

Zensar Technologies

HOLD

Sustained growth key to re-rating

Summary

Zensar's Q3 revenue growth was impacted by furloughs in Hi-tech. Going forward, we expect the company's revenues to improve led by reversal of furloughs and improving deal wins trajectory (up 28% YoY, book to bill of 1.2x). This coupled with company's intention to invest in capability building, sales and large deals, we expect 12% YoY growth each for FY25E and FY26E. In addition, considering 9MFY24E performance we have revised margin estimates for FY25E upwards by 52 bps leading to EPS upgrade of 2.2%. However, considering recent run up in price we maintain HOLD rating on the stock with a revised target price of Rs 605 (18x FY26E EPS, introduced FY26 estimates, previous target price Rs 530). We believe key trigger for further re-rating will be sustaining growth for next few quarters.

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) incentivizing sales for large deals & cross sell 2) restructuring of organization 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 7.2% over FY23-FY26E.
- Margin to taper in FY25E & stabilize:** The company saw a lot of one offs in margins & cost efficiency levers in 9MFY24 which will lead to EBITDA margin improvement of 676 bps to 18.2% in FY24E. Further with absence of one offs and investments we expect margins to taper by 85 bps to 17.3% in FY25E and maintain same margins at 17.3% for FY26E.

TP	Rs605
CMP	Rs561
Potential upside/downside	8%
Previous Rating	HOLD

Price Performance (%)			
	-1m	-3m	-12m
Absolute	(9.4)	9.8	157.1
Rel to Sensex	(9.9)	0.5	139.2

V/s Consensus			
EPS (Rs)	FY24E	FY25E	FY26E
IDBI Capital	29	29	33
Consensus	27	28	31
% difference	6.7	5.0	5.1

Key Stock Data	
Bloomberg/Reuters	ZENT IN/ZENT.BO
Sector	IT Services
Shares o/s (mn)	227
Market cap. (Rs mn)	127,170
3-m daily average value (Rs mn)	68.6
52-week high / low	Rs644 / 216
Sensex / Nifty	71,424 / 21,572

Shareholding Pattern (%)	
Promoters	49.2
FII	17.1
DII	16.2
Public	17.5

Financial snapshot

Year	FY22	FY23	FY24E	FY25E	FY26E
Revenue	42,437	48,483	49,151	55,215	61,841
Change (yoy, %)	12	14	1	12	12
EBITDA	6,565	5,523	8,922	9,552	10,698
Change (yoy, %)	(4)	(16)	62	7	12
EBITDA Margin(%)	15.5	11.4	18.2	17.3	17.3
Adj.PAT	4,162	3,275	6,470	6,668	7,572
EPS (Rs)	18	14	29	29	33
Change (yoy, %)	19.5	(21.1)	97.6	3	14
PE(x)	31	39	20	19	17
Dividend Yield (%)	0.9	0.9	1.3	2	2
EV/EBITDA (x)	18	22	13	12	10
RoE (%)	17	12	21	18	17
RoCE (%)	16	12	21	20	19

Source: IDBI Capital Research;

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Concall Highlights

- Total revenue for the quarter stood at \$144.7mn -3.2%QoQ in CC terms. Services revenue stood at US\$ 144.5mn -3.0% QoQ in CC terms. Sequential revenue degrowth in CC terms was led by hitech which decline by 7.7%/9.6% QoQ/YoY and Healthcare & lifescience decline by 5.2%/14.3% QoQ/YoY. Decline in revenue mainly led by higher furloughs in the quarter.
- In terms of verticals, Manufacturing & consumer services degrew by 1.8% QoQ, BFSI was flat QoQ. In terms of region wise, degrowth was led by USA which decline by 3.6%QoQ, Europe decline by 2.6% QoQ and Africa decline by 0.5% QoQ.
- Gross margin stood at 31.1%, 70bps QoQ decline mainly due to exchange loss(10bps) and furloughs & utilisation (200bps).The decline was partially offset due to operational efficiency, higher utilisation rate and reduced in discretionary spends (140bps). SG&A increased by 70bps (reversal of 160bps of lower management bonus payout) & exchange impact of 10bps. PDD reversal impacted the margin positively by 110bps.
- Order book stood at USD 167.5 mn. Management was confident that the order book shall convert into deals. Net new logo addition for the quarter - 9. Large deals to ramp in the next few quarters.
- **Demand environment** – Management stated that macro environment remains uncertain, cuts in discretionary cost would prevail in Q4 & initial quarter of FY25. Furloughs to continue in Hitech vertical. Focusing on new added services (AI & GenAI in particularly). Expects green shoots in new verticals(Healthcare). Company indicated that growth would be broad based across verticals except Hi-tech in the next few quarters.
- **Total Headcount for the quarter** – 10,225 employees with the utilization rate of 80.7%. Decline in utilization rate was led by higher furloughs. Attrition stood at 12 %.
- 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 softness in demand. The company plans to focus on levers like utilization, pyramid optimization, control in attrition and reduction in subcontracting cost to drive margins.

Exhibit 1: Financial snapshot

(Rs mn)

Year-end: March	Q3FY24	Q2FY24	QoQ (%)	Q3FY23	YoY (%)
Revenues (US\$ mn)	144.7	150.2	(3.7)	145.9	(0.8)
Revenues	12,041	12,408	(3.0)	11,976	0.5
COGS	8,296	8,463	(2.0)	8,699	(4.6)
Gross profit	3,745	3,945	(5.1)	3,277	14.3
SG&A	1,669	1,637	2.0	1,927	(13.4)
EBITDA	2,076	2,308	(10.1)	1,350	53.8
Depreciation & amortization	312	366	(14.8)	497	(37.2)
EBIT	1,764	1,942	(9.2)	853	106.8
Other income	357	306	16.7	183	95.1
PBT	2,121	2,248	(5.6)	1,036	104.7
Tax	504	510	(1.2)	270	86.7
Minority interest	0	0	n.m.	0	n.m.
Adjusted net profit	1,617	1,738	(7.0)	766	111.1
Exceptional item	0	0	n.m.	0	n.m.
Reported net profit	1,617	1,738	(7.0)	766	111.1
Diluted EPS (Rs)	7.1	7.7	(7.0)	3.4	111.2
As % of net revenue					
Gross profit	31.1	31.8		27.4	
SG&A	13.9	13.2		16.1	
EBITDA	17.2	18.6		11.3	
EBIT	14.6	15.7		7.1	
Reported net profit	13.4	14.0		6.4	
Tax rate	23.8	22.7		26.1	

Source: Company; IDBI Capital Research

Exhibit 2: Earnings Revision

Year-end: March	New	FY24F Old	Chg (%)	New	FY25F Old	Chg (%)	FY26E (Introduced)
Revenue (US\$ mn)	594	605	-1.8%	665	678	-1.9%	745
Revenue (Rs bn)	49,151	50,051	-1.8%	55,215	56,257	-1.9%	61,841
EBIT	7,404	7,557	-2.0%	7,957	7,817	1.8%	9,024
EBIT margin (%)	15.1%	15.10%	(16bps)	14.4%	13.90%	52 bps	14.6%
EPS (Rs)	28.6	27.9	2.4%	29.4	28.8	2.2%	33.4

Source: Company; IDBI Capital Research

Exhibit 3: Actual vs. estimates

Year to March	Q3FY24	Q3FY24E	Variance (%)
Revenue (US\$ mn)	144.7	143.4	0.9%
Revenue (Rs mn)	12,041	11,949	0.8%
EBIT (Rs mn)	1,764	1,729	2.0%
EBIT margin (%)	14.6%	14.5%	-4bps
Recurring PAT (Rs mn)	1,617	1,574	2.8%
Recurring PAT margin (%)	13.4%	13.2%	25 bps
EPS (Rs)	7.1	6.9	2.0%

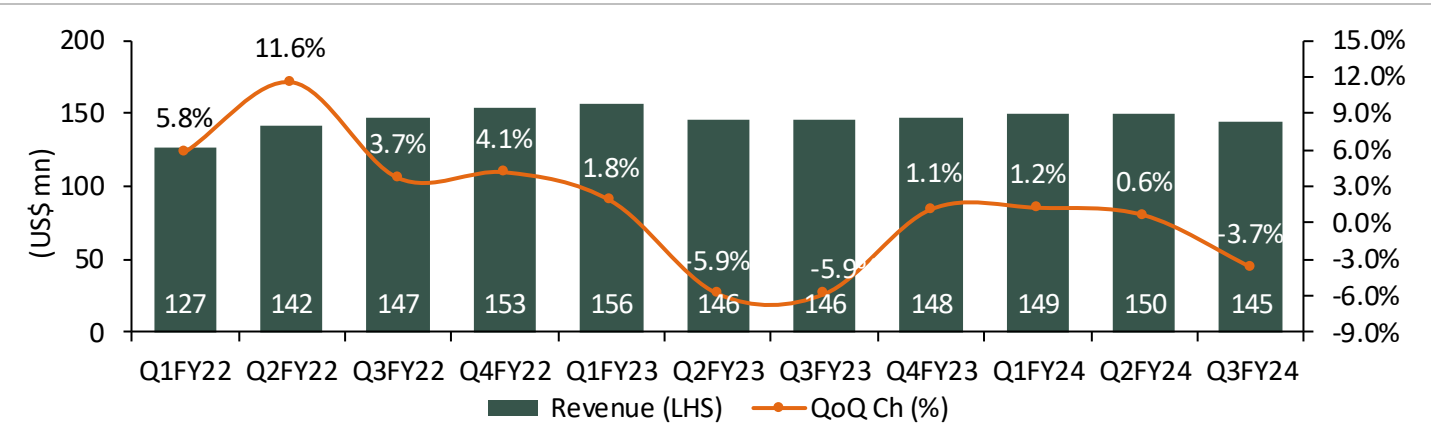
Source: Company; IDBI Capital Research

Exhibit 4: Large clients trend

Year-end: March	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24
US\$1 mn+	83	86	87	87	84	87	84	84
US\$5 mn+	27	26	28	28	29	29	29	32
US\$10 mn+	11	13	13	15	14	14	14	14
US\$20 mn+	4	4	3	4	4	4	4	4

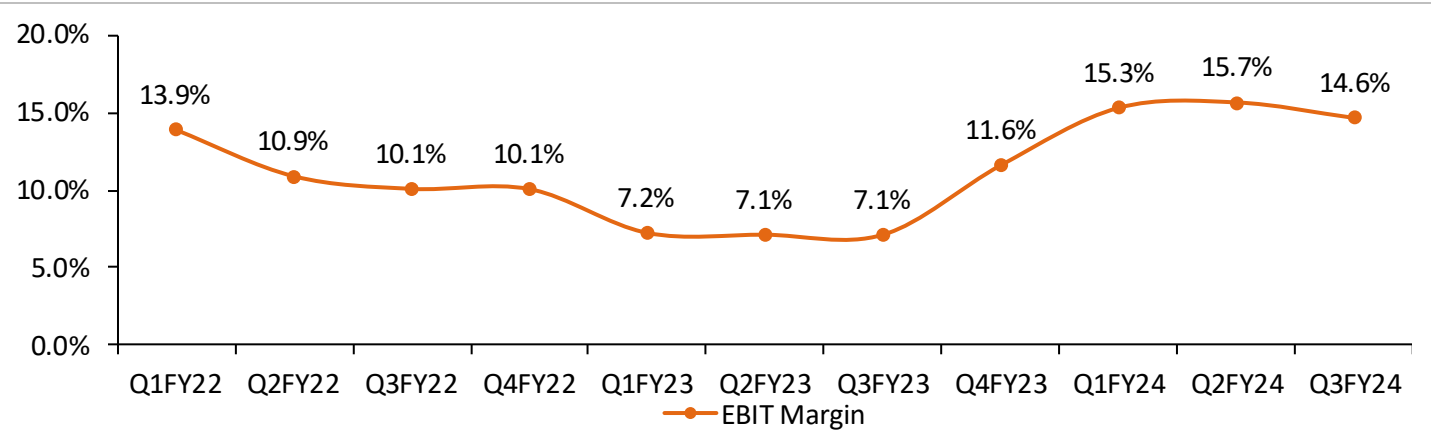
Source: Company; IDBI Capital Research

Exhibit 5: Q3FY24 Revenue growth was marginally above our estimates.



Source: Company; IDBI Capital Research

Exhibit 6: Q3FY24 EBIT margin has decline by ~100 bps QoQ



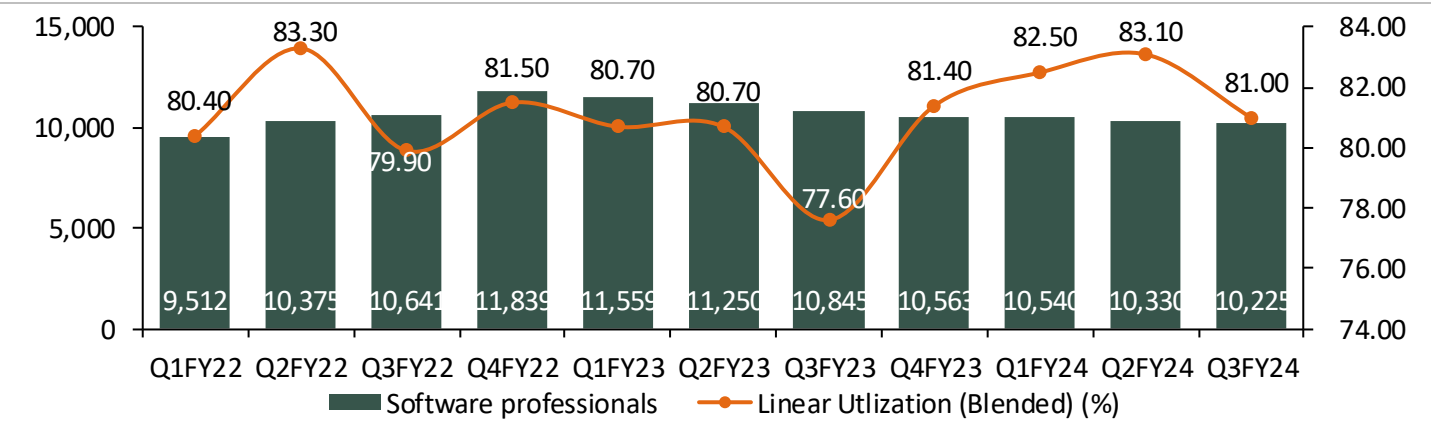
Source: Company; IDBI Capital Research

Exhibit 7: Revenue growth across various segments (%)

Parameters	% of revenue	QoQ growth (in CC)
	Total revenue	-3.2%
Geography	QoQ growth (in CC)	
US	66.0%	-3.6%
Europe	21.4%	-2.6%
Africa	12.5%	-0.5%
Service-Line	QoQ growth	
AMS	81.5%	-4.0%
IMS	18.5%	-2.1%
Verticals		
Hi Tech	25.9%	-7.7%
Manufacturing & Consumer services	26.1%	-1.8%
BFSI	38.6%	0.1%
Healthcare	9.4%	-5.2%

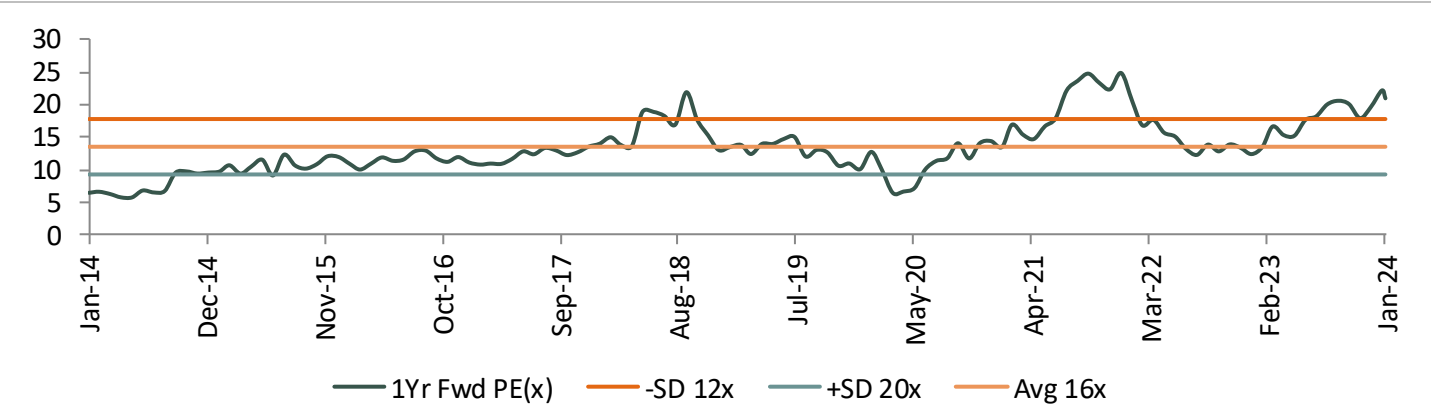
Source: Company; IDBI Capital Research

Exhibit 8: Utilisation decline 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	FY21	FY22	FY23	FY24E	FY25E	FY26E
Net sales	37,814	42,437	48,483	49,151	55,215	61,841
<i>Change (yoy, %)</i>	<i>(9.6)</i>	<i>12</i>	<i>14</i>	<i>1</i>	<i>12</i>	<i>12</i>
Operating expenses	(30,966)	(35,872)	(42,960)	(40,229)	(45,663)	(51,142)
EBITDA	6,848	6,565	5,523	8,922	9,552	10,698
<i>Change (yoy, %)</i>	<i>35.1</i>	<i>(4)</i>	<i>(16)</i>	<i>62</i>	<i>7</i>	<i>12</i>
<i>Margin (%)</i>	<i>18.1</i>	<i>15.5</i>	<i>11.4</i>	<i>18.2</i>	<i>17.3</i>	<i>17.3</i>
Depreciation	(1,747)	(1,848)	(1,830)	(1,519)	(1,595)	(1,675)
EBIT	5,101	4,717	3,693	7,404	7,957	9,024
Interest paid	(535)	(353)	(280)	(232)	(232)	(232)
Other income	255	1,377	1,028	1,490	1,250	1,400
Pre-tax profit	4,820	5,741	4,441	8,661	8,975	10,191
Tax	(1,260)	(1,525)	(1,166)	(2,191)	(2,307)	(2,619)
<i>Effective tax rate (%)</i>	<i>26.1</i>	<i>26.6</i>	<i>26.3</i>	<i>25.3</i>	<i>25.7</i>	<i>25.7</i>
Minority Interest	(69.5)	(54.0)	-	-	-	-
Net profit	3,491	4,162	3,275	6,470	6,668	7,572
Exceptional items	-	-	-	-	-	-
Adjusted net profit	3,491	4,162	3,275	6,470	6,668	7,572
<i>Change (yoy, %)</i>	<i>32.5</i>	<i>19</i>	<i>(21)</i>	<i>98</i>	<i>3</i>	<i>14</i>
EPS	15.3	18.3	14.5	28.6	29.4	33.4
Dividend per sh	1.2	5.0	5.0	7.1	8.8	10.0
<i>Dividend Payout %</i>	<i>7.8</i>	<i>27.3</i>	<i>34.6</i>	<i>25</i>	<i>30</i>	<i>30</i>

Balance Sheet

(Rs mn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Shareholders' funds	23,423	26,592	28,984	33,836	38,504	43,805
Share capital	451	452	453	453	453	453
Reserves & surplus	22,972	26,140	28,531	33,383	38,051	43,352
Total Debt	-	-	-	-	-	-
Other liabilities	3,239	3,544	2,866	2,866	2,866	2,866
Curr Liab & prov	7,384	8,299	8,582	8,652	9,254	9,947
Current liabilities	5,880	6,693	6,248	6,286	6,596	6,970
Provisions	1,505	1,606	2,334	2,366	2,658	2,977
Total liabilities	10,623	11,843	11,448	11,518	12,120	12,813
Total equity & liabilities	34,334	38,712	41,210	46,133	51,402	57,396
Net fixed assets	11,330	12,858	11,735	11,552	11,395	11,272
Investments	-	-	-	-	-	-
Other non-curr assets	3,076	3,226	6,291	6,354	6,524	6,705
Current assets	19,928	22,628	23,184	28,227	33,483	39,419
Inventories	-	-	-	-	-	-
Sundry Debtors	5,888	7,967	7,298	7,399	8,311	9,309
Cash and Bank	6,986	8,559	7,280	12,155	16,293	21,013
Loans and advances	3,633	1,636	4,509	4,509	4,509	4,509
Total assets	34,334	38,712	41,210	46,133	51,402	57,396

Cash Flow Statement

(Rs mn)

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	4,820	5,741	4,441	8,661	8,975	10,191
Depreciation	1,677	1,803	1,838	1,659	1,561	1,639
Tax paid	(1,255)	(1,572)	(1,585)	(2,204)	(2,426)	(2,750)
Chg in working capital	(30)	832	(1,921)	(30)	(311)	(304)
Other operating activities	5,551	(1,031)	-	59	3	(269)
Cash flow from operations (a)	10,764	5,772	2,773	8,144	7,801	8,507
Capital expenditure	333	(3,330)	(715)	(1,476)	(1,404)	(1,515)
Chg in investments	-	-	-	-	-	-
Other investing activities	(4,605)	1,121	(1,920)	-	-	-
Cash flow from investing (b)	(4,272)	(2,209)	(2,635)	(1,476)	(1,404)	(1,515)
Equity raised/(repaid)	0	1	1	-	-	-
Debt raised/(repaid)	(2,886)	-	-	-	-	-
Dividend (incl. tax)	(271)	(1,135)	(1,132)	(1,617)	(2,001)	(2,272)
Chg in minorities	(19)	(64)	501	-	-	-
Other financing activities	(1,496)	(792)	(787)	(176)	(258)	-
Cash flow from financing (c)	(4,671)	(1,991)	(1,417)	(1,793)	(2,259)	(2,272)
Net chg in cash (a+b+c)	1,821	1,573	(1,279)	4,875	4,138	4,720

Financial Ratios

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
Book Value (Rs)	102.9	117	128	149	170	193
Adj EPS (Rs)	15.3	18.3	14.5	28.6	29.4	33.4
Adj EPS growth (%)	33.0	20	-21	98	3	14
EBITDA margin (%)	18.1	15.5	11.4	18.2	17.3	17.3
Pre-tax margin (%)	12.7	13.5	9.2	17.6	16.3	16.5
Net Debt/Equity (x)	-0.3	-0.3	-0.3	-0.4	-0.4	-0.5
ROCE (%)	18.6	16	12	21	20	19
ROE (%)	15.8	17	12	21	18	17

DuPont Analysis

Asset turnover (x)	1.1	1.2	1.2	1.1	1.1	1.1
Leverage factor (x)	1.6	1.5	1.4	1.4	1.3	1.3
Net margin (%)	9.2	9.8	6.8	13.2	12.1	12.2

Working Capital & Liquidity ratio

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

Valuations

Year-end: March	FY21	FY22	FY23	FY24E	FY25E	FY26E
PER (x)	37	31	39	20	19	17
Price/Book value (x)	5.5	4.8	4.4	3.8	3.3	2.9
EV/Net sales (x)	3	3	2	2	2	2
EV/EBITDA (x)	18	18	22	13	12	10
Dividend Yield (%)	0.2	0.9	0.9	1.3	1.6	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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