

September 12, 2019

Mastek Limited: Ratings 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]A+(Positive); Reaffirmed
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]A+ (Positive)/ [ICRA]A1+; Reaffirmed
Total	19.0	19.0	

*Instrument details are provided in Annexure-1

Rationale

The ratings reaffirmation with positive outlook favourably factors in the improvement in the Mastek's business performance over the eleven quarters leading upto March 2019 as reflected in positive sequential organic revenue growth and QoQ improvement in its 12-month order backlog resulting in revenue visibility. The upward trajectory in organic revenue growth and better absorption of overhead costs has resulted in gradual albeit consistent improvement in the company's EBITDA margins. The ratings continue to factor in its strong financial flexibility, given the moderate debt on its books and robust liquidity position reflected in the cash and cash equivalents of ~Rs. 243.6 crore as on March 31, 2019 and the market value of its investments in Majesco USA of ~Rs. 246 crore as on March 31, 2019. Mastek's entry into the US market through the inorganic route (acquisition of TAISTech Group¹ in December 2016), has helped to diversify its revenue mix, apart from improving its scale and providing opportunities in the largest market in global IT services. The ratings also favourably factor in its strong presence in Government and retail verticals and client acquisition in the financial services vertical, which has aided its organic revenue growth.

The ratings remain constrained by the uncertainty around the Brexit outcome which could impact the company's near-term performance as also reflected in the first sequential quarterly revenue decline during Q1 FY2020. The company has limited diversification with the key verticals of Government and retail contributing to around 78% of its total revenues. Furthermore, the company generated approximately 58% of its revenues in Q1 FY2020 from the top-ten clients, thus any client exit may have an adverse impact on its revenues and profitability. The United Kingdom (UK) market contributed 72.9% of its revenues followed by US market with 25.5% and India with 1.6% in Q1 FY2020. Mastek remains exposed to any adverse changes in the regulatory environment in its key markets of the US and the UK apart from changes in the macro-economic environment. The ratings are further constrained by margin pressures caused by forex fluctuation, especially the pound vs rupee fluctuation. However, the company's policy of hedging a good portion of its receivables provides comfort. The ratings also factor in the challenges from intense competition with the larger Indian IT services companies and other small and mid-sized companies in the respective markets. Mastek's ability to sustain organic revenue growth and consequently profitability improvement will remain crucial. Additionally, in case of future acquisitions given its intent, ICRA will have to analyse the same for any bearing on its credit risk profile.

¹Three companies belonging to the same Group—TaisTech LLC, USA, Trans American Information Systems Inc. USA, and Trans American Information Systems Private Limited
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Key rating drivers and their description

Credit strengths

Vertical-focused company, targeting Government and retail space - The company has a strong track record in Government and retail verticals with each contributing 40% and 38% of the total sales, respectively, in Q1 FY2020. 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 existing systems and create new systems post Brexit, which will provide significant growth opportunities for the company. Also, the company has added Police and Defence departments under its portfolio in FY2019. In addition, the continued unbundling of large projects into smaller ones, which are awarded to SMEs is a positive for the company. Furthermore, opportunities in digital commerce in the retail space in the US and in the UK, augurs well for its growth prospects.

Increased presence in North America post-acquisition of TAISTech Group in December 2016 - The contribution of revenues from North America increased from 3% in Q3 FY2017 to 25.5% in Q1 FY2020. Mastek, after the acquisition of TAISTech has presence in digital commerce enabling implementations and support for the Oracle ATG and Oracle Commerce Cloud applications.

Sequential improvement in profitability leading to strengthening of liquidity position - The operating margins of the company have been improving QoQ owing to an increase in revenues leading to better absorption of fixed overheads and various operational efficiency measures undertaken.

Favourable financial profile given the low debt on the books, and healthy cash and cash equivalents - Apart from comfortable cash generation from operations, the company as on March 31, 2019, had cash and cash equivalents of ~Rs. 243.6 crore compared to a debt of ~Rs. 69.6 crore. In addition, it has a ~12% stake in a listed entity, Majesco USA, valued at ~Rs. 246 crore as on March 31, 2019.

Credit challenges

Uncertainties in the macro environment and limited revenue diversity - Mastek remains exposed to any adverse changes in the macro-economic and regulatory environment in its key markets of the US and the UK, which could put pricing pressure and impact its margins. Greater clarity around the Brexit outcome would be also be a rating driver. The company has limited diversification in the key verticals of Government and retail contributing to around 78% of its total revenues. Furthermore, the company generated approximately 58% of its revenues in Q1 FY2020 from the top-ten clients, thus any client exit may have an adverse impact on its revenues and profitability.

Exposure to foreign currency fluctuations, though the policy of hedging a large portion of its receivables provides comfort - Most of the revenues of the company is in foreign currency (GBP and US dollar), exposing it to foreign currency fluctuations. However, as per the company ~70% of their revenues is from onshore operations which provides a natural hedge to the company and the company's margins are protected to that extent. Also, the company hedges a good portion of its net receivables through forward contracts as part of its hedging policy.

Exposed to intense competition: The company 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 - Any acquisition, given its intent, ICRA shall have to analyse the same for any bearing on its credit risk profile.

Liquidity position: Superior

Mastek's liquidity comprises about Rs. 93.4 crore of cash and bank balance and Rs. 150.2 crore of liquid investments in the books as on March 31, 2019, i.e. a total of Rs. 243.6 crore of cash and equivalents. Additionally, the company at a consolidated level, holds ~12% stake in Majesco US, through its subsidiary Mastek UK, the market value of which is Rs. 246.0 crore as on March 31, 2019. The company has plans to monetise the stake in the near-term which provides significant comfort on the liquidity front.

Rating sensitivities

Positive triggers- ICRA could upgrade Mastek's rating if there is sustained improvement in business profile supported by further increase in scale and meaningful diversification of revenues across business segments.

Negative triggers- Negative pressure on Mastek's rating could arise if revenue growth become stagnant due to the impact of Brexit with substantial decline in profitability. Also, weakening of TD/TNW above 0.5 times (due to any significant debt-funded acquisition) would exert negative pressure on the company's rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for Information Technology (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 involved in providing enterprise solutions, focusing on vertical including 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, application security, customer relationship management (CRM) services and legacy modernisation. In December 2016, Mastek acquired the TAISTech Group, a digital commerce services player who provides strategic consulting, commerce implementations and support for the Oracle Commerce and Oracle Commerce Cloud applications to retail players in the USA. The company is headed by Mr. John Owen, who is the Group CEO, and the total employee strength as on June 30, 2019 stood at 2,035.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	817.2	1,033.2
PAT (Rs. crore)	70.0	101.5
OPBDIT/OI (%)	12.3%	12.8%
RoCE (%)	17.5%	19.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.3
Total Debt/OPBDIT (times)	0.7	0.5
Interest Coverage (times)	17.2	21.6
DSCR	15.3	5.5

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years					
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018		FY2017		
					13-Sep-19	3-Aug-18	21-Aug-17	1-Aug-17	7-Feb-17	20-Dec-16	24-Oct-16
1	Long term fund-based	Long Term	4.0	-	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+; removed from Rating Watch with developing implications, 'Stable' Outlook assigned	[ICRA]A+; placed on rating watch with developing implications	[ICRA]A+(Stable)
2	Short term non-fund based	Short term	9.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+; removed from Rating Watch with developing implications	[ICRA]A1+; placed on rating watch with developing implications	[ICRA]A1+
3	Long term/short term fund-based/non-fund based	Long term/Short term	6.0	-	[ICRA]A+(Positive)/[ICRA]A1+	[ICRA]A+(Positive)/[ICRA]A1+	[ICRA]A+(Stable)/[ICRA]A1+	[ICRA]A+(Stable)/[ICRA]A1+	[ICRA]A+/[ICRA]A1+; removed from Rating Watch with developing implications, 'Stable' Outlook	[ICRA]A+/[ICRA]A1+; placed on rating watch with developing implications	[ICRA]A+(Stable)/[ICRA]A1+

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]A+(Positive)
-	Short term non-fund based	-	NA	-	9.0	[ICRA]A1+
-	Long term/short term fund-based/non-fund based	-	NA	-	6.0	[ICRA]A+(Positive)/ [ICRA]A1+

Source: Mastek Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Trans American Information Systems Private Limited	100.00%	Full Consolidation
Mastek (UK) Limited	100.00%	Full Consolidation
IndigoBlue Consulting Limited	100.00%	Full Consolidation
Mastek Inc.	100.00%	Full Consolidation
TAISTech LLC, USA	100.00%	Full Consolidation
Trans American Information Systems Inc. USA	100.00%	Full Consolidation

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