

**ADD**

TP: Rs 1,540 | ▲ 8%

**MINDTREE**

| IT Services

| 15 October 2020

## Robust margin visibility

**Mindtree (MTCL) reported a strong Q2FY21 operational performance, with dollar revenue up 3.1% QoQ and EBIT margin at a 20-quarter high of 17.3% (+360bps QoQ). Management expects continued margin resilience in the near term despite impending wage hikes. Deal wins at US\$ 303mn slowed QoQ. We raise FY22/FY23 EPS by 18%/14% on higher margin assumptions and raise our target P/E by 10% to 21x. Rolling valuations over, we have a revised Sep'21 TP of Rs 1,540 (vs. Rs 1,220 earlier). Retain ADD.**

Ruchi Burde | Seema Nayak

research@bobcaps.in

**Margins outperform:** MTCL's Q2 performance was a beat on both topline and margins. At 3.1% QoQ, USD revenue growth bettered our estimate of 2.3% due to broad-based recovery, including in the troubled communication and travel verticals. Manufacturing and retail showed the highest recovery of 7.6% QoQ aided by strong project delivery. MTCL's EBIT margin was the biggest surprise, expanding 360bps QoQ to 17.3%, led by an 11.6% drop in SG&A costs. The company had seen steep margin contraction to 6.1% post takeover by L&T in Q1FY20. Management expects to sustain current margins.

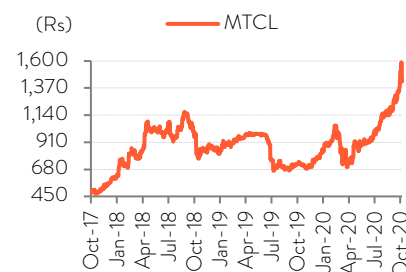
**Slowdown in new deals QoQ:** TCV stood at US\$ 303mn in Q2 (US\$ 694mn for H1FY21), declining 22.5% QoQ and remaining flatish YoY, with a significant portion coming from net new deals. The wins were from CPG, BFSI and healthcare. Management indicated that the large-deal pipeline remains strong and digital implementation is being expedited among enterprises.

**Healthy pipeline; positive outlook:** MTCL indicated that demand has grown in the areas of simplification of operations, cost takeout, vendor consolidation and customer experience. Contractual pricing remains stable and management anticipates a healthy win ratio and pipeline. Pending salary hikes will be carried out in Jan'21 but management expects margins to still remain intact.

Ticker/Price	MTCL IN/Rs 1,425
Market cap	US\$ 3.2bn
Shares o/s	165mn
3M ADV	US\$ 22.2mn
52wk high/low	Rs 1,606/Rs 675
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	79,171	91,883	100,695
EBITDA (Rs mn)	10,645	10,623	15,286	18,377	19,650
Adj. net profit (Rs mn)	7,542	6,309	9,698	11,511	12,354
Adj. EPS (Rs)	45.8	38.3	58.9	69.9	75.0
Adj. EPS growth (%)	32.1	(16.3)	53.7	18.7	7.3
Adj. ROAE (%)	24.9	19.5	28.2	28.4	26.1
Adj. P/E (x)	31.1	37.2	24.2	20.4	19.0
EV/EBITDA (x)	22.0	21.9	15.1	12.3	11.1

Source: Company, BOBCAPS Research

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## Other key highlights

- The travel, media and services vertical grew 5.6% QoQ in Q2FY21, still far below pre-Covid levels – MTCL expects recovery to take several quarters. Per management, travel segment customers remain engaged and there has been no loss of clients. BFSI grew 3.6% QoQ marked by traction across cloud migration and technology modernisation in insurance.
- Top client revenues declined 1% QoQ due to a high base in Q1. Management plans to broaden growth outside the top client by way of strong account mining among the rest of the top-10 clients.
- MTCL has reorganised its service lines into (1) customer success, (2) data and intelligence, (3) cloud, and (4) enterprise IT from its earlier split of (1) interactive, (2) data science and engineering services, (3) cloud services, and (4) others. Reporting of the digital segment has also been scrapped.
- Attrition at 13.8% declined 280bps QoQ.
- The board declared interim dividend of Rs 7.5/sh.

**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
<b>Revenues (US\$ mn)</b>	<b>261.0</b>	<b>271.0</b>	<b>(3.7)</b>	<b>253.2</b>	<b>3.1</b>
<b>Revenue</b>	<b>19,260</b>	<b>19,143</b>	<b>0.6</b>	<b>19,088</b>	<b>0.9</b>
Operating Expenditure	15,357	16,616	(7.6)	15,870	(3.2)
Cost of revenues	12,623	12,647	(0.2)	12,778	(1.2)
as % of sales	65.5	66.1	-	66.9	-
SG&A expenses	2,734	3,969	(31.1)	3,092	(11.6)
as % of sales	14.2	20.7	(31.5)	16.2	-
EBITDA	3,903	2,527	54.5	3,218	21.3
Depreciation	569	707	(19.5)	597	(4.7)
<b>EBIT</b>	<b>3,334</b>	<b>1,820</b>	<b>83.2</b>	<b>2,621</b>	<b>27.2</b>
Other Income	113	59	91.5	275	(58.9)
PBT	3,447	1,879	83.4	2,896	19.0
Total Tax	910	484	88.0	768	18.5
<b>Adjusted PAT</b>	<b>2,537</b>	<b>1,395</b>	<b>81.9</b>	<b>2,128</b>	<b>19.2</b>
(Profit)/loss from JV's/Ass/MI	0	0	-	0	-
APAT after MI	2,537	1,395	81.9	2,128	19.2
Extra ordinary items	0	0	-	0	-
Reported PAT	2,537	1,395	81.9	2,128	19.2
Reported EPS	15.4	8.5	81.9	12.9	19.2
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>
EBITDA	20.3	13.2	710	16.9	340
EBIT	17.3	9.5	780	13.7	360
EBT	17.9	9.8	810	15.2	270
PAT	13.2	7.3	590	11.1	200
Effective tax rate	26.4	25.8	60	26.5	(10)

Source: BOBCAPS Research

**FIG 2 – OPERATING METRICS**

(in US\$ terms)	Q2FY21 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Deal wins (US\$ mn)	303	(22.5)	(1.3)
<b>Revenue by Geography</b>			
North America	77.4	1.0	1.1
Europe	15.4	21.2	(15.7)
<b>Revenue by Vertical</b>			
Communications, Media and Technology	49.8	0.7	20.5
BFSI	20.4	3.6	(9.0)
Manufacturing & Retail	21.5	7.6	(4.6)
Travel, Media and Services	8.3	5.6	(52.7)
<b>Client Concentration</b>			
Top Client	28.9	(1.0)	35.1
Top 5 Clients	40.6	(2.4)	17.8
Top 10 Clients	49.4	(2.1)	10.4
Non-Top 10 Clients	50.6	8.7	(14.4)

Source: BOBCAPS Research

## Valuation methodology

MTCL's operating margin recovery following change of ownership is tracking ahead of expectations. We raise our FY21/FY22/FY23 EPS estimates by 24%/18%/14% as we factor in new elevated margin levels post Q2FY21. Rolling valuations forward, we have a revised Sep'21 target price of Rs 1,540 (vs. Rs 1,220 earlier), set at a target P/E of 21.5x – a 10% increase from our previous multiple of 19.6x.

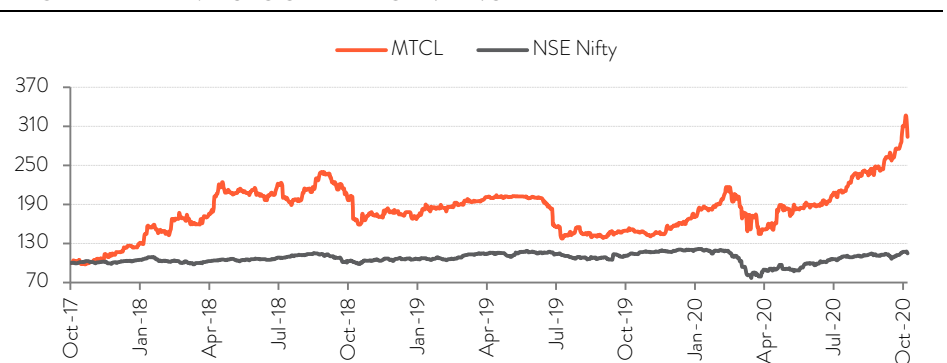
MTCL has substantial exposure to the technology vertical (~50% of revenue with a chunk coming from the top client), which is less vulnerable to Covid-19 headwinds – this lends the company relative resilience in these difficult times. Reiterate ADD.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Overall Revenues (US\$ mn)	1,029	1,053	2.3	1,143	1,178	3.1	1,252	1,291	3.1
YoY growth (%)	(5.5)	(3.3)	-	11.0	11.9	-	9.6	9.6	-
Revenues	78,448	79,171	0.9	89,137	91,883	3.1	97,686	100,695	3.1
EBITDA	12,972	15,286	17.8	16,113	18,377	14.0	17,659	19,650	11.3
EBITDA margins (%)	16.5	19.3	-	18.1	20.0	-	18.1	19.5	-
Net profits	7,845	9,698	23.6	9,743	11,511	18.2	10,835	12,354	14.0
EPS (Rs)	47.6	58.9	23.6	59.2	69.9	18.2	65.8	75.0	14.0

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Key downside risks to our estimates are:

- revenue contraction from large clients,
- sell off in mid-caps, and
- margin reverting to previous levels.

## 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>79,171</b>	<b>91,883</b>	<b>100,695</b>
EBITDA	10,645	10,623	15,286	18,377	19,650
Depreciation	1,641	2,754	2,422	2,813	3,119
EBIT	9,004	7,869	12,863	15,564	16,532
Net interest income/(expenses)	(29)	(529)	(563)	(680)	(720)
Other income/(expenses)	894	948	890	885	1,228
Exceptional items	0	0	0	0	0
EBT	9,869	8,288	13,191	15,768	17,040
Income taxes	2,327	1,979	3,493	4,257	4,686
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>9,698</b>	<b>11,511</b>	<b>12,354</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>7,542</b>	<b>6,309</b>	<b>9,698</b>	<b>11,511</b>	<b>12,354</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	19,522	22,656	24,829
Provisions	1,399	2,304	1,735	2,014	2,207
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	35,543	42,205	49,355
Shareholders' fund	33,061	31,568	37,185	43,847	50,997
<b>Total liabilities and equities</b>	<b>41,790</b>	<b>51,562</b>	<b>58,442</b>	<b>68,517</b>	<b>78,033</b>
Cash and cash eq.	2,562	5,870	11,365	19,946	28,365
Accounts receivables	13,356	14,389	16,268	17,621	19,311
Inventories	0	0	0	0	0
Other current assets	6,634	5,107	5,423	6,293	6,897
Investments	8,036	7,748	7,748	7,748	7,748
Net fixed assets	9,966	13,469	12,550	11,297	9,739
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	3,254	3,776	4,138
<b>Total assets</b>	<b>41,790</b>	<b>51,566</b>	<b>58,442</b>	<b>68,518</b>	<b>78,034</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	12,120	14,324	15,472
Interest expenses	(117)	(419)	(327)	(205)	(508)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(2,360)	9,459	(1,037)	667	(290)
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>10,756</b>	<b>14,786</b>	<b>14,675</b>
Capital expenditures	(1,708)	(1,496)	(1,504)	(1,560)	(1,560)
Change in investments	(301)	0	0	0	0
Other investing cash flows	209	419	327	205	508
<b>Cash flow from investing</b>	<b>(1,800)</b>	<b>(1,077)</b>	<b>(1,176)</b>	<b>(1,355)</b>	<b>(1,052)</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)	(4,085)	(4,849)	(5,204)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(5,218)</b>	<b>(3,369)</b>	<b>(4,085)</b>	<b>(4,849)</b>	<b>(5,204)</b>
<b>Changes in cash and cash eq.</b>	<b>(713)</b>	<b>3,308</b>	<b>5,494</b>	<b>8,582</b>	<b>8,419</b>
<b>Closing cash and cash eq.</b>	<b>2,562</b>	<b>5,870</b>	<b>11,365</b>	<b>19,946</b>	<b>28,365</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	45.8	38.3	58.9	69.9	75.0
Adjusted EPS	45.8	38.3	58.9	69.9	75.0
Dividend per share	33.0	17.0	20.6	24.5	26.3
Book value per share	200.8	191.7	225.8	266.3	309.7

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.3	3.0	2.9	2.5	2.2
EV/EBITDA	22.0	21.9	15.1	12.3	11.1
Adjusted P/E	31.1	37.2	24.2	20.4	19.0
P/BV	7.1	7.4	6.3	5.4	4.6

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	76.4	76.1	73.5	73.0	72.5
Interest burden (PBT/EBIT)	109.6	105.3	102.5	101.3	103.1
EBIT margin (EBIT/Revenue)	12.8	10.1	16.2	16.9	16.4
Asset turnover (Revenue/Avg TA)	177.4	166.3	143.9	144.7	137.4
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.6	1.6	1.5
Adjusted ROAE	24.9	19.5	28.2	28.4	26.1

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	2.0	16.1	9.6
EBITDA	43.8	(0.2)	43.9	20.2	6.9
Adjusted EPS	32.1	(16.3)	53.7	18.7	7.3
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.2	13.7	19.3	20.0	19.5
EBIT margin	12.8	10.1	16.2	16.9	16.4
Adjusted profit margin	10.7	8.1	12.2	12.5	12.3
Adjusted ROAE	24.9	19.5	28.2	28.4	26.1
ROCE	31.2	27.9	49.8	62.4	70.9
<b>Working capital days (days)</b>					
Receivables	61	65	71	67	67
Inventory	0	0	0	0	0
Payables	40	68	106	105	107
<b>Ratios (x)</b>					
Gross asset turnover	7.2	6.6	6.1	7.7	9.6
Current ratio	2.7	1.4	1.7	1.9	2.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.2)	(0.3)	(0.5)	(0.6)

Source: Company, BOBCAPS Research

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

**BUY** – Expected return >+15%

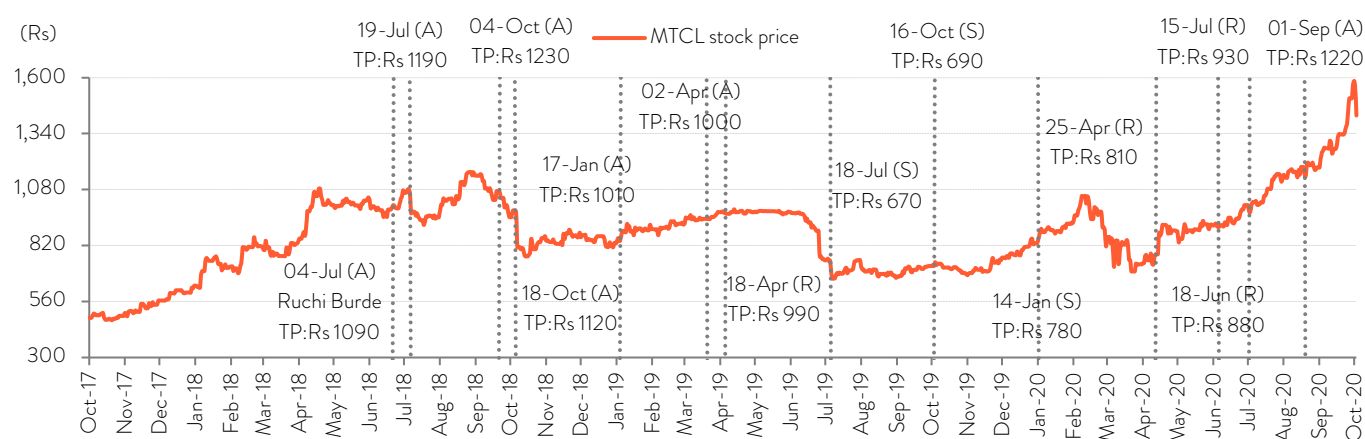
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): MINDTREE (MTCL IN)



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

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