

# Mphasis

ADD

Q1FY13 to be another weak quarter

CMP: Rs370

Target Price: Rs410

- Revenue to decline by 5% qoq due to seasonal shutdowns, decline in HP channel and voluntary reduction in govt. projects
- HP channel could stabilise from Q3FY13 onwards and organic growth in Direct Channel (DC) could recover from Q2 itself
- We largely maintain FY13/14 EPS estimates of Rs36 and Rs46. Maintain ADD with TP of Rs410 (10x average FY13-14 earnings)

We recently met MPHL's management and learned that Q1FY13 is likely to be a weak quarter, due to steady decline in Hewlett Packard (HP) channel, seasonal shutdowns in the US, and voluntary reduction in exposure to govt. projects, owing to receivables issues. The key takeaways of our management meet are:

**Q1 revenue to decline 5% qoq:** HP-channel volume is likely to decline by up to 10% in Q1, due to shutdowns (2-3% decline) and persistent weakness in HP channel (5-7% decline). DC is also likely to be weak and report a decline of 2-3% due to seasonal shutdowns at US client locations and conscious decision by MPHL's management to reduce exposure to government projects, as a result of elongated receivables cycle.

**Margins likely to erode due to weaker revenue:** MPHL's operating margin is expected to contract to 15% in Q1FY13, due to a decline in revenue, while margins in FY13 are likely to be about 16%, as the company will benefit from its measures to improve operating efficiency (like improvement in utilisation and employee pyramid right sizing).

**Digital Risk and "Project Pravega" the two key priorities:** MPHL will consolidate Digital Risk from early Q2FY13 and does not plan any major acquisition in FY13 (though a US\$20-30mn sized acquisition is a possibility), as integrating and digesting Digital Risk will be a priority. Also, under "Project Pravega", MPHL's focus will be on a phased execution of its strategy to achieve growth momentum through named-account focused hyper-specialization using new business models.

**Valuation:** MPHL trades at a P/E of 10.3x FY13 and 8x FY14 earnings. Maintain ADD with TP of Rs410, in view of MPHL's dividend yield of 4%+, strong cash flow, expected stability in HP channel and anticipated growth momentum in DC business.

## KEY FINANCIALS

(Rs mn)

Y/E 31 October	2011	2012	2013E	2014E
Revenue	50,980	53,574	57,160	65,633
EBITDA	9,843	10,495	10,604	13,144
EBITDA margin (%)	18.4	18.4	18.6	20.0
PAT	8,218	7,922	7,560	9,710
FDEPS (Rs)	39.0	37.6	35.9	46.1
% growth	(24.6)	(3.6)	(4.6)	28.4
P/E (x)	9.5	9.8	10.3	8.0
RoCE avg (%)	19.8	18.5	15.7	18.6

Source: Company, BRICS Research

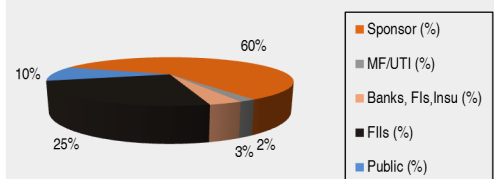
- ☒ Corporate development
- ☒ Earnings estimate change
- ☐ Target price change
- ☐ Rating change

## KEY DATA

Bloomberg	MPHL IN
Reuters	MBFL.BO
52-wk H/L (Rs)	439.9/316.9
6-m avg trd value	US\$1.1mn
Market cap	Rs77.8bn/US\$1.4bn
Shares o/s	210.1mn
Face value	Rs10

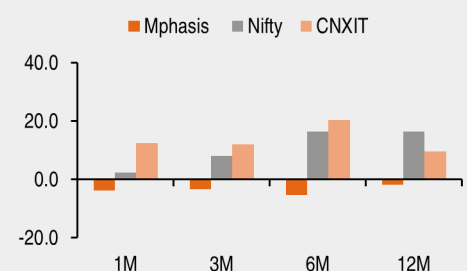
Source: Bloomberg

## SHAREHOLDING (%)



Source: Ace equity

## PRICE PERFORMANCE



Source: Bloomberg

Sushil Sharma

+91 22 66360073

sushil.sharma@bricssecurities.com

Manav Patel

+91 22 66360072

manav.patel@bricssecurities.com

**Q1FY13 quarterly preview – expect another weak quarter:** MPHL's revenue is expected to decline 6% qoq and after adjusting for hedging reserves, it is likely to decline by 5% qoq. HP channel's secular decline of 5-7% qoq continues unabated, while the DC channel has been impacted by the weak business growth in India, as management has decided to reduce exposure to government projects, due to receivables issues. Both the HP and DC channels have been further impacted by seasonal shutdowns at client locations. Operating margin in Q1FY13 is likely to come in at about 15%, due to weaker revenue growth. MPHL's management has guided for a steady operating margin of 16% for FY13 and an EPS of Rs8.5 for Q1FY13 and Rs36 for FY13.

**Exhibit 1: Q1FY13 preview**

Particulars	Jan-13 Estimate	Jan-12	yoy %	Oct-12	qoq %
Sales	12,429	13,672	(9.1)	13,062	(4.8)
EBITDA	2,224	2,522	(11.8)	2,703	(17.7)
EBITDA %	17.9	18.4	-55.3 bps	20.7	-280 bps
Depreciation	385	468	(17.7)	410	(6.0)
Other income	455	338	34.5	394	15.4
PBT	2,293	2,392	(4.1)	2,687	(14.7)
Tax	527	544	(3.0)	594	(11.2)
PAT	1,766	1,848	(4.4)	2,093	(15.6)

Source: Company, BRICS Research

**Revising estimates to factor in sharper decline in HP channel in Q1FY13 and consolidation of Digital Risk:** We have revised our estimates to factor in the consolidation of Digital Risk (annual revenue run rate of US\$150mn) from mid-February 2013. Also, the expected decline of 10% qoq in volume of the HP channel is sharper than our earlier estimate. However, on the positive side, the declining trend in HP channel appears to be coming to an end. We have raised our margin estimates to factor in the positive EPS accretion in FY14 (EPS neutral in FY13) from the Digital Risk acquisition and better operational efficiency, due to improvement in utilization and employee pyramid right sizing, once stability in the HP channel business returns.

**Exhibit 2: Change in estimates**

Particulars	New		Old		% change	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Sales	57,160	65,633	61,486	76,876	-7.0%	-14.6%
EBITDA	10,604	13,144	10,752	13,814	-1.4%	-4.8%
EBITDA Margin (%)	18.6	20.0	17.5	18.0		
PAT	7,560	9,710	7,563	9,805	0.0%	-1.0%
PAT Margin (%)	13.2	14.8	12.3	12.8		
FDEPS (Rs)	35.9	46.1	35.9	46.5	0.0%	-1.0%

Source: BRICS Research

## Financial summary

Income statement					Balance sheet				
(Rs mn)					(Rs mn)				
Y/E 31 October	2011	2012	2013E	2014E	Y/E 31 October	2011	2012	2013E	2014E
Revenue	50,980	53,574	57,160	65,633	Net fixed assets	2,946	2,510	3,093	3,067
Revenue growth (%)	1.2	5.1	6.7	14.8	Investments	17,765	25,192	22,034	22,859
Operating exp	41,137	43,079	46,556	52,489	Current assets	25,610	22,970	26,846	30,052
EBITDA	9,843	10,495	10,604	13,144	Inventories	—	—	—	—
EBITDA margin (%)	18.4	18.4	18.6	20.0	Sundry debtors	5,972	6,358	5,277	7,731
Depreciation	1,550	1,748	2,035	2,329	Cash & bank balance	2,896	4,211	8,853	10,480
EBIT	8,293	8,747	8,568	10,816	Loans & advances	9,641	6,652	7,027	5,551
MTM profit / (loss)	664	181	20	35	Other current assets	1	5	6	7
Other income	1,088	1,478	1,307	1,822	Total assets	55,994	61,299	68,749	72,917
Interest paid	—	—	—	—	Net worth	39,020	44,118	51,451	55,751
PBT	10,045	10,279	9,823	12,611	Share capital	2,100	2,101	2,101	2,101
Tax	1,827	2,357	2,264	2,901	Reserves & surplus	36,920	42,017	49,350	53,650
PAT	8,218	7,922	7,560	9,710	Minority interest	—	—	—	—
Minority interest	—	—	—	—	Total debt	2,924	3,228	2,959	2,305
EO income	—	—	—	—	Secured loans	489	538	538	538
APAT	8,218	7,922	7,560	9,710	Unsecured loans	2,435	2,690	2,421	1,767
PAT growth (%)	(24.7)	(3.6)	(4.6)	28.5	Current liabilities & prov	14,050	13,953	14,339	14,860
Shares o/s (mn)	210	210	210	210	Current liabilities	9,098	8,765	9,791	10,044
Fully diluted o/s shrs (mn)	210	210	210	210	Provisions	4,952	5,188	4,549	4,816
FDEPS (Rs) recurring	39.0	37.6	35.9	46.1	Net deferred tax liab	—	—	—	—
					Total liabilities	55,994	61,299	68,749	72,917

Cash flow statement					Key ratios				
(Rs mn)									
Y/E 31 October	2011	2012	2013E	2014E	Y/E 31 October	2011	2012	2013E	2014E
PBT	10,045	10,279	9,823	12,611	<b>Valuation ratios</b>				
Depreciation	1,550	1,748	2,035	2,329	PE (x)	9.5	9.8	10.3	8.0
Amortisation	—	—	—	—	CEPS (Rs)	46.5	46.0	45.7	57.3
Interest paid	—	—	—	1	PCE (x)	8.0	8.0	8.1	6.5
Tax paid	(1,827)	(2,382)	(2,264)	(2,901)	BVPS (Rs)	186	210	245	265
Chg in working capital	1,247	3,862	1,154	(1,057)	Price/Book (x)	2.0	1.8	1.5	1.4
Int/div in other income	(1,088)	(1,332)	(1,235)	(1,761)	EV/EBITDA (x)	7.9	7.3	6.8	5.3
Other operations	(664)	(181)	(20)	(35)	EV/Revenue (x)	1.5	1.3	1.3	1.1
CF from operations (a)	9,263	10,370	8,115	7,302	Dividend yield (%)	1.1	4.6	4.4	5.6
Capital expenditure	(3,370)	(527)	(1,383)	(1,077)	Cash flow yield (%)	2.8	2.5	12.1	6.4
Chg in investments	(3,165)	(7,427)	3,158	(824)	<b>Performance ratios</b>				
Other investing act	(1,631)	(1,766)	(1,669)	(2,195)	Raw material to sales (%)	72.5	71.2	71.9	69.9
Int/div in other income	1,088	1,332	1,235	1,761	SGA to sales (%)	8.2	9.2	9.5	10.1
CF from investments (b)	(7,078)	(8,388)	1,340	(2,336)	Effective tax rate (%)	18.2	22.9	23.0	23.0
Free cash flow (a+b)	2,185	1,982	9,455	4,966	PAT margin (%)	16.1	14.8	13.2	14.8
Equity raised/(repaid)	—	—	—	—	DPS (Rs)	4.0	17.0	16.1	20.7
Debt raised/(repaid)	—	—	—	—	Dividend payout ratio (%)	10	45	45	45
Interest paid	(22)	1,478	1,307	1,822	<b>Return ratios</b>				
Dividend (incl tax)	(1,004)	(4,189)	(3,980)	(5,112)	RoE avg (%)	22.8	19.1	15.8	18.1
Other fin activities	—	—	—	—	RoCE avg (%)	19.8	18.5	15.7	18.6
CF from financing (c)	(1,026)	(2,711)	(2,673)	(3,290)	Fixed asset turnover (x)	18.7	19.6	20.4	21.3
Net chg in cash (a+b+c)	1,112	(777)	6,735	1,627	<b>Working capital ratios</b>				
Opening balance	1,784	2,896	4,211	8,853	Inventory (days)	—	—	—	—
Closing balance	2,896	2,119	10,946	10,480	Payable (days)	90	84	87	—
					Receivable (days)	41	41	34	43
					Working capital (days)	(49)	(43)	(53)	43
					<b>Leverage ratios</b>				
					Interest cost (%)	—	—	—	—
					Net debt/equity (x)	—	—	(0.1)	(0.1)
					Interest coverage (x)	—	—	—	—

#### BRICS RECOMMENDATION SCALE

<b>BUY:</b>	More than 15% upside
<b>ADD:</b>	Upside up to 15% (between 0% and 15%)
<b>REDUCE:</b>	Downside up to 15% (between 0% and –15%)
<b>SELL:</b>	More than 15% downside

**Head Office:** Sadhana House, 1st Floor, 570, P. B. Marg, Behind Mahindra Tower,  
Worli, Mumbai - 400 018. Tel: (91-22) 6636 0000

**Disclaimer:** This Report/Document has been prepared solely for your information. All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication, but we make no representation as to its accuracy or completeness. All information is for private use of the person to whom it is provided and is not for public distribution and without any liability whatsoever on the part of BRICS Securities Limited, any associated company, or employee thereof (hereinafter collectively referred to as BRICS). This Report/Document shall not be copied, printed, distributed or re-distributed to any person. If you are not the intended recipient of this Report/Document, you should immediately send it to the sender. Nothing contained herein should be construed as an offer to buy or sell or a solicitation of an offer to buy or sell. The value of any investment may fall as well as rise. Past performance is no guide to the future. The rate of exchange between currencies may cause value of investment to increase or diminish; consequently investors may not get back full value of their original investment.

BRICS shall not be liable for any direct or indirect losses arising from action initiated by you on the basis of information provided in this Report/Document and BRICS accepts no responsibility for statements made or any other source of information received by you and you would be doing so at your own risk.

This Report/Document is not directed or intended for distribution to or use by any person or entity who is a US citizen or person resident in US or who is a citizen/resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject BRICS to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to a certain category of investors. Persons in whose possession this presentation may come are required to inform themselves of and to observe such restrictions.