

Zensar Technologies

BUY

Macro challenges in near term, long term growth intact

Summary

Zensar reported declining revenue in Q3FY23 mainly led by furloughs and lower pass through revenues. However, it has registered improvement in EBITDA margins of ~273 bps to 11.3%. Further, the company aims to improve margins to mid-teens (~15-16%) by Q2FY24E. Further, the new CEO has been instrumental in turning around a smaller size IT company CSS corp . Under his leadership CSS corp registered 5% sequential quarterly growth in revenues and 18% EBITDA with 60%+ Cash conversion. We expect the new CEO to make a similar turnaround in Zensar. The new CEO's current focus is on improving margins followed by revenue growth. Hence, we have conservatively built in revenue & PAT CAGR of 9% & 37% over FY23E-FY25E respectively. We maintain our Buy rating on the stock with a target price of Rs 280 (12x PE on FY25E EPS).

Key Highlights and Investment Rationale

- New CEO commentary:** The new CEO has highlighted that instead of tweaking the existing strategy, he will focus on execution of strategy. In addition, his current focus is on improving margins followed by revenue growth. Further, the new CEO's focus is on profitable growth rather than just revenue growth. This coupled with deal wins of US\$130 mn prompt us to conservatively build revenue CAGR of 9% over FY23E-FY25E.
- Margins have bottomed out:** During the last few quarters, Company's margins were impacted due to high attrition & weakness in key verticals. However, easing of supply side, improving utilization rates and lower sub con cost will drive margins. Zensar aspires to achieve mid-teens margins by 2QFY24E. We have conservatively built 10.9%, 14.2% and 15% EBITDA margin for FY23E, FY24E & FY25E respectively.

TP	Rs280
CMP	Rs221
Potential upside/downside	26%
Previous Rating	BUY

Price Performance (%)

	-1m	-3m	-12m
Absolute	9.1	1.8	(50.1)
Rel to Sensex	7.3	(1.0)	(53.4)

V/s Consensus

EPS (Rs)	FY23E	FY24E	FY25E
IDBI Capital	12.6	19.7	23.8
Consensus	12.3	17.9	21.7
% difference	2.1	10.1	9.6

Key Stock Data

Bloomberg/Reuters	ZENT IN/ZENT.BO
Sector	IT Services
Shares o/s (mn)	226
Market cap. (Rs mn)	50,131
3-m daily average value (Rs mn)	21.4
52-week high / low	Rs444 / 202
Sensex / Nifty	60,942 / 18,119

Shareholding Pattern (%)

Promoters	49.2
FII	10.8
DII	11.4
Public	28.6

Financial snapshot

Year	FY21	FY22	FY23E	FY24E	FY25E
Revenue	37,814	42,437	48,544	52,892	58,711
Change (yoy, %)	(10)	12	14	9	11
EBITDA	6,848	6,565	5,267	7,511	8,807
Change (yoy, %)	35	(4)	(20)	43	17
EBITDA Margin(%)	18.1	15.5	10.9	14.2	15.0
Adj.PAT	3,491	4,162	2,893	4,506	5,458
EPS (Rs)	15.3	18.3	12.6	19.7	23.8
Change (yoy, %)	33	20	(31)	56	21
PE(x)	14	12	17	11	9
Dividend Yield (%)	1	2	2	2	3
EV/EBITDA (x)	6	6	8	5	4
RoE (%)	15.8	16.6	10.5	14.9	16.1
RoCE (%)	19	16	10	16	18

Source: IDBI Capital Research;

Con-call Highlights

- Revenue in CC terms declined on sequential basis by 5.3% and grew by 3.6% on YoY basis to USD 145.9 mn. Contraction in revenue was mainly due to higher furloughs and delay in decision making.
- In terms of verticals, BFSI reported sequential decline of 1.3% & YoY growth of 19.8% in CC terms. Decline was mainly on account of reduction in Insurance vertical revenue on the back of delayed decision making by a large customer. HTM registered QoQ & YoY decline of 9.3% & 2.5% in CC terms led by higher furloughs & absence of pass through revenue. Consumer services reported a sequential and YoY contraction of 2.3% & 6.8% as macro uncertainties & inflation resulted in reduced discretionary spends.
- In terms of geographies, decline in US (-8% QoQ, -2.1% YoY in CC) was partially offset by growth in Europe (+2.2% QoQ, 18.7% YoY in CC) and Africa (+15% QoQ, flat YoY in CC). Company stated that despite challenging conditions in Europe, it was able to record growth due to its strong customer relationship. In Africa, growth in Banking and Consumer vertical was partially offset by decline in Insurance.
- Order book stood at USD 130.5 mn vs USD 141.8 mn in previous quarter (~8% reduction QoQ). The average order book for past 4 quarter now stands at USD 140.7 mn. 35% of the order book is net new which previously used to be at ~45%.
- Despite higher furloughs during the quarter, EBIT margin improved by 256 bps QoQ to 7.1%. Improvement in margin was led by lower cost of delivery (+360 bps), favorable currency movement, better realization, lower pass through revenue and reversal of provision for bad debts.
- Outlook – Company believes that on an overall basis, the worst has passed by. However, the macro environment still remains challenging as Insurance, HTM & CS verticals are seeing a lot of headwinds. Management expects CS and HTM verticals (~57% of revenues) to either perform at market levels or slightly better going forward. BFS is expected to remain strong. Insurance vertical is expected to stabilize in the near term. Africa & UK are expected to show steady performance going forward. Zensar would aim to increase annuity revenue by focusing on client relationship as this provides better visibility.
- Company aims to reach mid teen EBITDA margin by Q2FY24E on the back of levers like better utilization, easing supply side challenges and better pyramid. LTM attrition moderated to 22.8% v/s 26.3% QoQ.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q3FY23	Q2FY23	QoQ (%)	Q3FY22	YoY (%)
Revenues (US\$ mn)	145.9	155.0	(5.9)	147.1	(0.8)
Revenues	11,976	12,346	(3.0)	11,025	8.6
COGS	8,699	9,218	(5.6)	7,758	12.1
Gross profit	3,277	3,128	4.8	3,267	0.3
SG&A	1,928	2,074	(7.0)	1,682	14.6
EBITDA	1,349	1,054	28.0	1,585	(14.9)
Depreciation & amortization	497	492	1.0	474	4.9
EBIT	852	562	51.6	1,111	(23.3)
Other income	183	209	(12.4)	152	20.4
PBT	1,035	771	34.2	1,263	(18.1)
Tax	270	203	33.0	339	(20.4)
Minority interest	0	0	n.m.	(14)	n.m.
Adjusted net profit	765	568	34.7	910	(15.9)
Exceptional item	0	0	n.m.	0	n.m.
Reported net profit	765	568	34.7	910	(15.9)
Diluted EPS (Rs)	3.4	2.5	35.5	4.0	(16.4)
As % of net revenue					
Gross profit	27.4	25.3		29.6	
SG&A	16.1	16.8		15.3	
EBITDA	11.3	8.5		14.4	
EBIT	7.1	4.6		10.1	
Reported net profit	6.4	4.6		8.3	
Tax rate	26.1	26.3		26.8	

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

Year-end: March	FY23F			FY24F			FY25F		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	604	643	-6.0%	643	695	-7.4%	714	738	-3.2%
Revenue (Rs bn)	48,544	49,543	-2.0%	52,892	53,507	-1.1%	58,711	59,066	-0.6%
EBIT	3,292	3,757	-12.4%	5,436	5,347	1.7%	6,629	6,523	1.6%
EBIT margin (%)	6.8%	7.60%	(82) bps	10.3%	10.00%	28 bps	11.3%	11.0%	29 bps
EPS (Rs)	12.6	13.7	-7.8%	19.7	19.5	0.9%	23.8	23.9	-0.3%

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

Year to March	Q2FY23	Q2FY23E	Variance (%)
Revenue (US\$ mn)	145.9	147.6	-1.1%
Revenue (Rs mn)	11,976	12,130	-1.3%
EBIT (Rs mn)	852	686	24.3%
EBIT margin (%)	7.1%	5.7%	146 bps
Recurring PAT (Rs mn)	765	659	16.0%
Recurring PAT margin (%)	6.4%	5.4%	95 bps
EPS (Rs)	3.4	2.9	16.7%

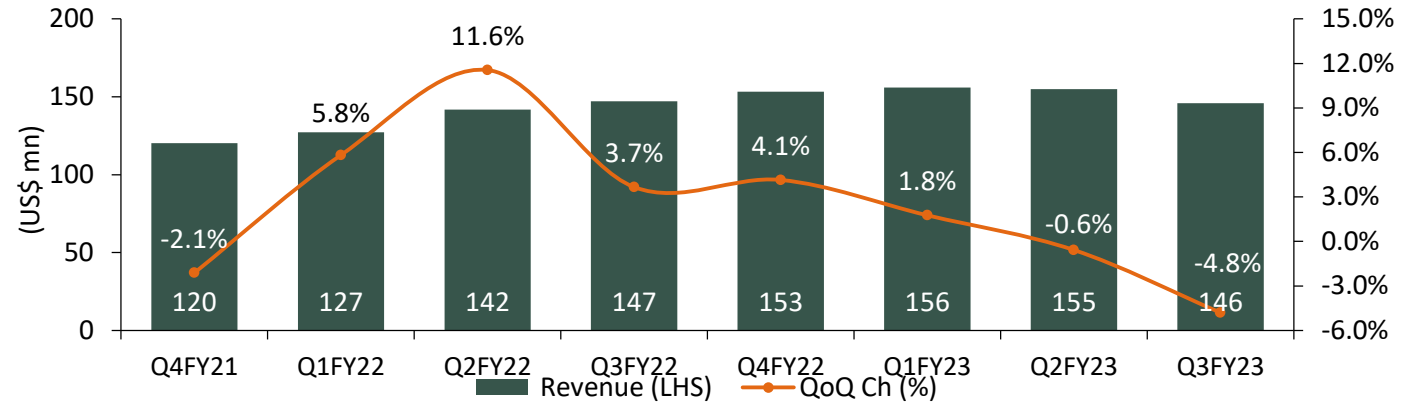
Source: Company; IDBI Capital Research

Exhibit 4: Large clients trend

Year-end: March	Q4FY21	Q1FY21	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
US\$1 mn+	78	79	85	81	83	86	87	87
US\$5 mn+	24	24	26	25	27	26	28	28
US\$10 mn+	7	8	10	11	11	13	13	15
US\$20 mn+	2	3	3	4	4	4	3	4

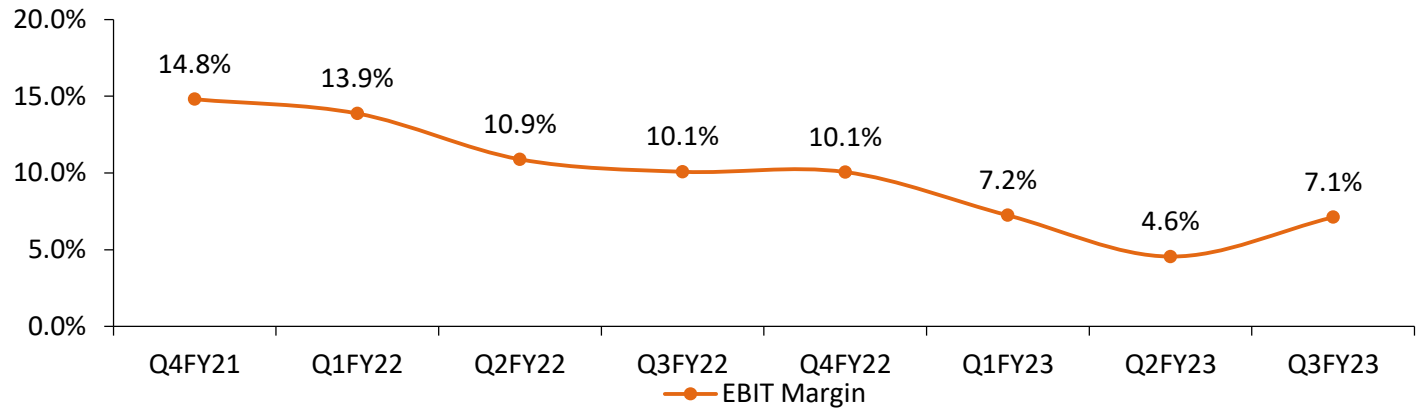
Source: Company; IDBI Capital Research

Exhibit 5: Q3FY23 Revenue growth was below our estimates.



Source: Company; IDBI Capital Research

Exhibit 6: Q3FY23 EBIT margin improved by 256 bps QoQ



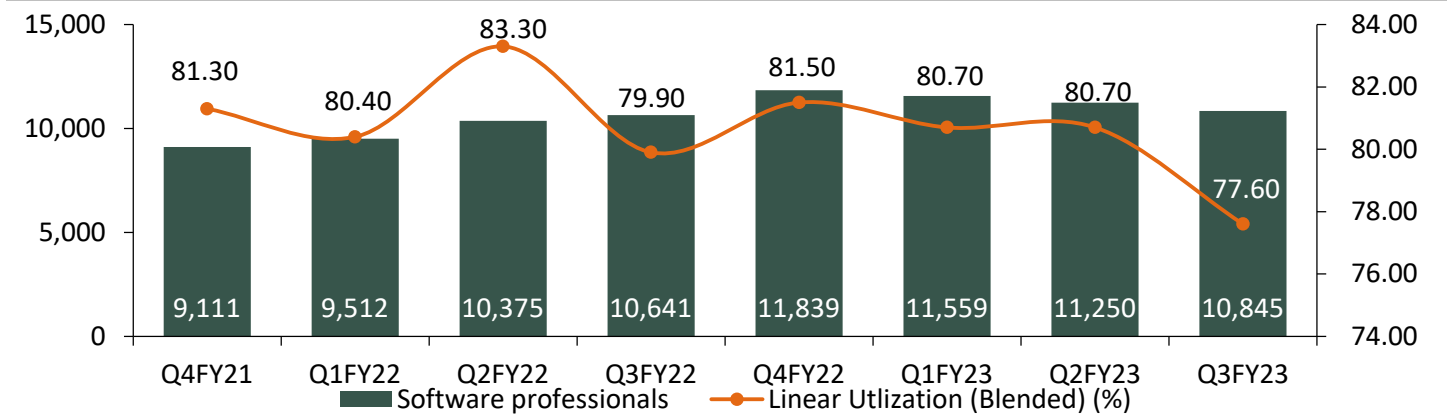
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

Parameters	% of revenue	YoY growth (in CC)
Total revenue		3.6%
Geography		QoQ growth (in CC)
US	70.0%	-8.0%
Europe	18.7%	1.2%
Africa	11.3%	-3.3%
Service-Line		
AMS	80.7%	-5.0%
IMS	19.3%	-9.2%
Verticals		
Hi Tech & Manufacturing	38.1%	-5.9%
Retail & Consumer services	18.4%	-3.2%
BFSI	35.5%	-2.3%
Emerging	7.9%	-24.1%

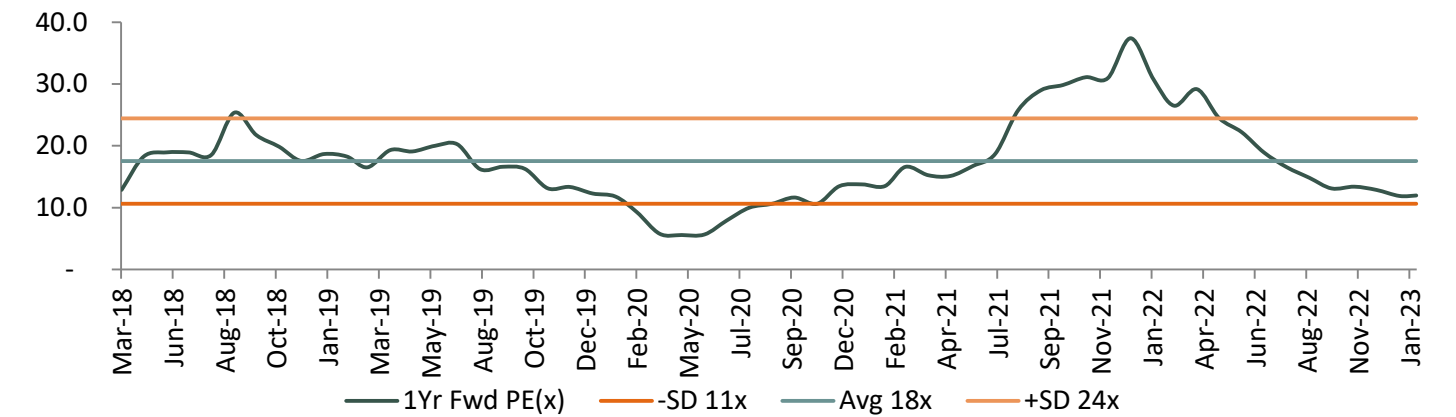
Source: Company; IDBI Capital Research

Exhibit 8: Utilisation declined 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	FY23E	FY24E	FY25E
Net sales	41,817	37,814	42,437	48,544	52,892	58,711
<i>Change (yoy, %)</i>	5	(10)	12	14	9	11
Operating expenses	(36,746)	(30,966)	(35,872)	(43,277)	(45,382)	(49,904)
EBITDA	5,071	6,848	6,565	5,267	7,511	8,807
<i>Change (yoy, %)</i>	3	35	(4)	(20)	43	17
<i>Margin (%)</i>	12.1	18.1	15.5	10.9	14.2	15.0
Depreciation	(1,592)	(1,747)	(1,848)	(1,976)	(2,074)	(2,178)
EBIT	3,479	5,101	4,717	3,292	5,436	6,629
Interest paid	(605)	(535)	(353)	(291)	(291)	(291)
Other income	884	255	1,377	1,015	1,072	1,181
Pre-tax profit	3,758	4,820	5,741	4,016	6,217	7,518
Tax	(1,042)	(1,260)	(1,525)	(1,064)	(1,647)	(1,992)
<i>Effective tax rate (%)</i>	28	26	27	27	27	27
Minority Interest	(82)	(70)	(54)	(58)	(63)	(68)
Net profit	2,634	3,491	4,162	2,893	4,506	5,458
Exceptional items	-	-	-	-	-	-
Adjusted net profit	2,634	3,491	4,162	2,893	4,506	5,458
<i>Change (yoy, %)</i>	(16)	33	19	(30)	56	21
EPS	11.5	15.3	18.3	12.6	19.7	23.8
Dividend per sh	5	1	5	3	5	7
<i>Dividend Payout %</i>	45	8	27	27	27	27

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Shareholders' funds	20,900	23,423	26,592	28,695	31,971	35,939
Share capital	451	451	452	452	452	452
Reserves & surplus	20,449	22,972	26,140	28,243	31,519	35,487
Total Debt	2,886	-	-	-	-	-
Other liabilities	3,771	3,239	3,544	3,544	3,544	3,544
Curr Liab & prov	8,162	7,384	8,299	8,921	9,299	9,933
Current liabilities	6,481	5,880	6,693	7,315	7,549	7,991
Provisions	1,681	1,505	1,606	1,606	1,750	1,942
Total liabilities	14,819	10,623	11,843	12,465	12,843	13,477
Total equity & liabilities	35,956	34,334	38,712	41,438	45,091	49,694
Net fixed assets	13,340	11,330	12,858	12,208	11,533	10,853
Investments	-	-	-	-	-	-
Other non-curr assets	2,039	3,076	3,226	3,320	3,422	3,542
Current assets	20,576	19,928	22,628	25,910	30,137	35,300
Inventories	941	-	-	-	-	-
Sundry Debtors	6,656	5,888	7,967	9,223	10,050	11,155
Cash and Bank	5,166	6,986	8,559	10,535	13,722	17,510
Loans and advances	2,670	3,633	1,636	1,636	1,636	1,636
Total assets	35,956	34,334	38,712	41,438	45,091	49,694

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Pre-tax profit	3,758	4,820	5,741	4,016	6,217	7,518
Depreciation	1,137	1,677	1,803	1,918	2,030	2,131
Tax paid	(1,092)	(1,255)	(1,572)	(1,108)	(1,700)	(2,062)
Chg in working capital	143	(30)	832	(634)	(449)	(471)
Other operating activities	864	5,551	(1,031)	(483)	(786)	(319)
Cash flow from operations (a)	4,811	10,764	5,772	3,709	5,312	6,798
Capital expenditure	(4,860)	333	(3,330)	(1,268)	(1,355)	(1,451)
Chg in investments	-	-	-	-	-	-
Other investing activities	3,924	(4,605)	1,121	1,171	1,305	-
Cash flow from investing (b)	(936)	(4,272)	(2,209)	(97)	(50)	(1,451)
Equity raised/(repaid)	0	0	1	-	-	-
Debt raised/(repaid)	308	(2,886)	-	-	-	-
Dividend (incl. tax)	(1,197)	(271)	(1,135)	(790)	(1,230)	(1,490)
Chg in minorities	(14)	(19)	(64)	(58)	(63)	(68)
Other financing activities	(1,064)	(1,496)	(792)	(787)	(782)	-
Cash flow from financing (c)	(1,968)	(4,671)	(1,991)	(1,635)	(2,076)	(1,558)
Net chg in cash (a+b+c)	1,907	1,821	1,573	1,976	3,187	3,788

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
Book Value (Rs)	91.5	102.9	117.1	125.3	139.6	156.9
Adj EPS (Rs)	12	15	18	13	20	24
Adj EPS growth (%)	-17	33	20	-31	56	21
EBITDA margin (%)	12	18	15	11	14	15
Pre-tax margin (%)	9	13	14	8	12	13
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	14	19	16	10	16	18
ROE (%)	13.1	15.8	16.6	10.5	14.9	16.1

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	6.0	8.5	9.3

Working Capital & Liquidity ratio

Inventory days	8	0	0	0	0	0
Receivable days	58	57	69	69	69	69
Payable days	26	26	32	32	32	33

Valuations

Year-end: March	FY20	FY21	FY22	FY23E	FY24E	FY25E
PER (x)	19.2	14.4	12.1	17.5	11.2	9.3
Price/Book value (x)	2.4	2.1	1.9	1.8	1.6	1.4
EV/Net sales (x)	1.2	1.1	1.0	0.8	0.7	0.6
EV/EBITDA (x)	10	6	6	8	5	4
Dividend Yield (%)	2	1	2	2	2	3

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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