Zensar Technologies (ZENTE)

ICICI direct Research

CMP: ₹ 232	Target: ₹ 235 (1%)	Target Period: 12 months	HOLD

January 25, 2023

Margin expansion takes front seat; growth recovery to take time

About the stock: Zensar Technologies (Zensar) offers application & IMS services to hi-tech, manufacturing, retail and BFSI.

- Zensar has grown organically and inorganically over the years
- Net debt free and healthy double digit return ratio (with RoCE of 19%)

Q3FY23 Results: Zensar reported weak numbers for Q3FY23.

- Revenue declined 5.3% QoQ in CC terms while dollar revenue fell 5.9% QoQ
- EBITDA margins improved ~280 bps QoQ to 11.3%
- Reported TCV of US$130.5 million, down 8% QoQ

What should investors do? Zensar's share price has grown by ~1.2x over the past five years (from ~₹ 188 in January 2018 to ~₹ 232 levels in January 2023).

- We maintain our **HOLD** rating on the stock

Target Price and Valuation: We value Zensar at ₹ 235 i.e. 13x P/E on FY25E.

Key triggers for future price performance:

- Management change is likely to bring in new initiatives to drive growth, which has been a pain point from last few quarters
- Moderation of subcontractor costs, which is expected to be one of the levers for margin expansion apart from pricing, utilisation improvement, more offshoring, etc
- Expect revenue growth at CAGR of 6.8% over FY22-25E

Alternate Stock Idea: Apart from Zensar, in our IT coverage we also like Persistent.

- Key beneficiary of growth in digital technologies and exposure to growth segments like healthcare & BFSI
- BUY with a target price of ₹ 4,920

ZENSAR

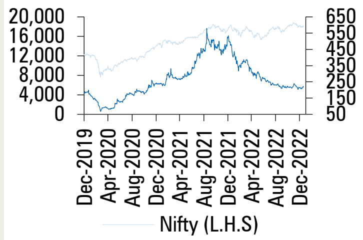
Particulars

Particular	Amount
Market Cap (₹ Crore)	5,281
Total Debt (₹ Crore)	-
Cash & Invets (₹ Crore)	1,020
EV (₹ Crore)	4,262
52 week H/L	486 / 202
Equity capital (₹ Crore)	45
Face value	₹ 2

Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	49	49	49	49
FII	17	16	13	11
DII	13	14	9	11
Public	21	21	29	29

Price Chart



Recent event & key risks

- TCV of US$130.5 mn, down 8% QoQ
- **Key Risk:** (i) Better-than-expected revenue (ii) Longer than expected recovery in key verticals

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Company Update

ICICI Securities – Retail Equity Research

Key Financial Summary

(₹ Crore)	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-
Net Sales	3,781	4,244	6.8%	4,806	4,810	5,169	6.8%
EBITDA	685	657	11.2%	509	601	734	3.8%
EBITDA Margin (%)	18.1	15.5		10.6	12.5	14.2	
Reported PAT	300	416	12.1%	232	312	406	-0.8%
EPS (₹)	13.2	18.3		10.3	13.8	17.9	
P/E	17.6	12.7		22.6	16.9	12.9	
ROE (%)	12.8	15.5		8.1	10.1	12.0	
ROCE (%)	18.9	15.5		10.1	12.1	14.7	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- Revenue during the quarter declined steeply. It reported revenue of US$145.9 mn, down 5.9% QoQ while in CC terms the decline was 5.3%. In rupee terms, the company reported revenue of ₹ 1,197.6 crore, down 3% QoQ. The company indicated that the revenue for the quarter was impacted by the higher than usual furloughs in Q3 and the continuance of macro environment headwinds on the key verticals of the company
- In CC terms, geography wise, US region (70% of the mix) declined 8% QoQ while Europe region reported muted growth of 2.2% QoQ. Africa region revenue was flat sequentially
- Vertical wise, in CC terms all verticals barring banking & emerging declined sequentially. Banking & emerging reported growth of 7.4% & 23.9%, respectively, while hi-tech, manufacturing, consumer service & insurance declined 4.9%, 7%, 2.3% & 10.3%, respectively
- The new CEO has indicated that margin expansion is the key focus area for the near term as it is not looking to buy business impacting margin performance. The strategy led by earlier CEO will continue for a time being in terms of continued investment in services lines till longer term strategy being worked out and it is likely to come up with the same in Q4
- The company indicated that growth in Europe was due to the strong relationship maintained by the company but it also indicated that it was witnessing some softness in demand in digital spending in the Europe due to delayed decision making. In Africa region the company indicated that growth in banking vertical was offset by the decline in Insurance. The company, however, expects this to improve as certain key clients are expected to ramp up the projects in upcoming quarters
- The company indicated that the Hi-Tech, Manufacturing & Emerging vertical was impacted by higher than expected furloughs, continuance of the deteriorating macros impacting the discretionary spend of clients & planned reduction of pass through revenues. In insurance vertical the company indicated that the revenue was impacted due to delayed decision making & deferral of milestone of a large client. It will take some time to recover on this
- EBITDA margins of the company improved 280 bps QoQ to 11.3%, aided by tailwinds of operational efficiency due to optimisation of employee cost by fresher deployment, improved offshoring, better realisations & SG&A rationalisation; currency benefits & one-time gain on reversal of bad debts (~+50 bps) mitigated by the headwinds of lower volumes & utilisations due to furloughs and lower pass-through revenue. The company indicated that it is looking to take margins around mid-teen range in three to four quarters from now. It mentioned that pricing is not conducive in this environment
- The company's LTM attrition declined 350 bps QoQ to 22.8% in Q3 & declined by 530 bps from the peak of 28.1%. The company indicated that it expects attrition to moderate further as supply side pressure eases out. The company's net employees during the quarter declined by 405 taking the total employee strength to 10,845. The technical employees of the company declined by 421 to 9,857 during the quarter Utilisation of the company declined 310 bps QoQ to 77.6% while offshore mix improved 180 bps QoQ to 44.7%
- The company during the quarter won TCV of US$130.5, down by 8% QoQ and indicated that 35% of TCV was from net new deals won during the quarter. The revenue from top five, 10, 20 declined 13.2%, 7.5%, 4.9%, respectively
- On the demand front the company indicated that the macro environment still remains challenging. The company had earlier indicated that it was witnessing softness in the verticals of Hi-Tech, Manufacturing & Consumer services now it is witnessing some softness in the Insurance vertical as well

due to delayed decision making by clients. The company further indicated that it expects the consumer services vertical to remain under pressure due to recessionary environment but it optimistic of gradual recovery in Hi-Tech & manufacturing vertical. The company further indicated that it is focusing on the revenue growth of the company but indicated that growth would be gradual process

- The company indicated that it has enough cash balances on its books (US$179.4 mn) and is looking for M&A opportunity to accelerate the growth of the company
- The company appointed Manish Tandon as CEO & MD of the company for five years from January 2023. MrTandon has over 27 years of industry experience and last served as CEO of CSS Corp, a technology services company in US and prior to that he worked with Infosys for 20 years
- The company declared an interim dividend of ₹ 1.5 per share

Exhibit 1: P&L

	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
Revenue	1197.6	1102.5	8.6	1234.6	-3.0	Revenue declined by 5.3% QoQ in CC terms, Higher than expected furloughs & continuing of macro impact on key verticals impacted revenues in Q3
Employee expense	869.9	775.8	12.1	921.8	-5.6	
Gross Margin	327.7	326.7	0.3	312.8	4.8	
Gross margin (%)	27.4	29.6	-227 bps	25.3	203 bps	
other expense	192.8	168.3	14.6	207.4	-7.0	
EBITDA	134.9	158.4	-14.8	105.4	28.0	
EBITDA Margin (%)	11.3	14.4	-310 bps	8.5	273 bps	Margin improved due to the tailwinds of operational efficiency due to optimization of employee cost by fresher deployment, improved offshoring, better realizations & SG&A rationalization; currency benefits & one-time gain on reversal of bad debts (~+50 bps) mitigated by the headwinds of lower volumes & utilizations
Depreciation & amortisation	49.7	47.4	4.9	49.2	1.0	
EBIT	85.2	111.0	-23.2	56.2	51.6	
EBIT Margin (%)	7.1	10.1	-295 bps	4.6	256 bps	
Other income (less interest)	18.3	15.2	20.4	20.9	-12.4	
PBT	103.5	126.2	-18.0	77.1	34.2	
Tax paid	27.0	33.9	-20.4	20.3	33.0	
PAT	76.5	92.3	-17.1	56.8	34.7	

Source: Company, ICICI Direct Research

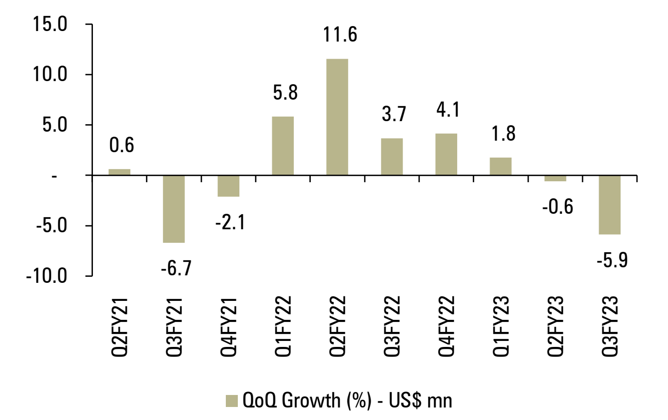
Exhibit 2: Change in estimates

	FY23E			FY24E			FY25E			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	4,819	4,806	-0.3	5,060	4,810	-4.9	5,313	5,169	-2.7	Numbers aligned as per weak Q3 and 9MFY23 performance
EBITDA	578	509	-11.9	718	601	-16.3	754	734	-2.7	
EBITDA Margin (%)	12	10.6	-140 bps	14.2	12.5	-170 bps	14.2	14.2	0 bps	Margins tweaked as per some delay in margin recovery
PAT	283	232	-17.8	395	312	-21.1	421	406	-3.5	
EPS (₹)	12	10.3	-17.3	17.3	13.8	-21.1	18.5	17.9	-3.5	

Source: Company, ICICI Direct Research

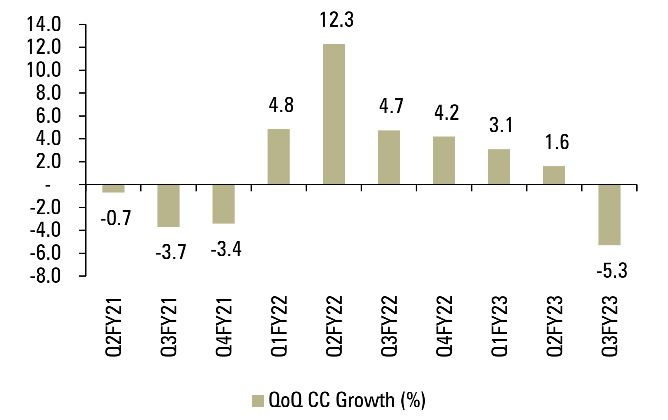
Key Metrics

Exhibit 3: QoQ dollar revenue growth



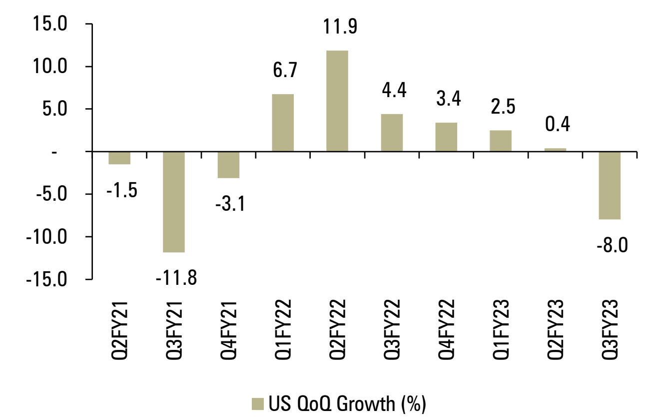
Source: Company, ICICI Direct Research

Exhibit 4: CC growth impacted by higher furloughs



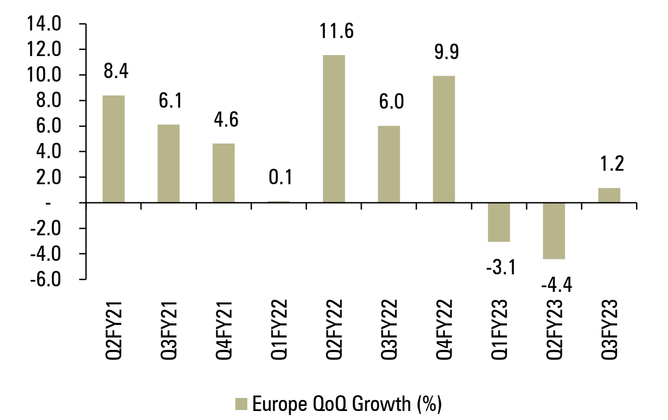
Source: Company, ICICI Direct Research

Exhibit 5: US impacted by furloughs



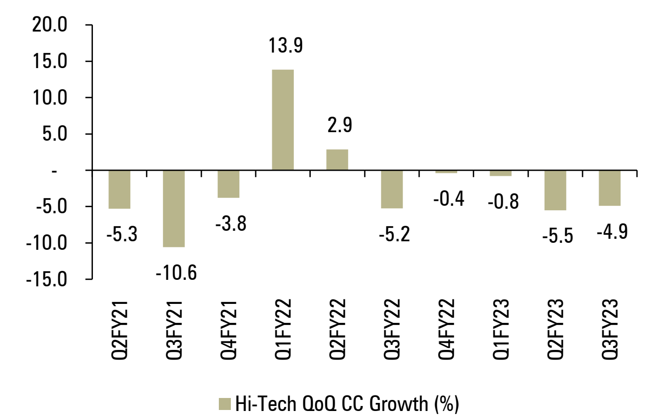
Source: Company, ICICI Direct Research

Exhibit 6: Strong client relations aid Europe growth



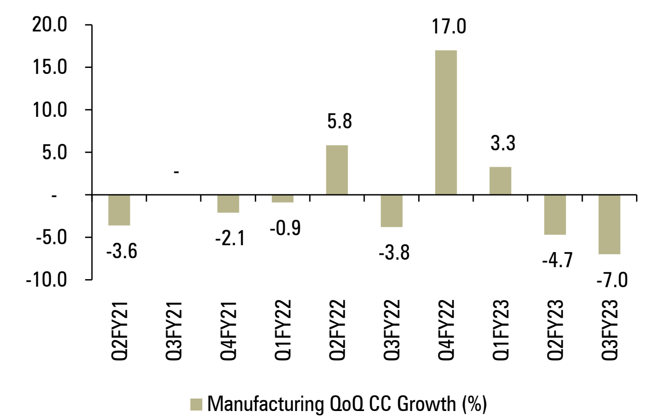
Source: Company, ICICI Direct Research

Exhibit 7: Hi-Tech continues to remain under stress



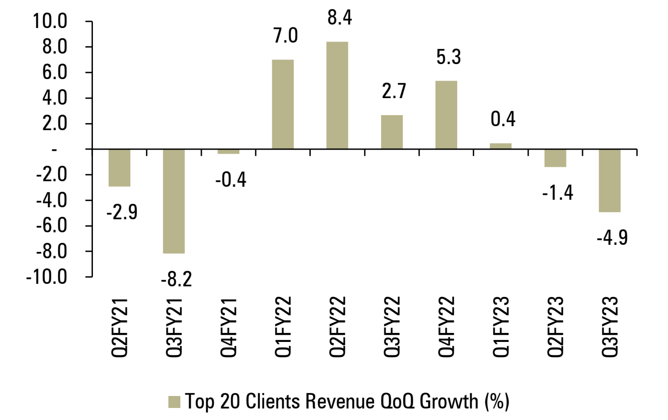
Source: Company, ICICI Direct Research

Exhibit 8: As does manufacturing



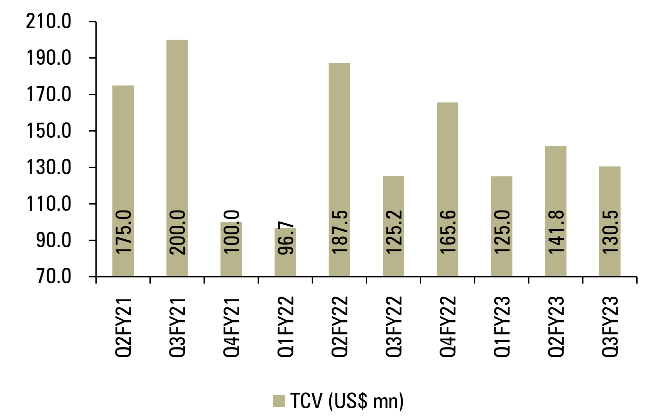
Source: Company, ICICI Direct Research

Exhibit 9: Top 20 clients QoQ growth



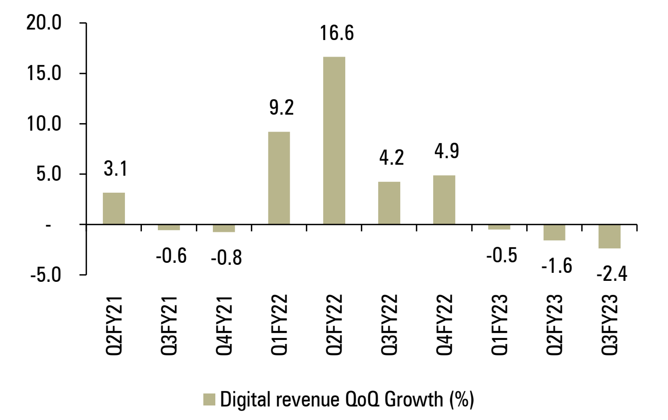
Source: Company, ICICI Direct Research

Exhibit 10: TCV down by 8% in Q3



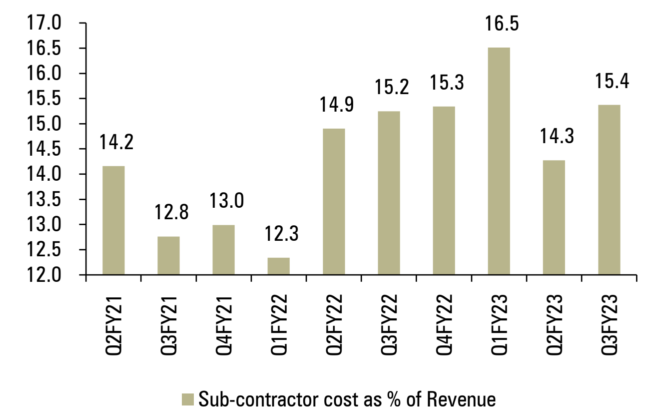
Source: Company, ICICI Direct Research

Exhibit 11: Digital revenue QoQ growth



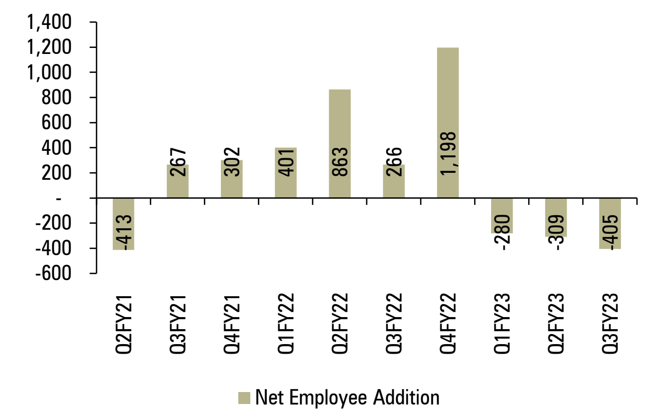
Source: Company, ICICI Direct Research

Exhibit 12: Sub-contractor cost trend



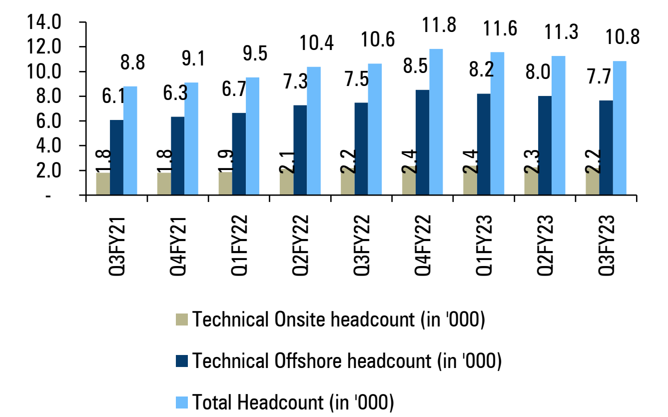
Source: Company, ICICI Direct Research

Exhibit 13: Net employee addition trend



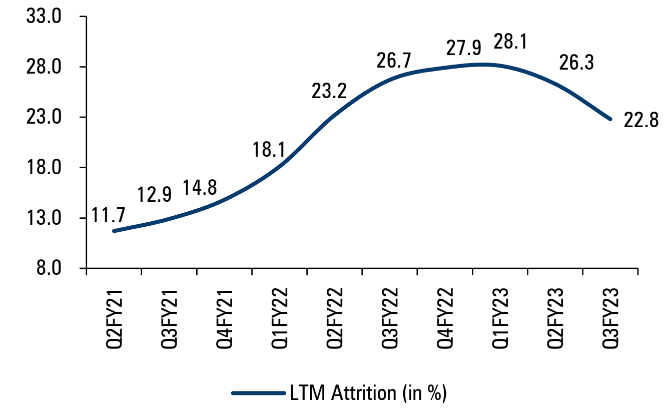
Source: Company, ICICI Direct Research

Exhibit 14: Headcount mix trend



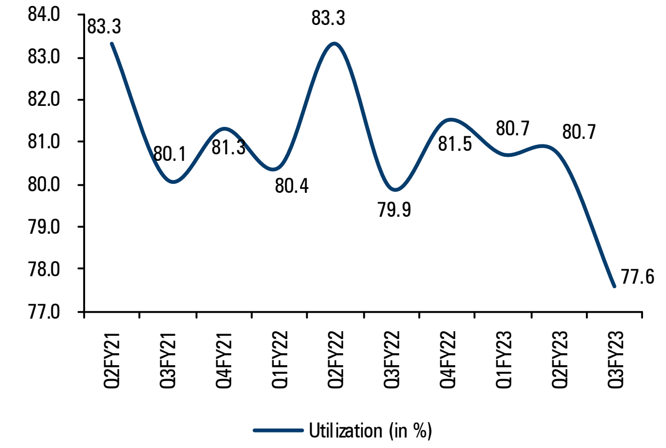
Source: Company, ICICI Direct Research

Exhibit 15: LTM attrition moderates by 530 bps from peak



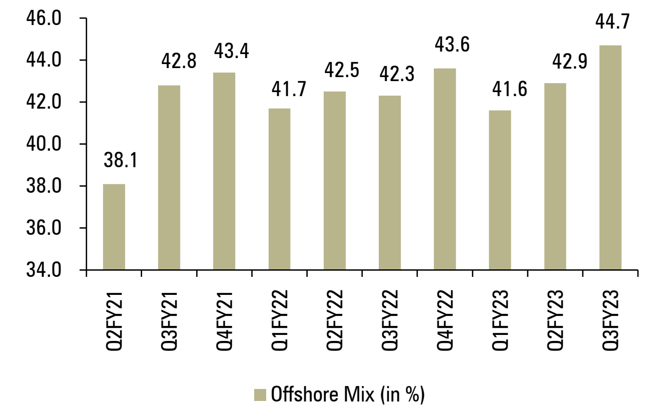
Source: Company, ICICI Direct Research

Exhibit 16: Utilisation declines in Q3 by furloughs



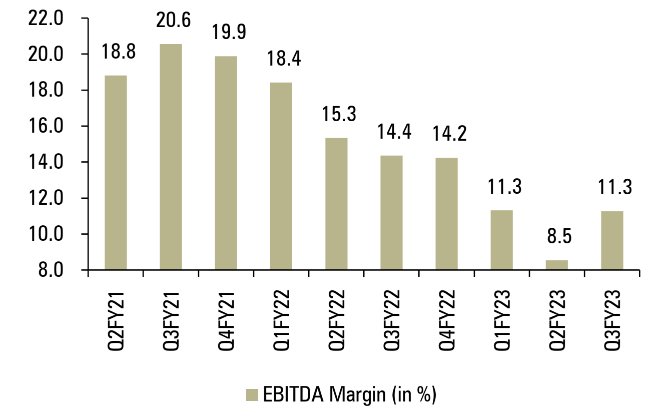
Source: Company, ICICI Direct Research

Exhibit 17: Offshore mix improving



Source: Company, ICICI Direct Research

Exhibit 18: EBITDA margin rebounds in Q3



Source: Company, ICICI Direct Research

Financial summary

Exhibit 19: Profit and loss statement ₹ crore	FY22	FY23E	FY24E	FY25E
Total Revenues	**4,244**	**4,806**	**4,810**	**5,169**
Growth (%)	12	13	0	7
Employee Benefit Expense	2,921	3,508	3,415	3,644
Other Expenses	666	788	794	791
EBITDA	**657**	**509**	**601**	**734**
Growth (%)	-4.1	-22.4	18.0	22.1
Depreciation	185	185	185	185
Other Income	138	42	51	47
Interest	35	40	40	40
PBT before Exceptional Items	574	326	427	557
Growth (%)	19.1	-43.2	30.9	30.4
Tax	153	88	115	150
PAT before Exceptional Items	421	238	312	406
Minority interest	5	6	-	-
PAT after exceptional items	**416**	**232**	**312**	**406**
Growth (%)	38.7	-44.1	34.1	30.4
Diluted EPS	18.3	10.3	13.8	17.9
EPS (Growth %)	38.7	-43.8	34.1	30.4

Source: Company, ICICI Direct Research

Exhibit 20: Cash flow statement ₹ crore	FY22	FY23E	FY24E	FY25E
Profit before Tax	**574**	**326**	**427**	**557**
Depreciation	185	185	185	185
Change in working capital	(243)	15	(10)	(50)
Income Taxes Paid	(152)	(88)	(115)	(150)
CF from operations	**335**	**431**	**476**	**534**
Other Investments	214	42	51	47
(Purchase)/Sale of Fixed Assets	(233)	(62)	(63)	(67)
CF from investing Activities	**(17)**	**(21)**	**(12)**	**(20)**
Inc / (Dec) in Equity Capital	3	-	-	-
Inc / (Dec) in sec.loan Funds	-	-	-	-
Dividend & Dividend tax	(88)	(63)	(84)	(110)
Interest Paid on Loans	(1)	(40)	(40)	(40)
CF from Financial Activities	**(86)**	**(103)**	**(124)**	**(150)**
Net change in cash	233	307	339	365
Opening cash	699	856	1,112	1,401
Closing cash	**856**	**1,112**	**1,401**	**1,716**

Source: Company, ICICI Direct Research

Exhibit 21: Balance sheet ₹ crore	FY22	FY23E	FY24E	FY25E
Equity	45	45	45	45
Reserves & Surplus	2,642	2,811	3,039	3,335
Networth	2,687	2,857	3,084	3,381
Total debt	-	-	-	-
Minority Interest	-	-	-	-
Other liabilities	354	354	354	354
Source of funds	**3,041**	**3,211**	**3,438**	**3,735**
Fixed assets	382	399	344	293
Intangible assets	180	92	74	58
Goodwill	724	724	724	724
Non current investments	161	161	161	161
Other non current assets	162	171	176	185
Current Investments	164	164	164	164
Cash Balance	856	1,112	1,401	1,716
Inventories	-	-	-	-
Debtors	797	745	746	801
Other current assets	447	442	447	465
Trade payables	316	274	274	295
Other Current liabilities	514	523	523	536
Application of funds	**3,041**	**3,211**	**3,438**	**3,735**

Source: Company, ICICI Direct Research

Exhibit 22: Key ratios ₹ crore	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
Diluted EPS	18.3	10.3	13.8	17.9
BV	118.0	126.2	136.2	149.3
DPS	4.9	2.8	3.7	4.8
Cash Per Share	37.6	49.1	61.9	75.8
Operating Ratios (%)				
EBITDA Margin	15.5	10.6	12.5	14.2
PAT Margin	9.8	4.8	6.5	7.9
Debtor days	69	57	57	57
Creditor days	27	21	21	21
Return Ratios (%)				
RoE	15.5	8.1	10.1	12.0
RoCE	15.5	10.1	12.1	14.7
RoIC	23.3	16.8	22.2	29.6
Valuation Ratios (x)				
P/E	12.7	22.6	16.9	12.9
EV / EBITDA	6.5	7.9	6.2	4.6
Market Cap / Sales	1.2	1.1	1.1	1.0
Price to Book Value	2.0	1.8	1.7	1.6
Solvency Ratios				
Debt/Equity	-	-	-	-
Debt / EBITDA	-	-	-	-
Current Ratio	1.5	1.5	1.5	1.5
Quick Ratio	1.5	1.5	1.5	1.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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