




Estimate change 
TP change 
Rating change 

CMP: INR241
TP: INR265 (+10%)
Neutral

Topline growth recovery needed for stock re-rating

Expect some reinvestment of margin gains in business

- Zensar (ZENT)'s 3QFY21 revenue performance (decline of 3.7% QoQ CC) – impacted by restructuring at its top client – was below our already muted expectation. With the company guiding for a weak 4Q on continued drag from the top client, we expect double-digit decline (-12.1% YoY) for FY21E.
- On the other hand, the 3Q EBIT margin (15.9%) was ahead of our expectation as it continued to benefit from the offshore revenue shift (+300bp QoQ; +910bp YoY). We expect the company to reinvest some of the gains from aggressive cost rationalization into growth and expect an EBIT margin of 14.8% in FY22E.
- ZENT continued to report healthy deal wins with 3QFY21 TCV of USD200m, suggesting a book-to-bill of 1.6x. The deal pipeline also remained strong at USD1.7b, which is encouraging. However, we remain cautious on a leaking bucket and pockets of weakness in the ZENT portfolio. On account of these factors, we expect only a 9.0% revenue CAGR for FY21–23E (the lowest among peers).
- While we trim our revenue growth estimates on a weaker-than-expected 2H FY21 performance, we remain positive on the company's margin performance.
- Despite required investments, we expect margins to inch up gradually from FY21E to FY23E. In our view, growth revival would be needed for a stock re-rating despite inexpensive valuations. Our TP implies 13x FY23E EPS. Maintain **Neutral**.

Margin-led beat

- ZENT's revenue de-growth of 3.7% CC was weaker than our expectation of 0.7% QoQ CC decline.
- Excluding the impact of decline in Hi-Tech (due to the top account), CC growth would have been 0.9% QoQ.
- Insurance (-8.7% QoQ) and Hi-Tech (-10.6% QoQ) declined, while Consumer grew 6.2% QoQ and Manufacturing was flat.
- Digital now constitutes 65% of total revenue.
- EBITDA margins expanded 120bp QoQ to 20.6% and EBIT margins 110bps to 15.9%. Expansion was seen despite lower utilization (-320bps QoQ) and on the back of a better offshore mix (+300bps QoQ) and sales cost optimization.
- PAT stood at INR 987m, an increase of 12.3% sequentially and a 4% beat to our estimates, majorly led by higher operating income.
- Deal TCV for the quarter stood at USD200m+ (+18% YoY).
- Zensar is now a zero-debt company with the highest ever net cash position of USD160.2m.
- DSO for 3Q is 73 days, implying an improvement of 20 days on a YoY basis.

Bloomberg	ZENT IN
Equity Shares (m)	226
M.Cap.(INRb)/(USDb)	54.3 / 0.7
52-Week Range (INR)	267 / 64
1, 6, 12 Rel. Per (%)	-1/43/4
12M Avg Val (INR M)	49

Financials & Valuations (INR b)

Y/E Mar	2021E	2022E	2023E
Sales	37.2	40.0	44.4
EBIT Margin (%)	13.9	14.8	15.1
PAT	3.6	4.1	4.7
EPS (INR)	15.6	17.9	20.3
EPS Gr. (%)	33.6	14.7	13.4
BV/Sh. (INR)	105.3	118.3	134.4

Ratios

RoE (%)	15.8	16.3	16.3
RoCE (%)	5.6	6.0	6.3
Payout (%)	20.3	20.3	20.3

Valuations

P/E (x)	15.4	13.4	11.8
P/BV (x)	2.3	2.0	1.8
EV/EBITDA (x)	6.7	5.6	4.5
Div Yield (%)	1.3	1.5	1.7

Shareholding pattern (%)

As On	Dec-20	Sep-20	Dec-19
Promoter	49.2	49.2	49.0
DII	24.6	24.5	24.7
FII	16.2	16.0	17.9
Others	10.0	10.2	8.4

FII Includes depository receipts

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Key highlights from management commentary

- Management alluded that 4Q would remain impacted on account of continued weakness in the top account.
- The business continues to gather steam, with several deals on the verge of closing, and a solid pipeline. Going forward, the company strategy would be to focus on delivering consistent profitable growth with a higher focus on deal closures. The topline is the clear priority.
- EBITDA is at decade highs, cash is at an all-time high, and Zensar is a zero-debt company. The management intends to use this ammunition to drive growth.
- Within verticals, Hi-Tech was impacted due to a client-specific issue, while other verticals have been fairly good.
- This quarter was good for the Insurance vertical – a couple of deals were closed. Legacy to cloud is becoming a big theme in this space, and Zensar's capability in digital foundation is helping with this. It would lead to growth revival in this vertical.
- The company started with 100 associates for the 'Work from Anywhere' program, which has now increased to 550. This has had a massive positive impact on margins.
- The company intends to make certain investments; with wage hikes, margins are likely to be pressured. However, they would remain in the narrow range.
- The management alluded that the current margin profile is not sustainable going forward.

Valuation and view – multiples should remain stable

- Barring FY19 – when Zensar's overall revenue growth (including inorganic) had come close to that of mid-cap peers (mostly organic) – the stock has always traded at a steep discount to the sector.
- This is largely attributable to its a) inferior growth (organic revenue CAGR of 4% over FY15–20 v/s 12%+ for mid-cap peers), b) payout ratio (20% v/s an average payout of 40%), and c) return profile (RoE of 18% v/s 30%+ for most peers).
- We value the stock at ~13x FY23E EPS. We expect the company's revenue to improve and PAT to grow in FY22, but would wait for any recovery before turning more constructive on the stock.

Quarterly Performance

Y/E March	FY20				FY21E				FY20	FY21E	(INR M)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			Est. 3QFY21	Var. (% / bp)
Revenue (USD m)	147	146	138	135	125	126	123	124	566	497	132	-7.1
QoQ (%)	-0.9	-0.9	-5.5	-2.2	-7.2	0.5	-2.4	0.7	1.6	-12.1	0.5	-291bp
Revenue (INR m)	10,244	10,277	9,819	9,763	9,485	9,364	9,065	9,272	40,102	37,187	9,760	-7.1
YoY (%)	16.0	8.6	-3.9	-6.8	-7.4	-8.9	-7.7	-5.0	2.9	-7.3	-4.4	-331bp
GPM (%)	29.8	29.3	23.9	30.0	29.6	34.8	34.6	33.6	28.3	33.1	33.8	84bp
SGA (%)	15.2	15.4	17.1	15.4	14.6	15.4	14.1	14.3	15.7	14.6	15.2	-111bp
EBITDA	1,500	1,435	672	1,429	1,418	1,818	1,863	1,787	5,037	6,885	1,815	2.6
EBITDA Margin (%)	14.6	14.0	6.8	14.6	14.9	19.4	20.6	19.3	12.6	18.5	18.6	195bp
EBIT	1,127	1,056	266	1,020	979	1,390	1,442	1,360	3,470	5,171	1,386	4.0
EBIT Margin (%)	11.0	10.3	2.7	10.5	10.3	14.8	15.9	14.7	8.7	13.9	14.2	171bp
Other income	-20	41	269	-11	28	-171	-82	-19	279	-244	-68	20.0
ETR	28.4	28.5	25.5	27.3	26.2	26.5	26.5	26.5	27.7	26.4	27.0	
Adj. PAT	780	757	383	709	727	878	987	971	2,629	3,563	947	4.2
QoQ (%)	-10.2	-3.0	-49.4	85.4	2.6	20.7	12.3	-1.6			6.1	
YoY (%)	-6.6	-20.5	-34.8	-18.4	-6.8	16.1	157.9	36.9	-18.9	35.5	138.6	
EPS (INR)	3.3	3.5	1.7	3.0	3.2	3.9	4.3	4.2	11.7	15.6	4.1	3.2

Key Performance Indicators

Y/E March	FY20				FY21				FY20	FY21
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenue (QoQ CC %)	3.9	0.1	(6.1)	(1.7)	(5.0)	(0.7)	(3.7)		6.7	
Margins										
Gross Margin	29.8	29.3	23.9	30.0	29.6	34.8	34.6	33.6	28.3	33.1
EBIT Margin	11.0	10.3	2.7	10.5	10.3	14.8	15.9	14.7	8.7	13.9
Net Margin	7.6	7.4	3.9	7.3	7.7	9.4	10.9	10.5	6.6	9.6
Operating metrics										
Headcount	10,095	10,147	9,879	9,452	8,955	8,542	8,809		9,452	
Attrition (%)	16.7	17.0	16.0	16.3	13.5	11.7	12.9		16.3	
Offshore Rev	33.2	34.8	33.7	37.2	36.6	39.8	42.8		34.7	
Key Verticals (YoY USD %)										
BFSI	17.8	33.1	16.6	15.8	(7.7)	(13.4)	(12.0)		20.7	
Manufacturing	17.6	8.1	3.6	(5.6)	(5.4)	(9.0)	(14.7)		5.5	
Retail	(18.6)	(17.2)	(35.2)	(37.0)	(41.4)	(27.6)	(1.4)		(27.0)	
Key Geographies (YoY USD %)										
North America	10.9	3.7	(7.7)	(13.7)	(15.5)	(13.4)	(14.4)		(2.2)	
UK	24.1	18.2	8.9	(6.3)	(19.1)	(13.8)	(4.6)		10.4	
Continental Europe	1.3	28.3	22.2	26.9	(4.6)	(16.4)	3.3		19.3	



Key highlights from management commentary

Growth and outlook

- The company reported sequential decline of 3.7% QoQ and 10.6% YoY in CC terms. This was largely due to decline in the Hi-Tech business.
- Management alluded that 4Q would remain impacted on account of continued weakness in the top account.
- Zensar won TCV worth USD200m, of which net new is 40%.
- The business continues to gather steam, with several deals on the verge of closing, and a solid pipeline.
- Going forward, the company strategy would be to focus on delivering consistent profitable growth with a higher focus on deal closures. The topline is the clear priority.
- EBITDA is at decade highs, cash is at an all-time high, and Zensar is a zero-debt company. The management intends to use this ammunition to drive growth.
- Within verticals, Hi-Tech was impacted due to a client-specific issue, while other verticals have been fairly good.
- This quarter was good for the Insurance vertical – a couple of deals were closed. Legacy to cloud is becoming a big theme in this space, and Zensar's capability in digital foundation is helping with this. It would lead to growth revival in this vertical.

Top client

- Despite decline in the top client due to softness in volumes from the customer, the company has maintained its wallet share.
- Over the last several quarters, the company has identified several areas where the customer is making incremental investments. Zensar is accordingly aligning itself.
- Softness is expected to continue in 4QFY21 as well.

Consumer business

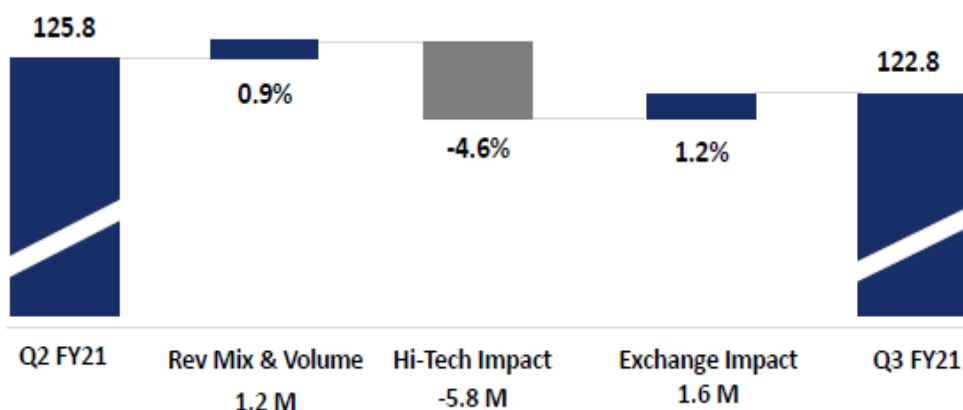
- The business was heavily impacted due to the pandemic, but has been reviving for the past two quarters.
- Zensar intends to grow the team and bring more leadership to the business.
- The majority of the business was around e-commerce, and the focus is now toward the digital supply chain.

Margin outlook

- Gross margins in 3Q stood at 34.6%; margins have been expanding fairly well for the past two quarters.
- The company started with 100 associates for the 'Work from Anywhere' program, which has now increased to 550. This has had a massive positive impact on margins.
- The company intends to make certain investments; with wage hikes, margins are likely to be pressured. However, they would remain in the narrow range.
- The management alluded that the current margin profile is not sustainable going forward.

Acquisitions

- The acquisition of Keystone Turbo has enhanced Zensar's retail practice, and Cynosure has accelerated the Insurance business.
- Indigo Slate is also doing well. Fool Proof has a strong presence in Europe.
- The company has good ammunition in the form of cash to go ahead with more tuck-in acquisitions.

Exhibit 1: Revenue growth was owing to the mix and volumes; exchange impact was offset by impact in Hi-Tech

Source: Company, MOFSL

Exhibit 2: Hi-Tech vertical was impacted due to decline in the Top client account

Verticals	Contribution to rev (%)	Growth QoQ (CC)
Hi-Tech	39.6	(10.6)
Manufacturing	12.3	-
Insurance	19.3	(8.7)
Banking	9.6	1.3
Consumer Services	15.3	6.2
Emerging	3.9	78.9

Source: Company, MOFSL

Exhibit 3: Europe/Africa reported strong growth, while America declined

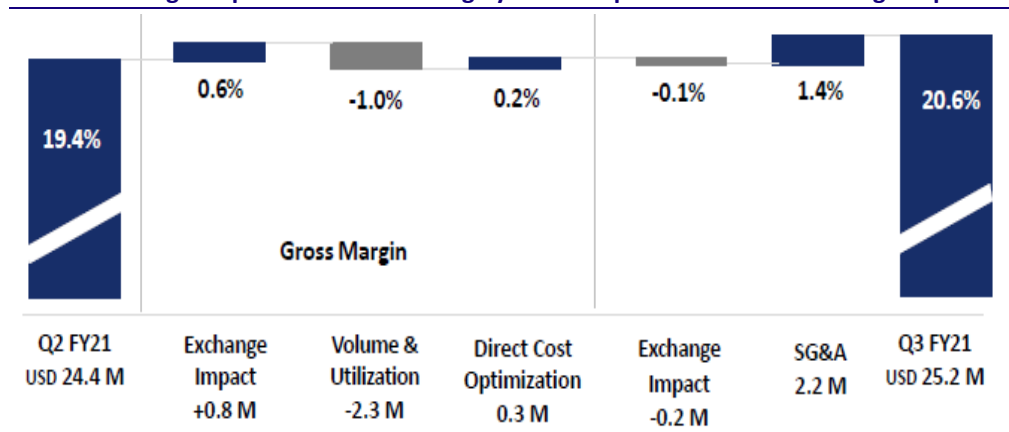
Geographies	Contribution to rev (%)	Growth QoQ (USD)
North America	70.3	(6.4)
Europe	17.4	6.3
Africa	12.3	11.6

Source: Company, MOFSL

Exhibit 4: Service lines declined sequentially

Service lines	Contribution to rev (%)	Growth QoQ (USD)
Digital & Application Services (DAS)	84.9	(2.6)
Digital Foundation Services (DFS)	15.1	(1.1)

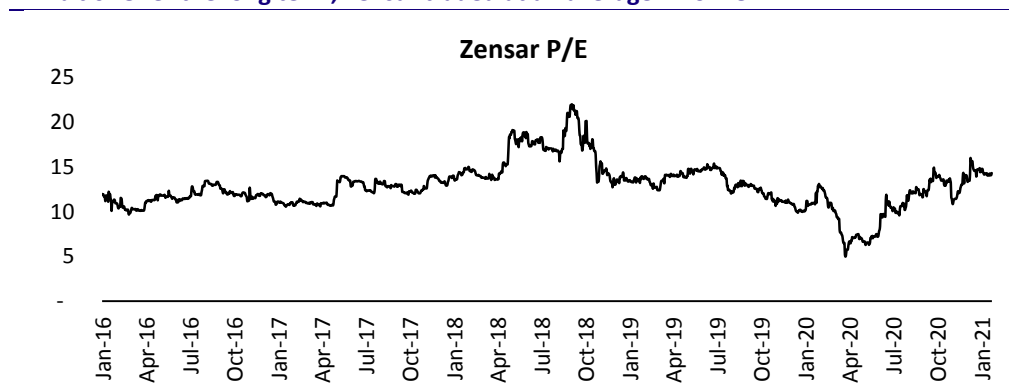
Source: Company, MOFSL

Exhibit 5: Margin expansion was seen largely on cost optimization and exchange impact

Source: Company, MOFSL

Valuation and view – multiples should remain stable

- Barring FY19 – when Zensar's overall revenue growth (including inorganic) had come close to that of mid-cap peers (mostly organic) – the stock has always traded at a steep discount to the sector.
- This is largely attributable to its a) inferior growth (organic revenue CAGR of 4% over FY15–20 v/s 12%+ for mid-cap peers), b) payout ratio (20% v/s an average payout of 40%), and c) return profile (RoE of 18% v/s 30%+ for most peers).
- We value the stock at ~13x FY23E EPS. We expect the company's revenue to improve and PAT to grow in FY22, but would wait for any recovery before turning more constructive on the stock.

Exhibit 6: Over the long term, Zensar traded at an average PE of ~8x

Source: Bloomberg, MOFSL

Exhibit 7: Revision to our estimates

	Revised			Earlier			Change		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
INR/USD	74.8	75.0	75.0	74.8	75.0	75.0	0.0%	0.0%	0.0%
USD Revenue - m	497	534	591	532	585	640	-6.5%	-8.8%	-7.5%
Growth (%)	(12.1)	7.3	10.8	(9.8)	9.9	9.4	-240bps	-260bps	150bps
EBIT margin (%)	13.9	14.8	15.1	12.9	13.8	13.8	100bps	100bps	130bps
PAT (INR m)	3,563	4,132	4,687	3,476	4,186	4,590	2.5%	-1.3%	2.1%
EPS	15.6	17.9	20.3	15.2	18.3	20.0	2.6%	-2.2%	1.2%

Source: Company, MOFSL

Operating metrics

Exhibit 8: Operating metrics

	Q1FY20	Q2FY20	Q3FY20	Q4FY20	1QFY21	2QFY21	3QFY21
Geographic Mix - %							
USA	75	73	73	73	75	73	70
Europe	16	16	16	16	15	16	17
ROW	9	11	11	11	10	11	12
Vertical Mix - %							
Manufacturing	52	52	54	53	58	55	52
Retail and consumer services	18	17	14	15	12	14	15
Financial services	25	29	29	29	27	29	29
Emerging	5	2	3	3	2	2	4
Service Mix - %							
Application Management Services	86	89	87	87	85	85	85
Infrastructure Management Services	14	11	13	13	15	15	15
Maintenance	4	4	4	4	4	4	4
Services	14	11	13	13	15	15	15
Project Type - %							
Fixed price	55	57	57	59	60	61	61
Time & material	45	43	43	41	40	39	39
Revenue by delivery - %							
Onsite	67	65	66	63	63	60	57
Offshore	33	35	34	37	37	40	43
Client concentration - %							
Top 5	40	39	41	40	43	40	38
Top 6-10	12	11	10	9	11	11	10
Top 10	51	50	51	49	54	51	48
Top 11-20	13	15	15	14	14	15	14
Top 20	64	65	66	63	68	66	62
Number of million-dollar clients							
1 Million dollar +	84	88	87	82	80	81	83
5 Million dollar +	20	23	24	24	24	23	24
10 Million dollar +	9	9	10	10	9	8	8
20 Million dollar +	2	2	2	2	2	2	2
Client metrics							
Number of active clients	149	145	142	138	132	134	134
Employee metrics							
Total headcount	10,095	10,147	9,879	9,452	8,955	8,542	8,809
Gross employees added during the period	1,281	981	611	471	229	394	991
Utilization	82.4	84.1	81.0	83.5	82.2	83.3	80.1
Attrition	16.7	17.0	16.0	16.3	13.5	11.7	12.9

Source: Company, MOFSL

Financials and valuations

Income Statement								(INR m)
Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Sales	29,381	30,556	30,058	38,988	40,102	37,187	40,020	44,360
Change (%)	11.8	4.0	(1.6)	29.7	2.9	(7.3)	7.6	10.8
Cost of Services	20,168	21,603	21,220	27,626	28,756	24,869	26,452	29,206
SG&A Expenses	4,964	5,135	5,334	6,445	6,312	5,432	5,823	6,432
EBITDA	4,250	3,819	3,503	4,917	5,035	6,885	7,745	8,721
% of Net Sales	14.5	12.5	11.7	12.6	12.6	18.5	19.4	19.7
Depreciation	651	486	651	894	1,567	1,714	1,841	2,041
Interest	106	88	227	373	605	525	480	532
Other Income	178	172	202	502	435	356	280	311
Forex	360	21	463	291	449	-75	0	0
PBT	4,031	3,438	3,290	4,442	3,747	4,928	5,704	6,459
Tax	1,246	1,103	1,013	1,310	1,038	1,303	1,512	1,712
Rate (%)	30.9	32.1	30.8	29.5	27.7	26.4	26.5	26.5
Minority Interest	28	35	50	51	82	62	60	60
Net Income	2,758	2,301	2,227	3,081	2,627	3,563	4,132	4,687
Change (%)	16.6	-16.6	-3.2	38.4	-14.7	35.6	16.0	13.4

Balance Sheet								(INR m)
Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	446	449	450	450	451	451	451	451
Reserves	12,205	14,267	16,239	18,973	20,900	23,283	26,510	30,162
Net Worth	12,651	14,716	16,689	19,424	21,351	23,734	26,961	30,612
Loans	1,481	1,306	60	2,578	2,886	3,254	3,254	3,254
Other liabilities	525	535	906	924	4,008	4,008	4,008	4,008
Capital Employed	14,658	16,556	17,655	22,925	28,244	30,996	34,223	37,875
Net Block	3,878	4,495	5,976	9,617	13,340	12,426	11,385	10,145
Other LT Assets	517	1,897	2,356	1,898	2,039	1,948	2,036	2,171
Curr. Assets	14,317	14,657	14,624	19,360	20,576	22,902	27,544	33,031
Current Investments	1,016	1,467	1,302	454	2,670	2,670	2,670	2,670
Inventories	1,259	1,127	1,060	985	941	855	920	1,020
Debtors	5,427	5,332	6,423	8,762	6,656	6,172	6,643	7,363
Cash & Bank Balance	2,844	5,996	5,137	3,259	5,166	8,438	12,180	16,289
Other Current Assets	2,699	736	702	5,901	5,143	4,766	5,131	5,688
Current Liab. & Prov	4,053	4,493	5,301	7,951	7,711	6,280	6,743	7,472
Trade payables	1,643	1,753	1,839	3,010	2,650	1,643	1,748	1,930
Other liabilities	2,118	2,740	3,461	4,941	5,061	4,637	4,995	5,543
Net Current Assets	10,263	10,164	9,323	11,409	12,865	16,622	20,802	25,559
Application of Funds	14,658	16,556	17,655	22,925	28,245	30,996	34,223	37,875

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
EPS	68.6	10.3	10.1	14.3	11.7	15.6	17.9	20.3
Cash EPS	16.2	12.3	12.7	17.5	18.6	23.1	25.9	29.1
Book Value	60.8	65.6	74.2	86.3	96.3	105.3	118.3	134.4
DPS	12.0	12.0	7.0	2.8	2.4	3.2	3.6	4.1
Payout %	17.5	116.1	69.0	19.6	20.3	20.3	20.3	20.3
Valuation (x)								
P/E	3.5	23.2	23.7	16.8	20.6	15.4	13.4	11.8
Cash P/E	14.9	19.6	19.0	13.7	12.9	10.4	9.3	8.2
EV/EBITDA	11.2	12.5	13.6	10.8	9.6	6.7	5.6	4.5
EV/Sales	1.6	1.6	1.6	1.4	1.2	1.2	1.1	0.9
Price/Book Value	3.9	3.7	3.2	2.8	2.5	2.3	2.0	1.8
Dividend Yield (%)	5.0	5.0	2.9	1.2	1.0	1.3	1.5	1.7
Profitability Ratios (%)								
RoE	25.0	17.2	14.7	18.0	12.9	15.8	16.3	16.3
RoCE	5.7	6.1	6.9	8.1	4.7	5.6	6.0	6.3
Turnover Ratios								
Debtors (Days)	67	64	78	82	61	61	61	61
Fixed Asset Turnover (x)	7.5	7.3	5.7	5.0	3.5	2.9	3.4	4.1

Cash Flow Statement

(INR m)

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
CF from Operations	3,805	3,244	3,298	4,183	4,253	5,582	6,233	7,009
Cash for Working Capital	-1,218	-201	-1,385	-2,622	1,884	-340	-525	-782
Net Operating CF	2,587	3,043	1,913	1,561	6,137	5,242	5,709	6,228
Net Purchase of FA	-423	-349	-515	-517	-781	-800	-800	-800
Free Cash Flow	2,164	2,694	1,398	1,043	5,356	4,442	4,909	5,428
Net Purchase of Invest.	1	-1,552	-1,050	-1,894	-2,372	281	280	311
Net Cash from Invest.	-422	-1,902	-1,565	-2,411	-3,153	-519	-520	-489
Proc. from equity issues	42	46	26	14	15	0	0	0
Proceeds from LTB/STB	-215	2,281	-922	-376	132	-617	-480	-532
Dividend Payments	-969	-261	-626	-633	-1,197	-834	-967	-1,097
Cash Flow from Fin.	-1,142	2,066	-1,522	-995	-1,051	-1,451	-1,447	-1,629
Exchange difference	-14	-56	315	-32	-27	0	0	0
Net Cash Flow	1,009	3,151	-859	-1,877	1,907	3,273	3,742	4,109
Opening Cash Bal.	1,835	2,845	5,996	5,137	3,259	5,166	8,439	12,180
Add: Net Cash	1,009	3,151	-859	-1,877	1,907	3,273	3,742	4,109
Closing Cash Bal.	2,845	5,996	5,137	3,259	5,166	8,439	12,180	16,289

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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