

MindTree (MTCL IN)

Decent results; structural uncertainties continue

INDIA | IT SERVICES | Quarterly Update

25 October 2017

Key takeaways from Q2FY18

- **USD revenue at US\$ 206mn, grew +6.8% yoy (+3% qoq)** – inline with consensus estimates of \$207mn. **CC revenue grew +2.1% qoq** – inline with estimates of +2.3% qoq.
- **Geographies:** US (+6.7% yoy), Europe +13.8%, India +6.8% while RoW -10.3% yoy.
- **Verticals:** Technology & Media +10% yoy, BFSI +7.3% yoy, Retail +1.1% yoy and Travel +7.6% yoy.
- **Service lines:** IMS +17% yoy, Development +12.2% yoy, Maintenance +6.2% yoy, Engineering +0.3% yoy. Package implementation -8.7% yoy.
- **Digital/SMAC revenues grew +13.8% yoy (+3.8% qoq) to 42.6% of revenues.**
- **EBIT margins at 8.2%**, +60bps qoq (-70bps yoy) - inline with street estimates of 8.4%. The margins were impacted by one-time employee restructuring cost (-100bps qoq), wage hike (-130bps) and buy-back cost (-20bps), offset by operational efficiencies (+120bps), absence of visa cost (+120bps) and positive FX impact (+50bps).
- Adjusted for Bluefin and Magnet360 results, the margins were at 10.4%
- **PAT** at Rs1.2bn, +77% yoy (-6.3% qoq) – boosted by exceptional other income of Rs 303mn, on writeback of provisions. Adjusted PAT inline with estimates of Rs 1bn.
- **TCV** of \$207mn (+13% yoy, -21% qoq). Digital dealflow of \$84mn (+31% yoy, -22% qoq).
- **Top Client/Top 5/Top 10** grew by +19.5%/+7.2%/+5.3% yoy.

Management comments/concall takeaways:

- Bluefin revenue grew to \$8.9mn (+21.9% qoq) – due to the ramp-up in the deal wins. It reported profit at EBITDA level (compared to loss in the last quarter).
- Magnet 360 revenue declined to \$4.5mn (-30.8% qoq) – due to delay in contract closure – also continued to report loss at EBITDA level.
- For FY18, the management has maintained **its guidance of 'higher single digit' revenue growth** – extremely challenging target in our opinion.
- The largest deal the company has announced in FY17 (among the many large deals) has ramp-up significantly and the client is now in top-10 bucket for Mindtree.
- Retail & CPG segment – the early adapter of the Digital, is expected to perform better due to the huge opportunities in the Digital space.
- The company will continue with the buyback and other forms of boosting shareholders' returns going ahead – as a part of the efficient capital allocation policy.
- Q3FY18 margins will be impacted by wage hike (-50bps) and higher fresher additions.

Outlook and valuation:

MTCL reported decent results in the quarter, led by recovery in Bluefin business. While the management maintained its revenue guidance for FY18 – we believe achieving 'high single digit' growth will also be a formidable challenge – given the continuing uncertainties in the acquired entities of Bluefin and Magnet360. At the same time, its ERD business appears to be stagnating for last three quarters, with virtually no organic growth.

We have revised our FY18/19 earnings estimates by +8/+2% taking into account the buyback impact, and the exceptional higher other income in 1HFY18. We continue to value MTCL at 12x FY19 earnings – discount to large-caps, but inline with TechM and Persistent. Maintain Sell with price target of Rs 380 (*unchanged*).

SELL (Maintain)

CMP RS 507

TARGET RS 380 (-25%)

COMPANY DATA

O/S SHARES (MN) :	168
MARKET CAP (RSBN) :	85
MARKET CAP (USDBN) :	1.3
52 - WK HI/LO (RS) :	566 / 400
LIQUIDITY 3M (USDMMN) :	3.3
PAR VALUE (RS) :	10

SHARE HOLDING PATTERN, %

	Jun 17	Mar 17	Dec 16
PROMOTERS :	13.6	13.7	13.7
FII / NRI :	40.4	39.2	39.0
FI / MF :	6.3	7.1	7.2
NON PRO :	12.5	12.6	13.2
PUBLIC & OTHERS :	27.1	27.5	26.9

Key Financials

Rs mn	FY17	FY18E	FY19E
Net Sales	52,364	53,999	58,622
EBIT	5,095	4,753	6,333
Net Profit	4,186	4,652	5,246
EPS, Rs	24.9	28.4	32.0
PER, x	20.3	17.9	15.8
EV/EBIDTA, x	12.0	12.7	9.8
P/BV, x	3.3	3.2	2.8
ROE, %	16.2	17.7	17.8

CHANGE IN ESTIMATES

Rs mn	Revised Est.		% Revision	
	FY18E	FY19E	FY18E	FY19E
Revenue(\$mn)	834	902	-0.1%	-0.2%
EBIT	4,753	6,333	-1.0%	-1.0%
Core PAT	4,652	5,246	5.8%	-0.1%
EPS (Rs)	28.2	32.0	7.8%	2.4%

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(Rs mn)	Q2FY18	Q2FY17	yoy growth %	Q1FY18	qoq growth %	vs. expectations %	Comments
US\$ revenues	206	193	6.8	200	3.0	0.4	Inline performance
Net sales	13,316	12,954	2.8	12,895	3.3	1.0	
EBIT	1,087	1,158	-6.1	976	11.4	6.9	
Margins (%)	8.2%	8.9%	-80bps	7.6%	60bps	50bps	Margin above estimates despite wage hike
Profit after tax	1,247	948	31.5	1,217	2.5	44.8	Higher than estimates, boosted by provision writeback
EPS	7.4	5.7	31.4	7.2	2.5	44.8	
Utilization	74.6	73.1	150bps	73.8	80bps		
TCV (\$ mn)	207	184	12.5	262	-21.0		

Quarterly performance

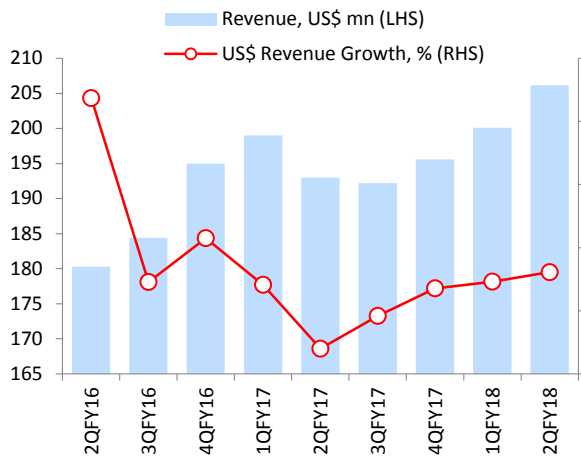
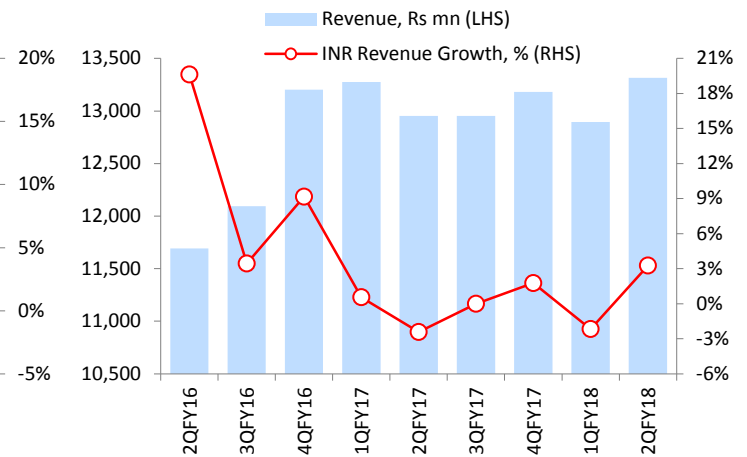
Rs mn	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
US\$ revenues	193	192	196	200	206
QoQ growth %	-3.0%	-0.4%	1.8%	2.3%	3.0%
Net sales	12,954	12,953	13,181	12,895	13,316
QoQ growth %	-2.4%	0.0%	1.8%	-2.2%	3.3%
YoY growth %	11%	7%	0%	-3%	3%
Cost of revenues	8,526	8,533	8,700	8,393	9,001
SGA & other exp	2,807	2,680	2,840	3,067	2,774
EBITDA	1,621	1,740	1,641	1,435	1,541
QoQ growth %	-16.9%	7.3%	-5.7%	-12.6%	7.4%
YoY growth %	-25%	-19%	-26%	-26%	-5%
Margins (%)	12.5%	13.4%	12.4%	11.1%	11.6%
Depreciation	463	459	468	459	454
EBIT	1,158	1,281	1,173	976	1,087
Margins (%)	8.9%	9.9%	8.9%	7.6%	8.2%
Other income	170	144	133	654	598
Pre-tax profit	1,281	1,379	1,259	1,590	1,660
Tax provided	333	348	287	373	413
Profit after tax	948	1,031	972	1,217	1,247
QoQ growth %	-23.2%	8.8%	-5.7%	25.2%	-6.3%
YoY growth %	-40.1%	-26.7%	-26.9%	-1.5%	77.2%
Margins (%)	7.3%	8.0%	7.4%	9.4%	9.4%
Other comprehensive income	241	41	234	-120	-6
PAT	707	990	738	1337	1253
EPS, Rs	5.7	6.1	5.8	7.2	7.4

Source: Company, PhillipCapital India Research

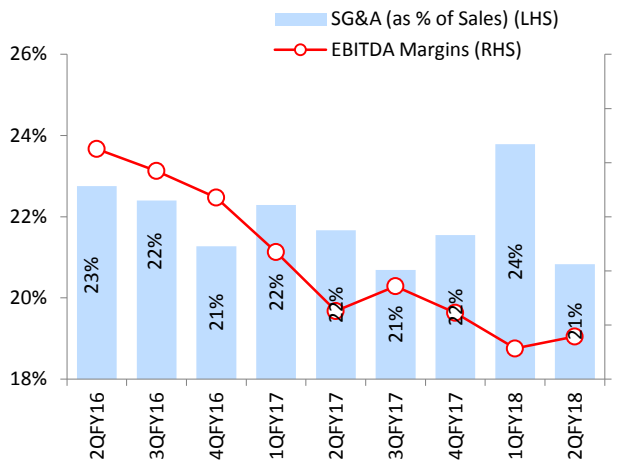
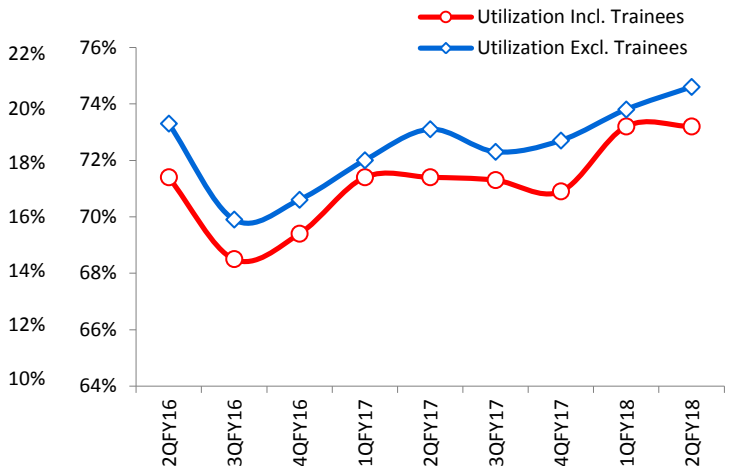
Operating metrics

YoY growth	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18
Service Lines					
Development	1.5%	-1.9%	-6.7%	0.1%	12.2%
Engineering	22.0%	19.3%	-2.8%	-1.5%	0.3%
Maintenance	-9.3%	-7.4%	2.0%	10.4%	6.2%
Consulting & IP Licensing	30.5%	25.5%	0.3%	-11.3%	6.8%
Package Implementation	5.4%	0.2%	-7.7%	-16.8%	-8.7%
Independent Testing	3.7%	2.6%	-1.3%	-7.3%	4.3%
Infrastructure management & tech support	25.3%	16.9%	17.6%	14.8%	17.0%
Digital/Smac	23.4%	13.8%	2.9%	6.6%	13.8%
Industry Verticals					
Hitech and Media Services	29.2%	26.7%	6.6%	5.6%	10.0%
BFSI	7.0%	0.1%	1.5%	1.4%	7.3%
Retail, CPG & Manufacturing	25.8%	23.7%	-3.1%	-5.3%	1.1%
Travel & Hospitality	10.9%	0.9%	-8.9%	-4.1%	7.6%
Geographies					
US	14.5%	12.8%	6.4%	4.9%	6.7%
Europe	-13.9%	-17.9%	-15.2%	-8.2%	13.8%
India	17.1%	19.7%	0.3%	-2.7%	6.8%
Rest of World	14.7%	4.2%	-4.1%	-10.8%	-10.3%
Client Mix					
Top Client	44.1%	34.8%	23.7%	17.4%	19.5%
Top 5 client	1.0%	-2.3%	4.4%	2.3%	7.2%
Top 10 client	0.0%	-4.6%	-1.3%	-2.0%	5.3%

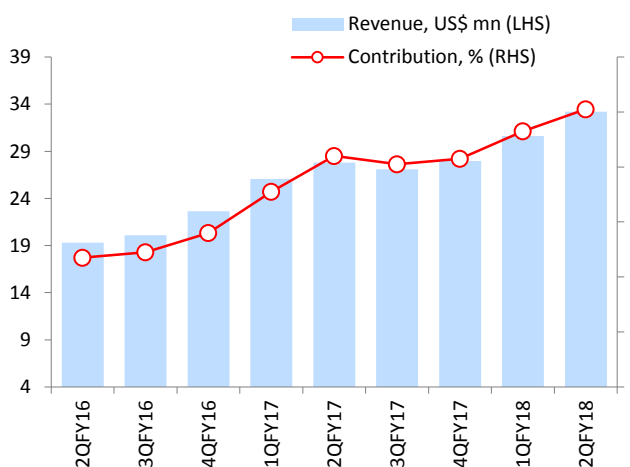
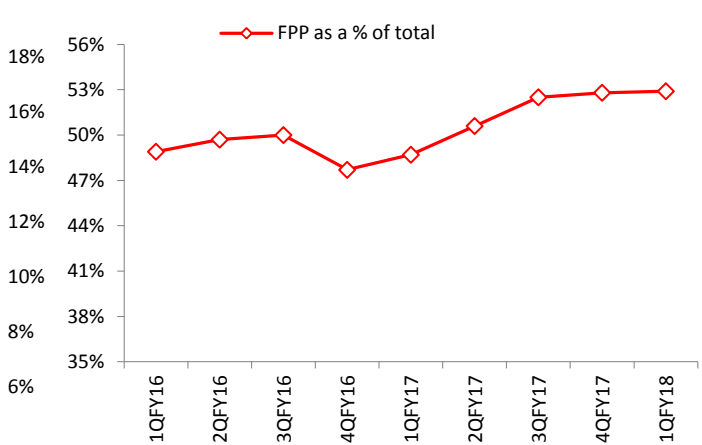
Source: Company, PhillipCapital India Research

US\$ revenue and qoq growth

INR revenues and qoq growth


Source: Company, PhillipCapital India Research

SG&A spend and EBITDA margins

Utilisations


Source: Company, PhillipCapital India Research

Top-client contribution

Business mix


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY16	FY17	FY18E	FY19E
Net sales	46,730	52,364	53,999	58,622
Growth, %	31.2	12.1	3.1	8.6
Other operating income	0	0	0	0
Total income	46,730	52,364	53,999	58,622
Employee expenses	-27,991	-34,125	-35,893	-38,627
SG&A	-10,529	-11,286	-11,538	-11,724
EBITDA (Core)	8,210	6,953	6,569	8,270
Growth, %	15.8	(15.3)	(5.5)	25.9
Margin, %	17.6	13.3	12.2	14.1
Depreciation	-1,658	-1,858	-1,816	-1,937
EBIT	6,552	5,095	4,753	6,333
Growth, %	7.9	(22.2)	(6.7)	33.2
Margin, %	14.0	9.7	8.8	10.8
Other Non-Operating Income	839	645	1,530	762
Pre-tax profit	7,231	5,549	6,168	6,995
Tax provided	-1,706	-1,363	-1,515	-1,749
Profit after tax	5,525	4,186	4,652	5,246
Net Profit	5,525	4,186	4,652	5,246
Growth, %	3.0	(24.2)	11.1	12.8
Net Profit (adjusted)	5,525	4,186	4,652	5,246
Wtd avg shares (m)	168	168	164	164

	FY16	FY17	FY18E	FY19E
US\$ Revenue (\$ mn)	714	780	834	902
Growth, %	22.3	9.2	6.9	8.2
Re / US\$ (rate)	65.4	67.2	64.8	65.0

Balance Sheet

Y/E Mar, Rs mn	FY16	FY17	FY18E	FY19E
Cash & bank	2,332	2,508	2,081	4,398
Debtors	9,728	8,962	9,603	10,156
Loans & advances	3,643	3,113	4,014	4,014
Other current assets	1,149	1,034	1,007	1,065
Total current assets	16,852	15,617	16,704	19,633
Investments	2,328	5,927	6,388	6,388
Gross fixed assets	11,620	10,220	9,942	10,542
Add: Capital WIP	232	192	298	298
Net fixed assets	11,852	10,412	10,240	10,840
Non-current assets	1,328	1,326	1,426	1,426
Total assets	32,769	33,906	35,325	38,854
Current liabilities	6,455	6,716	7,703	8,004
Provisions	1,289	1,105	1,272	1,345
Total current liabilities	7,744	7,821	8,975	9,350
Non-current liabilities	876	314	95	95
Total liabilities	8,620	8,135	9,070	9,445
Paid-up capital	1,678	1,680	1,639	1,639
Reserves & surplus	22,471	24,091	24,616	27,770
Shareholders' equity	24,149	25,771	26,255	29,409
Total equity & liabilities	32,769	33,906	35,325	38,854

Source: Company, PhillipCapital India Research Estimates

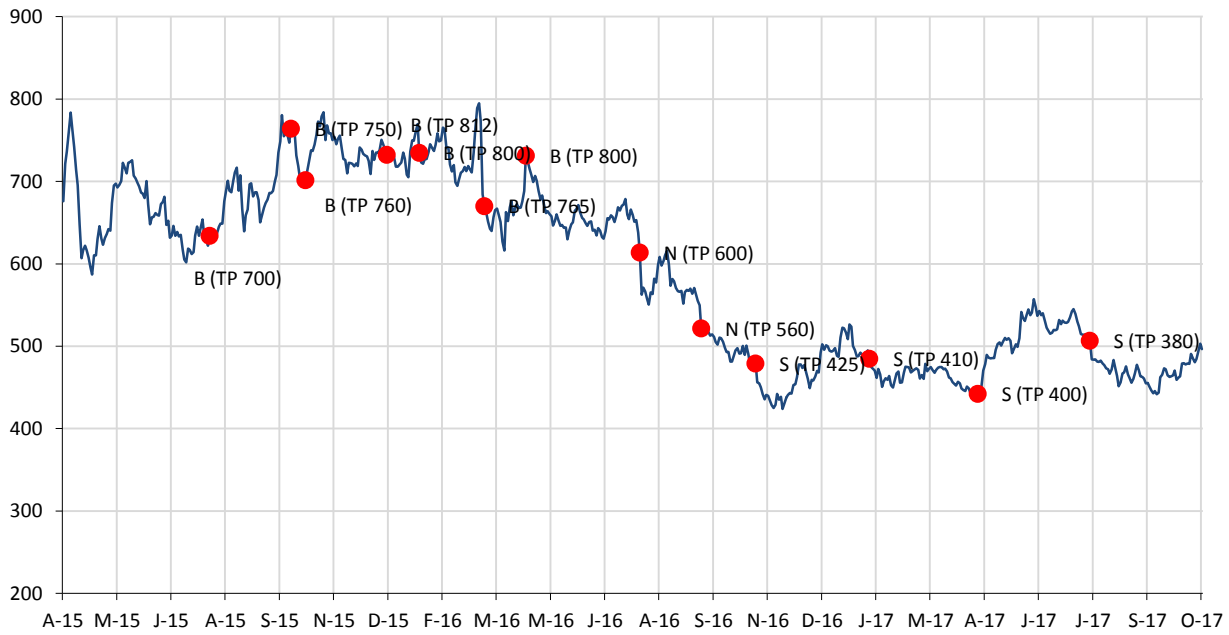
Cash Flow

Y/E Mar, Rs mn	FY16	FY17	FY18E	FY19E
Pre-tax profit	7,231	5,549	6,168	6,995
Depreciation	1,658	1,858	1,816	1,937
Chg in working capital	-1,811	1,117	-842	-310
Total tax paid	-2,422	-1,762	-1,292	-1,675
Cash flow from operating activities	4,656	6,762	5,850	6,947
Capital expenditure	-7,601	-418	-1,644	-2,537
Chg in investments	3,023	-3,599	-461	0
Cash flow from investing activities	-4,578	-4,017	-2,105	-2,537
Free cash flow	78	2,745	3,745	4,409
Equity raised/(repaid)	837	2	-2,700	0
Debt raised/(repaid)	-5	-5	-4	0
Dividend (incl. tax)	-2,045	-1,950	-2,282	-2,282
Other financing activities	-296	-616	-1,886	190
Cash flow from financing activities	-1,509	-2,569	-4,172	-2,092
Net chg in cash	-1,431	176	-427	2,317

Valuation Ratios

	FY16	FY17	FY18E	FY19E
Per Share data				
EPS (INR)	32.9	24.9	28.4	32.0
Growth, %	2.7	(24.3)	13.8	12.8
Book NAV/share (INR)	143.9	153.5	160.2	179.4
FDEPS (INR)	32.9	24.9	28.4	32.0
CEPS (INR)	42.8	36.0	39.5	43.8
CFPS (INR)	28.1	33.1	17.8	37.7
DPS (INR)	10.5	10.0	12.0	12.0
Return ratios				
Return on assets (%)	19.0	12.9	13.6	14.3
Return on equity (%)	22.9	16.2	17.7	17.8
Return on capital employed (%)	24.7	16.9	18.0	19.0
Turnover ratios				
Asset turnover (x)	2.9	2.8	2.9	2.9
Sales/Total assets (x)	1.6	1.6	1.6	1.6
Sales/Net FA (x)	5.3	4.7	5.2	5.6
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	76.0	62.5	64.9	63.2
Payable days	17.9	13.3	13.1	13.0
Working capital days	52.9	36.9	38.2	36.6
Liquidity ratios				
Current ratio (x)	2.2	2.0	1.9	2.1
Quick ratio (x)	2.2	2.0	1.9	2.1
Dividend cover (x)	3.1	2.5	2.4	2.7
Total debt/Equity (%)	1.8	3.8	9.5	8.4
Net debt/Equity (%)	(7.9)	(5.9)	1.5	(6.5)
Valuation				
PER (x)	15.4	20.3	17.9	15.8
PEG (x) - y-o-y growth	5.7	(0.8)	1.3	1.2
Price/Book (x)	3.5	3.3	3.2	2.8
Yield (%)	2.1	2.0	2.4	2.4
EV/Net sales (x)	1.8	1.6	1.5	1.4
EV/EBITDA (x)	10.1	12.0	12.7	9.8
EV/EBIT (x)	12.7	16.4	17.6	12.8

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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