

NOT RATED**COFORGE**

| IT Services

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CEO indicates demand bottoming out. Tepid recovery

- **CEO believes demand has bottomed out. Industry demand commentary turns positive for the first time in the current cycle**
- **In 1QFY25, BFS saw a temporary blip. Broadbased QoQ growth indicated from 2Q; FY25 EBITDA margin higher than FY24**
- **Cigniti consolidation from 2QFY25. A sharp margin pick up for it likely in FY25. We will be initiating coverage shortly on the sector and stock**

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CEO turns positive for the first time in the cycle: According to Coforge's CEO Sudhir Singh, demand is not just bottoming out, but it is picking up though only at a tepid clip. In the previous quarters his industry growth commentary was cautious, though he was bullish on Coforge's own prospects based on its superior execution capabilities. In a media interview a few months ago Mr Singh 'admitted' to 10-11% organic growth for both itself and for Cigniti, the acquired entity, in FY25. While no specific growth numbers were discussed in the 1QFY25 call, the CEO commentary seems to buttress that number with upsides possible.

Cigniti – consolidation from 2QFY25: Cigniti acquisition is on track and big margin expansion likely in rest of FY25; threat to testing business downplayed. On the Cigniti acquisition, about 28% of shares was acquired and as of 5 July 2024 Coforge is in control of the company and Cigniti's numbers will be consolidated with Coforge from 2QFY25.

Gen AI threat downplayed: The Gen AI threat for Cigniti's testing business was dismissed. Mr Singh stated that Cigniti was acquired to create three new verticals – in healthcare, retail and high tech. He believes that while Coforge will show industry-leading growth, Cigniti will grow faster than Coforge in the coming quarters and years. As indicated by him post the Cigniti acquisition announcement, non-functional testing will help gain business in the Gen AI era especially in mission-critical applications like those used by airlines.

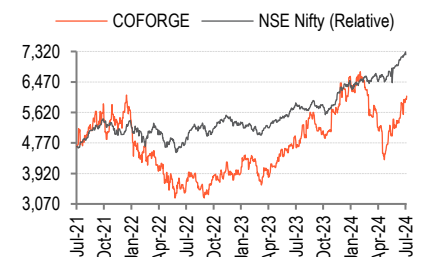
Cigniti's 1QFY25 performance: In 1QFY25 Cigniti delivered 2.4% QoQ US\$ revenue growth (US\$56 mn), 160bps QoQ expansion in EBITDA margin (12.6% vs 11% in 4QFY24). Coforge indicated that it will drive EBITDA margin up to 16% for FY25 for Cigniti.

1QFY25 growth driven by non-BFSI verticals: Growth was driven by 'others' (Healthcare, Retail, Hi-Tech and Manufacturing), Travel, Tourism and Hospitality (TTH) and government verticals. The BFSI sector showed a QoQ decline for Coforge, unlike many of its peers in 1QFY25.

| | |
|------------------|---------------------|
| Ticker/Price | COFORGE IN/Rs 6,179 |
| Market cap | US\$ 4.6bn |
| Free float | 43% |
| 3M ADV | US\$ 47.1mn |
| 52wk high/low | Rs 6,847/Rs 4,287 |
| Promoter/FPI/DII | 70%/13%/17% |

Source: NSE | Price as of 23 Jul 2024

Stock performance



Source: NSE



- 1QFY25 results were impacted by weak BFS growth, which Coforge says will reverse from 2Q.
- Coforge revenue growth was tepid at 1.6% QoQ CC growth. Growth was 7.8% YoY in constant currency terms.
- Coforge's CEO indicated that after scorching growth in the Banking space over the last two years, 1QFY25 saw a bit of normalisation. He stated that growth would pick up again from 2QFY25 and that BFS would deliver double-digit growth for the full year. In fact, Coforge expects to see broad-based growth QoQ from 2QFY25 across all its verticals.
- Unlike the past first quarter results, Coforge has come up with a strong gross margin (GM) performance on a QoQ basis. GM fell by only 110bps in a quarter where the company supposedly took a salary hike starting from 1 April 2024 for the entire workforce. In 1QFY24 and in 1QFY23 the QoQ GM compression was 350bps and 290bps respectively. Coforge shifted its salary cycle from 1 Apr to 1 Jul. The reason according to Coforge was to be in line with the industry. Three months ago the company had indicated continuance of the 1 Apr salary increase.
- Also, it indicated salary hikes will be moderated this year unlike in past years (impact of 140-150bps compared to 200-250bps in the past) as its average resource cost (ARC) shot up by 40% over the last two and half years. Mr Singh indicated hiring of a new delivery head soon who would help control ARC and help deliver the 50bps adj EBITDA margin expansion in FY25 vs FY24.
- Total order intake of US\$ 314mn during the quarter was the 10th consecutive quarter of US\$ 300mn+ of order intake. Order book executable over the next 12 months stands at US\$ 1,070mn, 19.3% YoY growth.
- The top 5 clients showed weakish growth on a QoQ basis considering that it consists largely of banking clients.
- For FY25, ESOP costs are expected to be 160-170bps vs 116bps in FY24.

Fig 1 – 1QFY25 performance

| Y/E March | 1QFY24 | 4QFY24 | 1QFY25 | YoY (%) | QoQ (%) | 1QFY25E | Dev (%) |
|---|--------|--------|--------|---------|---------|---------|---------|
| Net Sales (USD mn) | 271.8 | 286.8 | 291.4 | 7.2 | 1.6 | 291.4 | - |
| Net Sales | 22,210 | 23,585 | 24,008 | 8.1 | 1.8 | 24,291 | (1.2) |
| Direct Cost | 15,414 | 15,551 | 16,097 | 4.4 | 3.5 | 16,540 | (2.7) |
| Gross Profit | 6,796 | 8,034 | 7,911 | 16.4 | (1.5) | 7,751 | 2.1 |
| % of Sales | 30.6 | 34.1 | 33.0 | - | - | 31.9 | - |
| SG&A | 3,264 | 3,561 | 3,625 | 11.1 | 1.8 | 3,647 | (0.6) |
| % of Sales | 14.7 | 15.1 | 15.1 | - | - | 15.0 | - |
| EBITDA | 3,532 | 4,473 | 4,286 | 21.3 | (4.2) | 4,104 | 4.4 |
| EBITDA Margin (%) | 15.9 | 19.0 | 17.9 | - | - | 16.9 | - |
| Depreciation | 757 | 846 | 815 | 7.7 | (3.7) | 871 | (6.5) |
| Cost of ESOPs | 216 | 222 | 199 | (7.9) | (10.4) | 500 | (60.2) |
| ESOP Cost (%age of sales) | 0.97 | 0.94 | 0.83 | - | - | 2.06 | - |
| EBIT | 2,559 | 3,405 | 3,272 | 27.9 | (3.9) | 2,733 | 19.7 |
| EBIT Margin (%age of sales) | 11.5 | 14.4 | 13.6 | - | - | 11.2 | - |
| Other Income | (152) | (452) | (272) | - | - | (133) | 105.1 |
| Acquisition Related Expenses | - | 96 | 953 | - | - | - | - |
| Exceptional Items | 165 | - | - | - | - | - | - |
| Profit Before Tax | 2,242 | 2,857 | 2,047 | (8.7) | (28.4) | 2,600 | (21.3) |
| Provision for Taxation - Current & Deferred | 485 | 564 | 654 | 34.8 | 16.0 | 525 | 24.5 |
| Effective Tax Rate | 21.6 | 19.7 | 31.9 | - | - | 20.2 | - |
| Net Profit | 1,757 | 2,293 | 1,393 | (20.7) | (39.2) | 2,075 | (32.9) |
| Minority Share of Net Profit | 104 | 55 | 61 | - | - | 70 | - |
| Reported PAT | 1,653 | 2,238 | 1,332 | (19.4) | (40.5) | 1,939 | (31.3) |
| Adjusted PAT | 1,782 | 2,334 | 2,285 | - | - | 1,939 | 17.8 |
| NPM (%) | 8.0 | 9.9 | 9.5 | - | - | 8.0 | - |

Source: Company, BOBCAPS Research

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Note: Recommendation structure changed with effect from 21 June 2021

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