"Birlasoft Q3 FY-20 Earnings Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Birlasoft Limited Q3 FY20 Earnings Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vikas Jadhav – Head of Investor Relations at Birlasoft. Thank you and over to you sir.

Vikas Jadhav: Thanks Vikram. Good afternoon to all and welcome to Birlasoft Q3 FY20 earnings call discussions. I am Vikas from Investor Relations and joining us today we have our CXO team consisting of our COO & MD – DK, CFO – Rajeev Gupta, Head of HR – Samit Deb, Chief Delivery Officer – SK, and Roop Singh – our Chief Business Officer.

Please note that anything which we refer to our outlook on the future is a forward-looking statement must be read in conjunction with the disclaimer which we are putting in the investor updates and to the exchanges which mentions the risks the company faces.

Now with this I handover the call to DK. Over to you DK.

Dharmender Kapoor: Thank you Vikas. Good afternoon everyone, this is DK. Welcome to Birlasoft's Q3, financial year '20 earning call. We completed first year of merger on 16th January '20 and it has been a phenomenal journey I must say. We underwent the twists and turns in business as was expected with any sizable merger. I take this opportunity to thank all our stakeholders be it shareholders, employees, customers or our partners for firmly standing behind us in this journey.

Let's look at our performance for Quarter 3; our revenue for Quarter 3 financial year 20 is at $116.8 million versus what we did in Q2 which was at $109.9 million, which is a growth of 6.3% quarter on quarter. We have this growth coming from multiple customers including Invacare. With good growth the margin also saw good uptick, EBITDA margin improved from 11.1% to 12.9% in this quarter. If one looks from a year-on-year perspective on the performance in financial which we had reported last year, the margins have improved by around 408 bps year-on-year. The deal momentum is also healthy; we won $361 million of deals, of which, $ 278 were new wins. For the current year till date we have won $ 544 million worth of deals of which $ 416 million are new deals. While the deal pipeline continues to be healthy, we continue to expand our partner channels and sales bandwidth for expanding our footprints in enterprise and digital solutions. This is also the quarter which saw stability and growth for the first time after merger, in our SAP business. It was heartening to see growth across all horizontals with SAP and IES, but both ERP solutions, registering over 6% quarter-on-quarter growth. Last time, I did talk about SAP and how we were structuring it and we were setting up the leadership team in SAP and that has been completed and we are already seeing the growth in the SAP business as well which is good news for Birlasoft. I had mentioned earlier about our focus on top account.

The top customer led our growth in Q3, our top 5 and 10 grew 10% sequentially while top 20 saw growth 8% quarter-on-quarter. Through our cost and therefore in expanding our relationship with our key customer we experienced good progress in cross selling in US and European customer. We have added 135 people during the quarter taking our total headcount to 10,129 level. Our LTM attrition has come down from 22.5% in Quarter 2 to 20.3% in Quarter 3 which is YTD, whereas our Quarter 3 alone on standalone basis is around 15% accretion. So that means we've significantly improved our attrition from what it was in Q2 and also YTD has improved from where we earlier saw that in Quarter 2. However if I look at our Q3 standalone basis which is at 15%, I believe that we would continue to improve on our attrition so that our overall YTD comes to a healthy level.

While we were laying the foundation for growth in the last 1 year, our focus on improving the health of our balance sheet was an ongoing effort. With a good growth in Q3 those metrics have further improved and Rajeev will take you through that in some time.

On the integration front; we are done with all, except IT integration of two core systems which will get over in this quarter and we are progressing on this as per schedule. Going ahead our priorities remain number one growth. We will continue to strengthen our talent in service lines, sales and delivery. We made significant improvements in our structure—I did talk about that in the last quarter also—and we will continue to assign our talent to our focus area during this quarter and we will continue to work towards the same. The second would be improving the annuity revenue—I have been talking about this in the last 2-3 quarters that how we want to change the quality of revenue so that our growth and profitability become more and more sustainable with some of our key events in Q2 and Q3 we have seen good growth in annuity business and our ratio of annuity business versus project has started improving. We are working to further grow this proportion for annuity revenue with some of the deals that we have in our pipeline by using our significant strength in the ERP and digital business. Cross-selling, we have always been showcasing as one of our key element in the strategy. This will continue to remain a priority while expanding our relationship with key customer we are keeping our focus on reviewing and optimizing bottom tail accounts as well.

The ISVs and OEMs will also be our focus areas because we enjoy a very good partnership with SAP, Oracle, Salesforce.com, ServiceNow, Microsoft and Amazon. We will further expand our focus on our partner network in Europe and APAC. So far we had a much stronger relationship with the US and now we are expanding the same relationship to Europe and APAC as well so that we start experiencing the same growth in the other Geos as well. We all just want to be known as a very dependable partner to our customer. We have sharpened our focus on talent development through leadership programs and digital learning initiatives and in that way you must have noticed in our investor update that there are multiple awards that we won in the ERP space and in the digital space, there are multiple awards that we won during this quarter as well. That only showcases the strengths that we continue to build in our service lines.

Having said that last but most important is our focus on operational rigor, that has helped us show quarter on quarter growth in our EBITDA. Despite some of the headwinds during the integration process. We continue to optimize our cost structure to be more efficient and to run ourselves as an efficiently run organization. With this I will hand it over to our CFO, Rajeev Gupta for providing more color to our financials. Over to you Rajeev.

Rajeev Gupta: Thanks DK. Good afternoon to all of you. Let me take you through the financials in some more detail; our Q3 revenue was at $ 116.8 million, a quarter-on-quarter growth of 6.3%. This growth primarily came from Invacare although we also saw growth from accounts other than Invacare. In constant currency terms we had a favorable cross currency movement of 20 basis points hence constant currency growth was at 6.1% compared to previous quarter. Q3 EBITDA was at $15.1 million versus $12.1 million in Q2. A quarter-on-quarter growth of 24% and year-on-year growth of 47.8%, EBITDA improvement of $ 2.9 million compared to previous quarter is mainly from two areas, the first is growth in revenue and improvement in margins, the second is cost optimization of delivery and travel related cost. Q3 PAT was at $10.2 million versus $5.8 million in Q2, a quarter-in-quarter growth of 75.7% and year-on-year growth of 77.1%. Our other income was higher by $2 million mainly from Forex gains and gain from redemption of mutual fund.

I am pleased to share that our continued efforts towards improving the quality and health of our balance sheet have yielded further results. Cash and cash equivalents have improved from $77.9 million end of Q2 to $96.2 million end of Q3. Our Q3 cash collections were 116% of Q3 revenue. At the start of this fiscal year we had set a target to achieve cash and cash equivalents of $100 million. As you can note we are already there by end of Q3 and our endeavor will be to stay above $100 million by end of Q4. Our sustained efforts on reducing outstanding receivables have resulted in lowering DSO from 81 days end of Q2 to a benchmark of 65 days end of Q3. Unbilled revenues have further come down from $12.4 million end of Q2 to $9.4 million end of Q3. Our US dollar hedge book has increased from $78 million in Q2 to $82.8 million in Q3. The average hedge rate has improved from INR 72.2 in Q2 to INR 72.9 end of Q3.

On the tax front we have successfully closed quite a few past years' assessment, which will result in realizing income tax assets on the balance sheet. We incurred CAPEX of about $3.7 million this quarter mainly towards Bangalore facility. Our CAPEX for the first 9 months is around $6.7 million. We anticipate CAPEX for the year to be around $10 million much lower than $20 million estimated at the start of this year. Our health of the financials is in a much better shape than a year ago and our efforts will continue to improve it further. We sincerely appreciate the support of our shareholders and investors during this challenging year of integration. It gives me pleasure to share that we have declared our maiden interim dividend of INR 1 per share this quarter. With this I would like to now throw open the floor for questions.

Moderator: Thank you very much sir. Ladies and gentleman, we will now begin the question and answer session. We have our first question from the line of Nisarg Vakharia from Lucky Investment Managers. Please go ahead.

Nisarg Vakharia: Good evening gentlemen and congratulation on an outstanding set of results. Sir, it was very heartening to hear when I heard DK sir said that the growth in this quarter is actually not only contingent on the Invacare deal. Can you elaborate slightly more on that as to how much growth we would have got by the execution of Invacare deal and how much from the other business?

Dharmender Kapoor: I would say that I can't give you the specific numbers because we do not have that with customer to share how much billing we do for Invacare. But even without Invacare we have grown and handsomely from the previous quarter. So there is a good balance between the growth that we got from Invacare and from the other accounts in this particular quarter.

Nisarg Vakharia: ok, Our EBITDA margins have gone to almost 13% in this quarter, should we assume this as the new sustainable sort of margins going ahead?

Dharmender Kapoor: I would definitely be very positive for the next quarter also that we will be close. But it is yet to be seen from the perspective that we continue to stabilize the Invacare because it is still going through the transition period and that element of surprise might be there but it is not going to be any significant. So for the purpose of looking at sustainability we can definitely assume that we will be very much close to margin or EBITDA that we have already delivered.

Nisarg Vakharia: That's great sir, now since our cash balance has become a healthy Rs 700 crores odd, any discussions within the Board on rewarding the shareholders by doing a buyback or giving dividend?

Dharmender Kapoor: Absolutely as I have always maintained that we are definitely having all the options open and in fact we are discussing very actively on how do we conclude on that. So very soon we should be able to conclude that and come back. But yes those options are open and we are really working very actively on that. And dividend of course we have given interim dividend you must have seen that.

Moderator: We have a next question from the line of Shradha Agrawal from Amsec.

Shradha Agrawal: Congratulations to the management team on a solid quarter across all operating metrics. First thing is you've shared the TCV of new deal signings, can we have that number for deal renewals as well?

Dharmender Kapoor: Can we have that for?

Shradha Agrawal: Renewals in the quarter.

Dharmender Kapoor: So if you look at one that of course I shared about the new wins that we are talking about $278 million in this quarter but if you look at the renewal it is $84 million that we had in this quarter.

Shradha Agrawal: In this $ 278 did we have any large deal signings, large deals for that is upwards of $10 million, does that….?

Dharmender Kapoor: Yes.

Shradha Agrawal: And would you share some color…

Dharmender Kapoor: Invacare deal that we are talking.

Shradha Agrawal: Apart from Invacare I mean to ask.

Dharmender Kapoor: The Invacare is there and then we did have another Life-sciences contract where we signed a deal more than $20 million.

Shradha Agrawal: Any color on the pipeline if you would want to share, how does the pipeline look like?

Dharmender Kapoor: I think pipeline is very healthy for us, but I believe that whole integration now behind us and the good focus on the cross-selling with our tail accounts; we are seeing very good progress with our pipeline generation also. So today we have till the pipeline and we continue to add every month now the cross-selling opportunity and it is generating us. It is giving us the confidence that it will definitely be a good set of the quarters coming forward and giving the growth. But we have a good healthy pipeline now.

Shradha Agrawal: And Rajeev how should we look at tax rate for the future quarters?

Rajeev Gupta: We had shared it in previous quarters also; our tax rate hovers around 30%. This quarter in particular we saw the tax rates come down to about 28% and that is because the mix of revenue has been more in US and Europe which are low tax geographies. But you should check the tax rate could be at 30% from here on.

Shradha Agrawal: You did mention that your component of annuity revenue is ramping up but would it be possible to share the split between annuity and project lead revenue for us?

Dharmender Kapoor: Earlier as we said that our revenue was in the range of about 53% as the annuity business. It has already improved to about 58%.

Moderator: We have a next question from the line of Rohit Balakrishnan from Vrddhi Capital.

Rohit Balakrishnan: Hi Team, congratulations on a very strong quarter. You said about $278 million was new deal wins, so does this also include the renewals or these don't include renewals?

Dharmender Kapoor: These 278 do not include renewals.

Rohit Balakrishnan: So Invacare is how big component of this deal win?

Dharmender Kapoor: $242 million.

Rohit Balakrishnan: In terms of the pipeline if you take the dollar revenue in this quarter which is about 117 million, so two questions on this; one is obviously whatever run-offs that we have after the merger those are all behind us. Would that be absolutely a fair assumption?

Dharmender Kapoor: Some of the significant ones are definitely behind us. But as I said our annuity revenue is about 58% and then we have very long term projects and some of the projects in digital as you know that could also be short term. So it is not as if that the entire run-off will ever be for any other company or for us will be behind us but yes the percentage will not be as much as we saw in the last three quarters.

Rohit Balakrishnan: The bigger question was that whatever run-offs be, but the net adds which was not happening for us because we were under integration and the sales pipeline was still maybe not kicking in, so that would be from this quarter I mean can we take this as like a base for future quarters—just 117 million—which was what was the case at the first quarter of acquisition?

Dharmender Kapoor: Absolutely, I would say yes that we should take this as a new base because for last two quarters actually we said that we have hit the bottom but there were couple of surprises that came up. But I think as you also rightly mentioned that it is behind us, so we should take this as a new base.

Rohit Balakrishnan: In terms of pipeline—so your commentary is quite encouraging—can we sort of look at growing faster than the industry maybe in the coming year in FY21, will that be something that is possible for us?

Dharmender Kapoor: Definitely it's possible and we are working towards that and I'm sure that when all the wishes from your side we will continue to do better than the industry.

Rohit Balakrishnan: Just one more question on tax; so we are going to be on the old tax regime only. So we have substantial amount of deferred tax asset, so any sense on when do we move to the newer regime or that's still not something that we've worked on?

Rajeev Gupta: We did share this in the previous earnings call. We did evaluate between 30% tax and 25% tax rate, currently we have got MAT as well as deferred tax assets. In our view when we've simulated it will take is about 18 to 24 months to exhaust MAT as well as deferred tax assets. So it's more prudent to continue at 30% tax rate and then opt for 25% tax rate as you know once you opt for 25% tax rate there is no going back. So we don't want to take a dual whammy and then we see the impact of MAT as well as deferred tax assets.

Moderator: We have a next question from the line of VP Rajesh from Banyan Capital.

VP Rajesh: Congratulation DK, Rajeev and rest of the team, it's a fantastic quarter. In terms of number of clients, your $10 million plus clients went up by one and the $5 million plus clients went down by one, so is it just the Invacare impact or is there another client which has come in with more than 10 million plus of revenue?

Dharmender Kapoor: There are couple of accounts which have grown from $5 to $10 millions. I gave the example of what we won in the Invacare and another one, so definitely we are kind of the accounts that have grown from the lower category to the higher category that will be from $5 million to $10 million-$20 million.

VP Rajesh: What I was asking is that the fact that the fact that we are winning lot of deals ….(inaudible)… what is driving that significant improvement in the backlog?

Dharmender Kapoor: Again your voice dropped, but let me answer whatever I heard; there are couple of significant changes that we see that we are seeing from a structure perspective that is giving us the momentum. I talked about SAP, we have started seeing very good growth in the SAP again. We wanted to bring some changes into our leadership and pick-up the momentum again which is what has been demonstrative in this quarter. At the same time I have always talked about the cross-selling on both sides, with the accounts which are the larger and strategic accounts for us but also converting the tail accounts into the larger accounts so that we can go cross sell these services for simple reason that we already have a relationship there. So those are the 2-3 things that have worked very well for us in order to give us the momentum that we are seeing.

Moderator: We have a next question from the line of Abhishek from Elara Capital.

Abhishek: The first question is regarding your comments that for the quarter there was growth not just from Invacare contribution but other clients as well. So could you just elaborate as to what you did differently in this quarter for the clients outside Invacare versus what we were doing 1 or 2 quarters ago? I understand that there have been a leakage or run-off but apart from the run-offs are we doing anything differently in approaching our clients?

Dharmender Kapoor: I think my answer is same what I gave in the previous question but let me just give little bit more color to that; we started focusing on our clients, ones where we have sold a single service but now we are presenting ourselves there with more set of services that are felt after the merger. So when we are going with that with the relationship that we have with them, we are picking up the new opportunity, so which is what I talked about cross-selling. SAP is the second piece that I said that there is a momentum in the market. We have set our team right and now we are very much focused on how do we really expand ourselves into the SAP service line and those opportunities. Third is that we have started presenting ourselves very- very strongly in the manufacturing domain. As you might have seen last time that we restructured ourselves by consolidating few verticals into one, because they all are around the manufacturing processes. So we have far stronger case studies today that we can go in front of the customer, so that means that we are now being seen as a strong manufacturing player and that also is helping us get in front of the customer with much stronger footprint in those processes and that also is helping us close other deals with them. So these are the 3-4 stronger points that I would definitely credit that has helped us in really gaining the growth that we have gained in this quarter. I believe that we will continue to follow our strategy of really first going to our customer, existing customer, so that we can sell more number of services to them and then also the looking at going after the new customers because that is a significant shift that is there in the ERP space where there are clients who are shifting either from the older version to the new version or they are moving to the Cloud or they are making their existing enterprise solution more intelligently by using and integrating with digital technologies. So those are the ones which is helping us open new doors. So mostly with that strategy, our NN growth will see the momentum also. So these are the 3-4 strategies that we will continue to play with. I think the good part with that whole thing is that we have very strong partner network and that acts us as a very formidable channel for us and I'm sure that we will take all the benefit that we can from our strong relationship with Oracle, SAP, ServiceNow, Salesforce.com, Amazon and other.

Abhishek: Just a follow up on that you also had to comment about focusing to improve the partner network in Europe. Are we kind of also trying to secure large deals through the industry association channel that most of the mid-caps uses are we thinking on those lines?

Dharmender Kapoor: Yes absolutely because the very reason that why we want to expand our partner network in Europe and APAC is that we can go after larger deals and significant deals because a lot of time the partners are engaged and involved in order to go in front of the client so that for the larger transformation program we are seen as partnering with those ISVs and OEMs, so we saw that success in US and now we want to replicate that in Europe and APAC as well.

Abhishek: The third question is regarding the SAP or the ERP practice in general, so historically the SAP practice was volatile from quarterly perspective because it was predominantly implementation kind of a business. So how are we trying to change the mix of our business so that we don't get into that quarterly volatility especially on the ERP or the SAP business?

Dharmender Kapoor: There is a longer answer and technical answer that I have, which is part of our strategy but just to give to summary I talked about how we are trying to change the ratio of our annuity revenue against the project revenue. I think that is one strategy because the moment you try to look at securing annuity revenue you do not look at SAP as SAP alone, you try to look at what are the surround services and can those be bundled together, so that you continue to be seen as a partner that can go beyond implementation and provide services for a longer period of time. So that's the approach in nutshell that we are doing; but of course there can be a long technical and a more deeper answer to that which is actually part of our strategy.

Abhishek: One is on the momentum of the business, so heartening to know that you don't include I mean the deals do not include the renewals, so with the momentum of net new (NN) business that we are seeing and the roll-offs kind of stabilizing, do you believe that a 3% CQGR is a sustainable number, from the last one-year you have stabilized the business, so from here on over the next 12-18 months is a 2.5%-3% CQGR run-rate possible?

Dharmender Kapoor: I would shy away from giving any guidance. But as I earlier said that with all your wishes I'm very confident that we will continue to click that number.

Abhishek: The last one on the margin, so did we kind of over achieve our numbers on the margins in the Q3 or we were expecting the margins—I understand that the revenue contribution would have been a big driver—but outside of the tailwinds of Invacare contract did we over achieve our margins or we still have a good room to improve margins?

Dharmender Kapoor: No, we do have a room to improve margin. There are no doubts about that. But I think we need to first make ourselves sustainable at this level and the moment we get that then there is ample room for us to improve our margin going forward.

Moderator: We have a next question from the line of Apurva Prasad from HDFC Securities.

Apurva Prasad: Thanks for taking my question and congrats on the numbers. DK can you talk about some of the successes that you are seeing in top 10 specially in the cross-sell side and the annuity area of you spoke about earlier but may be specifically of the top 10 anything that you can probably more color on?

Dharmender Kapoor: I may not take the names, pardon me for that but I would give you some of the key examples. We were as I talked last time also that there is one client which is one of very large account for us and we have always been an annuity player for a very long time but what we started working there was by cross selling we went in front of them with our data in digital services and we saw significant opportunity getting signed up for the next 2 to 3 years with them. So that is one very-very good example that we have. Similarly if we look at one of the client which we actually opened last to last year—just about 2 years back—today we are getting into more than $20 million run rate every year with them and these are the opportunities which are all cross sold and are the mix of annuity as well as the new deals that we continue doing with them. There is another life-sciences account where we are the preferred data partner and there is significant growth there we have, at the same time there is an ample room for us to continue to grow with them because the data and data analytics is one thing that is becoming very significant for the life-sciences and pharma companies and we are seeing sufficient pipeline as well as growth momentum with them. So these are the three examples that I talked about. There are certain cases where we have started making a choice that should we go for one-time projects or should we be preferred as a partner which is a long-term annuity partner. And we have really started creating the right balance there that in some of the cases we have started preferring or being the long-term partner so that we can change the quality and the ratio of the revenue that we have and that is also another one which has given as the benefit because the moment we do that there is longer period that we have to continue to cross sell our other services and hence converting those accounts into the large accounts. So I think those are 4-5 examples that I took with you just now without really mentioning the name. But I think life-sciences, energy and utilities and discrete manufacturing are the three areas which clearly saw very good example where we could showcase that how we are changing the size of relationship that we have with our customers.

Apurva Prasad: That's very helpful DK and in terms of investments required further, do you think anymore investments to increase the leadership bandwidth incrementally from here would be required?

Dharmender Kapoor: From the investment perspective I think we are in control. I don't think that I need to really increase my cost to do that but I think we are very much in control and we have most of the leadership in place. So it is not from investment perspective it is not going to be any significantly different than what we had done in this quarter. In the year I cannot say that, because that's gone up and down but from quarter perspective I think that number definitely or that cost will be quite sustainable.

Moderator: As there are no further questions from the participants I now like to hand the conference over to the management for closing comments. Sir over to you.

Dharmender Kapoor: Thank you very much everyone for joining the call. As we are going through this change in our organization I'm very happy to see that we have seen very good stability, both from the operations perspective and the momentum and growth perspective in this quarter. Our objective would continue to remain that we grow quarter-on-quarter and also we continue to improve on the profitability because that is the only way by which we can have sustainable business. There are significant steps that we are taking in order to continue to create momentum in the growth as well as continuous improvement in the profit and I am sure that we will continue to deliver the result that we all will be proud of. Thank you very much.

Moderator: Thank you very much sir. Ladies and gentleman, on behalf of Birlasoft that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

Note : The above transcripts have been edited for better readability.