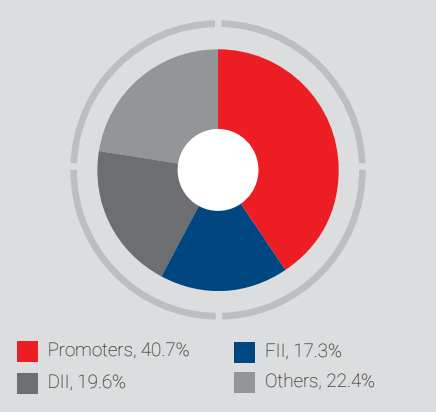
Birlasoft Ltd.

CMP: Rs 410	Rating: BUY	Target: Rs 485

Company Information

BSE Code	532400
NSE Code	BSOFT
Bloomberg Code	BSOFT IN
ISIN	INE836A01035
Market Cap (Rs. Cr)	11410
Outstanding shares(Cr)	27.8
52-wk Hi/Lo (Rs.)	457.8 / 172.2
Avg. daily volume (1yr. on NSE)	1851736
Face Value(Rs.)	2
Book Value	82.6

Share holding pattern as on June 2021



Company overview

Birlasoft Ltd. (BSOFT) was incorporated in 1990 as part of the diversified CK Birla Group, one of India's premier commercial and industrial houses. Birlasoft is the global technology services division of the CK Birla Group, with strategic equity participation by GE Capital. Birlasoft combines the power of domain, enterprise and digital technologies to reimagine business processes for customers and their ecosystem. The company's consultative and design thinking approach makes societies more productive by helping customers run businesses. Birlasoft offers IT services worldwide from development centers in India and Australia. BSOFT and KPIT's IT services business has merged to form a leading publicly listed Enterprise Digital and IT Services company. 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 Rationale

Annuity revenues and deal wins to drive growth

Birlasoft is aiming to achieve a target of US$1 billion in revenues in the next four years (implying a CAGR of 20%). The company aims to achieve this via organic and inorganic revenues

(US$150-200 million). Higher spending on platform-based digital initiatives, Cloud adoption, and aggressive automation would be the company's growth driver in FY22. On the platform side, the company accelerated customers' cloud 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. Birlasoft has significantly improved its annuity revenues from 60% in FY20 to 70% in FY21. 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 FY22. Going forward, it is expected that the company to continue to improve annuity revenues, cross sell to clients and focus on niche verticals. This coupled with Birlasoft's focus on client mining, expansion in Europe & APAC, improving growth in top 30 accounts, healthy deal pipeline, healthy order book, increase in deal sizes, project ramp ups, reversal of discounts, and focused ERP channel sales bode well for revenue growth in coming years. BSOFT has also improved its partnership status with Microsoft Azure and AWS, while progress on Google cloud has been slow but may soon accelerate. Further, management indicated that BSOFT will continue to make investments to capitalize on demand. As part of its micro vertical strategy, BSOFT has identified medical devices (part of Life sciences), high tech (part of Manufacturing; growing at over 20%), heavy industries (Cement, Building Materials; part of Manufacturing), and lending and payment (part of BFSI) as key micro verticals to focus on in order to accelerate growth.

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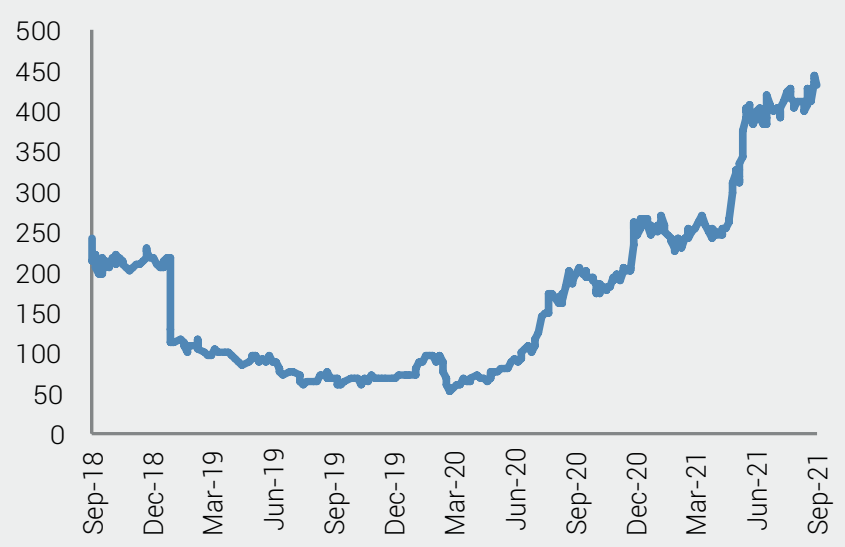
Birlasoft 3Yr. Price Chart



Margins to improve despite headwinds

Birlasoft reported an improvement in margins due to revenue growth, higher billing and lower bad debt partially offset by higher wage hikes and higher recruitment. Going forward, there are margin headwinds due to higher employee cost, lower utilisation and reskilling of employees. Though the expenses would increase with opening of travel in H2FY22, management remains confident to maintain the margin level of Q1FY22 (i.e 16%) despite a 200 bps impact of wage revision, 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 FY22E. The management expects operating profitable would be sustainable despite wage hike in Q2FY22 on the back of higher revenue growth and cost optimization measures. Management indicated that the company's priority currently is to make the required investments to capture high demand and that it is comfortable with operating at ~15% margins in the near term.

Management Outlook

Management remains confident of accelerating revenue growth on the back of broad-based demand and increased traction in the areas of Cloud, Digital and Cybersecurity. While the shortage of talent is a constraint on achieving higher growth (20%), BSOFT is confident of delivering revenue growth in the mid-teens in FY22. Birlasoft is planning to expand its presence in the Europe region to drive growth in the BFSI vertical. The company expects revenue growth of the Lifesciences vertical to recover from Q2. The deal

pipeline at the end of Q1 was 15% higher than Q4FY21 levels. BSOFT expects strong growth in deal ACV (Annual Contract Value); however, Total Contract Value (TCV) growth may remain even as the company is signing many digital transformation deals, which are by nature small in size. The deal pipeline remains robust. Management expects to sustain EBITDA Margin at the current level with an upward bias in FY22 as it anticipates headwinds stemming from wage hikes and investments in capability building and talent, which would be partially offset by revenue growth-led operating leverage, higher offshoring and other efficiencies. Higher spending on platform-based digital initiatives, Cloud adoption, and aggressive automation would be the company's growth driver in FY22. The company witnessed strong demand in digital transformation, enterprise solutions, application modernization, and acceleration of workload migration to cloud, cyber security and infrastructure. 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 management expects operating profitable would be sustainable despite wage hike in Q2FY22 because of higher offshoring revenue and cost-efficiency measures.

Management has reiterated the strong demand environment and that demand will continue to remain robust for the next 3-4 years. The company is benefitting from its strong partnership with hyperscalers like AWS, Microsoft Azure and Google Cloud.

Key risks

- Deterioration of demand for IT services in the wake of second wave of COVID-19
- Softness in SAP and IES
- Loss of any large clients

Valuation

Management has reiterated the strong demand environment and that demand will continue to remain robust for the next 3-4 years. The company is benefitting from its strong partnership with hyperscalers like AWS, Microsoft Azure and Google Cloud. It has also signed partnership with Azure US, which is a significant milestone. Management remains confident of accelerating revenue growth on the back of broad-based demand and increased traction in the areas of Cloud, Digital and Cybersecurity. Further, management indicated that BSOFT will continue to make investments to capitalize on demand. Given strong demand recovery for ERP services, acceleration in digital technologies, improving client mining, healthy deal pipeline, cross selling opportunities, increase in deal sizes, healthy order book, focus on niche verticals, reversal of discounts and expansion in Europe & APAC, it is expected that the company would register healthy growth in earnings going ahead. In addition, cost rationalisation is expected to drive margins. Further, robust margins and healthy cash balance could lead to inorganic expansion or healthy dividend payout. Thus, we recommend our investors to BUY the scrip with target of Rs. 485 from 12 months investment perspective. At the CMP, the scrip is valued at P/E multiple of 20.8x on FY23E Bloomberg consensus EPS of Rs. 19.7.

Particulars (in Rs Cr)	FY20	FY21	FY22E	FY23E
Net Sales	3291.0	3555.7	4063.8	4649.9
Growth (%)	-16.5	8.0	14.3	14.4
EBITDA	390.2	518.2	651.3	761.8
EBITDA Margin (%)	11.9	14.6	16.0	16.4
Net profit	224.3	320.8	457.9	546.6
Net Profit Margin (%)	6.8	9.0	11.3	11.8
EPS (Rs)	8.1	11.6	16.5	19.7

Consensus Estimate: Bloomberg, Ashika Research

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