

India Ratings Upgrades Mindtree to 'IND AAA'; Outlook Stable

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India Ratings and Research (Ind-Ra) has upgraded Mindtree Limited's Long-Term Issuer Rating to 'IND AAA' from 'IND AA+'. The Outlook is Stable. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating	Rating Action
Fund-based working capital limits*	-	-	-	INR5,100 (reduced from INR5,600)	IND A1+	Affirmed
Non-fund-based limits	-	-	-	INR1,500	IND A1+	Assigned

* Some limits are interchangeable to non-fund-based limits

Analytical Approach: Ind-Ra continues to take a consolidated view of Mindtree and its 100% subsidiaries Mindtree software (Shanghai) co. Limited and Bluefin Solutions Sdn Bhd to arrive at the ratings. This is due to the strong operational and strategic linkages among them, driven by similar business lines and common promoters.

The ratings also factor in the strong support from the parent, Larsen & Toubro (L&T; 'IND AAA'/Stable), owing to the strong legal, strategic and operational linkages between them.

The upgrade reflects Ind-Ra's expectation of an improvement in Mindtree's business and financial profile owing to the company becoming an integral part of L&T. Ind-Ra believes Mindtree will continue receiving financial and/or operational support from its parent, which will support its already strong standalone performance, thereby resulting in the strengthening of Mindtree's market position, improving the profitability and bolstering its overall credit profile.

KEY RATING DRIVERS

Strong Linkages with Parent: L&T acquired nearly 60% stake in Mindtree in July 2019 (currently increased to nearly 61%) and continues to be its parent. L&T is a leading player in India's engineering and construction segment with presence in various sectors such as infrastructure, power, heavy engineering, electrical and automation, hydrocarbons, infrastructure development projects, information technology (IT) and technology services, financial services, among others. The contribution of IT and technology services in L&T's overall revenue and profitability has been increasing since the last few years. The strategic, operational and legal linkages between Mindtree & L&T are detailed below:

- **Strong Strategic Linkages:** Ind-Ra believes investment in Mindtree continues to be a strategic investment for L&T as reflected in increasing share of IT and technology business (9MFY21: accounts 21% of consolidated revenue and 43% of consolidated EBITDA, FY20: 15%, 22%). Although, with the acquisition of Mindtree, L&T operates three companies - Mindtree, Larsen & Toubro Infotech Limited (LTI) and L&T Technology Services Limited (LTTS) - under the IT & technology segment, the agency takes comfort from Mindtree contributing nearly one-third to the revenue and profitability from this segment. Mindtree's strong strategic importance to L&T is also evident from L&T's spending of about INR100 billion, which represented around 4% of its total assets in acquiring about 60% stake in Mindtree in 2019.

- **Moderate Legal Linkages:** L&T fully consolidates Mindtree in its financial statements, effective FY20, implying significant reputation risk. Mindtree can leverage on the superior financial flexibility and strong balance sheet of L&T, in case of any contingency. Since Mindtree has no external bank debt outstanding on its books and has a robust cash position, L&T has not provided any explicit support to Mindtree in terms of corporate guarantees and/or short-term loans and advances. Nonetheless, Ind-Ra believes the extension of performance guarantee by L&T for INR5.3 billion at end-9MFY21 on behalf of Mindtree reflects the strategic intent of L&T to support Mindtree.

- **Strong Operational Linkages:** Ind-Ra considers the operational linkages between Mindtree and L&T to be strong. Both the companies have a common chairman and six of 12 directors of Mindtree also hold directorship positions in other L&T entities. L&T has also overhauled Mindtree's treasury operations in line with the L&T group's treasury philosophy. Additionally, the operational support for Mindtree could flow in the form of synergies with Larsen & Toubro Infotech Limited – another IT subsidiary of L&T having minimal client overlap with Mindtree – by joint bidding for projects. The agency believes Mindtree can also leverage on its strong parentage in securing large deals, which will strengthen its business profile.

Established Market Position: The ratings factor in Mindtree's strong market position in the sector supported by its significant presence in digital technology (average revenue contribution of above 35%), which encompasses cloud computing, artificial intelligence, machine learning and productised end-to-end solutions, among others. Additionally, although communication, media and technology (CMT) segment contributes nearly 50% to Mindtree's revenue in 9MFY21, the company's diversified presence in banking, financial services and insurance (20% of 9MFY21 revenue), retail, consumer products and manufacturing (RCM: 21%), and travel, transport, logistics and hospitality (TTH: 9%) also supports its strong market positioning. The agency believes while the company's presence in the diversified segments will ensure wider client outreach and help it offset the impact of one segment from incremental revenue from the other segment, a significant digital presence will ensure strong momentum in revenue growth.

Strong Revenue and Margins in 9MFY21: Mindtree's revenue grew 10.6% yoy to INR77.6 billion in FY20, supported by an uptick in revenue across all the segments and major geographies. Revenue growth was also strong in US dollar terms, wherein revenue grew 9% yoy to USD 1.1 billion in FY20. The company's revenue profile also showed resilience after COVID-19, wherein the strong growth in the CMT segment and almost stable performance of the RCM segment more than offset the decline in revenue from the TTH segment, resulting in an overall revenue growth of 3% yoy to INR58.6 billion in 9MFY21. The agency believes revenue from diversified segments, strong deal pipeline (USD1,006 million of total contract value signed during 9MFY21) and a healthy active client base (3QFY21: 276 clients, 3QFY20: 320) provide comfort and will support healthy revenue growth over the medium term.

The EBITDA margins contracted to 13.9% in FY20 (FY19: 15.2%), primarily due to multiple rounds of compensation revisions in line with Ind-Ra's expectations. However, consistent cost efficiency measures by the management such as improvement in operational efficiencies and better utilisation levels, resulted in EBITDA margins improving to 20.4% in 9MFY21. The agency expects the margins to remain healthy and in line with its FY21 performance over the medium term.

Liquidity Indicator - Adequate: Mindtree had cash and cash equivalent of INR24.6 billion at 9MFYE21 (FYE20: INR10.9 billion), against near zero debt levels (other than lease obligations). The company's cash flow generation has been healthy and more than sufficient to meet capex and dividend payment requirements over FY17- FY20. The company has been generously declaring dividends and engaging in share buybacks. Despite INR6 billion and INR2.8 billion of dividend payouts in FY20 and 9MFY21, respectively, Ind-Ra believes Mindtree will not require any debt funding in the medium term since all these payouts are funded through internal accruals. Mindtree generated positive free cash flow of INR2.6 billion on an average over FY17-FY20. The agency expects the free cash flow to remain positive over the medium term, factoring in an annual capex of INR1.5 billion-2 billion from FY22. Ind-Ra expects the capex to remain moderate in FY21. Furthermore, all the fund-based limits remained unutilised and can be used in case of any contingency. Mindtree did not avail the Reserve Bank of India prescribed moratorium under the COVID-19 relief package scheme.

Strong Consolidated Financial Credit Profile: The company has a robust financial credit profile attributable to the near zero debt levels and the strong cash and equivalents. The gross adjusted leverage (gross adjusted debt/EBITDAR) improved to 0.5x at FYE20 (FYE19: 0.7x). Ind-Ra expects no major increase in bank debt due to the absence of major debt-funded capex plans in the near term. As a result, the gross adjusted leverage is likely to be at or below 0.3x in FY21, primarily due to operating lease rent capitalisation. While the agency has not factored in any major debt-funded acquisition in its assumptions, the company's headroom to borrow remains comfortable.

Increasing Customer and Geographical Concentration: Mindtree's top 10 customers contributed 49% to the revenue in 3QFY21 (3QFY20: 45.6%). Also, revenue contribution from the top client has increased over the last few quarters and stood at 28.5% (nearly USD310 million annually) of the total revenue in 3QFY21. This is despite the continuous addition of new customers (eight new clients added in 3QFY21). Its geographic concentration has also increased with revenue from the US increasing to 77% in 9MFY21 (FY20: 75%). Although the company has a hedging policy in place and there is no increase in debtor days even after the COVID-19 outbreak, Ind-Ra believes any major disruption at its top client or negative change in regulatory guidance could impact the overall performance.

RATING SENSITIVITIES

Negative: Developments that could, individually or collectively, lead to a negative rating action include:

- the weakening of Mindtree's linkages with L&T and/or any weakness in L&T's credit profile,
- a substantial reduction in the revenue and/or a meaningful decline in the EBITDA margins, both on sustainable basis,
- any significant debt-funded acquisitions and/or higher-than-expected dividend payouts leading to the consolidated net leverage exceeding 1.0x on a sustained basis.

COMPANY PROFILE

Incorporated in 1999, Mindtree is a technology solution provider and provides digital transformation and technology services to its clients worldwide. The company classifies its business into four verticals wherein the majority of the revenue is being contributed by CMT (50% of 9MFY21 consolidated revenue), followed by RCM (21%), banking, financial services and insurance (20%) and TTH (9%). The company's service offerings include digital, test engineering, package solutions, Infrastructure management and technology support, and product engineering.

Mindtree derives majority of its revenue from America (accounts 77% of the consolidated revenue), followed by Europe (7%), the UK and Ireland (8%) and rest of the world (8%).

FINANCIAL SUMMARY

Particulars (INR million)	FY20	FY19
Revenue	77,643	70,215
EBITDA	10,815	10,645
Interest expense	529	29
Adjusted debt	5,668	8,571 [^]
Cash & equivalents	10,853	9,398
Source: Mindtree, Ind-Ra		
[^] Ind-Ra calculated after adjusting for lease rentals		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook/Rating Watch		
	Rating Type	Rated Limits (million)	Rating/Outlook	22 January 2020	29 March 2019	16 October 2017
Issuer rating	Long-term	-	IND AAA/Stable	IND AA+/Positive	IND AA/RWE	IND AA/Stable
Fund-based limits	Short-term	INR5,100	IND A1+	IND A1+	IND A1+/RWE	IND A1+
Non-fund-based limits	Short-term	INR1,500	IND A1+	-	-	-

COMPLEXITY LEVEL OF INSTRUMENTS

Fund-based limits	Low
Non-fund-based limits	Low

For details on the complexity level of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

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Applicable Criteria

[Corporate Rating Methodology](#)

[Parent and Subsidiary Rating Linkage](#)

[Short-Term Ratings Criteria for Non-Financial Corporates](#)

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