

INDUSTRY IT

CMP (as on 28 Mar 2019) Rs 439

Target Price Rs 660

Nifty 11,570

Sensex 38,546

KEY STOCK DATA

Bloomberg MAST IN

No. of Shares (mn) 24

MCap (Rs bn) / (\$ mn) 11/152

6m avg traded value (Rs mn) 49

STOCK PERFORMANCE (%)
52 Week high / low Rs 645/365

3M 6M 12M

Absolute (%) (3.7) (6.3) (17.3)

Relative (%) (10.5) (12.7) (34.2)

SHAREHOLDING PATTERN (%)

Promoters 45.86

Fls & Local MFs 9.09

FPIs 9.98

Public & Others 35.07

Source : BSE

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Version 2.0

Mastek, founded in 1982, is one of the oldest IT companies in India. Mastek has experience spanning over three decades but in its current version, it's just a four-year-old organisation (Demerger with Majesco happened in 4QFY15). Mastek has transformed itself post the demerger, led by (1) Appointment of experienced and capable CEO, John Owen, in Nov-2016 (2) Direct relationship with UK Govt. vs being a sub-contractor earlier and (3) Acquisition of TAIS Tech (SI for Oracle ATG), which marks its entry in the US. Under the new leadership, Mastek has delivered healthy revenue CAGR of 32% (~23% organic) and margin expansion of ~370bps over FY17-19E.

Mastek's differentiating factors are (1) UK focus (75%), (2) Among the top vendors for UK Govt. and (3) Focus on high growth UK Retail & Financial services verticals. Under the leadership of Mr. Owen, Mastek has strengthened its relationship with UK Govt and improved operational efficiencies (Rev/emp is up 14% over FY17-TTM). Mastek is blessed with lower exposure to Legacy (Digital is ~80% of rev) but generates low-teen margins (~13%) due to higher on-site rev mix (~72% vs mid-cap avg. of ~55%). Mastek is well placed to generate revenue/EPS CAGR of 15/16% over FY19-21E (despite US softness and Brexit uncertainty) and is available at attractive valuations of 8.3x FY21E vs mid-cap avg. of ~13x. Stake in Majesco US (~Rs 79/share), net cash position (Rs 82/share) provides additional comfort. We Initiate coverage with a BUY rating and a TP of Rs 660, based on 11x FY21E EPS.

Investment rationale

- Revenue from UK Govt. (~38%) has witnessed healthy growth (CQGR of 5.7%) led by Digital outcome & Specialists (DOS) and G-Cloud policy of UK Govt.

Mastek has been one of the prime beneficiaries of the vendor de-centralisation policy of the UK Govt., which favored small vendors like Mastek (currently in Top-10 vendors). The company has long-term and sticky relationship with the UK Govt (works with Home Office and NHS Digital) and is well placed to capture the benefit of increased Digital spend. We expect 24% revenue CAGR from UK Govt. over FY19-21E.

- UK ex-Govt (~37% of rev) is powered by increased spend by Retail and Financial services vertical. This has grown at 5.2% CQGR and we don't see any risk to the growth considering small base and niche focus. We expect revenue CAGR of 14% over FY19-21E.
- US business (TAIS Tech, 24% of rev, primarily Retail) is facing issues in the Oracle ATG portfolio (~75% of US rev). There are some senior level management changes and shift of focus from Oracle ATG to Oracle Commerce Cloud (OCC). Growth will be muted in near-term. US margins are in mid single digits.
- While the margin expansion had been significant over the past three years, we don't expect further margin expansion due to on-going issues in US business (re-vamp of sales team), higher on-site hiring (UK) and supply side issues (talent crunch).

Financial Summary (Consolidated)

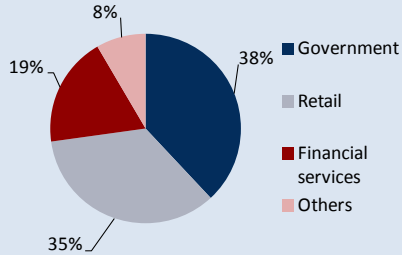
YE March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	5,602	8,172	10,313	11,686	13,496
EBITDA	509	1,004	1,317	1,507	1,758
APAT	290	700	995	1,164	1,338
Diluted EPS (Rs)	11.5	27.6	39.3	46.0	52.9
P/E (x)	38.3	15.9	11.2	9.5	8.3
EV / EBITDA (x)	20.1	9.7	7.0	5.7	4.6
RoE (%)	6.1	13.7	17.0	17.4	17.6

Source: Company, HDFC sec Inst Research

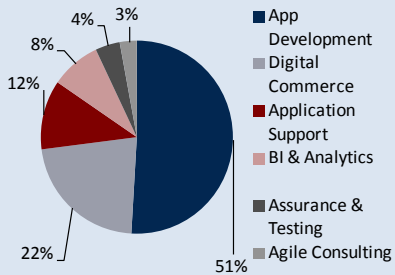
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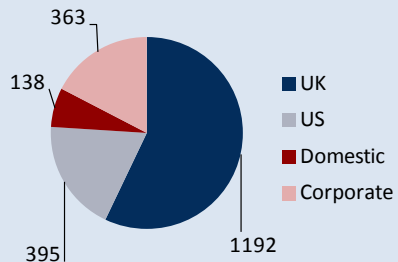
Verticals breakup (3QFY19)



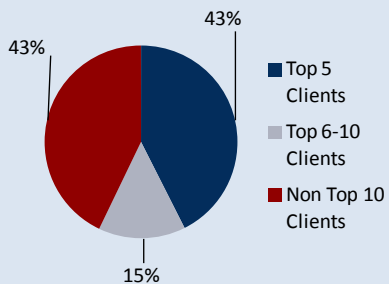
Services breakup (3QFY19)



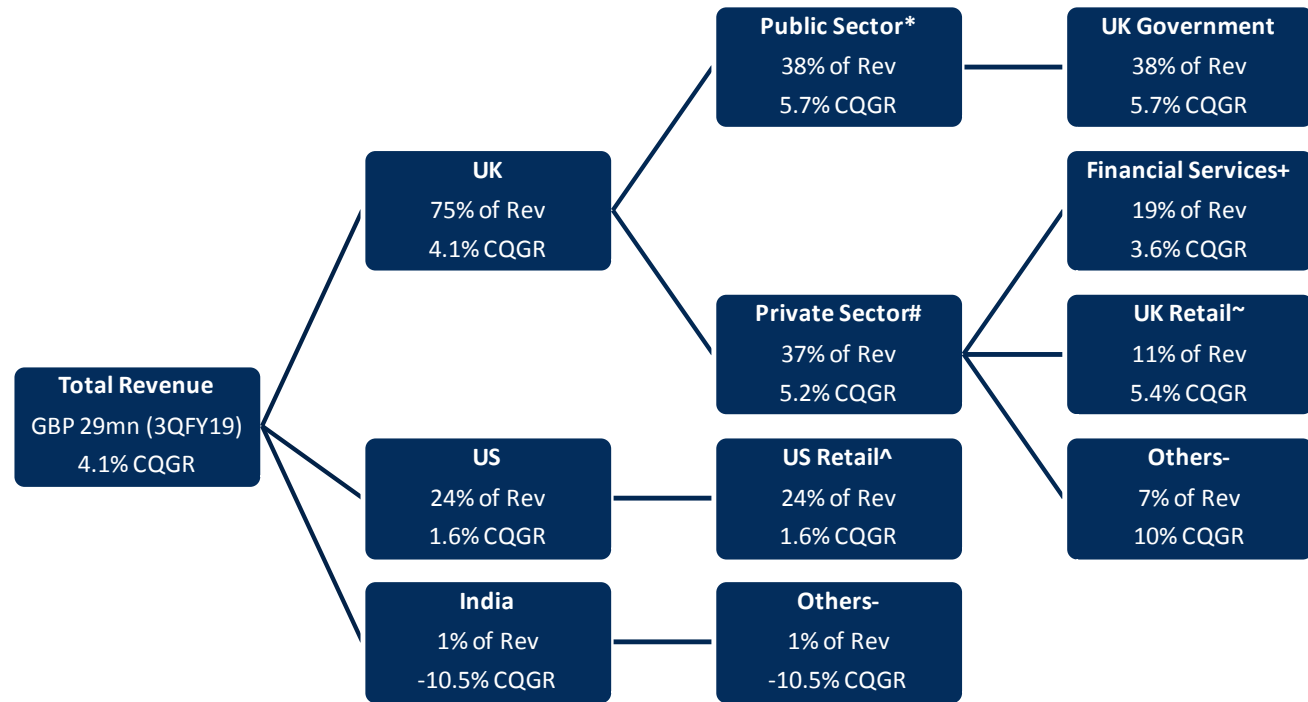
Employee Breakup (3QFY19)



Client Concentration (3QFY19)

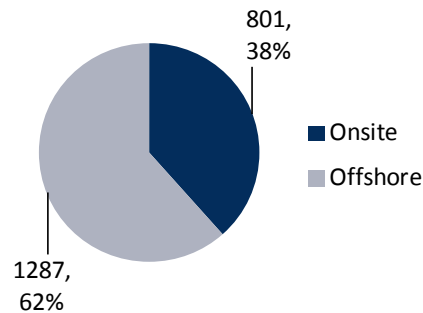


Mastek at a Glance

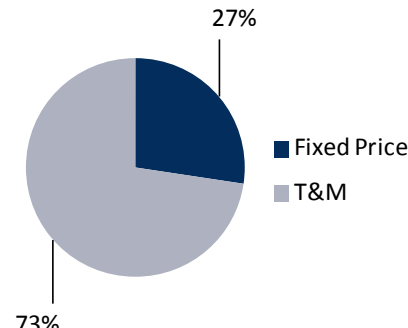


Source: Company, HDFC sec Inst Research, Based on 3QFY19 reported numbers, CQGR is for 6 quarter and is based on GBP revenues, * Public sector is based on reported Government revenue, #UK private is UK revenue minus Govt revenue, ^100% of US is assumed as US Retail, + 100% of Financial services is assumed to be in UK, ~UK retail is Total Retail minus US Retail, -Others is split between India and UK.

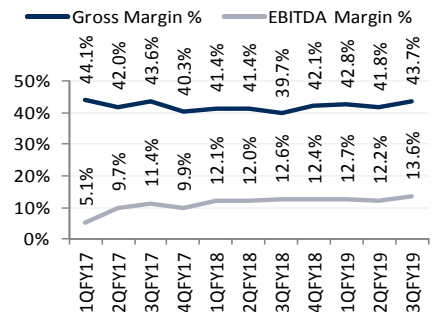
Effort Mix (%)



Revenue Mix Based On Billing Method



Margin Trend (%)



Source: Company, HDFC sec Inst Research, EBITDA margin adjusted for forex, Gross margin is (Total rev - employee expenses)/Total rev

UK geography (~75% of revenue) has been powering growth for Mastek (5.5% 6 Qtr-CQGR and 24.7% CAGR over CY16-18)

Mastek has very less exposure to legacy revenue, Digital is ~80% of revenue

According to Tech Market view, UK SITS market growth is set to accelerate led by Digital

UK: Mastek's key market

- UK's Software & IT Services (SITS) spend (Public + Private) is ~GBP 47bn, out of which digital spends is ~23% (~GBP 11bn).
- The total SITS spend growth was 1.7% for CY18 out of which Digital growth was 27.5% while legacy de-grew 6.2% in CY18.
- UK public sector spend is ~25% of total UK IT spend (~GBP 11.5bn). Digital for Public sector would be ~23% Digital (similar to total digital proportion). Private sector spend is ~75% of total spend, i.e. ~GBP 35.5bn.
- Mastek has presence in both Public and Private sectors. Mastek derives ~75% of its revenue from the UK region (Public + Private) and has grown at a CQGR of 5.5% over the last six quarters (24.7% CAGR over CY16-18).

- ~38% of Mastek's revenue is from the UK Government and ~37% from UK private sector (primarily Financial Services and Retail).
- UK Public/UK Private has grown at a strong six quarter CQGR 5.7/5.2% and CAGR of 20.9/28.7% over CY16-18 respectively.
- Mastek's participation in UK Public & Private sector spending is largely for Digital contracts. Mastek has very less exposure to legacy, Digital is ~80% of revenue.
- According to Tech Market view, UK Digital spending is growing at ~30%, while legacy spend is shrinking by ~5%.

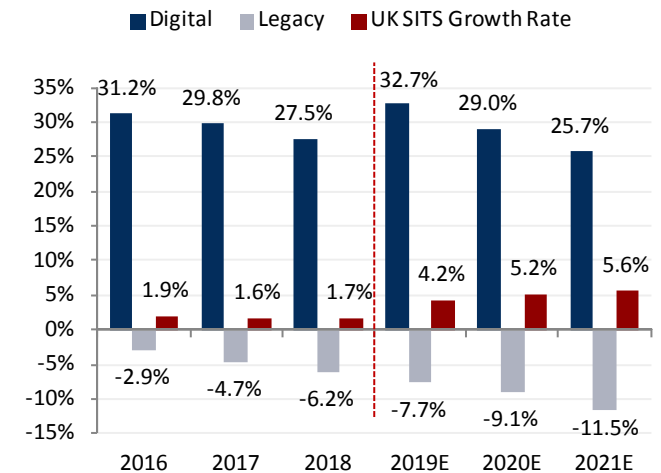
UK SITS Spend Split (Public + Private)

Segment*	GBP bn
Digital	5.7
Platform	3.9
Cyber security	1.3
Legacy	36.1
Total	47.0

Digital is 23% of the Total SITS Spend for the UK region which is growing at ~30%.

Legacy is de-growing at ~5%

UK SITS Growth Rate (%)

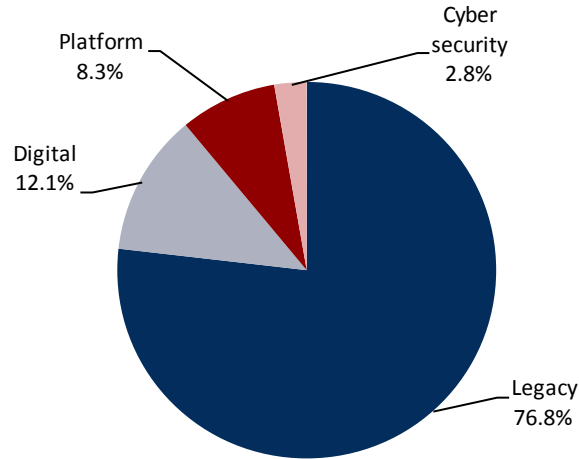


Source: Tech Market View, HDFC sec Inst Research , * CY17

Source: Tech Market View, HDFC sec Inst Research

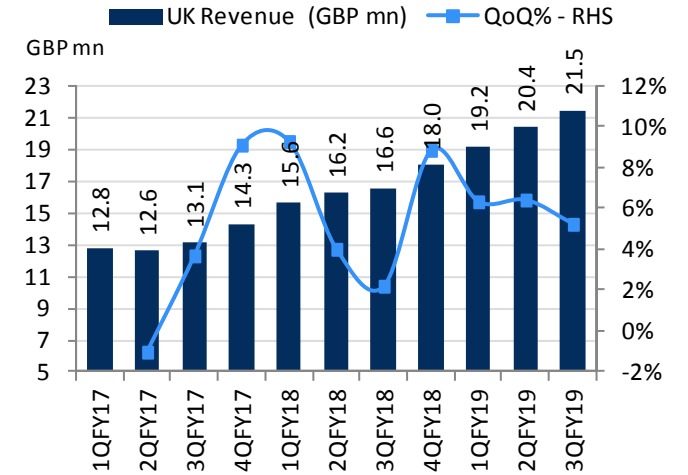
John Owen joined Mastek in Dec-16, acceleration in UK revenues post 4QFY17 (6% CQGR 4QFY17-3QFY19)

UK SITS Spend Split (Public + Private)



Source: Tech Market View, HDFC sec Inst Research

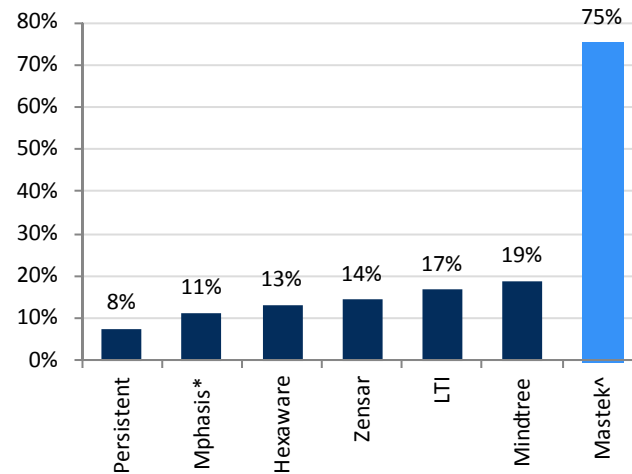
UK Revenue And Growth Rate (+26% YoY in CY18)



Source: Company, HDFC sec Inst Research

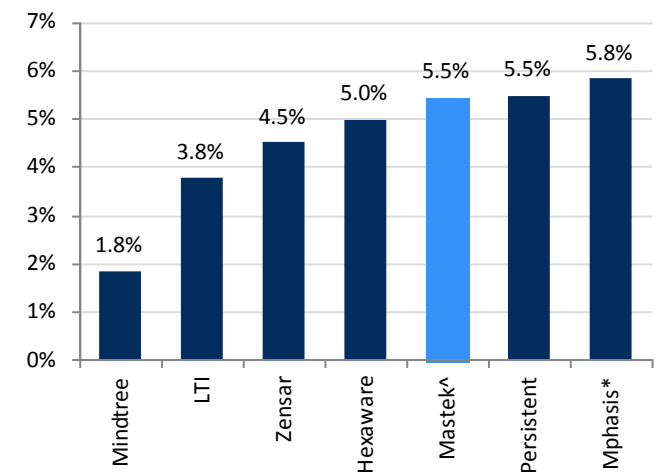
Mastek leading among Tier-2 IT in terms of Europe (UK) concentration and Growth

Europe As a % of Revenue For Tier-2 IT



Source: Company, HDFC sec Inst Research, 3QFY19, *includes ME & Africa, ^ Mastek is only UK

Europe 6-qtr CQGR Growth For Tier-2 IT (%)



Source: Company, HDFC sec Inst Research, *includes ME & Africa, ^ UK and growth is based on GBP revenues

Policy level changes at UK government to drive Digital IT spending with reduced vendor concentration

There are total 364 vendors in the UK Govt. DOS framework

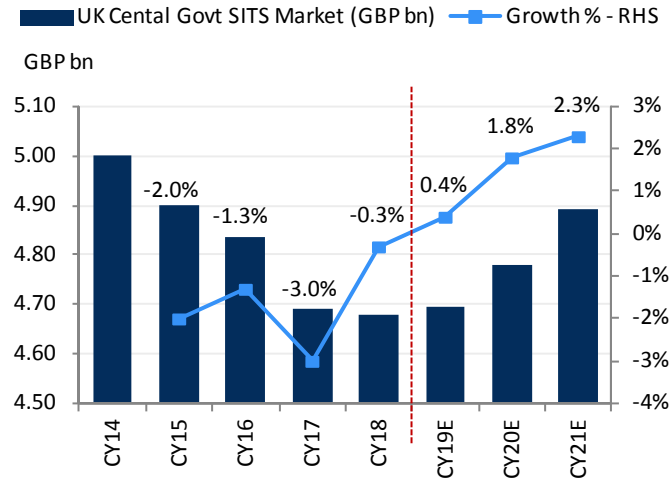
Mastek works closely with Home office and NHS digital departments of UK Govt.

UK Public Sector: Propelling growth

- UK public sector's Software and IT Services (SITS) spend market is ~GBP 11.5bn out of which central government spend is ~GBP 4.7bn. UK's central government IT spend was earlier dominated by large scale IT companies. In 2010, ~8 large vendors dominated ~80% of IT spend. Nature of spending was long duration (~10 years) legacy outsourcing deals.
- UK government realised the problem of vendor concentration and decided to bring it down. This led to initiatives like 1) renegotiation of legacy outsourcing contracts with reduced pricing, and 2) Insourcing. As a result, UK public sector IT spend was shrinking during CY14-18. As per Tech Market view estimates, UK Central Govt SITS spend will grow 0.4/1.8% in CY19/20E.
- Over a period of time there were policy level changes for UK's government tech spending which included steps like 1) Expansion of number of vendors by procuring IT services from a wide pool of vendors (including SMEs) through digital market place, 2) Disaggregation of contracts to short duration contracts (max 2 years), 3) 'Digital by default' and 'Cloud First' approach while giving out contracts.
- New policy framework is favorable for small/mid-scale IT companies as it provides them with a fair playing field to compete with Tier-1 players.
- Mastek has a long-standing relationship with UK government as it was working as a subcontractor to the large IT companies for execution of UK government's projects earlier. Mastek has a track record of delivering ~95% of the projects on-time and within the budgets. This long-term relationship and excellent execution capabilities make Mastek a prime beneficiary of UK Govt Digital spends.
- Mastek is well positioned to chase UK's public sector tech spending as 1) Mastek is currently working with 13 government departments on 20 projects, this provides Mastek a good reference to get further government contracts 2) Mastek is working closely with UK government and is one of very few Indian IT vendors (in Top-10) providing cost-effective solutions 3) Mastek carries no wallet share concentration and has low legacy contracts in its portfolio.

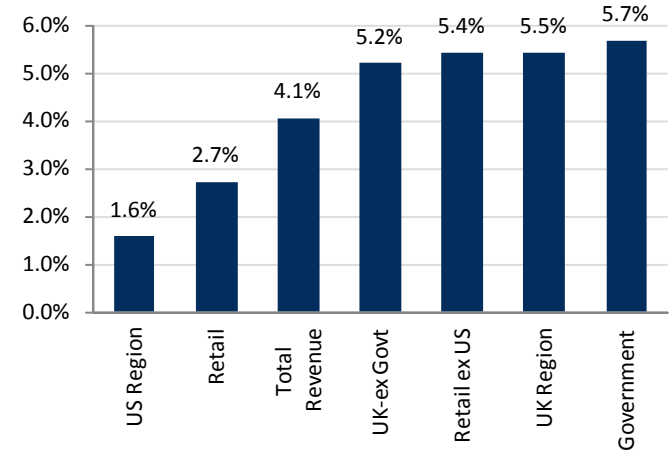
As per Tech Market View, UK central government SITS spending is expected to accelerate from CY19

UK Central Govt SITS Market Growth



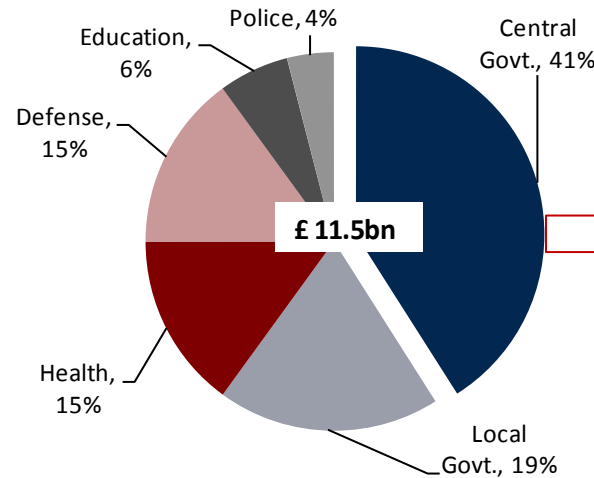
Source: Tech Market View, HDFC sec Inst Research

Mastek Revenue Segments 6-Qtr CQGR (%)



Source: Company, HDFC sec Inst Research, Growth rates calculated on GBP revenue

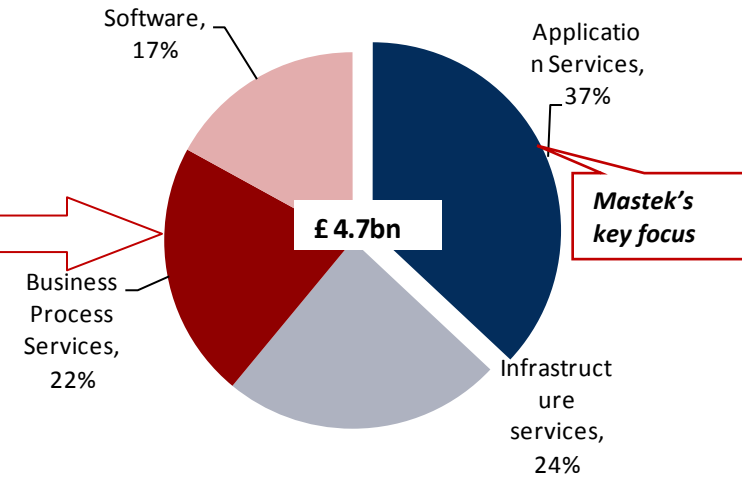
UK Public Sector SITS Market Spend Mix



Source: Tech Market View, HDFC sec Inst Research

37% of Central government spend (~GBP 1.7bn) is in Application services which is Mastek's core service line

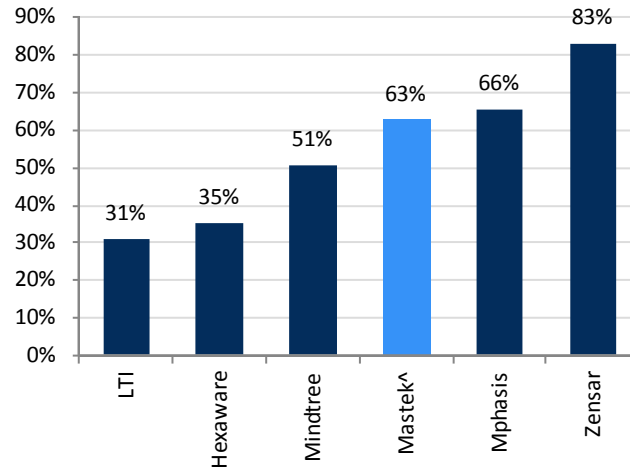
UK Central Government SITS Services Mix



Source: Tech Market View, HDFC sec Inst Research

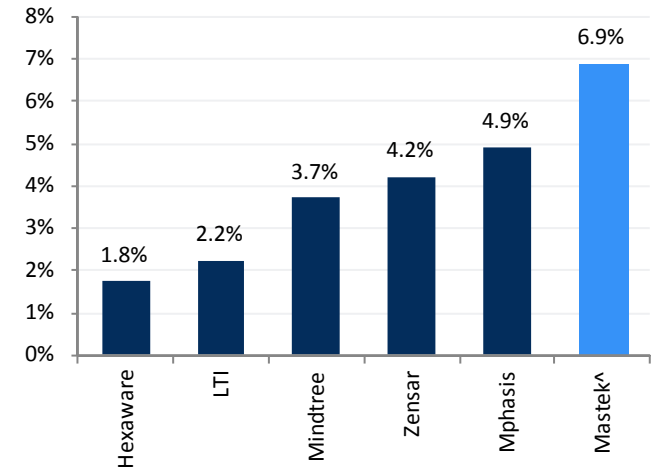
Application development, Mastek's core service line, has posted strong of 6.9% 6-Qtr CQGR

Application Services % Of Revenue for Mid-cap IT



Source: Company, HDFC sec Inst Research, ^ calculated on GBP revenues, App services is ADM + App support and maintenance

Application Services: 6-QTR CQGR %



Source: Company, HDFC sec Inst Research, ^ calculated on GBP revenues

In CY18, Mastek ranked 9th in DOS with a wallet share of GBP 20.4mn and 16th in G-cloud with a wallet share of GBP 12.6mn

Mastek's market share in DOS spending stood at ~4% for CY18

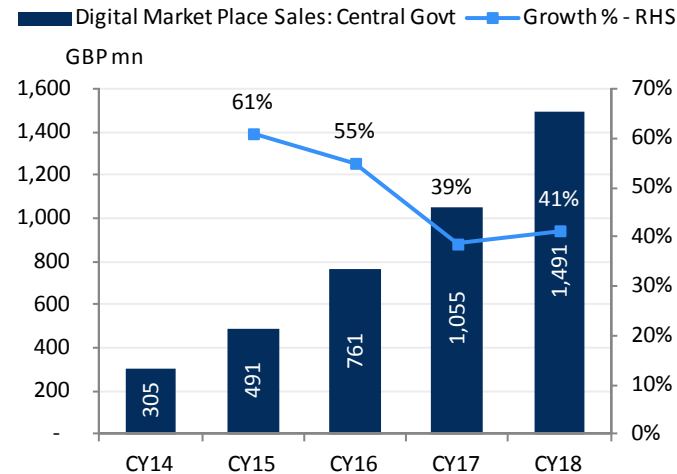
The central Govt spend in the Digital market place is ~GBP 1.5bn (~85% of Total Digital market place spend DOS+ G-Cloud)

The proportion of Digital component spend in the Central Government spend has increased from 15.7% in CY16 to 31.9% in CY18.

UK Government's Digital spend

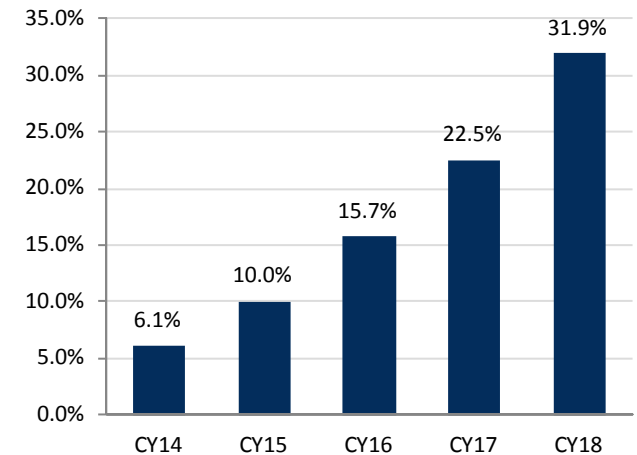
- UK Government's Digital IT spends is routed through the Digital Market Place. The total Digital Market Place spend was GBP 1.7bn in CY18 and has grown at a CAGR of 47% over CY15-18. The UK Govt Digital spend is categorized under two segments, (1) G-Cloud and (2) Digital Outcome & Specialist (DOS) framework.
- G-Cloud: UK Government follows 'Cloud First' approach, mandating IT services spend to be through Cloud, which is more cost effective. The total spend on G-Cloud is ~GBP 1.2bn and has grown at a CAGR of 29% over CY15-18. The G-Cloud composition in the total Digital spends is 67.6% in CY18, which has come down from 98.5% in CY15 after the launch of DOS framework.
- Digital outcome & Specialists (DOS): UK Government follows a Digital by default strategy which outlines the Digital transformation roadmap for the Government. The DOS strategy focuses on enhancing the digital experience for UK's citizens. The total spend on DOS is ~GBP 0.57bn and has grown 193% in CY18. The DOS composition in the total Digital spends has increased from 1.5% in CY16 to 32.4% in CY18.
- UK's public sector IT spending is well-diversified across vendors. There are total of 364 vendors which were awarded contracts in the DOS framework and Mastek is in the top-10 vendors in terms of value of contracts awarded with 4% market share.
- Mastek is only Indian IT company among Top-10 vendors in UK DOS spend category.

Digital Market Place Growth: Central Government



Source: Tech Market View, UK Govt, HDFC sec Inst Research

Digital As a % of UK Central Govt SITS Spend



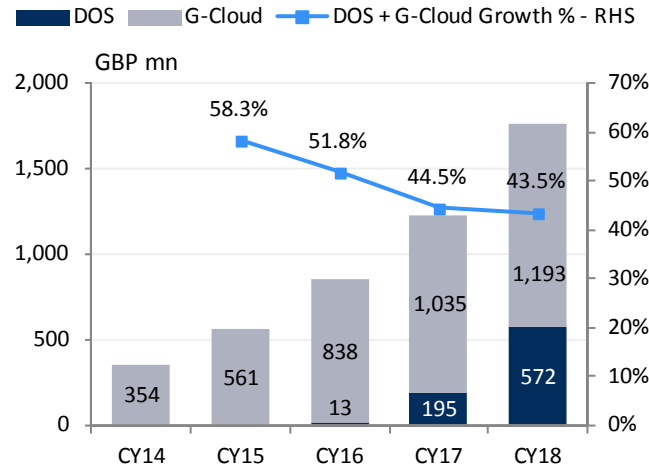
Source: Tech Market View, UK Govt, HDFC sec Inst Research

Mastek's revenue from the UK Govt Digital marketplace was ~GBP 33mn (~30.4% of CY18 revenue) and has grown at a CAGR of 24% over CY15-18

Mastek's focus is on the DOS framework of UK government

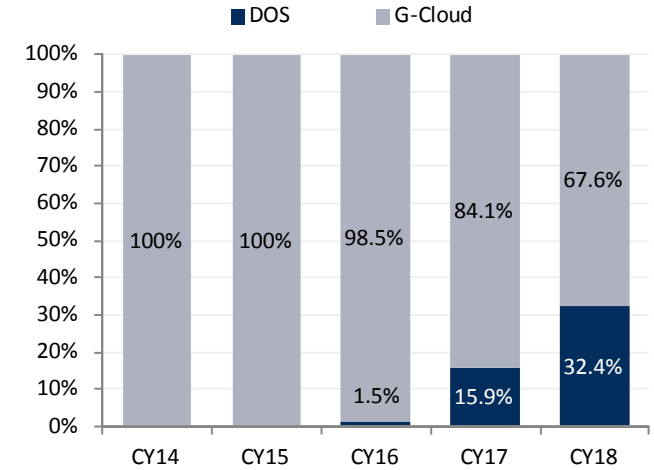
DOS is 19% and G-Cloud is 12% of CY18 revenue for Mastek

UK Govt Digital Spend (DOS + G-Cloud)



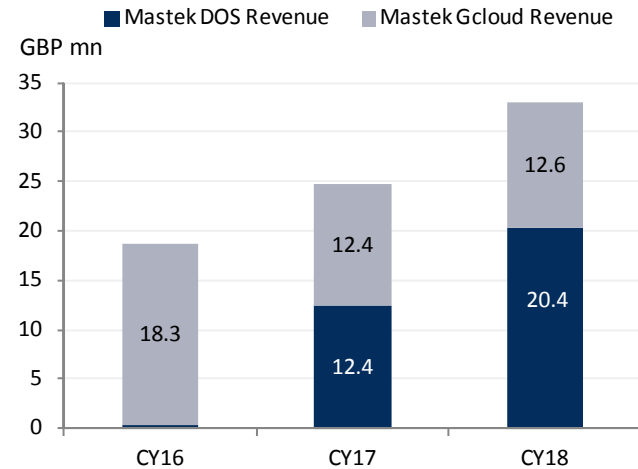
Source: UK Govt, HDFC sec Inst Research

DOS And G-Cloud Mix For UK Govt



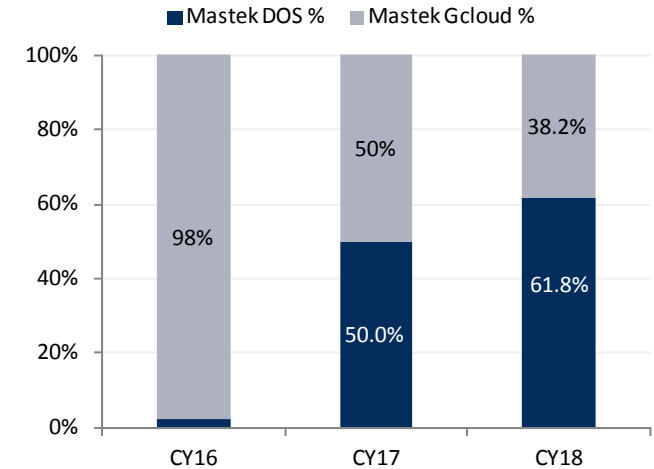
Source: UK Govt, HDFC sec Inst Research

Mastek's Revenue from DOS & G-Cloud Based on Contracts Awarded from Various UK Govt. Depts.



Source: UK Govt, HDFC sec Inst Research

DOS And G-Cloud Mix For Mastek, DOS Proportion Increasing Significantly



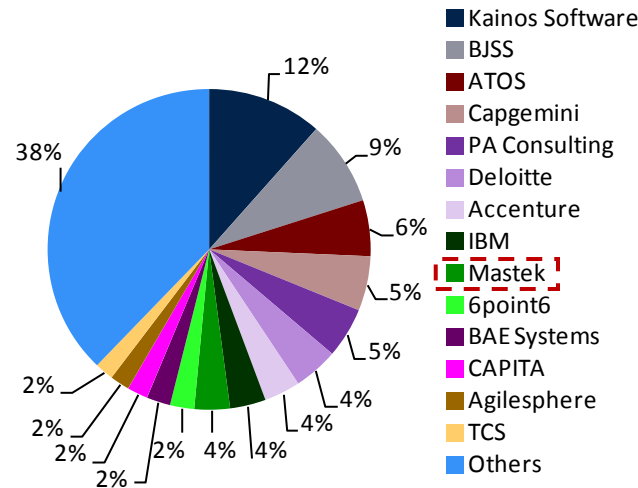
Source: UK Govt, HDFC sec Inst Research

Home office is the largest contributor for Mastek's DOS (GBP 9.8mn in CY18) and G-cloud business (GBP 10.3mn in CY18)

Mastek has ~4% Market Share in DOS Framework, and is ranked 9th as per CY18 spend

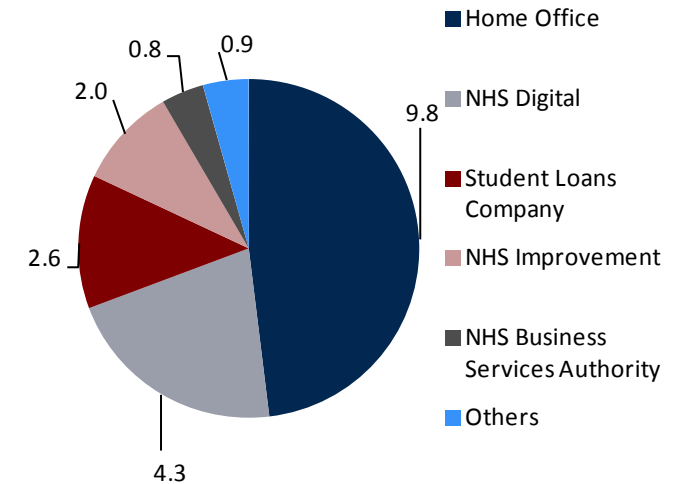
Mastek has ~1% Market Share in G-Cloud Framework, and is ranked 17th as per CY18 spend

Market Share in DOS Framework



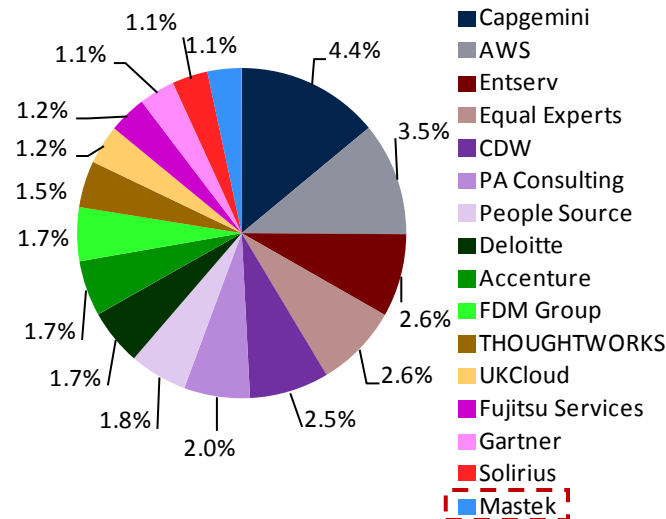
Source: UK Govt, HDFC sec Inst Research, as per data for CY18

Mastek's DOS Revenue from UK Govt. departments for CY18 (GBP mn)



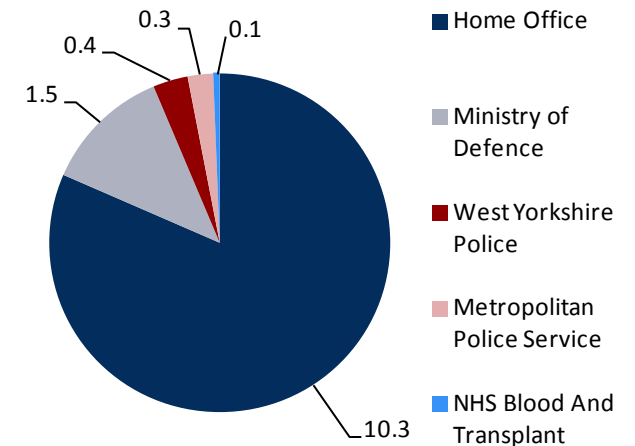
Source: UK Govt, HDFC sec Inst Research, as per data for CY18

Market Share in G-Cloud Framework



Source: UK Govt, HDFC sec Inst Research, as per data for CY18

Mastek's G- Cloud Revenue from UK Govt departments for CY18 (GBP mn)



Source: UK Govt, HDFC sec Inst Research, as per data for CY18

Mastek's operation in UK private sector is focused on select verticals, i.e. Financial Services & Retail

Well placed in UK Private sector

- Mastek's Private sector UK portfolio (~35% of its rev) is primarily focused on two verticals (1) Retail and (2) Financial services.
- Mastek has consciously focused on these two verticals and has been successful in growing revenue at 5.2% CQGR over the past six quarters.
- Retail ex-US and Financial Services has grown at a 6-qtr CQGR of 5.4/3.6% in GBP terms respectively. Mastek in UK is working with microfinance and personal finance companies for their digital transformation. Some of them have been listed in the table below.
- According to House of Commons Library paper on Retail sector in UK, *"Internet retailing is more popular in the UK than in any other EU country. In Jan 2008, internet sales accounted ~5% of Retail sales. In Aug 2018, internet sales accounted for ~18% of Retail*

sales". It's a well-established trend that, Retail and Financial services sectors are one of the most disrupted and highest spenders on Digital technology.

- As per our estimates, Mastek has a UK retail portfolio of ~GBP 41mn for TTM (~10% of rev) and has grown 34.9% in CY18.
- We like Mastek's strategy of focus on select verticals for digital services, this is further assisted by IndigoBlue (acquired in 2015), an agile consulting firm which supports Mastek's consulting capabilities to compete for consulting led digital business.
- We expect Mastek UK (ex-Govt) growth to continue considering its vertical focus and smaller size. The market opportunity is immense and Mastek has a lot of room to grow with the space. We expect UK ex-Govt to grow at a CAGR of 17% over FY18-21E.

Mastek's Client List

Government		Retail		Financial Services	
Department	Region	Client	Region	Client	Region
Home Office	UK	Morrison's super market	UK	International Personal Finance	UK
Metropolitan Police	UK	Lululemon athletic	UK	Yorkshire Building Society	UK
NHS Digital	UK	Specsaver	NorthAm	Together	UK
NHS Improvement	UK	Rue 21	UK	Student Loan Company	UK
Ministry of Justice	UK	BrandsMart USA	NorthAm	European Bank	UK
Ministry of Defense	UK		NorthAm		

Source: Company, HDFC sec Inst Research

US revenues are largely (~75% of US rev) from channel partner (Oracle)

Business changes at Oracle have caused challenges in US revenues for Mastek

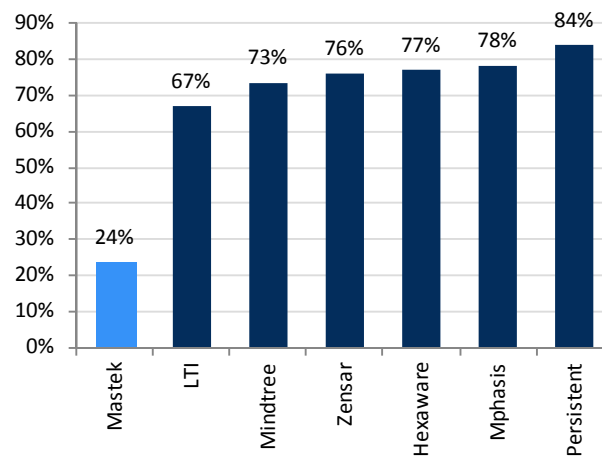
US business: Near term challenges

- Mastek entered the US geography in Dec-16 by acquiring TAIS Tech, an IT services company specialising in implementation & support for Oracle Commerce (ATG & Endeca) and Oracle Commerce Cloud (OCC). Consideration for the transaction was USD 25mn (~0.83x rev).
- Mastek’s US revenues are through Oracle channel (Oracle ATG at ~75% of US revenue), Mastek aims to make its US portfolio less dependent on Oracle.
- For portfolio diversification, Mastek is on-boarding more partners (Salesforce) and engaging with clients (via Oracle channel) for independent projects.
- US revenue is witnessing de-growth for the past couple of quarters (-1.9/-9.1% QoQ in 2Q/3Q FY19) which is largely due to Oracle withdrawing support to its ATG product in Oct-18. TAISTech was mostly dependent on the partner network sales channel rather than independent sourcing. This impacted

their ATG business post withdrawal of Oracle support for ATG.

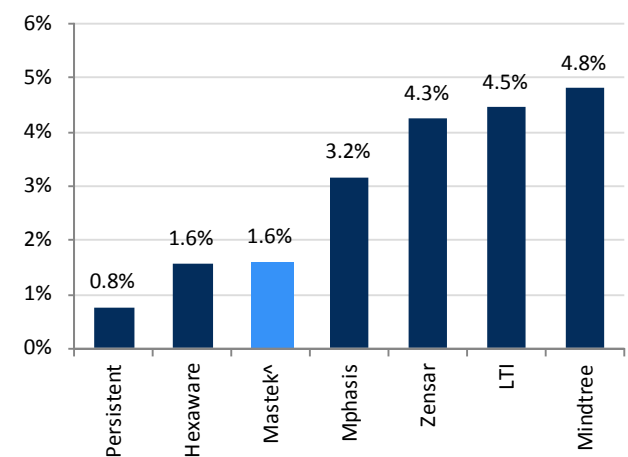
- Large Retail enterprises on Oracle ATG would have three options (1) Continue to operate on Oracle ATG as they have already spent huge dollars or (2) Self management with support from small vendors like Mastek, which can provide micro services around existing product or (3) Shift to OCC (Mastek may get implementation contract for OCC).
- The co-founder of TAIS Tech, who was heading the US operations has stepped down in Feb-19. He will be replaced by a new sales head and re-purposing of SG&A expensing will happen in the US geography.
- Mastek is revamping its business strategy in US given the business changes at Oracle & exit of senior leadership in US. We expect US revenues to remain muted for a couple of quarters, investments in sales engine may put some pressure on margins.

US as a % of Revenue



Source: Company, HDFC sec Inst Research, 3QFY19

US 6-qtr CQGR growth (%)



Source: Company, HDFC sec Inst Research, ^ calculated on GBP rev

Brexit: Risk or Opportunity?

- Mastek has a UK heavy portfolio (~75% of its rev); which exposes Mastek to the current Brexit issue, which can either be a positive or negative.
- There is uncertainty around the outcome of Brexit, and post Brexit (or maybe No Brexit) the impact on IT sector would largely depend upon what model does the UK adopt for its relationship with EU.
- Management commentary as per Annual Report stated *“While in the UK, economic activity is likely to be subdued owing to uncertainty over the outcome of Brexit negotiations, the withdrawal of UK from the European Union offers significant opportunity for Mastek. Over 27 new government departments will be created all requiring digital platforms and an experienced software engineering partner able to deliver mission-critical applications. Further, there’s*

already a shortage of approximately 69,000 engineers a year in the UK which will be exacerbated by Brexit.”

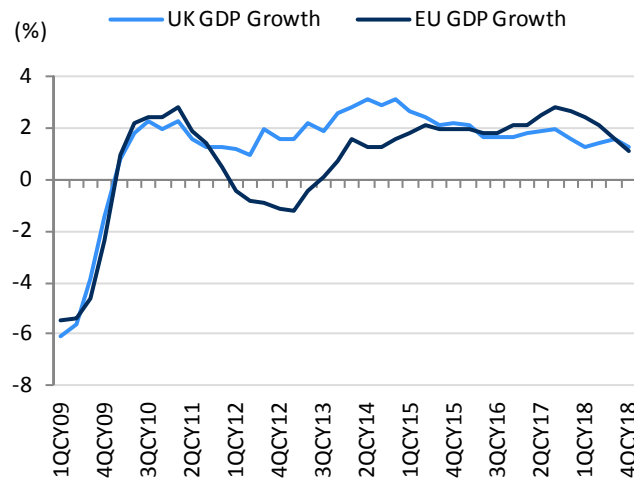
- Creation of new government departments and re-alignment of existing government process may result in additional tech spending in UK Public sector, which is largest revenue contributor for Mastek.
- European Union (EU) is the largest trading partner of UK (EU accounts for ~44% of total UK exports)
- Negative impact of Brexit can be 1) Likely slowdown of UK economy and lower tax collections may decelerate their IT spend 2) Depreciation of GBP can impact INR revenue realisation for Mastek, 3) Companies shifting their base from UK to Europe to gain access to European market. We believe that Mastek presence in UK Govt contracts are in critical departments like Home Office (Immigration & Biometrics) and NHS Digital (Healthcare) and spending going down immediately is very un-likely.

Key dates to watch for Brexit:

April 12, 2019: When a no-deal Brexit could be triggered if UK Parliament does not accept a deal till then.

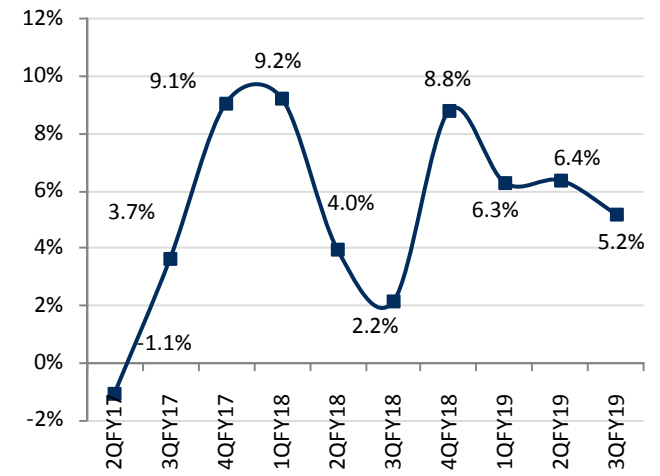
May 22, 2019: A short extension for Brexit, if UK parliament accepts a deal

GDP Growth Trend UK vs. EU YoY (%)



Source: Bloomberg, HDFC sec Inst Research

Mastek's UK Revenue Growth Trend: QoQ (%)



Source: Company, HDFC sec Inst Research

In 2014 post demerger from Majesco, Mastek lost its US presence

Mastek regained presence in US by acquiring TAIS Tech in Dec-16

Company background

- Mastek was founded in 1982 by college batch-mates Ashank Desai, Ketan Mehta and R. Sundar who were later joined by Sudhakar Ram.
- Post demerger of Majesco in 2014, Ketan Mehta operated as CEO of Majesco while Sudhakar Ram continued as Mastek CEO.
- Although Mastek has inherited experience of over three decades, but the Mastek in existence today is just a four-year-old organization. Post demerger of Majesco, Mastek lost its presence in US and Insurance segment (~50% of its rev before demerger).
- Mastek re-instated its presence in US by acquiring TAIS-Tech, a US based digital commerce company and SI for Oracle web commerce products.
- In Nov-16, John Owen was appointed as CEO of Mastek while Sudhakar Ram (Vice-Chairman & MD) and Ashank Desai (Non-Executive Director) continued on the Board of Directors of Mastek.
- Post appointment of John Owen, Mastek has transformed itself from operating as an IT sub-contractor to independently sourcing transformation projects from the UK Government.

Mastek Timeline

1982	Incorporated by name of Management & Software Technology Pvt. Ltd.
1991	Name changed to Mastek. Mastek acquired Carter Cast Systems, a UK IT company
1991	Mastek got listed
1992	Founded US subsidiary MajescoMastek
2003	Engaged by BT Global services to work on UK NHS project
2005	MajescoMastek acquired Entegram LLC a Connecticut (US) based software company
2008	MajescoMastek acquired Vector insurance services focusing on L&A insurance in NorthAm
2008	MajescoMastek acquired Systems Tasks Group focusing on P&C insurance in NorthAm
2009	MajescoMastek entered Canadian Market
2010	MajescoMastek acquired SEG Software LLC, provider of policy admin systems for Health & L&A insurance products
2014	MajescoMastek demerged from Mastek consolidating all insurance business under Majesco
2015	Mastek acquired IndigoBlue, UK based consulting firm
2016	Mastek acquired TAISTech, US based digital commerce company and John Over joined as CEO
2017	Corporate HQ moved from Mumbai to Reading, UK

Source: Company, HDFC sec Inst Research

John Owen joined Mastek in Nov-16 from Serco (Public services provider), he was Sales & Marketing Director and his responsibilities included handling the UK Govt. (Serco's largest customer)

Key Management Profile

Name	Designation	Educational background	Brief details
John Owen	Group CEO	Stanford University Graduate school of Business (Executive Program) Business studies & Marketing, University of Central Lancashire	John Owen joined Mastek in Nov 2016 and has over two decades of sales and marketing experience. He held senior leadership roles in HP, Nortel and Serco, as well as successful start-ups such as Sycamore Networks. Prior to Mastek, John was the Sales and Marketing Director for Serco PLC (Rev GBP 2.8bn) where his responsibilities included UK Govt (Serco's largest customer).
Abhishek Singh	Group CFO	MBA, I.M.D.R B.Com, Patna University	Abhishek handles Finance and IR functions at Mastek. He has two decades of experience in IT, Healthcare, Financial Services and BPM industries across both India and the United States. He has served in organisations like First Source and Tech Mahindra.
Prahlad Koti	MD UK	MBA, London Business School B.E, Computer science, BDT College of Engineering	Prahlad is responsible for Mastek UK's strategic plans. He manages the UK P&L. Prahlad has been associated with Mastek for over 25 years.
Hiren Shah	Senior Vice President of Service Lines	B.E, Sardar Patel College of Engineering	Hiren leads the technology service delivery team and drives the P&L and pipeline for service line growth. Prior to Mastek, he led high-ROI projects across India, Europe and the United States in his 30-year career.
Joe Venkataraman	Group Corporate Development Officer	PhD, Operations Research, IIM Calcutta	Joe holds responsibility for long-term strategy, UK P&L and health & viability of operations.
Maninder Kapoor Puri	Group Chief People Officer	English HNS, Delhi University	Maninder looks after at all aspects of HR practices and operations. Prior to Mastek, she held global human resource roles in organisations such as First Source Solutions, ICICI OneSource, Accenture and I-Gate Solutions.

Source: Company, HDFC sec Inst Research

Financials & Valuation

Revenue

- We forecast 15% GBP revenue CAGR over the FY19E-FY21E. This, we expect, will be led by traction in the digital, particularly in UK public sector.
- We also expect strong growth in the UK private sector led by Financial services and Retail (offset by sluggish growth in US Retail sector).
- De-growth is assumed for US in FY20E (-4.3% YoY) due to change in business of channel partner (Oracle). For FY21E, we expect sales & marketing investment coupled with management changes to aid Mastek post a moderate growth in US for FY21E (+4% YoY).
- We expect GPP revenue to touch GBP 128.4mn in FY 20E and GBP 148.3mn in FY21E, with revenue growth of 13.9% in FY20E and 15.5% in 21E.

Profitability

- We forecast EBITDA margin to remain flat on 1) Onsite hiring pipeline in UK which will keep utilisation muted 2) Higher sales expense, particularly in US. We expect EBITDA margin of 12.8/12.9/13.0% in FY19E/20E/21E.
- In absolute terms, we expect EBITDA to clock a 15.5% CAGR over FY19E-FY21E (Rs 1,317mn in FY19E to Rs 1,758mn in FY21E).
- We expect Mastek to achieve a healthy 16% EPS CAGR over FY19E-21E, in line with EBITDA growth.

Return ratios to remain healthy

- Mastek earns healthy return on invested capital (RoIC) of 34% for FY19E. Return on equity (RoE) of 17% and return on capital employed (RoCE) of 16%

are suppressed as a large part of capital is employed in cash & non-core investment (Majesco US).

Majesco stake monetisation

- Mastek owns a ~12% stake in Majesco US which is valued at Rs 2.49bn (at current valuation) and come to Rs 79/share after taking 20% discount. Mastek is looking to monetise and utilise the proceeds for an acquisition in the range of USD 20-30mn. We believe an acquisition post recovery of organic business in US would be a fair step.

Valuation

- We value Mastek on 11x FY21 EPS which is ~13% discount to mid-cap average. The company has traded at a four-year average P/E of ~11.6X and has corrected ~19% in the last one year due to growth slowdown led by the US business and concerns around outcome of Brexit. Growth will be led by UK region (Govt+Private) and margins will remain stable at current levels. The stock is attractive at current valuation of 8.3x FY21E, high net cash of Rs 82/share and Majesco US stake valued at Rs 79/share (taking 20% discount) provides downside protection.

Valuation Table

Particulars	Per Share (Rs)
EPS (FY21E)	52.9
Target P/E (x)	11
Value of Core Business (Rs)	582
Stake in Majesco US (Rs)	98
Discount (20%)	20
Value of Stake in Majesco US (Rs)	79
Target Price (Rs)	660
Upside (%)	50%

Source: Company, HDFC sec Inst Research

Revenue Trend & Assumptions

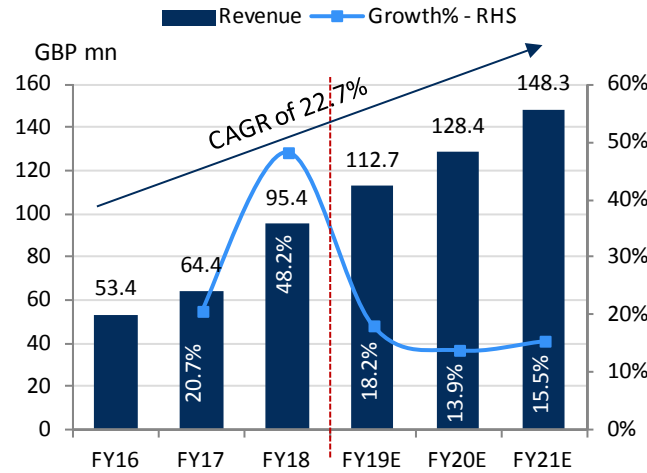
<i>GBP Mn</i>	FY16	FY17	FY18	FY19E	FY20E	FY21E	CAGR 16-18	CAGR 18-21E	CAGR 19-21E
Total Revenue	53.4	64.4	95.4	112.7	128.4	148.3	34%	16%	15%
<i>Growth YoY%</i>		20.7%	48.2%	18.2%	13.9%	15.5%			
Geography Mix									
UK	51.0	52.8	66.4	83.1	100.0	118.7	14%	21%	19%
<i>Growth YoY%</i>		3.4%	25.9%	25.1%	20.3%	18.6%			
<i>% of Rev</i>	95.6%	82.0%	69.6%	73.7%	77.9%	80.0%			
US	0.0	8.2	27.0	27.8	26.6	27.9	NA	1%	0%
<i>Growth YoY%</i>		NA	229.4%	3.2%	-4.3%	4.8%			
<i>% of Rev</i>	0.0%	12.7%	28.3%	24.7%	20.7%	18.8%			
Others	2.3	3.4	2.0	1.8	1.8	1.7	-7%	-5%	-1%
<i>Growth YoY%</i>		45.5%	-40.8%	-11.8%	-0.8%	-0.5%			
<i>% of Rev</i>	4.4%	5.3%	2.1%	1.6%	1.4%	1.2%			
Vertical Mix									
Government	29.6	27.5	32.0	41.4	51.9	63.9	4%	26%	24%
<i>Growth YoY%</i>		-7.2%	16.6%	29.3%	25.3%	23.2%			
<i>% of Rev</i>	55.5%	42.7%	33.6%	36.7%	40.4%	43.1%			
Financial Services	10.1	15.3	19.4	22.1	24.4	27.2	38%	12%	11%
<i>Growth YoY%</i>		50.4%	26.9%	13.9%	10.7%	11.2%			
<i>% of Rev</i>	19.0%	23.7%	20.3%	19.6%	19.0%	18.3%			
Retail Services	7.2	13.0	35.6	39.9	41.9	46.8	122%	10%	8%
<i>Growth YoY%</i>		80.2%	172.8%	12.3%	4.9%	11.8%			
<i>% of Rev</i>	13.6%	20.2%	37.3%	35.4%	32.6%	31.6%			
Others	6.4	8.6	8.5	9.4	10.2	10.4	15%	7%	5%
<i>Growth YoY%</i>		35.3%	-1.8%	10.7%	9.0%	1.9%			
<i>% of Rev</i>	11.9%	13.4%	8.9%	8.3%	8.0%	7.0%			
UK Private sector (ex Govt, computed)	21.4	25.3	34.4	41.7	48.1	54.7	27%	17%	14%
<i>Growth YoY%</i>		18.1%	36.0%	21.3%	15.3%	13.7%			
<i>% of Rev</i>	40.2%	39.3%	36.1%	37.0%	37.5%	36.9%			

Source: Company, HDFC sec Inst Research

FY18 organic GBP revenue growth (excluding TAISTech) is 21.8%

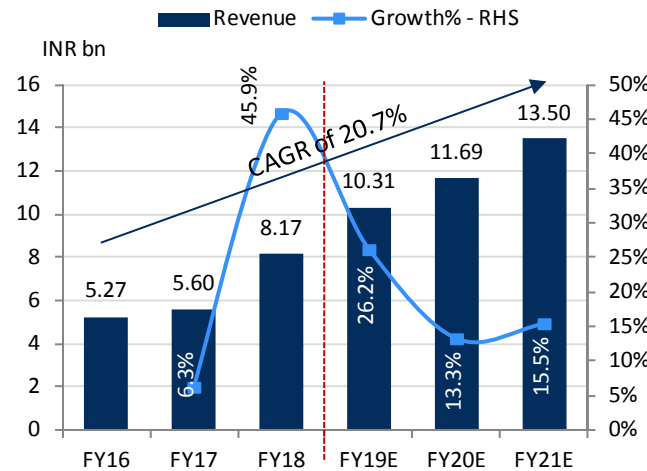
Margin expansion post the demerger has been significant (12.8% in FY19E vs 3.6% in FY16) led by operational efficiencies

Revenue Trend



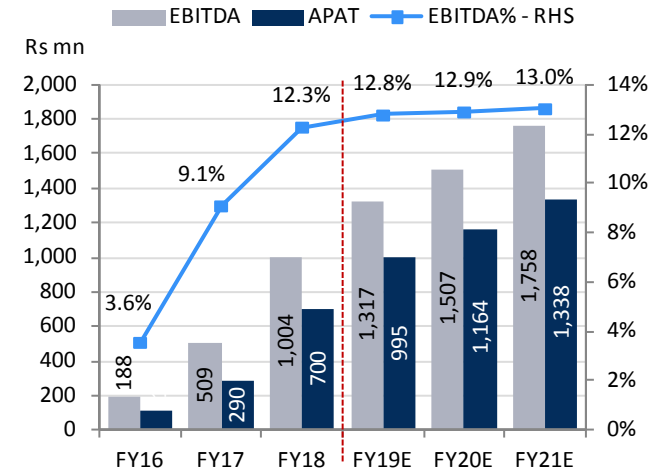
Source: Company, HDFC sec Inst Research, FY17 includes one quarter of TAISTech and FY18 includes full year.

INR Revenue Trend



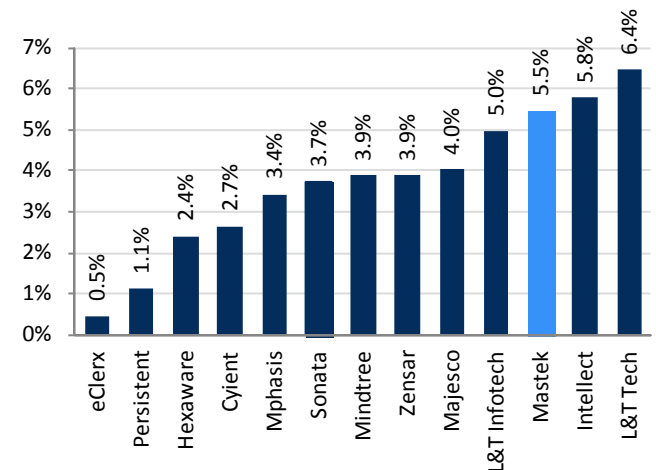
Source: Company, HDFC sec Inst Research, FY17 includes one quarter of TAISTech and FY18 includes full year.

EBITDA And APAT Trend



Source: Company, HDFC sec Inst Research

6-Qtr Growth For Mid-cap IT

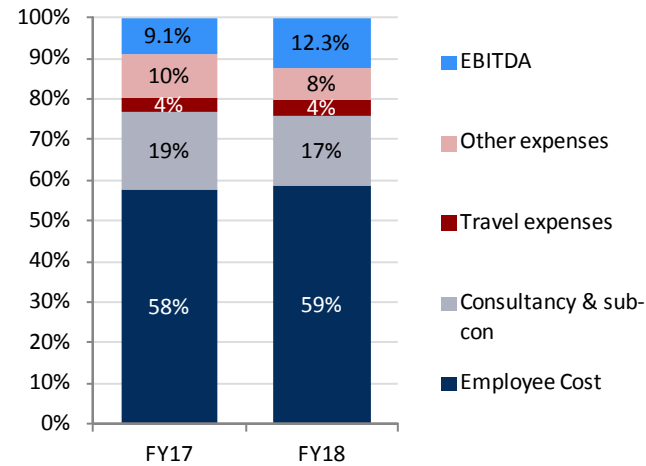


Source: Company, HDFC sec Inst Research, Mastek growth is based on GBP numbers

EBITDA Margin in FY18 at 12.3% vs. 9.1% in FY17 led by lower sub-contracting and other expenses

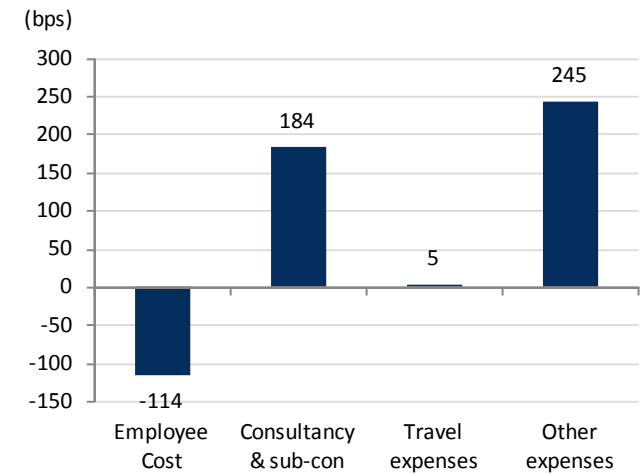
Margin expansion was led by Subcontracting (+184bps) and other expenses (+245bps) offset by employee expenses (-114bps)

Cost And EBITDA Breakup As a % Revenue



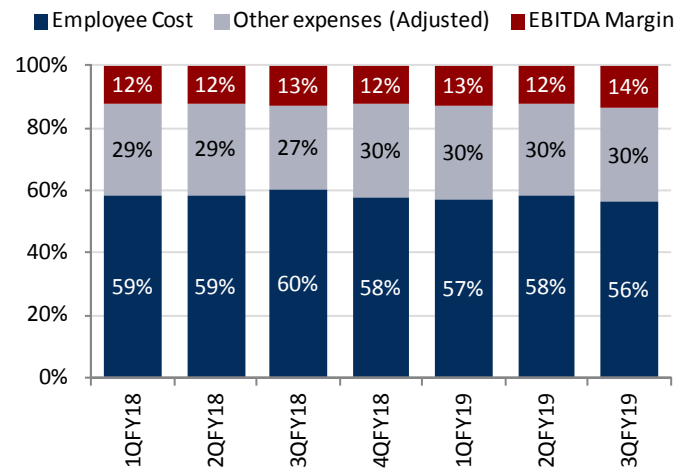
Source: Company, HDFC sec Inst Research

Margin Walkthrough Of 320bps Margin Expansion From FY17 to FY18 (bps)



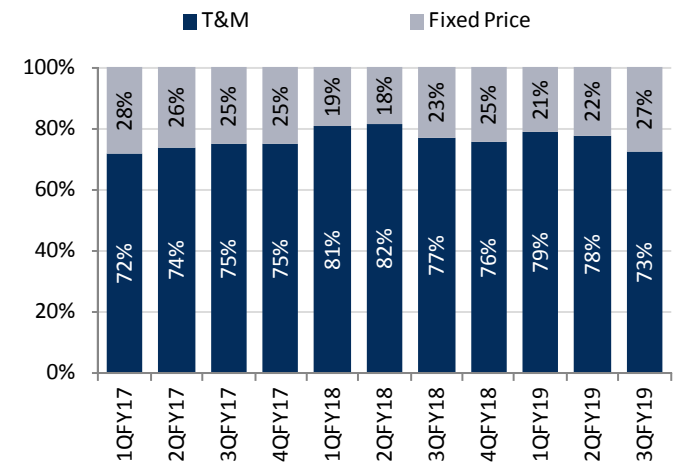
Source: Company, HDFC sec Inst Research

Cost Breakup (%)



Source: Company, HDFC sec Inst Research

Revenue Mix: Fixed Price Vs. T&M (%)

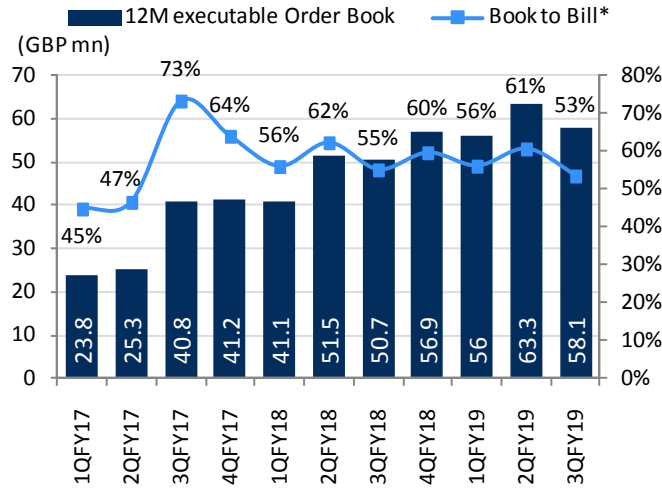


Source: Company, HDFC sec Inst Research

Onsite hiring of freshers to keep utilisation low, 75-80% to be steady state utilisation

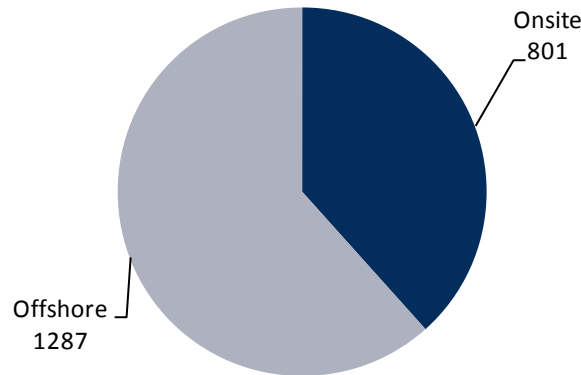
Mastek has an Onsite employee mix of ~38% with onsite revenues at ~72%

Order Book & Book to Bill Trend



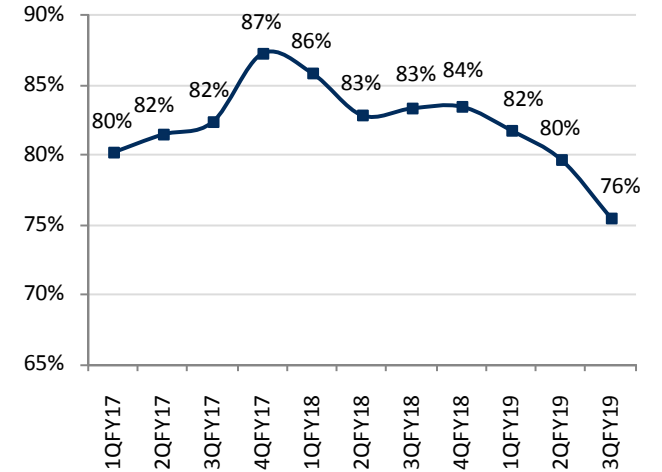
Source: Company, HDFC sec Inst Research, * Calculated on TTM revenues

Employee Mix (Nos)



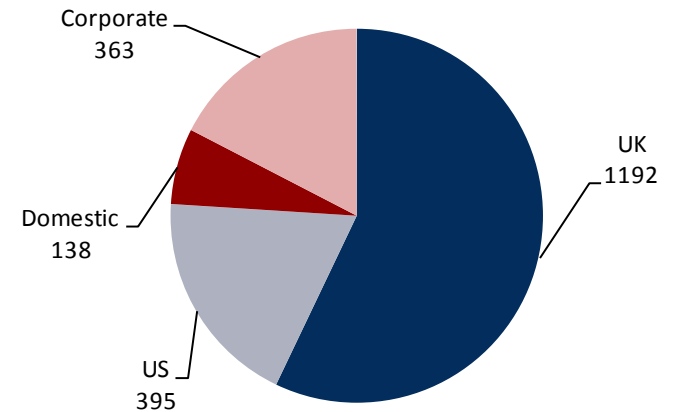
Source: Company, HDFC sec Inst Research, 3QFY19

Utilisation Trend (%)



Source: Company, HDFC sec Inst Research

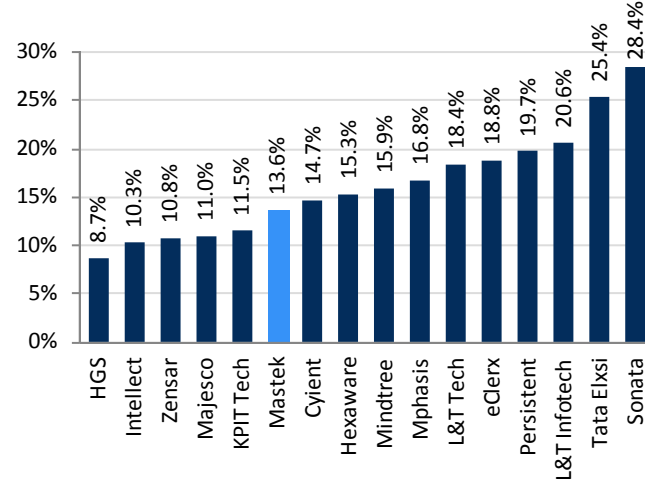
Employee Mix (Nos)



Source: Company, HDFC sec Inst Research, 3QFY19

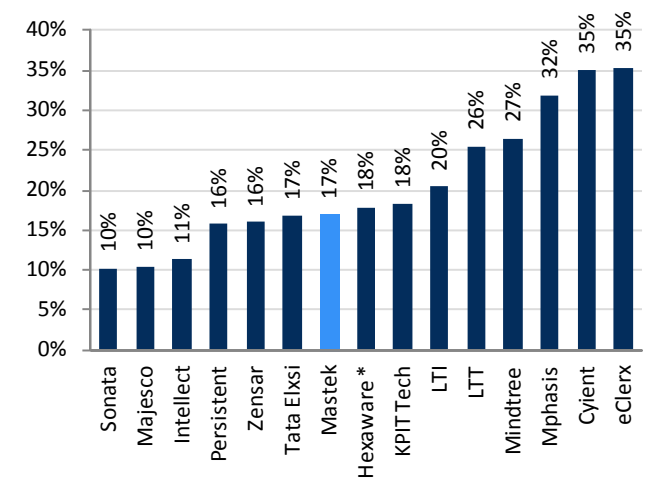
ROE for Mastek is suppressed, as a large part of capital is blocked in stake of Majesco US

EBITDA Margin for Tier-2 IT



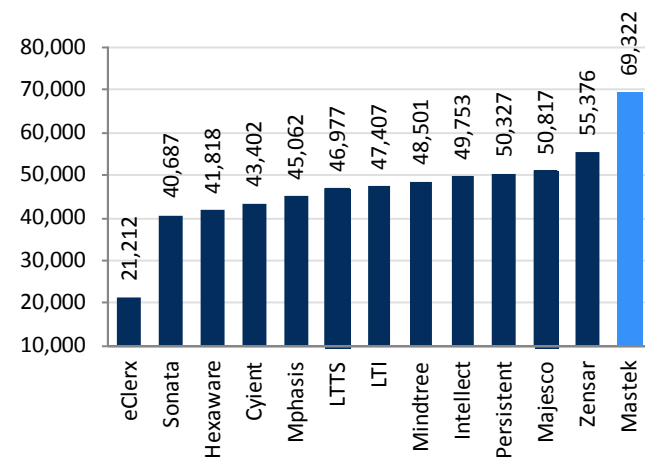
Source: Company, HDFC sec Inst Research, Margins for 3QFY19, 4QCY18 for Hexaware

RoE% for Tier-2 IT



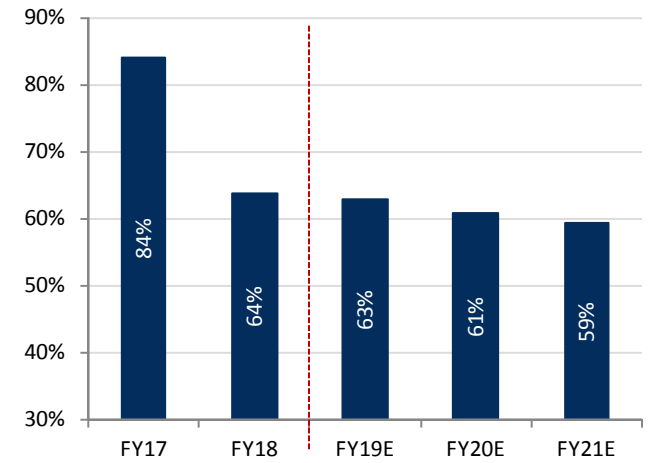
Source: Company, HDFC sec Inst Research, * CY, RoE% is for FY19E

Rev/Emp Trend for Tier-2 IT



Source: Company, HDFC sec Inst Research

Cash Conversion (OCF to EBITDA %)



Source: Company, HDFC sec Inst Research

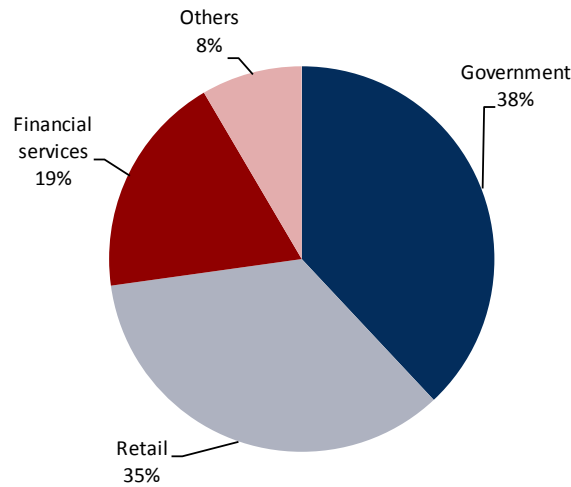
Strong Rev/employee for Mastek is a result of high onsite revenue mix (~72%)

Strong Growth in Government Vertical

Total Retail growth driven by growth of UK Retail offset by US Retail (TAISTech)

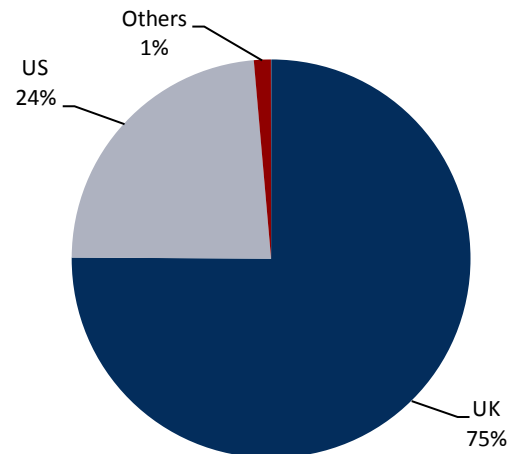
Core geography (UK) supporting overall growth

Revenue Mix By Vertical For 3QFY19 (%)



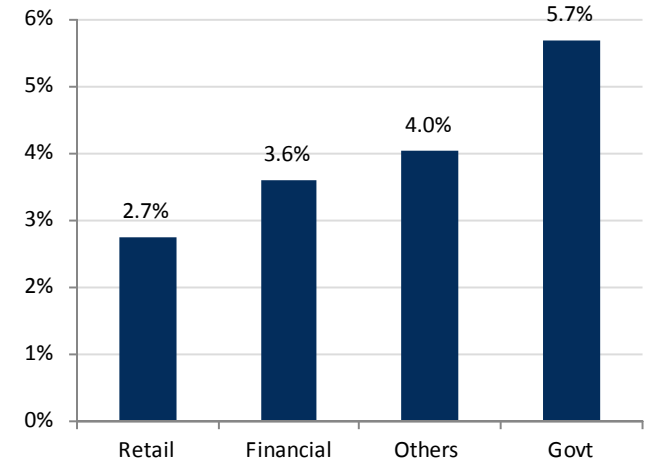
Source: Company, HDFC sec Inst Research

Revenue Mix by Geography For 3QFY19 (%)



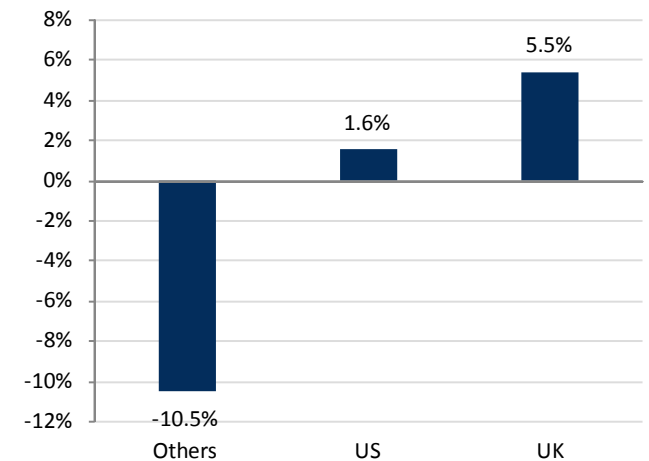
Source: Company, HDFC sec Inst Research

Verticals: 6-QTR CQGR (%)



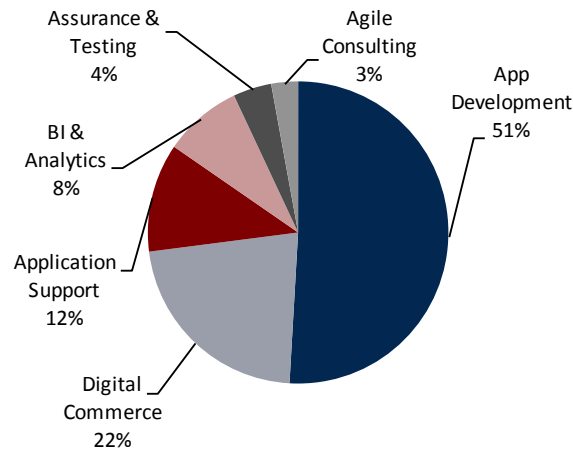
Source: Company, HDFC sec Inst Research, calculated on GBP revenue

Geography: 6-QTR CQGR (%)



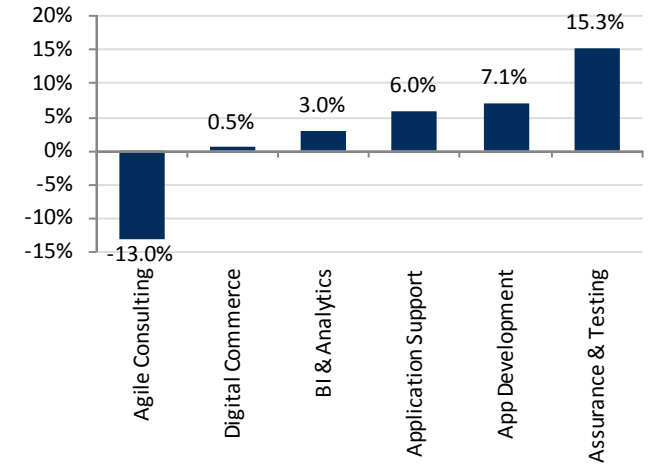
Source: Company, HDFC sec Inst Research, calculated on GBP revenue

Revenue Mix By Service Line For 3QFY19 (%)



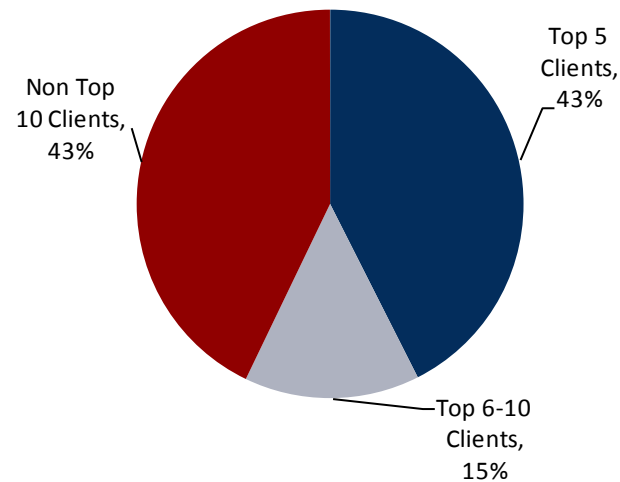
Source: Company, HDFC sec Inst Research

Service Lines: 6-QTR CQGR (%)



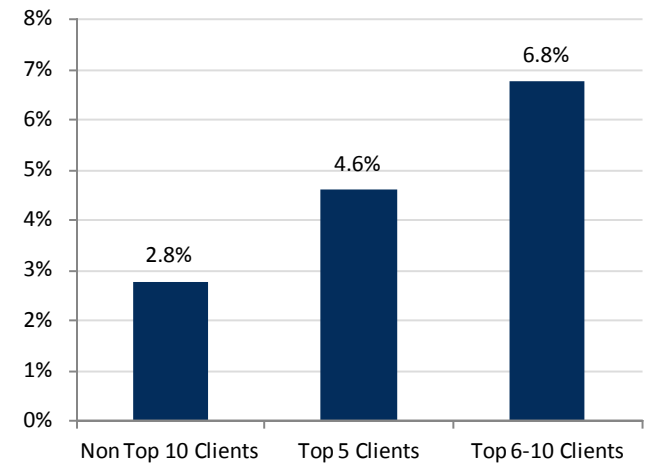
Source: Company, HDFC sec Inst Research, calculated on GBP revenue

Revenue Mix By Top Accounts For 3QFY19 (%)



Source: Company, HDFC sec Inst Research

Top Accounts: 6-QTR CQGR (%)



Source: Company, HDFC sec Inst Research, calculated on GBP revenue

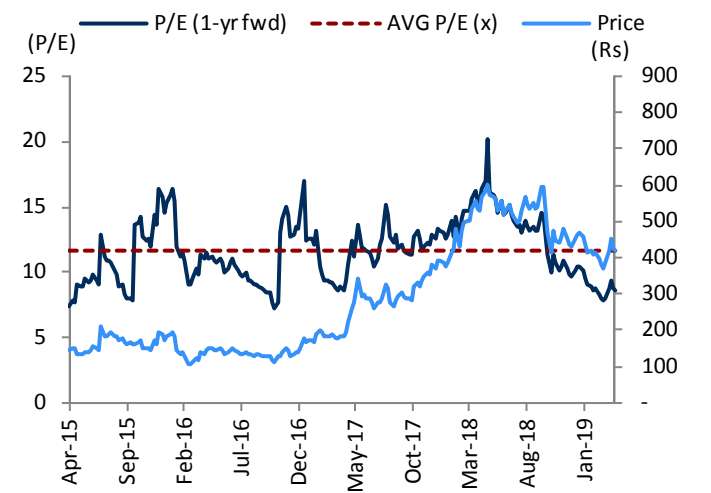
Relative IT Sector Valuation Metrics

Company	MCap (Rs bn)	CMP (Rs)	RECO	TP (Rs)	EPS (Rs)			P/E (x)			RoE (%)			USD Rev CAGR % FY19-21E	EPS CAGR % FY19-21E
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E		
TCS	7,506	2,000	BUY	2,385	83.0	89.1	99.5	24.1	22.5	20.1	35.8	36.7	38.6	11%	9%
Infosys	3,210	738	BUY	805	36.2	39.7	44.8	20.4	18.6	16.5	22.1	22.9	23.9	11%	11%
Wipro	1,534	255	NEU	241	14.9	16.3	17.2	17.1	15.7	14.8	18.1	17.7	17.1	6%	8%
HCL Tech	1,508	1,083	BUY	1,210	73.9	78.7	86.5	14.7	13.8	12.5	26.0	24.5	23.8	13%	8%
TechM	690	772	BUY	858	48.7	51.8	57.2	15.8	14.9	13.5	21.5	20.1	19.5	9%	8%
Tier-1 IT AVG								18.4	17.1	15.5	24.7	24.4	24.6	10%	9%
LTI	290	1,684	BUY	2,145	88.8	95.0	107.3	19.0	17.7	15.7	35.8	31.5	29.8	14%	10%
Mphasis	187	965	BUY	1,370	56.9	64.9	76.2	17.0	14.9	12.7	20.1	22.4	23.0	13%	16%
Mindtree	154	941	NEU	1,015	42.5	48.0	56.3	22.1	19.6	16.7	24.7	23.4	23.9	12%	15%
LTTS	160	1,545	BUY	1,845	65.6	70.5	92.1	23.6	21.9	16.8	31.6	28.3	30.8	16%	19%
Hexaware *	101	339	BUY	430	19.6	20.7	25.9	17.3	16.4	13.1	26.5	24.8	27.6	14%	15%
Cyient	73	652	BUY	765	38.5	43.2	47.8	16.9	15.1	13.6	17.6	18.0	18.1	10%	11%
Tata Elxsi	60	960	NR	875	45.6	46.8	54.6	21.1	20.5	17.6	34.2	28.8	28.0	9%	10%
Zensar	53	234	BUY	294	13.4	15.8	18.4	17.5	14.8	12.8	16.7	17.3	17.5	13%	17%
Persistent	51	635	BUY	800	45.2	49.4	57.1	14.0	12.9	11.1	16.1	16.1	16.4	10%	12%
eClerx	44	1,149	SELL	1,005	57.7	67.2	77.3	19.9	17.1	14.9	18.0	19.9	21.6	9%	16%
Sonata	35	335	BUY	457	23.7	25.3	28.6	14.1	13.2	11.7	35.3	33.4	33.5	13%	10%
Intellect	26	210	BUY	313	7.1	10.2	15.0	29.6	20.5	14.0	9.8	12.4	15.8	16%	45%
Majesco	14	485	BUY	719	22.1	28.2	33.5	22.0	17.2	14.5	11.2	14.0	17.2	23%	23%
HGS	13	615	NR	770	72.5	86.4	96.4	8.5	7.1	6.4	9.8	10.7	10.9	7%	15%
Mastek ^	10	439	BUY	660	39.3	46.0	52.9	11.2	9.5	8.3	17.0	17.4	17.6	15%	16%
Tier-2 IT AVG								18.2	15.9	13.3	21.6	21.2	22.1	13%	17%

Source: Company, HDFC sec Inst Research, * Dec Y-E, ^ Revenue CAGR as per GBP revenues

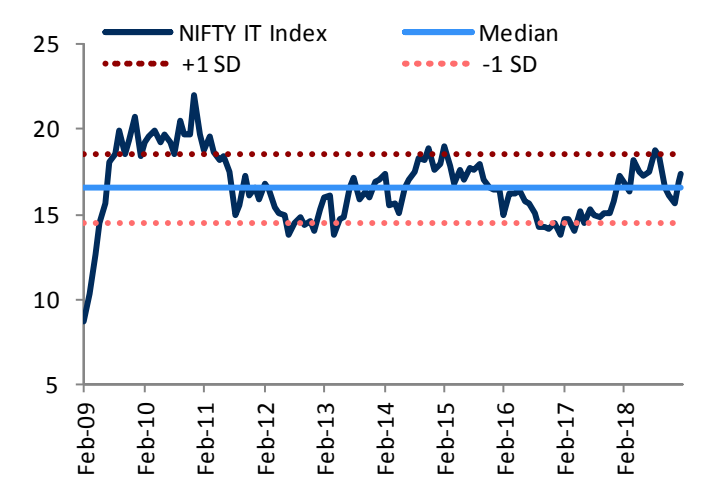
Mastek trading at ~25% discount to its four-year average P/E of 11.6x

Mastek 1-year Forward P/E(x)



Source: Bloomberg, HDFC sec Inst Research

NIFTY IT Index Valuation Trend (P/E 1-yr fwd)



Source: Bloomberg, HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues (GBP mn)	64.4	95.4	112.7	128.4	148.3
Growth (%)	20.7%	48.2%	18.2%	13.9%	15.5%
Net Revenues	5,602	8,172	10,313	11,686	13,496
Growth (%)	6.3%	45.9%	26.2%	13.3%	15.5%
Employee Expenses	3,233	4,809	5,896	6,615	7,621
Other Operating Expenses	1,860	2,359	3,100	3,564	4,116
EBITDA	509	1,004	1,317	1,507	1,758
EBITDA Margin (%)	9.1%	12.3%	12.8%	12.9%	13.0%
EBITDA Growth (%)	171.1%	97.1%	31.2%	14.4%	16.7%
Depreciation	149	188	181	207	236
EBIT	360	816	1,137	1,300	1,523
Other Income (Including EO Items)	68	203	215	267	271
Interest	38	59	62	54	54
PBT	391	960	1,290	1,513	1,740
Tax (Incl Deferred)	67	261	296	350	402
RPAT	324	700	995	1,164	1,338
EO (Loss) / Profit (Net Of Tax)	(34)	-	-	-	-
APAT	290	700	995	1,164	1,338
APAT Growth (%)	158.8%	141.4%	42.2%	17.0%	15.0%
Adjusted EPS (Rs)	11.5	27.6	39.3	46.0	52.9
EPS Growth (%)	158.8%	141.4%	42.2%	17.0%	15.0%

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

As at March	FY17	FY18	FY19E	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	117	119	119	119	119
Reserves	4,574	5,374	6,120	6,993	7,997
Total Shareholders' Funds	4,691	5,493	6,239	7,112	8,115
Long Term Debt	652	496	496	496	496
Short Term Debt	3	204	39	39	39
Total Debt	655	700	535	535	535
Net Deferred Taxes	(99)	(344)	(344)	(344)	(344)
Other Non-current Liabilities & Provns	481	332	332	332	332
TOTAL SOURCES OF FUNDS	5,727	6,181	6,762	7,635	8,638
APPLICATION OF FUNDS					
Net Block	744	708	744	806	907
CWIP	2	21	21	21	21
Goodwill	1,054	1,080	1,080	1,080	1,080
Investments	1,688	1,664	1,664	1,664	1,664
Other Non-current Assets	262	113	113	113	113
Total Non-current Assets	3,750	3,586	3,621	3,683	3,785
Cash & Equivalents	1,530	2,057	2,409	2,978	3,566
Debtors	851	1,351	1,734	1,997	2,343
Other Current Assets	819	875	1,079	1,231	1,432
Total Current Assets	3,200	4,284	5,222	6,206	7,341
Creditors	199	189	263	299	345
Other Current Liabilities & Provns	1,024	1,500	1,818	1,956	2,143
Total Current Liabilities	1,223	1,689	2,081	2,255	2,487
Net Current Assets	1,977	2,595	3,140	3,952	4,853
TOTAL APPLICATION OF FUNDS	5,727	6,181	6,762	7,635	8,638

Source: Company, HDFC sec Inst Research

Cash Flow (Consolidated)

Year ending March	FY17	FY18	FY19E	FY20E	FY21E
Reported PBT	391	960	1,290	1,513	1,740
Non-operating & EO Items	(44)	(25)	(215)	(267)	(271)
Interest Expenses	38	59	62	54	54
Depreciation	149	188	181	207	236
Working Capital Change	(68)	(448)	(194)	(242)	(314)
Tax Paid	(37)	(93)	(296)	(350)	(402)
OPERATING CASH FLOW (a)	429	641	828	916	1,043
Capex	(791)	(209)	(217)	(269)	(337)
<i>Free Cash Flow (FCF)</i>	<i>(362)</i>	<i>432</i>	<i>611</i>	<i>647</i>	<i>705</i>
Non-operating Income	64	36	215	267	271
INVESTING CASH FLOW (b)	(727)	(173)	(1)	(2)	(66)
Debt Issuance/(Repaid)	674	42	(165)	-	-
Interest Expenses	(26)	(27)	(62)	(54)	(54)
<i>FCFE</i>	<i>286</i>	<i>446</i>	<i>385</i>	<i>593</i>	<i>652</i>
Share Capital Issuance	21	24	-	-	-
Dividend	(23)	(107)	(249)	(291)	(335)
FINANCING CASH FLOW (c)	646	(68)	(475)	(344)	(388)
NET CASH FLOW (a+b+c)	347	400	352	569	588
EO Items, Others	17	(128)	-	-	-
Closing Cash & Equivalents	1,530	2,057	2,409	2,978	3,566

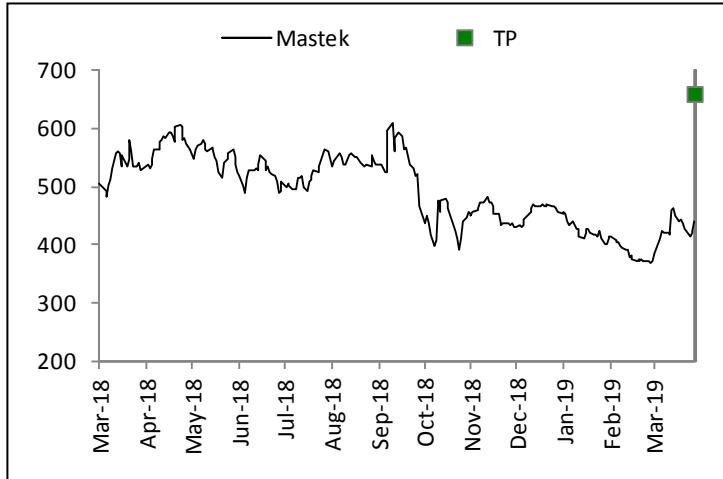
Source: Company, HDFC sec Inst Research

Key Ratios (Consolidated)

	FY17	FY18	FY19E	FY20E	FY21E
PROFITABILITY (%)					
EBITDA Margin	9.1	12.3	12.8	12.9	13.0
APAT Margin	5.2	8.6	9.6	10.0	9.9
RoE	6.1	13.7	17.0	17.4	17.6
RoIC (or Core RoCE)	15.1	23.9	34.0	35.2	36.6
RoCE	6.2	12.5	16.1	16.7	17.0
EFFICIENCY					
Tax Rate (%)	17.1	27.1	22.9	23.1	23.1
Fixed Asset Turnover (x)	7.5	11.5	13.9	14.5	14.9
<i>Debtors (days)</i>	<i>55</i>	<i>60</i>	<i>61</i>	<i>62</i>	<i>63</i>
<i>Other Current Assets (days)</i>	<i>53</i>	<i>39</i>	<i>38</i>	<i>38</i>	<i>39</i>
<i>Payables (days)</i>	<i>13</i>	<i>8</i>	<i>9</i>	<i>9</i>	<i>9</i>
<i>Other Current Liab & Provns (days)</i>	<i>67</i>	<i>67</i>	<i>64</i>	<i>61</i>	<i>58</i>
<i>Cash Conversion Cycle (days)</i>	<i>29</i>	<i>24</i>	<i>26</i>	<i>30</i>	<i>35</i>
Debt/EBITDA (x)	1.3	0.7	0.4	0.4	0.3
Net D/E (x)	-0.2	-0.2	-0.3	-0.3	-0.4
Interest Coverage (x)	9.6	13.9	18.4	24.3	28.5
PER SHARE DATA (Rs)					
EPS	11.5	27.6	39.3	46.0	52.9
CEPS	17.4	35.1	46.5	54.2	62.2
Dividend	3.5	6.0	8.7	10.2	11.7
Book Value	185	217	247	281	321
VALUATION					
P/E (x)	38.3	15.9	11.2	9.5	8.3
P/BV (x)	2.4	2.0	1.8	1.6	1.4
EV/EBITDA (x)	20.1	9.7	7.0	5.7	4.6
EV/Revenues (x)	1.8	1.2	0.9	0.7	0.6
OCF/EV (%)	4.2	6.6	9.0	10.6	12.9
FCF/EV (%)	-3.5	4.4	6.6	7.5	8.7
FCFE/Mkt Cap (%)	2.6	4.0	3.5	5.3	5.9
Dividend Yield (%)	0.8	1.4	2.0	2.3	2.7

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
29-Mar-19	439	BUY	660

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- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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