23 January 2023

Mphasis

Rating: **Buy**
Target Price: Rs.2,820
Share Price: Rs.2,020

Revenue slows on delayed ramp-ups; TCV and margins improve: Buy

In Q3, Mphasis undershot peers with its sequentially flattish IT services (82% of revenue). The weakness arose from furloughs and delayed ramp-ups in deals won previously. It did well, however, in its key strengths such as TCV (net new $401m) and client mining (first client moving to the $200m bracket), keeping alive revenue-acceleration hopes. BPM (18% of revenue) reflected weakness in Mortgages (~50% of BPM) though industry volumes have started stabilising in the last 2 months. Margins are trending up; to retain pace as revenue growth returns and utilisation/offshore improve. The weak Q3 leads to our ~4% cut in estimates and 3% in the target.

Another quarter of strong deals, weak growth. Mphasis' ability to secure TCV was strong (new TCV: $401m, up 20% y/y; TTM at $1352m, up 2%) but conversion to revenue was tested again by furloughs and delayed ramp-ups in IT Services ($352m, up 1% q/q, 13% y/y). The slower-environment impact was harder for Mphasis than for peers (industry growth: 2% q/q, 9% y/y). The company expects to regain pace as the furlough impact fades and ramp-ups begin.

Digital Risk 8.8% of revenue, down 35% y/y. The DR division is ~50% of the BPM service line and one of the key reasons for Mphasis' slowing growth. Its contribution, however, has shrunk considerably in the past one year, and US mortgage industry volumes appear to be stabilising in the last couple of months. Therefore, we expect reduced drag from DR from Q4.

Profitability higher, operating metrics support further expansion. Mphasis' Q3 EBIT margin was 16%, up 52bps q/q, 168bps y/y. Key operating levers like offshoring (by revenue) and utilisation were up sequentially and offer further tailwinds. Reported margins would improve from Q1 as hedging losses subside. We expect ~16% EBIT margins by FY25, leading to a 12% EBIT CAGR.

Maintaining a Buy. We cut estimates by ~4% and target by ~3% on delayed recovery in the core business. We expect Mphasis to start matching peers' growth rates from Q1 FY24, and value it at 25x FY25e EPS (23x earlier), slightly below LTIM, on better portfolio mix resulting into lower volatility in performance. Our new TP is Rs.2,820 (Rs2,900 earlier). **Risk:** Slowdown in top US BFSI accounts.

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	96,920	118,612	140,152	153,573	175,875
Net profit (Rs m)	12,166	14,311	16,581	18,857	21,367
EPS (Rs)	65.1	76.4	87.6	99.6	112.9
P/E (x)	31.3	26.7	23.3	20.5	18.1
EV / EBITDA (x)	20.3	17.7	14.3	12.6	11.2
P/BV (x)	5.9	5.6	5.1	4.6	4.2
RoE (%)	19.7	21.2	22.8	23.7	24.4
RoCE (%)	15.0	15.8	18.9	20.2	20.9
Dividend yield (%)	3.2	2.3	2.6	3.0	3.4
Net debt / equity (x)	-0.4	-0.3	-0.4	-0.4	-0.5

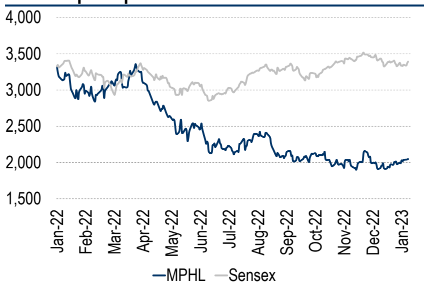
Source: Company, Anand Rathi Research

Key data	MPHL IN / MBFL.BO
52-week high / low	Rs.3466 / 1896
Sensex / Nifty	60622 / 18028
3-m average volume	$12.8m
Market cap	Rs.381bn / $4700.8m
Shares outstanding	188m

Shareholding pattern (%)	Dec'22	Sep'22	Jun'22
Promoters	55.7	55.5	55.7
- of which, Pledged			
Free float	44.4	44.5	44.3
- Foreign institutions	18.9	20.7	20.5
- Domestic institutions	19.5	17.8	18.2
- Public	5.9	6.0	5.6

Estimates revision (%)	FY23e	FY24e	FY25e
Sales ($)	(1.6)	(4.3)	(4.2)
EBIT	0.5	(0.9)	(1.4)
PAT	(2.6)	(4.1)	(4.6)

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Revenues (US$m)	**1,308.9**	**1,592.8**	**1,738.5**	**1,866.6**	**2,137.7**
Growth (%)	**5.6**	**21.7**	**9.1**	**7.4**	**14.5**
Net revenues (Rs m)	96,920	118,612	140,152	153,573	175,875
Employee & Direct Costs	70,787	89,501	104,520	113,802	131,727
Gross Profit	26,133	29,111	35,633	39,772	44,148
Gross Margin %	26.96	24.54	25.42	25.90	25.10
SG&A	8,408	8,834	10,462	11,151	12,205
EBITDA	**17,725**	**20,277**	**25,170**	**28,620**	**31,943**
EBITDA margins (%)	18.3	17.1	18.0	18.6	18.2
- Depreciation	2,418	2,906	3,264	3,735	4,263
Other income	1,632	2,505	1,149	1,303	1,879
Interest Exp	634	744	980	878	878
PBT	16,305	19,132	22,075	25,311	28,681
Effective tax rate (%)	25	25	25	26	26
+ Associates/(Minorities)	-	-	-	-	-
Net Income	12,166	14,311	16,581	18,857	21,367
WANS	187	187	189	189	189
FDEPS (Rs/share)	65.1	76.4	87.6	99.6	112.9

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	1,870	1,878	1,878	1,878	1,878
Net worth	65,267	69,431	75,999	83,341	91,466
Total debt (incl. Pref)	5,135	5,272	1,318	-	-
Minority interest	-	-	-	-	-
DTL/(Asset)	-6,172	-5,979	-7,364	-7,364	-7,364
Capital employed	**64,230**	**68,724**	**69,953**	**75,976**	**84,101**
Net tangible assets	7,795	8,693	7,500	6,067	4,436
Net Intangible assets	1,074	1,695	2,921	2,174	1,321
Goodwill	21,326	27,348	27,348	27,348	27,348
CWIP (tang. & intang.)	31	110	110	110	110
Long-term Assets (Liabilities)	-5,517	-7,642	-8,609	-8,629	-8,648
Investments (Financial)	18,460	18,130	18,130	23,569	30,640
Current Assets (ex Cash)	25,434	33,317	38,033	42,517	48,691
Cash	10,622	9,494	9,972	10,682	11,492
Current Liabilities	14,996	22,421	25,452	27,862	31,290
Working capital	10,438	10,896	12,581	14,655	17,401
Capital deployed	**64,230**	**68,724**	**69,953**	**75,976**	**84,101**
Contingent Liabilities	16,932	21,330	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT	16,305	19,132	22,075	25,311	28,681
+ Non-cash items	2,142	3,212	3,173	3,219	3,383
Operating profit before WC	18,447	22,344	25,248	28,530	32,063
- Incr./(decr.) in WC	453	1,501	3,070	2,074	2,746
Others incuding taxes	-3,448	-3,686	-5,587	-6,435	-7,294
Operating cash-flow	14,545	17,157	16,591	20,021	22,023
- Capex (tangible + Intangible)	1,262	1,200	1,418	1,554	1,780
Free cash-flow	13,284	15,957	15,173	18,467	20,243
Acquisitions	-805	-5,219	-1,878	-	-
- Dividend (including buyback & ta	6,527	12,177	10,013	11,515	13,242
+ Equity raised	268	442	-	-	-
+ Debt raised	-409	32	-3,954	-1,318	-
- Fin Investments	4,824	-1,798	-	5,439	7,071
- Misc. Items (CFI + CFF)	1,621	1,961	-1,150	-515	-880
Net cash-flow	-635	-1,128	477	710	810

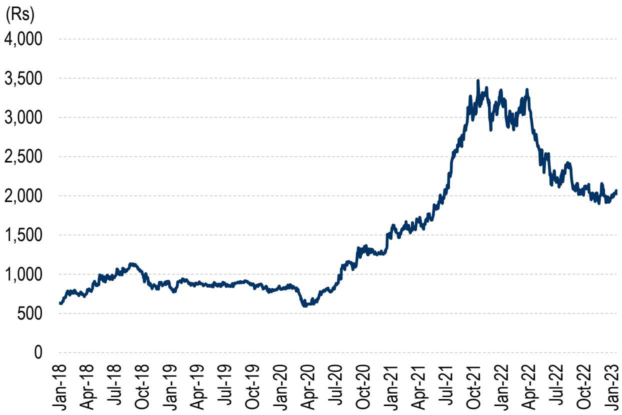
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	31.3	26.7	23.3	20.5	18.1
EV/EBITDA (x)	20.3	17.7	14.3	12.6	11.2
EV/sales (x)	3.7	3.0	2.5	2.3	1.9
P/B (x)	5.9	5.6	5.1	4.6	4.2
RoE (%)	19.7	21.2	22.8	23.7	24.4
RoCE (%) - After tax	15.0	15.8	18.9	20.2	20.9
RoIC (%) - After tax	23.2	24.2	27.8	30.6	34.0
DPS (Rs per share)	65.0	46.0	52.9	60.8	70.0
Dividend yield (%)	3.2	2.3	2.6	3.0	3.4
Dividend payout (%) - Inc. DDT	119.8	60.2	60.4	61.1	62.0
Net debt/equity (x)	-0.4	-0.3	-0.4	-0.4	-0.5
Receivables (days)	70	69	71	73	73
Inventory (days)					
Payables (days)	27	32	31	31	31
CFO:PAT%	119.6	119.9	100.1	106.2	103.1
FCF:PAT% - includ M&A payout	102.6	75.0	80.2	97.9	94.7

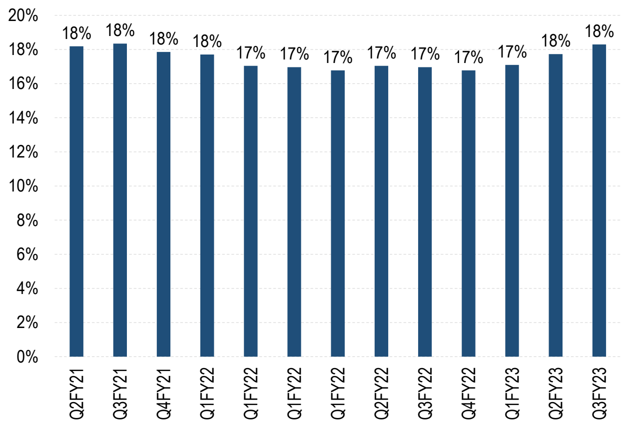
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBITDA margins



Source: Company, Anand Rathi Research

Result Highlights

Q3 FY23 Results at a Glance

Fig 7 – Q3 FY23 results (Rs m)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q/Q %	Y/Y %
Revenue ($ m)	414	431	436	440	429	-2.5%	3.7%
Growth Y/Y %	21%	23%	17%	12%	4%		
Industry Y/Y % (est.)	21%	20%	16%	13%	9%		
Revenue (Rs m)	30,955	32,448	33,909	35,273	35,356	0.2%	14.2%
Effec. exchange rate	74.8	75.3	77.8	80.1	82.3	2.8%	10.1%
New TCV wins ($ m)	335.0	347.0	302.0	302.0	401.0	32.8%	19.7%
TCV (LTM)	1,326.0	1,428.0	1,225.0	1,286.0	1,352.0	5.1%	2.0%
Y/Y %	36%	42%	-40%	25%	20%		
TCV:Rev.	0.8	0.8	0.7	0.7	0.9		
Employees (EoP)	34,915	36,534	36,899	36,876	35,450	-3.9%	1.5%
Rev. prod. ($ '000/employee)	12.3	12.1	11.9	11.9	11.9	-0.5%	-3.6%
Utilisation % (IT Services)	76.9%	73.0%	74.4%	72.3%	73.7%	142 bps	-313 bps
CoR (excl. D&A)	(23,417)	(24,609)	(25,341)	(26,583)	(26,245)	-1.3%	12.1%
As % of revenue	-76%	-76%	-75%	-75%	-74%	113 bps	142 bps
SG&A	(2,288)	(2,396)	(2,771)	(2,438)	(2,642)	8.4%	15.5%
As % of revenue.	-7%	-7%	-8%	-7%	-7%	-56 bps	-8 bps
EBITDA	5,250	5,443	5,797	6,252	6,469	3.5%	23.2%
EBITDA margins %	17.0%	16.8%	17.1%	17.7%	18.3%	57 bps	134 bps
EBIT	4,424	4,644	5,001	5,451	5,648	3.6%	27.7%
EBIT margins %	14.3%	14.3%	14.7%	15.5%	16.0%	52 bps	168 bps
Industry margins % (est.)	17.9%	17.3%	16.4%	14.6%	15.4%	78 bps	-259 bps
Other income (excl. forex)	190	235	241	284	273	-3.9%	43.7%
Non-recurring / Forex	398	486	320	75	(167)	NM	NM
Interest expenses	(216)	(208)	(232)	(260)	(244)	-6.2%	13.0%
PBT	4,796	5,157	5,330	5,550	5,510	-0.7%	14.9%
PBT margins %	15.5%	15.9%	15.7%	15.7%	15.6%	-15 bps	9 bps
Taxes	(1,219)	(1,236)	(1,310)	(1,366)	(1,387)	1.5%	13.8%
ETR %	-25%	-24%	-25%	-25%	-25%	-56 bps	24 bps
Associates / Minority							
Net income	3,577	3,921	4,020	4,184	4,123	-1.5%	15.3%
Net margins %	11.6%	12.1%	11.9%	11.9%	11.7%	-20 bps	11 bps
Industry net margins %	14.0%	14.3%	12.5%	11.8%	11.1%	-70 bps	-288 bps
EPS (Rs)	19.1	20.9	21.2	22.1	21.8	-1.4%	14.1%

Source: Company, Anand Rathi Research

Fig 8 – Quarterly results

Year-end: Mar (Rs m)	Q3FY23	% chg. Q/Q	% chg. Y/Y	9M as % of FY23	FY23e	FY23e % chg. Y/Y	FY24e % chg. Y/Y
Sales ($ m)	429	(2.5)	3.7	75	1,738	9.1	7.4
Sales	35,356	0.2	14.2	75	140,152	18.2	9.6
EBITDA	6,469	3.5	23.2	74	25,170	24.1	13.7
EBITDA margin (%)	18.3	57bps	134bps	-	18.0	86bps	68bps
EBIT	5,648	3.6	27.7	73	21,907	26.1	13.6
EBIT margin (%)	16.0	52bps	168bps	-	15.6	99bps	57bps
PBT	5,510	(0.7)	14.9	74	22,075	15.4	14.7
Tax	(1,387)	1.5	13.8	74	(5,494)	14.0	17.5
Tax rate (%)	(25.2)	-56bps	24bps	-	(24.9)	31bps	-61bps
Net income	4,123	(1.5)	15.3	74	16,581	15.9	13.7

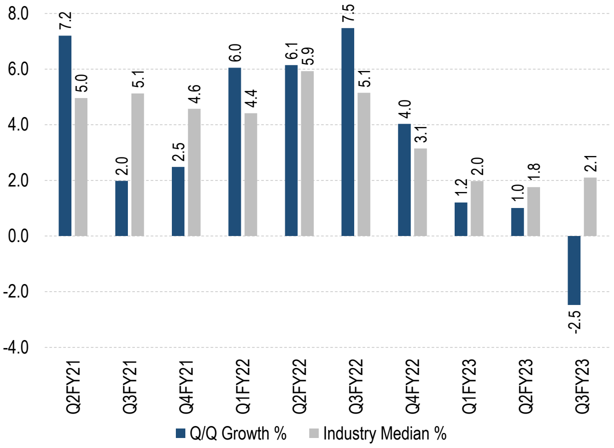
Source: Company, Anand Rathi Research

Slow revenue growth amid strong TCV

Mphasis' consolidated revenues were down 2.5% q/q, up 3.7% y/y. The Direct business (95% of revenue) was down 2.6% q/q, but y/y up 4.4%. The slower quarter stemmed primarily from furloughs, delayed ramp-ups and weakness in the Mortgage division. This belied our estimates as we expected a better IT Services performance and a steady correlation between Mphasis' deal wins and revenues. Mphasis blamed the slower ramp-ups for delays in the conversion of TCV to revenues. In Q3, DXC was steady.

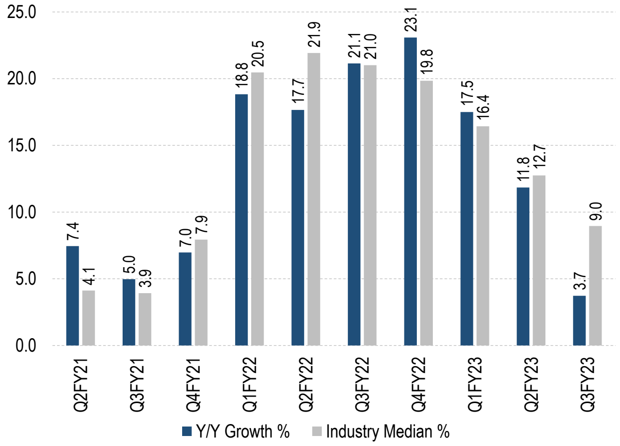
In Q3 FY23, Mphasis was down 2.5% sequentially, lagging the industry median for the third consecutive quarter, and much slower than its peers. It grew 4% y/y, again lower than the industry and slower than peers. The Direct business (95% of the total) for the first time in many quarters grew slower than the industry in Q3, recording a 4% y/y growth (up 13% y/y excl. Digital Risk).

Fig 9 – Revenues decline sequentially



Source: Company, Anand Rathi Research

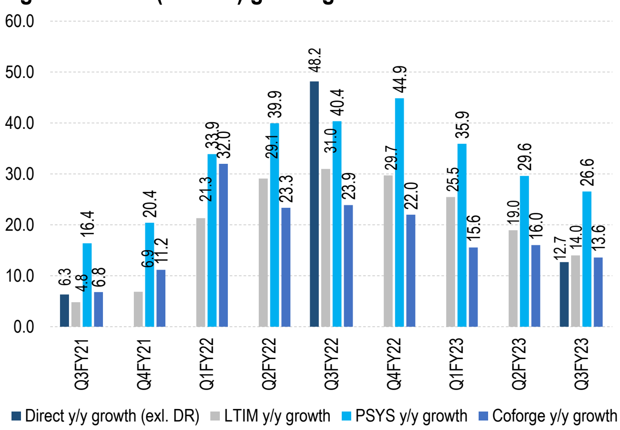
Fig 10 – … and grow slower than the industry, y/y



Source: Company, Anand Rathi Research

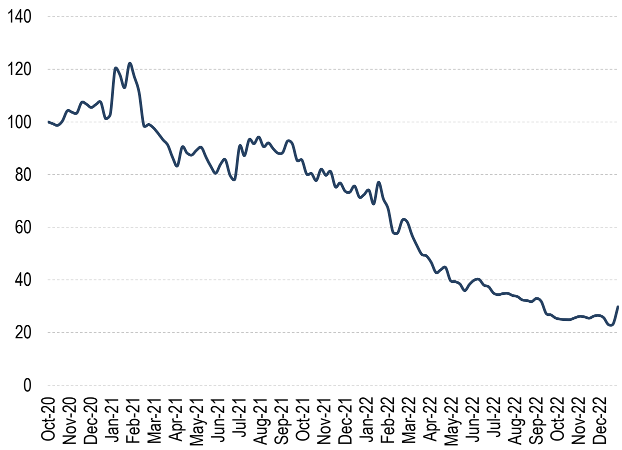
In Q3, Digital Risk was a drag on revenue, excluding which the Direct business has done slightly better (up 13% y/y, 14.5% in cc terms) than the industry and a step behind LTIM (+14%). Loan applications seem to be stabilising in the past few months, and have started picking up in the first few weeks of Jan.

Fig 11 – Direct (exl. DR) growing



Source: Company, Anand Rathi Research Note: Numbers are extrapolated from individual company financials for comparison purpose till Q1FY23.

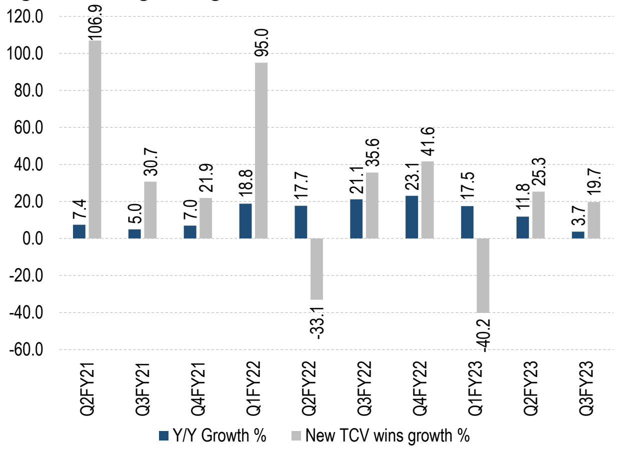
Fig 12 – Loan applications show signs of stabilization



Source: MBA published volumes, Bloomberg, Anand Rathi Research Note: Scaled to 100

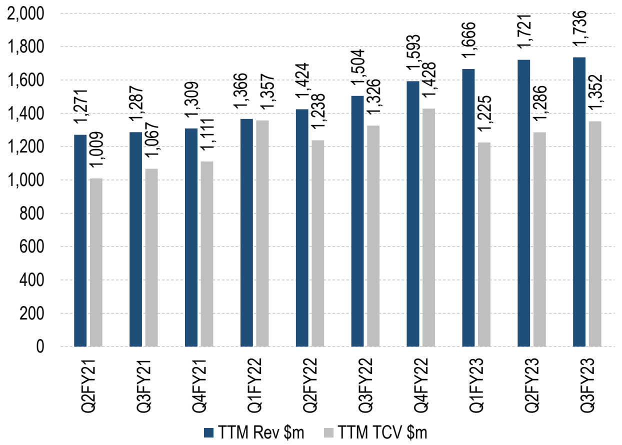
The correlations between Mphasis' new TCV wins and Direct revenue growth is high (0.85, down from a high of 0.93). The drop in correlation was largely due to slower ramp-ups in deals won and ramp-downs in DR. In TCV, it had a strong quarter ($300m+ for the fifth straight quarter) up 33% q/q, at $401m (up 20% y/y); Q2 new TCV wins were $302m. Management claims that the pipeline is 6% higher sequentially and, therefore, momentum remains sturdy.

Fig 13 – TCV growing faster than revenue



Source: Company, Anand Rathi Research

Fig 14 – TTM revenue, TTM net new TCV ($ m)



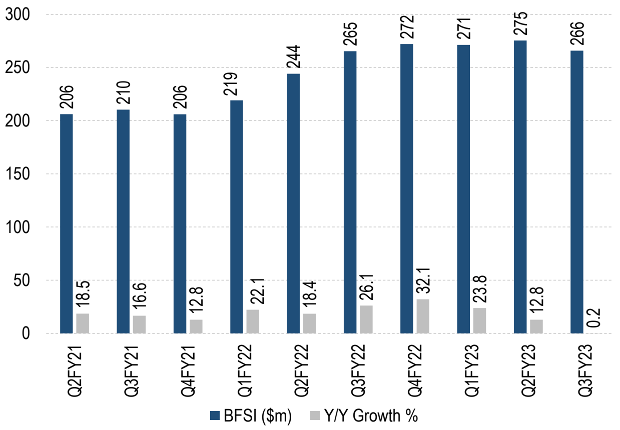
Source: Company, Anand Rathi Research

BFSI, TMT, Travel & Logistics decline sequentially

Mphasis' strength lies in three verticals: BFSI (62% of revenue), TMT (13%) and Travel & Logistics (13%). Within BFSI, growth was slower in the BFS vertical (down 4% q/q) while the Insurance vertical was down 3% q/q. Softness in the BFS vertical was due the mortgage side of the business. This division is seeing weakness in refinance, origination and home equity. Previously, the home equity line cushioned the fall in refinance and origination, but in Q3 this line of business also declined. Insurance was down 3% sequentially but the company is winning large deals in this vertical and is confident of winning more ahead.

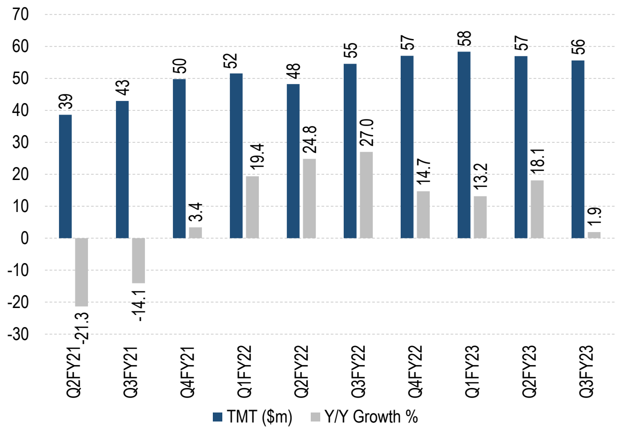
The TMT vertical declined further in Q3, largely due to furloughs; management believes that this is not a trend and growth should return. In Q3, 16% of the TCV came from the TMT vertical. The Blink acquisition is likely to aid growth in this vertical as deal sizes improve; for now, though, the focus is on integration and margins. It is a priority vertical for Mphasis (started as a legacy business from HP; hence, abilities are strong), and is likely to grow well ahead.

Fig 15 – BFSI flattish y/y, impacted by mortgage volumes



Source: Company, Anand Rathi Research

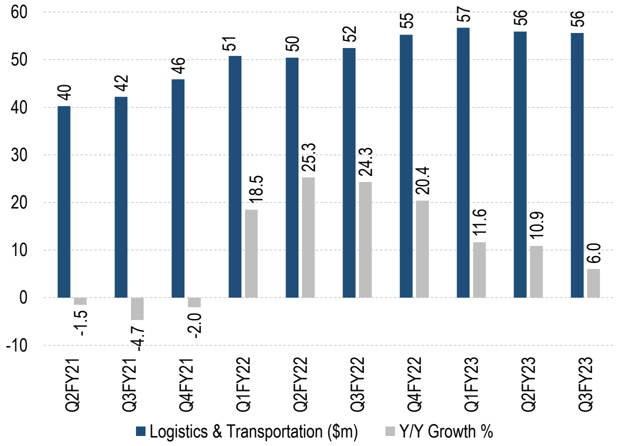
Fig 16 – TMT growth slower due to furloughs this year



Source: Company, Anand Rathi Research

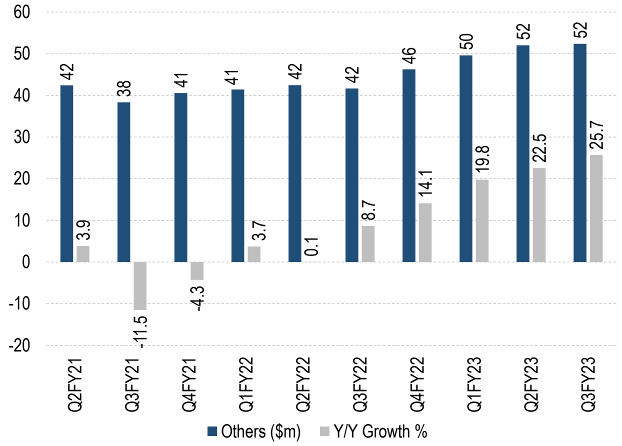
Mphasis' Logistics & Transportation vertical stepped down 0.5% sequentially (but y/y up 6%). Growth concerns persist in this vertical as some clients may face difficulties in the present economic context.

Fig 17 – Logistics and Transportation continue to grow



Source: Company, Anand Rathi Research

Fig 18 – Others (Healthcare, Manufacturing, Retail) leads y/y



Source: Company, Anand Rathi Research

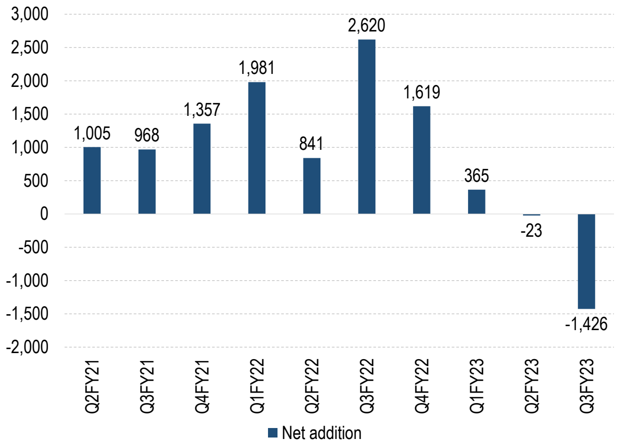
Other verticals (12% of revenue) were up 0.6% q/q, 26% y/y. The company said it is seeing strong growth in the Healthcare vertical (37% y/y in Q3) due to the recent deal wins. It won a large deal from a new customer in this vertical in Q3.

Headcount declines, productivity in line with peers

Mphasis' headcount declined by 1,426 in Q3 but the company added 535 in the last twelve months, which has helped it bring utilisation down to 73.7% in Q3 FY23 (extrapolated from on-site/offshore utilisation), from 76.9% a year ago. BPO onsite headcount was down 28% y/y due to the mortgage business and may still be slow in Q4. Offshore IT Services headcount declined by 1,060 as management re-focuses on margins amid weak revenue visibility. The company did not reveal any target hiring figure for FY23/FY24. Attrition is coming down.

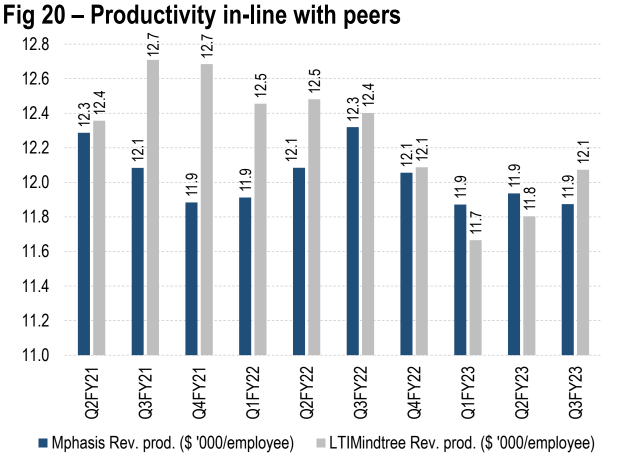
Management talked of having a healthy amount of offshore revenue. This would help it manage costs better. With respect to the mortgage business, management did not give guidance but, given it is 8.8% of the total, the further impact on earnings will be limited to that extent.

Fig 19 – Headcount declines sequentially



Source: Company, Anand Rathi Research

Fig 20 – Productivity in-line with peers

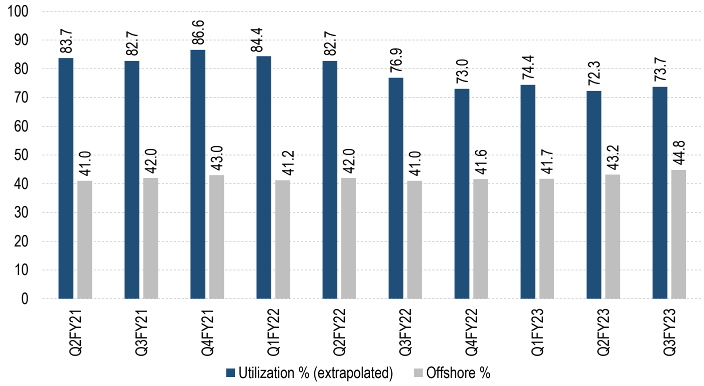


Source: Company, Anand Rathi Research Note: Figures are extrapolated from individual company financials for comparison purposes till Q1 FY23.

From an employee-productivity perspective, Mphasis is ~4% lower than its recent past, as it added more freshers and utilisation dipped. It is looking to improve offshoring but, given that utilisation is expected to inch up and BPO headcount is expected to come down, productivity should largely be stable. Mphasis benefitted from partial hikes in pricing though this appears difficult in the present dicey situation. However, along with greater utilisation, revenue productivity is still likely to improve.

Mphasis has caught up with its peer, LITMindtree, in terms of productivity despite its BPO division, ~26% of employees, who are included in the productivity chart above, while LTIMindtree does not have BPO practices.

Fig 21 – Utilisation and Offshoring can be levers for margin



Source: Company, Anand Rathi Research

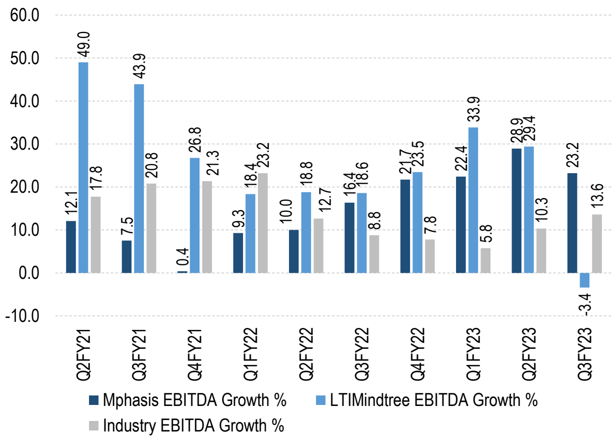
From a utilisation perspective, it appears that it has some headroom to deliver on margins. Supply-side challenge have eased, reflected in the lower attrition and commentary of peers. In Q3, management said utilisation could improve ~300-400bps.

EBITDA, NI growth higher than the industry

Mphasis delivered 23% EBITDA growth y/y in Q3 FY23, ahead of the industry. This it delivered despite its lower-than-industry growth. It absorbed headwinds from the DR business through better utilisation, offshoring and pyramid correction.

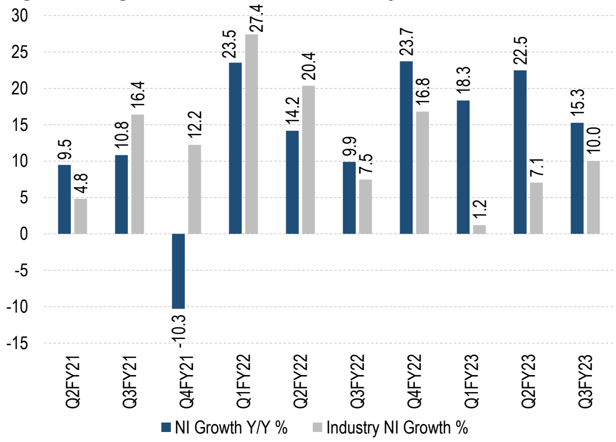
It delivered an 18.3% EBITDA margin in Q3, up 57bps q/q, 134bps y/y. Overall, it has delivered 17-18% EBITDA margins for the last 10 quarters. Levers in its favour are greater utilisation and offshoring. We expect it to continue to deliver ~19% margins in coming quarters.

Fig 22 – EBITDA growing better than industry



Source: Company, Anand Rathi Research

Fig 23 – NI growth better than industry



Source: Company, Anand Rathi Research

We expect company margins to improve 86bps in FY23 and another 68bps in FY24 as some headwinds abate and operational levers are deployed.

NI grew 15% y/y, above the industry average, while the NI margin was down 20bps q/q, but y/y up 11bps. This the company delivered despite lower other income incl. forex (down 70% q/q, 82% y/y). The ETR was up 56bps q/q but down 24bps y/y to 25.2%.

Outshines in client mining

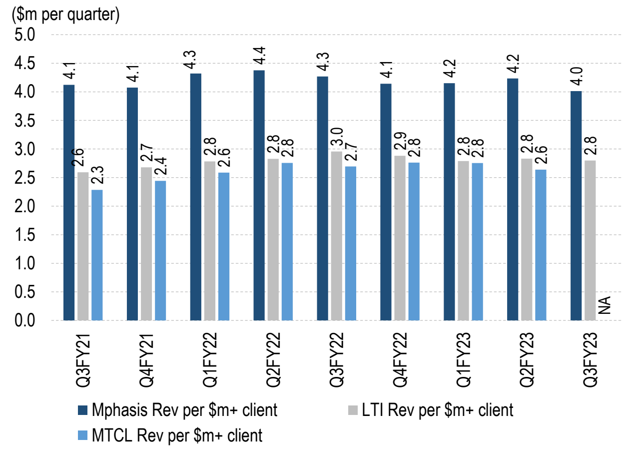
Mphasis clearly stands out when it comes to revenue per ($1m+) client. On this parameter it averaged $4.2m per client per quarter in the last nine quarters and is ahead of its peers. Further, the variability for Mphasis is much lower (barring Q3) over this time frame, highlighting strong and stable client relations and the consequential client-mining benefits.

On another parameter, Mphasis has added many clients (across revenue buckets) in the last few years, again reflecting strong client-mining capabilities. It added four clients (y/y) in Q3, taking the total to 46 ($5m+ clients). 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.

Compared to its peers, Mphasis has a lower percent of clients in the $1m-5m bucket. 57% of Mphasis' $1m+ clients fall in the $1m-5m bucket; for LTIM this is 62%. This further highlights the deeper relationship that Mphasis has with its clients.

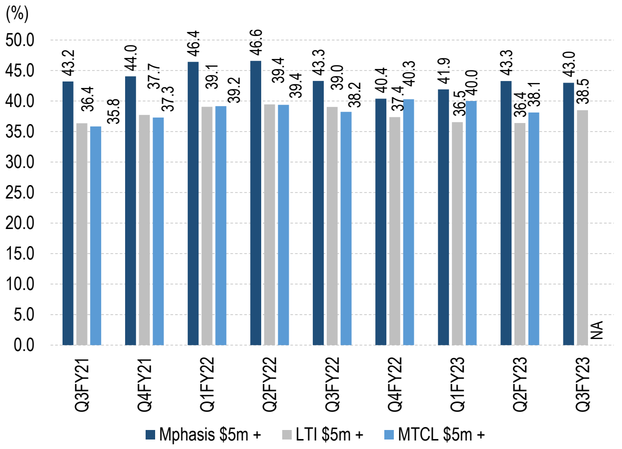
Efforts on the mining side have been quite visible in the $20m+ category where Mphasis added four clients (incl. one in $150m+ and one in $200m+) on an LTM basis. It has deepened its relations with clients, visible in the percent of $20m+ clients moving from 9.3% in Q3 FY22 to 12.1% in Q3 FY23, ahead of peers.

Fig 24 – Revenue per client higher than peers



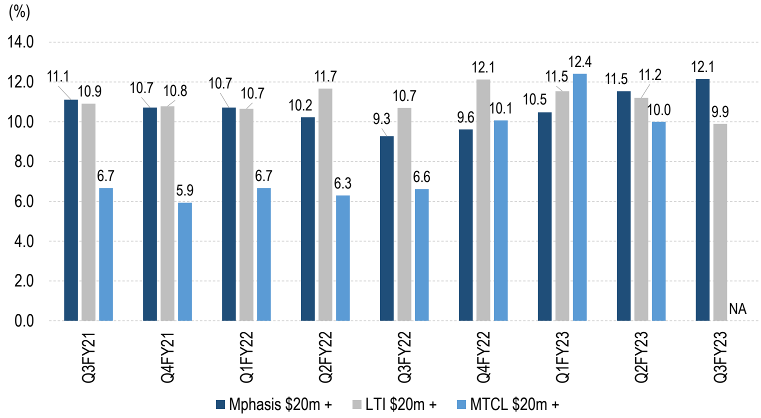
Source: Company, Anand Rathi Research Note: Q3FY23 LTI number is LTIM number

Fig 25 – Better than peers in $5m+ bucket (as a %of $1m+)



Source: Company, Anand Rathi Research Note: Q3FY23 LTI number is LTIM number

Fig 26 – Mphasis improves in the $20m+ bucket (as % of $1m+ clients)



Source: Company, Anand Rathi Research Note: Q3FY23 LTI number is LTIM number

Conference Call Highlights

Q3 FY23 concall highlights

- BFS performance impacted by Digital Risk (DR) portfolio. Insurance is seeing healthy TCV conversion.
- DR contributes 8.8% to revenue, of which 20% is origination and refinancing related.
- The pace of mortgage volume ramp-down was unanticipated. It is made up of origination, home equity line (negative co-relation with origination) and Servicing (more project based).
- The Healthcare vertical is growing well and the company is seeing healthy TCV conversions. It closed one large deal from a new customer here in Q3.
- Weakness in Hi-tech vertical largely due to furloughs in Q3.
- North America performance weighed down by DR.
- Application services growth driven by wallet- and market-share gains.
- Top-10 customer growth impacted by DR as well; doing well excl. DR.
- On an LTM basis, the top client contributed >$200m; the top-five, $150m or more each; the top-six, $75m or more each.
- Some clients are taking longer to ramp-up deals; renewals are also taking longer.
- Overall, seeing weakness in pockets of discretionary spends.
- Net new TCV was the second highest ever, 53% came from BFS. BFSI is 56% of the pipeline. Mphasis won five large deals, of which one is of $100m+.
- Largest deal announced in Q3 is from a top-10 account.
- Seeing many deals around core system modernisation and CX in banks.
- Seeing vendor consolidation as a theme; well positioned for it.
- EBIT margin improved to 15.3% due to pyramid correction despite headwinds from drop in DR revenue. Fresher billing is at all-time high.
- Utilisation to move up (3-4%) further; this, coupled with better growth, should lead to expanded margins ahead.
- The company is seeing scarcity in talent in niche/specific areas.
- Hired new M&A head; expect some activity in CY23.
- Previously, the company's treasury policy covered 80-100% for the next four quarters, Mphasis has reduce its coverage in the last three quarters, which should come closer to 40-50% in 1.5 quarters.

Business Outlook

- Q4 growth to be better than Q3.
- EBIT margin to be 15.25-17%.

Previous concall highlights

Q2 FY23 concall highlights

- Revenue in Q2 was impacted by furloughs in a key client and the more-than-expected ramp-down in Mortgage BPO. The client, which had a furlough impact in Q2, may be impacted in Q3 as well.
- Diversified mortgage business over the years, but this couldn't cushion the decline. Most mortgage revenues are onsite and the furloughs impact was also onsite. Interest-rate sensitive business is in low single-digits of total revenue.
- Not sure when Mortgage will bottom out. Within Mortgage, home equity, due diligence and servicing have grown.
- Gaining share with key BFS customers. Making investments in Europe and Canada to expand there and further strengthen BFSI.
- TMT vertical was impacted by furloughs, nothing directional. Pipeline in TMT is strong
- Pipeline is up 18% q/q and the company has a strong order book. It won two large deals in Q2 (cumulatively $110m) and 12 large deals in the last four quarters. 81% of TCV is in Newgen areas.
- Direct revenue and TCV correlation is exceeding 0.8.
- The two deals these are 3-4 year deals. Run rate in revenue to start in 2.5-3 months.
- Digitisation and modernisation drove the growth in the Apps segment
- The top-three clients brought $150m+ (LTM basis), and the top (banking) client's LTM contribution is over $200m. Average LTM contribution of the top-five clients surpasses $150m. The top-six clients bring more than $75m.
- Continues to invest above the guided margin.
- Q2 FY23 gross margin same as a year ago.
- Blink-related amortisation decreasing in absolute terms.
- Onsite headcount increased, but billability arose only towards the month's end. Headcount addition in IT and the Applications categories happened at end-Q2 and should reflect in Q3 revenue.
- Exit utilization was 4% higher. Utilization can improve 3-4% in the next couple of quarters.
- EBIT margin to be 15.3%-15.7%, with an upward bias.

Q1 FY23 concall highlights

- Softness in revenue due to Mortgage LoB. The company expects some more run-rate issue in this business. Weakness also seen in Europe.
- Growth currently is Apps- and offshore-driven.
- BFS continues to grow despite headwinds in mortgage LoB (DR). Digital Risk seeing weakness in refinance and origination but the company has added new lines (eg. Home equity loans), which has blunted the impact. Digital Risk has come down in contribution toward both revenue and profit.

- Insurance saw some milestone achievement in Q4; hence, down q/q, and the margin reflects a milestone achievement. Further, Insurance sees some impact from DXC but this vertical has a decent pipeline.
- Mortgage – refinance is less than half of the business and the company has expanded into compliance and operations
- Healthcare seeing strong demand and doing well on the back of recent deal wins
- Growth to accelerate in coming quarters as the company gains market share in clients and verticals, spending plans of clients, improving market presence through capability building (incl. M&As) and strength of pipeline.
- Increase of 5% in FP contracts
- Europe TCV to revenue timeline being stretched, although the pipeline is robust and company continues to win deals.
- Net new deal wins at $302m, Q1 FY23 had one large deal of $50m+ and the company signed a $60m deal with a top-5 client in Jul. 84% of TCV is in newgen areas.
- Pipeline is up 6 % q/q, 10% y/y, almost all tribe-driven. Correlation between TCV and revenue at 0.87.
- Average contribution from top-5 clients: $150m.
- Adjusted for M&A charges, EBIT of 15.8% (15.3% incl. M&A charge)
- Utilisation can improve another 600bps from current levels.
- Attrition is elevated but is past the peak and is stabilising.
- BPO onsite headcount down due to mortgage business. BPO business would not have any material impact on company growth rates.
- Growth to be in the leaders' quadrant
- EBIT margins to be 15.2–17%.

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.

- 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.
- 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).

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
- 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.
- 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.
- 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.

Factsheet

Fig 27 – Revenue-split, by industry (%)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Banking and Capital Market	55	54	53	54	54
Insurance	9	10	9	8	8
IT, Comm & Entertainment	13	13	13	13	13
Logistics & Transportation	13	13	13	13	13
Others (Life, Mfg, & Retail)	10	11	11	12	12

Source: Company, Anand Rathi Research

Fig 28 – Revenue-split by service line (%)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Application Services	63	65	66	67	69
Business Process Services	25	23	22	21	18
Infrastructure Services	12	11	12	12	13

Source: Company, Anand Rathi Research

Fig 29 – Revenue-split, by region (%)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
North America	81	82	82	82	82
EMEA	11	11	10	10	10
India	5	5	5	5	5
RoW	3	3	3	3	3

Source: Company, Anand Rathi Research

Fig 30 – Revenue-split, by delivery and billing (%)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
On-site	59.0	58.4	58.3	56.8	55.2
Offshore	41.0	41.6	41.7	43.2	44.8
Total	100	100	100	100	100
T&M %	55.0	54.7	54.5	56.0	56.8
FP %	29.0	29.7	29.9	30.0	30.5
Transaction Based%	16.0	15.6	15.6	13.9	12.7

Source: Company, Anand Rathi Research

Fig 31 – Client profiles (LTM)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Client concentration %					
Top 1	11.0	11.0	11.0	12.0	12.0
Top 5	43.0	44.0	45.0	45.0	45.0
Top 10	58.0	59.0	60.0	60.0	59.0
Total $1m+ clients	97	104	105	104	107
Client profiles (TTM, ">")					
$1m+	97	104	105	104	107
$5m+	42	42	44	45	46
$10m+	21	22	24	24	23
$20m+	9	10	11	12	13
$50m+	7	7	7	7	7
$75m+	6	6	6	6	6
$100m+	4	4	4	4	4

Source: Company, Anand Rathi Research

Fig 32 – Revenue-split by market segment (%)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
DXC	5%	5%	5%	5%	5%
Non DXC	95%	95%	95%	95%	95%

Source: Company, Anand Rathi Research

Fig 33 – Employee data

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Number of employees	34,915	36,534	36,899	36,876	35,450
Utilisation % (cum trainees)	76.9	73.0	74.4	72.3	73.7

Source: Company, Anand Rathi Research

Fig 34 – Key segments' growth, y/y (%)

	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Top-five verticals growth (Y/Y)					
Banking and Capital Market	29%	35%	25%	14%	1%
Insurance	13%	19%	16%	8%	-3%
IT, Comm & Entertainment	27%	15%	13%	18%	2%
Logistics & Transportation	24%	20%	12%	11%	6%
Others (Life, Mfg, & Retail)	9%	14%	20%	23%	26%
Service Lines					
Application Services	39%	37%	28%	26%	14%
Application Development	-1%	2%	25%	6%	9%
Business Process Services	7%	13%	-1%	-10%	-26%
Regions					
North America	29%	35%	30%	20%	5%
India	24%	23%	28%	12%	6%
RoW	-26%	-37%	-50%	-29%	4%
EMEA	14%	4%	-4%	-7%	-5%

Source: Company, Anand Rathi Research

Valuations

The stock trades at 18x FY25e EPS of Rs113. It, we reckon, is undervalued despite current sales weakness, considering Mphasis' robust pipeline, opportunities in BFSI (its largest vertical) and in Hi-tech (likely the next $100m vertical), strong pace of the Direct business (excl. the DR performance) and strong TCV wins.

Consolidated growth has started reflecting Direct growth. The pressure on account of the mortgage business is likely to impact figures less ahead since the company's reliance on that category has slid to 8.8%.

The EBIT margin is likely to expand from FY22's 14.6% (our estimates, FY23 15.6%, FY24 16.2%). The company should absorb headwinds with the help of utilisation and offshoring. The DXC contribution has stabilised at ~5% over the last five quarters.

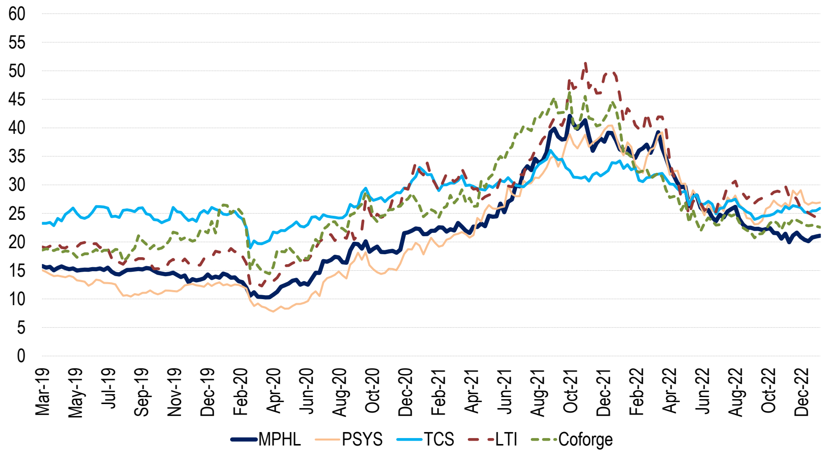
Its FCF-to-NI conversion had deteriorated in FY19 (65%) but rose to 101% in FY20. Over FY21, Mphasis generated 103% FCF:NI, which fell to 75% in FY22 on account of the Blink acquisition. We expect it at ~90% over FY23-FY25. Considering all these factors, we value the stock at 25x FY25e, with a target of Rs.2,820 (Rs.2,900 previously).

Fig 35 – Change in estimates (Rs m)

(Rs m)	FY23			FY24			FY25		
	New	Old	% Change	New	Old	% Change	New	Old	% Change
Revenue ($ m)	1,738	1,766	(1.6)	1,867	1,951	(4.3)	2,138	2,231	(4.2)
Revenues	1,40,152	1,42,270	(1.5)	1,53,573	1,60,223	(4.2)	1,75,875	1,83,166	(4.0)
EBITDA	25,170	25,039	0.5	28,620	28,885	(0.9)	31,943	32,400	(1.4)
EBITDA margins %	18.0%	17.6%	36 bps	18.6%	18.0%	61 bps	18.2%	17.7%	47 bps
EBIT	21,907	21,840	0.3	24,886	25,681	(3.1)	27,681	28,948	(4.4)
EBIT margins %	15.6%	15.4%	28 bps	16.2%	16.0%	18 bps	15.7%	15.8%	-7 bps
PBT	22,075	22,574	(2.2)	25,311	26,506	(4.5)	28,681	30,193	(5.0)
Net profit	16,581	17,020	(2.6)	18,857	19,667	(4.1)	21,367	22,403	(4.6)

Source: Anand Rathi Research

Fig 36 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- Slowdown in top US BFSI accounts.

Appendix

Analyst Certification

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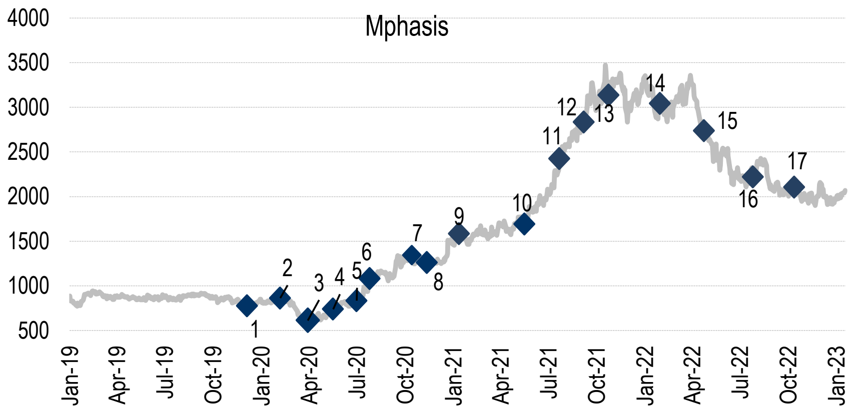
Rating and Target Price History (as of 20 January 2023)



	Date	Rating	TP (Rs)	Share Price (Rs)
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
15	2-May-22	Buy	4,150	2,796
16	25-Jul-22	Buy	3,420	2,321
17	25-Oct-22	Buy	2,900	2,038

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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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