



In partnership. With trust.

Mphasis

4QFY16 Result Update

Outlook hazy, margins to be under pressure

Sector: Technology

CMP: ₹ 472

Recommendation: Sell

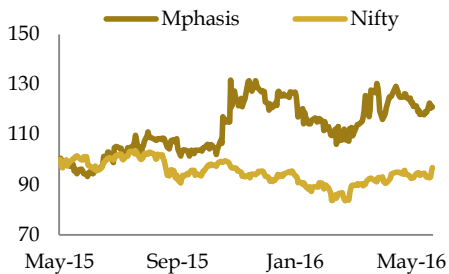
Market statistics

Current stock price (₹)	472
Shares O/S (cr.)	21.0
Mcap (₹ cr)	9,969
52W H/L (₹)	534/361
6m avg. volume	224,993
Bloomberg	MPHL.IN

Shareholding pattern

Promoters	60.47
Domestic Institution	9.89
Foreign Institution	21.97
Non-institution	7.67
of which more than 1%	
Aberdeen Global Indian Equity Fund Ltd	4.93
LIC OF India Market Plus 1 Growth Fund	1.64

Mphasis vs Nifty



Capital efficiency & valuations

Particulars	FY16	FY17E	FY18E
RoE (%)	12.3	11.5	12.0
EPS (₹)	34.4	35.3	38.6
CEPS (₹)	38.0	39.0	42.5
P/E (x)	13.7	13.4	12.2
P/BV (x)	1.6	1.5	1.4
EV/EBITDA (x)	10.5	10.3	8.6
Income growth (%)	5.1	(0.5)	8.5
EBITDA growth (%)	3.1	0.6	12.2
PAT growth (%)	0.0	10.2	9.4

Mphasis' US\$ revenues decreased 1.6% QoQ - primarily due to decline seen in HP business (down 0.5% QoQ, 24% of revenues now). International business (down 0.2% QoQ) impacted on account of project ramp down in Digital Risk. Management indicated discretionary budgets for clients remain under pressure, with longer decision cycles. We believe weak sentiment will continue looking at a declining headcount (the trend has been continuing since 20 quarters in ITO) and a weak outlook on HP's enterprise services business is likely to persist for some time. Margin at 15.4% (up 117bps QoQ) on account of lower wage expenses (5% QoQ decline in employees). We maintain our SELL rating on the stock on account of sluggish business fundamentals.

Mixed quarter. Mphasis reported US\$ revenues of US\$225.3mn (down 1.6% QoQ). Management indicated that HP channel revenues will remain weak. Business mix of Direct vs HP QoQ remained at 76:24. HP channel revenue declined 0.5% QoQ in US\$ terms. Direct International business net of rupee depreciation declined by 0.2% during Q4FY16 - on account of project ramp down in Digital Risk. EBIT margin for Q4FY16 was 14.3% (13.2% in Q3FY16). Business in Europe was up by 2.4% QoQ while US was down by 0.9%. RoW decreased 8.8% QoQ.

Operating metrics getting weaker, though cash supports downside: Consolidated headcount decreased by 1,210 (employees declining in ITO division, declining headcount since 20 quarters in ITO business) to 22,302. Mphasis added 11 clients this quarter (11 from the Direct channel). Net Cash & equivalents stand at ₹120/share (21% of the MCap is in form of cash). DSO's were increased 2 QoQ at 72 days this quarter. Utilisation and SG&A efficiencies are unlikely to provide much margin leverage going forward. Growth in the direct channel business going forward would be a positive. Mphasis did not declare any dividend for FY16. Mphasis ended the quarter with cash balance of US\$212mn.

Other details: New deal wins of US\$76mn TCV in Q4FY16 (US\$61mn in Q3FY16, US\$90mn in Q2, US\$76mn in Q1, US\$82mn in Q4FY15, total deal wins of US\$303mn TCV in FY16, higher by 14% YoY), which we believe is not enough significant for MPHL to grow at a decent pace going forward, considering the weakness in the HP channel. We believe the growth challenges in revenue growth, mainly on account of the HP channel would continue into FY17 as well. Management strengthened investment in Direct Channel (DC) with senior-level hiring from larger peers. Over the past 12-18 months, Mphasis management has taken a few initiatives: (1) enhanced focus on top 15 clients, (2) separated client mining and hunting teams, and (3) changed leadership in Digital Risk (DR) business. These steps have helped deal signings and revived growth in DI business.

HP channel decline remains unabated, acquisition being used to prop up declining revenue: HP channel (24% share) revenue visibility remains weak, even after more than four years of decline. HP continues to lose contracts in services business which has impacted Mphasis. The company has started considering large acquisitions; after successful integration of Digital Risk.

Valuation: MPHL does not compare well versus some of the other mid-cap IT companies. Valuations, though being cheap compared to some of the performing mid-caps, the revenue growth story is weak, while risks to its margins are higher. We maintain our Sell recommendation on the stock. We remain cautious on the stock as the business fundamentals and outlook remains challenged. We have low comfort on sustainability of growth in Direct International business given Mphasis' underinvestment in digital and lack of differentiation.

ANALYST

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Exhibit 1: Quarterly details

₹ mn	4QFY15	3QFY16	4QFY16	QoQ (%)	YoY (%)	Comments
Revenues (In US\$mn)	228.2	228.98	225.26	(1.6)	(1.3)	Direct International decreased by 0.2% QoQ. Won deals worth US\$76mn. HP business declined 0.5% to US\$54.8mn.
Revenues	14,290	15,167	15,173	0.0	6.2	
- Operating costs	12,275	13,001	12,829	(1.3)	4.5	
EBITDA	2,015	2,166	2,344	8.2	16.3	Margin was higher on account of lower wage expenses (5% QoQ decline in employees)
EBITDA margin (%)	14.1	14.3	15.4	117bps	135bps	
- Interest expense	51	53	47	(11.3)	(7.8)	
- Depreciation	232	167	181	8.4	(22.0)	Includes a forex gain of ₹34mn for the quarter vs ₹110mn in 3Q.
+ Other income, net (incl forex)	675	456	442	(3.1)	(34.5)	
PBT	2,407	2,402	2,558	6.5	6.3	
- Taxes	630	666	694	4.2	10.2	Tax rate to remain in the range of 27-28%
Effective tax rate (%)	26.2	27.7	27.1	(60)bps	96bps	
PAT	1,777	1,736	1,864	7.4	4.9	
Net margin (%)	12.4	11.4	12.3	84bps	(15)bps	
Reported profits	1,777	1,736	1,548	(10.8)	(12.9)	Incurs a cost of ₹316mn - impairment of a long term project

Source: Company.

Exhibit 2: Change in estimates

₹ mn	FY17E			FY18E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	975	931	(4.5)	1,067	1,011	(5.2)
Revenue	62,416	60,547	(3.0)	68,307	65,702	(3.8)
EBITDA margin (%)	15.2	14.9	(25)bps	16.0	15.4	(55)bps
EPS (₹)	36.6	35.3	(3.6)	41.0	38.6	(5.9)

Source: Trust Research

Geography wise Revenues: Business in Europe was up by 2.4% QoQ while US was down by 0.9%. RoW decreased 8.8% QoQ.

Exhibit 3: Geographical wise Performance

Geographical mix	Q2FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16
US	73.6	72.1	71.8	69.5	72.4	73.9	75.1	76.3	76.8
Europe	12.4	12.7	13.2	12.9	11.0	9.8	9.3	10.3	10.7
RoW	14.0	15.2	15.0	17.5	16.6	16.3	15.6	13.4	12.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company

Exhibit 4: Operating mix (%)

Details	Q2FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Application maintenance	26.4	28.4	28.8	29.0	29.1	29.2	30.3	32.8	34.1
Application development	23.3	22.4	23.7	25.5	24.5	24.8	24.0	22.7	24.5
Customer service	4.9	5.4	5.9	5.8	5.7	5.3	4.3	2.3	2.0
Service/ technical help desk	3.4	3.0	3.0	2.0	1.7	2.0	1.8	1.7	2.3
Transaction processing service	5.2	5.1	5.6	7.1	7.1	6.5	6.7	7.0	7.1
Infrastructure management services	18.7	19.7	18.0	19.6	17.3	14.9	15.0	14.9	13.6
Knowledge processes	18.3	16.0	15.0	11.0	14.6	17.2	17.9	18.7	16.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company



Human Resources: Consolidated headcount decreased by 1,210 (employees declining in ITO division, declining headcount since 20 quarters in ITO business) to 22,302.

Exhibit 5: Employee strength at MPHL

Details	Q2FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Applications (onsite)	2,296	2,315	2,298	2,317	2,343	2,366	2,370	2,311	2,322
BPO (onsite)	1,813	1,950	1,236	1,159	1,594	1,646	1,675	1,564	1,359
ITO (onsite)	212	208	219	199	186	169	167	195	212
Applications (offshore)	8,422	8,234	8,200	8,136	8,177	8,261	8,488	8,423	8,441
BPO (offshore)	15,098	15,221	16,926	16,853	15,797	16,093	6,159	6,019	5,511
ITO (offshore)	6,327	6,071	5,611	5,078	4,562	4,244	3,953	3,730	3,209
S&M	376	366	345	327	333	316	327	313	300
G&A	1,122	1,159	1,121	1,073	1,047	1,041	994	957	948
Total	35,666	35,524	35,956	35,142	34,039	34,136	24,133	23,512	22,302

Source: Company

Client Concentration: Mphasis added 11 clients this quarter (11 from the Direct channel) - 6 from Banking and Capital Market, 2 from Insurance, 1 from Information Technology, Communication & Entertainment and 2 from Emerging Industries.

Exhibit 6: Client details

Details	Q2FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Top client (%)	10.0	10.0	9.0	8.0	8.0	9.0	9.0	10.0	11.0
Top 5 clients (%)	34.0	35.0	35.0	35.0	34.0	35.0	36.0	37.0	38.0
Top 10 clients (%)	47.0	49.0	50.0	49.0	48.0	47.0	47.0	48.0	51.0
Top 20 clients (%)	60.0	61.0	62.0	62.0	61.0	60.0	60.0	61.0	61.0
US\$1mn+	112	110	104	100	102	98	100	102	103
US\$5mn+	43	42	41	42	39	36	39	35	35
US\$10mn+	19	17	17	17	19	20	19	18	14
US\$20mn+	11	10	10	8	9	8	7	8	8
Client added	8	16	10	3	12	10	8	8	11

Source: Company

Exhibit 7: Billing rates (US\$/hr)

Details	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Applications (onsite)	68	69	70	71	71	72	72	76
ITO (onsite)	66	65	62	70	70	66	63	67
Applications (offshore)	20	20	21	21	21	21	21	22
BPO (offshore)	6	6	7	7	6	6	10	10
ITO (offshore)	21	21	20	19	21	21	19	18

Source: Company

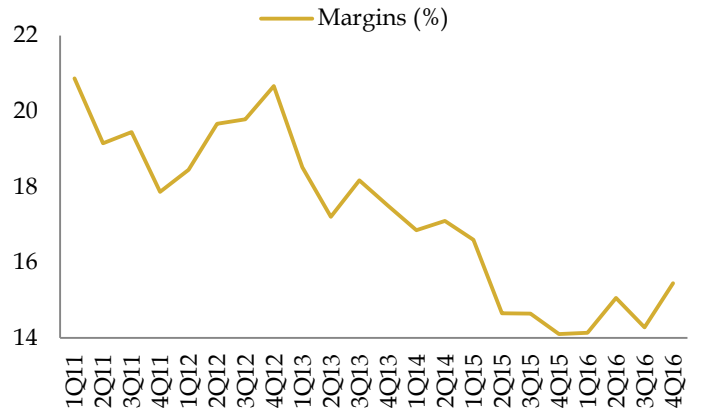


Exhibit 8: DSO days was up 2 QoQ to 72



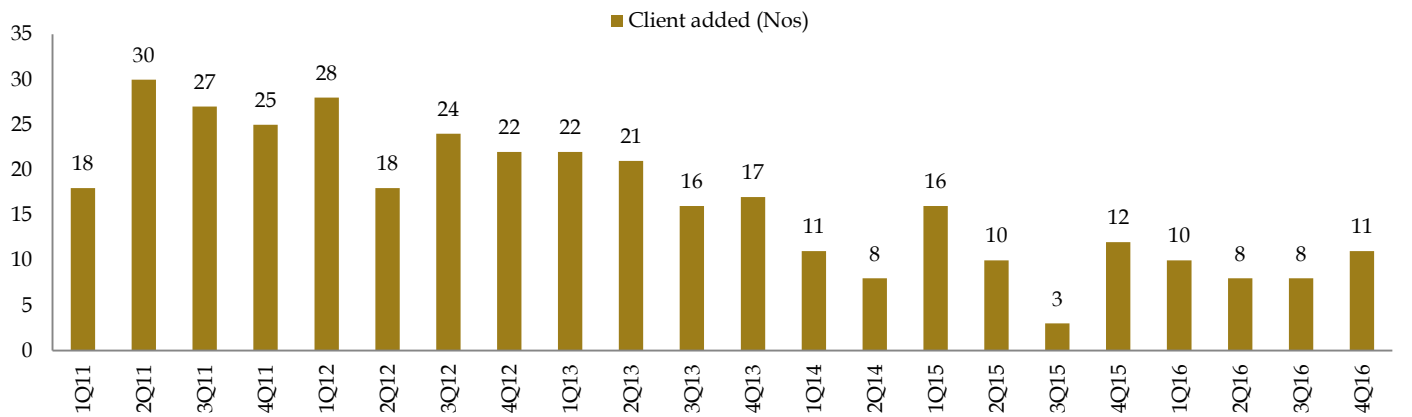
Source: Company, Trust

Exhibit 9: Margin was up QoQ, would see pressure ahead



Source: Company, Trust

Exhibit 10: Client addition at MPHL has been weak over the past 7-8 quarters compared to the past



Source: Company, Trust



Financials

Income Statement (₹ mn)

Year End-March	FY14*	FY15	FY16	FY17E	FY18E
Revenues	25,939	57,949	60,879	60,547	65,702
Op. Expenses	21,542	49,248	51,909	51,527	55,584
EBITDA	4,397	8,701	8,970	9,020	10,118
Other Income	500	1,967	1,954	2,119	2,169
Depreciation	504	980	744	770	820
EBIT	4,393	9,688	10,180	10,369	11,468
Interest	111	280	242	184	169
PBT	4,282	9,408	9,938	10,185	11,299
Tax	1,191	2,630	2,696	2,750	3,164
PAT	3,091	6,778	7,242	7,435	8,135
Ex. ordinary	64	32	495	-	-
Adj Pat	3,027	6,746	6,747	7,435	8,135

Key Parameters

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Per share (₹)					
EPS	14.7	32.2	34.4	35.3	38.6
CEPS	17.1	36.8	38.0	39.0	42.5
BVPS	243.4	260.3	299.3	313.5	328.7
DPS	7.0	16.0	-	18.0	20.0
Payout (%)	55.7	58.0	-	59.6	60.6
Valuation (x)					
P/E	12.6	11.5	13.7	13.4	12.2
P/BV	1.8	1.4	1.6	1.5	1.4
EV/EBITDA	8.9	8.1	10.5	10.3	8.6
Dividend Yield (%)	3.8	4.3	-	3.8	4.2
Return ratio (%)					
EBITDA Margin	17.0	15.0	14.7	14.9	15.4
PAT Margin	11.7	11.6	11.9	12.3	12.4
ROAE	6.0	12.7	12.3	11.5	12.0
ROACE	8.0	16.7	15.9	15.0	15.9
Leverage Ratios (x)					
Long Term D/E	0.1	0.1	0.0	0.0	0.0
Net Debt/Equity	(0.3)	(0.4)	(0.4)	(0.4)	(0.4)
Current ratio	2.0	2.7	3.3	3.5	3.5
Growth Ratios (%)					
Income growth	(55.2)	123.4	5.1	(0.5)	8.5
EBITDA growth	(57.5)	97.9	3.1	0.6	12.2
PAT growth	(59.3)	122.9	0.0	10.2	9.4
Turnover Ratios					
Inventor Days	-	-	0	0	0
Debtors Days	47	45	35.2	28.1	29.4
Payable days	15	8	9	9	9

* MPHL had a 5-month FY14

Balance Sheet (₹ mn)

Year End-March	FY14	FY15	FY16	FY17E	FY18E
Sources of Funds					
Equity Share Capital	2,101	2,101	2,102	2,103	2,107
Reserves & Surplus	49,048	52,696	60,829	63,873	67,148
Total Shareholders Fund	51,150	54,798	62,931	65,976	69,255
Non-current liabilities	3,879	3,375	2,378	2,425	2,492
Long term Borrowings	4,314	3,094	1,789	1,789	1,789
Deferred tax liabilities	(809)	(326)	(211)	(211)	(211)
Other LT liabilities & prov	375	607	801	847	914
Current Liabilities	13,904	15,168	12,844	12,901	13,812
Short-term borrowings	-	1,250	1,325	1,325	1,325
Trade payables	6,662	4,064	4,525	4,517	4,873
Other cur liabilities & Prov	7,242	9,854	6,993	7,058	7,614
Total Liabilities	68,932	73,341	78,153	81,302	85,559
Assets					
Non-current Assets	36,133	33,862	36,385	36,730	37,481
Fixed assets	2,238	1,760	1,728	2,155	2,235
Non-current investments	27,274	24,280	26,696	26,696	26,696
Long-term loans & adv	6,377	6,715	6,881	6,801	7,380
Other non-current assets	245	1,106	1,079	1,078	1,170
Current assets	32,799	39,479	41,768	44,572	48,078
Current investments	12,745	11,932	17,364	17,364	14,243
Trade receivables	7,883	6,252	6,489	6,469	7,020
Inventories	-	-	41	41	41
Cash & bank balances	4,583	13,208	8,549	11,575	16,874
Short-term loans & adv	2,139	2,508	2,508	2,488	2,700
Other current assets	5,449	5,579	6,817	6,635	7,200
Total Assets	68,932	73,341	78,153	81,303	85,559

Cash flow Statement

Year End-March	FY14	FY15	FY16	FY17E	FY18E
PBT	4,282	9,408	9,938	10,185	11,299
Depreciation	504	980	859	771	820
Others	85	538	(495)	-	-
CF before W.cap	4,871	10,926	10,302	10,955	12,119
Inc/dec in W.cap	4,647	122	3,861	(406)	1,020
Op CF after W.cap	224	10,804	6,440	11,361	11,098
Less Taxes	1,191	2,630	2,696	2,750	3,164
Net CF From Operations	(967)	8,174	3,744	8,611	7,935
Inc/(dec) in F.A + CWIP	356	614	712	1,197	900
(Pur)/sale of Investments	(1,475)	(3,807)	7,847	0	(3,121)
CF from Invst Activities	1,119	3,193	(8,559)	(1,197)	2,221
Loan Raised/(repaid)	(147)	357	(1,230)	-	-
Equity Raised	500	835	1,385	41	74
Dividend	1,721	3,934	-	4,430	4,930
CF from Fin Activities	(1,368)	(2,741)	155	(4,389)	(4,857)
Net inc/(dec) in cash	(1,216)	8,626	(4,660)	3,026	5,299
Op. bal of cash	5,799	4,583	13,209	8,549	11,575
Cl. balance of cash	4,583	13,208	8,549	11,575	16,874



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