

Client issue, furlough impacts Q3; leadership changes may bring in some recovery

About the stock: Birlasoft Ltd (Birlasoft) has strength in non-ERP digital businesses like CRM, B & data analytics, app development & enterprise solution.

- The company caters to manufacturing, BFSI, energy & utility and life sciences
- Debt free and healthy double digit return ratio (with RoCE of >19%)

Q3FY23 Results: Birlasoft reported weak numbers for Q3FY23.

- Revenue was flat QoQ in CC & declined 0.3% in dollar terms
- Adjusted EBITDA margins excluding provision feel ~180 bps QoQ to 13%
- Signed TCV of US\$231 mn during the quarter

What should investors do? Birlasoft's share price has grown by ~2.3x since its demerger (from ~₹ 114 in February 2019 to ~₹ 266 levels in February 2023).

- We maintain our **HOLD** rating on the stock

Target Price and Valuation: We value Birlasoft at ₹ 255 i.e. 13x P/E on FY25E EPS.

Key triggers for future price performance:

- Change in management, hiring of new vertical leaders likely to recoup some lost revenue momentum
- Revenue growth is expected to be achieved via client mining, cross sell, multi-year deals, expansion in Europe & APAC and focus on niche verticals
- Expect rupee revenues to grow at 10.1% CAGR over FY22-25E
- Expect EBITDA margin to be at 15.1% by FY25E on the back of easing of supply side challenges, higher utilisation, etc

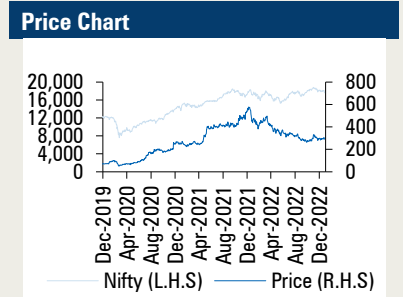
Alternate Stock Idea: Apart from Birlasoft, in our IT coverage we also like Newgen.

- Strong logo additions, increasing annuity revenues & GSI opportunity to aid revenue growth at 18.7% CAGR in FY22-25E
- BUY with target price of ₹ 460



Particulars	
Particular	Amount
Market Cap (₹ Crore)	7,358
Total Debt	-
Cash and Invest (₹ Crore)	1,169
EV (₹ Crore)	6,189
52 week H/L	501/ 250
Equity capital	54.4
Face value	2.0

Shareholding pattern				
	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	40.4	40.3	41.5	41.3
FII	15.4	15.2	13.0	12.4
DII	22.7	21.1	19.9	20.1
Public	21.4	21.4	25.7	26.2



- Recent event & key risks**
- Provision of ₹151 crore due to client filing for bankruptcy in US
 - Key Risk:** (i) Lower than expected revenue growth (ii) Higher than expected margins

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Key Financial Summary

₹ Crore	FY21	FY22	3 Year CAGR (FY19-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	3,556	4,130	17.4%	4,752	5,084	5,516	10.1%
EBITDA	529	640	27.8%	525	756	834	9.2%
EBITDA Margins (%)	14.9	15.5		11.0	14.9	15.1	
Net Profit	321	464	19.5%	343	499	554	6.1%
EPS (₹)	11.6	16.3		12.1	17.7	19.7	
P/E	23.1	16.0		21.2	14.6	13.1	
RoNW (%)	14.7	17.9		15.4	19.9	19.6	
RoCE (%)	19.8	23.1		19.7	26.1	25.5	

Key takeaways of recent quarter & conference call highlights

- Revenue for the quarter was flat QoQ while in dollar terms revenue declined by 0.3% to \$148.4 mn. In rupee terms, the company reported revenue of ₹ 1,221.9 crore, up 2.5% QoQ
- Geography wise, US (83.1% of mix) declined 0.7% QoQ while Europe continue to grow reporting growth of 7% QoQ. Vertical wise manufacturing and E&U declined 2.6% QoQ & 1.7% QoQ, respectively, while BFSI & Lifesciences reported growth of 5% & 1.3% QoQ, respectively. The company indicated that furloughs & deal delays impacted E&U vertical
- Adjusted EBITDA margin excluding provision declined 180 bps QoQ to 13% while reported EBITDA margin of the company was 0.6%. The company indicated that apart from the provisions margins of the company were impacted by higher-than-expected furlough impacts, investment in new leadership & impact of some residual wage hikes
- The company has informed that Birlasoft Solutions Inc. a subsidiary of the company, has received an intimation that Invacare Corporation, a customer in the US, has filed for bankruptcy on February 1, 2023. The company has made a provision of US\$19 mn or ₹ 151 crore against receivables from this client till that date on billed, unbilled as well as contractual assets which may include cost of third-party licenses, subcontractors etc. Birlasoft also indicated that it is taking legal opinion and clarity on i) whether the work can be continued with this client after February 1, 2023 ii) whether the client can be billed for the services to be provided hereafter iii) any additional provisions to be made, which may come up in Q4 and beyond iv) resources on this project can be shifted to other projects etc v) Bankruptcy filed by the client for US operations while Birlasoft has been working with this client on global profile, so what happens to the work relationship outside US. The company also mentioned that it expects zero revenue from this contract in Q4 and have taken a hit of 3% on Q3 revenue. Birlasoft also indicated that provisions may continue at least in Q4 till further clarity emerges. The company also mentioned that this was fixed price contract signed in 2019. Hence, despite only two months of delay in billed payment (unbilled extra) the amount may look large due to nature of contract wherein the company has spent on efforts and the cost was front loaded. The company also mentioned that none of its other accounts have been facing any issues
- Birlasoft also mentioned that performance for the quarter was impacted due to higher-than-expected furloughs, projects put on hold by few of its clients for the quarter and investments in new leaderships. The company indicated that longer term technology spend trends are intact as customers continue to spend on cloud transformation. It also indicated that customers are also increasingly spending on customer experience & cost optimisation but deal pipeline is now skewed towards cost take out deals due to high inflation scenario
- The company indicated it will focus on growth in top accounts where it is likely to increase investments while continuing to strengthen its capabilities such as digital, data & analytics which are working well for it. Birlasoft also mentioned that it has a good chunk of legacy business. Hence, it would like to take up these new capabilities to its core verticals such as BFSI and manufacturing to aid growth going forward. The company also mentioned that it is now looking for sustained quarterly growth, going forward, before it can think of reaching US\$1 bn revenue as indicated by earlier CEO
- The company indicated that its growth momentum in BFSI continues to be good since it has been in a leadership position in couple of processes in this space and it is looking to capitalise the same for further growth acceleration. Birlasoft also mentioned it also has a good set of clients in BFSI space and growth in some top accounts helping them

- The company also mentioned it has appointed new leaders in hi-tech and manufacturing verticals and is hopeful of good growth in this vertical from the medium-term perspective. Birlasoft also welcomed new leaders in life sciences as well as energy verticals while indicating that some more leaders are in the pipeline. The company also mentioned that it is seeing growth in both legs of manufacturing in terms of discretionary and non-discretionary spending while it indicated that there could be slower growth for couple of quarters but it is likely to rebound as the cycle reverse
- The company indicated that ex-provisions, it is looking at sequential growth in both revenues and profitability in Q4. Birlasoft mentioned that since it is investing into leadership building as well as strengthening of few capabilities, it is likely to take a hit on EBITDA margins in the near term and indicated that it may take few quarters to reach 15% EBIT margin. The company also indicated that they aspire to expand margins in the medium term on easing of supply side pressure
- The company indicated that currently is focusing on growing its organic capabilities & organic business & it will evaluate the opportunity of inorganic growth at later stage if it feels the need of it. The management indicated that it is not actively looking for any inorganic opportunity
- The company continues to win steady deals & indicated that its pipeline remains strong. Birlasoft for the quarter reported TCV of US\$231 mn, up 39.2% QoQ including new deal wins of US\$ 102 mn, down 26.1% QoQ.
- The company also mentioned that TCV it won for the quarter includes three large deals & it aspires to have more sticky revenue from clients, going forward, especially from top 20 accounts. The company also mentioned that its legacy business is likely to report flattish revenue growth in FY23 while growth from new age and digital business is likely to be industry leading
- The company's revenue from its Top 5/10/20 clients grew by 1.7%/1.2% & 0.4% QoQ respectively
- The company's LTM attrition declined 190 bps QoQ to 25.5%. The company indicated that it expects attrition to moderate further and will provide a tailwind lever for margin improvement. The company's utilisation during the quarter improved by 160 bps QoQ to 84%
- The company's net headcount during the quarter declined by 228 to 12,530. Out of the 228, the net decline in technical employees was 182 taking the total technical employees to 11,386

Exhibit 1: P&L

	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
Revenue	1,222	1,072	14.0	1,192	2.5	CC growth was flat on QoQ due to higher than expected furloughs, hold on some projects
Employee expense	732	607	20.6	694	5.5	
Gross Margin	490	465	5.3	498	-1.7	
Gross margin (%)	40.1	43.4	-330 bps	41.8	-170 bps	
Other expense	483	302	59.6	322	49.9	
EBITDA	7.4	162.8	-95.5	176.4	-95.8	
EBITDA Margin (%)	0.6	15.2	-1458 bps	14.8	-1419 bps	EBITDA margins adjusted to ₹151 crore were at 13%, impacted by higher SG&A expenses
Depreciation & amortisation	21	19	11.9	21	1.6	
EBIT	-14	144	-109.5	156	-108.8	
EBIT Margin (%)	-1.1	13.4	-1455 bps	13.1	-1418 bps	
Other income (less interest)	7	10	-29.3	-9	-179.8	
PBT	-7	154	-104.4	147	-104.6	
Tax paid	10	40	-76.0	32	-70.3	
PAT	-16	114	-114.4	115	-114.2	

Source: Company, ICICI Direct Research

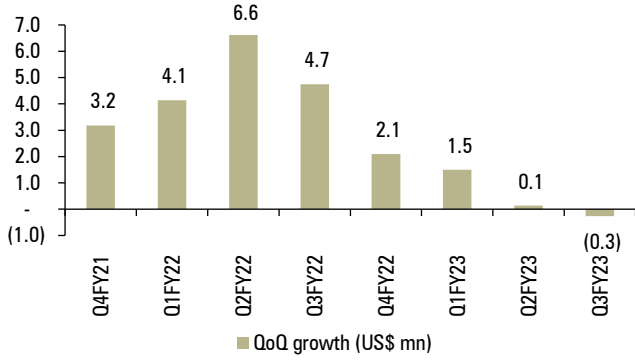
Exhibit 2: Change in estimates

	FY23E			FY24E			FY25E			Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change	
(₹ Crore)										
Revenue	4,719	4,752	0.7	5,144	5,084	-1.2	5,659	5,516	-2.5	We re-align numbers on weak 9M performance
EBITDA	708	525	-25.8	798	756	-5.2	891	834	-6.4	
EBITDA Margin (%)	15.0	11.0	-395 bps	15.5	14.9	-64 bps	15.7	15.1	-62 bps	FY23E margin will hit by one time provision while FY24E and FY25E margins are trimmed on continue leadership and capability investments which likely erode margins
PAT	467	343	-26.7	527	499	-5.2	587	554	-5.6	
EPS (₹)	17	12	-26.7	18.7	18	-5.2	21	20	-5.6	

Source: Company, ICICI Direct Research

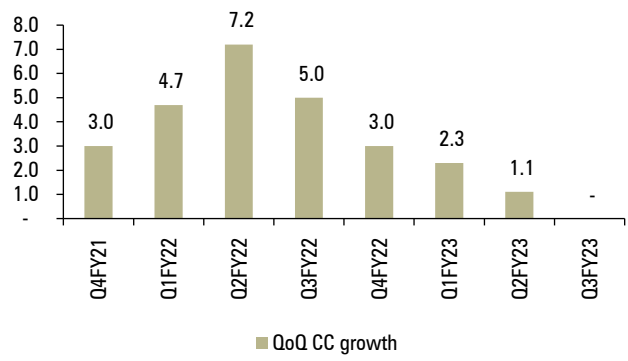
Key Metrics

Exhibit 3: Dollar revenue trend QoQ



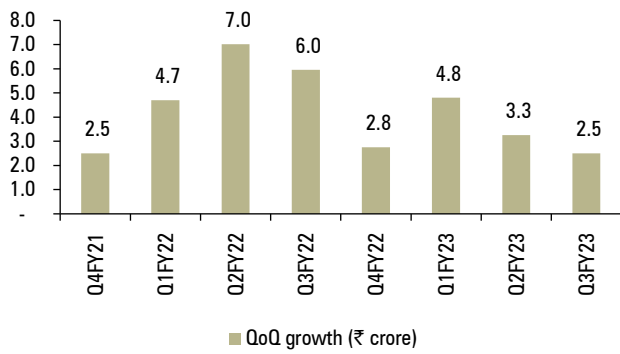
Source: Company, ICICI Direct Research

Exhibit 4: CC growth flat in Q3, 3% impact of client issue



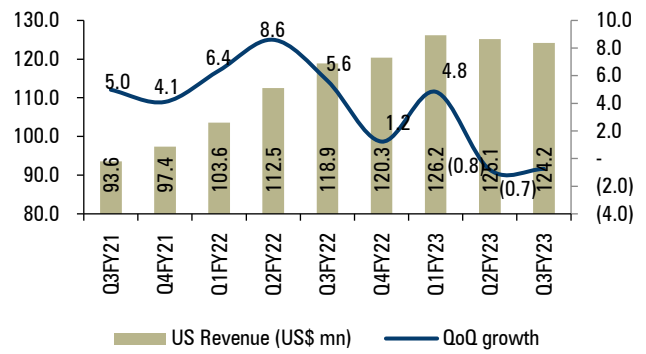
Source: Company, ICICI Direct Research

Exhibit 5: Rupee revenue QoQ growth



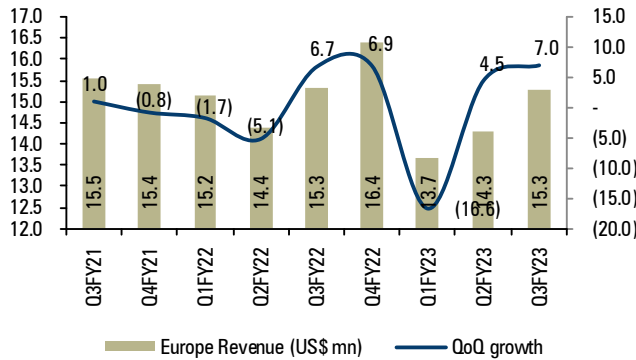
Source: Company, ICICI Direct Research

Exhibit 6: US revenue declines on furloughs & client issue



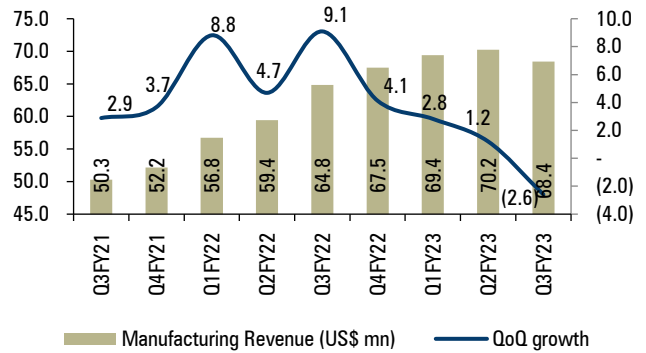
Source: Company, ICICI Direct Research

Exhibit 7: Europe sees further recovery Q3



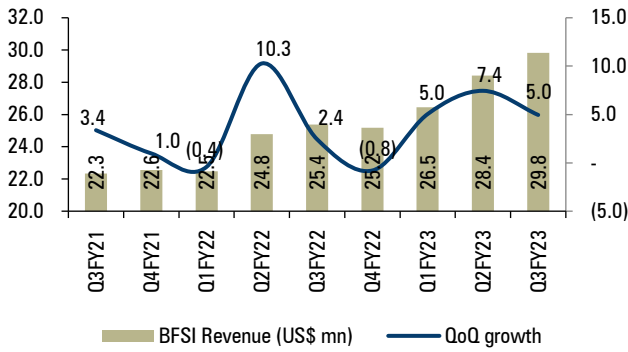
Source: Company, ICICI Direct Research

Exhibit 8: Manufacturing hit by furlough



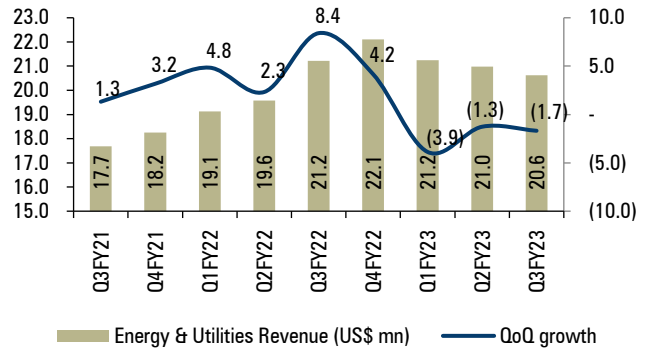
Source: Company, ICICI Direct Research

Exhibit 9: While BFSI growth continues



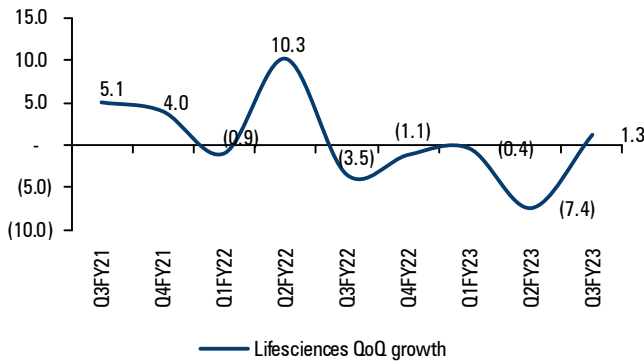
Source: Company, ICICI Direct Research

Exhibit 10: Energy impacted by furlough & deal delays



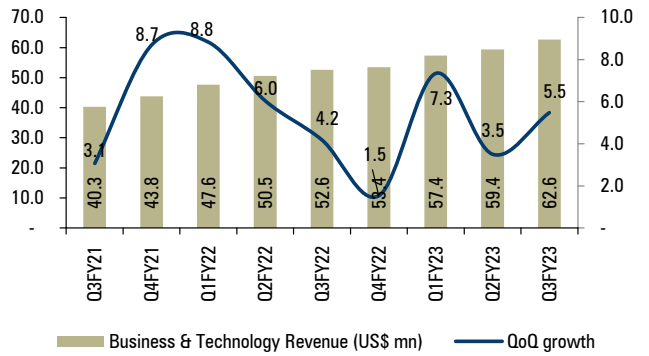
Source: Company, ICICI Direct Research

Exhibit 11: Lifesciences still sluggish



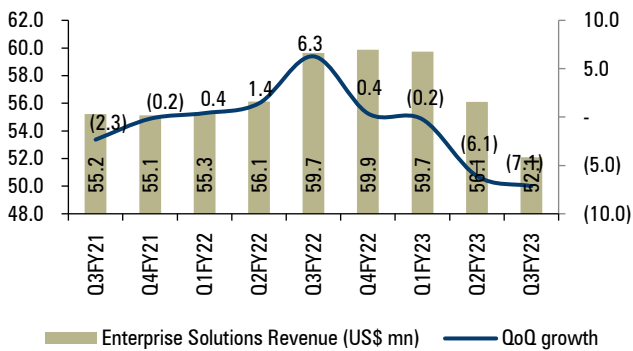
Source: Company, ICICI Direct Research

Exhibit 12: Business & tech revenue QoQ growth



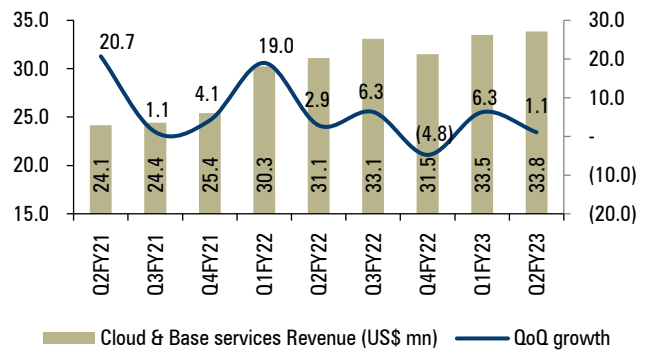
Source: Company, ICICI Direct Research

Exhibit 13: Enterprise solutions continues to decline



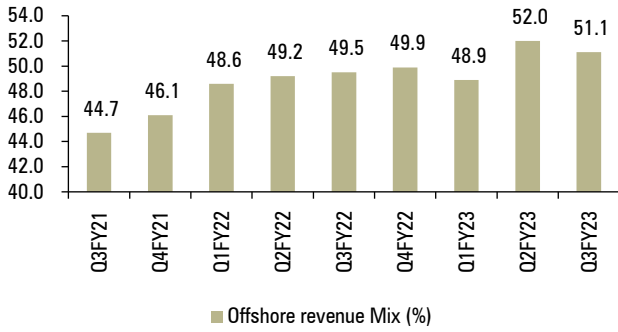
Source: Company, ICICI Direct Research

Exhibit 14: Cloud & Base services revenue QoQ growth



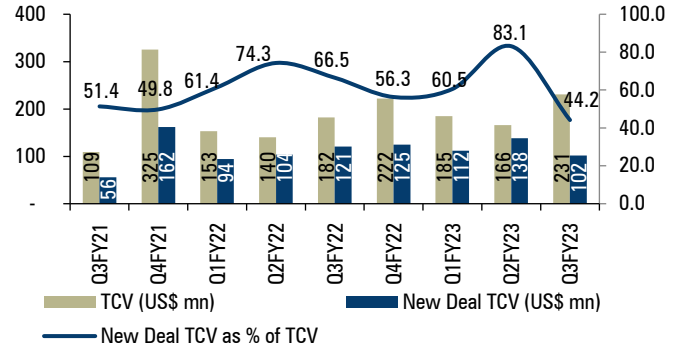
Source: Company, ICICI Direct Research

Exhibit 15: Offshore mix improving



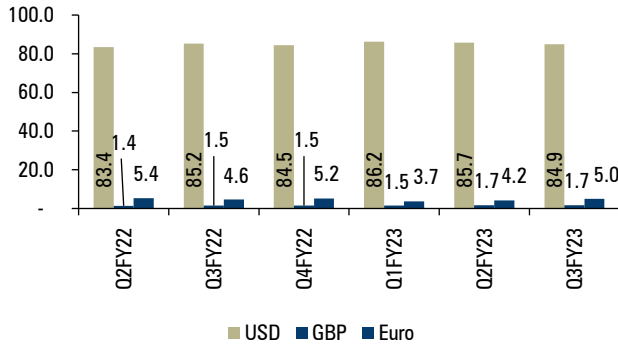
Source: Company, ICICI Direct Research

Exhibit 16: TCV wins remains strong



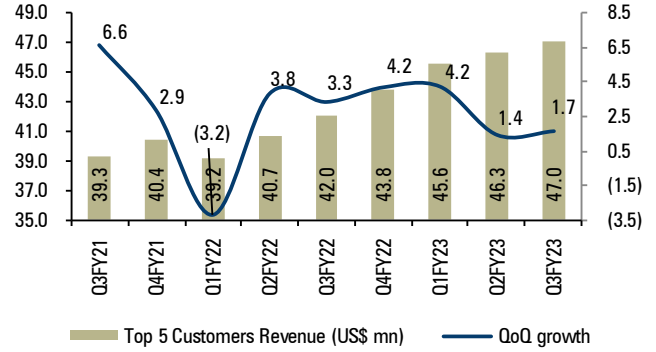
Source: Company, ICICI Direct Research

Exhibit 17: Currency mix of revenue (%)



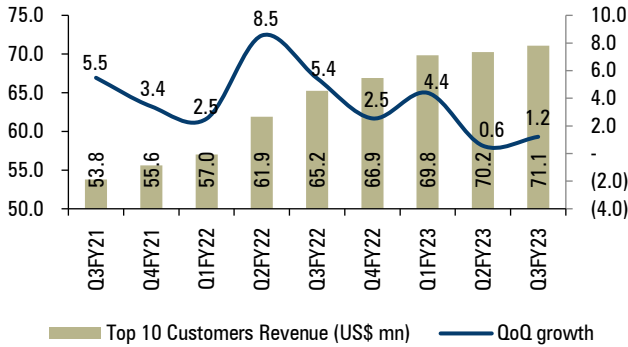
Source: Company, ICICI Direct Research

Exhibit 18: Top five customer's revenue QoQ growth



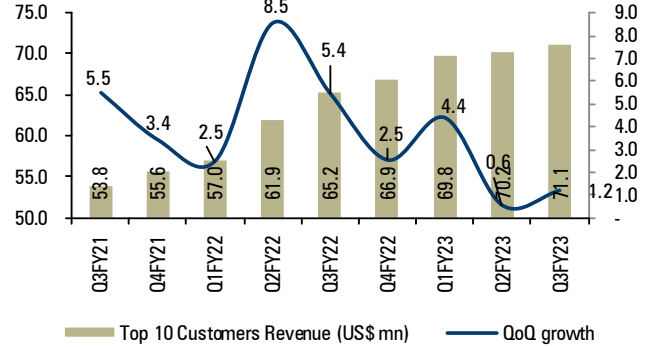
Source: Company, ICICI Direct Research

Exhibit 19: Top 10 customer's revenue QoQ growth



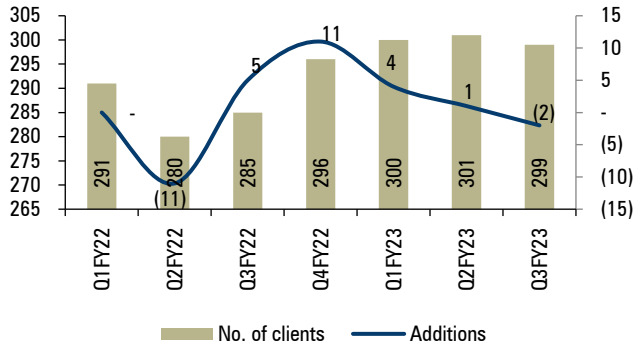
Source: Company, ICICI Direct Research

Exhibit 20: Top 20 customer's revenue QoQ growth



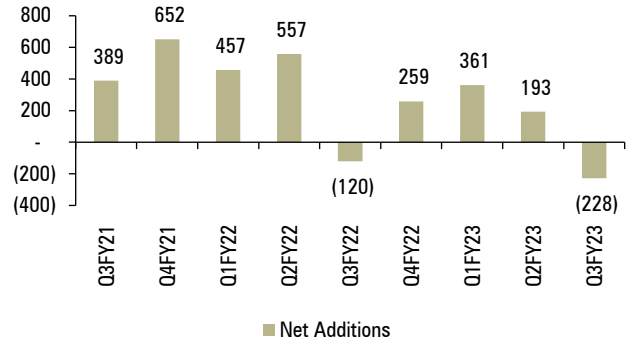
Source: Company, ICICI Direct Research

Exhibit 21: Number of clients additions trend



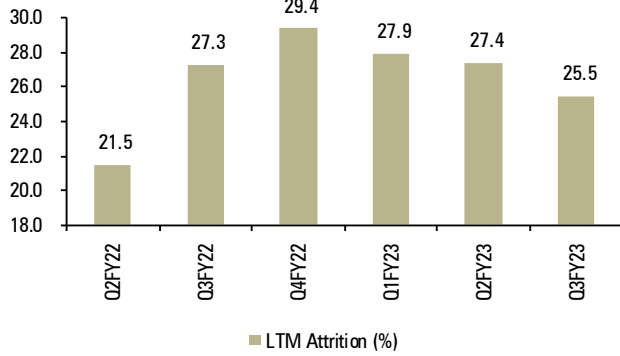
Source: Company, ICICI Direct Research

Exhibit 22: Net headcount additions trend



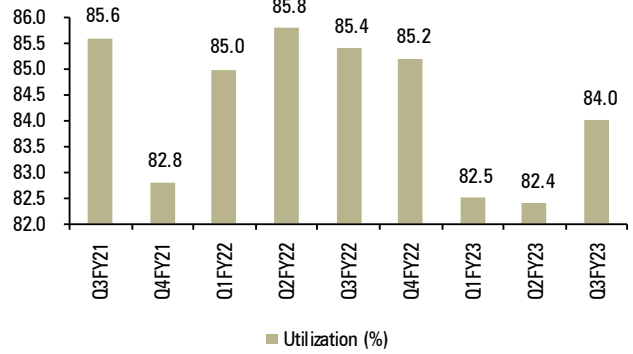
Source: Company, ICICI Direct Research

Exhibit 23: LTM attrition moderating but still elevated



Source: Company, ICICI Direct Research

Exhibit 24: Utilisation trend



Source: Company, ICICI Direct Research

Financial Summary

Exhibit 25: Profit & loss statement (₹ crore)				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Total operating income	4,130	4,752	5,084	5,516
Growth (%)	16.2	15.0	7.0	8.5
COGS (employee expenses)	2,369	2,785	2,924	3,199
Other expenses	1,121	1,457	1,361	1,492
Total Operating Expenditure	3,490	4,242	4,285	4,690
EBITDA	640	525	756	834
Growth (%)	21.0	(18.0)	44.0	10.3
Depreciation	77	95	102	110
Other income (net)	53	20	20	20
PBT	617	463	675	744
Total Tax	153	120	175	190
PAT	464	343	499	554
Growth (%)	44.5	(26.1)	45.8	11.0
Diluted EPS (₹)	16.3	12.1	17.7	19.7
Growth (%)	40.7	(25.6)	45.8	11.0

Source: Company, ICICI Direct Research,

Exhibit 26: Cash flow statement (₹ crore)				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Profit	464	463	675	744
Add: Depreciation	77	95	102	110
Others	22	(20)	(20)	(20)
Inc/(dec) in working capital	(256)	(71)	(104)	(83)
Taxes paid	(178)	(120)	(175)	(190)
CF from operating activiti	281	346	477	561
(Inc)/dec in Fixed Assets	(64)	(81)	(86)	(94)
Others	(243)	511	40	40
CF from investing activiti	(307)	430	(47)	(54)
Dividend paid & dividend tax	(111)	(226)	(226)	(226)
Others	(36)	(488)	(20)	(20)
CF from financing activiti	(147)	(714)	(245)	(245)
Net Cash flow	(173)	62	185	262
Exchange difference	(3)	-	-	-
Opening Cash	558	383	445	630
Closing cash & Bank	383	445	630	892

Source: Company, ICICI Direct Research

Exhibit 27: Balance Sheet (₹ crore)				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Equity Capital	56	54	54	54
Reserve and Surplus	2,527	2,177	2,450	2,779
Total Shareholders funds	2,583	2,231	2,505	2,834
Total Debt	-	-	-	-
Lease liability	91	91	91	91
Provisions	49	57	61	66
Other non current liabilities	-	-	-	-
Total Liabilities	2,723	2,379	2,657	2,990
Assets				
Property, plant and equipment	147	161	176	145
Goodwill	457	457	457	457
Intangibles	10	10	10	10
Right-of-use assets	112	83	53	19
Other non current assets	224	207	264	286
Cash & bank balance	383	445	630	892
Current Investments	786	315	315	315
Trade receivables	681	784	838	910
Unbilled revenue	168	193	206	224
Other financial assets	20	23	25	27
Other current assets	395	455	487	528
Total Current Assets	2,433	2,215	2,501	2,896
Trade payables	210	241	258	280
Lease liability	32	32	32	32
OCL & provisions	419	482	515	559
Total Current Liabilities	660	754	805	871
Net Current Assets	1,773	1,460	1,696	2,025
Application of Funds	2,723	2,379	2,657	2,991

Source: Company, ICICI Direct Research

Exhibit 28: Key ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
Diluted EPS	16.3	12.1	17.7	19.7
Cash EPS	19.3	16.0	22.0	24.3
BV	92	82	92	104
DPS	4.0	8.3	8.3	8.3
Cash Per Share	14	16	23	33
Operating Ratios (%)				
EBITDA margin	15.5	11.0	14.9	15.1
PBT Margin	14.9	9.7	13.3	13.5
PAT Margin	11.2	7.2	9.8	10.0
Debtor days	60	60	60	60
Unbilled days	15	15	15	15
Creditor days	19	19	19	19
Return Ratios (%)				
RoE	17.9	15.4	19.9	19.6
RoCE	23.1	19.7	26.1	25.5
RoC	36.3	26.6	38.3	41.7
Valuation Ratios (x)				
P/E	16.0	21.2	14.6	13.1
EV / EBITDA	9.8	12.7	8.6	7.5
EV / Net Sales	1.5	1.4	1.3	1.1
Market Cap / Sales	1.8	1.6	1.5	1.3
Price to Book Value	2.9	3.3	2.9	2.6
Solvency Ratios				
Debt/EBITDA	-	-	-	-
Debt / Equity	-	-	-	-
Current Ratio	1.9	1.9	1.9	1.9
Quick Ratio	1.9	1.9	1.9	1.9

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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