

Technology

MINT.BO, Rs253

Rating	BUY
Sector coverage view	Neutral
Target Price (Rs)	400
52W High -Low (Rs)	496 - 181
Market Cap (Rs bn)	10.0

Financials

April y/e	2008	2009E	2010E
Sales (Rs bn)	7.4	12.4	14.1
Net Profit (Rs bn)	1.1	0.5	1.9
EPS (Rs)	26.7	13.2	44.0
EPS gth	12.3	(50.5)	232.5
P/E (x)	9.4	19.1	5.7
EV/EBITDA (x)	8.3	3.3	3.3
Div yield (%)	1.0	0.8	-

Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
22.3	22.8	1.9	(45.4)

Shareholding, December 2008

	% of		Over/(under) weight
	Pattern	Portfolio	
Promoters	34.7	-	-
FIs	6.2	0.0	0.0
MFs	1.6	0.0	0.0
UTI	-	-	-
LIC	1.0	0.0	0.0

MindTree Consulting: Weak revenue performance underlines the challenges for mid-sized Indian IT players. Maintain BUY on inexpensive valuations

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- **4QFY09 consolidated results—revenues miss expectations**
- **FY2009—forex losses mar a solid operational year in a challenging environment**
- **FY2010E revenue guidance appears aggressive**
- **Revising estimates; maintain BUY**

MindTree (MT) reported a weak 4QFY09 revenue performance in line with the larger peers. Consolidated revenues declined 10.6% qoq to US\$67 mn as the company witnessed substantial ramp-down from select clients. Operating margin performance was in line with expectations, while net income exceeded expectations on account of lower-than-expected forex losses and tax provisions. Volume decline of 7.4% qoq for the standalone IT services business clearly underscores the industry-wide loss of business momentum. FY2010E consolidated revenue guidance of US\$290-300 mn appears aggressive and builds in a sharp uptick in revenue trajectory from the September 2009 quarter. MT's EPS estimates remain extremely sensitive to Re/US\$ movement given the high extent of hedging; quarterly net income performance will display volatility to that extent. We revise our EPS estimate for FY2010/11E upwards by 19%/17% to build in our revised Re/US\$ assumptions. Maintain BUY; MT remains the best mid-sized Indian IT player, in our view and valuations at 5.8XFY2010E and 5X FY2011E EPS appear inexpensive. Target price remains unchanged at Rs400/share.

4QFY09 consolidated results—revenues miss expectations. MT's revenue performance disappointed for the second consecutive quarter. Consolidated revenues of US\$67.1 mn missed our expectation by 5% and just about met the lower end of its guidance. Standalone revenues of US\$51.6 mn declined 9.3% qoq and 2.5% yoy, clearly depicting the revenue challenge facing the Indian IT industry in general, and the mid-sized companies in particular. Ramp-downs from specific clients continues to weigh down the overall revenue performance, as delays in decision making continue and new deals remain slow to ramp up. Standalone revenue decline of 9.3% qoq was driven by a volume decline of 7.4% qoq and a blended pricing decline of 1.9% (1.3% decline in constant currency).

4QFY09 EBITDA margins were in line with expectations. Consolidated EBITDA margins declined 490 bps qoq despite sharp rupee depreciation; OPM was impacted negatively by pricing decline, sharp drop in utilization, and cross-currency factors even as Re depreciation had a positive impact. Consolidated net income of Rs188 mn was ahead of our expectation of a loss of Rs3 mn; outperformance was driven by lower-than-expected forex losses (Rs500 mn versus our estimate of Rs740 mn).

FY2009—forex losses mar a solid operational year in a challenging environment.

MT (standalone) had a robust operational year with US\$ revenue growth of 21% to US\$223 mn (commendable though not exceptional), and EBITDA margin expansion of 920 bps yoy (aided by Rupee and operating leverage of the business given small base); EBITDA expanded 111% yoy to Rs2.64 bn. However, standalone net income performance was severely impacted by massive forex losses (Rs1.76 bn) which led to a net income decline of 71% yoy despite an EBITDA growth of 111% yoy. We explain the rationale for the magnitude of loss in the below mentioned paragraph.

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MT hedged FX exposure through leveraged options, which we view as a rather aggressive (and somewhat unnecessary) policy. The company had written twice the numbers of call options at around 41 relative to puts it bought at 39. Since the rupee has decisively breached 41, the company will be forced to sell US\$ at the stipulated 41 rate. Mindtree now has US\$90 mn of hedges net, majority of which will mature in FY2010E with the rest in equal installments over the subsequent two years. Since the auditors have refused to recognize these options as cash flow hedges, MT is forced to mark-to-market the entire hedges at the end of every quarter. This resulted in extra-ordinary FX losses of Rs1.76 bn in FY2009.

FY2010E revenue guidance appears aggressive. We find MT's FY2010E consolidated revenue guidance of US\$290-300 mn (yoy growth of 7.8-11.5%, (2)-2% on an organic basis) aggressive, in the light of weak FY2009E exit revenue trajectory. MT management has indicated weak revenue performance for the June 2009 quarter; this is in line with larger peers. Even assuming a flat June 2009 quarter, MT would need to deliver revenue COGR of 5.3% over 2Q-4QFY10E to meet its FY2010E revenue guidance at the lower end, a stretched target in our view. We build in revenue of US\$277 mn for FY2010E, 4.5% lower than the lower-end of the management guidance.

FY2010E basic EPS of Rs49.3-50.9 builds in a Re/US\$ rate of 51.4 and forex loss of US\$3 mn. MT's has guided for a basic EPS of Rs49.3-50.9 for FY2010E, a growth of ~300% yoy, driven completely by the non-recurrence of the massive forex losses (at the assumed Re/US\$ rate) booked in FY2009E. We highlight that MT lost an EPS of approximately Rs34/share on account of forex losses in FY2009. The company has indicated a forex loss of US\$3 mn (Rs2.5/share) for FY2010E at Re/US\$ rate of 51.4. Thus, lower forex losses contribute to close to 85-90% of the absolute increase in EPS implied in MT's guidance.

Other metrics (standalone)—DSO the sole positive. MT (standalone) reported a sequential volume and pricing decline of 7.4% and 1.9% respectively for its IT services business for the March 2009 quarter. Utilization including trainees dropped a sharp 540 bps qoq to 64.3%. DSO improved by 10 days qoq to 71 days. The company continued its fresher intake reporting a net hiring of 265 for the quarter.

Revising estimates; maintain BUY despite expectations of a challenging FY2010E. We have raised our EPS estimates to factor in lower volume/pricing assumptions and revised Re/US\$ forecast. Our revised fully-diluted EPS estimate for FY2010E is Rs44 (Rs37 earlier) and for FY2011E is Rs50.7 (Rs43.2 earlier). We highlight that we continue to remain conservative on our OPM assumptions and expect MindTree to re-invest part of Re benefits into the business (lateral hiring towards the later half of FY2010E, investments in S&M organization, etc.)

FY2010E could be challenging for Mindtree noting low annuity revenue base from its clients. Further, we also believe that the company may be impacted adversely in situations of vendor consolidation exercise undertaken by clients. We however still back the company to grow at faster than the Tier-1 pack and industry over the medium term noting the company has in place critical blocks for sustainable growth i.e. management, strong client base, strong processes and good employee friendly brand. In addition, valuations at 5.8X FY2010E and 5X FY2011E earnings appear undemanding; maintain BUY.

Mindtree Consulting: Indian GAAP consolidated quarterly earnings statement

Rs mn	Mar-08	Dec-08	Mar-09	qoq (%)	yoy (%)	Kotak E	Deviation
Revenues	2,098	3,638	3,381	(7.1)	61.1	3,513	(3.8)
Software development expenses	(1,324)	(1,956)	(1,960)	0.2	48.1	(2,008)	(2.4)
Gross profit	775	1,682	1,421	(15.5)	83.4	1,506	(5.6)
SG&A expenses	(392)	(572)	(556)	(2.9)	41.7	(611)	(9.0)
EBITDA	383	1,109	865	(22.0)	126.1	895	(3.3)
Depreciation	(107)	(161)	(159)	(0.9)	48.4	(171)	(6.7)
EBIT	275	949	706	(25.6)	156.3	724	(2.5)
Interest	(16)	(52)	(41)	(19.4)	161.3	(76)	(45.1)
Other income	79	(757)	(480)	(36.6)	(704.0)	(662)	(27.5)
Profit before tax	339	140	184	31.7	(45.6)	(13)	
Tax	9	(37)	27	(173)	214.0	3	
Net profit	347	103	211	105.2	(39.2)	(10)	
Minority interest	—	(16)	(23)			(21)	
Share of profit/(loss) in associates	—	-	(0)			-	
Net income	347	87	188	115.5	(45.9)	(31)	
Extraordinaries	—	—	—			-	
Net profit- reported	347	87	188	115.5	(45.9)	(31)	
EBITDA margin	18.2	30.5	25.6			25.5	
EPS (Rs/ share)	9.2	2.3	4.9	115.5	(46.5)	(0.8)	(704.1)
Shares outstanding (mn)	37.6	38.0	38.0			38.0	
Fully Diluted EPS (Rs/ share)	8.8	2.1	4.6	115.5	(48.1)	(0.8)	(704.1)
Fully Diluted Shares outstanding (mn)	39.5	41.2	41.2			41.2	
Guidance (FY2010)	lower end		upper end				
Revenues (US\$ mn)	290.0		300.0				
Growth (%)	7.8		11.5				
Net Income (US \$mn)	37.7		39.0				
EPS	49.3		50.9				

Source: Kotak Institutional Equities estimates.

MindTree missed 4QFY09 guidance on revenues and outperformed on margins, as expected

	4QFY09 Guidance	4QFY09 Actual	Actual versus guidance (%)
MindTree standalone			
Revenues (US\$ mn)	54.0	51.7	(4.3)
EBITDA (US\$ mn)	12.1	13.2	9.1
EBITDA margin (%)	22.4	25.5	312 bps
MindTree consolidated			
Revenues (US\$ mn)	70.0	66.1	(5.6)
EBITDA (US\$ mn)	15.7	17.9	14.0
EBITDA margin (%)	22.5	27.1	465 bps

Source: Company, Kotak Institutional Equities

Key changes to estimates, fiscal year-ends March, 2010E-2011E

Standalone	New		Old		Change (%)	
	2010E	2011E	2010E	2011E	2010E	2011E
Revenues (Rs mn)	10,901	12,302	11,197	12,164	(2.6)	1.1
Revenues (US\$ mn)	215	244	238	265	(10.0)	(7.9)
EBITDA (Rs mn)	2,476	2,755	2,510	2,563	(1.3)	7.5
Net Profit (Rs mn)	1,318	1,546	1,260	1,388	4.6	11.4
EPS (Rs/share)	32.2	37.7	30.7	33.8	4.6	11.4
Fully diluted EPS (Rs/share)	32.0	37.6	30.6	33.7	4.6	11.4
Re/ \$ rate	50.8	50.5	47.0	46.0	8.2	9.9
EBITDA margin (%)	22.7	22.4	22.4	21.1		
Consolidated						
Revenues (Rs mn)	14,056	15,694	14,546	15,835	(3.4)	(0.9)
Revenues (US\$ mn)	277	311	310	344	(10.7)	(9.8)
EBITDA (Rs mn)	3,293	3,615	3,169	3,267	3.9	10.7
Net Profit (Rs mn)	1,812	2,086	1,526	1,779	18.7	17.3
EPS (Rs/share)	44.2	50.8	37.3	43.3	18.7	17.3
Fully diluted EPS (Rs/share)	44.0	50.7	37.1	43.2	18.7	17.3
Re/ \$ rate	50.8	50.5	47.0	46.0	8.2	9.9
EBITDA margin (%)	23.4	23.0	21.8	20.6		

Source: Kotak Institutional Equities estimates.

Condensed consolidated financials for MindTree Limited, 2007-2011E, March fiscal year-ends (Rs mn)

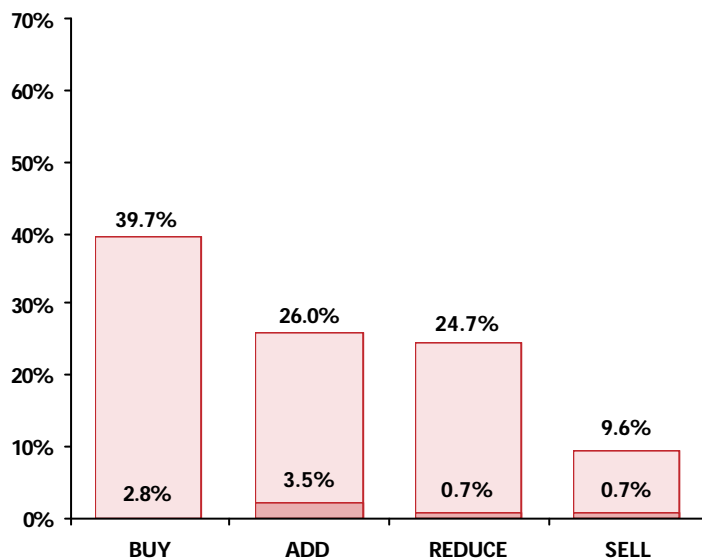
	2007	2008	2009E	2010E	2011E
Profit model					
Revenues	5,904	7,398	12,375	14,056	15,694
EBITDA	1,086	1,254	3,309	3,293	3,615
Interest (expense)/income	(30)	(59)	(162)	(110)	(55)
Depreciation	(244)	(356)	(570)	(720)	(815)
Other income	82	279	(1,974)	(103)	143
Pretax profits	893	1,118	604	2,360	2,888
Tax	7	(85)	(67)	(492)	(802)
Profit after tax	899	1,033	537	1,868	2,086
Diluted earnings per share (Rs)	22.8	26.1	13.2	44.0	50.7
Balance sheet					
Total equity	4,355	5,331	5,513	7,433	9,400
Deferred taxation liability	(46)	(90)	(190)	(190)	(190)
Total borrowings	264	919	1,394	1,376	—
Minority interest	—	—	328	—	—
Current liabilities	1,038	1,392	3,082	2,970	3,489
Total liabilities and equity	5,610	7,553	10,126	11,589	12,700
Cash	768	553	488	435	471
Other current assets	2,002	2,765	4,203	5,481	6,204
Goodwill	—	214	1,460	1,460	1,460
Tangible fixed assets	699	2,625	2,962	3,199	3,552
Investments	2,141	1,395	1,013	1,013	1,013
Total assets	5,610	7,553	10,126	11,589	12,700
Free cash flow					
Operating cash flow, excl. working capital	942	1,398	1,889	2,909	3,615
Working capital changes	(123)	(408)	251	(1,389)	(204)
Capital expenditure	(549)	(2,176)	(369)	(958)	(1,168)
Investment changes/acquisition	(1,620)	491	(2,538)	—	—
Free cash flow	(1,350)	(695)	(766)	562	2,244
Ratios (%)					
EBITDA margin	18.4	16.9	26.7	23.4	23.0
EBIT margin	14.3	12.1	22.1	18.3	17.8
Debt/equity	0.1	0.2	—	—	—
Net debt/equity	(0.6)	(0.2)	(0.0)	(0.0)	(0.2)
RoAE	31.9	21.3	5.5	20.4	18.4
RoACE	25.3	16.5	32.2	22.9	22.3

Source: Company data, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of March 31, 2009

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