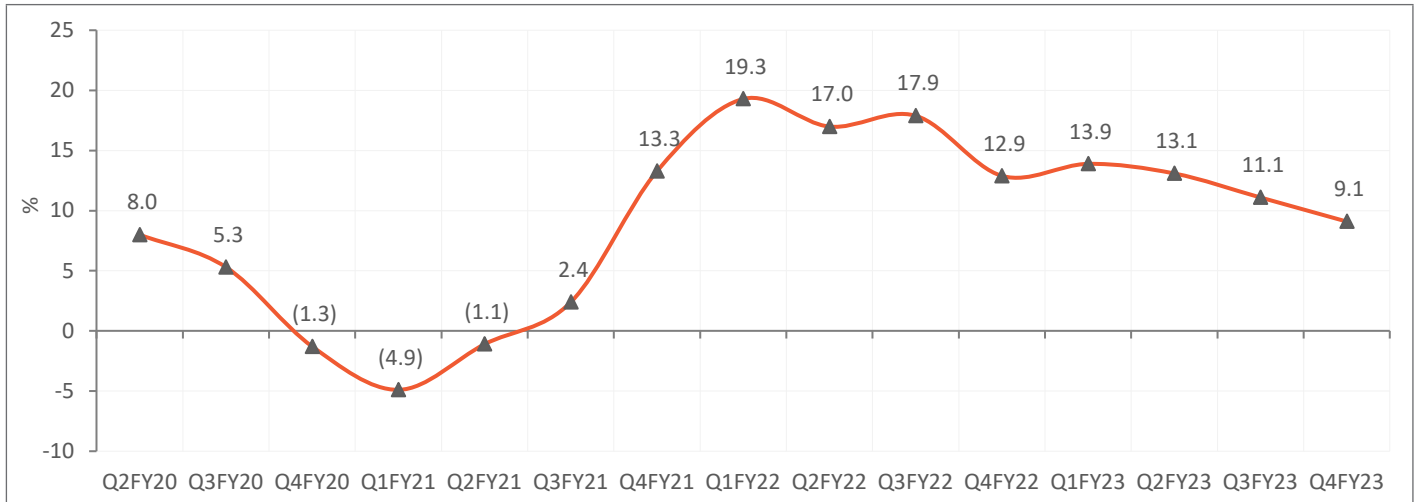
Source: Sharekhan Research

Subcontracting costs as % of revenue



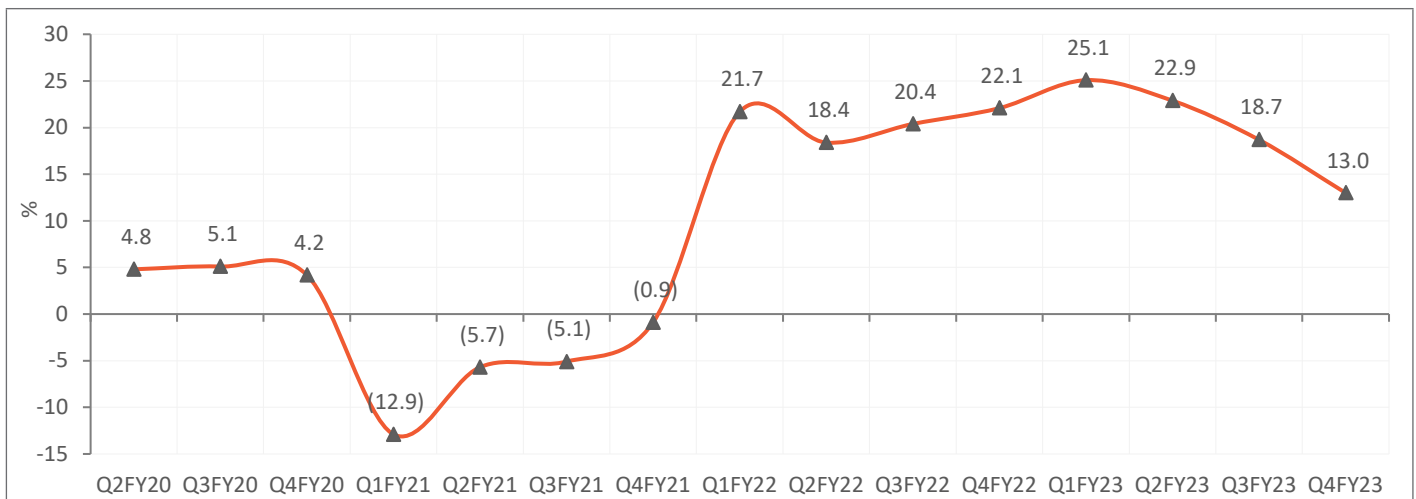
Source: Sharekhan Research

BFSI revenue growth trend



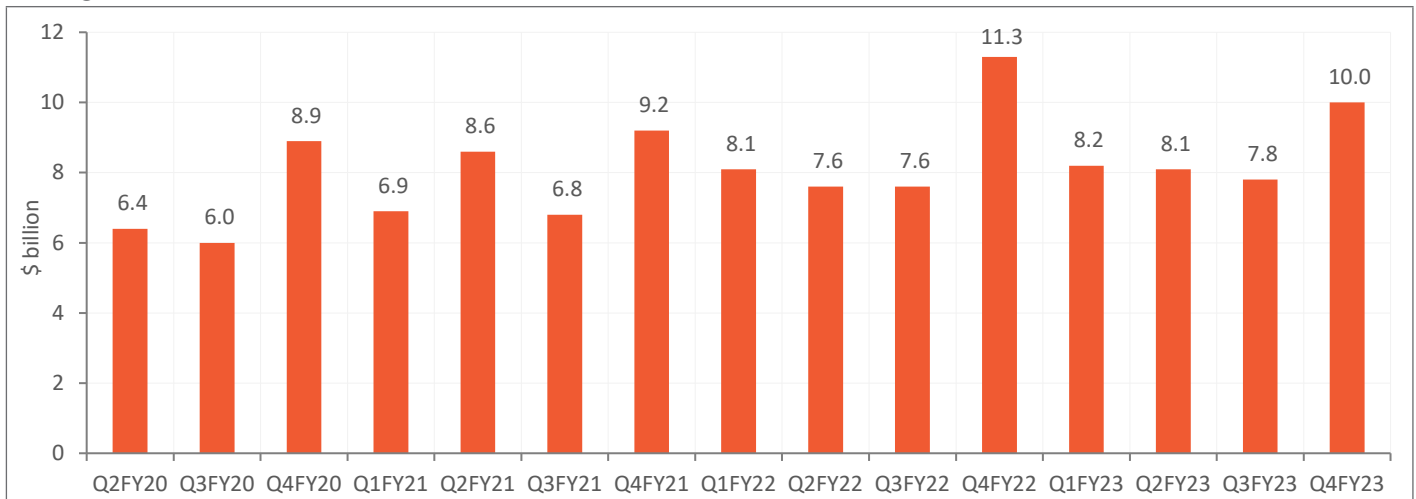
Source: Sharekhan Research

Retail vertical trend



Source: Sharekhan Research

Healthy deal TCVs



Source: Sharekhan Research

Outlook and Valuation

■ Sector View – Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds, the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence concerns relating to macroeconomic headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

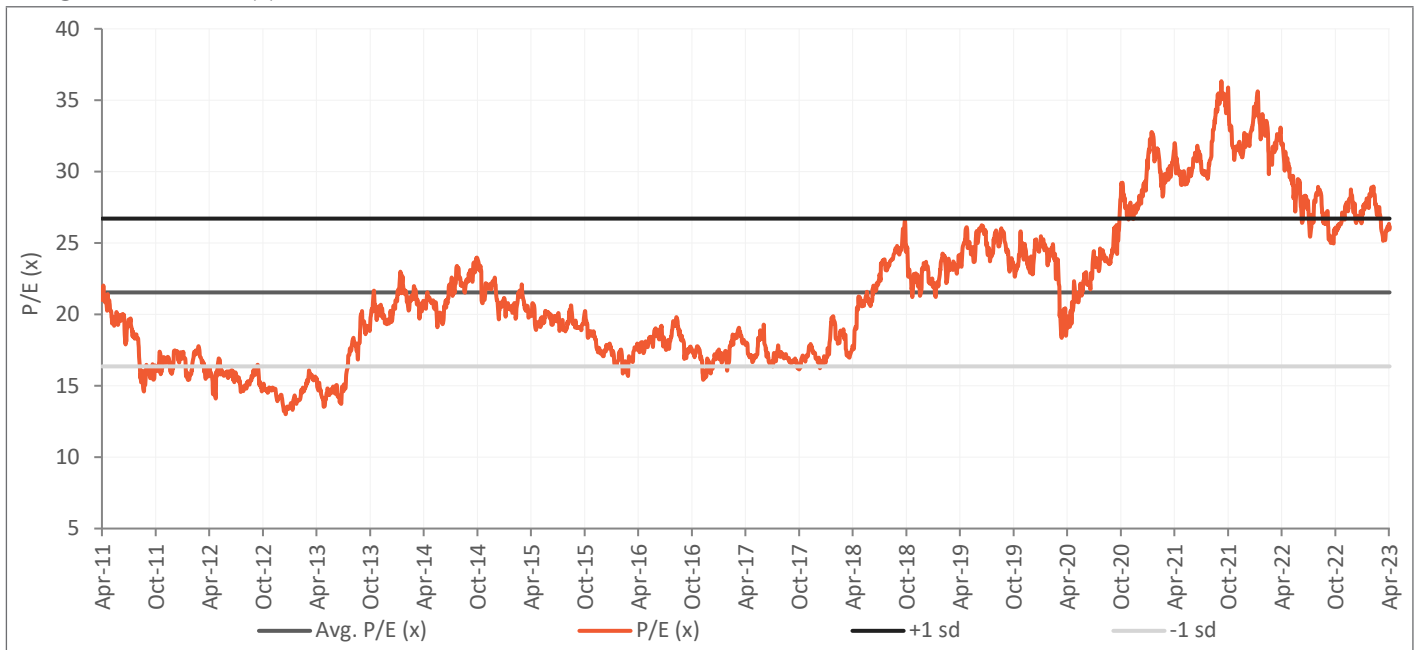
■ Company Outlook – Staying ahead of the race

Being one of the largest IT services companies worldwide and having preferred partners as clients, TCS can capture a fair share of spends on digital and Cloud transformation initiatives and is well-positioned to participate in clients' transformation journeys. Further, the company is well-placed from a competitive perspective, especially in newer technologies. A stable management, full-service capabilities, the ability to structure large multi-service deals and multi-horizon transformation demand would help TCS to deliver strong revenue growth in the next three years. The management intends to keep the payout ratio at 80-100% of free cash generated.

■ Valuation – Maintain Buy with unchanged PT of Rs. 3,650

We believe that near-term outperformance would be restricted for TCS owing to uncertain earnings outlook, CEO transition and global macro headwinds. Thus, we advise investors to adopt a staggered buying approach for long term investment. We maintain our Buy rating on TCS with an unchanged PT of Rs. 3,650.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY23	FY24E	FY23	FY24E	FY23	FY24E	FY23	FY24E
HCL Tech	1,095	271	2,97,065	21.4	20.5	14.8	13.6	4.5	4.2	22.9	24.0
Infosys	1,428	415	5,92,601	24.5	23.0	16.3	15.2	4.1	3.8	30.4	30.1
TCS	3,242	366	11,86,063	28.1	26.2	19.3	18.0	13.0	11.3	46.6	46.3

Source: Company, Sharekhan estimates

About company

TCS is among the pioneers of IT services outsourcing business in India and is the largest (\$25,707 million revenue in FY2022) IT services firm in terms of export revenue. Incorporated in 1968, the company provides a comprehensive range of IT services to industries such as BFS, insurance, manufacturing, telecommunications, retail and transportation. TCS is an IT services, consulting and business solutions organization that has been partnering with many of the world's largest businesses in their transformation journeys for over 50 years. TCS is well positioned to benefit from growing demand for offshore IT services, given its solid execution capabilities, long-standing relationships with clients, and stable management team. The company is a serious contender for winning large deals, as it has better experience compared to peers in implementing large, complex and mission-critical projects. TCS is one of the preferred IT vendors for most Fortune 500/Global 1,000 companies.

Investment theme

TCS is one of the leading IT services companies with a wide-range of capabilities, robust digital competencies, strong platform and stable management. The company is the preferred partner of large corporates and is increasing its participation in large digital implementation. Hence, we believe TCS would continue to gain market share in digital versus its large peers, given its superior execution capabilities on the digital front. We remain positive on the sustainability of its revenue growth momentum in the medium term, given strong deal wins, broad-based service offerings, higher spend on digital technologies and best-in-class execution.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

N. Chandrasekaran	Chairman
Rajesh Gopinathan	Chief Executive Officer
N. Ganapathy Subramaniam	Chief Operating Officer
Samir Seksaria	Chief Financial Officer
Milind Lakkad	EVP and Global Head, HR

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.41
2	Vanguard Group Inc	1.07
3	SBI Funds Management Ltd	0.98
4	BlackRock Inc	0.96
5	Invesco Ltd	0.87
6	JPMorgan Chase & Co	0.57
7	Axis Asset Management Co Ltd	0.53
8	First State Investments ICVC	0.38
9	UTI Asset Management Co Ltd	0.35
10	Norges Bank	0.29

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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