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TECHNOLOGIES**

| IT Services

| 23 October 2024

## Unseasonal furloughs in TMT clients impacts revenue growth

- **Weak QoQ growth due to client specific issues in TMT vertical whereas BFSI and HLS show good traction.**
- **Weaker Gross margin QoQ set off by lower SGA. Reiterates mid-teen EBITDA margin guidance.**
- **TCV clocked is the highest ever. And more of it is in the managed services type of work. Will be reinitiating coverage soon.**

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**Unseasonal furloughs impact revenue:** The weak revenue growth of 0.3% in QoQ CC terms (against our estimate of 3% growth) was impacted by TMT vertical (~22% of revenue) declining by 8.8% due to unseasonal furloughs seen in 2-3 large clients. BFSI (~41%) grew by 3%, Manufacturing & consumer services (~26%) grew by 1.6% and healthcare & life sciences (~11%) grew by 8.6%. It was the seventh successive quarter of BFSI growth.

**Margin walk:** Lower SGA spending offset weaker than expected gross margin performance (Figure 1) Gross margin was down 230 bps QoQ, primarily due to 170bps from wage hikes, 110bps from lower utilization related to furloughs, and a 60bps from a prior R&D credit. This was partially offset by 70bps from currency and 40bps from operational efficiencies, including improved offshore mix. The gross margin drop was offset by SG&A reduction of 240bps QoQ, primarily due to provision for doubtful debts from a customer in the previous quarter which did not recur, reduced ESOP charges, and other savings.

**Highest TCV clocked:** US\$201mn (up 3.6% YoY and 31% QoQ) was the stronger order inflow in its history

**3Q should see weaker furlough impact compared to the past:** While there are going to be more broad-based furloughs in 3Q, the impact is expected to be weaker due to the peculiar situation faced in 2Q by the company.

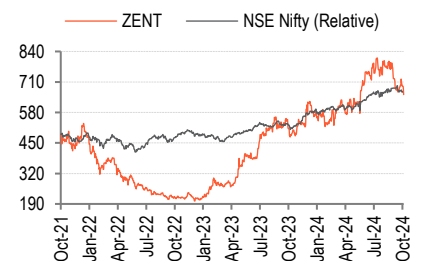
**The strategy is to grow the non-TMT verticals:** The TMT clients (legacy technology companies) are facing growth challenges, and the outlook remains uncertain, as clients themselves are unsure if they have reached the bottom of the current challenges. The strategy is to drive growth in other verticals and reduce exposure of TMT over the next 2-3 years.

**Greater shift to offshore due to more managed services work being taken on:** Offshore revenue has moved from 40% to 50% of total because of this.

Ticker/Price	ZENT IN/Rs 656
Market cap	US\$ 1.8bn
Free float	50%
3M ADV	US\$ 8.0mn
52wk high/low	Rs 840/Rs 456
Promoter/FPI/DII	49%/15%/19%

Source: NSE | Price as of 22 Oct 2024

## Stock performance



Source: NSE



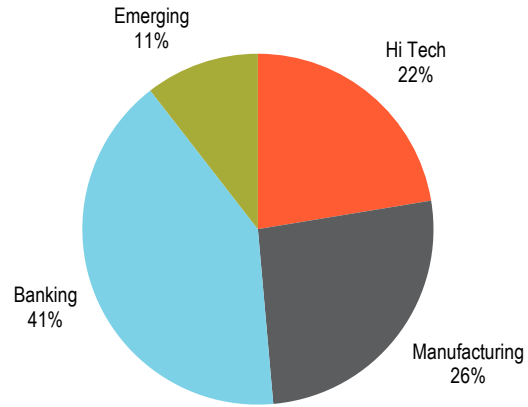
- The healthcare & life sciences vertical experienced substantial growth partly due to S4 Hana SAP implementation. Bridgeview (acquired entity in HLS) revenues in 2Q were not significant. The annual revenue from Bridgeview is US\$12mn-US\$13mn,
- The expectation for deal flow entering the second half of FY25 is positive, with the belief that performance from 2Q to 3Q in FY25 will exceed that of FY24. The target range for the book-to-bill ratio remains between 1.0 to 1.2 times quarterly revenue
- There has been no observed material change in discretionary spending patterns within the BFSI sector for the company's customer base. Growth within the BFSI sector is primarily driven by the payments and packages segments rather than insurance.

**Fig 1 – Quarterly results: Comparison of actuals with estimates**

Y/E March (Rs mn)	2QFY24	1QFY25	2QFY25	YoY (%)	QoQ (%)	2QFY25E	Deviation (%)
Net Sales (US\$ mn)	150.2	154.4	156.2	4.0	1.1	159.7	(2.2)
<b>Net Sales</b>	<b>12,408</b>	<b>12,881</b>	<b>13,080</b>	<b>5.4</b>	<b>1.5</b>	<b>13,383</b>	<b>(2.3)</b>
Direct Cost	8,463	8,968	9,406	11.1	4.9	9,283	1.3
<b>Gross Profit</b>	<b>3,945</b>	<b>3,913</b>	<b>3,674</b>	<b>(6.9)</b>	<b>(6.1)</b>	<b>4,100</b>	<b>(10.4)</b>
<b>% of Sales</b>	<b>31.8</b>	<b>30.4</b>	<b>28.1</b>	<b>-</b>	<b>-</b>	<b>30.6</b>	<b>-</b>
SG&A	1,637	1,952	1,663	1.6	(14.8)	2,030	(18.1)
% of Sales	13.2	15.2	12.7	-	-	15.2	-
<b>EBITDA</b>	<b>2,308</b>	<b>1,961</b>	<b>2,011</b>	<b>(12.9)</b>	<b>2.5</b>	<b>2,070</b>	<b>(2.8)</b>
<b>EBITDA Margin (%)</b>	<b>18.6</b>	<b>15.2</b>	<b>15.4</b>	<b>-</b>	<b>-</b>	<b>15.5</b>	<b>(0.6)</b>
Depreciation	366	247	297	(18.9)	20.3	258	15.1
<b>EBIT</b>	<b>1,942</b>	<b>1,714</b>	<b>1,714</b>	<b>(11.7)</b>	<b>0.0</b>	<b>1,812</b>	<b>(5.4)</b>
<b>EBIT Margin (%)</b>	<b>15.7</b>	<b>13.3</b>	<b>13.1</b>	<b>-</b>	<b>-</b>	<b>13.5</b>	<b>-</b>
Finance Costs	57	42	45	(21.1)	6.7	42	6.7
Other Income (net)	363	424	411	13.2	(3.2)	404	1.8
Profit Before Tax	2,248	2,097	2,080	(7.5)	(0.8)	2,173	(4.3)
Provision for Taxation - Current & Deferred	510	518	522	2.4	0.8	537	(2.8)
Effective Tax Rate (%)	22.7	24.7	25.1	-	-	24.7	-
Net Profit	1,738	1,579	1,558	(10.4)	(1.3)	1,636	(4.8)
Minority Share of Net Profit	-	-	-	-	-	-	-
<b>PAT attributable to equity shareholders after Minority Interest</b>	<b>1,738</b>	<b>1,579</b>	<b>1,558</b>	<b>(10.4)</b>	<b>(1.3)</b>	<b>1,636</b>	<b>(4.8)</b>
<b>NPM (%)</b>	<b>14.0</b>	<b>12.3</b>	<b>11.9</b>	<b>-</b>	<b>-</b>	<b>12.2</b>	<b>-</b>

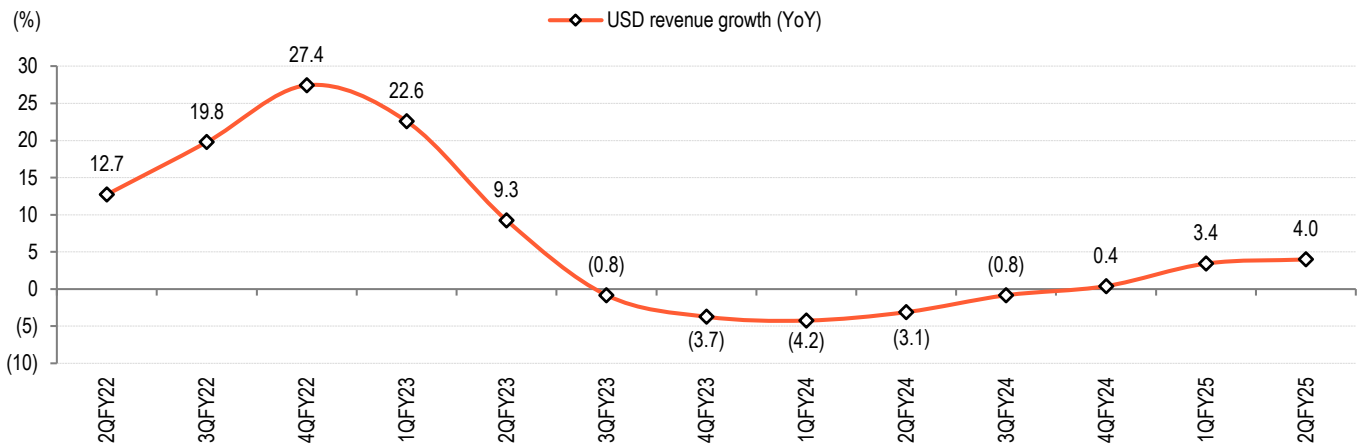
Source: Company, BOBCAPS Research

**Fig 2 – Vertical mix for 2QFY25**



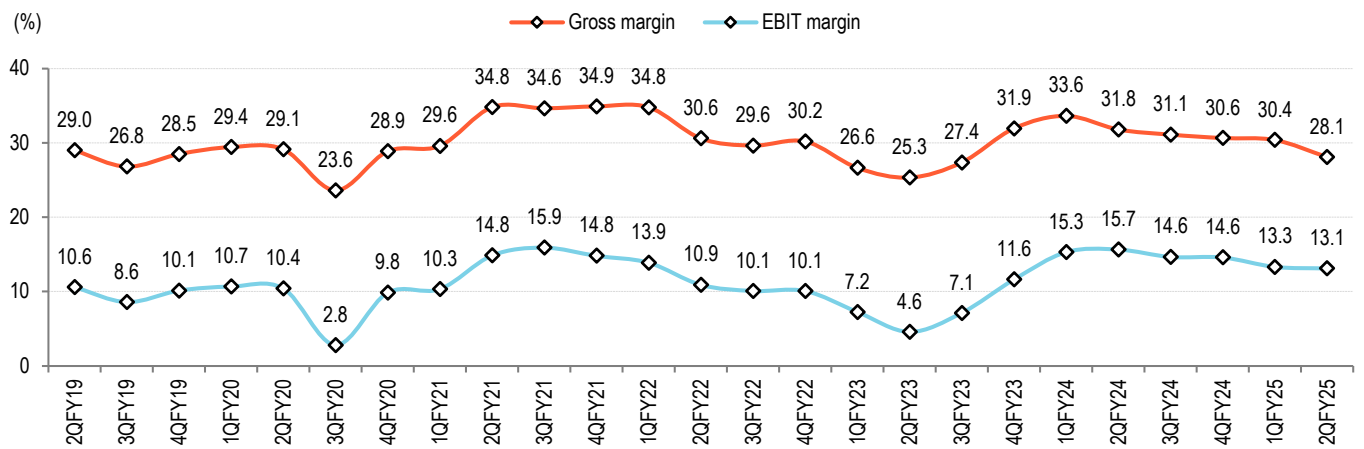
Source: Company, BOBCAPS Research

**Fig 3 – USD Revenue growth (YoY)**



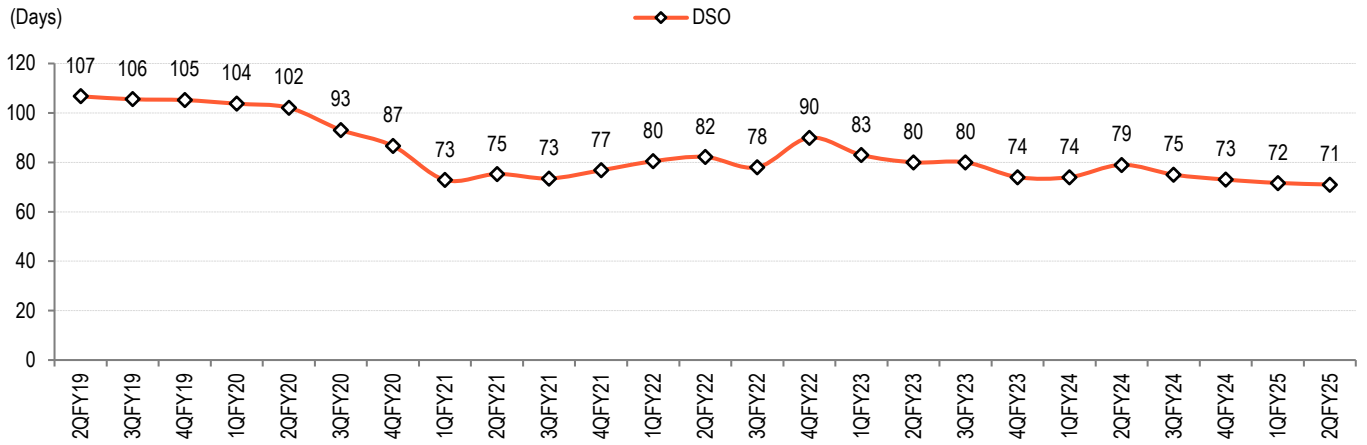
Source: Company, BOBCAPS Research

**Fig 4 – Gross Margin and EBIT Margin**



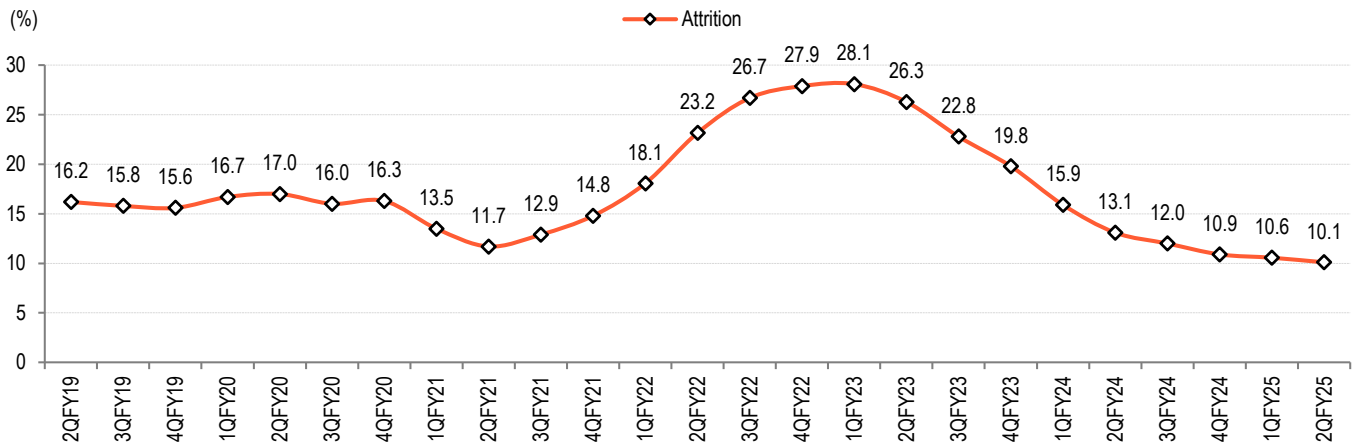
Source: Company, BOBCAPS Research

**Fig 5 – DSO**



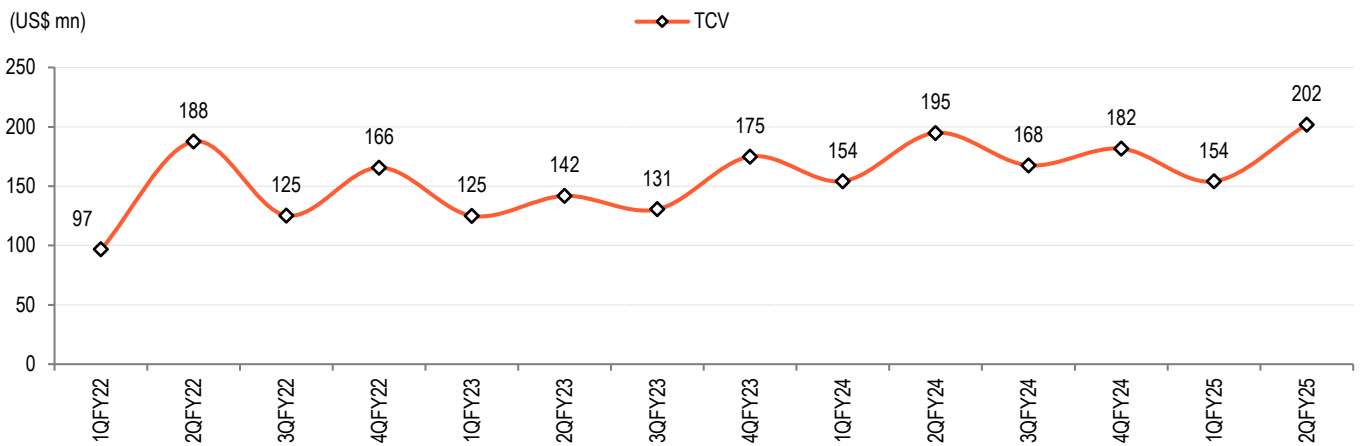
Source: Company, BOBCAPS Research

**Fig 6 – Attrition trend**



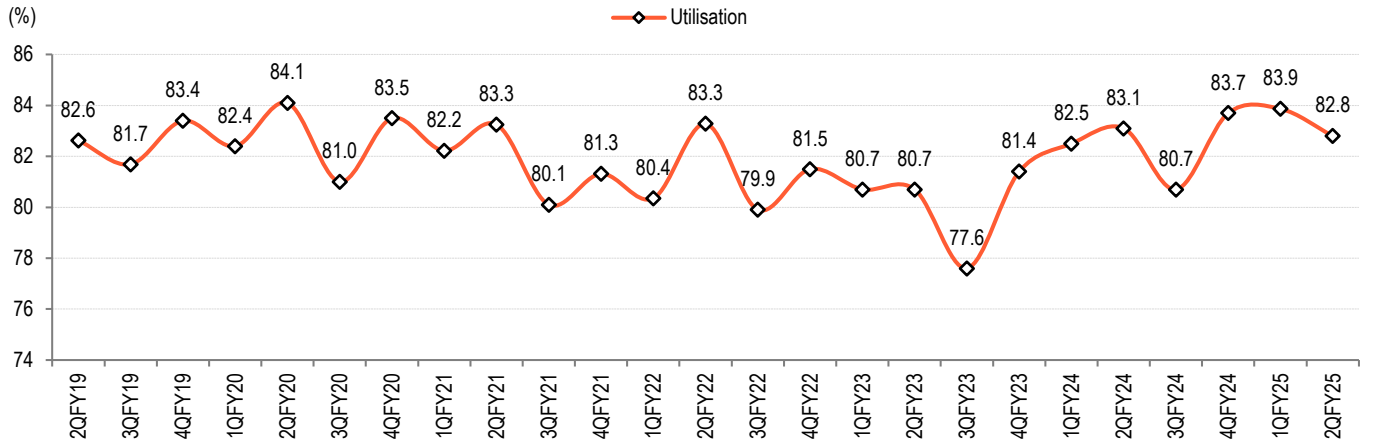
Source: Company, BOBCAPS Research

**Fig 7 – TCV**



Source: Company, BOBCAPS Research

**Fig 8 – Utilization (%) – excluding trainees**



Source: Company, BOBCAPS Research

**Fig 9 – Quarterly Snapshot**

Year to 31 March	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
INR/US%	77.19	79.65	82.08	82.22	82.20	82.61	83.21	83.03	83.40	83.70
Revenue (in US\$ mn)	156	155	146	148	149	150	145	148	154	156
<b>(Rs mn)</b>										
Revenue	12,034	12,346	11,976	12,127	12,272	12,408	12,041	12,297	12,881	13,080
Gross margin	3,205	3,128	3,277	3,873	4,126	3,945	3,745	3,768	3,913	3,674
SGA	1,844	2,074	1,928	2,114	1,825	1,637	1,669	1,738	1,952	1,663
EBITDA	1,361	1,054	1,349	1,759	2,301	2,308	2,076	2,030	1,961	2,011
Depreciation and Amortisation	490	492	497	351	423	366	312	237	247	297
EBIT	871	562	852	1,408	1,878	1,942	1,764	1,793	1,714	1,714
Forex gain/loss	98	159	71	58	5	-	60	(60)	(19)	(181)
Other income	115	125	188	214	279	363	360	581	444	592
Interest	64	75	76	63	60	57	64	28	42	45
PBT	1,020	771	1,035	1,617	2,102	2,248	2,120	2,286	2,097	2,080
Tax	269	203	270	424	540	510	504	553	518	522
PAT	751	568	765	1,193	1,562	1,738	1,616	1,733	1,579	1,558
EPS	3.32	2.51	3.38	5.27	6.90	7.67	7.13	7.65	6.96	6.88
<b>YoY Growth (%)</b>										
US\$ Revenue	22.6	9.3	(0.8)	(3.7)	(4.2)	(3.1)	(0.8)	0.4	3.4	4.0
INR Revenues	28.5	17.5	8.6	5.1	2.0	0.5	0.5	1.4	5.0	5.4
Gross profit	(1.6)	(2.7)	0.3	11.2	28.7	26.1	14.3	(2.7)	(5.2)	(6.9)
EBIT	(33.0)	(50.9)	(23.2)	21.3	115.6	245.6	107.0	27.3	(8.7)	(11.7)
Net profit	(25.7)	(39.8)	(15.8)	(8.0)	108.0	206.0	111.2	45.3	1.1	(10.4)
<b>QoQ Growth (%)</b>										
US\$ Revenues	1.8	(0.6)	(5.9)	1.1	1.2	0.6	(3.7)	2.35	4.28	1.1
INR Revenues	4.3	2.6	(3.0)	1.3	1.2	1.1	(3.0)	2.1	4.7	1.5
EBIT	(25.0)	(35.5)	51.6	65.3	33.4	3.4	(9.2)	1.6	(4.4)	0.0
Net profit	(42.1)	(24.4)	34.7	55.9	30.9	11.3	(7.0)	7.2	(8.9)	(1.3)
<b>Margins (%)</b>										
Gross margin	26.6	25.3	27.4	31.9	33.6	31.8	31.1	30.6	30.4	28.1
EBITDA	11.3	8.5	11.3	14.5	18.8	18.6	17.2	16.5	15.2	15.4
EBIT	7.2	4.6	7.1	11.6	15.3	15.7	14.6	14.6	13.3	13.1
PAT	6.2	4.6	6.4	9.8	12.7	14.0	13.4	14.1	12.3	11.9
SGA	15.3	16.8	16.1	17.4	14.9	13.2	13.9	14.1	15.2	12.7

Source: Company, BOBCAPS Research

**Fig 10 – Key Metrics**

Key Metrics	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
Revenue (US\$ mn)	156	155	146	148	149	150	145	148	154	156
<b>P and L (Rs mn)</b>										
Revenue	12,034	12,346	11,976	12,127	12,272	12,408	12,041	12,297	12,881	13,080
EBITDA	1,361	1,054	1,349	1,759	2,301	2,308	2,076	2,030	1,961	2,011
EBIT	871	562	852	1,408	1,878	1,942	1,764	1,793	1,714	1,714
PAT	751	568	765	1,193	1,562	1,738	1,616	1,733	1,579	1,558
<b>Vertical Mix (%)</b>										
Hi Tech	27.4	25.7	25.9	27.6	26.2	27.2	25.9	25.5	24.7	22.4
Manufacturing	13.2	12.4	12.2	12.7	12.4	25.9	26.1	26.3	25.8	26.2
Banking	16.7	17.5	18.4	16.1	17.7	37.3	38.6	38.7	39.7	40.9
Emerging	7.5	9.8	7.9	7.3	6.7	9.6	9.4	9.5	9.8	10.5
Retail and Consumer services	18.8	17.9	19.7	19.3	20.9	-	-	-	-	-
Insurance	16.5	16.7	15.8	17.0	16.1	-	-	-	-	-
<b>Geographical Mix (%)</b>										
US	70.9	71.6	70.0	70.3	69.4	66.1	66.0	67.2	68.7	67.6
Europe	18.1	17.4	18.7	18.1	19.2	21.6	21.4	20.8	19.8	21.1
Africa	11.0	11.0	11.3	11.6	11.4	12.3	12.5	12.0	11.5	11.3
<b>Service offering Mix (%)</b>										
Digital services	58.4	57.7	58.6	58.7	56.8	56.2	54.4	55.6	55.7	55.5
Core Application Services	23.7	22.3	22.0	23.9	24.9	25.6	27.0	25.9	26.0	24.3
Cloud, Digital Led next gen CIS	11.9	12.0	13.6	12.7	18.3	18.2	18.5	18.4	18.3	20.3
Core Infrastructure Services	5.9	8.0	5.7	4.7	-	-	-	-	-	-
<b>Revenue Mix (%)</b>										
Onsite	58.4	57.1	55.3	53.6	52.0	50.9	50.4	50.0	51.4	49.7
Offshore	41.6	42.9	44.7	46.4	48.0	49.1	49.6	50.0	48.6	50.3
IT Utilization (%) (excluding trainees)	80.7	80.7	77.6	81.4	82.5	83.1	80.7	83.7	83.9	82.8
<b>Clients Concentration (%)</b>										
Top 5 Clients	33.3	34.6	31.9	34.3	34.0	31.5	29.2	28.3	28.3	28.1
Top 10 Clients	45.2	45.5	44.7	46.1	45.2	42.2	40.6	40.8	42.1	42.0
Top 20 Clients	61.2	60.7	61.3	61.4	61.7	48.3	57.5	57.2	58.7	58.4
<b>Number of Clients</b>										
1 US\$ mn +	86.0	87.0	87.0	84.0	87.0	84.0	84.0	85.0	85.0	86.0
5 US\$ mn +	26.0	28.0	28.0	29.0	29.0	29.0	32.0	31.0	31.0	32.0
10 US\$ mn +	13.0	13.0	15.0	14.0	14.0	14.0	14.0	14.0	14.0	15.0
20 US\$ mn +	4.0	3.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Employees	11,559.0	11,250.0	10,845.0	10,563.0	10,540.0	10,330.0	10,225.0	10,349.0	10,396.0	10,240.0
TTM Attrition (%)	28.1	26.3	22.8	19.8	15.9	13.1	12.0	10.9	10.6	10.1

Source: Company, BOBCAPS Research



**Fig 11 – QoQ and YoY growth of various parameters**

	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	2QFY25
<b>QoQ Growth (%)</b>										
Company	1.8	(0.6)	(5.9)	1.1	1.2	0.6	(3.7)	2.3	4.3	1.1
<b>Service Offering</b>										
Digital services	(0.6)	(1.8)	(4.4)	1.3	(2.1)	(0.5)	(6.7)	4.6	4.4	0.8
Core Application Services	9.6	(6.5)	(7.1)	9.8	5.5	3.4	1.6	(1.8)	4.7	(5.5)
Cloud, Digital Led next gen CIS	(0.7)	0.3	6.7	(5.6)	45.9	0.1	(2.1)	1.8	3.7	12.2
Core Infrastructure Services	(1.6)	34.8	(32.9)	(16.6)	-	-	-	-	-	-
<b>Industry</b>										
Hi Tech	(23.4)	(6.7)	(5.1)	7.7	(3.9)	4.4	(8.3)	0.8	1.1	(8.4)
Manufacturing	41.4	(6.6)	(7.4)	5.2	(1.2)	110.1	(2.9)	3.1	2.3	2.7
Retail and Consumer services	18.8	(5.3)	3.6	(1.0)	9.6	-	-	-	-	-
Insurance	(5.1)	0.6	(10.9)	8.8	(4.1)	-	-	-	-	-
Banking	18.8	4.2	(1.0)	(11.5)	11.3	112.0	(0.3)	2.6	7.0	4.2
Emerging	29.4	29.9	(24.1)	(6.6)	(7.1)	44.1	(5.7)	3.4	7.1	8.9
<b>Geography</b>										
US	2.5	0.4	(8.0)	1.5	(0.1)	(4.2)	(3.8)	4.2	6.6	(0.5)
Europe	(3.1)	(4.4)	1.2	(2.1)	7.4	13.2	(4.6)	(0.5)	(0.7)	7.8
Africa	4.6	(0.6)	(3.3)	3.8	(0.5)	8.5	(2.1)	(1.7)	(0.2)	(0.5)
<b>Client Concentration</b>										
Top 5	1.8	3.3	(13.2)	8.7	0.3	(6.8)	(10.7)	(0.8)	4.4	0.3
Top 10	0.0	0.1	(7.5)	4.3	(0.8)	(6.1)	(7.3)	2.9	7.5	1.0
Top 20	0.4	(1.4)	(4.9)	1.3	1.7	(21.2)	14.7	1.8	7.0	0.6
<b>YoY Growth (%)</b>										
Company	22.6	9.3	(0.8)	(3.7)	(4.2)	(3.1)	(0.8)	0.4	3.4	4.0
<b>Service Offering</b>										
Digital services	23.6	2.5	(3.0)	(5.5)	(6.9)	(5.6)	(7.9)	(4.9)	1.4	2.7
Core Application Services	5.6	4.7	(3.0)	4.6	0.6	11.2	21.7	8.8	8.0	(1.3)
Cloud, Digital Led next gen CIS	44.8	36.0	15.3	0.2	47.3	47.0	34.9	45.5	3.4	16.0
Core Infrastructure Services	60.1	56.2	(5.8)	(25.8)	-	-	-	-	-	-
<b>Industry</b>										
Hi Tech	(19.9)	(28.1)	(30.0)	(27.0)	(8.4)	2.6	(0.8)	(7.2)	(2.4)	(14.4)
Manufacturing	43.6	25.6	24.7	28.7	(10.0)	102.4	112.2	107.9	115.3	5.2
Retail and Consumer services	58.6	27.1	21.4	15.4	6.5	-	-	-	-	-
Insurance	8.3	(2.9)	(11.0)	(7.5)	(6.6)	-	-	-	-	-
Banking	106.2	56.8	29.4	8.4	1.5	106.5	108.1	141.4	132.1	14.0
Emerging	150.4	180.4	35.1	19.1	(14.4)	(5.1)	18.0	30.7	50.6	13.7
<b>Geography</b>										
US	23.8	11.1	(2.1)	(3.9)	(6.3)	(10.5)	(6.5)	(4.0)	2.4	6.4
Europe	25.9	8.2	3.0	(8.3)	1.6	20.3	13.5	15.4	6.7	1.6
Africa	10.8	0.1	1.0	4.4	(0.8)	8.4	9.7	3.9	4.2	(4.5)
<b>Client Concentration</b>										
Top 5	6.3	8.1	(7.5)	(0.8)	(2.2)	(11.8)	(9.2)	(17.2)	(13.8)	(7.2)
Top 10	12.1	4.8	(5.7)	(3.5)	(4.2)	(10.1)	(9.9)	(11.1)	(3.7)	3.5
Top 20	17.8	7.2	(0.8)	(4.7)	(3.5)	(22.9)	(7.0)	(6.5)	(1.6)	25.7

Source: Company, BOBCAPS Research

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