Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Coforge Ltd

Decent Quarter, Maintain Buy

IT & ITeS	Sharekhan code: COFORGE

Reco/View: Buy	↔	CMP: Rs. 5,106	Price Target: Rs. 6,200	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Coforge reported revenue at $278.1 million, up 2.3% q-o-q/14.1% y-o-y in constant currency, missing our estimate of 2.8% q-o-q growth, led by BFS, Insurance and Travel, Transportation and Hospitality (TTH).
- Reported EBITDA margin stood at 15.3%, up 33 bps q-o-q, lower than our estimate of 16.6%. The quarter saw a one-time increase in ESOP costs due to an acceleration in ESOP investment.
- The company reported a record order intake of $313 million and signed three large deals during the quarter. Management reiterated its FY24 annual revenue growth guidance of 13% to 16% in constant currency.
- The company reported a decent quarter, though revenue growth was a tad lower than expectations. The company continues to reiterate its revenue growth guidance, led by the consistently robust order intake, strong 12-month executable order book, recent large deal wins, and continued net additions. Hence, we maintain Buy rating with unchanged price target of Rs. 6,200. At the CMP the stock trades at 25.4x/21x its FY25/26E EPS.

Coforge reported constant currency (CC) revenue growth of 2.3% q-o-q/14.1% y-o-y, missing our estimate of 2.8%. USD revenue grew 2.3% q-o-q /16.2% y-o-y to $278.1 million, led by BFS, Insurance and Travel, Transportation and Hospitality (TTH). In rupee terms, the company reported revenue of Rs. 2,276.2 crore, up 2.5% q-o-q/16.2% y-o-y. Reported EBITDA margin stood at 15.3%, up 33 bps q-o-q, but was lower than our estimate of 16.6%, while adjusted EBITDA margin stood at 17.6%, up 160 bps q-o-q. Q2 saw a one-time increase in ESOP costs due to an acceleration in ESOP investment. Net profit stood at Rs. 181 crore, up 9.5% q-o-q/ down 10% y-o-y. The company reported robust total order intake of $313 million during the quarter and signed three large deals. Order book executable over the next 12 months stood at $935 million, up 16.6% y-oy. The company added eight new logos during the quarter. Attrition (LTM) dipped 30 bps to 13.0%. The company had net addition of 414, up 1.7% sequentially, taking the global headcount to 24,638. Despite the uncertain environment, the company reported a decent quarter, although revenue growth was a tad lower than expectations. The company continues to reiterate its revenue growth guidance, led by consistently robust order intake, strong 12-month executable order book, recent large deal wins, and continued net additions. Hence, we maintain our Buy rating with an unchanged price target (PT) of Rs. 6,200. At the CMP, the stock trades at 25.4x/21x its FY25/26E EPS.

Key positives

- The company reported order intake of $313 million, registering the seventh consecutive quarter of over US$300 million order intake.
- Net additions stood at 414 employees, taking the total headcount to 24,638.
- LTM attrition rate moderated by 30 bps q-o-q to 13%.

Key negatives

- Utilisation rate, including trained employees, fell by 100 bps q-o-q to 80% from 81%.
- Revenue from the Top 5 and Top 10 clients fell by 4.2% and 4.5% q-o-q, respectively.

Management Commentary

- The company reiterated its FY2024 annual revenue growth guidance of 13% to 16% in CC terms and reaffirmed gross margin improvement of 50 bps compared to FY23 and its adjusted EBITDA margin is likely to be at similar levels as FY23.
- Management expects Q3 revenue growth to be tepid with significant sequential margin improvement of at least 100 bps in Q3. The company expects margin levers from client event, benefits of initiatives on ARC reduction, and previous hedge losses getting converted into hedge gains given the currency movement.

Revision in estimates – We have fine-tuned our earnings estimates to factor persisting macro-overhang

Our Call

wontinues to reiterate its revenue growth guidance, led by the consistently robust order intake, strong 12-month executable order book, recent large deal wins, and continued net additions. We expect Sales/PAT CAGR of 17%/22% over FY23-26E. Hence, we maintain Buy rating with an unchanged price target (PT) of Rs. 6,200. At the CMP, the stock trades at 25.4x/21x its FY25/26E EPS.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	6432	8,014.6	9,472.8	11,043.1	12,736.2
OPM (%)	17.3	17.5	16.5	17.3	18.2
Adjusted PAT	661.7	811.7	916.3	1,231.1	1,484.9
% YoY growth	39.7	22.7	12.9	34.4	20.6
Adjusted EPS (Rs.)	109.0	133.6	150.6	201.3	242.8
P/E (x)	46.8	38.2	33.9	25.4	21.0
P/B (x)	11.4	10.1	8.6	7.0	5.8
EV/EBIDTA (x)	27.9	22.1	19.6	15.6	12.5
RoNW (%)	25.5	27.9	27.3	30.5	30.2
RoCE (%)	27.3	29.3	29.8	32.6	34.5

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 Aug 08, 2023

Medium Risk

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

Source: Morningstar

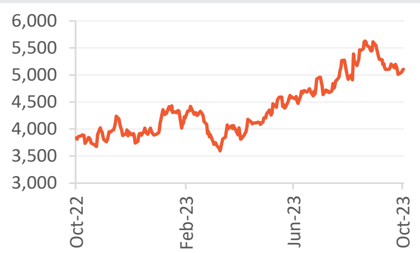
Company details

Market cap:	Rs. 31,425 cr
52-week high/low:	Rs. 5760/3565
NSE volume: (No of shares)	5.6 lakh
BSE code:	532541
NSE code:	COFORGE
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	27
FII	25
DII	37
Others	11

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.8	6.1	33.9	32.6
Relative to Sensex	-4.0	9.0	23.8	21.8

Sharekhan Research, Bloomberg

Key highlights

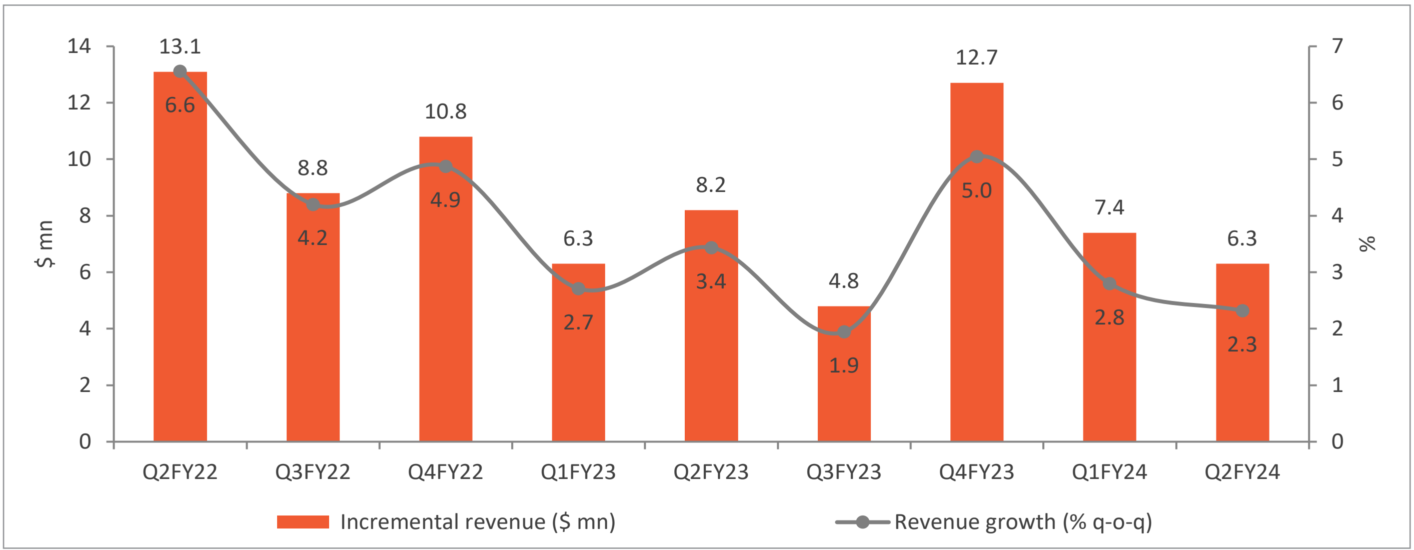
- **Revenue growth:** Coforge reported revenue of $278.1 million, up 2.3% q-o-q/14.1% y-o-y in constant currency terms. In USD terms, revenue growth was 2.3% q-o-q/12.6% y-o-y. In rupee terms, the company reported revenue of Rs. 2,276.2 crore, up 2.5% q-o-q/16.2% y-o-y. Growth was led by the BFS, Insurance and Travel, Transportation and Hospitality (TTH) which grew 3.8%/2.4% and 2.3% q-o-q in constant currency.
- **Revenue growth across verticals:** Verticals BFS, Insurance, Travel and Others grew 4.0% 2.3%/2.3 and 0.5% q-o-q and 12%/10%/8% and 19% y-o-y respectively.
- **Performance across geographies:** Americas, EMEA and RoW grew by 1.7%, 2.8%, and 3.2%, respectively.
- **EBITDA margin declines:** Adjusted EBIDTA margin improved to 160 bps. Reported EBITDA margin stood at 15.3%, up 33 bps q-o-q. Q2 saw a one-time increase in ESOP costs due to an acceleration in ESOP investment. The company expects ESOP costs to normalise from Q3.
- **Strong deal wins and robust deal pipeline:** Coforge reported robust order intake of $313 million in Q2FY24 down 41% q-o-q/up 3% y-o-y. Total order book executable over the next 12 months stood at $935 million, up 16.6% y-o-y. The company signed three large deals during the quarter.
- **Top accounts:** Revenue from the top 5 clients and top 10 clients declined by 4.3% and 4.5% q-o-q, respectively. The company added 8 new clients during the quarter. The company added 2 clients each in over $10 million and $1-5 million category, respectively.
- **Net headcount additions:** Net additions stood at 414, taking the total headcount to 24,638. Utilisation rate, including trained employees, dipped by 100 bps to 80% from 81%. in Q1FY24. LTM attrition rate declined by 30 bps q-o-q to 13%, which is one of the lowest in the industry.
- **Healthy balance sheet metrics:** Cash and cash equivalents stood at Rs. 356.2 crore in Q2FY24 compared with Rs. 569.9 crore during Q1FY24. The reduction of cash was due to a payment of a dividend amounting to Rs. 232.2 crore and payment towards the acquisition of an additional stake in its subsidiaries. DSO increased to 64 days in Q2FY24 from 61 days in Q1FY24.

Results — Rs cr

Particulars	Q2FY24	Q2FY23	Q1FY24	YoY %	QoQ %
Revenues ($ mn)	**278.1**	**246.9**	**271.8**	**12.6**	**2.3**
Revenues in INR	**2,276.2**	**1,959.4**	**2,221.0**	**16.2**	**2.5**
Direct expenses	1,537.7	1,331.6	1,541.4	15.5	-0.2
Gross Profit	**738.5**	**627.8**	**679.6**	**17.6**	**8.7**
Selling / G&A	339.2	268.2	326.4	26.5	3.9
Acquisition related expenses & costs of ESOPs	51.9	15.2	21.6	241.4	140.3
EBITDA	**347.4**	**344.4**	**331.6**	**0.9**	**4.8**
Depreciation	77.2	61.4	75.7	25.7	2.0
EBIT	**270.2**	**283.0**	**255.9**	**-4.5**	**5.6**
Other income	(29.5)	(15.0)	(15.2)	96.7	94.1
PBT	**240.7**	**268.0**	**240.7**	**-10.2**	**0.0**
Tax provision	52.8	47.4	48.5	11.4	8.9
Minority Interest	6.9	19.5	10.4	-64.6	-33.7
Net profit	**181.0**	**201.1**	**181.8**	**-10.0**	**-0.4**
EPS (Rs)	29.6	33.0	29.8	-10.3	-0.8
Margin (%)					
EBITDA	15.3	17.6	14.9	-231	33
EBIT	11.9	14.4	11.5	-257	35
NPM	8.0	10.3	8.2	-231	-23
Effective Tax rate (%)	21.9	17.7	21.6	425	30

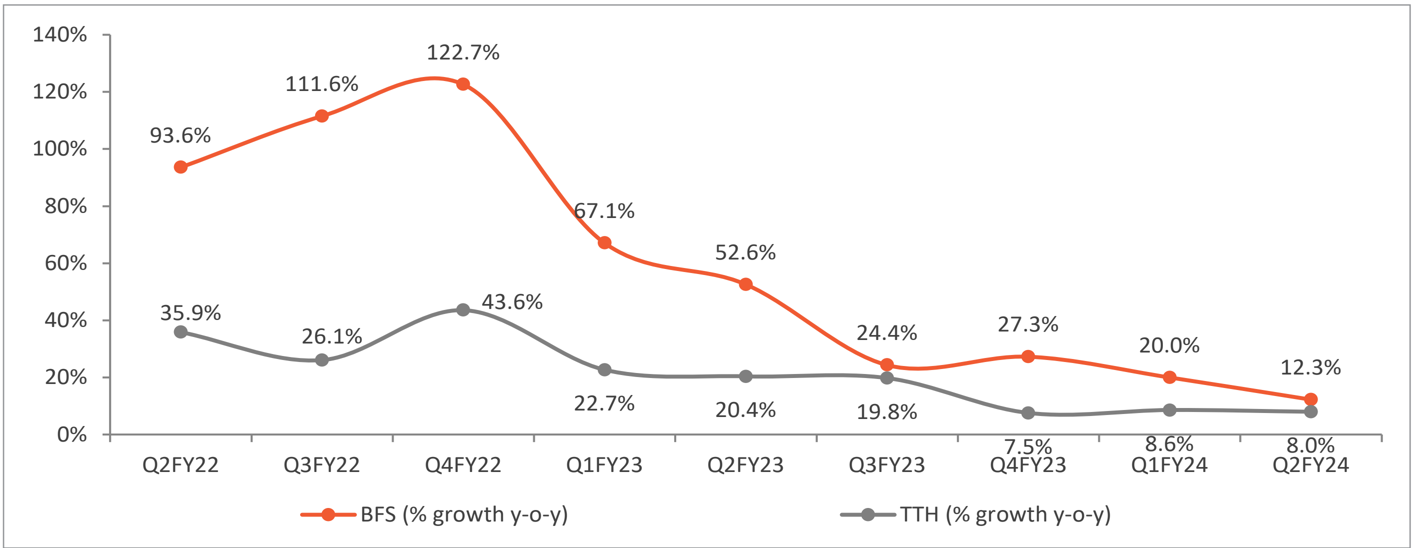
Source: Company; Sharekhan estimates

Revenue growth trend



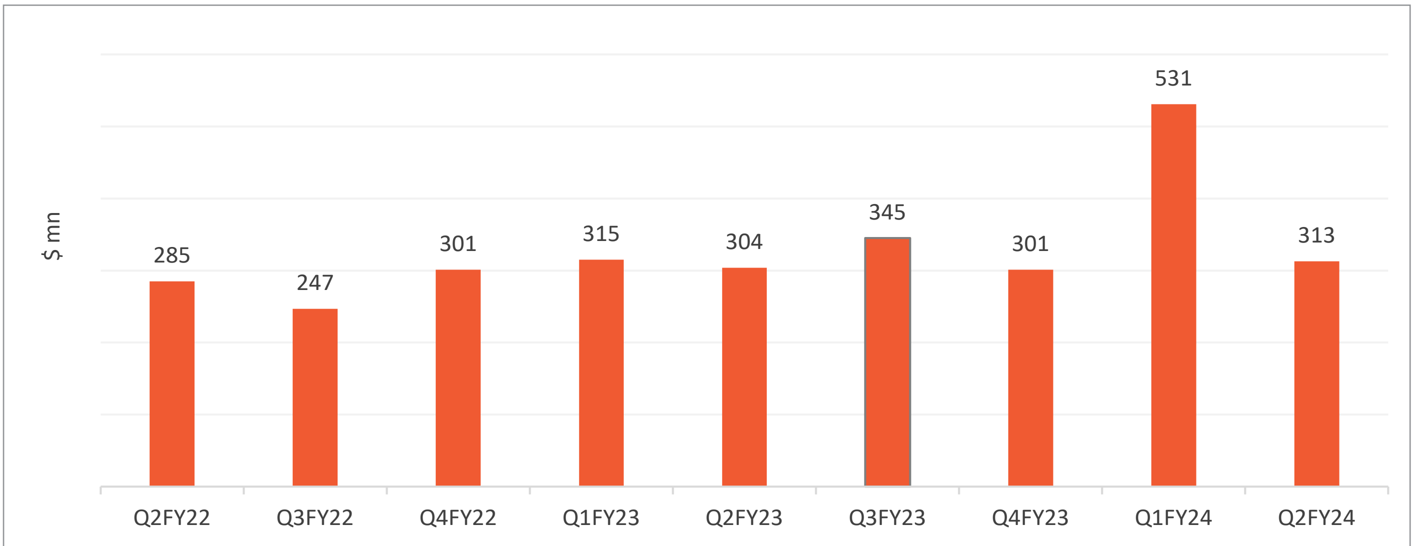
Source: Company, Sharekhan Research

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



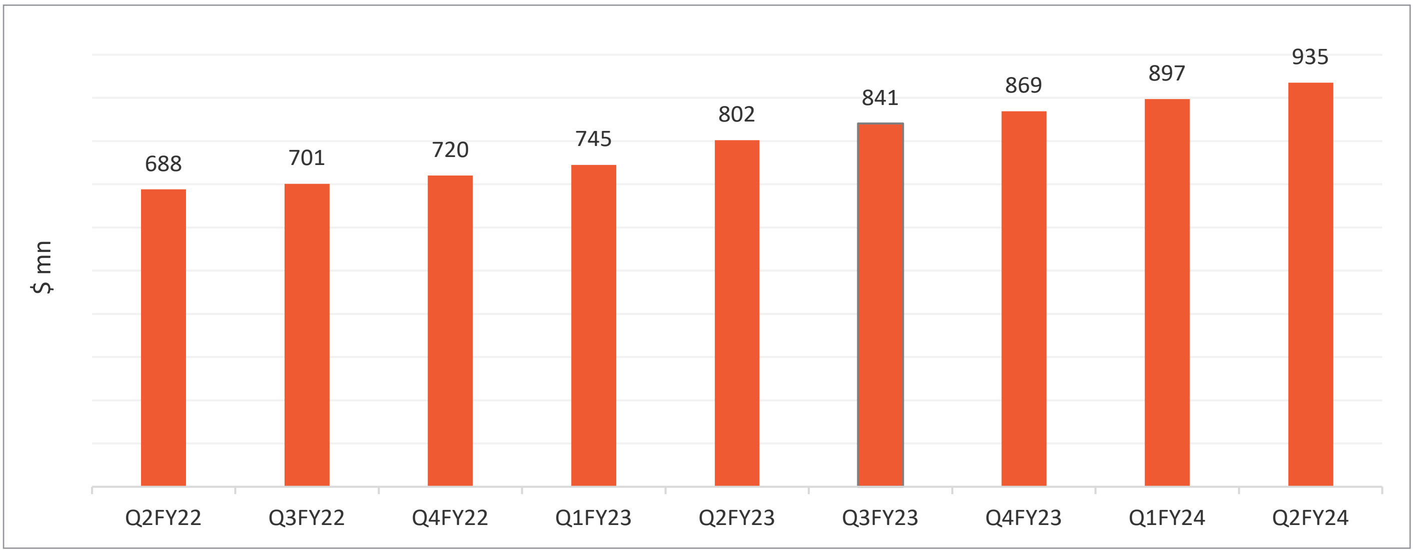
Source: Company, Sharekhan Research

Fresh order book trend



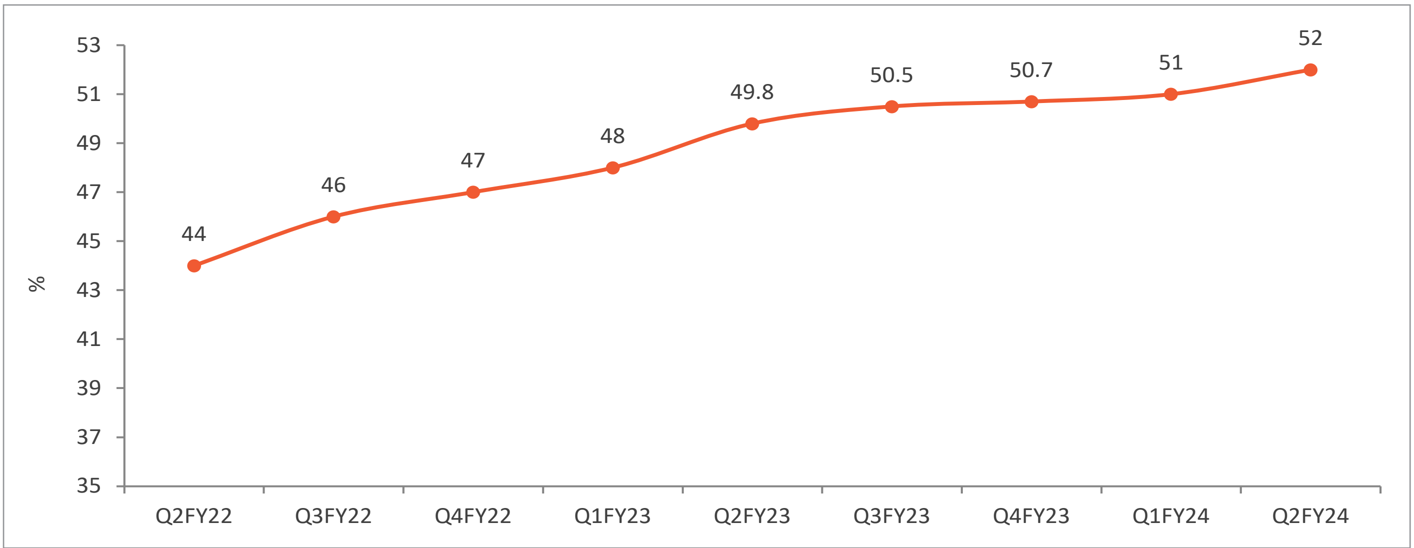
Source: Company, Sharekhan Research

Executable orders to be executed over next 12 months



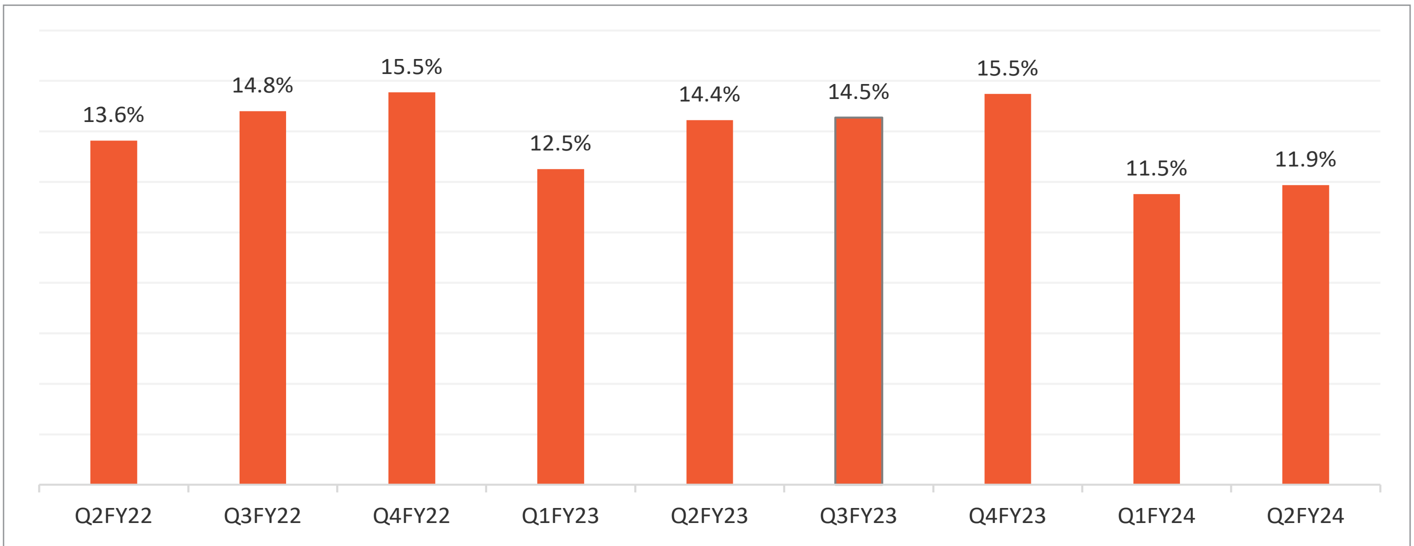
Source: Company, Sharekhan Research

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.

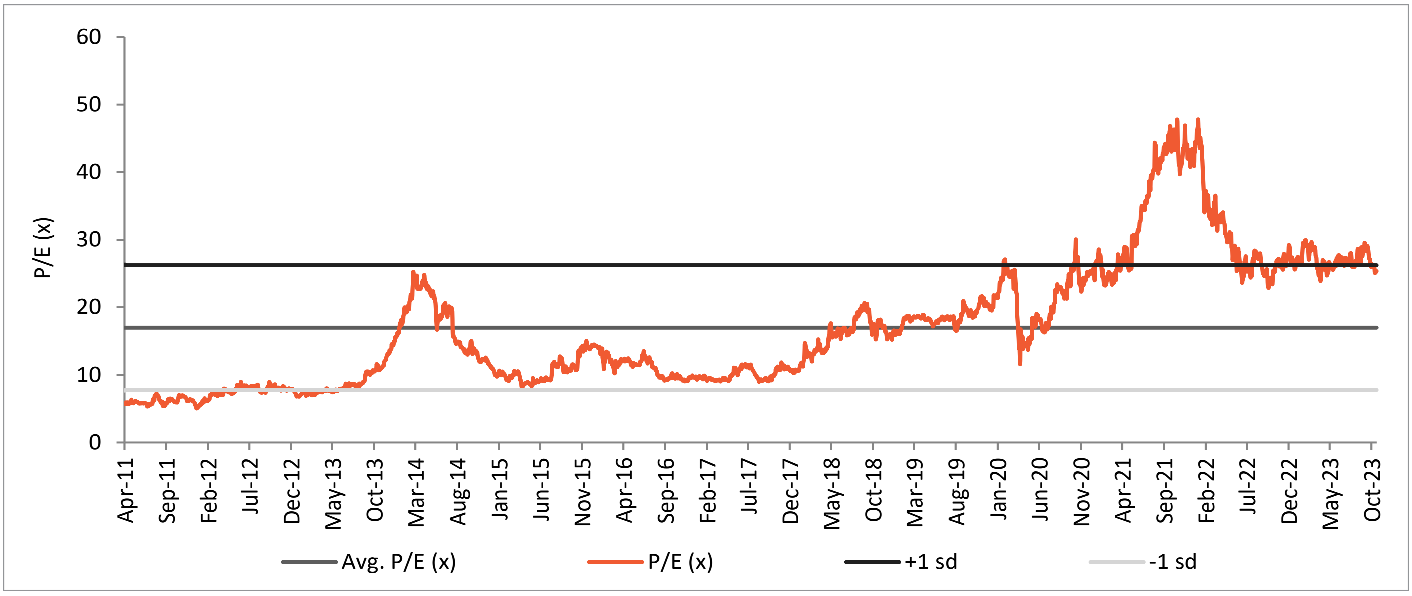
■ Company outlook - Well-prepared for next leg of growth

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 - Maintain Buy with unchanged PT of Rs 6,200

Despite the uncertain environment, the company reported decent quarter though revenue growth was tad lower than expectations. The company continues to reiterate its revenue growth guidance led by the consistently strong order intake, strong 12-month executable order book, recent large deal wins and continued net additions. We expect Sales/PAT CAGR of 17%/22% over FY23-26E. Hence, we maintain Buy rating with unchanged price target (PT) of Rs. 6200. At the CMP, the stock trades at 25.4x/21x its FY25/26E 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co Ltd/India	6.45
2	HDFC Asset Management Co Ltd	6.16
3	Life Insurance Corp of India	5.97
4	SBI Funds Management Ltd	5.27
5	Aditya Birla Sun Life Asset Manage	4.34
6	Capital Group Cos Inc/The	3.78
7	UTI Asset Management Co Ltd	3.7
8	Vanguard Group Inc/The	3.61
9	DSP Investment Managers Pvt Ltd	3.15
10	Mirae Asset Global Investments Co	2.8

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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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

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