

# Zensar Technologies

## BUY

Long term prospect looks attractive

### Summary

Zensar's Q3FY22 revenues were below peers and profitability was subdued. However, we believe the company is in turnaround phase and will take few quarters to get in line with industry level growth. The company is winning deals and has seen healthy client mining (addition of 1 client in US\$20 mn and US\$10 mn category). In addition, improving logo addition in Hi tech, robust growth in BFSI, addition of new leadership, defined sales pitch and new sales hires bodes well for future revenue growth. In addition, the company aims to improve margins by offshoring, pyramid rationalization, lower sub-contracting cost and price hikes. The company expects to maintain mid-teens margins in near term (4-5 quarters) and high teen margin in longer term. Hence, we maintain our BUY rating on the stock with a target price of Rs 585/share (PE of 21x on FY24 EPS).

### Key Highlights and Investment Rationale

#### Consistent deal wins, new logos & restructuring to drive growth

Revenue growth in Q3 was impacted by furloughs in Hi Tech. We expect the company to register improving growth in Hi tech, BFSI and consumer services led by absence of furloughs, new logo addition and new leadership. Further Zensar is witnessing consistent deal wins (US\$125 mn in Q3), improving client mining, benefits from salesforce & hyperscaler partnership and hiring of new leadership which bodes well for long term revenue growth.

#### Margins to improve in the long run

Zensar has taken a long term view on margins and is addressing talent issue by hiring fresher, lower sub-contracting; reduce time to productivity, up skilling, reskilling, price hike, near-shoring and offshoring. This will help to achieve high teen margins in long run.

<b>TP</b>	<b>Rs585</b>
<b>CMP</b>	<b>Rs416</b>
Potential upside/downside	+41%
Previous Rating	BUY

### Price Performance (%)

	-1m	-3m	-12m
Absolute	(12.8)	(14.7)	72.7
Rel to Sensex	(13.5)	(9.2)	55.1

### V/s Consensus

EPS (Rs)	FY22E	FY23E	FY24E
IDBI Capital	17.4	21.3	27.9
Consensus	17.0	21.9	26.1
% difference	2.1	(2.5)	7.0

### Key Stock Data

Bloomberg/Reuters	ZENT IN/ZENT.BO
Sector	IT Services
Shares o/s (mn)	226
Market cap. (Rs mn)	94,132
3-m daily average value (Rs mn)	82.3
52-week high / low	Rs587 / 222
Sensex / Nifty	57,492 / 17,149

### Shareholding Pattern (%)

Promoters	49.1
FII	17.8
DII	13.6
Public	19.5

### Financial snapshot

(Rs mn)

Year	FY20	FY21	FY22E	FY23E	FY24E
Revenue	41,817	37,814	42,405	50,014	58,016
Change (yoy, %)	5	(10)	12	18	16
EBITDA	5,071	6,848	6,734	8,252	10,269
Change (yoy, %)	3	35	(2)	23	24
EBITDA Margin(%)	12.1	18.1	15.9	16.5	17.7
Adj.PAT	2,634	3,491	3,955	4,850	6,357
EPS (Rs)	11.5	15.3	17.4	21.3	27.9
Change (yoy, %)	(17)	33	13	23	31
PE(x)	36	27	24	20	15
Dividend Yield (%)	1	0	1	1	2
EV/EBITDA (x)	18	13	13	10	8
RoE (%)	13.1	15.8	15.9	17.2	19.5
RoCE (%)	14	19	17	20	23

Source: IDBI Capital Research;

### Concall Highlights

- Despite seasonally weak quarter company had a broad based growth
- US 20.8%/4.4% growth was primarily driven by BFSI and consumer services verticals
- Europe had a 6<sup>th</sup> consecutive quarter of growth 23.7%/6.1%; while south Africa had slightly muted performance 8.3%/-3.1% due cross currency headwind
- BFSI had a consistent performance 21.3%/6.1% with multiple wins this quarter, consumers services, 26%/8.5% witnessing attraction from various offerings from new and existing customers
- Hi tech Manufacturing 7.1%/-3.4% had an impact of furloughs and some project closures
- Gross margin was 29.6%, -100bps primarily due to cross currency impact of 0.4%, furlough and utilization of 1.2% which partially offset by improved cost of delivery 0.6%
- Order book stood at US\$125.2mn of which 32% was net new wins and 68% of renewals; added 1 clients each to US\$20mn+ and US\$10mn clients category.
- Company has elevated fresher hiring program and plans to triple the fresher intake in next 12 months. Working toward expanding talent catchment by expanding near shore delivery location within India and also in Latent and South America and east Europe, in order to meet the talent requirement. Also working with clients for selective rate hikes.
- Enhanced partnership with hyperscalers has augmented the cloud transformation capability
- ETR was 26.9% vs. 25.5% QoQ, ETR was elevated due to onetime hit or else it would have been 26%.
- Margin is expected remain in mid-teens for next few quarter and as the margin levers kicks in company will aim to achieve high teens.
- Company is on track and would require 2-4 quarter to achieve the predictable and profitable growth.
- Subcontracting expenses has increased from 14.9% to 15.2%, due to inelastic supply demand, cost of hire for replacement of attrition has gone up, wage hikes have been increased, and expect the subcon cost to remain elevated until supply constrain persists.

## Exhibit 1: Financial snapshot

(Rs mn)

Q3FY22 revenue growth of 4.7%/19.9% QoQ in CC was a beat to our forecast.

EBIT margin declined by 80bps QoQ to 10.1%.

Year-end: March	Q3FY22	Q2FY22	QoQ (%)	Q3FY21	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>147.1</b>	<b>141.9</b>	<b>3.7</b>	<b>122.8</b>	<b>19.8</b>
<b>Revenues</b>	<b>11,025</b>	<b>10,506</b>	<b>4.9</b>	<b>9,065</b>	<b>21.6</b>
COGS	7,758	7,292	6.4	5,925	30.9
Gross profit	3,267	3,214	1.6	3,140	4.0
SG&A	1,683	1,602	5.1	1,277	31.8
<b>EBITDA</b>	<b>1,584</b>	<b>1,612</b>	<b>(1.7)</b>	<b>1,863</b>	<b>(15.0)</b>
Depreciation & amortization	474	468	1.3	421	12.6
EBIT	1,110	1,144	(3.0)	1,442	(23.0)
Other income	152	142	7.0	-82	(285.4)
PBT	1,262	1,286	(1.9)	1,360	(7.2)
Tax	339	328	3.4	360	(5.8)
Minority interest	-14	-14	n.m.	-13	n.m.
<b>Adjusted net profit</b>	<b>909</b>	<b>944</b>	<b>(3.7)</b>	<b>987</b>	<b>(7.9)</b>
Exceptional item	0	0	n.m.	402	n.m.
<b>Reported net profit</b>	<b>909</b>	<b>944</b>	<b>(3.7)</b>	<b>987</b>	<b>(7.9)</b>
<b>Diluted EPS (Rs)</b>	<b>4.0</b>	<b>4.2</b>	<b>(3.6)</b>	<b>4.3</b>	<b>(7.0)</b>
<b>As % of net revenue</b>					
Gross profit	29.6	30.6		34.6	
SG&A	15.3	15.2		14.1	
EBITDA	14.4	15.3		20.6	
EBIT	10.1	10.9		15.9	
Reported net profit	8.2	9.0		10.9	
Tax rate	26.9	25.5		26.5	

Source: Company; IDBI Capital Research

**Exhibit 2: Earnings Revision**

Year-end: March	FY22F			FY23F			FY24E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (US\$ mn)	570	565	0.8%	667	661	0.8%	774	767	0.8%
Revenue (Rs bn)	42,405	41,838	1.4%	50,014	49,612	0.8%	58,016	57,550	0.8%
EBIT	4,899	4,483	9.3%	6,326	6,508	-2.8%	8,246	8,336	-1.1%
EBIT margin (%)	11.6%	10.7%	0 bps	12.6%	13.1%	(47) bps	14.2%	14.5%	(27) bps
EPS (Rs)	17.4	16.1	8.2%	21.3	21.9	-2.7%	27.9	28.2	-1.1%

Source: Company; IDBI Capital Research

**Exhibit 3: Actual vs. estimates**

Year to March	Q3FY22	Q3FY22E	Variance (%)
Revenue (US\$ mn)	147.1	145.9	0.8%
Revenue (Rs mn)	11,025	10,940	0.8%
EBIT (Rs mn)	1,110	932	19.0%
EBIT margin (%)	10.1%	8.5%	155 bps
Recurring PAT (Rs mn)	909	786	15.6%
Recurring PAT margin (%)	8.2%	7.2%	106 bps
EPS (Rs)	4.0	3.5	15.7%

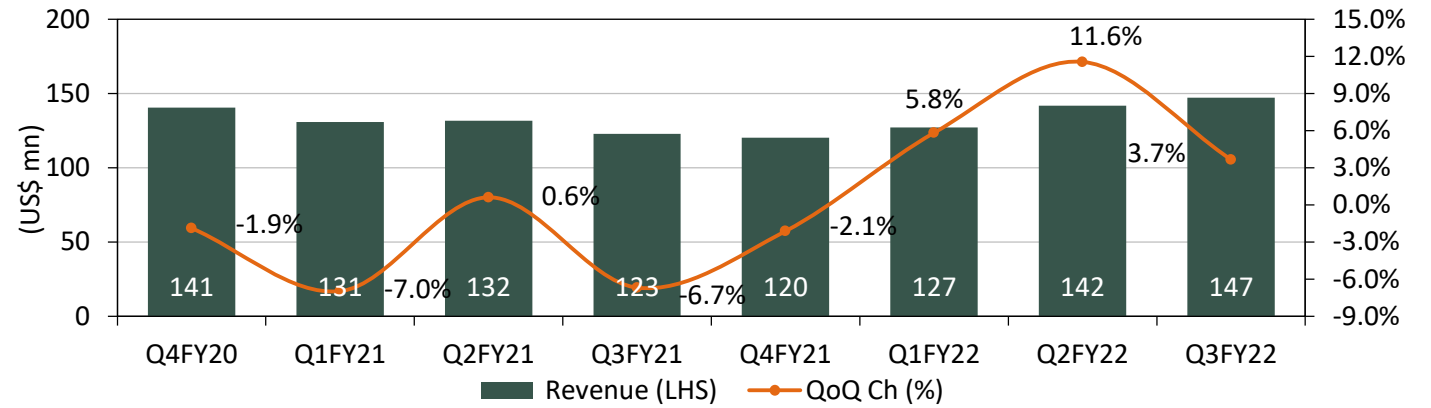
Source: Company; IDBI Capital Research

**Exhibit 4: Large clients trend**

Year-end: March	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY21	Q2FY22	Q3FY22
US\$1 mn+	87	85	86	83	78	79	85	81
US\$10 mn+	24	24	24	24	24	24	26	25
US\$50 mn+	10	9	8	8	7	8	10	11
US\$100 mn+	2	2	2	2	2	3	3	4

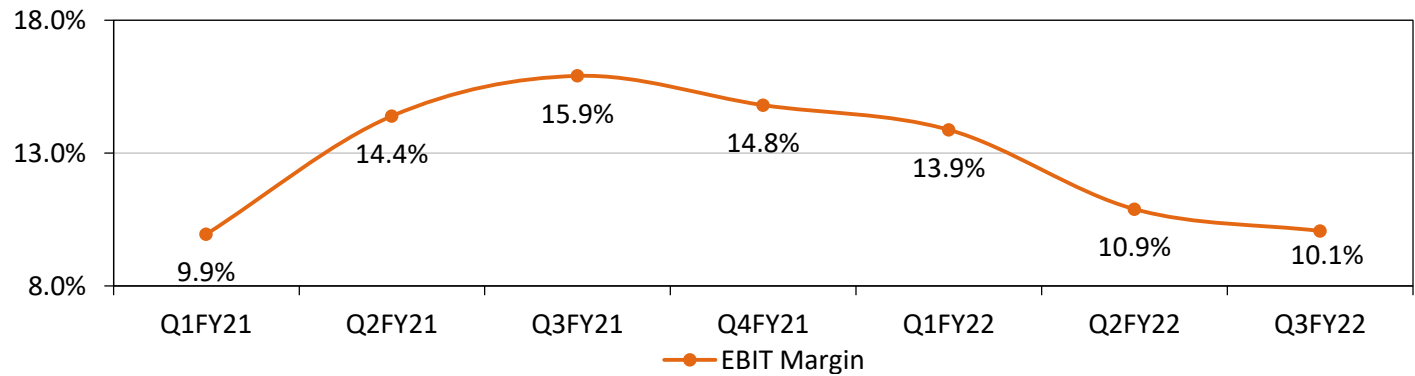
Source: Company; IDBI Capital Research

**Exhibit 5: Q3FY22 Revenue growth was beat to our forecast**



Source: Company; IDBI Capital Research

**Exhibit 6: Q3FY22 EBIT margin was better than our estimate**



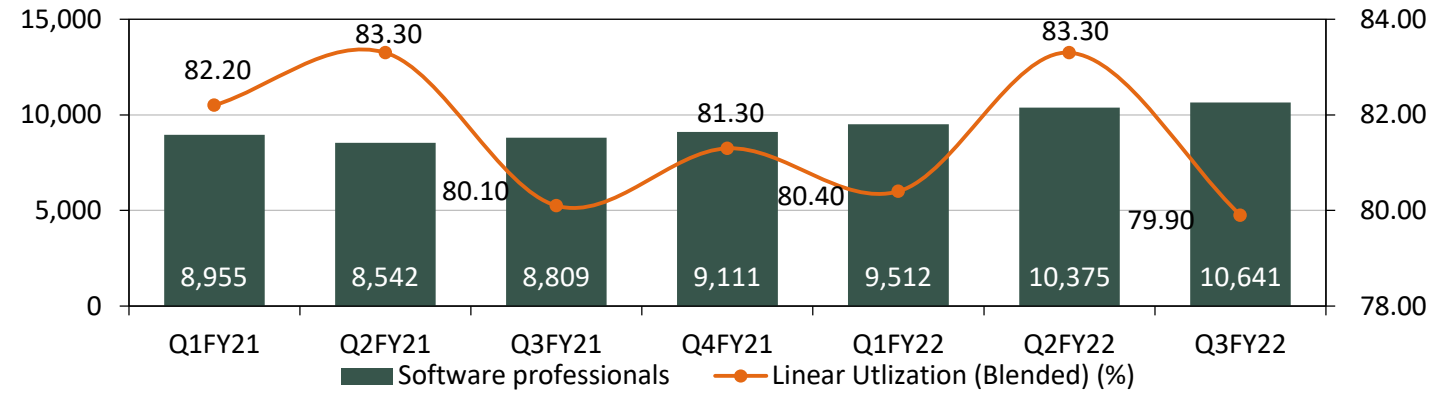
Source: Company; IDBI Capital Research

**Exhibit 7: Revenue growth across various segments (%)**

Parameters	% of revenue	YoY growth (in CC)
Total revenue		19.9%
Digital revenue	71%	31.8%
<b>Geography</b>		
US	70.9%	4.4%
Europe	18.0%	6.0%
India	11.1%	-4.1%
<b>Service-Line</b>		
AMS	82.3%	0.6%
IMS	17.7%	20.7%
<b>Verticals</b>		
Hi Tech	36.7%	-2.1%
Manufacturing	9.7%	-5.6%
Consumer services	16.1%	9.6%
Insurance	17.6%	-1.4%
Banking	14.1%	22.4%
Emerging	5.8%	57.2%

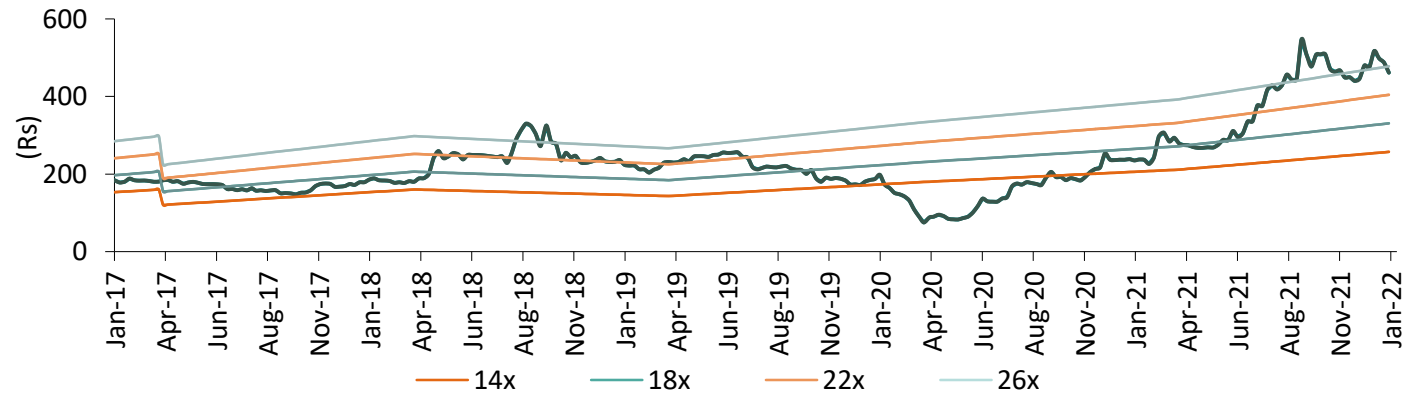
Source: Company; IDBI Capital Research

**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	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Net sales</b>	<b>39,663</b>	<b>41,817</b>	<b>37,814</b>	<b>42,405</b>	<b>50,014</b>	<b>58,016</b>
<i>Change (yoy, %)</i>	28	5	(10)	12	18	16
Operating expenses	(34,897)	(36,746)	(30,966)	(35,671)	(41,762)	(47,748)
<b>EBITDA</b>	<b>4,928</b>	<b>5,071</b>	<b>6,848</b>	<b>6,734</b>	<b>8,252</b>	<b>10,269</b>
<i>Change (yoy, %)</i>	32	3	35	(2)	23	24
<i>Margin (%)</i>	12.4	12.1	18.1	15.9	16.5	17.7
Depreciation	(894)	(1,592)	(1,747)	(1,834)	(1,926)	(2,022)
<b>EBIT</b>	<b>4,034</b>	<b>3,479</b>	<b>5,101</b>	<b>4,899</b>	<b>6,326</b>	<b>8,246</b>
Interest paid	(373)	(605)	(535)	(354)	(354)	(354)
Other income	793	884	255	894	712	848
<b>Pre-tax profit</b>	<b>4,454</b>	<b>3,758</b>	<b>4,820</b>	<b>5,439</b>	<b>6,684</b>	<b>8,740</b>
Tax	(1,267)	(1,042)	(1,260)	(1,426)	(1,771)	(2,316)
<i>Effective tax rate (%)</i>	28	28	26	26	27	27
Minority Interest	(51)	(82)	(70)	(58)	(63)	(68)
<b>Net profit</b>	<b>3,136</b>	<b>2,634</b>	<b>3,491</b>	<b>3,955</b>	<b>4,850</b>	<b>6,357</b>
Exceptional items	-	-	-	-	-	-
<b>Adjusted net profit</b>	<b>3,136</b>	<b>2,634</b>	<b>3,491</b>	<b>3,955</b>	<b>4,850</b>	<b>6,357</b>
<i>Change (yoy, %)</i>	30	(16)	33	13	23	31
EPS	13.9	11.5	15.3	17.4	21.3	27.9
Dividend per sh	3	5	1	4	5	7
<i>Dividend Payout %</i>	20	45	8	24	24	24



**Balance Sheet**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Shareholders' funds</b>	<b>19,424</b>	<b>20,900</b>	<b>23,423</b>	<b>26,429</b>	<b>30,115</b>	<b>34,946</b>
Share capital	450	451	451	451	451	451
Reserves & surplus	18,973	20,449	22,972	25,978	29,664	34,495
<b>Total Debt</b>	<b>2,578</b>	<b>2,886</b>	-	-	-	-
Other liabilities	775	3,771	3,239	3,239	3,239	3,239
<b>Curr Liab &amp; prov</b>	<b>7,951</b>	<b>8,162</b>	<b>7,384</b>	<b>7,685</b>	<b>8,404</b>	<b>9,102</b>
Current liabilities	5,940	6,481	5,880	6,180	6,629	7,043
Provisions	2,011	1,681	1,505	1,505	1,775	2,059
<b>Total liabilities</b>	<b>11,304</b>	<b>14,819</b>	<b>10,623</b>	<b>10,924</b>	<b>11,643</b>	<b>12,341</b>
<b>Total equity &amp; liabilities</b>	<b>30,897</b>	<b>35,956</b>	<b>34,334</b>	<b>37,640</b>	<b>42,045</b>	<b>47,574</b>
Net fixed assets	9,617	13,340	11,330	12,540	11,964	11,428
Investments	-	-	-	-	-	-
Other non-curr assets	1,898	2,039	3,076	3,143	3,284	3,430
<b>Current assets</b>	<b>19,382</b>	<b>20,576</b>	<b>19,928</b>	<b>21,957</b>	<b>26,797</b>	<b>32,716</b>
Inventories	985	941	-	-	-	-
Sundry Debtors	8,762	6,656	5,888	6,573	7,752	8,993
Cash and Bank	3,259	5,166	6,986	8,280	11,617	15,958
Loans and advances	454	2,670	3,633	3,633	3,633	3,633
<b>Total assets</b>	<b>30,897</b>	<b>35,956</b>	<b>34,334</b>	<b>37,640</b>	<b>42,045</b>	<b>47,574</b>

**Cash Flow Statement**

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Pre-tax profit	4,454	3,758	4,820	5,439	6,684	8,740
Depreciation	1,197	1,137	1,725	1,834	1,885	1,979
Tax paid	(1,404)	(1,092)	(1,255)	(1,443)	(1,863)	(2,412)
Chg in working capital	1,235	143	(30)	(385)	(460)	(542)
Other operating activities	(3,041)	864	5,551	(429)	(767)	(912)
<b>Cash flow from operations (a)</b>	<b>2,441</b>	<b>4,811</b>	<b>10,812</b>	<b>5,016</b>	<b>5,479</b>	<b>6,853</b>
Capital expenditure	(4,839)	(4,860)	285	(3,044)	(1,309)	(1,443)
Chg in investments	-	-	-	-	-	-
Other investing activities	1,579	3,924	(4,605)	1,121	1,171	1,305
<b>Cash flow from investing (b)</b>	<b>(3,260)</b>	<b>(936)</b>	<b>(4,320)</b>	<b>(1,923)</b>	<b>(138)</b>	<b>(138)</b>
Equity raised/(repaid)	0	0	0	-	-	-
Debt raised/(repaid)	2,519	308	(2,886)	-	-	-
Dividend (incl. tax)	(633)	(1,197)	(271)	(949)	(1,164)	(1,526)
Chg in minorities	(18)	(14)	(19)	(58)	(63)	(68)
Other financing activities	141	(1,064)	(1,496)	(792)	(787)	(782)
<b>Cash flow from financing (c)</b>	<b>2,009</b>	<b>(1,968)</b>	<b>(4,671)</b>	<b>(1,799)</b>	<b>(2,014)</b>	<b>(2,376)</b>
<b>Net chg in cash (a+b+c)</b>	<b>1,190</b>	<b>1,907</b>	<b>1,821</b>	<b>1,294</b>	<b>3,327</b>	<b>4,339</b>

### Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
Book Value (Rs)	86.3	91.5	102.9	116.1	132.3	153.5
Adj EPS (Rs)	14	12	15	17	21	28
Adj EPS growth (%)	30	-17	33	13	23	31
EBITDA margin (%)	12	12	18	16	17	18
Pre-tax margin (%)	11	9	13	13	13	15
Net Debt/Equity (x)	0	0	0	0	0	0
ROCE (%)	20	14	19	17	20	23
ROE (%)	17.4	13.1	15.8	15.9	17.2	19.5
<b>DuPont Analysis</b>						
Asset turnover (x)	1.5	1.3	1.1	1.2	1.3	1.3
Leverage factor (x)	1.5	1.7	1.6	1.4	1.4	1.4
Net margin (%)	7.9	6.3	9.2	9.3	9.7	11.0
<b>Working Capital &amp; Liquidity ratio</b>						
Inventory days	9	8	0	0	0	0
Receivable days	81	58	57	57	57	57
Payable days	31	26	26	26	26	26

### Valuations

Year-end: March	FY19	FY20	FY21	FY22E	FY23E	FY24E
PER (x)	29.9	36.1	27.1	24.0	19.5	14.9
Price/Book value (x)	4.8	4.6	4.0	3.6	3.1	2.7
EV/Net sales (x)	2.3	2.2	2.3	2.0	1.7	1.4
EV/EBITDA (x)	19	18	13	13	10	8
Dividend Yield (%)	1	1	0	1	1	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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