



Powered by the Sharekhan 3R Research Philosophy

Mastek Ltd

Decent Q4; Maintain Hold

IT & ITES

Sharekhan code: MASTEK

Reco/View: Hold

CMP: Rs. 1,585

Price Target: Rs. 1,740

Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey with check	Red
Right Quality (RQ)	Green with check	Grey	Red
Right Valuation (RV)	Green	Grey with check	Red
	+ Positive	= Neutral	- Negative

What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Grey	↔	Grey

ESG Disclosure Score **NEW**

ESG RISK RATING
Updated Mar 08, 2023 **21.77**

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 4,837 cr
52-week high/low:	Rs. 3,000/1475
NSE volume: (No of shares)	0.58 lakh
BSE code:	523704
NSE code:	MASTEK
Free float: (No of shares)	1.9 cr

Shareholding (%)

Promoters	37.3
FII	13.3
DII	3.9
Others	45.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.6	-6.7	-3.1	-43.6
Relative to Sensex	-6.3	-4.6	-3.9	-49.1

Sharekhan Research, Bloomberg

Summary

- Mastek reported strong constant currency (CC) revenue growth of 5.3% q-o-q, beating our estimates of 1.8% cc revenue growth led by strong in-quarter execution and demand for Digital Engineering, Experience, and Cloud Transformation services.
- EBITDA margin improved 44 bps q-o-q to 17.7% but was slightly below our estimates of 17.9% driven by cost-optimization focus but was offset by higher employee costs. 12 months order backlog was Rs 1,794.1 crore (\$218.3mn), up 5.2% in rupee terms and 4.1% in constant currency terms on q-o-q basis.
- With respect to US, the management mentioned that they have not seen any ramp down of new projects but admitted that they are seeing longer decision cycles. The management believes this trend is likely to stay for at least 2-3 quarters.
- We believe the outlook for FY24 looks uncertain in the near term given the incrementally deteriorating macro environment. Hence despite a decent quarter and strong order backlog, we maintain a Hold rating on Mastek with a revised PT of Rs. 1,740 as sustaining the momentum amidst uncertainty would be challenging. At CMP, the stock trades at 15.6x its FY2024E EPS and 13.2 its FY2025E EPS.

Mastek reported strong constant currency (CC) revenue growth of 5.3% q-o-q, beating our estimates of 1.8% cc revenue growth led by strong in-quarter execution and demand for Digital Engineering, Experience, and Cloud Transformation services. Revenue growth was aided by higher working days and currency movement during Q4. Revenues at Rs 709.2 crore was up by 22% on y-o-y basis and up 7.7% q-o-q. EBITDA margin improved 44 bps q-o-q to 17.7% but slightly below our estimates (17.9%) driven by cost-optimization focus but was offset by higher employee costs. Net profit came at Rs. 72.6 crore (up 13.1% q-o-q) and was 8.7% below our estimates owing to lower other income. 12-month order backlog was Rs 1,794.1 crore (\$218.3mn) as compared to Rs 1,705.8 crore (\$206.2 million) in Q3FY23, reflecting a growth of 5.2% in rupee terms and 4.1% in constant currency terms on Q-o-Q basis. Key market Europe witnessed strong growth, up 10.5% q-o-q while the third largest market, Middle East continued to grow steadily growing 8% q-o-q. However, softness was reflected in US which recorded flatish growth during the quarter. During Q4FY23, growth momentum was led by Government & Education, Financial Services and Healthcare which grew 11.9% / 10.7% and 6.4% q-o-q respectively. LTM attrition rate at 21% moderated by 230 bps q-o-q. Utilisation (%) (including trainees) improved to 73.8% from 69.3% in Q3FY23, up 450 bps. The management cited that in the UK while the environment is volatile the secure government services and core public sector service business is still resilient. With respect to US, the management mentioned that they have not seen any ramp down of new projects but admitted that they are seeing longer decision cycles. The management believes this trend is likely to stay for at least two to three quarters. We believe the outlook for FY24 looks uncertain in the near term given the incrementally deteriorating macro environment owing to the recent developments in its key Europe and US markets. Hence despite a decent quarter and strong order backlog we maintain a Hold rating on Mastek with a revised PT of Rs. 1,740 as sustaining the momentum amidst uncertainty would be challenging. At the CMP the stock trades at 15.6x its FY2024E EPS and 13.2 its FY2025E EPS.

Key positives

- Utilisation (%) (including trainees) improved to 73.8% from 69.3% in Q3FY23, up 450 bps.
- Contribution from Top 5 Clients improved by 150 bps to 29.6% from 28.1% q-o-q.
- LTM Attrition moderated to 21% in Q4FY23 from 23.3% in Q3FY23 declining 230 bps q-o-q.
- Twelve-month order backlog was Rs 1,794.1 crore, up 5.2% q-o-q in rupee terms and 4.1% q-o-q in constant currency.

Key negatives

- Net reduction of 65 employees taking the headcount to 5622.
- Cash and Cash equivalents dropped to Rs 270 crore from Rs 324.9 crore in Q3FY23.

Management Commentary

- Management highlighted that they are continuing to diversify and see larger deals and opportunities in the areas where they are good which includes Oracle cloud, Salesforce business and UK public sector digital engineering business.
- The management stated that they have made some strong hiring not just at the leadership level but also at the account level and even the domain level in some cases. The capability investments that they have made will help them to position themselves better going forward in addition to getting the right people.
- Mastek cited that there is room for EBITDA margin improvement through different levers like utilization, subcon etc. They highlighted that they are comfortable with the 18% range and stated that they would look at improving the EBITDA margin to the 19-20% range. The management stated that they are looking at achieving growth some couple of percentage points above the industry growth.

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

Our Call

Valuation – Decent Q4, Maintain Hold: We believe the outlook for FY24 looks uncertain in the near term given the incrementally deteriorating macro environment owing to the recent developments in its key Europe and US markets. Hence despite a decent quarter and strong order backlog we maintain a Hold rating on Mastek with a revised PT of Rs. 1,740 as sustaining the momentum amidst uncertainty would be challenging. At the CMP the stock trades at 15.6x its FY2024E EPS and 13.2 its FY2025E EPS.

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	FY23	FY24E	FY25E
Revenue	2,183.8	2,563.4	2,735.1	3,004.5
OPM (%)	21.2	17.8	18.0	18.5
Adjusted PAT	295.1	267.7	318.0	378.6
% YoY growth	41.0	-9.3	18.8	19.1
Adjusted EPS (Rs)	103.4	86.6	101.9	120.2
P/E (x)	15.3	18.3	15.6	13.2
P/B (x)	4.2	2.9	2.6	2.3
EV/EBITDA	9.2	10.8	9.8	8.3
ROE (%)	30.6	19.4	17.6	18.3
ROCE (%)	27.3	20.3	16.8	18.0

Source: Company; Sharekhan estimates

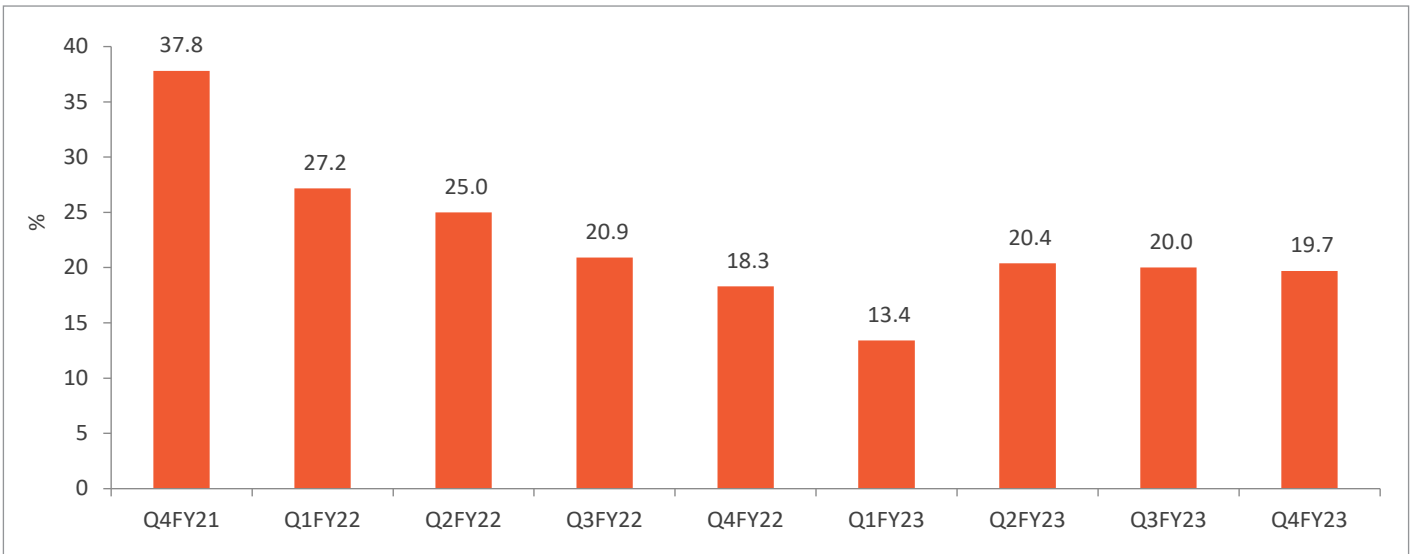
Key results highlights

- ◆ **12-month order backlog:** 12 months order backlog at the end of Q4FY23 stood at Rs 1,794.1 crore (\$218.3mn) as compared to Rs 1,705.8 crore (\$206.2 mn) in Q3FY23, reflecting a growth of 5.2% in rupee terms and 4.1% in CC terms q-o-q and Rs 1,469.1 crore (\$193.8 million) in Q4FY22, reflecting growth of 22.1% in rupee terms and 17.2% in constant currency terms on y-o-y basis
- ◆ **Demand environment:** The management cited that in the UK while the environment is volatile the secure government services and core public sector service business is still resilient. Also, they stated that they have been helped by the higher number of working days and currency movement in Q4. With respect to US, the management mentioned that they have not seen any ramp down of new projects but admitted that they are seeing longer decision cycles. The management believes this trend is likely to stay for at least 2-3 quarters.
- ◆ **Trends across markets:** Key market Europe witnessed strong growth, up 10.5% q-o-q while the third largest market, Middle East continued to grow steadily growing 8% q-o-q. However, softness was reflected in US, which recorded flattish growth during the quarter.
- ◆ **Trends on verticals:** During Q4FY23, growth momentum was led by Government & Education, Financial Services and Healthcare which grew 11.9% / 10.7% and 6.4% q-o-q respectively while Manufacturing and Retail/Consumer saw muted growth growing 3.7% and 0.1% q-o-q respectively.]
- ◆ **New accounts added:** The company added 28 new clients in Q4FY23. Total active clients during Q4FY23 were 464 as compared to 444 in Q3FY23.
- ◆ **Attrition moderates, Utilisation improves:** Net reduction of 65 employees taking the headcount to 5622. LTM attrition rate at 21% moderated by 230 bps q-o-q. Utilisation (%) (including trainees) improved to 73.8% from 69.3% in Q3FY23, up 450 bps.
- ◆ **Cash balance:** The total cash, cash equivalents and fair value of Mutual Funds stood at Rs 270 crore as on March 31, 2023 as compared to Rs. 324.9 crore at the end of December 31, 2022. DSO improved in Q4FY23 to 93 compared to 98 days in Q3FY23 . The company completed second tranche buyout of CCPS during the quarter.

Results (consolidated)					Rs cr	
Particulars	Q4FY23	Q4FY22	Q3FY23	YoY (%)	QoQ (%)	
Revenues In USD (mn)	86.3	77.2	80.1	11.7	7.7	
Revenues In INR	709.2	581.5	658.7	22.0	7.7	
Employee benefits expense	380.7	291.2	346.4	30.7	9.9	
Other expenses	202.9	169.6	198.6	19.6	2.2	
EBITDA	125.5	120.7	113.7	4.0	10.4	
Depreciation & amortization	19.6	12.2	19.6	61.2	0.1	
EBIT	105.9	108.5	94.1	-2.4	12.5	
Other Income	-0.4	17.9	6.0	-102.3	-106.8	
Finance costs	9.3	2.5	8.2	267.5	12.4	
PBT	96.3	123.9	91.9	-22.3	4.7	
Tax Provision	23.7	35.7	24.8	-33.7	-4.6	
PAT	72.6	88.2	67.1	-17.7	8.1	
Minority interest	0.0	-8.3	-2.9			
EO	0.0	0.0	0.0			
Net profit	72.6	79.9	64.2	-9.2	13.1	
Adjusted net profit	72.6	79.9	64.2	-9.2	13.1	
EPS (Rs)	23.5	26.1	20.9	-10.0	12.3	
Margin (%)						
EBITDA	17.7	20.8	17.3	-305	44	
EBIT	14.9	18.7	14.3	-373	65	
NPM	10.2	13.7	9.7	-351	49	
Tax rate	24.6	28.8	27.0	-423	-239	

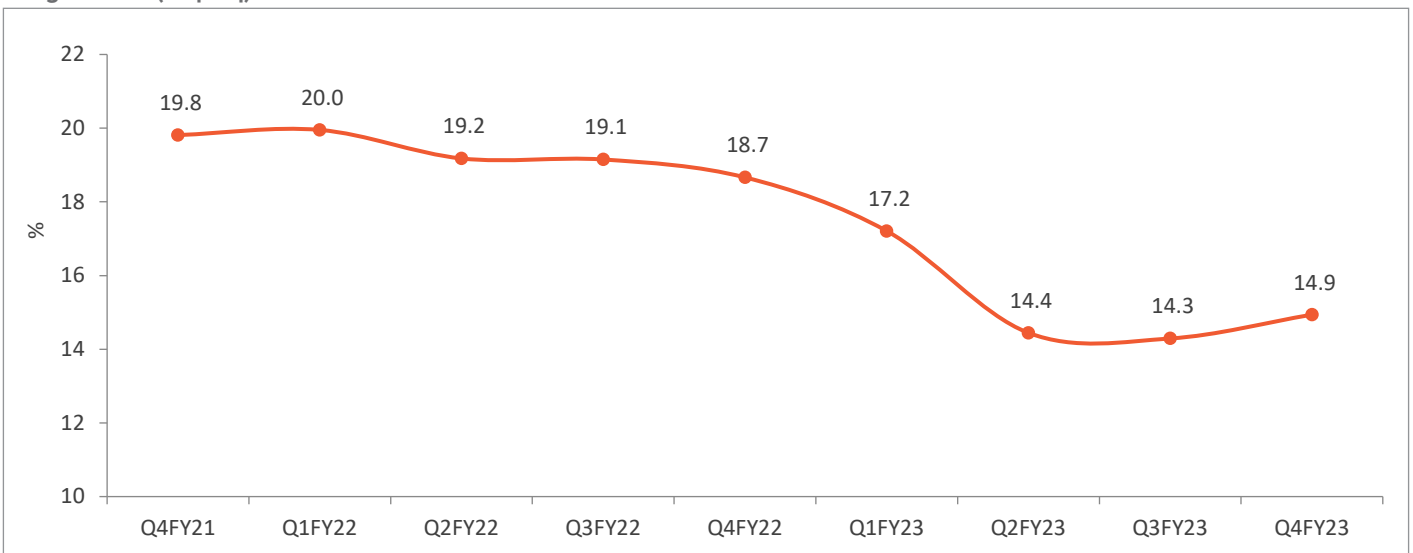
Source: Company, Sharekhan Research

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



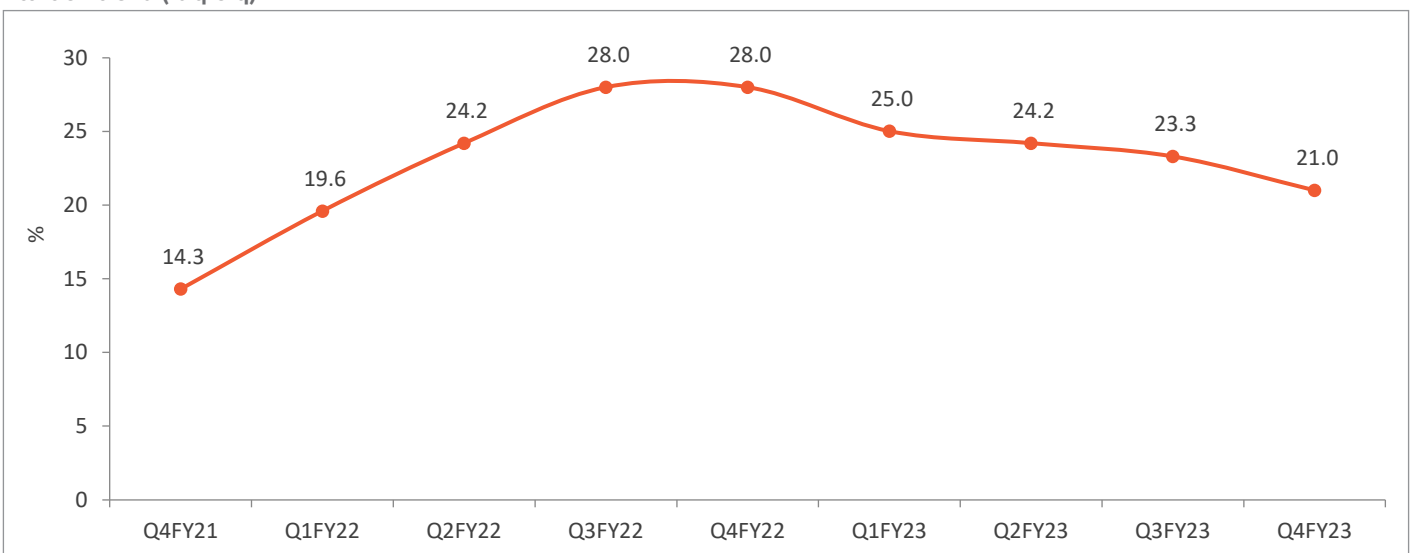
Source: Company, Sharekhan Research

Margin trend (% q-o-q)



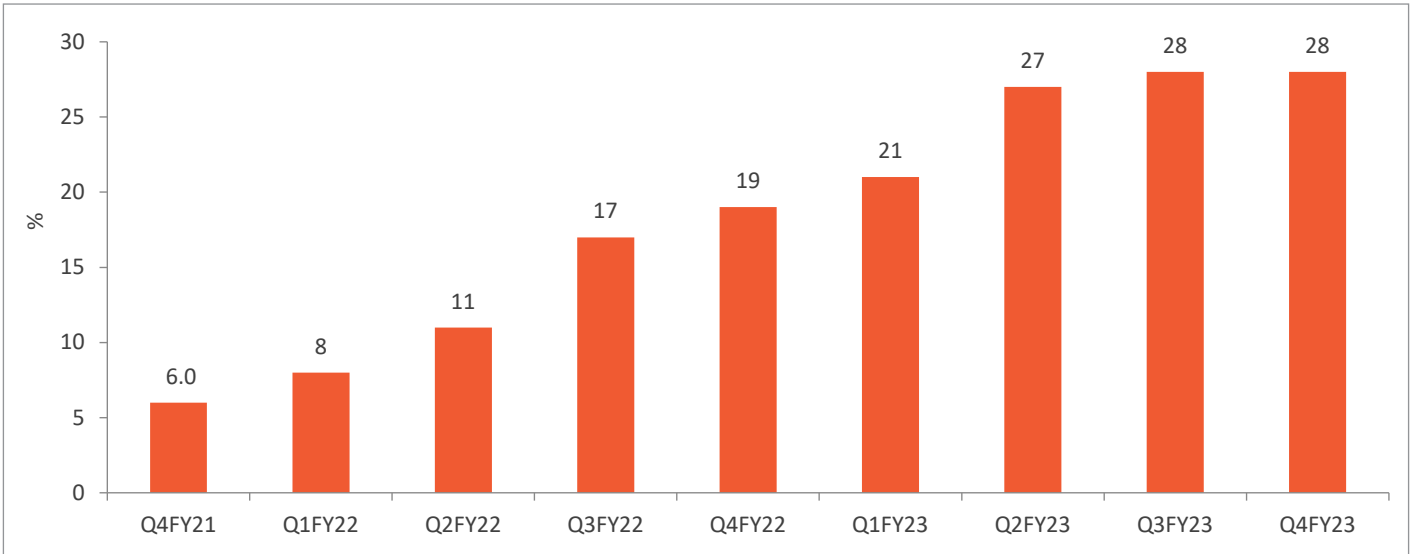
Source: Company, Sharekhan Research

Attrition trend (% q-o-q)



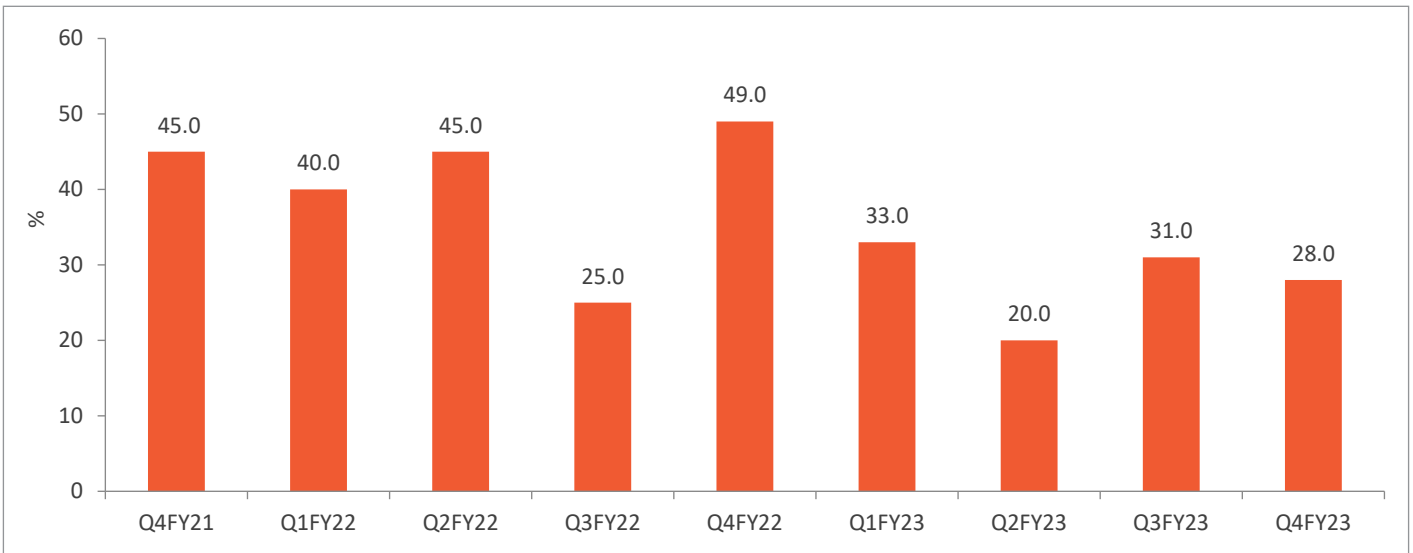
Source: Company, Sharekhan Research

Number of Fortune 1000 clients



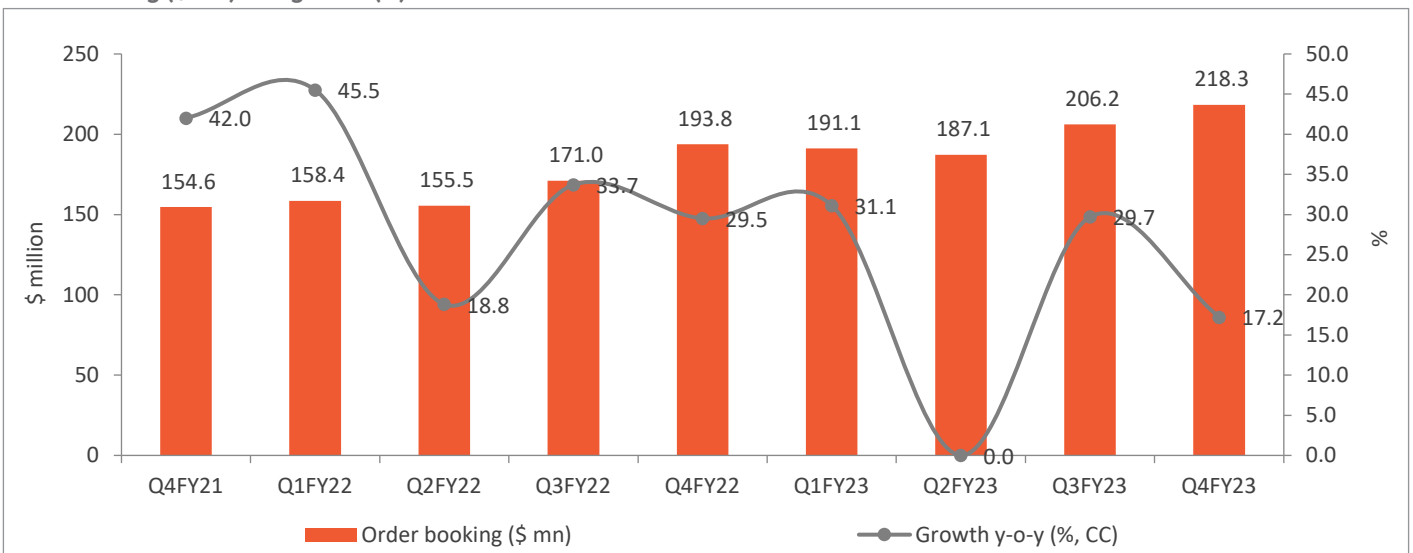
Source: Company, Sharekhan Research

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.

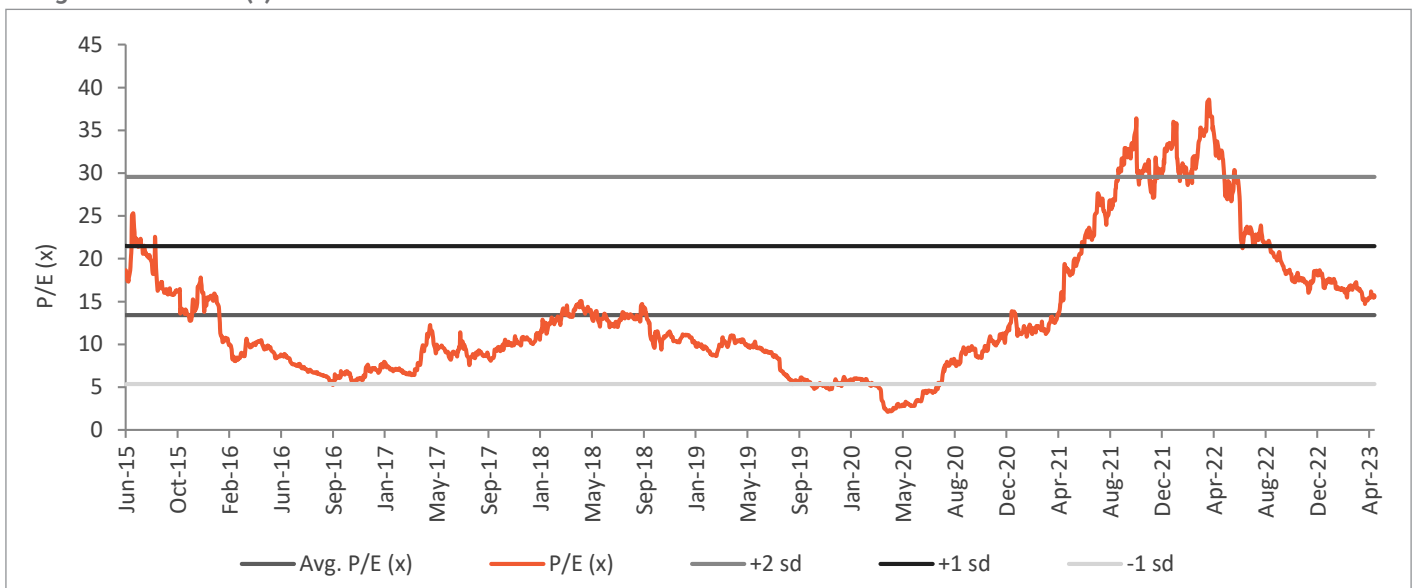
■ Company outlook - Long-term outlook intact

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 - Decent Q4, Maintain Hold

We believe the outlook for FY24 looks uncertain in the near term given the incrementally deteriorating macro environment owing to the recent developments in its key Europe and US markets. Hence despite a decent quarter and strong order back log we maintain a Hold rating on Mastek with a revised PT of Rs. 1,740 as sustaining the momentum amidst uncertainty would be challenging. At the CMP the stock trades at 15.6x its FY2024E EPS and 13.2 its FY2025E EPS.

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
Vijay Iyer	President Americas
Prameela Kalive	Chief Operating Officer
Arun Agarwal	Group CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Smallcap World Fund Inc	7.87
2	Capital Group Cos Inc	7.87
3	Vanguard Group Inc	2.33
4	Abakkus Growth Fund 1	1.51
5	Abakkus Emerging Opportunities Fund	1.49
6	ICICI Prudential Asset Management	0.72
7	BlackRock Inc	0.61
8	Dimensional Fund Advisors LP	0.53
9	Norges Bank	0.31
10	Edelweiss Asset Management Ltd	0.20

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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