

Market statistics

Current stock price (`)	1069
Shares O/S (cr.)	19.3
Mcap (` cr)	20,682
52W H/L (`)	1278/637
6m avg. volume	626,408
Bloomberg	MPLH.IN

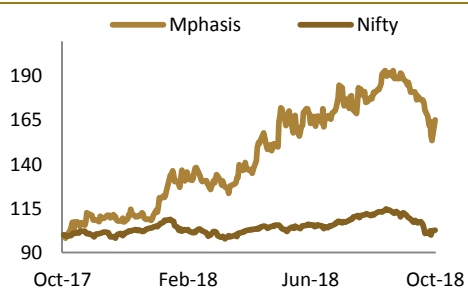
Mphasis reported 3% QoQ revenue growth in constant currency terms. Direct Core/HP business segments reported 3%/6.4% growth on a cc basis. EBIT margin declined 20bps to 16.4% vs. our expectations of a 40bps gain, largely due to lower FX realizations at Rs69.5/US\$ and impacted by transition of large deals. Mphasis maintained its OPM guidance in the range of 15-17% for FY19 despite wage hikes due in Q3. OPM should improve gradually as hedge rates improve to Rs70/US\$. Digital Risk (10.2% of rev) declined 10% QoQ. We maintain our SELL rating on the stock on account of underinvestment in business, increasing concentration of revenues and medium term risks to profitability.

Shareholding pattern

Promoters	52.35
Domestic Institution	8.71
Foreign Institution	29.07
Non-institution	9.87
of which more than 1%	

Good quarter, margin miss. Mphasis reported US\$ revenues of US\$275.6mn (up 2.6% QoQ) on account of 6.4% cc QoQ growth in the HP channel. Digital Risk business adversely affected growth as its revenues declined by ~10% in the quarter — in line with its commentary of revenues in the range of US\$27mn-US\$30mn. Mphasis is slightly skeptical on this segment given rising interest rates, but it sees significant potential in terms of its elite client roster that features several Tier I mortgage players that can be cross-sold on various other service offerings. The company signed record TCV of about US\$210mn in the quarter and also witnessed strong traction in the Emerging Industries vertical. The company is focusing on developing its capabilities in this vertical with the key focus on the sub-segment Transportation/ Logistics/ Healthcare. Profitability in the quarter was lower than expected as it incurred certain large-deal-related transition costs and overall lower FX realization of Rs69.5/US\$.

Mphasis vs Nifty



Operating metrics getting weaker, though cash supports downside: Consolidated headcount increased by 322 to 22,888 (net addition in 2Q18, 3Q18, 1Q19 of last 9 quarters). Mphasis added 8 clients this quarter (6 from the Direct channel). Net Cash & equivalents stand at `130/share (12.2% of the MCap is in form of cash). DSO's increased 2 QoQ to 67 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. Among services AMS (34.4% of rev) led the growth. Among geographies, Americas posted 3.9% QoQ. Netnew deals in Direct International with TCV of USD 210mn included 77% from Digital/Newgen services. Digital/Newgen services was 45.9% of Direct Core and grew 48.2% YoY. **Near-term outlook:** Wage increase to impact margin in 3Q/4Q and MPLH indicated continuity in mid-teens and high-teens growth for Direct Core and HP/DXC channel, respectively.

Capital efficiency & valuations

Particulars	FY18	FY19E	FY20E
RoE (%)	14.6	19.7	21.0
EPS (`)	44.0	56.3	64.0
CEPS (`)	47.7	60.2	68.2
P/E (x)	19.2	19.0	16.7
P/BV (x)	3.0	3.7	3.3
EV/EBITDA (x)	16.3	16.4	14.2
Income growth (%)	7.7	19.1	13.2
EBITDA growth (%)	9.7	27.4	14.7
PAT growth (%)	4.2	30.1	13.8

Other details: Mphasis focused on certain key points to drive growth going forward: 1) Strong Management: Infused new talent across levels, senior leaders in focus markets, 2) domain expertise in all verticals, 3) Focus on clients: Strategic customers, HP/DXC Technology, Blackstone Portfolio and New client acquisition, 4) Geography focus – Americas, Europe, 5) Strong TCV wins, 6) Margin expansion: Pyramid optimization, Increased pricing power and Business Model Shift

HP channel revenue to become stable from here on, acquisition being used to prop up declining revenue: HP channel (27% 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.

Valuation: MPLH does not compare well versus some of the other mid-cap IT companies. Valuations are not 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	2QFY18	1QFY19	2QFY19	QoQ (%)	YoY (%)	Comments
Revenues (In US\$m)	239.1	268.7	275.6	2.6	15.3	Core/HP business segments reported 3%/6.4% growth on a cc basis.
Revenues	16,047	18,202	19,149	5.2	19.3	
- Operating costs	13,554	15,001	15,820	5.5	16.7	
EBITDA	2,493	3,201	3,329	4.0	33.5	Margins decreased due to impact from transition of large deals.
EBITDA margin (%)	15.5	17.6	17.4	(20)bps	185bps	
- Interest expense	37	42	26	(38.1)	(29.7)	
- Depreciation	181	179	184	2.8	1.7	Includes a forex gain of `26mn for the quarter vs `67mn in 1Q.
+ Other income, net (incl forex)	375	449	467	4.0	24.5	
PBT	2,650	3,429	3,586	4.6	35.3	
- Taxes	673	846	877	3.7	30.3	Tax rate to remain in the range of 27-28%
Effective tax rate (%)	25.4	24.7	24.5	(22)bps	(94)bps	
PAT	1,977	2,583	2,709	4.9	37.0	
Net margin (%)	12.3	14.2	14.1	(4)bps	183bps	
Reported profits	1,977	2,583	2,709	4.9	37.0	

Source: Company.

Exhibit 2: Change in estimates

` mn	FY19E			FY20E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	1,114	1,125	1.0	1,237	1,261	1.9
Revenue	72,433	77,969	7.6	80,418	88,267	9.8
EBITDA margin (%)	16.3	17.4	85bps	16.5	17.6	110bps
EPS (`)	49.0	56.3	14.9	54.5	64.0	17.4

Source: Trust Research

Geography wise Revenues: Business in Europe was down 3.4% QoQ while US increased 3.9%. RoW decreased 1.4% QoQ.

Exhibit 3: Geographical wise Performance

Geographical mix	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
US	77.6	78.0	79.1	79.5	80.1	80.2	79.1	79.1	80.1
Europe	10.5	9.6	9.5	9.8	9.5	9.8	11.0	11.5	10.8
RoW	11.9	12.4	11.4	10.7	10.4	10.0	9.9	9.4	9.1
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	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Application maintenance	35.4	37.0	36.9	35.6	34.6	33.1	31.2	30.2	34.4
Application development	23.9	23.1	24.5	24.7	24.0	26.3	26.2	27.5	27.7
Customer service	1.8	1.9	1.8	1.5	1.7	1.4	1.3	1.2	1.0
Service/ technical help desk	2.4	2.3	2.2	5.4	7.2	7.6	7.4	8.2	6.5
Transaction processing service	7.0	6.2	6.5	7.0	6.8	7.0	6.9	6.6	6.3
Infrastructure management services	13.6	14.2	13.8	13.8	13.4	13.2	15.2	14.8	14.2
Knowledge processes	15.9	15.4	14.3	12.1	12.3	11.4	11.8	11.5	9.9
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 322 to 22,888 (net addition in 2Q18, 3Q18, 1Q19 of last 9 quarters).

Details	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Applications (onsite)	2,357	2,299	2,353	2,373	2,363	2,392	2,456	2,550	2,703
BPO (onsite)	1,189	1,127	1,040	1,044	998	981	950	914	914
ITO (onsite)	281	251	274	277	676	1,106	1,120	1,087	1,071
Applications (offshore)	8,468	8,615	8,807	8,668	8,486	8,228	8,281	8,680	8,958
BPO (offshore)	5,561	5,351	5,176	5,191	5,360	5,304	5,139	5,092	5,140
ITO (offshore)	3,196	3,136	3,074	3,055	3,011	3,062	3,121	3,075	2,937
S&M	300	315	325	346	330	300	278	270	270
G&A	939	940	945	943	932	897	894	898	895
Total	22,291	22,034	21,994	21,897	22,156	22,270	22,239	22,566	22,888

Source: Company

Client Concentration: Mphasis added 12 clients this quarter (6 from the Direct channel). MPHL added 9 clients in Emerging Industries and added 3 client in Banking and Capital Market.

Exhibit 5: Client details

Details	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Top client (%)	12.0	11.0	11.0	12.0	12.0	12.0	13.0	13.0	14.0
Top 5 clients (%)	40.0	40.0	40.0	40.0	40.0	39.0	40.0	41.0	43.0
Top 10 clients (%)	54.0	55.0	55.0	55.0	54.0	55.0	56.0	56.0	58.0
Top 20 clients (%)	65.0	65.0	66.0	65.0	66.0	66.0	69.0	68.0	69.0
US\$1mn+	98	92	90	90	90	88	90	93	95
US\$5mn+	28	30	36	39	37	38	37	37	36
US\$10mn+	14	14	14	15	15	17	17	18	19
US\$20mn+	14	8	7	7	7	8	8	8	8
Client added	6	6	5	12	5	6	5	12	12

Source: Company

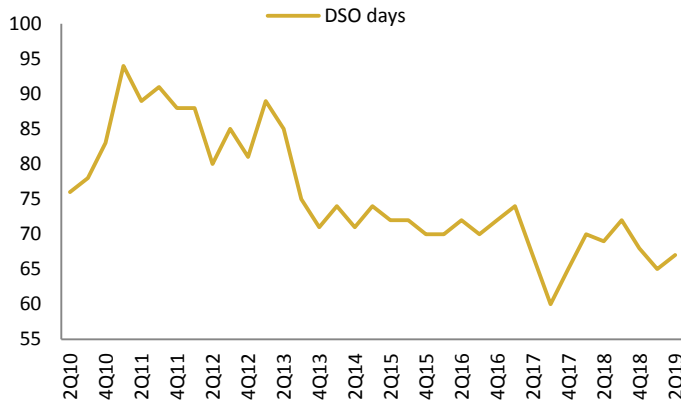
Exhibit 6: Billing rates (US\$/hr)

Details	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19
Applications (onsite)	78	78	80	83	84	85	85	86
ITO (onsite)	71	73	74	77	86	88	86	86
Applications (offshore)	21	22	21	21	22	22	22	22
BPO (offshore)	11	11	11	11	11	11	10	10
ITO (offshore)	18	18	19	19	20	22	24	23

Source: Company

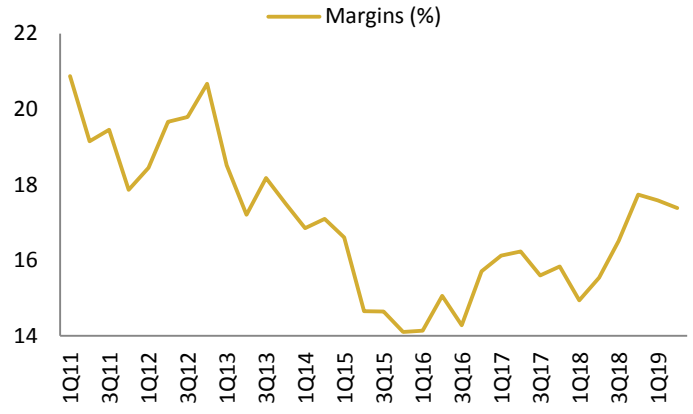


Exhibit 7: DSO days was up 2 days QoQ to 67



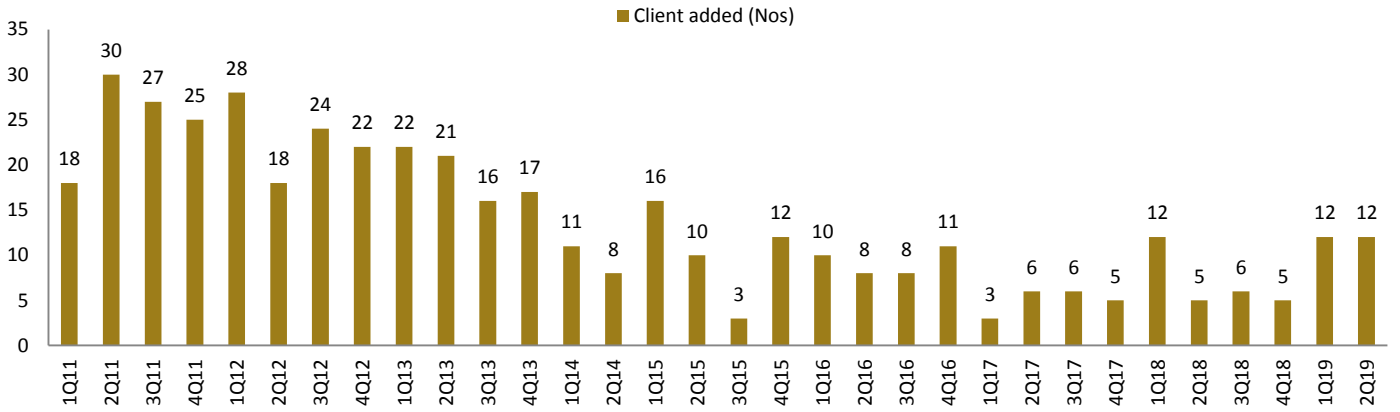
Source: Company, Trust

Exhibit 8: Margin down QoQ on large deal transitions



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	FY18	FY19E	FY20E
Revenues	60,879	60,763	65,459	77,969	88,267
Op. Expenses	51,909	51,075	54,834	64,429	72,737
EBITDA	8,970	9,688	10,625	13,541	15,530
Other Income	1,954	2,385	1,620	1,925	2,125
Depreciation	744	592	709	759	809
EBIT	10,180	11,481	11,536	14,706	16,846
Interest	242	139	130	120	96
PBT	9,938	11,342	11,406	14,586	16,750
Tax	2,696	3,155	2,900	3,692	4,355
PAT	7,242	8,187	8,506	10,895	12,395
Ex. ordinary	495	152	131	-	-
Adj Pat	6,747	8,035	8,375	10,895	12,395

Key Parameters

Year End-March	FY16	FY17	FY18	FY19E	FY20E
Per share (`)					
EPS	34.4	38.9	44.0	56.3	64.0
CEPS	38.0	41.7	47.7	60.2	68.2
BVPS	299.3	292.4	283.6	288.2	320.6
DPS	20.0	17.0	20.0	24.0	27.0
Payout (%)	67.9	51.1	53.2	49.9	49.4
Valuation (x)					
P/E	13.7	14.9	19.2	19.0	16.7
P/BV	1.6	2.0	3.0	3.7	3.3
EV/EBITDA	10.5	12.1	16.3	16.4	14.2
Dividend Yield (%)	4.0	2.9	2.4	2.2	2.5
Return ratio (%)					
EBITDA Margin	14.7	15.9	16.2	17.4	17.6
PAT Margin	11.9	13.5	13.0	14.0	14.0
ROAE	12.3	13.2	14.6	19.7	21.0
ROACE	15.9	17.5	18.8	25.2	27.6
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)	(0.3)	(0.4)
Current ratio	3.3	3.7	2.8	2.5	2.6
Growth Ratios (%)					
Income growth	5.1	(0.2)	7.7	19.1	13.2
EBITDA growth	3.1	8.0	9.7	27.4	14.7
PAT growth	(0.8)	20.0	4.2	30.1	13.8
Turnover Ratios					
Inventor Days	0	0	0	0	0
Debtors Days	38	38	40	39	38
Payable days	9	8	9	9	9

* MPHL had a 5-month FY14

Balance Sheet (` mn)

Year End-March	FY16	FY17	FY18	FY19E	FY20E
Sources of Funds					
Equity Share Capital	2,102	2,104	1,933	1,935	1,937
Reserves & Surplus	60,829	59,420	52,885	53,844	60,160
Total Shareholders Fund	62,931	61,524	54,818	55,779	62,097
Non- current liabilities	2,378	(2,766)	(41)	(1,222)	(1,108)
Long term Borrowings	1,789	11	38	38	38
Deferred tax liabilities	(211)	(3,369)	(1,007)	(2,143)	(2,143)
Other LT liabilities & prov	801	592	928	883	996
Current Liabilities	12,844	10,886	14,020	15,725	17,251
Short-term borrowings	1,325	2,602	3,899	3,899	3,899
Trade payables	4,525	3,878	5,024	5,825	6,576
Other cur liabilities & Prov	6,993	4,406	5,097	6,002	6,776
Total Liabilities	78,153	69,644	68,796	70,283	78,240
Assets					
Non- current Assets	36,385	25,120	29,336	31,363	32,611
Fixed assets	1,728	2,244	1,848	2,421	2,512
Non-current investments	26,696	15,324	20,184	20,184	20,184
Long-term loans & adv	6,881	1,111	1,140	1,495	1,693
Other non-current assets	1,079	6,441	6,164	7,263	8,222
Current assets	41,768	44,523	39,460	38,920	45,629
Current investments	17,364	22,701	14,651	14,651	14,651
Trade receivables	6,489	6,310	8,116	8,117	9,189
Inventories	41	-	-	-	-
Cash & bank balances	8,549	6,133	4,642	3,976	8,004
Short-term loans & adv	2,508	707	824	1,068	1,209
Other current assets	6,817	8,672	11,227	11,108	12,575
Total Assets	78,153	69,644	68,796	70,283	78,240

Cash flow Statement

Year End-March	FY16	FY17	FY18	FY19E	FY20E
PBT	9,938	11,342	11,406	14,586	16,750
Depreciation	859	(2,566)	3,071	(377)	809
Others	(495)	(152)	(131)	-	-
CF before W.cap	10,302	8,624	14,346	14,210	17,559
Inc/dec in W.cap	3,861	2,870	2,057	(80)	2,198
Op CF after W.cap	6,440	5,755	12,289	14,290	15,361
Less Taxes	2,696	3,155	2,900	3,692	4,355
Net CF From Operations	3,744	2,600	9,389	10,598	11,006
Inc/(dec) in F.A + CWIP	712	1,108	313	1,332	900
(Pur)/sale of Investments	7,847	(6,034)	(3,190)	-	-
CF from Invst Activities	(8,559)	4,926	2,877	(1,332)	(900)
Loan Raised/(repaid)	(1,230)	(501)	1,324	-	-
Equity Raised	1,385	(5,256)	(10,559)	(4,499)	42
Dividend	-	4,185	4,523	5,434	6,119
CF from Fin Activities	155	(9,943)	(13,757)	(9,933)	(6,077)
Net inc/(dec) in cash	(4,660)	(2,417)	(1,491)	(667)	4,028
Op. bal of cash	13,209	8,550	6,133	4,642	3,976
Cl. balance of cash	8,549	6,133	4,642	3,976	8,004



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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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