Zensar Technologies Limited

May 09, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long/short term fund based facilities	140.00	140.00	[ICRA]AA+(Stable)/[ICRA]A1+; reaffirmed, removed from ratings watch with developing implications
Total	**140.00**	**140.00**	

Rating action

ICRA has reaffirmed the rating outstanding on the Rs. 140 crore long/short-term fund-based bank facilities of Zensar Technologies Limited (Zensar/the company) at [ICRA]AA+ (pronounced ICRA double A plus) and [ICRA]A1+ (pronounced ICRA A one plus). The outlook on the long-term rating is Stable. The ratings have been removed from ratings watch with developing implications.

Rationale

ICRA had placed the ratings of Zensar on watch with developing implications following the announcement of acquisition of Cynosure Inc in March 2018. The acquisition of Cynosure Inc. was done at an initial upfront payment of US$ 33 million followed by performance based deferred pay out of up to US$ 27 million over the next two fiscal years. The acquisition of Cynosure Inc. provides entry into fast growing Insurance vertical for key market such as USA and Europe as licensed partner for Guidewire Inc. suite of Insurance products. Guidewire Inc. Insurance suite provides complete set of systems to support core operation including underwriting policy, administration, billing and claims management for Property and Casualty Insurers through customable common developed platform thereby replacing core legacy systems used by such Insurance companies.

The ratings reaffirmation takes into account the favourable revenue and client diversification expected from the acquisition and the continued strong financial profile of Zensar characterised by healthy profitability indicators, recurring free cashflows, strong capitalisation and coverage indicators and adequate liquidity with cash and liquid investments to the tune of ~Rs.457 crore as of March 31, 2018. The acquisition of Cynosure has expanded Zensar’s addressable market and growth potential in the Insurance vertical lending diversification to Zensar’s business verticals and client profile. The revenue share of Insurance vertical is expected to increase from current 15% to 20% post integration of the acquisition. The acquisition which is partly debt funded, is expected to have minimal impact on the financial profile of Zensar owing to its healthy cash accruals. The ratings also draw comfort from the past track record of successful integration of acquisition including recent acquisitions Foolproof Inc (Nov 2017) and Keystone Logic (April 2018).

The ratings also take into account the concentration risk arising out of moderately high revenue coming from a single client though the same is expected to reduce going forward. The profitability remains susceptible to pricing pressures, wage inflation, adverse foreign exchange fluctuations and general slowdown in business across USA and Europe because of a sluggish growth outlook for such markets.

In the future, Zensar intends to grow its revenues organically as well as inorganically. While increasing the scale and size of operations, a leveraged funding structure for future acquisitions could materially impact the financial risk profile for the company. Further, a large cross-border acquisition would entail careful integration of operations to realize likely synergies.

Outlook: Stable

ICRA believes Zensar Technologies Limited will continue to benefit from its strong clientele and expanding footprint in the digital solutions. The outlook may be revised to Positive if there is substantial improvement in revenue growth and profitability indicators. The outlook may be revised to Negative if there are any major large size debt-funded acquisitions, weakening the capital structure and liquidity profile.

Key rating drivers

Credit strengths

Increased revenue visibility due to company's expanding footprint in the digital solutions space and other verticals – Zensar has been expanding its offerings in the digital solutions space since FY2014 with the acquisition of PA access. From the period onwards, revenues from this segment have grown from 5% to 30% of revenues in FY2017. Zensar acquired two companies—Foolproof Limited (expert in user/customer experience) and Keystone Logic (expert in Omni-channel fulfillment and supply chain management) in FY2018 to expand its footprint in the digital space. After successful integration of these companies, Zensar has now acquired Cynosure Inc, a licensed partner of Guidewire Software Inc, to expand its footprint in the fast growing Insurance segment.

Diversified presence across service lines and end-user industries - 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; and infrastructure management services. Further, its clientele is distributed across retail, manufacturing, telecom, consumer services, and banking and financial services, resulting in sectoral diversification.

Healthy margins and RoCE with recurring free cash flows and strong financial profile due to lack of capital intensive nature of business – By virtue of its nature of business, which involves low investments in capital assets, the necessity for debt funding has been lower for Zensar. The company has a strong presence in the regions it operates in and commands an operating margin of 11.7% and net margins of 7.9% in FY2018. Zensar has generated healthy free cash flows every year due to stable profit margins and acquisitions, largely funded out of large cash balances and internal accruals.

Part of a large, established and diversified group – Zensar is part of the ~Rs. 179 billion (FY2017) diversified RPG Group with a presence in infrastructure, tyres, technology and pharmaceuticals. Zensar benefits from the strong management pedigree of the Group.

Credit weaknesses

Weak demand outlook for IT services, intense competition from established Indian and foreign-based IT services providers – In FY2018, Zensar's reported revenue growth of ~2% due to the company's efforts to scale down its multi-vendor services business (part of IMS) in addition to overall slowdown in the IT Services Outsourcing segment. The multi-vendor services business provides Annual Maintenance Contracts (AMC) for various IT hardware installations at the clients premise. The Global IT services segment is expected to grow in mid to high single digits FY2018-2020 CAGR over the next few years, coupled with increasing competition from existing incumbents, which may hamper future growth and profitability.

Moderate scale of operations with high dependence on single client; supported to a large extent by the strong and long track relationship – With revenues of around Rs. 3,000 crore (FY2018), Zensar is a mid-sized IT services company in the US$ 152 billion Indian IT Services industry (source: Nasscom). The company derives ~25% of its revenues from its largest client, exposing it to client concentration risks. However, this risk is partially mitigated by its strong and long-standing relationship and growing wallet share of business with the client.

Margins vulnerable to pricing pressures, wage inflation and foreign exchange fluctuations – Given the stiff competition in the industry, the company's profit margins are susceptible to pricing pressures and wage inflation. Further, with majority of revenues coming internationally, the company's revenues and margins are exposed to forex risks, although hedging mechanisms employed by the company partially mitigate the same. Being in a highly labour intensive business, availability of skilled work force and retention of such work force remains a key challenge.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Information Technology (Services) Industry

About the company:

Zensar Technologies Limited (ZTL) is among top 15 software service providers in India (Source: Nasscom, Company). Based out of Pune, it was initially a joint venture between RPG Enterprises and Fujitsu and started functioning with its present organisational structure in 2001. ZTL employs ~8000 people and is present in 140+ countries providing IT/ ITES solutions with many fortune 500 companies as its clients. It has 14+ global delivery centres servicing over 290+ Global customers.

In FY2018, the company reported a net profit of Rs.246.5 crore on an operating income of Rs. 3,107.5 crore, as compared to a net profit of Rs. 238.4 crore on an operating income of Rs. 3055.6 crore in the previous year.

Key Financial Indicators (Audited)

	FY 2017	FY 2018
Operating Income (Rs. crore)	3055.6	3107.5
PAT (Rs. crore)	238.4	246.5
OPBDIT/ OI (%)	12.5%	11.7%
RoCE (%)	23.6%	22.7%
Total Debt/ TNW (times)	0.1	0.0
Total Debt/ OPBDIT (times)	0.3	0.0
Interest coverage (times)	43.6	16.1
NWC/ OI (%)	18.7%	21.9%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating May 2018	Chronology of Rating History for the past 3 years: Date & Rating in FY2018 Mar 2018	Date & Rating in FY2017 Sep 2016	Date & Rating in FY2016 Aug 15
Fund based facilities	Long/short Term	140.00	NA	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA+&/ [ICRA]A1+&	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+

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/short-term fund based facilities	NA	NA	-	140.00	[ICRA]AA+(Stable)/[ICRA]A1+

Source: Zensar Technologies Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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