

# Mphasis BFL

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## Shareholding (%)

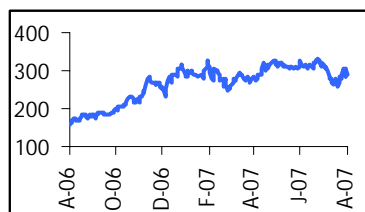
Foreign Promoters	50.5
FII's	11.6
MFs	11.0
Others	26.9

## Share price performance

52-week high/low (Rs)	341/155		
	-1m	-3m	-12m
Abs (%)	-5.7	-8.0	86.3
Rel* (%)	-4.7	-12.3	51.0

\*to Nifty

## Stock chart



## Strong growth despite rupee appreciation; upgraded to 'accumulate'

Mphasis BFL (Mphasis), for the first time, declared consolidated numbers post its merger with EDS India. In Q1FY08, Mphasis reported revenues of Rs5.3bn and net profits of Rs513mn, a sequential increase of 5.5% and a decline of 18.4% respectively. The company's operating margins declined only 64 bps QoQ, despite rupee appreciation of more than 6% and salary hikes to 60% of the employees.

We are introducing our consolidated FY08E and FY09E estimates, post the legal completion of Mphasis' merger with EDS India in Q1FY08 and the disclosure of the merged entity's data. We expect Mphasis to post an EPS of Rs 13.6 and Rs 18.0 in FY08E and FY09E respectively, implying a two-year EPS CAGR of 44.4%.

Mphasis reported negative returns in the past one quarter due to rupee appreciation. EDS India, however, is showing increased traction in its application business; consequently, we expect a majority of the work to be off-shored to Mphasis. Therefore, Mphasis is expected to grow much faster than its peers.

Currently, Mphasis is quoting at FY08E and FY09E PER of 22.2x and 16.8x respectively. We believe that at the current valuations, there is some upside to the stock. Therefore, we upgrade our view on the stock from 'Reduce' to an 'Accumulate', with a target price of Rs 325, 18x FY09E earnings.

## Key highlights of Q1FY08 are:

- ▲ **Revenues grow 5.5% sequentially:** During Q1FY08, Mphasis' consolidated revenues grew by about 12% in dollar terms; a rupee appreciation of more than 6%, however, meant that the revenue growth in rupee terms was at 5.5%. The application business grew 7.6% to Rs 3.47 bn, whereas the BPO business reported a decline of 0.2% sequentially to Rs 1.2 bn. The company, for the first time, reported ITO revenues (infrastructure management); the division's revenues increased 5.9% sequentially to Rs 597 mn.

## Accumulate Rs292

9 August 2007

### Market cap

Rs bn 61

US\$ mn 1,500

### Avg 3m daily volume

803,555

### Avg 3m daily value

USD mn 6

### Shares outstanding (mn)

208

### Reuters

BFLS.BO/MPHASIS

### Bloomberg

BFL IN

### Sensex

15,100

### Nifty

4,403

## Mphasis BFL

- ▲ **Operating margins decline by 64bps:** Rupee appreciation of more than 6% and salary hikes to about 60% of the employees had a negative impact of more than 300bps on the company's operating margins (EBIT). However, this decline was restricted to 64bps due to lower SG&A expenses, as the company benefited from economies of scale.

The margins are expected to increase, going forward, on account of:

- a) benefits from economies of scale
  - b) lower per capita employee cost
- ▲ **Higher forex losses impacts net income:** Mphasis reported forex loss of Rs 179 mn in Q1FY08 as against a loss of Rs 34 mn in Q4FY07. The higher forex loss resulted in an 18.4% decrease in net profits, despite the sequential increase in EBIT by 0.4% to Rs 673 mn.
  - ▲ **Employee addition shows good visibility:** Mphasis added a net of 2,000 employees in Q1FY08, with about 900 additions in the applications business, 550 in the BPO business, and 590 in the ITO business. The company has added around 4,500 employees in the last two quarters and is expected to add another 4,500 in H2CY07. We believe that the addition of employees is likely to result in execution of more contracts, indicating good revenue visibility going forward.
  - ▲ **Business from clients of EDS India flows in:** Mphasis is witnessing an increased visibility from EDS as a client as well as from EDS clients. Mphasis is expected to benefit from the increased traction in EDS India's application business. EDS India signed contracts of around USD 1.8 bn in Q2CY07. We believe that Mphasis would benefit from these new contracts, as EDS India is expected to offshore significant work to Mphasis.
  - ▲ **Financials:** Mphasis, for the first time, reported its consolidated numbers, after the legal completion of its merger with EDS India. We, therefore, are introducing our consolidated numbers for FY08E and FY09E respectively. We expect Mphasis to report an EPS of Rs 13.6 and Rs 18.0 in FY08E and FY09E respectively, implying a two-year EPS CAGR of 44.4%.
  - ▲ **Valuations:** Mphasis has underperformed the indices in the past one quarter on account of rupee appreciation. However, we believe that the synergies with EDS could help Mphasis increase traction in its business. Therefore, at the current FY08E and FY09E PER of 22.2x and 16.8x respectively, there is still some upside to the stock. Further, Mphasis is expected to grow at a two-year EPS CAGR of 44.4%; this is significantly higher than its peers. Therefore, we upgrade our view on Mphasis from **'Reduce'** to an **'Accumulate'** with a price target of Rs325, 18x FY09E earnings.

## Mphasis BFL

**Table 1: Quarterly result table**

Rs mn	Q1FY08	Q4FY07	Q-o-Q (%)	Q1FY07	Y-o-Y (%)
Revenues	5,316	5,040	5.5%	3,756	41.5%
Application	3,475	3,231	7.6%	2,662	30.5%
BPO	1,244	1,246	-0.2%	920	35.2%
ITO	597	563	5.9%	174	242.4%
Cost of Revenues	3,979	3,704	7.4%	2,940	35.4%
Gross Profit	1,336	1,336	0.0%	817	63.6%
GPM	25.1%	26.5%		21.7%	
SG&A	663	666	-0.3%	521	27.3%
EBIT	673	670	0.4%	295	127.8%
EBIT Margin	12.7%	13.3%		7.9%	
Forex gains/Losses	(179)			80	
		(34)			
Other Income	33	27	22.7%	15	
Provision for doubtful debts	0	1	-21.8%	5	-91.1%
PBT	526	663	-20.6%	386	36.3%
Tax	13	34	-62.4%	60	-78.5%
Tax rate	2.4%	5.1%		15.4%	
Net Income	513	629	-18.4%	326	57.2%
NPM	9.7%	12.5%		8.7%	

Source: IISL Research, Company

**Table 2: Estimates (Consolidated)**

Rs mn	FY07	FY08E	FY09E
Revenues	17,606	24,159	31,666
% change		37.2%	31.1%
EBITDA	3,075	4,537	5,725
% change		47.6%	26.2%
Net Profit	1,801	2,834	3,752
% change		57.4%	32.4%
EPS (Rs)	8.7	13.6	18.0
PE (x)	35.0	22.2	16.8
ROCE (%)	28.4%	28.6%	29.7%
ROE (%)	21.6%	25.3%	27.1%

Source: IISL Research, Company

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