

**HOLD**

TP: Rs 3,470 | ▲ 15%

**MPHASIS**

| Technology & Internet

| 21 January 2022

## Strong growth, lukewarm margins

- Q3 revenue growth robust at 7.6% QoQ USD, ahead of our estimate, driven by direct business, BCM and communications
- EBIT margin at 15.1% slightly below expectations owing to ramp-up in hiring, higher depreciation and elevated SG&A cost
- We cut FY23/FY24 EPS by 5%/2% and revise our Dec'22 TP to Rs 3,470 (vs. Rs 3,650). Maintain HOLD on moderate margin outlook

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**Strong growth:** MPHL's Q3FY22 revenue growth of 7.6% QoQ USD was a positive surprise, outperforming our estimate of 5.4%. Growth was driven entirely by direct business which was up 8.7% and also included US\$ 9mn from Blink Interactive acquired in Q2FY22. DXC business declined 10.4% QoQ USD, forming a mere 5% of quarterly revenues. Within verticals, banking and capital markets (BCM) continued its uptrend of the last two quarters, growing 10.2% QoQ USD. Insurance was up 8.9% after two sluggish quarters. The IT, communication and entertainment vertical took pole position with the highest growth rate of 14.5%.

**EBIT margin underperforms:** Operating margin stood at 15.1%, flat QoQ and slightly below our estimate of 15.5%. Employee cost and SG&A increased 8% and 14% QoQ respectively. Depreciation jumped 26% QoQ owing to acquisition-related costs. Onsite revenues grew 9.6% QoQ (mostly from increased hiring in Europe), which negatively impacted the margin. MPHL added the highest number of fresh graduates quarterly in Q3FY22 and aims to add over 5,500 freshers in FY22.

**TCV robust:** The company reported strong TCV of US\$ 335mn in Q3, up 39% QoQ USD. This was MPHL's eighth quarter of wins crossing US\$ 200mn. The correlation between TCV and revenue remains high. MPHL bagged four large deals along with numerous smaller ones. Two of the large contracts were from the healthcare and BFSI verticals, while two others were short-cycle wins. The pipeline remains strong, growing 10% YoY. Nevertheless, management maintained that large deals are lumpy by nature and would vary from quarter to quarter.

**Balanced outlook:** Similar to peers, management reiterated that the demand environment remains strong. Growth is expected to be driven completely by the direct business while the DXC portion gradually wanes. EBIT margin for FY22 is guided at 15.5-17%. Based on the positive growth outlook, we raise our revenue estimates for FY23/FY24 by 1% each. However, we lower our margin assumptions given the lukewarm display in Q3 despite soaring growth. Overall, we lower FY22/ FY23/FY24 EPS by 1%/5%/2% and maintain our target one-year forward P/E at 34x. Retain HOLD with a revised TP of Rs 3,470 (vs. Rs 3,650).

## Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	MPHL IN/Rs 3,025
Market cap	US\$ 7.6bn
Free float	40%
3M ADV	US\$ 34.2mn
52wk high/low	Rs 3,660/Rs 1,511
Promoter/FPI/DII	52%/29%/14%

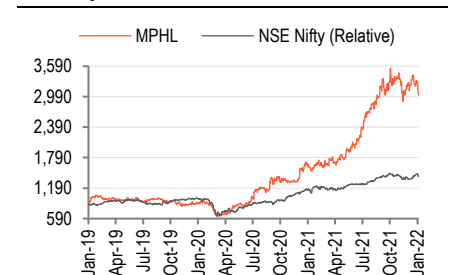
Source: NSE | Price as of 21 Jan 2022

## Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	97,223	119,012	141,495
EBITDA (Rs mn)	18,028	21,289	25,734
Adj. net profit (Rs mn)	12,167	14,148	16,830
Adj. EPS (Rs)	65.1	75.7	90.1
Consensus EPS (Rs)	65.1	77.6	88.9
Adj. ROAE (%)	19.7	20.9	23.1
Adj. P/E (x)	46.4	39.9	33.6
EV/EBITDA (x)	31.4	26.6	21.9
Adj. EPS growth (%)	2.7	16.3	19.0

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



## Other highlights

- Talent redeployment from DXC business is complete.
- Direct business has been strong for the last three quarters.
- DSO was at 59 days in Q3FY22, MPHL's lowest ever, down 3 days QoQ.
- The revenue share of fixed price projects grew 300bps QoQ to 29% in Q3.

**Fig 1 – Quarterly performance**

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenue (US\$ mn)	418	336	24.4	388	7.6	1,171	968	21.0
<b>Revenue excluding hedging gains/losses (US\$ mn)</b>	<b>414</b>	<b>334</b>	<b>24.0</b>	<b>385</b>	<b>7.5</b>	<b>1,162</b>	<b>967</b>	<b>20.2</b>
Revenue	31,237	24,744	26.2	28,692	8.9	86,837	71,980	20.6
Revenue excluding hedging gains/losses	30,955	24,602	25.8	28,460	8.8	86,163	71,877	19.9
Operating Expenditure	25,705	20,089	28.0	23,715	8.4	71,434	58,623	21.9
Cost of revenues	21,961	17,073	28.6	20,428	7.5	61,650	50,308	22.5
as % of sales	70.3	69	-	71.2	-	71.0	69.9	-
SG&A expenses	3,744	3,016	24.1	3,287	13.9	9,784	8,315	17.7
as % of sales	12.0	12	-	11.5	-	11.3	11.6	-
<b>EBITDA</b>	<b>5,532</b>	<b>4,655</b>	<b>18.8</b>	<b>4,977</b>	<b>11.2</b>	<b>15,403</b>	<b>13,357</b>	<b>15.3</b>
Depreciation	826	606	36.3	657	25.7	2,107	1,801	17.0
<b>EBIT</b>	<b>4,706</b>	<b>4,049</b>	<b>16.2</b>	<b>4,320</b>	<b>8.9</b>	<b>13,296</b>	<b>11,556</b>	<b>15.1</b>
Other Income	90	218	(58.7)	277	(67.5)	677	514	31.7
PBT	4,796	4,267	12.4	4,597	4.3	13,973	12,070	15.8
Total Tax	1,219	1,011	20.6	1,182	3.1	3,585	3,072	16.7
<b>Adjusted PAT</b>	<b>3,577</b>	<b>3,256</b>	<b>9.9</b>	<b>3,415</b>	<b>4.7</b>	<b>10,388</b>	<b>8,998</b>	<b>15.4</b>
APAT after MI	3,577	3,256	9.9	3,415	4.7	10,388	8,998	15.4
Extra ordinary items	-	0	-	-	-	0	0	-
Reported PAT	3,577	3,256	9.9	3,415	4.7	10,388	8,998	15.4
Reported EPS	19.1	17	9.9	18.3	4.7	56	48	15.3
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBIDTA	17.7	18.8	(110)	17.3	40	17.7	18.6	(80)
EBIT	15.1	16.4	(130)	15.1	-	15.3	16.1	(70)
EBT	15.4	17.2	(190)	16.0	(70)	16.1	16.8	(70)
PAT	11.5	13.2	(170)	11.9	(50)	12.0	12.5	(50)
Effective Tax rate	25.4	23.7	170	25.7	(30)	25.7	25.5	20

Source: Company, BOBCAPS Research

**Fig 2 – Operating metrics**

Particulars	Q3FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Business Segment (in USD terms)</b>			
Direct International	93.0	8.7	35.7
DXC	5.0	(10.4)	(52.3)
<b>Revenue by Vertical (in INR terms)</b>			
Banking and Capital Markets	54.8	10.2	30.5
Insurance	8.7	8.9	14.2
Information Technology, Communication & Entertainment	13.1	14.5	28.9
Logistics and Transportation	12.6	5.3	26.1
Others	10.0	(0.7)	10.3
TCV (US\$ mn)	335.00	39	24.3
<b>IT Services – Client Concentration (in INR terms)</b>			
Top client contribution to revenues	11.0	8.9	26.2
Top 5 client contribution to revenues	43.0	11.5	35.7
Top 10 client contribution to revenues	58.0	10.8	40.8
<b>Revenue by Project Type</b>			
		<b>(bps)</b>	<b>(bps)</b>
T & M	71.0	(300)	(400)
Fixed price	29.0	300	400

Source: BOBCAPS Research, Company

## Valuation methodology

MPL's stellar Q3FY22 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 (5% of revenue vs. 6% in Q2FY22), but limited scope for margin upside in upcoming quarters.

Our dollar revenue growth forecast of 17.4% CAGR for MPL over FY21-FY24 factors in 23.3% direct revenue growth and a 39.8% drop in DXC business. Post Q3, we cut FY23/FY24 EPS estimates by 5%/2% and update our TP to Rs 3,470 (vs. Rs 3,650 earlier). Our target one-year forward P/E remains at 34x. The stock is currently trading at 39.7x 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)	1,600	1,862	2,126	1,587	1,844	2,104	0.8	1.0	1.0
YoY growth (%)	21.9	16.4	14.2	20.9	16.1	14.1	-	-	-
Revenues ex-hedging (US\$ mn)	1,572	1,859	2,125	1,563	1,839	2,102	0.6	1.1	1.1
Revenues	119,012	141,495	161,552	118,144	140,107	159,921	0.7	1.0	1.0
EBIT	18,245	22,041	26,982	18,400	22,946	27,165	(0.8)	(3.9)	(0.7)
EBIT margins (%)	15.3	15.6	16.7	15.6	16.4	17.0	-	-	-
Net Profits	14,148	16,830	20,596	14,265	17,687	21,011	(0.8)	(4.8)	(2.0)
EPS (Rs)	75.7	90.1	110.2	76.6	95.0	112.9	(1.2)	(5.2)	(2.3)

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	1,313	1,600	1,862	2,126
YoY growth (%)	5.7	21.9	16.4	14.2
EBIT (%)	16.1	15.3	15.6	16.7

Source: Company, BOBCAPS Research

**Fig 5 – Peer comparison**

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		RoE (%)		P/E (x)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	BUY	4,770	14.1	104.0	120.3	39.6	37.5	36.8	31.9
INFO IN	BUY	2,250	17.1	54.4	62.3	29.8	32.0	32.8	28.7
WPRO IN	BUY	850	18.2	22.6	26.9	20.5	21.6	26.8	22.5
HCLT IN	BUY	1,610	12.6	49.0	56.2	20.3	20.9	23.8	20.8
TECHM IN	BUY	1,970	16.1	65.5	81.1	21.5	23.6	24.3	19.7
LTI IN	BUY	8,490	23.2	131.1	166.8	28.9	30.9	48.8	38.4
MPL IN	HOLD	3,470	19.1	75.7	90.1	20.9	23.1	39.9	33.6
MTCL IN	BUY	5,610	23.9	97.9	105.3	34.2	31.0	42.1	39.1
PSYS IN	HOLD	4,580	27.9	82.3	98.3	22.0	22.7	52.3	43.7
COFORGE IN	BUY	7,040	27.5	123.4	173.2	27.9	33.1	42.1	30.0
ECLX IN	BUY	3,690	22.9	125.8	143.6	27.0	28.4	20.5	17.9

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
Coforge	COFORGE IN	4.4	5,200	7,040	BUY
eClerx Services	ECLX IN	1.3	2,563	3,690	BUY
HCL Technologies	HCLT IN	42.6	1,168	1,610	BUY
Infosys	INFO IN	102.2	1,786	2,250	BUY
L&T Infotech	LTI IN	15.1	6,394	8,490	BUY
Mindtree	MTCL IN	9.1	4,119	5,610	BUY
Mphasis	MPL IN	7.6	3,025	3,470	HOLD
Persistent Systems	PSYS IN	4.6	4,302	4,240	HOLD
Tata Consultancy Services	TCS IN	193.5	3,834	4,770	BUY
Tech Mahindra	TECHM IN	18.7	1,594	1,970	BUY
Wipro	WPRO IN	45.0	605	850	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Jan 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>88,436</b>	<b>97,223</b>	<b>119,012</b>	<b>141,495</b>	<b>161,552</b>
EBITDA	16,505	18,028	21,289	25,734	30,714
Depreciation	2,317	2,418	3,043	3,693	3,731
EBIT	14,188	15,610	18,245	22,041	26,983
Net interest inc./(exp.)	0	0	0	0	0
Other inc./(exp.)	967	696	741	549	663
Exceptional items	0	0	0	0	0
EBT	15,155	16,306	18,986	22,590	27,645
Income taxes	3,306	4,139	4,838	5,761	7,050
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>11,849</b>	<b>12,167</b>	<b>14,148</b>	<b>16,830</b>	<b>20,596</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>11,849</b>	<b>12,167</b>	<b>14,148</b>	<b>16,830</b>	<b>20,596</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	12,769	11,927	17,933	21,321	24,343
Provisions	2,242	3,494	4,891	5,815	6,639
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	68,177	73,862	80,820
Shareholders' fund	58,296	65,268	70,047	75,732	82,690
<b>Total liab. and equities</b>	<b>86,399</b>	<b>92,843</b>	<b>105,025</b>	<b>115,022</b>	<b>125,826</b>
Cash and cash eq.	11,484	11,310	15,577	19,445	24,688
Accounts receivables	7,217	8,147	9,782	11,630	13,278
Inventories	0	0	0	0	0
Other current assets	21,596	23,437	30,976	36,828	42,048
Investments	13,257	18,460	18,460	18,460	18,460
Net fixed assets	8,730	8,870	7,612	6,041	4,734
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
<b>Total assets</b>	<b>86,399</b>	<b>92,842</b>	<b>105,024</b>	<b>115,021</b>	<b>125,825</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>13,710</b>	<b>11,528</b>	<b>14,680</b>	<b>16,585</b>	<b>20,642</b>
Capital expenditures	(1,243)	(1,477)	(1,785)	(2,122)	(2,423)
Change in investments	1,552	3,702	0	0	0
Other investing cash flows	2,182	696	741	549	663
<b>Cash flow from investing</b>	<b>2,491</b>	<b>2,921</b>	<b>(1,044)</b>	<b>(1,573)</b>	<b>(1,761)</b>
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)	(9,369)	(11,145)	(13,639)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(8,247)</b>	<b>(14,623)</b>	<b>(9,369)</b>	<b>(11,145)</b>	<b>(13,639)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>7,954</b>	<b>(174)</b>	<b>4,267</b>	<b>3,868</b>	<b>5,243</b>
<b>Closing cash &amp; cash eq.</b>	<b>11,484</b>	<b>11,310</b>	<b>15,577</b>	<b>19,445</b>	<b>24,688</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	63.4	65.1	75.7	90.1	110.2
Adjusted EPS	63.4	65.1	75.7	90.1	110.2
Dividend per share	35.0	65.0	41.6	49.5	60.6
Book value per share	312.0	349.3	374.9	405.3	442.5

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	6.4	5.8	4.8	4.0	3.5
EV/EBITDA	34.2	31.4	26.6	21.9	18.2
Adjusted P/E	47.7	46.4	39.9	33.6	27.4
P/BV	9.7	8.7	8.1	7.5	6.8

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	78.2	74.6	74.5	74.5	74.5
Interest burden (PBT/EBIT)	106.8	104.5	104.1	102.5	102.5
EBIT margin (EBIT/Revenue)	16.0	16.1	15.3	15.6	16.7
Asset turnover (Rev./Avg TA)	111.1	108.5	120.3	128.6	134.2
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
<b>Adjusted ROAE</b>	<b>21.4</b>	<b>19.7</b>	<b>20.9</b>	<b>23.1</b>	<b>26.0</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	14.4	9.9	22.4	18.9	14.2
EBITDA	24.7	9.2	18.1	20.9	19.4
Adjusted EPS	10.0	2.7	16.3	19.0	22.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	18.7	18.5	17.9	18.2	19.0
EBIT margin	16.0	16.1	15.3	15.6	16.7
Adjusted profit margin	13.4	12.5	11.9	11.9	12.7
Adjusted ROAE	21.4	19.7	20.9	23.1	26.0
ROCE	19.9	18.5	20.5	24.3	29.0
<b>Working capital days (days)</b>					
Receivables	33	29	27	28	28
Inventory	0	0	0	0	0
Payables	70	63	69	73	72
<b>Ratios (x)</b>					
Gross asset turnover	16.3	11.0	14.4	20.7	30.0
Current ratio	2.7	2.8	2.5	2.5	2.6
Net interest coverage ratio	NA	NA	NA	NA	NA
<b>Adjusted debt/equity</b>	<b>0.0</b>	<b>0.0</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.2)</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

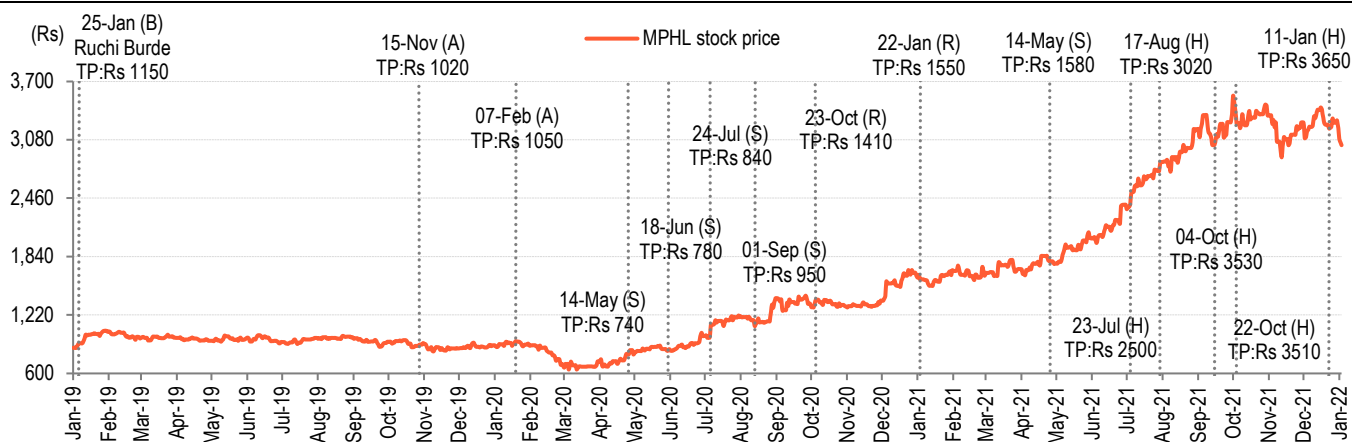
**HOLD** – Expected return from -6% to +15%

**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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