

BSE SENSEX 37,582
S&P CNX 11,110

CMP: INR960 TP: INR1120 (+17%) Buy

Motilal Oswal values your support in the Asiamoney Brokers Poll 2019 for India Research, Sales and Trading team. We request your ballot.



Stock Info

Bloomberg	MPHL IN
Equity Shares (m)	193
M.Cap.(INRb)/(USD\$b)	178.7 / 2.5
52-Week Range (INR)	1278 / 855
1, 6, 12 Rel. Per (%)	4/-9/-16
12M Avg Val (INR M)	353
Free float (%)	47.8

Financials Snapshot (INR b)

Y/E Mar	2019	2020E	2021E
Net Sales	77.3	87.6	100.1
EBITDA	13.2	16.7	19.2
PAT	10.7	12.4	13.9
EPS (INR)	56.1	64.2	72.1
Gr. (%)	27.4	14.5	12.2
BV/Sh (INR)	281.9	310.0	364.9
RoE (%)	20.0	22.5	22.6
RoCE (%)	18.4	19.9	19.8
P/E (x)	16.6	14.5	13.0
P/BV (x)	3.3	3.0	2.6

Shareholding pattern (%)

As On	Jun-19	Mar-19	Jun-18
Promoter	52.2	52.3	52.4
DII	8.0	8.0	9.1
FII	29.9	29.7	29.2
Others	9.8	10.0	9.4

FII Includes depository receipts

Direct Core flourishing in Digital; Macro remains supportive

We attended Mphasis' (MPHL) analyst day, where management shared the outlook on industry and highlighted its strategy that is turning around growth for the company. Key takeaways:

- MHPL has transformed itself into a provider of new-gen digital services – an evolution in sync with the shift in technology consumption by customers.
- According to ISG, the Digital segment in the Global IT Services market is expected to deliver a healthy CAGR of 16.4% over FY18-22. Everest expects BFSI (MPHL's largest vertical) growth to accelerate with a CAGR of 3-4% over FY19-22, with the drivers being return of ERP wave, payment infra modernization, product innovation by insurers, and FinTech mindset.
- MPHL's next-gen services have been driving Direct Core revenue growth. The key drivers are [1] new client wins in Blackstone portfolio and outside and [2] partnerships with next-gen technology players like AWS and Azure.
- Blackstone's portfolio companies contributed 5% of Direct Core revenue in FY19 and will continue expanding its contribution to revenues.
- MHPL's relationship with DXC has transformed over the years from that of being an IMS supplier in the Americas in FY16 to becoming a reliable service transformation and solution partner in FY19. It is now expanded from the Americas to Europe and APAC as well.

Valuation and view

MHPL has been among the few mid-tier IT companies over the last few quarters where: [1] growth visibility has remained intact with continued revenue growth of low-to-mid teens and [2] margin estimates have not been revised downward (in part thanks to the already low base). It has amongst the best cash generation and RoE in excess of 20%. Our FY19-21 CC revenue CAGR is 12.5% and EPS CAGR is 13%. Our price target of INR1,120 discounts forward earnings by 15x, implying an upside of 17%. Maintain **Buy**. Any impact to business from DXC amidst the latter's struggles in its current business portfolio could pose a risk to our thesis.

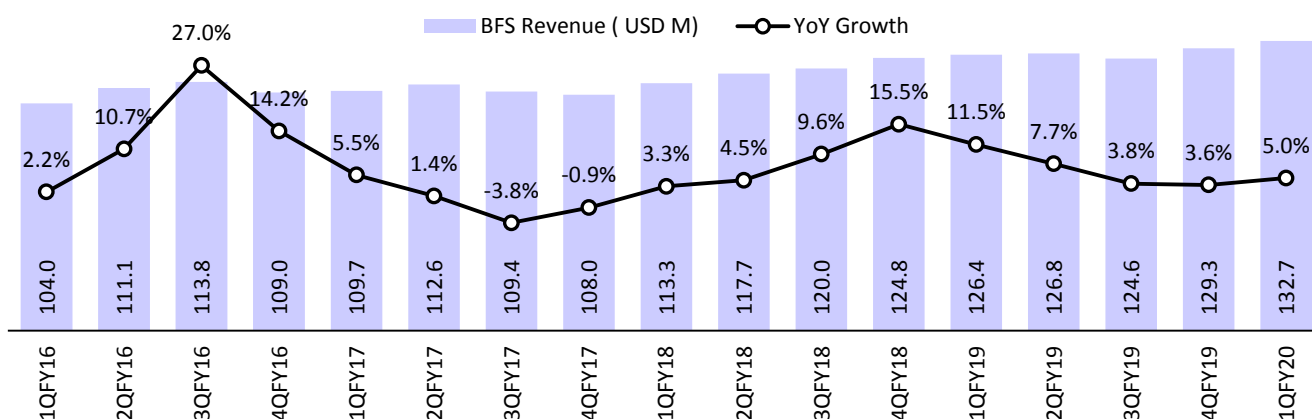
IT SERVICES: Structural shift in consumption pattern

- There has been a structural shift in the consumption pattern, fuelled by [1] the faster go-to-market strategy by clients and [2] the higher focus on customer experience. This has mandated changes to the inherent model of Indian IT services.
- Led by the shortening of capex cycle and the advent of digital services, companies have been forced to change their traditional waterfall model to a more agile-based delivery system.
- Advent of Digital has also led to a shortening of overall deal sizes (TCVs shrank by ~50% over the last few years) and an increase the number of buyers. Within organizations, verticals now have their own IT budgets.

Growth in BFSI likely to accelerate

- Within BFS, the deal environment has been polarized. Higher momentum is coming from customer-facing areas, while the buy-side (dominant for MPHL) market is still under pressure. The company's BFS segment has been under pressure for some time now amid macro uncertainties.

Exhibit 1: BFS revenue has been volatile but bottomed out in 1QFY20



Source: Company, MOFSL

- Global IT spends within the BFSI segment are driven by [1] regulatory changes – 1.2%, [2] sourcing expansion – 0.3% and [3] ITO expansion – 0.8%, taking the overall average growth to 2.8%
- That said, BFSI growth should inch up another 1.3%, led by:
 1. The returning of ERP wave, particularly in small- and mid-size banks.
 2. Modernizing of the payment infrastructure (new payment norms drive investments by every bank).
 3. Product innovations in the insurance sector.
 4. Adaption of a fin-tech structure.
- Onshore engineering talent deficit and cost arbitrage penetration will likely add another 0.25% to sourcing. Cost arbitrage is not being explored as much by large banks but by the tier below. This should have an incremental effect on MHP's revenue.

- There are some risks associated with these growth drivers – [1] cyclicality in the European market driving subdued spending, [2] the risk of increased GICs to retain key IP and [3] protectionist government policy.

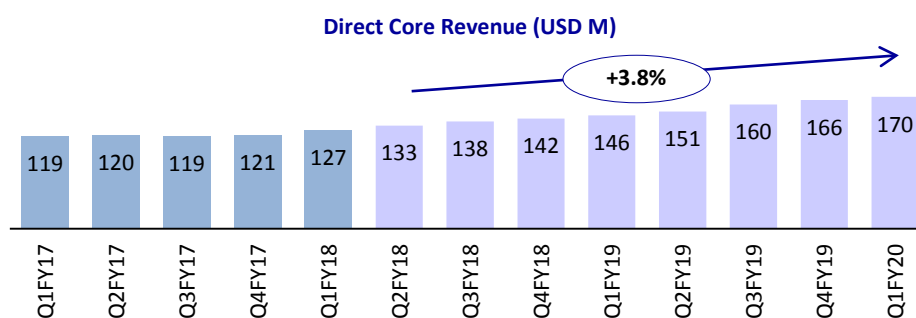
Can Blackstone portfolio make a difference?

- Currently, MPHL garners achieves ~5% of the direct core revenue from 10 of the Blackstone portfolio companies. Revenue almost doubled in FY19 in this segment and continues to grow at a strong double-digit rate.
- Blackstone portfolio comprises mostly of mid-market companies (anywhere between USD1b-3b revenues), which are more likely to be new to outsourcing and have requirements in new areas around Data.
- Further, Blackstone has a very strong presence in the BFS segment. It spends north of USD1.5b every year in the US BFS space.
- This creates a huge opportunity for MHPL to dive into a readily available client segment. **Assuming that FY20 also witnesses the doubling of Blackstone revenue, it will consist of ~9% of FY20 Direct Core revenue (~USD62m).**

New-gen services driving Direct Core growth

- Direct Core business delivered a healthy CQGR of 3.8% over the period 3QFY18 – 1QFY20. It grew at 17.2% YoY CC in 1QFY20, the strongest in the past few years.

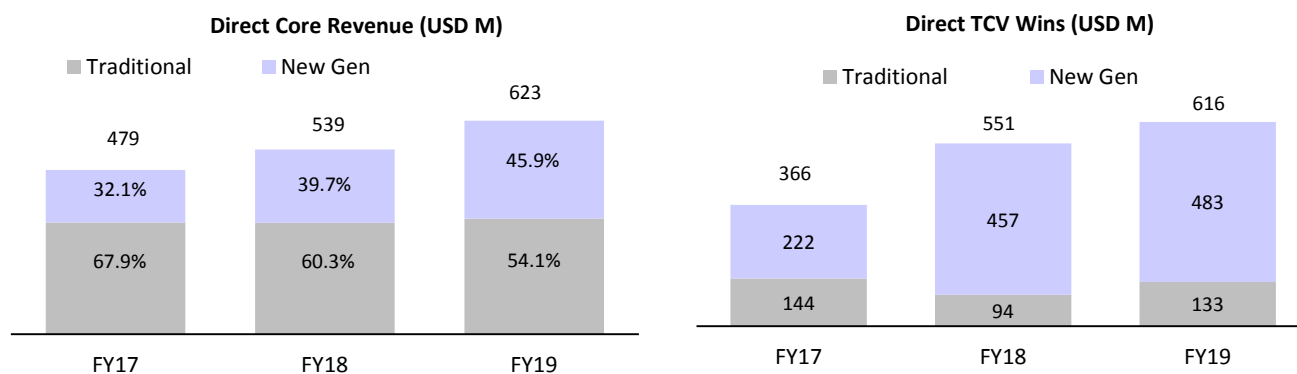
Exhibit 2: Healthy growth rate in Direct Core post Blackstone transaction in 3QFY17



Source: MOFSL, Company

- Direct Core TCV wins grew at a healthy CAGR of 47.6% over FY17-19. In FY19, 80% of new deals won came from new-gen areas.

Exhibit 3: New-gen areas dominate new wins and are growing strongly in Direct Core

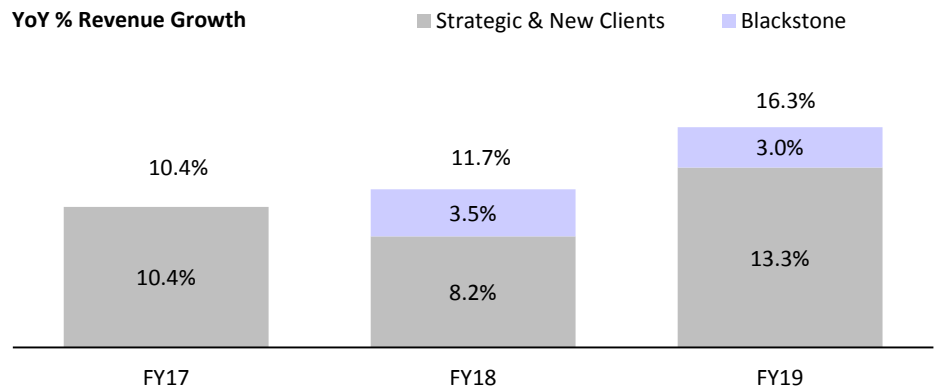


Source: MOFSL, Company

■ **New Gen services growth drivers:**

1. Next-generation partnerships with established cloud players like AWS (jump started with the Stelligent acquisition), Azure, Google Cloud Platform, Pivotal (top partner) and Silicon valley-based start-ups.
2. New client wins have fuelled growth in Direct Core. In FY19, new client acquisition grew ~91% and Blackstone accounts grew ~98%. For 1QFY20, new client acquisition grew ~104% YoY and Blackstone accounts grew ~55% YoY.

Exhibit 4: New client addition and Blackstone portfolio fueling growth

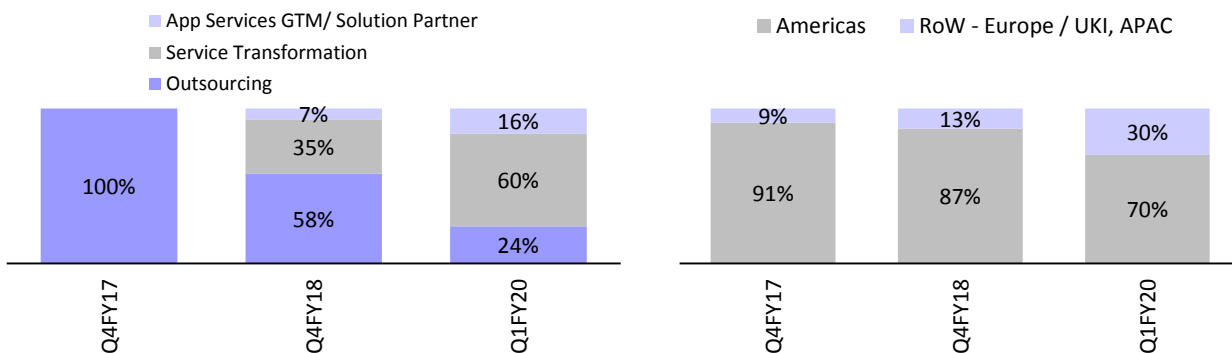


Source: MOFSL, Company

DXC-Mphasis Relationship Transformation

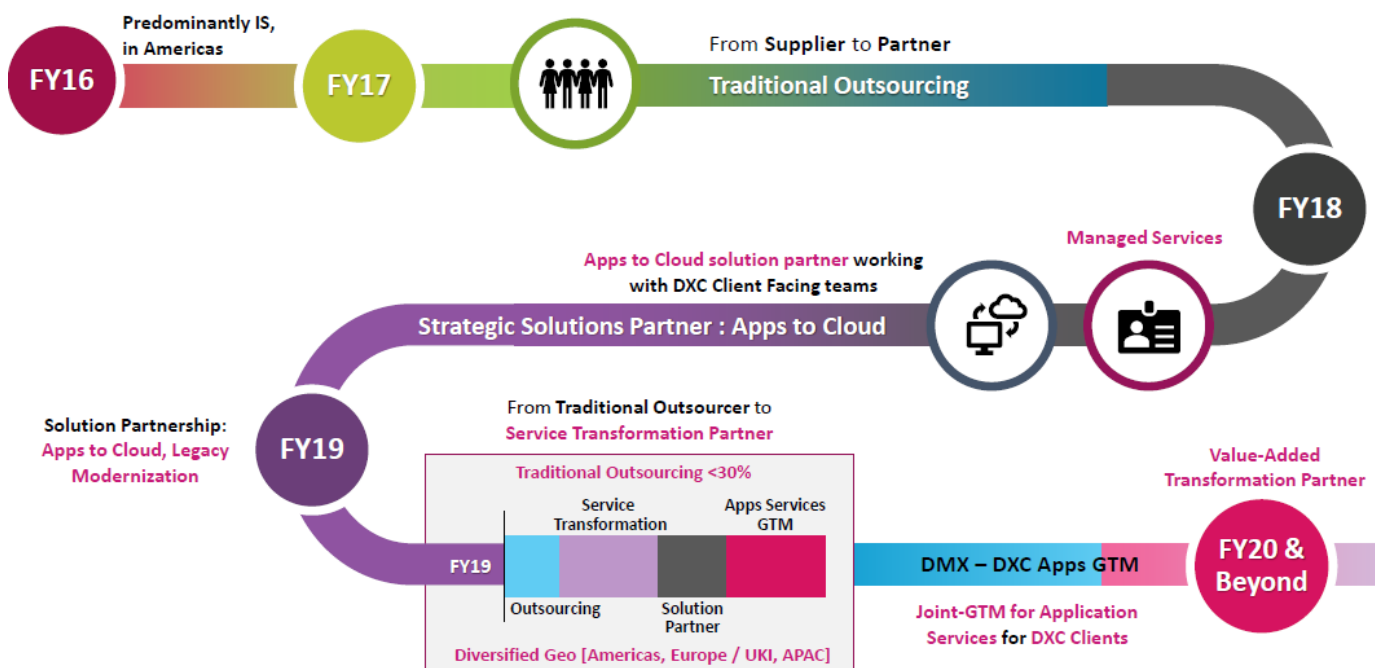
- MHPL’s relationship with DXC/HPE has transformed over the past three years from just being a supplier in FY16 predominantly in the IMS space in the Americas, to becoming a traditional outsourcing partner in FY17 and then a service transformation and solutions partner in FY19, moving up the value chain in terms of high-end engineering.

Exhibit 5: Shift in geographical penetration and types of services being provided



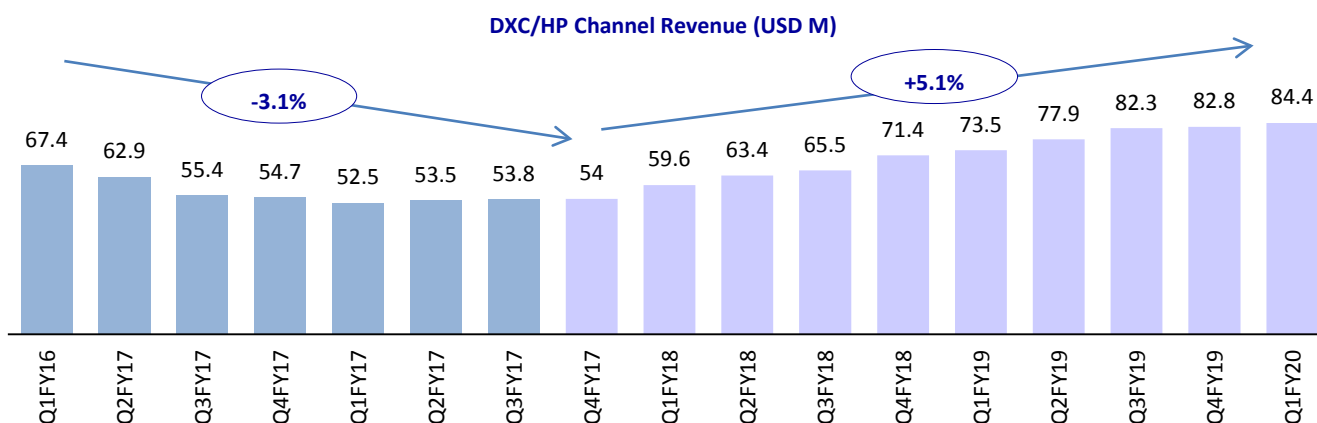
Source: MOFSL, Company

Exhibit 6: MHPL's relationship with DXC has transformed over the years



Source: MOFSL, Company

Exhibit 7: Revenue trend reversal post Blackstone transaction in FY17



Source: MOFSL, Company

Valuation and view

- Revenue from the HP channel inclined for eight straight quarters, increasing in share from 23% to 27% of total revenues. Also, the company has laid its focus on the direct international channel, which it aims to grow above industry average.
- There has been significant addition to visibility post the announcement of Blackstone's acquisition of HPE's stake and a commitment by HP to the tune of USD990m in cumulative revenue over a five-year period. This resulted in the first quarter of growth in the HP channel in five years in 2QFY17. The relationship is seeing further expansion with HPE, HPI, DXC and Micro Focus each, aided by restructuring at the group level.
- With this, revenue growth has been improving and the company should clock 13% in FY19. Deal wins have been going strong for MPHL with a total of USD153m, implying growth of 32% QoQ. This provides significant comfort and

visibility on the trajectory improving sequentially going forward, and industry growth rates next year onward.

- MHPL has been among the few mid-tier IT companies over the last few quarters where: [1] growth visibility has remained intact with continued revenue growth of low-to-mid teens and [2] margin estimates have not been revised downward (in part thanks to the already low base). It has amongst the best cash generation and RoE in excess of 20%. Our FY19-21 CC revenue CAGR is 12.5% and EPS CAGR is 13%. Our price target of INR1,120 discounts forward earnings by 15x, implying an upside of 17%. Maintain **Buy**.

Key triggers

- Momentum gain in Direct International channel.
- Uptick in operating margin.
- Sustained pick up in quarterly deals TCV.

Key risks

- Continued volatility in Direct Channel emerging markets.
- Failure to grow Direct International channel faster than industry growth.
- Volatility in Digital Risk.

Story in charts

Exhibit 8: Situation at HP improving dramatically...

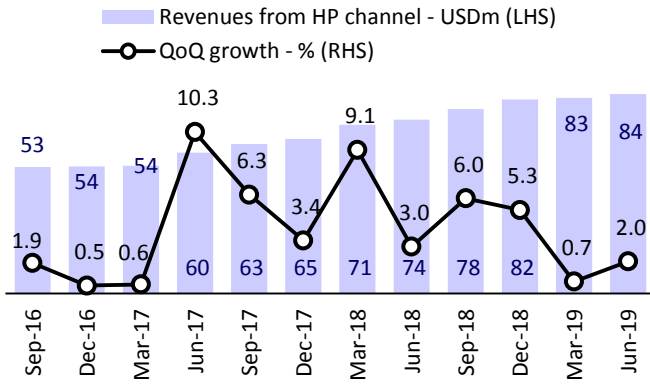


Exhibit 9: Direct business volatile because of Emerging revenue and Digital Risk

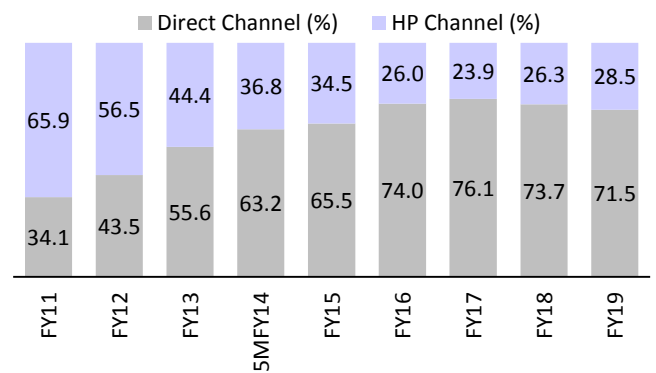


Exhibit 10: Softness in India market...

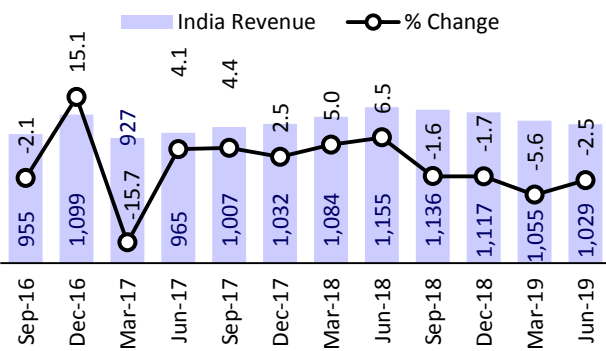
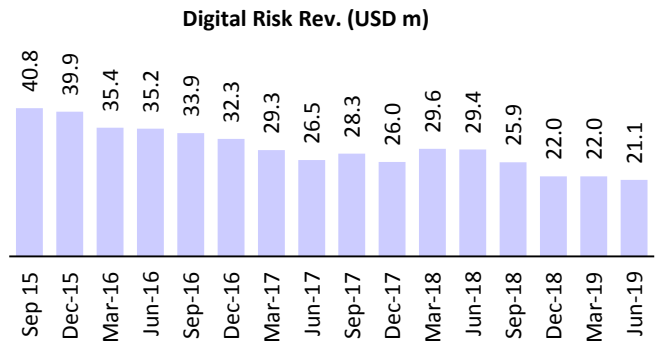


Exhibit 11: ...And in Digital Risk



5MFY14* comparison normalized to be comparable

Exhibit 12: Margins stable; room for upside as growth revival continues

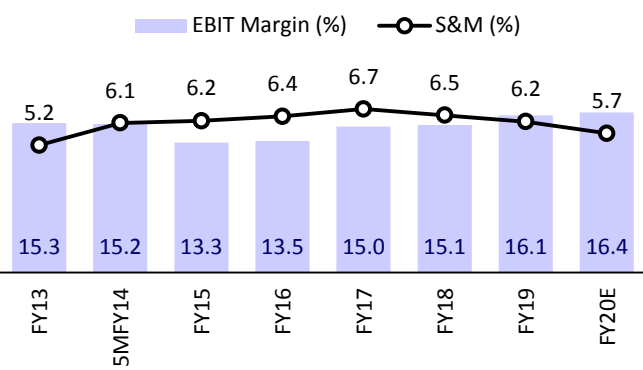
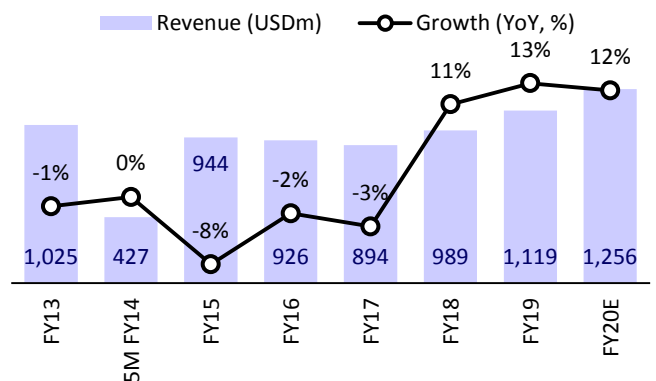


Exhibit 13: Revenue growth after six consecutive years of decline



Source: Company, MOFSL

Operating metrics	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Vertical Contribution (%)												
Banking and Capital Markets	50.3	49.0	48.8	49.1	48.6	47.7	47.3	47.0	46.0	44.1	44.3	44.7
Insurance	14.5	15.0	14.6	13.5	12.9	12.8	11.6	11.3	11.3	11.8	12.0	11.7
IT, Commn & Entmt	9.6	9.7	10.7	12.5	14.1	14.4	16.9	17.2	17.0	16.8	17.3	16.6
Emerging Industries	25.7	26.3	25.9	24.9	24.4	25.1	24.2	24.5	25.7	27.3	26.4	27.1
Total	100	100	100	100	100	100	100	100	100	100	100	100
Revenue by Project Type (%)												
TTM	81	79	81	79	77	75	74	73	75	76	77	76
FPP	19	21	19	21	23	25	26	27	25	24	23	24
Revenue by Delivery Location (%)												
Onsite	52	51	51	54	55	56	56	57	58	57	58	58
Offshore	48	49	49	46	45	44	44	43	42	43	42	42
Secondary Market Segment (%)												
HP Channel	24	24	24	26	26	26	27	27	28	29	28	28
Mature Market - Direct Channel	72	71	72	70	70	70	69	69	68	67	68	68
Emerging Market - Direct Channel	4	5	4	4	4	4	4	3	4	4	3	3
Service Type (%)												
App Maintenance	35	37	37	36	35	33	31	30	34	36	34	32
App Development	24	23	24	25	24	26	26	27	28	30	31	33
Customer Service	2	2	2	1	2	1	1	1	1	1	1	1
Service/Technical Help Desk	2	2	2	5	7	8	7	8	6	7	7	7
Transaction Processing Service	7	6	7	7	7	7	7	7	6	6	6	6
Infra Management Services	14	14	14	14	13	13	15	15	14	13	13	12
Knowledge Processes	16	15	14	12	12	11	12	11	10	7	8	7
CLIENT METRICS												
Client wins												
BCM	3	1	1	4	0	2	1	4	3	11	12	7
Insurance	1	2	1	2	0	1	2	0	0	1	2	1
ITCE	1	1	1	2	1	0	0	1	0	3	5	5
Emerging industries	1	2	2	4	4	3	2	7	9	5	4	6
Total	6	6	5	12	5	6	5	12	12	20	23	19
Client wins Channels												
Direct Channel	4	4	4	7	3	4	4	7	5	18	19	12
HP Channel	2	2	1	5	2	2	1	5	7	2	4	7
Total Client additions	6	6	5	12	5	6	5	12	12	20	23	23
Clients Contributing More than												
USD1m	98	92	90	90	90	89	90	93	95	96	94	96
USD5m	27	30	36	39	37	39	37	37	36	33	33	33
USD10m	14	14	14	15	15	17	17	18	19	19	17	17
USD20m	9	8	7	7	7	8	8	8	8	8	8	8
Clients - Direct Channel												
USD1m	64	59	57	58	59	57	58	61	63	63	62	67
USD5m	21	24	26	26	24	25	24	24	24	23	25	25
USD10m	12	12	12	13	12	13	14	15	15	15	13	13
USD20m	7	7	6	6	6	6	6	6	6	6	6	6
Clients - HP Channel												
USD1m	34	33	33	32	31	32	32	32	32	33	32	29
USD5m	6	6	10	13	13	14	13	13	12	10	8	8
USD10m	2	2	2	2	3	4	3	3	4	4	4	4
USD20m	2	1	1	1	1	2	2	2	2	2	2	2

Financial Valuations

Key Assumptions

Y/E	SME Mar 14	Mar 15	Mar 16	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
INR/USD Rate	58.7	61.3	65.7	67.1	64.5	69.9	69.9	71.0
Revenues (USD m)	427	944	926	894	989	1,119	1,256	1,412
Total Delivery Headcount	35,663	34,059	22,324	21,979	22,264	24,465	27,333	29,428
Net Addition	-1,389	-1,604	-11,735	-345	285	2,201	2,868	2,095
Per Capita Productivity (USD)	28,717	27,716	41,465	40,658	44,421	45,727	45,960	47,965
HP Channel Revenue (%)	36.8	34.5	26.0	23.9	26.3	28.3	28.5	
Direct Channel Revenue (%)	63.2	65.5	74.0	76.1	73.7	71.7	71.5	

Income Statement

(INR M)

Y/E	SME Mar 14	Mar 15	Mar 16	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Revenues	25,939	57,949	60,879	60,763	65,459	77,310	87,573	1,00,095
Change (%)	7.4	-6.9	5.1	-0.2	8	18.1	13.3	14.3
Cost Of Goods Sold	18,600	42,540	44,708	43,649	47,309.0	55,734	61,583	69,268
SG&A Expenses	2,942	6,708	7,201	7,426	7,525	8,337	9,298	11,625
EBITDA	4,397	8,701	8,970	9,688	10,625	13,239	16,692	19,201
% of Net Sales	17.0	15.0	14.7	15.9	16	17.1	19.1	19.2
Depreciation	504	980	744	592	709	759	2,315	2,564
Interest	0	0	0	0	0.0	0	0	0
Other Income	389	1,687	1,712	2,246	1,490	1,592	2,042	2,138
PBT	4,282	9,408	9,938	11,342	11,406	14,072	16,419	18,775
Tax	1,191	2,630	2,696	3,155	2,900	3,339	4,039	4,881
Rate (%)	27.8	28.0	27.1	27.8	25	23.7	24.6	26.0
PAT	3,091	6,778	7,242	8,187	8,506	10,733	12,380	13,893
Net Income	3,091	6,778	7,242	8,187	8,506	10,733	12,380	13,893
Change (%)	-0.3	-8.6	6.9	13.0	3.9	26.2	15.3	12.2

Balance Sheet

(INR M)

Y/E	SME Mar 14	Mar 15	Mar 16	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Share Capital	2,101	2,101	2,102	2,104	1,933	1,862	1,863	1,790
Reserves	49,049	52,697	60,828	59,420	52,885	50,636	55,897	63,527
Net Worth	51,150	54,798	62,930	61,524	54,818	52,498	57,760	65,317
Loans	5,555	6,253	5,338	2,760	3,949	5,456	8,985	8,585
Capital Employed	56,705	61,051	68,268	64,284	58,767	57,954	66,745	73,902
Gross Block	10,912	10,055	9,300	3,400	4,304	5,357	12,646	14,446
Less : Depreciation	8,734	8,499	8,128	1,167	2,478	3,244	5,196	7,760
Net Block	2,178	1,556	1,172	2,233	1,826	2,113	7,450	6,686
CWIP	62	318	953	387	399	406	452	445
Goodwill	21,865	21,781	22,942	14,069	17,015	19,585	19,533	19,533
Investments	18,154	14,431	21,118	23,956	17,821	13,292	15,864	15,864
Deferred tax assets	968	826	941	3,527	1,057	814	969	969
Curr. Assets	26,522	35,014	31,968	28,998	31,742	36,531	38,597	47,981
Debtors	12,967	11,371	12,333	10,871	13,560	17,687	19,933	22,249
Cash	4,700	13,311	8,783	6,315	7,148	6,618	6,421	13,489
Loans & Advances	8,855	10,332	10,852	11,812	11,034	12,226	12,243	12,243
Current Liab. & Prov	13,044	12,875	10,826	8,888	11,093	14,787	16,120	17,575
Net Current Assets	13,478	22,139	21,142	20,110	20,649	21,744	22,477	30,405
Application of Funds	56,705	61,051	68,268	64,282	58,767	57,954	66,745	73,902

Financial Valuations

Ratios

Y/E	5ME Mar 14	Mar 15	Mar 16	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Basic (INR)								
EPS	14.7	32.3	34.5	38.9	44.0	56.1	64.2	72.1
Cash EPS	17.1	36.9	38.0	41.7	47.7	61.7	78.9	91.9
Book Value	243.5	260.8	299.4	292.4	283.6	281.9	310.0	364.9
DPS	7.0	16.0	20.0	17.0	20.0	78.3	28.0	28.0
Payout %	47.6	49.6	58.0	43.7	45.4	140.6	43.6	38.9
Valuation (x)								
P/E*	26.5	28.9	27.1	24.0	21.2	16.6	14.5	13.0
Cash P/E*	22.7	25.3	24.6	22.4	19.6	15.1	11.8	10.2
EV/EBITDA*	17.0	20.1	19.1	17.4	15.0	12.0	9.6	7.6
EV/Sales*	2.9	3.0	2.8	2.8	2.4	2.1	1.8	1.5
Price/Book Value	3.8	3.6	3.1	3.2	3.3	3.3	3.0	2.6
Dividend Yield (%)*	1.8	1.7	2.1	1.8	2.1	8.4	3.0	3.0
Profitability Ratios (%)								
RoE*	14.8	12.8	12.3	13.2	14.6	20.0	22.5	22.6
RoCE*	5.5	11.5	11.2	12.4	13.8	18.4	19.9	19.8
RoIC	8.8	16.7	17.0	18.5	22.1	26.8	26.6	27.9
Turnover Ratios								
Debtors (Days)	74	77	71	70	68	74	78	77
Fixed Asset Turnover (x)	29.0	31.0	44.6	35.7	32.3	39.3	18.3	14.2
Leverage Ratio								
Debt/Equity Ratio(x)	0.1	0.1	0.1	0.0	0.1	0.1	0.2	0.1

Cash Flow Statement

(INR M)

Y/E	5ME Mar 14	Mar 15	Mar 16	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
CF from Operations	3,642	7,900	7,871	6,193	11,685	11,735	14,541	16,457
Chg. in Wkg. Capital	-4,674	-50	-3,531	-1,436	294	-1,625	-930	-860
Net Operating CF	-1,032	7,850	4,340	4,757	11,979	10,110	13,610	15,597
Net Purchase of FA	-356	-614	-995	-1,087	-314	-1,053	-7,698	-1,793
Free Cash Flow	-1,388	7,236	3,345	3,670	11,665	9,057	5,912	13,804
Net Purchase of Invest.	1,475	3,807	-7,848	6,035	3,189	1,959	-2,520	0
Net Cash from Invest.	1,119	3,193	-8,843	4,948	2,875	906	-10,218	-1,793
Proceeds from equity	436	0	5,933	-5,305	-10,577	4,427	-855	-73
Proceeds from LTB/STB	-45	1,601	-915	-2,578	1,189	1,507	3,529	-400
Dividend Payments	-1,721	-4,033	-5,045	-4,290	-4,637	-17,482	-6,264	-6,264
Net CF from Financing	-1,330	-2,432	-26	-12,172	-14,024	-11,547	-3,590	-6,737
Free Cash Flow	-1,388	7,236	3,345	3,670	11,665	9,057	5,912	13,804
Net Cash Flow	-1,243	8,610	-4,529	-2,467	830	-531	-198	7,067
Opening Cash Balance	5,941	4,697	13,307	8,778	6,311	7,140	6,609	6,411
Add: Net Cash	-1,243	8,610	-4,529	-2,467	830	-531	-198	7,067
Closing Cash Balance	4,697	13,307	8,778	6,311	7,140	6,609	6,411	13,478

E: MOFSL Estimates; *Annualized values for 5m FY14E

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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