

Mphasis Limited

March 29, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term / short term- non fund based facilities	700.0	700.0	[ICRA]AA+ (Stable) / [ICRA]A1+; Reaffirmed
Total	700.0	700.0	

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings factors the established position of Mphasis Limited (Mphasis/ the company) in the Information Technology (IT) and IT enabled services (ITeS) industry, vast experience of the management, solid execution track record, presence across business domains, verticals and healthy financial profile marked by strong growth in earnings and large cash reserves.

Mphasis' revenues grew by 7.7% and 18.8% YoY during FY2018 and 9MFY2019 respectively supported by higher order executions and new deal wins, including deals from clientele of Blackstone Group. The growth was also supported by the master services agreement (MSA) entered with Hewlett Packard Enterprise (HPE), which provides for minimum contract value of \$990 million over five years, apart from including Mphasis in its Preferred Provider Program. Mphasis continue to witness higher deal wins in its new generation services (~81% of total deal wins in Q3FY2019) wherein it enjoys better pricing and margins. On the margin front, Mphasis' operating margins expanded by 30 bps and 150 bps YoY during FY2018 and 9MFY2019 respectively which was also aided by enhanced scale, better pricing, automation and operating efficiencies. Overall, Mphasis' financial profile remains healthy marked by stable earnings, sizeable network, strong liquidity with large cash reserves, healthy capital structure and coverage metrics.

The ratings also consider the vulnerability of revenues and earnings to pricing pressure from competitors, foreign currency fluctuations, wage inflation, challenges of training and geo-political risks, with ~80% of revenues derived from North America. Further, Mphasis has to make steady payouts in the form of dividends or share buybacks to support the holding company, Marble Pte II Limited, wherein the repayments on the bond programme raised by Marble Pte II Limited are solely dependent on payouts from Mphasis.

Outlook: Stable

ICRA believes Mphasis will continue to benefit from its established position in the industry, MSA signed with HPE and additional opportunity of securing deals in Blackstone's portfolio. The outlook may be revised to Positive if substantial growth in revenue and profitability, strengthens the financial risk profile. The outlook may be revised to 'Negative' if cash accrual is lower than expected, or if any major capital expenditure, or higher than expected cash up streaming to Marble II Pte Limited, weakens the liquidity position of the company.

Key rating drivers

Credit strengths

Established position in the industry with long track record: Established in 2000, Mphasis is a mid-sized player catering to the IT / IT enabled Services / BPO industry in various domains such as banking and financial services, communication, insurance, etc. The company has strong domain expertise and offers wide range of services. Based on its expertise, the company continues to add new logos to its clientele which aided in healthy growth of its top line in recent years.

Access to Blackstone's clientele: Being a part of Blackstone Group, Mphasis has access to its investment portfolio and the company has leveraged the same since its acquisition. With Blackstone expanding its assets under management across verticals, new opportunities for client wins shall continue for Mphasis.

Strong growth in HP channel: Mphasis derives ~55-58% of its revenues from top 10 clients signifying moderate customer concentration. However, most of these customers are reputed companies which have been associated with Mphasis for long-term. Specifically, revenues from HP channel has grown sharply during FY2018 and FY2019 (following de-growth in FY2016/2017) primarily enabled by the five-year MSA entered for minimum contract value of \$990 million, apart from including Mphasis in its Preferred Provider Program. Revenue visibility remains strong supported by this contract, which also provide for additional three automatic renewals of two years each, apart from other its recurring orders.

Financial profile characterized by healthy revenue growth and debt and coverage metrics: During 9MFY2019, Mphasis witnessed strong growth of 18.8% YoY in revenues and 34% YoY in net profits. Mphasis' operating margins improved by 150 bps YoY during FY2018 and 9MFY2019 respectively which was also aided by enhanced scale, better pricing, automation and operating efficiencies. The financial profile remains healthy characterised by stable earnings, sizeable network, strong liquidity with large cash reserves, healthy capital structure and coverage metrics.

Credit challenges

Higher share of revenues from North America: With ~79% of revenues derived from North American market, Mphasis' revenues and earnings are exposed to macro environment uncertainties in the USA pertaining to IT budgets, which could result in demand compression, pricing pressure and increased credit risk from vulnerable clients.

Moderate scale of operations: With revenues of Rs. 6,548 crore in FY2018, Mphasis' scale of operations is moderate operating in the USD ~160 billion Indian IT industry, thereby restricting its pricing flexibility and margins. Also, inherent to the industry, the company's margins are susceptible to wage inflation and forex related risks, although hedging mechanisms employed by the company mitigate the same to an extent.

Steady payout to support parent's debt obligations: In FY2017, Blackstone Group acquired stake in Mphasis through an investment holding entity, Marble II Pte Limited (rated Ba2 by Moodys), which raised 5.3% senior notes for \$500 million (due in June 2022). The bond indenture mandates the coupon and principal to be serviced through payouts from Mphasis, necessitating steady outflows from Mphasis. Mphasis' dividend payouts during FY2018 and 9M FY2019 was Rs. 394.9 crore and Rs. 466.1 crore respectively; the company also did a share buyback in Dec 2018 wherein the total payout was Rs. 988 crore.

Liquidity Position:

Mphasis's liquidity profile is strong with cash reserves and investments of Rs.1,812 crore as of December 31, 2018.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Information Technology
Parent/Group Support	-
Consolidation / Standalone	Consolidated

About the company:

Mphasis is a mid-sized IT company primarily engaged in providing IT / ITeS / BPO services catering to clients in the banking and capital markets, emerging industries, information technology, communication and entertainment and insurance. The company derives its revenues primarily from software services & projects, licensing arrangements & application services, infrastructure outsourcing services. Headquartered in Bangalore, the company has presence across US, Europe, Australia, Asia Pacific, Japan and India.

Mphasis was incorporated in August 1992, as BFL Software Limited. Its name was changed to Mphasis BFL Limited in July 2000 after the merger of the US-based IT consulting company Mphasis Corporation (founded in 1998) and the Indian IT services company BFL Software Limited which was founded in 1993. In June 2006, Electronic Data Systems Corporation (EDS) acquired Mphasis, and later EDS was acquired by Hewlett-Packard (HP, rated Baa2 by Moodys); thereby resulting in Mphasis becoming a 60.47% subsidiary of HP. However, in September 2016, global private equity major Blackstone Group acquired HP's stake through its SPV – Marble Pte II Limited. During May 2018, Marble II Pte. sold off 8% of its stake in the company for ~Rs.1,400 crore, reducing its shareholding to 52.3%. Mphasis acquired Stelligent Systems LLC in Nov 2018 for a consideration of \$25 million.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	6,076.4	6,545.8
PAT (Rs. crore)	791.6	837.5
OPBDIT/OI (%)	15.9%	16.2%
RoCE (%)	17.6%	18.7%
Total Debt/TNW (times)	0.0	0.1
Total Debt/OPBDIT (times)	0.3	0.4
Interest coverage (times)	69.8	81.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years			
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding as on Dec-18 (Rs. crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
1	Long-term/short-term-	700.0	-	Mar 2019	Dec 2017	Jun 2016	Jun 2015
Non fund based facilities				[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based/ non-fund based	NA	NA	NA	700.0	[ICRA]AA+ (Stable)/ [ICRA]A1+

Source: MPPL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Mphasis Corporation	100%	Full consolidation
Mphasis Deutschland GmbH	100%	
Mphasis Australia Pty Limited	100%	
Mphasis (Shanghai) Software & Services Company Limited	100%	
Mphasis Consulting Limited	100%	
Mphasis Ireland Limited	100%	
Mphasis Belgium BVBA	100%	
Mphasis Lanka (Private) Limited	100%	
Mphasis Poland s.p.z.o.o	100%	
PT. Mphasis Indonesia	100%	

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