Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Coforge Ltd

Good Q3, maintain Buy

IT & ITeS	Sharekhan code: COFORGE
Reco/View: Buy ↔	CMP: **Rs. 4,101**
Price Target: **Rs. 4,900** ↑	

↑ 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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 19.29

Updated Dec 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

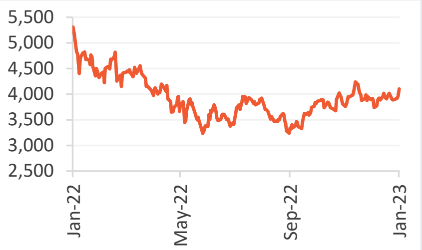
Company details

Market cap:	Rs. 25,042 cr
52-week high/low:	Rs. 5,403/3,210
NSE volume: (No of shares)	2.9 lakh
BSE code:	532541
NSE code:	COFORGE
Free float: (No of shares)	3.7 cr

Shareholding (%)

Promoters	40
DII	21
FII	27
Others	12

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.3	6.5	15.9	-22.8
Relative to Sensex	7.1	4.1	6.5	-24.7

Sharekhan Research, Bloomberg

Summary

- Coforge's reported revenues at $251.7 million, up 3.7% q-o-q in cc, in-line with street estimates but missed our estimates by ~70bps. Adjusted EBITDA margin in Q3FY23 improved 10 bps to 18.5%. The margins for the quarter saw an impact of forex loss of 70 bps, which almost nullified tailwinds from INR depreciation for the quarter.
- The company had a robust order intake of $345 million, fourth consecutive quarter of order intake of over $300 million. The company signed five large deals signed during the quarter (including one over $50 million TCV deal). The Management has upped its FY23 annual revenue growth guidance to 22% in cc and reaffirmed its adjusted EBITDA annual margin guidance at 18.5-19%.
- The management stated that across the verticals of Banking and Financial Services (BFS) and Insurance client spending are largely still strong. The company is seeing a rebound in its travel, transportation, and hospitality vertical, which has picked up pace post-pandemic.
- We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Coforge on the back of consistent deal wins and healthy order backlog provides decent revenue visibility (FY23 guidance raised in Q3FY23).Hence we maintain Buy rating on Coforge with revised PT of 4900. (to reflect the rollover of target multiple to FY25E EPS).At the CMP, the stock trades at 25.8x/21.9x its FY24E/FY25E EPS respectively.

Coforge's reported revenues at $251.7 million, up 3.7% q-o-q in cc, in-line with street estimates but missed our estimates by ~70 bps. Adjusted EBITDA margin in Q3FY23 improved 10 bps to 18.5%. The margins for the quarter saw an impact of forex loss of 70 bps, which almost nullified tailwinds from INR depreciation for the quarter. Net profit at Rs 228.2 crores was up 13.5% q-o-q. The company had a robust order intake of $345 million, fourth consecutive quarter of an order intake of over $300 million. The company signed five large deals signed during the quarter (including one 50M+ TCV deal). The BFS vertical grew 24% y-o-y in cc whereas Travel, Transportation and Hospitality (TTH) grew by 20% y-o-y in cc while Insurance declined 10% y-o-y in cc. Other verticals grew by 23% y-o-y in cc. Net headcount addition decreased by 2.1% q-o-q to 22,505 employees. LTM attrition rate declined 60 bps q-o-q to 15.8%, which is one of the lowest in the industry. Utilisation rate including trained employees increased by 300 bps to 80.3%. from 77.3% in Q2FY23. The company has upped its FY23 annual revenue growth guidance to 22% in cc and reaffirmed its Adjusted EBITDA annual margin guidance at 18.5-19%. The management stated that across the verticals of Banking and Financial Services (BFS) and Insurance client spending is still strong. The company is also seeing a rebound in its Travel, Transportation, and the Hospitality vertical, which has picked up pace post-pandemic. The company announced an interim dividend of Rs. 19 per share. We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Coforge on the back of consistent deal wins and healthy order backlog provides decent revenue visibility (FY23 guidance raised in Q3FY23).Hence we maintain Buy rating on Coforge with revised PT of 4900. (to reflect the rollover of target multiple to FY25E EPS).At CMP, the stock trades at 25.8x/21.9x its FY24E/FY25E EPS, respectively.

Key positives

- Record order intake was US$ 345 million, fourth consecutive quarter of US$ 300+ million order intake.
- LTM attrition down 60 bps q-o-q to 15.8%
- Offshore revenue contribution (IT revenue only) increased to 50.5%.
- Utilization rate improved to 80.3% in Q3FY23 compared to 77.3% in Q2FY23.

Key negatives

- Americas revenues declined by 2.2% q-o-q in cc
- Headcount at the end of the quarter at 22,505, net reduction of 486 employees.

Management Commentary

- Management stated that across the verticals of Banking and Financial Services(BFS) and Insurance client spending are largely still strong. The company is seeing a rebound in Travel, Transportation, and Hospitality vertical, which has picked up pace post-pandemic.
- The company has upped its FY23 annual revenue growth guidance to 22% in cc and reaffirmed its Adjusted EBITDA annual margin guidance at 18.5-19%.
- The management stated that there is a good mix of cost takeout deals and cloud transformation in the five large deals it won. The company indicated that incremental deals are skewed towards cost take out programs. The company indicated that it has a good runaway for growth despite macros issues due to continued order wins.

Revision in estimates – We have fine-tuned our estimates for FY23/24/25 owing to macro overhang and INR-USD reset.

Our Call

Valuation – Good Q3,Maintain Buy: We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Coforge on the back of consistent deal wins and healthy order backlog provides decent revenue visibility (FY23 guidance raised in Q3FY23). Hence we maintain a Buy on Coforge with revised PT of Rs. 4900. (to reflect the rollover of target multiple to FY25E EPS). At CMP, the stock trades at 25.8x/21.9x its FY24E/FY25E EPS respectively.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spends.

Valuation (consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	6432	7,952.7	8,864.7	9,970.9
OPM (%)	17.3	17.5	17.9	18.2
Adjusted PAT	661.7	821.0	966.7	1,143.5
% YoY growth	39.7	24.1	17.7	18.3
Adjusted EPS (Rs.)	109.0	135.1	158.9	187.6
P/E (x)	37.6	30.3	25.8	21.9
P/B (x)	9.1	7.4	6.3	5.3
EV/EBIDTA (x)	22.4	17.6	15.1	12.8
RoNW (%)	25.5	27.0	26.6	26.6
RoCE (%)	27.3	26.8	26.6	27.7

Source: Company; Sharekhan estimates

Key highlights

- **Revenue growth led by BFS vertical:** BFS vertical grew 24% y-o-y in cc whereas Travel, Transportation and Hospitality (TTH) grew by 20% y-o-y in cc while Insurance declined 10% y-o-y in cc. Other verticals grew by 23% y-o-y in cc
- **Performance across geographies:** EMEA grew by 35.8% y-o-y in cc and Americas grew by 4.8% y-o-y in cc. ROW declined by 4.9% y-o-y in cc terms due to a contraction in business in India.
- **Positive outlook across verticals:** On the BFS front, the company indicated that the performance for the quarter was impacted by furloughs. Coforge expects the performance to see a strong rebound from Q4FY23 onwards. On the insurance front, the company is seeing a rebound due to deal momentum. The company also expects a travel rebound and continued client spending on touchless onboarding at airports, data analytics, etc.
- **Adjusted EBITDA margin:** Adjusted EBITDA margin for the quarter increased by almost 10 bps to 18.5%. The margins for the quarter saw an impact of forex loss of 70 bps, which almost nullified tailwinds from rupee depreciation for the quarter.
- **Large deal wins and robust deal pipeline:** The company had a robust order intake of $345 million, fourth consecutive quarter of $300+ million order intake. The company signed five large deals signed during the quarter (including one 50M+ TCV deal). Order book executable over next 12 months stood at $841 million at the end of the quarter, a 20.0% y-o-y growth. The company added 11 new logos during the quarter.
- **Healthy growth of top accounts and strong client metrics:** The top 5 clients grew by 5.5% and top 10 clients grew by 3.4% q-o-q to $60 million and $91.4 million, respectively. Coforge added 3, 4 and 5 clients on a y-o-y basis in the $10 million+ bucket, $5-10 million bucket and $1-5 million bucket, respectively.
- **Revenue guidance raised:** The company raised its FY23 constant currency revenue growth guidance to 22% from at least 20%.The company also added that 22% CC growth guidance for FY23 is conservative, in its opinion, and it would like to exceed the growth for FY23. The company also mentioned that this annual guidance translates into 3.4% CC growth in Q4, which is not challenging. The management said they intend is to get to $2 billion worth annualised run rate but have not established any timeline.
- **Reiterated adjusted EBITDA margin:** The company reiterated adjusted EBITDA margin guidance between 18.5% and 19.0% for FY23.
- **Net headcount additions:** Net headcount addition decreased by 2.1% q-o-q to 22,505 employees. As on 31st December 2022, there were more than 1,000 graduate engineers undergoing training. As they get trained, they would be billable in the next few quarters.
- **Improvement in utilisation and rates:** Utilisation rate including trained employees increased by 300 bps to 80.3%. from 77.3% in Q2FY23
- **Low attrition:** LTM attrition rate declined 60 bps q-o-q to 15.8% which is one of the lowest in the industry.
- **ADR listing delayed:** The company stated that they intend on an ADR listing and will wait till the market stabilises.
- **Effective Tax rate (ETR):** The effective tax rate for Q3FY23 was 23.3% as compared to 17.7% in Q2 FY23. The increase in tax rate was on account of deferred tax adjustments pertaining to a subsidiary.
- **Healthy balance sheet metrics:** The cash and bank balances stood at $49.5million vs $50.3 million. The company's capex stood at $5 million. DSO increased by 3 days to73 days from 70 days in Q2FY2023.

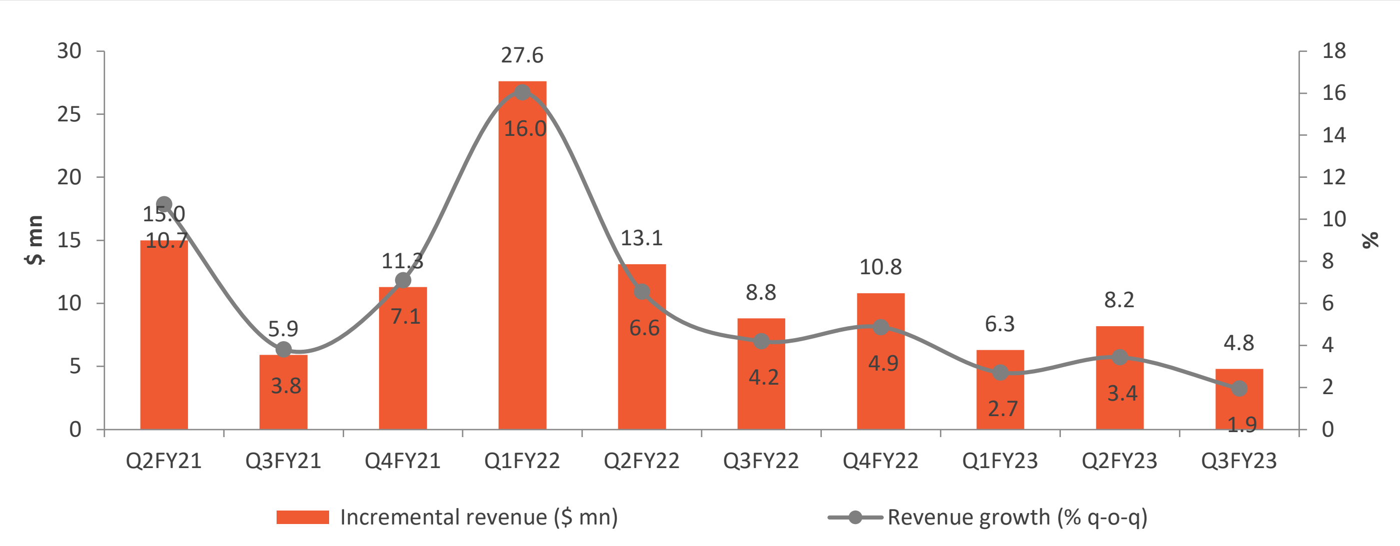
Results

Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	% YoY	% QoQ
Revenues ($ mn)	**251.7**	**221.6**	**246.9**	**13.6**	**1.9**
Revenues in INR	**2,055.8**	**1,658.1**	**1,959.4**	**24.0**	**4.9**
Direct expenses	1,369.8	1,121.0	1,331.6	22.2	2.9
Gross Profit	**686.0**	**537.1**	**627.8**	**27.7**	**9.3**
Selling / G&A	306.3	214.5	268.2	42.8	14.2
Acquisition related expenses & costs of ESOPs	18.2	20.6	15.2	-11.7	19.7
EBITDA	**361.5**	**302.0**	**344.4**	**19.7**	**5.0**
Depreciation	62.4	56.6	61.4	10.2	1.6
EBIT	**299.1**	**245.4**	**283.0**	**21.9**	**5.7**
Other income	8.3	(12.2)	(15.0)	-168.0	-155.3
PBT	**307.4**	**233.2**	**268.0**	**31.8**	**14.7**
Tax provision	71.5	36.0	47.4	98.6	50.8
Minority Interest	7.7	13.5	19.5	-43.0	-60.5
Net profit	**228.2**	**183.7**	**201.1**	**24.2**	**13.5**
EPS (Rs)	**37.4**	**30.3**	**33.0**	**23.4**	**13.3**
Margin (%)					
EBITDA	17.6	18.2	17.6	-63	1
EBIT	14.5	14.8	14.4	-25	11
NPM	11.1	11.1	10.3	2	84
Effective Tax rate (%)	23.3	15.4	17.7	782	557

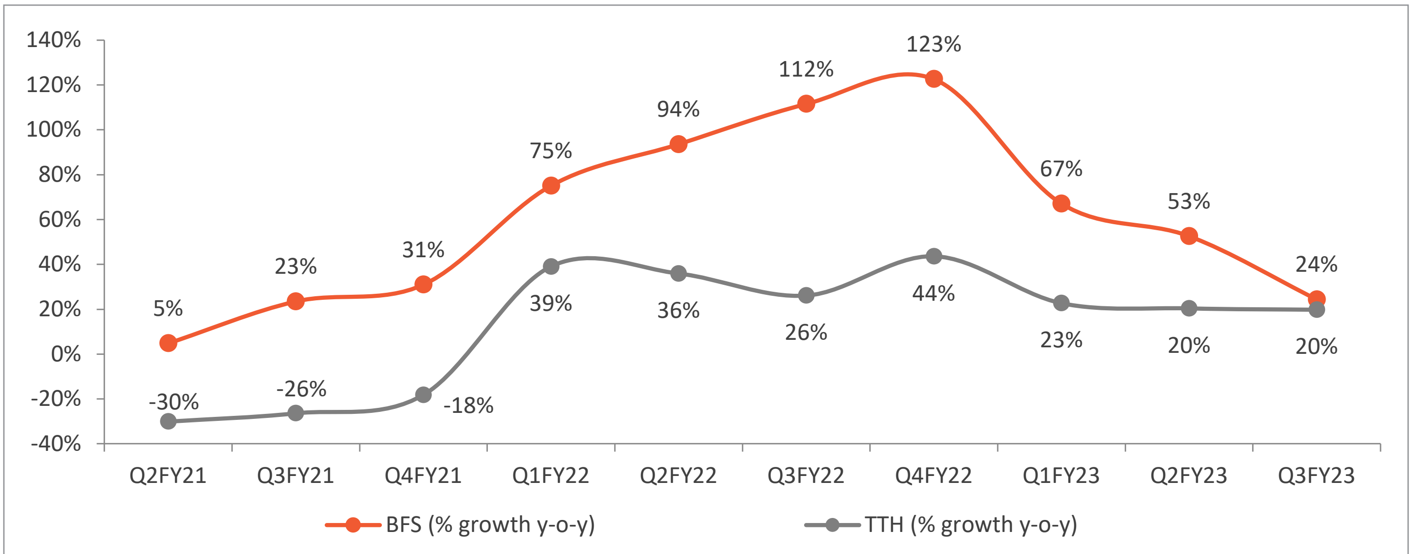
Source: Company, Sharekhan Research

Revenue growth trend



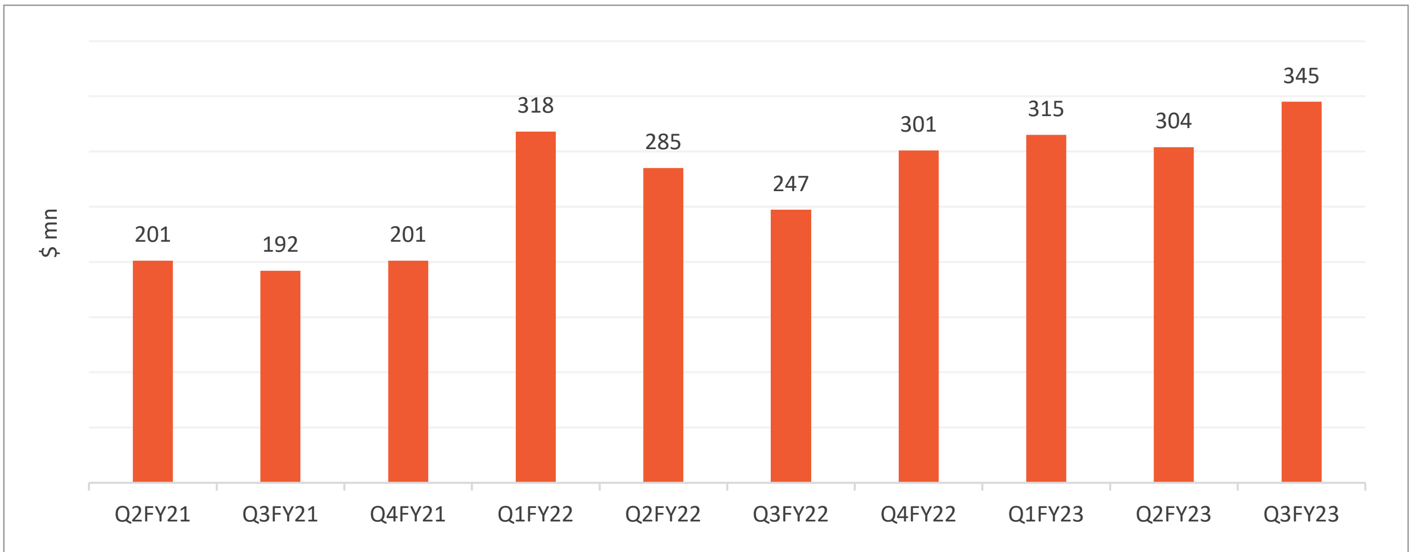
Source: Company, Sharekhan Research

BFS growth (y-o-y) and TTH growth (y-o-y) trend



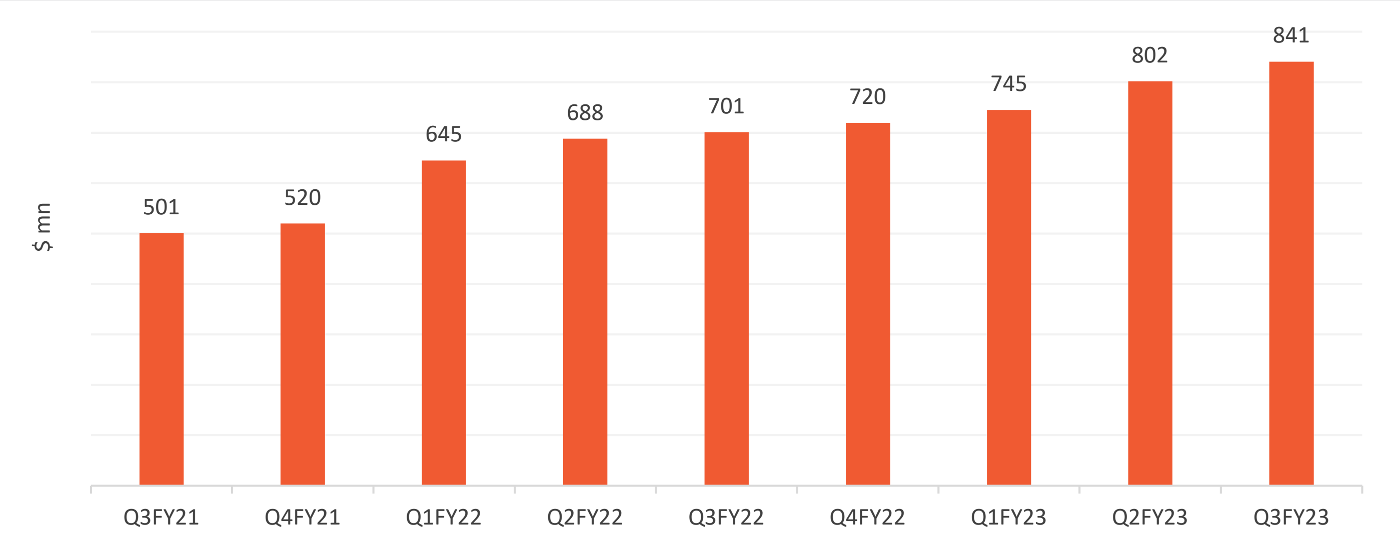
Source: Company, Sharekhan Research

Fresh order book trend



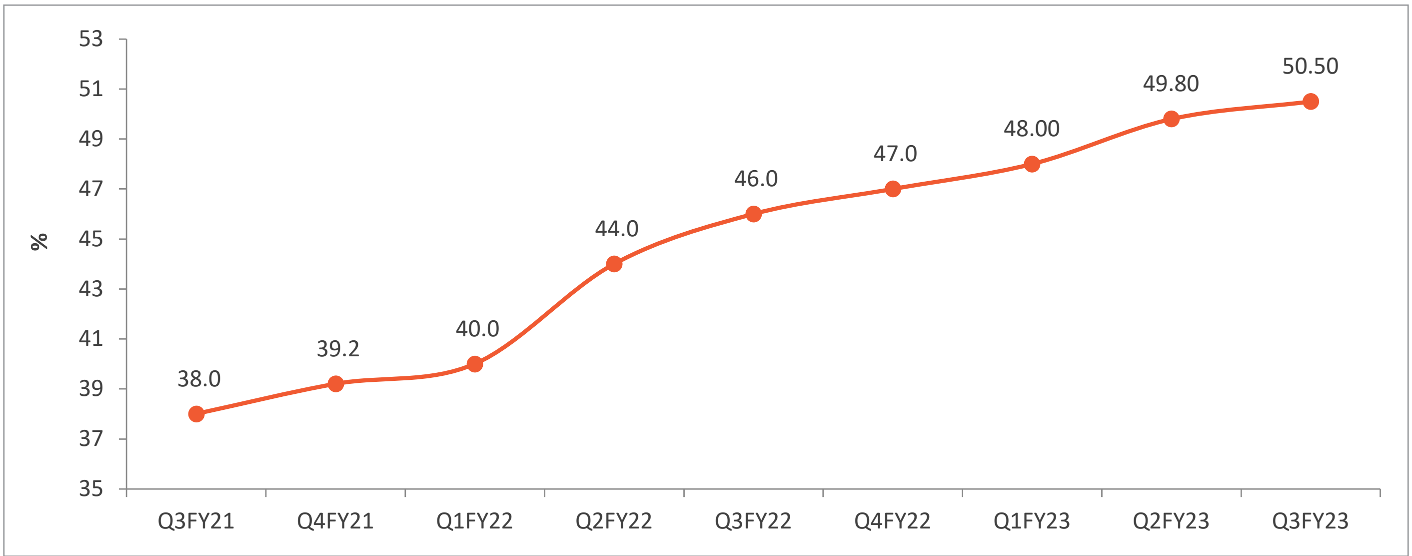
Source: Company, Sharekhan Research

Executable orders to be executed over next 12 months



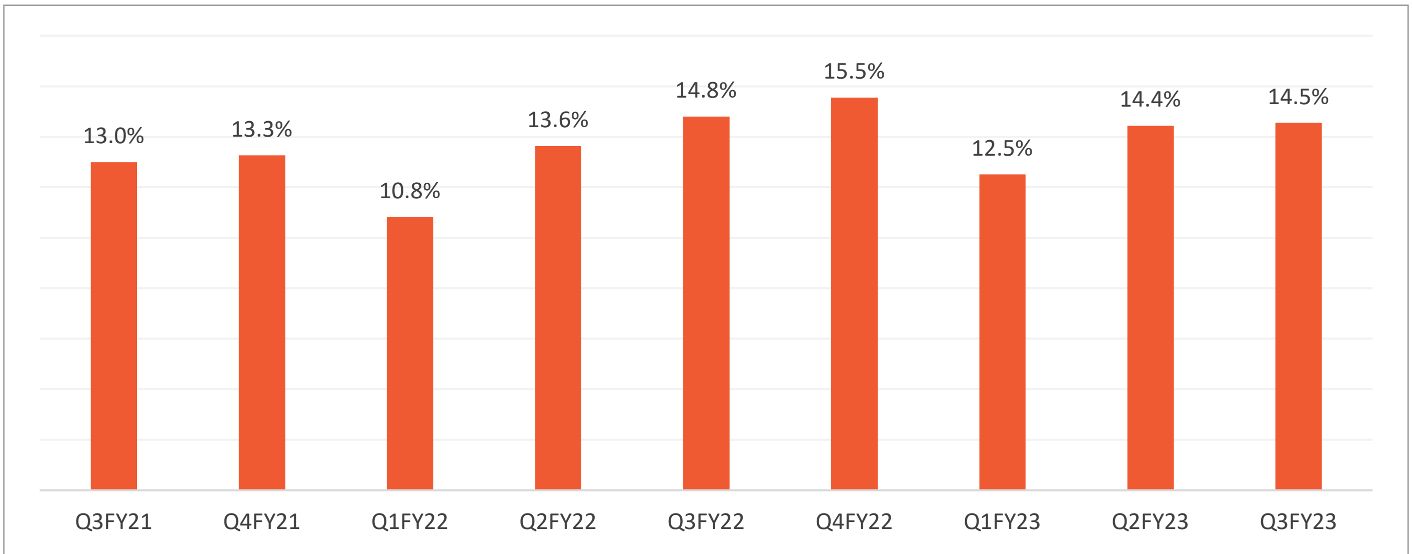
Source: Company, Sharekhan Research

Offshore revenue mix (%) trend



Source: Company, Sharekhan Research

EBIT margin trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

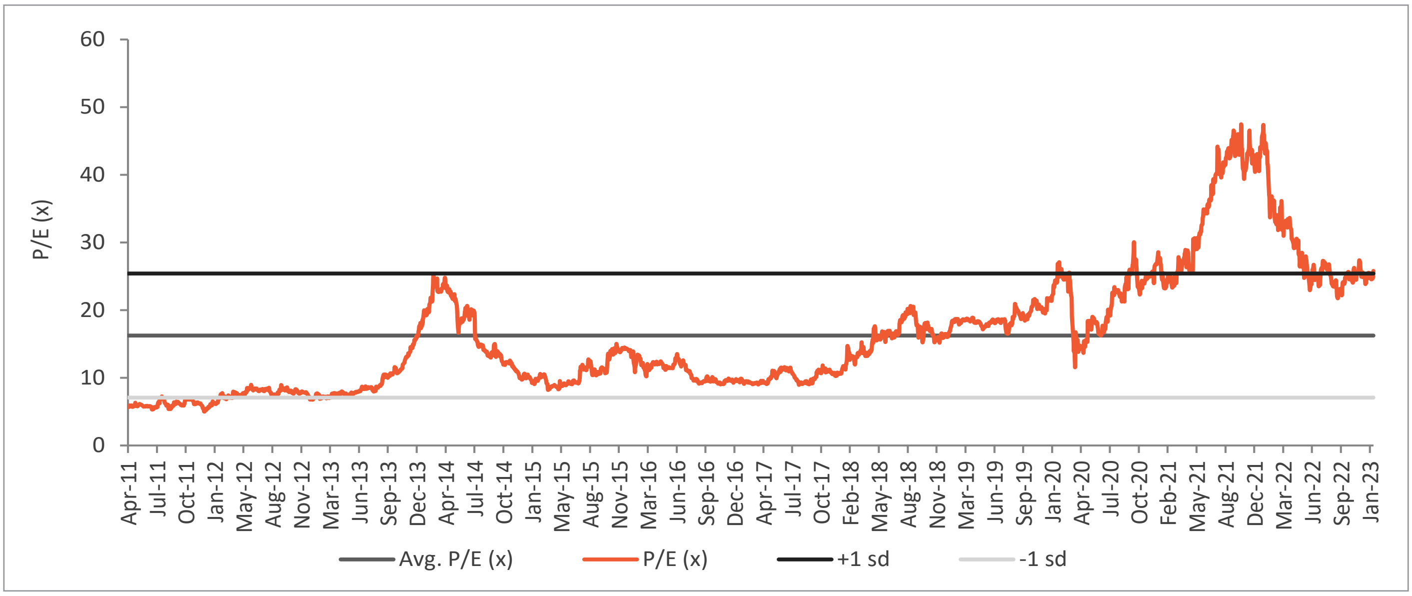
■ Company outlook - Well-prepared for next leg of growth

Coforge has successfully transformed and re-organised itself into one of the fastest-growing mid-sized IT services provider under a revamped management in the past few years. Strong leadership, deep domain capability in select verticals, improved capability and marquee client base would help the company to sustain growth momentum. Further, strategic focus on diversifying the business into emerging verticals, improvement in client metrics, strong executable orders and sharp recovery in travel segment would further aid growth. Strong growth, better digital mix and operating efficiencies should drive margin expansion in the next two years.

■ Valuation - Good Q3,Maintain Buy

We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Coforge on the back of consistent deal wins and healthy order backlog provides decent revenue visibility (FY23 guidance raised in Q3FY23).Hence we maintain Buy rating on Coforge with revised PT of 4900. (to reflect the rollover of target multiple to FY25E EPS).At the CMP, the stock trades at 25.8x/21.9x its FY24E/FY25E EPS respectively.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Established in 1981, Coforge is one of the leading mid-sized Indian IT services company, engaged in providing services in cloud, managed services, data & analytics, automation, application development & maintenance and Business Process Management. The company focuses on three key industries such as insurance, travel, transportation & hospitality and BFS. The company has started focusing on other industries such as manufacturing, healthcare, hi-tech, public sector to capture the opportunity. Digital technologies revenue, including product engineering, intelligent automation, data, integration and cloud, stood around 71% of total revenue. Coforge has over 22,000 professionals serving customers in North America, Europe, Asia and Australia.

Investment theme

Coforge's deep-domain expertise in select industry verticals and sub-verticals with heavy investments on technology, proprietary products and resources position it to participate in customers' transformation journey. Further, the company has reinvested its excess profitability in enhancing the technical capabilities by adding management/sales bandwidth. The company has also started scaling up the sub-segments such as healthcare within other verticals to drive its growth. We believe the company's differentiated positioning in select verticals, strong leadership, robust executable orders and mining of strategic accounts would position the company to deliver strong revenue growth going ahead.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

Sudhir Singh	Chief Executive Officer & ED
Ajay Kalra	Chief Financial Officer
Madan Mohan	EVP & Global Head - TTH
Gautam Samanta	EVP & Global Head - BFS
Rajeev Batra	EVP & Global Head - Insurance

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management	6.50
2	Life Insurance Corp of India	4.79
3	Capital Group Cos Inc	4.56
4	UTI Asset Management	3.68
5	HDFC Asset Management Co Ltd	2.76
6	Vanguard Group Inc	2.15
7	Aditya Birla Sun Life Asset Management	1.92
8	Carne Global Fund Managers Ire	1.49
9	Nomura Holdings Inc	1.36
10	Goldman Sachs Group Inc	1.35

Source: Bloomberg (Old Data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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