

Mphasis Limited

CMP Rs. 178.0
BUY

Q2 FY2009
Result Update

Mphasis Limited report an exceptionally good results for Q209. Revenues grew 13% Q-Q & 39% Y-Y. Profit growth has been better at 79% Q-Q and 113% Y-Y. Margins sharply improved during the quarter. OPM margins stand at 15.8% v/s. 11.2% in Q1 and 12.3% in Q2 last year. Similar change has been witnessed on the NPM, which now stand at 16.9%. Such margins were last observed during the December 2005 Quarter.

The key gains came in from the currency front. The company moderately hedges and been a key beneficiary of the INR depreciation. The earnings do include Rs. 149 Mn. of foreign exchange gain (v/s. Loss of Rs. 15.9 Mn in Q1) on account of restatement of financials.

The trend of improvisation in operating performance continues for Mphasis with the business mix change. ITO has seen the highest growth on account of low base and a sharp improvement in margins. Also, it is the highest return business. BPO & Application businesses also continue to do well in terms of both growth and margins. The management expects some good traction for the BPO industry as a whole in the next year.

Company has maintained its gross hiring plans at 7,000 but is now more focused towards bettering the utilization rates. Overall the utilization rates for Q2 improved sharply for the all the three segments from 71% , 56% & 72% for Application, BPO & ITO to 77% , 67% & 74% respectfully. Share of business from EDS channel, though growing, is coming down gradually in % terms. It now stands at 40% v/s. 41% in last quarter. Another key improvement was the increase in fixed price contracts from 3% to 6%. The management views that there is an emerging trend in favour of fixed price contracts and is not a quarterly aberration.

Mphasias is changing its Financial year from April to March to November to October effective 1 Nov 2008, in lines with its new parent HP. HP-EDS has decided to cut 24,600 jobs as a part of the integration. This is basically with the intent of replacing the expensive US employee with overseas employees. Mphasis could possibly be a key beneficiary of this exercise. Discussions in the coming month with HP could bring in more clarity on this front.

Mphasis offers the highest visibility in terms of offshoring from its EDS-HP parentage. It is a decent size company with over 28,000 employees, over Half a Billion dollar revenues, both poised & capable of high growth in the coming times. Relatively lower forex hedging (still balance sheet hedging), enables maximizing the gains from currency movement. The possibility of HP-EDS increasing its stake in this company through integration with HP India and the consequent buyback & maybe de-listing remain a distant possibility.

Mphasis trades at 11.2 times FY09E earnings of Rs. 15.75 per share. We recommend buy with a target of Rs. 236 based on 15x FY09E (33% upside).

Data Points

Revenues by Vertical / Industry	Sept 08	Jun 08	Sept 07	FY08
Banking & Financial Services	43%	40%	45%	42%
Technology & OEMs	23%	24%	23%	23%
Telecom	11%	12%	12%	13%
Manufacturing & Retail	13%	15%	10%	12%
Logistics, Airlines & Transportation	6%	5%	7%	7%
Healthcare & Pharma	4%	4%	3%	3%
Total	100%	100%	100%	100%

Revenues by Geography	Sept 08	Jun 08	Sept 07	FY08
USA	68%	66%	67%	66%
Europe	19%	19%	20%	21%
Asia Pacific	5%	5%	5%	5%
India & Middle East	8%	10%	8%	8%
Total	100%	100%	100%	100%

Revenues by Service Type	Sept 08	Jun 08	Sept 07	FY08
Application Maintenance & Other Services	33%	33%	34%	34%
Application Development	31%	30%	33%	31%
Customer Service	10%	11%	11%	11%
Service / Technical Help Desk	8%	8%	8%	8%
Transaction Processing Service	6%	6%	5%	6%
Infrastructure Management Services	8%	8%	5%	6%
Knowledge Processes	4%	4%	4%	4%
Total	100%	100%	100%	100%

Revenues by Project Type	Sept 08	Jun 08	Sept 07	FY08
Time and Material	94%	97%	95%	96%
Fixed Price	6%	3%	5%	4%
Total	100%	100%	100%	100%

Revenues by Delivery Location	Sept 08	Jun 08	Sept 07	FY08
Onsite	26%	24%	23%	22%
Offshore	74%	76%	77%	78%
Total	100%	100%	100%	100%

Group - Client Concentration	Sept 08	Jun 08	Sept 07	FY08
Revenues from Top Client	11%	12%	8%	10%
Revenues from Top 5 Clients	31%	33%	29%	30%
Revenues from Top 10 Clients	46%	47%	46%	46%
<u>Clients Contributing more than:</u>				
\$ 1 million Revenues	98	94	86	85
\$ 5 million Revenues	32	28	26	27
\$ 10 million Revenues	18	15	15	15
\$ 20 million Revenues	9	7	7	6
Receivables Days	41	43	42	40

Mphasis : Quarterly Financials & Segment Analysis

Earnings Statement								
YE March (Rs. Mn.)	Q2FY09	Q1FY09	Q-Q(%)	Q2FY08	Y-Y(%)	H109	H108	Y-Y(%)
Net Revenues	8,360.6	7,422.1	12.64%	6,016.9	38.95%	15,782.7	11,332.5	39.27%
Cost of Revenues	5,754.5	5,472.0	5.16%	4,590.0	25.37%	11,226.5	8,569.4	31.01%
Gross Profit	2,606.1	1,950.1	33.64%	1,426.9	82.64%	4,556.2	2,763.2	64.89%
Selling Expenses	323.8	276.1	17.28%	251.1	28.95%	599.9	497.9	20.48%
General & Admin Expenses	951.0	837.0	13.62%	425.0	123.76%	1,788.0	841.6	112.45%
Provision for Doubtful debts	7.6	2.1	261.90%	12.2	-37.70%	9.7	12.6	-23.11%
Total Expenditure	7,036.9	6,587.2	6.83%	5,278.3	33.32%	13,624.1	9,921.5	37.32%
Operating Profit	1,323.7	834.9	58.55%	738.6	79.22%	2,158.6	1,411.0	52.98%
OPM (%)	15.83%	11.25%	40.75%	12.28%	28.98%	13.68%	12.45%	9.84%
Forex Gain/(Loss)	149.0	(15.9)	-1037.11%	(37.6)	-496.28%	133.1	(217.0)	-161.35%
Other Income	14.8	33.3	-55.56%	22.9	-35.37%	48.1	55.7	-13.60%
PBT	1,487.5	852.3	74.53%	723.9	105.48%	2,339.8	1,249.8	87.22%
Tax	76.6	62.3	22.95%	60.8	25.99%	138.9	73.6	88.67%
PAT Before MI	1,410.9	790.0	78.59%	663.1	112.77%	2,200.9	1,176.1	87.13%
Minority Interest	0.0	0.0		0.0		0.0	0.0	0.00%
PAT	1,410.9	790.0	78.59%	663.1	112.77%	2,200.9	1,176.1	87.13%
Equity Capital	2,089.3	2,088.7	0.03%	2,086.1	0.15%	2,089.3	2,086.1	0.15%
EPS	6.7	3.8	78.25%	3.2	113.33%	10.5	5.6	87.66%

Ratio Analysis								
YE March (Rs. Mn.)	Q2FY09	Q1FY09	Q-Q(bps)	Q2FY08	Y-Y(bps)	H109	H108	Y-Y(bps)
GPM (%)	31.17%	26.27%	489.7	23.71%	745.6	28.87%	24.38%	448.6
OPM (%)	15.83%	11.25%	458.4	12.28%	355.7	13.68%	12.45%	122.6
PBT (%)	17.79%	11.48%	630.9	12.03%	576.1	14.83%	11.03%	379.7
PAT (%)	16.88%	10.64%	623.2	11.02%	585.5	13.95%	10.38%	356.7

Segmental Analysis								
YE March (Rs. Mn.)	Q2FY09	Q1FY09	Q-Q(%)	Q2FY08	Y-Y(%)	H109	H108	Y-Y(%)
Revenues								
Application Services	5,378.2	4,709.0	14.21%	4,003.3	34.34%	10,087.2	7,477.9	34.89%
BPO Services	1,727.9	1,637.3	5.53%	1,314.5	31.45%	3,365.2	2,558.7	31.52%
ITO Services	1,254.5	1,075.8	16.61%	699.1	79.45%	2,330.3	1,295.9	79.82%
Total	8,360.6	7,422.1	12.64%	6,016.9	38.95%	15,782.7	11,332.5	39.27%
Profits								
Application Services	1,355.4	919.4	47.42%	939.9	44.21%	2,274.8	1,862.5	22.14%
BPO Services	489.6	409.5	19.56%	311.8	57.02%	899.1	636.3	41.30%
ITO Services	340.2	241.5	40.87%	175.2	94.18%	581.7	264.4	120.04%
Total	2,185.2	1,570.4	39.15%	1,426.9	53.14%	3,755.6	2,763.2	35.92%
YE March (%)	Q2FY09	Q1FY09	Q-Q(bps)	Q2FY08	Y-Y(bps)	H109	H108	Y-Y(bps)
Margins								
Application Services	25.20%	19.52%	567.7	23.48%	172.4	22.55%	24.91%	(235.6)
BPO Services	28.33%	25.01%	332.4	23.72%	461.5	26.72%	24.87%	185.0
ITO Services	27.12%	22.45%	467.0	25.06%	205.8	24.96%	20.40%	456.2
Total	26.14%	21.16%	497.8	23.71%	242.2	23.80%	24.38%	(58.7)
Business Mix								
Application Services	64.33%	63.45%	88.2	66.53%	(220.6)	63.91%	65.99%	(207.3)
BPO Services	20.67%	22.06%	(139.3)	21.85%	(118.0)	21.32%	22.58%	(125.7)
ITO Services	15.00%	14.49%	51.0	11.62%	338.6	14.76%	11.44%	333.0

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