

View: Muted growth, generous appraisal hollows down the profitability

Mindtree reported disastrous quarterly earnings with a muted revenue growth of 1.1% in CC terms and an OPM decline of over 650bps sequentially in Q1FY20. The revenue growth slip was on account of weaker-than-expected ramp-up on deals owing to the uncertainty around the management changes; while profitability took a blow as Mindtree made generous appraisals (announced one-time special rewards to employees as Mindtree celebrated completion of 20 years in operations of about ₹450mn, on top of regular wage hikes) to its employees.

The departing management reiterated the confidence on financial performance for FY20 and still expects company to deliver industry leading revenue growth and better profitability for FY20 on YoY basis. However, we do not subscribe to the same given the terrible start to the year and significant attrition at the Top leadership level (three founders and few other KMPs have resigned in last one month). We see that deteriorating financial performance and uncertainty around the Top-leadership could prolong the pain in its performance for some more time. Accounting for the steep earnings cuts (28%/11% for FY20/21e) and ascribing lower valuation multiple of 14x (earlier 16x) we have downgraded our rating on Mindtree to SELL with a TP of ₹ 700 valued at 14x FY21E earnings.

Transition pains to impact near term performance

Despite the weak start, the departing management is still confident of a sharp comeback in growth performance Q2 onwards as it signed its best ever contract closures in the quarter at US\$324mn. However, we believe that the uncertainty around the transition-plans may prolong the pain. The current leadership of Mindtree has resigned effective 17th July from the board but the new management (L&T) has not announced replacement for the CEO and few other top-positions that have got vacated in last few weeks amidst hostile takeover.

New leadership and its renewed strategy holds the key

Announcement of the new CEO (and other KMPs) and the renewed strategic roadmap would be the key determining factor for Mindtree's performance in the near term. However, given the immediate priority on stabilizing the team and profitability; the new management would give a push back its 'Growth' agenda on the back burner.

Q1FY20 Result (₹ Mn)

Particulars	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Revenue	18,342	16,395	11.9	18,394	(0.3)
Total Expense	16,501	14,085	17.2	15,591	5.8
EBITDA	1,841	2,310	(20.3)	2,803	(34.3)
Depreciation	669	400	67.3	428	56.3
EBIT	1,172	1,910	(38.6)	2,375	(50.7)
Other Income	220	279	(21.1)	290	(24.1)
Interest	130	28	364.3	0	
EBT	1,262	2,161	(38.6)	2,665	(52.6)
Tax	335	579	(42.1)	681	(50.8)
RPAT	927	1,582	(41.4)	1,984	(53.3)
APAT	927	1,582	(41.4)	1,984	(53.3)
			(bps)		(bps)
Gross Margin (%)	31.7	36.6	(492)	37.5	(578)
EBITDA Margin (%)	10.0	14.1	(405)	15.2	(520)
NPM (%)	5.1	9.6	(460)	10.8	(573)
Tax Rate (%)	26.5	26.8	(25)	25.6	99
EBIT Margin (%)	6.4	11.6	(526)	12.9	(652)

CMP	₹ 752
Target / Downside	₹ 700 / 7%
BSE Sensex	38,715
NSE Nifty	11,553

Scrip Details

Equity / FV	₹ 1,642mn / ₹ 10
Market Cap	₹ 124bn
	US\$ 2bn
52-week High/Low	₹ 1,184/₹ 735
Avg. Volume (no)	957,501
NSE Symbol	MINDTREE
Bloomberg Code	MTCL IN

Shareholding Pattern Jun'19(%)

Promoters	13.3
MF/Banks/FIs	7.7
FII	36.2
Public / Others	42.9

Valuation (x)

	FY19A	FY20E	FY21E
P/E	16.4	20.8	15.0
EV/EBITDA	11.4	11.5	8.8
ROE (%)	24.9	17.2	21.4
RoACE (%)	24.8	18.3	22.3

Estimates (₹ mn)

	FY19A	FY20E	FY21E
Revenue	70,215	76,339	84,539
EBITDA	10,645	10,498	13,707
PAT	7,541	5,934	8,236
EPS (₹)	45.9	36.1	50.2

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Exhibit 1: Quarterly performance versus estimates

(in ₹ mn)	Actual	Estimates		% Variation		Comment
		Dolat	Consensus	Dolat	Consensus	
Revenues (in US\$ mn)	264.2	268.3	267.0	(1.5)	(1.0)	Revenue missed on weak deal ramp-up
Sales	18,342	18,692	18,580	(1.9)	(1.3)	
EBIT	1,172	2,131	2,191	(45.0)	(46.5)	OPM declines largely on wage-hike, special compensation rewards
EBIT Margin (%)	6.4	11.4	11.8	(500 bps)	(540 bps)	
PAT	927	1,762	1,800	(47.4)	(48.5)	PAT halves on weak OPM

Source: Company, DART

Change in estimates

Strong TCV wins have supported our stable revenue outlook for the company in FY20/21E. However, the sharp drop in profitability in Q1 and significant attrition in KMPs has resulted in significant cut in our OPM estimate for FY20/21E. We believe the earnings performance may remain volatile in near term as profitability may recover sharply as growth rate improves (as guided by the management). However conservatively we are now factoring gradual recovery in financial performance over Q2-Q4 and thus have resulted in steep ~28%/11% decline in our FY20/21E earnings estimates.

Exhibit 2: Change in estimates

(₹ mn)	FY20E			FY21E		
	Old	New	% change	Old	New	% change
Revenues (US\$ mn)	1,108	1,100	(0.8)	1,206	1,208	0.2
YoY growth (%)	10.6	9.8		8.8	9.8	
Revenues	77,191	76,339	(1.1)	84,401	84,539	0.2
EBITDA	13,361	10,498	(21.4)	14,886	13,707	(7.9)
EBIT Margin (%)	17.3	13.8		17.6	16.2	
Net profits	8,317	5,934	(28.7)	9,241	8,236	(10.9)
EPS (₹)	50.5	36.0	(28.7)	56.1	50.0	(10.9)

Source: Company, DART

Exhibit 3: Key assumptions in our estimates

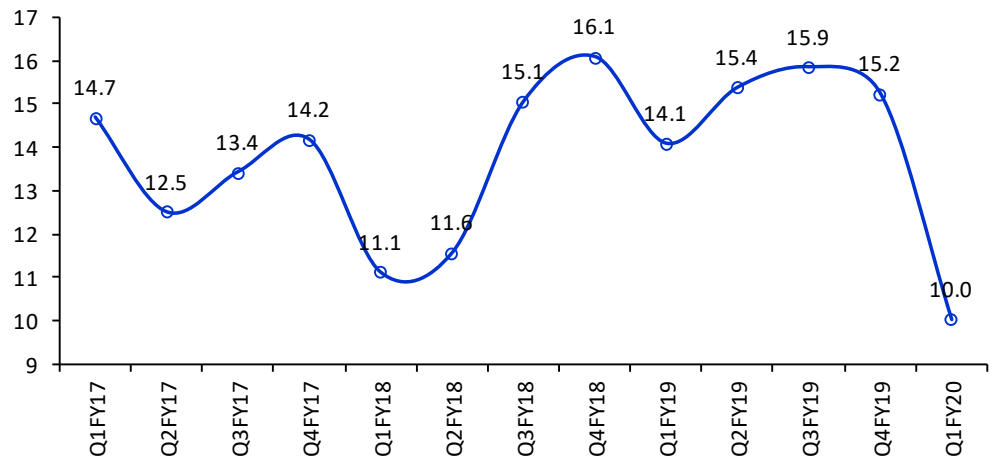
Metrics	FY20E	FY21E
USD Revenue (Mn)	1,100	1,208
USD Revenue growth (%)	9.8	9.8
USD/INR	69.4	70.0
INR Revenue growth (%)	8.7	10.7
EBITDA Margins (%)	13.8	16.2
EPS growth (%)	(21.3)	38.8

Source: Company, DART

EBITDA Margin trickle down sharply

Mindtree reported a sharp decline of 520bps QoQ in its EBITDA margin in Q1FY20 due to wage hike (-190bps), visa cost (-30bps), one-time impact due to rewards to employees (-260bps) and rupee appreciation (-40bps). The management expects margin improvement in Q2 aided by healthy deal momentum, better cost management and operational efficiencies.

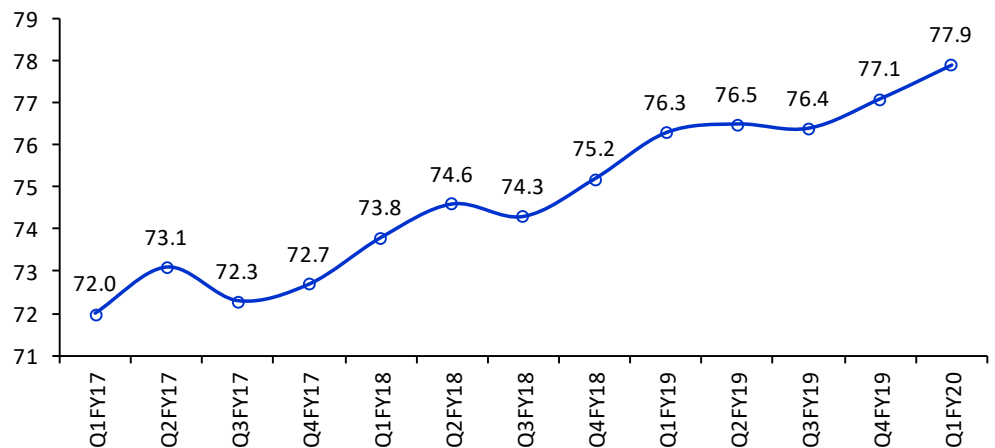
Exhibit 4: Sharp decline in EBITDA margin (%)



Source: Company, DART

Improved Utilisation: Utilisation (excluding trainees) improved by 80bps QoQ to 77.9% in Q1FY20.

Exhibit 5: Utilisation improves but margin declines

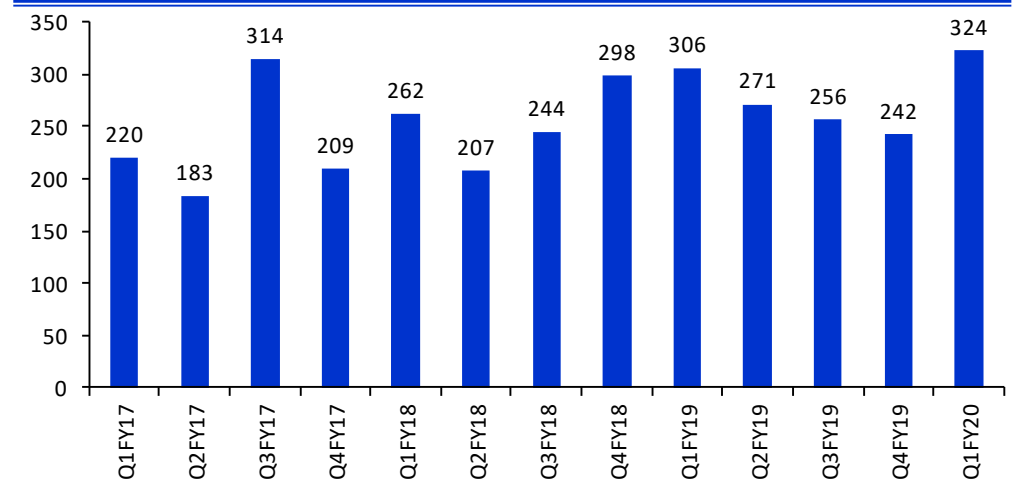


Source: Company, DART

Healthy TCV win

TCV win during the quarter improved by 5.9% YoY to USD 324mn during the quarter. Out of the total TCV win, USD 248mn TCV were renewals and USD 76mn were new during the quarter. The management remained confident on the deal momentum and order pipeline going ahead, which would help Mindtree achieve industry leading growth in FY20.

Exhibit 6: Strong TCV wins to aid future growth



Source: Company, DART

Digital Reclassification

Digital revenues contributed 38% of sales and grew 3.6% QoQ/ 19.1% YoY in Q1FY20. Company also shared further split for its Digital revenue – a) Interactive (accounts for 23.9% of revenues) which grew by 7.1% QoQ, Data Science & Engineering Services (accounts for 10.5%) which declined by 2.9% QoQ, Cloud Services (contributed about 3.3%) which grew by 7.3% QoQ and Others (0.3% of revenues) which declined 39.5% QoQ.

Exhibit 7: Digital Revenue breakup

(Revenue USD Mn)	Q1FY20	Q4FY19	QoQ (%)	Q1FY19	YoY (%)
Interactive	63	59	7.1	52	20.5
Data Science & Engineering Services	28	29	(2.9)	25	11.5
Cloud Services	9	8	7.3	7	28.9
Others	1	1	(39.5)	0	228.2
Total Digital	100	97	3.6	84	19.1

Source: Company, DART

Outlook: The management has guided for strong revenue growth in FY20 (above industry growth) helped by strong deal wins and healthy pipeline. Margin in Q2FY20 will be impacted by wage hike to senior management (-100bps) however despite this management expects it to improve profitability sequentially as cost would normalise for the one-time impact of special reward to employee in Q1FY20.

Profit and Loss Account

(₹ Mn)	FY18A	FY19A	FY20E	FY21E
Revenue	54,628	70,215	76,339	84,539
Total Expense	47,223	59,570	65,841	70,832
COGS	35,641	44,212	49,696	53,655
Employees Cost	0	0	0	0
Other expenses	11,582	15,358	16,145	17,177
EBIDTA	7,405	10,645	10,498	13,707
Depreciation	1,715	1,641	2,757	2,980
EBIT	5,690	9,004	7,741	10,727
Interest	169	29	505	480
Other Income	1,902	893	825	980
Exc. / E.O. items	0	0	0	0
EBT	7,423	9,868	8,061	11,227
Tax	1,722	2,327	2,127	2,991
RPAT	5,701	7,541	5,934	8,236
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	5,701	7,541	5,934	8,236

Balance Sheet

(₹ Mn)	FY18A	FY19A	FY20E	FY21E
Sources of Funds				
Equity Capital	1,639	1,642	1,642	1,642
Minority Interest	0	0	0	0
Reserves & Surplus	25,779	31,423	34,402	39,288
Net Worth	27,418	33,065	36,044	40,930
Total Debt	94	179	179	179
Net Deferred Tax Liability	(3)	361	361	361
Total Capital Employed	27,509	33,605	36,584	41,470

Applications of Funds

Net Block	9,568	9,966	11,416	14,716
CWIP	92	0	0	0
Investments	2,356	3,764	4,264	4,889
Current Assets, Loans & Advances	25,031	27,672	30,376	33,262
Inventories	0	0	0	0
Receivables	10,155	13,356	16,106	18,456
Cash and Bank Balances	3,289	2,562	2,516	3,052
Loans and Advances	11,587	11,754	11,754	11,754
Other Current Assets	0	0	0	0
Less: Current Liabilities & Provisions	9,538	7,797	9,472	11,397
Payables	1,710	2,131	2,881	3,681
Other Current Liabilities	7,828	5,666	6,591	7,716
Net Current Assets	15,493	19,875	20,904	21,865
Total Assets	27,509	33,605	36,584	41,470

E – Estimates

Important Ratios

Particulars	FY18A	FY19A	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	34.8	37.0	34.9	36.5
EBIDTA Margin	13.6	15.2	13.8	16.2
EBIT Margin	10.4	12.8	10.1	12.7
Tax rate	23.2	23.6	26.4	26.6
Net Profit Margin	10.4	10.7	7.8	9.7
(B) As Percentage of Net Sales (%)				
COGS	65.2	63.0	65.1	63.5
Employee	0.0	0.0	0.0	0.0
Other	21.2	21.9	21.1	20.3
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	33.7	310.5	15.3	22.3
Inventory days	0	0	0	0
Debtors days	68	69	77	80
Average Cost of Debt	82.8	21.2	282.1	268.2
Payable days	11	11	14	16
Working Capital days	104	103	100	94
FA T/O	5.7	7.0	6.7	5.7
(D) Measures of Investment				
AEPS (₹)	34.8	45.9	36.1	50.2
CEPS (₹)	45.2	55.9	52.9	68.3
DPS (₹)	7.0	33.0	15.0	17.0
Dividend Payout (%)	20.1	71.9	41.5	33.9
BVPS (₹)	167.3	201.4	219.5	249.3
RoANW (%)	21.4	24.9	17.2	21.4
RoACE (%)	22.0	24.8	18.3	22.3
RoAIC (%)	24.0	32.6	23.8	29.6
(E) Valuation Ratios				
CMP (₹)	752	752	752	752
P/E	21.6	16.4	20.8	15.0
Mcap (₹ Mn)	123,503	123,503	123,503	123,503
MCap/ Sales	2.3	1.8	1.6	1.5
EV	120,308	121,120	121,167	120,630
EV/Sales	2.2	1.7	1.6	1.4
EV/EBITDA	16.2	11.4	11.5	8.8
P/BV	4.5	3.7	3.4	3.0
Dividend Yield (%)	0.9	4.4	2.0	2.3
(F) Growth Rate (%)				
Revenue	4.3	28.5	8.7	10.7
EBITDA	3.1	43.8	(1.4)	30.6
EBIT	6.9	58.2	(14.0)	38.6
PBT	28.6	32.9	(18.3)	39.3
APAT	29.3	32.3	(21.3)	38.8
EPS	32.5	32.0	(21.3)	38.8
Cash Flow				
(₹ Mn)	FY18A	FY19A	FY20E	FY21E
CFO	5,644	6,356	8,121	11,271
CFI	(2,000)	(1,984)	(1,950)	(3,925)
CFF	(2,877)	(5,088)	(6,215)	(6,809)
FCFF	4,633	4,673	6,671	7,971
Opening Cash	2,508	3,275	2,559	2,516
Closing Cash	3,275	2,559	2,516	3,052

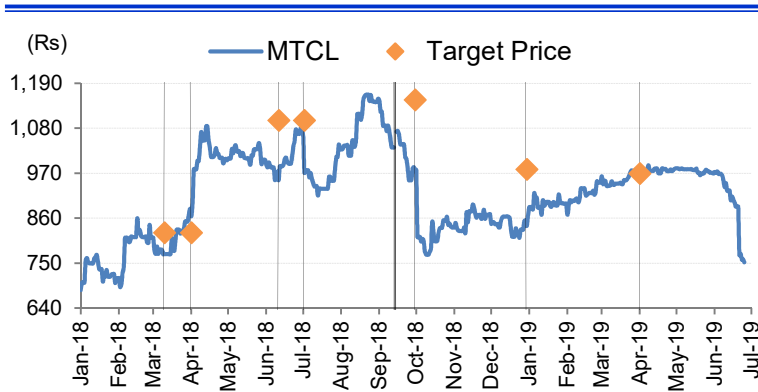
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)
Mar-18	Reduce	825	773
Apr-18	Sell	825	865
Jun-18	Accumulate	1,100	953
Jul-18	Accumulate	1,100	971
Oct-18	Accumulate	1,150	978
Jan-19	Accumulate	980	841
Apr-19	Reduce	970	969

*Price as on recommendation date

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