Birlasoft Limited (KPITEC)

CMP: ₹ 570 | Target: ₹ 650 (14%) | Target Period: 12 months

HOLD

October 24, 2024

Result Update

Weak show on margins & TCV front…

About the stock: Birlasoft Limited (Birlasoft), is the global technology services division of the CK Birla Group. It merged with KPIT's IT Services business in 2019.

- It caters to four verticals - Manufacturing (40%), BFSI (23%), Energy & Utilities (E&U) (16%) and Lifesciences (21%);
- It has delivered strong profit growth of 29.1% CAGR over FY20-24.

Q2FY25 Performance: Birlasoft reported revenue of US$ 163.3 mn, up 2.6% QoQ/ up 3.2% YoY (up 2.2% QoQ/ up 2.9% YoY in CC terms). The company reported EBITDA margin of 12.1%, down ~260 bps QoQ primarily due to increase in its onshore revenues, ramp up in deals which were delayed earlier in the ERP vertical and pricing pressures in certain projects.

Investment Rationale

- **Revenue recovery to be key focus ahead:** The management indicated that the company is focusing on winning more annuity and transformational deals amid a concentrated vendor consolidation deals portfolio currently which is helping them gain market share but not materially helping on the revenue or margin front. The management is making efforts to improve the pricing for existing deals. **We expect dollar revenue growth at 7.6% CAGR between FY24-27E. Consequently, PAT to grow at 8.7% CAGR over FY24-27E.**
- **Weak TCV; Management expects H2 to be better:** The company **reported TCV of US$ 136 mn, down 15% QoQ (owing to delay in decision making at client's end), marking a second consecutive decline with new TCV wins of US$ 47mn during the quarter**. However, the pipeline remains broad based and strong which provides for some revenue visibility in the future. Thus, TCV is expected to recover in H2. This, coupled with the ramp up of the US$100mn deal (secured in Q2FY24) being on track is expected to drive growth going ahead.
- **Margin recovery expected from Q4 onwards:** The management expects margins to show some recovery by Q4 only, after a seasonally soft Q3 due to wage hikes (~150 bps impact), furloughs, partially offset by planned offshoring. **Key margin levers at play would be shift from onsite to offsite, pricing and utilization. We bake in EBITDA margins of 13.2%/14.5%/16% in FY25E/FY26E/FY27E implying a growth in absolute EBITDA at 8.5% CAGR over FY24-27E.**

Rating and Target Price

- Birlasoft's long-term prospects remain positive and we remain hopeful of some recovery around Q4. Nonetheless, margin recovery could take some time.
- Thus, we downgrade the stock to **HOLD** (from BUY) as **we introduce our estimates for FY27E and revise our target price downwards to ₹650 (vs. ₹770 earlier) valuing it at 25x P/E on average of FY26E & FY27E EPS.**

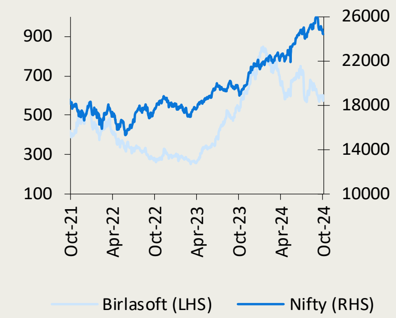
Particulars

Particular	Amount
Market Cap (₹ Crore)	15,803
Total Debt	-
Cash & Inv (₹ Crore)	1,459
EV (₹ Crore)	14,344
52 week H/L	861/ 509
Equity capital	55.2
Face value	2.0

Shareholding pattern

	Dec-23	Mar-24	Jun-24	Sep-24
Promoter	40.9	40.9	40.9	40.9
FII	21.2	23.5	18.8	11.7
DII	20.2	18.6	20.9	24.3
Others	17.6	17.0	19.4	23.2

Price Chart



Key risks

- Delayed recovery in margins;
- Better than expected revenue growth

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Key Financial Summary

₹ Crore	FY22	FY23	FY24	5 Year CAGR (FY19-24)	FY25E	FY26E	FY27E	3 Year CAGR (FY24-27E)
Net Sales	4,130.4	4,794.8	5,278.1	16%	5,514.7	6,052.2	6,703.6	8%
EBITDA	640.1	520.5	836.2	22%	727.2	877.4	1,069.4	9%
EBITDA Margins (%)	15.5	10.9	15.8		13.2	14.5	16.0	
Net Profit	463.6	331.6	623.8	18%	548.7	661.4	801.9	9%
EPS (₹)	16.3	11.9	22.3		19.5	23.4	28.4	
P/E	34.4	47.7	25.4		28.9	23.9	19.7	
RoNW (%)	17.9	13.5	20.5		16.0	16.9	17.6	
RoCE (%)	23.1	18.0	26.9		21.1	22.0	23.0	

Source: Company, ICICI Direct Research

ICICI Securities – Retail Equity Research

Performance highlights and outlook

- **Revenue Performance**: Birlasoft reported revenue of US$ 163.3 mn, up 2.6% QoQ/ up 3.2% YoY (up 2.2% QoQ/ up 2.9% YoY in CC terms). In rupee terms the revenue stood at ₹1,368.22 crore, up 3.07% QoQ/ up 4.45% YoY. The company's revenue from Top 5/10 clients was up by sequentially by 4.1%/2.4% respectively.

- **Geography performance**: Geography wise, changing the dynamics of the previous quarter, Americas region (87.3% of mix) grew by 6.7% QoQ while ROW (12.7% of the mix) declined sharply by 18.5% QoQ.

- **Margin Performance**: The The company reported an absolute EBITDA of ₹165.3 crore with EBITDA margins coming at 12.1%, down ~260 bps QoQ primarily due to increase in its onshore revenues, ramp up in deals which were delayed earlier in the ERP vertical and pricing pressures in certain projects which were in the nature of vendor consolidation deals. The PAT for the quarter stood at ₹127.5 crore, translating to a PAT margin of 9.3% (down 200 bps QoQ)

- **Segment performance**: Segment wise on a QoQ basis the growth was led by Manufacturing (40% of the mix) which grew by 4.7% closely followed by ER&U (16.1% of the mix) which grew by 4.6% while BFSI (23.3% of the mix) which led the growth last quarter saw a muted performance growing at 1.3% QoQ. Life science (20.6% of the mix) faced some pressures and de-grew by 1.2%.

  – **Lifesciences**: This segment has seen a consecutive muted performance over the past five quarters. It reported a dip of 1.2% sequentially, lower than its 6% decline for the past two quarters. The management expects the muted performance to be continued for the couple of more quarters.

- **Service Lines Performance:**

  – **ERP:** Its ERP business has grown sequentially to 4.4% from a decline of 10% seen last quarter. This growth came on the back of ramp up in the projects that were delayed last quarter. The management is further expecting the ERP business to see an uptick in Q4 on account of strong momentum coming in from Oracle and SAP business.

  – **Digital/Data:** This business reported a strong growth sequentially to 6.5%, from a dip of 4.4% in Q1. The management stated that they have a lot of digital wins on the table and is hopeful of converting them. The company aims to build a strong digital business moving ahead which in turn will help in growing their existing portfolio.

  – **Infrastructure:** This service line saw a dip of 18.9% QoQ from the highs of 36.8% in Q1. This decline was on account of delayed real estate projects, as clients are in the wait and watch phase due to the US elections.

- **Outlook/Aspiration**: **The management is focusing to win more of annuity and transformational deals** to achieve a greater revenue growth. On the margins front, they endeavour to improve their margins Q4 onwards and **aim to achieve margins in the band of 15-16%. Key margin levers at play would be shift from offsite to onsite, pricing, improved utilization rates and improved digital business revenues**.

- **TCV & Pipeline**: The TCV for the quarter stood at US$ 136 mn (down 15% QoQ), with the new deal win TCV of US$ 89 mn and renewals of US$ 47 mn. **Decline in TCV was caused due to delayed decision making from the client's end**. However, the company is optimistic of improving its TCV wins moving forward on the back of gaining a balanced mix of transformational and vendor consolidation deals. **It also aims to increase its deal win ratio to 38% in the medium term from its current 30-35%.**

- **Headcount and Attrition**: The total headcount for the quarter stood at 12, 578 employees, down 287 employees. This reduction was due to the rationalising in the support staff. The attrition rate came at 12%, up 20 bps QoQ.

- **Dividend:** The company declared an interim dividend of ₹2.5 per share.

Exhibit 1: Quarter Performance

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
Revenue	1,368	1,310	4.5	1,327	3.1	Revenue grew by 2.6% QoQ in dollar terms and 2.2% QoQ in CC terms.
Employee expense	830	744	11.5	760	9.1	
Gross Margin	539	566	-4.8	567	-5.1	
Gross margin (%)	39.4	43.2	-383 bps	42.7	-337 bps	
Other expense	373	359	4.1	372	0.3	
EBITDA	165.3	207.1	-20.2	195.1	-15.3	
EBITDA Margin (%)	12.1	15.8	-373 bps	14.7	-261 bps	EBITDA margins declined ~261 bps QoQ primarily due to increase in its onshore revenues, ramp up in deals which were delayed earlier in the ERP vertical and pricing pressures in certain projects which were in the nature of vendor consolidation deals.
Depreciation & amortisation	22	22	3.4	21	8.0	
EBIT	143	186	-22.9	175	-18.0	
EBIT Margin (%)	10.5	14.2	-371 bps	13.1	-269 bps	
Other income (less interest)	27	10	169.0	30	-12.4	
PBT	170	196	-13.2	205	-17.2	
Tax paid	42	50	-16.4	55	-22.8	
PAT	128	145	-12.1	150	-15.1	

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY24	FY25E	FY26E	FY27E
Total operating Income	**5,278**	**5,515**	**6,052**	**6,704**
Growth (%)	10.1	4.5	9.7	10.8
COGS (employee expenses)	3,048	3,309	3,548	3,838
Other expenses	1,394	1,478	1,627	1,797
Total Operating Expenditure	4,442	4,788	5,175	5,634
EBITDA	**836**	**727**	**877**	**1,069**
Growth (%)	60.7	(13.0)	20.7	21.9
Depreciation	85	87	92	96
Other income (net)	84	96	99	99
PBT	835	737	884	1,072
Total Tax	211	188	223	270
PAT	**624**	**549**	**661**	**802**
Growth (%)	88.1	(12.0)	20.5	21.2
Diluted EPS (₹)	**22.3**	**19.5**	**23.4**	**28.4**
Growth (%)	86.7	(12.6)	20.5	21.2

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement ₹ crore

(Year-end March)	FY24	FY25E	FY26E	FY27E
Profit before Tax	835	737	884	1,072
Add: Depreciation	85	87	92	96
Others	52	(96)	(99)	(99)
Inc/(dec) in working capital	(73)	(23)	(106)	(131)
Taxes paid	(181)	(188)	(223)	(270)
CF from operating activities	**718**	**516**	**549**	**668**
(Inc)/dec in Fixed Assets	(26)	(114)	(126)	(139)
Others	(601)	112	107	107
CF from investing activities	**(627)**	**(3)**	**(18)**	**(32)**
Dividend paid & dividend tax	(124)	(169)	(169)	(169)
Others	(44)	(15)	(8)	(8)
CF from financing activities	**(168)**	**(184)**	**(178)**	**(178)**
Net Cash flow	(76)	329	353	458
Exchange difference	2	-	-	-
Opening Cash	499	425	753	1,106
Closing cash & Bank	**425**	**753**	**1,106**	**1,565**

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet ₹ crore

(Year-end March)	FY24	FY25E	FY26E	FY27E
Equity Capital	55	55	55	55
Reserve and Surplus	2,989	3,368	3,861	4,493
Total Shareholders funds	3,044	3,424	3,916	4,548
Total Debt	-	-	-	-
Lease liablity	58	58	58	58
Provisions	71	74	82	90
Other non current liabilties	7	7	7	7
Total Liabilities	**3,180**	**3,563**	**4,062**	**4,703**
Assets				
Property,plant and equipment	105	158	220	292
Goodwill	496	496	496	496
Intangibles	9	9	9	9
Right-of-use assets	87	61	34	5
Other non current assets	461	461	513	579
Cash & bank balance	425	753	1,106	1,565
Current Investments	1,034	1,034	1,034	1,034
Trade receivables	768	802	880	975
Unbilled revenue	269	281	308	341
Other financial assets	3	3	3	4
Other current assets	269	282	309	342
Total Current Assets	2,767	3,155	3,641	4,261
Trade payables	281	293	322	356
Lease liablity	35	35	35	35
OCL & provisions	430	449	493	546
Total Current Liabilities	746	778	850	938
Net Current Assets	2,022	2,377	2,791	3,323
Application of Funds	**3,180**	**3,562**	**4,062**	**4,703**

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

(Year-end March)	FY24	FY25E	FY26E	FY27E
Per share data (₹)				
Diluted EPS	22.3	19.5	23.4	28.4
Cash EPS	25.5	22.9	27.1	32.3
BV	110	123	141	164
DPS	4.5	6.1	6.1	6.1
Cash Per Share	15	27	40	56
Operating Ratios (%)				
EBITDA margin	15.8	13.2	14.5	16.0
PBT Margin	15.8	13.4	14.6	16.0
PAT Margin	11.8	10.0	10.9	12.0
Debtor days	53	53	53	53
Unbilled days	19	19	19	19
Creditor days	19	19	19	19
Return Ratios (%)				
RoE	20.5	16.0	16.9	17.6
RoCE	26.9	21.1	22.0	23.0
RoIC	43.9	36.3	41.1	46.5
Valuation Ratios (x)				
P/E	25.4	28.9	23.9	19.7
EV / EBITDA	17.2	19.3	15.6	12.3
EV / Net Sales	2.7	2.5	2.3	2.0
Market Cap / Sales	3.0	2.9	2.6	2.4
Price to Book Value	5.2	4.6	4.0	3.5
Solvency Ratios				
Debt/EBITDA	-	-	-	-
Debt / Equity	-	-	-	-
Current Ratio	1.8	1.8	1.8	1.8
Quick Ratio	1.8	1.8	1.8	1.8

Source: Company, ICICI Direct Research

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