

HOLD

TP: Rs 3,510 | ▲ 3%

MPHASIS

| Technology & Internet

| 22 October 2021

Mixed bag

- Q2 revenue grew 6.4% QoQ USD, outperforming our (4.9%) and street estimates; EBIT margin a miss at 15.1%
- DXC contracted 29% QoQ USD but stellar pickup in direct channel business by 10% shored up topline growth
- We trim FY22/FY23 EPS by 4%/1% and slightly reduce our TP to Rs 3,510 (vs. Rs 3,530); retain HOLD

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Mixed quarter: MPHL reported a revenue beat but a miss on margins in Q2FY22. Revenue at US\$ 385mn grew 6.6% QoQ CC vs. our estimate of 5.4%. Direct business performed well, growing 9.9% QoQ CC, but DXC business contracted more than expected by 24.5%. The silver lining for MPHL was that dependence on DXC revenue contribution has reduced to only 6% in Q2. EBIT margin stood at 15.1% (-80bps QoQ), below our 16.8% estimate. Adjusted for a one-time impact of Rs 4.5bn from the Blink acquisition, EBIT margin was flattish QoQ at 15.8%.

BFSI leads growth: The BFSI vertical grew 13.3% QoQ and insurance recovered slightly with a 2.3% uptick. Logistics and transportation dipped 0.5% QoQ but moved up the most YoY, indicating recovery in upcoming quarters.

Deal wins slow down: Though management had earlier stated that the pipeline was robust, Q2 deal TCV declined 52% QoQ and 33% YoY to US\$ 241mn. In line with commentary across the sector about the changing dynamics of large deals, MPHL also indicated that clients are more enthusiastic about 9-12-month contracts, rather than multiyear engagements.

Europe focus: Europe is emerging as a strategic focus area for MPHL with the geography growing 5.9% QoQ INR in Q2. The deal pipeline is strong and comprises several new clients. The BFS vertical in the UK is working well for the company. It has 5 of the top 10 European banks as customers and is looking to further expand its footprint.

Demand outlook robust: Management has guided for industry-leading growth from the direct business in FY22 and expects DXC revenue share to remain in mid-single digits. Unfavourable seasonality will come into play in H2 as usual. MPHL has guided for operating margins within a narrow 15.5-17.5% range, with a northward bias. We retain HOLD on the stock considering robust demand but limited scope for margin upside in upcoming quarters. Post Q2, we cut FY22/FY23 EPS estimates by 4%/1% and reduce our Sep'22 TP to Rs 3,510 (vs. Rs 3,530). Our target one-year forward P/E remains at 35x.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	MPHL IN/Rs 3,396
Market cap	US\$ 8.4bn
Free float	40%
3M ADV	US\$ 38.5mn
52wk high/low	Rs 3,660/Rs 1,281
Promoter/FPI/DII	52%/29%/14%

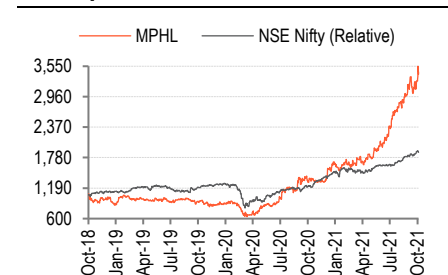
Source: NSE | Price as of 21 Oct 2021

Key financials

Y/E 31 Mar	FY20A	FY21E	FY22E
Total revenue (Rs mn)	88,436	97,223	116,882
EBITDA (Rs mn)	16,505	18,028	21,375
Adj. net profit (Rs mn)	11,849	12,167	14,244
Adj. EPS (Rs)	63.7	65.4	76.5
Consensus EPS (Rs)	63.7	65.4	77.6
Adj. ROAE (%)	21.4	19.7	21.0
Adj. P/E (x)	53.4	52.0	44.4
EV/EBITDA (x)	38.3	35.1	29.6
Adj. EPS growth (%)	10.4	2.7	17.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Other highlights

- In Sep'21, MPHL announced the acquisition of Blink, a US-based design consultancy services firm, for a consideration of US\$ 94mn. Q2FY22 included nine days of revenue from the acquisition (US\$ 0.9mn). The integration will be completed over the course of the next two quarters.
- DSO increased by 1 day QoQ to 62 in Q2.
- Utilisation dipped to 80% in Q2 from 81% in Q1.
- MPHL added 841 employees QoQ.
- On a sequential basis, the company added four new clients in the US\$ 1mn revenue bucket, two in the US\$ 5mn category, and one in the US\$ 10mn bucket. Management intends to sustain client mining traction going forward.

Fig 1 – Quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenue (US\$ mn)	388	329	18.0	365	6.4	753	632	19.1
Revenue excluding hedging gains/losses (US\$ mn)	385	327	17.6	363	6.1	748	633	18.2
Revenue	28,692	24,354	17.8	26,908	6.6	55,600	47,236	17.7
Revenue excluding hedging gains/losses	28,460	24,238	17.4	26,748	6.4	55,208	47,275	16.8
Operating Expenditure	23,715	19,830	19.6	22,014	7.7	45,729	38,534	18.7
Cost of revenues	20,428	16,974	20.3	19,261	6.1	39,689	33,235	19.4
as % of sales	71.2	70	-	71.6	-	71.4	70.4	-
SG&A expenses	3,287	2,856	15.1	2,753	19.4	6,040	5,299	14.0
as % of sales	11.5	12	-	10.2	-	10.9	11.2	-
EBITDA	4,977	4,524	10.0	4,894	1.7	9,871	8,702	13.4
Depreciation	657	600	9.5	624	5.3	1,281	1,195	7.2
EBIT	4,320	3,924	10.1	4,270	1.2	8,590	7,507	14.4
Other Income	277	114	143.0	310	(10.6)	587	296	98.3
PBT	4,597	4,038	13.8	4,580	0.4	9,177	7,803	17.6
Total Tax	1,182	1,046	13.0	1,184	(0.2)	2,366	2,061	14.8
Adjusted PAT	3,415	2,992	14.1	3,396	0.6	6,811	5,742	18.6
APAT after MI	3,415	2,992	14.1	3,396	0.6	6,811	5,742	18.6
Extra ordinary items	-	0	-	-	-	0	0	-
Reported PAT	3,415	2,992	14.1	3,396	0.6	6,811	5,742	18.6
Reported EPS	18.3	16	14.1	18.2	0.6	36	31	18.3
Margins (%)			(bps)		(bps)			(bps)
EBITDA	17.3	18.6	(120)	18.2	(80)	17.8	18.4	(70)
EBIT	15.1	16.1	(110)	15.9	(80)	15.4	15.9	(40)
EBT	16.0	16.6	(60)	17.0	(100)	16.5	16.5	-
PAT	11.9	12.3	(40)	12.6	(70)	12.3	12.2	10
Effective Tax rate	25.7	25.9	(20)	25.9	(10)	25.8	26.4	(60)

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

	Q2FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by business segments (in USD terms)			
Direct International	92.0	9.7	32.0
DXC	6.0	(29.2)	(55.9)
Revenue by Vertical (in INR terms)			
Banking and Capital Markets	54.1	13.3	19.9
Insurance	8.7	2.3	8.4
Information Technology, communication & Entertainment	12.4	(6.3)	24.6
Logistics and Transportation	13.0	(0.5)	25.0
Others	10.9	2.8	(0.1)
TCV (US\$ mn)	241.0	(52.0)	(33.1)
IT Services – Client Concentration (in INR terms)			
Top client	11.0	6.6	8.0
Top 5 clients	42.0	6.6	26.9
Top 10 clients	57.0	10.5	34.3
Revenue by Project Type		(bps)	(bps)
T & M	74.0	0	(100)
Fixed price	26.0	0	100

Source: Company, BOBCAPS Research

Valuation methodology

MPL's stellar Q2FY22 showing in the direct business came as a positive surprise, counteracting the steep reduction in DXC. We retain our HOLD rating considering strong momentum in the direct channel and a receding mix of DXC business (6% of revenue vs. 9% in Q1FY22), but limited scope for margin upside in upcoming quarters.

Our dollar revenue growth forecast of 16.1% CAGR for MPL over FY21-FY24 factors in 21.9% direct revenue growth and a 39.8% drop in DXC business. Post Q2, we cut FY22/FY23 EPS estimates by 4%/1% and reduce our Sep'22 TP to Rs 3,510 (vs. Rs 3,530). Our target one-year forward P/E remains at 35x. The stock is currently trading at 34.6x FY23E P/E compared to its five-year 12-month rolling average of 16.7x.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change		
	FY22E	FY23	FY24E	FY22E	FY23	FY24E	FY22E	FY23	FY24E
Reported Revenues (US\$ mn)	1,570	1,802	2,056	1,554	1,767	2,008	1.1	2.0	2.4
YoY growth (%)	19.6	14.7	14.1	18.3	13.7	13.6	-	-	-
Revenues ex-hedging (US\$ mn)	1,570	1,802	2,056	1,554	1,767	2,008	1.1	2.0	2.4
Revenues	116,882	136,956	156,280	117,346	137,839	156,621	(0.4)	(0.6)	(0.2)
EBIT	18,372	22,342	26,488	19,248	22,479	26,547	(4.6)	(0.6)	(0.2)
EBIT margins (%)	15.7	16.3	16.9	16.4	16.3	17.0	-	-	-
Net Profits	14,244	17,242	20,517	14,840	17,349	20,565	(4.0)	(0.6)	(0.2)
EPS (Rs)	76.5	92.6	110.2	79.7	93.2	110.5	(4.0)	(0.6)	(0.2)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	1,313	1,570	1,802	2,056
YoY growth (%)	5.7	19.6	14.7	14.1
EBIT (%)	16.1	15.7	16.3	16.9

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS IN	BUY	4,630	13.8	103.4	119.7	39.4	37.4	36.5
INFO IN	BUY	2,000	14.4	53.9	59.5	29.6	30.7	32.0
WPRO IN	BUY	840	18.4	23.4	26.9	21.2	21.6	28.8
HCLT IN	BUY	1,440	10.7	49.1	55.2	20.3	20.5	24.6
TECHM IN	BUY	1,660	14.1	66.8	78.1	21.9	22.7	27.8
LTI IN	BUY	7,980	21.1	134.5	161.8	29.5	29.9	46.0
MPL IN	HOLD	3,510	17.1	76.5	92.6	21.0	23.6	35.0
MTCL IN	SELL	3,390	21.0	94.1	100.2	33.0	29.8	36.0
PSYS IN	HOLD	3,560	21.0	74.0	91.5	19.9	21.5	35.0
COFORGE IN	BUY	6,930	26.8	130.9	176.8	29.5	33.4	35.0

Source: BOBCAPS Research

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 BFS demand.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,154	1,240	BUY
Coforge	COFORGE IN	4.5	5,448	6,930	BUY
eClerx Services	ECLX IN	1.0	2,050	2,880	BUY
HCL Technologies	HCLT IN	43.9	1,211	1,440	BUY
IndiaMart InterMesh	INMART IN	3.5	8,574	8,430	HOLD
Infosys	INFO IN	99.7	1,754	2,000	BUY
Just Dial	JUST IN	0.7	867	1,190	BUY
L&T Infotech	LTI IN	15.6	6,653	7,980	BUY
Mindtree	MTCL IN	9.8	4,475	3,390	SELL
Mphasis	MPHL IN	8.4	3,396	3,510	HOLD
Persistent Systems	PSYS IN	4.3	4,037	3,560	HOLD
Tata Consultancy Services	TCS IN	177.1	3,533	4,630	BUY
Tech Mahindra	TECHM IN	17.8	1,524	1,660	BUY
Wipro	WPRO IN	51.4	696	840	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Oct 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21E	FY22E	FY23E	FY24E
Total revenue	88,436	97,223	116,882	136,956	156,280
EBITDA	16,505	18,028	21,375	26,019	30,180
Depreciation	2,317	2,418	3,003	3,676	3,692
EBIT	14,188	15,610	18,372	22,342	26,488
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	967	696	715	647	868
Exceptional items	0	0	0	0	0
EBT	15,155	16,306	19,087	22,989	27,356
Income taxes	3,306	4,139	4,844	5,747	6,839
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	11,849	12,167	14,244	17,242	20,517
Adjustments	0	0	0	0	0
Adjusted net profit	11,849	12,167	14,244	17,242	20,517

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21E	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	12,769	11,927	17,612	20,637	23,549
Provisions	2,242	3,494	4,803	5,628	6,422
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	68,210	74,034	80,964
Shareholders' fund	58,296	65,268	70,080	75,904	82,834
Total liab. and equities	86,399	92,843	104,649	114,323	124,960
Cash and cash eq.	11,484	11,310	15,921	20,343	25,709
Accounts receivables	7,217	8,147	9,607	11,257	12,845
Inventories	0	0	0	0	0
Other current assets	21,596	23,437	30,421	35,646	40,676
Investments	13,257	18,460	18,460	18,460	18,460
Net fixed assets	8,730	8,870	7,621	5,999	4,651
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	104,648	114,322	124,959

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21E	FY22E	FY23E	FY24E
Cash flow from operations	13,710	11,528	15,082	17,247	20,429
Capital expenditures	(1,243)	(1,477)	(1,753)	(2,054)	(2,344)
Change in investments	1,552	3,702	0	0	0
Other investing cash flows	2,182	696	715	647	868
Cash flow from investing	2,491	2,921	(1,038)	(1,408)	(1,477)
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)	(9,432)	(11,418)	(13,586)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(8,247)	(14,623)	(9,432)	(11,418)	(13,586)
Chg in cash & cash eq.	7,954	(174)	4,611	4,421	5,367
Closing cash & cash eq.	11,484	11,310	15,921	20,343	25,709

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21E	FY22E	FY23E	FY24E
Reported EPS	63.7	65.4	76.5	92.6	110.2
Adjusted EPS	63.7	65.4	76.5	92.6	110.2
Dividend per share	35.0	65.0	41.9	50.8	60.4
Book value per share	313.2	350.6	376.5	407.8	445.0

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21E	FY22E	FY23E	FY24E
EV/Sales	7.1	6.5	5.4	4.6	4.0
EV/EBITDA	38.3	35.1	29.6	24.2	20.7
Adjusted P/E	53.4	52.0	44.4	36.7	30.8
P/BV	10.8	9.7	9.0	8.3	7.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21E	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	78.2	74.6	74.6	75.0	75.0
Interest burden (PBT/EBIT)	106.8	104.5	103.9	102.9	103.3
EBIT margin (EBIT/Revenue)	16.0	16.1	15.7	16.3	16.9
Asset turnover (Rev./Avg TA)	111.1	108.5	118.4	125.1	130.6
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	21.4	19.7	21.0	23.6	25.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21E	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	14.4	9.9	20.2	17.2	14.1
EBITDA	24.7	9.2	18.6	21.7	16.0
Adjusted EPS	10.4	2.7	17.1	21.0	19.0
Profitability & Return ratios (%)					
EBITDA margin	18.7	18.5	18.3	19.0	19.3
EBIT margin	16.0	16.1	15.7	16.3	16.9
Adjusted profit margin	13.4	12.5	12.2	12.6	13.1
Adjusted ROAE	21.4	19.7	21.0	23.6	25.9
ROCE	19.9	18.5	20.7	25.0	29.0
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	14.2	20.1	29.3
Current ratio	2.7	2.8	2.5	2.6	2.6
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

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

BUY – Expected return >+15%

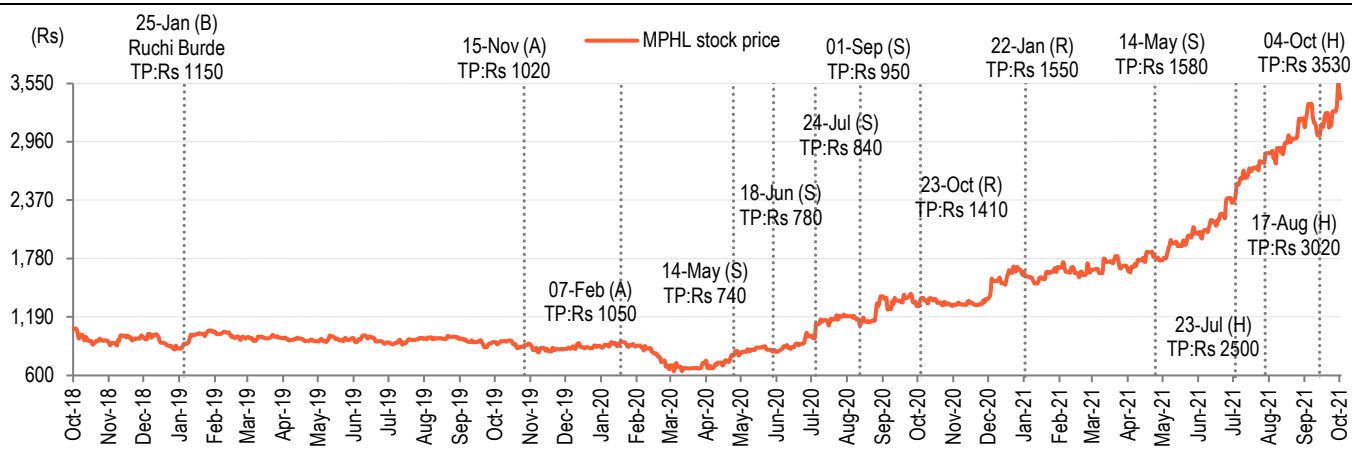
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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



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

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