

Mastek

Q3FY10 Earnings Review

Recommendation	:	Marketperformer
CMP	:	Rs 295
Target	:	Rs 282
Upside/(Downside) Potential	:	(5.2%)

Sector	:	IT
Sensex	:	17400
Bloomberg code	:	MAST IN
Reuters Code	:	MAST BO

AT A GLANCE

Issued Equity Capital (Cr. Shrs)	:	2.69
Mkt. Cap (Rs. in Crs)	:	1095
Major Shareholders		
Promoters (%)	:	42.91%
Free Float (%)	:	57.09%
Avg. Daily Vol. ('000)	:	267.43

Background: Incorporated in 1982, Mastek is a leading IT player with global operations providing enterprise solutions to businesses and governments worldwide. Mastek is having its operations in the U.S, Europe, Canada, Middle East and Asia Pacific with employee strength of over 3700 people. The company has crystallized its focus on two verticals – Insurance and Government – in which it has substantial experience and intellectual property. The company derives majority of its revenue from the government vertical (35.7%) followed by insurance (29.4%) while the rest comes from banking & financial services (BFSI). In Insurance vertical company is acknowledged for its enterprise solution offering called Flixir.

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Quarterly numbers disappoints

The company reported total revenues of Rs 172.17 crore against a guidance of Rs 188 - 195 crore. In constant currency terms, the total revenues were at Rs 179.6 crore. The revenues declined by 11% QoQ. The net profit for the quarter stood at Rs 15.26 crore against the guidance of Rs 21 – 23 crore. The net profit declined by 35% QoQ. Mastek failed to meet its quarterly guidance by a big margin due to rupee appreciation against GBP and USD, which account for 39% and 54% of its total revenues respectively. Also, the company faced a severe pricing decline of 20% from one of its leading client in the US. In addition to this, the company witnessed delay in contract extensions and signing new deals.

Order book remained stagnant

The order book at the end of the third quarter decreased to Rs 279 crore from Rs 296 crore mainly due to rupee appreciation. In USD terms the order book remained stagnant. The company derives a large part of its revenues from transformational deals which is witnessing slower decision making. Also, the management suggested that the government spending in UK is low due to the oncoming elections. However, the Insurance sector is showing positive signs with traction beginning in the US.

The guidance turns negative for Q4FY10

The management has guided for a total income of Rs 160 to 165 crore for Q4FY10. The guidance assumes a decline of 7% to 4% partly on rupee appreciation going forward. The decline is also attributed to the meek order book and slower decision making. The net profit for Q4FY10 is guided at Rs 10 to 11crore. The decline in net profit is due to the fresh hiring and certain one time expenditure during Q4FY10.

Valuations

Mastek's results came in as a major disappointment largely on account of rupee appreciation, delay in deal closures and a one time price cut. The guidance for the next quarter dents the full year topline by 24% and bottomline by 46%. The company has failed to book any incremental order during the quarter. Also, there is no significant pipeline to back the growth going forward with most of its large projects ramping down. However the fresh hiring and increased traction in insurance vertical could aid in bringing growth. Currently, in light of the bleak business outlook we revise our estimates for FY11 and FY12 downwards from a growth of 12% and 18% to 8% and 12% respectively. At the current market price the stock is quoting at 9x and 8.4x its FY11E and FY12E estimates. We recommend a Marketperformer rating on the stock with a revised target price of 282.

FY June (Rs Crore)	Turnover	EBITDA	Pre-tax Profit	Net Profit	EPS (Rs)	BVPS (Rs)	PE (X)	DPS	P/BV (X)	ROE (%)
2010E	716	107.40	77.4	75.00	27.83	206.9	10.6	10	1.43	13.45%
2011E	773	131.50	100.4	87.40	32.48	229.3	9.08	10	1.29	14.16%
2012E	866	147.20	115.70	94.90	35.28	254.6	8.36	10	1.16	13.86%

Operational highlights

The revenue from government segment declined to 28% from 29% in the sequential quarter. In the Government vertical, the company operates in partnerships with BT, Thales and Capita. The partnership with BT won the NHS project which has already seen a ramp down. The Thales partnership is also in the process of ramping down the project over the next 2 quarters. The revenues from other financial services vertical, declined to 17% from 22% due to absence of new wins and renewal. The revenues from IT & other services vertical remained stagnant at 17%. However, the largest contributing Insurance vertical has started to building traction mainly from its Elixir platform.

REVENUE BY REGIONS	Q3FY10	Q2FY10	Q3FY09
North America	39%	42%	38%
Europe	54%	52%	55%
Others	7%	6%	7%
Total	100%	100%	100%
REVENUE BY OFFERINGS	Q3FY10	Q2FY10	Q3FY09
Development	60%	61%	67%
Maintenance	39%	37%	32%
Processing (BPO / PAAS)	1%	2%	1%
Total	100%	100%	100%
PROJECTS REVENUE BY TYPE	Q3FY10	Q2FY10	Q3FY09
Fixed Price	43%	49%	52%
Time & Material	55%	49%	47%
Processing (BPO / PAAS)/Transaction based Revenues	1%	2%	1%
Total	100%	100%	100%
REVENUE BY INDUSTRY	Q3FY10	Q2FY10	Q3FY09
Insurance	39%	32%	30%
Government	28%	29%	37%
Other Financial Services	17%	22%	16%
IT & Other services	17%	17%	17%
Total	100%	100%	100%

Result summary and comments Q3FY10 (Consolidated)

in Rs crore	Q3 FY10	Q2 FY10	Gr qoq (%)	Q3 FY09	Gr yoy (%)	Comments
Revenue	170.33	190.9	-11%	231.11	-26%	rupee appreciation, delay in contract extension and absence of new deal wins
Other Income	1.84	2.33	-21%	1.91	-4%	
Total Income	172.17	193.23	-11%	233.02	-26%	
Staff Costs	106.46	119.53	-11%	139.65	-24%	
Travelling & conveyance	7.93	10.3	-23%	9.81	-19%	
Exchange Loss / (gain)	-2.61	1.47	-278%	-2.03	29%	
Other Expenses	31.5	36.38	-13%	40.46	-22%	
Total Expenditure	143.28	167.68	-15%	187.89	-24%	
EBIDTA	28.89	25.55	13%	45.13	-36%	
Interest	-0.95	0.85	-212%	1.11	-186%	
Gross Profit after Interest but before Depreciation & Taxation	29.84	24.7	21%	44.02	-32%	
Depreciation and amortisation	6.46	6.64	-3%	6.71	-4%	
Profit Before Tax	23.38	18.06	29%	37.31	-37%	
Provision for taxation - Current Tax	5.18	3.68	41%	3.53	47%	
- Deferred Tax	2.72	-0.78	-449%	0.25	995%	
- Previous period	0.22	-8.38	-103%	0.15	47%	
- Net	8.12	-5.48	-248%	3.93	107%	
Net profit after Tax	15.26	23.54	-35%	33.38	-54%	
EBIDTA margin	16.8%	13.2%		19.4%		pricing cut by 20% in one of its project, low volumes and salary hike given to select employees
Tax rate	22.2%	20.4%		9.5%		
PAT margin	8.9%	12.2%		14.3%		

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STOCK RATINGS : Outperformer: > 20% upside over the next 12 months; Marketperformer: trade within a +/-20% range over the next 12 months; Underperformer: > 20% downside over the next 12 months.