

Operationally healthy, attrition still a key concern...

After a weak quarter performance in Q1FY20, Mindtree reported a good Q2FY20 with beat on revenues and in-line margins. Revenues in constant currency grew by 3.2% QoQ and 11.1% YoY while adjusted EBITDA margins expanded 40 bps QoQ to 13%. Growth in revenues was broad based among verticals across geographies. In terms of digital revenues, it increased 2.6% QoQ & 18.7% YoY and comprised 38% of revenues while digital TCV was up 2.2% QoQ. Pointers which were key draggers in this quarter were 1) Dip in total TCV by 5.2% QoQ 2) Increase in attrition to 16.5% (vs. 13% in Q2FY19) and 3) Decline in top 2-5 clients by 4.3% QoQ.

Revenues on improving growth trajectory

Revenue growth of 2.6% QoQ was driven by volume growth as realization dipped 4.2% on the back of higher offshoring effort and ramp up of certain projects which are not billed. Top customer was the prime contributor to the growth as revenues from it grew 5.1% on QoQ basis. In the same respects, management indicated that most of renewals with the client has been done giving visibility till mid CY20. On the order book front, company's order book declined 5.2% QoQ to US\$307 million wherein TCV from new increased 1.6x while TCV from the renewals dipped 25% QoQ. This implies healthy deal pipeline from the new business while weakness in existing business could be due to the delay in decision making by the customers in the midst of leadership transition at the company. However, management commentary of a healthy pipeline and deal ramp ups expected in H2FY20E, bodes well for revenue growth in FY20E. Hence, we expect the company's overall dollar revenue to grow at a CAGR of 9.7% to \$1,205 million in FY19-21E.

Margins likely to improve in H2FY20E

Adjusted EBITDA margins expanded 40 bps QoQ to 13% and was in-line with our expectation. Management expects margins to improve on QoQ basis for H2FY20E with factors as employee pyramid, offshoring and annuity business to play part. Additionally, certain deals of which costs were incurred in Q2FY20 is likely to convert to revenues in Q3, is expected to act as a tailwind for margins. We expect margins to improve to 15.0% in FY21E.

Valuation & Outlook

Increasing attrition from last 4-5 quarters and decline in realisation is a key near term concern. However, steady quarter, healthy deal pipeline from the new business and expected margin improvement in coming quarters are key positives to be look at. Hence, we revise our recommendation from REDUCE to **HOLD** with a revised target price of ₹ 690/share. Key things to watch out in coming quarters are 1) Attrition 2) Realisation 3) Deal TCV and 4) Digital revenue growth.



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	11,953.0
Total Debt (₹ Crore)	0.5
Cash and Investments (₹ Crore)	939.8
EV (₹ Crore)	11,013.7
52 week H/L	998 / 652
Equity capital	164.2
Face value	₹ 10

Key Highlights

- Top client growth, deal TCV from new business and digital revenues to be key growth drivers. A key risk to our growth assumption is spike in attrition due to changes in leadership and management structure
- Levers visible to improve margins from hereon. Though low base in Q1FY20 to keep margins in FY20E lower than FY19
- Revise our recommendation from REDUCE to HOLD with revised target price of ₹ 690

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Key Financial Summary

Key Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	5,236	5,463	7,022	7,723	8,557	10.4%
EBITDA	705	741	1,065	1,004	1,284	9.8%
EBITDA Margins (%)	13.5	13.6	15.2	13.0	15.0	
Net Profit	419	570	754	553	752	-0.1%
EPS (₹)	24.9	34.3	45.9	33.7	45.8	
P/E	29.2	21.2	15.9	21.6	15.9	
RoNW (%)	16.2	20.8	22.8	15.3	18.6	
RoCE (%)	21.2	24.9	29.8	22.1	26.5	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q2FY20	Q2FY20E	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Comments
Revenue	1,914.3	1,887.3	1,755.4	9.1	1,834.2	4.4	US\$ revenues grew 2.6% QoQ to \$271 million led by broad based growth across verticals and growth in top client was key contributor
Employee expenses	1,264.7	1,236.2	1,117.1	13.2	1,253.2	0.9	
Gross Margin	649.6	651.1	638.3	1.8	581.0	11.8	
Gross margin (%)	33.9	34.5	36.4	-243 bps	31.7	226 bps	
SG&A expenses	401.4	405.8	368.4	9.0	396.9	1.1	
EBITDA	248.2	245.4	269.9	-8.0	184.1	34.8	
EBITDA Margin (%)	13.0	13.0	15.4	-241 bps	10.0	293 bps	Adjusted EBITDA margins expanded 40 bps QoQ on account of second leg of compensation (-150 bps) partially offset by operational efficiency in terms of utilisation uptick & higher offshoring (+140 bps) and currency (+50 bps)
Depreciation	70.7	67.9	40.3	75.4	66.9	5.7	
EBIT	177.5	177.4	229.6	-22.7	117.2	51.5	
EBIT Margin (%)	9.3	9.4	13.1	-381 bps	6.4	288 bps	
Other income	19.7	23.7	52.4	-62.4	22.0	-10.5	
PBT	197.2	201.1	282.0	-30.1	139.2	41.7	
Tax paid	59.2	49.8	83.4	-29.0	35.4	67.2	
PAT	135.0	140.1	206.3	-34.6	92.7	45.6	PAT came in below our estimates on the back of lower other income

Key Metrics

Closing employees	21,267	21,435	19,402	9.6	20,935	1.6	
Attrition (%)	16.5	15.3	13.0	350 bps	15.1	140 bps	Attrition spiked sharply by 140 bps QoQ and remains a key concern
Utilisation ex-trainees(%)	79.0	77.5	76.5	250 bps	77.9	110 bps	
Average \$/₹	70.6	70.4	71.2	-0.8	69.4	1.7	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	7,604	7,723	1.6	8,368	8,557	2.3	Revision in revenue estimates due to change in exchange rate assumptions
EBITDA	1,011	1,004	-0.7	1,255	1,284	2.3	
EBITDA Margin (%)	13.3	13.0	-30 bps	15.0	15.0	0 bps	Kept FY21E margin estimates intact, while being conservative on FY20E estimates
PAT	619	553	-10.8	802	752	-6.2	
EPS (₹)	37.7	33.7	-10.8	48.8	45.8	-6.2	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook:** Management alluded its continuous focus on growth momentum going in H2. New deal pipeline which has grown 2.5x YoY, deal ramp ups expected to happen in second half of this fiscal along with optimistic outlook in broad verticals gives us the confidence of healthy revenue growth in next two quarters
- **Margin walkthrough:** EBITDA margin expanded 300 bps QoQ to 13% on low Q2 base while on adjusted terms, margins increased 40 bps QoQ. The movement in margins was on account of second leg of compensation (-150 bps) partially offset by operational efficiency in terms of utilisation uptick & higher offshoring (+140 bps) and currency (+50 bps). Management expects margins to improve on QoQ basis for H2FY20E
- **Key draggers in the quarter:** Pointers which were key draggers in this quarter were 1) Dip in total TCV by 5.2% QoQ 2) Increase in attrition to 16.5% (vs. 13% in Q2FY19) and 3) Decline in top 2-5 clients by 4.3% QoQ. In the same respects, management cited that decline in total TCV was just a timing difference due to the nature of the projects and same has impacted top 2-5 client's growth. Increase in attrition for last 4-5 quarters has been mainly due to the leadership transition phase. Post the leadership change, there has been some attrition even at senior level, though stability is coming back as per management
- **Order book:** The company's order book declined 5.2% QoQ to US\$307 million wherein TCV from new increased 2.5x YoY while TCV from the renewals dipped 16.2% YoY. The change in management could have led to dip in renewals. We expect renewals to gain momentum in coming quarters. The digital order book increased 2.2% QoQ to US\$140 million. Digital order book accounts for 46% of overall order book. Dip in overall order book was due to the timing difference, hence quarter to quarter volatility could be there
- **Clientele details:** Top customer contribution to overall revenues was at 20.6% in the quarter and witnessed growth of 5.1% QoQ. Top 2-5 customers dipped 4.3% QoQ while top 6-10 customers grew 8% QoQ. Three clients were dropped from active client base on sequential basis taking the active client base to 343. MTL added three clients in the \$1 million bucket
- **Employee update:** With net hiring of 332 in Q2 (1063 in H1), employee strength stood at 21,267. Utilisation (ex-trainees) improved 110 bps QoQ to 79% and is at multi quarter high
- **Tax rate:** Tax as a percentage of PBT was at 26.4% in Q2FY20. Management stated ETR in the similar range is expected for next two years and will not incorporate the new tax regime announced as of now

Key Metrics

Exhibit 3: Geography wise break-up

	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Revenue by geography (%)						
US	72.7	73.6	73.4	73.6	73.7	73.7
Europe	20.1	18.7	18.7	18.5	17.8	17.6
India	3.1	3.3	3.6	3.7	4.1	4.2
RoW	4.2	4.4	4.2	4.2	4.4	4.5
Growth QoQ (%)						
US	9.3	3.3	1.8	4.5	1.0	2.6
Europe	1.7	-5.1	2.1	3.1	-3.0	1.4
India	3.4	8.6	11.3	7.1	11.7	5.1
RoW	-4.6	6.9	-2.6	4.2	5.6	4.9

Source: Company, ICICI Direct Research

Growth was broad based across geographies

Exhibit 4: Industry wise break-up

	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Revenue by verticals (%)						
Technology, Media & services	38.9	39.3	39.4	39.6	39.4	39.8
BFSI	22.3	22.4	21.7	21.8	21.6	21.6
Retail, CPG & Mfg	23.1	21.7	22.3	22.2	22.2	21.7
Travel & Hospitality	15.8	16.7	16.7	16.4	16.8	16.9
Growth QoQ (%)						
Technology, Media & services	9.3	3.1	2.3	4.7	0.3	3.6
BFSI	4.9	2.5	-1.1	4.7	-0.1	2.6
Retail, CPG & Mfg	4.9	-4.2	4.9	3.7	0.8	0.3
Travel & Hospitality	6.1	7.8	2.1	2.3	3.3	3.2

Source: Company, ICICI Direct Research

Within BFSI, seeing decent growth in insurance and Tier 2 banks

Within retail & CPG, company has major presence in CPG than retail. This is the major reason for the vertical not feeling the pressure compared to other IT companies

Exhibit 5: Service offerings break up

	Q2FY19	Q1FY20	Q2FY20	QoQ	YoY
Revenue by service offerings (%)					
Interactive	20.7	23.9	23.8	2.1	26.5
Data Science and Engineering services	10.5	10.5	11	7.5	15.2
Cloud Services	3.6	3.3	3	-6.8	-8.3
Others	0.4	0.3	0.2	-31.6	-45.0
Total Digital	35.2	38.0	38.0	2.6	18.7
Test Engineering	18.9	18.2	18.7	5.4	8.8
Package Solutions	8.2	7.4	7	-3.0	-6.1
Infrastructure Management & Tech Support	23.3	23.8	24.6	6.0	16.1
ADM and Product Engineering	14.4	12.6	11.7	-4.8	-10.6

Source: Company, ICICI Direct Research

Digital growth remains strong

Exhibit 6: Client & human resource matrix

	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
<i>Client metrics</i>						
\$1 mn Clients	117	111	116	120	122	130
\$10 mn Clients	19	21	21	23	23	21
\$25 mn Clients	4	4	4	4	4	4
\$50 mn Clients	1	1	1	1	1	1
\$100 mn Clients	1	1	1	1	1	1
<i>Headcount, Utilization & Attrition</i>						
Total Employees	18990	19402	19908	20204	20935	21267
Utilization (Excluding trainees)	76.3	76.5	76.4	77.1	77.9	79.0
LTM Attrition	12.2	13.0	13.4	14.2	15.1	16.5

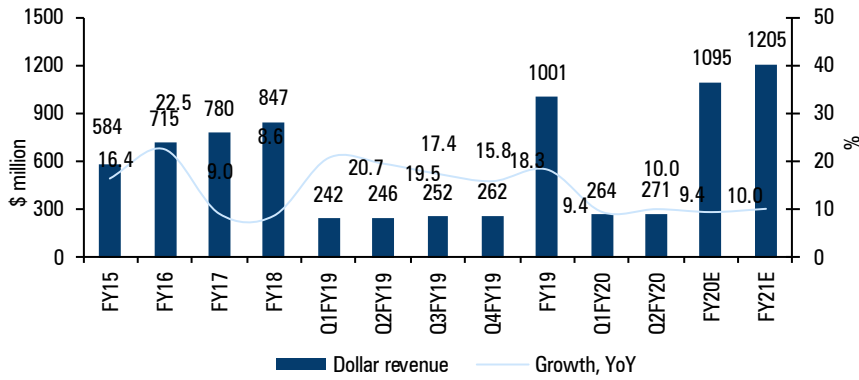
Source: Company, ICICI Direct Research

The company added eight clients in US\$1 million bucket

Increase in attrition remains key risk for the company

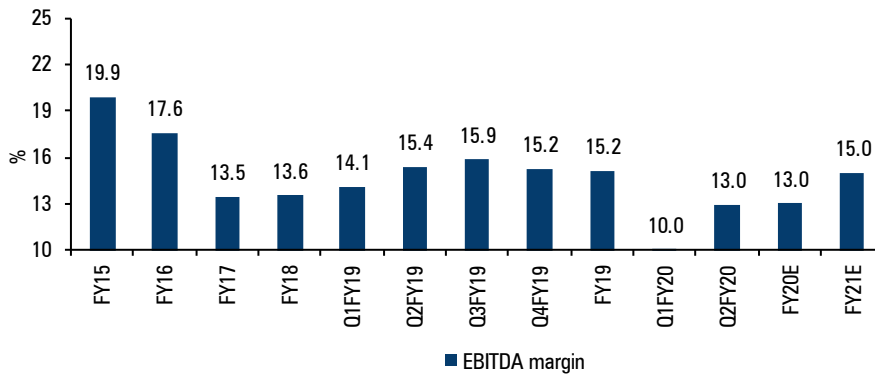
Financial story in charts

Exhibit 7: Dollar revenues to increase 9.7% over FY19-21E



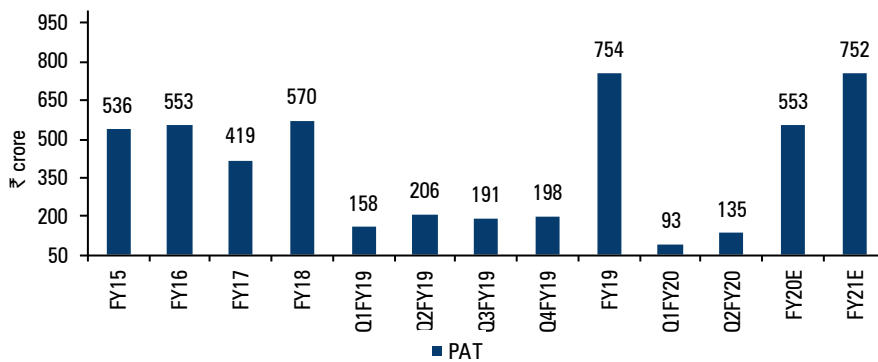
Source: Company, ICICI Direct Research

Exhibit 8: Keep EBITDA margin estimates intact for FY21E



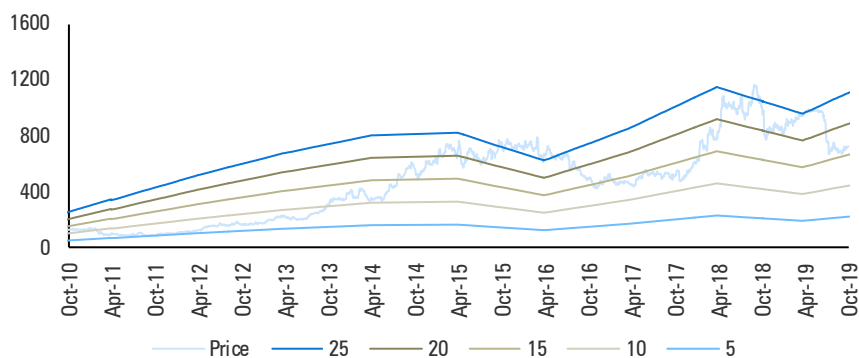
Source: Company, ICICI Direct Research

Exhibit 9: PAT trend



Source: Company, ICICI Direct Research

Exhibit 10: One year forward rolling price to earnings



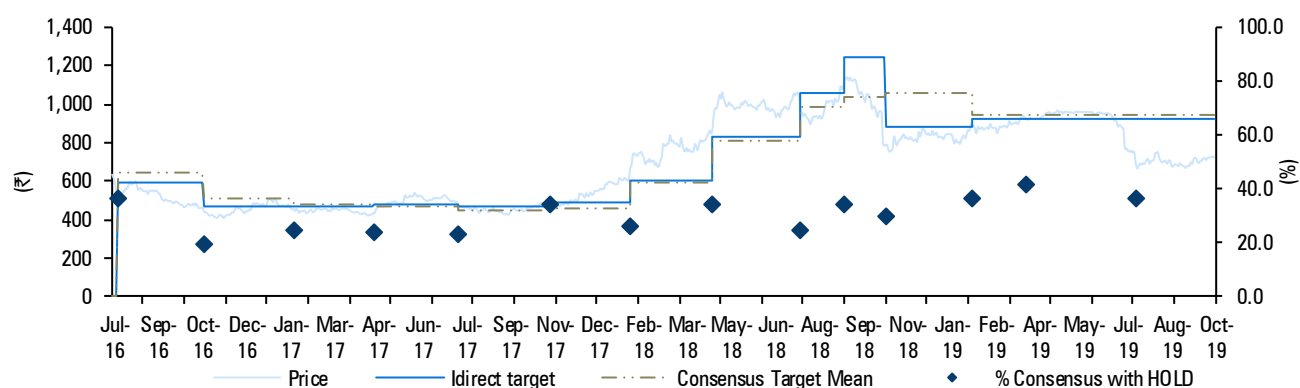
Source: Company, ICICI Direct Research

Exhibit 11: Valuation

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY17	5,236	12.1	24.9	(24.2)	29.2	14.1	22.9	29.1
FY18	5,463	4.3	34.3	37.6	21.2	15.9	16.2	21.2
FY19	7,022	28.5	45.9	34.0	15.9	15.1	20.8	24.9
FY20E	7,723	10.0	33.7	(26.7)	21.6	10.3	22.8	29.8
FY21E	8,557	10.8	45.8	36.1	15.9	10.9	15.3	22.1

Source: Company, ICICI Direct Research

Exhibit 12: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 13: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S Position (m)	Change (m)
1	Larsen & Toubro Ltd	3-Jul-19	60.6%	99.7
2	Nalanda Capital Pte Ltd	30-Jun-19	10.6%	17.4
3	Natarajan (Krishnakumar)	30-Jun-19	3.7%	6.1
4	Bagchi (Subroto)	30-Jun-19	3.1%	5.1
5	Arohi Asset Management Pte. Ltd.	30-Jun-19	2.8%	4.6
6	The Vanguard Group, Inc.	30-Jun-19	2.6%	4.3
7	Amansa Capital Pte Ltd.	30-Jun-19	2.5%	4.1
8	Westwood Global Investments, L.L.C.	30-Jun-19	1.9%	3.2
9	Bagchi (Susmita)	30-Jun-19	1.6%	2.7
10	Janakiraman (S)	30-Jun-19	1.5%	2.5

Source: Reuters, ICICI Direct Research

Exhibit 14: Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Larsen & Toubro Ltd	542.96m	52.20m	Coffee Day Group	-395.34m	-28.06m
Ravanan (Rostow)	11.14m	1.13m	Sundaram Asset Management Company Limited	-6.85m	-0.66m
Union Investment Luxembourg S.A.	4.07m	0.30m	Edelweiss Asset Management Ltd.	-6.44m	-0.62m
Westwood Global Investments, L.L.C.	3.91m	0.29m	Pictet Asset Management Ltd.	-7.68m	-0.56m
Mirae Asset Global Investments (India) Pvt. Ltd.	2.13m	0.22m	Amansa Capital Pte Ltd.	-5.94m	-0.44m

Source: Reuters, ICICI Direct Research

Exhibit 15: Shareholding Pattern

(in %)	Mar-19	Jun-19	Sep-19
Promoter	13.32	13.32	73.76
FII	86.68	86.68	26.24
DII	0.00	0.00	0.00
Others	100.00	100.00	100.00

Source: Company, ICICI Direct Research

Financial summary

Exhibit 16: Profit and loss statement				
	₹ crore			
	FY18	FY19	FY20E	FY21E
Total Revenues	5,463	7,022	7,723	8,557
Growth (%)	4.3	28.5	10.0	10.8
COGS	3,564	4,421	5,097	5,477
Other Expenses	1,158	1,536	1,622	1,797
EBITDA	741	1,065	1,004	1,284
Growth (%)	5.1	43.8	(5.7)	27.9
Depreciation	172	164	286	317
Other Income	190	89	86	110
Interest paid	17	3	52	53
PBT before Exceptional Items	742	987	752	1,024
PBT	742	987	752	1,024
Growth (%)	33.8	32.9	(23.8)	36.1
Total Tax	172	233	199	271
PAT before MI	570	754	553	752
Minority Int & Pft. from associa	-	-	-	-
PAT	570	754	553	752
EPS - diluted	34.3	45.9	33.7	45.8
EPS (Growth %)	37.6	34.0	(26.7)	36.1

Source: Company, ICICI Direct Research

Exhibit 17: Cash flow statement				
	₹ crore			
	FY18	FY19	FY20E	FY21E
Net profit before Tax	742	987	752	1,024
Depreciation	172	164	286	317
(inc)/dec in Current Assets	(214)	(366)	(278)	(203)
(inc)/dec in current Liabilities	130	130	75	27
CF from operations	564	630	541	756
Other Investments	(99)	(23)	86	110
(Purchase)/Sale of Fixed Asset	(101)	(171)	(309)	(342)
CF from investing Activities	(200)	(193)	(223)	(233)
Inc / (Dec) in Equity Capital	0	0	-	-
Inc / (Dec) in sec.loan Funds	196	(300)	-	-
Dividend & Dividend tax	(214)	(218)	(243)	(331)
Interest Paid on Loans	(5)	(4)	(52)	(53)
CF from Financial Activities	(288)	(522)	(295)	(384)
Cash generating during the yea	77	(72)	23	140
Opening cash balance	251	329	257	280
Exchange rate differences	(0)	13	-	-
Closing cash	329	256	280	420

Source: Company, ICICI Direct Research

Exhibit 18: Balance sheet				
	₹ crore			
	FY18	FY19	FY20E	FY21E
Equity	164	164	164	164
Reserves & Surplus	2,578	3,142	3,452	3,873
Networth	2,741	3,307	3,616	4,037
Minority Interest	-	-	-	-
Total Debt	301	1	1	1
Other long term liabilities	9	17	17	17
Source of funds	3,051	3,324	3,634	4,055
Net Block	351	376	399	425
CWIP	9	30	30	30
Other intangible assets&Goodwi	606	591	591	591
Other long term assets	267	415	475	555
Current investments	721	684	684	684
Debtors	1,016	1,336	1,453	1,613
Cash & Cash equivalents	329	256	280	420
Loans and advances	2	12	14	15
Other Current Assets(OCA)	436	480	639	681
Trade payables	171	213	231	256
Other Current liabilities	393	502	544	546
Provisions	122	140	154	154
Application of funds	3,051	3,324	3,634	4,055

Source: Company, ICICI Direct Research

Exhibit 19: Key ratios				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
Adjusted EPS (Diluted)	34.3	45.9	33.7	45.8
BV per share	164.8	201.4	220.2	245.9
DPS	13.0	27.0	14.8	20.2
Cash per Share	19.8	15.6	17.1	25.6
Operating Ratios				
EBITDA Margin (%)	13.6	15.2	13.0	15.0
PBT Margin (%)	13.6	14.1	9.7	12.0
PAT Margin (%)	10.4	10.7	7.2	8.8
Debtor days	68	69	69	69
Creditor days	11	11	11	11
Return Ratios (%)				
RoE	20.8	22.8	15.3	18.6
RoCE	24.9	29.8	22.1	26.5
RoIC	28.6	38.2	27.2	33.1
Valuation Ratios (x)				
P/E	21.2	15.9	21.6	15.9
EV / EBITDA	15.1	10.3	10.9	8.5
Price to Book Value	4.4	3.6	3.3	3.0
EV / Net Sales	2.1	1.6	1.4	1.3
Market Cap / Sales	2.2	1.7	1.5	1.4
Solvency Ratios				
Debt/EBITDA	0.4	0.0	0.0	0.0
Debt / Equity	0.1	0.0	0.0	0.0
Current Ratio	2.1	2.1	2.3	2.4
Quick Ratio	2.1	2.1	2.3	2.4

Source: Company, ICICI Direct Research

Exhibit 20: ICICI Direct coverage universe (IT)

Sector / Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
HCL Tech (HCLTEC)	1,089	1,150	Hold	143,444	74.7	73.7	83.7	14.2	14.4	12.6	9.8	8.8	7.6	26.5	25.7	26.4	24.5	21.7	22.0
Infosys (INFTEC)	768	855	Hold	343,388	35.4	39.1	44.8	22.3	20.2	17.6	15.2	13.6	11.7	32.9	32.4	34.3	23.7	24.2	25.6
MindTree (MINCON)	728	690	Hold	11,953	45.9	33.7	45.8	15.9	21.6	15.9	10.3	10.9	8.5	29.8	22.1	26.5	22.8	15.3	18.6
L&T Intotech (LTINFO)	1,500	1,710	Hold	26,301	87.3	84.1	96.8	17.4	18.0	15.6	12.8	12.1	10.1	40.4	33.0	32.2	31.0	25.1	24.4
NIIT Tech (NIITEC)	1,407	1,345	Hold	8,125	65.7	74.3	83.9	20.1	18.3	16.0	11.1	9.3	7.9	24.2	23.5	23.8	19.9	19.8	19.7
TCS (TCS)	2,010	2,005	Hold	739,500	83.8	86.2	95.5	23.4	22.8	20.6	17.7	16.6	14.8	43.8	42.6	43.9	34.4	33.4	34.4
Tech M (TECMAH)	719	720	Buy	64,661	47.7	45.8	51.7	15.0	15.7	13.9	9.0	9.0	7.8	23.6	21.1	21.2	21.2	17.9	17.8
Wipro (WIPRO)	247	300	Buy	150,558	14.9	17.2	20.5	16.7	14.5	12.2	10.2	9.9	7.9	17.8	18.7	20.0	15.8	18.0	19.1

Source: Company, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavors to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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