

**RESULT UPDATE**

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**ZENSAR TECHNOLOGIES LTD**

**PRICE : Rs.302**  
**TARGET PRICE : Rs.347**

**RECOMMENDATION : BUY**  
**FY08E PE : 9x**

**Highlights**

- Better-than-expected results, organic revenue growth at 10% QoQ, EBIDTA margins improve by about 170 bps.
- Deeper penetration in existing relationships, leveraging on ThoughtDigital (TD) acquisition, increased focus on annuity business and new potential accounts among first-time outsourcers to spur growth.
- Higher proportion of value-added services, improved profitability in the BPO business and scale benefits expected to help sustain margins.
- Upbeat revenue guidance at Rs.8.5 bn for FY08, likely to be achievable, in our view. PAT guidance at Rs.850 mn, aggressive, in our view.
- We expect Zensar to achieve an EPS of Rs.33 in FY08. We have been positive on the prospects of Zensar and maintain a **BUY** with a DCF-based revised price target of Rs.347, a 15% upside from current levels.
- An accelerated slowdown/recession in major user economies and a sharper-than-expected appreciation in the rupee v/s major currencies are pronounced risks for a smaller player like Zensar.

**We maintain BUY on Zensar with a price target of Rs.347**

**Q4FY07 results**

(Rs mn)	Q4FY07 *	Q3FY07	% QoQ	Q4FY06	% YoY
<b>Income</b>	<b>1713.6</b>	<b>1480.0</b>	<b>15.8</b>	<b>1252.3</b>	<b>36.8</b>
Expenditure	1470.2	1294.9		1034.5	
<b>EBIDTA</b>	<b>243.4</b>	<b>185.1</b>	<b>31.5</b>	<b>217.8</b>	<b>11.7</b>
Depreciation	40.7	38.6		40.4	
<b>EBIT</b>	<b>202.7</b>	<b>146.5</b>	<b>38.4</b>	<b>177.4</b>	<b>14.3</b>
Interest	9.2	3.2		4.2	
Other inc	37.7	17.2		13.3	
<b>PBT</b>	<b>231.2</b>	<b>160.5</b>	<b>44.1</b>	<b>186.5</b>	<b>24.0</b>
Tax	51.3	29.5		5.2	
Minority Interest	5.8	-1.2		-4.1	
<b>PAT</b>	<b>174.1</b>	<b>132.2</b>	<b>31.7</b>	<b>185.4</b>	<b>-6.1</b>
E.O items	-2.0	0.0		-13.4	
Shares (mn)	23.6	23.6		23.4	
EPS (Rs)	7.4	5.6		7.9	
<b>Margins (%)</b>					
Operating Profit	14.2	12.5		17.4	
Gross Profit	11.8	9.9		14.2	
Net Profit	10.2	8.9		14.8	

Source: Company \* - ThoughtDigital financials consolidated WEF 23/2/07

**Revenues on the rise**

- Revenues during the quarter grew about 16% on a sequential basis. TD financials were merged wef 23/2/07.
- TD contributed Rs.80 mn to the quarter's revenues (for a period of five weeks). Excluding TD, organic revenues grew about 10%, which is higher than several peers.
- The revenues grew on the back of higher volumes, even as realizations remained almost flat and the rupee impacted revenues to the extent of about 1.75%.
- Revenues from Cisco, the top client of Zensar, grew faster than overall revenues as some new projects started in Q4FY07.

- In Q3FY07, revenues had suffered from the lower number of working days in the US and due to the completion of a few projects from Cisco.
- In the BPO business, revenues were sequentially up 10% to Rs.65 mn. The company is now offering integrated IT-BPO services to clients.
- Also, Zensar has focused on the transaction processing business, which de-focused on the low-margin outbound voice business.
- The re-organization is almost complete and the business earned EBIDTA margins of 25% during the quarter, though these high levels may not be sustainable, in our view.
- During the quarter, the company added 54 new clients (including the TD acquisition) to take the total number of active clients to 236. The key wins have been in the areas of EAS, BI and Data Warehousing.

### SBP and Global Delivery Platform (GDP) gain acceptance

- In the non-enterprise application services (EAS) business, Zensar is finding increasing acceptance for its global delivery platform model. Initially, in SBP, the designing work was done in Pune.
- In GDP, the company does the project design work at any of the near-shore locations along with the client's staff. The development work is done at any of the remote locations with the help of SBP. SBP reduces the requirements of engineers as most of the work is automated. Zensar is also able to utilize the services of functional experts spread across the world who are not necessarily its own employees. The project testing work is done on-site.
- This allows the company to scale up its business without undue pressure of recruiting its own employees.
- Zensar's center in Poland has been inaugurated and 20 employees are undergoing training. Post this, they will be posted in Poland.

### EBIDTA margins

- EBDITA margins during the quarter improved about 170 bps despite the 1.7% rupee appreciation.
- The company was able to improve margins due to higher capacity utilization. Employees who were on training last quarter turned billable in Q4FY07.

### Future prospects

(Rs mn)	FY06	FY07*	% YoY	FY08E	% YoY
<b>Income</b>	<b>4288.5</b>	<b>6058.6</b>	<b>41.3</b>	<b>8584.2</b>	<b>41.7</b>
Expenditure	3746.8	5245.2		7418.9	
<b>EBDITA</b>	<b>541.7</b>	<b>813.4</b>	<b>50.2</b>	<b>1165.2</b>	<b>43.3</b>
Depreciation	154.7	152.6		209.0	
<b>EBIT</b>	<b>387.0</b>	<b>660.8</b>	<b>70.8</b>	<b>956.2</b>	<b>44.7</b>
Interest	16.1	21.0		57.2	
Other inc	46.3	104.8		86.0	
<b>PBT</b>	<b>417.2</b>	<b>744.6</b>	<b>78.5</b>	<b>985.0</b>	<b>32.3</b>
Tax	54.6	166.1		197.0	
Minority Interest	-4.8	4.5		4.0	
<b>PAT</b>	<b>367.4</b>	<b>574.0</b>	<b>56.2</b>	<b>784.0</b>	<b>36.6</b>
E.O items	-27.5	-2.0		0.0	
Shares (mn)	23.4	23.6		23.6	
<b>EPS (Rs.)</b>	<b>15.7</b>	<b>24.3</b>		<b>33.2</b>	
<b>Margins (%)</b>					
EBDITA	12.6	13.4		13.6	
EBIT	9.0	10.9		11.1	
Net Profit	8.6	9.5		9.1	

Source: Company, Kotak Securities - Private Client Research \* - Including Thought Digital's financials wef 23/2/07

- We have made changes to our FY08 estimates to accommodate the Q4FY07 results and also our changed assumption of the exchange rate.
- We now assume the average rupee-US dollar exchange rate at Rs.43 per US dollar for FY08.
- We expect Zensar to achieve revenues of Rs.8.58 bn in FY08. BPO revenues are expected to rise to Rs.294 mn in FY08 as against Rs.241 mn in FY07.
- EBIDTA margins are expected to improve marginally due to higher offshore revenues (TD clients expected to be serviced from offshore locations), higher revenues from value-added services and improving profitability in the BPO business.
- We have assumed a capex of Rs.500 mn in FY08. With the company having currency hedges of about \$8 mn currently and also having paid cash for the TD acquisition, we expect the other income component to be lower.
- Zensar has borrowed about \$15 mn through ECBs at about Libor + 1%. This is expected to increase the interest outgo for Zensar.
- Consequently, PAT is expected to grow to Rs.784 mn in FY08, leading to earnings of Rs.33 per share.

### Concerns

- The rupee has appreciated to Rs.41 v/s the US dollar. This is higher than our assumed levels of about Rs.43 per US dollar in FY08. While we expect the rupee to stabilize at about Rs.43 per US dollar for FY08, a sharp acceleration from the current levels may impact our earnings estimates for the company.
- A steep deceleration in major global economies could impact revenue growth of Indian vendors.