

HOLD
 TP: Rs 4,830 | ▲ 0%

COFORGE

| Technology & Internet

| 21 July 2023

Miss on margins; deal momentum strong

- Q1 revenue in line at US\$ 272mn led by BFSI but EBIT margin at 10% fell short of estimates
- Quarterly TCV the highest ever at US\$ 531mn; spends by retail & commercial banks (ex-mortgage) expected to continue
- Valuations fair post recent rally; maintain HOLD with a TP of Rs 4,830 (unchanged), based on 24x FY25E EPS

Saptarshi Mukherjee
 research@bobcaps.in

Broad-based revenue growth: Coforge’s Q1FY24 revenue increased 2.7% QoQ CC and was spread across service lines. BFS/insurance led the way, rising 4.7%/3.1% QoQ, while the travel, transportation & hospitality (TTH) vertical was up 1.2% QoQ. Growth momentum in BFSI was backed by the recent ramp-up in large deals and robust traction in top accounts. Among geographies, the US (+5.8% QoQ) market helmed growth even as the EU and ROW slowed. Management maintained its FY24 dollar revenue growth guidance of 13-16% YoY CC.

Strong deal momentum: Q1 saw the highest ever deal TCV for Coforge at US\$ 531mn, backed by two large wins in the BFS vertical and includes a US\$ 300mn project from an existing BFSI client with a minimum average contract value of US\$ 60mn+. These wins resulted in a robust 12M executable order book of US\$ 897m (+20% YoY).

Steep miss on margins; guided to improve gradually: EBIT margin contracted 168bps QoQ to 10.1% in Q1 vs. our estimate of 13.6% due to the full impact of compensation hikes, a bigger bench, visa costs and continued investments toward sales. Management is confident of a sharp margin recovery on the back of ramp-ups in large margin-accretive deals, rising utilisation and an improved offshore mix for the sales team.

Valuation fair post rally; retain HOLD: The stock is trading at 27.5x/24x FY24E/ FY25E EPS. Coforge aspires to achieve above-industry growth of 7-10% in FY24 and is confident of clocking quarterly growth of 3-4%. Consistent deal wins in a stressed demand environment and good revenue visibility support our positive outlook on the company. However, following the recent runup in stock price, valuations look fair, leading us to retain our HOLD rating. Our TP stays at Rs 4,830 based on 24x FY25E EPS – a 20% discount to midcap peer PSYS

Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	COFORGE IN/Rs 4,819
Market cap	US\$ 3.7bn
Free float	43%
3M ADV	US\$ 17.2mn
52wk high/low	Rs 5,055/Rs 3,210
Promoter/FPI/DII	70%/13%/17%

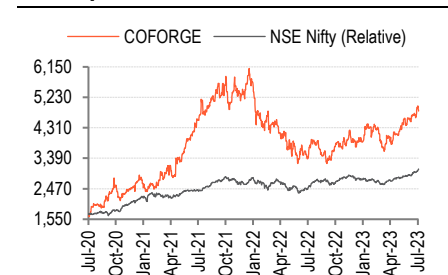
Source: NSE | Price as of 20 Jul 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	80,146	92,191	1,00,830
EBITDA (Rs mn)	14,062	16,318	18,351
Adj. net profit (Rs mn)	6,847	10,566	12,142
Adj. EPS (Rs)	113.4	175.0	201.1
Consensus EPS (Rs)	113.4	176.0	197.0
Adj. ROAE (%)	22.1	28.3	27.5
Adj. P/E (x)	42.5	27.5	24.0
EV/EBITDA (x)	20.6	17.8	15.8
Adj. EPS growth (%)	6.0	54.3	14.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

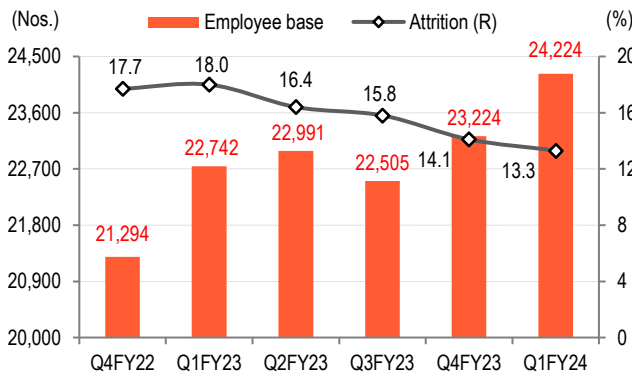


Fig 1 – Quarterly performance

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue (US\$ mn)	272	264	239	3.0	13.7	273	(0.4)
Revenue (Rs mn)	22,210	21,700	18,294	2.4	21.4	22,441	(1.0)
EBIT	2,242	2,556	2,288	(12.3)	(2.0)	3,052	(26.5)
PAT	1,757	1,148	1,497	53.0	17.4	2,156	(18.5)
EBIT Margin (%)	10.1	11.8	12.5	(168bps)	(241bps)	13.6	(351bps)
PAT Margin (%)	7.9	5.3	8.2	262bps	(27bps)	9.6	(170bps)

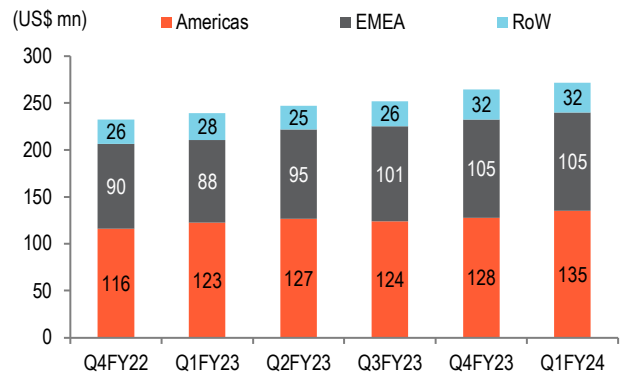
Source: Company, BOBCAPS Research

Fig 2 – Employee base and Attrition



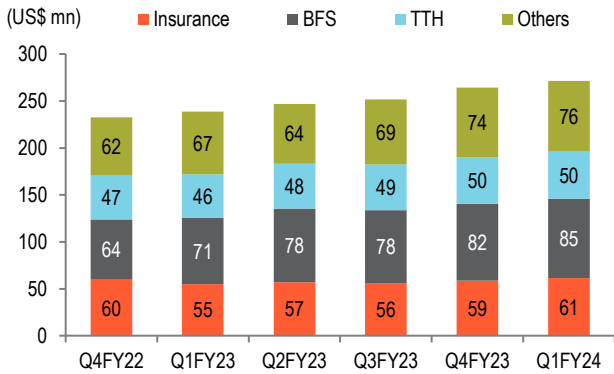
Source: Company, BOBCAPS Research

Fig 3 – Revenue by geography



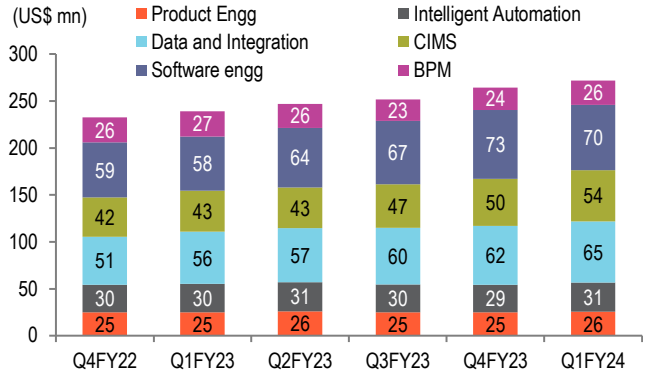
Source: Company, BOBCAPS Research

Fig 4 – Revenue by vertical



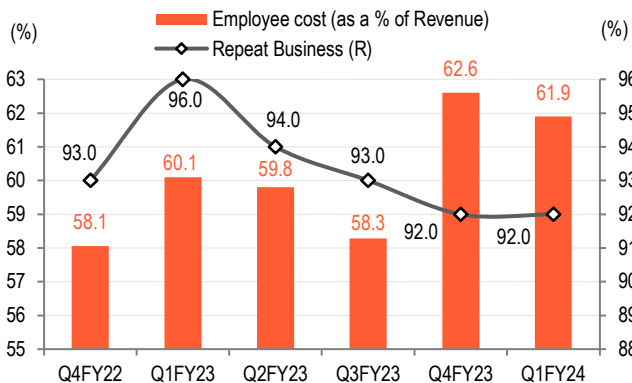
Source: Company, BOBCAPS Research

Fig 5 – Revenue by business segment



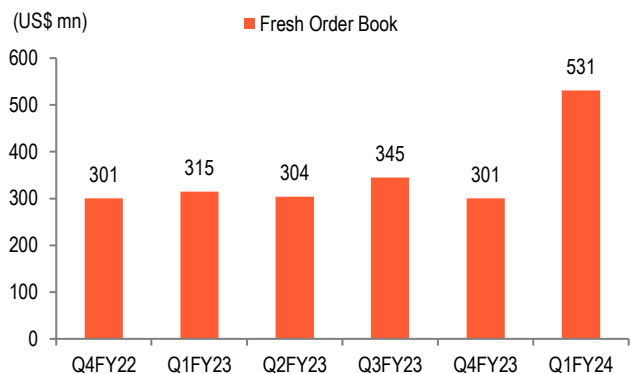
Source: Company, BOBCAPS Research

Fig 6 – Employee cost and Repeat business



Source: Company, BOBCAPS Research

Fig 7 – Fresh order book



Source: Company, BOBCAPS Research

Earnings call highlights

- Coforge's revenue grew 2.7% QoQ CC in Q1FY24 underpinned by two large deal wins, six logo additions and a focus on strong execution.
- Management retained FY24 revenue guidance of 13-16% growth in CC terms and expects 50bps improvement in gross margin.
- The company clocked its highest ever deal wins at US\$ 531mn TCV (North Americas US\$ 155mn, EMEA US\$ 346mn, and ROW US\$ 30mn).
- The travel and transportation vertical remained muted this quarter, indicating initial signs of softness in the segment.
- The company added 1,000 employees during the quarter, of which 200 were freshers. Utilisation was roughly flat at 81% and attrition dropped to 13.3%.
- Annual increments were rolled out in April.

Valuation methodology

The stock is trading at 27.5x/24x FY24E/ FY25E EPS. Coforge aspires to achieve above-industry growth of 7-10% in FY24 and is confident of clocking quarterly growth of 3-4%. Consistent deal wins in a stressed demand environment and good revenue visibility support our positive outlook on the company.

However, following the recent runup in stock price, valuations look fair, leading us to retain our HOLD rating. Our TP stays at Rs 4,830 based on 24x FY25E EPS – a 20% discount to midcap peer PSYS.

Key risks

- Above-expected improvement in the BFSI, retail and hi-tech verticals in developed economies represents an upside risk to our estimates.
- Further cuts in IT-related spends by clients represents a key downside risk.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.3	1,064	1,110	HOLD
Coforge	COFORGE IN	3.7	4,819	4,830	HOLD
HCL Technologies	HCLT IN	38.2	1,156	1,240	HOLD
Infosys	INFO IN	74.2	1,450	1,760	BUY
Mphasis	MPHL IN	5.0	2,214	2,541	BUY
Persistent Systems	PSYS IN	4.9	5,044	5,330	HOLD
Tata Consultancy Services	TCS IN	154.2	3,463	3,580	HOLD
Tech Mahindra	TECHM IN	13.3	1,253	1,130	HOLD
Wipro	WPRO IN	27.9	418	420	HOLD

Source: BOBCAPS Research, NSE | Price as of 20 Jul 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Total revenue	46,628	64,320	80,146	92,191	1,00,830
EBITDA	7,555	11,395	14,062	16,318	18,351
Depreciation	1,836	2,272	2,585	2,384	2,384
EBIT	5,719	8,669	11,232	13,934	15,967
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	113	(266)	(630)	252	252
Exceptional items	0	0	0	0	1
EBT	6,182	8,647	9,276	14,186	16,219
Income taxes	1,302	1,689	2,061	3,192	3,649
Extraordinary items	350	241	0	0	0
Min. int./Inc. from assoc.	104	495	368	428	428
Reported net profit	4,776	6,462	6,847	10,566	12,142
Adjustments	0	0	0	0	1
Adjusted net profit	4,776	6,462	6,847	10,566	12,142

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	6,238	10,918	11,030	11,417	12,482
Provisions	921	697	1,098	1,263	1,381
Debt funds	0	0	0	0	0
Other liabilities	194	766	766	766	766
Equity capital	606	609	609	609	609
Reserves & surplus	24,055	27,705	33,127	40,307	46,847
Shareholders' fund	24,661	28,314	33,736	40,916	47,456
Total liab. and equities	32,014	40,695	46,630	54,362	62,086
Cash and cash eq.	7,999	4,535	6,542	12,261	16,236
Accounts receivables	5,562	10,567	10,979	12,629	15,194
Inventories	3	3	3	3	3
Other current assets	4,398	4,952	11,053	13,801	14,984
Investments	3,013	3,550	3,550	3,550	3,550
Net fixed assets	9,592	15,591	13,006	10,622	10,622
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	1,447	1,497	1,497	1,497	1,497
Other assets	0	0	0	0	0
Total assets	32,014	40,695	46,630	54,362	62,086

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash flow from operations	8,452	8,875	3,913	9,381	12,505
Capital expenditures	(757)	(3,841)	(2,000)	(3,000)	(4,000)
Change in investments	(246)	0	0	0	0
Other investing cash flows	(1,552)	18	(4,433)	3,152	(146)
Cash flow from investing	(2,555)	(3,823)	(6,433)	152	(4,146)
Equities issued/Others	(4,148)	51	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	1,543	0	0	0
Dividends paid	(686)	(3,111)	(2,472)	(3,815)	(4,384)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(4,834)	(1,517)	(2,472)	(3,815)	(4,384)
Chg in cash & cash eq.	1,063	3,535	(4,992)	5,718	3,975
Closing cash & cash eq.	7,999	11,534	6,542	12,261	16,236

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	79.1	107.1	113.4	175.0	201.1
Adjusted EPS	79.1	107.1	113.4	175.0	201.1
Dividend per share	26.1	42.8	34.0	52.5	60.3
Book value per share	396.0	454.7	541.7	657.1	762.1

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	6.3	4.5	3.6	3.2	2.9
EV/EBITDA	38.8	25.6	20.6	17.8	15.8
Adjusted P/E	60.9	45.0	42.5	27.5	24.0
P/BV	12.2	10.6	8.9	7.3	6.3

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	77.3	74.7	73.8	74.5	74.9
Interest burden (PBT/EBIT)	108.1	99.7	82.6	101.8	101.6
EBIT margin (EBIT/Revenue)	12.3	13.5	14.0	15.1	15.8
Asset turnover (Rev./Avg TA)	143.9	176.9	183.6	182.6	173.2
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.4	1.4	1.3
Adjusted ROAE	19.6	24.4	22.1	28.3	27.5

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Revenue	11.4	37.9	24.6	15.0	9.4
EBITDA	1.7	50.8	23.4	16.0	12.5
Adjusted EPS	8.5	35.3	6.0	54.3	14.9
Profitability & Return ratios (%)					
EBITDA margin	16.2	17.7	17.5	17.7	18.2
EBIT margin	12.3	13.5	14.0	15.1	15.8
Adjusted profit margin	10.2	10.0	8.5	11.5	12.0
Adjusted ROAE	19.6	24.4	22.1	28.3	27.5
ROCE	17.3	20.9	21.3	24.2	25.9
Working capital days (days)					
Receivables	44	46	49	47	50
Inventory	0	0	0	0	0
Payables	83	89	83	69	64
Ratios (x)					
Gross asset turnover	4.8	5.1	5.6	7.8	9.5
Current ratio	2.6	1.7	2.4	3.1	3.4
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.2)	(0.2)	(0.3)	(0.3)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

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BUY – Expected return >+15%

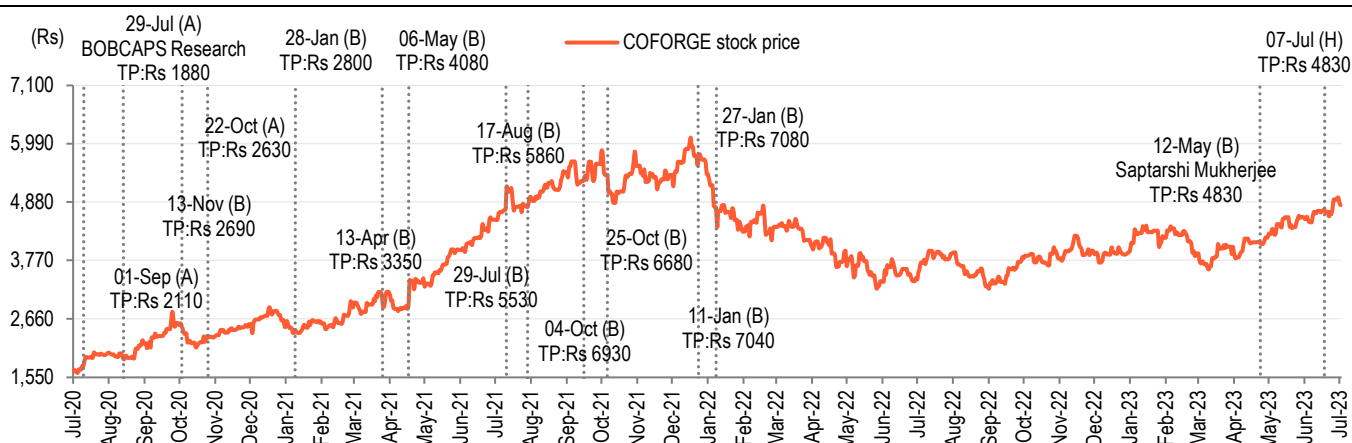
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): COFORGE (COFORGE IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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