

Zensar Technologies

BUY

Near term challenges

We maintain BUY on Zensar despite muted performance in 2QFY20. Deal pipeline remains strong but TCV wins have slowed down due to macro uncertainty. Margin recovery is slower than expected and Retail weakness is weighing on growth. We cut FY21E Rev/EPS by 3.7/5.4% and reduce P/E multiple to 12x from 14x. Our TP of Rs 240 is based on 12x Sep-21E EPS.

HIGHLIGHTS OF THE QUARTER

- Revenue stood at USD 152.3mn (-0.7% QoQ, +0.3% CC) vs. est. of USD 157.8mn led by drop in core revenue (96% of rev, -0.9% QoQ). Non-core (4% of rev) grew 4.4% QoQ led by MVS.
- Digital (50.1% of rev, +2.6/25.1% QoQ/YoY) growth has slowed down. Growth was impacted by drop in Cloud & Infra (14% of rev, -15.8% QoQ CC).
- Hi-Tech (40%) and BFSI (27%) grew 1.1/15.2% QoQ while Retail (17%) was down 7.7% QoQ due to completion of large projects and delay in client decision making. Retail recovery will be slow, BFSI growth will be led by Cynosure (Insurance) and Hi-Tech (ex top client) is exposed to trade war risks.
- Deal wins have slowed down due to delay in decision making, TCV stood at USD 120mn vs. USD 160mn in 1Q.

Financial Summary

YE March (Rs bn)	2QFY20	2QFY19	YoY (%)	1QFY20	QoQ (%)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues	10.72	9.49	13.0	10.66	0.6	31.16	39.15	43.56	49.46	56.89
EBIT	1.12	1.05	6.2	1.14	(1.8)	3.08	4.19	4.85	5.56	6.61
APAT	0.80	0.95	(15.9)	0.79	1.5	2.41	3.24	3.52	4.10	4.89
Diluted EPS (Rs)	3.5	4.2	(15.9)	3.4	1.4	10.6	14.3	15.5	18.1	21.5
P/E (x)						18.8	14.0	12.9	11.1	9.3
EV / EBITDA (x)						10.7	8.4	6.6	5.8	4.9
RoE (%)						15.1	17.6	16.6	17.0	17.6

Source: Company, HDFC sec Inst Research # Consolidated

- EBIT margin stood at 10.4%, down 26bps QoQ (vs est. of 10.0%) due to salary hike offset by higher utilisation (+170bps) and offshoring. Target is to improve core EBITDA margins to ~15% (currently at 14%) through offshoring, pyramid rationalisation and lower sub-con.

STANCE

Zensar's key vertical (~53% of rev) Hi-Tech and Manufacturing are exposed to macro uncertainty and can get impacted if trade war risk accelerate. BSFI is doing well led by ramp-up of large deals in Insurance. Retail performance has been disappointing and is taking longer than expected to recover. Overall the growth engine will have near term challenges and will recover with large deal wins. Deal pipeline is healthy at USD 1bn and ~52% of the pipeline are large deals (TCV >USD 5mn). Margin recovery is slow but will recover gradually with growth. We build 11/16/15% Revenue/EBIT/PAT CAGR over FY19-22E. We maintain our positive view based on (1) High exposure to Digital, (2) Robust deal pipeline, (3) Scope for margin expansion and (4) Reasonable valuation. Risks include delay in decision making, trade wars and deterioration of US/Europe macro environment.

INDUSTRY	IT
CMP (as on 22 Oct 2019)	Rs 199
Target Price	Rs 240
Nifty	11,588
Sensex	38,964

KEY STOCK DATA	
Bloomberg	ZENT IN
No. of Shares (mn)	225
MCap (Rs bn) / (\$ mn)	45/630
6m avg traded value (Rs mn)	11

STOCK PERFORMANCE (%)			
52 Week high / low	Rs 272/177		
	3M	6M	12M
Absolute (%)	(11.1)	(14.4)	(25.3)
Relative (%)	(12.7)	(13.9)	(38.9)

SHAREHOLDING PATTERN (%)		
	Jun-19	Sep-19
Promoters	48.89	48.88
FIs & Local MFs	2.03	2.40
FPIs	39.84	39.93
Public & Others	9.24	8.79
Pledged Shares	0.00	0.00

Source : BSE

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Revenue came at USD 153.3mn up 0.3/14.1% QoQ/YoY CC, revenue was impacted by large project completion from 2 Top clients

EBIT margin was flat QoQ impacted by wage hike offset by operational efficiencies (Utilisation, offshore)

Subcontracting expenses is down 2.2% QoQ/YoY and stood at 14.8% of revenue

Quarterly consolidated financial snapshot

Particulars (Rs bn)	2QFY20	2QFY19	YoY (%)	1QFY20	QoQ (%)
Net Sales USD mn	152.3	138.1	10.3	153.3	(0.7)
Net Sales	10.72	9.49	13.0	10.66	0.6
Cost of Revenue	7.60	6.69	13.7	7.52	1.0
SG&A	1.62	1.53	6.4	1.62	(0.1)
EBITDA	1.50	1.27	17.7	1.52	(1.0)
Depreciation	0.39	0.22	71.9	0.38	1.6
EBIT	1.12	1.05	6.2	1.14	(1.8)
Interest	0.14	0.10	46.3	0.17	(16.3)
Exchange Gain/(Loss)	0.17	0.35	(51.3)	0.11	59.3
Other income	0.01	0.04	(76.3)	0.04	(76.3)
PBT	1.16	1.35	(14.0)	1.12	3.7
Tax	0.33	0.38	(13.2)	0.32	4.1
Minority Interest	0.03	0.02	75.0	0.01	133.3
RPAT	0.80	0.95	(15.9)	0.79	1.5
EO Items (Adj For Tax)	0.00	0.00	NM	0.00	NM
APAT	0.80	0.95	(15.9)	0.79	1.5

Source: Company, HDFC sec Inst Research

Margin analysis

MARGIN ANALYSIS %	2QFY20	2QFY19	YoY (%)	1QFY20	QoQ (%)
Employee Expenses % Net Sales	70.9	70.5	39	70.6	31
SG&A Expenses % Net Sales	15.1	16.1	(95)	15.2	(9)
Gross Margin %	29.1	29.5	(39)	29.4	(31)
EBITDA margin (%)	14.0	13.4	56	14.2	(22)
EBIT Margin (%)	10.4	11.1	(67)	10.7	(26)
Tax Rate (%)	28.4	28.2	28	28.3	12
APAT Margin (%)	7.5	10.0	(256)	7.4	7

Source: Company, HDFC sec Inst Research

Digital (50.1% of rev) grew 2.6/25.1% QoQ/YoY and 3.5% QoQ CC, Digital growth has slowed down to 25% vs. >30% earlier

US de-grew 3.6% QoQ impacted by Retail

Europe grew 1.3% QoQ, there is acceleration in YoY growth in Europe for past 6 qtrs

Africa growth was strong for two consecutive qtrs due to BFSI traction

The company has exited the RoW business as it was a non-core business

Business Mix

(USD mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Digital	47	51	184	57	61	65	69	251	74	76
QoQ %	8.7%	8.3%		10.1%	7.8%	5.8%	6.9%		7.8%	2.6%
YoY %	34.6%	34.7%	34.7%	36.6%	39.7%	36.0%	34.3%	36.5%	31.4%	25.1%
% of Rev	38.7%	40.6%	38.1%	43.0%	44.2%	44.9%	46.4%	44.7%	48.5%	50.1%
Legacy (Non Digital)	75	75	298	75	77	79	80	311	79	76
QoQ %	0.3%	0.1%		-0.1%	2.6%	2.7%	0.7%		-0.9%	-3.7%
YoY %	-8.6%	3.4%	-7.0%	3.1%	2.9%	5.4%	6.0%	4.3%	5.1%	-1.4%
% of Rev	61.3%	59.4%	61.9%	57.0%	55.8%	55.1%	53.6%	55.3%	51.5%	49.9%
Total Revenue	123	127	482	132	138	144	149	562	153	152
QoQ %	3.4%	3.3%		4.0%	4.9%	4.1%	3.5%		3.1%	-0.7%
YoY %	4.3%	14.2%	5.4%	15.2%	16.4%	17.2%	17.5%	16.6%	16.4%	10.3%

Source: Company, HDFC Sec Inst Research

Geographical Mix

(USD mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
US	90	91	351	98	103	109	113	423	117	113
QoQ %	5.2%	1.7%		6.8%	5.1%	6.5%	3.8%		3.2%	-3.6%
YoY %	2.8%	11.7%	3.0%	14.8%	20.1%	21.5%	24.0%	20.5%	19.9%	9.9%
% of Rev	73.3%	72.2%	72.8%	74.1%	74.3%	76.0%	76.2%	75.2%	76.3%	74.0%
Europe	17	18	67	18	20	21	22	80	23	23
QoQ %	-1.7%	8.6%		0.4%	9.4%	4.1%	7.8%		3.8%	1.3%
YoY %	17.4%	17.5%	28.3%	14.4%	17.2%	24.2%	23.2%	19.1%	27.4%	18.0%
% of Rev	13.5%	14.2%	14.0%	13.7%	14.3%	14.3%	14.9%	14.3%	15.0%	15.3%
Africa	12	13	48	13	13	12	12	49	13	16
QoQ %	0.2%	11.9%		-2.0%	-2.2%	-5.6%	-0.3%		12.1%	22.2%
YoY %	7.7%	31.9%	20.0%	18.9%	7.6%	1.3%	-9.6%	3.7%	3.3%	29.0%
% of Rev	9.6%	10.4%	9.9%	9.8%	9.1%	8.3%	8.0%	8.8%	8.7%	10.7%
Row	4	4	16	3	3	2	1	10	0	0
QoQ %	-4.6%	-8.2%		-22.0%	0.3%	-36.6%	-33.5%		NM	NM
YoY %	-12.6%	4.4%	-33.1%	20.2%	-31.4%	-54.4%	-67.0%	-39.9%	NM	NM
% of Rev	3.6%	3.2%	3.3%	2.4%	2.3%	1.4%	0.9%	1.7%	0.0%	0.0%
Total Revenue	123	127	482	132	138	144	149	562	153	152
QoQ %	3.4%	3.3%		4.0%	4.9%	4.1%	3.5%		3.1%	-0.7%
YoY %	NA	NA	NA	15.2%	16.4%	17.2%	17.5%	16.6%	16.4%	10.3%

Source: Company, HDFC Sec Inst Research

Hi-Tech growth has slowed-down after 6 qtrs of strong growth

Retail (8.6% QoQ) was impacted by completion of projects, Retail is expected to be soft in near term

BFSI (27% of rev) led growth among Verticals up 13.1% QoQ, growth in BFSI was led by Insurance (20.8 % of rev, +15.4% QoQ) and BFS (6.4% of rev, +6.0% QoQ)

Vertical Mix

(USD mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Manufacturing (A+B)	63	65	249	66	73	73	77	288	80	80
QoQ %	3.1%	2.8%		1.4%	10.1%	0.9%	5.3%		3.9%	0.3%
YoY %	3.8%	10.9%	3.6%	10.0%	18.3%	15.8%	18.6%	15.7%	21.5%	10.7%
% of Rev	51.5%	51.3%	51.7%	50.0%	52.5%	50.9%	51.8%	51.3%	52.2%	52.7%
Hi-Tech (A)	41	47	171	47	52	54	57	210	60	60
QoQ %	-1.8%	12.3%		2.0%	9.8%	3.7%	4.9%		5.5%	1.1%
YoY %	NA	NA	NA	18.0%	23.4%	30.2%	21.6%	23.3%	25.9%	16.0%
% of Rev	33.8%	36.8%	35.4%	36.1%	37.7%	37.6%	38.1%	37.4%	39.0%	39.7%
Core Manufacturing (B)	22	18	79	18	20	19	20	78	20	20
QoQ %	13.7%	-15.3%		0.1%	11.0%	-6.3%	6.6%		-0.7%	-2.2%
YoY %	NA	NA	NA	-6.4%	7.0%	-11.8%	10.9%	-0.8%	10.1%	-3.0%
% of Rev	17.7%	14.5%	16.3%	14.0%	14.8%	13.3%	13.7%	13.9%	13.2%	13.0%
Retail (C)	33	34	130	33	30	30	32	125	29	26
QoQ %	3.2%	4.2%		-5.6%	-8.0%	0.9%	6.4%		-10.7%	-8.6%
YoY %	11.6%	17.6%	12.2%	7.4%	-6.6%	-8.7%	-6.7%	-3.8%	-11.9%	-12.4%
% of Rev	27.0%	27.2%	26.9%	24.7%	21.7%	21.0%	21.6%	22.2%	18.7%	17.2%
BFSI	25	26	98	31	32	35	33	130	37	41
QoQ %	4.2%	1.6%		20.6%	3.0%	8.8%	-4.7%		11.0%	13.1%
YoY %	10.6%	32.7%	17.6%	35.3%	31.6%	37.4%	28.9%	33.3%	18.6%	30.2%
% of Rev	20.6%	20.2%	20.3%	23.5%	23.0%	24.1%	22.2%	23.2%	23.9%	27.2%
Emerging (D)	1	2	5	2	4	6	7	19	8	4
QoQ %	6.4%	46.5%		39.1%	59.3%	49.7%	13.8%		19.5%	-45.5%
YoY %	NA	NA	NA	87.6%	245.4%	385.7%	277.5%	257.7%	224.4%	11.0%
% of Rev	1.0%	1.4%	1.1%	1.8%	2.8%	4.0%	4.4%	3.3%	5.1%	2.8%

Source: Company, HDFC Sec Inst Research

Digital services was strong at +6.1% QoQ while core application was down 0.7% QoQ

Digital consulting, Automation are new service lines which are being focused

Within Service lines CIS and IMS business dragged the revenues

CIS and IMS revenue de-grew after a strong growth qtr, CIS business was impacted by project completion at a key client

Service Mix

Services Split (USD mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Digital & Application Services (DAS) (A+B)	102	109	402	112	117	119	126	474	127	130
QoQ %	3.4%	7.0%		3.0%	4.6%	1.7%	5.7%		0.8%	2.7%
YoY %	NA	NA	NA	20.2%	19.2%	17.2%	15.9%	17.9%	13.4%	11.3%
% of Rev	82.9%	85.9%	83.4%	85.0%	84.8%	82.9%	84.7%	84.3%	82.8%	85.6%
Digital Services (A)	43	46	168	50	54	57	61	223	63	67
QoQ %	7.2%	6.6%		9.7%	7.5%	5.4%	7.1%		3.8%	6.1%
YoY %	NA	NA	NA	30.4%	34.8%	32.5%	33.2%	32.8%	26.1%	24.4%
% of Rev	35.1%	36.2%	34.8%	38.2%	39.2%	39.7%	41.1%	39.6%	41.4%	44.2%
Core Applications (B)	59	63	234	62	63	62	65	251	63	63
QoQ %	0.7%	7.2%		-1.8%	2.2%	-1.5%	4.4%		-2.1%	-0.7%
YoY %	NA	NA	NA	12.9%	8.4%	6.0%	3.2%	7.2%	2.9%	0.1%
% of Rev	47.8%	49.6%	48.6%	46.8%	45.6%	43.2%	43.6%	44.7%	41.4%	41.4%
Cloud and Infrastructure Services (CIS) (MVS+IMS)	21	18	80	20	21	25	23	88	26	22
QoQ %	3.6%	-14.5%		9.9%	6.6%	16.9%	-7.4%		15.9%	-16.8%
YoY %	NA	NA	NA	-6.4%	3.6%	17.0%	26.7%	10.1%	33.7%	4.3%
% of Rev	17.1%	14.2%	16.6%	15.0%	15.2%	17.1%	15.3%	15.7%	17.2%	14.4%
Multi Vendor Support (MVS)	7	6	26	7	7	6	6	27	6	6
QoQ %	-0.3%	-6.3%		12.5%	4.7%	-11.5%	-3.4%		-4.3%	4.4%
YoY %	NA	NA	NA	-3.1%	10.1%	-2.3%	0.7%	3.7%	-14.3%	-14.6%
% of Rev	5.4%	4.9%	5.4%	5.3%	5.3%	4.5%	4.2%	4.8%	3.9%	4.1%
IMS (Next Gen Cloud & Services)	14	12	54	13	14	18	17	61	20	16
QoQ %	5.5%	-18.3%		8.5%	7.6%	32.1%	-8.8%		23.5%	-23.1%
YoY %	NA	NA	NA	-8.2%	0.5%	25.9%	40.5%	13.2%	60.0%	14.4%
% of Rev	11.7%	9.3%	11.2%	9.7%	9.9%	12.6%	11.1%	10.9%	13.3%	10.3%
Total Revenue (DAS + CIS)	123	127	482	132	138	144	149	562	153	152
QoQ %	3.4%	3.3%		4.0%	4.9%	4.0%	3.5%		3.1%	-0.7%
YoY %	4.3%	14.2%	5.4%	15.2%	16.5%	17.2%	17.4%	16.6%	16.4%	10.2%

Source: Company, HDFC Sec Inst Research

Onsite revenue de-grew 2.7% QoQ while offshore grew 3.7% QoQ (support to margins)

De-growth was driven by T&M projects, 42.6% of rev down 1.6% QoQ while Fixed price was flat QoQ

Onsite-offshore Mix

Revenue (USD Mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Onsite	77	79	303	85	92	97	100	374	104	102
QoQ %	4.2%	2.8%		7.2%	7.8%	5.6%	3.5%		4.2%	-2.7%
YoY %	-1.2%	9.3%	-0.7%	19.1%	23.8%	25.4%	26.3%	23.3%	22.7%	10.7%
% of Rev	63.0%	62.7%	62.9%	64.6%	66.4%	67.4%	67.4%	66.5%	68.1%	66.7%
Offshore	45	47	179	47	46	47	48	188	49	51
QoQ %	2.0%	4.1%		-1.3%	-0.5%	1.0%	3.5%		0.9%	3.7%
YoY %	15.2%	23.4%	17.7%	8.8%	4.3%	3.3%	2.7%	5.3%	4.9%	9.4%
% of Rev	37.0%	37.3%	37.1%	35.4%	33.6%	32.6%	32.6%	33.5%	31.9%	33.3%
Total Revenue	123	127	482	132	138	144	149	562	153	152
QoQ %	3.4%	3.3%		4.0%	4.9%	4.1%	3.5%		3.1%	-0.7%
YoY %	4.3%	14.2%	5.4%	15.2%	16.4%	17.2%	17.5%	16.6%	16.4%	10.3%

Source: Company, HDFC Sec Inst Research

Project Mix

Particulars (USD mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Fixed Price	65	69	251	69	74	77	81	302	87	87
QoQ %	8.0%	5.2%		1.2%	6.8%	4.1%	5.2%		7.6%	0.0%
YoY %	17.6%	31.4%	13.0%	26.8%	22.8%	18.3%	18.3%	20.4%	25.9%	17.9%
% of Rev	53.2%	54.2%	52.0%	52.7%	53.7%	53.7%	54.6%	53.7%	57.0%	57.4%
T&M	57	58	231	62	64	67	68	260	66	65
QoQ %	-1.5%	1.1%		7.4%	2.7%	4.0%	1.5%		-2.4%	-1.6%
YoY %	-7.5%	-1.2%	-1.7%	4.6%	9.8%	16.0%	16.4%	12.5%	5.9%	1.4%
% of Rev	46.8%	45.8%	48.0%	47.3%	46.3%	46.3%	45.4%	46.3%	43.0%	42.6%
Total Revenue	123	127	482	132	138	144	149	562	153	152
QoQ %	3.4%	3.3%		4.0%	4.9%	4.1%	3.5%		3.1%	-0.7%
YoY %	4.3%	14.2%	5.4%	15.2%	16.4%	17.2%	17.5%	16.6%	16.4%	10.3%

Source: Company, HDFC Sec Inst Research

Weakness was across Top client buckets, growth was led by Non Top 10 Clients, up 1.7% QoQ

Top 5 Clients de-grew 1.7% QoQ impacted by project closures

Top 6-10 clients declined 7.7% QoQ after 4 consecutive qtrs of strong growth

Utilisation recovered, up 170bps QoQ, Utilition is at 6 qtr high (limited lever for margin expansion)

Attrition inched up higher to 17.0% up 30bps QoQ, Attrition has been increasing for the past 5 qtrs

Client Mix

(USD mn)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Top 5	44	49	175	49	53	56	56	211	58	57
QoQ %	6.0%	10.1%		1.3%	6.7%	6.4%	-0.5%		4.2%	-1.7%
YoY %	0.7%	14.8%	1.2%	24.0%	26.2%	26.6%	14.4%	20.8%	17.7%	8.4%
% of Rev	36.2%	38.6%	36.3%	37.6%	38.2%	39.1%	37.6%	37.6%	38.0%	37.6%
Top 10	55	60	216	60	64	71	72	261	75	73
QoQ %	6.2%	9.9%		-0.3%	7.1%	10.3%	1.2%		4.8%	-3.1%
YoY %	3.9%	18.1%	3.1%	22.2%	24.7%	29.5%	19.2%	21.0%	25.3%	13.4%
% of Rev	44.8%	47.7%	44.8%	45.7%	46.7%	49.5%	48.4%	46.5%	49.2%	48.0%
Top 6-10	11	12	41	11	12	15	16	50	17	16
QoQ %	7.1%	9.3%		-7.0%	8.7%	28.3%	7.5%		6.9%	-7.7%
YoY %	19.6%	34.9%	12.0%	14.3%	18.4%	41.7%	39.4%	22.1%	60.2%	35.9%
% of Rev	8.6%	9.1%	8.5%	8.1%	8.4%	10.4%	10.8%	8.9%	11.2%	10.4%
Non Top 5	78	78	307	82	85	88	93	351	95	95
QoQ %	1.9%	-0.6%		5.8%	3.7%	2.6%	6.0%		2.4%	0.0%
YoY %	6.5%	13.8%	8.0%	10.5%	11.1%	11.9%	19.4%	14.2%	15.6%	11.4%
% of Rev	63.8%	61.4%	63.7%	62.4%	61.8%	60.9%	62.4%	62.4%	62.0%	62.4%
Non Top 10	68	66	266	72	74	73	77	301	78	79
QoQ %	1.2%	-2.2%		8.0%	3.0%	-1.4%	5.7%		1.5%	1.7%
YoY %	4.7%	10.8%	7.4%	9.9%	10.1%	7.2%	15.9%	13.0%	8.9%	7.6%
% of Rev	55.2%	52.3%	55.2%	54.3%	53.3%	50.5%	51.6%	53.5%	50.8%	52.0%

Source: Company, HDFC Sec Inst Research

Headcount, Attrition And Utilisation Data

(Nos.)	3Q FY18	4Q FY18	FY18	1Q FY19	2Q FY19	3Q FY19	4Q FY19	FY19	1Q FY20	2Q FY20
Total headcount	8,597	8,905	8,905	9,122	9,482	9,813	10,073	10,073	10,166	10,219
Net additions	183	308	381	217	360	331	260	1,168	93	53
Onsite	1,847	1,866	1,866	2,019	2,274	2,360	2,420	2,420	2,579	2,537
Offshore	5,713	5,868	5,868	6,077	6,044	6,259	6,501	6,501	6,213	6,353
BPO/Others	243	248	248	253	284	283	275	275	213	205
Marketing	70	68	68	64	80	76	79	79	80	85
Support	724	855	855	709	800	835	798	798	1,081	1,039
Attrition (%)	15.0%	14.9%	14.9%	18.8%	17.0%	15.8%	15.6%	15.6%	16.7%	17.0%
Utilisation (%)	84.8%	83.8%	84.4%	85.8%	82.6%	81.7%	83.4%	83.4%	82.4%	84.1%

Source: Company, HDFC Sec Inst Research

Deal TCV in 1Q was USD 120mn with book-to-bill of 0.79x vs. book-to-bill of 1.33x in FY19

We cut USD revenue estimate by 3.0/3.7% for FY20/21 based on continued Retail weakness and slowdown in TCV wins. High exposure to Hi-Yech also poses a risk specially considering trade wars and macro uncertainty

Key Assumptions

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Digital Growth (%)	34.7	36.5	25.4	23.3	25.3
Legacy Growth (%)	(7.0)	4.3	(2.4)	(1.2)	(3.7)
Total USD revenue growth (%)	5.4	16.6	10.0	11.3	12.7
USD/INR rate	64.5	69.3	70.2	71.5	73.0
EBITDA margin (%)	9.9	10.7	11.1	11.2	11.6

Source: Company, HDFC Sec Inst Research

Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
FY20E			
Revenue (USD bn)	0.638	0.619	(3.0)
Revenue (Rs bn)	44.99	43.56	(3.2)
EBIT (Rs bn)	4.93	4.85	(1.5)
EBIT margin (%)	11.0%	11.1%	19 bps
EPS (Rs)	15.5	15.5	(0.4)
FY21E			
Revenue (USD bn)	0.715	0.688	(3.7)
Revenue (Rs bn)	51.35	49.46	(3.7)
EBIT (Rs bn)	5.84	5.56	(4.7)
EBIT margin (%)	11.4%	11.2%	(12) bps
EPS (Rs)	19.1	18.1	(5.4)
FY22E			
Revenue (USD bn)	0.804	0.775	(3.6)
Revenue (Rs bn)	58.99	56.89	(3.6)
EBIT (Rs bn)	6.98	6.61	(5.4)
EBIT margin (%)	11.8%	11.6%	(22) bps
EPS (Rs)	22.9	21.5	(5.8)

Source: Company, HDFC Sec Inst Research

Peer Set Comparison

Company	MCap (Rs bn)	CMP (Rs)	TP (Rs)	RECO	EPS (Rs)				P/E (x)				RoE (%)			
					FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E
TCS	7,698	2,051	1,975	NEU	68.8	83.9	85.5	92.9	29.8	24.5	24.0	22.1	30.1	36.1	35.3	37.1
Infosys	2,739	644	835	NEU	34.6	37.2	37.9	43.7	18.6	17.3	17.0	14.7	22.0	24.4	25.4	28.5
Wipro	1,508	254	230	NEU	13.5	15.1	16.8	18.0	18.8	16.8	15.1	14.1	16.5	17.3	17.8	17.7
HCL Tech	1,444	1,064	1,275	BUY	64.7	74.6	73.1	83.7	16.4	14.3	14.6	12.7	25.3	26.0	22.6	23.2
TechM	631	718	650	NEU	43.2	48.9	45.4	51.0	16.6	14.7	15.8	14.1	21.5	22.0	19.4	20.0
Tier-1 IT Median									18.6	16.8	15.8	14.1	22.0	24.4	22.6	23.2
LTI	280	1,611	1,845	BUY	66.9	87.3	83.7	95.5	24.1	18.4	19.2	16.9	33.2	34.6	27.5	27.1
Mphasis	171	915	1,180	BUY	45.4	57.6	58.3	69.1	20.2	15.9	15.7	13.2	14.6	20.0	19.7	20.9
LTTS	153	1,475	1,705	BUY	45.5	68.0	74.0	88.4	32.4	21.7	19.9	16.7	27.7	32.0	28.4	28.5
Mindtree	120	729	760	NEU	32.3	44.1	36.4	47.9	22.6	16.6	20.1	15.2	21.4	24.9	17.3	22.9
Hexaware *	111	371	450	BUY	16.8	19.6	20.4	24.6	22.2	19.0	18.2	15.1	26.6	26.5	23.5	24.4
Cyient	48	423	485	NEU	38.6	43.6	39.8	42.7	11.0	9.7	10.6	9.9	18.1	19.5	16.6	16.2
Zensar	45	199	240	BUY	10.6	14.3	15.5	18.1	18.7	13.9	12.8	11.0	15.1	17.6	16.6	17.0
Persistent	48	619	655	BUY	42.0	47.5	43.3	47.5	14.7	13.0	14.3	13.0	16.0	15.7	13.8	14.7
Tata Elxsi	44	702	680	NR	38.5	46.6	38.6	45.1	18.2	15.1	18.2	15.6	37.0	34.5	23.7	24.0
Sonata	33	318	448	BUY	18.6	24.0	26.5	29.9	17.2	13.3	12.0	10.6	31.0	35.1	33.7	33.8
Intellect	25	188	315	BUY	3.5	7.7	7.6	11.7	NM	24.6	24.9	16.1	6.7	11.1	9.3	12.8
eClerx	16	434	460	NEU	74.0	61.7	50.1	51.2	5.9	7.0	8.7	8.5	24.1	17.6	13.8	14.1
Majesco	12	414	700	BUY	(1.5)	18.3	20.9	31.1	NM	22.6	19.8	13.3	NM	8.4	8.3	11.4
HGS	12	554	760	NR	96.5	84.6	85.3	101.2	5.7	6.5	6.5	5.5	10.5	8.5	11.2	11.8
Mastek	8	347	505	BUY	27.7	40.4	38.3	42.7	12.5	8.6	9.1	8.1	13.7	16.1	12.9	13.0
Tier-2 IT Median									18.2	15.1	15.7	13.2	19.8	19.5	16.6	17.0

Company	MCap (USD bn)	CMP USD	TP	RECO	EPS (USD)				P/E (x)				RoE (%)			
					FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
Accenture	126	187	NA	NR	5.6	6.5	7.8	8.6	33.6	28.9	24.0	21.8	41.7	42.0	34.9	35.0
Cognizant	34	61	NA	NR	2.5	3.6	4.0	4.3	23.9	16.8	15.3	14.1	14.1	19.0	19.0	20.4
Capgemini^	20	106	NA	NR	4.9	4.4	6.5	7.2	21.7	24.3	16.2	14.8	11.5	10.1	13.4	13.6
Global IT Median									23.9	24.3	16.2	14.8	14.1	19.0	19.0	20.4

Source: HDFC sec Inst Research, Bloomberg, *Dec YE, ^CMP and EPS in EUR terms

Income statement (consolidated)

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues (US \$mn)	482	562	619	688	775
Growth (%)	5.4	16.6	10.0	11.3	12.7
Net Revenues (Rs mn)	31.16	39.15	43.56	49.46	56.89
Growth (%)	1.4	25.7	11.3	13.5	15.0
Personnel expenses	22.07	27.63	30.57	34.45	39.27
SG&A	5.36	6.45	6.60	7.87	9.34
EBITDA	3.73	5.08	6.39	7.14	8.28
Depreciation	0.65	0.89	1.54	1.57	1.68
EBIT	3.08	4.19	4.85	5.56	6.61
EBIT Margin (%)	9.9	10.7	11.1	11.2	11.6
EBIT Growth (%)	(9.2)	36.1	15.9	14.7	18.8
Other Income (Including EO Items)	0.67	0.79	0.68	0.71	0.73
Interest	0.23	0.37	0.60	0.61	0.63
PBT	3.51	4.61	4.94	5.66	6.71
Tax (Incl Deferred)	1.05	1.31	1.32	1.44	1.71
Minority Interest	0.05	0.05	0.10	0.11	0.11
RPAT	2.41	3.24	3.52	4.10	4.89
EO (Loss) / Profit (Net Of Tax)	0.00	0.00	0.00	0.00	0.00
APAT	2.41	3.24	3.52	4.10	4.89
APAT Growth (%)	2.9	34.5	8.4	16.7	19.1
Adjusted EPS (Rs)	10.6	14.3	15.5	18.1	21.5
EPS Growth (%)	2.9	34.5	8.4	16.7	19.1

Source: Company, HDFC sec Inst Research

Balance sheet (consolidated)

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital – Equity	0.45	0.45	0.45	0.45	0.45
Reserves	16.24	18.97	21.67	24.81	28.56
Total Shareholders' Funds	16.69	19.42	22.12	25.26	29.01
Minority Interest	0.14	0.17	0.27	0.38	0.49
Total Debt	0.06	2.58	2.58	2.58	2.58
Net Deferred Taxes	(0.31)	(0.45)	(0.45)	(0.45)	(0.45)
Long Term Provisions & Others	0.78	0.78	0.89	1.01	1.16
TOTAL SOURCES OF FUNDS	17.35	22.50	25.41	28.78	32.79
APPLICATION OF FUNDS					
Net Block	1.69	3.47	3.67	3.88	4.19
CWIP	0.06	0.12	0.12	0.12	0.12
Goodwill	4.22	6.03	6.03	6.03	6.03
Investments	0.00	0.00	0.00	0.00	0.00
LT Loans & Advances	0.37	0.43	0.42	0.46	0.51
Total Non-current Assets	6.34	10.04	10.24	10.49	10.85
Inventories	1.06	0.98	1.39	1.58	1.82
Debtors	6.42	8.76	9.55	10.84	12.63
Other Current Assets	3.78	5.92	6.53	7.91	9.10
Cash & Equivalents	5.05	4.74	5.20	6.00	7.18
Total Current Assets (ex Cash)	11.26	15.67	17.48	20.34	23.55
Creditors	1.84	3.01	3.16	3.59	4.13
Other Current Liabilities & Provns	3.46	4.94	4.36	4.45	4.67
Total Current Liabilities	5.30	7.95	7.51	8.05	8.79
Net Current Assets	5.96	7.72	9.96	12.29	14.76
TOTAL APPLICATION OF FUNDS	17.35	22.50	25.41	28.78	32.79

Source: Company, HDFC sec Inst Research

Cash flow statement (consolidated)

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	3.51	4.61	4.94	5.66	6.71
Non-operating & EO items	(0.83)	(0.23)	(0.16)	(0.35)	(0.40)
Interest expenses	0.23	0.30	0.60	0.61	0.63
Depreciation	0.65	0.89	1.54	1.57	1.68
Working Capital Change	(0.11)	(2.62)	(2.12)	(2.25)	(2.37)
Tax Paid	(1.04)	(1.39)	(1.32)	(1.44)	(1.71)
OPERATING CASH FLOW (a)	2.42	1.56	3.47	3.80	4.53
Capex	(1.45)	(4.17)	(1.74)	(1.78)	(1.99)
Free cash flow (FCF)	0.97	(2.61)	1.72	2.02	2.54
Investments	0.00	0.00	0.00	0.00	0.00
Non-operating Income	0.06	0.04	0.16	0.35	0.40
INVESTING CASH FLOW (b)	(1.38)	(4.13)	(1.58)	(1.43)	(1.59)
Debt Issuance/(Repaid)	(1.34)	2.76	0.00	0.00	0.00
Interest Expenses	(0.10)	(0.13)	(0.60)	(0.61)	(0.63)
FCFE	(0.47)	0.02	1.13	1.41	1.92
Share Capital Issuance	0.03	0.01	0.00	0.00	0.00
Dividend	(0.63)	(0.63)	(0.82)	(0.96)	(1.14)
FINANCING CASH FLOW (c)	(2.04)	2.01	(1.42)	(1.58)	(1.77)
NET CASH FLOW (a+b+c)	(1.00)	(0.56)	0.47	0.80	1.18
EO Items, Others	0.15	0.25	0.00	0.00	0.00
Closing Cash & Equivalents	5.05	4.74	5.20	6.00	7.18

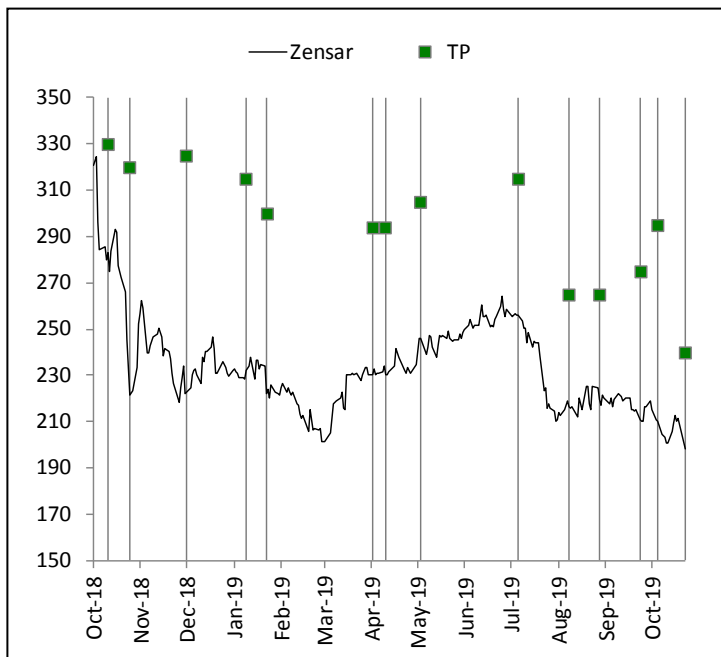
Source: Company, HDFC sec Inst Research

Key ratios (consolidated)

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	29.2	29.4	29.8	30.3	31.0
EBITDA Margin	9.9	10.7	11.1	11.2	11.6
APAT Margin	7.7	8.3	8.1	8.3	8.6
RoE	15.1	17.6	16.6	17.0	17.6
RoIC (or Core RoCE)	18.9	19.9	18.7	19.3	20.3
RoCE	11.8	13.2	12.5	13.1	13.7
EFFICIENCY					
Tax Rate (%)	29.9	28.4	26.8	25.5	25.5
Fixed Asset Turnover (x)	8.6	6.2	5.4	5.0	4.8
Inventory (days)	14	11	14	14	14
Debtors (days)	75	82	80	80	81
Other Current Assets (days)	44	55	55	58	58
Payables (days)	24	32	31	31	31
Other current liabilities (days)	41	46	37	33	30
Cash Conversion Cycle (days)	54	59	67	75	78
Debt/EBITDA (x)	0.0	0.5	0.4	0.4	0.3
Net D/E (x)	(0.3)	(0.1)	(0.1)	(0.1)	(0.2)
Interest Coverage (x)	16	14	11	12	13
PER SHARE DATA (Rs)					
EPS	10.6	14.3	15.5	18.1	21.5
CEPS	13.5	18.2	22.2	25.0	28.9
Dividend	3	3	4	4	5
Book Value	73	85	97	111	128
VALUATION					
P/E(x)	18.8	14.0	12.9	11.1	9.3
P/BV(x)	2.7	2.3	2.1	1.8	1.6
EV/EBITDA(x)	10.7	8.4	6.6	5.8	4.9
EV/Revenues (x)	1.3	1.1	1.0	0.8	0.7
OCF/EV (%)	6.1	3.6	8.2	9.2	11.2
FCF/EV(%)	2.4	-6.1	4.1	4.9	6.3
FCFE/MktCap (%)	-1.0	0.0	2.5	3.1	4.3
Dividend Yield (%)	1.2	1.4	1.6	1.8	2.2

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
10-Oct-18	283	BUY	330
25-Oct-18	234	BUY	320
30-Nov-18	234	BUY	325
8-Jan-19	229	BUY	315
22-Jan-19	222	BUY	300
1-Apr-19	230	BUY	294
9-Apr-19	230	BUY	294
2-May-19	246	BUY	305
5-Jul-19	256	BUY	315
8-Aug-19	217	BUY	265
27-Aug-19	225	BUY	265
22-Sep-19	215	BUY	275
4-Oct-19	211	BUY	295
22-Oct-19	199	BUY	240

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

We, **Amit Chandra, MBA, Apurva Prasad, MBA & Akshay Ramnani, CA**, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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