

**SELL**

TP: Rs 3,390 | ▼ 22%

**MINDTREE**

| Technology & Internet

| 14 October 2021

## Upbeat Q2 but valuations lofty

- **Strong Q2 beat led by significant revenue surprise and resilient operating margin**
- **Management expects conducive demand dynamics to sustain growth over medium term; 20%+ FY22 EBITDA margin target unchanged**
- **We raise FY22-FY24 EPS by 2-4% and revise our TP to Rs 3,390 (vs. Rs 3,210). Maintain SELL on expensive valuations**

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**Growth outperforms:** MTCL's Q2FY22 revenue grew 12.8% QoQ USD, well above our and consensus estimates of 7.5%. Growth was broad-based across verticals, led by travel/manufacturing & retail which increased 14.4%/29.6% QoQ USD. Part of retail & CPG revenue growth was seasonal as the top 6 to 20 clients in this vertical are from Europe. BFSI continued to build on the recovery seen in Q1 with 8.4% USD growth. MTCL's investment in Europe has fructified with the geography growing 36.4% QoQ. Top client growth was flat QoQ but up 12.8% YoY. TCV was somewhat muted at US\$ 360mn, declining 28.6% QoQ (+18.8% YoY).

**Supply challenges raise attrition:** MTCL's operating margin was resilient despite the wage hike impact and challenging talent market. EBITDA margin stood at 20.5%, up 20bps QoQ. EBIT margin rose 50bps QoQ to 18.2%, ahead of our estimate of 18%. The 20bps tailwind can be broken down as follows: (1) 190bps tailwind from robust growth and higher operational efficiency, (2) 140bps headwind from wage hikes, and (3) 30bps headwind from cross-currency movement. The company hired 4,400 employees in Q2 to backfill attrition which climbed to 17.7% (+400bps QoQ and YoY). Utilisation levels normalised to 82.9%, down 30bps QoQ.

**Strong medium-term demand outlook:** Management believes the near-to-medium term demand environment remains robust. Technology has become central to clients' strategy and their IT spending focus has now shifted from maximising cost efficiency to maximising revenue growth.

**Robust strategy:** MTCL will continue to invest towards enhancing its digital and marketing capabilities. It remains focused on reducing top client concentration and diversifying the client base through cross-selling, upselling and new logo addition.

**Maintain SELL:** We increase FY22/FY23/FY24 EPS by 4%/2%/2% to factor in the Q2 operational beat and raise our target P/E to 36x (five-year avg. P/E + 3 std. deviations) vs. 30x earlier led by the upbeat demand climate. This yields a new Sep'22 TP of Rs 3,390. While we acknowledge MTCL's strong operational dynamics, valuations at 46.3x/43.6x FY22E/FY23E PE are lofty and leave limited scope for further upside.

## Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	MTCL IN/Rs 4,364
Market cap	US\$ 9.5bn
Free float	87%
3M ADV	US\$ 64.5mn
52wk high/low	Rs 4,734/Rs 1,262
Promoter/FPI/DII	74%/11%/15%

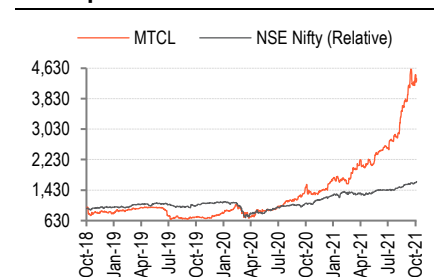
Source: NSE | Price as of 13 Oct 2021

## Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	79,678	103,469	119,833
EBITDA (Rs mn)	16,426	21,576	24,266
Adj. net profit (Rs mn)	11,103	15,492	16,490
Adj. EPS (Rs)	67.4	94.1	100.2
Consensus EPS (Rs)	67.4	85.6	99.0
Adj. ROAE (%)	29.7	33.0	29.8
Adj. P/E (x)	64.7	46.4	43.6
EV/EBITDA (x)	43.5	33.0	29.2
Adj. EPS growth (%)	76.0	39.5	6.4

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>350.1</b>	<b>261.0</b>	<b>34.1</b>	<b>310.5</b>	<b>12.8</b>	<b>661</b>	<b>514</b>	<b>28.5</b>
Revenue	25,862	19,260	34.3	22,917	12.9	48,779	38,348	27.2
Operating Expenditure	20,555	15,357	33.8	18,272	12.5	38,827	31,227	24.3
Cost of revenues	15,644	12,623	23.9	13,673	14.4	29,317	25,401	15.4
as % of sales	60.5	65.5	-	59.7	-	60.1	66.2	-
SG&A expenses	4,911	2,734	79.6	4,599	6.8	9,510	5,826	63.2
as % of sales	19.0	14.2	33.8	20.1	-	19.5	15.2	-
<b>EBITDA</b>	<b>5,307</b>	<b>3,903</b>	<b>36.0</b>	<b>4,645</b>	<b>14.3</b>	<b>9,952</b>	<b>7,121</b>	<b>39.8</b>
Depreciation	610	569	7.2	582	4.8	1,192	1,166	2.2
<b>EBIT</b>	<b>4,697</b>	<b>3,334</b>	<b>40.9</b>	<b>4,063</b>	<b>15.6</b>	<b>8,760</b>	<b>5,955</b>	<b>47.1</b>
Other Income	623	113	451.3	589	5.8	1,212	388	212.4
PBT	5,320	3,447	54.3	4,652	14.4	9,972	6,343	57.2
Total Tax	1,331	910	46.3	1,218	9.3	2,549	1,678	51.9
<b>Adjusted PAT</b>	<b>3,989</b>	<b>2,537</b>	<b>57.2</b>	<b>3,434</b>	<b>16.2</b>	<b>7,423</b>	<b>4,665</b>	<b>59.1</b>
Other comprehensive income/(loss)	-	1402	-	288	-	288	2,296	-
APAT after MI	3,989	3,939	1.3	3,722	7.2	7,711	6,961	10.8
Extra ordinary items	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>3,989</b>	<b>3,939</b>	<b>1.3</b>	<b>3,722</b>	<b>7.2</b>	<b>7,711</b>	<b>6,961</b>	<b>10.8</b>
Reported EPS	20.8	15.4	35.2	20.8	-	42	28	47.0
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	20.5	20.3	30	20.3	20	20.4	18.6	180
EBIT	18.2	17.3	90	17.7	50	18.0	15.5	240
EBT	20.6	17.9	270	20.3	30	20.4	16.5	390
PAT	15.4	20.5	(500)	16.2	(80)	15.8	18.2	(230)
Effective Tax rate	25.0	26.4	(140)	26.2	(120)	25.6	26.5	(90)

Source: BOBCAPS Research, Company

**Fig 2 – Operating metrics**

(US\$ terms)	Q2FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Deal Win TCV	360	(28.6)	18.8
<b>Revenue by Geography</b>			
North America	72.8	7.2	26.2
Europe	19.6	36.4	70.7
Add RoW	-	-	-
<b>Revenue by Vertical</b>			
Communications, media and technology	42.5	5.6	14.5
BFSI	17.5	8.4	15.1
Manufacturing & Retail	25.4	29.6	58.5
Travel, Media and Services	13.5	14.4	118.2
<b>Client Concentration</b>			
Top Client	24.3	0.0	12.8
Top 5 Clients	35.7	4.6	17.9
Top 10 Clients	45.1	7.1	22.5
Non Top 10 Clients	54.9	17.9	45.5

Source: BOBCAPS Research, Company

## Valuation methodology

We raise our FY22/FY23/FY24 EPS estimates by 4%/2%/2% to bake in the Q2FY22 outperformance. Given the upbeat demand environment, we increase our target one-year forward P/E to 36x (vs. 30x), which is three standard deviations above the last five-year average and translates to a revised Sep'22 TP of Rs 3,390 (vs. Rs 3,210). While we acknowledge the stronger operational dynamics for MTCL, valuations at 46.3x/43.6x FY22E/FY23E PE are lofty and leave limited scope for further upside. Maintain SELL.

**Fig 3 – Revised estimates**

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Overall Revenues (US\$ mn)	1,390	1,577	1,756	1,340	1,500	1,678	3.8	5.1	4.7
YoY Growth (%)	29.1	13.5	11.4	24.4	12.0	11.8	-	-	-
Revenues	103,469	119,833	133,478	101,176	117,426	131,320	2.3	2.1	1.6
EBITDA	21,576	24,266	28,379	21,174	23,782	27,923	1.9	2.0	1.6
EBITDA margin (%)	20.9	20.3	21.3	20.9	20.3	21.3	-	-	-
Net profits	15,492	16,490	19,620	14,861	16,120	19,258	4.2	2.3	1.9
EPS (Rs)	94.1	100.2	119.2	90.3	97.9	117.0	4.2	2.3	1.9

Source: BOBCAPS Research, Company

**Fig 4 – Key assumptions**

Parameter	FY21	FY22E	FY23E	FY24E
Revenue (US\$ mn)	1,077	1,390	1,577	1,756
YoY Growth (%)	(1.1)	29.1	13.5	11.4
EBIT (%)	17.4	18.6	18.1	19.1

Source: Company, BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

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

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,154	1,240	BUY
Coforge	COFORGE IN	4.4	5,338	6,930	BUY
eClerx Services	ECLX IN	1.1	2,247	2,880	BUY
HCL Technologies	HCLT IN	45.6	1,265	1,530	BUY
IndiaMart InterMesh	INMART IN	3.8	9,480	8,430	HOLD
Infosys	INFO IN	96.6	1,709	2,020	BUY
Just Dial	JUST IN	0.8	929	1,330	BUY
L&T Infotech	LTI IN	13.9	5,951	6,780	BUY
Mindtree	MTCL IN	9.5	4,364	3,390	SELL
Mphasis	MPHL IN	7.7	3,130	3,530	HOLD
Persistent Systems	PSYS IN	4.2	4,002	3,560	HOLD
Tata Consultancy Services	TCS IN	182.0	3,655	4,630	BUY
Tech Mahindra	TECHM IN	16.2	1,402	1,660	BUY
Wipro	WPRO IN	49.3	673	630	HOLD

Source: BOBCAPS Research, NSE | Price as of 13 Oct 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>103,469</b>	<b>119,833</b>	<b>133,478</b>
EBITDA	10,623	16,426	21,576	24,266	28,379
Depreciation	2,754	2,596	2,346	2,573	2,841
EBIT	7,869	13,830	19,229	21,693	25,538
Net interest inc./(exp.)	(529)	(504)	(514)	(600)	(640)
Other inc./(exp.)	948	1,656	2,087	1,496	1,978
Exceptional items	0	0	0	0	0
EBT	8,288	14,982	20,803	22,589	26,876
Income taxes	1,979	3,879	5,311	6,099	7,257
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>15,492</b>	<b>16,490</b>	<b>19,620</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>6,309</b>	<b>11,103</b>	<b>15,492</b>	<b>16,490</b>	<b>19,620</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	25,513	29,548	32,912
Provisions	2,304	2,510	2,268	2,626	2,926
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	48,977	58,521	69,877
Shareholders' fund	31,568	43,194	50,624	60,168	71,524
<b>Total liab. and equities</b>	<b>51,562</b>	<b>63,618</b>	<b>78,405</b>	<b>92,343</b>	<b>107,362</b>
Cash and cash eq.	5,870	7,597	13,933	23,992	36,220
Accounts receivables	14,389	12,742	19,843	22,982	25,599
Inventories	0	0	0	0	0
Other current assets	5,107	4,910	7,087	8,208	9,142
Investments	7,748	20,468	20,468	20,468	20,468
Net fixed assets	13,469	13,993	12,467	11,414	10,093
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	4,252	4,925	5,485
<b>Total assets</b>	<b>51,566</b>	<b>63,618</b>	<b>78,405</b>	<b>92,343</b>	<b>107,362</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>12,776</b>	<b>17,629</b>	<b>20,673</b>
Capital expenditures	(1,496)	(305)	(1,489)	(1,520)	(1,520)
Change in investments	0	0	0	0	0
Other investing cash flows	419	1,152	1,573	896	1,338
<b>Cash flow from investing</b>	<b>(1,077)</b>	<b>847</b>	<b>84</b>	<b>(624)</b>	<b>(182)</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)	(6,526)	(6,946)	(8,264)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(3,369)</b>	<b>(4,677)</b>	<b>(6,526)</b>	<b>(6,946)</b>	<b>(8,264)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>3,308</b>	<b>1,727</b>	<b>6,335</b>	<b>10,059</b>	<b>12,228</b>
<b>Closing cash &amp; cash eq.</b>	<b>5,870</b>	<b>7,598</b>	<b>13,933</b>	<b>23,992</b>	<b>36,220</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	38.3	67.4	94.1	100.2	119.2
Adjusted EPS	38.3	67.4	94.1	100.2	119.2
Dividend per share	17.0	23.6	32.9	35.1	41.7
Book value per share	191.7	262.3	307.5	365.4	434.4

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	9.2	9.0	6.9	5.9	5.2
EV/EBITDA	67.5	43.5	33.0	29.2	24.7
Adjusted P/E	113.9	64.7	46.4	43.6	36.6
P/BV	22.8	16.6	14.2	11.9	10.0

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	76.1	74.1	74.5	73.0	73.0
Interest burden (PBT/EBIT)	105.3	108.3	108.2	104.1	105.2
EBIT margin (EBIT/Revenue)	10.1	17.4	18.6	18.1	19.1
Asset turnover (Rev./Avg TA)	166.3	138.3	145.7	140.4	133.7
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>33.0</b>	<b>29.8</b>	<b>29.8</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	10.6	2.6	29.9	15.8	11.4
EBITDA	(0.2)	54.6	31.4	12.5	16.9
Adjusted EPS	(16.3)	76.0	39.5	6.4	19.0
<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	18.1	19.1
Adjusted profit margin	8.1	13.9	15.0	13.8	14.7
Adjusted ROAE	19.5	29.7	33.0	29.8	29.8
ROCE	27.9	45.0	53.1	59.4	71.3
<b>Working capital days (days)</b>					
Receivables	65	62	57	65	66
Inventory	0	0	0	0	0
Payables	68	103	97	105	108
<b>Ratios (x)</b>					
Gross asset turnover	6.6	5.8	7.8	10.0	12.4
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%

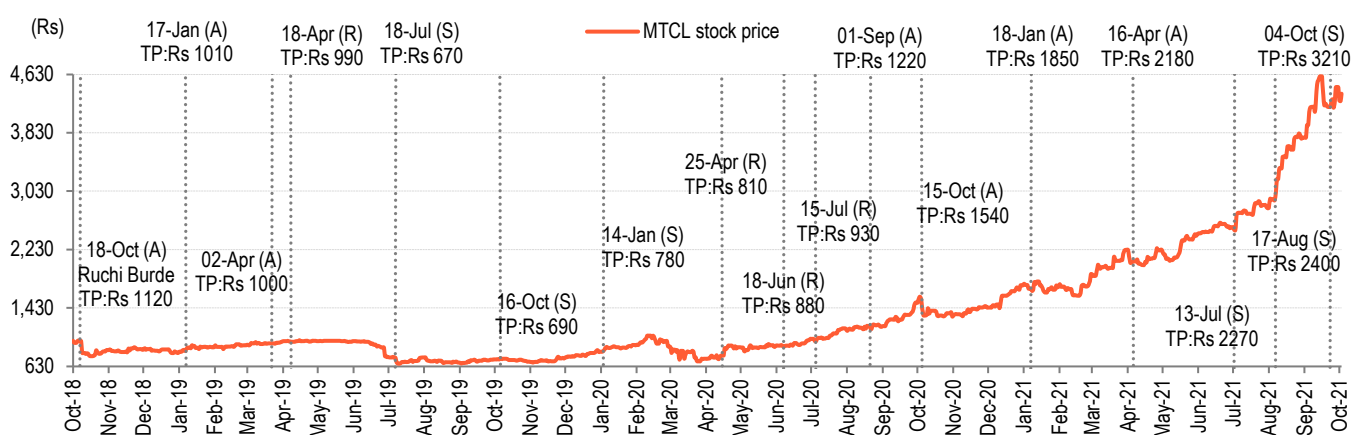
**HOLD** – Expected return from -6% to +15%

**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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