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Technology

Target price Rs550

Earnings revision

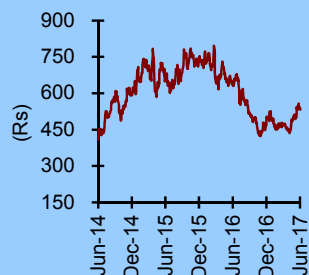
(%)	FY18E	FY19E
Sales	↓ 3.1	↓ 2.9
EBITDA	↑ 0.5	↓ 1.5
EPS	↑ 1.3	↓ 0.5

Shareholding pattern

	Sep '16	Dec '16	Mar '17
Promoters	13.7	13.7	13.7
Institutional investors	46.0	46.2	46.3
MFs and UTI	6.3	6.8	6.7
Banks / FIs	0.3	0.4	0.4
FII	39.4	39.0	39.2
Others	40.3	40.1	40.0

Source: www.nseindia.com

Price chart



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INDIA

Mindtree

HOLD

Downgrade from BUY

Deal ramp-ups getting pushed out but intake strong **Rs532**

Reason for report: Company update and Recommendation change

We met Mr. Krishnakumar Natarajan, Executive Chairman, Mindtree to get an update on the business. We believe that though deal intake, new logo acquisition and margin execution are trending in-line with expectations, ramp-ups on the new deals won in H2FY17 are slower than expected. As such, Q1FY18 may not be as strong as envisaged earlier with growth expected to pick-up in Q2FY18 and sustain in H2FY18. EBITDA margins, though, are expected to grow YoY even at current currency levels (we now model an expansion of 30bps vs a decline of 20bps YoY earlier). Though we remain constructive on the longer term story for Mindtree, given the 20% run-up in the stock since reporting Q4FY17 results and modest upside to our target price, we downgrade the stock to HOLD. Following are the key takeaways from our meeting:

- **Slower than expected deal ramp-ups to impact growth in Q1FY18.** Mindtree had secured new deal TCV of US\$218mn in H2FY17 which included multiple marquee new logo acquisitions. However, the ramp-ups on some of those deals are happening at a slower pace than expected earlier which will have a bearing on growth in Q1FY18. The deals are now expected to ramp-up fully in H2FY18.
- **Decision making and deal wins continue to be healthy though.** Mindtree continues to see strong deal closures across digital and legacy services, with faster velocity of decision making seen in digital services. Interestingly, Mindtree continues to win new logos, which have the potential to scale to within top-10 clients over the next 18 to 24 months.
- **Client specific issues to persist in the near-term but worst behind.** Though Mindtree believes that worst is behind as far as client specific issues within the top-10 clients are concerned, they don't expect any growth to materialise from these clients in FY18. Growth in FY18 is expected to be driven largely through new deal ramp-ups and scaling up of non-top-10 clients. The largest client, Microsoft, which had posted revenue growth of 37.8% in FY17, should continue to grow well in FY18.
- **Bluefin fundamentals to remain challenging in the near-term but Magnet 360 doing well.** Strategy of taking Bluefin capabilities to the US market will have a long gestation with Bluefin fundamentals in the UK to remain challenged in the near-term. Magnet 360, on the other hand is doing very well on growth but the profitability in that business will remain subdued in FY18 on account of front-ended investments (inauguration of a CoE in Munich) and retention costs. Bluefin and Magnet 360 have the potential to be a margin lever of ~100bps in FY19.

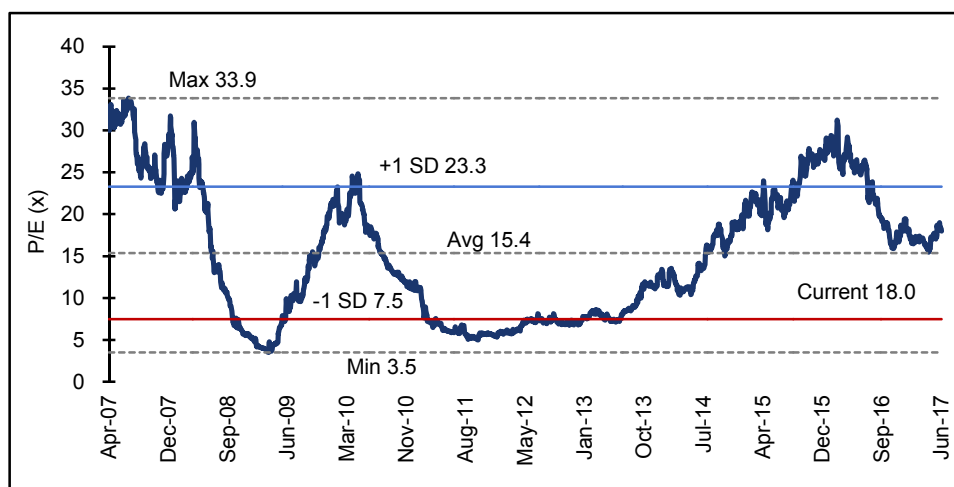
Market Cap	Rs89.4bn/US\$1.4bn
Reuters/Bloomberg	MINT.BO/MTCL IN
Shares Outstanding (mn)	168
52-week Range (Rs)	795/424
Free Float (%)	86.3
FII (%)	39.2
Daily Volume (US\$'000)	4,541
Absolute Return 3m (%)	12.9
Absolute Return 12m (%)	(17.4)
Sensex Return 3m (%)	7.9
Sensex Return 12m (%)	19.4

Year to March	FY16	FY17P	FY18E	FY19E
Revenue (Rs mn)	46,730	52,364	54,003	61,436
Net Income (Rs mn)	5,422	4,186	4,726	6,170
Recurring EPS (Rs)	32.9	24.9	28.0	36.6
% Chg YoY	2.7	(24.4)	12.7	30.6
P/E (x)	16.2	21.4	19.0	14.5
CEPS (Rs)	42.1	35.9	38.9	48.1
EV/E (x)	10.2	11.6	11.0	9.0
Dividend Yield (%)	2.3	2.2	2.6	3.3
RoCE (%)	21.6	15.3	15.1	17.5
RoE (%)	24.6	16.7	17.3	20.5

Please refer to important disclosures at the end of this report

- **EBITDA margin to expand YoY despite recent appreciation in the INR.** EBITDA margin in FY18 should grow on a YoY basis even at the current USD/INR levels from the 13.7% reported in FY17 with utilisation and productivity expected to be the primary drivers. That said, margins should be under pressure in Q1FY18 on account of visa costs, INR appreciation and slower than expected revenue growth. We expect EBITDA margin in Q1FY18 to decline by 180bps QoQ. We expect wage hikes to be dispersed and selective and lesser of a margin drag in FY18 than is typical. We are reasonably confident about our 30bps YoY margin expansion expectation for FY18.
- **Lead indicators still constructive but recent stock appreciation drives our rating to HOLD.** We won't worry much about the slower ramp-ups as they are just a timing issue and should get executed on in H2FY18. New logo acquisition and deal wins are more important lead indicators, where Mindtree seems to be doing very well, even thus far in Q1FY18. We also see room for EBITDA margins to eventually improve to 16% from our FY19 estimate of 15.1% with productivity and turnaround in acquisitions likely to be the key levers. However, we downgrade the stock to HOLD given 20% appreciation in the stock price since reporting Q4FY17 results and limited upside to our target price of Rs550.

Chart 4: P/E



Source: Bloomberg, I-Sec research

Valuation methodology and key risks

We **downgrade MindTree to HOLD rating from BUY** with a target price of Rs550 (unchanged) based on 15x FY19E EPS. The key risks to our call are: i) better than expected execution on the margins, ii) INR depreciation, and iii) faster than expected ramp-ups in new deal wins.

Financial summary

Table 1: Profit and loss statement

(Rs mn, year ending March 31)

	FY16	FY17P	FY18E	FY19E
Operating Revenues (Sales)	46,730	52,364	54,003	61,436
Operating Expenses	38,592	45,183	46,422	52,165
EBITDA	8,138	7,181	7,581	9,271
% margins	17.4	13.7	14.0	15.1
Depreciation & Amortisation	1,658	1,858	1,835	1,935
Interest & Finance Chgs	160	191	282	197
Other Income	839	417	861	1,143
Recurring PBT	7,159	5,549	6,325	8,282
Add: Extraordinaries exps / (Inc)	0	0	0	0
Less: Taxes	1,737	1,363	1,599	2,112
- Current tax	1,894	1,577	1,599	2,112
- Deferred tax / MAT Credit	(157)	(214)	-	-
Net Income (Reported)	5,422	4,186	4,726	6,170
Recurring Net Income	5,422	4,186	4,726	6,170

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY16	FY17P	FY18E	FY19E
Assets				
Total Current Assets	16,047	19,744	22,554	26,932
of which cash and deposits	2,332	5,542	8,055	10,606
Total Current Liabilities & Provisions	8,356	9,310	9,736	11,187
of which borrowings	415	415	415	415
Net Current Assets	7,691	10,435	12,818	15,745
Investments	2,159	2,559	2,959	3,359
of which Strategic/Group	58	58	58	58
of which Other Marketable	2,101	2,501	2,901	3,301
Goodwill on consolidation	7,606	7,606	7,606	7,606
Net Fixed Assets	4,625	3,814	3,330	2,931
Tangible assets	4,367	3,556	3,072	2,673
Intangible assets	258	258	258	258
Capital Work-in-Progress	232	250	250	250
Other Long Term Assets	2,733	2,610	2,673	2,958
Total Assets	25,046	27,275	29,636	32,849
of which cash and equivalents	4,433	8,043	10,956	13,907
Liabilities				
Borrowings	1,090	1,099	1,099	1,099
Minority Interest	0	0	0	0
Equity Share Capital	1,678	1,678	1,678	1,678
Face Value per share (Rs)	10	10	10	10
Preference Share Capital	0	0	0	0
Reserves & Surplus	22,278	24,498	26,859	30,072
Net Worth	23,956	26,176	28,537	31,750
Total Liabilities	25,046	27,275	29,636	32,849

Source: Company data, I-Sec Research

Table 5: Quarterly trend

(Rs mn, year ending March 31)

	Jun-16	Sep-16	Dec-16	Mar-17
Net sales	13,276	12,954	12,953	13,181
% growth (YoY)	35.8	11.1	7.1	-0.2
Recurring EBITDA	1,951	1,621	1,740	1,869
Margin (%)	14.7	12.5	13.4	14.2
Other income	198	170	144	(95)
Extra ordinaries Inc / (Loss)	0	0	0	0
Recurring Net Income	1,235	948	1,031	972

Source: Company data, I-Sec research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY16	FY17P	FY18E	FY19E
Operating Cashflow before W Cap changes	6,725	5,818	5,982	7,159
Working Capital Inflow / (Outflow)	(2,243)	588	67	(661)
Capex	(1,584)	(1,047)	(1,350)	(1,536)
Free Cashflow	2,898	5,359	4,699	4,962
Cashflow from other Invst Act (Ex Capex)	(2,749)	17	461	743
Proceeds from Issue of Share Capital	24	-	-	-
Inc/(Dec) in Borrowings / Deferred Liabilities	407	(182)	(282)	(197)
Dividend paid	(2,151)	(1,966)	(2,365)	(2,957)
Others	92	(18)	-	-
Increase/(Decrease) in Cash	(1,479)	3,210	2,513	2,551
Inc/(Dec.) in Cash & eqv.	(4,673)	3,610	2,913	2,951

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY16	FY17P	FY18E	FY19E
Per Share Data (Rs)				
EPS (Basic Recurring)	32.9	24.9	28.1	36.6
EPS (Basic Reported)	32.9	24.9	28.1	36.6
Diluted Earnings per share	32.9	24.9	28.0	36.6
Cash earnings per share	42.1	35.9	38.9	48.1
Dividend per share	12	12	14	18
Book Value per share	143	156	170	189
Growth Ratios (%)				
Operating Income (Sales)	31.2	12.1	3.1	13.8
EBITDA	14.7	(11.8)	5.6	22.3
Recurring Net Income	1.1	(22.8)	12.9	30.6
Diluted Recurring EPS	2.9	(24.3)	12.7	30.5
Diluted Recurring CEPS	10.8	(14.7)	8.4	23.4
Valuation Ratios (x)				
P/E	16.2	21.4	19.0	14.5
P/CEPS	12.6	14.8	13.7	11.1
P/BV	3.7	3.4	3.1	2.8
EV / EBITDA	10.2	11.6	11.0	9.0
EV / Sales	1.8	1.6	1.5	1.4
EV / FCF	28.8	15.6	17.8	16.8
Operating Ratios				
Software Development Expenses/Sales (%)	60.0	65.2	65.7	63.9
SG&A/Sales (%)	22.6	21.1	20.3	21.0
Other Income / PBT (%)	11.7	7.5	13.6	13.8
Effective Tax Rate (%)	24.3	24.6	25.3	25.5
NWC / Total Assets (%)	23.0	28.5	32.6	35.8
Fixed Asset Turnover (x) on avg	10.5	13.2	16.3	21.4
Receivables (days) on average	93	85	85	85
Payables (days) on average	13	12	13	13
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratios (%)				
Recurring Net Income Margins	11.6	8.0	8.8	10.0
RoIC (Based on Avg)	30.7	20.2	22.6	29.1
RoCE (Based on Avg)	21.6	15.3	15.1	17.5
RoNW (Based on Avg)	24.6	16.7	17.3	20.5
Dividend Payout Ratio	38.0	47.0	50.0	47.9
Dividend Yield	2.3	2.2	2.6	3.3
EBITDA Margins	17.4	13.7	14.0	15.1

Source: Company data, I-Sec research

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ANALYST CERTIFICATION

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