

REDUCE

TP: Rs 1,550 | ▼ 3%

MPHASIS

| IT Services

| 22 January 2021

DXC revenue contracts further; BFS growth slows

Mphasis (MPHL) reported dollar revenue growth of 2% QoQ in Q3FY21, in line with estimates but lagging behind peers. As expected, growth was dragged down by tapering DXC business, which fell 18.2% QoQ CC. EBIT margin at 16.4% improved 30bps QoQ (15.9% est.). TCV at US\$ 247mn was strong. We increase FY23 EPS by 4% and roll forward to a revised Dec'21 TP of Rs 1,550 (vs. Rs 1,410). Given the laggardly performance vis-à-vis peers, we maintain **REDUCE** on a largely unchanged P/E multiple of 16.9x.

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DXC contraction continues: MPHL reported QoQ revenue growth (ex-hedging gains) of 2% USD/1.6% CC, in line with our estimates. Banking and capital markets' growth slowed to 1% vs. 15% in Q2. DXC revenue continued to slide, falling 18.2% QoQ CC and worsening from the 15.5% decline in Q2. Growth now relies entirely on the direct-international segment (85% of revenue) as the minimum revenue commitment-MRC with DXC ends in Sep'21. EBIT margin was at 16.4% (est. 15.9%), up 30bps QoQ but below the Q3 peer average. Management expects the upward bias in EBIT margin to continue as higher demand for offshore services aids structural gains.

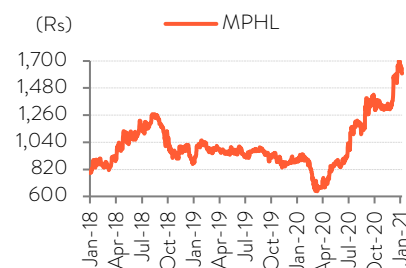
Deal pipeline strong: TCV stood at US\$ 247mn, down from US\$ 360mn in Q2. MPHL bagged large deals in insurance (~US\$ 50mn) and logistics-transportation. The pipeline remains strong, growing 49% YoY, and is now tilted towards large deals.

Hi-tech to drive growth: The information technology, communication & entertainment vertical was up 10.7% QoQ in Q3. Its countercyclical nature and robust pipeline make it a growth driver. Among geographies, Europe remains strong, up 12% QoQ in rupee terms and emerging as a key market for FY21.

Ticker/Price	MPHL IN/Rs 1,599
Market cap	US\$ 4.1bn
Shares o/s	186mn
3M ADV	US\$ 8.5mn
52wk high/low	Rs 1,735/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	97,849	114,911	133,933
EBITDA (Rs mn)	13,240	16,505	18,221	22,584	26,361
Adj. net profit (Rs mn)	10,734	11,849	12,273	15,108	17,806
Adj. EPS (Rs)	57.7	63.7	65.9	81.2	95.7
Adj. EPS growth (%)	30.9	10.4	3.6	23.1	17.9
Adj. ROAE (%)	20.0	21.4	20.1	22.4	23.8
Adj. P/E (x)	27.7	25.1	24.3	19.7	16.7
EV/EBITDA (x)	22.3	18.0	16.3	13.2	11.1

Source: Company, BOBCAPS Research

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Other highlights

- DXC revenue stood at ~US\$ 43.4mn in Q3FY21, below the ~US\$ 50mn quarterly MRC run-rate. Management expects this shortfall to be plugged in the remaining three quarters until the revenue commitment ends in Sep'21 and may invoke fallback provisions in the agreement if need be.
- TCV stood strong at US\$ 867mn in FY21 YTD, growing 64% YoY.
- Of the US\$ 247mn TCV won in Q3, new-gen services formed 71%. Revenue from this segment grew 11.4% YoY on a reported basis during the quarter.
- Top client concentration came down to 11% of revenue, declining 7% QoQ in rupee terms.
- Segmental gross margins increased across verticals barring BFS where they remained flat.

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Revenue (US\$ mn)	336	319	5.3	329	2.1	968	922	5.0
Revenue excluding hedging gains/losses (US\$ mn)	334	318	5.1	327	2.0	967	920	5.1
Revenue	24,744	22,767	8.7	24,354	1.6	71,980	64,974	10.8
Revenue excluding hedging gains/losses	24,602	22,694	8.4	24,238	1.5	71,877	64,763	11.0
Operating Expenditure	20,089	18,498	8.6	19,830	1.3	58,623	52,910	10.8
Cost of revenues	17,073	16,228	5.2	16,974	0.6	50,308	46,360	8.5
as % of sales	69.0	71	-	69.7	-	69.9	71.4	-
SG&A expenses	3,016	2,270	32.9	2,856	5.6	8,315	6,550	26.9
as % of sales	12.2	10	-	11.7	-	11.6	10.1	-
EBITDA	4,655	4,269	9.0	4,524	2.9	13,357	12,064	10.7
Depreciation	606	575	5.4	600	1.0	1,801	1,707	5.5
EBIT	4,049	3,694	9.6	3,924	3.2	11,556	10,357	11.6
Other Income	218	172	26.7	114	91.2	514	648	(20.7)
PBT	4,267	3,866	10.4	4,038	5.7	12,070	11,005	9.7
Total Tax	1,011	929	8.8	1,046	(3.3)	3,072	2,688	14.3
Adjusted PAT	3,256	2,937	10.9	2,992	8.8	8,998	8,317	8.2
APAT after MI	3,256	2,937	10.9	2,992	8.8	8,998	8,317	8.2
Extra ordinary items	-	0	-	-	-	0	0	-
Reported PAT	3,256	2,937	10.9	2,992	8.8	8,998	8,317	8.2
Reported EPS	17.4	16	10.3	16.0	8.8	48	45	7.9
Margins (%)			(bps)		(bps)			(bps)
EBITDA	18.8	18.8	10	18.6	20	18.6	18.6	-
EBIT	16.4	16.2	10	16.1	30	16.1	15.9	10
EBT	17.2	17.0	30	16.6	70	16.8	16.9	(20)
PAT	13.2	12.9	30	12.3	90	12.5	12.8	(30)
Effective Tax rate	23.7	24.0	(30)	25.9	(220)	25.5	24.4	100

Source: BOBCAPS Research

FIG 2 – OPERATING METRICS

	Q3FY21 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Revenue by Business Segment (US\$ terms)			
Direct International	85.0	3.7	18.0
DXC	13.0	(17.1)	(41.6)
Revenue by Vertical (Rs terms)			
Banking and Capital Markets	53.9	1.3	27.0
Insurance	9.8	3.4	(6.5)
Information Technology, Communication & Entertainment	13.0	10.7	(11.3)
Logistics and Transportation	12.8	4.4	(1.6)
Others	11.6	(10.1)	(8.6)
Revenue by Project Type		(bps)	(bps)
T & M	75.0	0	200
Fixed price	25.0	0	(200)

Source: BOBCAPS Research

Valuation methodology

We revise FY21/FY22/FY23 EPS estimates for MPHL by +1%/-0.3/+4% to accommodate the Q3 operating margin beat and elevated direct channel growth. On rolling valuations forward, we have a revised Dec'21 target price of Rs 1,550 (Rs 1,410 earlier), based on a largely unchanged one-year forward P/E multiple of 16.9x, which is the last five-year average +1SD (vs. 16.4x earlier).

Over the last three quarters, the company has seen (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.

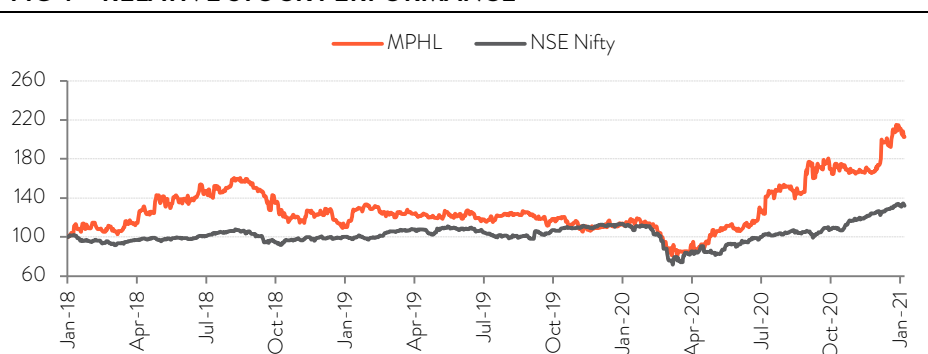
DXC had committed to minimum revenue of US\$ 990mn over five years when it sold its stake in MPHL to Blackstone in CY16. Subsequently, the HP/DXC business was a growth lynchpin for MPHL in FY18 and FY19, posting >20% YoY dollar revenue growth each year. This revenue commitment ends in Sep'21, diminishing the margin of safety for the HP/DXC business. 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. Maintain REDUCE.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Reported Revenues (US\$ mn)	1,310	1,313	0.2	1,479	1,502	1.6	1,655	1,717	3.7
YoY (%)	5.5	5.7	-	12.9	14.4	-	11.9	14.3	-
Revenues (ex-hedging, US\$ mn)	1,310	1,313	0.2	1,479	1,502	1.6	1,655	1,717	3.7
Revenues	98,575	97,849	(0.7)	115,343	114,911	(0.4)	129,106	133,933	3.7
EBIT	15,820	15,813	0.0	19,719	19,640	(0.4)	21,918	22,865	4.3
EBIT margins (%)	16.0	16.2	-	17.1	17.1	-	17.0	17.1	-
Net Profits	12,141	12,273	1.1	15,160	15,108	(0.3)	17,092	17,806	4.2
EPS (Rs)	65.2	65.9	1.1	81.4	81.2	(0.3)	91.8	95.7	4.2

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 the logistics and transportation vertical, and
- sharper rupee depreciation, aiding margins.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	77,311	88,436	97,849	114,911	133,933
EBITDA	13,240	16,505	18,221	22,584	26,361
Depreciation	759	2,317	2,407	2,944	3,496
EBIT	12,481	14,188	15,813	19,640	22,865
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	1,592	967	623	504	877
Exceptional items	0	0	0	0	0
EBT	14,073	15,155	16,436	20,144	23,741
Income taxes	3,339	3,306	4,164	5,036	5,935
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	10,734	11,849	12,273	15,108	17,806
Adjustments	0	0	0	0	0
Adjusted net profit	10,734	11,849	12,273	15,108	17,806

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	14,744	17,315	20,182
Provisions	3,100	2,242	4,021	4,722	5,504
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	62,054	68,977	77,136
Shareholders' fund	52,498	58,296	63,920	70,842	79,001
Total liabilities and equities	72,741	86,399	95,777	105,972	117,779
Cash and cash eq.	6,572	11,484	14,424	22,677	29,456
Accounts receivables	8,620	7,217	9,383	9,445	11,008
Inventories	0	0	0	0	0
Other current assets	21,339	21,596	26,808	29,908	34,859
Investments	13,292	13,257	13,257	13,257	13,257
Net fixed assets	2,113	8,730	7,790	6,570	5,083
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
Total assets	72,741	86,399	95,777	105,972	117,779

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	11,405	14,166	14,680	18,052	21,302
Interest expenses	(98)	(967)	(623)	(504)	(877)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,421)	1,370	(3,623)	110	(2,866)
Other operating cash flows	(389)	(2,832)	0	0	0
Cash flow from operations	9,497	11,737	10,434	17,658	17,559
Capital expenditures	(815)	(1,372)	(1,468)	(1,724)	(2,009)
Change in investments	5,725	0	0	0	0
Other investing cash flows	(2,111)	967	623	504	877
Cash flow from investing	2,798	(405)	(844)	(1,220)	(1,132)
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)	(6,649)	(8,185)	(9,647)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(13,418)	(6,420)	(6,649)	(8,185)	(9,647)
Changes in cash and cash eq.	(1,122)	4,912	2,940	8,253	6,779
Closing cash and cash eq.	6,572	11,484	14,424	22,677	29,456

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	57.7	63.7	65.9	81.2	95.7
Adjusted EPS	57.7	63.7	65.9	81.2	95.7
Dividend per share	0.0	28.6	29.7	36.5	43.0
Book value per share	282.0	313.2	343.4	380.6	424.4

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.8	3.4	3.0	2.6	2.2
EV/EBITDA	22.3	18.0	16.3	13.2	11.1
Adjusted P/E	27.7	25.1	24.3	19.7	16.7
P/BV	5.7	5.1	4.7	4.2	3.8

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.3	78.2	74.7	75.0	75.0
Interest burden (PBT/EBIT)	112.8	106.8	103.9	102.6	103.8
EBIT margin (EBIT/Revenue)	16.1	16.0	16.2	17.1	17.1
Asset turnover (Revenue/Avg TA)	108.4	111.1	107.4	113.9	119.7
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.5	1.5	1.5
Adjusted ROAE	20.0	21.4	20.1	22.4	23.8

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	18.1	14.4	10.6	17.4	16.6
EBITDA	24.6	24.7	10.4	23.9	16.7
Adjusted EPS	30.9	10.4	3.6	23.1	17.9
Profitability & Return ratios (%)					
EBITDA margin	17.1	18.7	18.6	19.7	19.7
EBIT margin	16.1	16.0	16.2	17.1	17.1
Adjusted profit margin	13.9	13.4	12.5	13.1	13.3
Adjusted ROAE	20.0	21.4	20.1	22.4	23.8
ROCE	18.0	19.9	19.3	23.8	27.7
Working capital days (days)					
Receivables	40	33	31	30	28
Inventory	0	0	0	0	0
Payables	75	70	70	73	74
Ratios (x)					
Gross asset turnover	39.3	16.3	11.8	16.0	23.0
Current ratio	2.5	2.7	2.7	2.8	2.9
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%

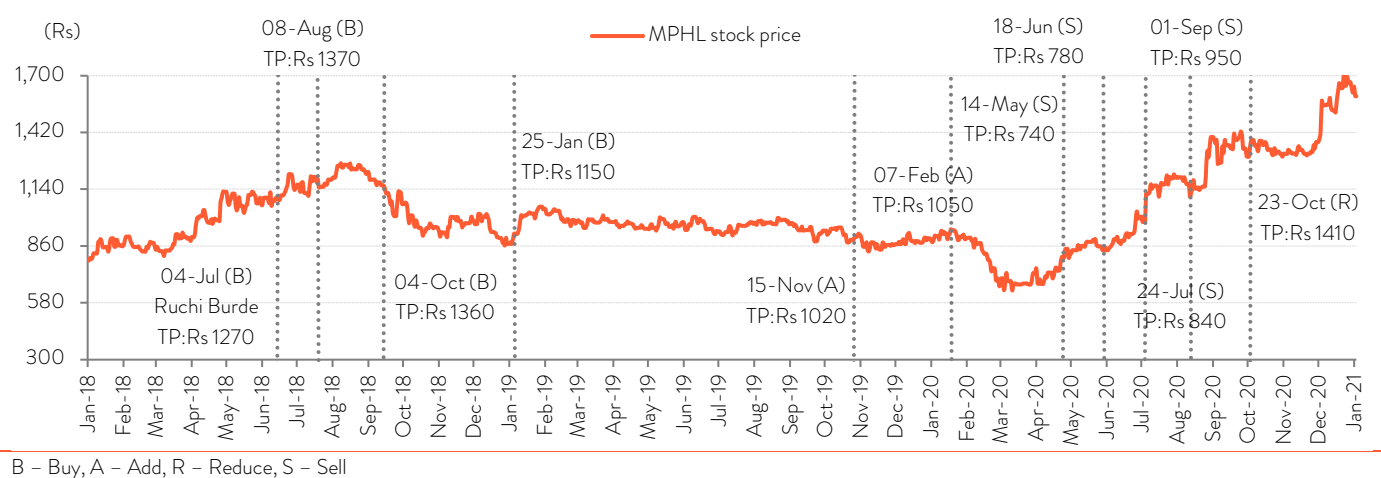
ADD – Expected return from >+5% to +15%

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)



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