Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Birlasoft Limited

Setting sight on new peaks

IT & ITeS	Sharekhan code: BSOFT	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 376**	
Price Target: **Rs. 450**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

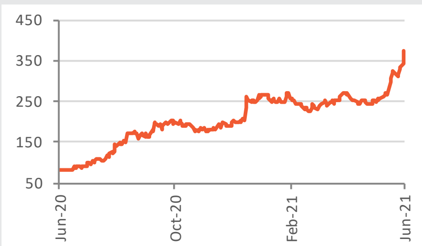
Company details

Market cap:	Rs. 10,437 cr
52-week high/low:	Rs. 384 / 77
NSE volume: (No of shares)	16.9 lakh
BSE code:	532400
NSE code:	BSOFT
Free float: (No of shares)	16.4 cr

Shareholding (%)

Promoters	41
FII	21
DII	18
Others	20

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	50.2	62.7	95.7	350.3
Relative to Sensex	44.6	60.3	80.7	298.2

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on Birlasoft with a revised PT of Rs. 450, given strong earnings growth potential, improving deal win rates and strong deal bookings.
- Birlasoft is confident of clocking double-digit revenue growth in FY2022, led by strong deal win TCVs, increasing deal sizes, robust deal pipeline, strong top accounts mining and broad-based growth
- Management expects EBITDA margin would sustain at 15% with an upward bias in FY2022 despite wage revisions and investments, which would be partly offset by strong revenue growth, higher offshoring and other efficiencies.
- We expect the company's revenue/earnings to report a 15%/27% CAGR over FY2021-FY2023E. We prefer stock despite sharp run-up in last one year given strong FCF growth, healthy net cash balance and improving dividend payout ratio.

Birlasoft Limited (Birlasoft) impressed by delivering USD revenue growth of 3.4% y-o-y, margin expansion of 300 bps y-o-y and net profit growth of 43% y-o-y in a year hit by the pandemic. Annuity revenue increased to over 70% in FY2021 from 61% at the beginning of FY2021 and ~51% in Q3FY2020. In addition, Birlasoft reported record high large deal win TCVs of $888 million (up 32.7% y-o-y), robust deal pipeline (2x y-o-y to $1.2 billion), strong 107% y-o-y growth in free cash flow (FCF) and strong growth in top accounts in FY2021. Revenue from the top 5, top 10, and top 20 clients grew by 21.1%, 19.8%, and 19.2%, respectively, in FY2021. The management remains optimistic on strong double-digit revenue growth in FY2022E because of large deal wins, rising deal sizes, a strong deal pipeline, favourable demand across verticals and strong growth in top 20 accounts. It expects manufacturing (largest revenue contributor) and lifesciences verticals would lead growth in FY2022. In addition, the management would focus on deploying the earlier success of its micro vertical strategy in certain verticals across all verticals and deepening relationships with top 30 accounts to drive revenue growth going ahead. The management aims to reach $1 billion revenue mark ($480 million in FY2021) in the next four years, implying a revenue growth CAGR of 20%. The company sees EBITDA margin sustaining at 15% with an upward bias in FY2022 as the headwinds such as wage revision, investments in capabilities and increased hiring would be partly offset by strong revenue growth, higher offshoring and other efficiencies.

Our Call

Valuation: set for strong revenue growth, maintain Buy: Strong y-o-y growth across the top 20 accounts indicates higher cross-selling activities, higher annuity revenue and strong relationship with customers. Given large deal wins, strong deal pipelines, focus on higher client mining, increasing annuity revenue, anticipated recovery in ERP services and broad-based demand, we believe the company would register revenue growth at 15% CAGR over FY2021-FY2023, while higher offshoring and cost efficiency measures would help the company to sustain EBITDA margin in the medium-term. We introduced FY2024E numbers in this note. At CMP, the stock trades at 25.5x/20.8x/17.6x its FY2022E/FY2023E/FY2024E earnings. We continue to remain positive on the stock considering strong net cash of Rs. 1,119 crore (11% of market capitalisation), healthy FCF generation and improving pay-out ratio. Hence, we maintain a Buy rating on Birlasoft with a revised price target (PT) of Rs. 450.

Key Risks

(1) Deterioration in demand for IT services in the wake of second wave of COVID-19; (2) loss of any large clients; and (3) stiff competition in the market.

Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	3,555.7	4,105.6	4,842.3	5,500.7
OPM (%)	14.9	15.3	15.5	16.0
Adjusted PAT	320.8	419.0	513.9	608.5
% y-o-y growth	*43.0*	*30.6*	*22.6*	*18.4*
Adjusted EPS (Rs.)	11.3	14.7	18.1	21.4
P/E (x)	33.3	25.5	20.8	17.6
P/B (x)	4.8	4.3	3.7	3.3
EV/EBITDA (x)	17.9	14.9	12.2	10.2
RoNW (%)	15.8	18.1	19.6	20.4
RoCE (%)	20.0	21.9	23.7	25.0

Source: Company; Sharekhan estimates

Outlook and Valuation

■ Sector view – Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimate that IT services spending would grow by 6%-9% over CY2021-CY2024E, as compared to the average of 4.2% achieved in CY2010-CY2019. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, possible investments in transformation projects by clients, and an increase in online adoption across verticals. India's IT-BPM industry is estimated to reach $350 billion by 2025 from currently estimated revenue of $191 billion.

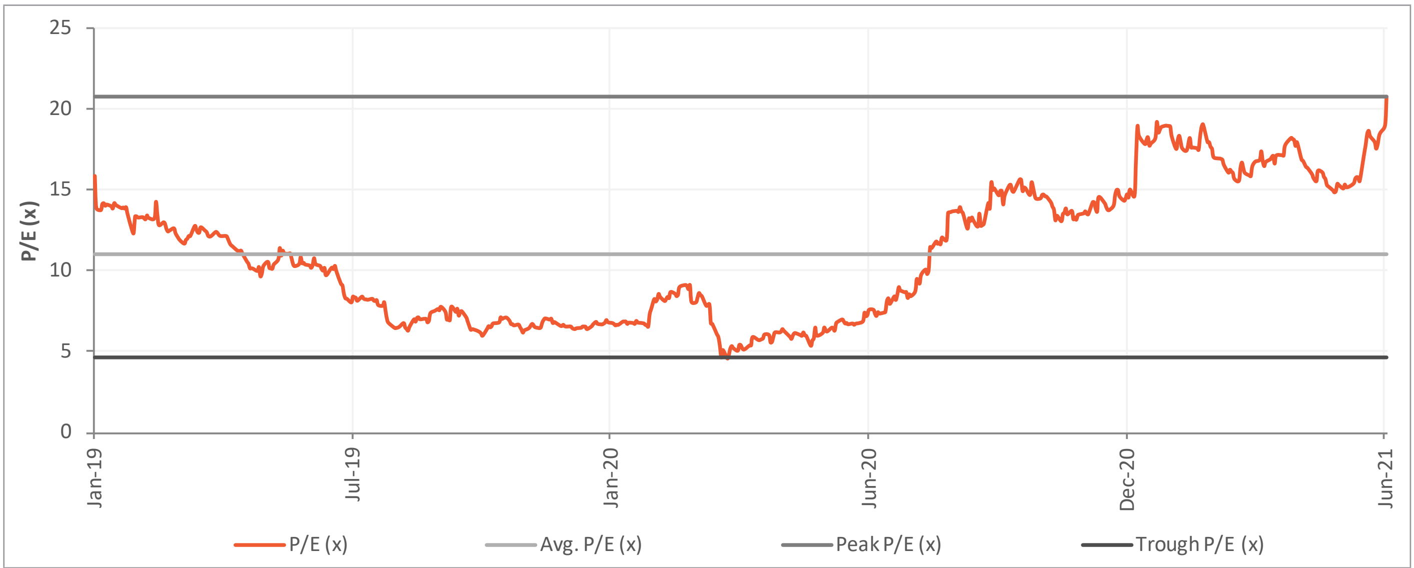
■ Company outlook – Moving in the right direction

The management sees strong traction for virtual engagement, cloud adoption, and digital transformation work. We believe the company's focus on deepening relationships with existing large clients, vertical sales structure, leveraging of core and peripheral services, ramp-up of deal wins, and defined incentives for cross-selling/up-selling would drive revenue growth. Management aspires to maintain EBITDA margins above 15% in subsequent quarters despite wage hike and investments for capability enhancements.

■ Valuation – Strong growth visibility, recommend Buy

Strong y-o-y growth across the top 20 accounts indicates higher cross-selling activities, higher annuity revenue and strong relationship with customers. Given large deal wins, strong deal pipelines, focus on higher client mining, increasing annuity revenue, anticipated recovery in ERP services and broad-based demand, we believe the company would register revenue growth at 15% CAGR over FY2021-FY2023, while higher offshoring and cost efficiency measures would help the company to sustain EBITDA margin in the medium-term. We introduced FY2024E numbers in this note. At CMP, the stock trades at 25.5x/20.8x/17.6x its FY2022E/FY2023E/FY2024E earnings. We continue to remain positive on the stock considering strong net cash of Rs. 1,119 crore (11% of market capitalisation), healthy FCF generation and improving pay-out ratio. Hence, we maintain a Buy rating on Birlasoft with a revised price target (PT) of Rs. 450.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Mastek	2,013	3	5,088	22.7	18.8	10.9	9.6	5.8	4.7	28.5	27.8
Persistent	2,512	8	19,197	33.0	28.9	21.9	18.2	6.1	5.4	19.6	19.8
Birlasoft	376	28	10,437	25.5	20.8	14.9	12.2	4.3	3.7	18.1	19.6

Source: Company, Sharekhan estimates

About company

Promoted by CK Birla Group, Birlasoft was heavily dependent on GE for its business till FY2015. During this phase (FY2015-FY2018), the non-GE business reported a healthy 15%-16% CAGR and the company divested the GE business in a slump sale to GENPACT. On January 15, 2019, Birlasoft (India) Limited (an unlisted company) merged and amalgamated with KPIT Technologies Limited (merger) and the engineering business of KPIT Technologies Limited was on a going concern basis demerged and transferred to an independent entity. Post restructuring, Birlasoft became an organisation with a mix of digital and ERP revenue. Birlasoft had strengths primarily on the non-ERP digital businesses, while KPIT IT services possessed core strengths on the enterprise software solutions and capabilities in digital transformation services.

Investment theme

Post the merger in January 2019, the new combined entity had very complementary skill sets from both the businesses. Focus on deepening relationship with existing large accounts, verticalised sales structure, leveraging core and peripheral services, and defined incentives of cross-sell/up-sell are expected to drive the company's revenue growth going ahead. Further, Birlasoft has been signing a steady mix of net-new deals and renewal of deals, which indicates the company's position in the enterprise digital space. Management expects gradual improvement in operating profitability to continue, given its cost-optimisation initiatives and reduction in discretionary spends.

Key Risks

(1) Deterioration of demand for IT services in the wake of second wave COVID-19; (2) loss of any large clients; and (3) stiff competition in the market.

Additional Data

Key management personnel

Amita Birla	Chairman & non-executive Director
Dharmender Kapoor	CEO & MD
Shreeranganath Kulkarni	Chief Delivery Officer (CDO)
Roop Singh	Chief Business Officer (CBO)
Arun Dinakar Rao	Chief People Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Ashish Dhawan	3.60
2	L&T Mutual Fund Trustee	3.21
3	ICICI Prudential Asset Management Co Ltd	3.01
4	ICICI Prudential Long Term	2.83
5	Ellipsis Partners LLC	2.57
6	IDFC Mutual Fund	2.21
7	Vanguard Group Inc	2.14
8	Invesco Asset Management	2.11
9	KPIT Tech Employee	1.99
10	Central India Industries Limited	1.86

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;