

# MindTree Ltd

Rs541

OUTPERFORMER

## RESULT NOTE

Mkt Cap: 21.7bn; US\$477m

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**Result:** Q3FY11  
**Comment:** Lackluster quarter  
**Last Report:** 4 January 2011 (Price Rs563; Recommendation: Outperformer)

### Key valuation metrics

Year to March (Rs m)	Sales	Chg yoy (%)	Net Profit	EPS (Rs)	Chg yoy (%)	PER (x)
2009	12,375	67.3	523	13.7	(48.3)	39.5
2010	12,960	4.7	2,148	52.8	285.2	10.2
2011E	15,148	16.9	1,184	29.0	(45.1)	18.7
2012E	17,768	17.3	1,903	46.5	60.7	11.6
2013E	21,335	20.1	2,248	55.0	18.2	9.8

Source: Company, IDFC Securities

## Key result highlights

- **Results below expectations** – MindTree reported revenues of US\$85m (+4% qoq and +21% yoy) – below IDFC exp. of US\$87m. Revenue growth was driven largely by improvement in pricing realization (because of one-time IP licensing deal) while volumes remained flat qoq. Due to stronger rupee, INR revenues were flat sequentially at Rs3.8bn – below our expectation of Rs3.9bn. Sequentially EBIT margins declined by ~70bp to 6.3% due to wireless business related restructuring costs. Services business margins were flat qoq at 15.6% – lower billing days and currency impact was offset by better price realizations. Net profit was Rs305m (+31% qoq and -43% yoy) vs. IDFC exp of Rs336m.
- **IT Services business continues to be on track** – MindTree’s core IT services business continued to show traction. Driven by growth in BFSI and manufacturing vertical this business reported volume led revenue growth of ~8% qoq. We expect it to continue to grow well as it is levered to discretionary IT spending.
- **R&D services grows; OPD services decline:** After two quarters of decline, R&D services grew by ~5% during the quarter. Company expects this growth trend to continue and has also won a deal with a Japanese semiconductor company. However, OPD services declined by ~5% sequentially because of client’s constrained budgets during the quarter.
- **Other highlights** – MindTree added ~1,000 employees on gross basis and 87 on net basis (1% of quarter ago-base). Excluding the employees lost due to wireless business restructuring net employee addition was 180. LTM attrition inched up to ~24%, while it declined sequentially on absolute basis. Company added 3 new Fortune 500 accounts during the quarter. Sequentially, revenues from Europe and APAC/RoW grew by double-digit while US declined by 1%. DSOs reduced to 68 from 76 in the last quarter.

**Valuations and View:** On the back of muted Q3 we reduce our FY12E EPS by ~4%; however, raise FY11 EPS estimate by ~75% to account for lower restructuring cost in product business. We also introduce FY13 estimates. Levered to discretionary spending, we expect MindTree USD revenues to grow at ~24% CAGR for FY11-13. We reduce our 12-month target price of MindTree to Rs650 based on 14x FY12E EPS (from earlier Rs680). We believe 14x (~40% discount to Tier1 IT target multiple) is a fair multiple for MindTree given ~24% USD revenue CAGR. Trading at ~12x FY12E EPS, we maintain MindTree stock as Outperformer.

IDFC Securities Ltd.

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## Q3FY11 results

Year to March 31 (Rs m)	3Q10	2Q11	3Q11	QoQ (%)	YoY (%)
<b>Revenue (US\$ m)</b>	<b>70.4</b>	<b>82.4</b>	<b>85.3</b>	<b>3.5</b>	<b>21.0</b>
Revenue	3,319	3,844	3,848	0.1	15.9
Direct costs	2,012	2,559	2,586	1.0	28.5
Gross profit	1,306	1,285	1,262	(1.8)	(3.4)
Gross margin (%)	39.4	33.4	32.8	(63bp)	(656bp)
SG&A	649	837	813	(2.9)	25.3
EBITDA	657	447	449	0.3	(31.7)
<b>EBITDA margin (%)</b>	<b>19.8</b>	<b>11.6</b>	<b>11.7</b>	<b>3bp</b>	<b>(813bp)</b>
Depreciation	168	177	206	16.1	22.6
EBIT	489	270	243	(10.0)	(50.3)
<b>EBIT margin (%)</b>	<b>14.7</b>	<b>7.0</b>	<b>6.3</b>	<b>(71bp)</b>	<b>(842bp)</b>
Interest exp	1	0	1	266.7	83.3
Other income	202	43	95	123.2	(52.8)
Profit before tax	691	313	337	7.9	(51.1)
Provision for taxes	153	80	32	(59.6)	(78.8)
<b>Profit after taxes</b>	<b>538</b>	<b>232</b>	<b>305</b>	<b>31.2</b>	<b>(43.3)</b>
EPS - basic (Rs.)	13.7	5.9	7.7	30.9	(44.1)
<b>EPS - fully diluted (Rs.)</b>	<b>13.1</b>	<b>5.7</b>	<b>7.5</b>	<b>31.3</b>	<b>(43.0)</b>

Source: Company

#### □ Key deal wins during the quarter

- ♦ Selected by a leading Fortune 500 Retail chain based in US to provide services in the areas of digital business, IMTS and Testing
- ♦ MindTree will provide business consulting services in the area of business transformation to improve customer's distribution competitiveness to a global CPG company
- ♦ A large semiconductor company based in Japan partnered with MindTree to build life style accessory products using the low energy Bluetooth technology

#### □ Other result highlights

- ♦ Company has successfully reduced the DSOs back to the normal level of 68 days
- ♦ Added 9 clients in the quarter which included 3 Fortune 500 clients
- ♦ Utilization excluding trainees decreased to 71.2% – lowest in last five quarters – because of lower working days in the quarter
- ♦ On an LTM basis the attrition inched up to 24.2% from 21.9% in the previous quarter. However, on an annualized basis the quarterly attrition reduced to 25.6% from 26.8% in the previous quarter
- ♦ As of Dec'10 company has outstanding hedges of US\$157m at weighted average rate of Rs45/US\$

#### □ Maintain Outperformer with a 12 month target price of Rs650

On the back of muted Q3 we reduce our FY12E EPS by ~4%; however, raise FY11 EPS estimate by ~75% to account for lower restructuring cost in product business. We also introduce FY13 estimates. Levered to discretionary spending, we expect MindTree USD revenues to grow at ~24% CAGR for FY11-13. We have marginally changed our INR assumption to Rs45.5/USD for FY11E, Rs43.7/USD for FY12E and Rs41.7/USD for FY13.

## Earnings revision table

	FY11E	FY12E	FY13E
<b>Reported Net income (Rs m)</b>			
- New	1,184	1,903	2,248
- Old	679	1,990	-
Change (%)	74.5	(4.4)	-
<b>Reported EPS (Rs) - Fully diluted</b>			
- New	29.0	46.5	55.0
- Old	16.6	48.7	-
Change (%)	74.6	(4.4)	-

Source: IDFC Research

We reduce our 12-month target price of MindTree to Rs650 based on 14x FY12E EPS (from earlier Rs680). We believe 14x (~40% discount to Tier1 IT target multiple) is a fair multiple for MindTree given ~24% revenue CAGR. Trading at ~12x FY12E EPS, we maintain MindTree stock as Outperformer.

### Other key result tables

## Key HR metrics

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
Total employees	8,127	8,297	9,012	9,584	9,671	0.9	19.0
- net hiring	677	170	715	572	87	(84.8)	(87.1)
Delivery employees	7,460	7,651	8,353	8,893	8,968	0.8	20.2
- net addition	628	191	702	540	75	(86.1)	(88.1)
Sales and support	667	646	659	691	703	1.7	5.4
<b>Utilization (%)</b>							
- inc trainees	71.4	71.4	70.5	70.0	69.3	(70bp)	(210bp)
- ex trainees	72.9	72.6	71.9	73.0	71.2	(180bp)	(170bp)
Attrition rate – LTM (%)	10.7	14.1	17.8	21.9	24.2	230bp	1350bp

Source: Company

## Volume and pricing details

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
<b>Billed hours ('000)</b>							
Onsite	293.9	305.2	326.1	352.2	344.8	(2.1)	17.3
Offshore	2,415.4	2,380.0	2,550.0	2,761.2	2,766.8	0.2	14.5
<b>Total</b>	<b>2,709.3</b>	<b>2,685.2</b>	<b>2,876.1</b>	<b>3,113.4</b>	<b>3,111.7</b>	<b>(0.1)</b>	<b>14.8</b>
<b>Billing rates (US\$/person-hr)</b>							
Onsite	64.5	67.1	68.7	70.2	71.3	1.6	10.4
Offshore	20.7	22.0	20.7	20.3	21.4	5.2	3.4
<b>Revenue (US\$ m)</b>							
Onsite	18.97	20.47	22.41	24.71	24.58	(0.5)	29.6
Offshore	49.90	52.30	52.80	56.05	59.09	5.4	18.4
<b>Total</b>	<b>68.87</b>	<b>72.77</b>	<b>75.21</b>	<b>80.76</b>	<b>83.67</b>	<b>3.6</b>	<b>21.5</b>
<b>Revenues by location (%)</b>							
Onsite	27.5	28.1	29.8	30.6	29.4	(122bp)	183bp
Offshore	72.5	71.9	70.2	69.4	70.6	122bp	(183bp)
<b>Efforts by location (%)</b>							
Onsite	10.8	11.4	11.3	11.3	11.1	(23bp)	23bp
Offshore	89.2	88.6	88.7	88.7	88.9	23bp	(23bp)

Source: Company

IDFC Securities

Revenue Mix

(%)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ (%)	YoY (%)
<b>Geography wise</b>							
America	64.4	62.8	64.6	63.1	60.4	(1.0)	13.5
Europe	18.4	18.7	16.9	18.0	19.4	11.5	27.6
India	6.4	6.3	8.0	8.5	8.4	2.2	58.8
APAC / Rest of the World	10.8	12.2	10.5	10.4	11.8	17.4	32.2
<b>Service offering</b>							
IT services	51.1	53.3	54.1	57.0	59.3	7.6	40.4
R&D services	21.1	20.6	18.9	16.9	16.7	2.2	(4.2)
OPD services	27.8	26.1	27.0	26.1	24.0	(4.9)	4.5
<b>Service line wise</b>							
AD	51.8	52.7	51.2	50.3	45.6	(6.2)	6.5
AM	20.8	18.9	19.6	20.3	21.6	10.1	25.7
Testing - IVS	17.0	17.0	17.0	17.6	17.8	4.6	26.7
PI	4.2	4.8	4.1	2.8	2.9	7.2	(16.4)
IMS	3.7	4.1	5.0	5.9	8.1	42.0	164.9
Consulting/IP led	2.5	2.5	3.1	3.1	4.0	33.5	93.6
<b>Vertical wise</b>							
Manufacturing	12.1	12.5	13.6	14.0	15.1	11.6	51.0
BFSI	16.0	17.5	17.3	18.1	20.2	15.5	52.8
Travel and Transportation	12.6	14.3	13.3	12.6	11.8	(3.1)	13.3
R&D services	14.4	14.4	13.3	11.8	12.0	5.2	0.8
S/w prod engg	27.8	26.1	27.0	26.1	24.0	(4.9)	4.5
Wireless products	6.7	6.2	5.6	5.1	4.7	(4.7)	(15.1)
Others	10.4	9.0	9.9	12.3	12.2	2.6	42.0

Source: Company

Key Client Metrics

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	QoQ	YoY
Total active clients	253	258	261	261	269	8	16
New clients added	35	27	31	21	30	9	(5)
Fortune 500 clients	40	40	39	45	48	3	8
<b>Customer Concentration (%)</b>							
Top Customer	7.2	7.2	7.0	6.8	6.9	10bp	(30bp)
Top 5 Customers	28.4	27.9	26.9	26.2	25.6	(60bp)	(280bp)
Top 10 Customers	40.5	40.0	40.2	39.9	40.2	30bp	(30bp)
Repeat business	98.2	99.1	98.9	99.4	98.3	(110bp)	10bp
<b>Receivables position</b>							
Days of Sales Outstanding	65	68	68	76	68	(8)	3
<b>Client relationships</b>							
US\$ 1 mn+	58	60	62	64	63	(1)	5
US\$ 5 mn+	13	13	13	14	14	0	1
US\$ 10 mn+	5	5	5	5	5	0	0

Source: Company

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