

Robust operating performance...

Coforge Ltd (Coforge) registered healthy revenue growth, up 8.1% QoQ in constant currency terms, above our estimate of 7.0% QoQ growth. The revenue growth was broad based across verticals mainly led by insurance (up 13.5% QoQ) and BFS (up 10.2% QoQ). Digital revenues (including IP) also increased 18.7% QoQ. Further, Coforge has guided for revenue growth of 6% YoY organic growth in FY21E and 17.8% EBITDA margin in FY21E before Esop cost.

Healthy deal pipeline, digital to drive growth

Coforge is witnessing healthy traction in cloud, data and artificial intelligence (AI). This has led to healthy growth in digital revenues. The company is driving this growth via partnerships with large players in cloud like Microsoft Azure, Google cloud and AWS and partnering with product start-ups that can help it to drive new age technology growth. Hence, we expect the company to benefit from improved traction in digital technology, going forward. Further, we expect Coforge to witness healthy traction in the BFS and insurance vertical led by large deal wins and wallet share gain in travel segment. In addition, the company expects strong revenue growth in healthcare vertical (as seen in this quarter). Hence, based on ramp up of large deal wins, vendor consolidation opportunities and healthy order book we expect dollar revenues to increase 5.2% YoY in FY21E and 13.2% & 12.1% in FY22E & FY23E, respectively, led by a revival across verticals.

Higher utilisation, cost rationalisation to boost margins

The company saw a 180 bps increase in margins in Q2FY21 mainly led by higher utilisation and cost rationalisation. Further, improvement in license revenues from its subsidiary, ramp up of large deals, higher utilisation and cost rationalisation bode well for margins in coming quarters. Hence, we expect EBITDA margins to improve 80 bps to 18.3% in FY22E and expect margins to stabilise at 18.5% in FY23E.

Valuation & Outlook

Coforge is expected to benefit from increased investment in Cloud, AI and data. Further, the company is winning healthy deals in the BFS & insurance sector. This, coupled with wallet share gain in transport & improving growth trajectory in healthcare will lead to healthy growth in revenues in coming years. This, coupled with improving margins, prompt us to have a positive view on the stock from a long term perspective. However, the recent run up in stock price factors in most positives. Hence, we downgrade the stock from BUY to **HOLD** with a revised target price of ₹ 2690 (24x FY23E EPS).



Particulars

Particular	Amount
Market Capi (₹ Crore)	15,116.7
Total Debt (₹ Crore)	4.8
Cash & Invests (₹ Crore)	917.1
EV (₹ Crore)	14,204.4
52 week H/L	2813 / 739
Equity capital	62.5
Face value	10.0

Key Highlights

- Dollar revenue to improve in coming quarters based on large deal won and order book growth
- Margins to improve gradually
- Recent run up in stock price factors in most positive downgrade to HOLD from BUY rating

Research Analyst

Devang Bhatt
devang.bhatt@icicisecurities.com

Key Financial Summary

Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	3,676	4,184	4,617	5,228	5,939	12.4%
EBITDA	645	720	808	957	1,099	15.1%
EBITDA Margins (%)	17.6	17.2	17.5	18.3	18.5	
Net Profit	403	444	466	581	679	15.2%
EPS (₹)	65.7	71.4	75.7	94.4	110.3	
P/E	37.4	34.4	32.4	26.0	22.3	
RoNW (%)	19.5	18.5	20.1	22.0	22.6	
RoCE (%)	25.2	23.0	25.5	27.0	27.6	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY21E	Q2FY20 YoY (%)	Q1FY21 1oQ (%)		Comments	
Revenue	1,153.7	1,120.6	1,038.5	11.1	1,057.0	9.1	US\$ revenues increased 10.5% QoQ to \$140.2 million mainly on the back of large deal won in previous quarter
Employee expenses	777.6	739.0	679.6	14.4	724.1	7.4	
Gross Margin	376.1	381.6	358.9	4.8	332.9	13.0	
Gross margin (%)	32.6	34.1	34.6	-196 bps	31.5	110 bps	Gross margins improved due to higher utilisation
SG&A expenses	171.3	183.8	169.1	1.3	164.3	4.3	
EBITDA	204.8	197.8	189.8	7.9	168.6	21.5	
EBITDA Margin (%)	17.8	17.7	18.3	-52 bps	16.0	180 bps	The increase in margins was led by gross margin expansion and cost rationalisation
Depreciation & amortisation	46.0	49.3	44.7	2.9	46.5	-1.1	
EBIT	158.8	148.5	145.1	9.4	122.1	30.1	
EBIT Margin (%)	13.8	13.3	14.0	-21 bps	11.6	221 bps	
Other income (less interest)	-6.3	5.4	7.6	-182.9	4.8	-231.3	
PBT	152.5	153.9	152.7	-0.1	108.9	40.0	
Tax paid	30.3	35.1	27.6	9.8	26.0	16.5	
PAT	120.7	112.9	119.5	1.0	79.9	51.1	PAT was higher than our expectation due to lower than expected depreciation and tax rate

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			FY23E Introduced	Comments
	Old	New	% Change	Old	New	% Change		
Revenue	4,554	4,617	1.4	5,148	5,228	1.5	5,939	We expect revenues to improve in coming quarters led by healthy deal pipeline
EBITDA	797	808	1.4	942	957	1.6	1,099	
EBITDA Margin (%)	17.5	17.5	0 bps	18.3	18.3	0 bps	18.5	Improving revenue growth to drive margins
PAT	462	466	0.9	572	581	1.6	679	
EPS (₹)	75.1	75.7	0.9	92.9	94.4	1.6	110.3	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook** – During the quarter, the company reported healthy revenue growth mainly led by large deal wins in BFS in previous quarters and wallet share gain in travel segment. Coforge expects travel vertical to have bottomed out but expects it to remain subdued in FY21E. The company, during the quarter, won a US\$32million deal in the insurance segment and other large deal in BFS. Further, Coforge expects strong revenue growth in the healthcare vertical (as seen in this quarter). In addition, the company has seen healthy growth in fresh order wins up 14.0% YoY and 8.1% QoQ. This has given Coforge confidence of revenue growth of 6.0% YoY in FY21E
- **Margin trajectory** – The company saw a 180 bps increase in margins in Q2FY21 mainly led by higher utilisation and cost rationalisation. Further, Coforge has also guided EBITDA margin of 17.8% (in cc terms) for FY21E excluding Esop expenses led by better revenue visibility and cost rationalisation
- **Digital business** – The digital business (including IP) is now contributing 43% to revenues, up from 40% in Q1FY21. Digital revenues increased 18.7% QoQ. Coforge has hired Arun Varadarajan. He has rich experience in digital technologies and will head the company's digital business
- **Deal wins** – The order intake has been consistently showing a healthy position. Fresh order intake was at US\$201 million, up 8.1% QoQ. The executable order book over the next 12 months is up 20.7% YoY US\$489 million. The company added 12 new customers of which seven were from the US, three from EMEA and two from RoW
- **Client position** – The company's top 5 and Top 6-10 clients increased 6.2% QoQ and 1.25% QoQ, respectively
- **DSO days** – DSO days increased by four days to 75 days mainly due to extended credit to customers
- **Employees** – The company added 564 employees to 11,162 and all were billable. The company's utilisation also dipped 134 bps QoQ to 10.5%

Key Metrics

Exhibit 3: Geography-wise break-up

	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
<u>Revenue by geography (%)</u>					
America	49.0	48.0	46.0	47.0	48.0
EMEA	37.0	37.0	40.0	36.0	36.0
RoW	14.0	15.0	14.0	17.0	16.0
<u>Growth QoQ (%)</u>					
America	7.3	-0.4	-1.9	-7.4	12.8
EMEA	13.5	1.7	10.6	-18.5	10.5
RoW	-6.1	9.0	-4.5	10.0	4.0

Source: Company, ICICI Direct Research

Americas and EMEA led the growth in the quarter

Exhibit 4: Vertical wise break-up

	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
<u>Revenue by verticals (%)</u>					
Banking & financial services	17.0	16.0	15.0	17.0	17.0
Insurance	31.0	30.0	31.0	33.0	34.0
Transport	28.0	29.0	27.0	19.0	19.0
Others	24.0	25.0	27.0	30.0	30.0
<u>Growth QoQ (%)</u>					
Banking & financial services	14.1	-4.3	-4.0	2.7	10.5
Insurance	14.8	-1.6	5.8	-3.6	13.8
Transport	7.3	5.3	-4.7	-36.2	10.5
Others	-4.6	6.0	10.5	0.7	10.5

Source: Company, ICICI Direct Research

The company has gained market share in travel vertical and healthy deal wins in Q1FY21 led to higher growth in BFS & Insurance

Exhibit 5: Service-wise break-up

	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
<u>Revenue by service mix (%)</u>					
SI & PI	1.0	2.0	1.0	5.0	5.0
IP Assets	5.0	6.0	8.0	6.0	7.0
Managed Services	17.0	16.0	17.0	16.0	17.0
Application Development & Manage	74.0	73.0	72.0	70.0	69.0
BPO	3.0	3.0	3.0	3.0	3.0
<u>Growth QoQ (%)</u>					
SI & PI	7.3	103.4	-48.8	353.0	10.5
IP Assets	-10.5	22.1	36.5	-32.1	28.9
Managed Services	7.3	-4.3	8.7	-14.7	17.4
Application Development & Manage	10.3	0.3	0.9	-11.9	8.9
BPO	-19.5	1.7	2.3	-9.4	10.5

Source: Company, ICICI Direct Research

Exhibit 6: Client & human resource matrix

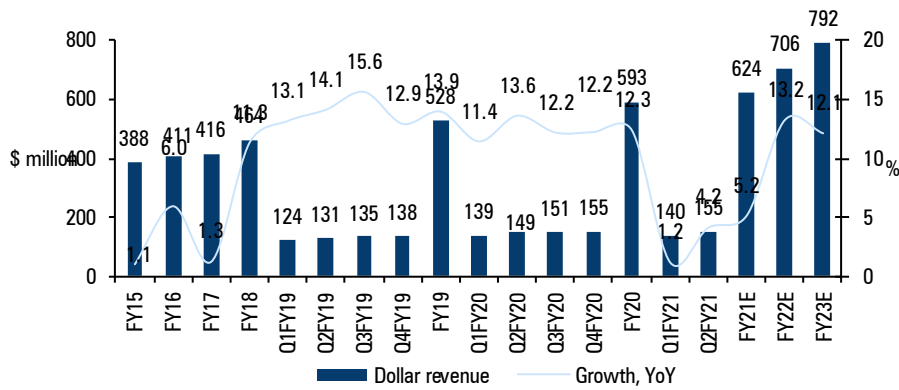
	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
<u>Client metrics</u>					
Between 1 to 5 million	70	74	80	81	83
Between 5 to 10 million	16	17	15	15	16
Above 10 million	9	9	11	11	10
<u>Headcount, Utilization, Attrition</u>					
Total Employees	10,800	10,849	11,156	10,598	11,162
Utilization	80.7	79.3	78.1	77	81
Attrition	12.3	11.9	11.8	11.8	10.5

Source: Company, ICICI Direct Research

Utilisation improved due to improved demand and attrition dipped

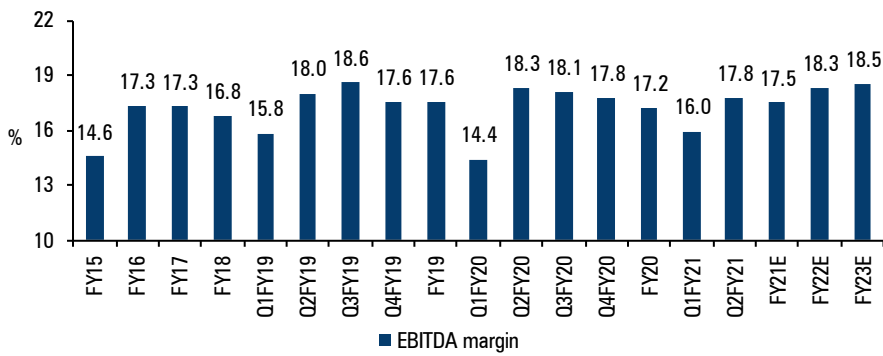
Financial story in charts

Exhibit 7: Dollar revenues may grow at 10.1% CAGR in FY20-23E



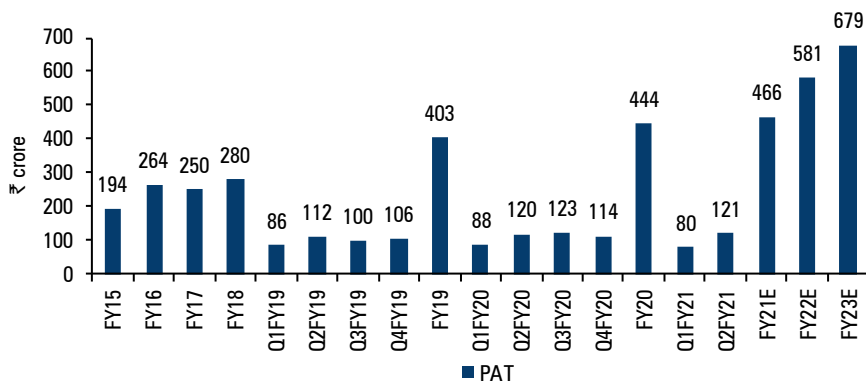
Source: Company, ICICI Direct Research

Exhibit 8: Change in margin estimates for FY21E, FY22E & FY23E



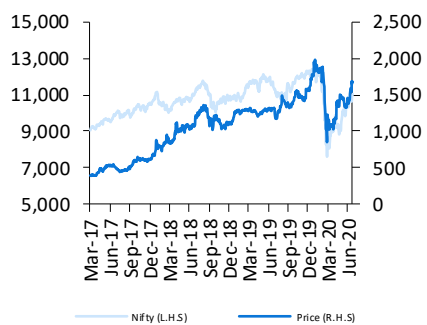
Source: Company, ICICI Direct Research

Exhibit 9: PAT trend



Source: Company, ICICI Direct Research

Exhibit 10: Three year chart



Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: Profit and loss statement					₹ crore
	FY20	FY21E	FY22E	FY23E	
Total operating Income	4,184	4,617	5,228	5,939	
Growth (%)	13.8	10.4	13.2	13.6	
COGS (employee expenses)	2,753	3,107	3,471	3,932	
S,G&A expenses	711	702	800	909	
Total Operating Expenditure	3,464	3,809	4,271	4,841	
EBITDA	720	808	957	1,099	
Growth (%)	11.6	12.3	18.4	14.9	
Depreciation	173	189	214	244	
Other Income (net)	56	36	43	59	
PBT	603	655	786	914	
Total Tax	128	149	179	208	
Adjusted 'PAT	444	466	581	679	
Growth (%)	10	5	25	17	
Adjusted EPS (₹)	71.4	75.7	94.4	110.3	
Growth (%)	8.7	6.1	24.6	16.8	

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement					₹ crore
	FY20	FY21E	FY22E	FY23E	
Profit before Tax	603	655	786	914	
Add: Depreciation	173	189	214	244	
(Inc)/dec in Current Assets	(362)	(202)	(200)	(269)	
Inc/(dec) in CL and Provisions	-	84	119	139	
Taxes paid	(181)	(149)	(179)	(208)	
CF from operating activities	297	577	740	819	
(Inc)/dec in Investments	(679)	-	-	-	
(Inc)/dec in Fixed Assets	(73)	(254)	(157)	(178)	
Others	7	36	43	59	
CF from investing activities	112	(218)	(113)	(119)	
Issue/(Buy back) of Equity	28	(337)	-	-	
Inc/(dec) in loan funds	(5)	-	-	-	
Dividend paid & dividend tax	(147)	(210)	(261)	(305)	
CF from financing activities	(133)	(547)	(261)	(305)	
Net Cash flow	300	(188)	365	395	
Exchange difference	11	-	-	-	
Opening Cash	558	903	716	1,080	
Closing Cash	903	716	1,080	1,475	

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Liabilities					
Equity Capital	63	61	61	61	
Reserve and Surplus	2,334	2,255	2,574	2,948	
Total Shareholders funds	2,397	2,315	2,635	3,008	
Total Debt	5	5	5	5	
Provisions	59	59	59	59	
Minority Interest / Other non	164	189	215	243	
Total Liabilities	2,625	2,569	2,914	3,315	
Assets					
Net Block	670	735	677	612	
Capital WIP	0	0	0	0	
Total Fixed Assets	671	735	678	612	
Goodwill	409	409	409	409	
Deferred tax assets	130	130	130	130	
Debtors	857	970	1,072	1,218	
Other Current Assets	377	416	470	535	
Cash	903	716	1,080	1,475	
Current Investments	14	14	14	14	
Total Current Assets	2,151	2,114	2,636	3,241	
Trade payables	284	313	355	403	
Other current liabilities	498	549	622	707	
Short term provisions	33	36	41	47	
Total Current Liabilities	815	899	1,018	1,157	
Net Current Assets	1,336	1,215	1,618	2,084	
Application of Funds	2,625	2,569	2,914	3,315	

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios					₹ crore
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Per share data (₹)					
Adjusted EPS (Diluted)	71.4	75.7	94.4	110.3	
DPS	31	35	43	50	
Cash per Share	145.2	116.2	175.5	239.7	
BV per share (Diluted)	385.3	376.2	428.1	488.7	
Operating Ratios (%)					
EBITDA Margin	17.2	17.5	18.3	18.5	
PBT Margin	14.4	14.2	15.0	15.4	
PAT Margin	10.6	10.1	11.1	11.4	
Debtor days	75	77	75	75	
Creditor days	25	25	25	25	
Return Ratios (%)					
RoE	18.5	20.1	22.0	22.6	
RoCE	23.0	25.5	27.0	27.6	
RoIC	32.0	33.6	40.8	46.8	
Valuation Ratios (x)					
P/E (Adjusted)	34.4	32.4	26.0	22.3	
EV / EBITDA	19.7	17.8	14.7	12.4	
EV / Net Sales	3.4	3.1	2.7	2.3	
Market Cap / Sales	3.6	3.3	2.9	2.5	
Price to Book Value	6.4	6.5	5.7	5.0	
Solvency Ratios					
Debt/EBITDA	0.0	0.0	0.0	0.0	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	1.5	1.5	1.5	1.5	
Quick Ratio	1.5	1.5	1.5	1.5	

Source: Company, ICICI Direct Research

Exhibit 15: ICICI Direct coverage universe (IT)

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	EPS (₹)				P/E (x)				RoCE (%)				RoE (%)			
					FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
					HCL Tech (HCLTEC)	867	960	Buy	2,35,301	40.8	45.2	52.2	59.3	21	19	17	15	23.0	23.6	24.5
Infosys (INFTEC)	1,130	1,350	Buy	4,81,941	38.9	45.9	49.2	56.4	29	25	23	20	30.8	33.5	33.3	35.3	25.2	27.2	26.9	28.4
TCS (TCS)	2,671	3,300	Buy	10,02,262	86.2	87.2	103.8	118.0	31	31	26	23	43.5	44.5	49.0	52.9	37.5	37.1	42.3	45.6
Tech M (TECMAH)	838	765	Buy	81,039	45.9	44.0	51.0		18	19	16		19.1	16.4	17.4		18.5	16.0	16.7	
Wipro (WIPRO)	345	435	Buy	1,97,250	16.6	18.1	19.8	22.2	21	19	17	16	19.3	21.0	22.4	24.5	17.4	18.6	19.9	21.9
Mindtree (MINCON)	1,385	1,680	Buy	22,818	38.3	58.8	68.0	76.3	36	24	20	18	23.0	29.7	30.0	29.6	20.0	25.5	25.4	24.6
LTI (LTINFC)	3,052	3,570	Buy	53,283	86.6	105.9	124.8	146.2	35	29	24	21	30.7	31.8	31.3	30.9	28.1	28.3	28.0	27.5
Coforge (NIITEC)	2,456	2,690	Hold	15,116	71.4	75.7	94.4	110.3	34	32	26	22	23.0	25.5	27.0	27.6	18.5	20.1	22.0	22.6
Infoedge (INFEDG)	3,398	3,555	Hold	43,696	26.8	27.8	33.4		127	122	102		18.0	10.6	12.0		13.5	7.9	8.9	
Teamlease (TEASER)	2,278	2,205	Buy	3,900	20.5	48.2	62.8		111	47	36		15.0	12.7	14.1		6.5	12.9	14.5	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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