

*Stable set of results, despite double digit CC growth, margin continue to falter, while hostile takeover has taken its toll in the form of higher attrition, downgrade to Neutral*

Current	Previous
<b>CMP: Rs 743</b>	
<b>Rating: Neutral</b>	<b>Rating: Hold</b>
<b>Target: Rs 742</b>	<b>Target: Rs 742</b>

(NR-Not Rated)

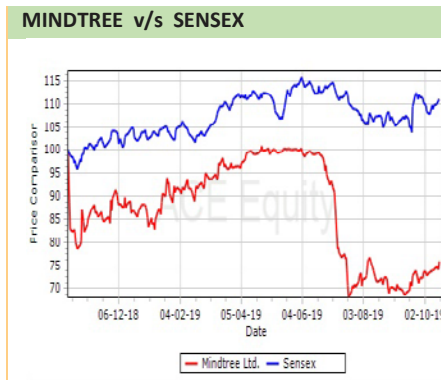
Stock Info	
INDEX	
BSE	532819
NSE	MINDTREE
Bloomberg	MTCL IN
Reuters	MINT.BO
Sector	Information Technology
Face Value (Rs)	10
Equity Capital (Rs Mn)	1646
Market Cap (Rs Mn)	122326
52w H/L (Rs)	1002 / 652
Avg Weekly Vol (BSE+NSE)	143,444,530

Shareholding Pattern	%
<b>(As on Sept, 2019)</b>	
Promoters	73.8
Public & Others	26.2

Source: NSE, Arihant Research

Stock Performance (%)	3m	6m	12m
MINDTREE	-0.8	-23.5	-24.6
SENSEX	-1.4	-1.7	9.8

Source: ACE Equity, Arihant Research



Source: ACE Equity, Arihant Research

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*Mindtree reported stable set of numbers in Q2FY20, mostly in line with our estimates except a minor miss on PAT. Consolidated revenue for Q2FY20 stood at Rs 19,143mn, slightly above our estimate of Rs 19,030mn, registering +9.1% YoY/+4.4% QoQ growth. Reported EBITDA grew +34.8% QoQ/-3.2% YoY to Rs 2482 mn, a tad above our estimate of Rs 2474 mn, while EBITDA margin expanded 293bps YoY to 13% exactly matching our estimate of 13%. PAT for the quarter grew +45.6% YoY to Rs 1350 mn, missing our estimate of Rs 1427 mn. Despite stable results, we downgrade the stock from Hold to Neutral due to factors like 1) new management will take time to effectively manage the transition, 2) spike in attrition rate, 3) muted outlook on margin despite strong topline growth. We recommend Neutral rating on the stock with a target price of Rs 742 (unchanged).*

**Q2FY20 Highlights**

- Consolidated revenue for Q2FY20 stood at Rs 19,143mn, slightly above our estimate of Rs 19,030mn, registering +9.1% YoY/+4.4% QoQ growth. In US dollar terms, revenue was at US\$271 mn (growth of +2.6% QoQ/+10% YoY). In Constant Currency (CC) terms, growth of +3.2% QoQ/+11.1% YoY.
- Reported EBITDA grew +34.8% QoQ/-3.2% YoY to Rs 2482mn, a tad above our estimate of Rs 2474 mn, while EBITDA margin expanded 293bps YoY to 13% exactly matching our estimate of 13%.
- Consolidated PAT for the quarter grew +45.6% YoY to Rs 1350 mn, missing our estimate of Rs 1427 mn. Mindtree has 343 active clients as of Q2FY20 end, with US\$5mn clients growing by 1 during Q2FY20.

**Future Outlook**

After the hostile takeover by L&T, some senior level exits happened and attrition rate spiked, which is a cause of concern. However, the new CEO and L&T group have taken conscious efforts in protecting the culture and people of Mindtree. We believe as the deal pipeline is strong in digital, and there is continued traction in revenue growth, Mindtree will continue to show robust growth in next few years, provided the new management tackle the attrition issue to ensure a smooth transition and put concerted focus on margin improvement.

**Valuations**

After factoring in stable results, we have kept our FY20E/FY21E estimate unchanged and continue to value the stock at a P/E of 15x its FY21E earnings. At CMP of Rs 743, Mindtree is trading at FY20E and FY21E, P/E multiples of 19.7x and 15x respectively. **We downgrade the stock from Hold to Neutral due to reasons mentioned above, with an unchanged 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	21.4
FY19	70,215	10,645	7,541	45.9	15.2	22.8	16.2
FY20E	78,022	10,533	6,199	37.7	13.5	17.9	19.7
FY21E	88,111	13,217	8,138	49.5	15.0	20.4	15.0

Source: Company, Arihant Research

## Q2FY20 and H1FY20 Financial Performance

Rs Mn (consolidated)	Q2FY20	Q1FY20	Q2FY19	Q-o-Q	Y-o-Y	H1FY20	H1FY19	Y-o-Y
<b>Net Revenue</b>	<b>19,143</b>	<b>18,342</b>	<b>17,554</b>	<b>4.4%</b>	<b>9.1%</b>	<b>37,485</b>	<b>33,949</b>	<b>10.4%</b>
Employee cost	12,647	12,532	11,171	0.9%	13.2%	25,179	21,566	16.8%
Other Expenses	4,014	3,969	3,684	1.1%	9.0%	7,983	7,374	8.3%
<b>EBITDA</b>	<b>2,482</b>	<b>1,841</b>	<b>2,565</b>	<b>34.8%</b>	<b>-3.2%</b>	<b>4,323</b>	<b>5,009</b>	<b>-13.7%</b>
<i>EBITDA margin %</i>	<i>13.0%</i>	<i>10.0%</i>	<i>14.6%</i>	<i>+293bps</i>	<i>-165bps</i>	<i>11.5%</i>	<i>14.8%</i>	<i>-322bps</i>
Depreciation	707	669	403	5.7%	75.4%	1,376	803	71.4%
<b>EBIT</b>	<b>1,775</b>	<b>1,172</b>	<b>2,162</b>	<b>51.5%</b>	<b>-17.9%</b>	<b>2,947</b>	<b>4,206</b>	<b>-29.9%</b>
Other Income	197	220	524	-10.5%	-62.4%	417	803	-48.1%
Finance cost	138	130	1	6.2%	-	268	29	824.1%
Exceptional Item	-	-	-	-	-	-	-	-
<b>PBT</b>	<b>1,834</b>	<b>1,262</b>	<b>2,685</b>	<b>45.3%</b>	<b>-31.7%</b>	<b>3,096</b>	<b>4,980</b>	<b>-37.8%</b>
Tax Expense	484	335	756	44.5%	-36.0%	819	1,335	-38.7%
Effective tax rate %	26.4%	26.5%	28.2%	-15bps	-177bps	26.5%	26.8%	-35bps
<b>PAT</b>	<b>1,350</b>	<b>927</b>	<b>1,738</b>	<b>45.6%</b>	<b>-22.3%</b>	<b>2,277</b>	<b>3,645</b>	<b>-37.5%</b>
MI & Associates	-	-	-	-	-	-	-	-
<b>Consolidated PAT</b>	<b>1,350</b>	<b>927</b>	<b>1,738</b>	<b>45.6%</b>	<b>-22.3%</b>	<b>2,277</b>	<b>3,645</b>	<b>-37.5%</b>
<i>PAT margin %</i>	<i>7.1%</i>	<i>5.1%</i>	<i>9.9%</i>	<i>+200bps</i>	<i>-285bps</i>	<i>6.1%</i>	<i>10.7%</i>	<i>-466bps</i>
<b>EPS (Rs)</b>	<b>8.2</b>	<b>5.6</b>	<b>10.6</b>	<b>45.5%</b>	<b>-22.5%</b>	<b>13.8</b>	<b>22.2</b>	<b>-37.7%</b>

Source: Company, Arianth Research

## Post Result Conference Call Highlights

- During the quarter, the company secured some deals in digital and testing in its BFSI vertical. The management sounded optimistic about its insurance vertical as it expects reasonable growth in Tier – II banks.
- Double digit CC growth was possible due to strong growth in its top client. Mindtree management expressed confidence in continued growth in its top client account at least till H1CY20 on the back of renewal deals signed during the quarter. There is also further scope of winning new deals from the top client in subsequent quarters and hence growth outlook remains strong.
- In Q2FY20, EBITDA margin improved by 293bps on QoQ basis, contributed by operational efficiencies (+140bps), favourable forex movement (+50bps) and rest from reduced visa costs. Going forward the management expects the margin to improve gradually in subsequent quarters barring cross currency headwinds and one-off items.
- Attrition rate jumped to 20.2% in Q2FY20 from 18.5% in Q1FY20, highest in four years since June 2015. The company said this unusual hike in attrition can be partly attributed to factors like a) change in management, b) seasonal wage hike impact, c) skilled & talented Mindtree employees being target of poaching for other competitors and d) some senior level exit after management change.
- As far as tax rate is concerned, Mindtree management said that for next couple of years the effective tax rate will not change and the management will decide on the timing for switching to the new tax rate over next 12-18 months.

## 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, Aриhant 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	1,646	1,646
Reserves & Surplus	22,471	24,091	25,775	31,419	33,083	38,322
<b>Net Worth</b>	<b>24,149</b>	<b>25,771</b>	<b>27,414</b>	<b>33,061</b>	<b>34,729</b>	<b>39,968</b>
<b>Loan Funds</b>	<b>433</b>	<b>991</b>	<b>3,009</b>	<b>1,599</b>	<b>1,745</b>	<b>2,007</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>36,241</b>	<b>41,742</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	8,457	10,792
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>29,876</b>	<b>34,783</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>20,117</b>	<b>23,861</b>
<b>Total Assets</b>	<b>25,014</b>	<b>26,439</b>	<b>30,190</b>	<b>34,357</b>	<b>36,241</b>	<b>41,742</b>

Source: Company, Aриhant 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>-1,475</b>	<b>-1,614</b>
Operating CF after WC changes	6,348	8,098	6,943	7,865	9,059	11,602
Less: Taxes	-1,706	-1,363	-1,722	-2,327	-2,178	-2,934
<b>Operating Cash Flow</b>	<b>4,642</b>	<b>6,735</b>	<b>5,221</b>	<b>5,538</b>	<b>6,880</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>4,225</b>	<b>3,997</b>	<b>5,349</b>
Loan raised/(repaid)	410	558	2,018	-1,410	178	262
Equity raised	841	2	-41	3	4	0
Interest & others	-6,738	-464	-1,503	1,451	-1,995	277
Dividend	-2,079	-2,181	-2,557	-4,938	-3,553	-3,553
<b>Cash Flow from Financing Activities</b>	<b>-7,566</b>	<b>-2,085</b>	<b>-2,083</b>	<b>-4,894</b>	<b>-5,366</b>	<b>-3,014</b>
<b>Net inc /(dec) in cash</b>	<b>-4,508</b>	<b>3,779</b>	<b>2,118</b>	<b>-669</b>	<b>-1,369</b>	<b>2,335</b>
Opening balance of cash	9,106	4,598	8,377	10,495	9,826	8,457
Closing balance of cash	4,598	8,377	10,495	9,826	8,457	10,792

Source: Company, Arianth 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	49.4
CEPS	42.8	36.0	45.2	55.9	53.7	66.9
BVPS	144	153	167	201	211	243
DPS	10.5	11.0	13.0	30.0	18.0	18.0
<b>Valuation (x)</b>						
P/E	22.6	29.8	21.4	16.2	19.7	15.0
P/CEPS	17.4	20.7	16.4	13.3	13.8	11.1
P/BV	5.2	4.8	4.4	3.7	3.5	3.1
EV/EBITDA	19.4	21.7	20.5	14.2	14.5	11.4
<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%	17.9%	20.4%
ROCE	26.2%	20.1%	18.8%	26.2%	21.8%	24.8%
Dividend Yield	1.4%	1.5%	1.7%	4.0%	2.4%	2.4%
<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, Arianth Research

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**Stock Rating Scale****Absolute Return**

BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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