

**BUY**

TP: Rs 3,350 | ▲ 16%

**COFORGE**

| IT Services

| 13 April 2021

## SLK Global acquisition to derisk travel business

**Coforge has acquired 60% stake in SLK Global Solutions – a BPM and digital solutions company for the financial services industry. The acquisition will help derisk the company's dependence on the troubled travel vertical. It will also provide a stable revenue stream and further bolster BFS and insurance vertical growth, besides being EBITDA margin-accretive. We raise FY22/FY23 EPS 5%/17% and roll to a new Mar'22 TP of Rs 3,350 (vs. Rs 2,800), based on an unchanged target P/E of 22x. The recent correction in IT stocks provides a good entry point. BUY.**

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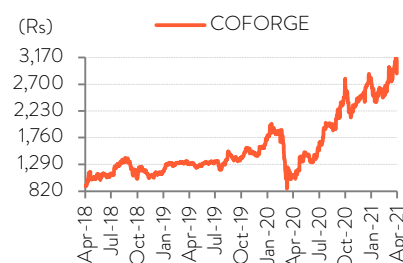
**SLK Global – a sizeable acquisition:** Coforge will initially acquire a 60% stake from SLK Global's founders who are fully exiting the business for a cash consideration of Rs 9.2bn. Fifth Third Bank's stake in SLK will reduce to 40% and will remain at that level for the next two years, after which Coforge will acquire an additional 20% stake. The transaction provides a minimum revenue commitment from Fifth Third Bank for the next five years.

Ticker/Price	COFORGE IN/Rs 2,891
Market cap	US\$ 2.4bn
Shares o/s	62mn
3M ADV	US\$ 15.9mn
52wk high/low	Rs 3,195/Rs 1,019
Promoter/FPI/DII	70%/13%/17%

Source: NSE

**Derisking of revenue streams:** The deal strengthens Coforge's BFS vertical which has been growing consistently at 8-9% sequentially over the last three quarters and also helps derisk dependence on the troubled travel vertical (~20% of revenues). SLK Global offers digital platforms and BPM solutions across subsegments such as banking, cards, mortgage lending, tax settlement and insurance. Its domain expertise in the insurance segment is expected to help stabilise Coforge's insurance vertical where QoQ growth has been fluctuating. A total of 7,000 employees will be assimilated by Coforge as part of the deal.

## STOCK PERFORMANCE



Source: NSE

**Encouraging financials:** SLK Global had consolidated revenue of US\$ 62mn in FY20 and US\$ 73mn in FY21 (15% growth despite Covid-19 impact). Fifth Third Bank will continue to be one of its top-5 clients, besides being a JV partner. We expect the acquisition to be EBITDA-accretive for Coforge.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	36,762	41,839	46,542	61,512	75,370
EBITDA (Rs mn)	6,453	7,431	8,123	10,959	13,754
Adj. net profit (Rs mn)	4,089	4,539	4,760	7,505	9,488
Adj. EPS (Rs)	66.2	73.5	77.1	121.5	153.6
Adj. EPS growth (%)	45.9	11.0	4.9	57.6	26.4
Adj. ROAE (%)	20.3	18.7	17.1	23.6	25.3
Adj. P/E (x)	43.7	39.3	37.5	23.8	18.8
EV/EBITDA (x)	27.1	23.2	20.7	14.9	11.9

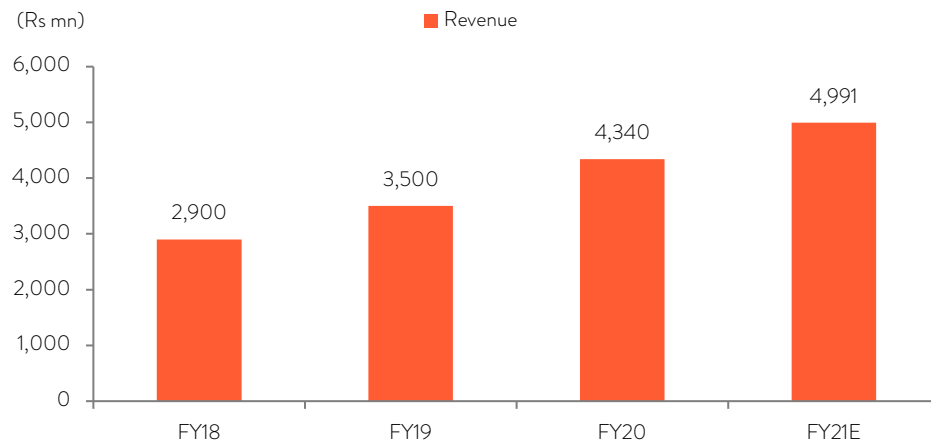
Source: Company, BOBCAPS Research

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**FIG 1 – SLK GLOBAL REVENUE**



Source: BOBCAPS Research, Company

## Valuation methodology

We raise FY22/FY23 EPS estimates for Coforge by 5%/17% taking into account the annual revenue flowthrough from the SLK Global acquisition. We assume 15%/10% YoY USD revenue growth for FY22/FY23 for the acquired entity. On rolling valuations forward, we arrive at a revised Mar'22 target price of Rs 3,350 (from Rs 2,800) on an unchanged target P/E of 22x – this is + 1.5sd above the five-year mean based on the company's upbeat outlook, timely revenue diversification and wallet share gains in the travel vertical.

Our EPS upgrade for FY22 is conservative because weakness in the travel and transportation vertical is likely to continue for the near term. We expect full gains from the acquisition to start from FY23. Maintain BUY.

**FIG 2 – REVISED ESTIMATES**

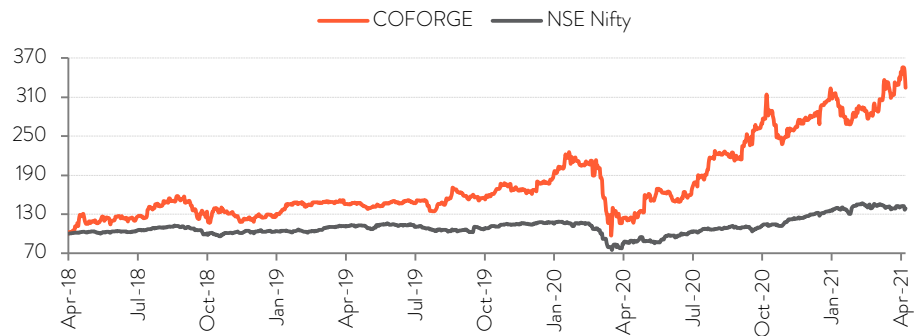
(Rs mn)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	753	804	6.8	855	963	12.6
YoY growth (%)	20.5	28.7	-	13.6	19.8	-
Revenues	57,600	61,512	6.8	66,710	75,370	13.0
EBITDA (post RSU)	10,269	10,959	6.7	11,749	13,754	17.1
EBITDA margin (%)	17.8	17.8	-	17.6	18.2	-
Net Profits	7,144	7,505	5.0	8,120	9,488	16.9
EPS (Rs)	115.6	121.5	5.0	131.4	153.6	16.9

Source: BOBCAPS Research

**FIG 3 – PEER TARGET P/E COMPARISON**

Company	One-year forward target P/E (x)
TCS	28
INFO	26
WPRO	19
HCLT	19
TECHM	16
LTI	30
COFORGE	22
MTCL	23
PSYS	19

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**

Source: NSE

### Key risks

Downside risks to our earnings estimates include:

- challenges at the company's top clients,
- a sharp decline in demand, and
- recovery failing to materialise in the travel vertical.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>36,762</b>	<b>41,839</b>	<b>46,542</b>	<b>61,512</b>	<b>75,370</b>
EBITDA	6,453	7,431	8,123	10,959	13,754
Depreciation	1,248	1,730	1,880	2,131	2,291
EBIT	5,205	5,701	6,244	8,828	11,464
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	476	462	218	1,360	1,342
Exceptional items	0	0	0	0	0
EBT	5,681	5,978	6,282	10,189	12,806
Income taxes	1,404	1,203	1,371	2,140	2,689
Extraordinary items	0	185	180	0	0
Min. int./Inc. from associates	188	236	150	545	628
<b>Reported net profit</b>	<b>4,089</b>	<b>4,539</b>	<b>4,760</b>	<b>7,505</b>	<b>9,488</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>4,089</b>	<b>4,539</b>	<b>4,760</b>	<b>7,505</b>	<b>9,488</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	6,345	7,222	8,033	10,617	13,009
Provisions	3,626	4,127	4,590	6,067	7,434
Debt funds	224	224	224	224	224
Other liabilities	455	455	455	455	455
Equity capital	615	615	615	615	615
Reserves & surplus	21,625	25,657	28,676	33,745	40,094
Shareholders' fund	22,240	26,272	29,291	34,360	40,709
<b>Total liabilities and equities</b>	<b>32,890</b>	<b>38,299</b>	<b>42,594</b>	<b>51,723</b>	<b>61,830</b>
Cash and cash eq.	8,726	13,390	17,199	13,932	21,305
Accounts receivables	7,352	8,368	9,308	12,302	15,074
Inventories	0	0	0	0	0
Other current assets	3,324	3,783	4,208	5,561	6,814
Investments	3,955	3,955	3,955	13,135	13,135
Net fixed assets	8,302	7,572	6,692	5,562	4,271
CWIP	7	7	7	7	7
Intangible assets	0	0	0	0	0
Deferred tax assets, net	1,231	1,231	1,231	1,231	1,231
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>32,890</b>	<b>38,299</b>	<b>42,594</b>	<b>51,723</b>	<b>61,830</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	5,525	6,505	6,790	10,180	12,407
Interest expenses	(476)	(462)	(218)	(1,360)	(1,342)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(151)	(97)	(90)	(287)	(266)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>4,898</b>	<b>5,946</b>	<b>6,482</b>	<b>8,532</b>	<b>10,799</b>
Capital expenditures	(750)	(1,000)	(1,000)	(1,000)	(1,000)
Change in investments	0	0	0	(9,180)	0
Other investing cash flows	476	462	218	1,360	1,342
<b>Cash flow from investing</b>	<b>(274)</b>	<b>(538)</b>	<b>(782)</b>	<b>(8,820)</b>	<b>342</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	0	(744)	(1,891)	(2,980)	(3,768)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>0</b>	<b>(744)</b>	<b>(1,891)</b>	<b>(2,980)</b>	<b>(3,768)</b>
<b>Changes in cash and cash eq.</b>	<b>4,624</b>	<b>4,664</b>	<b>3,809</b>	<b>(3,268)</b>	<b>7,373</b>
<b>Closing cash and cash eq.</b>	<b>8,726</b>	<b>13,390</b>	<b>17,199</b>	<b>13,932</b>	<b>21,305</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	66.2	73.5	77.1	121.5	153.6
Adjusted EPS	66.2	73.5	77.1	121.5	153.6
Dividend per share	0.0	10.0	25.4	40.1	50.7
Book value per share	360.0	425.2	474.1	556.2	658.9

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	4.8	4.1	3.6	2.7	2.2
EV/EBITDA	27.1	23.2	20.7	14.9	11.9
Adjusted P/E	43.7	39.3	37.5	23.8	18.8
P/BV	8.0	6.8	6.1	5.2	4.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	72.0	75.9	75.8	73.7	74.1
Interest burden (PBT/EBIT)	109.1	104.9	100.6	115.4	111.7
EBIT margin (EBIT/Revenue)	14.2	13.6	13.4	14.4	15.2
Asset turnover (Revenue/Avg TA)	123.4	117.5	115.1	130.4	132.7
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.5	1.5	1.5
Adjusted ROAE	20.3	18.7	17.1	23.6	25.3

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	22.9	13.8	11.2	32.2	22.5
EBITDA	28.8	15.2	9.3	34.9	25.5
Adjusted EPS	45.9	11.0	4.9	57.6	26.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	17.6	17.8	17.5	17.8	18.2
EBIT margin	14.2	13.6	13.4	14.4	15.2
Adjusted profit margin	11.1	10.8	10.2	12.2	12.6
Adjusted ROAE	20.3	18.7	17.1	23.6	25.3
ROCE	18.1	20.5	23.7	26.0	27.8
<b>Working capital days (days)</b>					
Receivables	66	69	69	64	66
Inventory	0	0	0	0	0
Payables	132	128	127	139	134
<b>Ratios (x)</b>					
Gross asset turnover	4.3	5.3	6.5	10.0	15.3
Current ratio	1.9	2.3	2.4	1.9	2.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.4)	(0.5)	(0.6)	(0.4)	(0.5)

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

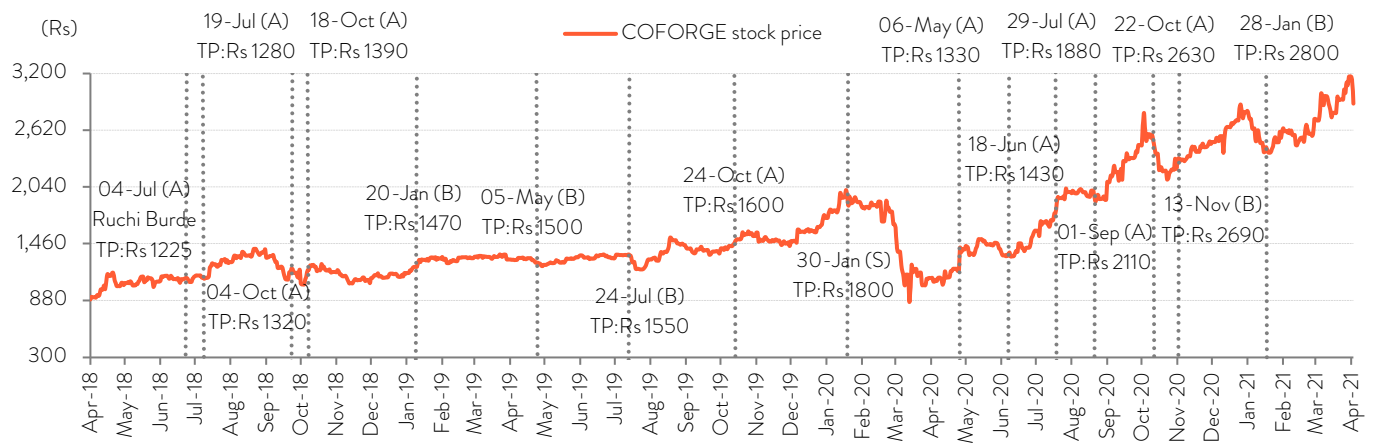
**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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, A – Add, R – Reduce, S – Sell

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