

Mastek

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,381	MAST IN
	REUTERS CODE
S&P CNX: 2,851	MAST.BO

12 January 2006

Not Rated

Previous Recommendation: Not Rated

Rs664

Equity Shares (m)	13.9
52-Week H/L (Rs)	730/325
1,6,12 Rel. Perf. (%)	24/52/47
M.Cap. (Rs b)	9.2
M.Cap. (US\$ b)	0.2

YEAR END	NET SALES (Rs M)	PAT (Rs M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
6/05A	5,670	534	38.5	84.1	17.2	4.4	22.3	29.7	0.6	4.0
6/06E	7,009	705	50.9	32.0	13.1	3.3	22.9	31.6	0.4	2.6
6/07E	8,702	870	62.7	23.3	10.6	2.5	22.1	28.6	0.3	1.7

Topline records strong growth: Mastek posted revenue of Rs1.7b for 2QFY06, a growth of 14% QoQ as against our expectation of 4%. The quarter saw broad-based growth across all geographies, with operations in Europe growing at 16% QoQ and that in the US growing at 12% QoQ. Among the core verticals, BFSI grew by 18% while government contracts grew by 13%.

Margins decline: EBITDA margins fell by 98bp to 16.6% from 17.6%. The lower margins were due to amortization of goodwill on integration of Entegram LLC (Rs4.5m, an impact of 26bp) as well as a brand-building exercise undertaken in the US and UK. Since amortization of goodwill has been completed in this quarter, it will not recur in the future quarters.

PAT growth slower than topline growth but in line with EBITDA increase: Net profit for 2QFY06 stood at Rs162m — a growth of 8% QoQ. EBITDA grew by 7.5% QoQ, despite a high minority interest outgo of Rs40m, a growth of 11.1% over 1QFY06.

Outlook and view: Management's confidence in the visibility of future revenue and profitability has improved, as reflected in robust employee addition and infrastructure expansion. Given the prospect of improved growth momentum, we have upgraded our FY06 and FY07 earnings estimates to Rs50.9 from Rs49.6 and to Rs62.7 from Rs60.4 respectively. The stock is trading at 13.1x FY06E and 10.6x FY07E. We do not have a rating on the stock.

Y/E JUNE	QUARTERLY PERFORMANCE										(Rs Million)	
	FY05				FY06				FY05	FY06E		
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
Net Income	1,528	1,386	1,475	1,528	1,506	1,714	1,825	1,964	5,670	7,009		
Change (%)	72.6	48.9	43.3	32.3	-1.5	23.6	23.8	28.5	41.7	23.6		
Total Expenses	1,073	1,159	1,263	1,292	1,241	1,429	1,541	1,662	4,786	5,873		
EBITDA	455	227	212	237	265	284	285	303	884	1,136		
Change (%)	283.6	206.4	44.0	25.2	27.3	25.1	34.4	27.9	90.3	28.6		
As % of Sales	29.8	16.4	14.4	15.5	17.6	16.6	15.6	15.4	15.6	16.2		
Other Income	25	15	26	31	25	38	35	35	96	133		
Interest	1	3	1	5	1	3	1	1	11	6		
Depreciation	64	70	61	49	69	73	77	80	244	299		
Extraordinary Expenses	-10	-15	-16	-12	-9	-11	-10	-10	-52	-40		
PBT	424	183	192	226	229	257	252	267	777	1,003		
As % of Sales	27.8	13.2	13.0	14.8	15.2	15.0	13.8	13.6	13.7	14.3		
Change (%)	414.5	345.7	65.3	36.3	31.2	45.9	37.2	20.1	117.5	32.8		
Tax	10	12	19	42	24	33	27	28	82	112		
Tax/PBT (%)	2.3	6.4	9.7	18.7	10.5	12.9	10.6	10.6	10.6	11.2		
PAT	415	171	173	183	205	223	225	238	695	891		
Adjusted PAT	122	128	138	147	150	162	190	203	534	705		
As % of Sales	8.0	9.2	9.3	9.6	10.0	9.4	10.4	10.4	9.4	10.1		
Change (%)	301.7	2,140.8	74.0	48.4	23.4	26.5	38.2	38.1	84.0	32.0		

E: MOST Estimates

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REVENUE BREAK-UP (RS M)

Y/E JUNE	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
North America	290.4	223.3	273.0	232.2	222.7	212.1	231.2	276.7	309.3
Growth (%)	-6	-23	22	-15	-4	-5	9	20	12
Europe	485.5	607.0	687.5	719.2	874.2	975.6	1,004.1	901.5	1,050.0
Growth (%)	15	25	13	5	22	12	3	-10	16
Asia Pacific	50.8	53.1	43.6	56.2	40.6	28.2	29.5	36.9	42.9
Growth (%)	9	5	-18	29	-28	-31	5	25	16
India	18.5	22.8	23.1	17.9	10.5	14.5	14.6	16.9	15.8
Growth (%)	1	23	1	-23	-41	38	1	16	-7
BPO	0.0	0.0	0.0	11.1	10.5	6.8	10.4	11.1	12.5
Growth (%)					-5	-35	54	7	13
Share of JV	86.0	122.8	127.7	244.1	227.9	237.6	238.4	262.9	283.2
Growth (%)	-4	43	4	91	-7	4	0	10	8

Source: Company/Motilal Oswal Securities

REVENUE BY VERTICAL (RS M)

	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Financial Services	336	394	461	481	514	528	613	552	649
Growth (%)	10.0	17.0	17.0	4.0	7.0	3.0	16.0	-10.0	18.0
Government	198	272	331	330	451	553	525	543	613
Growth (%)	3.0	38.0	22.0	0.0	36.0	23.0	-5.0	3.0	13.0

Broad-based revenue growth

Mastek posted revenue of Rs1.7b for 2QFY06, a QoQ growth of 14% as against our expectations of 4%. The quarter saw broad-based growth across all geographies with operations in Europe and the US registering an increase of 16% and 12% respectively. Among the core verticals, BFSI grew by 18% while government contracts grew by 13%.

Traction in insurance offering boosts revenue

Mastek's insurance offering, which is a focus area for the company, gained traction in this quarter, closing three significant deals.

Mastek also launched its insurance solution 'Elixir', in the UK. Elixir is a comprehensive sales and administration system that uses a component-based architecture and is specifically tailored for Life & Pensions and Savings & Investments.

During the quarter, Mastek commenced a relationship with one of the top Global 50 insurance majors, by securing a large project for developing an end-to-end policy

administration platform for group life products in the Asia Pacific.

In the US, Mastek was selected as a preferred vendor by a Fortune 250 Insurance P&C (Stock) carrier. We believe the revenues begin to accrue in subsequent quarters.

Additionally, Mastek has entered into an Elixir License deal with Capita in the UK. The deal is valued at £15m for a minimum period of ten years. In addition to the above, Mastek would also receive revenue on account of customizing its products to suit customers needs.

Decline in EBITDA margins

EBITDA margins fell by 98bp to 16.6% from 17.6% due to the amortization of goodwill on integration of Entegram LLC (Rs4.5m, which has an impact of 26bp) and a brand-building exercise undertaken in the US and UK. The amortization of goodwill has been completed in this quarter and is not expected to recur in the future. However, we expect the company to vigorously pursue branding and marketing activities in the UK and the US, which could impact margins.

Robust employee addition and infrastructure expansion signal a good pipeline

Employee addition continues to be robust, with an increase of 329 employees (343 software professionals) in the two quarters of FY06 as opposed to addition of 344 employees (only 208 software professionals) in the full year FY05.

EMPLOYEE ADDITIONS

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Total Emp.	2,536	2,729	2,794	2,754	2,951	3,083
Growth (%)	5	8	2	-1	7	4
Additions	FY05 = 344			1H = 329		
S/w Prof.	2,103	2,262	2,304	2,227	2,441	2,570
Growth (%)	4	8	2	-3	10	5
Additions	FY05 = 208			1H = 343		

Source: Company/Motilal Oswal Securities

Infrastructure expansion: During the quarter, the company commissioned its third development centre in Pune measuring 55,000 sq. ft., which can accommodate 520 professionals. It also acquired another property measuring 42,000 sq. ft. on a lease basis at Mahape in Navi Mumbai and commenced construction of a new 115,000 sq. ft. facility at Mahape. The latter construction is expected to be ready by December 2006.

We believe that the robust employee addition and infrastructure expansion are indicators of the management's confidence in the prospective revenue growth for Mastek ahead.

TOP CLIENT GROWTH

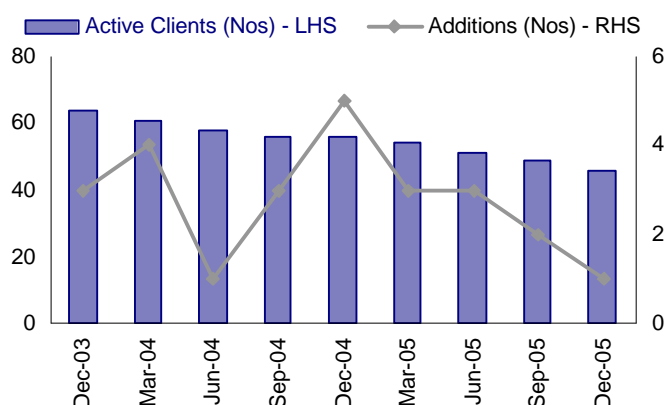
	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Revenue from Top 5 Clients	355	435	524	605	700	802	818	813	978
Growth (%)	-3.0	23.0	20.0	16.0	16.0	15.0	2.0	-1.0	20.0
Top 5 Clients Revenue (%)	42.0	48.0	51.0	59.0	61.0	65.0	64.0	66.0	69.0
Revenue from Top 5-10 Clients	169	167	185	164	195	208	244	222	227
Growth (%)	5.0	-1.0	11.0	-11.0	19.0	6.0	18.0	-9.0	2.0
Top 10 Clients Revenue (%)	62.0	66.0	69.0	75.0	78.0	82.0	83.0	84.0	85.0

Source: Company/Motilal Oswal Securities

Client base further rationalized

The number of active clients has reduced to 46 in 2QFY06 from 49 in 1QFY06. The company has consciously followed the strategy of rationalizing its client base with greater emphasis on strengthening existing relationships where there is possibility of operations ramping up.

CLIENT BASE



Source: Company/Motilal Oswal Securities

Deloitte JV could result in lower revenue in forthcoming quarters

The Mastek-Deloitte JV DCOTG, has reported robust results in the first half of the year, driven primarily by a few major projects, which resulted in increased utilization and head count. Some of these have been completed in the current quarter, which could result in reducing the revenue run-rate going forward. Due to swings in project-related work, there could be a drop in profitability in the next two quarters. However, aggressive cost-reduction measures that are being undertaken by management could minimize the impact on profitability.

PAT growth slower than topline growth but in line with EBITDA

Net profit for 2QFY06 stood at Rs162m, a growth of 8% QoQ in line with the EBITDA growth of 7.5% QoQ. Minority interest was Rs40m, a growth of 11.1% over 1QFY06. The high minority interest was on account of strong performance from the Deloitte JV.

Guidance for 3QFY06

The company believes there would be a significant increase in revenues in the quarters ahead due to a strong project pipeline. For 3QFY06, Mastek has given guidance for revenues of Rs1,770m-Rs1,820m and net profit of Rs163m-Rs173m, translating to a growth of 3% to 6% QoQ.

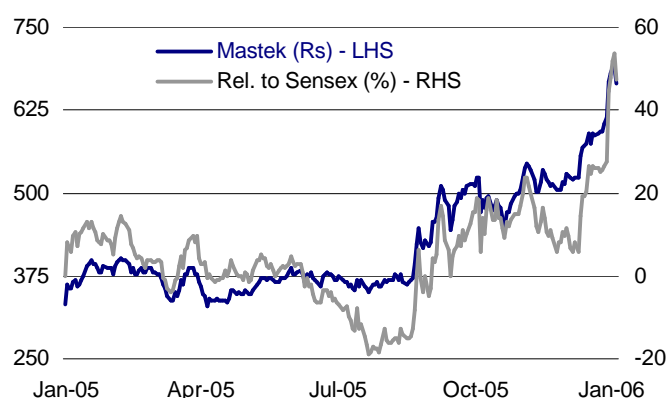
Outlook and view

The management's confidence in the visibility of future revenue and profitability has improved, as reflected in robust employee addition and infrastructure expansion. The impact of this initiative is already reflected in 2QFY06 topline

growth. Additionally, the company has a good order backlog of Rs3.1b as against Rs2.7b at the end of 1QFY06.

Given the prospect of improved growth momentum, we have upgraded our earnings estimates for FY06 to Rs50.9 from our earlier estimate of Rs49.6. FY07E earnings have been upgraded to Rs62.7 from Rs60.4. The stock is trading at 13.1x FY06E and 10.6x FY07E. We do not have a rating on the stock.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E JUNE	2003	2004	2005	2006E	2007E
Net Sales	3,721	4,425	5,670	7,009	8,702
Change (%)		18.9	28.1	23.6	24.2
EBITDA	646	616	884	1,136	1,343
Change (%)		-4.7	43.5	28.6	18.2
Depreciation	140	248	244	299	378
EBIT	506	368	640	837	965
Interest	9	12	11	6	4
Other Income	73	10	96	133	149
PBT & EO Items	571	466	726	963	1110
Profit before Prior Adj	571	466	726	963	1110
EO Item (Loss from Equity Affilia	0	-18	-52	-40	-40
PBT	571	448	674	923	1,070
Tax	68	21	82	112	122
Rate (%)	11.8	4.7	12.2	12.1	11.4
PAT	503	427	591	811	948
(-) Minority Interest	0	137	57	106	78
PAT after Minority Interest	503	290	534	705	870
Change (%)		-42.2	84.0	32.0	23.3
EBITDA Margin (%)	17.4	13.9	15.6	16.2	15.4
PAT Margin (%)	13.5	6.6	9.4	10.1	10.0

RATIOS					
Y/E JUNE	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS	35.4	20.9	38.5	50.9	62.7
Growth (%)		-40.9	84.1	32.0	23.3
Cash EPS	45.3	38.8	56.1	72.4	90.0
Book Value	108.8	126.6	152.0	201.8	263.1
DPS	3.0	3.0	7.5	7.5	7.5
Payout (incl. Div. Tax.) (%)	8.5	9.7	19.9	14.5	12.4
Valuation (x)					
P/E		31.7	17.2	13.1	10.6
Cash P/E		17.1	11.8	9.2	7.4
Price/Book Value		5.2	4.4	3.3	2.5
EV/Sales		0.8	0.6	0.4	0.3
EV/EBITDA		6.0	4.0	2.6	1.7
Dividend Yield (%)		0.5	1.1	1.1	1.1
Profitability Ratios (%)					
RoE	32.6	14.2	22.3	22.9	22.1
RoCE	33.5	15.2	29.7	31.6	28.6
Turnover Ratios					
Debtors (Days)	87	101	92	91	90
Asset Turnover (x)	2.4	2.2	2.5	2.4	2.3
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

BALANCE SHEET					
(Rs Million)					
Y/E JUNE	2003	2004	2005	2006E	2007E
Equity Share Capital	71	69	69	69	69
Reserves	1,474	1,687	2,039	2,730	3,580
Minority Interest	0	283	284	285	285
Net Worth	1,545	2,039	2,393	3,084	3,934
Loans	10	11	16	0	0
Net Deferred Tax Liability	-26	-63	-108	-140	-180
Capital Employed	1,529	1,987	2,301	2,944	3,754
Gross Fixed Assets	1,120	1,416	1,697	1,950	2,400
Less: Depreciation	547	791	994	1,293	1,671
Net Fixed Assets	573	625	703	657	729
Capital WIP	30	35	64	60	50
Investments	350	443	726	1,000	1,250
Curr. Assets	1,210	1,806	1,947	2,588	3,386
Debtors	885	1,229	1,426	1,740	2,157
Cash & Bank Balance	196	454	379	667	1,006
Loans & Advances	129	123	142	181	224
Current Liab. & Prov.	634	921	1,139	1,373	1,701
Net Current Assets	576	884	808	1,215	1,686
Application of Funds	1,529	1,987	2,301	2,932	3,715

E: MOST Estimates

CASH FLOW STATEMENT					
(Rs Million)					
Y/E JUNE	2003	2004	2005	2006E	2007E
PBT before EO Items	571	466	726	963	1110
Add: Depreciation	140	248	244	299	378
Interest	9	12	11	6	4
Less: Direct Taxes Paid	68	21	82	112	122
(Inc)/Dec in WC	-380	-50	2	-120	-131
CF from Operations	272	655	899	1,037	1,238
EO, Misc. & Other Items	0	-18	-52	-40	-40
CF from Op. incl. EO Items	272	637	847	997	1,198
(Inc)/Dec in FA	-743	-305	-351	-250	-440
(Pur)/Sale of Investments	-350	-93	-283	-274	-250
CF from Investments	-1,093	-398	-634	-524	-690
Inc/(Dec) in Net Worth	1,059	71	-165	-34	-20
Inc/(Dec) in Debt	10	1	5	-16	0
Less: Interest Paid	-9	-12	-11	-6	-4
Dividend Paid	-43	-42	-118	-118	-118
CF from fin. activity	1,017	19	-288	-174	-141
Inc/Dec in Cash	196	258	-75	299	367
Add: Beginning Balance	0	196	454	379	667
Closing Balance	196	454	379	678	1,033



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	Mastek
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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