

*Dismal results, wage hike and one-off staff benefits significantly eroded margin; robust deal pipeline and high TCV are the only comfort points, maintain Hold with revised TP of Rs 742*

Current	Previous
CMP: Rs 691	
Rating: Hold	Rating: Hold
Target: Rs 742	Target: Rs 1080

(NR-Not Rated)

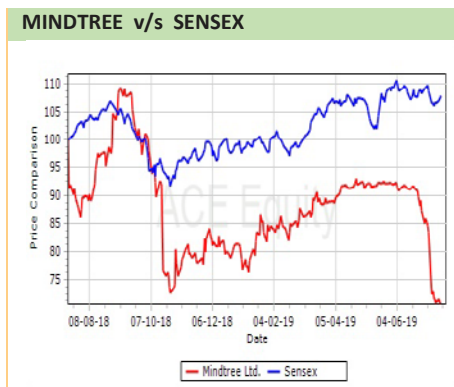
Stock Info	
INDEX	
BSE	532819
NSE	MINDTREE
Bloomberg	MTCL IN
Reuters	MINT.BO
Sector	Information Technology
Face Value (Rs)	10
Equity Capital (Rs Mn)	1645
Market Cap (Rs Mn)	113,669
52w H/L (Rs)	1184 / 671
Avg Weekly Vol (BSE+NSE)	17,155,860

Shareholding Pattern	%
<b>(As on June, 2019)</b>	
Promoters	13.3
Public & Others	86.7

Source: NSE, Arihant Research

Stock Performance (%)	3m	6m	12m
MINDTREE	-22.6	-13.3	-30.4
SENSEX	0.2	7.8	7.4

Source: ACE Equity, Arihant Research



Source: ACE Equity, Arihant Research

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*Mindtree came out with poor set of numbers in Q1FY20, revenue was mostly in line, however margin tanked and as a result PAT nosedived. Revenue grew 11.9% YoY to Rs 18,342 mn against our estimate of Rs 18,526mn. Reported EBITDA declined 28.2% YoY to Rs 1841mn, while EBITDA margin contracted by 561bps YoY to 10% against 15.6% YoY and 14.5% QoQ due to wage hike impact. Lower margin led to a whopping 46.7% YoY fall in PAT to Rs 927mn. After factoring in the dismal Q1FY20 results, we have revised our FY20E/FY21E estimate downwards. We have cut our target price from Rs 1080 earlier to Rs 742, and now value the stock at a P/E of 15x its revised FY21E earnings. Though we have cut our target price, we maintain our Hold rating on Mindtree as we believe all the negatives are factored in the current price.*

**Q1FY20 Highlights**

- Consolidated revenue for Q1FY20 stood at Rs 18,342 mn, registering 11.9% YoY growth. In USD terms, revenue was at US\$264.2mn (growth of 0.8% QoQ/9.4% YoY). In CC terms, growth of 1.1% QoQ/10.3% YoY).
- In rupee terms, EBITDA declined by 28.2% YoY to Rs 1841 mn, while EBITDA margin contracted by 561bps YoY to 10% due to several factors like wage hike impact (-190bps), cross currency headwinds (-40bps), higher visa costs (-30bps) and one-time bonus to employees (-260bps) for its 20<sup>th</sup> anniversary.
- Despite significant decline in margin, company said impact from wage hikes was lower in Q1FY20 than usual as Mindtree had deferred wage hikes for its senior staffs (~15% of total staff) to next quarter (100-150bps expected impact on Q2FY20E margin). In this quarter Mindtree has provided 7% average salary hike to its offshore staffs and 3% average hike to its onsite employees and covered ~85% of total employees.
- Mindtree has 346 active clients as of Q1FY20 end, with US\$5 million clients growing by 1 taking the total to 46. Other key highlights of the quarter was all time high deal closures of US\$324mn and digital share of revenue increasing to 38% in Q1FY20 from 35% in Q1FY19.

**Valuations**

After factoring in dismal Q1FY20 results, we have cut our FY20E/21E estimates and now value the stock at 15x FY21E revised earnings, which yields a target price of Rs 742. At CMP of Rs 691, Mindtree is trading at FY20E and FY21E, P/E multiples of 18.3x and 14x respectively. **We maintain our Hold rating on the stock, with a revised target price of Rs 742.**

**Financial Performance**

YE March (Rs Mn)	Net Sales	EBITDA	PAT	EPS (Rs)	EBITDA Margin %	RoE (%)	P/E (x)
FY18	54,628	7,405	5,701	34.8	13.6	20.8	19.9
FY19	70,215	10,645	7,541	45.9	15.2	22.8	15.0
FY20E	78,022	10,533	6,199	37.7	13.5	18.1	18.3
FY21E	88,111	13,217	8,138	49.5	15.0	20.6	14.0

Source: Company, Arihant Research

## Q1FY20 Financial Performance

Rs Mn (consolidated)	Q1FY20	Q4FY19	Q1FY19	Q-o-Q	Y-o-Y
<b>Net Revenue</b>	<b>18,342</b>	<b>18,394</b>	<b>16,395</b>	<b>-0.3%</b>	<b>11.9%</b>
Employee cost	12,532	11,504	10,395	8.9%	20.6%
Other Expenses	3,969	4,087	3,690	-2.9%	7.6%
<b>EBITDA</b>	<b>1,841</b>	<b>2,667</b>	<b>2,565</b>	<b>-31.0%</b>	<b>-28.2%</b>
<i>EBITDA margin %</i>	<i>10.0%</i>	<i>14.5%</i>	<i>15.6%</i>	<i>-446bps</i>	<i>-561bps</i>
Depreciation	669	428	400	56.3%	67.3%
<b>EBIT</b>	<b>1,172</b>	<b>2,239</b>	<b>2,165</b>	<b>-47.7%</b>	<b>-45.9%</b>
Other Income	220	290	279	NA	-21.1%
Finance cost	130	-	28	NA	NA
Exceptional Item	-	-	-	-	-
<b>PBT</b>	<b>1,262</b>	<b>2,529</b>	<b>2,416</b>	<b>-50.1%</b>	<b>-47.8%</b>
Tax Expense	335	681	579	-50.8%	-42.1%
Effective tax rate %	26.5%	26.9%	24.0%	-38bps	296bps
<b>PAT</b>	<b>927</b>	<b>1,779</b>	<b>1,738</b>	<b>-47.9%</b>	<b>-46.7%</b>
MI & Associates	-	-	-	-	-
<b>Consolidated PAT</b>	<b>927</b>	<b>1,779</b>	<b>1,738</b>	<b>-47.9%</b>	<b>-46.7%</b>
<i>PAT margin %</i>	<i>5.1%</i>	<i>9.7%</i>	<i>10.6%</i>	<i>-462bps</i>	<i>-93bps</i>
<b>EPS (Rs)</b>	<b>5.6</b>	<b>10.8</b>	<b>10.6</b>	<b>-47.9%</b>	<b>-46.7%</b>

Source: Company, Arianth Research

## Post Result Conference Call Highlights

- Attrition rate jumped to 18.5% in Q1FY20, highest in four years since June 2015. Usually attrition goes up in Q1 for IT services companies due to seasonal factors like compensation revision. However this unusual hike in attrition can be part attributed to the L&T takeover and top management uncertainty.
- As articulated in last quarter concall, Mindtree reclassified its digital revenue into three core groups, 1) Mindtree Interactive, 2) Data Science & Engineering Services and 3) Cloud Services. This will help them focus more on digital.
- Mindtree management said its future outlook is robust as deal pipeline is healthy across all verticals giving confidence of full year growth.
- In last quarter concall, Mindtree management gave guidance of revenue growth in mid-teens for FY20E and slight expansion in FY20E margins over FY19. Despite margin dipping to 10% in Q1FY20, company maintained its stance of achieving mid-teen revenue growth on the back of strong deal pipeline and still hopeful of achieving normalised margin of ~13% in FY20E.
- Driving profitability continue to be focus area for Mindtree management and expect some relief on margin front in Q2.
- Some growth pangs are being seen in its Europe business for past few quarters, due to headwinds related to banking. The company is taking steps and making sustained efforts on the marketing side to revive growth.
- With core business strength being intact on the back of strong digital growth and robust deal pipeline, the management is confident that future will be bright and any uncertainty due to change in top management will be addressed in few weeks time and hopeful that attrition due to management change will be contained.

## Consolidated Financials

## Income Statement (Rs Mn)

Year End-March	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>Revenues</b>	46,730	52,364	54,628	70,215	78,022	88,111
Change (%)	31.2%	12.1%	4.3%	28.5%	11.1%	12.9%
Employee Costs	27,991	34,125	35,641	44,212	50,715	56,391
Other Expenses	10,529	11,058	11,582	15,358	16,775	18,503
<b>Total Expenses</b>	38,520	45,183	47,223	59,570	67,489	74,895
<b>EBITDA</b>	8,210	7,181	7,405	10,645	10,533	13,217
Other Income	839	417	1,902	893	1,007	1,252
Depreciation	1,658	1,858	1,715	1,641	2,642	2,877
Interest	160	191	169	29	520	520
<b>PBT</b>	<b>7,231</b>	<b>5,549</b>	<b>7,423</b>	<b>9,868</b>	<b>8,377</b>	<b>11,073</b>
Tax	1,706	1,363	1,722	2,327	2,178	2,934
Rate (%)	23.6%	24.6%	23.2%	23.6%	26.0%	26.5%
<b>PAT</b>	<b>5,525</b>	<b>4,186</b>	<b>5,701</b>	<b>7,541</b>	<b>6,199</b>	<b>8,138</b>
<b>MI &amp; Associates</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Consolidated PAT</b>	<b>5,525</b>	<b>4,186</b>	<b>5,701</b>	<b>7,541</b>	<b>6,199</b>	<b>8,138</b>
Change (%)	3%	-24.2%	36.2%	32.3%	-17.8%	31.3%

Source: Company, Arianth Research

## Balance Sheet (Rs Mn)

Year End-March	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>Sources of Funds</b>						
Share Capital	1,678	1,680	1,639	1,642	1,645	1,645
Reserves & Surplus	22,471	24,091	25,775	31,419	32,661	37,900
<b>Net Worth</b>	<b>24,149</b>	<b>25,771</b>	<b>27,414</b>	<b>33,061</b>	<b>34,306</b>	<b>39,545</b>
<b>Loan Funds</b>	<b>433</b>	<b>991</b>	<b>3,009</b>	<b>1,599</b>	<b>1,724</b>	<b>1,986</b>
MI, Deferred Tax & other Liabilities	432	-323	-233	-303	-233	-233
<b>Capital Employed</b>	<b>25,014</b>	<b>26,439</b>	<b>30,190</b>	<b>34,357</b>	<b>35,797</b>	<b>41,298</b>
<b>Application of Funds</b>						
Net Block	6,805	5,750	5,029	6,137	7,051	8,270
CWIP	232	192	92	297	129	151
Other Non-current Assets	6,990	6,672	6,837	7,296	7,735	8,240
<b>Net Fixed Assets</b>	<b>14,027</b>	<b>12,614</b>	<b>11,958</b>	<b>13,730</b>	<b>14,914</b>	<b>16,661</b>
<b>Investments</b>	<b>62</b>	<b>58</b>	<b>58</b>	<b>1,200</b>	<b>1,210</b>	<b>1,220</b>
Debtors	9,728	8,962	10,155	13,356	14,963	16,760
Cash & Bank Balance	4,598	8,377	10,495	9,826	8,013	10,348
Loans & Advances & other CA	3,948	3,271	4,381	4,795	6,455	7,231
<b>Total Current Assets</b>	<b>18,274</b>	<b>20,610</b>	<b>25,031</b>	<b>27,977</b>	<b>29,432</b>	<b>34,339</b>
Current Liabilities & Provisions	7,349	6,843	6,857	8,550	9,758	10,923
<b>Net Current Assets</b>	<b>10,925</b>	<b>13,767</b>	<b>18,174</b>	<b>19,427</b>	<b>19,673</b>	<b>23,416</b>
<b>Total Assets</b>	<b>25,014</b>	<b>26,439</b>	<b>30,190</b>	<b>34,357</b>	<b>35,797</b>	<b>41,298</b>

Source: Company, Arianth Research

## Cash Flow Statement (Rs Mn)

Year End-March	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>PBT</b>	<b>7,231</b>	<b>5,549</b>	<b>7,423</b>	<b>9,868</b>	<b>8,377</b>	<b>11,073</b>
Depreciation	1,658	1,858	1,715	1,641	2,642	2,877
Interest & others	454	-404	202	-864	-487	-732
Cash flow before WC changes	9,343	7,003	9,340	10,645	10,533	13,217
<b>(Inc)/dec in working capital</b>	<b>-2,995</b>	<b>1,095</b>	<b>-2,397</b>	<b>-2,780</b>	<b>-1,628</b>	<b>-1,614</b>
Operating CF after WC changes	6,348	8,098	6,943	7,865	8,905	11,602
Less: Taxes	-1,706	-1,363	-1,722	-2,351	-2,178	-2,934
<b>Operating Cash Flow</b>	<b>4,642</b>	<b>6,735</b>	<b>5,221</b>	<b>5,514</b>	<b>6,727</b>	<b>8,668</b>
(Inc)/dec in F.A + CWIP	-1,584	-871	-1,020	-1,313	-2,883	-3,319
(Pur)/sale of investment	0	0	0	0	0	0
<b>Cash Flow from Investing</b>	<b>-1,584</b>	<b>-871</b>	<b>-1,020</b>	<b>-1,313</b>	<b>-2,883</b>	<b>-3,319</b>
<b>Free Cash Flow (FCF)</b>	<b>3,058</b>	<b>5,864</b>	<b>4,201</b>	<b>4,201</b>	<b>3,844</b>	<b>5,349</b>
Loan raised/(repaid)	410	558	2,018	-1,410	178	262
Equity raised	841	2	-41	3	3	0
Interest & others	-6,738	-464	-1,254	260	-520	-520
Dividend	-2,079	-2,181	-2,557	-4,935	-3,553	-3,553
<b>Cash Flow from Financing Activities</b>	<b>-7,566</b>	<b>-2,085</b>	<b>-1,834</b>	<b>-6,082</b>	<b>-3,892</b>	<b>-3,811</b>
<b>Net inc /(dec) in cash</b>	<b>-4,508</b>	<b>3,779</b>	<b>2,367</b>	<b>-1,881</b>	<b>-49</b>	<b>1,538</b>
Opening balance of cash	9,106	4,598	8,377	10,495	9,826	8,013
Closing balance of cash	4,598	8,377	10,495	9,826	8,013	10,348

Source: Company, Arian Research

## Key Ratios

Year End-March	FY16	FY17	FY18	FY19	FY20E	FY21E
<b>Per Share (Rs)</b>						
EPS	32.9	24.9	34.8	45.9	37.7	49.5
CEPS	42.8	36.0	45.2	55.9	53.7	67.0
BVPS	144	153	167	201	209	240
DPS	10.5	11.0	13.0	30.0	18.0	18.0
<b>Valuation (x)</b>						
P/E	21.0	27.7	19.9	15.0	18.3	14.0
P/CEPS	16.1	19.2	15.3	12.4	12.9	10.3
P/BV	4.8	4.5	4.1	3.4	3.3	2.9
EV/EBITDA	19.4	21.7	20.5	14.2	14.6	11.5
<b>Return Ratio (%)</b>						
EBIDTA Margin	17.6%	13.7%	13.6%	15.2%	13.5%	15.0%
PAT Margin	11.8%	8.0%	10.4%	10.7%	7.9%	9.2%
ROE	22.9%	16.2%	20.8%	22.8%	18.1%	20.6%
ROCE	26.2%	20.1%	18.8%	26.2%	22.0%	25.0%
Dividend Yield	1.5%	1.6%	1.9%	4.3%	2.6%	2.6%
<b>Leverage Ratio (%)</b>						
Total D/E	0.0	0.0	0.1	0.0	0.1	0.1
Net D/E	-0.2	-0.3	-0.3	-0.2	-0.2	-0.2
<b>Turnover Ratios</b>						
Asset Turnover (x)	1.9	2.0	1.8	2.0	2.2	2.1
Receivable Days	76	62	68	69	70	69
Payable days	57	48	46	44	46	45

Source: Company, Arian Research

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**Stock Rating Scale**

	<b>Absolute Return</b>
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

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