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BIRLASOFT

| IT Services

| 01 August 2024

Among the weakest performers this quarter

- **Big miss on revenue and margins. Significant shifts in cost items on a QoQ basis help prevent collapse in margins**
- **Great volatility around vertical and service line growth. The company says it is a one quarter blip and things should be on track from 2QFY25**
- **However, order inflow statistics do not give much comfort. We are in the process of initiating coverage on the sector and stock**

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A big revenue decline QoQ: Birlasoft's 1QFY25 constant currency (CC) QoQ revenue declined 2.7%, significantly lower than our 2% estimate. Our revenue growth expectations were built on the view management held three months ago that it would be among the growth leaders in FY25. Also, it clocked 9.5% revenue growth in FY24 (ex Invacare). While it was not the best among Tier-2 peers, the performance was commendable.

Lack of project starts the key issue: The CEO Angan Guha indicated that "challenging operating environment and tightened discretionary spends by customers continued to impact revenue". Deals that were supposed to ramp up were pushed back into 2Q and beyond. Much of the pushback of deal ramp-ups was in manufacturing (largely connected with ERP work) and some in the Healthcare vertical. The revenue compression was probably accentuated by a significant delivery shift offshore – by 430bps QoQ.

BFSI did well but manufacturing dragged: Banking, financial services and insurance (BFSI) and Energy & Utilities and Infrastructure drove growth QoQ at 8.1%, 3.6%, ~37%, respectively. But the weakness was due to Life Sciences and Manufacturing declining by 9.2% and 6% QoQ, respectively. In the service lines, Data & Digital declined 4.4% QoQ, while Enterprise Resource Planning (ERP) declined by 10.1%.

2Q should see growth: Birlasoft is calling 2QFY25 a growth quarter as some deferred projects come back, but it is not willing to point out the strength.

EBIT margin was a miss but could have been worse: EBIT margin came in at 13.1% compared to our estimate of 14.8% – a big miss. The big decline in margin happened as Birlasoft had staff to deliver on some projects that got deferred and that led to utilisation falling QoQ by 460bps. The miss would have been greater had there not been a one-off tailwind of 167bps in the quarter due to the reversal of provisions made towards a Long-Term Special Award formulated for a select group of senior leaders. This reversal lowered employee cost.



The margin was also under pressure QoQ due to cost of equipment which added 430bps (this was connected to growth in the Infrastructure business). Offsetting this was lower 'other expenses' connected with costs of subcontractors and consulting services which dropped by a similar extent on a QoQ basis.

Birlasoft stated that it was keen to grow the Infrastructure business from a long-term perspective and, hence, the cost of equipment-related cost item would continue to exist on its P&L going forward too.

The company delivered a total contract value of US\$ 160mn (down 33% QoQ/up 10% YoY). The order inflow was weak for Birlasoft in FY24 with only 1% YoY growth. This could put pressure on growth going forward unless things change dramatically in the coming quarters.

Birlasoft continues to invest in capabilities to better capitalise on the turnaround in demand conditions as and when they happen.

Mr Guha, CEO, stated that while the BFSI business had been growing well for multiple quarters now, it had become large and, hence, the pace of growth would moderate. But he expects other verticals also to step in and start delivering growth.

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