

## MindTree

BUY

## Green shoots to full bloom

Rs623

Reason for report: Initiating coverage

**MindTree enjoys strong management bandwidth versus other mid-caps and provides an attractive alternative to Fortune-500/1000 clients besides large vendors. However, the company can witness continued growth volatility given higher project-based revenues. With signs of recovery in global economy, we expect growth beyond FY10 to be healthy for MindTree given expected pick-up in discretionary spend for the industry and resulting margin uptick for MindTree as most of the margin pressure is bottoming out. Despite the stock's run up recently, we initiate coverage with BUY and Rs725 target price. Our target FY11E P/E is at ~30% discount to Infosys' target P/E, which we believe is fair considering MindTree's quality management, better corporate governance and EBITDA & EPS CAGR of 20% and 12% respectively through FY10E-12E.**

- **Client mining – Steps in the right direction.** Earlier, MindTree underperformed peers on client mining despite a marquee client list. But recently it has addressed these by: i) recruiting lateral account managers from large global IT companies (account manager strength rose to ~10-12 from 2-3 YoY), ii) exiting ~50 client accounts given scale-up issues due to limited scope and iii) multi-service offerings to clients. These investments are likely to yield better results on revenues & margins, when global IT spending is showing signs of recovery even on discretionary/project-based spend, which forms a material part of revenues.
- **Margin-related pressure bottoming out.** With likely recovery in IT spending in H2FY10/FY11, we expect MindTree's EBITDA margin to improve hereon considering: i) utilisation (including trainees) touched a bottom of 61.1% in Q1FY10 from 70% in Q2FY09, ii) billing rate, post Aztecsoft's consolidation, reduced 5-8% from Q3FY09 levels (Q3FY09, the first quarter to reflect full consolidation of Aztec), iii) Q1FY10 SG&A at 19.5% (similar to pre-IPO levels) versus 16-18% in FY08-09. Besides, we believe, incremental investment in S&M is likely to be lower.
- **Well positioned to outperform with quality management & marquee clients.** Given MindTree's quality management and marquee client list – Volvo, Unilever, LSI Logic, Symantec, United Technologies, Microsoft etc – which acts as a big differentiator versus other mid-cap peers, the company is likely to outperform after FY10. We expect 19% & 20% revenue & EBITDA CAGR in FY10E-12E post 1% & 30% decline in FY10E dollar revenues and rupee EBITDA respectively.

Market Cap	Rs24.4bn/US\$508mn
Reuters/Bloomberg	MINT.BO/MTCL.IN
Shares Outstanding (mn)	39.12
52-week Range (Rs)	625/189
Free Float (%)	66.6
FII (%)	11.6
Daily Volume (US\$'000)	2,750
Absolute Return 3m (%)	32.9
Absolute Return 12m (%)	102.0
Sensex Return 3m (%)	16.3
Sensex Return 12m (%)	31.0

Year to March	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	12,375	12,745	14,539	16,802
Net Income (Rs mn)	523	1,708	2,078	2,163
EPS (Rs)	13.8	43.4	52.4	54.3
% Chg YoY	(49.4)	215.3	20.7	3.7
P/E (x)	45.3	14.4	11.9	11.5
CEPS (Rs)	29.1	61.8	72.7	77.6
EV/E (x)	7.3	10.3	7.7	6.2
Dividend Yield (%)	0.2	0.5	0.6	0.6
RoCE (%)	36.1	20.7	25.3	21.6
RoE (%)	9.6	29.7	29.6	23.9

Note: Our financials are including recently acquired company Kyocera Wireless (India)

## Technology

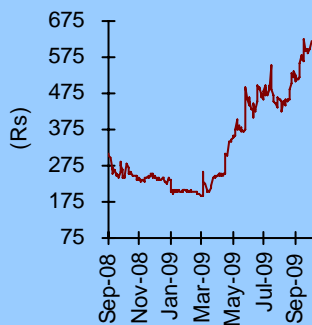
Target price Rs725

## Shareholding pattern

	Dec '08	Mar '09	Jun '09
Promoters	34.7	34.5	33.4
Institutional investors	9.0	10.8	13.0
MFs and UTI	1.6	0.4	0.3
Insurance Cos.	1.2	1.2	1.1
FIs	6.2	9.2	11.6
Others	56.3	54.7	53.6

Source: www.nseindia.com

## Price chart



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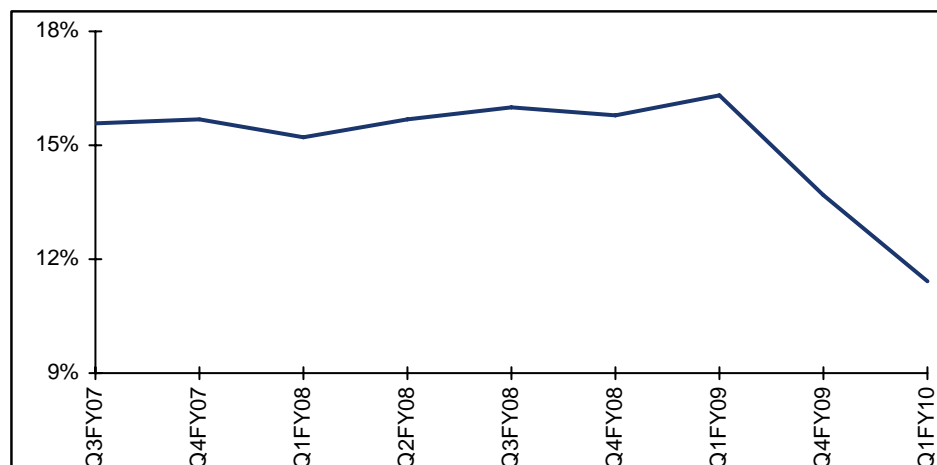
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## Investment argument

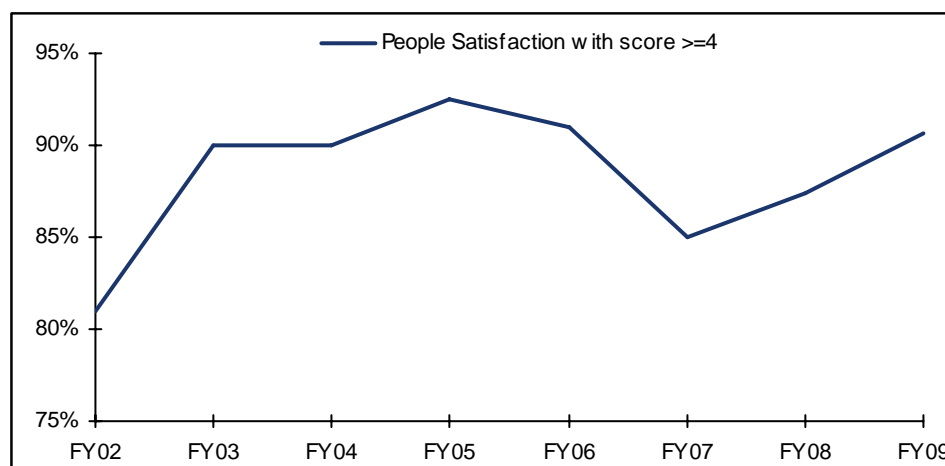
MindTree enjoys strong management bandwidth versus other mid-cap peers and provides an attractive alternative to Fortune-500/1000 clients besides large vendors. Apart from quality management, the marquee client list of MindTree is a strong differentiator, which led to 64% revenue CAGR in FY03-07, albeit on a small base (Infosys's 40% CAGR). However, with higher project-based revenues, organic revenue CAGR (excluding Aztecsoft) declined to 30.9% in FY07-09 (Infosys's 25% CAGR) and we expect FY10E rupee organic revenues (excluding Aztecsoft and Kyocera Wireless India) to decrease ~7% (~12% dollar revenues) versus flat dollar revenues for Infosys. We expect MindTree's growth to continue to be volatile given its higher project/discretionary revenues (contributing more than two-thirds of revenues). However, with signs of recovery in the global economy, we expect growth beyond FY10 to be healthy considering expected pick-up in discretionary spend for the industry and resulting margin uptick for MindTree as most of the margin pressure is bottoming out. We expect CAGR of 19% and 20% through FY10E-12E in dollar revenues and rupee EBITDA respectively. Despite the stock's run up recently, we initiate coverage with BUY and Rs725 target price. Our target FY11E P/E is at ~30% discount to Infosys' target multiple, which we believe is fair considering MindTree's quality management, better corporate governance, management's efforts to improve client mining, expected recovery in IT spending/discretionary projects beyond CY09 and EBITDA & EPS CAGR of 20% & 12% respectively in FY10E-12E.

## Quality management

The experience of the MindTree management in building large professional service organisations extends back to >20 years. MindTree was incorporated in 1999 by Mr Ashok Soota, Mr Subroto Bagchi and eight other industry professionals with an average 20 years of industry experience. Co-founders have previously worked with leading IT consulting companies such as Cambridge Technology Partners, Lucent Technologies and Wipro, and bring a significant amount of experience in building and developing IT businesses. Mr Ashok Soota (Executive Chairman) was the vice chairman of Wipro and Mr Subroto Bagchi (Gardener and Executive Vice Chairman) was the vice president of Wipro. We believe quality management has led to MindTree's successful survival post the dotcom burst within couple of years of its incorporation. Even post the dotcom burst MindTree's revenue CAGR of 64% through FY03-07 (albeit on a small base) was among the highest in the industry. Strong management capability is also reflected in lower attrition rate at 11.4% (despite being a mid-cap) and in client satisfaction survey (Chart 3).

**Chart 1: Lower attrition rate – LTM basis (%)**

Note: Attrition data for Q2FY09 and Q3FY09 not available  
 Source: Company data, I-Sec Research

**Chart 2: Employee satisfaction**

Note: Employee satisfaction survey by MindTree in May '09 revealed that 90.6% of the participants (forming +69% of total employees) have given a satisfaction rating of 4 or higher on a scale of 5 (the highest satisfaction).  
 Source: Company data, I-Sec Research

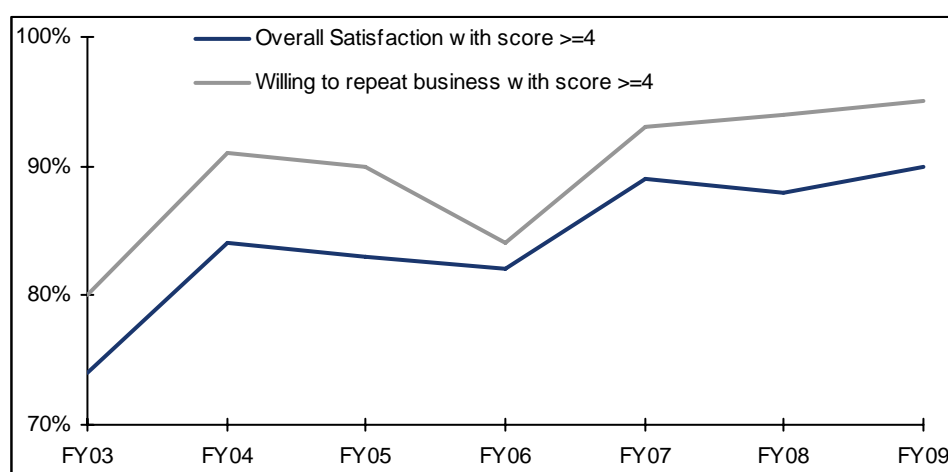
## MindTree, an alternative to large vendors for Fortune-500/1000 companies

While top four Indian companies lead the IT Services industry, there are many small- and mid-sized IT companies in India. Large companies have the capacity and resources (in terms of number of people and capital) to service large projects. Mid-sized providers such as MindTree seek to compete through emphasising on more personalised service, specialisation and flexibility. Given the growth in the global trade and increased range of specialised services being sought from Indian technology services providers across a range of industries, we believe there is significant scope for mid-sized service providers such as MindTree that have high quality management and deep domain expertise in diverse verticals. MindTree delivers business and technology solutions through its two business divisions – Information Technology Services (ITS) and Product Engineering Services (PES). In Q1FY10, ITS contributed

56.6% to total revenues and PES 43.4%. MindTree provides end-to-end project execution, both onsite and offshore, with offshore revenues forming as high as 70.8% of total revenues. With MindTree's strong domain skills and customer-centric approach, it has developed many strategic marquee client relationships such as Volvo, AIG, Unilever, LSI Logic, Symantec, United Technologies, Microsoft etc. MindTree's sales team is complemented by a team of domain experts from large IT companies with hands-on experience of providing solution architecture and industry-specific service offering inputs.

Therefore, we strongly believe that MindTree's strong management bandwidth versus other mid-cap vendors provides an alternative to Fortune-500/1000 clients besides large vendors.

**Chart 3: Customer satisfaction**



Note: Customer experience survey conducted in December '08 by MindTree was responded to by 67% of its customers. More than 90% rated MindTree 4 and above on a scale of 5 on overall satisfaction and >95% rated MindTree 4 and above on a scale of 5 on their willingness to do repeat business.

Source: Company data, I-Sec Research

## Product Engineering Services – Niche offerings

MindTree differentiates from larger peers by focussing on some niche services offerings such as R&D services (RDS) and software product engineering (SPE), which together form Product Engineering Services (PES) unit of MindTree. PES contributed 43.4% of the total revenues in Q1FY10 and RDS 14.1%. RDS is organised into two divisions: i) Engineering, which provides product realisation services to technology and product companies, including product architecture and product design, product re-engineering and product assurance and ii) Research, which conceives and develops intellectual property, primarily in the short range wireless communication segment and licences and customises such intellectual property for MindTree's clients. Engineering services within RDS serves clients in six industries, including Automotive, Communication Systems, Consumer Appliances and Computer Peripherals, Industrial Systems, Medical Electronics and Storage and Computing systems. Within RDS, MindTree further differentiates by focussing on storage and servers and consumer appliances, together which form more than two-thirds of RDS revenues. We believe, the competition within Automation/Industrial Systems and Communication Systems is

higher among Indian vendors with very few focussing on Storage/Server and Consumer Appliances.

Through acquisition of Aztecsoft in May '08, MindTree further strengthened its SPE offerings. Aztecsoft is a leading player in the fast growing Outsourced Product Development (OPD) and Testing markets. Together with Aztecsoft, MindTree is able to cover the entire product development stack, including chip design, embedded software, platform software, middleware and application software. In addition, the combined team size in Testing (at +2,000) makes MindTree one of the top 3-4 players in the Indian industry. Within SPE, MindTree provides Product Development, Product Testing, Sustenance Engineering, Professional Services and Product Tech Support for clients in Technology vertical for domains including Business Application Products, Tools and Platforms and Portal and Web Products.

**Table 1: MindTree's clients in PES**

**R&D Services Clients:**

Volvo  
Toshiba  
Nissan  
NEC  
HP  
ABB  
Symantec

United Technologies  
AMD  
Schneider Electric  
Texas Instruments  
Logitech  
Qualcomm

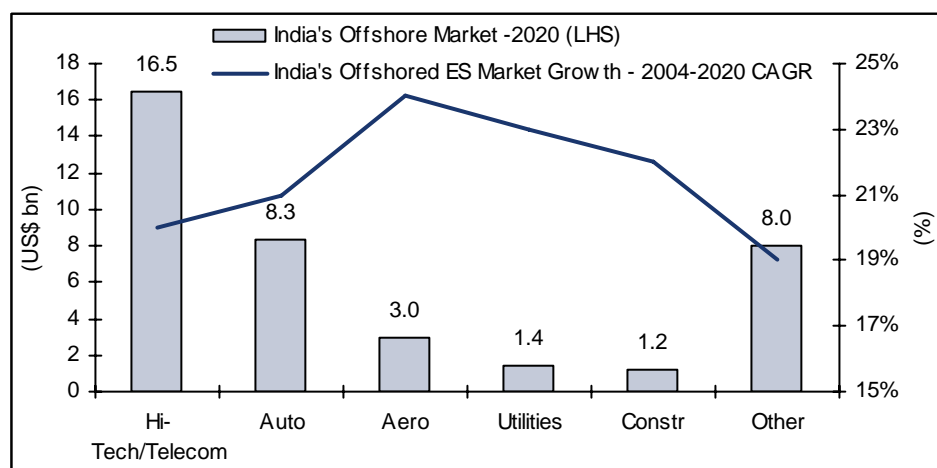
**SPE Clients:**

Microsoft  
Yahoo  
Sony  
Cadence  
eBay  
Oracle

Verisign  
Real Player  
AOL

Source: Company data, I-Sec Research

**Chart 4: India's offshored engineering services market growth by sector ('05-20)**



Note: For the above chart, Hi-Tech includes Semiconductors, Telecom, Consumer Electronics, Computer Systems, Medical Devices and Industrial Automation.

Source: NASSCOM-Booz, Allen, Hamilton

## Client mining – Steps in the right direction

MindTree earlier underperformed peers on client mining despite its marquee client list. However, off late, it has been addressing these issues by: i) recruiting lateral account managers from large global IT companies (account manager strength increased to ~10-12 from 2-3 YoY), ii) exiting ~50 client accounts considering scale-up issues due to limited scope and iii) multi-service offerings to clients. Therefore, we believe that these investments are likely to yield better results on revenues and margins during times when global IT spending is showing signs of recovery, even on discretionary/project based spend, which forms a material part of MindTree's revenues.

Recently MindTree has recruited senior account managers for its top clients from IBM, Cognizant and Infosys, who are known for their client mining capability versus other large-cap peers. MindTree has also launched new services, including infrastructure services and SAP implementation besides its traditionally focussed services of application development and maintenance. With bouquet of services, MindTree has started pitching for deals involving multiple services. Large deal win from Arcelor Mittal is a testimony of MindTree's competitive strength. However, due to recessionary pressure, the deal has difficulty in terms of ramp-up, which would be addressed with improving global demand.

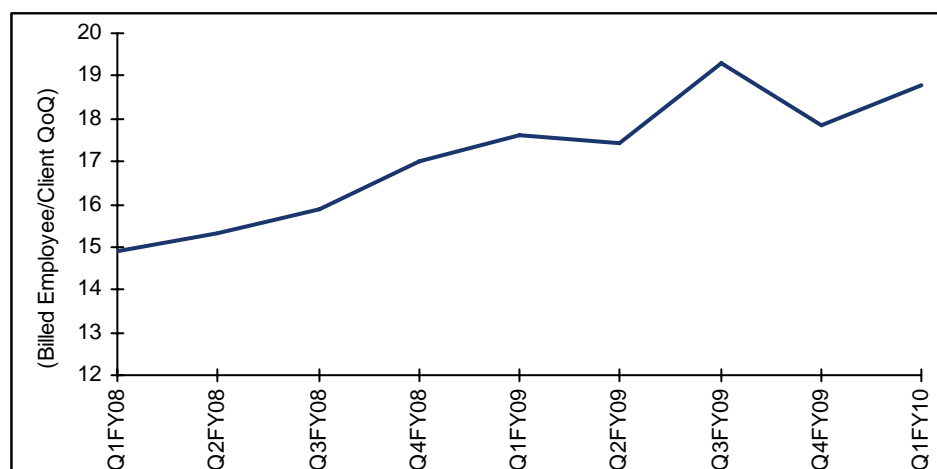
**Table 2: Client mining can be further improved**

	Clients	Billed Employee / client	Offshore revenue contribution	Top 10 clients contribution
MindTree	239	19	71	39.4
Hexaware	177	12	41	49.9
Infosys	569	115	53	25.8
Wipro	690	60	50	20.6

Note: i) For Wipro we have assumed that out of total active clients for IT Services reported, 80% of the clients represents Global IT Services, excluding BPO, Infocrossing and India/Middle East IT Services. Top-10 clients contribution for Wipro represents for consolidated IT Services, ii) for Hexaware we have assumed that offshore revenue contribution for business (excluding Caliber Point and Focus Frame) at 41.1% which is similar for consolidated business. Also, we have assumed that out of the total billed clients reported, 85% of the clients represent for business, excluding Caliber Point and Focus Frame. Top-10 client contribution for Hexaware represents for business, excluding Caliber Point and Focus Frame.

Source: Company data, I-Sec Research

**Chart 5: Client mining improving**

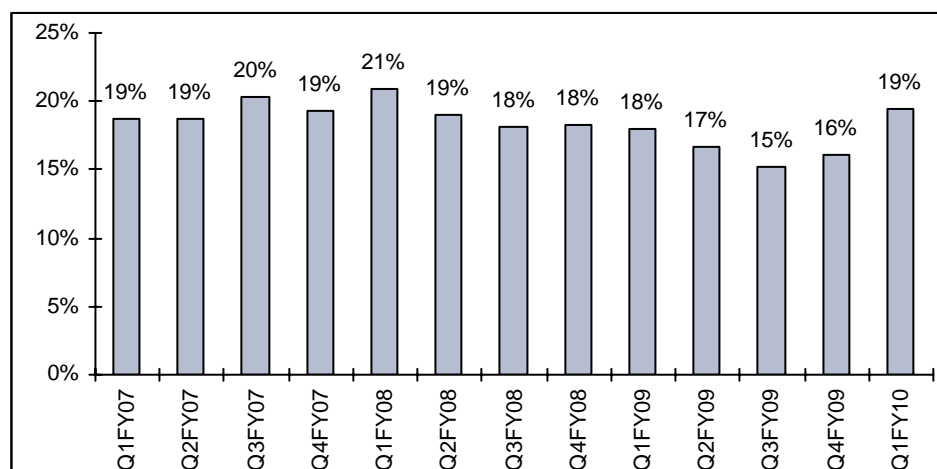


Source: Company data, I-Sec Research

## Margin-related pressure bottoming out

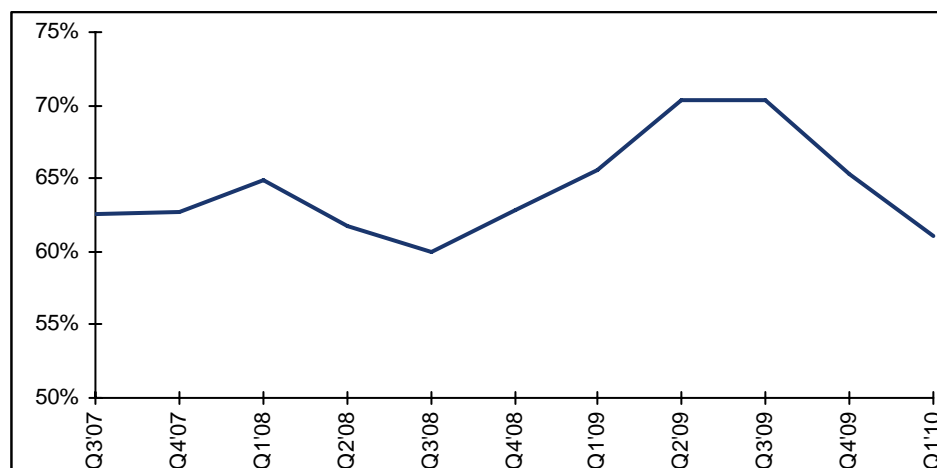
With expected recovery in IT spending in CY10, we expect MindTree's EBITDA margin to improve hereon given: i) utilisation rate (including trainees) touching a bottom of 61.1% in Q1FY10 from 70% in Q2FY09, ii) billing rate, post consolidation of Aztecsoft, reducing 5-8% from Q3FY09 levels (full quarter impact of Aztecsoft consolidation) and iii) SG&A at 19.5% in Q1FY10 (similar to pre-IPO levels) versus 16-18% in FY08-09. Besides, we believe that incremental investment in S&M is likely to be lower hereon.

**Chart 6: SG&A QoQ**

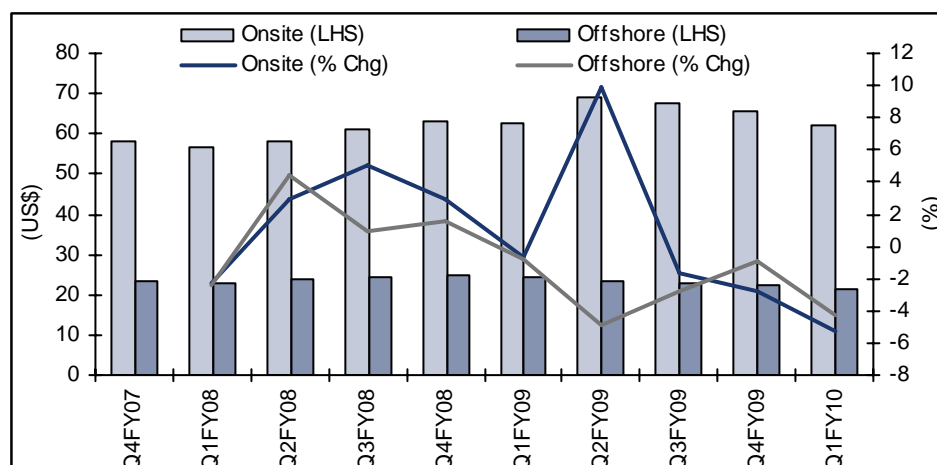


Source: Company data, I-Sec Research

**Chart 7: Utilisation rate (including trainees) QoQ**



Source: Company data, I-Sec Research

**Chart 8: Billing rates – Onsite and offshore QoQ**

Source: Company data, I-Sec Research

### Growth likely to witness an inflection beyond FY10...

Post strong CAGR of 57%, 131% and 88% in revenues, EBITDA and PAT through FY04-09, we expect FY10E revenue growth to be a meagre 3%, with expected 30% decline in EBITDA. On an organic (excluding Aztecsoft and Kyocera Wireless India) basis, we expect revenues to decline ~12% in dollar terms and ~7% in rupee terms in FY10E. This is largely driven by slowdown in the global economy, leading to cut in technology spending. With more than two-thirds of MindTree's total revenues coming from discretionary/project-based revenues, the impact of slowdown is likely to have a higher toll on financials. However, the reverse is also likely to be true in good times considering higher growth in discretionary technology spend, post significant downturn in downcycle. With signs of recovery in the global economy, we expect growth beyond FY10 to be healthy for MindTree considering the expected pick-up in discretionary spend for the industry and resulting margin uptick for MindTree as most of the margin pressure is bottoming out.

### ...demand slowdown in top clients seems to have bottomed out

We believe that demand slowdown in top client accounts has bottomed out, with material decline in revenues from top client accounts in the past few quarter (Table 8). Our check indicates that growth in top clients, within SPE, BFSI, Retail/FMCG, may start in the coming quarters (expect weak Q3FY10 considering lower billing base); however, we expect trouble to continue in Manufacturing (especially within Auto)/Hi-Tech verticals for some more quarters. Multi-year large deal win from Arcelor Mittal has not been ramping up as per schedule due to recessionary pressures on the client. However, we expect these issues to be addressed soon with improving global demand. Besides likely deal ramp-up from Arcelor Mittal beyond FY10, MindTree has recently won a multi-year deal from another leading consumer care brand, after competing with global MNCs and large Indian IT companies. With demand slowdown within top clients having bottomed out, growth in clients from other verticals/new client wins is likely to provide flat-to-positive momentum in consolidated revenue growth, at least in the short term (excluding Q3FY10 as explained earlier) before an uptick.

We expect CAGR of 19% and 20% through FY10E-12E post the expected decline of 1% and 30% in FY10E dollar revenues and rupee EBITDA respectively. We expect 12% EPS CAGR through FY10E-12E.

### Valuation downside lower

Despite the stock's recent run up recently, we initiate coverage on MindTree with BUY and Rs725 target price. Our target FY11E P/E is at ~30% discount to Infosys' target multiple and we expect MindTree to trade at the higher end of the valuations versus other comparable mid-caps, which, we believe, is fair given its quality management, corporate governance, management's effort to improve client mining, our belief that MindTree will be at an inflection beyond FY10 with likely recovery in IT spending in CY10 and margin pressure bottoming out for MindTree. We expect EBITDA and EPS CAGR to be 20% and 12% respectively through FY10E-12E.

## IT Services – Strong positioning with large clients

IT Services contributed 56.6% to consolidated revenues in Q1FY10, which has reduced from 79% in Q1FY09, post the acquisition of Aztecsoft in Q2FY09. IT Services have registered healthy revenue CAGR of 53% over FY04-09, albeit on a small base (Infosys posted 35.4% CAGR in consolidated revenues over the same period). IT Services comprise application development, data warehousing, business intelligence, application maintenance, package implementation, IMS, Testing and IT strategic consulting for clients in certain focussed industries, including BFSI, manufacturing, travel and transportation. We agree that MindTree's positioning within IT Services is similar to larger peers; however, it provides greater mindshare to most clients within its focussed verticals. Given the growth in the global trade and the increased range of specialised services being sought from Indian technology services providers across a range of industries, we believe there is significant scope for mid-sized service providers such as MindTree with high quality management to participate in industry growth.

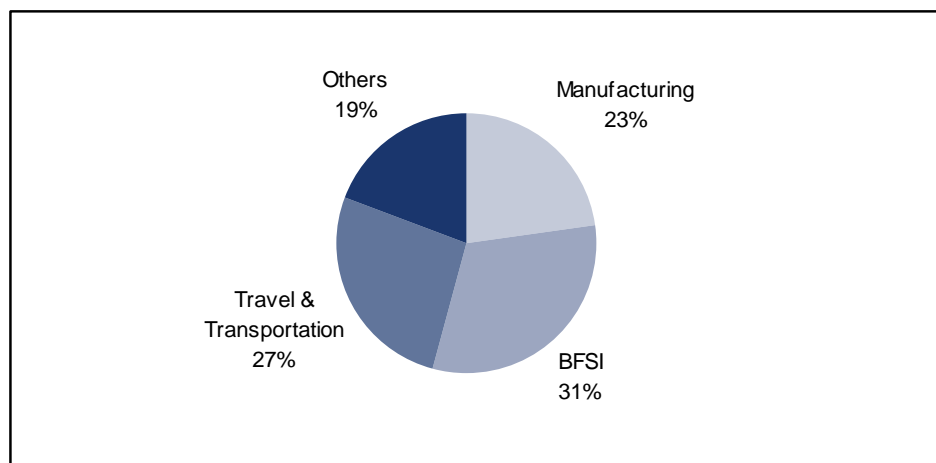
## MindTree – Attractive alternative for large clients

While top four Indian companies lead the technology services industry growth, there are many small- and mid-sized IT companies in India. Large companies have the capacity and resources (in terms of number of people and capital) to service large projects. Mid-sized providers such as MindTree seek to compete through emphasising on more personalised service, specialisation and flexibility. MindTree provides end-to-end project execution, both onsite and offshore, with offshore revenues contributing as high as 71% to revenues. MindTree's sales team is complemented by a team of domain experts from large IT companies with hands-on experience on providing solution architecture and industry-specific service offering inputs. With MindTree's strong management and its domain skills with customer-centric approach, it has developed many strategic marquee client relationships, including AIG, Volvo, Unilever, Port of Singapore Authority (PSA), Avis within IT Services.

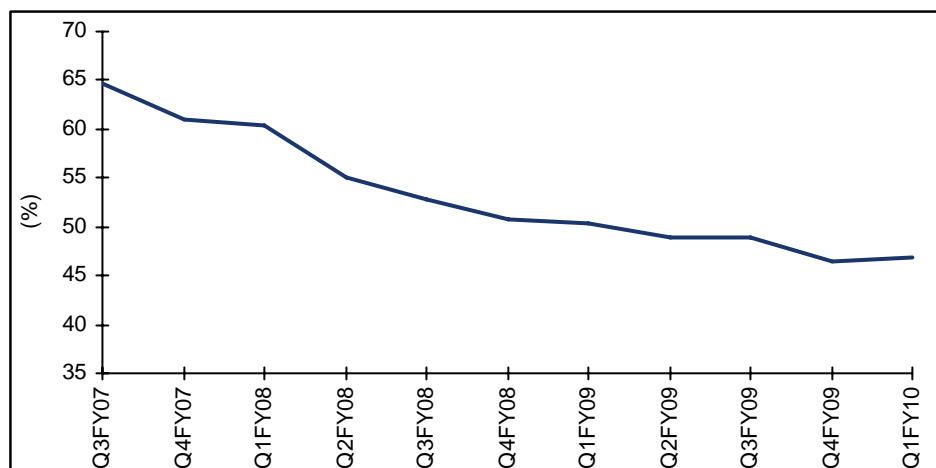
**Table 3: Some strategic client relationships**

Clients	...Since	Industry	Services offered
AIG	5 yrs	Insurance	App Dev & Maintenance
Avis Budget Group	9 yrs	Car Rental	App Dev, Maintenance & Independent Testing
Cadence	7 yrs	Software & Programming	App Dev & Maintenance, Package Implementation, Independent Testing
PSA	8 yrs	Leading Port Operator	App Dev & ERP Package Implementation
Unilever	9 yrs	FMCG	App Dev & Maintenance
Volvo	7 yrs	Automobile	Sole Outsourcing Partner for Volvo IT

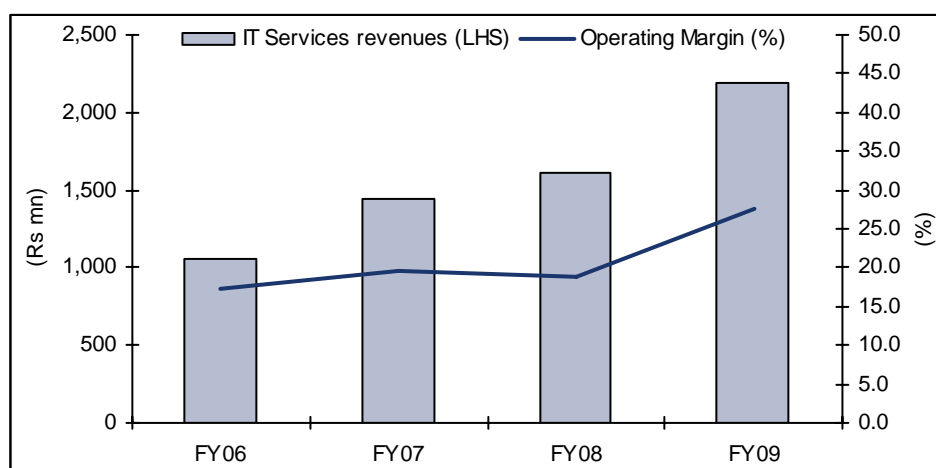
Source: Company data, I-Sec Research

**Chart 9: Vertically diversified within IT Services**

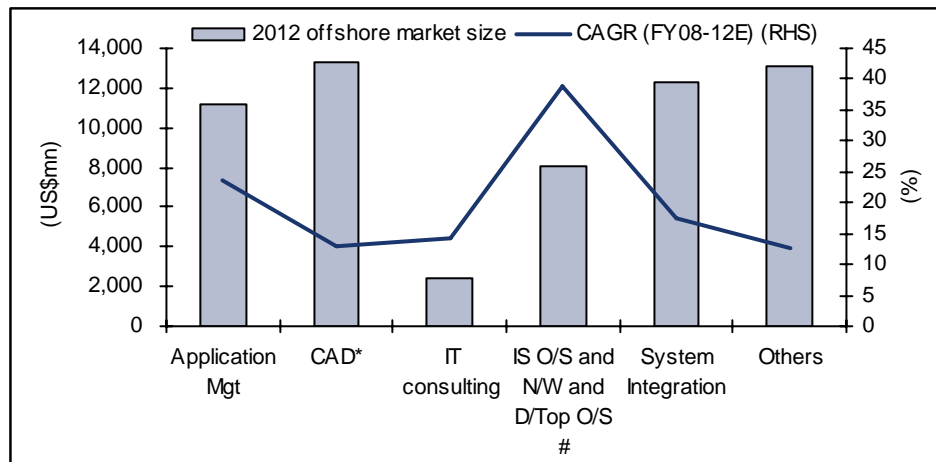
Source: Company data, I-Sec Research

**Chart 10: Reducing contribution of development services**

Source: Company data, I-Sec Research

**Chart 11: IT Services revenues and segmental operating margins**

Source: Company data, I-Sec Research

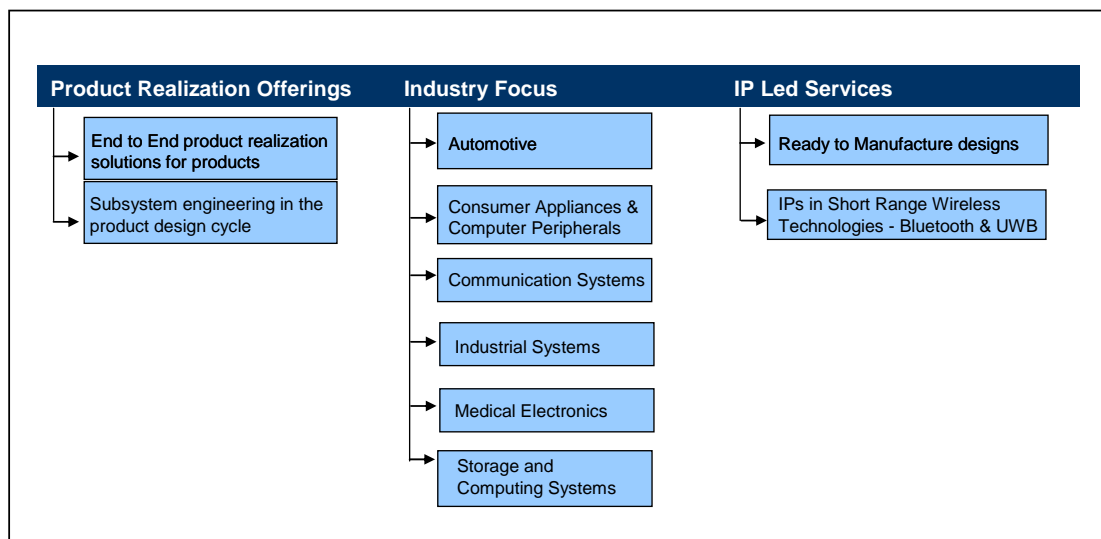
**Chart 12: Huge opportunity still exists in some global offshore IT Services**

\* Custom application development; # IS outsourcing & network and desktop outsourcing  
 Source: Company data, I-Sec Research, NASSCOM

## RDS – Differentiated offerings

RDS contributed 14.1% to Q1FY10 revenues, with healthy 43.7% CAGR through FY04-09E. RDS is organised into two divisions: i) Engineering, which contributes more than 90% to RDS services that provide product realisation services to technology and product companies and ii) Research, which conceives and develops intellectual property primarily. The RDS team consists of >1,100 employees, of which 100-150 are for research and are not billed.

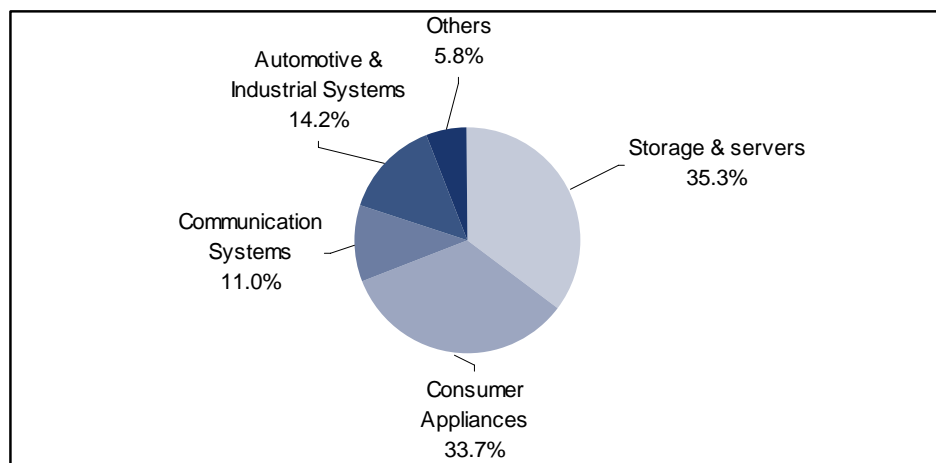
**Chart 13: RDS a strong differentiator for MindTree versus other mid-caps**



Source: Company data, I-Sec Research

## RDS - Engineering – Well diversified

Within RDS, Engineering provides product realisation services to technology and product companies, including product architecture and product design, product re-engineering, product assurance, porting/optimisation, testing, validation and technical support. MindTree has technical expertise and domain knowledge in the areas of Application Specific Integrated Circuit (ASIC), System on a Chip (SOC), digital/analogue board design, embedded software, system software design and user interface. Engineering services within RDS serves clients in six industries, including Automotive, Communication Systems, Consumer Appliances and Computer Peripherals, Industrial Systems, Medical Electronics and Storage and Computing systems. Within RDS, MindTree further differentiates by focussing on storage and servers and consumer appliances – together both contribute more than two-thirds of RDS revenues. We believe competition within Automation/Industrial Systems and Communication Systems is higher among Indian vendors, with very few focussing on Storage/Server and Consumer Appliances.

**Chart 14: Vertical-wise revenue break-up within RDS in Q4FY09**

Source: Company data, I-Sec Research

### RDS - Research – Intellectual property led approach

Research creates intellectual property (IP) in the core area of short-range wireless technology. Such IPs complements R&D Engineering services offerings. These standard-based technology building blocks reduce product design cycles significantly and may be licensed as individual reusable components or as a part of a turnkey product design solution. Such IPs provide MindTree's customers and partners the benefit of product-proven and reusable components, designed and tested continuously for flexibility and interoperability which can be configured for multiple applications with minimal customisation efforts. Research has a team of 100-150, which focusses on IP development. These employees are not billed to the clients. MindTree has developed licensable IPs in the areas of Bluetooth (silicon and wireless components except radio) and Ultra Wide Band (UWB) technology. Other IPs are in the domain of storage networking, data networking and multimedia. In addition, the company provides tools and building blocks to reduce time to market. Revenues from IP contribute ~1% to total revenues.

## Application of MindTree's IP

MindTree's IPs are used by global ODMs and OEMs in the short-range wireless domain. Applications of its IPs include:

**Table 4: Application of MindTree's IP**

Industry	Application
Automotive	HFCK, diagnostic scanners, and back seat entertainment
Consumer Electronics	Mobile handsets, headsets, laptops, PDAs, printers, games consoles, mobile gaming devices, Human Interface Devices (HID), TVs, set-top boxes, DVD Players, MP3 players, and Portable Media Players
Home Entertainment	TVs, set-top boxes, and DVD players
Computing	Human Interface Devices (HID), laptops, and PCs
Industry Automation	Industry meters, scanners, and Human Interface Devices (HID)
Medical	Diagnostic scanners and medical equipment

Source: Company data, I-Sec Research

**Table 5: Some client relationship within RDS**

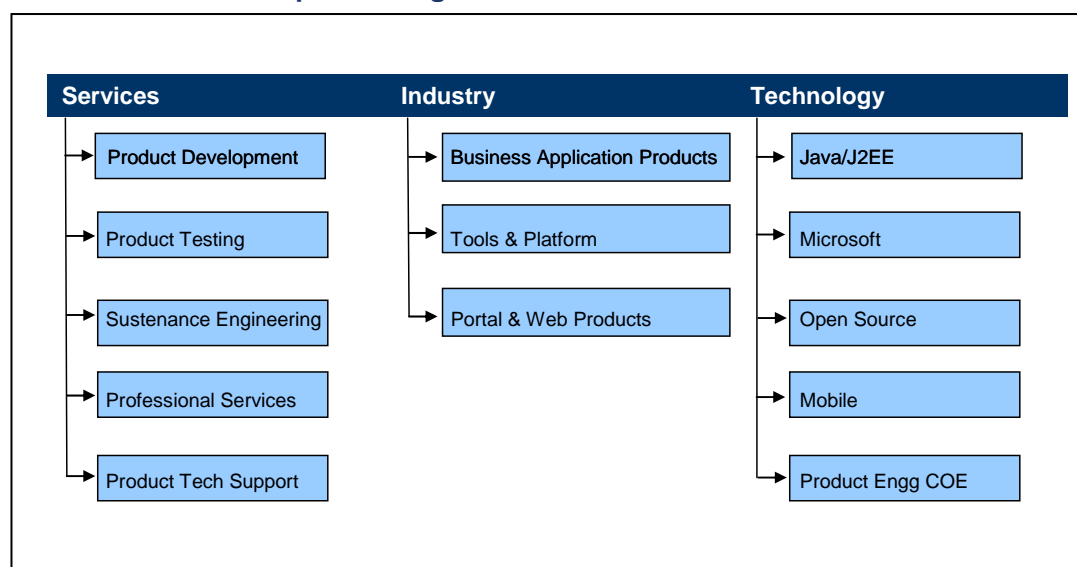
Clients	...Since	Industry	Services Offered
LSI Logic	9 yrs	Semiconductors, Electronics	Storage sub-systems
Symantec	6 yrs	Information Security	Product Dev & Support, Independent Testing
Texas Instruments	5 yrs	Semiconductors, Electronics	VLSI & Software
United Technologies	8 yrs	Conglomerate	Embedded Software & App Dev, Hardware Dev, Product Engineering

Source: Company data, I-Sec Research

## Software product engineering – End-to-end OPD stack

Software product engineering (SPE) contributed 29.3% to MindTree's revenues in Q1FY10. However, the acquisition of Aztecsoft in May '08 (consolidation effective August '08) helped MindTree strengthen its SPE offerings. The product stack of outsource product development (OPD) encompasses embedded, platform/infrastructure, middleware, application, and SaaS/cloud-computing software segments. Through its R&D Services business, MindTree is well recognised in the hardware engineering, system platform and embedded software segments of the OPD market. With the addition of Aztecsoft, MindTree will offer customers a complete end-to-end OPD product stack encompassing embedded, platform/infrastructure, middleware, application, and SaaS/cloud-computing software segments. Aztecsoft brings presence from platform to cloud computing segments and has successfully completed over 1,600 product releases. In addition, Aztecsoft also brings deep expertise in independent testing. Together with Aztecsoft, MindTree has 2,000+ testing services team, making it one of the strongest in the market.

**Chart 15: MindTree's positioning with SPE**



Source: Company data, I-Sec Research

## Better client quality of Aztecsoft

Annualised revenues of Aztecsoft, at the time of the acquisition, were ~US\$80mn (with +10% PAT margin), which declined due to recessionary challenges off late. Aztecsoft's leading clients include Microsoft, AOL, Cadence Design, Hyperion (now acquired by Oracle) etc. Only 15% of Aztecsoft's customers are start ups and small organisations, with revenue concentration higher with larger clients. Aztecsoft's top-10 clients contributed 70% and top-5 56% to its revenues, with total client base of ~80 at the time of acquisition by MindTree.

## Synergies higher through Aztecsoft

Aztecsoft has expertise in OPD and with MindTree's vertical expertise and domain experience Aztecsoft will be able to position product development services to companies, which are in specific industry focus solutions. On the IT Services side, the Aztecsoft acquisition brings in 80 new clients (with minimum overlap) – MindTree has started cross selling IT and R&D services to them. Also, Aztecsoft brings deep expertise in independent testing. Together their testing services team comprises 2,000+ people, helping MindTree feature in the top-3 or 4 in Testing, which itself helps showcase significant capability so as to bid for larger deals in the space and win new customers.

## Fortifying PE Services expertise – Acquisition of Kyocera Wireless (India)

MindTree, on September 29, '09 entered into an agreement with Kyocera Wireless Corporation (KWC) to acquire its Indian subsidiary, Kyocera Wireless (India) Pvt (KWI) in an all-cash deal. Under the terms of agreement, MindTree would make an upfront payment of ~US\$6mn and subsequent payments would be linked to revenues in FY11 and FY12.

KWI employs 600 people at its development centre in Bangalore and is engaged in wireless product development, software engineering and product testing for KWC's global product portfolio. The company also develops custom wireless handsets for Indian service providers. Post the acquisition, the company would keep providing services to KWC and other Kyocera entities across the world on a contract basis. The acquisition would not only strengthen MindTree's position in global PE Services by offering end-to-end design and technology services to wireless OEMs and service providers, but also add a major strategic client, Kyocera, to its marquee client list. Kyocera Corporation (holding company of Kyocera Group), founded in 1959, is a leading supplier of telecommunications equipment, office-document imaging equipment, solar power generating systems, semiconductor packages, electronic components, cutting tools and industrial ceramics. During the year ended March 31, '09, the company's net sales totalled ¥1.13trn (~US\$11.5bn).

### Impact on financials

MindTree expects KWI to add ~US\$9mn revenues in H2FY10, with PAT margin in the range of 13-15%. However, acquiring a company with ~US\$9mn revenues (for six months indicating ~US\$18mn revenues on an annualised basis) and 13-15% PAT margin by just paying US\$6mn implies that revenue assurance to KWI from its parent may be lacking or revenues are largely non-recurring. Therefore, we believe that the agreement entails future payments linked to revenues in FY11 and FY12. In Table 6, we have shown the impact of KWI consolidation on MindTree's financials. Please note that our estimates for KWI are based on our initial understandings which might change post more clarity from the MindTree management.

**Table 6: Impact of KWI acquisition – EPS-accretive**

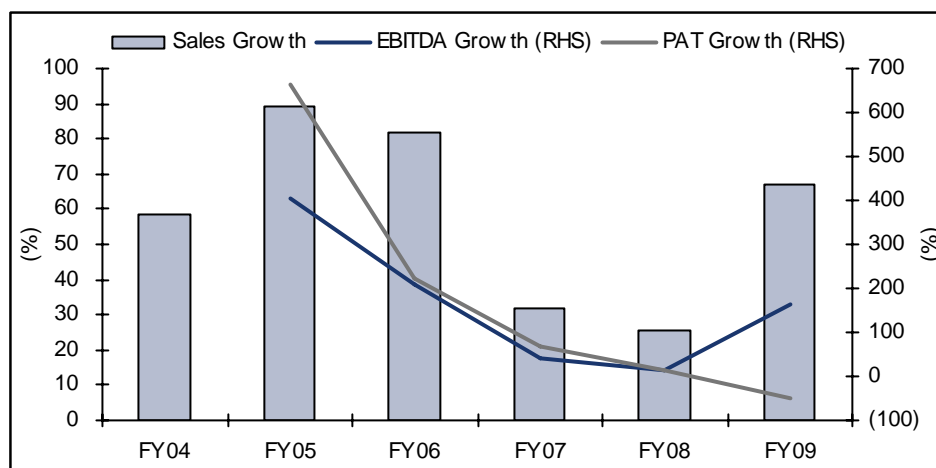
	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>
MindTree's revenues (US\$ mn)	257	301	356
% change	(4.7)	17.3	18.2
Revenues from Kyocera (US\$ mn)	9.0	16.2	17.8
<b>Total revenues (US\$ mn)</b>	<b>266</b>	<b>317</b>	<b>373</b>
% change	(1.3)	19.4	17.8
<b>Total revenues (Rs mn)</b>	<b>12,745</b>	<b>14,539</b>	<b>16,802</b>
% change	3.0	14.1	15.6
MindTree PAT (Rs mn)	1,646	1,987	2,087
% to sales	13.4	14.4	13.0
Kyocera PAT (Rs mn)	62	91	76
% to sales	14.4	12.2	9.5
% to MindTree PAT	3.8	4.6	3.7
<b>Total PAT (Rs mn)</b>	<b>1,708</b>	<b>2,078</b>	<b>2,163</b>
% to sales	13.4	14.3	12.9
<b>MindTree EPS (Rs)</b>	<b>41.8</b>	<b>50.1</b>	<b>52.4</b>
<b>Total EPS (Rs)</b>	<b>43.4</b>	<b>52.4</b>	<b>54.3</b>

Source: I-Sec Research

## Financials – Growth to pick up beyond FY10

Post strong sales, EBITDA and PAT CAGR of 57%, 131% and 88% in FY04-09, we expect revenue growth to be a meagre 3% in FY10E, largely driven by slowdown in the global economy, leading to cut in IT spending. With more than two-thirds of MindTree's total revenues coming from discretionary/project-based revenues, the impact of slowdown is likely to have a higher toll on financials. With signs of recovery in the global economy, we expect growth beyond FY10 to be healthy for MindTree given the expected pick-up in discretionary spend for the industry and the resulting margin uptick for MindTree as most of the margin pressure has bottomed out.

**Chart 16: Growth in sales, EBITDA and PAT through FY03-09**

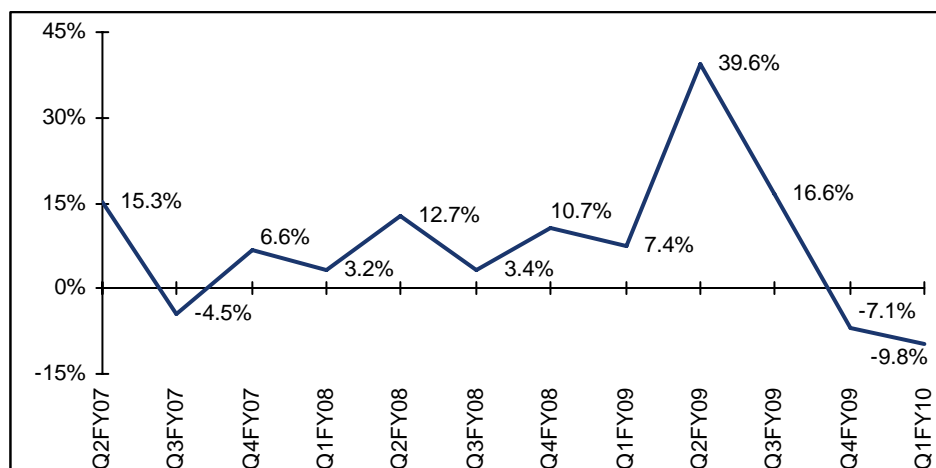


Source: Company data, I-Sec Research

## Volatility in growth to continue

We expect volatility in MindTree's growth to continue considering higher project-based/discretionary revenues contributing more than two-thirds of the overall revenues.

**Chart 17: QoQ growth in revenues**



Source: Company data, I-Sec Research

## Client mining increasing; need for further improvement

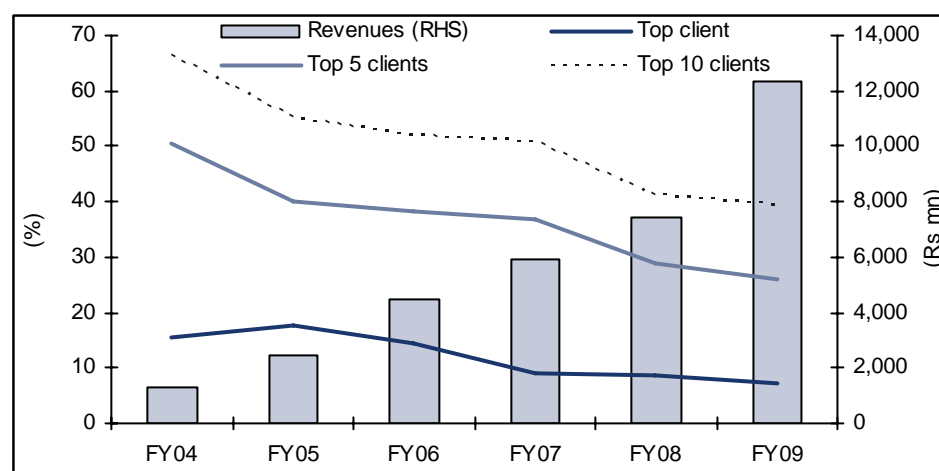
MindTree has underperformed as regards client mining, despite a marquee client list. However, there have been notable improvements off late by increasing client mining despite lower annuity revenues, indicating increasing acceptance of MindTree within clients as an alternative to large vendors. Despite improving client mining (Table 2, Chart 5), we believe MindTree's traction with each of the client can be further improved versus peers, though the gap will likely continue versus large-sized peers given scale-up issues versus large-caps. However, we believe the gap can be reduced further.

**Table 7: Client mining improving**

	Q4FY07	Q4FY08	Q4FY09	Q1FY10
> US\$1mn clients	31	46	64	60
> US\$5mn clients	4	6	13	12
> US\$10mn clients	2	2	3	3

Source: Company data, I-Sec Research

**Chart 18: Client concentration improving with increasing revenues**



Source: Company data, I-Sec Research

## Demand slowdown in top clients seems to have bottomed out

We believe that demand slowdown in top client accounts has bottomed out, with material decline in revenues from top client accounts in the past few quarter (Table 8). Our check indicates that growth in top clients, within SPE, BFSI, Retail/FMCG, may start in the coming quarters (expect weak Q3FY10 considering lower billing base); however, we expect trouble to continue in Manufacturing (especially within Auto)/Hi-Tech verticals for some more quarters. Multi-year large deal win from Arcelor Mittal has not been ramping up as per schedule due to recessionary pressures on the client. However, we expect these issues to be addressed soon with improving global demand. Besides likely deal ramp-up from Arcelor Mittal beyond FY10, MindTree has recently won a multi-year deal from another leading consumer care brand, after competing with global MNCs and large Indian IT companies. With demand slowdown within top clients having bottomed out, growth in clients from other verticals/new client wins is likely to provide flat-to-positive momentum in consolidated revenue growth, at least in the short term (excluding Q3FY10 as explained earlier) before an uptick.

Recently, MindTree recruited senior account managers for its top clients from IBM, Cognizant and Infosys that are known for their client mining capability versus other large-cap peers.

**Table 8: Demand slowdown stabilising within top clients in past few quarters**

US\$ revenue growth QoQ (%)	Q3FY09	Q4FY09	Q1FY10
Top customer	(4.5)	(13.0)	(4.4)
Top 5 customers	1.4	(13.3)	(1.8)
Top 10 customers	(0.4)	(11.5)	(3.1)
Top 2-5 customers	3.7	(13.4)	(0.9)
Top 6-10 customers	(4.0)	(7.6)	(5.6)
Other customers	6.5	(7.6)	(11.7)

Source: Company data, I-Sec Research

## Margin-related pressure bottoming out

With expected recovery in IT spending in H2FY10/FY11, we expect EBITDA margin to improve hereon considering: i) utilisation has touched a bottom of 61.1% in Q1FY10 from 70% in Q2FY09, ii) billing rate, post consolidation of Aztecsoft, reduced 5-8% from Q3FY09 levels (full quarter impact of Aztecsoft consolidation) and iii) SG&A at 19.5% in Q1FY10 (similar to pre-IPO levels) versus 16-18% in FY08-09. Besides, we believe incremental investment in S&M is likely to be lower hereon (Charts 6-8).

## Other margin levers – Fresher recruitment & fixed price contribution

MindTree's strong traction with Fortune-500/1000 clients as an alternative to large vendors has resulted in a team of highly experienced people. Therefore, the company has higher a composition of experienced employees, with an average age of 27-28, indicating average experience of employees of MindTree at five years. Therefore, we believe that the headroom to recruit more freshers is higher for MindTree.

Similarly, MindTree derived only 13.1% of its revenues from fixed price projects in FY09, down from 21.1% in FY08. Therefore, with higher number of experienced employees within the team, MindTree can increase the fixed price contribution.

## Hedge losses unlikely to increase hereon

At present, MindTree has ~US\$75-80mn effective cashflow hedge which is maturing over the next four quarters, post Q1FY10 at a strike rate of ~Rs49. Besides, it also has ~US\$120-125mn ineffective hedge, which is maturing in the next four years through FY10E-13E at a strike of ~Rs42. MindTree has already marked to market these total hedges worth ~US\$200mn in FY09, at closing rupee-dollar rate of Rs50.7. Therefore, if rupee appreciates, these losses are likely to reverse and will improve the balance sheet. We believe depreciation of rupee beyond Rs50.7 seems unlikely and therefore, further strain to the balance sheet is unlikely going forward.

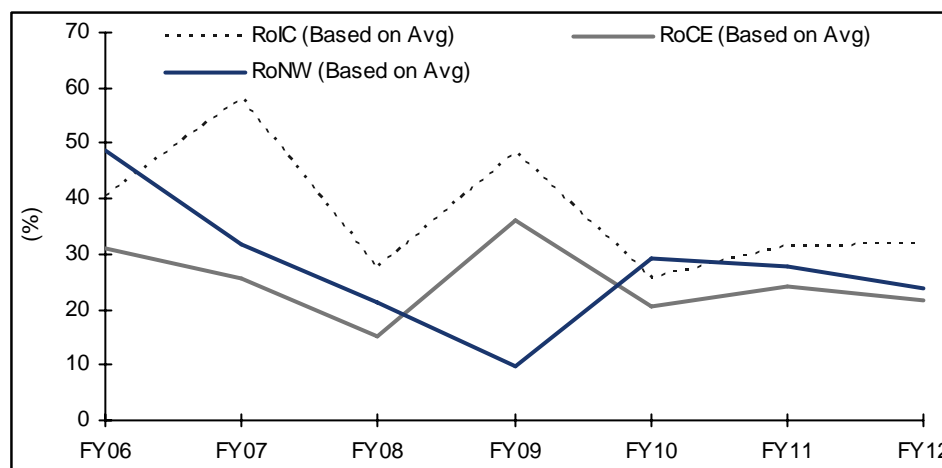
## Tax rate to remain lower versus mid-cap peers

Till FY07, MindTree has paid minimal taxes due to accumulated losses in international operations. However, from FY08, the tax rate rose to 8%, which further increased to 11% in FY09 due to improving profitability in international operations and expiry of 10-year holidays in some of its 10A/10B facilities. For FY10, the management expects tax rate to further increase to ~15%, with no major increase in FY11 and FY12 despite sunset clause for tax benefits under section 10A/10B expiring by March '11. Lower-than-peers increase in tax rate beyond FY11 is due to higher revenue contribution of MindTree from SEZ facilities at ~35-40%.

## RoIC to improve beyond FY10

MindTree's RoIC has been declining since FY07 (excluding FY09) from 58.3% due to decline in EBITDA margin, increase in tax rate from negligible taxes before FY08, higher debt for capex and acquisition of TES PV Electronics (in FY08) and Aztecsoft (in FY09) and resulting goodwill worth Rs1,460mn (constituting 20% of capital employed). However, we expect RoIC to improve beyond FY10 considering amalgamation of Aztecsoft in FY09 (versus earlier status of Aztecsoft being a subsidiary with 80% stake), resulting goodwill write-off, expected increase in dollar revenues growth beyond Q1FY10 and resulting increase in EBITDA margin.

**Chart 19: RoIC to improve beyond FY10 (%)**



Source: Company data, I-Sec Research

## Inflection point in growth likely beyond FY10

Post strong sales, EBITDA and PAT CAGR of 57%, 131% and 88% in FY04-09, we expect FY10E revenue growth to be a meagre 3%, with expected 30% decline in EBITDA. On an organic (excluding Aztecsoft and Kyocera Wireless India) basis, we expect revenues to decline ~12% in dollar terms and ~7% in rupee terms in FY10E. This is largely driven by slowdown in the global economy, leading to cut in IT spending. With more than two-thirds of MindTree's total revenues coming from discretionary/project-based revenues, the impact of slowdown is likely to have a higher toll on financials. However, the reverse is also likely to be true in good times considering higher growth in discretionary technology spend post significant downturn.

in downcycle. With signs of recovery in the global economy, we expect growth beyond FY10 to be healthy for MindTree considering the expected pick-up in discretionary spend for the industry and the resulting margin uptick for MindTree as most of the margin pressure is bottoming out. We expect CAGR of 19% and 20% through FY10E-12E post the likely decline of 1% and 30% in FY10 dollar revenues and rupee EBITDA respectively. We expect 12% EPS CAGR through FY10E-12E.

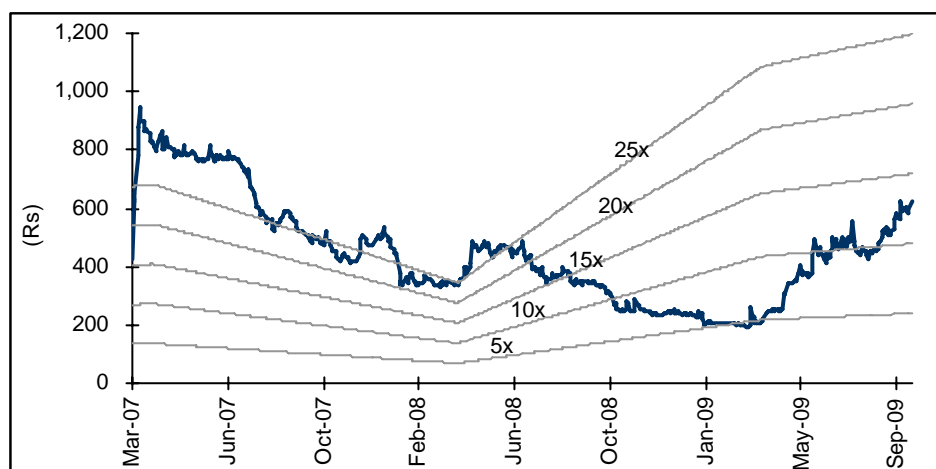
### Need to manage investor expectations better

MindTree reduced its FY10 revenue guidance [excluding Kyocera Wireless (India)] to US\$255-270mn from US\$290-300mn due to global recession impacting revenue ramp-up from clients. MindTree also reduced FY10 EPS guidance [excluding Kyocera Wireless (India)] to Rs37.4-45.3 from Rs49.3-50.9. We believe significant downgrade in rupee EPS guidance is largely due to material downgrade in revenues. The revised guidance is realistic and will likely be achieved. The management has to behave cautiously while guiding for future performance considering higher volatility in earnings versus peers due to higher non-annuity business.

## Valuation downside lower

MindTree's historic growth has been impressive, albeit on a small base. With an increasing base, we believe that the impact of industry slowdown is likely to be higher for MindTree considering higher project-based revenues (more than two-thirds of total revenues being discretionary/project based). However, the reverse is also likely to be true in good times considering higher growth in discretionary technology spend post significant downturn in downcycle. We believe that with MindTree's strong management and rich domain expertise, growth will pick up beyond FY10 considering the likely uptick in discretionary IT spending. MindTree's valuation multiple are likely to trade at extreme ends versus other comparable mid-caps in upcycle and downcycles (reflected in one-year forward P/E band in Chart 20; however, the company was listed in March '07 and therefore, P/E bands do not reflect sufficient history). With signs of recovery in the global economy, we expect growth beyond FY10 to be healthy for MindTree considering the expected pick-up in discretionary spend for the industry and resulting margin uptick for MindTree as most of the margin pressure is bottoming out.

**Chart 20: One-year forward P/E bands**



Source: Bloomberg, I-Sec Research

Despite the stock's recent run up recently, we initiate coverage with BUY and Rs725 target price. Our target FY11E P/E is at ~30% discount to Infosys' target multiple and we expect MindTree to trade at the higher end of the valuations versus other comparable mid-caps' multiples, which we believe is fair considering its rich management, corporate governance, management's efforts to improve client mining and our belief that MindTree will be at an inflection point beyond FY10 considering likely recovery in IT spending in CY10 with margin pressure bottoming out and resulting EBITDA and EPS CAGR of 20% and 12% respectively through FY10E-12E.

**Table 9: Comparable valuations**

Company	Price (Rs)	I-Sec EPS (Rs)		Consensus EPS (Rs)		I-Sec P/E (x)		Consensus P/E (x)		I-Sec EV/E (x)		Consensus EV/E (x)	
		FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
MindTree	623	43.4	52.4	39.9	47.0	14.4	11.9	15.6	13.3	10.3	7.7	NA	NA
Mphasis	667	42.3	43.6	41.0	44.0	15.8	15.3	16.3	15.2	11.4	9.6	12.6	11.4
Patni Computers	447	31.5	33.7	33.1	36.4	14.2	13.2	13.5	12.3	6.4	6.1	9.1	8.9
Tech Mahindra	926	NA	NA	50.3	59.9	NA	NA	18.4	15.5	NA	NA	NA	NA
Hexaware	78	NA	NA	6.3	7.4	NA	NA	12.4	10.6	NA	NA	4.8	4.3
KPIT Cummins	77	NA	NA	8.7	9.7	NA	NA	8.8	7.9	NA	NA	NA	NA

Source: Bloomberg, I-Sec Research

## Risks

### Higher discretionary/project-based revenues

MindTree's annuity revenues are less than one-third of the total revenues, with the balance largely being project-based/discretionary. With increasing base, we believe the impact of industry slowdown is likely to be higher for MindTree given higher discretionary/project-based revenues. In FY10, we expect organic (excluding Aztecsoft and Kyocera Wireless India) dollar revenue to decline ~12% versus large cap peers' flat-to-single digit growth. Notably, MindTree's revenues from development business has reduced to 50.3% in Q1FY09 (acquired Aztecsoft in Q2FY09) from 64.6% in Q3FY07 due to higher growth in maintenance revenues (contribution rose to 29% from 22%), independent testing (contribution rose to 6.3% from 2.6%) and IMS practice (contribution rose to 4.6% from 1.5%).

**Table 10: Services mix matrix through Q3FY07-Q1FY10**

Revenue by Service Offering (%)	Q3FY07	Q4FY07	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10
Development	64.6	61.0	60.4	55.0	52.8	50.7	50.3	49.0	48.9	46.5	46.9
Maintenance	22.5	25.5	25.6	28.9	29.1	31.5	28.7	24.5	23.2	24.0	23.6
Consulting & IP Licensing	4.6	5.5	4.9	3.7	3.6	4.5	4.9	4.7	3.4	3.7	2.9
Package Implementation	3.6	2.3	1.7	5.2	5.2	4.3	5.2	4.7	3.6	3.5	4.1
Independent Testing	2.6	3.4	3.5	4.7	6.3	5.0	6.3	13.5	17.5	19.0	18.1
Infrastructure Mgmt & Tech Support	1.5	1.9	3.9	2.5	3.0	4.0	4.6	3.6	3.4	3.3	4.4
Others	0.6	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company data, I-Sec Research

### Client concentration though lower than mid-caps peers, still a risk

MindTree derives 39% of its revenues from top-10 clients (reduced from 50.7% in Q3FY07); though better than other mid-cap peers, with more than two-thirds of the business being project/discretionary base, maintaining client stickiness would be a challenge. Therefore, volatility in client growth is likely to be higher YoY. Please note that most of the top clients have relationships more than five years old.

### Outstanding options are 9.5% of equity capital

MindTree has always believed in reward and retaining key employees through strong management leadership and via ESOPs. Current outstanding ESOPs are ~9.5% of the equity capital, with weighted average remaining contractual life of 3.5 years and weighted average price of Rs308.68 versus the current market price of Rs623. Therefore, with deep in the money options, equity capital is likely to get diluted. MindTree accounts for stock compensation charges as per the intrinsic value method, in line with SEBI guidelines. However, the charge under fair value method is much higher (Table 11). The impact was higher in FY09 considering lower reported PAT due to higher MTM forex hedge loss.

**Table 11: ESOP charge higher under fair value method***(Rs mn)*

	<b>FY09</b>	<b>FY08</b>
ESOP Charge under Intrinsic Value	10.0	19.2
% to sales	0.1	0.3
ESOP Charge under Fair Value Method	133.8	79.2
% to sales	1.1	1.1
Difference	123.9	60.0
% to sales	1.0	0.8
% to PAT	23.7	5.8

Source: I-Sec Research

**Risk of captive units**

MindTree offers services through dedicated offshore centres to some clients operating in IT Services and in PES. Therefore, any consolidation of clients or increasing work migration to captives would lead to loss of the clients/volumes for MindTree.

**Other risks**

Other risks include: i) slower-than-expected recovery of the US and Europe markets will hurt MindTree the most considering higher project/discretionary revenues and may result into downgrade in our estimates and ii) rupee appreciation will affect MindTree more than peers, considering that 71% of its revenues come from offshore location and thus, natural hedge is lower than peers.

## Company overview

MindTree, formerly MindTree Consulting was incorporated in 1999 by 10 reputed industry professionals. It is an India-based IT Services company that delivers business and technology solutions to its clients across the US, Asia Pacific and Europe through global software development. The company has offices in India, the US, the UK, Japan, Singapore, Australia, Germany, Sweden, the UAE and France. Headquartered in Bangalore, the company employs ~7,700 people.

**Table 12: Company background – Key events (from inception to '08)**

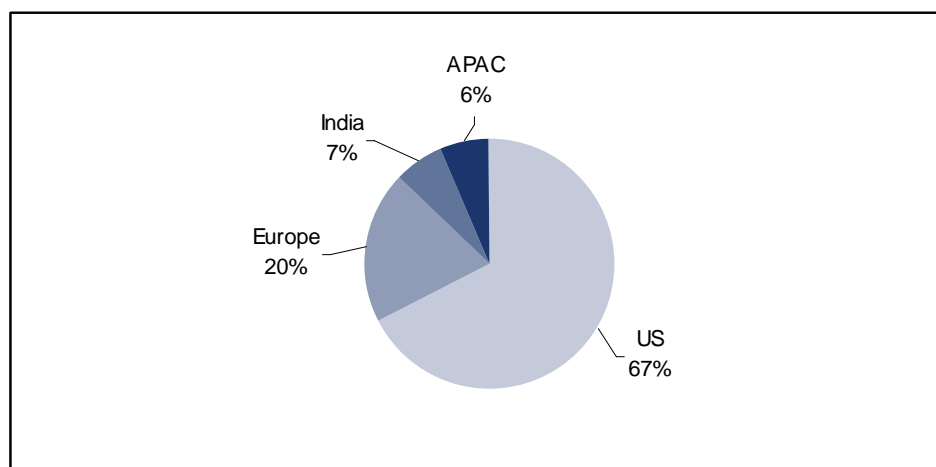
1999	MindTree was established in 1999 as MindTree Consulting by 10 industry professionals who came from Cambridge Technology Partners, Lucent Technologies and Wipro.
2001	Commenced IT outsourcing partnership with Volvo Information Technology.
2004	Acquired the software division of ASAP Solutions and ARPSL
2005	MindTree opened its west campus development center in Bangalore. Also, acquired Linc Software Services Private
2006	Started the Development Centre in Chennai
2007	MindTree made its Initial Public Offering (IPO). Also, acquired 100% of the outstanding equity shares of TES PV Electronic Solutions Private, which was subsequently renamed as MindTree Technologies Private (MTPL)
2008	<p>March - Name of the company was changed from MindTree Consulting to MindTree</p> <p>May – Acquired 32.6% stake in Aztecsoft</p> <p>June - MindTree opened its own development centre, MindTree Coromandel, in Chennai, India. Also, increased its equity stake in Aztecsoft to 79.9%. Consequently, Aztecsoft became a subsidiary of MindTree.</p> <p>September - Established a testing Centre of Excellence (CoE) in partnership with Hewlett Packard (HP), for HP's quality and performance testing tools.</p> <p>October - Formed a partnership with Murex and became a preferred partner for system implementation and support services and hosted the Murex Offshore Development Centre (ODC) in Bangalore.</p> <p>November - Became an SAP channel partner authorised to resell the SAP Business All-in-One solutions to midsize companies in North America.</p>

Source: Company data, I-Sec Research

## Geographically skewed towards the US

MindTree's business is geographically more focussed towards the US (~67% in Q1FY10) versus larger peers. The company also has exposure to the Indian market (~6.5% of revenues), which is relatively better than peers. Key customers in India are Hindustan Unilever, Titan, TVS Motors, ICICI Bank and some state Governments.

**Chart 21: Revenues by geography (Q1FY10)**

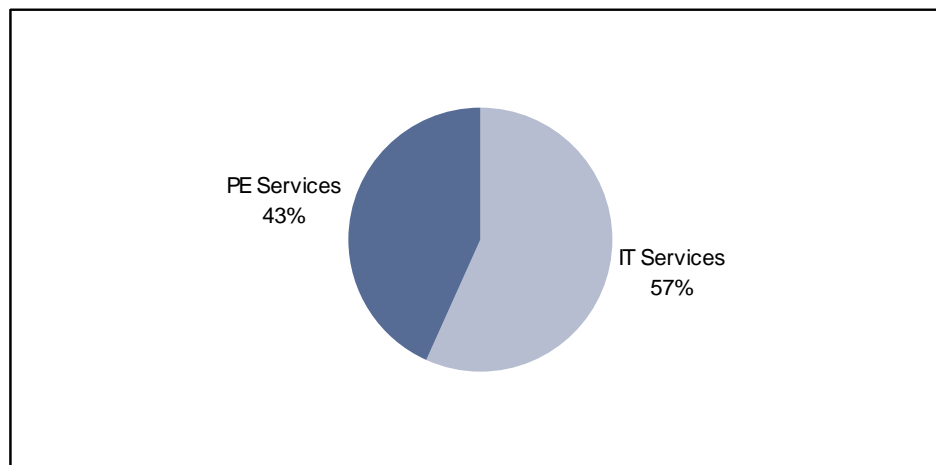


Source: Company data, I-Sec Research

## Business mix

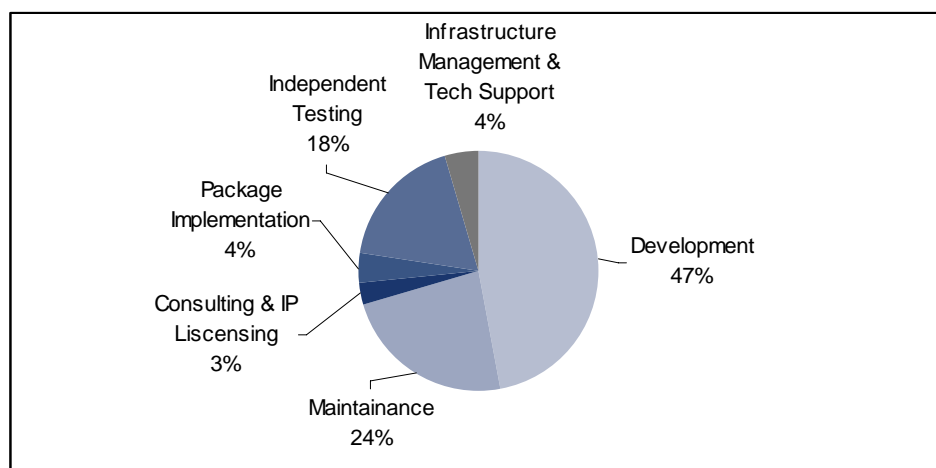
MindTree's services are organised into two divisions – IT Services and Product Engineering Services (PES).

**Chart 22: Revenues by service units (Q1FY10)**



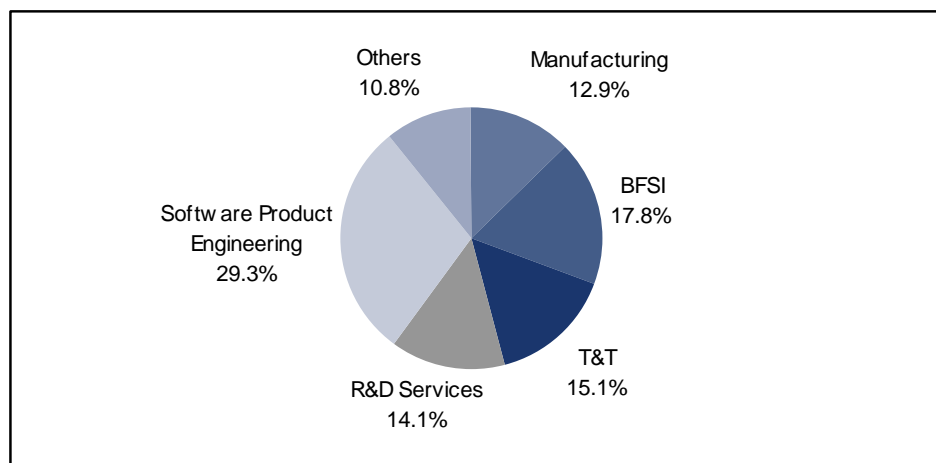
Source: Company data, I-Sec Research

**Chart 23: Revenues by service offerings (Q1FY10)**

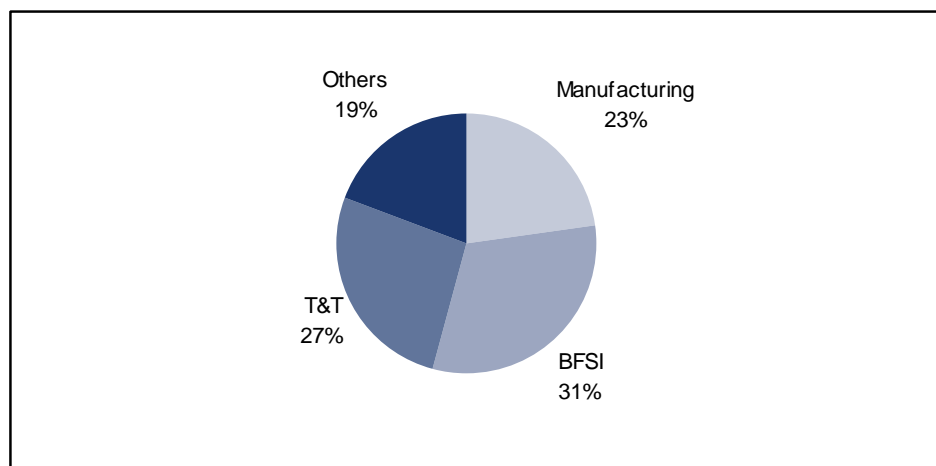


Source: Company data, I-Sec Research

Within Services, MindTree provides a comprehensive range of service offerings including consulting, application development and maintenance, package implementation, data warehousing and business intelligence, product engineering, testing and infrastructure management services across industries such as Manufacturing, BFSI, Travel & Transportation (T&T), RDS and SPE. Within IT Services only (excluding PES), BFSI (31.4%), Manufacturing (22.8%) and T&T (26.7%) contribute more than 80% to IT Services revenues.

**Chart 24: Vertical-wise revenues in Q1FY10**

Source: Company data, I-Sec Research

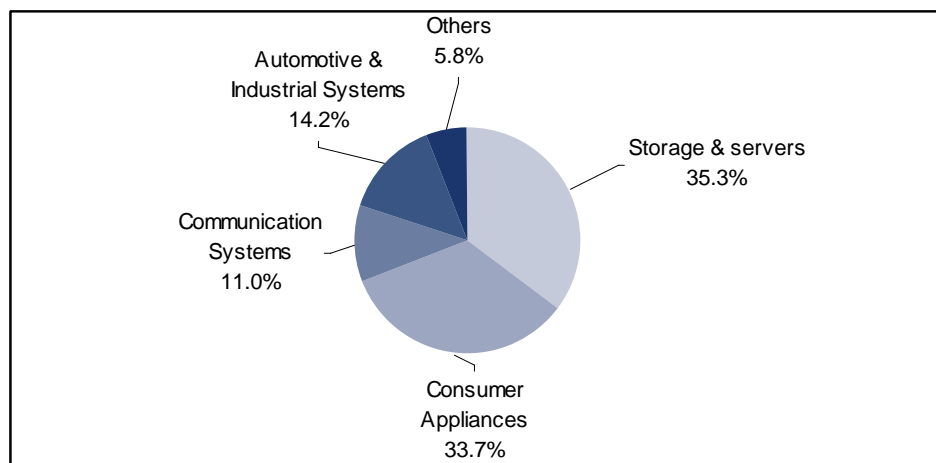
**Chart 25: Vertical-wise revenues within IT Services only in Q1FY10**

Source: Company data, I-Sec Research

**Product Engineering Services mix**

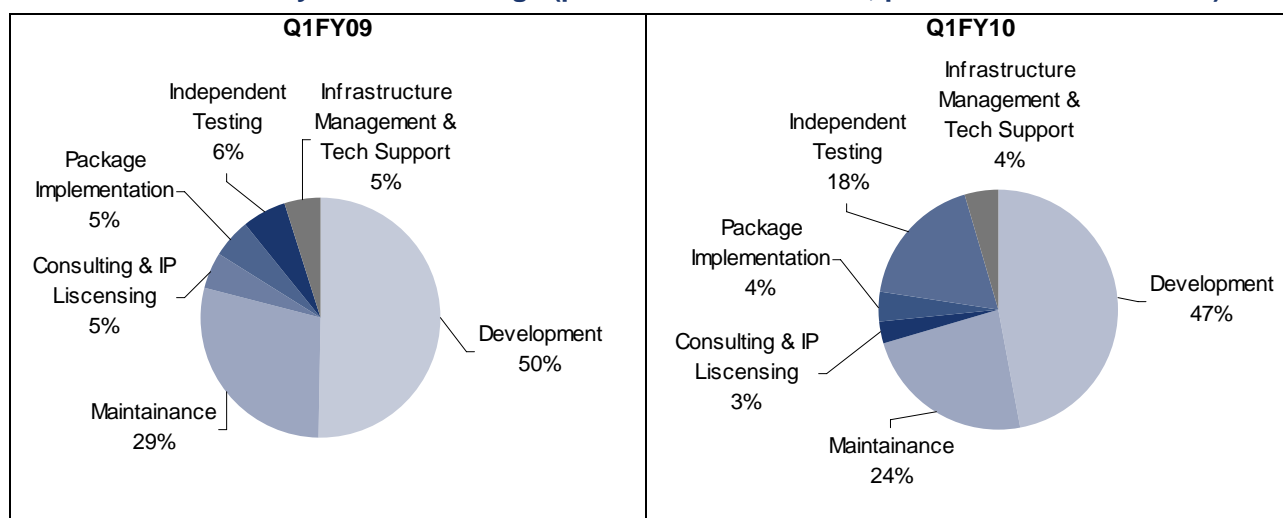
Product Engineering Services (PES) further consists of RDS and Software Product Engineering Services (SPE Services). RDS (which contributed 14.1% to total revenues in Q1FY10) involves providing faster product realisation by leveraging expertise in product design, product re-engineering, porting/optimisation, validation, testing and technical support through IP building blocks in the areas of Bluetooth, VOIP, iSCI, IVO6 and others in Telecom, Wireless, Industrial Automation, Avionics, Storage, Consumer Products and Computing.

MindTree has a strong research team which focuses on developing IPs, primarily in the short range wireless communication segment and licenses and customises those for its clients. The company derives most of its RDS revenues from verticals such as Storage & Servers (35.3% in Q4FY09) and Consumer Appliances (33.7% in Q4FY09), which are comparatively less crowded. Only ~11% (Q4FY09) of its RDS revenues is derived from Communications, which is the focus area of other RDS vendors.

**Chart 26: Vertical-wise revenues within RDS in Q4FY09**

Source: Company data, I-Sec Research

MindTree's SPE Services cater to product development, product testing, sustenance engineering, performance testing and performance engineering for clients belonging to a wide range of industries such as business application products, software tools and platforms, community and social networking portals and information and transaction portals. With the acquisition of Aztecsoft, an industry leader in product engineering and independent testing, MindTree further strengthened its SPE business (Chart 27).

**Chart 27: Revenues by service offerings (pre Aztecsoft - Q1FY09; post Aztecsoft – Q1FY10)**

Source: Company data, I-Sec Research

### Well-diversified customer base

MindTree boasts of 239 active clients, including 32 global Fortune-500 companies across a wide range of industries. Key clients are AIG, Microsoft, Volvo, Avis, Unilever, Cadence, eBay, Texas Instruments etc. The age of relationship with some global clients shows the strong track record of providing excellent IT & PES services.

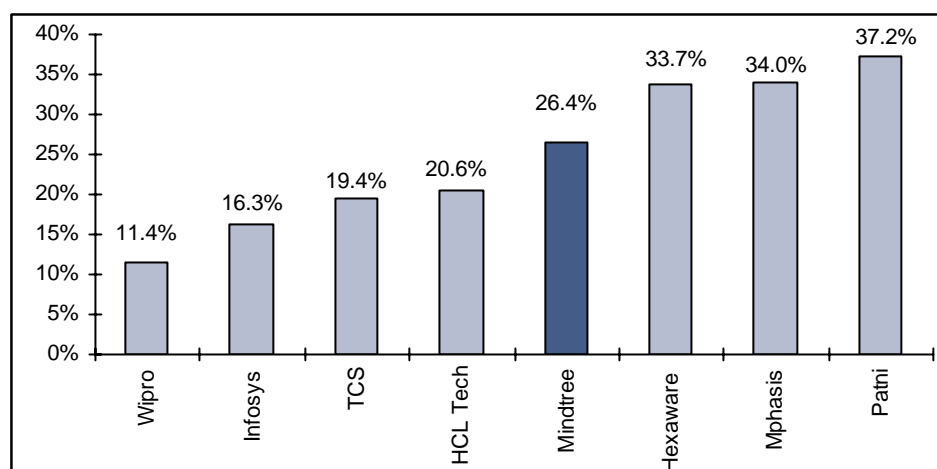
**Table 13: Marquee client list with long-term relationship**

Clients	...Since	Industry	Services Offered
AIG	5 yrs	Insurance	App Dev & Maintenance
Avis Budget Group	9 yrs	Car Rental	App Dev, Maintenance & Independent Testing
Cadence	7 yrs	Software & Programming	App Dev & Maintenance, Package Implementation, Independent Testing
CIT Group, Inc.	2 yrs	Finance Company	App Dev, Maintenance & Independent Testing
eBay	3 yrs	e-Commerce	Product Dev, Independent Testing, Tech Support
Kodak	2 yrs	Photographic & Optical	Consulting, App Dev & Maintenance, Production Support
Microsoft	10 yrs	Computer Software	Product Dev & Testing, Independent Testing
PSA	8 yrs	Leading Port Operator	App Dev & ERP Package Implementation
SITA	3 yrs	Information Technology	Consulting, App Dev & Maintenance
Symantec	6 yrs	Information Security	Product Dev & Support, Independent Testing
Time Inc.	3 yrs	Periodicals	App Dev, Maintenance & Testing
TravelClick	2 yrs	e-Commerce	Remote Infrastructure Management & Product Dev
Texas Instruments	5 yrs	Semiconductors, Electronics	VLSI & Software
Unilever	9 yrs	FMCG	App Dev & Maintenance
United Technologies	8 yrs	Conglomerate	Embedded Software & App Dev, Hardware Dev, Product Engineering
Volvo	7 yrs	Automobile	Sole Outsourcing Partner for Volvo IT

Source: Company data, I-Sec Research

MindTree also has a diversified customer base with no single customer accounting for more than 10% of revenues and only approximately one-fourth of the total business coming from top-5 customers; this compares favourably with mid-sized peers. Revenue contribution from the top client (~7%) versus Patni (12.3%), Hexaware (12.6%) and Mphasis (14%) shows lower client concentration risk for MindTree though it is still higher than large-caps peers (Infosys-4.5%, TCS-5.7%, Wipro-2.6%).

Similarly, while revenues from top-5 customers (~26%) are higher than large-sized Indian IT vendors, when compared with mid-sized peers, which reflects on MindTree's more diversified customer base than other mid-sized firms.

**Chart 28: Revenue contribution from top-5 customers**

Source: Company data, I-Sec Research

### Client experience

**AIG.** MindTree started off with AIG by providing internet application services and went on to become a preferred offshore vendor for subsidiaries of AIG (since January '04). MindTree has a dedicated offshore development centre in Bangalore for AIG subsidiaries and provides application development and maintenance services.

**Volvo.** MindTree has worked closely with Volvo since '01 to implement technology solutions for its business units, Volvo trucks, buses, construction equipment and

penta. Over the years, MindTree has expanded its work to Volvo's operations in many countries. An example of that is the flexible and scalable dealer management system used by Volvo's dealers in more than 18 countries with utmost satisfaction.

**Microsoft.** Owing to MindTree's deep expertise in Microsoft Technologies and a healthy client-vendor relationship between the two for the past 10 years (MindTree has been offering product development & testing, and independent testing services to Microsoft), MindTree is Microsoft's Service Ready Partner.

**Texas Instruments (TI)** awarded MindTree with 2008 Supplier Excellence Award, making it the first Indian company to receive this honor. MindTree's relationship with TI started in '03 and it includes system-on-chip development, embedded software, reference design development and testing. TI also leverages MindTree's short-range wireless IP to provide compelling solutions for end customers across multiple industry verticals. TI is among the top customers of MindTree.

### Management overview

MindTree was co-founded by Mr Ashok Soota and Mr Subroto Bagchi along with eight other reputed and experienced industry professionals working earlier with Cambridge Technology Partners, Lucent and Wipro. Mr Ashok Soota, prior to co-founding MindTree, served as the Vice Chairman of Wipro and Mr Subroto Bagchi supervised Wipro's global R&D division and served as the Vice President at Lucent Technologies.

**Table 14: Management overview**

S.No.	Name	Designation	Qualification and experience
1	Ashok Soota	Executive Chairman	MBA - Asian Institute of Management, The Philippines, B Tech - University of Roorkee (now IIT Roorkee) Prior to MindTree, served as Vice Chairman - Wipro, President of Wipro Infotech (1984-99) and CEO of Shriram Refrigeration (1978). Has also been President, Confederation of Indian
2	Subroto Bagchi	Gardener, Executive Vice Chairman	Degree in Political Science - Utkal University, Bhubaneshwar Served as COO of MindTree (1999-2008) prior to being appointed Gardener & Vice Chairman (on April 1, 2008).
3	Krishnakumar Natarajan	CEO, Managing Director	MBA - XLRI, Jamshedpur, B.Tech - College of Engineering, Chennai Previously served as Chief Executive of the Electronic Commerce & Financial Solutions Division at Wipro and held several other key positions there from 1982-1999.
4	S. Janakiraman	President, Group CEO - Product Engineering Services	Masters in Electronics - IIT, Chennai, B.Tech - NIT, Trichy Has held posts of Chairman and Advisor to India Semiconductor Association and is also the President of Indo Japan Chamber of Commerce and Industries (IJCCI), Karnataka.
5	Vinod Deshmukh	President, CEO - R&D Services	Masters in Technology - IIT Kanpur, B.Tech - Nagpur University Started his professional career with Tata Institute of Fundamental Research, Mumbai. Served as the Vice President at Wipro prior to joining MindTree.
6	Ashok Krishnamoorthy	CEO - Software Product Engineering	MBA - IIM Ahmedabad, B.Tech - Birla Institute of Technology, Mesra. Worked with Wipro, Sanmar, ICL-Fujitsu and Microland prior to joining Aztecsoft where he was instrumental in building Software Product Engineering (SPE) business.
7	Anjan Lahiri	President and CEO - IT Services	MBA in Decision Sciences - University of Florida, Gainesville, BSc (Electronics Engineering) - Birla Institute of Technology, Ranchi. Started his professional career with Wipro Infotech in 1987 and held position of Director with Cambridge Technology Part
8	Scott Staples	President and CEO - Knowledge Services	MBA - Fairleigh Dickinson University, Madison, New Jersey, Bachelor of Arts (English) - University of Delaware. Prior to MindTree, he was a Director at Cambridge Technology Partners and earlier also worked as Director of Marketing at Gemini Consulting.
9	Parthasarathy N.S.	CEO - Independent Testing & IMTS	Masters (Honours) from BITS Pilani, M.Tech - IIT Kharagpur. Prior to MindTree, he was General Manager of Wipro's Technology Solutions Division.
10	Kamran Ozair	Executive Vice President and Chief Technology Officer	Masters in Comp Science - University of Wisconsin, Madison, Graduate - Dartmouth College, Hanover. Prior to MindTree, he was a Director at Cambridge Technology Partners.

Source: Company data, I-Sec Research

## Global footprint

MindTree has presence in 10 countries through 20 offices spread across the US, Asia-Pacific, Europe and the Middle East. MindTree is further planning to expand its footprints, both in new and existing countries. This reach has helped it expand customer base from 78 in FY04 to 239 as of end Q1FY10.

**Table 15: Geographical footprint**

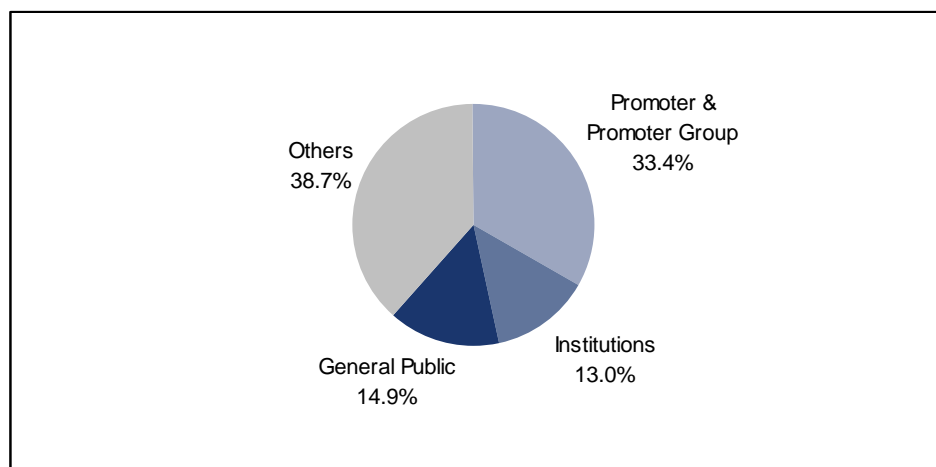
Location	No. of Offices
India	7
US	5
UK	1
France	1
Germany	1
Sweden	1
UAE	1
Singapore	1
Japan	1
Australia	1
<b>Total</b>	<b>20</b>

Source: Company data, I-Sec Research

## Ownership structure

Walden Software Investments participated in the first round of funding for MindTree and is a major stakeholder's in the company's business. The company's co-founders Mr Ashok Soota and Mr Subroto Bagchi also own more than 5% in the company's current ownership structure.

**Chart 29: MindTree's ownership structure as of June 30, '09**



Source: BSE India, I-Sec Research

**Table 16: Non-promoter holding more than 1% of equity capital (June 30, '09)**

Name of the Shareholder	No. of Shares	% Holding
Life Insurance Corporation of India	391,611	1.00
Global Technology Ventures	2,648,561	6.77
AIG Offshore Systems Services Inc	1,240,167	3.17
Capital International Global Emerging Market Pvt	4,290,909	10.97
Walden Software Inv	5,993,535	15.32
Saif III Mauritius Company	1,889,899	4.83
Nalanda India Fund Ltd	1,165,419	2.98
<b>Total</b>	<b>17,620,101</b>	<b>45.04</b>

Source: BSE India, I-Sec Research

## Financials

**Table 17: Profit and Loss statement**
*(Rs mn, year ending March 31)*

	FY07	FY08	FY09	FY10E	FY11E	FY12E
<b>Revenues</b>	<b>5,904</b>	<b>7,398</b>	<b>12,375</b>	<b>12,745</b>	<b>14,539</b>	<b>16,802</b>
%YoY	31.5	25.3	67.3	3.0	14.1	15.6
<b>Software Development Expenses</b>	<b>3,660</b>	<b>4,725</b>	<b>6,968</b>	<b>7,949</b>	<b>8,916</b>	<b>10,447</b>
% Sales	62.0	63.9	56.3	62.4	61.3	62.2
<b>Gross Profit</b>	<b>2,244</b>	<b>2,673</b>	<b>5,407</b>	<b>4,796</b>	<b>5,623</b>	<b>6,356</b>
% Sales	38.0	36.1	43.7	37.6	38.7	37.8
<b>SG&amp;A</b>	<b>1,147</b>	<b>1,419</b>	<b>2,097</b>	<b>2,488</b>	<b>2,689</b>	<b>3,013</b>
% Sales	19.4	19.2	16.9	19.5	18.5	17.9
<b>EBITDA</b>	<b>1,096</b>	<b>1,254</b>	<b>3,310</b>	<b>2,308</b>	<b>2,934</b>	<b>3,343</b>
%YoY	39.9	14.4	163.9	(30.3)	27.1	13.9
% Sales	18.6	17.0	26.7	18.1	20.2	19.9
<b>Depreciation &amp; Amortisation</b>	<b>244</b>	<b>356</b>	<b>570</b>	<b>669</b>	<b>754</b>	<b>864</b>
% Sales	4.1	4.8	4.6	5.3	5.2	5.1
<b>EBIT</b>	<b>852</b>	<b>898</b>	<b>2,740</b>	<b>1,639</b>	<b>2,180</b>	<b>2,479</b>
%YoY	54.4	5.4	205.2	(40.2)	33.0	13.7
% Sales	14.4	12.1	22.1	12.9	15.0	14.8
<b>Interest expense</b>	<b>30</b>	<b>59</b>	<b>162</b>	<b>50</b>	<b>28</b>	<b>27</b>
% Sales	0.5	0.8	1.3	0.4	0.2	0.2
<b>Other Income</b>	<b>74</b>	<b>279</b>	<b>(1974)</b>	<b>404</b>	<b>288</b>	<b>204</b>
% Sales	1.2	3.8	(16.0)	3.2	2.0	1.2
<b>PBT</b>	<b>895</b>	<b>1,118</b>	<b>604</b>	<b>1,993</b>	<b>2,440</b>	<b>2,656</b>
% Sales	15.2	15.1	4.9	15.6	16.8	15.8
<b>Total Tax Provision</b>	<b>(5)</b>	<b>85</b>	<b>67</b>	<b>285</b>	<b>362</b>	<b>493</b>
%Sales	(0.1)	1.2	0.5	2.2	2.5	2.9
%PBT	(0.5)	7.6	11.1	14.3	14.8	18.6
<b>Net profit after tax</b>	<b>900</b>	<b>1,033</b>	<b>537</b>	<b>1,708</b>	<b>2,078</b>	<b>2,163</b>
%Sales	15.3	14.0	4.3	13.4	14.3	12.9
Associates / (Minority Interest)	0	0	(13.6)	0	0	0
<b>PAT before Extraordinary Exp / (Inc)</b>	<b>900</b>	<b>1,033</b>	<b>523</b>	<b>1,708</b>	<b>2,078</b>	<b>2,163</b>
%YoY	66.1	14.7	(49.3)	226.6	21.7	4.1
%Sales	15.3	14.0	4.2	13.4	14.3	12.9
Extraordinary Exp / (Inc)	0	0	0	0	0	0
<b>PAT after Extraordinary Exp / (Inc)</b>	<b>900</b>	<b>1,033</b>	<b>523</b>	<b>1,708</b>	<b>2,078</b>	<b>2,163</b>
%YoY	66.1	14.7	(49.3)	226.6	21.7	4.1
%Sales	15.3	14.0	4.2	13.4	14.3	12.9

Note: Our financials include the recently acquired company Kyocera Wireless (India)

Source: Company data, I-Sec Research

**Table 18: Balance sheet***(Rs mn, year ending March 31)*

	FY07	FY08	FY09	FY10E	FY11E	FY12E
<b>SHARE CAPITAL :</b>						
Equity Share Capital	378	379	380	394	397	398
Share Application Money	0	1	0	0	0	0
Preference Share Capital	-	-	-	-	-	-
<b>Share Capital</b>	<b>378</b>	<b>380</b>	<b>380</b>	<b>394</b>	<b>397</b>	<b>398</b>
<b>RESERVES &amp; SURPLUS:</b>						
Share Premium	2,750	2,761	2,552	1,435	1,495	1,533
Capital Reserve	-	-	-	2	2	2
General Reserve	90	194	202	202	202	202
P&L	1,124	1,964	2,435	3,997	5,898	7,876
Others	13	32	(56)	(30)	44	44
<b>Rerves &amp; Surplus</b>	<b>3,977</b>	<b>4,952</b>	<b>5,133</b>	<b>5,605</b>	<b>7,640</b>	<b>9,657</b>
<b>NETWORTH (NW)</b>	<b>4,355</b>	<b>5,331</b>	<b>5,513</b>	<b>5,999</b>	<b>8,037</b>	<b>10,055</b>
<b>DEBT:</b>						
Secured Loans	264	919	1,376	288	288	288
Unsecured Loans	-	-	18	18	18	18
<b>Total Debt</b>	<b>264</b>	<b>919</b>	<b>1,394</b>	<b>306</b>	<b>306</b>	<b>306</b>
<b>MINORITY INTEREST</b>	-	-	328	-	-	-
<b>TOTAL SOURCES OF FUNDS</b>	<b>4,619</b>	<b>6,250</b>	<b>7,234</b>	<b>6,305</b>	<b>8,343</b>	<b>10,361</b>
<b>FIXED ASSET :</b>						
Gross Block:	1,368	3,582	4,941	4,926	5,576	6,326
Less: Accumulated Depreciation	800	1,189	2,110	2,160	2,914	3,778
<b>Net Block</b>	<b>568</b>	<b>2,393</b>	<b>2,831</b>	<b>2,765</b>	<b>2,661</b>	<b>2,547</b>
<b>GOODWILL</b>	-	<b>214</b>	<b>1,460</b>	<b>131</b>	<b>131</b>	<b>131</b>
<b>CAPITAL WIP</b>	<b>132</b>	<b>233</b>	<b>130</b>	<b>130</b>	<b>130</b>	<b>130</b>
<b>INVESTMENT:</b>						
Marketable Securities	2,140	1,395	1,007	350	350	350
Others	0	-	7	7	7	7
<b>Total Investment</b>	<b>2,141</b>	<b>1,395</b>	<b>1,013</b>	<b>357</b>	<b>357</b>	<b>357</b>
<b>CURRENT ASSETS:</b>						
Debtors	1,172	1,756	2,792	3,109	3,503	4,138
Cash & Bank Balances	768	553	488	457	1,687	3,491
Loans & Advances	830	949	1,411	1,592	2,368	2,927
<b>TOTAL CURRENT ASSETS</b>	<b>2,770</b>	<b>3,258</b>	<b>4,691</b>	<b>5,158</b>	<b>7,558</b>	<b>10,556</b>
<b>CURRENT LIABILITIES &amp; PROVISIONS:</b>						
Sundry Creditors	244	201	216	185	280	325
Advances from Customers	6	17	44	58	73	95
Unearned Revenue	27	21	48	61	70	81
Other Current Liabilities	584	923	2,552	1,419	1,202	1,323
<b>Total Current Liabilities</b>	<b>862</b>	<b>1,162</b>	<b>2,860</b>	<b>1,723</b>	<b>1,625</b>	<b>1,824</b>
<b>Total Provision</b>	<b>176</b>	<b>170</b>	<b>222</b>	<b>709</b>	<b>1,082</b>	<b>1,767</b>
<b>TOTAL CURRENT LIABILITIES &amp; PROVISIONS</b>	<b>1,038</b>	<b>1,332</b>	<b>3,082</b>	<b>2,432</b>	<b>2,707</b>	<b>3,590</b>
<b>WORKING CAPITAL</b>	<b>1,732</b>	<b>1,926</b>	<b>1,609</b>	<b>2,725</b>	<b>4,851</b>	<b>6,966</b>
<b>DEFERRED TAX ASSET/(LIABILITY)</b>	<b>46</b>	<b>90</b>	<b>190</b>	<b>197</b>	<b>213</b>	<b>230</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>4,619</b>	<b>6,250</b>	<b>7,234</b>	<b>6,305</b>	<b>8,343</b>	<b>10,361</b>

Note: Our financials include the recently acquired company Kyocera Wireless (India)

Source: Company data, I-Sec Research

**Table 19: Cashflow statement***(Rs mn, year ending March 31)*

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Operating C.Flow bef. W.Cap Changes	1,135	1,352	2,757	2,408	2,828	2,937
(Inc)/Dec in Working Capital	(314)	(440)	(955)	(1,250)	(923)	(398)
<b>Cash flow from Operations</b>	<b>821</b>	<b>912</b>	<b>1,802</b>	<b>1,157</b>	<b>1,905</b>	<b>2,539</b>
(Inc)/Dec in FA	(549)	(2,176)	(369)	(624)	(650)	(750)
Purchase of Business/Acquisition	(17)	(254)	(2,920)	(131)	-	-
(Inc)/Dec in Invest.	(1,576)	845	1,003	657	-	-
Dividend/Int Income	20	85	63	73	85	180
<b>Cash flow from Investing</b>	<b>(2,122)</b>	<b>(1,501)</b>	<b>(2,224)</b>	<b>(26)</b>	<b>(565)</b>	<b>(570)</b>
Inc./(Dec) in Debt	(493)	639	469	(1,088)	-	-
Inc./(Dec) in Share Capital and related items	2,366	(119)	6	303	63	40
Minority Interest	-	-	-	(328)	-	-
Interest Paid on Loans	(30)	(59)	(159)	(50)	(28)	(27)
Dividend Paid (Including Dividend Tax)	(35)	(88)	(90)	-	(146)	(177)
<b>Cash flow from financing</b>	<b>1,807</b>	<b>373</b>	<b>226</b>	<b>(1,162)</b>	<b>(110)</b>	<b>(165)</b>
<b>Net +/- in Cash &amp; Cash Equivalent</b>	<b>506</b>	<b>(215)</b>	<b>(196)</b>	<b>(30)</b>	<b>1,230</b>	<b>1,804</b>
<b>Cash &amp; Cash Equivalent at the end of the year</b>	<b>768</b>	<b>553</b>	<b>488</b>	<b>457</b>	<b>1,687</b>	<b>3,491</b>

Note: Our financials include the recently acquired company Kyocera Wireless (India)

Source: Company data, I-Sec Research

**Table 20: Key ratios***(Year ending March 31)*

	FY07	FY08	FY09	FY10E	FY11E	FY12E
<b>Per Share Data (Rs)</b>						
EPS	23.8	27.2	13.8	43.4	52.4	54.3
Cash EPS	29.3	35.9	29.1	61.8	72.7	77.6
Dividend per share	0.0	2.0	1.0	3.2	3.8	4.0
Book Value per share	115.3	140.6	145.1	152.4	202.6	252.4
<b>Growth Ratios (%)</b>						
Operating Income (Sales)	31.5	25.3	67.3	3.0	14.1	15.6
EBITDA	39.9	14.4	163.9	(30.3)	27.1	13.9
Recurring Net Income	66.1	14.7	(49.3)	226.6	21.7	4.1
Recurring EPS	59.6	(4.3)	(48.3)	213.4	21.7	4.1
Recurring CEPS	33.2	2.5	(17.1)	111.1	18.7	7.1
<b>Valuation Ratios (x)</b>						
P/E	26.1	22.9	45.3	14.4	11.9	11.5
P/CEPS	21.2	17.4	21.4	10.1	8.6	8.0
P/BV	5.4	4.4	4.3	4.1	3.1	2.5
EV / EBITDA	19.8	18.6	7.3	10.3	7.7	6.2
EV / Sales	3.7	3.2	2.0	1.9	1.6	1.2
EV / FCF	85.2	(15.4)	(16.3)	59.3	18.0	11.6
<b>Operating Ratio</b>						
Software Development Expenses/Sales (%)	62.0	63.9	56.3	62.4	61.3	62.2
SG&A/Sales (%)	19.3	19.0	16.3	19.1	18.0	17.5
Other Income / PBT (%)	4.9	19.7	(353.7)	17.8	10.7	6.7
Effective Tax Rate (%)	(0.5)	7.6	11.1	14.3	14.8	18.6
NWC / Total Assets (%)	30.6	25.4	15.6	31.2	43.9	49.9
Fixed Asset Turnover (x) on average	12.7	4.7	3.6	3.5	5.1	6.1
Receivables (days) on average	70	72	67	85	83	83
D/E Ratio (x)	0.1	0.2	0.3	0.1	0.0	0.0
<b>Return/Profitability Ratio (%)</b>						
Recurring Net Income Margins	15.3	14.0	4.2	13.4	14.3	12.9
RoIC (Based on Avg)	58.3	27.6	48.5	25.0	31.5	31.5
RoCE (Based on Avg)	25.8	15.3	36.1	20.7	25.3	21.6
RoNW (Based on Avg)	31.9	21.3	9.6	29.7	29.6	23.9
Dividend Payout Ratio		8.6	8.5	8.5	8.5	8.5
Dividend Yield		0.3	0.2	0.5	0.6	0.6
EBITDA Margins	18.6	17.0	26.7	18.1	20.2	19.9

Note: Our financials include the recently acquired company Kyocera Wireless (India)

Source: Company data, I-Sec Research

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**BUY:** +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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