

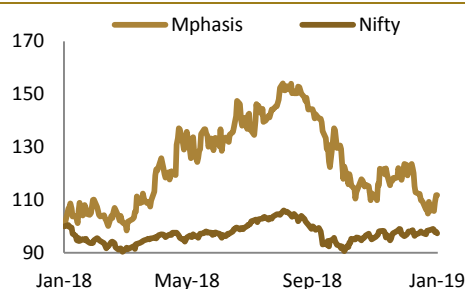
Market statistics

Current stock price (`)	920
Shares O/S (cr.)	18.6
Mcap (` cr)	17,129
52W H/L (`)	1278/797
6m avg. volume	459,270
Bloomberg	MPLH.IN

Shareholding pattern

Promoters	52.29
Domestic Institution	8.22
Foreign Institution	28.93
Non-institution	10.56
of which more than 1%	

Mphasis vs. Nifty



Capital efficiency & valuations

Particulars	FY19E	FY20E	FY21E
RoE (%)	26.3	30.0	30.5
EPS (`)	58.6	65.5	73.9
CEPS (`)	62.6	70.2	78.8
P/E (x)	15.7	14.0	12.4
P/BV (x)	3.7	3.2	2.8
EV/EBITDA (x)	14.4	12.5	10.8
Income growth (%)	18.7	13.4	11.7
EBITDA growth (%)	25.3	12.0	14.6
PAT growth (%)	30.2	12.0	12.9

Mphasis reported 3.1% QoQ revenue growth in cc terms. Direct Core/HP business segments reported 2%/6.4% growth on a cc basis despite headwinds in Digital Risk business. EBIT margin declined just 65bps to 15.8%, largely due to expected G&A and pyramid optimization despite wage hikes and lower working days. Allaying fears of a slowdown in HP channel (~25% of sales) with DXC Tech's Luxoft acquisition, Mphasis has highlighted no near-to-medium-term impact, with a positive impact in the long term. The continuous addition of Blackstone portfolio cos. to its clientele (10 vs. 5 at the end FY18), strong US\$ growth in top five strategic accounts (~25% YoY in 9MFY19) and a gradual shift of mix towards niche service transformation work in DXC/HP channel provide confidence of sustainable and profitable growth. We upgrade our rating on the stock to BUY, given confidence in its business growth and compelling valuations (at 14x FY20E EPS).

Good quarter. Mphasis reported US\$ revenues of US\$282.7mn (up 2.6% QoQ) on account of 6.4% cc QoQ growth in the HP channel. Digital Risk adversely affected growth as its revenues declined by ~20%. 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 TCV of about US\$122mn 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.

Growth and margin visibility. Allaying growth fears in HP business following DXC Tech's Luxoft acquisition, Mphasis stated that Luxoft's addressable space in DXC Tech is going to be different - more of a front end as compared to Mphasis' back-end service transformation work. With ongoing consolidation of vendors by DXC Tech (to improve its margins), Mphasis expects a continued increase in its market share due to its differentiated service transformation capabilities. Mphasis continues to gain traction among Blackstone portfolio companies, with ~5% of overall revenues to come from this channel and three/five new conversions in Q3FY19/9MFY19, respectively. Its strategic accounts (top five have risen by ~25% YoY in US\$ terms) also continue to grow at a healthy rate. With strong and industry-leading growth in a relatively high-margin new-gen services, growing share of new-gen deals in overall deal TCV (~80% of deals were in new-gen areas in Q3FY19), ongoing cost-optimization efforts (G&A and Pyramid optimization) and lower hedge losses in FY20, Mphasis indicated an upward bias to its EBIT margin guidance band (15-17% in FY19).

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

Valuation: With strong historical revenue growth and expectations, differentiated growth channels in the form of Blackstone portfolio companies and long client relationships (HP group companies such as DXC Tech, HPE, HP Inc. and Micro Focus and 16 strategic accounts), improving margin profile (guided for 15-17% EBIT margins in FY19), confident management commentary and strong leading indicators (New deal TCV up ~14% YoY on LTM basis), we believe that the recent correction in stock price provides a good opportunity to enter this stock. **We upgrade our rating on the stock to BUY, given confidence in its business growth and compelling valuations (at 14x FY20E EPS).**

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Exhibit 1: Quarterly details

` mn	3QFY18	2QFY19	3QFY19	QoQ (%)	YoY (%)	Comments
Revenues (In US\$m)	251.4	275.6	282.7	2.6	12.5	Core/HP business segments reported 2%/6.4% growth on a cc basis.
Revenues	16,607	19,149	19,710	2.9	18.7	
- Operating costs	13,865	15,820	16,404	3.7	18.3	
EBITDA	2,742	3,329	3,306	(0.7)	20.6	Margins decreased due to impact from wage hikes
EBITDA margin (%)	16.5	17.4	16.8	(61)bps	26bps	
- Interest expense	29	26	28	7.7	(3.4)	
- Depreciation	176	184	196	6.5	11.4	Includes a forex gain of `76mn for the quarter vs `27mn in 2Q.
+ Other income, net (incl forex)	354	467	499	6.9	41.0	
PBT	2,891	3,586	3,581	(0.1)	23.9	
- Taxes	741	877	801	(8.7)	8.1	Tax rate to remain in the range of 24-25%
Effective tax rate (%)	25.6	24.5	22.4	(209)bps	(326)bps	
PAT	2,150	2,709	2,780	2.6	29.3	
Net margin (%)	12.9	14.1	14.1	(4)bps	116bps	
Reported profits	2,150	2,709	2,780	2.6	29.3	

Source: Company.

Exhibit 2: Change in estimates

` mn	FY19E			FY20E		
	Old	New	%Chg	Old	New	%Chg
Revenue (US\$ mn)	1,125	1,122	(0.3)	1,261	1,258	(0.2)
Revenue	77,969	77,681	(0.4)	88,267	88,082	(0.2)
EBITDA margin (%)	17.4	17.1	(25)bps	17.6	16.9	(65)bps
EPS (`)	56.3	58.6	4.1	64.0	65.5	2.3

Source: Trust Research

Geography wise Revenues: Business in Europe was up 6.8% QoQ while US increased 0.2%. RoW increased 18.2% QoQ.

Exhibit 3: Geographical wise Performance

Geographical mix	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
US	78.0	79.1	79.5	80.1	80.2	79.1	79.1	80.1	78.3
Europe	9.6	9.5	9.8	9.5	9.8	11.0	11.5	10.8	11.1
RoW	12.4	11.4	10.7	10.4	10.0	9.9	9.4	9.1	10.4
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	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Application maintenance	37.0	36.9	35.6	34.6	33.1	31.2	30.2	34.4	35.8
Application development	23.1	24.5	24.7	24.0	26.3	26.2	27.5	27.7	29.8
Customer service	1.9	1.8	1.5	1.7	1.4	1.3	1.2	1.0	1.1
Service/ technical help desk	2.3	2.2	5.4	7.2	7.6	7.4	8.2	6.5	6.7
Transaction processing service	6.2	6.5	7.0	6.8	7.0	6.9	6.6	6.3	6.2
Infrastructure management services	14.2	13.8	13.8	13.4	13.2	15.2	14.8	14.2	12.7
Knowledge processes	15.4	14.3	12.1	12.3	11.4	11.8	11.5	9.9	7.6
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 737 to 24,215.

Details	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Applications (onsite)	2,299	2,353	2,373	2,363	2,392	2,456	2,550	2,991	3,539
BPO (onsite)	1,127	1,040	1,044	998	981	950	914	914	884
ITO (onsite)	251	274	277	676	1,106	1,120	1,087	1,312	1,210
Applications (offshore)	8,615	8,807	8,668	8,486	8,228	8,281	8,680	8,962	9,286
BPO (offshore)	5,351	5,176	5,191	5,360	5,304	5,139	5,092	5,140	5,236
ITO (offshore)	3,136	3,074	3,055	3,011	3,062	3,121	3,075	2,994	2,843
S&M	315	325	346	330	300	278	270	270	292
G&A	940	945	943	932	897	894	898	895	925
Total	22,034	21,994	21,897	22,156	22,270	22,239	22,566	23,478	24,215

Source: Company

Client Concentration: Mphasis added 20 clients this quarter (18 from the Direct channel). MPHL added 5 clients in Emerging Industries and added 11 client in Banking and Capital Market.

Exhibit 5: Client details

Details	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Top client (%)	11.0	11.0	12.0	12.0	12.0	13.0	13.0	14.0	14.0
Top 5 clients (%)	40.0	40.0	40.0	40.0	39.0	40.0	41.0	43.0	46.0
Top 10 clients (%)	55.0	55.0	55.0	54.0	55.0	56.0	56.0	58.0	59.0
Top 20 clients (%)	65.0	66.0	65.0	66.0	66.0	69.0	68.0	69.0	70.0
US\$1mn+	92	90	90	90	88	90	93	95	96
US\$5mn+	30	36	39	37	38	37	37	36	33
US\$10mn+	14	14	15	15	17	17	18	19	19
US\$20mn+	8	7	7	7	8	8	8	8	8
Client added	6	5	12	5	6	5	12	12	20

Source: Company

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

Details	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Applications (onsite)	78	80	83	84	85	85	86	85
ITO (onsite)	73	74	77	86	88	86	86	81
Applications (offshore)	22	21	21	22	22	22	22	23
BPO (offshore)	11	11	11	11	11	10	10	10
ITO (offshore)	18	19	19	20	22	24	23	24

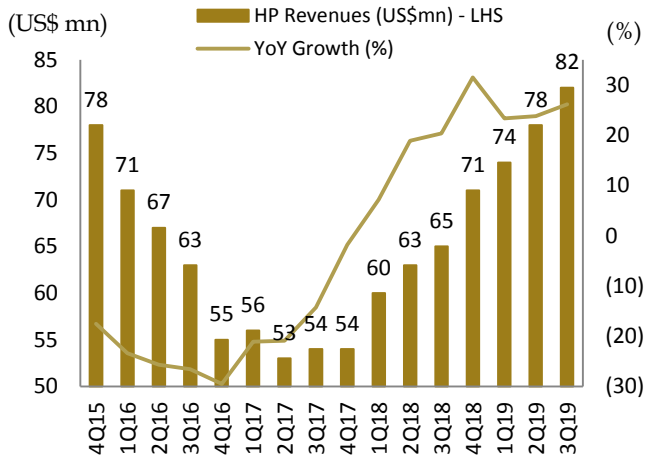
Source: Company

HP Channel (~28% of sales): After falling ~20% YoY for five straight years, HP has shown a strong recovery in FY18/9MFY19, where it is up ~20%/~24% YoY. This comes on the back of strategic changes such as One Mphasis and team centralizations incorporated by new CEO Nitin Rakesh, which drove the segment growth. Mphasis expects this growth momentum to sustain in this segment as it penetrates deeper into segments of HP (i.e., HPE, HP Inc. and Micro Focus), other than DXC Tech, which contributes ~80% of current HP segment revenues.

Direct International (Ex- Digital Risk) (~65% of sales): Direct International has been the best performing business segment of Mphasis, with an industry-leading YoY growth over the last three years. Both growth in key strategic accounts and hunting of Blackstone portfolio companies are fuelling continued growth in this segment. Digital Risk (~7% of revenues; down ~20% QoQ in Q3FY19) has been underperforming over the last few quarters but Mphasis expects growth stability and margin improvements in this segment, going ahead.

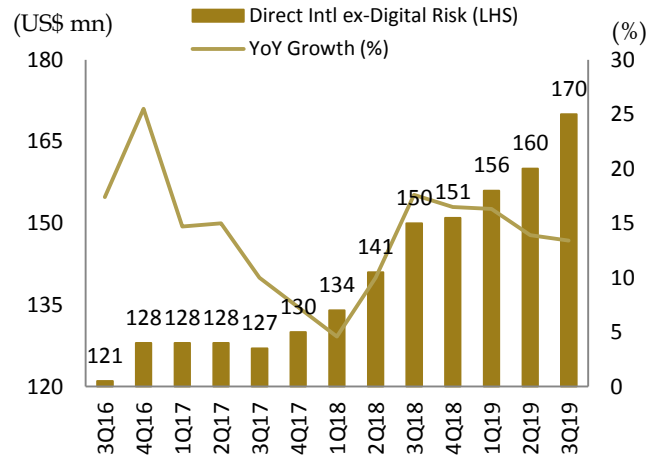


Exhibit 7: HP/DXC revenue to accelerate from FY20



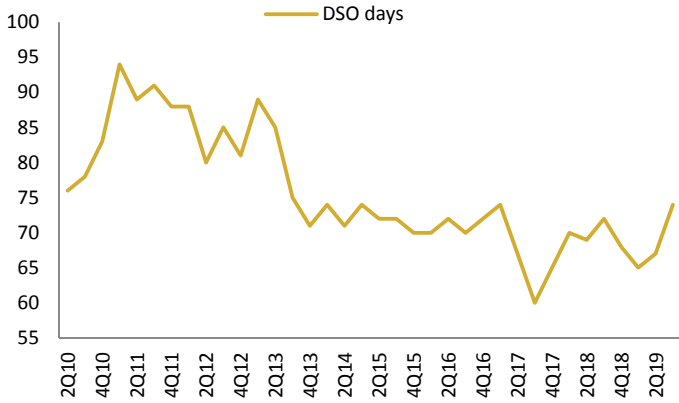
Source: Company, Trust

Exhibit 8: Direct Intl. (excl. Digital Risk) continues growing



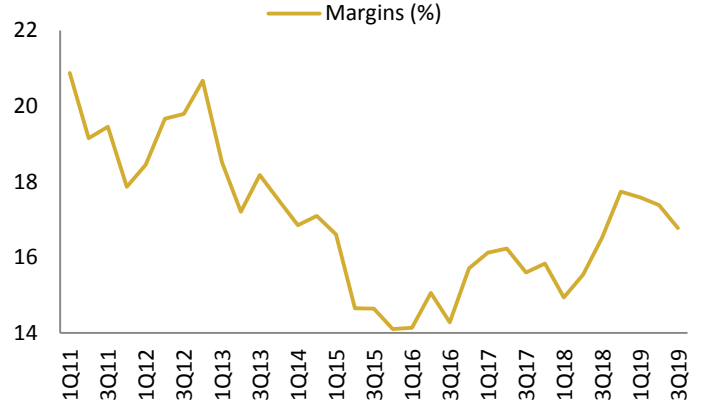
Source: Company, Trust

Exhibit 9: DSO days was up 7 days QoQ to 74



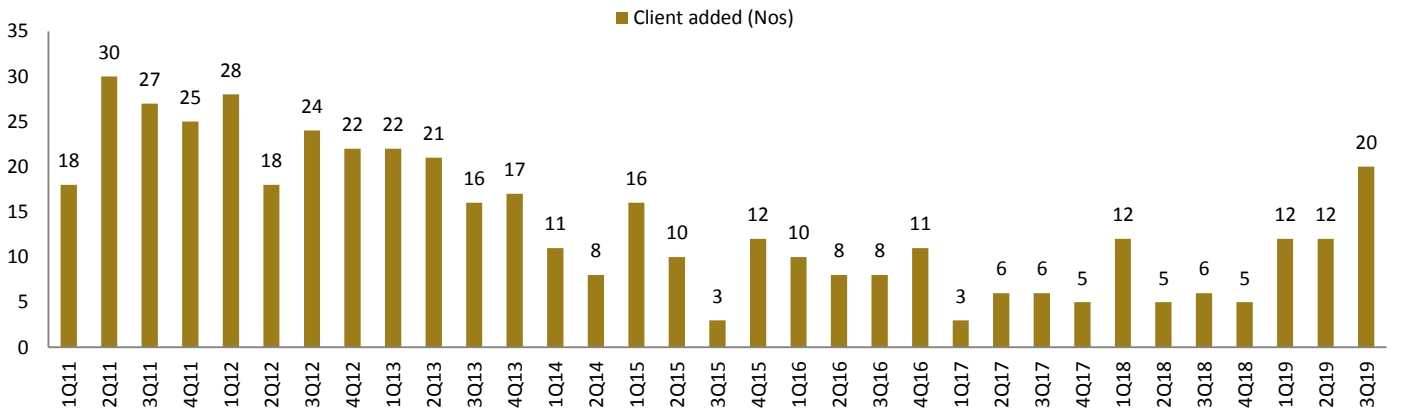
Source: Company, Trust

Exhibit 10: Margin down QoQ on wage hikes



Source: Company, Trust

Exhibit 11: Client addition at MPHL has been robust over the past 3 quarters compared to the recent past



Source: Company, Trust



Financials

Income Statement (` mn)

Year End-March	FY17	FY18	FY19E	FY20E	FY21E
Revenues	60,763	65,459	77,681	88,082	98,383
Op. Expenses	51,075	54,834	64,369	73,168	81,288
EBITDA	9,688	10,625	13,311	14,915	17,094
Other Income	2,385	1,620	1,939	2,346	2,546
Depreciation	592	709	759	867	916
EBIT	11,481	11,536	14,492	16,394	18,724
Interest	139	130	124	112	90
PBT	11,342	11,406	14,368	16,282	18,634
Tax	3,155	2,900	3,467	4,070	4,845
PAT	8,187	8,506	10,901	12,211	13,789
Ex. ordinary	152	131	-	-	-
Adj Pat	8,035	8,375	10,901	12,211	13,789

Key Parameters

Year End-March	FY17	FY18	FY19E	FY20E	FY21E
Per share (`)					
EPS	38.9	44.0	58.6	65.5	73.9
CEPS	41.7	47.7	62.6	70.2	78.8
BVPS	292.4	283.6	251.9	285.8	324.5
DPS	17.0	20.0	24.0	27.0	30.0
Payout (%)	51.1	53.2	48.0	48.2	47.5
Valuation (x)					
P/E	14.9	19.2	15.7	14.0	12.4
P/BV	2.0	3.0	3.7	3.2	2.8
EV/EBITDA	12.1	16.3	14.4	12.5	10.8
Dividend Yield (%)	2.9	2.4	2.6	2.9	3.3
Return ratio (%)					
EBITDA Margin	15.9	16.2	17.1	16.9	17.4
PAT Margin	13.5	13.0	14.0	13.9	14.0
ROAE	13.2	14.6	21.4	24.4	24.2
ROACE	17.5	18.8	26.3	30.0	30.5
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.5)	(0.4)	(0.2)	(0.3)	(0.3)
Current ratio	3.7	2.8	2.0	2.2	2.4
Growth Ratios (%)					
Income growth	(0.2)	7.7	18.7	13.4	11.7
EBITDA growth	8.0	9.7	25.3	12.0	14.6
PAT growth	20.0	4.2	30.2	12.0	12.9
Turnover Ratios					
Inventor Days	0	0	0	0	0
Debtors Days	38	40	38	37	37
Payable days	8	9	9	9	9

* MPHL had a 5-month FY14

Balance Sheet (` mn)

Year End-March	FY17	FY18	FY19E	FY20E	FY21E
Sources of Funds					
Equity Share Capital	2,104	1,933	1,862	1,864	1,866
Reserves & Surplus	59,420	52,885	45,023	51,393	58,668
Total Shareholders Fund	61,524	54,818	46,885	53,257	60,533
Non- current liabilities	(2,766)	(41)	(198)	(78)	34
Long term Borrowings	11	38	38	38	38
Deferred tax liabilities	(3,369)	(1,007)	(1,118)	(1,118)	(1,118)
Other LT liabilities & prov	592	928	882	1,002	1,114
Current Liabilities	10,886	14,020	15,714	17,330	18,820
Short-term borrowings	2,602	3,899	3,899	3,899	3,899
Trade payables	3,878	5,024	5,820	6,615	7,349
Other cur liabilities & Prov	4,406	5,097	5,996	6,816	7,572
Total Liabilities	69,644	68,796	62,401	70,509	79,387
Assets					
Non- current Assets	25,120	29,336	31,447	32,549	33,689
Fixed assets	2,244	1,848	2,537	2,470	2,454
Non-current investments	15,324	20,184	20,184	20,184	20,184
Long-term loans & adv	1,111	1,140	1,490	1,689	1,887
Other non-current assets	6,441	6,164	7,236	8,205	9,164
Current assets	44,523	39,460	30,955	37,961	45,699
Current investments	22,701	14,651	9,651	9,651	9,651
Trade receivables	6,310	8,116	8,087	9,170	10,243
Inventories	-	-	-	-	-
Cash & bank balances	6,133	4,642	1,085	5,384	10,441
Short-term loans & adv	707	824	1,064	1,207	1,348
Other current assets	8,672	11,227	11,067	12,549	14,016
Total Assets	69,644	68,796	62,401	70,509	79,387

Cash flow Statement

Year End-March	FY17	FY18	FY19E	FY20E	FY21E
PBT	11,342	11,406	14,368	16,282	18,634
Depreciation	(2,566)	3,071	648	867	916
Others	(152)	(131)	-	-	-
CF before W.cap	8,624	14,346	15,016	17,149	19,551
Inc/dec in W.cap	2,870	2,057	(176)	2,140	2,236
Op CF after W.cap	5,755	12,289	15,191	15,009	17,315
Less Taxes	3,155	2,900	3,467	4,070	4,845
Net CF From Operations	2,600	9,389	11,725	10,938	12,470
Inc/(dec) in F.A + CWIP	1,108	313	1,448	800	900
(Pur)/sale of Investments	(6,034)	(3,190)	(5,000)	-	-
CF from Invst Activities	4,926	2,877	3,552	(800)	(900)
Loan Raised/(repaid)	(501)	1,324	-	-	-
Equity Raised	(5,256)	(10,559)	(13,606)	49	35
Dividend	4,185	4,523	5,227	5,888	6,548
CF from Fin Activities	(9,943)	(13,757)	(18,834)	(5,839)	(6,513)
Net inc/(dec) in cash	(2,417)	(1,491)	(3,557)	4,299	5,057
Op. bal of cash	8,550	6,133	4,642	1,085	5,384
Cl. balance of cash	6,133	4,642	1,085	5,384	10,441



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Served as Director or Employee	No

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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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