

December 12, 2011

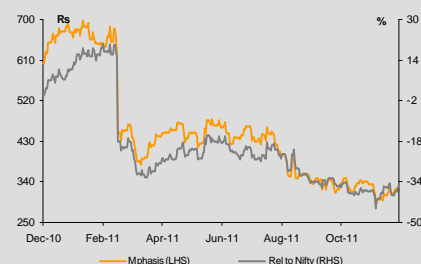
Reco	Previous Reco
Reduce	Reduce
CMP	Target Price
Rs 326	Rs 325
EPS change FY13E/14E (%)	NA
Target Price change (%)	NA
Nifty	4,867
Sensex	16,213

Price Performance

(%)	1M	3M	6M	12M
Absolute	(3)	(9)	(30)	(46)
Rel. to Nifty	4	(3)	(21)	(36)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	IT Services
Bloomberg	MPHL@IN
Equity Capital (Rs mn)	2101
Face Value(Rs)	10
No of shares o/s (mn)	210
52 Week H/L	712/277
Market Cap (Rs bn/USD mn)	68/1,302
Daily Avg Volume (No of sh)	300341
Daily Avg Turnover (US\$m)	1.9

Shareholding Pattern (%)

	Sep-11	Jun-11	Mar-11
Promoters	60.5	60.5	60.5
FII/NRI	20.3	20.4	19.0
Institutions	11.4	6.3	6.8
Private Corp	2.6	7.7	8.2
Public	5.2	5.2	5.6

Source: Capitaline

Manik Taneja

manik.taneja@emkayglobal.com
+91 22 6612 1253

Priya Gajwani

priya.gajwani@emkayglobal.com
+91 22 6612 1385

We hosted Mr Ganesh Murthy, CFO, Mphasis for investor meetings in Mumbai recently. We present key takeaways:

- **Challenges within core HP Enterprise Svcs continue, co expects increased traction in HP Technology Svcs and HP Imaging and Printing Group**
- **Direct channel revenue growth to remain strong. Recent deal wins in domestic business lend visibility**
- **Co targeting EBIT margins of 15-18% in FYOct'12. Lower investments in Javelina, absence of RSU charge, fresher hiring and consolidation of facilities to drive margins up**
- **Inexpensive valuations at ~9x FYOct'11/Oct'12E EPS with cash at ~26% of mktcap limits downsides. Improvement in op performance needs to preclude stock upsides**

Core HP struggles to continue, traction in other segments strong

Mphasis mgmt indicates that business within core HP (read Enterprise Svcs) is expected to be sluggish (note that rev from Enterprise Svcs are down by ~10% over the past 2 qtrs) albeit stable ahead citing formation of a governance council at HP which is taking the relationship forward with Mphasis. Co continues to aggressively target opportunities within HP outside of Enterprise Svcs and is targeting rev of US\$ 100 mn in FYOct'12(V/s US\$ 35 mn in FYOct'11 implying a tough CQGR of 30%+). Mphasis has recently won a US\$ 25 mn ACV business from HP Tech Svcs and expects to gain traction within HP Imaging and Printing Group as well. Strong growth within Direct Channel business is expected to continue (co has recently won 2 large deals in the emerging geographies, albeit we see working capital stretching on account of these deals). We highlight that co wide revenue growth for Mphasis might still be low single digits, far cry lower than industry/peers growth

Margins to improve ahead after the sharp decline in 2 yrs

Mphasis's EBITDA margins(ex one offs and hedging gains) have continued to decline since April'09 (down ~1200 bps over the period) before recovering in Oct'11 qtr to 18.5% aided by lower currency, improved utilization and lower investments in the Javelina platform. Over the next few quarters, we see margin tailwinds in the form of (1) lower investments in the Javelina platform, (2) absence of RSU charge (co is now issuing ESOP's at current market price unlike in the past when RSU's were issued at face value), (3) broadening of employee pyramid(co has hired ~1,300 freshers in the past 2 qtrs and plans to hire ~1,600 freshers in FYOct'12) and (4) consolidation of delivery centers. **However we note that currency depreciation will be a less meaningful margin tailwind for the company ahead on account of INR based billing for nearly 45% of revenues and hedges at ~Rs 48/\$**

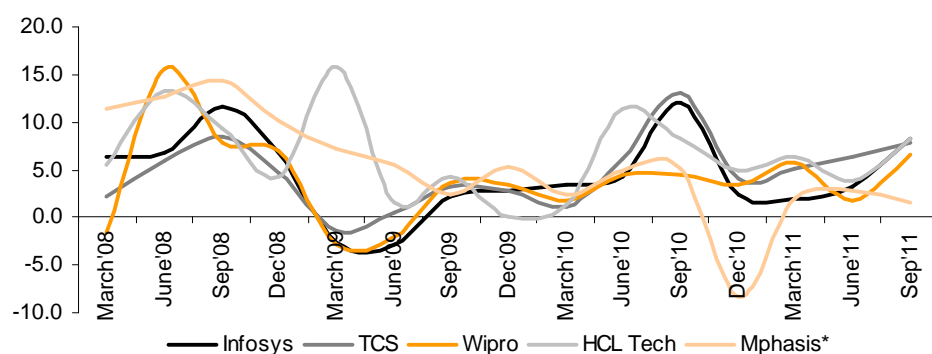
Inexpensive valuations, however improvement in performance needs to preclude stock upsides

Valuations at ~9x/8.5xOct'11/Oct'12 P/E with ~27% of market cap in cash will limit sharp downsides. Several quarters of disappointing performance has driven ~50% decline in stock over the past 1 yr. In our view, an improvement in operational performance needs to preclude any stock upsides.

Y/E, Oct	Net	EBITDA	PAT	EPS	ROE	P/E	EV/	P/B
(in Rs mn)	Sales	Core	%	(Rs)	%	(x)	EBITDA	(x)
FY10	50,366	12,649	25.1	10,908	51.9	38.6	6.2	4.1
FY11	50,980	9,846	19.3	8,216	39.0	22.0	8.3	5.1
FY12E	55,173	10,148	18.4	7,452	35.4	18.7	9.2	4.5
FY13E	59,741	10,913	18.3	8,030	38.1	17.6	8.5	3.7

Sequential Revenue growth (in %)

While Mphasis's revenue performance stood out during late CY08/early CY09 driven by rampups from HP channel, we see no end to recent revenue struggles



Source: Companies, Emkay Research

Mphasis's margins benefited during late CY08-early CY09 aided by INR depreciation given negligible hedging and ~60 bps margin sensitivity to every 1% change in currency then. Currency depreciation will be a marginal tailwind this time around given ~45% of INR billing and reasonable hedge positions

(All fig in Rs mn except %)	April'09	July'09	Oct'09	Jan'10	April'10	July'10	Oct'10	Jan'11	April'11	July'11	Oct'11
Reported Revenues	10,485	11,056	11,322	11,916	12,205	12,791	13,454	12,335	12,571	12,936	13,138
Hedging Gains/(Losses)	-240	15	107	357	338	210	272	171	110	125	-104
Revenues(ex Hedging)	10,724	11,041	11,215	11,559	11,867	12,581	13,182	12,164	12,461	12,811	13,242
Reported EBITDA	2,818	2,919	2,946	3,135	3,150	3,159	3,204	2,574	2,406	2,514	2,351
Reported Mgns, %	26.9	26.4	26.0	26.3	25.8	24.7	23.8	20.9	19.1	19.4	17.9
EBITDA ex Hedging gains/(losses)	3,058	2,904	2,839	2,778	2,812	2,949	2,932	2,403	2,296	2,389	2,455
EBITDA mgns(ex hedging), %	28.5	26.3	25.3	24.0	23.7	23.4	22.2	19.8	18.4	18.7	18.5
EBITDA ex Hedging and Provision reversals	3,058	2,904	2,839	2,572	2,812	2,949	2,702	1,969	2,020	1,808	2,455
EBITDA mgns(ex hedging and provision reversal), %	28.5	26.3	25.3	22.3	23.7	23.4	20.5	16.2	16.2	14.1	18.5

Source: Company, Emkay Research

Key Financials

Income Statement

Y/E, Oct (Rs. m)	Oct'10	Oct'11E	Oct'12E	Oct'13E
Net Sales	50,366	50,980	55,173	59,741
Growth (%)	18	1	8	8
Total Expenditure	(37,717)	(41,134)	(45,024)	(48,828)
Growth (%)	20	9	9	8
EBIDTA	12,649	9,846	10,148	10,913
Growth (%)	12	(22)	3	8
EBIDTA %	25.1	19.3	18.4	18.3
Other Income	581	665	-	-
Depreciation	(1,637)	(1,550)	(1,783)	(1,997)
EBIT	11,011	8,295	8,365	8,916
Interest	8	(22)	1,440	1,650
EBT	12,100	10,043	9,805	10,566
Tax	(1,192)	(1,827)	(2,353)	(2,536)
EAT	10,908	8,216	7,452	8,030
Growth (%)	20	(25)	(9)	8
EAT (%)	21.7	16.1	13.5	13.4

Balance Sheet

Y/E, Oct (Rs. m)	Oct'10	Oct'11E	Oct'12E	Oct'13E
Equity share capital	2,099	2,100	2,089	2,089
Reserves & surplus	30,892	36,898	42,606	48,758
Minority Interest	-	-	-	-
Networth	32,992	38,998	44,697	50,848
Secured Loans	-	-	-	-
Unsecured Loans	454	2,924	2,924	2,924
Loan Funds	454	2,924	2,924	2,924
Deferred Tax Liabilities	3	22	22	22
Total Liabilities	33,449	41,944	47,643	53,794
Goodwill	-	-	-	-
Gross Block	14,145	20,037	22,037	24,037
Less: Depreciation	7,836	8,495	10,278	12,275
Net block	6,309	11,542	11,759	11,762
Capital WIP	89	102	102	102
Investment	-	-	-	-
Current Assets	37,886	43,375	49,166	56,504
Inventories	-	-	-	-
Sundry debtors	12,054	13,072	13,907	15,058
Cash & bank balance	1,784	2,896	7,367	12,715
Loans & advances	9,446	9,641	10,128	10,966
Other current assets	2	1	-	-
Current Liab & Prov	11,590	14,050	14,360	15,549
Current liabilities	8,094	9,098	9,069	9,820
Provisions	3,497	4,952	5,291	5,729
Net current assets	26,296	29,325	34,806	40,955
Misc exps	-	-	-	-
Deferred Tax	754	975	975	975
Total Assets	33,448	41,944	47,642	53,794

Cash Flow

Y/E, Oct (Rs. m)	Oct'10	Oct'11E	Oct'12E	Oct'13E
Net Profit after Tax	10,908	8,216	7,452	8,030
Add : Depreciation	1,637	1,550	1,783	1,997
Add : Misc exp w/off	-	-	-	-
Net changes in WC	(2,443)	(2,460)	(310)	(1,189)
Operational Cash Flows	9,170	10,812	8,225	9,226
Capital expenditure	(1,799)	(6,796)	(2,000)	(2,000)
Investments	(6,988)	(3,165)	-	-
Investing Cash Flows	(8,787)	(9,961)	(2,000)	(2,000)
Borrowings	421	2,470	-	-
dividend paid	(858)	(980)	(1,605)	(1,744)
Issue of shares	1	(11)	-	-
Share Premium	(135)	-	-	-
Financing Cash Flows	(385)	261	(1,754)	(1,878)
changes in cash	(2)	1,112	4,471	5,348
Opening balance	1,786	1,784	2,896	7,367
Closing balance	1,784	2,896	7,367	12,715

Key ratios

Y/E, Oct	Oct'10	Oct'11E	Oct'12E	Oct'13E
EPS (Rs)	51.9	39.0	35.4	38.1
CEPS (Rs)	59.7	46.3	43.8	47.6
Book Value Per Share (Rs)	157.1	185.0	212.0	241.2
Dividend Per Share (Rs)	4.0	6.5	7.1	7.6
Valuations Ratios (x)				
PER	6.2	8.3	9.2	8.5
P/CEPS	10.0	13.0	13.7	12.6
P/BV	2.1	1.7	1.5	1.3
EV/EBIDTA	4.1	5.1	4.5	3.7
EV/Sales	1.0	1.0	0.8	0.7
M-Cap/sales	1.3	1.3	1.2	1.1
Profitability Ratios (%)				
RoCE	38.7	22.0	18.7	17.6
RoNW	38.6	22.8	17.8	16.8
EBITDA Margin	25.1	19.3	18.4	18.3
EBIT Margins	21.9	16.3	15.2	14.9
Net Profit Margin	21.7	16.1	13.5	13.4

Emkay Global Financial Services Ltd.

Corporate Add: B – Ruby Mills Tower, 7th Floor, South East Wing, Senapati Bapat Marg, Dadar (W), Mumbai - 400028 India.

Tel.: +912266121212 Web: www.emkayglobal.com

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