

December 26, 2014

Mastek Ltd (MASTEK)

₹ 410

Value creation gets real....

Mastek has announced the merger of Majesco with Cover-All (COVR), an NYSE listed core insurance systems and services provider. As part of the share swap deal, Majesco will be listed in the US while Cover-All shareholders' (includes potential dilution) would hold 16.5% of outstanding shares of the combined entity. We believe the deal valuations could be construed as base value for Mastek's insurance business even as incremental value could accrue, over time, with scale and synergy benefits. Assuming Mcap/sales deal multiple – itself at a 64% discount to comps – yields ₹ 723 crore value for the insurance piece, in-line with our ₹ 750 crore estimate, attributed in the September 18, 2014 note.

Acquires Agile, announces merger with Cover-All Technologies...

Earlier last week, Mastek announced 1) acquisition of Agile Technologies, a \$9 million revenue run-rate US-based consulting services provider to the insurance industry and 2) merger with NYSE-listed Cover-All Technologies, a US-based property & casualty insurance software provider. The merged company would retain the Majesco brand with pro-forma revenues of ~\$100 million in FY15E and ~\$110 million in FY16E and with 150+ customers. Recent developments are part of the ongoing restructuring exercise at Mastek where it plans to demerge its solutions (55% of revenues) and insurance (renamed Majesco, 45% of revenues) business. Mastek expects to complete the merger by July 2015.

Deal basics, imputed valuations for combined entity

Majesco will issue 36.25 million shares to existing Cover-All shareholders in exchange for 27.5 million outstanding shares. This implies share swap ratio of 1.3:1 i.e. 1.3 shares of Majesco will be issued for every share held in Cover-All. Back of the envelope calculations imply an imputed market cap of \$209 million for the combined entity given Majesco's 16.5% stake is valued at \$34.6 million (COVR's Mcap on December 12, 2014).

Scenario analysis suggests per share value range of ₹ 450-890

Our scenario analysis suggests ₹ 723-1653 crore Mcap can be attributed to insurance business while solutions business may be worth ₹ 280-340 crore. Our current case assumes – target Mcap/sales multiple of 1.75x for Majesco US – in line with Cover-All's acquisition multiple & 64% discount to global peer group average, 25% hold company discount & target 3x EV/EBITDA multiple for solutions business (57% discount to peer group average regardless of ₹ 100 crore cash balance) - and yields a per share value of ₹ 448. However, we would highlight that our target multiple for Majesco US is conservative given BenefitFocus – comparable revenue size to Majesco – trades at Mcap/sales multiple of 7.8x despite making adjusted EBITDA margins of 3.4%. Finally, our base, best case analysis yields a per share value of ₹ 600, ₹ 890 (refer exhibit 1) & implies upside potential of 46%, 117% relative to current market price, respectively.

Raising fair price; thesis obligated by execution and earnings delivery...

We believe the insurance business post Agile acquisition and Cover-All merger could be a formidable player in the mid-market segment. Further, value creation in the insurance business is getting real with Majesco's US listing. We believe the combined insurance business could be valued at 2.5x on Mcap/pro-forma sales metric (25% hold-co discount, 1.5-2x earlier) given deeper market expertise and cross-selling opportunities within the acquired clients while the services business could be valued at 3.5x trailing pro-forma EV/EBITDA. This translates to a fair value of ₹ 600.

Rating matrix

Rating	:	Buy
Target	:	₹ 600
Target Period	:	12 months
Potential Upside	:	46%

What's Changed?

Target	Changed from ₹ 500 to ₹ 600		
EPS FY15E	Unchanged		
EPS FY16E	Unchanged		
Rating	Unchanged		

Key Financials

₹ Crore	FY13	FY14	FY15E	FY16E
Net Sales	683	923	885	936
EBITDA	59	91	63	90
Net Profit	34	52	33	52
EPS (₹)	13.9	21.1	14.6	23.2

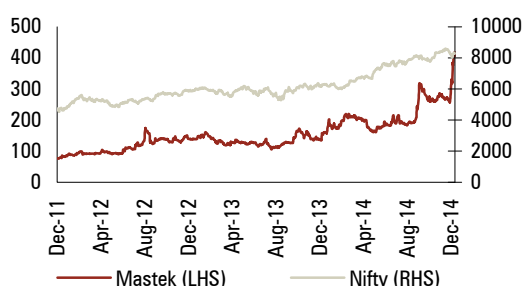
Valuation summary

	FY13	FY14	FY15E	FY16E
P/E	29.4	19.5	28.1	17.6
Target P/E	43.0	28.5	41.1	25.8
EV / EBITDA	12.6	8.2	11.9	8.3
P/BV	1.7	1.6	1.6	1.5
RoNW (%)	6.4	9.2	5.6	8.3
RoCE (%)	7.0	10.4	5.0	8.8

Stock data

Particular	Amount
Market Capitalization (₹ Crore)	908.6
Total Debt (Sep-14) (₹ Crore)	14.7
Cash and Investments (Sep-14) (₹ Crore)	173.5
EV (₹ Crore)	749.7
52 week H/L	423 / 153
Equity capital	11.1
Face value	5.0

Price performance



Research Analysts

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Exhibit 1: Scenario analysis yields base case per share value of ₹ 600

Mastek (Insurance)	Current case	Base case	Best case
FY16 proforma revenue (\$ million)	110	110	110
Target Mcap/Sales multiple (x) *	1.8	2.5	4.0
Peer group average (x)	4.9	4.9	4.9
Discount to peer group average (%)	64.1	48.7	17.9
Potential Majesco US Mcap (\$ million)	193	275	440
Rupee assumption (₹/USD)	60	60	60
Majesco US Mcap (₹ crores)	1155	1650	2640
Mastek holding in Majesco (%)	83.5	83.5	83.5
Mastek holding in Majesco (₹ crores)	964	1378	2204
Holding co. discount (%)	25	25	25
Value reflected in Mastek (₹ crores)	723	1033	1653
Mastek (Solutions)			
FY14 revenue (₹ crores)	416	416	416
EBITDA	60	60	60
Target EV/ trailing EBITDA multiple (x)	3.0	3.5	4.0
Peer group average (x)	6.9	6.9	6.9
Discount to peer group average (x)	56.8	49.6	42.4
Solutions enterprise value	180	210	240
Cash (₹ crores)	100	100	100
Target market cap (₹ crores)	280	310	340
Mastek			
Overall Mastek potential market cap (₹ crores)	1,003	1,343	1,993
Price per share (₹)	448	600	890

*Current case multiple inline with Cover-All's acquisition multiple, Source: Company, ICICIdirect.com Research

Exhibit 2: Insurance business valuation comps

(\$ million)	Mcap	Sales	Gross (%)	EBITDA (%)	R&D/Sales (%)	RoCE (%)	Mcap/Sales
Solera Holdings	3,435	987	77.5	38.2	9.2	13.4	3.5
Guidewire Software	3,532	350	57.5	7.2	21.8	8.1	10.1
Pegasystems	1,609	509	69.1	15.7	15.7	21.4	3.2
BenefitFocus	859	105	40.4	(19.1)	22.5	NA	8.2
Ebix	617	205	80.2	41.6	13.1	16.0	3.0
Sapiens International	350	135	37.2	14.6	8.8	7.0	2.6
Symbility Solutions	79	22	80.7	(14.6)	20.8	NA	3.6
<i>Average</i>			<i>63.2</i>	<i>11.9</i>	<i>16.0</i>	<i>13.2</i>	<i>4.9</i>
(₹ crores)							
Majesco (Insurance)	NA	507	~50.0	5.9	11.3	0.8	NA

Source: Bloomberg, Company, ICICIdirect.com Research

Exhibit 3: Solutions business valuation comps

(₹ crores)	Mcap	Sales	EBITDA	EBITDA (%)	RoCE (%)	EV/EBITDA	Mcap/Sales
Geometric	815	1,095	140.0	12.8	28.3	5.8	0.7
Tata Elxsi	1,825	775	150.0	19.4	46.0	11.7	2.4
Datamatics Global	460	734	98.0	13.4	19.1	5.5	0.6
Nucleus Software	612	346	92.0	26.6	21.7	4.1	1.8
Blue Star Infotech	222	270	27.0	10.0	22.2	7.6	0.8
<i>Average</i>				<i>16.4</i>	<i>27.4</i>	<i>6.9</i>	<i>1.3</i>
(₹ crores)							
Mastek (Solutions)	NA	416	59.9	14.4	17.3	NA	NA

Peer group set based on revenue size, Source: Company, Capital line, Bloomberg, ICICIdirect.com Research

Majesco awaits large addressable market

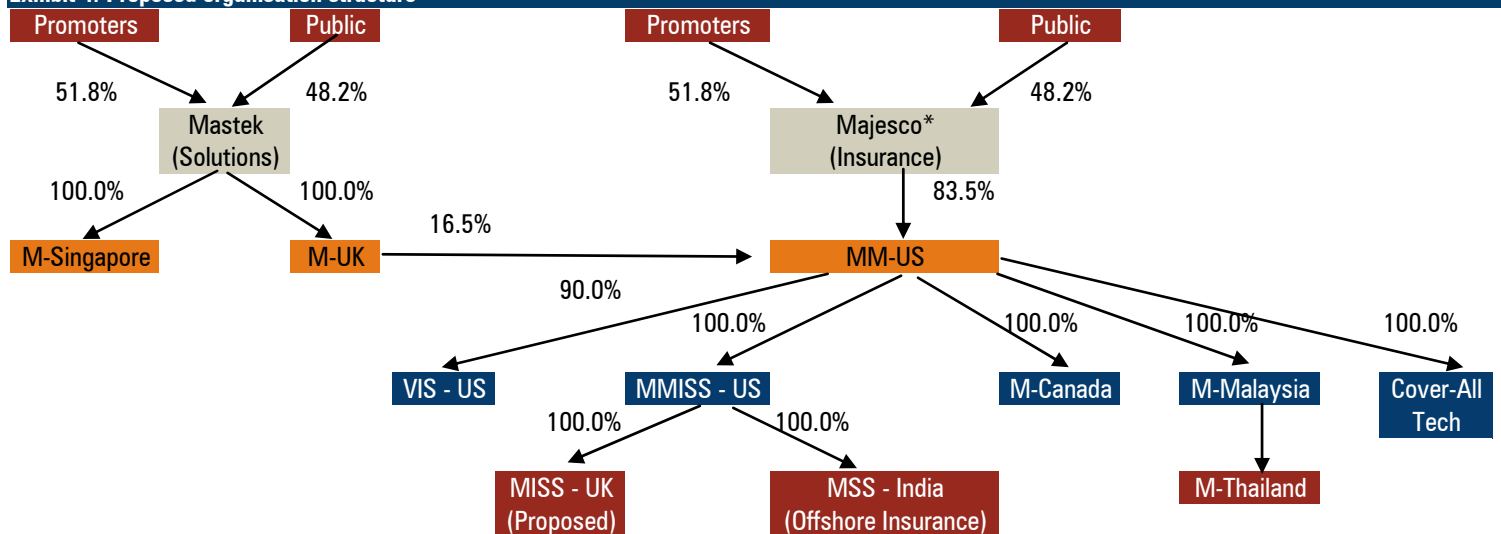
Top 100 US property and casualty (P&C) insurers underwrote net premium worth ~\$422 billion in CY13. Typically, insurers budget ~3-3.5% of their annual revenues on IT related spends including staffing, hardware, maintenance & product development translating to ~\$15 billion. Even if we were to assume that 80-85% of spends could be in-sourced or attributed to hardware and staffing related, core product development, even then business intelligence & data analytics and warehousing could still be a large addressable market worth couple of billion dollars (\$2-\$3 billion). Acknowledging that Guidewire and Accenture (Duck Creek) are large vendors and their relationships generally could be sticky, Majesco is a notable vendor with seven of the top 25 insurers as customers while CoverAll with its mid-market focus could help capture incremental opportunities through cross-selling.

Brief profile of three entities within Majesco & proposed organisation structure...

Post the merger and acquisition, Majesco Mastek will likely achieve FY16E pro-forma revenue run-rate of \$110 million – in the \$100 million sweet spot to bid for larger engagements. Brief profile of the three entities is as follows:

1. Majesco (\$80 million revenue, 5.9% EBITDA margins): The current entity serves ~100 insurance customers in all segments of the insurance industry, with 20% CAGR in mid-market segment. The company scaled up its presence across the US (>80% of revenues), UK and APAC starting with three clients in 2005
2. Cover-All Technologies (\$20 million, 17%): The company offers commercial lines focused policy admin system, business intelligence and data analytics services to 30+ customers with an employee base of 150. With healthy cash flow generation, the company will repay its higher cost \$3 million debt on its books (8% interest)
3. Agile Technologies (\$9 million): With a 17-year history, Agile has built a long-term relationship (over 10 years) with its customers & offers IT strategy, transformation consulting, BPO & IT process re-engineering to North American insurance companies

Exhibit 4: Proposed organisation structure



Source: Company, ICICIdirect.com Research

Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY13	FY14	FY15E	FY16E	
Total operating Income	683	923	885	936	
Growth (%)	(5)	35	(4)	6	
COGS (employee expenses)	524	684	681	696	
S,G&A expenses	100	147	142	150	
Total Operating Expenditure	624	832	822	846	
EBITDA	59	91	63	90	
Growth (%)	137	54	(31)	42	
Depreciation	22	33	34	35	
Other Income	9	11	12	15	
PBT	44	68	41	69	
Total Tax	9	16	8	17	
PAT	34	52	33	52	
Growth (%)	LP	51	(37)	59	
EPS (₹)	13.9	21.1	14.6	23.2	

Source: Company, ICICIdirect.com Research

Balance sheet		₹ Crore			
(Year-end March)	FY13	FY14	FY15E	FY16E	
Liabilities					
Equity Capital	12	11	11	11	
Reserve and Surplus	521	549	573	611	
Total Shareholders funds	533	560	584	622	
Total Debt	2	1	1	1	
Total Liabilities	570	586	610	648	
Assets					
Total Fixed Assets	249	261	253	245	
Investments	3	3	3	3	
Other non current assets	84	85	85	85	
Debtors	149	117	126	136	
Loans and Advances	21	24	22	23	
Cash	122	90	114	153	
Total Current Assets	405	406	438	487	
Current liabilities	139	144	142	145	
Provisions	32	24	26	26	
Total Current Liabilities	171	167	168	171	
Net Current Assets	234	238	270	316	
Application of Funds	570	586	610	648	

Source: Company, ICICIdirect.com Research

Cash flow statement		₹ Crore			
(Year-end March)	FY13	FY14	FY15E	FY16E	
Profit before tax	44	68	41	69	
Add: Depreciation	22	33	34	35	
(Inc)/dec in Current Assets	23	45	(8)	(11)	
Inc/(dec) in CL and Provisions	6	(29)	1	3	
Taxes paid	(9)	(23)	(8)	(17)	
CF from operating activities	80	89	48	64	
(Inc)/dec in Inv. (+) Int inc	9	(43)	12	15	
(Inc)/dec in Fixed Assets	(18)	(27)	(26)	(27)	
CF from investing activities	(9)	(70)	(14)	(12)	
Issue/(Buy back) of Equity	(36)	(54)	-	-	
Inc/(dec) in loan funds	(7)	(0)	-	-	
Dividend paid & dividend tax	-	(12)	(9)	(13)	
CF from financing activities	(43)	(67)	(10)	(14)	
Net Cash flow	26	(40)	25	38	
Exchange difference	(3)	8	-	-	
Opening Cash	98	122	90	114	
Closing Cash	122	90	114	153	

Source: Company, ICICIdirect.com Research

Key ratios		FY13	FY14	FY15E	FY16E
Per share data (₹)					
EPS		13.9	21.1	14.6	23.2
Cash EPS		29.7	45.4	33.7	47.0
BV		240.5	252.8	263.4	280.8
DPS		3.0	4.0	3.5	5.0
Cash Per Share		55.1	40.5	51.6	68.9
Operating Ratios (%)					
EBITDA Margin		8.7	9.9	7.1	9.6
PBT / Total Operating income		6.4	7.3	4.6	7.4
PAT Margin		5.0	5.6	3.7	5.5
Inventory days		-	-	-	-
Debtor days		88	53	50	51
Creditor days		76	56	59	56
Return Ratios (%)					
RoE		6.4	9.2	5.6	8.3
RoCE		7.0	10.4	5.0	8.8
RoIC		8.4	11.8	5.9	11.0
Valuation Ratios (x)					
P/E		29.4	19.5	28.1	17.6
EV / EBITDA		12.6	8.2	11.9	8.3
EV / Net Sales		1.1	0.8	0.8	0.8
Market Cap / Sales		1.3	1.0	1.0	1.0
Price to Book Value		1.7	1.622	1.557	1.460
Solvency Ratios					
Debt/EBITDA		0.0	0.0	0.0	0.0
Debt / Equity		0.0	0.0	0.0	0.0
Current Ratio		2.4	2.4	2.6	2.9
Quick Ratio		2.4	2.4	2.6	2.9

Source: Company, ICICIdirect.com Research

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