

December 27, 2019

## Zensar Technologies Limited: Rating reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/Short-term - Fund-based/Non-fund based	191.00	177.00	[ICRA]AA+(Stable)/[ICRA]A1+; reaffirmed
Long-term - Non-fund based	-	14.00	[ICRA]AA+(Stable); reaffirmed
<b>Total</b>	<b>191.00</b>	<b>191.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The reaffirmed rating derives comfort from the healthy financial profile of Zensar Technologies Limited (ZTL) characterised by healthy revenue growth, steady profitability indicators and recurring free cash flows. In FY2019, the operating income (OI) grew by 27.6%YoY led by 29.2%YoY growth in application managed services (AMS) and 19.8% YoY growth in infrastructure managed services (IMS). The growth was driven by recent acquisitions of Cynosure (acquired in April 2018) and Indigo Slate (acquired in July 2018), coupled with growth in base AMS vertical while the IMS division growth was driven by cloud infrastructure services. ZTL has an established presence in the regions it operates in and commanded operating margins of 12.1% in FY2019 and 13.8% in H1 FY2020, and net margins of 8.0% in FY2019 and 7.4% in H1 FY2020. The rating also takes into account the broad client base, the diversified revenue base across geographies as well as the presence in multiple verticals, lending diversification and stability to revenues. The acquisitions of Foolproof Limited (November 2016), Keystone Limited (April 2017), Cynosure Inc. (April 2018) and Indigo Slate (July 2018) have diversified ZTL's service offerings (digital services) and expanded its addressable market and growth potential. The company's revenue contribution from digital services grew to 44.7% as of March 2019 and 50.1% as of September 2019 from 38.1% in March 2018. With a healthy deal book of over one billion dollars (total contract value including renewals) as of September 2019, growing digital presence, integration of acquisitions, growth prospects of cloud infrastructure services and a focused effort to scale top-tier growth accounts, ZTL's revenues and profitability are expected to improve from the current levels.

The recent acquisitions have led to a build-up in debt (Rs. 300.1 crore as on March 31, 2019 and Rs. 292.1 crore as of September 2019, (excluding finance lease obligations), though the coverage indicators remain comfortable. The liquidity profile remains supported by significant cash and liquid investments of Rs. 417.8 crore as of March 2019 and Rs. 429.9 crore as of September 2019.

The rating is constrained by moderately high customer concentration risk arising out of the dependence for revenues on a single client, mitigated to a large extent by the strong and established relationship with the customer. While increasing the scale and size of operations, a leveraged funding structure for future acquisitions could materially impact the company's financial risk profile. Further, a large cross-border acquisition would entail careful integration of operations to realise likely synergies. Profitability remains susceptible to pricing pressures, wage inflation, adverse foreign exchange fluctuations and general stagnation and negative headwinds in business across the US, Europe and South Africa.

## Key rating drivers

### Credit strengths

**Healthy revenue visibility due to expanding footprint in the digital space for AMS and IMS** - ZTL's revenues from the digital segment grew from 5.0% in FY2014 to 44.7% as of March FY2019 and 50.1% as of September 2019. In FY2019, the OI grew by 27.6% YoY, led by 29.2% YoY growth in AMS and 19.8% YoY growth in IMS. The growth in AMS was driven primarily by the recent acquisitions of Cynosure (acquired in April 2018) and Indigo Slate (July 2018), coupled with 11.0-12.0% growth in base AMS business. Cynosure is a licensed Guidewire Software partner in the property and casualty (P&C) insurance segment while Indigo Slate is a digital marketing customer experience agency. The IMS division grew primarily led by cloud infrastructure services with healthy growth prospects and is margin accretive, providing growth levers for the future.

**Diversified presence across various service lines and verticals** - The company's revenues are diversified across various service offerings, such as application management services comprising application development work and support services, testing services and product engineering, infrastructure management services and digital offerings. Further, its clientele is distributed across manufacturing (industrial and hi-tech), retail, and banking and financial services (BFSI), resulting in sectoral diversification. Manufacturing (Hitech) and BFSI (Insurance) are the focus verticals for the company's management, going forward. The Hitech vertical grew by 34.8% YoY and 17.5% YoY in FY2019 and H1 FY2020, respectively, while BFSI grew by 45.8% YoY and 23.7% YoY in FY2019 and H1 FY2020, respectively. The growth in BFSI was led by the insurance vertical post acquisition of Cynosure in FY2019. The retail segment remained muted with a growth of 5.3% YoY in FY2019 and 11.0% YoY degrowth in H1 FY2020. Increasing competition from online platforms, shutdown and consolidation of brick and mortar stores have led to a decline in the overall front-end retail environment.

**Healthy financial profile characterised by healthy liquidity indicators, margins and recurring cash flows** - ZTL recorded operating margins of 12.1% in FY2019 and 13.8% in H1 FY2020 and net margins of 8.0% in FY2019 and 7.4% in H1 FY2020. Going forward, the revenues are expected to grow, led by a healthy deal book of over one billion dollars (total contract value, including renewals) and scaling of the digital business including, acquisitions, demand for cloud infrastructure business and focused effort to scale top-tier growth accounts. Despite the debt-funded capex of Rs. 300.4 crore as on March 2019, the financial profile remains healthy supported by adequate cash and cash equivalents of Rs. 417.8 crore and recurring accruals of Rs. 331.0 crore as on March 31, 2019. The company continued to maintain a net cash position of Rs. 117.5 crore as on March 31, 2019. In H 1FY2020, the debt levels were recorded at Rs. 292.1 crore (excluding finance lease liabilities) with cash and cash equivalents of Rs. 429.9 crore, maintaining a net cash position of Rs. 137.8 crore.

**Part of a large, established and diversified Group imparts financial flexibility** - ZTL is part of the ~Rs. 255-billion (FY2019 revenues) RPG Group with a diversified presence in infrastructure, tyres, technology and pharmaceuticals. ZTL derives financial flexibility and benefits from the strong management pedigree of the Group.

## Credit challenges

**Moderate scale of operations with moderately high dependence on single client; supported by strong and established relationship** - With revenues of Rs. 3,966.3 crore as on March 31, 2019 and revenues of Rs. 2,143.3 crore on September 30, 2019, ZTL is a mid-sized information technology (IT) company in the \$177–181 billion Indian IT industry<sup>1</sup>. The company derived 36.5% of its revenues from its top five clients in FY2019 with moderately high dependence on a single client, exposing it to client concentration risks. However, this risk is partially mitigated by the strong and established relationship and the growing wallet share of business with the client.

**Margins vulnerable to wage inflation and forex fluctuations and pricing pressure** - Given the intense competition in the industry, ZTL's profit margins are susceptible to pricing pressures and wage inflation. Further, much of the revenues and margins are exposed to forex risks, although ZTL's hedging mechanisms mitigate the same to an extent. Being in a highly labour-intensive business, the availability and retention of a skilled workforce are the key challenges. ZTL is also exposed to the hiring norms of the countries it operates in.

**Intense competition from established Indian and foreign-based IT service providers** - The increasing competition and pricing pressures from the existing incumbents may impact the company's future growth and profitability indicators. ZTL is adapting to the changing technology landscape by focusing on digital technologies.

## Liquidity position: Strong

The company generated healthy funds flow from operations (FFOs) of Rs. 301.6 crore in FY2019 supported by healthy revenue growth and improvement in accruals. The liquidity is supported by significant cash and cash equivalents of Rs. 417.8 crore in FY2019 (Rs. 429.9 crore in H1 FY2020) and unutilised fund-based limits. ZTL's average utilisation of fund-based and non-fund based limits (fungible limits) for 12 months ended November 2019 was 2.5% of sanctioned limits. It has a modest capex plan of ~Rs. 70 crore in CY2020 to be financed by internal accruals. Going forward, the free cash flows could come under pressure if the company continues with large debt-funded acquisitions post Cynosure and Indigo Slate.

## Rating sensitivities

**Positive triggers** – A rating upgrade for ZTL is unlikely in the medium term given the moderate scale and size of the company.

**Negative triggers** – Negative pressure on ZTL's rating could arise in case of sizeable debt-funded acquisitions, which could significantly impact the financial profile and liquidity position. Specific credit metrics that could lead to a downgrade of ZTL's ratings include Total Debt/OPBITDA exceeding 1.25 times and a weakening in DSCR to below 2.5 times on a sustained basis.

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<sup>1</sup> Source: Nasscom

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Information Technology (Services) Industry</a>
Parent/Group Support	Not Applicable
Consolidation	For arriving at the ratings, ICRA has considered the consolidated financials of ZTL. As on March 31, 2019 the company had seven subsidiaries and 16 step-down subsidiaries, which are listed in Annexure-2.

## About the company

ZTL is among the top software service providers in India. Based out of Pune, it was initially a joint venture between RPG Enterprises and Fujitsu Limited, and started functioning with its present organisational structure from 2001. The company employs ~10,219 associates and enjoys a footprint across more than 22 countries, providing IT/ITeS solutions to many Fortune 500 companies. It has over 300 customers and provides services, including IT consulting, application development and maintenance, package implementation and BPO operations. Currently, the business segments are— application management services (including application development, Oracle and SAP work and digital services), and IMS and cloud digital services.

In H1 FY2020, the company reported a net profit of Rs. 158.4 crore on an operating income (OI) of Rs. 2,143.3 crore, compared to a net profit of Rs. 178.9 crore on an OI of Rs. 1,873.4 crore in H1 FY2019.

## Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	3107.7	3966.3
PAT (Rs. crore)	246.5	318.7
OPBDIT/OI (%)	11.7%	12.1%
RoCE (%)	22.7%	24.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.6
Total Debt/OPBDIT (times)	0.0	0.6
Interest Coverage (times)	16.1	12.9
DSCR	12.5	10.6

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

### Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years						
		Type	Amount Rated	Amount Outstanding	Rating	FY2019		FY2018				FY2017
					27-Dec-2019	25-Jan-2019	01-Aug-2018	09-May 2018	26-Mar-2018	15-Dec-2017	28-Jul-2017	29-Sep-2016
1	Fund based/non fund based	Long term/short term	177.00	-	[ICRA]AA+ (Stable)/[ICRA] A1+	[ICRA]AA+ (Stable)/[ICRA] A1+	-	-	-	-	-	-
2	Non-fund based	Long Term	14.00	-	[ICRA]AA+ (Stable)	-	-	-	-	-	-	-
3	Fund-based	Long term/short term	-	-	-	-	[ICRA]AA+ (Stable)/[ICRA] A1+	[ICRA]AA+ (Stable)/[ICRA] A1+; removed from ratings watch	[ICRA]AA+ (Stable)/[ICRA] A1+ &	[ICRA]AA+ (Stable)/[ICRA] A1+	[ICRA]AA+ (Stable)/[ICRA] A1+	[ICRA]AA+ (Stable)/[ICRA] A1+

Amount in Rs. crore; &- placed on ratings watch with developing implications

### Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [click here](#)

### Annexure-1: Instrument details

ISI	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term/Short-term-Fund based/Non-fund based	NA	NA	NA	177.00	[ICRA]AA+(Stable)/[ICRA]A1+
NA	Long-term - Non-fund based	NA	NA	NA	14.00	[ICRA]AA+(Stable)

Source: Company

### Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Zensar Technologies Inc.	100%	Full Consolidation
Professional Access Limited, USA	100%	Full Consolidation
PSI Holding Group Inc., USA	100%	Full Consolidation
Zensar Technologies IM Inc.	100%	Full Consolidation
Zensar Technologies IM B.V.	100%	Full Consolidation
Zensar Technologies (Shanghai) Company Ltd.	100%	Full Consolidation
Zensar Info Technologies (Singapore) Pte. Ltd	100%	Full Consolidation
Zensar Technologies (Singapore) Pte. Ltd, Singapore	100%	Full Consolidation
Zensar Technologies (UK) Ltd, UK	100%	Full Consolidation
Foolproof Ltd. UK	100%	Full Consolidation
Knit Ltd. UK	100%	Full Consolidation
Foolproof (SG) Pte. Ltd.	100%	Full Consolidation
Keystone Logic Inc., USA	100%	Full Consolidation
Zensar IT Services Ltd., India	100%	Full Consolidation
Zensar (Africa) Holdings (Pty) Ltd, South Africa	100%	Full Consolidation
Zensar (South Africa) (Pty) Ltd, South Africa	75%	Full Consolidation
Cynosure Inc. USA	100%	Full Consolidation
Cynosure Interface Services Private Limited	100%	Full Consolidation
Cynosure APAC Pty Ltd	100%	Full Consolidation
Keystone Logic Mexico S. DE R.L. DE C.V	100%	Full Consolidation
Keystone Technologies Mexico S. DE R.L. DE C.V	100%	Full Consolidation
Zensar Technologies (Canada) Inc	100%	Full Consolidation
Indigo Slate Inc. USA	100%	Full Consolidation

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