Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Coforge Ltd

## Guidance reiterated, Maintain Buy

| IT & ITeS | Sharekhan code: COFORGE |
|---|---|
| **Reco/View: Buy** ↔ | CMP: **Rs. 4,639** |
| | Price Target: **Rs. 5,500** ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade


**Summary**

- Reported revenue stood at $271.8 million, up 2.7%q-o-q/18.4% y-o-y in constant currency (cc) terms, missing our estimates of 3.5% q-o-q growth.
- Adjusted EBIDTA margin declined to 16%, down 360 bps q-o-q /50 bps y-o-y due to global salary hikes, visa costs, etc. Company reported a record order intake of $ 531 million.
- Management reiterated its FY24 annual revenue growth guidance of 13% to 16% in constant currency and the annual adjusted EBITDA guidance of around 18.3%.
- Despite the challenging demand environment, the company remains confident in achieving revenue growth guidance due to consistent order intake, robust 12-month executable order book, recent large deal wins, and strong net additions. Hence, we maintain Buy rating with a revised price target of Rs. 5500. At the CMP, the stock trades at 28.1x/22.9x its FY24/25E EPS.


**Coforge reported Revenue at $271.8 million, up 2.7%q-o-q/18.4% y-o-y in constant currency (cc) terms, missing our estimates of 3.5% q-o-q growth. Revenues stood at Rs. 2221 crore, up 2.4% q-o-q/21.4% y-o-y. EBIT margins dropped to 11.5%, down~ 100 bps y-o-y, while adjusted EBIDTA margin declined during the quarter to 16%, down 360 bps q-o-q /50 bps y-o-y due to global salary hikes, disbursement of annual variable pay, impact of hedge loss and booking of annual visa costs. Net profit stood at Rs. 165.3 crore, up 44% q-o-q/ 10% y-o-y missed our estimates at Rs. 236.3 crore. The Company reiterated its FY24 annual revenue growth guidance of 13% to 16% in constant currency and annual adjusted EBITDA guidance of around 18.3%. Order intake continued to be strong at $531 million. The company signed two $ 50M+ deals signed in the Banking and Financial Services (BFS) vertical. The company added 6 new clients in Q1FY24. Headcount stood at 24,224, a net addition of 1,000 people. LTM attrition at 13.3%, down 80 bps q-o-q. Despite stressed demand, the company reiterated its revenue growth guidance on the back of the consistently strong order intake, strong 12-month executable order book, the recent large deal wins and strong net additions during the quarter. Hence, we maintain Buy rating with a revised price target of Rs. 5500. At the CMP the stock trades at 28.1x/22.9x its FY24/25E EPS.**

**Key positives**

- Record order intake of $531 million, the sixth consecutive quarter of US$ 300+ million order intake.
- Company reiterated its FY24 annual revenue growth guidance of 13% to 16% in CC terms.
- Net additions stood at 1000 employees, taking total headcount to 24,224.
- LTM attrition rate moderated 80 bps q-o-q to 13.3%

**Key negatives**

- Adjusted EBIDTA margins fell to 16%, down 360 bps q-o-q /50 bps y-o-y
- Utilisation rate including trained employees fell by 50 bps q-o-q to 81% from 81.5%

**Management Commentary**

- Management stated that currently, both the US and Europe markets are performing well for the company, with the US witnessing more than 5% growth in deals despite subdued demand perception. Although Europe remained flat after several strong quarters, it is expected to rebound again.
- Hiring plans are aligned with anticipated growth, targeting a growth range of 13% to 16%. For the upcoming three quarters, they aim to achieve sequential growth of 2.5-3.5%. They have already built a strong bench to support the growth, especially for servicing significant deals, and are confident in continuing internal hiring to meet their growth plan.

**Revision in estimates –** We have fine-tuned earnings estimates for FY24/FY25E owing to macro-overhang.

**Our Call**

**Valuation – Mixed Q1, Maintain Buy:** Although demand environment is stressed the company continues to do well in its key markets. The confident reiteration of the revenue growth guidance by the management is on account of the consistently robust order intake, strong 12-month executable order book, recent order wins and strong net employee additions. We expect 17%/23% Sales and PAT CAGR over FY23-25E. Hence, we maintain Buy rating on the stock with a revised price target of Rs. 5500. At CMP, the stock trades at 28.1x/22.9x its FY24/25E EPS.

**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 | 9,449.6 | 10,944.6 |
| OPM (%) | 17.3 | 17.5 | 17.6 | 18.2 |
| Adjusted PAT | 661.7 | 811.7 | 1,002.6 | 1,235.0 |
| % YoY growth | 39.7 | 22.7 | 23.5 | 23.2 |
| Adjusted EPS (Rs.) | 109.0 | 133.6 | 164.8 | 202.7 |
| P/E (x) | 42.6 | 34.7 | 28.1 | 22.9 |
| P/B (x) | 10.3 | 9.2 | 7.7 | 6.3 |
| EV/EBIDTA (x) | 25.3 | 20.1 | 16.7 | 13.5 |
| RoNW (%) | 25.5 | 27.9 | 29.6 | 30.2 |
| RoCE (%) | 27.3 | 29.3 | 32.0 | 33.9 |

*Source: Company; Sharekhan estimates*

**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 22.28

Updated Jul 08, 2023

Medium Risk

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

*Source: Morningstar*

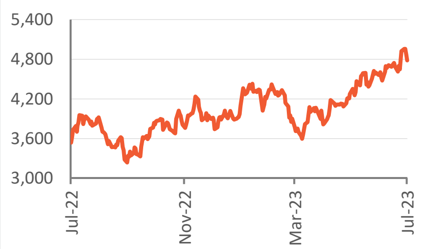
**Company details**

| | |
|---|---|
| Market cap: | Rs. 28,337 cr |
| 52-week high/low: | Rs. 5,051 / 3,210 |
| NSE volume: (No of shares) | 4.3 lakh |
| BSE code: | 532541 |
| NSE code: | COFORGE |
| Free float: (No of shares) | 3.7 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 27 |
| FII | 25 |
| DII | 37 |
| Others | 11 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 0.7 | 21.2 | 13.1 | 28.1 |
| Relative to Sensex | -4.2 | 9.4 | 3.1 | 8.4 |

*Sharekhan Research, Bloomberg*

## Key highlights

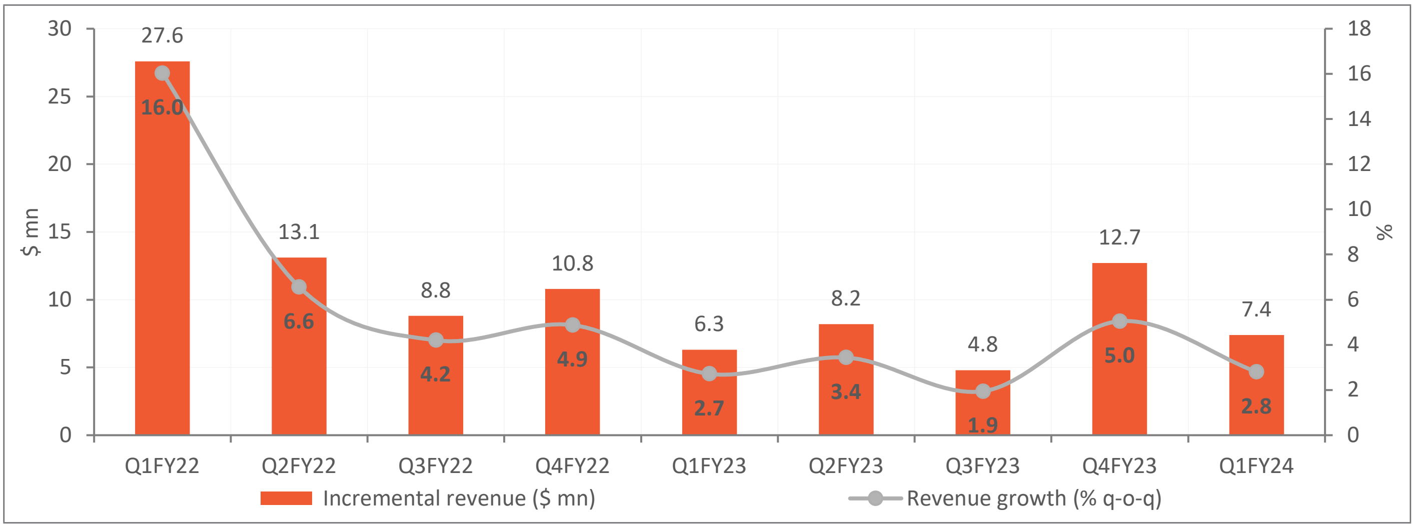
- **Guidance for FY24:** The Company reiterated its FY24 annual revenue growth guidance of 13% to 16% in constant currency and the annual adjusted EBITDA guidance of around 18.3%.
- **Revenue growth across verticals:** Verticals BFS, Insurance, Travel and Others grew 3.1% 5.6%/0.1 and 2.1% q-o-q and 11%/20%/9% and 13% y-o-y respectively in cc terms.
- **Performance across geographies:** Americas, EMEA and RoW grew 5.8%/0.2% and -0.6% respectively.
- **EBITDA margin decline:** Adjusted EBIDTA margins declined to 16%, down 360 bps q-o-q /50 bps y-o-y due to global salary hikes, disbursement of annual variable pay, impact of hedge loss and booking of all annual visa costs.
- **Strong deal wins and robust deal pipeline:** Coforge reported robust order intake of $531million in Q1FY24 up 76% q-o-q/64% y-o-y. Total order book executable over the next 12 months stood at $ 897 million. A large deal of $300 million Total Contract Value (TCV) was secured from an existing BFS (Banking and Financial Services) customer, ensuring a minimum annual commitment of $60 million for the next five years. Additionally, a $65 million TCV deal was also signed with an existing BFS customer, with over half of it comprising new business.
- **Top accounts:** Top 5 clients and top 10 clients grew 12.2/ by 9.2% q-o-q respectively. The company added 2, and 4 clients on a y-o-y basis in the $10 million+ category, and $1-5 million category, respectively.
- **Net headcount additions:** Net additions stood at 1000 employees, taking the total headcount to 24,224. Utilisation rate including trained employees dipped by 50 bps to 81 % from 81.5%. in Q4FY23. LTM attrition rate declined 80 bps q-o-q to 13.3% which is one of the lowest in the industry.
- **Healthy balance sheet metrics:** Cash & cash equivalents stood at Rs. 370.8 crore as of June 30, 2023 versus Rs. 602.5 crore as of March 31, 2023. DSO remained stable at 61 days q-o-q.

**Results (Consolidated)** Rs cr

| Particulars | Q1FY24 | Q1FY23 | Q4FY23 | Y-o-Y % | Q-o-Q % |
|---|---|---|---|---|---|
| **Revenues ($ mn)** | **271.8** | **238.7** | **264.4** | **13.9** | **2.8** |
| **Revenues in INR** | **2,221.0** | **1,829.4** | **2,170.0** | **21.4** | **2.4** |
| Direct expenses | 1,563.0 | 1,273.9 | 1,430.6 | 22.7 | 9.3 |
| **Gross Profit** | **658.0** | **555.5** | **739.4** | **18.5** | **-11.0** |
| Selling / G&A | 326.4 | 254.3 | 315.0 | 28.4 | 3.6 |
| Acquisition related expenses & costs of ESOPs | 15.5 | 9.4 | 16.8 | 65.4 | -7.5 |
| **EBITDA** | **316.1** | **291.8** | **407.6** | **8.3** | **-22.5** |
| Depreciation | 75.7 | 63.0 | 71.7 | 20.2 | 5.6 |
| **EBIT** | **240.4** | **228.8** | **335.9** | **5.0** | **-28.4** |
| Other income | (15.2) | (7.6) | (48.7) | 100.0 | -68.8 |
| **PBT** | **225.2** | **221.2** | **287.2** | **1.8** | **-21.6** |
| Tax provision | 48.5 | 49.3 | 37.9 | -1.6 | 28.0 |
| Minority Interest | 10.4 | 22.2 | 1.9 | -53.2 | 447.4 |
| **Net profit** | **166.3** | **149.7** | **247.4** | **11.1** | **-32.8** |
| **EPS (Rs. )** | **29.8** | **24.6** | **40.6** | **21.3** | **-26.5** |
| | | | | | |
| **Margin (%)** | | | | | |
| EBITDA | 14.2 | 16.0 | 18.8 | -172 | -455 |
| EBIT | 10.8 | 12.5 | 15.5 | -168 | -466 |
| NPM | 7.5 | 8.2 | 11.4 | -70 | -392 |
| Effective Tax rate (%) | 21.6 | 22.3 | 24.5 | -66 | -283 |

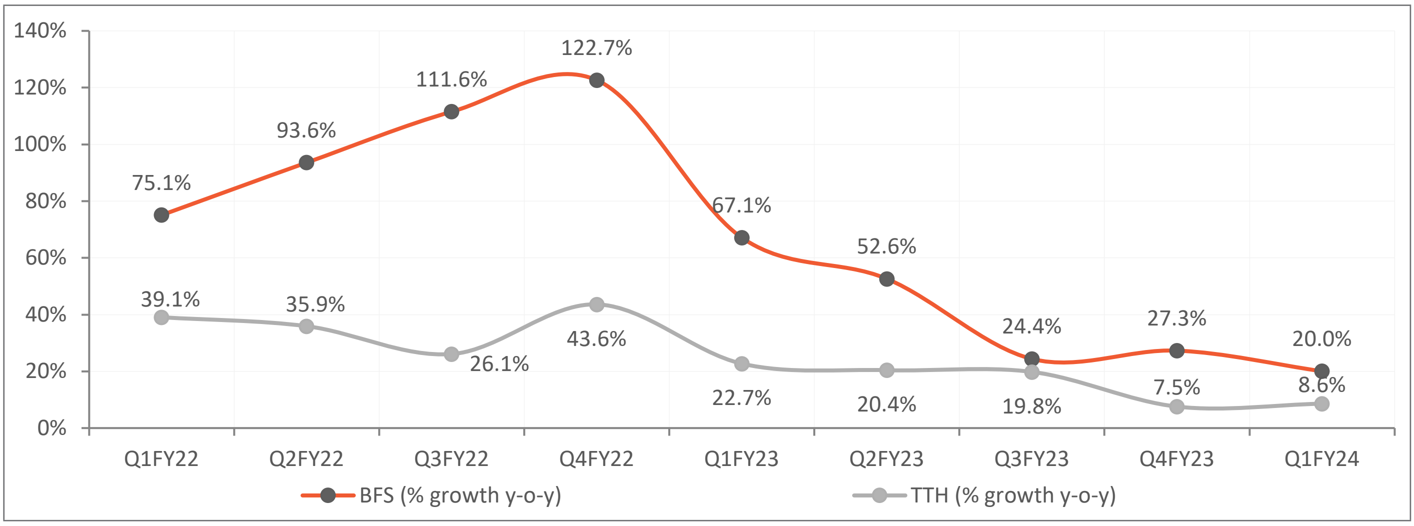
*Source: Company; Sharekhan Research*

**Revenue growth trend**



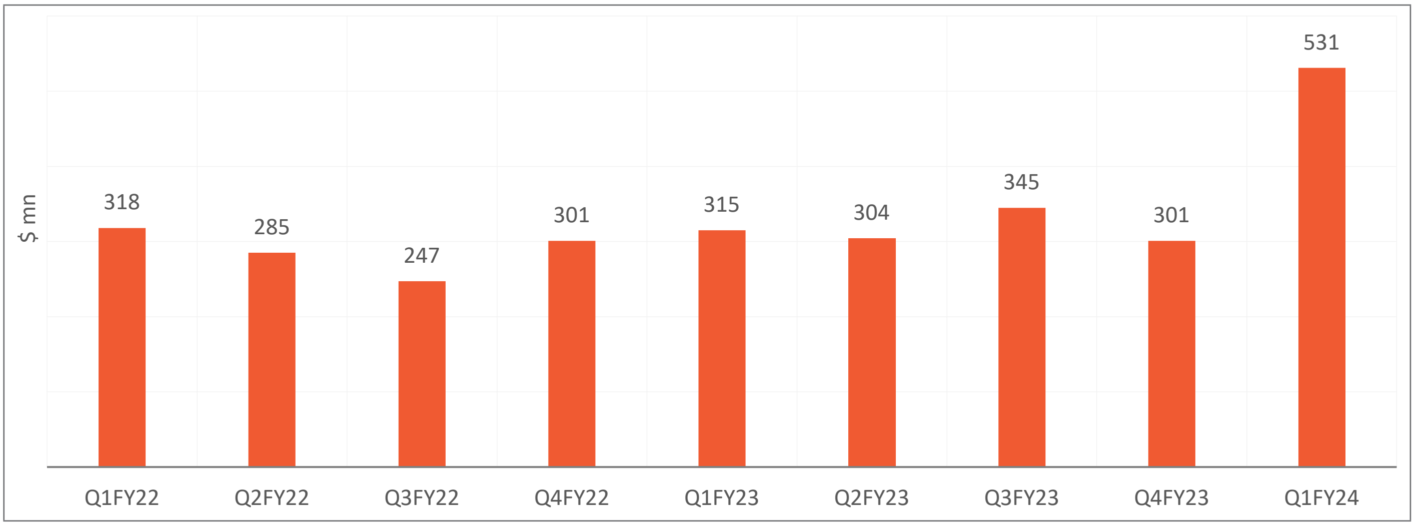

*Source: Company; Sharekhan Research*

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



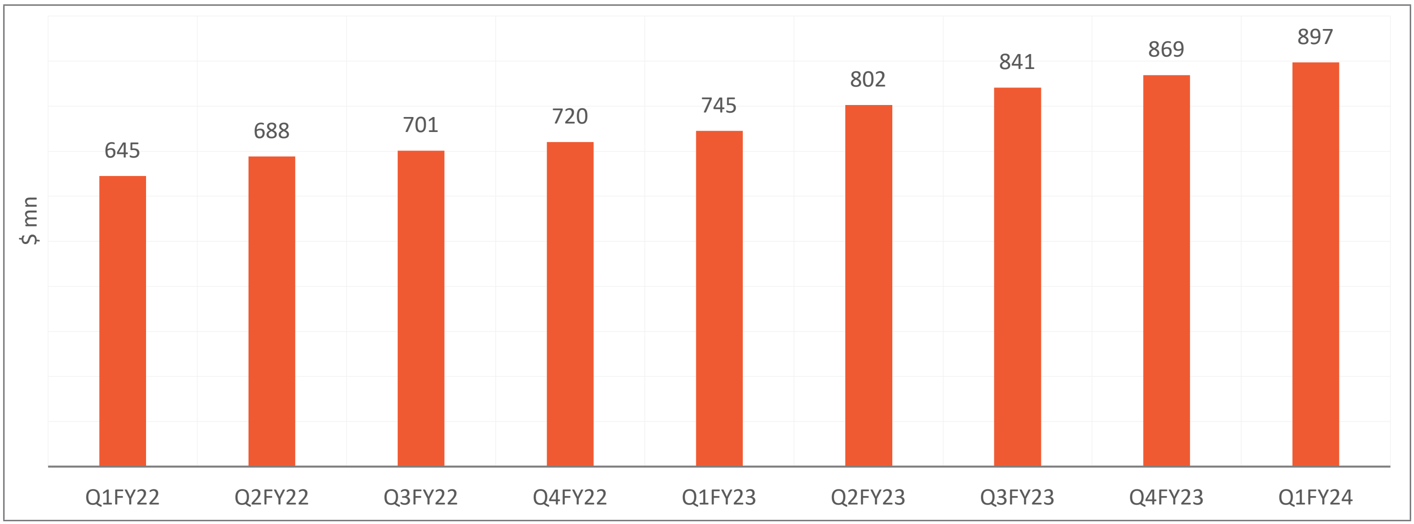

*Source: Company; Sharekhan Research*

**Fresh order book trend**



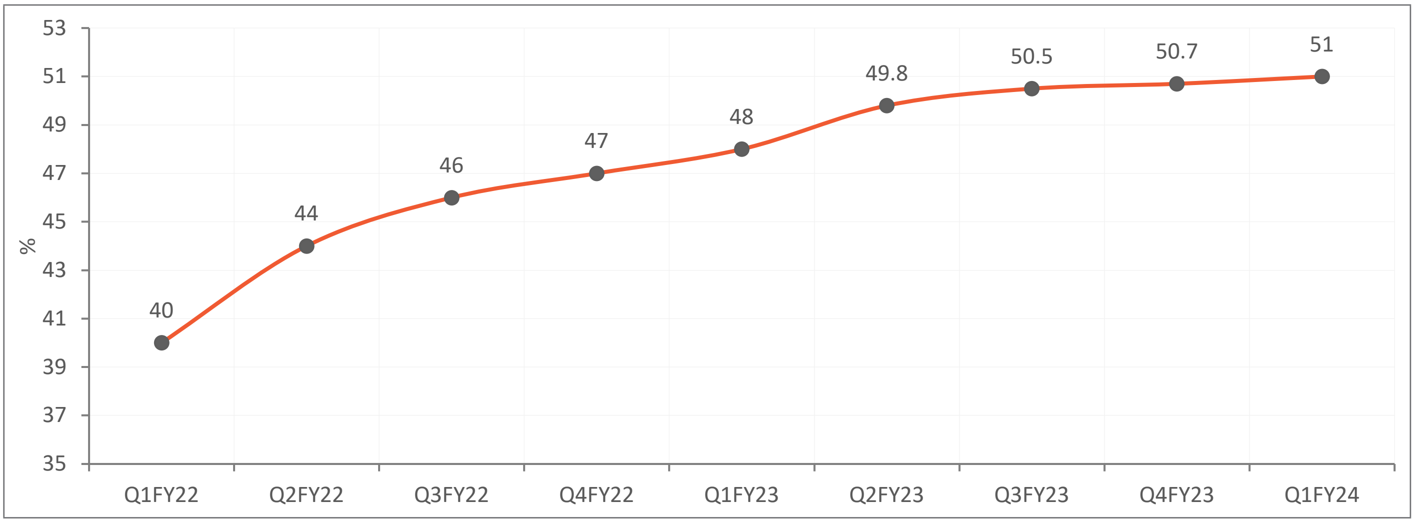

*Source: Company; Sharekhan Research*

**Executable orders to be executed over next 12 months**



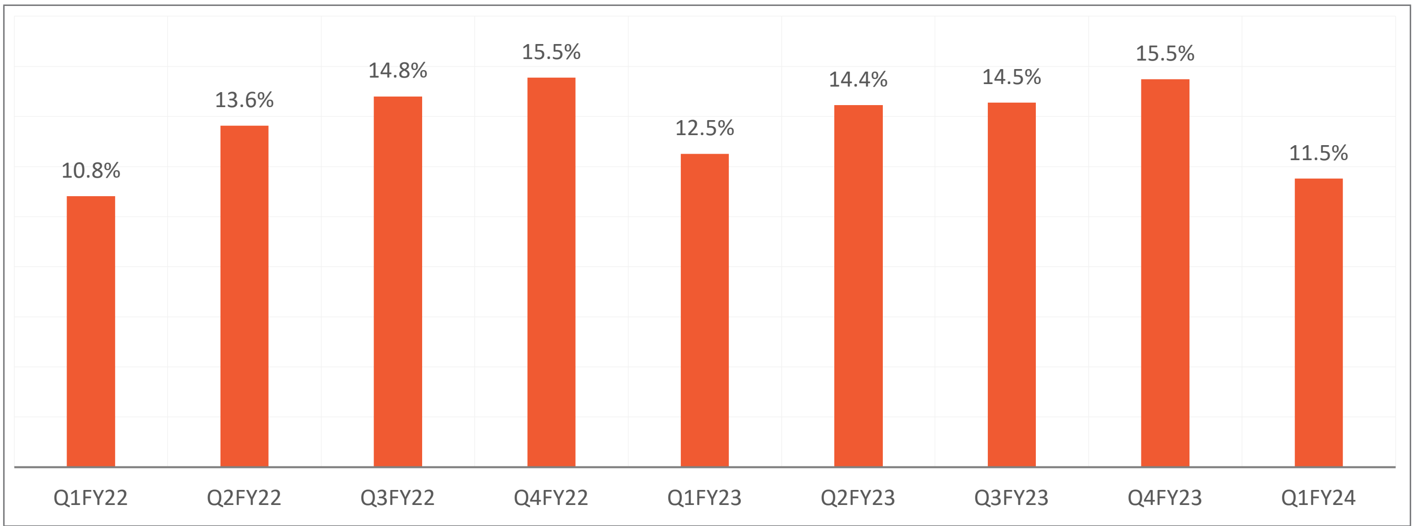

*Source: Company; Sharekhan Research*

**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 – Mixed Q1, Maintain Buy

Although demand environment is stressed the company continues to do well in its key markets. The confident reiteration of the revenue growth guidance by the management is on account of the consistently robust order intake, strong 12-month executable order book, recent order wins and strong net employee additions. We expect 17%/23% Sales  and PAT CAGR over FY23-25E. Hence, we maintain Buy rating on the stock with a revised price target of Rs. 5500. At CMP, the stock trades at 28.1x/22.9x its FY24/25E EPS.

**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) 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 | EVP & Global Head - TTH |
| Gautam Samanta | EVP & Global Head - BFS |
| Rajeev Batra | EVP & Global Head - Insurance |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Axis Asset Management Co Ltd/India | 6.5 |
| 2 | Life Insurance Corp of India | 6.01 |
| 3 | Capital Group Cos Inc/The | 4.19 |
| 4 | UTI Asset Management Co Ltd | 3.61 |
| 5 | Aditya Birla Sun Life Asset Manage | 3.55 |
| 6 | HDFC Asset Management Co Ltd | 3.53 |
| 7 | Motilal Oswal Asset Management Co | 2.74 |
| 8 | Mirae Asset Global Investments Co | 2.48 |
| 9 | Vanguard Group Inc/The | 2.16 |
| 10 | Goldman Sachs Group Inc/The | 1.74 |

*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*

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