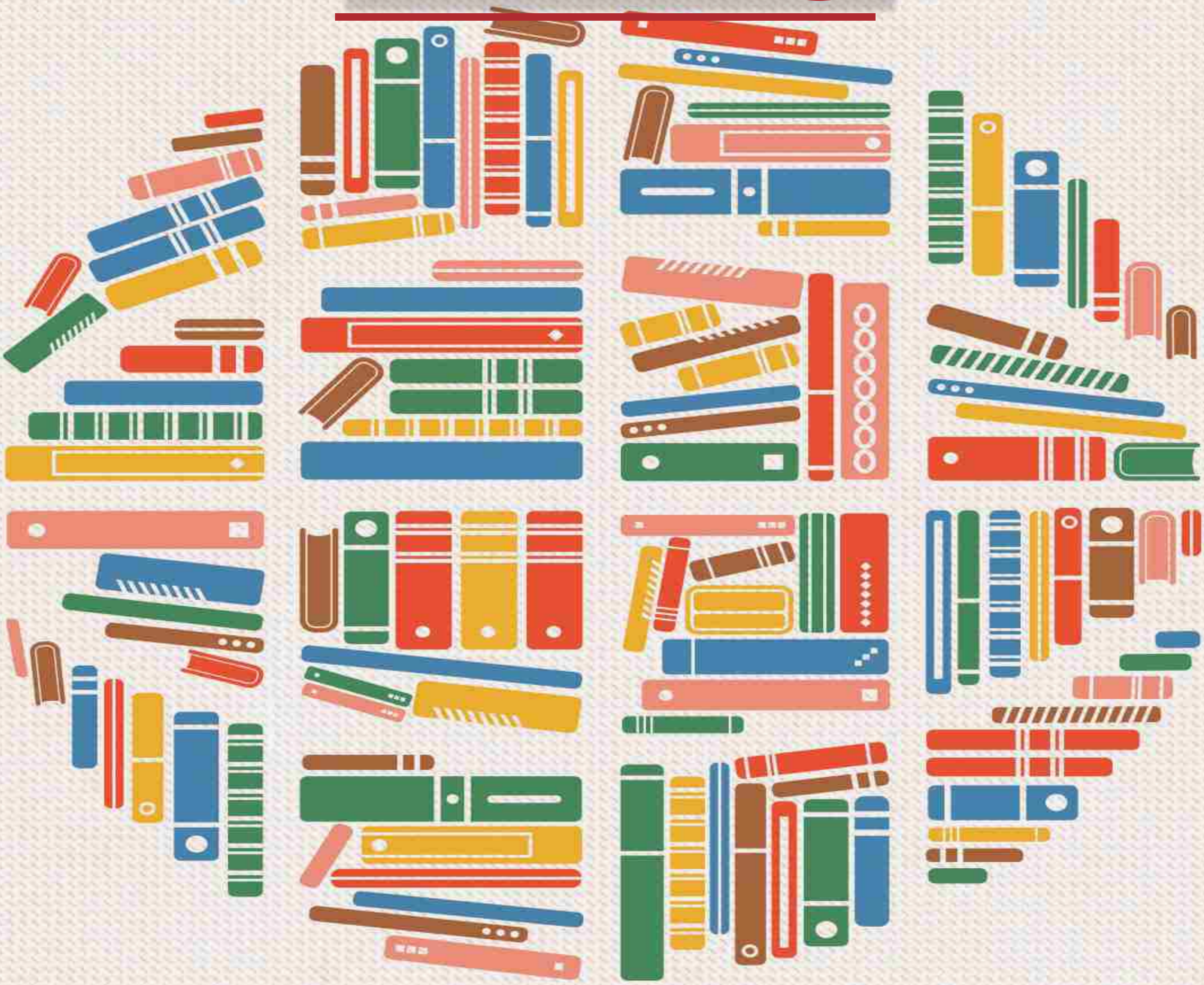
ICICI direct Research

August 20, 2020

Stock TALES



Stock Tales are concise, holistic stock reports across wider spectrum of sectors. Updates will not be periodical but based on significant events or change in price.

Birlasoft Ltd (KPITEC)

CMP: ₹ 171 | Target: ₹ 210 (23%) | Target Period: 12 months | **BUY**

August 20, 2020

Improving execution, attractive valuation…

Birlasoft Ltd (Birlasoft) post the merger with KPIT Technologies has successfully overcome integration challenges, restructured its sales & delivery functions and optimised its cost structure. Apart from this, the complimentary business of merged companies has enabled Birlasoft to win large deals and improve deal wins. Going forward, we expect improving opportunities from cross sell, large deal wins, client mining opportunities, focus on niche verticals and geographical expansion to drive revenues in the long run. In addition, cost rationalisation and migration to new tax regime will help improve EBITDA and PAT margins. As a result, we expect revenues, profits to increase at 11%, 25% CAGR, respectively, in FY20-23E.

Large deal wins, cross sell, client mining key growth drivers

Post the merger, Birlasoft has aligned its sales structure towards more cross selling, adding new logos, diving multi service deals and client mining. Further, the company has also hired leaders from Tier 1 companies, which will help strengthen its leadership, improve client mining and drive operational efficiency. The company is also rationalising its tail clients to improve sales effort for top client mining. We believe this will drive its long-term revenues and improve revenue per client (that is the lowest at US$1.2 vs. midcap peers at US$3). Further, the company has also shown improved performance in terms of deal wins. Birlasoft has signed record deals of US$669 million (book to bill ratio of 1.44x) in FY2020, of which ~65% was new deals. In Q1FY21 the company's overall deals increased 104% YoY despite challenging times. We believe consistent deal wins coupled with large deal wins will be a key driver of revenues in the long run.

Sustained improvement in margins expected; going forward

In the past few quarters, the company has seen some cost rationalisation. This has led EBITDA margins to improve from 9.9% in Q1FY20 to 12.3% in Q1FY21. Going forward, we expect margins to improve led by higher offshoring, increase in annuity revenues & fixed price projects, increase in utilisation and rationalisation of support staff & sub-contracting cost. Hence, we expect EBITDA margins to reach 15% in FY22E (as indicated by the company of achieving 15% EBITDA margins in next four quarters). Also, we expect PAT margins to improve in coming quarters due to migration of the company to the new tax regime.

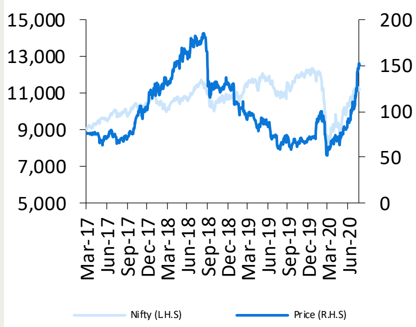
Valuation & Outlook

Birlasoft's focus on niche verticals, geographic expansion, cross selling, client mining, large deal wins are key long-term revenue drivers. This coupled with talent from tier 1 players will drive revenue growth. Also, cost efficiency, tax rationalisation will drive profitability. Further, the company's healthy cash balance could lead to inorganic expansion or healthy dividend payout. This, coupled with attractive valuation of 11x FY23E EPS prompts us to recommend **BUY** with target price of ₹ 210 (13x FY23E EPS).

Particulars

Particular	Amount
Market Capitalization (₹Crore)	4,749.3
Total Debt	-
Cash and Investments (₹Crore)	663.1
EV (₹Crore)	4,086.1
52 week H/L	188/48
Equity capital	55.3
Face value	2.0

Price Performance



Key Highlights

- Healthy revenue growth and improving margins keeps us positive on the stock from a long-term perspective.
- Assign Buy rating to stock with target price of ₹ 210

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Key Financial Summary

₹Crore	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	2,551	3,291	3,687	4,068	4,475	10.8%
EBITDA	306	392	479	610	671	19.6%
EBITDA Margins (%)	12.0	11.9	13.0	15.0	15.0	
Net Profit	272	224	303	399	441	25.2%
EPS (₹)	13.4	8.1	10.8	14.2	15.7	
P/E	14.6	21.1	15.7	11.9	10.8	
RoNW (%)	15.9	11.9	14.7	17.7	17.8	
RoCE (%)	15.5	17.0	19.1	22.5	22.7	

Source: Company, ICICI Direct Research

Company Background

Birlasoft Ltd (Birlasoft), a CK Birla group company, became a listed company on 15 January 2019. Birlasoft (the unlisted company) was merged with KPIT Technologies Ltd (listed company). The companies were later demerged resulting in two companies, one catering to engineering side (KPIT Technologies) and other catering to IT services side (Birlasoft). Birlasoft had US$145 million of IT services revenues and KPIT's IT division had US$330 million revenues resulting in a combined entity of US$475 million.

The combined entity (Birlasoft) has complementary skills from both businesses. Birlasoft has strength in non-ERP digital businesses like CRM, BI & Data Analytics, Application Development while KPIT IT Services has core strengths in Enterprise Software Solutions like Oracle, JD Edwards, SAP, Infor, etc and capabilities in digital transformation services. The merged entity will have the following distinguishing points: 1) The highest percentage of business coming from core enterprise systems, 2) capabilities from the enterprise product and cloud companies: SAP, Oracle, JD Edwards and Salesforce.com. 3) the company possesses significant 'Digital' capability in analytics, Robotic Process Automation (RPA), digital portals, user experience and digital advisory services, 4) the company possesses significant capability and presence in application development, support and maintenance for next generation services in the digital world.

In terms of geographies, Birlasoft generates, 82% from America, 8.7% from Europe and 9.7% from Rest of the World (RoW). In terms of verticals, the company generates 40.7% from manufacturing, 17.1% from BFSI, 17.0% from energy & utilities and 25% from life-sciences.

Exhibit 1: Geographical concentration

Geography concentration (in %)	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Americas	76.3	78.4	79.6	81.6
Europe	12.4	11	10.6	8.7
Row	11.3	10.5	9.8	9.7
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: company, ICICI Direct Research

Exhibit 2: Vertical concentration

Vertical split (in %)	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Manufacturing	48.1	45.4	43.3	40.7
BFSI	19.3	19.9	18.8	17.1
Energy & utility	18.1	17.8	18.3	17.0
Lifescience	14.6	16.9	19.6	25.2
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: company, ICICI Direct Research

Exhibit 3: Service concentration

Service offerings (in %)	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Integrated Enterprise Solution	33	32.5	32.6	32.3
SAP	19.2	16.8	16.8	16.2
Digital Transformation	28.6	28.4	27.7	26.9
Custom Application Development	10.8	13	13	12.5
Other Horizontals	8.4	9.3	9.9	12.0
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: company, ICICI Direct Research

Investment Rationale

Client mining, cross sell, growth in white space key revenue drivers

The integration of Birlasoft and KPIT has led to more offerings. This has led to cross selling opportunities among existing clients. The company has a huge client base of 356 of which 100 are single service clients. We believe due to higher single service clients, revenue per client is lower at US$1.2 vs. other midcap peers of ~ US$3. This represents tremendous scope for revenue improvement via cross selling and client mining. To improve cross selling and client mining, the company has devised a strategy to focus on top 50 clients for developing a deeper engagement model with clients, based on their business imperatives, current engagements and industry led relationships. This will enable Birlasoft to have a 360° view of the value that the company provides clients while enabling a long term strategic partnership with the customer. Also, the company has devised a strategy to follow top 150 customers, with a focus on cross selling and leveraging core & peripheral services to drive revenue. Birlasoft has also aligned sales structure across verticals to improve cross selling opportunities, multi service deals and client mining. These strategies are bearing fruits and are visible in an increase in US$10 million clients from five in Q1FY20 to eight clients in Q1FY21.

Apart from client mining and cross selling, the company is also focusing on select tech and micro verticals like medical devices, process manufacturing, re-insurance, personal finance and service in upstream companies. This focus on niche white space will enable Birlasoft to develop expertise in these fields and grow its revenues while competing with larger rivals. Apart from this focus on niche segment, the company is adding to its partner network in Europe and APAC region to expand its footprints in these geographies. We believe these efforts will lead to an improved revenue trajectory in coming years.

Hiring from tier 1 players for improved client relationship

The company has hired a few people from top tier companies to strengthen its leadership. In addition, these hirings will enable Birlasoft to strengthen its existing client relationship, operational efficiencies and better delivery execution. This, in turn, will help in improved cross selling and client mining.

Exhibit 4: Brief profile of Tier 1 hires

Name	Designation	Description
Roop Singh	Chief Business Officer	25+ years experience. He was VP and business head of IBM's BFS in the US and prior to that with Wipro
Shreeranganath Kulkarni	Chief Delivery Officer	30+ years experience. He was MD and technology delivery lead for financial services in Accenture; prior to that with Cognizant and Infosys
Vijay Mishra	Senior VP SAP & BU Head	Joined from Infosys. He managed a team of consultants globally and was responsible for competency development and business growth on new products from SAP, including S4/HANA and other cloud based products
Anjan Sen	VP SAP Delivery	Joined from Cognizant where he was leading SAP SBU
Chandrasekar Thyagarajan	CFO	30+ years experience, He was CFO at IBM and has spent 18 years in CXO levels with Indian and Global companies

Source: company, ICICI Direct Research

Consistent deal wins to drive growth

Birlasoft and KPIT have complimentary skills. While Birlasoft has strength in non-ERP Digital businesses like CRM, BI & Data Analytics, Application Development, KPIT IT Services has core strengths in Enterprise Software Solutions like Oracle, JD Edwards, SAP, Infor, etc. This has enabled the company to win large end to end deals. The Invacare deal won in Q3FY20 is one such example in which the deal size is US$240 million executable in 10 years. In this deal, the company will provide complete IT-as-a-Services support right from infrastructure support (like migration to cloud) to digital services like analytics platform, e-commerce portal and global implementation of SAP S/4HANA and associated SAP solutions. We believe this large deal will create reference ability and showcase the company's ability to participate & win large deals in future. In addition, apart from this large deal win, Birlasoft has been signing a steady mix of net-new deals and renewal deals over last four quarters. The company signed record deals of US$669 million (book to bill ratio of 1.44x) in FY2020, of which ~65% was new deals. In Q1FY21, Birlasoft's overall deals increased 104% YoY of which new deals increased 53.4% YoY. This consistent deal win despite challenging times gives us near term revenue visibility. Hence, we expect the company to register improved revenue growth in coming quarters.

Exhibit 5: Deal wins look encouraging

Consistent deal wins	Q1FY20	Q2FY20	Q3FY20	Q4FY20	FY20	Q1FY21
Renewals	30	74	84	48	236	90.7
New deals	58	30	278	67	433	89
Total Deals	**88.0**	**104.0**	**362.0**	**115.0**	**669**	**179.7**

Source: Company, ICICI Direct Research

Offshoring & cost rationalisation to drive margins

Over the past few quarters, the company has seen some cost rationalisation which has led EBITDA margins to improve from 9.9% in Q1FY20 to 12.3% in Q1FY21. However, despite this margin improvement, EBITDA margins are far lower than other midcap peers. Hence, there is significant scope to improve EBITDA margins, going forward. The company is aiming to improve margins by higher offshoring. Given the recent pandemic (putting stress on clients to reduce IT budgets) and visa related challenges, we believe higher offshoring will be leveraged by clients. We expect Birlasoft to benefit from the same. In addition, the company is increasing its fixed price projects (increased from 45% in Q1FY20 to 52% in Q1FY21), which will give Birlasoft better leeway to improve margins. In addition, the company aims to increase annuity revenues from current ~60% to 70-75%. Further, Birlasoft has higher support staff (~10% vs. midcap peers of ~7%). We believe this is mainly due to horizontal focus of previous organisation. Now, the company has shifted to vertical focus, which, we believe, will help in rationalising support staff by 1-2%. This, coupled with rationalisation of tail accounts & sub-contracting cost, increase in utilisation (from ~78% in Q1FY21 to 82%) and G&A optimisation will drive margin improvement in coming quarters and reach 15% in FY22E (as indicated by the company of achieving 15% EBITDA margins in next four quarters). In addition, we expect PAT margins to improve in coming quarters due to migration of the company to the new tax regime.

Key Risk

1) Churn in leadership

2) Client bankruptcy in top clients impacting revenues and profitability

Financial Summary

Exhibit 6: Profit & loss statement (₹ crore)

(Year-end March)	FY20	FY21E	FY22E	FY23E
Total operating Income	**3,291**	**3,687**	**4,068**	**4,475**
Growth (%)	29.0	12.0	10.3	10.0
COGS (employee expenses)	1,998	2,139	2,339	2,573
Other expenses	902	1,069	1,119	1,231
Total Operating Expenditure	2,899	3,208	3,458	3,804
EBITDA	**392**	**479**	**610**	**671**
Growth (%)	27.9	22.3	27.3	10.0
Depreciation	83	88	98	107
Other income (net)	27	24	27	32
PBT	336	415	540	595
Total Tax	112	112	140	155
PAT	**224**	**303**	**399**	**441**
Growth (%)	(4.7)	34.9	32.0	10.3
Diluted EPS (₹)	**8.1**	**10.8**	**14.2**	**15.7**
Growth (%)	(39.8)	33.9	32.0	10.3

Source: Company, ICICI Direct Research,

Exhibit 7: Cash flow statement (₹ crore)

(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit	224	415	540	595
Add: Depreciation	83	88	98	107
Others	174	(24)	(27)	(32)
Inc/(dec) in working capital	(88)	206	(9)	19
Taxes paid	(80)	(112)	(140)	(155)
CF from operating activitie	**312**	**573**	**461**	**536**
(Inc)/dec in Fixed Assets	(54)	(63)	(69)	(76)
Others	8	38	41	46
CF from investing activities	**(46)**	**(25)**	**(28)**	**(31)**
Dividend paid & dividend tax	(100)	(140)	(196)	(224)
Others	(80)	(14)	(14)	(14)
CF from financing activitie	**(180)**	**(154)**	**(210)**	**(238)**
Net Cash flow	86	394	223	267
Exchange difference	1	-	-	-
Opening Cash	542	630	1,024	1,247
Closing cash & Bank	**630**	**1,024**	**1,247**	**1,513**

Source: Company, ICICI Direct Research

Exhibit 8: Balance Sheet (₹ crore)

(Year-end March)	FY20	FY21E	FY22E	FY23E
Equity Capital	55	55	55	55
Reserve and Surplus	1,837	1,999	2,203	2,419
Total Shareholders funds	1,892	2,055	2,258	2,474
Total Debt	-	-	-	-
Lease liablity	114	114	114	114
Provisions	70	77	85	94
Other non current liabilties	-	-	-	-
Total Liabilities	**2,076**	**2,246**	**2,457**	**2,682**
Assets				
Property,plant and equipment	141	142	143	144
Goodwill	454	454	454	454
Intangibles	17	17	17	17
Right-of-use assets	139	112	83	51
Other non current assets	248	181	165	120
Cash & bank balance	630	1,024	1,247	1,513
Current Investments	33	33	33	33
Trade receivables	740	606	669	736
Unbilled revenue	74	121	134	147
Other financial assets	36	40	44	48
Other current assets	176	197	217	239
Total Current Assets	1,688	2,021	2,344	2,717
Trade payables	190	213	235	259
Lease liablity	31	31	31	31
OCL & provisions	390	437	482	530
Total Current Liabilities	611	681	748	820
Net Current Assets	1,077	1,340	1,595	1,896
Application of Funds	**2,076**	**2,246**	**2,457**	**2,682**

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios

(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
Diluted EPS	8.1	10.8	14.2	15.7
Cash EPS	11.1	14.1	17.9	19.7
BV	68	74	81	89
DPS	2.0	5.0	7.1	8.1
Cash Per Share	23	37	45	54
Operating Ratios (%)				
EBITDA margin	11.9	13.0	15.0	15.0
PBT Margin	10.2	11.2	13.3	13.3
PAT Margin	6.8	8.2	9.8	9.8
Debtor days	82	60	60	60
Unbilled days	8	12	12	12
Creditor days	21	21	21	21
Return Ratios (%)				
RoE	11.9	14.7	17.7	17.8
RoCE	17.0	19.1	22.5	22.7
RoIC	21.9	32.9	43.6	49.8
Valuation Ratios (x)				
P/E	21.1	15.7	11.9	10.8
EV / EBITDA	10.4	7.7	5.7	4.8
EV / Net Sales	1.2	1.0	0.9	0.7
Market Cap / Sales	1.4	1.3	1.2	1.1
Price to Book Value	2.5	2.3	2.1	1.9
Solvency Ratios				
Debt/EBITDA	-	-	-	-
Debt / Equity	-	-	-	-
Current Ratio	1.7	1.4	1.4	1.4
Quick Ratio	1.7	1.4	1.4	1.4

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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