Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

Mindtree (MTCL IN)

Rating: REDUCE | CMP: Rs744 | TP: Rs716

October 16, 2019

Q2FY20 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	REDUCE		REDUCE	
Target Price	716		687	
Sales (Rs. m)	77,112	84,882	76,575	84,682
% Chng.	*0.7*	*0.2*		
EBITDA (Rs. m)	10,191	11,045	9,922	11,563
% Chng.	*2.7*	*(1.4)*		
EPS (Rs.)	39.3	46.9	39.2	49.0
% Chng.	*0.4*	*(4.50)*		

Key Financials - Standalone

Y/e Mar	FY19	FY20E	FY21E	FY22E
Sales (Rs.m)	70,215	77,112	84,882	92,604
EBITDA (Rs. m)	10,645	10,191	11,405	13,045
Margin (%)	*15.2*	*13.2*	*13.4*	*14.1*
PAT (Rs. m)	7,540	6,472	7,714	9,137
EPS (Rs.)	45.9	39.3	46.9	55.5
Gr. (%)	*33.6*	*(14.4)*	*19.1*	*18.5*
DPS (Rs.)	33.0	5.0	5.0	5.0
Yield (%)	*4.4*	*0.7*	*0.7*	*0.7*
RoE (%)	*24.9*	*19.5*	*21.0*	*20.7*
RoCE (%)	*28.4*	*24.4*	*24.5*	*23.5*
EV/Sales (x)	1.6	1.4	1.2	1.0
EV/EBITDA (x)	10.6	10.5	9.0	7.3
PE (x)	16.2	18.9	15.9	13.4
P/BV (x)	3.7	3.7	3.1	2.5

Key Data	MINT.BO | MTCL IN
52-W High / Low	Rs.979 / Rs.652
Sensex / Nifty	38,599 / 11,464
Market Cap	Rs.122bn/ $ 1,713m
Shares Outstanding	165m
3M Avg. Daily Value	Rs.1605.09m

Shareholding Pattern (%)

Promoter's	73.76
Foreign	10.83
Domestic Institution	5.28
Public & Others	10.13
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	9.0	(21.8)	(22.8)
Relative	4.9	(20.4)	(29.6)

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Talent retention to keep margins under pressure

Mindtree reported inline quarter on revenue & margin front. Attrition increased sharply & is not a surprise. Positives were stable TCV momentum inspite of management transition & broad-based growth amongst verticals. MTCL posted a revenue growth of 2.6% QOQ USD & 3.2% QoQ CC inline with our estimates. Growth was broad-based mainly led by recovery in top account (5% QoQ USD). Margin came inline with our estimates at 9.3% aided by cost optimization & INR depreciation.

Attrition was 8 quarter high at 16.5% (+140bps QoQ, +350bps YoY). We believe rise in attrition can put execution risk to the TCV. Mindtree has possibly the highest exposure to discretionary spending. Projects cycle have relatively short durations, requiring high touch with clients to back-fill completed projects and win new ones for overall growth. Hence, people continuity becomes even more important. We also highlight that Mindtree's key client base also works with other Tier 1 IT vendors.

We maintain our Reduce rating on MTCL as we believe potential cost of talent retention & managing attrition will continue to keep margins under pressure. We incorporate FY22E estimates & value MTCL on Sep-21 EPS(Rs.51.2) at unchanged multiple of 14x arriving at a target price of Rs. 716(earlier: Rs 687) We retain our revenue estimates for FY20/21E & reduce margins estimates for FY21E which leads to 4% EPS cut for FY21E. Stock is currently trading at 19x/16x/13.5x FY20/21/22E .Maintain Reduce.

- **Inline revenues & margins:** MTCL reported an inline revenue growth with our estimates of US$ 271mn (Ple: $268mn) & CC revenue growth was at 3.1% QoQ EBIT margin came at 9.3% (-288bps QoQ, -381bps YoY) inline with our estimates. We have estimated EBIT margins of 10.5%/10.6%/11.2% for FY20/21/22E. We believe potential cost of talent retention & managing attrition will continue to keep margins under pressure. EPS was Rs.8.20 inline with our estimates.
- **Broad based growth across verticals & geographies:** MTCL posted a decent growth in its core verticals. Manufacturing (0.3% QoQ, 10% YoY USD), BFSI (2.6% QoQ, 6.1% YoY USD) & travel (3.2% QoQ, 11% YoY). Geography wise US (2.6% QoQ, 10.1% YoY) & Europe (1.4% QoQ, 3.5% YoY USD) posted decent growth.
- **Decline in Renewals:** MTCL maintained a decent TCV momentum in Q2FY20 at USD307mn(-5.7% QoQ, 5% YoY) but renewals were down by 17% QoQ basis to USD186mn.
- **Spike in Attrition:** We have expected Attrition to rise when LTI-MTCL deal was announced & in this quarter also we saw Attrition was 8 quarter high at 16.5% (+140bps QoQ, +350bps YoY). We believe rise in attrition can put execution risk to the TCV. Attrition can lead to loss of customer connect & revenues.

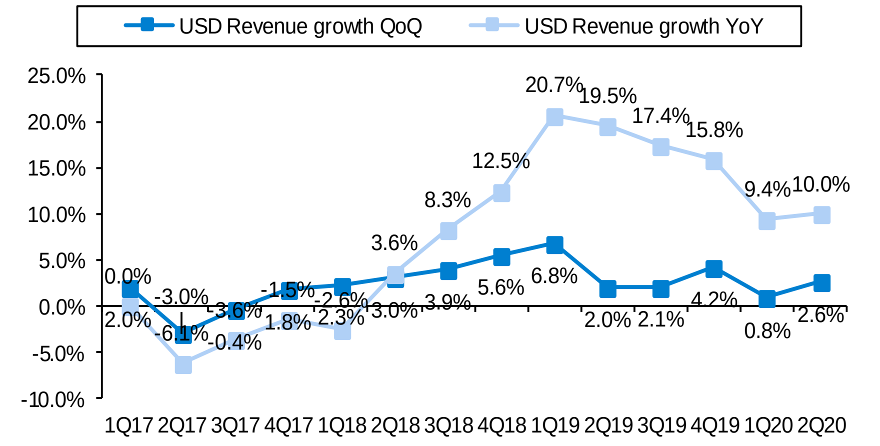
Exhibit 1: Q2FY20 quick view on results

Rs m	2Q19	1Q20	2Q20	QoQ gr.	YoY gr.	2Q20E	% var from est
Net Sales (US$ m)	246.4	264.2	271.0	2.6	10.0	268.4	1%
Net Sales	17,554	18,342	19,143	4.4	9.1	18,880	1%
EBITDA	2,699	1,841	2,482	34.8	(8.0)	2,247	10%
EBITDA margin (%)	15.4	10.0	13.0	293bp	-241bp	11.9	106bp
EBIT	2,296	1,172	1,775	51.5	(22.7)	1,741	2.0
EBIT margin (%)	13.1	6.4	9.3	288bp	-381bp	9.2	5bp
PBT	2,819	1,262	1,834	45.3	(34.9)	1,923	(4.6)
Income tax	757	335	484	44.5	(36.0)	530	(8.6)
Reported PAT	2,062	927	1,350	45.6	(34.5)	1,393	(3.1)
EPS diluted (Rs.)	12.55	5.64	8.20	45.4	(34.7)	8.5	(3.2)

Source: Company, PL

MTCL reported inline revenue growth to our estimates to US$ 271mn (PLe: $2268mn) & CC revenue growth was at 3.1% QoQ

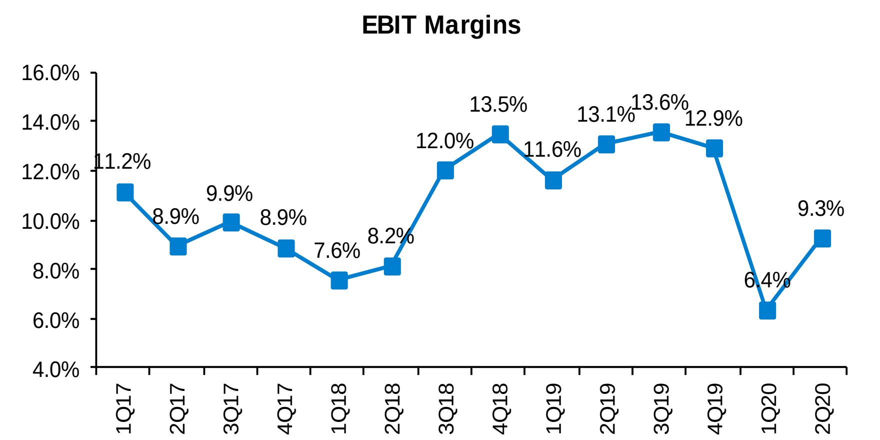
Exhibit 2: Weak revenue growth



Source: Company, PL

We believe potential cost of talent retention & managing attrition will continue to keep margins under pressure.

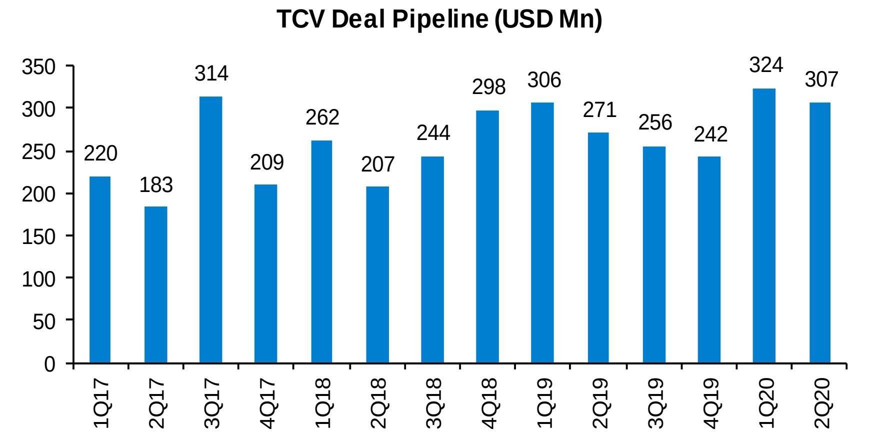
Exhibit 3: EBIT margin inline with our estimates



Source: Company, PL

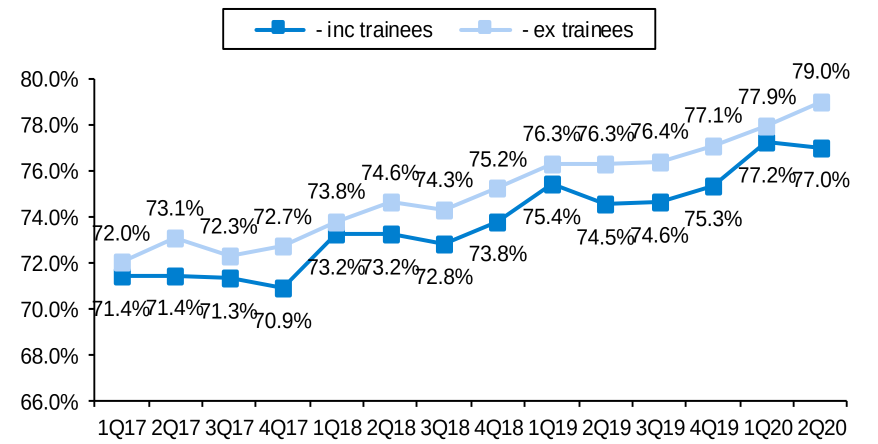
MTCL maintained a decent TCV momentum in Q2FY20 at USD307mn(-5.7% QoQ, 5% YoY) but renewals were down by 17% QoQ basis to USD186mn.

Exhibit 4: Momentum in TCV maintained



Source: Company, PL

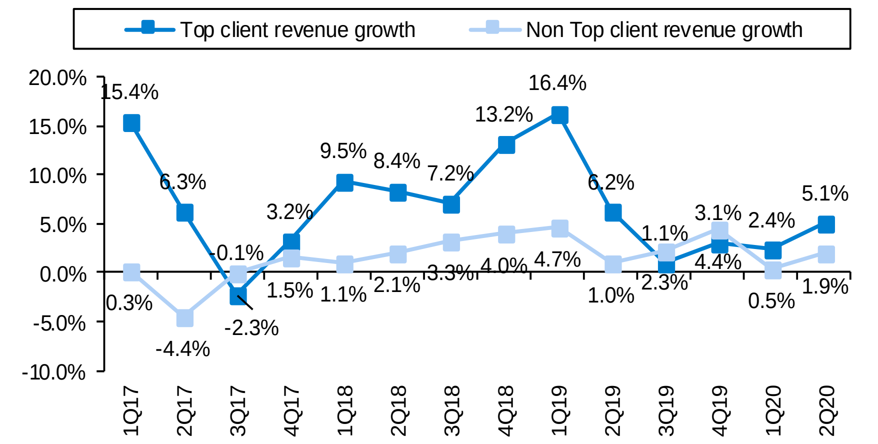
Exhibit 5: Utilization continues to improve



Source: Company, PL

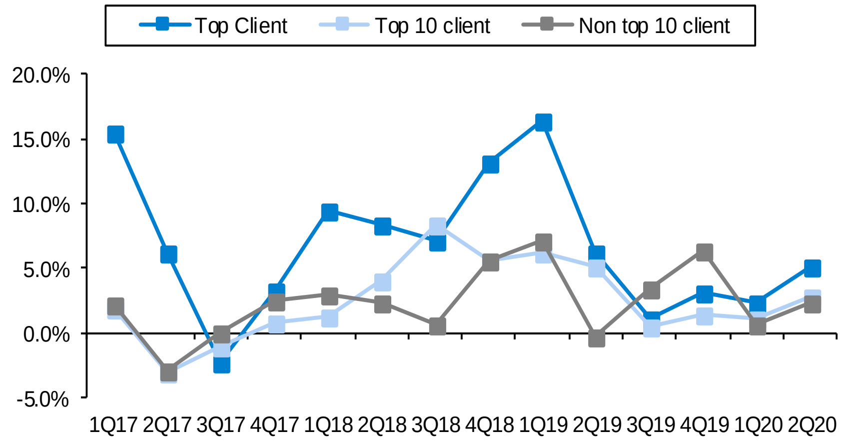
Revenue momentum from top client was better than Non top client in the quarter.

Exhibit 6: Revenues from top client's (USD) marginally grew



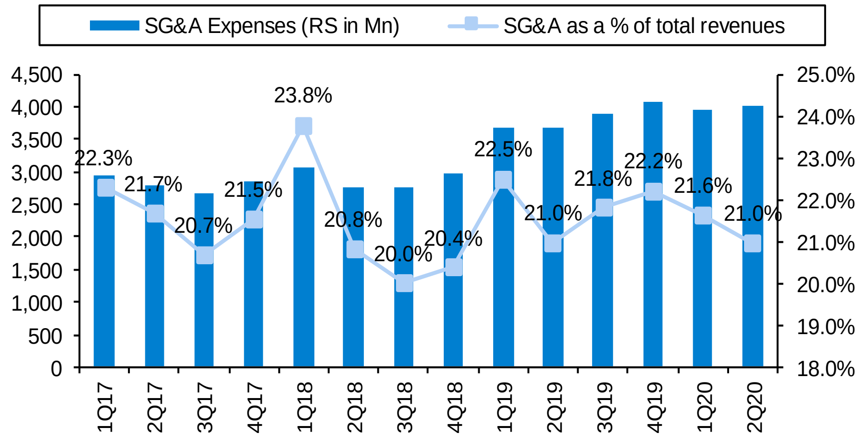
Source: Company, PL

Exhibit 7: Weak revenue growth among all clients



Source: Company, PL

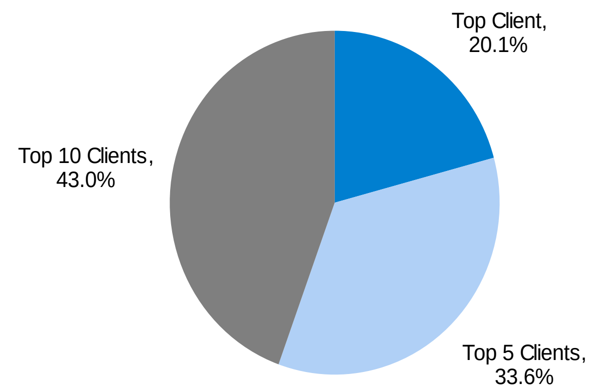
Exhibit 8: SG&A Expenses declined



Source: Company, PL

Revenue contribution from top clients continue to remain steady

Exhibit 9: Customer Concentration (%)



Source: Company, PL

Exhibit 10: Geography wise Revenues

(US$ m)	Q2FY19	Q1FY20	Q2FY20	QoQ (%)	YoY (%)
America	181	194	200	3.1	10.1
Europe	46	50	48	(3.8)	4.7
India	8	9	11	22.5	36.6
APAC / Rest of the World	10	11	12	7.5	15.2
Geography wise(% of sales)					
America	73.6%	73.3%	73.7%	37bp	10bp
Europe	18.7%	19.0%	17.8%	-119bp	-90bp
India	3.3%	3.4%	4.1%	67bp	80bp
APAC / Rest of the World	4.2%	4.2%	4.4%	20bp	20bp

Source: Company, PL

Exhibit 11: Revenue by service lines

Revenue by Service Offering*	Q2FY19	Q1FY20	Q2FY20	QoQ (%)	YoY (%)
Interactive	20.7%	23.9%	23.8%	-10bp	310bp
Data Science and Engineering services	10.5%	10.5%	11.0%	50bp	50bp
Cloud Services	3.6%	3.3%	3.0%	-30bp	-60bp
Others	0.4%	0.3%	0.2%	-10bp	-20bp
Digital	35.2%	38.0%	38.0%	0bp	280bp
Test Engineering	18.9%	18.2%	18.7%	50bp	-20bp
Package Solutions	8.2%	7.4%	7.0%	-40bp	-120bp
Infrastructure Management & Tech Support	23.3%	23.8%	24.6%	80bp	130bp
ADM and Product Engineering	14.4%	12.6%	11.7%	-90bp	-270bp
Total	**100.0%**	**100.0%**	**100.0%**		

Source: Company, PL

Exhibit 12: TCV Data

(USD mn)	Q2FY19	Q1FY20	Q2FY20	QoQ (%)	YoY (%)
Renewals	222	248	186	(17.1)	(1.7)
New	49	76	121	45.6	26.3
Total	**271**	**324**	**307**	**(5.7)**	**4.9**
Expiring within 1 year	198	271	239	6.8	2.9
Expiring > 1 year	73	53	68	(39.5)	15.6
Digital	162	137	140	(16.1)	3.1

Source: Company, PL

Exhibit 13: Client Metrics

	Q2FY19	Q1FY20	Q2FY20	QoQ (%)	YoY (%)
Total active clients	341	346	343	*-3.00*	*2.0*
New clients added	18	12	14	*2.00*	*(4.0)*
Customer Concentration (%)					
Top Customer	20.2%	20.1%	20.6%	*50bp*	*40bp*
Top 5 Customers	33.8%	33.6%	33.2%	*-40bp*	*-60bp*
Top 10 Customers	44.8%	43.0%	43.1%	*10bp*	*-170bp*
Receivables position					
Days of Sales Outstanding	68	66	66	*0.0*	*(2.0)*
Client relationships					
US$ 1m+	111	122	130	*8.0*	*19.0*
US$ 5m+	44	46	47	*1.0*	*3.0*
US$ 10m+	21	23	21	*(2.0)*	*0.0*
US$ 50m+	1	1	1	*0.0*	*0.0*

Source: Company, PL

Exhibit 14: Headcount Metrics

	Q2FY19	Q1FY20	Q2FY20	QoQ (%)	YoY (%)
Total employees	19,402	20,935	21,267	*332.0*	*9.6*
- net hiring	412	731	332	*(399.0)*	*(19.4)*
Delivery employees	18,214	19,681	20,001	*320.0*	*9.8*
- net addition	377	1,844	1,787	*(57.0)*	*374.0*
Sales and support	1,188	1,254	1,266	*12.0*	*6.6*
Utilization %					
- inc trainees	74.5%	77.2%	77.0%	*-20bp*	*250bp*
- ex trainees	76.3%	77.9%	79.0%	*110bp*	*270bp*
Attrition rate - LTM	13.0%	15.1%	16.5%	*140bp*	*350bp*

Source: Company, PL

Exhibit 15: Order Book

US$ m	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20
New order booking	220	183	314	209	262	207	244	306	271	256	242	324	307
Digital Order Booking	93	64	103	50	108	84	132	139	162	136	126	137	140

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Net Revenues	**70,215**	**77,112**	**84,882**	**92,604**
YoY gr. (%)	*28.5*	*9.8*	*10.1*	*9.1*
Employee Cost	44,212	50,960	57,701	62,166
Gross Profit	26,003	26,152	27,181	30,438
Margin (%)	*37.0*	*33.9*	*32.0*	*32.9*
SG&A Expenses	-	-	-	-
Other Expenses	-	-	-	-
EBITDA	**10,645**	**10,191**	**11,405**	**13,045**
YoY gr. (%)	*43.8*	*(4.3)*	*11.9*	*14.4*
Margin (%)	*15.2*	*13.2*	*13.4*	*14.1*
Depreciation and Amortization	1,641	2,092	2,424	2,646
EBIT	**9,004**	**8,099**	**8,981**	**10,399**
Margin (%)	*12.8*	*10.5*	*10.6*	*11.2*
Net Interest	29	358	180	180
Other Income	893	977	1,694	2,226
Profit Before Tax	**9,868**	**8,718**	**10,495**	**12,446**
Margin (%)	*14.1*	*11.3*	*12.4*	*13.4*
Total Tax	2,328	2,246	2,781	3,308
Effective tax rate (%)	*23.6*	*25.8*	*26.5*	*26.6*
Profit after tax	**7,540**	**6,472**	**7,714**	**9,137**
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	**7,540**	**6,472**	**7,714**	**9,137**
YoY gr. (%)	*32.3*	*(14.2)*	*19.2*	*18.5*
Margin (%)	*10.7*	*8.4*	*9.1*	*9.9*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**7,540**	**6,472**	**7,714**	**9,137**
YoY gr. (%)	*32.3*	*(14.2)*	*19.2*	*18.5*
Margin (%)	*10.7*	*8.4*	*9.1*	*9.9*
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	7,540	6,472	7,714	9,137
Equity Shares O/s (m)	**164**	**165**	**165**	**165**
EPS (Rs)	**45.9**	**39.3**	**46.9**	**55.5**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Non-Current Assets				
Gross Block	**17,162**	**20,341**	**23,283**	**26,444**
Tangibles	17,162	20,341	23,283	26,444
Intangibles	-	-	-	-
Acc: Dep / Amortization	**13,108**	**15,200**	**17,624**	**20,270**
Tangibles	13,108	15,200	17,624	20,270
Intangibles	-	-	-	-
Net fixed assets	**4,054**	**5,141**	**5,659**	**6,174**
Tangibles	4,054	5,141	5,659	6,174
Intangibles	-	-	-	-
Capital Work In Progress	-	-	-	-
Goodwill	5,912	5,701	5,701	5,701
Non-Current Investments	1,200	772	772	772
Net Deferred tax assets	387	532	532	532
Other Non-Current Assets	2,564	2,804	2,905	3,006
Current Assets				
Investments	6,836	5,239	5,239	5,239
Inventories	-	-	-	-
Trade receivables	13,356	13,098	14,418	15,730
Cash & Bank Balance	2,562	9,881	14,961	21,476
Other Current Assets	4,795	5,012	5,517	6,019
Total Assets	**41,790**	**48,197**	**55,722**	**64,667**
Equity				
Equity Share Capital	1,642	1,646	1,646	1,646
Other Equity	31,419	31,698	38,460	46,645
Total Networth	**33,061**	**33,344**	**40,106**	**48,291**
Non-Current Liabilities				
Long Term borrowings	5	-	-	-
Provisions	-	-	-	-
Other non current liabilities	173	5,237	5,237	5,237
Current Liabilities				
ST Debt / Current of LT Debt	-	-	-	-
Trade payables	2,131	2,179	2,179	2,179
Other current liabilities	6,419	7,437	8,200	8,960
Total Equity & Liabilities	**41,790**	**48,197**	**55,722**	**64,667**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
PBT	9,868	8,718	10,495	12,446
Add. Depreciation	1,641	2,092	2,424	2,646
Add. Interest	29	358	180	180
Less Financial Other Income	893	977	1,694	2,226
Add. Other	-	-	-	-
Op. profit before WC changes	11,538	11,168	13,099	15,272
Net Changes-WC	(2,223)	6,037	(1,164)	(1,156)
Direct tax	(2,328)	(2,246)	(2,781)	(3,308)
Net cash from Op. activities	**6,987**	**14,959**	**9,154**	**10,808**
Capital expenditures	(1,947)	(2,968)	(2,942)	(3,161)
Interest / Dividend Income	-	-	-	-
Others	(772)	2,025	-	-
Net Cash from Invt. activities	**(2,719)**	**(943)**	**(2,942)**	**(3,161)**
Issue of share cap. / premium	3	4	-	-
Debt changes	(3,004)	(5)	-	-
Dividend paid	(6,504)	(952)	(952)	(952)
Interest paid	(29)	(358)	(180)	(180)
Others	4,539	(5,386)	-	-
Net cash from Fin. activities	**(4,995)**	**(6,697)**	**(1,132)**	**(1,132)**
Net change in cash	**(727)**	**7,319**	**5,080**	**6,515**
Free Cash Flow	5,040	11,991	6,212	7,647

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY19	FY20E	FY21E	FY22E
Per Share(Rs)				
EPS	45.9	39.3	46.9	55.5
CEPS	55.9	52.0	61.6	71.6
BVPS	201.4	202.6	243.6	293.3
FCF	30.7	72.9	37.7	46.4
DPS	33.0	5.0	5.0	5.0
Return Ratio(%)				
RoCE	28.4	24.4	24.5	23.5
ROIC	30.6	23.1	20.6	19.3
RoE	24.9	19.5	21.0	20.7
Balance Sheet				
Net Debt : Equity (x)	(0.3)	(0.5)	(0.5)	(0.6)
Debtor (Days)	69	62	62	62
Valuation(x)				
PER	16.2	18.9	15.9	13.4
P/B	3.7	3.7	3.1	2.5
P/CEPS	55.5	51.6	61.1	71.0
EV/EBITDA	10.6	10.5	9.0	7.3
EV/Sales	1.6	1.4	1.2	1.0
Dividend Yield (%)	4.4	0.7	0.7	0.7

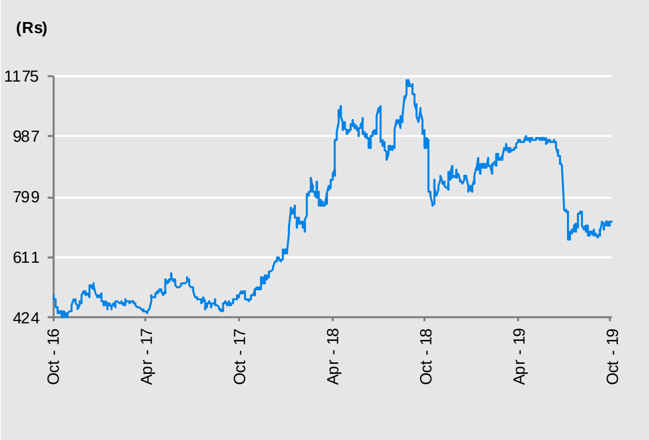
Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Net Revenue	**17,872**	**18,394**	**18,342**	**19,143**
YoY gr. (%)	*29.7*	*25.6*	*11.9*	*9.1*
Raw Material Expenses	11,142	11,504	12,532	12,647
Gross Profit	6,730	6,890	5,810	6,496
Margin (%)	*37.7*	*37.5*	*31.7*	*33.9*
EBITDA	**2,833**	**2,803**	**1,841**	**2,482**
YoY gr. (%)	*36.6*	*19.0*	*(20.3)*	*(8.0)*
Margin (%)	*15.9*	*15.2*	*10.0*	*13.0*
Depreciation / Depletion	410	428	669	707
EBIT	**2,423**	**2,375**	**1,172**	**1,775**
Margin (%)	*13.6*	*12.9*	*6.4*	*9.3*
Net Interest	-	-	130	138
Other Income	(200)	290	220	197
Profit before Tax	**2,223**	**2,665**	**1,262**	**1,834**
Margin (%)	*12.4*	*14.5*	*6.9*	*9.6*
Total Tax	311	681	335	484
Effective tax rate (%)	*14.0*	*25.6*	*26.5*	*26.4*
Profit after Tax	**1,912**	**1,984**	**927**	**1,350**
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	**1,912**	**1,984**	**927**	**1,350**
YoY gr. (%)	*35.1*	*8.9*	*(41.4)*	*(34.5)*
Margin (%)	*10.7*	*10.8*	*5.1*	*7.1*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**1,912**	**1,984**	**927**	**1,350**
YoY gr. (%)	*35.1*	*8.9*	*(41.4)*	*(34.5)*
Margin (%)	*10.7*	*10.8*	*5.1*	*7.1*
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	**1,912**	**1,984**	**927**	**1,350**
Avg. Shares O/s (m)	165	165	164	165
EPS (Rs)	**11.6**	**12.1**	**5.6**	**8.2**

Source: Company Data, PL Research

Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	3-Oct-19	Reduce	687	720
2	18-Jul-19	Reduce	755	750
3	4-Jul-19	Reduce	817	899
4	10-Jun-19	Reduce	873	970
5	18-Apr-19	Reduce	873	972
6	5-Apr-19	Reduce	873	947
7	20-Mar-19	Hold	887	943
8	16-Jan-19	BUY	1,140	841
9	7-Jan-19	BUY	1,140	835
10	18-Oct-18	BUY	1,140	978

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	Hold	507	466
2	HCL Technologies	BUY	1,210	1,077
3	Hexaware Technologies	Hold	347	369
4	Infosys	Hold	819	815
5	L&T Technology Services	Accumulate	1,709	1,591
6	Larsen & Toubro Infotech	Accumulate	1,665	1,505
7	Mindtree	Reduce	687	720
8	Mphasis	Accumulate	1,038	937
9	NIIT Technologies	Accumulate	1,445	1,368
10	Persistent Systems	Hold	534	560
11	Redington (India)	BUY	114	108
12	Sonata Software	Accumulate	382	313
13	Tata Consultancy Services	Hold	1,985	2,004
14	TeamLease Services	Hold	3,203	2,965
15	Tech Mahindra	Reduce	619	703
16	Wipro	Reduce	245	244
17	Zensar Technologies	Accumulate	249	211

PL's Recommendation Nomenclature (Absolute Performance)

Buy : > 15%
Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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