

SELL

TP: Rs 1,580 | ▼ 12%

MPHASIS

| IT Services

| 14 May 2021

DXC drag to continue; cut to SELL

Mphasis (MPHL) reported dollar revenue growth of 1.8% QoQ in Q4FY21, underperforming our estimate. Growth was dragged down by a slow pickup in direct channel business, which grew 3% QoQ USD. EBIT margin at 16.1% (16.5% est.) declined 30bps QoQ. We prune FY22/FY23 EPS by 1%/2% and roll forward to a revised Mar'22 TP of Rs 1,580 (vs. Rs 1,550), based on an unchanged 17x P/E. Considering the laggardly performance vis-à-vis peers and non-renewal of DXC's MRC, we downgrade the stock to SELL (vs. REDUCE).

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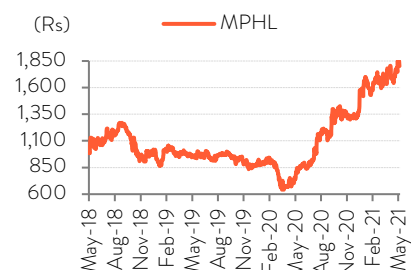
BCM growth declines: MPHL's Q4 revenue grew 1.8% QoQ USD/2% CC, underperforming our estimate of 2.7%. The banking and capital markets (BCM) vertical contracted 4.3% vs. 1% growth in Q3 in INR terms. DXC revenue continued to slide, falling 7.2% QoQ USD. Growth now relies entirely on the direct-international segment (86% of revenue) as the minimum revenue commitment (MRC) with DXC ends in Sep'21. EBIT margin at 16.1% was down 30bps QoQ. 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\$ 245mn vs. US\$ 247mn in Q3. MPHL bagged a large 10-year deal worth ~US\$ 250mn in the BFSI vertical. The pipeline remains strong, growing 55% YoY, and is now tilted towards large contracts which are transformation-led and integrated in nature.

Cut to SELL on DXC headwinds: DXC channel business continues to decline and there is little hope that the MRC will be renewed after Sep'21. MPHL has been able to mitigate its decline in DXC revenue (-43% YoY USD in Q4) with growth in the direct channel (+21% YoY), but the negative impact from DXC remains evident, leading to a subpar quarterly performance. We thus move to SELL from REDUCE.

Ticker/Price	MPHL IN/Rs 1,799
Market cap	US\$ 4.6bn
Shares o/s	186mn
3M ADV	US\$ 12.0mn
52wk high/low	Rs 1,883/Rs 786
Promoter/FPI/DII	52%/29%/14%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	77,311	88,436	97,223	112,897	130,391
EBITDA (Rs mn)	13,240	16,505	18,028	22,187	25,663
Adj. net profit (Rs mn)	10,734	11,849	12,167	14,890	17,417
Adj. EPS (Rs)	57.7	63.7	65.4	80.0	93.6
Adj. EPS growth (%)	30.9	10.4	2.7	22.4	17.0
Adj. ROAE (%)	20.0	21.4	19.7	22.0	23.8
Adj. P/E (x)	31.2	28.3	27.5	22.5	19.2
EV/EBITDA (x)	25.1	20.2	18.6	15.1	13.0

Source: Company, BOBCAPS Research | P – Provisional

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Other highlights

- DXC formed 12% of Q4FY21 revenue and management has guided for a mid-single-digit revenue share in FY22. The direct channel (now 86% of quarterly revenue) is guided to clock industry-leading growth, supporting EBIT margin in the range of 15.5-17%.
- MPL's information technology, communication & entertainment vertical grew 15% QoQ in Q4, backed by its countercyclical nature and robust pipeline. Among geographies, Europe remains strong with 14% QoQ growth in rupee terms and is emerging as a key market for FY22.
- The board has recommended dividend of Rs 65/sh (including a special dividend of Rs 10 for FY21).

FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenue (US\$ mn)	342	320	7.1	336	1.8	1,310	1,242	5.5
Revenue excluding hedging gains/losses (US\$ mn)	340	320	6.2	334	1.7	1,306	1,239	5.4
Revenue	25,243	23,462	7.6	24,744	2.0	97,223	88,436	9.9
Revenue excluding hedging gains/losses	24,847	23,476	5.8	24,602	1.0	96,724	88,239	9.6
Operating Expenditure	20,572	19,021	8.2	20,089	2.4	79,195	71,931	10.1
Cost of revenues	17,415	16,591	5.0	17,073	2.0	67,723	62,951	7.6
as % of sales	69.0	71	-	69.0	-	69.7	71.2	-
SG&A expenses	3,157	2,430	29.9	3,016	4.7	11,472	8,980	27.8
as % of sales	12.5	10	-	12.2	-	11.8	10.2	-
EBITDA	4,671	4,441	5.2	4,655	0.3	18,028	16,505	9.2
Depreciation	617	610	1.1	606	1.8	2,418	2,317	4.4
EBIT	4,054	3,831	5.8	4,049	0.1	15,610	14,188	10.0
Other Income	182	319	(42.9)	218	(16.5)	696	967	(28.0)
PBT	4,236	4,150	2.1	4,267	(0.7)	16,306	15,155	7.6
Total Tax	1,067	618	72.7	1,011	5.5	4,139	3,306	25.2
Adjusted PAT	3,169	3,532	(10.3)	3,256	(2.7)	12,167	11,849	2.7
APAT after MI	3,169	3,532	(10.3)	3,256	(2.7)	12,167	11,849	2.7
Extra ordinary items	-	0	-	-	-	0	0	-
Reported PAT	3,169	3,532	(10.3)	3,256	(2.7)	12,167	11,849	2.7
Reported EPS	17.0	19	(9.8)	17.4	(2.2)	65	64	2.6
Margins (%)			(bps)		(bps)			(bps)
EBITDA	18.5	18.9	(40)	18.8	(30)	18.5	18.7	(10)
EBIT	16.1	16.3	(30)	16.4	(30)	16.1	16.0	-
EBT	16.8	17.7	(90)	17.2	(50)	16.8	17.1	(40)
PAT	12.6	15.1	(250)	13.2	(60)	12.5	13.4	(90)
Effective tax rate	25.2	14.9	1,030	23.7	150	25.4	21.8	360

Source: Company, BOBCAPS Research

FIG 2 – OPERATING METRICS

	Q4FY21 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Revenue by Business Segment (US\$ terms)			
Direct International	86.0	2.9	21.1
DXC	12.0	(7.2)	(43.4)
Revenue by Vertical (Rs terms)			
Banking and Capital Markets	49.7	(4.3)	17.1
Insurance	10.0	5.7	(5.9)
Information Technology, communication & Entertainment	14.4	15.1	3.1
Logistics and Transportation	13.3	8.0	(2.3)
Others	11.8	5.1	(4.6)
Revenue by Project Type		bps	bps
T & M	73.0	(200)	100
Fixed price	27.0	200	(100)

Source: Company, BOBCAPS Research

Valuation methodology

We prune FY22/FY23 EPS estimates by 1%/2% to accommodate MPHL's Q4FY21 performance. On rolling valuations forward, we have a revised Mar'22 target price of Rs 1,580 (Rs 1,550 earlier), based on an unchanged one-year forward P/E multiple of 17x, which is one standard deviation over the last five-year average.

During 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 see risks to growth from DXC's waning revenue commitment and MPHL's high client concentration.

In CY16, when DXC sold its stake in MPHL to Blackstone, it had committed to minimum revenues of US\$ 990mn over five years. Subsequently, the HP/DXC business was a growth lynchpin for MPHL in FY18 and FY19, posting over 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. Our estimates build in a best-case EBIT margin of 17% in FY22 and 21% YoY growth for the direct channel vs. 17% growth in FY21. Even so, we expect DXC to remain a drag on overall growth (total growth estimated at 12.6% YoY USD in FY22) and hence downgrade the stock from REDUCE to SELL.

FIG 3 – REVISED ESTIMATES

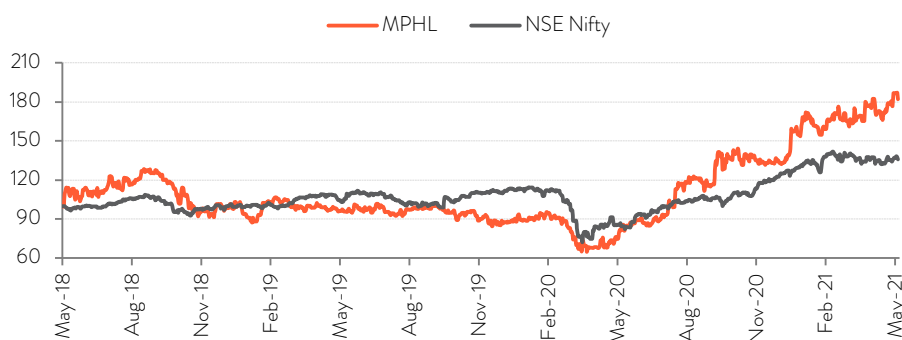
(Rs mn)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
Reported Revenues (US\$ mn)	1,502	1,476	(1.7)	1,717	1,672	(2.6)
YoY growth (%)	14.4	12.6	-	14.3	13.3	-
Revenues (ex-hedging, US\$ mn)	1,502	1,476	(1.7)	1,717	1,672	(2.6)
Revenues	114,911	112,897	(1.8)	133,933	130,391	(2.6)
EBIT	19,640	19,245	(2.0)	22,865	22,182	(3.0)
EBIT margin (%)	17.1	17.0	-	17.1	17.0	-
Net profits	15,108	14,890	(1.4)	17,806	17,417	(2.2)
EPS (Rs)	81.2	80.0	(1.4)	95.7	93.6	(2.2)

Source: BOBCAPS Research

FIG 4 – PEER COMPARISON

Company	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS	BUY	3,780	17.2	118	135	44.2	40.7	28
INFO	ADD	1,540	13.1	56	59	30.4	30.3	26
HCLT	BUY	1,190	11.9	55	63	22.6	23.1	19
TECHM	BUY	1,190	15.0	64	76	21.1	22.3	16
LTI	BUY	4,710	17.5	132	155	29.1	28.8	30
MPHL	SELL	1,580	12.9	80	94	22.0	23.8	17
PSYS	SELL	1,340	15.0	63	70	17.1	16.9	19
COFORGE	BUY	4,080	23.2	132	163	25.2	26.2	25

Source: BOBCAPS Research

FIG 5 – 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	FY21P	FY22E	FY23E
Total revenue	77,311	88,436	97,223	112,897	130,391
EBITDA	13,240	16,505	18,028	22,187	25,663
Depreciation	759	2,317	2,418	2,942	3,481
EBIT	12,481	14,188	15,610	19,245	22,182
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	1,592	967	696	609	1,040
Exceptional items	0	0	0	0	0
EBT	14,073	15,155	16,306	19,854	23,222
Income taxes	3,339	3,306	4,139	4,963	5,806
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	10,734	11,849	12,167	14,890	17,417
Adjustments	0	0	0	0	0
Adjusted net profit	10,734	11,849	12,167	14,890	17,417

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	11,687	12,769	11,927	17,012	19,648
Provisions	3,100	2,242	3,494	4,640	5,359
Debt funds	5,428	12,955	11,811	11,811	11,811
Other liabilities	28	137	343	343	343
Equity capital	1,862	1,865	1,870	1,870	1,870
Reserves & surplus	50,636	56,431	63,398	68,428	74,311
Shareholders' fund	52,498	58,296	65,268	70,298	76,181
Total liabilities and equities	72,741	86,399	92,843	104,103	113,342
Cash and cash eq.	6,572	11,484	11,310	16,740	21,512
Accounts receivables	8,620	7,217	8,147	9,279	10,717
Inventories	0	0	0	0	0
Other current assets	21,339	21,596	23,437	29,384	33,937
Investments	13,292	13,257	18,460	18,460	18,460
Net fixed assets	2,113	8,730	8,870	7,621	6,096
CWIP	406	553	31	31	31
Intangible assets	19,585	21,405	21,326	21,326	21,326
Deferred tax assets, net	814	2,157	1,261	1,261	1,261
Other assets	0	0	0	0	0
Total assets	72,741	86,399	92,842	104,102	113,341

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	11,405	13,510	14,585	17,832	20,898
Interest expenses	(98)	0	(696)	(609)	(1,040)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,421)	341	(2,361)	(849)	(2,636)
Other operating cash flows	(389)	(141)	0	0	0
Cash flow from operations	9,497	13,710	11,528	16,375	17,222
Capital expenditures	(815)	(1,243)	(1,477)	(1,693)	(1,956)
Change in investments	5,725	1,552	3,702	0	0
Other investing cash flows	(2,111)	2,182	696	609	1,040
Cash flow from investing	2,798	2,491	2,921	(1,085)	(916)
Equities issued/Others	104	151	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(8,867)	(2,333)	0	0	0
Dividends paid	(4,655)	(6,065)	(14,623)	(9,860)	(11,533)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(13,418)	(8,247)	(14,623)	(9,860)	(11,533)
Changes in cash and cash eq.	(1,122)	7,954	(174)	5,430	4,772
Closing cash and cash eq.	6,572	11,484	11,310	16,740	21,512

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	57.7	63.7	65.4	80.0	93.6
Adjusted EPS	57.7	63.7	65.4	80.0	93.6
Dividend per share	27.0	35.0	65.0	43.8	51.3
Book value per share	282.0	313.2	350.6	377.6	409.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	4.3	3.8	3.4	3.0	2.6
EV/EBITDA	25.1	20.2	18.6	15.1	13.0
Adjusted P/E	31.2	28.3	27.5	22.5	19.2
P/BV	6.4	5.7	5.1	4.8	4.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	76.3	78.2	74.6	75.0	75.0
Interest burden (PBT/EBIT)	112.8	106.8	104.5	103.2	104.7
EBIT margin (EBIT/Revenue)	16.1	16.0	16.1	17.0	17.0
Asset turnover (Revenue/Avg TA)	108.4	111.1	108.5	114.6	119.9
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.5	1.5	1.5
Adjusted ROAE	20.0	21.4	19.7	22.0	23.8

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
YoY growth (%)					
Revenue	18.1	14.4	9.9	16.1	15.5
EBITDA	24.6	24.7	9.2	23.1	15.7
Adjusted EPS	30.9	10.4	2.7	22.4	17.0
Profitability & Return ratios (%)					
EBITDA margin	17.1	18.7	18.5	19.7	19.7
EBIT margin	16.1	16.0	16.1	17.0	17.0
Adjusted profit margin	13.9	13.4	12.5	13.2	13.4
Adjusted ROAE	20.0	21.4	19.7	22.0	23.8
ROCE	18.0	19.9	18.5	21.9	25.1
Working capital days (days)					
Receivables	40	33	29	28	28
Inventory	0	0	0	0	0
Payables	75	70	63	67	74
Ratios (x)					
Gross asset turnover	39.3	16.3	11.0	13.7	19.0
Current ratio	2.5	2.7	2.8	2.6	2.6
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	0.0	(0.1)	(0.1)

Source: Company, BOBCAPS Research

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

BUY – Expected return >+15%

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

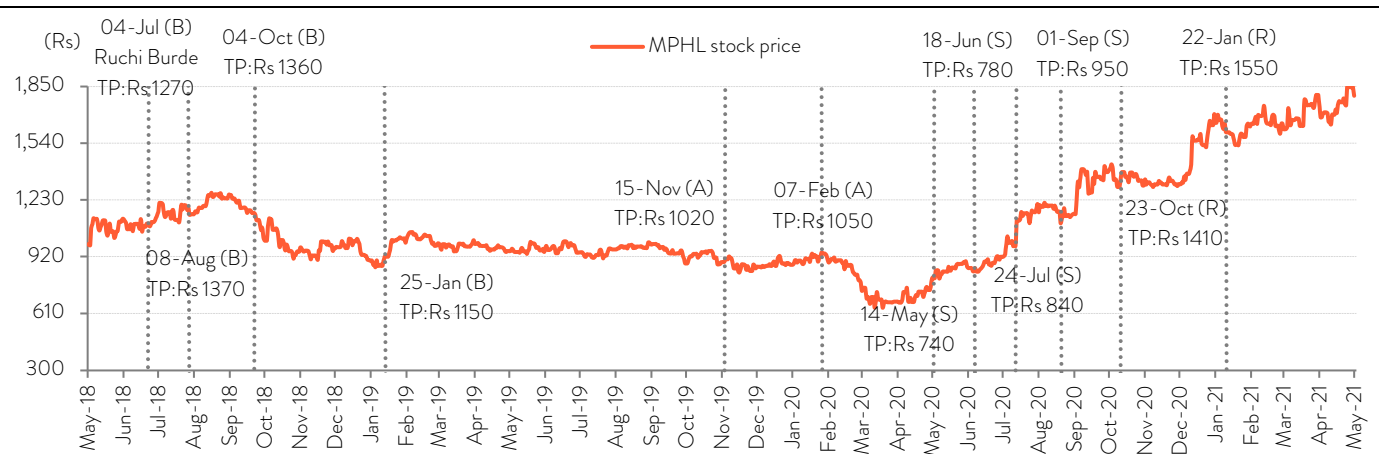
REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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, A – Add, R – Reduce, S – Sell

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