April 07, 2020

Mphasis Limited: Ratings re-affirmed

Summary of rated instruments

Instrument*	Previously 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 in Annexure - I

Rationale

The ratings remain supported by 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, and strong execution track record, presence across business domains with increasing focus on new generation service offerings. Stable demand for outsourcing coupled with strategic tie-ups with its key clientele and healthy financial profile marked by sustained growth in earnings and large cash reserves further underpin the ratings.

Mphasis' financial profile remains healthy marked by stable earnings, sizeable networth, strong liquidity with large cash reserves, healthy capital structure and coverage metrics. The revenues grew by 18.1% and 13.9% YoY during FY2019 and 9MFY2020 respectively supported by higher order executions and new deal wins. The growth was also supported by stable revenue contribution from Hewlett Packard (HP) channel backed by the master services agreement (MSA), which provides for minimum contract value of $990 million over a period of five years. Post the term, contract renewals of three consecutive two-year terms lends visibility to revenues. Direct Core segment, which contributes ~72% of revenues, has witnessed stable growth supported by addition of new clients to its portfolio across verticals, including deals from clientele of Blackstone group (parent). Mphasis' operating margins expanded by 90 bps and 140 bps YoY during FY2019 and 9MFY2020 respectively aided by enhanced scale and operating efficiencies.

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

The Indian IT services industry continues to face geopolitical uncertainties such as proposed legislations on restricting outsourcing or immigration in its key markets, which may have an adverse impact on the current business model of the industry. The demand for IT services remains exposed to macro-economic uncertainties such as a growth slowdown in key markets in the US and Europe and the Brexit-related challenges, which may pose a challenge to the Indian IT services industry. ICRA expects COVID-19 to adversely impact the performance of IT services sector and has revised its US$ growth estimates for FY2021 to 3%-5% from 6%-8% earlier.

The Stable outlook on the [ICRA]AA+ rating reflects ICRA's opinion that Mphasis will continue to benefit from its long track record of operations, established clientele, and healthy financial risk profile.

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: Given the Blackstone Group's parentage, 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 and geographies, new opportunities for client wins shall continue for Mphasis.

Stable revenue flow from HP channel and improving momentum from Direct Core segment: Mphasis derives ~60% of its revenues from top 10 clients signifying moderate customer concentration. However, most of the customers have long-standing association with the company. While the revenue growth from HP channel was strong in FY2019, the same had decelerated during 9m FY2020 but revenue from the same is expected to be steady over the medium term, primarily enabled by the five-year MSA entered for minimum contract value of $990 million. Post the term, contract renewals of three consecutive two-year terms lends visibility to revenues. Direct Core segment, which contributes ~72% of revenues, has witnessed stable growth supported by addition of new clients to its portfolio across verticals, including deals from clientele of Blackstone group (parent).

Financial profile characterized by healthy revenue growth and debt and coverage metrics: During 9MFY2020, Mphasis witnessed strong growth of 13.9% YoY in revenues. Mphasis' operating margins expanded by 90 bps and 140 bps YoY during FY2019 and 9MFY2020 respectively aided by enhanced scale and operating efficiencies. The company's financial risk profile remains healthy characterised by stable earnings, sizeable networth, strong liquidity with large cash reserves, healthy capital structure and coverage metrics. As of December 2019, the company's cash and liquid investments was robust at Rs. 2235.9 crore

Credit Challenges

Higher share of revenues from North America and moderate customer concentration: With ~80% of revenues derived from North American market in 9M FY2020, 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. Mphasis derived about 60% of its revenues from top ten clients during 9M FY2020 signifying moderate customer concentration. However, given its long-standing and strategic association with the clients mitigates the concentration related risks.

Moderate scale of operations: With revenues of Rs. 7,731 crore in FY2019, Mphasis' scale of operations is moderate operating in the USD ~175 billion Indian IT industry, thereby restricting its pricing flexibility and margins. Also, inherent to the industry, the company's profit 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 FY2019 and 9M FY2020 was Rs.466.2 crore and Rs 606.5 crore respectively.

Liquidity Position: Strong

Mphasis's liquidity profile is strong with cash reserves and investments of Rs. 2,129.3 crore as of December 31, 2019 and no repayment obligations in the absence of any long-term loans.

Rating Sensitivity factors

Positive Triggers

- Sustained improvement in the scale of operations, together with reduced reliance on U.S. market and sustained improvement in profit margins, which is turn will result in higher cash flow from operations.

Negative Triggers

- Sharp deterioration in financial profile emanating from weak end-user demand and / or higher than expected dividend outflow or any large debt funded acquisition will be a trigger for rating downgrade

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Information Technology
Parent/Group Support	NA
Consolidation / Standalone	The rating is based on standalone financial statements of the company

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 acquired Mphasis, and later EDS was acquired by Hewlett-Packard; 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%.

Key financial indicators (audited)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	6,545.8	7,731.0
PAT (Rs. crore)	837.5	1,073.4
OPBDIT/OI (%)	16.2%	17.1%
RoCE (%)	18.7%	24.6%
Total Debt/TNW (times)	0.1	0.1
Total Debt/OPBDIT (times)	0.4	0.4
Interest coverage (times)	81.7	76.2

Source: the company

Status of non-cooperation with previous CRA: NA

Any other information: None

Rating history for last three years:

	Instrument	Type	Current Rating (FY2020) Amount Rated (Rs. crore)	Amount Outstanding as on Mar-20 (Rs. crore)	Date & Rating 07-Apr 2020	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019 29-Mar 2019	Date & Rating in FY2018 22-Dec 2017	Date & Rating in FY2017 28-Jun 2016
1	Non-fund based facilities	Long-term/ short term-	700.0	-	[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	Non-fund based	NA	NA	NA	700.0	[ICRA]AA+ (Stable)/ [ICRA]A1+

Source: Company

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%	

Source: Company

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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