No longer tethered to HP's business, Mphasis turns over a new leaf with 'four pillar' strategy

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Mphasis building in Bangalore

Synopsis

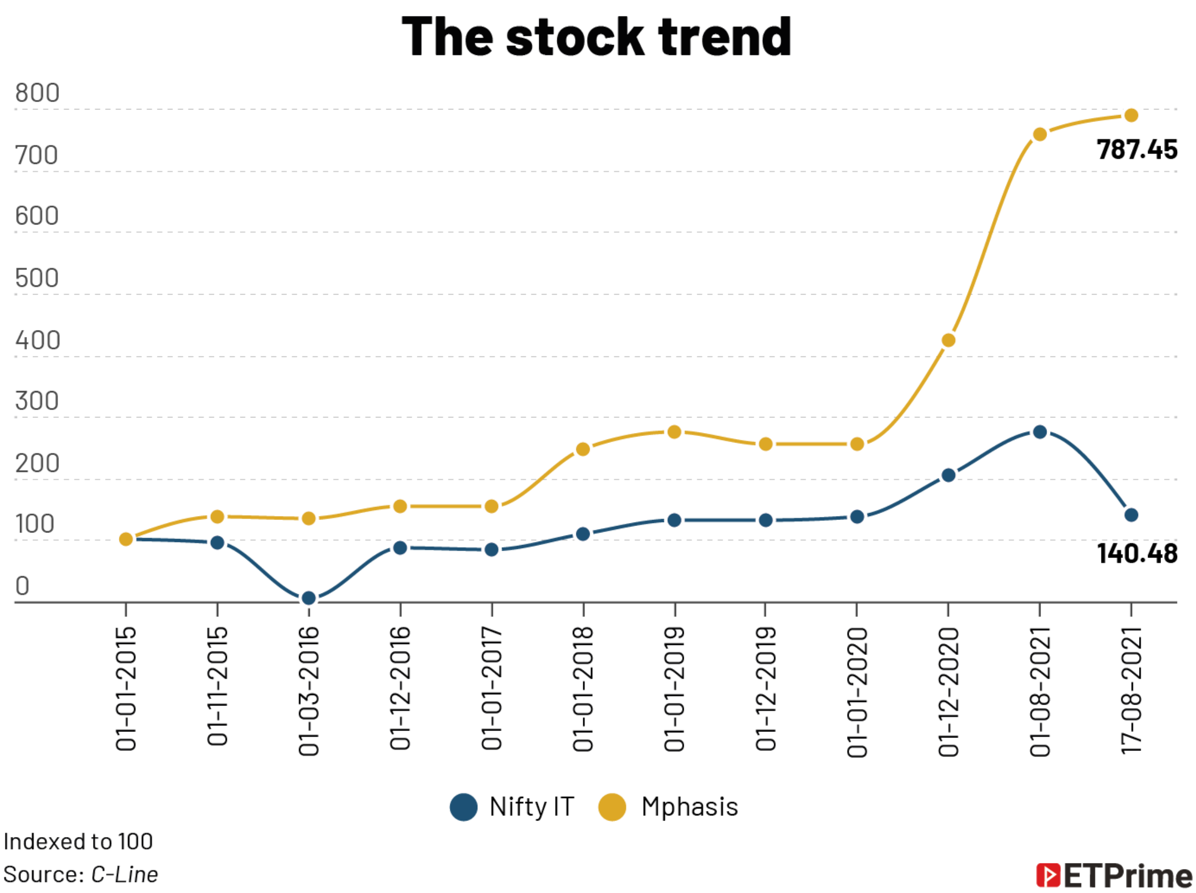
Till about a decade ago, business from erstwhile owner HP used to account for about 70% of Mphasis's revenue. That has now dropped to less than a tenth of the total. With Blackstone's backing, Mphasis has set out to chart its own course. It is shoring up management talent, building new businesses and capabilities, and expanding to more geographies.

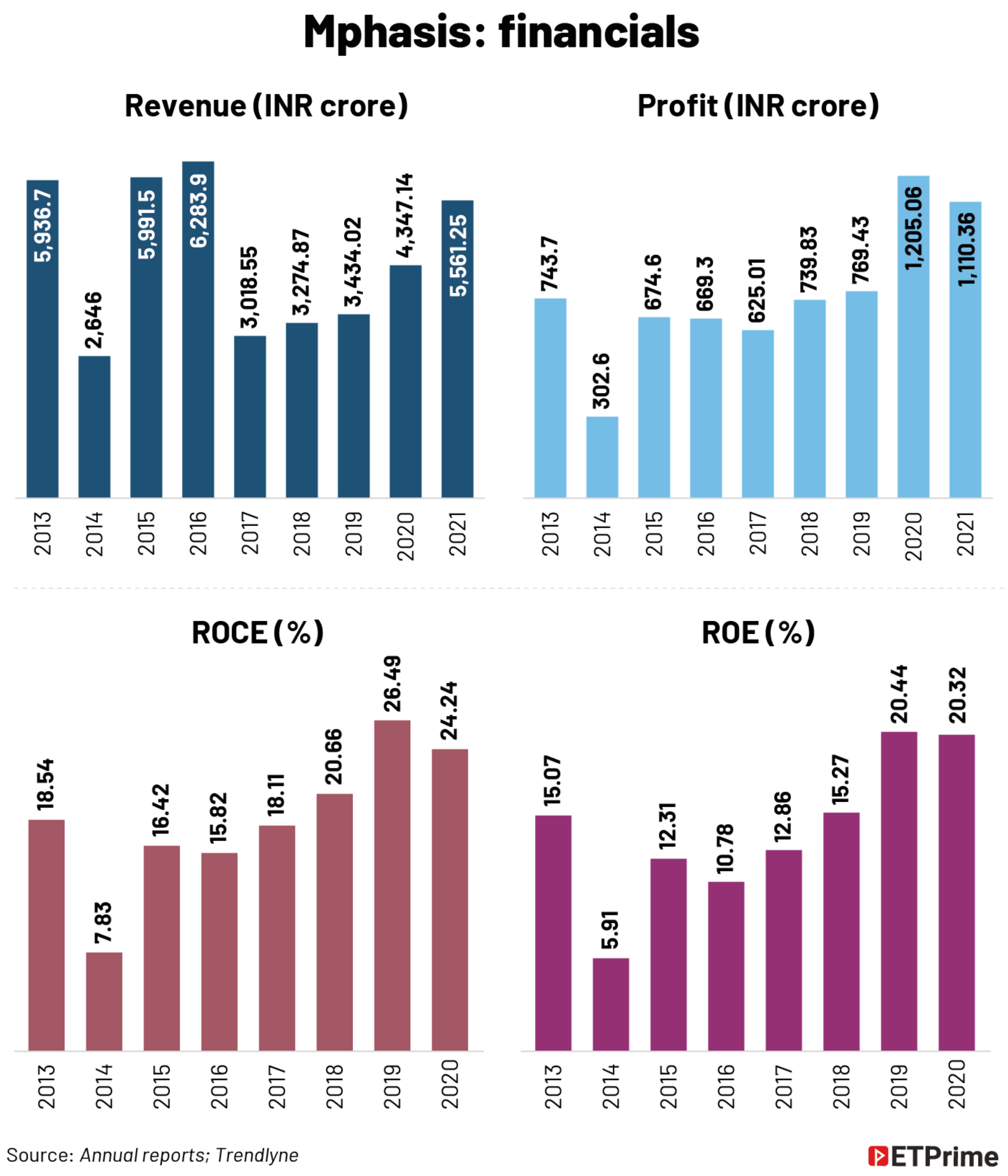
When most companies report earnings, their performance (or lack thereof) tends to be the highlight of the show. But for over a decade, Mphasis was not like most companies. Its performance was tied to the performance of its constantly changing owner — first, Electronic Data Systems (EDS), and then, HP.

Even after HP sold its stake to private-equity player Blackstone, the company continued to be a large contributor to Mphasis's revenue. But HP's business was not stable. It split its business, then merged part of it with CSC to create DXC Technology, which has effectively been in restructuring mode since it began. As a natural result, Mphasis struggled.

At the end of 2010, Mphasis had crossed USD1 billion in revenue, 12 years after it began, and was one of the only four at that point that had managed the feat. The company had no intention of taking another 12 to reach USD2 billion, its then top management told analysts. At the end of FY21, the company's revenue was USD1.31 billion.

Now, for the first time, revenue from the erstwhile HP business has dropped to less than a tenth of the overall revenue, after a long, painful contraction. Mphasis, with Blackstone backing it for the second time, is effectively in charge of its own destiny. Hiring new management, building out new businesses and technology capabilities and expanding to new geographies are part of the new 'four pillar' strategy. ET Prime takes a look.





Passing the parcel

Founded by Jerry Rao and Jeroen Tas in 1998, Mphasis was first acquired by BFL Software in 2000. The combined entity retained the Mphasis name. Six years later, outsourcing giant EDS bought a nearly 42% stake in the company for USD380 million. EDS also merged its India arm with Mphasis, and, in return, was issued shares that took its stake to over 60%.

In 2008, Hewlett-Packard bought EDS for USD14.9 billion and acquired its stake in Mphasis along with it. EDS began to go to market as HP Enterprise Services.

Under its deal with HP, Mphasis not only worked with HP as a client but was also effectively a sub-contractor, getting business with HP clients and had a rate card that was negotiated. At the end of FY10, the HP channel accounted for about 70% of Mphasis's revenue, which even back in 2011 was beginning to show decline.

Mphasis had to mitigate concentration risk. In 2010, the company talked for the first time about being more aggressive in bringing in business directly and began to invest in building out those teams. By FY12, the share of HP revenue had come down to about 54%, partly because revenue itself had continued to decline, hurt by the financial crisis. That year, HP would write off USD8 billion in EDS's valuation.

"If you look at it, the Mphasis standalone business stagnated after the EDS acquisition. When you are getting large amounts of business without having to invest in sales and marketing, you would naturally focus on that. To restart that process later is harder, because you need to restructure how you do things. We did well, but it was not possible to immediately counter the drop in (HP) revenue," says a former Mphasis executive.

In virtually every quarter, Mphasis would talk up its direct international growth and inform the market that the HP revenue continued to disappoint. In 2014, HP split into two businesses — Hewlett Packard Enterprise (HPE) and HP Inc. While HPE would provide data centre and infrastructure services, networking, and software, HP Inc would sell printers and computing devices.

By 2016, HP revenue had been falling practically every quarter for four years. HP also wanted out of the business and Mphasis was on the block. In April, private-equity player Blackstone bought the company for the first time, a deal that valued Mphasis at over USD1 billion.

To sweeten the deal for the PE player, HP offered a minimum revenue commitment — it would guarantee USD990 million in revenue to Mphasis over five years. With the ownership change, came a leadership change. In February 2017, long-time Mphasis CEO Ganesh Ayyar stepped down and former Syntel CEO Nitin Rakesh took the helm. Soon after, HP Enterprise Services merged with Computer Sciences Corporation to form DXC. The revenue commitment that HP had made was shifted to DXC.

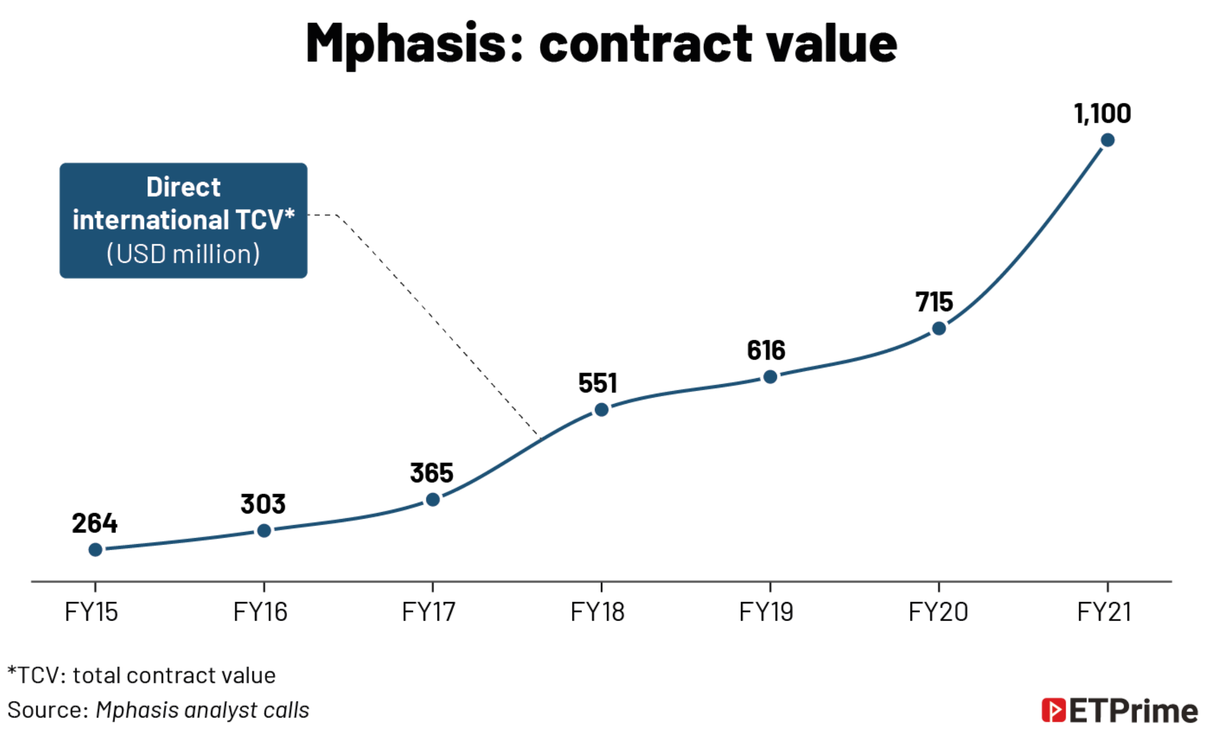
While the revenue commitment meant business from the HP channel subsequently showed growth, the creation of DXC meant large amounts of restructuring. DXC also wanted to cut down the amount it spent on subcontracting. So, the minimum revenue commitment was harder to reach. In February 2021, over USD50 million was outstanding, which would need to be consumed by this September.

Nor was the minimum revenue commitment going to be renewed. That was a strictly one-time offer to sweeten the initial Blackstone buyout. (When Mphasis reported results last month, the company was asked if it was considering invoking penalty clauses against DXC if the revenue commitment was not met.)

While Mphasis would continue to have some contribution from DXC, there were no guarantees anymore and past performance was not encouraging. At the same time, IT valuations were soaring, and Blackstone was trying to sell out its holding to another PE firm. Though Carlyle was the last PE firm in the fray, there was no agreement on price.

Finally, Blackstone announced that it would be selling its stake in Mphasis to other funds advised by Blackstone and bringing in the Abu Dhabi Investment Authority and UC Investments, committing about USD2.8 billion to acquire a controlling stake. Blackstone had initially purchased a majority stake in Mphasis in 2016 from HP at INR430 a share. Based on offer documents, the blended acquisition price for this deal was over INR1,400 a share.

"The HP/DXC issue was a significant overhang. It is finally less of a problem. Sure, there won't be guaranteed revenue coming in, but the company is no longer tied to a large struggling firm. Having control of your own fate is important," says the former Mphasis executive.



Charting its own course

One of the key points of the Blackstone deal was for the company to be able to sell into Blackstone's other portfolio companies. Back when the first deal was announced, the portfolio consisted of about 80 companies, with over USD1.5 billion in addressable IT spend. Mphasis targeted about 20 of those and began to mine them for contracts.

Blackstone had a strategy of helping its portfolio companies with business with each other. When Blackstone owned BPO Intelenet (which was later acquired by Teleperformance), the BPO company received as much as 20% of its revenue from other portfolio firms, CEO Rakesh pointed out in 2018. While that was not meant to be taken as guidance, he told analysts, it gave an idea of the company's aspirations. At the end of FY20, Blackstone portfolio companies' revenue accounted for about 5% of Mphasis' total, so there remains significant room for growth.

"The good thing about Mphasis is that they know what they are good at and don't claim that they can do everything. They are very honest with clients about it. But as they scale, they need to get better at marketing."

— Mrinal Rai, principal analyst, ISG

For Mphasis, there has never been a better time to take control of its own destiny. The pandemic has pushed demand for IT services to new heights and there are more than enough deals in the market for everybody to grow. The company also ploughed the cost savings from travel during the pandemic into investments for growth, keeping its margin stable, while other players expanded their margins.

This showed up in the company's deal wins. At the end of FY21, the average size of large deals was USD75 million, up 2.5 times from two years.

Now, the company is betting on a 'four-pillar strategy' to drive sustainable growth. They are:

1. Improving capabilities by hiring specialists in its cloud unit, and other domain experts
2. Geographic expansion of sales and delivery — into markets such as Canada, and expanding its Europe focus by pushing into the Nordics and Germany, Austria, and Switzerland
3. Improving its leadership pool and promoting talent
4. Expanding IP-driven offerings in artificial intelligence and machine learning

The strategy is already being implemented. Mphasis opened its Canada office in Calgary and has begun a hiring programme for senior leadership. In April, the company brought in Paritosh Sharma to head strategic accounts and sales. Sharma was previously general manager and head of Europe for Wipro. The company has also hired and promoted over 20 people to its vice-president and senior vice-president leadership pool.

Another key part is the client-acquisition programme, which the company has reinvigorated over the past few quarters. Here the company focuses on five verticals — banking and financial services, insurance, hi-tech, logistics and healthcare.

"We have an elaborate operating model in place to transition newly acquired clients to strategic-client status, with the client-engagement structure and investments defined through the phase of the transition. We are pleased with the outcomes of our NCA (new client acquisition) strategy," says CEO Rakesh.

He points out that hi-tech is on its way to becoming a USD100 million vertical and that the company has added a significant number of new clients. For example, Mphasis now has all top 10 US banks by asset size as clients. Three years ago, only five in this category were customers.

But experts say Mphasis still has work to do on growth.

"The good thing about Mphasis is that they know what they are good at and don't claim that they can do everything. They are very honest with clients about it. But as they scale, I would think they need to get better at marketing," says Mrinal Rai, principal analyst with IT-advisory firm ISG. He adds that the company will also need to improve its partnership with hyperscale cloud players.

(*Data support by Rochelle Britto; graphics by Mohammad Arshad*)
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