

January 27, 2022

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	4.0	30.0	[ICRA]AA-(Stable) reaffirmed/assigned
Short-term non-fund based	9.0	50.0	[ICRA]A1+ reaffirmed/assigned
Long-term/short-term fund based/non-fund based	6.0	6.0	[ICRA]AA-(Stable) / [ICRA]A1+ reaffirmed
Total	19.0	86.0	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation factors in Mastek Limited's (Mastek) steady financial performance in FY2021 and the current fiscal, as demonstrated by its steady revenue growth, healthy profit margins, robust debt protection metrics and strong liquidity profile (unencumbered cash/deposits/liquid investments of ~Rs. 943.9 crore as on September 30, 2021). Moreover, healthy internal accrual generation has continued to result in low reliance on debt, translating into a comfortable capital structure and robust debt protection metrics. Additionally, the ratings continue to derive comfort from Mastek's established business profile supported by an established track record in digital transformation business, strong presence in Oracle cloud-based solutions implementation through Evolutionary Systems (Evosys¹) and healthy order book position of Rs. 1,154.3 crore as on September 30, 2021, which provides revenue visibility. The acquisition of Evosys has led to increase in Mastek's scale of operation, and diversifications of its geographical presence, product/service mix and client base. Additionally, cross-selling opportunities from the same are expected to support the company's revenue growth and revenue base diversification.

However, the ratings remain constrained by Mastek's high revenue dependence on the UK's public sector, exposing it to risk of any changes in the UK government's policy on IT spending. However, the risk is mitigated to an extent since 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 opinion that Mastek will continue to benefit from its established business profile, healthy order book position and favourable demand outlook of the industry.

¹ The Evosys Group was acquired by Mastek in February 2020.

Key rating drivers and their description

Credit strengths

Vertical-focused company with major presence in Government, health and retail spaces – 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’s key service lines include digital application engineering, including application development work, cloud native development, DevOps work, and cloud and enterprise application, which includes implementation of Oracle cloud and enterprise applications. Mastek has a strong track record in the Government, health, and retail verticals with each generating 34.6%, 23.2% and 14.2%, respectively, of total sales in H1 FY2022. It generates healthy revenue from the UK public sector for various digital transformation programmes and serves various UK Government departments in delivering critical IT projects. In FY2021, for the first time, Mastek became part of an elite group of suppliers for the UK government’s digital marketplace. The healthcare and life science segments witnessed healthy revenue growth in FY2021 and H1 FY2022, mainly in the US market, supported by a growing base of customers after the Evosys acquisition. Mastek facilitates the digital transformation of retailers for better supply chain, inventory management and customer satisfaction. Although the retail vertical was impacted by the pandemic in FY2021 and H1 FY2022, Mastek has won new deals in recent quarters.

Increased level of geographical and customer diversification – Mastek had a major presence in the UK, which contributed to 96% of the company’s overall revenues in FY2016. However, this geographical concentration declined to 69% in FY2018 with the acquisition of TAISTech. The same further dipped to 67% in FY2021, with the acquisition of Evosys in Q4 FY2020. After the acquisition of TAISTech, Mastek is now present in digital commerce enabling implementation and support for the Oracle ATG and Oracle Commerce Cloud applications. Further, the acquisition of Evosys enhanced its addressable market in the US, West Asia, the EU region and the UK through cross-selling and upselling its service offerings. In H1 FY2022, the UK and EU markets drive 68.6% of the revenues, followed by the US (16.8%) and West Asia (8.7%). Moreover, in Q2 FY2022, Mastek’s top 10 customers drove 45% of its revenues over 63% in Q3 FY2020 (pre-acquisition of Evosys) leading to higher customer diversification with the acquisition of Evosys.

Healthy order book position provides revenue visibility – The company has a favourable order book position, which assures revenue visibility in the short to medium term. Mastek’s 12-month order backlog was Rs. 1,154.3 crore at the end of Q2 FY2022 over Rs. 940.5 crore at the end of Q2 FY2021, reflecting a growth of 22.7% YoY. The order book is supported by healthy demand for digital and cloud across geographies and Mastek is well positioned to take advantage of the opportunities available in the market. The acquisition of Evosys led to healthy increase in customers because the business is characterised by shorter sales cycles with quicker delivery timelines. In FY2021, Evosys booked ~160 customers. This provides Mastek with co-selling/ cross-selling opportunities for its digital transformation services to a large customer base.

Healthy financial profile supported by improved profitability, comfortable capital structure and strong liquidity position – The company’s financial profile remains healthy, aided by steady revenue growth, improved profitability, comfortable capital structure and robust debt protection metrics. In FY2021, Mastek recorded revenue growth of 61% to reach Rs. 1,721.9 crore, driven by growth across verticals, especially in the UK public sector and full year impact of the Evosys acquisition. In H1 FY2022, Mastek’s revenue grew by 32.0% YoY supported by growth across geographies and segments. Its operating margin improved to 22.0% in FY2021 from 14.5% in FY2020 supported by inclusion of higher margin Evosys business coupled with operational efficiency from significant reduction in discretionary cost, lower travel expenses from pandemic restrictions, and higher offshoring leading to lower employee costs. Moreover, despite increased employee costs owing to elevated attrition levels, it was able to sustain its margins at 21.5% in H1 FY2022. Further, Mastek’s capital structure remained comfortable with gearing of 0.2x as on September 30, 2021, and a robust liquidity position in the form of sizeable cash and liquid investment of Rs. 943.9 crore and net cash position of Rs. 719.1 crore as on September 30, 2021. ICRA does not foresee any material adverse impact of the third wave of the pandemic on the company’s operations. Its financial profile is expected to remain healthy over the near to medium term, given its established business position, order book in hand and steady earnings outlook.

Credit challenges

High concentration on UK public sector; although mitigated to an extent by track record of consistent performance – Mastek derived 68.6% of its operating revenue in H1 FY2022 from the UK and EU markets. The company continues to generate most of its revenues from the UK’s public sector, which exposes it to risk of any changes in the UK government’s policy on IT spending. However, Mastek has three decades of experience in delivering critical programmes for the UK government, which 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. Due to accelerated demand for digitisation, the IT industry has experienced high attrition levels over recent quarters. Mastek’s 12-month LTM attrition at end September 2021 was 24.2%. This high attrition is expected to increase the overall wage costs. Further, much of the revenues and margins are exposed to forex risks, although Mastek’s hedging mechanisms mitigate this risk to an extent.

Liquidity position: Strong

The liquidity position is strong, supported healthy internal accrual generation, unencumbered cash and bank balance/ liquid investments of ~Rs. 943.9 crore as well as unutilised bank limits of Rs. 11 crore (at standalone level) as on September 30,2021. 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 debt repayment of £ 6.9 million and cash outflow of Rs.165-166 crore (of which Rs 28.8 crore is paid in Q3 FY2022 and balance to be paid in Q4) toward discharge of put option liability to CCPS holders of Trans American Information Systems Private Limited in FY2022.

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 – Negative 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 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.

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 offering includes, 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.

Key financial indicators (audited)

Mastek - Consolidated	FY2020	FY2021	H1 FY2022*
Operating Income (Rs. crore)	1071.5	1721.9	1050.4
PAT (Rs. crore)	113.8	251.8	161.7
OPBDIT/OI (%)	14.5%	22.0%	21.5%
PAT/OI (%)	10.6%	14.6%	15.4%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	1.2	1.3
Total Debt/OPBDIT (times)	2.3	0.7	0.5
Interest Coverage (times)	43.0	46.7	63.4

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, * Unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019
						Jan 27, 2022	Dec 01, 2020	Apr 21, 2020	Sep 12, 2019
1	Fund based	Long Term	30.0	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+(Stable)	[ICRA]A+(Positive)	[ICRA]A+(Positive)
2	Non-fund based	Short Term	50.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Fund based/ Non-fund based	Long Term/ Short Term	6.0	-	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]A+(Stable)/ [ICRA]A1+	[ICRA]A+(Positive)/ [ICRA]A1+	[ICRA]A+(Positive)/ [ICRA]A1+

Amount in Rs. Crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term - Fund Based Limits	Simple
Short Term – Non-Fund based Limits	Very Simple
Long Term/Short Term – Fund based/Non-fund based	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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Long term fund-based	-	-	-	30.0	[ICRA]AA-(Stable)
NA	Short term non-fund based	-	-	-	50.0	[ICRA]A1+
NA	Long term/short term fund-based/non-fund based	-	-	-	6.0	[ICRA]AA-(Stable)/[ICRA]A1+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure-2: List of entities considered for consolidated analysis (As on March 31, 2021)

Company Name	Ownership	Consolidation Approach
Trans American Information Systems Private Limited	100.0%	Full Consolidation
Mastek (UK) Limited	100.0%	Full Consolidation
IndigoBlue Consulting Limited	100.0%	Full Consolidation
Mastek, Inc.	100.0%	Full Consolidation
Trans American Information Systems, Inc.	100.0%	Full Consolidation
Mastek Digility Inc.	100.0%	Full Consolidation
Mastek Arabia FZ LLC	100.0%	Full Consolidation
Evolutionary Systems Pvt. Ltd.	100.0%	Full Consolidation
Evolutionary Systems Consultancy LLC	100.0%	Full Consolidation
Evolutionary Systems Pty Ltd	100.0%	Full Consolidation
Evolutionary Systems Bahrain SPC	100.0%	Full Consolidation
Evolutionary Systems Egypt LLC	100.0%	Full Consolidation
Evosys Kuwait Company for designing and equipping Computer Centers LLC	100.0%	Full Consolidation
Evosys Consultancy Services Malaysia	100.0%	Full Consolidation
Newbury Taleo Group, Inc	100.0%	Full Consolidation
Evolutionary Systems BV	100.0%	Full Consolidation
Evolutionary Systems Qatar WLL	100.0%	Full Consolidation
Evosys Kuwait Company for designing and equipping Computer Centers LLC	100.0%	Full Consolidation
Evolutionary Systems (Singapore) PTE. LTD.	100.0%	Full Consolidation
Evolutionary Systems Company Limited-Uk	100.0%	Full Consolidation
Evolutionary Systems Corp.	100.0%	Full Consolidation

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

ANALYST CONTACTS

Shamsher Dewan

+91 124 4545 328

shamsherd@icraindia.com

Kinjal Shah

+91 22 6114 3442

kinjal.shah@icraindia.com

Deepak Jotwani

+91 124 4545 870

deepak.jotwani@icraindia.com

Pawan Mundhra

+91 20 6606 9918

Pawan.mundhra@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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