

Information Technology

IPO Note – 7th Feb '07

Issue Details:

Present Equity Capital	Rs mn
Shares Offered	5,593,300
Issue Price Band	Rs 365 – Rs 425
Issue Size	Rs 2041.6 – Rs 2377.2 mn
Face Value	Rs 10 each
Post Issue Mkt Cap*	Rs 15.85 bn

* on the upper band

Issue Open: Feb 9, 2007

Issue Close: Feb 14, 2007

Lead Managers:

Kotak Investment Banking
JM Morgan Stanley

Pre Issue Equity Shares	31.7 mn
Post Issue Equity Shares	37.3 mn

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MindTree Consulting Limited

MindTree Consulting Ltd is an international IT company that delivers business and technology solutions through global software development. It was incorporated in 1999 by ten industry professionals including Mr Ashok Soota (CMD), Mr Subroto Bagchi (COO) among others.

Key Objects of the Issue:

Purpose	Rs Mn
o Fund a new development Centre in Chennai	1207.4
o Prepay certain loans	187.7

Major Presence in following verticals: (% of FY06 revenues)

- IT Services (76.5%)
- R&D Services (23.5%)

Investment Rationale:

- Comprehensive Range Of IT Services
- Strong R&D Capabilities
- Experienced Management Team

Concerns:

- No Definitive Agreements To Utilize The Proceeds Of The Issue, however, we believe it would be for strategic acquisition
- Limited Clientele (Top 5 clients contributed 38% of FY06 revenues with Top client contributing 14%)
- Highly Competitive Market
- Over Dependence On Limited Verticals

Our View:

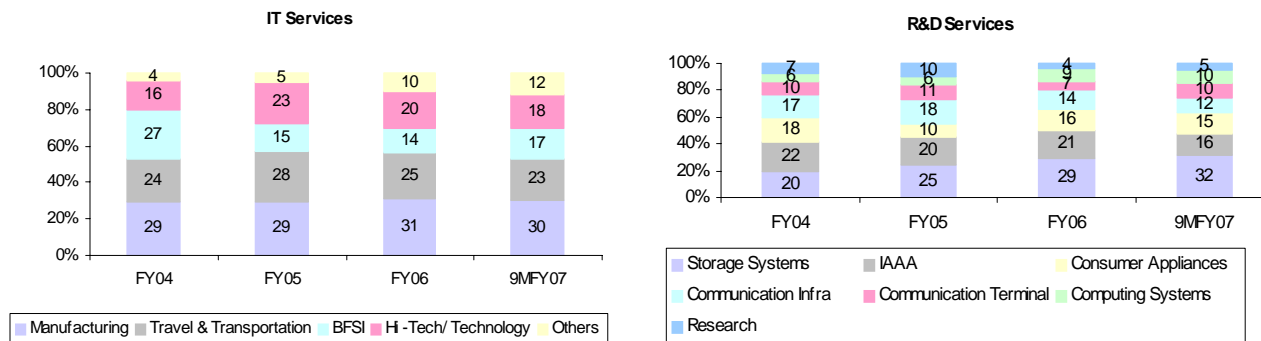
On post diluted basis (at higher band of price of Rs 425), stock is available at a PER of 18x of 9MFY07 fully diluted (post issue) – annualized earnings for FY07 is Rs 23.5. Company is witnessing constant enhancement in margins. **We believe that price offered is attractive and recommend Subscribe.**

Shareholding Pattern

Shareholder Category	Pre-issue (%)	Post-Issue (%)
Promoter Group	42.23	35.90
Investors	49.45	42.03
Employees	6.47	6.49
Public	0.00	14.00
Others	1.85	1.58

Business Overview

MindTree Consulting is an international IT company and is organized into two divisions:



Key Strengths

- **Comprehensive Range Of IT Services:** The company has developed a comprehensive range of service offerings. They offer IT strategic consulting, application development, data warehousing and business intelligence, application maintenance, package implementation, testing, product engineering and infrastructure management services. The comprehensive range of offerings enable the company to obtain additional business from existing clients as well as address a larger base of potential new clients.
- **Strong R&D Capabilities:** It's R&D division is further divided into two segments: (a) Engineering, and (b) R&D Services. The R&D engineering services team provides product realization services to technology and product firms. The R&D research team creates and develops intellectual property primarily in the short-range wireless communication segment and licenses and customizes such IP for the clients. Company has 20 IPs and has applied for 5 patents. Management believes that their R&D IP capabilities create opportunities to cross-sell their R&D engineering services to their clients and also supplement their IT services capabilities.
- **Experienced Management Team:** The company was incorporated in 1999 by 10 industry professionals who have an average of 20 years of industry experience. The management team came from diverse backgrounds and geographies and with different areas of specialization within the IT industry. The founders (Mr Ashok Soota and others) have previously worked with leading IT consulting companies including Cambridge Technology Partners, Lucent Technologies and Wipro Limited. This proves to be a key strength for the company.

Strategy

The company's goal is to be a global IT organization and to achieve this; they have been increasing their geographical footprint in an aggressive manner.

- **Leverage Existing Clients Relationships:** The company wants to continue to grow the business by enhancing the existing relationships and increasing the scope of engagements with their clients by expanding the breadth of services they offer. The management believes that their capability to provide both IT and R&D services enable them to deepen their relationships with existing clients through cross-selling opportunities. It has some elite clients like AIG, AVIS, Symantec, Unilever, Volvo etc.
- **Target Large Clients:** The company intends to diversify their existing client base with the addition of new clients, typically Fortune 1000 companies, which offer them the potential to scale their relationship. Currently, the company has 18 marketing offices across the globe, which company is planning to further expand their geographical coverage by opening new offices in existing as well as new countries.
- **Strengthen Capabilities Through Inorganic Expansion:** The company has done two acquisitions till now and have fully integrated them. It is intending to continue to look for strategic acquisition opportunities that have complementary capabilities and help them expand into new geographies.

Concerns

- **No Definitive Agreements to Utilize the Proceeds of the Issue:** Although the company wants to utilize the proceeds from the IPO for setting up a development center in Chennai, it has not yet entered into any definitive agreements to do the same. This can be a cause of concern for investors. However, we believe that funds could be used for strategic acquisition (it has already announced an acquisition of IC design company for cash, no further details are available).
- **Limited Clientele:** Top 5 clients contributed 38.4% of FY06 revenues and out of which the Top customer contributed as high as 14.3% of revenues. Such high client concentration can put pricing pressure on the company and can be a serious threat to the growth of the overall company, in case of loss of any key client.
- **Highly Competitive Market:** MindTree derives a substantial amount of revenues from IT division (76.5% of FY06 revenues). Within IT services, a majority of the revenues are derived from custom application development services, which is a very competitive market and rapidly evolving. Big domestic and international players are part of this market which is a major threat for the company as these biggies have resources like funds, brand etc to compete aggressively. Low cost was the major unique selling point of MindTree, but in current scenario of increasing wage rates and supply pressures, it is being difficult to leverage low cost base.
- **Over Dependence On Limited Verticals:** The Company derives significant proportion of revenues from manufacturing (in IT services) and storage (in R&D services). It got 31.3% of FY06 revenues from manufacturing and 28.6% from storage industry. Any significant decline in the spending by the clients in these industries can affect company's growth drastically.

Valuations:

On post diluted basis (at higher band of price of Rs 425), stock is available at a PER of 18x of 9MFY07 fully diluted (post issue) – annualized earnings for FY07 is Rs 23.5. Company is witnessing constant enhancement in margins. **We believe that price offered is attractive and recommend Subscribe.**

The company witnessed one-time items (like restructuring in the business of one of top client resulted in loss of revenues to MindTree, it closed down one of its divisions) in 9MFY07, impacting the revenues by \$14 mn. If we normalize this, then the growth would have been more in 9MFY07.

The company is also looking for strategic acquisitions, which we believe will further increase the company's scale and geographical presence.

Financial Performance

Y/E March	Rs Mn			
	FY04	FY05	FY06	9MFY07
Net Sales	1304.4	2465.1	4488.0	4337.9
% chg		89.0	82.1	
EBIDTA	50.3	247.7	753.9	796.3
% chg		392.4	204.4	
% to revenues	3.9	10.0	16.8	18.4
PAT	14.9	178.6	537.6	655.0
% chg		1098.7	201.0	
% to revenues	1.1	7.2	12.0	15.1
Diluted EPS (Rs)	0.4	4.8	14.4	17.6
% chg		1098.7	201.0	

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