Mastek Ltd (MASTEK)

CMP: ₹ 1810 | Target: ₹ 1880 (4%) | Target Period: 12 months | **HOLD**

April 21, 2023

Company Update

ICICI Securities – Retail Equity Research

Aiming for industry leading growth in FY24...

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 improve margins from ~14% to 21%
- Net debt free and healthy double digit return ratio (with RoCE of 20%)

Q4Y23 Results: Reported strong revenue growth in Q4.

- Revenue grew 5.3% QoQ in CC terms while in dollar terms revenue grew 7.7% QoQ
- The EBITDA margin grew 40 bps QoQ to 17.7%
- Reported 12 mn order backlog of US$218.3 mn, up 4.1%QoQ in CC terms

What should investors do? Mastek's share price has grown by ~3.1x over the past five years (from ~₹ 592 in April 2018 to ~₹ 1,810 levels in April 2023).

- We change our rating on the stock from REDUCE to **HOLD**

Target Price and Valuation: We value Mastek at ₹ 1,880 i.e. 14x P/E on FY25E 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
- The management change in the US region likely help in the recovery in FY24, which along with recent acquisition MST solutions may bring growth back in the market.
- Expect revenues to grow at 12.8% CAGR in FY23-25E

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 ₹ 1,600

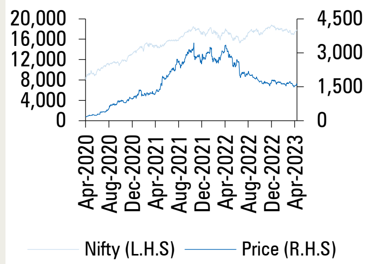
Particulars

Particulars	Amount
Market Capitalization (₹ Crore)	5,878.8
Total Debt (₹ Crore)	370.8
Cash and Investments (₹ Crore)	270.0
EV (₹ Crore)	5,979.6
52 week H/L	2959/ 1475
Equity capital (₹ Crore)	15.3
Face value	5.0

Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoters	37	37	37	37
FII	7	8	13	13
DII	7	6	4	4
Public	49	49	46	46

Price Chart



Recent Event & Key risks

- Appointed new US head & COO during the quarter
- **Key Risk:** (i) US business still performing below expectation, (ii) Rebound in UK business

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Key Financial Summary

₹ Crore	FY21	FY22	FY23	5 Year CAGR (FY18-23)	FY24E	FY25E	2 Year CAGR (FY23-25E)
Net Sales	1,722	2,184	2,563	25.7	2,942	3,259	12.8
EBITDA	364	463	456	35.5	537	610	15.6
EBITDA Margins (%)	21.2	21.2	17.8		18.3	18.7	
Net Profit	209	333	310	34.7	380	436	18.6
EPS (₹)	68	92	90		117	134	
P/E	26.6	17.4	18.9		15.5	13.5	
RoNW (%)	24.4	31.1	18.4		19.0	18.6	
RoCE (%)	21.5	26.7	17.0		19.3	19.3	

Source: Company, ICICI Direct Research

Key takeaways of quarter and conference call highlights

- The company reported strong revenue growth of 5.3% QoQ in CC terms while in dollar terms revenue grew 7.7% to US$86.3 mn. The company mentioned that revenue growth was largely from organic business. In rupee terms, the company reported revenue of ₹ 709.2 crore, up 7.7% QoQ

- Geography wise, growth was led by the UK region (60.4% of revenue mix), which reported growth of 10.5% QoQ while the Middle East continues to report consistent growth reporting growth of 8.7% QoQ. US region (26% of revenue mix) reported muted growth of 0.5% QoQ. The company indicated that seasonally weak quarter for MST and delayed decision making in the US due to macro concerns are reasons for the muted performance

- Vertical wise government (43% of mix) grew 11.8% QoQ while health, financial services & manufacturing reported QoQ growth of 6.1%, 9.4% & 3.6%, respectively. Retail continues to be under pressure and for Q4 it reported flattish growth

- EBITDA of the company improved 40 bps QoQ to 17.7% aided by revenue growth, operational efficiency and currency benefit but the margin expansion was restricted despite strong revenue growth due to higher employee cost (up 9.9% QoQ) due to hiring of onshore employees and currency impact on the onshore employee cost. The company further informed that subcontractor cost still remains high as they are required as per the specific contracts

- For FY23, the company reported growth of 18.5% in CC terms while in dollar terms revenue grew 8.6% to US$309.1 mn. In rupee terms, Mastek reported revenue of ₹ 2,563.4 crore, up 17.4%. The company reported an EBITDA of ₹ 455.9 crore with an EBITDA margin of 17.8% while PAT came in at ₹ 310.3 crore with a PAT margin of 12.1%

- The company mentioned that strong growth in Q4 was organic and was led by some strong deal momentum and higher working days (adjusted to furloughs in Q3). Mastek indicated that FY23 was a challenging year for it as it did see slower growth in a couple of quarters, which impacted its annual growth. These challenges were largely pertaining to the UK public sector, which had seen muted growth, especially on the NHS side. The company mentioned it is seeing this business bottoming out in Q4 but considering recent leadership changes in NHS and some structural changes (NHS digital merging into NHS England), it is keeping cautious view for UK NHS in FY24 and expects growth to be muted. Mastek indicated that it is looking for industry leading revenue growth in FY24 (as per management, Tier I companies likely to grow in the range of 7-9% in FY24 (a) while some midcaps and small caps are likely grow faster than that number, (b) and Mastek expects its growth to be a couple of percentage points higher than that of (b). The company also indicated that it is now targeting deals of >10 mn across markets for the future growth as it is seeing strengthening of its relationship in their few key accounts where client mining opportunity exists

- The company mentioned that their UK government business outside NHS where they have National Home office (NHO) is key strategic where it provides services in the areas of border security, immigration and trade related services. Mastek indicated that it is now participating in some large framework in these accounts, which are likely to drive growth, going forward. The company mentioned that there are multiple vendors who are competing for these accounts but Mastek is confident of winning deals and likely to continue market share gain in these accounts. Mastek also indicated few other areas of growth here are police protection, pension schemes, biometrics, etc. The company also indicated it is working with 29 to 30 councils in the UK market, which will likely to aid growth there. The company also indicated that it is exploring AWS and Salesforce partnerships apart from oracle (they have a presence in UK government through oracle cloud where they have sticky and longer-term deals). The company also indicated that health deal, which it won in Q3 is ramping up well. Mastek mentioned that UK private growth has been steady for the year but majority of the growth in UK market will be driven by public sector

- As far as the US market is concerned, the company mentioned that the results for the quarter have been disappointing considering the investments it has been making in the market. Mastek indicated it has seen a delay in decision making by clients and has witnessed a dip in Oracle business in the US market. The company indicated that it has taken some proactive actions in terms of leadership change. The company have appointed Vijay Iyer as President of Americas effective February 24, 2023 and are hopeful of growth recovery in the US market in FY24. The company also indicated that decision making in the US has now gone to the top level of the organisation (CEO approval now vs. CTO approval in the past), which is making decision process slower. The company is seeing mining of existing clients as a growth opportunity in the market. Mastek indicated it considers organisations in the US with annual revenue range of US$1 to 10 billion as a sweet spot for opportunity (especially with US$2-7 bn). The company also indicated that in this market, clients are breaking large deals into small deals, which is likely to work in its favour as it is converting more deals into managed services deals that are sticky in nature and provide better visibility. The company indicated that Oracle & Salesforce business (45-47% of revenue mix) are likely to see a recovery in FY24 and are likely to grow better than company average. The company also indicated it is winning both costs take out as transformational deals in the market

- The company indicated that it has strong growth in the Middle East market despite continuing to rationalise its accounts in the geography. Mastek indicated that growth in the region is aided by healthcare, which is doing well for them in both Middle East & US market. BFSI growth for the quarter was driven by strategic accounts in the UK market, US market (couple of accounts) and Middle East region

- On margin, the company indicated it is comfortable at current EBITDA margin range of 18% and margins are likely to be in a similar range in the near term. The management indicated that despite strong growth coming in FY24, margins are unlikely to expand materially as it would continue to invest strengthening of its sales channels. Hence, a large part of growth is likely to be invested in restricting margin expansion. The company, however, maintained medium term aspirational range of 19-20% based on levers like i) it has onboarded freshers in FY23 and some of them are likely to become billable, which will help in pyramid optimisation, ii) moderating subcontractor costs

- The company indicated that its 12 mn backlog has increased by 5.9% QoQ to US$218.3 mn while in CC terms it grew 4.1%. Mastek further indicated that its deal pipeline is strong across geography and also indicated that the order value of wins in FY24 is expected to be higher compared to FY23

- The company added 28 new clients in the quarter taking the total new client addition to 104 during the quarter. The company's clients contributing US$1 mn+ revenue increased to 61 in Q4 compared to 59 in Q3 and 47 in Q4FY22 while the number clients contributing US$3mn+ revenue increased to 21 from 20 in Q3 & 19 in Q4FY22. The company's revenue contribution from Top five clients increased by 13.5% QoQ in Q4 while contribution from top 10 clients increased 11.6% QoQ

- The company's LTM attrition continued to decline and the company mentioned that its LTM attrition declined to 21% in Q4FY23 from the peak of 28% in Q4 last year. On a sequential basis, it reported a decline of 230 bps. The company's utilisation excluding trainees improved 450 bps QoQ but was down 210 bps YoY. The company's net employees during the quarter declined by 65 bringing the total employees to 5,622

- The company indicated it has completed the second tranche of payment to Evosys shareholders and expects to complete the final tranche of payment by October 2023

- The company declared a final dividend of ₹ 12 per share taking the total dividend to ₹ 19 per share for FY23 which was similar to that of FY22.

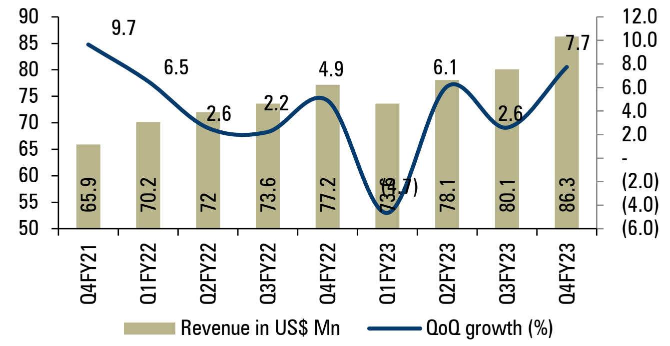
Exhibit 1: P&L

	Q4FY23	Q4FY22	YoY (%)	Q3FY22	QoQ (%)	Comments
Revenue in USD mn	86.3	77.2	11.8	80.1	7.7	Revenue grew by 5.3% QoQ in CC terms and the growth was majorly by organic contribution
Revenue	709.2	581.5	22.0	658.7	7.7	
Employee expense	380.7	291.2	30.7	346.4	9.9	Employee cost increased due to investment of growth back into the company to stregthen sales channel
Gross Margin	328.4	290.3	13.1	312.3	5.2	
Gross margin (%)	46.3	49.9	-361 bps	47.4	-110 bps	
Other expense	202.9	169.6	19.6	198.6	2.2	
EBITDA	125.5	120.7	4.0	113.7	10.4	
EBITDA Margin (%)	17.7	20.8	-305 bps	17.3	35 bps	
Depreciation & amortisation	19.6	12.2	61.2	19.6	0.1	
EBIT	105.9	108.5	-2.4	94.1	12.5	
EBIT Margin (%)	14.9	18.7	-373 bps	14.3	65 bps	
Other income (less interest)	-9.7	15.4	-162.8	-2.2	337.6	
PBT	96.3	123.9	-22.3	91.9	4.7	
Tax paid	23.7	35.7	-33.7	24.8	-4.6	
PAT	72.6	88.2	-17.7	67.1	8.1	

Source: Company, ICICI Direct Research

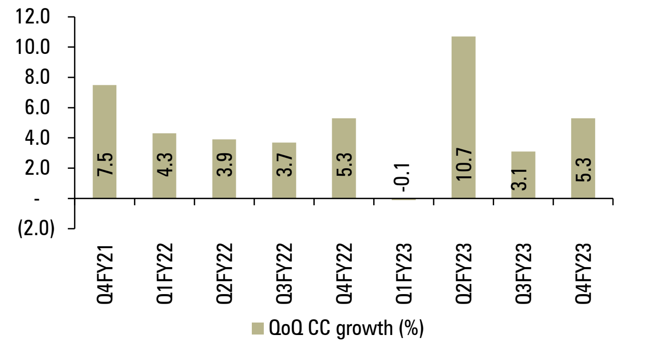
Key Metrics

Exhibit 2: Growth led by Non-NHS UK public and MEA



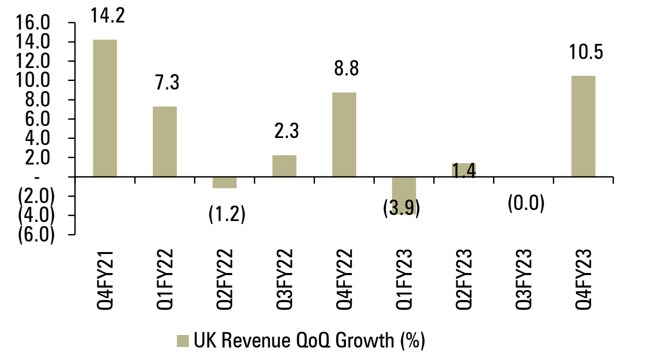
Source: Company, ICICI Direct Research

Exhibit 3: Q4 CC growth largely organic



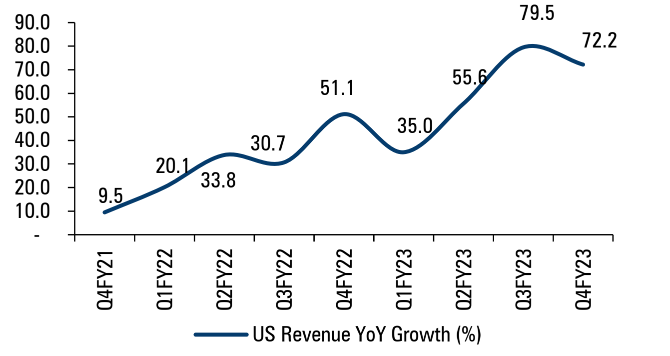
Source: Company, ICICI Direct Research

Exhibit 4: UK ex NHS grows strongly



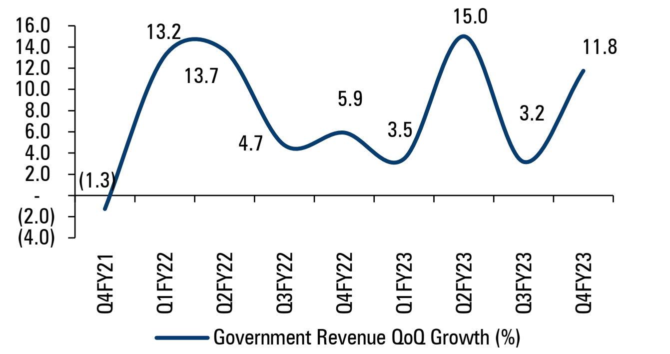
Source: Company, ICICI Direct Research

Exhibit 5: Oracle business seen dip in US



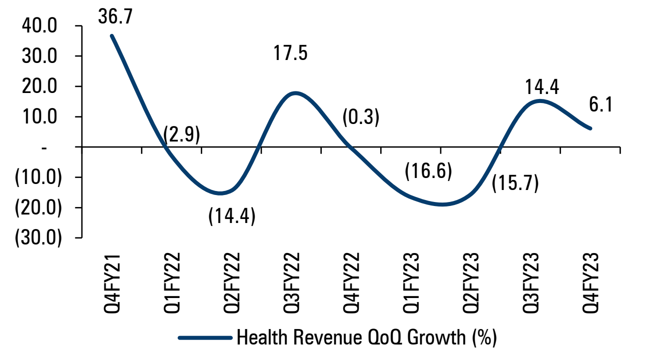
Source: Company, ICICI Direct Research

Exhibit 6: Government revenue sees rebound



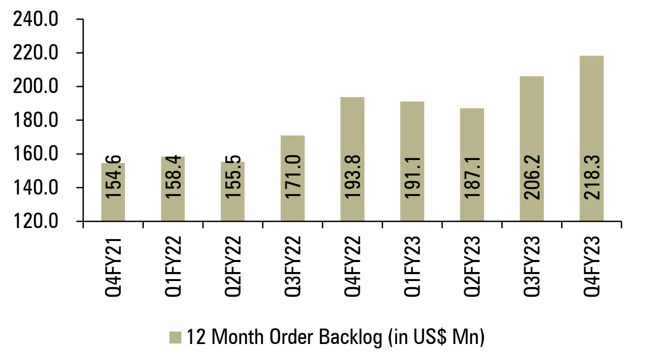
Source: Company, ICICI Direct Research

Exhibit 7: Health in US was steady while UK was weak



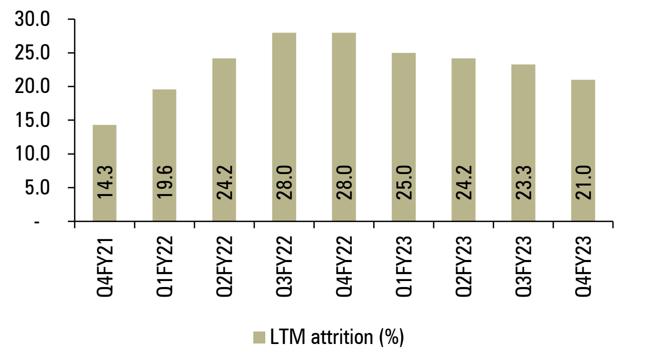
Source: Company, ICICI Direct Research

Exhibit 8: 12-month order backlog up 4.1% QoQ in CC



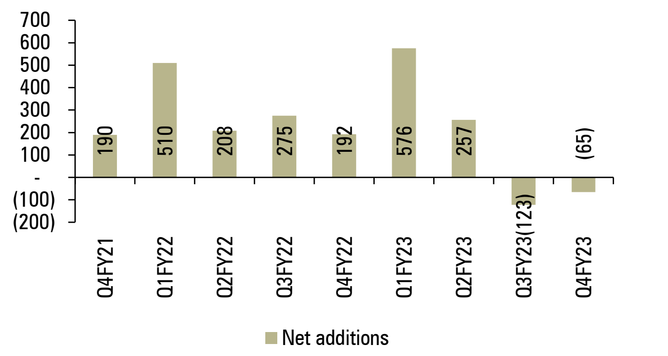
Source: Company, ICICI Direct Research

Exhibit 9: LTM attrition continues to moderate



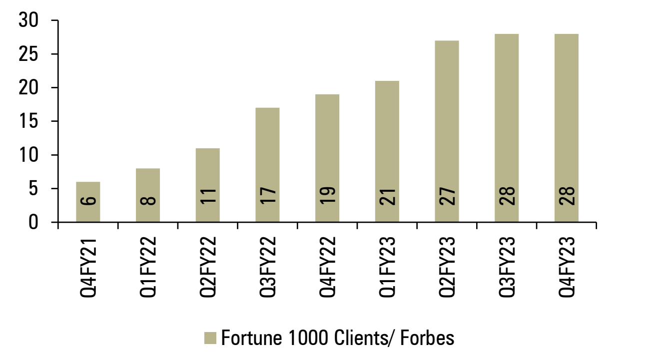
Source: Company, ICICI Direct Research

Exhibit 10: Net employee declines in Q4



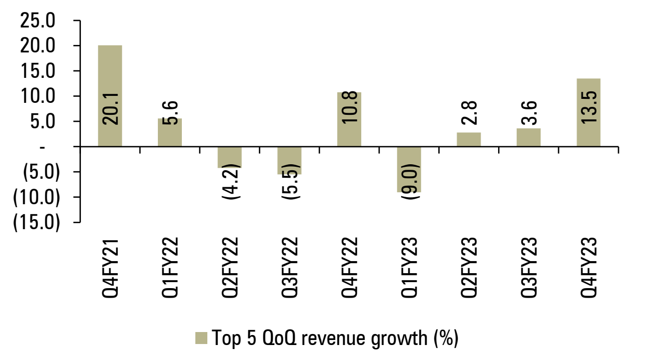
Source: Company, ICICI Direct Research

Exhibit 11: Fortune 1000/ Forbes clients trend



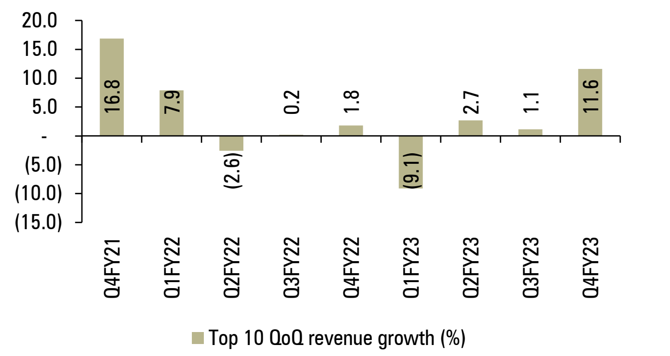
Source: Company, ICICI Direct Research

Exhibit 12: Top five client's revenue grows strongly



Source: Company, ICICI Direct Research

Exhibit 13: Top 10 client's revenue growth trend



Source: Company, ICICI Direct Research

Financial summary

Exhibit 14: Profit and loss statement ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Net Sales	**2,184**	**2,563**	**2,942**	**3,259**
Growth (%)	27	17	15	11
COGS (employee expenses)	1,095	1,376	1,581	1,744
Other expenses	626	732	824	906
Total Operating Expenditure	1,721	2,108	2,405	2,650
EBITDA	**463**	**456**	**537**	**610**
Growth (%)	27	(1)	18	14
Depreciation	43	67	81	90
Net Other Income	28	14	78	95
PBT	448	402	534	615
Total Tax	115	117	134	154
Exceptional item	-	25	-	-
Adjusted PAT	**333**	**310**	**380**	**436**
Growth (%)	59	(7)	22	15
Diluted EPS (₹)	103.8	95.5	117.0	134.4

Source: Company, ICICI Direct Research

Exhibit 15: Cash flow statement ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Profit before tax	**448**	**402**	**534**	**615**
Add: Depreciation	43	67	81	90
(Inc)/dec in Current Assets	(175)	(156)	(145)	(122)
Inc/(dec) in CL and Provisions	66	(115)	147	123
Taxes paid	(109)	(136)	(134)	(154)
CF from operating activities	**273**	**107**	**356**	**408**
(Inc)/dec in Inv. (+) Int inc (+) Goodwill	464	274	103	120
(Inc)/dec in Fixed Assets	(484)	(1,011)	(44)	(49)
CF from investing activities	**(20)**	**(737)**	**59**	**71**
Issue/(Buy back) of Equity	2	2	-	-
Dividend paid & dividend tax	(48)	(57)	(68)	(79)
Others	(75)	147	25	25
CF from financing activities	**(128)**	**93**	**(56)**	**(66)**
Net Cash flow	119	(518)	359	413
Exchange difference	(6)	19	-	-
Opening Cash	608	727	208	567
Closing Cash	**727**	**208**	**567**	**981**

Source: Company, ICICI Direct Research

Exhibit 16: Balance sheet ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Liabilities				
Equity Capital	15	15	15	15
Reserve and Surplus	1,056	1,668	1,980	2,338
Total Shareholders funds	1,071	1,683	1,995	2,353
Minority interest	150	91	112	137
Total Debt	190	371	371	371
Other liabilities	294	362	415	460
Total Liabilities	**1,706**	**2,507**	**2,893**	**3,320**
Assets				
Total Fixed Assets	841	1,747	1,722	1,693
Investments	52	38	38	38
Other non current assets	79	110	110	111
Debtors	436	507	581	644
Loans and Advances	-	-	-	-
Cash & investments	782	270	629	1,043
Other current assets	298	469	539	597
Total Current Assets	1,515	1,246	1,749	2,284
Current liabilities	755	601	689	764
Provisions	28	33	38	42
Total Current Liabilities	783	634	727	806
Net Current Assets	733	612	1,022	1,478
Application of Funds	**1,706**	**2,507**	**2,893**	**3,320**

Source: Company, ICICI Direct Research

Exhibit 17: Key ratios ₹ crore

	FY22	FY23	FY24E	FY25E
Per share data (₹)				
Diluted EPS	103.8	95.5	117.0	134.4
Cash EPS	120.2	118.3	144.4	164.9
BV	333.6	518.3	614.2	724.4
DPS	19.0	19.0	21.1	24.2
Cash Per Share	232.3	65.2	177.8	307.3
Operating Ratios (%)				
EBITDA Margin	21.2	17.8	18.3	18.7
PBT Margin	20.5	15.7	18.2	18.9
PAT Margin	15.3	12.1	12.9	13.4
Inventory days	-	-	-	-
Debtor days	73	72	72	72
Creditor days	28	26	26	26
Return Ratios (%)				
RoE	31.1	18.4	19.0	18.6
RoCE	26.7	17.0	19.3	19.3
RoIC	45.4	17.4	20.1	22.8
Valuation Ratios (x)				
P/E	17.4	18.9	15.5	13.5
EV / EBITDA	11.4	13.1	10.5	8.5
EV / Net Sales	2.4	2.3	1.9	1.6
Market Cap / Sales	2.7	2.3	2.0	1.8
Price to Book Value	5.3	3.4	2.9	2.5
Solvency Ratios				
Debt/EBITDA	0.4	0.8	0.7	0.6
Debt / Equity	0.2	0.2	0.2	0.2
Current Ratio	0.9	1.5	1.5	1.5
Quick Ratio	0.9	1.5	1.5	1.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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