

Acquisition of BPM company SLK Global Solutions...

Coforge Ltd (Coforge) has entered into an agreement with M/s SLK Global Solutions Pvt Ltd (SLK) to acquire a 60% stake in the company for a consideration of ~US\$122 million (₹ 918 crore) leading to a valuation of ~3x FY20 EV/sales. The company will acquire additional 20% over the next two years. The company will fund the acquisition via debt (~₹ 375 crore or US\$50 million) and rest through cash. The acquisition will add ~10% to the company's topline. We believe it has robust EBITDA and PAT margin. Hence, we expect SLK to be PAT margin accretive. SLK is a business process company with ~49% of revenues generated from mortgage, 40% from banking and the rest from insurance.

Scaling up of BPM business

SLK is a business process transformation enterprise, offering BPM and digital solutions for the financial services industry. It has deep domain expertise in the banking and insurance segments in North America, enjoying multiple long-standing and scalable relationships with marquee clients, including with Fifth Third Bank, which in addition to being the largest customer is also a significant minority shareholder. The acquired entity derives its revenues from North America with delivery centres and offices in India (Pune, Kolhapur, Bangalore), the US and the Philippines. The acquisition will enable Coforge to acquire a new Top-five client, substantially scale up its current BPM operations business, strengthen its presence in the financial services vertical and expand its footprint in the US geography. This acquisition will also add an Indian Tier-III city location capability and enable it to compete for large deals with a material BPO/BPM operations component. The transaction also provides for a minimum revenue commitment from Fifth Third Bank for five years. Historically, Coforge's revenues have grown at a CAGR of 22% to ₹ 434 crore in FY18-20. SLK's revenues are expected to grow 15% YoY in FY21E.

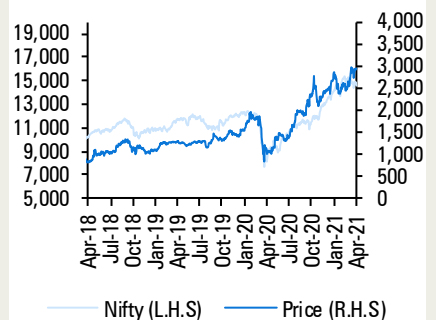
Valuation & Outlook

The acquired company has been growing at a healthy 22% CAGR in FY18-20. Going forward, SLK is expected to further grow at a consistent pace and Coforge can also cross sell IT services to its clients. This will further boost the company's financials. The acquisition will add ~10% to the company's topline and is expected to be EBITDA and EPS accretive. This, coupled with consistent large deal wins, digital prowess, client mining in BFS & Insurance, healthy order book and revival in travel segment are other key positives for Coforge. However, most positives are factored in the current price. Hence, we downgrade the stock from BUY to **HOLD** with a revised target price of ₹ 3,300 (27x PE on FY23E EPS) (earlier target price ₹ 2,875).

Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	18,525.2
Total Debt (₹ Crore)	4.8
Cash & Investment (₹ Crore)	917.1
EV (₹ Crore)	17,612.9
52 week H/L	3196/ 1023
Equity capital	62.5
Face value	10.0

Price Performance



Key Risk

- A higher than expected pace of growth in digital technologies will positively impact Coforge's revenue growth
- If Coforge is unable to realise the cost savings or realise the benefits of the cost savings it will adversely impact its margins

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Key Financial Summary

Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	3,676	4,184	4,616	5,902	6,791	17.5%
EBITDA	645	720	779	1,133	1,317	22.3%
EBITDA Margins (%)	17.6	17.2	16.9	19.2	19.4	
Net Profit	403	444	446	635	748	19.0%
EPS (₹)	65.7	71.4	72.3	102.9	121.2	
P/E	45.7	42.0	41.5	29.2	24.8	
RoNW (%)	19.5	18.5	19.4	23.9	24.4	
RoCE (%)	25.2	23.0	23.5	26.4	27.1	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 1: Profit and loss statement				
	₹ crore			
	FY20	FY21E	FY22E	FY23E
Total operating Income	4,184	4,616	5,902	6,791
Growth (%)	13.8	10.3	27.9	15.1
COGS (employee expenses)	2,753	3,139	3,883	4,469
S,G&A expenses	711	698	885	1,005
Total Operating Expenditure	3,464	3,836	4,768	5,474
EBITDA	720	779	1,133	1,317
Growth (%)	11.6	8.3	45.4	16.3
Depreciation	173	185	242	278
Other Income (net)	56	2	(16)	(16)
PBT	603	597	875	1,023
Total Tax	128	125	193	225
Adjusted 'PAT	444	446	635	748
Growth (%)	10	1	42	18
Adjusted EPS (₹)	71.4	72.3	102.9	121.2
Growth (%)	8.7	1.3	42.3	17.8

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement				
	₹ crore			
	FY20	FY21E	FY22E	FY23E
Profit before Tax	603	597	875	1,023
Add: Depreciation	173	185	242	278
(Inc)/dec in Current Assets	(362)	(171)	(340)	(247)
Inc/(dec) in CL and Provisions	-	84	250	173
Taxes paid	(181)	(125)	(193)	(225)
CF from operating activities	297	570	835	1,003
(Inc)/dec in Investments	(679)	-	-	-
(Inc)/dec in Fixed Assets	(73)	(88)	(1,062)	(129)
Others	7	2	(16)	(16)
CF from investing activities	112	(85)	(1,078)	(145)
Issue/(Buy back) of Equity	28	(337)	-	-
Inc/(dec) in loan funds	(5)	-	-	-
Dividend paid & dividend tax	(147)	(201)	(286)	(337)
CF from financing activities	(133)	(688)	(61)	(487)
Net Cash flow	300	(204)	(304)	372
Exchange difference	11	-	-	-
Opening Cash	558	903	699	395
Closing Cash	903	699	395	767

Source: Company, ICICI Direct Research

Exhibit 3: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity Capital	63	61	61	61
Reserve and Surplus	2,334	2,244	2,593	3,005
Total Shareholders funds	2,397	2,305	2,654	3,065
Total Debt	5	5	380	380
Provisions	59	59	59	59
Minority Interest / Other non	164	172	220	270
Total Liabilities	2,625	2,541	3,313	3,774
Assets				
Net Block	670	723	1,693	1,694
Capital WIP	0	0	0	0
Total Fixed Assets	671	723	1,694	1,694
Goodwill	409	409	409	409
Deferred tax assets	130	130	130	130
Debtors	857	969	1,210	1,392
Other Current Assets	377	415	531	611
Cash	903	699	395	767
Current Investments	14	14	14	14
Total Current Assets	2,151	2,098	2,150	2,784
Trade payables	284	313	401	461
Other current liabilities	498	549	702	808
Short term provisions	33	36	46	53
Total Current Liabilities	815	899	1,149	1,323
Net Current Assets	1,336	1,199	1,001	1,462
Application of Funds	2,625	2,541	3,313	3,774

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
Adjusted EPS (Diluted)	71.4	72.3	102.9	121.2
DPS	31	33	47	56
Cash per Share	145.2	113.3	64.0	124.3
BV per share (Diluted)	385.3	373.4	430.1	496.7
Operating Ratios (%)				
EBITDA Margin	17.2	16.9	19.2	19.4
PBT Margin	14.4	12.9	14.8	15.1
PAT Margin	10.6	9.7	10.8	11.0
Debtor days	75	77	75	75
Creditor days	25	25	25	25
Return Ratios (%)				
RoE	18.5	19.4	23.9	24.4
RoCE	23.0	23.5	26.4	27.1
RoC	32.0	32.5	30.7	34.7
Valuation Ratios (x)				
P/E (Adjusted)	42.0	41.5	29.2	24.8
EV / EBITDA	24.5	22.9	16.3	13.8
EV / Net Sales	4.2	3.9	3.1	2.7
Market Cap / Sales	4.4	4.0	3.1	2.7
Price to Book Value	7.8	8.0	7.0	6.0
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.3	0.3
Debt / Equity	0.0	0.0	0.1	0.1
Current Ratio	1.5	1.5	1.5	1.5
Quick Ratio	1.5	1.5	1.5	1.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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