

**BUY**

TP: Rs 1,150 | ▲ 24%

**MPHASIS**

| IT Services

| 27 July 2019

## In-line operating performance

**Mphasis' (MPHL) Q1FY20 revenue at US\$ 297mn met expectations, marked by balanced growth in both direct and DXC/HP channels. Hedging gains after four quarters supported in-line reported EBIT margins of 15.5% (-30bps QoQ). Management is targeting above-industry growth in the direct core business and industry-level growth in DXC/HP for FY20. The guided EBIT margin range remains at 15-17%. We trim FY20/FY21 EPS by 2%/3.6% on a lower currency reset and higher delivery costs. On rollover to Jun'20, our TP stays at Rs 1,150.**

**Ruchi Burde**

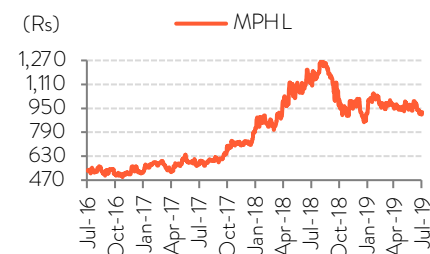
research@bobcaps.in

**Operating performance meets expectations:** MPHL's June quarter revenue at US\$ 297mn (+3% QoQ) was largely on par with our estimate. The company clocked 2% QoQ growth each in the direct channel (ex-Digital Risk) and DXC/HP channel. Digital Risk revenues were stable, per our calculations. Reported EBIT margins at 15.5% were in line and supported by hedging gains of Rs 19mn vs. hedging losses in the four prior quarters. EBIT margins excluding hedging gains stood at 15.4%, declining 130bps QoQ due to mid-term wage revision, visa costs and one-off bad debt provision.

Ticker/Price	MPHL IN/Rs 930
Market cap	US\$ 2.6bn
Shares o/s	193mn
3M ADV	US\$ 2.9mn
52wk high/low	Rs 1,279/Rs 858
Promoter/FPI/DII	60%/23%/17%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

**FY20 growth outlook intact:** Management maintained its guidance of above-industry growth in the direct core business, industry-level growth in DXC/HP and 15-17% EBIT margins. We highlight the steady traction in BFSI (+1.9% QoQ in dollar terms in Q1) and absence of client-specific concerns, which contrasts with the growth challenges and soft BFSI commentary from peers.

**Retain BUY:** 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.

## 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)	21.1	16.1	15.0	13.6	12.0
EV/EBITDA (x)	16.5	13.5	10.9	9.4	8.2

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

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**FIG 1 – JUN'19 QUARTER PERFORMANCE**

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	YoY (%)	QoQ (%)
<b>Revenue (US\$ mn)</b>	<b>268</b>	<b>271</b>	<b>278</b>	<b>289</b>	<b>297</b>	<b>10.7</b>	<b>3.0</b>
<b>Revenue ex-hedging gains/losses (US\$ mn)</b>	<b>269</b>	<b>276</b>	<b>283</b>	<b>292</b>	<b>297</b>	<b>10.5</b>	<b>1.8</b>
Revenue	18,202	19,149	19,710	20,250	20,626	13.3	1.9
Revenue ex-hedging gains/losses	18,218	19,479	20,028	20,469	20,607	13.1	0.7
Operating expenditure	15,001	15,820	16,404	16,846	16,883	12.5	0.2
Cost of revenues	12,945	13,770	14,204	14,815	14,771	14.1	(0.3)
as % of sales	71.1	71.9	72.1	73.2	71.6	-	-
SG&A expenses	2,056	2,050	2,200	2,031	2,112	2.7	4.0
as % of sales	11.3	10.7	11.2	10.0	10.2	-	-
<b>EBITDA</b>	<b>3,201</b>	<b>3,329</b>	<b>3,306</b>	<b>3,404</b>	<b>3,743</b>	<b>16.9</b>	<b>10.0</b>
Depreciation	179	184	196	200	550	207.3	175.0
<b>EBIT</b>	<b>3,022</b>	<b>3,145</b>	<b>3,110</b>	<b>3,204</b>	<b>3,193</b>	<b>5.7</b>	<b>(0.3)</b>
Other income	407	441	471	273	342	(16.0)	25.3
<b>PBT</b>	<b>3,429</b>	<b>3,586</b>	<b>3,581</b>	<b>3,477</b>	<b>3,535</b>	<b>3.1</b>	<b>1.7</b>
Total tax	846	877	801	815	888	5.0	9.0
Adjusted PAT	2,583	2,709	2,780	2,662	2,647	2.5	(0.6)
<b>APAT after MI</b>	<b>2,583</b>	<b>2,709</b>	<b>2,780</b>	<b>2,662</b>	<b>2,647</b>	<b>2.5</b>	<b>(0.6)</b>
<b>Extraordinary items</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Reported PAT</b>	<b>2,583</b>	<b>2,709</b>	<b>2,780</b>	<b>2,662</b>	<b>2,647</b>	<b>2.5</b>	<b>(0.6)</b>
<b>Reported EPS</b>	<b>13.4</b>	<b>14.0</b>	<b>14.4</b>	<b>14.3</b>	<b>14.2</b>	<b>6.0</b>	<b>(0.7)</b>
<b>Margins (%)</b>						<b>(bps)</b>	<b>(bps)</b>
EBITDA	17.6	17.4	16.8	16.8	18.1	60	130
EBIT	16.6	16.4	15.8	15.8	15.5	(110)	(30)
EBT	18.8	18.7	18.2	17.2	17.1	(170)	-
PAT	14.2	14.1	14.1	13.1	12.8	(140)	(30)
Effective Tax rate	24.7	24.5	22.4	23.4	25.1	50	170

Source: Company, BOBCAPS Research

**FIG 2 – JUN'19 QUARTER OPERATING METRICS**

Particulars	Q1FY20 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
<b>Revenue by Business Segments (US\$ terms)</b>			
HP Channel	28	2.0	14.8
Digital Risk	7	(0.6)	(28.8)
Direct Channel (ex-Digital Risk)	65	2.0	15.5
<b>Revenue by Verticals (Rs terms)</b>			
Banking and Capital Markets	45	1.5	7
Insurance	12	(1.9)	17
Information Technology, communication & Entertainment	17	(3.3)	9
Emerging Industries	27	3.2	25
<b>Revenue by Service Type (Rs terms)</b>			
App Maintenance & Other Services	32	(4)	20
App Development	33	6	36
Customer Service	1	0	6
Service/Tech Helpdesk	7	5	3

Particulars	Q1FY20 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Transaction Processing Services	6	1	8
Infra Mgmt Services	12	(3)	(7)
Knowledge Process	7	(2)	(26)
<b>IT Services – Client Concentration (Rs terms)</b>			
Top clients	15	9	31
Top 5 clients	48	4	33
Top 10 clients	61	4	23
<b>Revenue by Project Type</b>		<b>(bps)</b>	<b>(bps)</b>
T & M	76	(100)	300
Fixed price	24	100	(300)
	<b>Q1FY20</b>	<b>QoQ (%)</b>	<b>YoY (%)</b>
<b>Total employees</b>	<b>25,499</b>	<b>4.1</b>	<b>13.0</b>

Source: Company, BOBCAPS Research

## Valuation methodology

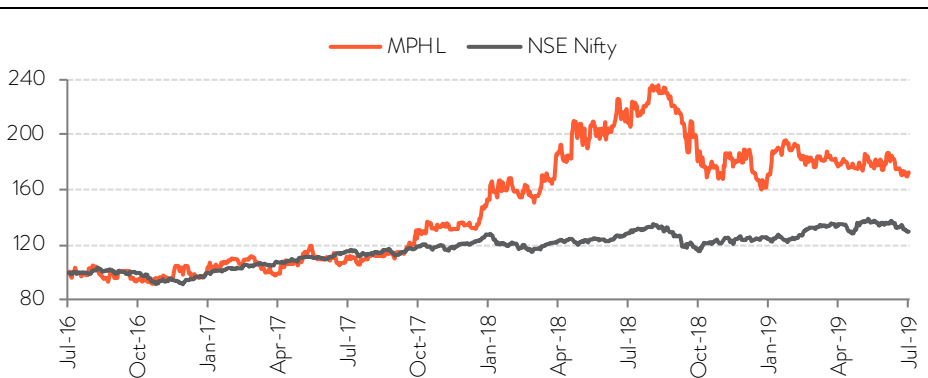
We trim FY20/FY21 EPS estimates by 2%/3.6% to pencil in a lower currency reset and higher delivery costs. We also introduce FY22 EPS at Rs 77.2, which incorporates dollar revenue growth of 11.5% and EBIT margins of 16.5%. On rolling valuations over, we have an unchanged Jun'20 target price of Rs 1,150, arrived at by ascribing a one-year forward P/E multiple of 16.2x, which is one standard deviation above the average P/E under Blackstone ownership. Retain BUY on differentiated growth avenues, namely HP/DXC and Blackstone portfolio companies.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Change (%)	Old	New	Change (%)	New
Reported Revenues (US\$ mn)	1,251	1,251	0.0	1,401	1,400	(0.1)	1,562
YoY (%)	13.1	13.1	-	12.0	12.0	-	11.5
Revenues ex-hedging (US\$ mn)	1,251	1,251	0.0	1,401	1,400	(0.1)	1,562
Revenues	87,547	86,414	(1.3)	98,072	98,009	(0.1)	1,09,310
EBIT	14,853	14,265	(4.0)	16,720	16,028	(4.1)	18,086
EBIT margins (%)	17.0	16.5	-	17.0	16.4	-	16.5
Net Profits	11,750	11,521	(2.0)	13,224	12,754	(3.6)	14,378
EPS (Rs)	63.1	61.9	(2.0)	71.0	68.5	(3.6)	77.2

Source: BOBCAPS Research

**FIG 4 – 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
<b>Total revenue</b>	<b>65,459</b>	<b>77,311</b>	<b>86,414</b>	<b>98,009</b>	<b>1,09,310</b>
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
<b>Reported net profit</b>	<b>8,507</b>	<b>10,734</b>	<b>11,521</b>	<b>12,754</b>	<b>14,378</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>8,507</b>	<b>10,734</b>	<b>11,521</b>	<b>12,754</b>	<b>14,378</b>

### 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
<b>Total liabilities and equities</b>	<b>69,849</b>	<b>72,741</b>	<b>79,805</b>	<b>87,873</b>	<b>96,628</b>
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
<b>Total assets</b>	<b>69,849</b>	<b>72,741</b>	<b>79,805</b>	<b>87,873</b>	<b>96,628</b>

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
<b>Cash flow from operations</b>	<b>7,330</b>	<b>9,497</b>	<b>9,725</b>	<b>11,948</b>	<b>13,526</b>
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
<b>Cash flow from investing</b>	<b>4,977</b>	<b>2,798</b>	<b>(195)</b>	<b>(493)</b>	<b>(555)</b>
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
<b>Cash flow from financing</b>	<b>(13,797)</b>	<b>(13,418)</b>	<b>(6,242)</b>	<b>(6,910)</b>	<b>(7,790)</b>
<b>Changes in cash and cash eq.</b>	<b>(1,491)</b>	<b>(1,122)</b>	<b>3,288</b>	<b>4,545</b>	<b>5,181</b>
<b>Closing cash and cash eq.</b>	<b>4,642</b>	<b>6,572</b>	<b>9,860</b>	<b>14,405</b>	<b>19,586</b>

**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	2.7	2.3	2.1	1.8	1.6
EV/EBITDA	16.5	13.5	10.9	9.4	8.2
Adjusted P/E	21.1	16.1	15.0	13.6	12.0
P/BV	3.3	3.3	3.0	2.7	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
<b>YoY growth (%)</b>					
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
<b>Profitability &amp; Return ratios (%)</b>					
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
<b>Working capital days (days)</b>					
Receivables	40	40	41	43	44
Inventory	0	0	0	0	0
Payables	63	75	70	72	72
<b>Ratios (x)</b>					
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%

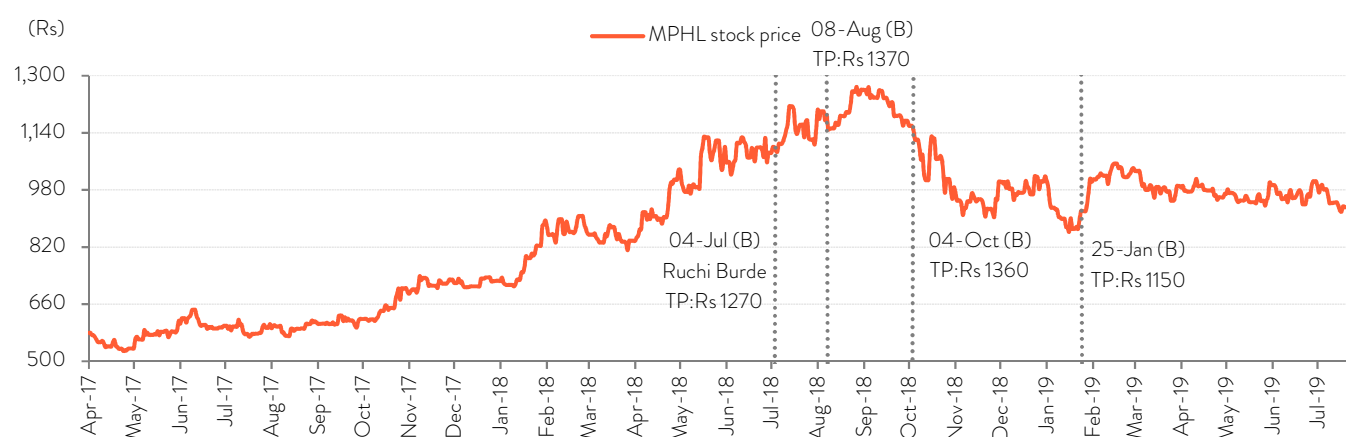
**ADD** – Expected return from >+5% to +15%

**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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