

BUY

TP: Rs 2,541 | ▲ 29%

MPHASIS

| Technology & Internet

| 29 May 2023

Dull quarter; sequential recovery guided from Q2

- Weak Q4 revenue print (-4.1% QoQ); DR and DXC remained a drag on growth
- Growth in direct business likely to be back-ended with strong sequential uptick from Q2FY24
- Current deal TCV can support US\$ 120mn+ incremental revenue over FY23-FY25E; we assume coverage with BUY and a TP of Rs 2,541

Saptarshi Mukherjee
research@bobcaps.in

Q4 weak: MPHL reported a dollar revenue decline of 4.1% QoQ (4.5% QoQ CC) in Q4FY23, much below consensus estimates of a 0.3% QoQ dip. Growth was adversely impacted by a 3.4% QoQ CC decline in direct international business (owing to a 26% QoQ drop in Digital Risk – DR). DXC, which forms 3.8% of revenue, fell 25% QoQ CC following some stability in the last two quarters.

Mortgage business to stabilise in Q2: MPHL has historically gained market share from peers (especially in BFSI), but management expects tighter spends and lower conversions to limit share gains and increase the ask-rate for bookings (which was lower in Q4 adjusted for large deals). That said, mortgage business represented by DR still forms 7% of MPHL's revenue and has largely bottomed out, per management.

Portfolio diversification via non-BFSI deal pipeline: Net new deal TCV of direct international business stood at US\$ 309mn (including a US\$ 150mn deal in BFSI) in Q4, taking the FY23 bookings to US\$ 1.3bn (-8% YoY). The pipeline is up 9% QoQ and 35% YoY, but pipeline to TCV conversion is slowing due to delayed decision-making. TCV to revenue conversion has also slowed to 0.8x vs. 0.9x in Q4FY22.

Margin to stay range-bound in FY24: EBIT margin was flat sequentially at 15.3% as the impact of lower revenue was mitigated by higher offshore utilisation and fresher deployment. MPHL expects the softness in BFSI to continue in Q1FY24 and is guiding for margins within a range of 15.25-16.25% for all the quarters of FY24, led by a focus on pyramid optimisation, better utilisation and offshore leverage. Offshore utilisation including trainees is at 75% vs. the previous peak of 83-84%.

BUY, TP Rs 2,541: The stock is currently trading at 20.6x/17.3x FY24E/FY25E EPS. We expect MPHL to perform well led by (i) DR and DXC combined run rate (US\$ 173mn on annualised run-rate in Q4), and (ii) strong net new TCV at >US\$ 1bn+ (5Y average) that can support US\$ 120mn+ in incremental revenue over FY23-FY25E. We thus assume coverage on MPHL with BUY and have a TP of Rs 2,541, valuing the stock at 22.2x FY25E EPS – in line with the 3Y mean.

Key changes

Target	Rating
▼	▲

Ticker/Price	MPHL IN/Rs 1,975
Market cap	US\$ 4.5bn
Free float	40%
3M ADV	US\$ 12.5mn
52wk high/low	Rs 2,700/Rs 1,660
Promoter/FPI/DII	52%/29%/14%

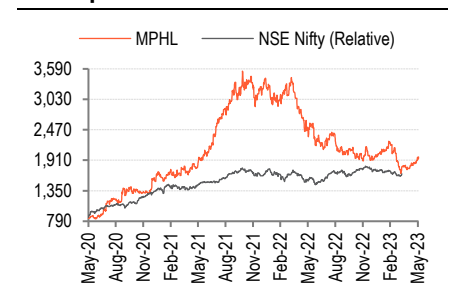
Source: NSE | Price as of 26 May 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	1,37,984	1,50,662	1,76,874
EBITDA (Rs mn)	24,239	27,119	31,838
Adj. net profit (Rs mn)	16,297	17,878	21,384
Adj. EPS (Rs)	87.2	95.7	114.4
Consensus EPS (Rs)	87.2	96.3	115.8
Adj. ROAE (%)	21.9	22.0	25.3
Adj. P/E (x)	22.6	20.6	17.3
EV/EBITDA (x)	15.3	13.6	11.5
Adj. EPS growth (%)	13.9	9.7	19.6

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

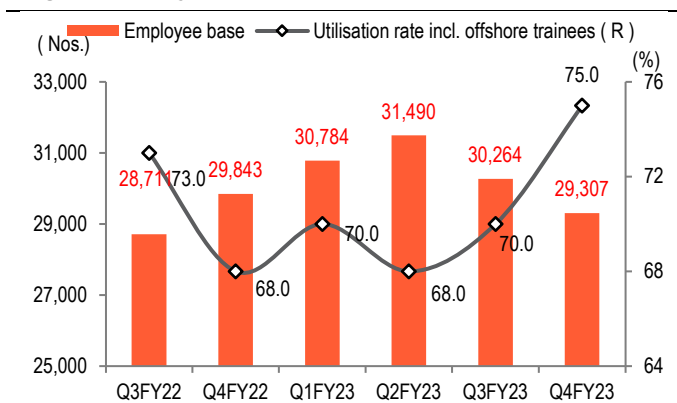


Fig 1 – Quarterly performance

(mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US\$ Revenue	409	426	435	(4.1)	(6.1)	1,712	1,606	6.6
INR Revenue	33,612	35,062	32,777	(4.1)	2.5	1,37,985	1,19,614	15.4
EBIT	5,152	5,354	4,973	(3.8)	3.6	21,087	18,269	15.4
PAT	4,053	4,123	3,921	(1.7)	3.4	16,379	14,309	14.5
EBIT Margin (%)	15.3	15.3	15.2	6bps	16bps	15.3	15.3	(0.3bps)
PAT Margin (%)	12.1	11.8	12.0	30bps	10bps	11.9	12.0	(20bps)

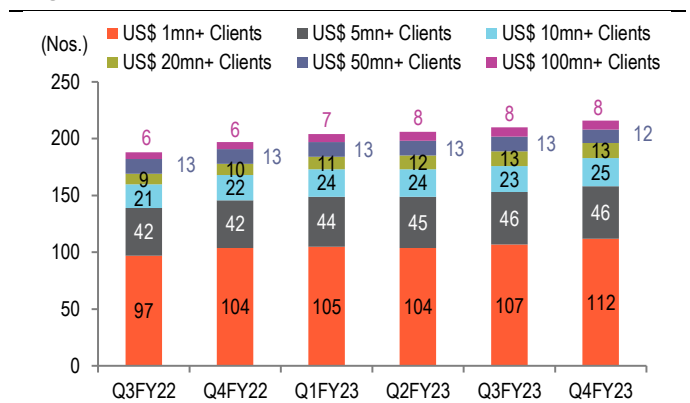
Source: Company, BOBCAPS Research

Fig 2 – Employee matrix



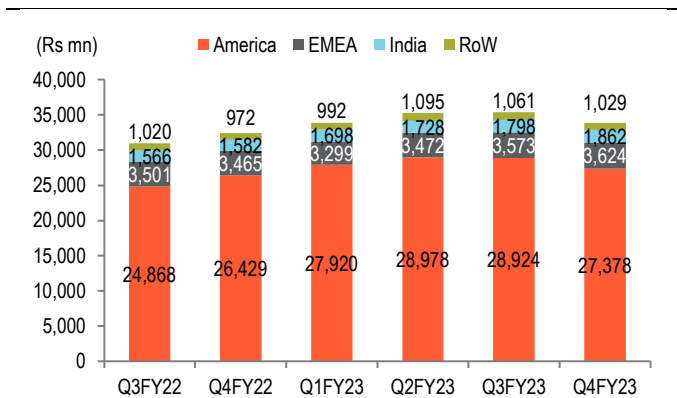
Source: Company, BOBCAPS Research

Fig 3 – Client breakup



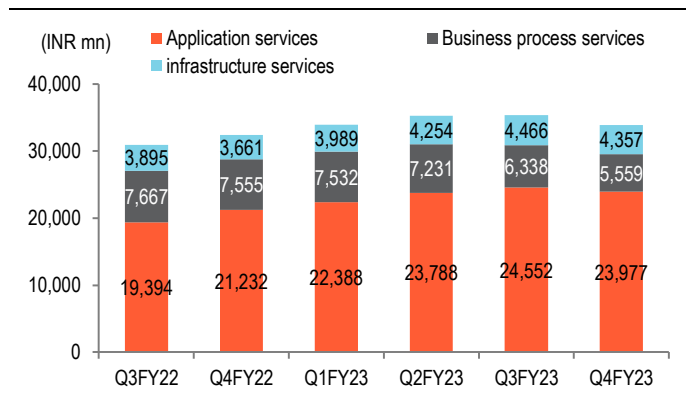
Source: Company, BOBCAPS Research

Fig 4 – Revenue by geography (INR mn)



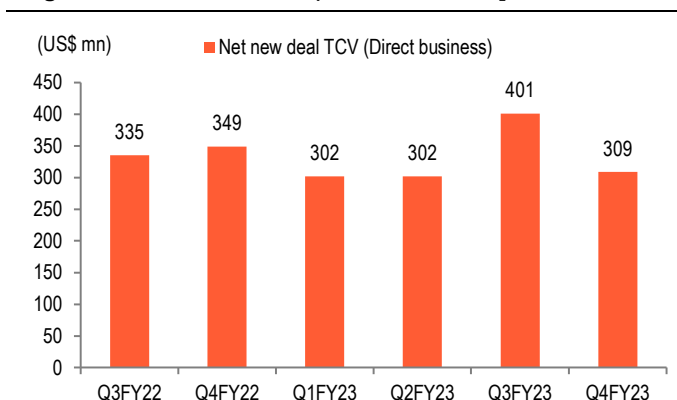
Source: Company, BOBCAPS Research

Fig 5 – Revenue by service type (INR mn)



Source: Company, BOBCAPS Research

Fig 6 – Net new deal TCV (Direct business)



Source: Company, BOBCAPS Research

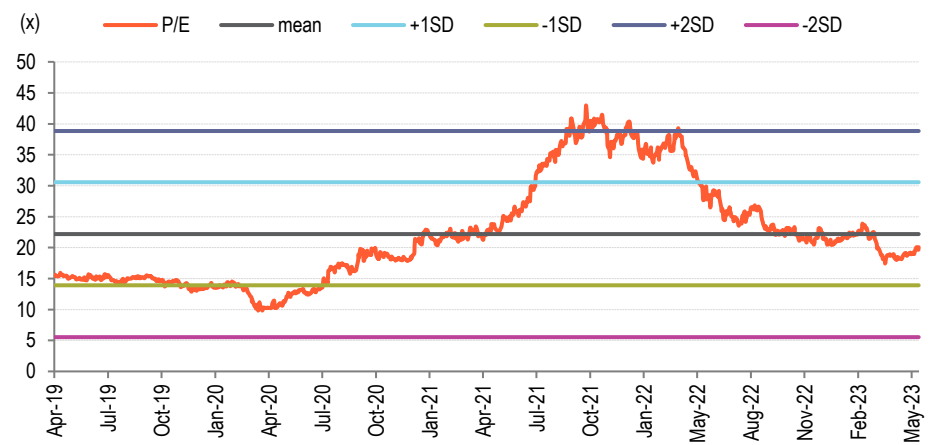
Earnings call highlights

- Though mortgage rates have started to decline, MPHL indicated that consumer demand for mortgage remains uncertain. Its mortgage vertical exposure has come down from 8.8% in Q3FY23 to 6.8% in Q4FY23.
- The company is seeing a delay in conversion of deal wins to revenue because of a slowdown in decision-making and weakness in the mortgage space.
- Management expects a soft beginning in Q1FY24 due to client-specific issues in BFS and delayed contract conversion in the current environment. The company expects the mortgage business to bottom out by the end of Q1 and stability to return from Q2 onwards.
- Of the total contract value (TCV) in Q4FY23, MPHL indicated that 70% came from BFSI, 15% from insurance, 9% from TMT and 4% from logistics & transportation. TCV has held above US\$ 300mn for all the four quarters of FY23, and management is confident of maintaining this run-rate in FY23.
- DXC revenue declined 24.8% QoQ CC and now accounts for 3.8% of the topline vs. 4.8% in Q3FY23 and 5.2% in Q4FY22. Management expects DXC revenue share to stabilise at these levels.
- Geography-wise, US revenue (80.8% of the mix) declined 5.3% QoQ in Q4 while EMEA (10.7%) and India (5.5%) grew 1.4% and 3.6% QoQ respectively.
- Vertical-wise, BFS (53.1% of the mix), insurance (7.6%) and telecom, media & technology (TMT: 12.7%) declined 5.1%, 11.3% and 6.1% QoQ respectively. Logistics & transportation grew 0.6% and other verticals grew 2% QoQ.
- The company is seeing traction (i) in the areas of modern engineering practices & developer productivity, and (ii) in areas that use automation elements such as contact centre automation that uses digital self-help and chatbots.
- MPHL is looking at M&A as a strategic tool to diversify its vertical and geography base, with some deals under discussion and a few at the diligence stage.

Valuation methodology

The stock is currently trading at 20.6x/17.3x FY24E/FY25E EPS. We expect MPHL to perform well led by (i) DR and DXC combined run rate (US\$ 173mn on annualised run-rate in Q4), and (ii) strong net new TCV at >US\$ 1bn+ (5Y average) that can support US\$ 120mn+ in incremental revenue over FY23-FY25E. We thus assume coverage on MPHL with BUY and have a TP of Rs 2,541, valuing the stock at 22.2x FY25E EPS – in line with the three-year mean of its one-year forward P/E multiple.

Fig 7 – P/E band



Source: Company, BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- extension of the global macro downcycle beyond CY23,
- further hike in interest rates globally, leading to lower valuation multiples and further downside risk to mortgage business revenue, and
- weakness in BFSI vertical due to tepid credit demand.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.3	925	1,110	BUY
Coforge	COFORGE IN	3.4	4,460	4,830	BUY
HCL Technologies	HCLT IN	37.6	1,139	1,240	BUY
Infosys	INFO IN	67.4	1,317	1,760	BUY
Mphasis	MPHL IN	4.5	1,975	2,541	BUY
Persistent Systems	PSYS IN	5.0	5,089	5,330	BUY
Tata Consultancy Services	TCS IN	148.2	3,329	3,580	HOLD
Tech Mahindra	TECHM IN	11.8	1,115	1,130	HOLD
Wipro	WPRO IN	26.8	402	420	HOLD

Source: BOBCAPS Research, NSE | Price as of 26 May 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Total revenue	97,223	1,19,614	1,37,984	1,50,662	1,76,874
EBITDA	18,028	21,175	24,239	27,119	31,838
Depreciation	2,418	2,906	3,253	3,594	3,657
EBIT	15,610	18,269	20,986	23,525	28,180
Net interest inc./(exp.)	0	0	0	0	1
Other inc./(exp.)	696	861	644	312	332
Exceptional items	0	0	0	0	0
EBT	16,306	19,130	21,630	23,837	28,512
Income taxes	4,139	4,821	5,333	5,959	7,128
Extraordinary items	0	0	0	0	1
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	12,167	14,309	16,297	17,878	21,384
Adjustments	0	0	0	0	1
Adjusted net profit	12,167	14,309	16,297	17,878	21,384

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	0	0	0	0	0
Other current liabilities	11,927	18,573	19,797	22,703	26,652
Provisions	3,494	5,160	4,115	6,192	7,269
Debt funds	11,811	12,519	10,528	10,528	10,528
Other liabilities	342	718	1,030	1,030	1,030
Equity capital	1,870	1,878	1,884	1,884	1,884
Reserves & surplus	63,398	67,554	77,464	81,120	84,344
Shareholders' fund	65,268	69,432	79,348	83,004	86,228
Total liab. and equities	92,842	1,06,402	1,14,818	1,23,456	1,31,707
Cash and cash eq.	11,310	9,682	10,558	12,324	12,602
Accounts receivables	8,147	8,523	8,523	12,383	14,538
Inventories	0	0	0	0	0
Other current assets	23,437	30,605	34,867	39,214	46,036
Investments	18,460	18,130	17,526	17,526	17,526
Net fixed assets	8,870	10,388	11,012	9,678	8,674
CWIP	31	110	324	324	324
Intangible assets	21,326	27,348	29,586	29,586	29,586
Deferred tax assets, net	1,261	1,616	2,422	2,422	2,422
Other assets	0	0	0	0	0
Total assets	92,842	1,06,402	1,14,818	1,23,456	1,31,707

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Cash flow from operations	11,528	17,122	14,823	17,936	20,760
Capital expenditures	(1,477)	(2,439)	(836)	(2,260)	(2,653)
Change in investments	3,702	0	0	0	0
Other investing cash flows	696	(1,139)	(2,356)	(3,688)	(3,668)
Cash flow from investing	2,921	(3,578)	(3,192)	(5,948)	(6,321)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(2,356)	(1,687)	0	0	0
Dividends paid	(14,623)	(9,475)	(10,792)	(11,839)	(14,161)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(16,979)	(11,163)	(10,792)	(11,839)	(14,161)
Chg in cash & cash eq.	(2,530)	2,381	839	149	278
Closing cash & cash eq.	8,955	11,336	12,175	12,324	12,602

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	65.1	76.6	87.2	95.7	114.4
Adjusted EPS	65.1	76.6	87.2	95.7	114.4
Dividend per share	65.0	42.1	48.0	52.6	62.9
Book value per share	349.3	371.6	424.7	444.2	461.5

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	3.8	3.1	2.7	2.4	2.1
EV/EBITDA	20.5	17.5	15.3	13.6	11.5
Adjusted P/E	30.3	25.8	22.6	20.6	17.3
P/BV	5.7	5.3	4.7	4.4	4.3

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	74.6	74.8	75.3	75.0	75.0
Interest burden (PBT/EBIT)	104.5	104.7	103.1	101.3	101.2
EBIT margin (EBIT/Revenue)	16.1	15.3	15.2	15.6	15.9
Asset turnover (Rev./Avg TA)	108.5	120.1	124.7	126.5	138.6
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.5	1.5	1.5
Adjusted ROAE	19.7	21.2	21.9	22.0	25.3

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
YoY growth (%)					
Revenue	9.9	23.0	15.4	9.2	17.4
EBITDA	9.2	17.5	14.5	11.9	17.4
Adjusted EPS	2.7	17.6	13.9	9.7	19.6
Profitability & Return ratios (%)					
EBITDA margin	18.5	17.7	17.6	18.0	18.0
EBIT margin	16.1	15.3	15.2	15.6	15.9
Adjusted profit margin	12.5	12.0	11.8	11.9	12.1
Adjusted ROAE	19.7	21.2	21.9	22.0	25.3
ROCE	18.5	19.6	20.6	21.7	25.2
Working capital days (days)					
Receivables	29	25	23	25	28
Inventory	0	0	0	0	0
Payables	63	70	71	68	73
Ratios (x)					
Gross asset turnover	11.0	12.4	12.9	14.6	19.3
Current ratio	2.8	2.1	2.3	2.2	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

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

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

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BUY – Expected return >+15%

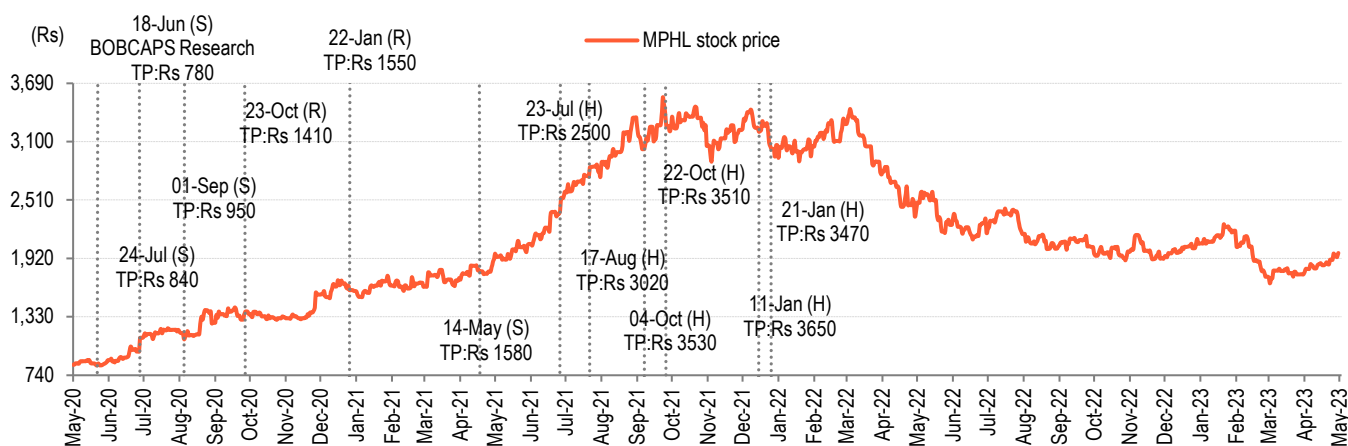
HOLD – Expected return from -6% to +15%

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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