

Attrition lowest among IT services companies...

About the stock: Coforge offers system integration, apps & BPO services to BFSI, travel & healthcare verticals.

- Revenues grew at 18.1% CAGR in the past five years
- Healthy OCF, EBITDA (~75%) and robust return ratios (RoCE > 20%)

Q2FY23 Results: Coforge reported strong Q2FY23 results.

- Revenue grew 6.2% QoQ in CC terms & 3.4% QoQ in dollar terms
- Adjusted EBITDA margin improved ~190 bps QoQ to 18.4%
- Attrition declined 160 bps QoQ to 16.4%

What should investors do? Coforge's share price has grown by ~6.9x over the past five years (from ~₹ 612 in October 2017 to ~₹ 3850 levels in October 2022).

- We maintain our **BUY** rating on the stock

Target Price and Valuation: We value Coforge at ₹ 4570 i.e. 24x P/E on FY25E EPS

Key triggers for future price performance:

- Increase in deal size; signed a US\$105 mn BFS deal (for four years), insurance US\$20 million (three years), healthy order book to drive growth
- Bottoming out of travel vertical (in US), preferred partnership with Fortune 500 insurance & Tier 1 banking companies, recent acquisition and aggressive hiring to drive 16.8% revenue CAGR over FY22-25E
- A 170 bps improvement in margins over FY22-25E due to offshoring, higher fresher additions and utilisation improvement

Alternate Stock Idea: Apart from Coforge, in our IT coverage we also like LTI.

- LTI and Mindtree to create a large entity of US\$3.5 billion revenue through merger. The combined entity will enjoy scale benefit, large order wins etc
- BUY with a target price of ₹ 5,525

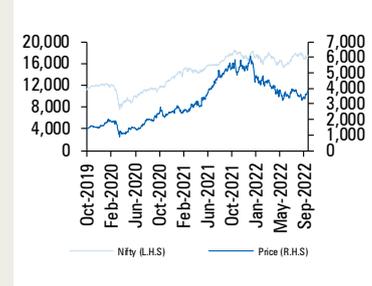
Particulars

Particular	Amount
Market Capitalisation (₹ Cro)	23,933
Total Debt (₹ Crore)	336.5
Cash & Investment (₹ Crore)	453.5
EV (₹ Crore)	23,816
52 week H/L	6135/ 3210
Equity capital	60.9
Face value	10.0

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	50	40	40	40
FII	19	22	22	21
DII	20	25	26	26
Public	11	12	12	13

Price Chart



Recent event & key risks

- Maintains guidance of at least 20% CC revenue growth in FY23
- Key Risk:** (i) Lower than expected growth (ii) Lower than expected margins

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Key Financial Summary

Financials	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 year CAGR (FY22-25E)
Net Sales	4,663	6,432	18.1	8,108	9,235	10,241	16.8%
EBITDA	786	1,115	18.1	1,532	1,755	1,946	20.4%
EBITDA Margins (%)	16.9	17.3		18.9	19.0	19.0	
Net Profit	456	662	12.7	918	1,061	1,183	21.3%
EPS (₹)	73.3	106.5		147.8	170.8	190.3	
P/E	52.5	36.1		26.0	22.5	20.2	
RoNW (%)	18.5	24.2		28.4	27.8	26.4	
RoCE (%)	23.3	25.6		31.6	31.2	30.0	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- US\$ revenues grew 3.4% QoQ to US\$246.9 million while growth in CC terms was 6.2% QoQ. The company reported rupee revenues of ₹ 1,959.4 crore, up 7.1% QoQ
- In CC terms, geography wise EMEA region (38.5% of mix) grew at strong rate of 12.9% QoQ while Americas region (51.3% mix) grew 4.5%. RoW region revenues declined 3.7% QoQ due to contraction of India business
- Vertical wise in CC terms, BFS (31.7% of mix) reported strong revenue growth of 14% QoQ while insurance & travel reported growth of 5.7% & 4.9% QoQ, respectively. Other reported a marginal decline of 0.9% QoQ
- Adjusted EBITDA margins (ex. Esop expenses) increased ~190 bps to 18.4%. The company indicated the following levers for this expansion: a) increase in offshore mix, b) increase in utilisation as freshers become billable, c) higher contribution of high margin business, d) operational efficiency and e) currency depreciation. The company indicated that only ~10 bps of the tailwind impact was contributed by currency depreciation while rest 180 bps was others contributions
- The company indicated that there was a significant pick-up in offshore business mix. Coforge indicated that its offshore mix has increased from 36% in Q2FY21 to ~50% in Q2FY23. The company indicated that this shift is key lever for margin improvement
- Coforge has maintained its revenue guidance, as it continues to guide **at least 20% CC revenue growth in FY23**. The company also indicated that it expects minimal impact of furloughs in H2FY23. Coforge maintained its adjusted EBITDA margin guidance band at 18.5-19%. The company indicated that revenue growth drivers, going forward, would be i) continued healthy TCV, ii) continued strong performance from its top clients, iii) continued momentum on large deals. **Coforge is confident of surpassing US\$1 bn revenues in FY23 while it has set an internal target to reach US\$2 bn annual revenues mark in the next five years (i.e. FY23-28) while it is hopeful of achieving the same well within that timeframe**
- The company indicated that EMEA region continues to be strong for them and their exposure there is limited to banking and travel vertical only. They do not have exposure to any other sector. In Europe, the company has strong relationship with clients. However, it remained cautiously optimistic on this territory due to unfolding geopolitical risks
- The company indicated that BFS growth continues to be strong on account of healthy deal wins in the previous quarters. Coforge also mentioned that it has a negligible exposure to mortgage business (2 to 2.5% mix). Hence, it does not see any impact on this vertical due to macro concerns. It also indicated that going in CY23, client spending growth in this vertical is expected to be in the range of mid to high single digit. The company mentioned that cost optimisation programs, automation and cloud transformation are some of the areas where tech spending continue to be strong in this vertical. Data analytics is also one of the growth drivers in this segment
- Coforge mentioned that travel vertical continue to be strong for them as it is now above pre-Covid levels. The company did mention that demand continues to be strong on traditional businesses like airlines, hotels and logistics while it sees some moderation in tech spending in some of the subsectors like cruise, etc, which is discretionary in nature, where the company is watchful for the next six to nine months

- The company has won two US\$30 mn+ deals in this quarter. First deal is for three years with large wealth management provider while second deal is with large size bank, also for three years, wherein the bank is looking to spend US\$2 bn over the next few years for cloud migration for its global offices including US, UK, Poland, Hong Kong and India, etc
- Coforge indicated that its tax rate for the quarter was low at 17.7% due to one-time benefit of the loss booked by one of its foreign subsidiary company. The company indicated that it expects the tax rate would be in range of 21-22% for FY23
- Coforge added 11 new clients during the quarter. The company reported fresh order intake of US\$304 mn, down 3.5% QoQ during the quarter. This was the third successive quarter of the company reporting above US\$300 mn+ of fresh order taking its total executable order book over the next 12 months to US\$ 802 mn. The company indicated that with the robust order book & strong pipeline it expects the sustained revenue growth in H2FY23
- The LTM attrition declined 160 bps QoQ to 16.4%, which is the lowest among the IT services companies. The company mentioned that its low attrition rate could be partly explained by support and care it provided to its employees during pandemic and partly by industry par wage hikes. Coforge also reported that its utilisation including trainees has increased by 110 bps QoQ to 77.3%
- The company indicated that as far as net hiring trend is concerned, it remained strong in IT headcount, which added more than 1000+ people in H1 while for BPO business, it is down on net basis, resulting into muted addition on overall basis. Coforge indicated that hiring trend in BPO business is as per plan when they acquired SLK global business to bring in more automation in this space. The company also mentioned that SLK global business also has an exposure to mortgage business and hence current hiring trends are reflection of the same. It indicated that now they are integrating tech solutions in their BPO business to enhance volumes going forward. The company also indicated that this business i.e. BPO is not margin dilutive on the overall entity
- On pricing, Coforge indicated that it will be a minor lever for margin expansion but it also mentioned that they did not receive any material price hikes so far and are pushing clients for price hike
- **The company indicated that it has delayed its ADR offering for a time being as it feels the market is not conducive for the same**
- The company declared an interim dividend of ₹ 13 per share

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue in USD	246.9	247.1	212.8	16.0	238.7	3.4	Revenue increased by 6.2% QoQ in CC terms
Revenue	1,959.4	1,971.5	1,569.4	24.9	1,829.4	7.1	
Employee expenses	1,331.6	1,350.5	1,065.6	25.0	1,273.9	4.5	
Gross Margin	627.8	621.0	503.8	24.6	555.5	13.0	
Gross margin (%)	32.0	31.5	32.1	-6 bps	30.4	168 bps	
SG&A expenses	282.9	276.0	230.1	22.9	263.7	7.3	
EBITDA	344.9	345.0	273.7	26.0	291.8	18.2	
EBITDA Margin (%)	17.6	17.5	17.4	16 bps	16.0	165 bps	adjusted Margin were up by 190 bps out of which 10bps was a benefit from currency while 180bps was on account of improved utilisation, increase in off shore mix, higher contribution of high margin business & operational efficiency
Depreciation & amortisation	61.4	70.0	59.8	2.7	63.0	-2.5	
EBIT	283.5	275.0	213.9	32.5	228.8	23.9	
EBIT Margin (%)	14.5	13.9	13.6	84 bps	12.5	196 bps	
Other income (less interest)	-15.0	-12.0	-7.7	94.8	-7.6	97.4	
PBT	268.5	263.0	206.2	30.2	221.2	21.4	
Tax paid	47.4	65.8	44.6	6.3	49.3	-3.9	
PAT	201.6	182.3	146.8	37.3	149.7	34.7	

Source: Company, ICICI Direct Research

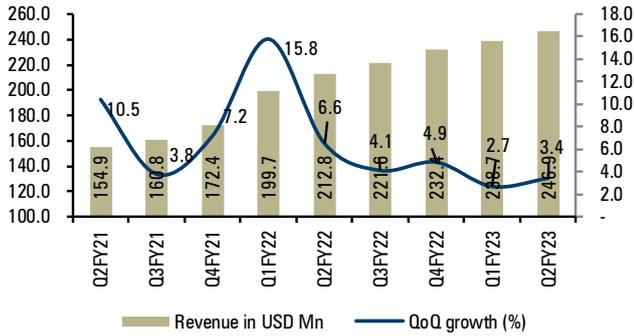
Exhibit 2: Change in estimates

(₹ Crore)	FY23E			FY24E			FY25E	Comments
	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	7,972	8,108	1.7	9,123	9,235	1.2	10,241	Numbers re-aligned on H1 performance
EBITDA	1,522.7	1,532	0.6	1,778.9	1,755	-1.4	1,946	
EBITDA Margin (%)	19.1	18.9	-20 bps	19.5	19.0	-50 bps	19.0	
PAT	918.3	918	0.0	1,087	1,061	-2.4	1,183	
EPS (₹)	147.8	147.8	0.0	175.0	170.8	-2.4	190.3	

Source: Company, ICICI Direct Research

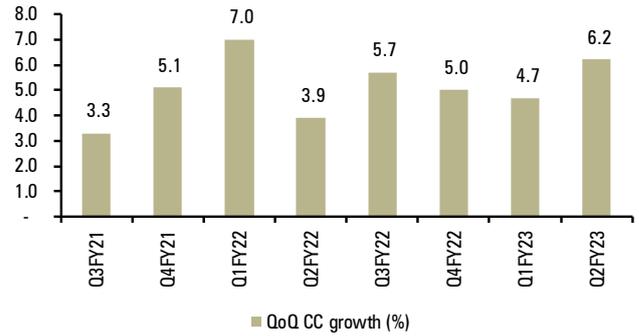
Key quarterly highlights

Exhibit 3: Revenue with QoQ growth



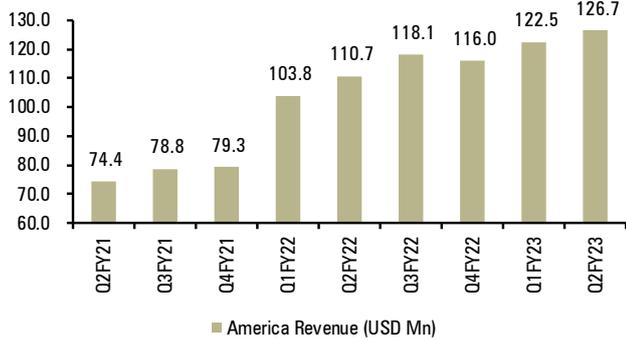
Source: Company, ICICI Direct Research

Exhibit 4: QoQ CC growth



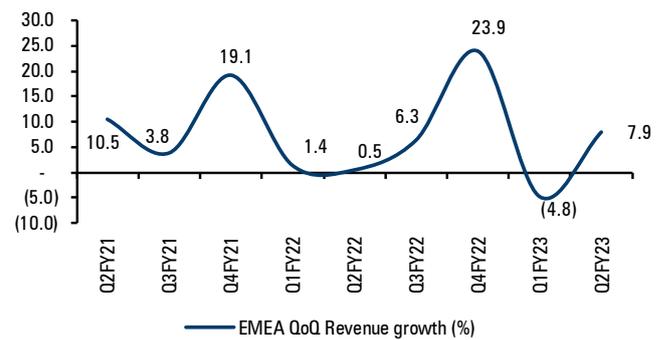
Source: Company, ICICI Direct Research

Exhibit 5: America revenue up 3.4% QoQ



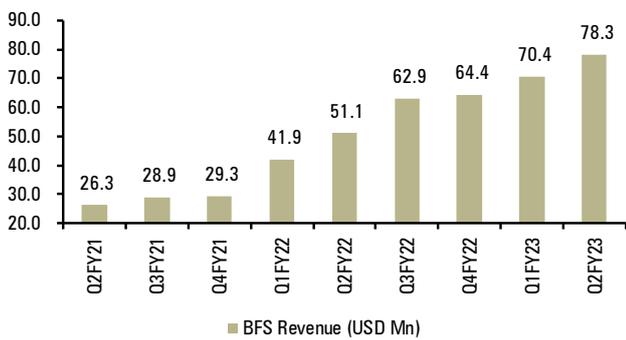
Source: Company, ICICI Direct Research

Exhibit 6: EMEA sees uptick



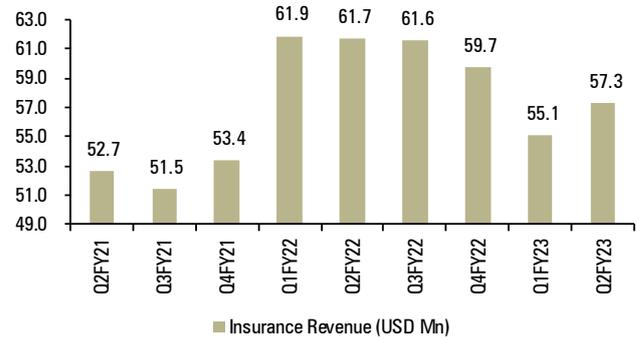
Source: Company, ICICI Direct Research

Exhibit 7: BFS reports 11% QoQ growth



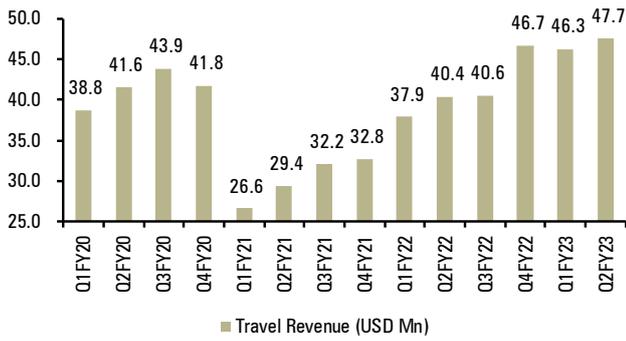
Source: Company, ICICI Direct Research

Exhibit 8: Insurance reports recovery after blip in Q1



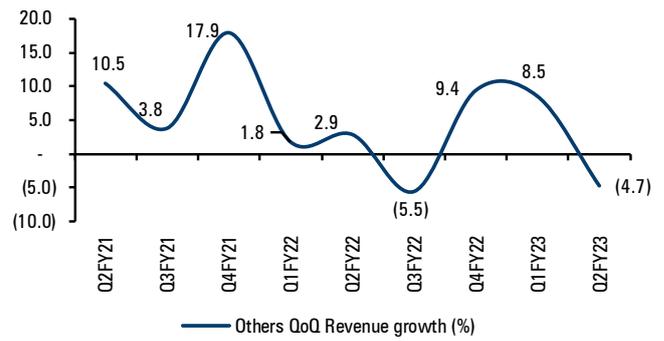
Source: Company, ICICI Direct Research

Exhibit 9: Travel surpasses pre Covid levels



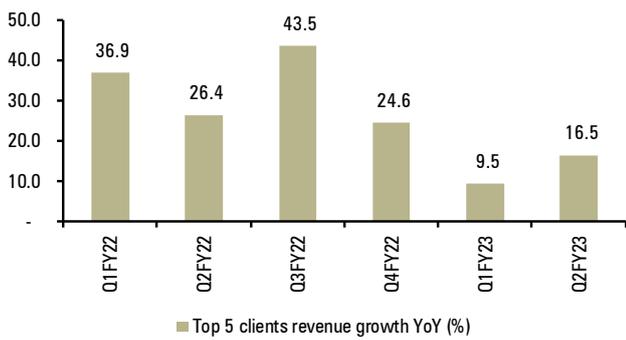
Source: Company, ICICI Direct Research

Exhibit 10: Others QoQ growth trend



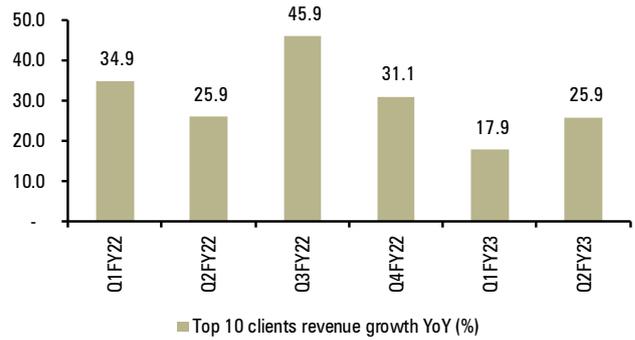
Source: Company, ICICI Direct Research

Exhibit 11: Top five clients growth picks up



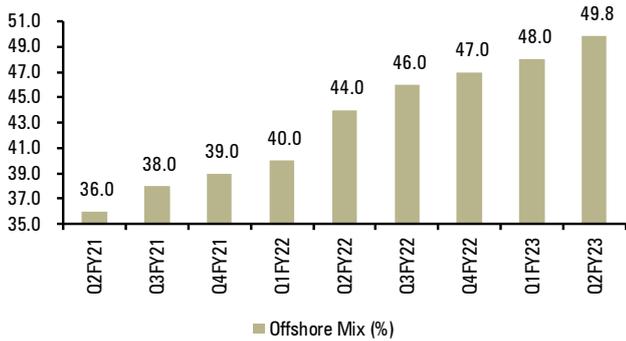
Source: Company, ICICI Direct Research

Exhibit 12: As does for Top 10 clients



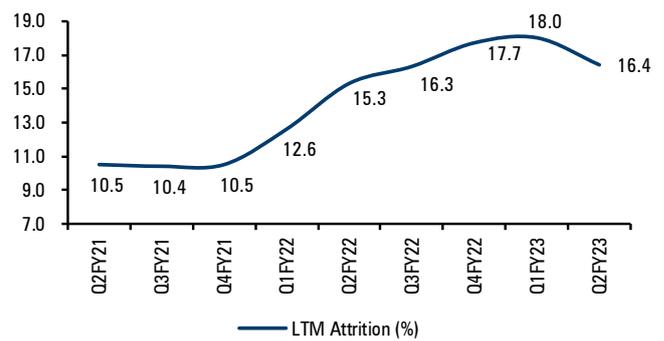
Source: Company, ICICI Direct Research

Exhibit 13: Offshore mix improving continuously



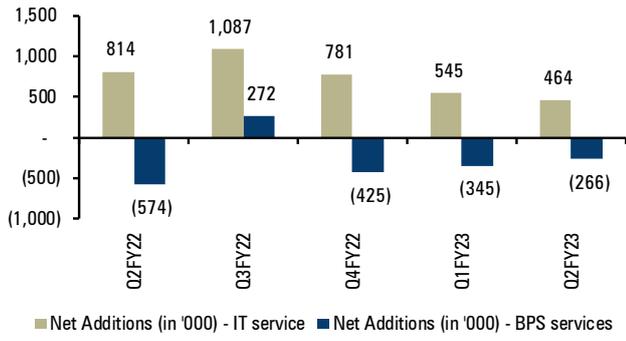
Source: Company, ICICI Direct Research

Exhibit 14: LTM attrition lowest in industry



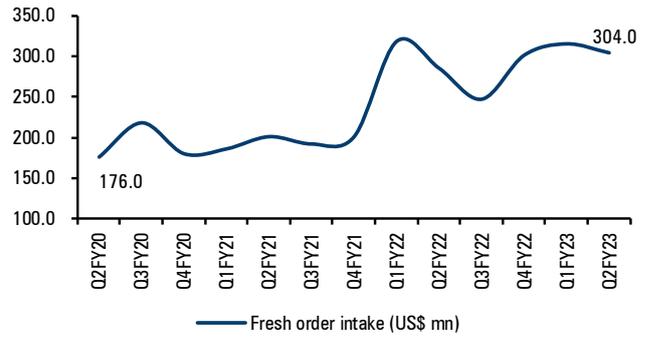
Source: Company, ICICI Direct Research

Exhibit 15: Additions strong for IT, BPO decline as per plan



Source: Company, ICICI Direct Research

Exhibit 16: Fresh order intake continues to healthy



Source: Company, ICICI Direct Research

Financial summary

Exhibit 17: Profit and loss statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Total operating Income	6,432	8,108	9,235	10,241
Growth (%)	37.9	26.1	13.9	10.9
COGS (employee expenses)	4,374	5,432	6,187	6,861
S,G&A expenses	943	1,143	1,293	1,434
Total Operating Expenditure	5,317	6,575	7,480	8,295
EBITDA	1,115	1,532	1,755	1,946
Growth (%)	41.8	37.4	14.5	10.9
Depreciation	227	284	323	358
Other Income (net)	(27)	(7)	(7)	(7)
PBT	862	1,242	1,424	1,580
Total Tax	147	273	313	348
Adjusted 'PAT	662	918	1,061	1,183
Growth (%)	45	39	16	11
Adjusted EPS (₹)	106.5	147.8	170.8	190.3
Growth (%)	45.3	38.8	15.5	11.5

Source: Company, ICICI Direct Research

Exhibit 18: Cash flow statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Profit before Tax	862	1,242	1,424	1,580
Add: Depreciation	227	284	323	358
(Inc)/dec in Current Assets	(392)	(495)	(309)	(274)
Inc/(dec) in CL and Provisions	217	611	230	205
Taxes paid	(265)	(273)	(313)	(348)
CF from operating activities	766	1,368	1,355	1,521
(Inc)/dec in Investments	-	-	-	-
(Inc)/dec in Fixed Assets	(154)	(154)	(175)	(195)
Others	2	(7)	(7)	(7)
CF from investing activities	(956)	(161)	(182)	(202)
Issue/(Buy back) of Equity	5	-	-	-
Inc/(dec) in loan funds	(45)	-	-	-
Dividend paid & dividend tax	(375)	(413)	(477)	(532)
CF from financing activities	(156)	(563)	(627)	(682)
Net Cash flow	(347)	644	545	638
Exchange difference	(7)	-	-	-
Opening Cash	812	454	1,098	1,643
Closing Cash	454	1,098	1,643	2,281

Source: Company, ICICI Direct Research

Exhibit 19: Balance sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity Capital	61	61	61	61
Reserve and Surplus	2,672	3,177	3,761	4,411
Total Shareholders funds	2,733	3,238	3,822	4,472
Total Debt	337	337	337	337
Provisions	105	105	105	105
Minority Interest / Other non CL	197	247	297	347
Total Liabilities	3,371	3,927	4,560	5,261
Assets				
Net Block	996	545	547	534
Capital WIP	9	9	9	9
Total Fixed Assets	1,005	554	556	542
Goodwill	1,071	1,071	1,071	1,071
Deferred tax assets	155	155	155	155
Debtors	1,389	1,547	1,762	1,954
Other Current Assets	378	722	823	912
Cash	454	1,098	1,643	2,281
Current Investments	-	-	-	-
Total Current Assets	2,221	3,367	4,227	5,147
Trade payables	652	647	737	818
Other current liabilities	480	965	1,099	1,219
Short term provisions	32	39	45	49
Total Current Liabilities	1,164	1,651	1,881	2,086
Net Current Assets	1,057	1,715	2,347	3,061
Application of Funds	3,371	3,927	4,561	5,261

Source: Company, ICICI Direct Research

Exhibit 20: Key ratios				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
Adjusted EPS (Diluted)	106.5	147.8	170.8	190.3
DPS	49	68	79	88
Cash per Share	73.0	176.7	264.5	367.1
BV per share (Diluted)	439.9	521.2	615.1	719.8
Operating Ratios (%)				
EBITDA Margin	17.3	18.9	19.0	19.0
PBT Margin	13.4	15.3	15.4	15.4
PAT Margin	10.3	11.3	11.5	11.5
Debtor days	79	70	70	70
Creditor days	37	29	29	29
Return Ratios (%)				
RoE	24.2	28.4	27.8	26.4
RoCE	25.6	31.6	31.2	30.0
RoIC	29.3	48.1	53.3	57.8
Valuation Ratios (x)				
P/E (Adjusted)	35.9	25.8	22.4	20.1
EV / EBITDA	21.2	15.0	12.8	11.2
EV / Net Sales	3.7	2.8	2.4	2.1
Market Cap / Sales	3.7	2.9	2.6	2.3
Price to Book Value	8.7	7.3	6.2	5.3
Solvency Ratios				
Debt/EBITDA	0.3	0.2	0.2	0.2
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	1.5	1.4	1.4	1.4
Quick Ratio	1.5	1.4	1.4	1.4

Source: Company, ICICI Direct Research

Exhibit 21: ICICI Direct coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HCL Tech (HCLTEC)	1,017	1,115	BUY	2,75,980	49.8	52.8	58.3	20.4	19.3	17.4	24.2	25.8	27.4	21.8	21.9	23.0
Infosys (INFTEC)	1,500	1,670	BUY	6,31,143	52.1	59.7	68.7	28.8	25.1	21.8	36.0	35.8	38.3	29.2	29.7	31.6
TCS (TCS)	3,155	3,630	BUY	11,54,431	104.7	115.7	130.3	30.1	27.3	24.2	51.4	49.3	48.7	43.0	42.0	41.0
Tech M (TECMAH)	1,041	1,170	BUY	1,01,270	63.1	66.2	77.9	16.5	15.7	13.4	22.5	21.8	22.7	20.7	19.4	20.3
Wipro (WIPRO)	381	420	HOLD	2,08,837	23.5	23.1	26.1	16.2	16.5	14.6	18.8	18.7	20.3	19.6	18.5	20.1
LTI (LTINFC)	4,741	5,525	BUY	83,073	130.8	150.5	180.0	36.2	31.5	26.3	32.3	30.8	31.0	26.1	25.6	26.0
Mindtree (MINCON)	3,455	4,000	BUY	56,940	100.3	119.2	142.0	34.5	29.0	24.3	38.0	37.9	37.1	30.2	29.3	28.6
Coforge (NIITEC)	3,850	4,570	BUY	23,448	106.5	147.8	170.8	36.1	26.0	22.5	25.6	31.6	31.2	24.2	28.4	27.8
TeamLease (TEASER)	2,922	4,240	BUY	4,996	22.5	85.6	124.6	130.0	34.1	23.5	15.4	17.6	20.8	(4.7)	17.4	20.4
Infoedge (INFEDG)	3,975	5,230	BUY	49,955	35.8	47.8	54.2	111.1	83.2	73.3	4.2	5.7	6.3	3.2	4.3	4.7

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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