MIRAE ASSET Sharekhan

Mastek Ltd

Mixed Quarter, outlook positive

IT & ITES	Sharekhan code: MASTEK
Reco/View: BUY ↔	CMP: Rs. 2,751	Price Target: Rs. 3,610 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result Update

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		↔	

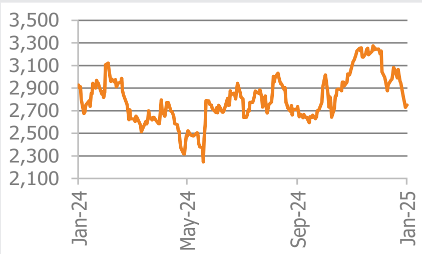
Company details

Market cap:	Rs. 8,491 cr
52-week high/low:	Rs. 3,375/2,137
NSE volume: (No of shares)	1.69 lakh
BSE code:	523704
NSE code:	MASTEK
Free float: (No of shares)	2.0 cr

Shareholding (%)

Promoters	35.0
FII	23.7
DII	30.9
Others	10.4

Price chart



Source: NSE India, Mirae Asset Sharekhan Research

Price performance

(%)	1m	3m	6m	12m
Absolute	-14.8	-7.9	-2.4	-6.1
Relative to Sensex	-9.8	-2.5	2.7	-13.2

Source: Mirae Asset Sharekhan Research, Bloomberg

Summary

- Reported revenues stood at $102.9 million, up 0.1% q-o-q/7.6% y-o-y in CC terms, missing our estimates of $104.8 million. Reported revenue was impacted by currency fluctuations.
- EBITDA margin fell ~30 bps q-o-q to 16.2% impacted by wage hike but beat our estimates of 15.9%. Twelve-month order backlog was Rs 2,138.7 crore, up 3.4%rupee terms and 1.5% in CC.
- Management expects steady growth in US in quarters ahead, with full growth potential to be realized from the first half of the next year.
- We maintain a Buy with unchanged PT of Rs. 3,610. At CMP, the stock trades at 23.6/21.3/18.2x its FY25/26/27E EPS.

Mastek reported revenues of $102.9 million, up 0.1% q-o-q/7.6% y-o-y in constant currency (CC), missing our estimates of $104.8 million. Revenue in $ terms was down 0.7%q-o-q/up 9.4% y-o-y while revenue in rupee terms stood at Rs 869.5 crore, up 0.2% q-o-q/10.9% y-o-y. EBITDA margin fell ~30 bps q-o-q to 16.2% impacted by wage hikes and currency fluctuations but beat our estimates of 15.9%. Adjusted net profit stood at Rs 90.7 crore, down 22.4% q-o-q/ up 20.5%y-o-y. 12 months order backlog was Rs 2,138.7 crore ($249.8 million), up 3.4% in rupee terms and 1.5% in CC terms. The company also secured a $40+ million deal in the UK SGS post-quarter, set for delivery over two years with an 80/20 renewal and expansion split. The deal improves the 12-month backlog by 8-9%. We believe the company is well placed to deliver strong growth in FY25 and fiscals ahead driven by recovery in Healthcare in UK, steady momentum in the US and consistent additions of new logos. We expect sales/PAT CAGR of ~14%/16% over FY24-27E. We maintain Buy with an unchanged price target (PT) of Rs. 3,610. At CMP, the stock trades at 23.6/21.3/18.2x its FY25/26/27E EPS.

Key positives

- Health & Lifesciences vertical grew 19.6% q-o-q/31.8% y-o-y.
- Digital & application engineering vertical grew 8.2% q-o-q/23.9% y-o-y.

Key negatives

- Net headcount declined by 245 q-o-q, taking the total headcount to 5,260
- Utilisation (excluding trainees) fell 420 bps q-o-q to 76.2%

Management Commentary

- UK healthcare business is reviving strongly and tailwinds are robust. New government continues to invest in health care, and management is seeing a lot of direct investment.
- UK and European private sector businesses are also showing significant improvement with recent wins of large deals. Overall, the outlook for the U.K. business is very positive
- Management expects steady growth in the US in upcoming quarters, with full growth potential expected to be realized from the first half of the next year, facilitated by the consolidation of acquired capabilities and synergies
- Company is pleased with its current double-digit profit margins in the U.S. market but prioritizes growth over further margin expansion.
- While there's potential for margin improvement, Management aims to maintain a balance between profitability and expanding its market share in the US.
- Management aims to maintain current margin levels in the UK while aspiring to restore AMEA to double-digit margins in the forthcoming quarters.
- Company has not observed any significant changes in deal cycles for its mid-sized, project-based deals in the U.S. However, customer discussions and activity have increased due to AI-related initiatives.
- Company will strategically adjust headcount, reducing it in low-revenue areas (AMEA) and increasing it in growth areas like US services and UK businesses. However, the ratio of headcount growth to revenue growth is expected to decrease as AI-powered automation increases efficiency.

Revision in earnings estimates – We have revised our estimates to factor in Q3FY25 performance.

Our Call

Valuation – Maintain Buy with unchanged PT of Rs. 3,610: Mastek reported muted performance in a seasonally soft quarter impacted by furloughs, salary hikes and currency fluctuations. The 12-month order backlog remains steady providing strong revenue visibility. Health care business in the UK is seeing a strong revival with growth driven by the new Government investment in healthcare and other sectors. We believe the company is well placed to deliver strong growth in FY25 and fiscals ahead driven by recovery in healthcare in UK, steady momentum in US and consistent additions of new logos. We expect sales/PAT CAGR of ~14%/16% over FY24-27E. We maintain Buy with an unchanged price target (PT) of Rs. 3,610. At CMP, the stock trades at 23.6/21.3/18.2x its FY25/26/27E 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	FY24	FY25E	FY26E	FY27E
Revenue	3,054.8	3,461.8	3,952.7	4,532.8
OPM (%)	16.7	15.8	16.2	16.3
Adjusted PAT	304.4	363.7	403.8	472.9
YoY growth (%)	13.7	19.5	11.0	17.1
Adjusted EPS (Rs.)	98.2	116.6	129.4	151.5
P/E (x)	28.0	23.6	21.3	18.2
P/B (x)	4.1	3.6	3.2	2.8
EV/EBITDA	16.9	15.5	13.3	11.6
ROE (%)	15.9	16.3	16.0	16.6
ROCE (%)	16.4	17.1	18.5	19.4

Source: Company; Mirae Asset Sharekhan estimates

Key result highlights

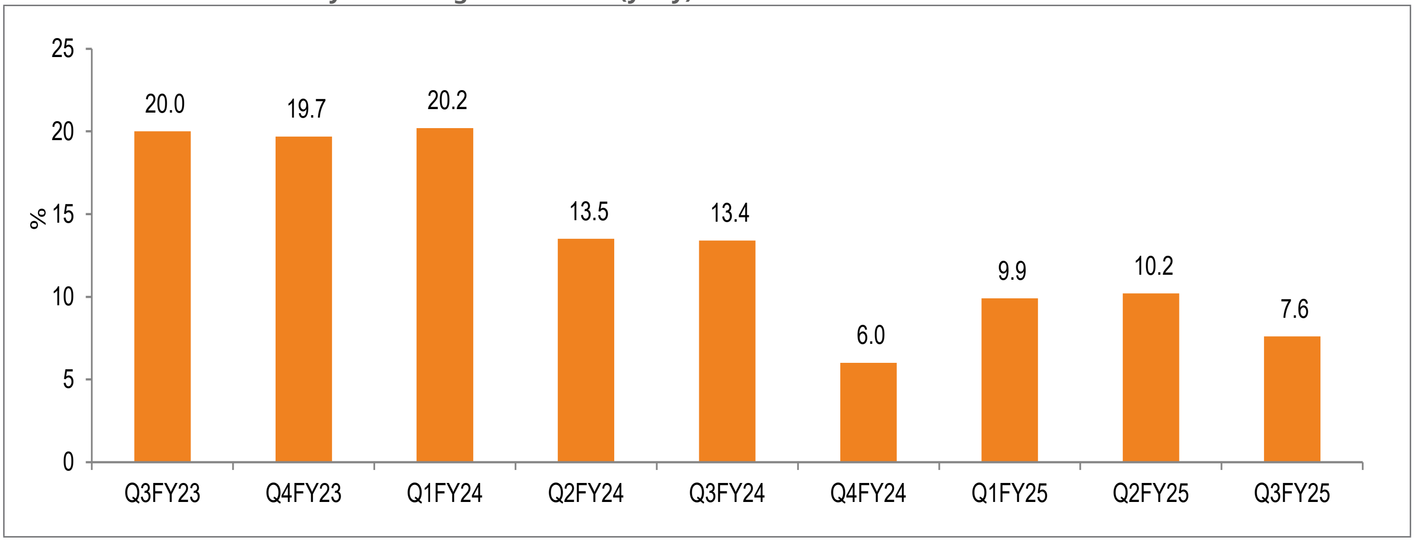
- **Revenue growth:** Company reported revenue at $102.9 million, up 0.1% q-o-q/7.6% y-o-y in constant currency, beating our estimates of $104.8 million. Revenue in USD terms was down 0.7%q-o-q/up 9.4% y-o-y while revenue in rupee terms stood at Rs 869.5 crore, up 0.2% q-o-q/10.9% y-o-y.
- **EBITDA margins:** This fell ~30 bps q-o-q to 16.2% after absorbing the salary hike but beat our estimates of 15.9%.
- **Order backlog:** The 12-month order backlog was Rs 2,138.7 crore ($249.8 million), up 3.4% in rupee terms and 1.5% on constant currency basis. The company secured a $40+ million deal in UK SGS post-quarter, set for delivery over two years with an 80/20 renewal and expansion split. The deal improves the 12-month backlog by 8-9%.
- **Geography-wise performance:** North America, Europe and APMEA grew 3.4%/13.1% and 8% y-o-y respectively.
- **Vertical-wise performance:** Health & Lifesciences, Retail, Manufacturing and Financial services grew 31.8%/21.1% and 11.3% y-o-y respectively. Government & Education declined 0.7% y-o-y.
- **Client metrics:** Total active clients during Q2FY25 were 351 as compared to 380 in Q2FY25. Revenue from Top-5 and Top-10 grew 5.9%/3.3 q-o-q respectively.
- **Attrition and utilisation:** LTM attrition was flat sequentially at 20.1%. Total headcount declined by 245 q-o-q taking the total headcount to 5,260. Utilisation (excluding trainees) fell 420 bps q-o-q to 76.2%
- **Cash balance:** Total cash, cash equivalents, and fair value of mutual funds stood at Rs. 497 crore at the end of Q3FY25 versus Rs. 390.5 crore at the end of Q2FY25. DSO stood at 89 compared to 95 in Q2FY25.

Results (Consolidated) Rs cr

Particulars	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Revenues In USD (mn)	102.9	94.0	103.6	9.4	-0.7
Revenues In INR	869.5	784.3	867.4	10.9	0.2
Employee benefits expense	461.4	431.0	475.3	7.1	-2.9
Other expenses	267.5	219.8	249.0	21.7	7.4
EBITDA	140.7	133.5	143.1	5.3	-1.7
Depreciation & amortization	16.6	21.8	19.9	-24.2	-16.6
EBIT	124.1	111.7	123.3	11.1	0.7
Other Income	9.5	3.4	5.0	181.0	87.9
Finance costs	11.9	13.3	11.1	-11.1	6.5
PBT	121.7	101.7	117.2	19.6	3.9
Tax Provision	31.0	24.0	0.3	29.1	11,374.1
PAT	90.7	77.7	116.9	16.7	-22.4
Minority interest	0.0	-2.4	0.0		
EO	4.0	0.0	11.8		
Net profit	94.7	75.3	128.7	25.7	-26.4
Adjusted net profit	90.7	75.3	116.9	20.5	-22.4
EPS (Rs)	30.4	24.3	41.2	24.9	-26.4
Margin (%)					
EBITDA	16.2	17.0	16.5	-85	-32
EBIT	14.3	14.2	14.2	3	6
NPM	10.4	9.6	13.5	83	-304
Tax rate	25.5	23.6	0.2	186	2,522

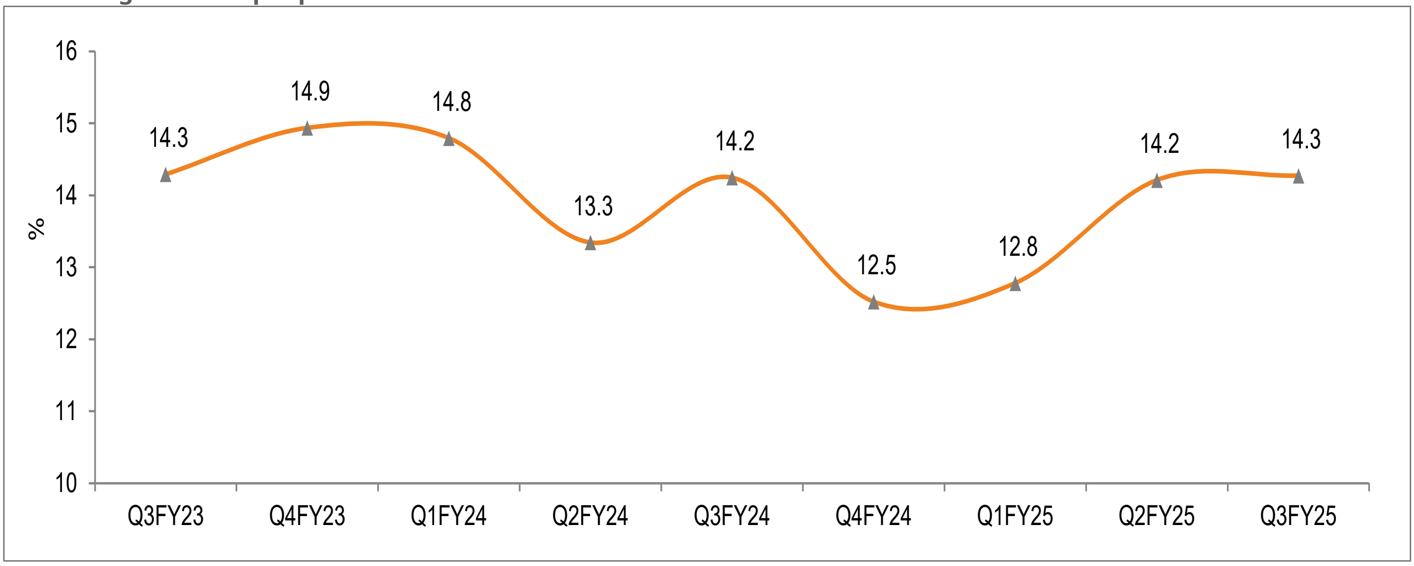
Source: Company; Mirae Asset Sharekhan Research

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



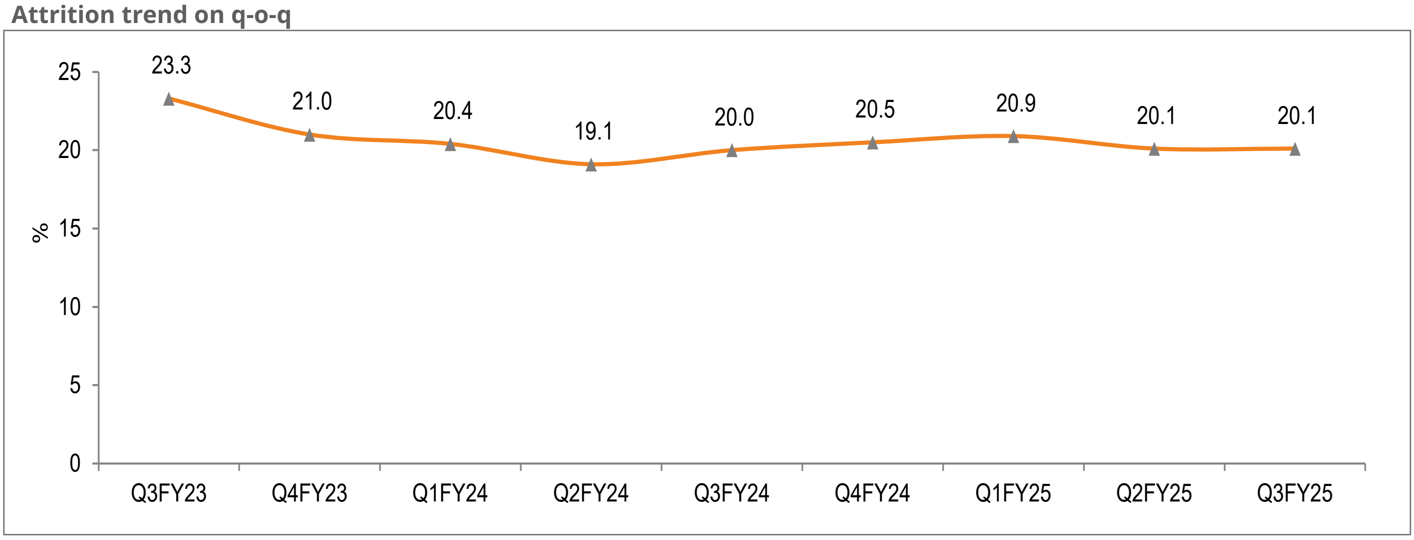
Source: Company; Mirae Asset Sharekhan Research

EBIT Margin Trend q-o-q



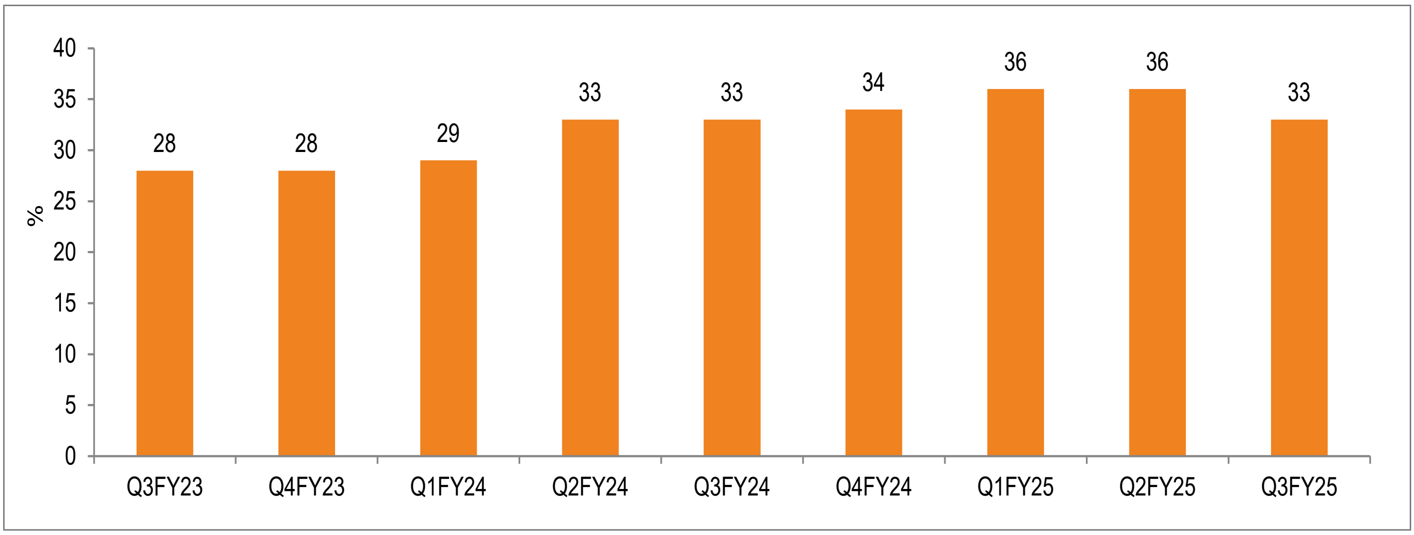
Source: Company; Mirae Asset Sharekhan Research

Attrition trend on q-o-q



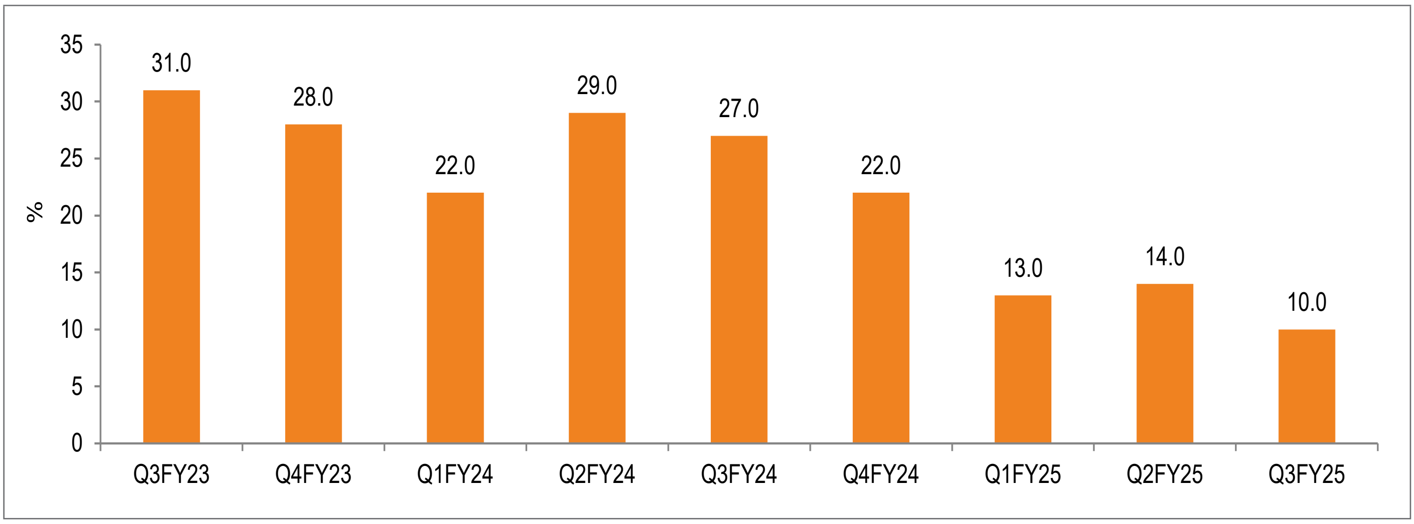
Source: Company; Mirae Asset Sharekhan Research

Number of Fortune 1000 clients



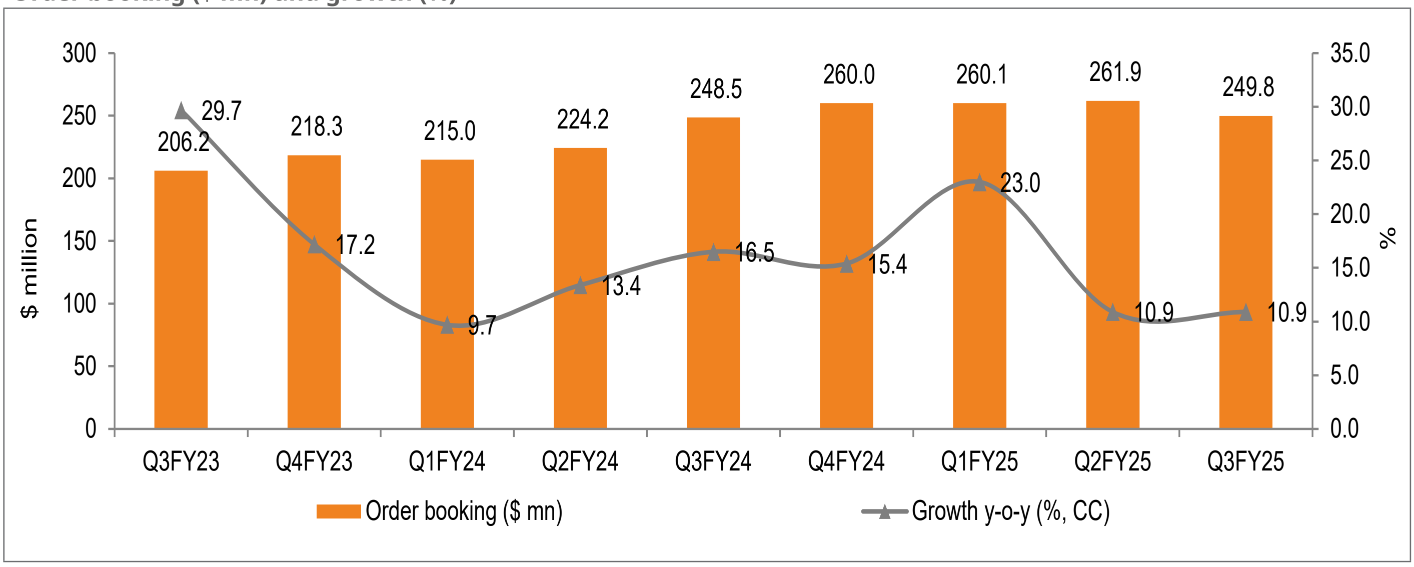
Source: Company; Mirae Asset Sharekhan Research

Number of new clients addition



Source: Company; Mirae Asset Sharekhan Research

Order booking ($ mn) and growth (%)



Source: Company; Mirae Asset Sharekhan Research

Outlook and Valuation

■ Sector View - Macro headwinds bottoming out; 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 the Nifty last year, we expect overall outperformance in CY25 as well, driven by receding headwinds and better earnings visibility.

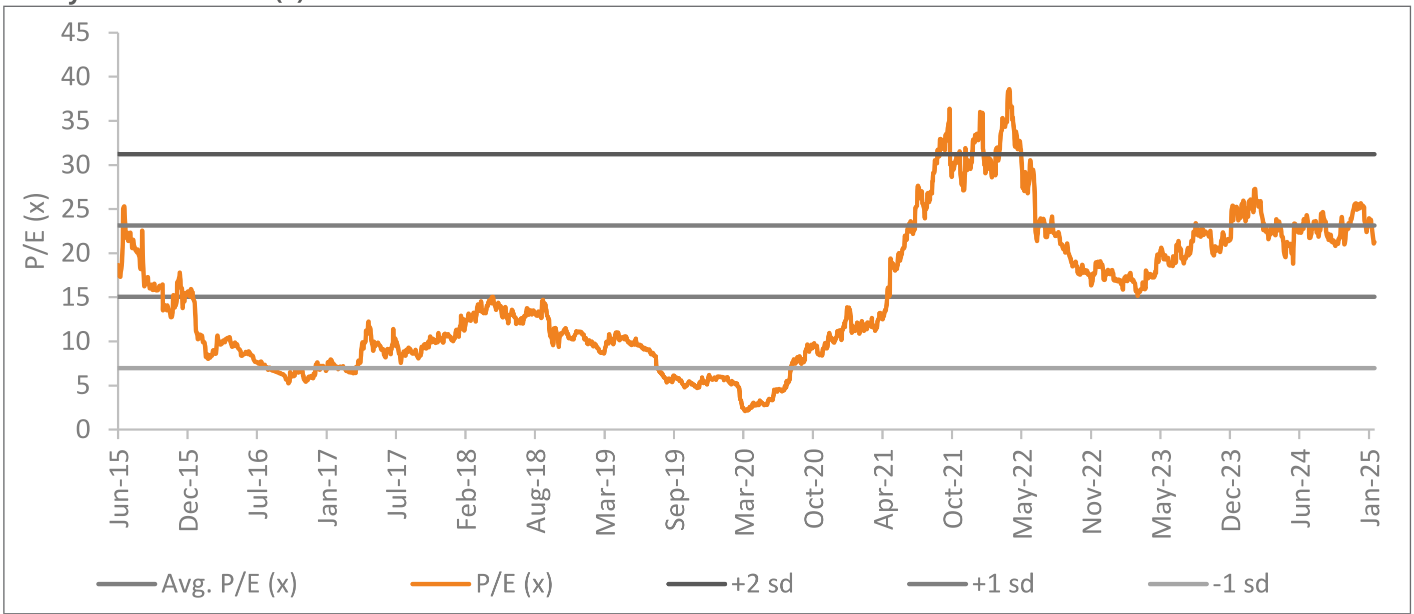
■ Company Outlook – Long-term outlook intact

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). The 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 revised PT of Rs 3,610

Mastek reported muted performance in a seasonally soft quarter that was hit by furloughs, salary hikes and currency fluctuations. The 12-month order backlog remains steady providing strong revenue visibility. Health care business in the UK is seeing a strong revival with growth driven by the new Government investment in healthcare and other sectors. We believe the company is well placed to deliver strong growth in FY25 and fiscals ahead driven by recovery in healthcare in UK, steady momentum in US and consistent additions of new logos. We expect sales/PAT CAGR of ~14%/16% over FY24-27E. We maintain Buy with an unchanged price target (PT) of Rs. 3,610. At CMP, the stock trades at 23.6/21.3/18.2x its FY25/26/27E EPS.

One-year forward P/E (x) band



Source: Company; Mirae Asset Sharekhan Research

About the 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. 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 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.

Key Risks

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

Umang Nahata	Global CEO
Abhishek Singh	President U.K. and Europe
Vijay Iyer	President Americas
Prameela Kalive	Chief Operating Officer
Arun Agarwal	Group CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	7.93
2	ICICI Prudential Asset Management	2.80
3	Vanguard Group Inc/The	2.18
4	Tata Asset Management Pvt Ltd	2.03
5	ABAKKUS GROWTH FUND 1	1.57
6	Abakkus Emerging Opportunities Fun	1.47
7	Blackrock Inc	0.98
8	Dimensional Fund Advisors LP	0.81
9	Norges Bank	0.52
10	State Street Corp	0.06

Source: Bloomberg

Understanding the Mirae Asset 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: Mirae Asset Sharekhan Research

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