2 May 2022

Mphasis

Rating: Buy
Target Price: Rs.4,150
Share Price: Rs.2,796

Strong growth quarter, margins to start trending up; Buy

Mphasis had another strong quarter, growing 4% q/q (4.3% CC) to $431m. TCVs were a high $347m, up 42% y/y (TTM up 29% y/y). Commentary on US/mortgage was a little cautious but retained a high FY23 growth outlook (supported by hiring and TCVs) despite the situation. Q4 EBIT margin was 14.3% (flattish q/q) and FY23 guidance is 15.3% to 17%, with all four levers (M&A, utilisation, offshoring and pyramid) offering tailwinds ahead. We raise our estimates ~10%, largely on margins, and our target to Rs4,150 (36x FY24, slightly above LTI on better FCF profile). We retain a Buy.

Growth surpassing peers; TCV endures, reflecting industry trends. Mphasis' grew 4.7% q/q (CC) in Q4 (direct), better than peers and despite some softness in BFS (up 1% q/q)/BPM (down 2% q/q). The softness stemmed from rising interest rates in the US impacting the mortgage business. Mphasis has absorbed this impact so far by diversifying into wider services and expects to do so in FY23 as well, leading to a strong FY23 growth outlook. Application services were strong (up 9% q/q). New TCV for FY22 was $1.4bn, up 28% y/y, on $1.5bn FY22 direct business revenue.

EBIT margin betterment can be faster; many tailwinds. The 14.3% Q4 EBIT margin was down 108bps y/y. This included ~80bp impact from Blink and some impact from weaker operational rigour. Ahead, the company is focusing on expanding margins and has all the levers in place–fresher hiring is increasing (5,500 in H2 FY22), utilization is 73% now, offshore by revenue is 42% (down y/y). Therefore, we now expect EBIT margins of 16.3% by FY24, leading to a 27% FY22-24 EBIT CAGR.

Business outlook. FY23 growth would be in the top quadrant of the industry and EBIT maintained at 15.25-17%.

Maintaining a Buy. We raise our FY23e/FY24e ~9% to 11%, on expectations of better margins. Hence, we raise our target to Rs.4,150 (from Rs.3,910 earlier), 36x FY24e EPS. We expect Mphasis to deliver a 19% revenue CAGR and a 23% EPS CAGR over FY22-24. **Risk:** Slowdown in US BFSI top accounts.

Key financials (YE Mar)	FY20	FY21	FY22	FY23e	FY24e
Sales (Rs m)	88,239	96,920	118,612	144,764	170,736
Net profit (Rs m)	11,850	12,166	14,311	17,719	21,652
EPS (Rs)	63.4	65.1	76.4	94.4	115.4
P/E (x)	44.1	43.0	36.6	29.6	24.2
EV / EBITDA (x)	30.7	28.3	24.7	19.4	16.1
P/BV (x)	9.0	8.0	7.5	6.8	6.0
RoE (%)	21.4	19.7	21.2	24.2	26.3
RoCE (%)	16.6	15.0	15.8	19.1	21.5
Dividend yield (%)	1.3	2.3	1.6	1.9	2.2
Net debt / equity (x)	-0.3	-0.4	-0.3	-0.3	-0.4

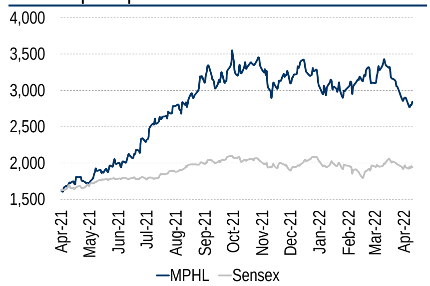
Source: Company, Anand Rathi Research

Key data	MPHL IN / MBFL.BO
52-week high / low	Rs.3660 / 1712
Sensex / Nifty	57061 / 17103
3-m average volume	$20.8m
Market cap	Rs.534bn / $6986.9m
Shares outstanding	188m

Shareholding pattern (%)	Mar'22	Dec'21	Sep'21
Promoters	55.8	55.9	56.0
- *of which, Pledged*			
Free float	44.2	44.1	44.1
- Foreign institutions	21.1	21.1	20.9
- Domestic institutions	18.0	17.8	18.0
- Public	5.1	5.2	5.3

Estimates revision (%)	FY23e	FY24e
Sales ($)	1.1	2.7
EBIT	7.7	11.0
PAT	9.1	10.7

Relative price performance



Source: Bloomberg

Mohit Jain
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Revenues (US$m)	1,239.7	1,308.9	1,592.8	1,917.4	2,261.4
Growth (%)	10.8	5.6	21.7	20.4	17.9
Net revenues (Rs m)	88,239	96,920	118,612	144,764	170,736
Employee & Direct Costs	65,093	70,787	89,501	109,176	128,626
Gross Profit	23,146	26,133	29,111	35,588	42,110
Gross Margin %	26.23	26.96	24.54	24.58	24.66
SG&A	6,838	8,408	8,834	9,772	11,037
EBITDA	16,308	17,725	20,277	25,816	31,072
EBITDA margins (%)	18.5	18.3	17.1	17.8	18.2
- Depreciation	2,316	2,418	2,906	3,196	3,196
Other income	1,977	1,632	2,505	1,588	1,575
Interest Exp	813	634	744	582	582
PBT	15,156	16,305	19,132	23,625	28,869
Effective tax rate (%)	22	25	25	25	25
+ Associates/(Minorities)	-	-	-	-	-
Net Income	11,850	12,166	14,311	17,719	21,652
WANS	187	187	187	188	188
FDEPS (Rs/share)	63.4	65.1	76.4	94.4	115.4

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	1,865	1,870	1,878	1,878	1,878
Net worth	58,296	65,267	69,431	77,221	87,454
Total debt (incl. Pref)	5,713	5,135	5,272	4,745	4,271
Minority interest	-	-	-	-	-
DTL/(Asset)	-6,646	-6,172	-5,979	-5,979	-5,979
Capital employed	57,363	64,230	68,724	75,987	85,746
Net tangible assets	7,936	7,795	8,693	7,963	7,561
Net Intangible assets	887	1,074	1,695	2,934	2,295
Goodwill	21,405	21,326	27,348	27,348	27,348
CWIP (tang. & intang.)	74	31	110	110	110
Long-term Assets (Liabilities)	-5,986	-5,517	-7,642	-7,661	-7,679
Investments (Financial)	13,257	18,460	18,130	14,504	15,955
Current Assets (ex Cash)	23,096	25,434	33,317	41,095	49,403
Cash	11,257	10,622	9,494	15,375	19,888
Current Liabilities	14,562	14,996	22,421	25,682	29,135
Working capital	8,534	10,438	10,896	15,413	20,268
Capital deployed	57,363	64,230	68,724	75,987	85,746
Contingent Liabilities	17,144	-	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	15,156	16,305	19,132	23,625	28,869
+ Non-cash items	1,592	2,142	3,212	2,190	2,203
Operating profit before WC	16,748	18,447	22,344	25,816	31,072
- Incr./(decr.) in WC	-422	453	1,501	4,517	4,856
Others incuding taxes	-3,960	-3,448	-3,686	-5,888	-7,199
Operating cash-flow	13,210	14,545	17,157	15,411	19,018
- Capex (tangible + Intangible)	1,261	1,262	1,200	1,827	2,155
Free cash-flow	11,949	13,284	15,957	13,584	16,863
Acquisitions	-	-805	-5,219	-1,878	-
- Dividend (including buyback & ta	6,065	6,527	12,177	9,929	11,419
+ Equity raised	151	268	442	-	-
+ Debt raised	-224	-409	32	-527	-475
- Fin Investments	-2,440	4,824	-1,798	-3,626	1,450
- Misc. Items (CFI + CFF)	3,410	1,621	1,961	-1,005	-993
Net cash-flow	4,841	-635	-1,128	5,881	4,513

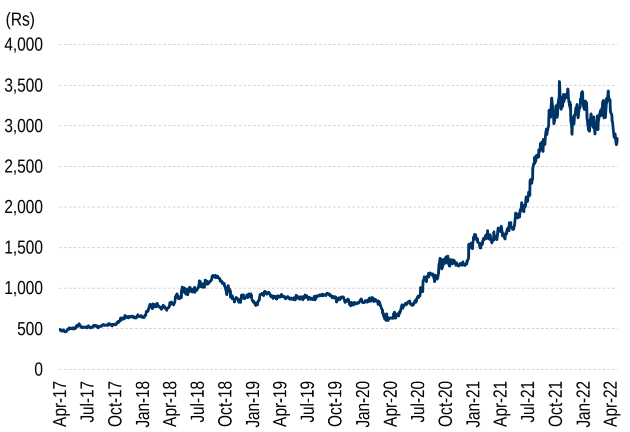
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	44.1	43.0	36.6	29.6	24.2
EV/EBITDA (x)	30.7	28.3	24.7	19.4	16.1
EV/sales (x)	5.7	5.2	4.2	3.4	2.9
P/B (x)	9.0	8.0	7.5	6.8	6.0
RoE (%)	21.4	19.7	21.2	24.2	26.3
RoCE (%) - After tax	16.6	15.0	15.8	19.1	21.5
RoIC (%) - After tax	24.9	23.2	24.2	28.3	32.5
DPS (Rs per share)	35.0	65.0	46.0	52.9	60.8
Dividend yield (%)	1.3	2.3	1.6	1.9	2.2
Dividend payout (%) - Inc. DDT	66.3	119.8	60.2	56.0	52.7
Net debt/equity (x)	-0.3	-0.4	-0.3	-0.3	-0.4
Receivables (days)	73	70	69	71	73
Inventory (days)					
Payables (days)	34	27	32	32	32
CFO:PAT%	111.5	119.6	119.9	87.0	87.8
FCF:PAT% - includ M&A payout	100.8	102.6	75.0	66.1	77.9

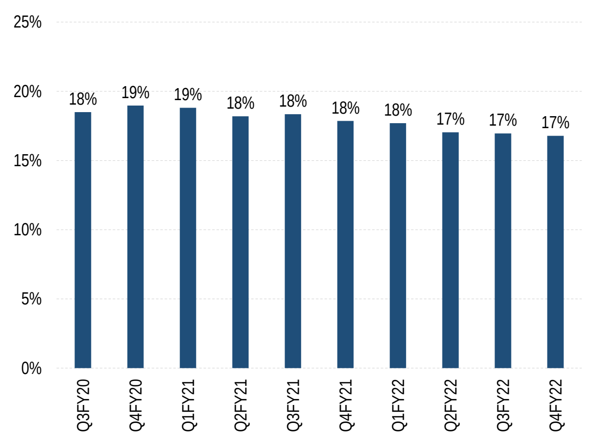
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBITDA margins



Source: Company, Anand Rathi Research

Result Highlights

Q4 FY22 Results at a Glance

Fig 7 – Segment-wise

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q/Q %	Y/Y %
Revenue ($ m)	342	363	385	414	431	4.0%	25.9%
Growth Y/Y %	7%	19%	18%	24%	26%		
Industry Y/Y % (est.)	6%	21%	21%	21%	15%		
Revenue (Rs m)	25,044	26,749	28,460	30,955	32,448	4.8%	29.6%
Effec. exchange rate	73.2	73.7	73.9	74.8	75.3	0.8%	2.9%
New TCV wins ($ m)	245.0	505.0	241.0	335.0	347.0	3.6%	41.6%
TCV (LTM)	1,111.0	1,357.0	1,238.0	1,326.0	1,428.0	7.7%	28.5%
Y/Y %	22%	95%	-33%	36%	42%		
TCV:Rev.	0.7	1.4	0.6	0.8	0.8		
Employees (EoP)	29,473	31,454	32,295	34,915	36,534	4.6%	24.0%
Rev. prod. ($ '000/employee)	11.9	11.9	12.1	12.3	12.1	-2.1%	1.4%
Utilisation % (IT Services)	86.6%	84.4%	82.7%	76.9%	73.0%	-383 bps	-1354 bps
CoR (excl. D&A)	(18,262)	(19,940)	(21,535)	(23,417)	(24,609)	5.1%	34.8%
As % of revenue	-73%	-75%	-76%	-76%	-76%	-19 bps	-292 bps
SG&A	(2,310)	(2,074)	(2,076)	(2,288)	(2,396)	4.7%	3.7%
As % of revenue.	-9%	-8%	-7%	-7%	-7%	1 bps	184 bps
EBITDA	4,472	4,735	4,849	5,250	5,443	3.7%	21.7%
EBITDA margins %	17.9%	17.7%	17.0%	17.0%	16.8%	-19 bps	-108 bps
EBIT	3,855	4,111	4,192	4,424	4,644	5.0%	20.5%
EBIT margins %	15.4%	15.4%	14.7%	14.3%	14.3%	2 bps	-108 bps
Industry margins % (est.)	17.6%	16.8%	17.2%	17.4%	17.3%	-10 bps	-25 bps
Other income (excl. forex)	460	518	569	472	564	19.5%	22.6%
Non-recurring / Forex	65	109	-	116	157	35.3%	141.5%
Interest expenses	(144)	(157)	(163)	(216)	(208)	-3.7%	44.4%
PBT	4,236	4,581	4,598	4,796	5,157	7.5%	21.7%
PBT margins %	16.9%	17.1%	16.2%	15.5%	15.9%	40 bps	-102 bps
Taxes	(1,067)	(1,184)	(1,182)	(1,219)	(1,236)	1.4%	15.8%
ETR %	-25%	-26%	-26%	-25%	-24%	145 bps	122 bps
Associates / Minority							
Net income	3,169	3,397	3,416	3,577	3,921	9.6%	23.7%
Net margins %	12.7%	12.7%	12.0%	11.6%	12.1%	53 bps	-57 bps
Industry net margins %	12.6%	13.8%	13.9%	14.0%	14.2%	21 bps	160 bps
EPS (Rs)	17.0	18.2	18.2	19.1	20.9	9.4%	23.2%

Source: Company, Anand Rathi Research

Fig 8 – Quarterly results

Year-end: Mar (Rs m)	Q4FY22	% chg. Q/Q	% chg. Y/Y	FY21	FY22e	FY22e % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	431	4.0	25.9	1,309	1,593	21.7	20.4
Sales	32,448	4.8	29.6	96,920	118,612	22.4	22.0
EBITDA	5,443	3.7	21.7	17,725	20,277	14.4	27.3
EBITDA margin (%)	16.8	-19bps	-108bps	18.3	17.1	-119bps	74bps
EBIT	4,644	5.0	20.5	15,307	17,371	13.5	30.2
EBIT margin (%)	14.3	2bps	-108bps	15.8	14.6	-115bps	98bps
PBT	5,157	7.5	21.7	16,305	19,132	17.3	23.5
Tax	(1,236)	1.4	15.8	(4,139)	(4,821)	16.5	22.5
Tax rate (%)	(24.0)	145bps	122bps	(25.4)	(25.2)	19bps	20bps
Net income	3,921	9.6	23.7	12,166	14,310	17.6	23.8

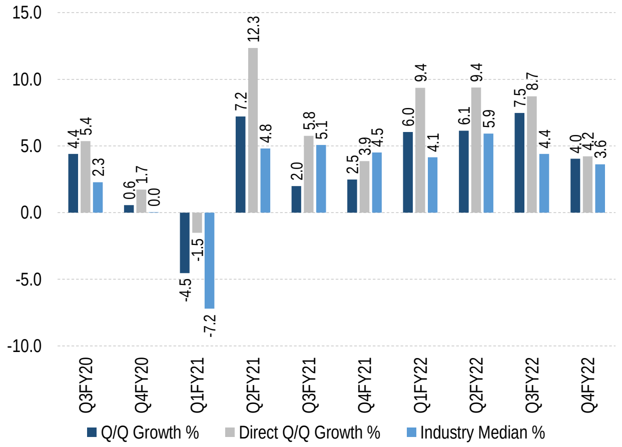
Source: Company, Anand Rathi Research

Growth endures, TCV strong

Mphasis' consolidated revenues grew 4% q/q, 26% y/y. Direct, on the other hand, grew 4.2% q/q, 35.5% y/y. Q4 included ~ $11m from the Blink acquisition. This is broadly in line with our estimates; in Q4, dependence on DXC fell to 5% (from 12% a year back, 23% two years back), converging performance of consolidated numbers to the Direct business performance. Consequently, Mphasis' consolidated performance is comparable with the industry.

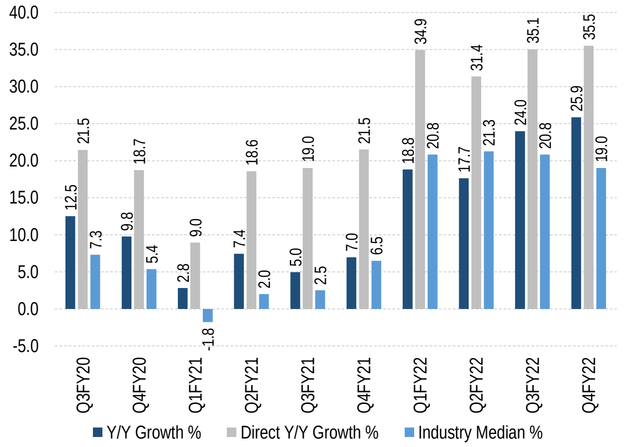
In Q4 FY22, Mphasis grew 4% sequentially, in line with the industry median; its DXC business reduced drag and grew 1% sequentially. Management spoke about not looking at the DXC business as a growth engine and continued on its strategy of prioritising resources to the Direct business. Adjusted for Blink, Mphasis grew 3.9% q/q, 23% y/y, still ahead of the industry. The Direct business (95% of the total) has consistently grown faster than the industry median, recording a fourth consecutive quarter of 30%+ y/y growth. The company expects Direct business growth to endure and deliver industry-leading growth in FY23.

Fig 9 – Direct, core, consolidated figures grew faster than the industry



Source: Company, Anand Rathi Research

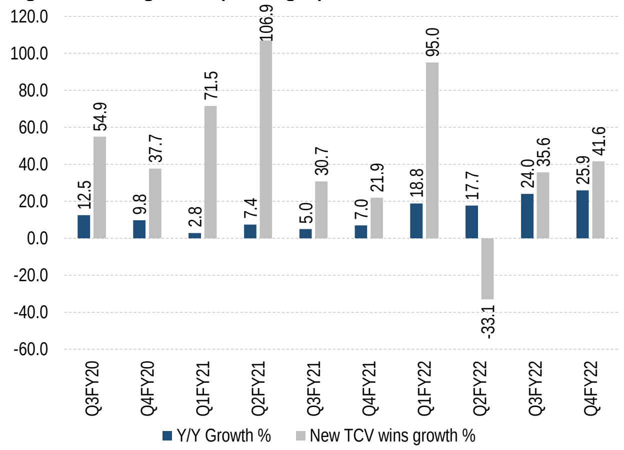
Fig 10 – Direct business, consolidated revenue growing faster than the industry



Source: Company, Anand Rathi Research

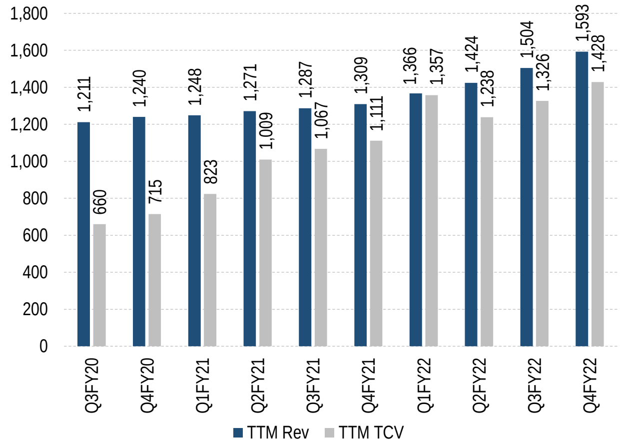
Mphasis reports new TCV wins, which have a high correlation (exceeding 0.9) with Direct business revenue growth. In TCV, it had a good growth quarter q/q, with Q4 at $347m (up 42% y/y); Q3 new TCV wins were $335m. The average size of large deals ($20m+, five closed in Q4) on a TTM basis has increased 2x in two years. Management claims that the pipeline is 16% higher than last year. This is despite closing large deals throughout the year.

Fig 11 – TCV growth picking up



Source: Company, Anand Rathi Research

Fig 12 – TTM revenue, TTM net new TCV ($ m)



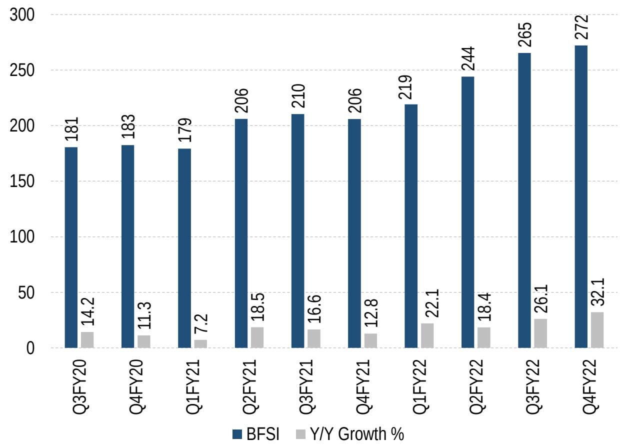
Source: Company, Anand Rathi Research

BFSI growth speeds up; TMT, Travel growth slows y/y

Mphasis' strength lies in three verticals: BFSI (63% of revenue), TMT (13%) and Travel & Logistics (13%). In BFSI, growth has sped in the last few quarters and is more driven by BFS (up 35% y/y) than by Insurance (19% y/y). However, in Q4, BFS grew just 1% q/q, reflecting some softness. The company said that BFSI tech spending is robust on the Application Services side but the business related to mortgages is soft on account of interest-rate movements in the US. While this will have a short-term impact, the company still believes that BFS revenues will continue to grow in FY23.

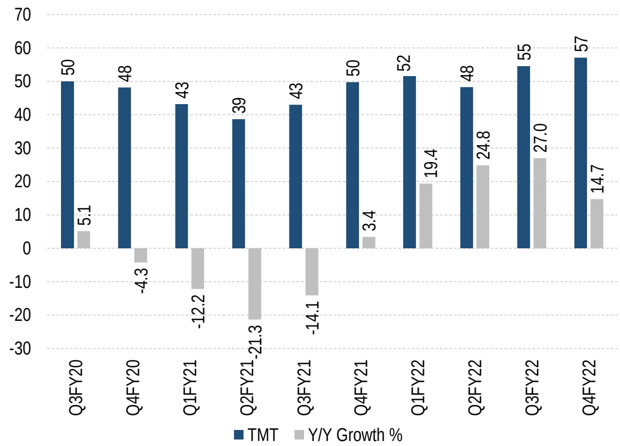
The TMT vertical's growth slowed in Q4 after accelerating for the last five quarters. The Blink acquisition is likely to aid growth in this vertical as deal sizes improve. DXC-related drags appear to be behind now. It is a priority vertical for Mphasis (started as a legacy business from HP; hence, capabilities are strong), and is likely to continue on a growth trajectory.

Fig 13 – BFSI growth reflects softness in mortgage division



Source: Company, Anand Rathi Research

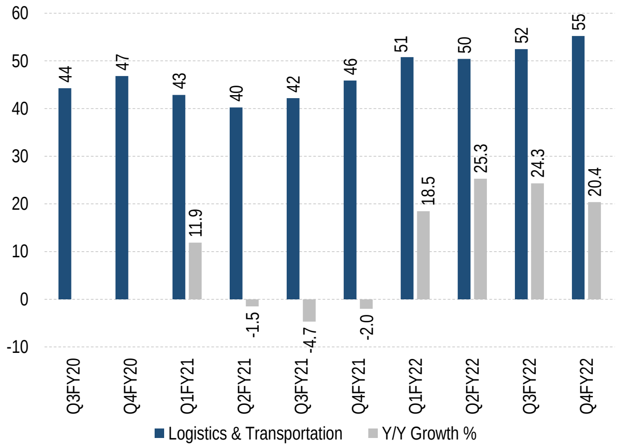
Fig 14 –TMT growth holding up



Source: Company, Anand Rathi Research

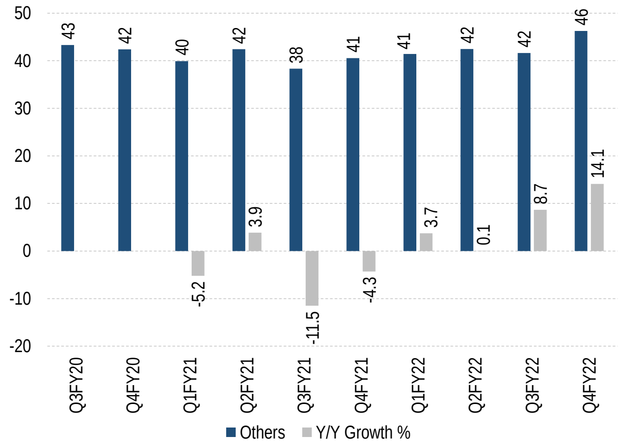
Mphasis' Logistics & Transportation vertical has been growing well for the last four quarters (Q4, 20% y/y, 5% q/q) and demand is strong here. The company is investing in the Travel sub-vertical here and expects it to start contributing to growth in FY23.

Fig 15 – Logistics and Transportation growing well



Source: Company, Anand Rathi Research

Fig 16 – Others (healthcare, manufacturing, retail)



Source: Company, Anand Rathi Research

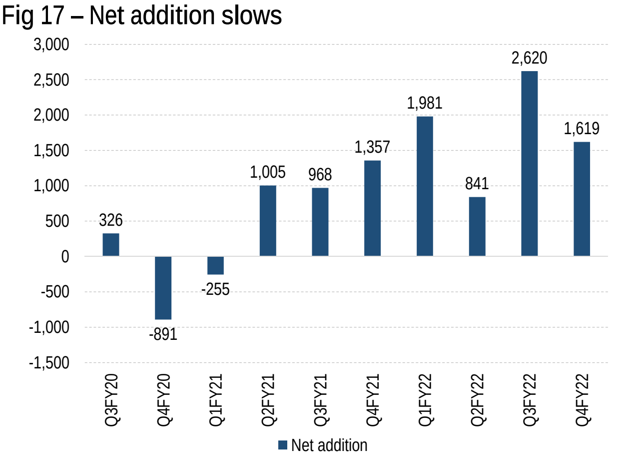
We expect this vertical to grow steadily. Other verticals (11% of revenue) were up 14% y/y, 2% q/q. The company mentioned the healthcare sub vertical within "others"; it intends to report Healthcare separately in the future as it comes into focus.

Manpower addition slows, utilisation and productivity drop

Mphasis added 6,931 employees (organic) in the last twelve months, which has helped it bring utilisation down to 73% in Q4 FY22 (extrapolated from on-site/offshore utilisation), from 86.6% a year ago. Hiring was lower in this quarter sequentially but fresh graduate intake was strong. The company did not reveal any target hiring figure for FY23 but said that in the last two quarters it has on boarded 5,500 fresh graduates and expects to keep adding at the same speed at least.

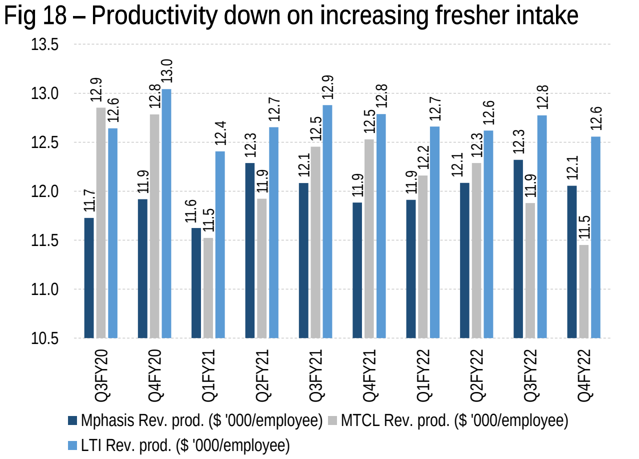
Attrition is now stable and the wage-hikes impact next year is not going to be way different from FY22, also reflected in its margin guidance. Management said that the onsite-offshore mix will continue to favour offshoring, albeit gradually, as some of the near-shore locations are counted as onsite.

Fig 17 – Net addition slows



Source: Company, Anand Rathi Research

Fig 18 – Productivity down on increasing fresher intake

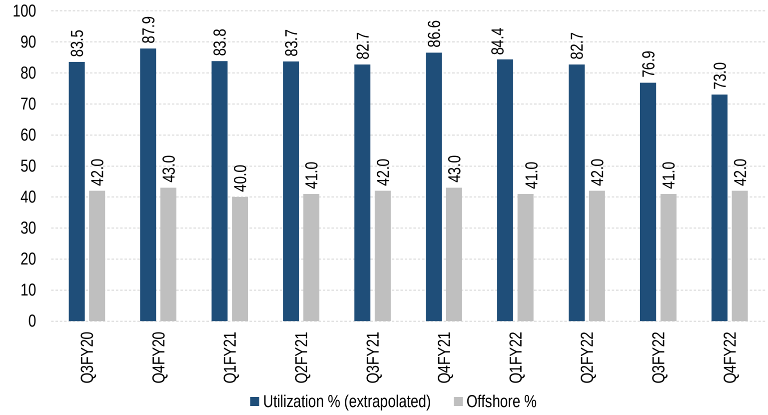


Source: Company, Anand Rathi Research

From an employee-productivity perspective, Mphasis is 2% lower than its recent past, as the company added more freshers and utilisations dipped further. It is looking at price increases; if it can achieve this along with better utilisation, revenue productivity is likely to inch up further. Also, as it improves utilisation, productivity should keep inching up ahead despite some increases in offshore.

While it appears that productivity is lower than that of peers (excl. Q3 and Q4 FY22), Mphasis has ~30% of employees in the BPO division, which are included in the productivity chart above while the other two do not have BPO practices.

Fig 19 – Utilization and Offshoring can be margin levers



Source: Company, Anand Rathi Research

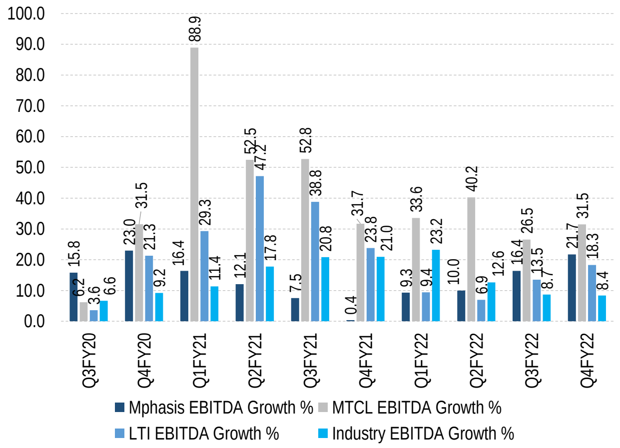
From a utilisation perspective, it appears that it has some headroom to deliver on margins even if the supply-side is more constrained. Also, given its higher on-site presence, the ability to manage attrition costs should be better than peers. In Q4, management said that the mix will tilt in favour of offshoring ahead.

EBITDA, NI growth higher than the industry

Mphasis delivered 22% EBITDA growth y/y in Q4 FY22 and 14% in FY22, both ahead of the industry. This was possible due to better-than-industry growth and better execution (managing the declines) on the DXC front.

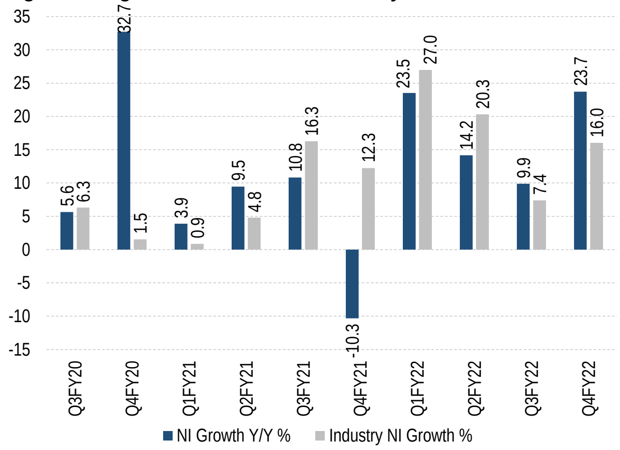
On the other hand, it acquired Blink and had to absorb the margin impact. In the last two quarters, the impact has been ~70-80bps. This resulted in a 16.8% Q4 FY22 EBITDA margin (down 19bps q/q, 108bps y/y). Overall, Mphasis delivered margins of 17-18% for seven consecutive quarters (down from a peak 19% in Q4 FY21). Ahead, it expects headwinds from Blink to soften while improving on the supply side, leading to expectations of better margins in FY23. We expect it to deliver 17-18% margins in the next three quarters, before returning to 18-19% by Q4 FY23.

Fig 20 – EBITDA growth better than industry



Source: Company, Anand Rathi Research

Fig 21 – NI growth better than industry



Source: Company, Anand Rathi Research

We expect Mphasis margins to improve 74bps in FY23 and another 37bps in FY24 as some of the headwinds abate and operational levers are deployed.

NI grew 24% y/y, above the industry average, and the NI margin expanded 53bps q/q but contracted 57bps y/y after absorbing the Blink acquisition.

Client addition and mining strong in 4Q with two $150m clients added in FY22

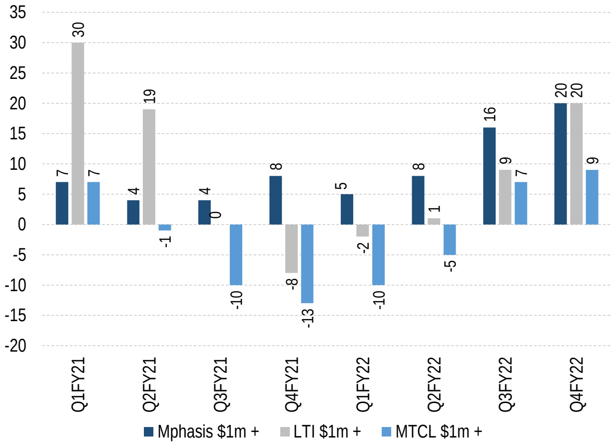
Mphasis has added many clients (across revenue buckets) in the last few years, reflecting strong client-mining capabilities. It added nine this quarter, taking the total to 195 ($1m+ clients only). Its strategy of shifting a client from one bucket to the next has been playing out well and the company is confident that it will continue to shift clients to the next bucket.

Efforts on the mining side have been quite visible in the $20m+ category where Mphasis added six clients (incl. two in $150m+, two in the $100m+, one in the $75m+, two in the $50m+ and one in the $20m+) on an LTM basis. The ability to scale up will come handy ahead as it has acquired 14 clients in Q2 through Blink, which are potential client-mining/cross-selling targets.

In comparison, LTI and Mindtree added six and seven clients respectively during the same period.

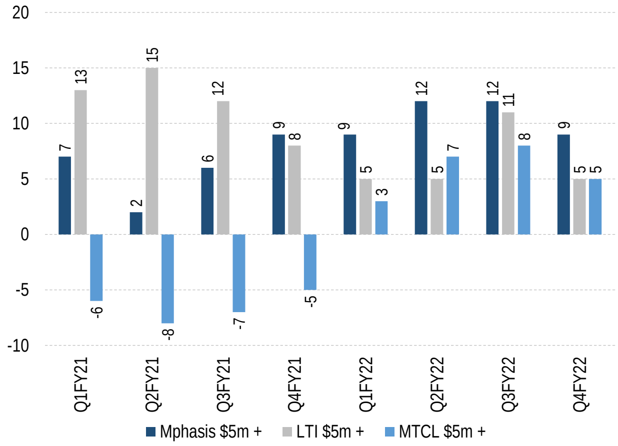
On the new client addition ($1m-$5m) side, Mphasis added 20 clients on LTM basis, while LTI and Mindtree added 20 and 9 clients respectively. Therefore, Mphasis does well on the client addition side as well.

Fig 22 – Clients addition strong in $1m-$5m bucket (LTM basis)



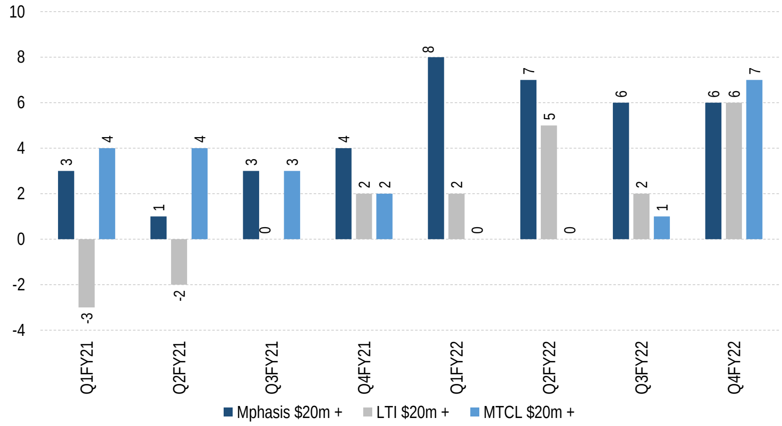
Source: Company, Anand Rathi Research

Fig 23 – Better addition than peers in $5m-$20m bracket (LTM basis)



Source: Company, Anand Rathi Research

Fig 24 – Mphasis at par with LTI in +$20m bracket addition (LTM basis)



Source: Company, Anand Rathi Research

Conference Call Highlights

Q4 FY22 concall highlights

- DXC contribution to continue to shrink as Direct grows faster.
- Direct business crosses $400m and grew 30% in cc organically.
- Europe continues to be in focus; investments made in this region are yielding good results, per management. Direct grew 20%+ y/y in cc in FY22.
- Blink contributed $11m in Q4 ($23m for the year), and 13.5% sequentially. It was fully integrated for Q3 and Q4.
- BFSI Tech spend is robust and the company is diversified from the pure interest rate-related mortgage-origination business. Therefore, while short-term growth will be somewhat impacted, overall, BFSI is still likely to grow.
- The logistics vertical is soft due to the base effect. Demand is not a concern.
- New deal TCV was $347m (72% is in new-gen areas). FY22 TCV at $1.43bn, up 28% y/y. Direct TCV and direct revenue are highly correlated. The company said that the pipeline is up 14% and is largely tribe driven.
- Won five large deals in Q4 and 12 in FY22.
- Top-2 clients contributed $150m+ each in FY22. Average contribution of top-5 clients exceeds $140m. Top-6 clients contribute $75m+ each.
- RSU costs (120bps) were absorbed in full in Q4.
- Acquisition-related costs reduced as percent of revenue. 0.8% acquisition cost in the Dec quarter, 0.7% in the Mar quarter. Management expects to absorb this impact in Q4.
- Logistics margins were down due to a significant ramp-up and to investments made in capabilities and sub-verticals in transportation (eg. Airlines).
- In the last two quarters, the company has on-boarded 5,500 freshers; hence, utilization fell sharply. Not expected to improve in the short term although it is a margin lever ahead.
- Attrition is stable. The company doesn't expect wage hikes to be unusually high compared to FY22.
- The onsite-offshore mix to continue to favour offshore. Taiwan and Mexico counted as onsite currently; hence, onsite appears higher than from a business standpoint.
- The "Others" verticals' biggest component is healthcare, growing rapidly and a focus area for the company. Ahead, the company plans to call it out separately.

Business Outlook

- FY23 growth to be less than FY22 but management is confident of delivering industry-leading Direct growth.
- Margin guidance of 15.25-17% for FY23 on reported basis (incl. of M&A and RSU costs).

Previous concall highlights

Q3 FY22 concall highlights

- Direct division continues to be the growth driver and its contribution to continue to increase.
- Europe pipeline is strong; this region will be the growth driver beyond FY22
- Within BFS all sub-segments are growing and gaining market share with key clients
- Net new TCV at $335m, eighth straight quarter of more than $200m. Pipeline is up.
- Conversion rate of clients from one basket to another is one of the best in the industry
- Largest deal in Q3 came from a new client in Healthcare, a digital transformation deal over three years. Pipeline of new logos in healthcare is strong.
- Won a large deal with an existing banking client of $300m over three years.
- The other two large deals are shorter cycle and quick consumption deals
- Highest fresher addition in Q3 and will close FY22 with the highest fresher addition of over 5,500 in FY22 (mainly in H2). Increasing campus hiring. Expanding into non-metro tier-2 cities for talent.
- ESOP affected EBIT margins by 80bps
- Trainee utilisation low due to accelerated fresher hiring. Utilisation excluding trainees down due to building up of bench to capture revenue growth. Expect utilization to improve.
- Going to tier-2, -3 cities to find talent, to sustain growth at current levels and manage supply-side challenges. The company is also looking at global talent (onshore talent), expanding in Canada, Europe, Mexico, and Taiwan.
- There are shorter deals but they are chunky. On the other hand, the company is winning multi-year deals. In terms of tenure, it is seeing shorter-cycle deals in the last few quarters. But the average deal size is not lower.
- Pipeline is 10% higher than last year and 7% sequentially. The company is seeing strong demand and order book.
- The pricing environment is favourable.
- Blink will lead to higher TCV and order book, In Q3 Mphasis won two joint deals because of the acquisition.
- Attrition high, compared to the past. Expect it to be stable in the short term.
- Potential margin (15.1% reported): 17.7-18.2% - Impact of 80bps from Blink, 100-150bps from lower utilisation and 80bps from ESOP.
- Although the company is not pushing for offshore mix, it is favourable. It is happy with the current mix but said that further headcount will be mainly offshore.

- Confident of delivering industry-leading growth in the Direct business for FY22
- Ambition of keeping operating margins within the 15.5-17% band.

Q2 FY22 concall highlights

- DXC at 6% of revenues; to be in mid single digits at end-FY22. Therefore, management is expecting some stability ahead.
- US market doing well; Europe pipeline strong. Expect Europe to be growth driver in FY22 and beyond.
- The company continues to gain market share in the BFS vertical.
- Strong performance across all client buckets. Client migration from one tier to another tier continues to be good. Contribution from the top five exceeds $120m on a TTM basis. The top-four clients are now Rs100m+ on a TTM basis and all top-five clients are $75m + on a TTM basis.
- Large deals on a TTM basis have increased 2.5x in two years to $80m+
- The company absorbed the higher cost of revenue and expanded gross margin; the reported EBIT includes M&A charge of Rs208m (70bps), of which some part is one-off while some costs will continue to be high.
- The company is adding 3-4 clients from Fortune-500 each quarter, of which the bulk are from US. It has added 20 (10 from acquisitions) Fortune-500 clients since FY20.
- DXC entered into a two-year automatic renewal although MRC ended in Q2 FY22.
- Focusing on investing in the Direct business, while retaining client relations at DXC. A certain amount of revenue to continue to come from DXC ahead.
- On-site/offshore mix to turn a little favourable toward offshoring.
- Seeing deals in Europe (the UK, France and the Nordics) of healthy sizes in BFSI.
- Hiring across the pyramid (including freshers); significant efforts being put in expanding and retaining the employee base
- G&A expense increased 0.7% on account of M&A expense but is now likely to be stable.
- Employee productivity up due to a large transformation deal
- Infra business growing well, excl. DXC
- On a q/q basis, TCV is at similar levels excl. large deals in Q1
- TCV and Direct revenue correlation very high, exceeding 0.9.
- Seeing transformation deals broken down into 6-9 month programs; expecting this trend to continue
- Blink integrated for nine days for this quarter; full integration (financial) from Q3. Revenue of $900,000 from Blink in Q2.
- Improving pricing metrics with clients; this should mitigate increase in CoR due to supply-side challenges
- Revenue from India is not lumpy; the company sees this as a growth business and continues to invest here

- Management is confident of delivering industry-leading Direct growth in FY22
- The company has guided to an EBIT margin of 15.5%-17% on reported basis for FY22. H2 to be in this range (excl. Blink). Over time, the company expects to return to its targeted band incl. Blink as it scales up the latter and realizes the benefits of cross selling.

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.
- 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).

Q4 FY21 concall highlights

- Direct in Europe grew 25% y/y in constant currency in FY21.
- Europe pipeline strong (especially new clients). This region will continue to be the growth driver in FY22.
- Gaining market share in BCM with key clients; expect this vertical to grow sequentially in Q1FY22. BCM to see robust growth in FY22.
- Insurance vertical has robust TCV and pipeline (including large deals). This vertical is likely to continue on its sequential growth trajectory.
- The company is seeing an improvement in client mining. Expect all top 5 accounts to grow in FY22.
- TCV was $245m for Q4, $1.1bn for FY21. New-gen services contributed 73% of FY21 TCV, tribe-led deals account for75% of FY21 TCV. Average large deal size was $79m. Overall, seeing longer and larger deals (average three years). Average tenure of deals is ~3 years.
- Mphasis closed a landmark (10-year) deal in BFSI in the UK,of $250m;revenues to reflect in Q2FY22.
- Revenue productivity and margins were lower for the quarter as the company was unable to bill some resources during the transition period. This is likely to self-correct in 1HFY22. Overall, pricing remains stable.
- Expanding sales team in the UK and Canada (already added geographic leader). The company is building delivery centres in Mexico, Costa Rica, Taiwan and Estonia.
- DXC to come down further and settle at mid-single digits (as percent of revenue) over the medium term.
- FY22 EBIT margin: 15.5-17%
- Continue to have industry leading growth in Direct. FY22 growth in direct higher than in FY21 (17% cc). Share of Direct to continue to increase (currently 86%).

Factsheet

Fig 25 – Rev-split, by industry (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Banking and Capital Market	50	51	55	55	54
Insurance	10	9	9	9	10
IT, Comm & Entertainment	15	14	13	13	13
Logistics & Transportation	13	14	13	13	13
Others (Life, Mfg, & Retail)	11.9	11	11	10	11

Source: Company, Anand Rathi Research

Fig 26 – Rev-split by Service Line (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Application Services	60	62	61	63	66
Business Process Services	26	27	26	25	23
Infrastructure Services	14	11	13	12	11

Source: Company, Anand Rathi Research

Fig 27 – Rev-split, by Region (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
North America	76	76	78	81	81
EMEA	13	12	12	11	11
India	5	5	5	5	5
RoW	6	7	5	3	3

Source: Company, Anand Rathi Research

Fig 28 – Rev-split, by delivery and billing (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
On-site	57.0	59.0	58.0	59.0	58.0
Offshore	43.0	41.0	42.0	41.0	42.0
Total	100	100	100	100	100
T&M %	57.0	58.0	58.0	55.0	55.0
FP %	27.0	26.0	26.0	29.0	30.0
Transaction Based%	16.0	16.0	16.0	16.0	15.0

Source: Company, Anand Rathi Research

Fig 29 – Client profiles (LTM)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Client concentration %					
Top 1	10.0	11.0	11.0	11.0	11.0
Top 5	41.0	42.0	42.0	43.0	44.0
Top 10	53.0	55.0	57.0	58.0	59.0
Total $1m+ clients	160	166	173	186	195.0
Client profiles (TTM, ">")					
$1m+	84	84	88	97	104
$5m+	37	39	41	42	42
$10m+	18	18	19	21	22
$20m+	9	9	9	9	10
$50m+	5	7	7	7	7
$75m+	5	5	5	6	6
$100m+	2	4	4	4	4

Source: Company, Anand Rathi Research

Fig 30 – Rev-split-Market Segment (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
DXC	12%	9%	6%	5%	5%
Non DXC	88%	91%	94%	95%	95%

Source: Company, Anand Rathi Research

Fig 31 – Employee Data

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Number of employees	29,473	31,454	32,295	34,915	36,534
Utilisation % (cum trainees)	86.6	84.4	82.7	76.9	73.0

Source: Company, Anand Rathi Research

Fig 32 – Key segments' growth Y/Y (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Top-five verticals growth (Y/Y)					
Banking and Capital Market	17%	25%	20%	29%	35%
Insurance	-6%	9%	9%	13%	19%
IT, Comm & Entertainment	3%	19%	25%	27%	15%
Logistics & Transportation	-2%	18%	25%	24%	20%
Others (Life, Mfg, & Retail)	-4%	4%	0%	9%	14%
Service Lines					
Application Services	0%	15%	22%	39%	38%
Application Development	-16%	-13%	9%	-1%	-1%
Business Process Services	55%	53%	13%	7%	11%
Regions					
North America	6%	17%	18%	29%	34%
India	7%	49%	18%	24%	26%
RoW	7%	19%	-2%	-26%	-37%
EMEA	16%	19%	28%	14%	6%

Source: Company, Anand Rathi Research

Valuations

The stock trades at 24x FY24e EPS of Rs115. This, we think, is undervalued, considering Mphasis' robust pipeline, opportunities in BFSI (its largest vertical), Hi-tech (likely the next $100m vertical), Europe (strong pipeline), strong pace now of the Direct business and steady TCV wins.

While the slowing DXC is no longer a concern, given its lower concentration (5%), Direct business growth has counter-balanced the slowdown in DXC. Consolidated growth has started reflecting Direct growth more.

The EBIT margin is likely to expand from FY22's 14.6% (our estimates, FY23 15.6%, FY24 16.3%). Lower margins in H2 FY22 and H1 FY23e are due to the Blink acquisition and cost pressures. However, the company has absorbed these headwinds and we expect it to pull up margins in FY23. We expect it to improve operational efficiencies to regain some of the margin it lost in FY22, and cross FY21 levels by FY24. Since DXC contributed only 6% to revenue in FY22 and we expect ~3% by FY24, Mphasis' risk profile has markedly improved.

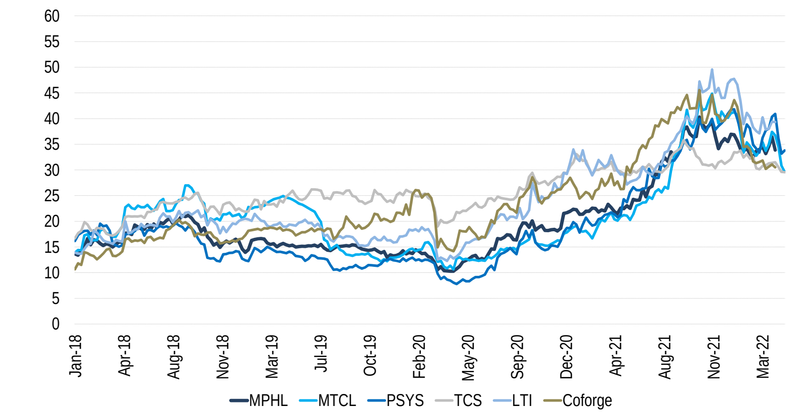
Its FCF-to-NI conversion had deteriorated in FY19 (65%) but rose to 101% in FY20. Over FY21, Mphasis generated 103% FCF:NI and fell to 75% in FY22 on account of the Blink acquisition, we expect it to be ~70% in FY23 and FY24. Considering all these factors, we value the stock at 36x FY24e, with a slightly higher target of Rs.4,150 (Rs.3,910 previously).

Fig 33 – Change in estimates (Rs m)

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	1,917	1,896	1.1	2,261	2,203	2.7
Revenues	144,764	142,632	1.5	170,736	165,695	3.0
EBITDA	25,816	24,307	6.2	31,072	28,421	9.3
EBITDA margins %	17.8%	17.0%	79 bps	18.2%	17.2%	105 bps
EBIT	22,620	21,003	7.7	27,876	25,117	11.0
EBIT margins %	15.6%	14.7%	90 bps	16.3%	15.2%	117 bps
PBT	23,625	21,655	9.1	28,869	26,074	10.7
Net profit	17,719	16,241	9.1	21,652	19,556	10.7

Source: Anand Rathi Research

Fig 34 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Slowdown in US BFSI top accounts.

Appendix

Analyst Certification

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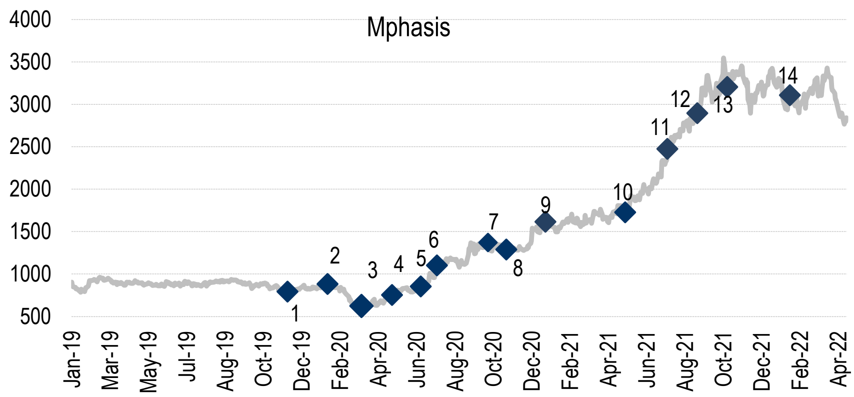

	Date	Rating	TP (Rs)	Share Price (Rs)
1	2-Dec-19	Buy	1,000	880
2	7-Feb-20	Buy	1,130	933
3	31-Mar-20	Buy	1,030	664
4	15-May-20	Buy	970	805
5	29-Jun-20	Hold	1000	893
6	27-Jul-20	Hold	1175	1118
7	15-Oct-20	Sell	1,240	1,426
8	24-Oct-20	Hold	1,480	1,382
9	25-Jan-21	Buy	1,930	1,599
10	16-May-21	Buy	2,260	1,789
11	24-Jul-21	Buy	3,130	2,506
12	23-Sep-21	Buy	3,740	3,247
13	25-Oct-21	Buy	3,900	3,247
14	25-Jan-22	Buy	3,910	3,042

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Additional information on recommended securities/instruments is available on request.

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