

HOLD

TP: Rs 2,541 | ▲ 9%

MPHASIS

| Technology & Internet

| 22 July 2023

Tepid Q1; cut to HOLD post runup

- Q1 missed estimates as dollar revenue slipped 3.4% QoQ following a slowdown in both direct business and DXC
- Deal TCV at record high of US\$ 707mn aided by AI capabilities and wins in newer verticals and geographies
- Positives priced in post the recent stock runup; cut from BUY to HOLD with TP unchanged at Rs 2,541

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Weak Q1: MPHL reported a dollar revenue decline of 3.4% QoQ (-3.5% QoQ CC) in Q1FY24, much below our estimate. Growth was adversely impacted by a 3.2% QoQ CC fall in direct international business. DXC, which forms 3.5% of revenue, decreased 10.9% QoQ CC but is likely to stabilise near term.

Insurance and TMT business show improvement: MPHL has historically gained market share from peers in the BFSI vertical, but this quarter saw a better showing from non-BFSI service lines (healthcare, telecom, media and technology or TMT) and geographies (Canada). The digital risk business formed 6.3% of Q1 revenue and is seeing capacity build-up from clients, backed by recovery in other segments.

Portfolio diversification: Deal TCV during the quarter was MPHL's highest ever at US\$ 707mn, backed by AI-led wins which formed roughly a third of the total and included US\$ 100mn+ engagements. MPHL bagged seven large deals in Q1, of which only two came from BFS, including one with US\$ 100mn+ TCV. The remaining five came from non-BFS, non-top 10 clients and the Canada market, with four of these worth over US\$ 100mn each. Despite material deal conversion, the pipeline is up 6% QoQ and 23% YoY.

Margin to stay range-bound in FY24: EBIT margin was stable at 15.4% as the impact of lower revenue was mitigated by higher offshore utilisation. MPHL expects BFS to remain soft in the near term but believes margins would stay within the guided range of 15.25-16.25% for the remaining quarters of this fiscal led by pyramid optimisation, better utilisation and offshore leverage. Offshore utilisation including trainees stood at 75% vs. the previous peak of 83-84%.

Cut to HOLD post runup: Despite revenue leakages, we expect continued deal wins in direct business to support revenue over FY23-FY25. That said, the positives appear priced in post the ~24% stock runup over the past 14 days. MPHL is currently trading at 24.4x/20.4x FY24E/FY25E EPS. We value the stock at 22.2x FY25E EPS – in line with the 3Y mean – and downgrade our rating from BUY to HOLD with an unchanged TP of Rs 2,541.

Key changes

| Target | Rating |
|--------|--------|
| ◀▶ | ▼ |

| | |
|------------------|-------------------|
| Ticker/Price | MPHL IN/Rs 2,331 |
| Market cap | US\$ 5.3bn |
| Free float | 40% |
| 3M ADV | US\$ 14.7mn |
| 52wk high/low | Rs 2,445/Rs 1,660 |
| Promoter/FPI/DII | 52%/29%/14% |

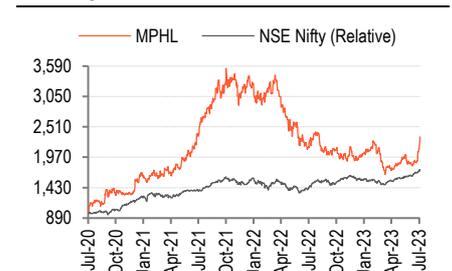
Source: NSE | Price as of 21 Jul 2023

Key financials

| Y/E 31 Mar | FY23A | FY24E | FY25E |
|-------------------------|----------|----------|----------|
| Total revenue (Rs mn) | 1,37,984 | 1,50,662 | 1,76,874 |
| EBITDA (Rs mn) | 24,239 | 27,119 | 31,838 |
| Adj. net profit (Rs mn) | 16,297 | 17,878 | 21,384 |
| Adj. EPS (Rs) | 87.2 | 95.7 | 114.4 |
| Consensus EPS (Rs) | 87.2 | 96.3 | 115.8 |
| Adj. ROAE (%) | 21.9 | 22.0 | 25.3 |
| Adj. P/E (x) | 26.7 | 24.4 | 20.4 |
| EV/EBITDA (x) | 18.1 | 16.1 | 13.6 |
| Adj. EPS growth (%) | 13.9 | 9.7 | 19.6 |

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

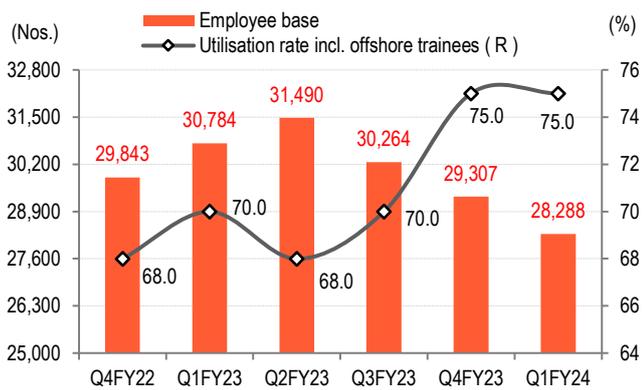


Fig 1 – Quarterly performance

| (Rs mn) | Q1FY24 | Q4FY23 | Q1FY23 | QoQ (%) | YoY (%) | Estimates | Variance (%) |
|-------------------|--------|--------|--------|---------|---------|-----------|--------------|
| Revenue (US\$ mn) | 398 | 412 | 429 | (3.4) | (7.2) | 406 | (2.0) |
| Revenue (Rs mn) | 32,520 | 33,612 | 34,112 | (3.2) | (4.7) | 33,373 | (2.6) |
| EBIT | 4,995 | 5,152 | 5,204 | (3.0) | (4.0) | 5,121 | (2.5) |
| PAT | 3,961 | 4,053 | 4,019 | (2.3) | (1.4) | 3,961 | 0.0 |
| EBIT Margin (%) | 15.4 | 15.3 | 15.3 | 3bps | 10bps | 15.3 | 2bps |
| PAT Margin (%) | 12.2 | 12.1 | 11.8 | 12bps | 40bps | 11.9 | 31bps |

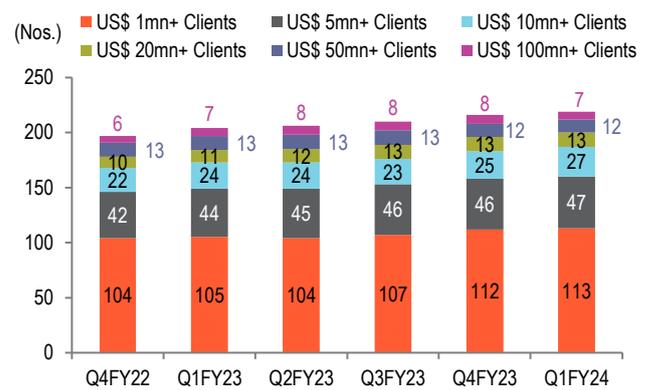
Source: Company, BOBCAPS Research

Fig 2 – Employee matrix



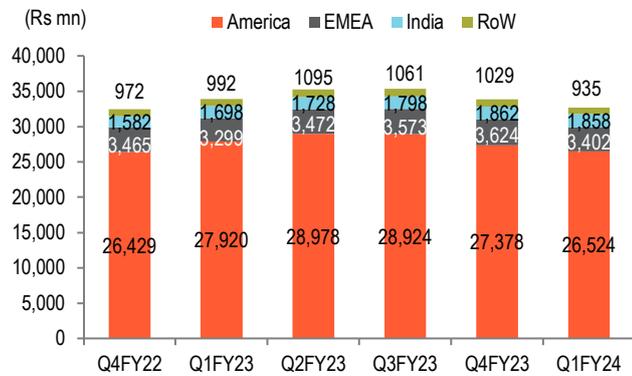
Source: Company, BOBCAPS Research

Fig 3 – Client breakup



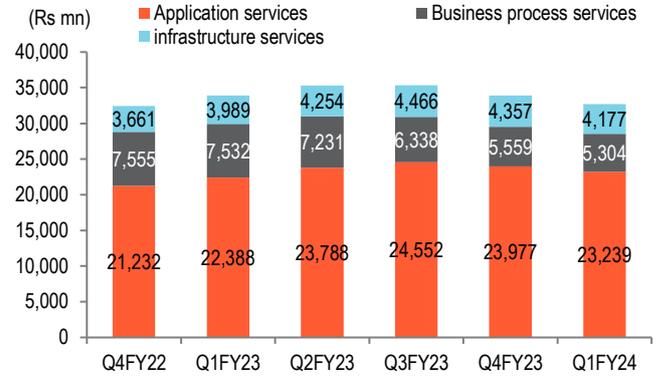
Source: Company, BOBCAPS Research

Fig 4 – Revenue by geography



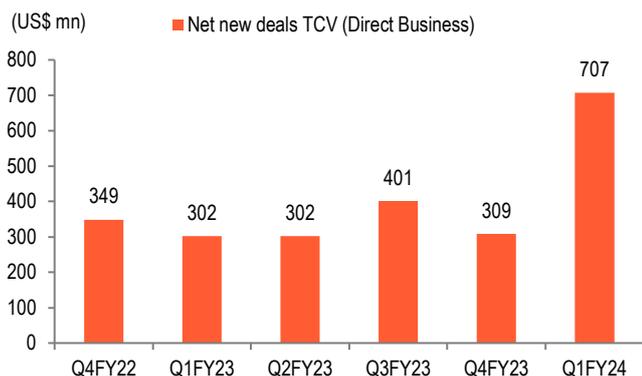
Source: Company, BOBCAPS Research

Fig 5 – Revenue by service type



Source: Company, BOBCAPS Research

Fig 6 – Net new deal TCV (Direct business]



Source: Company, BOBCAPS Research

Earnings call highlights

- MPHL's go-to-market strategy is account-centric and has helped the company bag deals worth US\$ 707mn TCV in Q1FY24.
- Integration of AI capabilities into the existing technology landscape played a key role in deal signings. A third of the wins in Q1 came from AI-related products, including one with TCV over US\$ 100mn. Management has already patented 250+ AI assets which are ready to use.
- Five of the seven large deals came from non-top 10, non-BFS clients and four of these are worth over US\$ 100mn each.
- The pipeline is well distributed across verticals. While BFS continues to generate ~40% of the pipeline, smaller verticals have been robust with healthcare seeing a 63% YoY jump in pipeline.
- Direct business (ex-mortgage) was impacted by tightness in discretionary spending and weakness in select BFS pockets. TMT (direct) business grew 6% QoQ. The top 5 clients dipped 2% YoY, weighed down by mortgage business pressure over the past three quarters.
- Management expects to hold the EBIT margin in the guided range of 15.25%-16.25% aided by a tighter focus on utilisation, pyramid optimisation and some increase in offshore leverage.

Valuation methodology

Despite revenue leakages, we expect continued deal wins in direct business to support revenue over FY23-FY25. That said, the positives appear priced in post the ~24% stock runup over the past 14 days. MPHL is currently trading at 24.4x/20.4x FY24E/FY25E EPS. We value the stock at 22.2x FY25E EPS – in line with the 3Y mean – and downgrade our rating from BUY to HOLD with an unchanged TP of Rs 2,541.

Key risks

- A further rise in interest rates would be a key downside risk to our estimates as deal wins could soften due to longer client decision-making cycles, especially in the financial services, retail, hi-tech and telecom verticals

Sector recommendation snapshot

| Company | Ticker | Market Cap (US\$ bn) | Price (Rs) | Target (Rs) | Rating |
|---------------------------|------------|----------------------|------------|-------------|--------|
| Affle (India) | AFFLE IN | 0.3 | 1,047 | 1,110 | HOLD |
| Coforge | COFORGE IN | 3.5 | 4,640 | 4,830 | HOLD |
| HCL Technologies | HCLT IN | 36.8 | 1,115 | 1,240 | HOLD |
| Infosys | INFO IN | 68.1 | 1,332 | 1,760 | BUY |
| Mphasis | MPHL IN | 5.3 | 2,331 | 2,541 | HOLD |
| Persistent Systems | PSYS IN | 4.6 | 4,750 | 5,330 | HOLD |
| Tata Consultancy Services | TCS IN | 150.0 | 3,368 | 3,580 | HOLD |
| Tech Mahindra | TECHM IN | 12.7 | 1,195 | 1,130 | HOLD |
| Wipro | WPRO IN | 27.0 | 405 | 420 | HOLD |

Source: BOBCAPS Research, NSE | Price as of 21 Jul 2023

Financials

Income Statement

| Y/E 31 Mar (Rs mn) | FY21A | FY22A | FY23A | FY24E | FY25E |
|----------------------------|---------------|-----------------|-----------------|-----------------|-----------------|
| Total revenue | 97,223 | 1,19,614 | 1,37,984 | 1,50,662 | 1,76,874 |
| EBITDA | 18,028 | 21,175 | 24,239 | 27,119 | 31,838 |
| Depreciation | 2,418 | 2,906 | 3,253 | 3,594 | 3,657 |
| EBIT | 15,610 | 18,269 | 20,986 | 23,525 | 28,180 |
| Net interest inc./(exp.) | 0 | 0 | 0 | 0 | 1 |
| Other inc./(exp.) | 696 | 861 | 644 | 312 | 332 |
| Exceptional items | 0 | 0 | 0 | 0 | 0 |
| EBT | 16,306 | 19,130 | 21,630 | 23,837 | 28,512 |
| Income taxes | 4,139 | 4,821 | 5,333 | 5,959 | 7,128 |
| Extraordinary items | 0 | 0 | 0 | 0 | 1 |
| Min. int./Inc. from assoc. | 0 | 0 | 0 | 0 | 0 |
| Reported net profit | 12,167 | 14,309 | 16,297 | 17,878 | 21,384 |
| Adjustments | 0 | 0 | 0 | 0 | 1 |
| Adjusted net profit | 12,167 | 14,309 | 16,297 | 17,878 | 21,384 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY21A | FY22A | FY23A | FY24E | FY25E |
|---------------------------------|---------------|-----------------|-----------------|-----------------|-----------------|
| Accounts payables | 0 | 0 | 0 | 0 | 0 |
| Other current liabilities | 11,927 | 18,573 | 19,797 | 22,703 | 26,652 |
| Provisions | 3,494 | 5,160 | 4,115 | 6,192 | 7,269 |
| Debt funds | 11,811 | 12,519 | 10,528 | 10,528 | 10,528 |
| Other liabilities | 342 | 718 | 1,030 | 1,030 | 1,030 |
| Equity capital | 1,870 | 1,878 | 1,884 | 1,884 | 1,884 |
| Reserves & surplus | 63,398 | 67,554 | 77,464 | 81,120 | 84,344 |
| Shareholders' fund | 65,268 | 69,432 | 79,348 | 83,004 | 86,228 |
| Total liab. and equities | 92,842 | 1,06,402 | 1,14,818 | 1,23,456 | 1,31,707 |
| Cash and cash eq. | 11,310 | 9,682 | 10,558 | 12,324 | 12,602 |
| Accounts receivables | 8,147 | 8,523 | 8,523 | 12,383 | 14,538 |
| Inventories | 0 | 0 | 0 | 0 | 0 |
| Other current assets | 23,437 | 30,605 | 34,867 | 39,214 | 46,036 |
| Investments | 18,460 | 18,130 | 17,526 | 17,526 | 17,526 |
| Net fixed assets | 8,870 | 10,388 | 11,012 | 9,678 | 8,674 |
| CWIP | 31 | 110 | 324 | 324 | 324 |
| Intangible assets | 21,326 | 27,348 | 29,586 | 29,586 | 29,586 |
| Deferred tax assets, net | 1,261 | 1,616 | 2,422 | 2,422 | 2,422 |
| Other assets | 0 | 0 | 0 | 0 | 0 |
| Total assets | 92,842 | 1,06,402 | 1,14,818 | 1,23,456 | 1,31,707 |

Cash Flows

| Y/E 31 Mar (Rs mn) | FY21A | FY22A | FY23A | FY24E | FY25E |
|------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Cash flow from operations | 11,528 | 17,122 | 14,823 | 17,936 | 20,760 |
| Capital expenditures | (1,477) | (2,439) | (836) | (2,260) | (2,653) |
| Change in investments | 3,702 | 0 | 0 | 0 | 0 |
| Other investing cash flows | 696 | (1,139) | (2,356) | (3,688) | (3,668) |
| Cash flow from investing | 2,921 | (3,578) | (3,192) | (5,948) | (6,321) |
| Equities issued/Others | 0 | 0 | 0 | 0 | 0 |
| Debt raised/repaid | 0 | 0 | 0 | 0 | 0 |
| Interest expenses | (2,356) | (1,687) | 0 | 0 | 0 |
| Dividends paid | (14,623) | (9,475) | (10,792) | (11,839) | (14,161) |
| Other financing cash flows | 0 | 0 | 0 | 0 | 0 |
| Cash flow from financing | (16,979) | (11,163) | (10,792) | (11,839) | (14,161) |
| Chg in cash & cash eq. | (2,530) | 2,381 | 839 | 149 | 278 |
| Closing cash & cash eq. | 8,955 | 11,336 | 12,175 | 12,324 | 12,602 |

Per Share

| Y/E 31 Mar (Rs) | FY21A | FY22A | FY23A | FY24E | FY25E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 65.1 | 76.6 | 87.2 | 95.7 | 114.4 |
| Adjusted EPS | 65.1 | 76.6 | 87.2 | 95.7 | 114.4 |
| Dividend per share | 65.0 | 42.1 | 48.0 | 52.6 | 62.9 |
| Book value per share | 349.3 | 371.6 | 424.7 | 444.2 | 461.5 |

Valuations Ratios

| Y/E 31 Mar (x) | FY21A | FY22A | FY23A | FY24E | FY25E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 4.5 | 3.7 | 3.2 | 2.9 | 2.5 |
| EV/EBITDA | 24.2 | 20.7 | 18.1 | 16.1 | 13.6 |
| Adjusted P/E | 35.8 | 30.4 | 26.7 | 24.4 | 20.4 |
| P/BV | 6.7 | 6.3 | 5.5 | 5.2 | 5.1 |

DuPont Analysis

| Y/E 31 Mar (%) | FY21A | FY22A | FY23A | FY24E | FY25E |
|------------------------------|-------------|-------------|-------------|-------------|-------------|
| Tax burden (Net profit/PBT) | 74.6 | 74.8 | 75.3 | 75.0 | 75.0 |
| Interest burden (PBT/EBIT) | 104.5 | 104.7 | 103.1 | 101.3 | 101.2 |
| EBIT margin (EBIT/Revenue) | 16.1 | 15.3 | 15.2 | 15.6 | 15.9 |
| Asset turnover (Rev./Avg TA) | 108.5 | 120.1 | 124.7 | 126.5 | 138.6 |
| Leverage (Avg TA/Avg Equity) | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Adjusted ROAE | 19.7 | 21.2 | 21.9 | 22.0 | 25.3 |

Ratio Analysis

| Y/E 31 Mar | FY21A | FY22A | FY23A | FY24E | FY25E |
|--|------------|------------|------------|------------|------------|
| YoY growth (%) | | | | | |
| Revenue | 9.9 | 23.0 | 15.4 | 9.2 | 17.4 |
| EBITDA | 9.2 | 17.5 | 14.5 | 11.9 | 17.4 |
| Adjusted EPS | 2.7 | 17.6 | 13.9 | 9.7 | 19.6 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 18.5 | 17.7 | 17.6 | 18.0 | 18.0 |
| EBIT margin | 16.1 | 15.3 | 15.2 | 15.6 | 15.9 |
| Adjusted profit margin | 12.5 | 12.0 | 11.8 | 11.9 | 12.1 |
| Adjusted ROAE | 19.7 | 21.2 | 21.9 | 22.0 | 25.3 |
| ROCE | 18.5 | 19.6 | 20.6 | 21.7 | 25.2 |
| Working capital days (days) | | | | | |
| Receivables | 29 | 25 | 23 | 25 | 28 |
| Inventory | 0 | 0 | 0 | 0 | 0 |
| Payables | 63 | 70 | 71 | 68 | 73 |
| Ratios (x) | | | | | |
| Gross asset turnover | 11.0 | 12.4 | 12.9 | 14.6 | 19.3 |
| Current ratio | 2.8 | 2.1 | 2.3 | 2.2 | 2.2 |
| Net interest coverage ratio | NA | NA | NA | NA | NA |
| Adjusted debt/equity | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

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

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BUY – Expected return >+15%

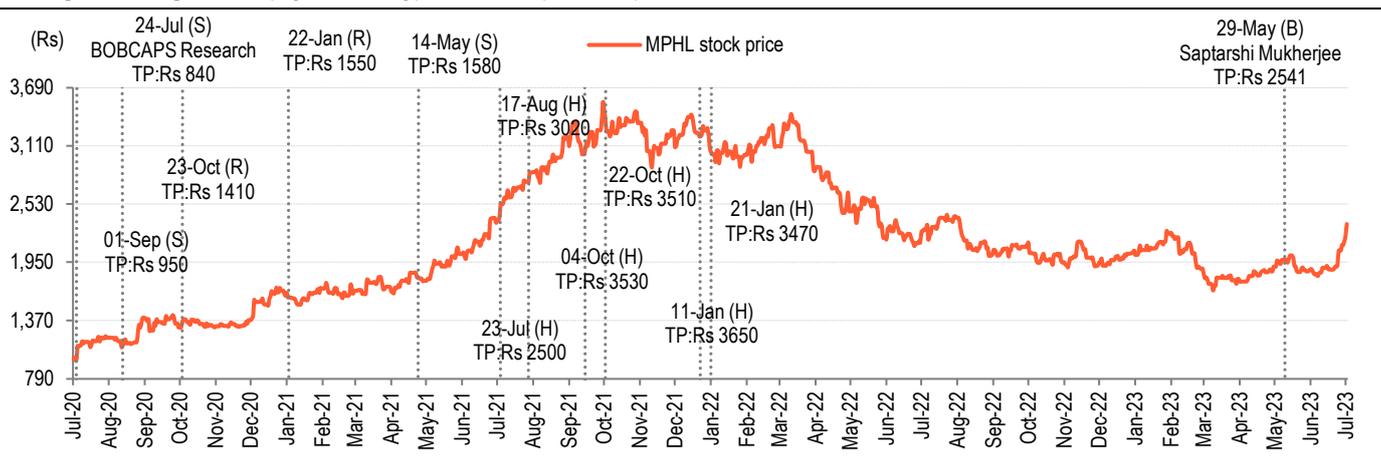
HOLD – Expected return from -6% to +15%

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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