Result Update

ICICIdirect.com
On-line Share Trading

October 12, 2009

Mastek Ltd (MASTEK)

Rs 266

Rating matrix

Rating	:	**Hold**
Target	:	Rs 260
Target Period	:	12 months
Potential Upside	:	-2 %

Key Financials

(Rs Crore)	FY08	FY09	FY10E	FY11E
Net Sales	893.9	942.6	803.3	902.5
EBITDA	160.0	159.2	139.7	162.8
Net Profit	125.9	141.1	121.9	138.2

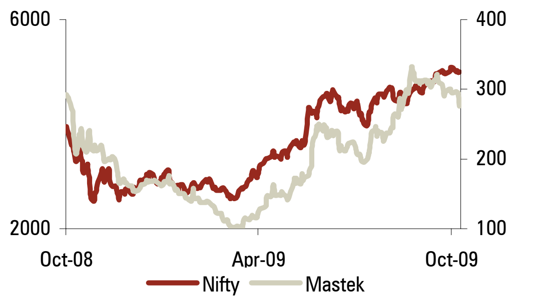
Valuation summary

	FY08	FY09	FY10E	FY11E
PE (x)	6.0	5.1	5.9	5.2
Target PE (x)	5.9	5.0	5.7	5.1
EV to EBITDA(x)	3.4	3.4	3.9	3.4
Price to book (x)	1.8	1.4	1.2	1.0
RoNW (%)	33.7	31.3	22.2	21.5
RoCE (%)	30.5	24.4	18.7	20.4

Stock data

Market Capitalisation	Rs 716.3crore
Debt (Q1FY10)	Rs 58.4 crore
Cash (Q1FY10)	Rs 228.3 crore
EV	Rs 546.5 crore
52 week H/L (Rs)	343/97
Equity capital	Rs 13.5 crore
Face value	Rs. 5
MF Holding (%)	0.4
FII Holding (%)	28.5

Price movement (stock vs Nifty)



Analyst's name

Yash Gadodia
yash.gadodia@icicisecurities.com

Srishti Anand
srishti.anand@icicisecurities.com

WHAT'S CHANGED...

PRICE TARGET .... Changed from Rs 301 to Rs 260

EPS (FY10E) .... Changed from Rs 46.4 to Rs 45.3

EPS (FY11E) .... Changed from Rs 55.6 to Rs 51.4

RATING.. Unchanged

Elixir failing to give life in medium term...

Mastek reported dismal numbers for Q1FY10. The company missed its guidance yet again and failed to scale up its order book. The BT channel that was once a boon for Mastek has turned into a bane. This has handicapped the company's revenue from the government business. The company has failed to plug in this revenue slippage via any new account. The company's flagship product Elixir i.e. end-to-end enterprise solution for the life & pension insurance industry has not yet started yielding results.

- **Dismal quarterly performance**

  The company failed to meet its revenue as well as PAT guidance (revenue guidance Rs195 to Rs 205 crore and PAT guidance of Rs 30 to Rs 32 crore) and reported revenues of Rs 189.4 crore (ICICIdirect.com estimate: Rs 202.3crore). The EBITDA margin expanded by 18 bps (QoQ ICICIdirect.com estimate: +87 bps) on the back of high pricing pressure and volume de-growth. The company managed to report PAT of Rs 26 crore because of the tax write back of Rs 7.1crore. Otherwise the PAT would have been much lower at Rs 19.3 crore. The company's current order book position is at Rs 242 crore, down 19% (QoQ). It has been on the decline for the past four quarters. It was almost 50% of Rs 505 crore that was the order book status at the end of Q1FY09.

Valuation

The company has been missing its guidance since Q109, holds a poor order book, still lacks clarity on a couple of signoffs as to when they will happen and has failed to replace BT account's revenue slippage with any other new work. Therefore, we expect the revenue to de-grow significantly by14.8% and growth to return back only in FY11. Due to lumpy business, we value the company at its FY11E book value of Rs 260.

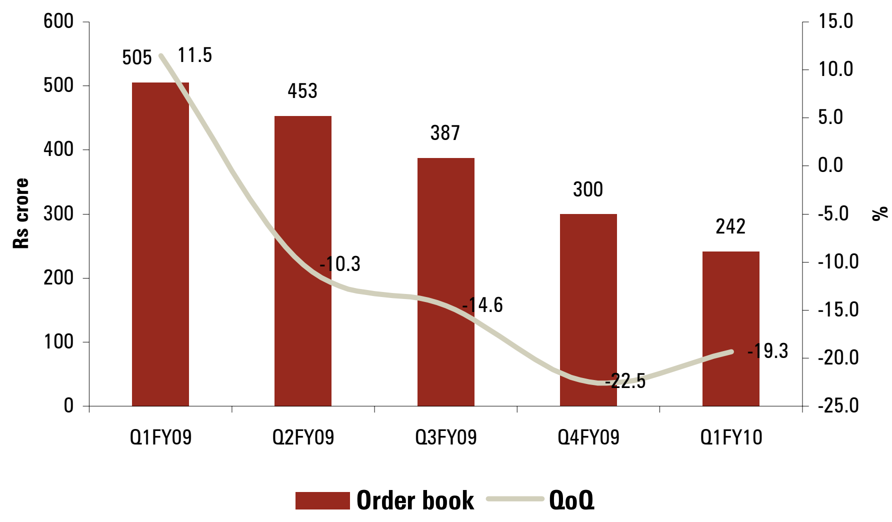
Exhibit 1: Performance Highlights

(Rs Crore)	Q1FY10	Q1FY10E	Q1FY09	Q4FY09	QoQ(Ch %)	YoY(Ch%)
Net Sales	189.4	202.3	257.8	202.6	(6.5)	(26.5)
EBITDA Margin (%)	15.5	16.1	18.2	15.3	0.2	(2.7)
Depreciation	7.1	6.7	7.8	7.3	(3.3)	(9.6)
Interest	1.0	0.8	1.2	1.2	(13.9)	(19.5)
Other Income	2.0	3.0	3.9	11.5	(82.4)	(47.7)
Reported PAT	26.4	26.0	41.2	35.3	(25.1)	(35.9)
EPS (Rs)	9.8	9.7	15.3	13.1	(25.1)	(35.9)

Source: Company, ICICIdirect.com Research

The order book has been deteriorating in the past four quarters. This is because the BT channel has stopped yielding incremental work. Also, as a majority of the company's services is discretionary based, experienced excessive demand erosion with the onset of the financial crisis. The company's current order book position is less than 50% of the order book at the end of Q1FY09. Thus, very poor order visibility and poor account mining outlines heavy revenue de-growth of 15% (YoY)

Exhibit 2: Eroding order book status



Source: Company, ICICIdirect.com Research

The company's client base has deteriorated excessively YoY. The company has lost 7 clients from the Fortune 1000 company bracket. Also, poor account management has resulted in 12 clients stepping down from annual billing > US$1 million segment

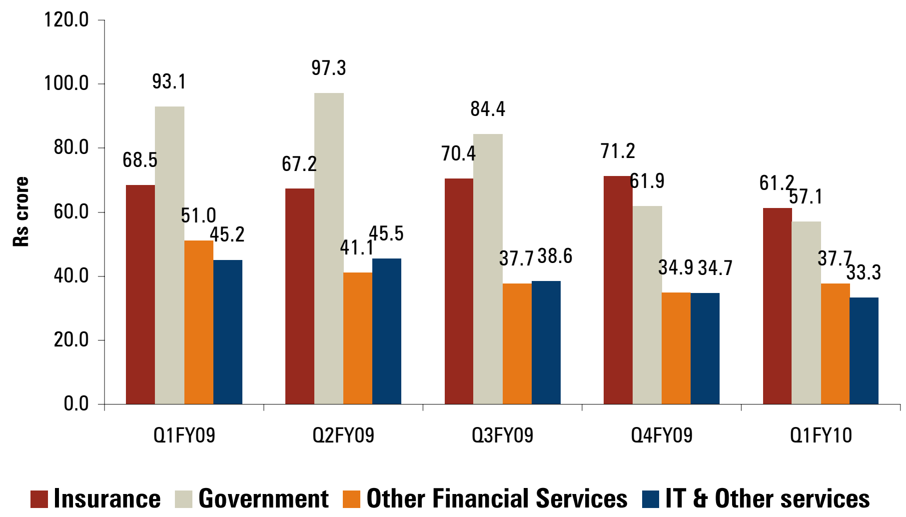
Exhibit 3: Deteriorating client metrics

	Q109	Q209	Q309	Q409	Q110
Active Clients	93	89	88	87	88
Additions	3	4	2	2	3
No. of Fortune 1000 Clients	25	21	21	21	18
No. of Clients with potential of Annual Billing > USD 1 mn	39	37	33	32	27

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. The BT/NHS deal gave an annual revenue run rate of £26 million. Out of this, almost £18 million came in from developmental work. Now this channel will only yield maintenance revenue. In addition the company has not added any other channel that can plug in this revenue slippage. Thus, future growth of this vertical is a concern in the near term. On the insurance front, the company is using the Capita channel to tap clients for its Elixir solution but all its new SOA-based modules of Elixir have not started yielding.

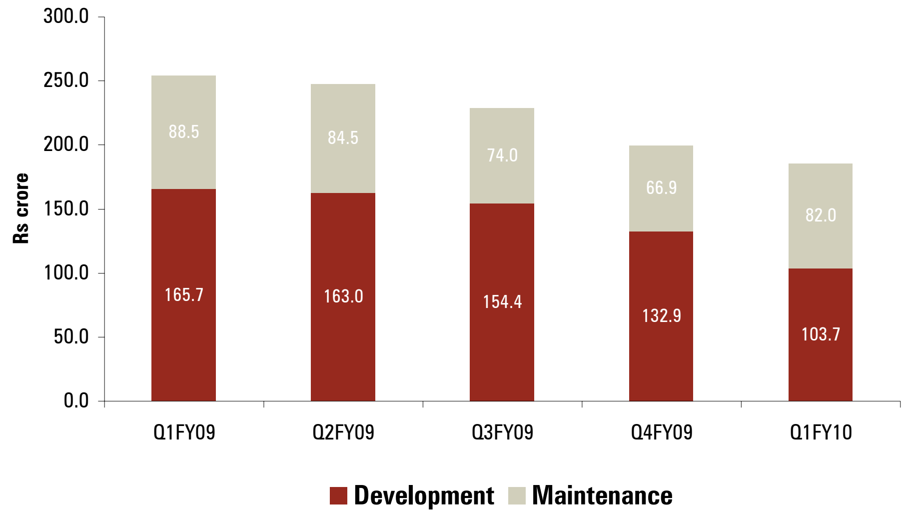
Exhibit 4: Revenue by industry



Source: Company, ICICIdirect.com Research

The company has got handicapped by no new work from BT, which has dragged down its revenue share from developmental work

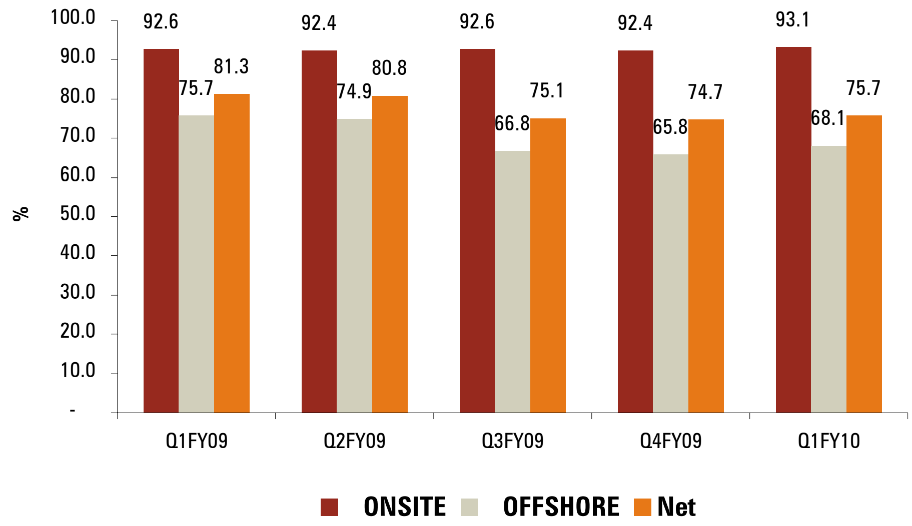
Exhibit 5: Revenue by nature of work



Source: Company, ICICIdirect.com Research

The company managed to pull up its offshore utilisation (including virtual bench) on the back of high voluntary attrition seen in virtual bench. The virtual bench now stands at 230 people (vs. 351 in Q409). Thus, the effect of net addition of -165 people (QoQ) helped to improve utilisation

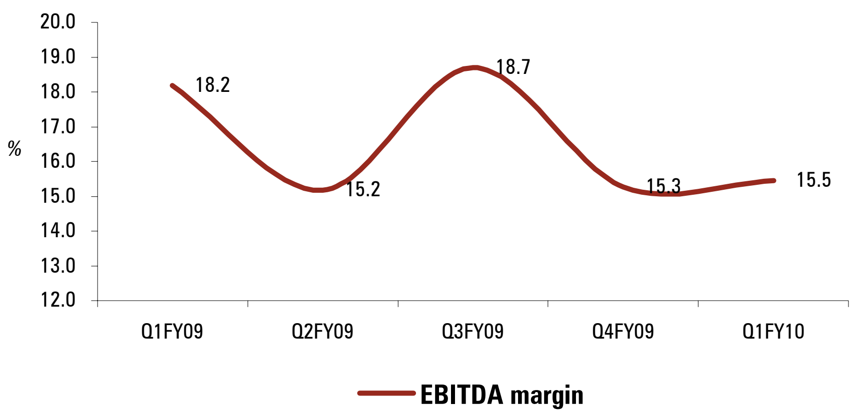
Exhibit 6: Utilisation trend (Including virtual bench)



Source: Company, ICICIdirect.com Research

EBITDA margins continued to be muted at 15.5% on the back of heavy pricing pressure and volume de-growth. The company has made significant investment in the past in development and launch of Elixir platform. This has kept the SGA cost as % to sales high. We expect the margin to rebound to 18% level by Q3FY10 once the investments start yielding

Exhibit 7: Trend in EBITDA margin



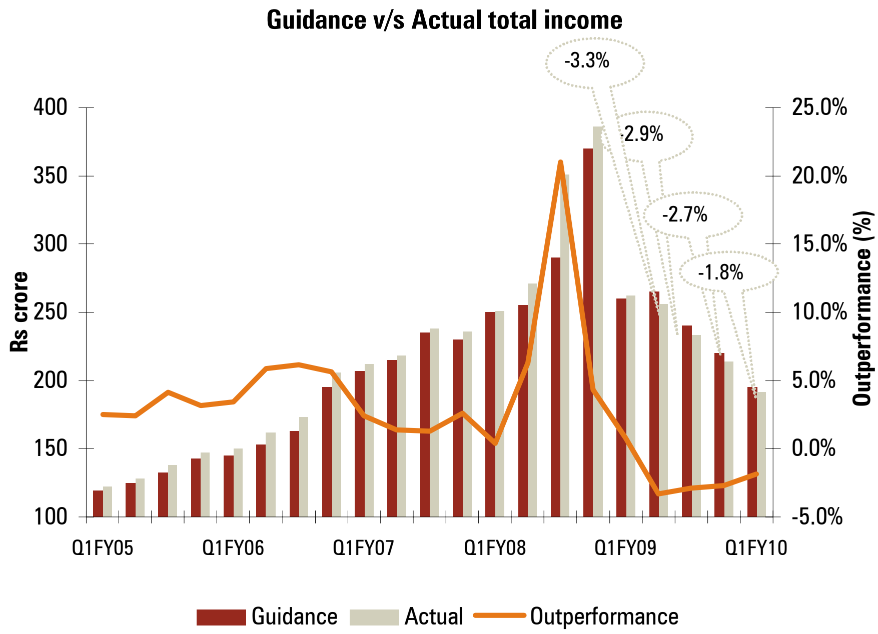
Source: Company, ICICIdirect.com Research

Valuations

The company has guided a total income of Rs 195 crore to Rs 205 crore for Q2FY10 and a PAT of Rs 27 crore to Rs 29 crore. The company has been missing even the lower end of its total income guidance in the past four quarters. This is because of a lack in clarity about new incremental work, which is also getting reflected in its de-growing order book.

The company has always outperformed its total income lower end guidance in the past but with onset of financial turmoil in September 2008 it failed to continue the trend

Exhibit 8: Actual performance vs. guidance for total income



Source: Company, ICICIdirect.com Research

On the back of mounting concerns regarding the future of the company's government business, lack of clarity on when IT spending in insurance sector will pace up as well as a very poor order book, we are downgrading the revenue estimate for FY10 and FY11 by 7% and 8%, respectively. Thus, we are revising down the EPS estimate for FY10 and FY11 from Rs 46.4 and Rs 55.6 to Rs 45.3 and Rs 51.4, respectively.

Exhibit 9: Valuation metrics for Mastek

	Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBIDTA (x)	RoNW(%)	RoCE(%)
FY09	942.6	52.5	5.1	3.4	31.3	24.4
FY10E	803.3	45.3	5.9	3.9	22.2	18.7
FY11E	902.5	51.4	5.2	3.4	21.5	20.4

Source: Company, ICICIdirect.com Research

We believe all these concerns have been priced in. That is why the stock has sharply corrected post the Q1FY10 results. The company looks very cheap as compared to other midcap peers on a P/E as well as EV/EBITDA basis. However, on account of the lumpy nature of the order book, lack of clarity in its government as well as insurance business that constitute more than 65% and no positive triggers, we value the company on FY11E book value per share of Rs 260. We may revisit our rating on this stock if the company manages to increase its order book substantially or start winning deals for its Elixir solution or replace BT/NHS account with some other discrete account.

ICICI direct.com coverage universe

Infosys					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	INFTEC	**CMP(Rs)**	2239.8	**FY09**	21693.5	104.4	21.5	15.3	32.8	37.9
		Target(Rs)	2453	**FY10E**	22315.9	106.0	21.1	16.0	27.6	34.7
Mcap(crore)	128114	**% Upside**	9.5	**FY11E**	24639.5	116.8	19.2	15.5	25.6	32.6
TCS					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	TCS	**CMP(Rs)**	580.6	**FY09**	27813.0	26.4	22.0	15.8	33.2	39.6
		Target(Rs)	634	**FY10E**	29377.0	31.1	18.7	14.3	30.6	34.6
Mcap(crore)	113635	**% Upside**	9.2	**FY11E**	31940.0	35.2	16.5	13.3	27.9	30.1
HCL Tech					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	HCLTEC	**CMP(Rs)**	302.1	**FY09**	10630	19.0	15.9	9.1	22.5	15.7
		Target(Rs)	344	**FY10E**	12230	16.7	18.1	7.7	17.1	18.0
Mcap(crore)	20275.1	**% Upside**	13.9	**FY11E**	13391	25.3	11.9	7.2	22.1	16.9
Tech Mahindra					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	TECHM	**CMP(Rs)**	924.7	**FY09**	4464.8	77.4	11.9	11.0	52.2	65.6
		Target(Rs)	897	**FY10E**	4719.2	58.9	15.7	10.7	31.1	26.4
Mcap(crore)	11280.7	**% Upside**	(3.0)	**FY11E**	5193.0	69.0	13.4	9.8	26.9	26.9
Wipro					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	WIPRO	**CMP(Rs)**	573.8	**FY09**	25456.5	25.6	22.4	16.8	28.1	21.0
		Target(Rs)	554.0	**FY10E**	26977.8	28.3	20.3	15.4	24.5	20.5
Mcap(crore)	84061.7	**% Upside**	(3.5)	**FY11E**	29001.1	31.5	18.2	14.7	23.0	20.0
3i Infotech					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	3IINFO	**CMP(Rs)**	95.8	**FY09**	2285.6	17.4	5.5	7.9	29.4	10.8
		Target(Rs)	108	**FY10E**	2522.0	13.3	7.2	7.2	17.4	10.9
Mcap(crore)	1331.6	**% Upside**	12.7	**FY11E**	2726.5	13.5	7.1	6.9	15.7	10.9
Rolta					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	ROLIND	**CMP(Rs)**	191.5	**FY09**	1372.8	17.7	10.8	8.4	22.7	15.7
		Target(Rs)	200	**FY10E**	1540.9	18.3	10.5	7.4	19.2	14.0
Mcap(crore)	3082.3	**% Upside**	4.5	**FY11E**	1763.9	18.9	10.1	6.7	18.0	13.8
KLG Systel					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	KLGSYS	**CMP(Rs)**	295.5	**FY09**	234.8	23.0	12.8	6.3	27.1	16.0
		Target(Rs)	227	**FY10E**	255.7	18.8	15.7	5.8	28.7	12.0
Mcap(crore)	347.5	**% Upside**	(23.2)	**FY11E**	283.0	22.7	13.0	5.2	29.5	13.1
ICSA					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	INNCOM	**CMP(Rs)**	204.5	**FY09**	1100.4	32.6	6.3	5.3	29.4	25.7
		Target(Rs)	241	**FY10E**	1462.0	34.0	6.0	4.7	25.7	23.6
Mcap(crore)	963.0	**% Upside**	17.9	**FY11E**	2095.9	56.5	3.6	2.9	30.4	32.1
NIIT					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	NIIT	**CMP(Rs)**	70.9	**FY09**	1148.6	4.2	16.9	12.4	15.8	16.5
		Target(Rs)	76.0	**FY10E**	1237.2	4.0	17.7	10.4	13.4	17.0
Mcap(crore)	1166.3	**% Upside**	7.2	**FY11E**	1385.3	5.7	12.4	8.5	18.0	20.0

Source: Company, ICICIdirect.com Research

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Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICIdirect.com Research Desk,
ICICI Securities Limited,
7th Floor, Akruti Centre Point,
MIDC Main Road, Marol Naka
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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