

August 13, 2019

Analyst Meet Update

■ Change in Estimates | ■ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	ACCUMULATE		ACCUMULATE	
Target Price	1,042		1,042	
Sales (Rs. m)	87,995	99,541	87,995	99,541
% Chng.	-	-	-	-
EBITDA (Rs. m)	15,826	17,832	15,826	17,832
% Chng.	-	-	-	-
EPS (Rs.)	62.9	73.1	62.9	73.1
% Chng.	-	-	-	-

Key Financials - Standalone

Y/e Mar	FY18	FY19	FY20E	FY21E
Sales (Rs. m)	65,458	77,310	87,995	99,541
EBITDA (Rs. m)	10,624	13,238	15,826	17,832
Margin (%)	16.2	17.1	18.0	17.9
PAT (Rs. m)	8,505	10,712	11,717	13,596
EPS (Rs.)	43.3	55.4	62.9	73.1
Gr. (%)	13.8	27.9	13.6	16.1
DPS (Rs.)	19.7	26.0	19.0	19.0
Yield (%)	2.0	2.7	2.0	2.0
RoE (%)	14.6	20.0	21.0	21.3
RoCE (%)	17.0	23.3	25.7	25.9
EV/Sales (x)	2.5	2.2	1.8	1.5
EV/EBITDA (x)	15.7	12.7	9.9	8.3
PE (x)	22.2	17.3	15.3	13.1
P/BV (x)	3.4	3.5	3.0	2.6

Key Data

MBFL.BO | MPHL IN

52-W High / Low	Rs.1,279 / Rs.855
Sensex / Nifty	37,582 / 11,110
Market Cap	Rs.179bn / \$ 2,528m
Shares Outstanding	186m
3M Avg. Daily Value	Rs.440.9m

Shareholding Pattern (%)

Promoter's	52.29
Foreign	28.93
Domestic Institution	8.21
Public & Others	10.56
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	1.8	(5.9)	(16.6)
Relative	4.9	(8.5)	(15.6)

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New Gen capabilities - Strategic pillars for future growth & profitability

We attended Mphasis analyst meet where the management highlighted the key growth drivers in direct core & new growth areas in the DXC/HP Channel. Mphasis management mentioned that speed, flexibility, domain expertise, scalability, solution architecting, strong eco system of alliance partners is helping them to drive sustainable growth. Mphasis has developed core capabilities in sub-verticals especially in BFSI, where regardless of industry weakness in the segment management maintains its strong outlook for the same. Mphasis is more focused in wealth management & mortgage services in BFSI which is helping them to build digital inroads in this verticals. BFS accounts for 44.7% of Mphasis' revenues and is higher relative to peers. Management was quite confident of driving growth from new logos and wallet share gain in existing accounts. Further, Mphasis reported that it does not have a meaningful exposure to the capital markets segment. Also, management was confident on revenue uptick in Digital Risk. The segment can reach US\$25-30 mn revenue band in FY2020E on ramp-up of deal wins. Revenue from new clients, largely BFSI-focused, grew 91% in FY2019 and 104% in 1QFY20 and is another growth driver.

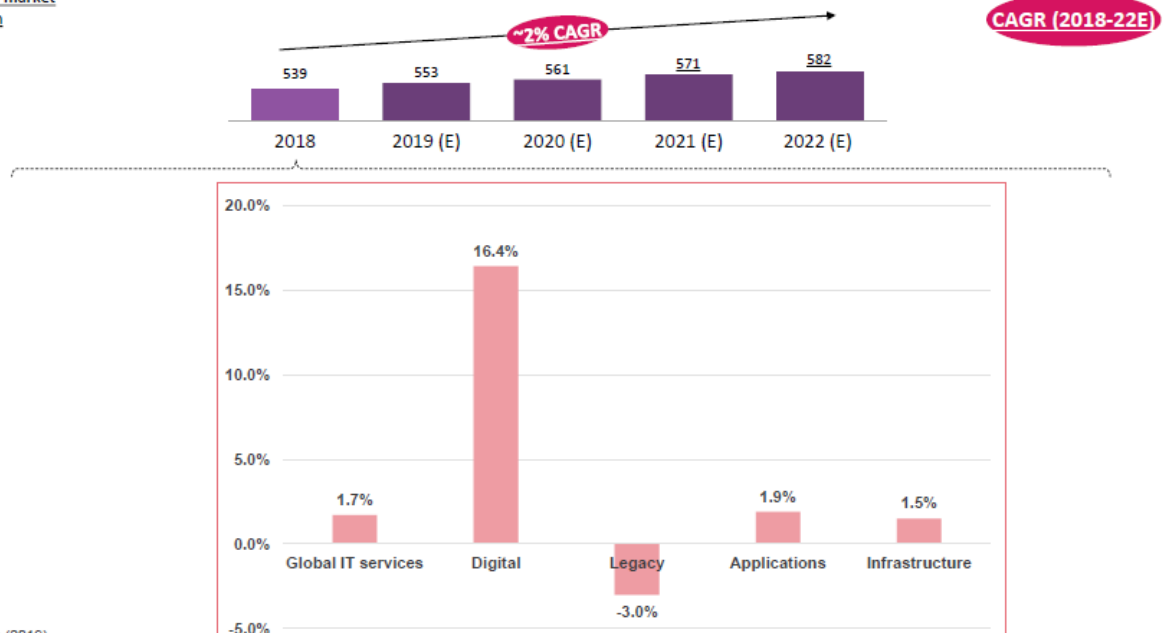
Mphasis has been one of the few mid-tier IT company over the last few quarters which has not seen in downward revision on margins, growth visibility is stable & it has best cash generation among its peers & RoE in excess of 20%. We expect Mphasis to post 11/12% growth in revenues for FY20E/21E & our EBIT margin estimates stands at ~16.6% for FY20E/21E. We believe recovery in digital business will be gradual while direct core business will be the key growth driver. Good growth in the core business and growing revenue contribution from the Blackstone portfolio provide visibility on growth. We have fine tune our estimates & value Mphasis at 15x FY21E earnings to arrive at revised target price of Rs1042. The stock currently trades at attractive valuation of 14.8/12.7x FY20E/FY21E earnings.

- **BFSI spends have strong tailwind for growth:** Mphasis analyst provided us with a session by an industry analyst for outlook on BFSI spends. The key takeaways are 1) BFSI IT outsourcing spends grew 2.8% in 2018 led by strong growth in insurance, 2) Technology spends are fueled by change initiatives with shift in mix from run to change, 3) Lack of talent in new technologies, new skills will help in outsourcing growth, 4) Insourcing trend will continue as companies view new digital technology important for their business, 5) BFSI technology spending can accelerate in the medium term on the back of growth in the BFSI business, regulatory driven by spending and ITO expansion.
- **New gen services driving direct core growth:** Mphasis has strong traction in next-gen services. Management reported that cloud and cognitive portfolio of services has enabled rapid growth in next-gen services and have helped the company win large strategic deals. Mphasis reported that 80% of net new deal wins in the Direct International segment were in the area of new-gen services. New client wins have fueled growth in Direct Core. In FY19, new client acquisition grew ~91% and Blackstone accounts grew ~98%. For 1QFY20, new client acquisition grew ~104% YoY and Blackstone accounts grew ~55% YoY. Direct Core business delivered a healthy CQGR of 3.8% over the period 3QFY18 –1QFY20. Direct core posted a strong growth of 17.2% YoY CC in Q1FY20, strongest in last 2 years.

- **Mphasis has capability to grow DXC channel further:** DXC reported 4.5% revenue decline in US\$ terms in FY2019. The company has increased focus on cost optimization and has indicated cutting down on subcontractor spends and reduction in vendor count. Despite challenges faced by DXC, Mphasis is confident of gaining share and growing in the account. Management mentioned that spend is of \$3bn & they are still just at 10% of that spend. They will plan to use multiple levers such as insourcing etc to gain traction. Mphasis also does not expect pricing pressures from expiry of minimum revenue contribution in 2021 as per MSA with DXC due to the strategic nature of relationship.
- **Blackstone portfolio to grow further:** Blackstone has a very strong presence in the BFS segment. It spends ~ USD1.5b every year in the US BFS space. Revenues from Blackstone portfolio accounted to 6% of Mphasis's direct core revenues in Q1FY20 (5% in Q4FY19). Management expects Blackstone portfolio companies to reach 10% of its overall revenues over next few quarters.
- **Focus on talent management as technologies are changing rapidly:** Mphasis has developed technical trainings for ~25 competencies focusing on next age skills. Mphasis employees gets certifications & ranking based on this skill. Employees' progress on learning new skills is tracked on the company's Talent Next platform. The platform employs gamification elements to increase engagement. The platform also enables personalized skill development. Employees are given recommendations for new skills based on their existing capabilities and company requirements.

Exhibit 1: Shift in technology consumption

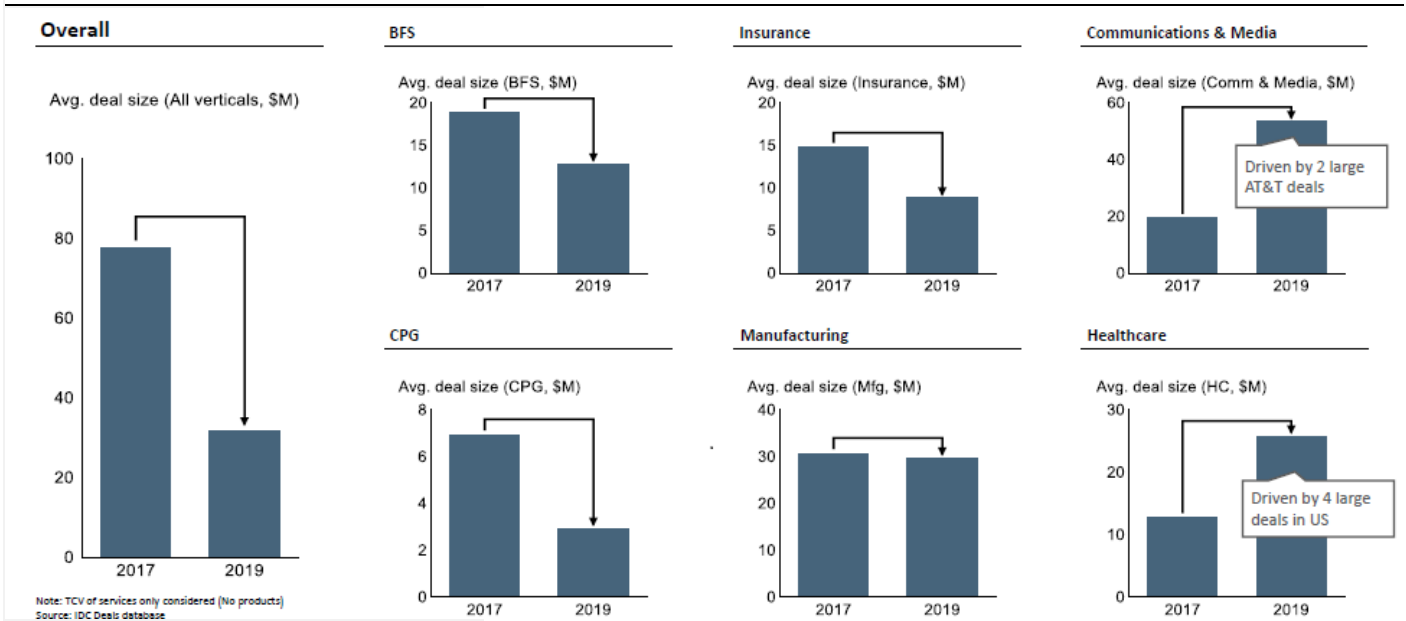
Global ITS market
US\$ billion



Source: Everest Group (2019)

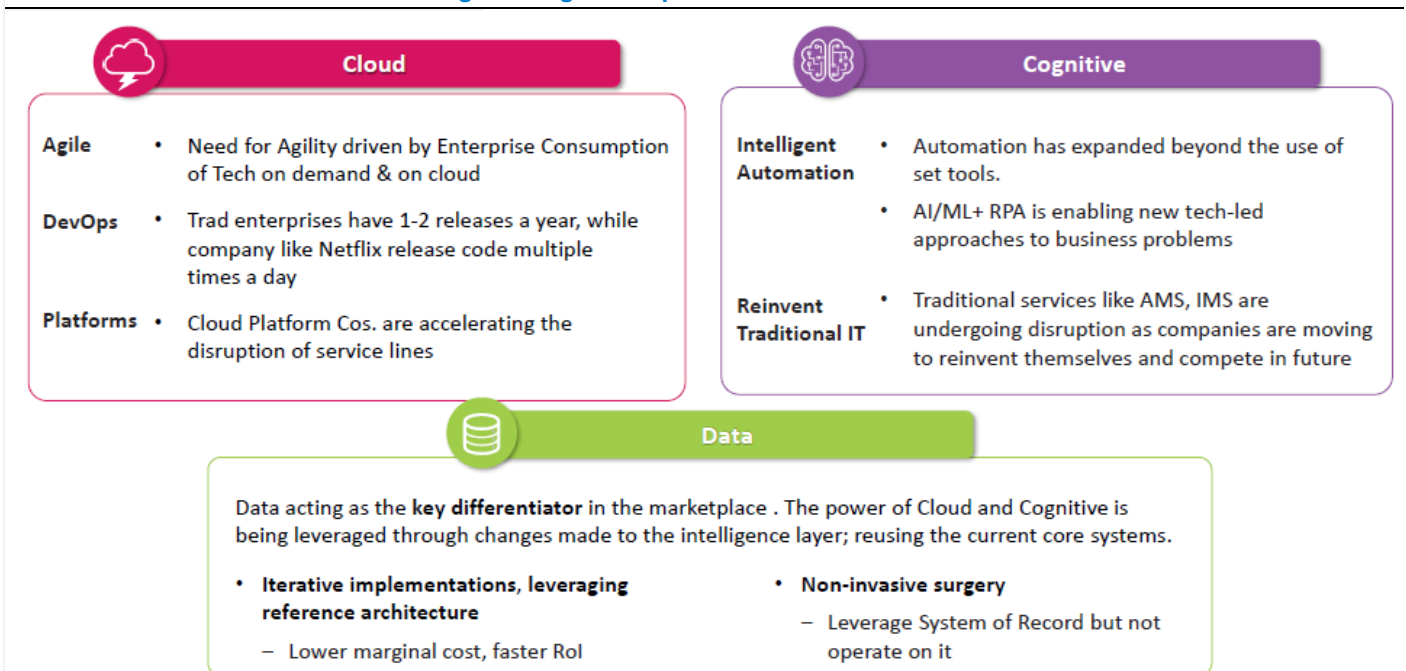
Source: Company, PL

Exhibit 2: Deal sizes have decreased in the last 2 years



Source: Company, PL

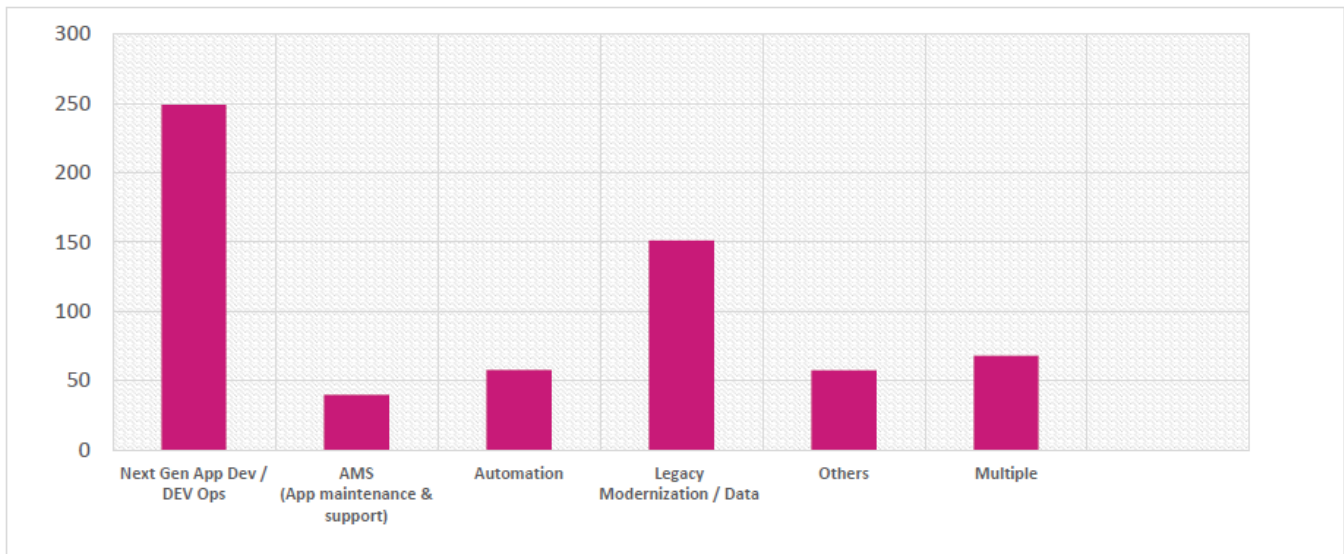
Exhibit 3: Industries are in Different Stages of Digital Adoption



Source: Company, PL

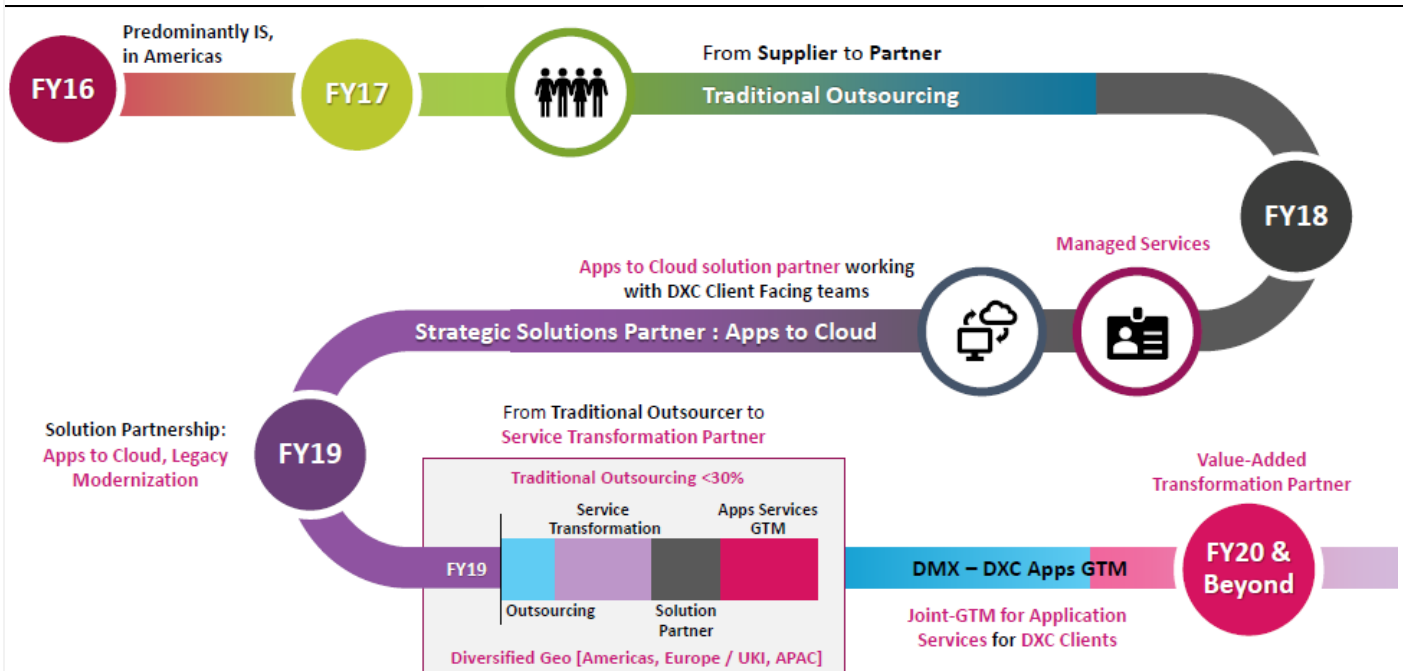
Exhibit 4: FY19 New Gen TCV Wins – By Tribes – DC

(In \$M)

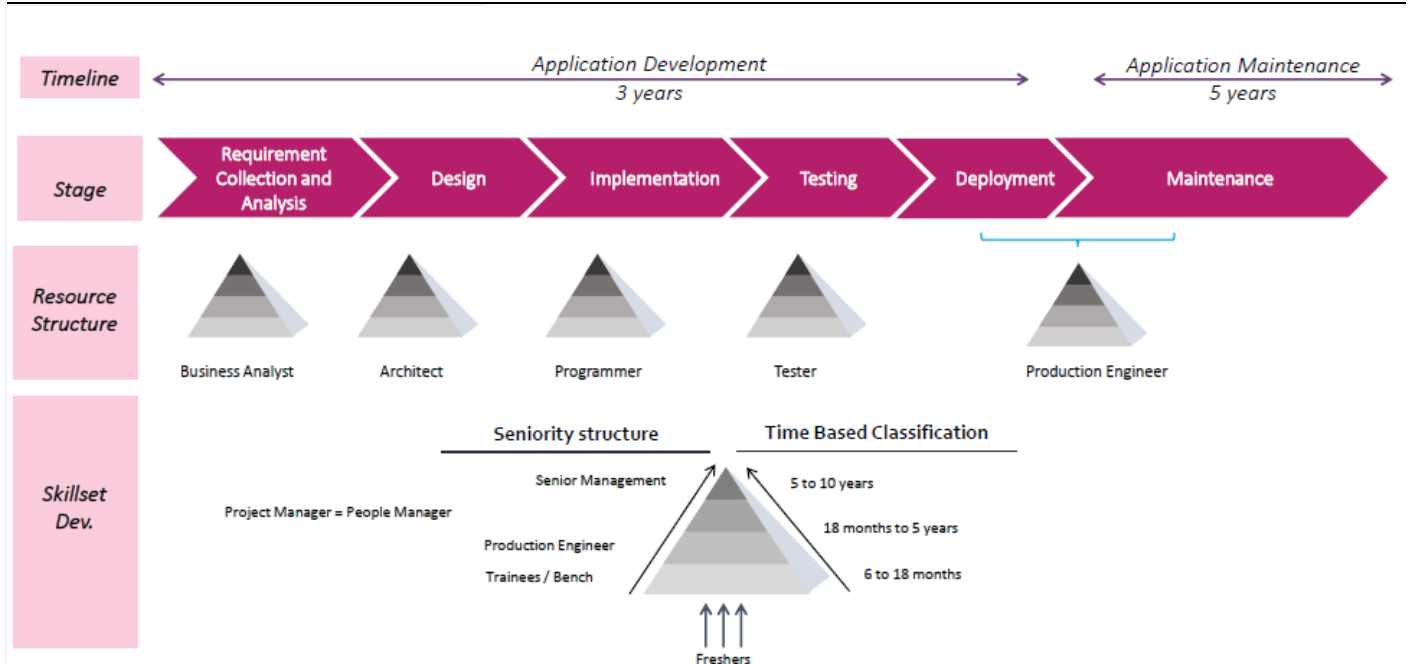


Source: Company, PL

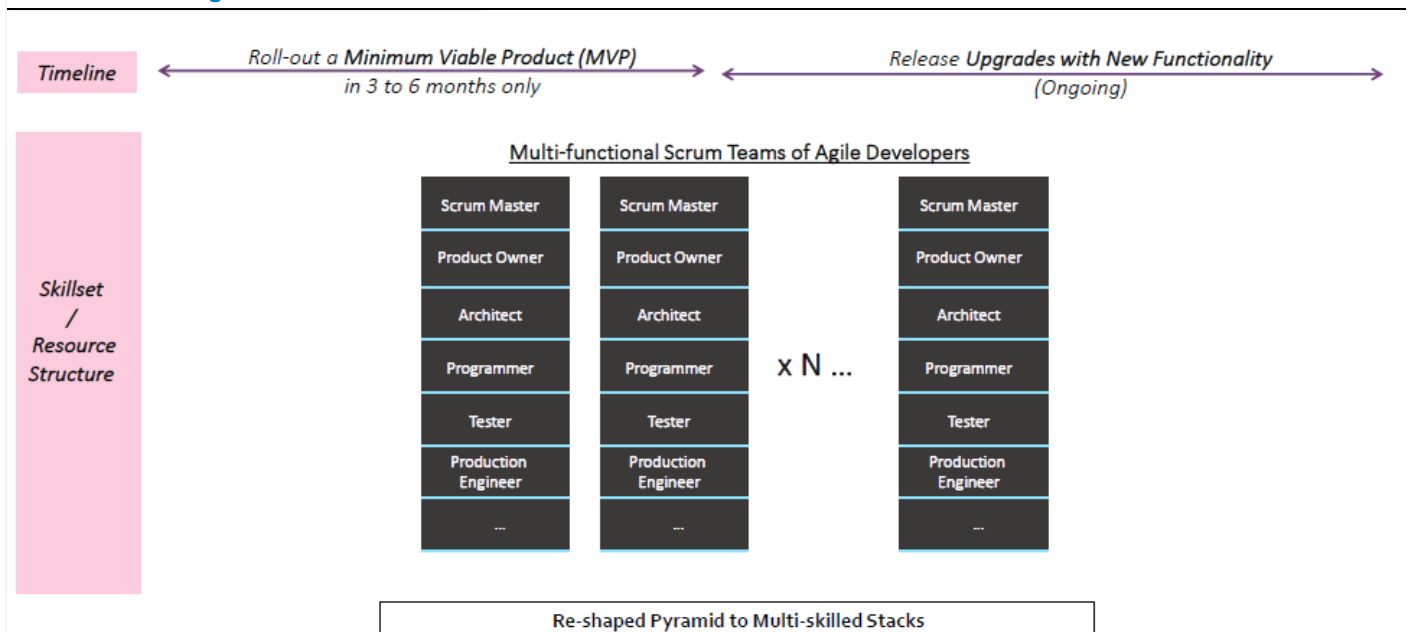
Exhibit 5: DXC-Mphasis Relationship Transformation



Source: Company, PL

Exhibit 6: Re-Skilling the Workforce: Traditional Systems Development Life Cycle (SDLC)


Source: Company, PL

Exhibit 7: Creating a Next Gen Talent Pool


Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
Net Revenues	65,458	77,310	87,995	99,541
YoY gr. (%)	7.7	18.1	13.8	13.1
Employee Cost	47,309	55,755	62,334	70,289
Gross Profit	18,149	21,555	25,660	29,252
Margin (%)	27.7	27.9	29.2	29.4
SG&A Expenses	3,333	3,529	4,501	5,274
Other Expenses	(33)	-	-	-
EBITDA	10,624	13,238	15,826	17,832
YoY gr. (%)	9.7	24.6	19.6	12.7
Margin (%)	16.2	17.1	18.0	17.9
Depreciation and Amortization	709	759	1,476	1,265
EBIT	9,915	12,479	14,351	16,567
Margin (%)	15.1	16.1	16.3	16.6
Net Interest	-	-	-	-
Other Income	1,490	1,592	1,389	1,748
Profit Before Tax	11,405	14,071	15,740	18,315
Margin (%)	17.4	18.2	17.9	18.4
Total Tax	2,900	3,339	4,023	4,718
Effective tax rate (%)	25.4	23.7	25.6	25.8
Profit after tax	8,505	10,732	11,717	13,596
Minority interest	-	20	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	8,505	10,712	11,717	13,596
YoY gr. (%)	6.4	25.9	9.4	16.0
Margin (%)	13.0	13.9	13.3	13.7
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	8,505	10,712	11,717	13,596
YoY gr. (%)	6.4	25.9	9.4	16.0
Margin (%)	13.0	13.9	13.3	13.7
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	8,505	10,712	11,717	13,596
Equity Shares O/s (m)	196	193	186	186
EPS (Rs)	43.3	55.4	62.9	73.1

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
Non-Current Assets				
Gross Block	6,955	7,357	8,391	9,144
Tangibles	6,955	7,357	8,391	9,144
Intangibles	-	-	-	-
Acc: Dep / Amortization	-	-	-	-
Tangibles	-	-	-	-
Intangibles	-	-	-	-
Net fixed assets	6,955	7,357	8,391	9,144
Tangibles	6,955	7,357	8,391	9,144
Intangibles	-	-	-	-
Capital Work In Progress	-	-	-	-
Goodwill	17,015	19,585	19,533	19,533
Non-Current Investments	-	-	-	-
Net Deferred tax assets	1,057	814	969	969
Other Non-Current Assets	5,367	4,925	10,900	10,900
Current Assets				
Investments	-	-	-	-
Inventories	-	-	-	-
Trade receivables	8,116	9,554	8,438	9,545
Cash & Bank Balance	21,719	17,116	21,788	30,625
Other Current Assets	-	-	-	-
Total Assets	69,853	73,711	82,337	94,650
Equity				
Equity Share Capital	1,932	1,862	1,863	1,863
Other Equity	52,886	50,636	57,359	66,818
Total Network	54,818	52,498	59,223	68,682
Non-Current Liabilities				
Long Term borrowings	-	-	-	-
Provisions	-	-	-	-
Other non current liabilities	1,016	1,275	6,595	6,595
Current Liabilities				
ST Debt / Current of LT Debt	-	-	-	-
Trade payables	14,020	19,937	16,519	19,373
Other current liabilities	-	-	-	-
Total Equity & Liabilities	69,853	73,711	82,337	94,650

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
PBT	11,405	14,071	15,740	18,315
Add. Depreciation	709	759	1,476	1,265
Add. Interest	130	155	259	80
Less Financial Other Income	1,490	1,592	1,389	1,748
Add. Other	-	-	-	-
Op. profit before WC changes	12,244	14,985	17,475	19,659
Net Changes-WC	4,766	446	(916)	130
Direct tax	(2,900)	(3,339)	(4,023)	(4,718)
Net cash from Op. activities	14,110	12,092	12,535	15,071
Capital expenditures	(8,365)	(3,731)	(2,458)	(2,017)
Interest / Dividend Income	-	-	-	-
Others	-	-	-	-
Net Cash from Invt. activities	(8,365)	(3,731)	(2,458)	(2,017)
Issue of share cap. / premium	(173)	(69)	1	-
Debt changes	-	-	-	-
Dividend paid	(4,648)	(6,045)	(4,137)	(4,137)
Interest paid	(130)	(155)	(259)	(80)
Others	(7,921)	(6,694)	(1,011)	-
Net cash from Fin. activities	(12,871)	(12,964)	(5,406)	(4,217)
Net change in cash	(7,127)	(4,602)	4,671	8,837
Free Cash Flow	5,744	8,361	10,077	13,054

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Net Revenue	19,149	19,710	20,250	20,626
YoY gr. (%)	19.3	18.7	16.1	7.7
Raw Material Expenses	13,770	14,204	14,815	14,771
Gross Profit	5,379	5,506	5,435	5,855
Margin (%)	28.1	27.9	26.8	28.4
EBITDA	3,329	3,306	3,404	3,743
YoY gr. (%)	33.5	20.6	10.0	12.4
Margin (%)	17.4	16.8	16.8	18.1
Depreciation / Depletion	184	196	200	550
EBIT	3,145	3,110	3,204	3,193
Margin (%)	16.4	15.8	15.8	15.5
Net Interest	-	-	-	-
Other Income	441	471	273	342
Profit before Tax	3,586	3,581	3,477	3,535
Margin (%)	18.7	18.2	17.2	17.1
Total Tax	877	801	815	888
Effective tax rate (%)	24.5	22.4	23.4	25.1
Profit after Tax	2,709	2,780	2,662	2,647
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	2,709	2,780	2,662	2,647
YoY gr. (%)	37.0	29.3	6.2	(2.3)
Margin (%)	14.1	14.1	13.1	12.8
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	2,709	2,780	2,662	2,647
YoY gr. (%)	37.0	29.3	6.2	(2.3)
Margin (%)	14.1	14.1	13.1	12.8
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	2,709	2,780	2,662	2,647
Avg. Shares O/s (m)	193	193	193	186
EPS (Rs)	14.0	14.4	13.8	14.2

Source: Company Data, PL Research

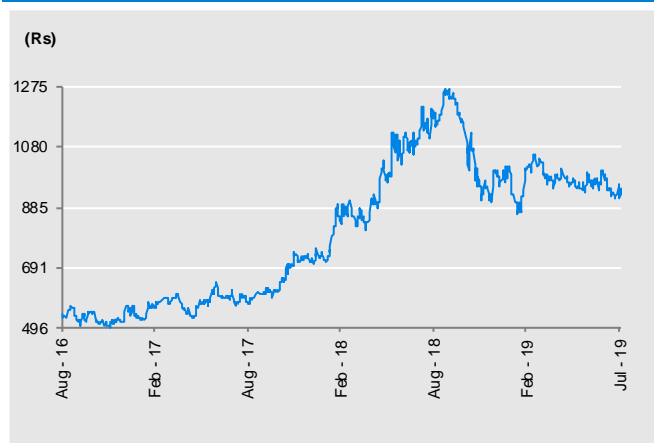
Key Financial Metrics

Y/e Mar	FY18	FY19	FY20E	FY21E
Per Share(Rs)				
EPS	43.3	55.4	62.9	73.1
CEPS	46.9	59.3	70.9	79.9
BVPS	279.2	271.5	318.2	369.0
FCF	29.3	43.2	54.1	70.1
DPS	19.7	26.0	19.0	19.0
Return Ratio(%)				
RoCE	17.0	23.3	25.7	25.9
ROIC	21.7	31.3	34.0	31.4
RoE	14.6	20.0	21.0	21.3
Balance Sheet				
Net Debt : Equity (x)	(0.4)	(0.3)	(0.4)	(0.4)
Debtor (Days)	45	45	35	35
Valuation(x)				
PER	22.2	17.3	15.3	13.1
P/B	3.4	3.5	3.0	2.6
P/CEPS	47.3	59.9	71.5	80.6
EV/EBITDA	15.7	12.7	9.9	8.3
EV/Sales	2.5	2.2	1.8	1.5
Dividend Yield (%)	2.0	2.7	2.0	2.0

Source: Company Data, PL Research

Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	26-Jul-19	Accumulate	1,042	930
2	4-Jul-19	Accumulate	1,111	994
3	10-Jun-19	Accumulate	1,111	955
4	28-May-19	Accumulate	1,111	952
5	5-Apr-19	Accumulate	1,090	975
6	25-Jan-19	Accumulate	1,260	921
7	7-Jan-19	Accumulate	1,220	925
8	21-Oct-18	Accumulate	1,220	1,068
9	5-Oct-18	Accumulate	1,250	1,148

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	Hold	500	544
2	HCL Technologies	BUY	1,210	1,023
3	Hexaware Technologies	Hold	347	371
4	Infosys	Accumulate	782	727
5	L&T Technology Services	Accumulate	1,693	1,599
6	Larsen & Toubro Infotech	Accumulate	1,701	1,576
7	Mindtree	Reduce	755	750
8	Mphasis	Accumulate	1,042	930
9	NIIT Technologies	Accumulate	1,445	1,354
10	Persistent Systems	Hold	520	561
11	Redington (India)	BUY	114	107
12	Sonata Software	Accumulate	400	352
13	Tata Consultancy Services	BUY	2,291	2,133
14	TeamLease Services	Hold	3,203	3,079
15	Tech Mahindra	Reduce	610	640
16	Wipro	Reduce	238	260
17	Zensar Technologies	Accumulate	260	217

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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