

Mastek Limited

Industry	IT
Bloomberg	MAST IN
BSE CODE	523704

Macro challenges to impact growth in FY20, margin likely to look sustainable

RATING	ACCUMULATE
CMP	468
Price Target	527
Potential Upside	13%

Rating Change	↓
Estimate Change	↓
Target Change	↓

Stock Info

52wk Range H/L	643/365
Mkt Capital (Rs Cr)	1121
Free float (%)	52%
Avg. Vol 1M (,000)	154
No. of Shares (Cr)	2
Promoters Pledged (Cr)	0

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4QFY19 Result Update

- ❑ Mastek 4QFY19 performance showed a mixed set of numbers .Revenue during the quarter stood at Rs 267crore , a growth of 0.8% in rupee term and 1.9%QoQ in cc terms, below our estimates of 3.8% QoQ mainly impacted by macro challenges in UK business whereas margin came at 13.2% in line with our estimates of 13.1%.
- ❑ PAT for the quarter stood at Rs 27.4crore mainly led margin beat and higher other income.
- ❑ UK market showed a slow growth of 2.7%QoQ during the quarter which is lowest in the last few quarters .The slow growth was mainly caused by weakness in government both in public and majorly in private sector due to delay in project sign off .The management is seeing challenges in UK business resulting from brexit , thus expects FY20 to post slower growth in UK market
- ❑ US which now contributes 22% of revenue continued to post de growth and further declined 5.8%QoQ during the quarter .However the management expects growth to be seen in FY20.
- ❑ Order backlog during the quarter increased 5.3%QoQ to Rs 544.9 crore or in euro 60.2 million as compared to 517.3 or euro 58.1million in Q3FY19.

View and Valuation

Mastek 4QFY19 result reflected weakness in revenue performance whereas margin remained intact. Revenue (growth of 0.8%QoQ) was mainly impacted due to slow growth in government vertical (particularly in private sector), weakness in financial service (declined 3.5%QoQ) and IT services(declined 36%QoQ). Also Retail remained soft due to restructuring going on in US business. Going forward we expect Mastek revenue to grow in FY20 on the back of order backlog which now stands at Rs 544 crore however the pace of growth is expected to be much slower than FY19(25%YoY growth)seeing the macro challenges in UK. Mastek mature market (UK) which was clocking more than 35%YoY growth in FY19, we now expected it to grow in mid teens mainly impacted by Brexit as the company is facing delay in project signing off and delayed in investment done by UK public sector. Even the management has stated of growth in public and private to be lower in near term. However we expect softness in UK market to be cushioned with some growth coming from US market in FY20 as the restructuring process is completely done (removing of legacy management business) and we further do not expect any decline from this market. Also we see some revenue growth to supported by inorganic growth as management is planning to go for M&A in FY20 On margin we expect FY20 will see a sustainable margin growth on the back of better operational efficiencies and contribution from digital business. Post the result we have reduced our revenue and PAT growth by 6%/7% for FY20 seeing near term macro concerns. We value the stock at target of Rs527 (11 x FY20EPS) and recommend Accumulate.

Key Risks to our rating and target

- ❑ Prolonged weakness in US business
- ❑ Slow down in order booking. and ramp up of projects.

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19	FY20E
Net Sales	527	562	817	1033	1150
EBITDA	18	53	100	132	146
EBIT	2	40	81	114	127
PAT	14	37	70	100	112
EPS (Rs)	6	16	30	43	48
EPS growth (%)	-24%	164%	90%	43%	12%
ROE (%)	4	7	11	19	20
ROCE (%)	4	10	15	18	17
BV	139	201	235	302	342
P/B (X)	1.0	0.9	2.1	1.5	1.4
P/E (x)	24.0	11.5	16.5	10.9	9.8

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4QFY19 Results
revenue growth below estimates

Financials	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales /	224	244	257	265	267	19.4%	0.8%	817	1,033	26.4%
Other Income	7	3	9	6	7	-3%	15%	21	25	18.1%
Employee	130	140	150	149	149	14.6%	-0.5%	481	587	22.1%
Other Expenses	66	73	76	82	83	25.8%	2.0%	237	315	32.9%
EBITDA	28	31	31	34	35	26.6%	3.8%	100	132	32.0%
Dep and	4	4	5	4	4	19.3%	0.2%	19	17	-7.5%
EBIT	24	27	27	30	31	27.7%	4.3%	81	114	41.1%
Interest	2	1	2	1	1	-29.5%	-18.5%	6	6	4.6%
PBT	30	29	33	34	37	23.5%	18.8%	96	133	38.3%
Tax	10	6	8	8	10	-4.3%	26.9%	26	32	22.4%
Exceptional	-	-	-	-	(1)			-	1	
PAT	19	22	25	27	27	41.2%	3.3%	70	100	43.5%

4QFY19: Revenue miss , margin remained intact

- Revenue for the quarter stood at RS 267 crore , a growth of 0.8% QoQ in rupee term and 1.9% in constant currency mainly impacted by softness in UK market and weakness in financial service segment and It services .
- Revenue from UK market showed a slow of 2.7%QoQ which is lowest in last few quarters .Even US which had started 24 months back have shown de growth of 5.8%QoQ due to restructuring process to remove legacy management from US business.
- Industry wise, Government posted a 12%QoQ whereas financial, retail and IT services declined by 3.5%/0.7%and 36%QoQ.

Macro challenges resulted in slow growth in UK business

Verticals (crore)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	QoQ%	YoY%
UK	136	143	161	174	186	199	204	2.7%	26.6%
US	58	62	60	65	67	62	59	-5.8%	-2.1%
Others	4	4	2	5	4	4	4	11.2%	72.0%

Government posted growth; Financial& IT services offset the overall growth

Industry(in crore)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	QoQ%	YoY%
Government	69	70	71	77	99	101	113	12.4%	59.6%
Finncial service	34	45	51	54	49	50	48	-3.5%	-7.1%
Other IT service	77	78	80	90	93	92	92	-0.7%	14.7%
Retail	18	17	21	23	16	23	14	-36.0%	-32.9%

12 consecutive quarter of uptick in margins

Ebitda for the quarter came at Rs35.3 crore, a growth of 3.3%QoQ and 26.6%YoY .Margin improved 40 bps in 4QFY19 to 13.2% as compared to 12.8% last quarter led by operational efficiency. The management expects to sustain the margins going ahead .

Concall highlights

- Despite the market headwind created by brexit the company maintained its growth momentum in 4QFY19.
- **Macro challenges persists:** Brexit has impacted the company in couple of ways during the quarter ;
 - **In private sector,** the company has seen the biggest impact as it dampened confidence in investment priority which resulted in delay of project sign offs .Unfortunately in the short term outlook; the environment will not change too much till October as announced by the government last week.
 - **In the UK public sector,** the company was probably not directly impacted because the company has resilient revenue stream coming through this account however the management has seen brexit issue resulted in delayed investment as the civil servant were more distracted with contingency planning revenue scenario .Going forward, the management feels once they get clarity, the opportunity in public sector will continue however the rate of growth in public and private will be lower. (UK still has to replace the services which were delivered by European Union previously).

- **US business** which contributes 22% of the revenue , the company has completely reset the business by removing the legacy management(impacted by 4.6% in 4QFY19) and is process of appointing of new leader to set the business back to strategic growth . The company sees no further drag in revenue from here on and expects FY20 to see growth in US business.
- **Continued growth in order back:** the company now has order backlog of Rs544.9 crore (euro 60.2 million) by growing 4.5% during the quarter. The company has positive book to bill.
- **Continued growth in digital:** The digital business as percentage of overall revenue now stands at 84% vs 82% base last quarter.
- **Employee count:** the company maintained it employee count to flat demonstrating the use of technology in transformational work. The employee count for FY19 remained at 2069 of which 1264 came from offshore based in India and rest came from onsite location.
- **Strategy for FY20:** 12 consecutive revenue growths were seen in 4QFY19 under the vision 2020.The company is finally moving to last phase which is growth phase in FY20 (through organic and through acquisition).The company with a vision of 2020 of Fix, win and growth strategy of 3 year, it also working on strategy of making UK and US business mix to balance in next 3 years to better protect the business from external factors.
- **Outlook for FY20:** Despite drag in US business and even some impact in UK business due to client moving out all through the year, the company managed to post strong growth in FY19. The company expects with strong leadership team across the board, the company can absorb and mange the external factors (Brexit a, churn coming from legacy customers and also the challenges of execution issue they that previously had in US business) and is confident of continuing its growth trajectory in FY20.
- **Appointing a leader for US business:** In order to continue the growth trajectory, the company is looking to appoint new leader in US business to support the performance of the segment. The company is likely to announce it by 1QFY20.
- **Hedge book:** FX hedge rate for next 12 months stand at 7.5 million at average rate of Rs 95.9 per pound.
- **Margin outlook:** The Company is confident to continue maintain the margin trajectory in FY20.
- **ETR** to continue for 22% to 23% for next few years.
- **Debts:** The Company will continue to use cheap debt backed by their own asset.
- **Noncore stake sale :** The company is looking for investment from sale of Majesco stake completely(12% or 5 million share)to support their inorganic growth plan .

Exhibit: Revenue trend

While government posted growth; Financial and IT services offset the overall revenue growth.

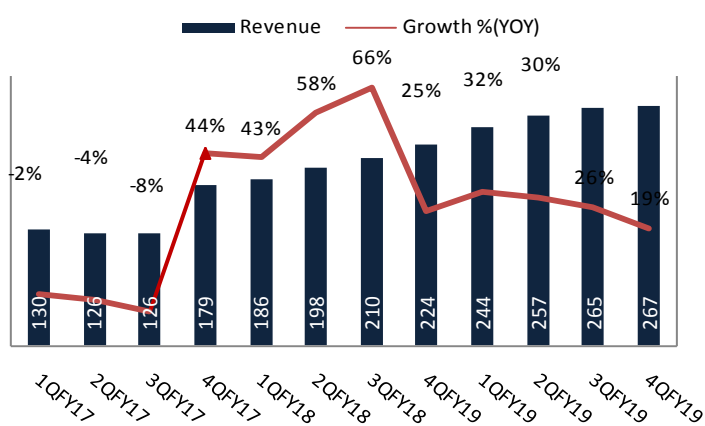


Exhibit: Service line

Application service declined in 4QFY19

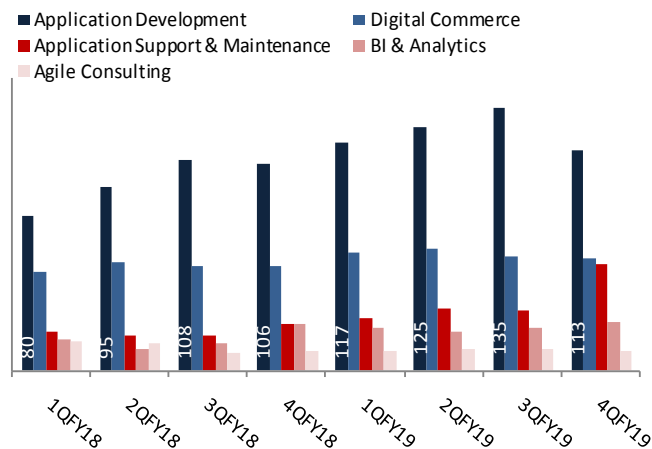


Exhibit: Margin Trend

Margin expanded by 40bps led by operational efficiency

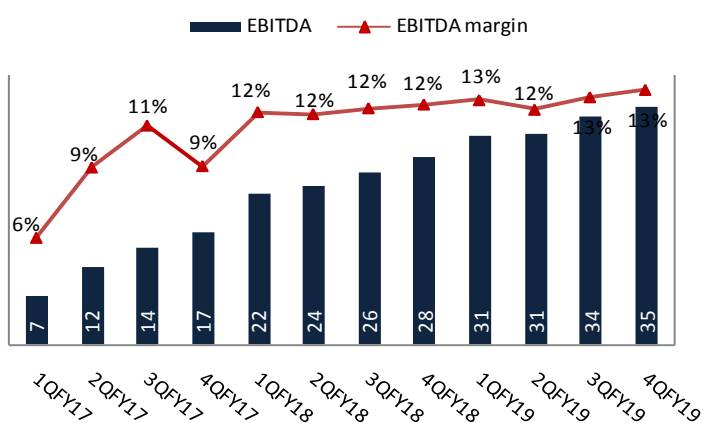


Exhibit: Fixed Price and Time &Material

Continued growth in fixed price contracts

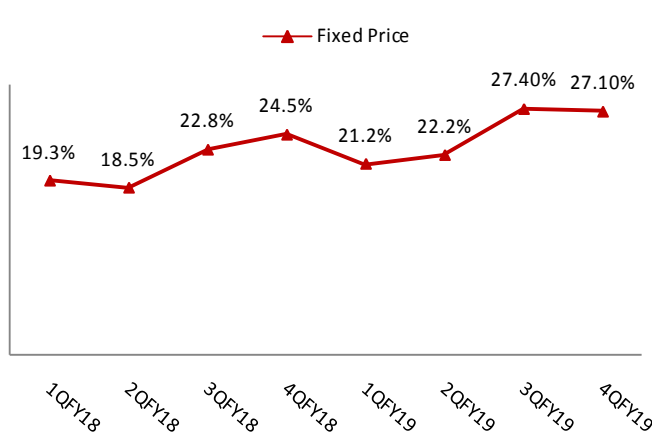
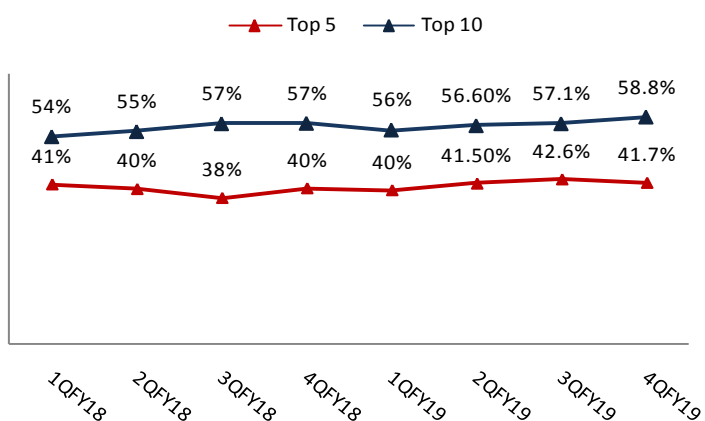


Exhibit: Top Client

Continued growth in Top 5 client



Financial Details
Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Share Capital	12	11	11	11	12	12	12	12
Reserves	521	549	585	308	432	537	704	800
Networth	533	560	596	319	444	549	716	811
Debt	1	1	20	0	65	50	69	69
Other Non Cur Liab	36	25	27	6	103	52	32	32
Total Capital Employed	570	586	643	325	611	651	818	913
Net Fixed Assets (incl CWIP)	250	261	280	66	75	73	71	72
Non Cur Investments	3	3	2	19	169	166	282	282
Other Non Cur Asst	334	346	357	133	245	245	220	221
Non Curr Assets	337	348	359	151	414	412	503	503
Inventory	0	0	0	0	0	0	0	0
Debtors	149	117	133	97	85	135	208	232
Cash & Bank	122	90	163	89	48	88	93	81
Other Curr Assets	76	94	89	44	14	10	49	55
other financial asset	0	0	0	0	68	77	19	19
Short-term loans and advances	21	24	35	16	0	0	0	0
Curr Assets	405	406	472	277	320	428	484	585
Creditors	5	4	13	9	20	19	9	10.5539
Provisions	32	24	17	6	32	5	12	14
Other Curr Liab	135	140	151	88	3	44	36	40
Other financial liabilities	0	0	0	0	39	27	0	0
Other long-term liabilities	0	0	0	0	4	9	6	5.75
Curr Liabilities	171	167	180	103	122	185	169	175.353
Net Curr Assets	234	238	292	174	197	243	315	409.593
Total Assets	742	754	832	428	734	840	987	1088.33

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Revenue from Operation	683	923	1,013	527	562	817	1,033	1,150
Change (%)	-6%	35%	10%	-48%	7%	45%	26%	11%
EBITDA	57	90	56	18	53	100	132	146
Change (%)	179%	58%	-38%	-67%	191%	88%	32%	11%
Margin (%)	8%	10%	5%	3%	9%	12%	13%	13%
Depr & Amor.	22	33	37	16	13	19	17	19
EBIT	35	57	18	2	40	81	114	127
Int. & other fin. Cost	0	1	1	1	3	6	6	4
Other Income	9	11	17	17	10	21	25	23
EBT	44	68	34	19	47	96	133	146
Exp Item	-	-	12	3	3	-	1	-
Tax	9	16	5	3	7	26	32	33
Minority Int & P/L share of Ass.	-	-	-	-	-	-	-	-
Reported PAT	34	52	18	14	37	70	100	112
Adjusted PAT	34	52	18	14	37	70	100	112
Change (%)	6760%	51%	-66%	-22%	169%	90%	43%	12%
Margin(%)	5%	6%	2%	3%	7%	9%	10%	10%

Financial Details
Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
ROE	6.3	9.0	3.9	3.6	7.4	11.1	18.6	19.7
ROCE	7.7	11.7	5.5	3.9	10.1	15.2	18.1	16.8
Asset Turnover	3	4	4	8	8	11	14	16
Current Ratio	3	4	4	8	8	11	14	16
Debtor Days	80	46	48	67	55	60	74	74
Book Value Per Share	216	253	264	139	201	235	302	342
Payable Days	2	2	5	7	13	8	3	3
Earnings Per Share	14	23	8	6	16	30	43	48
P/E	9	9	54	24	11	17	11	10
Price / Book Value	1	1	2	1	1	2	2	1
EV/EBITDA	3	4	15	13	8	11	8	8
EV/Sales	0	0	1	0	1	1	1	1
Dividend Payout%	22%	19%	32%	42%	22%	20%	14%	13%

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
PAT	44	68	34	19	47	70	133	146
(inc)/Dec in Working Capital	28	16	-8	7	-10	-45	-99	-19
Non Cash Op Exp	18	28	42	13	10	48	89	23
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	-9	-23	1	-8	-4	-9	-32	-33
others	0	0	0	0	0	0	0	0
CF from Op. Activities	80	89	68	31	43	64	91	116
(inc)/Dec in FA & CWIP	-18	-27	-49	-13	-15	-15	0	0
Free Cashflow	62	63	19	19	28	49	91	116
(Pur)/Sale of Inv	-256	-570	-494	0	0	-113	4	-84
others	0	0	0	0	0	0	0	0
CF from Inv. Activities	-9	-70	-24	16	-119	-24	-12	-104
inc/(dec) in NW	0	0	0	0	0	0	0	0
inc/(dec) in Debt	0	0	19	-1	67	4	16	0
Int. Paid	0	-1	-1	0	-3	-3	0	0
Div Paid (inc tax)	0	-12	-10	-9	-2	-11	-17	-17
others	-42	-55	14	6	2	3	-6	-4
CF from Fin. Activities	-43	-67	22	-4	64	-7	-7	-21
Inc(Dec) in Cash	29	-48	66	43	-12	34	5	-13
Add: Opening Balance	82	119	67	25	59	54	88	93
Closing Balance	111	71	134	67	48	88	93	80

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