

Zensar Technologies Ltd.

Industry **TECHNOLOGY**
Bloomberg **ZENT IN**
BSE CODE **504067**

Poor quarter, retail remained the growth dragger

RATING **NEUTRAL**

CMP **174**
Price Target **187**
Potential Upside **7%**

Rating Change 

Estimate Change 

Target Change 

Stock Info

52wk Range H/L 1.61
Mkt Capital (Rs Cr) 3931
Free float (%) 28%
Avg. Vol 1M (000) 5
No. of Shares (Crs) 23
Promoters Pledged (Crs) 0

Fig in Rs cr

FINANCIAL	FY19	FY20E	FY21E
Net Sales	3,966	4,212	4,519
EBITDA	479	497	594
EBIT	390	340	431
PAT	314	267	351
EPS (Rs)	14	12	16
EPS	30%	-15%	31%
ROE (%)	17%	13%	15%
ROCE (%)	19%	14%	16%
BV	86	95	108
P/B (X)	3	2	2
P/E (x)	17	15	11

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3QFY20 Result update

- ZENSARTECH reported weak 3QFY20. Both revenue and margin saw steep decline owing to higher furloughs, volume discount and continued softness in the retail vertical.
- Revenue for the quarter came at USD143.3million, a de-growth of 6.4%QoQ in cc terms. Whereas EBITDA stood at Rs70 crore, declined 53.6% QoQ.
- EBITDA margin came at 6.8%, a contraction of 720bps QoQ. However adjusting for one time and seasonal item, normalized EBITDA was at 11.2%. The 280bps drop from 2Q was mainly owing to lower utilization and higher S&A.
- Gross margin during the quarter came at 23.6% vs. 29.1% last quarter.
- The other income stood at Rs 39.6 crore, a growth of 119%QoQ primarily led by the onetime gain (Rs25.6crore) related to write off of contingent consideration business.
- PAT for the quarter stood at Rs40crore (declined 50.5%QoQ) vs. Rs 80 crore mainly led by revenue misses.

Softness in Core application drags revenue growth,

Service wise, the application and digital services business witnessed of steep decline of 8.1%QoQ mainly due to decline in legacy business. Digital Services posted a muted growth of 0.5%QoQ. While Core application, traditional services showed de-growth of 17.3%QoQ, resulted in dragging overall revenue growth. However some portion was offset by strong growth in next gen CIS business and core CIS business (4.7%/18.3%QoQ in cc terms).

Shift focus to other vertical, FY21 to see growth

While the Retail hit continued in 3Q also (declined 21.5%QoQ in cc terms) due to Sector specific issues, other segment remained soft for the quarter. Hi-Tech/Retail/Manufacturing/BFSI all reported a de-growth of 2.6/3.9/21.5/4.7 QoQ. The management has now indicated of driving growth more from financial services and Hi-tech & Manufacturing business. Also the company will relook at retail vertical and will try to expand into more of consumer services rather than just retail.

View and Valuation

ZENSARTECH posted a disappointing performance in 3Q result. Revenue reported another quarter of steep decline (down 5.9%QoQ) while margin in 3Q reached 2.8% which is lowest in company's history. The sharp decline in revenue were primarily attributable to onetime items (higher than expected furloughs, project specific customer ramp downs) and continued softness in the retail vertical. Going forward, 4Q to see some growth recovery owing to continued growth in CIS business while retail will continue to drag growth in next few quarters. Also continued risk due to uncertainty related trade war will hold back growth in Hi-Tech and manufacturing for near future.

However for the medium to long term we expect healthy deal (60% of the pipeline are large deals TCV >USD 5mn) wins and shift focus from retail vertical to other verticals will help to recover growth but that will take time. Margin recovery will be slow but will recover gradually with growth.

Factoring in near term challenges, we have cut down our revenue and Pat estimates by 3%/6.5% and 16.5%/12.5% for FY20/21E. Thus we remain Neutral on the stock with revised target price of Rs187 (earlier Rs214).

Key Risks to our rating and target

- Weakness in digital traction.
- Slow down in order booking.

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3QFY20 Results

Soft Quarter

Financials	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	YoY %	QoQ%	FY18	FY19	Fig in Rs cr
										YoY %
Net Sales	1,036	1,057	1,071	1,072	1,021	-1.4%	-4.8%	3,108	3,966	27.6%
Other Income	3	25	15	18	40	1477.3%	119.0%	74	93	24.6%
COGS	59	57	62	36	70	18.9%	97.7%	140	188	34.0%
Employee Exp	566	569	575	611	596	5.3%	-2.3%	1,705	2,153	26.2%
Other Expenses	125	140	126	117	126	0.4%	7.0%	849	1,146	34.9%
EBITDA	110	130	146	150	70	-36.9%	-53.6%	365	479	31.4%
Depreciation	24	25	38	39	41	73.7%	7.0%	65	89	37.4%
EBIT	87	105	108	112	28	-67.2%	-74.5%	300	390	30.1%
Interest	11	11	17	14	13	17.2%	-8.7%	23	37	64.5%
PBT	78	119	106	116	55	-29.4%	-52.2%	352	445	26.7%
Tax	22	36	30	33	14	-35.4%	-57.2%	105	127	20.6%
PAT	55	83	75	80	41	-25.5%	-48.4%	241	314	29.9%

Concall Highlights

- **Unusual quarter:** 3QFY20 result was soft on account of onetime items which had amplified effect in seasonally weak quarter. The sequential decline in 3Q primarily on account certain one times (included higher expected furloughs of USD4million, Specific year end volume discount of USD1.5million from 2 of top clients) and ramp down in retail vertical impacting USD5 million. The company saw higher Furlough in Africa (11% of the business) which came as the surprise during the quarter
- The Company reported a strong order booking during the quarter. Won USD170 dollar of TCV wins, 45% coming from net new. Out of USD170 million, 75million is incremental. Unweighted pipeline is above USD1billion and weight is at USD650million with number of deal in final stage of discussion.
- **Retail performance:** The decline in retail vertical was strategically planned. The company rationalized 8 accounts. Some residual of rationalization will continue in 4Q however most of them have bottomed out. Thus With deal wins and normalization of the accounts the management expects the growth to return in coming quarters.
- **Business update :**
 - The digital revenue increased sequentially by 1.6% on a 20.2% YoY basis. The legal business declined by 13.4% QoQ. Almost all of the de growth came from legally part.
 - The company's cloud and infrastructure business seeing strong momentum with clients'. The Company has signed 4 net logos as well grown existing accounts during the quarter. Both next gen CIs business and core CIS business registered a 5.4%/19.6% QoQ.
- **Margin performance :** Reported EBITDA was At 6.8%, however adjusting for one time and seasonal item, normalized EBITDA was at 11.2%. The 280bps drop from 2Q was mainly owing to lower utilization and higher S&A of 210/70bps respectively. Gross margin stood at 23.6% vs. 29.1% last quarter. The company is working on cost rationalizing initiatives to better drive operating track and drive margins, Management expect get its target EBITDA of 15% over the coming quarters.
- **Client addition:** On account mining focus, the company added one new client each in USD5 million and 10 million per annum category sequentially. Now USD 1million+ account consist of 92, USD5 million+ categories have 24 while 10 million+ accounts is at 10.
- **Patents:** The total patent filing has now crossed 100. The company now stand at 101 with 11 patents has been granted.
- **Headcount metrics :** The global headcount now ends at 9915, a decline of 268 associates QoQ on account of project ramp down. Voluntary attrition stands at 16%.
- **Shift to other vertical:** The retail has seen significant challenge due to degree of the customers, hence it was needed to be moderated. The management endeavor is to drive growth now more from financial services and Hi-tech & Manufacturing business. Also Relook at retail and broaden into more of consumer services rather than just retail. The company is seeing confidence in consumer vertical
- **Outlook :** The management expect in current fiscal growth to normalize and expect to return to 1QFY21 levels (USD153 million). The company sees most of the one times are now behind and expect to grow industry level in revenue and margins in coming quarters. In 4Q, the management feels all the furloughs and discounts will come back. Also some part of retail will see recovery.

Revenue Mix

Weakness seen in CIS and Core business

<i>VERTICAL (USD mn)</i>	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	QoQ% cc
Application Management	112	115	118	126	127	130	120	-8%	-8.10%
>>Digital Services	52	54	56	61	63	67	68	1%	0.50%
>>Core Application	60	60	61	65	63	63	52	-17%	-17.30%
IMS	20	20	24	23	26	22	23	4%	3.60%
>>Core Infrastructure	6	6	11	8	9	7	8	19.7%	18.30%
>> Services Third Party	7	7	6	6	6	6	5	-14%	-13.50%
>> Cloud,Digital Led next	6	7	7	8	11	9	9	5%	4.70%

Revenue by Business Units

Client specific issue impacted Retail vertical

<i>Business unit(USD mn)</i>	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	QoQ% cc
Manufacturing	66	71	72	77	80	80	78	-2.7%	-2.90%
Retail and Consumer	33	29	30	32	29	25	20	-20.4%	-21.50%
Financial	31	31	34	33	37	43	41	-4.2%	-4.70%
Emerging	2	4	6	7	8	4	4	0.0%	0.00%

Revenue by Geography

Weakness across geographies

<i>GEOGRAPHY (USD mn)</i>	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	QoQ% cc
US	100	103	109	114	117	113	106	-6%	-5.90%
Europe	19	20	21	22	23	23	22	-4%	-7.10%
Africa	17	16	14	13	13	16	15	-9%	-9.00%

Revenue by Project Type

Fixed Price project remained soft

<i>Project Type (USD mn)</i>	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	YoY%
Fixed Price	71	74	77	82	87	87	82	-6%	7%
Time & Materials	64	64	67	68	66	65	61	-6%	-9%

Revenue by Client

Project closure impacted top client revenue

<i>Client (USD mn)</i>	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	QoQ%	YoY%
Revenue-top 5 client	51	53	56	56	58	57	57	-1%	1%
Revenue-top 10 client	62	64	71	73	75	73	71	-3%	-1%
Revenue-top 20 clients	77	80	87	90	94	95	91	-4%	5%

Exhibit: Revenue trend

Furloughs and client specific issue in retail washed the overall revenue.

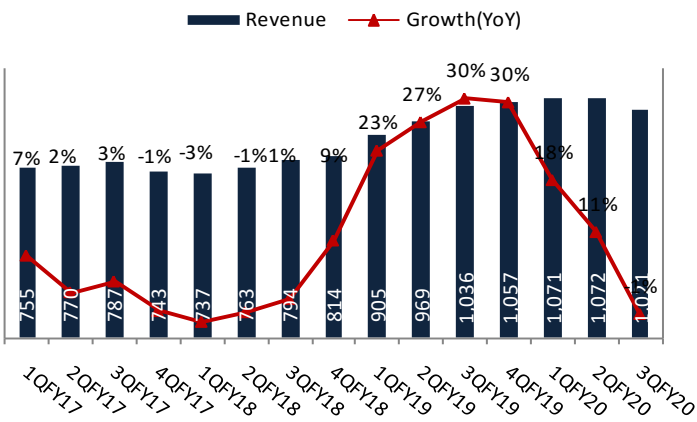


Exhibit: Digital revenue

Slow growth QoQ continued, now contributes more than half of the revenue (54%).

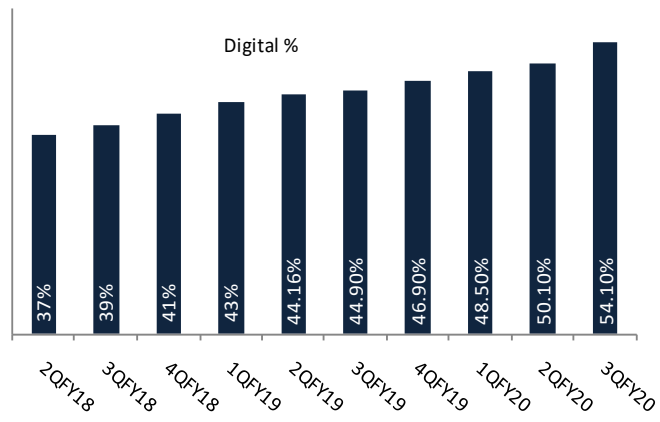


Exhibit: Margin Trend

Steep decline in margins due to revenue impact.

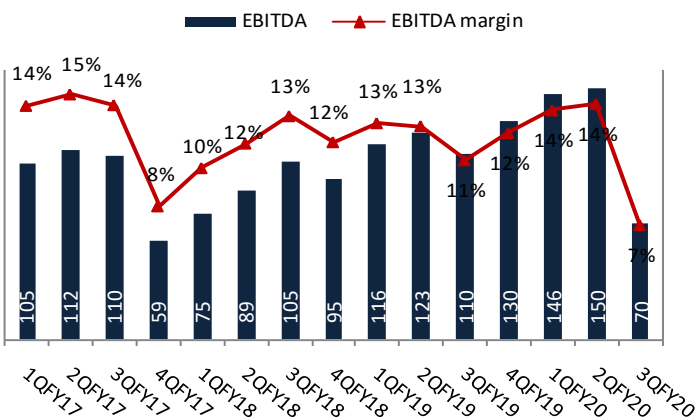


Exhibit: Utilization trend

Steep decline in Utilization.

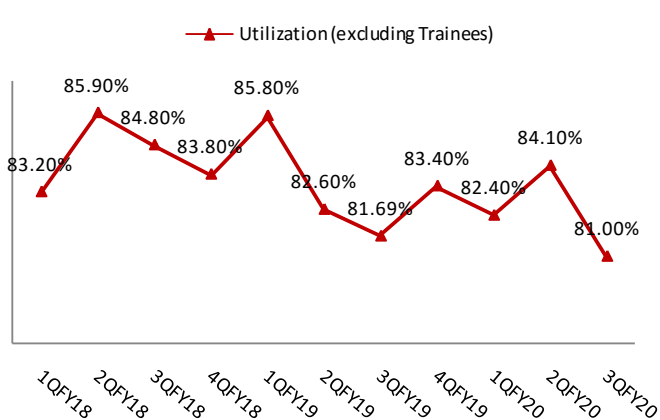
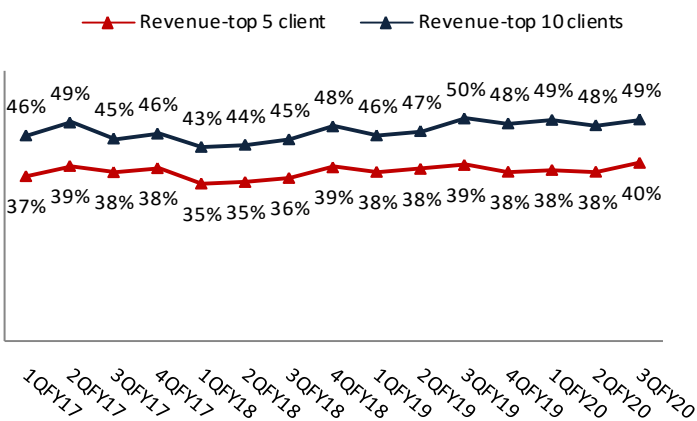


Exhibit: Top client revenue

Top client revenue declined due to project completion.



Operational Details

Geography %	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
US	72.2%	74.1%	74.3%	76.0%	76.2%	76.3%	74.0%	74.2%
Europe	14.2%	13.7%	14.3%	14.3%	14.9%	15.0%	15.3%	15.6%
Africa	10.4%	9.8%	9.1%	8.3%	8.0%	8.7%	10.6%	10.2%
ROW	3.2%	2.4%	2.3%	1.3%	0.9%	0.0%	0.0%	0.0%
Project Type	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Project Type	54.2%	52.7%	53.7%	53.7%	54.6%	57.0%	57.4%	57.5%
Time & Materials	45.8%	47.3%	46.3%	46.3%	45.4%	43.0%	42.6%	42.5%
Clients	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
1 Million dollar +	80	91	98	100	92	91	93	92
5 Million dollar +	17	19	20	20	19	20	23	24
10 Million dollar +	4	5	7	7	9	9	9	10
20 Million dollar +	2	2	2	2	2	2	2	2
Top clients rev	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Revenue-top 5 client	38.6%	37.6%	38.2%	39.1%	37.6%	38.0%	37.6%	39.6%
Revenue-top 10 clients	47.7%	45.7%	46.7%	49.5%	48.4%	49.2%	48.0%	49.3%
Revenue-top 20 clients	59.3%	57.1%	57.6%	60.2%	59.7%	61.3%	62.6%	63.6%
Repeat business %	87.0%	87.1%	86.6%	82.6%	84.5%	84.7%	86.3%	84.2%
Number of active clients	253	291	325	322	327	289	309	308
New clients added in the period	28	42	38	26	17	7		
Revenue mix	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Onsite	62.7%	64.6%	66.4%	67.4%	67.4%	68.1%	66.7%	67.6%
Offshore	37.3%	35.4%	33.6%	32.6%	32.6%	31.9%	33.3%	32.4%
Headcount	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Technical -Onsite	1866	2019	2274	2360	2420	2579	2537	2368
Technical -Offshore	5868	6077	6044	6259	6501	6213	6353	6474
Technical -BPO / Others	248	253	284	283	275	213	205	197
Marketing	68	64	80	76	79	80	85	90
Support (including trainees)	855	709	800	835	798	1081	1039	822
Attrition	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Attrition	14.9%	18.8%	17.0%	15.8%	15.6%	16.7%	17.0%	16.0%
Revenue By	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Dollar	74.2%	73.5%	72.5%	72.8%	72.0%	70.7%	68.8%	68.7%
Euro	1.3%	1.1%	1.1%	0.8%	0.9%	1.5%	1.2%	1.7%
GBP	12.3%	13.1%	14.6%	15.9%	16.8%	17.1%	17.0%	16.7%
ZAR	8.9%	9.4%	8.9%	7.9%	7.6%	8.3%	10.3%	9.8%
Others	3.3%	2.9%	2.8%	2.6%	2.7%	2.4%	2.7%	3.2%
Segments	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20
Application Management		84.9%	84.9%	82.8%	84.9%	82.8%	85.6%	84.0%
>>Digital Services		39.2%	40.1%	39.7%	41.1%	41.4%	44.2%	47.5%
>>Core Application		45.7%	44.8%	43.2%	43.6%	41.4%	41.3%	36.5%
IMS		15.1%	15.1%	17.2%	15.1%	17.2%	14.4%	16.0%
>>Core Infrastructure		4.8%	4.6%	7.4%	5.5%	6.2%	4.4%	5.6%
>> Services Third Party		5.4%	5.4%	4.5%	4.2%	3.9%	4.1%	3.8%
>> Cloud,Digital Led next		4.9%	5.0%	5.3%	5.4%	7.1%	5.9%	6.6%

Financial Details

Balance Sheet

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Share Capital	44	44	45	45	45	45	45	45
Reserves	902	1,113	1,203	1,421	1,624	1,897	2,102	2,390
Networth	946	1,157	1,265	1,470	1,669	1,942	2,147	2,435
Debt	75	1	1	1	6	102	102	102
Other Non Current Liab	35	41	49	74	78	78	77	77
Total Capital Employed	1,078	1,298	1,466	1,683	1,766	2,294	2,499	2,787
Net Fixed Assets (incl CWIP)	424	549	119	134	175	359	248	310
Non Current Investments	1	1	26	96	144	70	70	70
Other Non Cur Asst	60	61	337	399	513	723	731	731
Non Current Assets	61	62	364	495	658	793	801	801
Inventory	129	123	126	113	106	98	105	112
Debtors	358	454	540	533	642	876	930	930
Cash & Bank	146	197	275	327	204	317	342	402
Other Curr Assets	139	170	90	79	71	328	348	374
Current investments	148	93	108	147	130	45	274	442
bank balance	-	-	2	2	3	9	9	9
unbilled revenue	-	-	235	255	307	264	264	264
other financial asset	-	-	11	18	-	-	-	-
Short-term loans and advances	82	87	-	-	-	-	-	-
Curr Assets	1,001	1,124	1,386	1,473	1,463	1,938	2,272	2,533
Creditors	151	130	166	177	184	301	320	343
other financial liabilities	-	-	101	80	162	254	254	254
Other Curr Liab	252	257	306	136	162	184	241	250
Curr Liabilities	408	437	403	420	530	795	823	857
Net Curr Assets	593	687	983	1,053	933	1,143	1,450	1,676
Total Assets	1,486	1,735	1,869	2,103	2,296	3,089	3,322	3,644

Income Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue from Operation	2,335	2,656	2,997	3,056	3,108	3,966	4,212	4,519
Change (%)	10%	14%	13%	2%	2%	28%	6%	7%
EBITDA	358	392	484	382	365	479	497	594
Change (%)	19%	9%	24%	-21%	-4%	31%	4%	20%
Margin (%)	15%	15%	16%	12%	12%	12%	12%	13%
Depr & Amor.	38	42	65	49	65	89	157	163
EBIT	320	350	419	333	300	390	340	431
Int. & other fin. Cost	10	11	11	9	23	37	56	51
Other Income	30	27	8	24	74	93	93	101
EBT	340	366	417	349	352	445	377	481
Exp Item	-	-	-	-	-	-	-	-
Tax	102	101	125	110	105	127	103	125
Minority Int & P/L share of Ass.	-	-	-	4	5	5	7	5
Reported PAT	238	265	292	238	246	319	274	356
Adjusted PAT	238	265	292	235	241	314	267	351
Change (%)	36%	11%	10%	-20%	3%	30%	-15%	31%
Margin(%)	10%	10%	10%	8%	8%	8%	6%	8%

Financial Details

Key Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
ROE	28%	25%	24%	17%	15%	17%	13%	15%
ROCE	32%	29%	30%	21%	17%	19%	14%	16%
Asset Turnover	6	5	25	23	18	11	17	15
Current Ratio	2	3	3.4	3.5	2.8	2.4	2.8	3.0
Debtor Days	56	62	94	94	111	105	105	105
Book Value Per Share	216	261	279	327	372	431	477	541
Payable Days	43	52	56	65	74	86	95	108
Earnings Per Share	11	12	13	10	11	14	12	16
P/E	7	11	14	18	17	17	15	11
Price / Book Value	2	2	3	3	2	3	2	2
EV/EBITDA	4	7	8	10	11	11	8	6
EV/Sales	1	1	1	1	1	1	1	1

Cash Flow Statement

Fig in Rs Cr

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
PBT	340	366	417	349	352	445	377	481
(inc)/Dec in Working Capital	-52	38	-141	-28	-138	-262	0	0
Non Cash Op Exp	388	381	500	438	456	577	0	0
Int Paid (+)	0	0	0	0	0	0	0	0
Tax Paid	-105	-99	-105	-102	-104	-139	-103	-125
others	0	0	0	0	0	0	0	0
CF from Op. Activities	231	321	255	307	206	156	363	515
(inc)/Dec in FA & CWIP	-33	-37	-43	-35	-52	-52	-47	-225
Free Cashflow	198	283	212	272	153	104	317	290
(Pur)/Sale of Inv	-105	58	-5	-25	-10	161	-228	-168
others	9	-203	7	-129	-94	-328	0	0
CF from Inv. Activities	-128	-182	-41	-189	-157	-241	-275	-394
inc/(dec) in NW	2	6	4	5	3	0	0	0
inc/(dec) in Debt	-52	-27	-26	-20	44	230	0	0
Int. Paid	-12	-12	-11	-9	-10	-13	0	0
Div Paid (inc tax)	-41	-54	-97	-26	-63	-63	-63	-63
others	4	0	0	0	0	1	0	0
CF from Fin. Activities	-99	-87	-129	-50	-204	201	-63	-63
Inc(Dec) in Cash	4	51	85	68	-155	116	26	59
Add: Opening Balance	141	145	190	259	15	183	317	342
Closing Balance	145	196	275	327	186	314	343	402

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