



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. 202	
Price Target: Rs. 240	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

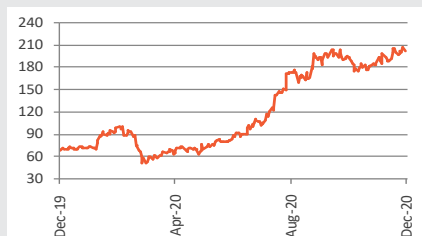
Company details

Market cap:	Rs. 5,606 cr
52-week high/low:	Rs. 225/48
NSE volume: (No of shares)	23.5 lakh
BSE code:	532400
NSE code:	BSOFT
Free float: (No of shares)	16.4 cr

Shareholding (%)

Promoters	41
DII	13
FII	23
Others	23

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.7	4.4	143.1	194.9
Relative to Sensex	1.4	-16.3	112.7	185.5

Sharekhan Research, Bloomberg

Birlasoft Limited

Digital engines to power growth

IT & ITes

Sharekhan code: BSOFT

Company Update

Summary

- We maintain a Buy rating on Birlasoft Ltd and raise the price target (PT) to Rs. 240 given strong revenue growth potential, scope for margin improvement and reasonable valuations.
- Company's USD revenue is likely to grow by 2% q-o-q to \$118 million in Q3FY2021, as Invacare revenue stabilises and incremental revenue contribution from deal that was spilled over to Q3. Expect margin to rise 50 bps q-o-q to 14.4%.
- Management is aiming for USD revenue growth of 12-15% in FY2022E, led by clients' higher digital spends. We believe company can comfortably achieve top-end of its target led by strong execution and large deal wins.
- Management believes that the strong relationships with Oracle and SAP would help it grab opportunity from any increase in spends on either product.

Birlasoft Limited's (Birlasoft) management is confident that revenue would rise both y-o-y and q-o-q in Q3FY2021 despite lower billable days, with an improvement in EBITDA margin. We expect the company's USD revenue to grow by 2% q-o-q to \$118 million in Q3FY2021, led by stabilisation in Invacare's revenue, contribution of incremental revenue from the deal that has spilled over to Q3FY2021 and strong growth in the manufacturing vertical (strong demand for its offering from its hi-tech and discrete manufacturing clients). The management believes that the resurgence of COVID-19 cases in Europe would have minimal impact on Birlasoft as Europe fetches only 13.3% of its total revenue and because work-from-home is in force. The company has the highest level of partnership with SAP, Oracle, JD Edwards and Salesforce, an achievement that even eludes its peers. The management believes that the strong relationships with both Oracle and SAP would help the company to grab opportunity from any increase in spends on either product. During November-December usually, enterprises usually take decisions on the subsequent year's IT budgets that translate into business for Indian IT companies. Based on the discussion with clients, Birlasoft's management indicated about its clients' rising budgets for digital transformation work and increased focus on cost optimization would drive incremental offshoring. Therefore, the management remains optimistic of outpacing average industry revenue growth and targets USD revenue growth of 12-15% for FY2022 (exceeding our estimates). Further, growth will be aided by reversal of one-time discounts provided to the affected clients (during Q3/Q4 FY2021) and continued rise in share of its annuity business (target 70% share in Q4FY2021). In its Q2FY2021 conference call, the management guided for higher EBITDA margins in Q3FY2021 than Q2FY2021. We expect the number to be at 14.4% (an improvement of 50bps q-o-q) on the back higher offshore revenue, revenue growth, reversal of some of discounts and continued lower travel costs. We believe there is a scope for margins to improve in FY2022E and FY2023E once expenses in the overlapping areas reduce.

Our Call

Valuation: Reasonably valued, maintain Buy: We forecast a decent revenue growth q-o-q for Q3FY2021 with an improvement in margin. With clients raising budgets on digital technologies, continued deal wins and increasing share of annuity business, the management aspires to deliver revenue growth of 12-15% in FY2022E, higher-than our estimates. We believe Company would comfortably achieve the top-end of the target band led by strong execution and robust enterprise digital capabilities. We currently forecast Birlasoft would clock a 25% CAGR in earnings over FY2021-2023E, aided by higher spends on Cloud and Cloud-related technologies, improvement in profitability and lower tax provision. At CMP, the stock trades at 16x/13x of FY2022E/FY2023E earnings, at a significant discount to peers. Further, net cash on balance sheet stood at Rs. 917 crore (16% of market capitalisation) and FCF generation remains strong. Hence, we maintain Buy on Birlasoft with a price target of Rs. 240.

Key Risks

(1) Currency fluctuation; (2) loss of any large clients and (3) stiff competition in the market.

Valuation

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	3,305.2	3,291.0	3,594.2	4,022.2	4,408.4
OPM (%)	9.7	11.9	13.8	14.8	15.4
Adjusted PAT	231.0	224.3	287.3	368.1	447.6
% y-o-y growth		(2.9)	28.1	28.1	21.6
Adjusted EPS (Rs.)	8.3	8.1	10.2	13.0	15.9
P/E (x)	24.4	25.1	19.8	15.5	12.8
P/B (x)	3.3	3.0	2.7	2.4	2.1
EV/EBITDA (x)	15.8	13.0	10.0	8.2	6.9
RoNW (%)	13.5	12.4	14.5	16.7	18.2
RoCE (%)	28.1	15.7	18.7	20.7	21.4

Source: Company; Sharekhan estimates

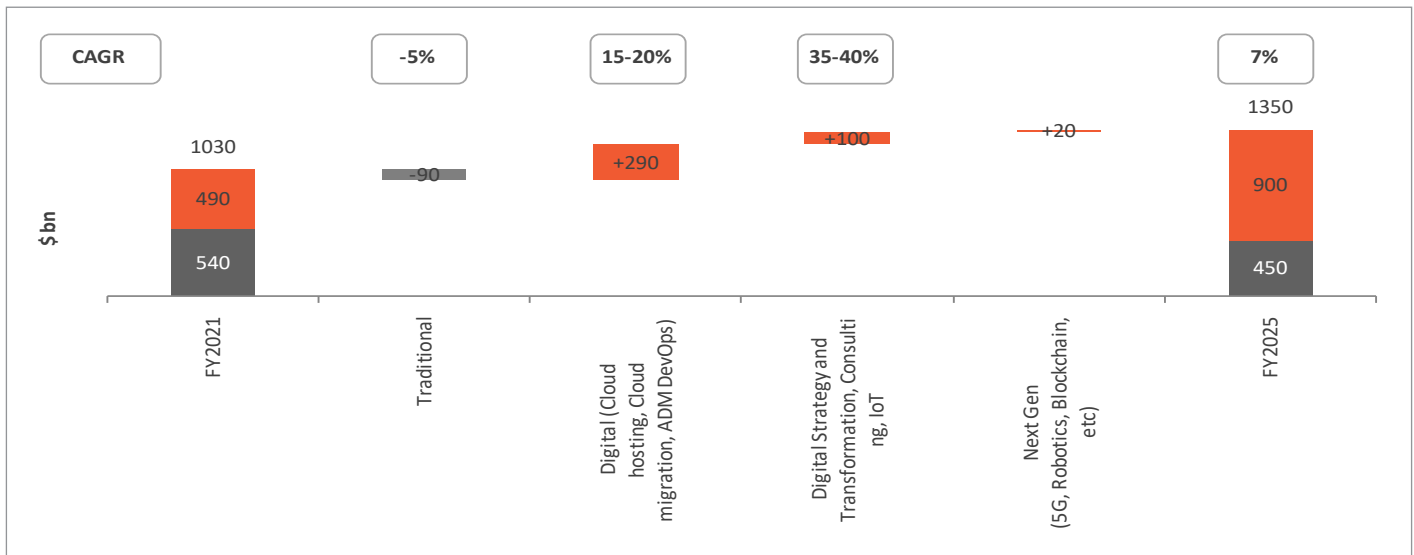
Digital and next-gen technologies to be key growth engines

The COVID-19 pandemic has catalysed demand for cloud transformation. Top Cloud solutions providers have reported strong revenue growth during quarter ending September, registering a robust 29%/48%/45% y-o-y growth by AWS, Azure and Google Cloud, respectively. Cloud is one of the transformational pillars in the digital journeys of enterprises as half of their total transformational spends comes from related technologies. Amazon Web Services (AWS) continues to be the largest cloud service provider with a 32% market share, followed by Azure (19%) and Google Cloud (7%) which is growing rapidly. It is estimated that around \$500 billion would be spent on cloud over next three years.

As per Gartner, worldwide IT spending is likely to report a 7% CAGR over FY2021-FY2025, led by a 16% CAGR in overall digital technology. Digital technologies (Cloud hosting, Cloud migration, ADM DevOps, consulting, IoT, etc.) would report a 15%-20% CAGR under incremental revenue over FY2021-FY2025, while next-generation technologies (5G, robotics, and blockchain) are expected to report a CAGR of 35%-45% over the same period.

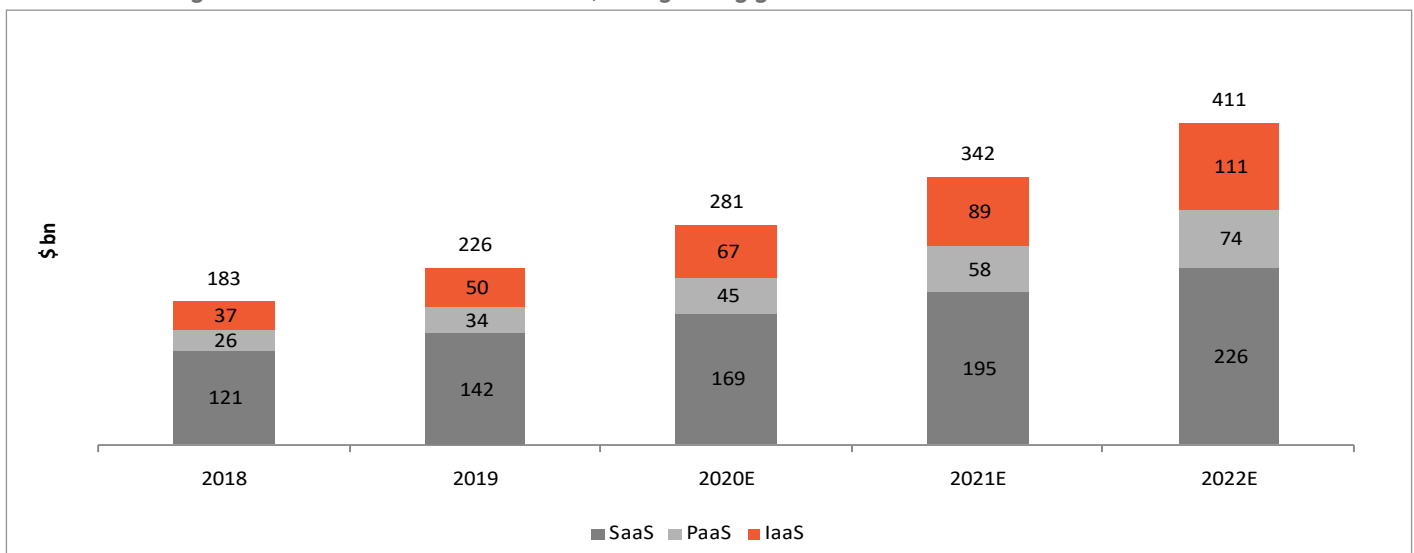
IT services vendors are placed well considering size of opportunities from the long-term contracts to operate IT infrastructure on the cloud. Indian IT service providers generate revenue by helping enterprises migrate to the Cloud roadmap including services such as data management, processes and applications transformation, digital transformation, creating multi-cloud environment and offering products and platforms.

Digital and next-gen technologies will drive incremental growth



Source: Gartner; Sharekhan Research

Cloud market to grow at 22% CAGR over 2019-2022E, led by strong growth in IaaS



Source: industry; Sharekhan Research

Uniquely positioned to capture opportunities in the Enterprise digital place

Birlasoft has built unique and strong capabilities in the Enterprise Product and Cloud solutions areas by entering into partnerships with SAP, Oracle, JD Edwards, Salesforce.com, Microsoft, Service Now, etc. The management believes that it has the highest level of partnership with SAP, Oracle and Salesforce, an achievement that even similar peers have not achieved. The company generated 13.7% revenue from SAP in Q2FY2021, while integrated enterprise solutions (include Oracle, JD Edwards and others) contributed 32.3% of its revenue. Management believes that the strong relationships with both Oracle and SAP would help the company to grab opportunity from any increase in spends by either of products. Though significant movement of SAP workloads to cloud would support its growth as only 2,000 of SAP's 45,000 ERP customers have migrated to cloud till date, management believes that customers would evaluate its cost benefits before taking decision in shifting ERP to Cloud. The management aims to scale up its Microsoft cloud business to \$100 million over next couple of years from \$20-25 million currently.

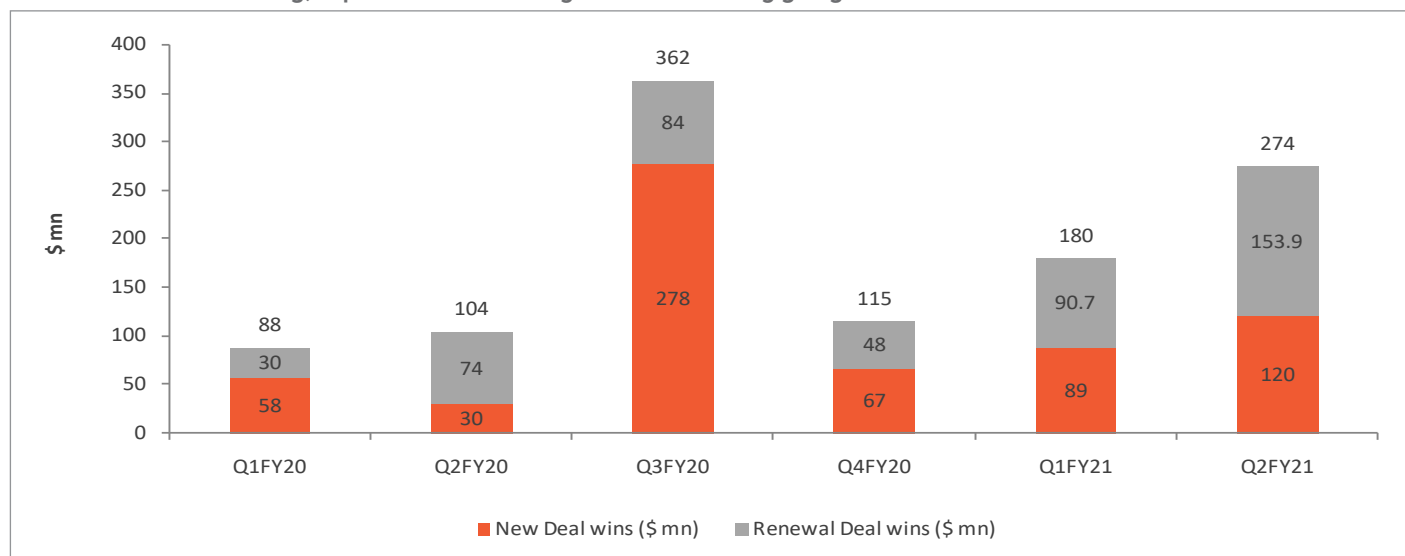
Expect growth to recover in Q3FY2021 despite lower billing days

After three consecutive quarters of outpacing the industry average, revenue growth disappointed (falling 4.6% q-o-q) in Q2FY2021 owing to moderation in Invacare's revenue, full quarter impact of pricing discounts offered to customers and project deferrals. However, the management remains confident that it would report positive revenue growth in Q3FY2021 on both y-o-y and q-o-q terms despite lower billable days and continued reduction in tail accounts. The management highlighted that the execution of a transformational project, which spilled over to Q3FY2021 has started contributing to revenues from the first week of October 2020. Though the manufacturing vertical would continue its growth momentum given strong demand for its offering from its hi-tech and discrete manufacturing clients, revenue growth of energy and utilities vertical would recover on the back of a ramp-up of a large deal. The management indicated that growth in the lifesciences vertical and aero sub-segment are expected to come back in Q4FY2021 with the return of discretionary spends. Further, management believes that the resurgence of COVID-19 cases in Europe would have very limited impact on the company given (1) lower revenue contribution from Europe and (2) enablement of work-from-home mode. We expect USD revenue to grow by 2% q-o-q to \$118 million in Q3FY2021, led by stabilisation in Invacare's revenue, ramp-up of deals and continued growth in manufacturing vertical. Further, management indicated that the one-time discounts provided to the affected clients would be reversed by Q3FY2021/Q4FY2021.

Management expects 12-15% growth in FY2022E; deal wins to remain strong

The management remains optimistic that it will deliver better than the average industry revenue growth in FY2022. It expects USD revenue growth of 12-15% in FY022E, exceeding our estimates. The growth would be driven by ramp-up of large deals, higher tech spending by clients, cost-take out initiatives and higher client mining. TCVs of overall deals (including renewals) and net new deals were up 136% y-o-y and 138% y-o-y respectively during H1FY2021. The management targets to maintain total deal signings of \$100-\$150 million per quarter in coming quarters, which would help acceleration in revenue growth going ahead. Further, the company has been increasing its share in the annuity business by 2-4% in each quarter. With this pace, the company aims to achieve 70% share from the annuity business by the end of Q4FY2021.

Deal wins remained strong, expect deal TCVs likely to remain healthy going ahead

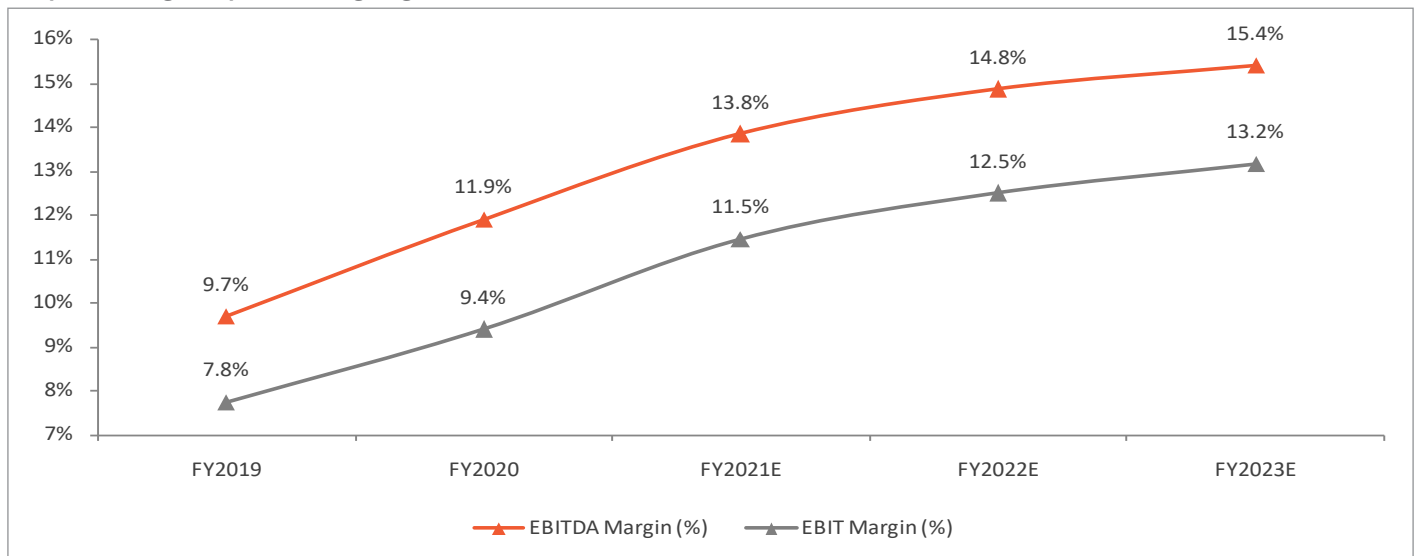


Source: Company; Sharekhan Research

Expect margin improvement in Q3FY2021, management aspires for 15% in Q1FY2022

EBITDA margin improved from 7.9% in Q4FY2019 to 12.9% in Q4FY2020 and 13.9% in Q2FY2021, led by cost optimisation initiatives, divesting tail accounts, lower travel expenses and higher utilisations. Management targets EBITDA margin to reach 15% in Q1FY2022 from 13.9% currently, which is on track. Note that management indicated to achieve 15% EBITDA margin at the time when EBITDA margin was at 9.9%. During Q2FY2021 conference call, management guided that EBITDA margin in Q3FY2021 would be better than Q2FY2021. We expect Q3FY2021 EBITDA margin would be at 14.4% on the back of higher offshore revenue, revenue growth, reversal of some of discounts and continued lower travel and facility expenses. We believe there is a scope for margin improvement in FY2022E and FY2023E post the reduction of expenses in the overlapping areas.

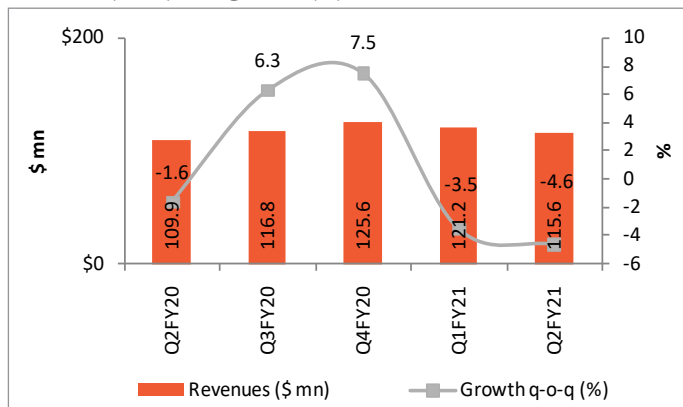
Scope for margin improvement going ahead



Source: Company; Sharekhan Research

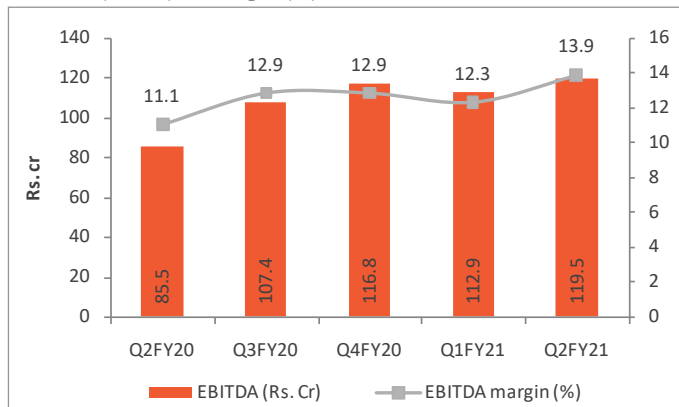
Financials in charts

Revenue (\$mn) and growth (%)



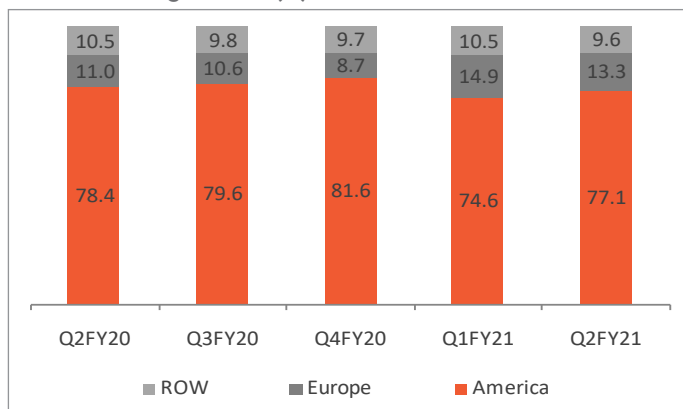
Source: Company, Sharekhan Research

EBITDA (Rs. cr) & margin (%)



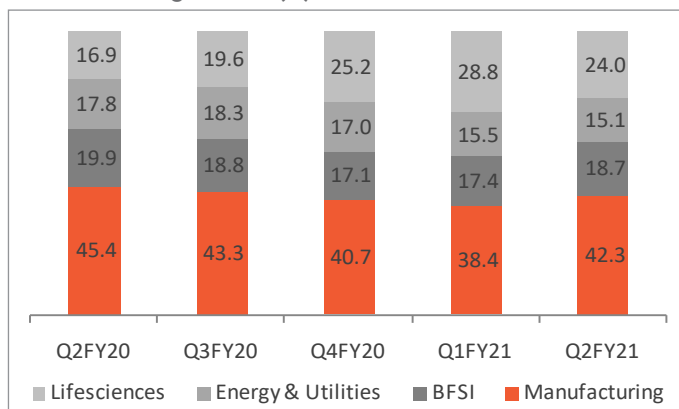
Source: Company, Sharekhan Research

Revenue mix by vertical (%)



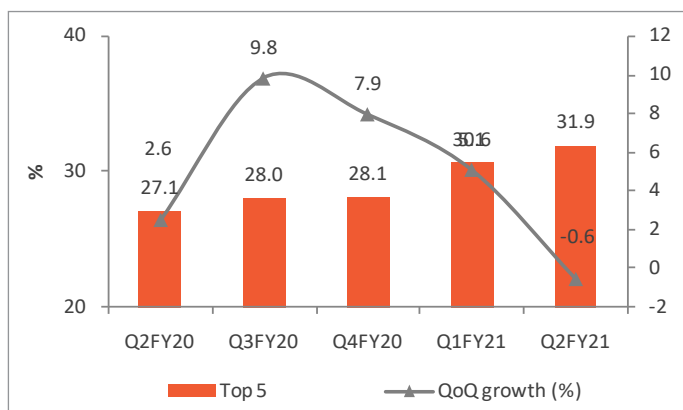
Source: Company, Sharekhan Research

Revenue mix by vertical (%)



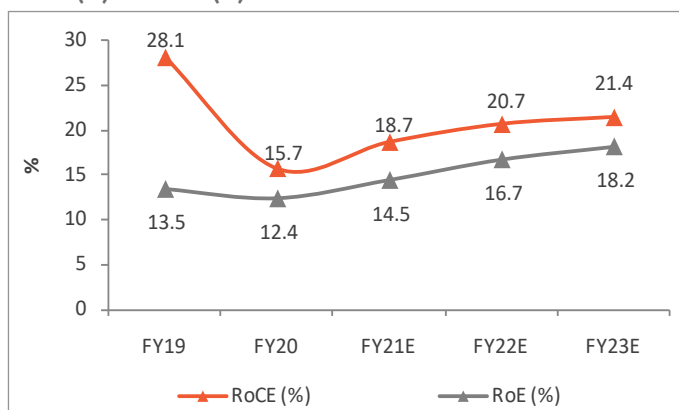
Source: Company, Sharekhan Research

Client revenue concentration



Source: Company, Sharekhan Research

RoCE (%) and RoE (%) trends



Source: Company, Sharekhan Research

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 5-9% over CY2021-24E as compared to the average of 4.2% achieved in CY2010-19. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential 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.

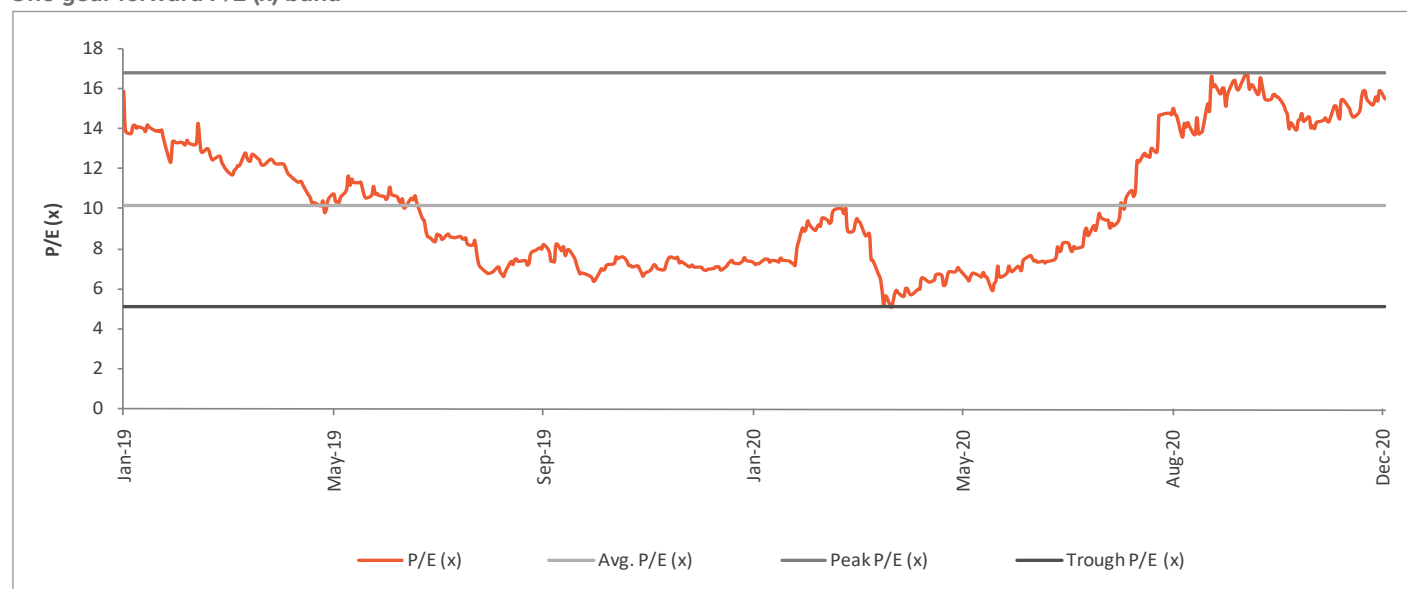
■ Company outlook - moving on right direction

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. The management aspires to achieve EBITDA margin of 15% by Q1FY2022 from 13.9% currently.

■ Valuation - Reasonably valued, recommend Buy

We forecast a decent revenue growth q-o-q for Q3FY2021 with an improvement in margin. With clients raising budgets on digital technologies, continued deal wins and increasing share of annuity business, the management aspires to deliver revenue growth of 12-15% in FY2022E, higher-than our estimates. We believe Company would comfortably achieve the top-end of the target band led by strong execution and robust enterprise digital capabilities. We currently forecast Birlasoft would clock a 25% CAGR in earnings over FY2021-2023E, aided by higher spends on Cloud and Cloud-related technologies, improvement in profitability and lower tax provision. At CMP, the stock trades at 16x/13x of FY2022E/FY2023E earnings, at a significant discount to peers. Further, net cash on balance sheet stood at Rs. 917 crore (16% of market capitalisation) and FCF generation remains strong. Hence, we maintain Buy on Birlasoft with a price target of Rs. 240.

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/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Persistent	1316	8	10055	23.9	19.4	14.7	12.1	3.8	3.5	16.8	18.8
Mastek	991	2	2453	15.3	13.2	7.0	6.0	3.1	2.6	22.1	21.7
Birlasoft	202	28	5606	19.8	15.5	10.0	8.2	2.7	2.4	14.5	16.7

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)
Arun Dinakar Rao	Chief People Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Ashish Dhawan	3.61
2	IDFC Mutual Fund	3.34
3	L&T Mutual Fund Trustee	2.60
4	Ellipsis Partners LLC	2.54
5	Ashish Kacholia	2.35
6	FMR LLC	2.11
7	Vanguard Group Inc	2.00
8	Dimensional Fund Advisor	1.98
9	Bengal Finance & Investment	1.80
10	New Horizon Opportunities	1.80

Source: Bloomberg

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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 deteriorating 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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