

Client related furlough, mortgage business impacting overall growth...

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%)

Q2FY23 Results: Mphasis reported muted Q2FY23 results.

- Direct revenue grew 2% QoQ in CC terms
- EBIT margins were flat at 15.3%
- TCV wins continued to be strong with US\$300 mn+ during the quarter

What should investors do? Mphasis' share price has grown by ~3.1x over the past five years (from ~₹ 650 in October 2017 to ~₹ 2042 levels in October 2022).

- We change our rating on the stock from BUY to **HOLD**

Target Price and Valuation: We value Mphasis at ₹ 2210 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 11% 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 LTI.

- Industry leading growth and healthy margins prompt us to be positive on the stock
- BUY with a target price of ₹ 5,525



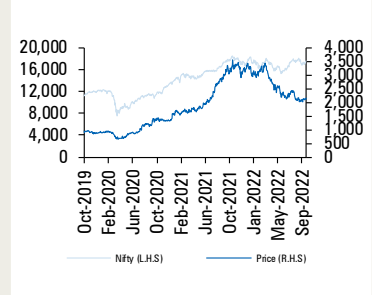
Particulars

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	3595/ 1982
Equity Capital (₹ crore)	187.8
Face Value (₹)	₹ 10

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	56.0	55.8	55.8	55.7
FII	21.1	21.1	21.1	20.3
DII	17.0	18.0	18.0	17.8
Public	5.9	5.1	5.1	6.2

Price Chart



Recent event & key risks

- Continued strong momentum of deal wins
- Key Risk:** (i) Higher than expected revenue (ii) Lower than expected margins

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Key Financial Summary

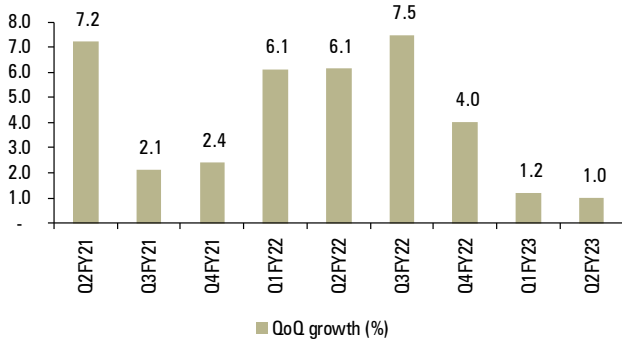
(₹ Crore)	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	9,722	11,961	14.5	13,994	15,208	16,377	11.0
EBITDA	1,803	2,118	16.9	2,421	2,783	3,046	12.9
EBITDA Margins (%)	18.5	17.7		17.3	18.3	18.6	
Net Profit	1,217	1,431	12.6	1,654	1,914	2,091	13.5
Diluted EPS (₹)	64.4	75.6		87.4	101.1	110.5	
P/E (x)	31.3	26.7		23.1	20.0	18.3	
RoE (%)	18.6	20.6		22.0	23.4	23.4	
RoCE (%)	21.8	23.7		24.5	26.1	26.4	

Key takeaways of recent quarter & conference call highlights

- Revenue growth of the company was muted for a second successive quarter with revenue of US\$440.3 million (mn), up 1% QoQ while in CC terms growth was 1.8% QoQ. In rupee terms, revenues came in at ₹ 3,527 crore, up 4% QoQ
- The company indicated that revenue growth in the quarter was impacted by the following factors: a) earlier than expected furloughs from a key client & b) higher than expected ramp down in the mortgage business due to macroeconomic uncertainties. The company also mentioned that a client has a history of furlough in Q2 due to its annual closure but this time there was some unexpected element to it. Normal furloughs are expected to hit in Q3
- Direct revenue (93.7% of mix) grew 4.2% QoQ while DXC revenues (4.6% mix) increased 1.1% QoQ. In CC terms, direct revenue grew 2% QoQ while DXC declined 1% QoQ
- Geography wise US region (82.2% of mix) reported growth of 3.8% QoQ while EMEA (8.2% of mix) grew 5.2% QoQ. In CC terms, the US region reported growth of 20.4% YoY. Excluding DCX, growth was 21.4% YoY while Europe reported growth of 21.4% YoY
- Vertical wise, banking (54.2% of the mix) reported growth of 5.7% QoQ despite the decline in mortgage business. Others vertical reported strong growth of 8% QoQ. In CC terms, BFS reported growth of 15.7% YoY while TMT, logistics & others reported growth of 33%, 16.5% & 34% YoY, respectively
- The company reported flat EBIT margins for the quarter at 15.3%. Mphasis indicated that the margins of the company were stable even after muted revenue growth as result of the reduced SG&A expenses during the quarter. The company maintained its EBIT margin guidance in the band of 15.3-17% for FY23
- Mphasis indicated the following levers for margin improvement in H2: a) improvement in utilisation, b) getting revised price from clients, c) improvement of off shore mix, d) reduction in ESOP expenses and e) reduction of amortisation expenses
- The TCV (new bookings) continues to remain strong despite macroeconomic factors. The company for the fourth successive quarter got new TCV wins of US\$300+ mn with a TCV of US\$302 mn, up 25.3% YoY. Mphasis also indicated that it won two large deals of TCV worth US\$110 mn. The company indicated that it is winning majority of the large deals in verticals other than BFS indicating its growth in those verticals. Mphasis also added five new clients during the quarter
- The company's total headcount during the quarter declined by 23 to 36,876 during the quarter. Mphasis during the quarter added 156 net new employees to its technology services team taking the total headcount to 23,596
- Mphasis indicated that its growth strategy for the future is based on the following 3 points: a) Tech enhancement: The company indicated that it will improve delivery capability by investing to accelerate its hyper scaler ability; b) Vertical Focus: Mphasis will improve its end-to-end capability in BFS & Insurance & c) geography expansion: The company indicated that it will expand its presence in the Europe & Canada market by investing & offering its capabilities in BFS & insurance space
- The company indicated that it is seeing normal furlough in H2. However, the pace of change of the mortgage business is unprecedented and recovery is likely once macro issues settle. The company said it is in constant conversation with its client to assess any macro related impact

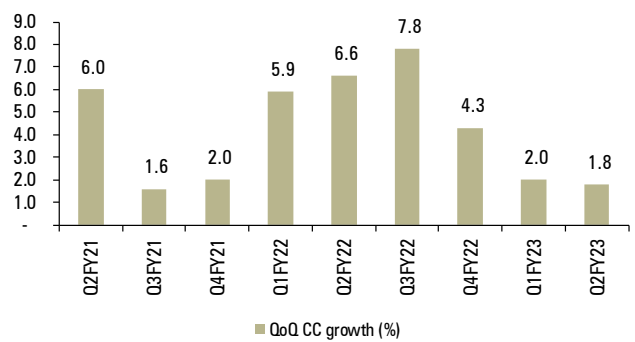
Key Metrics

Exhibit 1: QoQ dollar revenue growth



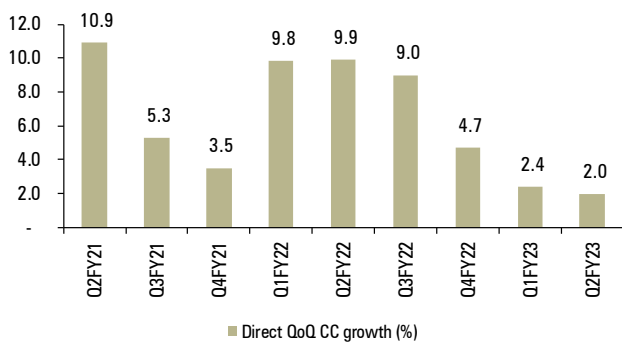
Source: Company, ICICI Direct Research

Exhibit 2: QoQ CC growth



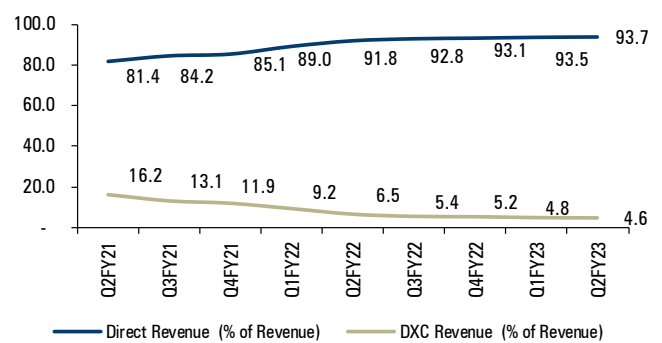
Source: Company, ICICI Direct Research

Exhibit 3: Direct QoQ CC growth



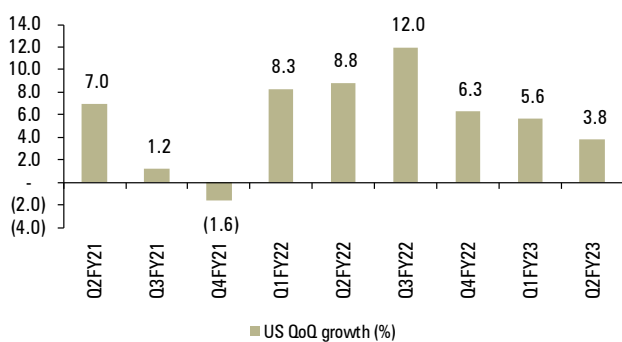
Source: Company, ICICI Direct Research

Exhibit 4: Direct & DXC revenue mix trend



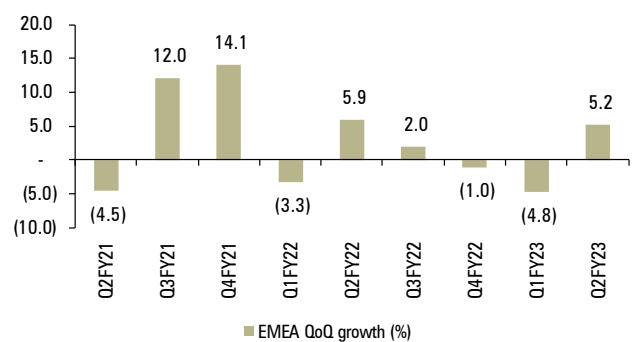
Source: Company, ICICI Direct Research

Exhibit 5: US QoQ growth



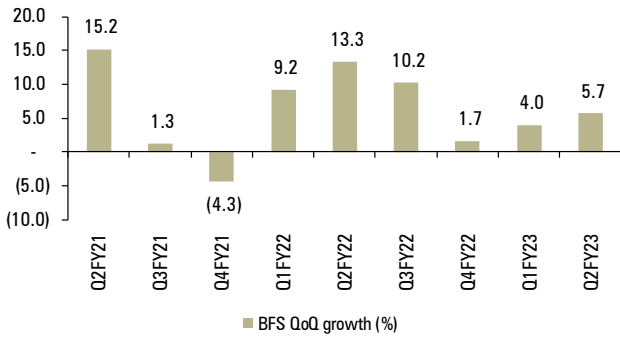
Source: Company, ICICI Direct Research

Exhibit 6: EMEA QoQ growth



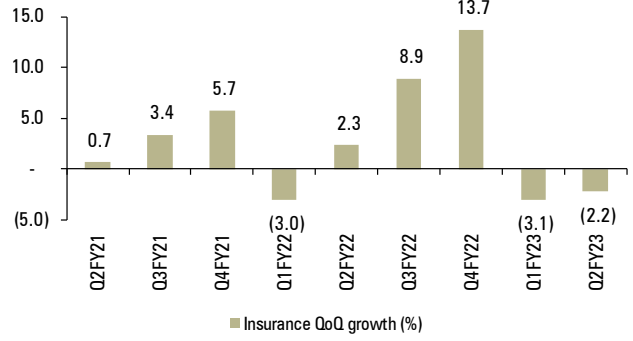
Source: Company, ICICI Direct Research

Exhibit 7: BFS QoQ growth



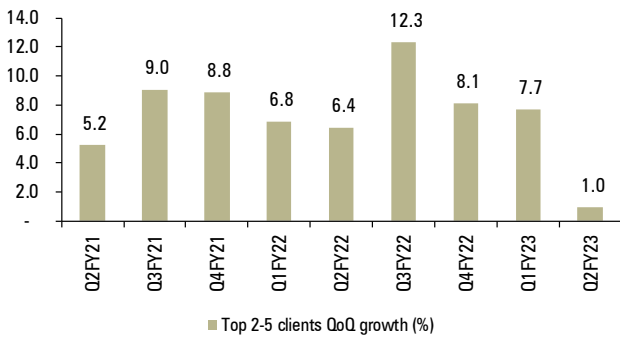
Source: Company, ICICI Direct Research

Exhibit 8: Insurance QoQ growth



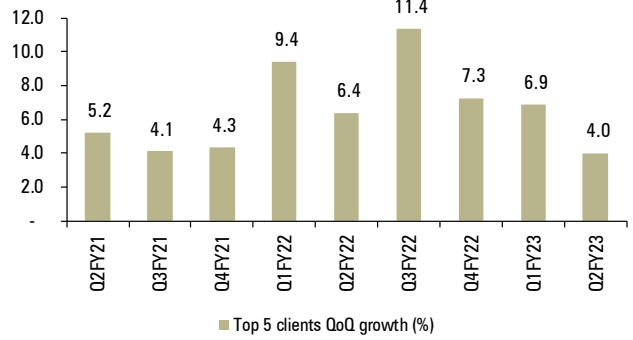
Source: Company, ICICI Direct Research

Exhibit 9: Top 2-5 clients growth trend



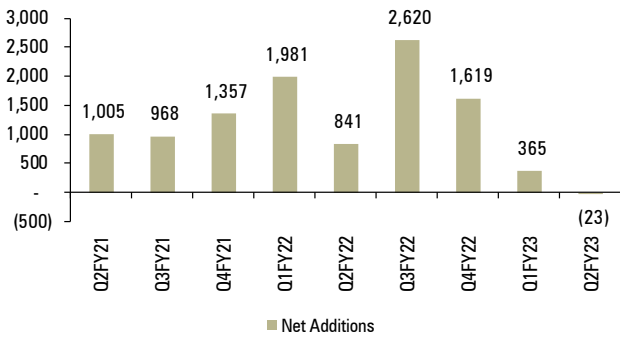
Source: Company, ICICI Direct Research

Exhibit 10: Top 5 clients growth trend



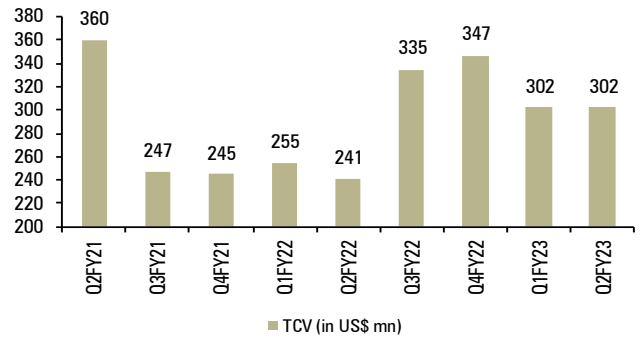
Source: Company, ICICI Direct Research

Exhibit 11: Net employee addition trend



Source: Company, ICICI Direct Research

Exhibit 12: TCV wins trend



Source: Company, ICICI Direct Research

Exhibit 1: P&L

	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	3,520	2,869	22.7	3,411	3.2	Revenue growth impacted by furloughs in key client & higher than expected ramp down in mortgage LOB
Employee expense	2,532	2,043	23.9	2,394	5.7	
Gross Margin	988	827	19.6	1,017	-2.8	
Gross margin (%)	28.1	28.8	-73 bps	29.8	-174 bps	
Other expense	371	329	12.7	417	-11.1	
EBITDA	618	498	24.1	600	3.0	
EBITDA Margin (%)	17.5	17.3	20 bps	17.6	-4 bps	
Depreciation & amortisation	80	66	21.9	80	0.6	
EBIT	538	432	24.4	520	3.3	
EBIT Margin (%)	15.3	15.1	21 bps	15.3	2 bps	Margin were flat despite muted revenue growth due decline in SG&A expenses
Other income (less interest)	17	28	-37.2	13	39.2	
PBT	555	460	20.7	533	4.1	
Tax paid	137	118	15.6	131	4.3	
PAT	418	342	22.5	402	4.1	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(\$ Crore)	FY23E			FY24E			FY25E	Comments
	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	14,575	13,994	-4.0	17,205	15,208	-11.6	16,377	Numbers re-aligned on weak H1 performance and client specific concerns
EBIT	2,186	2,099	-4.0	2,753	2,433	-11.6	2,669	
EBIT Margin (%)	15.0	15.0	0 bps	16.0	16.0	0 bps	16.3	
PAT	1,719	1,654	-3.8	2,153	1,914	-11.1	2,091	
EPS (\$)	90.8	87.4	-3.8	113.8	101.1	-11.1	110.5	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 3: Profit and loss statement					₹ crore
	FY22	FY23E	FY24E	FY25E	
Total Revenues	11,961	13,994	15,208	16,377	
Growth (%)	23	17	9	8	
Employee Benefit Expense	7,035	8,117	8,669	9,286	
Other Expenses	2,809	3,457	3,756	4,045	
EBITDA	2,118	2,421	2,783	3,046	
Growth (%)	17	14	15	9	
Depreciation	291	322	350	377	
Other Income	160	168	180	180	
Interest	74	62	62	62	
PBT before Excep Items	1,913	2,205	2,552	2,788	
Growth (%)	17	15	16	9	
Tax	482	551	638	697	
PAT before Excep Items	1,431	1,654	1,914	2,091	
Exceptional items	-	-	-	-	
PAT	1,431	1,654	1,914	2,091	
Growth (%)	18	16	16	9	
Diluted EPS	76	87	101	110	
EPS (Growth %)	17	16	16	9	

Source: Company, ICICI Direct Research

Exhibit 4: Cash flow statement					₹ crore
	FY22	FY23E	FY24E	FY25E	
Profit before Tax	1,913	2,205	2,552	2,788	
Depreciation	291	322	350	377	
(inc)/dec in Current Assets	(660)	(952)	(448)	(431)	
(inc)/dec in current Liabilities	510	308	306	294	
Income Taxes Paid	(369)	(551)	(638)	(697)	
Others	31	(55)	(68)	(68)	
CF from operations	1,716	1,277	2,054	2,263	
Other Investments	(163)	117	130	130	
(Purchase)/Sale of Fixed Assets	(119)	(154)	(167)	(180)	
CF from investing Activities	(282)	(37)	(38)	(51)	
Inc / (Dec) in Equity Capital	44	-	-	-	
Inc / (Dec) in sec.loan Funds	3	(30)	(30)	(30)	
Dividend & Dividend tax	(1,218)	(1,075)	(1,244)	(1,359)	
Interest Paid on Loans	(74)	(62)	(62)	(62)	
CF from Financial Activities	(1,244)	(1,167)	(1,336)	(1,451)	
Net change in cash	189	73	680	761	
Opening cash	771	827	755	1,291	
Closing cash	827	755	1,291	1,908	

Source: Company, ICICI Direct Research

Exhibit 5: Balance sheet					₹ crore
	FY22	FY23E	FY24E	FY25E	
Equity	188	188	188	188	
Reserves & Surplus	6,755	7,334	8,004	8,736	
Networth	6,943	7,522	8,192	8,924	
Total debt	527	497	467	437	
Other liabilities	903	1,248	1,350	1,448	
Source of funds	8,373	9,267	10,009	10,809	
Net Block	869	917	956	986	
CWIP	11	11	11	11	
Intangible assets under developme	170	99	21	(62)	
Long term Loans and advances	-	79	86	92	
Other non current assets	1,255	1,799	1,923	2,041	
Current Investments	1,435	1,435	1,435	1,435	
Goodwill	2,735	2,735	2,735	2,735	
Inventories	-	-	-	-	
Debtors	2,227	2,664	2,895	3,117	
Cash Balance	827	755	1,291	1,908	
Bank Balance	123	123	123	123	
Short term Loans and advances	32	211	230	247	
Other current assets	1,073	786	854	920	
Trade payables	850	858	933	1,005	
Other Current liabilities	1,425	1,417	1,539	1,658	
Provisions	108	72	78	84	
Application of funds	8,373	9,267	10,009	10,809	

Source: Company, ICICI Direct Research

Exhibit 6: Key ratios					₹ crore
	FY22	FY23E	FY24E	FY25E	
Per share data (₹)					
Diluted EPS	75.6	87.4	101.1	110.5	
BV	370.6	401.5	437.3	476.3	
DPS	46.0	56.8	65.7	71.8	
Cash Per Share	50.7	46.9	75.5	108.4	
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	22.0	23.4	23.4	
RoCE	23.7	24.5	26.1	26.4	
RoIC	30.6	30.2	34.0	36.4	
Valuation Ratios (x)					
P/E	26.7	23.1	20.0	18.3	
EV / EBITDA	17.4	15.2	13.0	11.7	
Market Cap / Sales	3.2	2.8	2.5	2.4	
Price to Book Value	5.5	5.1	4.7	4.3	
Solvency Ratios					
Debt / Equity	0.08	0.07	0.06	0.05	
Debt / EBITDA	0.2	0.2	0.2	0.1	
Quick Ratio	1.4	1.6	1.6	1.6	

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

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Sell: <-15%



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