



“Zensar Technologies Limited  
Q3 FY2019 Earnings Conference Call”

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**Management:**

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**Mr. Sanjay Rawa- Global Financial Controller - Zensar Technologies Limited**

**Moderator:** Ladies and gentlemen, good day and welcome to the Zensar Q3 FY2019 Earnings Call, hosted by Elara Securities. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “\*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sandeep Kishore – CEO and MD Zensar. Thank you and over to you!

**Sandeep Kishore:** Thank you. Hello, and good afternoon, everyone. Thank you for joining us on the Q3 fiscal 2019 analyst call. On the call today, I have with me from the Zensar management team, Ajay Bhandari, Head of our Strategy and Corp Dev; Navneet Khandelwal, our CFO; Vivek Ranjan, our CHRO; Harjott Atrii, Global Head of Cloud Infrastructure Business; and Sanjay Rawa, our Global Financial Controller.

I will provide you with a brief update on quarter three fiscal 2019, which will then be followed by an update on other financial metrics from Navneet, post which we will open the floor for questions.

I trust all of you have had a chance to go through the detailed Q3 FY2019 financial results and fact sheets that we released yesterday. Let me take this opportunity to present some key pointers.

In terms of topline, we had a very good Q3 fiscal 2019. On an overall basis, we delivered a sequential growth of 4% in dollar terms and 4.5% in constant currency.

Our revenue for core business had a solid sequential growth of 6% and 6.4% in dollar terms and constant currency, respectively. In quarter three fiscal 2019, our digital revenue accounted for 44.9% of overall business, a growth of 5.8% quarter-on-quarter and 35.9% Y-o-Y, primarily driven by our CX/UX front-end development capabilities and cloud infrastructure services together.

We continued our large deal momentum in quarter three by winning key deals across regions from key and existing clients. Multiple net new logos were also added during the quarter, some of which we publicly announced. We won deals of more than \$200 million in quarter three.

Our Application Services business continued a steady run this quarter. Digital and Application Services grew sequentially by 2.1% in constant currency terms on the back of our digital services revenue, which grew 5.9% sequentially.

Our Cloud infrastructure business continued its growth momentum by delivering a solid growth of 17.4% quarter-on-quarter on constant currency with Cloud, digital-led next-generation CIS increasing by 10.1% sequentially, while core infrastructure services grew by 55.6%.

Third-party maintenance, which is part of our noncore business, declined by 11.5% sequentially.

Regional growth was led by the US market, which is our largest market, followed by the UK. US grew by 6.6%, while UK grew by 5.7% on constant currency sequentially.

In terms of business sector, financial services grew sequentially by 9.6% and Hitech grew by 3.8%. Retail and consumer services grew sequentially by 1.1% in quarter three, all in constant currency.

In terms of our acquisition, all acquired companies have had a strong quarter, and they all continue to play a pivotal role in their respective areas while helping cross-sell core Zensar services as well.

Keystone had a very good quarter with a sequential growth of 10.5% and a Y-o-Y growth of 27%. Indigo Slate, the company we most recently acquired, had its first full quarter as part of Zensar. It grew by 59.2% sequentially.

Foolproof continues to do well and helps us differentiate in the European market. In terms of revenue, it grew by 16.4% on a Y-o-Y basis. Cynosure performed very well with an 18.8% sequential growth with some key wins in the P&C and Guidewire market.

Overall, Q3 fiscal 2019, GM and EBITDA, were adversely affected. Gross margin declined by 3.8% and EBITDA declined by 12.5% sequentially. Overall, EBITDA for quarter three was 10.9%.

Key factors for lower operating margins in quarter three, new deals execution and transition stage, normal Q3 furloughs, lower utilization and drop in noncore business margin.

Our core EBITDA stood at \$17.2 million, which is 12.7% of the core revenue. Our Q3 fiscal 2019 PAT was impacted on two main counts, forex losses and lower operating margins, as mentioned earlier.

Overall, pipeline remains very healthy and crossed \$1 billion mark for the first time in our company. The booking stood at \$500 million on YTD basis in the previous nine months of the fiscal.

As mentioned earlier, we continue to execute well on our strategy of expanding our business with identified top-tier clients with headroom to grow our business and also drive multi-services across application, digital and cloud infrastructure.

We have been successful in this across our regions with cross-sell and identified accounts increasing significantly. As a result, our top clients' revenue has been increasing steadily sequentially.

In Q3 fiscal 2019, revenue from top 5, 10 and 20 clients grew sequentially at 6.4%, 10.3% and 8.8%, respectively, while growing 26.6%, 29.4% and 26.0% on a year-on-year basis.

In quarter three fiscal 2019, we had 20 clients in the \$5-plus million category, up from 15 a year ago. We now have 7 clients in the \$10-plus million category compared to 6 a year ago. We have 100 clients in the \$1 million-plus category, up from 81 a year ago.

We continue our emphasis on digital and our business strategy pivots on our digital capabilities, solutions and services. Zensar Return on Digital continues to be an integral part of all \$10-plus

million wins so far and about 15% of our clients are benefiting from RoD platform. With the launch of RoD NeXT, New and Exponential Technology, we are seeing a lot of traction across our existing and new clients as we consolidate Zensar's leadership in digital space. RoD NeXT integrates new and exponential technologies by bringing together human experience, smarter platforms and artificial intelligence as key tenets.

Zensar continues to get included across reports this quarter by reputed industry analysts for our capability. In quarter three fiscal 2019, some of the notable mentions were: Zensar mentioned in Gartner for Tech CEO Research, Revitalize Application Management Services With Kanban; Zensar named as an Aspirant in Everest Blockchain Services PEAK Matrix Assessment; Zensar has been featured as a major contender in Digital Services - PEAK Matrix Assessment and Market Trends 2019: Design and Innovation to Power the Next Wave of Digital; Zensar mentioned as a disruptor in Intelligent Automation Services RadarView; Zensar mentioned as a challenger in Blockchain Services RadarView; Zensar mentioned in Global Software Testing Services Overview 2018; Zensar recognized as an innovator in Avasant's Hybrid Enterprise Cloud Services RadarView Report; Zensar featured in Novarica's Market Navigator Report: Business Intelligence Solutions for Insurers 2018; Zensar won People Matters L&D Award for Best in Future Tech Skill Building. Zensar was featured 100 Best Companies for Women in 2018 in a BCWI study.

Quarter three fiscal 2019 also saw us add more associates. At the close of the quarter, our global head count stood at 9813, a net increase of 331 and 1216 associates on a sequential and year-on-year basis, respectively. Our attrition rate stood at 16.6%, down 40 basis points from last quarter.

Let me also take quick opportunity to highlight a few key yearly trends that we have seen. In terms of revenue, we grew 17.1% in dollar terms. On constant currency, it was 17.6%. For our core business, the revenue increased by 21.2% and 23.2% in dollar terms and constant currency, respectively. Our gross margin increased by 4.3% while EBITDA declined by 5.6% in U.S. dollar terms on a year-on-year basis.

PAT declined by 15.9% year-on-year. Our digital revenue continued to follow great momentum and have had a stellar growth of 35.9%. YTD fiscal 2019, as I mentioned earlier, had a total booking which crossed \$0.5 billion in the first nine month.

On the deal front, we have had some significant wins in the last nine months as the demand environment looks good and more deals are being actively fought in cloud infrastructure, managed services and application and digital services. Cloud infrastructure business continues to improve both in revenues and order booked, driven by Vinci, with more than seven deals of \$10-plus million closed in the nine months of this fiscal. At Zensar, we continue to keep investing in business to ensure sustained growth.

Lastly, you may have seen the announcement a few hours ago. We have exited the ROW business. We have called that ROW as part of our noncore business and are happy to conclude this transaction. ROW constituted our India, Middle East and Australia business. We are committed to concentrate management focus, as been mentioning earlier, on our core business.

With that, let me call Navneet Khandelwal, our CFO, to provide update on key finance data, after which we will open the floor for questions. Navneet?

**Navneet Khandelwal:** Thank you, Sandeep. Good day, everyone. Welcome to this call. In addition to Sandeep talking about the business, I will take you through some of the details on financials.

We have reported revenue for the quarter at Rs.10355 million, which reflects a sequential growth of 6.9% in rupee terms. But in US dollar terms, the reported revenue is \$143.7 million, reflecting a growth of 4% sequentially.

The reported numbers include Rs.458 million or \$6.4 million of Indigo Slate against Rs.281 million or \$4 million reported last quarter. Revenue without Indigo Slate for the quarter in rupees terms is Rs.9987 million, reflecting a sequential growth of 5.2%. And in dollar terms, it is \$137.3 million, reflecting growth of 2.3%.

This quarter, the Board of Directors of the company declared an interim dividend of Re.1 per share. The US dollar realization during the quarter has been Rs.72.1 per dollar against Rs.70.1 in the previous quarter. The year before in the same quarter, it was Rs.64.7.

The gross margin for the quarter has declined by 218 basis points due to execution of new deals, which are in transition, normal Q3 furloughs, lower utilization and drop in noncore business margin. Also during this quarter, the company has US contingent consideration payable business combinations, consummated in previous years, amounting to GBP 1.7 million or Rs.1564 lakhs based on company's assessment being no longer payable. This reversal is accounted for under other income.

The effective tax rate for the quarter is at 27.8% as against 28.1% in the previous quarter. Billed DSO stood at 72 days against 67 days in the previous quarter, while DSO, including unbilled, stood at 106 days as against 107 days in Q2. The total amount of outstanding hedges as of December 31, 2018 was equivalent to \$98.9 million against \$110.9 million in the previous quarter.

As of end December, our cash-and-cash equivalent balance was \$67.7 million as against \$57.4 million at the end of last quarter. This year, we are expanding our footprints across India. We are developing centers across our pan-India locations and are adding around 1500 seats to bolster the company's growth plan.

As mentioned by Sandeep, we have signed a definitive agreement for sale of our ROW business to First Tek today. The ROW business has been nonstrategic to us but is core to the strategy of First Tek. As a part of this deal, we have divested our nongovernment business and are in the process of concluding most of our government business in the next few quarters. Our ROW business, still YTD Q3 FY2019, saw a decline by 29.2 percentage in revenue and generated a loss of \$1.28 million before tax.

With that, I come to the end of my presentation and open the house for questions and answers.

**Moderator:** Thank you. We will now begin the question and answer session. The first question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

**Mukul Garg:** Thanks for the opportunity. Sandeep, first, I wanted to understand the margin bit a little more in-depth. Can you help us understand the different moving parts within the subcontracting and furloughs, which you guys have mentioned in the release? Where was the surprise, which happened in both these cases, which impacted the margins by so much?

**Sandeep Kishore:** Sure, absolutely happy to give that detail and the color, Mukul. But before I get into the basis point between the Q2 and the Q3 drop, let me also state that the total booking that we have done, we have started executing several of those projects in the quarter. And when you execute large deals, there are multiple components of the large deals. Some of that are system integration, tools and software, which you have to deploy on these customers' program and project and then you start building the services model as well. So here are the details on the gross margin walk on the basis point, and Navneet can add a little more on them as well. We have a 50-basis point impact on furlough. We had a 41-basis point impact on ROW and MVS combined. We had a 50-basis point on lower utilization. And we have 93-basis point impact on transition, 34-basis point impact on the system integration tools, which comes initially with lower margins, and then when you deploy services, it adds up. And then we had a gain of 42-basis points on account of exchange. That is the walk of the gross margin between quarter two and quarter three.

**Mukul Garg:** Understood. And within this, and especially on the furlough side, was there something, which surprised during the quarter? Generally, Q3 furloughs are a recurring part of the industry. So was it something, which was probably more aggravated than historically it has been, especially with your largest client? Was there any impact from the US channel macro issues?

**Sandeep Kishore:** No. I do not think there were any surprises as such. I mean, if you have seen our business, it is almost half and half, it is more now towards managed services, less towards T&M. So, furloughs impact on the T&M counts predominantly, does not impact on the managed services count. When you start a lot of new programs and projects, which we have won, I mean, it is part of our strategy to fight and win larger deals. That is where we are pivoting our entire organization, which are relevant to our clients. So sometimes when you start the deal execution in the last month of the quarter, there is a little increased impact of furlough, which has happened here. But in the overall normal business, there was absolutely no surprise.

**Mukul Garg:** Understood. And as a follow-up to that, you mentioned you guys are winning a lot of deals. The TCV you were doing this quarter was also quite impressive. So given that deal momentum and associated transition costs, which usually occur, should we see the margin trajectory or the margin improvement trajectory a little bit more of a steep climb than what you are expecting earlier and build that into expectations?

**Sandeep Kishore:** Mukul, we have mentioned earlier, in the last quarter and the previous quarter that our core business-operating margin is at - in the range of about 15%. That did drop, as I have mentioned, to 12.7%. And we are quite committed to bring it back into the 15% range, and you will see that correction happening in the midterm pretty soon.

**Mukul Garg:** So, the new deal should not impact the margins going forward that much, the transition costs from that?

**Sandeep Kishore:** It should not.

**Mukul Garg:** Understood. And this other question, which I had, was on the growth impact of the deal TCV, which is there. You have done YTD about \$500 million. How should we see that impacting FY2020 growth rate? I am not asking for a guidance on FY2020, but if you take this \$500 million TCV which you have won, given that it is a long duration TCV, should we assume that in the first year, it will be about 10% of that will transition into revenue and there will be a gradual ramp-up? Or given that this is a transitioning from another vendor, they will be a steady state then within one or two quarters itself?

**Sandeep Kishore:** There are a couple of contours. First, obviously, we do not give any guidance. That is not the policy of the company. Second, if you connect the dot and look at the number of hiring that we have done, we have added 1200 net new additional headcount. You heard Navneet talk about capacity expansion that we are doing. Then I mentioned earlier about the demand environment, which is \$1 billion of pipeline or we won over \$500 million-worth of new deal. So, where I stand now, I feel actually pretty good that we are executing well, focusing on fewer customers. Our top 20 accounts now constitute over 60% of our business. It used to be 55%, 12 months ago. So, focus on high-growth account, bringing multiple services in, drive our cloud infrastructure businesses into top-tier accounts. That is part of our strategy. That is why we are winning. And different deals come with different contours. Some deals, we have publicly announced, but we do feel that, based on what I see, you will see steady growth going into fiscal 2020 and 2021. And we definitely want to be in the top end of the NASSCOM guidance for sure.

**Mukul Garg:** Sandeep, what I was trying to refer towards was generally when there are five to seven-year deal duration; you see a steady ramp-up as you go toward the second or third year. Is that something, which we should expect in these deals as well? Or should we expect a more stable revenue inflow during the deal duration?

**Sandeep Kishore:** I think you should expect the normal ramp-up into all of these deals. Some deals are seven-years, as it typically happens. Some are three-year deals. So, on an average of five years is a good assumption to base your model on.

**Mukul Garg:** I understand. I have the few other questions. I will get back into the queue and come back later. Thank you for answering.

**Moderator:** Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

**Nitin Padmanabhan:** Thanks for taking my questions. See, on the margin bit, so margins and revenues as well, so if I just look at the report, there is an incremental cost of \$4 million from purchase of traded goods, so the shift has been Rs.136 million to Rs.434 million. So I would presume that that \$4 million would also be, in some form, be an element of revenue as well. So in that context, if you look at it that

way, now, obviously, it looks like bulk of the growth is this. So just wanted some colour and thoughts from you on, one, the growth, is that the right way to look at the growth number in terms of that being contributed by the hardware and software? And two, when we roll and the margins that we see are it primarily being driven lower because of this large element that has gone up? And finally, if you will go into next quarter and if this is not going to recur, is there going to be a quick sort of rebase to the earlier margins instantly? So those were the three questions to start with, yes.

**Ajay Bhandari:**

Nitin, this is Ajay. Your observation is partially right. Yes, the increase in traded costs you are seeing is partially because of a slight rise in the production licenses that you just stated. In fact, Sandeep, in his commentary, when he mentioned that in some of the system integration projects that we have undertaken in some of them, there is an upfront investment and tools and software, which we have made, and that has increased the products and licenses revenue slightly. I would not say substantially, but slightly. I mean, last quarter it was around 1 million. This quarter, it is around 2-odd million. So it is not been a substantial part of the growth in revenue. The increase in traded costs is also because, as you are aware, while we exited the ROW business, we still have another non-core business, which is the MVS business. And in the MVS business, there are some elements, some part of the costs, also come as part of this traded cost. So, what you have seen there is some of the clean-ups we are doing in the MVS business to prepare for exit. So, the impact of the additional products that we purchased on the decline in revenue is actually very small as they are around 0.2% or so. So, it is not substantial at all. The dual play services revenue has been pretty good. We have had a decline in revenue in the noncore business. If you look at MVS and ROW that is declined fairly substantially almost by 2.1 million on a quarter-on-quarter basis. So that has declined. At the same time, our additional services in the core business that has gone up by around 2.5%. So, the quality of the revenue, that way is pretty healthy. From a gross margin standpoint, the bulk of the decline has been on account of two factors. First is the transition cost that Sandeep was mentioning earlier, is accounted for roughly a percentage of the decline. And the second element is the furloughs, which is the first question that was asked by Mukund on furloughs. That is accounted for slightly less than a percentage. And you would have seen the head count we have ramped up substantially to get into the steady state of some of the projects that we are transitioning and there has been a utilization impact of roughly 0.5%. So largely, these three factors have contributed to the decline in gross margin.

**Nitin Padmanabhan:**

Okay. And see, the other thing is, I think we had quite a few large deals in the earlier quarters. And if we look at the incremental revenue additions, appears that relative, for instance, the wins in Q1 that we announced, it appears that it has not really come through from a revenue perspective. Do you think that these should start ramping up going forward and thereby revenue attrition would be much better? And so that is one. And second is that from a margin perspective, do you think the reset will be the instantaneous in the next quarter or it is going to take some more time?

**Ajay Bhandari:**

Let me take your first question first about ramping up of revenue. I mean, if you look at the revenue in all the customer where we closed deal and if you see their quarterly trending, almost all of them have gradually increased quarter-on-quarter. So even the ones that we closed on quarter one have seen a quarter-on-quarter improvement right up to quarter three. I would say that almost all of them would have reached its steady-state revenue per year or steady-state ACV roughly between Q4 of



this year and Q1 of next year. So, they are all hitting the peak. I mean some of them are gradually ramping up towards peak ACV. Some of the transitions we are doing right now, which has impacted our margins this quarter, are hitting peak only in Q1, so you will see some transition costs, coming to us in the next quarter as well. But as far as whether this is steady state, furloughs, of course, you will see the immediate impact of that, and now ROW, because ROW on a year-to-date basis, it would be around 57% of ROW and the loss was minus 15%. And as we exited some of those businesses its impact may be less in Q4 but more than Q1 of next year, we will start seeing. But the transition impact, I think it really depends on the rate at which we are closing deals. So, if we continue to close larger deals, then in a way, as long as the net impact of transition is lower than this quarter, you will see margins going up. But if you continue to do well, then maybe a transition quarter kind of continues. So, I would say that furloughs, to a certain extent, utilization and the loss of ROW will help shore margins, but transition costs, depending upon how we win deals, I am at the moment not able to comment whether that will be a direct positive impact on the gross margin.

**Nitin Padmanabhan:** Sir, thank you. I will come back for followup. Thank you.

**Moderator:** Thank you. The next question is from the line of Madhu Babu from Centrum Broking. Please go ahead.

**Madhu Babu:** Just on two things. The onsite intensity has been increasing on a directional basis over the last four, five quarters. So that is one. And second, subcontracting expenses, those have also been an uptrend, if you see a five-six-quarter perspective. So just seeing the margins on a Y-o-Y basis, even on a Y-o-Y, the currency has fallen almost by 10%, but the margins, even on a Y-o-Y basis, are down by 200 basis points. How should we read that?

**Navneet Khandelwal:** Madhu, you are right. The onsite mix of the business has increased. The reason for that is also, if you were to look at on a Y-o-Y basis, we have made a couple of acquisitions, which have come with the high onsite content. Even on Q-on-Q basis, like Indigo Slate, which is 100% onsite business, was there for two months in the last quarter and it is there for three months in the current quarter. So that is one of the reasons why our onsite mix of revenues has increased. With respect to the subcontracting cost, there is a chunk of contracting cost, which has come as a result of the new deals that we have won and where initially it had started with rebadging, and which has contributed to higher number of subcontractors. As the deals get into more of steady state, this cost should gradually come down over a period of time. That is where it is. In terms of exchange, yes, the exchange movement has been significant, but as you rightly pointed out, since 70% or roughly 68% - 69% of revenue, being at onsite component, the impact, which flows onto the gross margin as a result of the exchange movement, is limited in our case and that is why you do not see a big uptick on the margins from an exchange perspective on a Y-o-Y basis.

**Madhu Babu:** So, what is the sensitivity, Sir? 1%-rupee depreciation, is it like 20 basis points positive for margin?

**Navneet Khandelwal:** No, it is not 20 basis points for us.

**Madhu Babu:** Overall at the portfolio level, company level?

- Sandeep Kishore:** It will be somewhere between say 0.1 to 0.15 at best. That is where it is ranging for us.
- Madhu Babu:** Okay. And the second, the hiring has been very strong. Of course, there were some acquisitions also, which added. But should we read this as an interpretation that next year, the momentum of the deals ramping up there should be seen as a good sign for good growth outlook for the next year?
- Sandeep Kishore:** This is Sandeep here. I mentioned this point as a response to an earlier question as well. Based on where we see today, this deal pipeline is very good. It is the highest we have seen. Our cloud infrastructure business, which was not doing well until about a year ago, we have completely revamped, and we are now focused and have started winning. So, we feel confident that both the hiring as well as all the facilities expansion that we are doing are effectively aligned to address the opportunities that we are seeing in the market. Now hiring is - 40% of the net hiring has been onsite. That number, if you remove the acquisition, would start to moderate down. As we go into the full fiscal 2020 and later years, you will start to see more hiring happening on a much more global basis than this year onsite - much more India basis than just onsite.
- Madhu Babu:** And the City of San Diego deal, that has ramped up, Sir, this quarter? Was there any high incremental from that?
- Sandeep Kishore:** Yes, it has ramped up fully. We have Harjott Atrii on the line with us. Harjott heads our cloud infrastructure business. Harjott, do you want to just give a business color, particularly on the San Diego account?
- Harjott Atrii:** Yes. Sure, Sandeep. Thanks. So, City of San Diego deal has ramped up and we have completed the transition successfully and we are in the steady-state mode. And we also started more expansion of revenue within City of San Diego as well.
- Madhu Babu:** Okay Sir. Thanks.
- Moderator:** Thank you. The next question is from the line of Ashish Chopra from Motilal Oswal Securities Limited.
- Ashish Chopra:** Thanks for the opportunity. I had a couple of questions. Firstly, on the margins again, if, Sandeep, you could just explain. I mean we understand that the ramp-up in some of these large deals put some sort of pressure on the margin in the initial stages. But given the kind of order book you have and given the kind of deal pipeline you have, so there would be some of these ramp-ups on an ongoing basis as well while the existing ones would ramp up fully by 1Q. So, would it be fair to assume that the margins in the core business will have some sort of an impact, at least in the current stage, considering that there will some of these large deals coming in? Or should we treat 3Q as a slightly abnormal quarter where there were multiple large deals that ramped up all at once, and hence, despite the ramp-ups, you could do - accord a better margin in the range of 15%?
- Sandeep Kishore:** Ashish, as I explained with the detailed walk on our BPS on the gross margin drop, it happened on all those accounts. And in transition, Ajay also mentioned, there is about 90 basis points. Utilization

because we ramped up to execute projects. As we talked about, we ramped up 1200 people on a year-on-year basis and utilization dropped by about 90 basis points sequentially. That had a 50-basis point impact. So those are the elements on the gross margin drop. From a business ramp-up perspective, let me add a few color just so that you get a context of what we are saying. All the deals that we have won, other than the Q3 deals and some of the Q2, which are still in transition, earlier deals have all ramped up quite well. If you take a look at our year-on-year revenue increase, we have added, of course, including acquisition, close to \$22 million on a quarter basis. That is over \$88 million, \$90 million on an annualized basis. It effectively adds up the revenue of all the deals. If you exclude the acquisition and compare it on a pure organic basis, there is about \$60 million, \$58 million of incremental revenue, which we have delivered on an annualized basis. That has all come from the wins which we announced until the middle of quarter two. From middle of quarter two to quarter three, the deals are still under execution and those transitions are happening. And we do believe sometime towards the end of quarter four, early quarter one, those deals will move into steady state. But transition is a fact of life. They keep coming. Our endeavor in the management and the leadership team in the company is to make sure that we smoothen this out. We do understand that Q3 had an unusual situation because it has furloughs, it had utilization drop and the transition came in as well. And our focus will be that we start to move deals faster into steady state and effectively aid the margin. Our other points had also been that even though we do not give any guidance on margin forecast or revenue forecast, however, we do want to operate in that 15% range of EBITDA. That is what we have been operating. We are now at 12.7%. And in medium term, we are going to get back to 15% range on EBITDA.

**Ashish Chopra:**

Got it. And just a second question that I had was on the retail vertical. So, I think that has been a segment that has been relatively soft for a few quarters now, because it is in some contrast to the fact that the growth in digital has been so strong. So, I just wanted to know, are we still sort of continuing to reel a little bit under the pressures from maybe online commerce or that agility kind of impact that we had earlier? And by when do we see the impact of this very robust digital performance also starting to rub off on retail on an overall basis in the segment?

**Ajay Bhandari:**

Ashish there are two things about retail. First is that I mean, if you looked at the entire omnichannel space, we were heavily weighted towards e-commerce and, to a certain extent, less weighted towards the order management supply chain side of that business. We are seeing a shift. The business trajectory is all completely inverted in the sense we are seeing a lot more business on the order management, warehouse management and supply chain side than on e-commerce. Now one interpretation of that is that most people have taken their decisions on commerce platforms and they are now shifting their spend and focus on making their supply chains more agile and that is why a bulk of the buying is happening there rather than on the redevelopment of their commerce sites. We have changed strategy a little there. So therefore, our go-to-market is now becoming a lot more order management or supply chain-oriented than commerce-oriented even though we are substantially also overhauled our commerce expertise. We used to be a package-dependent commerce structured, largely ATG. Now we are package-independent or platform-independent. And we continue to do work, whether it is in the Magento, hybris or custom developed site, which is visible these days, forms the bulk of the business. As far as retail growth itself is concerned, I mean, at the moment, we have used two or three vehicles to grow. One is we are continuing to use

order management to grow. Second is we do have a good set of accounts, and at the moment, the whole effort is to farm them and grow them. And the third is, as I have explained to some of you, we do have excellent capability in the commerce supply chain, omnichannel, warehouse management and order management space, and we are utilizing that experience even to build an alternate business in the retail product development space, where we will have decent amount of successes and can spin off our product engineering business as well. So those have been the strategies we have taken to revive the retail business. Retail decline has been arrested. This year, this quarter, retail did better than previous quarter even though marginally. And we believe, in the next quarter, retail will continue to do well. Though in terms of dramatic growth, this happened because of our commerce dependence earlier, I think we are still a couple of quarters away before we can go back to the kind of growth rates. But we do feel that retail will continue to grow from this point onwards.

**Ashish Chopra:** Got it. Thanks a lot.

**Moderator:** Thank you. The next question is from the line of Amit Chandra from HDFC Securities. Please go ahead.

**Amit Chandra:** Thanks for the opportunity. Sir, we are seeing like a pretty good acceleration in the dollar revenue growth and we are winning strong TCV numbers. But the margin drop that is there, it is reflecting that the deals that we are winning is at a lower margin, okay, or there is a drop on the pricing front. So is it the case that the deals that we are winning, mostly on the CIS side, are at the cost of margins or at a lower pricing because if you see the revenue per employee also, that is also not increasing despite increasing the digital component?

**Sandeep Kishore:** Amit, the short answer is no. We are not winning deals at the cost of margin. That is not the strategic focus of our company. The reason the margin dropped in this quarter, I explained with a step-by-step walk on account of all those aspects. Our complete objective and alignment, every deal that we find, of course, we need to be competitive, but there is no plan to win deal just on a lower margin. No, that is absolutely not the case. We have mentioned that our operating margin core business will get back to the 15% range in the midterm. As the deals starts to go into steady state, you will actually see the margin rise up. These are very complex deals that you win in cloud infrastructure services. They need a lot of tools implementation, software implementation, and the customers do not want to go to multiple vendors to supply multiple pieces of software and services. These are large SI projects. So you have a responsibility to work with technology companies and technology platforms like ServiceNow and like Cisco and like Palo Alto Networks and like AWS and Azure, and integrate it into the client environment. So when you do that, the first phase is always taking the tools and softwares and deploy it and then you integrate it and manage it and provision it and continuously monitor that environment. We won because we fought and it is part of our strategy. In the last four, five months, several of those deals have been won. There have all been currently under the execute phase. So the margin, we are pretty conscious of that and the margin will go right back up as you start to go into steady state.

**Amit Chandra:** Sir, so the transition impact that you mentioned is only for this quarter or as the deals that we have won in the current quarter also, these deals also go into the transition phase, then we will see that impact again in the coming quarters?

**Sandeep Kishore:** If you think of all the deals that we have won in towards the end of Q2 and Q3, you will have transition in Q4 as well because these are anywhere between three to four or five-month transition. So some impact actually will also be in Q4. But when you go into Q1, they will pretty much all move into steady state.

**Amit Chandra:** Okay. And Sir, like on the subcon expenses, so we have seen a very steady rise in the subcon expenses, basically from 13% of revenues in FY2018 to 17% in this quarter, and on a nine-month basis, also the subcon is up by 70% Y-o-Y. So the subcon expenses is largely related to the ramp-up in the deal won and how the tight labor market in the US is also impacting this. So can we assume that the subcon expenses have reached a stage where we do not see it increasing further or still there is an upside to it?

**Sandeep Kishore:** So actually, you have probably answered the question yourself. With the tight labor market in the US, higher subcon is a reality in the business now. However, because you have to manage the deployment of the projects and manage your profitability of the business, it will start to moderate up. I do think because we won several projects and you have to stack up because the client is not waiting for a longer period to start executing the project, so you have to execute the projects pretty much very close to the time you win it. And that is why you go ahead and bring subcontractors. Some of this will moderate down because as you move to steady state, there is a reasonable percentage of the work, which will move into a managed service phase that we deliver from our facilities in the US and in India as well. So you should not see significant increase but moderate increase in subcon. That is the new reality of the business that we are in.

**Amit Chandra:** Okay. And Sir, we have heard talks about digital being higher-margin business and also there is scope for offshoring in this business. So can we expect this thing to happen in our business because most of the contracts we have is largely onsite? So can we see offshoring being a margin lever going forward?

**Sandeep Kishore:** The short answer is yes, however, it is not going to happen in the very near term. And the reason for that is the kind of digital work that are being outsourced by the clients are all reasonably higher business impact work that needs to happen closer to the customer. That is why we are also hiring, even our own talent, in the US, in the UK and in South Africa - in the three core markets. As they move into "support and maintain mode," you will see offshore moving in here. While in the short run, I still see a lot of onsite work will happen, closer to the customer, on the complex digital program. In all the work that Ajay talked about in retail, the supply chain, omnichannel, order management, as well as with insurance companies - an insurance program that we won is a very complex deployment of billing, claims, policies and digital frontend. They all need to happen almost on a 50-50 basis, 50% onsite, 50% offshore. And that is a reality of the business that we are doing. Now the management objective clearly is that you deploy them faster, make sure that the support and maintain and the run part of it, you do it in a managed services mode. So it kind of

becomes geography-agnostic or independent. And whether you then do it from your centers - we have four centers in the US, from where we deliver programs, and of course, several centers here in India. So you move them in those centers in the managed services and that is the margin lever. because then it is not people-dependent, then it is not dependent on augmentation of your sheer talent - then it is based on tools and architecture and process and the whole efficiency of the model that you deploy. And that will start to happen.

**Amit Chandra:** Okay Sir. Thanks for the opportunity.

**Moderator:** Thank you. The next question is from the line of Vishal Desai from Axis Capital. Please go ahead.

**Vishal Desai:** Thanks for the opportunity and good evening to the management team. Just to understand the dynamics in the quarter in terms of the revenue, if I understood correctly Indigo Slate contributed to around \$2 million of incremental revenue in this quarter, and so ex of that, our growth would have been somewhere around 2% or so if I got it right. Secondly, in terms of the revenue booking pertaining to that increase in the purchase of traded goods item. So if I have to understand right, has services business contributed to the growth, ex on an organic basis or the purchase of traded goods increment that has come in, in this quarter in terms of expenses has had no real contribution in terms of revenue? If you could help me reconcile that because from my understanding, I feel that probably that was the major contributor to the drop in the margin per se. Because all the other line items which I see, whether it is employment benefit expenses, other expenses or change in inventories, as a percentage of the total revenue are largely around about at the same level?

**Ajay Bhandari:** Yes. Vishal, this is Ajay. So your question is, did the entire growth come from traded goods or whether there was any services element? So the answer to that is no. Because if I just told you about the breakup, roughly 2.5% growth came from pure services, no traded growth - roughly \$3.5 million. And so we had a quarter-on-quarter decline in our two noncore businesses, which is ROW and MVS, and that was to the extent of \$2.1 million. So when you just ignore that, then our services business actually grew by \$5.6 million quarter-on-quarter, which is pretty healthy. There was an increase in products and licenses to the extent of \$2.5 million. But if you look at other component of our services business, our insurance acquisition, Cynosure, grew by \$1.1 million. We had a bit of furloughs, \$1.3 million, which is services, which will be there next quarter, was not there this quarter. So the growth is pretty healthy even with the addition of products and licenses.

**Vishal Desai:** Okay. So if I understand correctly, you are saying that the purchase of traded goods, the increment that has happened in this quarter, is not the entire amount of revenue booking from that has not really kicked in, in this quarter as well. It is the upfront costs, which have been built in related to the multiple project ramps, which Sandeep spoke about?

**Ajay Bhandari:** Absolutely. I mean, we used to have a products and license division, which we shutdown almost, I, would say, six to eight quarters back. So we do not really do that business anymore. These have been as a part of some of the large deals where, as a part of a deal, there have to be upfront provisioning of tools, which we have done. Therefore, this has come in. But the services business, if you just add up the rest, I mean, if I adjusted it for furloughs and the decline in MVS and ROW,

then we added close to \$7 million of business this quarter as opposed to the previous quarter. So that is actually pretty healthy.

**Vishal Desai:** Fair enough. Thanks. All the best Sir.

**Moderator:** Thank you. The next question is from the line of Mukul Garg from Haitong Securities. Please go ahead.

**Mukul Garg:** Thanks. Just a couple of clarifications. First, Navneet, you mentioned that the divestment of ROW, the non-government part is over and government part is still there. So did I understand that clearly that I think ROW in total last year was a little over Rs.100 Crores and you have divested about Rs.54 Crores right now? So rest of that business should be out in next one to two quarters. And what kind of margin profile the remaining business has right now?

**Navneet Khandelwal:** Yes. So last year, the ROW business was about Rs. 71.7 crores Q3 YTD. As compared to that, Q3 YTD is Rs.56.6 Crores this year. And the government business will still take a couple of quarters more to go down. And in terms of margin profile, it is similar to the overall ROW business. Ajay, do you want to add to this?

**Ajay Bhandari:** Yes. So we have four government clients or contracts. Of that four, two come to a complete end in this quarter actually and one of them in the next quarter. So by the end of this quarter, ROW would be, I would say, almost 96%, 97% closed, barring one government contract, which will take another quarter or two. So yes - it is almost over.

**Mukul Garg:** Got it. There is a lot of change in \$1 million-plus client classification compared to what it used to be reported earlier. Can you help us understand what changed in the number of clients?

**Ajay Bhandari:** So Mukul, we have been actually advised by all the analysts only that they prefer to see the \$1 million-plus clients in a cumulative format rather than a bucket format. So all we have done is changed it to a cumulative format, which will read the \$1 million-plus clients include from \$1 million-plus up to the \$100 million, so all of them. Earlier, what we would do is in \$20 million-plus, we would include the \$20 million-plus and the \$10 million we will not include the \$20 million-plus in the \$10 million-plus bucket. But now since we got feedback that you all prefer to see it on a cumulated basis, we have just turned it to cumulative basis retrospectively.

**Mukul Garg:** Understood. Another thing, which, if I remember correctly, Sandeep mentioned last quarter, that usually the TCV mentioned is a \$10 million-plus deal wins, and last quarter, if we include the ones below that as well, the total cumulative TCV was about \$400 million. Is it possible to share the number, including Q3 as well for the same?

**Sandeep Kishore:** We will send that to you separately, Mukul. So we have not done the calculation for this quarter, but we can send that to you. We did close \$200 million-plus of business this quarter, but the total number, we will need to calculate that and send it back to you.

**Mukul Garg:** And one final question, Sandeep. On the subcontracting plus the onsite work, which is being delivered, going forward, do you think it is possible to have talent availability within the organization to do the work internally versus subcontracting? Some of your larger peers have highlighted talent shortages in the market? So do you think that is a risk, which is increasing the dependency on subcon across the industry?

**Sandeep Kishore:** I think the subcon increase, as I mentioned earlier, is the new reality for all the reasons that we know - Talent shortage, immigration, intense project and program timeline, complexity of the work that we are doing. All of this needs really top-class talent. The kind of hiring that you end up doing in India is from freshers to two, five, seven-year range. Almost every work that we are doing in the United States and in South Africa and in London, they are all 15 to 20 years-plus average experience, so totally different type of skill profile. And to deploy programs objectives faster, you do have to depend initially on talent. We have four delivery centers in the United States. We have just started the program of actually fresher hiring in US now for the first time. And hence, over the next several quarters, you will see our dependency on subcon coming down but it is not going to go back to the levels, which it used to, between two years or three years ago. Subcon needs to be an integral part of the growth strategy for the industry and so we do have to find ways and means to do more platforms, do more managed services, deploy programs faster. And if you are actually taking senior talent, which is 15-20 years of average work experience, it should take shorter to develop and complete the program. So there are some of those evolutions, which is a larger discussion and that will happen. And as that thing starts to settle down, we do believe that, that will have an positive impact on the margin improvement as well.

**Mukul Garg:** Understood. Thanks a lot for answering my questions.

**Moderator:** Thank you. We will take the last question from the line of Ravi Menon from Elara Securities. Please go ahead.

**Ravi Menon:** Thank you. Sandeep, if you had to roughly think about the \$200 million in TCV you won this quarter, how much of that would you say has come from the new capabilities that you added through the acquisitions over the last year or so? And how much would be just improved win rates?

**Sandeep Kishore:** I probably did not get the question, Ravi. You were saying how much of the \$200 million came through the acquired companies?

**Ravi Menon:** No. I was saying that you have got new capabilities through the acquisitions. So how much of that would be, I would say, purely from new capabilities?

**Sandeep Kishore:** Yes, so actually, if you think about it in a different colour, so CIS, which is our cloud infrastructure business, is completely organic, 100%. So that is roughly 50% of our win is CIS. So 50% of the win has actually come from the CIS business, which are homegrown yet new capabilities. The go-to-market that we do today in cloud infrastructure business is 100% new. It is built on the next version of Vinci, which we have been talking about. And then the remaining 50% is roughly half and half. So hence, 75% of the win has come from new capability; 50%, which is infrastructure



and cloud; other 25% from Cynosure, Foolproof, Indigo Slate and Keystone. And the rest, 25%, is our normal core Zensar differentiated services.

**Ravi Menon:** Okay. And then for core infrastructure services, you have a client routine but it is up sharply now, right? So you said that part of it is because of Vinci. Any change in client portfolio as well that has led to the reshaped recovery in core infrastructure services?

**Sandeep Kishore:** So Harjott, would you like to just answer that quickly?

**Harjott Atrii:** Thanks, Sandeep. So the wins we had are primarily because of a disruptive solution approach, which is heavy autonomies-focused led by Vinci as part of RoD NeXT. And all these solutions and platforms, we are taking them and winning at large enterprise customers with very significant headroom for growth as well. Does that answer your question?

**Ravi Menon:** That is great. So essentially, these are really new customers that you are getting?

**Harjott Atrii:** Correct. Yes, and they are all net new customers.

**Ravi Menon:** Great. And in Hitech, strong growth there despite the furloughs so any estimate on what would be the headwinds to revenue from furloughs this quarter for Hitech specifically and also for the overall company? I mean, at the revenue level, you already called it out for the margins.

**Ajay Bhandari:** Can you repeat that question, please?

**Ravi Menon:** The furloughs, what will be the headwinds to the revenue from furloughs this quarter for Hitech specifically and also for the overall company?

**Ajay Bhandari:** Well, we had roughly a \$1.3 million impact on revenue on account of furloughs. And I would say most of 60% -70% of that would have been part of the Hitech business. So yes, Hitech is a large portion of that.

**Ravi Menon:** Okay. All right. Great and one last question on the capex. Sandeep, I think you are talking about expansion of facilities in India to multiple locations. So any guidance on the capex for the next year?

**Navneet Khandelwal:** Yes. We have also invested in the current year as well and we actually invested into the onsite facilities in the current year. So next year is going to be more focused on offshore facilities. So the capex should not change very significantly from what you have seen.

**Ravi Menon:** Great. Thank you gentlemen. Best of luck.

**Moderator:** Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Sandeep Kishore for closing comments.



**Sandeep Kishore:**

Thank you for joining the call, and we look forward to staying in touch and talk to you again on Q4 call. Thank you so much.

**Moderator:**

Thank you. On behalf of Zensar and Elara Securities, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.