

**REDUCE**

TP: Rs 1,410 | ▲ 4%

MPHASIS

| IT Services

| 23 October 2020

**DXC remains soft but pipeline healthy – raise to REDUCE**

Mphasis (MPHL) reported strong Q2FY21 revenue and margins. Revenue grew 6% QoQ CC despite DXC business dropping 14.9%. EBIT margin at 16.1% improved 40bps QoQ (15.7% est.). TCV at US\$ 360mn was at its peak on the back of a healthy order book. We increase FY21-FY23 EPS by 5-10% and roll over to a revised Sep'21 TP of Rs 1,410 (vs. Rs 950). Though risks to the DXC business persist, we reset our target P/E to 16.4x based on MPHL's strong pipeline and diverse revenue mix. Raise to REDUCE from SELL.

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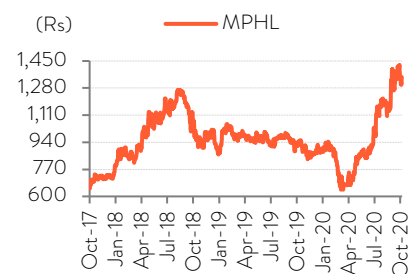
**Diversified revenue mix:** Revenue growth of 6% QoQ CC beat our estimate of 1.6% due to a strong pickup in direct revenue (10.9% QoQ CC), which offset a 14.9% revenue decline in DXC. Strong momentum in banking and capital markets aided revenue mix diversification. Overall, QoQ growth was uplifted by higher investment in sales, improved client mining and a focus on Europe revenues as well as direct channel growth. EBIT margin stood at 16.1%, expanding 40bps QoQ, marginally outperforming our estimate of 15.7%.

**TCV at record high:** Direct business TCV stood at an all-time high of US\$ 360mn in Q2, coming from the areas of cloud, modernisation and big data. About 73% of TCV was from new-gen areas. MPHL's cloud pipeline has grown 3x YoY. TTM deal wins crossed US\$ 1bn for the first time in Q2. MPHL saw increased number of large deals bagged (US\$ 200mn+ TCV), with most of them being transformation-led and integrated in nature.

**Improved growth visibility:** MPHL's outlook on the banking and capital markets vertical remains upbeat. Europe is expected to remain a significant growth driver even beyond FY21. Per management, the pipeline is up 75% YoY, lending improved visibility for the near-to-mid-term. EBIT margin is guided to lie within 15.5-16.5% in FY21.

Ticker/Price	MPHL IN/Rs 1,350
Market cap	US\$ 3.4bn
Shares o/s	186mn
3M ADV	US\$ 9.6mn
52wk high/low	Rs 1,465/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	98,575	115,343	129,106
EBITDA (Rs mn)	13,240	16,505	18,228	22,667	25,408
Adj. net profit (Rs mn)	10,734	11,849	12,141	15,160	17,092
Adj. EPS (Rs)	57.7	63.7	65.2	81.4	91.8
Adj. EPS growth (%)	30.9	10.4	2.5	24.9	12.7
Adj. ROAE (%)	20.0	21.4	19.9	22.5	22.9
Adj. P/E (x)	23.4	21.2	20.7	16.6	14.7
EV/EBITDA (x)	18.8	15.2	13.8	11.1	9.7

Source: Company, BOBCAPS Research

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## Other highlights

- 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 (only US\$ 200mn of the commitment left for next four quarters). MPHL aims to continue derisking dependence on DXC which now forms 16% of revenue vs. 20% in Q1FY21.
- As per CEO Nitin Rakesh, enterprises are moving from crisis management mode to accelerated transformation mode. New, unexpected growth has taken place in the technology world as a few sectors are moving towards a digital-only operating model.
- Q3FY21 is expected to be slow QoQ due to the furlough impact, especially in the BFS and insurance segments.

**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue (US\$ mn)	329	306	7.4	303	8.4
<b>Revenue excluding hedging gains/losses (US\$ mn)</b>	<b>327</b>	<b>305</b>	<b>7.4</b>	<b>305</b>	<b>7.2</b>
Revenue	24,354	21,581	12.8	22,882	6.4
Revenue excluding hedging gains/losses	24,238	21,462	12.9	23,037	5.2
Operating Expenditure	19,830	17,529	13.1	18,704	6.0
Cost of revenues	16,974	15,361	10.5	16,261	4.4
as % of sales	69.7	71	-	71.1	-
SG&A expenses	2,856	2,168	31.7	2,443	16.9
as % of sales	11.7	10	-	10.7	-
EBITDA	4,524	4,052	11.6	4,178	8.3
Depreciation	600	582	3.1	595	0.8
<b>EBIT</b>	<b>3,924</b>	<b>3,470</b>	<b>13.1</b>	<b>3,583</b>	<b>9.5</b>
Other Income	114	134	(14.9)	182	(37.4)
PBT	4,038	3,604	12.0	3,765	7.2
Total Tax	1,046	871	20.1	1,015	3.1
<b>Adjusted PAT</b>	<b>2,992</b>	<b>2,733</b>	<b>9.5</b>	<b>2,750</b>	<b>8.8</b>
APAT after MI	2,992	2,733	9.5	2,750	8.8
Extra ordinary items	-	0	-	-	-
Reported PAT	2,992	2,733	9.5	2,750	8.8
Reported EPS	16.0	15	8.9	14.8	8.2
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>
EBITDA	18.6	18.8	(20)	18.3	30
EBIT	16.1	16.1	-	15.7	40
EBT	16.6	16.7	(10)	16.5	10
PAT	12.3	12.7	(40)	12.0	30
Effective Tax rate	25.9	24.2	170	27.0	(110)

Source: BOBCAPS Research

**FIG 2 – OPERATING METRICS**

	Q2FY21 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
<b>Revenue by Business Segment (US\$ terms)</b>			
Direct International	82.0	11.3	19.4
DXC	16.0	(14.2)	(28.7)
<b>Revenue by Vertical (Rs terms)</b>			
Banking and Capital Markets	53.2	15.2	31.7
Insurance	9.5	0.7	(4.4)
Information Technology, Communication & Entertainment	11.7	(12.2)	(17.3)
Logistics and Transportation	12.2	(7.9)	3.5
Others	12.9	4.3	9.2
<b>Revenue by Project Type</b>		<b>(bps)</b>	<b>(bps)</b>
T & M	75.0	100	100
Fixed price	25.0	(100)	(100)

Source: BOBCAPS Research

## Valuation methodology

We increase FY21/FY22/FY23 EPS estimates by 5%/9%/10% to accommodate the operating margin beat and elevated direct channel growth in Q2FY21. On rolling valuations forward, we have a revised Sep'21 target price of Rs 1,410 (Rs 950 earlier), based on a higher one-year forward P/E of 16.4x (12x earlier).

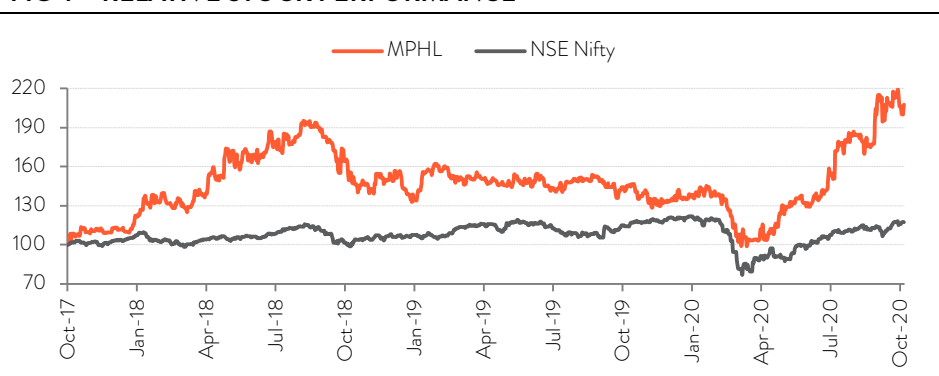
Our target multiple has been reset based on (1) increased pipeline visibility, (2) revenue mix diversification, (3) sustained momentum in banking and capital markets, and (4) predictable margins. That said, we still see risks to growth from DXC's waning revenue commitment and MPHL's high client concentration. Upgrade from SELL to REDUCE.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Reported Revenues (US\$ mn)	1,245	1,310	5.3	1,369	1,479	8.0	1,513	1,655	9.4
YoY (%)	0.2	5.5	-	10.0	12.9	-	10.5	11.9	-
Revenues (ex-hedging, US\$ mn)	1,245	1,310	5.3	1,369	1,479	8.0	1,513	1,655	9.4
Revenues	94,885	98,575	3.9	106,781	115,343	8.0	117,982	129,106	9.4
EBIT	15,069	15,820	5.0	18,075	19,719	9.1	19,814	21,918	10.6
EBITDA margins (%)	15.9	16.0	-	16.9	17.1	-	16.8	17.0	-
Net profits	11,610	12,141	4.6	13,944	15,160	8.7	15,538	17,092	10.0
EPS (Rs)	62.4	65.2	4.6	74.9	81.4	8.7	83.5	91.8	10.0

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Key upside risks to our estimates are:

- increased deal win momentum in the direct channel,
- stronger pickup in logistics and transportation vertical, and
- sharper rupee depreciation, aiding margins.

## 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>98,575</b>	<b>115,343</b>	<b>129,106</b>
EBITDA	13,240	16,505	18,228	22,667	25,408
Depreciation	759	2,317	2,409	2,949	3,490
EBIT	12,481	14,188	15,820	19,719	21,918
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	1,592	967	515	494	871
Exceptional items	0	0	0	0	0
EBT	14,073	15,155	16,334	20,213	22,789
Income taxes	3,339	3,306	4,194	5,053	5,697
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>12,141</b>	<b>15,160</b>	<b>17,092</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>10,734</b>	<b>11,849</b>	<b>12,141</b>	<b>15,160</b>	<b>17,092</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	14,854	17,380	19,454
Provisions	3,100	2,242	4,051	4,740	5,306
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	61,994	68,940	76,771
Shareholders' fund	52,498	58,296	63,859	70,805	78,637
<b>Total liabilities and equities</b>	<b>72,741</b>	<b>86,399</b>	<b>95,856</b>	<b>106,018</b>	<b>116,489</b>
Cash and cash eq.	6,572	11,484	14,225	22,563	29,874
Accounts receivables	8,620	7,217	9,452	9,480	10,611
Inventories	0	0	0	0	0
Other current assets	21,339	21,596	27,007	30,021	33,603
Investments	13,292	13,257	13,257	13,257	13,257
Net fixed assets	2,113	8,730	7,800	6,582	5,028
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>95,856</b>	<b>106,018</b>	<b>116,489</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	14,549	18,108	20,582
Interest expenses	(98)	(967)	(515)	(494)	(871)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,421)	1,370	(3,752)	174	(2,074)
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>10,282</b>	<b>17,788</b>	<b>17,637</b>
Capital expenditures	(815)	(1,372)	(1,479)	(1,730)	(1,937)
Change in investments	5,725	0	0	0	0
Other investing cash flows	(2,111)	967	515	494	871
<b>Cash flow from investing</b>	<b>2,798</b>	<b>(405)</b>	<b>(964)</b>	<b>(1,236)</b>	<b>(1,066)</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)	(6,578)	(8,213)	(9,260)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(13,418)</b>	<b>(6,420)</b>	<b>(6,578)</b>	<b>(8,213)</b>	<b>(9,260)</b>
<b>Changes in cash and cash eq.</b>	<b>(1,122)</b>	<b>4,912</b>	<b>2,740</b>	<b>8,339</b>	<b>7,311</b>
<b>Closing cash and cash eq.</b>	<b>6,572</b>	<b>11,484</b>	<b>14,225</b>	<b>22,563</b>	<b>29,874</b>

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	57.7	63.7	65.2	81.4	91.8
Adjusted EPS	57.7	63.7	65.2	81.4	91.8
Dividend per share	0.0	28.6	29.3	36.6	41.3
Book value per share	282.0	313.2	343.0	380.4	422.4

### Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.2	2.8	2.6	2.2	1.9
EV/EBITDA	18.8	15.2	13.8	11.1	9.7
Adjusted P/E	23.4	21.2	20.7	16.6	14.7
P/BV	4.8	4.3	3.9	3.5	3.2

### DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.3	78.2	74.3	75.0	75.0
Interest burden (PBT/EBIT)	112.8	106.8	103.3	102.5	104.0
EBIT margin (EBIT/Revenue)	16.1	16.0	16.0	17.1	17.0
Asset turnover (Revenue/Avg TA)	108.4	111.1	108.2	114.3	116.0
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.5	1.5	1.5
Adjusted ROAE	20.0	21.4	19.9	22.5	22.9

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	11.5	17.0	11.9
EBITDA	24.6	24.7	10.4	24.4	12.1
Adjusted EPS	30.9	10.4	2.5	24.9	12.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	17.1	18.7	18.5	19.7	19.7
EBIT margin	16.1	16.0	16.0	17.1	17.0
Adjusted profit margin	13.9	13.4	12.3	13.1	13.2
Adjusted ROAE	20.0	21.4	19.9	22.5	22.9
ROCE	18.0	19.9	19.2	23.8	26.7
<b>Working capital days (days)</b>					
Receivables	40	33	31	30	28
Inventory	0	0	0	0	0
Payables	75	70	70	73	73
<b>Ratios (x)</b>					
Gross asset turnover	39.3	16.3	11.9	16.0	22.2
Current ratio	2.5	2.7	2.7	2.8	3.0
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

## Disclaimer

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

**BUY** – Expected return >+15%

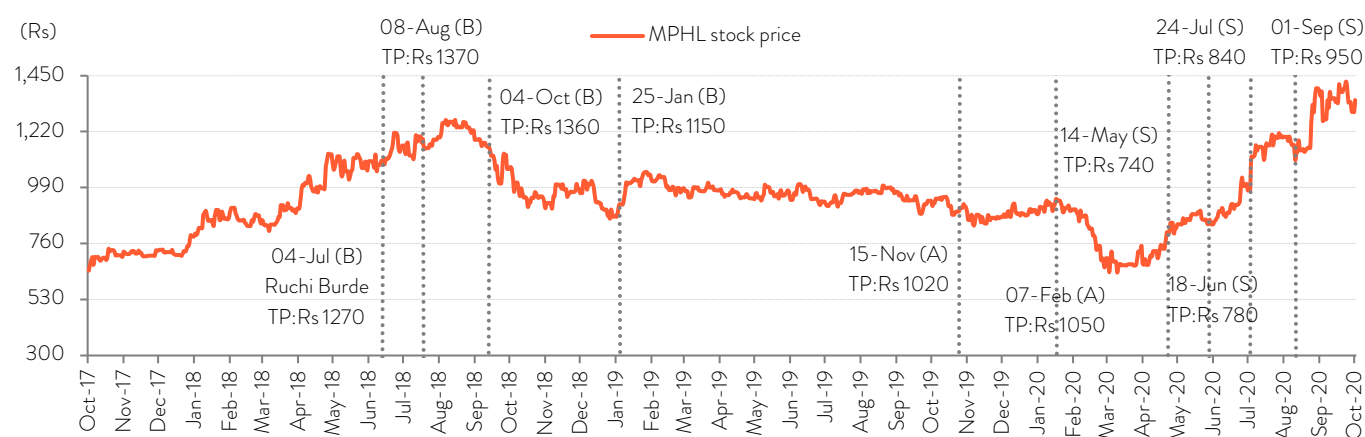
**ADD** – Expected return from >+5% to +15%

**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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