

BUY

TP: Rs 5,610 | ▲ 18%

MINDTREE

| Technology & Internet

| 13 January 2022

Margin beat despite supply constraints; upgrade to BUY

- Mindtree (MTCL) reported growth of 4.7% QoQ USD, in-line with estimates. Momentum was driven by travel, CMT and BFSI
- Deal pipeline was strong. EBIT margin at 19.2% (up 110bps QoQ), beating our estimate of 18.4% in a supply constrained environment
- We raise FY23/24 EPS by 5%/7.5% and upgrade the stock to BUY, with a new TP of Rs5,610 on superlative growth and margin show

Ruchi Burde | Seema Nayak
researchreport@bobcaps.in

In-line growth performance: MTCL showed growth of 4.7%, in-line with our estimate of 4.8% QoQ USD, in a seasonally weak quarter consisting of furloughs. The growth was broad-based across verticals. Travel, CMT and BFSI grew 7%/6.1%/4.7%, QoQ USD. Retail growth was muted QoQ. Travel revenues have crossed pre-pandemic levels. HLS: the new vertical crossed USD4.8mn quarterly revenue run-rate. Among service lines, Data and Intelligence grew the most, followed by cloud. The digital demand has been secular and broad based. Digital core transformation and hyper personalization are the key demand drivers.

Consistent margin beat: EBITDA margin at 21.5%, up 100bps QoQ. EBIT margin was at 19.2%, up 110bps QoQ vs. outperforming our estimate of 18.4%. 60bps tailwind came from operational efficiencies and 40bps came from cross currency gains. The margin uptick was led by decline in employee and SG&A costs. Gross margin expanded ~60bps QoQ. Pyramid correction is also a strong lever used to rein the margin. Management seems confident of achieving 20%+ EBITDA margin going forward too. The continuous margin improvement bodes well for MTCL in a supply constrained environment.

Attrition up; sub-con under control: Attrition stood at 21.9%, up 410bps QoQ, 940bps YoY. Mindtree hired >2000 employees in Q3FY22. Subcontractor costs as % of revenue came down 80bps QoQ, to 9.8%. To tackle attrition, MTCL is focused on reskilling workforce and hiring freshers from diverse academic background,

Strong TCV: Deal momentum was continued with TCV at USD358mn, was flat Qoq, up 14.7% YoY. YTD TCV crossed USD1.2bn. Key deals were won in cloud, travel, manufacturing, hi-tech and BFSI. MTCL won one of the largest deals in Data and Intelligence service line and 10 new deals in cloud in Q3. It is seeing increased number of deals with a long tail, eventually converting into strategic partnership.

Upgrade to BUY: On renewed sales strategy, strong deal pipeline, deft margin defense despite supply pressure, we upgrade MTCL target multiple to 46x (vs. 36x earlier) and raise TP to Rs 5,610 (vs. Rs3,540 earlier). Upgrade to BUY.

Key changes

	Target	Rating
	▲	▲

Ticker/Price	MTCL IN/Rs 4,744
Market cap	US\$ 10.6bn
Free float	87%
3M ADV	US\$ 69.3mn
52wk high/low	Rs 5,060/Rs 1,550
Promoter/FPI/DII	74%/11%/15%

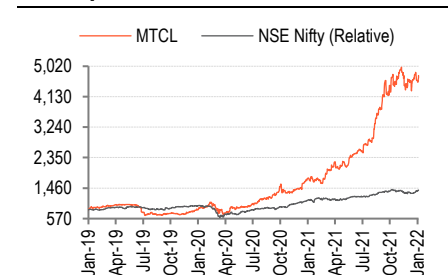
Source: NSE | Price as of 13 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	79,678	105,133	125,496
EBITDA (Rs mn)	16,426	22,077	25,415
Adj. net profit (Rs mn)	11,103	16,124	17,339
Adj. EPS (Rs)	67.4	97.9	105.3
Consensus EPS (Rs)	67.4	85.6	99.0
Adj. ROAE (%)	29.7	34.2	31.0
Adj. P/E (x)	70.4	48.4	45.0
EV/EBITDA (x)	47.3	35.1	30.3
Adj. EPS growth (%)	76.0	45.2	7.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Other con call highlights

- **Fresher hiring leverage:** MTCL is making fresher talent an important part of organizational fabric. It hired 2,227 employees QoQ and is hiring ~1500 freshers each quarter. Hiring more freshers and getting them trained efficiently to become billable sooner is one of the important margin levers which MTCL has used deftly. With ramped up hiring, utilization was at 81.5%, down by just 140bps QoQ.
- **Long tail rationalization:** MTCL is focused on its tail client rationalization. Since management change, 150 long tail clients have been rationalized and 75 new strategic logos have been added. Account mining, cross and up selling remain the top priorities to extract maximum value out of top clients.
- **Diversification in travel vertical:** MTCL aims to diversify beyond airlines and hotels in travel and hospitality verticals into sub segments such as car rentals, F&B hospitality, surface transportation. The diversification helps against omicron scare for the vertical.
- Top client grew 7.2% QoQ USD, the highest in last six quarters. Top client is of supreme importance for MTCL. While MTCL is aiming for consistent growth of top client, it also focused on bringing the concentration down.
- DSO was up one day QoQ, to 64 days in Q3FY22. MTCL aims to keep the DSO between 60-65 days.
- MTCL made several top leadership changes in the departments of delivery, ESG, HR, sustainability. This helps it be on top of changing industry dynamics.

Upgrade to BUY on strategic changes:

On following successful strategic initiatives, we upgrade the stock to BUY from SELL earlier.

Sales engine transformation paying off: MTCL's sales transformation initiatives included 1) alignment of sales team with service lines to create 2 in box structure 3) investments to strengthen account and delivery partners team especially for strategic clients 3) named logo acquisition strategy and 4) rationalization of tail accounts. A part of year-long transformation exercise to create a role-based organization which brings delivery closer to the client, this sales engine transformation is paying off. This approach has helped maintain growth focus and improve account mining.

4*4*4 strategy execution roots success for client mining: Management's 4/4/4 strategy emphasizes focus on 4 verticals, 4 service lines and 4 geographies with view to leverage its niche. Company's service lines namely Customer Success, Data & Intelligence, Cloud and Enterprise IT targets front office, middle office and back-office IT spends creating ideal service mix for cross selling. Moreover, its service offerings align well with IT spending priorities of clients namely digital transformation to forge growth (MTCL Customer success service) and cost take outs to fund digital transformation (MTCL Enterprise TI).

Selection as strategic partner offsets for rare large deals: Management echoed the trend of low larger deals and higher mix of small to medium sized deals, as cited by many

peers recently. This is largely due to absence of bundled deals and more prevalence of digital / product engineering deals which require short cycled sprint deliveries. Strategic transformation partner ends up working on several such deals in a single client account thus creating multiyear engagement.

Fig 1 – Quarterly performance

Rs mn	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenues (in US\$ mn)	366.4	274.1	33.7	350.1	4.7	1,027	788	30.3
Revenue	27,500	20,237	35.9	25,862	6.3	76,279	58,585	30.2
Operating Expenditure	21,579	15,558	38.7	20,555	5.0	60,406	46,785	29.1
Cost of revenues	16,458	12,610	30.5	15,644	5.2	45,775	38,011	20.4
as % of sales	59.8	62.3	-	60.5	-	60.0	64.9	-
SG&A expenses	5,121	2,948	73.7	4,911	4.3	14,631	8,774	66.8
as % of sales	18.6	14.6	27.8	19.0	-	19.2	15.0	-
EBITDA	5,921	4,679	26.5	5,307	11.6	15,873	11,800	34.5
Depreciation	632	717	(11.9)	610	3.6	1,824	1,883	(3.1)
EBIT	5,289	3,962	33.5	4,697	12.6	14,049	9,917	41.7
Other Income	581	489	18.8	623	(6.7)	1,793	877	104.4
PBT	5,870	4,451	31.9	5,320	10.3	15,842	10,794	46.8
Total Tax	1,495	1,186	26.1	1,331	12.3	4,044	2,864	41.2
Adjusted PAT	4,375	3,265	34.0	3,989	9.7	11,798	7,930	48.8
Other comprehensive income/(loss)	-	0	-	-	-	0	2,296	-
APAT after MI	4,375	3,265	34.0	3,989	9.7	11,798	10,226	15.4
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	4,375	3,265	34.0	3,989	9.7	11,798	10,226	15.4
Reported EPS	26.5	19.8	33.6	24.2	9.5	72	48	48.5
Margins (%)			(bps)		(bps)			(bps)
EBIDTA	21.5	23.1	(160)	20.5	100	20.8	20.1	70
EBIT	19.2	19.6	(30)	18.2	110	18.4	16.9	150
EBT	21.3	22.0	(60)	20.6	80	20.8	18.4	230
PAT	15.9	16.1	(20)	15.4	50	15.5	17.5	(200)
Effective Tax rate	25.5	26.6	(120)	25.0	40	25.5	26.5	(100)

Source: BOBCAPS Research, Company

Fig 2 – Operating metrics

(US\$ terms)	Q3FY22 (% Contri to Revenue)	Growth	
		QoQ (%)	YoY (%)
Deal wins	358	(0.6)	14.7
Revenue breakup-Geography			
North America	73.0	4.9	26.4
Europe (UK, Ireland and Continental Europe)	18.6	(0.7)	63.6
APAC	8.4	15.7	47.7
Revenue breakup-Verticals			
Communications, media and technology	43.1	6.1	15.5
BFSI	17.5	4.7	19.4
Manufacturing & Retail	24.3	0.1	50.4
Travel, Media and Services	13.8	7.0	107.3

(US\$ terms)	Q3FY22 (% Contri to Revenue)	Growth	
		QoQ (%)	YoY (%)
Client concentration			
Top Client	24.9	7.2	16.8
Top 5 Clients	35.4	3.8	18.9
Top 10 Clients	44.9	4.2	22.5
Non Top 10 Clients	55.1	5.0	44.4
Service lines			
Customer success	42.9	4	51
Data and Intelligence	14.8	8	33
Cloud	19.1	7	33
Enterprise IT	23.2	2	12
		QoQ addition	YoY addition
Headcount	31,959	2,227	9,764
		QoQ bps	YoY bps
Attrition	21.9	420	940

Source: BOBCAPS Research, Company

Valuation methodology

MTCL's renewed sales strategy, optimistic pipeline outlook, stable travel vertical growth from diversification, superior Q3FY22 results and consistent margin performance beating consensus for last couple of quarter, gives us the comfort to revise one year forward target multiple to 46x (vs. 36x earlier) – which is in-line with MTCL's average PE under L&T ownership + 2sd; which is at parity with our target multiple for LTI too. Its deep-rooted expertise in hi-tech and CMT vertical sets it apart from other mid-sized players. Factoring Q3FY22 numbers, we increase FY23/FY24 EPS by 5.1%/7.5% and raise TP to Rs 5,610 (vs Rs 3,540 earlier). Upgrade to BUY from SELL.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Overall Revenues (US\$ mn)	1,412	1,651	1,879	1,390	1,577	1,756	1.6	4.7	7.0
YoY Growth (%)	31.1	17.0	13.8	29.1	13.5	11.4	-	-	-
Revenues	105,133	125,496	142,834	103,469	119,833	133,478	1.6	4.7	7.0
EBITDA	22,077	25,415	30,371	21,576	24,266	28,379	2.3	4.7	7.0
EBITDA margin (%)	21.0	20.3	21.3	20.9	20.3	21.3	-	-	-
Net profits	16,124	17,339	21,095	15,492	16,490	19,620	4.1	5.1	7.5
EPS (Rs)	97.9	105.3	128.1	94.1	100.2	119.2	4.1	5.1	7.5

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	1077	1412	1651	1879
YoY Growth (%)	(1.1)	31.1	17.0	13.8
EBIT (%)	17.4	18.7	18.2	19.3

Source: Company, BOBCAPS Research

Fig 5 – Peer Comparison

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		RoE (%)		P/E (x)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	BUY	4,770	14.1	104.0	120.3	39.6	37.5	37.5	32.4
INFO IN	BUY	2,250	17.1	54.4	62.3	29.8	32.0	34.9	30.4
WPRO IN	BUY	850	18.2	22.6	26.9	20.5	21.6	28.7	24.2
HCLT IN	BUY	1,560	10.9	49.2	55.5	20.4	20.6	27.1	24.1
TECHM IN	BUY	1,970	16.1	65.5	81.1	21.5	23.6	26.2	21.2
LTI IN	BUY	8,270	21.4	132.0	162.5	29.0	30.1	54.0	43.9
MPHL IN	HOLD	3,650	17.0	76.6	95.0	21.1	24.2	43.1	34.8
MTCL IN	BUY	5,610	23.9	97.9	105.3	34.2	31.0	48.4	45.0
PSYS IN	HOLD	4,240	24.8	78.5	93.1	21.0	21.7	57.6	48.6
COFORGE IN	BUY	7,040	27.5	123.4	173.2	27.9	33.1	46.4	33.1
ECLX IN	BUY	3,690	22.9	125.8	143.6	27.0	28.4	23.1	20.3

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- Attrition impacting margin negatively
- Travel vertical growth slowdown from third wave impact
- Slowdown in deal pipeline

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Coforge	COFORGE IN	4.8	5,727	7,040	BUY
eClerx Services	ECLX IN	1.5	2,912	3,690	BUY
HCL Technologies	HCLT IN	49.0	1,334	1,560	BUY
Infosys	INFO IN	109.2	1,897	2,250	BUY
L&T Infotech	LTI IN	16.9	7,133	8,270	BUY
Mindtree	MTCL IN	10.6	4,744	5,610	BUY
Mphasis	MPHL IN	8.3	3,306	3,650	HOLD
Persistent Systems	PSYS IN	4.9	4,518	4,240	HOLD
Tata Consultancy Services	TCS IN	197.9	3,898	4,770	BUY
Tech Mahindra	TECHM IN	20.3	1,719	1,970	BUY
Wipro	WPRO IN	48.6	650	850	BUY

Source: BOBCAPS Research, NSE | Price as of 13 Jan 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	77,643	79,678	105,133	125,496	142,834
EBITDA	10,623	16,426	22,077	25,415	30,371
Depreciation	2,754	2,596	2,401	2,574	2,841
EBIT	7,869	13,830	19,675	22,841	27,530
Net interest inc./(exp.)	(529)	(504)	(511)	(600)	(640)
Other inc./(exp.)	948	1,656	2,485	1,511	2,007
Exceptional items	0	0	0	0	0
EBT	8,288	14,982	21,649	23,752	28,897
Income taxes	1,979	3,879	5,525	6,413	7,802
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	6,309	11,103	16,124	17,339	21,095
Adjustments	0	0	0	0	0
Adjusted net profit	6,309	11,103	16,124	17,339	21,095

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	25,923	30,944	35,219
Provisions	2,304	2,510	2,304	2,751	3,131
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	49,343	59,379	71,588
Shareholders' fund	31,568	43,194	50,990	61,026	73,235
Total liab. and equities	51,562	63,618	79,218	94,721	111,585
Cash and cash eq.	5,870	7,597	14,298	24,718	37,678
Accounts receivables	14,389	12,742	20,162	24,068	27,393
Inventories	0	0	0	0	0
Other current assets	5,107	4,910	7,201	8,596	9,783
Investments	7,748	20,468	20,468	20,468	20,468
Net fixed assets	13,469	13,993	12,413	11,359	10,038
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	4,321	5,157	5,870
Total assets	51,566	63,618	79,218	94,721	111,585

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	7,754	5,557	13,008	18,332	21,999
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	1,974	911	1,367
Cash flow from investing	(1,077)	847	484	(609)	(153)
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)	(6,792)	(7,304)	(8,886)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(3,369)	(4,677)	(6,792)	(7,304)	(8,886)
Chg in cash & cash eq.	3,308	1,727	6,701	10,419	12,960
Closing cash & cash eq.	5,870	7,598	14,298	24,718	37,678

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	38.3	67.4	97.9	105.3	128.1
Adjusted EPS	38.3	67.4	97.9	105.3	128.1
Dividend per share	17.0	23.6	34.3	36.9	44.8
Book value per share	191.7	262.3	309.7	370.6	444.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	10.0	9.8	7.4	6.1	5.3
EV/EBITDA	73.4	47.3	35.1	30.3	25.1
Adjusted P/E	123.8	70.4	48.4	45.0	37.0
P/BV	24.7	18.1	15.3	12.8	10.7

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	110.0	104.0	105.0
EBIT margin (EBIT/Revenue)	10.1	17.4	18.7	18.2	19.3
Asset turnover (Rev./Avg TA)	166.3	138.3	147.2	144.3	138.5
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.6	1.5
Adjusted ROAE	19.5	29.7	34.2	31.0	31.4

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	10.6	2.6	31.9	19.4	13.8
EBITDA	(0.2)	54.6	34.4	15.1	19.5
Adjusted EPS	(16.3)	76.0	45.2	7.5	21.7
Profitability & Return ratios (%)					
EBITDA margin	13.7	20.6	21.0	20.3	21.3
EBIT margin	10.1	17.4	18.7	18.2	19.3
Adjusted profit margin	8.1	13.9	15.3	13.8	14.8
Adjusted ROAE	19.5	29.7	34.2	31.0	31.4
ROCE	27.9	45.0	54.3	62.4	76.4

Working capital days (days)

	FY20A	FY21A	FY22E	FY23E	FY24E
Receivables	65	62	57	64	66
Inventory	0	0	0	0	0
Payables	68	103	96	104	107

Ratios (x)

	FY20A	FY21A	FY22E	FY23E	FY24E
Gross asset turnover	6.6	5.8	8.0	10.6	13.4
Current ratio	1.4	1.4	1.6	1.9	2.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.2)	(0.2)	(0.3)	(0.4)	(0.5)

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

Disclaimer

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

BUY – Expected return >+15%

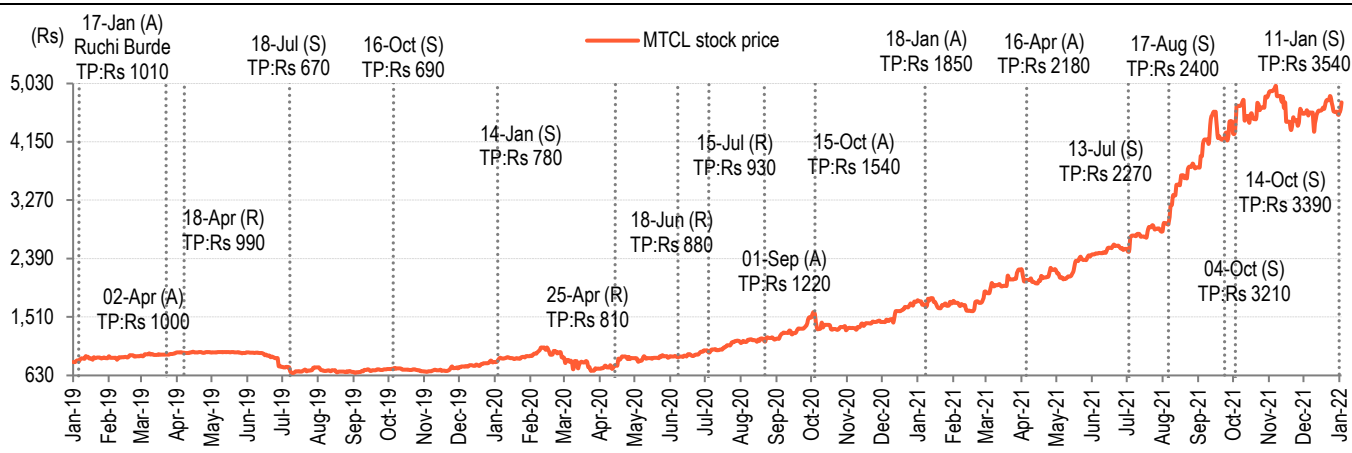
HOLD – Expected return from -6% to +15%

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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