

**REDUCE**

TP: Rs 930 | ▼ 5%

**MINDTREE**

| IT Services

| 15 July 2020

## Cloudy revenue visibility

**Mindtree (MTCL) reported an operational beat in Q1FY21 led by above-expected margins. Despite a challenging environment, operating margins expanded 110bps QoQ on 1.9% QoQ CC topline growth. Deal wins were healthy, albeit led by renewals. Management expects continued margin resilience in the near term but the revenue outlook remains cloudy. We raise FY21/FY22 EPS by 9%/10% on upbeat operating margins. Rolling valuations forward, we have a revised Jun'21 TP of Rs 930 (Rs 880 earlier). Retain REDUCE.**

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**Margins surprise positively:** MTCL reported an above-expected operating performance on the back of a margin beat. Revenue at US\$ 253mn was down 9.1% QoQ vs. our estimate of an 8% decline. EBITDA margins at 16.9% expanded 110bps QoQ against our estimate of a 50bps decline. Margin expansion was supported by higher offshore volumes (+5.9% QoQ) and SG&A expense optimisation (-29% QoQ or 490bps operating margin tailwind). Lower subcontracting expenses and travel costs collectively contributed 320bps in margin tailwinds.

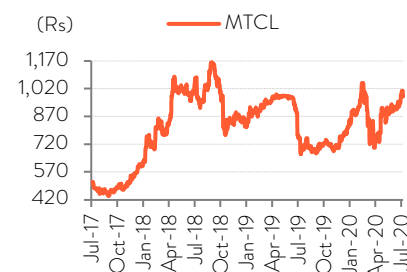
**Renewals prop up deal wins:** Deal win TCV at US\$ 391mn (+21% YoY, -0.5% QoQ) was healthy, but aided by renewals. Surprisingly, renewal deal TCV at US\$ 315mn stood at a record high. Management indicated that large deal closures have slowed. The company discontinued disclosures on digital contract wins from Q1FY21.

**Revenue outlook uncertain:** Management expects continued margin gains in Q2FY21 aided by the absence of visa costs and knowledge transfer revenue flow-through from deals under transition. The revenue outlook remains uncertain but MTCL expects a better Q2. Management anticipates slow recovery in travel, transportation and hospitality while hinting at positive traction in the hi-tech and CPG verticals.

Ticker/Price	MTCL IN/Rs 978
Market cap	US\$ 2.1bn
Shares o/s	165mn
3M ADV	US\$ 14.6mn
52wk high/low	Rs 1,063/Rs 652
Promoter/FPI/DII	74%/11%/15%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	70,215	77,643	78,448	89,137	97,686
EBITDA (Rs mn)	10,645	10,623	12,972	16,113	17,659
Adj. net profit (Rs mn)	7,542	6,309	7,845	9,743	10,835
Adj. EPS (Rs)	45.8	38.3	47.6	59.2	65.8
Adj. EPS growth (%)	32.1	(16.3)	24.3	24.2	11.2
Adj. ROAE (%)	24.9	19.5	23.2	25.0	24.1
Adj. P/E (x)	21.4	25.5	20.5	16.5	14.9
EV/EBITDA (x)	15.0	15.0	12.1	9.5	8.3

Source: Company, BOBCAPS Research

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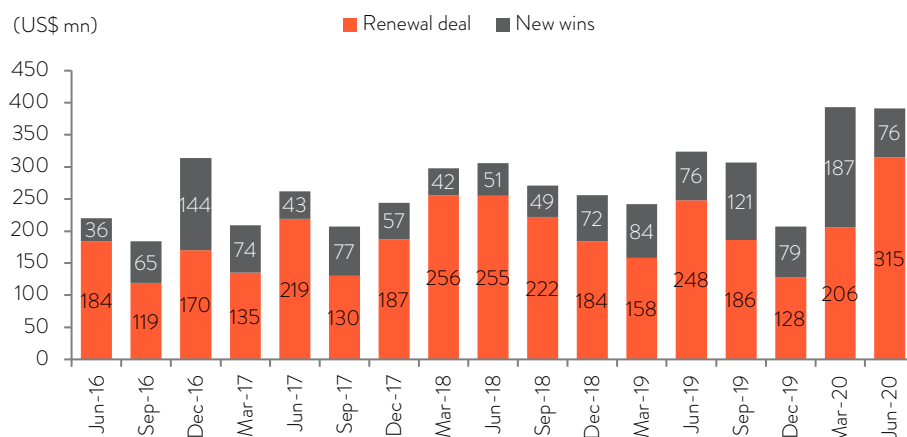
## Earnings call highlights

- Q1FY21 operating margin expansion of 110bps QoQ was aided by 30bps in operational efficiency gains and 80bps in currency tailwinds. Visa expense headwinds of 90bps were offset by similar tailwinds from the absence of Covid-19 relief fund donations.
- MTCL realigned its capability into four subsegments to adapt to the changing demand dynamics: (1) Customer Success, (2) Data Intelligence, (3) Cloud and Infrastructure Management, and (4) Enterprise IT.
- Management indicated that the pricing discounts/concessions extended to clients in the current challenging times were temporary and pose no risk in the medium-to-long term.
- A spike in volumes from the top client aided Jun'20 quarter performance. Management remains optimistic about opportunities to grow top client revenues and emphasised diversity of engagement.
- MTCL has not decided on annual wage revisions but has rolled out promotions.

**FIG 1 – JUN'20 QUARTER PERFORMANCE**

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
<b>Revenues (US\$ mn)</b>	<b>253.2</b>	<b>264.2</b>	<b>(4.2)</b>	<b>278.4</b>	<b>(9.1)</b>
<b>Revenue</b>	<b>19,088</b>	<b>18,342</b>	<b>4.1</b>	<b>20,505</b>	<b>(6.9)</b>
Operating Expenditure	15,870	16,546	(4.1)	17,268	(8.1)
Cost of revenues	12,778	12,532	2.0	12,933	(1.2)
as % of sales	66.9	68.3	-	63.1	-
SG&A expenses	3,092	4,014	(23.0)	4,335	(28.7)
as % of sales	16.2	21.9	(26.0)	21.1	-
<b>EBITDA</b>	<b>3,218</b>	<b>1,796</b>	<b>79.2</b>	<b>3,237</b>	<b>(0.6)</b>
Depreciation	597	669	(10.8)	679	(12.1)
<b>EBIT</b>	<b>2,621</b>	<b>1,127</b>	<b>132.6</b>	<b>2,558</b>	<b>2.5</b>
Other Income	275	90	205.6	55	400.0
<b>PBT</b>	<b>2,896</b>	<b>1,217</b>	<b>138.0</b>	<b>2,613</b>	<b>10.8</b>
Total Tax	768	335	129.3	551	39.4
Adjusted PAT	2,128	882	141.3	2,062	3.2
(Profit)/loss from JV's/Ass/MI	0	0	-	0	-
APAT after MI	2,128	882	141.3	2,062	3.2
Extra ordinary items	0	0	-	0	-
<b>Reported PAT</b>	<b>2,128</b>	<b>882</b>	<b>141.3</b>	<b>2,062</b>	<b>3.2</b>
Reported EPS	12.9	5.4	141.3	12.5	3.2
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>
EBITDA	16.9	15.2	160	15.8	110
EBIT	13.7	12.9	80	12.5	130
EBT	15.2	14.5	70	12.7	240
PAT	11.1	10.8	40	10.1	110
Effective Tax rate	26.5	25.6	100	21.1	540

Source: Company, BOBCAPS Research

**FIG 2 – DEAL RENEWALS BUOYED JUN'20 QUARTER DEAL WIN TCV**

Source: Company, BOBCAPS Research

**FIG 3 – JUN'20 QUARTER OPERATING METRICS**

(In US\$ terms)	Q1FY21 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Deal wins	391	(0.5)	20.7
Digital revenues	37.0	(12.6)	(6.7)
<b>Revenue by Geography</b>			
North America	79.0	(6.4)	2.7
Europe	13.1	(22.1)	(29.5)
India	4.1	(4.4)	(4.2)
APAC	3.8	(13.6)	(17.2)
<b>Revenue by Vertical</b>			
Communications, media and technology	51.0	7.6	24.1
BFSI	20.3	(9.5)	(9.9)
Manufacturing & Retail	20.6	(7.7)	(11.1)
Travel, Media and Services	8.1	(54.5)	(53.8)
<b>Client concentration</b>			
Top Client	30.1	10.4	43.5
Top 5 Clients	42.9	2.9	22.4
Top 10 Clients	52.0	(0.2)	15.9
Non-Top 10 Clients	48.0	(17.0)	(19.3)

Source: Company, BOBCAPS Research

**Revenue performance was weak across client buckets except for the top client**

**Revenue ex-top client declined 15.5% QoQ**

## Valuation methodology

MTCL's operating margin recovery post change of ownership is tracking ahead of expectations. We raise our FY21/FY22 EPS estimates by 9%/10% as we increase margin assumptions. We also introduce FY23 EPS at Rs 65.8/sh and bake in 9.6% US dollar revenue growth and 18.1% EBITDA margins.

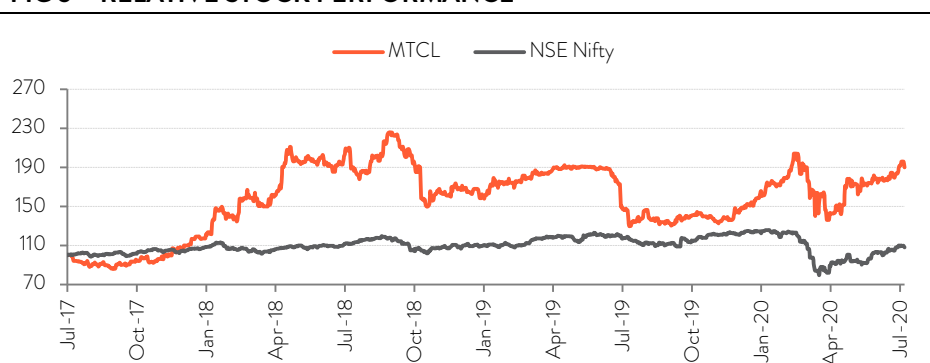
Rolling valuations forward, we have a revised Jun'21 target price of Rs 930 (Rs 880 earlier), set at an unchanged target P/E of 15.3x. MTCL's substantial exposure to the technology vertical (~51% of revenue with a chunk coming from the top client), which is less vulnerable to Covid-19 headwinds, lends the company relative resilience in these difficult times. However, valuations at 16.5x/14.9x FY22E/FY23E PE limit upside. Reiterate REDUCE.

**FIG 4 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E			FY23
	Old	New	Change (%)	Old	New	Change (%)	New
Overall Revenues (in US\$ mn)	1,047	1,029	(1.7)	1,162	1,143	(1.7)	1,252
YoY growth (%)	(3.9)	(5.5)	-	11.0	11.0	-	9.6
Revenues	80,074	78,448	(2.0)	90,658	89,137	(1.7)	97,686
EBITDA	12,556	12,972	3.3	14,993	16,113	7.5	17,659
EBITDA margins (%)	15.7	16.5	-	16.5	18.1	-	18.1
Net profits	7,195	7,845	9.0	8,874	9,743	9.8	10,835
EPS (Rs)	43.7	47.6	9.0	53.9	59.2	9.8	65.8

Source: BOBCAPS Research

**FIG 5 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Key upside risks to our estimates are:

- sharp rupee depreciation,
- above-expected uptick in demand, especially from large clients,
- quick and frictionless leadership overhaul, and
- earlier-than-expected operational stability.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>70,215</b>	<b>77,643</b>	<b>78,448</b>	<b>89,137</b>	<b>97,686</b>
EBITDA	10,645	10,623	12,972	16,113	17,659
Depreciation	1,641	2,754	2,483	2,932	3,250
EBIT	9,004	7,869	10,489	13,181	14,408
Net interest income/(expenses)	(29)	(529)	(581)	(680)	(720)
Other income/(expenses)	894	948	765	845	1,154
Exceptional items	0	0	0	0	0
EBT	9,869	8,288	10,674	13,346	14,842
Income taxes	2,327	1,979	2,829	3,603	4,007
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>7,542</b>	<b>6,309</b>	<b>7,845</b>	<b>9,743</b>	<b>10,835</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>7,542</b>	<b>6,309</b>	<b>7,845</b>	<b>9,743</b>	<b>10,835</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	7,330	17,690	19,343	21,979	24,087
Provisions	1,399	2,304	1,719	1,954	2,141
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	1,642	1,642	1,642	1,642	1,642
Reserves & surplus	31,419	29,926	34,470	40,109	46,380
Shareholders' fund	33,061	31,568	36,112	41,751	48,022
<b>Total liabilities and equities</b>	<b>41,790</b>	<b>51,562</b>	<b>57,175</b>	<b>65,684</b>	<b>74,250</b>
Cash and cash eq.	2,562	5,870	10,365	18,099	25,779
Accounts receivables	13,356	14,389	16,120	17,095	18,734
Inventories	0	0	0	0	0
Other current assets	6,634	5,107	5,373	6,105	6,691
Investments	8,036	7,748	7,748	7,748	7,748
Net fixed assets	9,966	13,469	12,510	11,138	9,448
CWIP	297	136	136	136	136
Intangible assets	4,732	4,732	4,732	4,732	4,732
Deferred tax assets, net	388	1,835	1,835	1,835	1,835
Other assets	848	3,148	3,224	3,663	4,014
<b>Total assets</b>	<b>41,790</b>	<b>51,566</b>	<b>57,175</b>	<b>65,684</b>	<b>74,250</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	6,927	9,063	10,328	12,675	14,085
Interest expenses	(117)	(419)	(184)	(165)	(434)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(2,360)	9,459	(1,004)	723	(281)
Other operating cash flows	1,855	(10,349)	0	0	0
<b>Cash flow from operations</b>	<b>6,305</b>	<b>7,754</b>	<b>9,140</b>	<b>13,233</b>	<b>13,370</b>
Capital expenditures	(1,708)	(1,496)	(1,525)	(1,560)	(1,560)
Change in investments	(301)	0	0	0	0
Other investing cash flows	209	419	184	165	434
<b>Cash flow from investing</b>	<b>(1,800)</b>	<b>(1,077)</b>	<b>(1,340)</b>	<b>(1,395)</b>	<b>(1,126)</b>
Equities issued/Others	3	0	0	0	0
Debt raised/repaid	(3,004)	0	0	0	0
Interest expenses	(37)	0	0	0	0
Dividends paid	(2,180)	(3,369)	(3,304)	(4,104)	(4,564)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(5,218)</b>	<b>(3,369)</b>	<b>(3,304)</b>	<b>(4,104)</b>	<b>(4,564)</b>
<b>Changes in cash and cash eq.</b>	<b>(713)</b>	<b>3,308</b>	<b>4,495</b>	<b>7,734</b>	<b>7,680</b>
<b>Closing cash and cash eq.</b>	<b>2,562</b>	<b>5,870</b>	<b>10,365</b>	<b>18,099</b>	<b>25,779</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	45.8	38.3	47.6	59.2	65.8
Adjusted EPS	45.8	38.3	47.6	59.2	65.8
Dividend per share	33.0	17.0	16.7	20.7	23.0
Book value per share	200.8	191.7	219.3	253.6	291.7

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.3	2.1	2.0	1.7	1.5
EV/EBITDA	15.0	15.0	12.1	9.5	8.3
Adjusted P/E	21.4	25.5	20.5	16.5	14.9
P/BV	4.9	5.1	4.5	3.9	3.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.4	76.1	73.5	73.0	73.0
Interest burden (PBT/EBIT)	109.6	105.3	101.8	101.2	103.0
EBIT margin (EBIT/Revenue)	12.8	10.1	13.4	14.8	14.7
Asset turnover (Revenue/Avg TA)	177.4	166.3	144.3	145.1	139.6
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.6	1.6	1.6
Adjusted ROAE	24.9	19.5	23.2	25.0	24.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	28.5	10.6	1.0	13.6	9.6
EBITDA	43.8	(0.2)	22.1	24.2	9.6
Adjusted EPS	32.1	(16.3)	24.3	24.2	11.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.2	13.7	16.5	18.1	18.1
EBIT margin	12.8	10.1	13.4	14.8	14.7
Adjusted profit margin	10.7	8.1	10.0	10.9	11.1
Adjusted ROAE	24.9	19.5	23.2	25.0	24.1
ROCE	31.2	27.9	40.7	53.2	62.6
<b>Working capital days (days)</b>					
Receivables	61	65	71	68	67
Inventory	0	0	0	0	0
Payables	40	68	103	103	105
<b>Ratios (x)</b>					
Gross asset turnover	7.2	6.6	6.0	7.5	9.5
Current ratio	2.7	1.4	1.7	1.9	2.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.2)	(0.3)	(0.4)	(0.5)

Source: Company, BOBCAPS Research



## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

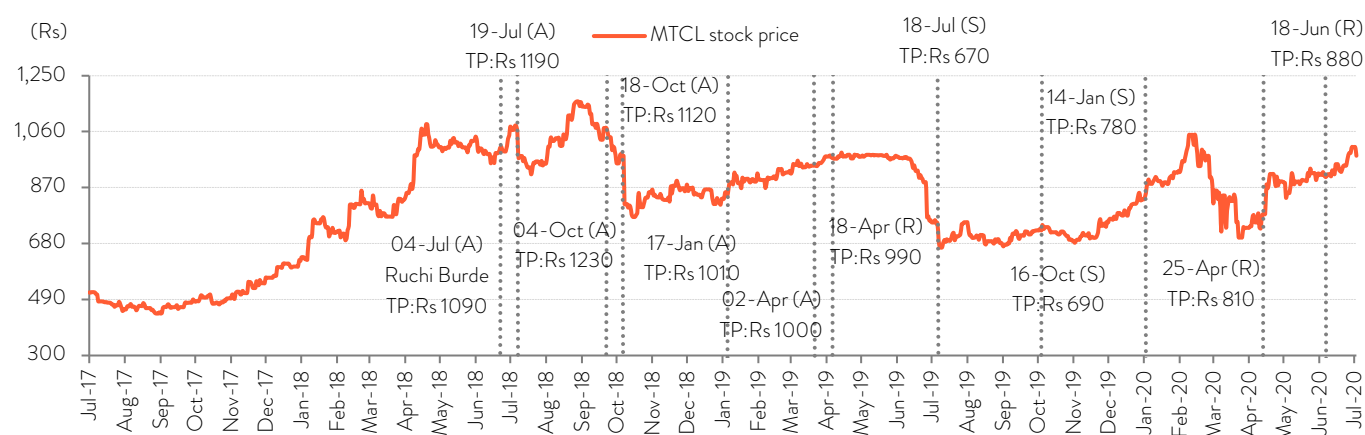
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### HISTORICAL RATINGS AND TARGET PRICE: MINDTREE (MTCL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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