Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Birlasoft Ltd

Long-term earnings potential intact; Maintain Buy

IT & ITeS	Sharekhan code: BSOFT

Reco/View: Buy	↔	CMP: Rs. 268	Price Target: Rs. 320	↓

↑ 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 20.05

Updated Dec 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. 7,325 cr
52-week high/low:	Rs. 502/250
NSE volume: (No of shares)	24.2 lakh
BSE code:	532400
NSE code:	BSOFT
Free float: (No of shares)	16.0 cr

Shareholding (%)

Promoters	41
DII	12
FII	20
Others	26

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-8.5	-2.6	-18.7	-42.9
Relative to Sensex	-6.5	-1.0	-21.8	-43.6

Sharekhan Research, Bloomberg

Summary

- For Q3FY23, Birlasoft reported weak USD revenues of $148.4 million, up 3.5% y-o-y/down 0.3% q-o-q with flat CC revenue growth, missing our CC growth estimates of 1.7% q-o-q due to decline of 7.1% q-o-q in Enterprise Solutions, which was offset by a growth of 5.5% q-o-q in Business & Technology Transformation.
- EBITDA at Rs.7.4 crore was impacted due to a one-time provision taken on account of filing of bankruptcy by one of a major client-Invacare. EBITDA margin at 0.6% was impacted due to higher than usual furloughs and investments and one-time provision. New deal wins moderated to $102 million in Q3FY23 although the company signed strong deal wins at $231 million TCV up 39% q-o-q.
- Birlasoft has created a provision amounting to Rs 151.04 crore against the outstanding receivables and contract assets. They are not expecting any revenues from Invacare in Q4FY23. The management stated that while provision has been made to account for the revenue impact, on the cost side they need more clarity on account of many nuances and are taking legal opinion on the same.
- Global macro challenges coupled with bankruptcy of major client raises concern on FY24 growth/ margin outlook and the same would be near term overhang on Birlasoft. However, post the recent correction we believe the robust deal pipeline and long-term earnings potential would continue to act as tailwinds .Hence we maintain Buy on Birlasoft with revised PT of Rs 320. We advise investors to adopt a staggered approach to invest from long term perspective.

For Q3FY23, Birlasoft reported weak USD revenue of $148.4 million, up 3.5% y-o-y/down 0.3% q-o-q due to a decline of 7.1% q-o-q in Enterprise Solutions which was offset by a growth of 5.5% q-o-q in Business & Technology Transformation. Revenue in rupee terms stood at Rs. 1221.9 crore, up 14% y-o-y & up 2.5% q-o-q. EBITDA at Rs. 7.4 crore was impacted due to the one-time provision taken on account of filing of bankruptcy was one of their major client- Invacare. Consequently, the company reported a net loss of Rs. 16.4 crore for Q3FY23 , reflecting the impact of a one-time provision. The company stated that the contribution of Invacare to the topline was ~3%. Birlasoft has created a provision amounting to Rs. 151.04 crore against outstanding receivables and contract assets. . The management stated that while provision has been made to account for the revenue impact, on the cost side they need more clarity on account of many nuances and are taking legal opinion on the same. The management stated that the creation of provision was based on billed receivables, unbilled receivables and contract assets. The management stated that EBITDA margin (ex-Invacare) was 13.4% for Q3FY23 and was hit due to higher-than-usual furloughs and investments. Despite uncertainty due to ongoing global headwinds and bankruptcy filed by one of their top client- Invacare, the management indicated that they would achieve 15% EBITDA margin (ex-Invacare) in Q4FY23 or by Q1FY24. New deal wins moderated to $102 million, while the company signed strong deal wins at $231 million TCVs, up 39% q-o-q as TCVs of renewal deal wins rose ~4.6x to $129 million. Attrition rate moderated by 190 bps q-o-q to 25.5%. Total headcount stood at 12,530 during Q3FY2023, with a decline of 228 employees q-o-q. The company's utilisation rate improved by 160 bps sequentially to 84%. Global macro challenges coupled with bankruptcy of major client raises concerns on FY24 growth/ margin outlook and the same would be near term overhang on Birlasoft. However, post the recent correction we believe the robust deal pipeline and long-term earnings potential would continue to act as tailwinds. Hence, we maintain a Buy on Birlasoft with revised PT of Rs. 320. We advise investors to adopt a staggered approach to invest from a long-term perspective.

Key positives

- The company signed strong deal wins at $231 million TCV up 39% q-o-q as TCV of renewal deal wins rose ~4.6x to $129 million.
- Attrition rate moderated by 190 bps q-o-q to 25.5%.
- The company's utilization rate improved by 160 bps sequentially to 84%.

Key negatives

- Birlasoft's major client, medical device maker Invacare has filed for bankruptcy.
- The number of $10 million+ and $5+ million client decreased by one and three, on a q-o-q basis respectively.
- Sequential decline in Enterprise solutions continued with a 7.1% fall in Q3FY23.

Management Commentary

- The company continues to have a positive outlook on the BFSI vertical, and they expect an uptick in the Manufacturing vertical as they are seeing a lot of traction. The company believes Hitech vertical is witnessing a tough cycle and anticipates it to turnaround as the cycle turns.
- The management stated that EBITDA margin (ex-Invacare) was 13.4% for Q3FY23 and was impacted due to higher than usual furloughs and investments. Despite uncertainty due to ongoing global headwinds and bankruptcy filed by one of their top client-Invacare, the management indicated that they would achieve 15% EBITDA margin (ex-Invacare) in Q4FY23 or by Q1FY24.
- The management stated that while provision has been made to account for the revenue impact, on the cost side they need more clarity on account of many nuances and are taking legal opinion on the same. The management stated that the creation of provision was based on billed receivables, unbilled receivables, and contract assets.

Revision in estimates – We have fine-tuned our earnings estimates for FY23/FY 24/FY25 owing to macro overhang and INR-USD reset.

Our Call

Valuation: Long term earning potential intact, Maintain Buy: Global macro challenges coupled with bankruptcy of major client raises concern on FY24 growth/ margin outlook and the same would be near term overhang on Birlasoft. However, post the recent correction we believe the robust deal pipeline and long-term earnings potential would continue to act as tailwinds .Hence we maintain Buy on Birlasoft with revised PT of Rs 320. We advise investors to adopt a staggered approach to invest into the stock from long term perspective.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spends.

Valuation Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	4,130.4	4,822.4	5,239.6	5,769.3
OPM (%)	15.5	11.0	14.2	15.0
Adjusted PAT	455.6	341.0	501.6	583.2
% YoY growth	42.0	(25.2)	47.1	16.3
Adjusted EPS (Rs.)	16.4	12.2	18.2	21.5
P/E (x)	16.3	21.9	14.7	12.5
P/B (x)	4.0	3.7	3.3	2.9
EV/EBIDTA (x)	14.6	17.5	12.2	10.2
RoNW (%)	19.1	12.6	16.7	17.2
RoCE (%)	21.7	15.5	20.6	21.5

Source: Company; Sharekhan estimates

Key result highlights from earnings call

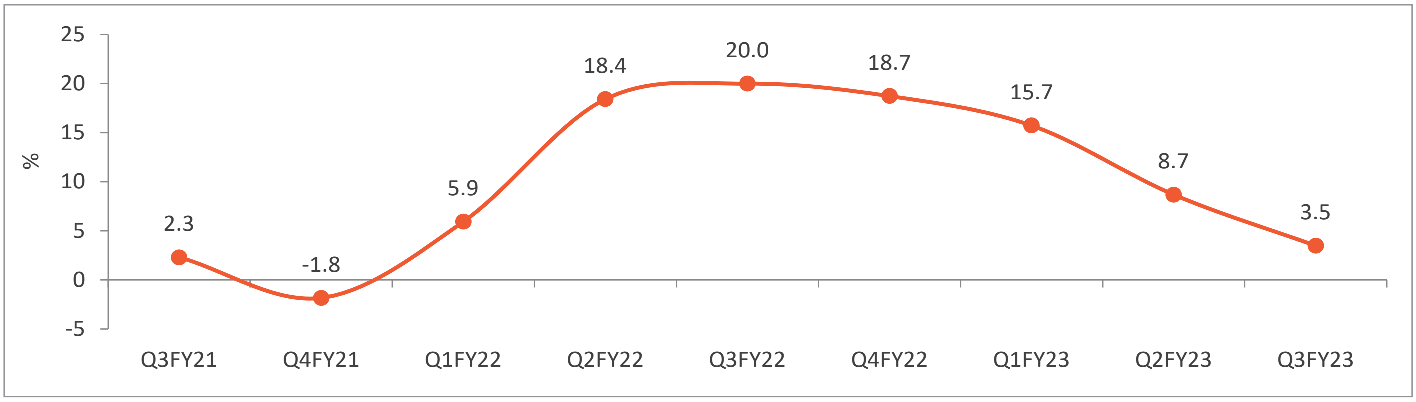
- **Weak Quarter:** The company reported weak dollar revenue at $148.4 million, up 3.5% y-o-y/down 0.3% q-o-q due to decline of 7.1% q-o-q in Enterprise Solutions which was offset by growth of 5.5% q-o-q in Business & Technology Transformation. Revenue in rupee terms stood at Rs. 1221.9 crore, up 14.0% y-o-y & up 2.5% q-o-q. EBITDA at Rs. 7.4 crore was impacted due to the one-time provision taken on account of filing of bankruptcy was one of their major client-Invacare. Consequently, the company reported a Net Loss of Rs. 16.4 crore for Q3FY23 , reflecting the impact of a one-time provision. EBITDA excluding the one-time provision was Rs. 158.4 crore while EBITDA margin was 13.4%.
- **Top client files for bankruptcy:** Birlasoft's major client, medical device maker Invacare has filed for bankruptcy. Invacare Corporation, a leading manufacturer and distributor of medical equipment used in non-acute care settings, has announced that the company and two of its subsidiaries have filed for bankruptcy protection and restructuring. The company stated that the contribution of Invacare to the topline was ~3%. Birlasoft has created a provision amounting to Rs. 151.04 crore against the outstanding receivables and contract assets. They are not expecting any revenues from Invacare in Q4FY23. The management stated that while provision has been made to account for the revenue impact, on the costs side, they need more clarity on account of many nuances and are taking a legal opinion on the same. The management stated that the creation of provision was based on billed receivables, unbilled receivables, and contract assets.
- **Commentary on key verticals & geographies:** The BFSI vertical continued to grow strongly, up 5.0% q-o-q in Q3FY23, while the lifesciences grew 1.3% q-o-q. Manufacturing, Energy & Utilities declined by 2.6%/ 1.7% q-o-q respectively. The company continues to have a positive outlook on the BFSI vertical, and they expect an uptick in the Manufacturing vertical as they are seeing a lot of traction. The company believes that the Hitech vertical is witnessing a tough cycle and anticipates it to turnaround as the cycle turns. Manufacturing, Life sciences and Energy & Utilities vertical would be led by new leadership. In terms of geographies.
- **EBITDA margin:** The management stated that EBITDA margin (ex-Invacare) was 13.4% for Q3FY23 and was impacted due to higher than usual furloughs and investments. Despite uncertainty due to ongoing global headwinds and bankruptcy filed by one of their top client- Invacare, the management indicated that they would achieve 15% EBITDA margin (ex-Invacare) in Q4FY23 or by Q1FY24. The management expressed optimism of achieving operationally better Q4FY23 on account of longer working days and ramp-up of deals. The company stated that it aspires to achieve EBITDA margins of 18% in the long term.
- **TCV of new deal wins moderates, while aggregate TCV deal wins rise strongly:** New deal wins moderated to $102 million while the company signed strong deal wins at $231 million TCV up 39% q-o-q as TCV of renewal deal wins rose ~4.6x to $129 million. The management stated they signed 3 good deals in the quarter.
- **Client additions:** The number of active client additions declined by two q-o-q. The number of $10 million+ clients decreased by one on a q-o-q basis, taking the total to 13 clients. The number of $5 million+ clients decreased by three on a q-o-q basis, taking the total to 24 clients.
- **Healthy growth in top accounts:** Client concentration of Top 5, Top 10 and Top 20 increased to 31.7%, 47.9% and 64.1% respectively from 31.1%, 47.2% and 63.7% in Q2FY23.
- **Attrition rate moderates and utilisation improves:** Attrition rate moderated by 190 bps q-o-q to 25.5%. Total headcount stood at 12,530 during Q3FY2023, with a decline of 228 employees q-o-q. The company's utilization rate improved by 160 bps sequentially to 84%.
- **Cash balance declines on buyback:** Cash & cash equivalents came at Rs. 1001.5 crores versus Rs. 794.7 crore in Q2FY2023 due to best ever quarterly collections. DSO improved to 55 days from 56 days in Q2FY23.

Results | Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	% YoY	% QoQ
Revenues ($ mn)	**148.4**	**143.4**	**148.8**	**3.5**	**-0.3**
Net sales	**1,221.9**	**1,071.9**	**1,192.1**	**14.0**	**2.5**
Employee benefit expenses	732.0	606.7	693.8	20.6	5.5
Gross Profit	**489.9**	**465.2**	**498.3**	**5.3**	**-1.7**
Operating expenses	482.6	302.4	321.9	59.6	49.9
EBITDA	**7.4**	**162.8**	**176.4**	**-95.5**	**-95.8**
Depreciation	21.0	18.8	20.7	11.7	1.6
EBIT	**(13.6)**	**144.0**	**155.7**	**-109.5**	**-108.8**
Other income	12.4	12.8	(2.7)	-3.4	-554.6
Finance cost	5.6	3.1	5.8	79.4	-4.2
PBT	**(6.8)**	**153.7**	**147.2**	**-104.4**	**-104.6**
Tax provision	9.5	39.7	32.1	-76.0	-70.3
Net profit	**(16.4)**	**114.0**	**115.1**	**-114.4**	**-114.2**
EPS (Rs.)	**(0.6)**	**4.0**	**4.1**	**-114.7**	**-114.5**
Margin (%)					
EBITDA	0.6	15.2	14.8	-1,459	-1,419
EBIT	-1.1	13.4	13.1	-1,455	-1,418
NPM	-1.3	10.6	9.7	-1,197	-1,099

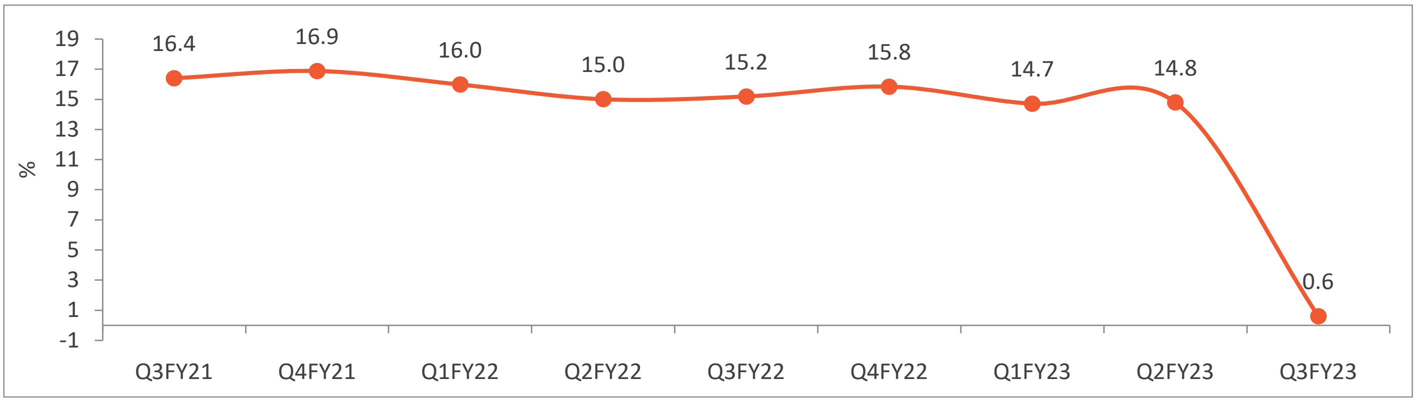
Source: Company, Sharekhan Research

USD revenue growth trend (y-o-y)



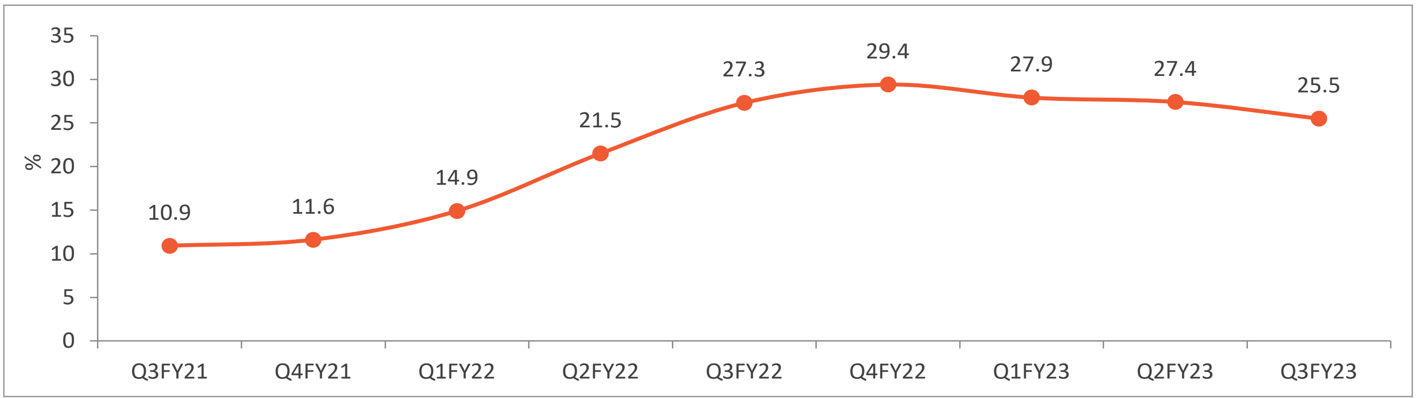
Source: Company, Sharekhan Research

EBITDA margin trend



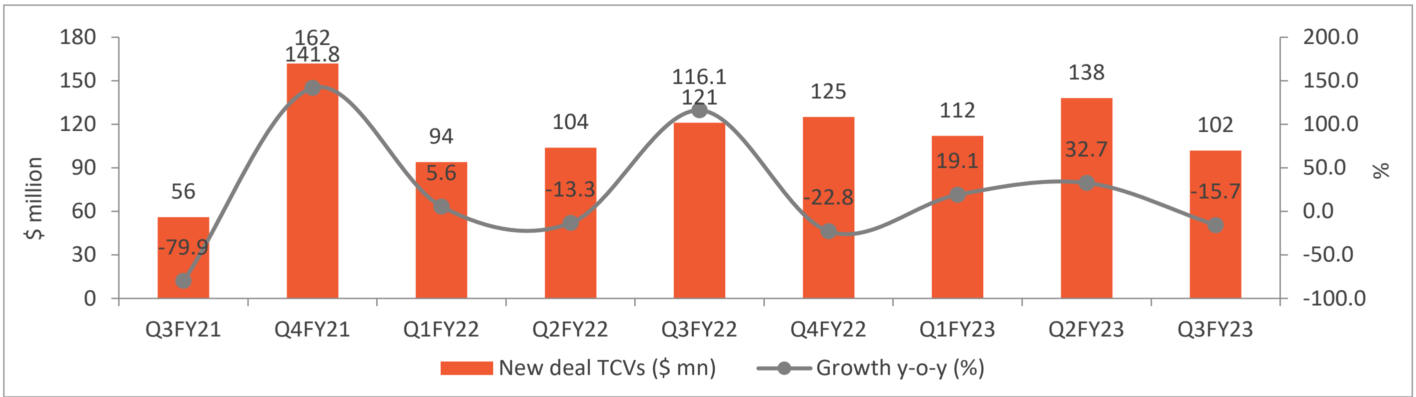
Source: Company, Sharekhan Research

Attrition trend



Source: Company, Sharekhan Research

New deal TCVs ($ mn) and growth (yoy %)



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain.**

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

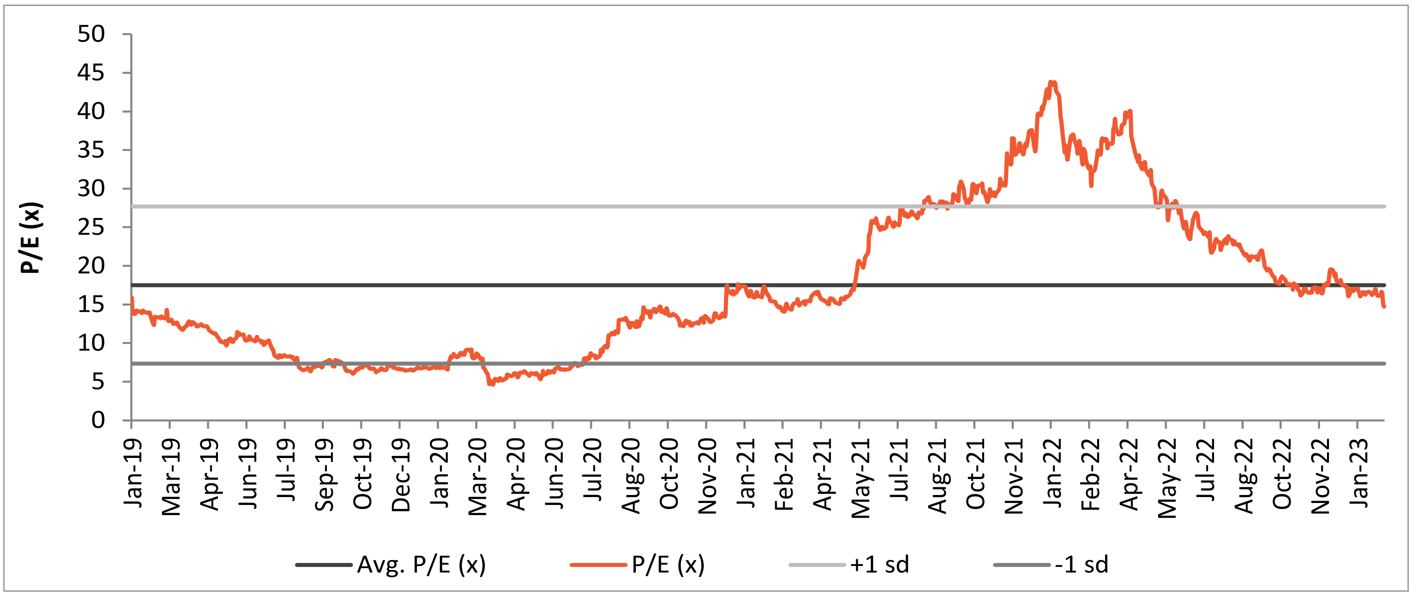
■ **Company outlook - Moving in the right direction.**

The management sees strong traction for virtual engagement, Cloud adoption, and digital transformation work. We believe the company's focus on deepening 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 led by 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 - Long-term earning potential intact. Maintain Buy**

Global macro challenges coupled with bankruptcy of major client raises concern on FY24 growth/ margin outlook and the same would be near term overhang on Birlasoft. However, post the recent correction we believe the robust deal pipeline and long-term earnings potential would continue to act as tailwinds .Hence we maintain Buy on Birlasoft with revised PT of Rs 320. We advise investors to adopt a staggered approach to invest from long term perspective.

One-year forward P/E (x) band



Source: Sharekhan Research

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 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 (an unlisted company) merged and amalgamated with KPIT Technologies Limited (merger) and the engineering business of KPIT Technologies Limited, which was on a going concern basis, demerged and transferred to an independent entity. Post restructuring, Birlasoft became a $450 million-475 million organisation with a mix of digital and ERP revenue. Birlasoft had strengths primarily on 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 indicate 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) Rupee appreciation and/or adverse cross-currency movements, 2) Constraint in local talent supply in the US would have an adverse impact on its earnings and 3) Macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

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

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management Co	5.56
2	ICICI Prudential Asset Management Co	3.36
3	L&T Mutual Fund Trustee	2.73
4	Aditya Birla Sun Life Asset Management	2.66
5	Central India Industries Ltd	1.89
6	Vanguard Group Inc	1.83
7	Dimensional Fund Advisors	1.3
8	BlackRock Inc	0.91
9	Tata Asset Management Pvt Ltd	0.78
10	Nippon Life India Asset Management	0.59

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 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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