

25 January 2018

Mastek Ltd. – BUY

CMP : 479
Target Price : 585
Upside : 22%+
Stop Loss : 413 (closing basis)

Investment Thesis

Recently, the stock price of Mastek Ltd. (Mastek) corrected by ~5% from 52-week high of Rs.511 despite reporting good set of numbers in the recent quarters on the acquisition of the US-based TAIS by Mastek.

Mastek is an IT services provider with global operations, providing solutions to government, retail and financial services organizations worldwide. Mastek has faced multiple headwinds in FY16 due to the conclusion of two major deals and slow ramp-up in other projects along with cost overruns of ₹3.1mn in Crica, termination of its joint venture with Legal Practice Technologies (LPT). In FY17, Mastek has appointed a new management team led by CEO John Owens, which helped Mastek to drive a revival in both organic growth and margins. New team's focused execution and sales strategy has translated to strong cost management, a doubling of EBITDA margins and market share gains in UK government contracts (due to a thrust on direct selling). Under the new leadership, the company is aiming to be the leader in digital transformation and aspires to attain to the tier-II industry average EBITDA margin by 2020.

Recently, Mastek has acquired the US-based TAIS for \$26mn for all cash deal from its internal accruals. The acquisition has opened up fresh opportunities to establish Mastek's presence in the US IT-services market. TAIS is an IT-services company implementing the Oracle CX package for mid-market retailers such as Tillys, Rue21, Mason, Stamps, Petmate and Toms Shoes from centers in the US (Dallas) and India (NCR and Chennai). Mastek has lagged peers in growth partly because of its strategy of participating in a concentrated target market (UK 92%, government 43% till FY17). The acquisition is likely to open new avenue for Mastek in the US market. The TAIS acquisition is likely to be completed by FY18E and will account for 32% of overall revenue, leading to a over 40% increase in revenue of Mastek in the coming year.

Financials

- During the past 5 years, revenue of Mastek de-grew at a CAGR of 4.9% while PAT grew at a CAGR of 71.3% in the same period.

Consol. (Rs.Mn.)	FY15	FY16	FY17	FY18E	FY19E
Revenue	10,126	5,269	5,625	6,468	7,439
EBITDA	556	182	529	608	699
% growth	-38.2	-67.3	190.7	15.0	15.0
PAT	177	137	369	424	488
EPS (INR)	7.9	6.0	15.8	18.2	20.9
P/E (x)	60.9	80.2	30.3	26.4	22.9
RoE (%)	3.0%	4.3%	10.6%	11.1%	11.6%

- Mastek has reported 5.6% QoQ growth in rupee terms in net revenue to stood at Rs.2,095mn in Q3FY18 as against Rs.1,985mn in Q2FY18. While in constant currency, revenue was grown by 4.1% QoQ.

Stock Data

Market Cap (INR MN)	11,541
Market Cap (\$ MN)	181.50
Shares O/S (in MN)	23.40
Avg. Volume (3 month)	495,000
52-Week Range (Rs.)	511 / 165

Shareholding Pattern

Promoters	47.88%
FII's	3.08%
Institutions	8.65%
Others (incl. body corporate)	40.39%

Performance (%)	1M	6M	1Yr
Absolute	25.7%	48.9%	146.3%
BSE IT	15.3%	23.1%	29.9%

Key Ratios

Div Yield	0.7%
TTM PE	17.7x
ROE	11.9%
TTM EPS (INR)	27.5/-

- EBITDA of Mastek is reported at Rs.315mn in Q3FY18 compared with Rs.293mn, up by 7.4% QoQ. As a result, EBITDA margin has also gained by 21bps QoQ to 14.6% in Q3FY18 as against 14.4% in Q2FY18.
- Mastek has added 8 new client in Q3FY18, taking its total active client to 173. Top 5 clients of Mastek have contributed to 37.8% while top 10 have contributed to 57.1% to total revenue in Q3FY18.

Key Business Highlights

- Mastek is an IT solutions provider and provides vertically focused enterprise technology solutions. The Company specializes in developing, maintaining and managing digital solutions for clients in government, health, retail and financial services.
- Mastek's portfolio includes business and technology services, which consists of IT consulting, application development, systems integration, application management outsourcing, testing, data warehousing and business intelligence, application security, customer relationship management (CRM) services and legacy modernization.
- Mastek carries out its operations in the United Kingdom and India and has its offshore software development centers in India at Mumbai, Pune, Chennai and Mahape.

Valuation

- Mastek UK is registered with the G Cloud and the GDS frameworks, which has helped Mastek to create a good pipeline of opportunities in the government sector in UK. Mastek UK continued positioned largely in UK, as its major business comes from this region and ranked among the top three vendors in delivering large complex programs in agile manner and helping government to cut cost and time in delivery. The company order book and pipeline are strong in both public and private sector and new opportunities have been identified. This has given a base for building up growth and profitability to Mastek, going forward.
- Mastek will continue to invest in agile methodologies in line with its aspiration of being involved in large and complex transformation programs which will help its customers to leverage digital opportunities in agile manner. Overall, Mastek is geared-up to make rapid progress in digital transformation space and accelerate its growth in the US and UK markets. It is well poised to become a leader and sees significant traction in agile and digital transformation solutions and expects to have a stable and profitable financial performance in the coming years.
- Margin of Mastek has grown and stabilized at ~12% in the last four quarters, before which they averaged between 6-7% for the past two years. We believe with higher offshore, better utilization level and SG&A leverage, Mastek will further expand its margins in the coming years. We expect an uptick in the EBITDA margins at 13-14% by FY20E from 9.3% in FY17.
- With new management team, aim to be the leader in digital transformation, acquisition of the US-based TAIS, ranked among the top three vendors in delivering large complex programs in the UK, investment in agile methodologies and EBITDA margin catching up, we value Mastek at 28.00x FY19E EPS of Rs.20.90 to arrive at target price of Rs.585.00, an upside of ~22%.

Risk & Concern

- Any loss of client or weak execution of the project may negatively impact future growth prospect of Mastek.
- Any TAIS-integration related challenges, if arises, may affect Mastek's US expansion plan in the coming years.
- Any sharp rupee appreciation against major currencies will

Graphs & Charts

Figure 1: Net Sales Trend

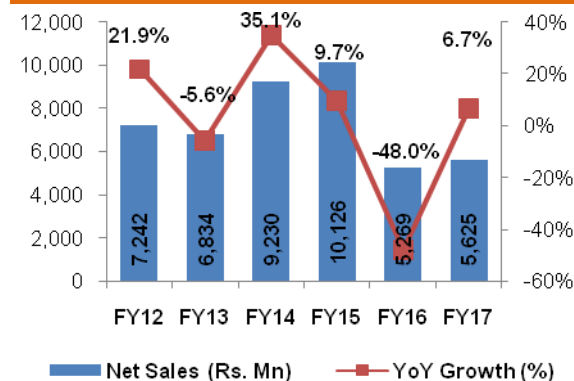


Figure 2: EBITDA & EBITDA Margin Trend

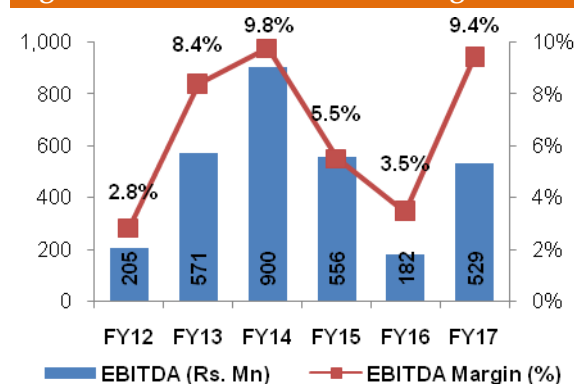


Figure 3: PAT Trend

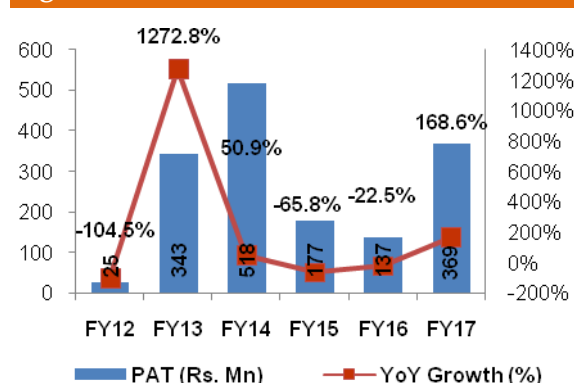
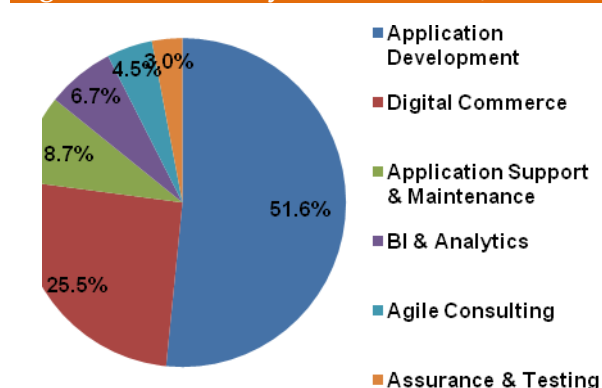


Figure 4: Revenue by Service Line (Q3FY18)



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Corporate Office :Plot No. M-2, Cama Industrial Estate, Walbhat Road, Behind 'The Hub' Goregaon (E), Mumbai - 400 063.

Tel.: 022-67605500 / 600

Head Office :2/2 A, First Floor, Lakshmi Insurance Building, Asaf Ali Road, New Delhi - 110 002. Tel.: 011-30181290 / 94

Web: www.bonanzaonline.com

