

CMP: ₹ 1860

Target: ₹ 1950 (5%)

Target Period: 12 months

HOLD

May 2, 2023

## Growth likely to be back ended with sequential growth from Q2FY24 onwards...

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

- The company's direct revenue increased 19.3% YoY on a reported basis and 12% in CC terms in FY23
- OCF, EBITDA of 75% and double digit return ratio (with RoCE of 20%)

**Q4FY23 Results:** Mphasis reported weak Q4FY23 results.

- In CC terms, direct revenue fell 3.4% QoQ and revenue declined 4.5% QoQ
- EBIT margins were flat at 15.3%
- Won TCV of US\$309 mn with two large deals in Q4

**What should investors do?** Mphasis' share price has grown by ~1.8x over the past five years (from ~₹ 1009 in May 2018 to ~₹ 1860 levels in May 2023).

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

**Target Price & Valuation:** We value Mphasis at ₹ 1950 i.e. 18x 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 and expansion in Europe bode well for long term growth
- Further, the management stability, improving deal size, market share gains via vendor consolidation, low legacy exposure to drive 9.7% CAGR in revenues over FY23-25E
- Improving revenue trajectory, higher offshoring, utilisation & fresher deployment to boost EBIT margins (+80 bps to 16.1% in FY23-25E)

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

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 1,600

### Key Financial Summary

| (₹ Crore)          | FY21  | FY22   | 5 Year |                |        | 2 Year |                 |
|--------------------|-------|--------|--------|----------------|--------|--------|-----------------|
|                    |       |        | FY23   | CAGR (FY18-23) | FY24E  | FY25E  | CAGR (FY23-25E) |
| Net Sales          | 9,722 | 11,961 | 13,798 | 16.1           | 14,707 | 16,606 | 9.7             |
| EBITDA             | 1,803 | 2,118  | 2,434  | 18.0           | 2,662  | 3,072  | 12.3            |
| EBITDA Margins (%) | 18.5  | 17.7   | 17.6   |                | 18.1   | 18.5   |                 |
| Net Profit         | 1,217 | 1,431  | 1,638  | 14.4           | 1,821  | 2,062  | 12.2            |
| Diluted EPS (₹)    | 64.4  | 75.6   | 86.4   |                | 96.0   | 108.7  |                 |
| P/E (x)            | 28.5  | 24.4   | 21.4   |                | 19.2   | 17.0   |                 |
| RoE (%)            | 18.6  | 20.6   | 20.6   |                | 21.0   | 21.7   |                 |
| RoCE (%)           | 21.8  | 25.3   | 25.8   |                | 26.6   | 27.8   |                 |

Source: Company, ICICI Direct Research



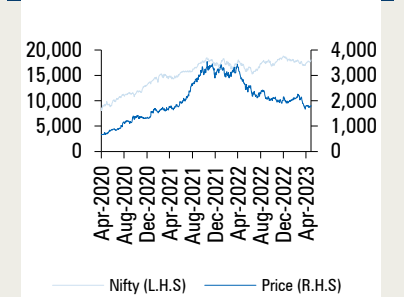
### Particulars

| Particular                 | Amount     |
|----------------------------|------------|
| Market Cap (₹ crore)       | 35,271.0   |
| Total Debt (₹ crore)       | 681.6      |
| Cash and Invests (₹ crore) | 2,421.3    |
| EV (₹ crore)               | 33,531.2   |
| 52 week H/L                | 2873/ 1660 |
| Equity Capital (₹ crore)   | 188.4      |
| Face Value (₹)             | ₹ 10       |

### Shareholding pattern

|           | Jun-22 | Sep-22 | Dec-22 | Mar-23 |
|-----------|--------|--------|--------|--------|
| Promoters | 55.8   | 55.7   | 55.6   | 55.6   |
| FII       | 21.1   | 20.3   | 18.9   | 17.7   |
| DII       | 18.0   | 17.8   | 19.5   | 21.0   |
| Public    | 5.1    | 6.2    | 5.9    | 5.6    |

### Price Chart



### Recent event & key risks

- EBIT margin guidance of 15.25-16.25% in FY24
- 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 Q4 results with consolidated revenue declining 4.1% QoQ to US\$412 mn while in CC terms revenue declined 4.5% QoQ. In rupee terms, Mphasis reported a revenue of ₹ 3,361 crore, down 4.1% QoQ. Direct revenue (94.6% of mix) declined 3.1% QoQ while in CC terms it declined 3.4% QoQ. DXC revenue (3.8% of mix) declined 24.5% QoQ while in CC terms it declined 24.8% QoQ. The company mentioned that digital risk contributed 6.8% to revenue in Q4 compared to 8.8% in Q3, 15% in Q1
- Geography wise, US region revenue (80.8% of mix) declined 5.3% QoQ while EMEA (10.7% of mix) and India grew 1.4% & 3.6% QoQ, respectively
- Vertical wise BFS (53.1% of mix), insurance (7.6% of mix) & TMT (12.7% of mix) declined 5.1%, 11.3% & 6.1% QoQ, respectively. Logistics & transportation and other reported growth of 0.6% & 2% QoQ, respectively
- EBIT margin was flat during the quarter at 15.3% despite a decline in revenue due to lower employee. The employee cost declined 5.2% QoQ
- For FY23, the net revenue grew 16.7% in rupee terms while in dollar terms revenue grew 7.8% (9.7% in CC). Direct revenue (93.9% of mix), which was impacted by mortgage LOB slowdown grew 19.3% in reported terms and 12% in CC terms. The company mentioned that ex Digital Risk (DR) direct business grew 19.6% in CC terms. DXC revenue (4.5% of mix) declined 19% on a reported basis and 23.5% in CC terms in FY23. In FY23, Mphasis said its BPS business declined 16% due to decline in mortgage business. The company, across all quarters and FY23, reported an EBIT margin of 15.3%. Mphasis also mentioned that despite the accelerated decline of DR business the company was able to sustain margins at 15.3% due to utilisation improvement, fresher deployment and increase in offshoring
- The company mentioned that its performance in Q4 was impacted by a decline in mortgage & DXC business. Mphasis said direct revenue declined 1.8% YoY in Q4 and ex DR it declined 1%. The company mentioned that mortgage business was impacted by high interest rates and. The volume of transactions, although it picked up a bit in January, declined over the remaining quarters. The company also mentioned that the contribution of DR LOB declined to 6.8% in Q4 compared to 8.8% in Q3
- The company mentioned that although global macro uncertainty prevails the demand for enterprise digital transformation still remains strong. Mphasis mentioned that demand for cost takeout and vendor consolidation deals is witnessing increased traction. The company mentioned that clients want to move forward with digital transformation agenda through driving the cost optimisation programs. Mphasis, however, mentioned that due to the uncertain macros it is witnessing higher scrutiny on spending decisions of clients leading to a delay in deal bookings and conversion to revenues. The company also mentioned that it is seeing a slowdown in discretionary spending by clients
- The company mentioned that starting FY24 it is aligning its GTM strategy alongside verticals to drive better sales synergy as the company focuses to increase its wallet share and market share within its existing clients & newer clients. Mphasis mentioned that it wants to consolidate the learnings from the different accounts to verticals to develop its offerings for stronger client mining & scaling of accounts
- The company, despite the uncertain macros in Q4FY24, won a net new TCV of US\$309 mn, down 11% QoQ with two large deals. Mphasis mentioned that one of the large deals is of US\$150 mn+ from a new client in the BFS vertical. The company mentioned that the deal is of zero cost transformation project wherein the company is gaining wallet share from other vendors. Mphasis also mentioned that out of the total TCV, 70% contribution came from BFSI, 15% from Insurance, 9% from TMT and 4% from logistics & transportation. The company mentioned that during all four quarters of

### 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        |
| <b>Overall ESG Score</b> | <b>0.0</b> | <b>0.0</b> | <b>31.0</b> |

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

FY23 it sustained TCV above US\$300 mn and it will like to sustain the same momentum, going forward, in FY24

- The company mentioned that it finished FY23 with a total TCV of US\$1.3bn with 10 large deals. Mphasis mentioned that the average deal size in FY23 was at US\$61 mn, which has doubled in three years. The company also mentioned that the deal pipeline remains strong despite the robust TCV conversion in FY23. Mphasis mentioned that its deal pipeline is up 9% QoQ and 35% YoY. The company said its pipeline remains diversified but is still dominated by BFSI contributing 36% of the pipeline. However, Mphasis added that non BFSI pipeline is growing at a stronger pace of 52% YoY growth indicating that the company's aim of diversifying from BFSI segment is bearing results. The company said that among the non BFSI pipeline Hitech/TMT has the largest pipeline and also mentioned that healthcare over last 18 months has won good TCV. In the insurance vertical, Mphasis added that its large client had gone through an internal restructuring, which impacted the revenue growth but the company said it has won two large deals in insurance. With those ramping up, the vertical should see growth by Q1FY24 end. The company also mentioned that the pipeline is distributed across areas of data, modernisation, cyber security, platforms & agile ops
- The company mentioned that it is starting FY24 with an extended deal pipeline of cloud, digital transformation and vendor consolidation opportunities. Mphasis, however, indicated that it expects soft beginning in Q1FY24 due to client specific issues in BFS and delayed contract conversion in current environment. The company said that it expects mortgage decline to bottom out by end of Q1 and expects stability across the mortgage business segment from Q2 onwards. The company mentioned it also expects DXC business to remain steady at Q4FY23 levels. With the stability across mortgage & DXC LOB Mphasis mentioned that it expects industry average growth in direct business ex of mortgage business. The company also mentioned that it expects sequential growth in direct business ex DR from Q2FY24 onwards
- On the margin front, the company has guided for an EBIT margin of 15.25-16.25% across each quarter of FY24. Mphasis mentioned that lever for margin improvement is increase in utilisation, fresher deployment, increases offshoring and currency benefits. The company also indicated that it will aim to achieve the higher end of the margin guidance for FY24
- The company's net employees during the quarter declined by 1,408 bringing the total employees to 34,042. Mphasis mentioned that the decline in employee in the last few quarters was due to company tightening hiring policy and focus on improving its utilisation by deploying freshers. The company indicated that it has not conducted any layoff but the open positions due to voluntary attrition were filled by deploying freshers instead of lateral hirings leading to a decline in headcount
- **M&A:** The company indicated that it is actively looking for an M&A opportunity. Mphasis mentioned that it is looking at M&A as a strategic tool to diversify its vertical & geography base. The company added that some M&A deals are under discussion and few are at diligence stage. However, Mphasis has not given any fixed time for closing the M&A deals but mentioned that it will complete one to two deals in FY24
- On new technology, the company indicated that it has been one of the leaders in the ChatGPT and generative AI space as it had developed its own machine learning platform in 2019 itself. Mphasis also mentioned that it has incorporated the earlier versions of ChatGPT & ChatGPT4 in its own ML platform. The company further mentioned that the recent revolution around the ChatGPT has made it a board room discussion among clients and gives the company opportunity to win new deal opportunities. Mphasis mentioned that the areas in which it is seeing traction for this tech are: i) modern engineering practises & developer productivity, which provides

company opportunity to gain wallet shares from competitors by aligning clients software development practises using this tools & 2) areas which uses automation elements like contact centre automation which uses digital self-help & chatbots

- The company declared a dividend of ₹ 50 per share for FY23

Exhibit 1: P&L

|                              | Q4FY23 | Q4FY22 | YoY (%) | Q3FY23 | QoQ (%) | Comments  |
|------------------------------|--------|--------|---------|--------|---------|---|
| Revenue                      | 3,361  | 3,278  | 2.5     | 3,506  | -4.1    | Decline in DR and DXC business led to decline of revenue in Q4. |
| Employee expense             | 2,379  | 2,301  | 3.4     | 2,509  | -5.2    |   |
| Gross Margin                 | 983    | 976    | 0.6     | 998    | -1.5    |   |
| Gross margin (%)             | 29.2   | 29.8   | -55 bps | 28.5   | 78 bps  |   |
| Other expense                | 384    | 399    | -3.8    | 380    | 1.0     |   |
| EBITDA                       | 599    | 577    | 3.7     | 618    | -3.0    |   |
| EBITDA Margin (%)            | 17.8   | 17.6   | 20 bps  | 17.6   | 20 bps  |   |
| Depreciation & amortisation  | 84     | 80     | 4.5     | 82     | 1.7     |   |
| EBIT                         | 515    | 497    | 3.6     | 535    | -3.8    |   |
| EBIT Margin (%)              | 15.3   | 15.2   | 16 bps  | 15.3   | 6 bps   | Decline in employee cost aided to maintain margins at 15.3%     |
| Other income (less interest) | 19     | 18     | 2.7     | 16     | 21.2    |   |
| PBT                          | 534    | 516    | 3.6     | 551    | -3.1    |   |
| Tax paid                     | 129    | 124    | 4.2     | 139    | -7.1    |   |
| PAT                          | 405    | 392    | 3.4     | 412    | -1.7    |   |

Source: Company, ICICI Direct Research

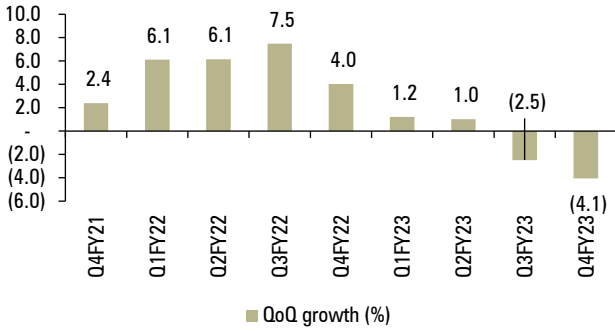
Exhibit 2: Change in estimates

| (₹ Crore)       | FY24E  |        |          | FY25E  |        |          | Comments                           |
|-----------------|--------|--------|----------|--------|--------|----------|------------------------------------|
|                 | Old    | New    | % Change | Old    | New    | % Change |                                    |
| Revenue         | 14,297 | 14,707 | 2.9      | 15,285 | 16,606 | 8.6      | We are baking in back ended growth |
| EBIT            | 2,288  | 2,309  | 0.9      | 2,491  | 2,674  | 7.3      |                                    |
| EBIT Margin (%) | 16.0   | 15.7   | -30 bps  | 16.3   | 16.1   | -20 bps  | Margins as per guided range        |
| PAT             | 1,805  | 1,821  | 0.9      | 1,957  | 2,062  | 5.3      |                                    |
| EPS (₹)         | 95.4   | 96.0   | 0.9      | 103.4  | 108.7  | 5.3      |                                    |

Source: Company, ICICI Direct Research

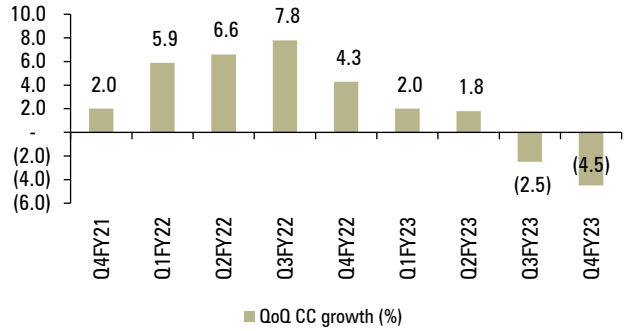
Key Metrics

Exhibit 3: DR contribution declines to 6.8% in Q4



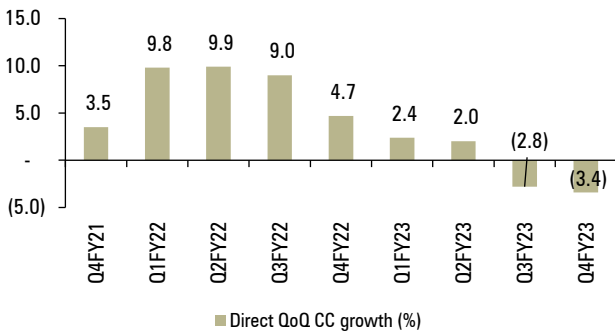
Source: Company, ICICI Direct Research

Exhibit 4: QoQ CC growth



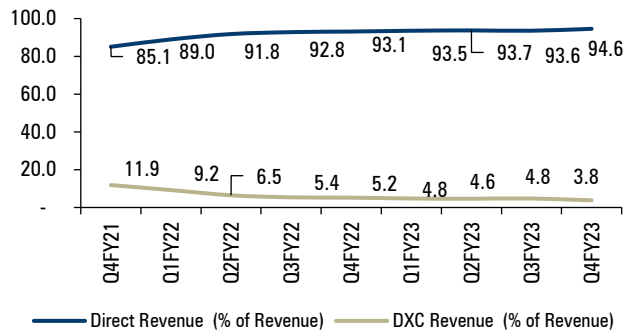
Source: Company, ICICI Direct Research

Exhibit 5: Direct QoQ CC growth



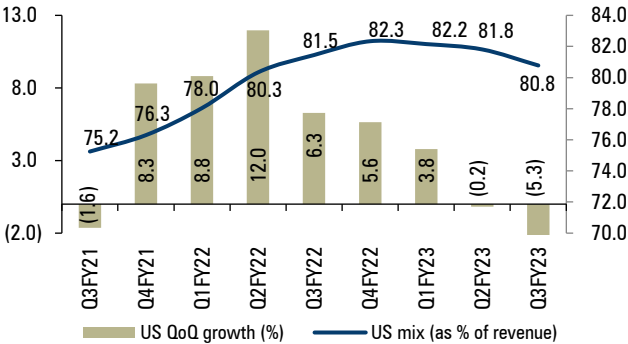
Source: Company, ICICI Direct Research

Exhibit 6: Direct & DXC revenue mix trend



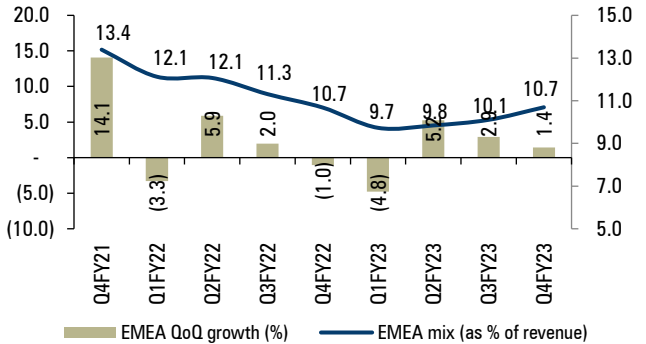
Source: Company, ICICI Direct Research

Exhibit 7: US growth impacted by mortgage decline



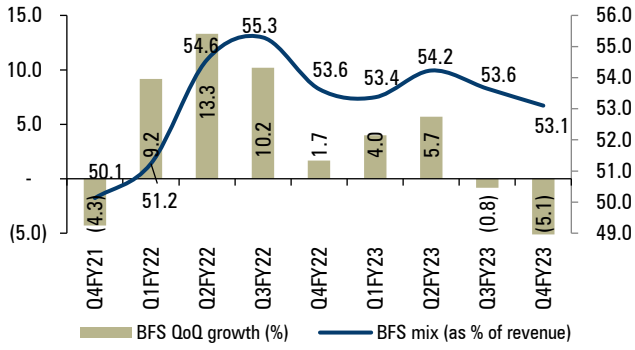
Source: Company, ICICI Direct Research

Exhibit 8: EMEA growth remains steady



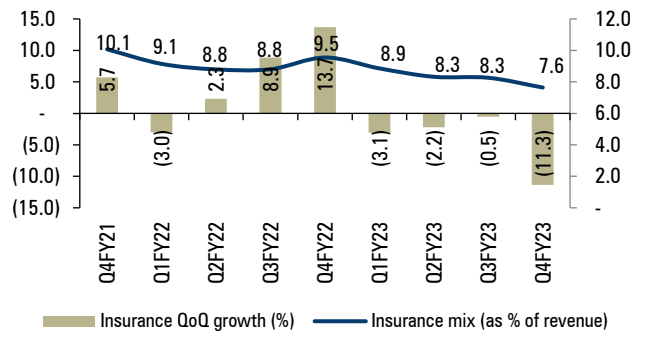
Source: Company, ICICI Direct Research

**Exhibit 9: BFS excluding DR declines in Q4**



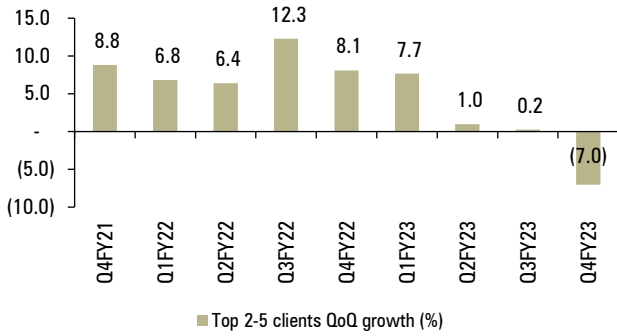
Source: Company, ICICI Direct Research

**Exhibit 10: Insurance impacts client specific issue**



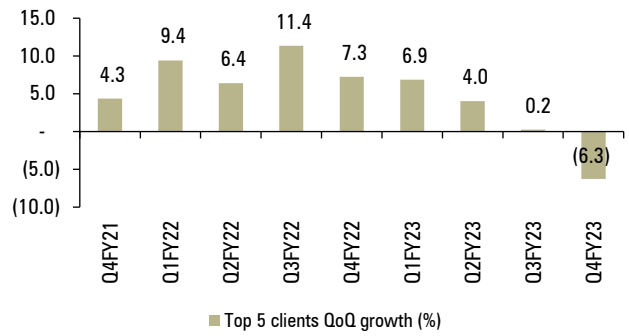
Source: Company, ICICI Direct Research

**Exhibit 11: Decline due to high BFS exposure in top clients**



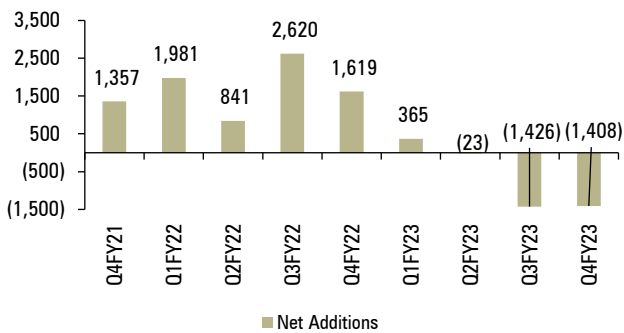
Source: Company, ICICI Direct Research

**Exhibit 12: Top five clients growth trend**



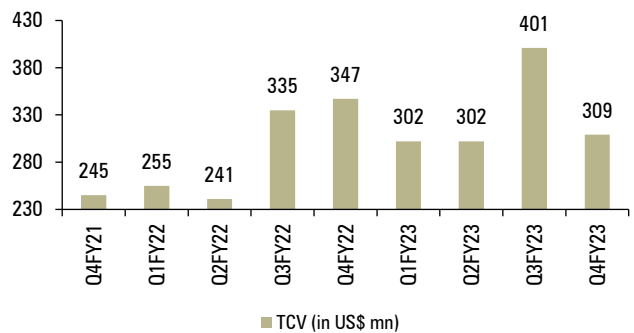
Source: Company, ICICI Direct Research

**Exhibit 13: Net employee declines on internal sourcing**



Source: Company, ICICI Direct Research

**Exhibit 14: TCV wins remain above US\$300 mn**



Source: Company, ICICI Direct Research

## Financial summary

| Exhibit 15: Profit and loss statement |               |               |               |               |
|---------------------------------------|---------------|---------------|---------------|---------------|
|                                       | ₹ crore       |               |               |               |
|                                       | FY22          | FY23          | FY24E         | FY25E         |
| <b>Total Revenues</b>                 | <b>11,961</b> | <b>13,798</b> | <b>14,707</b> | <b>16,606</b> |
| Growth (%)                            | 23            | 15            | 7             | 13            |
| Employee Benefit Expense              | 7,035         | 8,076         | 8,530         | 9,548         |
| Other Expenses                        | 2,809         | 3,289         | 3,515         | 3,985         |
| <b>EBITDA</b>                         | <b>2,118</b>  | <b>2,434</b>  | <b>2,662</b>  | <b>3,072</b>  |
| Growth (%)                            | 17            | 15            | 9             | 15            |
| Depreciation                          | 291           | 325           | 353           | 399           |
| Other Income                          | 160           | 162           | 229           | 200           |
| Interest                              | 74            | 97            | 110           | 125           |
| PBT before Excep Items                | 1,913         | 2,173         | 2,428         | 2,750         |
| Growth (%)                            | 17            | 14            | 12            | 13            |
| Tax                                   | 482           | 535           | 607           | 687           |
| PAT before Excep Items                | 1,431         | 1,638         | 1,821         | 2,062         |
| Exceptional items                     | -             | -             | -             | -             |
| <b>PAT</b>                            | <b>1,431</b>  | <b>1,638</b>  | <b>1,821</b>  | <b>2,062</b>  |
| Growth (%)                            | 18            | 14            | 11            | 13            |
| <b>Diluted EPS</b>                    | <b>76</b>     | <b>86</b>     | <b>96</b>     | <b>109</b>    |
| EPS (Growth %)                        | 17            | 14            | 11            | 13            |

Source: Company, ICICI Direct Research

| Exhibit 16: Cash flow statement     |                |                |                |                |
|-------------------------------------|----------------|----------------|----------------|----------------|
|                                     | ₹ crore        |                |                |                |
|                                     | FY22           | FY23           | FY24E          | FY25E          |
| <b>Profit before Tax</b>            | <b>1,913</b>   | <b>2,173</b>   | <b>2,428</b>   | <b>2,750</b>   |
| Depreciation                        | 291            | 325            | 353            | 399            |
| (inc)/dec in Current Assets         | (660)          | (449)          | (503)          | (673)          |
| (inc)/dec in current Liabilities    | 510            | (129)          | 205            | 400            |
| Income Taxes Paid                   | (369)          | (593)          | (607)          | (687)          |
| Others                              | 31             | 134            | (68)           | (25)           |
| <b>CF from operations</b>           | <b>1,716</b>   | <b>1,462</b>   | <b>1,808</b>   | <b>2,162</b>   |
| Other Investments                   | (163)          | 294            | 179            | 150            |
| (Purchase)/Sale of Fixed Assets     | (119)          | (111)          | (162)          | (183)          |
| <b>CF from investing Activities</b> | <b>(282)</b>   | <b>182</b>     | <b>17</b>      | <b>(33)</b>    |
| Inc / (Dec) in Equity Capital       | 44             | 27             | -              | -              |
| Inc / (Dec) in sec.loan Funds       | 3              | (356)          | (30)           | (30)           |
| Dividend & Dividend tax             | (1,218)        | (865)          | (1,093)        | (1,237)        |
| Interest Paid on Loans              | (74)           | (97)           | (110)          | (125)          |
| <b>CF from Financial Activities</b> | <b>(1,244)</b> | <b>(1,291)</b> | <b>(1,233)</b> | <b>(1,392)</b> |
| Net change in cash                  | 189            | 353            | 592            | 737            |
| Opening cash                        | 771            | 827            | 1,044          | 1,487          |
| <b>Closing cash</b>                 | <b>827</b>     | <b>1,044</b>   | <b>1,487</b>   | <b>2,074</b>   |

Source: Company, ICICI Direct Research

| Exhibit 17: Balance sheet         |              |              |              |               |
|-----------------------------------|--------------|--------------|--------------|---------------|
|                                   | ₹ crore      |              |              |               |
|                                   | FY22         | FY23         | FY24E        | FY25E         |
| Equity                            | 188          | 188          | 188          | 188           |
| Reserves & Surplus                | 6,755        | 7,746        | 8,475        | 9,300         |
| Networth                          | 6,943        | 7,935        | 8,663        | 9,488         |
| Total debt                        | 584          | 682          | 652          | 622           |
| Other liabilities                 | 319          | 195          | 216          | 231           |
| <b>Source of funds</b>            | <b>7,846</b> | <b>8,812</b> | <b>9,531</b> | <b>10,341</b> |
| Net Block                         | 869          | 972          | 1,011        | 1,036         |
| CWIP                              | 11           | 5            | 5            | 5             |
| Intangible assets under developme | 170          | 156          | 75           | (17)          |
| Long term Loans and advances      | -            | -            | -            | -             |
| Other non current assets          | 1,255        | 1,564        | 1,835        | 2,022         |
| Current Investments               | 1,435        | 1,368        | 1,368        | 1,368         |
| Goodwill                          | 2,735        | 2,959        | 2,959        | 2,959         |
| Inventories                       | -            | -            | -            | -             |
| Debtors                           | 2,227        | 2,521        | 2,687        | 3,034         |
| Cash Balance                      | 827          | 1,044        | 1,487        | 2,074         |
| Bank Balance                      | 123          | 9            | 9            | 9             |
| Short term Loans and advances     | 32           | 29           | 31           | 35            |
| Other current assets              | 1,073        | 982          | 1,047        | 1,182         |
| Trade payables                    | 850          | 864          | 921          | 1,040         |
| Other Current liabilities         | 1,952        | 1,692        | 1,803        | 2,036         |
| Provisions                        | 108          | 242          | 258          | 291           |
| <b>Application of funds</b>       | <b>7,846</b> | <b>8,812</b> | <b>9,531</b> | <b>10,341</b> |

Source: Company, ICICI Direct Research

| Exhibit 18: Key ratios      |         |       |       |       |
|-----------------------------|---------|-------|-------|-------|
|                             | ₹ crore |       |       |       |
|                             | FY22    | FY23  | FY24E | FY25E |
| <b>Per share data (₹)</b>   |         |       |       |       |
| Diluted EPS                 | 75.6    | 86.4  | 96.0  | 108.7 |
| BV                          | 370.6   | 421.7 | 460.5 | 504.3 |
| DPS                         | 46.0    | 50.0  | 57.6  | 65.2  |
| Cash Per Share              | 50.7    | 56.0  | 79.5  | 110.7 |
| <b>Operating Ratios (%)</b> |         |       |       |       |
| EBITDA Margin               | 17.7    | 17.6  | 18.1  | 18.5  |
| PAT Margin                  | 12.0    | 11.9  | 12.4  | 12.4  |
| Debtor days                 | 68      | 67    | 67    | 67    |
| Creditor days               | 26      | 23    | 23    | 23    |
| <b>Return Ratios (%)</b>    |         |       |       |       |
| RoE                         | 20.6    | 20.6  | 21.0  | 21.7  |
| RoCE                        | 25.3    | 25.8  | 26.6  | 27.8  |
| RoIC                        | 33.5    | 33.0  | 34.7  | 38.8  |
| <b>Valuation Ratios (x)</b> |         |       |       |       |
| P/E                         | 24.4    | 21.4  | 19.2  | 17.0  |
| EV / EBITDA                 | 15.8    | 13.8  | 12.4  | 10.6  |
| Market Cap / Sales          | 2.9     | 2.6   | 2.4   | 2.1   |
| Price to Book Value         | 5.0     | 4.4   | 4.0   | 3.7   |
| <b>Solvency Ratios</b>      |         |       |       |       |
| Debt / Equity               | 0.08    | 0.09  | 0.08  | 0.07  |
| Debt / EBITDA               | 0.3     | 0.3   | 0.2   | 0.2   |
| Quick Ratio                 | 1.1     | 1.3   | 1.3   | 1.3   |

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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