

October 22, 2016

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Rating	Accumulate
Price	Rs479
Target Price	Rs510
Implied Upside	6.5%
Sensex	28,077
Nifty	8,693

(Prices as on October 21, 2016)

Trading data

Market Cap. (Rs bn)	80.2
Shares o/s (m)	167.4
3M Avg. Daily value (Rs m)	373.1

Major shareholders

Promoters	13.76%
Foreign	37.25%
Domestic Inst.	7.33%
Public & Other	41.66%

Stock Performance

(%)	1M	6M	12M
Absolute	(6.2)	(33.0)	(35.0)
Relative	(4.7)	(41.5)	(37.9)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2017	29.0	29.5	-1.7
2018	34.0	35.8	-5.0

Price Performance (RIC: MINT.BO, BB: MTCL IN)



Source: Bloomberg

Mindtree's (MTCL's) Q2FY17 revenue and margins were significantly below ours and consensus expectations. Company reported revenue/EBITDA/Net Profit miss of 1.5%/12%/15% respectively. Revenue miss was due to a) delay in project ramp-ups, b) pricing pressure in renewal deals and c) slow down in Bluefin. EBITDA margins at 12.5% are 150bps below our and street expectations and are at multi-year lows.

Management expects some of the revenue challenges to persist in Q3FY17 as well, though they expect revenue growth in Q3. On the margin front, company expects recovery to be a long drawn process. We reduce FY17/18 EPS by ~10%/7% driven mostly by lower revenue growth and EBIT margins. We retain "Accumulate" with a TP of Rs510 (was 550) based on 14x Sep-18 EPS. While we do believe that the current quarter margins are unsustainably low, there is lack of visibility on margin recovery.

- **Revenues and Margins significantly below estimates:** MTCL's Q2FY17 USD revenue declined by 3% QoQ to 193m, a miss of 1.5%. Revenues in CC terms declined by 1.7% for the quarter. Revenues in INR declined by 2.4% QoQ. EBITDA margins contracted by 210bps QoQ to 12.5% (PLe: 14% Cons: 13.8%) due to impact of wage hike and restructuring costs. EPS declined by 23% QoQ to Rs5.6 (PLe: Rs6.6, Cons: Rs6.6).
- **Margin trajectory a concern:** Margins for Mindtree have been the lowest since FY12. Margins will continue to be a concern in the short term; however, company is trying to address it through operational efficiencies and through an attempt to increase revenues.
- **Sluggish growth across verticals and geographies:** Revenues declined across all verticals for the quarter. Revenues in BFSI/Retail/Travel and Hi-tech & Media declined by 3.8/2.6/6.9 and 1.4%, respectively, mainly due to slower ramp-ups of projects. Amongst geographies, revenues declined in US and UK by 1.7% and 10.1%, respectively, while India and RoW grew by 9.5% and 2.5%, respectively.

Key financials (Y/e March)	2015	2016	2017E	2018E
Revenues (Rs m)	35,619	46,896	52,796	58,015
Growth (%)	17.5	31.7	12.6	9.9
EBITDA (Rs m)	7,092	8,304	7,708	9,106
PAT (Rs m)	5,363	6,033	4,856	5,695
EPS (Rs)	32.0	36.0	29.0	34.0
Growth (%)	19.0	12.5	(19.5)	17.3
Net DPS (Rs)	8.5	11.0	13.0	14.0

Profitability & Valuation	2015	2016	2017E	2018E
EBITDA margin (%)	19.9	17.7	14.6	15.7
RoE (%)	29.4	27.1	18.9	19.9
RoCE (%)	28.9	26.7	19.2	20.1
EV / sales (x)	2.1	1.6	1.4	1.2
EV / EBITDA (x)	10.8	9.1	9.5	7.7
PE (x)	15.0	13.3	16.5	14.1
P / BV (x)	4.0	3.3	3.0	2.6
Net dividend yield (%)	1.8	2.3	2.7	2.9

Source: Company Data; PL Research FY17E/ FY18E as per Ind AS, prior financials as per IGAAP

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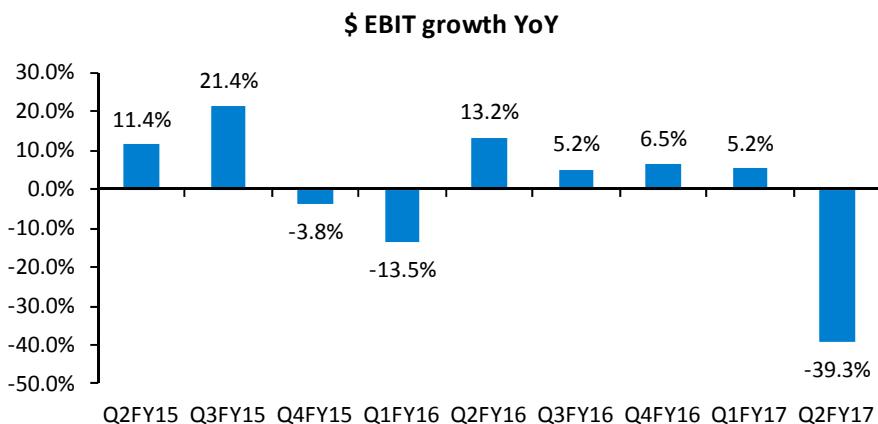
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Exhibit 1: Comprehensive miss on revenue and margins

(Rs m)	Q2FY17	Q1FY17	QoQ	Q2FY16	YoY	Cons	PLe	Var (Act. v/s Est.)
Sales (\$ m)	193.0	199.0	-3.0%	180.3	7.0%	197.4	196.0	-1.5%
Sales	12,954.0	13,276.0	-2.4%	11,693.0	10.8%	13,223.0	13,132.0	-1.4%
EBITDA	1,621.0	1,951.0	-16.9%	2,164.0	-25.1%	1,829.0	1,838.5	-11.8%
<i>EBITDA Margin</i>	<i>12.5%</i>	<i>14.7%</i>	<i>-218 bps</i>	<i>18.5%</i>	<i>-599 bps</i>	<i>13.8%</i>	<i>14.0%</i>	<i>-149 bps</i>
PAT	948.0	1,235.0	-23.2%	1,582.0	-40.1%	1,151.0	1,117.9	-15.2%
EPS (diluted)	5.6	7.3	-23.2%	9.4	-40.1%	6.6	6.6	-14.6%

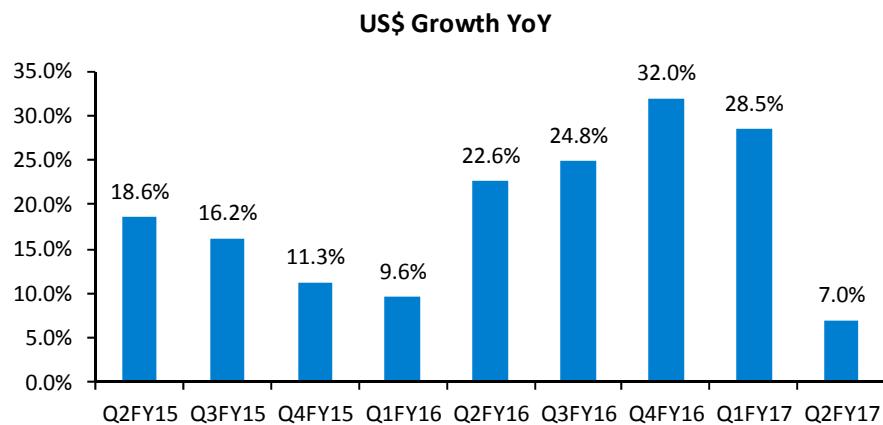
Source: Company Data, Bloomberg, PL Research

- Revenue in USD terms declined by 3% QoQ and increased by 7% YoY.
- Revenue in CC terms declined by 1.7% QoQ.
- EBITDA declined 17% QoQ and 25.1% YoY, respectively.
- EBITDA margins at 12.5%, lowest since FY12 were impacted by wage hike (-230bps), restructuring costs impact (-30bps) partly offset by operational efficiency (40bps).
- Adoption of Ind AS accounting standards has increased amortization amount lowering PAT margins by ~70bps. PAT declined by 23.2% QoQ and 40% YoY.

Exhibit 2: USD EBIT growth trend YoY

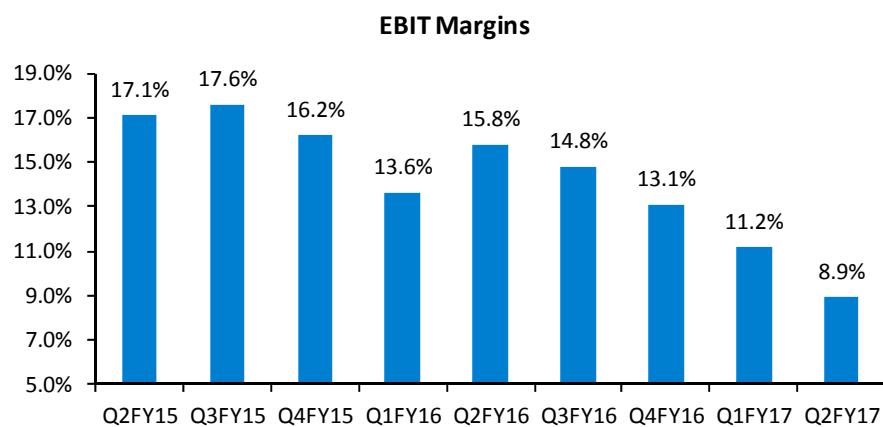
Source: Company Data, PL Research

Exhibit 3: USD Revenue growth YoY



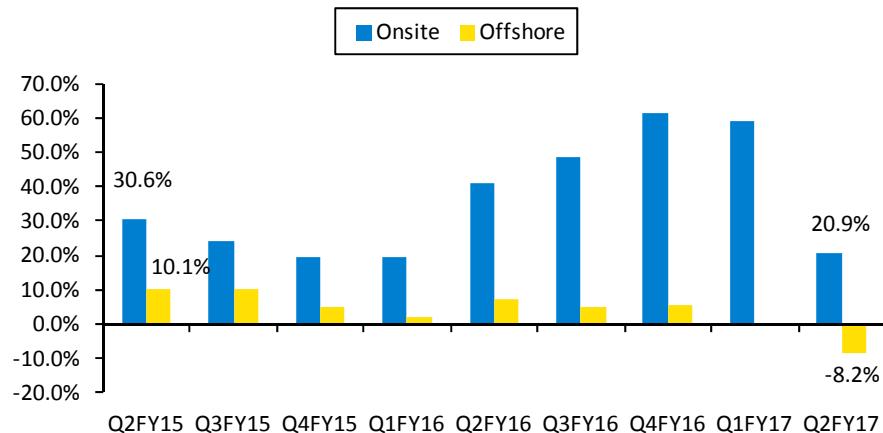
Source: Company Data, PL Research

Exhibit 4: EBIT Margin at multi-year lows



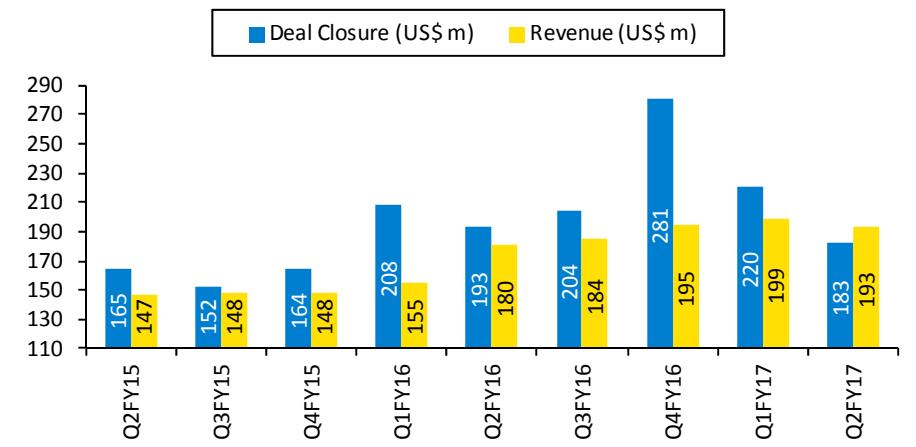
Source: Company Data, PL Research, * Ind AS

Exhibit 5: Offshore revenue declined on YoY basis



Source: PL Research

Exhibit 6: Deal Closure for the quarter



Source: Company Data, PL Research

Exhibit 7: Earnings change summary

	FY17	FY18
Revenue(US\$)	788.0	865.9
Change	-1.4%	-2.0%
Growth (YoY)	10.3%	9.9%
EBITDA	7,708	9,106
Change	-8.2%	-5.5%
Growth (YoY)	-7.2%	18.1%
EBITDA margin (%)	14.6%	15.7%
Change	-107	-59
Change (YoY)	-311	110
EBIT	5,792	6,938
Change	-10.5%	-7.0%
Growth (YoY)	43.8%	13.2%
EBIT margin (%)	11.0%	12.0%
Change	-111	-65
Change (YoY)	-390	99
EPS	29.0	33.9
Change	-9.6%	-6.8%
Growth (YoY)	-19.5%	17.0%

Source: Company Data, PL Research

We have revised our estimates and lowered USD revenue estimates by 1.4/2% for FY17/FY18, respectively, factoring in the revenue miss in H1FY17 and soft growth guidance for Q3FY17. We have also lowered EBIT margins by 100/65 bps for FY17/FY18, respectively. EBIT margin decline is driven by adoption of Ind AS, lower margins in acquisitions and pricing pressure. Net-net we have lowered our FY17/FY18 EPS estimates by 9.6/6.8%, respectively.

Exhibit 8: Assumptions (As per Ind AS)

Y/e March	FY17	FY18
Revenue - USD m	788	866
<i>Growth</i>	10.3%	9.9%
EBITDA - INR m	7,708	9,106
<i>EBITDA margin</i>	14.6%	15.7%
EBIT - INR m	5,792	6,938
<i>EBIT margin</i>	11.0%	12.0%
EPS - Rs	29.0	33.9
<i>Growth</i>	-19.5%	17.0%

Source: Company Data, PL Research

Exhibit 9: Europe impacted due to macro factors and decline in Bluefin

USD growth	Revenue contribution	QoQ	YoY
US	67.6%	-1.7%	14.5%
Europe	21.4%	-10.1%	-13.9%
India	3.5%	9.5%	17.1%
Rest of World	7.5%	2.5%	14.7%

Source: Company Data, PL Research,

Exhibit 10: All the verticals declined QoQ

USD growth	Revenue contribution	QoQ	YoY
Hi-Tech & Media Services	36.7%	-1.4%	15.2%
BFSI	24.7%	-3.8%	-0.6%
Retail, CPG & Manufacturing	24.2%	-2.6%	-0.7%
Travel & Hospitality	14.4%	-6.9%	8.6%

Source: Company Data, PL Research,

Exhibit 11: Service split

USD growth	Revenue contribution	QoQ	YoY
Development	22.0%	-6.0%	1.5%
Engineering	9.8%	-3.0%	22.0%
Maintenance	17.8%	-0.2%	-9.3%
Consulting	3.8%	-10.1%	45.3%
Package implementation	13.1%	-8.6%	5.4%
IP Led Revenue	1.2%	16.4%	-1.2%
Independent Testing	12.4%	-6.0%	3.7%
Infrastructure Management & Tech Support	19.9%	4.9%	25.3%

Source: Company Data, PL Research,

Exhibit 12: Client concentration

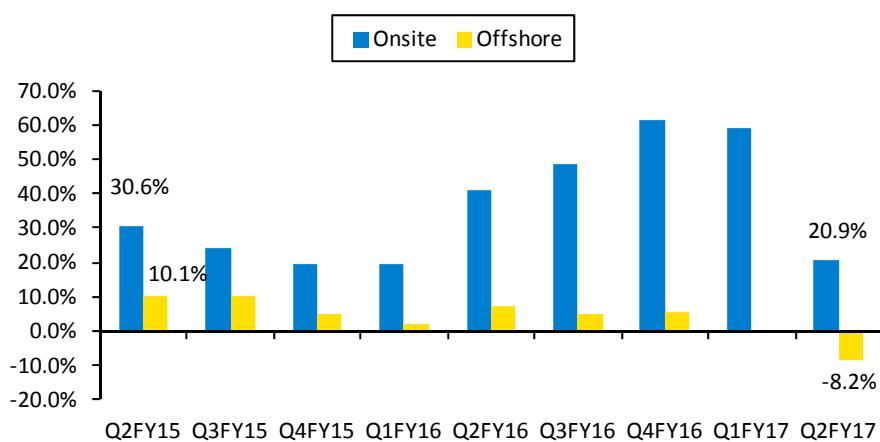
	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Number of active clients	207	217	218	296	294	348	343	337
New clients added	5	8	16	18	23	37	17	18
Number of m \$ clients								
\$1 m clients	83	88	88	92	93	101	98	107
\$5 m clients	27	28	28	29	29	31	31	30
\$10 m clients	13	14	13	13	13	15	16	16
\$20 m+ clients	6	6	8	8	7	8	7	6
Repeat business	99.4%	99.2%	98.9%	98.9%	98.5%	96.0%	98.2%	97.8%

Source: Company Data, PL Research

Exhibit 13: Employee metrics

	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Total Employees	13,323	14,202	14,427	15,582	16,243	16,623	16,110	16,216
Software professionals	12,500	13,350	13,560	14,655	15,296	15,623	15,092	15,189
Sales & Support	823	852	867	927	947	1,000	1,018	1,030
Gross addition	1,016	1,517	900	1,801	1,306	1,020	210	744
Net addition	305	879	225	1,155	661	380	(513)	109
Attrition (LTM)	18.1%	18.2%	18.4%	17.1%	16.0%	15.7%	16.5%	16.4%
Utilization								
Including Trainees	71.8%	70.2%	70.3%	71.4%	68.5%	69.4%	71.4%	71.4%
Excluding Trainees	74.2%	71.1%	71.9%	73.3%	69.9%	70.6%	72.0%	73.1%

Source: Company Data, PL Research

Exhibit 14: Onsite Offshore revenue growth mix

Source: Company Data, PL Research

Exhibit 15: A brief overview of the operating metrics

Revenue by verticals (%)	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Retail, CPG & Manufacturing	22.2%	21.7%	22.0%	20.6%	20.3%	18.2%	24.1%	24.2%
BFSI	23.5%	25.0%	26.4%	24.7%	25.1%	23.2%	24.9%	24.7%
Travel & Hospitality	16.2%	16.0%	15.5%	13.9%	15.6%	16.1%	15.0%	14.4%
Hi-Tech & Media Services	32.7%	32.6%	31.7%	30.4%	30.2%	31.4%	36.1%	36.7%
Others *	5.4%	4.7%	4.3%	10.5%	8.7%	11.1%		
Revenue by services (%)								
Development	23.7%	23.2%	24.4%	23.2%	23.7%	23.0%	22.7%	22.0%
Engineering	10.3%	10.0%	9.0%	8.6%	8.3%	9.8%	9.8%	9.8%
Maintenance	21.4%	20.8%	21.7%	21.0%	19.8%	18.0%	17.3%	17.8%
Consulting	4.1%	3.9%	3.7%	2.8%	2.6%	4.0%	4.1%	3.8%
Package Implementation	5.8%	7.5%	7.2%	13.3%	12.9%	13.6%	13.9%	13.1%
Independent Testing	15.4%	15.4%	14.9%	12.8%	12.8%	12.6%	12.8%	12.4%
Infrastructure Management & Tech Support	17.6%	17.5%	17.7%	17.0%	18.1%	17.5%	18.4%	19.9%
IP Licensing	1.6%	1.7%	1.4%	1.3%	1.8%	1.3%	1.0%	1.2%
Revenue by geography (%)								
America	63.1%	64.9%	67.5%	63.2%	63.5%	65.9%	66.7%	67.6%
Europe	24.2%	23.7%	21.9%	26.6%	26.4%	24.5%	23.1%	21.4%
India	4.1%	3.6%	3.4%	3.2%	2.7%	2.8%	3.1%	3.5%
APAC	8.6%	7.8%	7.2%	7.0%	7.4%	6.8%	7.1%	7.5%
Revenue by project type (%)								
Fixed Price	46.5%	46.5%	48.9%	49.7%	50.0%	47.7%	48.7%	50.6%
Time & Material	53.5%	53.5%	51.1%	50.3%	50.0%	52.3%	51.3%	49.4%
Revenue by location (%)								
Offshore	54.2%	52.9%	51.9%	47.6%	45.5%	42.4%	40.5%	40.8%
Onsite	45.8%	47.1%	48.1%	52.4%	54.5%	57.6%	59.5%	59.2%

Source: Company Data, PL Research * Revenues from Bluefin solutions & Magnet 360 earlier shown under others are classified in relevant industry

Income Statement (Rs m)

Y/e March	2015	2016	2017E	2018E
Net Revenue	35,619	46,896	52,796	58,015
Raw Material Expenses	20,741	28,026	33,047	35,839
Gross Profit	14,878	18,870	19,750	22,176
Employee Cost	—	—	—	—
Other Expenses	7,786	10,566	12,041	13,070
EBITDA	7,092	8,304	7,708	9,106
Depr. & Amortization	1,018	1,332	1,916	2,168
Net Interest	1	3	200	220
Other Income	835	805	814	825
Profit before Tax	6,908	7,774	6,407	7,543
Total Tax	1,545	1,741	1,550	1,848
Profit after Tax	5,363	6,033	4,856	5,695
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	5,363	6,033	4,856	5,695
Avg. Shares O/S (m)	167.4	167.4	167.4	167.4
EPS (Rs.)	32.0	36.0	29.0	34.0

Cash Flow Abstract (Rs m)

Y/e March	2015	2016	2017E	2018E
C/F from Operations	5,983	4,779	5,546	7,120
C/F from Investing	(2,098)	(1,360)	(1,531)	(1,682)
C/F from Financing	(1,382)	(2,200)	(2,181)	(2,349)
Inc. / Dec. in Cash	2,503	1,219	1,833	3,088
Opening Cash	1,184	3,763	4,982	6,816
Closing Cash	3,763	4,982	6,816	9,904
FCFF	4,940	3,065	4,015	5,437
FCFE	4,936	3,065	4,015	5,437

Key Financial Metrics

Y/e March	2015	2016	2017E	2018E
Growth				
Revenue (%)	17.5	31.7	12.6	9.9
EBITDA (%)	16.3	17.1	(7.2)	18.1
PAT (%)	19.0	12.5	(19.5)	17.3
EPS (%)	19.0	12.5	(19.5)	17.3
Profitability				
EBITDA Margin (%)	19.9	17.7	14.6	15.7
PAT Margin (%)	15.1	12.9	9.2	9.8
RoCE (%)	28.9	26.7	19.2	20.1
RoE (%)	29.4	27.1	18.9	19.9
Balance Sheet				
Net Debt : Equity	(0.2)	(0.2)	(0.3)	(0.3)
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	15.0	13.3	16.5	14.1
P / B (x)	4.0	3.3	3.0	2.6
EV / EBITDA (x)	10.8	9.1	9.5	7.7
EV / Sales (x)	2.1	1.6	1.4	1.2
Earnings Quality				
Eff. Tax Rate	22.4	22.4	24.2	24.5
Other Inc / PBT	12.1	10.4	12.7	10.9
Eff. Depr. Rate (%)	10.3	11.8	15.0	15.0
FCFE / PAT	92.0	50.8	82.7	95.5

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2015	2016	2017E	2018E
Shareholder's Funds	20,128	24,315	26,990	30,335
Total Debt	23	23	23	23
Other Liabilities	334	334	334	334
Total Liabilities	20,485	24,672	27,347	30,692
Net Fixed Assets	4,987	5,015	4,630	4,145
Goodwill	922	5,732	5,732	5,732
Investments	5,351	541	541	541
Net Current Assets	7,119	11,278	14,337	18,169
<i>Cash & Equivalents</i>	<i>3,763</i>	<i>4,982</i>	<i>6,816</i>	<i>9,904</i>
<i>Other Current Assets</i>	<i>9,420</i>	<i>13,491</i>	<i>15,622</i>	<i>17,166</i>
<i>Current Liabilities</i>	<i>6,064</i>	<i>7,195</i>	<i>8,100</i>	<i>8,901</i>
Other Assets	2,106	2,106	2,106	2,106
Total Assets	20,485	24,672	27,347	30,692

Quarterly Financials (Rs m)

Y/e March	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Net Revenue	12,145	13,203	13,276	12,954
EBITDA	2,147	2,206	1,951	1,621
<i>% of revenue</i>	17.7	16.7	14.7	12.5
Depr. & Amortization	345	475	468	463
Net Interest	—	63	51	47
Other Income	147	105	198	170
Profit before Tax	1,949	1,773	1,630	1,281
Total Tax	440	443	395	333
Profit after Tax	1,509	1,330	1,235	948
Adj. PAT	1,509	1,330	1,235	948

Key Operating Metrics

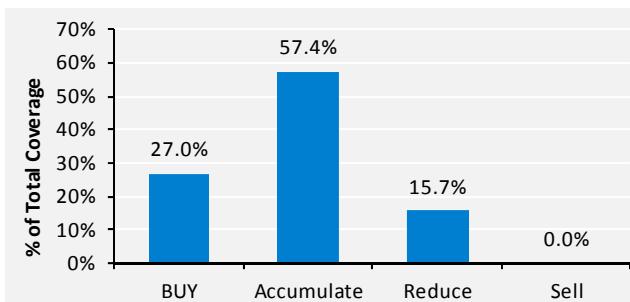
Y/e March	2015	2016	2017E	2018E
Revenue (US\$ m)	584	715	788	866

Source: Company Data, PL Research.

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