Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Tata Consultancy Services Ltd

Soft Q2, Outlook Positive

IT & ITES	Sharekhan code: TCS
Reco/View: Buy ↔	CMP: **Rs. 4,228**
	Price Target: **Rs. 5,230** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

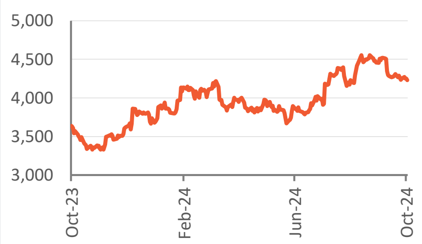
Company details

Market cap:	Rs. 15,29,872 cr
52-week high/low:	Rs. 4,586 / 3,313
NSE volume: (No of shares)	24.5 lakh
BSE code:	532540
NSE code:	TCS
Free float: (No of shares)	102.2 cr

Shareholding (%)

Promoters	71.8
FII	12.4
DII	11.0
Others	4.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.2	8.1	6.2	16.5
Relative to Sensex	-5.8	6.0	-2.6	-7.0

Sharekhan Research, Bloomberg

Summary

- Reported revenues stood at $7,670 million, up 0.9% q-o-q in constant currency (CC) terms, a tad below our estimate of 1% q-o-q in CC terms.
- EBIT margin fell by ~60 bps q-o-q to 24.7%, missing our estimate of 24.9%. Total order book TCV stood at $8.6 billion, up 4% q-o-q/down 23% y-o-y. Book-to-Bill ratio stood at 1.1x.
- With the US Fed's rate cuts easing cycle and stable macros, growth recovery narrative remains strong for the IT sector and TCS for H2FY25 and FY26.
- We maintain Buy with an unchanged PT of Rs. 5,230. At CMP, the stock trades at 30.5/26.6/24.5x FY25/26/27E EPS.

Reported revenue growth stood at $7,670 million, up 2.2% q-o-q/6.4% y-o-y. Revenue growth in constant currency (CC) terms stood at 0.9% q-o-q, tad below our estimates of a 1% growth. Revenue in rupee terms stood at Rs. 64,259 crore, up 2.6% q-o-q/7.7% y-o-y. Growth was led by Energy, Resources and Utilities and Manufacturing verticals' EBIT margin fell ~60 bps q-o-q to 24.1%, missing our estimates of 24.9% owing to headwinds from higher third-party expenses on account of a large transformation project and incremental investment in talent partially offset by currency impact. Net profit stood at Rs. 11,909 crore, down 1.1% q-o-q and up 5% y-o-y. Total order book TCV stood at $8.6 billion, up 4% q-o-q/down 23% y-o-y. Book-to-Bill ratio stood at 1.1x. North America's TCV stood at $4.2 billion, with BFSI TCV at $2.9 billion and consumer business TCV at $1.2 billion. LTM attrition inched up by 20 bps q-o-q to 12.3%.Net headcount additions improved by 5726, taking the closing headcount to 612,724. Deal pipeline is at an all-time high and remains strong across industries geographies and industries. TCS reported soft numbers with a miss on both revenues and margins. Though revenues were just slightly off the mark, margin performance surprised us negatively. However, with the US Fed rate easing cycle and stable macro data, the growth recovery narrative remains strong for the IT sector and TCS for H2FY25 and FY26. Any material weakness would be a good opportunity to invest from a medium to long term perspective. We maintain Buy on TCS with an unchanged PT of Rs. 5,230. At CMP, the stock trades at 30.5/26.6/24.5x FY25/26/27E EPS.

Key positives

- Net headcount additions stood at 5,726, with the trend continuing for the second consecutive quarter
- BFSI grew 1.9% q-o-q, second consecutive quarter of growth

Key negatives

- LTM attrition rose 20 bps to 12.3% from 12.1% in Q1FY25
- Sub-contractor costs rose 2.6% q-o-q
- Deal win TCVs stood at $8.6 billion, down 23% y-o-y.

Management Commentary

- Clients continue to prioritise efficiency through cost transformation programs and demand for discretionary deals with low immediate ROI remains relatively subdued.
- Easing inflation and expectations of good holiday season bolsters the company's optimism on improvement in discretionary spend and capital investments.
- Deal pipeline is at an all-time high and remains strong across industries geographies and industries.
- Management would aim to reach the aspirational margin of 26-28%, however they are uncertain on the timing.

Revision in estimates – We have fine-tuned our estimates to factor in soft Q2FY25 performance.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 5,230: TCS reported a soft Q2 with miss on both revenues and margins, though revenues miss was tad below our estimates, margins performance surprised us negatively. Deal TCV wins at $8.6 billion, was below our expectations with the eight-quarter average at~ $9.6 billion, but within the company's comfort zone of $7-9 billion. On a positive note, employee headcount rose 0.9% q-o-q, and BFSI vertical rose 1.9% q-o-q, outpacing the company average. With the US Fed rate cuts easing cycle and stable macro data, the growth recovery narrative remains strong for the IT sector and TCS for H2FY25 and FY26. We expect Sales/PAT CAGR of 8.2%/10.3% over FY24-27E. Any material weakness in the near term would be a good opportunity to invest from a medium to long-term perspective. We maintain Buy on TCS with an unchanged PT of Rs. 5,230. At CMP, the stock trades at 30.5/26.6/24.5x FY25/26/27E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and a recession in the US can moderate the pace of technology spending.

Valuation Rs cr

Particulars	FY2024	FY2025E	FY2026E	FY2027E
Revenue	2,40,893	2,59,184	2,84,443	3,05,342
OPM (%)	26.7	26.9	27.8	28.1
Adjusted PAT	46,585	50,181	57,488	62,470
% y-o-y growth	10.5	7.7	14.6	8.7
Adjusted EPS (Rs.)	128.8	138.7	158.9	172.7
P/E (x)	32.8	30.5	26.6	24.5
P/B (x)	16.8	16.3	15.8	15.3
EV/EBITDA	23.2	21.4	19.4	17.8
ROE %	51.0	54.2	60.3	63.6
ROCE %	59.8	63.5	70.1	74.0

Source: Company; Sharekhan estimates