

March 25, 2021

Zensar Technologies Limited: Ratings reaffirmed; outlook revised to Stable

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	177.00	177.00	[ICRA]AA+/[ICRA]A1+ reaffirmed; Outlook revised to Stable from Negative
Long-term - Non-fund based	14.00	14.00	[ICRA]AA+ reaffirmed; Outlook revised to Stable from Negative
Total	191.00	191.00	

*Instrument details are provided in Annexure-1

Rationale

The revision in outlook to Stable from Negative for Zensar Technologies Limited (ZTL) reflects its healthy operating profitability and liquidity position in 9M FY2021 leading to an improvement in the credit profile, despite the reduction in its revenue (8% YoY decline in 9M FY2021), which will remain a key sensitivity going forward. ICRA expects the company to report improved growth momentum in FY2022 for continuing businesses.

The ratings derive comfort from ZTL's healthy financial profile, characterised by the recurring free cash flows and a strong cash and cash equivalent position. The company has repaid its bank debt and is debt free as on December 31, 2020 (excluding operating lease obligations). The liquidity profile remains supported by significant cash and bank balance of Rs. 724.1 crore and Investment in mutual funds of Rs. 446.2 crore as of December 2020. The ratings also take into account its broad client base, the diversified revenue base across geographies as well as the presence in multiple verticals, all of which lend diversification and stability to the revenues. The acquisitions of Foolproof Limited (November 2016), Keystone Limited (April 2017), Cynosure Inc. (April 2018) and Indigo Slate (July 2018) diversified ZTL's service offerings (digital services) and expanded its addressable market, while adding to its growth potential. Its operating margin improved to 17.6% for 9M FY2021 versus 12.1% in FY2020 supported by effective cost optimisation measure taken by the company, higher offshore revenue (39.7% in 9MFY2021 versus 33.4% in FY2020), reduction in total headcount (9524 at end FY2020 to 8809 at end Q3 FY2021) and lower subcontracting expenses.

The company's core revenue contribution from digital services grew to 63.6% as of 9M FY2021 from 54.5% in FY2020. With a healthy order book as of December 2020, a growing digital presence, the integration of acquisitions, the growth prospects of cloud infrastructure services, and a focused effort to scale up top-tier growth accounts, ZTL's revenues and profitability are expected to improve from the current levels and will remain the key monitorable.

The ratings remain constrained by the 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 the size of its 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. Its profitability remains susceptible to pricing pressures, wage inflation, adverse foreign exchange rate fluctuations, lower-than-expected economic recovery for key markets such as US, Europe and South Africa.

Key rating drivers and their description

Credit strengths

Diversified presence across various service lines and verticals – The company's revenues are diversified across various service offerings, such as the digital application services (DAS) comprises core application services and digital services. The digital foundation services comprise cloud, digital led next gen core infrastructure service and core infrastructure services. Further, its clientele is distributed across the manufacturing (industrial and hi-tech), retail, and banking and financial services (BFSI)

domains, resulting in sectoral diversification. The hi-tech vertical grew by 13% YoY and -1% YoY in FY2020 and 9M FY2021, respectively. The BFSI sector grew by 19% YoY and -6% YoY in FY2020 and 9M FY2021. In FY2021, the hi-tech segment has witnessed softness from its top client, coupled with closure of some projects from other clients, led to a reduction in its revenues. The BFSI segment witnessed degrowth in current fiscal due to closure of a certain significant project.

Healthy financial profile supported by improved profitability, cash accruals and robust liquidity position – The company's financial profile remains healthy, supported by improved profitability (17.6% in YTD December 2021 versus 12.1% in FY2020), strong capital structure and robust liquidity position in the form of strong cash and liquid investment of US\$160 million as on December 31, 2020. ZTL has repaid all its bank debts as on December 31, 2020.

Part of a large, established and diversified Group imparts financial flexibility – ZTL is part of the ~Rs. 246-billion (FY2020 revenues) RPG Group, which has a diversified presence in infrastructure, tyres, technology and pharmaceuticals. It derives financial flexibility and benefits from the strong management lineage of the Group.

Credit challenges

Moderate scale of operations with a moderately high dependence on a single client; supported by strong and established relationship – With revenues of Rs. 4,181.7 crore as on March 31, 2020 and revenues of Rs. 2,905.1 crore on December 31, 2020, ZTL is a mid-sized information technology (IT) company. The company derived 38.8% and 37.8% of its core revenues from its top five clients in FY2020 and Q3 FY2021, respectively, with moderately high dependence on a single client, exposing it to client concentration risks. However, this risk is partially mitigated by a strong and established relationship with the top clients.

Revenue degrowth in FY2021 impacted by pandemic and softness from top client in hi-tech business – The company's revenue degrew by 8% in 9M FY2021 impacted by ramp down in accounts by clients across verticals that undertook cost cutting measure due to COVID-19, slowdown in customer's business and some large project closure in insurance segment. The softness in revenue from one of its top 5 client has also impacted the revenue growth in current fiscal, while company continues to maintain its healthy wallet share from that 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. The company is also exposed to the hiring norms of the countries it operates in.

Liquidity position: Strong

The company is expected to generate healthy fund flow from operations (FFOs) of Rs. 450-500 crore in FY2021, supported by a healthy operating profitability. The liquidity is supported by significant cash and bank balance of Rs. 724.1 crore and investment in mutual funds of Rs. 446.2 crore on December 31, 2020 and unutilised fund-based limits. ZTL's utilisation of fund-based limits is zero as on December 31, 2020. Going forward, the free cash flows could come under pressure if the company opts for any large debt-funded acquisitions.

Rating sensitivities

Positive factors – A rating upgrade for ZTL is unlikely in the medium term given the moderate scale of operations. However, the ratings could be upgraded if company demonstrates significant improvement in its scale of business, supported by growth across verticals.

Negative factors – Negative pressure on ZTL's ratings could arise in case of sizeable debt-funded acquisitions, which could significantly impact the financial profile and the liquidity position. Specific credit metrics that could lead to a downgrade of ZTL's ratings include Total Debt/OPBITDA (debt including lease liability) exceeding 1.25 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology(IT) Services Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of ZTL. As on December 31, 2020 the company had 5 subsidiaries and 12 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 ~8,809 associates providing IT/ITeS solutions to many Fortune 500 companies. It has about 134 active customers and provides services, including IT consulting, application development and maintenance, and package implementation. At present, the business segments are—digital application services and digital foundation services.

In 9M FY2021, the company reported a net profit of Rs. 216.4 crore on an operating income (OI) of Rs. 2,905.1 crore, compared to a net profit of Rs. 199.6 crore on an OI of Rs. 3,163.9 crore in 9M FY2020.

Key financial indicators (audited)

LTHL Consolidated	FY2019	FY2020	H1 FY2021
Operating Income (Rs. crore)	3966.3	4181.7	1,970.7
PAT (Rs. crore)	318.7	271.6	77.2
OPBDIT/OI (%)	12.1%	12.1%	16.6%
PAT/OI (%)	8.0%	6.5%	3.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.7	0.5
Total Debt/OPBDIT (times)	0.6	1.5	0.7
Interest Coverage (times)	12.9	8.4	11.5

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2021)				Chronology of Rating History for the past 3 years									
	Type	Amount Rated (Rs. crore)	Amount Outstanding as of Feb 29, 2020 (Rs. crore)	Date & Rating in	Date & Rating in FY2020			Date & Rating in FY2019			Date & Rating in FY2018			
					Mar 25, 2021	Feb 25, 2020	Dec 27, 2019	Jan 25, 2019	August 01, 2018	May 09, 2018	Mar 26, 2018	Dec 15, 2017	July 28, 2017	
1	Fund based/Non-fund based	Long-term and short term	177.0	-	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Negative) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	-	-	-	-	-	-
2	Non-fund based	Long-term	14.0	--	[ICRA]AA+ (Stable)	[ICRA]AA+ (Negative)	[ICRA]AA+ (Stable)	-	-	-	-	-	-	-
3	Fund based	Long-term and 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+

&= Under 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 www.icra.in

Annexure-1: Instrument details

ISIN No	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	177.0	[ICRA]AA+(Stable)/ [ICRA]A1+
NA	Long-term - Non-fund based	NA	NA	NA	14.0	[ICRA]AA+(Stable)

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	ZTL Ownership	Consolidation Approach
Zensar Technologies Inc.	100%	Full Consolidation
Professional Access Limited, USA	100%	Full Consolidation
Zensar Technologies (Singapore) Pte. Ltd., Singapore	100%	Full Consolidation
Zensar Technologies (UK) Ltd., UK	100%	Full Consolidation
Zensar Technologies GMBH, Germany	100%	Full Consolidation
Zensar Technologies B.V. Amsterdam	100%	Full Consolidation
Foolproof Ltd., UK	100%	Full Consolidation
Foolproof (SG) Pte. Ltd.	100%	Full Consolidation
Keystone Logic Inc., USA	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
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

Source: Company data

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About ICRA Limited:

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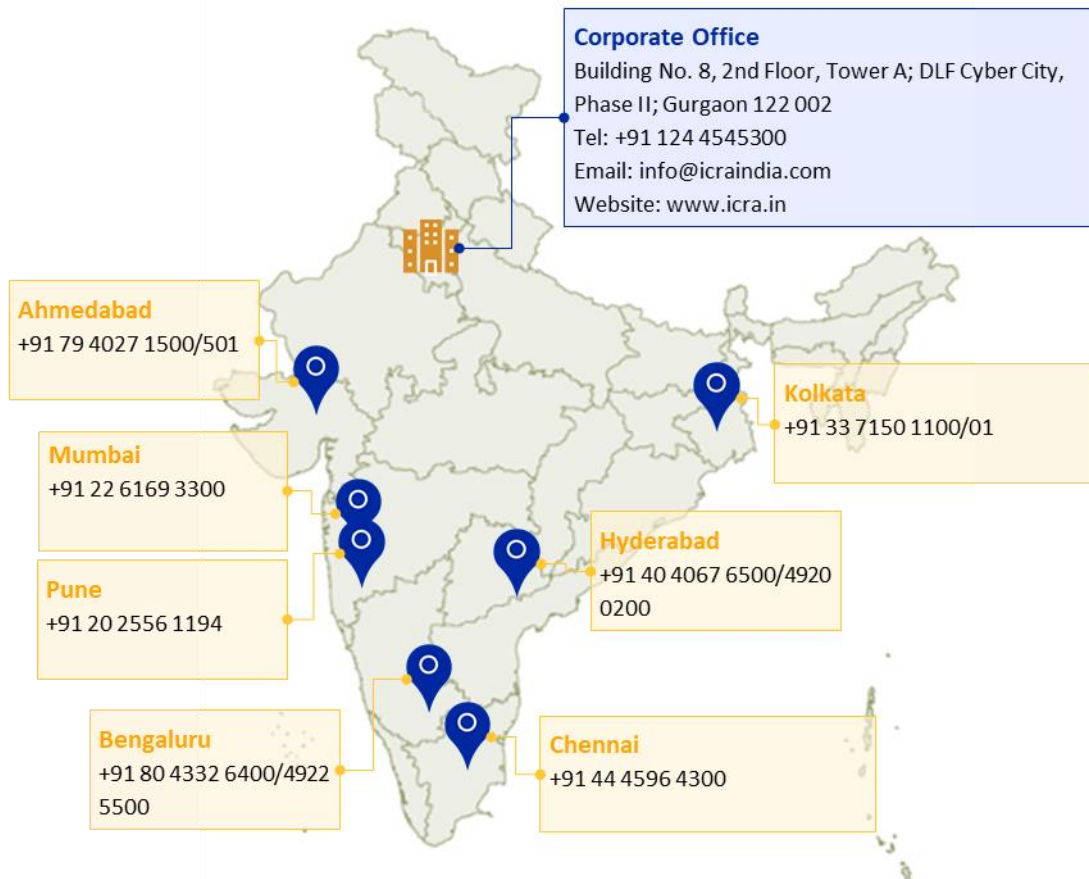
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