

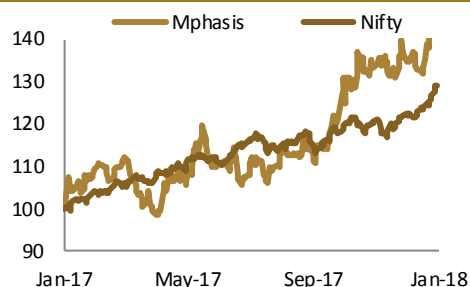
Market statistics

Current stock price (₹)	822
Shares O/S (cr.)	19.3
Mcap (₹ cr)	15,882
52W H/L (₹)	854/522
6m avg. volume	163,466
Bloomberg	MPHL.IN

Shareholding pattern

Promoters	60.40
Domestic Institution	9.08
Foreign Institution	21.80
Non-institution	8.71
of which more than 1%	
Aberdeen Global Indian Equity Fund	4.63
LIC Market Plus 1 Growth Fund	2.17

Mphasis vs Nifty



Capital efficiency & valuations

Particulars	FY18E	FY19E	FY20E
RoE (%)	14.5	16.8	17.1
EPS (₹)	42.0	45.8	50.8
CEPS (₹)	45.7	49.8	55.0
P/E (x)	19.6	17.9	16.2
P/BV (x)	3.1	2.9	2.6
EV/EBITDA (x)	16.8	15.2	13.3
Income growth (%)	6.5	9.8	10.2
EBITDA growth (%)	5.6	8.5	12.0
PAT growth (%)	1.1	9.2	11.0

Mphasis' US\$ revenues increased 3.7% QoQ in cc terms –due to an increase in HP/DXC & the direct business (up 3.7% QoQ in cc terms). HP's enterprise services business is likely to uptick from here onwards. Margin was at 16.5% (up 98bps QoQ) helped by revenue trajectory as well as one-time benefit from client settlement. We maintain our SELL rating on the stock on account of underinvestment in business, increasing concentration of revenues and medium term risks to profitability. We believe the valuations has run up far more than fundamental value of the stock.

Good quarter. Mphasis reported US\$ revenues of US\$251.4mn (up 5.1% QoQ). Management indicated that HP channel revenues should see some traction from here onwards. Business mix of Direct vs HP moved to 75:25 QoQ from 74:26 in this quarter. HP channel revenue increased 3.6% QoQ in INR terms. Direct International business net of rupee depreciation increased by 3.7% during Q3FY18 – MPHL won deals with TCV of US\$130mn in Q3FY18 with the deals in focus areas of Digital, NextGen and GRC services. EBIT margin for Q3 was 15.5% (14.4% in Q2FY18), helped by a one-time settlement with a client (+40bps). Business in Europe was up 8.6% QoQ while US increased 5.3%. RoW increased 0.5% QoQ. Operating margins increased 98bps QoQ at 16.5% on better revenue trajectory and one-time gains.

Operating metrics getting weaker, though cash supports downside: Consolidated headcount increased by 114 to 22,270 (net addition from last 2 quarters). Mphasis added 6 clients this quarter (4 from the Direct channel). Net Cash & equivalents stand at ₹120/share (14.5% of the MCap is in form of cash). DSO's increased 3 QoQ to 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 ended the quarter with cash balance of US\$359mn.

Other details: New deal wins of US\$130mn TCV in Q3FY18 (US\$436mn in 9MFY18, US\$365mn in FY17, total deal wins of US\$303mn TCV in FY16), 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 FY19 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 here on, acquisition being used to prop up declining revenue: HP channel (25% share) revenue should see traction from here onwards, after more than four years of decline. HP continued to lose contracts in services business which had impacted Mphasis. The company has started considering tuck-in acquisitions; after successful integration of Digital Risk. Challenge at Digital Risk continues; with company facing macro-economic winds to the business.

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 have low comfort on sustainability of growth in Direct International business given Mphasis' underinvestment in digital and lack of differentiation. We maintain our SELL rating on the stock.

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Exhibit 1: Quarterly details

` mn	3QFY17	2QFY18	3QFY18	QoQ (%)	YoY (%)	Comments
Revenues (In US\$m)	223.5	239.1	251.4	5.1	12.5	Direct International increased by 3.6% QoQ. Won deals worth US\$130mn. HP business increased 3.6%.
Revenues	15,361	16,047	16,607	3.5	8.1	
- Operating costs	12,965	13,554	13,865	2.3	6.9	
EBITDA	2,396	2,493	2,742	10.0	14.4	Margins increased on better revenue trajectory and one-time client settlement
EBITDA margin (%)	15.6	15.5	16.5	98bps	91bps	
- Interest expense	23	37	29	(21.6)	26.1	
- Depreciation	131	181	176	(2.8)	34.4	Includes a forex gain of `42mn for the quarter vs `26mn in 2Q.
+ Other income, net (incl forex)	617	375	354	(5.6)	(42.6)	
PBT	2,859	2,650	2,891	9.1	1.1	
- Taxes	815	673	741	10.1	(9.1)	Tax rate to remain in the range of 27-28%
Effective tax rate (%)	28.5	25.4	25.6	24bps	(288)bps	
PAT	2,044	1,977	2,150	8.8	5.2	
Net margin (%)	13.3	12.3	12.9	63bps	(36)bps	
Reported profits	2,044	1,977	2,150	8.8	5.2	

Source: Company.

Exhibit 2: Change in estimates

` mn	FY18E			FY19E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	958	978	2.1	1,047	1,058	1.1
Revenue	63,154	64,739	2.5	68,033	71,100	4.5
EBITDA margin (%)	15.4	15.8	35bps	16.0	15.6	(35)bps
EPS (`)	39.8	42.0	5.5	44.2	45.8	3.6

Source: Trust Research

Geography wise Revenues: Business in Europe was up 8.6% QoQ while US increased 5.3%. RoW increased 0.5% QoQ.

Exhibit 3: Geographical wise Performance

Geographical mix	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18
US	76.3	76.8	77.1	77.6	78.0	79.1	79.5	80.1	80.2
Europe	10.3	10.7	10.7	10.5	9.6	9.5	9.8	9.5	9.8
RoW	13.4	12.4	12.2	11.9	12.4	11.4	10.7	10.4	10.0
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	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Application maintenance	32.8	34.1	35.8	35.4	37.0	36.9	35.6	34.6	33.1
Application development	22.7	24.5	23.2	23.9	23.1	24.5	24.7	24.0	26.3
Customer service	2.3	2.0	1.9	1.8	1.9	1.8	1.5	1.7	1.4
Service/ technical help desk	1.7	2.3	2.1	2.4	2.3	2.2	5.4	7.2	7.6
Transaction processing service	7.0	7.1	7.0	7.0	6.2	6.5	7.0	6.8	7.0
Infrastructure management services	14.9	13.6	13.6	13.6	14.2	13.8	13.8	13.4	13.2
Knowledge processes	18.7	16.4	16.4	15.9	15.4	14.3	12.1	12.3	11.4
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 increased by 114 to 22,270 (net addition from last 2 quarters).

Details	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Applications (onsite)	2,311	2,322	2,340	2,357	2,299	2,353	2,373	2,363	2,392
BPO (onsite)	1,564	1,359	1,236	1,189	1,127	1,040	1,044	998	981
ITO (onsite)	195	212	215	281	251	274	277	676	1,106
Applications (offshore)	8,423	8,441	8,495	8,468	8,615	8,807	8,668	8,486	8,228
BPO (offshore)	6,019	5,511	5,682	5,561	5,351	5,176	5,191	5,360	5,304
ITO (offshore)	3,730	3,209	3,158	3,196	3,136	3,074	3,055	3,011	3,062
S&M	313	300	289	300	315	325	346	330	300
G&A	957	948	943	939	940	945	943	932	897
Total	23,512	22,302	22,358	22,291	22,034	21,994	21,897	22,156	22,270

Source: Company

Client Concentration: Mphasis added 6 clients this quarter (4 from the Direct channel). MPHL added 3 clients in Emerging Industries and added 2 clients in Banking and Capital Market & 1 in Insurance.

Exhibit 5: Client details

Details	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Top client (%)	10.0	11.0	11.0	12.0	11.0	11.0	12.0	12.0	12.0
Top 5 clients (%)	37.0	38.0	39.0	40.0	40.0	40.0	40.0	40.0	39.0
Top 10 clients (%)	48.0	51.0	53.0	54.0	55.0	55.0	55.0	54.0	55.0
Top 20 clients (%)	61.0	61.0	63.0	65.0	65.0	66.0	65.0	66.0	66.0
US\$1mn+	102	103	102	98	92	90	90	90	88
US\$5mn+	35	35	28	28	30	36	39	37	38
US\$10mn+	18	14	15	14	14	14	15	15	17
US\$20mn+	8	8	9	14	8	7	7	7	8
Client added	8	11	3	6	6	5	12	5	6

Source: Company

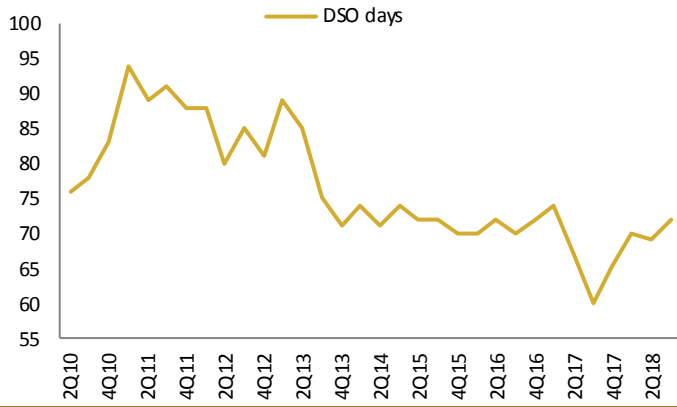
Exhibit 6: Billing rates (US\$/hr)

Details	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Applications (onsite)	76	76	77	78	78	80	83	84
ITO (onsite)	67	68	68	71	73	74	77	86
Applications (offshore)	22	21	22	21	22	21	21	22
BPO (offshore)	10	10	10	11	11	11	11	11
ITO (offshore)	18	19	19	18	18	19	19	20

Source: Company

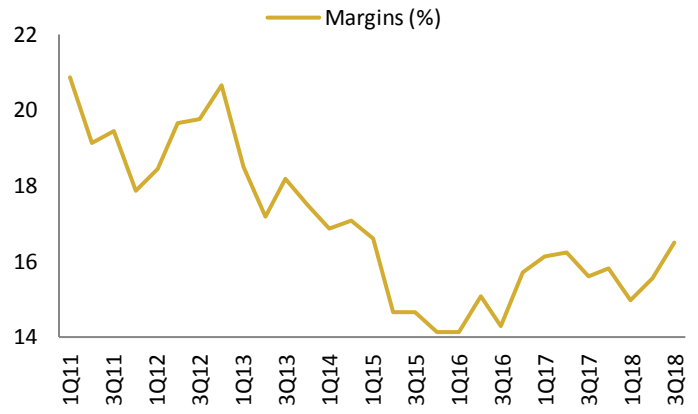


Exhibit 7: DSO days was up 3 days QoQ to 72



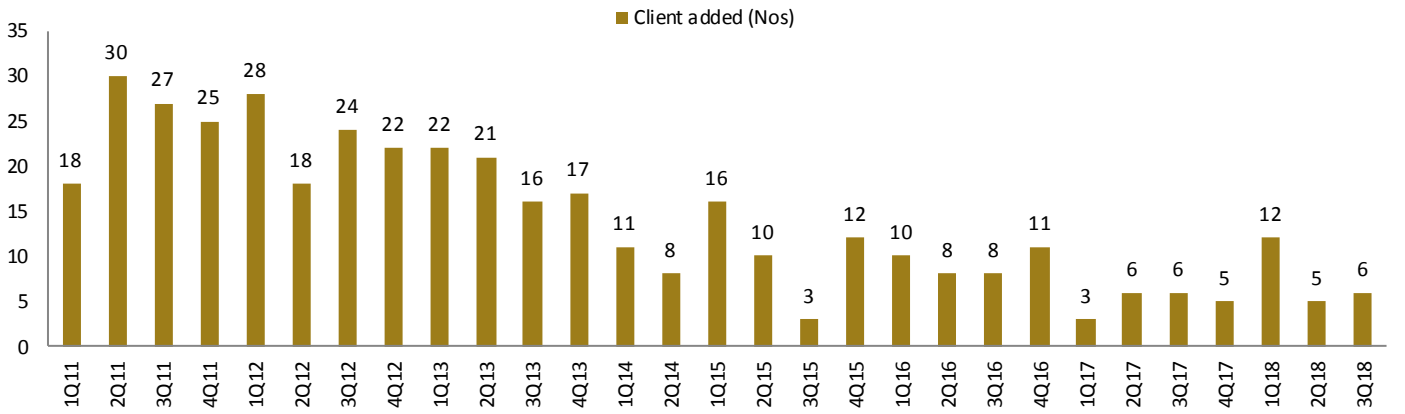
Source: Company, Trust

Exhibit 8: Margin up QoQ on better operational efficiencies



Source: Company, Trust

Exhibit 9: 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	FY16	FY17	FY18E	FY19E	FY20E
Revenues	60,879	60,763	64,739	71,100	78,348
Op. Expenses	51,909	51,075	54,512	60,004	65,919
EBITDA	8,970	9,688	10,227	11,097	12,429
Other Income	1,954	2,385	1,577	1,766	1,966
Depreciation	744	592	712	759	809
EBIT	10,180	11,481	11,092	12,103	13,586
Interest	242	139	116	116	93
PBT	9,938	11,342	10,976	11,987	13,493
Tax	2,696	3,155	2,851	3,117	3,643
PAT	7,242	8,187	8,125	8,871	9,850
Ex. ordinary	495	152	-	-	-
Adj Pat	6,747	8,035	8,125	8,871	9,850

Key Parameters

Year End-March	FY16	FY17	FY18E	FY19E	FY20E
Per share (`)					
EPS	34.4	38.9	42.0	45.8	50.8
CEPS	38.0	41.7	45.7	49.8	55.0
BVPS	299.3	292.4	261.0	284.5	310.7
DPS	20.0	17.0	18.0	19.0	21.0
Payout (%)	67.9	51.1	50.1	48.5	48.3
Valuation (x)					
P/E	13.7	14.9	19.6	17.9	16.2
P/BV	1.6	2.0	3.1	2.9	2.6
EV/EBITDA	10.5	12.1	16.8	15.2	13.3
Dividend Yield (%)	4.0	2.9	2.2	2.3	2.6
Return ratio (%)					
EBITDA Margin	14.7	15.9	15.8	15.6	15.9
PAT Margin	11.9	13.5	12.6	12.5	12.6
ROAE	12.3	13.2	14.5	16.8	17.1
ROACE	15.9	17.5	18.7	21.4	22.1
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.4)	(0.5)	(0.4)	(0.4)	(0.4)
Current ratio	3.3	3.7	3.1	3.3	3.4
Growth Ratios (%)					
Income growth	5.1	(0.2)	6.5	9.8	10.2
EBITDA growth	3.1	8.0	5.6	8.5	12.0
PAT growth	(0.8)	20.0	1.1	9.2	11.0
Turnover Ratios					
Inventor Days	0	0	0	0	0
Debtors Days	38	38	39	39	39
Payable days	9	8	7	7	7

* MPHL had a 5-month FY14

Balance Sheet (` mn)

Year End-March	FY16	FY17	FY18E	FY19E	FY20E
Sources of Funds					
Equity Share Capital	2,102	2,104	1,933	1,935	1,937
Reserves & Surplus	60,829	59,420	48,508	53,124	58,254
Total Shareholders Fund	62,931	61,524	50,441	55,059	60,191
Non- current liabilities	2,378	(2,766)	178	253	334
Long term Borrowings	1,789	11	11	11	11
Deferred tax liabilities	(211)	(3,369)	(580)	(580)	(580)
Other LT liabilities & prov	801	592	747	822	903
Current Liabilities	12,844	10,886	11,563	12,465	13,438
Short-term borrowings	1,325	2,602	2,602	2,602	2,602
Trade payables	4,525	3,878	4,182	4,603	5,057
Other cur liabilities & Prov	6,993	4,406	4,779	5,261	5,779
Total Liabilities	78,153	69,644	62,182	67,778	73,964
Assets					
Non- current Assets	36,385	25,120	25,816	26,658	27,663
Fixed assets	1,728	2,244	2,333	2,373	2,465
Non-current investments	26,696	15,324	15,324	15,324	15,324
Long-term loans & adv	6,881	1,111	1,242	1,364	1,503
Other non-current assets	1,079	6,441	6,917	7,597	8,371
Current assets	41,768	44,523	36,366	41,119	46,301
Current investments	17,364	22,701	11,671	11,671	11,671
Trade receivables	6,489	6,310	6,917	7,597	8,371
Inventories	41	-	-	-	-
Cash & bank balances	8,549	6,133	7,667	10,748	14,023
Short-term loans & adv	2,508	707	887	974	1,073
Other current assets	6,817	8,672	9,223	10,129	11,162
Total Assets	78,153	69,644	62,182	67,778	73,964

Cash flow Statement

Year End-March	FY16	FY17	FY18E	FY19E	FY20E
PBT	9,938	11,342	10,976	11,987	13,493
Depreciation	859	(2,566)	3,501	759	809
Others	(495)	(152)	-	-	-
CF before W.cap	10,302	8,624	14,477	12,747	14,302
Inc/dec in W.cap	3,861	2,870	1,113	1,497	1,766
Op CF after W.cap	6,440	5,755	13,364	11,250	12,536
Less Taxes	2,696	3,155	2,851	3,117	3,643
Net CF From Operations	3,744	2,600	10,513	8,133	8,893
Inc/(dec) in F.A + CWIP	712	1,108	801	800	900
(Pur)/sale of Investments	7,847	(6,034)	(11,030)	-	-
CF from Invest Activities	(8,559)	4,926	10,229	(800)	(900)
Loan Raised/(repaid)	(1,230)	(501)	-	-	-
Equity Raised	1,385	(5,256)	(15,138)	49	42
Dividend	-	4,185	4,071	4,302	4,760
CF from Fin Activities	155	(9,943)	(19,208)	(4,253)	(4,718)
Net inc/(dec) in cash	(4,660)	(2,417)	1,534	3,080	3,275
Op. bal of cash	13,209	8,550	6,133	7,667	10,748
Cl. balance of cash	8,549	6,133	7,667	10,748	14,023



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Recommendation **Expected absolute returns (%) over 12 months**

Buy More than 15%

Hold 15% to -15%

Sell Less than -15%

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