

BUY

TP: Rs 1,150 | ▲ 20%

MPHASIS

| IT Services

| 12 August 2019

Analyst meet takeaways: Staying agile amid structural demand shift

Mphasis (MPHL), at its analyst meet, highlighted its constant strategic adaption to stay aligned with the changing technology demands of clients. MPHL continues to successfully identify growth opportunities in BFSI, its largest vertical at ~57% of FY19 revenue, even as peers struggle. Blackstone's connect with large global banks and financial institutions could offer added upsides. We stay optimistic on MPHL's growth prospects backed by differentiated growth avenues, namely HP/DXC and Blackstone portfolio companies.

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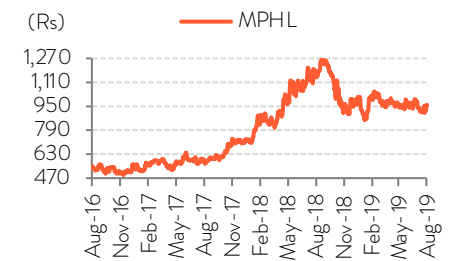
Aligning to clients' priorities: Average deal sizes have shrunk >50% over 2017-19, per IDC. With clients looking for agile, low-capex service engagements that impact both business and technology, management highlighted that its two strategic pillars, namely F2B (front to back) and service transformation, continue to fuel broad-based revenue growth (3.3% CQGR under Blackstone ownership since Q4FY17 vs. -1.3% CQGR in prior 12 quarters). Also, a proactive solutioning approach aided rapid new-client revenue growth (>100% YoY in Q1).

Ticker/Price	MPHL IN/Rs 960
Market cap	US\$ 2.6bn
Shares o/s	193mn
3M ADV	US\$ 3.0mn
52wk high/low	Rs 1,279/Rs 858
Promoter/FPI/DII	60%/23%/17%

Source: NSE

Spotting BFSI opportunities: Tech spending in BFSI is expected to rise 1.3% in CY19, per IT advisory firm Everest Group, as enterprises invest to modernise core systems, payment infrastructure and product innovation. But insourcing and business challenges for European banks pose downside risk. MPHL continues to spot opportunities in this vertical (~57% of FY19 revenue), while peers struggle. Blackstone's connect with global financial powerhouses also augurs well.

STOCK PERFORMANCE



Blackstone ecosystem a powerful growth lever: Blackstone (US\$ 545bn AUM) has an impressive structured mechanism to promote growth synergies among its 97 portfolio companies (US\$ 76bn combined revenues). MPHL derived 5% of FY19 direct channel revenues from this segment (+98% YoY) and continues to build on the support of the powerful Blackstone ecosystem.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	8,507	10,734	11,521	12,754	14,378
Adj. EPS (Rs)	44.1	57.7	61.9	68.5	77.2
Adj. EPS growth (%)	14.9	30.9	7.3	10.7	12.7
Adj. ROAE (%)	14.6	20.0	20.9	21.0	21.5
Adj. P/E (x)	21.8	16.7	15.5	14.0	12.4
EV/EBITDA (x)	17.1	13.9	11.2	9.7	8.5

Source: Company, BOBCAPS Research

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Other analyst meet highlights

Paradigm shift in technology consumption landscape

- The need for agility, customer-centricity and cost takeouts is driving a change in technology consumption patterns. Clients are scouting for end-to-end solutions that impact both business and technology.
- Speed, flexibility, scalability and security are key considerations for technology investment decisions. Lower total cost of ownership continues to be a key factor, but the cost focus/priority has declined over the years.
- ISG comments:
 - Today's 'Generation 3' IT services contracts are more focused on business value and 'software as a service (SaaS)' engagements.
 - The need for agility and mutually beneficial (client-vendor) relations are key changes compared to the past.
 - 50-70% of applications are estimated to move to the cloud over the next five years vs. 20-30% at present
 - Automation is a critical theme for enterprise clients. This requires revenue cannibalisation for IT services vendors but is essential to stay competitive.
- New technologies are shifting the growth opportunities for IT players in the cloud ecosystem. Infrastructure hardware/data centres are struggling while native cloud application development and migration hold significant potential.
- Different industries are in different digital adoption cycles. MPHL is in four (payer, insurance, travel, P&C insurance) of the five industries that are investing to become digital leaders.

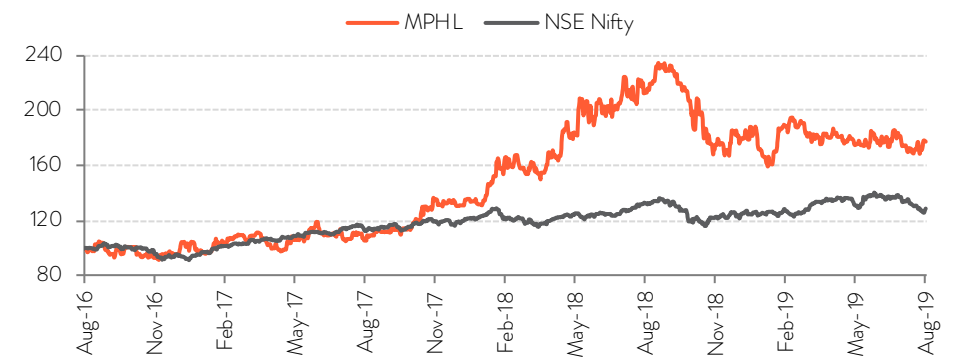
MPHL benefitting from proactive approach, Blackstone connect

- MPHL is changing how offerings are taken to clients – the focus now is on a more proactive solutioning approach rather than the traditional RFP-led approach. Traditional/legacy sourcing still goes through the RFP cycle and is thus invariably more competitive and carries traditional business challenges.
 - 84% of MPHL's wins in FY19 were proactive deal wins. The company has a 49% strike rate in proactive deals led by an institutionalised early engagement sales process and robust account planning.
 - A proactive approach coupled with an enhanced services portfolio accelerated growth in revenues from new clients (+104% YoY in Q1).
- In terms of the Blackstone opportunity, Bob Barthelmes, IT CIO for Blackstone companies, who oversees strategic support for their technology investments, is facilitating the relationship for MPHL.

Valuation methodology

We reiterate BUY on robust growth prospects for MPHL backed by differentiated growth avenues, namely HP/DXC and Blackstone portfolio companies. In our view, these unique channels also serve to insulate growth amid global macro concerns. We have an unchanged Jun'20 target price of Rs 1,150, arrived at by ascribing a one-year forward P/E multiple of 16.2x to the stock, which is one standard deviation above the average P/E under Blackstone ownership.

FIG 1 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- In the past, MPHL had suffered adversely due to high HP/DXC channel revenue concentration. Unfavourable changes in HP/DXC and Blackstone portfolio company relationships could pose downside risks to our estimates.
- Inability of the company to arrest the sharp decline in Digital Risk revenues, adverse currency movements, and a steep decline in IT spending at other clients could also adversely impact financial performance.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	65,459	77,311	86,414	98,009	1,09,310
EBITDA	10,626	13,240	16,392	18,613	20,672
EBIT	9,917	12,481	14,265	16,028	18,086
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	1,490	1,592	1,101	978	1,085
Exceptional items	0	0	0	0	0
EBT	11,407	14,073	15,366	17,005	19,171
Income taxes	2,900	3,339	3,846	4,251	4,793
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	8,507	10,734	11,521	12,754	14,378
Adjustments	0	0	0	0	0
Adjusted net profit	8,507	10,734	11,521	12,754	14,378

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	10,842	11,687	13,021	14,768	16,471
Provisions	245	3,100	3,551	4,028	4,492
Debt funds	3,898	5,428	5,428	5,428	5,428
Other liabilities	49	28	28	28	28
Equity capital	1,932	1,862	1,862	1,862	1,862
Reserves & surplus	52,883	50,636	55,915	61,759	68,347
Shareholders' fund	54,815	52,498	57,777	63,621	70,209
Total liabilities and equities	69,849	72,741	79,805	87,873	96,628
Cash and cash eq.	4,641	6,572	9,860	14,405	19,586
Accounts receivables	8,127	8,620	10,891	12,352	13,776
Inventories	0	0	0	0	0
Other current assets	10,923	21,339	23,675	26,852	29,948
Investments	26,245	13,292	13,292	13,292	13,292
Net fixed assets	1,843	2,519	1,689	573	(373)
CWIP	19	406	406	406	406
Intangible assets	17,014	19,585	19,585	19,585	19,585
Deferred tax assets, net	1,056	814	814	814	814
Other assets	0	0	0	0	0
Total assets	69,849	72,741	79,805	87,873	96,628

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	9,331	11,405	13,647	15,340	16,964
Interest expenses	(96)	(98)	(1,101)	(978)	(1,085)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,503)	(1,421)	(2,821)	(2,414)	(2,353)
Other operating cash flows	(404)	(389)	0	0	0
Cash flow from operations	7,330	9,497	9,725	11,948	13,526
Capital expenditures	(313)	(815)	(1,296)	(1,470)	(1,640)
Change in investments	7,366	5,725	0	0	0
Other investing cash flows	(2,076)	(2,111)	1,101	978	1,085
Cash flow from investing	4,977	2,798	(195)	(493)	(555)
Equities issued/Others	29	104	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(9,877)	(8,867)	0	0	0
Dividends paid	(3,949)	(4,655)	(6,242)	(6,910)	(7,790)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(13,797)	(13,418)	(6,242)	(6,910)	(7,790)
Changes in cash and cash eq.	(1,491)	(1,122)	3,288	4,545	5,181
Closing cash and cash eq.	4,642	6,572	9,860	14,405	19,586

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	44.1	57.7	61.9	68.5	77.2
Adjusted EPS	44.1	57.7	61.9	68.5	77.2
Dividend per share	20.0	0.0	27.8	30.8	34.8
Book value per share	283.9	282.0	310.4	341.8	377.2

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.8	2.4	2.1	1.8	1.6
EV/EBITDA	17.1	13.9	11.2	9.7	8.5
Adjusted P/E	21.8	16.7	15.5	14.0	12.4
P/BV	3.4	3.4	3.1	2.8	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	74.6	76.3	75.0	75.0	75.0
Interest burden (PBT/EBIT)	115.0	112.8	107.7	106.1	106.0
EBIT margin (EBIT/Revenue)	15.1	16.1	16.5	16.4	16.5
Asset turnover (Revenue/Avg TA)	91.5	108.4	113.3	116.9	118.5
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.4	1.4	1.4
Adjusted ROAE	14.6	20.0	20.9	21.0	21.5

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	7.7	18.1	11.8	13.4	11.5
EBITDA	9.7	24.6	23.8	13.6	11.1
Adjusted EPS	14.9	30.9	7.3	10.7	12.7
Profitability & Return ratios (%)					
EBITDA margin	16.2	17.1	19.0	19.0	18.9
EBIT margin	15.1	16.1	16.5	16.4	16.5
Adjusted profit margin	13.0	13.9	13.3	13.0	13.2
Adjusted ROAE	14.6	20.0	20.9	21.0	21.5
ROCE	13.2	18.0	20.4	22.3	24.5
Working capital days (days)					
Receivables	40	40	41	43	44
Inventory	0	0	0	0	0
Payables	63	75	70	72	72
Ratios (x)					
Gross asset turnover	29.3	35.4	41.1	86.7	1,093.2
Current ratio	2.1	2.5	2.7	2.9	3.0
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

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

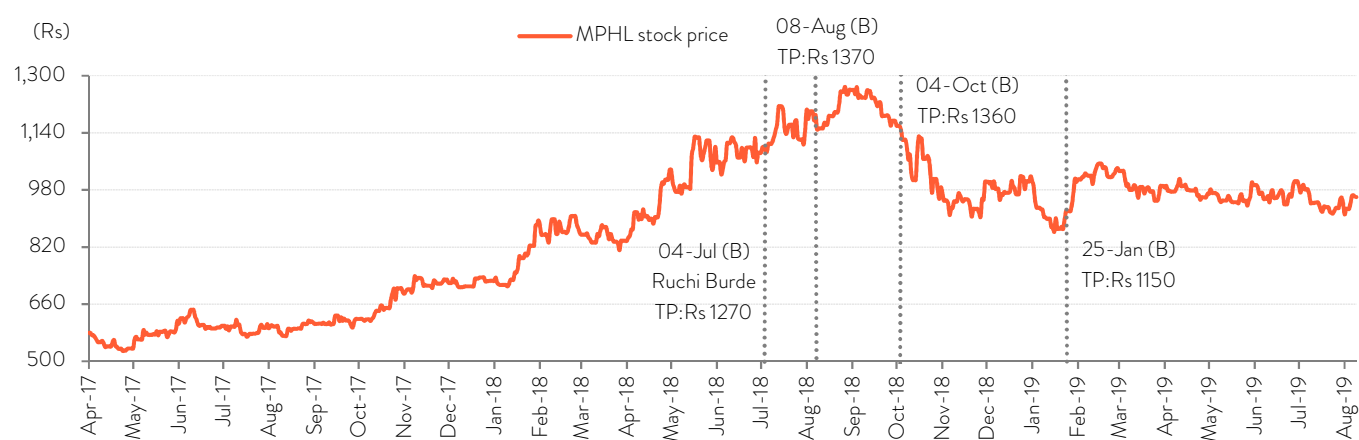
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: MPHASIS (MPHL IN)



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

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