

Company

20 July 2009 | 9 pages

MindTree (MINT.BO)

 Equity

Sell: Decline of ~8.5% in Revenues and ~900bps in Margins QoQ

- Revenues/margins significantly below expectations** — Mindtree reported 1Q10 revenues of \$62.1m, down ~8.5% qoq (CIRA expectation: \$67.7m). EBITDA margins declined ~900bps to 16.6% and receivable days worsened to ~86 days (4Q09: 70 days). Significantly higher other income of Rs332m (4Q09: loss of Rs480m) resulted in higher than expected profit after tax of Rs567m.
- FY10 guidance revised down post 1Q** — MindTree management has revised its FY10 guidance lower just three-months after issuing full year guidance. Revenues are now expected to be \$255m-270m (earlier \$290m-300m) and net profit is expected to be ~Rs1.5b-1.8b (earlier Rs1.9b-2.0b).
- Other highlights of 1Q results** — Volumes declined ~3.4% while pricing declined ~3.8% sequentially, mainly due to fixed price contract slippages. Net forex gain in 1Q was Rs305m (loss of Rs493m in 4Q).
- Tier-I vs. Tier-II: Increasing difference in trends?** — While Tier-I players like TCS and Infosys have delivered good results in 1Q, smaller players like MindTree have struggled. We believe this is due to: (1) Discretionary proportion is higher for Tier-II players in most cases, and (b) More deals today are multi-year deals in maintenance, BPO and infra – where Tier-I players are better placed.
- Maintain Sell; Revised guidance still not conservative** — MindTree's earlier guidance implied ~5-7% CAGR in revenues qoq from 2Q-4Q to meet FY10 guidance, a stretch in our view (see 'Indian Tech' report, 10 June 2009). Present guidance implies ~2-6% growth and risk of disappointment remains. The stock has appreciated meaningfully over the past few days along with the sector. Post this disappointment we see meaningful downside ahead. Maintain Sell.

Sell/High Risk	3H
Price (20 Jul 09)	Rs553.65
Target price	Rs415.00
Expected share price return	-25.0%
Expected dividend yield	0.5%
Expected total return	-24.5%
Market Cap	Rs21,037M
	US\$433M

Price Performance (RIC: MINT.BO, BB: MTCL IN)



Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2007A	878	27.00	57.0	20.5	4.8	31.1	0.4
2008A	1,033	26.52	-1.8	20.9	3.9	21.3	0.4
2009E	523	13.49	-49.1	41.0	3.6	9.4	0.2
2010E	1,711	44.97	233.4	12.3	2.8	25.8	0.5
2011E	1,786	46.93	4.4	11.8	2.3	21.7	0.7

Source: Powered by dataCentral

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Results Tables

Figure 1. MindTree — Key Financials

RsM, unless stated	1Q09	4Q09	1Q10	QoQ	YoY
Revenues (\$m)	54.6	67.9	62.1	-8.5%	13.7%
Revenues	2,236	3,381	3,048	-9.8%	36.3%
Direct costs	1,351	1,960	1,934	-1.3%	43.2%
Gross profit	885	1,421	1,114	-21.6%	25.9%
Gross margin	39.6%	42.0%	36.5%	-548bp	-304bp
SG&A	417	556	607	9.3%	45.7%
EBITDA	469	865	507	-41.4%	8.2%
EBITDA margin	21.0%	25.6%	16.6%	-896bp	-432bp
Depreciation	108	159	161	1.1%	49.2%
EBIT	361	706	346	-51.0%	-4.1%
EBIT margin	16.1%	20.9%	11.3%	-953bp	-478bp
Interest charges	24	42	24	-42.2%	-1.6%
Other income	-457	-480	332	-169.3%	-172.8%
PBT	-121	184	654	254.8%	-642.0%
Taxes	8	-27	87	-421.9%	947.0%
PAT	-129	211	567	168.4%	-539.8%
Basic EPS	-3.42	4.97	14.51	192.0%	-524.3%
Fully diluted EPS	-3.42	4.94	14.26	188.7%	-517.0%

Source: Company Reports

Figure 2. MindTree — Revenue Mix

	1Q09	2Q09	3Q09	4Q09	1Q10
Geography					
America	60.4%	63.8%	66.2%	67.2%	67.3%
Europe	24.1%	20.5%	19.9%	17.2%	19.8%
India	5.2%	5.3%	6.7%	8.0%	6.5%
APAC/Rest of World	10.3%	10.4%	7.2%	7.6%	6.4%
Service Lines					
AD	50.3%	49.0%	48.9%	46.5%	46.9%
AM	28.7%	24.5%	23.2%	24.0%	23.6%
Consulting	4.8%	3.7%	3.4%	3.7%	2.9%
PI	5.2%	4.7%	3.6%	3.5%	4.1%
Testing - IVS	6.3%	13.5%	17.5%	19.0%	18.1%
IMS	4.6%	3.6%	3.4%	3.3%	4.4%
IP-led	0.2%	1.0%	0.0%	0.0%	0.0%

Source: Company Reports

Figure 3. MindTree — Key Client Metrics

	1Q09	2Q09	3Q09	4Q09	1Q10
Top Customer	7.9%	7.6%	7.0%	6.7%	7.0%
Top 5 Customers	27.9%	26.4%	25.8%	24.6%	26.4%
Top 10 Customers	42.9%	39.8%	38.2%	37.2%	39.4%
Repeat business	98.3%	99.1%	99.7%	99.2%	99.1%
US\$1m+	48	60	60	64	60
US\$5m+	8	12	13	13	12
US\$10m+	2	4	3	3	3
Total active clients	199	268	260	261	239
New clients added	26	27	22	22	18

Source: Company Reports

Figure 4. MindTree — Key Execution Metrics

	1Q09	2Q09	3Q09	4Q09	1Q10
Employee base					
Total	5,716	7,601	7,649	7,866	7,693
Delivery	5,308	7,076	7,128	7,281	7,073
Non-Delivery	408	525	521	585	620
Utilization					
- inc trainees	65.6%	70.4%	70.3%	65.3%	61.1%
- ex trainees	65.6%	71.0%	71.8%	67.1%	63.7%
Attrition rate - LTM	16.3%	15.0%	13.8%	13.7%	11.4%
DSO	86	83	79	70	86

Source: Company Reports

MindTree

Company description

MindTree is a mid-tier Indian IT services company providing offshore-based services to global organizations in BFSI, Manufacturing, Transportation and Hi-Tech industries. It offers a range of services including IT and R&D services. In IT services, its offerings include application development, maintenance, package implementation, testing and infrastructure management. The company has consciously stayed away from BPO services. In R&D services, it offers product design, re-engineering, optimization and support.

Investment strategy

We rate MindTree shares Sell/High Risk (3H). The business environment for IT services remains challenging given the global slowdown. Tier-II companies like MindTree will be more impacted by the slowdown, in our view. We expect revenue and EPS CAGRs of ~24% and ~21% over FY08-11E. MindTree is more expensive than similar-sized players. A high quality of management team lends credibility to future plans, but challenges remain.

Valuation

Our target price of Rs415 is derived from 9x FY10-11E average EPS, towards the lower end of the trading band of 4-36x one-year forward earnings since listing because challenges remain for the group. We believe a P/E-based valuation is appropriate to value MindTree given the company's earnings record and the widespread use of this methodology to value IT services companies.

Risks

We rate MindTree High Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Upside risks to our target price are: 1) faster than expected recovery in the global economy; 2) better-than-expected pricing; 3) further INR depreciation; and 4) extension of STPI tax benefits.

Tata Consultancy Services (TCS.BO; Rs500.10; 1L)

Valuation

Our target price of Rs525 is based on 18x the average of FY10-11E EPS. Given that businesses are bottoming and we estimate TCS' earnings to grow at a ~7% CAGR over FY09-12E, we believe the stock should trade at the mid-point of its historical three-year trading range of 8-27x 12-month forward earnings. We believe P/E remains the most appropriate valuation measure given TCS' past profitability and future earnings visibility.

Risks

We rate TCS Low Risk despite our quantitative risk-rating system suggesting High Risk. The company has significant scale, enjoys a good brand name and continues to generate significant FCF. Key downside risks that could cause the shares to be lower than our target price are: (1) any significant appreciation of the rupee against the USD/EUR/GBP; (2) a prolonged recession in the US; and (3) any margin dilutive acquisition.

Infosys Technologies (INFY.BO; Rs1,972.70; 1L)

Valuation

Our Rs2,060 target price is based on 20x the average FY10-11E EPS. This is towards the mid-point of the last 3-year trading band of 11-30x 12-month forward earnings and factors in some deceleration in growth. Our estimates continue to assume a certain P/E premium to the market; this is justified, in our view, given the strong FCF and ROIC for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys' profitability record and higher earnings visibility.

Risks

Although our quantitative risk-rating system suggests Medium Risk, we rate Infosys shares Low Risk given superior branding, management quality and cost optimization abilities. Key downside risks are: 1) any significant appreciation of the rupee against the USD/EUR/GBP; 2) pressure on billing rates (as Infosys still continues to enjoy a 10-15% premium in its billing rates); 3) a prolonged slowdown in the US economy; and 4) limited H1B visas. Any of these risk factors could impede the shares from reaching our target price.

Appendix A-1

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MindTree (MINT.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA

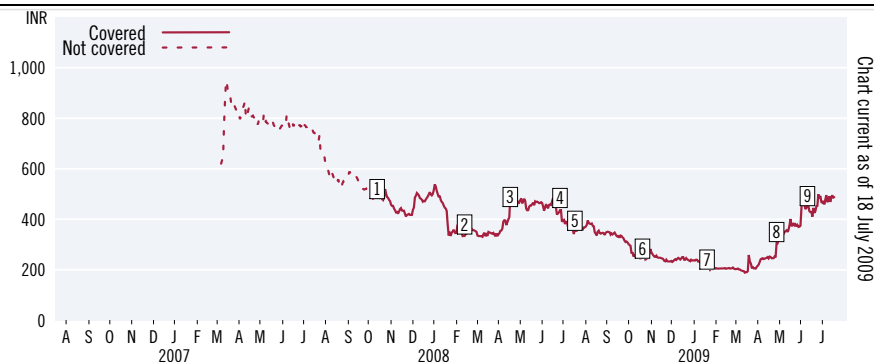


Chart current as of 18 July 2009

	Date	Rating	Target Price	Closing Price
1	12-Oct-07	*3H	*487.00	492.20
2	13-Feb-08	3H	*380.00	333.95
3	17-Apr-08	3H	*465.00	488.40

	Date	Rating	Target Price	Closing Price
4	26-Jun-08	3H	*485.00	436.05
5	17-Jul-08	3H	*390.00	366.05
6	21-Oct-08	*1H	*367.00	283.85

	Date	Rating	Target Price	Closing Price
7	20-Jan-09	*3H	*190.00	216.55
8	28-Apr-09	3H	*240.00	306.90
9	10-Jun-09	3H	*415.00	462.45

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Infosys Technologies (INFY.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA

Covered since October 5 2006

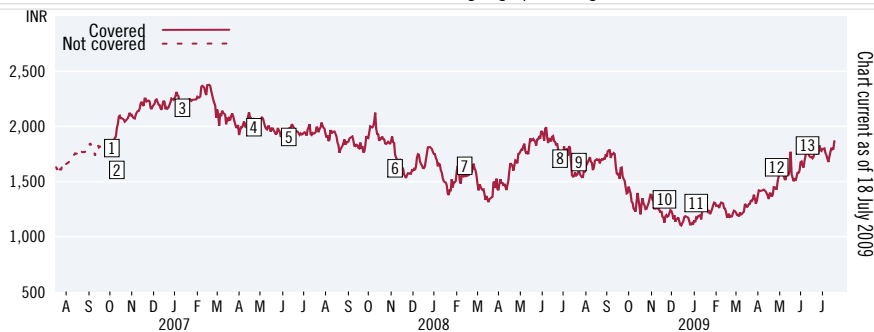


Chart current as of 18 July 2009

	Date	Rating	Target Price	Closing Price
1	4-Oct-06	1L	*2,165.00	1,803.20
2	11-Oct-06	1L	*2,340.00	1,981.35
3	11-Jan-07	1L	*2,660.00	2,183.00
4	23-Apr-07	1L	*2,580.00	2,067.55
5	10-Jun-07	1L	*2,440.00	1,951.05

	Date	Rating	Target Price	Closing Price
6	7-Nov-07	1L	*2,190.00	1,743.85
7	13-Feb-08	*1M	*2,060.00	1,549.15
8	26-Jun-08	1M	*2,175.00	1,781.85
9	23-Jul-08	1M	*1,910.00	1,603.70
10	20-Nov-08	1M	*1,420.00	1,127.25

	Date	Rating	Target Price	Closing Price
11	4-Jan-09	1M	*1,350.00	1,130.95
12	28-Apr-09	*1L	*1,650.00	1,431.55
13	10-Jun-09	1L	*2,060.00	1,803.25

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tata Consultancy Services (TCS.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Surendra Goyal, CFA
Covered since October 5 2006



Chart current as of 18 July 2009

	Date	Rating	Target Price	Closing Price
1	4-Oct-06	1L	*592.50	494.05
2	16-Oct-06	1L	*650.00	565.23
3	15-Jan-07	1L	*780.00	663.95
4	23-Apr-07	1L	*775.00	623.05
5	13-Jun-07	1L	*730.00	601.40

	Date	Rating	Target Price	Closing Price
6	7-Nov-07	1L	*645.00	499.13
7	13-Feb-08	*1M	*582.50	434.48
8	26-Jun-08	1M	*587.50	438.43
9	23-Jul-08	*2M	*462.50	429.25
10	23-Oct-08	2M	*312.50	273.73

	Date	Rating	Target Price	Closing Price
11	20-Nov-08	*2H	*280.00	234.75
12	28-Apr-09	*3M	*307.50	299.30
13	10-Jun-09	*1L	*465.00	390.88
14	17-Jul-09	1L	*525.00	433.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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