March 02, 2023

Mastek Limited: Ratings reaffirmed;rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based -Cash Credit	30.00	31.00	[ICRA]AA-(Stable); reaffirmed/assigned
Short -term – Non fund based	50.00	50.00	[ICRA]A1+; reaffirmed
Long-term /Short -term – Fund based/ Non-Fund based	6.00	6.00	[ICRA]AA- (Stable)/ [ICRA]A1+; reaffirmed
Long Term - Non-Fund based facilities	-	129.00	[ICRA]AA-(Stable); assigned
Total	**86.00**	**216.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation factors in Mastek Limited's (Mastek) established position in the Information Technology (IT) and IT enabled services (ITeS) industry, strong execution track record and presence across diverse business segments. Established relationships with a strong customer base and a robust financial profile further underpin the ratings. Mastek's financial profile continues to be healthy supported by steady financial performance in FY2022 and 9M FY2023, demonstrated by healthy internal accrual generation, which has resulted in low reliance on debt, translating into a comfortable capital structure and robust debt protection metrics.

Mastek posted revenue growth of 18% YoY in CC terms in 9M FY2023, partly also supported by revenue consolidation from the newly acquired entity (MST Solutions) in July 2022. The organic growth momentum has witnessed some moderation in the current fiscal owing to global macroeconomic headwinds and lower revenue from one of the large healthcare customers in the UK. However, the orderbook remains strong with 12-month order backlog of Rs. 1,705.8 crore as on December 31, 2022, which provides revenue visibility over the medium term.

The company acquired MST Solutions, a Salesforce consulting company in July 2022, which is expected to strengthen Mastek's presence mainly in the healthcare and public sectors in the US and support enhanced geographic diversification of its revenue stream. Mastek intends to take its Salesforce capability to other geographies including the UK and Middle East making it a global salesforce practice. Mastek paid an upfront purchase consideration of $ 80 million for this acquisition and earnout between $ 0 to $ 35 million will be paid, subject to achieving financial targets. This was funded by debt of ~$ 30 million and the balance through internal accruals, resulting in some increase in the company's debt levels and moderation in debt protection metrics over the near term, though they continue to be healthy. However, the integration and synergy benefits from this acquisition will remain a key sensitivity.

The ratings, however, remain constrained by Mastek's high revenue dependence on the UK's public and healthcare sectors, exposing it to risk of any changes in the UK Government's policy on IT spending. However, the risk is mitigated to an extent as Mastek has an established track record of several decades in serving the UK public sector for critical IT projects. The company also faces stiff competition from other prominent players in the global IT services industry, leading to margin pressure. Additionally, industry participants, including Mastek, continue to face challenges in the form of wage inflation, foreign currency fluctuations, talent acquisition and retention. ICRA also notes the company's plans to grow inorganically through acquisitions in the short to medium term, funded by its sizeable cash and liquid investments. Any sizeable debt-funded acquisition can materially impact the company's financial risk profile and will be evaluated on a case to-case basis.

The Stable outlook on the rating reflects ICRA's opinions that Mastek will continue to report healthy internal accruals over the near to medium term, aided by its healthy order book position and increased revenue contribution from its recently acquired companies and maintain a comfortable capital structure and coverage metrics.

Key rating drivers and their description

Credit strengths

Established operational track record and presence in the industry – Mastek's established business profile is supported by its strong track record in the digital transformation business and healthy presence in Oracle cloud-based solutions implementation through Evosys. The company now also has presence in the Salesforce consulting business with the acquisition of MST Solutions. The company's key service lines include digital application engineering, including application development work, cloud native development, DevSecOps work, and cloud and enterprise application, which includes implementation of Oracle cloud and enterprise applications. Mastek has a strong track record in the Government & education, health, and retail verticals with each generating ~41%, ~17% and ~15%, respectively, of total revenue in 9M FY2023.

Increased level of geographical diversification – Given the acquisition of MST Solutions in July 2022, the revenue contribution from the US has increased to 23.8% in 9M FY2023 from 17.7% in FY2022, resulting in decline in concentration of the UK & Europe to 62.5% in 9M FY2023 from 68.0% in FY2022. ICRA expects with increased contribution from the US market the geographic diversification is likely to further improve in the medium term.

Healthy financial profile supported by steady accruals, comfortable capital structure and strong liquidity position – The company's financial profile remains healthy, aided by steady internal accruals, a comfortable capital structure and robust debt protection metrics. In 9M FY2023, Mastek recorded revenue of $ 231.8 million (Rs 1,854.2 crore), translating into 7.4% YoY growth in USD terms and 15.7% in INR terms. The revenue growth in the current fiscal was also partly supported by revenue from the MST acquisition. The organic growth momentum has witnessed moderation in the current fiscal owing to the global macroeconomic headwinds and lower revenue from one of the large healthcare customers in the UK. ICRA expects steady revenue growth in the near to medium term supported by strong order book (12-month order backlog of Rs 1,705.8 crore as on December 31,2022) and synergy benefits from the acquisition. Though the evolving macroeconomic headwinds across markets and challenges from integration of MST Solutions will remain key sensitivities. Further, Mastek's capital structure and debt protection metrics remained comfortable, despite debt-funded acquisition with gearing of 0.3 times and Total Debt/OPBITDA of 0.9 times as on September 30, 2022. ICRA expects the company's financial profile to remain healthy over the near to medium term, supported by stable earnings outlook and no material increase in debt levels.

Credit challenges

High concentration on UK public and health sectors; although mitigated to an extent by track record of consistent performance – Mastek derived 62.5% of its operating revenue in 9M FY2023 from the UK and EU markets. The company continues to generate most of its revenues from the UK's public and healthcare sectors, which exposes it to risk of any changes in the UK Government's policy on IT spending. ICRA noted the impact on organic revenue growth in FY2022 due to lower revenue from the NHS, which is the key customer for healthcare revenue in the UK, due to some restructuring in the organisation. However, Mastek's three decades of experience in delivering critical programmes for the UK Government mitigates the risk to an extent.

Margins vulnerable to competitive pressures, wage inflation, forex fluctuations and pricing pressure – Given the intense competition in the industry, Mastek's profit margins are susceptible to pricing pressures and wage inflation. Further, much of the revenues and margins are exposed to forex risks, although Mastek's hedging mechanisms mitigate this risk to an extent. In 9M FY2023, the company's operating margins declined to 17.8% from 21.2% in FY2022 owing to high salary increments amid high attritions and currency headwinds. The employee attrition for the company is on a declining trend from the last three quarters, with LTM[1] attrition at 23.3% as on December 31, 2022, versus 28.0% in March 2022. ICRA expects attrition to further decline for the next two to three quarters before stabilising supported by strong hiring in FY2022, which has addressed the demand-supply mismatch to an extent.

Liquidity position: Adequate

Mastek's liquidity position is adequate, supported by healthy internal accrual generation, cash and bank balance/liquid investments of ~Rs. 325 crore as well as unutilised bank limits of Rs. 37 crore (at standalone level) as on December 31, 2022. The company's recurring cash flow from operations and its cash balances are expected to be adequate to service its scheduled debt repayments and put option liability. The company has annual debt repayment of £ 6.9 million and cash outflow of ~Rs. 121 crore (of which ~Rs 39 crore is paid in Q3 FY2023 and balance to be paid in Q4 FY2023) in FY2023 toward discharge of put option liability to compulsory convertible preference share (CCPS) holders of Trans American Information Systems Private Limited.

Environment and Social Risk

Environmental concern: Given the service-oriented business, Mastek's direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material.
Social concern: Like other Indian IT service companies, Mastek faces the risk of data breaches and cyber-attacks that could affect the large volumes of customer data that it manages. Any material lapses on this front could result in substantive liabilities, fines, or penalties and reputational impact. Also, Mastek remains exposed to the risk of changes in immigration laws in the key developed markets where it provides its services. While such changes would be motivated by those economies' own social and political considerations, they could have the effect of heightening the competition among IT players for skilled workforce leading to higher attrition rates and may have an adverse impact on profitability. Managing various facets of human capital, including skills, compensation, and training, is in any case a key differentiating factor among IT companies.

Rating sensitivities

Positive factors – ICRA could upgrade Mastek's ratings, if the company exhibits a sustained improvement in its business profile, supported by increase in scale of operations, while generating adequate returns and maintaining strong credit metrics and liquidity.

Negative factors – Pressure on Mastek's ratings may arise, if any significant reduction in the company's revenues and profitability weakens the RoCE. The ratings may be downgraded, if any increase in working capital intensity impacts the liquidity position, or any significant debt-funded acquisition(s) weaken(s) the debt coverage indicators.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities Information Technology (Services)
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Mastek. The consolidated entities are all enlisted in Annexure-2.

[1] LTM- Last twelve months

About the company

Mastek (formerly known as Management and Software Technology Private Limited) was incorporated in 1982. It is an IT company providing enterprise digital and cloud transformation services to the Government/public sector, health, and life science, retail, and financial service sectors. The company's service offerings include Application Development, Oracle Suite & Cloud Migration, Digital Commerce, Application Support & Maintenance, BI & Analytics, Assurance & Testing and Agile Consulting. Evosys – A Mastek company, is an Oracle platinum partner and a leading Oracle cloud implementation and consultancy company, serving 1,000+ Oracle cloud customers across 30+ countries. MST solutions – A Mastek company, is an independent Salesforce consulting and system integration partner focussed in American southwest region.

Key financial indicators (audited)

Mastek – Consolidated	FY2021	FY2022	H1FY2023*
Operating income	1,721.9	2,183.8	1,195.6
PAT	251.8	333.4	170.6
OPBDIT/OI	22.0%	21.2%	18.1%
PAT/OI	14.6%	15.3%	14.3%
Total outside liabilities/Tangible net worth (times)	1.2	1.0	1.2
Total debt/OPBDIT (times)	0.7	0.4	0.9
Interest coverage (times)	46.7	60.2	30.0

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes, and amortisation; Amount in Rs crore *unaudited*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021		Date & rating in FY2020
					Mar 2, 2023	Jan 27, 2022	Dec 01, 2020	Apr 21, 2020	Sep 12, 2019
1	**Fund-based- Cash Credit**	Long-term	31.00	-	**[ICRA]AA- (Stable)**	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Positive)
2	**Non-Fund based bank facilities**	Short-term	50.00	-	**[ICRA]A1+**	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	**Fund-based/ Non-Fund based**	Long-term and short-term	6.00	-	**[ICRA]AA- (Stable)/ [ICRA]A1+**	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+
4	**Non-Fund based bank facilities**	Long term	129.00		**[ICRA]AA- (Stable)**	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Short -term –Non Fund-based	Very Simple
Long-term/ Short -term – Fund-based / Non-Fund-based	Simple
Long Term- Non-Fund-based	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based-Cash Credit	NA	NA	NA	31.00	[ICRA]AA-(Stable)
NA	Non Fund-based	NA	NA	NA	50.00	[ICRA]A1+
NA	Fund-based / Non Fund-based	NA	NA	NA	6.00	[ICRA]AA-(Stable)/ [ICRA]A1+
NA	Non Fund Based	NA	NA	NA	129.00	[ICRA]AA-(Stable)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	Mastek Ownership	Consolidation Approach
Mastek Enterprise Solutions Private Limited	100%	Full Consolidation
Mastek (UK) Limited	100%	Full Consolidation
IndigoBlue Consulting Limited	100%	Full Consolidation
Mastek Inc.	100%	Full Consolidation
Trans American Information Systems Inc.	100%	Full Consolidation
Mastek Digital Inc.	100%	Full Consolidation
Mastek Arabia FZ - LLC	100%	Full Consolidation
Evolutionary Systems Consultancy LLC	49%	Full Consolidation
Mastek Systems Pty. Ltd.	100%	Full Consolidation
Evolutionary Systems Bahrain WLL	100%	Full Consolidation
Evolutionary Systems Egypt LLC	100%	Full Consolidation
Evosys Kuwait Company for designing and equipping Computer Centres LLC	49%	Full Consolidation
Evosys Consultancy Services (Malaysia) SDN. BHD.	100%	Full Consolidation
Newbury Cloud Inc.	100%	Full Consolidation
Evolutionary Systems BV	100%	Full Consolidation
Evolutionary Systems Qatar WLL	49%	Full Consolidation
Evolutionary Systems Saudi LLC	100%	Full Consolidation
Evolutionary Systems (Singapore) Pte. Ltd.	100%	Full Consolidation
Evolutionary Systems Company Limited	100%	Full Consolidation
Evolutionary Systems Corp.	100%	Full Consolidation
Evolutionary Systems Canada Limited	100%	Full Consolidation
Metasoftech Solutions LLC	100%	Full Consolidation
Meta Soft Tech Systems Private Limited	100%	Full Consolidation

Source: Company

Note: ICRA has taken a consolidated view of the parent (Mastek), its subsidiaries and associates while assigning the ratings.

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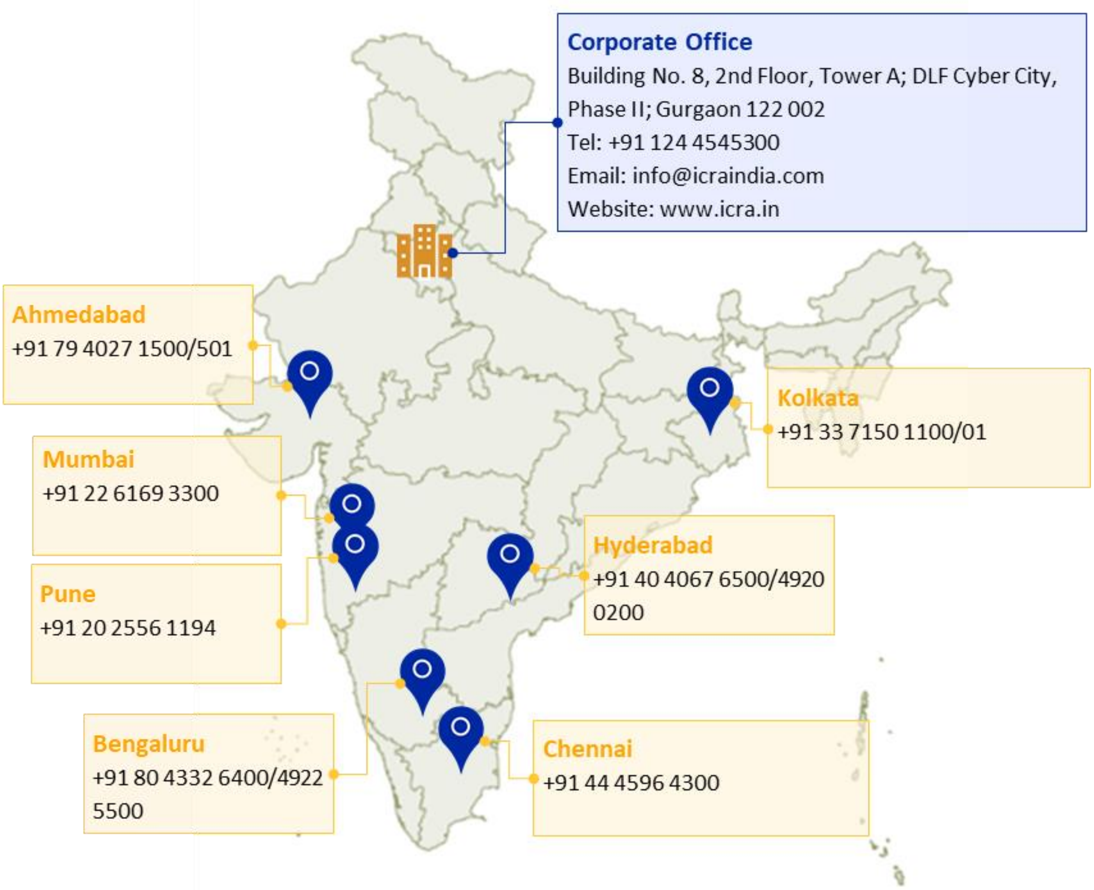

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