Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Results update

Coforge Ltd

Executing its way forward, Maintain Buy

IT & ITeS	Sharekhan code: COFORGE
Reco/View: Buy ↔	CMP: **Rs. 4,525**
	Price Target: **Rs. 5,000** ↑

↑ 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 Updated May 08, 2023	22.28

Medium Risk

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

Source: Morningstar

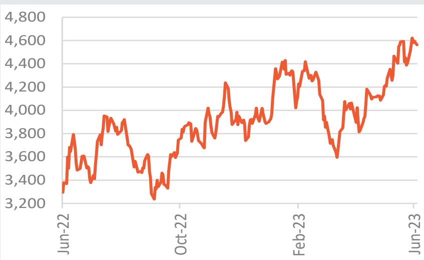
Company details

Market cap:	Rs. 27,641 cr
52-week high/low:	Rs. 4,650/3,210
NSE volume: (No of shares)	4.3 lakh
BSE code:	532541
NSE code:	COFORGE
Free float: (No of shares)	4.3 cr

Shareholding (%)

Promoters	30
FII	25
DII	32
Others	12

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.7	17.0	17.2	35.0
Relative to Sensex	4.4	8.1	15.0	12.0

Sharekhan Research, Bloomberg

Summary

- The company highlighted the strategy and growth equations as it aims to double revenues within next five years to $2 billion by scaling up key accounts and new verticals, using partnership-led growth and acquisitions.
- Management stated that client interactions indicate that demand is more uncertain than earlier assumed. Company is not expecting a rebound in H2FY24 and highlighted tougher demand environment for BFS vertical.
- Despite grim demand environment, the management reiterated its FY24 CC revenue guidance of 13-16% and added that they expect a 50-bps rise in gross margins in FY24, which reflects management's confidence on the revenue visibility for FY24 given the consistent deal intake and a strong executable order book.
- We believe management focus on scaling and mining of key accounts, expansion and strengthening of existing partnerships and logo additions besides consistent deal intake will continue to drive performance. Hence, we maintain Buy on Coforge with revised PT of Rs 5,000. At CMP, the stock trades at 27.9/23.4x its FY24E/ FY25E EPS respectively.

During Coforge's Investor Day, the management highlighted the strategy and growth equations as the company aims to double revenues to $2 billion within next five years implying upwards of ~14.4% CAGR. The growth equation broadly involves scaling key accounts, new verticals, partnerships and acquisitions with incremental revenues of $450 million from key accounts and $150 million each from the above other components. The company also indicated a structure to support its five-year growth plan with horizontals (Cloud, Digital, AI, Salesforce, Lo code No Code, Product Engineering and Business Process services), Global verticals (BFS, Insurance and TTH) and geo units (US, Europe, ANZ and APAC). The company during the Investor Day conference indicated their journey over last few years and differentiating factors, which sets them apart from peers. The management stated that the interactions with their clients indicate that the demand environment is more uncertain than thought of earlier. The management said that they are not expecting a rebound in H2FY24. However, the management reiterated its FY24 CC revenue guidance of 13-16% and added that they expect a 50-bps improvement in gross margins, which reflects the management's confidence on the revenue visibility for FY24 given the consistent deal intake and strong executable order book. The Company is focussing on increasing the intake of freshers and hiring to drive growth. The company would also focus on 16 key accounts where a 45% incremental growth is anticipated from within 32 key accounts. We believe management focus on scaling and mining of key accounts, expansion and strengthening of existing partnerships and logo additions besides consistency in deal intake will continue to drive performance. Hence, we maintain a Buy on Coforge with a revised PT of Rs 5000. At CMP, the stock trades at 27.9/23.4x its FY24E/ FY25E EPS respectively.

The Growth equation: The Company expressed that they have outlined following components of growth 1) Scaling up of key accounts 2) Scaling of new verticals - Investing in public sector outside India 3) Partnership led growth – Microsoft, Salesforce, PEGA, ServiceNow, Duck Creek, AWS and 4) Acquisitions- Whishworks, incessant, SLK.

Margin Improvement levers: The company indicated that there is still room for margin improvement by optimising average resource cost for delivery organisation, increase in fresher billability, operating leverage and improving price realisation. For FY24, the company guided for a 50-bps rise in gross margins.

Aiming for $2billion mark: The company highlighted that delivery execution has under pinned the journey to $1billion revenue mark through domain and technology, product engineering, innovation to deliver solutions , IP to deliver business asks and academy model to align teams to client needs. Achievement of the $2-billion revenue mark would be led by increased mining of targeted Key accounts, client service investments to drive costs value. Three-in-box consulting led delivery to drive trusted partner status and generation of large multi-tower/ partner driven deals. The company expects incremental revenues of $450 million from key accounts and $150 million each from new verticals, partnerships and acquisitions.

Our Call

Valuation – Executing its way forward, Maintain Buy: We believe that the management's focus on scaling and mining of key accounts, expansion and strengthening of existing partnerships and new logo additions besides consistency in deal intake will continue to drive performance. We expect a sales/PAT CAGR of 13.6% and 20.6% over FY23-25. Hence, we maintain Buy rating on Coforge with revised PT of Rs 5000. At CMP, the stock trades at 27.9/23.4x its FY24E/ FY25E EPS respectively.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and possible recession in the US that may moderate the pace of technology spends.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	6432	8,014.6	9,137.4	10,342.0
OPM (%)	17.3	17.5	17.6	18.1
Adjusted PAT (Rs cr)	661.7	811.7	986.6	1,180.7
% YoY growth	39.7	22.7	21.5	19.7
Adjusted EPS (Rs)	109.0	133.6	162.2	193.8
P/E (x)	41.5	33.9	27.9	23.4
P/B (x)	10.1	8.9	7.5	6.2
EV/EBITDA	24.7	19.6	16.8	14.0
ROE (%)	25.5	27.9	29.2	29.1
ROCE (%)	27.3	29.3	30.7	31.7

Source: Company; Sharekhan estimates

Investor Day 2023 highlights

Revenue and margin guidance: The management reiterated its FY24 CC revenue guidance of 13-16% and added that they expect a 50-bps point improvement in gross margins, which may be offset by SG&A investments in high growth areas. The company expects to maintain 15% SG&A costs going forward. While the company has set an internal target of 100 bps improvement in gross margin, back-to-office costs may offset the same. However, the company expects the improvement in gross margins for FY25 to flow to EBITDA levels. The company does not expect growth to be backloaded and expects Q2FY24 to be stronger than Q1FY24.

Demand environment: The management stated that the interactions with their clients indicate that the environment is more uncertain. The management expressed that they are not expecting a rebound in H2FY24. Softness in demand is more on account of variation in verticals rather than geographies. The aggregate demand is dominated by the travel and banking sectors. Banking demand is tough all around and not limited to regional banks. Conversations in the BFS vertical have turned to cost from growth earlier. Insurance vertical is not a drag and will grow in -line with firm. Core verticals growth to be +2 %or -2% of each other.

Fresher hiring: Earlier the annual intake was 250, then increased to 1,050, and currently stands at 1,000-1,100 per year. Overall, there is a focus on increasing the intake of freshers and hiring to drive growth. The company expects $10 million this year for intake of freshers, hiring of laterals, with 50% of the portfolio being fixed-price.

Key accounts and new verticals: Company to focus on 16 key accounts where a 45% incremental growth is anticipated from within 32 Key accounts. The company to launch 3 more verticals with 4th being Public Sector outside India and fifth from Retail/CPG and 6th being healthcare vertical.

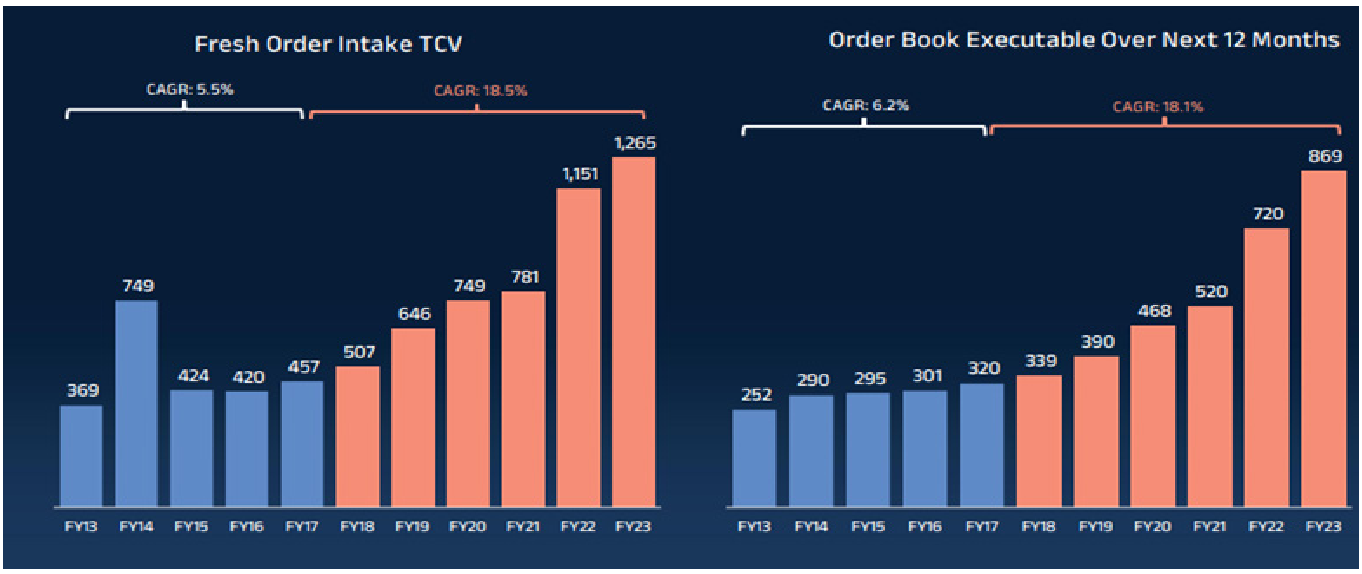
BFS growth Equation for next 5 years: BFS growth equation comprises of Scalable Logos, targeted domain offerings (AWM, GRC, Cards & Payments), ability to win large deals and geo expansion and targeting Hunting

Cloud and digital growth equation for five years: The growth under Cloud and Digital to come from hyperscalers across technology service line, doubling down on partnerships, value creation at intersection of Cloud, Data and AI and through Digitisation and Automation

Smart M&A investments: M&A continues to be an integral part of Coforge's growth strategy. The company looks at assets/capabilities which are aligned with the key verticals and helps Augment up-selling/ cross selling to scale-up accounts.

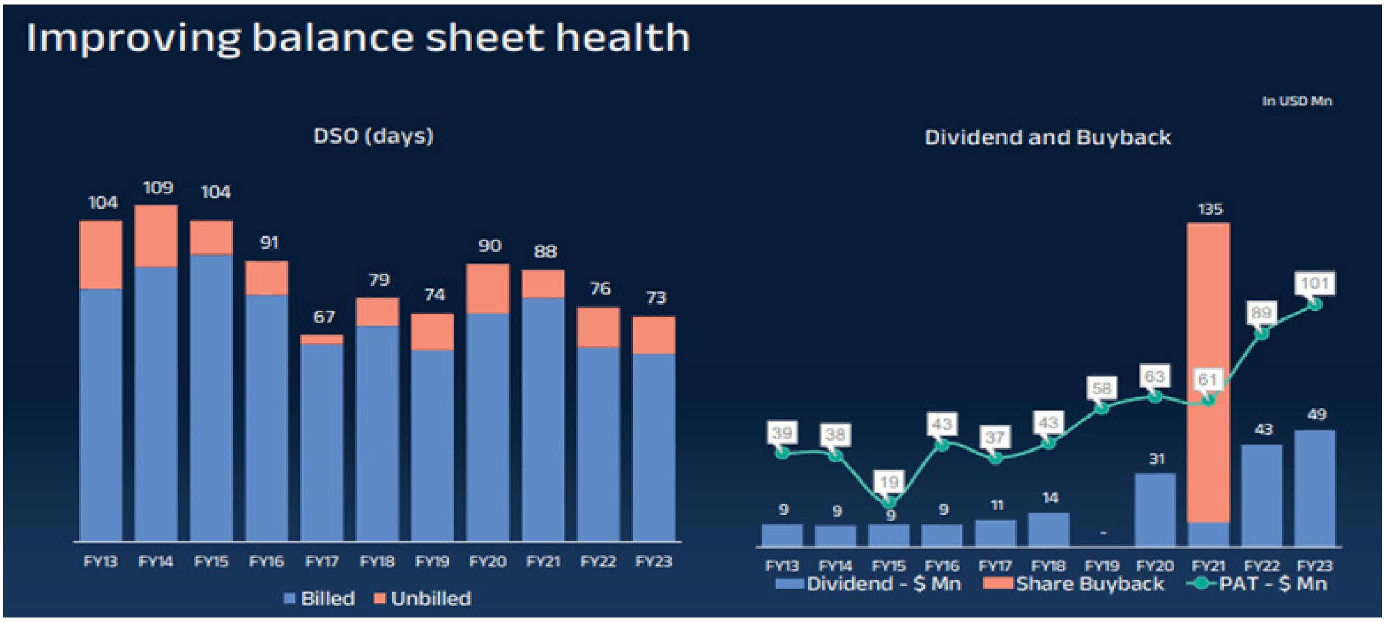
Generative AI: The management stated that generative AI could have a slightly deflationary impact on demand in the long term, affecting areas such as programming, testing and hyper-automation. However, AI could also speed up modernization and bring about faster move towards native Cloud environment. Also, it could create new opportunities as the non-digitalized firms could attempt to adopt generative AI technologies. The emphasis would be on retraining employees with speed, as project cycles are expected to become shorter. Delivering commitments will be of paramount importance.

Order Intake and Order Book Executable over Next 12 months



Source: Company; Sharekhan Research

Improving balance sheet

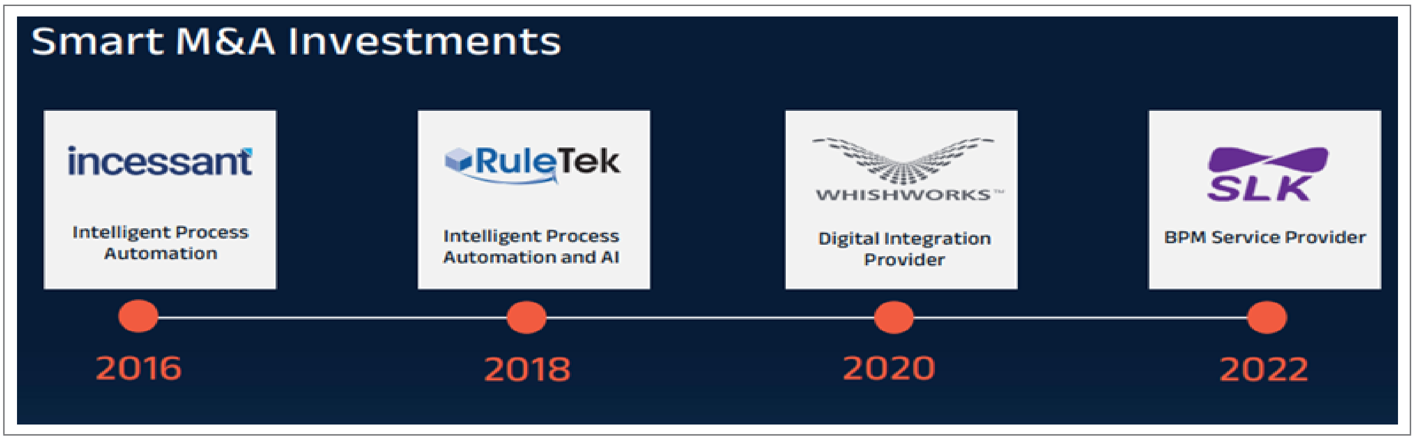


Source: Company; Sharekhan Research

Partnerships and Client focus

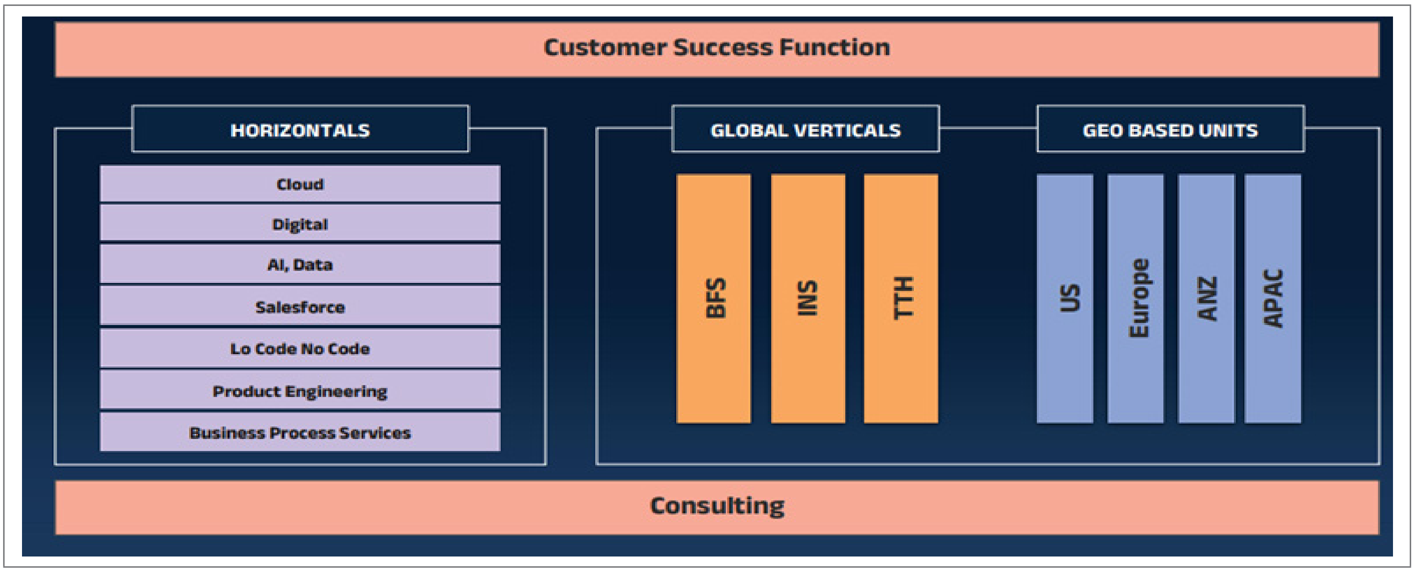
Source: Company; Sharekhan Research

Smart M&A investments



Source: Company; Sharekhan Research

Structure for 5 year growth plan



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.

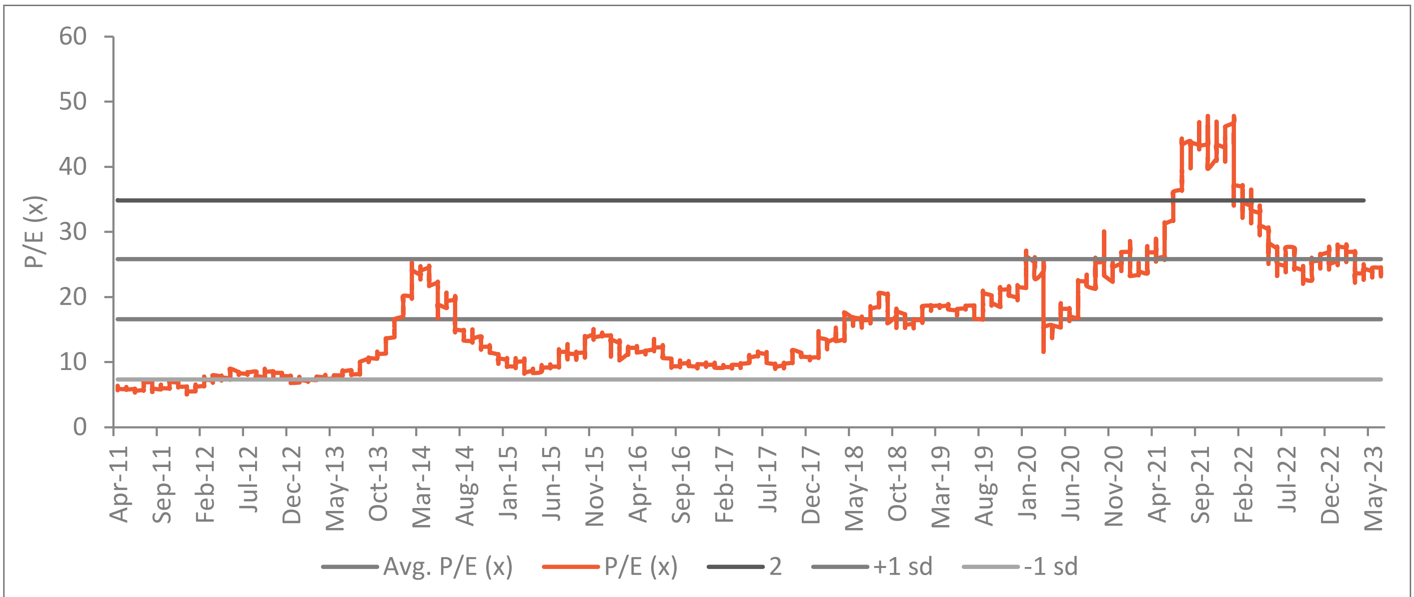
■ Company Outlook – Well-prepared for next leg of growth

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 – Executing its way forward, Maintain Buy

We believe that the management's focus on scaling and mining of key accounts, expansion and strengthening of existing partnerships and new logo additions besides consistency in deal intake will continue to drive performance. We expect a sales/PAT CAGR of 13.6% and 20.6% over FY23-25. Hence, we maintain Buy rating on Coforge with revised PT of Rs 5000. At CMP, the stock trades at 27.9/23.4x its FY24E/ FY25E EPS, respectively.

One-year forward P/E (x) band



Source: Sharekhan Research

About the 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

- Rupee appreciation and/or adverse cross-currency movements
- Contagion effect of banking crisis, macro headwinds and possible recession in the US that may moderate the pace of technology spends.

Additional Data

Key management personnel

Sudhir Singh	Chief Executive Officer & ED
Ajay Kalra	Chief Financial Officer
Madan Mohan	Head – Enterprise Application Services
Gautam Samanta	EVP & Global Head - BFS
Sanjeev Prasad	Global leader-Cloud and Digital

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co Ltd	6.5
2	Life Insurance Corp of India	5.9
3	Capital Group Cos Inc	4.3
4	UTI Asset Management Co Ltd	3.7
5	Aditya Birla Sun Life Asset Manage	3.5
6	HDFC Asset Management Co Ltd	3.5
7	Motilal Oswal Asset Management Co	2.7
8	Vanguard Group Inc	2.5
9	Mirae Asset Global Investments Co	2.2
10	CARNE GLOBAL FUND MANAGERS IRE	1.5

Source: Bloomberg

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

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