Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Birlasoft Ltd

Robust Q3; on right growth path

IT & ITeS	Sharekhan code: BSOFT
Reco/View: Buy ⇔	CMP: **Rs. 437**
	Price Target: **Rs. 580** ⇔

↑ Upgrade ⇔ Maintain ↓ Downgrade

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		⇔	

ESG Disclosure Score NEW

ESG RISK RATING	20.6
Updated Jan 08, 2022	

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

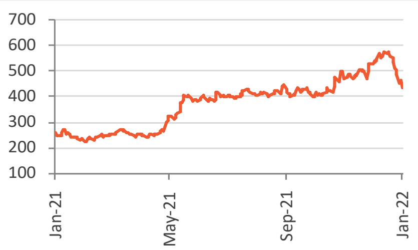
Company details

Market cap:	Rs. 12,194 cr
52-week high/low:	Rs. 585/223
NSE volume: (No of shares)	32.7 lakh
BSE code:	532400
NSE code:	BSOFT
Free float: (No of shares)	16.6 cr

Shareholding (%)

Promoters	41
DII	23
FII	19
Others	17

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-19.0	4.3	7.3	69.6
Relative to Sensex	-17.9	8.8	-1.9	48.7

Sharekhan Research, Bloomberg

Summary

- Revenue growth was strong, but remained in-line with expectations, while EBITDA margins missed the mark. New deal TCVs, deal pipeline and client mining stayed healthy; OCF to EBITDA stood at 75%.
- We expect revenue growth to accelerate in FY2023, led by strong deal intake, good client mining, pick-up in enterprise solutions revenue and robust demand. We expect EBITDA margin to be stable with an upward bias in FY2023, aided by operational efficiencies, pyramid improvement and higher fixed price contract.
- The management aims to clock $1 billion in revenues ($480 million in FY2021) by FY2025, implying a CAGR of 20%. We expect revenue and earnings to clock a 16% and 21% CAGR, respectively over FY2022-FY2024E.
- We maintain a Buy on Birlasoft with a PT of Rs. 580, given robust demand in enterprise business, strong deal intake, robust deal pipeline and sharp focus on micro-verticals.

Birlasoft Limited (Birlasoft) reported yet another quarter of strong revenue growth led by robust growth in manufacturing and energy & utilities (E&U) verticals, a pick-up in enterprise solutions and continued client mining, while EBITDA margin lagged our estimates as backfill attrition drove up expenses. Constant currency (CC) revenue grew by 5% q-o-q in Q3FY22. US Dollar revenues grew by 4.7% q-o-q to $143.4 million, inline with our estimates of $143.5 million. Net new deal TCVs increased by 20% y-o-yfor 9MFY22, while the deal pipeline grew by 50% y-o-y to $1.2 billion. Strong deal intake, robust deal pipeline, good client mining, pick-up in enterprises solution revenue and strong demand would help the company to accelerate its revenue growth in FY2023E. The management expects to maintain EBITDA margins with an upward bias in subsequent quarters despite supply-side challenges and investments in strategic areas, aided by healthy operating leverage, pyramid management, higher fixed price contract and operational efficiencies.

Key positives

- Manufacturing vertical's revenue grew 9.1% q-o-q
- Top 10/20 accounts grew 5.4% q-o-q/4.6% q-o-q
- Enterprise solutions service line grew by 6.3% q-o-q

Key negatives

- Attrition rate inched up by 720bps q-o-q to 31.4%
- Net headcount additions declined by 120 on q-o-q

Management Commentary

- Revenue growth is expected to be better in FY2023 as compared to FY2022 on the back of strong growth in enterprises solutions business, strong deal intake, solid deal pipeline & strong demand.
- Management aims to reach $1 billion revenue by FY25, implying a CAGR of 20% over FY21-FY25
- Management is optimistic of an EBITDA margin of over 15% in the coming quarters
- Attrition is expected to stabilize at 18-19% in the mediumterm

Revision in estimates – We have tweaked our earnings estimates for FY22E/FY23E/FY24E, factoring Q3FY22 results, strong demand in enterprise business and increase in new deal wins.

Our Call

Valuation: Attractive valuation, maintain Buy: The company's enterprise solutions business is expected to grow at a faster rate in FY2023E compared to FY2022 on the back of strong demand in enterprise business andhigher spends on legacy modernisation by clients. Further, prices are getting revised on the back COLA adjustments (3-4%) and new demand (5-10%). We forecast that the company would register a 16% and 21% CAGR, respectively, in revenue and earnings over FY2022-FY2024.At CMP, the stock trades at 23x/19x its FY2023E/FY2024E earnings. We remain positive on the stock considering strong net cash position of Rs. 1,135 crore (9% of market capitalisation), strong partnership with hyperscalers, increasing net new deal wins, robust demand from enterprise customers and strong FCF generation. Hence, we maintain a Buy rating on Birlasoft with price target (PT) of Rs. 580.

Key Risks

(1) Currency fluctuation; (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	4,156.1	4,969.8	5,833.5
OPM (%)	14.9	15.3	16.0	16.2
Adjusted PAT	320.8	450.5	546.5	658.4
% y-o-y growth	*43.0*	*40.4*	*21.3*	*20.5*
Adjusted EPS (Rs.)	11.3	15.9	19.2	23.2
P/E (x)	38.7	27.6	22.7	18.9
P/B (x)	6.0	5.3	4.7	4.1
EV/EBITDA (x)	23.1	18.9	15.0	12.4
RoNW (%)	15.8	19.4	20.6	21.7
RoCE (%)	20.0	22.1	24.8	26.3

Source: Company; Sharekhan estimates

Revenue in-line, margins off the mark

Birlasoft reported strong in-line revenue growth performance, while EBITDA margin lagged our estimateowing to supply-side constraints. Constant currency (CC) revenue grew by 5% q-o-q, led by strong growth in manufacturing and energy and utilities verticals. US Dollar revenue grew by 4.7% q-o-q to $143.4 million, in-line with our estimate of $143.5 million. EBITDA margin improved 20 bps q-o-q to 15.2%, below our estimates, led by volume growth (up 90bps) and absence of one-time contact expenses (up 50bps). These margin tailwinds were partially offset by impact of one-month wage revision (up 70bps) and higher sub-contractor expenses (down 50bps). Net profit came in at Rs. 114 crore and was 1% ahead our estimates, led by higher-than-expected other income (up37% q-o-q).

Key result highlights from earnings call

- **Revenue growth stays strong:** The company reported double-digit revenue growth of 20% y-o-y, led by double-digit revenue growth across verticals with leading revenue growth of 29% y-o-y in the manufacturing vertical. Top 10 and top 20 account grew 21.3% y-o-y and 22.8% y-o-y respectively. Further, cloud & base services grew 29% y-o-y. With significant improvement in growth momentum over last four quarters, the company delivereda CQGR of 4.7% over Q3FY21-Q3FY22.
- **Other expenses surged** by 6.7% q-o-q (versus rupee revenue growth of 6% q-o-q), owing to higher subcontractor expenses and strategic investments.
- **Cloud biz growth dims:** The company's Cloud and base services (22% of total revenue) growth moderated to 2.9% q-o-q and 29% y-o-y in during the quarter that was led by higher demand for transformation initiatives. Further, the growth is expected to remain strong going ahead, led by strong partnership with the hyperscalers and higher spend on infrastructure and application modernisation.
- **Enterprise solutions bounce backas expected:** Enterprises solutions business growth accelerated to6.3% q-o-q and 8% y-o-y. The strong recovery in the enterprise solutions business was led by the ramp-up of deals won in Q2FY2022. Clients have been investing on legacy modernisation which would help to drive the growth of its enterprise solutions. Growth momentum in enterprise solution business will continue for long-term on the back of Cloud migration and Cloud-related applications.
- **Expect strong growth across verticals:** The manufacturing and energy & utilities (E&U) verticals reported strong revenue growth of 9.1% q-o-q and 8.4% q-o-q. The BFSI vertical grew 2.4% q-o-q during the quarter, while Lifesciences vertical declined by 3.5% q-o-q led by a high base and closure of a transformation project. The strong growth momentum in manufacturing will continue on the back of strong demand in h-tech and digital space. Further, there are a lot of opportunities in platform area. With stabilisation of crude oil prices at higher level and large deal wins in E&U vertical, the company expects strong growth in energy & utilities vertical to continue in coming quarters.
- **FY2023E outlook strong:** Higher spending on digital initiatives, Cloud adoption, and aggressive automation would boost growth going ahead. The management cited that the demand environment (traction for specifically in the areas of cloud, digital and cybersecurity) across verticals remains robust, though some supply-side challenges are likely to continue in the near term. Management remains optimistic in order booking, deal pipeline and revenue growth in the medium-term. The company's net new deal TCVs for 9MFY22 was up by 20% y-o-y, while deal pipeline stood at $1.2 billion (up 9% q-o-q and 50% y-o-y) in Q3FY2022. Management also indicated that growth in the enterprise solution in FY2023 would be better as compared to FY2022. Hence, the revenue growth in FY2023 is expected to be better compared to FY2022. The management aims to reach $1 billion in revenues ($480 million in FY2021) by FY2025, implying a revenue growth CAGR of 20%.
- **Margin outlook:** The management expects to maintain EBITDA margins with an upward bias in subsequent quarters despite supply-side challenges and investment in strategic areas. Growth in the enterprise segment would also drive up margins. The management expects to deliver EBITDA margin of more than 15% in the coming quarters.
- **Net new deal wins and deal pipeline remained strong:** The company signed $182 million of TCVs of deal (including renewals), up 30% q-o-q. Net new deal TCVs stood at $121 million, up 16% q-o-q and 116% y-o-y. TCV of renewal deals remained at $61 million, down by 69% q-o-q and 15% y-o-y. Clients are pushing for restructuring of deals, which are modular in nature and short cycled deals as well. This has resulted in

smaller size deals, which has increased deal ACVs for the company versus deal TCVs. Further, the deal pipeline increased 50% y-o-y.

- **Net staff additions fall, attrition surges:** The total number of employees stood at 11,945, with sequential net decline of 120 employees. The company on-boarded around 300 freshers in Q3FY2022 (versus 292 freshers in Q2FY2022). Attrition rate increased significantly to 31.4% in Q3FY2022 as compared to 24.2% in Q2FY2022, due to strong demand and talent crunch. Management expects attrition rate would soften from Q1FY2023 as freshers would get into billable and travels would open up. Quarterly annualized attrition rate stood at 34% in Q3FY2022. The management hopes attrition rate will stabilize in the range of 18-19% in the medium-term. The company indicated that it would hire 1,500 freshers in FY2023 compared to 900 fresher in last 9-12 months, which will optimize the resource expenses and meet demand.
- **DSOdaysrise; cash balance stays healthy:** DSO days increased by a dayq-o-qto 55 days and improved 2 days on y-o-y basis. Cash & cash equivalents remained at Rs. 1,135crore ($153 million) versus Rs. 1,074 crore ($145 million) in Q2FY2022.
- **Annuity revenuesrise q-o-q:** Annuity revenues' contribution to total revenue increasedto 72% in Q2FY2022 as compared to 70% in Q1FY2022.The company will provide annuity revenue as % of total revenue for Q3FY22 in Q4FY22.
- **Client additions remained stable:** The number of client additionsrose by 5 on q-o-q basis during the quarter. The number of $10-million+ clients increased by three on y-o-y (flat q-o-q basis), taking the total count of such clients to 12. However, the number of $5 million+ clients increased by one on a q-o-q basis (flat on y-o-y basis), taking the total count of such clients to 21.
- **Focus on client mining in top accounts:** Revenue from top 10 and top 20 accounts grew by 5.4% and 4.6% on a q-o-q basis, respectively, while top 5 accounts grew by 3.3% q-o-q during the quarter. It indicates higher focus on client mining activities.
- **Strong operating cash flows:** Operating cash flow grew strongly to Rs. 121.6 crore compared to Rs. 58.5 crore in Q2FY2022. OCF to EBITDA stood strong at 74.6%, while FCF to net profit stood at 71.8% in Q3FY2022.

Results Rs cr

Particulars	Q3FY22	Q3FY21	Q2FY22	y-o-y (%)	q-o-q (%)
Revenue ($ mn)	**143.4**	**119.5**	**136.9**	**20.0**	**4.7**
Net sales	**1,071.9**	**880.8**	**1,011.7**	**21.7**	**6.0**
Employee benefit expenses	606.7	525.4	576.4	15.5	5.2
Gross Profit	**465.2**	**355.4**	**435.2**	**30.9**	**6.9**
Operating expenses	302.4	210.9	283.5	43.4	6.7
EBITDA	**162.8**	**144.4**	**151.8**	**12.7**	**7.3**
Depreciation	18.8	20.2	19.4	-7.1	-2.8
EBIT	**144.0**	**124.2**	**132.4**	**15.9**	**8.7**
Other income	12.8	15.6	9.4	-17.9	36.8
Finance cost	3.1	3.2	3.4	-1.8	-9.8
PBT	**153.7**	**136.6**	**138.3**	**12.5**	**11.1**
Tax provision	39.7	40.2	35.1	-1.3	13.2
Net profit	**114.0**	**96.4**	**103.3**	**18.3**	**10.4**
EPS (Rs.)	**4.0**	**3.4**	**3.6**	**18.2**	**10.7**
Margin (%)				**bps**	**Bps**
EBITDA	15.2	16.4	15.0	-121	19
EBIT	13.4	14.1	13.1	-67	35
NPM	10.6	10.9	10.2	-31	43

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Expect acceleration in technology spending going forward

The COVID-19 outbreak has accelerated the need for business continuity, operational resilience and the switch to digital transactions, which has led to strong demand for IT services. Industry analysts such as Gartner estimate that IT services spending would clock an 8.5% CAGR over CY2021-CY2024E as compared to an average of 3.6% achieved in CY2010-CY2020. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals. India's IT-BPM industry is estimated to reach $350 billion by 2025 from the current estimated revenue of $191 billion.

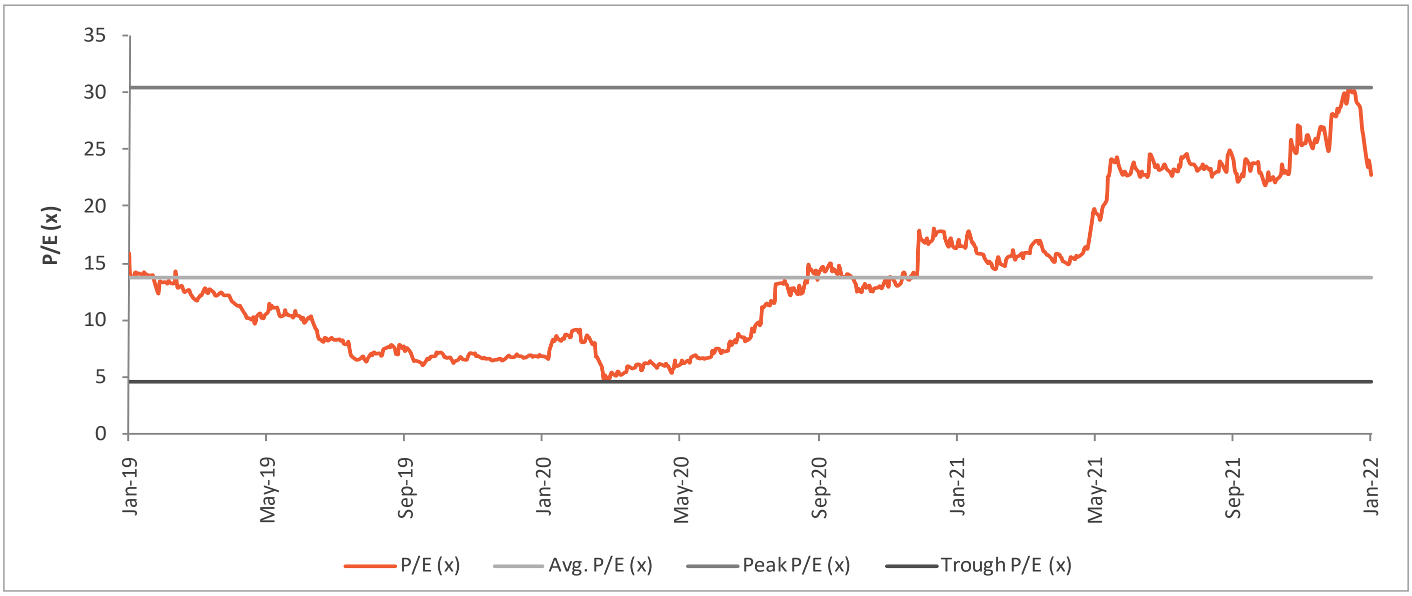
■ Company outlook - moving on right direction

The management sees strong traction for virtual engagement, cloud adoption and digital transformation work. We believe that the company's focus on deepening relationship with existing large accounts, vertical sales structure, leveraging of core and peripheral services, ramp-up of deal wins and defined incentives of cross-selling/up-selling would drive revenue growth.We believe revenue growth would accelerate in FY2023 on the back strong growth in enterprise solutions, robust deal intake, healthy deal pipeline and broad-based demand across verticals.Further, the management aspires to maintain its EBITDA margin of above 15% in the subsequent quarters despite supply-side issues and investments for capability enhancements.

■ Valuation -

The company's enterprise solutions business is expected to grow at a faster rate in FY2023E compared to FY2022 on the back of healthy deal intake, higher spends on legacy modernisation by clients and strong demand. Further, the prices are getting revised on the back COLA adjustments (3-4%) and new demand (5-10%). We forecast that the company would register a 16% and 21% CAGR, respectively, in revenue and earnings over FY2022-FY2024. At CMP, the stock trades at 23x/19x its FY2023E/FY2024E earnings. We remain positive on the stock considering strong net cash position of Rs. 1,135 crore (9% of market capitalisation), strong partnership with hyperscalers, increasing net new deal wins, robust demand from enterprise customers and strong FCF generation. Hence, we maintain a Buy rating on Birlasoft with price target (PT) of Rs. 580.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Company	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Persistent	4,070	8	31,102	46.2	34.3	32.9	23.7	9.7	8.3	22.5	26.0
Mastek	2,603	3	7,736	25.9	22.9	13.3	10.9	6.9	6.1	29.8	29.6
Birlasoft	437	28	12,194	27.6	22.7	18.9	15.0	5.3	4.7	19.4	20.6

Source: Company, Sharekhan Research

About company

Promoted by the CK Birla Group, Birlasoft was heavily dependent on GE for its business till FY2015.During this phase (FY2015-FY2018), the non-GE business was growing at a healthy 15-16% CAGR and the company divested the GE business in a slump sale to GENPACT.On January 15, 2019, Birlasoft (India) Ltd (an unlisted company) merged and amalgamated with KPIT Technologies Limited (merger) and the engineering business of the KPIT Technologies Limited was on a going concern basis demerged and transferred to an independent entity.Post restructuring Birlasoft became ~$450-475 million 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 revenue growth for the company going ahead. Further, Birlasoft has been signing steady mix of net-new deals and renewal of deals, which indicates the company's positioning in the enterprise digital space. Management expects gradual improvement in operating profitability would continue given its cost optimization 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)
ArunDinakar Rao	Chief People Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co	3.32
2	ICICI Prudential Asset Management Co	3.29
3	L&T Mutual Fund Trustee	2.86
4	Aditya Birla Sun Life Asset Management	2.27
5	Emirate of Abu Dhabi United Arab Emirates	2.27
6	Vanguard Group Inc	2.17
7	Central India Industries Ltd	1.85
8	Ashish Dhawan	1.79
9	Nippon Life India Asset Management	1.49
10	Ellipsis Partners LLC	1.26

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

Sharekhan

by BNP PARIBAS

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