

December 01, 2020

Mastek Limited: Long-term rating upgraded to [ICRA]AA-(Stable); short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based	4.0	4.0	[ICRA]AA- (Stable); Upgraded from [ICRA]A+ (Stable)
Short-term non-fund based	9.0	9.0	[ICRA]A1+; reaffirmed
Long-term/short-term fund-based/non-fund based	6.0	6.0	[ICRA]AA- (Stable) / [ICRA]A1+; Long-term rating upgraded from [ICRA]A+ (Stable) and short-term rating reaffirmed
Total	19.0	19.0	

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade favourably factors in the improvement in Mastek Limited's (Mastek) overall business risk profile post the acquisition of Evolutionary Systems Private Limited (Evosys) in February 2020 and its ongoing integration. The acquisition provides Mastek access to the value accretive and fast-growing cloud ERP market and further integration of the same is expected to provide cross-sell opportunities, which will support its revenue growth. The acquisition of Evosys has helped the company in diversifying its geographical presence, product and service mix, along with customer diversification. Besides, the ratings factor in the growth in organic revenues and revenue visibility especially from the UK public sector in H1 FY2021, following clarity on Government spending as conveyed by the management. The scaling up of the company's business through the acquisition and growth in its organic UK business will support its improved margin trajectory. However, some of the gains on travel/other discretionary costs in H1 FY2021 are unlikely to be sustainable once business returns to normalcy in FY2022. The ratings factor in its high financial flexibility and comfortable liquidity position as reflected in the cash and liquid investment of Rs. 476.4 crore as on September 30, 2020 with moderate scheduled debt repayment in FY2021. Additionally, the company has tendered its entire stake in Majesco US, held through its subsidiary, Mastek UK, to its acquirer for a cash consideration of USD 32.3 million on October 19, 2020, thus strengthening its liquidity profile.

The ratings remain exposed to any adverse changes in the regulatory environment in its key markets of US and the UK, apart from changes in the macro-economic environment. ICRA also notes the margin pressures caused by forex fluctuation. However, the company's policy of hedging a good portion of its receivables provides comfort. The ratings factor in the challenges faced due to intense competition from the larger Indian IT services companies and other small as well as mid-sized companies in the respective markets. The ratings note the company's improving albeit moderate vertical and customer concentration. Key verticals of the Government, health and retail contributed to around 72% of its total revenues in H1 FY2021. Furthermore, it generated approximately 46% of its revenues in Q2 FY2021 from the top ten clients, thus any client exit may have an adverse impact on its revenues and profitability. Mastek's ability to sustain organic revenue growth leading to an improvement in its profitability at increased scale will remain crucial. Additionally, ICRA will have to analyse any future acquisitions, considering its intent, for any bearing on its credit risk profile.

Key rating drivers and their description

Credit strengths

Vertical-focused company with major presence in Government, health and retail spaces – The company has a strong track record in the Government, health and retail verticals with each generating 34%, 19% and 19% of the total sales, respectively, in H1 FY2021. Certain critical departments such as the Home Office and Health (where Mastek already has successful relationships) are expected to have a bigger share of IT spends to support changes in the existing systems and create new systems post Brexit, which will provide significant growth opportunities for the company. In addition, strong presence of Evosys in the local UK Government could help Mastek access some new departments of the UK Government in the medium term.

Geographical and customer diversification post inorganic initiatives in 2016 and 2020 – Mastek had major presence in UK, which contributed to 96% of the company's overall revenues in FY2016. However, the geographical concentration towards the UK declined to 72% in FY2020 from 96% in FY2016 with TAISTech acquisition, which has further dipped to less than 66% in H1 FY2021 with the acquisition of Evosys in Q4 FY2020. Mastek, after the acquisition of TAISTech, has a presence in digital commerce enabling implementations and support for the Oracle ATG and Oracle Commerce Cloud applications. Further, the acquisition of Evosys in Q4 FY2020 enhanced its addressable market in Middle East, US, Continental Europe and the local government of UK through cross-selling and up-selling of Mastek's service offerings. At present, UK and Europe contribute to 66% of the overall revenues in H1 FY2021, followed by the US and Middle East with revenue contribution of 17% and 12%, respectively. Moreover, in Q2 FY2021, the top 10 customers contributed to 46% of the revenues compared to 63% in Q3 FY2020 (pre-acquisition of Evosys) leading to higher customer diversification with the acquisition of Evosys.

Improved order book position and revenue visibility – The company witnessed a strong revenue growth of 62% YoY in H1 FY2021 benefiting from inorganic expansion of Evosys, along with organic growth. The acquisition provides Mastek access to the value-accretive and fast-growing cloud ERP market and further integration of the same is expected to provide cross-sell opportunities, which will support its revenue growth. The organic growth is mainly contributed by the UK public sector with higher revenue visibility following clarity on the Government spending. Consequently, Mastek's order book grew by 23% QoQ in rupee terms to Rs. 940.5 crore as on September 30, 2020.

Favourable financial and liquidity profile with strong credit metrics and healthy cash and liquid investments – The ongoing integration of Evosys and continued organic growth for Mastek ensured improvement in the company's profitability and scale. However, some of the gains on travel/other discretionary costs in H1 FY2021 are unlikely to be sustainable once business returns to normalcy in FY2022. This ensured healthy cash generation leading to strong credit metrics as evinced by gearing of 0.2 times as on September 30, 2020 and interest coverage of 33.8 times in H1 FY2021. Moreover, it has healthy cash and liquid investments of Rs. 476.4 crore and a net cash of Rs. 223.4 crore (excluding lease liability as debt) as on September 30, 2020. Additionally, the company has sold its stake in Majesco US, held through its subsidiary, Mastek UK, for a cash consideration of USD 32.3 million on October 19, 2020, further strengthening its liquidity profile.

Credit challenges

Any adverse impact on revenues and profitability due to the economic fallout of coronavirus outbreak across its key markets – Owing to the ongoing pandemic, the near-term macro-economic outlook across geographies, predominantly in US and Europe, has weakened considerably with likely adverse impact on GDP growth for CY2020. The timing and pace

of recovery in these markets would be critical for Mastek's growth trajectory especially in the private sector. An adverse macro-economic scenario may not only lead to reduction in discretionary spends by clients, but also pricing pressure and impact its margins, going forward. Furthermore, the company generated approximately 46% of its revenues in Q2 FY2021 from its top 10 clients, thus any client exit may have an unfavourable impact on its revenues and profitability.

Exposure to foreign currency fluctuations and intense competition – Most of the company's revenues are denominated in foreign currency (GBP and US dollar), exposing it to foreign currency fluctuations. However, ~63% of its H1 FY2021 revenues are from onshore operations, which provide a natural hedge, thus protecting its margins. Moreover, Mastek hedges a good portion of its net receivables through forward contracts as a part of its hedging policy. It faces intense competition from the larger Indian IT services companies and other small and mid-sized companies in the respective markets.

Acquisition plans in future – ICRA shall have to analyse any acquisition, considering its intent, for any bearing on the company's credit risk profile.

Liquidity position: Strong

Mastek's liquidity profile remains **strong**, as reflected by its cash and liquid investment of Rs. 476.4 crore and a net cash of Rs. 223.4 crore (excluding lease liability as debt) as on September 30, 2020. Additionally, the company has sold its stake in Majesco US, held through its subsidiary, Mastek UK, for a cash consideration of USD 32.3 million on October 19, 2020, further strengthening its liquidity profile. The recurring cash flow from operations and its cash balances are expected to be comfortable to service its scheduled debt repayments of Rs. 18.1 crore in FY2021 and Rs. 64.7 crore in FY2022. Further, its liquidity is supported by undrawn working capital fund-based limits of Rs. 11 crore.

Rating sensitivities

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

Negative triggers – 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) weakens the debt coverage indicators.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology(IT)Services Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on consolidated financial statements of the rated entity.

About the company

Mastek Limited (formerly known as Management and Software Technology Private Limited) was incorporated in 1982. It is an IT company providing enterprise solutions to the Government / public sector, retail sector and financial services. Mastek's portfolio includes business and technology services, comprising IT consulting, application development, systems integration, application management outsourcing, testing, data warehousing and business intelligence, www.icra.in

application security, customer relationship management (CRM) services and legacy modernisation. The company is headed by Mr. John Owen, the Group CEO. It acquired Evosys in February 2020. At present, the first leg of the transaction involving cash buyout of Evosys Middle East business has already been completed. However, the second leg regarding the acquisition of the overseas business of Evosys through demerger cooperation agreement and shareholders agreement is awaiting regulatory approvals. As on September 30, 2020, Mastek's total employee strength stood at 3,354. The company is primarily present in the UK and European market with 66% of its revenues in H1 FY2021 coming from this geography. With the acquisition of Evosys, ~12% of the revenues are contributed from Middle East geography, which was non-existent till 9M FY2020. Mastek registered revenues of Rs. 795.8 crore and a PAT of Rs. 105.7 crore in H1 FY2021, at the consolidated level.

Key financial indicators (audited, consolidated)

	FY2019	FY2020
Operating Income (Rs. crore)	1,033.2	1,071.5
PAT (Rs. crore)	101.5	113.8
OPBDIT/OI (%)	12.7%	14.5%
PAT/OI (%)	9.8%	10.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	1.0
Total Debt/OPBDIT (times)	0.5	2.3
Interest Coverage (times)	21.5	43.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Current Rating	Earlier Rating	FY2020	FY2019	FY2018	
					01-Dec-20	21-Apr-20	12-Sep-19	3-Aug-18	21-Aug-17	1-Aug-17
1	Long term fund-based	Long Term	4.0	-	[ICRA]AA-(Stable)	[ICRA]A+(Stable)	[ICRA]A+(Positive)	[ICRA]A+(Positive)	[ICRA]A+(Stable)	[ICRA]A+(Stable)
2	Short term non-fund based	Short term	9.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Long term/short term fund-based/non-fund based	Long term/Short term	6.0	-	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]A+(Stable)/[ICRA]A1+	[ICRA]A+(Positive)/[ICRA]A1+	[ICRA]A+(Positive)/[ICRA]A1+	[ICRA]A+(Stable)/[ICRA]A1+	[ICRA]A+(Stable)/[ICRA]A1+

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Long term fund-based	-	NA	-	4.0	[ICRA]AA- (Stable)
-	Short term non-fund based	-	NA	-	9.0	[ICRA]A1+
-	Long term/short term fund-based/non-fund based	-	NA	-	6.0	[ICRA]AA- (Stable) / [ICRA]A1+

Source: Mastek Limited

Annexure-2: List of entities considered for consolidated analysis (As on March 31, 2020)

Company Name	Ownership	Consolidation Approach
Mastek (UK) Limited	100.0%	Full Consolidation
IndigoBlue Consulting Limited (merged with Mastek (UK) Limited with effect from 30 June 2018)	100.0%	Full Consolidation
Mastek, Inc.	100.0%	Full Consolidation
Trans American Information Systems Private Limited	100.0%	Full Consolidation
Trans American Information Systems, Inc.	100.0%	Full Consolidation
Taistech LLC (merged with Trans American Information Systems, Inc. with effect from 31 December 2019)	100.0%	Full Consolidation
Evolutionary Systems Private Limited	100.0%	Full Consolidation
Mastek Arabia FZ LLC	100.0%	Full Consolidation
Newbury Cloud, Inc.	100.0%	Full Consolidation
Evosys Kuwait WLL	100.0%	Full Consolidation
Evosys Consultancy Services (Malaysia) SdnBhd	100.0%	Full Consolidation
Evolutionary Systems Saudi LLC	100.0%	Full Consolidation
Evolutionary Systems Qatar WLL	100.0%	Full Consolidation
Evolutionary Systems Pty Ltd	100.0%	Full Consolidation
Evolutionary Systems Corp.	100.0%	Full Consolidation
Evolutionary Systems Company Limited	100.0%	Full Consolidation
Evolutionary Systems BV	100.0%	Full Consolidation
Evolutionary Systems Bahrain SPC	100.0%	Full Consolidation
Evolutionary Systems (Singapore) Pte. Ltd.	100.0%	Full Consolidation
Evolutionary Systems Consultancy LLC	100.0%	Full Consolidation
Evolutionary Systems Egypt LLC	100.0%	Full Consolidation

Analyst Contacts

Subrata Ray

+91 22 6114 3408

subrata@icraindia.com

Jay Sheth

+91 22 6114 3419

jay.sheth@icraindia.com

Abhilash Mishra

+91 22 6114 3421

abhilash.mishra@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

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For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 2556 0194/ 6606 9999

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