

Results inline; witness acceleration in TCV signings; Maintain Buy

- Results were inline with decline in revenues by about 4% QoQ in CC terms. OPM declined marginally given savings on sub-con costs (sustainable). PAT stood at Rs2.75bn inline (DE Rs2.74bn).
- Added new TCV of about US\$259mn in Q1 (best ever); taking the growth in order wins to 30% on TTM basis. Also, added a large deal win of about US\$216mn it signed in Jul'20 with tenure of three years.
- Company expect that the growth in Direct International will be led by robust TCV which should sustain given its good track record on deal wins (new logos) as well as improved mining, this along-with reducing exposure in DXC would ensure sustained financial outperformance.
- Improved growth would potential drive profitability up (guided OPM of 15.5%-16.5% for FY21) and strong payouts (yield of 4%). We assign Accumulate rating with TP of Rs 1180 valued at 16x FY22E earnings.

Strong deal wins to ensure sustained growth performance

Deal win traction is led by its key differentiation such as focus on Tech changes as clients are consuming tech differently and thus looking for different partner, also given its early engagement with the customer that requires loads of investments (architect, digital designer) that is driving its wins without RFPs **(80% of its TCV is proactively generated)**. Winning against very large players where they were long incumbents as clients are fielding both Challengers versus Champions in arena. Digital Risk turnaround is largely done with as it has made following changes in its approach. 1) improved wins given its integrated GTM selling model; 2) bundled transformation services in BFS segment and not just mortgage deals; 3) lower dependence on counter-cyclical deals such as refinancing in favour of home equity or origination deals. Revenues in HP-DXC channel declined 12% QoQ, however this softness was not surprising for the management as some of the decline was related to current environment at DXC's client end, so hereon it can focus on improving numbers over next few quarters (Pending MRC US\$250mn ending Sep'21)

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Revenue	22,882	20,626	10.9	23,462	(2.5)
Total Expense	18,716	16,883	10.9	19,021	(1.6)
EBITDA	4,166	3,743	11.3	4,441	(6.2)
Depreciation	583	550	6.0	609	(4.3)
EBIT	3,583	3,193	12.2	3,832	(6.5)
Other Income	378	541	(30.2)	526	(28.2)
Interest	195	199	(2.0)	207	(5.8)
EBT	3,766	3,535	6.5	4,151	(9.3)
Tax	1,015	888	14.3	618	64.2
RPAT	2,751	2,647	3.9	3,533	(22.1)
APAT	2,751	2,647	3.9	3,533	(22.1)
			(bps)		(bps)
Gross Margin (%)	28.9	29.9	(95)	31.1	(216)
EBITDA Margin (%)	18.2	18.1	6	18.9	(72)
NPM (%)	12.0	12.8	(81)	15.1	(304)
Tax Rate (%)	27.0	25.1	184	14.9	1207
EBIT Margin (%)	15.7	15.5	18	16.3	(67)

CMP	Rs 980
Target / Upside	Rs 1,180 / 20%
BSE Sensex	38,209
NSE Nifty	11,216

Scrip Details

Equity / FV	Rs 1,865mn / Rs 10
Market Cap	Rs 183bn
	US\$ 2bn
52-week High/Low	Rs 1,099/Rs 630
Avg. Volume (no)	286,826
NSE Symbol	MPHASIS
Bloomberg Code	MPHL IN

Shareholding Pattern Jun'20(%)

Promoters	52.2
MF/Banks/FIs	9.2
FIIIs	28.5
Public / Others	10.0

Valuation (x)

	FY20A	FY21E	FY22E
P/E	15.4	15.6	13.3
EV/EBITDA	10.7	10.0	8.6
ROE (%)	21.4	19.1	20.1
RoACE (%)	20.4	18.5	19.5

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	88,436	96,702	108,689
EBITDA	16,505	17,617	20,064
PAT	11,850	11,708	13,765
EPS (Rs.)	63.5	62.7	73.7

VP Research: Rahul Jain

Tel: +9122 40969771

E-mail: rahulj@dolatcapital.com

Associate: Divyesh Mehta

Tel: +91 22 40969768

E-mail: divyesh.mehta@dolatcapital.com

Exhibit 1: Quarterly performance versus estimates

(In Rs mn)	Actual	Estimates		% Variation		Comment
		Dolat	Consensus	Dolat	Consensus	
Revenues (in US\$ mn)	305	304	304	0.4	0.5	\$Revenue in-line with our estimates.
Sales	22,882	22,801	22,659	0.4	1.0	
EBIT	3,583	3,420	3,495	4.8	2.5	EBIT above estimates due to one-time savings in G&A & sub-con.
EBIT Margin (%)	15.7	15.0	15.4	70 bps	20 bps	
PAT	2,751	2,744	2,812	0.2	(2.2)	PAT in-line with estimates despite higher ETR :27%.

Source: Company, DART

Change in estimates

Factoring the robust deal signings (best ever) for the quarter and also for July'20, we have upgraded our growth estimates by 4%/6% respectively for FY21/22E. Also given its confident stance on OPM with its guided band of 15.5% to 16.5%, we have increased our OPM estimates marginally, resulting in earnings upgrade of about 1.5%/5.5% respectively for FY21/22E.

Exhibit 2: Change in estimates

(Rs mn)	FY20A Actual	FY21E			FY22E		
		Old	New	% change	Old	New	% Change
Revenues (US\$ mn)	1,239	1,239	1,282	3.5	1,343	1,429	6.4
YoY growth (%)	10.9	0.0	3.5		8.4	11.4	
Revenues	88,436	92,997	96,702	4.0	102,147	108,689	6.4
EBIT	14,189	14,374	15,073	4.9	16,269	17,231	5.9
EBIT Margin (%)	16.0	15.5	15.6		15.9	15.9	
Net profits	11,849	11,530	11,708	1.5	13,014	13,765	5.8
EPS (Rs)	63.6	61.9	62.8	1.5	69.8	73.8	5.7

Source: Company, DART

Exhibit 3: Key assumptions in our estimates

Metrics	FY21E	FY22E
Growth in Revenues (US\$ mn)	3.5	11.4
Growth in Direct International (US\$ mn)	10.6	14.7
Growth in DXC channel revenues (US\$ mn)	(15.5)	(0.7)
INR/US\$ rate	75.5	76.0

Source: Company, DART

Exhibit 4: Quarterly and Full Year Performance Trends

Rs mn	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	YoY (%)	QoQ (%)	YTD FY20	YTD FY21	YoY (%)
Revenue (in US\$ mn)	297	305	318	320	305	2.7	(4.6)	297	305	2.7
Revenue	20,626	21,581	22,767	23,462	22,882	10.9	(2.5)	20,626	22,882	10.9
Operating Expenditure	17,433	18,111	19,073	19,630	19,299	10.7	(1.7)	17,433	19,299	10.7
Cost of revenues	14,908	15,905	16,761	16,670	16,737	12.3	0.4	14,908	16,737	12.3
as % of sales	72.3	73.7	73.6	71.1	73.1			72.3	73.1	
SG&A expenses	2,525	2,206	2,312	2,960	2,562	1.5	(13.4)	2,525	2,562	1.5
as % of sales	12.2	10.2	10.2	12.6	11.2			16.9	15.3	
EBITDA	3,743	4,052	4,269	4,441	4,166	11.3	(6.2)	3,743	4,166	11.3
Depreciation	550	582	575	609	583	6.0	(4.3)	550	583	6.0
EBIT	3,193	3,470	3,694	3,832	3,583	12.2	(6.5)	3,193	3,583	12.2
Other Income	342	134	172	319	183	(46.6)	(42.8)	342	183	
PBT	3,535	3,604	3,866	4,151	3,766	6.5	(9.3)	3,535	3,766	6.5
Total Tax	888	871	929	618	1,015	14.3	64.2	888	1,015	14.3
Adjusted PAT	2,647	2,733	2,937	3,533	2,751	3.9	(22.1)	2,647	2,751	3.9
Reported PAT	2,647	2,733	2,937	3,533	2,751	3.9	(22.1)	2,647	2,751	3.9
Reported EPS	14.2	14.7	15.8	19.0	14.7	3.7	(22.2)	14.2	14.7	3.7

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	18.1	18.8	18.8	18.9	18.2	6	(72)	18.1	18.2	6
EBIT	15.5	16.1	16.2	16.3	15.7	18	(67)	15.5	15.7	18
EBT	17.1	16.7	17.0	17.7	16.5	(68)	(124)	17.1	16.5	(68)
PAT	12.8	12.7	12.9	15.1	12.0	(81)	(304)	12.8	12.0	(81)
Effective Tax rate	25.1	24.2	24.0	14.9	27.0	184	1,207	25.1	27.0	184

Source: DART, Company, Q1FY20, Q4FY20 are restated

What to expect next Quarter

Powered by robust deal signings in Q1 as well as large deal signing of US\$216mn in July'19, we believe that the Mphasis would witness significant momentum starting Q2. Thus, we expect 3% QoQ growth in revenues for Q2 and OPM gains of about 10bps at 15.8% as we expect the operating leverage gains would cover-up for some normalisation of Travel/G&A spends.

Exhibit 5: What to expect next Quarter

(Rs Mn)	Q2FY21E	Q1FY21	Q2FY20	QoQ (%)	YoY (%)
Sales (US\$ mn)	314.1	305.1	304.7	3.0%	3.1%
Sales	23,728	22,882	21,581	3.7%	10.0%
EBIT	3,749	3,583	3,470	4.6%	8.0%
PAT	2,913	2,751	2,733	5.9%	6.6%
EPS (Rs)	15.6	14.7	14.7	5.9%	6.4%
EBIT Margin (%)	15.8	15.7	16.1	14 bps	-28 bps

Source: DART, Company

Key Highlights

Strategic highlights

- **Long term Legacy Modernization:** It is done across applications infrastructure and data has seen massive acceleration which is creating an opportunity in terms of deals as company offerings zero cost transformation, as company take on larger bundle of client applications and apply this transformation to release, operating efficiency to reinvest in change areas, hence this has been a huge area of traction in the recent past. **App Services accounts 64% of its revenues.**
- **Technology Leadership:** Relentless focus on technology leadership using architecture & design, as well as transformation and the solution led approach to go-to-market, coupled with geographical diversification and industry vertical market focus is yielding good results in a direct core business for the company.
- **Proactive approach for pipeline generation:** Early engagement by Mphasis leads to improved pipeline origination and help client to think through the right problem to solve not letting them wait to put out an RFP. In the past, 80% of its new TCV has been generated through its proactive approach. As defining the problem and creating a competitive RFP backup process by client leads to longer sales cycles as well as competitive pricing pressure.
- **Restructuring the way business is being run in Digital Risk segment (11.7% of revenues):** 1) Integrated the entire client go to market, as part of company's direct channel as an integrated selling model. 2) Bundled a number of transformation services, along with mortgage operations. To create a sticky long-term transformational program which provides a better visibility. 3) Added cyclical and counter cyclical clients. **Cyclical clients:** are into refinance which are interest rate sensitive - interest rates go down, refinance volume rise. **Counter cyclical clients:** are into loan processing, home equities, which are counter cyclical to refinance, and also origination which is also counter cyclical to refinancing.

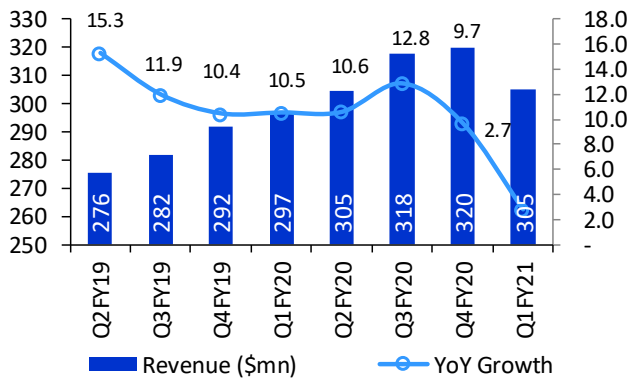
Financial highlights

- **Revenue:** \$Revenue declined 4.6% QoQ in Q1FY21 on CC basis. **Direct International** revenue (78% of Revenue) grew 10.8% YoY and declined 0.5% QoQ on CC basis. Within Direct International, **Direct Core** revenue (63% of revenue) grew 15.5% YoY and 0.5% QoQ on a reported basis and grew 6.9% YoY and declined 2.1% QoQ on CC basis. The growth momentum is likely to sustain as deal win momentum has accelerated.
- **DXC revenue** (20% of Revenue) declined 14.3% YoY and 15.8% QoQ on CC Basis due to decline in discretionary spends in DXC's clients. The cut in revenues are not surprising, despite the steep fall Mphasis expect traction can improve hereon as it is still able to win more wallet share of their total spends.
- **Profitability:** EBIT margin declined by 13bps on QoQ basis to 15.7% as against our expectations at 15% - margins were better led by savings in sub-contracting cost and Travel cost. Mphasis has guided for 15.5% to 16.5% EBIT Margin range for FY21. Margin confidence is led by sustained large deal momentum that should drive up top-line performance hereon.
- **Net profit** grew 3.9% YoY and declined 22.1% QoQ to Rs. 2.75Bn in Q1 FY21; inline with our estimates.
- **New TCV wins** of USD 259 million in Q1 FY21 in Direct International; highest ever TCV win for a quarter.

- **Cash Management:** Cash position continues to be strong and improved by Rs2.7bn during the quarter to INR 27.5bn (\$64mn). Net operating cash generated during the quarter was Rs 3.2bn, (\$42mn).
- **Vertical Commentary:** A strong growth momentum and positive outlook can be seen in key vertical Banking and capital markets, as this segment report a double digit growth of 12% consecutively QoQ. **Logistics and Transportation** vertical has grown at CAGR of 34% since Q1FY18 with robust growth shown in Emerging Industry segment. Sectors including banking, life insurance, consumer products, etc. are not much impacted and at the end are expected to recover much faster and such verticals are termed as companies' green zones. Around 66% of Mphasis revenue portfolio falls in the green zone with less than near term impact and faster recovery. The sluggish growth in **Insurance** was discretionary but sequential growth is expected in **BCM and Insurance** as their pipelines are getting converted.
- **Deal wins:** Added record deal wins of \$259 mn. Q1 FY21 deal wins include one deal of over \$100 million TCV. Have signed another large deal in July'20 of \$216 mn in TCV spread over three years. This is a global deal, covering multiple geographies, and spans across tech services and also its automation element.
- **Client mining:** In Q1 FY21, Mphasis added one client in the greater than \$100 mn bucket and three clients in the greater than \$25mn bucket since Q1FY18.

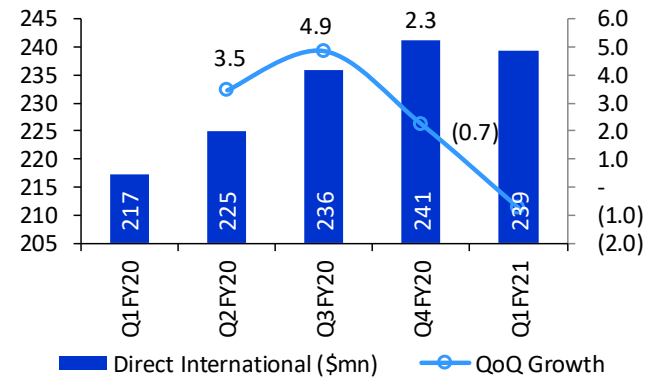
Story in Charts

Exhibit 6: Revenue growth YoY declined by 2.7% due to weakness in Insurance and Logistics Vertical



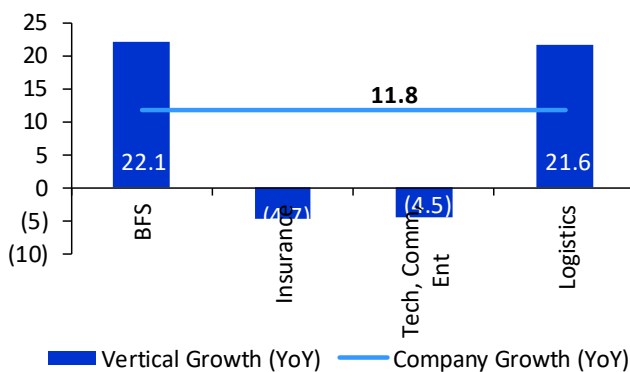
Source: Company, DART

Exhibit 7: Direct Intl. has largely been resilient in current environment with only 0.7% QoQ decline



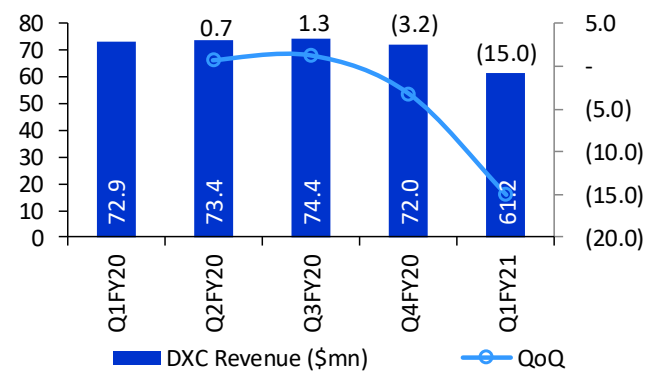
Source: Company, DART

Exhibit 8: Co. & Vertical wise YoY growth in Rs terms



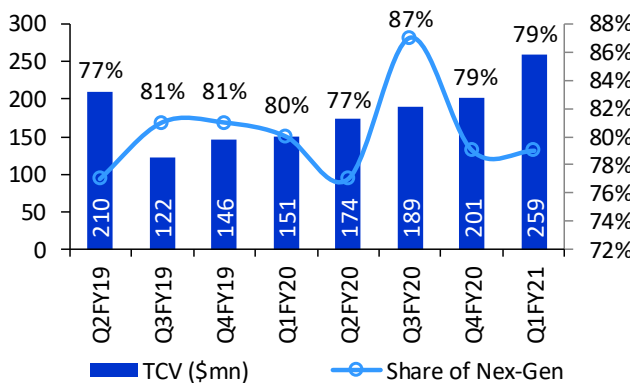
Source: Company, DART

Exhibit 9: DXC business revenue de-grew due to cut in discretionary spends in DXC's clients



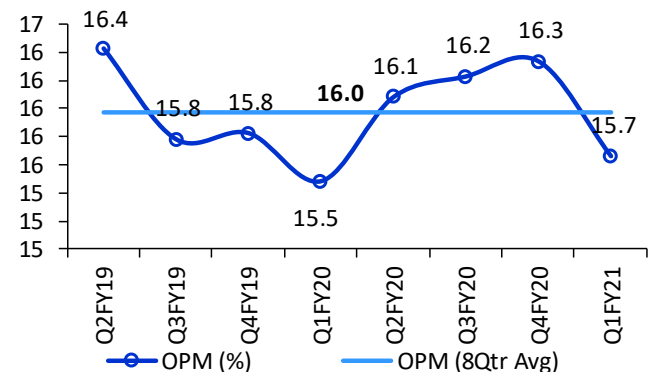
Source: Company, DART

Exhibit 10: TCV wins have been robust with \$259mn during the quarter including \$105mn large deal.



Source: Company, DART

Exhibit 11: EBIT Margin declined by 67bps QoQ within its guided band 15.5%-16.5% for FY21.



Source: Company, DART

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	77,311	88,436	96,702	108,689
Total Expense	64,071	71,931	79,085	88,625
COGS	55,648	61,928	68,255	76,616
Employees Cost	0	0	0	0
Other expenses	8,423	10,003	10,830	12,009
EBIDTA	13,240	16,505	17,617	20,064
Depreciation	759	2,316	2,544	2,833
EBIT	12,481	14,189	15,073	17,231
Interest	155	813	784	767
Other Income	1,747	1,780	1,421	1,890
Exc. / E.O. items	0	0	0	0
EBT	14,073	15,156	15,709	18,354
Tax	3,339	3,306	4,001	4,588
RPAT	10,734	11,850	11,708	13,765
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	10,734	11,850	11,708	13,765

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	1,862	1,865	1,866	1,867
Minority Interest	0	0	0	0
Reserves & Surplus	50,636	56,431	62,540	70,703
Net Worth	52,498	58,296	64,406	72,570
Total Debt	5,426	5,713	5,513	5,313
Net Deferred Tax Liability	1,366	567	623	686
Total Capital Employed	59,290	64,575	70,542	78,569

Applications of Funds

Net Block	21,711	30,228	29,169	27,931
CWIP	16	74	74	74
Investments	13,292	13,257	16,787	21,257
Current Assets, Loans & Advances	38,692	43,976	48,258	54,346
Inventories	0	0	0	0
Receivables	9,554	17,696	20,961	23,559
Cash and Bank Balances	6,416	11,257	11,863	14,858
Loans and Advances	0	0	0	0
Other Current Assets	22,722	15,024	15,435	15,929
Less: Current Liabilities & Provisions	14,421	22,959	23,746	25,039
Payables	7,850	6,667	7,029	7,876
Other Current Liabilities	6,570	16,293	16,717	17,163
<i>sub total</i>				
Net Current Assets	24,271	21,017	24,512	29,307
Total Assets	59,290	64,575	70,542	78,569

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	28.0	30.0	29.4	29.5
EBIDTA Margin	17.1	18.7	18.2	18.5
EBIT Margin	16.1	16.0	15.6	15.9
Tax rate	23.7	21.8	25.5	25.0
Net Profit Margin	13.9	13.4	12.1	12.7
(B) As Percentage of Net Sales (%)				
COGS	72.0	70.0	70.6	70.5
Employee	0.0	0.0	0.0	0.0
Other	10.9	11.3	11.2	11.0
(C) Measure of Financial Status				
Gross Debt / Equity	0.1	0.1	0.1	0.1
Interest Coverage	80.5	17.5	19.2	22.5
Inventory days	0	0	0	0
Debtors days	45	73	79	79
Average Cost of Debt	3.3	14.6	14.0	14.2
Payable days	37	28	27	26
Working Capital days	115	87	93	98
FA T/O	3.6	2.9	3.3	3.9
(D) Measures of Investment				
AEPS (Rs)	57.6	63.5	62.7	73.7
CEPS (Rs)	61.7	75.9	76.4	88.9
DPS (Rs)	27.0	25.0	25.0	25.0
Dividend Payout (%)	46.8	39.4	39.9	33.9
BVPS (Rs)	281.9	312.5	345.1	388.6
RoANW (%)	20.0	21.4	19.1	20.1
RoACE (%)	18.3	20.4	18.5	19.5
RoAIC (%)	23.7	26.7	26.9	28.2
(E) Valuation Ratios				
CMP (Rs)	980	980	980	980
P/E	17.0	15.4	15.6	13.3
Mcap (Rs Mn)	182,738	182,738	182,738	182,738
MCap/ Sales	2.4	2.1	1.9	1.7
EV	181,747	177,193	176,388	173,193
EV/Sales	2.4	2.0	1.8	1.6
EV/EBITDA	13.7	10.7	10.0	8.6
P/BV	3.5	3.1	2.8	2.5
Dividend Yield (%)	2.8	2.6	2.6	2.6
(F) Growth Rate (%)				
Revenue	18.1	14.4	9.3	12.4
EBITDA	24.6	24.7	6.7	13.9
EBIT	25.9	13.7	6.2	14.3
PBT	22.0	7.7	3.7	16.8
APAT	26.2	10.4	(1.2)	17.6
EPS	30.9	10.2	(1.2)	17.5

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	9,497	13,210	10,532	13,484
CFI	2,893	1,408	(4,383)	(4,945)
CFF	(13,042)	(8,238)	(5,544)	(5,544)
FCFF	8,682	11,967	9,047	11,889
Opening Cash	7,068	3,520	11,257	11,863
Closing Cash	6,416	9,901	11,863	14,858

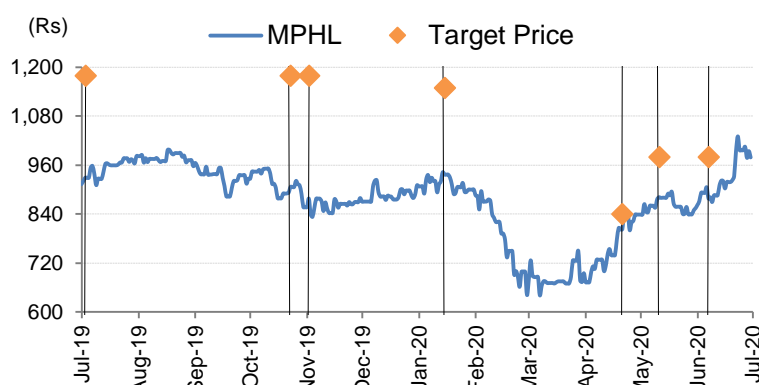
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jul-19	Buy	1,180	930
Nov-19	Buy	1,180	907
Nov-19	Buy	1,180	879
Feb-20	Buy	1,150	937
May-20	Buy	840	803
Jun-20	Accumulate	980	882
Jun-20	Accumulate	980	879

*Price as on recommendation date

DART Team

Purvag Shah	Managing Director	purvag@dolatcapital.com	+9122 4096 9747
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Amit Khurana, CFA	Head of Equities	amit@dolatcapital.com	+9122 4096 9745
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CONTACT DETAILS

Equity Sales	Designation	E-mail	Direct Lines
Dinesh Bajaj	VP - Equity Sales	dineshb@dolatcapital.com	+9122 4096 9709
Kapil Yadav	VP - Equity Sales	kapil@dolatcapital.com	+9122 4096 9735
Yomika Agarwal	VP - Equity Sales	yomika@dolatcapital.com	+9122 4096 9772
Jubbin Shah	VP - Derivatives Sales	jubbins@dolatcapital.com	+9122 4096 9779
Ashwani Kandoi	AVP - Equity Sales	ashwanik@dolatcapital.com	+9122 4096 9725
Lekha Nahar	AVP - Equity Sales	lekhan@dolatcapital.com	+9122 4096 9740
Pooja Soni	Manager - Institutional Sales	poojas@dolatcapital.com	+9122 4096 9700
Equity Trading	Designation	E-mail	
P. Sridhar	SVP and Head of Sales Trading	sridhar@dolatcapital.com	+9122 4096 9728
Chandrakant Ware	VP - Sales Trading	chandrakant@dolatcapital.com	+9122 4096 9707
Shirish Thakkar	VP - Head Domestic Derivatives Sales Trading	shirisht@dolatcapital.com	+9122 4096 9702
Kartik Mehta	Asia Head Derivatives	kartikm@dolatcapital.com	+9122 4096 9715
Dinesh Mehta	Co- Head Asia Derivatives	dinesh.mehta@dolatcapital.com	+9122 4096 9765
Bhavin Mehta	VP - Derivatives Strategist	bhavinm@dolatcapital.com	+9122 4096 9705

Dolat Capital Market Private Limited.

Sunshine Tower, 28th Floor, Senapati Bapat Marg, Dadar (West), Mumbai 400013

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Registered office: Office No. 141, Centre Point, Somnath, Daman – 396 210, Daman & Diu

Board: +9122 40969700 | Fax: +9122 22651278 | Email: research@dolatcapital.com | www.dolatresearch.com
