

10th April'2008

**Not Rated**

Price **Rs311** Target Price **N.A**

Sensex **15,791**

**Price Performance**

(%)	1M	3M	6M	12M
Absolute	20	(6)	(3)	2
Rel. to Sensex	21	24	15	(15)

Source: Capitaline

**Stock Details**

Sector	IT Services
Reuters	MAST.BO
Bloomberg	MAST@IN
Equity Capital(Rs mn)	143
Face Value(Rs)	5
52 Week H/L	419/220
Market Cap(Rs bn)/USD mn)	9/222
Daily Avg Volume (No of shares)	41548
Daily Avg Turnover (US\$)	0.3

**Shareholding Pattern (%)**(31<sup>st</sup> Dec.'07)

Promoters	40.2
FII/NRI	30.0
Institutions	10.3
Private Corp.	6.8
Public	12.7

**Manik Taneja**[manik.taneja@emkayshare.com](mailto:manik.taneja@emkayshare.com)

+91 22 6612 1253

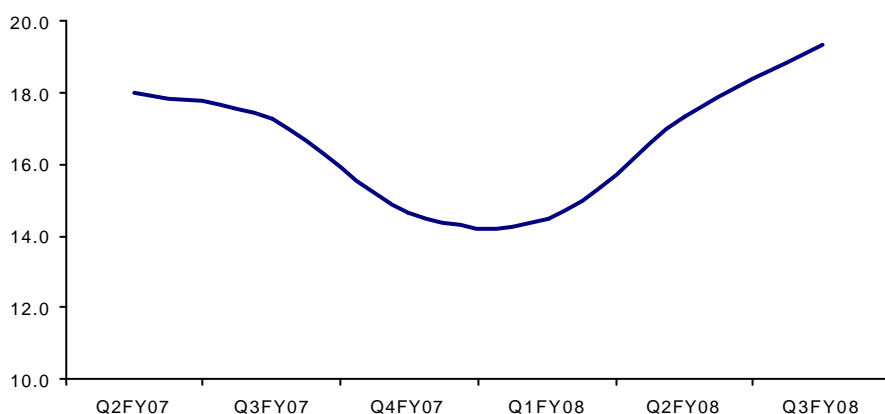
**Mastek Ltd****Margins surprise; Raise FY09 estimates by ~17%**Result  
Update

Mastek reported strong Q3FY08 results with revenues at Rs 2334 mn (**up 10.3% QoQ including ~Rs 160 mn contribution from recently acquired entity STG**). Net profits have grown by ~30% QoQ to Rs 351 mn aided by a sequential EBITDA margin expansion of 200 bps (**included a writeback of Rs 60 mn**) and lower than expected tax rate @13.2% (**V/s our estimates of ~16%**). We have revised our FY08E and FY09E earnings by 16% and 17% to incorporate STG acquisition (**a US based IT solutions provider to the property and casualty space**) as well as higher operating margins, though raise doubts over sustainability of the reported margins. We would also like to note that despite (1) healthy client addition of 11 customers during the quarter and (2) executable order book growing by 12% sequentially to Rs 4060 mn (**marks the 3<sup>rd</sup> successive quarter of double digit growth**), the US revenues (ex STG acquisition) were down ~4.5% QoQ while UK revenues were up a mere 2.4% sequentially.

We are raising our FY08E and FY09E earnings by ~16% and ~17% respectively to Rs 43.7 and Rs 46.4. (from Rs 37.7 and Rs 39.6 earlier). Though valuations continue to remain attractive at 7.5x and 7x on FY08E and FY09E earnings which should be further supported by an open market buyback (**management indicated during the investor call that something concrete would be announced over the next 2 weeks**), we note that the heads into FY09 with (1)NHS contract ramp down is a quarter away and (2) integration of STG being underway thereby raising some doubts about sustainability of the margins going forward.

**Other highlights****Organic revenues up by 2.7% QoQ, EBDITA margins + 200 bps sequentially**

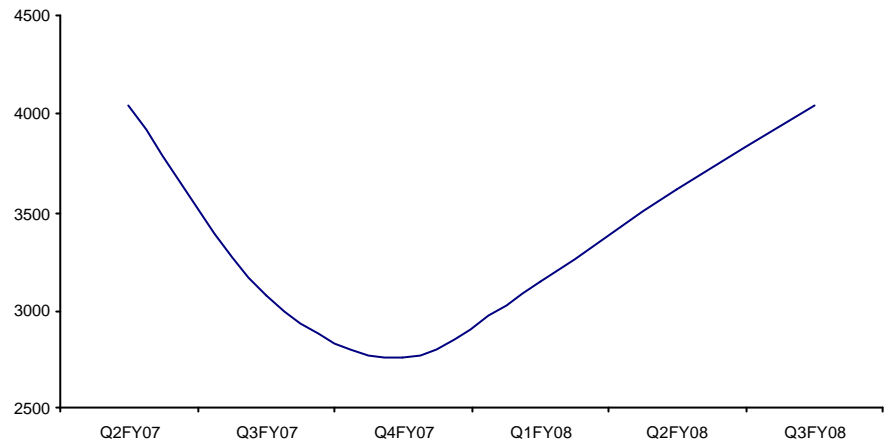
Mastek has reported revenues of Rs 2334 mn, up 10.3% QoQ (including contribution of Rs 160 mn from System Task Group). On an organic basis, Mastek has reported a 2.7% sequential growth in revenues. The positive surprise came in the form of ~200 bps sequential expansion in EBITDA margins to 19.3% driven by higher utilization and other operational efficiencies. However ex one off items (Rs 60 mn of cost write back and Rs 40 mn of expenses related to acquisition of STG), the margins have expanded by 110 bps QoQ.

**EBITDA margins**

## Order book growth continues; UK revenue growth disappoints

Mastek has reported a 12% sequential increase in order book position (executable over the next 12 months) to Rs 4060 mn. We note **that this marks the 3<sup>rd</sup> successive quarter of double digit increase in order book position.**

### Order Book over next 12 months



However the US revenues (ex STG contribution) have degrown by 4.5% sequentially (company attributed it to end of a project in US). Besides the revenue growth from Europe also remained muted at 2.4%.

## Client addition is healthy; top 5 contributions continues to be modest

Mastek has reported a client addition of 11 customers during the quarter including 1 customer for STG post the acquisition. Besides STG brought in ~35 new customers which offers an opportunity for cross sell. However the top 5 client contribution continues to be weak with the top 5 contribution degrowing by 2% QoQ during the quarter

Client profiles(ex JV)	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08	Q3FY08
Active Clients	39	41	44	46	50	94
Additions	1	4	4	2	4	11
Top 5 contribution,%	74	74	72	70	68	59
Top 5 (in US\$m)	33.6	35.6	31.9	35.4	36.1	35.3
QoQ growth, %		6%	-10%	11%	2%	-2%
Top 10 contribution,%	88	89	88	85	84	75
Top 10 (in US\$ mn)	39.9	42.8	38.9	43.0	44.5	44.9
QoQ growth, %		7.3%	-9.0%	10.4%	3.6%	0.8%

Besides we note that the recently announced partnership with Thales for working with UK's Ministry of Defence along with a new deal win from Legal and General bodes well for the company.

## Valuations continue to be inexpensive; Buyback should offer support

We have revised our earnings estimates by ~16% and 17% for FY08E and FY09E respectively to Rs 43.7 and Rs 46.4 respectively (from Rs 37.7 and Rs 39.6 earlier) to factor in higher operating margins and STG acquisition. Mastek continues to quote at inexpensive valuations of ~7.5x and 7x on FY08E and FY09E earnings with further support in the form of an open market buyback (**the company management during the investor call indicated that a final announcement to that effect would be made over the next 2 weeks**). However we note that despite the increased visibility from new deals

over the past 2 months, Mastek heads into FY09 with (1) NHS contract ramp down a quarter away (contributes to ~15-16% of FY08 revenues) and (2) Integration of STG thereby making the sustenance of margins at the current level slightly difficult.

The key risks to our estimates remain in the form of further worsening of the credit crisis in the US BFSI segment and subsequent spread to other geographies which could impact development spend in the Insurance space as well, given Mastek's high dependence on development revenues

## Income Statement

Y/E, Mar (Rs. m)	FY07	FY08E	FY09E
Net Sales	7944.3	8948.4	10597.3
Growth (%)		12.6	18.4
Total Expenditure	(6625.60)	(7319.53)	(8617.99)
Growth (%)		10.5	17.7
EBIDTA	1318.7	1628.9	1979.3
Growth (%)		23.5	21.5
EBIDTA %	16.6	18.2	18.7
Other Income	296	202	120
Depreciation	(299.2)	(330.3)	(419.5)
EBIT	1019.5	1298.6	1559.8
Interest	8.9	36.1	60.0
EBT	1306.2	1464.0	1619.8
Tax	(201.0)	(218.6)	(294.5)
EAT	1105.2	1245.4	1325.3
Growth (%)		12.7	6.4
EAT (%)	13.9	13.9	12.5

## Balance Sheet

Y/E, Mar (Rs. m)	FY07	FY08E	FY09E
Equity share capital	142	143	143
Reserves & surplus	3,374	4,276	5,330
Minority Interest	-	0	0
Networth	3,516	4,419	5,473
Secured Loans	4	826	826
Unsecured Loans			
Loan Funds	4	826	826
Total Liabilities	3,520	5,246	6,300
Gross Block	1,921	3,653	4,098
Less: Depreciation	1,209	1,539	1,959
Net block	712	2,113	2,139
Capital WIP	316	210	240
Investment	1,096	1,320	1,320
Current Assets	3,160	3,526	4,853
Sundry debtors	2,129	2,574	2,903
Cash & bank balance	894	683	1,653
Loans & advances	137	268	297
Current Liab & Prov	1,852	2,013	2,353
Current liabilities	1,368	1,521	1,780
Provisions	484	492	572
Net current assets	1,308	1,512	2,500
Misc exps	-	-	-
Deferred Tax	89	90	100
Total Assets	3,520	5,246	6,300

## Cash Flow

	FY07	FY08E	FY09E
Net Profit after Tax	1062	1244	1321
Add : Depreciation	299	330	420
Add : Misc exp w/off	0	0	0
Net changes in WC	(159.1)	(204.3)	(988.2)
Operational Cash Flows	1120.2	1079.1	1715.6
Capital expenditure	(342.0)	(1625.6)	(475.2)
Investments	270.0	224.2	0.0
Investing Cash Flows	(72)	(1,401)	(475)
Borrowings	(7.5)	822.3	0.0
dividend paid	(212.6)	(416.6)	(266.7)
Issue of shares	50.1	-69.2	0.0
Share Premium	48.5	-69.6	0.0
Financing Cash Flows	(509.2)	335.8	(270.7)
changes in cash	539	13	970
Opening balance	355	670	683
Closing balance	894	683.0	1653.0

## Key ratios

	FY07	FY08E	FY09E
EPS (Rs)	32.1	43.7	46.4
CEPS (Rs)	42.7	55.2	61.1
Book Value Per Share (Rs)	125.6	155.1	192.1
Dividend Per Share (Rs)	7.6	8.0	8.0
Valuations Ratios (x)			
PER	10.0	7.3	6.9
P/CEPS	6.1	4.7	4.3
P/BV	2.5	2.1	1.7
EV/EBIDTA	6.2	5.7	4.2
EV/Sales	1.0	1.0	0.8
M-Cap/sales	1.1	1.0	0.9
Profitability Ratios (%)			
RoCE	28.9	27.3	24.7
RoNW	27.3	31.4	26.7
EBITDA Margin	16.6	18.2	18.7
EBIT Margins	12.8	14.5	14.7
Net Profit Margin	11.3	13.9	12.5

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**Emkay Share and Stock Brokers Ltd.,**  
Paragon Center, Ground Floor, C-6  
Pandurang Budhkar Marg, Worli, Mumbai – 400 013. , Tel no. 66121212. Fax: 66121299