



#### 3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■

+ Positive = Neutral - Negative

#### What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

#### Reco/View

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 1,194	
Price Target: Rs. 1,400	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

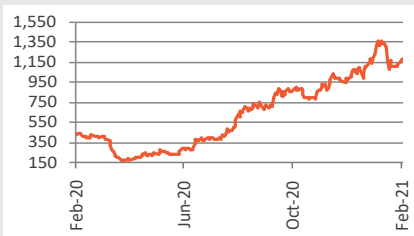
#### Company details

Market cap:	Rs. 2,977 cr
52-week high/low:	Rs. 1,460 / 170
NSE volume: (No of shares)	2.4 lakh
BSE code:	523704
NSE code:	MASTEK
Free float: (No of shares)	1.3 cr

#### Shareholding (%)

Promoters	44.3
FII	7.5
DII	16.2
Others	32.0

#### Price chart



#### Price performance

(%)	1m	3m	6m	12m
Absolute	-3.2	32.8	95.4	176.5
Relative to Sensex	-6.6	10.2	63.3	151.6

Sharekhan Research, Bloomberg

#### Summary

- We recommend a Buy with a price target (PT) of Rs. 1,400 as risk-reward balance remains favourable.
- Strong beat on all fronts, led by strong growth in the UK public sector, accelerated growth in Evosys business and recovery in US business; EBITDA margin rose 233 bps q-o-q to 23.5%; added 57 new customers
- The management remains confident on delivering strong growth in the UK public and Evosys businesses in FY2022, led improving demand, strong deal wins and addition of new logos. US recovery likely to aid growth
- Stock trades at a reasonable valuation of 13x its FY2023E EPS; cash & cash equivalents represent 26% of its current market capitalisation.

Mastek Limited (Mastek) delivered another strong quarterly performance, led by strong growth in the UK public sector, accelerated growth in Oracle services business and recovery in US business. Mastek reported stronger-than-expected constant currency (CC) revenue growth of 7.3% q-o-q/73.3% y-o-y, led by a 9.5% q-o-q growth in Evosys business and 7.3% q-o-q growth in organic business. Growth in organic business was aided by continued growth momentum in the government vertical and a strong recovery in the US business. EBITDA margin improved by 233 bps q-o-q to 23.5% in Q3FY2021, exceeding our estimates, led by revenue growth, continued lower travel & administration expenses and higher offshoring. Net income came in at Rs. 57.4 crore and was above our estimates, aided by stronger-than-expected revenue growth and operating profitability. Order backlog remained at Rs. 946.7 crore (\$129.6 million), rising 0.7% q-o-q in rupee terms, owing to weak seasonality. The company signed the third large deal worth \$1.8 million under a joint go-to-market strategy post the acquisition. Management stated that the government sector spends over ~GBP 12 billion per annum in the IT services and software space. Within this, Mastek services three of the top four UK public sector spenders (central, local, healthcare and defence). Hence, the management remains confident on delivering strong growth in UK public segment as it focuses on deepening existing relationships and widening the customer base by adding new logos. Growth momentum in Evosys business would continue on the back of large opportunities in the cloud-migration space, strong order booking, a healthy deal pipeline, market share gains from competitors and led by a dedicated sales team to migrate customers from SAP to Oracle cloud. We expect margins to move in a narrow band in the coming quarters, given investments in building capabilities to drive growth.

#### Key positives

- Added 57 new customers
- EBITDA margin expanded 233 bps q-o-q to 23.5%, ahead of our estimates
- Free cash flow to net profit stood at 125% for 9MFY2021.

#### Key negatives

- Revenue for top 5 accounts declined 5.3% q-o-q in Q3FY2021
- Order booking growth remained muted on q-o-q basis due to furloughs

#### Our Call

**Valuation – Recommend Buy with a price target of Rs. 1,400:** We raise our earnings estimates for FY2021/FY2022E/FY2023E on account of strong beat in revenue and margin, strong client additions and strong traction for cross-selling initiative from Mastek and Evosys. A healthy deal pipeline, new logo additions, strong order book and higher demand for cloud business are expected to drive Mastek's revenue growth in FY2022E. We expect EBITDA margin would be sustainable in medium-term on the back lower travel expenses and higher offshoring. Net cash remained at Rs. 521 crore as of December 31, 2020, which is 17% of its current market capitalisation. At CMP, the stock is trading at a reasonable valuation of 14x/13x its FY2022E/FY2023E EPS. Given the strong growth potential and a healthy balance sheet, we maintain Buy rating on Mastek with a revised price target (PT) of Rs. 1,400.

#### Key Risks

- 1) Integration issue from inorganic initiatives; 2) intense competition; and 3) currency risks.

#### Valuation

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	1,033.2	1,071.5	1,715.7	2,082.4	2,289.2
OPM (%)	12.7	14.5	21.5	20.7	20.3
Adjusted PAT	100.9	132.9	209.4	234.4	252.2
% y-o-y growth	44.3	31.7	57.5	11.9	7.6
Adjusted EPS (Rs.)	40.1	42.9	78.9	88.3	95.0
P/E (x)	29.8	27.8	15.1	13.5	12.6
P/B (x)	4.2	3.8	3.3	2.8	2.4
EV/EBITDA (x)	21.0	17.8	7.5	6.4	6.0
RoNW (%)	15.9	14.4	24.1	22.6	20.7
RoCE (%)	18.9	14.7	21.9	22.4	21.9

Source: Company; Sharekhan research

## Stellar quarter

Mastek delivered stronger-than-expected constant currency (CC) revenue growth of 7.3% q-o-q/73.3% y-o-y, led by 9.5% q-o-q growth in Evosys business and a 7.3% q-o-q growth in organic business. Growth of the organic business was aided by a continued growth momentum in the government vertical and a strong recovery in the US business (3% q-o-q). In rupee terms, revenue grew by 8.1% q-o-q to Rs. 442.9 crore. EBITDA margin improved by 233 bps q-o-q to 23.5% in Q3FY2021, exceeding our estimates, led by revenue growth, continued lower travel and administration expenses and higher offshoring. Net income came in at Rs. 57.4 crore and was above our estimates, aided by stronger-than-expected revenue growth and operating profitability.

### Key result highlights from earnings concall

- ◆ **Order backlog:** The 12-month order backlog was Rs. 946.7 crore (\$129.6 million) in Q3FY2021 as compared to Rs. 941 crore in Q2FY2021, up 0.7% q-o-q in rupee terms and a decline of 2.3% on a CC basis. Order pipeline remains healthy, while sequential order wins was marginal due to furlough. The company has won deals from central & local governments of the UK. Digital & Cloud migration continue to witness strong demand. The company highlighted that company signed another large deal of worth \$1.8 million for duration of three years under joint go-to-market strategy.
- ◆ **Client concentration moderated post acquisition:** Revenue contribution from the top-5/top-10 clients stood at 30.4% /44.2%, respectively, in Q3FY2021 versus 43%/63% in Q3FY2020. Revenue from the top 5 clients declined by 5.3% q-o-q, while revenue from top 10 clients increased by 5.1% q-o-q.
- ◆ **Strong cash balance:** Cash & cash equivalents stood at Rs. 778.6 crore in Q3FY2021 compared to Rs. 476.4 crore in Q2FY2021, an increase of 63% q-o-q. Net cash balance (after adjusting debt) stood at Rs. 520.9 crore in Q3FY2021 versus Rs. 223 crore in Q2FY2021. Further, it includes Rs 237.1 crore (\$32.3m) from sale of stake in Majesco. Mastek repaid loan of \$1.2 million during Q3FY2021.
- ◆ **Rise in headcount:** Total employee count stood at 3,602 in Q3FY2021 versus 3,354 employees in Q2FY2021. Of this, 2,541 employees were based offshore in India, while the rest were at various onsite locations. The company recruited 248 staffs in Q3FY2021, while it plans to hire over ~150 employees in Q4FY2021.
- ◆ **Growth outlook:** The management indicated that it sees a good traction in both public sector and the digital transformation deals post Brexit. Further, cross-selling and joint go-to-market (GTM) initiatives of both Mastek & Evosys are gaining traction. The company has signed its third deal of worth \$1.8 mn in North America under its joint GTM strategy. With improvement in average deal sizes, strong deal wins and higher spends on digital transformation, we expect acceleration of revenue growth going ahead. The UK government and traction for its ERP business would aid to the growth momentum. The management focuses on US region to drive its growth momentum.
- ◆ **Wage hike:** The management indicated that it has rolled out an annual wage hike cycle, effective from October 1, 2020.
- ◆ **Margin outlook:** The management aims to maintain EBITDA margin at high-teens as it would invest back excess profitability into the business to drive growth. Further, the management indicated it expects possibilities of higher offshoring in coming quarters.
- ◆ **Strong growth momentum to continue in UK public segment:** The management highlighted that revenues from UK business grew 6.5% q-o-q on CC basis. The growth was driven by strong UK public sector performance. Management stated that the government sector spends over GBP 12 billion per annum in the IT services and software space, of which 70% is spent on operation and delivery. Mastek caters to 3 out of top 4 spenders in the UK public-sector. The management believes there is huge headroom for growth in UK region given its strategic approach such as deepening existing relationship and widening the customer base with winning new logos. The company won a deal from UK public sector in Q3FY2021, which is expected to provide GBP 15 million potential opportunities from that engagement. Company plans to onboard the sales leadership in Q4FY2021 and make investments to drive growth in UK private sector. The management indicated to add 30+ employees in its UK business during Q4FY2021.

- ◆ **US business growth likely to accelerate:** The management indicated that US business delivered revenue growth of 3%+ q-o-q on CC basis despite weak seasonality. The company added one non-retail customer during Q3FY2021, which is expected to reduce sectoral concentration in the US. The US business added 5 logos. Given a cross-sales opportunity and sales-team in-place, management expects acceleration in revenue growth in US business going ahead.
- ◆ **Strong demand for Oracle Services (Evosys):** The Mastek sees strong demand traction for the Oracle suite and cloud migration. It expects strong demand for these services from Canada and European countries. As Oracle has opened up local data centers in the Middle East, management expects higher cloud adoption in coming quarters. The company is exploring alliance and partnerships to win transformation deals from enterprise customers. Evosys added 49 customers during the quarter, of which 15 customers were added in North America. Further, 10 customers of these 49 customers generate more than \$1 billion revenue. Evosys added 120 employees during the quarter and expect to add similar number of employees in Q4FY2021. The management focuses three key verticals such as 1) healthcare and lifesciences, 2) manufacturing and 3) construction. The company reported 9.5% q-o-q growth in Evosys business during the quarter. The management expects growth momentum in Evosys to continue in the coming quarters, given large opportunities in the cloud-migration space, strong order booking, healthy deal pipeline and opportunity to migrate from SAP customers to Oracle cloud.
- ◆ **Strong client addition:** Mastek added 57 new clients in Q3FY2021 (versus 37 clients in Q2FY2021), taking total client count to 618. The company focuses on annuity kind of projects to increase the contribution of annuity revenue going ahead.

Particulars	Rs cr				
	Q3FY21	Q3FY20	Q2FY21	y-o-y (%)	q-o-q (%)
<b>Revenue (Rs.)</b>	<b>442.9</b>	<b>243.7</b>	<b>409.7</b>	<b>81.7</b>	<b>8.1</b>
Employee benefits expense	225.6	136.6	210.4	65.2	7.2
Other expenses	113.4	73.5	112.8	54.3	0.5
<b>EBITDA</b>	<b>103.9</b>	<b>33.6</b>	<b>86.6</b>	<b>208.8</b>	<b>20.0</b>
Depreciation and amortization	11.7	5.8	11.6	101.0	0.5
<b>EBIT</b>	<b>92.2</b>	<b>27.8</b>	<b>74.9</b>	<b>231.4</b>	<b>23.0</b>
Other Income	3.9	9.6	4.1	-59.1	-3.7
Finance costs	1.8	0.8	2.1	120.0	-15.4
<b>PBT</b>	<b>94.3</b>	<b>36.6</b>	<b>76.9</b>	<b>158.0</b>	<b>22.7</b>
Tax Provision	24.0	6.0	17.7	298.7	35.3
<b>Adjusted net profit</b>	<b>57.4</b>	<b>30.5</b>	<b>51.0</b>	<b>88.0</b>	<b>12.7</b>
EPS (Rs.)	22.2	10.2	19.8	118.0	12.6
<b>Margin (%)</b>				<b>BPS</b>	<b>BPS</b>
EBITDA	23.5	13.8	21.1	965	233
EBIT	20.8	11.4	18.3	940	253
NPM	13.0	12.5	12.4	43	53

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimates IT services spending to grow by 5-8% over CY2021-CY2024E as compared to an average of 4.2% achieved in CY2010-CY2019. Forecasts indicate a higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients and increased online adoption across verticals. Gartner estimates that cloud consulting and integration (C&I) services will double from \$98 billion in 2018 to \$184 billion in 2022 (at a 17% CAGR) with migration at 70% of the market size. UK's software and IT Services (SITS) spend (public + private) is ~GBP 47 billion, of which UK public sector's spend is ~25% (~GBP 12 billion). Hence, we believe there is a huge headroom for Mastek to grow in the UK, as it currently gets less than 5% of total spends of Home Office and NHS Digital.

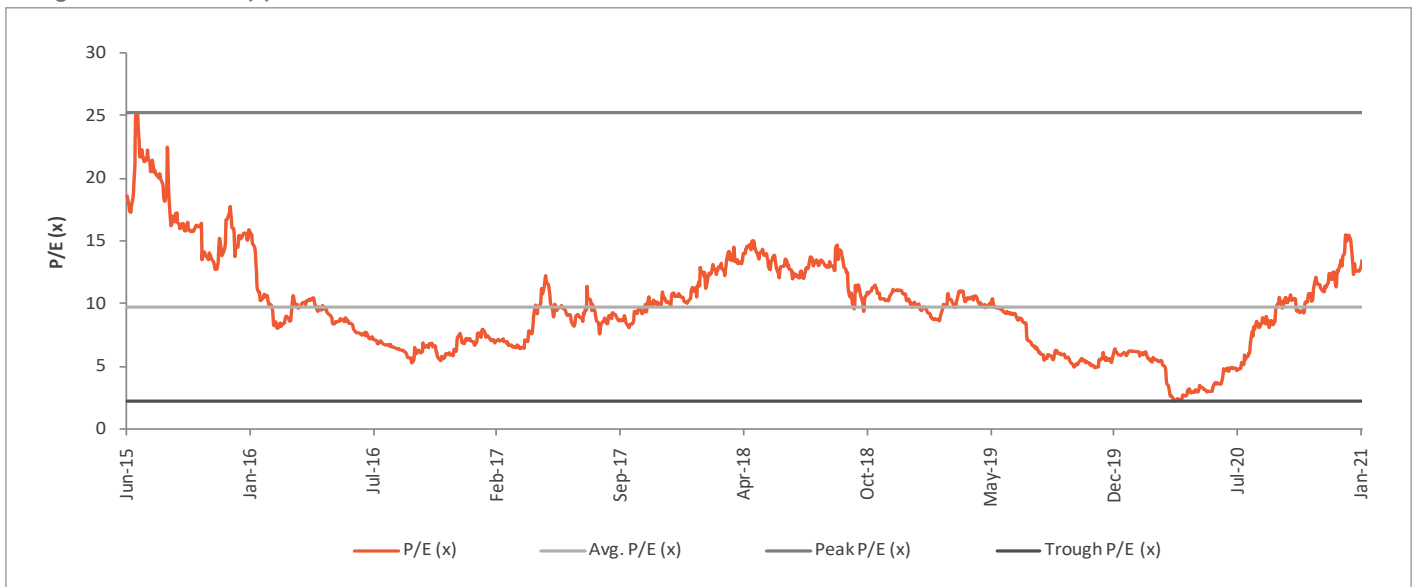
### ■ Company outlook - Focus on improving annuity type deals

Mastek has created a consistent and predictable revenue stream from the UK's public sector over the past few years, thanks to introduction of Digital Outcomes and Specialists (DOS) framework by the UK government (replacement of Digital Services-2 framework in 2016). Direct revenue from the UK public sector has recently reached 95% of its total revenue from this segment as compared to 70% of indirect revenue from the UK public sector five years ago. Management indicated that revenue growth momentum in the UK public-sector would continue in FY2022E on account of higher spends in UK. Further, management indicated that Evosys revenue would maintain growth momentum because of strong demand for cloud migration and strong deal wins.

### ■ Valuation - Reasonable valuation

We have revised raise our earnings estimates upward for FY2021/FY2022E/FY2023E on account of strong beat in revenue and margin, strong client additions and strong traction for cross-selling initiative from Mastek & and Evosys. A healthy deal pipeline, new logo additions, strong order book and higher demand for its cloud business are expected to drive Mastek's revenue growth in FY2022E. We expect EBITDA margin would be sustainable in medium-term on the back lower travel expenses and higher offshoring. Net cash remained at Rs. 521 crore as of December 31, 2020, which is 17% of its current market capitalisation. At CMP, the stock is trading at a reasonable valuation of 14x/13x its FY2022E/FY2023E EPS. Given the strong growth potential and a healthy balance sheet, we maintain Buy rating on Mastek with a revised price target (PT) of Rs. 1,400.

### One-year forward P/E (x) band



Source: Sharekhan Research

### Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Persistent Systems	1,570	8	12,000	27.7	21.7	17.1	13.5	4.6	4.1	17.3	20.0
Mastek	1,194	2	2,977	15.1	13.5	7.5	6.4	3.3	2.8	24.1	22.6

Source: Sharekhan Research

## About company

Established in 1982, Mastek provides IT services to four verticals – government (mostly caters to the UK government), retail, financial, and information technology (IT) services. Mastek continues to be ranked among the top three vendors in delivering agile development services to the UK government on digital, G-Cloud, and GDS frameworks. The company primarily provides digital solutions to its retail (ex. Oracle Cloud Commerce platform) and financial clients (primarily wealth management and digital banking clients), while it helps the government to reduce cost and time in delivery in the UK. On the region front, the company is positioned largely in the UK, as 67% of its revenue comes from this region, followed by the US/ME/RoW with contribution to total revenue of 18%/10%/5%, respectively. In September 2014, demerger of insurance products and service business of Mastek formed a new company named Majesco Limited.

## Investment theme

Mastek has a long-standing relationship with the UK government as it was working as a subcontractor to large IT companies for execution of UK government's projects earlier. This long-term relationship and excellent execution capabilities make Mastek a prime beneficiary of UK government's digital spends. We expect strong order pipeline along with significant headroom for growth with the UK public sector (spend is ~GBP 11.5 billion), higher client mining of top accounts, and cross/up-sell opportunities to drive strong growth for Mastek going forward. Further, Mastek has been largely participating for digital contracts of UK public and private sector, where UK digital spending is growing at 30%. Mastek focuses on accelerating its revenue momentum in the US.

## Key Risks

1) High dependence on the UK market; 2) headwinds in cross-currency (especially GBP/INR) fluctuations; and 3) intense competition may adversely impact our estimates.

## Additional Data

### Key management personnel

Ashank Desai	Group CEO
Abhishek Singh	Group CFO
Umang Nahata	CEO, Evosys
Narasimha Murthy	Group Chief Delivery Officer
Arun Agarwal	Vice President, Finance

Source: Company

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	IDFC Mutual Fund/India	3.86
2	ABAKKUS GROWTH FUND	3.29
3	KACHOLIA ASHISH	2.88
4	Reliance Capital Trustee Co Ltd	1.10
5	Dimensional Fund Advisors	0.90
6	Nippon Life India Asset Management	0.81
7	ICICI Prudential Asset Management	0.73
8	Edelweiss Asset Management Ltd	0.72
9	BOI AXA investment Managers	0.50
10	Samsung Life Insurance Co Ltd	0.32

Source: Bloomberg

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## Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: [compliance@sharekhan.com](mailto:compliance@sharekhan.com);

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