

Mastek Limited

Industry **TECHNOLOGY**
Bloomberg **MAST IN**
BSE CODE **523704**

Macro uncertainty to impact revenue growth in near term

RATING **NEUTRAL**

CMP 465
Price Target 450
Potential Upside -3%

Rating Change ↓

Estimate Change ↓

Target Change ↓

Stock Info

52wk Range H/L 643/365
Mkt Capital (Rs Cr) 1118
Free float (%) 52%
Avg. Vol 1M (,000) 20
No. of Shares (Cr) 2
Promoters Pledged % 0%

Research Analyst

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1QFY20 Result update

- ❑ Company reported a mix set of numbers in its 1QFY20 result. Revenue saw a steep decline of 7.3%QoQ (missing our estimates of growth in 1Q) Whereas EBITDA margin remain stable improving 10 bps to 13.3% during the quarter(in line with our estimates of 13.3%).
- ❑ PAT for the quarter stood at Rs 24.2, a de growth of 11.6%QoQ largely led by miss in revenue growth.
- ❑ Segment wise, US posted a strong revenue growth of 7.3%QoQ while revenue from UK declined by11.6% in rupee term primarily led by deal closure and timing issue where the project signing got delayed .India revenue remained soft .
- ❑ Order backlog during the quarter remained solid and increased 10.6%QoQ and 13.4%QoQ in cc terms to Rs602.7 crore (£ 68.8 m) as compared to Rs 544.9 crore (£ 60.2 m) in Q4FY19.
- ❑ Despite the challenges, the company is confident of continued double digit growth in FY20 as the company gets into its final phase of vision 2020(growth phase).

View and Valuation

Company started the year with the weak revenue growth whereas margin remained stable in 1QFY20 .Revenue declined 7.3%QoQ mainly impacted by softness in UK market (majorly in private sector) while margin improved 10 bps to 13.3% due to better operational efficiency. Order backlog went up by 10.6%QoQ to Rs 602 crore or (£ 68.8 million).

Going forward, we expect MASTEK's revenue to improve from 1QFY20 onwards on the back of strong order backlog and improved growth from US market (USD 44 million business).Although order intake remained solid, However, political instability around the UK market due to uncertainty around Brexit is resulting in delay in decision making and slow down in UK discretionary spending in private sector which is raising concern for continued revenue improvement. Though management is planning to grow through M&A activities and through focus on UK public sector, however we still believe the M&A activities is a quarter or two acts and will take time to execute. We are hopeful of value accretive M&A by company going ahead. We will revisit the stock once the acquisition is announced.

Till then , seeing the macro challenges in UK business(~75% revenue generator), we are reducing our multiple from 12 times to 10 times and reach at target price of Rs 450 and recommend Neutral.

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	FY17	FY18	FY19	FY20E	FY21E
Net Sales	562	817	1033	1071	1262
EBITDA	53	100	132	137	164
EBIT	40	81	114	116	142
PAT	37	70	100	105	129
EPS (Rs)	16	30	43	45	55
EPS growth (%)	164%	90%	43%	5%	23%
ROE (%)	7	11	12	14	17
ROCE (%)	10	15	18	16	17
BV	201	235	302	337	384
P/B (X)	0.9	2.1	1.5	1.4	1.2
P/E (x)	11.5	16.5	10.3	10.3	8.4

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1QFY20 Results

Weak revenue growth

Financials	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales	244	257	265	267	248	1.4%	-7.3%	817	1,033	26.4%
Other Income	3	9	6	7	5	63.9%	-26.0%	21	25	18.1%
Employee Exp	140	150	149	149	135	-3.3%	-9.1%	481	587	22.1%
Other Expenses	73	76	82	83	80	8.5%	-4.4%	237	315	32.9%
EBITDA	31	31	34	35	33	6.3%	-6.8%	100	132	32.0%
Depreciation	4	5	4	4	6	44.7%	32.6%	19	17	-7.5%
EBIT	27	27	30	31	27	0.6%	-12.3%	81	114	41.1%
Interest	1	2	1	1	1	-35%	-25%	6	6	4.6%
PBT	29	33	34	37	31	9.0%	-14.5%	96	133	38.3%
Tax	6	8	8	10	7	12.8%	-27.2%	26	32	22.4%
Exceptional	-	-	-	(1)	-			-	1	
PAT	22	25	27	27	24	8.0%	-11.6%	70	100	43.5%

1QFY20 performance: Weak Revenue performance

- Company's 1QFY20 revenue stood at RS 247.5 crore, a decline of 7.3%QoQ. In constant currency terms revenue decline by 5.5%QoQ primarily on account of decline in UK market.
- US market posted a strong revenue growth of 7.3%QoQ while revenue from UK declined 11.6% in rupee term primarily led by deal closure and timing issue where the project signing got delayed. India revenue remained soft.
- Industry wise, While Retail led the growth by growing 1.9%QoQ owing to improvement in US revenue, all the other segments declined due to weakness in UK market. Financial service declined 14.6%QoQ, followed by Government segment which posted decline of 12.4% QoQ mainly due to steep decline in UK private sector.

Steep decline in UK market while US saw growth

Verticals (USD Mn)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ%	YoY%
UK	143	161	174	186	199	204	181	-11.6%	3.7%
US	62	60	65	67	62	59	63	7.3%	-3.0%
Others	4	2	5	4	4	4	4	-3.2%	-20.8%

Barring Retail, all the segment remained soft

Industry(in crore)	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ%	YoY%
Government	70	71	77	99	101	113	99	-12.4%	29.0%
Financial service	45	51	54	49	50	48	41	-14.6%	-24.0%
Retail	78	80	90	93	92	92	93	1.9%	3.5%
Other IT service	17	21	23	16	23	14	14	-2.2%	-39.8%

Strong order backlog

- The company pipeline remain solid during the quarter as the company sees strong order backlog which stood at Rs 602.7 crore (€ 68.8 m) on 1QFY20 as compared to Rs 544.9 crore (€ 60.2 m) in Q4FY19; growth of 10.6% QoQ and constant currency growth of 13.4%.

Margin remained stable

- EBITDA for the quarter stood at Rs 32.9 crore, a decline of 6.8%QoQ. Despite steep dip in revenue growth, the company managed to maintain the margin to 13.3%, a improvement of 10 bps QoQ and 60bpsYoY mainly on back of proactive management of cost structure and better operational efficiencies. The company also managed the margin despite continued investment that the company had made so to be future ready.
- PAT for the quarter stood at Rs 24.2, a decline of 11.6%QoQ largely led by miss in revenue growth.

Concall Highlights

- **MACRO aspect:** The brexit is expected to impact the economy .However due to lack of clarity on the stability of brexit, The shadow of brexit will continues to result in UK business challenging for FY20.The company expects the growth to continue as for last 3 year the company has been implementing Vision 2020 strategy which has not only resulted in better financial performance but also built in better revenue resilience which is helping to navigate with these external factors.
- **UK public sector:** The Company has not lost any customer but only seeing general slowdown in spending and right shift in new project particularly in private sector.UK public sector continues to grow strongly QoQ and it has become better for the company's global business. The company expects this sector to continue to grow and even accelerate as the political instability gets resolved.NHS is expected to drive growth.
- **UK private sector:** The Company's UK private sector has mostly suffered during the quarter due to stress with the new project getting deferred and moving to the right .Also more damaging for the sector is slow down in discretionary spending which is taking lot of momentum in this business. The company is not seeing structural issue rather it is the brexit which is impacting the sector. The company expects it to recover once the clarity comes in however though no growing in similar pace but sees revenue growth to bottom out from hereon .
- **Performance in US:** Encouraging performance has been posted by the company from the US market. However the company expects one quarter can't reflected as the recovery trend but sees confidence in better revenue visibility in FY20.
- **Investment:** Last year the company was spending 12 million pounds on training digital to fresh graduates .This investment was intended to support UK expansion.
- **Cash balance:** the company had a cash balance of Rs 247 crore after incorporating the payout of US acquisition and contingent's consideration that the company paid during the quarter.
- **Liquidation the Majesco stake:** For getting inorganic growth, the company is actually going through a process of cleaning up the balance sheet. The company is monetizing the majesco stake and also some legacy office buildings so to confirm the core business to simply on value creation.
- **Strategy:** As the company seeing slow down in UK private sector, it has shifted its SG& from UK private sector which is not been strong to the Public sector where the company continues to win deals in new account and expand existing accounts and Also re energize the US business where the company is cross selling &up selling core business to the customer base.
- **Outlook for FY20:** Despite the challenges, the company is confident of continued double digit growth in FY20 as the company gets into its final phase of vision 2020(growth phase) .As the company progress through the year, the company will continue to work on becoming the leader in digital space. The company expects to grow organically but as it is last phase which is growth phase, the company will go for growth through organic and also go for M&A to get the growth in FY20.The Company expects to get back to its growth from 2HFY20.

Exhibit: Revenue trend

UK private sector washed away the overall revenue growth.

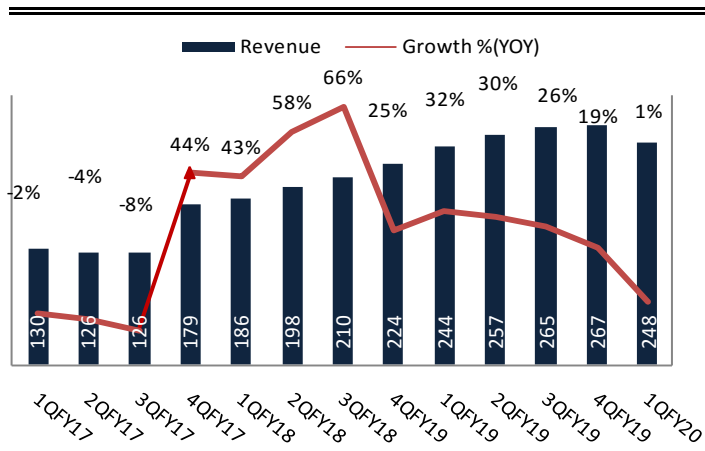


Exhibit: Service line

Most of service line declined due macro challenges.

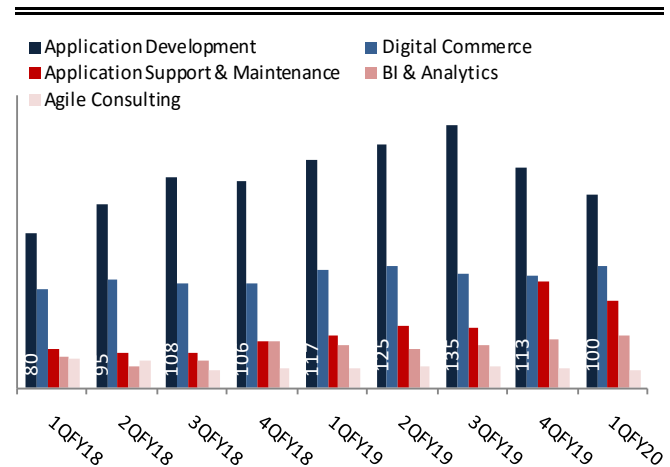


Exhibit: Margin Trend:

Better Operational efficiency led to margin expansion in FY19.

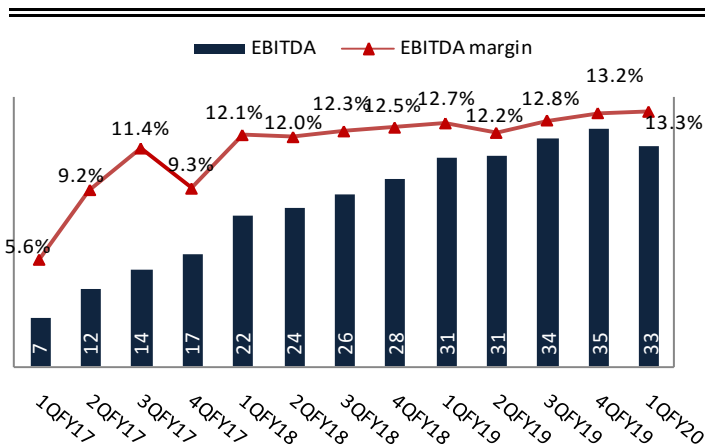


Exhibit: Fixed Price and Time &Material

Decline in fixed price contracts due to weakness in UK market.

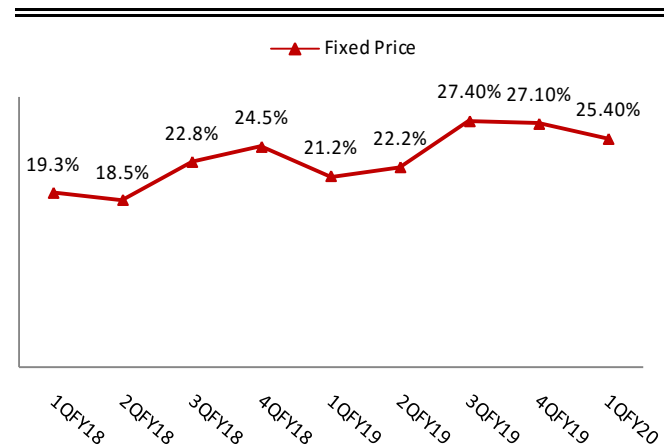
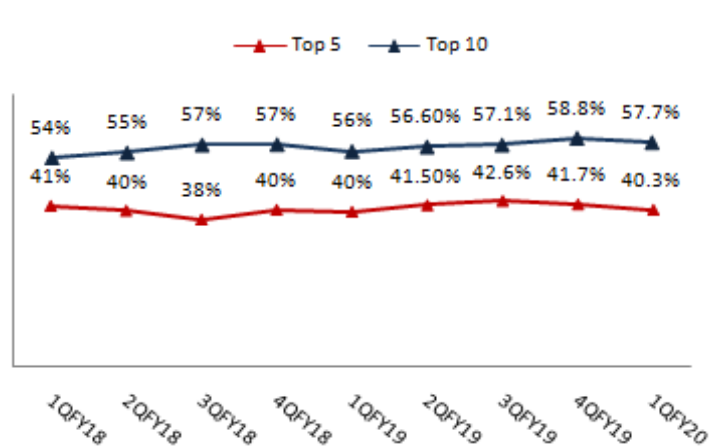


Exhibit: Top Client

Softness seen in top client.



Financial Details

Balance Sheet

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	11	11	11	12	12	12	12	12
Reserves	549	585	308	432	537	704	793	905
Networth	560	596	319	444	549	716	805	917
Debt	1	20	0	65	50	69	69	69
Other Non Current Liab	25	27	6	103	52	32	59	59
Total Capital Employed	586	643	325	611	651	818	933	1,045
Net Fixed Assets (incl CWIP)	261	280	66	75	73	71	65	61
Non Current Investments	3	2	19	169	166	282	282	282
Other Non Cur Asst	346	357	133	245	245	220	214	210
Non Current Assets	348	359	151	414	412	503	496	492
Inventory	-	-	-	-	-	-	-	-
Debtors	117	133	97	85	135	208	216	255
Cash & Bank	90	163	89	48	88	93	108	148
Other Curr Assets	94	89	44	14	10	49	51	60
Other financial asset	-	-	-	68	77	19	19	19
Short-term loans and advances	24	35	16	0	0	0	0	0
Current Assets	406	472	277	320	428	484	608	734
Creditors	4	13	9	20	19	9	10	12
Provisions	24	17	6	32	5	12	13	15
Other Curr Liab	140	151	88	3	44	36	37	44
Other financial liabilities	-	-	-	39	27	0	27	27
Other long-term liabilities	-	-	-	4	9	6	6	6
Curr Liabilities	167	180	103	122	185	169	171	182
Net Current Assets	238	292	174	197	243	315	437	553
Total Assets	754	832	428	734	840	987	1,104	1,226

Income Statement

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	923	1,013	527	562	817	1,033	1,071	1,262
Change (%)	35%	10%	-48%	7%	45%	26%	4%	18%
EBITDA	90	56	18	53	100	132	137	164
Change (%)	58%	-38%	-67%	191%	88%	32%	4%	20%
Margin (%)	10%	5%	3%	9%	12%	13%	13%	13%
Depr & Amor.	33	37	16	13	19	17	21	22
EBIT	57	18	2	40	81	114	116	142
Int. & other fin. Cost	1	1	1	3	6	6	3	3
Other Income	11	17	17	10	21	25	24	28
EBT	68	34	19	47	96	133	137	168
Exp Item	-	12	3	3	-	1	-	-
Tax	16	5	3	7	26	32	31	39
Minority Int & P/L share of Ass.	-	-	-	-	-	-	-	-
Reported PAT	52	18	14	37	70	100	105	129
Adjusted PAT	52	18	14	37	70	100	105	129
Change (%)	51%	-66%	-22%	169%	90%	43%	5%	23%
Margin(%)	6%	2%	3%	7%	9%	10%	10%	10%

Financial Details

Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	9.0	3.9	3.6	7.4	11.1	12.4	13.6	17.3
ROCE	11.7	5.5	3.9	10.1	15.2	18.1	15.6	16.9
Asset Turnover	4	4	8.0	7.5	11.2	14.5	16.6	20.7
Current Ratio	2	3	2.7	2.6	2.3	2.9	3.6	4.0
Debtor Days	46	48	67	55	60	74	74	74
Book Value Per Share	253	264	139	201	235	302	337	384
Payable Days	2	5	7	13	8	3	3	3
Earnings Per Share	23	8	6	16	30	43	45	55
P/E	9	54	24	11	17	10	10	8
Price / Book Value	1	2	1	1	2	1	1	1
EV/EBITDA	4	15	13	8	11	8	8	6
EV/Sales	0	1	0	1	1	1	1	1

Cash Flow Statement

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	68	34	19	47	70	101	137	168
(inc)/Dec in Working Capital	16	(8)	7	(10)	(45)	(51)	20	(30)
Non Cash Op Exp	28	42	13	10	48	55	21	22
Int Paid (+)	-	-	-	-	-	-	-	-
Tax Paid	(23)	1	(8)	(4)	(9)	(31)	(31)	(39)
others	-	-	-	-	-	-	-	-
CF from Op. Activities	89	68	31	43	64	76	146	121
(inc)/Dec in FA & CWIP	(27)	(49)	(13)	(15)	(15)	(16)	(14)	(18)
Free Cashflow	63	19	19	28	49	60	132	102
(Pur)/Sale of Inv	(570)	(494)	-	-	(113)	(153)	(99)	(40)
others	-	-	-	-	-	-	-	-
CF from Inv. Activities	(70)	(24)	16	(119)	(24)	(53)	(113)	(58)
inc/(dec) in NW	-	-	-	-	-	-	-	-
inc/(dec) in Debt	-	19	(1)	67	4	1	-	-
Int. Paid	(1)	(1)	(0)	(3)	(3)	(2)	-	-
Div Paid (inc tax)	(12)	(10)	(9)	(2)	(11)	(18)	(17)	(17)
others	(55)	14	6	2	3	3	-	-
CF from Fin. Activities	(67)	22	(4)	64	(7)	(16)	(17)	(17)
Inc(Dec) in Cash	(48)	66	43	(12)	34	6	15	39
Add: Opening Balance	119	67	25	59	54	87	93	108
Closing Balance	71	134	67	48	88	93	108	148

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