

Zensar Technologies Ltd.

Industry	IT
Bloomberg	ZENT IN
BSE CODE	504067

Wage hike and continued investment likely to keep margin under pressure in near term.

RATING **NEUTRAL**

CMP	246
Price Target	226
Potential Upside	-8%

Rating Change 

Estimate Change 

Target Change 

Stock Info

52wk Range H/L	352/196
Mkt Capital (Rs Cr)	5528
Free float (%)	28%
Avg. Vol 1M (,000)	68
No. of Shares (Cr)	23
Promoters Pledged (Cr)	0

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4QFY19 Result Update

- Zensar technologies posted a strong set of numbers in 4QFY19 result. Revenue came in at USD 150.1 million, a growth of 4.4%QoQ which is bit higher than our estimates of USD148 million mainly driven by strong growth in core business whereas PAT for the quarter stood at Rs83.2crore in line with the estimates.
- Adjusted EBITDA came in Rs 132crore, a growth of 17.5%QoQ. Margin expanded 180bps mainly driven from improvement in Utilization; absence of certain furlough that occurred in 3QFY19 and reduced subcontracting cost.
- Digital continued its growth momentum in 4QFY19 by growing 8.1%QoQ primarily driven by company's Return on digital next offering in application and cloud infrastructure services business .It now contributes 46.4% of total revenue.
- The company won TCV of 150 mn in 4QFY19, thus taking the total to USD 750mn for FY19 which is almost double of FY18 wins (deal win FY18 was 350 to 400mn) .The company plans to focus more and more of 10+ million dollar deal win and less on smaller deal wins going ahead .
- Vertical wise, growth was seen in Hi-tech which grew 5.7%QoQ, retail grew 6.7%QoQ whereas financial service saw decline of 4.3%QoQ mainly due to completion of project. For FY20, Mangement expects healthy pipeline to support growth in HI tech, insurance however retail which saw one off in 4QFY19 will get back after two quarters.

View and Valuation

ZENSARTECH exited the year on strong note. Revenue for the year grew 17.5% YoY in USD terms mainly driven by strong growth in TCV wins and continued growth in digital application business. Despite divestment from non-core business management managed to expand its margin by 50bps to 12.2% in FY19 mainly led by INR depreciation and better execution in 4QFY19.

Going ahead, we expect Zensar to post 15%YoYgrowth in FY20 mainly driven by robust TCV wins and continued traction in digital application business through Rod and Rod next platform .Also the growth is expected to be supported by Cloud, Digital led next gen business, however it still small contributor (~5.4% of the revenue) in the overall revenue Total TCV now stands at USD 750 mn ,(which is doubled of the previous year), out of which approx 300 mn dollar deal are of short span of 2 years, thus giving some visibility of growth In FY20.

On margin front, despite beat in margin in 4QFY19, we have kept our margin unchanged seeing the continued investment plan, absence of currency benefit and some impact due to disinvestment from Row business. Though management is aspiring of 15% margin in its core business in medium term, wage hike and supply crunch issue will hamper the margins in near term. Thus, we largely maintain our target of Rs 226 and recommend Neutral.

Key Risks to our rating and target

- Slow growth in large deal wins

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19	FY20E
Net Sales	2997	3056	3108	3966	4569
EBITDA	484	382	365	479	560
EBIT	419	333	300	390	445
PAT	292	238	246	319	346
EPS (Rs)	13	11	11	14	15
EPS growth (%)	10%	-19%	3%	29%	9%
ROE (%)	24%	17%	16%	18%	17%
ROCE (%)	27%	19%	15%	16%	17%
BV	56	65	74	86	99
P/B (X)	3.3	2.8	2.4	2.9	2.5
P/E (x)	14.2	17.4	16.4	17.4	16.0

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4QFY19 Results

PAT in line

Financials	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	YoY %	QoQ%	FY18	FY19	YoY %
Net Sales /	814	905	969	1,036	1,057	29.9%	2.1%	3,108	3,966	27.6%
Other Income	27	24	41	3	25	-6%	896%	74	93	24.6%
COGS	37	37	35	59	57	52.6%	-4.2%	140	188	34.0%
Employee	437	486	531	566	569	30.1%	0.5%	1,705	2,153	26.2%
Other Expenses	122	129	119	125	140	15.2%	12.0%	849	1,146	34.9%
EBITDA	95	116	123	110	130	36.0%	17.6%	365	479	31.4%
Dep and	14	18	22	24	25	81.0%	5.9%	65	89	37.4%
EBIT	82	98	100	87	105	28.3%	20.8%	300	390	30.1%
Interest	5	6	10	11	11	118.2%	1.4%	23	37	64.5%
PROFIT BEFORE	103	116	132	78	119	14.9%	51.5%	352	445	26.7%
Tax	30	32	37	22	36	18.5%	62.8%	105	127	20.6%
Exceptional	-	-	-	-	-			-	-	
PAT	73	84	95	57	83	13.5%	47.2%	246	319	29.3%

4QFY19: Strong Core business led the growth in 4QFY19

- 4QFY19 revenue came in at USD 150.1million, a growth of 4.4% in USD terms mainly led by strong growth in core business which grew 5.2%QoQ. In cc terms revenue grew 4.1%, cross currency headwind during the quarter was 30 bps. In rupee term, revenue stood at Rs1057 crore, a growth of 2.7%QoQ.
- Application service business grew faster pace during the quarter. Digital and application services grew 6.7%QoQ in USD terms on the back of the company's growth in digital service revenue. Cloud infrastructure business fell by 6.3%QoQ primarily due to completion of projects mainly in financial service segment. Cloud next gen digital business continued to posted a strong growth of 7.1%QoQ.

Digital service remain strong, softness seen in IMS

Segments (in mn\$)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	QoQ%	CC QoQ
Application Management	99	102	109	115	117	119	127	6.7%	6.3%
Digital Services	40	43	46	52	54	57	62	8.1%	7.7%
Core Application	58	59	63	63	63	62	65	5.4%	4.9%
IMS	20	21	18	20	21	25	23	-6.6%	-6.5%
Core Infrastructure	4	4	6	6	7	11	9	-18.2%	-18.1%
Services Third Party	7	7	6	7	7	6	6	-2.6%	-2.8%
Cloud, Digital Led next		10	6	7	7	7	8	6.4%	6.9%

Project completion led to softness in Financial services

Business unit(USD mn)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	QoQ%	CC QoQ
Manufacturing	61	63	65	68	73	73	78	6.2%	8.4%
Retail and Consumer	32	33	34	33	30	30	32	7.6%	6.7%
Financial Services	24	25	26	32	32	35	33	-3.7%	-4.3%
Emerging	1	1	2	2	4	6	7	15.7%	19.7%

- Verticals wise, Manufacturing led the growth by growing 16.2%QoQ in cc terms, Hi-tech continued its growth momentum and grew 5.7%QoQ in cc terms. Retail and Consumer Services after remaining soft for some quarter posted a growth of 6.7%QoQ in cc terms while Insurance declined by 4.3%QoQ in cc terms during the quarter. Insurance saw a soft quarter because of project completion in cloud infrastructure business however saw healthy increase in deal win in P&C space especially in Guide wire in 4QFY19. The management expects the cynosure to continue to grow in FY20.

Growth seen in both Europe and US geography

Geography(USD mn)	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	QoQ%	CC QoQ
US	85	90	91	100	103	109	114	4.7%	4.6%
Europe	17	17	18	19	20	21	22	8.7%	7.5%
Africa	12	12	13	13	13	12	12	0.3%	-2.0%
ROW	5	4	4	3	3	2	1	-27.9%	-27.0%

Better execution and increase in volume led to margin expansion

- ❑ EBITDA during the quarter stood at Rs132 crore, a growth 17.5%QoQ. Margin expanded 180bps mainly driven from improvement in Utilization(170); absence of certain furlough occurred in 3QFY19 and reduced subcontracting cost (20bps).Also Sequential increase in volume(11%QoQ helped in the gross and EBITDA margin to recover during the year. However some portion was offset by INR appreciation.
- ❑ Other income during the quarter came in at Rs 25 crore as compared to Rs 3 crore in the last quarter. Thus PAT for the quarter stood at Rs 82.7crore, a growth of 46.4%QoQ mainly aided by higher other income and lower tax rate.

Margin guidance for FY20

In medium term company is focusing to achieve 15% margin in its core business through cost optimization initiatives as well as drive better rate realization as the company works more in digital business. Also the company expects to improve by expanding its volume business in cloud infrastructure business which has higher margin plan than the Application business.

Concall highlights

- **Margin performance in 4QFY19:** Sequential increase of 11% in volume helped in the recovery of gross and EBITDA margin during the year. Core EBITDA increased 18.1%QoQ and stood at USD 20 mn which now stands at 14.1% of the core revenue. The total EBITDA margin improved 160bps to 12.5% mainly due improvement in Utilization, absence of certain furlough and reduced subcontracting cost.
- **Continued growth in digital revenue:** The Company continue to post growth in Digital business which now contributes 46.4% of the overall revenue.4QFY19 saw a sequential growth of 8.1% and 35.6%YoY primarily driven by company's Return on digital next offering in application and cloud infrastructure services business.
- **Traction continued in large deal:** The Company continued its large deal momentum in 4QFY19 by winning deal across regions from existing as well as new client in all the focused verticals.Multiple new logos were added during the quarter. The company won TCV of 150 mn in 4QFY19, thus taking the total to USD 70mn for FY19 which is almost double of FY18 wins (deal win FY18 was 350 to 400mn).Out of total USD750 mn deal wins in FY19, USD500 mn deal wins is from 10million + dollar win and average deal duration for USD350 mn deal is 5 to 7 years .The company focus over the period of time is to focus more and more of 10+ million dollar deal win and less on smaller deal wins.
- **Update on business sector**
 - **Hi-tech** grew 5.7%QoQ in cc terms mainly coming from Indigo slate. Without acquisition, hi tech still managed to grow in high teens in FY19.With the healthy pipeline in Hi tech and manufacturing, the management continues to see the momentum going ahead
 - **Retail and consumer** grew 6.7%QoQ in cc terms during the quarter due to someone off, however for FY19 retail posted a soft growth and management is reworking on building the retail business and expects it to get into growth momentum after two more quarters.
 - **Insurance** declined by 4.3%QoQ in cc terms during the quarter. Insurance saw a soft quarter because of project completion in cloud infrastructure business however saw healthy increase in deal win in P&C space especially in Guide wire in 4QFY19.The management expects the cynosure to continue to grow in FY20.
- **Strong growth came in from all acquisition:** All acquired companies had a very strong growth during the quarter .Keystone had a good quarter with sequential growth of 16.1%, indigo slate also picked up space by growing 6.5%QoQ.Foolproof continues to do well and support the company to grow in European region .The revenue growth from foolproof came in 10.2%QoQ. Cynosure (focused in insurance business) continued it growth momentum and grew 18.3%QoQ during the quarter.
- **Payout for the acquired entity in FY20:** The company has paid 50 mn dollar in current year for the two acquisition .The company has the obligation of 6 to 10 mn dollar to be paid in FY20 based on performance .
- **Commentary on macro demand:** The Company sees robust demand coming from the market. The company has not seen any softness or any decline in the overall pipeline and company continue to focus on its three business sector that is Hi-tech, retail and insurance where they haven't seen any slow down due to macro challenges.
- **Outlook for FY20:** the company's overall deal remain healthy and is now stands at billion dollar .The Company has won over USD 750 mn of TCV in FY19.Though the exit for FY19 was pretty strong but with strong deal pipeline and robust TCV the management expects to continue to see growth in FY20.

Exhibit: Revenue trend

Continued uptick in revenue growth led by strong growth in core business.

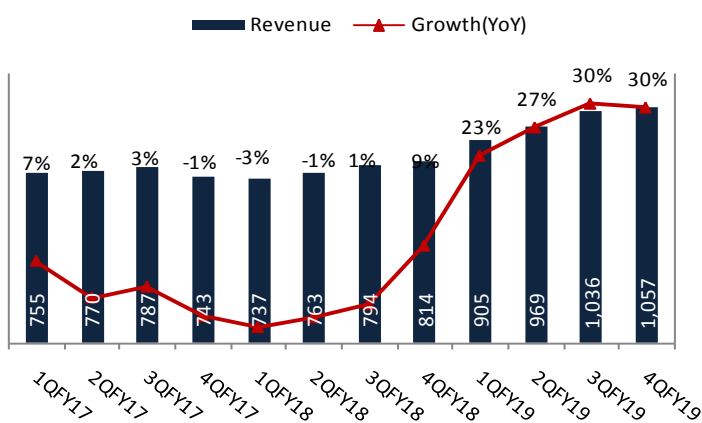


Exhibit: Digital revenue

Sustained growth momentum in Digital.

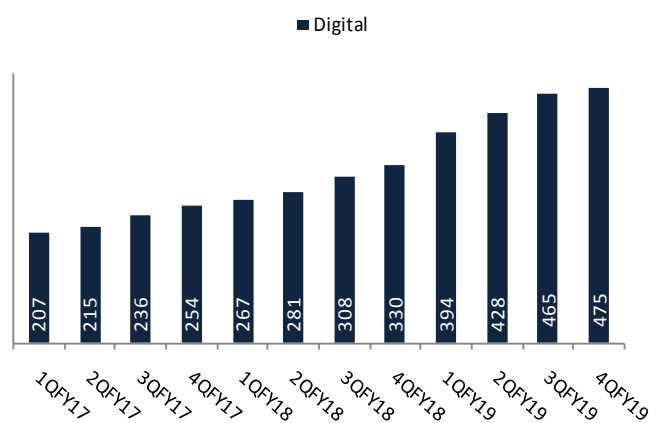


Exhibit: EBITDA and EBITDA margin

Improvement in Utilization; absence of certain furlough and reduced subcontracting cost helped the margin growth.

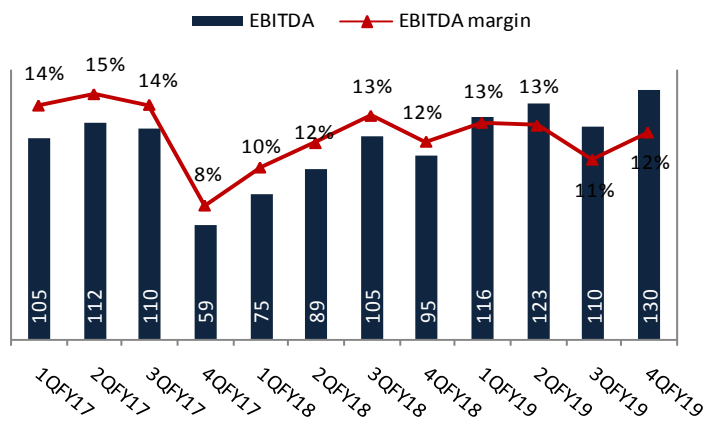


Exhibit: Utilization

Rise in Utilization rate during the quarter.

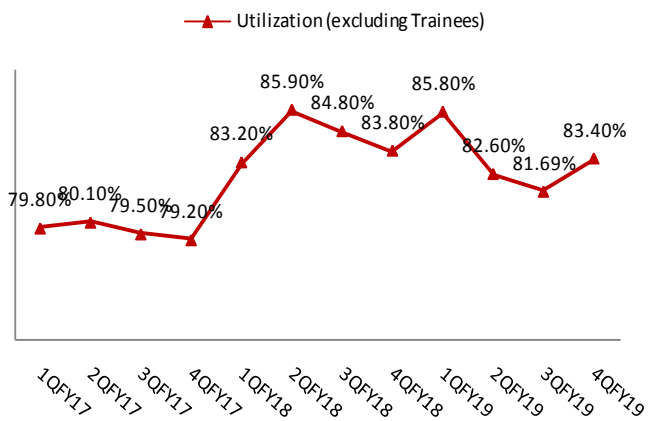
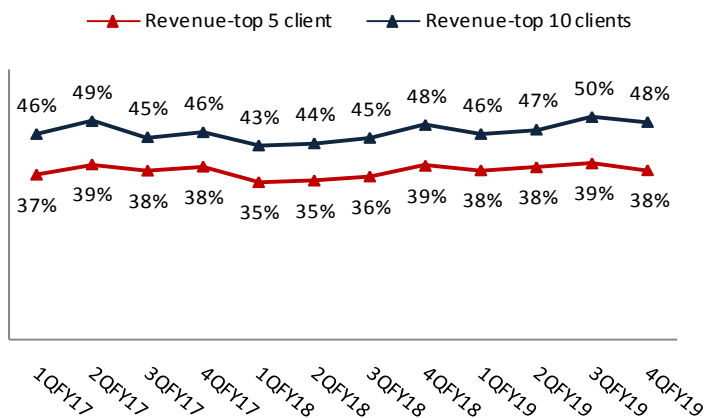


Exhibit: Top client contribution

Softness seen in top client growth.



Operational Details

By Industry(%)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Manufacturing	52.4%	51.7%	51.5%	51.3%	50.0%	52.5%	51.0%	51.8%
Retail & Consumer	26.5%	27.0%	27.0%	27.2%	24.7%	21.7%	21.0%	21.6%
Financial Services	20.0%	20.4%	20.6%	20.2%	23.5%	23.0%	24.1%	22.2%
Emerging	1.1%	0.9%	1.0%	1.3%	1.8%	2.8%	4.0%	4.4%
Geographical Segment	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
US	74.4%	72.0%	73.3%	72.2%	74.1%	74.3%	76.0%	76.2%
Europe	13.8%	14.2%	13.5%	14.2%	13.7%	14.3%	14.3%	14.9%
Africa	9.5%	9.9%	9.6%	10.4%	9.8%	9.1%	8.3%	8.0%
ROW	2.4%	3.9%	3.6%	3.2%	2.4%	2.3%	1.3%	0.9%
Project Type	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Fixed Price	47.9%	50.9%	53.2%	54.2%	52.7%	53.7%	53.7%	54.6%
Time & Materials	52.1%	49.1%	46.8%	45.8%	47.3%	46.3%	46.3%	45.4%
No. of \$mn Clients	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
1 Million dollar +	87	84	81	80	91	98	100	92
5 Million dollar +	13	14	15	17	19	20	20	19
10 Million dollar +	6	6	6	4	5	7	7	9
20 Million dollar +	2	2	2	2	2	2	2	2
Top clients	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Revenue-top 5 client	35%	35%	36%	39%	38%	38%	39%	38%
Revenue-top 10 client	43%	44%	45%	48%	46%	47%	50%	48%
Revenue-top 20 clients	55%	56%	56%	59%	57%	58%	60%	60%
Repeat business %	76%	82%	80%	87%	87%	87%	83%	85%
Number of active clients	243	248	260	253	291	325	322	327
New clients added	38	14	12	28	42	38	26	17
Revenue mix	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Onsite	63%	63%	63%	63%	65%	66%	67%	67%
Offshore	37%	37%	37%	37%	35%	34%	33%	33%
Utilization	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Utilization (excl Trainees)	83%	86%	85%	84%	86%	83%	82%	83%
Headcount	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Technical -Onsite	1810	1806	1847	1866	2019	2274	2360	2420
Technical -Offshore	5779	5674	5713	5868	6077	6044	6259	6501
Technical -BPO / Others	259	247	243	248	253	284	283	275
Marketing	91	78	70	68	64	80	76	79
Support (including trainees)	628	609	724	855	709	800	835	798
Gross employees	606	419	684	900	724	906	1045	1035
% of women	26%	26%	26%	28%	27%	27%	28%	28%
Attrition	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Attrition	17%	15%	15%	15%	19%	17%	16%	16%

Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Share Capital	44	44	44	45	45	45	45	45
Reserves	685	902	1,113	1,203	1,421	1,624	1,897	2,180
Networth	729	946	1,157	1,265	1,470	1,669	1,942	2,225
Debt	133	75	1	1	1	6	102	102
Other Non Cur Liab	37	35	41	49	74	78	78	77
Total Capital Employed	899	1,078	1,298	1,466	1,683	1,766	2,294	2,578
Net Fixed Assets (incl CWIP)	399	424	549	119	134	175	359	440
Non Cur Investments	1	1	1	26	96	144	70	70
Other Non Cur Asst	54	60	61	337	399	513	723	731
Non Curr Assets	54	61	62	364	495	658	793	801
Inventory	105	129	123	126	113	106	98	113
Debtors	335	358	454	540	533	642	876	930
Cash & Bank	142	146	197	275	327	204	317	459
Other Curr Assets	94	139	170	90	79	71	328	378
Current investments	42	148	93	108	147	130	45	45
bank balance	-	-	-	2	2	3	9	9
unbilled revenue	-	-	-	235	255	307	264	264
other financial asset	-	-	-	11	18	-	-	-
Short-term loans and advances	86	82	87	-	-	-	-	-
Curr Assets	803	1,001	1,124	1,386	1,473	1,463	1,938	2,199
Creditors	106	151	130	166	177	184	301	347
other financial liabilities	-	-	-	101	80	162	254	254
Other Curr Liab	301	252	257	306	136	162	184	241
Curr Liabilities	358	408	437	403	420	530	795	863
Net Curr Assets	445	593	687	983	1,053	933	1,143	1,336
Total Assets	1,257	1,486	1,735	1,869	2,103	2,296	3,089	3,440

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Revenue from Operation	2,129	2,335	2,656	2,997	3,056	3,108	3,966	4,569
Change (%)	19%	10%	14%	13%	2%	2%	28%	15%
	-	-	-	45	-	-	-	-
EBITDA	300	358	392	484	382	365	479	560
Change (%)	21%	19%	9%	24%	-21%	-4%	31%	17%
Margin (%)	14%	15%	15%	16%	12%	12%	12%	12%
Depr & Amor.	33	38	42	65	49	65	89	115
EBIT	267	320	350	419	333	300	390	445
Int. & other fin. Cost	10	10	11	11	9	23	37	44
Other Income	3	30	27	8	24	74	93	77
EBT	261	340	366	417	349	352	445	479
Exp Item	-	-	-	-	-	-	-	-
Tax	86	102	101	125	110	105	127	133
Minority Int & P/L share of Ass.	-	-	-	-	-	-	-	-
Reported PAT	175	238	265	292	238	246	319	346
Adjusted PAT	175	238	265	292	238	246	319	346
Change (%)	10%	36%	11%	10%	-18%	3%	29%	9%
Margin(%)	8%	10%	10%	10%	8%	8%	8%	8%

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
ROE	27%	28%	25%	24%	17%	16%	18%	17%
ROCE	27%	27%	25%	27%	19%	15%	16%	17%
Asset Turnover	5	6	5	25	23	18	11	10
Current Ratio	2	2	3	3	4	3	2	3
Debtor Days	58	56	62	94	94	111	105	105
Payable Days	18	24	18	20	21	22	28	28
Book Value Per Share	33	43	52	56	65	74	86	99
Earnings Per Share	8	11	12	13	11	11	14	15
P/E	6	7	11	14	17	16	17	16
Price / Book Value	1	2	2	3	3	2	3	2
EV/EBITDA	4	4	7	8	10	11	11	10
EV/Sales	1	1	1	1	1	1	1	1

Cash Flow Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PBT	261	340	366	417	349	352	445	479
(inc)/Dec in Working Capital	-115	-52	38	-141	-28	-138	-353	0
Non Cash Op Exp	296	388	381	500	438	456	514	0
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	-75	-105	-99	-105	-102	-104	-127	-133
others	0	0	0	0	0	0	0	0
CF from Op. Activities	106	231	321	255	307	206	34	402
(inc)/Dec in FA & CWIP	-34	-33	-37	-43	-35	-52	-273	-197
Free Cashflow	72	198	283	212	272	153	-239	205
(Pur)/Sale of Inv	5	-105	58	-5	-25	-10	85	0
others	4	9	-203	7	-129	-94	75	0
CF from Inv. Activities	-25	-128	-182	-41	-189	-157	-114	-197
inc/(dec) in NW	2	2	6	4	5	3	0	0
inc/(dec) in Debt	-65	-52	-27	-26	-20	44	252	0
Int. Paid	-12	-12	-12	-11	-9	-10	0	0
Div Paid (inc tax)	-38	-41	-54	-97	-26	-63	-63	-63
others	0	4	0	0	0	0	0	0
CF from Fin. Activities	-114	-99	-87	-129	-50	-204	193	-63
Inc(Dec) in Cash	-33	4	51	85	68	-155	113	142
Add: Opening Balance	174	141	145	190	259	15	204	317
Closing Balance	141	145	196	275	327	186	317	459

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