

Decent order book; Demand environment remain resilient

CMP: INR 3,119

Rating: Accumulate

Target Price: INR 3,609

Stock Info

BSE	532540
NSE	TCS
Bloomberg	TCS IN
Reuters	TCS.BO
Sector	IT
Face Value (INR)	1
Equity Capital (INR Cr)	370
Mkt Cap (INR Cr)	1,127,042
52w H/L (INR)	4,043/ 2,926
Avg Yearly Vol (in 000')	2,475

Shareholding Pattern %

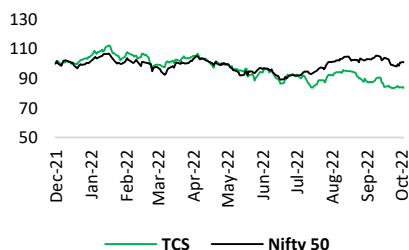
(As on June, 2022)

Promoters	72.30
FII	13.50
DII	8.36
Public & Others	5.84

Stock Performance (%)

	1m	3m	12m
TCS	-4.9	-6.3	-22.3
Nifty	-4.1	5.3	-4.5

TCS Vs Nifty



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Revenue in USD term above estimate: The company's USD revenue growth +8.6% YoY/1.4% QoQ to \$6,877 mn above our estimate \$6,769 mn driven by deal ramp ups and a seasonally strong quarter. Constant currency (CC) revenue growth up 15.4% YoY & 4% QoQ. Reported revenue of INR 55,309 Cr (up 4.8% QoQ/18% YoY). The growth was broad-based led by strong performance in Retail and CPG (23% YoY/8% QoQ), Communications & Media (+21% YoY/6% QoQ), Manufacturing vertical (+14% YoY/2% QoQ), BFSI (14% YoY/4% QoQ) and Regional Markets & Others (9% QoQ/20% YoY)

Improvement in margin sequentially : EBIT margin was up 91 bps QoQ/-160 bps YoY at 24% against our estimates of 24.5%. Out of the 91bps improvement, 50bps came from a depreciating currency, which was partly offset by other cross-currency headwinds. The company is progressing towards achieving its operating margin priorities for the year, adding that headwinds from the supply-chain challenges are abating. That sets up well for the seasonally weak H2FY23.

Decent Order book at \$8.1 bn and Book to Bill at 1.2x: The company's deal booking of \$8.1bn, compared to \$8.2 billion during the June quarter. Management stated that the company has no reason to change its quarterly deal win guidance of \$7 billion to \$9 billion. The management continues to maintain that while there is an increasing sense of caution in discussions.

Geography: Among major markets, North America led with +17.6% growth; Continental Europe grew +14.1% and UK grew +14.8%. In emerging markets, India grew +16.7%, Latin America grew +19.0%, Middle East & Africa grew +8.2% and Asia Pacific grew +7.0%.

Tech spends expected to remain precedence despite cost inflation: Management mentioned that the company does not see any budget cancellation by the clients and the overall demand environment continues to remain strong but clients have become watchful regarding committing big investments.

Outlook & Valuation: TCS,USD revenue above our estimate in Q2FY23, The company's deal booking of \$8.1bn was led by growth across all the segments. We believe, the demand environment to remain strong over the long term but the fear of recession in advanced economies and ongoing geo-political tensions have impacted the macro environment and raised concerns over IT spends. We expect margins to be under pressure in FY23, resulting in a margin contraction of 49 bps in FY22-25E. However, we remain constructive on TCS from the medium to long term with its ability to engage with large clients (TCV \$8.1bn). **We value TCS at a PE of 24x to its FY25E EPS of INR 150 and reduced the target price to INR 3,609 per share (earlier TP: INR 3,720 per share). We maintain our Accumulate rating on the stock.**

Exhibit:1 Financial Performance

Particulars (INR Cr)	FY21	FY22	FY23E	FY24E	FY25E
Revenues (US\$ mn)	22,174	25,707	27,890	30,911	34,386
Net Sales	1,64,177	1,91,754	2,12,734	2,41,207	2,74,305
EBIT	42,481	48,453	51,827	59,377	67,975
Net profit	32,430	38,327	41,471	47,791	55,035
EPS (INR)	87	104	113	131	150
PE (x)	35.97	30.10	27.52	23.88	20.74
EBIT Margin	25.88%	25.27%	24.36%	24.62%	24.78%
ROE	37.23%	42.66%	35.77%	32.21%	27.06%
ROCE	36.63%	40.12%	33.52%	30.02%	25.07%

Source: Arihant Research, Company Filings, Ace Equity, Bloomberg

Exhibit 2: Q2FY23 - Quarterly Performance (Consolidated)

Consolidated Income Statement (INR Cr)	Q2FY23	Q1FY23	Q2FY22	Q-o-Q	Y-o-Y
Revenue (Mn USD)	6,877	6,780	6,333	1.4%	8.6%
Net Revenue	55,309	52,758	46,867	4.8%	18.0%
Employee Costs	31,041	30,327	26,384	2.4%	17.7%
Other Operating Expenses	9,752	9,015	7,367	8.2%	32.4%
Depreciation	1,237	1,230	1,116	0.6%	10.8%
EBIT	13,279	12,186	12,000	9.0%	10.7%
EBIT margin %	24.0%	23.1%	25.60%	91bps	-160bps
Other Income	965	789	1,111	22.3%	-13.1%
Finance Costs	148	199	142	-25.6%	4.2%
Exceptional Items	-	-	-	-	-
PBT	14,096	12,776	12,969	10.3%	8.7%
Tax Expense	3,631	3,257	3,316	11.5%	9.5%
Effective Tax Rate %	25.8%	25.5%	25.6%	27bps	19bps
Reported PAT	10,465	9,519	9,653	9.9%	8.4%
MI & Associates	-34	-41	-29		
Consolidated PAT	10,431	9,478	9,624	10.1%	8.4%
PAT Margin %	18.9%	18.0%	20.5%	89bps	-168bps
EPS (INR)	28.5	25.9	26.0	10.1%	9.6%

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Q2FY23 – Key Concall Highlights

- Broad-based growth across geography and verticals (even Continental Europe growth improved to 14.1% vs. 12.1% in 1Q).
- **Orderbook** : The Management stated that the company has no reason to change its quarterly deal win guidance of \$7 billion to \$9 billion. The management continues to maintain that while there is an increasing sense of caution in discussions.
- **EBIT margin**: The company is progressing towards achieving its operating margin priorities for the year, adding that headwinds from the supply-chain challenges are abating. That sets up well for the seasonally weak H2FY23.
- The company DSO has 62 days outstanding down one day as compared to Q1FY23.
- **Strong hiring continues**: The overheated tech job market has started cooling off and it expects supply-side constraints to come down going ahead.
- **LTM attrition** at 21.5% in IT Services, compared to 19.7% during the June quarter. The management said that attrition will come down on a QoQ basis, the management did not specify an exact quantum for the same.
- **Client budget**: The company will get to know the client budgets for next year over the next three to six months. TCS has not seen any change in the spending pattern of clients or any cancellation of deals.
- Long term demand environment remains strong but clients have become watchful regarding committing big investments.
- There has been some delay in decision-making on the part of clients in view of the macro situation.
- **Strong Segment**: There has been an uptick in the Travel and Hospitality segment as Travel picks up globally led by increase investment in various operations. BFSI grows strongly driven by strong spending data analytics and customer experience.
- **Product and platform**: Overall, the product and platform is stable and the number of opportunity across the vertical is looking good.
- **Services**: There was strong, broad-based growth for all services in Q2, led by Cloud, Enterprise Application Services, and Cyber Security.
- The company revenue productivity was impacted in FY22 due to capacity creation (employee afflation). It will use that headroom to drive growth in FY23.

Exhibit 3: Elevated attrition exerted pressure on EBITM over last few quarters

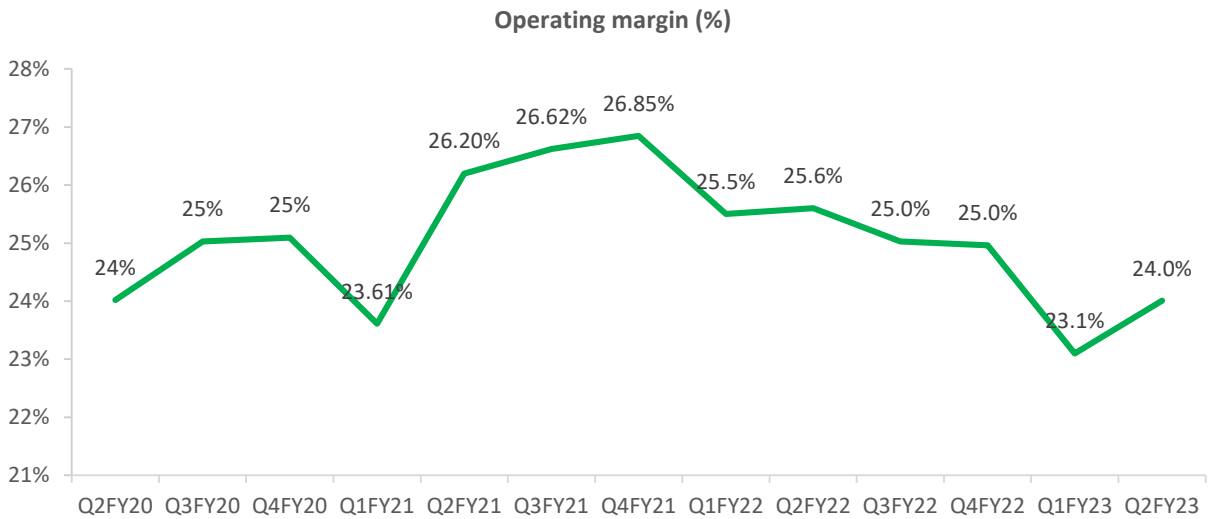


Exhibit 4: Decent revenue growth momentum

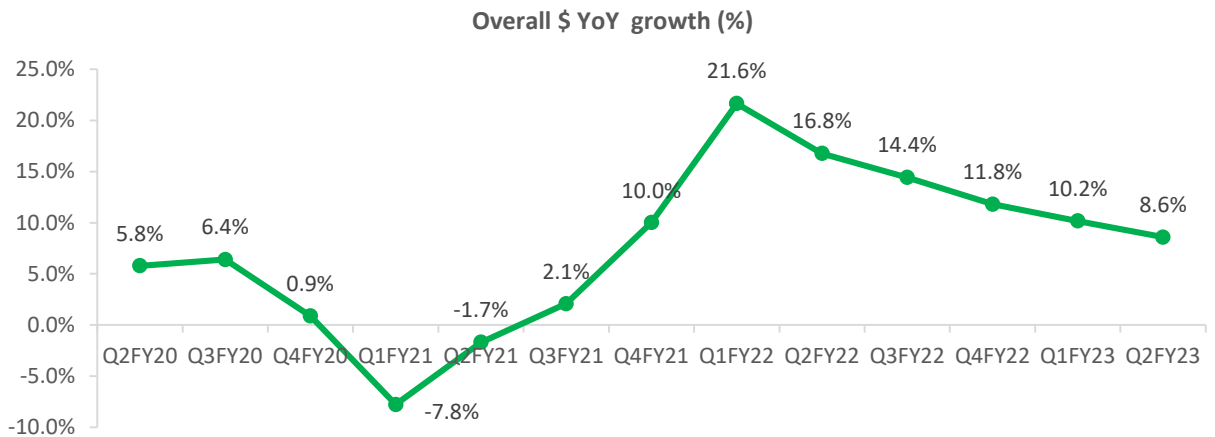
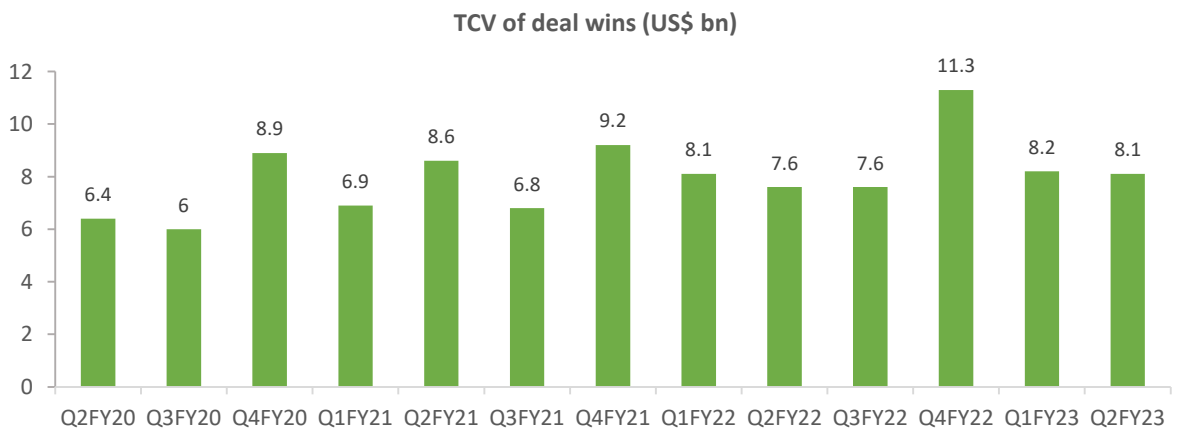


Exhibit 5: Deal intake has remained healthy



Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Key Financials

Income Statement (INR Cr)					
Year End-March	FY21	FY22	FY23E	FY24E	FY25E
Revenues (US\$ mn)	22,174	25,707	27,890	30,911	34,386
<i>Change (%)</i>	0.6%	15.9%	8.5%	10.8%	11.2%
Revenues	1,64,177	1,91,754	2,12,734	2,41,207	2,74,305
<i>Change (%)</i>	4.6%	16.8%	10.9%	13.4%	13.7%
Employee costs	91,814	1,07,554	1,20,620	1,36,041	1,54,982
Operation and other expenses	1,17,631	1,38,697	1,55,934	1,76,443	2,00,928
Total Operating Expenses	2,09,445	2,46,251	2,76,554	3,12,484	3,55,911
Depreciation	4,065	4,604	4,973	5,387	5,402
EBIT	42481	48453	51827	59377	67975
EBIT Margin (%)	25.9%	25.3%	24.4%	24.6%	24.8%
Interest	637	784	792	793	793
Other Income	3,134	4,018	4,420	5,304	6,365
PBT	44,978	51,687	55,455	63,888	73,546
Exceptional Items	1,218	0	0	0	0
PBT after exceptional Items	43,760	51,687	55,455	63,888	73,546
Tax	11,198	13,238	13,864	15,972	18,386
<i>Rate (%)</i>	24.9%	25.6%	25.0%	25.0%	25.0%
PAT	32,562	38,449	41,591	47,916	55,159
Non-controlling interest	-132	-122	-120	-125	-124
Consolidated PAT	32,430	38,327	41,471	47,791	55,035
<i>PAT Margin (%)</i>	19.8%	20.1%	19.6%	19.9%	20.1%

Balance Sheet (INR Cr)					
Year End-March	FY22	FY23E	FY24E	FY25E	
Sources of Funds					
Share Capital	366	366	366	366	366
Reserves & Surplus	88,773	1,14,872	1,47,291	2,02,284	2,02,284
Non controlling interest	707	707	707	707	707
Total Equity	89,846	1,15,945	1,48,364	2,03,357	2,03,357
Deferred Tax Liability (Net)	590	590	590	590	590
Capital Employed	99,163	1,25,328	1,57,833	2,12,924	2,12,924
Application of Funds					
Gross Block	30,567	31,841	33,966	36,232	36,232
Less: Depreciation	19,793	22,090	24,515	27,076	27,076
Net Block	10,774	9,751	9,451	9,156	9,156
CWIP	1,205	1,205	1,205	1,205	1,205
Financial Assets	10,478	10,348	10,602	10,896	10,896
Investments	223	247	281	319	319
Inventories	20	21	30	34	34
Sundry debtors	41,810	40,798	46,084	52,407	52,407
Cash and bank	18,221	41,196	69,138	1,16,222	1,16,222
Other Current Assets	17,997	21,899	21,821	21,500	21,500
Total Current assets	1,08,310	1,37,488	1,75,139	2,33,454	2,33,454
Total Current liabilities	42,351	44,236	49,369	52,629	52,629
Net Current assets	65,959	93,252	1,25,771	1,80,824	1,80,824
Capital Employed	99,163	1,25,328	1,57,833	2,12,924	2,12,924

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Key Financials

Cash Flow Statement (INR Cr)

Year End-March	FY22	FY23E	FY24E	FY25E
Profit for the Year	38,449	41,591	47,916	55,159
Depreciation	4,604	4,973	5,387	5,402
Finance Costs	784	792	793	793
Operating Profit before WC Changes	54,204	58,349	51,225	58,484
Operating Profit after WC Changes	51,435	60,217	62,576	68,971
Direct Taxes Paid & Exceptional Items	-11,486	-13,864	-15,972	-18,386
Cash Flow from Operating Activities	39,949	46,353	46,604	50,585
Cash Flow from Investing Activities	-897	61	-955	-1,122
Cash Flow from Financing Activities	-33,581	-17,706	-17,707	-2,378
Net Change in Cash & Cash Equivalents	5,471	28,708	27,942	47,084
Opening Cash & Cash Equivalents	6,858	12,488	41,196	69,138
Closing Cash & Cash Equivalents	12488	41,196	69138	116222

Key Ratios

Year End-March	FY21	FY22	FY23E	FY24E	FY25E
Per share (INR)					
EPS	86.7	103.6	113.3	130.6	150.4
BVPS	226	235	245	317	556
Valuation (x)					
P/E	36.0	30.1	27.5	23.9	20.7
P/BV	13.2	12.7	9.8	7.7	5.6
Return ratio (%)					
EBITDA Margin	28.4%	27.7%	26.7%	26.9%	26.7%
EBIT Margin	25.9%	25.3%	24.4%	24.6%	24.8%
PAT Margin	19.8%	20.1%	19.6%	19.9%	20.1%
ROE	37.2%	42.7%	35.8%	32.2%	27.1%
ROCE	36.6%	40.1%	33.5%	30.0%	25.1%
Leverage Ratio (%)					
Total D/E	0.1	0.1	0.1	0.1	0.1
Turnover Ratios					
Asset Turnover (x)	15.0	18.7	22.2	25.9	30.0
Inventory Days	2	6	6	6	6
Receivable Days	81	75	70	70	70

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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