SSKI

INDIA RESEARCH

8 August 2007

BSE Sensex: 15308

Initiating coverage

MindTree Consulting

Rs592

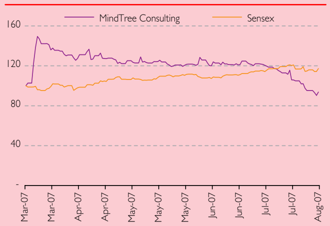
UNDERPERFORMER

Mind the valuations

Mkt Cap: Rs23.2bn; US $572m

Stock data	
Reuters	MINT.BO
Bloomberg	MTCL IN
1-yr high/low (Rs)	1022/425
1-yr avg daily volumes (m)	0.81
Free float (%)	64.6

Relative price performance



Performance (%)

	1mth	3mth
MindTree	(23.2)	(24.3)
Sensex	2.3	11.2

MindTree Consulting (MindTree), a mid-sized IT and R&D services company, has strong management bandwidth. It services marquee clients like Volvo, AIG, LSI Logic, United Technologies, Symantec, Avis and Unilever. However, a high share of development services in revenues creates a project-based business profile, which lowers sales productivity, hurts utilization and leads to poor client mining. Thus, contrary to street expectations of an expansion, we see margins declining by 170bp over FY07-09 due to rupee appreciation and salary inflation. The management has cut its FY08 earnings guidance after Q1FY08 results, but we see further risk to consensus estimates for FY09. While the stock price has fallen 23% in just one month, further downside is likely at valuations of 19.8x FY09E earnings (19.2x for Infosys). Initiating coverage with Underperformer and a price target of Rs510.

Superior quality management: A strong management has successfully steered MindTree even through troubled times, which is a testimony to its ability. MindTree registered a robust 65% revenue CAGR over FY04-07 on the back of its positioning as the second best choice for clients offshoring IT and R&D services and looking for management attention. While R&D services are a good differentiator, we believe MindTree offers generic IT services with little differentiation.

Project-based nature of business and poor client mining haze visibility: Mindtree derived 65% of its FY07 revenues from development services, which tend to be volatile as they are project-based. Despite having a 71% share of offshore revenue compared to 35% for Hexaware (a comparable peer), MindTree fares poorly in terms of client mining with an average of just 15 billed people per client compared to 23 for Hexaware. Poor client mining lowers sales productivity, reduces visibility and affects utilization.

Valuation premium to tier-1 peers unjustified: Mindtree trades at premium valuations even to tier-1 companies, which we attribute to its superior management. However, we expect margins to decline by 170bp over FY07-09 due to the impact of rupee appreciation and salary inflation. We do not see too many operating levers playing out as most of the metrics are inherent to the business. At 19.8x FY09E earnings and 12.1x EV/EBITDA, we initiate coverage with Underperformer and a price target of Rs510.

Key valuation metrics

As on 31 March	FY05	FY06	FY07	FY08E	FY09E
Net sales (Rs m)	2,465	4,488	5,904	7,643	10,528
Adj. net profit (Rs m)	169	542	901	1,004	1,198
Shares in issue (m)	30	31	33	39	40
Adj. EPS (Rs)	5.6	17.3	27.7	25.6	29.9
% growth	503.1	210.0	59.7	(7.5)	16.5
PER (x)	105.8	34.1	21.4	23.1	19.8
Price/Book (x)	66.3	14.4	4.4	4.4	3.8
EV/EBITDA (x)	74.4	24.5	15.1	16.3	12.1
RoE (%)	94.5	69.6	31.9	21.0	20.9
RoCE (%)	11.8	31.4	25.6	17.8	21.6

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INVESTMENT ARGUMENT

MindTree, despite starting late as an IT services company, has battled troubled times on the back of its strong management. While MindTree began as an R&D services provider to position itself differently, it eventually succumbed to being an alternative for clients looking beyond tier-1 Indian vendors for IT services. MindTree has a marquee client roster with names such as Volvo, AIG, LSI Logic, United Technologies and Symantec. We believe lower margins are inherent to the business, though we see only a few levers available for margin expansion. Compared to a few similar sized peers, MindTree's valuations appear expensive. Also, Tech Mahindra and Tanla Solutions, IT companies that debuted on the stock markets in the last 12 months, have performed well and trade at a discount to MindTree despite developing their own niches with better potential. At 19.8x FY09E earnings, the stock trades at a premium even to Infosys.

❑ Strong management background

Management has good experience in areas of technology, marketing and R&D services

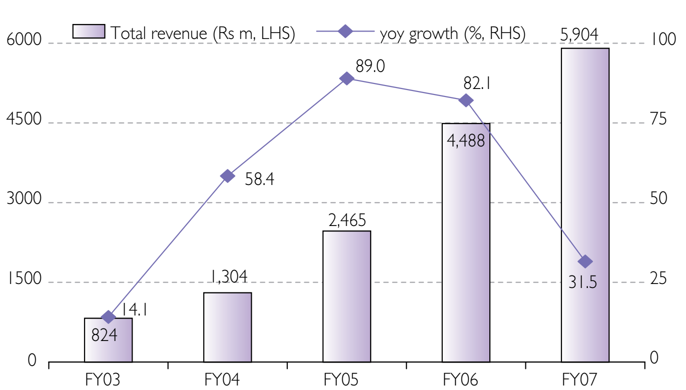
MindTree was incorporated in 1999 by Mr. Ashok Soota, Mr. Subroto Bagchi and eight other industry professionals. Mr. Ashok Soota (CMD) was vice chairman of Wipro and Mr. Subroto Bagchi (COO) was vice president at Wipro. The management has good experience in the areas of technology, marketing and R&D services, and played key roles in organizations like Cambridge Technology partners, Lucent and Wipro. We believe the strong management has steered the company through the dotcom meltdown and has enabled it to diversify into providing IT services against the original plan of being a niche R&D services provider.

❑ R&D services – a differentiated positioning

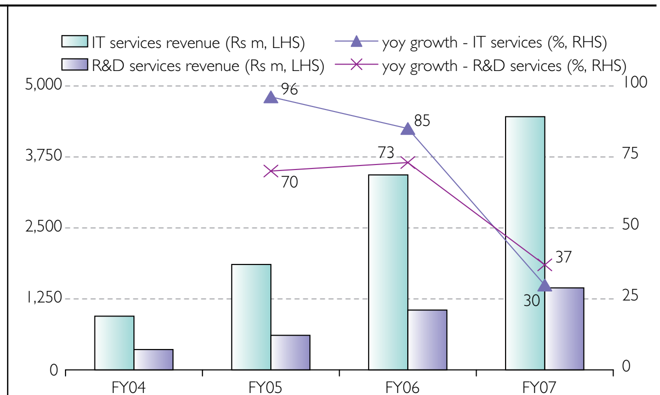
In FY07, ~75% of revenues accrued from generic IT services and 25% from R&D services

MindTree derives ~76% of its revenues from providing generic IT services and 25% from R&D services. Within R&D services, we believe MindTree has differentiated itself by pursuing opportunities in the storage and servers sub-vertical, which constituted 42% of its R&D services revenues in FY07. MindTree derived just 17% of its R&D services revenues from the communications sub-vertical in FY07, which typically forms a large portion of revenues for R&D service providers.

Exhibit 1: MindTree has witnessed strong revenue growth…



…in both IT and R&D services



Source: Company

Share of offshore in R&D services, at 71%, highest among peers

❑ High share of offshore in revenues due to R&D services

MindTree derived 25% of its FY07 revenues by providing R&D services, which mainly include working on clients' product architecture and product designing, re-engineering, testing, validating and providing technical support. As most of these activities are performed at its offshore development centres, share of offshore revenues – at 71% – is the highest among peers. In the IT services business, we believe onsite-centric services (including package implementation and consulting) formed just 7.3% of FY07 revenues.

Revenue growth slowdown in FY07 due to client rationalization, ramp down of GE account, etc

❑ Revenue growth slowed down in FY07

MindTree experienced slow revenue growth of 31.5% yoy in FY07 against 58% in FY04, 89% in FY05 and 82% in FY06. The growth slowdown can be attributed to:

- Ramp down of professional services work of ASAP (acquired company)
- Ramp down of GE account due to unfavorable terms (pricing, etc)
- Client rationalization
- Significant offshorization

Excluding the impact of discontinuation of professional services and ramp down in GE account, revenue growth was 45% yoy in FY07. The client rationalization exercise and ramp down of onsite professional services activities highlight the management's initiative of focusing on business, which would accrue value over the long term.

High client concentration could be a key reason for lower number of billed employees

❑ Client mining – need of the hour

MindTree had a base of 175 active clients in Q1FY08 and billed 2,558 employees, implying an average of 15 billed engineers per client. Hexaware, a similar sized company with 164 active clients, billed 23 engineers per client despite having a lower offshore revenue share compared to MindTree. MindTree has a higher proportion of employees delivering services from offshore centres in India. Delivering services from an offshore location for the same amount of revenues typically necessitates a larger team size compared to delivering services onsite. We believe the project-based nature of its business leads to poor client mining. Thus, MindTree needs to focus more on annuity business and cross-sell services to existing clients.

Exhibit 2: Client mining data

Company	Clients (No)	Billed employees	Billed employees per client	Offshore efforts ratio (%)	Top 10 clients Rev. share (%)
MindTree	175	2,558	15	85.8	42.8
Hexaware	164	3,785	23	61.0	42.2
Patni	267	9,839	37	69.3	48.8
Satyam	551	28,214	51	74.9	34.4
Wipro	647	33,226	51	68.3	24.1

Source: Company, SSKI Research

❑ Margins lower despite higher offshore revenue share

A non-billed IP team, business from captive India-based centres of clients, lower utilization, poor client mining, etc act as drag on margins

MindTree's EBITDA margins, at 18.6% in FY07, appear quite low compared to those of peers given that its offshore revenue share is significant at 71% of overall revenues. In our view, the main reasons for lower margins are:

- A 100-people team, working on creating IP, is not billed. IP licensing revenues constituted only 1.2% of the overall revenues in FY07 (USD 1.5m)
- The company has a very high proportion of experienced employees. The average experience of an employee is 4.75 years
- Its R&D services business includes working for the India-based captive centres of clients, wherein billing is in INR terms
- MindTree's onsite billing rates are lower compared to rates for peers
- A high share of development services leads to lower utilization
- Poor client mining, and
- High leasing expenses as most of its centres are leased (it bought out two centers in Q1FY08, which were leased earlier)

❑ Higher proportion of development revenues causes volatility

Development work pertains to discretionary technology spend; poses downside risk in case of lower IT spending

At 65% of revenues in FY07, the share of development revenues is high for MindTree compared to peers. Development-related work pertains to discretionary technology spend and poses downside risk in case of a slowdown in IT spending while it is also susceptible to volatility in revenues on account of a lower annuity base. Thus, MindTree's CQGR in revenues over the last eight quarters was 9.7% but the growth has ranged from 30% to -4% in individual quarters.

❑ Expect 15% net profit CAGR over FY07-09

While net profit growth likely to be subdued due to higher tax rate, equity dilution to lead to lower EPS growth

MindTree seems to be focusing on improving the quality of its business by churning out small accounts and discontinuing projects with lower margins. It is focusing on mining potentially large clients and increasing visibility. Thus, we expect CAGR of 34% in rupee revenues and 39% in USD revenues over FY07-09. We expect EBITDA margins to decline about 170bp due to the impact of currency movement and salary inflation. While apparently there are plenty of operating levers, we expect only a few of them to actually play out. Due to lower margins and a higher tax rate, the strong revenue growth would result in only 15% CAGR in net profit.

❑ Initiating coverage with Underperformer rating

Though the street is quite optimistic on margin levers, we expect margins to remain flat

MindTree has a superior quality of management and its R&D services differentiation positions it uniquely in the market place. However, issues like poor client mining, a higher share of development services in revenues leading to volatility in quarterly revenues and lower margins are some of the issues that need to be addressed. While we agree that MindTree has certain margin levers, we are less optimistic than the street that they would play out. We see margins declining by 170bp over FY07-09E due to rupee appreciation and salary inflation.

A comparison of MindTree's valuations with tier-1 players, similar-sized peers and IT companies listed on the bourses in last 12 months suggests that valuations are expensive. The stock price may hold in the near term as 77% of MindTree's equity is with promoters and financial investors (lock-in of one year since the date of IPO), and the price has corrected 23% in just a month. However, at 19.8x FY09E earnings

Valuations of 19.8x FY09E earnings and 12.1x EV/EBITDA build in high expectations; risk-reward is unfavorable

and 12.1x EV/EBITDA, we believe the valuation premium is unjustified. Initiating coverage on the stock with an Underperformer rating and a price target of Rs510.

Exhibit 3: Comparative valuations

	EPS CAGR (%)	PE (x)		RoE (%)
	FY07-09E	FY08E	FY09E	FY07
MindTree	3.8 (15*)	23.1	19.8	32
Mphasis	51	21.5	15.4	22
KPIT	19	15.6	12.7	30
Infotech Enterprises	19	15.1	12.5	33
Hexaware	17	11.9	9.8	26

*Source: SSKI Research, Bloomberg. *PAT CAGR*

❑ Risk to our call

Effective use of margin levers may surprise us on the upside

We believe MindTree needs to achieve a trade-off between margins and growth. To achieve margin expansion, MindTree needs to compromise on growth and vice-versa. If the company bags a few large deals offering volume discount, it could be a key risk to our call and growth can surprise positively.

Given that the stock price has fallen 23% in just one month, there could be a bounce back. However, the stock is likely to Underperform in the longer term as current valuations appear expensive.

STRONG MANAGEMENT; GOOD POSITIONING

MindTree witnessed strong growth owing to its positioning as a good alternative to tier-1 companies with strong management bandwidth promising client attention. In FY07, IT services contributed ~75% of revenues and R&D services constituted the remaining. Client rationalization and ramp down in professional management services led to slower growth in FY07. While client addition is strong, the company needs to improve client mining to achieve margin expansion. We believe higher revenue share from development services has increased volatility of quarterly revenue growth. We forecast 34% CAGR in MindTree's revenues over FY07-09.

MINDTREE A GOOD ALTERNATIVE TO TIER-1 VENDORS

IT services form 75% of revenues with the remaining coming from R&D services

MindTree was incorporated to primarily offer R&D services given that a majority of its management had worked in Wipro and was therefore inclined to operate at the higher-end of the IT services value chain. But as the dotcom bubble burst, the company was quick to diversify into providing generic IT services (application development, re-engineering and maintenance). Given the strong management background, MindTree has managed to position itself as an alternative to tier-1 vendors and promises management attention to clients. Key clients now include Volvo, AIG, United Technologies, Avis, LSI Logic, Symantec and Unilever. IT services constituted 75% of FY07 revenues and the remaining came from R&D services. With people strength of 4,432 as of Q1FY08, MindTree has 18 sales offices and 175 customers.

Revenues registered 65% CAGR over FY04-07 to Rs5.9bn with both IT services and R&D services witnessing robust 68% and 59% CAGR respectively.

Exhibit 4: Revenue growth over last five years

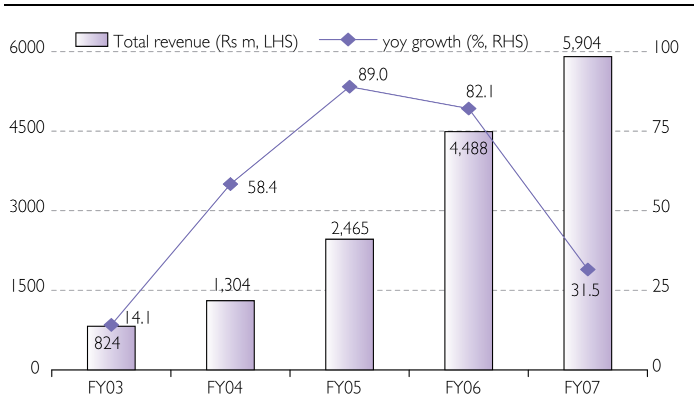
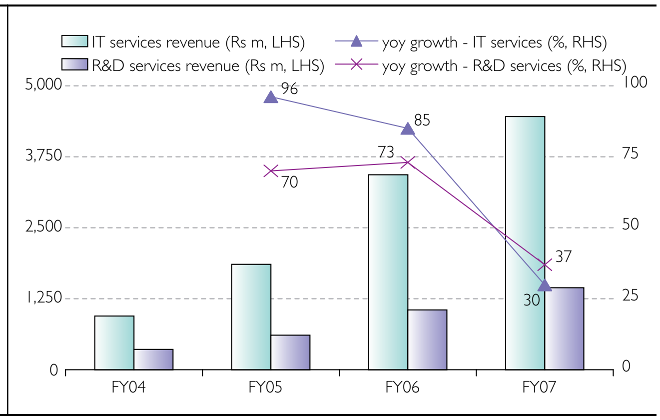


Exhibit 5: Revenue breakup – IT services and R&D services



Source: Company

Revenue growth slowed in FY07

Revenue growth slower at 31.5% yoy in FY07 against 58% in FY04, 89% in FY05 and 82% in FY06

MindTree witnessed a slowdown in its revenue growth in FY07 to 31.5% yoy against 58% in FY04, 89% in FY05 and 82% in FY06. The key reasons for the muted growth include:

- Ramp down of onsite professional services activities (body shopping work) of ASAP (an acquired company), which had a US $3.5m impact on revenues.
- Ramp down of GE account (a $6m impact) due to unfavorable pricing terms.
- Client rationalization: MindTree added only seven new clients on a net basis during FY07 against a gross addition of 78 clients and compared to addition of 32 and 38 clients on a net basis during FY05 and FY06 respectively.
- Significant offshorization: Offshore revenues rose sharply from 61.3% of total revenues in FY06 to 70.8% in FY07, i.e. a 950bp offshore shift. Adjusting for discontinuation of onsite professional services, the offshore shift has been 730bp. In FY07, onsite revenues declined 3.3% yoy and the proportion fell to 29.2% of revenues, while offshore revenues witnessed a strong growth of ~71% yoy.

But for the impact of discontinuation of professional services and ramp down in GE account, revenue growth would have been 45% yoy in FY07. This highlights the management's intent to focus on improving margins.

STRONG MANAGEMENT BACKGROUND

MindTree was founded by Mr. Ashok Soota and Mr. Subroto Bagchi, both reputed professionals of the Indian IT industry, with eight other professionals having significant experience in the areas of technology, marketing and R&D services. The promoters had played key roles in organizations like Cambridge Technology partners, Lucent and Wipro. We believe MindTree's success can primarily be assigned to its strong management team.

Strong management team

The promoters have rich industry experience…

MindTree was incorporated in 1999 by 10 individual promoters with extensive industry experience at Wipro, Lucent and Cambridge Technology Partners.

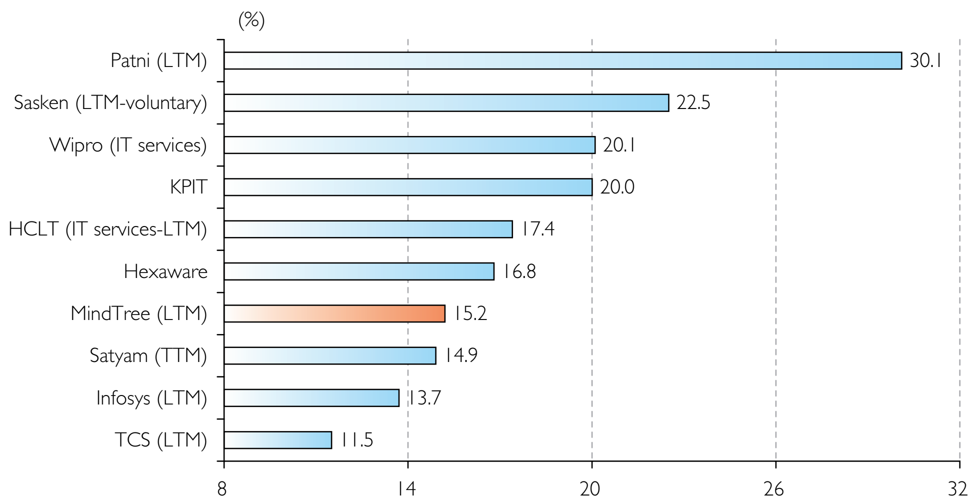
- Chairman and managing director, Mr. Ashok Soota, was vice chairman with Wipro Infotech (15 years).
- COO, Mr. Subroto Bagchi, was vice president in Lucent Tech and Wipro.
- President and CEO of IT Services, Mr. Krishna Kumar Natarajan, was CEO at Wipro's Financial Solutions and Electronic Commerce Division.
- Mr. Janakiraman, President and CEO of R&D services, was CEO - Global R&D in Wipro.
- Mr. Parthasarathy (EVP, Delivery and Operations) and Mr. Banerjee (Sr VP, R&D Services), also served with Wipro prior to joining MindTree.
- Mr. Lahiri (Head - European Operations), Mr. Scott Staples (EVP US operations) and Mr. Kamran Ozair (SVP and CTO of IT services) were with Cambridge Technology Partners.
- CFO and Company Secretary, Mr. Rostow Ravanan, worked with Lucent Tech and KPMG Corporate Finance prior to joining MindTree.

Attrition of 15.2% in Q1FY08 lower than that for peers

❑ Attrition lower than for peers; excludes attrition among new hires

MindTree's attrition level, at 15.2% in Q1FY08, is lower than that for peers. The figure does not include attrition of employees working for less than six months in the organization and involuntary attrition. MindTree is currently offering salary of Rs320,000 to campus recruits (joining in 2008), which is comparable to salaries offered by tier-1 companies.

Exhibit 6: Attrition for QEJune 2007 – peer comparison



Source: SSKI Research, Company

CLIENT MINING: NEED OF THE HOUR

MindTree serviced 155 clients in FY07 and while it added 78 new clients in the fiscal year, the client base went up by only seven, implying that 71 of the existing clients did not give business in subsequent quarters. For MindTree's size, we believe client attrition is significantly high. We attribute this to the high project-based nature of its business against annuity business.

Average team size of 15 for a client much lower than 23 for Hexaware, a comparable peer

❑ Poor client mining impacting margins

MindTree had an active client base of 175 as of Q1FY08 and billed about 2,560 employees. Thus, the average team size for a client works out to about 15. Hexaware, which is quite similar in size and client concentration to MindTree, manages a team of about 23 people per client on an average. This is despite a higher share of onsite in Hexaware's business, which requires less people for the same revenues compared to offshore delivery.

Exhibit 7: Client mining data

Company	Clients (No)	Billed employees	Billed employees per client	Offshore efforts ratio (%)	Top 10 clients Rev. share (%)
MindTree	175	2,558	15	85.8	42.8
Hexaware	164	3,785	23	61.0	42.2
Patni	267	9,839	37	69.3	48.8
Satyam	551	28,214	51	74.9	34.35
Wipro	647	33,226	51	68.3	24.1

Source: Company

❑ Client attrition remains high

Though 78 new clients added in FY07, base increased by only seven

MindTree added 78 new clients in FY07, yet its active client base increased by only seven. In our view, the cost of acquiring a new client would be significantly higher than the cost of mining an existing client. Also, high client attrition results in lower utilisation as it hazes visibility given the time mismatch between the end of a project and beginning of a new project. The high proportion of business from development services creates volatility, and hence we believe it impacts margins.

With ~51% of revenues coming from top 10 clients, client concentration is quite high

MindTree derived 50.7% of its FY07 revenues from top 10 clients. While this level of client concentration is typical of a tier-2 company in the IT sector, growth in revenues from this group has been a little disappointing for MindTree as revenues from top client declined by 17% yoy in FY07. While the growth in #2-5 client group was impressive at 48%, a 27% rise in revenues from the #6-10 group was lower than the overall revenue growth of 32% in FY07. The decline in top client revenues can be assigned to a different top client in the fiscal year.

Exhibit 8: Revenue growth of top 10 clients

(Rs m)	FY04	FY05	FY06	FY07
Top customer	207	436	642	531
yoy growth (%)	-	110.4	47.1	(17.2)
Top 5 customers	654	989	1,755	2,178
yoy growth (%)	-	51.3	77.5	24.1
Top 10 customers	862	1,376	2,397	2,993
yoy growth (%)	-	59.5	74.2	24.9
#2-5	446	552	1,113	1,647
yoy growth (%)	-	23.8	101.6	48.0
#6-10	209	387	642	815
yoy growth (%)	-	85.4	65.8	26.9

Source: Company

Just 20% of active client base is billed more than USD 1m p.a.; efforts on to improve client mining

MindTree had 31 clients billing more than USD 1m per annum, which is just 20% of its active client base. In comparison, Hexaware – with a similar client base – has 46 clients in the $1m+ per annum business segment. However, we believe MindTree is trying to address the issue of mining more clients. Despite augmenting its base by just seven clients in FY07 on a net basis, it has added 13 clients in the $1m group.

Exhibit 9: MindTree – client details

	FY04	FY05	FY06	FY07
Number of active clients	78	110	148	155
Net client add	-	32	38	7
Number of million dollar clients (LTM)				
$ 1m clients	7	16	18	31
$ 5m clients	-	1	4	4
$ 10m clients	-	-	-	2

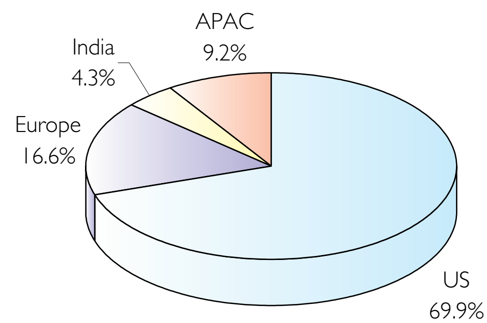
Source: Company

USA contributed 70% to Q4FY07 revenues…

❑ Highly skewed to the US geography

In Q1FY08, MindTree derived 70% of revenues from USA, 17% from Europe, 9% from APAC, and the remaining from India. The exposure to US geographies is comparable to that of larger companies.

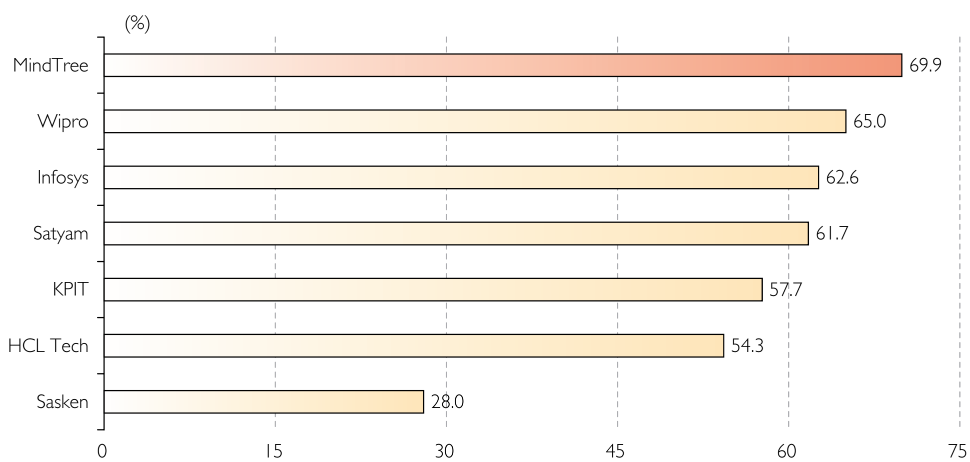
Exhibit 10: MindTree's geography-wise revenue break-up for Q1FY08



Source: Company

…exposure to US geographies comoparable to larger companies

Exhibit 11: Exposure to US geography – peer comparison



Source: Company

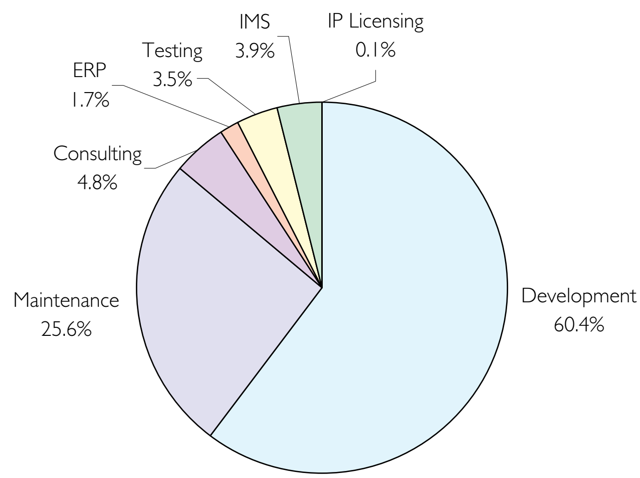
OTHER KEY HIGHLIGHTS

Revenues from high-growth new service areas are currently low

❑ Higher proportion of development revenues may lead to volatility

MindTree offers a wide range of services to clients. At 60% of revenues (Q1FY08), development work is high compared to peers. Development-related work pertains to discretionary technology spend and poses downside risk in case of a slowdown in IT spending while being susceptible to volatility in revenues on account of a lower annuity base. Revenues from new service areas – like package implementation, testing and infrastructure management – are low at present. Consulting contributes 4.8% to revenues, which is significant considering the size of the company. IP licensing is 0.1% of overall revenues. In Q4FY07 it was 0.8% of overall revenues, while it formed 5% of R&D services revenues. In IT services, the variety of services is not a differentiator compared to larger peers.

Exhibit 12: Break-up of service offerings – QE June 2007

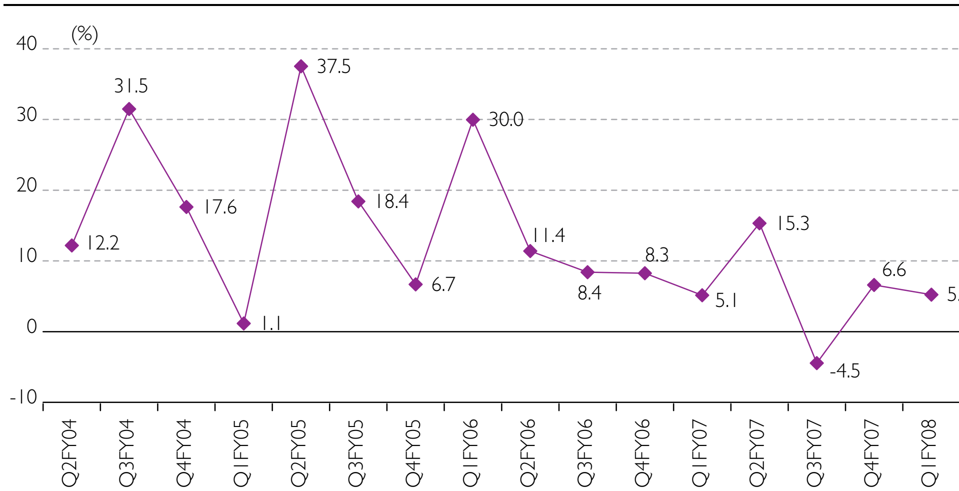


Source: Company

As is evident from the following exhibit, MindTree reports a high level of volatility in quarterly revenue growth.

Higher share of development work imparts volatility to revenues as it has a lower annuity base

Exhibit 13: Quarterly revenue growth (qoq; %) for MindTree



Source: Company

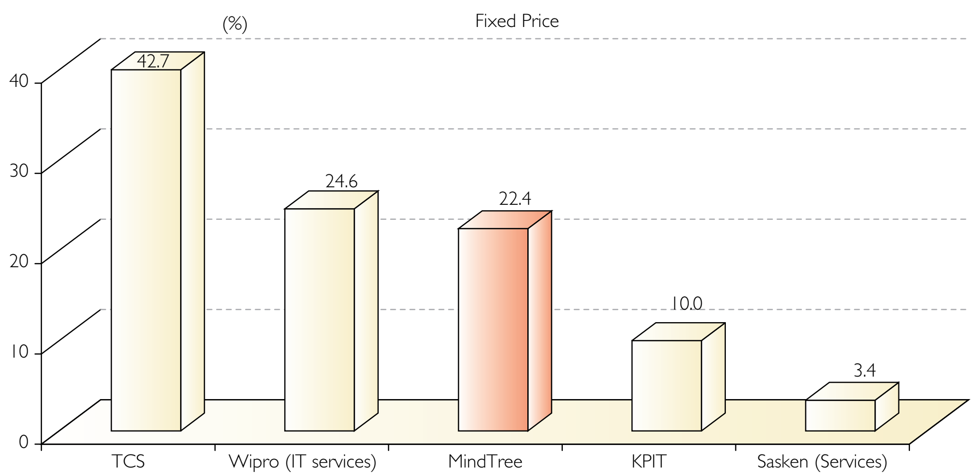
We believe the high level of quarterly volatility is due to larger exposure to development related revenues. The quarterly volatility may result in irrational exuberance, which could further lead to overreaction – both upwards and downwards – in the stock price.

❑ Relatively higher share from fixed price contracts

Higher proportion of fixed price contracts provides scope for increasing productivity and margins

Fixed price contracts, at 22.4% of revenues as of Q1FY08, are higher for MindTree compared to other mid-cap peers like KPIT Cummins and Sasken. Larger companies, with better flexibility in operations, face a lesser extent of execution risk in case of fixed price contracts. On the other hand, a higher proportion of fixed price contracts provides an opportunity to increase productivity (average realization) and margins.

Exhibit 14: Fixed price contracts as % of revenues for QEJune '07– peer comparison



Source: Company, SSKI Research

❑ Inorganic strategy – specific to client requirements so far

ASAP acquired for SAP implementation skills to mine Volvo relationship…

MindTree has acquired two companies so far – ASAP Solutions (ASAP) and Linc Software Services (Linc). ASAP, a 200 people company, was acquired for Rs32m. The company offered SAP implementation skills which MindTree needed to mine the Volvo relationship (one of the larger clients). ASAP had significant revenues coming from professional services (onsite body shopping work), which MindTree discontinued in FY07. Currently, SAP practice has 150-180 people with package implementation contributing 2.8% to revenues in FY07.

…while Linc acquired to gain IBM mid range series related skills to mine AIG

Linc was acquired to gain IBM mid-range series related skills (iSeries) for AIG – one of MindTree's larger clients. The company was acquired for Rs306m and had revenues of $6.5m at the time of acquisition.

Exhibit 15: MindTree's acquisition history

Company	Acquired on	Consideration (Rs m)	Comments
ASAP	1-Oct-04	32	ASAP engaged in providing SAP services to clients in India and abroad
Linc	4-Jun-05	306	IBM iSeries skills acquired. Integrated wef April 2005

Source: Company, SSKI Research

Though there could be more acquisitons, the ticket size would be small

Acquisitions have typically contributed ~8% of revenues in the recent past and MindTree does not expect the proportion to increase in the coming period. This reflects that the ticket size of future acquisitions would be small. However, the company has an active M&A cell, which keeps scouting for acquisition targets (up to US $30m in size). Guidance for FY08 does not include acquisitions.

IT SERVICES: NO DIFFERENTIATION

IT services contributed 75% of MindTree's revenues in FY07, registering 68% CAGR over FY04-07 to revenues of Rs4.5bn in FY07. MindTree offers an extensive range of services including application development and maintenance, package implementation, data warehousing and business intelligence. Revenue contribution of package implementation services stands at only 1.7%, while testing and infrastructure management services contribute 3.5% and 3.9% to revenues respectively in Q1FY08. Bulk of MindTree's revenues is generated from development services. With 70% revenues being derived from the US geography, there is little differentiation in its positioning.

❑ Positioning as an alternative to larger peers aided marquee wins

MindTree, given its strong management bandwidth, has positioned itself in the market place as a good alternative to tier-1 offshore vendors, promising management attention to clients. This has enabled MindTree to win some marquee clients.

MindTree has long-standing relationships with companies like Avis, Unilever, Volovo, AIG, etc

- AIG – relationship since 2004. Set up a dedicated ODC in Bangalore and is a preferred offshore vendor for subsidiaries of AIG. Provides mainly ADM services.
- Volvo group – relationship since 2001. Works with various divisions of Volvo across France, Sweden, Belgium and India.
- Unilever – relationship since 2000. Mindtree designed and implemented global information systems including supply chain systems and data warehousing, and developed applications for the company.
- Avis – relationship since 2000. Developed avis.com, an online platform.

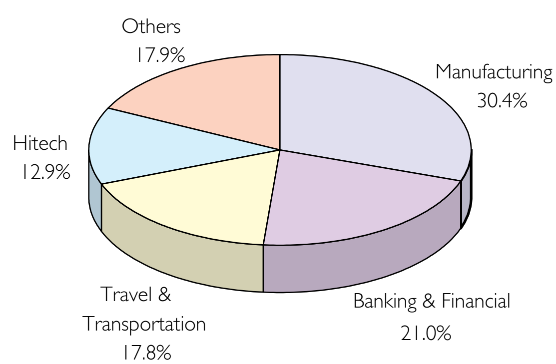
Other key clients include HP and Johnson & Johnson.

❑ Servicing a diverse set of industries

Exposure to BFSI likley to remain lower vis-à-vis peers as MindTre lacks knowledge in core banking

MindTree typically focuses on less crowded segments, as is evident from its high exposure to manufacturing (30.4% of revenues in FY07), travel and transportation (17.8%) and Hitech (12.9%) verticals. At 21%, MindTree's exposure to BFSI is lower than that of larger peers. According to the management, BFSI is not expected to become a strong vertical due to MindTree's lack of knowledge in core banking.

Exhibit 16: MindTree – vertical-wise revenue break-up (FY07)



Source: Company

MindTree has ~1,100 people strong R&D services team of which 100-120 people are in pure research

MindTree has good presence in storage/ servers and consumer appliances segments

A 100-120 people team dedicated to IP creation, which helps MindTree market its R&D services

R&D SERVICES: IP-LED APPROACH

R&D services contributed 25% to MindTree's revenues in FY07, registering 59% CAGR over FY04-07 to Rs1.4bn. Mindtree has adopted an IP-led approach for getting the business. IP-led revenues contributed 5% of R&D services revenues (1.2% of total revenues) in FY07. In this practice, the company focuses on less crowded sub-verticals like storage/ servers and consumer appliances. It derives only 16.6% of R&D service revenues from the communications vertical, which is typically an area of focus for most vendors in R&D services.

❑ MindTree offers a wide range of R&D services

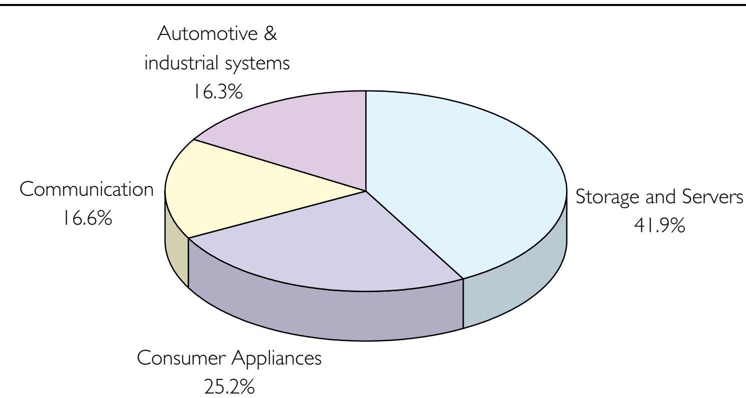
The R&D engineering services team provides product realization services to technology and product firms including product architecture and product design, product re-engineering, porting/ optimization, testing, validation and technical support. MindTree has technical expertise and domain knowledge in the areas of ASIC (Application Specific Integrated Circuit)/ SOC (System on a Chip), digital/ analog board design, embedded software, system software design and user interface.

The R&D services team is ~1,100 people strong, of which 100-120 people are purely into research and not billed.

❑ Focus on underserved sub-verticals

MindTree focuses on relatively underserved verticals and has strong presence in storage/ server and consumer appliances segments, which account for 42% and 25% respectively of R&D services revenues. At 16.6%, the company's exposure to the crowded telecom vertical is lower compared to peers.

Exhibit 17: R&D services revenue break-up across verticals (FY07)



Source: Company

❑ IP-led revenues – 5% of R&D services revenues in FY07

The 100-120 strong research team deployed in the R&D services division focuses on IP creation, which helps MindTree market its R&D services. These people are not billed to the clients directly. The research division creates intellectual properties (IP) in the core area of short range wireless technology. 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.

IP contributed 1.2% to total revenues and 5% to R&D services revenues in FY07.

❑ Marquee client relationships; competition specific to niche areas

LSI Logic, SYMANTEC, United Technologies and a leading handset manufacturer – key clients for R&D services

Key clients in the R&D services space include:

- LSI Logic – the relationship began in 2000. MindTree developed expertise in storage sub-systems with this relationship.
- SYMANTEC – the relationship began in late 2003 since SYMANTEC acquired MindTree's client PowerQuest. MindTree works on product engineering activities for enterprise security, data and data center management groups.
- United Technologies – relationship since 2002 from Carrier group and extended its presence in UTC Fire and Security, Hamilton Sundstrand and OTIS.
- MindTree has a relationship with a leading handset manufacturer for IP based solutions. It has licensed Bluetooth IP in audio products to the client.

Texas Instrument and Alcatel are also MindTree's clients but difficult to mine. Most of the clients for R&D services are in the US. Key competitors include Sasken (in the communication domain), KPIT Cummins (automotive), Tata Elxsi and L&T Infotech (industrial automation), Wipro and HCL Tech.

FINANCIALS: TOO MANY MARGIN DAMPENERS

In FY07, MindTree experienced subdued growth (28% yoy in USD terms), which we attribute to client rationalization. Excluding the impact of the same, growth would have been at an estimated 39%. Going forward, we expect the growth momentum to sustain. Also, client mining could lead to higher growth from existing clients. While there are several metrics that can be improved at MindTree, we believe only a few margin levers like increased hiring of freshers and SG&A leverage would play out. Net profit growth, at 15% CAGR over FY07-09E, is estimated to be lower than the 27% CAGR in EBITDA on account of a higher tax rate.

CLIENT MINING TO DRIVE GROWTH

Strong volume growth and higher billing rates likley to drive 35% CAGR in rupee revenues over FY07-09

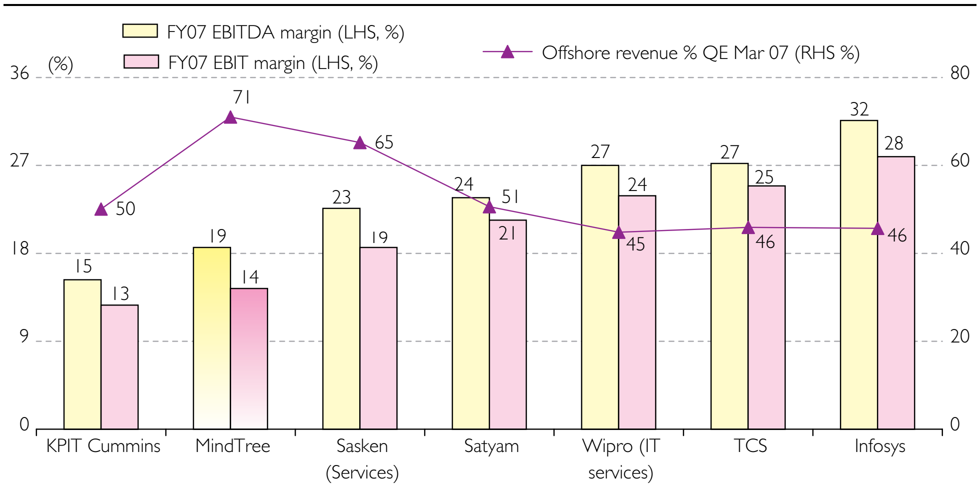
MindTree clocked a robust 88% CAGR in revenues in USD terms over FY04-06. However, growth slowed down to 28% yoy in FY07 as the company discontinued providing services to GE, ramped down the professional services practice and the share of offshore in revenues increased. Excluding the impact of client rationalization and offshore shift, revenue growth would have been an estimated 45% yoy. For FY08, we expect revenues to grow by 37% yoy in USD terms owing to better client mining in IT services.

WHY MARGINS ARE LOWER COMPARED TO PEERS?

Despite high share of offshore, margins comparable to mid-sized peers with higher onsite volumes

In FY07, MindTree derived 75% of its revenues from IT services (application development, maintenance, package implementation and consulting) and 25% from R&D services (product development and engineering). Despite offshore revenue share of 71%, EBITDA margin of 18.6% is comparable to some of the mid-sized IT services companies, which have much lower offshore revenue share. We believe there are several factors that act as a drag on MindTree's margins. These include a high proportion of development work, which is project-based in nature, in revenues. Consequently, MindTree operates at lower utilization and is forced to spend more on account management and client acquisition.

Exhibit 18: Margins and offshore revenues – peer comparison

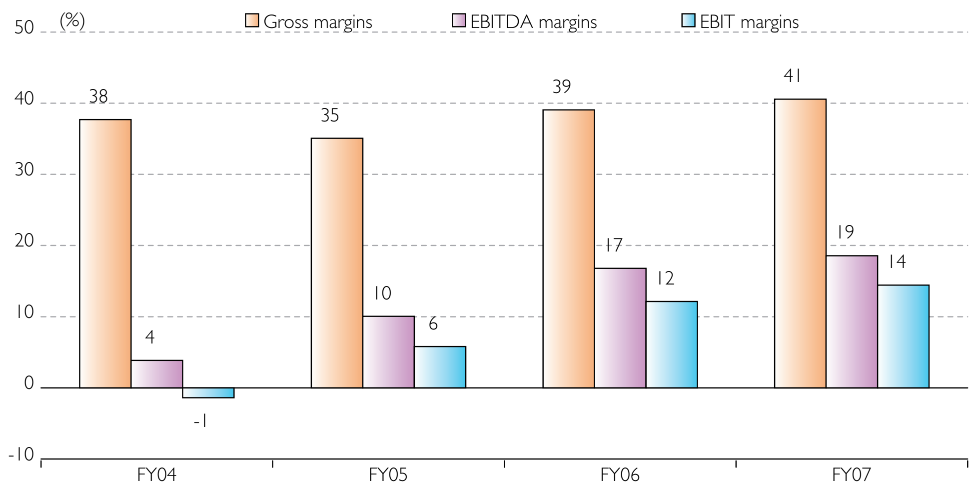


Source: Company

However, margins have improved steadily due to higher offshore revenue share and better billing rates.

Margins improved primarily on the back of offshorization

Exhibit 19: MindTree – trend in margins



Source: Company

❑ Margin drag #1 – high experience profile

MindTree has employees with an average age of 27.6 years and average experience of 4.6 years

MindTree's positioning as a good alternative to tier-1 vendors required it to have a team of highly experienced people to infuse confidence on quality of its services and execution capability. Thus, the company has a higher proportion of experienced employees with an average age of 27.6 years and average experience of 4.6 years. About 45% of employees have less than three years of experience, which is lower compared to larger peers (52% for TCS and 61% for Infosys).

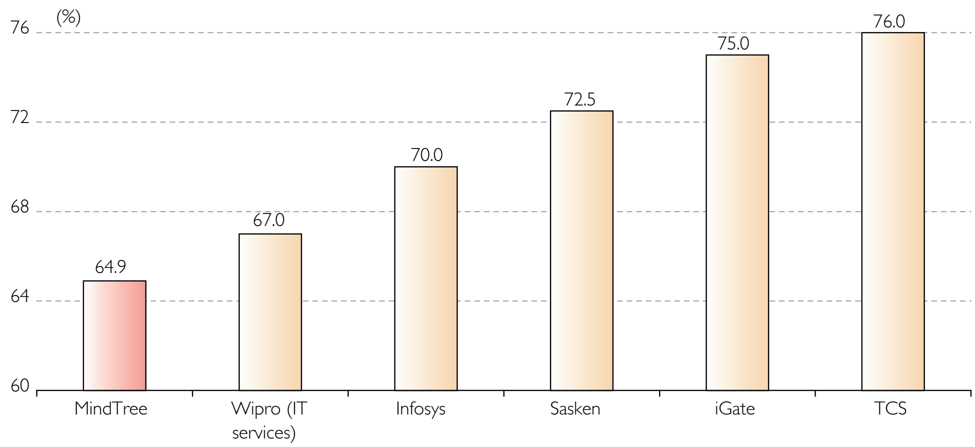
❑ Margin drag #2 – lower utilization

Business more dependent on short-term projectsdue to higher share of development work and poor client mining

MindTree operates at a gross utilization level of 64.9%, which is among the lowest in the industry. As discussed before, we believe the higher proportion of development work in revenues and poor client mining have increased the business's dependence on short-term projects. Given that the work is project-based, there would be issues with timely deployment of resources in the next project as soon as an earlier one ends. Also, certain clients impose a few restrictions like a "cool off period", which restrains the deployment of employees working on a certain project for a client in a similar project for another client.

MindTree operates at a gross utilization level of 64.9%

Exhibit 20: Blended utilization (incl. trainee) for QE June 2007– peer comparison



Source: Company

❑ Margin drag #3 – 100-120 people in R&D research are not billed

The non-billed IPcreation team in R&D services impacts overall margins

MindTree focuses on IP-led R&D services and has a dedicated team of 100-120 people working to identify key technology trends for the future and create IP in those areas. These people are not directly billed to clients. IP licensing revenues stood at 1.2% of the total revenues in FY07. A team of 100 people in services division would have generated Rs155m in revenues. However, MindTree's IP-led revenues were only Rs71m in FY07. Thus, the opportunity revenue loss of Rs84m dented EBITDA margin to the extent of 143bp.

Exhibit 21: Impact of unbilled people in R&D services on margins

Unbilled people in R&D research (no.)	100
Utilization assumed (%)	70
Offshore efforts in R&D services assumed (%)	94
Blended billing rate assumed at current level (USD/ hr)	25.7
Potential revenue from unbilled R&D people (Rs m)…(a)	155
IP led revenue earned in FY07 (Rs m)…(b)	71
Impact of unbilled R&D services employees on revenues (Rs m)…(a-b)	84
Margin impact in FY07 (bp)	143

Source: SSKI Research

❑ Margin drag #4 – pricing for captives in India is at a lower rate

Billing to clients' captive India centres is in INR terms, i.e. lower than the offshore rates charged

Some of MindTree's clients in R&D services have set up captive centres in India for in-house product development and support. MindTree works with these India centres of clients as an extension of their R&D team. Thus, billing to these centres is in INR terms and is lower than the average offshore rate charged to clients.

Notably, clients are increasingly opening captives, especially for R&D services. With this, if the proportion of revenues from India were to increase for MindTree, it would continue to be a drag on billing rates and margins.

❑ Margin drag #5 – poor client mining

MindTree, in our view, executes a lot of short-term projects. It had an active client base of 175 as of Q1FY08 and billed about 2,560 employees. Thus, the average team size for a client works out to about 15. Hexaware, which is quite similar in size and client concentration to MindTree, manages a team of about 23 people per client on an average. This is despite higher offshore revenue share (which requires more people to generate the same revenues compared to onsite) of 71% for MindTree compared to just 35% for Hexaware.

Exhibit 22: Client mining data

Company	Clients (No)	Billed employees	Billed employees per client	Offshore efforts ratio (%)	Top 10 clients Rev. share (%)
MindTree	175	2,558	15	85.8	42.8
Hexaware	164	3,785	23	61.0	42.2
Patni	267	9,839	37	69.3	48.8
Satyam	551	28,214	51	74.9	34.35
Wipro	647	33,226	51	68.3	24.1

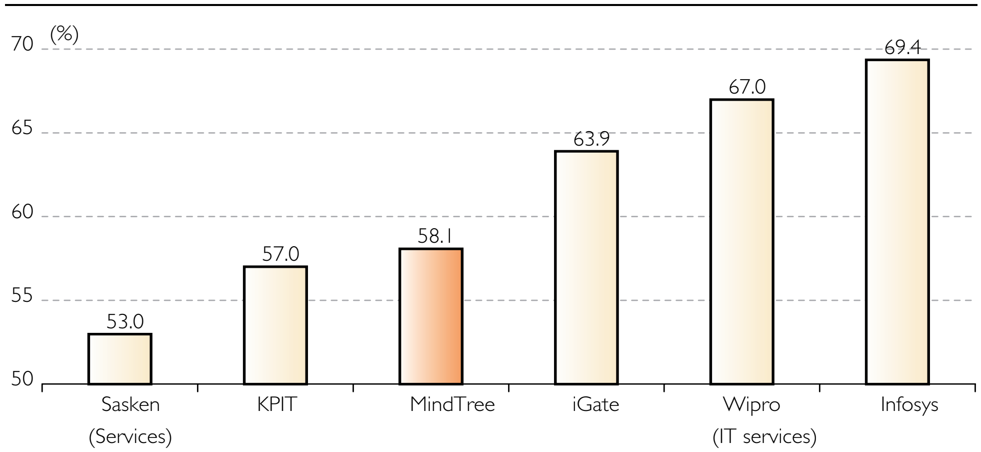
Source: Company, SSKI Research

❑ Margin drag #6 – lower onsite billing rates vis-à-vis peers'

A low-margin onsite project for a large Middle East airline depresses overall onsite biling rates

MindTree's onsite billing rates are lower than those commanded by tier-1 players but higher than those for tier-2 players. About 80-90 people work on a cargo maintenance project, done entirely onsite, for a large Middle East airline company. MindTree billed a total of about 350 people onsite in FY07. The onsite billing rates are low for this project, which depresses the overall onsite billing rates for MindTree.

Exhibit 23: Billing rate comparison for QEMar '07 – onsite



Source: Company, SSKI Research

❑ Margin drag #7 – MindTree is in investment mode

Administration costs and other expenses are high at 22% of reveneus and impact margins

MindTree, being a relatively late entrant (started operations in 1999) is currently in an investment mode. Hence, its administration costs and other expenses stand at ~22% of revenues. The company has been investing into the following:

- Developing expertise in new verticals as some of the vertical practices were set up a few years ago
- Beefing up presence in various countries across geographies, and

- Expanding the sales force and strengthening account management to improve client mining.

We expect a marginal increase in these expenses on account of scale benefit as MindTree needs to invest for growth and it is in the process of building its own premises, due to which expenses could initially rise.

WHAT ARE THE KEY MARGIN LEVERS?

MindTree, in our opinion, would be able to work upon some of the above factors that act as a drag on margins. While we expect a change in the project-based nature of work and client mining to play out in the long-term, there are a few measures that could lead to margin expansion in the near term.

❑ Margin lever #1 – expanding the bottom of the pyramid

Proportion of employees with lesser years of experience set to increase

MindTree plans to expand the bottom of the pyramid, which would act as a margin lever. Going forward, the company plans to increase the number of recruitments at freshers level. Out of a planned addition of 1,600 employees in FY08, only about 600 (i.e. 37.5%) recruitments are expected to be laterals while the remaining hires would be from campuses. We expect the proportion of MindTree employees with >3 years of experience to increase to 55% in FY09 from 45% currently.

❑ Margin lever #2 – improving utilization

MindTree focusing on mining clients

In FY07, MindTree increased the number of USD 1m customers by 13 despite beefing up the client base by just seven on a net basis. This shows that it is focusing on mining clients. As ticket size per client increases, the company would be in a position to plan resource utilization more effectively and improve sales productivity. MindTree targets to increase utilization to 66% (excluding trainees) in the near term (64.9% in Q1FY08), and take it up to 72% over a period of time.

❑ Margin lever #3 – increase in billing rates

Contract renewals and new contracts coming in at higher billing rates

MindTree is able to increase billing rates on contract renewals by 2-3% onsite and 4-6% offshore. It is also signing new contracts at billing rates 3-5% higher than the average rates. The company has reported a 4.1% increase in onsite billing rates from FY06 (average) to Q1FY08 and a 7.4% increase in offshore billing rates over the same period.

❑ Margin lever #4 – SG&A leverage

SG&A expenses expected to come down further with owned facilities; to lead to margin expansion

MindTree, on account of benefits of scale, saw its SG&A expenses declining from 43.7% of revenues in FY03 to 33.8% of FY04, 24.8% in FY05 and 21.8% in FY06. At 22% of revenues, SG&A expenses remained flat in FY07. The company is building its own campus at Chennai and Bhubaneswar, and has bought two centres in Mysore, which were leased earlier and housed about 3,500 people. Thus, lease and rental charges declined to 1.3% of revenues in Q1FY08 from 3.8% in FY07.

EXPECT 23% EARNINGS CAGR OVER FY07-09

MindTree is likely to post 34% CAGR in revenues over FY07-09. However, we expect 15% net profit CAGR for the period as margins would decline primarily due to the adverse impact of currency movement.

❑ Margins likely to shrink by 170bp over FY07-09

Despite a few margin levers playing out, rupee appreciation to have a net impact of 170bp on margins over FY07-09

MindTree, as discussed earlier, possesses a few levers to defend its margins. Despite that, we expect EBITDA margins to decline by 170bp over the next two years mainly due to rupee appreciation against the USD and salary inflation. Excluding the currency impact, margins would have remained flat over FY07-09E.

❑ Building own campus in Chennai

Setting up of own facility to act as a margin lever on EBITDA level

MindTree has had leased most of its facilities till now. However, it now plans to develop its own campus in Chennai. The main objective of its recent IPO (Rs2.4bn raised in February 2007), as stated in the RHP, was to fund a new development center at Chennai (estimated cost of Rs1.2bn). MindTree proposes to incur USD 29m as capital expenditure in FY08. The Chennai facility is expected to be operational in Q4FY08.

MindTree bought two centres at its Mysore campus, which were earlier leased. The centres house 3,500 people. Thus, lease and rental charges declined to 1.3% of revenues in Q1FY08 from 3.8% in FY07. Thus, depreciation expense increased to 4.9% of revenues in Q1FY08 compared to 4.1% in FY07.

❑ Tax rate likely to increase

Tax rate to rise as accumulated losses on onsite business get exhausted in FY08

MindTree paid minimal taxes in Q4FY07 as a majority of its revenues were derived from offshore locations and onsite business had accumulated losses. In Q1FY08, tax rate increased to 10.4% as MindTree has exhausted the accumulated losses in all international geographies. Most of the international operations had accumulated losses in the earlier years.

❑ Hedged position stands at USD 69m for four years

MindTree bills ~80% of its revenues in USD currency. As of end Q1FY08, it had $69m of forwards and options, of which $22m pertained to inflows over the next 12 months and the remaining for inflows 48 months thereafter.

❑ FY08 guidance – 36% rise in USD revenues; 14% growth in PAT

PAT growth lags topline growth due to higher tax rate and EPS growth to be impacted by equity dilution

In Q1FY08, MindTree maintained its guidance of generating revenues of $178m-180m, which implies 36.2-37.7% yoy growth. The guidance builds in addition of 1,600 net employees, 38% higher than the Q4FY07 employee base. However, the rupee appreciation against various currencies compelled the management to cut its original net profit guidance of $25.1m-25.2m (25.9-26.4% yoy growth) to $22.5m-22.6m, a growth of just 14%. The PAT growth too has been revised downwards due to lower margins.

MindTree revised its EPS guidance to Rs24.5 for FY08 from its earlier guidance of Rs28.9-29.4. The guidance assumes an exchange rate of Rs41/ USD.

We expect MindTree to register 34% revenue CAGR and 27% EBITDA CAGR over FY07-09

❑ Expect 15.4% net profit CAGR over FY07-09

MindTree would likely post 34% CAGR in revenues and 27% CAGR in EBITDA over FY07-09. However, net profit CAGR would be lower at 15.4% on account of higher depreciation and tax rate while EPS CAGR would be only 4% due to equity dilution on account of the recent IPO.

❑ Strong balance sheet with good return ratios

MindTree has a strong balance sheet with a net cash position of Rs1.6bn, viz. 29% of the total assets as at the end of Q1FY08. RoE is expected to be 21% for FY08 and FY09; this is lower than RoE of 32% in FY07 and 70% in FY06 due to the high level of cash on balance sheet on account of the recent IPO.

VALUATIONS: EXPENSIVE TO TIER-1 PEERS

MindTree, by virtue of its strong management, has experienced strong business momentum so far. However, given its scale and project-based nature of work, we believe a demand slowdown poses risk to growth. The stock trades at a premium to tier-1 companies, which despite their size are expected to post higher earnings growth. The stock has provided an annualized return of 93% since its IPO in February 2007 – comparable with returns offered by two other IT stocks (Tech Mahindra and Tanla Solutions) listed in the last 12 months. At this juncture, MindTree's valuations – relative to its growth prospects – seem expensive vis-à-vis tier-1 companies. Thus, with 34% revenue CAGR, 27% EBITDA CAGR and 15% net profit CAGR over FY07-09, valuations of 19.8x FY09E earnings leave little room for disappointment. While the stock price has fallen 23% in just one month, we initiate coverage with an Underperformer rating and a price target of Rs510 per share, a further downside of 14%.

❑ Trades at a premium to tier-1 companies

MindTree headed by a competent management team

MindTree trades at 23.1x FY08E and 19.8x FY09E earnings compared to 23.9x and 19.2x respectively for Infosys. Although there are a few mid-sized companies trading at premium valuations to tier-1 companies, we believe it is more restricted to product companies than generic IT services companies. We see no differentiation in MindTree's positioning or services offering in the market. In fact, the project-based nature of its business entails higher risk. We agree that MindTree's management is of superior quality in the mid-sized companies' space, but valuations build in a higher premium, to which we do not agree.

Comparable mid-sized peers are available at cheaper valuations

Exhibit 24: Comparative valuations

	EPS CAGR (%)	PE (x)		RoE (%)
	FY07-09E	FY08E	FY09E	FY07
MindTree	3.8 (15*)	23.1	19.8	32
Mphasis	51	21.5	15.4	22
KPIT	19	15.6	12.7	30
Infotech Enterprises	19	15.1	12.5	33
Hexaware	17	11.9	9.8	26

*Source: SSKI Research, Bloomberg. *PAT CAGR*

❑ Expensive compared to other IT companies listed in last 12 months

Despite better growth prospects, Tech Mahindra and Tanla Solutions trade at much lower valuations

MindTree completed its IPO at a price of Rs425 in February 2007 and got listed in March 2007 at Rs550. the stock price has risen by 39% from the IPO price. Tech Mahindra and Tanla Solutions, both from the IT sector, also completed their IPOs and got listed in the last 12 months. While Tech Mahindra has provided annualized returns of 265%, Tanla has returned 142% and MindTree has provided annualized return of 93%. We note that according to Bloomberg consensus estimates, Tech Mahindra and Tanla are expected to post net profit CAGR of 43% and 48% respectively over FY07-09 while MindTree would post an 11% CAGR (for better comparison, we are taking into account Bloomberg estimates for MindTree as well). However, MindTree trades at 17.4x FY09E earnings compared to 13.5x for Tech Mahindra (superior growth prospects) and 11.9x for Tanla.

Exhibit 25: Comparison with other IT IPOs in the last 12 months

	Listing date	CMP (Rs)	IPO Price (Rs)	Market cap ($ m)	Revenues ($ m)	FY07-09E EPS CAGR (%)	PE (x) FY08E	PE (x) FY09E	Annualized return on IPO price (%)
Tech Mahindra*	Aug-06	1,282	365	3,841	723	42.9%	18.9	13.5	265
Tanla Solutions*	Jan-07	487	265	601	55	47.6%	15.9	11.9	142
MindTree*	Mar-07	592	425	552	146	10.8%	23.2	17.4	93

*Source: Bloomberg, SSKI Research. *All estimates are from Bloomberg, including MindTree*

❑ Initiating coverage with Underperformer; price target of Rs510

Margin levers not adequate to compensate for the impact of rupee appreciation

While we agree that MindTree offers superior management quality, we are less optimistic about its operational performance including the margin levers that the street expects would yield superior EBITDA growth. We believe there are certain parameters that require a significant change in the way the company conducts business. One such area is quarterly volatility in growth due to the high ratio of development services, which imparts a project-based profile to the business. It would be challenging for the company to transition from this project-based business profile to winning long-term annuity contracts from clients and increase future visibility without impacting growth. In our view, the risk to growth is high and there would be likely disappointment on the margin front.

At 19.8x FY09E earnings, we find the valuation premium unjustified

At 19.8x FY09E earnings, we believe the street is assigning premium valuations to MindTree because of its superior quality management and seemingly different positioning through its R&D services offering. The valuations, however, ignore the possibility of lack of improvement in some of the parameters where MindTree compares poorly with larger peers. We initiate coverage on MindTree with an Underperformer rating and a price target of Rs510.

ANNEXURE I: QUARTERLY RESULTS

Quarterly fianncials

Year end Mar, Rs m	Q1FY07	Q4FY07	Q1FY08	FY07	FY08E
Income from software development	**1,332.8**	**1,565.6**	**1,615.0**	**5,903.5**	**7,643.2**
Software development expenses	(788.0)	(930.8)	(1,017.6)	(3,508.8)	(4,918.7)
% of revenue	*59.1*	*59.5*	*63.0*	*59.4*	*64.4*
Gross profit	544.8	634.8	597.4	2394.7	2724.5
Gross margin (%)	*40.9*	*40.5*	*37.0*	*40.6*	*35.6*
Admin and other expenses	(256.1)	(342.7)	(338.1)	(1298.3)	(1447.6)
% of revenue	*19.2*	*21.9*	*20.9*	*22.0*	*18.9*
EBITDA	**288.7**	**292.1**	**259.3**	**1096.4**	**1276.9**
Depreciation	(46.5)	(66.9)	(78.8)	(244.4)	(380.2)
% of revenue	*3.5*	*4.3*	*4.9*	*4.1*	*5.0*
EBIT	242.2	225.2	180.5	852.0	896.7
Operating margin (%)	*18.2*	*14.4*	*11.2*	*14.4*	*11.7*
Interest	(8.6)	(6.6)	(9.4)	(30.0)	(37.7)
Forex gains / (loss)	(3.4)	12.5	(3.7)	-	158.8
Other income	23.4	16.1	62.4	73.6	108.2
PBT	**253.6**	**247.2**	**229.9**	**895.7**	**1126.0**
Total tax	(11.1)	(1.8)	(23.9)	4.9	(122.5)
Provision for tax incl FBT	(21.3)	(14.7)	(24.7)	(41.5)	0.0
Deferred tax	10.2	12.9	0.9	46.4	0.0
PAT	**242.5**	**245.4**	**206.0**	**900.5**	**1003.5**
qoq growth (%)					
Revenue	5.1	6.6	3.2	-	-
EBITDA	-	-	(11.2)	-	-
qoq growth	-	-	(16.1)	-	-
yoy growth (%)					
Revenue	37.5	23.5	21.2	31.5	29.5
EBITDA	-	-	(10.2)	45.4	16.5
Net profit	-	-	(15.1)	66.1	11.4
EBITDA margin (%)	21.7	18.7	16.1	18.6	16.7
Net margin (%)	18.2	15.7	12.8	15.3	13.1
Effective tax rate (%)	4.4	0.7	10.4	(0.5)	10.9

Source: Company

ANNEXURE II: QUARTERLY METRICS

Operating metrics

	FY07	Q3FY07	Q4FY07	Q1FY08
Geography-wise revenue breakup (%)				
US	63.3	64.7	64.7	69.9
Europe	22.1	21.7	19.9	16.6
India	5.2	4.1	4.7	4.3
APAC	9.4	9.5	10.8	9.2
Revenue by Service Offering (%)				
Development	64.7	64.6	61.0	60.4
Maintenance	22.3	22.5	25.5	25.6
Consulting	4.5	4.4	4.7	4.8
Package Implementation	2.8	3.6	2.3	1.7
Independent Testing	2.7	2.6	3.4	3.5
Infrastructure Management & Tech Support	1.2	1.5	1.9	3.9
IP Licensing	1.2	0.2	0.8	0.1
Other Services	0.6	0.6	0.4	0.0
Revenue by Industry (ITS) (%)				
Manufacturing	30.4	30.9	26.2	25.7
Banking & Financial	21.0	18.5	24.6	27.3
Travel & Transportation	17.8	15.3	17.5	17.0
Hitech	12.9	12.5	16.0	17.0
Others	17.9	22.8	15.7	13.0
Revenue by Industry (RDS) (%)				
Storage and Servers	41.9	44.4	42.7	44.9
Consumer Appliances	25.2	24.4	24.8	26.4
Communication Systems	16.6	15.2	15.3	10.6
Automotive & Industrial Systems	16.3	16.0	17.2	18.1
Client details (no)				
Number of active clients	-	153	155	175
New client added	-	19	17	28
Number of million dollar Clients *				
$ 1m Clients	-	29	31	34
$ 5m Clients	-	4	4	4
$ 10m Clients	-	2	2	2
Client contribution to revenue				
Top Customer (%)	9.0	-	-	9.6
Top 5 Customers (%)	36.9	-	-	28.4
Top 10 Customers (%)	50.7	-	-	42.8
Fortune 500 accounts	36	-	-	38
Revenue from Repeat Business (%)	92.0	-	-	94.0
Accounts Receivable Days	78	-	-	75
Revenue by Project Type (%)				
Fixed Price	26.3	25.8	25.3	22.4
Time & Materials	73.7	74.2	74.7	77.6
Revenue Mix efforts (%)				
Onsite	14.90	14.50	14.20	14.20
Offshore	85.10	85.50	85.80	85.80
Revenue break up (%)				
Onsite	29.20	29.00	29.00	29.00
Offshore	70.80	71.00	71.00	71.00

	FY07	Q3FY07	Q4FY07	Q1FY08
Effort				
Billed Hours				
Onsite	-	163,233	168,628	188,962
Offshore	-	959,001	1,017,800	1,140,994
Total	-	1,122,234	1,186,428	1,329,956
Revenue ($ 000s)				
Onsite	-	9,024	9,792	10,716
Offshore	-	22,114	24,008	26,278
Total	-	31,138	33,800	36,994
Utilization (%)				
Including Trainees	-	62.6	62.70	64.9
Excluding Trainees	-	70.4	62.70	65.1
MindTree Minds (no.)				
Total MindTree	-	4,006	4,162	4,432
Software Professionals	-	3,661	3,814	4,068
Sales and Support	-	345	348	364
Gross Addition	-	316	371	485
Net Addition	-	106	156	270
Lateral Employees	-	106	156	253
Attrition (LTM) - %	-	15.6	15.7	15.2

Source: Company

Income statement

As on 31 March (Rsm)	FY05	FY06	FY07	FY08E	FY09E
Net sales	**2,465**	**4,488**	**5,904**	**7,643**	**10,528**
% growth	89.0	82.1	31.5	29.5	37.7
Operating expenses	2,217	3,734	4,807	6,366	8,752
EBITDA	**248**	**754**	**1,096**	**1,277**	**1,775**
% growth	392.4	204.3	45.4	16.5	39.0
Other income	51	66	74	108	103
Net interest	(21)	(53)	(30)	(38)	(38)
Depreciation	105	209	244	380	510
Pre-tax profit	173	558	896	1,126	1,332
Current Tax	4	15	(5)	122	133
Profit after tax	**169**	**542**	**901**	**1,004**	**1,198**
Non-recurring items	10	(5)	0	0	0
Net profit after non-recurring items	179	538	901	1,004	1,198
% growth	1,098.7	201.0	67.5	11.4	19.4

Key ratios

As on 31 March	FY05	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	10.0	16.8	18.6	16.7	16.9
EBIT margin (%)	5.8	12.1	14.4	11.7	12.0
PAT margin (%)	6.8	12.1	15.3	13.1	11.4
RoE (%)	94.5	69.6	31.9	21.0	20.9
RoCE (%)	11.8	31.4	25.6	17.8	21.6
Gearing (x)	4.3	0.6	0.1	0.1	0.0

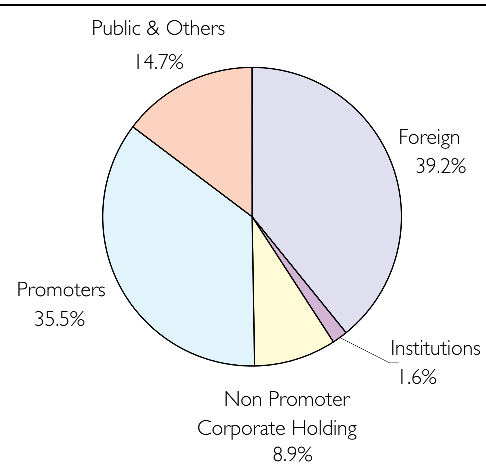
Valuations

As on 31 March	FY05	FY06	FY07	FY08E	FY09E
Reported EPS (Rs)	5.9	17.2	27.7	25.6	29.9
Adj. EPS (Rs)	5.6	17.3	27.7	25.6	29.9
PER (x)	105.8	34.1	21.4	23.1	19.8
Price/Book (x)	66.3	14.4	4.4	4.4	3.8
EV/Net sales (x)	7.5	4.1	2.8	2.7	2.0
EV/EBITDA (x)	74.4	24.5	15.1	16.3	12.1
EV/CE (x)	12.8	9.1	3.6	3.8	3.4

Balance sheet

As on 31 March (Rs m)	FY05	FY06	FY07	FY08E	FY09E
Paid-up capital	44	59	378	378	378
Preference share capital	666	0	0	0	0
Reserves & surplus	226	1,229	3,977	4,842	5,875
Total shareholders' equity	269	1,288	4,355	5,220	6,253
Total current liabilities	536	814	1,038	1,376	1,895
Total Debt	1,166	742	264	264	0
Total liabilities	1,702	1,556	1,301	1,640	1,895
Total equity & liabilities	**1,971**	**2,844**	**5,656**	**6,859**	**8,148**
Net fixed assets	336	389	699	1,544	2,218
Investments	0	0	0	0	0
Total current assets	1,608	2,456	4,910	5,268	5,883
Deferred tax assets	0	0	46	46	46
Other non-current assets	27	0	0	0	0
Working capital	1,072	1,641	3,873	3,893	3,988
Total assets	**1,971**	**2,844**	**5,656**	**6,859**	**8,148**

Shareholding pattern



As of June 2007

Cash flow statement

As on 31 March (Rsm)	FY05	FY06	FY07	FY08E	FY09E
Pre-tax profit	173	558	896	1,126	1,332
Depreciation	105	209	244	380	510
chg in Working capital	(116)	(378)	(123)	(259)	(519)
Total tax paid	(4)	(15)	5	(122)	(133)
Ext ord. Items	10	(5)	-	-	-
Operating cash Inflow	167	369	1,022	1,125	1,189
Capital expenditure	(292)	(254)	(535)	(1,225)	(1,183)
Free cash flow (a+b)	(124)	115	487	(100)	6
Chg in investments	(84)	(198)	(1,603)	-	-
Debt raised/(repaid)	258	242	(478)	-	(264)
Capital raised/(repaid)	0	(650)	319	-	-
Misc	(27)	485	1,781	(138)	(165)
Net chg in cash	23	(7)	506	(239)	(423)

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SSKI INDIA

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

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2. Affiliates of SSKI are currently not having any mandate from the subject company.
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