

Mastek

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Not Rated

Rs472

Mastek reported 1.4% sequential decline in revenues to Rs1.5b in 1QFY06. Normalizing the revenues for the Rs80m one-time software revenue license revenue in 4QFY05, the company reported sequential growth of 4%.

The quarter saw broad-based growth across all geographies, except Europe, which declined 10% QoQ. Normalizing for the one-time software license revenue, the decline reported was lower at 2% QoQ.

The company acquired Entegram LLC, a US-based company with presence in the insurance domain, which would add ERP capabilities to Mastek's service offerings.

EBITDA margin expanded by 210bp due to lower travel expenses, fewer sub-contractors hired during the quarter, and increase in productivity of certain fixed-price projects.

Net profit at Rs150m, grew slower at 2% QoQ due to higher minority interest at Rs35.9m, which was on account of stronger performance of the Deloitte JV. The company reported an EPS of Rs10.9 for the quarter. The stock is currently trading at 10.5x FY06E earnings. We do not have a rating on the stock.

QUARTERLY PERFORMANCE									(Rs Million)
Y/E JUNE	FY04				FY05				FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Revenues	975	1,017	1,029	1,282	1,281	1,386	1,475	1,528	1,506
QoQ change %	10.4	4.3	1.2	24.6	-0.1	8.3	6.4	3.6	-1.4
Direct Expenses	-572	-607	-618	-747	-731	-833	-916	-923	-933
Sales, General & Admin. Expenses	-306	-299	-264	-306	-341.7	-326	-347	-369	-308.2
Operating Profit	97	111	147	229	208	227	212	237	265
Margin (%)	9.9	11.0	0.1	17.9	16.2	16.4	14.4	15.5	17.6
Depreciation	-51.3	-56.6	-54.9	-76.0	-64	-70.2	-60.8	-48.8	-69
Other Income	32.2	26.0	23.6	29.1	25	14.6	26.3	30.7	25
Interest Expense	-1	-4	-4	-3	-1	-3	-1	-5	-1
PBT (Before Exceptional Items)	76	77	112	180	167	169	176	214	219
Losses in Equity Affiliates	0.0	0.0	0.0	-7.1	-10	-14.6	-15.6	-12.1	-9
Provision for Tax	-3.0	-2.2	-0.9	-19.6	-10	-11.8	-18.6	-42.2	-24
Rate (%)	3.9	2.9	0.8	10.9	5.8	7.0	10.6	19.8	11.0
Profit after Tax bef. Min. interest	73	75	111	153	148	142	142	159	186
Minority interest	-42.9	-33.4	-10.6	-33.8	-26	-14	-4.4	-12.0	-36
Net Income	30	41	100	119	122	128	138	147	150
QoQ change %	-93.9	36.6	142.1	18.7	2.2	5.3	7.4	7.0	1.99

E: MOST Estimates

REVENUE BREAK-UP

Y/E JUNE	SEP-03	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
North America	307.9	290.4	223.3	273.0	232.2	222.7	212.1	231.2	276.7
% Growth	10.6	-5.7	-23.1	22.2	-14.9	-4.1	-4.7	9.0	19.7
Europe	422.6	485.5	607.0	687.5	719.2	874.2	975.6	1004.1	901.5
% Growth	-14.5	14.9	25.0	13.3	4.6	21.6	11.6	2.9	-10.2
Asia Pacific	46.7	50.8	53.1	43.6	56.2	40.6	28.2	29.5	36.9
% Growth	22.1	8.6	4.6	-17.9	28.9	-27.8	-30.6	4.6	25.2
India	18.4	18.5	22.8	23.1	17.9	10.5	14.5	14.6	16.9
% Growth	31.6	1.0	22.8	1.5	-22.5	-41.3	38.5	0.6	15.5
BPO	-	-	-	-	11.1	10.5	6.8	10.4	11.1
% Growth	-	-	-	-	-	-5.4	-35.4	53.5	6.7

* 2% decline, normalizing for Rs80m one-time revenue in the form of software license revenue

Broad-based growth expands revenue

Mastek reported 1.4% sequential decline in revenues to Rs1.5b in 1QFY06. Normalizing for the Rs80m one-time software revenue license revenue in 4QFY05, the company reported sequential growth of 4%. The quarter saw broad-based growth across all geographies, except Europe, which declined 10% QoQ. Normalizing for the one-time software license revenue, the decline reported was lower at 2% QoQ.

Among the key business verticals, BFSI declined 10% QoQ (grew 3.5% QoQ upon normalizing for one-time revenues in 4QFY05), while government grew 3% QoQ.

Lower other expense, productivity gains expand margins

EBITDA margin expanded by 210bp due to lower travel expenses, fewer sub-contractors hired during the quarter, and increase in productivity of certain fixed-price projects. While productivity gains are not likely to be sustained through the rest of the year, the travel expenses and sub-contractor (professional) charges are expected to stay range-bound. With revenue growth expected to pick up during the rest of the year as indicated by a strong order pipeline, we believe that there is scope for further improvement in margins.

Employee addition picks up during the quarter

The company maintains that the order pipeline for the rest of the year is strong, which is reflected in the employee addition in the quarter. After two successive quarters of negative net addition in technical staff, 1QFY06 saw a net addition of 237 employees. The company expects similar ramp-ups in the next three quarters, amounting to a net addition of around 600-700 employees. We believe that this is an indication of robust volume growth during the rest of the year.

Low client addition cause for concern

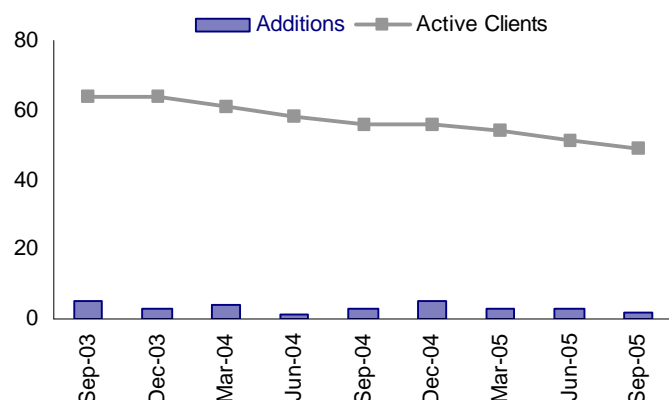
While companies across the board have been reporting phenomenal client growth in the past few quarters, the client additions for Mastek in the past few quarters have been low. Quarter after quarter, the company has also been losing clients, citing rationalization of the client base as reason for the decline. This would result in increased concentration of top clients, thereby rendering the company vulnerable to the vagaries in ramp-up from these clients, which could lead to greater volatility in revenue growth, as the clients graduate to Platinum client status (>US\$10m revenue).

REVENUE BY VERTICAL	SEP-03	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Financial Services	304.3	336.1	393.8	461.3	480.5	513.7	528.0	613.0	551.9
% Change	11.8	10.4	17.2	17.2	4.2	6.9	2.8	16.1	-10.0*
Government	192.0	198.0	272.4	331.3	330.4	450.6	553.3	525.1	542.8
% Change	-23.6	3.1	37.6	21.6	-0.3	36.4	22.8	-5.1	3.4

* 3.5% growth, normalizing for Rs80m one-time revenue in the form of software license revenue

EMPLOYEE ADDITION	SEP-03	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Software Professionals	1,590	1,751	1,909	2,019	2,103	2,262	2,304	2,227	2,441
QoQ change	121	39	5	(25)	(14)	67	(128)	(105)	237

CLIENTS ADDITIONS (NOS)



Source: Company/Motilal Oswal Securities

Entegram acquisition to supplement insurance business

Mastek acquired Entegram LLC, a US based company with presence in the insurance domain and net asset value of US\$250,000, in a US\$2m deal. The company has paid US\$750,000 in cash, while the remaining US\$1.25m would be paid over the next 24 months. The acquisition would add ERP capabilities to Mastek's service offerings, with specialization in SAP technology. The Hartford based firm

is expected to help Mastek gain a stronger foothold in the US insurance market through its existing client relationships, many of which are seeking offshore capabilities in their engagements. We believe that the successful integration of this acquisition, a first for Mastek, would be crucial for the company's growth in the insurance domain in the US.

Net profit growth muted at 2%

While EBITDA margin improved by 210bp during the quarter, the increase in net profit was muted at 2% due to increase in depreciation expense by Rs80m, and greater minority interest outgo at Rs36m. Minority interest outgo would continue to increase as the revenue growth in the Deloitte JV picks up speed. The company reported an EPS of Rs10.9 for the quarter ended September 2005.

2QFY06 guidance indicates 4-7% revenue growth

The company believes that there would be significant increase in revenues in the quarters ahead due to a strong project pipeline. For 2QFY06, Mastek has guided for revenues of Rs1,590-1,640m and net profit of Rs153-163m, translating to a growth of 4-7% QoQ. The stock is currently trading at 10.5x FY06E EPS. We do not have a rating on the stock.

TOP CLIENT GROWTH	SEP-03	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
% of Revenue - Top 5 Clients	46	42	48	51	59	61	65	64	66
Revenue from Top 5 clients	365.4	355.0	435.2	523.8	605.0	700.2	802.0	817.6	813.1
% Growth	-8.7	-2.9	22.6	20.4	15.5	15.7	14.5	1.9	-0.6
% of Revenue - Top 10 Clients	66	62	66	69	75	78	82	83	84
Revenue from Top 5-10 clients	160.7	169.0	166.9	184.9	164.1	195.1	207.5	244.1	221.7
% Growth	1.0	5.2	-1.3	10.8	-11.2	18.9	6.3	17.6	-9.1

Source: Company/Motilal Oswal Securities

For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 56575200 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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