

BSE SENSEX 63,168
S&P CNX 18,755

CMP: INR4,562 TP: INR4,290 (-6%) Neutral

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Stock Info

	COFORGE IN
Bloomberg	
Equity Shares (m)	61
M.Cap.(INRb)/(USD b)	278.8 / 3.4
52-Week Range (INR)	4650 / 3210
1, 6, 12 Rel. Per (%)	4/15/12
12M Avg Val (INR M)	1571
Free float (%)	69.8

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	80.1	95.5	108.5
EBITDA (%)	17.5	17.6	18.0
PAT	6.9	11.1	12.1
EPS (INR)	113.6	181.1	198.7
Adj. PAT	8.1	11.1	12.1
Adj. EPS (INR)	133.1	181.1	198.7
EPS Gr. (%)	17.7	36.1	9.7
BV/Sh. (INR)	504.8	613.4	732.6

Ratios

RoE (%)	27.1	32.0	29.5
RoCE (%)	23.7	24.8	25.4
Payout (%)	49.0	40.0	40.0

Valuations

P/E (x)	34.9	25.7	23.4
P/BV (x)	9.0	7.4	6.2
EV/EBITDA (x)	19.6	16.1	13.6
Div Yield (%)	1.4	1.6	1.7

Shareholding pattern (%)

As On	Mar-23	Dec-22	Mar-22
Promoter	30.2	40.0	40.1
DII	32.2	26.7	25.7
FII	25.4	21.3	22.4
Others	12.2	12.0	11.8

FII Includes depository receipts

FY24 guidance reiterated despite adverse H2 outlook

At Coforge's Investor Day 2023, the management has reiterated its FY24 USD revenue growth guidance of 13-16% YoY, but noted persistent pressure on client spending in industries like BFSI. The company continues to benefit from its sharp focus on execution (with a 3-in-a-box model), along with relatively favourable demand in TTH (Travel, Transportation & Hospitality) followed by Insurance (especially L&A). Despite the challenging environment, Coforge remains confident about generating incremental revenues from its clients, especially from 16 priority accounts, which it expects to contribute 45% of its incremental growth in FY24. On the other hand, management commentary indicated increasing concerns about deal closures and a shift in spending to cost optimization over the last two quarters, although Coforge believes it is too small to be impacted by the slowdown. Coforge does not expect industry spending to improve over 2HFY24 vs. H1, which adds to risk on FY25 revenue growth for the industry. It expects to improve gross margin by 50bp YoY in FY24, which it plans to reinvest in SG&A and deliver flat margin (pre-RSU 18.3%) in FY24. It expects to slowly move to 35% gross margin over the medium term, resulting in 150-300bp EBITDA margin expansion.

Roadmap to reach USD2b milestone

- The primary focus is on mining its 16 priority accounts (high potential, strong relationship but small exposure) through broadening the revenue stream from each of these accounts. The management expects these accounts to contribute meaningfully in the long term and plans to expand the strategy to more accounts over the next few years.
- It expects to see three new verticals achieve scale and will start reporting them separately (Public sector plus potentially Retail and Healthcare), along with regions where it is subscale (US mid-west and south-west).
- Coforge aims to scale up its partnership-led business with Microsoft, AWS, and Salesforce, replicating its success with partners like Pega and Duck Creek.
- The management expects to achieve the USD2b revenue milestone through: 1) USD250m from partnership-led business, 2) USD150m from new verticals, 3) USD450m from existing clients, and 4) USD150 from new accounts.
- The management also indicated that it would fill the white gaps with few strategic acquisitions that are likely to complement its core business.

BFS – Near-term outlook remains challenging

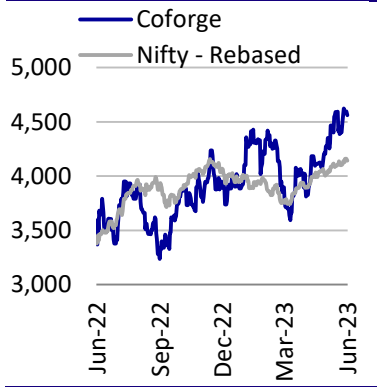
- Most of the banks are shifting from growth investments to cost take-out, and the companies do not have appetite to invest in long-term projects.
- The management indicated heightened caution from clients in BFS in the near term. The client conversations suggested muted demand for FY24.
- Coforge continues to do well in BFS, winning both small and large (USD105m transformation deal) orders.
- Growth in the BFS (~33 of revenues) is quite challenging in the near term due to Fed rate hikes, leading to global banks being cautious in their IT spending.

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Stock performance (one-year)

- Despite near-term headwinds, BFS should see good growth for COFORGE over the medium term on the back of four growth levers: 1) multiple scalable logos, 2) target domain offerings, 3) ability to win large deals, and 4) geographic expansion and targeted hunting.

Healthy demand across other verticals

- The management indicated that demand is healthy across verticals. Spending on travelling and transportation is quite healthy, with demand outpacing supply.
- The momentum remains intact in insurance, with good growth in L&A (Life & Annuity). The P&C (Property & Casualty) segment is expected to have an adverse impact due to an economic slowdown, as a few of its clients have reprioritized their spending toward cost take-out programs.
- Among regions, growth in the UK is relatively stronger than in North America. The company is also diversifying its focus on EMEA, Australia, and APAC.

Optimizing margins while fueling investments for growth

- The company continued to invest rigorously in SG&A expenses between FY18 and FY23. The investment is expected to continue in FY24, with 14.8%-15% of revenue.
- The management expects SG&A growth to outpace revenue growth in FY24.
- It expects to optimize the direct cost by: (1) reducing average resource costs for delivery and improving 50bp on gross margin, (2) increasing freshers' billability with improved utilization, and (3) operating leverage.
- It expects SG&A investments to stabilize and start incentivizing in FY25.

Valuation and view

- We see COFORGE's robust growth performance and large deal wins supporting growth in FY24.
- Strong execution, robust client roasting, and continued investment in S&M have helped the company gain wallet share and deliver industry-leading growth.
- **We believe the robust outlook is already factored into the price and we do not see any potential upside from here on. Our TP of INR4,290 implies 22x FY25E EPS. We reiterate our Neutral rating on fair valuations.**

BFS – Good growth aspects over medium term, though near-term outlook remains weak

- The management indicated heightened caution from clients in BFS in the near term. The client conversations suggested muted demand for FY24.
- Most of the banks are shifting from growth investments to cost take-out and the companies do not have appetite to invest for long-term projects.
- COFORGE has delivered a strong 40% revenue CAGR in BFS over FY19-23. It also has won significant deals in BFS, including USD105m transformation deal and USD60m managed services deal.
- Along with the current BFS portfolio (asset and wealth, retail, central banking, mortgage, GRC, fin-tech), it will bet big on card and payments, BFS platforms, GRC, security, ESG and AWM.
- Despite near-term headwinds, BFS should see good growth for COFORGE over the medium term on the back of four growth levers: 1) multiple scalable logos, 2) target domain offerings, 3) ability to win large deals, and 4) geographic expansion and targeted hunting.

Exhibit 1: COFORGE has rapidly expanded domain capabilities in BFS



Source: Company

Focus on cloud and partnerships to drive growth

- Though the near-term environment remains challenging (the management sees no improvement in 2HFY24 either) and clients remain cautious, the management expects strong growth in the medium term to be driven by cloud.
- The management believes that cloud transformation is an integral part for client success and therefore a slowdown in hyperscalers should be short-lived.
- Though generative AI will have some deflationary impact in the medium term in areas such as QE, testing, coding and BPO, the project duration will decrease with increasing velocity of deals. On the other hand, generative AI will speed up cloud adoption and will boost the cloud native move.
- The management's growth strategy for cloud and digital includes – a) leverage hyperscalers across business lines, b) doubling down on platforms, c) driving value through cloud, data and AI, d) driving digitalization and automation at scale.

Four components to drive profitable growth

- The focus is on mining its 16 priority accounts (high potential, strong relationship but small exposure) through broadening the revenue stream from each of these accounts.
- Three new verticals, Public sector, Retail and Healthcare, should achieve scale.
- It is scaling up its partnership-led business with Microsoft, AWS, and Salesforce, replicating its success with partners like Pega and Duck Creek
- The management also indicated that it would fill the white gaps with few strategic acquisitions that are likely to complement its core business.

Exhibit 2: Drive sustainable and profitable growth ahead



Source: Company

Exhibit 3: Five-year growth plan



Source: Company

Valuation and view

- We see COFORGE's robust growth performance and large deal wins supporting growth in FY24.
- Strong execution, robust client roasting, and continued investment in S&M have helped the company gain wallet share and deliver industry-leading growth.
- **We believe the robust outlook is already factored into the price and we do not see any potential upside hereon. Our TP of INR4,290 implies 22x FY25E EPS. We reiterate our Neutral rating on fair valuations.**

Financials and valuations

Income Statement

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Sales	29,914	36,762	41,809	46,628	64,320	80,146	95,456	1,08,535
Change (%)	7.8	22.9	13.7	11.5	37.9	24.6	19.1	13.7
Cost of revenue	19,179	23,907	27,502	31,692	43,736	54,059	64,058	72,936
SGA expenses	5,723	6,402	6,840	6,545	8,527	11,438	13,891	15,303
RSU costs	0	0	17	480	633	587	737	760
EBITDA	5,012	6,453	7,450	7,911	11,424	14,062	16,770	19,536
% of Net Sales	16.8	17.6	17.8	17.0	17.8	17.5	17.6	18.0
Depreciation	1,273	1,248	1,730	1,836	2,272	2,585	3,143	3,574
Other Income	298	476	461	113	-266	-630	477	326
PBT	4,037	5,681	6,181	6,188	8,886	10,847	14,104	16,288
Tax	950	1,404	1,229	1,302	1,468	2,208	3,244	3,746
Rate (%)	23.5	24.7	19.9	21.0	16.5	20.4	23.0	23.0
Minority Interest	0	188	238	104	530	513	-197	410
Adjusted PAT	3,087	4,089	4,714	4,782	6,888	8,126	11,057	12,132
Change (%)	9.5	32.5	15.3	1.4	44.0	18.0	36.1	9.7
Extraordinary Items	0	56	128	226	269	1,188	0	0
Reported PAT	3,087	4,033	4,586	4,556	6,619	6,938	11,057	12,132

Balance Sheet

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Share Capital	615	618	625	606	609	611	611	611
Reserves	17,125	20,105	23,340	24,055	26,722	30,214	36,848	44,127
Net Worth	17,740	20,723	23,965	24,661	27,331	30,825	37,459	44,738
Loans	179	100	48	5	3,365	3,382	2,582	1,082
Minority Interest	222	75	0	0	983	874	0	0
Other liabilities	2,710	1,670	2,443	2,043	6,073	4,360	5,193	5,904
Capital Employed	20,851	22,568	26,456	26,709	37,752	39,441	45,234	51,725
Net Block	4,500	4,191	4,013	3,902	4,452	4,455	3,940	4,081
CWIP	7	14	3	2	86	46	46	46
Intangibles	4,293	3,996	5,988	5,690	14,821	16,299	15,670	14,956
Investments	0	0	0	0	0	0	0	0
Deferred tax assets	1,719	1,397	2,884	4,245	7,976	9,970	13,127	14,926
Curr. Assets	16,179	17,992	21,510	21,295	22,209	26,064	33,892	40,650
Debtors	5,858	5,877	8,565	8,895	13,894	16,131	17,783	20,220
Cash & Bank Balance	4,102	5,194	8,195	7,999	4,468	5,699	11,082	14,727
Investments	3,733	4,033	976	247	67	88	88	88
Other Current Assets	2,486	2,888	3,774	4,154	3,780	4,146	4,938	5,615
Current Liab. & Prov	5,847	5,833	7,942	8,425	11,792	17,393	21,442	22,934
Trade payables	1,453	1,647	2,634	3,398	6,160	6,481	10,461	11,894
Other liabilities	3,685	3,852	4,979	4,802	5,316	10,552	10,552	10,552
Provisions	709	334	329	225	316	360	429	488
Net Current Assets	10,332	12,159	13,568	12,870	10,417	8,671	12,450	17,716
Application of Funds	20,851	22,568	26,456	26,709	37,752	39,441	45,234	51,725

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)								
EPS	51.3	66.5	75.5	77.4	110.9	130.6	177.7	195.0
Cash EPS	72.4	85.9	101.2	103.4	143.2	153.0	228.2	252.4
Book Value	294.7	337.0	384.1	407.0	448.7	504.8	613.4	732.6
DPS	15.0	15.0	31.0	20.5	52.0	64.0	71.1	78.0
Payout % (excl.div.taxes)	29.2	22.6	41.0	26.5	46.9	49.0	40.0	40.0
Valuation (x)								
P/E	89.0	68.6	60.4	59.0	41.1	34.9	25.7	23.4
Cash P/E	63.0	53.1	45.1	44.1	31.9	29.8	20.0	18.1
EV/EBITDA	53.3	42.1	37.0	33.9	24.2	19.6	16.1	13.6
EV/Sales	8.9	7.4	6.6	5.8	4.3	3.4	2.8	2.4
Price/Book Value	15.5	13.5	11.9	11.2	10.2	9.0	7.4	6.2
Dividend Yield (%)	0.3	0.3	0.7	0.4	1.1	1.4	1.6	1.7
Profitability Ratios (%)								
RoE	17.6	21.1	21.1	19.7	26.0	27.1	32.0	29.5
RoCE	14.0	17.9	18.6	18.0	23.7	23.7	24.8	25.4
Turnover Ratios								
Debtors (Days)	66	58	63	68	65	68	65	64
Fixed Asset Turnover (x)	6.4	8.5	10.2	11.8	15.4	18.0	22.7	27.1

Cash Flow Statement

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
CF from Operations	3,951	5,240	5,633	7,121	9,089	10,532	13,326	15,706
Change in Working Capital	-128	-713	-2,664	502	-1,433	-1,027	-720	-2,708
Net Operating CF	3,823	4,527	2,969	7,623	7,656	9,505	12,606	12,998
Net Purchase of FA	-838	-676	-703	-757	-1,475	-1,537	-2,000	-3,000
Free Cash Flow	2,985	3,851	2,266	6,866	6,181	7,968	10,606	9,998
Net Purchase of Invest.	-1,866	-1,624	1,826	-1,597	-8,089	-1,179	0	0
Net Cash from Invest.	-2,704	-2,300	1,123	-2,354	-9,564	-2,716	-2,000	-3,000
Inc./ (Dec.) in Equity	66	87	275	18	51	18	0	0
Proceeds from LTB/STB	0	-64	-133	-697	2,139	-1,315	-800	-1,500
Dividend Payments	-810	-1,086	-1,469	-4,852	-3,748	-4,285	-4,423	-4,853
Cash Flow from Fin.	-744	-1,063	-1,327	-5,531	-1,558	-5,582	-5,223	-6,353
Other adjustments	375	1,164	2,765	-262	-3,466	1,207	5,383	3,645
Net Cash Flow	224	-72	236	66	-65	24	0	0
Opening Cash Balance	3,502	4,101	5,193	8,194	7,998	4,467	5,698	11,081
Add: Net Cash	599	1,092	3,001	-196	-3,531	1,231	5,383	3,645
Closing Cash Balance	4,101	5,193	8,194	7,998	4,467	5,698	11,081	14,726

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
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UNDER REVIEW	Rating may undergo a change
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