

**SELL**

TP: Rs 840 | ▼ 25%

**MPHASIS**

| IT Services

| 24 July 2020

## Strong deal wins; DXC remains soft

Mphasis (MPHL) reported weak revenue but an operating margin beat in Q1FY21. Dollar revenue declined 5.1% QoQ as DXC business dropped 15%. Margins dipped 70bps QoQ vs. an estimated decline of 220bps. TCV was robust at US\$ 259mn, growing 29% QoQ on the back of a healthy order book. We increase FY21/FY22 EPS by 14%/5% and roll over to a revised Jun'21 TP of Rs 840 (vs. Rs 780). Despite strong contract wins, we stay apprehensive on overall growth prospects considering risks to the DXC business. Reiterate SELL.

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**Weak revenue but beat on margins:** Dollar revenues declined 4.6% QoQ CC (vs. a 3.1% decline estimated) due to the pandemic impact and a 12.6% CC fall in DXC business. Operating margin at 15.7% dipped 70bps QoQ vs. our forecast of a sharper 220bps decline, aiding a slight beat on operating performance. Management has guided for EBIT margins in the range of 15.5-16.5% for FY21.

**Strong deal wins:** TCV was at an all-time high of US\$ 259mn in Q1, increasing 29% QoQ, boosted by a large US\$ 105mn deal. So far in Q2, MPHL has bagged a three-year contract worth US\$ 216mn with an existing client in the technology services space. Deal ramp-up is expected in Q2 and Q3FY21.

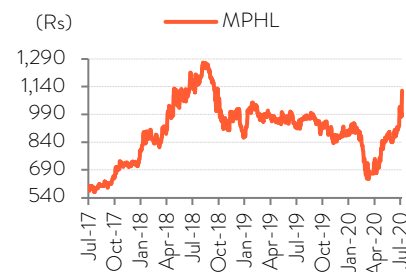
**Derisking of DXC segment looks difficult:** DXC had committed to minimum revenue of US\$ 990mn over five years when it sold its stake in MPHL to Blackstone in CY16. Subsequently, the HP/DXC business was a growth lynchpin for MPHL in FY18 and FY19, posting >20% YoY dollar revenue growth each year.

This revenue commitment ends in Sep'21, diminishing the margin of safety for the HP/DXC business (~26% gross revenue share in Q4, 27% in FY20). MPHL now aims to derisk its dependence on DXC. We believe it will be hard to replace this revenue stream fully in the near term despite strong deal wins in the direct channel.

Ticker/Price	MPHL IN/Rs 1,117
Market cap	US\$ 2.8bn
Shares o/s	186mn
3M ADV	US\$ 4.2mn
52wk high/low	Rs 1,175/Rs 630
Promoter/FPI/DII	52%/29%/14%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	77,311	88,436	94,885	106,781	117,982
EBITDA (Rs mn)	13,240	16,505	17,478	20,984	23,218
Adj. net profit (Rs mn)	10,734	11,849	11,610	13,944	15,538
Adj. EPS (Rs)	57.7	63.7	62.4	74.9	83.5
Adj. EPS growth (%)	30.9	10.4	(2.0)	20.1	11.4
Adj. ROAE (%)	20.0	21.4	19.0	20.9	21.1
Adj. P/E (x)	19.4	17.5	17.9	14.9	13.4
EV/EBITDA (x)	15.5	12.5	11.9	9.9	8.7

Source: Company, BOBCAPS Research

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## Other highlights

- The Covid-19 pandemic has accelerated digital adoption across enterprises. Customer experience, digital workplaces, data analytics, personalisation, as-a-service model, and predictive analytics are the emerging areas – reflecting a massive shift from ‘run the business’ to ‘transform the business’. Management expects these segments to fuel growth and aid recovery commencing Q2FY21. EBIT margin is guided to be in the range of 15.5-16.5% for FY21
- Management aims to spotlight three key areas for growth revival: (1) winning large deals and improving client metrics, (2) derisking DXC revenues by raising traction in the Direct International business before Sep’21, and (3) ensuring margin stability.
- BFSI, healthcare and CPG are expected to be the ‘green-zone’ verticals, which are relatively less affected by Covid-19. Currently, 60% of MPHL’s revenues are in this green zone. Roughly 1% of revenue comes from the airlines and hospitality business. The company is striving to increase its logistics and transportation portfolio, with a focus on e-commerce and online delivery.
- No new clients were added in the US\$ 20mn-100mn+ bucket; three were added in the US\$ 1mn+ bucket, and one each in the US\$ 5mn+/10mn+ segments.
- MPHL is working to enhance capabilities in blockchain and quantum computing.

**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
<b>Revenue (US\$ mn)</b>	<b>303</b>	<b>306</b>	<b>(1.0)</b>	<b>320</b>	<b>(5.1)</b>
Revenue excluding hedging gains/losses (US\$ mn)	305	305	0.2	320	(4.5)
Revenue	22,882	21,581	6.0	23,462	(2.5)
Revenue excluding hedging gains/losses	23,037	21,462	7.3	23,476	(1.9)
Operating Expenditure	18,704	17,529	6.7	19,021	(1.7)
Cost of revenues	16,261	15,361	5.9	16,591	(2.0)
as % of sales	71.1	71	-	70.7	-
SG&A expenses	2,443	2,168	12.7	2,430	0.5
as % of sales	10.7	10	-	10.4	-
<b>EBITDA</b>	<b>4,178</b>	<b>4,052</b>	<b>3.1</b>	<b>4,441</b>	<b>(5.9)</b>
Depreciation	595	582	2.2	610	(2.5)
<b>EBIT</b>	<b>3,583</b>	<b>3,470</b>	<b>3.3</b>	<b>3,831</b>	<b>(6.5)</b>
Other Income	182	134	35.8	319	(42.9)
PBT	3,765	3,604	4.5	4,150	(9.3)
Total Tax	1,015	871	16.5	618	64.2
<b>Adjusted PAT</b>	<b>2,750</b>	<b>2,733</b>	<b>0.6</b>	<b>3,532</b>	<b>(22.1)</b>
APAT after MI	2,750	2,733	0.6	3,532	(22.1)

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Extra ordinary items	-	0	-	-	-
<b>Reported PAT</b>	<b>2,750</b>	<b>2,733</b>	<b>0.6</b>	<b>3,532</b>	<b>(22.1)</b>
Reported EPS	14.8	15	0.6	18.9	(21.7)
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>
EBITDA	18.3	18.8	(50)	18.9	(70)
EBIT	15.7	16.1	(40)	16.3	(70)
EBT	16.5	16.7	(20)	17.7	(120)
PAT	12.0	12.7	(60)	15.1	(300)
Effective Tax rate	27.0	24.2	280	14.9	1,210

Source: BOBCAPS Research

**FIG 2 – OPERATING METRICS**

	Q1FY21	Growth (%)	
	(% Contr. to Revenue)	QoQ	YoY
<b>Revenue by Business Segment (US\$ terms)</b>			
Direct International	79.0	0.1	11.0
Direct Core	63.2	(2.2)	6.4
Direct Others	15.3	6.6	30.0
DXC	20.0	(15.1)	(16.4)
<b>Revenue by Vertical (Rs terms)</b>			
Banking and Capital Markets	49.1	4.9	22.1
Insurance	10.0	(14.4)	(4.7)
Information Technology, Communication & Entertainment	14.2	(7.8)	(4.5)
Logistics and Transportation	14.1	(5.9)	21.6
Others	13.2	(3.2)	3.0
<b>Revenue by Project Type</b>		<b>(bps)</b>	<b>(bps)</b>
T & M	74.0	200	(200)
Fixed price	26.0	(200)	200

Source: BOBCAPS Research

## Valuation methodology

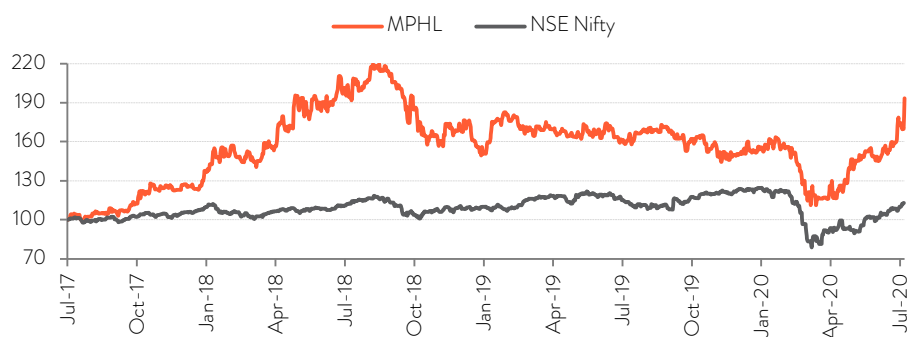
We increase FY21/FY22 EPS estimates by 14%/5% to accommodate the operating margin beat. On rolling valuations forward, we have a revised Jun'21 target price of Rs 840 (vs. Rs 780 earlier), based on an unchanged one-year forward P/E multiple of 11x. Reiterate SELL due to (1) a diminishing margin of safety as DXC's revenue commitment nears an end, and (2) high client concentration risk.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Change (%)	Old	New	Change (%)	New
Reported Revenues (US\$ mn)	1,220	1,245	2.1	1,332	1,369	2.8	1,513
YoY (%)	(1.8)	0.2	-	9.2	10.0	-	10.5
Revenues (ex-hedging, US\$ mn)	1,220	1,245	2.1	1,332	1,369	2.8	1,513
Revenues	93,297	94,885	1.7	1,03,901	1,06,781	2.8	1,17,982
EBIT	13,122	15,069	14.8	17,166	18,075	5.3	19,814
EBIT margins (%)	14.1	15.9	-	16.5	16.9	-	16.8
Net profits	10,169	11,610	14.2	13,256	13,944	5.2	15,538
EPS (Rs)	54.6	62.4	14.2	71.2	74.9	5.2	83.5

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key upside risks

- Increased deal win momentum in Direct channel
- Sharper rupee depreciation aiding margins
- Stronger pick-up in Logistics and Transportation vertical

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>77,311</b>	<b>88,436</b>	<b>94,885</b>	<b>106,781</b>	<b>117,982</b>
EBITDA	13,240	16,505	17,478	20,984	23,218
Depreciation	759	2,317	2,409	2,910	3,404
EBIT	12,481	14,188	15,069	18,075	19,814
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	1,592	967	510	518	903
Exceptional items	0	0	0	0	0
EBT	14,073	15,155	15,579	18,592	20,717
Income taxes	3,339	3,306	3,968	4,648	5,179
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>10,734</b>	<b>11,849</b>	<b>11,610</b>	<b>13,944</b>	<b>15,538</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>10,734</b>	<b>11,849</b>	<b>11,610</b>	<b>13,944</b>	<b>15,538</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	11,687	12,769	14,298	16,090	17,778
Provisions	3,100	2,242	3,899	4,388	4,849
Debt funds	5,428	12,955	12,955	12,955	12,955
Other liabilities	28	137	137	137	137
Equity capital	1,862	1,865	1,865	1,865	1,865
Reserves & surplus	50,636	56,431	61,751	68,140	75,259
Shareholders' fund	52,498	58,296	63,616	70,005	77,125
<b>Total liabilities and equities</b>	<b>72,741</b>	<b>86,399</b>	<b>94,905</b>	<b>103,576</b>	<b>112,843</b>
Cash and cash eq.	6,572	11,484	14,694	23,198	30,265
Accounts receivables	8,620	7,217	9,099	8,777	9,697
Inventories	0	0	0	0	0
Other current assets	21,339	21,596	25,996	27,792	30,708
Investments	13,292	13,257	13,257	13,257	13,257
Net fixed assets	2,113	8,730	7,745	6,437	4,802
CWIP	406	553	553	553	553
Intangible assets	19,585	21,405	21,405	21,405	21,405
Deferred tax assets, net	814	2,157	2,157	2,157	2,157
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>72,741</b>	<b>86,399</b>	<b>94,905</b>	<b>103,576</b>	<b>112,843</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	11,405	14,166	14,019	16,854	18,942
Interest expenses	(98)	(967)	(510)	(518)	(903)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,421)	1,370	(3,095)	807	(1,688)
Other operating cash flows	(389)	(2,832)	0	0	0
<b>Cash flow from operations</b>	<b>9,497</b>	<b>11,737</b>	<b>10,414</b>	<b>17,143</b>	<b>16,351</b>
Capital expenditures	(815)	(1,372)	(1,423)	(1,602)	(1,770)
Change in investments	5,725	0	0	0	0
Other investing cash flows	(2,111)	967	510	518	903
<b>Cash flow from investing</b>	<b>2,798</b>	<b>(405)</b>	<b>(913)</b>	<b>(1,084)</b>	<b>(867)</b>
Equities issued/Others	104	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(8,867)	0	0	0	0
Dividends paid	(4,655)	(6,420)	(6,290)	(7,555)	(8,418)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(13,418)</b>	<b>(6,420)</b>	<b>(6,290)</b>	<b>(7,555)</b>	<b>(8,418)</b>
<b>Changes in cash and cash eq.</b>	<b>(1,122)</b>	<b>4,912</b>	<b>3,210</b>	<b>8,504</b>	<b>7,066</b>
<b>Closing cash and cash eq.</b>	<b>6,572</b>	<b>11,484</b>	<b>14,694</b>	<b>23,198</b>	<b>30,265</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	57.7	63.7	62.4	74.9	83.5
Adjusted EPS	57.7	63.7	62.4	74.9	83.5
Dividend per share	0.0	28.6	28.1	33.7	37.6
Book value per share	282.0	313.2	341.7	376.1	414.3

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.7	2.3	2.2	1.9	1.7
EV/EBITDA	15.5	12.5	11.9	9.9	8.7
Adjusted P/E	19.4	17.5	17.9	14.9	13.4
P/BV	4.0	3.6	3.3	3.0	2.7

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.3	78.2	74.5	75.0	75.0
Interest burden (PBT/EBIT)	112.8	106.8	103.4	102.9	104.6
EBIT margin (EBIT/Revenue)	16.1	16.0	15.9	16.9	16.8
Asset turnover (Revenue/Avg TA)	108.4	111.1	104.7	107.6	109.0
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.5	1.5	1.5
Adjusted ROAE	20.0	21.4	19.0	20.9	21.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	18.1	14.4	7.3	12.5	10.5
EBITDA	24.6	24.7	5.9	20.1	10.6
Adjusted EPS	30.9	10.4	(2.0)	20.1	11.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	17.1	18.7	18.4	19.7	19.7
EBIT margin	16.1	16.0	15.9	16.9	16.8
Adjusted profit margin	13.9	13.4	12.2	13.1	13.2
Adjusted ROAE	20.0	21.4	19.0	20.9	21.1
ROCE	18.0	19.9	18.4	22.2	24.8
<b>Working capital days (days)</b>					
Receivables	40	33	31	31	29
Inventory	0	0	0	0	0
Payables	75	70	69	72	72
<b>Ratios (x)</b>					
Gross asset turnover	39.3	16.3	11.5	15.1	21.0
Current ratio	2.5	2.7	2.7	2.9	3.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	0.0	(0.1)	(0.2)

Source: Company, BOBCAPS Research

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### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

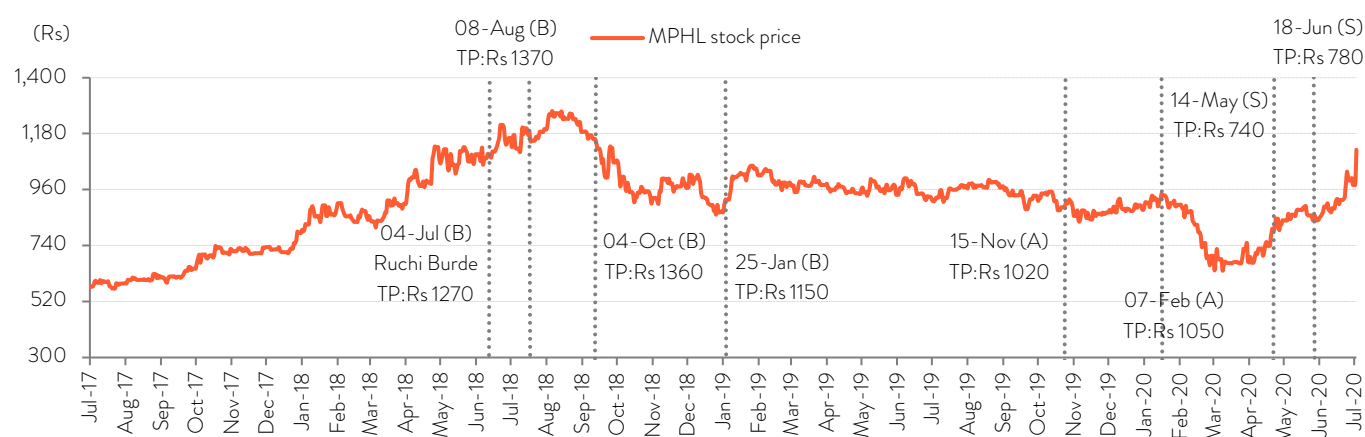
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): MPHASIS (MPHL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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