23 September 2021

# Mphasis

Rating: Buy
Target Price: Rs.3,740
Share Price: Rs.3,247

*Blink to bolster Mphasis' experience competencies: retaining a Buy*

**Mphasis acquired Seattle-based Blink UX for $94m plus retention-payouts over the next two years. Founded in 2000, Blink is into customer research, user design and customer experience, essentially strengthening Mphasis' value proposition in engineering/product design and in customer-facing industries such as BFSI. It brings a reputed set of clients (leaders across sectors) with whom it shares long-tenured relations. Margins take a hit over the next two years but expect stabilisation thereafter. No change in overall margin guidance band despite the acquisition. We maintain a Buy.**

**Blink provides access to marquee clients and design capabilities.** Blink brings customer-facing design capabilities to Mphasis, augmenting latter's focus on building a greater presence in the Hi-Tech vertical. Its capabilities are recognized by Gartner/Forrester and will help Mphasis in other consumer-facing industries as well. It immediately gives Mphasis access to 65 clients (with limited overlap to its existing accounts) which include Microsoft, Amazon, Facebook, Apple, Google, Nike, Mastercard and Starbucks among others. The long 10-year tenure with clients reflects high repeat business.

**Blink is not margin dilutive, adj. for retention payouts.** Blink is expected to clock $33m-35m revenues in CY21 (a 42% CAGR over FY17-FY20), including some acquisitions. It delivers all its services onsite and still has better gross margins than Mphasis. At the EBITDA level, it has margins similar to Mphasis' onsite business. However, Mphasis' EBIT margin is expected to take a ~100bp hit in the next two years (transitory!) as retention-payouts (for two years) and amortization (of intangibles over five years) take effect. Overall, Mphasis is keeping the guidance margin band unchanged, as growth and synergies may offset some of these costs over medium term.

**Maintaining a Buy.** The acquisition is consistent with both Mphasis' strategy and size (Blink is <3% of revenue, profitable). Revised estimates reflect higher D&A, lower other income, and retention payouts. In exchange, new clients and new services open up for Mphasis, offering longer growth potential. Reflecting this, we raise our target to Rs3,740, at 45x FY23 (from 35x earlier).

| Key financials (YE Mar) | FY19 | FY20 | FY21 | FY22e | FY23e |
|---|---|---|---|---|---|
| Sales (Rs m) | 78,194 | 88,239 | 96,920 | 112,653 | 128,298 |
| Net profit (Rs m) | 10,734 | 11,850 | 12,166 | 13,790 | 15,505 |
| EPS (Rs) | 56.1 | 63.4 | 65.1 | 73.7 | 82.9 |
| P/E (x) | 57.8 | 51.1 | 49.8 | 44.0 | 39.1 |
| EV / EBITDA (x) | 42.2 | 36.6 | 33.6 | 30.1 | 26.2 |
| P/BV (x) | 11.8 | 10.6 | 9.5 | 8.8 | 8.2 |
| RoE (%) | 20.0 | 21.4 | 19.7 | 20.4 | 21.3 |
| RoCE (%) | 17.1 | 16.6 | 15.0 | 15.5 | 17.2 |
| Dividend yield (%) | 0.8 | 1.1 | 2.0 | 1.5 | 1.7 |
| Net debt / equity (x) | -0.3 | -0.3 | -0.4 | -0.3 | -0.3 |

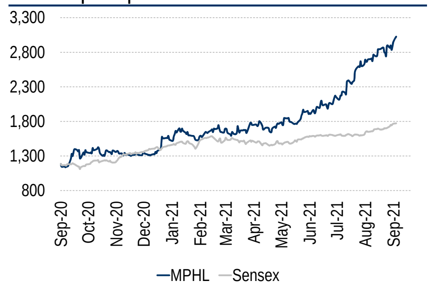
*Source: Company, Anand Rathi Research*

| Key data | MPHL IN / MBFL.BO |
|---|---|
| 52-week high / low | Rs.3303 / 1233 |
| Sensex / Nifty | 58927 / 17547 |
| 3-m average volume | $31.2m |
| Market cap | Rs.609bn / $8237.9m |
| Shares outstanding | 187m |

| Shareholding pattern (%) | Jun'21 | Mar'21 | Dec'20 |
|---|---|---|---|
| Promoters | 56.0 | 56.0 | 56.1 |
| *- of which, Pledged* | - | - | - |
| Free float | 44.0 | 44.0 | 43.9 |
| - Foreign institutions | 20.8 | 21.8 | 22.8 |
| - Domestic institutions | 18.5 | 17.2 | 16.0 |
| - Public | 4.8 | 5.0 | 5.2 |

| Estimates revision (%) | FY22e | FY23e |
|---|---|---|
| Sales ($) | 1.5 | 3.6 |
| EBIT | (3.4) | (4.0) |
| PAT | (4.6) | (7.3) |

Relative price performance




*Source: Bloomberg*

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# Quick Glance – Financials and Valuations

## Fig 1 – Income statement (Rs m)

| Year-end: Mar | FY19 | FY20 | FY21 | FY22e | FY23e |
|---|---|---|---|---|---|
| Revenues ($ m) | 1,118 | 1,240 | 1,309 | 1,528 | 1,741 |
| *Growth (%)* | *13* | *11* | *6* | *17* | *14* |
| Net revenues | 78,194 | 88,239 | 96,920 | 112,653 | 128,298 |
| Employee & direct costs | 57,840 | 65,093 | 71,244 | 84,135 | 96,295 |
| Gross profit | 20,354 | 23,146 | 25,676 | 28,518 | 32,003 |
| *Gross margins %* | *26.03* | *26.23* | *26.49* | *25.31* | *24.94* |
| SG&A | 6,231 | 6,838 | 7,951 | 8,703 | 9,228 |
| EBITDA | 14,123 | 16,308 | 17,725 | 19,815 | 22,775 |
| *EBITDA margins (%)* | *18.1* | *18.5* | *18.3* | *17.6* | *17.8* |
| - Depreciation | 759 | 2,316 | 2,418 | 2,808 | 3,120 |
| Other income | 864 | 1,977 | 1,632 | 2,218 | 1,459 |
| Interest expenses | 155 | 813 | 634 | 628 | 440 |
| PBT | 14,073 | 15,156 | 16,305 | 18,597 | 20,674 |
| *Effective tax rate (%)* | *24* | *22* | *25* | *26* | *25* |
| + Associates / (Minorities) | - | - | - | - | - |
| Net income | 10,734 | 11,850 | 12,166 | 13,790 | 15,505 |
| WANS | 191 | 187 | 187 | 187 | 187 |
| FDEPS (Rs / sh) | 56.1 | 63.4 | 65.1 | 73.7 | 82.9 |

## Fig 2 – Balance sheet (Rs m)

| Year-end: Mar | FY19 | FY20 | FY21 | FY22e | FY23e |
|---|---|---|---|---|---|
| Share capital | 1,862 | 1,865 | 1,870 | 1,870 | 1,870 |
| Net worth | 52,498 | 58,296 | 65,267 | 70,079 | 75,258 |
| Debt | 5,426 | 5,713 | 5,135 | 4,621 | 4,159 |
| Minority interest | - | - | - | - | - |
| DTL / (Assets) | -5,718 | -6,646 | -6,172 | -6,172 | -6,172 |
| Capital employed | 52,206 | 57,363 | 64,230 | 68,528 | 73,246 |
| Net tangible assets | 1,202 | 7,936 | 7,795 | 7,015 | 6,189 |
| Net intangible assets | 924 | 887 | 1,074 | 7,441 | 6,817 |
| Goodwill | 19,585 | 21,405 | 21,326 | 21,326 | 21,326 |
| CWIP (tang. & intang.) | 16 | 74 | 31 | 31 | 31 |
| Investments (strategic) | | | | | |
| Investments (financial) | 13,292 | 13,257 | 18,460 | 14,768 | 11,815 |
| Current assets (excl. cash) | 26,231 | 25,679 | 27,923 | 30,931 | 34,893 |
| Cash | 6,416 | 11,257 | 10,622 | 10,955 | 17,000 |
| Current liabilities | 15,460 | 23,132 | 23,003 | 23,939 | 24,825 |
| Working capital | 10,771 | 2,547 | 4,921 | 6,993 | 10,069 |
| Capital deployed | 52,206 | 57,363 | 64,230 | 68,528 | 73,246 |
| Contingent liabilities | 18,296 | 17,144 | - | - | - |

## Fig 3 – Cash-flow statement (Rs m)

| Year-end: Mar | FY19 | FY20 | FY21 | FY22e | FY23e |
|---|---|---|---|---|---|
| PBT | 14,073 | 15,156 | 16,305 | 18,597 | 20,674 |
| + Non-cash items | 272 | 1,592 | 2,142 | 1,654 | 2,101 |
| Oper. prof. before WC | 14,345 | 16,748 | 18,447 | 20,251 | 22,775 |
| - Incr. / (decr.) in WC | 1,421 | -422 | 453 | 2,321 | 3,098 |
| Others incl. taxes | -3,427 | -3,960 | -3,448 | -4,558 | -5,146 |
| Operating cash-flow | 9,497 | 13,210 | 14,545 | 13,373 | 14,530 |
| - Capex (tang. + intang.) | 849 | 1,261 | 1,262 | 1,466 | 1,670 |
| Free cash-flow | 8,648 | 11,949 | 13,284 | 11,906 | 12,860 |
| Acquisitions | -1,696 | - | -805 | -6,928 | - |
| - Div.(incl. buyback & taxes) | 14,604 | 6,065 | 6,527 | 8,979 | 10,326 |
| + Equity raised | 104 | 151 | 268 | - | - |
| + Debt raised | 1,246 | -224 | -409 | -513 | -462 |
| - Fin investments | -5,099 | -2,440 | 6,358 | -3,692 | -2,954 |
| - Misc. (CFI + CFF) | -552 | 3,410 | 87 | -1,154 | -1,019 |
| Net cash-flow | -651 | 4,841 | -635 | 332 | 6,045 |

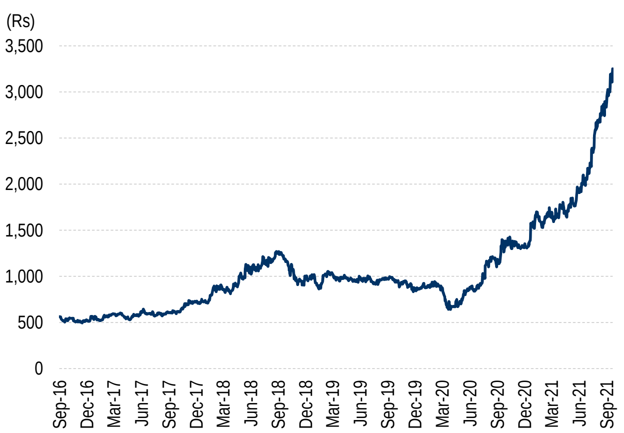
*Source: Company, Anand Rathi Research*

## Fig 4 – Ratio analysis

| Year-end: Mar | FY19 | FY20 | FY21 | FY22e | FY23e |
|---|---|---|---|---|---|
| P/E (x) | 57.8 | 51.1 | 49.8 | 44.0 | 39.1 |
| EV / EBITDA (x) | 42.2 | 36.6 | 33.6 | 30.1 | 26.2 |
| EV / Sales (x) | 7.6 | 6.7 | 6.0 | 5.2 | 4.5 |
| P/B (x) | 11.8 | 10.6 | 9.5 | 8.8 | 8.2 |
| RoE (%) | 20.0 | 21.4 | 19.7 | 20.4 | 21.3 |
| RoCE (%) - after tax | 17.1 | 16.6 | 15.0 | 15.5 | 17.2 |
| RoIC (%) - after tax | 27.4 | 24.9 | 23.2 | 23.5 | 25.2 |
| DPS (Rs / sh) | 27.0 | 35.0 | 65.0 | 48.0 | 55.2 |
| Dividend yield (%) | 0.8 | 1.1 | 2.0 | 1.5 | 1.7 |
| Dividend payout (%) - incl. DDT | 148.5 | 66.3 | 119.8 | 65.1 | 66.6 |
| Net debt / equity (x) | -0.3 | -0.3 | -0.4 | -0.3 | -0.3 |
| Receivables (days) | 86 | 73 | 70 | 69 | 69 |
| Inventory (days) | - | - | - | - | - |
| Payables (days) | 45 | 34 | 27 | 27 | 27 |
| CFO : PAT % | 88.5 | 111.5 | 119.6 | 97.0 | 93.7 |

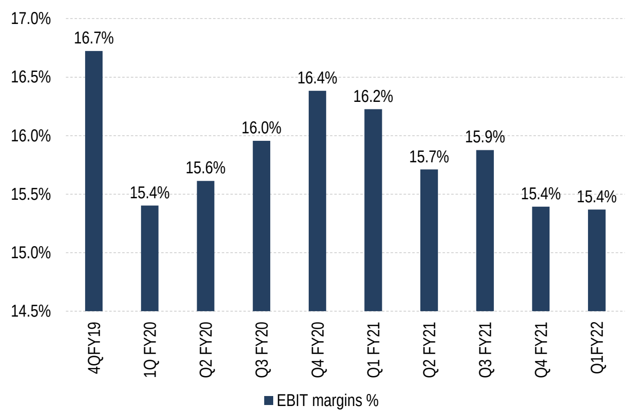
*Source: Company, Anand Rathi Research*

## Fig 5 – Price movement




*Source: Bloomberg*

## Fig 6 – EBIT margins




*Source: Company, Anand Rathi Research*

# Blink Interactive adds capabilities

**About Blink Interactive**

Blink offers market research, prototype and design services, which can be utilized by its clients looking to introduce new products. These services are particularly valuable for consumer-facing businesses.

Examples of assignments include:

1) Increase in customer satisfaction ratings or volumes by designing better user interfaces.

2) Designing an interface which would still be familiar to the older generation but would also feature all the new things, making it quite a modern interface.

3) Designing an interface which is unique to each user/role and is more aligned to his/her responsibilities rather than the traditional way of providing the same interface to all staff.

From a growth perspective, Blink regularly features in the top-5,000 fastest-growing private companies.

Has won recognitions (San Francisco Design Week, Gartner in Design Systems 2020) for its design capabilities.

Blink has ~130 employees and is likely to generate $35m revenue (at the top end) for FY22/CY21. This translates to revenue per employee of $270,000, ~5.5x that of Mphasis. Blink generates all its revenues from the US and delivers its services from onsite locations.

**Impressive clientele**

Blink designs interfaces; hence, assignment sizes are not comparable to IT. In CY20, it had 65 clients; assuming that the number of clients would have been stable in CY21, it is aiming at generating $36m revenue, translating to $0.5m average revenue per client. It has more than 10-year relations with many clients:

1) Amazon, 13 years +

2) Microsoft, 18 years +

3) Starbucks, 11 years +

So, the repeat business is high and, given its rich clientele, Mphasis now has an opportunity to offer more of its services to these new sets of clients. The overlap in clients is limited to a few in BFSI and Hi-Tech. Blink, on the other hand, has clients across industries such as aerospace, apparel, retail CPG, education, entertainment, government, healthcare, industrials, music, publishing, QSR, e-commerce, sports, telecoms and travel, some of which may offer fresh growth opportunities for Mphasis.

**Financials**

Mphasis has bought Blink for $94m, a large part of which is payable immediately. This values Blink at 2.7x-2.8x CY21 sales.

Besides, there are retention pay-outs which will be routed through the P&L over the next two years. Mphasis expects the payouts to be in the range of ~50bps of EBIT margins. In totality, Blink is estimated to be valued at ~3x

CY21 sales, which appears reasonable given its growth potential and client list.

Blink is a highly onsite-centric business from a delivery perspective; despite that, it enjoys better gross margins than Mphasis' onsite business. Currently, Blink also incurs higher SG&A to fuel growth but its EBITDA margins appear to be better than those of Mphasis' onsite business, largely driven by high revenue productivity.

Blink was founded in 2000; hence, from a scalability perspective, it has seen a pickup only in the last few years.

### Impact on Mphasis and synergies

Mphasis expects its margins to be ~100bps lower after integration with Blink. This includes a ~50bp impact from retention payouts in the next two years. From the third year (FY25), margins will bounce back to the extent of these pay-outs. Besides, faster growth may help Mphasis offset this impact by then.

The acquisition will be funded through internal accruals; therefore, Mphasis may see lower other income till reserves build up again. Also, the company will allocate intangible assets from the total consideration and these intangibles will be amortised over five years. We have considered this in our revised D&A estimates.

Blink will continue to operate as an independent entity and will retain the founders, leadership and design-oriented workforce. Mphasis expects revenue synergies to play out in BFSI and Hi-Tech, where it plans to sell Blink-related services to its larger BFSI and Hi-Tech clients. Mphasis' 70% of the deal pipeline has opportunities to cross-sell/embed Blink's services. Besides, it will make efforts to mine clients to cross-sell some of its services to the now-enlarged client base.

Here is the representative list of clients for Blink:

Fig 7 – Clients list

| | BFSI | IT, Communication & Entertainment |
|---|---|---|
| 1 | American Express | Dell |
| 2 | Capital One | Facebook |
| 3 | JPMorgan Chase | GE |
| 4 | Mastercard | Bang & Olufsen / HARMAN |
| 5 | Edelman Financial Engines | Deere & Company |
| 6 | Robinhood | Amazon Web Services (AWS) |
| 7 | Liberty Mutual | Apple |
| 8 | Silicon Valley Bank | Qualtrics |
| 9 | USAA | Adobe |
| 10 | Fiserv | Adobe |

*Source: Company*

# Conference Call Highlights

## Acquisition conference-call highlights

- The target entities, co-founders Karen Clark Cole (CEO) and Kelly Franznick (CIO) have 21 years' work experience.
- Blink has aided in developing user experience for the Starbucks app, Amazon Alexa, Xbox 360; it thereby enjoys strong capabilities in customer-facing applications.
- Blink is expected to register $33m-35m CY21 revenue, a 42% revenue CAGR over FY17-20. The growth rate inclusive of two acquisitions on the design side as Blink is strong in research
- Blink has 65 clients (CY20) and has long tenured (10 year+) relations with many of them.
- Within Mphasis, BFSI and Hi-Tech verticals are likely to gain the most from this acquisition.
- Retaining the current leadership, which averages 20+ years' experience; for this, retention-payouts are structured over the next two years.
- The company delivers mostly onsite; despite this, gross margins are high, reflecting quality of revenue
- Management expects a 100bp impact to EBIT for two years due to performance-based retention and the amortisation cost which will normalise ahead. The charge is equally divided between retention-payout and amortisation. The charge is over two years and intangibles amortization is over five years.
- Blink has 130+ employees.
- Retention to be paid in cash over two years, which is above and beyond the $94m consideration
- Hi-Tech integration to be done at end-FY22 or start of FY23.

## Q1 FY22 concall highlights

- Q1 growth was broad-based, not dependent on any large deal or segment. Therefore, the pace is likely to continue.
- Expansion in Canada (setting up a new centre in Calgary in partnership with the government of Alberta and the University of Calgary); also plans to expand in Europe.
- NCA (New Client Acquisition) program has a dedicated leadership, with a focus on the BFSI, Hi-Tech, Healthcare and Travel verticals.
- Hi-tech to become the next $100m vertical for Mphasis.
- The top-10 US banks by assets are now Mphasis' clients
- DXC is likely to reach mid-high single digits in revenue concentration at end-FY22
- Added two clients in the $100m category, and two in $50m. Conversion of clients to higher buckets is accelerating.
- Europe pipeline strong; the region to be a growth driver in FY22 and beyond.

- TCV of $505m, an all-time high (including a large $250m deal). This deal is of 10 years. Hence, huge deal revenue expected from Q3. The average deal tenure moved toward 2-3 years. Most deals are transformation-led.
- Average deal size: $96m. Mphasis is seeing larger and longer deals.
- In Q1, it absorbed the higher cost of revenue and unexpected Covid'19-related expenses. It still sustained margins by moderating discretionary SG&A expenses. This, as a lever, is available for FY22.
- Value-based pricing to absorb supply-side driven margin pressures. The company is looking to raise prices when contracts provide opportunities.
- Unbilled days were 35 out of 61 of DSO (in line with previous figures). The trend is not expected to differ from previous years.
- Tailwinds in margins from foreign exchange if the exchange rate holds at current levels.

### Business Outlook

- Industry-leading growth in Direct in FY22; expects top-quartile growth overall.
- Margins to be maintained at 15.5-17%.
- For M&A not looking at just Europe; open to new markets. Intent to do so in FY22; looking at strategic/tuck-in size (sub-10/-15% of revenue).

# Factsheet

Fig 8 – Revenue-split, by market segment (%)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| DXC | 20 | 16 | 13 | 12 | 9 |
| Direct | 80 | 84 | 87 | 88 | 91 |
| Direct core (of Mphasis) | 63 | NA | NA | NA | NA |

*Source: Company, Anand Rathi Research*

Fig 9 – Revenue-split, by industry (%)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| Banking and Capital markets | 49 | 53 | 53 | 50 | 51 |
| Insurance | 10 | 10 | 10 | 10 | 9 |
| Information technology | 14 | 12 | 13 | 15 | 14 |
| Logistics & Transportation | 14 | 12 | 13 | 13 | 14 |
| Others | 13 | 13 | 11 | 12 | 11 |

*Source: Company, Anand Rathi Research*

Fig 10 – Revenue split, by service line (%)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| Application Services | 64 | 59 | 56 | 60 | 62 |
| Business Process Services | 21 | 27 | 29 | 26 | 27 |
| Infrastructure Services | 15 | 14 | 15 | 14 | 11 |

*Source: Company, Anand Rathi Research*

Fig 11 – Revenue-split, by region (%)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| North America | 77 | 78 | 78 | 76 | 76 |
| India | 4 | 5 | 5 | 5 | 5 |
| APAC (RoW) | 7 | 6 | 5 | 6 | 7 |
| EMEA | 12 | 11 | 12 | 13 | 12 |

*Source: Company, Anand Rathi Research*

Fig 12 – Key service line and geographic growth (%)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| Top-five horizontal growth (y/y) | | | | | |
| Application Maintenance & Other Services | 1 | -1 | -4 | 0 | 15 |
| Infrastructure Management Services | -22 | -24 | -25 | -16 | -13 |
| Business Process Services | 44 | 78 | 68 | 55 | 53 |
| | | | | | |
| Y/Y key geographic growth (%) | | | | | |
| North America | 2 | 5 | 5 | 6 | 17 |
| India | -18 | 7 | 5 | 7 | 49 |
| APAC (RoW) | 20 | 29 | 5 | 7 | 19 |
| EMEA | 3 | 18 | 5 | 16 | 19 |

*Source: Company, Anand Rathi Research*

### Fig 13 – Revenue-split, by delivery type and billing (%)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| On-site | 60.0 | 59.0 | 58.0 | 57.0 | 59.0 |
| Offshore | 40.0 | 41.0 | 42.0 | 43.0 | 41.0 |
| | | | | | |
| T&M | 59 | 59 | 59 | 57 | 58 |
| FP | 26 | 25 | 24 | 27 | 26 |
| Transaction-based | 15 | 16 | 17 | 16 | 16 |

*Source: Company, Anand Rathi Research*

### Fig 14 – Direct client profiles (LTM)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| Client concentration, % | | | | | |
| Top-1 | 12.0 | 12.0 | 11.0 | 10.0 | 11.0 |
| Top-5 | 39.0 | 39.0 | 40.0 | 41.0 | 42.0 |
| Top-10 | 48.0 | 50.0 | 52.0 | 53.0 | 55.0 |
| | | | | | |
| New TCV wins ($ m) | 259 | 360 | 247 | 245 | 505 |
| No. of Direct clients added | 6 | 5 | 6 | 8 | 6 |

*Source: Company, Anand Rathi Research*

### Fig 15 – Clients contributing more than (based on TTM)

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| $1m+ | 79 | 80 | 81 | 84 | 84 |
| $5m+ | 32 | 31 | 35 | 37 | 39 |
| $10m+ | 16 | 17 | 16 | 18 | 18 |
| $20m+ | 7 | 8 | 9 | 9 | 9 |
| $50m+ | 4 | 4 | 5 | 5 | 7 |
| $75m+ | 4 | 4 | 4 | 5 | 5 |
| $100m+ | 2 | 2 | 2 | 2 | 4 |

*Source: Company, Anand Rathi Research*

### Fig 16 – Employee movement

| | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 |
|---|---|---|---|---|---|
| Number of employees | 26,143 | 27,148 | 28,116 | 29,473 | 31,454 |
| Utilisation % (cum trainees) | 83.8 | 83.7 | 82.7 | 86.6 | 84.4 |

*Source: Company, Anand Rathi Research*

# Valuations

The stock trades at 39x FY23e EPS of Rs83. This, we think, does not capture the correct earnings potential as Mphasis will suffer from higher costs and lower synergies initially. Also, relatively, Mphasis organically is likely to be in the top growth quadrant and the Blink acquisition will give it a strong push into the Hi-tech vertical with a wider client footprint. From a margin standpoint again, the company will incur costs in the first two years; hence, EPS may be suppressed. Considering this, the long-term potential, and prevailing valuations, we find Mphasis attractive and expect it to trade at 45x FY23, reflecting its robust pipeline, opportunities in Hi-Tech (likely the next $100m vertical), Europe (strong pipeline), strong current pace on the Direct business side and record TCV. While the slowing DXC is no longer a concern given its lower concentration, Direct business growth should counter-balance any potential slowdown, given its strong TCV data.

The EBIT margin would contract from FY21's 15.8% (our estimates: 15.1% in FY22, 15.3% in FY23) due to retention-payouts and amortisation costs related to the Blink acquisition. Since DXC contributed only 15% to revenue in FY21 (from 24% in FY20; we expect 4% by FY23), Mphasis' risk profile has markedly improved. Also, as the contribution from DXC slid sharply, there was no impact on margins despite supply-side pressure and the higher cost of revenue. Hence, we believe that the stock should trade at a premium as the EBIT CAGR is likely to be higher than peers. Higher TCVs and conversion to revenues suggest persistent high growth.

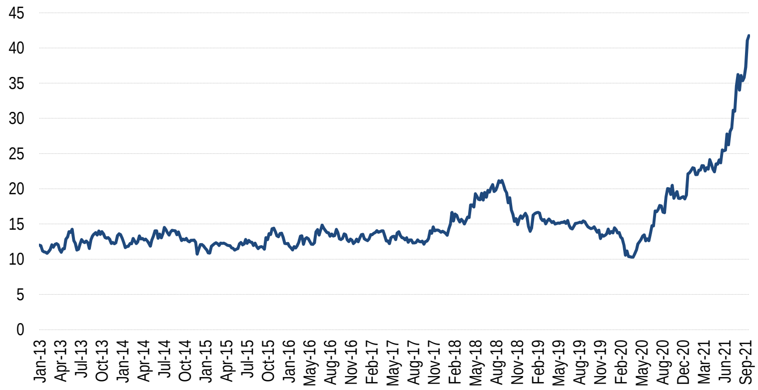
Its FCF-to-NI conversion had deteriorated in FY19 (65%) but rose to 101% in FY20. Over FY21, Mphasis generated 103% FCF:NI. Given that the Blink acquisition was all cash, FY22 FCF:NI should drop to 36% and bounce back in FY23 to 83%. Considering all these factors and that the DXC risk is now ebbing, we value it at 45x FY23e (35x previously), with a higher target of Rs3,740 (Rs3,130 previously).

Fig 17 – Change in estimates (Rs m)

| | FY22 | | | FY23 | | |
|---|---|---|---|---|---|---|
| | New | Old | Chg % | New | Old | Chg % |
| Revenues ($ m) | 1,528 | 1,505 | *1.5* | 1,741 | 1,681 | *3.6* |
| Revenues | 112,653 | 110,949 | *1.5* | 128,298 | 123,882 | *3.6* |
| EBITDA | 19,815 | 20,108 | *(1.5)* | 22,775 | 22,966 | *(0.8)* |
| *EBITDA margins %* | *18* | *18* | *-53bps* | *18* | *19* | *-79bps* |
| EBIT | 17,007 | 17,612 | *(3.4)* | 19,655 | 20,470 | *(4.0)* |
| *EBIT margins %* | *15* | *16* | *-78bps* | *15* | *17* | *-120bps* |
| PBT | 18,597 | 19,492 | *(4.6)* | 20,674 | 22,310 | *(7.3)* |
| Net profit | 13,790 | 14,454 | *(4.6)* | 15,505 | 16,732 | *(7.3)* |

*Source: Anand Rathi Research*

Fig 18 – PE band




*Source: Bloomberg, Anand Rathi Research*

## Risk

- Slowdown in top accounts.

## Appendix

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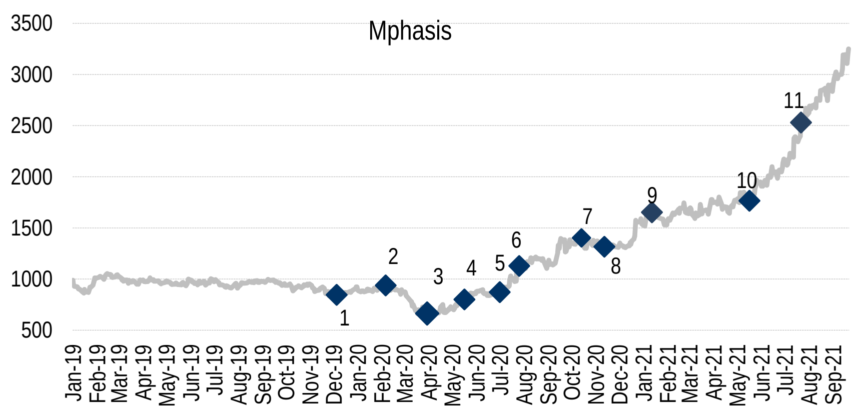
Rating and Target Price History (as of 23 September 2021)




| | Date | Rating | TP (Rs) | Share Price (Rs) |
|---|---|---|---|---|
| 1 | 2-Dec-19 | Buy | 1,000 | 880 |
| 2 | 7-Feb-20 | Buy | 1,130 | 933 |
| 3 | 31-Mar-20 | Buy | 1,030 | 664 |
| 4 | 15-May-20 | Buy | 970 | 805 |
| 5 | 29-Jun-20 | Hold | 1000 | 893 |
| 6 | 27-Jul-20 | Hold | 1175 | 1118 |
| 7 | 15-Oct-20 | Sell | 1,240 | 1,426 |
| 8 | 24-Oct-20 | Hold | 1,480 | 1,382 |
| 9 | 25-Jan-21 | Buy | 1,930 | 1,599 |
| 10 | 16-May-21 | Buy | 2,260 | 1,789 |
| 11 | 24-Jul-21 | Buy | 3,130 | 2,506 |

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Ratings Guide (12 months)

| | Buy | Hold | Sell |
|---|---|---|---|
| Large Caps (>US$1bn) | >15% | 5-15% | <5% |
| Mid/Small Caps (<US$1bn) | >25% | 5-25% | <5% |

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