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MPHASES

| IT Services

| 29 July 2024

## Weak quarter but bullish commentary

- **Weak quarter despite talk of BFSI bottoming out. Significant TCV uptick QoQ from a very weak base. Much discussion on expanded pipelines**
- **MPHL hints at industry leading growth for FY25 – implies ~2% CQGR for next three quarters driven by BFSI and top accounts**
- **CEO hints at likely market share shifts in industry in next 12-24 months depending on who brings in AI/Gen AI infused solutions to market**

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**2% CQGR required for the next three quarters:** MPHL indicated it would lead industry growth in FY25. And it expects industry to grow in the low-mid single digits in FY25. To hit 5% growth in US\$ terms in FY25 it will have to grow 2% CQGR. In the last two quarters since its organic growth moved into the positive territory, growth was 1% CQGR. Recovery in the mortgages business is not part of this view as MPHL says it is not clear about the trajectory of mortgage rates in the US.

**EBIT margin in line:** 1QFY25 revenue was down on a QoQ basis by 0.1% in constant currency terms compared to our expectation of a 2% increase. The EBIT margin came in at 15% against our expectation of 15.2%. EBIT margin would have been 15.8% had it not been for the amortisation of Silverline acquisition (80bps impact in the quarter). It stuck to the EBIT margin band of 14.6% to 16% for FY25

**Pipeline has grown well:** MPHL's overall pipeline is up 22% YoY and 17% QoQ. Pipeline pickup is broad-based across sectors, top-10, non-top-10, banking and financial services (BFS), non-BFS, geographies, and large deals (>US\$ 20m accounts). The top-10 pipeline grew by 31% QoQ, non-BFS pipeline by 25%. The BFS pipeline is up 7% QoQ. 78% of the pipeline emerged from proactive deals.

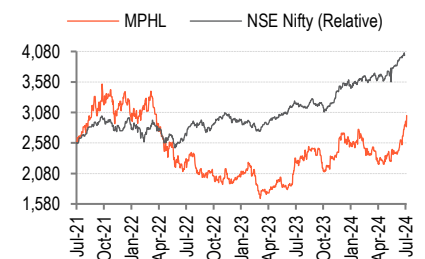
**Top clients have grown ahead of company:** MPHL's top 10 client accounts grew 1.2% QoQ, and 11 to 30 grew 3.4%. The banking, financial services and insurance (BFSI) vertical grew by ~1.6%.

**Volume destruction in some services likely:** MPHL's CEO Nitin Rakesh indicated that the industry is pivoting to IT services infused by AI/Gen AI and there is significant volume destruction across areas like IT operations, contact centres, etc. Pricing based on number of tickets solved or instances or widgets handled, etc, will be replaced by pricing based on a different outcome like availability or reduction in tickets.

Ticker/Price	MPHL IN/Rs 3,030
Market cap	US\$ 6.8bn
Free float	40%
3M ADV	US\$ 41.5mn
52wk high/low	Rs 3,081/Rs 2,069
Promoter/FPI/DII	52%/29%/14%

Source: NSE | Price as of 26 Jul 2024

## Stock performance



Source: NSE



- The CEO believes that part of the reason for the demand slowdown in 2024 was not just macro factors but customers being uncertain about what to spend on. This is like the commentary we heard from TCS over the last few quarters. According to Nitin, things are changing for the better as greater clarity is emerging.
- The CEO says that among MPHL clients there is increasing consensus around a soft landing.
- MPHL announced the launch of two market-leading platforms – Mphasis Neo-Zeta and Mphasis Neo Crux. The first is a platform for transforming legacy applications written in languages like COBOL or legacy Java to reduce relearning time by over 50%. This is unlocking a large addressable market for applications that are considered too complex and expensive for modernisation. Neo Crux helps in improving developer productivity.
- Between 40% and 50% of the applications are on cloud today, but the other 50% are not because the business case doesn't stack up. The complexity of these applications, their mission-critical nature and, most importantly, the effort required to re-architect to be truly cloud-native was very expensive. MPHL is using GenAI to relearn and extract rules and launched the platforms (Mphasis Neo Zeta and Mphasis Neo Crux) to unlock these modernisation-driven deals.
- MPHL admitted to pricing pressure in the market compared to two quarters ago. Since much of the work it does is based on proactive deal sourcing (93%) it is able to make the desired margins.
- Other key CEO statements on the analyst call and in media interviews:
  - Organisations are looking to find short-term savings to fund long-term technological priorities.
  - While discretionary spends haven't changed vastly compared to the previous quarter, there has been a gradual pickup in client engagement.
  - Of the three large deal wins, one was a US\$ 100m win in the BFSI vertical.
  - Total contract value (TCV) to revenue conversion has been steady.
  - The Gen AI platforms-based approach is opening up areas from an addressable market perspective, where MPHL was not competitive before as it was not necessarily the lowest cost provider due to its scale and volume play.
  - If a player does not transform what it delivers to the customer (infusing Gen AI and reducing the cost of executing the legacy part), then somebody else will.
- We are in the process of initiating coverage on the sector and stock soon.

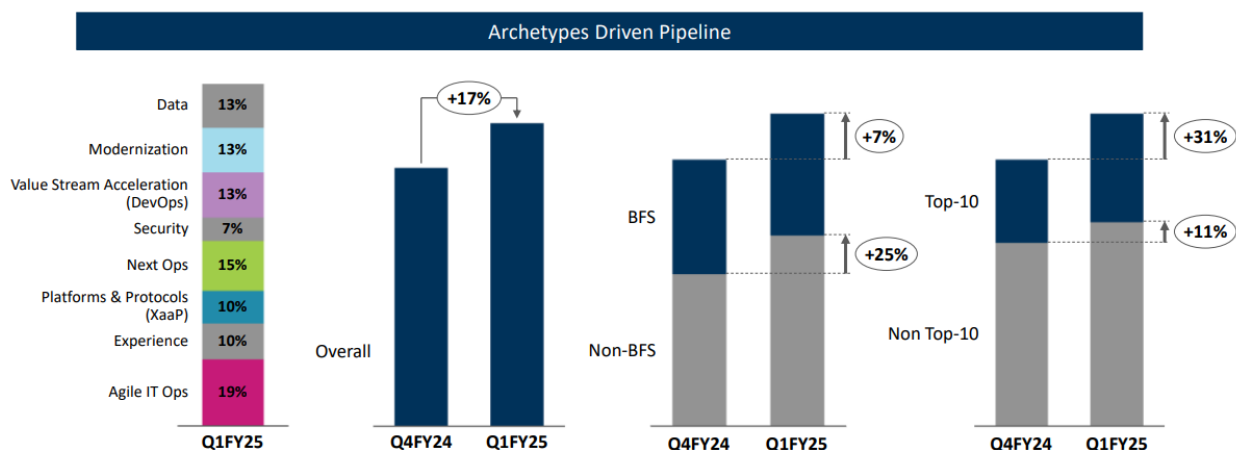
**Fig 1 – 1QFY25 performance**

Y/E Mar (Rs mn)	1QFY24	4QFY24	1QFY25	YoY (%)	QoQ (%)	1QFY25E	Dev (%)
USD Revenue (US\$ mn)	398	411	410	3.2	(0.1)	418	(1.7)
Net sales	32,520	34,121	34,225	4.9	0.3	34,851	(2.1)
Direct Costs	23,703	24,558	24,519	3.6	(0.2)	24,866	(1.2)
% of sales	72.9	72.0	71.6	-	-	71.3	-
Gross Profit	8,817	9,563	9,706	8.5	1.5	9,986	(4.2)
% of sales	27.1	28.0	28.4	-	-	28.70	-
Selling expenses	2,035	2,761	2,527	35.7	(8.5)	2,873	(3.9)
% of sales	6.3	8.1	7.4	-	-	8.2	-
G&A expenses	1,787	1,721	2,044	(3.7)	18.8	1,826	(5.8)
% of sales	5.5	5.0	6.0	-	18.4	5.2	-
Provision for doubtful debts	0	0	0	-	-	-	-
<b>EBIT</b>	<b>4,995</b>	<b>5,081</b>	<b>5,135</b>	<b>1.7</b>	<b>1.1</b>	<b>5,287</b>	<b>(3.9)</b>
% of sales	15.4	14.9	15.0			15.2	
Other Income	263	143	238	(45.6)	66.4	85	68.2
<b>PBT</b>	<b>5,258</b>	<b>5,224</b>	<b>5,373</b>	<b>(0.7)</b>	<b>2.9</b>	<b>5,372</b>	<b>(2.8)</b>
Exceptional item	0	0	0	-	-	-	-
Provision for tax	1,297	1,291	1,328	(0.5)	2.9	1,332	(3.1)
Effective tax rate	24.7	24.7	24.7	-	0.0	24.8	-
<b>PAT (reported)</b>	<b>3,961</b>	<b>3,933</b>	<b>4,045</b>	<b>(0.7)</b>	<b>2.9</b>	<b>4,040</b>	<b>(2.7)</b>
NPM (%)	12.2	11.5	11.8	-	-	11.6	-

Source: Company, BOBCAPS Research

**Fig 2 – Pipeline statistics**

**Broad-based Acceleration in Pipeline**

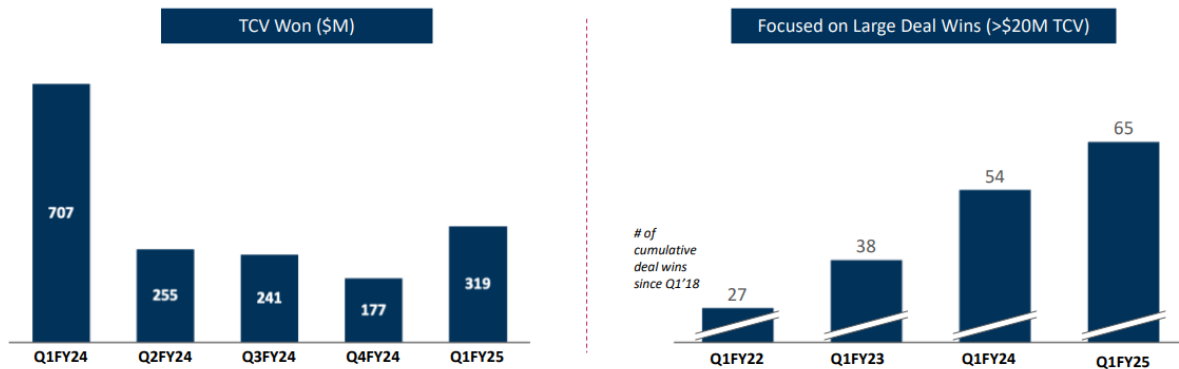


- Broad-based pipeline growth across all chosen verticals with US pipeline up by 27% YoY
- BFS pipeline up 7% QoQ and 15% YoY. Top-10 pipeline up 31% QoQ
- Pipeline remains strong, even with healthy TCV wins
- One-third of the pipeline is AI-led

Source: Company, BOBCAPS Research

Fig 3 – TCV trends

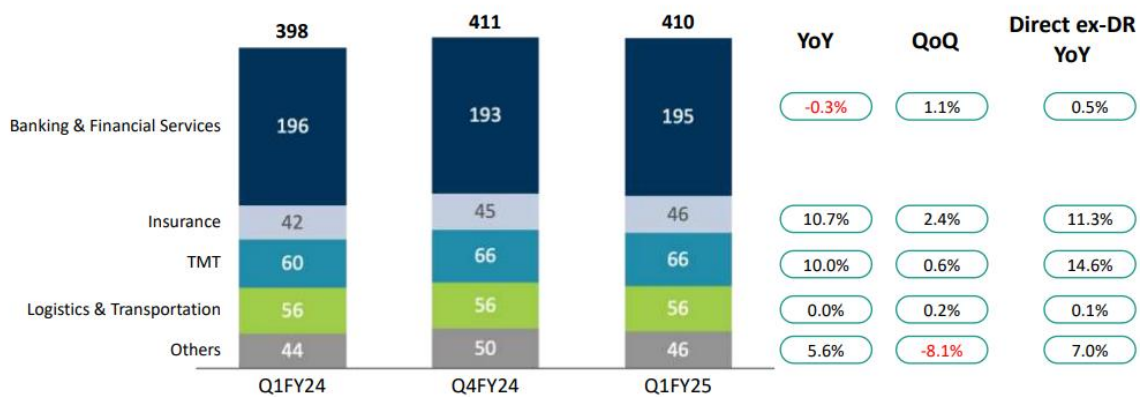
**Healthy TCV Closures in a Challenging Environment**



- TCV at \$319M for Q1FY25. Three large deals in the quarter, including one \$100M+ deal
- More than 90% of wins are proactive deals
- Pickup in TCV closures. Broad based TCV wins across verticals and client pyramid
- Conversion from TCV to revenue continues to improve
- LTM TCV wins at \$992M

Source: Company, BOBCAPS Research

Fig 4 – Vertical performance picture



- Key verticals grew sequentially in Direct business
- Focus on new engines of Direct growth paying off
- Healthy revenue ramp-up in new customers across segments

Source: Company, BOBCAPS Research

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