

Dismal performance writ all over

February 25, 2011

Reco	Previous Reco
Reduce	Hold
CMP	Target Price
Rs 455	Rs 450
EPS change FY11E/12E (%)	(24) / (24)
Target Price change (%)	(25)
Sensex	17,632
Nifty	5,263

Price Performance

(%)	1M	3M	6M	12M
Absolute	(9)	3	1	(15)
Rel. to Nifty	(2)	15	5	(21)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	IT Services
Bloomberg	MPHL@IN
Equity Capital (Rs mn)	2100
Face Value(Rs)	10
No of shares o/s (mn)	210
52 Week H/L	752/545
Market Cap (Rs bn/USD mn)	132/2,906
Daily Avg Volume (No of sh)	409515
Daily Avg Turnover (US\$m)	5.8

Shareholding Pattern (%)

	D'10	S'10	J'10
Promoters	60.5	60.6	60.6
FII/NRI	18.0	18.3	18.3
Institutions	8.0	7.7	7.7
Private Corp	8.3	7.8	7.7
Public	5.2	5.6	5.8

Source: Capitaline

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- **Mphasis's results have sparked a sharp pull down in share price and we see no respite to co's woes given 24% EPS cuts for FY12/13 given patchy disclosures in the recent past**
- **We factor in 5.5%/16% YoY rev growth for FY12/13 (V/s 23.5/19.5% earlier) and build in lower op mgns at 19.5%/19.6%(despite lower currency resets) driving a 24%/25% cut in Oct'11/Oct'12 EPS to Rs 37.8/41.3**
- **Mphasis' s Jan'11 results vindicate our downgrade on stock in Nov'09 with co continuing to surprise both on revenues/margins in atleast 4 of the past 5 quarters**
- **Lower ratings to REDUCE with a revised TP of Rs 450, based on ~11x Oct'12 EPS with a possible open offer from HP remaining a key upside risk to our call**

See no respite to Mphasis's woes

Mphasis's Jan'11 results missed expectations massively thereby resulting a sharp negative reaction to the stock price. However we are clearly perturbed and baffled by Mphasis's disclosures in the past few quarters with co indicating that Oct'10 quarter had the benefit of one time revenues of ~US\$ 9 mn along with certain provision write backs (Rs 230 mn). We clearly are surprised as in that case it should have disclosed to investors/ analysts during Oct'10 results which clearly wasn't the case. Further company's quarterly results report which was amongst the best in the sector until late FY10 has only suffered in the recent past with restatements, reclassifications and no disclosure of key metrics every quarter now.

Mphasis's margins back to July'08 levels, further pressure ahead

Mphasis's EBIT margins have shrunk to 13.2% (ex benefit from hedging gains and provision write backs in Jan'11 quarter), **near July'08 levels of 13.3% and most notably below co's guided range of 18-20%** (Company closed FY ending Oct'10 at 21.7%). We highlight that we see more downside surprises to our EBIT margins of 16.7%/17% for Oct'11/Oct'12 emanating from (1) supply side pressures (*wage pressures still to be implemented for Mphasis , certainly higher for Mphasis given high attrition and a greater proportion of offshore business/manpower*), (2) further impact of pricing cuts for the HP sourced business and (3) step up in SG&A expenses as company tried to grow the direct business more aggressively (*note that Mphasis's SG&A expenses at ~8% is the lowest across the sector currently*).

Quarter's show damages 'cheap valuation, strong MNC offshoring' thesis

Mphasis's Jan'11 results damage optimistic beliefs on 'cheap valuations for a predictable and strong volume growth play driven by offshoring from HP' within certain quarters of the street. We cut our Oct'11E/Oct'12E earnings by ~24%/24.4% to Rs 37.8/41.3 despite aid from lower currency resets to Rs 45/\$ (V/s Rs 44/\$ earlier). We cut our ratings to REDUCE (V/s HOLD earlier) with a revised TP of Rs 450 (V/s Rs 600 earlier) with a potential open offer by HP remaining the key risk to our call

Y/E Oct	Net	EBITDA	EBITDA	PAT	EPS	ROE	P/E	EV/	P/B
(in Rs mn)	Sales		%		(Rs)	%	(x)	EBITDA	(x)
FY10	42,639	11,275	26.4	9,087	43.3	48.1	10.5	7.6	4.1
FY11	50,366	12,649	25.1	10,908	51.9	38.7	8.8	6.3	2.9
FY12E	52,321	10,219	19.5	7,977	37.8	23.6	12.0	7.2	2.4
FY13E	60,380	11,861	19.6	8,721	41.4	23.1	11.0	5.7	2.0

Key Financials - Quarterly

Rs mn	Q Jan'10	Q April'10	Q July'10	Q Oct'10	Q Jan'11	YoY (%)	QoQ (%)	YTD'12	YTD '11	YoY (%)
Revenue	11,916	12,205	12,791	13,454	12,335	3.5	(8.3)	12,335	11,916	3.5
Operating Expenditure	8,780	9,055	9,632	10,250	9,761	11.2	(4.8)	9,761	8,780	11.2
Cost of revenues	7,794	8,077	8,598	9,051	8,769	12.5	(3.1)	8,769	7,794	12.5
as % of sales	65.4	66.2	67.2	67.3	71.1			71	65	
SG&A expenses	987	978	1,034	1,199	992	0.6	(17.3)	992	987	0.6
as % of sales	8.3	8.0	8.1	8.9	8.0			8	8	
EBITDA	3,136	3,150	3,159	3,204	2,574	(17.9)	(19.7)	2,574	3,136	(17.9)
Depreciation	458	402	404	374	359	(21.5)	(3.9)	359	458	(21.5)
EBIT	2,678	2,748	2,755	2,830	2,215	(17.3)	(21.7)	2,215	2,678	(17.3)
Other Income	330	275	174	310	347	5.4	12.1	347	330	5.4
PBT	3,008	3,023	2,929	3,140	2,562	(14.8)	(18.4)	2,562	3,008	(14.8)
Total Tax	325	350	217	300	295	(9.2)	(1.7)	295	325	(9.2)
Adjusted PAT	2,683	2,673	2,712	2,840	2,267	(15.5)	(20.2)	2,267	2,683	(15.5)
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0			0	0	
APAT after MI	2,683	2,673	2,712	2,840	2,267	(15.5)	(20.2)	2,267	2,683	(15.5)
Extra ordinary items	0	0	0	0	0			0	0	
Reported PAT	2,683	2,673	2,712	2,840	2,267	(15.5)	(20.2)	2,267	2,683	(15.5)
Reported EPS	12.8	12.7	12.9	13.5	10.8	(15.5)	(20.2)	11	13	(15.5)

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	26.3	25.8	24.7	23.8	20.9	(545)	(295)	20.9	26.3	(545)
EBIT	22.5	22.5	21.5	21.0	18.0	(452)	(308)	18.0	22.5	(452)
EBT	25.2	24.8	22.9	23.3	20.8	(447)	(257)	20.8	25.2	(447)
PAT	22.5	21.9	21.2	21.1	18.4	(413)	(273)	18.4	22.5	(413)
Effective Tax rate	10.8	11.6	7.4	9.6	11.5	71	196	11.5	10.8	71

Source: Company, Emkay Research

(All fig in Rs mn except %)	Oct'09	Jan'10	April'10	July'10	Oct'10	Jan'11
Reported Revenues	11,322	11,916	12,205	12,791	13,454	12,335
Hedging Gains/(Losses)	107	357	338	210	272	171
Revenues(ex Hedging)	11,215	11,559	11,867	12,581	13,182	12,164
Reported EBITDA	2,946	3,135	3,150	3,159	3,204	2,574
Reported Mgns, %	26.0	26.3	25.8	24.7	23.8	20.9
EBITDA ex Hedging gains/(losses)	2,839	2,778	2,812	2,949	2,932	2,403
EBITDA mgns(ex hedging), %	25.3	24.0	23.7	23.4	22.2	19.8
EBITDA ex hedging gains/(losses) and reversals		2,572			2,702	1,969
EBITDA mgns(ex hedging and provision reversals), %		22.3			20.5	16.2

Source: Company, Emkay Research

Sharp cut in earnings despite lower currency resets

(in Rs mn, except EPS)	Oct'11E			Oct'12E		
	Old	New	change	Old	New	change
Reported Revenues(US\$ mn)	1,356	1,160	-14.5%	1,618	1,342	-17.1%
Revenues(ex hedging , in US\$ mn)	1,342	1,145	-14.7%	1,618	1,342	-17.1%
Revenues	59,669	52,321	-12.3%	71,172	60,380	-15.2%
EBITDA	13,692	10,219	-25.4%	15,777	11,861	-24.8%
Net Profits	10,489	7,977	-24.0%	11,540	8,721	-24.4%
EPS	49.8	37.8	-24.0%	54.7	41.4	-24.4%

Key Financials

Income Statement

Y/E, Oct (Rs. m)	Oct'09	Oct'10	Oct'11E	Oct'12E
Net Sales	42,639	50,366	52,321	60,380
Growth (%)		18	4	15
Total Expenditure	(31,364)	(37,717)	(42,102)	(48,519)
Growth (%)		20	12	15
EBIDTA	11,275	12,649	10,219	11,861
Growth (%)		12	(19)	16
EBIDTA %	26.4	25.1	19.5	19.6
Other Income	292	581	202	-
Depreciation	(2,022)	(1,637)	(1,485)	(1,624)
EBIT	9,253	11,011	8,733	10,237
Interest	28	8	720	1,238
EBT	9,728	12,100	9,801	11,475
Tax	(641)	(1,192)	(1,824)	(2,754)
EAT	9,087	10,908	7,977	8,721
Growth (%)		20	(27)	9
EAT (%)	21.3	21.7	15.2	14.4

Balance Sheet

Y/E, Oct (Rs. m)	Oct'09	Oct'10	Oct'11E	Oct'12E
Equity share capital	2,096	2,099	2,089	2,089
Reserves & surplus	21,358	30,892	37,982	45,682
Minority Interest	-	-	-	-
Networth	23,453	32,992	40,071	47,772
Secured Loans	-	-	-	-
Unsecured Loans	33	454	454	454
Loan Funds	33	454	454	454
Deferred Tax Liabilities	1	3	3	3
Total Liabilities	23,488	33,449	40,527	48,229
Goodwill	-	-	-	-
Gross Block	12,989	14,145	17,232	19,732
Less: Depreciation	6,880	7,836	9,321	10,945
Net block	6,109	6,309	7,911	8,787
Capital WIP	127	89	89	89
Investment	-	-	-	-
Current Assets	25,703	37,886	42,955	51,501
Inventories	-	-	-	-
Sundry debtors	9,064	12,054	11,611	13,399
Cash & bank balance	1,786	1,784	8,143	13,576
Loans & advances	7,240	9,446	8,601	9,926
Other current assets	1	2	-	-
Current Liab & Prov	9,147	11,590	11,181	12,903
Current liabilities	6,414	8,094	7,597	8,768
Provisions	2,734	3,497	3,584	4,136
Net current assets	16,556	26,296	31,774	38,598
Misc exps	-	-	-	-
Deferred Tax	695	754	754	754
Total Assets	23,488	33,448	40,527	48,228

Cash Flow

Y/E, Oct (Rs. m)	Oct'09	Oct'10	Oct'11E	Oct'12E
Net Profit after Tax	9,087	10,908	7,977	8,721
Add : Depreciation	2,022	1,637	1,485	1,624
Add : Misc exp w/off	-	-	-	-
Net changes in WC	(3,410)	(2,443)	409	(1,722)
Operational Cash Flows	9,376	9,170	10,343	8,953
Capital expenditure	(1,163)	(1,799)	(3,087)	(2,500)
Investments	(7,612)	(6,988)	-	-
Investing Cash Flows	(8,776)	(8,787)	(3,087)	(2,500)
Borrowings	(20)	421	-	-
dividend paid	(858)	(858)	(980)	(933)
Issue of shares	112	(10)	-	-
Share Premium	105	(135)	-	-
Financing Cash Flows	640	(389)	(1,187)	(1,056)
changes in cash	1,240	(2)	6,359	5,433
Opening balance	546	1,786	1,784	8,143
Closing balance	1,786	1,784	8,143	13,576

Key Ratios

Y/E, Oct	Oct'09	Oct'10	Oct'11E	Oct'12E
EPS (Rs)	43.3	51.9	37.8	41.4
CEPS (Rs)	52.9	59.7	44.9	49.1
Book Value Per Share (Rs)	111.7	157.1	190.1	226.6
Dividend Per Share (Rs)	3.5	4.0	3.8	4.1
Valuations Ratios (x)				
PER	10.5	8.8	12.0	11.0
P/CEPS	11.3	10.0	13.4	12.2
P/BV	4.1	2.9	2.4	2.0
EV/EBIDTA	7.6	6.3	7.2	5.7
EV/Sales	2.0	1.6	1.4	1.1
M-Cap/sales	2.2	1.9	1.8	1.6
Profitability Ratios (%)				
RoCE	48.8	38.7	23.6	23.1
RoNW	48.1	38.6	21.8	19.9
EBITDA Margin	26.4	25.1	19.5	19.6
EBIT Margins	21.7	21.9	16.7	17.0
Net Profit Margin	21.3	21.7	15.2	14.4

Recommendation History: Mphasis Limited - MPHL IN

Date	Reports	Reco	CMP	Target
25/02/2011	Mphasis Q1FY11 Result Update	Hold	627	600
23/11/2010	Mphasis Q4FY10 Result Update	Hold	561	630
26/08/2010	Mphasis July'10 Result Update	Hold	626	630
27/05/2010	Mphasis Company Update 270510	Hold	600	560

Recent Research Reports

Date	Reports	Reco	CMP	Target
27/01/2011	eClerx Q3FY11 Result Update	Accumulate	686	740
02/02/2011	Infinite Computer Q3FY11 Result Update	Buy	181	250
09/02/2011	Patni Computer Q4CY10 Result Update	Not Rated	464	NA
14/02/2011	Mahindra Satyam Q3FY11 Result Update	Reduce	65	65

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