



Powered by the Sharekhan 3R Research Philosophy

3R MATRIX			
	+	=	-
Right Sector (RS)	Green	Grey	Orange
Right Quality (RQ)	Green	Grey	Orange
Right Valuation (RV)	Green	Grey	Orange
+ Positive	= Neutral	- Negative	

What has changed in 3R MATRIX

	Old	New
RS	Green	Grey
RQ	Green	Grey
RV	Grey	Grey

ESG Disclosure Score NEWESG RISK RATING 21.77

Updated Oct 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

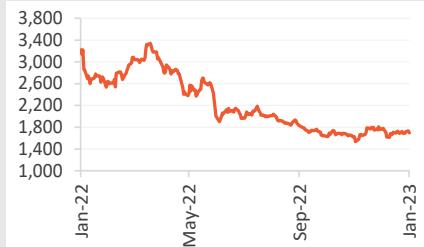
Company details

Market cap:	Rs. 5,099 cr
52-week high/low:	Rs. 3,411 / 1492
NSE volume:	0.87 lakh
(No of shares)	
BSE code:	523704
NSE code:	MASTEK
Free float:	1.9 cr
(No of shares)	

Shareholding (%)

Promoters	37.3
FII	13.0
DII	3.7
Others	46.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.9	3.8	-13.7	-47.3
Relative to Sensex	-2.8	-0.0	-26.6	-46.3

Sharekhan Research, Bloomberg

Mastek Ltd

Weak Q3; Maintain Hold

IT & ITES		Sharekhan code: MASTEK	
Reco/View:	Hold	CMP: Rs. 1,696	Price Target: Rs. 1,900
↑	Upgrade	↔	Maintain

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Mastek reported Q3FY23 revenue of \$80.1 million, up 3.1% q-o-q in CC missing our estimates by ~70 bps affected by furloughs and seasonality while EBITDA margin at 17.3% was broadly in line with estimates.
- MST Solutions' revenues in Q3FY23 were higher than \$10 million exceeding management expectations of \$9.5 million. The US market's share in the overall business mix rose from 18.5% in Q3FY22 to 27.5% Q3FY23 aided by MST Solutions. Management has a fairly strong outlook on MST Solutions in CY23.
- The management cited continuous cautiousness with certain customers and markets and expressed that cost optimisation and efficiencies were now a key part of conversation. While client budgets have not been reduced, the company is observing that clients are breaking down some large deals into smaller chunks.
- Although the order backlog is strong, the outlook for FY24E looks uncertain on account of global headwinds with gradual recovery in the coming quarters. We believe the structural growth story for the Indian IT sector remains intact. Hence, we maintain a Hold rating on Mastek with an unchanged PT of Rs. 1,900.

Mastek reported Q3Y23 revenue of \$80.1 million, up 3.1% q-o-q in constant currency missing our estimates by ~ 70 bps affected by furloughs and seasonality. Revenues at Rs 687.5 crore was up by 19.3 % on YoY basis and up 5.3% q-o-q. EBITDA margin at 17.3% was broadly in-line with estimates on account of easing of supply-side pressures and currency impact. Adjusted net profit stood at Rs 64.2 crore down 12.3% y-o-y. Key market Europe witnessed de-growth of 2.6%.q-o-q with greater softness in Europe outside of UK due to slowdown and delays. During Q3FY23, growth momentum continued, with the Financial Services growing 10.7% q-o-q while Healthcare rebounded growing 11.5% q-o-q. Growth moderated for Manufacturing, Government & Education growing 5.2% and 0.4% q-o-q, respectively. MST Solutions revenues in Q3FY23 were higher than 10 million exceeding management expectations of 9.5million. Management has fairly a strong outlook on MST Solutions in CY23. The management cited continuous cautiousness with certain customers and certain markets and expressed that cost optimisation and efficiencies were now a key part of conversation. While client budgets have not been reduced, the company is observing that clients are breaking down some large deals into smaller chunks. 12 months order backlog was Rs 1,705.8 crore, up 12.1% q-o-q and 5.3% q-o-q in constant currency. Although the order backlog for Mastek is strong, the outlook for FY24E looks uncertain on account of global headwinds with gradual recovery in the coming quarters. We believe the structural growth story for the Indian IT sector remains intact. Hence, we maintain a Hold rating on Mastek with unchanged PT of Rs. 1,900.

Key positives

- MST Solutions revenues in Q3FY23 were higher than 10 million exceeding management expectations of 9.5million
- LTM Attrition moderated to 23.3% in Q3FY23 from 24.2% in Q2FY23 declining 90 bps q-o-q
- Twelve-month order backlog was Rs 1,705.8 crore, up 12.1% q-o-q and 5.3% q-o-q in constant currency

Key negatives

- Retail/consumer vertical witnessed 8.5% degrowth q-o-q mainly on account of furloughs
- Net reduction of 123 employees taking the headcount to 5687

Management Commentary

- Management cited continuous cautiousness with certain customers and certain markets and expressed that cost optimisation and efficiencies were now a key part of conversation. While client budgets have not been reduced, the company is observing that clients are breaking down some large deals into smaller chunks. Management believes this is an interesting proposition as Mastek could achieve market share gains.
- MST Solutions' revenues in Q3FY23 were higher than 10 million exceeding management expectations of 9.5million. Management has fairly a strong outlook on MST Solutions in CY23.
- Management expects a turnaround in UK Government and NHS deals, and expect recent transformational M&A (mergers and acquisitions) to broaden growth drivers and improve client mining.

Revision in estimates – We have fine-tuned our revenue/margin estimates for FY23/24/25 owing to macro headwinds and INR-USD reset.

Our Call

Valuation – Weak Q3, Maintain Hold: Although the order backlog for Mastek is strong, the outlook for FY24E looks uncertain on account of global headwinds with a gradual recovery in the coming quarters. We believe the structural growth story for the Indian IT sector remains intact. Hence, we maintain a Hold rating on Mastek with unchanged PT of Rs. 1,900.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures, and/or constraints in local talent supply in the US would affect earnings.

Valuation (Consolidated)

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	2,183.8	2,515.6	2,657.1	3,065.2
OPM (%)	21.2	18.1	18.6	18.6
Adjusted PAT	295.1	280.7	334.3	396.0
% y-o-y growth	41.0	-4.9	19.1	18.5
Adjusted EPS (Rs.)	103.4	91.4	107.8	126.5
P/E (x)	16.4	18.5	15.7	13.4
P/B (x)	4.5	4.1	3.4	2.9
EV/EBITDA (x)	9.6	9.1	7.9	6.3
RoNW (%)	30.6	23.8	23.7	23.5
RoCE (%)	27.5	24.4	23.4	24.2

Source: Company; Sharekhan estimates

Key results highlights

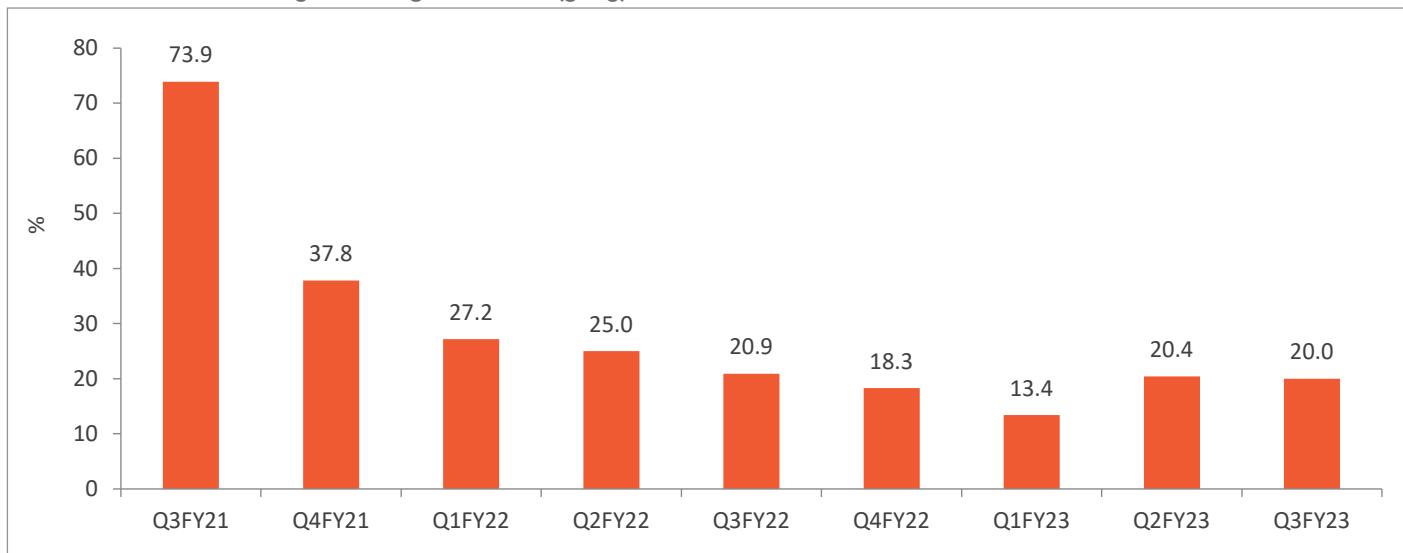
- ♦ **MST Solutions accelerating business in US:** The share of the US in the overall business mix has moved from 18.5% in Q3FY22 to 27.5% Q3FY23 aided by MST solutions. MST Solutions' revenues in Q3FY23 were higher than \$10 million exceeding management expectations of \$9.5 million. Management has fairly a strong outlook on MST Solutions in CY23.
- ♦ **12-month order backlog:** 12 months order backlog was Rs 1,705.8 crore (\$206.2 mn) as on December 31, 2022 as compared to Rs 1,522.0 crore (\$187.1 mn) in Q2FY23, reflecting a growth of 12.1% in rupee terms and 5.3% in CC terms on q-o-q basis and Rs 1,271.3 crore (\$171.0 mn) in Q3FY22, reflecting growth of 34.2% in rupee terms and 29.7% in constant currency terms on y-o-y basis.
- ♦ **Demand environment:** The management cited continuous cautiousness with certain customers and certain markets and expressed that cost optimisation and efficiencies were now a key part of conversation. While client budgets have not been reduced, the company is observing that clients are breaking down some large deals into smaller chunks. The management believes this is an interesting proposition as Mastek could achieve market share gains.
- ♦ **Trends across markets:** Middle East continued to grow steadily growing 7.2% q-o-q while growth moderated in US by 0.2% q-o-q. Key market Europe witnessed a decline of 2.6% q-o-q with greater softness in Europe outside of UK due to slowdown and delays. Large spends seen in Saudi and UAE in healthcare and financial services sector.
- ♦ **Trends on verticals:** During Q3FY23, growth momentum continued in Financial Services growing 10.7% q-o-q while healthcare rebounded growing 11.5% q-o-q. Growth moderated for Manufacturing, Government & education growing 5.2% and 0.4% q-o-q respectively while Retail/Consumer declined 8.5% q-o-q mainly on account of furloughs. Healthcare strategy is playing out, particularly in US.
- ♦ **New accounts added:** The Company added 31 new clients in Q3FY23. Total active clients during Q3FY23 was 444 as compared to 449 in Q2FY23.
- ♦ **Headcount falls, attrition moderates:** Net reduction of 123 employees taking the headcount to 5687. LTM attrition rate at 23.3% moderated by 90 bps q-o-q in Q2FY23. The management intends to continue hiring freshers as it wants to keep right resources given higher deal pipeline and order backlog.
- ♦ **Strategic acquisition:** Mastek made a strategic investment in Volteo Edge, an edge Intelligence SaaS Company in the Connected Enterprise Space and ServiceNow ecosystem.
- ♦ **Cash balance:** The total cash, cash equivalents and fair value of Mutual Funds stood at Rs 324.9 crore as on December 31, 2022 as compared to Rs. 351.6 crore at the end of September 30, 2022. DSO was higher at 98 due to delay in collection on account of holiday season.

Results (consolidated)

Particulars	Q3FY23	Q3FY22	Q2FY23	YoY (%)	QoQ (%)
Revenues In USD (mn)	80.1	73.6	78.1	8.9	2.6
Derived exch. rate (Rs/US\$)	82.2	75.0	80.1	9.6	2.7
Revenues In INR	658.7	551.9	625.3	19.3	5.3
Employee benefits expense	346.4	273.2	340.0	26.8	1.9
Other expenses	198.6	162.5	177.9	22.2	11.6
EBITDA	113.7	116.2	107.4	-2.2	5.9
Depreciation & amortization	19.6	10.6	17.1	85.7	14.6
EBIT	94.1	105.7	90.3	-10.9	4.2
Other Income	6.0	5.7	6.9	5.1	-12.7
Finance costs	8.2	1.6	5.3	415.0	57.0
PBT	91.9	109.8	92.0	-16.3	-0.1
Tax Provision	24.8	26.4	31.1	-6.0	-20.3
PAT	67.1	83.5	60.9	-19.6	10.2
Minority interest	-2.9	-9.8	-7.1		
EO	0.0	0.0	25.3		
Net profit	64.2	73.6	79.1	-12.8	-18.9
Adjusted net profit	64.2	73.6	53.8	-12.8	19.3
EPS (Rs)	20.9	24.2	25.8	-13.5	-19.0
Margin (%)					
EBITDA	17.3	21.1	17.2	-380	9
EBIT	14.3	19.1	14.4	-486	-15
NPM	9.7	13.3	8.6	-360	114
Tax rate	27.0	24.0	33.8	296	-683

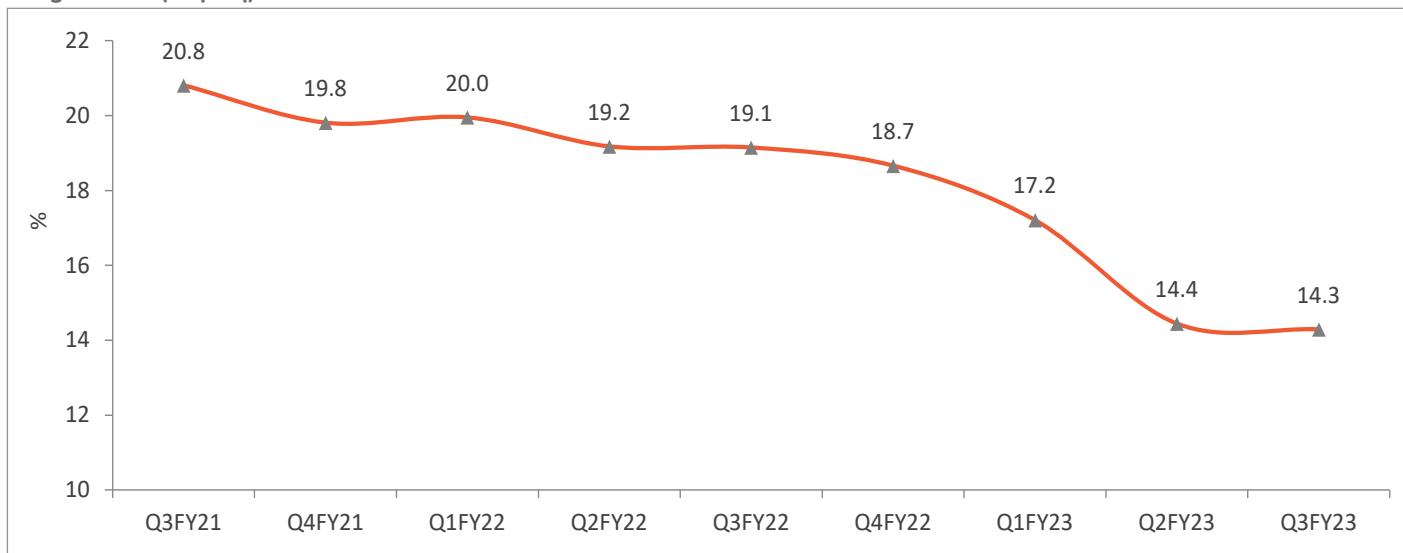
Source: Company, Sharekhan Research

Mastek's constant-currency revenue growth trend (y-o-y)



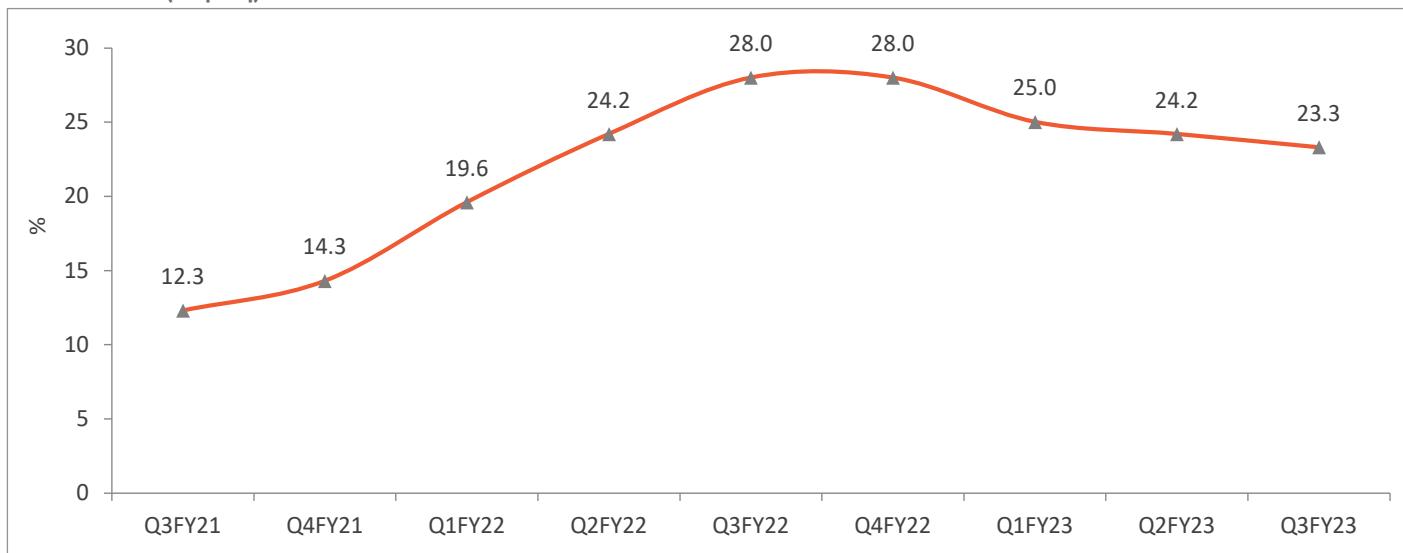
Source: Company, Sharekhan Research

Margin trend (% q-o-q)



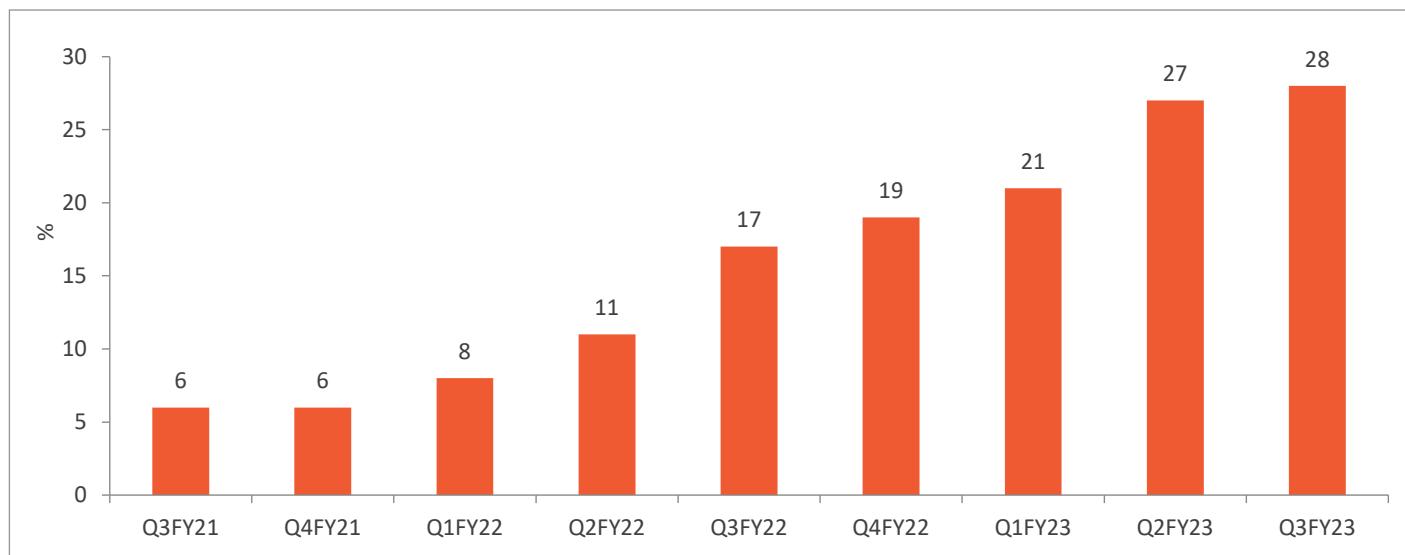
Source: Company, Sharekhan Research

Attrition trend (% q-o-q)



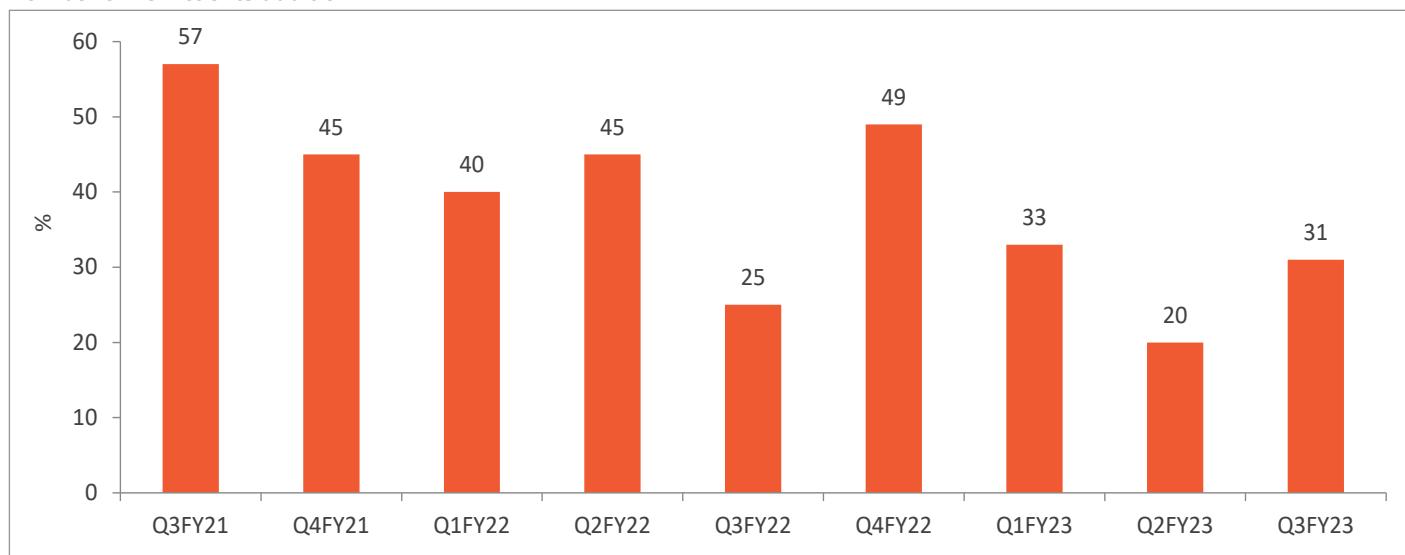
Source: Company, Sharekhan Research

Number of Fortune 1000 clients



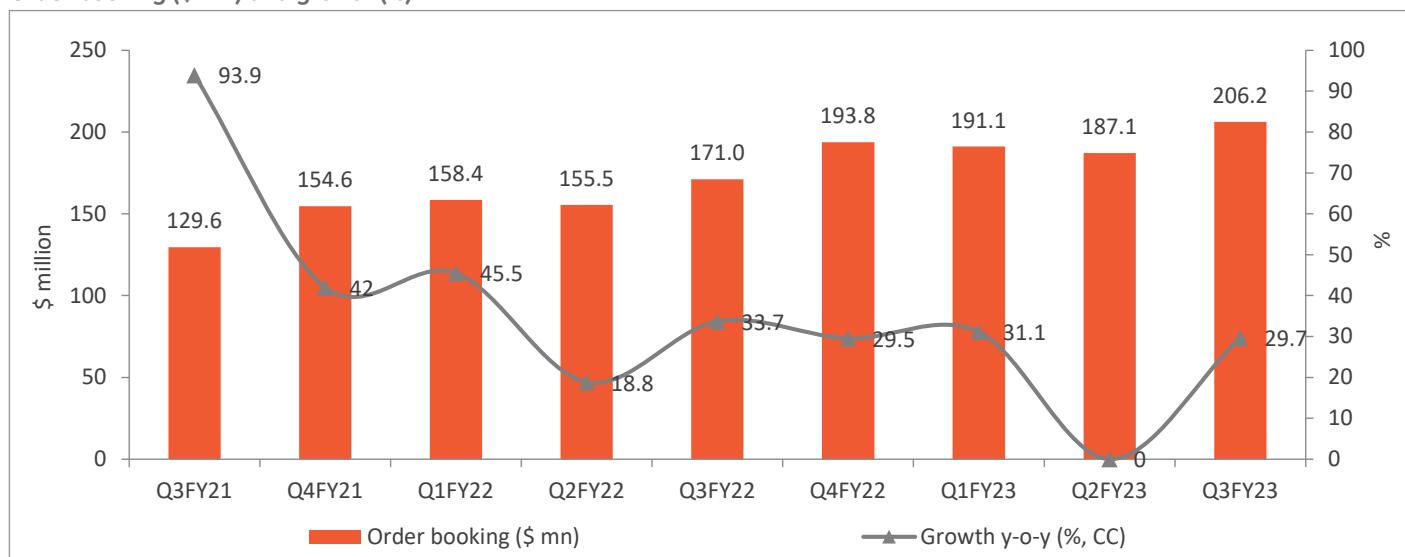
Source: Company, Sharekhan Research

Number of new clients addition



Source: Company, Sharekhan Research

Order booking (\$ mn) and growth (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

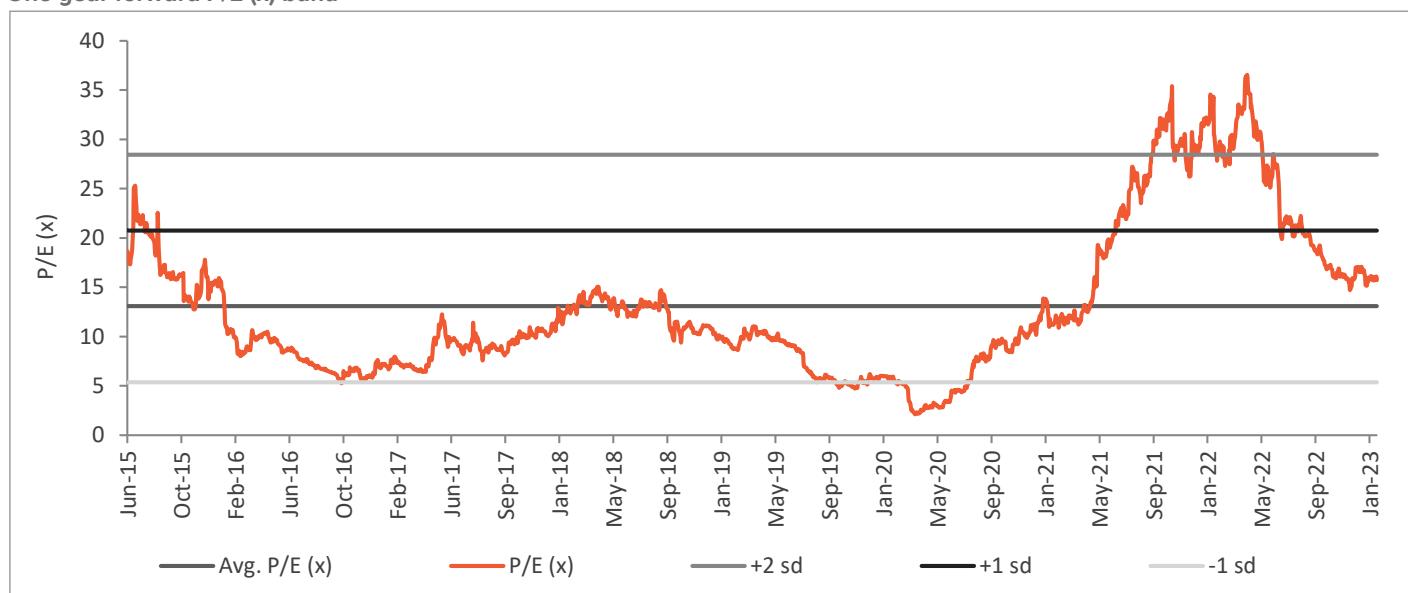
■ Company outlook - Long-term outlook intact

Mastek has created a consistent and predictable revenue stream from the UK's public sector over the past few years, thanks to the introduction of Digital Outcomes and Specialists (DoS) framework by the UK government (replacement of Digital Services-2 framework in 2016). Management indicated that revenue growth momentum in the UK public sector would continue in the coming quarters on account of higher spends on digital-transformation initiatives by UK government sector and addition of logos. Further, growth momentum in the US business is expected to accelerate because of strong demand for its integrated digital commerce solutions, increasing deal size, and new client additions.

■ Valuation - Weak Q3, Maintain Hold

Although the order backlog for Mastek is strong, the outlook for FY24E looks uncertain on account of global headwinds with gradual recovery in the coming quarters. We believe the structural growth story for the Indian IT sector remains intact. Hence, we maintain a Hold rating on Mastek with unchanged PT of Rs. 1900.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Established in 1982, Mastek provides IT services to five verticals – government (mostly caters to the UK government), retail, health, financial, and others. 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 and financial 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 and Europe, as 67.1% of its revenue comes from this region, followed by the US/ME/RoW with contribution to total revenue of 18.8%/9.2%/4.9%, respectively. During February 2020, the company acquired Evolutionary Systems (Evosys) through its subsidiaries, which provided access to new geographies as well as fast-growing segments.

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 12 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) Rupee appreciation and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

Hiral Chandrana	Global CEO
Abhishek Singh	President UK and Europe
Umang Nahata	President Americas and AMEA
Narasimha Murthy	Group Chief Delivery Officer
Arun Agarwal	Group CFO

Source: Company

Top shareholders

Sr. No.	Holder Name	Holding (%)
1	The Vanguard Group Inc.	2.32
2	ABAKKUS GROWTH FUND	2.31
3	ABAKKUS Emerging opportunity fund	1.88
4	Dimensional Fund Advisors LP	0.70
5	BlackRock Inc.	0.57
6	IDFC Mutual Fund/India	0.23
7	Edelweiss Asset Management Limited	0.20
8	ICICI Prudential Asset Management	0.20
9	HSBC Asset Management	0.12

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 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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