

Company Update

Mphasis Ltd

Bloomberg Code: MPHIL IN

India Research - Stock Broking

BUY

Growth Drivers Remain Intact

We remain positive about the future growth prospects of Mphasis. We expect revenues to grow at 12% CAGR FY18-21E. We are optimistic about the future potential from the Blackstone channel. We expect the Digital Risk business to swing back to normalcy by FY20 as new deals are ramped up. Growth of Direct Core will be aided by new deals and strong order book, which currently stands at \$484 Mn. We expect acquisition of Stelligent will add to Mphasis' capabilities and aid new deal wins. We expect earnings to grow at 17.28% CAGR FY18-21E. This is on the backdrop of improved operational efficiency and consistent revenue growth. We recommend a "BUY" rating for Mphasis with a target price of Rs.1247.

Revenue growth led by Direct Core and DXC/HP channel*: Overall revenues grew at 2.8% on quarterly basis in Q3FY19. Growth in this quarter has an inorganic component of around 0.5% due to Stelligent acquisition. Organic growth was driven by Direct Core and DXC/HP businesses. Direct Core grew 6% (QoQ) and DXC/HP channel grew 6.4% (QoQ). YTD FY19, 10 new logos from Blackstone channel have been added, out of which 3 were added in this quarter. Fresh order intake of \$112 Mn into Direct International business in this quarter has made its order book YTD worth \$484 Mn. 81% of these deal wins are related to New-Gen services.

Quarterly margin impacted by seasonal factors: On yearly basis, EBITDA margins were up 30 bps at 15.8% due to revenue growth and operational efficiencies. But on quarterly basis, EBITDA margin has declined by 60 bps due to wage hikes and seasonal client shutdowns. Going forward, we can expect reduction in subcontracting expenses in DXC channel and rationalization of General and Administration expenses to aid margins.

New deal wins provide revenue visibility: 3 largest deals have been won in this quarter. Two of them are in the AI domain and the other one is related to migration to cloud. These clients were acquired from Blackstone channel. In the coming year, we expect addition of more logos from Blackstone.

Valuation & Risks

We recommend "BUY" with a target price of Rs. 1247 and an upside potential of 21%. We value the stock at its 3-year historical average PE of 19x for FY20E EPS of Rs. 65.4. Key risks to our call include stagnation of DXC/HP channel business and delays in project closures.

Exhibit 1: Valuation Summary (Rs. Mn)

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	60764	65458	78454	90652	102898
EBITDA	9687	10623	13729	16771	18522
EBITDA Margin (%)	15.9	16.2	17.5	18.5	18.0
Adj. Net Profit	7915	8374	10264	12179	13510
EPS (Rs.)	37.6	43.3	55.2	65.4	72.6
RoE (%)	13.2	14.4	18.8	21.1	20.8
PE (x)*	15.4	19.5	18.6	15.7	14.1

Source: Company, Karvy Research, *Represents multiples for FY17 - FY18 are based on historic market price

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Recommendation (Rs.)

CMP (as on Feb 06, 2019)	1026
Target Price	1247
Upside (%)	21

Stock Information

Mkt Cap (Rs.mn/US\$ mn)	191056 / 2670
52-wk High/Low (Rs.)	1279 / 799
3M Avg. daily value (Rs. mn)	356.7
Beta (x)	0.8
Sensex/Nifty	36975 / 11062
O/S Shares(mn)	186.2
Face Value (Rs.)	10.0

Shareholding Pattern (%)

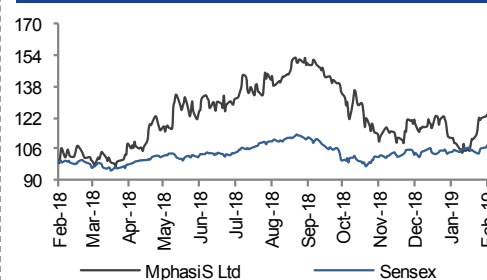
Promoters	52.3
FIIs	28.9
DIIs	7.8
Others	11.0

Stock Performance (%)

	1M	3M	6M	12M
Absolute	10	13	(13)	21
Relative to Sensex	6	7	(11)	12

Source: Bloomberg

Relative Performance*



Source: Bloomberg; *Index 100

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Stelligent Systems acquisition to boost revenue: MphasiS acquired Stelligent Systems with capabilities in DevOps Automation Services on Amazon AWS in this quarter. It will provide access to top talent and will shorten deployment cycle by providing agility to delivery. The acquisition of Stelligent Systems closed mid-quarter hence its impact in Q3 is limited to 0.5% of revenue. But in the coming quarter, we will see full impact of this acquisition on revenue.

Cost take-out program aided margins: Over the past 6 quarters, the EBIT margin has improved by 300 bps due to cost-cutting initiative by the management. As part of the initiative, management rationalized G&A expenses by optimizing pyramid and a fresh campus hire program. It also resorted to rationalization of the supply chain and readjustment of utilization. Further some G&A costs were repurposed along with efficiencies driven by creating shared services. We expect the benefits of this would continue to aid margins in the future.

Company Background

MphasiS was formed in June 2000 after the merger of the US-based IT consulting company MphasiS Corporation and the Indian IT services company BFL Software Limited. In June 2006, Electronic Data Systems (EDS) purchased a controlling stake in the company (42%) for \$80 Mn and operated the company as an independent EDS unit. In 2008, Hewlett-Packard confirmed a deal with Electronic Data Systems to acquire the company for \$13.9 Bn. In April 2016, it was announced that Blackstone had acquired 84% of Hewlett-Packard's stake in MphasiS in a deal worth between \$825 Mn and \$1.1 Bn. On 29 Jan 2017, Nitin Rakesh joined MphasiS as the Chief Executive Officer and Director.

MphasiS Limited is an IT solution provider in cloud and cognitive services. The Company's segments include Banking and Capital Market, Insurance, Information Technology, Communication and Entertainment and Emerging Industries. The geographical segments include United States of America, India, Asia Pacific and Europe, Middle East and Africa. It offers cloud computing, cognitive solutions, digital services, securing businesses, application services and infrastructure services. The Company serves various industries such as banking and capital market which includes retail banking, credit cards and payments, wealth management and brokerage, corporate banking solutions and investment banking technology. Its insurance industry includes property and casualty, life and retirement and health. Its other industries consist of communications, energy and utilities, healthcare, life science, logistics, manufacturing and travel and transportation.

*DXC/HP channel is the partnership between DXC Technology & MphasiS to transform and modernize enterprise applications for public, private and hybrid cloud. DXC Technology was setup from the merger of Computer Sciences Corporation, Electronic Data Systems and Enterprise Services segment of HPE (Hewlett Packard Enterprise).

Exhibit 2: Q3FY19 Financials

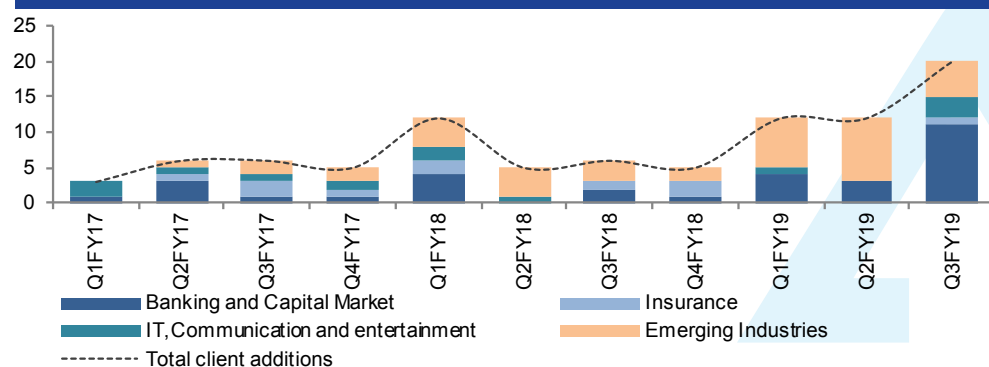
(Rs. Mn)	Q3FY19	Q2FY19	QoQ %	Q3FY18	YoY %
Turnover	19710	19149	2.9	16607	18.7
Expenditure	16404	15820	3.7	14349	14.3
EBITDA	3306	3329	(0.7)	2742	20.6
Depreciation	196	184	6.5	176	11.4
Interest	28	26	7.7	29	(3.4)
Other Income	506	441	14.8	312	62.3
PBT	2576	2678	(3.8)	2225	15.8
Tax	801	877	(8.7)	741	8.1
Adj. PAT	1775	1801	(1.5)	1484	(16.4)
EBITDA Margin (%)	16.5	17.4	(88) bps	16.5	0 bps
EBIT Margin (%)	15.8	16.4	(65) bps	15.5	33 bps
Net Profit Margin (%)	13.3	13.9	(54) bps	12.4	89 bps

Source: Company, Karvy Research

Exhibit 3: Segmental Financials

(Rs. Mn)	Q3FY19	Q2FY19	QoQ %	Q3FY18	YoY %
Segment-wise revenues					
Banking and capital market	8825	8964	(1.6)	7732	14.1
Insurance	2369	2199	7.7	2079	13.9
IT, Communication and entertainment	3370	3316	1.6	2334	44.4
Emerging industries	5464	5000	9.3	4072	34.2
Segment-wise EBIT					
Banking and capital market	2271	2538	(10.5)	1776	27.9
Insurance	693	591	17.3	541	28.1
IT, Communication and entertainment	872	803	8.6	486	79.4
Emerging industries	1813	1615	12.3	1243	45.9
Segment-wise EBIT Margin (%)					
Banking and capital market	25.7	28.3	(258) bps	23.0	276 bps
Insurance	29.3	26.9	238 bps	26.0	323 bps
IT, Communication and entertainment	25.9	24.2	166 bps	20.8	505 bps
Emerging industries	33.2	32.3	88 bps	30.5	266 bps

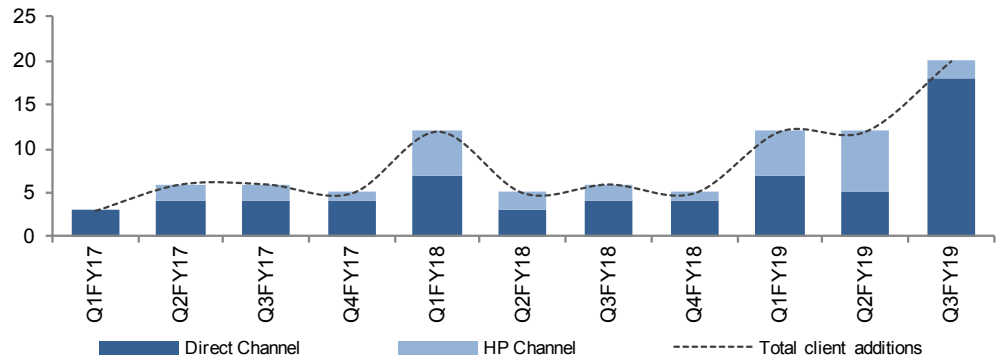
Source: Company, Karvy Research

Exhibit 4: New client addition vertical-wise


Source: Company, Karvy Research

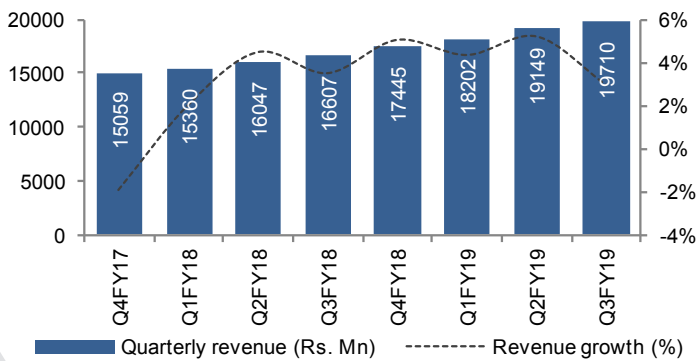
Performance Highlights

Exhibit 5: New client addition secondary market segment-wise



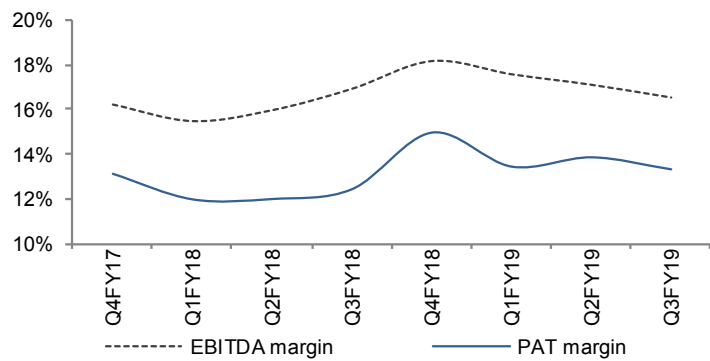
Source: Company, Karvy Research

Exhibit 6: Quarterly Revenue & Revenue Growth



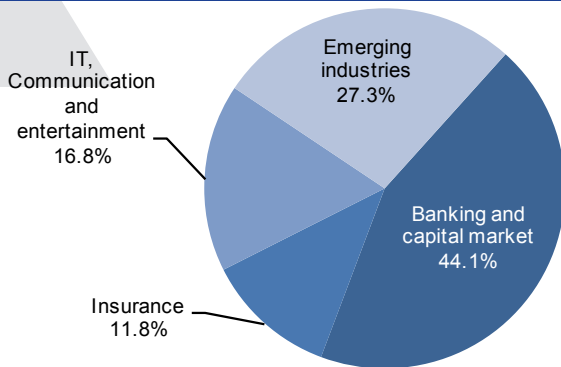
Source: Company, Karvy Research

Exhibit 7: Quarterly Margins Trend



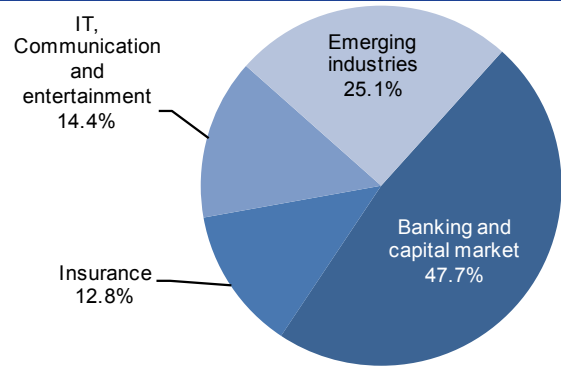
Source: Company, Karvy Research

Exhibit 8: Revenue Mix Vertical-wise (Q3FY19)



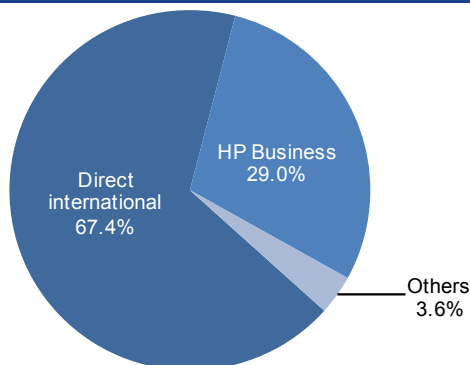
Source: Company, Karvy Research

Exhibit 9: Revenue Mix Vertical-wise (Q3FY18)



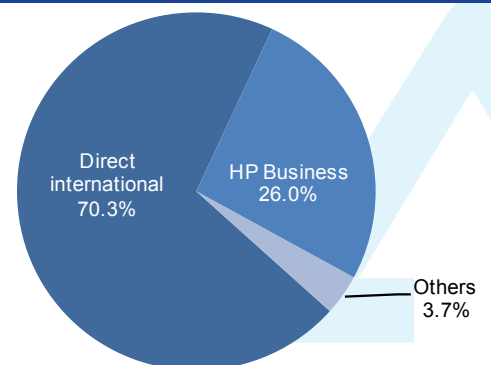
Source: Company, Karvy Research

Exhibit 10: Secondary Market Segment (Q3FY19)



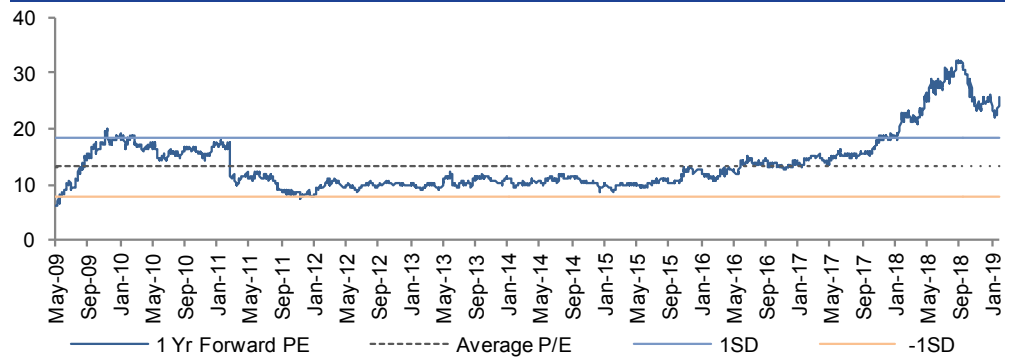
Source: Company, Karvy Research

Exhibit 11: Secondary Market Segment (Q3FY18)



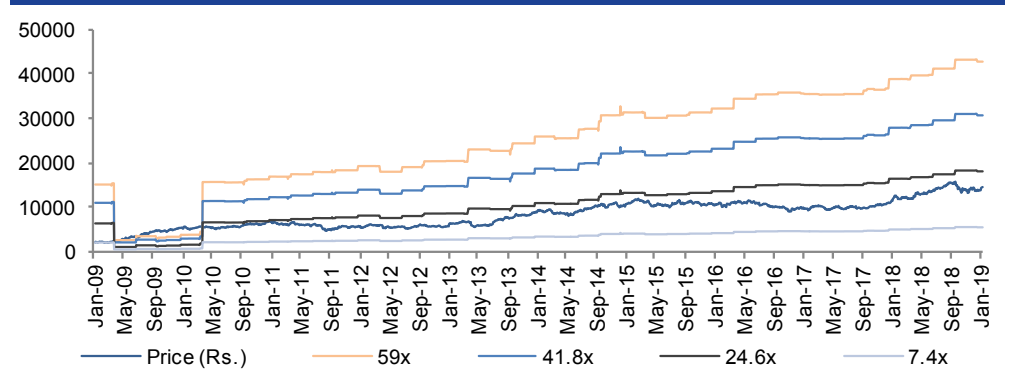
Source: Company, Karvy Research

Exhibit 12: 10 Year PE Band for Mphasis Ltd



Source: Bloomberg, Karvy Research

Exhibit 13: 10 Year PE Band for NSE IT



Source: Bloomberg, Karvy Research

Financials

Exhibit 14: Income Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Revenues	60764	65458	78454	90652	102898
Growth (%)	(0.1)	7.7	19.9	15.5	13.5
Operating Expenses	51076	54835	64725	73881	84376
EBITDA	9687	10623	13729	16771	18522
Growth (%)	7.8	9.7	29.2	22.2	10.4
Depreciation & Amortization	791	708	418	368	327
EBIT	8896	9915	13312	16402	18195
Other Income	2386	1621	506	0	0
Interest Expenses	139	130	133	164	182
PBT	11143	11406	13685	16238	18013
Tax	3076	2901	3421	4060	4503
Adjusted PAT	7915	8374	10264	12179	13510
Growth (%)	17.5	5.4	20.7	18.7	10.9

Source: Company, Karvy Research

Exhibit 15: Balance Sheet

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Cash & Cash Equivalents	6144	7067	8007	17054	24741
Sundry Debtors	6310	8127	7961	7111	7511
Loans & Advances	1818	1964	2250	2150	2153
Investments	23956	17821	9700	9520	9585
Net Block	2233	1826	1898	1689	1513
CWIP	11	23	151	151	151
Miscellaneous	32698	33032	42166	40443	39210
Total Assets	73171	69859	72132	78117	84864
Current Liabilities & Provisions	4406	5097	3397	2977	2634
Debt	2613	3937	5170	5437	5718
Other Liabilities	4628	6008	9273	8491	7790
Total Liabilities	11647	15042	17840	16905	16143
Shareholders Equity	2104	1933	1861	1861	1861
Reserves & Surplus	59420	52885	52431	59351	66860
Total Network	61524	54818	54292	61212	68721
Total Network & Liabilities	73171	69859	72132	78117	84864

Source: Company, Karvy Research

Exhibit 16: Cash Flow Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
PBT	11144	11407	13685	16238	18013
Depreciation	792	708	418	368	327
Interest	131	101	133	164	182
Tax Paid	(2903)	(2783)	(3421)	(4060)	(4503)
Inc/dec in Net WC	(1045)	(1502)	7322	1550	(324)
Other Income	(1210)	(219)	0	0	0
Other non cash items	(267)	(381)	0	0	0
Cash flow from operating activities	6642	7330	18137	14261	13694
Inc/dec in capital expenditure	(1181)	(327)	(200)	209	176
Inc/dec in investments	(1361)	5074	0	0	0
Others	5222	178	0	0	0
Cash flow from investing activities	2679	4925	(200)	209	176
Inc/dec in borrowings	(4623)	(846)	0	0	0
Issuance of equity	3	29	0	0	0
Dividend paid	(5055)	(3949)	(4501)	(5258)	(6001)
Interest paid	(71)	(98)	(133)	(164)	(182)
Others	2646	(8933)	(9937)	0	0
Cash flow from financing activities	(7100)	(13797)	(14571)	(5422)	(6183)
Net change in cash	2221	(1543)	3365	9047	7687

Source: Company, Karvy Research

Exhibit 17: Key Ratios

YE Mar	FY17	FY18	FY19E	FY20E	FY21E
EBITDA Margin (%)	15.9	16.2	17.5	18.5	18.0
EBIT Margin (%)	14.6	15.1	17.0	18.1	17.7
Net Profit Margin (%)	13.0	12.8	13.1	13.4	13.1
Dividend Payout Ratio (%)	45.2	46.2	36.3	30.6	27.6
Net Debt/Equity (x)	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
RoE (%)	13.2	14.4	18.8	21.1	20.8
RoCE (%)	14.0	15.9	22.1	25.5	25.3

Source: Company, Karvy Research

Exhibit 18: Valuation Parameters

YE Mar	FY17	FY18	FY19E	FY20E	FY21E
EPS (Rs.)	37.6	43.3	55.2	65.4	72.6
DPS (Rs.)	17.0	20.0	20.0	20.0	20.0
BVPS (Rs.)	29.2	28.4	29.2	32.9	36.9
PE (x)	15.4	19.5	18.6	15.7	14.1
P/BV (x)	19.8	29.7	35.2	31.2	27.8
EV/EBITDA (x)	12.2	15.1	13.7	10.7	9.3
EV/Sales (x)	1.9	2.4	2.4	2.0	1.7

Source: Company, Karvy Research; *Represents multiples for FY17 - FY18 are based on historic market price

Stock Ratings	Absolute Returns
Buy	: > 15%
Hold	: 5-15%
Sell	: < 5%

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