22 April 2022

Mastek

Rating: Buy
Target Price: Rs.3,400
Share Price: Rs.2,825

Aims at sustained high growth till FY25, margins at 20%+; Buy

Mastek bounced back in Q4 with 4.9% sequential growth and a $194m order backlog, up 25% y/y. Management spoke about sustaining high growth till FY25 while reducing exposure to the UK and government businesses. It will achieve this by scaling up its Enterprise business in the US (new leadership) and Europe, and by acquiring some targets (revenue ~$35m) in the US (in FY23). FY23 fresher hiring targets are up 50% (to 1,000) to support growth. EBITDA margins to be maintained above 20% in FY23. We largely retain our FY23e/FY24e, but tweak our target to Rs.3,400 (23x FY24e, a 35% discount to LTI). We retain a Buy recommendation.

Aspires to $1bn revenue by FY26/27. Mastek aspires to the top-3 by growth in midcap IT companies. Its strategy is to generate high growth in the US (Retail, Healthcare, Oracle) as it is now subscale there while maintaining focus on its top accounts in the UK. From a tech standpoint, it is Oracle cloud ERP aligned but looking to add a few more complementary alliances like Microsoft, Amazon, UIPAth, SF and Pega to widen service offerings to support larger clients (revenue $2bn+ or Fortune-1000). Client mining was identified as a strategic focus area for growth.

EBITDA margins to hold at 20-21%. Mastek expects to maintain medium term margins at 20%+ by improving offshore (~2-3% points: by effort), increasing fresher intake to 15-17% (from 12% now) of the workforce, raising gross utilisation (as was the case in Q4), and by operating leverage (on strong growth). However, it also needs S&M investments (for instance, it is doubling its US sales team) to accelerate and the two are likely to offset each other, keeping margins steady at ~20%. M&A-related tailwinds or headwinds would be besides this. Attrition has started coming off the peaks.

Estimates tweaked; target raised to Rs.3,400 (23x FY24e). Mastek is likely to further accelerate in the US with new leadership. It is also diversifying from greater business concentrations (UK and government). While our estimates are largely unchanged, taking into account the change in peer-set multiples, we revise our target to 23x (from 24x earlier) and retain our Buy. **Risks:** M&A and integration-related.

Key financials (YE Mar)	FY20	FY21	FY22e	FY23e	FY24e
Sales (Rs m)	10,715	17,219	21,838	26,767	31,959
Net profit (Rs m)	1,089	2,093	2,951	3,715	4,560
EPS (Rs)	42.9	80.5	96.6	120.8	147.3
P/E (x)	79.8	41.5	29.4	23.4	19.1
EV / EBITDA (x)	52.7	22.2	17.5	14.6	12.4
P/BV (x)	11.0	10.1	8.1	6.1	4.7
RoE (%)	14.5	25.4	30.6	29.7	27.7
RoCE (%)	8.6	14.8	18.2	20.0	20.1
Dividend yield (%)	0.3	0.5	0.7	0.9	1.0
Net debt / equity (x)	-0.1	-0.5	-0.5	-0.5	-0.5

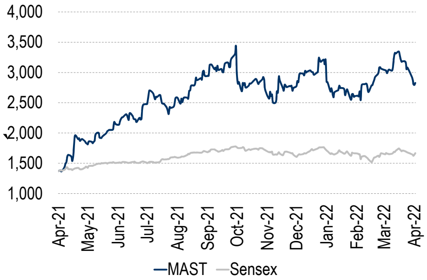
Source: Company, Anand Rathi Research

Key data	MAST IN / MAST.BO
52-week high / low	Rs3669 / 1360
Sensex / Nifty	57912 / 17393
3-m average volume	$4.1m
Market cap	Rs85bn / $1114.1m
Shares outstanding	30m

Shareholding pattern (%)	Mar'22	Dec'21	Sep'21
Promoters 37.	3	37.6	37.8
- of which, Pledged	-	-	-
Free float	62.7	62.4	62.3
- Foreign institutions	6.6	4.8	4.2
- Domestic institutions	6.7	7.2	8.0
- Public	49.4	50.4	50.1

Estimates revision (%)	FY23e	FY24e
Sales ($)	0.7	1.5
EBITDA	1.0	1.5
Net profit	-0.6	0.1

Relative price performance



Source: Bloomberg

Mohit Jain
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)					
Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Revenues (US$m)	150.7	231.9	293.0	354.5	423.3
Growth (%)	1.9	53.9	26.3	21.0	19.4
Net revenues (Rs m)	10,715	17,219	21,838	26,767	31,959
Employee & Direct Costs	5,841	8,827	10,955	13,856	17,122
Gross Profit	4,874	8,391	10,884	12,910	14,837
Gross Margin %	45.49	48.73	49.84	48.23	46.43
SG&A	3,340	4,747	6,259	7,389	8,311
EBITDA	1,534	3,645	4,625	5,521	6,527
EBITDA margins (%)	14.3	21.2	21.2	20.6	20.4
- Depreciation	249	450	429	501	556
Other income	192	279	361	362	399
Interest Exp	36	81	77	101	101
PBT	1,441	3,393	4,480	5,282	6,268
Effective tax rate (%)	21	26	26	25	25
+ Associates/(Minorities)	-50	-424	-383	-246	-141
Net Income	1,089	2,093	2,951	3,715	4,560
WANS	25	26	31	31	31
FDEPS (Rs/share)	42.9	80.5	96.6	120.8	147.3

Fig 2 – Balance sheet (Rs m)					
Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	121	126	150	151	152
Net worth	7, 905	8, 585	10, 714	14, 333	18,628
Total debt (incl. Pref)	3, 332	2, 406	1, 903	-	-
Minority interest	1, 371	1, 820	1, 503	1, 749	1,891
DTL/(Asset)	- 226	79	98	98	98
Capital employed	12,381	12,891	14,217	16,180	20,616
Net tangible assets	762	636	720	800	938
Net Intangible assets	1, 039	831	710	972	1,234
Goodwill	6, 767	6, 601	6, 980	9, 098	11,215
CWIP (tang. & intang.)	17	15	44	44	44
Other Long term Assets/(Liabilities)	- 1,213	- 2,509	- 2,339	- 2,594	-2,876
Investments (Financial)	1, 938	2, 145	656	590	531
Current Assets (ex Cash)	4, 498	5, 643	7, 333	8, 586	9,773
Cash	2, 210	5, 914	7, 271	6, 773	8,712
Current Liabilities	3,635	6,386	7,158	8,090	8,955
Working capital	863	-743	175	497	818
Capital deployed	12,381	12,891	14,217	16,180	20,616
Contingent Liabilities					

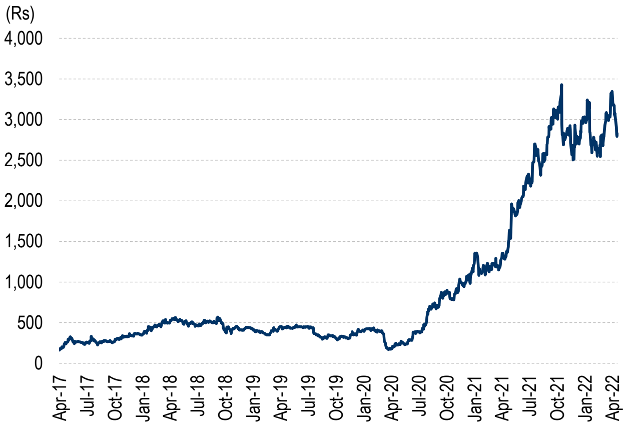
Fig 3 – Cash Flow statement (Rs m)					
Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	1,441	3,393	4,480	5,282	6,268
+ Non-cash items	510	483	432	416	462
Operating profit before WC	1,951	3,876	4,912	5,697	6,730
- Incr./(decr.) in WC	-355	525	1,091	321	321
Others incuding taxes	-471	-479	-1,090	-1,320	-1,567
Operating cash-flow	1,835	2,872	2,731	4,055	4,842
- Capex (tangible + Intangible)	157	118	365	581	694
Free cash-flow	1,679	2,754	2,366	3,474	4,149
Acquisitions	-4,256	-	-1,660	-2,379	-2,379
- Dividend (including buyback & ta	315	136	475	743	912
+ Equity raised	21	85	19	647	647
+ Debt raised	2,371	-1,054	-779	-1,903	-
- Fin Investments	-1,679	-1,859	-1,916	-44	-36
- Misc. Items (CFI + CFF)	-95	-198	30	-362	-399
Net cash-flow	1,274	3,706	1,357	-498	1,939

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis					
Year end Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	79.8	41.5	29.4	23.4	19.1
EV/EBITDA (x)	52.7	22.2	17.5	14.6	12.4
EV/sales (x)	7.98	4.68	3.68	2.95	2.41
P/B (x)	11.0	10.1	8.1	6.1	4.7
RoE (%)	14.5	25.4	30.6	29.7	27.7
RoCE (%) - After tax	8.6	14.8	18.2	20.0	20.1
RoIC (%) - After tax	11.9	24.0	34.1	33.6	31.9
DPS (Rs per share)	8.0	14.5	19.0	24.2	29.5
Dividend yield (%)	0.3	0.5	0.7	0.9	1.0
Dividend payout (%) - Inc. DDT	22.3	18.0	19.7	20.0	20.0
Net debt/equity (x)	-0.1	-0.5	-0.5	-0.5	-0.5
Receivables (days)	126	93	85	85	85
Inventory (days)					
Payables (days)	42	8	7	10	10
CFO:PAT%	161.2	114.1	81.9	102.4	103.0
FCF:PAT% - includ M&A payout	-236.7	131.6	23.9	29.5	38.8

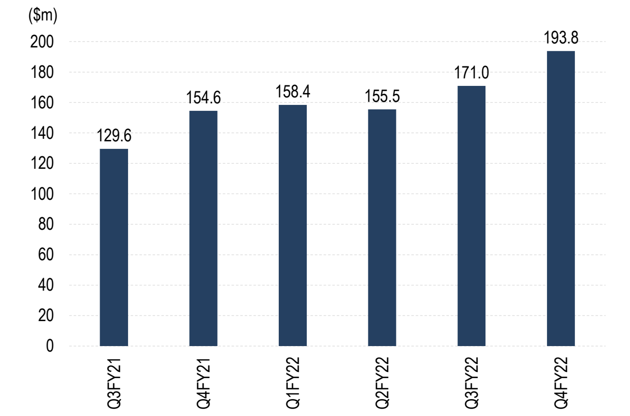
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Order backlog (12 month only)



Source: Company

Result Highlights

Q4 FY22 Results at a Glance

Fig 7 – Segment-wise results

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q/Q %	Y/Y %
Revenue ($ m)	66	70	72	74	77	4.9%	17.1%
Growth Y/Y %	42%	38%	31%	22%	17%		
Industry Y/Y % (est.)	6%	21%	21%	21%	19%		
Revenue (Rs m)	4,832	5,165	5,339	5,519	5,815	5.4%	20.3%
Effec. exchange rate	73.3	73.6	74.2	75.0	75.3	0.5%	2.7%
12m Order Backlog ($ m)	154.6	158.4	155.5	171.0	193.8	13.3%	25.4%
Y/Y %	49%	56%	22%	32%	25%		
Order Backlog:Rev	2.3	2.3	2.2	2.3	2.5		
Employees (EoP)	3,792	4,302	4,510	4,785	4,977	4.0%	31.3%
Rev. prod. ($ '000/employee)	17.8	17.3	16.3	15.8	15.8	-0.1%	-11.3%
Utilisation % (IT Services)	77%	75%	73%	70%	73%	290 bps	-420 bps
Attrition %	14%	20%	24%	28%	28%	0 bps	1370 bps
CoR (excl. D&A)	(2,431)	(2,572)	(2,739)	(2,732)	(2,912)	6.6%	19.8%
As % of revenue	-50%	-50%	-51%	-49%	-50%	-59 bps	23 bps
SG&A	(1,342)	(1,465)	(1,473)	(1,625)	(1,696)	4.4%	26.4%
As % of revenue.	-28%	-28%	-28%	-29%	-29%	28 bps	-140 bps
EBITDA	1,059	1,128	1,128	1,162	1,207	3.8%	13.9%
EBITDA margins %	21.9%	21.8%	21.1%	21.1%	20.8%	-31 bps	-117 bps
EBIT	957	1,030	1,024	1,057	1,085	2.7%	13.4%
EBIT margins %	19.8%	20.0%	19.2%	19.1%	18.7%	-49 bps	-115 bps
Industry margins % (est.)	17.6%	16.8%	17.2%	17.4%	17.3%	-10 bps	-25 bps
Other income (excl. forex)	59	54	25	69	71	3.0%	21.4%
Non-recurring / Forex	(26)	(7)	52	(12)	108	NM	NM
Interest expenses	-18	-17	-19	-16	-25	57.5%	43.2%
PBT	972	1,060	1,083	1,098	1,239	12.9%	27.5%
PBT margins %	20.1%	20.5%	20.3%	19.9%	21.3%	141 bps	120 bps
Taxes	(215)	(258)	(267)	(264)	(357)	35.4%	66.1%
ETR %	-22.1%	-24.4%	-24.7%	-24.0%	-28.8%	-480 bps	-670 bps
Associates / Minority	(152)	(109)	(92)	(98)	(83)	-15.1%	-45.1%
Net income	605	693	723	736	799	8.5%	32.0%
Net margins %	12.5%	13.4%	13.5%	13.3%	13.7%	40 bps	121 bps
Industry net margins %	12.6%	13.8%	13.9%	14.0%	13.6%	-39 bps	100 bps
EPS (Rs)	23.3	26.4	26.9	24.2	26.2	8.2%	12.3%

Source: Company, Anand Rathi Research

Fig 8 – Quarterly result (Rsm)

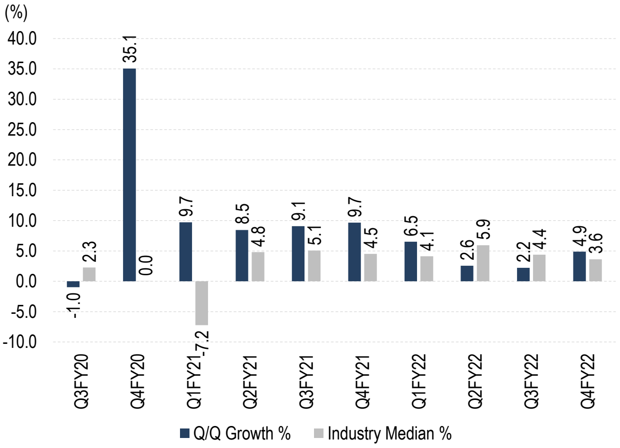
Year-end: Mar (Rs m)	Q4FY22	% chg. Q/Q	% chg. Y/Y	FY21	FY22e	FY22e % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	77	4.9	17.1	232	293	26.3	21.0
Sales	5,815	5.4	20.3	17,219	21,838	26.8	22.6
EBITDA	1,207	3.8	13.9	3,645	4,625	26.9	19.4
EBITDA margin (%)	20.8	-31bps	-117bps	21.2	21.2	1bps	-55bps
EBIT	1,085	2.7	13.4	3,195	4,196	31.3	19.6
EBIT margin (%)	18.7	-49bps	-115bps	18.6	19.2	66bps	-46bps
PBT	1,239	12.9	27.5	3,393	4,480	32.0	17.9
Tax	(357)	35.4	66.1	(876)	(1,146)	30.9	15.2
Tax rate (%)	(28.8)	-480bps	-670bps	(25.8)	(25.6)	23bps	58bps
Net income	799	8.5	32.0	2,093	2,951	41.0	25.9

Source: Company, Anand Rathi Research

Eyes billion dollar revenue, quarterly performance as estimated

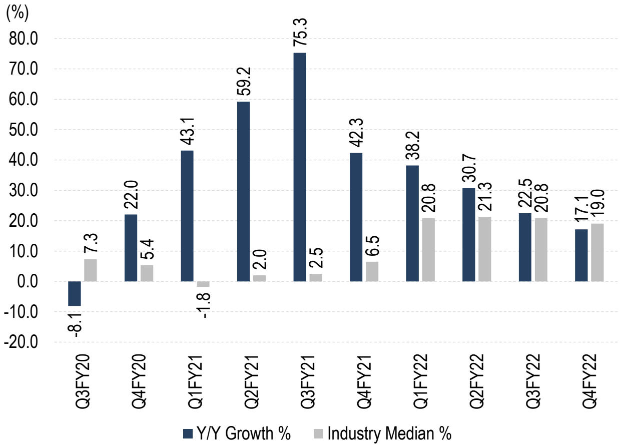
Mastek's growth was in line with estimates. In Q4 FY22, it grew 5% sequentially, faster than the industry median after two quarters, reflecting a rising order book. On a CC basis, its growth was ~5%. From a y/y perspective, its revenue grew 17.1%, slightly below our estimate for the industry. This should self-correct ahead as the growth momentum is maintained and currently reflects weakness during the middle of the year. In FY22, its growth has clearly become broader with the US contributing after many years. At the analyst meet, it set forth its aspirations of $1bn revenue sometime in FY26/27 while lowering concentration risks. This is primarily because it is expecting very high growth in the US.

Fig 9 – Q/Q growth improves, beats industry growth



Source: Company, Anand Rathi Research

Fig 10 – Y/Y growth comes lower than industry

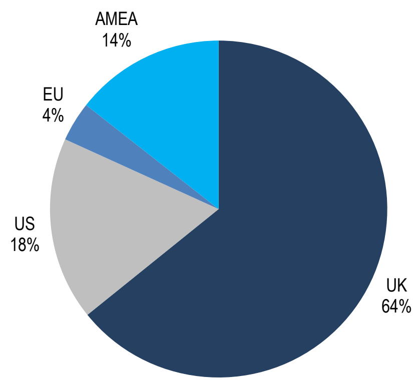


Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Mastek intends to sustain its growth momentum with the following strategy:

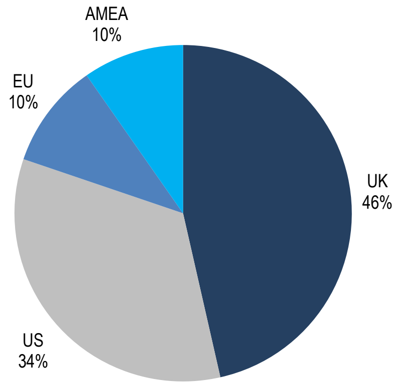
- Double down on North America, specifically in Health & Life Sciences.
  - As part of restructuring, Umang Nahata will head North America initiatives for Mastek. Raman Sapra will head the M&A initiatives and global services.
  - M&A is a big part of strategy in this region as the company aims to increase contribution from the US to 33.8% in FY25 from 17.6% in FY22. On our estimates, it will need $50m-$60m revenue from inorganic initiatives by FY25 to achieve this target.
  - Mastek is currently looking for targets of $25m-50m revenue. This would be for the US region.

Fig 11 – FY22 region split



Source: Company, Anand Rathi Research

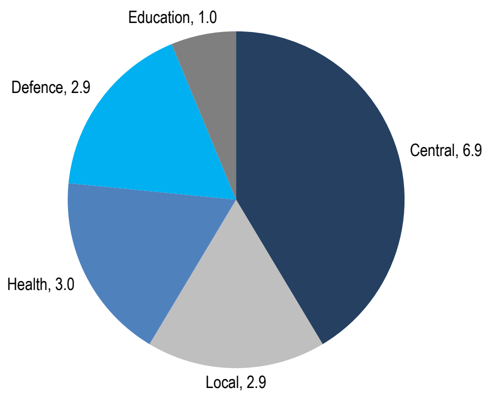
Fig 12 – FY25 target region split



Source: Company, Anand Rathi Research

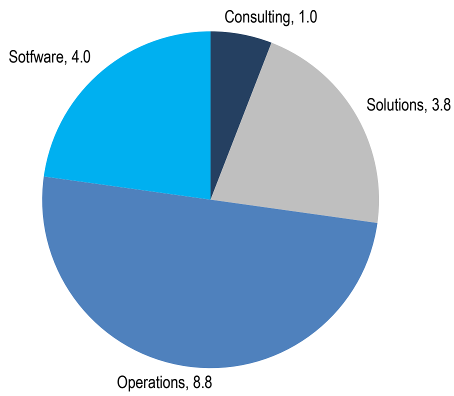
- Scale up top-5 accounts in the UK public sector. These include Home Office, HMRC, NHS, MOD and DWP.
  - Mastek services four of five major spenders in the UK public sector.
  - The wallet share is currently 10-15% (20% with some), presenting significant headroom for growth
  - Digital demand is growing 13% y/y.
  - In two specific frameworks, G-Cloud and Digital Outcome & Specialists, Mastek ranks in the top-20 and top-5 respectively.
  - It is very well insulated in its UK government business as it is focusing on critical infrastructure assignments.
  - It is strong in Software and Solutions. Operations presents a good annuity opportunity.

Fig 13 – UK Public sector split as of FY22 ($ bn)



Source: Company, Anand Rathi Research

Fig 14 – UK Public sector split by activity ($ bn)



Source: Company, Anand Rathi Research

- Dominant in Oracle Cloud as the company continues to bet big on this. Oracle contributes 33-34% towards Mastek's revenue and management doesn't see this business slowing down. The contribution from its Platforms business is minimal, but in 3-4 years 5% should come from platforms and innovations.
  - Mastek is the preferred partner for Oracle in the UK.

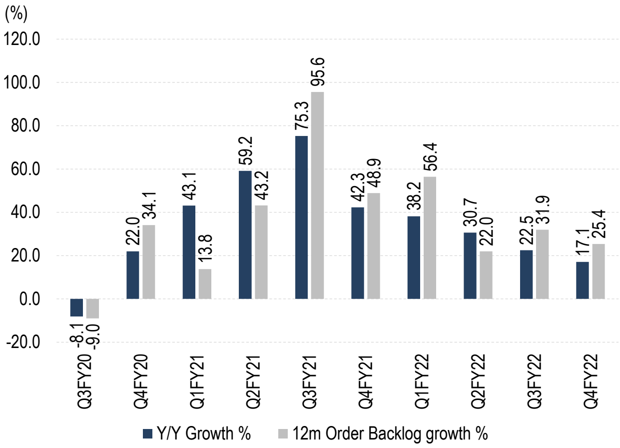
- It wants to get into the CX space with Oracle, where it is currently small. Overall, 25% of Oracle's business comes from CX, presenting an attractive opportunity for Mastek.

- CES - Managed services and multi-tower large deals. These include Cloud Enhancement Services and will transition Mastek into a full stack services provider.
- M&A focus in Automation/CX, Data Cloud and Azure/AWS. The company is planning at least one acquisition this year of \$20m-\$50m revenue. Management should be in a position to announce something in the next 2-3 months. On 31st Mar'22, it had Rs6,024m net cash.

Mastek reports a 12-month order backlog which can be used as a proxy for TCV. On the TCV front, it had a strong quarter q/q with Q4 at \$194m (up 25% y/y), compared to \$171m in Q3 and, despite the jump in the order backlog, the pipeline remains strong. The company said that its pipeline is 3.5x times its revenue and that their average deal was \$0.5million two years ago. Now, it is more than a million dollars. Further, the biggest deal closed last year was around £25m-£30m, that engagement is now £50m with the same customer. In Q4, it closed a three-year, \$65m deal with the Home Office in the UK.

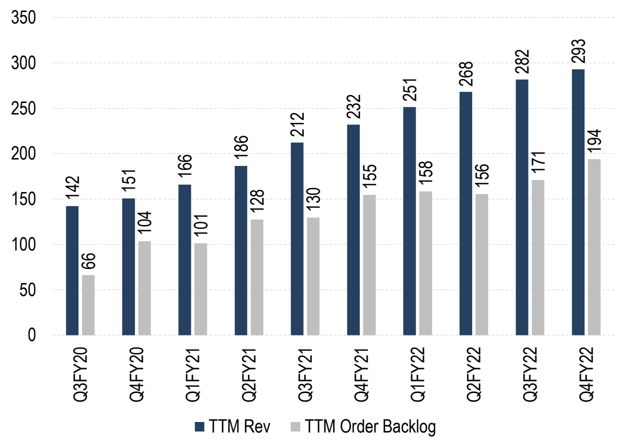
Key wins in the quarter are three deals in Government (two in the UK, one in ANZ), three in Healthcare (one in the UK, two in the Americas), one in Retail & Consumer (the Americas), one in Education (the UK), one in Technology (the UK) and two in Manufacturing (both in the Americas). On a TTM basis, revenues have been growing on par with TCV with Q4 TCV at \$194m, up 25%, while revenues have grown 26%.

Fig 15 – Current TCV growth can support 20% CAGR



Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Fig 16 – TTM revenue and TCV absolute figures

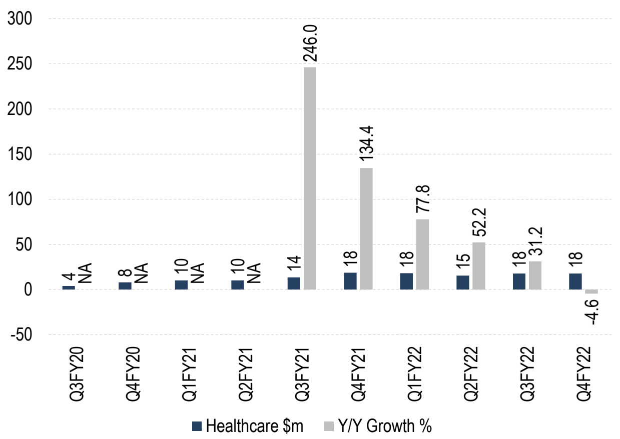


Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Growth across verticals, barring Healthcare

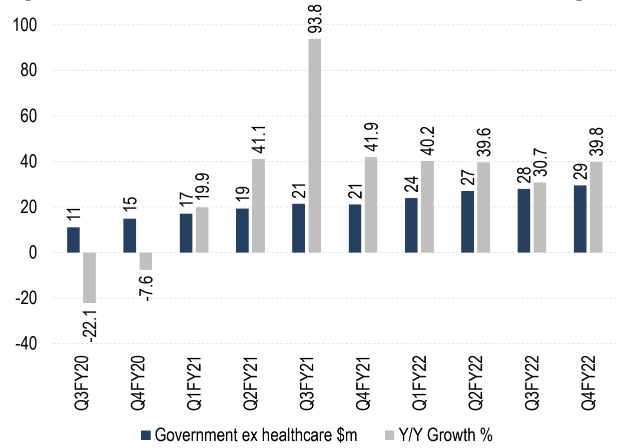
Mastek's strength lies in three verticals: government (61% of revenue, incl. Healthcare), Retail (15%) and BFSI (~10%, per our estimate, reclassified in Q4). In Q4, it saw below-company-level growth in Government while Healthcare was down 1% q/q (rebounded in Q3 from weak Q2). Government grew 40% y/y (excl. Healthcare) while Healthcare was down 5% y/y. In the UK government, Mastek won a \$65m+ order over three years with the Home office. This vertical is expected to be a growth drive in FY23 as well. The company stated its intention of focusing on the Healthcare vertical in North America.

Fig 17 –Healthcare flattish for five quarters now



Source: Company, Anand Rathi Research

Fig 18 – Government, excl. Healthcare on a solid footing

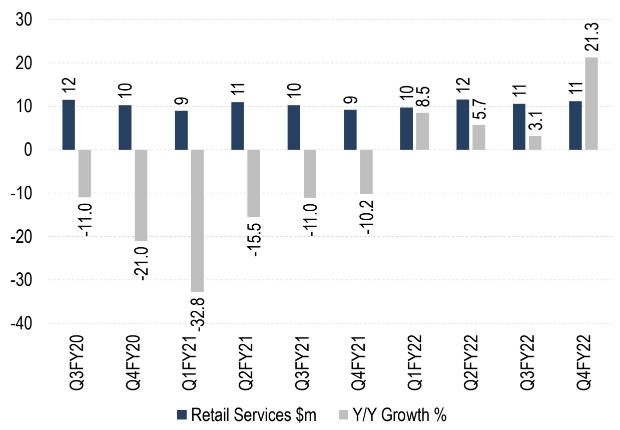


Source: Company, Anand Rathi Research

The Retail vertical delivered strong growth y/y and q/q. The UK private sector continued to underperform and Mastek is increasing its sales investments to improve its performance there. Management expects to deliver growth in this segment in FY23. In Q3, Management said Retail is one of its key focus verticals in UK private verticals and in Q4, management said that Retail/Consumer are key focus areas in North America as well.

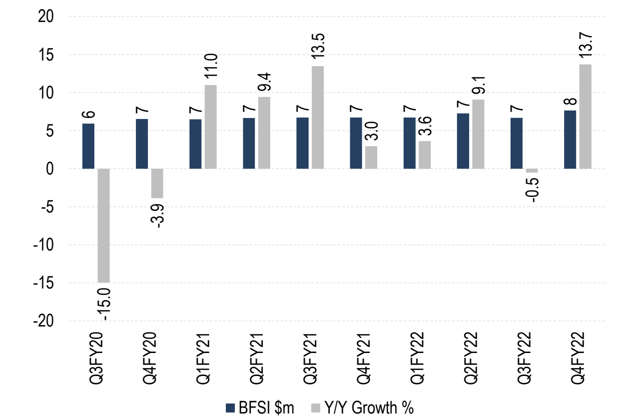
Mastek changed its verticals classifications in Q4 FY22; hence, BFSI trends have not yet been established. It is also sub-scale in this vertical and faces intense competition. So, while it is looking to continue doing business in the vertical, it is looking to scale up the other two faster.

Fig 19 – Retail steady sequentially



Source: Company, Anand Rathi Research

Fig 20 – BFSI vertical trends (reclassified in 4Q)

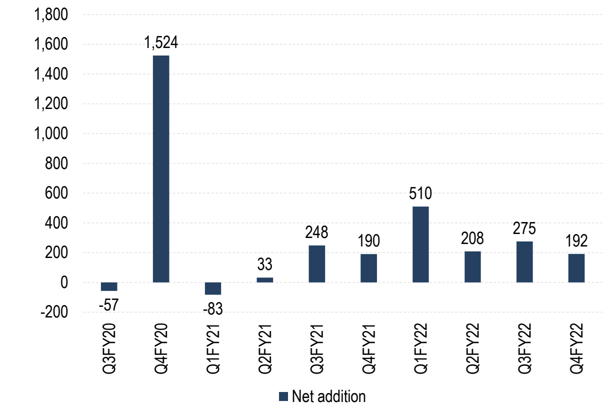


Source: Company, Anand Rathi Research Note: Q4FY22 reclassified so may not match with company factsheet

Manpower addition putting pressure on supply and margins; productivity steady

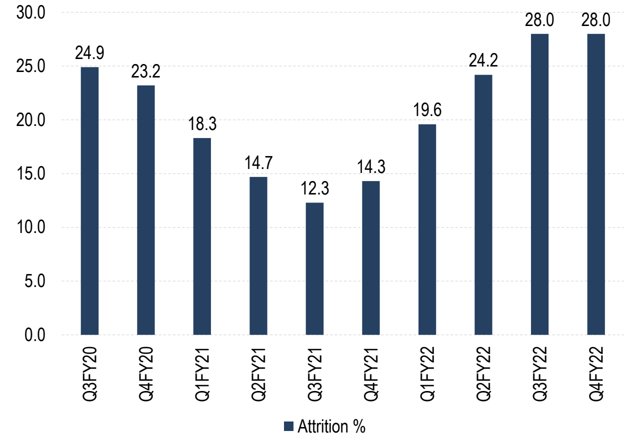
Mastek added 1,185 employees in the last twelve months, helping bring utilisation down to 73% in Q4 FY22 from 77.2% a year ago. Hiring was sequentially lower in this quarter as the company looked to improve utilization. It hired 600+ fresh graduates in FY22 and intends to hire ~1000 in FY23. Management said the offshore mix could further improve by 100-200bps to support margins. Attrition is a concern across the industry and smaller companies are suffering more relatively. Attrition is at a four-year high 28% but was steady q/q, implying that on a quarterly basis, attrition has come off a bit.

Fig 21 – Net addition slows, looking to hire 1000 freshers in FY23



Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Fig 22 – Attrition at four-year high

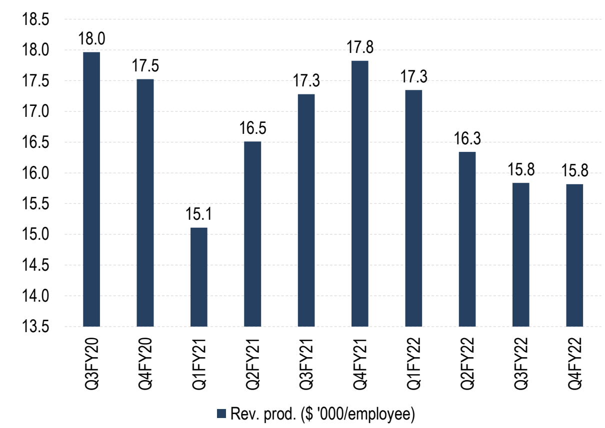


Source: Company, Anand Rathi Research

Overall, Mastek has delivered margins of 21-22% for five consecutive quarters (down from a peak of 23.5% in Q3 FY21), absorbing the cost escalations by way of strong growth. It is likely to be 20-21% in FY23 as well despite return of travel and other costs.

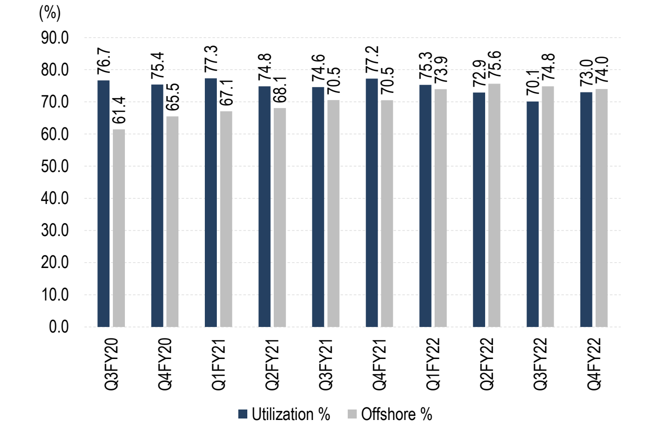
From an employee-productivity perspective, Mastek is ~12% lower than in the recent past, reflecting the interplay of higher offshoring and lower utilization. From a utilization perspective, it appears that it has some headroom to deliver on margins even if the supply-side is more constrained. Compared to the industry, Mastek still operates at very high employee productivity. As it shifts more workloads offshore, productivity will likely decline and converge to the industry.

Fig 23 –Employee productivity steady sequentially



Source: Company, Anand Rathi Research

Fig 24 – Utilization and offshore can be levers for margins



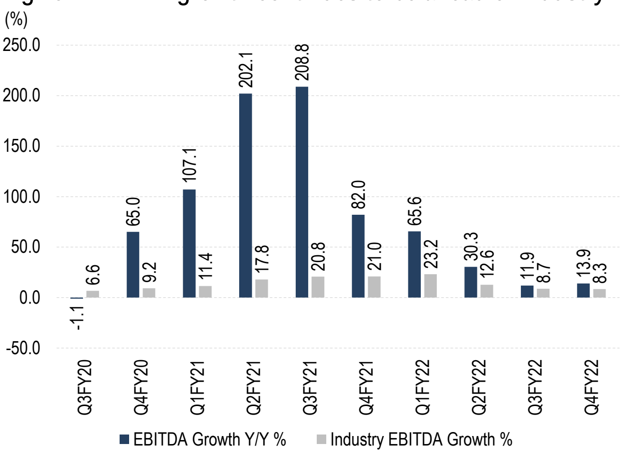
Source: Company, Anand Rathi Research

Healthy EBITDA/NI growth

Mastek delivered 14% EBITDA growth y/y in Q4 FY22 and 27% in FY22, ahead of the industry. This was driven by its growth in the previous four quarters (excl. Q2 FY22) averaging 4% q/q while maintaining EBITDA margins at 21%.

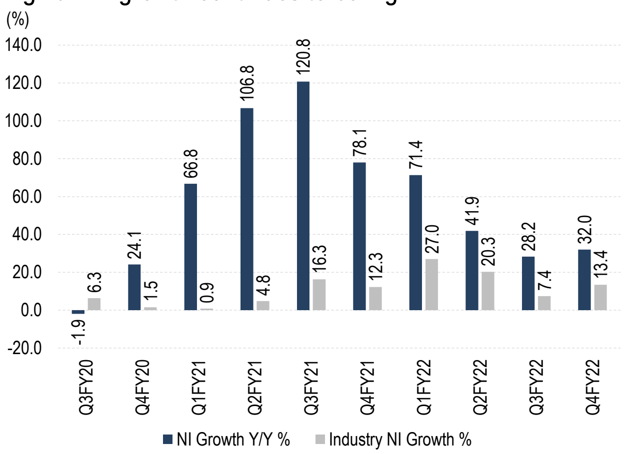
Margins contracted in Q4 as the company faced supply-side challenges. It saw a peak margin of 23.5% in Q3 FY21, now down to 20.8% after absorbing two wage hikes. Given the current attrition and hiring figures, it is unlikely that cost pressures will abate in the short term; hence, we expect Mastek to stay in the 20-21% range in FY23 as well. NI grew 32% y/y, above the industry average, while the NI margin expanded 121bps y/y in Q4 and is expected to stay in the 14%+ range.

Fig 25 – EBITDA growth continues to be ahead of industry



Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Fig 26 – NI growth continues to be high



Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Other Updates

- 20-25% of Oracle's business in the Mid-East is run by Mastek/Evosys. The company is only picking up high-value, high-potential business there. The focus is on removing the long tail in the Middle East. The company is seeing opportunities in Servicenow, Microsoft and others in this region.
- Mastek is in the top-10 fastest-growing organizations in the UK
- Value-Based Delivery – 5-20% value of the contract to be directly linked to the outcome of clients. Doing VBD for Oracle business for two years, now taking it across businesses.
- Creating a special team to focus on $2bn+ customers and a dedicated sales team for these Fortune-1000 customers. Focusing on the top-30 accounts in North America; looking to mine them with a new team.
- Industry mix aspiration for FY25 – public 40.7% (FY22: 52.7%), private 59.3% (FY22: 47.3%)
- For front office and middle office, the company is building alliances with Microsoft, AWS and Salesforce. For back office (Oracle) it sees much headroom to grow.
- Europe to be driven by SAS relationship with Oracle. Confident of growing here on the back of Oracle's investments in the region.

- Europe is completely on the Enterprise side. Within Europe, the focus is on the Nordics, France and the Netherlands, where Oracle is partnering with Evosys/Mastek.

Business Outlook

- Mastek's organic growth to be faster than industry growth
- Aspiration of keeping operating EBIDTA margin near 20% for the foreseeable future.
- To maintain payouts of 18-20%.

Conference-call takeaways

Notes from last quarters' conference calls

Q3 FY22

- UK break-up - 70% public, 30% private sector
- UK grew despite furloughs and seasonal impact; the private sector was affected by project completion and go-lives. Europe private business was expected to dip in Q3; as few projects were completed, furloughs and holidays. Taking a focused approach to UK private, focusing on micro-finance, financial services, retail and consumer sector. Seeing traction in a couple of other sectors. Closed two medium-sized deals in Q4 in the UK private sector. UK private has a good pipeline and good traction. UK order book strong and will reflect in revenues ahead
- Confident of bringing healthcare on an uptick, starting Q4.
- Developed-markets margin profile is better; focusing on higher quality revenue and fewer clients in the Middle East so that margins are aided.
- Offshore mix could improve 100-200bps as the UK private business grows.
- Average deal sizes are increasing.
- Past large deals in North America were in the $0.5m range; now they are in the $5m-$10m range, many integrated and managed services.
- UK large deals are +$25m and in the US large deals are +$5m. The company is seeing many deals in the UK of $10m-25m, for three years. Expect few significant deals in Q4 across the UK as well as the Americas.
- Management is seeing good deal momentum which is reflected in the order backlog and is seeing many more deals in the pipeline
- Closed the biggest deal in the UK, more than $60m over four years with the NHS. Deals won with the NHS in January as well, to be announced in Q4.
- North America Oracle cloud had a good order booking quarter; deals won include large managed services deals and integrated deals. Added 2-3 marquee logos in North America in Oracle Cloud.
- Added seven Fortune-1000 clients in Q3. Many big clients (revenue-wise) are approaching Mastek, which is confident of closing some of these deals.
- Opened a center in Romania, as the company continues to see traction in Nordic and Netherlands. This will aid in accelerating in Europe.
- Bought 10% of CCPS (complete in Jan), balance 20% in Q3 CY22.
- In Q3, cash payout of Rs290m toward CCPS, final dividend for FY21 of Rs20m and one UK loan has been paid off in Q3.
- Management shared plans of being listed on the Dow Sustainability Index

- EBITDA margin to remain ~21% as the company is not expecting major downside in the medium term. Downside of margin of 50-100bps max.

From Q2 FY22

- Seeing a very high growth demand environment; pipeline consists of $25 5m deals (may not win all). Of these 25, 7-8 are above $10m and a few of them are larger than $25m. These will be decided in the next two quarters.
- Client base is changing; onboarding clients from Fortune 1000, and enterprise clients. This will help the company scale up faster.
- First $10m account in the US market to be signed soon.
- Won its first deal in Canada in life sciences, a +$1m deal; can grow to a couple of million dollars in six months.
- Won a large deal in Finland, Mastek to provide end-to-end BT program.
- Won a deal from a UK government agency that is in the Vehicle and Driver space
- In the UK softness came from NHS as some implementation programs came to an end although there is a good pipeline. The UK seeing delays in decision-making; many large deals in the works. Pipeline strongest it has ever been. H2 to improve.
- In the UK government, Mastek won a large deal in Oct; it is a three-year deal, which should lead to $40m-50m business. Q4 should reflect revenue from this deal. UK education and local sector seeing good momentum as well. Mastek has a good chance of winning 5-6 deals across the NHS division
- Opened a new department in the UK of a couple of million dollars. This has potential to become larger.
- Added three non-retail customers, of which a couple are from Fortune-1000 in D2X in the US.
- In the private sector, Mastek will be announcing a couple of deals from Fortune-500 companies in the next quarter. In the UK private sector, it built a team that is growing a pipeline in retail, manufacturing and micro-finance. Europe is a bigger opportunity in the private sector, and the pipeline is good here.
- Will add more leadership to the company; some already brought in this quarter. Building leadership to take Mastek to a billion dollars.
- Revenue growth to bounce back from Q4.
- The company is seeking to maintain margins at current levels, and will invest in skill, SG&A capabilities. Margins to be 21% in the short term and 20% in the long term (100bps to be re-invested into the company)

From Q1 FY22

- There is some delay in UK decision-making; hence, the order backlog grew slightly slower. Reflecting this, the pipeline grew faster as some of the deals are now likely to close in Q2.
- Mastek is investing in building digital capabilities, training employees in leadership (new leader in the deliveryunit), building marketing and sales

teams and partnerships for the new areas – primarily, the UK private sector and the US.

- Won a $6m account, jointly sold in Europe,showcasing synergy between Evosys and Mastek
- The Middle East had some execution challenges due to local lockdowns. The situation is likely to improve ahead; if not, the company may look to increaseits local presence through employees or sub-contractors.
- For H2 and beyond, it is optimistic about the US, currently winning deals in diverse sectors incl.healthcare/pharmacy. The US has a vast untapped market. The company is seeing good momentum in healthcare and life science in the Americas. The new CEO spoke about improving marketing efforts there, building on partnership strategy (for example Microsoft and ServiceNow)and inorganic opportunities.
- The UK public sector isgrowingfast and is likely to maintain its growth rates. There is also an element of accelerated spends on account of BRexit in Dec. However, some segmentsmay see macro-level issues that might affect NHS momentum.
- Mastek is looking at penetrating Fortune-1000 companies as it achieves the scale to deliver large assignments.
- Q2 salary hike is under consideration, impact on margins to be mitigated.
- The strong revenue momentum in the three businesses continues.
- Expect pressure on margins similar to the industry, but the intention is to maintain them at FY21 levels, as the company leverages fixed costs and rebalances SG&A. Growth is a huge advantage here.

From Q4 FY21

- Signed a large deal with the UK government in biometrics, of £25m (£35m opportunity, if extended), a three-year deal with a possible two-year extension.
- Pipeline has deals ofover£35m-100m (some larger ones are partner-ships). Mastek is not looking at sub-contracting and is working as prime contractor on these assignments.
- Some private-sector clients' revenues were down to 10% compared to pre-Covid levels; hence, their discretionary spends shrank. Mastek lost a couple of customers but on the other hand on-boarded a few.
- Mastek has appointed a Head for sales in the private sector (Apr), and hired a Head for delivery. The new leadership team is likely to improve on the UK private business as it recovers.
- The US business recorded 13 new logos (10 non-retail), which reflects Mastek's renewed focus on adding more verticals other than retail.
- Current levels of annual EBITDA margin (21.2%) to be maintained (20-21%).

Factsheet

Fig 27 – Revenue

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Revenue ($ m)	66	70	72	74	77

Source: Company, Anand Rathi Research

Fig 28 – Revenue, by area

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
North merica A	15	15	18	19	18
UK	70	70	67	66	69
RoW	6	6	6	6	5
ME	10	9	9	9	8

Source: Company, Anand Rathi Research

Fig 29 – Revenue, by verticals

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
BFSI	10	10	10	9	10
Government	60	60	59	62	61
Others	16	17	15	14	15
Retail Services	14	14	16	14	15

Source: Company, Anand Rathi Research Note: Some verticals have been reclassified in Q4FY22 so may not match with company factsheet

Fig 30 – Client concentration

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Top 5 Clients	33	33	31	29	30
Top 10 Clients	47	48	45	44	43
Active Clients	639	651	447	421	450

Source: Company, Anand Rathi Research

Fig 31 – Workforce

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Technical	3,227	3,718	3,879	4,105	4,245
Technical Support	126	138	142	148	173
Marketing	208	208	230	242	259
Support	231	238	259	290	300
Utilization % (gross)	77	75	73	70	73
12 m Order Backlog ($ m)	154.6	158.4	155.5	171.0	193.8
Active clients	639	651	447	421	450
Revenue per active client ($ m)	0.1	0.1	0.2	0.2	0.2

Source: Company, Anand Rathi Research

Fig 32 – Revenue by Delivery location

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
On-site	29.5	26.1	24.4	25.2	26.0
Offshore	70.5	73.9	75.6	74.8	74.0

Source: Company, Anand Rathi Research

Fig 33 – Revenue by practice

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Digital & Application Engineering	48.8	NA	48	43.2	40.8
Cloud & Enterprise Apps	30.7	NA	31.6	34.4	35.5
Digital Commerce & Experience	11.8	NA	12.5	11.4	11.2
Data, Automation and AI	8.7	NA	7.9	11	12.5

Source: Company, Anand Rathi Research

Fig 34 – Key segments' growth Y/Y (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Revenue, by region (%)					
North America	8%	24%	34%	29%	48%
UK	44%	48%	30%	22%	15%
RoW	82%	137%	73%	36%	-4%
ME		-17%	9%	10%	1%
Revenue, by vertical (%)					
BFSI	3%	4%	9%	0%	14%
Government	74%	54%	44%	31%	19%
Others	55%	45%	34%	30%	8%
Retail Services	-10%	9%	6%	3%	21%

Source: Company, Anand Rathi Research Note: Some verticals have been reclassified in Q4FY22 so may not match with company factsheet

Valuations

A mid-sized IT-services company ($309m revenue at the Q4 run-rate), Mastek is attempting to become bigger ($1,000m revenue), organically and inorganically. It is run by a healthy mix of promoters and professionals and achieved its target of a $200m company by Q4 FY20 with the Evosys acquisition ($67m revenue in FY20). It ended FY22 with $293m revenue.

It is now looking at its next leg of growth by acceleration in its US business as the UK is on a steady high-growth path and is now enjoying tailwinds. In the US, it has appointed a new CEO in Chicago and is rejuvenating its business by inducting leaders, investing in sales, and on reinforcement through Evosys. Mastek/Evosys have announced some deals in the US and growth in the US region is shaping up well.

It is expected to grow its regional operations in the UK/US, with 19%/36% CAGRs over FY22-FY24. However, it may see faster recovery now that the new leadership is in place and there are tailwinds in both the US and the UK. Besides, there are expectations of inorganic growth in the US.

As its operating metrics and business characteristics converge to the sector's parameters, we value it on FY24e PE as a primary valuation method, and FCF/EV as a secondary one. The stock trades at 19x FY24e EPS and 3% FCF/EV yield (excl. the M&A payouts). Our target multiple is 23x FY24e as the appointment of a new CEO is showing positive results, given his background in the US and in running sales/operations in a large Indian IT. US growth rates have accelerated in the last three quarters.

The multiple is also a reflection of our expectations of sustained growth in the UK government order-book and management guidance of steady FY23 margins. The uncertainties after the sudden departure of the previous CEO seem to be behind. After the event, management and the founders assured a continuity of performance and recruited Hiral Chandrana (Jul'21) as global CEO. Mr Chandrana has over 25 years' experience and a good track record in IT services and Digital Solutions across diverse industries.

Also, business is now concentrated in the UK; hence, the ability of Mastek to absorb regional shocks appears low, including cross-currency headwinds. This is also one of the key reasons for our curtailed target multiple (in the context of its very strong showing in FY22) compared to its peer-set (KPIT, PSYS, Mindtree).

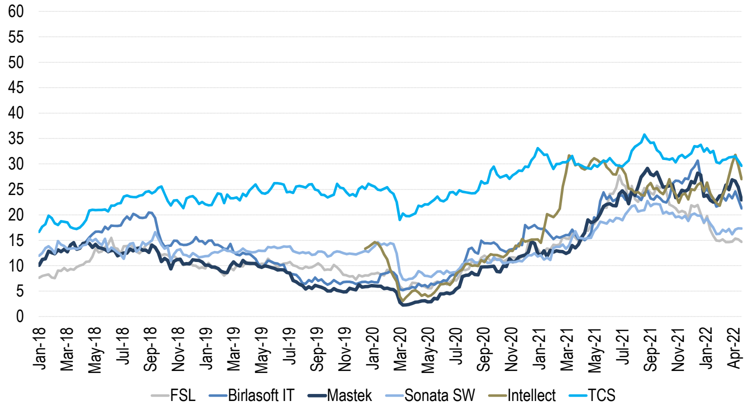
Mastek has, over the last few years, consistently expanded its operating margins, with the EBIT margin moving up from 9.9% in FY18, 18.6% in FY21 and to 19.2% in FY22. We expect it to be stable and clock 18.7% in FY24. We expect 20%/19%/23% CAGRs over FY22-FY24 in revenue/EBIT/EPS.

Fig 35 – Change in estimates (Rs m)

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	355	352	0.7	423	417	1.5
Revenues	26,767	26,482	1.1	31,959	31,378	1.9
EBITDA	5,521	5,464	1.0	6,527	6,428	1.5
EBITDA margins %	20.6%	20.6%	-1 bps	20.4%	20.5%	-6 bps
EBIT	5,020	4,996	0.5	5,971	5,901	1.2
EBIT margins %	18.8%	18.9%	-11 bps	18.7%	18.8%	-12 bps
Other Income	262	198	32	298	250	19
PBT	5,282	5,193	1.7	6,268	6,151	1.9
Net profit	3,715	3,737	(0.6)	4,560	4,554	0.1

Source: Anand Rathi Research

Fig 36 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- M&A and integration-related challenges.

Appendix

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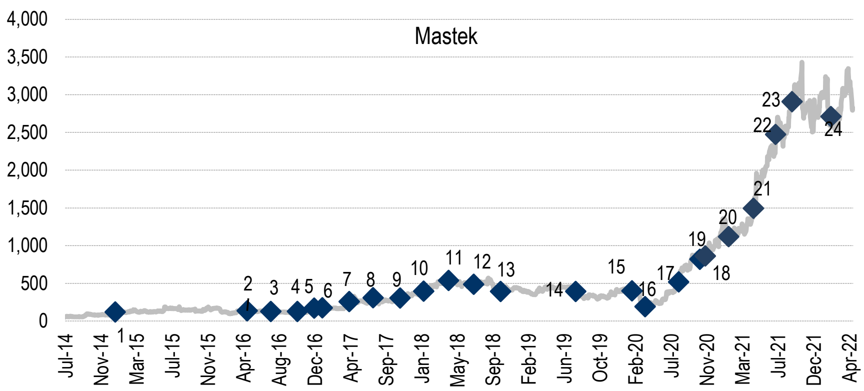

	Date	Rating	TP (Rs)	Share Price (Rs)
11	19-Apr-18	Hold	650	587
12	19-Jul-18	Buy	730	501
13	25-Oct-18	Buy	670	413
14	23-Jul-19	Buy	650	457
15	12-Feb-20	Buy	620	419
16	31-Mar-20	Buy	510	190
17	30-Jul-20	Buy	780	652
18	15-Oct-20	Buy	1,120	884
19	31-Oct-20	Buy	1,150	845
20	02-Feb-21	Buy	1,500	1,194
21	29-Apr-21	Hold	1,930	1,617
22	21-Jul-21	Hold	2,880	2,491
23	21-Oct-21	Buy	3,400	2,840
24	25-Jan-22	Buy	3,510	2,745

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