

31<sup>st</sup> January'2008**BUY**

Price	Target Price
<b>Rs232</b>	<b>Rs 357</b>

<b>Sensex</b>	<b>17,759</b>
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**Price Performance**

(%)	1M	3M	6M	12M
Absolute	(24)	(23)	(17)	(20)
Rel. to Sensex	(14)	(14)	(30)	(36)

Source: Capitaline

**Stock Details**

Sector	IT Services
Reuters	MBFL.BO
Bloomberg	MPHL@IN
Equity Capital(Rs mn)	2086
Face Value(Rs)	10
52 Week H/L	340/200
Market Cap(Rs bn)	48.3
Daily Avg Volume (No of shares)	268143
Daily Avg Turnover (US\$)	1.9

**Shareholding Pattern (%)**

(30 <sup>th</sup> Sep.'07)	
Promoters	60.9
FII/NRI	12.5
Institutions	7.7
Private Corp.	11.1
Public	7.7

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**Mphasis Ltd.**Result  
Update**Results tepid, Investments to fuel growth continue**

Mphasis's Q3FY08 results were tepid with both the headline and bottomline numbers coming in below estimates. Revenues came in at Rs 6323 mn, up 5.1% QoQ. Operating margins declined by 40 bps sequentially to 17.5%, while net profits at Rs 663 mn were flat QoQ. We would like to note that despite the lack of positive catalysts in numbers, the employee addition remained on track ( net addition during the quarter was 2,158) with an increase in offshore IT services and ITO pricing. Besides the revenue growth in ITO and BPO was in line, with applications growth tad lower on account of end of certain projects. The management continued to emphasize that investments to fuel future growth would continue and stuck with the indication of 8k-10k net additions for CY08 which support the local EDS's comments that off shoring momentum would pick up from Q1CY08.

We have revised our estimates (*FY09E and FY10E EPS cut by ~9%*) with the factors being (1) higher than expected employee addition during the quarter, (2) increase in pricing and build in higher investments going forward. We expect Mphasis to report revenue, EBITDA and PAT CAGR of 36%, 38.8% and 42.5% over FY07-10E. We would note that the stock has corrected by ~ 20%+ in the recent past and believe that the current market price factors in the soft quarterly performance already and hence would recommend a 'BUY' on the stock with a revised 1 year forward target price to Rs 357 (*from Rs 384 earlier*) based on 15x 1 year forward rolling earnings multiple.

**Results tepid, Investments for the future continue**

In Rs mn	Q3FY08	Q2FY08	QoQ(%)	Q3FY07	YoY (%)
<b>Net sales</b>	<b>6,323</b>	<b>6,017</b>	<b>5.1%</b>	<b>4,547</b>	<b>39.1%</b>
Total Income	6,323	6,017		4,547	
Operating expenses	5,218	4,938		3,664	
<b>EBITDA</b>	<b>1,104</b>	<b>1,079</b>	<b>2.4%</b>	<b>883</b>	<b>25.1%</b>
Margins (%)	17.5	17.9		19.4	
Depreciation	374	340		282	
<b>EBIT</b>	<b>730</b>	<b>739</b>	<b>-1.2%</b>	<b>601</b>	<b>21.5%</b>
Margins (%)	11.5	12.3		13.2	
Interest Paid	0	0		0	
Other income	(28)	(15)		(84)	
Pre-tax profit	702	724	<b>-3.0%</b>	516	<b>36.0%</b>
Tax provided	40	61		36	
Profit after tax	663	663		481	
<b>Emkay Net profit</b>	<b>663</b>	<b>663</b>	<b>-0.1%</b>	<b>480</b>	<b>37.9%</b>
EPS, Rs	3.2	3.2		2.3	

Source: Company, Emkay Research

**Other result highlights****Numbers lack any positive catalysts, Employee addition remains strong**

Mphasis's Q3FY08 results were tepid and lacked any positive catalysts unlike the past few quarters when the company has beaten both street as well as our expectations. The revenue growth was slightly subdued at 5.1% QoQ growth while net profits were sequentially flat at Rs 663 mn. We would like to note that the company has made investments of ~ Rs 110 mn during the quarter, adjusting for which the net profits would

have been in line with our estimates. The company's hiring remained on track with net employee addition during the quarter at 2,158 people during the quarter taking the total employee count to 26,236. The offshore IT applications and ITO pricing also moved by to US\$ 22/hr and US\$ 21/hr (from US\$ 21/hr and US\$ 20/hr during Q2FY08). The management sounded confident for the next few quarters, maintaining the employee addition outlook for CY08 at 8k-10k and indicated that the applications business growth would be on track from the next quarter.

### Revenues growth tepid, operating margins decline by 40 bps sequentially

Mphasis reported revenues of Rs 6323 mn, up 5.1% QoQ which were below expectations. The operating margins declined by 40 bps sequentially to 17.5% (V/s expectation of 150 bps margin expansion) on account of investments in maintenance costs associated with new facilities and new software licenses. The ITO revenue growth and BPO revenue growth remained in line with growth of ~12% and 4.2% respectively, however the applications growth disappointed at 4.2% sequential growth. The company attributed the slower growth in the applications business to the closure of certain projects and indicated that they would pick up from the next quarter onwards.

### Employee addition during the quarter at 2,158, in line with expectations

Mphasis added 2,158 people during Q3FY08 taking the total employee count to 26,236 at the end of Q3FY08. The company added 1,614 employees on the BPO side and 438 people on the ITO business during the quarter. The company indicated that they were on course to adding 8k-10k people during CY08.

### Net profits flat QoQ at Rs 663 mn

Mphasis reported net profits of Rs 663 mn during the quarter which was flat QoQ. The net profits came in lower than expectation and were impacted negatively by lower revenue growth, lower operating margins and higher depreciation despite help from lower than expected tax rates (at 5.6% V/s expectations of 12%).

### Cut earnings estimates by 9%, Target revised to Rs 357

We have tweaked our FY09E and FY10E earnings to account for higher than expected employee addition during the quarter, higher pricing, lower utilization and higher investments and thereby cut our FY09E and FY10E estimates by ~9%. We expect Mphasis to record revenue, EBITDA and net profit CAGR of 36%, 38.8% and 42.5% over FY07-10E.

### Revised FY09E and FY10E estimates

	FY09E			FY10E		
(in Rs mn, except EPS)	Old	New	change	Old	New	change
Revenues	34832	34134	-2.0%	45312	45008	-0.7%
EBITDA	6752	6465	-4.3%	8677	8296	-4.4%
Net Profits	4677	4265	-8.8%	5788	5282	-8.7%
EPS	22.3	20.3	-8.9%	27.6	25.2	-8.9%

However we maintain that Mphasis remains central to EDS's resurrection moves by way of increased off shoring (***Mphasis continues to expand aggressively with a quarterly run rate of 2,000 people currently***) and believe that this quarter's performance was an aberration in the larger scheme of things. The management remained confident that growth would return to historical levels as witnessed over the past few quarters from Q1CY08. We have cut our price target to Rs 357 from Rs 384 earlier, based on 15x 1 year rolling forward P/E multiple.

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