

# Mindtree

7 June 2017

Reuters: MINT.BO; Bloomberg: MTCL IN

## Not Too Late To Sell: Market Is Giving It The Benefit Of Doubt

We believe the difficult phase that Mindtree is going through is not a temporary one and its stock is likely to test investors' patience. Indian IT services industry is facing structural challenges such as: (1) Value compression of contracts from usage of automation, platforms and cloud. (2) Increased in-sourcing by customers. (3) Insufficient capability of many players in 'new' services. (4) High competitive intensity because of convergence of capabilities and strategies of players in a relatively low entry barrier industry. Cyclically, we believe the US growth could disappoint as current economic expansion has been the second-longest post World War II and various indicators seem to be peaking. We believe attempts at fiscal reflation by the Trump administration are likely to disappoint and such steps may be delayed and/or diluted. Subdued US growth will mean weak IT services spending. In such an industry and macro context, we believe diversified Indian mid-sized IT services companies will be challenged like never before in the past. They have been vulnerable because of concentrated client mix and lack of clear differentiation vis-à-vis Tier-1 players. In a growing market that did not matter much as it does now when growth is constrained. Mindtree, since its inception, has replicated strategies of successful Indian IT services companies to get thus far. However, a 'me too' strategy in the current industry context will lead to mediocre and volatile growth, weak margins and return ratios and loss of relevance to customers over the long run as we believe large companies will outmaneuver it. A large part of the market, in our opinion, believes that: (1) Mindtree has in it not only to make it through this transition phase in the industry but also remain a relevant player. (2) It will grow into a large-cap next generation IT services company after this phase. Based on its performance over the past 18-24 months and our reading of its capabilities and strategies and the evolving industry and macro context, we have doubts about this view that the market holds. We initiate coverage on Mindtree with a sell rating and a target price of Rs424 by March 2018 (down 22% from CMP) which is 11.5x FY19E EPS (a 20% discount to the target P/E multiple we have assigned to Infosys and TCS). While the stock is down ~30% from its life-time high, we see more downside. We believe any bullishness surrounding any good short-term performance (which may be the case in 1HFY18) should be used to exit from the stock.

**Vulnerable in an era of wallet share grab:** Most large IT services companies faced with value compression in traditional services have been focused on grabbing a greater wallet share within their customers. We believe the most vulnerable in this vendor consolidation exercise will be mid-sized companies where customer relationships are not meaningful. Mindtree, in our view, fits the bill as it works with ~50 Fortune 500 clients and has 30 clients from which it gets more than US\$5mn in annual revenues but only one with more than US\$50mn (as of 4QFY17-end).

**Mindtree has not re-invented itself enough to attack large incumbents:** We have been flummoxed by the defensive attitude that Mindtree has displayed over the past 18-24 months. We would have expected a sub-US\$1bn revenue company in the current industry context to come up with a value proposition that attacked current Tier-1 incumbents who have large legacy services in their portfolio and who are fearful of cannibalisation of these revenues. Or that it will emerge as the go-to-digital-services player with deep and differentiated skills. But neither has happened. We believe this could be because of one or more of the following: (1) A management that has not been bold enough or lacking bandwidth (because of material churn in its ranks) when delivery and sales are crying for attention (2) behind the curve development of automation capabilities in traditional services (3) possible reluctance to self cannibalise (4) Non-differentiated Digital skills when customers are looking for end-to-end capabilities and scale. This probably explains the 4% decline in Digital order inflow in FY17. (6) M&A activity, which we believe, has not been executed well and probably does not bring a great deal of value to the table.

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Revenue	35,619	46,819	52,364	56,680	62,653
Growth YoY (%)	17.5	31.4	11.8	8.2	10.5
EBIT	6,074	6,840	5,327	6,602	7,388
as % of sales	17.1	14.6	10.2	11.6	11.8
Adj. PAT	5,363	5,899	4,159	5,405	6,195
Growth YoY (%)	18.9	10.0	(29.5)	30.0	14.6
FDEPS (Rs)	31.9	35.1	24.7	32.1	36.8
RoE (%)	30.9	28.1	17.4	20.7	21.6
RoCE (%)	34.3	31.9	21.8	24.9	25.6
RoIC (%)	49.8	40.6	27.8	35.8	38.8
P/E(x)	17.1	15.6	22.1	17.0	14.8
P/BV (x)	4.3	3.8	3.6	3.2	2.9

Source: Company, Nirmal Bang Institutional Equities Research

## SELL

Sector: Information Technology

CMP: Rs547

Target price: Rs424

Downside: 22%

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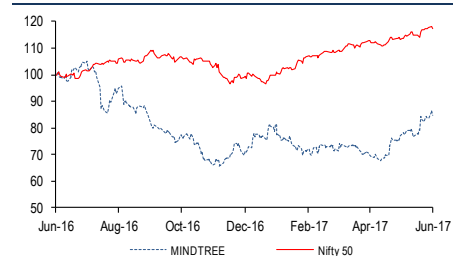
+91-22-3926 8017

### Key Data

Current Shares O/S (mn)	168.0
Mkt Cap (Rsbn/US\$bn)	91.9/1.4
52 Wk H / L (Rs)	682/3.99
Daily Vol. (3M NSE Avg.)	582,173

Share holding (%)	4QFY17	3QFY17	2QFY17
Promoter	12.2	12.2	12.2
FII	39.2	39.1	39.4
DII	6.6	7.2	7.1
Others	42.0	41.5	41.3

### One-Year Indexed Stock



### Price Performance (%)

	1 M	6 M	1 Yr
Mindtree	10.2	18.9	(15.2)
Nifty Index	3.8	18.3	17.5

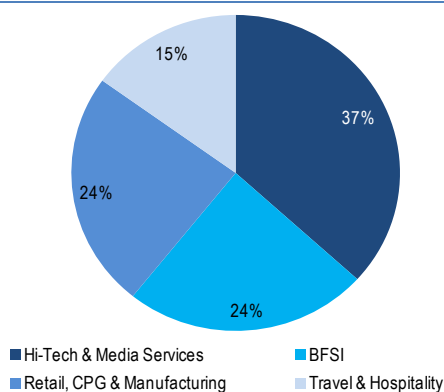
Source: Bloomberg

## Why Mindtree is a Sell

### Mindtree lacks a sharply differentiated proposition

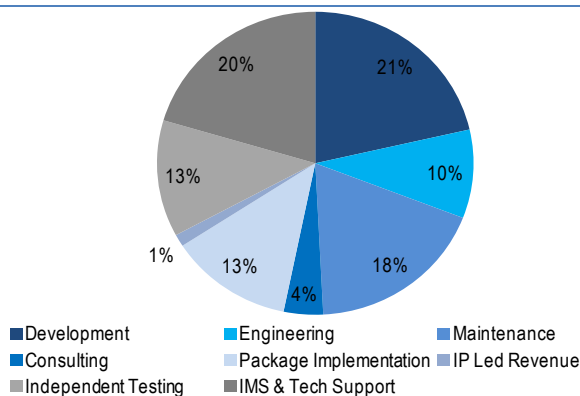
Diversified mid-sized companies in the Indian IT services industry have been generally vulnerable because of concentrated client mix and lack of clear differentiation vis-à-vis Tier-1 players. In a growing market that did not matter much, but in a market where growth is constrained we believe this has/will hurt. Mindtree, since its inception, has replicated strategies of a successful large-cap Indian IT services companies to get thus far (it should have grown faster, in our view, to become a material vendor to some of its large customers). The strategy involved having diversified vertical and service line revenue streams with low concentration of revenues from top customers. While Mindtree has succeeded in the first two, the high client concentration remains a weak point (currently at 42% for top 10 clients in 4QFY17 against 17%-22% among Tier-1 IT services peers like Infosys, Wipro and HCL Technologies). Lately, Mindtree has been dependent on its largest client for growth, which accounted for as much as 60% of its organic growth in FY17 (and 14% of its revenues in 4QFY17).

**Exhibit 1: 4QFY17 Revenues by industry**



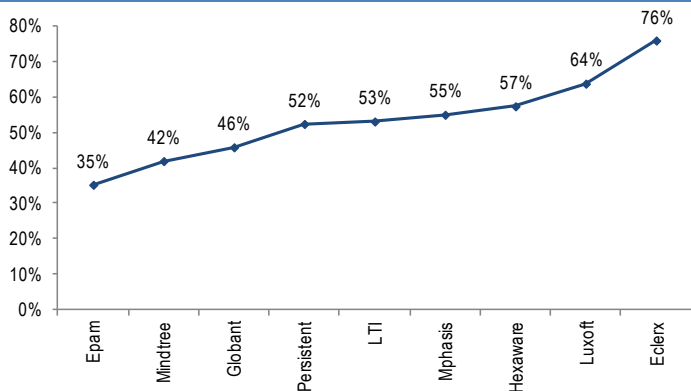
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 2: 4QFY17 Revenues by service offering**



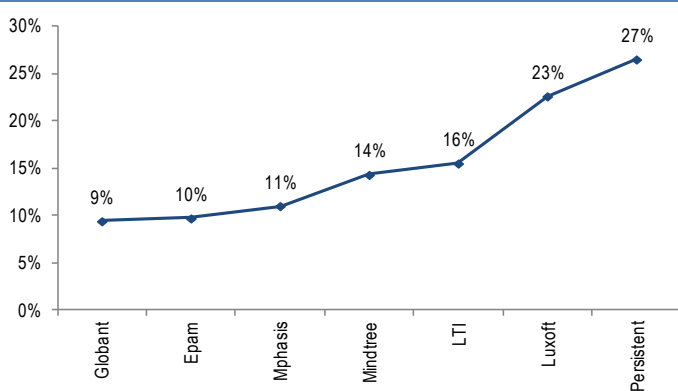
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 3: Top 10 clients' revenue contribution in latest quarter**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: Top client's revenue contribution in latest quarter**



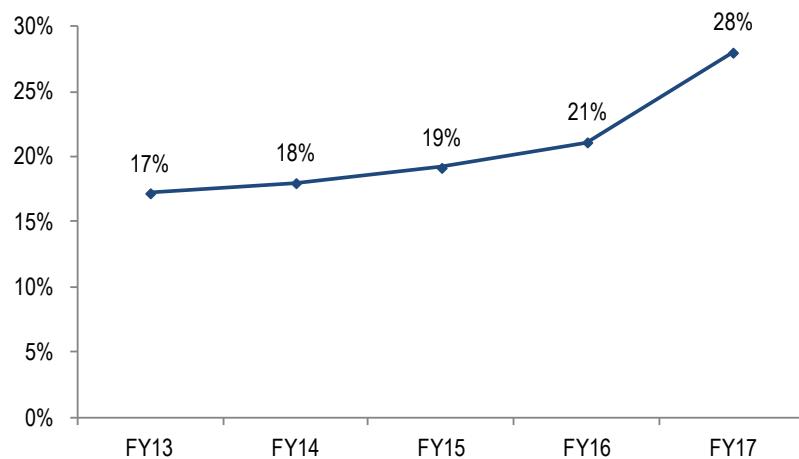
Source: Company, Nirmal Bang Institutional Equities Research

Mindtree's response to the structural threats in the IT services industry has been to follow the moves of its larger peers. It has focused on creating capabilities in digital, automation and platforms. But we believe these capabilities are not well developed or differentiated enough or the response has been late. This, we believe, impacted its revenue growth, order inflow and margins over the past few years. We believe this lack of clear differentiation will lead to mediocre and volatile growth (a few good quarters followed by mostly low growth ones), weak margins and weak return ratios and the loss of its relevance over the long run with customers.

We believe Mindtree's current 'me too' strategies are bound to be outgunned by larger peers who are cash rich, who have deeper capabilities and that too 'at scale' and have far stronger customer relationships. We believe it has not tried to re-invent itself by sidestepping the legacy IT services market that is compressing in value and nor has it taken any steps to aggressively gain market share by attacking incumbents with a new value proposition for its customers in their existing streams of revenue. While we currently have Sell rating on them, we believe Persistent Systems has focused on the first and HCL Technologies has focused on the latter.

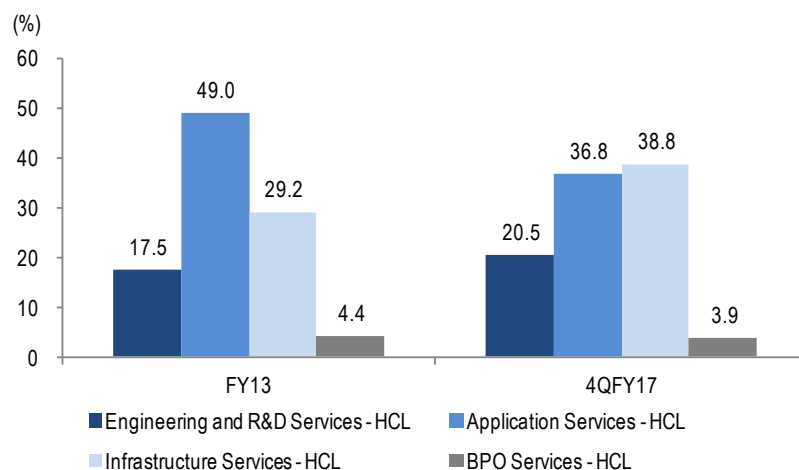
While the success of its new strategy is not yet proven, we believe Persistent System's focus on building an IP-based business which equals its effort-based business represents a differentiated move within Indian mid-sized IT services players. At least it is taking risks instead of sticking to the old way of doing things. Possibly the fact that it had not addressed business IT services in a material way in the past allows it to approach the structural challenges of the industry with a fresh mind. HCL Technologies' bold ALT-ASM (alternate application support and maintenance) proposition, something it took up two to four years ago that **guarantees** 30% savings on application maintenance contracts through aggressive use of automation stands out as another example in the mainstream IT services space. This strategy is to attack incumbent vendors who would be hesitant to cannibalise their own revenues. This was strategically done in an area of IT services where HCL Technologies was more of a challenger and not an incumbent. Exhibits 5 and 6 indicate the shift in business of both Persistent Systems and HCL Technologies. The growth in application maintenance business is not visible in HCL Technologies as it is clubbed under application services business – which includes ERP implementation services, something that has seen a significant decline in recent years.

**Exhibit 5: IP revenue exposure – Persistent Systems**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: HCL Technologies' service line mix (%)**



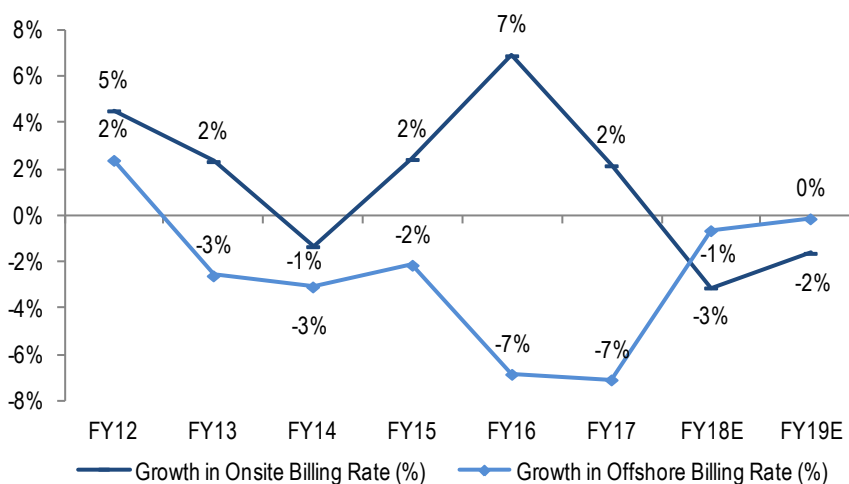
Source: Company, Nirmal Bang Institutional Equities Research

Sidestepping IT services and getting into a new/adjacent revenue stream – with restricted competition - is a big strategic call which Mindtree has not taken so far. However, creating a differentiated value proposition around a certain service line is something that should have come easier and should have been undertaken earlier. The differentiation that Mindtree has sought to make through its focus on 'digital', in our view, has not exactly worked out going by the growth rate and the fact that it is a 'me to' strategy.

What we have seen from Mindtree are diffident moves. The pricing pressure – on offshore work– indicates that the company has been forced to take on work at lower billing rates (because of competitive intensity) in the hope that it would develop automation capabilities which help bring margins back to the desired level. But we believe its response on automation has been inadequate and late. Mindtree has had an automation platform called Mwatch (which is largely IMS-related) and recently unveiled another one called ‘CAPE’ that could be applied to multiple traditional IT services. But ‘CAPE’ is at a preliminary stage of introduction into the market and is likely working on multiple POCs. These then have to go into production and Mindtree will require referenceable clients. As Mindtree moves forward a few steps, competition would have moved ahead as well. Thus the gap needs to be swiftly bridged if Mindtree has to gain market share (profitably) on the traditional services side.

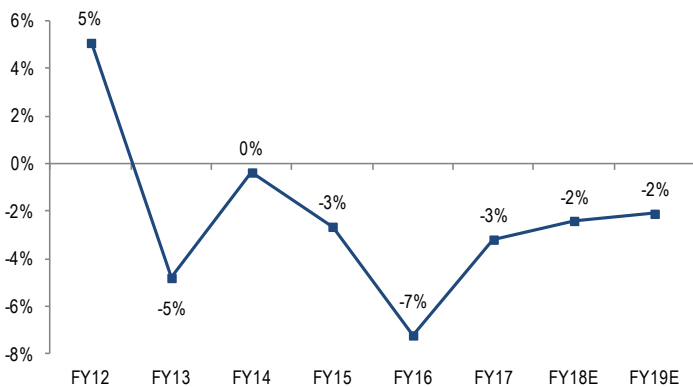
Unlike discussions on automation which tend to be fairly substantial on many analyst calls of Indian IT services in recent quarters, we heard very little commentary from Mindtree’s management. We do not believe that implementing automation solutions is a very difficult task, but one needs to have referenceable use cases and also be ahead of the competitive curve. Foremost, it requires a mindset to self cannibalise. Once that happens many other things fall in place. We believe Indian companies are addressing automation solutions through a combination of both in-house software and third party software depending on service line, process, customer maturity and automation software maturity.

**Exhibit 7: Offshore billing rate fall for Mindtree has been far larger than in Infosys**



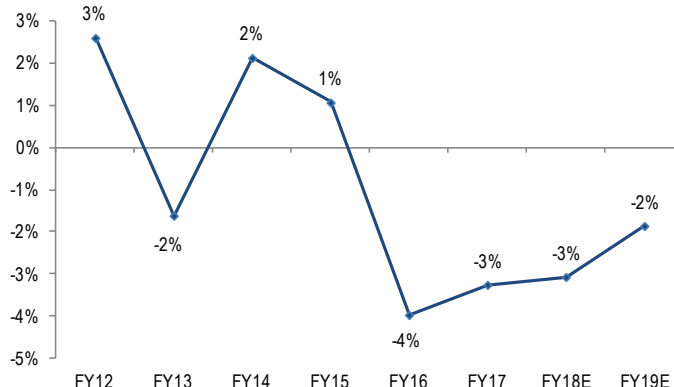
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 8: Growth in offshore billing rate of Infosys**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 9: Growth in onsite billing rate of Infosys**



Source: Company, Nirmal Bang Institutional Equities Research

## Mindtree vulnerable to vendor consolidation

Over the past few years, IT spending of large global corporations (on an aggregate basis) has been stagnant or marginally up (Exhibit 10). At the same time, many of these companies are facing new disrupters in their industries which are leveraging technology to give their customers better/cheaper/faster services and products. There is fear of a significant market share shift to these new players. In such a situation, incumbent global corporations want to cut spending on legacy services and channel savings into 'new areas' to counter this technology-driven competition. These customers of Indian IT services vendors have been extracting significant price concessions in legacy services, but at the same time have been compensating them by giving them a larger volume of business by pruning their vendor list. The vendors that are retained employ automation and tighten up operational levers to support margins while at the same time give cost savings to their customers.

Almost all mid-sized players are vulnerable to this form of vendor consolidation as they are likely to be marginal players to these large corporations in multi-vendor situations. This is especially the case when offerings are not well differentiated. All large Indian vendors that talk of bridging the gap due to compression in traditional services through increase in wallet share of a client are probably aiming at grabbing share from their peers. A mid-sized one is particularly vulnerable, especially one that is not able to provide some of the cost benefits that the larger player is able to and has lower skillsets in digital (or probably at a lower scale) and other 'newer' services.

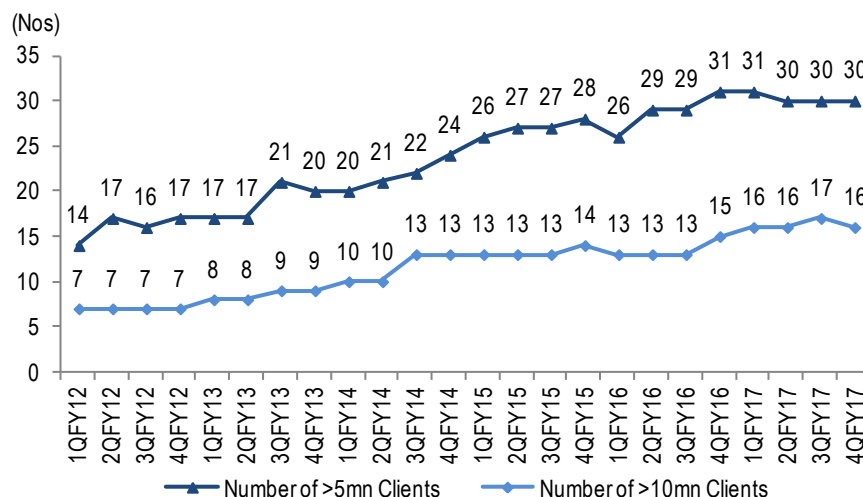
**Exhibit 10: Gartner's numbers on IT spending (in US\$m)**

(US\$m)	2016 Spending	2016 Growth	2017 Spending	2017 Growth
Data centre systems	171	0%	171	0.3%
Enterprise software	332	6%	351	5.5%
Devices	634	(3%)	645	1.7%
IT services	897	4%	917	2.3%
Communication services	1,380	(1%)	1,376	(0.3%)
Overall IT	3,414	0%	3,460	1.4%

Source: Gartner

Mindtree caters to ~50 Fortune 500 clients but the size of the engagements with them has been fairly marginal in comparison to customers' IT spending. Mindtree has only 1 customer which delivers it revenues of more than US\$50mn while it has about 3 of them which deliver it revenues between US\$25mn and US\$50mn, 11 which deliver revenues above US\$10mn but below US\$25mn and 14 which deliver revenues above US\$5mn but below US\$10mn. Before vendor consolidation happens (when the vendor is taken off the list) there will be signs of it in the form of MSA renegotiations, significant pricing pressure, order cancellation, slow ramp-up, etc. These are the things that have been experienced by Mindtree in the past 18-24 months with some of its large customers.

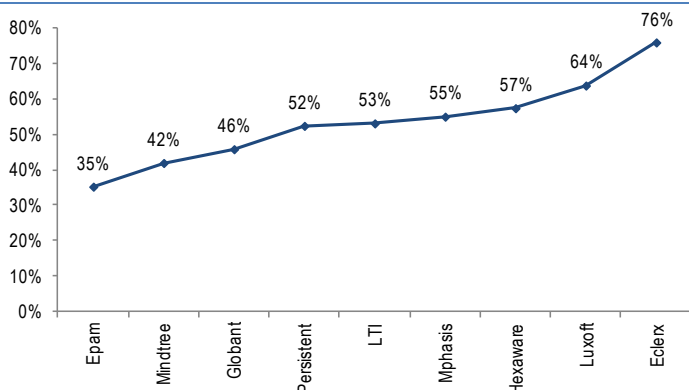
**Exhibit 11: Number of clients in various revenue buckets**



Source: Company, Nirmal Bang Institutional Equities Research

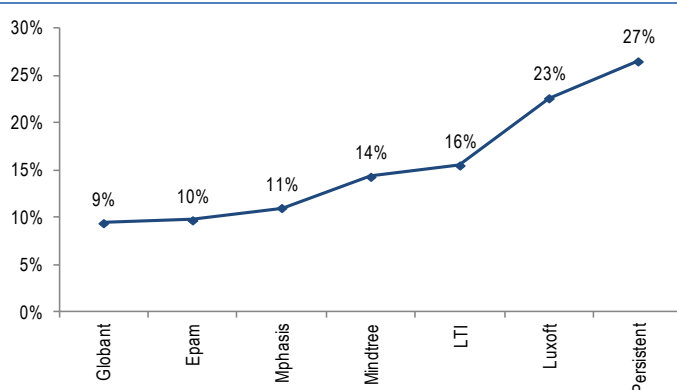
Mindtree is also vulnerable because of its high client concentration (just as in the case of a number of its peers). Any drag from some of its top clients will have an impact on overall growth rate as has been seen in FY17. Mid-sized firms are caught in a bind as efforts to push growth across more clients entail higher SG&A expenses (under normal circumstances) while as described above there is a risk from higher client concentration. However, a comparison of immediate peers in this area indicates that Mindtree, while vulnerable, is not exactly the worst positioned. There are others who are much worse off.

**Exhibit 12: Top 10 clients' revenue contribution**



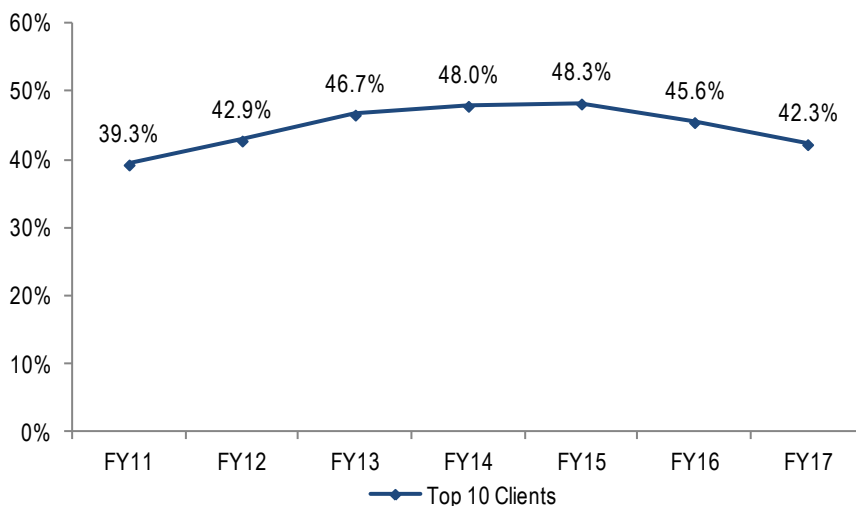
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 13: Top client's revenue contribution**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 14: Top 10 accounts' revenue share for Mindtree across various years**



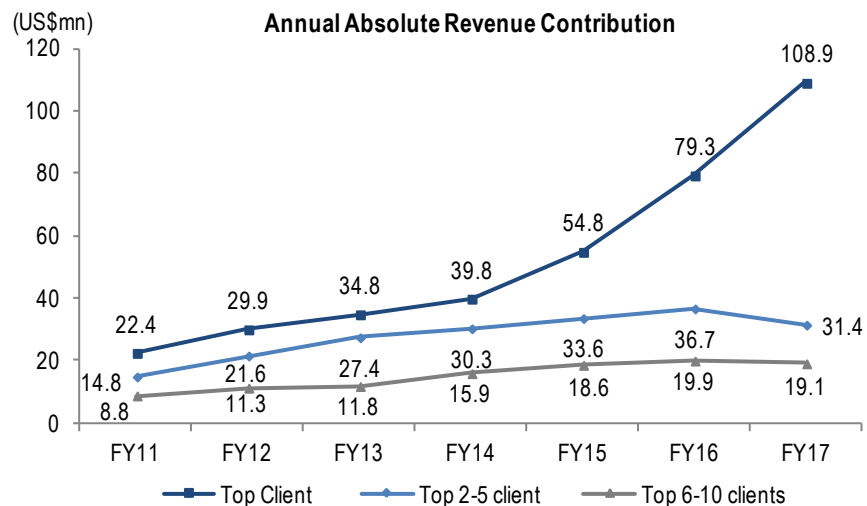
Source: Company, Nirmal Bang Institutional Equities Research

Mindtree's top 20 client size is just about right for a large player to focus on (as it is neither too big for the client to pass it on to a new vendor nor too small that it is immaterial). This builds, in our view, a stage where Mindtree will be firefighting on a day-to-day basis to prevent them from being poached by another vendor.

### Client mining suffers in the age of vendor consolidation...

An analysis of top clients indicates that except for the top client (which has been the primary driver of growth in recent quarters), clients 2-5 and 6-10 have not grown very much in the past three years. Revenue growth has been driven by growth in the number of clients rather than by increase of revenue per client. Most recent client additions have likely come through acquisitions of Bluefin, Relational Software and Magnet 360 done over the past 24 months. In FY10-FY15, Mindtree did a pruning of its clients as it felt it had a long tail (brought it down from 300+ to ~200) and weeded out non-strategic ones. But the number went back above 300 because of acquisitions. We feel the second round of pruning is probably not on the cards as of now despite the big increase in smaller clients as it is those clients that are driving growth for the company currently.

**Exhibit 15: Except for the top client, mining of top clients has been poor in the past three years. Revenue of Individual clients in various brackets**



Source: Company, Nirmal Bang Institutional Equities Research

Reasons for non-growth of the top accounts include:

- Renegotiation of master services agreements (MSA) between the company and clients. We believe all such renegotiations will likely involve lower pricing and these are mostly traditional services contracts.
- Ramp-down or cancellation of contracts.
- Vendor consolidation as we believe it has lost some of its older clients to other vendors.
- Clients deciding to do more work internally through their global in-house captives (GICs) many of which are in India and some in Eastern Europe.
- Mindtree not getting an adequate share of digital revenues from its existing clients because it does not have the full range of skillsets (consulting/ design).
- Potential inability to provide large automation related benefits to its customers

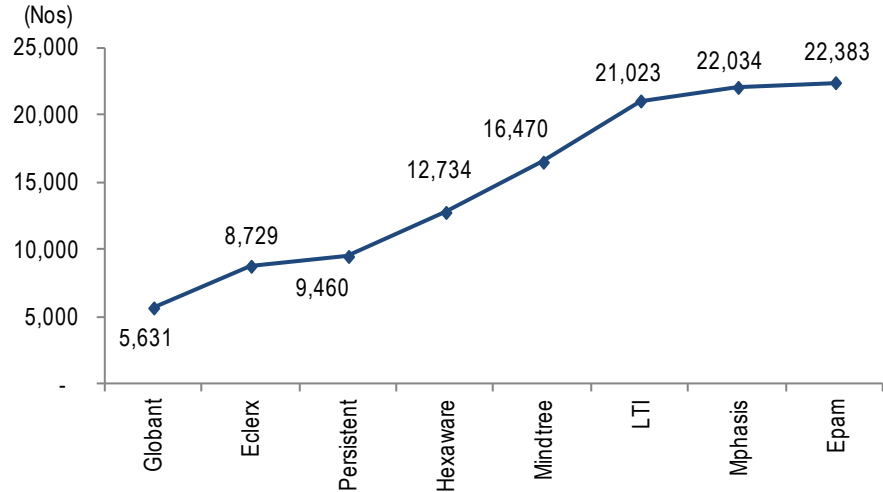
The growth of the largest client has been a different story altogether compared to the rest of top 10. We understand that the largest client is a software major (involved in building office productivity software tools and also cloud computing software to support 'as-a-service' operations). A large part of the growth at Mindtree for this client is being driven by provision of access to the cloud computing platform for the software major's clients (~50% of the total business) based on certain SLAs (service level agreements). We believe Mindtree also does application development, maintenance as well as product development work for the company. This client has shown 8% CQGR over the past eight quarters while average top 10 clients' (excluding top client) growth has been flat. Our analysis indicates that ~60% of the organic growth displayed by Mindtree in FY17 (7.5% growth YoY) has come from this client. Without growth in that client, organic growth would likely have been in very low single digit. We understand that this client will continue to grow as its cloud computing software continues to gain traction in the market. We are not sure what differentiates Mindtree from other vendors with regard to this client, and we are not very sure whether the skills are difficult to replicate. There is a risk that another peer (large or medium-sized) takes this client away from Mindtree and if that were to happen, the setback in growth could be pretty significant. This also exerts pressure on Mindtree to hold on to this client, even at the cost of compromising margins.

## Other mid-sized players globally have grown faster than Mindtree

Our study of comparables in the global IT services space throws up interesting companies which seem to be growing faster than the Indian IT services mid-sized players (Exhibit 19). These include players like Epam, Luxoft and Globant. From a size and revenue perspective, the closest comparable is Epam. While its headquarters is in the US, it is largely an Eastern European company with a large part of its workforce based in Ukraine and Belarus. Globant, on the other hand, is an Argentina-based player. Epam, Globant and Luxoft have been growing faster than Mindtree and some other Indian mid-sized players. Our study on Epam's commentary of its business threw up the following points.

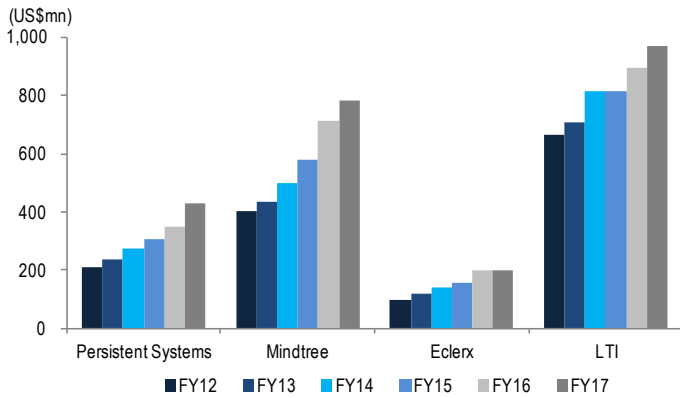
- That it has a much larger exposure to digital than the Indian players, possibly at as much as 70%.
- It claims to be an end-to-end digital services company with consulting, design and technology development being provided under the same roof.
- It is more focused on software services rather on broader IT and IT-enabled services that Indian companies are present in like Business Process Services (BPS) or Infrastructure Management Services (IMS). Probably, the latter two are going through value compression a lot more because of use of automation and platforms whereas pure software development work is still labour-intensive and continues to grow based on headcount. Probably, that is playing to the advantage of non-India based mid-sized players.
- The outsourcing model seems to be more Time & Material-based if one looks at Exhibit 30 where Epam has only about 10% of its revenues coming from fixed-price contracts.
- Epam probably is used by global corporations to reduce geographic risk amongst their vendor base. A bulk of IT and IT-enabled services offshoring is done to India and the Philippines. Epam and some of the other players likely provide the corporations a geographic redundancy for any emergency situation. There is probably a deliberate shift of work to an eastern European/Latin American- driven entity for that purpose especially if they cost broadly the same as Indian companies
- Revenue per employee is not very different if one were to take into consideration the higher billing rate attached to digital services. We are not very clear about the onsite-offshore mix of these players, but we believe they should be having a slightly higher tilt towards onsite (because of the digital nature of work and also they do not seem to be in the more traditional services like IMS and BPS which tend to be more offshore-centric).
- Also, unlike in the past two to three years, Mindtree has probably felt the heat of a better managed competition in the mid-sized Indian IT services space. The fact that some of its Indian mid-sized peers are rejuvenated – say Hexaware and the new L&T Infotech team that has come together. The new energy infused into these outfits will help drive growth for a fair bit of time, especially if it is incentivised with adequate amount of stock-based compensation – which seems to have happened with both. Hexaware seems to have brought together a number of people from the current CEO, Mr. Srikrishna's erstwhile organisation – HCL Technologies - and L&T Infotech has brought together a number of senior management personnel from various companies including Infosys.

**Exhibit 16: Total number of employees- Latest quarter**



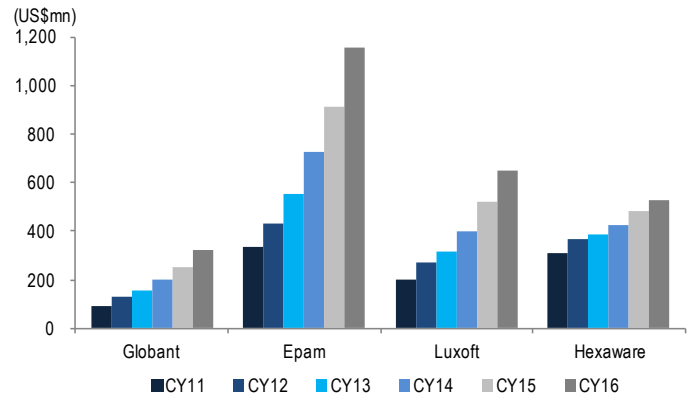
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 17: Revenues (US\$mn)**



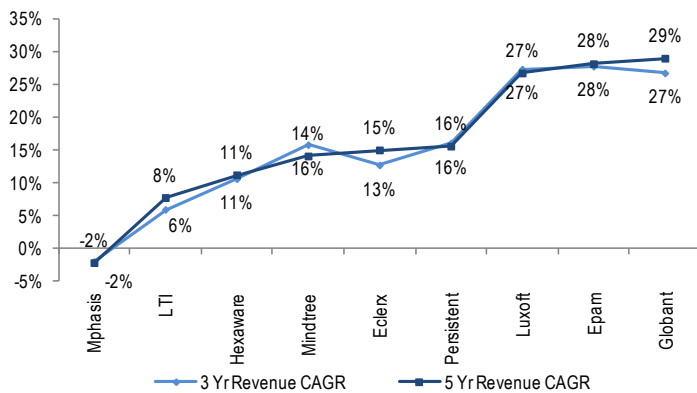
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 18: Revenues (US\$mn)**



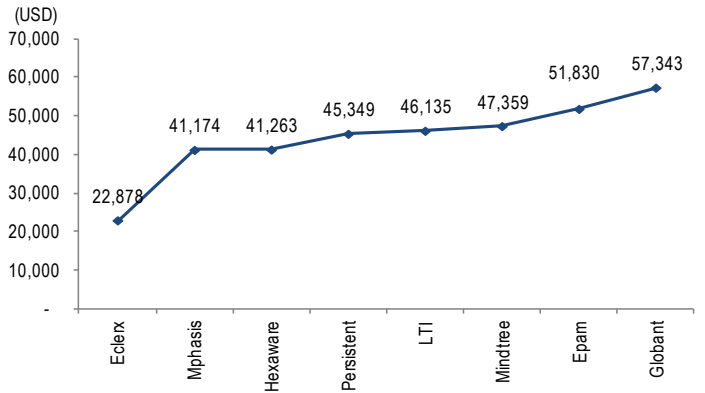
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 19: USD revenue CAGR**



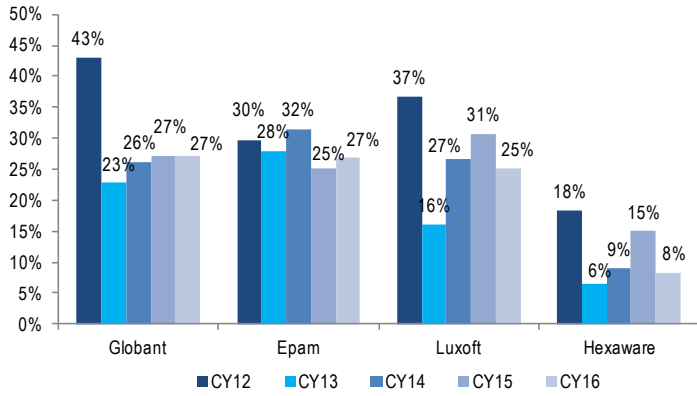
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 20: Revenues per employee (USD)**



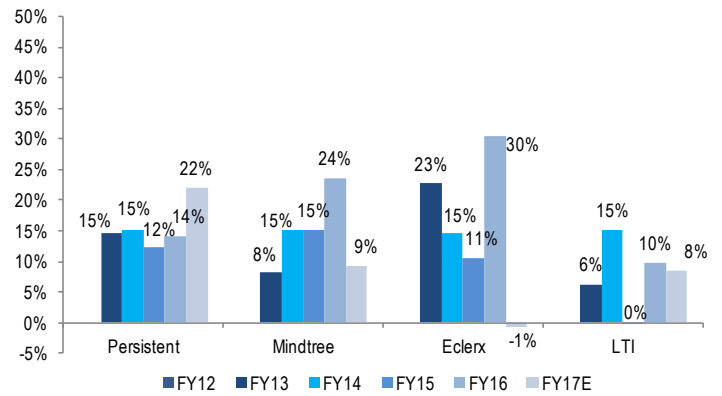
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 21: YoY revenue growth (%)**



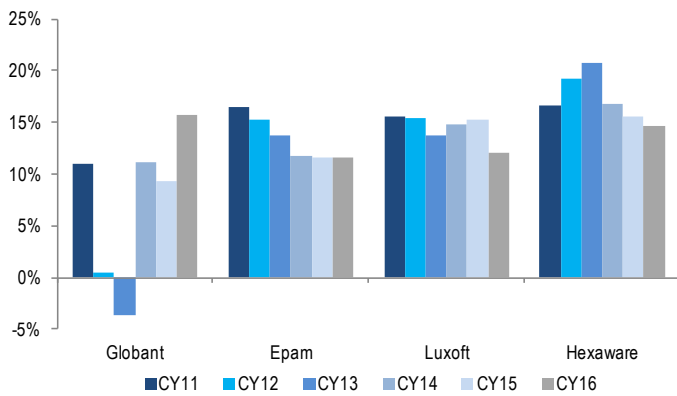
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 22: YoY revenue growth (%)**



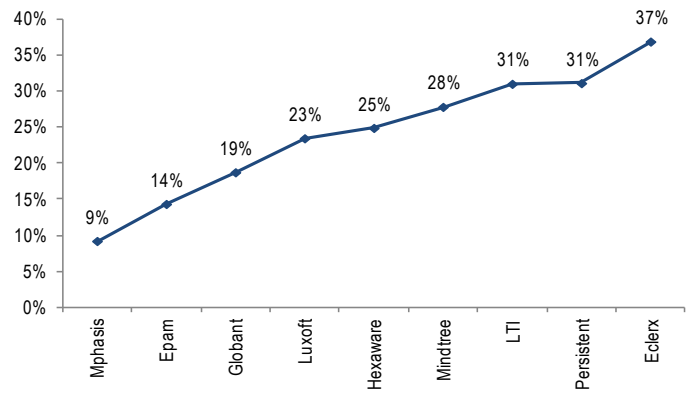
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 23: EBIT margin (%)**



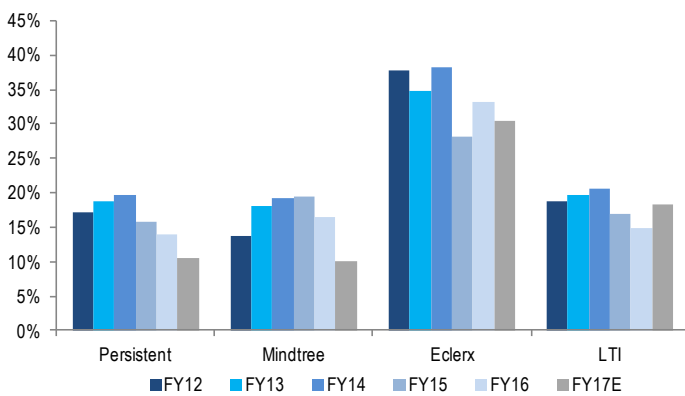
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 24: RoIC-Last FY**



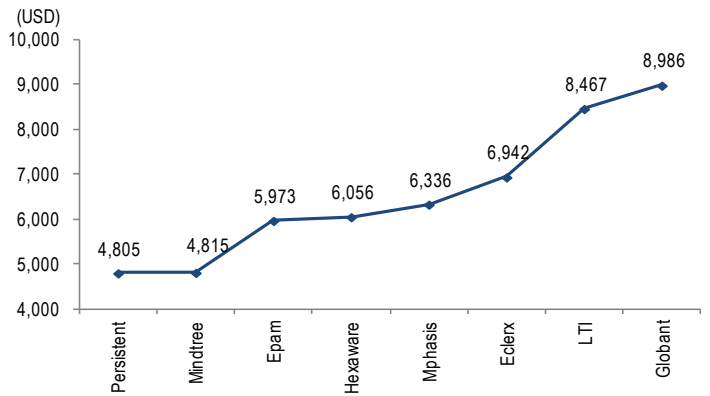
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 25: EBIT margin (%)**



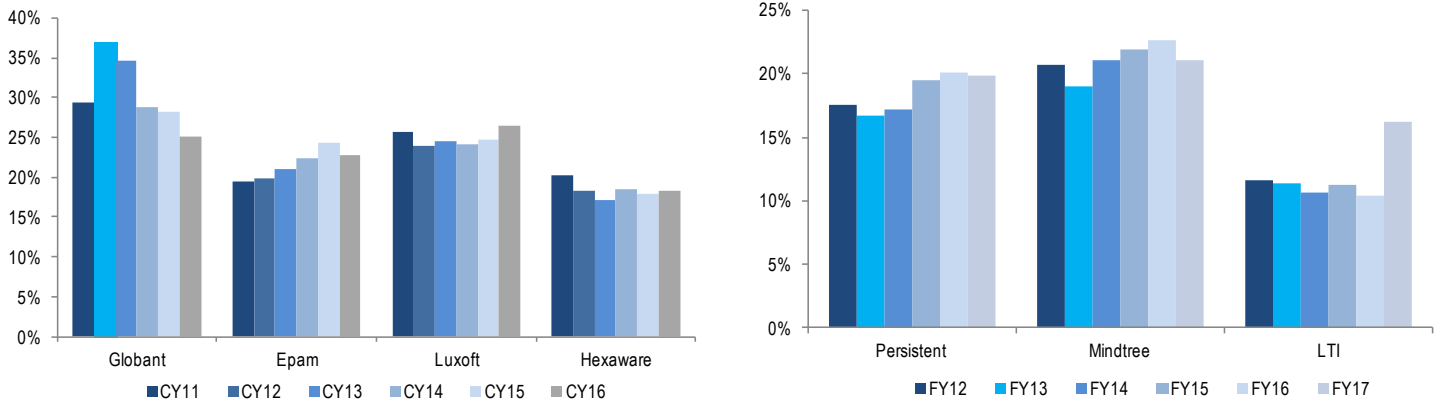
Source: Bloomberg, Company, Nirmal Bang Institutional Equities Research

**Exhibit 26: EBIT/ employee (USD) - Last FY**



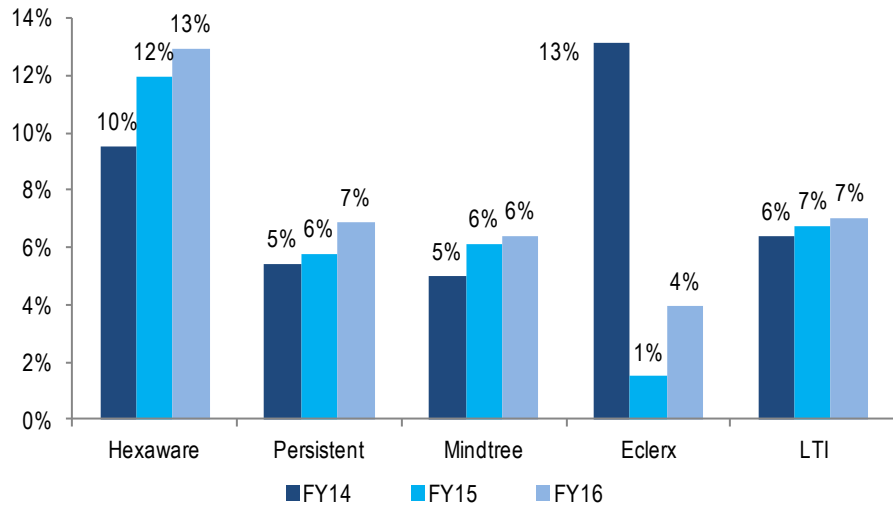
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 27: SG&A expenses as a % of sales**



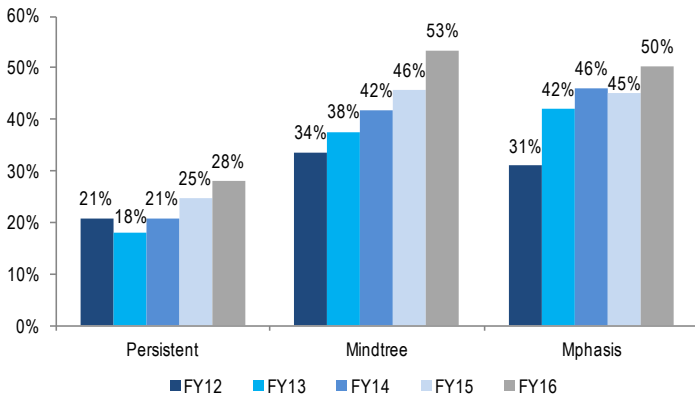
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 28: Sub-contractor/sales**



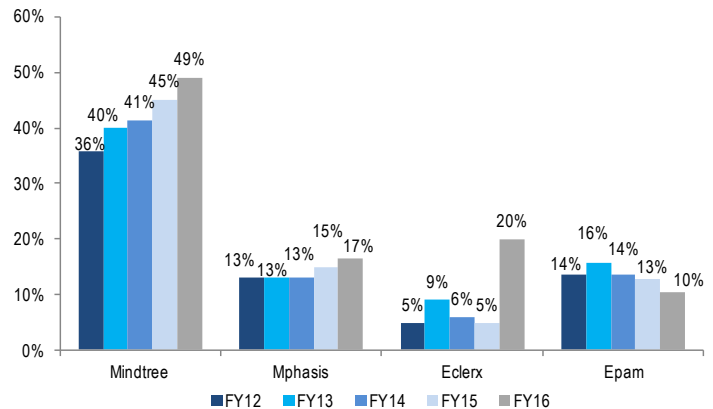
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 29: Onsite revenue mix**



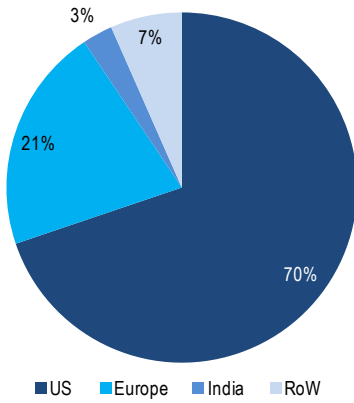
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 30: Fixed-price contract mix**

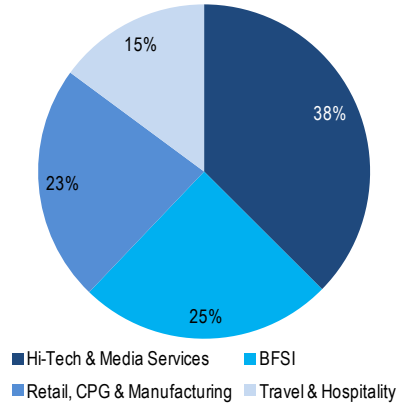


Source: Company, Nirmal Bang Institutional Equities Research

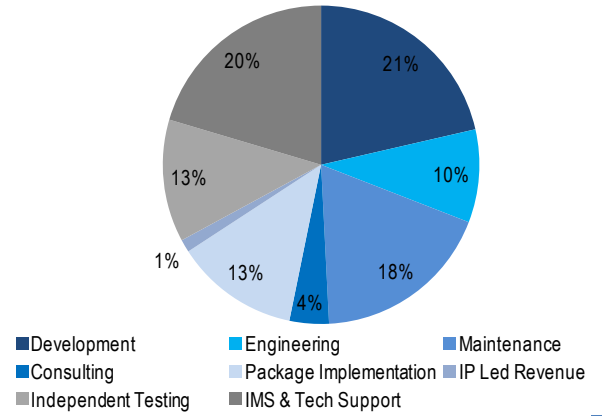
**Exhibit 31: Revenues by geography - Mindtree**



**Exhibit 32: Revenues by industry - Mindtree**

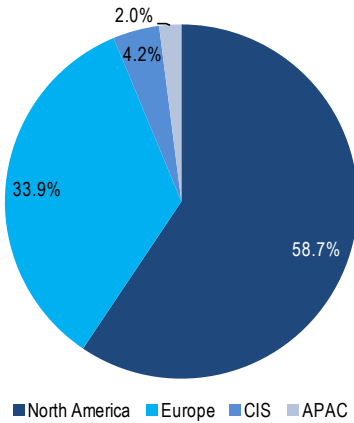


**Exhibit 33 : Revenues by service offering - Mindtree**

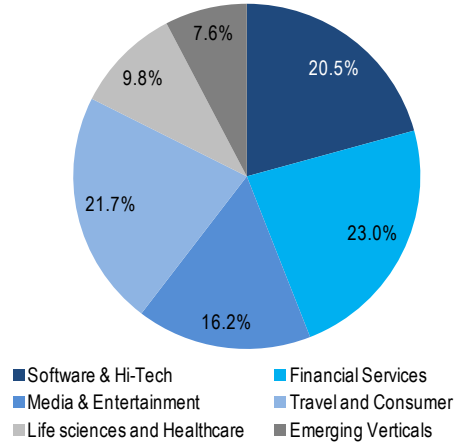


Source: Company, Nirmal Bang Institutional Equities Research

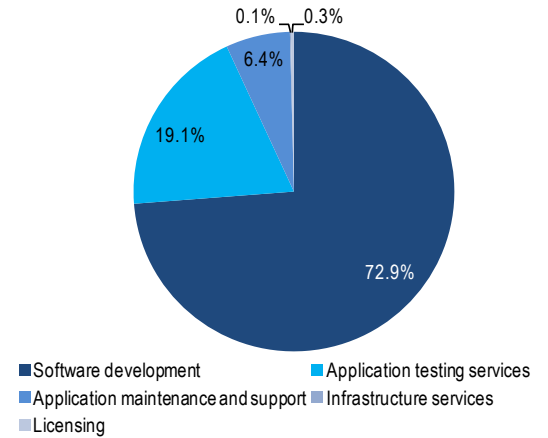
**Exhibit 34: Revenues by geography - EPAM**



**Exhibit 35: Revenues by industry - EPAM**



**Exhibit 36 : Revenues by service offering - EPAM**



Source: Company, Nirmal Bang Institutional Equities Research

## Senior management attrition has and is likely to affect business

Mindtree has probably suffered from one of the highest rates of senior management attrition over the past 24 months. We believe such levels of attrition, while bad for Tier-1 IT services companies, could impact mid and small-sized companies much more. Some of these senior managers have spent significant time with Mindtree and would have handled critical delivery or customer relationship functions. Their exits, in our view, have impacted customer relationships and execution. While some of the attrition could have been performance-related, we believe some of them could have been because of lack of growth opportunities in the company. We are sure that some of them would have aspired for the CEO role that finally went to Mr. Rostow Ramanan, starting April 2016. Mr. Ramanan, until March 2015, was the CFO of Mindtree right from the time it got listed in 2007. We are certain that some of the senior managers who were in delivery and sales were likely eyeing that role.

Except for its largest customer, Mindtree's top 10 clients have not been growing for the past eight quarters. Despite having the entire breadth of service lines, a 17-plus year history, there seems to be a sales or/and delivery problem (especially in some Fixed Price contracts) in scaling up or some large customer scale-down. We believe the constant churn at the middle/senior management level has hit customer relationships and delivery. As can be seen in Exhibit 37, some key positions like the head of digital business as well as a US sales head are yet to be filled up. We also believe the lower management bandwidth has resulted in Mindtree not being able to leverage or cross-sell skills of the acquisitions made over the past 12-18 months.

**Exhibit 37: Partial list of senior management executives who quit the company and their replacements**

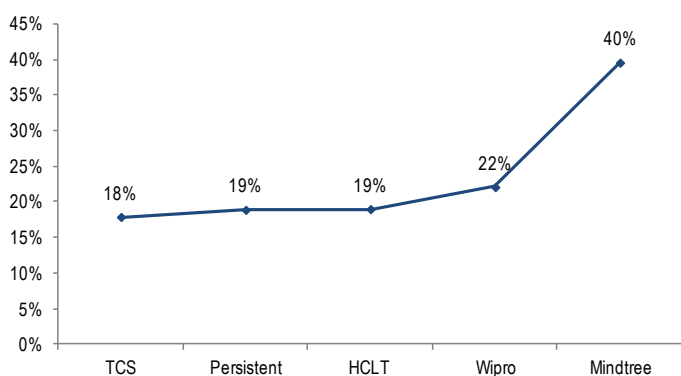
Person Who Quit	When	Responsibility Held	Replacement	Comments
Mr. Scott Staples	April 2017	President - Americas	None found yet. For the time being, the CEO is looking at this.	Mr. Staples, founder of Mindtree, probably felt the pressure of delivering revenues in a tough market. Has joined another company (though not in the same business) as its CEO. Continues to work with Mindtree in non-executive capacity and is on the board of Magnet 360.
Mr. Sunil Oberoi	March-April 2017	Head- Retail, CPG & Manufacturing	Mr. Anil Gandharve, internal hire; previously sales head of Europe.	-
Ms. R. Radha	September 2016	Head-Digital Business (~40% of revenues)	None found yet.	We believe it was a big loss for Mindtree and was partly driven by lack of visibility of upward movement in the company by Ms. Radha.
Mr. R.K. Veeraraghavan	September 2016	Head of Technology, Media & Services vertical	Mr. Balaji Thirumalai, an external hire.	-

Source: Company, Nirmal Bang Institutional Equities Research

## Surprising that digital has been a weak spot

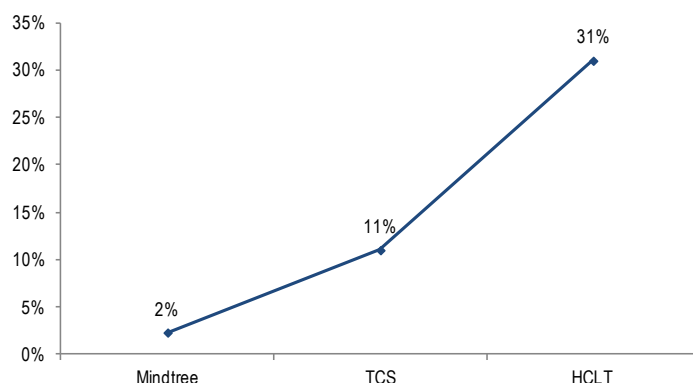
Mindtree has been positioning itself as a 'Born-Digital' IT services player as its initial days coincided with the dot.com boom when a lot of e-commerce-related IT services work was done. Mindtree further buttressed this positioning by spelling out that it has a larger part of revenues coming from this area than many of its larger and mid-sized Indian peers. And this announcement of exposure to digital happened in 1QFY15, much ahead of its peers. Defining what constitutes 'digital' revenues for lack of a standard does makes things tricky for analysts and investors. Currently, 40% of its revenues has seen indicated to be coming from digital (including revenues from its acquisitions). However, in the past four quarters there has been little movement in this revenue (see Exhibit 38 & 39). This is when the digital services market has been indicated to be growing at a very significant clip. Digital order inflow in FY17 was slower by 4% compared to that in FY16. Mindtree's management indicated that slowdown in digital deals is partially because of its focus on large multi-year digital deals that offer opportunity to deliver a balanced onsite-offshore mix as against onsite-centric smaller front-end projects. But we have a different take on this.

**Exhibit 38: Digital as share of Revenue in FY17**



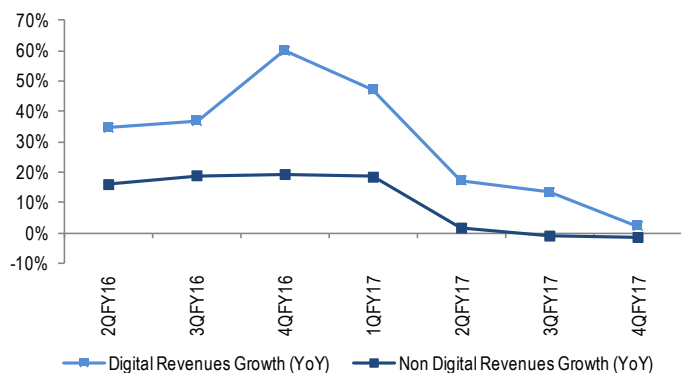
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 39: Growth in Digital Revenues (YoY)**



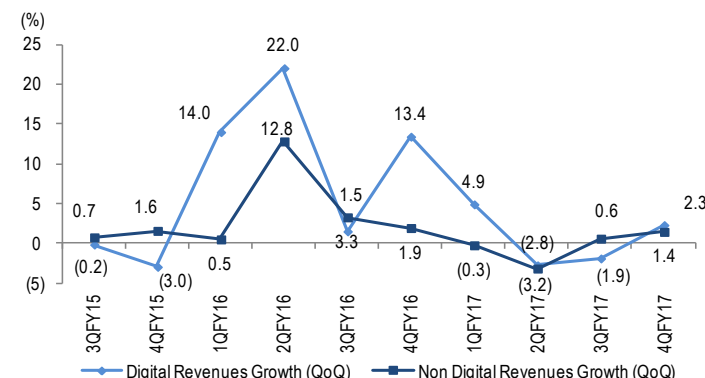
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 40: Digital revenue growth & non-digital revenue YoY growth - Mindtree**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 41: Digital revenue growth & non-digital revenue QoQ growth - Mindtree**



Source: Company, Nirmal Bang Institutional Equities Research

In our view, a part of this slower growth can be explained by the fact that Mindtree is more in the 'how to do' (implementation) segment of the digital business rather than spanning that as well as 'what to do' (consulting) part. In the 'how to do' part it has tried to build size using acquisitions, but we believe it still does not have scale. Also, we believe the 'how to do' space is fairly crowded with most Indian players both large and mid-sized having built some capability in that area. Also, we believe in the back-end integration part it will be at a disadvantage versus existing large Indian incumbents. We believe its current digital capabilities revolve around implementation of certain software packages which tend to be project activity and typically tend to be more onsite-centric. While the project sizes have increased over time we do not think they have reached levels which would be satisfactory even from Mindtree's standpoint.

We believe the market share of Indian companies (in aggregate) in digital is likely lower than what it is on the traditional services side. Whenever a new area opens up, as it has in the past few years in digital, it helps the entry of new players because corporate customers are willing to experiment as incumbents are probably on an equal footing or probably entrants have better capabilities in the areas that are relevant in the initial phase – consulting and design. Interaction with the industry players indicates that the field has become far wider with the entry of both start-ups as well as established 'Big-4' consulting firms in this space.

Based on the contract values being discussed in the digital space, we believe most of these are potentially 5 to 20 people working onsite for say three months to build some kind of Proof of Concept or PoC. It is our view many companies are probably involved in this exercise with the customer trying to find an optimal solution at very little cost. One reason why digital business is not really growing could be the fact that the PoCs are probably not translating into larger digital orders for many vendors.

However in digital, the window is fast closing on smaller players – probably customers have experimented with some of the newer players and now want to move beyond POCs and do something substantial and that is where an end-to-end player who does consulting-design-POC-implementation and back-end integration in an all-in-one package could probably be preferred over a piecemeal player.

Also, in digital, large contracts likely take longer decision cycle as the call is not made merely by the CIO or the CTO, but most likely by business heads of various key divisions as most of the digital technology (in the initial phase) is more customer-facing and is directly related to revenue generation.

## Recent acquisitions give no meaningful differentiation

Success and failure of M&A activity tend to have an exaggerated impact when the acquirer's size is small. The fact that Magnet 360 and Bluefin did not see material growth, needed to be restructured, and that they delivered losses for some period of time indicate that they probably did not meet expectations of Mindtree's management which they had when these were acquired. Some of it can be blamed on macro circumstances like Brexit. Some of it can be laid at the door of earnestness of an acquirer to plug a capability gap. Unsuccessful acquisitions tend to be not only dilutive from growth and margins standpoints, but also suck up top management bandwidth, especially at a time (as in the case of Mindtree) when it was in relatively shorter supply because of the departure of various people at the top.

### Exhibit 42: Various acquisitions done by Mindtree – A history

Sr. No.	Acquisition	Purpose of acquisition	Year of the deal	Valuation	Target employee strength	Target's financials at the time of acquisition
1	ASAP Solutions	This acquisition was done to accelerate its capability in the ERP segment.	Oct-2004	NA	120	No info.
2	Linc Software Services Ltd	This acquisition was done to enable MindTree to cater to the large installed base of IBM iSeries systems and strong worldwide demand for application development and maintenance on these platforms. Linc Software offered services to manufacturing, banking and insurance sectors with technology focus on all iSeries technologies, LANSAs, BPCS, WebSphere, AS/SET, Domino Notes etc.	May-2005	Undisclosed	220	US\$7mn - FY05 revenues.
3	CoSystems	Cosystems brought to MindTree the chance to expand its domain capability in telecom switching. CoSystems delivered complex systems and building blocks to telecom operators, ISPs, cable operators, and to the emerging wireless voice and packet infrastructure markets.	2005	Rs 10mn	20	No info.
4	TES-Purple Vision	This acquisition was done to build its capabilities in Electronics(IC design).	Nov-2007	US\$6.55mn	150	No info.
5	Aztecsoft	Aztecsoft focused on the growing OPD space and testing, and catered to the product engineering business.	2008	Rs 4,000mn	2,200	Rs690mn - Last quarter revenues.
6	Kyocera Wireless India Pvt Ltd	It focussed on wireless services.	2009	US\$6mn	600	
7	7Strata	This acquisition included taking over 7 Strata's proprietary infrastructure management software platform - 'RAPID' in order to boost Mindtree's growth in RIM segment. This software would help its customers save money and improve service levels by having an automated and integrated tool to manage IT operation processes.	Apr-2010	Rs 72mn	90	More than revenue growth it was the acquisition of the tool 'Rapid' which was more important to it.
9	Discoverture	This move aimed at helping Mindtree to tap the US\$1.5bn opportunity in the global P&C services market and capturing of Discoverture's 15 clients to provide it the opportunity to cross and upsell joint offerings. Discoverture is a significant player in the implementation of Duck Creek Software.	Jan-2015	US\$15mn	300	No info.
8	Bluefin	The strategy behind acquisition of Bluefin was to capture the market and position itself and deliver SAP HANA-based transformation to clients globally. It gave Mindtree more than 60 marquee clients in CPG and manufacturing domain, and a team of 170 experts in the U.K., the U.S., Malasiya and Singapore	Jul-2015	~US\$65mn	170	TTM revenues of ~US\$45mn with margins lower than Mindtree's.

11	Relational Solutions	Provider of analytical solutions to CPG companies. It specialises in supply chain optimisation and trade promotion analytics. It is an IP-driven business.	Jul-2015	US\$10mn	No info.	FY15 revenues of US\$3.2mn with about 30 clients having margins higher than Mindtree's.
10	Magnet 360	The acquisition of Magnet 360 was done to bring strong expertise across Salesforce Sales, Service and Marketing Cloud implementations and position it as a leader in the fast-growing cloud-based services market in combination with its own Salesforce practice. MTCL is a platinum Salesforce implementation partner.	Jan-2016	US\$50mn	100 Salesforce-certified professionals	US\$25mn annual revenues with margins lower than Mindtree's.

Source: Company, Media, Nirmal Bang Institutional Equities Research

A look at the various acquisitions done by the company in the past three years, the key ones are those of Magnet 360 (a Salesforce implementation provider) and Bluefin.

Magnet 360's 100 Salesforce experts along with Mindtree's ~100 Salesforce professionals had placed Mindtree among the top-10 Salesforce partners. With the acquisition, Mindtree became Salesforce's platinum partner in the US. The management indicated that Magnet 360 team has augmented Mindtree's ability to close Salesforce deals. The management indicated that Salesforce is supporting Mindtree in one of Mindtree's key accounts. But revenue growth and margins were not very good in FY17 for the entity.

Bluefin has also been a disappointment as it apparently got impacted by Brexit on both revenues as well as margins. Our study of other mid-sized players did not indicate that Brexit was a big business disrupter. May be Bluefin was a special case.

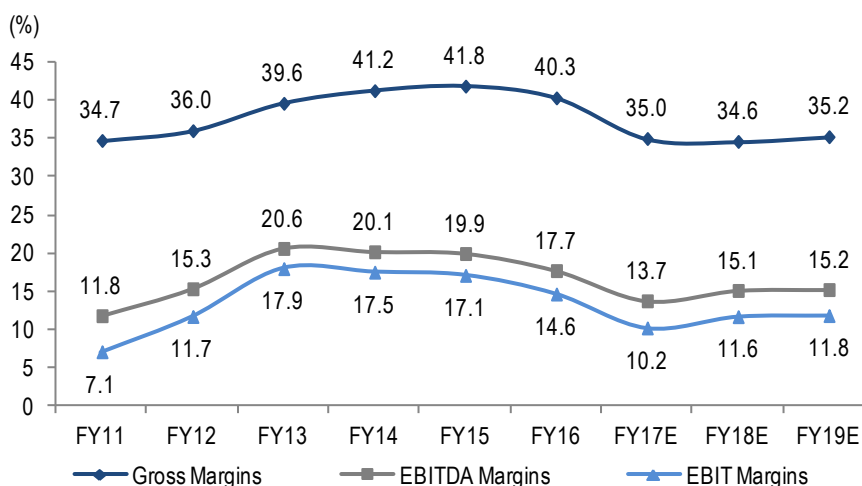
The acquisition of Discoverture, Bluefin and Magnet 360 seems to be all about implementation of packages (reflected in the growth of package implementation service line in Exhibit 80) of Duckcreek, SAP HANA and Salesforce packages. What is not very clear is whether this brings in consulting and design capabilities with respect to specific verticals. We believe the work that Bluefin and Magnet 360 do are largely project-oriented and the customer relationships are probably not very sticky. We do not think they bring in material annuity type of revenue which are so critical to deliver consistent growth. Besides with top management churn, we are not sure whether adequate attention has been paid to these entities and focus has been put on cross-selling and deriving synergies.

We believe these acquisitions, while probably plugging some capability gaps within Mindtree, are not exactly great differentiators especially when compared to Indian Tier-1 or MNC services players. Our view is that in each of these areas, the latter companies probably have much larger teams which would have built organically.

**Margins unlikely to improve materially from the current level**

As can be seen in Exhibit 43, EBIT margin of Mindtree has come off from 17.9% in FY13 to 10.2% in FY17. A lot of this has to do with a drop in gross margin from 39.6% to 35% and an increase in SG&A expenses from 19% to 21.2% over these years. Depreciation, as a percentage of sales, which stood at 2.6% has gone up to 3.5%. We expect EBIT margin, which stood at 10.2% in FY17, to move up to 11.5% in FY18E and remain flat in FY19E. We do not expect them to go back to high-teen level in the foreseeable future.

**Exhibit 43: Margin Picture over the years**

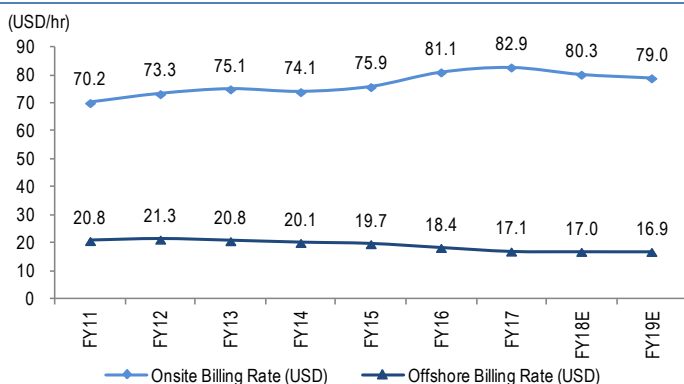


Source: Company, Nirmal Bang Institutional Equities Research

**The drop in gross margins has been driven by:**

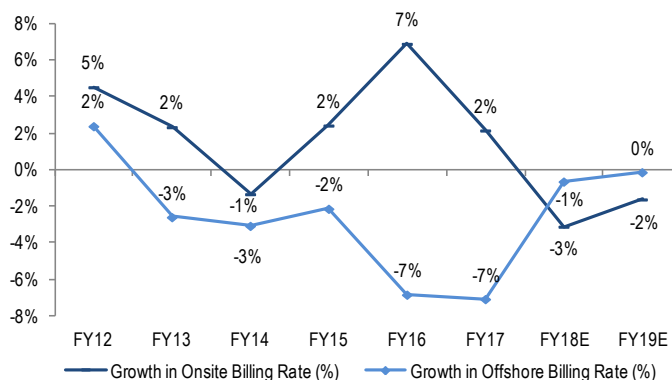
- Pricing pressure:** As can be seen from Exhibit 45, offshore pricing has been declining since many years and is currently 22% below its 3QFY12 peak. This has been because of high competitive intensity and customers' expectations from vendors to help them save significantly on the 'Run the Business' side so that they can spend savings on 'new' services (Digital, IOT, Security Services, etc). Also, there is pressure to hold on to existing relationships by matching aggressive pricing of competitors in the hope that Mindtree will be able to develop automation tools to counter pricing pressure going forward. We believe this will continue going forward too, but with lower intensity. We have not assumed any significant price decline for Mindtree in the coming quarters. Probably, we are being a tad optimistic on this front.

**Exhibit 44: Billing rate**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 45: Growth in billing rate**



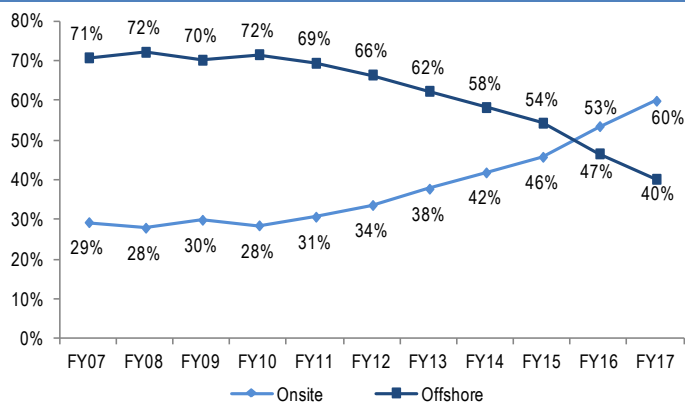
Source: Company, Nirmal Bang Institutional Equities Research

- Inadequately developed automation capability or/and unwillingness to cannibalise revenues:** Despite the use of its automation platform (largely IMS-related) called Mwatch, the steep fall in offshore pricing indicates that its automation capabilities are not very well developed. With a number of third party automation software available in the market, the expectation is not that Mindtree will develop an in-house software like 'Ignio/Mana/Holmes' as done by TCS/Infosys/Wipro. The expectation is that it is able to apply the right automation software for the right process and build use cases so that referenceability can be built up which can then be marketed to customers. It has recently introduced an automation platform called 'CAPE' (Comprehensive Automation Platform for Enterprises) which addresses multiple service

lines and is expected to be an integrated solution. Currently, we understand that it is being introduced to a few clients to develop Proof of Concept (PoC). We believe the introduction of 'CAPE' (unless it is significantly superior to the in-house software of IT services vendors and third party automation software players) is probably about 12-18 months behind that of the market.

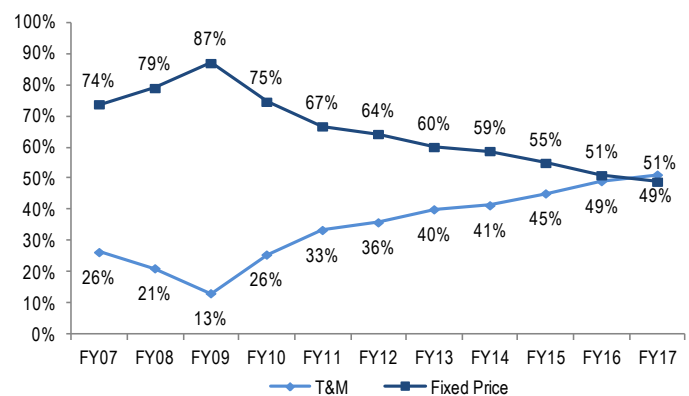
- Shift of delivery mix towards onsite:** While Mindtree has been talking about reversal of this trend, we believe a material change in the next couple of years looks difficult considering the thrust on digital which is largely a client-facing role in the initial phase of the relationship. We believe the digital contracts that Mindtree and many others in the market are getting are becoming large. But we do not believe they have reached a stage where a lot of work can be moved offshore. Only when the digital projects reach a stage where there is large-sized back-end integration, maintenance and support work would there be a larger offshore delivery side. A thin front-end could work to the competitive disadvantage of a player in the current market conditions as there is a lot of collaborative work required between the client and the service provider or between client, consulting, design and IT service providers if the assignments are not done by end-to-end players but different parts are done by best-of-breed players. Improving margins by shifting the work offshore looks to be a difficult proposition under these circumstances. A number of IT services players are setting up digital innovation hubs in their target markets where employees of clients as well as their own employees can work together in one space. Such investments may be required from Mindtree too in the foreseeable future. This will involve capex.

**Exhibit 46: Onsite & offshore revenue contribution**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 47: Revenue classification based on type of contracts**



Source: Company, Nirmal Bang Institutional Equities Research

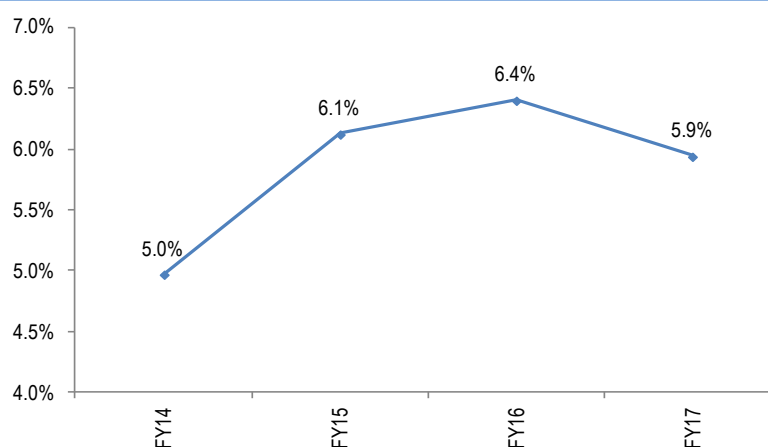
- Simultaneous rise in fixed price and onsite revenues raises risks to margins:** We also worry that there has been a rise in fixed price (FP) portion of the revenues along with the rise in onsite delivery which indicates that quite a bit of the incremental work being taken on is FP and onsite. Mindtree has stated in the past that one of the reasons for its poor performance on margins front has been slip-up on fixed-priced projects. We hope the systems and processes have been tightened to ensure that these problems do not recur or else the combination of higher onsite with fixed price could be a significant margin dampener.
- H1-B visa-related costs:** While there could be some margins uplift from better profitability of the subsidiaries, we expect that to be offset by higher onsite costs either because of higher local hiring and/or higher cost of renewals, lower onsite utilisation and higher sub-contractor charges. We also expect higher onsite wage inflation as a number of players who were dependent on H1-B visas will turn towards local hiring. In our estimates for FY18, we are not assuming a higher minimum wage for H1-B visa holders. This may potentially come through in FY19, but is dependent on some of the legislations being cleared by the US Congress. There seems to be bipartisan support to the bills and so we believe there is sufficient time for the bills to be cleared for FY19. There could also be higher use of sub-contractors by the company as staffing people on time could become an issue, especially if the hiring engine in the US is not well developed. Exhibit 49 gives the sub-contracting picture for Mindtree). We believe that Mindtree probably has about 50%-70% of its US onsite staff on H1-B visas and if the minimum wage moves up to US\$100,000, we have calculated the impact that it will have on margins of the company - both from pessimistic as well as optimistic basis. We believe that one or the other legislation in the US Congress on minimum wages is likely to be cleared in the next 12 months which could be a dampener on margins in FY19.

**Exhibit 48: Impact on Margin in case minimum wages are applied on H1-B visa holders.**

	Optimistic Case	Pessimistic case
Total Revenue (in US\$mn)	895	895
US revenue share - 68%	609	609
Onsite Revenue as %age of US revenue - 60%	365	365
Onsite Bill Rate Per month (in US\$)	12,000	12,000
Number of Technical Staff on US projects onsite	2,536	2,536
Those on H1 B Visas	50%	70%
Number of Technical Staff on H1 B visas	1,268	1,775
Current Average Compensation of H1 - B visa holder (in US\$)	75,000	65,000
Hit if salary moves to US\$100,000(in US\$mn)	32	62
As % of sales	3.54%	6.94%

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 49: Sub-contractor expenses as a percentage of sales**



Source: Company, Nirmal Bang Institutional Equities Research

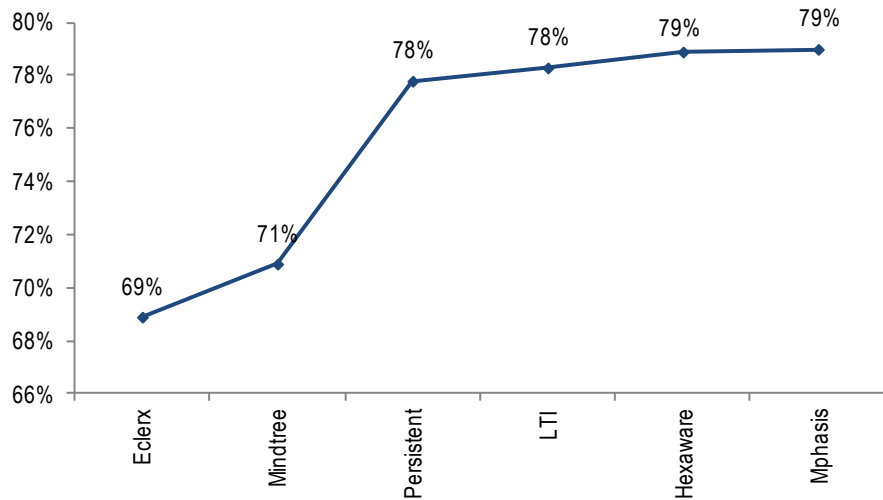
- **Initial phase of some large deals won being margin-dilutive:** From management commentary we understand that execution of some large projects won in recent quarters involves investment by Mindtree in the initial phase (this is not atypical in the industry). With 30%-35% of the order inflow coming from new projects, we assume that there will be some margin pressure from this area.
- **Employee pyramid advantages will not work:** We do not believe the employee pyramid is going to be as much of a lever to improve margins as was the case in the past. The work that used to be done by beginners typically in the recent past is increasingly getting automated and the requirement is for higher skilled labour onsite.

### Which are the low hanging fruits that will improve margins?

#### Employee utilisation

We fail to understand as to why utilisation is so low currently at Mindtree. It could be that Mindtree was expecting certain amount of volume growth to come through in FY17 but was clearly disappointed. But utilisation level was never high with Mindtree in the past. A utilisation in the high 70s could potentially help margins. We are factoring in utilisation level of 74% and 75% in FY18E and FY19E, respectively.

**Exhibit 50: Employee utilisation including trainees (%) for various Indian mid-sized companies - Latest quarter**



Source: Company, Nirmal Bang Institutional Equities Research

**Fixing the subsidiaries**

Bluefin and Magnet 360 delivered losses in aggregate in FY17 which impacted margins. An improvement in margins of the subsidiaries could help. We understand that in steady-state business conditions these companies can deliver high single-digit EBITDA margin.

## Risks to our view

The risks to our negative view on Mindtree stem largely from factors which could negate our sector-level views.(see the valuation section to get a gist of our view on the sector)

These include:

- Despite this being the second-longest expansion post World War II, the US economy continues to grow at a robust pace of 2.5% plus for more years.
- US interest rates move up a few percentage points without impacting growth of the economy.
- Trump administration's attempt at reflating the economy by a comprehensive tax reform programme will be cleared by the US Congress in 2017.
- Global corporations, who have been making record profits, start spending a lot more on technology initiatives than they have been so far and not return all of the money to shareholders through higher dividends and stock buybacks.

The risks to our negative view at the company level:

- If Mindtree is able to pull up margins significantly by running its subsidiaries at high single-digit EBITDA margin.
- Tightens up delivery by focusing more on automation, better execution of fixed-price projects, and working at a higher employee utilisation level than it has in the past.
- Put together a customer proposition that aggressively goes after existing incumbent vendors by either offering automation-driven cost savings for customers or build solid consulting and design skills front-end in select verticals.

## Financial analysis and valuation

### Guidance for FY17 was strong, but actual delivery fell short

Mindtree had given guidance of strong numbers for FY17 but fell short of it by a large amount for various reasons. It had guided 15% plus constant currency (CC) revenue growth in FY17 (with ~11% organic growth). While this was a deceleration from the ~19% organic CC growth in FY16, it was definitely better than Nasscom's industry growth rate of 10%-12% that it had given when the year started (which was subsequently reduced to 8%-10%). However, growth in FY17 came in at 9.1% in USD terms, 11.2% in CC terms and 7.5% in organic terms. The growth slowdown has been attributed to: (1) Ramp-down or cancellation by some of its top clients. (2) Delays in digital/discretionary spending decisions because of business challenges faced by clients. (3) Value compression in certain accounts on pricing pressure in traditional services. (4) Lack of growth in Bluefin and Magnet 360 which were acquired by Mindtree in FY16. This had to do with Brexit and possibly lack of integration of sales teams of Mindtree and that of the acquired entities. (5) Elongated sales cycles.

### FY18 guidance aggressive, expect organic growth to be broadly in line with that of FY17 (7.0%-7.5%)

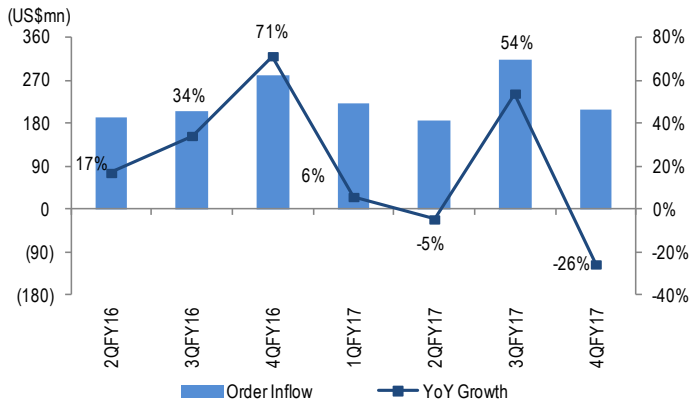
Mindtree has given guidance of low double-digit revenue growth for FY18 with EBTIDA margin indicated to be better than that in FY17. The management indicated that acceleration will be driven by order inflow witnessed in 2HFY17. We expect organic growth in FY18 (7.1%) of Mindtree to broadly be in line with 7.5% delivered in FY17. To deliver 10% growth in FY18E, Mindtree will have to deliver 3.75% CQGR for 4 quarters. While we do not believe this is impossible, we feel the weak exit from FY17 makes the task difficult. Our 7.1% YoY growth estimate implies 2.65% CQGR in FY18 which is not an easy task in the current market and macro environment. We expect 1HFY18 to be strong with ~3.5% CQGR growth in the first two quarters followed by a weak 2HFY18. Our revenue growth expectation is driven by flattening of offshore pricing, an improvement in offshore volume growth and slower growth of onsite volume. Mindtree expects balanced growth across verticals in FY18. Growth in Hi-tech will be led by the top account. BFSI growth will be driven by a large deal won in the insurance space. Growth in Travel and Hospitality vertical will be broad-based. Retail CPG vertical may witness some volatility given the continued weakness of a few large clients.

### Good order backlog and inflow has little meaning in current industry context

In today's industry context where contracts are going through value compression when customers are seeking to save on the traditional services side to fund their innovation and digital initiatives and where vendors are passing on their automation benefits to their customers without waiting for their master services agreements to end (as they fear someone else will do that before them), order backlogs have little meaning as clients tend to renegotiate MSAs (master services agreements), cancel orders or initiate slow ramp-ups. Order backlog is vulnerable to aggressive behaviour of peers in multi-vendor situations. In many cases we understand that Tier-1 companies themselves come up to clients in the midst of an MSA to self cannibalise so that they can take away a larger share of the wallet of the client.

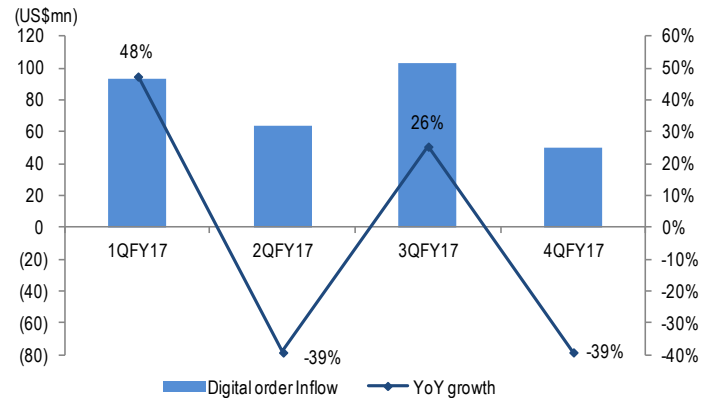
Therefore, we believe that the strong order inflow that Mindtree witnessed in 2HFY17 is good, but one cannot entirely rely on that to project revenue and profitability into the future. Even if one looks at the guidance that Mindtree provided for FY17 on the back of good growth in order backlog, some of the above mentioned problems did crop up leading to underperformance of the company vis-à-vis initial guidance. Also, if one looks at FY17 in entirety, deal wins totaled US\$926mn compared to US\$886mn in FY16, a growth of just 4.5% YoY. Deal wins in digital stood at US\$310mn in FY17 versus US\$332m in FY16, a decline of 4% YoY. It was just 2HFY17 that was the saviour or else the deal flow would have looked fairly poor.

**Exhibit 51: Total order inflow and YoY growth has been uneven**



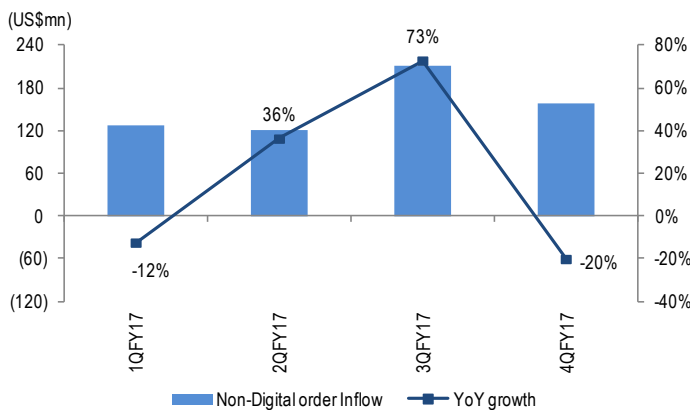
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 52: Digital order inflow and YoY growth - Fairly volatile**



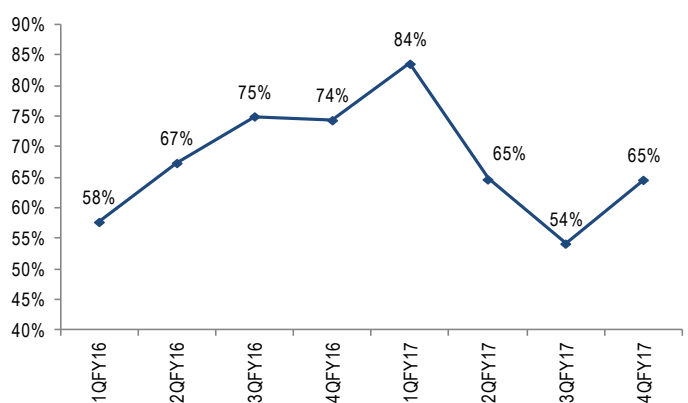
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 53: Non-digital order Inflow**



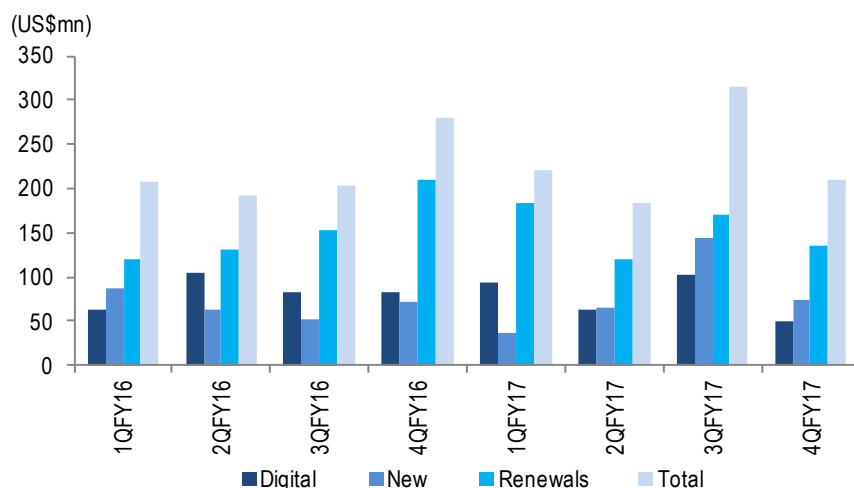
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 54: Renewals as a percentage of total order inflow**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 55: Total contract value signed (US\$mn)**



Source: Company, Nirmal Bang Institutional Equities Research

**Expect margins to improve in FY18 but remain flat in FY19**

While we expect Bluefin and Magnet 360 to deliver better profitability in FY18 (which will likely be the key positive driver of margins), we also expect employee utilisation (ex-trainees), which was at ~72% in FY17 to be much higher than what Mindtree had guided (73%-74% over the next few years). We see no reason as to why the current low level of utilisation should continue. We expect around 74% utilisation in FY18 and 75% in FY19. We expect modest pressure on onsite and offshore pricing, salary hikes (starting 1 July 2017 for employees below a certain pay grade, most likely), investments that are likely required in implementing some

of the new projects, and likely greater hiring in the US to act as headwinds over the next couple of years. While margins are likely to improve from the highly depressed level of FY17, they are unlikely to go back to the level that was exhibited during FY13-FY15.

### Our numbers are in line with consensus, but that is misleading!

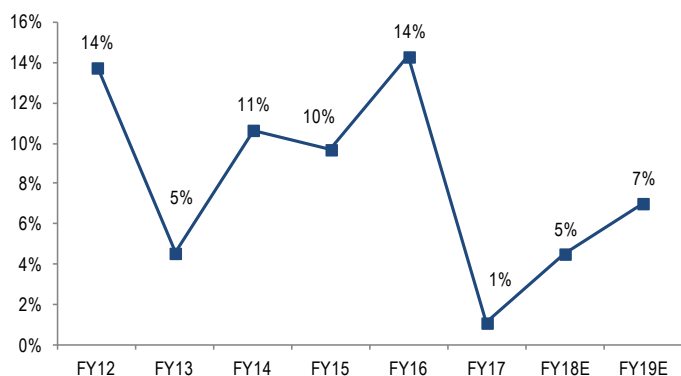
As can be seen in Exhibit 66 consensus revenues, EBIT and PAT numbers are broadly in line with ours as are margin estimates. We believe that on USD basis our revenues are lower than consensus but as we have used INR/USD rate of ~68 and 70 for FY18 and FY19, respectively, our INR revenue, EBIT and EPS estimates look inflated. We believe consensus is working with INR/USD rate of 65-67 for both the years.

The key assumptions on volume, pricing and margins have been given in Exhibits 56 to 62.

### Cash generation was very strong in FY17, but we believe it is unlikely to repeat

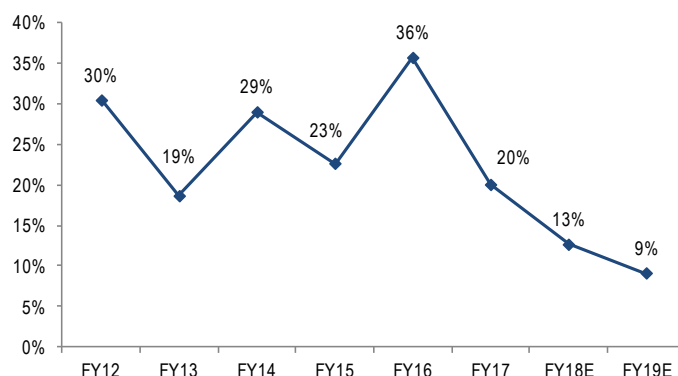
DSO (including unbilled) declined by 11 days sequentially and 22 days YoY to 71 days at the end of FY17. This led to FY17 FCF generation being at a strong 126% of net profit. We would hesitate to extrapolate some cash flows into the coming years. We believe the market environment is such that dramatic working capital improvement is unlikely.

**Exhibit 56: Offshore volume growth**



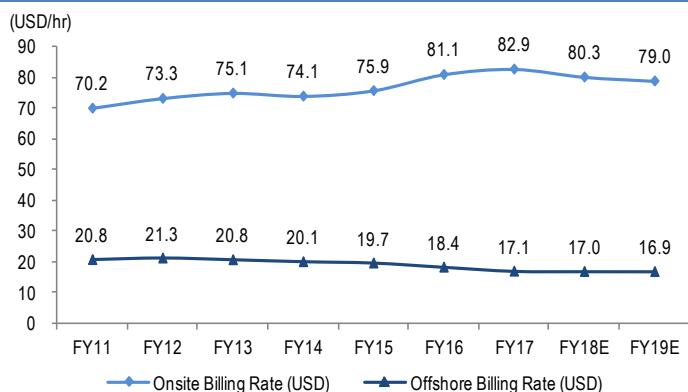
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 57: Onsite volume growth**



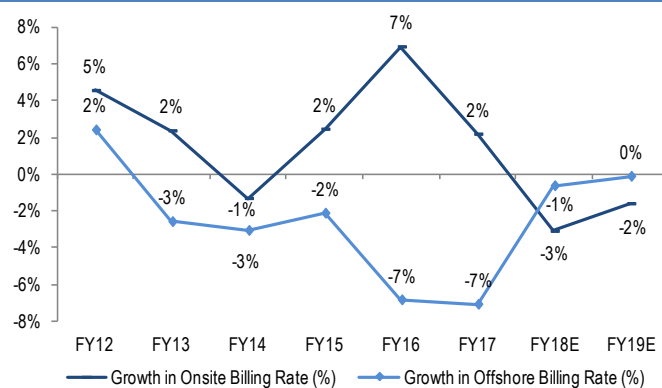
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 58: Billing rate**



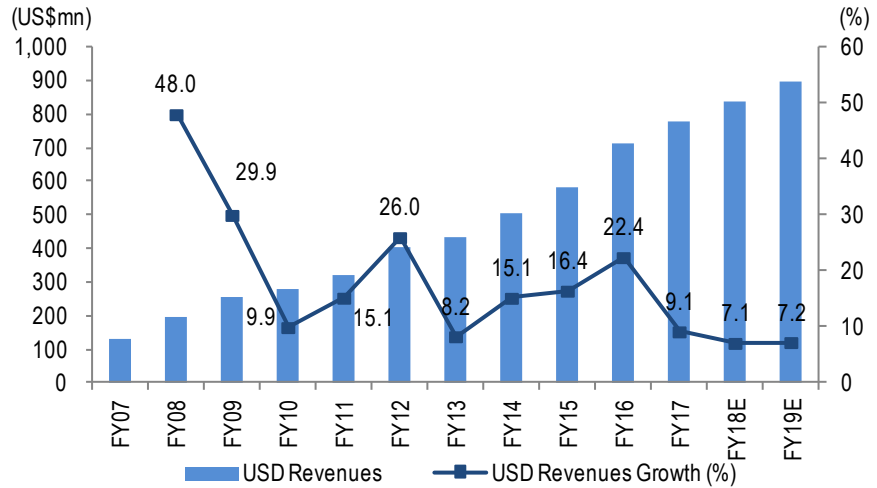
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 59: Growth in billing rate**



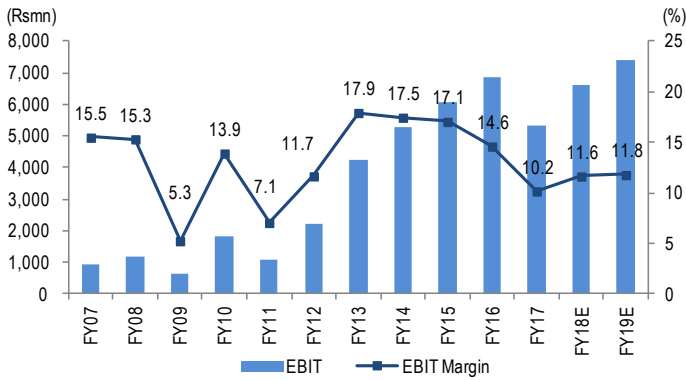
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 60: USD revenues and USD revenue growth (%)**



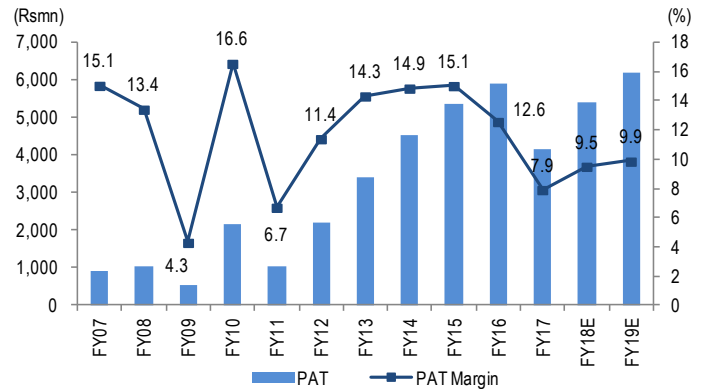
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 61: EBIT & EBIT margin**

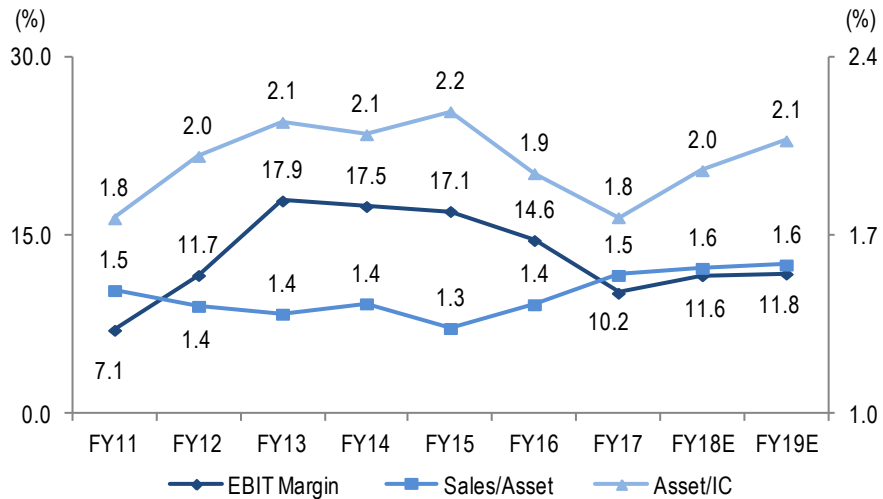


Source: Company, Nirmal Bang Institutional Equities Research

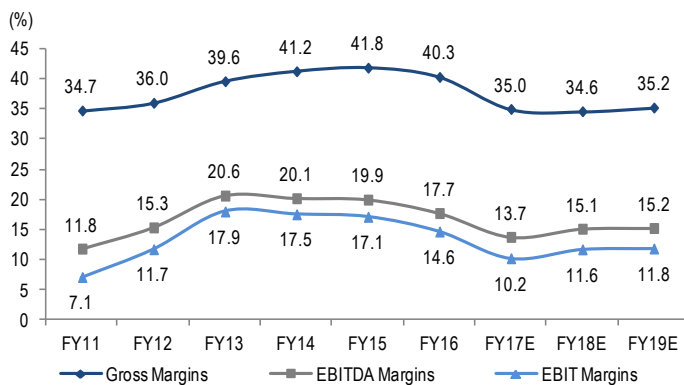
**Exhibit 62: PAT & PAT margin**



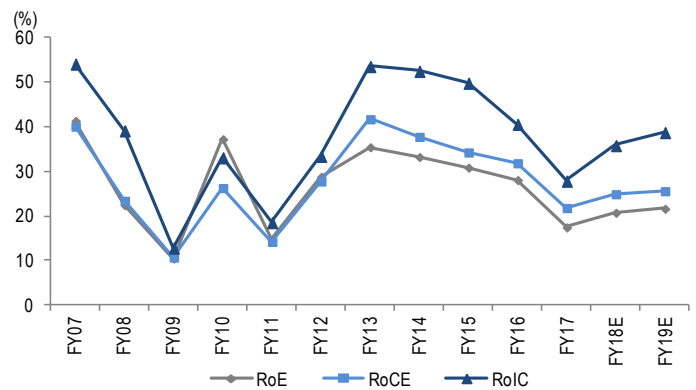
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 63: Drivers of RoIC**


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 64: Margins**


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 65: RoE, RoCE & RoIC**


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 66: NBIE estimates versus consensus estimates**

(Rsmn)	NBIE		Consensus		Deviation (%)	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Revenues	56,680	62,653	56,235	62,834	0.8	(0.3)
EBIT	6,602	7,388	6,187	7,297	6.7	1.2
EBIT margin (%)	11.6	11.8	11.0	11.6	6bps	2bps
PAT	5,405	6,195	5,083	6,062	6.3	2.2
EPS	32.1	36.8	30.1	35.7	6.6	3.2

Source: Bloomberg, Nirmal Bang Institutional Equities Research

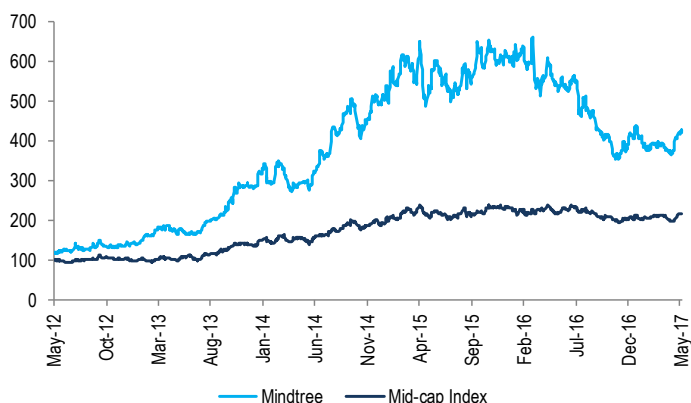
**Valuation**

**We have a negative view on Indian IT services sector:** We have been bearish on the stock return prospects of the sector for the past two years plus. In the near term, we believe the changes to H1-B visa rules proposed by the US Congress are likely to be realised (likely in 2018) and they will have a material negative impact on the margins of companies under our coverage over FY17-FY19E ([H1-B Related Minimum Wage Increase – Material Damage Likely To Margins](#)). We expect RoIC to also move down in tandem. We expect the sector to post 3%-6% USD revenue growth in FY18 (likely lowest growth estimate on the street, organic). In our sector reports [Structural And Cyclical Speed-breakers Ahead](#) and [Downside Risks Open Up - It Is That Time Of The Cycle!](#), we had indicated the reasons for being bearish on the sector: These include: (1) The probability of below-trend growth in the US over the next 12-24 months is high as the economic cycle is maturing. This, in our view, will have a deleterious impact on Global 2000 corporations' sales growth - key driver of Indian IT sector's revenue growth. (2) We believe volume growth, pricing and margins are all likely to disappoint current consensus expectations amid intense competition because of convergence of capabilities and strategies among Tier-1 Indian players. (3) We see revenue cannibalisation from automation to accelerate as the entire industry is in a challenger-defender paradigm and some players have already factored in aggressive assumptions on gains from it and therefore have to deliver unless they want to witness material margin downside. (4) We do not believe digital business is material enough to offset the pressure one expects in traditional business. Besides we believe Indian industry is not getting a fair share of this business because of lower capabilities in consulting and design. (5) We see P/E multiple remaining compressed for the sector as revenue and earnings growth will be anaemic. We also expect return ratios to move down materially over FY17-FY19.

We have valued Mindtree using a P/E multiple-based methodology. We have assigned 1SD below 10-year mean P/E multiple (as we are negative on the sector) to our top picks in the sector - TCS and Infosys. That target P/E multiple is 14.4x. Every other stock under our coverage is looked in comparison to these two in terms of riskiness, growth, margins and return ratios and a subjective discount is applied. We have accorded Mindtree a target P/E multiple of 11.5x which is at a 20% discount to Infosys/TCS' target P/E multiple. Despite being significantly smaller, organic revenue growth is at par or a tad better compared to Infosys/TCS. But margins are significantly poor and so are the return ratios and hence the discount.

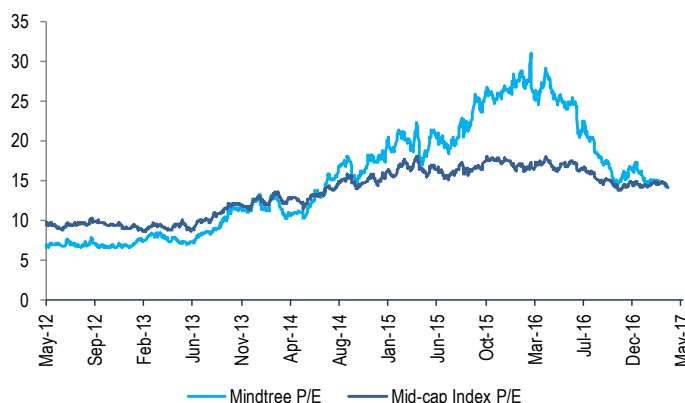
Mindtree stock is currently trading at a forward P/E multiple of 14.8x, which we believe it does not deserve. We initiate coverage on Mindtree with a Sell rating and a target price of Rs424 by March 2018 based on 11.5x FY19E EPS. While the stock is down 30% from its life-time high, we see more downside. We believe the stock could be a value trap. A large part of the market, in our opinion, still believes that: (1) Mindtree has in it not only to make it through this transition phase, but also remain a relevant player. (2) It will go back to growing into a large-cap next generation IT services company after this phase. Hence, it has traded at a significant P/E premium to not only its mid-cap peers (see Exhibit 68) but also to TCS (Exhibit 73) at certain points in time over the past three years. Valuation multiples also rose significantly higher compared to historical levels during this time frame. The premium was accorded as it was considered 'the' leading 'digital services' mid-sized player by the market which could outgrow industry significantly without any material dilution to its margins and return ratios. Based on its performance over the past 18-24 months and our reading of its capabilities and strategies and the evolving industry context, we have doubts about this view.

**Exhibit 67: Price performance of Mindtree versus mid-cap IT services basket**



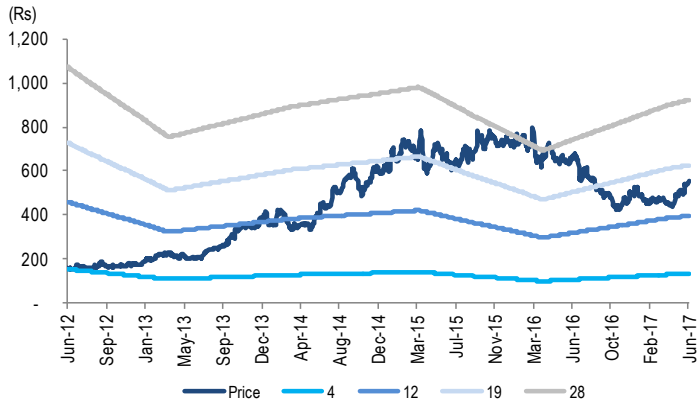
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 68: P/E comparison of Mindtree versus mid-cap IT services basket**



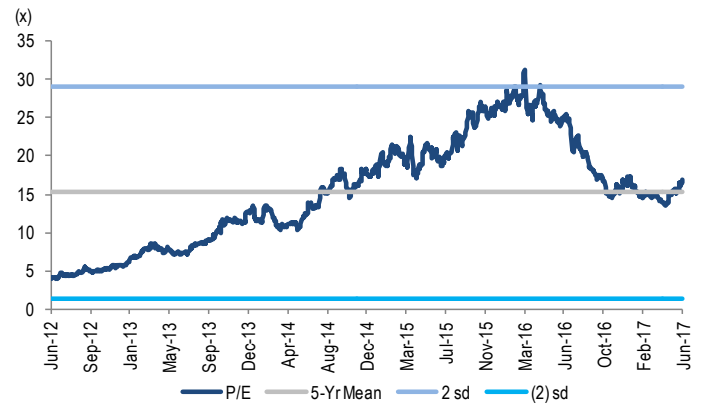
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 69: One-year forward price chart- 5 Years**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 70: One-year forward P/E chart- 5 Years**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 71: One-year forward price chart-3 years**



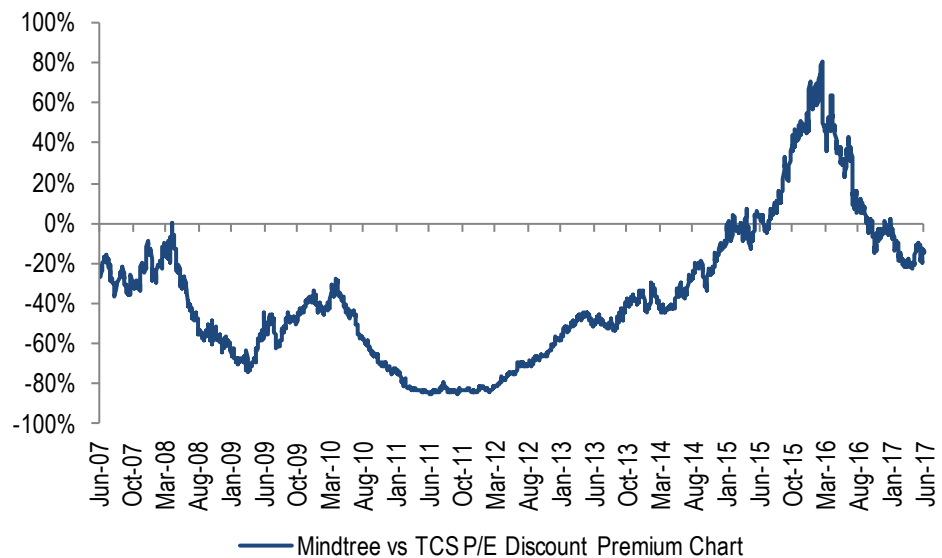
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 72: One-year forward P/E chart- 3 years**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 73: Premium/discount to TCS's P/E multiple**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 74: Comparative valuation**

Indian IT services sector: Valuations							
	TCS	Infosys	Wipro	HCL Tech	Tech Mahindra	Mindtree	Persistent
Year ending	March	March	March	March	March	March	March
Prices as on 06-Jun-2017	2,696	979	561	889	409	547	622
Currency	INR	INR	INR	INR	INR	INR	INR
Market value (Rsbn)	5,160	2,239	1,357	1,257	357	92	50
(US\$m)	80,073	34,740	21,056	19,502	5,544	1,423	772
March 2018 target price	1,996	887	437	743	403	424	534
Upside/(downside)	(26.0%)	(9.4%)	(22.1%)	(16.5%)	(1.3%)	(22.4%)	(14.1%)
Recommendation	Sell	Sell	Sell	Sell	Sell	Sell	Sell
<b>EPS (Rs)</b>							
FY16	126.5	59.0	36.7	40.1	35.0	35.1	37.2
FY17	137.4	62.9	35.0	59.8	31.6	24.7	37.7
FY18E	134.5	60.7	35.2	62.2	38.9	32.1	42.7
FY19E	138.6	61.6	37.9	64.5	40.0	36.8	46.3
<b>PE (x)</b>							
FY16	21.3	16.6	15.3	22.2	11.7	15.6	16.7
FY17	19.6	15.6	16.0	14.9	12.9	22.1	16.5
FY18E	20.0	16.1	15.9	14.3	10.5	17.0	14.5
FY19E	19.5	15.9	14.8	13.8	10.2	14.9	13.4
<b>EV/EBITDA (x)</b>							
FY16	16.6	11.2	10.7	16.8	7.5	10.8	11.6
FY17	15.9	10.8	10.6	11.0	7.5	12.4	10.6
FY18E	15.9	10.6	12.4	9.7	5.9	10.5	8.4
FY19E	15.5	10.5	11.5	9.2	5.7	9.5	7.7
<b>EV/Sales (x)</b>							
FY16	4.7	3.1	2.3	3.7	1.2	1.9	2.1
FY17	4.3	2.9	2.1	2.4	1.1	1.7	1.7
FY18E	4.1	2.7	1.9	2.1	0.9	1.6	1.5
FY19E	3.7	2.5	1.8	1.9	0.9	1.4	1.3
<b>RoIC (%)</b>							
FY15	60.9	64.9	34.3	61.2	41.6	49.8	48.1
FY16	63.1	58.8	31.8	38.5	33.8	40.6	43.5
FY17	60.8	51.1	29.7	46.2	26.2	27.8	31.1
FY18E	57.8	44.1	26.2	43.3	28.1	35.8	35.9
FY19E	56.1	41.4	23.6	39.8	26.2	38.8	37.1

Source: Company, Nirmal Bang Institutional Equities Research

## Financials

### Exhibit 75: Income statement

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Average INR/USD	61.7	65.5	67.2	67.9	70.0
Net sales (\$mn)	584	715	780	835	895
-Growth (%)	16.4	22.4	9.1	7.1	7.2
Net sales	35,619	46,819	52,364	56,680	62,653
-Growth (%)	17.5	31.4	11.8	8.2	10.5
Employee benefits expenses	20,726	27,963	34,058	37,081	40,603
% of sales	58.2	59.7	65.0	65.4	64.8
Gross margin	14893	18856	18306	19599	22050
% of sales	41.8	40.3	35.0	34.6	35.2
Other expenses	7,801	10,580	11,121	11,053	12,531
% of sales	21.9	22.6	21.2	19.5	20.0
EBITDA	7,092	8,276	7,185	8,547	9,520
% of sales	19.9	17.7	13.7	15.1	15.2
Depreciation & amortisation	1,018	1,436	1,858	1,945	2,132
EBIT	6,074	6,840	5,327	6,602	7,388
% of sales	17.1	14.6	10.2	11.6	11.8
Interest expenses	1	55	191	120	0
Other income (net)	835	857	413	773	927
PBT	6,908	7,642	5,549	7,255	8,315
-PBT margin (%)	19.4	16.3	10.6	12.8	13.3
Provision for tax	1,545	1,743	1,390	1,850	2,120
Effective tax rate (%)	22.4	22.8	25.0	25.5	25.5
Net profit	5,363	5,899	4,159	5,405	6,195
-Growth (%)	18.9	10.0	-29.5	30.0	14.6
-Net profit margin (%)	15.1	12.6	7.9	9.5	9.9

Note: All financials starting FY17 are based on IndAS whereas those before that are based on Indian GAAP.

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 77: Balance sheet

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Equity capital	837	1,678	1,680	1,680	1,680
Reserves & surplus	20,443	22,501	24,095	26,872	30,035
Net worth	21,280	24,179	25,775	28,552	31,715
Other liabilities	337	832	301	301	-
Total loans	18	14	13	-	-
<b>Total liabilities</b>	<b>21,635</b>	<b>25,025</b>	<b>26,089</b>	<b>28,853</b>	<b>31,715</b>
Net block	4,967	7,015	5,932	5,187	4,256
Goodwill	740	4,815	4,470	4,470	4,470
Investments	4,802	2,078	5,927	7,927	9,927
Deferred tax asset - net	493	432	624	624	624
Other non-current assets	1,768	2,146	2,202	2,202	2,202
Unbilled revenue	982	2,132	1,885	2,251	2,456
Other current assets	2,176	2,070	1,386	1,489	1,621
Debtors	6,963	9,728	8,962	10,166	11,091
Cash & bank balance	3,763	2,332	2,508	1,726	2,866
Total current assets	13,884	16,262	14,741	15,633	18,035
Total current liabilities	5,019	7,723	7,807	7,191	7,798
Net current assets	8,865	8,539	6,934	8,443	10,236
<b>Total assets</b>	<b>21,635</b>	<b>25,025</b>	<b>26,089</b>	<b>28,853</b>	<b>31,715</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 76: Cash flow

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
EBIT	6,074	6,840	5,327	6,602	7,388
(Inc./dec. in working capital)	105	(1,105)	1,781	(2,290)	(654)
<b>Cash flow from operations</b>	<b>6,179</b>	<b>5,735</b>	<b>7,108</b>	<b>4,312</b>	<b>6,734</b>
Other income	835	857	413	773	927
Depreciation & amortisation	1,018	1,436	1,858	1,945	2,132
Financial expenses	(1)	(55)	(191)	(120)	-
Tax paid	(1,545)	(1,743)	(1,390)	(1,850)	(2,120)
Dividends paid	(1,438)	(2,489)	(1,934)	(2,628)	(3,032)
<b>Net cash from operations</b>	<b>5,048</b>	<b>3,741</b>	<b>5,864</b>	<b>2,431</b>	<b>4,641</b>
Capital expenditure	2,723	4,702	411	1,600	1,600
<b>Net cash after capex</b>	<b>2,325</b>	<b>(961)</b>	<b>5,453</b>	<b>831</b>	<b>3,041</b>
Inc./(dec.) in debt	(93)	(4)	(1)	(13)	-
(Inc./dec. in investments)	291	2,724	(3,849)	(2,000)	(2,000)
Equity issue/(buyback)	3	4	2	-	-
<b>Cash from financial activities</b>	<b>201</b>	<b>2,724</b>	<b>(3,848)</b>	<b>(2,013)</b>	<b>(2,000)</b>
Others	52	(3,194)	(1,429)	400	99
Opening cash balance	1,185	3,763	2,332	2,508	1,726
Closing cash balance	3,763	2,332	2,508	1,726	2,866
Change in cash balance	2,578	(1,431)	176	(782)	1,140

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 78: Key ratios

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
<b>Per share (Rs)</b>					
EPS	31.9	35.1	24.8	32.2	36.9
FDEPS	31.9	35.1	24.7	32.1	36.8
Dividend per share	7.1	12.3	9.6	13.0	15.0
Book value	126	144	153	170	188
Dividend payout ratio (incl. DDT)(%)	27	42	47	49	49
<b>Return ratios (%)</b>					
RoE	30.9	28.1	17.4	20.7	21.6
RoCE	34.3	31.9	21.8	24.9	25.6
RoIC	49.8	40.6	27.8	35.8	38.8
<b>Turnover ratios</b>					
Asset turnover	1.3	1.4	1.5	1.6	1.6
Debtor days (incl. unbilled rev.)	81	92	76	80	79
Working capital cycle days	53	44	37	36	41
<b>Valuation ratios (x)</b>					
P/E	17.1	15.6	22.1	17.0	14.8
P/BV	4.3	3.8	3.6	3.2	2.9
EV/EBITDA	11.8	10.7	11.7	9.7	8.3
EV/Sales	2.4	1.9	1.6	1.5	1.3
M-cap/Sales	2.6	2.0	1.8	1.6	1.5
Dividend Yield (%)	1.3	2.2	1.7	2.4	2.7

Source: Company, Nirmal Bang Institutional Equities Research

## Company background

### History

Mindtree was founded in 1999 and became a public company in December, 2006. Its initial public offer or IPO took place in February, 2007. The company posted revenues of US\$780mn in FY17 compared to immediate peers like Mphasis US\$905mn (in FY17), Hexaware US\$525mn (in CY16) and Persistent Systems US\$429mn (in FY17). It employed 16,000+ employees as of 31 March 2017. Mindtree specialises in Application Development and Maintenance, Data Analytics, Digital Services, Enterprise Application Integration and Business Process Management, Engineering R&D, Independent Testing, Infrastructure Management Services and IT Strategy & Consulting. Mindtree has formed successful business and technology alliances with big companies like Microsoft, Salesforce, Hewlett Packard, Oracle, Bluetooth SIG, Intel, IBM, SAP, Orange, Sun Microsystems and many more. Its key verticals are BFSI, Travel, Retail and Consumer & Packaged Goods. The client list includes names like Microsoft, AIG, Unilever, Avis, Southwest Airlines, Fly Dubai, Getronics, P&G, Marriott, Adidas, Symantec, Samsung, etc.

### Management

- **Mr Krishnakumar Natarajan** is the executive chairman of Mindtree who co-founded the company in 1999. He started his career with Wipro where he launched and grew the e-commerce division, served as Group Vice President of Human Resources, and was Chief Marketing Officer for Wipro's IT business from 1982 to 1999. He has also been elected to the executive council of NASSCOM for three consecutive terms and is a regular speaker/faculty at reputed conferences and management schools worldwide. He holds a Mechanical Engineering degree from College of Engineering, Chennai, and Master's in Business Administration (PGBM) majoring in marketing and systems from XLRI, Jamshedpur. His current term as executive chairman was extended recently till 2020.
- **Mr Rostow Ravanan** is managing director, CEO and co-founder of Mindtree. He started his professional career at KPMG Corporate Finance and specialised in strategy consulting and mergers and acquisitions across various industries there. He has also worked with Lucent Technologies as Business Value Manager and in Bell Laboratories where he was responsible for long-term strategic planning. He is an alumnus of Harvard Business School and is a member of the Institute of Chartered Accountants of India and the Institute of Company Secretaries of India. He was made the CEO of Mindtree at the beginning of FY17.
- **Mr N.S. Parthasarathy** is the COO and co-founder of Mindtree in 1999. Prior to Mindtree, he was the general manager of Wipro's technology solutions division, where he led Wipro's development centre for some of its large customers. He received a Masters (Honours) degree from BITS Pilani and M.Tech. degree in Computer Science from IIT, Kharagpur, and is an alumnus of Harvard Business School.
- **Mr Jagannathan Chakravarthi** is CFO of Mindtree. Prior to joining Mindtree, he worked with Airtel, HCL Technologies & Ashok Leyland where he was responsible for finance and accounts & specialised in internal audit. He holds a Bachelor's degree in Commerce and is a member of the Institute of Chartered Accountants of India and the Institute of Cost Accountants of India.
- **Mr. Anil Gandharve** is vice president and head of retail, CPG & manufacturing industry group with global P&L responsibility. He has over 17 years of experience in business development, operations and consulting. He joined Mindtree in 2010 and has been instrumental in growing Mindtree's European business since then. Prior to joining Mindtree, he spent a decade with Infosys leading several responsibilities. Mr. Gandharve holds a mechanical degree from the Indian Institute of Technology, Delhi.
- **Mr. Balaji Thirumalai** is senior vice president and head, technology, media & services. He is responsible for global P&L of this segment. Mr. Thirumalai has over 20 years of experience in hi-tech, both in the valley and emerging markets. Prior to joining Mindtree, he managed SunEdison's Commercial and Industrial Business in Asia Pac. Prior to that, he co-founded an education technology start-up. He has spent over 17 years in the semiconductor industry in various leadership roles across engineering, product management, business development, strategy and general management at companies such as AMD, Altera, Xilinx and Cypress Semiconductor. He is a co-inventor of three US patents. He holds a master's in business administration from UC Berkeley's Haas School of Business and a master's in Electrical Engineering from the State University of New York at StonyBrook. He is based at Mindtree's Silicon Valley office.

- **Mr. Gaurav Johri** is senior vice president and head of platform solutions. He heads Mindtree's portfolio of platform and products and is responsible for driving the strategic push to make this business a significant part of Mindtree's revenues in the coming years. Prior to his current role, he was heading Mindtree's banking, financial services and insurance business and was influential in making it one of the largest and fastest-growing businesses at Mindtree. Prior to joining Mindtree, he held leadership roles at OnMobile and Infosys. He worked with Infosys for nearly a decade in various leadership roles helping marquee clients in banking and capital markets implement IT to improve their businesses. He was also part of the team at Infosys that incubated and set up OnMobile. He has an MBA from IIM, Kolkata, and BS in Electronics Engineering from IIT-BHU, Varanasi.
- **Ms. Guita Blake** is senior vice president and head - Europe. Ms. Blake joined Mindtree in February 2016. The role involves total responsibility and full accountability for all of Europe Mindtree Operations. Prior to working at Mindtree, she built her career over 20 years with Atos, Tech Mahindra, KPN and Olivetti where she held a variety of senior leadership roles across sales & marketing, delivery; market strategy and international portfolio management. Ms. Blake holds a post graduate degree in IT and Advanced Industry Marketing qualification from CIM, UK. She has also completed the Executive Leadership programme from Harvard Business School.

**Exhibit 79: Quarterly snapshot**

Year to 31 March	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
<b>Rs Million</b>												
<b>INR/USD</b>	62.0	60.4	62.2	62.1	63.5	64.9	65.9	67.7	66.7	67.1	67.4	67.4
US\$ revenues (mn)	141.3	147.1	147.7	147.8	154.9	179.7	184.4	195.6	199.0	193.0	192.2	195.6
Revenues	8,435	8,886	9,117	9,181	9,775	11,657	12,145	13,242	13,276	12,954	12,953	13,181
Gross margin	3,576	3,690	3,853	3,774	4,052	4,863	4,896	5,045	4,977	4,428	4,420	4,481
EBITDA	1,685	1,755	1,866	1,786	1,675	2,195	2,147	2,259	1,955	1,621	1,740	1,869
Depreciation	228	235	260	295	334	409	345	348	468	463	459	468
Other expenses	1,891	1,935	1,987	1,988	2,377	2,668	2,749	2,786	3,022	2,807	2,680	2,612
EBIT	1,457	1,520	1,606	1,491	1,341	1,786	1,802	1,911	1,487	1,158	1,281	1,401
Other income (net)	73	139	140	304	182	168	52	62	106	198	112	133
PBT	1,667	1,761	1,815	1,665	1,716	1,973	1,949	2,004	1,630	1,281	1,379	1,259
Tax	373	387	407	378	394	465	440	444	422	333	348	287
PAT	1,294	1,374	1,408	1,287	1,322	1,508	1,509	1,560	1,208	948	1,031	972
<b>YoY growth (%)</b>												
US\$ revenues	20	19	16	11	10	22	25	32	28	7	4	0
Revenues	30	15	15	11	16	31	33	44	36	11	7	0
Gross profit	35	14	19	12	13	32	27	34	23	(9)	(10)	(11)
EBIT	44	8	20	(4)	(8)	18	12	28	11	(35)	(29)	(27)
Net profit	(4)	7	59	31	2	10	7	21	(9)	(37)	(32)	(38)
<b>QoQ growth (%)</b>												
US\$ revenues	6	4	0	0	5	16	3	6	2	(3)	0	2
Revenues	2	5	3	1	6	19	4	9	0	(2)	0	2
EBIT	(6)	4	6	(7)	(10)	33	1	6	(22)	(22)	11	9
Net profit	32	6	2	(9)	3	14	0	3	(23)	(22)	9	(6)
<b>Margins (%)</b>												
Gross margin	42.4	41.5	42.3	41.1	41.5	41.7	40.3	38.1	37.5	34.2	34.1	34.0
EBITDA margin	20.0	19.8	20.5	19.5	17.1	18.8	17.7	17.1	14.7	12.5	13.4	14.2
EBIT	17.3	17.1	17.6	16.2	13.7	15.3	14.8	14.4	11.2	8.9	9.9	10.6
PAT	15.3	15.5	15.4	14.0	13.5	12.9	12.4	11.8	9.1	7.3	8.0	7.4
SG&A	22.4	21.8	21.8	21.7	24.3	22.9	22.6	21.0	22.8	21.7	20.7	19.8

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 80: Key metrics**

	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
<b>P and L (Rsmn)</b>												
Revenues	8,435	8,886	9,117	9,181	9,775	11,657	12,145	13,242	13,276	12,954	12,953	13,181
EBITDA	1,685	1,755	1,866	1,786	1,675	2,195	2,147	2,259	1,955	1,621	1,740	1,869
PAT	1,294	1,374	1,408	1,287	1,322	1,508	1,509	1,560	1,208	948	1,031	972
<b>Vertical mix (%)</b>												
Hi-Tech & Media Services	33	33	33	33	32	30	30	31	36	37	37	37
BFSI	23	23	24	25	26	25	25	23	25	25	24	24
Retail, CPG & Manufacturing	21	22	22	22	22	21	20	18	24	24	24	24
Travel & Hospitality	16	17	16	16	16	14	16	16	15	14	15	15
Others	7	6	5	5	4	11	9	11	NA	NA	NA	NA
<b>Horizontal mix (%)</b>												
Development	24	24	24	23	24	23	24	23	23	22	22	21
Engineering	10	9	10	10	9	9	8	10	10	10	10	10
Maintenance	21	21	21	21	22	21	20	18	17	18	18	18
Consulting	4	4	4	4	4	3	3	4	4	4	4	4
Package Implementation	5	5	6	8	7	13	13	14	14	13	12	13
IP-Led Revenues	2	2	2	2	1	1	2	1	1	1	1	1
Independent Testing	16	16	15	15	15	13	13	13	13	12	13	13
Infrastructure Management & Tech Support	19	19	18	18	18	17	18	17	18	20	20	20
<b>Geography mix (%)</b>												
US	59	60	63	65	68	63	64	66	67	68	69	70
Europe	27	26	24	24	22	27	26	25	23	21	21	21
India	4	4	4	4	3	3	3	3	3	4	3	3
RoW	11	10	9	8	7	7	7	7	7	8	7	7
<b>Utilisation (%) (including trainees)</b>	<b>72.1</b>	<b>73.5</b>	<b>71.8</b>	<b>70.2</b>	<b>70.3</b>	<b>71.4</b>	<b>68.5</b>	<b>69.4</b>	<b>71.4</b>	<b>71.4</b>	<b>71.3</b>	<b>70.9</b>
<b>Utilisation (%) (excluding trainees)</b>	<b>72.4</b>	<b>74.2</b>	<b>74.2</b>	<b>71.1</b>	<b>71.9</b>	<b>73.3</b>	<b>69.9</b>	<b>70.6</b>	<b>72.0</b>	<b>73.1</b>	<b>72.3</b>	<b>72.7</b>
Revenue mix-Onsite	44	46	46	47	48	52	55	58	60	59	60	61
Revenue mix-Offshore	56	54	54	53	52	48	46	42	41	41	40	40
<b>Client concentration (%)</b>												
Top client	9	9	10	10	11	11	11	12	13	14	14	14
Top 5 clients	32	32	33	32	33	32	32	30	30	30	30	31
Top 10 clients	49	49	48	47	49	46	46	43	43	43	42	42
<b>Number of clients</b>												
1mn dollar	75	77	83	88	75	92	93	101	98	107	106	111
5mn dollar	26	27	27	28	26	29	29	31	31	30	30	30
10mn dollar	13	13	13	14	13	13	13	15	16	16	17	16
25mn dollar	6	7	6	6	0	0	0	0	0	6	4	4
30mn dollar	3	4	4	4	0	0	0	0	0			
50mn dollar	0	0	1	1	0	2	2	2	2	2	1	1
100mn dollar	-	-	-	-	-	-	-	-	-	-	1	1
Employees	12,845	13,018	13,323	14,202	14,427	15,582	16,243	16,623	14,427	16,219	16,099	16,470
Attrition (%)	13	16	18	18	18	17	16	16	18	16	16	15
<b>Productivity metrics</b>												
<b>(mn USD)</b>												
Revenues	141	147	148	148	155	180	184	196	199	193	192	196
EBIT	23	25	26	24	21	28	27	28	22	17	19	21
PAT	21	23	23	21	21	23	23	23	18	14	15	14
<b>Per capita (annualised)</b>												
Revenues	44,002	45,184	44,344	41,628	42,947	46,130	45,410	47,067	55,174	47,598	47,755	47,505
EBIT	7,313	7,729	7,752	6,759	5,855	7,063	6,734	6,789	6,179	4,255	4,722	5,050
PAT	6,495	6,986	6,796	5,834	5,772	5,964	5,639	5,542	5,020	3,477	3,801	3,497
<b>Total contract value signed(US\$ mn)</b>												
Renewals	NA	102	106	114	120	130	153	209	184	119	170	135
New	NA	63	46	50	88	63	51	72	36	65	144	74
<b>Total</b>	<b>0</b>	<b>165</b>	<b>152</b>	<b>164</b>	<b>208</b>	<b>193</b>	<b>204</b>	<b>281</b>	<b>220</b>	<b>184</b>	<b>314</b>	<b>209</b>
Expiring within 1 year	NA	NA	NA	157	159	157	180	247	209	152	234	182
Expiring > 1 year	NA	NA	NA	7	49	36	24	34	11	31	80	27
<b>Digital</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>63</b>	<b>105</b>	<b>82</b>	<b>82</b>	<b>93</b>	<b>64</b>	<b>103</b>	<b>50</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 81: QoQ and YoY growth of key parameters

<b>QoQ Growth</b>	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
<b>Revenues by service offering</b>												
Development	11.0	3.0	(1.0)	(2.0)	10.0	10.0	5.0	3.0	-	(6.0)	1.0	(2.0)
Engineering	5.0	1.0	10.0	(3.0)	(6.0)	11.0	(1.0)	26.0	2.0	(3.0)	(3.0)	2.0
Maintenance	(3.0)	7.0	1.0	(3.0)	9.0	12.0	(3.0)	(3.0)	(2.0)	-	(2.0)	6.0
Consulting	6.0	15.0	(2.0)	(5.0)	(1.0)	(12.0)	(5.0)	64.0	4.0	(10.0)	2.0	4.0
Package Implementation	40.0	4.0	8.0	29.0	1.0	114.0	-	12.0	3.0	(8.0)	(6.0)	3.0
IP-Led revenues	64.0	(2.0)	-	6.0	(14.0)	8.0	42.0	(23.0)	(25.0)	20.0	16.0	(6.0)
Independent Testing	-	3.0	-	-	1.0	-	3.0	5.0	3.0	(6.0)	1.0	1.0
Infrastructure Management & Tech Support	8.0	3.0	(5.0)	(1.0)	6.0	11.0	9.0	2.0	7.0	5.0	2.0	2.0
<b>Revenue by industry</b>												
Hi-Tech & Media Services	9.0	4.0	-	-	2.0	11.0	2.0	10.0	17.0	(1.0)	-	2.0
BFSI	4.0	5.0	4.0	6.0	11.0	9.0	4.0	(2.0)	9.0	(4.0)	(3.0)	2.0
Retail, CPG & Manufacturing	2.0	6.0	3.0	(2.0)	6.0	9.0	1.0	(5.0)	35.0	(3.0)	(1.0)	2.0
Travel & Hospitality	13.0	9.0	(5.0)	(1.0)	2.0	4.0	15.0	9.0	(5.0)	(7.0)	4.0	2.0
Others	1.0	(15.0)	(6.0)	(13.0)	(4.0)	183.0	(15.0)	35.0	-	-	-	-
<b>Revenue by geography</b>												
US	7.0	6.0	5.0	3.0	9.0	9.0	3.0	10.0	3.0	(2.0)	1.0	3.0
Europe	2.0	1.0	(7.0)	(2.0)	(3.0)	41.0	2.0	(2.0)	(4.0)	(10.0)	(3.0)	2.0
India	1.0	19.0	3.0	(12.0)	(1.0)	9.0	(13.0)	10.0	13.0	9.0	(12.0)	(8.0)
RoW	19.0	(5.0)	(10.0)	(9.0)	(3.0)	13.0	8.0	(3.0)	6.0	2.0	(2.0)	(9.0)
<b>Client-wise revenue growth</b>												
Top client	34.0	37.0	43.0	37.0	39.0	44.0	42.0	53.0	53.0	45.0	35.0	22.0
Top 5 clients	24.0	22.0	17.0	9.0	13.0	20.0	23.0	22.0	15.0	1.0	(2.0)	3.0
Top 10 clients	28.0	22.0	14.0	7.0	9.0	14.0	20.0	19.0	13.0	-	(5.0)	(2.0)
<b>YoY growth</b>												
<b>Revenues by service offering</b>												
Development	10.0	9.0	9.0	11.0	11.0	18.0	25.0	31.0	20.0	2.0	(2.0)	(7.0)
Engineering	3.0	-	19.0	14.0	2.0	12.0	1.0	30.0	40.0	22.0	19.0	(3.0)
Maintenance	10.0	11.0	5.0	2.0	15.0	21.0	16.0	15.0	3.0	(9.0)	(7.0)	1.0
Consulting	63.0	66.0	44.0	14.0	7.0	(19.0)	(21.0)	36.0	42.0	46.0	56.0	-
Package Implementation	103.0	156.0	181.0	104.0	46.0	201.0	178.0	141.0	148.0	6.0	-	(8.0)
IP-Led Revenues	36.0	137.0	166.0	72.0	(10.0)	(1.0)	40.0	2.0	(11.0)	(1.0)	(19.0)	(1.0)
Independent Testing	5.0	4.0	8.0	3.0	4.0	1.0	4.0	9.0	10.0	4.0	3.0	(1.0)
Infrastructure Management & Tech Support	59.0	36.0	15.0	5.0	3.0	11.0	28.0	32.0	33.0	26.0	17.0	17.0
<b>Revenues by industry - Growth YoY</b>												
Hi-Tech & Media Services	15.0	17.0	41.0	14.0	6.0	14.0	15.0	27.0	46.0	30.0	27.0	17.0
BFSI	20.0	19.0	17.0	19.0	27.0	32.0	33.0	23.0	21.0	7.0	-	4.0
Retail, CPG & Manufacturing	22.0	19.0	20.0	9.0	14.0	17.0	14.0	11.0	41.0	26.0	24.0	32.0
Travel & Hospitality	36.0	31.0	(9.0)	16.0	4.0	(1.0)	20.0	33.0	24.0	11.0	1.0	(6.0)
Others	11.0	(3.0)	(16.0)	(30.0)	(34.0)	121.0	101.0	213.0	-	-	-	-
<b>Revenues by geography</b>												
US	23.0	25.0	27.0	23.0	25.0	28.0	26.0	34.0	27.0	15.0	13.0	6.0
Europe	17.0	7.0	(1.0)	(6.0)	(10.0)	25.0	36.0	37.0	36.0	(14.0)	(18.0)	(15.0)
India	(28.0)	(3.0)	1.0	8.0	6.0	(2.0)	(18.0)	3.0	17.0	17.0	20.0	-
RoW	40.0	31.0	7.0	(8.0)	(25.0)	(11.0)	7.0	15.0	27.0	15.0	4.0	(3.0)
<b>Client-wise revenue growth</b>												
Top client	34.0	37.0	43.0	37.0	39.0	44.0	42.0	53.0	53.0	45.0	35.0	22.0
Top 5 clients	24.0	22.0	17.0	9.0	13.0	20.0	23.0	22.0	15.0	1.0	(2.0)	3.0
Top 10 clients	28.0	22.0	14.0	7.0	9.0	14.0	20.0	19.0	13.0	-	(5.0)	(2.0)

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 82: Top 20 shareholders

S. No.	INVESTOR	SHAREHOLDING (%)
1	COFFEE DAY ENTERPRISES PVT LTD	10.4%
2	NALANDA INDIA FUND LTD	9.4%
3	COFFEE DAY TRADING LTD	6.3%
4	N KRISHNAKUMAR	4.8%
5	AMANSA CAPITAL PVT LTD	4.3%
6	MATTHEWS INDIA FUND	3.5%
7	V G SIDDHARTHA	3.2%
8	SUBROTO BAGCHI	3.1%
9	VANGUARD GROUP	2.4%
10	REKHA N SHAH	2.1%
11	TEMPLETON ASSET MGMT	2.1%
12	ONTARIO TEACHERS PENSION PLAN BO	1.8%
13	S JANAKIRAMAN	1.8%
14	NALANDA INDIA EQUITY FUND	1.7%
15	UTI ASSET MANAGEMENT CO LTD	1.7%
16	SUSMITA BAGCHI	1.7%
17	LSO INVESTMENTS PVT LTD	1.5%
18	OZAIR KAMRAN	1.5%
19	N S PARTHASARAT	1.4%
20	AROHI ASSEST MANAGEMENT PTE LTD	1.4%

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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