

Mphasis LimitedCMP Rs. 676.0
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Result Review

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The story of Mphasis largely remains unchanged. Nevertheless, the company has reported a really good quarter. Topline grew by 26% compared to Oct 08 and bottom line grew by 34% as compared to the same period. Since the previous year was just a seven month year, the annual numbers dont offer a sound basis of comparison. Although the annual results have been appended.

Ever since the acquisition by HP, there has been tremendous changes in the company in terms of aligning its cost structures. The operating margins when compared to last year's average show a difference of almost 10%, with current year's margin at 26%. This bout of profitability is also seen on account of new high value contracts which have come their way through generic sales growth as well as most of the contracts which have been gained due to the association with HP.

In terms of geographical segmentation 64% revenues is derived from the US, 20% from EU and APAC and middle east contributes to 16% of revenues. The company added 771 employees this quarter, which is mainly on account of its acquisition of AIG's captive unit in October 09. The effect of the acquisition will only be apparent from Q1 of the forthcoming financial year. Total employee addition this year was 4,721 which takes the count to 33,524. One remarkable thing is that HP, in their conference call have admitted to reducing 19,000 EDS employees so far. As per their own estimates they are still 6,000 employees shy of rationalizing their cost to offshore the work to low cost destinations. Also HP's influence, like we mentioned earlier, has helped them gain a large proportion of their contracts. This quarter Mphasis won 16 contracts out of which 13 were on account of its HP relation.

On its hedging policies, the company is conservative and has outstanding hedges of \$500 Mn @Rs. 49. They have increased their hedging length for the next two years which speaks a lot about the company's confidence in sustaining those amounts of revenues. One of the newest things they have entered into is to sell licensed products for the healthcare industry. Javelina is the newest product launched by a foreign subsidiary which embarks a new line of work for Mphasis.

Currently HP is also one of Mphasis' clients which contributes to 12% of revenues. This business is not a growth business since it caters to HP's internal IT requirement and the parent is consolidating its IT expenses to rationalize its IT spend. Most of the work that it might enjoy would be from independently won contracts.

The current strategy of the company is to focus on getting more and more business within HP and with HP and at the same time explore more low cost destinations outside of India.

Expectations and Assumptions

Its always imperative to identify ones expectations and assumptions while looking at any business and its future prospects. The case with Mphasis is that it has a very influential trigger for growth, being under the shade of its parent. A lot of go-to market business that they get on their own still needs to catch up with the kind of business they get due to its parent's influence. There is a probability that this expectation is already embedded in the price.

Operating costs have been rationalized from mid 70's to ~63%. Since the business is scaleable and a lot of employees have been cut loose in the past year in the industry as a whole, supply side issues tend to be less going ahead. But of a ten year expectation of how this company is destined to perform, there is a greater probability that it can meet some important value triggers like improved sales and maintaining rational operating expenses.

Mphasis operates in several of the same verticals in which most of the Indian IT companies operate. Looking at it from a competitive scenario, it has been the case that as you grow in size and scale, the reach of your contracts increases in terms of the nature of contracts being served. As more variety kicks in the portfolio, there is an improvement in capability and skill (in man hours spent on projects). At the same time, the competition also grows at its own pace, overlapping onto each other's territories. Although we can observe the number of competitors that have an advantage of being a subsidiary of one of the largest tech firms in the world. Synergies from such association coupled with higher scale are only to be seen as we go ahead.

Valuation

Mphasis trades at 15times (TTM). The argument remains the same and we believe that a lot of growth is still being conservatively looked at. We would like to restate what we said in the last quarter, "From a purely business perspective, the outlook seems to be brilliant with assured incremental business from the parent & at the same time other growth drivers like improvement in utilization as well as an overall improvement in volumes & business mix. This attracts an enviable certainty of growth."

One risk factor which is not about the business would be, that a lot of people are intently focused on the stock which might be immensely useful in the short run, but might compromise the 'stock's' performance in the long run because of extreme shifts in expected returns. In that case it would be even better to own more of it, when that happens.

Earnings Statement								
YE March (Rs. Mn.)	QE Oct 09	QE Jul 09	Q-Q (%)	QE Oct 08	Y-Y(%)	12ME Oct 09	7ME Oct 08	Y-Y(%)
Net Revenues	11321.8	11055.7	2.4%	8947.0	26.5%	42638.8	19065.2	123.6%
Cost of Revenues	7241.8	6986.4	3.7%	6316.0	14.7%	26901.2	13315.8	102.0%
Gross Profit	4080.0	4069.3	0.3%	2631.0	55.1%	15737.6	5749.4	173.7%
SG&A	1134.5	1150.2	-1.4%	929.0	22.1%	4455.1	1854.0	140.3%
Provision for Doubtful debts	0.0	0.0		9.0		8.0	11.3	-29.2%
Total Expenditure	8376.3	8136.6	2.9%	7254.0	15.5%	31364.3	15181.1	106.6%
Operating Profit	2945.5	2919.1	0.9%	1693.0	74.0%	11274.5	3884.1	190.3%
OPM (%)	0.3	0.3	-1.5%	0.2	37.5%	0.3	0.2	29.8%
Forex Gain/(Loss)	153.0	-15.2		175.0		292.2	163.9	
Other Income	72.2	47.4	52.3%	16.0	351.3%	182.9	53.9	239.3%
Depreciation	470.5	513.5	-8.4%			2022.1	1004.8	
PBT	3170.7	2951.3	7.4%	1884.0	68.3%	11749.6	4101.9	186.4%
Tax	250.6	145.5	72.2%	54.0	364.0%	640.7	142.7	349.0%
PAT Before MI	2449.6	2292.3	6.9%	1830.0	33.9%	9086.8	2954.4	207.6%
Minority Interest	0.0	0.0		0.0		0.0	0.0	0.0%
PAT	2449.6	2292.3	6.9%	1830.0	33.9%	9086.8	2954.4	207.6%
Equity Capital	2095.8	2093.3	0.1%	2088.9	0.3%	2093.3	2088.9	0.2%
EPS	11.7	10.9	7.3%	8.7	34.0%	43.2	14.1	206.6%
Ratio Analysis								
YE March (Rs. Mn.)	QE Oct 09	QE Jul 09	Q-Q(bps)	QE Oct 08	Y-Y(bps)	12ME Oct 09	7ME Oct 08	Y-Y(bps)
GPM (%)	36.0%	36.8%	-77.1	29.4%	663.0	36.9%	30.2%	675.3
OPM (%)	26.0%	26.4%	-38.7	18.9%	709.4	26.4%	20.4%	606.9
PBT (%)	28.0%	26.7%	131.0	21.1%	694.8	27.6%	21.5%	604.1
PAT (%)	21.6%	20.7%	90.2	20.5%	118.3	21.3%	15.5%	581.5

Data Points

Revenues by Vertical / Industry					
Particulars	QE Oct 09	QE Jul 09	QE Apr 09	QE Jan 09	QE Oct 08
Banking & Financial Services	41%	41%	39%	43%	44%
Technology & OEMs	22%	23%	24%	25%	23%
Telecom	12%	11%	12%	9%	11%
Manufacturing & Retail	13%	13%	12%	13%	12%
Logistics, Airlines & Transportation	5%	5%	6%	5%	6%
Healthcare & Pharma	6%	8%	7%	5%	4%
Total	100%	100%	100%	100%	100%

Revenues by Geography					
Particulars	QE Oct 09	QE Jul 09	QE Apr 09	QE Jan 09	QE Oct 08
USA	64%	66%	69%	67%	69%
Europe	20%	20%	20%	22%	19%
Asia Pacific	9%	6%	5%	4%	4%
India & Middle East	7%	8%	6%	7%	7%
Total	100%	100%	100%	100%	100%

Revenues by Service Type					
Industry	QE Oct 09	QE Jul 09	QE Apr 09	QE Jan 09	QE Oct 08
Application Maintenance & Other Services	37%	35%	33%	34%	34%
Application Development	27%	28%	31%	31%	30%
Customer Service	7%	8%	8%	8%	10%
Service / Technical Help Desk	6%	5%	7%	8%	8%
Transaction Processing Service	6%	5%	5%	5%	6%
Infrastructure Management Services	14%	14%	13%	10%	8%
Knowledge Processes	3%	3%	4%	4%	4%
License Income	1%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%

Revenues by Project Type					
Particulars	QE Oct 09	QE Jul 09	QE Apr 09	QE Jan 09	QE Oct 08
Time and Material	88%	91%	92%	94%	94%
Fixed Price	12%	9%	8%	6%	6%
Total	100%	100%	100%	100%	100%

Revenues by Delivery Location					
Particulars	QE Oct 09	QE Jul 09	QE Apr 09	QE Jan 09	QE Oct 08
Onsite	29%	25%	25%	28%	26%
Offshore	71%	75%	75%	72%	74%
Total	100%	100%	100%	100%	100%

Financials

Earnings Statement					
YE March (Rs. Mn.)	FY06	FY07	FY08	7ME Oct 08	Oct09
Net Sales	9,401.1	17,606.2	24,230.7	19,065.2	42,638.8
Cost of Revenues	6,485.6	13,187.7	18,735.7	14,254.6	26,901.2
Selling Expenses	584.6	918.4	952.7	727.7	1,791.3
General & Admin Expenses	868.1	1,456.7	1,750.5	1,203.6	2,663.8
Total Expenditure	7,938.3	15,562.8	21,438.9	16,185.9	31,364.3
Operating Profit	1,462.8	2,043.4	2,791.8	2,879.3	11,274.5
Other Income/Forex Gain	76.5 -	135.4 -	215.1	172.4	447.2
EBIT	1,539.3	1,908.1	2,576.7	3,051.7	9,699.6
Interest	(17.5)	(75.1) -	84.9 -	45.4 -	27.3
PBT	1,556.8	1,983.2	2,661.6	3,097.1	9,726.9
Tax	58.2	182.5	108.7	142.7	640.7
PAT	1,498.6	1,800.7	2,552.9	2,954.4	9,086.2

Ratio Analysis					
YE March (Rs. Mn.)	FY06	FY07	FY08	7ME Oct 08	Oct09
OPM (%)	15.6%	11.6%	11.5%	15.1%	26.4%
EBITDA (%)	16.4%	10.8%	10.6%	16.0%	27.5%
PBIT (%)	16.4%	10.8%	10.6%	16.0%	22.7%
PAT (%)	15.9%	10.2%	10.5%	15.5%	21.3%
EPS (Rs.)	8.9	8.4	11.9	13.7	43.4
P/E (x)	75.4	80.1	56.5	48.8	15.5
P/BV (x)	17.1	14.3	12.5	10.0	6.0
BVPS (Rs.)	39.2	46.9	53.9	66.8	111.9
Market Cap (Rs. Mn.)	112,995.8	144,202.3	144,132.6	144,266.4	140,626.8
M Cap/Sales (x)	12.0	8.2	5.9	7.6	3.3
EV (Rs. Mn.)	113,032.7	144,230.7	144,189.4	144,320.2	140,660.0
EV/EBITDA (x)	73.4	75.6	56.0	47.3	12.0
EV/Sales (x)	12.0	8.2	6.0	7.6	3.3
ROCE (%)	23.2%	18.9%	22.2%	21.2%	41.3%
RONW (%)	22.7%	17.9%	22.1%	20.6%	38.7%
Debtors T/o Days	82.3	87.5	87.4	98.4	77.6
Advances T/o Days	27.6	31.3	44.5	37.5	62.0
Creditors T/o Days	32.5	41.0	45.6	47.3	54.9
Working Cap T/o Days	91.0	97.6	79.6	77.9	76.6
Fixed Assets T/o (Gross)	3.0	3.1	3.1	2.0	2.0

Financials

Balance Sheet					
YE March (Rs. Mn.)	FY06	FY07	FY08	7ME Oct 08	Oct09
Equity Capital	1,684.0	2,149.1	2,148.0	2,150.0	2,095.8
Reserves	4,921.9	7,935.9	9,420.7	12,213.4	21,357.6
Shareholders Funds	6,605.9	10,085.0	11,568.8	14,363.4	23,453.4
Borrowed Funds	36.9	28.4	56.8	53.8	33.2
Total Liabilities	6,642.8	10,113.4	11,625.5	14,417.2	23,488.0
Fixed Assets	1,455.3	2,518.3	3,632.8	4,136.1	3,291.1
Goodwill	2,676.5	2,710.5	2,710.5	2,710.5	2,710.5
Current Assets					
Sundry Debtors	2,119.3	4,221.6	5,804.4	8,811.9	9,063.8
Loans & Advances	711.2	1,508.3	2,955.6	3,356.9	7,241.4
Cash & Bank Balance	988.5	1,892.6	952.5	545.9	1,785.6
Current Liabilities					
Sundry Creditors	836.2	1,975.3	3,025.9	4,239.6	6,413.7
Provisions	638.3	939.9	1,403.0	1,497.9	2,733.6
Net Current Assets	2,344.5	4,707.1	5,283.6	6,977.3	8,943.5
Deferred Tax Assets	166.5	177.4	260.1	344.5	344.5
Total Assets	6,642.8	10,113.4	11,625.5	14,417.2	23,487.9

Disclaimer

Disclosure of Interest Statement

1. Analyst Ownership of the scrip
2. PPFAS ownership of the scrip
3. PMS ownership of the scrip

Mphasis

- YES
YES
YES

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