July 22, 2010

Mastek (MASTEK)

Rs 270

Rating matrix

Rating	:	**Sell**
Target	:	Rs 231
Target Period	:	12 months
Potential Upside	:	-14 %

Key Financials

	FY09	FY10	FY11E	FY12E
Net Sales	942.6	713.8	684.7	750.7
EBITDA	159.2	87.2	63.9	85.5
EBITDA margin(%)	16.9	12.2	9.3	11.4
Net Profit	141.2	67.7	38.9	54.5
EPS	52.5	25.2	14.5	20.3

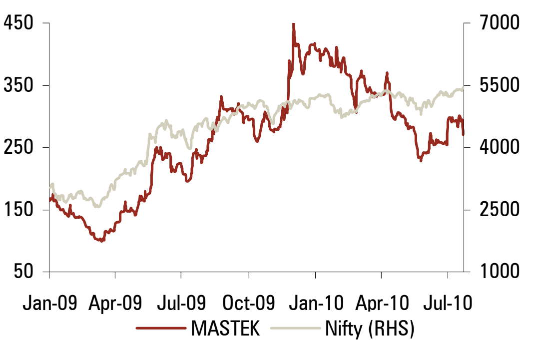
Valuation summary

	FY09	FY10	FY11E	FY12E
PE (x)	5.1	10.7	18.7	13.3
Target PE (x)	4.4	9.2	16.0	11.4
EV to EBITDA (x)	3.6	6.5	8.9	6.7
Price to book (x)	1.4	1.3	1.3	1.2
RoNW (%)	31.3	12.8	6.9	9.1
RoCE (%)	24.4	10.4	6.9	9.9

Stock data

Market Capitalisation	Rs 727 crore
Debt (Q4FY10)	Rs 42 crore
Cash (Q4FY10)	Rs 198 crore
EV	Rs 570.5 crore
52 week H/L	462/222
Equity capital	Rs 2.69 Crore
Face value	Rs. 5
FII Holding (%)	31.66
DII Holding (%)	12.13

Price movement



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WHAT'S CHANGED...

PRICE TARGET .... Changed from Rs 303 to Rs 231
EPS (FY11E) .... Changed from Rs 31.5 to Rs 14.5
EPS (FY12E) .... Changed from Rs 33.7 to Rs 20.3
RATING.. Changed from Reduce to Sell

Deep in the woods...

Mastek reported dismal numbers yet again for Q4FY10. The company's net profit plummeted 93% YoY and 83% QoQ. Mastek is confronted with such poor visibility that the management have abandoned their guidance policy. The senior management underwent restructuring resulting in outgo in the form of severance pay. This, in addition to MTM on forex hedge and wage hikes given to contain the spirally moving attrition, resulted in EBITDA margins nose dive to 4.7%. The company has become loss making at the net profit level on a standalone basis due to the UK government business becoming virtually still with a new government on board. The company managed to get one order from an US insurer and plans to invest in US Elixir version to customise it to US regulatory norms, thus leaving no levers to recoup margins.

- **Dismal performance with bleak outlook**

  The company met its revenue guidance but failed to meet the PAT guidance substantially (revenue guidance of Rs 160-165 crore and PAT guidance of Rs 11 crore). It reported revenues of Rs 163.2 crore (I-direct estimate: Rs 159 crore), down 4.2% QoQ. The EBITDA margin dropped off considerably by 1180 bps to 4.7% on account of lower revenue growth, forex loss to the tune of Rs 4.9 crore coupled with increase in staff costs of Rs 6.7 crore due to interim wage hikes for selected employees and hiring in addition to certain one-time expenditures. The PAT crashed downwards and came in at Rs 2.51 crore (I-direct estimate: Rs 10.2 crore), down 83% QoQ due to exchange losses and higher staff costs. This contains a deferred tax asset of Rs 0.5 crore.

Valuation

The company has been consistently underperforming its guidance for the last five quarters. The order book executable over the next 12 months is at Rs 306 crore, a majority of which is for the insurance vertical. The management's execution skills have failed the investor's confidence in the company's anchor solution Elixir. On the back of continuously deteriorating business fundamentals for the company largely due to internal instability and no outlook we rate Mastek as **SELL**.

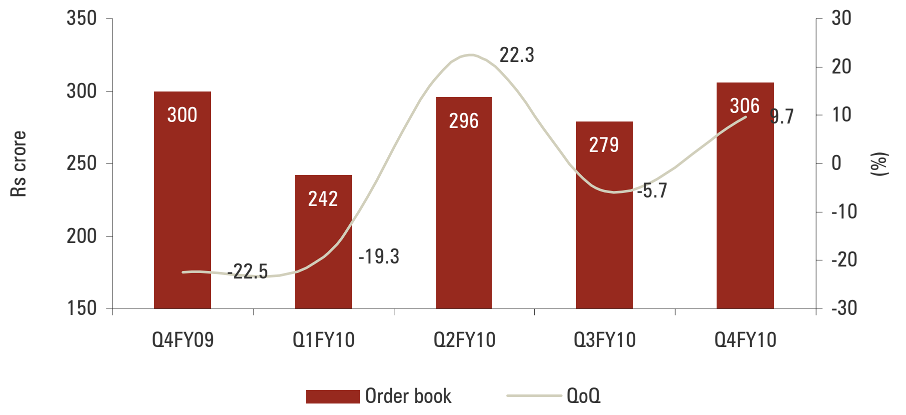
Exhibit 1: Financial Performance

(Rs Crore)	Q4FY10	Q4FY10E	Q3FY10	Q4FY09	QoQ(Ch %)	YoY(Ch%)
Net Sales	163.2	159.0	170.3	202.6	(4.2)	(19.5)
EBITDA Margin (%)	4.7	11.0	15.9	15.3	1118 bps dip	1057 bps dip
Depreciation	6.6	6.5	6.5	7.3	1.9	(9.7)
Interest	0.4	0.6	1.0	1.2	(59.6)	(65.2)
Other Income	1.9	1.6	1.8	11.5	2.7	(83.5)
Reported PAT	2.5	10.2	15.3	35.3	(83.6)	(92.9)
EPS (Rs)	0.9	3.8	5.7	13.1	(83.6)	(92.9)

Source: Company, ICICIdirect.com Research

The order book growth has seen a slight improvement at Rs 306 crore, up 9.7% from Q3FY10 of Rs 279 crore, with a majority of it for the insurance vertical

Exhibit 2: Trend in order book



Source: Company, ICICIdirect.com Research

The company's active client base has moved up by one due to the addition of the US insurer

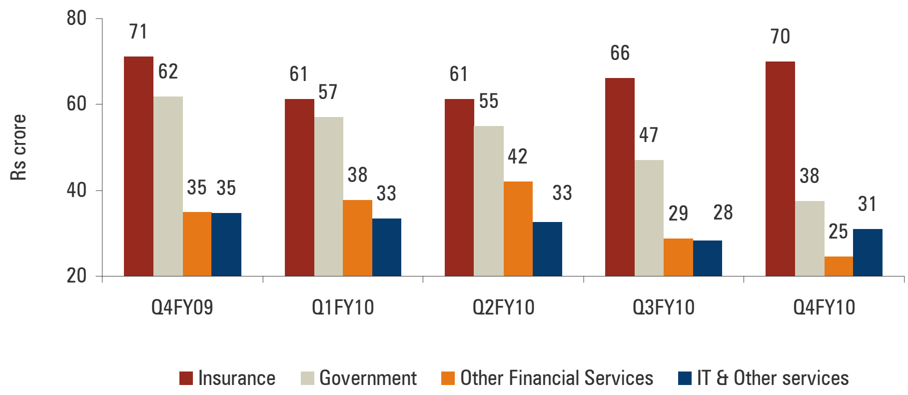
Exhibit 3: Client metrics

	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10
Active Clients	87	88	90	85	86
Additions	2	3	5	1	1
No. of Fortune 1000 Clients	21	18	18	18	19
No. of Clients with Annual Billing > USD 1 mn	32	27	26	28	28

Source: Company, ICICIdirect.com Research

The revenue from the government vertical has been heavily impacted after the BT channel stopped outsourcing incremental work to the company. This quarter it de-grew by 20% QoQ on a reported basis and other financial services by 14% QoQ .The other two i.e. the anchor vertical insurance grew by 6% QoQ while IT & other services grew by 9% QoQ. Thus, the revenue mix showed a drastic shift towards insurance

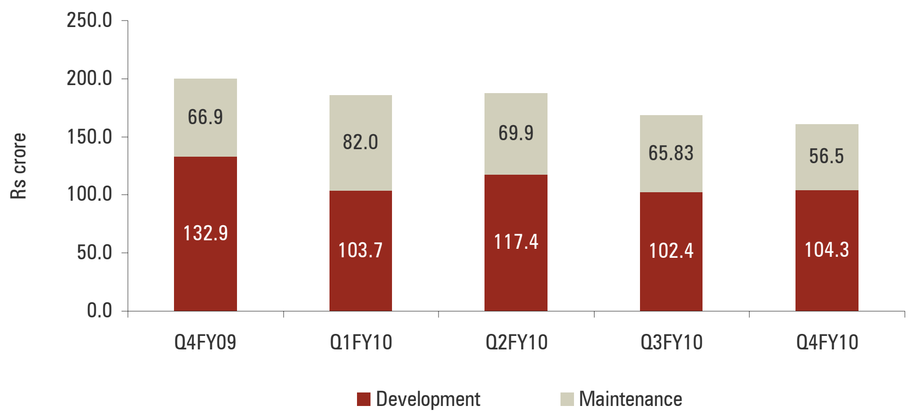
Exhibit 4: Revenue by industry



Source: Company, ICICIdirect.com Research

Developmental work remained almost flat whereas the maintenance stream de-grew with stagnation in the BT account

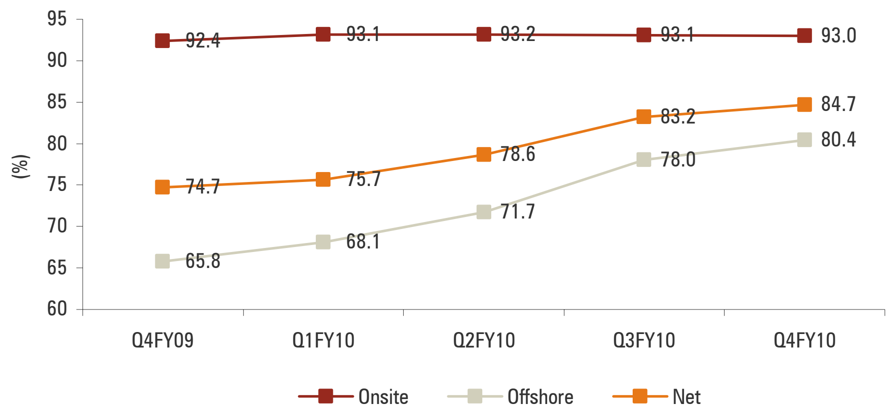
Exhibit 5: Revenue by nature of work



Source: Company, ICICIdirect.com Research

The company managed to hold its utilisation, both onsite and offshore, by recruiting higher number of people to offset skyrocketing attrition. This was purely bench management rather than mapping for any incremental work

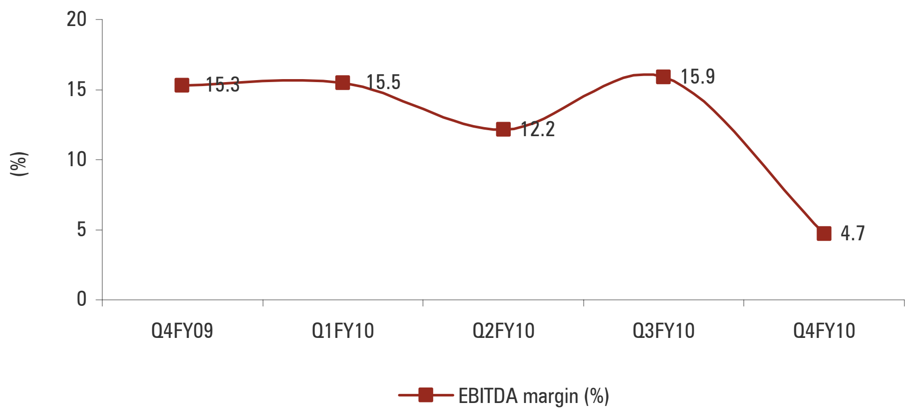
Exhibit 6: Utilisation trend (including virtual bench)



Source: Company, ICICIdirect.com Research

The EBITDA margin nose dived to 4.7% from 15.9% last quarter on the back of Rs 4.9 crore MTM forex loss coupled with increase in staff costs of Rs 6.7 crore due to interim wage hikes for selected employees, hiring to maintain bench as well as severance pay given to senior managers post the restructuring exercise

Exhibit 7: Trend in EBITDA margin(including forex loss)



Source: Company, ICICIdirect.com Research

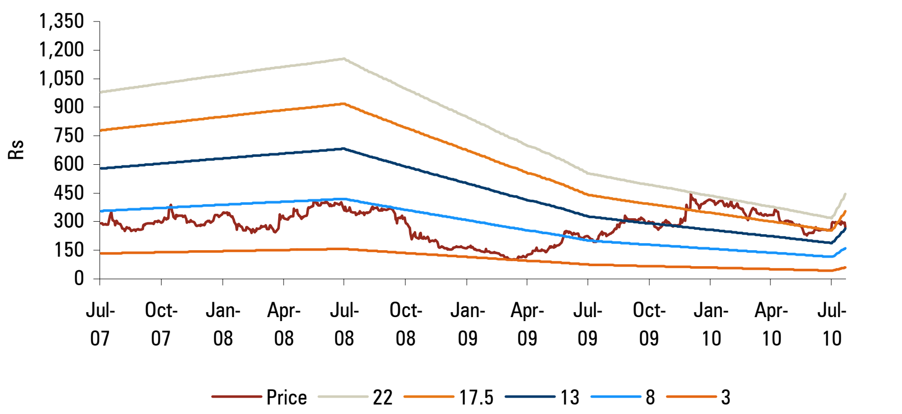
Valuation

The company has put up a dismal performance over the past seven quarters and is still deep in the woods. The management has given up the guidance policy on account of lack of clarity about execution even for the immediate quarter. Overall, at the time when IT companies are riding the recovery wave in the US to get new business this company is still engaged in dealing with internal management execution challenges.

On the revenue front, the company is already back to the FY06 run rate. With no outlook we believe it will de-grow in FY11 also. We expect it to de-grow by 4% in FY11 and bounce back to growth of 9.5% in FY12. Again, in Q1FY11 the margin will remain weak because of the impact of wage hikes given of 20% offshore and 3.5% onsite. Also, the company's continued investment in Elixir's various versions now in the US version will provide no levers in SGA to curb cost. Thus, we expect the EBITDA margin to crash from 12.1% in FY10 to 9.3% in FY11. We expect the margin to inch up only in FY12 to 11.4%. This is on the back of some demand improvement in the government vertical and little execution in Elixir helping to scale up insurance vertical.

Thus, we are downgrading the EPS for FY11 and FY12 by 54% and 40% to Rs 14.5 and Rs 20.3, respectively. Hence, we are de-rating the stock from REDUCE to outright **SELL**. Our target price is 1x BVPS for FY12E i.e. Rs 231 with 14% downside from current levels.

Exhibit 8: One year forward P/E chart



Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

Infosys					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	INFTEC	CMP(Rs)	2755.0	FY09	21693.5	104.6	26.3	19.6	32.8	37.9
		Target(Rs)	3144.0	FY10	22742.1	109.5	25.2	18.0	26.9	34.2
Mcap(crore)	157310.5	Upside(%)	14.1	FY11E	26502.5	116.6	23.6	16.2	21.0	29.5
				FY12E	31968.5	143.0	19.3	13.6	22.4	31.3

TCS					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	TCS	CMP(Rs)	842.5	FY09	27813.3	26.4	31.9	21.7	33.2	39.6
		Target(Rs)	960.0	FY10	30027.9	35.1	24.0	17.9	37.4	42.2
Mcap(crore)	164894.1	% Upside	13.9	FY11E	34915.2	40.4	20.8	15.3	33.2	38.2
				FY12E	41641.7	46.0	18.3	13.2	30.0	35.3

HCL Technologies					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	HCLTEC	CMP(Rs)	370.3	FY09	10630.5	19.0	19.5	10.9	22.5	14.9
		Target(Rs)	439.0	FY10E	12338.6	18.8	19.7	10.0	20.1	15.5
Mcap(crore)	25128.9	Upside(%)	18.6	FY11E	14024.3	25.1	14.7	9.4	22.7	14.4
				FY12E	16594.5	30.7	12.1	7.6	23.0	16.5

Tech Mahindra					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	TECHM	CMP(Rs)	749.0	FY09	4464.8	77.4	9.7	8.6	52.2	65.6
		Target(Rs)	822	FY10	4625.4	53.6	14.0	9.2	25.3	27.3
Mcap(crore)	9287.6	Upside(%)	9.7	FY11E	4848.7	65.4	11.5	9.7	26.3	24.5
				FY12E	5401.8	62.3	12.0	8.6	20.4	24.4

Wipro					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	WIPRO	CMP(Rs)	414.7	FY09	25699.5	26.7	15.5	18.9	28.6	23.3
		Target(Rs)	486.0	FY10	27141.3	31.4	13.2	16.5	26.5	22.4
Mcap(crore)	101572.5	Upside(%)	17.2	FY11E	31186.7	24.2	17.1	14.3	24.3	21.4
				FY12E	36649.4	24.9	16.6	12.4	22.6	21.3

Patni Computers					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	PATCOM	CMP(Rs)	521.0	CY09	3146.1	45.0	11.6	7.5	16.5	13.4
		Target(Rs)	594.0	CY10E	3347.3	44.1	11.8	6.7	14.6	13.5
Mcap(crore)	6720.9	Upside(%)	14.0	CY11E	3846.8	46.5	11.2	5.9	13.5	13.5
				CY12E	4278.0	49.1	10.6	5.4	12.6	13.2

Rolta					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	ROLIND	CMP(Rs)	176.2	FY09	1372.8	18.2	9.7	8.4	22.7	15.7
		Target(Rs)	225.0	FY10E	1551.3	16.5	10.7	6.6	17.7	13.3
Mcap(crore)	2839.5	Upside(%)	27.7	FY11E	1786.5	18.4	9.6	5.6	17.9	14.6
				FY12E	2087.3	22.5	7.8	4.8	18.4	16.4

NIIT					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	NIIT	CMP(Rs)	69.0	FY09	1168.5	4.2	16.3	12.0	15.8	16.5
		Target(Rs)	77	FY10	1199.3	4.3	16.2	9.1	14.2	18.0
Mcap(crore)	1139.2	Upside(%)	11.0	FY11E	1262.8	5.2	13.4	8.2	15.8	18.4
				FY12E	1419.0	6.6	10.5	6.7	18.1	20.6

Source: Company, ICICIdirect.com Research

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Add: Up to 10%;
Reduce: Up to -10%
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