

Analysis Report

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Tata Consultancy Services Limited: Q1 FY25 Financial and Operational Review

Executive Summary

Tata Consultancy Services (TCS) commenced FY25 with a positive financial performance, reporting sequential growth across nearly all markets and verticals, marking a good start to the fiscal year. While revenue witnessed modest sequential growth, constant currency (CC) growth stood at a healthy 4.4% year-over-year. Profitability metrics, however, saw a sequential decline in Q1 FY25, primarily attributable to the impact of annual wage hikes, a recurring pattern in the first fiscal quarter. Management expresses cautious optimism, anticipating FY25 to be better than FY24, underpinned by strong deal wins and continued focus on cost optimization and business transformation by clients. The Generative AI pipeline has doubled, signaling a significant emerging opportunity, though overall macroeconomic uncertainty continues to drive short-notice project re-evaluations.

Financial Performance Analysis (Last Three Quarters)

TCS's financial performance over the last three quarters (Q1 FY25, Q4 FY24, Q1 FY24) reflects a period of evolving demand dynamics and disciplined operational management.

Revenue and Growth Trends:

Revenue from operations:

Q1 FY25 (June 30, 2024): ■62,613 crore

Q4 FY24 (March 31, 2024): ■61,237 crore

Q1 FY24 (June 30, 2023): ■59,381 crore

Trend in Revenue Growth: Revenue has demonstrated a consistent upward trajectory over the last three reported quarters. Q1 FY25 saw a 2.25% sequential increase from Q4 FY24, which in turn had grown 3.12% from Q1 FY24. Management highlighted a 4.4% year-over-year constant currency growth for Q1 FY25, alongside 3.9% in dollar terms and 5.4% in rupee terms.

This indicates a positive momentum, with all key markets and most verticals (except Communication, Media, and Technology) returning to sequential growth in Q1 FY25. Notably, North America, after five quarters, showed sequential growth, contributing significantly to the positive trend.

Profitability Metrics:

Net Income (Profit for the period):

Q1 FY25: ■12,105 crore

Q4 FY24: ■12,502 crore

Q1 FY24: ■11,120 crore

Trend in Net Income: Net income increased substantially from Q1 FY24 to Q4 FY24, reflecting operational efficiencies and revenue growth in the preceding quarters. However, Q1 FY25 witnessed a sequential decline in net income, falling from ■12,502 crore in Q4 FY24 to ■12,105 crore. This dip is primarily due to the impact of annual wage hikes.

Gross Margins (Proxy: Revenue - Employee Benefits - Software Costs / Revenue):

Q1 FY25: 38.4%

Q4 FY24: 40.1%

Q1 FY24: 40.0%

Trend in Gross Margins: Gross margins remained largely stable from Q1 FY24 to Q4 FY24, hovering around 40%. The first quarter of FY25 saw a noticeable dip to 38.4%, largely influenced by the annual wage revisions taking effect from April 1st.

Operating Margins:

Q1 FY25: 24.7% (Management stated)

Q4 FY24: 25.6% (Calculated from financial data)

Q1 FY24: 22.9% (Calculated from financial data)

Trend in Operating Margins: Operating margins demonstrated a robust improvement from Q1 FY24 (22.9%) to Q4 FY24 (25.6%), reflecting strong

operational rigor, improved utilization, and reduction in subcontractor expenses. However, Q1 FY25 saw a sequential decline to 24.7%, absorbing a 170 basis point headwind from annual wage hikes, as confirmed by management.

Recurring Patterns and Anomalies:

A recurring pattern observed is the typical Q1 margin compression due to annual wage hikes. This has been consistently offset in subsequent quarters by operational efficiencies, including better productivity, improved utilization, and control over subcontractor expenses. Client focus on cost optimization and business transformation, alongside vendor consolidation, remains a consistent demand theme. Performance has shown consistent strength in Manufacturing, Life Sciences, and Healthcare, while Communication, Media, and Technology (CMI) continues to face persistent business challenges and decline.

Regarding significant anomalies, the financial statements highlight a **Settlement of Legal Claim** as an exceptional item of ₹958 crore for the year ended March 31, 2024. While the court judgment regarding this claim (totaling US \$193 million including compensatory, exemplary damages, and prejudgment interest) was passed on June 13, 2024, the *exceptional item* itself was recognized in the full year FY24 results, not directly impacting Q1 FY25's reported profit as an exceptional item for the quarter. TCS plans to vigorously defend its position against this adverse judgment.

Management's Strategic Insights and Outlook

Forward-Looking Statements and Tone:

Management's tone has been one of cautious optimism. In the Q1 FY25 earnings call, CEO K Krithivasan reiterated the belief that "FY'25 will be better than FY'24 overall." Despite the positive sequential growth across most segments, management explicitly states it is "too early to call a sustained growth momentum or a demand stability" due to ongoing volatility and clients' tendency to re-evaluate programs at short notice. This reflects a practical, grounded assessment of the current macroeconomic environment. The long-standing stance of not providing specific revenue or earnings guidance was also reiterated, though a request from an analyst to reconsider this was acknowledged.

Strategic Plans and Initiatives:

TCS continues to invest heavily in its core strengths and emerging technologies. Key strategic initiatives include:

Workforce Development: Significant investment in reskilling employees, targeting the creation of the world's largest AI-ready workforce, with 11 million

learning hours and 1.2 million competencies acquired in the quarter.

Ecosystem Partnerships: Strengthening alliances to expand service offerings, particularly in ER&D, Cyber Security, GenAI, and e-commerce platforms.

Service Portfolio Enhancement: Continued focus on high-growth areas such as AI.Cloud, Cyber-Security, and Enterprise Solutions. New labs, Centers of Excellence, and Delivery Centers are being established for AI, IoT, and Digital Engineering.

Product & Platform Innovation: Traction with proprietary platforms like ignio™ (24 new deals), TCS BaNCST™ (5 wins, focus on T+1, regulatory compliance), TCS ADD™ (2 wins), TCS OmniStore™ (GenAI enhancements), TCS iON (11.8M exams administered), and TCS AI WisdomNext™ (new GenAI aggregation platform).

Client-Centric Strategy: Emphasizing full-service capabilities and deep contextual knowledge to win large, strategic deals, as evidenced by a Total Contract Value (TCV) of \$8.3 billion in Q1 FY25, within the comfortable range of \$7-9 billion.

Key Risks Highlighted by Management:

Macroeconomic Uncertainty: The most persistent risk remains the uncertain global economic outlook, leading to clients scrutinizing and potentially deprioritizing smaller, discretionary programs. Decisions to ramp down or re-evaluate projects can happen at very short notice.

CMI Vertical Headwinds: The Communication, Media, and Technology sector faces continued challenges, with clients holding back large-scale investments until they see expected returns from prior 5G rollouts and a more favorable, lower interest rate environment.

Industry-Specific Shifts: While Manufacturing is strong, the advent of EVs and OEMs' vertical integration in the automotive sector could reshape spending priorities.

GenAI Productivity Demands: While a significant opportunity, widespread GenAI adoption for productivity could, in the long term, lead to increased client demands for cost savings in service engagements, potentially impacting pricing.

Key Opportunities Highlighted by Management:

Strategic Deal Wins: TCS's ability to secure large, complex, and mission-critical engagements positions it well to gain market share.

Persistent Demand for Cost Optimization and Business Transformation:

Clients continue to prioritize initiatives offering immediate ROI, such as vendor consolidation, operating model transformation, supply chain modernization, and cloud adoption.

AI and Generative AI: This is a major area of opportunity, with TCS's AI/GenAI pipeline doubling to \$1.5 billion and over 270 engagements underway. The focus on reimagining value chains to be AI-native presents significant long-term potential.

Growth in Resilient Verticals: Manufacturing, Life Sciences, and Healthcare are expected to continue their strong performance due to their non-cyclical nature and ongoing demand for R&D, supply chain transformation, and digital solutions.

Emerging Market Strength: Continued superior and diversified growth in markets like India, Middle East & Africa, Asia Pacific, and Latin America, alongside the return to sequential growth in North America.

Qualitative Forecast for the Upcoming Quarter (Q2 FY25)

Based on the financial data and management commentary, the outlook for TCS in the upcoming quarter is cautiously optimistic, with expectations of continued sequential improvement in key performance indicators.

Overall Outlook and Expected Key Financial Trends:

The overall sentiment for the upcoming quarter is one of incremental progress amidst persistent market volatility. Management's expectation for FY25 to be better than FY24 suggests confidence in a gradual demand recovery and TCS's ability to capture market share. The return to sequential growth in North America is a significant positive indicator, although its sustainability will be closely watched.

Revenue Growth:

For the upcoming quarter (Q2 FY25), we anticipate **continued sequential revenue growth**. The underlying drivers include:

Strong Deal Pipeline: The Q1 TCV of \$8.3 billion, combined with management's confidence that some large programs delayed from Q1 will be booked in Q2, provides a strong order book for execution.

Broad-based Recovery: The sequential growth witnessed across most geographies and verticals in Q1 FY25 is likely to continue, especially with North America gaining momentum.

Demand for Transformation: The ongoing client focus on cost optimization and business transformation, including cloud adoption, data analytics, and AI/GenAI initiatives, will fuel demand for TCS's services.

Resilient Verticals: Manufacturing, Life Sciences, and Healthcare are expected to maintain their positive growth trajectories, providing a stable base.

Margin Pressure:

Following the Q1 FY25 dip due to annual wage hikes, we forecast **sequential margin recovery** in the upcoming quarter.

Absorption of Wage Hikes: The primary headwind of annual wage increases has been absorbed in Q1.

Operational Levers: Management highlighted continued opportunities in productivity, utilization improvement, and pyramid optimization. As these levers are pulled, they are expected to contribute positively to margins.

Subcontractor Costs: The CFO indicated that subcontractor costs are likely to have "bottomed out or will remain stable," which suggests that this specific lever will not exert further negative pressure on margins, and could potentially offer marginal tailwinds if internal capacity utilization improves further.

Consolidated Summary of Management's Stated Outlook:

TCS management projects a more favorable FY25 compared to FY24, driven by its robust deal pipeline, market share gains, and a strong value proposition centered around cost optimization and strategic digital transformation. They acknowledge the volatile market, which necessitates agility in responding to clients' short-notice decisions regarding projects. The emphasis is on disciplined execution and leveraging their comprehensive service capabilities and contextual knowledge.

Significant Risks Most Pertinent for the Upcoming Quarter:

Client Discretionary Spend Volatility: Despite positive signs, the fundamental macroeconomic uncertainty persists. Clients may continue to exercise extreme caution with new discretionary spending, or even re-evaluate/pause existing programs at short notice if economic conditions deteriorate or confidence wavers.

CMI Vertical Underperformance: The persistent weakness in the Communication, Media, and Technology (CMI) vertical remains a drag on overall growth. A sustained recovery in this sector is dependent on external factors like interest rate movements and telcos seeing better ROI from their 5G investments, which are beyond TCS's direct control.

Intensified Competition and Pricing Pressure: As demand remains somewhat subdued in parts of the market, competition for deals could intensify, potentially leading to increased pressure on pricing, especially if clients increasingly demand a share of productivity gains from new technologies like GenAI.

Significant Opportunities Most Pertinent for the Upcoming Quarter:

AI and Generative AI Commercialization: The doubling of the AI/GenAI pipeline to \$1.5 billion and the launch of new platforms like TCS AI WisdomNext™ represent a substantial near-term opportunity. Successful execution of these engagements can drive new revenue streams and strengthen TCS's leadership in this transformative technology.

Large Deal Momentum: TCS's continued success in winning large and strategic deals (as evidenced by the \$8.3B TCV in Q1) is a critical growth driver. These multi-year engagements provide revenue visibility and allow for deeper client relationships and broader service penetration.

North America's Rebound: The return to sequential growth in North America is a crucial opportunity. Sustaining this momentum in its largest market will be pivotal for overall revenue acceleration and could signal a broader recovery in IT spending.

Operational Efficiencies Driving Margin Expansion: With wage hikes absorbed in Q1, the disciplined focus on improving utilization, optimizing the pyramid, and maintaining control over subcontractor costs presents a clear path to sequential margin improvement in Q2.