

**SELL**

TP: Rs 2,270 | ▼ 9%

**MINDTREE**

| IT Services

| 13 July 2021

## Demand robust; margin weighed down by supply constraints

- Mindtree (MTCL) reported a strong Q1FY22 performance with revenue growth of 7.7% QoQ USD, ahead of our (5.4%) and street estimates
- Despite a record-high gross margin of 40%, EBIT margin declined 80bps QoQ due to elevated SG&A, indicating supply constraints
- Downgrade to SELL on margin headwinds; TP revised to Rs 2,270 (vs. Rs 2,180) on rollover

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**Stellar growth; margins a drag:** MTCL reported an above-expected Q1 operating performance driven by a revenue beat. Dollar revenue growth at 7.7% QoQ was well ahead of our (5.4%) and consensus estimates. EBITDA margin at 20.3% declined 160bps QoQ, largely in line with our expectations. Gross margin at 40.3% (+260bps QoQ) was at a five-year high due to a higher mix of offshore business, but this was more than offset by a rise in SG&A to 20% of sales (five-quarter high) as subcontracting expenses hit a record high at 11.3% of revenue. Net profit at Rs 3.7bn was boosted by Rs 366mn in forex gains. A margin rebound looks unlikely as management announced sustained high hiring levels and another round of wage hikes.

**Secular growth beyond top client:** Revenue from the top client increased 5.4% QoQ, marking higher growth over the prior two quarters. Revenue ex-top client grew 8.6% QoQ, highlighting the company's success in client mining beyond its top account. MTCL plans to lower its top-client concentration going forward. The company clocked record deal wins in Q1 with TCV worth US\$ 504mn, up 34% QoQ and 29% YoY, crossing the half billion mark for the first time and signaling healthy future demand. TCV was broad-based, tilting slightly towards the CMT and RCM verticals and consisting mostly of annuity deals with increasing tenure.

**Covid-hit verticals make a comeback:** While BFSI grew 6.6% QoQ USD in Q1 (rebounding after two weak quarters), verticals adversely affected by Covid-19 such as manufacturing & retail/travel grew 6.3%/12.8% QoQ USD. MTCL has also bagged a major cloud migration deal in the travel space.

**Downgrade to SELL:** MTCL's strong results herald good demand for Indian IT, as indicated by (1) robust TCV, (2) rebound in Covid-hit verticals, and (3) growth in non-top clients. Weak execution, however, remains a concern as SG&A grew 38% QoQ (mostly driven by increased subcontracting costs), causing the EBIT margin to contract 80bps QoQ despite peak gross margins. We expect subdued margins to play spoilsport as more hiring and wage hikes get underway. Consequently, we downgrade the stock from ADD to SELL. On rollover, our new Jun'22 TP stands at Rs 2,270 (vs. Rs 2,180), based on an unchanged one-year forward P/E of 23.4x.

## Key changes

Target	Rating
▲	▼

Ticker/Price	MTCL IN/Rs 2,496
Market cap	US\$ 5.5bn
Free float	87%
3M ADV	US\$ 25.8mn
52wk high/low	Rs 2,618/Rs 963
Promoter/FPI/DII	74%/11%/15%

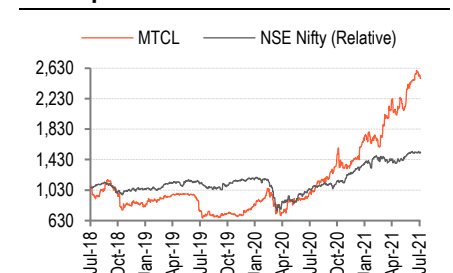
Source: NSE | Price as of 13 Jul 2021

## Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	79,678	98,486	112,947
EBITDA (Rs mn)	16,426	20,603	22,874
Adj. net profit (Rs mn)	11,103	14,436	15,453
Adj. EPS (Rs)	67.4	87.7	93.9
Consensus EPS (Rs)	67.4	82.3	92.7
Adj. ROAE (%)	29.7	31.0	28.4
Adj. P/E (x)	37.0	28.5	26.6
EV/EBITDA (x)	24.8	19.6	17.5
Adj. EPS growth (%)	76.0	30.0	7.0

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE

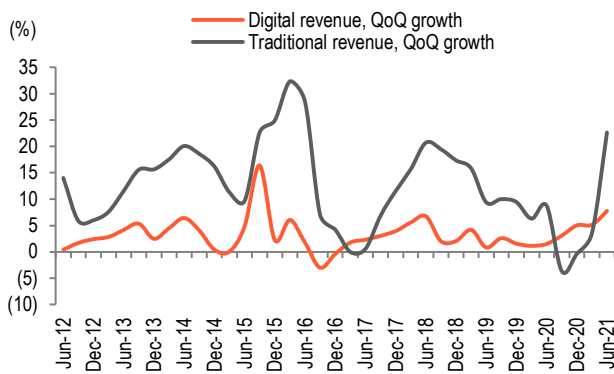


### Earnings call highlights

- EBITDA margin declined 160bps QoQ in Q1FY22 owing to the impact of record net employee additions (-170bps impact) and increased visa cost (-40bps), offset by tailwinds from cross-currency benefits, good growth and operational efficiency (+50bps).
- Management plans to sustain the robust hiring momentum and to dole out another round of wage hikes till the mid-management level.
- Attrition was up 160bps QoQ, reaching 13.7% in Q1FY22.
- Utilisation at 83.2% was down 110bps QoQ in Q1 due to the record net addition of 3,442 employees.
- DSO stood at 57 days, down 3 days QoQ.

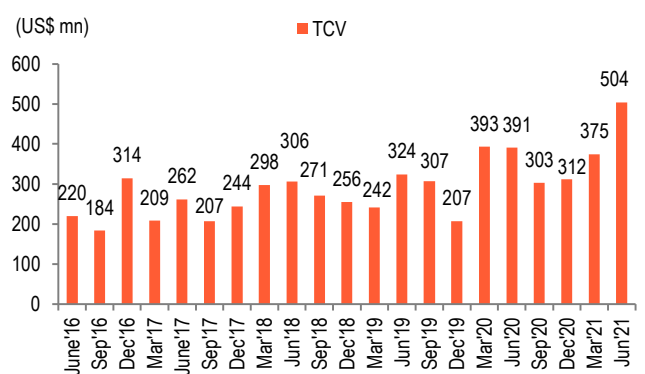
The L&T Nxt acquisition will be completed in Q2FY22, leading to an increase in amortisation.

**Fig 1 – Strong start to FY22**



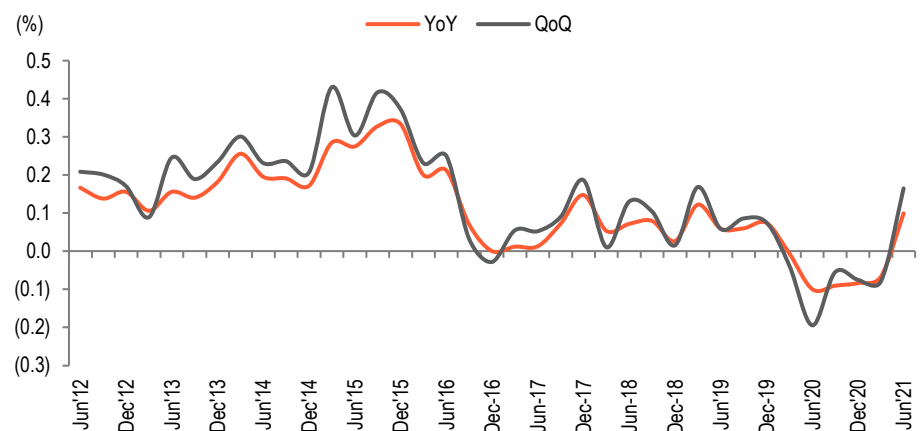
Source: Company, BOBCAPS Research

**Fig 2 – Deal wins cross half a billion mark**



Source: Company, BOBCAPS Research

**Fig 3 – BFSI revenue rebounds after two weak quarters**



Source: Company, BOBCAPS Research

**Fig 4 – Quarterly performance**

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>310.5</b>	<b>253.2</b>	<b>22.6</b>	<b>288.2</b>	<b>7.7</b>	<b>1,113</b>	<b>1,089</b>	<b>2.2</b>
<b>Revenue</b>	<b>22,917</b>	<b>19,088</b>	<b>20.1</b>	<b>21,093</b>	<b>8.6</b>	<b>82,358</b>	<b>77,643</b>	<b>6.1</b>
Operating Expenditure	18,272	15,870	15.1	16,467	11.0	65,966	67,020	(1.6)
Cost of revenues	13,673	12,778	7.0	13,123	4.2	52,197	50,647	3.1
as % of sales	59.7	66.9		62.2	-	63.4	65.2	-
SG&A expenses	4,599	3,092	48.7	3,344	37.5	13,769	16,373	(15.9)
as % of sales	20.1	16.2	23.9	15.9	-	16.7	21.1	-
<b>EBITDA</b>	<b>4,645</b>	<b>3,218</b>	<b>44.3</b>	<b>4,626</b>	<b>0.4</b>	<b>16,392</b>	<b>10,623</b>	<b>54.3</b>
Depreciation	582	597	(2.5)	713	(18.4)	2,461	2,754	(10.6)
<b>EBIT</b>	<b>4,063</b>	<b>2,621</b>	<b>55.0</b>	<b>3,913</b>	<b>3.8</b>	<b>13,931</b>	<b>7,869</b>	<b>77.0</b>
Other Income	589	275	114.2	275	114.2	1,252	419	198.8
PBT	4,652	2,896	60.6	4,188	11.1	15,183	8,288	83.2
Total Tax	1,218	768	58.6	1,015	20.0	3,911	1,979	97.6
<b>Adjusted PAT</b>	<b>3,434</b>	<b>2,128</b>	<b>61.4</b>	<b>3,173</b>	<b>8.2</b>	<b>11,272</b>	<b>6,309</b>	<b>78.7</b>
Other comprehensive income/(loss)	288	894	-	288	-	2,872	-2,118	-
APAT after MI	3,722	3,022	23.2	3,461	7.5	14,144	4,191	237.5
Extra ordinary items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>3,722</b>	<b>3,022</b>	<b>23.2</b>	<b>3,461</b>	<b>7.5</b>	<b>14,144</b>	<b>4,283</b>	<b>230.2</b>
Reported EPS	20.9	12.9	61.4	19.3	8.2	68	38	78.7
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	20.3	16.9	340	21.9	(160)	19.9	13.7	620
EBIT	17.7	13.7	400	18.6	(80)	16.9	10.1	680
EBT	20.3	15.2	510	19.9	40	18.4	10.7	780
PAT	16.2	15.8	40	16.4	(20)	17.2	5.4	1,180
Effective Tax Rate	26.2	26.5	(30)	24.2	190	25.8	23.9	190

Source: Company, BOBCAPS Research

**Fig 5 – Operating metrics**

(US\$ terms)	Q1FY22 (% Contr. to Rev)	QoQ (%)	YoY (%)
Deal wins	504	34.4	28.9
<b>Revenue by Geography</b>			
North America	76.6	7.7	18.9
Europe	16.2	11.2	51.6
<b>Revenue by Vertical</b>			
Communications, media and technology	45.4	6.8	18.2
BFSI	18.2	6.6	9.9
Manufacturing & Retail	22.1	6.3	31.6
Travel, Media and Services	13.3	12.8	46.9
<b>Client Concentration</b>			
Top Client	27.4	5.4	11.6
Top 5 Clients	38.5	7.5	10.1
Top 10 Clients	47.5	8.2	12.0
Non-Top 10 Clients	52.5	7.3	34.1

Source: Company, BOBCAPS Research

## Valuation methodology

We tweak our FY22/FY23 EPS estimates by -0.7%/+1% to bake in the Q1FY22 performance. Rolling valuations forward, we have a revised Jun'22 TP of Rs 2,270 (Rs 2,180 earlier), set at an unchanged one-year forward P/E of 23.4x, which is one standard deviation above the last five-year average.

Following a 45%+ stock upmove in the last six months, MTCL's valuations look full at 26.7x FY23 P/E. Moreover, we believe the company's delivery engine will be sorely tested amid rising supply challenges. With another round of wage hikes (effective Jul'21), high subcontracting expenses and sustained elevated hiring levels, we see limited scope for further margin expansion in the near future, heralding a possible end to the consensus earnings upgrade cycle for MTCL. We thus downgrade our rating to SELL from ADD.

**Fig 6 – Revised estimates**

(Rs mn)	FY22E			FY23E			FY24E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	1,272	1,300	2.2	1,412	1,443	2.2	1,614
YoY Growth (%)	18.2	20.8	-	11.0	11.0	-	11.8
Revenues	96,844	98,486	1.7	110,496	112,947	2.2	126,311
EBITDA	21,553	20,603	(4.4)	23,059	22,874	(0.8)	26,858
EBITDA margin (%)	22.3	20.9	-	20.9	20.3	-	21.3
Net profits	14,538	14,436	(0.7)	15,295	15,453	1.0	18,466
EPS (Rs)	88.3	87.7	(0.7)	92.9	93.9	1.0	112.2

Source: BOBCAPS Research

## Key risks

Upside risks to our estimates are:

- a sharp pick-up in Covid-hit verticals, and
- strong margin execution despite supply constraints.

## Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	35	968	1,190	BUY
Info Edge	INFOE IN	9	5,157	2,880	SELL
Infosys	INFO IN	88	1,545	1,540	ADD
L&T Infotech	LTI IN	9	4,018	4,710	BUY
Mindtree	MTCL IN	6	2,496	2,270	SELL
Mphasis	MPHL IN	5	2,191	1,580	SELL
Persistent Systems	PSYS IN	3	2,755	1,340	SELL
Tata Consultancy Services	TCS IN	161	3,188	3,890	BUY
Tech Mahindra	TECHM IN	12	1,050	1,190	BUY
Wipro	WPRO IN	40	525	470	ADD

Source: BOBCAPS Research, NSE | Price as of 13 Jul 2021

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>77,643</b>	<b>79,678</b>	<b>98,486</b>	<b>112,947</b>	<b>126,311</b>
EBITDA	10,623	16,426	20,603	22,874	26,858
Depreciation	2,754	2,596	2,315	2,582	2,857
EBIT	7,869	13,830	18,288	20,292	24,001
Net interest inc./(exp.)	(529)	(504)	(519)	(600)	(640)
Other inc./(exp.)	948	1,656	1,650	1,476	1,935
Exceptional items	0	0	0	0	0
EBT	8,288	14,982	19,419	21,168	25,296
Income taxes	1,979	3,879	4,984	5,715	6,830
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>6,309</b>	<b>11,103</b>	<b>14,436</b>	<b>15,453</b>	<b>18,466</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>6,309</b>	<b>11,103</b>	<b>14,436</b>	<b>15,453</b>	<b>18,466</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	17,690	17,914	24,284	27,850	31,145
Provisions	2,304	2,510	2,159	2,476	2,768
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	1,642	1,647	1,647	1,647	1,647
Reserves & surplus	29,926	41,547	48,366	57,310	67,997
Shareholders' fund	31,568	43,194	50,013	58,957	69,644
<b>Total liab. and equities</b>	<b>51,562</b>	<b>63,618</b>	<b>76,456</b>	<b>89,282</b>	<b>103,558</b>
Cash and cash eq.	5,870	7,597	13,428	22,913	34,454
Accounts receivables	14,389	12,742	18,888	21,661	24,224
Inventories	0	0	0	0	0
Other current assets	5,107	4,910	6,746	7,736	8,651
Investments	7,748	20,468	20,468	20,468	20,468
Net fixed assets	13,469	13,993	12,524	11,507	10,215
CWIP	136	224	224	224	224
Intangible assets	4,732	4,732	4,732	4,732	4,732
Deferred tax assets, net	1,835	355	355	355	355
Other assets	3,148	3,553	4,047	4,642	5,191
<b>Total assets</b>	<b>51,566</b>	<b>63,618</b>	<b>76,456</b>	<b>89,282</b>	<b>103,558</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>7,754</b>	<b>5,557</b>	<b>12,295</b>	<b>16,684</b>	<b>19,589</b>
Capital expenditures	(1,496)	(305)	(1,515)	(1,565)	(1,565)
Change in investments	0	0	0	0	0
Other investing cash flows	419	1,152	1,131	876	1,295
<b>Cash flow from investing</b>	<b>(1,077)</b>	<b>847</b>	<b>(384)</b>	<b>(689)</b>	<b>(270)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(3,369)	(4,677)	(6,081)	(6,509)	(7,778)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(3,369)</b>	<b>(4,677)</b>	<b>(6,081)</b>	<b>(6,509)</b>	<b>(7,778)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>3,308</b>	<b>1,727</b>	<b>5,830</b>	<b>9,485</b>	<b>11,541</b>
<b>Closing cash &amp; cash eq.</b>	<b>5,870</b>	<b>7,598</b>	<b>13,428</b>	<b>22,913</b>	<b>34,454</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	38.3	67.4	87.7	93.9	112.2
Adjusted EPS	38.3	67.4	87.7	93.9	112.2
Dividend per share	17.0	23.6	30.7	32.8	39.3
Book value per share	191.7	262.3	303.8	358.1	423.0

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	5.3	5.1	4.1	3.5	3.1
EV/EBITDA	38.5	24.8	19.6	17.5	14.6
Adjusted P/E	65.1	37.0	28.5	26.6	22.3
P/BV	13.0	9.5	8.2	7.0	5.9

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	76.1	74.1	74.3	73.0	73.0
Interest burden (PBT/EBIT)	105.3	108.3	106.2	104.3	105.4
EBIT margin (EBIT/Revenue)	10.1	17.4	18.6	18.0	19.0
Asset turnover (Rev./Avg TA)	166.3	138.3	140.6	136.3	131.0
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
<b>Adjusted ROAE</b>	<b>19.5</b>	<b>29.7</b>	<b>31.0</b>	<b>28.4</b>	<b>28.7</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	10.6	2.6	23.6	14.7	11.8
EBITDA	(0.2)	54.6	25.4	11.0	17.4
Adjusted EPS	(16.3)	76.0	30.0	7.0	19.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	13.7	20.6	20.9	20.3	21.3
EBIT margin	10.1	17.4	18.6	18.0	19.0
Adjusted profit margin	8.1	13.9	14.7	13.7	14.6
Adjusted ROAE	19.5	29.7	31.0	28.4	28.7
ROCE	27.9	45.0	50.5	55.7	67.2

### Working capital days (days)

	FY20A	FY21A	FY22E	FY23E	FY24E
Receivables	65	62	59	66	66
Inventory	0	0	0	0	0
Payables	68	103	99	106	108

### Ratios (x)

	FY20A	FY21A	FY22E	FY23E	FY24E
Gross asset turnover	6.6	5.8	7.4	9.4	11.6
Current ratio	1.4	1.4	1.6	1.9	2.1
Net interest coverage ratio	NA	NA	NA	NA	NA
<b>Adjusted debt/equity</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.4)</b>	<b>(0.5)</b>

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

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

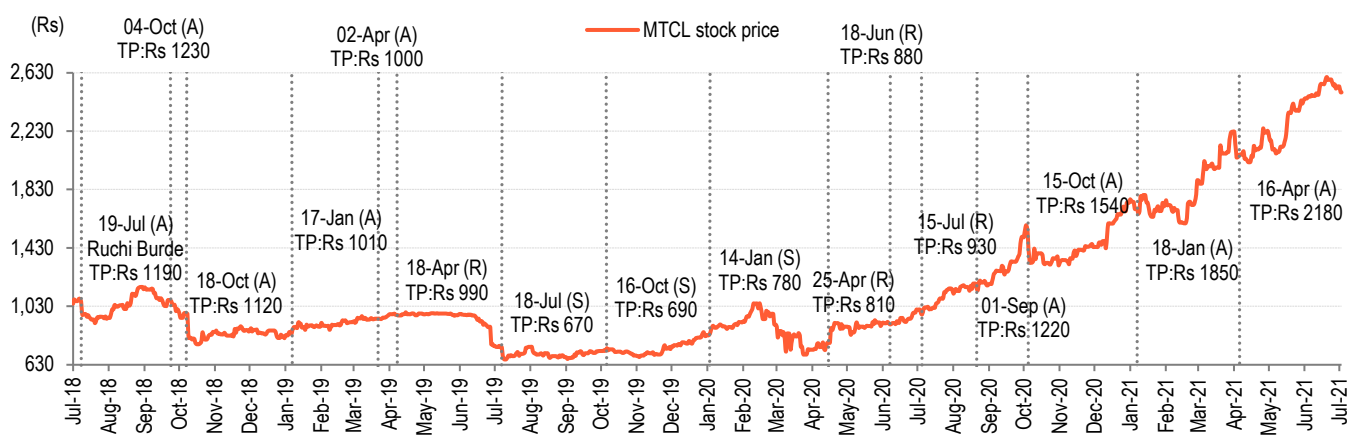
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): MINDTREE (MTCL IN)



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

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