

CMP: ₹ 410

Target: ₹ 525 (28%)

Target Period: 12 months

BUY

January 26, 2022

Furlough impacts Q3...

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%)

Q3FY22 Results: Zensar's numbers were hit by furlough.

- Revenue grew 4.7% in CC terms while dollar revenue grew 3.7% QoQ
- EBIT margins declined 110 bps QoQ to 14.3%
- Digital services contribute 71.5% of revenues

What should investors do? Zensar's share price has grown by ~2.7x over the past five years (from ~₹ 170 in January 2017 to ~₹ 410 levels in January 2022).

- We continue to remain positive and retain our BUY rating on the stock.

Target Price and Valuation: We value Zensar at ₹ 525 i.e. 20x P/E on FY24E

Key triggers for future price performance:

- Zensar is addressing key shortages of the past; the new CEO has devised a strategy to focus on experience side and build capabilities in digital engineering, data, artificial intelligence and machine learning
- Driving deal momentum, annuity revenues, increasing investment in sales & talent, leadership and tuck in acquisition to build capability bodes well for long term revenue growth
- Expect dollar revenue CAGR of 12.3 over FY21-24E

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 ₹ 4,985

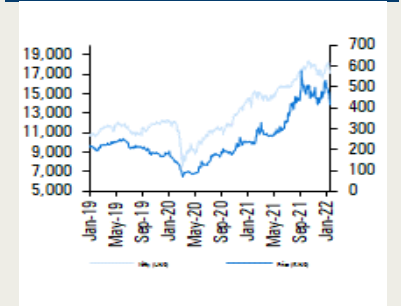
Particulars

Particular	Amount
Market Cap (₹ Crore)	9,227
Total Debt (₹ Crore)	-
Cash & Invts (₹ Crore)	1,062
EV (₹ Crore)	8,165
52 week H/L	587 / 222
Equity capital	45
Face value	₹ 2

Shareholding pattern

	Mar-21	Jun-21	Sep-21	Dec-21
Promoter	49	49	49	49
FII	16	17	16	18
DII	25	21	21	14
Public	10	13	14	19

Price Chart



Recent event & key risks

- Furlough hits Q3
- **Key Risk:** (i) Deceleration in deal pipeline, (ii) Inability to sustain margins

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 Year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 Year CAGR (FY21-24E)
Net Sales	3,983	4,182	3,781	4.9%	4,317	4,943	5,487	13.2%
EBITDA	493	507	685	9.2%	768	840	1,004	13.6%
EBITDA Margin (%)	12.4	12.1	18.1		17.8	17.0	18.3	
Reported PAT	314	263	300	-0.6%	409	467	598	25.9%
EPS (₹)	13.9	11.5	13.2		18.0	20.5	26.3	
P/E	29.4	35.6	31.1		22.8	20.0	15.6	
ROE (%)	16.1	12.6	12.8		15.5	15.6	17.5	
ROCE (%)	17.6	12.5	18.9		19.2	19.4	21.5	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- The company reported revenue of US\$147.1 mn, 3.7% QoQ dollar growth while CC growth was 4.7% QoQ. In rupee terms, revenue grew 4.9% QoQ to ₹ 1103 crore. Our calculation suggests that in US\$ term, organic revenues for the quarter grew 3.8% QoQ while that of M3Bi grew 1.3% QoQ
- Geography wise, growth came in from US markets as it grew 4.4% QoQ, while Europe grew 6% QoQ and Africa region witnessed some temporary blip resulting in a decline of 4.1% QoQ
- Vertical wise Hi-Tech & Engineering, which contributes 46.4% of revenues, declined 3.4% QoQ. Its decline was mitigated by growth in other verticals such as retail & BFSI, which grew 8.4% and 6% QoQ, respectively
- EBITDA margins for the quarter declined 110 bps QoQ to 14.3%; Margin headwinds were i) 120 bps impact due to lower volume and utilisation ii) 40 bps exchange impact iii) 20 bps SG&A impact. Margin tailwinds were i) 60 bps due to lower cost of delivery ii) 10 bps exchange impact
- The company indicated that de-growth in Hi-Tech segment was partly due to furlough and partly due to client re-alignment of budgets due to project closures. Zensar sounds confident of growth coming back to this segment Q4 onwards
- The company indicated that growth in the South Africa region was impacted partly by ZAR depreciation against the US\$ and partly due to new variant of virus across the country. Zensar also indicated that the impact of the new virus seems limited. They expect to be in the growth trajectory from Q4 onwards
- The company indicated that growth in the BFSI segment was mainly led by banking sub-segment where the company continued to win logos and acquisition of M3Bi also aiding growth. However, the company indicated that there was a decline of 2.9% QoQ in insurance vertical pertaining to weakness in some South African accounts due to new variant eruption
- The company indicated that the demand environment continued to be healthy and they are seeing strong growth for the foreseeable future. Zensar indicated that they are seeing more mid and small size deals in the market while the share of large size deal has been shrinking
- The company maintained EBITDA margin guidance in the mid-teens for few quarters for now since any incremental growth coming in will be invested back into talent (two hikes in a year, ~500 bps impact) and building capabilities. The management made it clear their current focus is to capture the growth
- The company indicated that they are increasing talent catchment areas by i) opening near shore delivery centre in LatAm and Europe and increasing fresher's intake. Zensar indicated that they are looking to triple their fresher hiring in the next 12 months. The company also indicated that they are looking to increase offshoring in Pune and Bangalore, which is expected to support margins in the medium term
- The current quarter wins were at US\$125.2 mn. The company indicated that approximate breakup of deal wins in terms of new wins and renewal were at 32:68
- The management indicated that subcontracting costs for the quarter increased from 14.9% of sales to 15.2% in Q3. The company maintained that subcontractor costs may remain at this elevated level for some time as demand continues to be strong

Exhibit 1: P&L

	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	Comments
Revenue	1,102.5	906.5	21.6	1,050.6	4.9	Revenue growth was lower due to decline in Hi-Tech vertical and South Africa geography
Employee expense	776	593	30.9	729	6.4	
Gross Margin	327	314	4.0	321	1.6	
Gross margin (%)	29.6	34.6	-501 bps	30.6	-96 bps	
other expense	168	128	31.8	160	5.1	
EBITDA	158	186	-15.0	161	-1.7	
EBITDA Margin (%)	14.4	20.6	-618 bps	15.4	-103 bps	Margins impacted largely due to lower utilisation
Depreciation & amortisation	47	42	12.6	47	1.3	
EBIT	111	144	-23.0	114	-3.0	
EBIT Margin (%)	10.1	15.9	-584 bps	10.9	-82 bps	
Other income (less interest)	15	-8	-285.4	14	7.0	
PBT	126	136	-7.2	129	-1.9	
Tax paid	34	36	-5.8	33	3.4	
PAT	92	100	-7.7	96	-3.7	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY22E			FY23E			FY24E	Comments
	Old	New	% Change	Old	New	% Change	Introduced	
(₹ Crore)								
Revenue	4,202	4,317	2.7	4,790	4,943	3.2	5,487	
EBITDA	748	768	2.7	910	840	-7.7	1,004	
EBITDA Margin (%)	17.8	17.8	0 bps	19.0	17.0	-200 bps	18.3	Margins re-aligned as per management guidance
PAT	413	409	-0.9	534	467	-12.6	598	
EPS (₹)	18.1	18.0	-0.9	23	20	-12.6	26	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 3: Profit and loss statement					₹ crore
	FY21	FY22E	FY23E	FY24E	
Total Revenues	3,781	4,317	4,943	5,487	
Growth (%)	-9.6	14.2	14.5	11.0	
Employee Benefit Expense	2,515	2,862	3,312	3,676	
Other Expenses	582	686	791	807	
EBITDA	685	768	840	1,004	
Growth (%)	35.1	12.2	9.4	19.5	
Depreciation	175	192	192	192	
Other Income	25	34	42	47	
Interest	54	40	40	40	
PBT before Exceptional Items	482	570	650	819	
Growth (%)	28.3	18.3	14.0	26.1	
Tax	126	154	175	221	
PAT before Exceptional Items	356	416	474	598	
Minority interest	7	7	8	-	
PAT after exceptional items	300	409	467	598	
Growth (%)	13.9	36.3	14.1	28.2	
Diluted EPS	13.2	18.0	20.5	26.3	
EPS (Growth %)	14.3	36.3	14.1	28.2	

Source: Company, ICICI Direct Research

Exhibit 5: Balance sheet					₹ crore
	FY21	FY22E	FY23E	FY24E	
Equity	45	45	45	45	
Reserves & Surplus	2,297	2,596	2,936	3,373	
Networth	2,342	2,641	2,981	3,418	
Total debt	-	-	-	-	
Minority Interest	29	29	29	29	
Other liabilities	324	324	324	324	
Source of funds	2,695	2,993	3,334	3,771	
Fixed assets	388	463	443	427	
Intangible assets	168	188	130	76	
Goodwill	577	577	577	577	
Non current investments	154	154	154	154	
Other non current assets	154	161	174	185	
Current Investments	363	363	363	363	
Cash Balance	699	835	1,174	1,612	
Inventories	-	-	-	-	
Debtors	589	669	766	850	
Other current assets	342	347	374	398	
Trade payables	220	246	282	313	
Other Current liabilities	518	518	540	559	
Application of funds	2,695	2,993	3,334	3,771	

Source: Company, ICICI Direct Research

Exhibit 4: Cash flow statement					₹ crore
	FY21	FY22E	FY23E	FY24E	
Profit before Tax	482	570	650	819	
Depreciation	175	192	192	192	
Change in working capital	315	(67)	(79)	(70)	
Income Taxes Paid	(140)	(154)	(175)	(221)	
CF from operations	858	540	578	713	
Other Investments	(547)	34	42	47	
(Purchase)/Sale of Fixed Assets	(39)	(237)	(64)	(71)	
CF from investing Activities	(528)	(203)	(23)	(24)	
Inc / (Dec) in Equity Capital	1	-	-	-	
Inc / (Dec) in sec.loan Funds	(330)	-	-	-	
Dividend & Dividend tax	(27)	(110)	(126)	(161)	
Interest Paid on Loans	(4)	(40)	(40)	(40)	
CF from Financial Activities	(359)	(150)	(166)	(201)	
Net change in cash	(29)	186	389	487	
Opening cash	517	699	835	1,174	
Closing cash	699	835	1,174	1,612	

Source: Company, ICICI Direct Research

Exhibit 6: Key ratios					₹ crore
	FY21	FY22E	FY23E	FY24E	
Per share data (₹)					
Diluted EPS	13.2	18.0	20.5	26.3	
BV	102.9	116.0	131.0	150.2	
DPS	3.6	4.9	5.5	7.1	
Cash Per Share	30.7	36.7	51.6	70.8	
Operating Ratios (%)					
EBITDA Margin	18.1	17.8	17.0	18.3	
PAT Margin	7.9	9.5	9.4	10.9	
Debtor days	57	57	57	57	
Creditor days	21	21	21	21	
Return Ratios (%)					
RoE	12.8	15.5	15.6	17.5	
RoCE	18.9	19.2	19.4	21.5	
RoIC	31.2	32.1	36.1	45.2	
Valuation Ratios (x)					
P/E	31.1	22.8	20.0	15.6	
EV / EBITDA	11.9	10.4	9.2	7.2	
Market Cap / Sales	2.4	2.1	1.9	1.7	
Price to Book Value	4.0	3.5	3.1	2.7	
Solvency Ratios					
Debt/Equity	-	-	-	-	
Debt / EBITDA	-	-	-	-	
Current Ratio	1.3	1.3	1.4	1.4	
Quick Ratio	1.3	1.3	1.4	1.4	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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