21 July 2022

Mastek

Streams of headwinds in the quarter, but profitability maintained: Buy

Rating: **Buy**
Target Price: Rs.2,710
Share Price: Rs.2,051

On cross-currency headwinds and the ramp-down in a key UK government healthcare account, Mastek's Q1 was weak. For the last three quarters, its US revenue was flattish, reflecting slower deal wins/execution. Management aims at acceleration in both regions by H2. The order backlog was a healthy $191m, up 21% y/y. In FY23, ~18-20% EBITDA margins would be maintained, primarily via better utilisation. We lower our organic FY23e/FY24e, but integrate the acquisition, resulting in a slight change to estimates. We retain a Buy on anticipated recovery in H2, driven by its order backlog & better execution. However, we lower our target to Rs2,710 (20x FY24e), a 20% cut, reflecting the weak organic performance and cross-currency headwinds.

UK healthcare a drag, UK private picks up pace. Mastek's Q1 revenues were down 4.7% q/q, but y/y up 4.8%, to $74m. A large UK healthcare account ramped down and the company was faced with delays in deal wins and execution in some of the other accounts. UK private grew and is looking better. Overall, UK was flattish in CC. US was slow, with the focus, to support growth, shifting to the newly acquired Salesforce capability (to be integrated from Q2).

Acquires Metasoftech, US revenue to reach 26-27%. Mastek acquired Metasoftech Solutions for $115m ($80m upfront; $35m earn-out), valuing it at 4.7x EV:sales (FY22) and ~3x FY24e EV:sales. Margins are likely to be similar to those of Mastek, given its India operations. It is the largest independent Salesforce consulting partner in the American Southwest (~320 employees) and operates in the Healthcare, Public Sector and Manufacturing verticals.

EBITDA margins resilient, 18-20% outlook maintained. The Q1 FY23 margin was 19.2% (down 160 bps q/q, 268bps y/y) hurt by slow growth, cross-currency and all-time low 68.7% utilisation. Some of these factors are levers for margin defence. Wage hikes are planned for Q2 and attrition started cooling (25%, vs 28% in Q4).

Organic estimates lowered, TP Rs2,710 (20x FY24e). We have lowered our FY23e/FY24e ~2%/5%, reflecting the weak revenue performance (down 5-7%). This gets offset by the Metasoftech integration. The stock now trades at 15x FY24 P/E, which we find attractive. **Risk:** M&A integration-related.

Key financials (YE Mar)	FY20	FY21	FY22	FY23e	FY24e
Sales (Rs m)	10,715	17,219	21,838	25,841	30,935
Net profit (Rs m)	1,089	2,093	2,951	3,734	4,217
EPS (Rs)	42.9	80.5	96.6	120.9	135.7
P/E (x)	57.6	30.0	21.3	16.8	14.9
EV / EBITDA (x)	37.0	15.6	12.3	11.1	9.5
P/BV (x)	7.9	7.3	5.9	4.4	3.4
RoE (%)	14.5	25.4	30.6	29.8	25.8
RoCE (%)	8.6	14.8	18.2	17.5	17.7
Dividend yield (%)	0.4	0.7	0.9	1.2	1.3
Net debt / equity (x)	-0.1	-0.5	-0.5	-0.1	-0.1

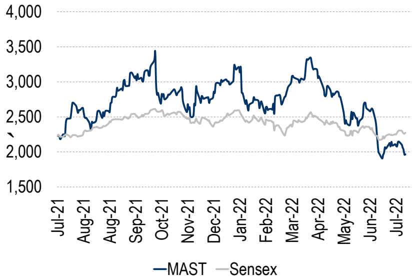
Source: Company, Anand Rathi Research

Key data	MAST IN / MAST.BO
52-week high / low	Rs3669 / 1851
Sensex / Nifty	55682 / 16605
3-m average volume	$2.8m
Market cap	Rs62bn / $771.7m
Shares outstanding	30m

Shareholding pattern (%)	Jun'21	Mar'21	Dec'21
Promoters	37.3	37.3	37.6
- *of which, Pledged*	-	-	-
Free float	62.7	62.7	62.4
- Foreign institutions	8.0	6.6	4.8
- Domestic institutions	5.7	6.7	7.2
- Public	49.0	49.4	50.4

Estimates revision (%)	FY23e	FY24e
Sales ($)	2.6	2.8
EBITDA	1.4	3.0
Net profit	2.6	(0.7)

Relative price performance



Source: Bloomberg

Mohit Jain
Research Analyst

Krishna Thakker
Research Associate

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Revenues (US$m)	**150.7**	**231.9**	**293.0**	**331.5**	**396.1**
Growth (%)	**1.9**	**53.9**	**26.3**	**13.1**	**19.5**
Net revenues (Rs m)	10,715	17,219	21,838	25,841	30,935
Employee & Direct Costs	5,841	8,827	10,955	14,072	17,394
Gross Profit	4,874	8,391	10,884	11,769	13,541
Gross Margin %	45.49	48.73	49.84	45.54	43.77
SG&A	3,340	4,747	6,259	6,671	7,566
EBITDA	**1,534**	**3,645**	**4,625**	**5,098**	**5,975**
EBITDA margins (%)	14.3	21.2	21.2	19.7	19.3
- Depreciation	249	450	429	483	547
Other income	192	279	361	1,021	673
Interest Exp	36	81	77	79	79
PBT	1,441	3,393	4,480	5,558	6,023
Effective tax rate (%)	21	26	26	29	28
+ Associates/(Minorities)	-50	-424	-383	-227	-131
Net Income	1,089	2,093	2,951	3,734	4,217
WANS	25	26	31	31	31
FDEPS (Rs/share)	42.9	80.5	96.6	120.9	135.7

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	121	126	150	151	152
Net worth	7,905	8,585	10,714	14,347	18,368
Total debt (incl. Pref)	3,332	2,406	1,903	-	-
Minority interest	1,371	1,820	1,503	1,731	1,862
DTL/(Asset)	-226	79	98	98	98
Capital employed	**12,381**	**12,891**	**14,217**	**16,176**	**20,328**
Net tangible assets	762	636	720	798	923
Net Intangible assets	1,039	666	264	264	264
Goodwill	6,767	6,767	7,426	16,206	19,952
CWIP (tang. & intang.)	17	15	44	44	44
Other Long term Assets/(Liabilities)	-1,213	-2,509	-2,339	-2,594	-2,876
Investments (Financial)	1,938	2,145	656	590	531
Current Assets (ex Cash)	4,498	5,643	7,333	8,290	9,460
Cash	2,210	5,914	7,271	654	972
Current Liabilities	3,635	6,386	7,158	8,076	8,942
Working capital	863	-743	175	214	517
Capital deployed	**12,381**	**12,891**	**14,217**	**16,176**	**20,328**
Contingent Liabilities					

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	1,441	3,393	4,480	5,558	6,023
+ Non-cash items	510	483	432	-261	178
Operating profit before WC	1,951	3,876	4,912	5,297	6,201
- Incr./(decr.) in WC	-355	525	1,091	38	304
Others incuding taxes	-471	-479	-1,090	-1,597	-1,675
Operating cash-flow	1,835	2,872	2,731	3,661	4,223
- Capex (tangible + Intangible)	157	118	365	561	672
Free cash-flow	1,679	2,754	2,366	3,100	3,551
Acquisitions	-4,256	-	-1,660	-8,779	-3,746
- Dividend (including buyback & taxe	315	136	475	747	843
+ Equity raised	21	85	19	647	647
+ Debt raised	2,371	-1,054	-779	-1,903	-
- Fin Investments	-1,679	-1,859	-1,916	-44	-36
- Misc. Items (CFI + CFF)	-95	-198	30	-1,021	-673
Net cash-flow	1,274	3,706	1,357	-6,616	318

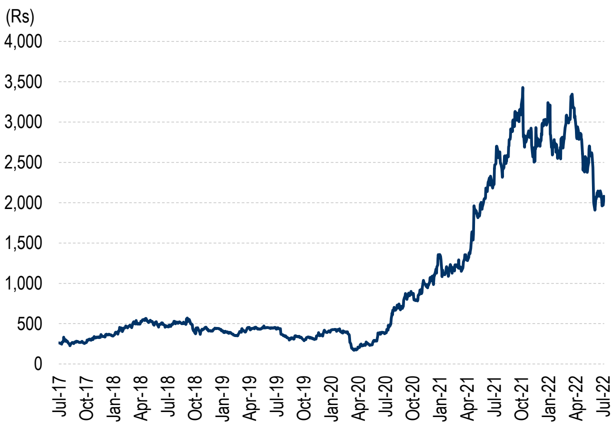
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	57.6	30.0	21.3	16.8	14.9
EV/EBITDA (x)	37.0	15.6	12.3	11.1	9.5
EV/sales (x)	5.72	3.28	2.57	2.35	1.96
P/B (x)	7.9	7.3	5.9	4.4	3.4
RoE (%)	14.5	25.4	30.6	29.8	25.8
RoCE (%) - After tax	8.6	14.8	18.2	17.5	17.7
RoIC (%) - After tax	11.9	24.0	34.1	23.1	18.8
DPS (Rs per share)	8.0	14.5	19.0	24.2	27.1
Dividend yield (%)	0.4	0.7	0.9	1.2	1.3
Dividend payout (%) - Inc. DDT	22.3	18.0	19.7	20.0	20.0
Net debt/equity (x)	-0.1	-0.5	-0.5	-0.1	-0.1
Receivables (days)	126	93	85	85	85
Inventory (days)					
Payables (days)	42	8	7	10	10
CFO:PAT%	161.2	114.1	81.9	92.4	97.1
FCF:PAT% - includ M&A payout	-236.7	131.6	23.9	-152.1	-4.6

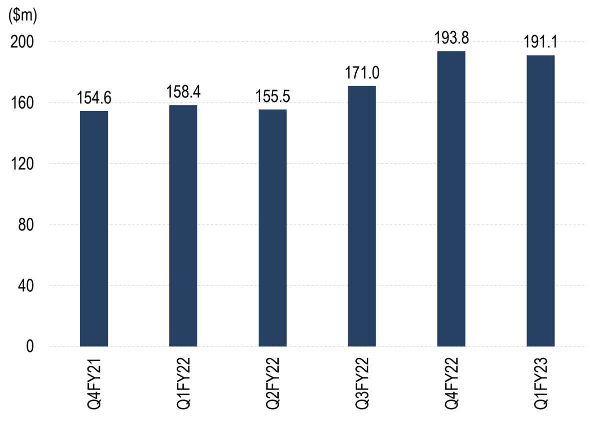
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Order backlog (12 month)



Source: Company

Result Highlights

Q1 FY23 Results at a Glance

Fig 7 – Segment-wise results

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q/Q %	Y/Y %
Revenue ($ m)	70	72	74	77	74	-4.7%	4.8%
Growth Y/Y %	38%	31%	22%	17%	5%		
Industry Y/Y % (est.)	20%	22%	21%	19%	17%		
Revenue (Rs m)	5,165	5,339	5,519	5,815	5,703	-1.9%	10.4%
Effec. exchange rate	73.6	74.2	75.0	75.3	77.5	2.9%	5.3%
12m Order Backlog ($ m)	158.4	155.5	171.0	193.8	191.1	-1.4%	20.6%
Y/Y %	56%	22%	32%	25%	21%		
Order Backlog:Rev	2.3	2.2	2.3	2.5	2.6		
Employees (EoP)	4,302	4,510	4,785	4,977	5,553	11.6%	29.1%
Rev. prod. ($ '000/employee)	17.3	16.3	15.8	15.8	14.0	-11.6%	-19.4%
Utilisation % (IT Services)	75%	73%	70%	73%	69%	-430 bps	-660 bps
Attrition %	20%	24%	28%	28%	25%	-300 bps	540 bps
CoR (excl. D&A)	(2,572)	(2,739)	(2,732)	(2,912)	(3,088)	6.0%	20.0%
As % of revenue	-50%	-51%	-49%	-50%	-54%	-406 bps	-434 bps
SG&A	(1,465)	(1,473)	(1,625)	(1,696)	(1,523)	-10.2%	4.0%
As % of revenue.	-28%	-28%	-29%	-29%	-27%	246 bps	166 bps
EBITDA	1,128	1,128	1,162	1,207	1,092	-9.5%	-3.2%
EBITDA margins %	21.8%	21.1%	21.1%	20.8%	19.2%	-160 bps	-268 bps
EBIT	1,030	1,024	1,057	1,085	981	-9.6%	-4.8%
EBIT margins %	20.0%	19.2%	19.1%	18.7%	17.2%	-145 bps	-274 bps
Industry margins % (est.)	16.4%	17.2%	17.9%	17.3%	15.9%	-136 bps	-47 bps
Other income (excl. forex)	54	25	69	71	1	-98.2%	-97.6%
Non-recurring / Forex	(7)	52	(12)	108	256	136.7%	NM
Interest expenses	-17	-19	-16	-25	-20	-21.8%	15.2%
PBT	1,060	1,083	1,098	1,239	1,219	-1.6%	15.0%
PBT margins %	20.5%	20.3%	19.9%	21.3%	21.4%	7 bps	85 bps
Taxes	(258)	(267)	(264)	(357)	(376)	5.2%	45.5%
ETR %	-24.4%	-24.7%	-24.0%	-28.8%	-30.8%	-199 bps	-646 bps
Associates / Minority	(109)	(92)	(98)	(83)	(72)	-13.6%	-34.1%
Net income	693	723	736	799	772	-3.4%	11.4%
Net margins %	13.4%	13.5%	13.3%	13.7%	13.5%	-21 bps	11 bps
Industry net margins %	13.4%	13.5%	13.3%	13.7%	11.7%	-205 bps	-172 bps
EPS (Rs)	26.4	26.9	24.2	26.2	25.2	-3.8%	-4.8%

Source: Company, Anand Rathi Research

Fig 8 – Quarterly result (Rs m)

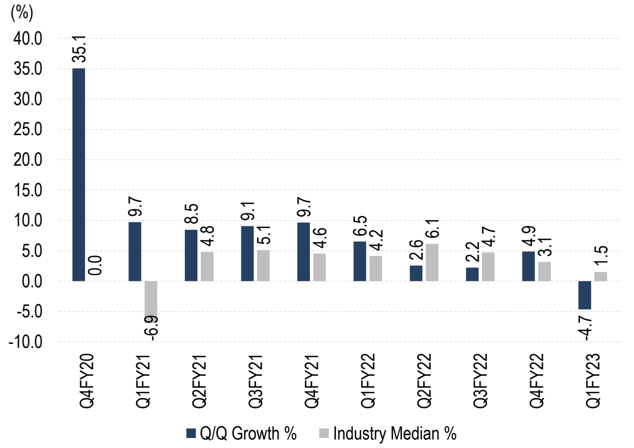
Year-end: Mar (Rs m)	Q1FY23	% chg. Q/Q	% chg. Y/Y	Q1 as % of FY23	FY22	FY22 % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	74	(4.7)	4.8	22	293	26.3	13.1
Sales	5,703	(1.9)	10.4	22	21,838	26.8	18.3
EBITDA	1,092	(9.5)	(3.2)	21	4,625	26.9	10.2
EBITDA margin (%)	19.2	-160bps	-268bps	-	21.2	1bps	-145bps
EBIT	981	(9.6)	(4.8)	21	4,196	31.3	10.0
EBIT margin (%)	17.2	-145bps	-274bps	-	19.2	66bps	-135bps
PBT	1,219	(1.6)	15.0	22	4,480	32.0	24.1
Tax	(376)	5.2	45.5	24	(1,146)	30.9	39.3
Tax rate (%)	(30.8)	-199bps	-646bps	-	(25.6)	23bps	-315bps
Net income	772	(3.4)	11.4	21	2,951	41.0	26.5

Source: Company, Anand Rathi Research

Lags industry growth y/y and q/q

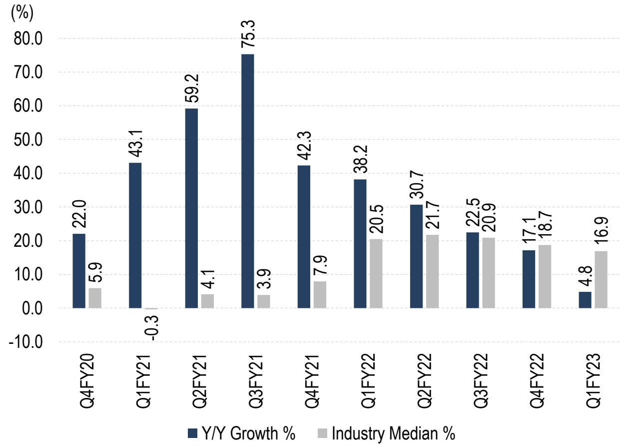
Mastek's growth declined q/q, broadly in line with estimates (-3.5% expected), largely due to the UK business. In Q1 FY23, it declined 4.7% sequentially, lagging the industry by a huge margin. In CC, its revenues were flat. Revenue growth was muted due to a large UK healthcare account pausing work (due to a leadership change), delay in decision-making in key deals and slower-than-expected ramp-up in some deals. From a y/y perspective, its revenue grew 4.8%, lower than the industry average for a second consecutive quarter.

Fig 9 – Q/Q declines, lags the industry



Source: Company, Anand Rathi Research

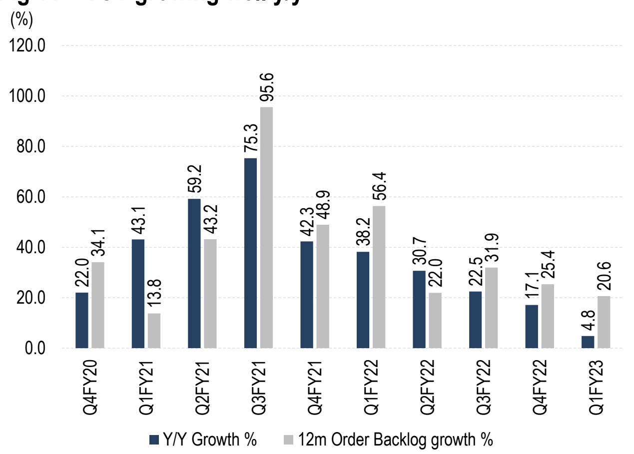
Fig 10 – Y/Y growth comes lower than the industry



Source: Company, Anand Rathi Research *Note: Evosys was integrated in Q4 FY20*

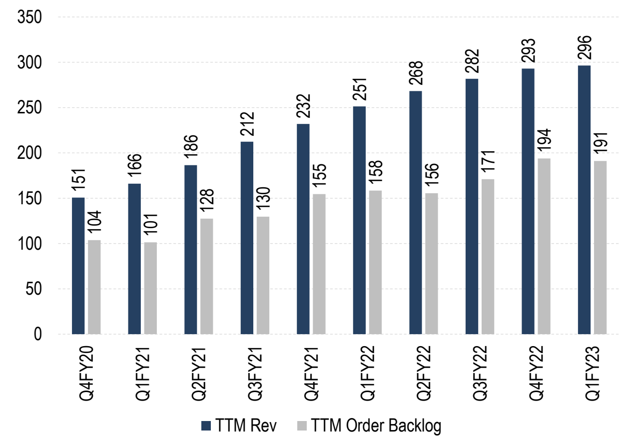
Mastek reports a 12-month order backlog, which can be used as a proxy for TCV. On the TCV front, it had a strong Q1 at $191m (up 21% y/y), compared to $194m in Q4. Management said that the demand environment is good and the company has not lost any deals (except a small one). The problem it is faced with is that deals are taking longer to convert. Some of the deals won include one from the University of Nottingham, one from a healthcare provider in the US and one from a hospital chain in Abu Dhabi (Cleveland Clinic). On a TTM basis, TCV has been growing faster than revenues, with TCV up 21%, while TTM revenues have grown 18%.

Fig 11 – TCV growing well y/y



Source: Company, Anand Rathi Research *Note: Evosys was integrated in Q4 FY20*

Fig 12 – TTM TCV growing faster than TTM revenue



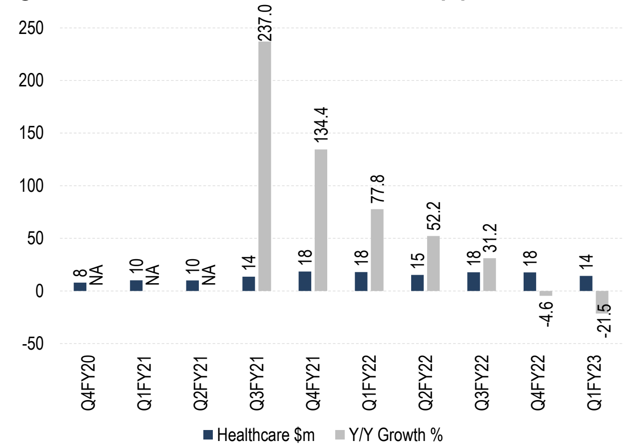
Source: Company, Anand Rathi Research *Note: Evosys was integrated in Q4 FY20*

Government exluding healthcare growing, BFSI and Healthcare decline sequentially.

Mastek's strength lies in three verticals: Government (60% of revenue, incl. Healthcare), Retail (16%) and BFSI (11%). In Q1, it saw below-company-level growth in Government (Education and Healthcare), while, excl. Healthcare, Government grew 16% y/y. Healthcare was down 19% q/q due to a large UK Healthcare client pausing work.

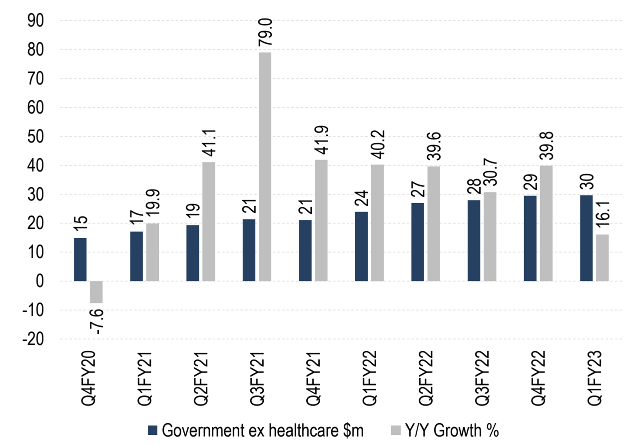
The paused account had already been ramped up in Q4. The pause is for 6-8 weeks, which ends in Jul. This program will return in a smaller fashion and will take at least 1-2 quarters to return to the Q4 run rate. Mastek is involved in other initiatives with this client, independent of the paused one, and has been working with this client for 20 years.

Fig 13 – Government Healthcare declines q/q



Source: Company, Anand Rathi Research Note: Q1 FY23 figures calculated according to the new classification

Fig 14 – Government, excl. Healthcare growing well y/y

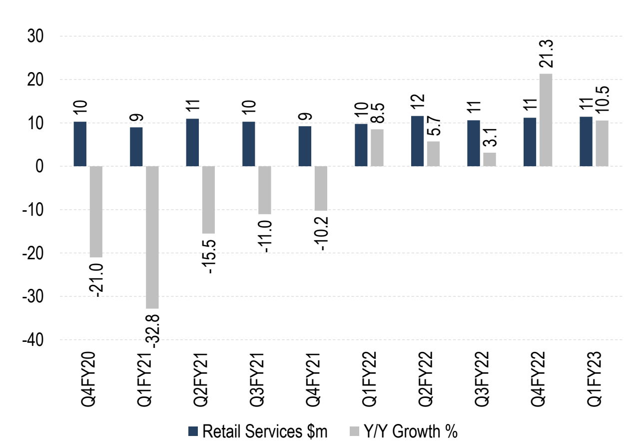


Source: Company, Anand Rathi Research Note: Q1 FY23 figures calculated according to the new classification

The Retail vertical delivered strong growth y/y (up 17%, 2% q/q, and is the company's focus vertical for the US and Europe. The UK private sector had a silver lining in Q1 with growth and a brighter outlook.

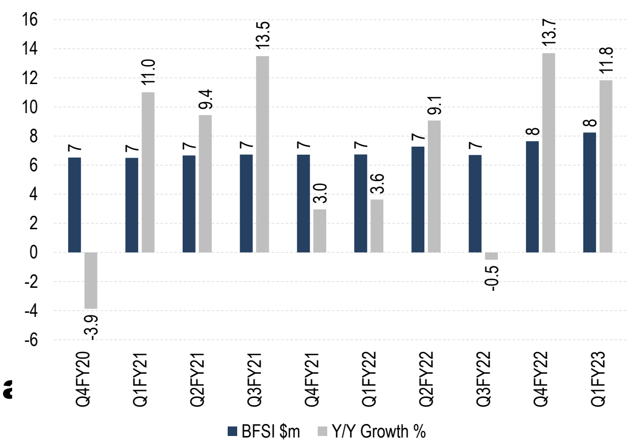
BFSI was down sequentially (8%) but came in higher than company growth y/ basis (12% vs 5%). The company is also sub-scale in this vertical and is faced with keen competition. The outlook for this vertical is therefore largely neutral.

Fig 15 – Retail vertical is steady



Source: Company, Anand Rathi Research Note: Q1 FY23 figures calculated according to the new classification

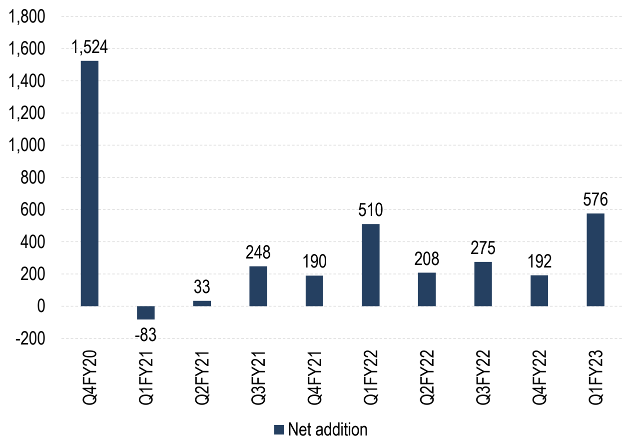
Fig 16 – BFSI, slow growth trajectory



Source: Company, Anand Rathi Research Note: Q1 FY23 figures calculated according to the new classification

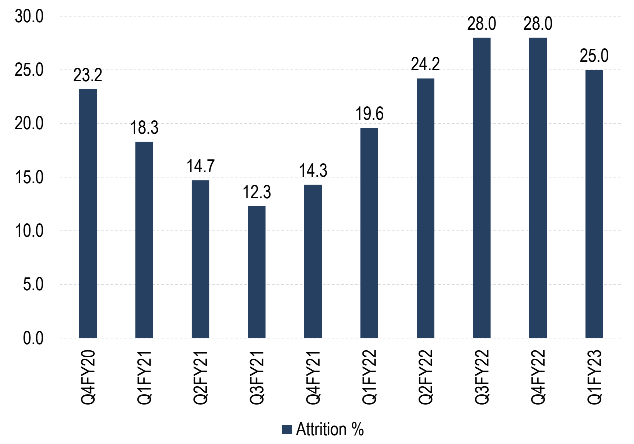
Mastek added 576 employees in Q1 FY23, which led to utilisation sliding to 68.7%, from 73% in Q4 FY22 and 75.3% in Q1 FY22. Hiring in this quarter was higher sequentially despite slowing growth. The company hired 400+ fresh graduates in Q1 FY23. Attrition dipped to 25% from its four-year high of 28% in Q4 FY22.

Fig 17 – Net addition improves, 400 freshers added



Source: Company, Anand Rathi Research *Note: Evosys was integrated in Q4 FY20*

Fig 18 – Attrition starts to cool off

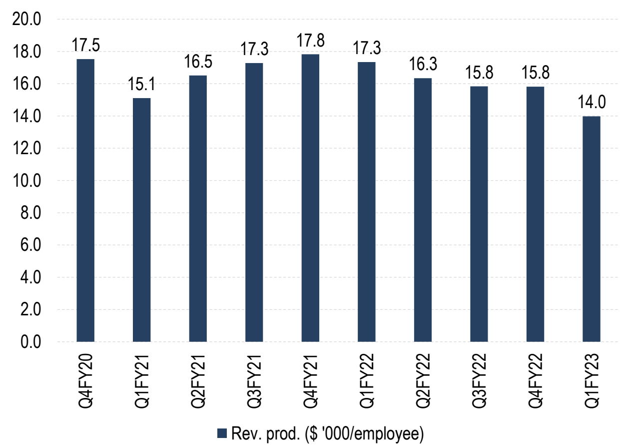


Source: Company, Anand Rathi Research

Overall, Mastek has delivered margins of 21-22% for five successive quarters before Q1 FY23 (down from a peak of 23.5% in Q3 FY21), absorbing the cost escalations by way of strong growth. In Q1 FY23 its margins fell to 19.2% and are likely to be 19-20% over the next two years. The decline was commendable given low utilisation and cross-currency headwinds during the quarter.

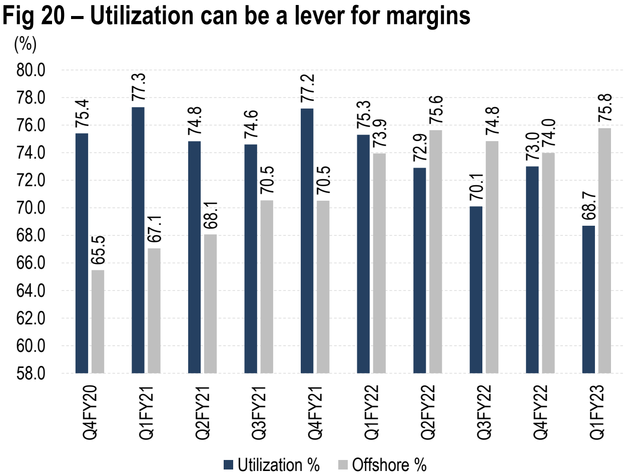
From an employee-productivity perspective, Mastek is ~22% lower than the in recent past, reflecting the interplay of higher offshoring and lower utilisation. Utilisation is now at an all-time low of 68.7% (down 430bps q/q, 660bps y/y) while offshoring (by effort) is near an all-time high of 75.8% (up 180bps q/q, 184bps y/y). From a utilisation perspective, it appears that it has headroom to deliver on margins even if the supply-side is more constrained. On our calculations, Mastek does not need to hire for FY23. Compared to the industry, it still operates at very high employee productivity. As it shifts more workloads offshore, productivity will likely decline and converge to that of the industry.

Fig 19 –Employee productivity declines sequentially



Source: Company, Anand Rathi Research

Fig 20 – Utilization can be a lever for margins



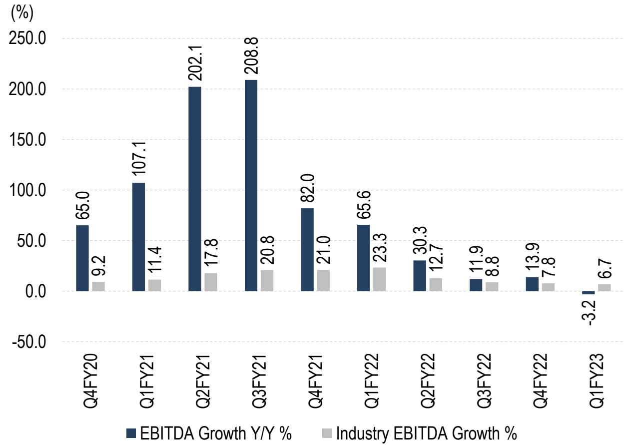
Source: Company, Anand Rathi Research

EBITDA/Net Income decline q/q

Mastek's EBITDA declined 10% q/q, 3% y/y, in Q1 FY23, well behind the industry. This was due to muted revenue growth and margins declining to 19.2% (down 160bps q/q, 268bps y/y) on weak operational execution in hiring.

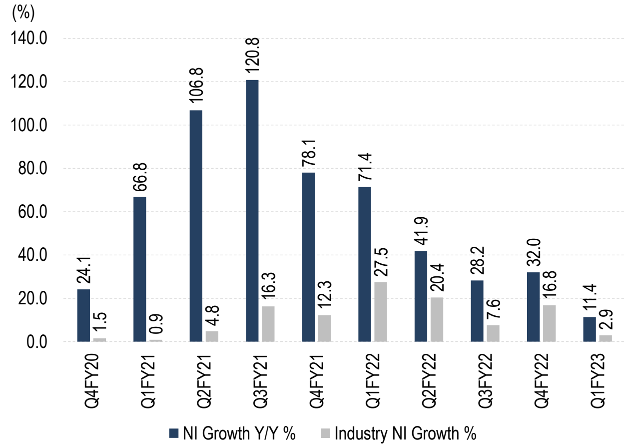
Mastek's margins contracted in Q1 as the company faced supply-side challenges or a skillset mismatch as it also had the problem of surplus bench at the same time. It saw a peak margin of 23.5% in Q3 FY21 and is now down to 19.2% due to currency headwinds, increase in wages and lower utilisation. NI declined 3% q/q but grew 11% y/y, supported by hedges (other income was Rs258m up 44% q/q, 448% y/y, while the NI margin contracted 21bps q/q but expanded 11bps y/y in Q1 and is expected to be maintained at ~14%.

Fig 21 – EBITDA growth comes in lower than industry



Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Fig 22 – NI growth supported by effective hedges



Source: Company, Anand Rathi Research Note: Evosys was integrated in Q4FY20

Conference-call takeaways

Q1 FY23

- Revenue growth muted due to a large UK healthcare account pausing work (due to leadership change), delay in decision-making in key deals and slower-than-expected ramp-up in some deals.
- The paused account had already been ramped up in Q4 as the pause was for 6-8 weeks, which ends in July. This program will return in a smaller fashion and will take at least 1-2 quarters to return to the Q4 run-rate.
- Healthcare is split into three areas: 1. Working with key providers in the Middle East. 2. Medical devices and healthcare customers in the US 3. A UK Healthcare account. Slowdown was mostly in the UK account.
- Management is seeing decision-making delays in private sectors of the UK, Europe and the US but has not lost any deals.
- The UK public sector is growing well (Mastek has been shortlisted for the DSP – Digital Specialists and Program framework) and is getting into larger deals.
- Converted some engagements from six months to 1-2 years in the UK government.
- Can be involved in the DSP program for certain capabilities or full stack. The Central government, Health and Defense divisions will benefit from this program. The DSP opportunity is of $4bn over 3-4 years.
- US strategy - Looking to mine in the US (identified 20-25 clients) and moving clients from project-based to managed services. The company said that it has started improving wallet-share and is seeing integrated deals in the US. Expect order-book and organic-revenue growth in H2 FY23.
- The demand environment is good and the company has not lost any deals (except a small one) that have been paused or are taking longer to convert.
- Some of the deals won – from the University of Nottingham, from a healthcare provider in the US and from a hospital chain in Abu Dhabi
- The focus is on the top-50 clients. The company is putting in place teams to mine these accounts. The focus is also on Fortune-1000 clients which are now 21, vs 19 in Q4.
- The Middle East business delivered the best ever order book in Q1.
- Focus on account mining led to active clients dropping by 50, to 502
- Top 4-5 clients constitute 80% of public sector. These are mission critical, large and long deals, so management not too concerned about the change in government in the UK. More than 80% of the UK government initiatives are mission-critical.
- Managed services and FP contracts have gone up
- Annuity business currently contributes 30-35% to overall revenue, ambition of moving it to 50%. Most implementations have been converted into managed services.
- EBITDA margin impacted by currency, wage pressures and lower utilisation.

- North America EBITDA margin impacted by a one-time expense and investments made.
- Wage hike in Q2.
- Funding of MST acquisition through internal cash of $50m and debt of $30m taken in the US, which should have interest cost of 350-360bps. Earn-outs will be all cash
- The US has a dedicated team, "Growth Office", which focused on M&A. A separate go-to-market US team will integrate and work on the acquisition.
- Most integration to be completed by end-FY23. Management has identified 25 accounts for cross-selling, most in the Americas, some in the UK. Already working on one deal together. Salesforce business to become $150m-$200m in the next few years.
- MST has relations with local governments in the US where it is digitizing multiple process areas. MST has EBITDA margins of 18-20%, which is similar to Mastek's. MST leaders to continue to be a part of Mastek, retention program built into the deal.

Business Outlook

- The company is likely to record industry-leading q/q growth in the next 3-4 quarters.
- And reach $1bn by FY25-FY26, with the help of 3-5 acquisitions. Two areas identified for acquisitions: Cloud platform and Data & Automation. Expect acquisitions in the next couple of years.
- Maintain EBITDA margins in high teens
- FY23 ETR: 24-25%

Notes from last quarters' conference calls

Q4FY22 Business Outlook

- Mastek's organic growth to be faster than industry growth
- Aspiration of keeping operating EBIDTA margin near 20% for the foreseeable future.
- Company to maintain payout in the range of 18-20%.

Q3FY22

- UK break-up - 70% public, 30% private sector
- UK grew despite furloughs and seasonal impact; the private sector was affected by project completion and go-lives. Europe private business was expected to dip in Q3; as few projects were completed, furloughs and holidays. Taking a focused approach to UK private, focusing on micro-finance, financial services, retail and consumer sector. Seeing traction in a couple of other sectors. Closed two medium-sized deals in Q4 in the UK private sector. UK private has a good pipeline and good traction. UK order book strong and will reflect in revenues ahead
- Confident of bringing healthcare on an uptick, starting Q4.
- EBITDA margin maintained, even though investment in talent and other costs.

- Developed-markets margin profile is better; focusing on higher quality revenue and fewer clients in the Middle East so that margins are aided.
- Offshore mix could improve 100-200bps as the UK private business grows.
- Average deal sizes are increasing.
- Past large deals in North America were in the $0.5m range; now they are in the $5m-$10m range, many integrated and managed services.
- UK large deals are +$25m and in the US large deals are +$5m. The company is seeing many deals in the UK of $10m-25m, for three years. Expect few significant deals in Q4 across the UK as well as the Americas.
- Management is seeing good deal momentum which is reflected in the order backlog and is seeing many more deals in the pipeline
- Closed the biggest deal in the UK, more than $60m over four years with the NHS. Deals won with the NHS in January as well, to be announced in Q4.
- North America Oracle cloud had a good order booking quarter; deals won include large managed services deals and integrated deals. Added 2-3 marquee logos in North America in Oracle Cloud.
- Hiring of experienced individuals should support North America growth.
- Added 25 customers, seven with $1bn revenue.
- Added seven Fortune-1000 clients in Q3. Many big clients (revenue-wise) are approaching Mastek, which is confident of closing some of these deals.
- Mastek is not putting effort in smaller clients as the focus is on clients with higher revenues where they can grow; hence active clients are down.
- In Q3, the focus was on retaining and recruiting and will continue to be a key priority in coming quarters. Engaging in five initiatives to retain and attract talent. In Q3, it ramped up fresher hiring. Expect significant fresher and lateral hiring in Q4. Talent challenge to continue for 2-3 quarters.
- Recruited head of marketing and partnerships from Capgemini. Also hired head of innovation and technology.
- Opened a center in Romania, as the company continues to see traction in Nordic and Netherlands. This will aid in accelerating in Europe.
- Bought 10% of CCPS (complete in Jan), balance 20% in Q3 CY22.
- In Q3, cash payout of Rs290m toward CCPS, final dividend for FY21 of Rs20m and one UK loan has been paid off in Q3.
- Management shared plans of being listed on the Dow Sustainability Index
- EBITDA margin to remain ~21% as the company is not expecting major downside in the medium term. Downside of margin of 50-100bps max.

From Q2 FY22

- Seeing a very high growth demand environment; pipeline consists of $25 5m deals (may not win all). Of these 25, 7-8 are above $10m and a few of them are larger than $25m. These will be decided in the next two quarters.
- Client base is changing; onboarding clients from Fortune 1000, and enterprise clients. This will help the company scale up faster.
- First $10m account in the US market to be signed soon.
- Won its first deal in Canada in life sciences, a +$1m deal; can grow to a couple of million dollars in six months.
- Won a large deal in Finland, Mastek to provide end-to-end BT program.
- Won a deal from a UK government agency that is in the Vehicle and Driver space
- In the US market, Mastek is focused on healthcare and life sciences. It is also looking at Data, Automation and AI (across all verticals).
- Evaluating M&A in Digital and Cloud; expect something by next quarter.
- Oracle continues to grow well. Oracle Cloud business showing strong momentum.
- For the 8th straight quarter Mastek grew sequentially and y/y.
- In the UK softness came from NHS as some implementation programs came to an end although there is a good pipeline. The UK seeing delays in decision-making; many large deals in the works. Pipeline strongest it has ever been. H2 to improve.
- In the UK government, Mastek won a large deal in Oct; it is a three-year deal, which should lead to $40m-50m business. Q4 should reflect revenue from this deal. UK education and local sector seeing good momentum as well. Mastek has a good chance of winning 5-6 deals across the NHS division
- Opened a new department in the UK of a couple of million dollars. This has potential to become larger.
- EBITDA margin was 21.1%, 71bps lower q/q. Wage hikes across the organization on 1st Jul and Mastek continued to invest in S&M. Utilization, operating levers, fixed cost leverage and growth cushioned the decline. Wage hike had a 200bp impact; fixed-cost leverage and operating levers offset this and led to only a 71bp decline.
- Added 45 customers in Q2
- Added three non-retail customers, of which a couple are from Fortune-1000 in D2X in the US.
- Oracle side seeing continuous growth across the UK, Europe and the US. ME is also seeing good momentum. Seeing gradual uptick in average deal sizes.
- Running 6-7 initiatives over 60-90 days to keep attrition in check.
- In the private sector, Mastek will be announcing a couple of deals from Fortune-500 companies in the next quarter. In the UK private sector, it built a team that is growing a pipeline in retail, manufacturing and micro-

finance. Europe is a bigger opportunity in thew private sector, and the pipeline is good here.

- Looking at 10 clients in the US to mine, where Mastek can have a run rate of $3m a year.
- Considering M&A in the US in data automation, cloud platform and CX space. Vigorously shortlisting candidates. M&A likely to be concluded in FY23.
- Will add more leadership to the company; some already brought in this quarter. Building leadership to take Mastek to a billion dollars.
- Revenue growth to bounce back from Q4.
- The company is seeking to maintain margins at current levels, and will invest in skill, SG&A capabilities. Margins to be 21% in the short term and 20% in the long term (100bps to be re-invested into the company)

From Q1 FY22

- There is some delay in UK decision-making; hence, the order backlog grew slightly slower. Reflecting this, the pipeline grew faster as some of the deals are now likely to close in Q2.
- Mastek is investing in building digital capabilities, training employees in leadership (new leader in the deliveryunit), building marketing and sales teams and partnerships for the new areas – primarily, the UK private sector and the US.
- Won a $6m account, jointly sold in Europe,showcasing synergy between Evosys and Mastek
- The Middle East had some execution challenges due to local lockdowns. The situation is likely to improve ahead; if not, the company may look to increaseits local presence through employees or sub-contractors.
- For H2 and beyond, it is optimistic about the US, currently winning deals in diverse sectors incl.healthcare/pharmacy. The US has a vast untapped market. The company is seeing good momentum in healthcare and life science in the Americas. The new CEO spoke about improving marketing efforts there, building on partnership strategy (for example Microsoft and ServiceNow)and inorganic opportunities.
- The UK public sector isgrowingfast and is likely to maintain its growth rates. There is also an element of accelerated spends on account of BRexit in Dec. However, some segmentsmay see macro-level issues that might affect NHS momentum.
- Mastek is looking at penetrating Fortune-1000 companies as it achieves the scale to deliver large assignments.
- Q2 salary hike is under consideration, impact on margins to be mitigated.
- The strong revenue momentum in the three businesses continues.
- Expect pressure on margins similar to the industry, but the intention is to maintain them at FY21 levels, as the company leverages fixed costs and rebalances SG&A. Growth is a huge advantage here.

Factsheet

Fig 23 – Revenue

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Revenue ($ m)	70	72	74	77	74

Source: Company, Anand Rathi Research

Fig 24 – Revenue, by area

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
North America	15	18	19	18	19
UK	70	67	66	69	67
RoW	6	6	6	5	5
ME	9	9	9	8	9

Source: Company, Anand Rathi Research

Fig 25 – Revenue, by verticals

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
BFSI	10	10	9	10	11
Government	60	59	62	61	60
Others	17	15	14	15	14
Retail Services	14	16	14	15	16

Source: Company, Anand Rathi Research Note: Some verticals have been reclassified in Q1FY23 so may not match with company factsheet

Fig 26 – Client concentration

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Top 5 Clients	33	31	29	30	29
Top 10 Clients	48	45	44	43	41
Active Clients	651	447	421	450	402

Source: Company, Anand Rathi Research

Fig 27 – Workforce

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Technical	3,718	3,879	4,105	4,245	4,743
Technical Support	138	142	148	173	203
Marketing	208	230	242	259	272
Support	238	259	290	300	335
Utilization % (gross)	75	73	70	73	69
12 m Order Backlog ($ m)	158.4	155.5	171.0	193.8	191.1
Active clients	651	447	421	450	402
Revenue per active client ($ m)	0.1	0.2	0.2	0.2	0.2

Source: Company, Anand Rathi Research

Fig 28 – Revenue, by delivery location

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
On-site	26.1	24.4	25.2	26.0	24.2
Offshore	73.9	75.6	74.8	74.0	75.8

Source: Company, Anand Rathi Research

Fig 29 – Revenue, by practice

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Digital & Application Engineering	NA	48	43.2	40.8	42.8
Cloud & Enterprise Apps	NA	31.6	34.4	35.5	37.8
Digital Commerce & Experience	NA	12.5	11.4	11.2	10.8
Data, Automation and AI	NA	7.9	11	12.5	8.6

Source: Company, Anand Rathi Research

Fig 30 – Key segments' growth Y/Y (%)

	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Revenue, by region (%)					
North America	24%	34%	29%	48%	28%
UK	48%	30%	22%	15%	0%
RoW	137%	73%	36%	-4%	-14%
ME	-17%	9%	10%	1%	13%
Revenue, by vertical (%)					
BFSI	4%	9%	0%	14%	12%
Government	54%	44%	31%	19%	0%
Others	45%	34%	30%	8%	14%
Retail Services	9%	6%	3%	21%	11%

Source: Company, Anand Rathi Research Note: Some verticals have been reclassified in Q1FY23 so may not match with company factsheet

Valuations

A mid-size IT services company ($294m revenue, at the Q1 run-rate), Mastek is attempting to become larger ($1,000m revenue, incl. the inorganic investments). It is run by a healthy promoter-professional mix and achieved its target of a $200m company by Q4 FY20 with the Evosys acquisition ($67m revenue in FY20). It ended FY22 with $293m revenue.

It is now looking at its next leg of growth by accelerating its US business. In the US, it has appointed a new CEO in Chicago and is rejuvenating its business by inducting new leaders, investing in sales, and on reinforcement through Evosys.

As its operating metrics and business characteristics converge to the sector's parameters, we value it on FY24e P/E as the primary valuation method, and FCF/EV as the secondary one. The stock trades at 15x FY24e EPS and 5% FCF/EV yield (excl. the M&A payouts). Our target multiple is 20x FY24e as the appointment of a new CEO is likely to lead to positive results, given his background in the US and in running sales/operations at a large Indian IT firm.

The multiple is also a reflection of our expectations of revival in the UK private business and in the US. The uncertainties after the sudden departure of the previous CEO seem to be behind. After the event, management and the founders assured a continuity of performance and recently recruited Hiral Chandrana (Jul'21) as global CEO. Mr Chandrana has over 25 years' experience and a good track record in IT services and Digital Solutions across diverse industries.

Also, business is now concentrated in the UK; hence, the ability of Mastek to absorb regional shocks appears low, including cross-currency headwinds as was evident in Q1 FY23. This is also one of the key reasons for our curtailed target multiple (in the context of its very strong showing in FY22). The concentration is likely to improve as it builds its business in the US organically and inorganically.

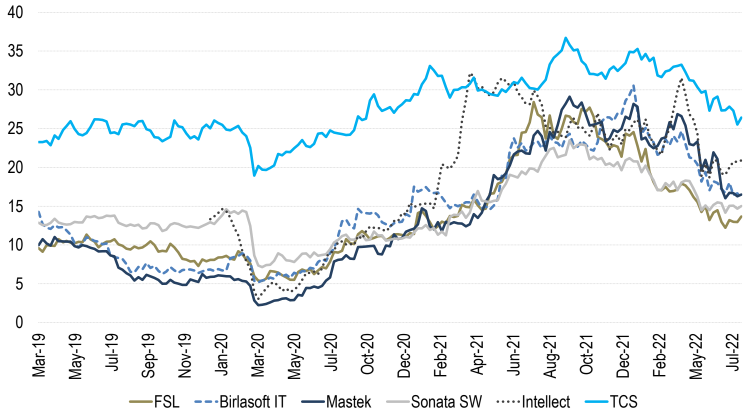
Mastek has, over the last few years, consistently expanded its operating margins, with the EBIT margin moving up from 9.9% in FY18 through 18.6% in FY21 to 19.2% in FY22. We expect it to shrink to 17.5% in FY24. We expect 16%/14%/19% CAGRs over FY22-FY24 in revenue/EBIT/EPS.

Fig 31 – Change in estimates (Rs m)

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	331	323	2.6	396	385	2.8
Revenues	25,841	24,915	3.7	30,935	29,732	4.0
EBITDA	5,098	5,028	1.4	5,975	5,800	3.0
EBITDA margins %	19.7%	20.2%	-45 bps	19.3%	19.5%	-19 bps
EBIT	4,615	4,527	2.0	5,428	5,244	3.5
EBIT margins %	17.9%	18.2%	-31 bps	17.5%	17.6%	-9 bps
Other Income	943	652	45	595	610	(3)
PBT	5,558	5,178	7.3	6,023	5,854	2.9
Net profit	3,734	3,638	2.6	4,217	4,249	(0.7)

Source: Anand Rathi Research

Fig 32 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- M&A integration-related challenges.

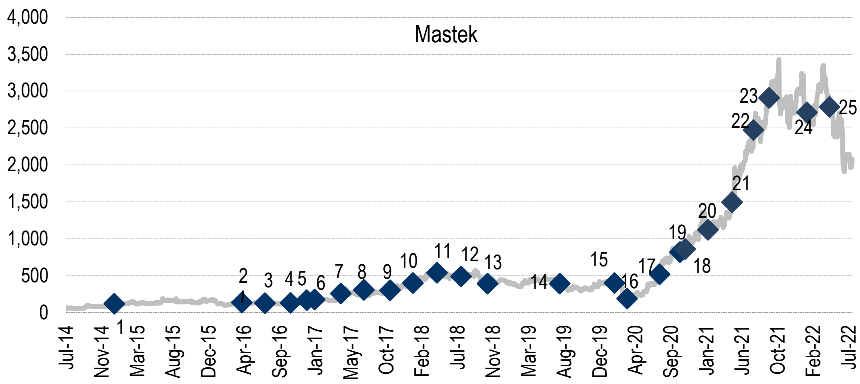
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 21 July 2022)



	Date	Rating	TP (Rs)	Share Price (Rs)
10	19-Jan-18	**Buy**	520	394
11	19-Apr-18	**Hold**	650	587
12	19-Jul-18	**Buy**	730	501
13	25-Oct-18	**Buy**	670	413
14	23-Jul-19	**Buy**	650	457
15	12-Feb-20	**Buy**	620	419
16	31-Mar-20	**Buy**	510	190
17	30-Jul-20	**Buy**	780	652
18	15-Oct-20	**Buy**	1,120	884
19	31-Oct-20	**Buy**	1,150	845
20	2-Feb-21	**Buy**	1,500	1,194
21	29-Apr-21	**Hold**	1,930	1,617
22	21-Jul-21	**Hold**	2,880	2,491
23	21-Oct-21	**Buy**	3,400	2,840
24	25-Jan-22	**Buy**	3,510	2,745
25	22-Apr-22	**Buy**	3,400	2,825

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)	**Buy**	**Hold**	**Sell**
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

Anand Rathi Share and Stock Brokers Ltd. (hereinafter refer as ARSSBL) (Research Entity, SEBI Regn No. INH000000834, Date of Regn. 29/06/2015) is a subsidiary of the Anand Rathi Financial Services Ltd. ARSSBL is a corporate trading and clearing member of Bombay Stock Exchange Ltd, National Stock Exchange of India Ltd. (NSEIL), Multi Stock Exchange of India Ltd (MCX-SX), and also depository participant with National Securities Depository Ltd (NSDL) and Central Depository Services Ltd. ARSSBL is engaged into the business of Stock Broking, Depository Participant, Mutual Fund distributor.

The research analysts, strategists, or research associates principally responsible for the preparation of Anand Rathi research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

General Disclaimer: This Research Report (hereinafter called "Report") is meant solely for use by the recipient and is not for circulation. This Report does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purpose of purchase or sale of any security, derivatives or any other security through ARSSBL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security (ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by ARSSBL to be reliable. ARSSBL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of ARSSBL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report. The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. ARSSBL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment.

Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report. Research Report may differ between ARSSBL's RAs and/ or ARSSBL's associate companies on account of differences in research methodology, personal judgment and difference in time horizons for which recommendations are made. User should keep this risk in mind and not hold ARSSBL, its employees and associates responsible for any losses, damages of any type whatsoever.

ARSSBL and its associates or employees may; (a) from time to time, have long or short positions in, and buy or sell the investments in/ security of company (ies) mentioned herein or (b) be engaged in any other transaction involving such investments/ securities of company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) these and other activities of ARSSBL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall ARSSBL and its associates or employees or any third party involved in, or related to computing or compiling the information have any liability for any damages of any kind.

Details of Associates of ARSSBL and Brief History of Disciplinary action by regulatory authorities & its associates are available on our website i.e. www.rathionline.com

Disclaimers in respect of jurisdiction: This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ARSSBL to any registration or licensing requirement within such jurisdiction(s). No action has been or will be taken by ARSSBL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. ARSSBL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to ARSSBL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

Statements on ownership and material conflicts of interest, compensation - ARSSBL and Associates

Answers to the Best of the knowledge and belief of ARSSBL/ its Associates/ Research Analyst who is preparing this report

Research analyst or research entity or his associate or his relative has any financial interest in the subject company and the nature of such financial interest.	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company	No
ARSSBL/its Associates/ Research Analyst/ his Relative have any other material conflict of interest at the time of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have managed or co-managed public offering of securities for the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation or other benefits from the subject company or third party in connection with the research report	No
ARSSBL/its Associates/ Research Analyst/ his Relative have served as an officer, director or employee of the subject company.	No
ARSSBL/its Associates/ Research Analyst/ his Relative has been engaged in market making activity for the subject company.	No

Additional information on recommended securities/instruments is available on request.

ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.