# Mastek Ltd (MASTEK)

ICICI direct Research

CMP: ₹ 375 | Target: ₹ 345 (-8%) | Target Period: 12 months

**REDUCE**

November 21, 2019

Company Update

## FY20E likely to be weak…

Mastek is a leading IT player with global operations providing enterprise solutions to government, retail and financial services organisations worldwide. The company has a major presence in the UK (71.5%) followed by the US (26.6%) and Rest of the world (1.9%). Acquisition of TaisTech in January 2017 opened the doors for its expansion in US geography and retail segment. Over H1FY20, slowdown in UK government business (39.6% of revenue) on the back of Brexit concerns have led to overall muted H1 and would likely lead to sluggish FY20E revenue and profitability performance. However, the performance is expected to improve in FY21E and beyond.

### Weakness in UK government business to impact FY20E

During FY16-19, the company's rupee revenue has grown at a healthy 25.2% CAGR. Acquisition of TaisTech got consolidated in FY18 for full year. However, in the near term (H1FY20), deferral of projects and delay in deal closures due to Brexit in UK had led to weak H1. Owing to major proportion of revenues coming from UK geography and government, we expect FY20E to report a revenue decline. The weakness would flow down to EBIT margin and profitability front. Though improving sentiments in UK government business, rising proportion in US business along with cost optimisation measures would led to improving profitability in FY21E. In addition, for uplifting growth, the management intends to go for inorganic route by way of certain acquisitions. However, we have not factored it in any acquisition.

### EBIT margins to see dip in FY20E

The EBIT margin for the company is likely to see a dip in FY20E (compared to FY19) on the back of pressure on revenues. However, we expect it to see a marginal improvement in FY21E. Hence, we expect EBIT margins of 10.6%, 10.8% in FY20E, FY21E, respectively.

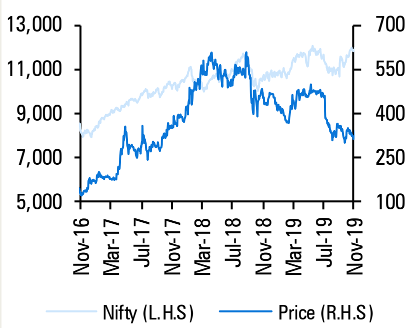
### Valuation & Outlook

The company's acquisition in the US has suffered on both the revenue and profitability front. Although the US operations have shown some signs of an improvement, it will still take time for a complete turnaround. In addition, the company's aim to further grow through acquisition poses a risk to profitability and balance sheet. Further, elevated attrition levels (24.1% in Q2FY20) and high dependence on top clients are also near term challenges. At the CMP, the stock is trading at an attractive valuation of ~9x FY21E EPS. While valuations appear to be cheap optically, it is largely on account of weak near term growth outlook coupled with acquisition led strategy. Hence, we recommend **REDUCE** on the stock with a target price of ₹ 345/share.

**Particulars**

| Particulars | Amount |
|---|---|
| Market Capitalisation | ₹ 938 Crore |
| Debt (March-19) | ₹ 69 Crore |
| Cash (March-19) | ₹ 207 Crore |
| EV | ₹ 799 Crore |
| 52 week H/L (₹) | 508 / 295 |
| Equity capital | ₹ 12 Crore |
| Face value | ₹ 5 |

**Price Performance**

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**Key Financial Summary**

| ₹ Crore | FY17 | FY18 | FY19 | FY20E | FY21E | CAGR FY19-21E |
|---|---|---|---|---|---|---|
| Net Sales | 560 | 817 | 1,033 | 998 | 1,064 | 1.5% |
| EBITDA | 49 | 100 | 132 | 128 | 138 | 2.6% |
| EBITDA Margins (%) | 8.7 | 12.2 | 12.7 | 12.8 | 13.0 | |
| Net Profit | 32 | 70 | 101 | 95 | 103 | 0.8% |
| EPS (₹) | 13 | 28 | 40 | 38 | 41 | |
| P/E | 28.9 | 13.4 | 9.3 | 10.0 | 9.2 | |
| RoNW (%) | 6.9 | 12.7 | 14.2 | 12.0 | 11.9 | |
| RoCE (%) | 7.6 | 15.6 | 17.0 | 14.7 | 14.6 | |

*Source: Company, ICICI Direct Research*

ICICI Securities – Retail Equity Research

## Financial summary

Exhibit 1: Profit and loss statement ₹ crore

| (Year-end March) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| **Net Sales** | **817** | **1,033** | **998** | **1,064** |
| Growth (%) | 46 | 26 | (3) | 7 |
| COGS (employee expenses) | 481 | 587 | 571 | 607 |
| Other expenses | 237 | 315 | 299 | 319 |
| Total Operating Expenditure | 718 | 902 | 871 | 926 |
| | | | | |
| **EBITDA** | **100** | **132** | **128** | **138** |
| Growth (%) | 105 | 32 | (3) | 8 |
| Depreciation | 19 | 17 | 22 | 23 |
| Net Other Income | 15 | 19 | 19 | 21 |
| PBT | 27 | 9 | 68 | 0 |
| Total Tax | 26 | 32 | 30 | 33 |
| Exceptional item | - | 1 | - | - |
| | | | | |
| **PAT** | **70** | **101** | **95** | **103** |
| Growth (%) | 116 | 45 | (7) | 9 |
| EPS (₹) | 28.0 | 40.3 | 37.6 | 40.9 |

*Source: Company, ICICI Direct Research*

Exhibit 2: Cash flow statement ₹ crore

| (Year-end March) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| **Profit before tax** | **96** | **132** | **124** | **136** |
| Add: Depreciation | 19 | 17 | 22 | 23 |
| (Inc)/dec in Current Assets | (58) | (55) | (1) | (21) |
| Inc/(dec) in CL and Provisions | 13 | 4 | (12) | 10 |
| Taxes paid | (9) | (31) | (30) | (33) |
| **CF from operating activities** | **65** | **75** | **73** | **83** |
| (Inc)/dec in Inv. (+) Int inc | (9) | (38) | 25 | 27 |
| (Inc)/dec in Fixed Assets | (15) | (15) | (23) | (24) |
| **CF from investing activities** | **(24)** | **(53)** | **2** | **2** |
| Issue/(Buy back) of Equity | 2 | 3 | - | - |
| Dividend paid & dividend tax | (11) | (18) | (23) | (26) |
| Others | 1 | (1) | 6 | 6 |
| **CF from financing activities** | **(7)** | **(16)** | **(17)** | **(19)** |
| Net Cash flow | 40 | 5 | 57 | 65 |
| Exchange difference | 6 | (0) | - | - |
| Opening Cash | 48 | 88 | 93 | 150 |
| **Closing Cash** | **88** | **93** | **150** | **216** |

*Source: Company, ICICI Direct Research*

Exhibit 3: Balance sheet ₹ crore

| (Year-end March) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| **Liabilities** | | | | |
| Equity Capital | 12 | 12 | 12 | 12 |
| Reserve and Surplus | 537 | 704 | 776 | 853 |
| Total Shareholders funds | 549 | 716 | 788 | 865 |
| Total Debt | 54 | 69 | 69 | 69 |
| Other liabilities | 52 | 32 | 31 | 33 |
| **Total Liabilities** | **655** | **818** | **888** | **968** |
| | | | | |
| **Assets** | | | | |
| Total Fixed Assets | 181 | 169 | 170 | 171 |
| Investments | 166 | 282 | 282 | 282 |
| Other non current assets | 64 | 52 | 58 | 62 |
| Debtors | 174 | 208 | 201 | 215 |
| Loans and Advances | 0 | 0 | 0 | 0 |
| Cash & investments | 206 | 207 | 264 | 330 |
| Other current assets | 48 | 68 | 69 | 73 |
| Total Current Assets | 428 | 484 | 535 | 619 |
| Current liabilities | 181 | 163 | 151 | 161 |
| Provisions | 5 | 6 | 6 | 6 |
| Total Current Liabilities | 185 | 169 | 156 | 167 |
| Net Current Assets | 243 | 316 | 379 | 452 |
| **Application of Funds** | **655** | **818** | **888** | **968** |

*Source: Company, ICICI Direct Research*

Exhibit 4: Key ratios ₹ crore

| | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| **Per share data (₹)** | | | | |
| EPS | 28.0 | 40.3 | 37.6 | 40.9 |
| Cash EPS | 36.9 | 49.5 | 48.5 | 52.7 |
| BV | 219.7 | 284.5 | 312.8 | 343.6 |
| DPS | 6.0 | 8.5 | 7.9 | 8.6 |
| Cash Per Share | 36.7 | 38.9 | 62.7 | 89.9 |
| **Operating Ratios (%)** | | | | |
| EBITDA Margin | 12.2 | 12.7 | 12.8 | 13.0 |
| PBT Margin | 11.8 | 12.9 | 12.5 | 12.7 |
| PAT Margin | 8.6 | 9.8 | 9.5 | 9.7 |
| Inventory days | - | - | - | - |
| Debtor days | 78 | 74 | 74 | 74 |
| Creditor days | 8 | 3 | 3 | 3 |
| **Return Ratios (%)** | | | | |
| RoE | 12.7 | 14.2 | 12.0 | 11.9 |
| RoCE | 15.6 | 17.0 | 14.7 | 14.6 |
| RoIC | 18.0 | 18.7 | 16.9 | 18.0 |
| **Valuation Ratios (x)** | | | | |
| P/E | 13.4 | 9.3 | 10.0 | 9.2 |
| EV / EBITDA | 7.9 | 6.1 | 5.8 | 4.9 |
| EV / Net Sales | 1.0 | 0.8 | 0.7 | 0.6 |
| Market Cap / Sales | 1.1 | 0.9 | 0.9 | 0.9 |
| Price to Book Value | 1.6 | 1.3 | 1.1 | 1.0 |
| **Solvency Ratios** | | | | |
| Debt/EBITDA | 0.5 | 0.5 | 0.5 | 0.5 |
| Debt / Equity | 0.1 | 0.1 | 0.1 | 0.1 |
| Current Ratio | 1.2 | 1.6 | 1.7 | 1.7 |
| Quick Ratio | 1.2 | 1.6 | 1.7 | 1.7 |

*Source: Company, ICICI Direct Research*

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%


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