

MPHISIS LTD.

Industry IT Consulting & Software
 Bloomberg MPH.L:IN
 BSE Code 526299
 NSE Code MPHISIS

Thursday, September 06, 2018

RATING NEUTRAL

CMP 1243

Price Target 1311

Previous Target

Potential Upside 5%

52wk Range H/L 1278/575

Mkt Capital (Rs Cr) 24,034

Free float (%) 40%

Avg. Vol 1M (,000) 384

No. of Shares (Crore) 19.3

Promoters Pledged % 0%

New deal wins driving growth in FY19

Key Highlights

- ☑ MPHISIS secured new deal TCV in Direct International of USD 153mn (highest in last 4 quarter at 33% QoQ) with 78% of TCV in digital-focus areas. The management expects the deal pipeline to remain strong with larger deal opportunities in FY19.
- ☑ Europe continues to witness strong growth in 1QFY19 (12% QoQ).The management expects the momentum to continue in FY19 led by increase its sales investment within region.
- ☑ MPHISIS has announced a buyback of INR9.9b (3.8% of paid-up equity and 36% of existing cash) at a price of INR1,350 per share.
- ☑ 3QFY19 is expected to be impacted by wage hike, however the management maintains its guidance of 15% to 17% and expects it to be in higher end of the band in FY19.

1Q FY19 Result: Strong performance in Revenue and Margin

MPHISIS entered 1QFY19 with stable performance in revenue and margin. Revenue for the quarter stood at Rs1820 crore (grew 4% QoQ) mainly led by strong contribution from both the HP channel (grew 8.2%QoQ) and Direct Core (grew 7.5%QoQ). EBIT margin declined 20 bps (excluding the benefit of the one-time revenue from India government business in 4QFY18) as the result of decline in forward rates. However, major proportion was absorbed by improvement in operational levers. PAT for the quarter stood at Rs 258 crore, grew 9% QoQ due to higher forex gain.

View and Valuation:

MPHISIS has started the year with the strong performance in both the major channels (Direct core and HP). Direct core channel (which contributes 58% of revenue) grew by 7.5% QoQ mainly led by strong traction in digital services. HP channel (27% of revenue) too outperformed and grew 8% primarily led by HP DXC partnership. In 1QFY19, MPHISIS has signed new deal TCV of USD 153mn out of which 78% of the wins are in digital segment. The management expects the deal pipeline to remain strong with larger deal opportunities in FY19.

Going forward, we believe Mphasis to continue to report healthy revenue growth led by new client wins in Blackstone Portfolio, better traction from Europe, growth in emerging verticals and HP channel. However, Digital Risk (11% of revenue) which was facing challenges in FY18 is still the concern for the management as the headwinds have not fully subsided.

On the margin front, we expect margin to land in the higher end of guided range of 15% to 17% on the back of FX tailwind, business model shift to fixed price projects and better margin in the digital services. Going ahead, we expect revenue and PAT to grow at the CAGR of 14% and 20% respectively over FY18-20E. **However, with stretch in valuation, we do not see much upside in near term. Thus, we are Neutral on the stock with target of Rs 1311(21x FY20EPS).**

Key Risks to our rating and target:

- ◆ Delay in growth in HP channels.
- ◆ Slowdown in digital deal wins.

KEY FINANCIAL/VALUATIONS	FY15	FY16	FY17	FY18	FY19E	FY20E
Net Sales	5,795	6,088	6,076	6,546	7,582	8,544
EBITDA	870	896	969	1,062	1,336	1,512
EBIT	772	822	890	992	1,263	1,436
PAT	675	669	792	837	1,071	1,207
EPS (Rs)	32	32	38	43	55	62
EPS growth (%)	-2%	-1%	18%	15%	28%	13%
ROE (%)	12%	11%	13%	15%	18%	18%
ROCE (%)	13%	13%	14%	18%	21%	21%
BV	261	299	292	284	315	354
P/E (x)	12	15	15	19	22	20
P/B (x)	1	2	2	3	4	4

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1Q FY 19 Results
PAT ABOVE ESTIMATES

Financials	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY %	QoQ%	FY17	FY18	YoY %
Net Sales	1,536	1,605	1,661	1,744	1,820	19%	4%	6,076	6,546	8%
Other Income	47	38	35	42	45	-3%	7%	239	162	-32%
Employee Cost	914	929	963	1,012	1,037	14%	2%	3,710	3,818	3%
Other Expenses	393	427	423	423	463	18%	9%	1,394	1,666	19%
EBITDA	230	249	274	309	320	39%	3%	969	1,062	10%
Depreciation	18	18	18	17	18	-1%	5%	79,149	70,821	-11%
EBIT	211	231	257	292	302	43%	3%	890	992	11%
Interest	2	4	3	4	4	118%	4%	14	13	-6%
PBT	256	265	289	330	343	34%	4%	1,114	1,141	2%
Tax	69	67	74	80	85	23%	6%	308	290	-6%
Exceptional	-	-	-	13	-			15	13	-14%
PAT	187	198	215	238	258	38%	9%	792	837	6%

Traction in direct core/HP channel led broad based revenue growth in 1QFY19

MPHASIS entered 1QFY19 with broad based growth by both HP channel and Direct Core. Revenue for the quarter stood at Rs1820 crore (grew 4% QoQ) mainly led by strong contribution from HP channel which grew 8.3%QoQ and Direct Core grew 7.6%QoQ. Digital Risk too has stabilized with it in the desired range of USD28-30m.

MPHASIS won deals with TCV of USD153m which is 32% higher than the previous quarter. 78% of TCV wins were in digital-focus areas.

Segmental performance

Secondary Market Segment	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY %	QoQ%
Direct International	1,042	1,100	1,140	1,175	1,264	21.3%	7.6%
DXC / HP Business	384	409	422	461	499	29.9%	8.3%
Others	61	56	60	68	59	-3.9%	-12.7%

Strong performance led by all verticals

VERTICALS	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	YoY %	QoQ%
Banking and Capital Market	730	760	773	805	857	17.4%	6.5%
Insurance	201	202	208	198	205	2.1%	3.4%
IT, Comm & Entertainment	186	221	233	288	314	69.2%	8.9%
Emerging Industries	371	382	407	412	446	20.2%	8.3%

Banking saw a growth of 6.5% QoQ, Insurance grew by 3.4% QoQ, IT, Comm & Entertainment by 8.9% while Emerging Technologies grew by 8.3% QoQ.

Margins impacted by forward rates

EBIT margin declined 20 bps (excluding the benefit of the one-time revenue from India government business in 4QFY18) as the result of decline in forward rates. However, major proportion was absorbed by improvement in operational levers. PAT for the quarter stood at Rs 258 crore, grew 9% QoQ due to higher forex gain.

Management Retrieve its margin guidance of 15% to 17%

3QFY19 is expected to be impacted by wage hike. However the management maintains its guidance of 15% to 17% mainly on the back by improvement in operational efficiency, benefits from fixed-price projects and higher realization.

Concall Highlights

- ✓ Growth during the quarter was broad-based, driven by both the HP channel and the Direct Core business. Digital Risk too has stabilized with it in the desired range of USD28-30m.
- ✓ Europe which is one of the key element of Mphasis growth strategy continues to witness strong growth in 1QFY19 with the revenue growth of 12% QoQ. The management expects Europe to be key growth drivers for rest of the year as it continues to increase its focus on sales investments within the region.
- ✓ TCV of deal wins for the quarter stood at USD153mn (vs USD183mn in 1QFY18).
- ✓ Under the capital allocation policy, Mphasis has announced a buyback of INR9.9b (3.8% of paid-up equity and 36% of existing cash) at a price of INR1,350 per share.

Exhibit: Direct core channel

Continued growth momentum in Direct core revenues (78% of Direct international).

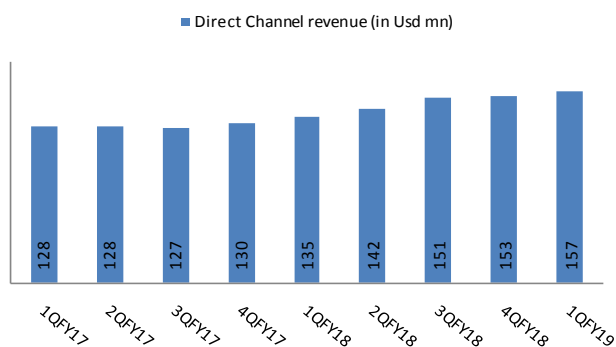


Exhibit: HP/DXC Channel

HP channel (27% of revenue) delivers steady growth.

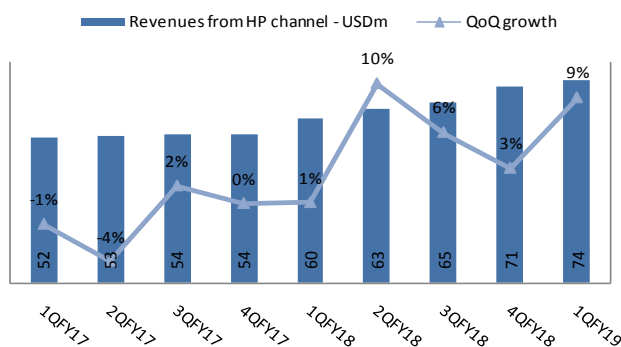


Exhibit: Digital Risk

Digital Risk has stabilized with it in the desired range of USD28-30m.

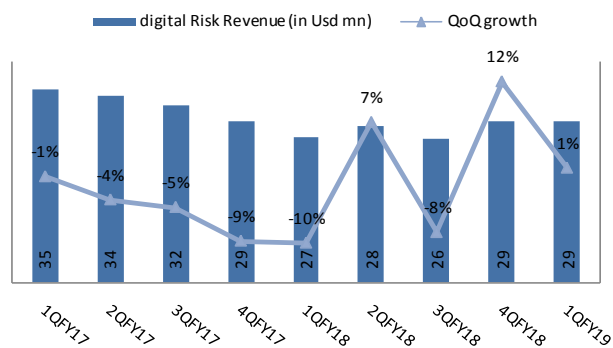


Exhibit: Segments

Strong performance across verticals.

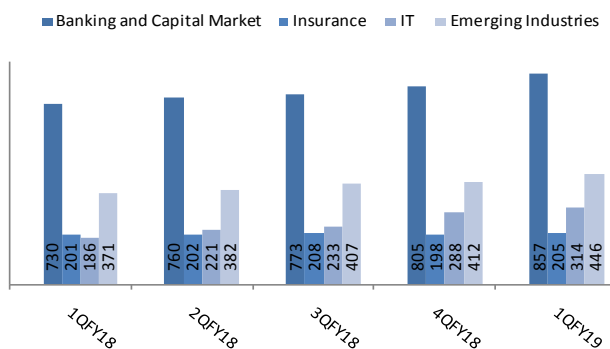


Exhibit: EBIT margins

Margins expected to land in the higher end of guided range of 15% to 17%.

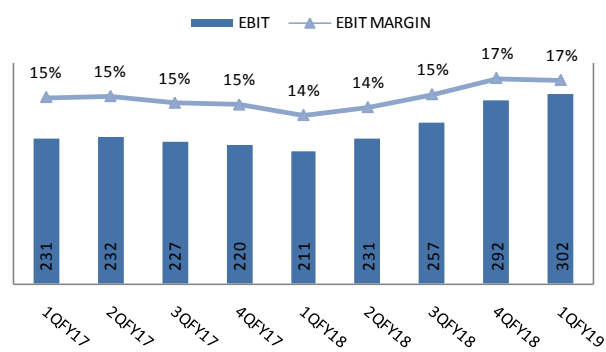
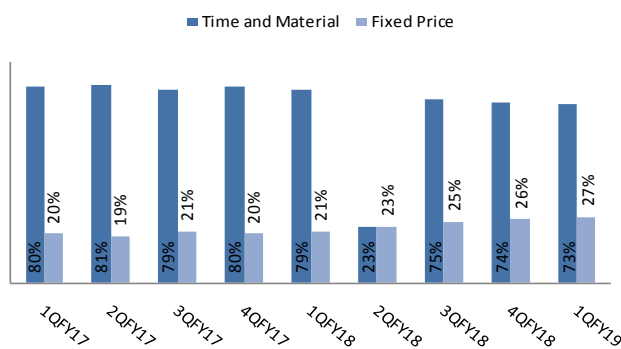


Exhibit: Revenue from Project type

Higher fixed project price will aid to margins in FY19.



Operational Metrics

<i>By Geography</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
AMERICAS	77%	77%	78%	79%	80%	80%	80%	79%	80%
EMEA	11%	11%	10%	10%	10%	10%	10%	11%	11%
INDIA	6%	6%	7%	6%	6%	6%	6%	6%	6%
ROW	6%	6%	5%	5%	4%	4%	4%	4%	3%
<i>Service Type</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
Application Maintenance & Other	36%	35%	37%	37%	36%	35%	33%	31%	30%
Application Development	23%	24%	23%	24%	25%	24%	26%	26%	28%
Customer Service	1%	1%	2%	2%	1%	2%	1%	1%	1%
Service / Technical Help Desk	2%	2%	2%	2%	5%	7%	8%	8%	8%
Transaction Processing Service	7%	7%	6%	6%	7%	7%	7%	7%	7%
IMS	14%	14%	14%	14%	14%	13%	13%	15%	15%
Knowledge Processes	16%	16%	15%	14%	12%	12%	11%	12%	11%
License Income	1%	1%	1%	1%	0%	0%	1%	0%	0%
<i>Client Concentration</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
Revenues from Top Client	11%	12%	11%	11%	12%	12%	12%	13%	13%
Revenues from Top 5 Clients	39%	40%	40%	41%	38%	40%	12%	40%	41%
Revenues from Top 10 Clients	53%	54%	55%	55%	54%	54%	55%	56%	56%
<i>By Delivery Location</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
Onsite	51%	52%	51%	51%	54%	55%	56%	56%	57%
Offshore	49%	48%	49%	49%	46%	45%	44%	44%	43%
<i>By Project Type</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
Time and Material	80%	81%	79%	80%	79%	23%	75%	74%	73%
Fixed Price	20%	19%	21%	20%	21%	23%	25%	26%	27%
<i>Headcount</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
<i>Onsite</i>									
Application Services	2,340	2,357	2,299	2,353	2,373	2,363	2,392	2,456	2,550
ITO Services / IS	215	281	251	274	277	676	1,106	1,120	1,087
BPO Services	1,236	1,189	1,127	1,040	1,044	998	981	950	914
<i>Offshore</i>									
Application Services	8,495	8,468	8,615	8,807	8,668	8,486	8,228	8,281	8,680
ITO Services / IS	3,158	3,196	3,136	3,074	3,055	3,011	3,062	3,121	3,075
BPO Services	5,682	5,561	5,351	5,176	5,191	5,360	5,304	5,139	5,092
Sales and Marketing	289	300	315	325	346	330	300	278	270
General and Administration	943	939	940	945	943	932	897	894	898
<i>New Client wins</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>	<i>1QFY19</i>
Banking and Capital Market	1	3	1	1	4	0	2	1	4
Insurance	0	1	2	1	2	0	1	2	0
Information Technology,	2	1	1	1	2	1	0	0	1
Emerging Industries	0	1	2	2	4	4	3	2	7
Direct Channel	3	4	4	4	7	3	4	4	7
HP / DXC Channel	0	2	2	1	5	2	2	1	5

Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	210	210	210	210	210	193	193	193
Reserves	4,724	4,905	5,270	6,083	5,942	5,289	5,896	6,639
Networth	4,934	5,115	5,480	6,293	6,152	5,482	6,089	6,833
Debt	498	431	434	311	260	390	390	390
Minority interest	-	-	-	-	-	-	-	-
Other Non Cur Liab	113	60	111	153	76	102	102	102
Total Capital Employed	5,545	5,606	6,025	6,758	6,489	5,973	6,581	7,324
Net Fixed Assets	239	224	176	173	224	185	174	181
Non Cur Investments	742	541	250	375	126	317	317	317
Other Non Cur Asst	16	25	105	104	198	151	151	151
Non Curr Assets	3,969	3,721	3,469	3,733	2,868	3,039	3,029	3,036
Current investment	1,158	1,275	1,193	1,736	2,270	1,465	1,996	2,331
Inventories	-	-	-	4	-	-	-	-
Trade receivables	651	778	625	649	628	812	940	1,059
Other current assets	586	545	558	682	270	280	265	299
Other financial assets	-	-	-	-	597	600	600	600
loans and advances	152	214	251	251	71	82	95	108
Cash	-	-	-	-	1	243	243	243
Bank balances	580	458	1,321	855	613	464	531	866
Current assest	3,127	3,269	3,948	4,177	4,449	3,946	4,670	5,505
Trade payables	621	451	406	453	388	502	582	656
current liabilities	263	567	489	560	100	145	167	189
Short term provisions	28	4	54	76	-	5	5	5
Employee liabilities	-	-	-	-	78	73	73	73
financial liabilities	-	-	-	-	160	180	180	180
Income tax liabilities	-	-	-	-	65	87	87	87
Curr Liabilities	1,550	1,384	1,392	1,152	828	1,012	1,118	1,217
Net Curr Assets	1,576	1,886	2,556	3,025	3,621	2,934	3,552	4,288
Total Assets	7,096	6,990	7,417	7,909	7,317	6,985	7,699	8,541

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	5,796	5,728	5,795	6,088	6,076	6,546	7,582	8,544
Change (%)	0	-1%	1%	5%	0%	8%	16%	13%
Other Operating Income	-	-	-	-	-	-	-	-
EBITDA	1,033	992	870	896	969	1,062	1,336	1,512
Change (%)	-2%	-4%	-12%	3%	8%	10%	26%	13%
Margin (%)	18%	17%	15%	15%	16%	16%	18%	18%
Depr & Amor.	145	122	98	74	79	71	73	76
EBIT	888	870	772	822	890	992	1,263	1,436
Int. & other fin. Cost	33	37	28	24	14	13	18	18
Other Income	140	117	197	196	239	162	189	213
EBT	995	950	941	994	1,114	1,141	1,434	1,631
Exp Item	-	6	3	55	15	13	-	-
Tax	251	258	263	270	308	290	363	424
Minority Int & P/L share of Ass.	-	-	-	-	-	-	-	-
Reported PAT	744	686	675	669	792	837	1,071	1,207
Adjusted PAT	744	686	675	669	792	837	1,071	1,207
Change (%)	-6%	-8%	-2%	-1%	18%	6%	28%	13%
Margin(%)	13%	12%	12%	11%	13%	13%	14%	14%

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Asset Turnover	24	25	29	35	31	32	42	48
Creditors (Days)	39	29	26	27	23	28	28	28
Debtor (Days)	41	50	39	39	38	45	45	45
Current Ratio	2	2	2.8	3.6	5.4	3.9	4.2	4.5
Debt/Equity	0	0	0.1	0.0	0.0	0.1	0.1	0.1
RoE	15%	13%	12%	11%	13%	15%	18%	18%
RoCE	16%	16%	13%	13%	14%	18%	21%	21%
DPS	17	7	16	20	17	20	20	20
Sales/Working Capital	4	3	2	2	2	2	2	2
Earnings Per Share	35	33	32	32	38	43	55	62
Book Value Per Share	235	243	261	299	292	284	315	354
EV/Sales	1	1	1	2	2	2	3	3
EV/EBITDA	8	9	8	11	12	15	18	16
P/BV	2	2	1	2	2	3	4	4
P/E	11	12	12	15	15	19	22	20
EPS GROWTH	-6%	-8%	-2%	-1%	18%	15%	28%	13%

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	995	428	941	945	1,114	1,141	1,434	1,631
(inc)/Dec in Working Capital	(17)	(121)	(20)	52	(105)	(150)	(43)	(88)
Non Cash Op Exp	53	21	(22)	(21)	(54)	21	73	76
Int Paid (+)	-	-	-	-	-	-	-	-
Tax Paid	(275)	(130)	(279)	(234)	(290)	(278)	(363)	(424)
others	-	-	(3)	(11)	(1)	-	-	-
CF from Op. Activities	756	198	616	731	664	733	1,123	1,217
(inc)/Dec in FA & CWIP	(74)	(36)	(72)	(127)	(118)	(33)	(63)	(83)
Free Cashflow	681	162	544	603	546	700	1,061	1,133
(Pur)/Sale of Inv	695	115	460	(562)	(126)	737	(531)	(335)
others	(1,164)	141	(755)	531	512	(211)	-	-
CF from Inv. Activitie	(543)	220	(366)	(158)	268	493	(593)	(418)
inc/(dec) in NW	0	0	0	0	0	0	(0)	-
inc/(dec) in Debt	129	-	8	(146)	(197)	128	-	-
Int. Paid	(31)	(11)	(22)	(18)	(7)	(10)	-	-
Div Paid (inc tax)	(415)	(418)	(172)	(404)	(505)	(395)	(463)	(463)
others	(0)	(0)	(0)	0	(0)	(1,103)	-	-
CF from Fin. Activities	(318)	(429)	(186)	(568)	(710)	(1,380)	(463)	(463)
Inc(Dec) in Cas	(105)	(11)	64	5	222	(154)	67	335
Add: Opening Balance	465	364	340	388	391	618	464	531
Closing Balance	360	353	403	393	613	464	531	866

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