Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Mastek Ltd

Decent Q1; Maintain Buy

IT & ITES	Sharekhan code: MASTEK
Reco/View: Buy ↔	CMP: **Rs. 2,640** / Price Target: **Rs. 3,150** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

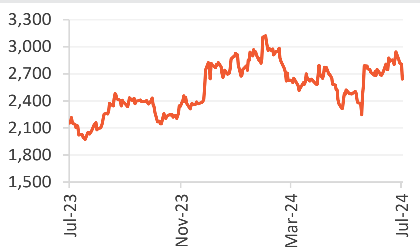
Company details

Market cap:	Rs. 8,142 cr
52-week high/low:	Rs. 3,147/1,964
NSE volume: (No of shares)	0.94 lakh
BSE code:	523704
NSE code:	MASTEK
Free float: (No of shares)	2.0 cr

Shareholding (%)

Promoters	36.3
FII	14.0
DII	7.1
Others	42.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.2	-2.2	-9.4	21.6
Relative to Sensex	-7.5	-12.5	-21.8	1.5

Sharekhan Research, Bloomberg

Summary

- Reported revenues stood at $97.3 million, up 4.1% q-o-q/9.9% y-o-y in constant currency (CC), beating our estimates of $95 million.
- EBITDA margin fell 80 bps q-o-q to 15.2% due to a delay in couple of project commencements and provision for aged receivables in Middle East, thus missing our estimates.
- The management expects top line momentum in Q1 to continue in the remaining quarters and aims to operate closer to a 16.5%-17% margin in H2FY25
- We maintain Buy with unchanged price target (PT) of Rs. 3,150. At CMP, the stock trades at 25.2/18.5x its FY25/26E EPS.

Mastek reported revenues of $97.3 million, up 4.1% q-o-q/9.9% y-o-y in constant currency terms, beating our estimates of $95 million. Revenue in rupee terms stood at Rs 813 crore, up 4.3% q-o-q/12.1% y-o-y. Revenue growth was led by Health & Lifesciences, manufacturing and financial services grew 11.3%/10.1% and 6.4% q-o-q respectively. EBITDA margins fell 80 bps q-o-q to 15.2% due to a delay in couple of project commencements and provision for aged receivables in Middle East, missing our estimates of 16.7%. Adjusted net profit stood at Rs 71.5 crore, down 22.3% q-o-q/ up 2% y-o-y impacted by higher tax rate. 12 months order backlog stood at Rs. 2,168.8 crore, flat sequentially and up 21% y-o-y in constant currency. Management expects the top line growth momentum seen in Q1 to continue in the remaining quarters and aims to operate closer to a 16.5-17% margin in the second half of the year. We believe the company is well placed to achieve industry-leading growth, given the strong start to FY25 in terms of revenues and with the management confident of sustaining the similar growth momentum in the remaining quarters driven by the strong order backlog and expectation of deal momentum building up in H2FY25. We maintain Buy with unchanged price target (PT) of Rs. 3,150. At CMP, the stock trades at 25.2/18.5x its FY25/26E EPS.

Key positives

- Health & lifesciences, manufacturing and financial services grew 11.3%/10.1% and 6.4% q-o-q respectively.
- Revenue from top-10 clients grew by 3.1% q-o-q

Key negatives

- EBITDA margins fell 80 bps q-o-q to 15.2%
- LTM attrition rose 40bps to 20.9% from 20.5% in Q4FY24

Management Commentary

- Topline momentum in Q1 is expected to continue in the remaining quarters .The management is more optimistic about second half of year as deal momentum builds
- Company aims to operate closer to a 16.5%-17% margin in the second half of the year.
- NHS business to return to growth path
- Management expects US business to outpace company growth

Revision in estimates – We have revised our estimates to factor in Q1FY25 performance

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 3,150: The company reported decent performance in Q1FY25 with strong growth in topline, which is expected to continue over the remaining quarters. Although margins contracted in Q1, the company is aiming to operate closer to 16.5-17% in H2FY25 as deal momentum builds in. The 12 month order backlog remains strong and stable providing strong revenue visibility. We expect a sales/PAT CAGR of 17.3%/20.4% over FY24-26E. We believe the company is well-placed to achieve industry-leading growth, given the strong start to FY25 in term revenues and with management confident of sustaining similar growth momentum in the remaining quarters driven by the strong order backlog and expectation of deal momentum building up in H2FY25 . We maintain Buy with unchanged price target (PT) of Rs. 3,150. At CMP, the stock trades at 25.2/18.5x its FY25/26E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, contagion effect of the banking crisis, and macro headwinds and recession in the US can moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY23	FY24	FY25E	FY26E
Revenue	2,563.4	3,054.8	3,512.2	4,202.7
OPM (%)	17.8	16.7	16.3	17.9
Adjusted PAT	267.7	304.4	322.6	441.1
YoY growth (%)	-9.3	13.7	6.0	36.8
Adjusted EPS (Rs.)	86.6	98.2	104.6	143.0
P/E (x)	30.5	26.9	25.2	18.5
P/B (x)	4.8	3.9	3.5	3.0
EV/EBITDA	18.1	16.1	14.5	10.7
ROE (%)	19.4	15.9	14.5	17.6
ROCE (%)	20.3	16.4	16.9	20.4

Source: Company; Sharekhan estimates

Key results highlights

Revenue growth: Reported revenue stood at $97.3 million, up 4.1% q-o-q/9.9% y-o-y in constant currency beating our estimates of $95 million. Growth was driven by Healthcare in the US, central government vertical in the UK, account mining and Data/AI solutions globally.

EBITDA margins: EBITDA margins fell 80 bps q-o-q to 15.2% due to delay in couple of project commencements and provision for aged receivables in Middle East, missing our estimates of 16.7%. Adjusted net profit stood at Rs 71.5 crore, down 22.3% q-o-q/ up 2% y-o-y impacted by a higher tax rate.

Order backlog: The 12-month order backlog stood at Rs 2,168.8 crore ($260.1 million), which was flat sequentially and up 21% y-o-y in constant currency terms.

Geography-wise performance: North America, Europe and RoW grew7.6%/ 1.5%/6.2% q-o-q, respectively.

Vertical-wise performance: Health & Lifesciences, Manufacturing and Financial services grew 11.3%/10.1% and 6.4% q-o-q respectively, while the retail vertical declined 1.5 % q-o-q. Government and Education was flat sequentially.

Client metrics: Mastek added 13 new clients in Q1FY25 compared to 22 in Q4FY24. Total active clients during Q1FY25 were 391 as compared to 430 in Q4FY24. Revenue Top-10 clients grew 3.1% q-o-q while revenue from Top-5 was flat sequentially.

Attrition and utilisation: LTM attrition rose 40bps to 20.9% from 20.5% in Q4FY24. Net headcount additions grew by 7 during the quarter taking total headcount to 5546. Utilisation was flat sequentially at 86.5%

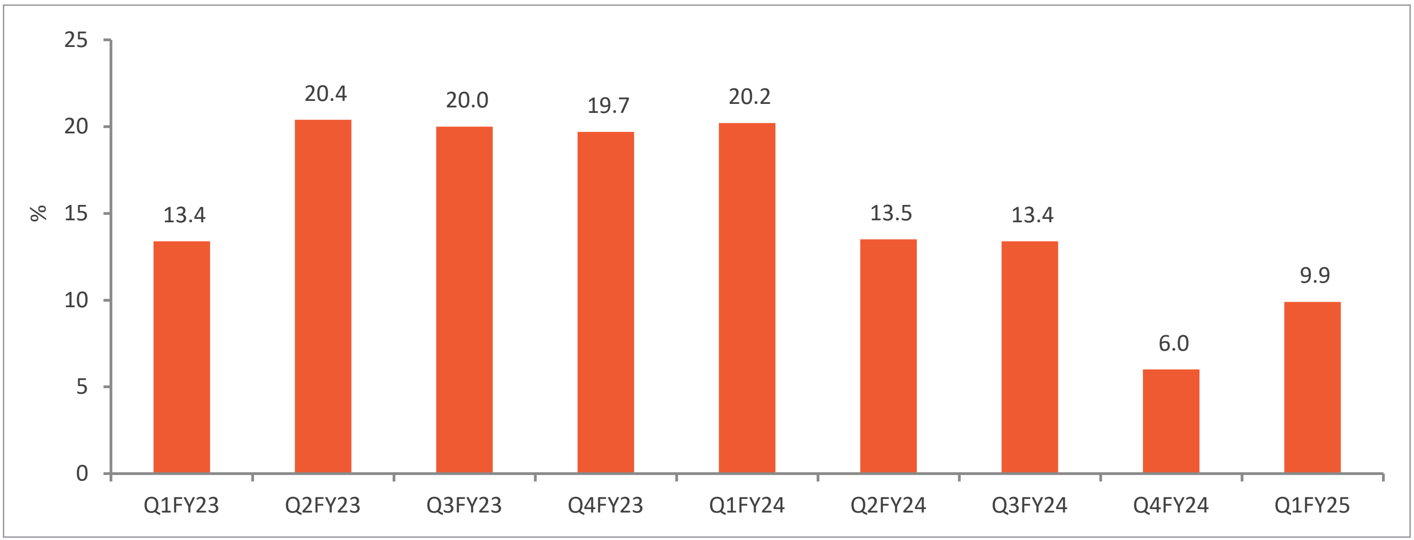
Cash balance: Total cash, cash equivalents, and fair value of mutual funds stood at Rs. 3835 crore as of June 30, 2024, versus Rs. 473.3 crore as on March 31, 2024. DSO stood at 92 compared to 89 in Q4FY24.

Results (Consolidated) Rs cr

Particulars	Q1FY25	Q1FY24	Q4FY24	YoY (%)	QoQ (%)
Revenues In USD (mn)	**97.3**	**88.1**	**93.7**	**10.4**	**3.8**
Revenues In INR	**812.9**	**725.3**	**779.7**	**12.1**	**4.3**
Employee benefits expense	444.8	390.5	420.0	13.9	5.9
Other expenses	244.1	207.7	234.6	17.5	4.1
EBITDA	**123.9**	**127.0**	**125.1**	**-2.4**	**-0.9**
Depreciation & amortization	20.1	19.7	27.5	1.8	-27.0
EBIT	**103.9**	**107.3**	**97.6**	**-3.2**	**6.4**
Other Income	4.2	2.4	5.5	77.5	-23.1
Finance costs	9.4	9.3	9.2	1.4	2.4
PBT	**98.6**	**100.3**	**93.9**	**-1.7**	**5.1**
Tax Provision	27.1	26.8	-0.6	1.2	-4,944.6
PAT	**71.5**	**73.5**	**94.4**	**-2.8**	**-24.3**
Minority interest	0.0	-3.4	-2.4		
EO	0.0	0.0	0.0		
Net profit	**71.5**	**70.1**	**92.1**	**2.0**	**-22.3**
Adjusted net profit	**71.5**	**70.1**	**92.1**	**2.0**	**-22.3**
EPS (Rs)	23.2	22.7	29.7	2.2	-22.0
Margin (%)					
EBITDA	15.2	17.5	16.0	-226	-80
EBIT	12.8	14.8	12.5	-201	26
NPM	8.8	9.7	11.8	-87	-301
Tax rate	27.5	26.7	-0.6	79	2,810

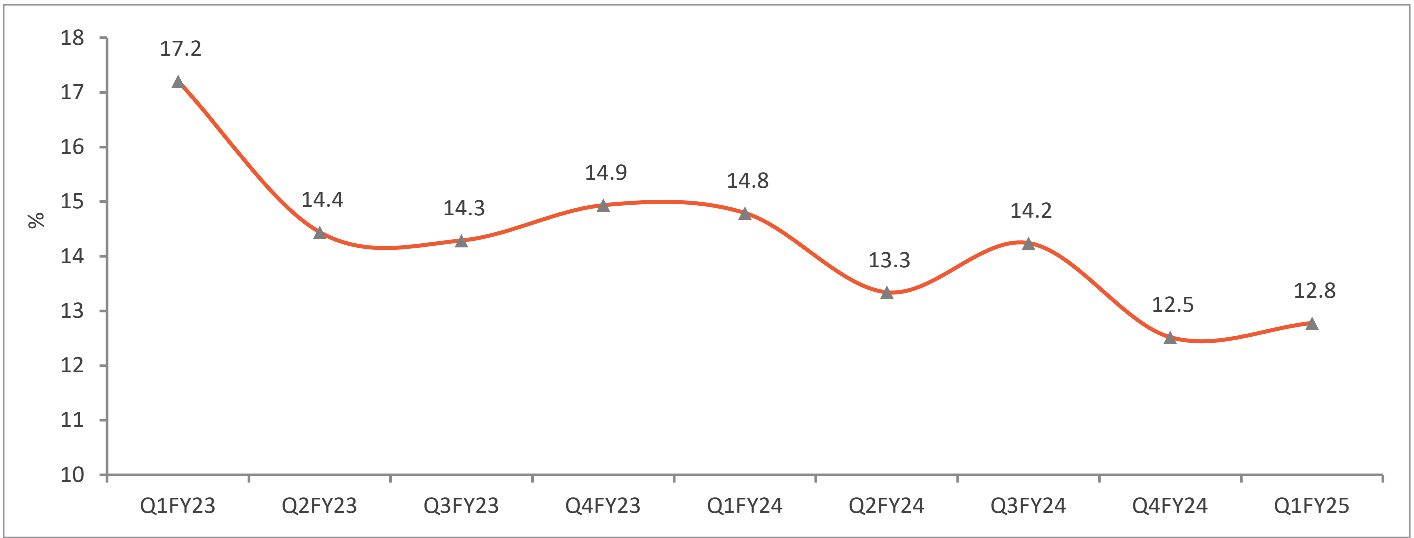
Source: Company, Sharekhan Research

Mastek's CC revenue growth trend (y-o-y)



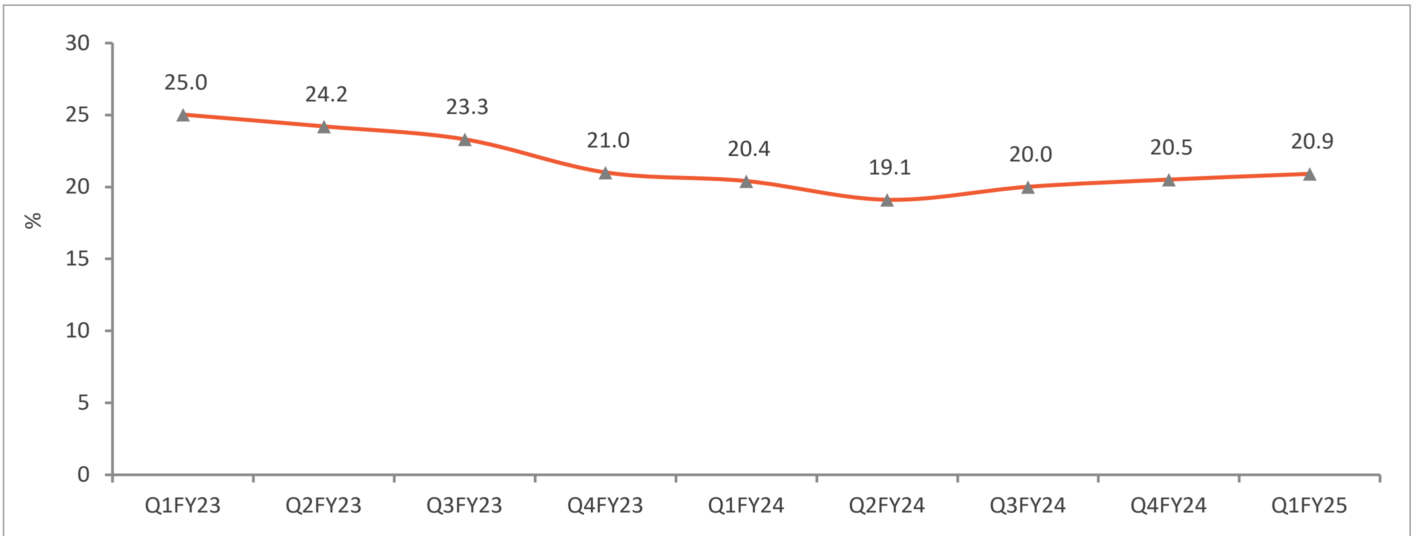
Source: Company, Sharekhan Research

EBIT margin trend on a q-o-q basis



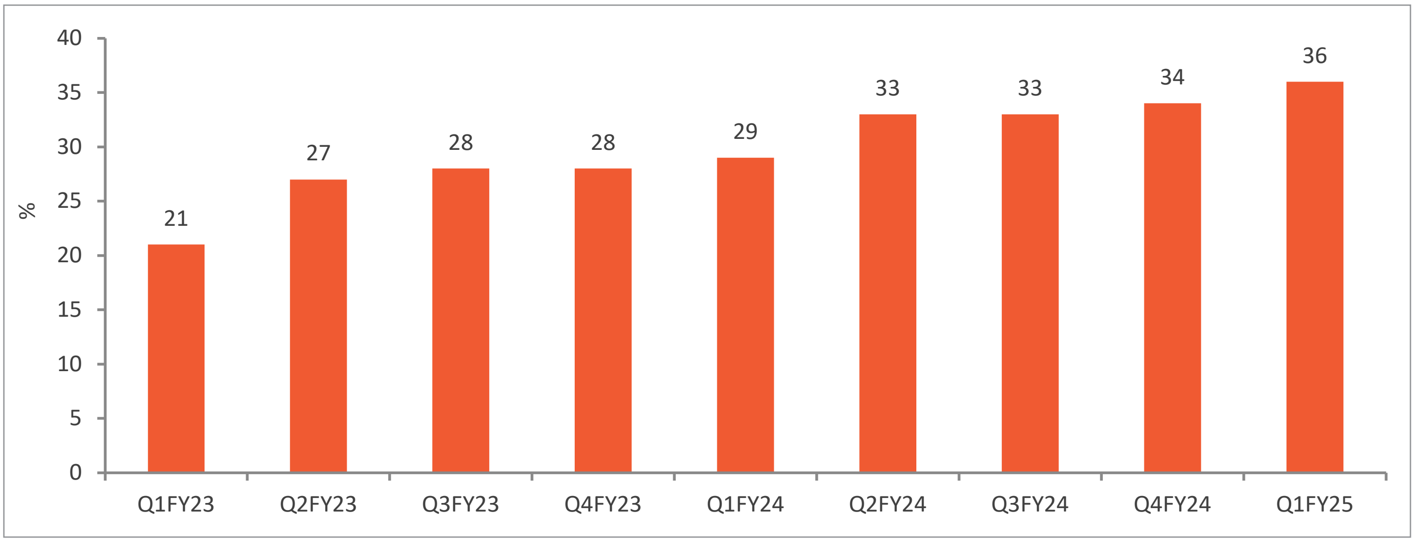
Source: Company, Sharekhan Research

Attrition trend on a q-o-q basis



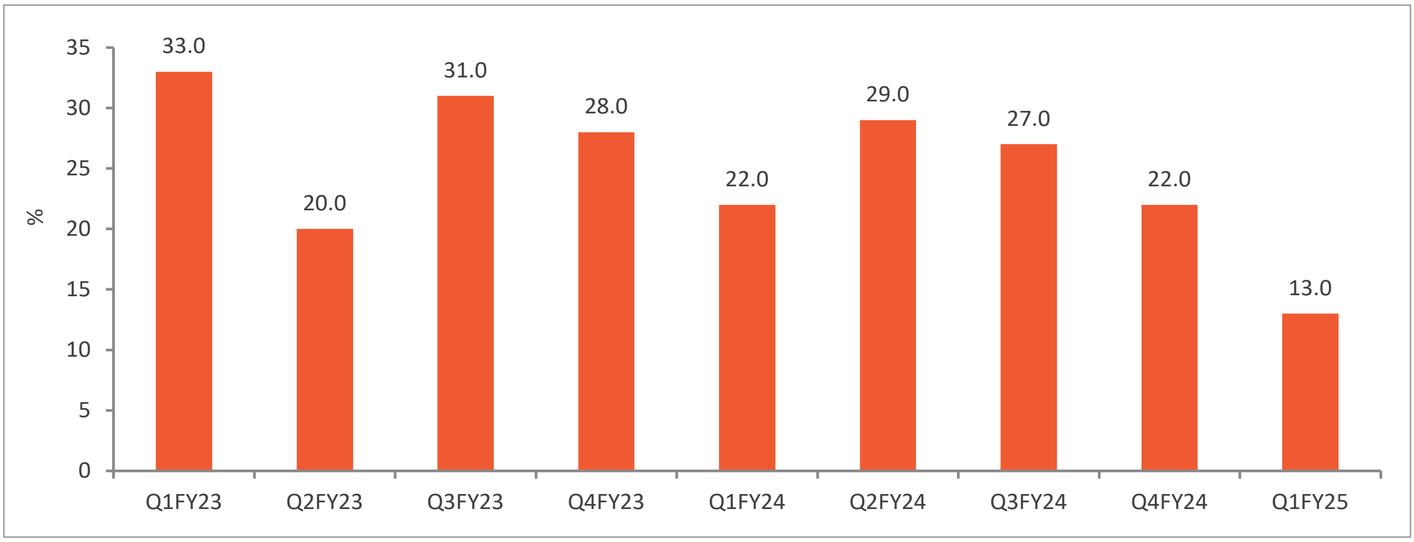
Source: Company, Sharekhan Research

Number of Fortune 1000 clients



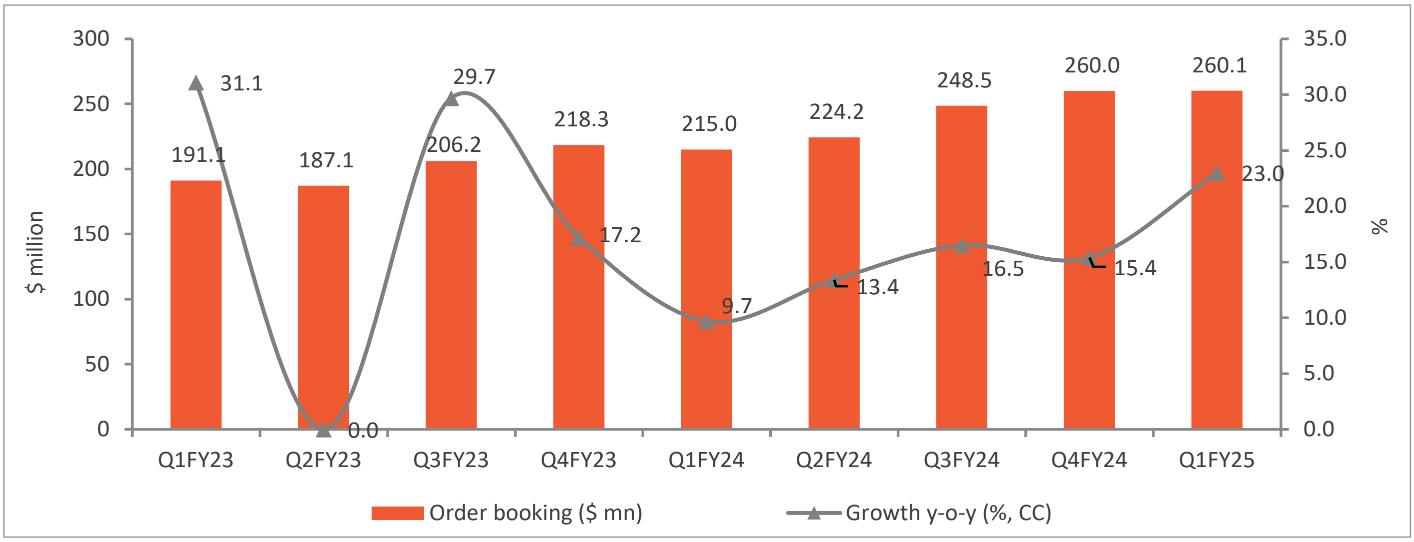
Source: Company, Sharekhan Research

Number of new client addition



Source: Company, Sharekhan Research

Order booking ($ million) and growth (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Macro headwinds bottoming out coupled with better earnings visibility.**

We anticipate growth momentum to return in FY2025, aided by a lower base coupled with easing sector headwinds. Although the IT sector has already outperformed Nifty last year, we expect overall outperformance in CY24 as well, driven by receding headwinds and better earnings visibility.

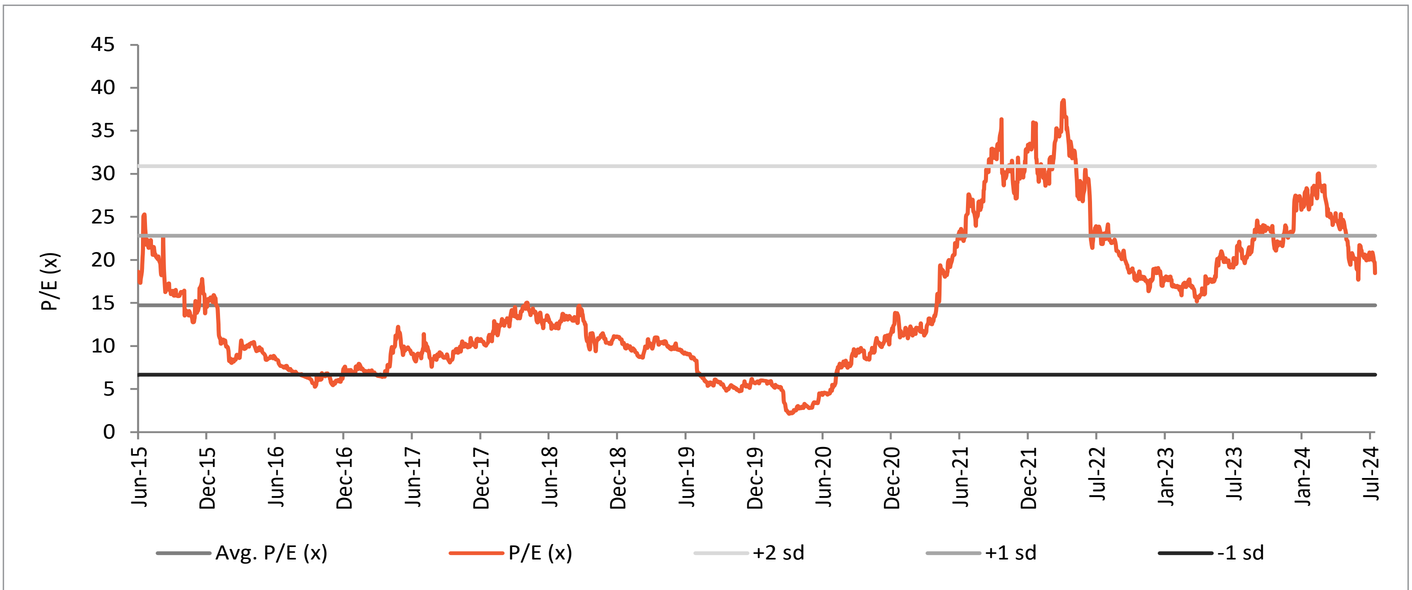
■ **Company outlook - Long-term outlook intact**

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 revenue growth momentum in the UK public sector would continue in the coming quarters on account of higher spends on digital-transformation initiatives by the UK government sector and the 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 - Maintain Buy with unchanged PT of Rs 3,150**

The company reported decent performance in Q1FY25 with strong growth in topline, which is expected to continue over the remaining quarters. Although margins contracted in Q1, the company is aiming to operate closer to 16.5-17% in H2FY25 as deal momentum builds in. The 12 month order backlog remains strong and stable providing strong revenue visibility. We expect a sales/PAT CAGR of 17.3%/20.4% over FY24-26E. We believe the company is well-placed to achieve industry-leading growth, given the strong start to FY25 in term revenues and with management confident of sustaining similar growth momentum in the remaining quarters driven by the strong order backlog and expectation of deal momentum building up in H2FY25 . We maintain Buy with unchanged price target (PT) of Rs. 3,150. At CMP, the stock trades at 25.2/18.5x its FY25/26E 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 U.K. government), retail, health, financial, and others. Mastek continues to be ranked among the top three vendors in delivering agile development services to the U.K. 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 U.K. On the region front, the company is positioned largely in the U.K. and Europe, as 67.1% of its revenue comes from this region, followed by the U.S./ME/RoW with contribution to total revenue of 18.8%/9.2%/4.9%, respectively.

Investment theme

Mastek has a long-standing relationship with the U.K. government as it was working as a subcontractor to large IT companies for the execution of U.K. government's projects earlier. This long-term relationship and excellent execution capabilities make Mastek a prime beneficiary of the U.K. government's digital spends. We expect a strong order pipeline along with significant headroom for growth with the U.K. 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 in digital contracts of the U.K. public and private sector, where U.K. digital spending is growing at 30%. Mastek focuses on accelerating its revenue momentum in the U.S.

Key Risks

1) Rupee appreciation and/or adverse cross-currency movements, 2) Contagion effect of the banking crisis, Macro headwinds and recession in the U.S. can moderate the pace of technology spending.

Additional Data

Key management personnel

Hiral Chandrana	Global CEO
Abhishek Singh	President U.K. 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	Capital Group Cos Inc/The	7.94
2	Vanguard Group Inc/The	2.44
3	ABAKKUS GROWTH FUND 1	1.60
4	Abakkus Emerging Opportunities Fun	1.54
5	Tata Asset Management Pvt Ltd	1.17
6	BlackRock Inc	0.98
7	Dimensional Fund Advisors LP	0.80
8	ICICI Prudential Asset Management	0.69
9	Norges Bank	0.42
10	State Street Corp	0.06

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 detoriating 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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