

MindTree

17 October 2012

Reuters: MINT.BO; Bloomberg: MTCL IN

Outlook Worsens; Downgrade To Hold

MindTree's 2QFY13 US dollar revenue grew 1.7% QoQ (US\$107.3mn, our estimate US\$108.7mn). This quarter, it was IT services (ITS) that posted poor growth of 1% QoQ even as product engineering services (PES) grew 3.3% QoQ. While margins got a boost on operational efficiency, higher utilisation and a weak rupee, net profit fell 18.9% QoQ owing to forex loss. However, it was above consensus estimates by 8.6% due to lower tax rate (11.4% vs 22.6%). In our view, worsening revenue growth, particularly in the ITS business, is a key concern for MindTree. Management has said it will grow slower than industry body, NASSCOM's industry growth target of 11-14% in FY13, the second consecutive occasion it has downgraded the outlook. Clearly, the revenue outlook is worsening for the company. We cut revenue/EPS estimates for FY14 by 6.6%/1.5%, respectively, and downgrade the stock to Hold (from Buy) with a revised target price of Rs725 (Rs820). We reduce our PE multiple to 9x (10x).

Revenue growth lacklustre, management commentary on stronger 2H optimistic: MindTree posted 1.7% QoQ growth in 2QFY13 dollar revenue (US\$107.3mn, 1.3% below our estimate). In rupee terms, revenue grew 5.9% QoQ to Rs5.96bn, below our estimate by 0.6% and above consensus estimates by 0.8%. For the quarter, it was the ITS business that lagged, growing 1% QoQ, mainly due to an 8.5% QoQ fall in the travel vertical. PES grew 3.3% QoQ. Management has downgraded the outlook and expects to now grow slower than NASSCOM's 11-14% industry growth target. This is the case, even as it expects 2HFY13 to be stronger than 1H, which in our view appears optimistic.

Margins surge on operational efficiency, forex loss prunes net profit: MindTree reported a 127bps QoQ rise in EBITDA margin in 2QFY13, led by operational efficiency and higher utilisation. However, higher-than-expected forex loss of Rs415mn, mainly due to re-booking of debtors at quarter-end led to an 18.9% QoQ fall in net profit. Nonetheless, it was above consensus estimates by 8.6% due to a lower tax rate.

Revenue outlook increasingly subdued; downgrade to Hold: The management's expectation of MindTree growing slower than NASSCOM's industry growth target indicates worsening revenue traction. Steadily falling growth in the ITS business is a key concern. While margin management has been good, slower revenue growth is likely to prevent a PE multiple expansion. **We thus downgrade the stock to Hold (from Buy) with a revised TP of Rs725 (Rs820) and cut our target PE multiple to 9x (10x).**

HOLD

Sector: IT

CMP: Rs677

Target Price: Rs725

Upside: 7.1%

Harit Shah

 harit.shah@nirmalbang.com
 +91-22-3926 8068

Key Data

Current Shares O/S (mn)	40.9
Mkt Cap (Rsbn/US\$m)	27.7/524.5
52 Wk H / L (Rs)	770/372
Daily Vol. (3M NSE Avg.)	129,136

Price Performance (%)

	1 M	6 M	1 Yr
MindTree	(2.6)	27.9	76.5
Nifty Index	0.7	6.8	10.4

Source: Bloomberg

Y/E March (Rsmn)	2QFY12	1QFY13	2QFY13	QoQ (%)	YoY (%)	1HFY12	1HFY13	Chg (%)
Revenue	4,567	5,630	5,963	5.9	30.6	8,698	11,593	33.3
Employee costs	3,047	3,442	3,570	3.7	17.2	5,840	7,012	20.1
Other expenses	932	1,014	1,074	5.9	15.2	1,809	2,088	15.4
EBITDA	588	1,174	1,319	12.4	124.3	1,049	2,493	137.7
Depreciation	174	159	159	0.0	(8.6)	354	318	(10.2)
EBIT	414	1,015	1,160	14.3	180.2	695	2,175	212.9
Interest costs	1	3	4	33.3	-	1	7	600.0
Other income	239	138	(341)	(347.1)	(242.7)	361	(203)	(156.2)
Income before income tax	652	1,150	815	(29.1)	25.0	1,055	1,965	86.3
Tax	109	260	93	(64.2)	(14.7)	166	353	112.7
Net profit	543	890	722	(18.9)	33.0	889	1,612	81.3
Diluted EPS (Rs)	13.4	21.6	17.4	(19.3)	30.0	22.0	38.9	77.3
EBITDA margin (%)	12.9	20.9	22.1	-	-	12.1	21.5	-
EBIT margin (%)	9.1	18.0	19.5	-	-	8.0	18.8	-
Net profit margin (%)	11.9	15.8	12.1	-	-	10.2	13.9	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Key financials

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	12,960	15,090	19,152	23,259	25,401
YoY (%)	4.7	16.4	26.9	21.4	9.2
EBITDA	2,456	1,777	2,933	4,911	5,001
EBITDA (%)	18.9	11.8	15.3	21.1	19.7
Adj. PAT	2,149	1,015	2,187	3,052	3,336
YoY (%)	310.8	(52.8)	115.5	39.5	9.3
FDEPS (Rs)	52.2	24.6	53.1	74.1	81.0
RoE (%)	35.2	14.0	25.2	27.8	23.9
RoCE (%)	22.3	11.4	21.0	29.8	22.8
P/E (x)	13.0	27.5	12.7	9.1	8.4
EV/EBITDA (x)	10.4	14.6	8.3	4.6	4.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actuals versus our, Bloomberg consensus estimates

(2QFY13)	Actuals	NBIE estimates	BBG consensus estimates	% variation from NBIE estimates	% variation from BBG consensus
Revenue (US\$mn)	107.3	108.7	-	(1.3)	-
Revenue (Rsmn)	5,963	6,002	5,916	(0.6)	0.8
EBITDA (Rsmn)	1,319	1,130	1,149	16.7	14.8
EBITDA margin (%)	22.1	18.8	19.4	329bps	270bps
EBIT (Rsmn)	1,160	959	969	20.9	19.7
EBIT margin (%)	19.5	16.0	16.4	347bps	308bps
Net profit (Rsmn)	722	711	665	1.6	8.6

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Key result data points

Volume growth disappointing, pricing sees uptick

- Total volumes up just 1% QoQ; onsite volumes grew 1.6% QoQ, offshore volumes grew 1.5% QoQ
- Blended pricing up 0.6% QoQ – onsite pricing declined 2.3% QoQ, while offshore pricing grew 1% QoQ
- From a segment-wise perspective, ITS revenue grew just 1% QoQ in US dollar terms, despite healthy growth in key verticals of focus, namely banking, financial services and insurance (BFSI, 6.3% QoQ) and manufacturing & retail (3.4% QoQ); **it was the steep 8.5% QoQ decline in the travel, media and services vertical that pressurised total revenue growth in the ITS business**
- **It should be noted that YoY revenue growth in the ITS business stood at 13.1%, the slowest since 4QFY10 and is without doubt a worrying sign; management has stated longer decision-making time frames, which is leading to longer sales cycles, particularly on the large deal front, which in our view, is likely to ensure that revenue growth stays in mid-single digits for 2HFY13.**
- On the other hand, PES revenue grew 3.3% QoQ in US dollar terms owing to a ramp-up in some deals won in the previous quarter
- Higher utilisation, rupee depreciation and operational efficiency (0.8% positive impact) boosted MindTree's EBITDA margin by 127bps QoQ to 22.1%, a creditable performance despite a 180bps impact of wage hikes
- **Thus, while core revenue growth is a concern, the company has been able to perform well on the profitability front.**

Vertical split – Travel suppresses overall growth

- BFSI grew by a healthy 6.3% QoQ at US\$24.7mn
- Manufacturing & retail grew 3.4% QoQ at US\$20.2mn
- **Travel, media & services declined 8.5% QoQ at US\$20.2mn, the major laggard**
- Others grew 5.9% QoQ at US\$8.5mn
- **ITS business in total grew 1% QoQ at US\$73.5mn**
- **PES business grew 3.3% QoQ at US\$33.8mn.**

Service line split

- Development grew 1.3% QoQ at US\$27.1mn
- Maintenance declined 0.6% QoQ at US\$23.1mn
- Consulting grew 11% QoQ at US\$3.9mn
- Package implementation declined 8.5% QoQ to US\$2.9mn
- Testing grew 3.5% QoQ at US\$19mn
- Infrastructure Management Services grew by a healthy 16.2% QoQ at US\$13.7mn
- Engineering declined 5.7% QoQ to US\$16.4mn.

Geographical split

- US grew 1.7% QoQ at US\$62.3mn
- Europe grew 3.5% QoQ at US\$31.4mn
- India declined 4.7% QoQ at US\$6.4mn
- Rest of the World grew 0.2% QoQ at US\$7.1mn.

Employee data

- Gross hires at 454 in 2QFY13, net employee base rises by 53
- Total employee base at 10,884 at the end of 2QFY13
- Last 12-month attrition rate declines to 16.3% from 17% in 1QFY13
- Employee utilisation rate, including trainees, at 71.7% (68.9% in 1QFY13)
- Employee utilisation rate, excluding trainees, at 72.3% (71.5% in 1QFY13).

Valuation

The management's expectation of MindTree growing slower than NASSCOM's growth target for the industry indicates worsening revenue traction. Steadily falling growth in the ITS business is a key concern. While margin management has been good, slower revenue growth is likely to prevent a PE multiple expansion. **We have therefore downgraded the stock to Hold (from Buy) with a revised TP of Rs725 (Rs820) and cut our target PE multiple to 9x (10x).**

Exhibit 3: Earlier,, revised estimates

Particulars	Earlier estimates	Revised estimates	Chg (%)
	FY14E		
Revenue (Rsmn)	27,187	25,401	(6.6)
EBITDA (Rsmn)	4,877	5,001	2.6
EBITDA margin (%)	17.9	19.7	113bps
EPS (Rs)	82.2	81.0	(1.5)

Source: Nirmal Bang Institutional Equities Research

Rating history

Date	Rating	Market price (Rs)	Target price (Rs)
4 June 2012	Buy	629	820
29 June 2012	Buy	641	820
16 July 2012	Buy	643	820
4 October 2012	Buy	660	820

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

This report is published by Nirmal Bang's Institutional Equities Research desk. Nirmal Bang has other business units with independent research teams separated by Chinese walls, and therefore may, at times, have different or contrary views on stocks and markets. This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information for the clients of Nirmal Bang Equities Pvt. Ltd., a division of Nirmal Bang, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

Nirmal Bang or any persons connected with it do not accept any liability arising from the use of this document or the information contained therein. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information. Nirmal Bang or any of its connected persons including its directors or subsidiaries or associates or employees or agents shall not be in any way responsible for any loss or damage that may arise to any person/s from any inadvertent error in the information contained, views and opinions expressed in this publication.

['Access our reports on Bloomberg Type NBIE <GO>'](#)

Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	+91 22 3926 8098 / 99
Hemindra Hazari	Head of Research	hemindra.hazari@nirmalbang.com	+91 22 3926 8017 / 18
Sales and Dealing:			
Neha Grover	AVP Sales	neha.grover@nirmalbang.com	+91 22 3926 8093
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Sudhindar Rao	Dealing Desk	sudhindar.rao@nirmalbang.com	+91 22 3926 8229, +91 22 6636 8832
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park
 Lower Parel (W), Mumbai-400013.
 Board No. : 91 22 3926 8000/1
 Fax. : 022 3926 8010