

HOLD

TP: Rs 2,500 | ▲ 4%

MPHASIS

| IT Services

| 23 July 2021

Direct business growth negates shortfall in DXC – raise to HOLD

- **MPHL grew 6.3% QoQ USD in Q1, outperforming our (4%) and street estimates. EBIT margin was a miss at 15.9% due to the pandemic impact**
- **DXC contracted 18% QoQ but topline growth was shored up by a stellar pickup in direct channel business at 10% QoQ USD**
- **We upgrade to HOLD from SELL and roll over to a new Jun'22 TP of Rs 2,500 (vs. Rs 1,580), set at a higher 25.5x P/E multiple**

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Strong execution: In line with the robust uptrend in India's IT sector, MPHL registered strong Q1FY22 revenue growth of 6.3% QoQ USD vs. our estimate of 4%. Direct business grew 10% USD, more than making up for a shortfall in the DXC segment (-17.7% QoQ, 9% of Q1 revenue). EBIT margin stood at 15.9%, down 20bps QoQ and below our estimate of 16.7%. Gross margin at 28.4% contracted 260bps QoQ due to the one-time pandemic impact and lower utilisation.

Broad-based growth: All verticals except insurance delivered QoQ growth. Logistics and transformation grew 11.5% QoQ USD, the highest among verticals, continuing its recovery since a dip in Q1FY21. Banking and capital markets was up 9.2% QoQ USD. Insurance was weak, contracting 3%.

Robust deal wins: Q1 TCW stood at US\$ 505mn, up 106% QoQ and 65% YoY. This included a lumpy, large deal worth US\$ 250mn – MPHL's sixth consecutive quarter of large US\$ 200mn+ wins. Per management, the nature of TCW has improved in terms of tenure and new-generation components. The pickup in deal wins is a result of demand tailwinds from the squeezing of longer-timeframe core transformation and cloud migration initiatives into a 3-5-year timeframe.

Outlook remains upbeat: Management reiterated its target of industry-leading growth in the direct business, with an overall EBIT margin band of 15.5-17% for FY22. MPHL hinted at opportunities for pricing increase amid robust demand and a supply crunch. The company is continuing to invest in (1) geographical footprint expansion, (2) adding leadership breadth and depth, (3) building digital competencies, and (4) focused new account acquisition (NCA).

Upgrade to HOLD: MPHL's stellar show in the direct business came as a positive surprise and counteracted the steep reduction in DXC business. We upgrade our rating to HOLD from SELL on the back of strong momentum in the direct channel and a receding mix of DXC business (at 9% of revenue vs. 20% in Q1FY21). Our revised Jun'22 TP of Rs 2,500 is set at a higher one-year forward P/E of 25.5x vs. 17x earlier, baking in a 15% discount to LTI.

Key changes

Target	Rating
▲	▲

Ticker/Price	MPHL IN/Rs 2,397
Market cap	US\$ 6.0bn
Free float	40%
3M ADV	US\$ 17.4mn
52wk high/low	Rs 2,450/Rs 976
Promoter/FPI/DII	52%/29%/14%

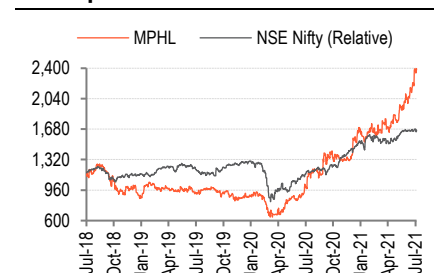
Source: NSE | Price as of 22 Jul 2021

Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	97,223	115,589	133,195
EBITDA (Rs mn)	18,028	22,163	25,814
Adj. net profit (Rs mn)	12,167	15,261	17,816
Adj. EPS (Rs)	65.4	82.0	95.7
Consensus EPS (Rs)	65.4	77.6	88.9
Adj. ROAE (%)	19.7	22.5	24.3
Adj. P/E (x)	36.7	29.2	25.0
EV/EBITDA (x)	24.8	20.2	17.2
Adj. EPS growth (%)	2.7	25.4	16.7

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Other key highlights

- MPHL added two new clients in the US\$ 50mn and US\$ 100mn buckets in Q1FY22. Growth has been especially strong among the top 6-10 clients, and MPHL has been able to gain wallet share among its top-10 accounts.
- DSO stood at 61 days, down 2 days QoQ.
- Offshore utilisation at 81% was down 30bps QoQ due to net hiring of 1,980 employees during the quarter.
- About 85% of deals are from new-gen areas.

Fig 1 – Quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenue (US\$ mn)	364	303	20.0	342	6.3	1,339	1,242	7.8
Revenue excluding hedging gains/losses (US\$ mn)	362	305	18.5	340	6.6	1,334	1,239	7.7
Revenue	26,908	22,882	17.6	25,243	6.6	99,387	88,436	12.4
Revenue excluding hedging gains/losses	26,676	23,037	15.8	24,847	7.4	98,798	88,239	12.0
Operating Expenditure	22,014	18,704	17.7	20,572	7.0	81,120	71,931	12.8
Cost of revenues	19,261	16,261	18.4	17,415	10.6	69,911	62,951	11.1
as % of sales	71.6	71	-	69.0	-	70.3	71.2	-
SG&A expenses	2,753	2,443	12.7	3,157	(12.8)	11,209	8,980	24.8
as % of sales	10.2	11	-	12.5	-	11.3	10.2	-
EBITDA	4,894	4,178	17.1	4,671	4.8	18,267	16,505	10.7
Depreciation	624	595	4.9	617	1.1	2,436	2,317	5.1
EBIT	4,270	3,583	19.2	4,054	5.3	15,831	14,188	11.6
Other Income	310	182	70.3	182	70.3	788	967	(18.5)
PBT	4,580	3,765	21.6	4,236	8.1	16,619	15,155	9.7
Total Tax	1,184	1,015	16.7	1,067	11.0	4,312	3,306	30.4
Adjusted PAT	3,396	2,750	23.5	3,169	7.2	12,307	11,849	3.9
APAT after MI	3,396	2,750	23.5	3,169	7.2	12,307	11,849	3.9
Extra ordinary items	-	0	-	-	-	0	0	-
Reported PAT	3,396	2,750	23.5	3,169	7.2	12,307	11,849	3.9
Reported EPS	18.2	15	22.8	17.0	7.2	66	64	3.7
Margins (%)			(bps)		(bps)			(bps)
EBITDA	18.2	18.3	(10)	18.5	(30)	18.4	18.7	(30)
EBIT	15.9	15.7	20	16.1	(20)	15.9	16.0	(10)
EBT	17.0	16.5	60	16.8	20	16.7	17.1	(40)
PAT	12.6	12.0	60	12.6	10	12.4	13.4	(100)
Effective Tax Rate	25.9	27.0	(110)	25.2	70	25.9	21.8	410

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

	Q1FY22	Growth	
	(% Contr. to Revenue)	QoQ (%)	YoY (%)
Revenue by Business Segment (in US\$ terms)			
Direct International	89.0	9.7	33.8
DXC	9.0	(18.0)	(46.5)
Revenue by Vertical (in Rs terms)			
Banking and Capital Markets	50.9	9.2	21.9
Insurance	9.1	(3.0)	6.7
Information Technology, Communication & Entertainment	14.1	4.4	16.7
Logistics and Transportation	13.9	11.5	15.8
Others	11.3	2.9	1.4
TCV (US\$ mn)	505.00	106	64.9
Revenue by Project Type			
		(bps)	(bps)
T & M	74.0	100	0
Fixed price	26.0	(100)	0

Source: Company, BOBCAPS Research

Valuation methodology

MPL's stellar show in the direct business came as a positive surprise, counteracting the steep reduction in DXC business. We upgrade our rating to HOLD from SELL on the back of strong momentum in the direct channel and a receding mix of DXC business (at 9% of revenue vs. 20% in Q1FY21). Our dollar revenue growth forecast of 14% CAGR for MPL over FY21-FY24 factors in 19.4% direct revenue growth and a 34.7% drop in DXC business.

We roll forward to a revised Jun'22 TP of Rs 2,500, set at a higher one-year forward P/E of 25.5x vs. 17x earlier, baking in a 15% discount to L&T Infotech (LTI). At CMP, MPL is trading at 25x FY23E P/E compared to its five-year 12-month rolling average of 15.2x.

Fig 3 – Revised estimates

(Rs mn)	FY22E			FY23E			FY24E
	Old	New	Change (%)	Old	New	Change (%)	New
Reported Revenues (US\$ mn)	1,488	1,522	2.2	1,687	1,708	1.2	1,941
YoY growth (%)	13.6	15.9	-	13.3	12.2	-	15.1
Revenues (ex-hedging, US\$ mn)	1,488	1,522	2.2	1,687	1,708	1.2	1,941
Revenues	113,303	115,589	2.0	131,555	133,195	1.2	151,385
EBIT	19,325	19,634	1.6	22,407	22,751	1.5	25,574
EBIT margins (%)	17.1	17.0	-	17.0	17.1	-	16.9
Net Profits	14,950	15,261	2.1	17,583	17,816	1.3	20,099
EPS (Rs)	80.3	82.0	2.1	94.5	95.7	1.3	108.0

Source: BOBCAPS Research

Fig 4 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		P/E (x)		ROE (%)	
					FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Tata Consultancy Services	TCS IN	BUY	3,890	15.1	109.8	127.0	29.3	25.3	41.4	43.1
Infosys	INFO IN	BUY	1,860	14.3	54.1	61.1	29.4	26.0	33.8	33.8
Wipro	WPRO IN	HOLD	590	18.4	23.5	27.1	24.9	21.6	7.1	7.5
HCL Technologies	HCLT IN	BUY	1,260	11.3	52.2	59.0	18.8	16.6	31.9	38.4
Tech Mahindra	TECHM IN	BUY	1,190	14.7	63.4	75.7	18.1	15.2	20.9	22.2
L&T Infotech	LTI IN	BUY	4,990	18.7	134.1	158.4	32.9	27.8	37.1	42.6
Mphasis	MPHL IN	HOLD	2,500	14.0	82.0	95.7	29.2	25.0	22.3	25.5
Mindtree	MTCL IN	SELL	2,270	15.8	87.7	93.9	31.5	29.4	50.5	55.7
Persistent Systems	PSYS IN	SELL	650	15.0	64.3	69.6	44.0	40.6	17.4	16.9
Coforge	COFORGE IN	BUY	4,080	23.3	131.3	163.3	35.5	28.6	25.1	26.3
eClerx Services	ECLX IN	BUY	1,620	16.8	120.3	135.1	18.4	16.4	38.3	41.6

Source: BOBCAPS Research, Company

Key risks

Key downside risks to our estimates are:

- vendor consolidation in favour of large players,
- EBIT margin impact due to a tight supply environment, and
- stagnation in BFSI demand.

Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	36	979	1,260	BUY
Info Edge	INFOE IN	9	5,225	2,880	SELL
Infosys	INFO IN	91	1,590	1,860	BUY
L&T Infotech	LTI IN	10	4,406	4,990	BUY
Mindtree	MTCL IN	6	2,759	2,270	SELL
Mphasis	MPL IN	6	2,397	2,500	HOLD
Persistent Systems	PSYS IN	3	2,829	1,340	SELL
Tata Consultancy Services	TCS IN	162	3,216	3,890	BUY
Tech Mahindra	TECHM IN	13	1,149	1,190	BUY
Wipro	WPRO IN	43	584	590	HOLD

Source: BOBCAPS Research, NSE | Price as of 22 Jul 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Total revenue	88,436	97,223	115,589	133,195	151,385
EBITDA	16,505	18,028	22,163	25,814	29,234
Depreciation	2,317	2,418	2,529	3,063	3,660
EBIT	14,188	15,610	19,634	22,751	25,574
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	967	696	766	1,003	1,225
Exceptional items	0	0	0	0	0
EBT	15,155	16,306	20,400	23,755	26,799
Income taxes	3,306	4,139	5,139	5,939	6,700
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	11,849	12,167	15,261	17,816	20,099
Adjustments	0	0	0	0	0
Adjusted net profit	11,849	12,167	15,261	17,816	20,099

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	12,769	11,927	17,417	20,070	22,811
Provisions	2,242	3,494	4,750	5,474	6,221
Debt funds	12,955	11,811	11,811	11,811	11,811
Other liabilities	137	343	343	343	343
Equity capital	1,865	1,870	1,870	1,870	1,870
Reserves & surplus	56,431	63,398	68,553	74,572	81,361
Shareholders' fund	58,296	65,268	70,423	76,442	83,231
Total liab. and equities	86,399	92,843	104,745	114,140	124,418
Cash and cash eq.	11,484	11,310	16,006	20,436	25,875
Accounts receivables	7,217	8,147	9,500	10,948	12,443
Inventories	0	0	0	0	0
Other current assets	21,596	23,437	30,085	34,667	39,401
Investments	13,257	18,460	18,460	18,460	18,460
Net fixed assets	8,730	8,870	8,075	7,010	5,620
CWIP	553	31	31	31	31
Intangible assets	21,405	21,326	21,326	21,326	21,326
Deferred tax assets, net	2,157	1,261	1,261	1,261	1,261
Other assets	0	0	0	0	0
Total assets	86,399	92,842	104,744	114,139	124,417

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Cash flow from operations	13,710	11,528	15,770	17,223	19,794
Capital expenditures	(1,243)	(1,477)	(1,734)	(1,998)	(2,271)
Change in investments	1,552	3,702	0	0	0
Other investing cash flows	2,182	696	766	1,003	1,225
Cash flow from investing	2,491	2,921	(967)	(995)	(1,046)
Equities issued/Others	151	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(2,333)	0	0	0	0
Dividends paid	(6,065)	(14,623)	(10,106)	(11,798)	(13,310)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(8,247)	(14,623)	(10,106)	(11,798)	(13,310)
Chg in cash & cash eq.	7,954	(174)	4,696	4,430	5,438
Closing cash & cash eq.	11,484	11,310	16,006	20,436	25,875

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21P	FY22E	FY23E	FY24E
Reported EPS	63.7	65.4	82.0	95.7	108.0
Adjusted EPS	63.7	65.4	82.0	95.7	108.0
Dividend per share	35.0	65.0	44.9	52.4	59.2
Book value per share	313.2	350.6	378.3	410.6	447.1

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21P	FY22E	FY23E	FY24E
EV/Sales	5.0	4.6	3.9	3.3	2.9
EV/EBITDA	27.0	24.8	20.2	17.2	15.0
Adjusted P/E	37.7	36.7	29.2	25.0	22.2
P/BV	7.7	6.8	6.3	5.8	5.4

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21P	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	78.2	74.6	74.8	75.0	75.0
Interest burden (PBT/EBIT)	106.8	104.5	103.9	104.4	104.8
EBIT margin (EBIT/Revenue)	16.0	16.1	17.0	17.1	16.9
Asset turnover (Rev./Avg TA)	111.1	108.5	117.0	121.7	126.9
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	21.4	19.7	22.5	24.3	25.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21P	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	14.4	9.9	18.9	15.2	13.7
EBITDA	24.7	9.2	22.9	16.5	13.2
Adjusted EPS	10.4	2.7	25.4	16.7	12.8
Profitability & Return ratios (%)					
EBITDA margin	18.7	18.5	19.2	19.4	19.3
EBIT margin	16.0	16.1	17.0	17.1	16.9
Adjusted profit margin	13.4	12.5	13.2	13.4	13.3
Adjusted ROAE	21.4	19.7	22.5	24.3	25.2
ROCE	19.9	18.5	22.1	25.3	27.9
Working capital days (days)					
Receivables	33	29	28	28	28
Inventory	0	0	0	0	0
Payables	70	63	68	73	73
Ratios (x)					
Gross asset turnover	16.3	11.0	13.6	17.7	24.0
Current ratio	2.7	2.8	2.5	2.6	2.7
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	(0.1)	(0.1)	(0.2)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

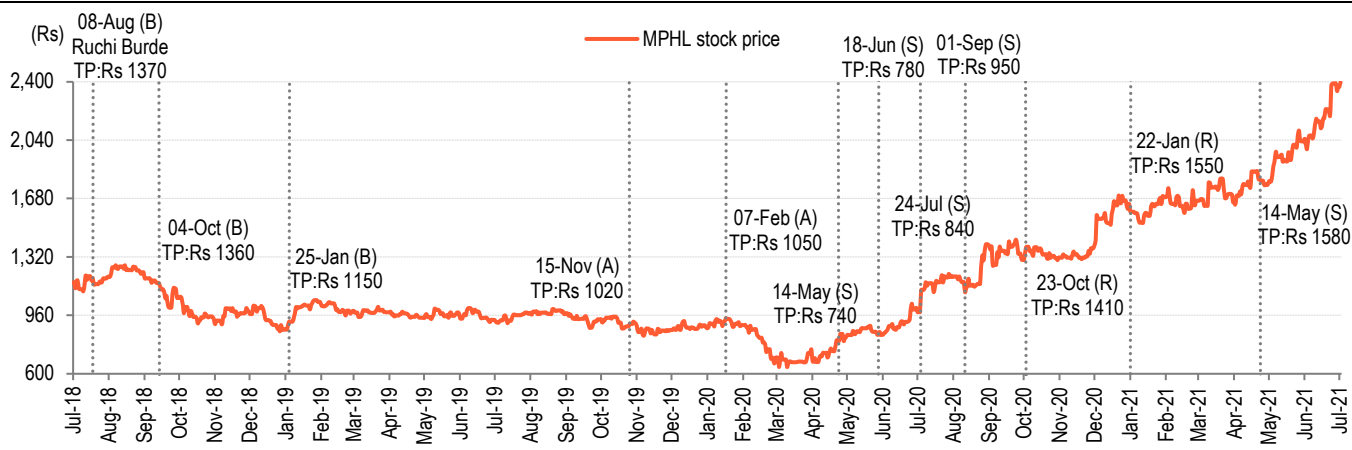
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): MPHASIS (MPHL IN)



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

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