

MPHASIS

IT - SERVICES

HOLD

Target Price: Rs 555

Deal wins strong; margin confidence high

Mphasis' Q1FY17INR revenue was lower than expected, but EBITat ~15.2% was higher than our estimate, led by higher utilization and cost efficiencies. Higher EBIT led to better PAT.

Multiple triggers: Deal wins were stronger at USD 96 mn (vs. USD 76/ USD 61 mn in Q4/Q3FY16). Management expects Direct International (73% share) to grow higher than the industry. HP (23% share) declined ~4.4% QoQ due to client ramp-downs and will stabilize from Q2FY17 (commentary status quo). EBIT guidance for FY17 stands at 14-16% (indicating higher confidence on H2, earlier guidance was for H1FY17). Revenue opportunity from Blackstone portfolio cos. to accrue from FY18. Blackstone transaction to close in Sep-16. Interim trigger – dividend.

CMP : Rs 540
Potential Upside : 3%

MARKET DATA

No. of Shares : 210 mn
Free Float : 40%
Market Cap : Rs 114 bn
52-week High / Low : Rs 622 / Rs 382
Avg. Daily vol. (6mth) : 231,412 shares
Bloomberg Code : MPHL IB Equity
Promoters Holding : 60%
FII / DII : 22% / 10%

Concall highlights

- ◆ **Strong deal wins** at USD 96 mn (75% in Digital, GRC and next generation services) will drive growth. These wins will reflect from Q3 onwards. Clients are reducing spends in traditional areas and investing in next gen services. Note: The worst in HP business is behind and revenue from Wyde (insurance) will start contributing from Q4
- ◆ **Direct International (73% of revenue) will grow higher than industry and remain a growth engine:** Direct International business grew 1.4% QoQ (reported basis) led by ramp-up in deal wins. Growth engines are– GRC, Digital, next generation services. Digital Risk (15-16% share; USD 33-35mn revenue quarterly run-rate) has stabilized and is expected to do better in FY17
- ◆ **Multiple levers to maintain EBIT margin at 14-16% (earlier for H1FY17) showcasing better confidence on H2 despite salary headwinds in Q3.** Management believes margin levers exist through leverage on S&M (20-30 bps), better quality of deal wins, automation in delivery and increasing share of IMS/ next generation services

Financial summary (Consolidated)

Y/E March	FY15	FY16	FY17E	FY18E
Sales (Rs mn)	57,949	60,847	64,207	71,864
Adj PAT (Rs mn)	6,778	7,214	8,717	10,599
Con. EPS* (Rs.)	-	39	43	47
EPS (Rs.)	32	34	41	50
Change YOY (%)	119.3	6.4	20.8	21.6
P/E (x)	16.8	15.7	13.0	10.7
RoE (%)	12.8	12.3	13.0	13.8
RoCE (%)	11.0	11.2	12.6	13.8
EV/EBITDA (x)	13.7	13.3	9.9	7.2
DPS	16	-	-	-

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

Revenue mix	Jun-15	Mar-16	Jun-16
HP	29%	24%	23%
Non-HP	71%	76%	77%

Price performance

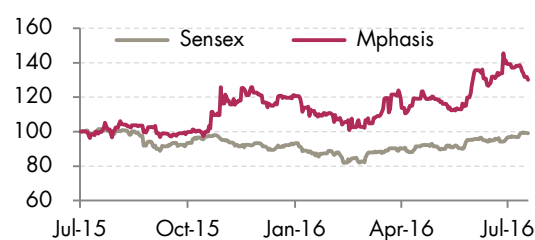


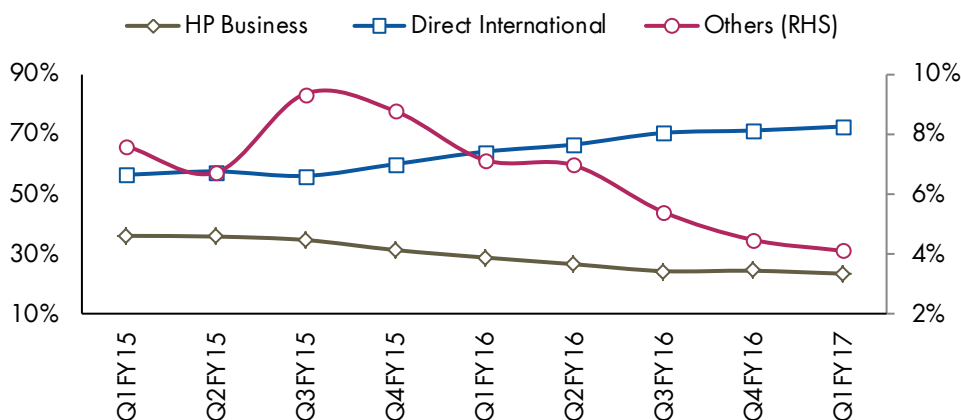
Exhibit 1: Results update (Rs mn)

	Quarter ended					12 months ended		
	Jun-16	Jun-15	% Chg	Mar-16	% Chg	FY17E	FY16	% Chg
Net sales	15,167	14,945	1.5	15,160	0.0	64,207	60,847	5.5
EBIDTA	2,308	1,896	21.7	2,200	4.9	9,759	8,261	18.1
Other income	519	373	-	443	-	2,274	1,636	-
PBIDT	2,827	2,269	24.6	2,643	7.0	12,033	9,897	21.6
PBT	2,827	2,269	24.6	2,643	7.0	12,033	9,897	21.6
Tax	784	611	-	723	-	3,316	2,683	-
Adjusted PAT	2,043	1,658	23.2	1,920	6.4	8,717	7,214	20.8
No. of shares (mn)	210	210	-	253	-	210	210	-
EBIDTA margin (%)	15.2	12.7	-	14.5	-	15.2	13.6	-
PBT margin (%)	18.6	15.2	-	17.4	-	18.7	16.3	-
EPS - annualized (Rs.)	9.7	7.9	23.5	7.6	28.5	41.5	34.3	20.8

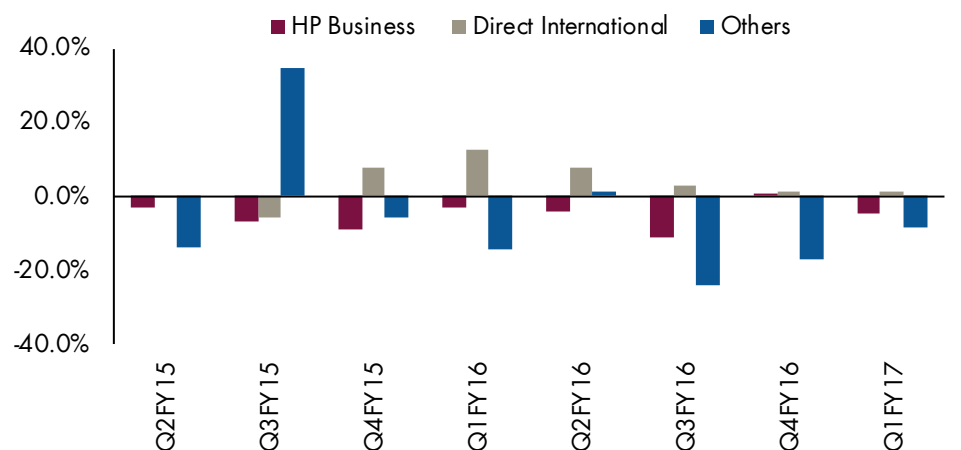
Source: Company, Axis Capital

Estimation and valuation

We expect 7% USD revenue CAGR over FY16-18E. Our FY17E/18E EPS remains largely intact at Rs 41/50. Our TP of Rs 555 (11x FY18E) implies 3% upside from **CMP of Rs540** given the recent appreciation in the stock (20% since Blackstone's announcement). Maintain **HOLD**. The stock trades at 13x/ 11x FY17E/FY18E.

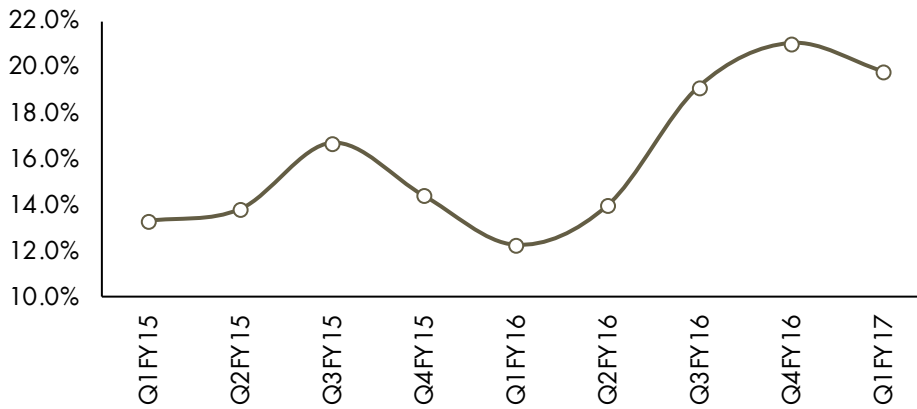
Exhibit 2: Revenue growth led by Direct International


Source: Company, Axis Capital

Exhibit 3: Revenue growth (% change QoQ)


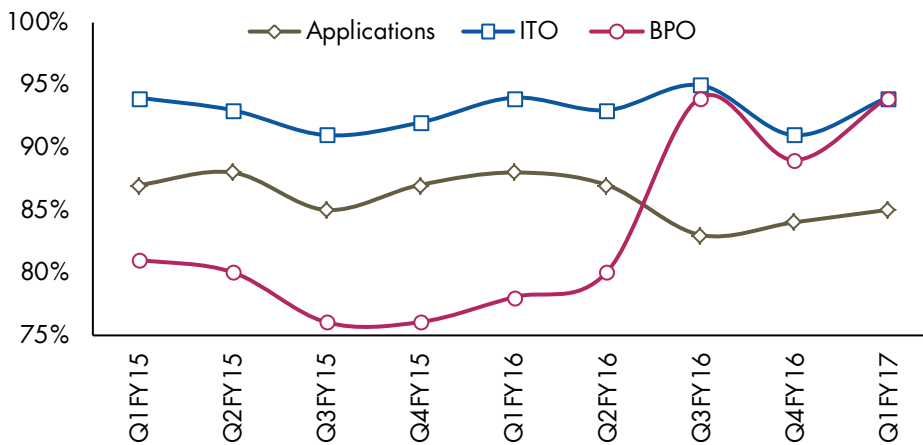
Source: Company, Axis Capital

Exhibit 4: Fixed price – low vs. industry, source of operating leverage



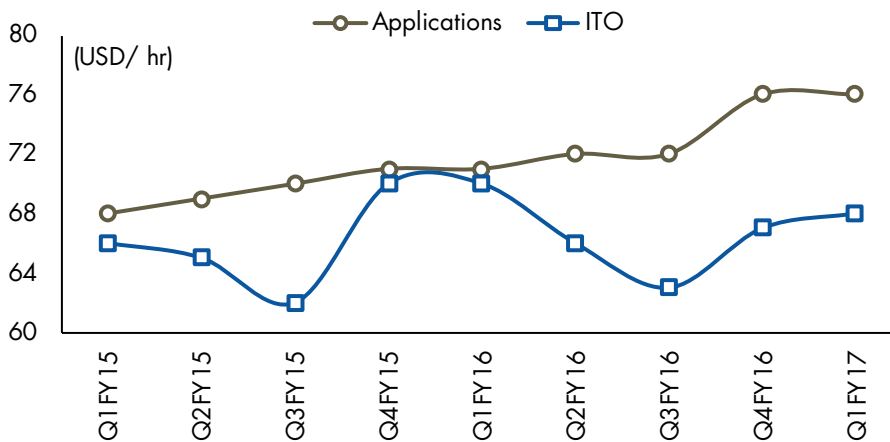
Source: Company, Axis Capital

Exhibit 5: Blended utilization across services (excluding trainees)

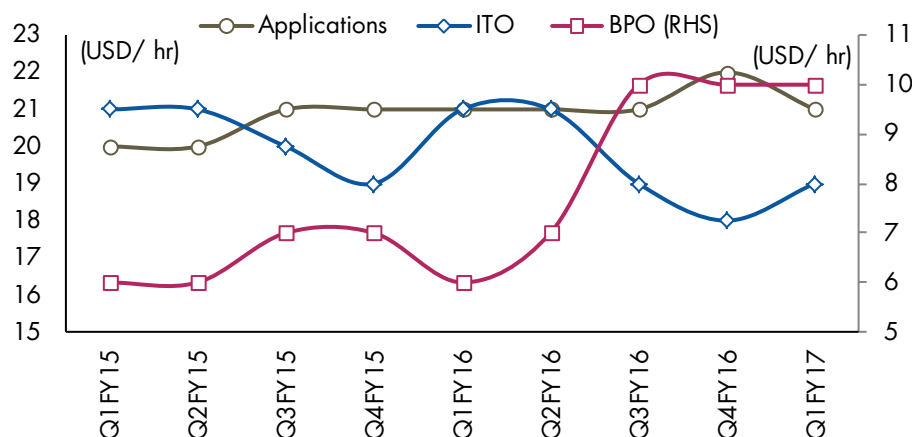


Source: Company, Axis Capital

Exhibit 6: Billing rates – Onsite



Source: Company, Axis Capital

Exhibit 7: Billing rates – Offshore


Source: Company, Axis Capital

Exhibit 8: Revenue concentration across top clients and client buckets

	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Top Client	10.0%	9.0%	8.0%	8.0%	9.0%	9.0%	10.0%	11.0%	11.0%
Top 5 Clients	35.0%	35.0%	35.0%	34.0%	35.0%	36.0%	37.0%	38.0%	39.0%
Top 10 Clients	49.0%	50.0%	49.0%	48.0%	47.0%	47.0%	48.0%	51.0%	53.0%
USD 1 mn revenues	110	104	100	102	98	100	102	103	102
USD 5 mn revenues	42	41	42	39	36	39	35	35	28
USD 10 mn revenues	17	17	17	19	20	19	18	14	15
USD 20 mn revenues	10	10	8	9	8	7	8	8	9

Source: Company, Axis Capital

Exhibit 9: Revenue across services lines; steady margin in BFSI

	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Banking and Capital Markets	6,616	7,273	7,516	7,336	7,376
Insurance	2,314	2,357	2,375	2,445	2,297
IT, Communication &Ent	2,135	1,975	1,511	1,626	1,545
Emerging Industries	3,854	3,914	3,720	3,760	3,872
Total	14,919	15,519	15,122	15,167	15,090
% share					
Banking and Capital Markets	44.3%	46.9%	49.7%	48.4%	48.9%
Insurance	15.5%	15.2%	15.7%	16.1%	15.2%
IT, Communication &Ent	14.3%	12.7%	10.0%	10.7%	10.2%
Emerging Industries	25.8%	25.2%	24.6%	24.8%	25.7%
Gross Margin [%]					
Banking and Capital Markets	17.2	19.9	20.8	22.7	23.8
Insurance	26.6	21.9	20.9	24.1	24.6
IT, Communication &Ent	27.9	31.4	33.4	36.9	30.3
Emerging Industries	34.4	35.6	30.3	32.6	33.0
Total	24.6	25.6	24.4	26.9	27.0

Source: Company, Axis Capital

Exhibit 10: Revenue by service lines (%)

	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Application Maintenance & Other Services	29.2	30.3	32.8	34.1	35.8
Application Development	24.8	24.0	22.7	24.5	23.2
Customer Service	5.3	4.3	2.3	2.0	1.9
Service / Technical Help Desk	2.0	1.8	1.7	2.3	2.1
Transaction Processing Service	6.5	6.7	7.0	7.1	7.0
Infrastructure Management Services	14.9	15.0	14.9	13.6	13.6
Knowledge Processes	17.2	17.9	18.7	16.3	16.2
License Income	0.0	0.0	0.0	0.1	0.2
Total	100.0	100.0	100.0	100.0	100.0

Source: Company, Axis Capital

Exhibit 11: Revenue by Geographies

	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Americas	73%	75%	76%	77%	77%
EMEA	10%	9%	10%	11%	11%
India / RoW	17%	16%	14%	12%	12%

Source: Company, Axis Capital

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Net sales	57,949	60,847	64,207	71,864
Other operating income	-	-	-	-
Total operating income	57,949	60,847	64,207	71,864
Cost of goods sold	(43,424)	(45,295)	(46,691)	(51,654)
Gross profit	14,525	15,552	17,516	20,211
<i>Gross margin (%)</i>	<i>25</i>	<i>26</i>	<i>27</i>	<i>28</i>
Total operating expenses	(6,804)	(7,291)	(7,757)	(8,250)
EBITDA	7,721	8,261	9,759	11,961
<i>EBITDA margin (%)</i>	<i>13</i>	<i>14</i>	<i>15</i>	<i>17</i>
Depreciation	-	-	-	-
EBIT	7,721	8,261	9,759	11,961
Net interest	(280)	(242)	(53)	-
Other income	1,681	1,671	2,243	2,760
Profit before tax	9,408	9,897	12,033	14,721
Total taxation	(2,630)	(2,683)	(3,316)	(4,122)
<i>Tax rate (%)</i>	<i>28</i>	<i>27</i>	<i>28</i>	<i>28</i>
Profit after tax	6,778	7,214	8,717	10,599
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	6,778	7,214	8,717	10,599
<i>Adj. PAT margin (%)</i>	<i>12</i>	<i>12</i>	<i>14</i>	<i>15</i>
Net non-recurring items	-	-	-	-
Reported net profit	6,778	7,214	8,717	10,599

Balance sheet (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Paid-up capital	2,101	2,102	2,102	2,102
Reserves & surplus	52,590	60,442	69,159	79,758
Net worth	54,691	62,544	71,261	81,860
Borrowing	5,753	4,608	4,608	4,608
Other non-current liabilities	500	730	730	730
Total liabilities	73,926	78,974	88,594	100,427
Gross fixed assets	10,055	9,300	11,675	13,184
Less: Depreciation	(8,499)	(8,128)	(9,669)	(11,394)
Net fixed assets	1,556	1,172	2,006	1,791
Add: Capital WIP	318	953	1,200	1,000
Total fixed assets	1,874	2,125	3,206	2,791
Total Investment	36,212	44,165	37,942	37,942
Debtors	6,306	6,530	7,036	7,876
Cash & bank	13,209	8,682	21,807	31,570
Loans & advances	10,332	10,762	11,434	12,580
Current liabilities	12,875	10,922	11,824	13,058
Net current assets	22,139	20,979	34,839	45,853
Other non-current assets	826	783	783	783
Total assets	73,926	78,974	88,594	100,427

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Profit before tax	9,408	9,897	12,033	14,721
Depreciation & Amortisation	-	-	-	-
<i>Chg in working capital</i>	<i>(1,024)</i>	<i>(3,367)</i>	<i>(735)</i>	<i>(1,251)</i>
Cash flow from operations	5,942	3,761	9,576	11,073
<i>Capital expenditure</i>	<i>599</i>	<i>120</i>	<i>(2,622)</i>	<i>(1,310)</i>
Cash flow from investing	4,655	(7,603)	3,601	(1,310)
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>1</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>1,439</i>	<i>(1,145)</i>	<i>-</i>	<i>-</i>
<i>Dividend paid</i>	<i>(3,931)</i>	<i>-</i>	<i>-</i>	<i>-</i>
Cash flow from financing	(2,665)	(1,323)	(53)	-
Net chg in cash	7,932	(5,165)	13,125	9,763

Key ratios

Y/E March	FY15	FY16	FY17E	FY18E
OPERATIONAL				
FDEPS (Rs)	32	34	41	50
DPS (Rs)	16	-	-	-
Dividend payout ratio (%)	50	-	-	-
GROWTH				
Net sales (%)	123	5	6	12
EBITDA (%)	98	7	18	23
Adj net profit (%)	119	6	21	22
FDEPS (%)	119.3	6.4	20.8	21.6
PERFORMANCE				
RoE (%)	12.8	12.3	13.0	13.8
RoCE (%)	11.0	11.2	12.6	13.8
EFFICIENCY				
Asset turnover (x)	1.2	1.1	1.1	1.3
Sales/ total assets (x)	0.8	0.8	0.8	0.8
Receivable days	40	39	40	40
FINANCIAL STABILITY				
Current ratio (x)	2.7	2.9	3.9	4.5
VALUATION				
PE (x)	16.8	15.7	13.0	10.7
EV/ EBITDA (x)	13.7	13.3	9.9	7.2
EV/ Net sales (x)	1.8	1.8	1.5	1.2
PB (x)	2.1	1.8	1.6	1.4

Source: Company, Axis Capital

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