

Mphasis BFL

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Market Performer

Rs731 P/E (FY03E) - 19x

Topline surges 13%

Key Highlights

- Consolidated revenues of Mphasis BFL have risen 13% QoQ as against our expectation of around 8%.
- Operationally, the company's performance is comparable to Q2FY03; OPM has remained at around 19% despite providing Rs17mn towards bad debts.
- Tax outgo has increased. But, a lower foreign exchange loss has compensated for this resulting in a net margin of around 15.7%.
- MsourceE (BPO) financials reveal that the BPO business has clocked a **loss** of Rs19mn (compared to Rs10mn profit in Q2FY03). However, Operational performance of the software business seems to have improved sequentially and hence the Mphasis' consolidated margins have not taken a hit.

Mphasis Software revenues up 11% QoQ

- Composition of the growth weighs more towards the software business than our expectation.
- The company saw increasing business coming from financial services, retail, logistics and from the transportation sector; technology-related revenues subsided.
- Onsite revenues increased 2% sequentially. Onsite billing rates saw a spike in Q2FY03, which has now decreased. Q3FY03 onsite billing rates are back to \$63 per hour (close to Q1FY03 levels).
- Offshore revenues spiked 30% sequentially after two quarters of revenue declines. Offshore billing rates also improved from \$18 per hour (Q2FY03) to around \$20 per hour.
- The company subcontracts some of its software services work to vendors. In Q2FY03, Mphasis used the services of around 200 people in this manner; in Q3, this number went up to around 300. This is the primary reason why despite the net attrition of around 20 personnel, the company's revenues managed to grow by 11% sequentially.

MsourceE (BPO) revenue growth rate slows down to 17% QoQ

- The company's revenues from its BPO (MsourceE) arm grew only 17% QoQ as compared to around 53% during Q2FY02.
- According to the company, one of the main reasons for this slow growth rate in MsourceE revenues is that one of its client has graduated from pilot to ramp-up phase and that the rates negotiated for the client for the ramp-up are lower than the pilot phase rates.
- The company's employees assigned for the pilot project continue to work for the client, but at lower rates. The actual ramp-up for the client during Q3FY03 was negligible and the ramp-up is expected to pick up pace during Q4FY03.
- **MsourceE recruitment spree continued this quarter as it added another 500 employees to its pay roll. YTD the net addition in the company stands at around 1,400 employees!**

Chinese acquisition awaiting approval

During Q3FY03, Mphasis announced that it had acquired China-based Navion (Shanghai) Software Development Co Ltd. As the company is still awaiting Indian/Chinese regulatory approval on the acquisition, the Q3FY03 financials do not account for the acquisition.

View and Valuation

The ongoing aggressive recruitments by MsourceE (BPO) seem to indicate that the company is expecting continuous ramp-up by its various key clients. The YTD 9-months (Apr-Dec, 2002) revenue numbers do not reflect full effects of the massive recruitment that has taken place during this period. We expect effects of these ramp-ups to start showing in the company's financials in the next 2 – 3 quarters.

We have revised our quarterly/yearly estimates mildly to reflect the better-than-expected performance from the software business. The stock is up around 40% from the last quarterly results announcement (10 Oct 2002), and is trading at a P/E (FY03E) of around 19x. **We continue to rate Mphasis as a Market Performer. However, concerns about the relatively weak Q3FY03 performance by MsourceE (BPO), might put some pressure on the stock price in the short-term.**

Projections

Yearly Projections

Rs Mn

Year Ended March 31	2002	2003	Change
		<i>Karvy Estimates</i>	%
Revenues			
Mphasis (IT Services)	2,899	3,388	16.9
MsourceE (BPO)	235	935	297.3
Total Revenues	3,134	4,323	37.9
Net Profits	408	674	65.1
EPS (Rs)	24.34	38.10	56.5
P/E (x)	30	19	

Note: Indian GAAP Consolidated Results

Quarterly Projections

Rs Mn

Year Ended March 31	Q4 2003E	Q4 2003E	Q4 2003E
	<i>Karvy Estimates</i>	<i>QoQ % Growth</i>	<i>YoY% Growth</i>
Mphasis (IT Services)	936	4	124
MsourceE (BPO)	304	16	349
Revenues	1,240	7	148
Net Profits	194	7	147
EPS (Rs)	10.98	7	145

Note: Indian GAAP Consolidated results

Consolidated Results

Indian GAAP Consolidated Results

Rs Mn

Year Ended March 31	Q3 2002	Q2 2002	QoQ %Chg	Q3 2002	YoY %Chg
Revenues					
Mphasis (IT Services)	897	806	11.3%	746	20.2%
Msource (BPO)	262	223	17.4%	58	352.1%
Total Revenues	1,159	1,029	12.7%	804	44.3%
Cost of revenues	716	632	13.2%	469	52.5%
Gross Profit	444	397	11.8%	334	32.7%
Selling expenses	83	80	3.8%	58	42.9%
General and administrative expenses	123	118	3.6%	145	-15.5%
Amortisation of ESOP costs	-	-		2	-70.2%
Provision for doubtful debts	17	(0)		17	-2.2%
Provision for e-structuring skills	-	5			
Restructuring costs	-	-			
Operating Profit	222	194	14.0%	113	95.7%
Foreign exchange gain, net	(9)	(12)	-19.8%	8	-224.4%
Other income	2	0	335.2%	2	7.0%
Interest, net	2	6	-62.0%	10	-78.5%
Profit Before Taxation	216	189	14.5%	132	63.5%
Income taxes	34	27	25.0%	3	1017.9%
Minority Interest	-	-		-	
Profit After Taxation	182	161	12.7%	129	40.9%
No. of Shares (Diluted)	18	17	1.2%	17	3.2%
EPS (Rs)	10.27	9.22	11.3%	7.53	36.5%
GPM	38.3%	38.6%		41.6%	
OPM	19.1%	18.9%		14.1%	
NPM	15.7%	15.7%		16.1%	
Tax/PBT	15.9%	14.5%		2.3%	
Other Income/PBT	-3.5%	-6.0%		6.8%	

Stock Ratings Absolute Returns

Buy	:	> 25%
Out Performer	:	16 - 25%
Market Performer	:	0 - 15%
Under Performer	:	< 0%

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