

## Zensar Technologies Limited

January 25, 2019

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/short-term - fund-based	140.00	-	-
Long-term/short-term - fund-based/non-fund based	-	191.00	[ICRA]AA+(Stable)/[ICRA]A1+; reaffirmed
<b>Total</b>	<b>140.00</b>	<b>191.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The reaffirmed ratings derive comfort from the healthy cash accruals of Zensar Technologies Limited (ZTL) and its recurring free cash flows, leading to a strong financial profile. The recent acquisitions have led to a build-up in debt (Rs. 366.05 crore as of September 2018), though the coverage indicators remain comfortable. The liquidity profile remains supported by significant cash and liquid investments aggregating to over Rs. 481.5 crore as of March 2018 and Rs. 450.3 crore as of September 2018. The ratings also take into account the broad client base, the diversified revenue base across geographies as well as the presence in multiple verticals, lending 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 38.1% as of March 2018 and 43.6% as of September 2018 from 27.0% in FY2016. With a healthy deal pipeline of ~\$800 million (total contract value) as of September 2018, growing digital presence, improvement in the infrastructure management services (IMS) vertical performance and successful integration of the acquisitions, the profitability is expected to improve from the current levels.

The ratings are constrained by the concentration risk arising out of the moderately high revenue (~25%) coming from one 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. The profitability remains susceptible to pricing pressures, wage inflation, adverse foreign exchange fluctuations and general stagnation in business across the US and Europe.

### Outlook: Stable

ICRA expects ZTL to continue to benefit from its strong clientele and expanding footprint in the digital services. The outlook may be revised to Positive if there is substantial growth in revenue and profitability. The outlook may be revised to 'Negative' if there are any major debt funded acquisitions, weakening the capital structure and return indicators

### Key rating drivers

#### Credit strengths

**Revenue visibility increases due to expanding footprint in digital solutions space** - ZTL's revenues from the digital segment grew from 5.0% in FY2014 to 38.1% as of March FY2018 and 43.6% as of September 2018. It acquired two companies, Foolproof Limited (expert in user/customer experience) and Keystone Logic (expert in Omni-channel fulfilment and supply chain management), in FY2017 and US-based Indigo Slate (Q2 FY2019) to expand its footprint in the digital space. The company also acquired Cynosure Inc., a licensed partner of Guidewire Software Inc., to increase its presence in the fast-growing property and casualty (P&C) insurance segment.

**Diversified presence across various service lines and verticals; improvement in IMS business to support margins** - 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 (IMS). In FY2018, the IMS division de-grew by 21% due to scaling down of the product and licenses business and the multi-vendor services (MVS). However, in H1 FY2019, the IMS division grew by 6% YoY, with an increased focus on cloud infrastructure, core infrastructure services, focused sales strategy and change in the senior management team. The company successfully won one of the largest deals in IMS with the City of San Diego and new deals with Fortune 500 companies. Further, its clientele is distributed across manufacturing (industrial and hi-tech), retail, and banking and financial services, resulting in sectoral diversification.

**Healthy margins and RoCE due to lack of capital intensive nature of business** - The necessity for debt funding has been low for ZTL as its nature of business involves low investments in capital assets. The company has a strong presence in the regions it operates and commanded operating margins of 11.7% (FY2018) and 12.8% (H1 FY2019) and net margins of 7.9% (FY2018) and 9.6% (H1 FY2019). Going forward, with the expected growth in revenues from digital services, the integration of acquisitions and the rationalisation of non-core verticals, the margins are expected to improve in FY2019.

**Part of a large, established and diversified Group** - ZTL is a part of the ~Rs. 235-billion (FY2018 revenues) diversified RPG Group with a presence in infrastructure, tyres, technology and pharmaceuticals. ZTL benefits from the strong management pedigree of the Group.

## Credit challenges

**Moderate scale of operations with high dependence on single client; supported by strong and established relationship** - With revenues of more than Rs. 3,000 crore (FY2018), ZTL is a mid-sized IT service company in the \$167-billion Indian IT industry<sup>1</sup>. The company derives 25% of its revenues from its largest 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 pricing pressures, wage inflation and forex fluctuations** - Given the intense competition in the industry, the company's profit margins are susceptible to pricing pressures and wage inflation. Further, majority of the revenues and margins are exposed to forex risks, although hedging mechanisms employed by the company mitigate the same to an extent. Being in a highly labour-intensive business, availability and retention of skilled workforce are the key challenges.

**Intense competition from established Indian and foreign-based IT service providers** - In FY2018, ZTL's revenue grew by 1.7% due to the company's efforts to scale down its MVS business (part of IMS). The company provides annual maintenance contracts (AMCs) for various IT hardware installations at the client's premise. The global IT service segment is expected to grow in high single digit over the medium term. Further, the increasing competition from the existing incumbents may hamper the company's future growth and profitability indicators.

## Liquidity position

The company's liquidity profile remains strong aided by healthy cash flow generation, surplus cash reserves and undrawn credit facilities from bank. Going forward, the free cash flows may be negatively impacted if the company continues its debt-funded acquisitions. The liquidity profile is supported by significant cash and liquid investments aggregating to over Rs. 481.5 crore as of March 2018 and Rs. 450.3 crore as of September 2018.

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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 December 31, 2018, the company had six subsidiaries and 15 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 in 2001. The company employs ~8,905 associates and enjoys a footprint across more than 12 countries, providing IT/ITeS solutions to many Fortune 500 companies. It has over 250 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 FY2019, the company reported a net profit of Rs. 178.9 crore on an operating income (OI) of Rs. 1,873.4 crore, compared to a net profit of Rs. 112.3 crore on an OI of Rs. 1,499.3 crore in H1 FY2018.

## Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	3,055.6	3,107.7
PAT (Rs. crore)	238.4	246.5
OPBDIT/OI (%)	12.50%	11.74%
RoCE (%)	23.60%	22.67%
Total Debt/TNW (times)	0.1	0.0
Total Debt/OPBDIT (times)	0.4	0.0
Interest Coverage (times)	43.5	16.1

## Status of non-cooperation with previous CRA: Not Applicable

## Any other information: None

### Rating history for last three years

	Current Rating (FY2019)		Chronology of Rating History for the Past 3 Years						
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Jan 2019	Date & Rating May 2018	Date & Rating in FY2018 Mar 18	Date & Rating in FY2017 Sept 16	Date & Rating in FY2016 Aug 15
1	Fund-based/non-fund based	Long term/short term	191.00	191.00	[ICRA]AA+ (Stable)/[ICRA]A1+; reaffirmed	-	-	-	-
2	Fund-based	Long term/short term	-	-	-	[ICRA]AA+ (Stable)/[ICRA]A1+	[ICRA]AA+&/[ICRA]A1+&	[ICRA]AA+ (Stable/A1+)	[ICRA]AA (Stable)/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](http://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	191.00	[ICRA]AA+(Stable)/ [ICRA]A1+

Source: Company

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

Company Name	Ownership	Consolidation Approach
Zensar Technologies Inc., USA	100%	Full Consolidation
Professional Access Limited, USA	100%	Full Consolidation
PSI Holding Group Inc., USA	100%	Full Consolidation
Zensar Technologies IM Inc., USA (erstwhile Akibia Inc.)	100%	Full Consolidation
Zensar Technologies IM B.V., Netherlands (erstwhile Akibia B. V.)	100%	Full Consolidation
Aquila Technology Corp., USA	100%	Full Consolidation
Zensar Technologies (Shanghai) Co. Ltd, China	100%	Full Consolidation
Zensar Info Technologies (Singapore) Pte. Ltd., Singapore	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, Singapore.	100%	Full Consolidation
Keystone Logic Inc., USA	100%	Full Consolidation
Zensar Information Technologies Ltd., India	100%	Full Consolidation
Zensar Software Technologies Ltd., India	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
Indigo Slate Inc. USA	100%	Full Consolidation

Source: Company

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