

REDUCE

TP: Rs 810 | ▲ 4%

MINDTREE

| IT Services

| 25 April 2020

Upbeat quarter; upgrade a notch to REDUCE

Mindtree (MTCL) reported an upbeat Q4 operating performance with 1.9% QoQ CC growth and swift margin recovery. Revenue growth was supported by the hi-tech vertical. Deal TCV at US\$ 393mn was robust with an all-time high share of new wins. Management flagged revenue and margin weakness in Q1FY21 on Covid-19 challenges but stays committed to its profitable growth strategy for the mid-to-long term. We trim FY21/FY22 EPS 2%/6%, roll to a Mar'21 TP of Rs 810 (vs. Rs 780), and upgrade from SELL to REDUCE on a resilient business mix.

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Good quarter: MTCL has demonstrated resilience in the current uncertain climate, clocking 1.9% QoQ CC revenue growth (1.2% QoQ in dollar terms) coupled with operating margin expansion to 15.8% in Q4FY20. Volumes grew 4.9% QoQ while realisations declined 3.9%. The company managed swift delivery transition to 'work from home' (WFH at 99.5%), preventing any revenue loss in Q4 (which contrasts favourably with larger peers Infosys, TCS and Wipro which have reported results thus far). Growth was driven by the hi-tech segment (+5.1% QoQ), while other verticals saw sequential revenue declines.

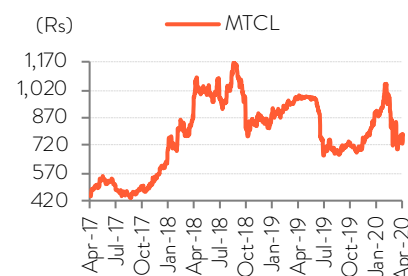
Swift margin recovery: MTCL's operating margin recovery is tracking ahead of expectations. Reported EBITDA margins at 15.8% improved by 20bps QoQ, despite exceptional items – (1) Rs 200mn contribution to PM Cares Fund (100bps) and (2) Rs 275mn forex loss (130bps). Excluding one-offs, the EBITDA margin was at 17.1%, up 150bps QoQ, marking a speedy recovery.

Robust deal wins: Deal TCV of US\$ 393mn surged 90% QoQ and had a record new deal (vs. renewal) share of 48%. Renewal deal TCV of US\$ 206mn was aided by a large multiyear annuity deal with an existing real estate client. Management remains focused on chasing large, multiyear deals to enhance the annuity revenue mix.

Ticker/Price	MTCL IN/Rs 780
Market cap	US\$ 1.7bn
Shares o/s	165mn
3M ADV	US\$ 10.4mn
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	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	54,628	70,215	77,643	83,171	91,848
EBITDA (Rs mn)	7,405	10,645	10,578	13,042	14,737
Adj. net profit (Rs mn)	5,701	7,542	6,264	7,552	8,699
Adj. EPS (Rs)	34.7	45.8	38.0	45.9	52.8
Adj. EPS growth (%)	39.5	32.1	(16.9)	20.6	15.2
Adj. ROAE (%)	21.4	24.9	19.4	22.4	22.6
Adj. P/E (x)	22.5	17.0	20.5	17.0	14.8
EV/EBITDA (x)	17.2	12.0	12.0	9.5	8.2

Source: Company, BOBCAPS Research

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Earnings call highlights

- **Travel & Hospitality ramp-down (16.2% of revenue):** Dollar revenue from the travel and hospitality vertical declined 1.3% QoQ in Q4FY20, and management expects this segment to bear the brunt of the pandemic. Moreover, a few of MTCL's top-10 clients belong to this vertical. However, traction in Hi-tech and CPG should help offset the impact as hi-tech in particular is likely to structurally benefit post Covid-19 due to an increase in demand for cloud, automation and virtualization services.
- **Covid-19 impact:**
 - Nearly all employees (99.5%) have been shifted to the work-from-home model with no loss of productivity. MTCL is the first of four IT services players that have reported results so far to have increased its utilisation (by 60bps) in Q4FY20.
 - A higher proportion of delivery will shift to work-from-home post the Covid-19 crisis, though this will depend on clients' willingness as well.
 - MTCL has moved campus training to an online platform for e-skilling and completed 100,000 online courses on 'Yorbit' – its digital learning platform.
 - All clients are facing a variety of challenges but are keen to get ahead of the curve in understanding the new normal. The travel and manufacturing verticals will be more affected. BFSI clients will re-prioritise their spending, while discretionary spending is being deferred. Pricing revision is being discussed with some clients but no trends have emerged so far.
 - The hi-tech vertical is seeing traction because of momentum in demand for collaborative tools.
 - Margins will see a near-term adverse effect but management intends to pursue its profitable growth strategy for the long term. Standard measures for cost reduction are already in play. MTCL has deferred a wage revision decision but targets to honour all new hiring offers made thus far.
 - While DSO stood steady at 66 days in Q4FY20 despite the Covid impact, there will be some short-term challenges in Q1FY21.
- A dividend Rs 10/sh was announced.

FIG 1 – MAR'20 QUARTER PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Revenues (US\$ mn)	278.4	262.0	6.3	275.2	1.2	1,089	1,001	8.7
Revenue	20,505	18,394	11.5	19,653	4.3	77,643	70,215	10.6
Operating Expenditure	17,268	15,591	10.8	16,590	4.1	67,065	59,570	12.6
Cost of revenues	12,933	11,504	12.4	12,535	3.2	50,647	44,212	14.6
as % of sales	63.1	62.5	-	63.8	-	65.2	63.0	-
SG&A expenses	4,335	4,087	6.1	4,055	6.9	16,418	15,358	6.9
as % of sales	21.1	22.2	(4.9)	20.6	-	21.1	21.9	-
EBITDA	3,237	2,803	15.5	3,063	5.7	10,578	10,645	(0.6)
Depreciation	679	428	58.6	699	(2.9)	2,754	1,641	67.8
EBIT	2,558	2,375	7.7	2,364	8.2	7,824	9,004	(13.1)
Other Income	55	290	(81.0)	215	(74.4)	419	865	(51.6)
PBT	2,613	2,665	(2.0)	2,579	1.3	8,243	9,869	(16.5)
Total Tax	551	681	(19.1)	609	(9.5)	1,979	2,327	(15.0)
Adjusted PAT	2,062	1,984	3.9	1,970	4.7	6,264	7,542	(16.9)
(Profit)/loss from JV's/Ass/MI	0	0	-	0	-	0	0	-
APAT after MI	2,062	1,984	3.9	1,970	4.7	6,264	7,542	(16.9)
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	2,062	1,984	3.9	1,970	4.7	6,264	7,542	(16.9)
Reported EPS	12.5	12.1	3.9	12.0	4.7	38	46	(17.0)
Margins (%)			(bps)		(bps)			(bps)
EBITDA	15.8	15.2	50	15.6	20	13.6	15.2	(150)
EBIT	12.5	12.9	(40)	12.0	40	10.1	12.8	(270)
EBT	12.7	14.5	(170)	13.1	(40)	10.6	14.1	(340)
PAT	10.1	10.8	(70)	10.0	-	8.1	10.7	(270)
Effective Tax rate	21.1	25.6	(450)	23.6	(250)	24.0	23.6	40

Source: Company, BOBCAPS Research

FIG 2 – MAR'20 OPERATING METRICS

(In US\$ terms)	Q4FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Deal wins (US\$ mn)	393	89.9	62.4
Digital Revenues	38.5	2.0	10.6
Revenue by Geography			
North America	76.8	4.1	10.9
Europe	15.3	(9.0)	(12.1)
India	3.9	(1.4)	12.0
APAC	4.0	(8.0)	1.2
Revenue by Vertical			
Hi-Tech	50.9	5.1	15.7
BFSI (in US\$ mn)	20.4	(3.1)	(0.6)
Manufacturing & Retail (in US\$ mn)	20.3	(0.3)	(2.8)
Travel, Media and Services (in US\$ mn)	16.2	(1.3)	5.0
Client concentration			
Top Client	24.8	8.6	33.1
Top 5 Clients	37.9	6.2	21.3
Top 10 Clients	47.4	5.2	17.4
Non-Top 10 Clients	52.6	(2.2)	(2.1)

Source: Company, BOBCAPS Research

Valuation methodology

MTCL has substantial exposure to the hi-tech vertical (~51% of revenue with a chunk coming from the top client), which is less vulnerable to Covid-19 headwinds, lending the company relative resilience in these challenging times. Moreover, a strong margin trajectory will ensure FY21 EPS growth whilst other peers are at risk of EPS decline. We thus upgrade MTCL to REDUCE from SELL.

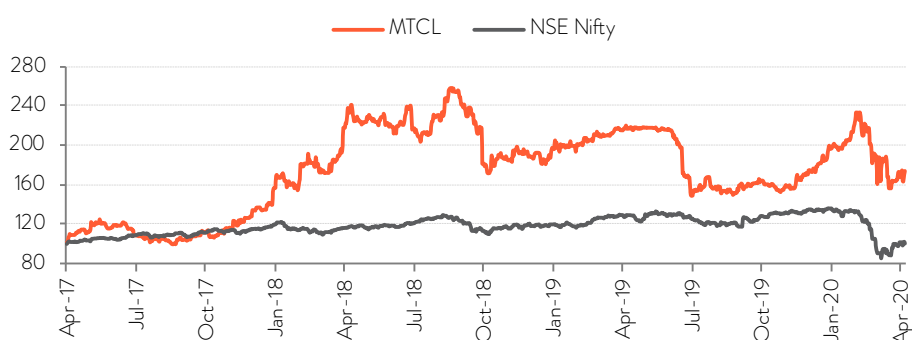
We trim FY21/FY22 EPS estimates by 2%/6% largely on account of lower revenue growth assumptions. Rolling valuations forward, we have a revised Mar'21 target price of Rs 810 (Rs 780 earlier), set at a target FY22E P/E of 15.3x.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)
Overall Revenues (in US\$ mn)	1,212	1,109	(8.5)	1,361	1,225	(10.0)
YoY growth (%)	11.0	1.9	-	1230.0	10.4	-
Revenues	84,822	83,171	(1.9)	95,259	91,848	(3.6)
EBITDA	13,142	13,042	(0.8)	15,286	14,737	(3.6)
EBITDA margins (%)	15.5	15.7	-	16.0	16.0	-
Net profits	7,690	7,552	(1.8)	9,268	8,699	(6.1)
EPS (Rs)	46.7	45.9	(1.8)	56.3	52.8	(6.2)

Source: BOBCAPS Research

FIG 4 – 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)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	54,628	70,215	77,643	83,171	91,848
EBITDA	7,405	10,645	10,578	13,042	14,737
Depreciation	1,715	1,641	2,754	2,666	2,978
EBIT	5,690	9,004	7,824	10,376	11,759
Net interest income/(expenses)	(169)	(29)	(529)	(600)	(680)
Other income/(expenses)	1,902	894	948	569	837
Exceptional items	0	0	0	0	0
EBT	7,423	9,869	8,243	10,345	11,916
Income taxes	1,722	2,327	1,979	2,793	3,217
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	5,701	7,542	6,264	7,552	8,699
Adjustments	0	0	0	0	0
Adjusted net profit	5,701	7,542	6,264	7,552	8,699

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	5,733	7,330	19,119	20,508	22,647
Provisions	1,218	1,399	875	1,823	2,013
Debt funds	3,000	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	1,639	1,642	1,642	1,642	1,642
Reserves & surplus	25,775	31,419	29,926	34,301	39,335
Shareholders' fund	27,414	33,061	31,568	35,943	40,977
Total liabilities and equities	37,365	41,790	51,562	58,274	65,638
Cash and cash eq.	3,289	2,562	5,870	10,184	17,550
Accounts receivables	10,155	13,356	14,389	17,090	17,615
Inventories	0	0	0	0	0
Other current assets	3,888	6,634	5,107	5,697	6,291
Investments	7,264	8,036	7,748	7,748	7,748
Net fixed assets	9,660	9,966	13,469	12,303	10,825
CWIP	92	297	136	136	136
Intangible assets	4,539	4,732	4,732	4,732	4,732
Deferred tax assets, net	318	388	1,835	1,835	1,835
Other assets	2,791	848	3,148	3,418	3,775
Total assets	37,365	41,790	51,566	58,274	65,638

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	5,784	6,927	9,018	10,218	11,677
Interest expenses	59	(117)	(419)	31	(157)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(833)	(2,360)	9,459	(1,224)	854
Other operating cash flows	634	1,855	(11,034)	0	0
Cash flow from operations	5,644	6,305	7,024	9,025	12,374
Capital expenditures	(1,011)	(1,708)	(1,496)	(1,500)	(1,500)
Change in investments	(877)	(301)	0	0	0
Other investing cash flows	(114)	209	419	(31)	157
Cash flow from investing	(2,002)	(1,800)	(1,077)	(1,531)	(1,343)
Equities issued/Others	1	3	0	0	0
Debt raised/repaid	1,960	(3,004)	0	0	0
Interest expenses	(2,694)	(37)	0	0	0
Dividends paid	(2,142)	(2,180)	(2,639)	(3,181)	(3,664)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,875)	(5,218)	(2,639)	(3,181)	(3,664)
Changes in cash and cash eq.	767	(713)	3,308	4,313	7,367
Closing cash and cash eq.	3,289	2,562	5,870	10,184	17,550

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	34.7	45.8	38.0	45.9	52.8
Adjusted EPS	34.7	45.8	38.0	45.9	52.8
Dividend per share	11.0	33.0	13.3	16.1	18.5
Book value per share	166.7	200.8	191.7	218.3	248.9

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	2.3	1.8	1.6	1.5	1.3
EV/EBITDA	17.2	12.0	12.0	9.5	8.2
Adjusted P/E	22.5	17.0	20.5	17.0	14.8
P/BV	4.7	3.9	4.1	3.6	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	76.8	76.4	76.0	73.0	73.0
Interest burden (PBT/EBIT)	130.5	109.6	105.4	99.7	101.3
EBIT margin (EBIT/Revenue)	10.4	12.8	10.1	12.5	12.8
Asset turnover (Revenue/Avg TA)	155.4	177.4	166.3	151.4	148.2
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.4	1.6	1.6
Adjusted ROAE	21.4	24.9	19.4	22.4	22.6

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	4.3	28.5	10.6	7.1	10.4
EBITDA	3.1	43.8	(0.6)	23.3	13.0
Adjusted EPS	39.5	32.1	(16.9)	20.6	15.2
Profitability & Return ratios (%)					
EBITDA margin	13.6	15.2	13.6	15.7	16.0
EBIT margin	10.4	12.8	10.1	12.5	12.8
Adjusted profit margin	10.4	10.7	8.1	9.1	9.5
Adjusted ROAE	21.4	24.9	19.4	22.4	22.6
ROCE	22.1	31.2	27.8	40.2	47.7
Working capital days (days)					
Receivables	64	61	65	69	69
Inventory	0	0	0	0	0
Payables	42	40	72	103	102
Ratios (x)					
Gross asset turnover	5.4	7.2	6.6	6.5	7.9
Current ratio	2.9	2.7	1.4	1.6	1.8
Net interest coverage ratio	(33.7)	NA	NA	NA	NA
Adjusted debt/equity	0.0	(0.1)	(0.2)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

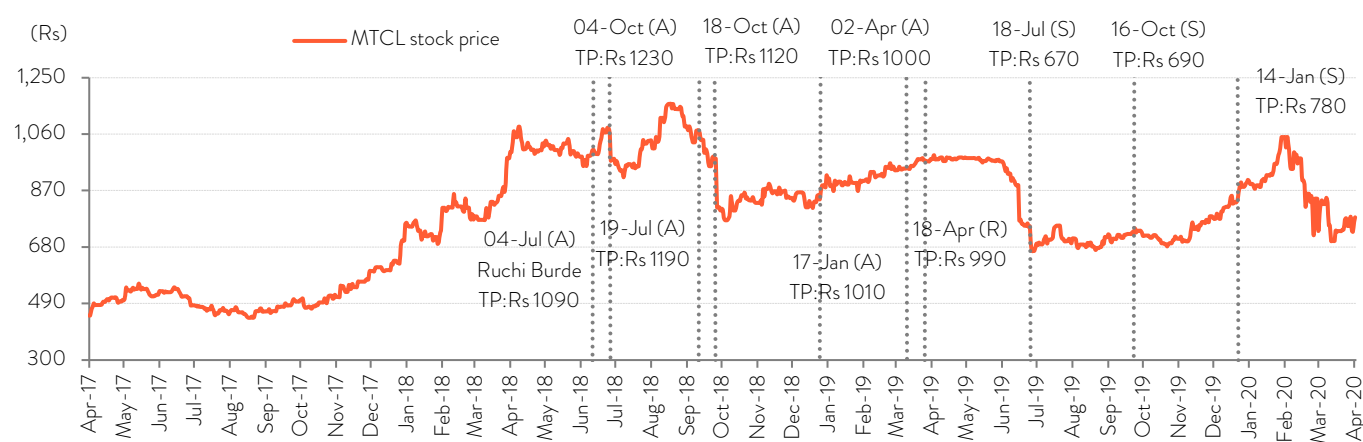
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: MINDTREE (MTCL IN)



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

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