Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Coforge Ltd

Well placed to deliver top quadrant performance

IT & ITeS	Sharekhan code: COFORGE
Reco/View: Buy ↔	CMP: **Rs. 5,555** / Price Target: **Rs. 7,670** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We maintain Buy rating on Coforge with unchanged PT of Rs. 7,670 as the company is well placed to deliver top quadrant performance in FY25 given the robust order book, consistent strong order intake and large deal pipeline. Stock trades at 26.4x/21.7x its FY25E/26E EPS.
- Fund-raising through QIP to assist the company in acquiring horizontal capability, forging partnerships/alliances and expansion in existing verticals or building new verticals.
- The company expects a complete reversal of furloughs and deal ramp-ups to contribute to a sharp uptick in margins in Q4FY24. Further, moderating attrition, peaking out of SG&A expenses, higher offshoring and better utilization would aid in margins uptick in FY25.
- The robust order book at $974 million executable over the next 12 months provides strong revenue visibility with Book to Bill of 0.9. The recent correction of ~19% from 52-week high provides good investment opportunity and entry point from medium to long-term perspective.

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		↔	

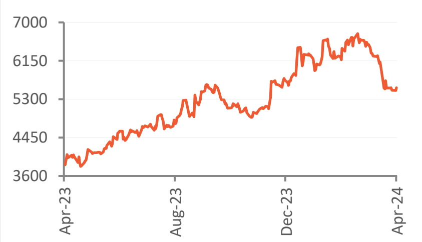
Company details

Market cap:	Rs. 34,304 cr
52-week high/low:	Rs. 6,840 / 3,754
NSE volume: (No of shares)	4.0 lakh
BSE code:	532541
NSE code:	COFORGE
Free float: (No of shares)	6.2 cr

Shareholding (%)

Promoters	0
FII	34
DII	55
Others	11

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-14.7	-8.0	8.9	44.3
Relative to Sensex	-14.8	-10.8	-3.4	19.3

Sharekhan Research, Bloomberg

We met Coforge's management to get an update on the company's outlook and growth plans from QIP. Coforge is looking to raise funds to the tune of Rs 3,200 crore. The QIP proceeds of Rs 3,200 crore would be purely utilised for M&A purposes. The inorganic pursuits would aid the company in acquiring horizontal capability, forging partnerships/alliances and expansion in existing verticals or building new verticals . However, the size and margin profile of the target company would provide clarity whether the M&A would EPS accretive or dilutive. The company is looking to retire debt from internal accruals. The company expects a sharp uptick in EBITDA margin in Q4FY24 owing to complete reversal of furloughs and deal ramp-ups. Further the company has several margin levers such as peaking out of SG&A expenses, moderating attrition, higher offshoring and Utilisation to support margin uptick in FY25-26. The company's robust order book executable over the next 12 months stood at $974 million in Q3FY24, providing strong revenue visibility. The company has consistently performed during the last several quarters despite a challenging environment and the management is confident of achieving the constant revenue growth guidance at the lower end of the guided range of 13-16% for FY24 . We believe that Coforge is well placed to deliver top quadrant performance in FY25 given the robust order book, consistent strong order intake and large deal pipeline. Any material weakness will provide a good investment opportunity. The recent correction of ~19% from 52 week high provides good investment opportunity and entry point from medium to long-term perspective. Hence, we maintain Buy rating with unchanged PT of Rs. 7,670. At the CMP, the stock trades at 26.4x/21.7x its FY25/26E EPS.

- **Fund raising:** The company's board has approved the possible offering of equity shares or other suitable securities with a maximum fund-raising of Rs 3,200 Crore. The avenue for funding includes qualified institutional placement (QIP) or any other legal modalities that are allowed, subject to the necessary permissions, including those from shareholders and regulators. The company will be looking to raise money in several ways, such as through preferential issuance, QIP, private placement, or any other means permitted by current laws. The company is looking at M&A and has identified 6-7 probable entities. Through the M&A , the company is seeking to acquire (1) A horizontal capability such as Cyber Security, Data services and Cloud Operations; (2) Alliance partnerships and (3) Expansion in existing verticals such as Banking and Travel and build new verticals such as Retail, Healthcare and Hi-Tech. The size and margin profile of the target company would provide clarity whether the M&A would EPS accretive or dilutive.
- **Multiple levers to support margins uptick:** Although the company is likely to invest heavily in S&M capabilities, newer sub geos and scaling up of verticals particularly Healthcare, Retail and CMT, the company expects SG&A expenses to be at ~15%. The company had witnessed unusually high furloughs in BFSI which had a higher than anticipated impact on the margins in Q3FY24. The company expects sharp uptick in EBITDA margin in Q4FY24 owing to complete reversal of furloughs and deal ramp ups. The company has adequate margin levers such peaking out of SG&A expenses, moderating attrition, higher offshoring and utilisation. With Utilisation at 79.4% for Q3FY24 there is headroom for uptick. The company expects 150-160 bps EBITDA improvement owing to multiple levers.
- **Robust order book and consistent performance:** The company's order book has been robust with order book executable over next 12 months standing at $974 million, up 15.8% y-o-y which provides strong revenue visibility for the quarters ahead. The company has been consistently winning TCV deals of more than $300 million since the last eight quarters despite the macro-overhang. The company has consistently performed during last several quarters, despite the challenging environment and while its large peers have revised down the revenue growth guidance for FY24, Coforge has maintained the constant currency revenue growth guidance at 13-16% and are confident of achieving the lower end of the guided range. We believe that Coforge is well placed to deliver top quadrant performance in FY25 given the robust order book, consistent strong order intake and large deal pipeline. The recent correction provides good investment opportunity and entry point from medium to long-term perspective.

Our Call

Valuation -Maintain Buy with unchanged PT of Rs 7,670: The company has consistently performed during last several quarters despite challenging environment and is confident of achieving the lower end of the guided range for FY24. The robust order book at $974 million provides strong revenue visibility while margin levers should aid margin uptick in FY25. We expect Sales/PAT CAGR of 17%/32% over FY24-26E. Hence, we maintain Buy rating on Coforge with unchanged PT of Rs. 7,670 as the company is well placed to deliver top quadrant performance in FY25 given the robust order book, consistent strong order intake and large deal pipeline. The stock trades at 26.4x/21.7x its FY25E/26E EPS.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	6432	8,014.6	9,328.5	10,865.3	12,668.2
OPM (%)	17.3	17.5	16.7	18.0	18.9
Adjusted PAT	661.7	811.7	902.8	1,286.1	1,564.0
% YoY growth	39.7	22.7	11.2	42.5	21.6
Adjusted EPS (Rs.)	109.0	133.6	148.4	210.3	255.8
P/E (x)	51.0	41.6	37.4	26.4	21.7
P/B (x)	12.4	11.0	9.3	7.6	6.2
EV/EBIDTA (x)	30.3	24.0	21.4	16.6	13.2
RoNW (%)	25.5	27.9	26.9	31.8	31.5
RoCE (%)	27.3	29.3	29.2	33.3	35.3

Source: Company; Sharekhan estimates

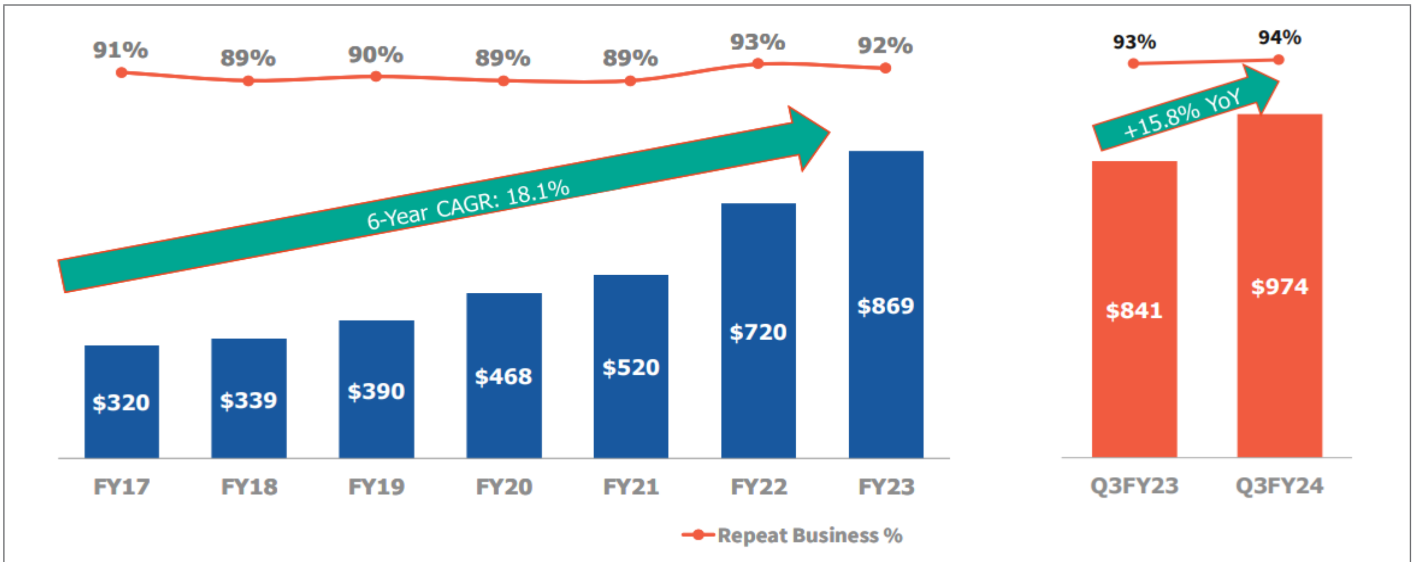
Key management meet takeaways

- The proceeds from QIP of Rs 3,200 crore would be purely utilised for M&A purposes.
- The company has identified 6-7 probable entities for M&A. On meeting the company's objectives and requirements, due diligence would be carried out on the selected entities and the share purchase agreement (SPA) would be signed depending on the valuations of the entity/entities. The QIP would be launched a few days before signing the SPA.
- The company is looking at 3 buckets/asset type from M&A perspective (1) horizontal capability such as Cyber Security, Data services and Cloud Operations; (2) alliance partnerships and (3) existing verticals such as Banking and Travel and build new verticals such as Retail, Healthcare and Hi-Tech.
- Although the approval is being sought to raise funds up to Rs. 3,200 crore, the exact amount to be raised by the Company within this limit will be determined by the board, based on market conditions and commercial factors and there is no guarantee the Company will raise the entire amount for which approval is being sought.
- The QIP would be valid for 1 year and renewed if required.
- The company is considering retiring debt through internal accruals . From the current Net debt position of Rs 501 crore as at the end of Q3FY24, the company aims to reach the Net Cash position by the end of FY25.
- The company expects a recovery in new order intake in Q4FY24 from Q3FY24. Strong order book is expected in Q4FY24 owing to high renewal/repeat business.
- Demand environment remains largely unchanged. Among vertical BFS and Insurance are likely to do well in Q4FY24 as unusually high furloughs witnessed in Q3FY24 are expected to reverse.
- The company expects Q4FY24 EBITDA margin uptick of 150-160 bps largely due to complete reversal of furloughs. For FY25, the company expects incremental ESOP costs to be offset by improving gross margins resulting in flat EBITDA. However, for FY26, the company expects an improvement in EBITDA by 130-150bp as ESOP cost are expected to go down coupled with an improvement in gross margins.
- The company expects hiring uptick in Q4FY24 owing to ramp up of deals in won in BFS and Insurance vertical during the quarter. The company expects fresher hirings of ~1500 in FY25.

Strong revenue visibility

The company reported eight consecutive quarter of $300+ Mn order intake with record order intake of $354 million in Q3FY24. The 12-month order book at $974 is at the highest level and has been growing at ~15%-21% since Q1FY23. The robust orderbook and strong order intake along with provides strong revenue visibility despite challenging environment. Though demand environment stays tough, Coforge expects budgets on BFSI to be focused on transformation space while in case of Travel vertical the demand is for cost take-out initiatives, IT productization, security, Cloud and data solutions. Within BFSI the company expects budget spends to continue towards legacy modernization, cloud migration, digital transformation, and supplier consolidation. BSFI contributed nearly ~54% of revenue for Q3FY24.

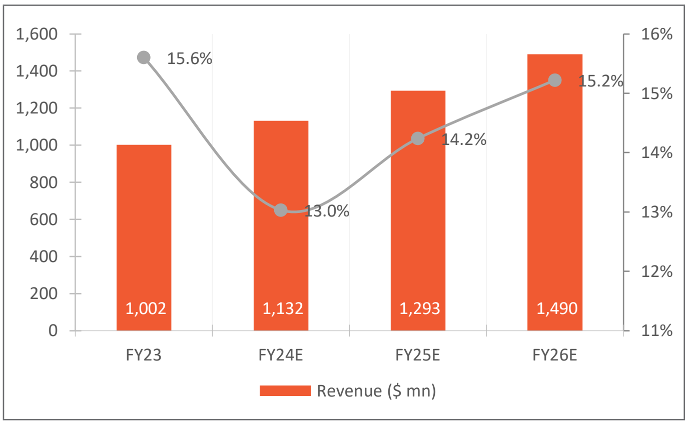
Order book executable over next 12 months ($mn)



Source: Sharekhan Research

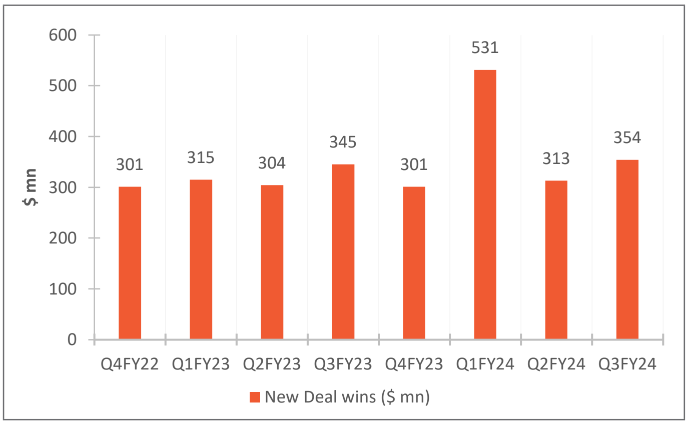
Financials in charts

Revenue growth to pick up from FY2025E



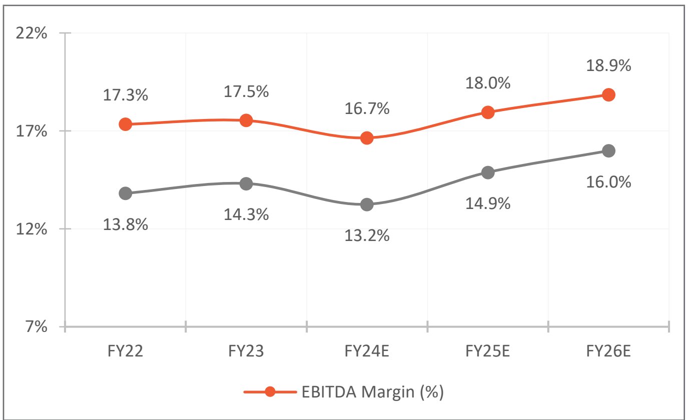
Source: Company, Sharekhan Research

Eight consecutive quarter of deal win TCV more than $300 million



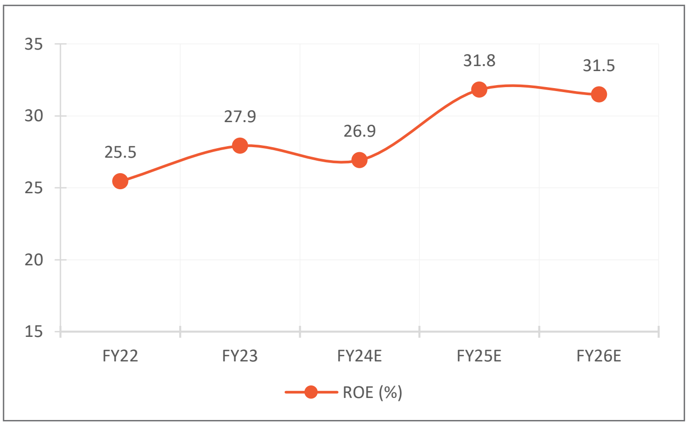
Source: Company, Sharekhan Research

Expect margin to improve over FY2024-FY2026E



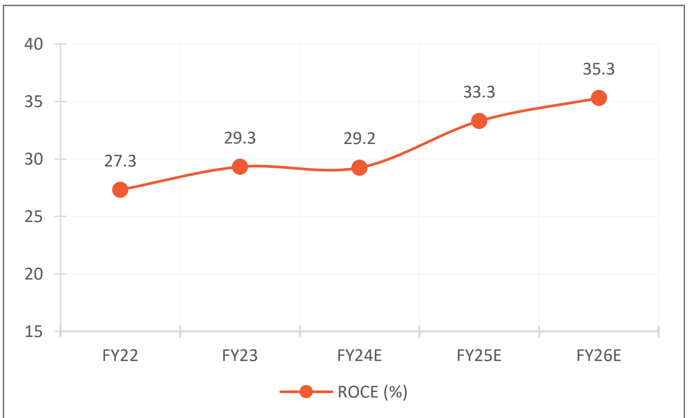
Source: Company, Sharekhan Research

ROE (%)



Source: Company, Sharekhan Research

ROCE (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Macro headwinds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25 aided by lower base coupled with easing sector headwinds. Though the IT sector has already outperformed Nifty last year, we expect overall outperformance in CY24 as well driven by receding headwinds and better earnings visibility.

■ 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 7,670

The company has consistently performed during last several quarters despite challenging environment and is confident of achieving the lower end of the guided range for FY24. The robust order book at $974 million provides strong revenue visibility while margin levers should aid margin uptick in FY25. We expect Sales/PAT CAGR of 17%/32% over FY24-26E. Hence, we maintain Buy rating on Coforge with unchanged PT of Rs. 7,670 as the company is well placed to deliver top quadrant performance in FY25 given the robust order book, consistent strong order intake and large deal pipeline. The stock trades at 26.4x/21.7x its FY25E/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

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

Additional Data

Key management personnel

Sudhir Singh	Chief Executive Officer & ED
Saurabh Goel	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	6.42
2	HDFC Asset Management Co Ltd	6.28
3	Life Insurance Corp of India	6.22
4	Capital Group Cos Inc	4.59
5	Aditya Birla Sun Life Asset Manage	3.94
6	SBI Funds Management Ltd	3.88
7	Vanguard Group Inc	3.61
8	DSP Investment Managers Pvt Ltd	3.34
9	UTI Asset Management Co Ltd	3.27
10	Motilal Oswal Asset Management Co	3.25

Source: Bloomberg

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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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