Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Birlasoft Ltd

Strong Q1; deal wins to fuel growth

IT & ITeS	Sharekhan code: BSOFT	Result 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. 408**	
Price Target: **Rs. 500**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 11,318 cr
52-week high/low:	Rs. 434/109
NSE volume: (No of shares)	19.5 lakh
BSE code:	532400
NSE code:	BSOFT
Free float: (No of shares)	16.5 cr

Shareholding (%)

Promoters	41
DII	23
FII	18
Others	18

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	62.7	58.0	246.0
Relative to Sensex	6.2	57.3	47.4	209.7

Sharekhan Research, Bloomberg

Summary

- Strong revenue growth despite COVID-19 second wave; new deal TCVs remained weak, but are expected to improve going ahead led by strong deal pipeline and easing of travel restrictions
- Management optimistic of a 15% y-o-y revenue growth in FY2022E, led by healthy deal pipeline, decent deal wins and strong growth in top accounts; EBITDA margin to sustain in Q2 despite wage revisions.
- We expect revenue and earnings to clock a 15% and 29% CAGR respectively over FY2021-FY2023E. We prefer stock given its healthy net cash balance and improving return ratios.
- We maintain a Buy on Birlasoft with a revised PT of Rs. 500, given its strong earnings growth potential, robust deal pipeline and strong demand environment.

Birlasoft Limited (Birlasoft) delivered strong revenue growth despite around $1 million revenue loss owing higher employee leaves due to COVID-19 second wave. Constant currency (CC) revenue grew by 4.1% q-o-q in Q1FY2022, slightly ahead of our estimates. US Dollar revenue grew by 4.1% q-o-q to $128.4 million, led by strong growth in manufacturing and energy & utilities verticals. Barring the top five accounts, revenue from the top 10 and top 20 accounts grew 2.5% q-o-q and 3.6% q-o-q during the quarter. EBITDA margin declined by 90 bps q-o-q to 16%, below our estimates, owing to higher leaves taken by employees because of COVID-19 second wave, rising subcontractor expenses and higher recruitment expenses. Net profit stood at Rs. 113.6 crore, 11% ahead of our estimates, aided by higher-than-expected other income. The management highlighted that the company's AWS advanced consulting partner status and its partnership with Microsoft and Google would strengthen its cloud portfolio, which would help company to accelerate cloud transformation journey of customers. The company expects net new deal win momentum would improve after easing out of travel restrictions in the US and Europe. Further, the management indicated that the deal pipeline increased by 15% q-o-q, which would also support the improvement in net new deal wins in coming quarters. Top accounts are expected to continue their growth momentum (they grew by 16-21% in FY2021) in FY2022. Management remains optimistic on delivering 15% y-o-y revenue growth in FY2022E because of healthy large deal wins, strong deal pipeline, favourable demand environment across verticals, and anticipated strong growth across top 20 accounts. EBITDA margin is expected to be sustainable in Q2FY2022 despite a 200 bps q-o-q impact due to wage revision, led by higher revenue growth, absence of COVID-19 effects, employee pyramid and lower sub-contractor expenses. Further, the management expects margin would improve on a q-o-q basis in Q3FY2022 and Q4FY2022.

Key positives

- Top 5/10/20 accounts grew by 5.6%, 10.7%, and 14.7%, respectively
- Business & technology transformation revenue grew by 8.8% q-o-q
- Expect sustainable EBITDA margin in Q2FY2022 despite wage revisions

Key negatives

- Top 5 accounts declined by 3.2% q-o-q
- Deal win TCVs declined 53% q-o-q

Our Call

Valuation: Attractive valuation, maintain Buy: We have raised earnings estimates for FY2022E/FY2023E/FY2024E on account of revenue beat, strong revenue growth in top accounts, anticipated sustainable margin performance and lower tax provisions for FY2022. Given strong deal pipelines, higher client mining, strong demand recovery for ERP services and strong demand, we believe the company would register a 15% and 29% CAGR, respectively, in revenue and earnings over FY2021-FY2023. At CMP, the stock trades at 25x/22x/19x its FY2022E/FY2023E/FY2024E earnings. We remain positive on the stock considering strong net cash of Rs. 1,119 crore (10% of market capitalisation), higher cash generation and improving return ratios. Hence, we maintain a Buy rating on Birlasoft with a revised price target (PT) of Rs. 500.

Key risk

(1) Deterioration of 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	4,135.2	4,837.6	5,495.0
OPM (%)	14.9	16.2	16.2	16.3
Adjusted PAT	320.8	456.5	534.1	618.5
% y-o-y growth	*43.0*	*42.3*	*17.0*	*15.8*
Adjusted EPS (Rs.)	11.3	16.0	18.8	21.7
P/E (x)	36.1	25.4	21.7	18.8
P/B (x)	4.8	4.2	3.7	3.2
EV/EBITDA (x)	17.9	14.0	11.7	10.0
RoNW (%)	15.8	19.6	20.2	20.5
RoCE (%)	20.0	23.3	24.4	25.0

Source: Company; Sharekhan estimates

Revenue beat, margins missed estimates: Birlasoft reported better-than-expected revenue performance despite the impact of the COVID-19 second wave, while margin missed our estimates. However, net profit was ahead of our estimates led by higher other income. Constant currency (CC) revenue growth stood at 4.1% q-o-q, slightly ahead of our estimates. Despite a revenue loss of ~$1 million, US Dollar revenue grew by 4.1% q-o-q to $128.4 million, led by strong growth in manufacturing (up 8.8% q-o-q) and the energy & utilities verticals (up 4.8% q-o-q). EBITDA margin declined 90 bps q-o-q to 16%, below our estimates, owing to impact of COVID-19 second wave, higher sub-contractor expenses and rising recruitment expenses, partially offset by improvement in utilisation, rupee tailwinds and cost optimisation. Net profit came at Rs. 113.6 crore and was 11% ahead of our estimates, aided by higher-than-expected other income (4.2x q-o-q, led by higher forex gain).

Key result highlights from earnings call

- **Revenue slightly beats expectations:** CC revenue grew by 4.1% q-o-q (negligible cross-currency impact). On a reported basis, revenue grew by 4.1% q-o-q and 5.9% y-o-y to $128.4 million despite the loss of revenue of ~$1 million due to leaves taken by employees because of COVID-19 second wave in India. Growth was driven by strong growth in manufacturing (up 8.8% q-o-q), and the energy & utilities verticals (up 4.8% q-o-q). Top 20 account grew 3.6% q-o-q during the quarter.

- **EBITDA margins missed our estimates:** EBITDA margin declined by 90% q-o-q to 16% in Q1FY2022 owing to revenue loss given the severe impact of COVID-19 second wave in India, rising recruitment expenses and higher sub-contractor expenses.

- **Strong outlook:** Higher spending on platform-based digital initiatives, Cloud adoption, and aggressive automation would be the company's growth driver in FY2022. Discounts provided to customers in FY2021 have taken back prior to starting of Q1FY2022. The company witnessed strong demand in digital transformation, enterprise solutions, application modernization, and acceleration of workload migration to cloud, cyber security and infrastructure. On the platform side, the company accelerated customers' could adoption journey by achieving AWS advanced consulting partner status, which is expected to further strengthen its cloud portfolio. The management also highlighted that its SAP and ERP pipeline in terms of both transformation and implementation side increased. The company expects the net new deal win momentum would improve once travel restrictions in US and Europe eased out. The company continued to maintain its annuity based revenue contribution at 71% during the quarter, while project based traction picked up especially in the enterprise IT area. Management expects this would lead to higher annuity based revenue at the later stages of the project and maintain the annuity-based revenue contribution at 70% by the end of FY2022. Management expect its top accounts would grow by 14-20%, similar to growth rate of top accounts in FY2021. Though the expenses would increase with opening of travel in H2FY2022, management remains confident to maintain the margin level of Q1FY2022 by optimizing the cost structure. Given large deal wins, strong deal pipelines, healthy growth momentum in key verticals, strong growth across top 20 accounts, and sharpening focus on top 30 accounts, management remains optimistic for 15% revenue growth in FY2022E. The management expects operating profitable would be sustainable despite wage hike in Q2FY2022 because of higher offshoring revenue and cost-efficiency measures.

- **Margin outlook:** Management expects to maintain Q2FY2022 EBITDA margin at Q1FY2022 EBITDA margin level (i.e 16%) despite a 200 bps impact of wage revision. Further, the management expects margin to improve in Q3FY2022 and Q4FY2022 on the back of higher revenue growth and cost optimisation measures.

- **Deal wins remained weak, expect to improve from Q3FY2022:** The company signed $153 million of TCVs of deal (including renewals), down 53% q-o-q. Net new deal TCVs stood at $94 million, down 42% q-o-q, but up 6% y-o-y. TCV of renewal deals remained at $59 million, falling by 64% q-o-q and 35% y-o-y. Management expects net new deal wins would improve once the travel restriction eases out. Further, the deal pipeline increased 15% q-o-q.

- **Net addition of employees in q-o-q, while attrition rate inched up; higher utilisation:** Total number of employees stood at 11,508, with sequential net addition of 457 employees. The company plans to broaden employee pyramids. As a result, it on-boarded 140 freshers in Q1FY2022 and has extended 340 offers for Q2FY2022. Attrition rate increased to 16.5% in Q1FY2022 as compared to 11.6% in Q4FY2021, due to demand and supply mismatch in the industry. Utilisation rate improved by 220 bps q-o-q to 85% in Q1FY2022.
- **Improved DSO and strong cash balance:** DSO days improved by two days on a sequential basis to 54 days, which is the lowest ever in its history. Cash & cash equivalents remained at Rs. 1,144.6 crore ($154 million) versus Rs. 1,118.9 crore ($153.1 million) in Q4FY2021.
- **Annuity revenue continued to improve:** Annuity revenue contribution to total revenue remained flat at 70% in Q1FY2022. With an increase in project-based deals in enterprise area, we believe the annuity revenue to total revenue would moderate in coming quarters. However, management believes that the annuity revenue contribution to total revenue would further improve to 70% by the end of FY2022.
- **ETR to be at 26-27%:** Management cited that the effective tax rate for FY2022 would be at 26-27% versus its earlier guidance of 27-29%.
- **Addition of clients led by cross-selling:** The number of $10-million+ clients increased by two y-o-y (one on a q-o-q basis), taking the total count of such clients to 10. The number of $5 million+ clients increased by five on a y-o-y basis (flat on q-o-q basis), taking the total count of such clients to 22. Client count remained flat on a q-o-q basis, taking the total active clients to 291.
- **Focus on client mining in top accounts:** Revenue from the top 10 and top 20 accounts grew by 2.5% and 3.6% on a q-o-q basis, respectively, while top 5 accounts declined 3.2% q-o-q during the quarter. Top accounts grew above company's growth rate y-o-y.

Results Rs cr

Particulars	Q1FY22	Q1FY21	Q4FY21	y-o-y (%)	q-o-q (%)
Revenue ($ mn)	**128.4**	**121.2**	**123.3**	**5.9**	**4.1**
Net sales	**945.3**	**914.6**	**902.9**	**3.4**	**4.7**
Employee benefit expenses	556.0	534.5	532.8	4.0	4.4
Gross Profit	**389.3**	**380.1**	**370.1**	**2.4**	**5.2**
Operating expenses	238.3	267.1	217.7	-10.8	9.4
EBITDA	**151.1**	**112.9**	**152.4**	**33.7**	**-0.9**
Depreciation	18.4	21.5	17.8	-14.4	3.6
EBIT	**132.6**	**91.4**	**134.6**	**45.1**	**-1.5**
Other income	21.5	(8.1)	5.1	-364.3	321.8
Finance cost	2.8	3.5	2.9	-19.3	-1.5
PBT	**151.2**	**79.8**	**136.8**	**89.6**	**10.6**
Tax provision	37.6	23.4	37.8	60.5	-0.6
Net profit	**113.6**	**56.3**	**99.0**	**101.7**	**14.8**
EPS (Rs.)	4.0	2.0	3.5	97.0	13.8
Margin (%)				**bps**	**Bps**
EBITDA	16.0	12.3	16.9	363	-90
EBIT	14.0	10.0	14.9	403	-88
NPM	12.0	6.2	11.0	586	106

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 grow by 7-9% over CY2021-CY2024E as compared to an average of 3.6% achieved in CY2010-CY2020. Forecasts indicate higher demand for cloud infrastructure services, 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 current estimated revenue of $191 billion.

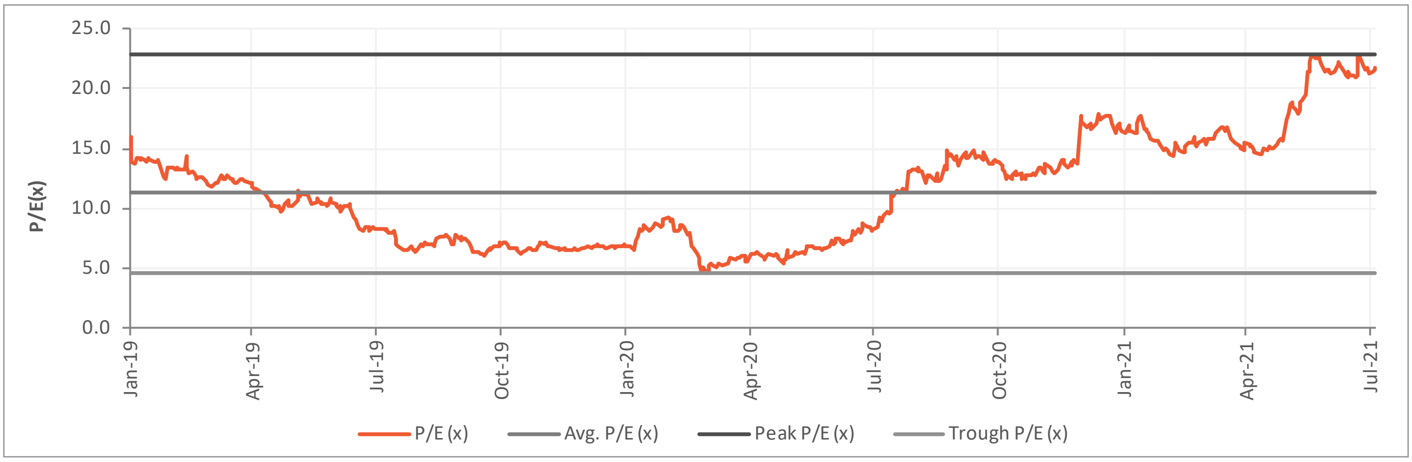
■ Company Outlook – Moving in the right direction

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, a 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 its EBITDA margin of above 15% in the subsequent quarters despite wage hike and investments for capability enhancements.

■ Valuation – Attractive valuation, maintain Buy

We have raised earnings estimates for FY2022E/FY2023E/FY2024E on account of revenue beat, strong revenue growth in top accounts, anticipated sustainable margin performance and lower tax provisions for FY2022. Given strong deal pipelines, higher client mining, strong demand recovery for ERP services and strong demand, we believe the company would register a 15% and 29% CAGR, respectively, in revenue and earnings over FY2021-FY2023. At CMP, the stock trades at 25x/22x/19x its FY2022E/FY2023E/FY2024E earnings. We remain positive on the stock considering strong net cash of Rs. 1,119 crore (10% of market capitalisation), higher cash generation and improving return ratios. Hence, we maintain a Buy rating on Birlasoft with a revised price target (PT) of Rs. 500.

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	2,572	3	6,530	27.4	23.9	13.3	11.5	7.2	6.0	29.0	27.9
Persistent	3,097	8	23,666	36.5	26.9	26.0	19.1	7.4	6.3	21.7	25.4
Birlasoft	408	28	11,318	25.4	21.7	15.3	12.8	4.6	4.0	19.6	20.2

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

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	L&T Mutual Fund Trustee	3.03
2	Ashish Dhawan	2.88
3	ICICI Prudential Asset Management Co Ltd	2.84
4	ICICI Prudential Long Term	2.84
5	Emirate of Abu Dhabi UAE	2.43
6	Vanguard Group Inc	2.33
7	Ellipsis Partners LLC	2.04
8	KPIT Tech Employee	1.99
9	Invesco Trustee Pvt Limited	1.96
10	IDFC Mutual Fund	1.92

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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