

Revenues subdued; margin expansion continues...

Zensar Technologies (Zensar) reported healthy Q2FY21 results on the profitability front. Dollar revenues increased 0.6% QoQ mainly led by 12.8% QoQ growth in consumer services and 11.5% QoQ growth in banking partially offset by 4.5% QoQ decline in hi tech and 2.9% QoQ decline in manufacturing. EBITDA margins increased 438 bps QoQ to 18.8% mainly led higher utilisation and offshoring. Reported PAT was at ₹ 50 lakh. Adjusting for one-time exceptional item of ₹ 88.7 crore, PAT increased 21.7% QoQ to ₹ 89.2 crore. Order book has also increased by 16.7% QoQ to ₹ 175 crore. Zensar also reduced debt by ₹ 128.9 crore to ₹ 85.6 crore (US\$11.5 million).

Conversion of deal pipeline key to re-rating

The company expects weakness in the top client to continue in the next two quarters. Coupled with a significant dip in H1FY21 & sale of third party maintenance segment, we expect FY21E revenues to decline 12.0% YoY. In the longer term, we expect the company to register healthy growth in core revenues (i.e. excluding third party maintenance revenues) mainly led by improving order book (increased 16.7% QoQ in Q2FY21), deal pipeline (US\$1.5 billion), net new wins and conversion ratio. This, coupled with bottoming out of retail vertical, improvement in cloud revenues and ramp up of projects will lead to healthy improvement in revenues. In addition, the company has also hired Nachiketa Mitra (from Cognizant) to boost its financial service (~26.6% of revenues) segment in the long term. Coupled with healthy cash on the balance sheet, we expect the company to pursue inorganic acquisition (in cloud or software engineering side). Hence, we expect the company to register improving revenue growth in the long term.

Margin outlook remains positive

Zensar plans to give wage hikes effective January 2021 and also plans to invest in leadership, invest in sales & marketing to drive growth, which is likely to act as headwind to margins. However, Zensar has many levers like lower travel cost, onsite employee rationalisation, divestment of non-core low margins assets, lower sub-contracting cost and higher offshoring, which will enable the company to post healthy margins, going forward. Hence, we revise our EBITDA margin estimates upwards.

Valuation & Outlook

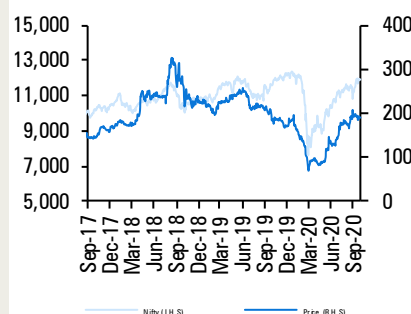
The company witnessed healthy traction in order booking. This, coupled with bottoming out of retail vertical, improvement in cloud revenues and ramp up in financial services vertical, will lead to healthy improvement in revenues in the long term. Further, improving margins are expected to boost the bottomline. Hence, we upgrade the stock from HOLD to **BUY** with a revised target price of ₹ 210 (9x FY23E EPS).



Particulars

Particular	Amount
Market Cap (₹ Crore)	4,005.9
Total Debt (₹ Crore)	288.6
Cash & Inverts (₹ Crore)	783.6
EV (₹ Crore)	3,510.9
52 week H/L	212 / 64
Equity capital	45.1
Face value	₹ 2

Price Performance



Key Highlights

- Healthy deal pipeline, improving growth in cloud, FS and retail to drive long term revenues
- We believe the company has many margin levers to drive profitability
- Upgrade from HOLD to BUY with revised target price of ₹ 210

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	3,983	4,177	3,839	4,012	4,391	1.7%
EBITDA	493	513	680	742	826	17.2%
EBITDA Margin (%)	12.4	12.3	17.7	18.5	18.8	
Adjusted PAT	314	268	386	455	525	25.2%
Adjusted EPS (₹)	13.9	11.5	16.8	19.9	22.9	
P/E	12.8	15.4	10.6	9.0	7.8	
ROE (%)	16.1	12.8	16.2	16.8	17.1	
ROCE (%)	17.6	12.7	17.7	17.6	17.7	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 1: Profit and loss statement		₹ crore			
	FY20	FY21E	FY22E	FY23E	
Total Revenues	4,177	3,839	4,012	4,391	
Growth (%)	4.9	-8.1	4.5	9.5	
Employee Benefit Expense	3,016.0	2,583.5	2,675.7	2,928.8	
Other Expenses	648.2	575.8	593.7	636.7	
EBITDA	513	680	742	826	
Growth (%)	4.1	32.5	9.2	11.2	
Depreciation	159.2	172.7	180.5	197.6	
Other Income	88.5	69.3	88.8	118.8	
Interest	60.6	36.7	16.5	16.5	
PBT before Exceptional Items	381.5	539.5	634.1	730.4	
Growth (%)	-14.3	41.4	17.5	15.2	
Tax	105.7	145.7	171.2	197.2	
PAT before Exceptional Items	275.8	393.9	462.9	533.2	
Minority interest	8.1	8.1	8.1	8.1	
Adjusted PAT	268	386	455	525	
Growth (%)	-14.6	44.1	17.9	15.5	
Adjusted Diluted EPS	11.5	16.8	19.9	22.9	
EPS (Growth %)	-17.3	46.1	17.9	15.5	

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement		₹ crore			
	FY20	FY21E	FY22E	FY23E	
Profit before Tax	376	540	634	730	
Depreciation	159	173	181	198	
Change in working capital	188	15	(36)	(66)	
Income Taxes Paid	(115)	(146)	(171)	(197)	
CF from operations	623	541	527	554	
Other Investments	(237)	69	89	119	
(Purchase)/Sale of Fixed Assets	(78)	(107)	(128)	(66)	
CF from investing Activities	(315)	(38)	(40)	53	
Inc / (Dec) in Equity Capital	2	-	-	-	
Inc / (Dec) in sec.loan Funds	11	(203)	-	-	
Dividend & Dividend tax	(120)	(93)	(136)	(158)	
Interest Paid on Loans	(12)	(37)	(17)	(17)	
CF from Financial Activities	(119)	(333)	(153)	(174)	
Net change in cash	189	170	335	433	
Opening cash	326	517	667	982	
Closing cash	517	667	982	1,395	

Source: Company, ICICI Direct Research

Exhibit 3: Balance sheet		₹ crore			
	FY20	FY21E	FY22E	FY23E	
Equity	45	45	45	45	
Reserves & Surplus	2,045	2,338	2,656	3,024	
Networth	2,090	2,383	2,701	3,069	
Total debt	289	86	86	86	
Minority Interest	24	24	24	24	
Other liabilities	377	377	377	377	
Source of funds	2,779	2,869	3,187	3,555	
Fixed assets	458	442	433	381	
Intangible assets	230	200	177	118	
Goodwill	647	647	647	647	
Non current investments	11	11	11	11	
Other non current assets	192	194	201	211	
Current Investments	267	267	267	267	
Cash Balance	517	667	982	1,395	
Inventories	94	88	92	101	
Debtors	666	610	638	698	
Other current assets	514	502	516	540	
Trade payables	265	242	253	277	
Other Current liabilities	551	517	524	537	
Application of funds	2,779	2,869	3,187	3,555	

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios		₹ crore			
	FY20	FY21E	FY22E	FY22E	
Per share data (₹)					
Diluted EPS	11.5	16.8	19.9	22.9	
BV	90.1	104.1	118.0	134.0	
DPS	2.8	4.1	6.0	6.9	
Cash Per Share	22.3	29.1	42.9	60.9	
Operating Ratios (%)					
EBITDA Margin	12.3	17.7	18.5	18.8	
PAT Margin	6.4	10.0	11.3	12.0	
Debtor days	58	58	58	58	
Creditor days	23	23	23	23	
Return Ratios (%)					
RoE	12.8	16.2	16.8	17.1	
RoCE	12.7	17.7	17.6	17.7	
RoC	17.7	26.2	29.0	33.2	
Valuation Ratios (x)					
P/E	15.4	10.6	9.0	7.8	
EV / EBITDA	6.8	4.6	3.8	2.9	
Market Cap / Sales	1.0	1.0	1.0	0.9	
Price to Book Value	2.0	1.7	1.5	1.3	
Solvency Ratios					
Debt / Equity	0.1	0.0	0.0	0.0	
Current Ratio	1.6	1.6	1.6	1.6	
Quick Ratio	1.4	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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