

## MindTree Consulting

 BSE code: 532819  
 NSE code: MINDTREE

**CMP: Rs 502**
**Target: Rs 497** ↓

**SELL**

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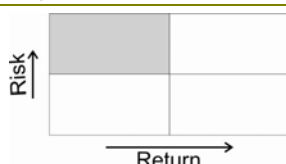
### Company data

Particulars	
Market cap (Rs bn / US\$ mn)	19.0/478.6
Outstanding equity shares (mn)	37.8
52-week high/low (Rs)	1,022/450
2-month average daily volume	55006

### Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs mn)	5,903.5	7,323.8	9,257.0
Growth (%)	31.5	24.1	26.4
Adj net profit (Rs mn)	900.5	1,011.6	1,207.4
Growth (%)	67.5	12.3	19.4
FDEPS (Rs)	27.7	26.6	31.1
Growth (%)	59.7	(3.9)	17.0
P/E (x)	18.1	18.9	16.1
ROE (%)	20.7	19.0	18.4

### Risk-return profile



### Shareholding pattern

(%)	Sep-07	Jun-07
Promoters	35.4	35.5
FII's	1.8	3.5
Banks & FI's	1.5	1.6
Public*	61.3	59.4

\*Includes 34.5% locked-in shares of foreign venture funds

### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
MindTree	502	(3.9)	(25.7)	(36.3)
Sensex	18,771	10.9	19.0	31.9
BSE IT	4,583	1.8	(8.4)	(7.6)

 Company website [www.mindtree.com](http://www.mindtree.com)

## Operational performance in line

MindTree Consulting's Q2FY08 operational performance is in line with our expectations. Volumes grew by 12.7% during the quarter over Q1FY08 with a 3.4% rise in billing rates. The company recorded revenue growth of 17% and 14.4% in dollar and rupee terms respectively, on par with our estimates. However, higher other income due to forex gains has pushed net profit above our expectations, with a growth of 34.6% and 31.8% in dollar and rupee terms respectively.

We maintain our negative outlook on the company considering that it draws 56% of its revenues from development projects which are dependent on the customer's discretionary spending power. This represents a significant risk to growth given concerns of an impending economic slowdown in the US, which would result in a sharp curtailing of discretionary IT spends. While the management has maintained its FY08 growth guidance, we have revised our estimates to build in the quarter's out-performance as well as our modified exchange rate assumption of Rs 39/US\$ for FY09. Consequently we are revising our target price for the stock from Rs 556 to Rs 497; we maintain our Sell recommendation.

### Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	1,819	1,790.5	1.6
EBIDTA	299	300.4	(0.5)
EBITDA margin (%)	16.4	16.8	(40bps)
PAT	272.0	223.3	21.8
EPS (Rs)	7.2	5.9	22.5

Source: Company, Religare Research

### Quarterly results

(Rs mn)	Q2FY08	Q1FY08	% Chg QoQ	Q2FY07	% Chg YoY
<b>Revenues</b>	1819.0	1615.0	12.7	1537.0	18.0
Software development	1,176.9	1,017.6	15.7	906.2	29.9
<b>Gross profit</b>	<b>642.6</b>	<b>597.4</b>	<b>7.6</b>	<b>631.0</b>	<b>1.8</b>
SG&A expenses	343.5	341.7	0.5	368.9	(6.9)
<b>EBITDA</b>	<b>299.1</b>	<b>255.7</b>	<b>17.0</b>	<b>262.1</b>	<b>14.1</b>
Depreciation	80.8	78.8	2.6	64.0	26.3
<b>EBIT</b>	<b>218.3</b>	<b>176.9</b>	<b>23.4</b>	<b>198.2</b>	<b>10.2</b>
Interest	17.8	9.4	89.3	8.6	107.5
Other income	98.9	62.4	58.4	16.9	485.8
<b>Profit before taxes</b>	<b>299.4</b>	<b>229.9</b>	<b>30.2</b>	<b>206.4</b>	<b>45.0</b>
Current taxes	29.6	24.7	19.7	(7.5)	(496.4)
Deferred taxes	(1.8)	(0.9)	108.1	(10.2)	(82.5)
<b>PAT</b>	<b>271.5</b>	<b>206.0</b>	<b>31.8</b>	<b>224.1</b>	<b>21.1</b>
Adjustments	-	-	-	-	-
<b>Adjusted net profit</b>	<b>271.5</b>	<b>206.0</b>	<b>31.8</b>	<b>224.1</b>	<b>21.1</b>
EPS	7.2	5.5	30.9	7.5	(4)

Source: Company, Religare Research

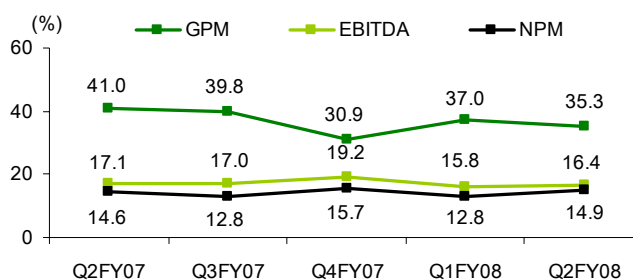
## Result highlights

**EBITDA margin up 60bps QoQ led by higher utilisation and stronger billing rates**

### EBITDA margin rises during the quarter

The EBITDA margin for Q2FY08 registered a 60bps QoQ expansion to 16.4%. The margin growth was mainly due to higher utilisation levels at 69.1% in Q2FY08 against 65.2% in Q1FY08, and an increase in blended billing rates by 3.4%.

### Profit margin movement



Source: Company, Religare Research

### Increase in annuity revenues

Annuity revenues rose from 33% in Q1FY08 to 37% in Q2FY08. The contribution from maintenance projects to revenues has increased from 25.6% in Q1FY08 to 28.9% in Q2FY08. The company will be focussing on the testing and package implementation segment going ahead as these are fixed price projects which will facilitate a de-risking of the business model.

## Key performance highlights

Parameters	Comments
<b>Volume growth</b>	Onsite and offshore volumes grew by 6.4% and 13.7% QoQ respectively, taking overall growth to 12.7% QoQ.
<b>Onsite-Offshore mix</b>	The onsite-offshore mix was biased towards offshore locations this quarter. Offshore business accounted for 86.6% of the total effort versus 85.8% in Q1FY08, with the revenue share rising 170bps QoQ to 72.7%.
<b>Employee addition</b>	Employee gross additions during the quarter stood at 784, raising the total number of employees to 4,896 in Q2FY08. The additions include 460 campus recruitments, and this figure is likely to rise to 560 in Q3.
<b>Attrition rate</b>	The attrition rate has inched up to 15.7% during the quarter as against 15.2% in Q1FY08.
<b>Clients &amp; deals</b>	The company has added three fortune 500 companies operating in the financial, consumer electronics and beverage verticals to its client roster. The number of US\$ 1mn clients has risen from 34 to 41 in Q2FY08.
<b>Utilisation levels</b>	Utilisation levels excluding trainees improved by 400bps QoQ from 65.1% to 69.1% in Q2FY08.
<b>Client growth</b>	MindTree added 28 new clients during the quarter, enhancing its active client base to 192. The top client and top 10 clients witnessed a decrease in revenue contribution to 9% and 40.7% as against 9.6% and 42.8% in Q1FY08. The top 5 clients contributed 31.5% of total revenues in comparison to 28.4% in Q1FY08.
<b>Services metrics</b>	The revenue share of development, consulting and infrastructure management services is down 460bps, 140bps and 70bps QoQ respectively. Maintenance services contributed 28.9% of revenues, up from 25.6% in Q1FY08. Contributions across service offerings are likely to come down in Q3 due to the lower number of working days.
<b>Vertical metrics</b>	The contribution of the BFSI, travel & transportation, hi-tech and manufacturing verticals in IT services has been flattish to negative during the quarter. Consumer appliances and communications systems (R&D vertical) have recorded an increased revenue contribution as the new customers added in Q1FY08 have ramped up business.
<b>Salary hikes</b>	During the quarter, the company gave salary hikes of 12-13% to offshore employees and 3-5% to onshore employees, which had a negative impact of 2.5% on the margins. During Q3FY08, 7% of the total employees will be getting salary hikes of which offshore increments are likely to be 10-12% with onsite hikes at 3-5%.
<b>Geographical mix</b>	Revenue share from the US geography has decreased by 290bps to 67% of revenues during the quarter. The contribution from Europe has increased by 160bps to 18.2% as against 16.6% in Q1FY08.

## Future outlook

### FY08 guidance remains unchanged

The company has maintained its FY08 revenue target of US\$ 178mn–180mn and profit target of US\$ 22.5mn–22.6mn. Despite the positive performance during the quarter, the management has chosen to remain conservative with its guidance until clarity emerges on the growth trend in its key development and maintenance service segments.

### We revise our estimates

MindTree's Q2FY08 operational performance has been in line with our expectations. However, other income due to forex gains has pushed net profit above our estimates, with a growth of 34.6% and 31.8% in dollar and rupee terms respectively. We are therefore increasing our net profit and EPS estimates for FY08 by 4% and 3.9% respectively. We are also realigning our FY09 estimates to an average exchange rate scenario of Rs 39/US\$ (from Rs 40.5/US\$) which has led to a 1.9% and 4% decline in our revenue and EPS estimates for FY09 respectively.

**Estimates revised to build in quarter's out-performance and modified exchange rate assumption**

### Revised estimates

(Rs mn)	FY08			FY09		
	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)
Revenues	7,323.8	7,323.8	-	9,437.4	9,257.0	(1.9)
Net profit	972.4	1,011.6	4.0	1,258.1	1,207.4	(4.0)
EPS (Rs)	25.6	26.6	3.9	32.4	31.1	(4.0)

Source: Religare Research

### EBITDA margin to decline in FY08

We expect the EBITDA margin to decline by 130bps in FY08 and to remain flat in FY09. The margin decline is on account of rupee appreciation anticipated in FY08 and FY09 and rising wage hike pressures.

### We decrease our target price and maintain Sell

At the current price of Rs 502, the stock is trading at 18.9x and 16.1x its expected FY08 and FY09 earnings of Rs 26.6 and Rs 31.1 respectively. We have reduced our one-year target price for the stock to Rs 497 from Rs 556 to build in the impact of our estimate revisions. We maintain our Sell recommendation on the stock.

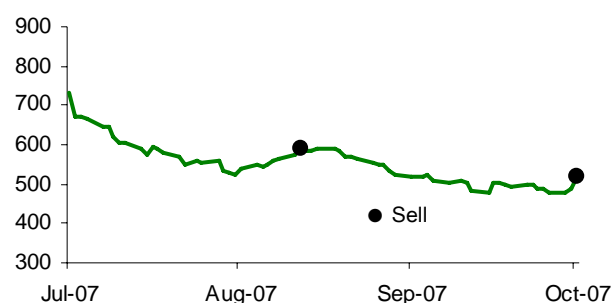
**We lower our target to Rs 497; maintain Sell**

### Recommendation history

Date	Event	Reco price	Tgt price	Reco
05-Sep-07	Initiating Coverage	589	556	Sell
26-Oct-07	Results Update	502	497	Sell

Source: Religare Research

### Stock performance



Source: Religare Research

## Consolidated financials

### Profit and Loss statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Revenues	4,488.0	5,903.5	7,323.8	9,257.0
Growth (%)	82.1	31.5	24.1	26.4
EBITDA	776.2	1,096.4	1,267.3	1,652.0
Growth (%)	206.6	41.2	15.6	30.4
Depreciation	231.8	244.4	364.4	519.6
EBIT	544.4	852.0	902.9	1,132.4
Growth (%)	281.0	56.5	6.0	25.4
Interest	52.6	30.0	59.4	50.7
Other income	65.7	73.6	279.2	280.5
EBT	557.5	895.7	1,122.7	1,362.2
Growth (%)	222.8	60.7	25.3	21.3
Tax	15.5	(4.9)	111.1	154.8
Effective tax rate	2.8	(0.5)	9.9	11.4
Adj net income	537.5	900.5	1,011.6	1,207.4
Growth (%)	201.0	67.5	12.3	19.4
Shares outstanding (mn)	29.4	37.8	38.4	39.1
FDEPS (Rs)	17.4	27.7	26.6	31.1
DPS (Rs)	2.0	2.0	2.0	2.0
CEPS (Rs)	28.7	36.7	36.2	44.5

Source: Company, Religare Research

### Cash flow statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Net income	537.5	900.5	1,011.6	1,207.4
Depreciation	231.8	244.4	364.4	519.6
Other adjustments	(32.7)	(68.4)	(186.4)	46.0
Changes in WC	(343.4)	(266.3)	(231.4)	(287.8)
Operating cash flow	393.2	810.2	958.2	1,485.2
Capital expenditure	(203.7)	(549.2)	(1,563.6)	(863.6)
Investments	(175.3)	(1,575.8)	257.1	-
Other investing inc/(exp)	(236.2)	(16.8)	-	-
Investing cash flow	(615.2)	(2,141.8)	(1,306.5)	(863.6)
Free cash flow	(222.0)	(1,331.6)	(348.3)	621.6
Issue of equity	64.6	2,365.3	131.1	119.1
Issue/repay debt	233.4	(472.1)	510.1	(200.0)
Dividends paid	(58.9)	(34.7)	(120.1)	(101.9)
Others	(24.0)	(21.1)	(5.3)	-
Financing cash flow	215.1	1,837.4	515.8	(182.8)
Beg. cash & cash eq	269.0	262.1	767.9	935.5
Chg in cash & cash eq	(6.9)	505.8	167.5	438.8
Closing cash & cash eq	262.1	767.9	935.5	1,374.2

Source: Company, Religare Research

### Balance sheet

(Rs mn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	262.1	768.0	935.5	1,374.2
Accounts receivable	1,097.7	1,171.6	1,440.4	1,794.9
Inventories	-	-	-	-
Others current assets	558.3	830.3	958.8	1,165.4
Current assets	1,918.1	2,769.9	3,334.7	4,334.6
LT investments	537.6	2,140.6	1,915.2	1,915.2
Net fixed assets	388.5	699.3	1,922.0	2,266.1
CWIP	-	46.4	50.2	54.2
Total assets	2,844.2	5,656.1	7,222.1	8,570.1
Payables	741.3	861.6	886.4	1,159.8
Others	73.1	176.0	232.0	282.0
Current liabilities	814.4	1,037.6	1,118.4	1,441.8
LT debt	742.0	263.8	776.0	576.0
Other liabilities	-	-	-	-
Equity capital	58.7	377.5	384.2	391.4
Reserves	1,229.1	3,977.2	4,943.5	6,160.9
Net worth	1,287.8	4,354.8	5,327.7	6,552.3
Total liabilities	2,844.2	5,656.1	7,222.1	8,570.1
BVPS (Rs)	43.9	115.3	138.7	167.4

Source: Company, Religare Research

### Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	17.3	18.6	17.3	17.8
EBIT margin (%)	12.1	14.4	12.3	12.2
Net profit margin (%)	12.0	15.3	13.8	13.0
FDEPS growth (%)	123.6	59.7	(3.9)	17.0
Receivables (days)	89.3	72.4	71.8	70.8
Inventory (days)	-	-	-	-
Payables (days)	72.9	65.4	53.4	55.7
Current ratio (x)	2.4	2.7	3.0	3.0
Interest coverage (x)	11.2	31.0	18.0	24.8
Debt/equity ratio (x)	0.6	0.1	0.1	0.1
ROE (%)	41.7	20.7	19.0	18.4
ROCE (%)	29.1	20.1	17.5	17.6
ROAE (%)	19.1	15.1	12.5	13.2
EV/Sales (x)	3.9	2.9	2.4	1.9
EV/EBITDA (x)	22.3	15.8	13.7	10.5
P/E (x)	28.9	18.1	18.9	16.1
P/BV (x)	11.4	4.4	3.6	3.0
P/CEPS (x)	17.5	13.7	13.9	11.3

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< - 5%	Returns	Absolute
	BUY	SELL		
Mid-caps**	> 25%	< 10%		

\*Market cap over US\$ 1bn \*\*Market cap less than US\$ 1bn

**Religare Securities**

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