Zensar

Estimate change	↑
TP change	↑
Rating change	↔

Bloomberg	ZENT IN
Equity Shares (m)	226
M.Cap.(INRb)/(USDb)	76.9 / 0.9
52-Week Range (INR)	324 / 202
1, 6, 12 Rel. Per (%)	17/55/-5
12M Avg Val (INR M)	322

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	48.5	51.2	57.7
EBIT Margin (%)	7.6	11.3	11.8
PAT	3.3	4.7	5.5
EPS (INR)	14.4	20.7	24.2
EPS Gr. (%)	-21.6	43.9	17.1
BV/Sh. (INR)	131.5	142.5	155.5
Ratios			
RoE (%)	11.6	15.2	16.3
RoCE (%)	8.6	12.7	13.8
Payout (%)	40.3	40.2	40.2
Valuations			
P/E (x)	23.7	16.5	14.1
P/BV (x)	2.6	2.4	2.2
EV/EBITDA (x)	11.8	8.4	6.8
Div Yield (%)	1.7	2.4	2.9

Shareholding pattern (%)

As On	Mar-23	Dec-22	Mar-22
Promoter	49.2	49.2	49.1
DII	15.8	11.5	14.8
FII	10.5	10.8	16.6
Others	24.5	28.6	19.5

FII Includes depository receipts

CMP: INR340 TP: INR390 (+15%) Buy

Another strong margin performance

Attractive valuation and strong earnings growth to drive stock

- ZENT reported muted growth of 0.4% QoQ in constant currency (CC), beating our estimate of a 0.8% QoQ decline in CC. Deal TCV rose 5.6% YoY to USD175m (seasonal high), with a book-to-bill ratio of 1.2x. ZENT achieved mid-teens EBITDA margin two quarters ahead of its target (14.5%), up 320bp QoQ, led by sharp improvement in both utilization and subcontractor costs.
- While Q4 revenue growth was a little ahead of our expectation, underlying growth (adjusted for one-off revenue recognition delay in Insurance in Q3 and furlough reversals in Q4) improvement remains a work in progress. Given the challenging near-term macro outlook, especially in key verticals like Hi-Tech, Manufacturing and Consumer (56% of Q4 revenues), FY24 topline growth will remain muted (est. 3.4% YoY CC). It will pick up in FY25, as the expanded service portfolio starts delivering on growth. Despite the high share of renewal in Q4, FY23 deal TCV at USD572m (1.0x Book to Bill, flat YoY) should help buffer the incremental impact from weaker macro. We factor in a USD revenue CAGR of 8.0% over FY23-25E.
- On the margin front, the company reported another quarter of exceptional performance in 4QFY23. The execution remains strong with multiple margin levers on utilization, pyramid rationalization and subcon. With a significant beat in Q4, a moderation in attrition (-300bp) and better utilization, we expect the margin to stabilize around the current level and should support FY24 earnings growth. We increase our FY24/FY25 EBITDA margin estimates to 14.6%/15.1% from 13.3%/13.7%, resulting in an INR EPS CAGR of 30% over FY23-25E (partially due to low FY23 base).
- The stock's relatively low valuation (at 14x FY25E P/E) is attributed to the company's weak revenue performance over the last two years. We continue to view the significant discount to its peers as excessive and more near-term focused. We expect the discount to narrow as growth recovers in FY24 and FY25. A good cash buffer of USD202m (22% of MCap) also provides a buffer for valuation. Our TP of INR390 implies 16x FY25E EPS. **Maintain BUY.**

Muted revenue growth, sharp improvement in margins

- Revenue declined 0.3% YoY in CC terms. EBIT was up 21.2% YoY, while PAT fell 8.2% YoY.
- In FY23, revenue in USD terms grew 6.1% YoY, while EBIT/PAT in INR terms declined 22.2%/27.5%.
- Revenue grew 0.4% QoQ in CC terms to USD147.5m (v/s our estimate of 0.8% QoQ CC decline).
- Deal TCV was strong at USD175m (+34% QoQ/+5.6% YoY) due to seasonality. The book-to-bill stood at 1.2x in Q4. Top 10 clients recovered 4.3% QoQ, led by a recovery from extended furloughs in Q3.
- EBITDA margin at 14.5% (+320bp QoQ) beat our estimate by 210bp, fueled by higher gross margin (+460bp QoQ).

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- PAT jumped 56% QoQ to INR1,193m, a significant beat to our estimates of INR818m, aided by better margins and higher other income.
- The board has declared a dividend of INR3.5/share.

Key highlights from the management commentary

- The strong growth in Insurance (+8% QoQ CC) was partly led by right shifting of clients, where the Q3 deferral billing cycle adjusted during the quarter, resulted in higher revenue recognition in Q4.
- Hi-tech growth was aided by the reversal of Q3 furloughs and a recovery in volume from its top clients.
- The current demand environment is uncertain with softening spends and delayed decisions from clients. Clients are looking to continue with their transformation projects once the macro environment stabilizes.
- Consumer growth was affected by a decline in revenue of a key client in Europe. Although the volume reversal is expected in Q1FY24, the rising inflation continues to impact spending for consumer clients.

Valuation and view

- The new CEO's (Mr. Manish Tandon) approach to focus on execution (rather than strategic change), along with renewed focus on improving margins, should help ZENT gain stability in revenue growth and improve its margin.
- ZENT's current valuation (14x FY25E EPS) is one of the lowest in our midcap IT coverage universe. Our TP of INR390 implies 16x FY25E EPS. **Maintain BUY.**

Quarterly performance **(INR m)**

Y/E March	FY22				FY23				FY22	FY23	Est.	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			3QFY23	(%/bp)
Revenue (USD m)	**127**	**142**	**147**	**153**	**156**	**155**	**146**	**148**	**569**	**604**	**145**	**1.5**
QoQ (%)	5.8	11.6	3.7	4.1	1.8	-0.6	-5.9	1.1	15.3	6.1	-0.4	151bp
Revenue (INR m)	**9,368**	**10,506**	**11,025**	**11,538**	**12,034**	**12,346**	**11,976**	**12,127**	**42,437**	**48,483**	**11,946**	**1.5**
YoY (%)	-1.2	12.2	21.6	31.6	28.5	17.5	8.6	5.1	15.7	14.2	3.5	157bp
GPM (%)	**34.8**	**30.6**	**29.6**	**30.2**	**26.6**	**25.3**	**27.4**	**31.9**	**31.2**	**27.8**	**28.6**	**338bp**
SGA (%)	16.4	15.2	15.3	16.0	15.3	16.8	16.1	17.4	15.7	16.4	16.2	123bp
EBITDA	**1,726**	**1,612**	**1,584**	**1,642**	**1,361**	**1,054**	**1,349**	**1,759**	**6,564**	**5,523**	**1,476**	**19.2**
EBITDA Margin (%)	**18.4**	**15.3**	**14.4**	**14.2**	**11.3**	**8.5**	**11.3**	**14.5**	**15.5**	**11.4**	**12.4**	**215bp**
EBIT	**1,300**	**1,144**	**1,110**	**1,161**	**871**	**562**	**852**	**1,408**	**4,715**	**3,693**	**998**	**41.1**
EBIT Margin (%)	**13.9**	**10.9**	**10.1**	**10.1**	**7.2**	**4.6**	**7.1**	**11.6**	**11.1**	**7.6**	**8.4**	**326bp**
Other income	95	142	152	634	149	209	183	209	1,023	750	108	94.4
ETR (%)	26.5	25.5	26.9	27.2	26.4	26.3	26.1	26.2	26.6	26.2	26.0	
Adj. PAT	**1,010**	**944**	**909**	**1,297**	**751**	**568**	**765**	**1,193**	**4,160**	**3,277**	**818**	**45.8**
QoQ (%)	11.6	-6.5	-3.7	42.7	-42.1	-24.4	34.7	55.9			6.9	
YoY (%)	38.9	7.5	-7.9	43.3	-25.6	-39.8	-15.8	-8.0	19.0	-21.2	-36.9	
EPS (INR)	**4.4**	**4.2**	**4.0**	**5.7**	**3.3**	**2.5**	**3.4**	**5.2**	**18.3**	**14.4**	**3.6**	45.8

Key performance indicators

Y/E March	FY22				FY23				FY22	FY23
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenue (QoQ CC %)	4.8	12.3	4.7	4.2	3.1	1.6	(5.3)	0.4	13.1	10.3
Margins										
Gross Margin	34.8	30.6	29.6	30.2	26.6	25.3	27.4	31.9	31.2	27.8
EBIT Margin	13.9	10.9	10.1	10.1	7.2	4.6	7.1	11.6	11.1	7.6
Net Margin	10.8	9.0	8.2	11.2	6.2	4.6	6.4	9.8	9.8	6.8
Operating metrics										
Headcount	9,512	10,375	10,641	11,839	11,559	11,250	10,845	10,563	11,839	10,563
Attrition (%)	18.1	23.2	26.7	27.9	28.1	26.3	22.8	19.8	28	20
Offshore Rev.	41.7	42.5	42.3	43.6	41.6	42.9	44.7	46.4	42.5	43.9
Key Verticals (YoY USD %)										
BFSI	6.4	13.6	29.9	35.1	42.3	24.9	12.6	9.9	21.4	15.9
Manufacturing	(6.6)	(3.5)	6.0	14.8	6.9	6.2	2.9	(7.4)	2.1	2.7
Retail	18.9	18.2	24.6	34.1	32.7	(1.4)	(13.0)	(21.0)	24.2	8.8
Key Geographies (YoY USD %)										
North America	(4.8)	8.4	20.9	28.9	23.8	11.0	(2.1)	(3.9)	12.8	6.5
Europe	20.5	24.0	23.8	30.2	25.9	8.2	3.0	(8.3)	24.8	6.1
South Africa	21.2	25.7	8.0	15.6	10.8	0.1	1.0	4.4	17.3	3.9

Key highlights from the management commentary

Growth and outlook

- ZENT reported revenue growth of 0.4% QoQ CC, led by recovery in furloughs (top 10 clients) and recognition of deferral revenues from earlier quarter in Q4.
- Though the demand environment remains tough, ZENT has significantly increased its addressable market by launching new offerings, which should support growth.
- The new service offerings that ZENT has developed over the last 1.5-2 years include services like E-SaaS, data, advanced engineering services and experience services. These services account for 35% of revenues.
- New service lines such as experience and advance engineering are gaining strong traction and are growing faster than traditional ADM and Infra. ZENT saw good traction in new offerings from existing clients.
- The current demand environment remains uncertain with softening spends and delayed decisions from clients. Clients are looking to continue with their transformation projects once the macro environment stabilizes.
- ZENT has sticky long-term clients and will only gain market share in case of any vendor consolidation.
- Hi-tech benefited from the furlough reversal and good growth for some large clients.
- Consumer was impacted by a decline in revenue of a key client in Europe. Revenue should come back in next quarter. At the macro level, there are still headwinds in Consumer.
- However, ZENT continues to see challenges in the consumer and Hi-tech verticals. The BFSI portfolio is more skewed toward insurance, so there is no major impact there. The UK, Europe and South Africa should continue to do well.

Margin performance and outlook

- Gross margin increased 480bp QoQ and EBITDA rose 320bp in 4QFY23.
- EBITDA margin improved on account of good FX, improvement in trade mix, reductions in subcon expenses, improved productivity and utilization

improvement on furlough reversal, which was partly offset by higher SG&A costs. The management expects range-bound margins going forward.

- Margin levers include improving commercials, productivity, subcontractor expenses, pyramid rationalization and utilization. There is some more scope for improvement in sub-contractor expenses.
- The wage hikes are planned to happen in 2QFY24.
- The company will only take pass-through revenues if services revenue is margin accretive.
- LTM attrition should continue to moderate with easing supply.

Other highlights

- The company saw strong improvement in DSOs (now at 74 days) on better collections during the quarter.
- Though overall headcount declined during the quarter, billed headcount increased on account of utilization.
- The management intends to stay focused on increasing billable headcount without increasing overall headcount.
- ZENT is looking at M&A more opportunistically and not as part of its core strategy.
- The board has declared a final dividend of INR3.5 per share.

Exhibit 1: Emerging vertical saw a sharp drop

Verticals	Contribution to revenue (%)	Growth QoQ (CC)
Hi-Tech	27.6	7.5
Manufacturing	12.7	4.3
Insurance	17.0	8.0
Banking	19.3	(2.1)
Consumer Services	16.1	(12.7)
Emerging	7.3	(6.7)

Source: Company, MOFSL

Exhibit 2: North America declined 8% QoQ

Geographies	Contribution to revenue (%)	Growth QoQ (USD)
North America	70.3	1.5
Europe	18.1	(2.1)
Africa	11.6	3.8

Source: Company, MOFSL

Exhibit 3: DFS dropped higher at 9.2%

Service lines	Contribution to revenue (%)	Growth QoQ (USD)
Digital & Application Services (DAS)	82.6	3.5
Digital Foundation Services (DFS)	17.4	(8.9)

Source: Company, MOFSL

Valuation and view

- The new CEO's (Mr. Manish Tandon) approach to focus on execution (rather than strategic change), along with renewed focus on improving margins, should help ZENT gain stability in revenue growth and improve its margin further.
- ZENT's current valuation (14x FY25E EPS) is one of the lowest in our midcap IT Coverage Universe. Our TP implies 16x FY25E EPS. We maintain our BUY rating on the stock.

Exhibit 4: Revisions to our estimates

	Revised estimate		Earlier estimate		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
USD:INR	82.0	82.0	82.5	82.5	-0.6%	-0.6%
Revenue (USD m)	624	704	614	689	1.7%	2.2%
Growth (%)	3.3	12.8	2.0	12.2	130bps	60bps
EBIT margin (%)	11.3	11.8	9.6	10.2	170bps	150bps
PAT (INR m)	4,705	5,508	3,984	4,733	18.1%	16.4%
EPS	20.7	24.2	17.5	20.8	18.1%	16.4%

Source: Company, MOFSL

Exhibit 5: Operating metrics

	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23
Geographic mix (%)									
USA	70	70	70	71	70	71	72	70	70
Europe	19	18	18	18	19	18	17	19	18
RoW	12	12	12	11	11	11	11	11	12
Service Mix (%)									
Application Management Services	85	85	85	82	82	82	80	81	83
Infrastructure Management Services	15	15	15	18	18	18	20	19	17
Project Type (%)									
Fixed price	62	64	61	60	59	58	58	58	54
Time and material	39	36	39	40	41	42	42	42	46
Revenue by delivery (%)									
Onsite	57	58	58	58	56	58	57	55	54
Offshore	43	42	43	42	44	42	43	45	46
Client concentration (%)									
Top five	37	38	35	34	33	33	35	32	34
Top six to 10	11	11	12	13	13	12	11	13	12
Top 10	48	49	47	47	46	45	46	45	46
Top 11-20	15	14	15	14	16	16	15	17	15
Top 20	63	64	62	61	62	61	61	61	61
Number of clients (USD m)									
Over USD1m	78	79	85	81	83	86	87	87	84
Over USD5m	24	24	26	25	27	26	28	28	29
Over USD10m	7	8	10	11	11	13	13	15	14
Over USD20m	2	3	3	4	4	4	3	4	4
Client metrics									
Number of active clients	134	135	143	144	147	147	146	148	148
Employee metrics									
Total headcount	9,111	9,512	10,375	10,641	11,839	11,559	11,250	10,845	10,563
Gross employees added during the period	1,332	1,508	1,545	1,416	2,331	1,220	1,194	593	552
Utilization	81.3	80.4	83.3	79.9	81.5	80.7	80.7	77.6	81.4
Attrition	14.8	18.1	23.2	26.7	27.9	28.1	26.3	22.8	19.8

Source: Company, MOFSL

Financials and valuations

Income Statement								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Sales	**30,058**	**38,988**	**40,102**	**36,681**	**42,437**	**48,483**	**51,195**	**57,746**
Change (%)	(1.6)	29.7	2.9	(8.5)	15.7	14.2	5.6	12.8
Cost of Services	21,220	27,626	28,756	24,417	29,214	35,000	35,032	39,098
SG&A Expenses	5,254	6,283	6,310	5,422	6,659	7,960	8,676	9,932
EBITDA	**3,583**	**5,079**	**5,037**	**6,842**	**6,564**	**5,523**	**7,486**	**8,715**
As a percentage of Net Sales	11.9	13.0	12.6	18.7	15.5	11.4	14.6	15.1
Depreciation	651	894	1,567	1,732	1,849	1,830	1,689	1,906
Interest	227	373	605	536	354	278	256	289
Other Income	202	502	435	367	907	642	819	924
Forex	463	291	449	-113	470	386	0	0
PBT	**3,370**	**4,604**	**3,749**	**4,828**	**5,738**	**4,443**	**6,360**	**7,445**
Tax	1,013	1,310	1,038	1,261	1,525	1,166	1,655	1,937
Rate (%)	30.1	28.5	27.7	26.1	26.6	26.2	26.0	26.0
Minority Interest	50	51	82	70	53	0	0	0
Net Income	**2,306**	**3,243**	**2,629**	**3,497**	**4,160**	**3,277**	**4,705**	**5,508**
Change (%)	-1.8	40.6	-18.9	33.0	19.0	-21.2	43.6	17.1

Balance Sheet								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Share Capital	450	450	451	451	452	453	453	453
Reserves	16,239	18,973	20,900	23,423	26,417	29,309	31,812	34,742
Net Worth	**16,689**	**19,424**	**21,351**	**23,874**	**26,869**	**29,762**	**32,265**	**35,195**
Loans	60	2,578	2,886	-	0	0	0	0
Other liabilities	906	924	4,008	3,526	3,544	2,866	2,866	2,866
Capital Employed	**17,655**	**22,925**	**28,244**	**27,401**	**30,413**	**32,628**	**35,131**	**38,061**
Net Block	**5,976**	**9,617**	**13,340**	**11,330**	**12,858**	**11,735**	**10,846**	**9,740**
Other LT Assets	2,356	1,898	2,039	3,076	3,226	6,291	6,365	6,543
Curr. Assets	**14,624**	**19,360**	**20,576**	**19,928**	**22,628**	**23,184**	**26,831**	**31,795**
Current Investments	1,302	454	2,670	7,410	5,141	7,045	9,045	11,045
Inventories	1,060	985	941	0	0	0	0	0
Debtors	6,423	8,762	6,656	5,888	7,967	7,298	8,416	9,492
Cash and Bank Balance	5,137	3,259	5,258	3,492	5,054	4,744	5,044	6,378
Other Current Assets	702	5,901	5,051	3,138	4,466	4,097	4,326	4,880
Current Liab. and Prov.	**5,301**	**7,951**	**7,711**	**6,933**	**8,299**	**8,582**	**8,910**	**10,017**
Trade payables	1,839	3,010	2,650	2,201	3,164	2,772	2,775	3,097
Other liabilities	3,461	4,941	5,061	4,732	5,135	5,810	6,135	6,920
Net Current Assets	**9,323**	**11,409**	**12,865**	**12,994**	**14,329**	**14,602**	**17,921**	**21,778**
Application of Funds	**17,655**	**22,925**	**28,245**	**27,400**	**30,413**	**32,628**	**35,131**	**38,061**

Financials and valuations

Ratios								
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
EPS	**10.1**	**14.3**	**11.7**	**15.3**	**18.3**	**14.4**	**20.7**	**24.2**
Cash EPS	13.0	18.2	18.6	22.9	26.5	22.4	28.1	32.6
Book Value	74.2	86.3	96.3	105.7	119.0	131.5	142.5	155.5
DPS	7.0	2.8	2.8	6.4	7.4	5.8	8.3	9.7
Payout (%)	69.0	19.6	24.0	41.8	40.3	40.3	40.2	40.2
Valuation (x)								
P/E ratio	33.5	23.8	29.1	22.2	18.6	23.7	16.5	14.1
Cash P/E ratio	26.1	18.7	18.2	14.9	12.9	15.2	12.1	10.4
EV/EBITDA ratio	19.6	14.8	14.0	9.6	10.1	11.8	8.4	6.8
EV/Sales ratio	2.3	1.9	1.8	1.8	1.6	1.3	1.2	1.0
Price/Book Value ratio	4.6	3.9	3.5	3.2	2.9	2.6	2.4	2.2
Dividend Yield (%)	2.1	0.8	0.8	1.9	2.2	1.7	2.4	2.9
Profitability Ratios (%)								
RoE	14.7	18.0	12.9	15.5	16.4	11.6	15.2	16.3
RoCE	12.5	15.3	10.6	14.1	12.0	8.6	12.7	13.8
Turnover Ratios								
Debtors (Days)	78	82	61	59	69	55	60	60
Fixed Asset Turnover (x)	5.7	5.0	3.5	3.0	3.5	3.9	4.5	5.6

Cash Flow Statement								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
CF from Operations	3,298	4,183	4,508	5,432	5,774	5,030	5,831	6,778
Cash for Working Capital	-1,385	-2,622	2,354	3,148	-2,427	2,113	-1,093	-702
Net Operating CF	**1,913**	**1,561**	**6,862**	**8,580**	**3,347**	**7,143**	**4,738**	**6,076**
Net Purchase of FA	-515	-517	-781	-393	-373	-334	-800	-800
Free Cash Flow	**1,398**	**1,043**	**6,081**	**8,187**	**2,974**	**6,809**	**3,938**	**5,276**
Net Purchase of Invest.	-1,050	-1,894	-2,372	-4,890	400	-4,941	-1,181	-1,076
Net Cash from Invest.	**-1,565**	**-2,411**	**-3,153**	**-5,283**	**27**	**-5,275**	**-1,981**	**-1,876**
Proc. from equity issues	26	14	15	15	32	4	0	0
Proceeds from LTB/STB	-922	-376	-502	-4,505	-1,260	-1,058	-256	-289
Dividend Payments	-626	-633	-1,228	-271	-881	-1,132	-2,202	-2,578
Cash Flow from Fin.	**-1,522**	**-995**	**-1,714**	**-4,761**	**-2,109**	**-2,186**	**-2,458**	**-2,866**
Exchange difference	315	-32	4	-20	14	8	0	0
Net Cash Flow	**-859**	**-1,877**	**1,999**	**-1,483**	**1,279**	**-310**	**300**	**1,334**
Opening Cash Bal.	**5,996**	**5,137**	**3,259**	**5,258**	**3,775**	**5,054**	**4,744**	**5,043**
Add: Net Cash	-859	-1,877	1,999	-1,483	1,279	-310	300	1,334
Closing Cash Bal.	**5,137**	**3,259**	**5,258**	**3,775**	**5,054**	**4,744**	**5,043**	**6,377**

NOTES

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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