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SYSTEMATIX INSTITUTIONAL EQUITIES

Systematix

Institutional Equities

14 April 2024

TCS

Margins surprise positively

RESULT UPDATE

Sector: IT & ITES

Rating: BUY

CMP: Rs 4,001

Target Price: Rs 4,600

Stock Info

Sensex/Nifty	75,038/22,666
Bloomberg	TCS IN
Equity shares (mn)	3647
52-wk High/Low	4,010/3,070
Face value	Rs 1
M-Cap	Rs 14,592.5bn/USD 175.8bn
3-m Avg turnover	USD 120.9mn

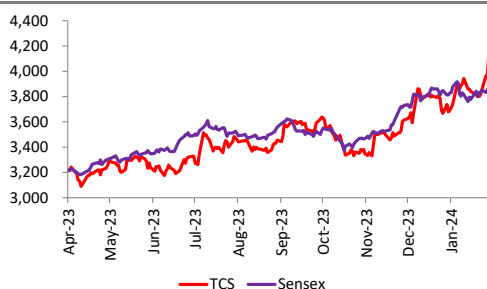
Financial Snapshot (Rs mn)

Y/E Mar	FY24	FY25E	FY26E
Net sales	24,08,930	25,61,776	27,51,660
EBIT	5,93,090	6,41,027	7,00,418
EBIT (%)	24.6%	25.0%	25.5%
PAT	4,59,060	5,13,240	5,64,292
EPS	125.9	141.8	155.9
P/E (x)	31.8	28.2	25.7
P/B (x)	16.1	14.7	13.0
EV/EBITDA (x)	22.1	20.3	18.4
RoE (%)	50.7%	52.2%	50.7%
RoCE (%)	59.3%	61.5%	61.1%

Shareholding Pattern (%)

	Dec'23	Sep'23	Jun'23
Promoter	72.4	72.3	72.3
- Pledged	0.5	0.5	0.5
FII	12.5	12.5	12.5
DII	10.1	10.1	9.9
Others	5.0	5.2	5.4

Stock Performance (1-year)



Tata Consultancy Services' (TCS IN) Q4 print was a mixed bag, with revenue growth tad below our expectations and margins surprising positively. Management in its commentary indicated that growth in its key market of North America and BFSI vertical seems to have bottomed out and is gradually restoring, albeit it cannot say from which quarter. We believe long-term trends in tech spending in BFSI (payment modernization, Basel III-related boost in risks & compliance, wealth management, etc), ESG, cloud transformation and AI are intact, as customers are willing to use new technologies to reduce the time to market. We expect growth opportunities in India, LATM, and the UK markets to offset the weakness in north America and continental Europe for some time. We have tweaked our FY25/FY26 estimates to build in 6% CAGR in revenue over FY23-26E from 7% earlier, factoring in growth recovery 2HFY25 onwards. Cost-related trends are intact and hence, we have not changed our margin estimates meaningfully. We have also not included any benefits from price hikes the company has been taking, which provides additional margin lever, in our view. Reiterating BUY rating with a revised target price of Rs 4,600 (Rs 4,575 earlier), based on 29.5x FY26E EPS. Key risks to our assumptions: 1) Abrupt exit/s from the leadership team, 2) sustained pressure on client discretionary spending in FY25/FY26, 3) non-encouraging outcomes of cost-saving programs, etc.

UK, LATM and India markets drive revenue growth

For Q4, the company reported YoY growth of 2.2% in CC, 2.3% in USD and 3.5% in INR terms. UK, India (BSNL deal), LATM and MEA markets drove growth, while North America and Europe remained weak during the quarter. The manufacturing, life sciences and energy & utilities verticals, along with regional markets, drove growth, while BFSI, retail and communications stayed weak during Q4. TCS recorded total contract value (TCV) of USD 13.2bn in Q4, much higher than its guidance of USD 7bn to USD 9bn, despite adjusting for the mega deal; this provides revenue visibility for FY25, and it contains many short-term deals to be executed over the next 1 year.

EBIT margin surprised positively.

Q4 EBIT margin of 26% surpassed expectations (ours and street). Headwinds from higher third party and travel costs of 90bps were mitigated by 190bps of lower subcontractor costs, productivity improvement, etc. Management maintained its aspirational EBIT margin guidance of 26%-28%, to be driven by improvements in utilization, pyramid optimization and gradual price hike in contracts. The company has announced a wage hike of 4-7% to its employees effective 1st April 2024, with outperformers receiving hikes in double digits, according to management.

Valuation & outlook

TCS trades at 28.2x 1-year forward multiple, a 10% premium to its average 10-year historical valuation. We believe TCS' premium valuations are justified, considering i) its market position ii) superior margin profile versus peers, iii) healthy return ratios and shareholder payout, iv) it is a likely beneficiary of vendor consolidation deals, and iii) it has an early lead in gen AI capabilities. The company has ample growth opportunities in markets except the US and Europe, which it appears to be capitalizing. Strong deal wins provide future growth visibility. Maintain BUY.

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What do the Q4FY24 result numbers say

- TCS' Q4FY24 revenue growth is as follows: a) 1.1% QoQ and 2.2% YoY in CC terms, b) up 1.1% QoQ and 2.3% YoY at USD 7,363mn in dollar terms, and c) up 1.1% QoQ and 3.5% YoY at Rs 6,12,370mn in rupee terms.
- UK, Latin America, India, and MEA (~40% of the mix) markets aided growth, while North America and Europe were weak. In USD revenue terms, UK, Latin America, India, and MEA grew at 9.5%, 13.7%, 37.1% and 7.5% YoY, respectively, while North America and Europe declined by 2.4% and 1.1% YoY, respectively. Manufacturing, life sciences and energy & utilities verticals reported YoY growth of 9.8%, 2.3% and 6.1%, respectively, while BFSI, communication and technology verticals declined by 2.6%, 4.9% and 5.7% YoY, respectively.
- EBIT margin improved 100 bps QoQ to 26%, despite 90 bps headwind from higher third-party expenses, mitigated by 190 bps reduction in subcontracting costs, productivity improvement, and better utilization.
- For FY24, TCS reported revenue growth of a) 3.4% in CC terms, b) up 4.1% in dollar terms at USD 29,080mn, and c) up 6.8% in rupee terms at Rs. 24,08,930mn. The company reported EBIT margin of 24.6% in FY24, up 50 bps YoY. TCS declared a final dividend of Rs 28 per share in Q4 taking its total dividend payout for FY24 to Rs 73 per share.
- TCS' robust TCV of USD 13.2bn was up by 62% QoQ, and it includes 1 mega deal it won during the quarter. For FY24, the company recorded TCV of USD 42.7bn, up by 25% YoY.
- During the quarter, its LTM attrition declined 80 bps QoQ to 12.5%. Currently, the company has an employee strength of 6,01,546.

Earnings call highlights

- The company indicated that customers continued to reprioritize their spending decisions during the quarter based on high RoI and immediate savings. Management continues to see pressure on customers' discretionary spending, while cloud transformation remains a key growth driver. Customers continue to fund cloud transformation from cost optimization deal savings, as they cannot delay transformation while conserving cash for long. Management believes customers' intent on spending in areas of cloud transformation, vendor consolidation, AI, employee experience enhancement, business process optimization and sustainability remained strong and resilient.
- Management indicated the performance of the BFSI vertical in FY24 was weak, due to the high inflation environment and geopolitical risks. The company is seeing pent up demand in verticals that would be growth drivers in the medium to long term. On retail banking side, the company cited payments and wealth management as segments where customers continued to try out new technologies. especially portfolio management, which uses generative AI to rebalance portfolio and improve productivity through automation. On the payments side, many global markets are considering UPI-like systems, which along with modernization provide growth opportunities. Risks and compliance pertaining to Basel III continue to be growth drivers.
- **ESG:** The company indicated ESG has been gaining traction among organizations and is becoming a crucial investment. The need for emissions reporting and regulatory compliance towards a net zero commitment is driving new business

of data collection and deriving insights. Sustainable financing has emerged as a top priority and is driving the transition towards a carbon-neutral economy. The company mentioned that clients are actively seeking their expertise in developing innovative technology-driven solutions that leverage Internet of Things (IoT) and advanced analytics, with the aim to a) reduce energy and resource consumption, b) monitor and measure greenhouse gas emissions throughout the supply chain, c) minimize the carbon footprint, d) reduce waste, and e) promote, recycle, and report their sustainability initiatives.

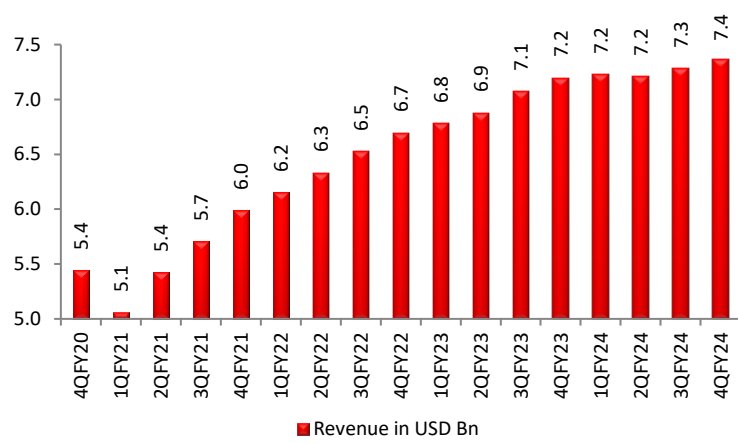
- **FY25 likely better than FY24:** Management expects to report better performance in FY25 vs FY24 in terms of growth. It expects strong deal wins and opportunities in markets other than north America and Continental Europe to drive this growth. The company is seeing a lot of growth opportunities in the LATM, AMEA and India markets.
- **BSNL deal:** The company indicated it has installed 10K towers so far as part of the deal as against 1,00,000 to be installed in total. Management cited delays in tower installations versus the original plan but expects to catch up. TCS indicated that much of the validation, verification, integration of the network with the existing 2G/3G network was done, as it has already secured the antennas, digital microwaves, and radios from partners (CDOT, Tejas Networks). Most of the towers installed have started carrying minor commercial network traffic. The company plans to complete the roll out over the next 3 quarters, as it expects to do the installation, commissioning, optimization cluster by cluster.
- TCS' COO is retiring next month, and the company mentioned that his responsibilities would be shared amongst the senior leadership, as it does not plan to appoint a new COO at least for the time being.
- 1QFY25 may see the impact of wage hikes, with some levers of margin improvement coming from pyramid optimization, utilization improvement, productivity improvement. The company does not expect subcontractor costs to reduce any further; rather it expects the same to rise gradually going forward. Management has guided EBIT margin of 26%-28% and has indicated price hike could be an additional lever for margin improvement.
- The company again started to visit college campuses and plans to hire 40K freshers in FY25.

Exhibit 1: TCS - Quarter results (Consol.)

(Rs mn)	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	YoY (%)	QoQ (%)	FY23	FY24	YoY (%)
Revenue USD mn	7,195	7,226	7,210	7,281	7,363	2.3	1.1	27,927	29,080	4.1
Revenue INR mn	5,91,620	5,93,810	5,96,920	6,05,830	6,12,370	3.5	1.1	22,54,580	24,08,930	6.8
Employee costs	3,36,880	3,51,490	3,51,230	3,47,220	3,51,380	4.3	1.2	12,75,220	14,01,320	9.9
Subcontractor costs	50,630	45,820	42,910	39,710	29,760	(41.2)	(25.1)	2,13,350	1,58,200	(25.8)
Facility costs	7,160	7,580	7,690	7,870	7,860	9.8	(0.1)	26,540	31,000	16.8
Travel costs	7,350	7,940	6,830	6,830	8,120	10.5	18.9	26,760	29,720	11.1
Other expenses	31,870	31,000	30,820	40,320	43,610	36.8	8.2	1,20,110	1,45,750	21.3
EBITDA	1,57,730	1,49,980	1,57,440	1,63,880	1,71,640	8.8	4.7	5,92,600	6,42,940	8.5
Depreciation	12,850	12,430	12,620	12,330	12,460	(3.0)	1.1	50,230	49,850	(0.8)
EBIT	1,44,880	1,37,550	1,44,820	1,51,550	1,59,180	9.9	5.0	5,42,370	5,93,090	9.4
Finance costs	2,720	1,630	1,590	2,300	2,260	(16.9)	(1.7)	7,790	7,780	(0.1)
Other income	11,750	13,970	10,060	8,620	11,570	(1.5)	34.2	34,490	44,220	28.2
Exceptional Items	-	-	-	(9,580)	-					
PBT	1,53,910	1,49,890	1,53,290	1,48,290	1,68,490	9.5	13.6	5,69,070	6,29,530	10.6
Tax	39,550	38,690	39,500	37,320	43,470	9.9	16.5	1,46,040	1,58,980	8.9
PAT	1,14,360	1,11,200	1,13,790	1,10,970	1,25,020	9.3	12.7	4,23,030	4,70,550	11.2
Share of JVs	(440)	(460)	(380)	(390)	(680)	54.5	74.4	(1,560)	(1,910)	22.4
PAT after JV share	1,13,920	1,10,740	1,13,410	1,10,580	1,24,340	9.1	12.4	4,21,470	4,68,640	11.2
EPS (Rs)	31.1	30.3	31.0	30.2	34.3	10.3	13.7	115.2	125.9	9.3
As a % of Revenue						YoY(bps)	QoQ(bps)			YoY(bps)
Employee costs	56.9	59.2	58.8	57.3	57.4	44	7	56.6	58.2	161
Subcontractor costs	8.6	7.7	7.2	6.6	4.9	(370)	(169)	9.5	6.6	(290)
Facility costs	1.2	1.3	1.3	1.3	1.3	7	(2)	1.2	1.3	11
Travel costs	1.2	1.3	1.1	1.1	1.3	8	20	1.2	1.2	5
Other expenses	5.4	5.2	5.2	6.7	7.1	173	47	5.3	6.1	72
EBITDA margin	26.7	25.3	26.4	27.1	28.0	137	98	26.3	26.7	41
Depreciation	2.2	2.1	2.1	2.0	2.0	(14)	(0)	2.2	2.1	(16)
EBIT margin	24.5	23.2	24.3	25.0	26.0	151	98	24.1	24.6	56
Finance costs	0.5	0.3	0.3	0.4	0.4	(9)	(1)	0.3	0.3	(2)
Other income	2.0	2.4	1.7	1.4	1.9	(10)	47	1.5	1.8	31
PBT	26.0	25.2	25.7	24.5	27.5	150	304	25.2	26.1	89
Effective Tax Rate	25.7	25.8	25.8	25.2	25.8	10	63	25.7	25.6	(2)
PAT	19.3	18.6	19.0	18.3	20.3	105	205	18.7	19.5	76

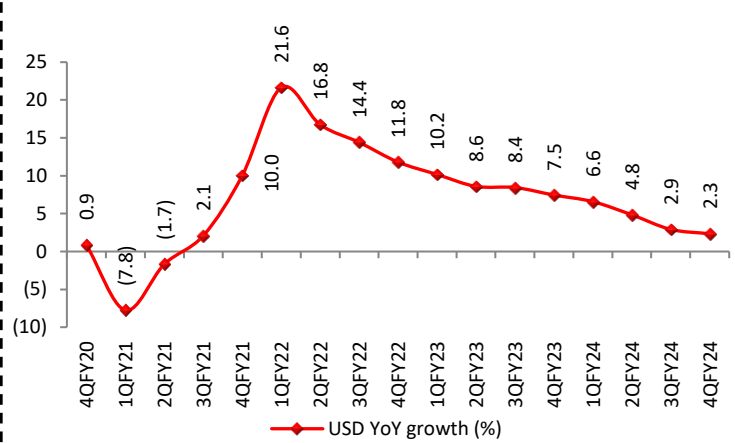
Source: Company, Systematix Institutional Research

Exhibit 2: USD revenue trend



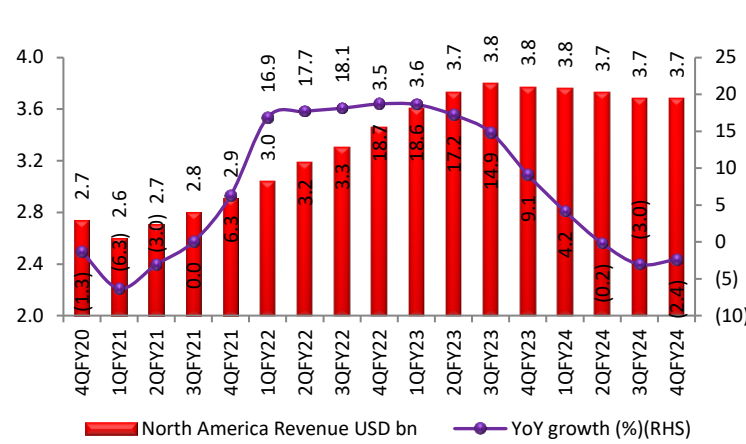
Source: Company, Systematix Institutional Research

Exhibit 3: USD YoY growth



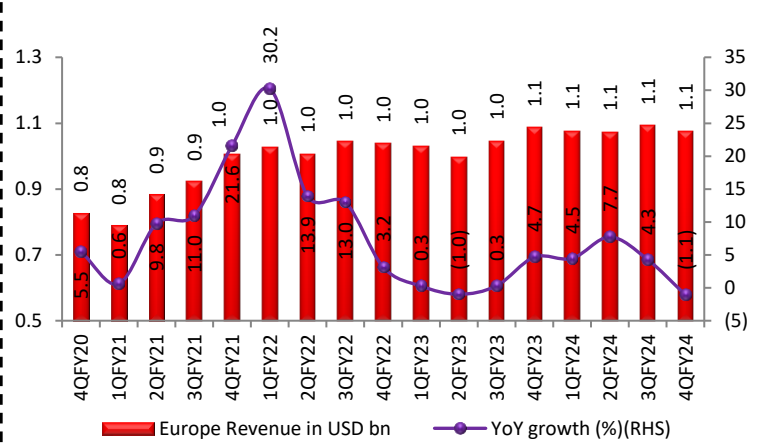
Source: Company, Systematix Institutional Research

Exhibit 4: North America revenue trend



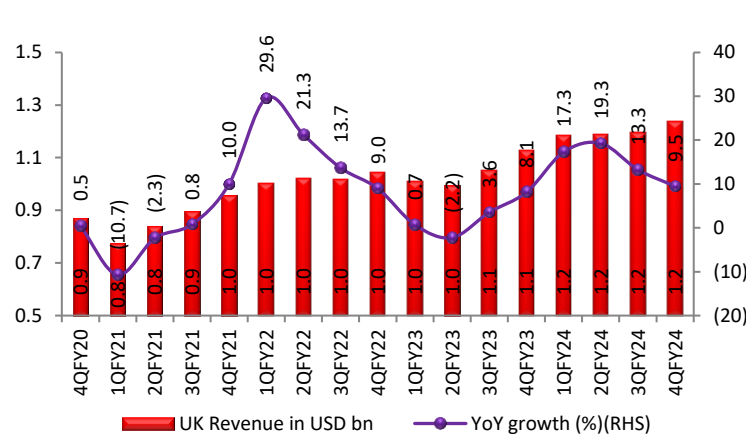
Source: Company, Systematix Institutional Research

Exhibit 5: Europe revenue trend



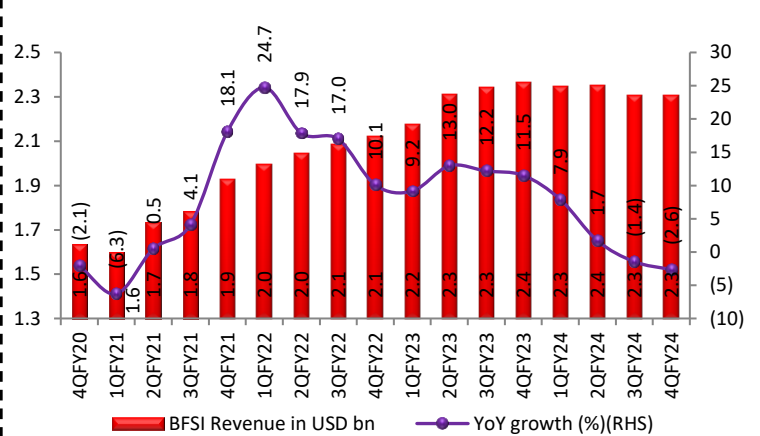
Source: Company, Systematix Institutional Research

Exhibit 6: UK revenue trend



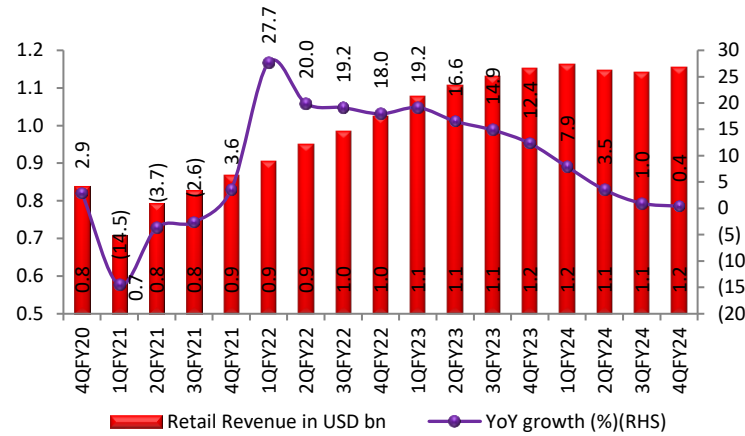
Source: Company, Systematix Institutional Research

Exhibit 7: BFSI revenue trend



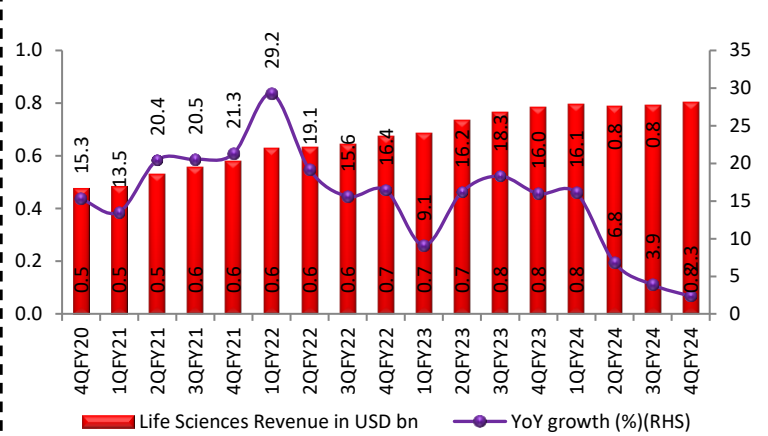
Source: Company, Systematix Institutional Research

Exhibit 8: Retail revenue trend



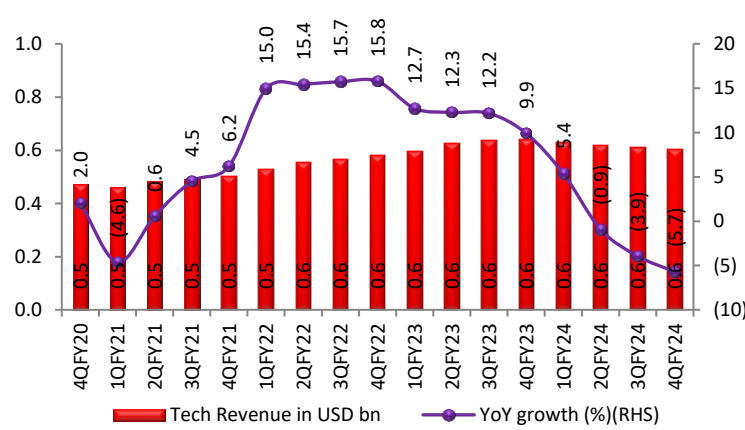
Source: Company, Systematix Institutional Research

Exhibit 9: Life sciences revenue trend



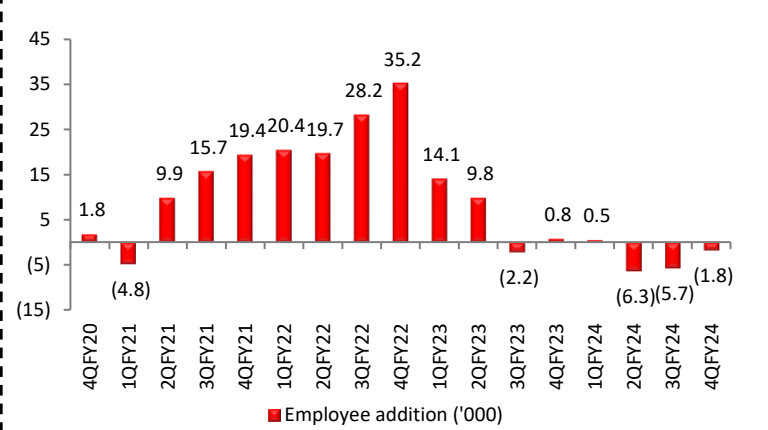
Source: Company, Systematix Institutional Research

Exhibit 10: Technology revenue trend



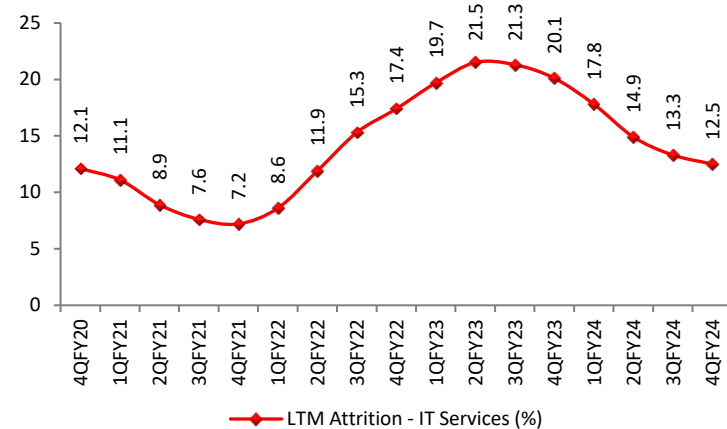
Source: Company, Systematix Institutional Research

Exhibit 11: Employee net addition trends



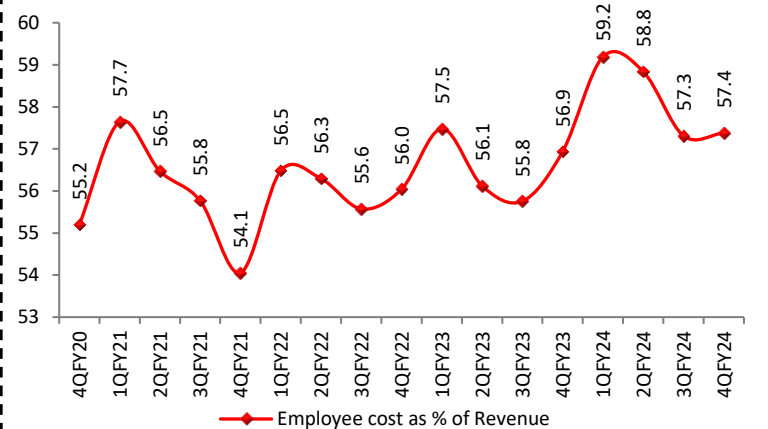
Source: Company, Systematix Institutional Research

Exhibit 12: LTM attrition trend



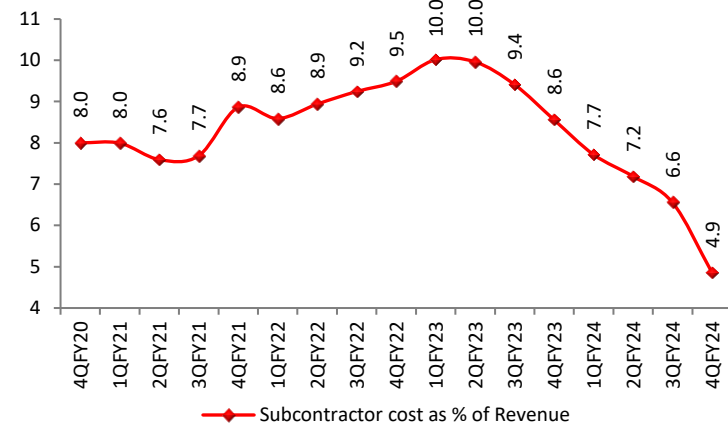
Source: Company, Systematix Institutional Research

Exhibit 13: Employee cost as a % of sales



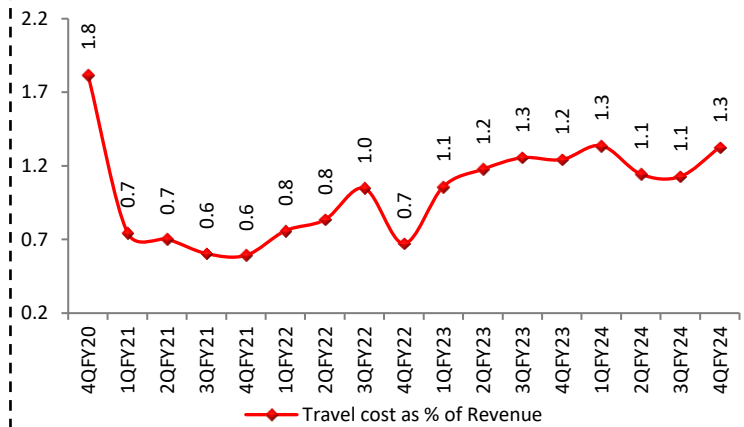
Source: Company, Systematix Institutional Research

Exhibit 14: Subcontractor cost as a % of sales



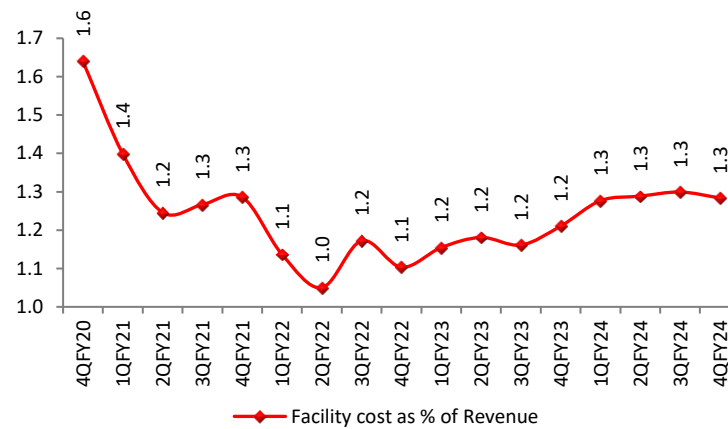
Source: Company, Systematix Institutional Research

Exhibit 15: Travel cost as a % of sales



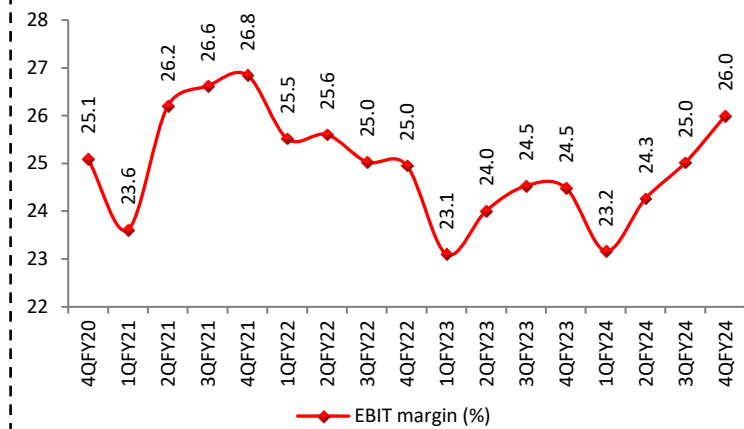
Source: Company, Systematix Institutional Research

Exhibit 16: Facility cost as a % of sales



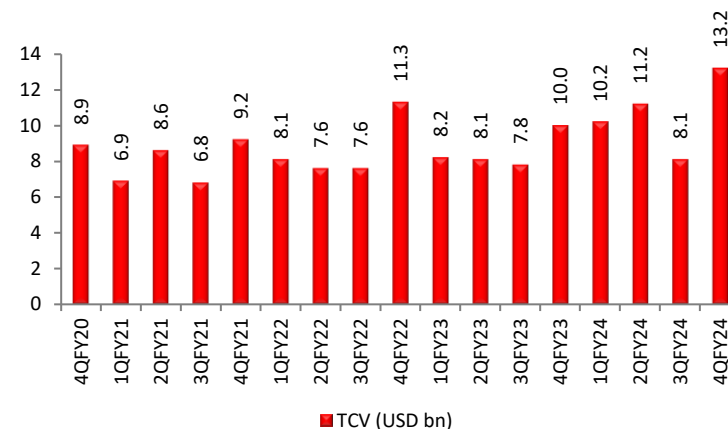
Source: Company, Systematix Institutional Research

Exhibit 17: EBIT margin trend



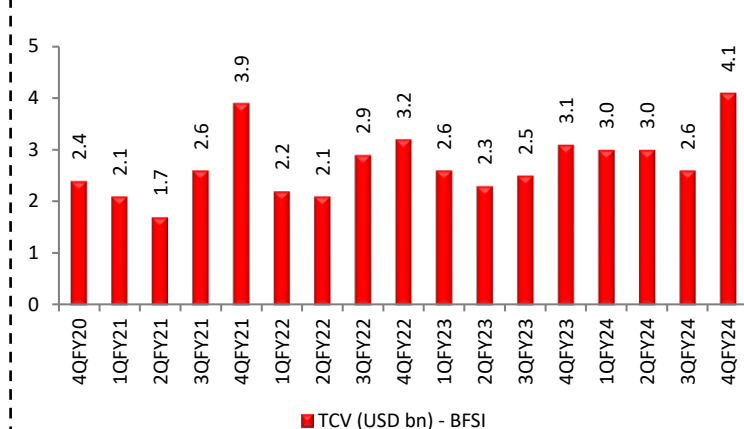
Source: Company, Systematix Institutional Research

Exhibit 18: TCV trend - overall



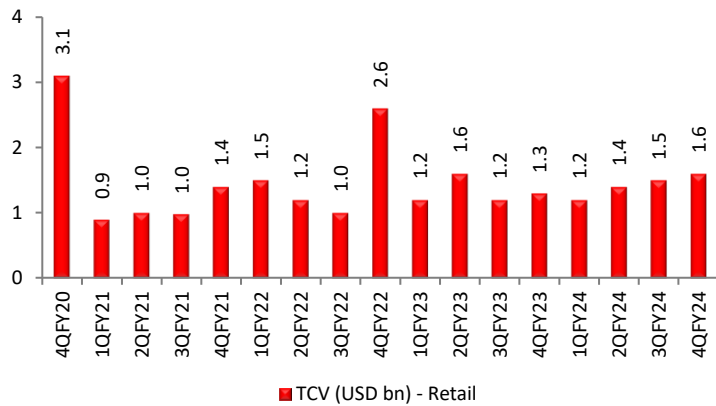
Source: Company, Systematix Institutional Research

Exhibit 19: TCV trend - BFSI



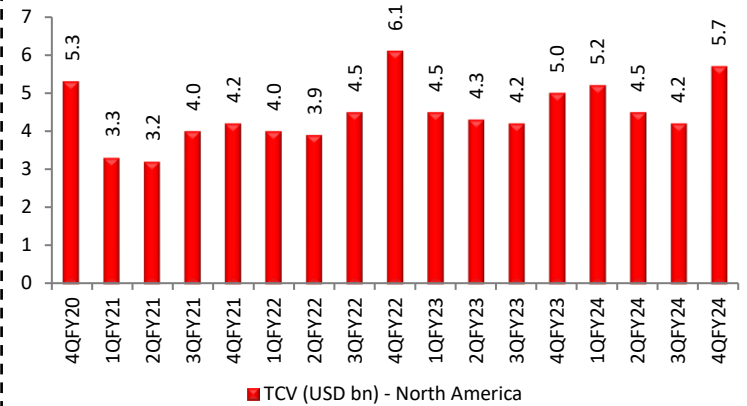
Source: Company, Systematix Institutional Research

Exhibit 20: TCV trend - retail



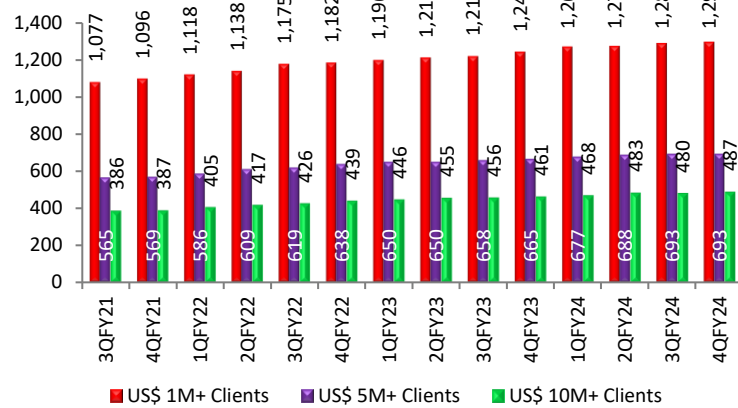
Source: Company, Systematix Institutional Research

Exhibit 21: TCV trend – North America



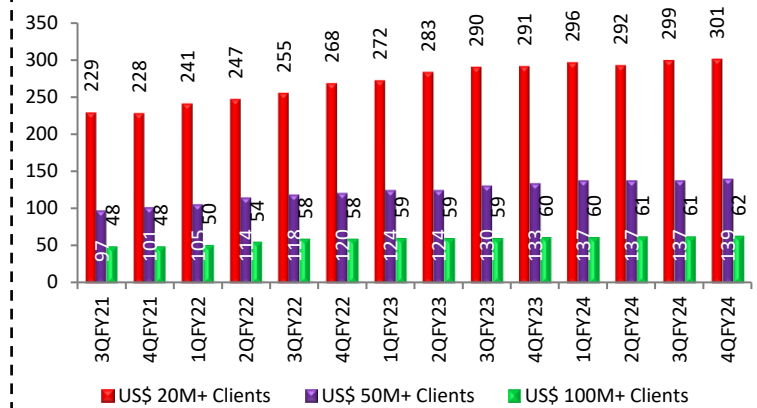
Source: Company, Systematix Institutional Research

Exhibit 22: Client addition trend



Source: Company, Systematix Institutional Research

Exhibit 23: Client addition trend



Source: Company, Systematix Institutional Research

Valuation

Exhibit 24: 1-year forward PE

Average PE

Particulars	3-year	5-year	10-year
Min	24.4	18.9	15.6
Max	36.1	36.1	36.1
Avg	28.5	27.3	25.7

Source: Company, Systematix Institutional Research



Source: Company, Systematix Institutional Research

Exhibit 25: Change in estimates

(Rs mn)	Old Estimates		New Estimates		% Variance	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Total Income	26,04,844	28,29,485	25,61,776	27,51,660	(1.7)	(2.8)
EBIT	6,47,979	7,20,224	6,41,027	7,00,418	(1.1)	(2.8)
EBIT margin (%)	24.9	25.5	25.0	25.5	15 bps	0 bps
PAT	5,08,962	5,68,045	5,13,240	5,64,292	0.8	(0.7)
EPS (Rs)	139.1	155.2	141.8	155.9	2.0	0.4

Source: Systematix Institutional Research

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Profit & Loss Statement

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Revenue	19,17,540	22,54,580	24,08,930	25,61,776	27,51,660
Employee expenses	10,75,540	12,75,220	14,01,320	14,88,062	15,74,925
Other expenses	3,11,430	3,86,760	3,64,670	3,80,562	4,20,329
EBITDA	5,30,570	5,92,600	6,42,940	6,93,152	7,56,406
EBITDA margin	27.7%	26.3%	26.7%	27.1%	27.5%
Depreciation	46,040	50,230	49,850	52,125	55,989
EBIT	4,84,530	5,42,370	5,93,090	6,41,027	7,00,418
EBIT margin	25.3%	24.1%	24.6%	25.0%	25.5%
Interest expense	7,840	7,790	7,780	7,804	7,804
Other income	40,180	34,490	44,220	51,097	59,776
Exceptional loss			9,580		
Profit before tax	5,16,870	5,69,070	6,19,950	6,84,320	7,52,390
Taxes	1,32,380	1,46,040	1,58,980	1,71,080	1,88,097
Tax rate	25.6%	25.7%	25.6%	25.0%	25.0%
JVs/associates/others	(1,220)	(1,560)	(1,910)	-	-
PAT	3,83,270	4,21,470	4,59,060	5,13,240	5,64,292
EPS	104.7	115.2	125.9	141.8	155.9

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Equity Share Capital	3,660	3,660	3,620	3,620	3,620
Reserv. & Surplus (Ex OCI)	8,87,730	9,00,580	9,01,270	9,80,110	11,10,002
Net worth	8,91,390	9,04,240	9,04,890	9,83,730	11,13,622
Deferred Tax Liability	5,900	7,920	9,770	9,770	9,770
Minority Interest	7,070	7,820	8,300	8,300	8,300
Short term debt	14,500	14,850	15,050	15,050	15,050
Long term debt	63,680	62,030	65,160	65,160	65,160
Trade payables	80,450	1,05,150	99,810	1,06,143	1,14,010
Other Provisions	14,110	3,450	1,400	1,410	1,420
Other liabilities	3,38,040	3,31,050	3,60,110	3,61,110	3,62,110
Total Liabilities	14,15,140	14,36,510	14,64,490	15,50,673	16,89,443
Net block	1,95,110	1,86,570	1,77,720	1,65,595	1,49,607
CWIP	12,050	12,340	15,640	15,640	15,640
Other Non-current asset	1,17,540	1,27,030	1,37,030	1,37,230	1,37,430
Investments	3,04,850	3,71,630	3,17,620	3,21,120	3,24,620
Cash and Cash Equivalents	1,24,880	71,230	90,160	1,53,436	2,62,342
Debtors	4,20,100	5,03,020	5,37,200	5,68,504	6,10,642
Inventories	200	280	280	318	342
Loans & Advances	67,560	14,980	4,930	4,930	4,930
Other current asset	1,72,850	1,49,430	1,83,910	1,83,900	1,83,890
Total Assets	14,15,140	14,36,510	14,64,490	15,50,673	16,89,443

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
PBT	5,16,870	5,69,070	6,19,950	6,84,320	7,52,390
Depreciation	46,040	50,230	49,850	52,125	55,989
Interest	7,840	7,790	7,780	7,804	7,804
Others	-2,040	-2,980	-2,270	-	-
Other Income					
(incl. interest recvd)	-26,670	-32,630	-38,220	-51,097	-59,776
Operating Profit before					
WC Changes	5,42,040	5,91,480	6,37,090	6,93,152	7,56,406
Incr./((decr.) in WC	35,760	41,920	14,660	24,209	33,495
Others including taxes	1,06,790	1,29,910	1,79,050	1,71,060	1,88,077
Operating Cash-Flow	3,99,490	4,19,650	4,43,380	4,97,883	5,34,834
Capex	29,950	31,000	26,740	40,000	40,000
Free cash-flow	3,69,540	3,88,650	4,16,640	4,57,883	4,94,834
Dividend	1,33,750	4,14,100	2,52,180	4,34,400	4,34,400
Equity raised	(80)	-	(80)	-	-
Fin Investments	15,220	70,580	-61,930	3,500	3,500
Misc. Items (CFI + CFF)	1,64,190	(42,380)	2,07,380	(43,293)	(51,972)
Net Δ in cash	56,300	(53,650)	18,930	63,276	1,08,906

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY22	FY23	FY24	FY25E	FY26E
Revenue growth	16.8%	17.6%	6.8%	6.3%	7.4%
EBIT (%)	25.3%	24.1%	24.6%	25.0%	25.5%
RoCE	50.0%	54.8%	59.3%	61.5%	61.1%
RoNW	43.0%	46.6%	50.7%	52.2%	50.7%
EPS (Rs)	105	115	126	142	156
DPS (Rs)	43	115	73	100	100
BVPS (Rs)	244	247	248	272	308
Debtor days	80	81	81	81	81
Creditor days	15	17	15	15	15
P/E (x)	38	35	31.8	28.2	25.7
P/B (x)	16	16	16	15	13
EV/EBITDA (x)	27	24	22.1	20.3	18.4

Source: Company, Systematix Institutional Research

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