

BUY

TP: Rs 6,680 | ▲ 24%

COFORGE

| Technology & Internet

| 25 October 2021

Strong Q2 performance coupled with large deals

- Robust Q2 revenue growth of 6.6% QoQ USD led by BFSI; EBIT margin in line at 14.8% (+230bps QoQ)
- Organic revenue growth guidance for FY22 raised to 22%+ YoY CC backed by highest-ever executable order book of US\$ 688mn
- We cut FY22/FY23 EPS 4%/3% on lower exchange rate estimates, and revise our Sep'22 TP to Rs 6,680 (from Rs 6,930) – retain BUY

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In-line performance: Coforge's Q2FY22 revenue grew 6.6% QoQ USD/7.5% QoQ CC, in line with our estimate of 6.8%/7.4%. Excluding SLK Global, revenue was up 3.9% QoQ CC. BFS spearheaded growth at 22.6% QoQ in rupee terms aided by inorganic revenue, continuing the stellar performance from last quarter. Recovery in the transportation vertical was a bit subdued at 5.7% QoQ. Insurance failed to recover with flattish growth of 1.8% due to delays in 'Advantage Go' license revenue. This will flow through in Q3, per management.

EBIT margin expands: EBIT margin stood at 14.8% (+230bps QoQ), in line with our estimate of 15%. Cost of revenue and SGA declined 220bps and 20bps QoQ respectively. Margin expansion was aided by (1) higher utilisation (+150bps QoQ to 78.5%), (2) ramp-up of deals in offshore locations, and (3) offshore pyramid optimisation.

Record executable order book: Coforge's executable orders for the next 12 months stood at a record US\$ 688mn, up 41% YoY and 7% QoQ. The company bagged three large deals, of which two were over US\$ 50mn TCV each. Order intake was robust with 11 new logos and totaled US\$ 285mn, comprising US\$ 123mn from the US, US\$ 114mn from EMEA and US\$ 48mn from RoW.

FY22 guidance raised: On the basis of a robust pipeline comprising large deals, ~40% YoY revenue growth in H1FY22 and good operating margins, management has raised organic revenue growth guidance to 'at least' 22% CC for FY22. This comes after back-to-back guidance upgrades over the last two quarters. SLK Global business is also expected to grow 22% YoY CC. EBITDA margin growth is guided at 40% USD YoY at 19% (vs. 18% in FY21). Management expects Insuretech to recover well in H2 as license revenues from 'Advantage Go' come through.

Maintain BUY: We cut FY22/FY23/FY24 EPS estimates by 4%/3%/6% as we reduce USDINR exchange rates and normalise FY24 revenue growth assumptions. Our Sep'22 TP thus reduces to Rs 6,680 (vs. Rs 6,930), based on an unchanged one-year forward P/E multiple of 35x which is 3SD above the stock's five-year mean. Maintain BUY given the strong all-round Q2 performance and sturdy deal pipeline.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	COFORGE IN/Rs 5,398
Market cap	US\$ 4.5bn
Free float	43%
3M ADV	US\$ 38.9mn
52wk high/low	Rs 6,030/Rs 2,078
Promoter/FPI/DII	70%/13%/17%

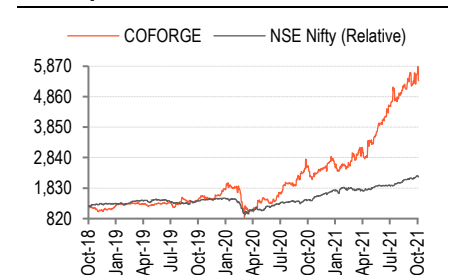
Source: NSE | Price as of 22 Oct 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	46,628	63,876	77,035
EBITDA (Rs mn)	8,035	11,913	14,943
Adj. net profit (Rs mn)	4,556	7,631	10,445
Adj. EPS (Rs)	75.0	125.6	172.0
Consensus EPS (Rs)	75.0	112.9	143.0
Adj. ROAE (%)	18.6	28.4	32.8
Adj. P/E (x)	72.0	43.0	31.4
EV/EBITDA (x)	41.0	27.5	21.8
Adj. EPS growth (%)	2.9	67.5	36.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Other highlights

- **Good supply-side management:** Coforge hired 877 new employees in Q2FY22 (including those inducted from the SLK Global acquisition), down from 7,480 hired in Q1FY22. Attrition also picked up (by 270bps QoQ to 15%), in line with the trend across the sector. Although elevated, this level of attrition is modest for a tier-II IT company in an environment of extreme supply pressure (peer churn at 17-20% in Q2).
- **Margin levers:** Offshoring is expected to be a key margin lever along with pyramid optimisation. Coforge will increase hiring of fresh graduates six-fold in FY22 (to 1,500) vs. two years ago.
- **Travel vertical:** Management expects travel revenue for FY22 to be similar to FY20 levels as the vertical recovers ground in the next two quarters. However, European travel clients will take time to revive; hence, the flow-through from their recovery will take place in FY23. Most pricing discounts on travel deals have been rolled back.
- **Client concentration:** Coforge has 61 Fortune-1000 companies in its client portfolio vs. less than 10 four years ago. It is trying to aggressively reduce top client concentration, with top 5/top 10 client share in revenue down from 25%/36% in Q1 to 23%/33% in Q2.
- **Dividend:** The board has recommended an interim dividend of Rs 13/sh.

Fig 1 – Quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenue (US\$ mn)	212.8	154.9	37.4	199.7	6.6	413	295	40.1
Revenue	15,694	11,537	36.0	14,616	7.4	30,310	22,107	37.1
Operating Expenditure	12,771	9,365	36.4	12,257	4.2	25,028	18,249	37.1
Cost of revenues	10,656	7,776	37.0	10,250	4.0	20,906	15,016	39.2
as % of sales	67.9	67.4	-	70.1	-	69.0	67.9	-
SG&A expenses	2,115	1,589	33.1	2,007	5.4	4,122	3,233	27.5
as % of sales	13.5	13.8	-	13.7	-	13.6	14.6	-
EBITDA	2,923	2,172	34.6	2,359	23.9	5,282	3,858	36.9
Depreciation	598	460	30.0	524	14.1	1,122	925	21.3
EBIT	2,325	1,712	35.8	1,835	26.7	4,160	2,933	41.9
Other Income	(128)	(63)	-	(44)	-	(172)	(15)	-
PBT	2,062	1,525	35.2	1,632	26.3	3,694	2,614	41.3
Total Tax	446	303	47.2	320	39.4	766	563	36.1
Adjusted PAT	1,616	1,222	32.2	1,312	23.2	2,928	2,051	42.8
(Profit)/loss from JV's/Ass/MI	148.0	15	-	76.0	-	224	45	-
APAT after MI	1,468	1,207	21.6	1,236	18.8	2,704	2,006	34.8
Extra ordinary items	51	124	-	96	-	147	304	-
Reported PAT	1,519	1,331	14.1	1,332	14.0	2,851	2,310	23.4
Reported EPS	24.2	19.4	24.7	20.4	18.8	44.5	32.2	38.2

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Margins (%)			(bps)		(bps)			(bps)
EBITDA	18.6	18.8	(20)	16.1	249	17.4	17.4	(2)
EBIT	14.8	14.8	(2)	12.6	226	13.7	13.3	46
EBT	13.1	13.2	(8)	11.2	197	12.2	11.8	37
PAT	9.7	11.5	(186)	9.1	57	8.9	9.1	(15)
Effective Tax rate	21.6	19.9	176	19.6	202	20.7	21.5	(81)

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

(in INR terms)	Q2FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Geography			
North America	52.0	8.2	47.4
Europe	32.0	(2.7)	20.9
RoW	15.0	22.9	27.5
Revenue by Vertical			
Banking and Financial Services	24.1	22.6	92.8
Insurance	29.2	1.8	16.8
Transportation	18.6	5.7	33.2
Other	28.1	3.3	27.4
Revenue Mix Onsite/Offshore			
Offshore	44.0	40.4	66.3
Onsite	56.0	14.2	19.0
Client Concentration			
Top 5	23.0	0.4	25.1
Non Top 5 client	77.0	9.7	39.7
Top 10	33.0	(1.3)	24.7
Number of employees	20,748	877	9,586
Attrition (%)	15.3	270bps	480bps
Utilisation	78.5	150bps	(250bps)
DSO (Days)	66	(5)	(9)

	Q2FY22	Q1FY22	Q2FY21
Significant New Customer Addition			
USA	6	6	7
Europe	5	4	3
ROW	0	1	0
Total	11	11	10
Fresh order intake (US\$ mn)			
USA	123	46	121
Europe	114	227	58
ROW	48	46	21
Total	285	319	200
Executable orders over next 12 months (US\$ mn)			
	688	645	489

Source: Company, BOBCAPS Research

Valuation methodology

Coforge has upgraded its FY22 organic revenue growth guidance to 'at least' 22% YoY CC (from 19% CC), backed by a 41% YoY increase in executable order book and three large deal wins in Q2FY22.

Post Q2, we pare FY22/FY23/FY24 EPS estimates by 4%/3%/6% as we reduce USDINR exchange rates and normalise FY24 revenue growth assumptions. Our Sep'22 TP thus reduces to Rs 6,680 (vs. Rs 6,930), based on an unchanged one-year forward P/E multiple of 35x, which is three standard deviations above the stock's five-year mean. Our valuation factors in the steady earnings upgrades, upbeat growth outlook, record executable order book and timely revenue diversification. Reiterate BUY.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	860	1,014	1169	857	1,009	1,197	0.3	0.5	(2.4)
YoY growth (%)	37.1	17.9	15.3	36.7	17.6	18.7	-	-	-
Revenues	63,876	77,035	88,865	64,635	78,938	93,680	(1.2)	(2.4)	(5.1)
EBITDA (post RSU)	11,913	14,943	17,493	11,963	15,313	18,454	(0.4)	(2.4)	(5.2)
EBITDA margins (%)	18.6	19.4	19.7	18.5	19.4	19.7	-	-	-
Net Profits	7,631	10,445	12,684	7,949	10,739	13,445	(4.0)	(2.7)	(5.7)
EPS (Rs)	125.6	172.0	208.9	130.9	176.8	221.4	(4.0)	(2.7)	(5.7)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn) (reported)	627.4	860.1	1013.6	1168.9
YoY Growth (%)	5.8	37.1	17.9	15.3
EBITDA Margin (%)	17.2	18.6	19.4	19.7

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E(%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS IN	BUY	4,630	13.8	103.4	119.7	39.4	37.4	36.5
INFO IN	BUY	2,000	14.4	53.9	59.5	29.6	30.7	32.0
WPRO IN	BUY	840	18.4	23.4	26.9	21.2	21.6	28.8
HCLT IN	BUY	1,440	10.7	49.1	55.2	20.3	20.5	24.6
TECHM IN	BUY	1,660	14.1	66.8	78.1	21.9	22.7	27.8
LTI IN	BUY	7,980	21.1	134.5	161.8	29.5	29.9	46.0
MPHL IN	HOLD	3,510	16.1	76.5	92.6	21.0	23.6	35.0
MTCL IN	SELL	3,390	21.0	94.1	100.2	33.0	29.8	36.0
PSYS IN	HOLD	3,560	21.0	74.0	91.5	19.9	21.5	35.0
COFORGE IN	BUY	6,680	27.1	125.6	172.0	28.4	32.8	35.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- challenges at the company's top clients,
- recovery taking longer to materialise in the travel vertical, and
- increased competition in the BFS vertical.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,154	1,240	BUY
Coforge	COFORGE IN	4.5	5,398	6,680	BUY
eClerx Services	ECLX IN	1.0	2,049	2,880	BUY
HCL Technologies	HCLT IN	43.3	1,194	1,440	BUY
IndiaMart InterMesh	INMART IN	3.2	7,912	8,430	HOLD
Info Edge	INFOE IN	10.8	6,290	6,530	BUY
Infosys	INFO IN	97.8	1,720	2,000	BUY
Just Dial	JUST IN	0.7	821	1,190	BUY
L&T Infotech	LTI IN	15.3	6,544	7,980	BUY
Mindtree	MTCL IN	10.0	4,534	3,390	SELL
Mphasis	MPHL IN	8.1	3,255	3,510	HOLD
Persistent Systems	PSYS IN	4.1	3,872	3,560	HOLD
Tata Consultancy Services	TCS IN	175.3	3,499	4,630	BUY
Tech Mahindra	TECHM IN	17.7	1,517	1,660	BUY
Wipro	WPRO IN	50.3	682	840	BUY

Source: BOBCAPS Research, NSE | Price as of 22 Oct 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	41,839	46,628	63,876	77,035	88,835
EBITDA	7,431	8,035	11,913	14,943	17,493
Depreciation	1,730	1,836	2,060	2,028	2,180
EBIT	5,701	6,199	9,852	12,915	15,313
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	462	113	305	1,103	1,538
Exceptional items	0	0	0	0	0
EBT	5,978	5,962	10,158	14,017	16,851
Income taxes	1,203	1,302	2,031	2,944	3,539
Extraordinary items	185	350	0	0	0
Min. int./Inc. from assoc.	236	104	496	628	628
Reported net profit	4,539	4,556	7,631	10,445	12,684
Adjustments	0	0	0	0	0
Adjusted net profit	4,539	4,556	7,631	10,445	12,684

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	7,526	6,238	11,206	13,477	15,514
Provisions	922	921	6,300	7,598	8,762
Debt funds	0	0	0	0	0
Other liabilities	387	295	295	295	295
Equity capital	625	606	606	606	606
Reserves & surplus	23,340	24,285	28,242	34,288	41,494
Shareholders' fund	23,965	24,891	28,848	34,894	42,100
Total liab. and equities	32,800	32,345	46,650	56,264	66,671
Cash and cash eq.	8,195	7,999	13,950	20,772	28,932
Accounts receivables	5,672	5,911	12,775	15,407	17,767
Inventories	3	3	3	3	3
Other current assets	3,976	4,398	6,947	8,137	9,204
Investments	3,651	3,013	3,013	3,013	3,013
Net fixed assets	10,001	9,592	8,532	7,504	6,323
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	1,302	1,429	1,429	1,429	1,429
Other assets	0	0	0	0	0
Total assets	32,800	32,345	46,650	56,264	66,671

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	3,601	9,157	10,319	11,747	13,728
Capital expenditures	(703)	(757)	(1,000)	(1,000)	(1,000)
Change in investments	3,702	21	0	0	0
Other investing cash flows	(1,041)	(1,552)	305	1,103	1,538
Cash flow from investing	1,958	(2,288)	(695)	103	538
Equities issued/Others	275	(4,148)	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(1,469)	(686)	(3,673)	(5,028)	(6,106)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(1,194)	(4,834)	(3,673)	(5,028)	(6,106)
Chg in cash & cash eq.	4,365	2,035	5,951	6,821	8,160
Closing cash & cash eq.	8,197	7,999	13,950	20,772	28,932

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	72.9	75.0	125.6	172.0	208.9
Adjusted EPS	72.9	75.0	125.6	172.0	208.9
Dividend per share	10.0	24.8	50.3	68.8	83.5
Book value per share	384.8	399.7	463.3	560.3	676.1

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	7.9	7.1	5.1	4.2	3.6
EV/EBITDA	44.6	41.0	27.5	21.8	18.2
Adjusted P/E	74.1	72.0	43.0	31.4	25.8
P/BV	14.0	13.5	11.7	9.6	8.0

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	75.9	76.4	75.1	74.5	75.3
Interest burden (PBT/EBIT)	104.9	96.2	103.1	108.5	110.0
EBIT margin (EBIT/Revenue)	13.6	13.3	15.4	16.8	17.2
Asset turnover (Rev./Avg TA)	138.5	143.2	161.7	149.7	144.5
Leverage (Avg TA/Avg Equity)	1.4	1.3	1.5	1.6	1.6
Adjusted ROAE	20.3	18.6	28.4	32.8	32.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	13.8	11.4	37.0	20.6	15.3
EBITDA	15.2	8.1	48.3	25.4	17.1
Adjusted EPS	10.1	2.9	67.5	36.9	21.4
Profitability & Return ratios (%)					
EBITDA margin	17.8	17.2	18.6	19.4	19.7
EBIT margin	13.6	13.3	15.4	16.8	17.2
Adjusted profit margin	10.8	9.8	11.9	13.6	14.3
Adjusted ROAE	20.3	18.6	28.4	32.8	32.9
ROCE	17.7	18.5	30.4	43.5	54.8
Working capital days (days)					
Receivables	48	45	53	67	68
Inventory	0	0	0	0	0
Payables	90	83	117	136	133
Ratios (x)					
Gross asset turnover	4.6	4.8	7.0	9.6	12.8
Current ratio	2.3	2.6	1.9	2.1	2.3
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.3)	(0.5)	(0.6)	(0.7)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

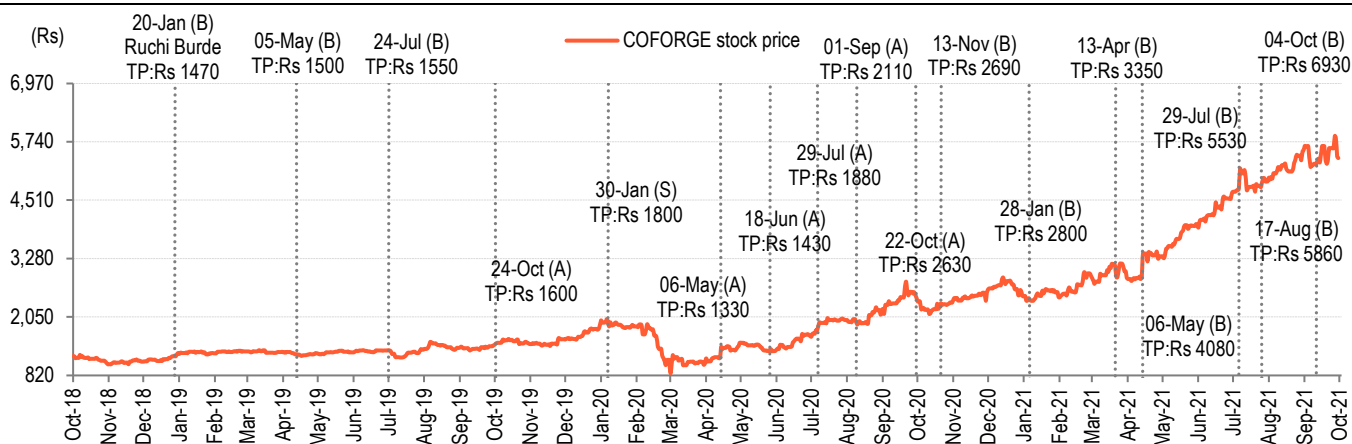
HOLD – Expected return from -6% to +15%

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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