

Zensar Technologies

HOLD

Margins healthy waiting for revenue growth

Summary

Zensar's strong Q2 growth in profitability was led by one off reversal of bonus of 190 bps. In addition, the company's deal wins of US\$194 mn (1.3x book to bill) had some spillover of Q1 and pre deal wins of Q3. Hence, normalized EBITDA margins stood at 17% and order book could be lower than reported. This coupled with company's intention to invest in capability building, sales and large deals, we have tapered our expectation for FY25E margins to 16.7% (down 140 bps from 18.1% in FY24E). As a result we maintain our EPS expectation for FY25E. In addition, we believe that we are yet to see some growth acceleration from company's end. Hence, with recent run up in price prompt us to downgrade the stock from BUY to HOLD with same target price of Rs530 (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 & client specific challenges. Hence, we have built in revenue CAGR of 5.9% over FY23-FY25E.
- **Margin to taper in FY25E:** The company saw a lot of one offs in margins & cost efficiency levers in H1FY24 which will lead to EBITDA margin improvement of 674 bps to 18.1% in FY24E. Further with absence of one offs, investments and revenue acceleration, we expect margins to taper by 140 bps to 16.7% in FY25E.

TP **Rs530**

CMP Rs550

Potential upside/downside -4%

Previous Rating BUY

Price Performance (%)

	-1m	-3m	-12m
Absolute	4.2	25.3	156.1
Rel to Sensex	6.3	25.5	142.4

V/s Consensus

EPS (Rs)	FY24E	FY25E
IDBI Capital	28	29
Consensus	25	27
% difference	13.3	7.0

Key Stock Data

Bloomberg/Reuters	ZENT IN/ZENT.BO
Sector	IT Services
Shares o/s (mn)	227
Market cap. (Rs mn)	124,516
3-m daily average value (Rs mn)	60.3
52-week high / low	Rs575 / 202
Sensex / Nifty	66,428 / 19,812

Shareholding Pattern (%)

Promoters	49.2
FII	16.7
DII	16.2
Public	17.9

Financial snapshot

Year	FY21	FY22	FY23	FY24E	FY25E
Revenue	37,814	42,437	48,483	50,051	56,257
Change (yoy, %)	(10)	12	14	3	12
EBITDA	6,848	6,565	5,523	9,076	9,412
Change (yoy, %)	35	(4)	(16)	64	4
EBITDA Margin(%)	18.1	15.5	11.4	18.1	16.7
Adj.PAT	3,491	4,162	3,275	6,316	6,513
EPS (Rs)	15	18	14	28	29
Change (yoy, %)	33.0	19.5	(21.1)	93	3
PE(x)	35.8	30.0	38.0	20	19
Dividend Yield (%)	0.2	0.9	0.9	2	2
EV/EBITDA (x)	17.3	17.7	21.2	12.5	11.6
RoE (%)	15.8	16.6	11.8	20	18
RoCE (%)	18.6	16.4	12	22	20

Source: IDBI Capital Research;

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Concall Highlights

- Total revenue for the quarter stood at \$150.2mn 0.6%/0.2% 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 followed by Manufacturing & consumer services (+6.7%), BFSI (+3.0%), However, hitech & healthcare industries which form ~36.7% of the total revenue declined by 8.3% and 1.7% respectively. In terms of services revenue, QoQ growth was led by Europe & UK (11.3% QoQ in CC) followed by SA (+7.9% QoQ in CC). European & SA is seeing good traction from old and new clients.
- Gross margin stood at 31.8%, 180bps QoQ decline mainly due to wage hike (190bps), reversal of one-time benefit (80bps), it was partially offset by the exchange gain (30bps) and utilisation benefit of 50bps. EBITDA for the quarter was at 18.6% which was lower by 10bps against Q1FY24. There was an impact of one time net off then, it would have been 17%.
- Order book stood at USD 194.8 mn vs USD 141.8 mn in Q2FY23 (+26%/+37% QoQ/YoY). Management informed that the order book contains spill over from the previous quarter and some deals were expected to get signed in Q3, however got confirmed in Q2 itself. Management was confident that the order book shall convert into deals.
- Demand environment – 4-5 new large deal (TCV - \$25mn) are in pipeline which are mostly of cost take out and can be margin dilutive. The company is putting more focus on Health care & life sciences vertical which yields higher dividends. As per management Hitech industry would remain weak as clients are reducing discretionary spends and reprioritized their expenses. The company expects turnaround in Hi Tech led by 8 new logo addition and improvement in salesforce. The company is targeting greater than US\$2 bn clients which have greater potential for mining & cross sell. The company has done 100 POC in generative AI.
- The company expects furloughs in Q3 to be in line with past 2-3 years.
- 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 same range of mid-teens(14%-16%) despite in demand softness and by focusing on levers like utilization and pyramid optimization, control in attrition, reduce in subcontracts.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q2FY24	Q1FY24	QoQ (%)	Q2FY23	YoY (%)
Revenues (US\$ mn)	150.2	149.3	0.6	155.0	(3.1)
Revenues	12,408	12,272	1.1	12,346	0.5
COGS	8,463	8,146	3.9	9,218	(8.2)
Gross profit	3,945	4,126	(4.4)	3,128	26.1
SG&A	1,637	1,825	(10.3)	2,074	(21.1)
EBITDA	2,308	2,301	0.3	1,054	119.0
Depreciation & amortization	366	423	(13.5)	492	(25.6)
EBIT	1,942	1,878	3.4	562	245.6
Other income	306	224	36.6	207	47.8
PBT	2,248	2,102	6.9	769	192.3
Tax	510	540	(5.6)	202	152.5
Minority interest	0	0	n.m.	0	n.m.
Adjusted net profit	1,738	1,562	11.3	567	206.5
Exceptional item	0	0	n.m.	0	n.m.
Reported net profit	1,738	1,562	11.3	567	206.5
Diluted EPS (Rs)	7.7	6.9	11.3	2.5	205.7
As % of net revenue					
Gross profit	31.8	33.6		25.3	
SG&A	13.2	14.9		16.8	
EBITDA	18.6	18.8		8.5	
EBIT	15.7	15.3		4.6	
Reported net profit	14.0	12.7		4.6	
Tax rate	22.7	25.7		26.3	

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

Year-end: March	New	FY24F Old	Chg (%)	New	FY25F Old	Chg (%)
Revenue (US\$ mn)	605	622	-2.7%	678	697	-2.8%
Revenue (Rs bn)	50,051	50,986	-1.8%	56,257	57,338	-1.9%
EBIT	7,557	6,895	9.6%	7,817	7,970	-1.9%
EBIT margin (%)	15.1%	13.52%	158 bps	13.9%	13.90%	0 bps
EPS (Rs)	27.9	25.2	10.7%	28.8	28.8	-0.1%

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

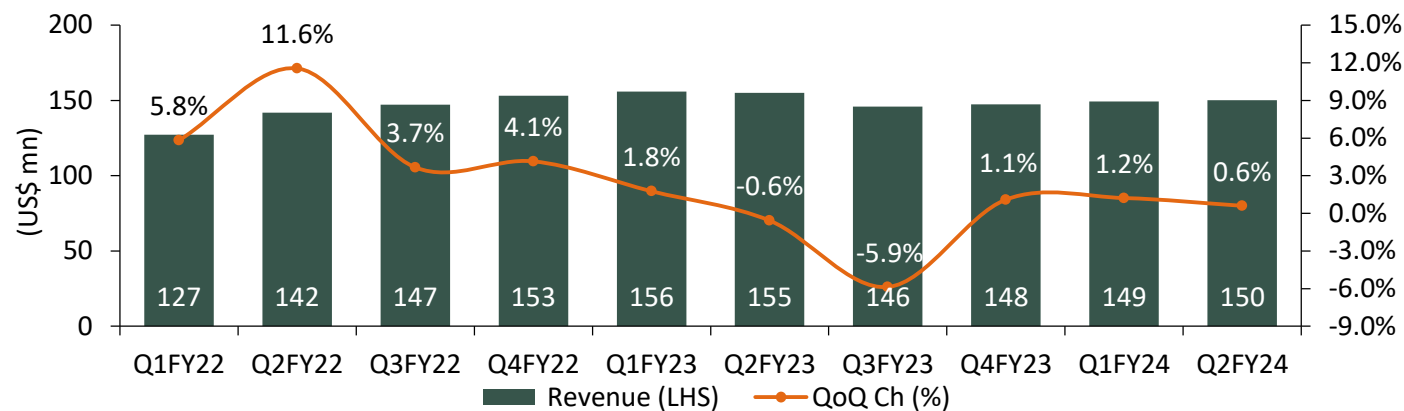
Year to March	Q2FY24	Q2FY24E	Variance (%)
Revenue (US\$ mn)	150.2	149.7	0.3%
Revenue (Rs mn)	12,408	12,377	0.3%
EBIT (Rs mn)	1,942	1,642	18.3%
EBIT margin (%)	15.7%	13.3%	240bps
Recurring PAT (Rs mn)	1,738	1,364	27.4%
Recurring PAT margin (%)	14.0%	11.0%	300 bps
EPS (Rs)	7.6	6.0	26.3%

Source: Company; IDBI Capital Research

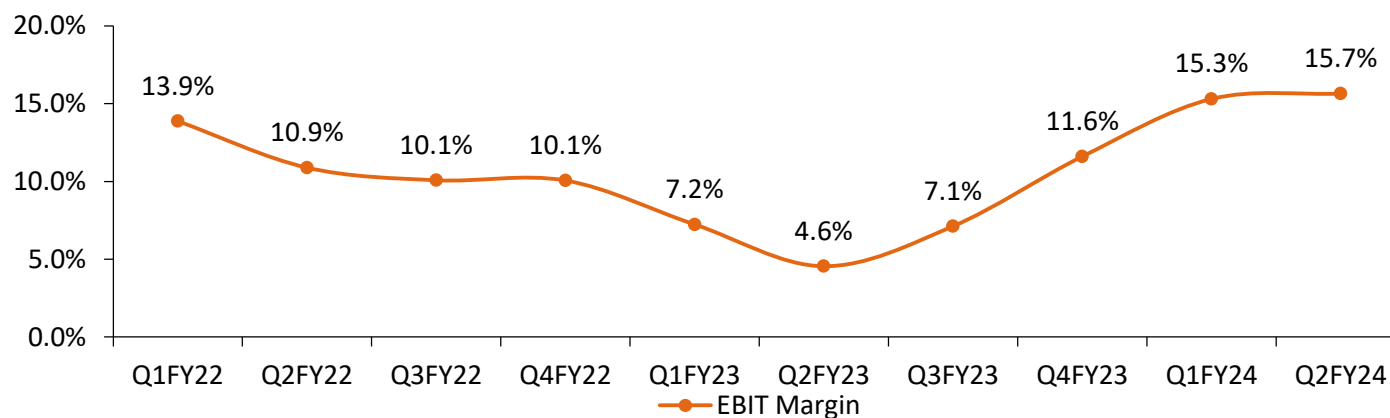
Exhibit 4: Large clients trend

Year-end: March	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
US\$1 mn+	81	83	86	87	87	84	87	84
US\$5 mn+	25	27	26	28	28	29	29	29
US\$10 mn+	11	11	13	13	15	14	14	14
US\$20 mn+	4	4	4	3	4	4	4	4

Source: Company; IDBI Capital Research

Exhibit 5: Q2FY24 Revenue growth was in line with our estimates.

Source: Company; IDBI Capital Research

Exhibit 6: Q2FY24 EBIT margin has slightly improved by 40 bps QoQ

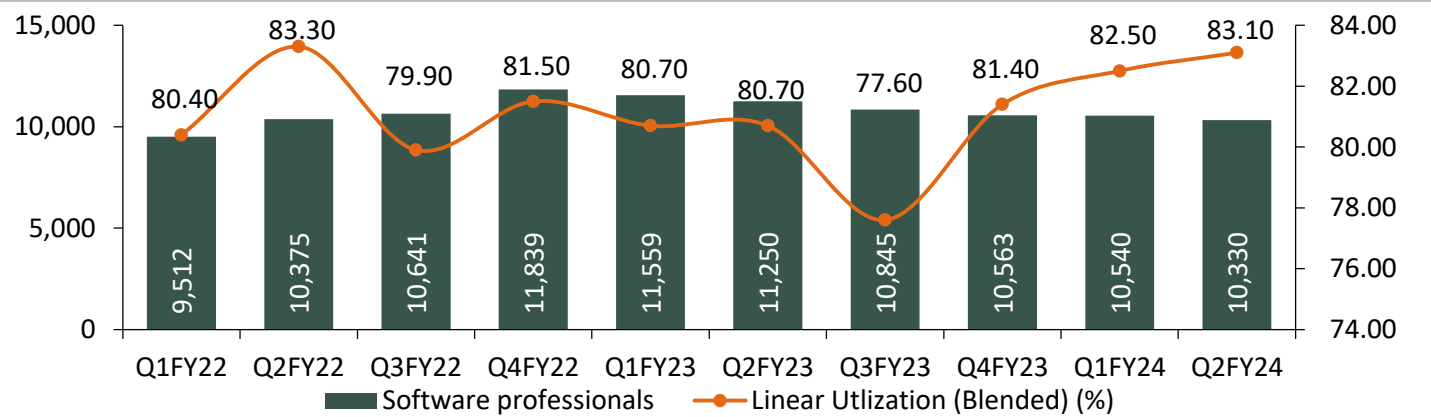
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

Parameters	% of revenue	QoQ growth (in CC)
Total revenue		0.6%
Geography		QoQ growth (in CC)
US	66.1%	-4.2%
Europe	21.6%	13.2%
Africa	12.3%	8.5%
Service-Line		QoQ growth
AMS	81.8%	0.7%
IMS	18.2%	0.1%
Verticals		
Hi Tech	27.1%	-8.3%
Manufacturing & Consumer services	25.9%	6.7%
BFSI	37.4%	3.0%
Healthcare	9.6%	-1.7%

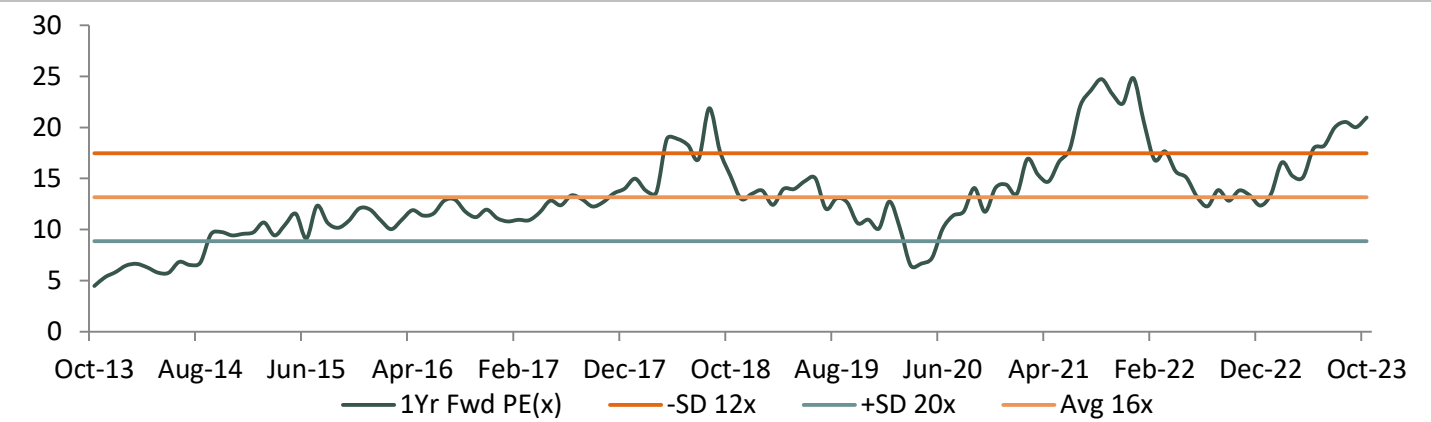
Source: Company; IDBI Capital Research

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	50,051	56,257
<i>Change (yoy, %)</i>	5.4	(10)	12	14	3	12
Operating expenses	(36,746)	(30,966)	(35,872)	(42,960)	(40,975)	(46,845)
EBITDA	5,071	6,848	6,565	5,523	9,076	9,412
<i>Change (yoy, %)</i>	2.9	35	(4)	(16)	64	4
<i>Margin (%)</i>	12.1	18.1	15.5	11.4	18.1	16.7
Depreciation	(1,592)	(1,747)	(1,848)	(1,830)	(1,519)	(1,595)
EBIT	3,479	5,101	4,717	3,693	7,557	7,817
Interest paid	(605)	(535)	(353)	(280)	(232)	(232)
Other income	884	255	1,377	1,028	1,130	1,181
Pre-tax profit	3,758	4,820	5,741	4,441	8,455	8,765
Tax	(1,042)	(1,260)	(1,525)	(1,166)	(2,139)	(2,253)
<i>Effective tax rate (%)</i>	27.7	26.1	26.6	26.3	25.3	25.7
Minority Interest	(81.8)	(69.5)	(54.0)	-	-	-
Net profit	2,634	3,491	4,162	3,275	6,316	6,513
Exceptional items	-	-	-	-	-	-
Adjusted net profit	2,634	3,491	4,162	3,275	6,316	6,513
<i>Change (yoy, %)</i>	(16.0)	33	19	(21)	93	3
EPS	11.5	15.3	18.3	14.5	27.9	28.8
Dividend per sh	5.2	1.2	5.0	5.0	9.8	10.1
<i>Dividend Payout %</i>	45.5	7.8	27.3	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	33,089	37,322
Share capital	451	451	452	453	453	453
Reserves & surplus	20,449	22,972	26,140	28,531	32,636	36,869
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	8,747	9,363
Current liabilities	6,481	5,880	6,693	6,248	6,338	6,655
Provisions	1,681	1,505	1,606	2,334	2,409	2,708
Total liabilities	14,819	10,623	11,843	11,448	11,613	12,229
Total equity & liabilities	35,956	34,334	38,712	41,210	45,480	50,329
Net fixed assets	13,340	11,330	12,858	11,735	11,567	11,428
Investments	-	-	-	-	-	-
Other non-curr assets	2,039	3,076	3,226	6,291	6,372	6,545
Current assets	20,576	19,928	22,628	23,184	27,541	32,356
Inventories	941	-	-	-	-	-
Sundry Debtors	6,656	5,888	7,967	7,298	7,534	8,468
Cash and Bank	5,166	6,986	8,559	7,280	11,311	14,983
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	45,480	50,329

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	8,455	8,765
Depreciation	1,137	1,677	1,803	1,838	1,659	1,561
Tax paid	(1,092)	(1,255)	(1,572)	(1,585)	(2,170)	(2,375)
Chg in working capital	143	(30)	832	(1,921)	(71)	(319)
Other operating activities	864	5,551	(1,031)	-	36	-
Cash flow from operations (a)	4,811	10,764	5,772	2,773	7,909	7,632
Capital expenditure	(4,860)	333	(3,330)	(715)	(1,491)	(1,422)
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)	(1,491)	(1,422)
Equity raised/(repaid)	0	0	1	1	-	-
Debt raised/(repaid)	308	(2,886)	-	-	-	-
Dividend (incl. tax)	(1,197)	(271)	(1,135)	(1,132)	(2,210)	(2,279)
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)	(2,386)	(2,537)
Net chg in cash (a+b+c)	1,907	1,821	1,573	(1,279)	4,031	3,673

Financial Ratios

Year-end: March	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (Rs)	91.5	103	117	128	146	165
Adj EPS (Rs)	11.5	15.3	18.3	14.5	27.9	28.8
Adj EPS growth (%)	-17.3	33	20	-21	93	3
EBITDA margin (%)	12.1	18.1	15.5	11.4	18.1	16.7
Pre-tax margin (%)	9.0	12.7	13.5	9.2	16.9	15.6
Net Debt/Equity (x)	-0.1	-0.3	-0.3	-0.3	-0.3	-0.4
ROCE (%)	13.7	19	16	12	22	20
ROE (%)	13.1	16	17	12	20	18

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	12.6	11.6

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)	47.7	35.8	30.0	38.0	19.7	19.1
Price/Book value (x)	6.0	5.3	4.7	4.3	3.8	3.3
EV/Net sales (x)	2.9	3.1	2.7	2.4	2.3	1.9
EV/EBITDA (x)	24.3	17.3	17.7	21.2	12.5	11.6
Dividend Yield (%)	1.0	0.2	0.9	0.9	1.8	1.8

Source: Company; IDBI Capital Research



Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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