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IT Services

We hosted the management of MindTree at IDFC Emerging Star Conference 2011. 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 is one of the youngest companies to cross the US\$250m mark and has a complete suite of technology services, including IT services, offshore product development and R&D services. The company is one of our preferred Tier2 IT services vendors.

□ Key takeaways from the meeting

IT services business to show traction: MindTree's core IT services business is highly levered to discretionary IT spending and is expected to show strong revenue traction on the back of improving macroeconomic environment. This segment reported volume-led revenue growth of ~8% qoq in Q3FY11, driven by growth in the BFSI and manufacturing verticals. For 9MFY11, this business segment has grown 30% yoy in USD terms – ahead of other two segments.

OPD and R&D services: The OPD business USD revenue has grown ~9% yoy in 9M FY11 and is expected to show healthy growth in FY12. R&D services USD revenues have grown ~5% yoy in 9M FY11 organically. Including Kyocera acquisition, USD revenues from R&D services have shown 28% yoy growth. Management expects this segment to remain slightly constrained in the coming few quarters. The company, however, has won a deal with a Japanese semiconductor company in the R&D space, which should boost growth in the long term.

Chairman's resignation not a business concern: The management commented that Mr. Soota had resigned for personal reasons; but coming just two months before his expected transition from executive chairman to non-executive chairman role, the decision came as a surprise to the management. At the time of resignation, Ashok Soota had only the strategy function reporting to him. The other four business functions (sales, delivery, finance and HR) were reporting to the CEO, Krishnakumar Natarajan. The transition of responsibilities (reporting lines) had been happening over past few years. Initially, only sales and delivery reported to Krishnakumar and the other three were reporting to Soota. In 2007-08, HR and finance started reporting to the CEO. Because of this gradual transition, the management said the resignation would not affect the business at large.

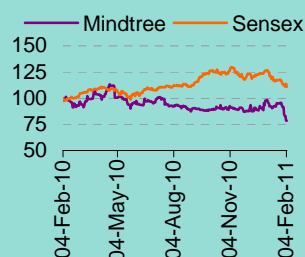
Margins to rebound in FY12: MindTree's operating margins have declined from 18%+ levels to ~11% in the past three quarters, while services margins were ~15%. With product business closure costs behind, the management expects a rebound in margins in FY12.

Hedges: As of December 2010, the company had outstanding hedges of US\$157m at a weighted average rate of Rs45/US\$.

□ Our view

Levered to discretionary spending, MindTree's USD revenues should expand by ~24% CAGR over FY11-13E. We see value in the MindTree's services business, which is currently trading at ~10x FY12E EPS. We have an Outperformer rating on the stock with a 12-month price target of Rs650, based on 14x FY12E EPS.

Price chart



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Key Financials

As on 31 March	FY09	FY10	FY11E	FY12E	FY13E
Net sales (Rs m)	12,375	12,960	15,148	17,768	21,335
Adj. net profit (Rs m)	523	2,148	1,184	1,903	2,248
Shares in issue (m)	38	39	40	40	40
Adj. EPS (Rs)	13.7	52.8	29.0	46.5	55.0
% change	(48.3)	285.2	(45.1)	60.7	18.2
PER (x)	32.8	8.5	15.5	9.6	8.2
Price/ Book (x)	2.9	2.7	2.3	1.9	1.6
EV/ EBITDA (x)	5.6	7.3	8.6	5.9	4.8
RoE (%)	9.4	34.2	16.3	21.9	21.1
RoCE (%)	40.6	25.8	18.2	24.7	24.0

Source: Company, IDFC Securities

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2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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