

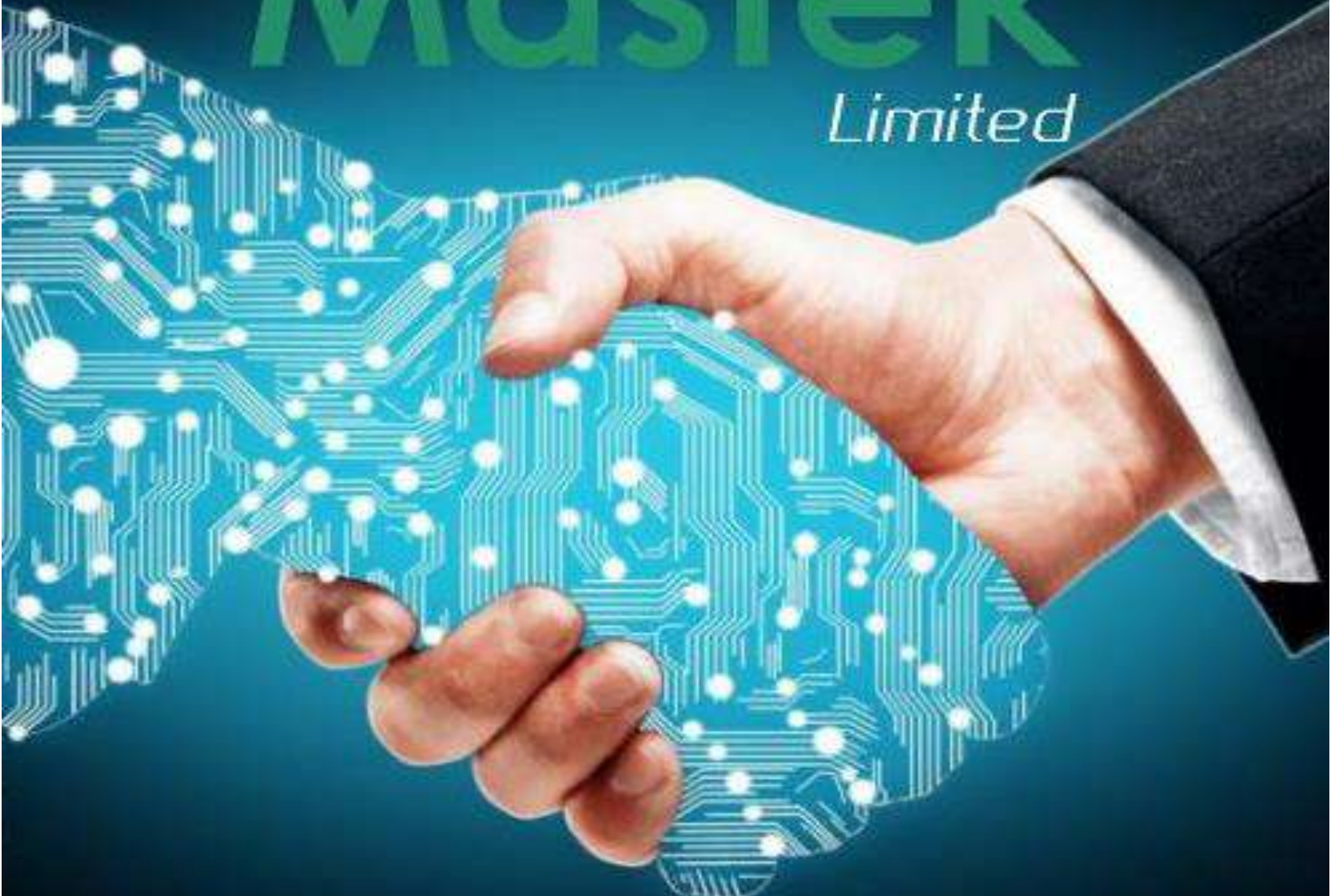


**STEWART &
MACKERTICH**
LEGACY | TRUST | GROWTH

INITIATING COVERAGE REPORT

23rd April 2019

Mastek *Limited*



Research Analyst
SHUBHAM KAKRANIA
smifs.institutional@smifs.com

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Brief Overview

CMP (INR) (As on 22nd April, 2019)	472
Target (INR)	623
Upside(%)	32%
Recommendation	Strong Buy

BSE Code	523704
NSE Code	MASTEK
Reuters Ticker	MAST .BO
Bloomberg Ticker	MAST IN

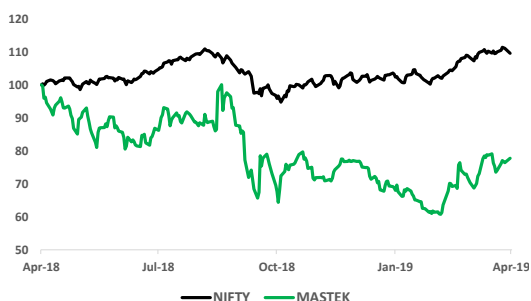
Stock Scan

Market cap (INR Cr.)	1133
Outstanding Shares (Cr.)	2.40
Face Value (INR)	5.00
Dividend Yield(%)	1.27
P/E (x)	11.17
Industry P/E (x)	20.63
Debt/Equity (x)	0.13
Beta vs. Nifty	0.97
52 Week High/ Low (INR)	643/365
Avg. Daily Volume (NSE)/1yr	130560

Shareholding Pattern (%)

	Mar-2019	Dec-2018	Sept-2018
Promoters	45.69	45.86	46.89
Institutions	17.53	19.07	17.66
Non-Institution	36.78	35.07	35.45

Stock vs. Nifty (Relative Returns)



Source: NSE

Mastek Limited: Inspiring Growth

We initiate a coverage on 'Mastek Limited' with **"Strong Buy"** rating. It is a global technology company, founded in 1982, delivering enterprise level digital transformation services and solutions for large public and private enterprises in the UK, US and India. Although Mastek has inherited experience of more than 30 years, but the Mastek in existence today is just a four-year-old organization. Post demerger of Majesco, Mastek lost its presence in US and Insurance segment. Mastek re-instated its presence in US by acquiring TAISTech. Mastek is a professionally run company, operating in the UK, US and Asia Pacific regions.

The company is well poised to achieve its objectives defined under "Vision 2020" i.e. to be a global leader in digital transformation services. It can be among the top providers of agile digital transformation solutions and a significant player within the digital transformation space in retail and financial services.

One of the key striking points for the company is that it has lower exposure to legacy business and more than ~80% of the revenues comes from digital. With its strong foothold in UK and long standing relationship with the UK government, it is well placed to generate strong earnings growth going forward.

Valuation: Mastek, with its proven capabilities in delivering large and complex enterprise-wide transformation projects, is well-placed to successfully partner businesses from end-to-end in their transformational journeys. In our opinion, company is expected to post strong performance in FY20E and FY21E led by healthy order pipeline, continued growth in the UK region and strong traction from the public sector. We have used DCF method and Relative Valuation to find the intrinsic value of the stock. **The derived intrinsic value and target price of Mastek is INR623 per share.**

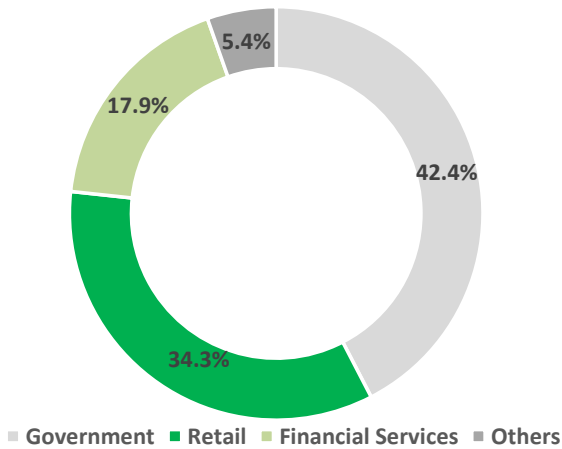
Financial Performance at a glance (Consolidated)

Particulars (INR Cr.)	FY17A	FY18A	FY19A	FY20E	FY21E
Revenue	560	817	1033	1192	1406
Revenue Growth(%)	6.3%	45.9%	26.4%	15.4%	17.9%
EBITDA	49	100	132	155	185
EBITDA Margin	8.7%	12.2%	12.7%	13.0%	13.2%
Net Profit	32	70	101	119	145
Net Profit Margin	5.7%	8.3%	9.5%	9.8%	10.1%
EPS	13.50	29.15	42.03	49.71	60.42
BVPS	195.44	228.87	298.50	337.99	386.19
P/E (x)	35.0	16.2	11.2	9.5	7.8
P/BV (x)	2.4	2.1	1.6	1.4	1.2
ROE (%)	6.9%	13.7%	15.9%	15.6%	16.7%
ROACE (%)	7.6%	13.1%	15.2%	15.0%	16.2%

Source: Company Data, SMIFS Research

Investment Rationale

Revenue Mix based on Verticals (Q4FY19)



Source: Company Data, SMIFS Research

The investments are being made with the objective of diversifying beyond just Oracle channel-fed approach and to develop capability to solicit businesses on their own as well as expand the services offering in ancillary space with Oracle Commerce.

Strong relationship with UK government: Mastek has a long-standing & sticky relationship with the UK government as it was working as a subcontractor to the large IT companies for execution of UK government’s projects. Mastek derives ~76% of its revenue from the UK region (Public + Private), out of which ~38% of revenue is from the UK Government and ~37% from UK private sector.

With its close relationship with the UK government, it is well poised to capture significant share in UK’s government spending (~GBP 4.7bn). Currently, Mastek works with 13 government departments in the UK. Mastek’s largest customers continue to be their biggest patron and appreciate the value that it brings on the table. These customers introduce Mastek on the newer deals with newer service lines and capabilities and help capture bigger share in UK government IT spending. Also, Mastek’s strong track record of delivering 95% of projects on-time has made them a proven player in this space. Mastek is going horizontal into newer departments every year and also increasing wallet share with the existing customers making UK government the strongest space for growth.

Revamping its business strategy in the US: Post-demerger, Mastek re-instated its presence in US market in Dec-16 by acquiring TAIS-Tech which specializes in implementation & support for Oracle Commerce and Oracle Commerce Cloud. US is still a nascent business and contributed ~22% to the total revenue in Q4FY19. Almost 75% of Mastek’s US revenues are through the Oracle channel which makes them huge dependents. US revenue has been witnessing de-growth for the past couple of quarters largely due to Oracle withdrawing support of its ATG product.

Now, Mastek is making efforts in its business strategy with the main objective of making the US portfolio less dependent on Oracle. This will help them cushion the impact of seasonality. Mastek is on-boarding more sales-force and engaging with clients for independent projects. US business on its own is very strong and Mastek has full control of TAIS-tech after the promoter of the company stepped down in Feb-19. He will be replaced by a new sales head and re-purposing of SG&A expenses will happen in the US geography.

Vendor de-centralization policy of UK government: Earlier, UK public sector was dominated by large IT companies, only ~8 vendors dominated about 80% of spend in 2010 & all of these were 10 year contracts for legacy outsourcing. UK government realized this problem and decided to cut down this huge concentration. This was done by (i) renegotiation of legacy outsourcing contracts with reduced pricing, (ii) contract disaggregation to more short term contracts (max 2 years) (iii) Insourcing iv) Increasing the vendor pool. These changes in regulations are beneficial for Mastek as it favors small size players like Mastek providing them fair playing field to compete with the heavy-weights in the sector. Currently, Mastek is working very closely with UK government(Top-10 vendors) and is well poised to benefit from the increased digital spend.

...Rationale Continued

The digital business that Mastek bought have strategically very sound growth, but that is an implementation business. The strategy is to use that as an insertion point and then build on a reputation for delivery into other areas like the testing, & Apps Development.

Mastek holds successful long term client relationship with Home Office and Health, which are expected to have a bigger share of Brexit IT projects while other key sectors continues to maintain significant spend in line with earlier years.

Land & Expand Strategy: The company has been acquiring customers and several of them are in the agile consulting space which is the sharp heads of the spear and these small engagements pave way for the larger projects. The strategy is of “Land and Expand”, where there will be more logos coming in and when they go through implementation phase is when the revenue for customer would swell. This strategy helped them grow in UK and similar strategy is being used in the US. They have set an account management structure and are building on it bit by bit.

The digital business that Mastek bought have strategically very sound growth, but that is an implementation business. The strategy is to use that as an insertion point and then build on a reputation for delivery into other areas like the testing, & Apps Development. Apps Development is the core business which is revenue accretive and will add value to the growth of the company going forward. The investments are made over a period of time on the core asset TAIS tech to enhance the offerings to the customer and convert them into ‘customer for life’ instead of current approach of single offering.

Newer opportunities open with Brexit: Brexit is festering one of the largest government IT programmes ever to get off the ground. While Brexit discussions are creating drag in business investments, IT spend in government space is expected to increase to support huge changes in the existing systems and a myriad of new systems.

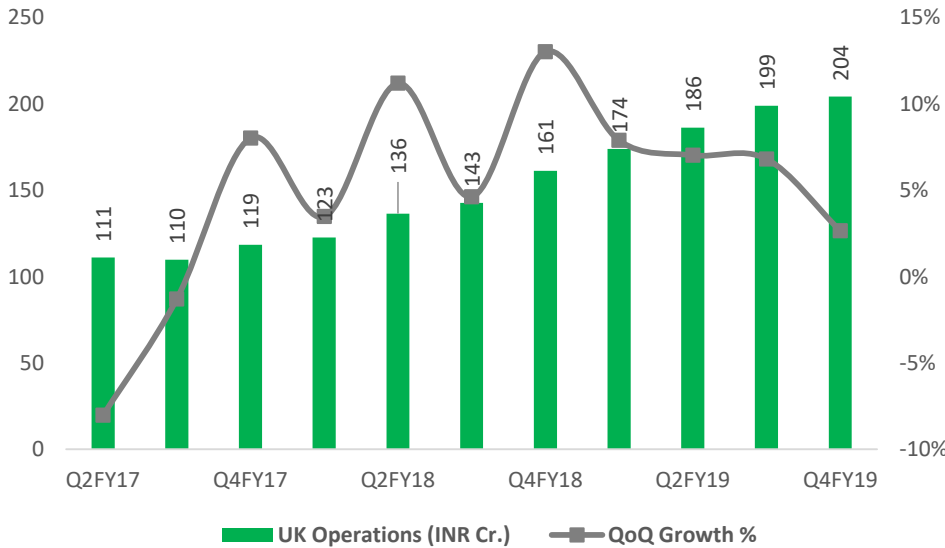
According to GlobalData, there are at least 27 core systems across UK government that will need to be reconfigured or rewritten as a result of changes to immigration, borders and customs controls.

A majority of Mastek’s revenue come from UK (~75% of its revenue) and the current Brexit issue will have a huge impact on the company. The Brexit could be more good than bad as the management expects that the withdrawal of UK from the European Union offers significant opportunity for Mastek. Though the economic activity is subdued owing to ambiguity over the result of Brexit negotiations, the creation of new government departments and re-structuring of existing processes may result in additional digital spending in UK.

According to management, the 27 new departments that will be created, will require digital platforms and an experienced software engineering partner to be able to deliver mission-critical applications. On the flip side, the negative impact of Brexit can be the slowdown in the UK economy and depreciation of GBP can impact INR revenue realization for Mastek. However, in our opinion, since Mastek has government contracts with some of the critical departments in the UK and the IT spending going down significantly is very un-likely.

...Rationale Continued

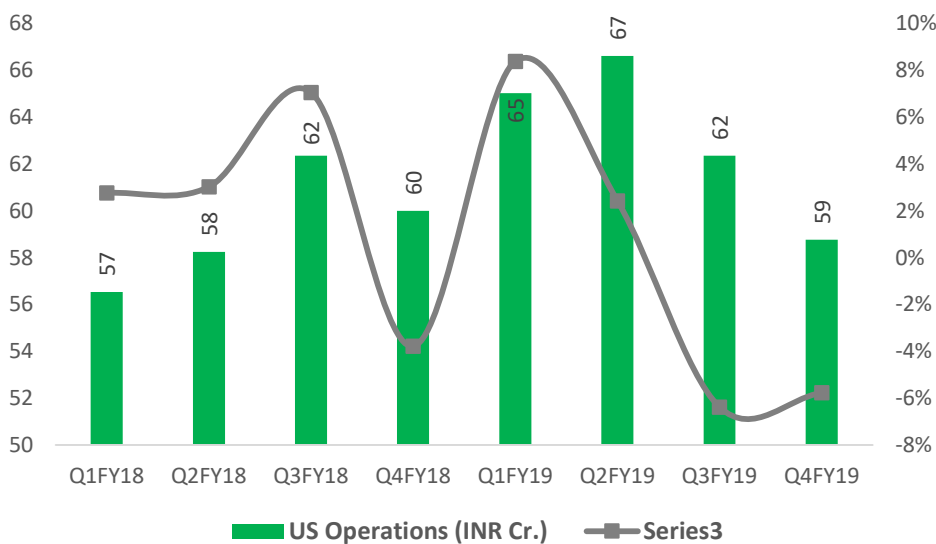
Faster growth in UK operations driven by the UK Government



Source: Company Data, SMIFS Research

In Q4FY19, Mastek's growth was led by UK, now contributing ~76.5% to revenue. The revenue grew by 26.6% YoY and 2.7% QoQ to INR204 Cr. Mastek continues to be among the Top 10 vendor for UK government contracts and does not see any potential direct impact of Brexit. Mastek UK growth to continue led primarily by the UK government. Mastek UK (ex govt.) has focused on two verticals (i) Retail; (ii) Financial Services. The market opportunity is immense and Mastek has a lot of room to grow within this space.

US business still in the nascent stage, we expect the growth to take off from FY20 onwards

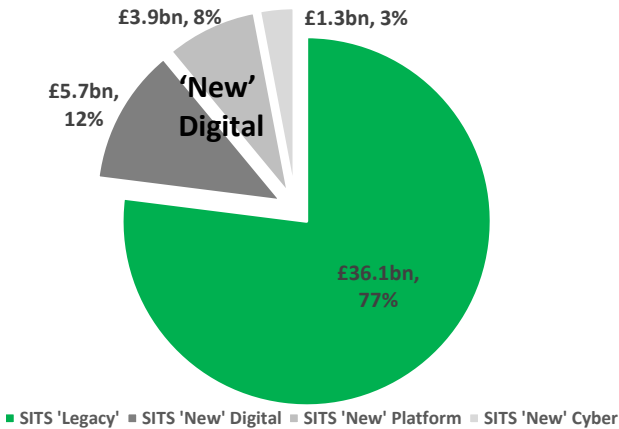


Source: Company Data, SMIFS Research

US has had a double-whammy in terms of a bit of weaker execution in H1FY19 that resulted in weaker order backlog to work with in H2FY19. The segmental performance was impacted by seasonality and the exit of the promoters of TAIS Tech business- since they were not executing as the business needed. Mastek is resetting the US business, and the management is confident of executing the strategy and growing in that market. The foundation in the platform looks strong and the company is building investments that will yield higher growth business going forward.

UK Region Software & IT Services Industry Outlook

UK Software & IT Services Spend in CY2017



Source: TechMarket View, SMIFS Research

UK's rising digital spends would provide significant opportunities for Mastek to capitalize since Mastek participates largely for digital contracts in UK Public & Private sector spending.

The United Kingdom (UK) economy grew at 1.7% in CY2017 and expected to grow at 1.3% in CY2018 mainly due to weak household spending and the drag on business investment from uncertainty relating to the outcome of the Brexit negotiations.

The UK's Software & IT Services (SITS) spend is ~GBP 47bn, out of which legacy spends is ~77% (~GBP 36bn) & digital spends is ~23% (~GBP 11bn). The digital spend comprises of SITS Digital (~12%), SITS Platform (~8%) and SITS Cyber (~3%). The total SITS spend growth in UK was 1.7% for CY18 as against 1.6% and 1.9% in CY17 and CY16 respectively.

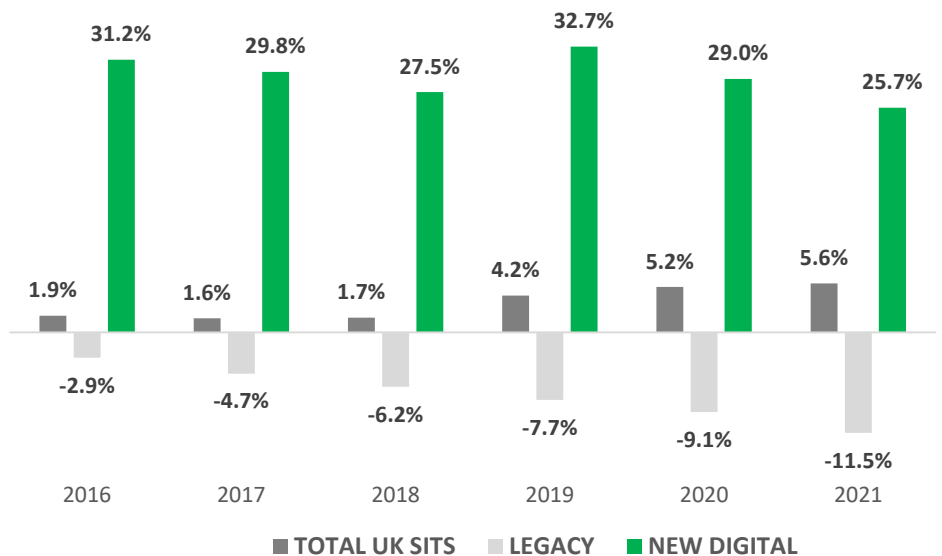
The growth in the SITS spending is coming from the new-age information and technology communications (ICT). In CY18, the total SITS spend growth was 1.7% out of which Digital growth was 27.5% while Legacy de-grew by -6.2%. There is a strong demand in the 'new' digital which is driving growth in the UK. Digital Marketplace helps public sector organizations find cloud technology and specialist services for digital projects via 3 frameworks:

- ⇒ G-Cloud (since 2012): cloud services including IaaS, SaaS and PaaS.
- ⇒ Digital Outcomes & Specialists (DOS)/Digital Services (since 2013): outcomes, specialists and user research services for digital projects.
- ⇒ Crown Hosting Data Centres (CHDC) (since 2015): physical datacentre space for services (sole supplier).

Over a period of time there were policy level changes for UK's government tech spending which will drive digital IT spending with reduced vendor concentration. According to Tech Market View, UK SITS market growth is set to accelerate led by Digital.

According to Tech Market view, UK Digital spending is growing at ~30%, while Legacy spend is shrinking by ~5%.

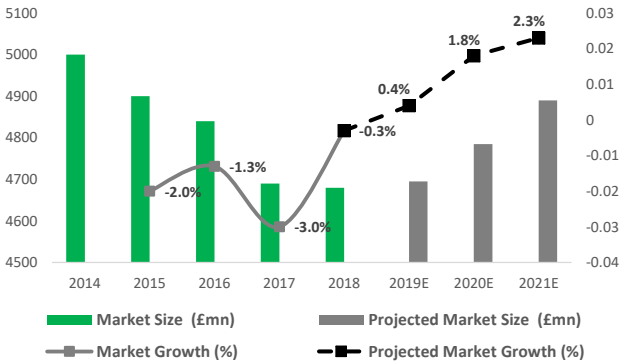
Total UK SITS spending growth over the years: Digital driving growth



Source: TechMarket View, SMIFS Research

UK Region Public Sector Software & IT Services Industry Outlook

UK Central Government SITS Market Growth



Source: TechMarket View, SMIFS Research

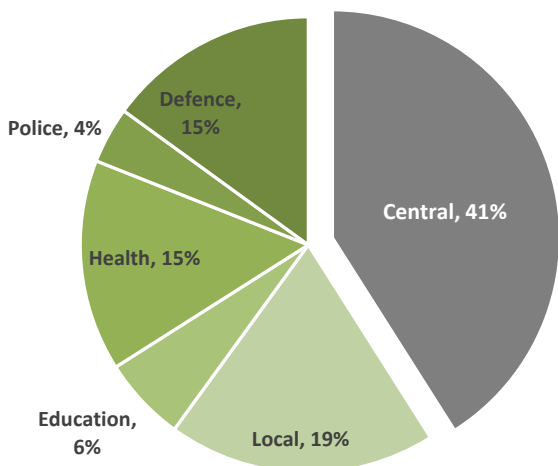
UK public sector spend is ~25% of total UK IT spend (~GBP 11.5bn) while the Private sector spend is ~75% of total spend, i.e. ~GBP 35.5bn. Digital for Public sector would be ~23% Digital (similar to total digital proportion). Out of the total public sector spend, central government spend is ~GBP 4.7bn (~41%). The Central Government includes departments, agencies and non-departmental public bodies in the UK, excluding Department of Health (included in healthcare), Ministry of Defence, and Security & Intelligence agencies (included in defence).

UK government realized the problem of vendor concentration in 2010 and made policy level changes to bring it down. This led to changes like renegotiation of legacy outsourcing contracts with reduced pricing, and Insourcing. As a result, UK public sector IT spend was shrinking during CY14-18. As per Tech Market view estimates, UK Central Govt SITS spend will grow 0.4/1.8% in CY19/20E. The growth is boosted by Brexit-related activity (setting up of new departments & re-alignment of existing departments) in latter years but subdued due to resources issues – both people and money.

Mastek derives ~75% of its revenue from the UK region, both Public & Private, out of which ~38% of Mastek’s revenue is from the UK Government and ~37% from UK private sector (primarily Financial Services and Retail). Out of the UK Central Government SITS spend (~GBP4.7bn), Application Services comprises of ~37% which is Mastek’s core service line.

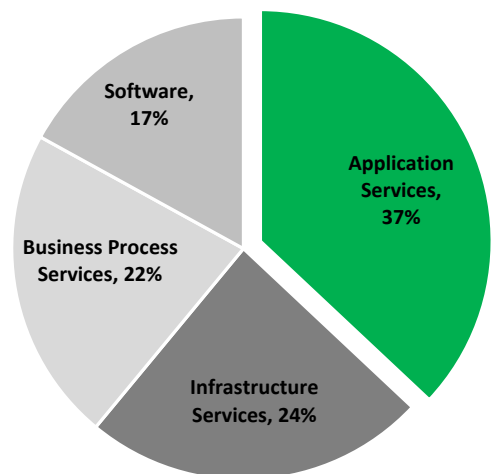
Out of the UK Central Government SITS spend (~GBP4.7bn), Application Services comprises of ~37%, which being the core service line of Mastek, will open up a whole lot of opportunities for future growth.

UK Public Sector SITS Market (~£11.5bn)



Source: TechMarket View, SMIFS Research

UK Central Government SITS Spend (~£4.7bn)



Source: TechMarket View, SMIFS Research

US Region Information Technology Services Outlook

Aligned to Mastek’s strategy to be a leader in Digital Commerce Transformation and Solutions, Mastek acquired TAISTech, US-based leading digital commerce solution provider, to augment service capability and offerings in digital commerce space.

Mastek will position itself as a “Digital Transformation Company” with full spectrum of service and will aim at enhancing its digital commerce offerings by adding complimentary capabilities including UI, UX, CPQ, et al.

The US economy grew at 2.3% in CY2017 and is estimated to grow at 2.9% in CY2018 mainly driven by President Trump’s tax cuts and increased consumer spending. The massive reduction in the corporation tax rate from 35% to 21% is likely to stimulate business investment and growth in the near term. US continues to remain the largest IT market, presenting huge growth opportunities to IT companies.

Mastek in North America

In United States, Mastek provides end-to-end solutions to Financial and Retail organisations using its unique agile-based Adapt 2.0 methodology. The Company’s subsidiary, Digility Inc. provides solution around client portals, mobility, information centralisation, Big Data and testing services.

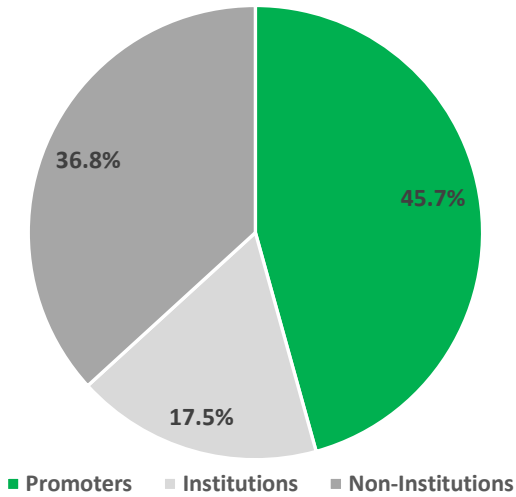
Aligned to Mastek’s strategy to become a leader in Digital Commerce Transformation and Solutions, Mastek acquired TAISTech, US-based leading digital commerce solution provider, to augment service capability and offerings in digital commerce space. TAISTech provides strategic consulting, large-scale digital commerce implementations and support for the Oracle ATG and Oracle Commerce Cloud applications. It also provides omnichannel strategy, creative design, mobile app development, ongoing maintenance and training. The acquisition has created a platform for Mastek’s accelerated growth in the US market and will augment Mastek’s 2020 vision to be a global leader in digital transformation services.

According to Frost & Sullivan, US B2C online sales are expected to reach USD 650 billion by 2022 and it is expected to command 32.6% share of global online B2B sales by 2025 , thus creating significant opportunity for Mastek. Commerce modernization (migration from ATG to Cloud), Omni-channel and B2B will be key focus areas for Mastek.

Region wise, the Americas continue to dominate the IT services market and accounts for around 45% of the total market share. Factors such as growing emphasis on developing an IT- efficient infrastructure is expected to increase the adoption of IT services in this region. Traditional and mature verticals - BFSI, manufacturing and Telecom continue to drive the growth while the share of Healthcare and Retail verticals augmented as Social, Mobility, Analytics and Cloud (SMAC) adoption increased across key industries.

Company: Mastek—Enterprise Digital Transformation: Inspiring Growth

Shareholding Pattern (March 2019)

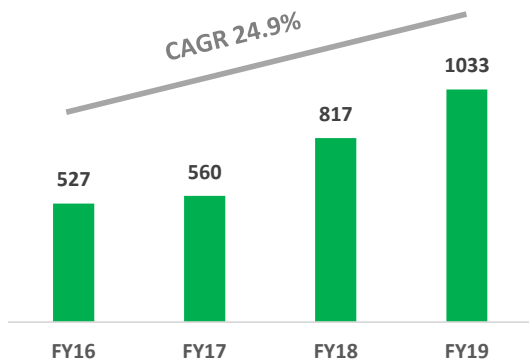


Incorporated in 1982, Mastek is engaged in providing software solutions and integration services. In recent years, Mastek has emerged as a leading provider of Enterprise Digital Transformation services for both public and private enterprises. For over three decades, Mastek's clients have relied on its architecture, design and innovative technology solutions that have improved the lives of millions of citizens and customers.

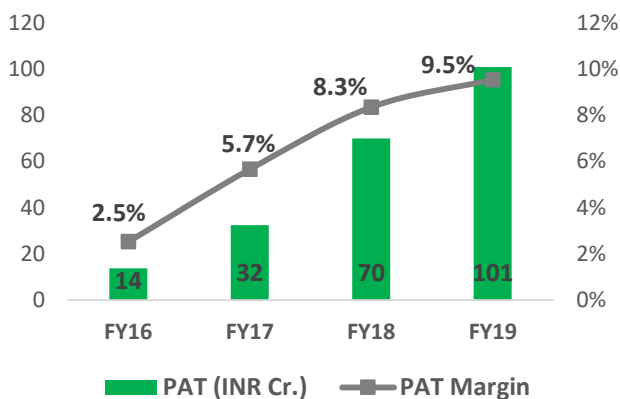
Mastek is professionally run company and is well poised to be among the top providers of agile digital transformation solutions and a significant player within the digital transformation space in retail and financial services.

Mastek operates in the UK, North America and Asia Pacific regions. Mastek currently derives ~76% of its revenue from the UK region. Mastek has presence in both Public and Private sectors. They enable large-scale business change programmes through service offerings, which include application development, support and testing, BI and analytics, agile consulting and digital commerce. Whether it's creating new applications, modernizing existing ones or recovering failing projects, they help enterprises to navigate the digital landscape and stay competitive.

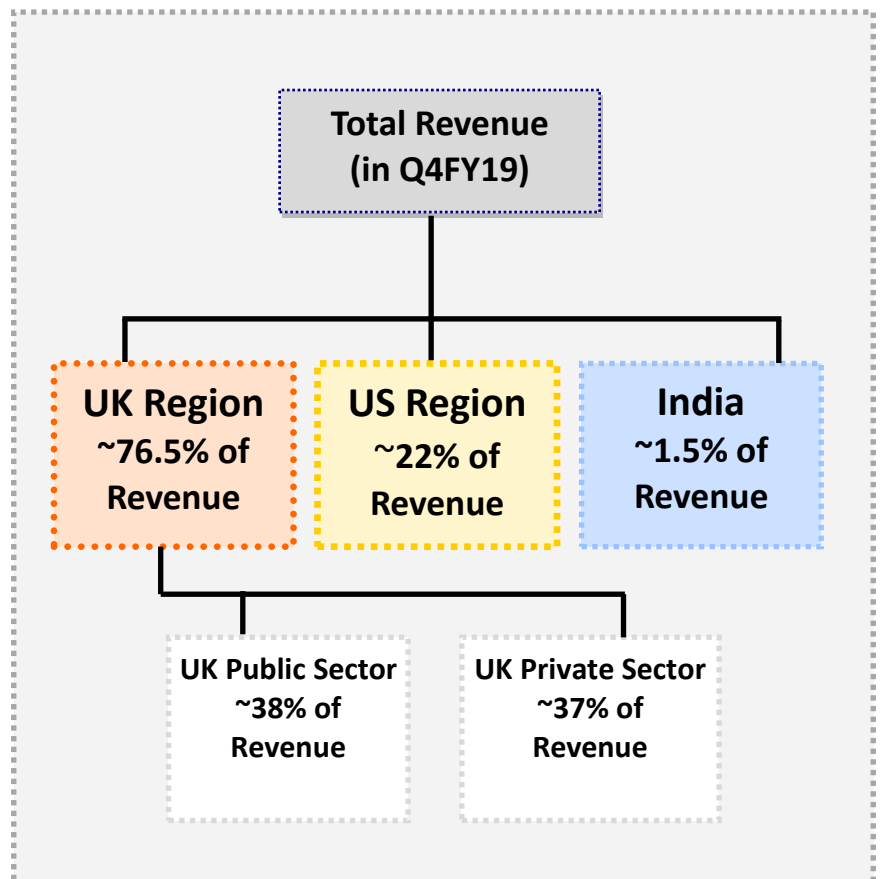
Revenue from Operations (INR Cr.)



Profit After Tax Performance

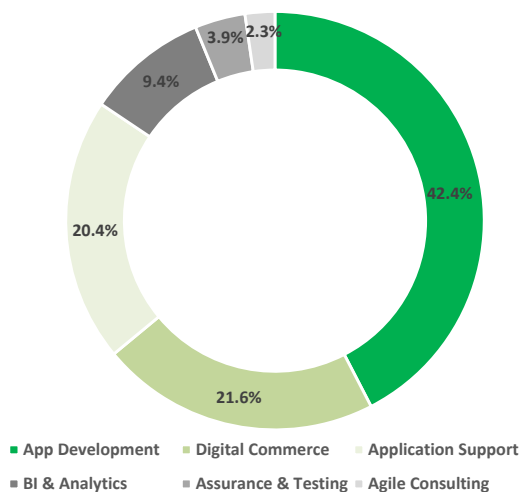


Source: Company Data, SMIFS Research



Company: Mastek—Enterprise Digital Transformation: Inspiring Growth

Revenue Mix by Services (Q4FY19)



Source: Company Data, SMIFS Research

“Vision 2020” articulates Mastek’s ambition to be a global leader in digital transformation services. Mastek is eyeing for an all-round growth in Agile and Digital Transformation space and geared up to unlock its potential. Over the next 3-4 years, management expects 45% to come from UK and US each and 10% from India.

Service Offerings

Mastek offers comprehensive services covering the full range of software development process - from an initial agile consulting exercise, to application development, testing and ongoing support as well as maintenance.

Agile Consulting - Enabling our clients to deliver digital change.

Business Intelligence and Analytics - Offering pragmatic analytics for business priorities.

Application Development- Delivering robust, scalable and secure applications.

Application Support & Maintenance- Bridging the business and IT gap

Assurance & Testing- Extending iterative, agile testing approach scaled to business needs.

Digital Commerce- Providing Omni channel e-commerce innovation.

The growth in UK market has been fairly broad based, majority has been from Government, retail has held on its own in the geography. The financial services vertical is going strong with couple of acquisitions of clients in this space and over the last twelve months they have grown, which has given them momentum. Government continues to be the mainstay in the UK region and they are going horizontal into newer departments every year and at the same time increasing the wallet share with existing customers.

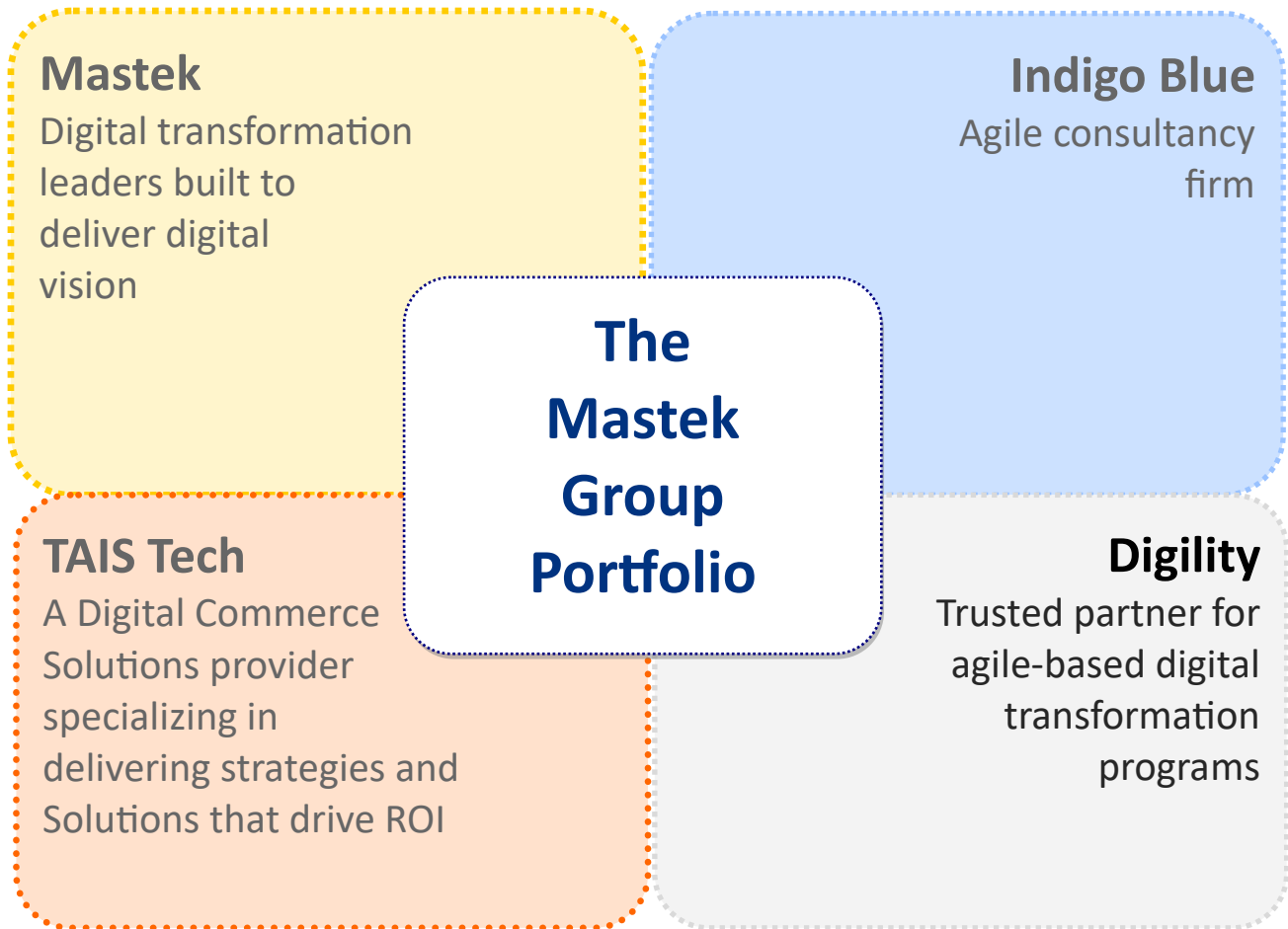
According to management, the deal pipeline is healthy going forward. Order backlog regained momentum in Q4FY19 to INR544.9 Cr. up 5% after a slowdown last quarter due to seasonality. It is expected that it will improve further going ahead in FY20 led by strong deal pipeline and no potential direct impact of Brexit.

Intending to further its growth through the inorganic route, Mastek is looking to acquire two-three companies in the next one year. The company has plans to monetize its non-core assets (stake in Majesco US & other real estate investments) which will be used for acquisitions to accelerate growth.

Demerger Rationales of Mastek & Majesco

- The Insurance Products & Services business (*now Majesco*) was different from the Solutions business (*Mastek*) in terms of business model, growth opportunities, investment required and staff profile.
- While the Insurance business offered tremendous growth potential, it had high investment requirements in terms of R&D, brand building and sales.
- Insurance business was cross funded by the solutions business limiting its own growth.
- The de-merger provided an opportunity to focus on building new capabilities and addressing new markets within the solutions business.
- Digitization across verticals and changing customer preferences leading to higher IT spend which provide excellent growth opportunity.

Company: Mastek— Inspiring Growth working with Diverse Enterprises



With Mastek’s ability to recover troubled/stalled DX projects, modernize legacy environments and create new digital interfaces, Mastek has built long-standing relationships with marquee clients across sectors.

Government	Retail	Financial Services
Home Office	Morrisons Supermarket	International Personal Finance
NHS Digital	BrandsMart USA	Together Financial Services
British Army Information Application Services	rue21	Yorkshire Building Society

Source: Company Data, SMIFS Research

Company: Mastek— Key Management Profile

John Owen, Group CEO: John leads the growth strategy at Mastek and has over two decades of sales and marketing experience. He has previously held senior leadership roles in global blue-chips such as HP, Nortel and Serco, as well as successful start-ups such as Sycamore Networks.

Prior to Mastek, John was the Sales and Marketing Director for Serco where his responsibilities included handling Serco's largest customer, the UK Government.

Abhishek Singh, Group CFO: As Group CFO, Abhishek oversees multiple functions globally including Finance, Investor Relationships, IT, Facilities and Infrastructure.

He has two decades of experience in the Information Technology, Healthcare, Financial Services and BPM industries across both India and the United States, including organisations like First Source Solutions and Tech Mahindra (then Mahindra-British Telecom).

Prahlad Koti, MD UK: Mr. Prahlad is responsible for the achievement of Mastek UK's strategic plans. He manages the UK P&L and develops the organisation for long term, successful growth. He has been associated with Mastek for over 25 years.

Hiren Shah, Senior VP of Service Lines: Hiren leads the technology service delivery team, driving the P&L and building the pipeline for service line growth. His role encompasses working with Geo MDs and Marketing to develop propositions appropriate to the service capability and then working with Account Managers and New Business Sales Leads to secure business growth.

Prior to Mastek, he led high-ROI projects across India, Europe and the United States in his almost 30-year career.

Joe Venkataraman, Group Corporate Development Officer: Joe spearheaded Mastek operations in the UK way back in the nineties. As the Chairman of Mastek UK, he holds responsibility for long-term strategy, UK P&L and ensuring the continued health and viability of the operation.

Maninder Kapoor Puri, Group Chief People Officer: Maninder is Group Chief People Officer, overseeing all aspects of HR practices and operations in order to meet the needs of the constantly evolving business – facilitating strategic planning and initiatives, change management and organisational design.

Prior to Mastek, she held global human resource roles in organisations such as First Source Solutions, ICICI OneSource, Accenture and iGate Solutions.

Dennis Badman, Chief Business Officer: Mastek recently appointed Dennis Badman who will join the Mastek Executive Committee and will be responsible for ensuring Mastek retains its global competitiveness as the company looks to strengthen its management capacity and leadership experience as it scales over the coming years.

Dennis joins from Fujitsu where he spent eight years including spells leading the Delivery, Business and Application Services team and also managed their largest account business with HMRC. Prior to Fujitsu, Dennis spent time at Telent, Marconi and Sycamore Networks.

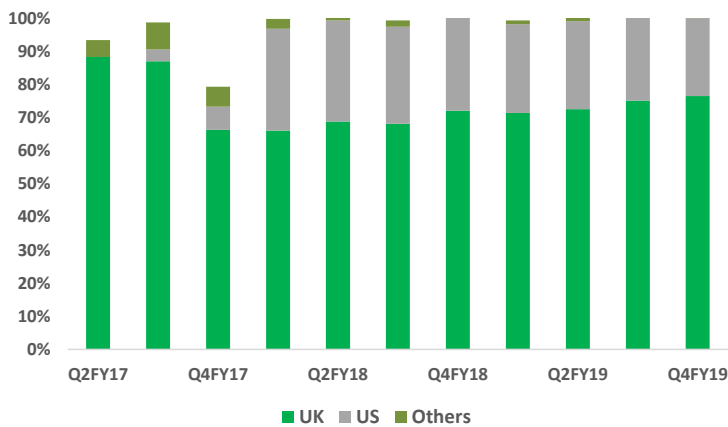
Key Operating Indicators

Quarter-wise Revenue Contribution in terms of Verticals

Revenue by Industry Segment	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
Retail	11.6%	13.7%	6.8%	39.3%	37.6%	38.9%	37.0%	35.6%	36.9%	36.3%	34.8%	34.3%
Government	47.6%	42.6%	48.0%	35.9%	34.7%	34.5%	33.4%	31.9%	31.5%	38.6%	38.0%	42.4%
Financial Services	26.8%	29.2%	26.0%	16.1%	19.3%	17.3%	21.5%	22.9%	22.0%	19.0%	18.7%	17.9%
Others	14.0%	14.5%	18.6%	8.7%	8.4%	9.3%	8.1%	9.6%	9.6%	6.1%	8.5%	5.4%

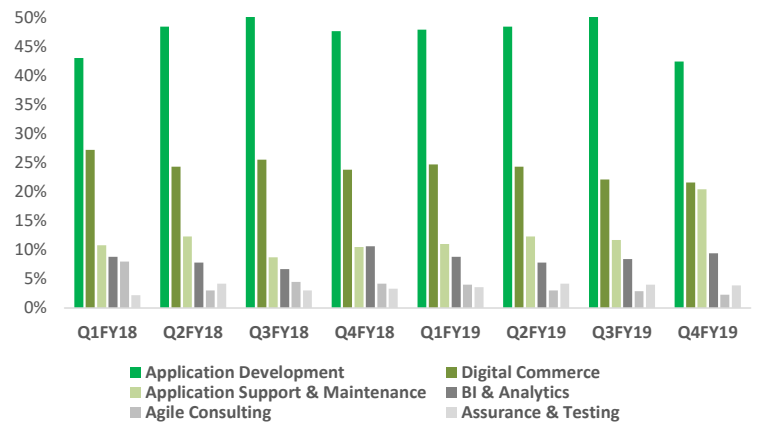
Source: Company Data, SMIFS Research

Quarter-wise Revenue Mix by Market Region



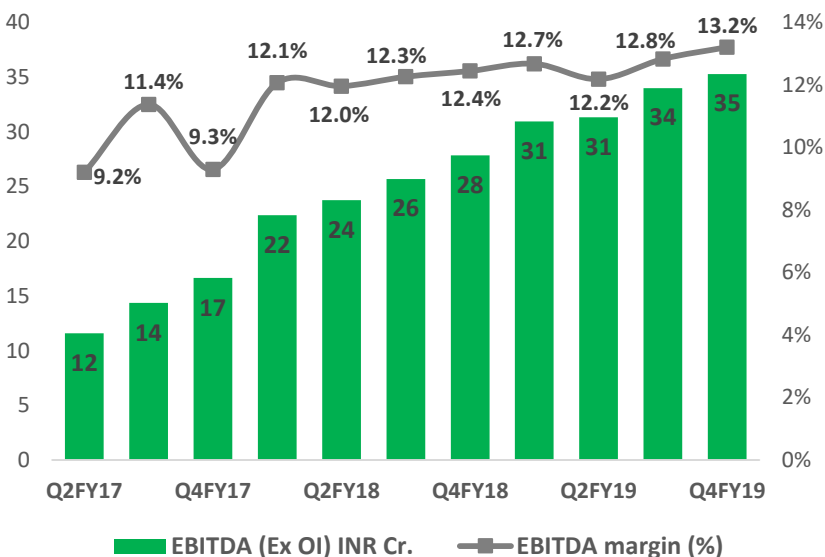
Source: Company Data, SMIFS Research

Quarter-wise Revenue Mix by Service Line



Source: Company Data, SMIFS Research

Quarter-wise EBITDA profile



Source: Company Data, SMIFS Research

The EBITDA Margin has been expanding consistently in the last several quarters led by operational efficiency. In Q4FY19, better utilization pushed up margins. Going forward, we expect further margin improvement as US revenues, which are currently at breakeven level will support margins.

Key Operating Indicators

Total Headcount

Manpower Statistics	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
UK	1011	1105	1141	1204	1192	1230	1192	1230
North America	301	302	386	428	427	409	395	389
Domestic	122	121	112	137	144	137	138	164
Corporate Services(Including trainees)	250	239	263	289	334	328	363	286
Total	1684	1767	1902	2058	2097	2104	2088	2069

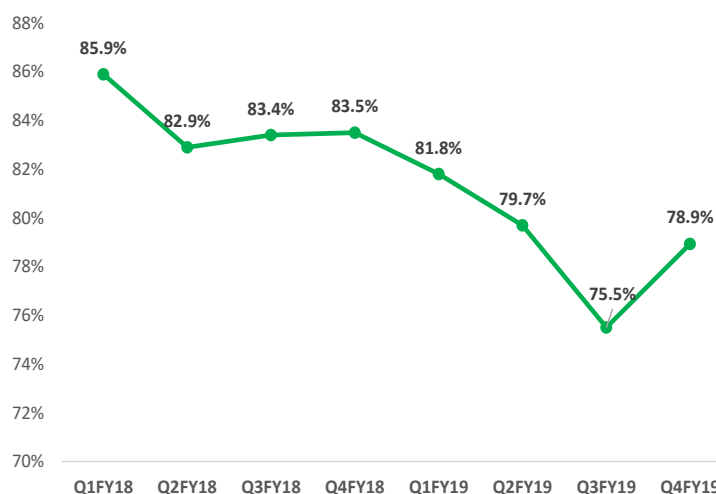
Source: Company Data, SMIFS Research

Mastek has added 7 new clients in Q4FY19; Continues to maintain high % of repeat business



Source: Company Data, SMIFS Research

Billable Utilization % improved in Q4FY19 which helped improve EBITDA margin



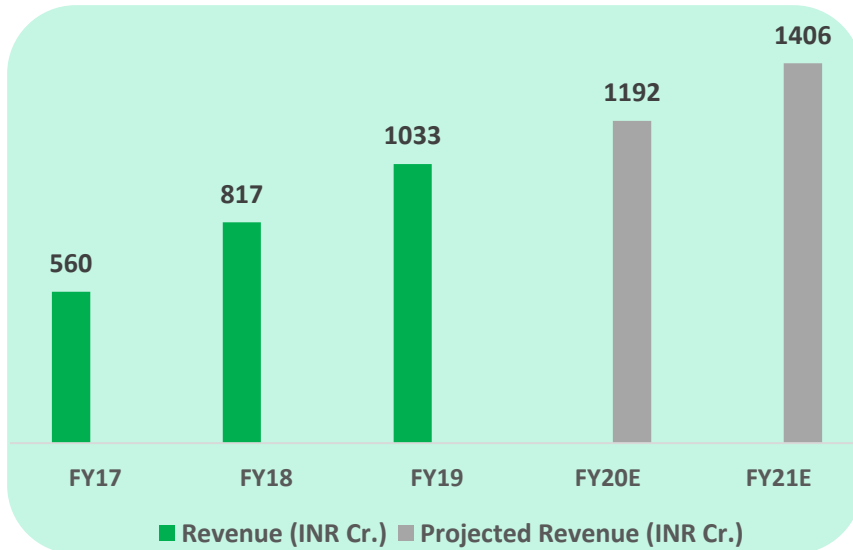
Source: Company Data, SMIFS Research

Quarter-wise Profile of Total Client

Profile of Client Revenue	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19
Top 5 Client Revenue	52.5%	52.3%	52.6%	38.2%	41.3%	40.1%	37.8%	40.3%	39.8%	41.5%	42.6%	41.7%
Top 6-10 Client Revenue	19.0%	20.8%	18.8%	14.9%	12.5%	15.0%	19.3%	16.9%	15.7%	15.1%	14.5%	17.1%
Non Top 10 Client Revenue	28.5%	26.9%	28.6%	46.9%	46.2%	44.9%	42.9%	42.8%	44.5%	43.4%	42.9%	41.2%
Clients accounting for >5% of Revenue	5	6	6	5	5	5	5	5	5	4	4	4
No. of Clients with Annual Billing > USD 1 mn	17	16	13	27	27	27	27	28	28	32	32	29
% of business from Clients with potential Annual Billing > USD 1 mn	83.7%	80.2%	81.4%	77.9%	72.1%	76.5%	76.1%	77.7%	75.9%	84.1%	87.0%	81.9%

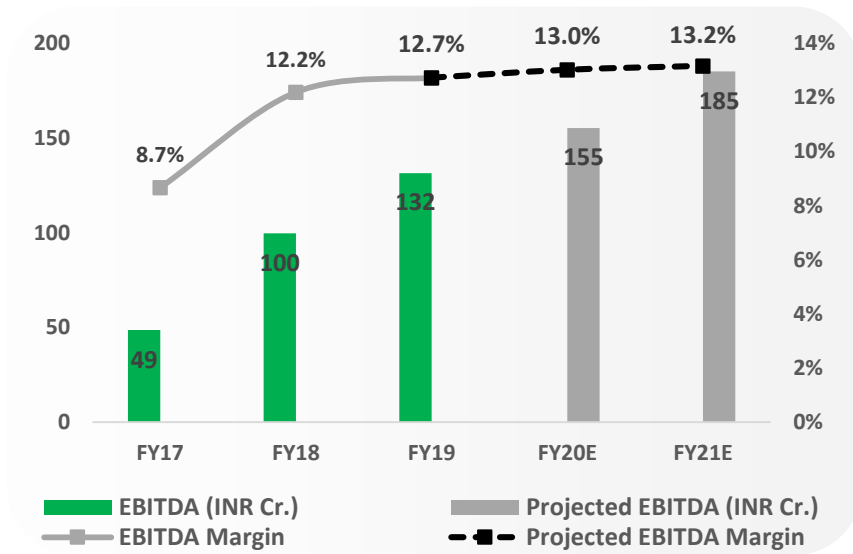
Source: Company Data, SMIFS Research

Key Performance Indicators



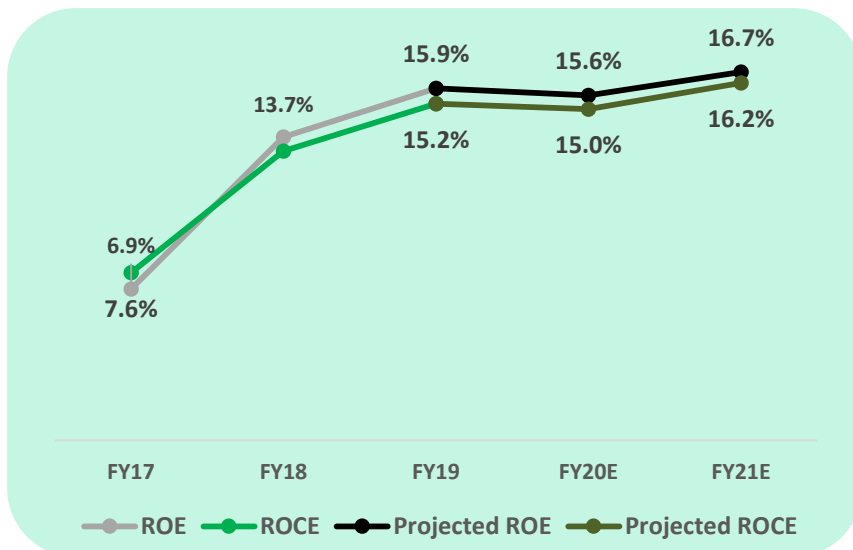
Revenue

We expect revenue growth of 15.4% and 17.9% in FY20E and FY21E respectively led by traction in digital spends, particularly in UK public sector, and strong growth in the UK private sector led by Financial services and Retail. In our opinion, the US growth will be muted due to sluggish growth in US Retail.



EBITDA Profile

We forecast EBITDA margin to grow gradually in FY20E and FY21E, offset by higher sales expenses in US and onsite hiring. We expect EBITDA margin of 13% and 13.2% in FY20E and FY21E respectively. The improvement in EBITDA margin will be led by operational efficiencies and US business stabilizing.

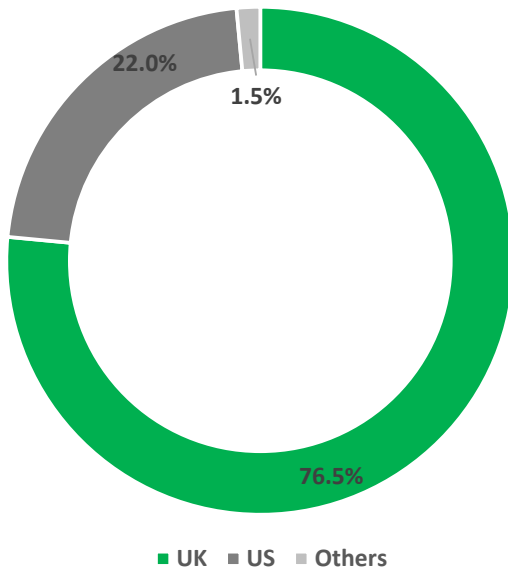


Return Ratios

Return ratios should remain healthy going forward in FY20E and FY21E with strong earnings growth potential. Since a large part of capital is deployed in Majesco US, the ROE and ROCE are suppressed. The management is open to dilute the investment for an acquisition opportunity, which creates scope for improvement.

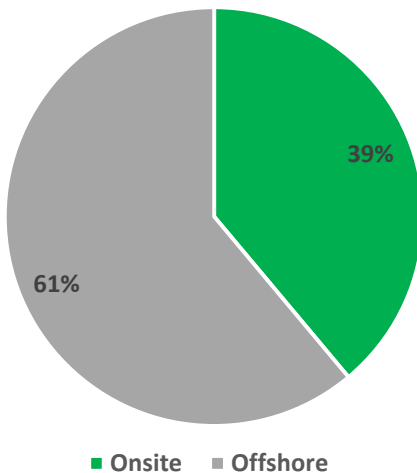
Source: Company Data, SMIFS Research

Revenue Mix by Market Region (Q4FY19)



Source: Company Data, SMIFS Research

Effort Mix (Q4FY19)



Source: Company Data, SMIFS Research

Key Investment Risks

Risk related to Brexit: There is uncertainty around the outcome of Brexit or no Brexit. Since the UK region contributes to ~75% of the revenue of Mastek, the outcome will have a significant impact on the company. Any slowdown in UK economy due to Brexit will have a direct impact on the company. Also, depreciation of GBP can impact INR revenue realization for the company.

High on-site mix compared to industry: Mastek has 38% On-site effort mix since the company is securing customers with an onsite presence and an onsite delivery. As long as the company operate its major portion of work in public sector, the first engagement will be onshore. This is a key risk since protectionism is rising in few economies like USA, UK, Australia, Singapore, etc. Any changes in immigration laws or any local regulations can impact the profitability and growth of the company.

Client and account risks: Mastek’s strategy is to engage with a few strategic customers and build long-term relationships with them. Any shift in customer preferences, priorities, and internal strategies can have an adverse impact on the company’s operations and outlook. Mastek does have the benefit of being very well entrenched with many of its customers, involved in their critical and strategic initiatives. Therefore, client concentration related risks are mitigated to an extent.

Global economy risk: Mastek’s derives ~75% revenue from UK and ~24% from US. The economic growth activity in these nations could directly or indirectly affect Mastek’s customers’ IT spends. A slowdown in these economies would pose lower growth or deferred IT spends thus impacting growth for Mastek.

Exchange rate risk: The exchange rate of Mastek’s major billing currencies like GBP, USD, Euro and AUD has fluctuated widely in the recent past and may continue to fluctuate significantly in the future thus resulting in wide fluctuation in not only revenues but also ForEx losses and gains. Adverse currency impact could also lead to impact on company’s profitability being hit.

Competition risk: The technology market has become so evolving and prominent that the risk of competition especially from technology giant from both India and abroad has increased. Thus, the shift of any major existing or prospective clients could affect Mastek’s business. Although, Mastek is well on its toes to serve the customer with its strong domain expertise, robust delivery capabilities, and significant project experience, there is no guarantee that it will always get the better of competition.

Outlook and Valuation

The information technology industry is witnessing a huge shift from 'legacy business' to 'digital' with more realistic expectations from the vendors. According to GlobalData, UK public sector spent more than GBP 1 billion across digital services, DOS and G-cloud. This together with key digital programmes driven by "Digital by Default" agenda of UK government, represents a large market opportunity for Mastek in UK.

The UK government is the mainstay of Mastek, as UK region continued to post strong growth in Q4FY19 led by robust growth in government contracts. The momentum in UK should continue, as management is confident of healthy deal pipeline with Mastek being the preferred vendor (top-10) for the UK government. Also, the company has been a major recipient of vendor de-centralization policy of UK government which favors small companies like Mastek. The focus on Retail and Financial services sectors in private sector, which are one of the most disrupted and highest spenders on digital technology provides huge market opportunity for Mastek going forward.

The only concern in the performance is the US business, which has de-grown in last couple of quarters due to poor execution. It is facing issues in the Oracle ATG portfolio. Having said that, investments are being made with the objective of diversifying beyond just Oracle channel-fed approach and to develop capability to solicit businesses on their own as well as expand the services offering in ancillary space with Oracle Commerce. This will help them cushion the impact of seasonality. Mastek is on-boarding more salesforce and engaging with clients for independent projects. The company, via TAIS acquisition, is looking at reducing the dependency on UK and scale up its business in US, which is yet to accelerate in terms of growth.

In our opinion, company is expected to post strong performance in FY20 and FY21 led by strong order book, continued growth in the UK region, strong traction from the public sector and stabilization of the US business. The company with its long-term and sticky relationship with the UK government is poised to benefit from the increased digital spend. Margins can improve modestly from here, given the scope of operational improvement and US business stabilizing.

On the back of strong traction from public sector, large deal wins and company's focus on high growth UK Retail & Financial Services verticals, it appears to us that company has strong earnings growth potential. We have used DCF method and Relative Valuation to find the intrinsic value of the stock. The derived intrinsic value of Mastek is INR623. We are using Mastek's intrinsic value INR623/share as the target price.

Relative Valuation on the basis of P/E Multiple

Parameters	Per share (INR)
Multiple (x)	9.4
EPS (FY21E)	60
Value of core business	565
Stake in Majesco US (INR)	104
Discount (20%)	20.8
Value of stake in Majesco US	83
Target Price	648

Valuation Matrix

Share Price as per DCF	597
Weight	50%
Share Price as per Relative Valuation	648
Weight	50%
Target Price	623
CMP	472
Upside	32%

Financial Details
Profit & Loss Statement Consolidated

Particulars (in Cr.)	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	560	817	1033	1192	1406
<i>Change (%)</i>	6.3%	45.9%	26.4%	15.4%	17.9%
Employee Benefit Expenses	323	481	587	667	785
Other Expenses	188	237	315	370	436
Total Expenses	512	718	902	1037	1221
EBITDA	49	100	132	155	185
<i>Change (%)</i>	166.8%	105.2%	31.9%	18.1%	19.2%
Depreciation & Amortization	15	19	17	20	21
EBIT	34	81	114	135	164
<i>Interest & Other Financial Cost</i>	4	6	6	7	6
Other Income	13	21	25	30	35
EBT	39	96	133	159	193
Tax	7	26	32	40	48
Reported PAT	32	70	101	119	145
<i>Change (%)</i>	135.8%	115.9%	44.2%	18.3%	21.5%
Basic EPS	13.50	29.15	42.03	49.71	60.42

Cash Flow Statement Consolidated

Particulars (in Cr.)	FY17	FY18	FY19E	FY20E	FY21E
Profit for the year	32	70	101	119	145
(Inc)/Dec in Working Capital	(7)	(45)	(103)	(60)	(56)
Non Cash Op Expenses	17	42	42	53	62
Interest Paid	4	6	6	7	6
Tax Paid	(4)	(9)	-	-	-
CF from Op. Activities	43	64	47	119	157
(Inc)/Dec in FA & CWIP	(12)	(15)	20	20	20
Free Cashflow	(39)	(2)	4	4	4
(Pur)/Sale of Inv.	(67)	(6)	(65)	(147)	(97)
CF from Inv. Activities	(119)	(24)	(41)	(124)	(73)
Inc/(Dec) in NW	2	2	2	2	2
Inc/(Dec) in Debt	67	4	16	-7	-7
Int. Paid	(3)	(3)	(3)	(3)	(3)
Div Paid (incl tax)	(2)	(11)	(15)	(24)	(29)
CF from Fin. Activities	65	(7)	0	(31)	(37)
Effect of changes in exchange rates	(8)	6	-	-	-
Inc(Dec) in Cash	(20)	40	5	(36)	47
Add: Opening Balance	67	48	88	93	57
Closing Balance	48	88	93	57	105

Source: Company Data, SMIFS Research

Financial Details
Balance Sheet Consolidated

Particulars (in Cr.)	FY17	FY18	FY19	FY20E	FY21E
Equity & Liabilities					
Share Capital	12	12	12	12	12
Reserves & Surplus	457	537	704	799	915
Total Net Worth	469	549	716	811	927
Long Term Borrowings	65	50	69	59	49
Other Non-Current Financial Liabilities	38	27	0	0	0
Provisions	10	7	12	12	12
Deferred tax liabilities (Net)	27	19	21	21	21
Non-Current Assets					
Tangible Fixed Assets	44	48	47	47	48
Intangible Assets	136	133	122	215	240
Financial Assets	173	168	285	285	285
Other Non-Current Assets	22	9	12	12	12
Deferred Tax Assets (Net)	36	53	37	37	37
Current Assets					
Inventory					
Debtors	85	135	208	250	288
Investments	105	118	115	114	114
Cash & Cash Equivalents	48	88	93	57	105
Other Current Financial Assets	74	77	19	19	19
Other Current Assets	8	10	49	49	49
Total Assets	731	840	987	1085	1196
Current Liabilities & Provisions					
ST Borrowings	0	4	0	3	6
Provisions	3	5	6	6	6
Trade Payables	20	19	9	11	13
Other Current Liabilities	32	44	36	40	40
Current Tax Liabilities	4	9	12	12	12
Other Current Financial Liabilities	63	109	106	110	110
Total Equity & Liabilities	731	840	987	1085	1195

Source: Company Data, SMIFS Research

Financial Ratios

Particulars (in INR Cr.)	FY17	FY18	FY19	FY20E	FY21E
Profit Margins					
EBITDA Margin	8.7%	12.2%	12.7%	13.0%	13.2%
EBIT Margin	8.1%	12.2%	13.1%	13.5%	13.8%
PBT Margin	6.8%	11.5%	12.6%	13.0%	13.4%
Net Income Margin	5.7%	8.3%	9.5%	9.8%	10.1%
Return Ratios					
ROE	6.9%	13.7%	15.9%	15.6%	16.7%
ROCE	7.6%	13.1%	15.2%	15.0%	16.2%
Per Share					
EPS	13.50	29.15	42.03	49.71	60.42
BVPS	195.44	228.87	298.50	337.99	386.19

Source: Company Data, SMIFS Research

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For queries related to compliance of the report, please contact: -

Sudipto Datta, Compliance Officer

Stewart & Mackertich Wealth Management Ltd.

Vaibhav, 4 Lee Road, Kolkata 700020, West Bengal, India.

Contact No.: +91 33 4011 5414 /91 33 6634 5414

Email Id.: compliance@smifs.com / sudipta@smifs.com

Website: www.smifs.com