

Mortgage pain, client issues continue; strong TCV only solace

About the stock: Mphasis Ltd (Mphasis) offers application services, BPO and infrastructure services, BFSI, technology, communication & logistic services.

- The company's direct revenue increased 35.7% YoY on a reported basis and 34.4% in CC terms in FY22
- OCF, EBITDA of 75% and double digit return ratio (with RoCE of 20%)

Q3FY23 Results: Mphasis reported weak Q3FY23 results.

- In CC terms, direct revenue declined 2.8% QoQ while the company's revenue declined 2.5% QoQ
- EBIT margins were flat at 15.3%
- TCV remained healthy at US\$401 mn in Q3

What should investors do? Mphasis' share price has grown by ~2.9x over the past five years (from ~₹ 710 in January 2018 to ~₹ 2025 levels in January 2023).

- We maintain our **HOLD** rating on the stock

Target Price & Valuation: We value Mphasis at ₹ 2070 i.e. 20x P/E on FY25E EPS.

Key triggers for future price performance:

- Strategy to mine top 10, 20 clients, adding high potential new logos, rise in deal sizes & expansion in Europe bodes well for long term growth
- Further, the management stability, improving deal size, market share gains via vendor consolidation, low legacy exposure to drive 8.5% CAGR in revenues over FY22-25E
- Improving revenue trajectory, higher offshoring, pricing and automation to boost EBIT margins (+100 bps to 16.3% in FY22-25E)

Alternate Stock Idea: Apart from Mphasis, in our IT coverage we like Cyient.

- The company offers engineering & development services to aerospace, transportation, energy & utilities segments
- BUY with a target price of ₹ 1,020

Key Financial Summary

(₹ Crore)	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	9,722	11,961	14.5	13,855	14,297	15,285	8.5
EBITDA	1,803	2,118	16.9	2,397	2,616	2,843	10.3
EBITDA Margins (%)	18.5	17.7		17.3	18.3	18.6	
Net Profit	1,217	1,431	12.6	1,638	1,805	1,957	11.0
Diluted EPS (₹)	64.4	75.6		86.6	95.4	103.4	
P/E (x)	31.1	26.5		23.2	21.0	19.4	
RoE (%)	18.6	20.6		21.8	22.1	22.2	
RoCE (%)	21.8	23.7		24.3	25.0	25.1	



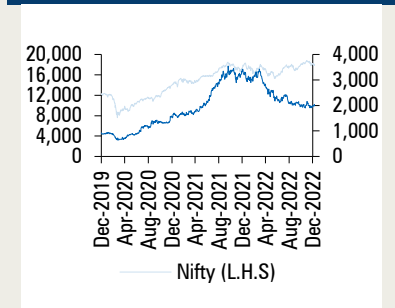
Particulars

Particular	Amount
Market Cap (₹ crore)	38,644.6
Total Debt (₹ crore)	527.2
Cash and Invests (₹ crore)	2,384.6
EV (₹ crore)	36,787.2
52 week H/L	3465/ 1896
Equity Capital (₹ crore)	187.8
Face Value (₹)	₹ 10

Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoters	55.8	55.8	55.7	55.6
FII	21.1	21.1	20.3	18.9
DII	18.0	18.0	17.8	19.5
Public	5.1	5.1	6.2	5.9

Price Chart



Recent event & key risks

- Won TCV of US\$401 mn
- Key Risk:** (i) Higher than expected revenue (ii) Lower than expected margins

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Key takeaways of recent quarter & conference call highlights

- The company reported weak Q3 results with consolidated revenue declining by 2.5% QoQ to US\$429.4 mn. In rupee terms, Mphasis reported a revenue of ₹ 3,506 crore, down 0.4% QoQ. Direct revenue (93.6% of mix) was flat sequentially while in CC terms it declined 2.8% QoQ. DXC revenue (4.8% of mix) grew 3.1% QoQ
- The company indicated that the macro environment over the last few months has deteriorated further. However, it sees continued investments in strategic areas of cloud transformation, data engineering, cyber security and customer experience. Mphasis is increasingly seeing lot of opportunities in the cost take out deals. Banking and insurance vertical has started witnessing accelerated spending on digital transformation. Ease of supply chain has been visible over the last few months. There is still scarcity of talent in niche areas
- The company indicated that budget in some areas such as BPO business is likely to be squeezed further in CY23. Mphasis indicated that the BFSI sector was impacted by furlough in Q3 and is likely to recover, going ahead. The company indicated that mortgage LoB has seen a significant ramp down during the quarter, which has resulted in direct revenue decline for the quarter, magnitude of the which was unprecedented and unanticipated. It was impacted by high interest rate and consumer inflation in the US market. The contribution of its digital risk (DR) subsidiary representing mortgage BPS business is now at 8.8% in Q3 vs. 15% in Q1. The company has indicated that it has witnessed 20% volume decline in the business for the quarter while volume decline was 80% in the last four quarters. Ex-DR BFS vertical grew 17% YoY in CC and 2% sequentially
- Geography wise US region (81.8% of mix) declined 0.2% QoQ while EMEA & India reported growth of 2.9% & 4.1% QoQ, respectively
- Vertical wise, BFS (53.6% of the mix) & insurance (8.3% of mix) declined 0.8% & 0.5% QoQ, respectively, while TMT, Logistics & Others grew 0.3%, 2.3% & 3.4%, respectively. The company indicated that in the others vertical the smaller segment like healthcare is growing strongly at 30% YoY CC
- Mphasis reported flat EBIT margins for the quarter at 15.3%. The company indicated that despite the steep decline in DR LOB and seasonally weak quarter it was able to maintain margins in the guided range due to easing of supply side challenges and continued deployment of freshers in the system
- Mphasis, during the quarter, won its second highest TCV of US\$401 mn, up 19.7% QoQ. The company in 9MFY23 has won TCV over US\$1 billion (bn) indicating that demand remains strong despite the challenging macros. Mphasis indicated that ~60% of TCV wins in Q3 were in the BFS vertical indicating that the outlook for this vertical remains strong and it provides medium term visibility of revenue conversion. The company, during the quarter, won five large deals while one deal is US\$100+ mn. Mphasis also indicated that the demand pipeline remains strong and the pipeline has grown over 6% QoQ
- Deals:** Mphasis mentioned that it is unusual that large customers are doing large tenure. There are deals, which are stretched out to multiyear opportunity. The company signed a deal early last year, which has stretched over 10 years. Mphasis mentioned that current TCV has healthy balance of long term and short-term deals. The company indicated that there has been caution from the clients in the last couple of quarters. It has seen a steady conversion of strategy deals and correlation is still strong there, which will provide good revenue visibility
- Mortgage business:** i) Origination: The company mentioned this was the only business it had till some time ago, where it had seen volumes drop. Mphasis mentioned that mortgage for new purchases in the US has been under pressure as home prices are still at elevated levels and increasing

Mphasis - ESG Disclosure Score*

Score	FY20	FY21	FY22
Environmental	0.0	0.0	16.8
Social	0.0	0.0	10.1
Governance	0.0	0.0	66.1
Overall ESG Score	0.0	0.0	31.0

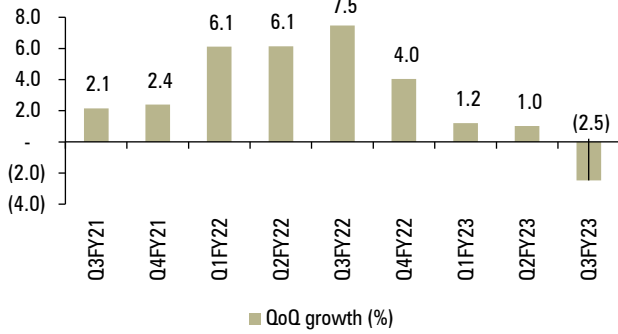
Source: Bloomberg, ICICI Direct Research, *Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures

interest rates are making them highly unaffordable. ii) It added home equity line of business some time ago, which has a negative correlation with home prices since home prices were down. There are a lot of owners who are likely to cash on home equity but since now home prices are higher, there is a decline in volume in the home equity market as well and equity value is coming down here iii) Third business is services business, which is more project based business where delinquency loans are bought and sold either between government institutions or between secondary buyers between one bank to other etc. Volumes are very low in this business currently and activities are largely frozen. The company indicated that this cannot operate for longer in a frozen state and bank delinquencies may go up, which is where the banks are expected to trade them and trading may pick up

- Some of the other pockets where the company is witnessing caution are i) some pockets of Hi-Tech where it had an unexpected furlough in Q2 which continued in Q3 as well ii) The company also mentioned that clients in two of their larger engagements are going through turbulences in their businesses, which are expected to recover, going forward
- **Margins:** The company mentioned that it is investing for opportunity and not leaving anything on the table. It mentioned that there is scope of further improvement in the utilisation which along with offshore mix improvement along with continued deployment of freshers are margin leavers ahead. The company also mentioned that headwinds in the revenue are also restricting operating leverage and growth coming back in the next couple of quarters will aid in steady margin expansion
- **Hiring:** The company's net employees during the quarter declined by 1,426 to 35,450. The company further indicated that its net billable employees declined by 1,227. The company mentioned that headcount reduction is in line with their optimisation strategy which they have been taking about. The company said it continues to add freshers in the system and they are at record high since they have been tracking it. The company also mentioned that fresher hiring provides them an opportunity to optimise lateral hiring on as required basis
- **M&A:** The company mentioned that they have hired new M&A leader some time ago and is reporting to CEO. Mphasis added that it is now looking, not only to tuck in deals but also strategic investments, going forward. It also mentioned that it is looking for vertical led capabilities as well as geography led capabilities. The company also indicated that 2023 would be a year in which it is looking for inorganic opportunity on account of correction of valuations of the companies in this space. As a result of the same, valuations are likely to be in their desired range

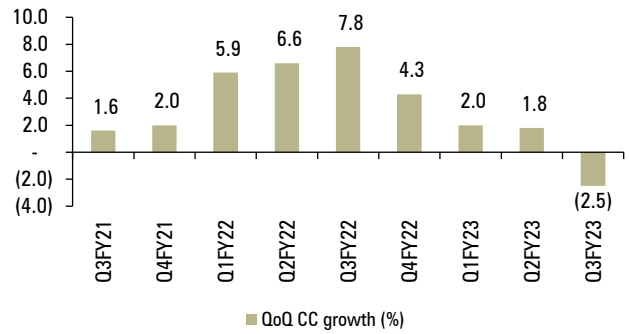
Key Metrics

Exhibit 1: Revenue impacted by decline in mortgage LOB



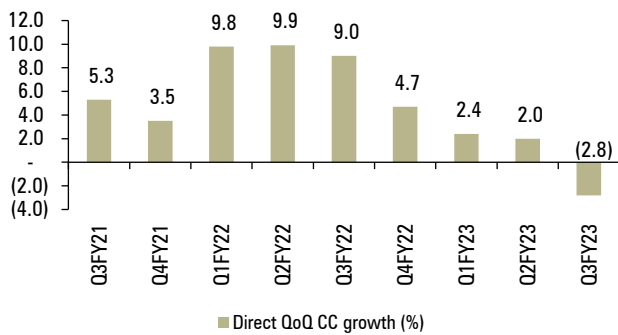
Source: Company, ICICI Direct Research

Exhibit 2: QoQ CC growth



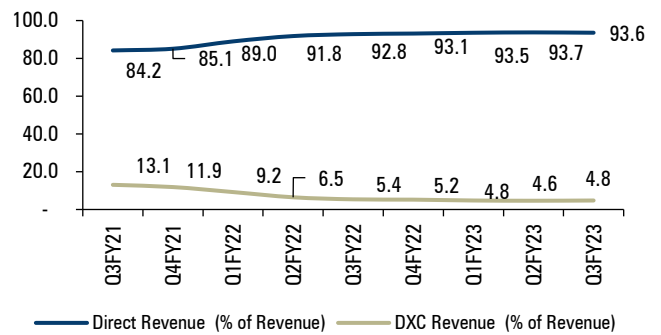
Source: Company, ICICI Direct Research

Exhibit 3: Direct QoQ CC growth



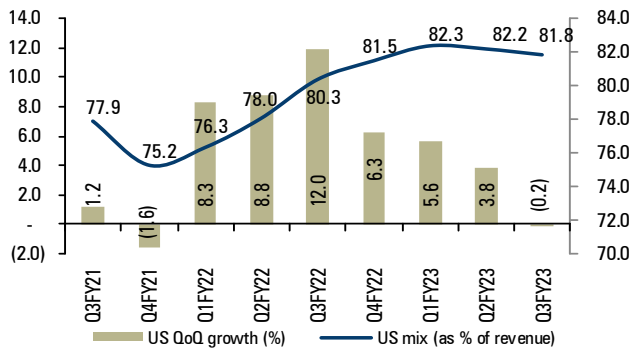
Source: Company, ICICI Direct Research

Exhibit 4: Direct & DXC revenue mix trend



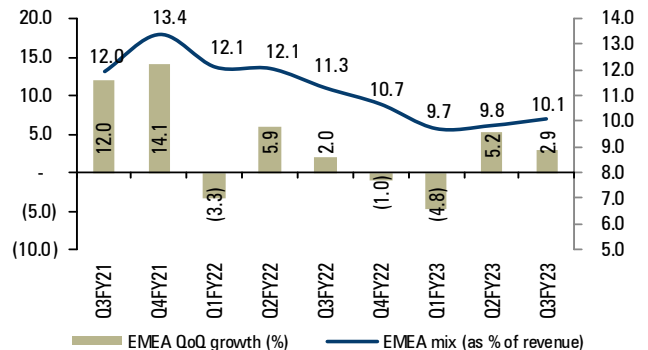
Source: Company, ICICI Direct Research

Exhibit 5: US growth impacted by furlough & core business



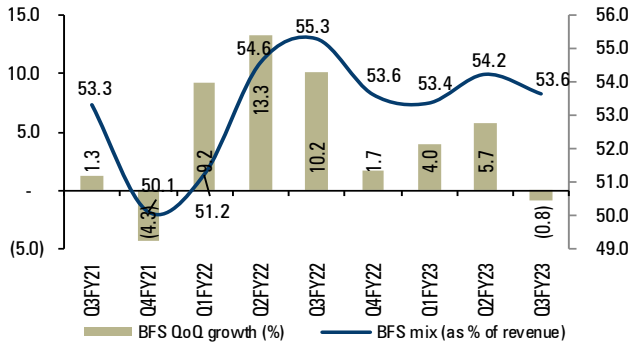
Source: Company, ICICI Direct Research

Exhibit 6: EMEA growth remains steady in Q3



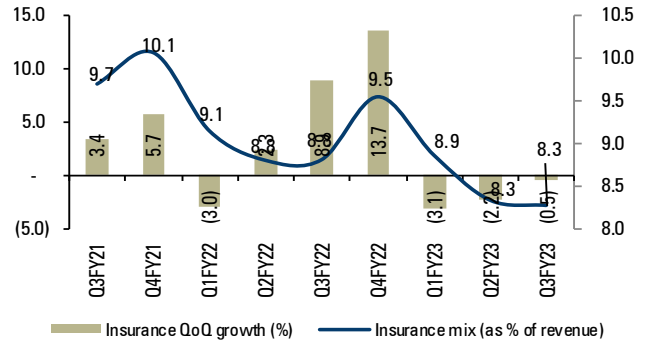
Source: Company, ICICI Direct Research

Exhibit 7: BFS excluding DR grew by 2% QoQ in Q3



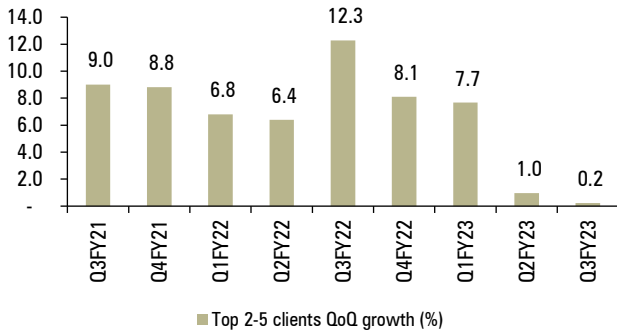
Source: Company, ICICI Direct Research

Exhibit 8: Insurance QoQ growth



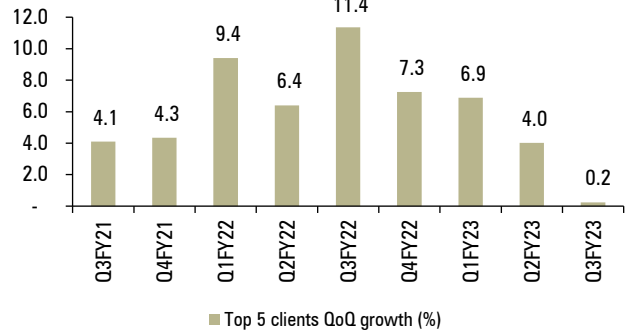
Source: Company, ICICI Direct Research

Exhibit 9: Top 2-5 client's growth trend



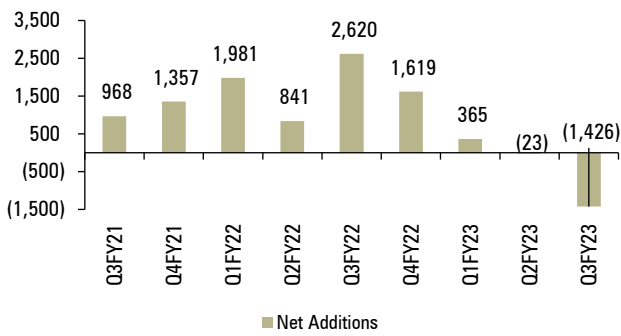
Source: Company, ICICI Direct Research

Exhibit 10: Top 5 clients growth trend



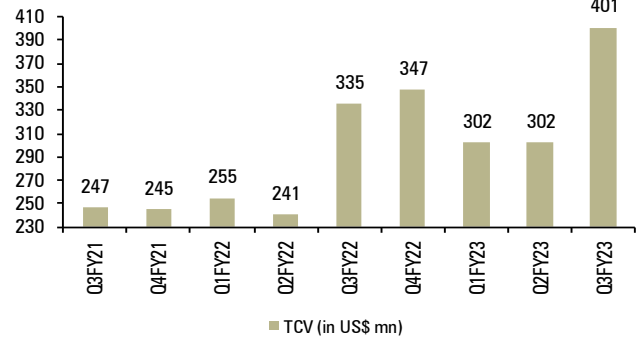
Source: Company, ICICI Direct Research

Exhibit 11: Net employee decline as per optimisation plan



Source: Company, ICICI Direct Research

Exhibit 12: TCV wins remains robust



Source: Company, ICICI Direct Research

Exhibit 13: P&L

	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
Revenue	3,506	3,124	12.2	3,520	-0.4	Mortgage LOB & higher than expected furloughs impacted revenues in Q3
Employee expense	2,509	2,196	14.2	2,532	-0.9	
Gross Margin	998	928	7.5	988	0.9	
Gross margin (%)	28.5	29.7	-124 bps	28.1	37 bps	
Other expense	380	374	1.5	371	2.6	
EBITDA	618	553	11.6	618	0.0	
EBITDA Margin (%)	17.6	17.7	-10 bps	17.5	6 bps	
Depreciation & amortisation	82	83	-0.6	80	2.5	
EBIT	535	471	13.8	538	-0.4	
EBIT Margin (%)	15.3	15.1	20 bps	15.3	0 bps	Margins were flat as gains from increased utilization & pyramid optimization wiped off due to decline in mortgage LOB
Other income (less interest)	16	9	73.3	17	-10.3	
PBT	551	480	14.9	555	-0.7	
Tax paid	139	122	13.8	137	1.5	
PAT	412	358	15.3	418	-1.5	

Source: Company, ICICI Direct Research

Exhibit 14: Change in estimates

₹ Crore)	FY23E			FY24E			FY25E			Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	13,994	13,855	-1.0	15,208	14,297	-6.0	16,377	15,285	-6.7	Numbers re-aligned on weak H1 performance and client specific concerns
EBIT	2,099	2,078	-1.0	2,433	2,288	-6.0	2,669	2,491	-6.7	
EBIT Margin (%)	15.0	15.0	0 bps	16.0	16.0	0 bps	16.3	16.3	0 bps	
PAT	1,654	1,638	-1.0	1,914	1,805	-5.7	2,091	1,957	-6.4	
EPS (₹)	87.4	86.6	-1.0	101.1	95.4	-5.7	110.5	103.4	-6.4	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 15: Profit and loss statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Total Revenues	11,961	13,855	14,297	15,285
Growth (%)	23	16	3	7
Employee Benefit Expense	7,035	8,036	8,149	8,667
Other Expenses	2,809	3,422	3,531	3,775
EBITDA	2,118	2,397	2,616	2,843
Growth (%)	17	13	9	9
Depreciation	291	319	329	352
Other Income	160	168	180	180
Interest	74	62	62	62
PBT before Excep Items	1,913	2,184	2,406	2,610
Growth (%)	17	14	10	8
Tax	482	546	602	652
PAT before Excep Items	1,431	1,638	1,805	1,957
Exceptional items	-	-	-	-
PAT	1,431	1,638	1,805	1,957
Growth (%)	18	14	10	8
Diluted EPS	76	87	95	103
EPS (Growth %)	17	14	10	8

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Profit before Tax	1,913	2,184	2,406	2,610
Depreciation	291	319	329	352
(inc)/dec in Current Assets	(660)	(901)	(163)	(364)
(inc)/dec in current Liabilities	510	273	111	249
Income Taxes Paid	(369)	(546)	(602)	(652)
Others	31	(55)	(68)	(68)
CF from operations	1,716	1,274	2,014	2,126
Other Investments	(163)	117	130	130
(Purchase)/Sale of Fixed Assets	(119)	(152)	(157)	(168)
CF from investing Activities	(282)	(35)	(28)	(39)
Inc / (Dec) in Equity Capital	44	-	-	-
Inc / (Dec) in sec.loan Funds	3	(30)	(30)	(30)
Dividend & Dividend tax	(1,218)	(1,065)	(1,173)	(1,272)
Interest Paid on Loans	(74)	(62)	(62)	(62)
CF from Financial Activities	(1,244)	(1,157)	(1,265)	(1,364)
Net change in cash	189	82	721	723
Opening cash	771	827	765	1,342
Closing cash	827	765	1,342	1,920

Source: Company, ICICI Direct Research

Exhibit 17: Balance sheet				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Equity	188	188	188	188
Reserves & Surplus	6,755	7,329	7,960	8,645
Networth	6,943	7,517	8,148	8,833
Total debt	527	497	467	437
Other liabilities	903	1,236	1,273	1,356
Source of funds	8,373	9,250	9,888	10,626
Net Block	869	918	963	1,001
CWIP	11	11	11	11
Intangible assets under developme	170	99	27	(51)
Long term Loans and advances	-	78	80	86
Other non current assets	1,255	1,785	1,830	1,930
Current Investments	1,435	1,435	1,435	1,435
Goodwill	2,735	2,735	2,735	2,735
Inventories	-	-	-	-
Debtors	2,227	2,637	2,721	2,909
Cash Balance	827	765	1,342	1,920
Bank Balance	123	123	123	123
Short term Loans and advances	32	209	216	231
Other current assets	1,073	778	803	858
Trade payables	850	850	877	938
Other Current liabilities	1,425	1,402	1,447	1,547
Provisions	108	71	73	78
Application of funds	8,373	9,250	9,888	10,626

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
Diluted EPS	75.6	86.6	95.4	103.4
BV	370.6	401.2	434.9	471.5
DPS	46.0	56.3	62.0	67.2
Cash Per Share	50.7	47.4	78.2	109.0
Operating Ratios (%)				
EBITDA Margin	17.7	17.3	18.3	18.6
PAT Margin	12.0	11.8	12.6	12.8
Debtor days	68	69	69	69
Creditor days	26	22	22	22
Return Ratios (%)				
RoE	20.6	21.8	22.1	22.2
RoCE	23.7	24.3	25.0	25.1
RoIC	30.6	30.0	32.8	34.9
Valuation Ratios (x)				
P/E	26.5	23.2	21.0	19.4
EV / EBITDA	17.2	15.2	13.7	12.4
Market Cap / Sales	3.2	2.8	2.7	2.5
Price to Book Value	5.5	5.0	4.7	4.3
Solvency Ratios				
Debt / Equity	0.08	0.07	0.06	0.05
Debt / EBITDA	0.2	0.2	0.2	0.2
Quick Ratio	1.4	1.6	1.6	1.6

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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