

Zensar Technologies

BUY

Robust turnaround in margins

Summary

Zensar reported strong Q1FY24 numbers especially on margin side. There was one of benefit of R&D credit to the tune of 100 bps in the quarter. However, excluding the same, Zensar's EBIT margins were significantly above expectations. The company expects to maintain mid teen EBITDA margins. Considering this and Q1 results we have revised EBIT margins upwards by 322 & 260 bps. In addition, we expect longer term revenues of the company to improve led by restructuring of organization, incentivisation of sales and cross sell. Hence, we have built in revenue & PAT CAGR of 7.4% & 41.1% over FY23-FY25E. Consequently, we upgrade the stock from HOLD to BUY with a revised target price of Rs 530 (18x FY25E EPS).

Key Highlights and Investment Rationale

- Revenue growth to lag in near term but improve in longer term:** The company is taking right steps to improve revenues in long run like 1) incentivising sales for large deals & cross sell 2) restructuring of organisation from Geo focus to Vertical focus and 3) hired COO and CBO to drive growth. Further, Zensar's plan to focus on client mining via cross sell will further boost revenue growth. However in near term we are cautious in terms of revenue growth due to uncertain macro. Hence, we have built in revenue CAGR of 7.4% over FY23-FY25E.
- Margin improvement looks sustainable:** We believe Q1 margins were more led by utilisation and offshoring (which seems sustainable). Going forward we believe the company has further room in utilisation and sub con. Hence, we expect 590 bps improvement in margins to 13.5% in FY24E and a further 40 bps improvement to 13.9% in FY25E.

TP	Rs530
CMP	Rs461
Potential upside/downside	15%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	19.9	72.7	80.1
Rel to Sensex	13.2	59.4	58.1

V/s Consensus

EPS (Rs)	FY24E	FY25E
IDBI Capital	25.2	28.8
Consensus	20.5	24.0
% difference	23.0	19.8

Key Stock Data

Bloomberg/Reuters	ZENT IN/ZENT.BO
Sector	IT Services
Shares o/s (mn)	226
Market cap. (Rs mn)	104,456
3-m daily average value (Rs mn)	51.1
52-week high / low	Rs475 / 202
Sensex / Nifty	67,572 / 19,979

Shareholding Pattern (%)

Promoters	49.2
FII	10.5
DII	15.4
Public	24.9

Financial snapshot

Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	37,814	42,437	48,483	50,986	57,338
Change (yoy, %)	(10)	12	14	5	12
EBITDA	6,848	6,565	5,523	8,588	9,747
Change (yoy, %)	35	(4)	(16)	55	14
EBITDA Margin(%)	18.1	15.5	11.4	16.8	17.0
Adj.PAT	3,491	4,162	3,275	5,708	6,520
EPS (Rs)	15.3	18.3	14.5	25.2	28.8
Change (yoy, %)	33	20	(21)	74	14
PE(x)	30	25	32	18	16
Dividend Yield (%)	0	1	1	2	2
EV/EBITDA (x)	14	15	18	11	9
RoE (%)	15.8	16.6	11.8	18.5	18.7
RoCE (%)	19	16	12	20	21

Source: IDBI Capital Research;

Con-call Highlights

- Total revenue for the quarter stood at \$149.3mn 1.3%/-1.6% QoQ/YoY in CC terms. Services revenue (excluding pass through revenue) stood at US\$ 149.2mn +2.4% QoQ in CC terms. Sequential revenue growth in CC terms was led by BFS (+10.2%), followed by consumer services (+10.3%). However, hitech, insurance and manufacturing industries which form ~60% of the total revenue declined by 3.5%, 3.5% and 1.8% respectively. In terms of services revenue, QoQ growth was led by Europe (+6% QoQ in CC) followed by US (+1.3% QoQ in CC) and Africa (+13.4% in CC). African market is observing ramp up in projects European market is seeing good traction from old and new clients.
- Zensar reported 168 bps QoQ expansion in gross margins to 33.6% mainly due to R&D credit received from overseas government, higher offshoring (up 160 bps to 48%) and higher utilisation (up 110 bps to 82.5%). This coupled with drop in attrition led to 370 bps QoQ improvement in EBIT margin to 15.3%.
- Order book stood at USD 154.2 mn vs USD 125 mn in Q1FY23 (-12%/+23% QoQ/YoY). The total TTM order book now stands at \$601.4mn (1x TTM revenue). Management informed that the order book contains a healthy balance of new and renewal deals.
- Demand environment – 1) Few new deal wins from key BFSI clients led to revenue growth in this vertical during the quarter. Though the demand environment in this industry remains weak, management informed that in most of the clients, Zensar has a small wallet share and as companies look to cut costs, Zensar will stand to benefit. 2) Hi tech vertical continued to see demand softness as clients are reducing discretionary spends and reprioritized their expenses. Though the management expects this industry to remain weak in the near term, deal pipeline is seeing an uptick. 3) Consumer services industry also continues to remain impacted by the tough macro resulting in demand weakness. Zensar informed that there are no client specific challenges in this vertical and the worst is behind and deal pipeline is picking up. 4) Manufacturing industry is also observing demand softness. In terms of services, data, engineering and analytics, advanced engineering and experience services are scaling up well
- Long term growth prospects remain strong with technologies like data, cloud and gen AI expected to drive growth. In terms of margin, Zensar aims to maintain EBITDA margin in the narrow range of mid-teens by focusing on levers like utilization and pyramid optimization.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q1FY24	Q4FY23	QoQ (%)	Q1FY23	YoY (%)
Revenues (US\$ mn)	149.3	147.5	1.2	155.9	(4.2)
Revenues	12,272	12,127	1.2	12,034	2.0
COGS	8,146	8,254	(1.3)	8,829	(7.7)
Gross profit	4,126	3,873	6.5	3,205	28.7
SG&A	1,825	2,115	(13.7)	1,844	(1.0)
EBITDA	2,301	1,758	30.9	1,361	69.1
Depreciation & amortization	423	351	20.5	490	(13.7)
EBIT	1,878	1,407	33.5	871	115.6
Other income	224	209	7.2	149	50.3
PBT	2,102	1,616	30.1	1,020	106.1
Tax	540	424	27.4	270	100.0
Minority interest	0	0	n.m.	0	n.m.
Adjusted net profit	1,562	1,192	31.0	750	108.3
Exceptional item	0	0	n.m.	0	n.m.
Reported net profit	1,562	1,192	31.0	750	108.3
Diluted EPS (Rs)	6.9	5.3	30.9	3.3	107.7
As % of net revenue					
Gross profit	33.6	31.9		26.6	
SG&A	14.9	17.4		15.3	
EBITDA	18.8	14.5		11.3	
EBIT	15.3	11.6		7.2	
Reported net profit	12.7	9.8		6.2	
Tax rate	25.7	26.2		26.5	

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

Year-end: March	FY24F			FY25F		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	622	643	-3.2%	697	714	-2.4%
Revenue (Rs bn)	50,986	52,892	-3.6%	57,338	58,711	-2.3%
EBIT	6,895	5,436	26.8%	7,970	6,629	20.2%
EBIT margin (%)	13.5%	10.30%	322 bps	13.9%	11.30%	260 bps
EPS (Rs)	25.2	19.7	27.9%	28.8	23.8	21.0%

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

Year to March	Q1FY24	Q1FY24E	Variance (%)
Revenue (US\$ mn)	149.3	150.0	-0.5%
Revenue (Rs mn)	12,272	12,368	-0.8%
EBIT (Rs mn)	1,878	1,515	24.0%
EBIT margin (%)	15.3%	12.2%	306bps
Recurring PAT (Rs mn)	1,562	1,259	24.1%
Recurring PAT margin (%)	12.7%	10.2%	254 bps
EPS (Rs)	6.9	5.6	23.1%

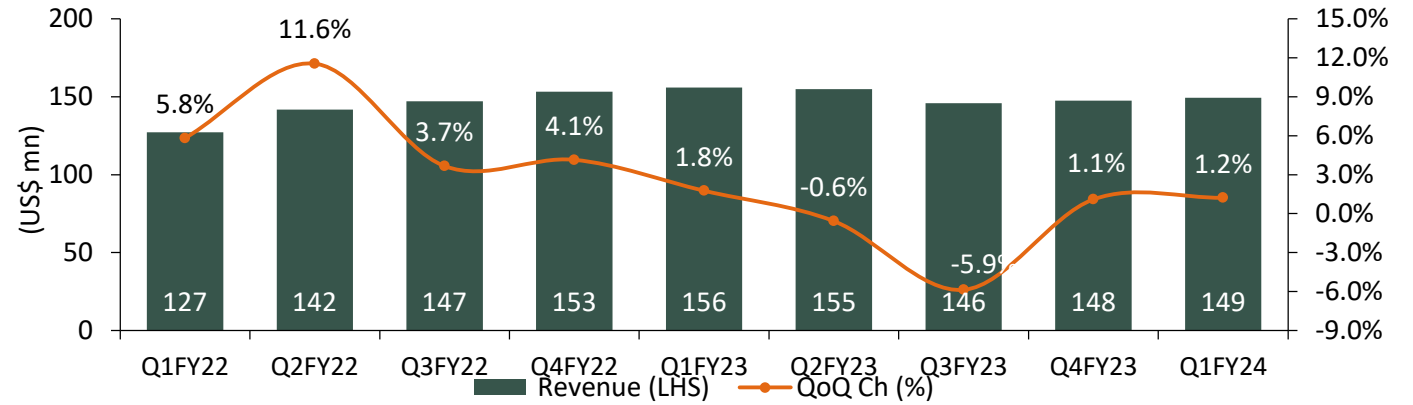
Source: Company; IDBI Capital Research

Exhibit 4: Large clients trend

Year-end: March	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
US\$1 mn+	85	81	83	86	87	87	84	87
US\$5 mn+	26	25	27	26	28	28	29	29
US\$10 mn+	10	11	11	13	13	15	14	14
US\$20 mn+	3	4	4	4	3	4	4	4

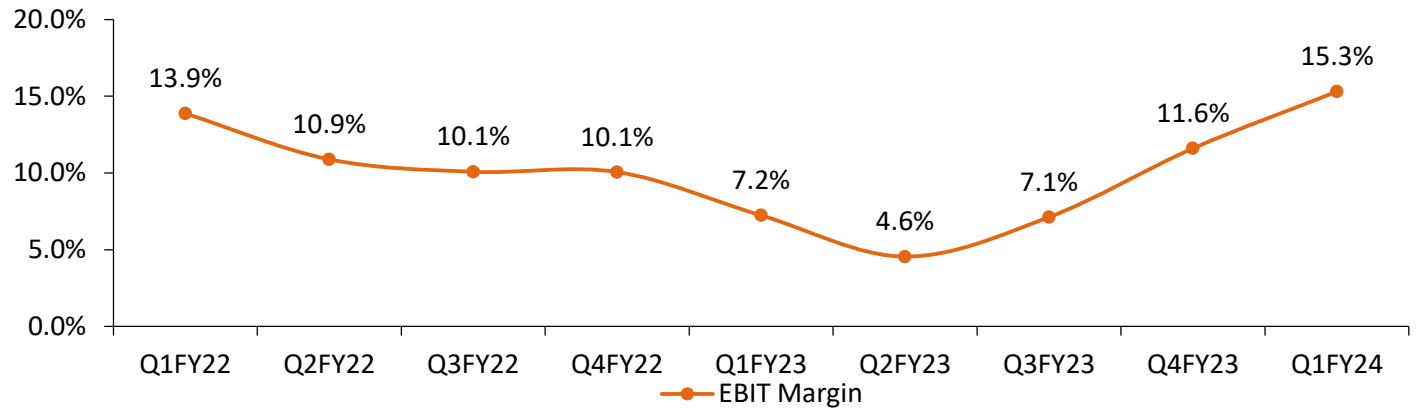
Source: Company; IDBI Capital Research

Exhibit 5: Q1FY24 Revenue growth was in line with our estimates.



Source: Company; IDBI Capital Research

Exhibit 6: Q1FY24 EBIT margin improved by 370 bps QoQ



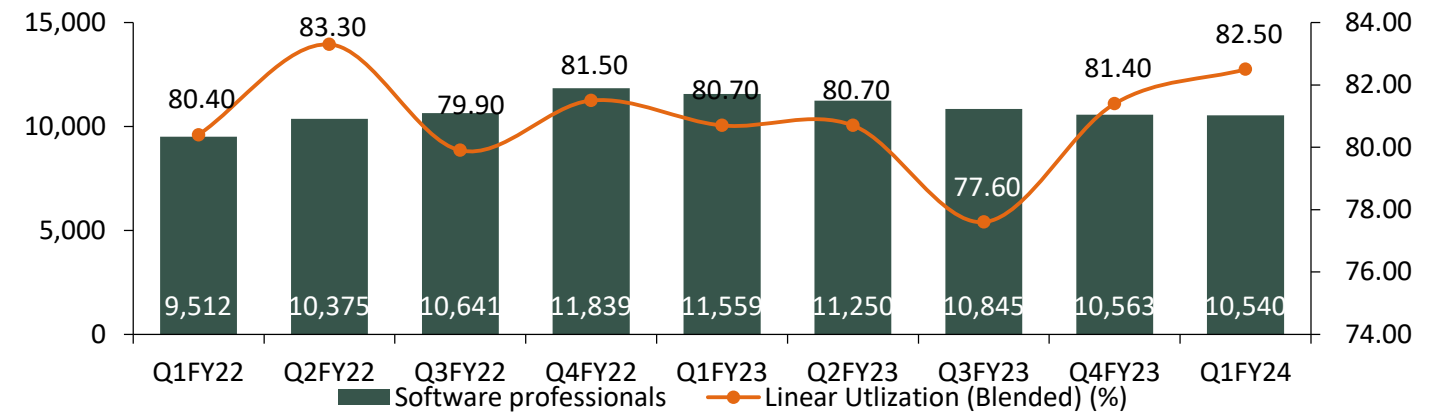
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

Parameters	% of revenue	QoQ growth (in CC)
Total revenue		1.3%
Geography		QoQ growth (in CC)
US	69.4%	-0.1%
Europe	19.2%	7.4%
Africa	11.4%	-0.5%
Service-Line		QoQ growth
AMS	81.7%	0.1%
IMS	18.3%	6.5%
Verticals		
Hi Tech & Manufacturing	38.1%	-5.3%
Retail & Consumer services	17.9%	10.3%
BFSI	34.2%	6.7%
Emerging	9.8%	-7.3%

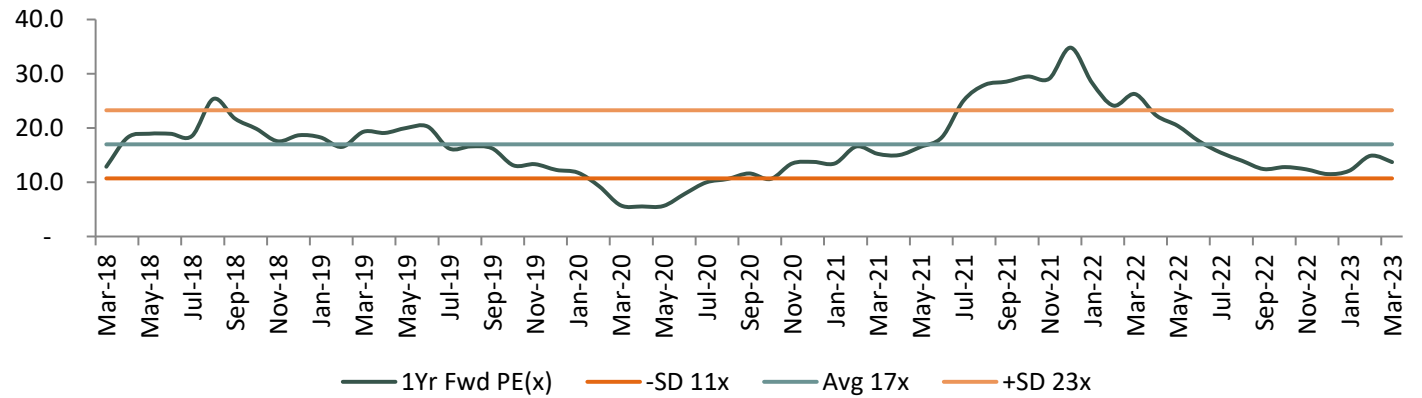
Source: Company; IDBI Capital Research

Exhibit 8: Utilisation improved QoQ



Source: Company; IDBI Capital Research

Exhibit 9: One-year forward PER trend



Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Net sales	41,817	37,814	42,437	48,483	50,986	57,338
<i>Change (yoy, %)</i>	5	(10)	12	14	5	12
Operating expenses	(36,746)	(30,966)	(35,872)	(42,960)	(42,398)	(47,591)
EBITDA	5,071	6,848	6,565	5,523	8,588	9,747
<i>Change (yoy, %)</i>	3	35	(4)	(16)	55	14
<i>Margin (%)</i>	12.1	18.1	15.5	11.4	16.8	17.0
Depreciation	(1,592)	(1,747)	(1,848)	(1,830)	(1,693)	(1,777)
EBIT	3,479	5,101	4,717	3,693	6,895	7,970
Interest paid	(605)	(535)	(353)	(280)	(280)	(280)
Other income	884	255	1,377	1,028	1,130	1,181
Pre-tax profit	3,758	4,820	5,741	4,441	7,745	8,871
Tax	(1,042)	(1,260)	(1,525)	(1,166)	(2,037)	(2,351)
<i>Effective tax rate (%)</i>	28	26	27	26	26	27
Minority Interest	(82)	(70)	(54)	-	-	-
Net profit	2,634	3,491	4,162	3,275	5,708	6,520
Exceptional items	-	-	-	-	-	-
Adjusted net profit	2,634	3,491	4,162	3,275	5,708	6,520
<i>Change (yoy, %)</i>	(16)	33	19	(21)	74	14
EPS	11.5	15.3	18.3	14.5	25.2	28.8
Dividend per sh	5	1	5	5	9	10
<i>Dividend Payout %</i>	45	8	27	35	35	35

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Shareholders' funds	20,900	23,423	26,592	28,984	32,694	36,932
Share capital	451	451	452	453	453	453
Reserves & surplus	20,449	22,972	26,140	28,531	32,241	36,479
Total Debt	2,886	-	-	-	-	-
Other liabilities	3,771	3,239	3,544	2,866	2,866	2,866
Curr Liab & prov	8,162	7,384	8,299	8,582	8,846	9,476
Current liabilities	6,481	5,880	6,693	6,248	6,391	6,716
Provisions	1,681	1,505	1,606	2,334	2,454	2,760
Total liabilities	14,819	10,623	11,843	11,448	11,712	12,342
Total equity & liabilities	35,956	34,334	38,712	41,210	45,184	50,052
Net fixed assets	13,340	11,330	12,858	11,735	11,409	11,106
Investments	-	-	-	-	-	-
Other non-curr assets	2,039	3,076	3,226	6,291	6,390	6,566
Current assets	20,576	19,928	22,628	23,184	27,384	32,380
Inventories	941	-	-	-	-	-
Sundry Debtors	6,656	5,888	7,967	7,298	7,675	8,631
Cash and Bank	5,166	6,986	8,559	7,280	10,990	14,817
Loans and advances	2,670	3,633	1,636	4,509	4,509	4,509
Total assets	35,956	34,334	38,712	41,210	45,184	50,052

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Pre-tax profit	3,758	4,820	5,741	4,441	7,745	8,871
Depreciation	1,137	1,677	1,803	1,838	1,755	1,739
Tax paid	(1,092)	(1,255)	(1,572)	(1,585)	(2,086)	(2,476)
Chg in working capital	143	(30)	832	(1,921)	(113)	(326)
Other operating activities	864	5,551	(1,031)	-	12	(4)
Cash flow from operations (a)	4,811	10,764	5,772	2,773	7,312	7,804
Capital expenditure	(4,860)	333	(3,330)	(715)	(1,429)	(1,437)
Chg in investments	-	-	-	-	-	-
Other investing activities	3,924	(4,605)	1,121	(1,920)	-	-
Cash flow from investing (b)	(936)	(4,272)	(2,209)	(2,635)	(1,429)	(1,437)
Equity raised/(repaid)	0	0	1	1	-	-
Debt raised/(repaid)	308	(2,886)	-	-	-	-
Dividend (incl. tax)	(1,197)	(271)	(1,135)	(1,132)	(1,998)	(2,282)
Chg in minorities	(14)	(19)	(64)	501	-	-
Other financing activities	(1,064)	(1,496)	(792)	(787)	(176)	(258)
Cash flow from financing (c)	(1,968)	(4,671)	(1,991)	(1,417)	(2,174)	(2,540)
Net chg in cash (a+b+c)	1,907	1,821	1,573	(1,279)	3,710	3,827

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	91.5	102.9	117.1	128.0	144.3	163.1
Adj EPS (Rs)	12	15	18	14	25	29
Adj EPS growth (%)	-17	33	20	-21	74	14
EBITDA margin (%)	12	18	15	11	17	17
Pre-tax margin (%)	9	13	14	9	15	15
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	14	19	16	12	20	21
ROE (%)	13.1	15.8	16.6	11.8	18.5	18.7

DuPont Analysis

Asset turnover (x)	1.3	1.1	1.2	1.2	1.2	1.2
Leverage factor (x)	1.7	1.6	1.5	1.4	1.4	1.4
Net margin (%)	6.3	9.2	9.8	6.8	11.2	11.4

Working Capital & Liquidity ratio

Inventory days	8	0	0	0	0	0
Receivable days	58	57	69	55	55	55
Payable days	26	26	32	24	25	25

Valuations

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
PER (x)	40.0	30.1	25.2	31.9	18.3	16.0
Price/Book value (x)	5.0	4.5	3.9	3.6	3.2	2.8
EV/Net sales (x)	2.5	2.6	2.3	2.0	1.8	1.6
EV/EBITDA (x)	20	14	15	18	11	9
Dividend Yield (%)	1	0	1	1	2	2

Source: Company; IDBI Capital Research



Notes

Dealing

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Key to Ratings Stocks:**BUY:** 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.**IDBI Capital Markets & Securities Ltd.****Equity Research Desk**

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