

Equities

26 September 2011 | 9 pages

MindTree (MINT.BO)

Sell: Trimming Earnings and Target Price

- Company Update
- Target Price Change
- Estimate Change
- Transfer of Coverage

- **Maintain Sell** — We transfer coverage of MindTree to Surendra Goyal from Vishal Agarwal, who has left Citi. We maintain our Sell/Medium Risk rating on the stock given macro headwinds that the sector faces. Our view remains that Tier I companies are in better position to handle the macro challenges. We trim earnings by ~9-13% and lower our target price to Rs335 from Rs375.
- **Expect a decent 2Q** — We expect 2QFY12 to be decent, continuing from a good 1Q performance. We expect ~6.5% qoq growth (largely volume led) and margin improvement of ~100bps qoq, supported by weak INR and offsetting wage hikes for part of the workforce.
- **Trim FY12/13 estimates to factor in macro headwinds** — In line with our sector thesis of “moderating global growth” and lower margin assumption for FY12, we trim FY12/FY13 estimates for Mindtree by ~9-13%. This is in line with the changes made for large cap stocks in our earlier note: [Macro Uncertainty to Weigh on Earnings and Multiples](#). CY12 IT budgets is the key – most IT companies have indicated that they have not witnessed any change in customer plans at this point.
- **Is Mindtree's business more discretionary?** — In 1Q, Mindtree has ~40% of revenues from application development, ~7% from package implementation /consulting and ~18% from testing. Mindtree's exposure to application development is on the higher side and that could be a risk if discretionary spend gets impacted next year.
- **Risks to our call** — (a) Sustained INR depreciation – Mindtree's sensitivity to INR depreciation should be high given high offshore – this could support the stock in the near term; (b) Lesser than anticipated impact of the global macro uncertainty; (c) Price increases in FY13 continue – we expect flattish prices in FY13.

Sell/Medium Risk	3M
Price (23 Sep 11)	Rs352.00
Target price	Rs335.00
	<i>from Rs375.00</i>
Expected share price return	-4.8%
Expected dividend yield	0.9%
Expected total return	-4.0%
Market Cap	Rs14,160M
	US\$287M

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



Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	2,148	52.92	292.3	6.7	2.1	34.2	0.9
2011A	1,015	24.83	-53.1	14.2	1.8	14.0	0.7
2012E	1,438	35.56	43.2	9.9	1.6	17.1	0.9
2013E	1,553	38.40	8.0	9.2	1.3	15.9	1.0
2014E	1,672	41.34	7.7	8.5	1.2	14.9	1.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	6.7	14.2	9.9	9.2	8.5
EV/EBITDA adjusted (x)	5.0	6.9	5.5	4.8	4.4
P/BV (x)	2.1	1.8	1.6	1.3	1.2
Dividend yield (%)	0.9	0.7	0.9	1.0	1.0
Per Share Data (Rs)					
EPS adjusted	52.92	24.83	35.56	38.40	41.34
EPS reported	52.92	24.83	35.56	38.40	41.34
BVPS	169.74	194.05	226.42	261.10	298.75
DPS	3.00	2.50	3.00	3.50	3.50
Profit & Loss (RsM)					
Net sales	12,960	15,091	18,273	21,144	24,756
Operating expenses	-11,157	-14,027	-16,756	-19,415	-22,911
EBIT	1,803	1,064	1,517	1,729	1,845
Net interest expense	743	239	210	134	165
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	2,546	1,303	1,727	1,863	2,010
Tax	-398	-288	-289	-310	-338
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	2,148	1,015	1,438	1,553	1,672
Adjusted earnings	2,148	1,015	1,438	1,553	1,672
Adjusted EBITDA	2,455	1,776	2,254	2,568	2,769
Growth Rates (%)					
Sales	4.7	16.4	21.1	15.7	17.1
EBIT adjusted	-34.2	-41.0	42.6	14.0	6.7
EBITDA adjusted	-25.8	-27.7	26.9	13.9	7.8
EPS adjusted	292.3	-53.1	43.2	8.0	7.7
Cash Flow (RsM)					
Operating cash flow	1,440	213	951	1,727	1,710
Depreciation/amortization	652	712	737	839	924
Net working capital	-593	-1,272	-999	-531	-721
Investing cash flow	1,241	-334	-853	-1,246	-1,440
Capital expenditure	-703	-733	-1,151	-1,381	-1,605
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-2,645	56	-126	-162	-162
Borrowings	-1,363	15	-5	0	0
Dividends paid	-136	-115	-139	-162	-162
Change in cash	36	-64	-28	318	107
Balance Sheet (RsM)					
Total assets	9,340	10,152	11,630	13,337	15,244
Cash & cash equivalent	523	459	431	749	856
Accounts receivable	2,370	2,825	3,755	4,171	4,748
Net fixed assets	2,859	3,034	3,448	3,989	4,671
Total liabilities	2,634	2,390	2,551	2,867	3,264
Accounts payable	0	0	0	0	0
Total Debt	31	46	41	41	41
Shareholders' funds	6,706	7,762	9,079	10,470	11,980
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	18.9	11.8	12.3	12.1	11.2
ROE adjusted	34.2	14.0	17.1	15.9	14.9
ROIC adjusted	31.9	14.4	18.3	17.8	16.4
Net debt to equity	-7.3	-5.3	-4.3	-6.8	-6.8
Total debt to capital	0.5	0.6	0.4	0.4	0.3

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Estimate changes

We trim estimates for FY12/13 by ~9-13%, as we incorporate (a) FY11 annual report, (b) smaller margin improvement in FY12 (than earlier estimated), (c) moderation in FY13 volumes and pricing – given our sector thesis of macro uncertainty is likely to impact growth in FY13E.

Figure 1. Estimate Changes

FYE	Net Profit	EPS	%	DPS
31 Mar	(RsM)	(Rs)	chg	(Rs)
2012E	1,438	35.56	-8.5	3.00
Prev	1,573	38.89		3.00
2013E	1,553	38.40	-13.1	3.50
Prev	1,787	44.18		3.50
2014E	1,672	41.34	na	3.50
Prev	na	na		na

Source: dataCentral, CIRA estimates

MindTree

Company description

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

Investment strategy

We rate MindTree shares as Sell/Medium Risk (3M). Mindtree has a higher proportion of application development work (~40% of revenues), so risks are higher given the global macro economic uncertainties facing the sector. In IT services, the tier-one players have done better than the industry, and we expect this to continue. We expect revenue and EBITDA CAGRs of ~19% and ~20% over FY11-13E. While the EBITDA CAGR of 20% looks good, it comes on the back of a sharp decline of ~28% yoy in FY11.

Valuation

Our Rs335 target price is derived from 9x Sep-12E EPS, in line with mid cap IT Services multiples and factors in management's decision to enter and then exit the telecom products business within a short span of time. With the Founder and Chairman deciding to move on from MindTree, this multiple also excludes the Promoter premium that the stock used to enjoy.

Risks

We rate MindTree shares Medium Risk which is in line with other mid-caps under our coverage, despite our quant risk rating system suggesting Low Risk. Upside risks to our target price are: (a) Sustained INR depreciation – Mindtree's sensitivity to INR depreciation should be high given higher offshore proportion of revenues; (b) Lesser than anticipated impact of the global macro uncertainty; and (c) Price increases in FY13 continue – we expect flattish prices in FY13.

Appendix A-1

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Analyst: Vishal Agarwal
Covered since June 18 2010

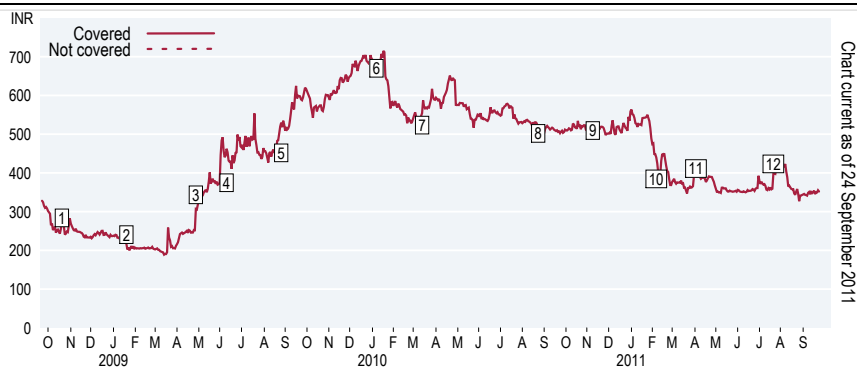


Chart current as of 24 September 2011

	Date	Rating	Target Price	Closing Price
1	21-Oct-08	*1H	*367.00	283.85
2	20-Jan-09	*3H	*190.00	216.55
3	28-Apr-09	3H	*240.00	306.90
4	10-Jun-09	3H	*415.00	462.45

* Indicates change

	Date	Rating	Target Price	Closing Price
5	26-Aug-09	*3M	*485.00	529.65
6	7-Jan-10	3M	*665.00	676.80
7	12-Mar-10	*1M	665.00	554.25
8	24-Aug-10	*3M	*510.00	521.00

	Date	Rating	Target Price	Closing Price
9	9-Nov-10	3M	*500.00	518.05
10	7-Feb-11	3M	*440.00	439.95
11	4-Apr-11	3M	*380.00	411.25
12	21-Jul-11	3M	*375.00	397.60

Rating/target price changes above reflect Eastern Standard Time

MindTree (MINT.BO) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Vishal Agarwal
Covered since June 18 2010

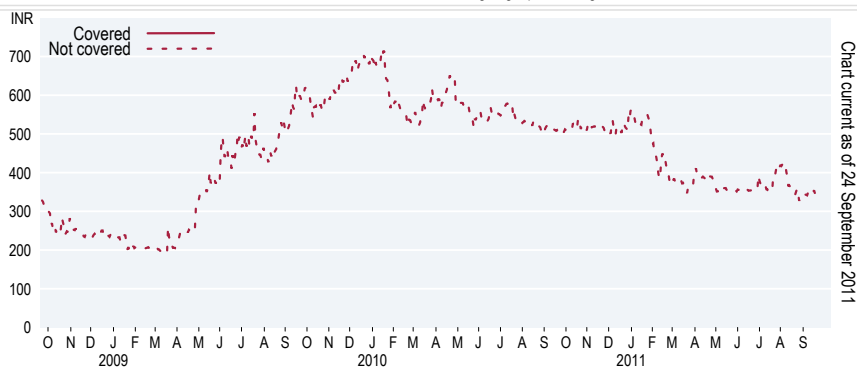


Chart current as of 24 September 2011

* Indicates change

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