

Q1FY12 Review
 Sector: IT Services
 BSE Sensex: 17,584

Mphasis

Downgrade
 CMP
 TP

REDUCE
 Rs431
 Rs400

Muted HP channel puts pressure on growth

HP channel led to revenue decline - Revenue declined 3%QoQ to USD265.6mn, below expectation. Rupee revenue grew 4.1%QoQ to Rs13,672mn. HP channel revenue remained flattish in rupee terms with 58% contribution but direct channel revenue grew 14.4%QoQ with 42% contribution, up from 31% contribution from a year back. EBITDA margin expanded 57bpsQoQ to 18.4%, below our expectation. PAT was Rs1,848mn, 1%QoQ growth. EPS was Rs8.8, 1%QoQ growth.

Onsite pricing for Applications declines, stable for other towers - Onsite pricing for applications segment declined 2.9%QoQ to USD67/hr. All other pricing including offshore and onsite for Applications, ITO and BPO remained stable. **The management expects no pressure from HP in terms of price negotiation.** Overall pricing is also expected to be stable.

US and Europe decline - In dollar terms, America (65% contribution) declined 4.5%QoQ, Europe (15% contribution) declined 9.1%QoQ and Emerging Markets (20% contribution) grew 7.7%QoQ.

All service lines decline except IMS - In rupee terms, Application maintenance (32% contribution) grew 1.8%QoQ, application development (28% contribution) grew 4.6%QoQ, IMS (24% contribution) grew 11.9%. Technical help desk (5% contribution) declined 16%QoQ and customer service (5% contribution) declined 3.3%QoQ.

Employee headcount declines; robust new client addition - Total headcount declined 4%QoQ to 38,798. Utilisation (including trainees) for Application, BPO and ITO grew 100bpsQoQ each to 77%, 71% and 81% respectively. Added 28 new clients (17 from direct channel and 11 from HP channel). Top client declined 3%QoQ, top 10 clients declined 3%QoQ.

Outlook and Recommendation - Q1FY12 financials are below expectations with higher than expected decline from HP. As HP is not performing well in its Enterprise Solutions segment, we expect pressure on revenue growth in Mphasis as well with a risk of pricing cut in future. The stock was at attractive valuations after the last quarter's earnings and it has given 37% absolute returns. We downgrade the recommendation from BUY to 'REDUCE' with a target price of Rs400 based on 10x PER multiple on 18-months forward earnings.

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QUARTERLY SNAPSHOT (Rs mn)

	Quarter Ended		
	Jul-11	Oct-11	Jan-12
Net sales	12,936	13,137	13,672
YoY Gr.(%)	1.1	-2.4	10.8
Op.Profit	2,517	2,349	2,522
OPM(%)	19.5	17.9	18.4
Adj.Net Profit	1,948	1,830	1,848
YoY Gr. (%)	-28.2	-35.6	-18.5

STOCK DATA

Market cap	Rs90,762mn
Book Value per share	Rs185
Shares O/S (F.V. Rs5)	210.6mn
Free Float	35%
Avg Trade Value (6 months)	Rs3,849mn
52 week High/Low	488/277
Bloomberg Code	MPHL IN
Reuters Code	MBFL.BO

PERFORMANCE (%)

	1M	3M	12M
Absolute	5.8	26.7	(11.3)
Relative	4.9	21.5	(6.7)

KEY FINANCIALS (Rs mn)

	FY09	FY10	FY11	FY12E	FY13E
Net Sales	42,639	50,365	50,980	54,620	60,382
YoY Gr.(%)	43.2	18.1	1.2	7.1	10.5
Op. Profit	11,275	12,649	9,845	10,555	11,076
Op. Marg.(%)	26.4	25.1	19.3	19.3	18.3
Adj. Net Profit	9,087	10,908	8,218	7,970	8,525
YoY Gr.(%)	118.2	20.0	-24.7	-3.0	7.0

KEY RATIOS

Dil. EPS (Rs)	43.3	51.8	39.0	37.9	40.5
ROCE (%)	39.4	32.9	19.8	18.0	16.3
RoE (%)	38.7	33.1	21.1	17.3	16.1
PER (x)	9.9	8.3	11.0	11.4	10.6
EV/ Net Sales (x)	2.1	1.8	1.8	1.7	1.6
EV/EBDITA (x)	8.1	7.2	9.5	8.9	8.5

RELATIVE PERFORMANCE

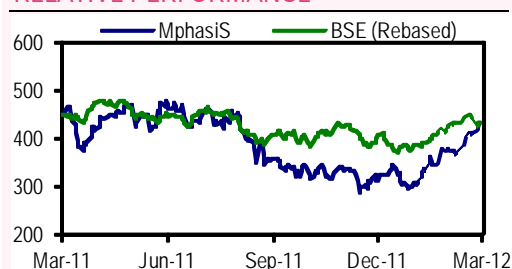


Exhibit 1 - Quarterly snapshot

	Q1FY11	Q4FY11	Q1FY12		QoQ	YoY	Variance	
			Actual	PINCe	Consensus		PINCe vs Actual	
Consolidated sales (USD mn)	271.0	274.0	265.6	279.5	285.0	-3.0%	-2.0%	-4.9%
Consolidated Sales (Rs mn)	12,335	13,137	13,672	14,392	13,983	4.1%	10.8%	-5.0%
Consolidated Operating Profit(Rs mn)	2,574	2,349	2,522	2,821	2,681	7.4%	-2.0%	-10.6%
<i>OPM</i>	<i>20.9%</i>	<i>17.9%</i>	<i>18.4%</i>	<i>19.6%</i>	<i>19.2%</i>	<i>57 bps</i>	<i>-242 bps</i>	<i>-115 bps</i>
PBT (Rs mn)	2,562	2,412	2,392	2,841	2,484	-0.8%	-6.6%	-15.8%
Tax (Rs mn)	295	582	544	682	437	-6.6%	84.4%	-20.2%
<i>Tax Rate</i>	<i>11.5%</i>	<i>24.1%</i>	<i>22.7%</i>	<i>24.0%</i>	<i>17.6%</i>	<i>-140 bps</i>	<i>1123 bps</i>	<i>-126 bps</i>
PAT (Rs mn)	2,267	1,830	1,848	2,159	2,047	1.0%	-18.5%	-14.4%
EPS (Rs)	10.8	8.7	8.8	10.3	9.9	1.0%	-18.4%	-14.4%

Source: PINC Research, Bloomberg, Company

Exhibit 2 - Information Technology, Communication and Entertainment lead growth

Primary Segment	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
Revenues (Rs mn)					
Banking and Capital Markets	3,137	3,414	3,569	4.5%	13.8%
Insurance	1,156	1,473	1,582	7.4%	36.9%
Information Technology, Communication and Entertainment	3,397	3,492	3,783	8.3%	11.4%
Emerging Industries	4,474	4,863	4,995	2.7%	11.6%
Total	12,164	13,242	13,929	5.2%	14.5%
% of Total (Revenue contribution)					
Banking and Capital Markets	25.8%	25.8%	25.6%	-16 bps	-17 bps
Insurance	9.5%	11.1%	11.4%	23 bps	185 bps
Information Technology, Communication and Entertainment	27.9%	26.4%	27.2%	79 bps	-77 bps
Emerging Industries	36.8%	36.7%	35.9%	-86 bps	-92 bps
Gross Profit (Rs mn)					
Banking and Capital Markets	657	857	945	10.3%	43.8%
Insurance	284	341	399	17.0%	40.5%
Information Technology, Communication and Entertainment	959	825	842	2.1%	-12.2%
Emerging Industries	1,165	1,205	1,303	8.1%	11.8%
Total	3,065	3,228	3,489	8.1%	13.8%
Gross Margin (%)					
Banking and Capital Markets	20.9%	25.1%	26.5%	138 bps	553 bps
Insurance	24.6%	23.2%	25.2%	207 bps	65 bps
Information Technology, Communication and Entertainment	28.2%	23.6%	22.3%	-137 bps	-597 bps
Emerging Industries	26.0%	24.8%	26.1%	131 bps	5 bps
Total	25.2%	24.4%	25.0%	67 bps	-15 bps

Source: PINC Research, Company

Exhibit 3 - IMS outperforms; BPO services under trouble

Practices (Rs mn)	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
Application Maintenance & Other Services	4,552	4,371	4,451	1.8%	-2.2%
Application Development	3,212	3,725	3,897	4.6%	21.3%
Customer Service	629	787	761	-3.3%	21.0%
Service/Technical Help Desk	465	623	523	-16.1%	12.5%
Transaction Processing Services	740	630	704	11.7%	-4.9%
Infrastructure Management Services	2,446	2,990	3,346	11.9%	36.8%
Knowledge Processes	117	78	84	7.7%	-28.2%
License Income	3	38	163	328.9%	5333.3%
Total	12,164	13,242	13,929	5.2%	14.5%

% of Total

Application Maintenance & Other Services	38%	33%	32%	-100 bps	-600 bps
Application Development	26%	28%	28%	0 bps	200 bps
Customer Service	5%	6%	5%	-100 bps	0 bps
Service/Technical Help Desk	4%	4%	4%	0 bps	0 bps
Transaction Processing Services	6%	5%	5%	0 bps	-100 bps
Infrastructure Management Services	20%	23%	24%	100 bps	400 bps
Knowledge Processes	1%	1%	1%	0 bps	0 bps
License Income	0%	0%	1%	100 bps	100 bps

Source: PINC Research, Company

Exhibit 4 - HP channel revenue declined 3% in dollar terms – (1% of this was due to shutdown at HP); Direct channel had good growth

By Secondary Market Segment (Rs mn)	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
HP Channel	8,339	8,163	8,121	-0.5%	-2.6%
Mature Market - Direct Channel	3,108	3,914	4,320	10.4%	39.0%
Emerging Market - Direct Channel	717	1,165	1,488	27.7%	107.5%
<i>Total of direct channel</i>	<i>3,825</i>	<i>5,079</i>	<i>5,808</i>	<i>14.4%</i>	<i>51.8%</i>
Total	12,164	13,242	13,929	5.2%	14.5%

% of total

HP Channel	68.6%	61.6%	58.3%	-334 bps	-1025 bps
Mature Market - Direct Channel	25.6%	29.6%	31.0%	146 bps	546 bps
Emerging Market - Direct Channel	5.9%	8.8%	10.7%	188 bps	479 bps
<i>Total of direct channel</i>	<i>31.4%</i>	<i>38.4%</i>	<i>41.7%</i>	<i>334 bps</i>	<i>1025 bps</i>

Source: PINC Research, Company

Exhibit 5 - APAC and Japan had good growth whereas matured markets of US and Europe declined

Geo Spread (USD mn)	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
America	176.1	180.8	172.7	-4.5%	-2.0%
Europe	48.8	43.8	39.8	-9.1%	-18.3%
Asia Pacific & Japan	46.1	49.3	53.1	7.7%	15.3%
% of Total					
America	65.0%	66.0%	65.0%	-100 bps	0 bps
Europe	18.0%	16.0%	15.0%	-100 bps	-300 bps
Asia Pacific & Japan	17.0%	18.0%	20.0%	200 bps	300 bps

Source: PINC Research, Company

Exhibit 6 - Healthy new client additions particularly in direct channel

	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
New client additions	18	25	28	12.0%	55.6%
<i>Direct Channel</i>	<i>13</i>	<i>17</i>	<i>17</i>	<i>0.0%</i>	<i>30.8%</i>
<i>HP Channel</i>	<i>5</i>	<i>8</i>	<i>11</i>	<i>37.5%</i>	<i>120.0%</i>
Segment wise client additions					
Banking and Capital markets	1	4	2	-50.0%	100.0%
Insurance	2	2	1	-50.0%	-50.0%
Information Technology, Communication & Entertainment	4	6	8	33.3%	100.0%
Emerging Industries	11	13	17	30.8%	54.5%

Source: PINC Research, Company

Exhibit 7 - Large clients not increasing

Customer Size Distribution	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
>1mn	119	120	122	1.7%	2.5%
>5mn	38	43	41	-4.7%	7.9%
>10mn	22	24	25	4.2%	13.6%
>20mn	14	12	12	0.0%	-14.3%

Source: PINC Research, Company

Exhibit 8 - Top client and top 10 clients declined each at 3%QoQ

Customer Concentration (USD mn)	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
Top Customer	27.1	27.4	26.6	-3.0%	-2.0%
Top 5	78.6	82.2	82.3	0.2%	4.8%
Top 10	119.2	120.6	116.9	-3.0%	-2.0%
Non Top 10 customers	151.7	153.4	148.8	-3.0%	-2.0%
Customer Concentration (%)					
Top Customer	10.0%	10.0%	10.0%	0 bps	0 bps
Top 5	29.0%	30.0%	31.0%	100 bps	200 bps
Top 10	44.0%	44.0%	44.0%	0 bps	0 bps
Non Top 10 customers	56.0%	56.0%	56.0%	0 bps	0 bps

Source: PINC Research, Company

Exhibit 9 - FPP revenues reached very low at 12% of overall revenue; offshoring remained stable at 68%

Service Delivery	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
Contract Type (Rs mn)					
Revenue from T&M	10,630	11,560	12,259	6.0%	15.3%
Revenue from FPP	1,534	1,682	1,670	-0.7%	8.9%
% of Total					
Revenue from T&M	87.0%	87.0%	88.0%	100 bps	100 bps
Revenue from FPP	13.0%	13.0%	12.0%	-100 bps	-100 bps
Delivery location (Rs mn)					
Onsite Revenue	4,051	4,198	4,450	6.0%	9.8%
Offshore Revenue	8,113	9,044	9,479	4.8%	16.8%
% of Total					
Onsite Revenue	33.0%	32.0%	32.0%	0 bps	-100 bps
Offshore Revenue	67.0%	68.0%	68.0%	0 bps	100 bps

Source: PINC Research, Company

Exhibit 10 - Onsite pricing for Applications declined due to rupee depreciation leading to pricing cut for one large client (not HP); other pricing remained stable

Price Movement(USD/hr)	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
APO					
Offshore	19	20	21	5.0%	10.5%
Onsite	72	69	67	-2.9%	-6.9%
ITO					
Offshore	19	21	21	0.0%	10.5%
Onsite	67	67	67	0.0%	0.0%
BPO					
Offshore	7	6	6	0.0%	-14.3%

Source: PINC Research, Company

Exhibit 11 - Reduction in headcount and focus to increase utilisation

People Management	Q1FY11	Q4FY11	Q1FY12	QoQ	YoY
Headcount					
Onsite - Applications	2,675	2,692	2,716	0.9%	1.5%
Onsite - BPO	192	141	121	-14.2%	-37.0%
Onsite -ITO	478	314	308	-1.9%	-35.6%
Offshore - Applications	12,657	12,682	11,820	-6.8%	-6.6%
Offshore - BPO	15,469	15,132	14,830	-2.0%	-4.1%
Offshore - ITO	8126	7,950	7,503	-5.6%	-7.7%
Total Headcount- Onsite	3,345	3,147	3,145	-0.1%	-6.0%
Total Headcount- Offshore	36,252	35,764	34,153	-4.5%	-5.8%
Sales and marketing	327	325	343	5.5%	4.9%
General and administration	1,135	1,190	1,157	-2.8%	1.9%
Overall Headcount	41,059	40,426	38,798	-4.0%	-5.5%
Utilization (excluding Trainees)-Blended					
Application	74.0%	80.0%	82.0%	200 bps	800 bps
BPO	80.0%	78.0%	79.0%	100 bps	-100 bps
ITO	71.0%	84.0%	82.0%	-200 bps	1100 bps
Utilization (including Trainees)-Blended					
Application	72.0%	76.0%	77.0%	100 bps	500 bps
BPO	69.0%	70.0%	71.0%	100 bps	200 bps
ITO	68.0%	80.0%	81.0%	100 bps	1300 bps

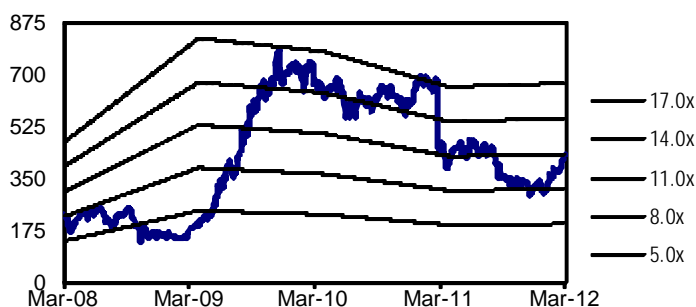
Source: PINC Research, Company

Year Ended Oct. (Figures are in Rs mn)

Income Statement					
Year ended 31 Oct (Rs mn)	FY09	FY10	FY11	FY12E	FY13E
Net sales	42,639	50,365	50,980	54,620	60,382
Growth (%)	43.2	18.1	1.2	7.1	10.5
Gross profit	15,738	16,846	14,003	14,994	15,963
Other operating charges	4,463	4,197	4,158	4,439	4,887
EBITDA	11,275	12,649	9,845	10,555	11,076
Growth (%)	116.7	12.2	(22.2)	7.2	4.9
Depreciation	2,022	1,638	1,552	1,748	1,932
Other income	475	1088	1752	1680	2000
EBIT	9,253	11,011	8,294	8,807	9,143
Interest paid					
Pre-tax profit (before E/o items)	9,728	12,099	10,046	10,487	11,143
Tax Provision	641	1,192	1,828	2,517	2,619
E/o loss / (Income)	0	0	0	0	0
Net profit	9,087	10,908	8,218	7,970	8,525
Adjusted net profit	9,087	10,908	8,218	7,970	8,525
Growth (%)	118.2	20.0	(24.7)	(3.0)	7.0
Diluted EPS (Rs)	43.3	51.8	39.0	37.9	40.5
Diluted EPS Growth (%)	213.7	19.6	(24.6)	(3.0)	7.0

Balance Sheet					
Year ended 31 Oct (Rs mn)	FY09	FY10	FY11	FY12E	FY13E
Equity Share capital	2,096	2,099	2,100	2,100	2,100
Reserves & surplus	21,358	30,892	36,898	43,977	50,926
Shareholders' funds	23,453	32,991	38,998	46,077	53,026
Minorities interests	0	0	0	0	0
Total Debt	33	454	2,924	2,924	2,924
Capital Employed	23,487	33,445	41,922	49,001	55,950
Net fixed assets	6,237	6,398	11,644	13,098	14,227
Net Other Current Assets	7,157	9,910	8,663	10,359	11,754
Cash & Cash Eq.	1,786	1,784	2,896	6,824	11,250
Investments	7,614	14,602	17,766	17,766	17,766
Net Deferred Tax Assets	694	751	953	953	953
Total assets	23,487	33,445	41,922	49,001	55,950

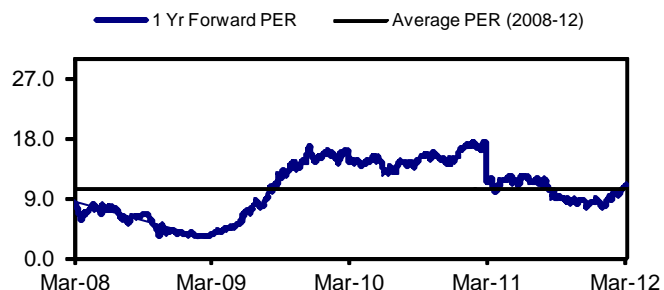
1 yr fwd P/E Band



Cash Flow Statement					
Year ended 31 Oct (Rs mn)	FY09	FY10	FY11	FY12E	FY13E
Pre-tax profit	9,728	12,099	10,046	10,487	11,143
Depreciation	2,022	1,638	1,552	1,748	1,932
Total tax paid	(1,646)	(1,813)	(1,954)	(2,517)	(2,619)
Chg in working capital	621	(3,068)	(482)	(1,733)	(1,452)
Other operating ASitivities	(207)	(450)	(1,022)	(1,680)	(2,000)
Cash flow from operations (a)	10,517	8,406	8,139	6,305	7,005
Capital expenditure	(1,753)	(1,462)	(6,098)	(2,708)	(3,004)
Chg in investments	(7,612)	(6,988)	(2,953)	0	0
Other investing ASitivities	307	527	930	1,680	2,000
Cash flow from investing (b)	(9,059)	(7,923)	(8,121)	(1,028)	(1,004)
Free cash flow (a+b)	1,458	483	18	5,277	6,001
Equity raised/(repaid)	80	45	13	0	0
Debt raised/(repaid)	(21)	420	2,292	0	0
Change in Minorities Interest	0	0	0	0	0
Dividend (incl. tax)	(486)	(858)	(980)	(1,365)	(1,575)
Other financing ASitivities	0	(9)	(31)	0	0
Cash flow from financing (c)	(427)	(402)	1,293	(1,365)	(1,575)
Net chg in cash (a+b+c)	1,031	81	1,311	3,912	4,426

Key Ratios					
Year ended 31 Oct	FY09	FY10	FY11	FY12E	FY13E
OPM (%)	26.4	25.1	19.3	19.3	18.3
Net margin (%)	21.3	21.7	16.1	14.6	14.1
Yield (%)	0.5	0.9	1.5	1.5	1.7
Net debt/Equity (x)	-0.4	-0.5	-0.5	-0.5	-0.5
Net Working Capital (days)	61	72	62	69	71
Asset turnover (x)	6.8	7.9	4.4	4.2	4.2
ROCE (%)	39.4	32.9	19.8	18.0	16.3
RoE (%)	38.7	33.1	21.1	17.3	16.1
EV/Net sales (x)	2.1	1.8	1.8	1.7	1.6
EV/EBITDA (x)	8.1	7.2	9.5	8.9	8.5
PER (x)	9.9	8.3	11.0	11.4	10.6
Price/Book (x)	3.9	2.8	2.3	2.0	1.7

Avg PER



T E A M

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Rating Objective		
Rating	Large Caps	Mid Caps
	M.Cap > USD1bn	M.Cap <= USD1bn
Return %		
BUY	More than 15	More than 20
Accumulate	5 to 15	10 to 20
Reduce	(-)5 to +5	0 to 10
Sell	Below (-)5	Less than 0



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