



# Mphasis

Sector: Technology

## 1QFY17 Result Update

CMP: ₹ 540

*Muted quarter, Direct business still weak*

Recommendation: Sell

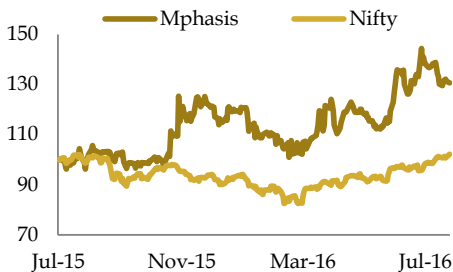
### Market statistics

Current stock price (₹)	540
Shares O/S (cr.)	21.0
Mcap (₹ cr)	11,316
52W H/L (₹)	624/365
6m avg. volume	234,518
Bloomberg	MPHL.IN

### Shareholding pattern

Promoters	60.47
Domestic Institution	10.49
Foreign Institution	20.48
Non-institution	8.56
of which more than 1%	
Aberdeen Global Indian Equity Fund	4.93
(Mauritius) Ltd	
LIC OF INDIA Market Plus 1	1.64
Growth Fund	

### Mphasis vs Nifty



### Capital efficiency & valuations

Particulars	FY16	FY17E	FY18E
RoE (%)	12.3	11.8	12.2
EPS (₹)	34.4	36.2	39.5
CEPS (₹)	38.0	39.0	42.4
P/E (x)	13.7	14.9	13.7
P/BV (x)	1.6	1.7	1.6
EV/EBITDA (x)	10.5	11.7	9.8
Income growth (%)	5.1	(0.3)	7.1
EBITDA growth (%)	3.1	2.2	10.4
PAT growth (%)	(0.8)	13.9	9.0

Mphasis' US\$ revenues decreased 0.3% QoQ - primarily due to decline seen in HP business (down 4.4% QoQ, 23% of revenues now). International business (up 1.4% QoQ). We believe weak sentiment will continue looking at a declining headcount (the trend has been continuing since 21 quarters in ITO). HP's enterprise services business is likely to be stable from Q2 onwards. Margin at 16.1% (up 42bps QoQ) on account of lower wage expenses (flat QoQ decline in employees) and lower SG&A QoQ. We maintain our SELL rating on the stock on account of sluggish business fundamentals, underinvestment in business, increasing concentration of revenues and medium term risks to profitability.

**Mixed quarter.** Mphasis reported US\$ revenues of US\$224.5mn (down 0.3% QoQ). Management indicated that HP channel revenues will become stable from Q2 onwards. Business mix of Direct vs HP QoQ remained at 77:23. HP channel revenue declined 4.4% QoQ in INR terms. Direct International business net of rupee depreciation increased by 1.4% during Q1FY17 - MPHL won deals with TCV of US\$96mn in Q1FY17 with 75% of the deals in our focus areas of Digital, NextGen and GRC services. EBIT margin for Q1 was 15.2% (14.5% in Q4FY16). Business in Europe and US was flattish QoQ while RoW decreased 2.1% QoQ.

**Operating metrics getting weaker, though cash supports downside:** Consolidated headcount increased by 56 (employees declining in ITO division, declining headcount since 21 quarters in ITO business) to 22,358. Mphasis added just 3 clients this quarter (3 from the Direct channel, lowest since 1Q09 with exception of Q3FY15). Cash & equivalents stand at ₹145/share (27% of the MCap is in form of cash). DSO's were increased 2 QoQ at 74 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 Q1FY17. Mphasis ended the quarter with cash balance of US\$448mn.

**Other details:** New deal wins of US\$96mn TCV in Q1FY17 (US\$76mn 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 growth rate in the Direct business. We believe the growth challenges in revenue growth 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 revenue to become stable from Q2, acquisition being used to prop up declining revenue:** HP channel (23% share) revenue would become stable from Q2 onwards, after more than four years of decline. HP continued 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. The stock is firm on hopes of a special dividend. We maintain our SELL rating on the stock.

ANALYST

Naushil Shah

+91-22 4224 5125

naushil.shah@trustgroup.co.in



## Exhibit 1: Quarterly details

₹ mn	1QFY16	4QFY16	1QFY17	QoQ (%)	YoY (%)	Comments
<b>Revenues (In US\$mn)</b>	<b>234.5</b>	<b>225.3</b>	<b>224.5</b>	<b>(0.3)</b>	<b>(4.3)</b>	Direct International increased by 1.4% QoQ. Won deals worth US\$96mn. HP business declined 4.4%.
<b>Revenues</b>	<b>14,945</b>	<b>15,160</b>	<b>15,167</b>	<b>0.0</b>	<b>1.5</b>	
- Operating costs	12,832	12,779	12,722	(0.4)	(0.9)	
<b>EBITDA</b>	<b>2,113</b>	<b>2,381</b>	<b>2,445</b>	<b>2.7</b>	<b>15.7</b>	Margin was higher on account of lower wage & SG&A expenses (both lower QoQ)
<b>EBITDA margin (%)</b>	<b>14.1</b>	<b>15.7</b>	<b>16.1</b>	<b>41bps</b>	<b>198bps</b>	
- Interest expense	67	47	53	12.8	(20.9)	
- Depreciation	217	181	137	(24.3)	(36.9)	Includes a forex gain of ₹84mn for the quarter vs ₹31mn in 4Q.
+ Other income, net (incl forex)	440	490	572	16.7	30.0	
<b>PBT</b>	<b>2,269</b>	<b>2,643</b>	<b>2,827</b>	<b>7.0</b>	<b>24.6</b>	
- Taxes	611	723	784	8.4	28.3	Tax rate to remain in the range of 27-28%
Effective tax rate (%)	26.9	27.4	27.7	38bps	80bps	
<b>PAT</b>	<b>1,658</b>	<b>1,920</b>	<b>2,043</b>	<b>6.4</b>	<b>23.2</b>	
Net margin (%)	11.1	12.7	13.5	81bps	238bps	
<b>Reported profits</b>	<b>1,479</b>	<b>1,604</b>	<b>2,043</b>	<b>27.4</b>	<b>38.1</b>	

Source: Company.

## Exhibit 2: Change in estimates

₹ mn	FY17E			FY18E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	931	925	(0.6)	1,011	1,000	(1.1)
Revenue	60,547	60,694	0.2	65,702	65,012	(1.1)
EBITDA margin (%)	14.9	15.1	15bps	15.4	15.6	15bps
EPS (₹)	35.3	36.2	2.5	38.6	39.5	2.3

Source: Trust Research

**Geography wise Revenues:** Business in Europe and US was flattish QoQ while RoW decreased 2.1% QoQ.

## Exhibit 3: Geographical wise Performance

Geographical mix	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
US	72.1	71.8	69.5	72.4	73.9	75.1	76.3	76.8	77.1
Europe	12.7	13.2	12.9	11.0	9.8	9.3	10.3	10.7	10.7
RoW	15.2	15.0	17.5	16.6	16.3	15.6	13.4	12.4	12.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company

## Exhibit 4: Operating mix (%)

Details	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Application maintenance	28.4	28.8	29.0	29.1	29.2	30.3	32.8	34.1	35.8
Application development	22.4	23.7	25.5	24.5	24.8	24.0	22.7	24.5	23.2
Customer service	5.4	5.9	5.8	5.7	5.3	4.3	2.3	2.0	1.9
Service/ technical help desk	3.0	3.0	2.0	1.7	2.0	1.8	1.7	2.3	2.1
Transaction processing service	5.1	5.6	7.1	7.1	6.5	6.7	7.0	7.1	7.0
Infrastructure management services	19.7	18.0	19.6	17.3	14.9	15.0	14.9	13.6	13.6
Knowledge processes	16.0	15.0	11.0	14.6	17.2	17.9	18.7	16.4	16.4
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company



**Human Resources:** Consolidated headcount increased by 56 (employees declining in ITO division, declining headcount since 21 quarters in ITO business) to 22,358.

**Exhibit 5: Employee strength at MPHL**

Details	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Applications (onsite)	2,315	2,298	2,317	2,343	2,366	2,370	2,311	2,322	2,340
BPO (onsite)	1,950	1,236	1,159	1,594	1,646	1,675	1,564	1,359	1,236
ITO (onsite)	208	219	199	186	169	167	195	212	215
Applications (offshore)	8,234	8,200	8,136	8,177	8,261	8,488	8,423	8,441	8,495
BPO (offshore)	15,221	16,926	16,853	15,797	16,093	6,159	6,019	5,511	5,682
ITO (offshore)	6,071	5,611	5,078	4,562	4,244	3,953	3,730	3,209	3,158
S&M	366	345	327	333	316	327	313	300	289
G&A	1,159	1,121	1,073	1,047	1,041	994	957	948	943
<b>Total</b>	<b>35,524</b>	<b>35,956</b>	<b>35,142</b>	<b>34,039</b>	<b>34,136</b>	<b>24,133</b>	<b>23,512</b>	<b>22,302</b>	<b>22,358</b>

Source: Company

**Client Concentration:** Mphasis added just 3 clients this quarter (3 from the Direct channel) - 1 from Banking and 2 from Information Technology, Communication & Entertainment.

**Exhibit 6: Client details**

Details	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Top client (%)	10.0	9.0	8.0	8.0	9.0	9.0	10.0	11.0	11.0
Top 5 clients (%)	35.0	35.0	35.0	34.0	35.0	36.0	37.0	38.0	39.0
Top 10 clients (%)	49.0	50.0	49.0	48.0	47.0	47.0	48.0	51.0	53.0
Top 20 clients (%)	61.0	62.0	62.0	61.0	60.0	60.0	61.0	61.0	63.0
US\$1mn+	110	104	100	102	98	100	102	103	102
US\$5mn+	42	41	42	39	36	39	35	35	28
US\$10mn+	17	17	17	19	20	19	18	14	15
US\$20mn+	10	10	8	9	8	7	8	8	9
Client added	16	10	3	12	10	8	8	11	3

Source: Company

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

Details	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Applications (onsite)	69	70	71	71	72	72	76	76
ITO (onsite)	65	62	70	70	66	63	67	68
Applications (offshore)	20	21	21	21	21	21	22	21
BPO (offshore)	6	7	7	6	6	10	10	10
ITO (offshore)	21	20	19	21	21	19	18	19

Source: Company

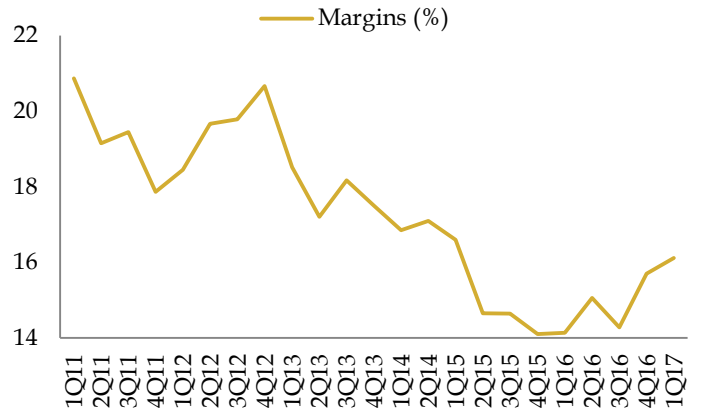


Exhibit 8: DSO days was up 2 QoQ to 74



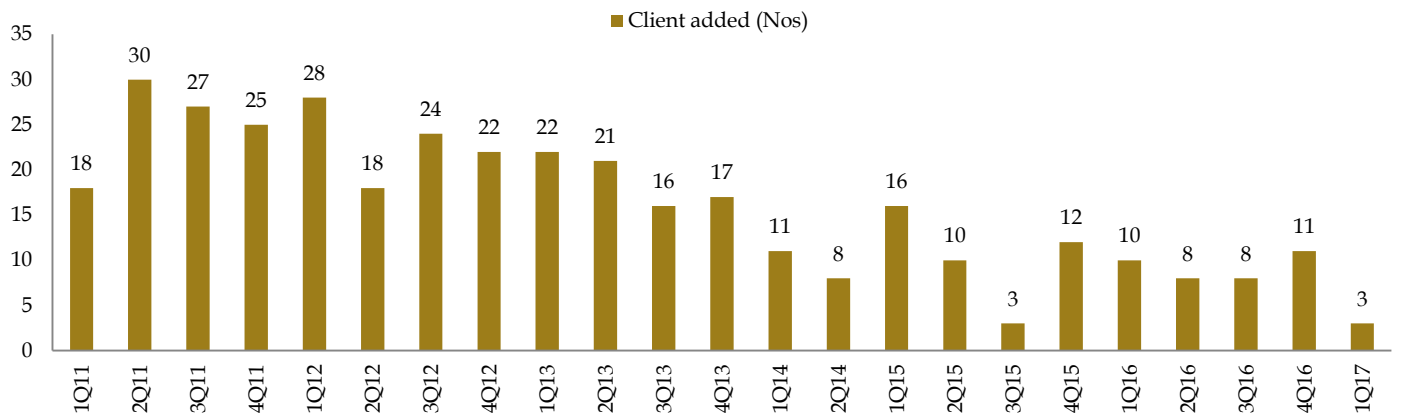
Source: Company, Trust

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
<b>Revenues</b>	<b>25,939</b>	<b>57,949</b>	<b>60,879</b>	<b>60,694</b>	<b>65,012</b>
Op. Expenses	21,542	49,248	51,909	51,530	54,895
<b>EBITDA</b>	<b>4,397</b>	<b>8,701</b>	<b>8,970</b>	<b>9,164</b>	<b>10,118</b>
Other Income	500	1,967	1,954	2,224	2,274
Depreciation	504	980	744	575	624
<b>EBIT</b>	<b>4,393</b>	<b>9,688</b>	<b>10,180</b>	<b>10,814</b>	<b>11,768</b>
Interest	111	280	242	232	217
<b>PBT</b>	<b>4,282</b>	<b>9,408</b>	<b>9,938</b>	<b>10,582</b>	<b>11,551</b>
Tax	1,191	2,630	2,696	2,955	3,234
<b>PAT</b>	<b>3,091</b>	<b>6,778</b>	<b>7,242</b>	<b>7,627</b>	<b>8,316</b>
Ex. ordinary	64	32	495	-	-
<b>Adj Pat</b>	<b>3,027</b>	<b>6,746</b>	<b>6,747</b>	<b>7,627</b>	<b>8,316</b>

### Key Parameters

Year End-March	FY14	FY15	FY16	FY17E	FY18E
<b>Per share (₹)</b>					
EPS	14.7	32.2	34.4	36.2	39.5
CEPS	17.1	36.8	38.0	39.0	42.4
BVPS	243.4	260.3	299.3	315.5	331.6
DPS	7.0	16.0	-	18.0	20.0
Payout (%)	55.7	58.0	-	58.1	59.3
<b>Valuation (x)</b>					
P/E	12.6	11.5	13.7	14.9	13.7
P/BV	1.8	1.4	1.6	1.7	1.6
EV/EBITDA	8.9	8.1	10.5	11.7	9.8
Dividend Yield (%)	3.8	4.3	-	3.3	3.7
<b>Return ratio (%)</b>					
EBITDA Margin	17.0	15.0	14.7	15.1	15.6
PAT Margin	11.7	11.6	11.9	12.6	12.8
ROAE	6.0	12.7	12.3	11.8	12.2
ROACE	8.0	16.7	15.9	15.8	16.5
<b>Leverage Ratios (x)</b>					
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	0.2	0.2
<b>Growth Ratios (%)</b>					
Income growth	(55.2)	123.4	5.1	(0.3)	7.1
EBITDA growth	(57.5)	97.9	3.1	2.2	10.4
PAT growth	(59.3)	122.9	(0.8)	13.9	9.0
<b>Turnover Ratios</b>					
Inventor Days	-	-	0	0	0
Debtors Days	47	45	38	39	38
Payable days	15	8	9	9	9

\* MPHL had a 5-month FY14

### Balance Sheet (₹ mn)

Year End-March	FY14	FY15	FY16	FY17E	FY18E
<b>Sources of Funds</b>					
Equity Share Capital	2,101	2,101	2,102	2,103	2,107
Reserves & Surplus	49,048	52,696	60,829	64,307	67,763
<b>Total Shareholders Fund</b>	<b>51,150</b>	<b>54,798</b>	<b>62,931</b>	<b>66,410</b>	<b>69,870</b>
<b>Non-current liabilities</b>	<b>3,879</b>	<b>3,375</b>	<b>2,378</b>	<b>2,723</b>	<b>2,778</b>
Long term Borrowings	4,314	3,094	1,789	1,789	1,789
Deferred tax liabilities	(809)	(326)	(211)	87	87
Other LT liabilities & prov	375	607	801	847	902
<b>Current Liabilities</b>	<b>13,904</b>	<b>15,168</b>	<b>12,844</b>	<b>12,902</b>	<b>13,658</b>
Short-term borrowings	-	1,250	1,325	1,325	1,325
Trade payables	6,662	4,064	4,525	4,518	4,813
Other cur liabilities & Prov	7,242	9,854	6,993	7,059	7,520
<b>Total Liabilities</b>	<b>68,932</b>	<b>73,341</b>	<b>78,153</b>	<b>82,035</b>	<b>86,306</b>
<b>Assets</b>					
<b>Non-current Assets</b>	<b>36,133</b>	<b>33,862</b>	<b>36,385</b>	<b>37,063</b>	<b>37,901</b>
Fixed assets	2,238	1,760	1,728	2,468	2,744
Non-current investments	27,274	24,280	26,696	26,696	26,696
Long-term loans & adv	6,377	6,715	6,881	6,818	7,303
Other non-current assets	245	1,106	1,079	1,081	1,158
<b>Current assets</b>	<b>32,799</b>	<b>39,479</b>	<b>41,768</b>	<b>44,972</b>	<b>48,405</b>
Current investments	12,745	11,932	17,364	20,253	20,253
Trade receivables	7,883	6,252	6,489	6,485	6,947
Inventories	-	-	41	41	41
<b>Cash &amp; bank balances</b>	<b>4,583</b>	<b>13,208</b>	<b>8,549</b>	<b>9,048</b>	<b>11,369</b>
Short-term loans & adv	2,139	2,508	2,508	2,494	2,672
Other current assets	5,449	5,579	6,817	6,651	7,125
<b>Total Assets</b>	<b>68,932</b>	<b>73,341</b>	<b>78,153</b>	<b>82,035</b>	<b>86,306</b>

### Cash flow Statement

Year End-March	FY14	FY15	FY16	FY17E	FY18E
<b>PBT</b>	<b>4,282</b>	<b>9,408</b>	<b>9,938</b>	<b>10,582</b>	<b>11,551</b>
Depreciation	504	980	859	873	624
Others	85	538	(495)	-	-
<b>CF before W.cap</b>	<b>4,871</b>	<b>10,926</b>	<b>10,302</b>	<b>11,455</b>	<b>12,175</b>
Inc/dec in W.cap	4,647	122	3,861	(349)	863
<b>Op CF after W.cap</b>	<b>224</b>	<b>10,804</b>	<b>6,440</b>	<b>11,804</b>	<b>11,312</b>
Less Taxes	1,191	2,630	2,696	2,955	3,234
<b>Net CF From Operations</b>	<b>(967)</b>	<b>8,174</b>	<b>3,744</b>	<b>8,849</b>	<b>8,078</b>
Inc/(dec) in F.A + CWIP	356	614	712	1,315	900
(Pur)/sale of Investments	(1,475)	(3,807)	7,847	2,889	-
<b>CF from Invst Activities</b>	<b>1,119</b>	<b>3,193</b>	<b>(8,559)</b>	<b>(4,204)</b>	<b>(900)</b>
Loan Raised/(repaid)	(147)	357	(1,230)	-	-
Equity Raised	500	835	1,385	284	74
Dividend	1,721	3,934	-	4,430	4,930
<b>CF from Fin Activities</b>	<b>(1,368)</b>	<b>(2,741)</b>	<b>155</b>	<b>(4,146)</b>	<b>(4,857)</b>
Net inc/(dec) in cash	(1,216)	8,626	(4,660)	498	2,321
<b>Op. bal of cash</b>	<b>5,799</b>	<b>4,583</b>	<b>13,209</b>	<b>8,549</b>	<b>9,048</b>
<b>Cl. balance of cash</b>	<b>4,583</b>	<b>13,208</b>	<b>8,549</b>	<b>9,048</b>	<b>11,369</b>



## Institutional Equity Team

Names	Designation	Sectors	Email ID's	Desk-Number
Naren Shah	Head Of Equity		naren.shah@trustgroup.co.in	+91-22-4084-5074
<b>Institutional Sales</b>				
Sriram Rangarajan	Sales		sriram.rangarajan@trustgroup.co.in	+91-22-4224-5216
Vivek Kumar	Sales		vivek.kumar@trustgroup.co.in	+91-22-4224-5197
<b>Sales Trading &amp; Dealing</b>				
Rajesh Ashar	Sales Trader		rajesh.ashar@trustgroup.co.in	+91-22-4224-5123
Nikhil Shah	Dealer		nikhil.shah@trustgroup.co.in	+91-22-4084-5089
Dealing Desk			trustfin@bloomberg.net	+91-22-4084-5089
<b>Research Team</b>				
Binyam Taddese	Analyst	Rates & Credit Research	binyam.taddese@trustgroup.co.in	+91-22-4224-5037
Naushil Shah	Analyst	Technology, Media & Telecom	naushil.shah@trustgroup.co.in	+91-22-4224-5125
Naveen Trivedi	Analyst	Consumer Staple & Durable	naveen.trivedi@trustgroup.co.in	+91-22-4224-5181
Shashwat Nanda	Analyst	Rates & Credit Research	shashwat.nanda@trustgroup.co.in	+91-22-4224-5038
Tejas Sarvaiya	Analyst	Seeds, Exchanges & MidCap	tejas.sarvaiya@trustgroup.co.in	+91-22-4084-5064
Ritu Chaudhary	Associate	Consumer Durable	ritu.chaudhary@trustgroup.co.in	+91-22-4224-5183

## DISCLAIMER

We are committed to providing completely independent and transparent recommendations to help our clients reach a better decision. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Nothing in this document should be construed as investment or financial advice, and nothing in this document should be construed as an advice to buy or sell or solicitation to buy or sell the securities of companies referred to in this document. The intent of this document is not in recommendatory nature. The recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. Trust Financial Consultancy Services Pvt. Ltd. has not independently verified all the information given in this document. Accordingly, no representation or warranty, express or implied, is made as to the accuracy, completeness or fairness of the information and opinions contained in this document. The Company reserves the right to make modifications and alternations to this statement as may be required from time to time without any prior approval. Trust Financial Consultancy Services Pvt. Ltd., its affiliates, their directors and the employees may from time to time, effect or have effected an own account transaction in, or deal as principal or agent in or for the securities mentioned in this document. They may perform or seek to perform investment banking or other services for, or solicit investment banking or other business from, any company referred to in this report. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting the document. This report has been prepared on the basis of information, which is already available in publicly accessible media or developed through analysis of Trust Financial Consultancy Services Pvt. Ltd. The views expressed are those of analyst and the Company may or may not subscribe to all the views expressed therein. Neither the Firm, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied, in whole or in part, for any purpose. Copyright in this document vests exclusively with Trust Financial Consultancy Services Pvt. Ltd.