

## Delay in client decision making impacting growth

**About the stock:** Mastek Ltd (Mastek) offers data, apps, cloud services to public & private enterprise in the UK, US, Middle East, Asia Pacific and India

- The company's recent acquisition of Evosys has enabled Mastek to provide end-to-end solutions and improves margins from ~14% to 21%
- Net debt free and healthy double digit return ratio (with RoCE of 20%)

**Q1FY23 Results:** Mastek reported muted Q1FY23 results.

- Dollar revenues declined by 4.7% QoQ to US\$73.6 million
- UK business declined by 3.9% QoQ due to pause in a key program of a large healthcare account
- Reported 12M order backlog of US\$191 mn, up by 4%QoQ in CC terms

**What should investors do?** Mastek's share price has grown by ~6.3x over the past five years (from ~₹ 328 in July 2017 to ~₹ 2,032 levels in July 2022).

- We maintain HOLD rating on the stock

**Target Price and Valuation:** We value Mastek at ₹ 2,000 i.e. 16x P/E on FY24E EPS

### Key triggers for future price performance:

- Growth in new logo acquisition, increasing deal size, expansion of sales & marketing and market share gains to drive revenues
- Management change in the US region may help it to grow stronger & achieve desired revenue mix
- Acquisition of MST solutions will help drive growth in US region
- Expect revenues to grow at 14.7% CAGR in FY22-24E

**Alternate Stock Idea:** Apart from Mastek, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth & healthy capital allocation prompt us to be positive.
- BUY with a target price of ₹ 1,745



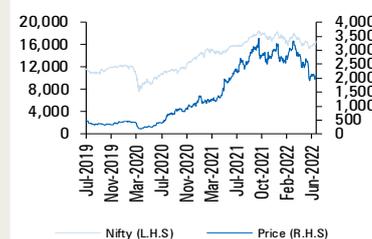
### Particulars

Particulars	Amount
Market Capitalization (₹ Crore)	5,776.9
Total Debt (₹ Crore)	190.3
Cash and Investments (₹ Crore)	781.9
EV (₹ Crore)	5,185.3
52 week H/L	3666/ 1851
Equity capital (₹ Crore)	15.0
Face value	5.0

### Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoters	37	38	37	37
FI	4	5	7	8
DII	8	7	7	6
Public	51	50	49	49

### Price Chart



### Recent Event & Key risks

- Pause in a key program of a large healthcare client
- Key Risk:** (i) US business ramp up higher than expected (ii) Slowdown in UK revenues

### Research Analyst

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## Key Financial Summary

₹ Crore	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Net Sales	1,072	1,722	2,184	31.3	2,442	2,871	14.7
EBITDA	155	364	463	57.0	464	546	8.6
EBITDA Margins (%)	14.5	21.2	21.2		19.0	19.0	
Net Profit	133	209	295	55.5	293	355	9.7
EPS (₹)	52	82	104		103	125	
P/E	38.8	24.8	19.6		19.7	16.3	
RoNW (%)	16.8	24.4	27.5		22.3	22.2	
RoCE (%)	11.3	21.5	26.7		23.3	23.4	

## Key takeaways of the quarter and conference call highlights

- The company reported flat growth of 0.1% QoQ growth in CC term while dollar revenue came in at US\$73.6mn, down by 4.7% QoQ. In rupee terms, revenue came in at ₹570.3 crore, down by 1.9% QoQ.
- The company indicated that the revenues were impacted by the following headwinds: i) currency impact of GBP/USD ii) pause in key program in a large healthcare client iii) slower than expected ramp ups iv) delayed decision making on high probability deals. The company also indicated that had factors i & ii would have not occurred, they could have posted 3-4% QoQ revenue growth.
- In terms of Geographies, UK market (67% of mix) declined by 3.9% QoQ while US market reported muted growth of 0.3% QoQ. ME region reported strong growth of 10.3% QoQ
- In terms of verticals, Government sector (40% mix) grew by 3.5% QoQ while retail/manufacturing grew by 4.8% & 3.4% respectively. Health & Financial services vertical reported a steep decline of 16.6% & 5.3% QoQ respectively.
- The company indicated that one of its key program in UK Healthcare, which it had been ramping up from last few quarters has been kept on pause due to a leadership change. The company indicated that it will take 2-3 quarters for this account to ramp up. It also indicated that the program is not cancelled but a temporary pause and was also applicable for other players. The company also indicated that apart from healthcare, it also works with UK government on various other mission critical projects consisting border and security etc. And large chunk of its business with the UK government falls in that category
- The company indicated that its EBITDA margin in Q1 was impacted by currency headwinds, supply side challenges & lower utilization. The company's EBITDA margins declined by 169bps to 19.2%. The company also indicated that the wage hike will be rolled out in Q2, despite that it is expected to reach EBITDA margins in the high teen range.
- The company maintained its aspiration to reach US\$1bn revenue mark in the second half of the decade which will be driven by both organic as well as inorganic route. In line with the same, it acquired MST Solutions (MST) a US based firm having a strong presence in verticals of Health, Hi-tech & Government at US\$76.6mn ( 2.6x Price to sales) . The acquisition in line with its earlier guidance of target companies with annual sales in the range of US\$20-40mn. The acquisition will be partly funded by debt and the company indicated it has already secured debt with costs of debt around 3.5%. The acquisition is in line with its strategy to scale up US business. The company also indicated that the margins of MST will be in similar range of that of Mastek
- The company indicated it has done restructuring of the US business where it looking to cut long tail of clients where the business is not scalable. As of result of the same the active client count has come down in Q1. The company also indicated that it won't hesitate to take similar call in future clients coming through acquisition to improve quality of revenues. The company also indicated that it has formed a 25/25 strategy to focus on Fortune 1000 clients, it added 2 Fortune 1000 clients bringing the total to 21.
- The company also indicated that it has qualified to bid for GBP 4 bn digital transformation framework by Home office in UK and with the kind of relationship it has with UK government, it is hopeful of some of the future deals coming its way.

**Exhibit 1: P&L**

	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
Revenue in USD mn	73.6	70.2	4.8	77.2	-4.7	Revenue dropped due to a) Currency impact of GBP/USD, b) pause in large healthcare client, c) slower than expected ramp up & d) delayed decision making on high probability deals
Revenue	570.3	516.5	10.4	581.5	-1.9	
Employee expense	308.8	257.2	20.0	291.2	6.0	
Gross Margin	261.5	259.3	0.9	290.3	-9.9	
Gross margin (%)	45.9	50.2	-434 bps	49.9	-406 bps	
other expense	152.3	146.5	4.0	169.6	-10.2	
EBITDA	109.2	112.8	-3.2	120.7	-9.5	
EBITDA Margin (%)	19.2	21.8	-268 bps	20.8	-169 bps	EBITDA margin was impacted by the following headwinds: GBP/USD currency impact, higher employee cost on account of supply side challenges & lower utilization, while it was mitigated was by decline in Other expenses
Depreciation & amortisation	11.1	9.7	13.9	12.2	-8.8	
EBIT	98.1	103.0	-4.8	108.5	-9.6	
EBIT Margin (%)	17.2	20.0	-274 bps	18.7	-145 bps	
Other income (less interest)	23.8	3.0	695.7	15.4	54.4	
PBT	121.9	106.0	15.0	123.9	-1.6	
Tax paid	37.6	25.8	45.5	35.7	5.2	
PAT	84.4	80.2	5.2	88.2	-4.4	

Source: Company, ICICI Direct Research

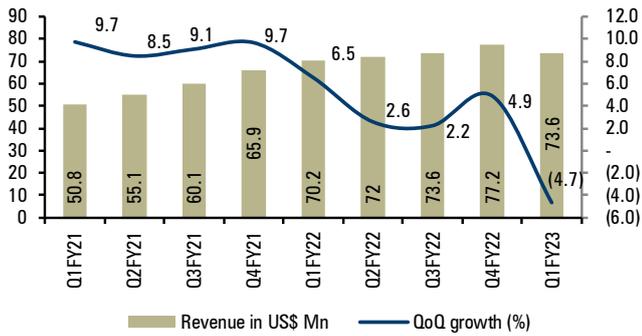
**Exhibit 2: Change in estimates**

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	2,575.2	2,442	-5.2	3,026	2,871	-5.1	Pause in key program in a large healthcare account and slower than expected ramp up in US region
EBITDA	522.8	464	-11.2	614	546	-11.2	
EBITDA Margin (%)	20.3	19.0	-130 bps	20.3	19.0	-130 bps	Aligned as per management guidance
PAT	333	293	-12.1	402	355	-11.7	
EPS (₹)	117.1	102.9	-12.1	141.4	124.9	-11.7	

Source: Company, ICICI Direct Research

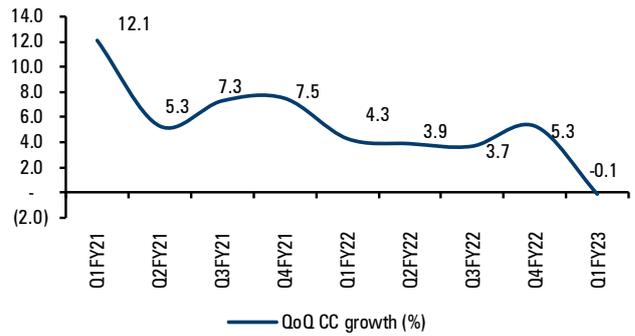
## Key Metrics

**Exhibit 3: Revenue in US\$ million with QoQ growth**



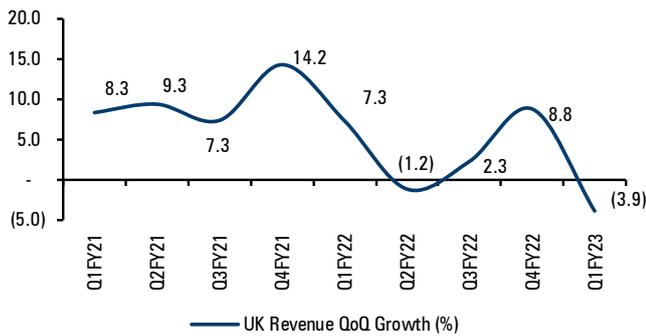
Source: Company, ICICI Direct Research

**Exhibit 4: QoQ CC growth**



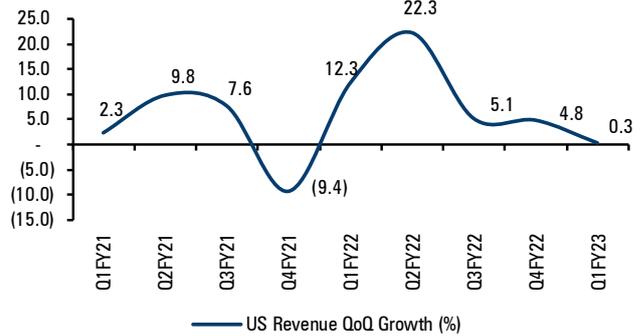
Source: Company, ICICI Direct Research

**Exhibit 5: UK QoQ Revenue growth**



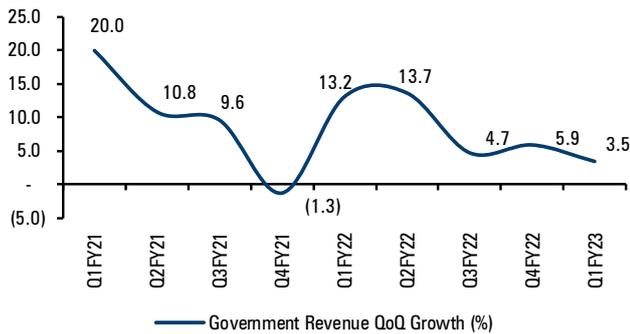
Source: Company, ICICI Direct Research

**Exhibit 6: US QoQ Revenue growth**



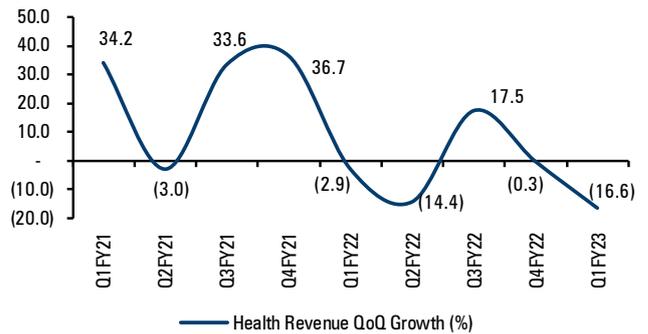
Source: Company, ICICI Direct Research

**Exhibit 7: Government QoQ Revenue growth**



Source: Company, ICICI Direct Research

**Exhibit 8: Health QoQ Revenue growth**



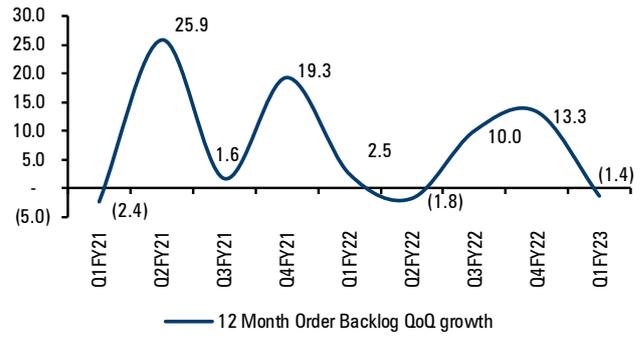
Source: Company, ICICI Direct Research

Exhibit 9: 12-month order backlog



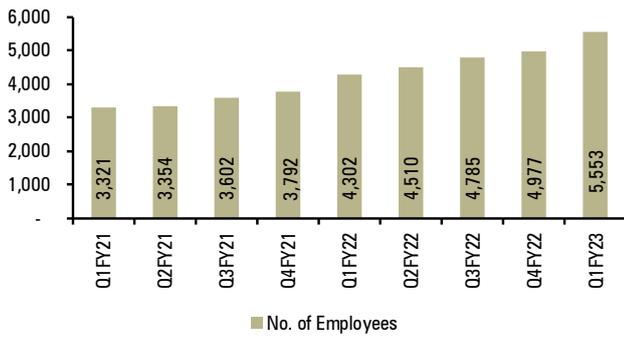
Source: Company, ICICI Direct Research

Exhibit 10: 12 month order backlog QoQ growth



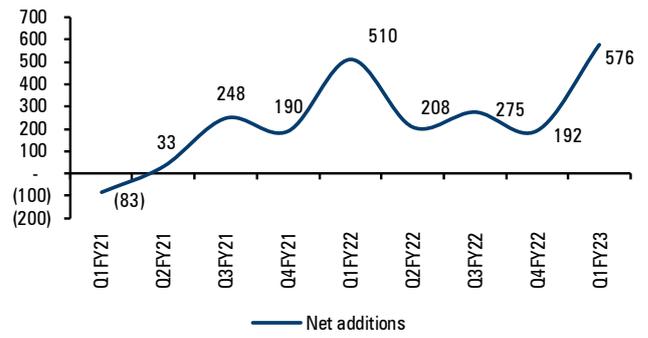
Source: Company, ICICI Direct Research

Exhibit 11: No. of employees



Source: Company, ICICI Direct Research

Exhibit 12: Net additions



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 13: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Net Sales</b>	<b>1,722</b>	<b>2,184</b>	<b>2,442</b>	<b>2,871</b>
Growth (%)	61	27	12	18
COGS (employee expenses)	883	1,095	1,294	1,522
Other expenses	475	626	684	804
Total Operating Expenditure	1,357	1,721	1,978	2,326
<b>EBITDA</b>	<b>364</b>	<b>463</b>	<b>464</b>	<b>546</b>
Growth (%)	135	27	0	18
Depreciation	45	43	67	79
Net Other Income	20	28	67	95
PBT	339	448	464	562
Total Tax	88	115	125	152
Exceptional item	-	-	-	-
<b>Adjusted PAT</b>	<b>209</b>	<b>295</b>	<b>293</b>	<b>355</b>
Growth (%)	57	41	(1)	21
Adjusted EPS (₹)	81.9	103.8	102.9	124.9

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Profit before tax</b>	<b>252</b>	<b>333</b>	<b>418</b>	<b>507</b>
Add: Depreciation	45	43	67	79
(Inc)/dec in Current Assets	(60)	(175)	(88)	(146)
Inc/(dec) in CL and Provisions	8	66	127	211
Taxes paid	(48)	(109)	(125)	(152)
<b>CF from operating activities</b>	<b>287</b>	<b>273</b>	<b>363</b>	<b>444</b>
(Inc)/dec in Inv. (+) Int inc (+) Goodw	439	464	75	103
(Inc)/dec in Fixed Assets	(258)	(484)	(37)	(43)
<b>CF from investing activities</b>	<b>181</b>	<b>(20)</b>	<b>38</b>	<b>60</b>
Issue/(Buy back) of Equity	8	2	-	-
Dividend paid & dividend tax	(15)	(48)	(53)	(64)
Others	(100)	(75)	8	8
<b>CF from financing activities</b>	<b>(118)</b>	<b>(128)</b>	<b>(57)</b>	<b>(68)</b>
Net Cash flow	371	119	344	436
Exchange difference	20	(6)	-	-
Opening Cash	221	608	727	1,071
<b>Closing Cash</b>	<b>608</b>	<b>727</b>	<b>1,071</b>	<b>1,506</b>

Source: Company, ICICI Direct Research

Exhibit 15: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Liabilities</b>				
Equity Capital	13	15	15	15
Reserve and Surplus	846	1,056	1,296	1,587
Total Shareholders funds	859	1,071	1,311	1,602
Minority interest	182	150	196	251
Total Debt	241	190	190	190
Other liabilities	333	294	328	386
<b>Total Liabilities</b>	<b>1,614</b>	<b>1,706</b>	<b>2,026</b>	<b>2,430</b>
<b>Assets</b>				
Total Fixed Assets	804	841	823	799
Investments	41	52	52	52
Other non current assets	80	79	80	82
Debtors	375	436	487	573
Loans and Advances	3	-	-	-
Cash & investments	806	782	1,125	1,561
Other current assets	186	298	333	391
Total Current Assets	1,370	1,515	1,945	2,525
Current liabilities	658	755	844	992
Provisions	23	28	31	37
Total Current Liabilities	681	783	875	1,029
Net Current Assets	689	733	1,070	1,496
<b>Application of Funds</b>	<b>1,614</b>	<b>1,706</b>	<b>2,026</b>	<b>2,430</b>

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios				
	₹ crore			
	FY21	FY22	FY23E	FY24E
<b>Per share data (₹)</b>				
EPS	81.9	103.8	102.9	124.9
Cash EPS	103.2	122.0	129.9	156.6
BV	335.8	376.8	461.3	563.6
DPS	14.5	19.0	18.5	22.5
Cash Per Share	239.9	262.4	386.4	543.6
<b>Operating Ratios (%)</b>				
EBITDA Margin	21.2	21.2	19.0	19.0
PBT Margin	19.7	20.5	19.0	19.6
PAT Margin	12.2	13.5	12.0	12.4
Inventory days	-	-	-	-
Debtor days	79	73	73	73
Creditor days	35	28	28	28
<b>Return Ratios (%)</b>				
RoE	24.4	27.5	22.3	22.2
RoCE	21.5	26.7	23.3	23.4
RoIC	39.5	45.4	44.1	53.7
<b>Valuation Ratios (x)</b>				
P/E	24.8	19.6	19.7	16.3
EV / EBITDA	14.3	11.2	10.4	8.1
EV / Net Sales	3.0	2.4	2.0	1.5
Market Cap / Sales	3.4	2.6	2.4	2.0
Price to Book Value	5.8	5.3	4.3	3.5
<b>Solvency Ratios</b>				
Debt/EBITDA	0.7	0.4	0.4	0.3
Debt / Equity	0.3	0.2	0.1	0.1
Current Ratio	0.8	0.9	0.9	0.9
Quick Ratio	0.8	0.9	0.9	0.9

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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