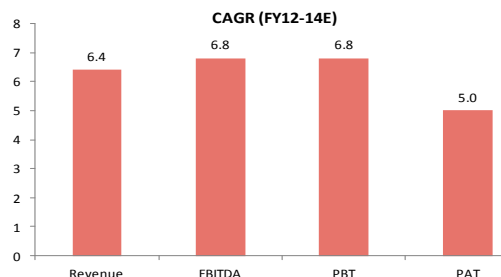


August 30, 2012

Result Highlights

IT services
Sector Outlook - Cautious



Stock Recommendation	Not Rated
CMP (₹)	369
Price Target (₹)	NA
Upside (%)	NA
52 Week H / L ₹	439/277
BSE 30	17491

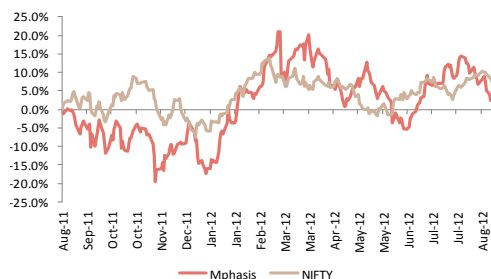
Key Data

No. of Shares, Mn.	210
Mcap, ₹ Mn	77501
Mcap, USD Mn @ ₹55	1409
2 W Avg Qty (BSE+NSE) Mn	0.1

Share holding, June '12

Promoters	60.5
Institutional Investors	22.0
Others	6.1
Public & Others	11.4

Performance	1 M	3 M	6 M	12 M
Stock Return %	-5.1	-2.3	-15.1	2.7
Relative Return %	-8.8	-8.3	-13.3	-4.8



Naushil Shah

naushil.s@sunidhi.com
Phone: +91-022-61131318

Mphasis' US\$ revenues have been declining for the last four quarters – primarily due to weak HP contribution. Management indicated discretionary budgets for clients remain under pressure, with longer decision cycles. We believe weak sentiment due to a declining headcount (4 quarters in Applications and ITO business) and a weak outlook on HP's enterprise services business is likely to persist for some time. HP channel revenues declined 10.1% QoQ to US\$138.6 mn, while direct channel revenues grew at 1.6% to US\$113.4 mn.

Quarter details. Mphasis reported a ~5.2% QoQ decline in USD revenues to US\$252 mn. Reported EBITDA margin of 19.8% was up 10 bps QoQ on account of Rupee depreciation, mostly being offset by wage hikes and promotions during the quarter. Net headcount increase of 458, was on account of an increase of 1,409 employees in the BPO space. Applications and ITO space has seen a continuous decline since last 4 quarters. The total employee base stood at 37,637 – a number almost equivalent to 3QFY10, coming on the back of 4,560 combined reductions in Q3FY11-Q2FY12, does not paint a pretty picture in terms of demand. Management indicated that HP enterprise service revenues will remain weak, while it expects HP non-enterprise service revenues to grow. HP non-ES contribution to share of HP revenues increased to 8.9% in Q3 from 7.5% in Q2. HP (overall) business was down 6.2% QoQ in constant currency terms.

Other key points. HP's contribution to revenue was lower by 300 bps QoQ at 55% this quarter. Mphasis added 24 clients this quarter (of which 20 are from the Direct channel). Net Cash & equivalents stand at ₹123/share (~33% of the MCap is in form of cash). DSO's increased 5 days QoQ to 85 days this quarter. Mphasis has given wage hikes of ~8% and 3% for offshore/onsite employees respectively, which impacted margins by ~200bps QoQ in the quarter. Management expects to maintain margin QoQ, through multiple cost levers.

Valuation: Apart from Buyback, delisting and cash/share, Mphasis does not compare well versus some of the other mid-cap IT companies. Valuations, though being cheap compared to some of the performing mid-caps, the revenue growth story is weak, while risks to its margins are higher. Mphasis trades at single digit P/E multiples. We have modeled in 4.6% US\$ revenue growth for FY13E and 3.4% YoY growth in EPS.

Financials	Revenues	EBIDTA	Net Profit	EPS	P/E	EV/EBIDTA	ROE
	₹ mn	₹ mn	₹ mn	₹	x	x	%
FY10	50,365	12,648	10,907	52.0	7.1	6.0	38.6
FY11	50,980	9,845	8,218	39.1	9.4	7.8	22.8
FY12E	54,188	10,561	7,855	37.4	9.9	7.4	18.6
FY13E	55,945	11,077	8,127	38.6	9.6	6.9	16.7
FY14E	61,384	12,055	8,652	41.0	9.0	6.1	15.6

Source: Company, Sunidhi Research

**Exhibit 1: Q3FY12 quarterly details**

₹ mn	3Q11	2Q12	3Q12	QoQ	YoY	Comments
Revenues	12,936	13,289	13,551	2.0	4.8	Mphasis revenue stood at US\$252mn, down 5.2% QoQ. HP channel revenues declined 10.1% qoq to US\$138.6mn
- Operating costs	10,420	10,675	10,869	1.8	4.3	
EBITDA	2,517	2,614	2,682	2.6	6.6	
EBITDA margin (%)	19.5	19.7	19.8	10bps	30bps	Rupee depreciation was offset by margin pressure due to the wage hikes (200bps).
- Interest expense	15	65	42	(34.6)	179.5	
- Depreciation	440	455	422	(7.3)	(4.2)	
+ Other income, net (incl forex)	444	405	484	19.4	8.8	Forex gain of ₹90mn. Other income for the quarter was ` 393mn against ` 322mn in the previous quarter mainly due to better yield from investments.
PBT	2,505	2,499	2,701	8.1	7.8	
- Taxes	557	605	614	1.4	10.1	
Effective tax rate (%)	22.2	24.2	22.7	(150)bps	50bps	Tax rates to remain in the 23-24% range
PAT	1,948	1,894	2,087	10.2	7.2	
- Minority interests	0	0	0			
Consolidated PAT	1,948	1,894	2,087	10.2	7.2	
Net margin (%)	15.1	14.3	15.4	110bps	30bps	
Reported profits	1,948	1,894	2,087	10.2	7.2	

Source: Company, Sunidhi Research

Exhibit 2: Geographical wise Performance

Geographical mix	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12
US	68.7	65.2	65.4	65.4	66.0	65.6	65.2	64.8	64.1
Europe	17.6	18.3	18.0	17.3	17.1	16.2	14.7	14.9	14.8
APAC	13.8	16.5	16.6	17.4	17.0	18.2	20.1	20.4	21.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, Sunidhi Research

Exhibit 3: Vertical wise Performance

Vertical Mix	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Application maintenance	37.3	36.9	37.4	35.6	36.9	33.0	32.0	34.5	33.0
Application development	27.0	27.7	26.4	25.9	26.2	28.1	28.0	25.7	26.2
Customer service	5.2	4.7	5.2	6.2	5.7	5.9	5.5	5.8	5.4
Service/ technical help desk	5.5	5.6	3.8	5.6	4.5	4.7	3.8	3.8	4.2
Transaction processing service	5.4	6.0	6.1	5.8	5.0	4.8	5.1	5.1	5.4
Infrastructure management services	17.9	17.9	20.1	20.3	21.1	22.6	24.0	24.3	24.7
Knowledge processes	1.6	1.2	1.0	0.6	0.6	0.9	1.8	0.9	1.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, Sunidhi Research



Human Resources: Net headcount increase of 458, was on account of an increase of 1,409 employees in the BPO space. Applications and ITO space has seen a continuous decline since last 4 quarters. The total employee base stood at 37,637 – a number almost equivalent to 3QFY10, coming on the back of 4,560 combined reductions in Q3FY11-Q2FY12, does not paint a pretty picture in terms of demand.

Exhibit 4: Employee strength

Employees	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Applications (onsite)	2,115	2,535	2,675	2,761	2,748	2,692	2,716	2,496	2,441
BPO (onsite)	165	189	192	153	149	141	121	116	101
ITO (onsite)	267	457	478	378	315	314	308	312	307
Applications (offshore)	12,463	12,071	12,657	12,459	12,799	12,682	11,820	10,966	10,286
BPO (offshore)	16,259	15,137	15,469	16,246	15,693	15,132	14,830	14,844	16,253
ITO (offshore)	7,006	8,139	8,126	8,244	8,063	7,950	7,503	7,010	6,844
S&M		317	327	325	315	325	343	336	347
G&A		1,117	1,135	1,173	1,182	1,190	1,157	1,099	1,058
Total	38,275	39,962	41,059	41,739	41,264	40,426	38,798	37,179	37,637

Source: Company, Sunidhi Research

Client Concentration: Of the 24 new clients added in Q3FY12, thrust came from the Direct channel with 20 new additions.

Exhibit 5: Client details

Client concentration	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Top client	11.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	9.0
Top 5 clients	29.0	28.0	29.0	28.0	30.0	30.0	31.0	31.0	31.0
Top 10 clients	45.0	45.0	44.0	44.0	44.0	44.0	44.0	44.0	44.0
Top 20 clients	62.0	63.0	60.0	61.0	61.0	59.0	59.0	60.0	58.0
US\$1mn+	109	115	119	119	120	120	122	126	129
US\$5mn+	39	38	38	39	41	43	41	42	41
US\$10mn+	22	23	22	25	24	24	25	24	24
US\$20mn+	13	14	14	14	12	12	12	12	10
Receivable days	78	83	94	89	91	88	88	80	85
Client added	22	21	18	30	27	25	28	18	24

Source: Company, Sunidhi Research

Billing rates: Pricing remained stable during the quarter across businesses.

Exhibit 6: Billing rates (in US\$/hr)

Details	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Applications (onsite)	71	72	72	72	70	69	67	67	66
ITO (onsite)	67	67	67	67	67	67	67	63	64
Applications (offshore)	20	20	19	20	20	20	21	20	20
BPO (offshore)	7	7	7	7	7	6	6	6	6
ITO (offshore)	21	20	19	20	21	21	21	20	21

Source: Company, Sunidhi Research

**Valuations Summary**

Year End-October	FY10	FY11	FY12E	FY13E	FY14E
Per share (₹)					
EPS	52.0	39.1	37.4	38.6	41.0
CEPS	59.8	46.5	45.8	47.5	50.7
BVPS	157.2	185.7	216.9	246.8	278.4
DPS	4.0	6.5	7.0	7.5	8.0
Payout (%)	9.0	19.4	21.9	22.7	22.8
Valuation (x)					
P/E	7.1	9.4	9.9	9.6	9.0
P/BV	2.3	2.0	1.7	1.5	1.3
EV/EBITDA	6.0	7.8	7.4	6.9	6.1
Dividend Yield (%)	1.1	1.8	1.9	2.0	2.2
Return ratio (%)					
EBITDA Margin	25.1	19.3	19.5	19.8	19.6
PAT Margin	21.7	16.1	14.5	14.5	14.1
ROAE	38.6	22.8	18.6	16.7	15.6
ROACE	42.5	26.7	23.0	21.1	20.2
Leverage Ratios (x)					
Total D/E	0.0	0.1	0.1	0.1	0.1
Net Debt/Equity	(0.5)	(0.5)	(0.4)	(0.4)	(0.4)
Current ratio	2.0	1.8	2.1	2.2	2.3
Growth Ratios (%)					
Income growth	18.1	1.2	6.3	3.2	9.7
EBITDA growth	12.2	(22.2)	7.3	4.9	8.8
PAT growth	20.0	(24.7)	(4.4)	3.5	6.5
Turnover Ratios					
Inventory Days	-	-	-	-	-
Debtors Days	88	90	90	91	90
Payable days	11	12	12	13	13
Income Statement(₹ mn)					
Year End-October	FY10	FY11	FY12E	FY13E	FY14E
Revenues	50,365	50,980	54,188	55,945	61,384
Op. Expenses	37,717	41,135	43,627	44,867	49,329
EBITDA	12,648	9,845	10,561	11,077	12,055
Other Income	1,080	1,770	1,646	1,761	1,851
Depreciation	1,638	1,552	1,777	1,867	2,043
EBIT	12,091	10,063	10,430	10,971	11,862
Interest	(8)	18	174	170	170
PBT	12,099	10,046	10,256	10,801	11,692
Tax	1,192	1,828	2,402	2,674	3,040
PAT	10,907	8,218	7,855	8,127	8,652
Minority	-	-	-	-	-
Adj Pat	10,907	8,218	7,855	8,127	8,652

Source: Company, Sunidhi Research

Balance Sheet (₹ mn)

Year End-October	FY10	FY11	FY12E	FY13E	FY14E
Sources of Funds					
Equity Share Capital	2,099	2,100	2,102	2,105	2,109
Reserves & Surplus	30,892	36,897	43,503	49,830	56,588
Net Worth	32,991	38,998	45,605	51,934	58,697
Loan Funds					
Deferred Tax Liability	(751)	(952)	(878)	(878)	(878)
Capital Employed	32,694	40,969	48,066	54,395	61,158
Application of Funds					
Net Block	2,512	2,946	2,786	2,918	3,075
Goodwill	3,886	8,698	8,698	8,698	8,698
Investments	14,600	17,765	24,248	28,248	31,248
Current Assets					
Debtors	12,054	13,072	13,489	14,346	15,808
Inventory	-	-	-	-	-
Cash	1,784	2,897	2,729	4,382	7,037
Others	9,448	9,642	7,499	7,975	8,745
Current Liabilities					
Creditors	8,094	9,098	10,185	10,891	12,153
Provisions	3,497	4,952	1,198	1,281	1,301
Net Current Asset	11,696	11,561	12,334	14,531	18,137
Misc Expenses	-	-	-	-	-
Total	32,694	40,969	48,066	54,395	61,158
Cash flow Statement					
Year End-October	FY10	FY11	FY12E	FY13E	FY14E
PBT	12,099	10,046	10,256	10,801	11,692
Depreciation	1,638	1,552	1,777	1,867	2,043
Others	(57)	(201)	74	-	-
CF before W.cap	13,679	11,396	12,107	12,668	13,735
Inc/dec in W.cap					
Op CF after W.cap	10,925	12,645	11,166	12,124	12,785
Less Taxes	1,192	1,828	2,402	2,674	3,040
Net CF From Operations	9,733	10,817	8,764	9,450	9,745
Inc/(dec) in F.A + CWIP					
(Pur)/sale of Investments	7,929	7,976	6,483	4,000	3,000
CF from Invst Activities	(8,787)	(9,962)	(8,100)	(6,000)	(5,200)
Loan Raised/(repaid)					
Equity Raised	(386)	(614)	474	49	84
Dividend	982	1,597	1,722	1,847	1,974
CF from Fin Activities	(948)	258	(832)	(1,798)	(1,890)
Net inc /(dec) in cash	(2)	1,113	(167)	1,653	2,655
Op. bal of cash	1,786	1,784	2,897	2,729	4,382
Cl. balance of cash	1,784	2,897	2,730	4,382	7,037



Sunidhi's Rating Rationale

The price target for a **large cap stock** represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as **Outperform**, the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as **Underperform**, the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as **Neutral**.

(For Mid & Small cap stocks from 12 months perspective)

BUY	Absolute Return >20%
ACCUMULATE	Absolute Return Between 10-20%
HOLD	Absolute Return Between 0-10%
REDUCE	Absolute Return 0 To Negative 10%
SELL	Absolute Return > Negative 10%

Apart from Absolute returns our rating for a stock would also include subjective factors like macro environment, outlook of the industry in which the company is operating, growth expectations from the company vis a vis its peers, scope for P/E re-rating/de-rating for the broader market and the company in specific.

SUNIDHI SECURITIES & FINANCE LTD

Member: National Stock Exchange (Capital, F&O & Debt Market) & The Stock Exchange, Mumbai

SEBI Registration Numbers: NSE: INB 230676436 BSE: INB 010676436

Maker Chamber IV, 14th Floor, Nariman Point, Mumbai: 400 021

Tel: (+91-22) 6636 9669 Fax: (+91-22) 6631 8637 Web-site: <http://www.sunidhi.com>

Disclaimer: "This Report is published by Sunidhi Securities & Finance Ltd. ("Sunidhi") for private circulation. This report is meant for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. While utmost care has been taken in preparing this report, we claim no responsibility for its accuracy. Recipients should not regard the report as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without any notice and this report is not under any obligation to update or keep current the information contained herein. Past performance is not necessarily indicative of future results. This Report accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this report. Sunidhi and its associated companies, directors, officers and employees may from time to time have a long or short position in the securities mentioned and may sell or buy such securities, or act upon information contained herein prior to the publication thereof. Sunidhi may also provide other financial services to the companies mentioned in this report."