



“Zensar Technologies Ltd. Q1FY23 Earnings
Conference Call”

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Moderator: Ladies and gentlemen, good morning, and welcome to the Zensar Technologies Q1FY23 Earnings Conference Call hosted by HDFC 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. Amit Chandra from HDFC Securities. Thank you and over to you, sir.

Amit Chandra: Good morning everyone. On behalf of HDFC Securities, I welcome you all to the Zensar Quarter 1 FY23 Earnings Call. We have with us today Mr. Ajay Bhutoria – CEO & MD of Zensar Technologies, Mr. Sachin Zute – CFO and few other members from the senior management team.

Before I hand over the call to Ajay, I would like to highlight that the safe harbor statement is on the second slide of the analyst presentation and is assumed to be read and understood. With this, I hand over the call to Ajay. Thank you, and over to you, Ajay.

Ajay S. Bhutoria: Thank you, Amit. Good morning, good afternoon, and good evening everyone. Thank you for taking time to join us today to discuss Zensar's financial results for the first quarter of FY23. With me on this call are a few others from the Zensar leadership team. I have Sachin Zute, our Chief Financial Officer, Prameela Kalive, our Chief Operating Officer, Vivek Ranjan – Chief Human Relations Officer, Nachiketa Mitra – Global Head of Banking Financial Services and Insurance, Arjun Warty – Head of Corporate Development, Ankush Akar – Global Finance Controller.

I am pleased to report that we are starting FY23 with revenues of \$155.9 million representing quarterly year-on-year growth of 26.3% in constant currency and 22.6% in reported currency this growth translates into a sequential quarter-on-quarter growth of 3.1% in constant currency and 1.7% in reported currency, making it our highest ever quarter and five consecutive quarters of growth.

Let me walk you through the performance of our geographies and verticals for the quarter. All the growth numbers are in constant currency.

The US region registered quarterly year-on-year growth of 23.8% and sequential quarter-on-quarter growth of 2.5% mainly driven by growth in the BFSI vertical.

Europe region registered quarterly year-on-year growth of 39.8% and a sequential quarter-on-quarter growth of 3.5% driven by growth across verticals and service lines. We continue to have good traction in the region from both long-standing and new clients.

South Africa region witnessed a rebound in its performance this quarter with quarterly year-on-year growth of 21.1% and a sequential quarter-on-quarter growth of 6%. This growth was driven by new deals across banking and financial services and in cloud and advanced engineering.

Moving to our verticals, we saw continued momentum in BFSI vertical with quarterly year-on-year growth of 56.1% and a sequential quarter-on-quarter growth of 8.1%. We are witnessing consistent growth in this vertical over the last few quarters aided by consistent addition of new clients and new deals and scaling up of some of our top existing clients.

The HTM vertical saw slightly muted growth this quarter with quarterly year-on-year growth of 3.8% and a sequential quarter-on-quarter growth of 0.5%. While we have witnessed somewhat of a slowdown in the vertical, we continue to make investments to drive growth in this industry segment.

Our Consumer Services vertical registered a quarterly year-on-year growth of 24.4% and a sequential quarter-on-quarter decline of 0.4%. We are seeing some reduction in discretionary spend in this sector, but we expect growth from newly opened relationships to offset some of the headwinds.

Our gross margin stood at 26.6% in Q1 FY23, representing a sequential quarter-on-quarter decline of 360 basis points. Our EBITDA margin stood at 11.2%, a sequential quarter-on-quarter decline of 290 basis points., we ended the quarter with a net cash position of \$163.5 million.

The order book for Q1 FY23 stood at \$125 million supported by multiple wins across verticals. The order book has a healthy mix of new wins and renewals. We have also scaled two additional clients to the \$10 million plus category bringing the total number of clients in this category to 13.

For the first quarter, our last 12-month attrition stood at 28.1%. Attrition continues to be at an elevated level, and we expect the situation to gradually stabilize over the next few quarters.

We revamped our fresher program in FY22 and remain focused on their training and fast deployment.

Effective July 1st, we will be giving one of the biggest hikes in the recent past making it to two consecutive years of high wage hikes. We continue to invest in associate learning and have expanded the scope of our continuous training programs, thus allowing for our associates to upskill and train themselves for high demand skills.

Our service lines continue to deliver targeted solutions to our clients. Our big bets in service lines continue to reward us positively. We see growth momentum in advanced engineering, data engineering and platform services.

As always, I'm excited to speak about the work we do for our clients. We continue to deliver value to our clients through integrated solutions encompassing multiple capabilities and service lines.

Let me take a couple of minutes to share some examples of high impact work that we have done for our clients.

We are helping, for example, to optimize warehouse operations in real time for a US retailer by implementing integrated automation for its warehouse execution system. Another example, we are providing engineering services and end-to-end support for platform services to a multi-stakeholder non-profit organization for Internet governance. We have been selected by a large South African bank to modernize and migrate its mission-critical core banking platform to cloud to support the environment as a managed service.

We have been selected by a leading global medical device company to design and implement a service model to support their technology and business transformation, while also providing end-to-end IT services, infrastructure and application support. We have been selected by a leading payment card manufacturing firm to be its key systems integrator and strategic partner for high velocity enterprise transformation through cloud engineering and DevOps.

We have been selected by a leading mobility services firms to be its strategic partner in building a business-wide enterprise cloud data platform that integrates seven lines of businesses and enterprise and client applications. We also won a multi-year managed services deal to provide end-to-end application support for the same client.

We have been working with a leading infrastructure service provider for application development and support for its core applications including their mobile app. We have partnered with a leading multi-brand insurance company in the UK to support a variety of technology transformation initiatives extending across digital engineering on legacy technology stacks, building our new product lines and enabling the group's innovation agenda.

We have been selected and engaged as the SAP partner for a leading pharmaceutical company for its SAP enterprise application management support. We are extending our support to a large UK-based P&C insurance company to optimize and automate its existing end-to-end application lifecycle management by the addition and set up of tooling, processes and new ways of working with improved developer efficiencies.

We continue to progress along our sustainability journey in line with our published ESG vision and mission.

A sustainability and CSR committee was formed at Board level to govern sustainability charter and provide guidance for our ESG initiatives. We successfully published our second integrated annual report that captured the economic value that Zensar has created with sustainability at the

core of its operations. We launched our team of #OnlyOneEarth on World Environment Day and formed a dedicated community of sustainability champions to execute Zensar sustainability charter. We continue to emphasize Zensar's fundamental belief of being a responsible corporate citizen towards the environment by focusing on arresting carbon emissions, water conservation, effective waste management, and by participating in community initiatives.

We saw growth across our key portfolios and geographies despite evolving macroeconomic uncertainties. We currently see pockets of softness in business. Some of our clients have indicated a reduction in spend amidst the uncertain economic climate. We are keeping close watch on the economic environment and continue to stay close to our clients so as to respond to their needs and accordingly, adapt our investment plans.

To reiterate what I said in the last earnings call, we continue to focus on execution to drive resilience in our business. The areas in which we have invested such as engineering, data and platforms are bearing fruit and have gained traction. Our strategic focus has resulted in an improved mix across the company in terms of client spread, vertical spread and service line spread. As a result, we are now confident about our long-term growth regardless of short-term uncertainties.

With that, I will now invite Sachin Zute – our Chief Financial Officer, to provide an update on critical financial data. After which, we will open the floor for questions.

Sachin Zute:

Thank you, Ajay. Good day, everyone. Welcome to the call. In addition to Ajay talking about the business, I'll take you through key financial metrics. In constant currency, growth for Q1 for FY23 was 3.1 sequentially and 26.3% year-on-year. In dollar terms, the reported revenue was \$155.9 million for the quarter, reflecting growth of 1.7% sequentially and 22.6% year-on-year. The U.S. dollar realization during the quarter has been Rs. 77.1 per dollar against Rs. 75.20 in previous quarter.

Our gross margin stood at 26.6% in the quarter, a decline of 360 basis points from the previous quarter. This decline was primarily driven by higher cost of delivery, having negative impact of 2.5%, volume and utilization negative impact of 1%, and exchange rate impact of negative 0.1%. Our PAT reflect a removal of onetime favorable items in other income of the previous year.

Before we proceed further, I want to highlight that higher cost of delivery includes the following aspects:

One, continued supply side tightness and record intake of freshers we had done in last few quarters who are undergoing their training and awaiting deployment. As freshers continue to get deployed in next few quarters, we believe it will provide us margin improvement levers and partially offset some of the headwinds such as salary hikes, which we have provided effectively July, as Ajay mentioned earlier.

We continue to invest in growth, both through hiring of fresher talent, working through retaining our high-performing associates. This will place us on a better footing forward, achieving our long-term predictable growth aspiration.

Further, we continue to focus on various cost optimization measures, including fresher deployment, improving utilization, driving favorable commercial terms, optimizing pyramid and improving shore mix. The effective tax rate has decreased to 26.3% in the quarter against 27% in the previous quarter. For the quarter ended June 30, 2022, DSO decreased by 7 days when compared with the previous quarter. It stood at 83 days against 90 days, improving our cash conversion metrics.

Our balance sheet continues to be strong and debt free. Cash and cash equivalents, including investments in mutual funds increased from \$155.7 million at the end of previous quarter to \$163.5 million at the end of Q1 FY23, an increase of \$7.8 million. The amount of outstanding hedges as on June 30, 2022, was equivalent to \$154.2 million against \$131.7 million at the end of previous quarter.

The last item before I end my presentation, we have reclassified few of our accounts to better reflect our current industry verticals. Though the impact is not material, we have restated the data for last few quarters along with FY21 and FY22 which is provided in the fact sheet.

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

Moderator: Thank you very much. The first question is from the line of Manik Taneja from JM Financial. Please go ahead.

Manik Taneja: Just wanted to pick your brains around the way our margins have performed over the last few quarters and the way forward. So, my question was for Ajay and Sachin. So, our aspiration was to get to mid-teens EBITDA margins for FY23, and given the way our margins have progressed over the course of last few quarters, and the fact that wage increments are yet to come through in the second quarter, how should we be thinking about that aspiration for FY23, as well as if you could help us understand the likely impact of wage increments in Q2FY23 and the other offsetting factors that you expect to take into account for the second quarter?

Ajay S. Bhutoria: I'll take a shot, and then I'll request Sachin to add. So, Manik, what has played out during this last quarter, that is Q1FY23, is extension of the issues and topics that have been the cause of decline in the previous quarters as well, namely attrition, increased salary interventions, an extremely inelastic labor market that continues to persist driving up cost of recruitment, increase in spend on sub-contractors, etc. And then slightly up because we also have substantially expanded our fresher program. Our long-term, last 12-month attrition, as you just heard, stands at 28.1%, what we realize is that because of this and, of course, you know, we are laser-focused, on implementing margin improvement measures, and there's a bunch of them.

Now specifically to answer your question, what we feel is going to happen in the course of the next few quarters is that while we were attempting to get back to mid-teens, end of financial year '23, we believe that, that is going to get pushed out by two quarters. So, getting to mid-teens will be around second quarter of FY24. That's the first question.

To answer your second question, yes, we've got wage hikes and we've given very material wage hikes, one of best in recent years. We have done internal modeling and the impact of wage hikes will be in similar range as what we had last year. Manik, does that answer your questions?

Manik Taneja: Just trying to prod you a little bit on some of the margin pressures that you spoke about. Some of these have been associated with the industry over the last 12 months and given the way we reported in May. So, I would say some of these factors were not new. So, what surprised you relative to some of these trends playing out over the last 12 months?

Ajay S. Bhutoria: So, Manik, we had a slightly positive trend towards attrition in the previous quarter. And this quarter, we saw attrition somewhat bounce back, and the resulting impact of that is, higher cost of interventions that we had to do to retain our people, higher cost of recruitment of talent to backfill the attrition as well as to support growth. Our subcontractor spent went up. These were areas which turned out to be higher than what we had initially anticipated.

Moderator: Thank you. The next question is from the line of Sandip Agarwal from Edelweiss. Please go ahead.

Sandip Agarwal: Ajay, while you explained that, you know, our margin journey has been postponed by two quarters, but if you leave that aside also, even our growth is not supernormal. So, why I'm asking this is that if you see 3 years back when one of the large Indian IT companies got a new CEO, he came and he upfront said that I will invest 200 to 300 basis points in my sales and marketing engine, we will first fix that growth problem, and then we will look at the margin problem because growth gives us the additional leverage to scale up, to bring in efficiencies and all those things. And exactly that way it got delivered. In fact, revenue growth was visible in just 2 quarters' time, massively outperforming the industry.

In our case, contrary to that, while we have been much faster in losing our margins, but we have been extremely slow in getting that growth. So, this is really surprising that on one side, we are giving away our margins at much more pace than what we have anticipated, and when it comes to getting growth, if you compare with past, how it has happened versus that, yes, it may be a little bit good, but then there is an industry tailwind as well, but we have not done a supernormal job on the growth as well.

So, my worry is that, where are we heading to in this business? Is there a fundamental problem? Or how big is the problem from our top client? Or what are our internal issues? Are we servicing the wrong industries where margins will be low or talent crunch will be higher than the other part of the industry?

I'm sure you would have brainstormed on this a lot, but it will be very helpful if you can throw some light for us because it is really impossible kind of situation, which you are giving us, that margins will fall sharper than what we have anticipated, and growth will come slower than what we have anticipated. That means even we are not fully confident of what we are doing. That is the message we get from this number. So, if you can please guide us more?

Ajay S. Bhutoria:

So, let me start by saying that and let me make a very strong reiteration that we are not clamping down on growth. Growth resilience and creating a consistent headroom for growth is ultra-critical for us.

Let me just step back and share some data points with you, Sandip. When we started on this journey, our quarterly revenue was \$120 million, and that is four quarters back. This last quarter, we gave \$155.9 million. That is the magnitude of growth we have covered in four quarters. To give you a sense of what we have achieved, actually five quarters. So, here is some details about 5 quarters of growth.

So, when we started on this journey and, Sandip, just around the time when we published our strategic plan, post that, you know, the first quarter of FY22, our growth was 4.8%. Second quarter of FY22, our growth was 12.3%, of which 6% was inorganic, 6.3% was organic. The following quarter, we gave growth of 4.7%. The last quarter, we gave a growth of 4.2%. And this quarter, it is 3.1%. So, if you see last five quarters, we have consistently delivered growth, and the last two quarters, we've been above median, right?

Additionally, our new logo acquisition continues to be strong. Last year, for the full year, we got 45 new logos. Last quarter, we added 9 new logos.

Next interesting data point is that if you look at our dependence on top clients, exactly a year back, 38.4% of our revenue came from our top 5 clients. Now, our top 5 clients contribute 33.3%. So, it will give you a sense of how our dependence on our top 5 clients has reduced. We have, in this quarter, alone, Sandip, scaled up 2 more clients in the 10 plus category. And if I go the last several quarters, you'll find the data points to be similarly favorable. The reason I go back, you know, so many quarters, Sandip, is to answer your question as to the journey that we have covered in the last one year.

Now, from a margin perspective, there are two issues, First of all is that it's an industry issue, slightly exacerbated in our case, which is that attrition continues to be at a historically high level, We are talking of last 12 month attrition for us at 28.1%. That is very sizable. And that, look, is mostly in line with what's happening in the industry and what is happening with companies of our ilk, You know, for a company like us, which is about 12,000 people, that kind of attrition has an impact. That's number one.

Number two is, beginning of last year, we did not have a freshers program. In course of the year, we put a freshers program, a very, very strong training program and an onboarding program.

The first three quarters, all our competitors, including us, were going after freshers. So, suddenly, all the freshers evaporated from the market. We could only hire about 600, and then last quarter, we added 1,300 freshers.

Now one of the things that competition, I think, has been able to do better than us is because of this fresher program, you are better able to handle the pyramid. In our case, we had to depend to drive youth. I just shared the growth numbers with you. That kind of growth, you know, we went, like I said, from \$120 million per quarter to \$155.9 million per quarter, that kind of growth, we had to then fulfill with lateral hiring, with subcons, and we also had to backfill for attrition. That is the reason why the margins have come down.

Now we are focused on getting that back, and we see traction in the freshers program. We see green shoots. We see the deployment improve the cost of delivery, the gross margin in the projects and clients where they have been deployed. And that is why we are confident that this improvement of pyramid will be one of the biggest levers that is going to help draw our margins back to the mid-teens that we spoke of.

So, I just wanted to share, you know, your question was a very detailed question, and I thought I should do justice by giving you, you know, a very elaborate and expansive answer.

Sandip Agarwal:

No, Ajay, thanks a lot for that. Just a small follow-up and I'm sorry. I have to again, you know, come back to that. So, two things in this. So, will it be fair to say, and I'm not specifying top 5, top 10, but will it be fair to say that one of our large client's pain, which we have seen and the client itself is going through a big challenge, that pain has broadly bottomed out for us at least if not for the client? That is part one. And is that the primary reason of our so much of problem on both margins and growth? How much of our problem you will attribute to that client? And if it is a material number, has it bottomed out? So, that is half of the question.

And second half of the question will be, like, you know, there is only one small concern in the way we are approaching is that right now on one side, the industry was struggling with the manpower, so, we are also struggling. But if let's say this macro worries, God forbid, comes true, and there is a hard landing of recession hypothetically, then in that case, what we will be left with will be low growth and very high cost resources, which you cannot, obviously, you know, in our industry, we don't have a pattern of letting people go off when times are tough. So, we will be only dependent on natural attrition as a lever, which itself falls very sharply when, you know, macro is worrisome. Although I don't think that we will have a scenario like that in tech, I think people will continue to spend on tech in a very big way. So, I have a strong view on this external cycle.

But having said so, I'm saying hypothetically, if that situation arises, where, you know, both growth starts falling even for a quarter or two because of macro worries or postponement or delays and at the same time, we are left with very expensive subcontractors and resources, then our situation will even worsen. So, what is our backup plan for that?

Ajay S. Bhutoria: Actually, two questions. Let me answer both. The first is large client's situation. So, Sandip, I'll refrain from talking about specific clients, but let's talk about top 5 clients, right? So, top 5 clients for us, I just shared with you some data points. From Q1 FY22 to Q1 FY23, our dependence, the percentage of revenue from our top clients has fallen from 38.4% to 33.3%, 5% improvement, right? Just gives us better growth resilience. Number one.

Number two is that in this client, and we are hyper-focused on making sure that we provide absolutely top-quality services to our top clients, right, just as we would with any new clients. So, there is absolutely no diminution in the quality of service we provide. What we have seen is that there is ups and downs, a little bit up, a little bit down, no material rise, not a very material fall. So, it will go up a little bit, go down a little bit, but it will stay within the range. So, that's to answer your first question.

To your second question, yes, we are watching over the macroeconomic conditions very, very carefully. I had mentioned in the last earnings call that, in the short term, there is going to be a blip, and we have seen that play out during this quarter. Our consumer services has been impacted. Our HTM has been impacted. And various areas where client spend has reduced or postponed or deferred or, in some cases, cut out already, cut out completely.

Now in terms of how that will impact our costs, so few data points. First of all is that this blip, we feel, is here to stay for maybe two, three quarters. I told the last couple of times and I still maintain it, that the long-term secular growth trajectory of the industry is not changing. That long-term growth is going to continue. With inflation and fed intervention, etc., there is going to be a cool off. It's a two, three quarter affair.

Next thing is attrition. We believe that in the coming couple of quarters, the attrition rate is going to fall by about 5% to 7%. So, that is going to ease our troubles a little bit, but it is still considerable, and it will still need backfill. And we are hoping that as we crank up our fresher engine and our junior engine, fresher and juniors, that we are able to backfill our departures with people at the lower end of the pyramid. We've had success in the initial deployment, and we hope to accelerate that.

Outside of this, we are applying other levers as well. So, pyramid lever, obviously, is critical to reduce cost of delivery, and cost of delivery is the reason why our gross margin went down and then the subsequent impact on EBITDA and PAT, but also improve our utilization, continue to push the shore mix and continue to work on commercial conversations with some select clients, continue to drive revenue levers, which means, deeper investment in service lines that yield, greater margins, and so on and so forth. So, those are other levers, Sandip, which I had not talked about in the previous question, the answer to the previous two questions.

Moderator: Thank you. The next question is from the line of Sandeep Shah from Equirus Securities.

Sandeep Shah: What I'm asking is can you throw some light in terms of the growth outlook across sectors for the rest of the three quarters of FY23 when you said, a couple of segments including hi-tech and consumer are getting impacted because of the macros?

Ajay S. Bhutoria: So, Sandeep, if I understood your question right, let me start to respond, what's the impact of the macro and how are things going to look going forward? So, just a small call out is that I'll refrain from giving future guidance but let me give you a sense of what's happening right now. So, like I had mentioned, and I had called out the previous quarter is that there will be short-term blip because of macroeconomic conditions. And we have seen that play out this quarter, especially in sectors like Consumer Services and HTM. Clients are reassessing their spend and have been situations where they have cut down, deferred, reduced or completely eliminated discretionary spend. And we think that for especially these two verticals, there is an impact.

However, BFSI continues to do very well for us. The momentum is strong. Geography-wise, UK and South Africa, UK continues to deliver well, South Africa is back in growth. And even in the verticals that are impacted, we are winning new deals, etc. And we just have to monitor how some of these deals and the growth in other verticals and geographies offset some challenges that we have due to macroeconomic conditions in HTM and Consumer Services.

Moderator: Thank you. The next question is from the line of Mr. Divyesh Mehta. Please go ahead.

Divyesh Mehta: Can you share the number of freshers added this quarter? And can you share what's the full year outlook on freshers addition? How many people are we looking to add?

Ajay S. Bhutoria: Divyesh, can you please repeat your question?

Divyesh Mehta: I'll repeat. How many freshers have we added in the current quarter? And what is the full year outlook on the number of fresher addition?

Ajay S. Bhutoria: So, Divyesh, let me share some numbers. In the last quarter, towards the end of the quarter, we added 1,300 freshers. We remain strongly committed to adding freshers in the forthcoming quarters. In this current quarter, we hope to add another 400 or 500 freshers. And obviously, we are going to dial it based on business conditions in terms of how we stagger the onboarding of the people that we want to bring in, but we want this trend to continue. We have made a very significant investment in the whole fresher program. It has begun to fire, and we will continue to drive that very hard.

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

Amit Chandra: Sir, you mentioned about some pockets of weakness in the retail vertical. So, if you can elaborate, you know, what kind of weakness you're seeing in terms of, you know, is it certain pockets or is it across clients? And also, you know, what actually gives you the confidence that

this will not accelerate to other verticals as well? And in terms of your conversation with clients, how you're seeing their spending plans for the next year?

Ajay S. Bhutoria:

Just to reiterate, we see because of economic uncertainties, spend reduction with retail and some HTM clients. What they are doing is they are looking to curtail their expenditure in line with what they see as the economic uncertainty that is looming. So, the first area of expenditure cut is discretionary spend, and towards that, areas such as experience, design and, actually, in some cases, large transformation programs. They have either started deferring or cutting back or, in some cases, slicing up too much smaller projects. So, they're doing all three, depending on how critical the program is. And we see this, from a wide swath of clients in these two sectors.

We think as the economic uncertainty plays out, as the economic cool off happens over the course of next couple of quarters, this is going to impact these two verticals for us. And as things start coming back under the new normal, especially the Fed's have realized their goals of stabilizing inflation and, in effect, cooling the economy to stable levels, I think it's very clear that the long-term prognosis for these two sectors also continues to be strong. So, we just have to watch for what happens over the next two to three quarters.

Amit Chandra:

And sir, on the margin front, you know, you mentioned that we have scaled up the freshers hiring program. And we intend to bring the margins to mid-teens over the next two, three quarters. But if I see our subcon spending, it is one of the highest in the industry, and it has scaled up significantly over the last five, six quarters. And in terms of the on-site presence also, it has also been increasing. So, is it fair to assume that the deals that we are winning are, largely on-site deals wherein it is having lower margins? Or we are planning to win deals which are more offshore from here on to bring the margins back to the mid-teens level. So, how things are structuring? And how we are confident to bring margins back because this seems to be structural and with the macro being the concern, how we intend to scale the margins back?

Ajay S. Bhutoria:

So, Amit, I'll answer your question in three parts. So, first of all, we are very, very strongly focused on growth, right? We want to create growth resilience, and we want to create headroom for future growth. That's number one.

Number two is that, look, when you are growing, and I just shared some numbers of growth. We had quite a significant growth journey over the last 5 quarters. Now in an environment that is so supply inelastic, you know, you have to go hire people.

Now, of course, you would want to hire all laterals. You want to hire as much of freshers that can be put into the pool. But then, there is no running away from the fact that with this kind of growth and with such inelastic industry supply situation, you will increase your subcontractor outlay because we have won those projects, we have to deliver the projects. And if we can't find people and we have to go into subcons, we will have to go into those subcons. Our objective is that over a period of time, we will start rationalizing them.

The third thing is revenue mix, onsite versus offshore. What we have, Amit, is it goes up and down, but it's largely within that range. So, this quarter, the on-site component went up by 200 basis points. Last quarter, if you remember, our on-site component went down by 125 basis points. So, this will be range bound. You know, we'll operate within the range. Some quarters it will go up a little bit. Some quarters it will go down a little bit.

Long term, we are putting measures in place, and that will play out over the next three to four quarters. It's a very strong push towards increasing offshore business that, obviously is always margin accretive for us. So, increasingly, we have to do that. But just to assure you that this movement is not a sudden spurt, we've been in this range for a while now.

Moderator: Thank you. The next question is from the line of Mukul Garg from Motilal Oswal Financial Services. Please go ahead.

Mukul Garg: Ajay, I know the discussion on margin has been quite threadbare today, but sorry, just wanted to kind of delve a little bit deeper on parts of the commentary, which you have shared. You have been talking about the supply side inelasticity impacting the profitability over the last few quarters. Now this is something which as, you know, earlier participant also mentioned, has been an industry phenomenon. And I think Zensar hasn't been able to match the industry in terms of absorbing the cost.

So, I'm just wondering whether besides the fresher addition or the subcontractor, has there been any other factor which really has hurt us a lot more than others whether in terms of the respective branding position as a potential employer or in terms of the incentives we have offered in the near term to the sales guys as we kind of ventured into our journey to recover our growth? And whether those measures will start cooling off over next quarter or in the next few quarters, which can give us some leeway to bounce back our profitability sharper than what our industry peers are doing and as we had to kind of put in more investment in the near term?

Ajay S. Bhutoria: Right. So, Mukul, let me answer your question in two parts. So, first of all is that the margin situation that we have encountered has arisen because of, you know, the key driver is, on one side, a fairly sizable increase in our growth trajectory. You know, if you remember, we came out of seven, eight quarters of shrinkage, and now we've had five straight quarters of growth. So, the growth has been quite, quite strong, And then you have to fulfill talent for that growth. And we have suffered very high attrition, I mean, industry as a whole and then us, particularly, we have suffered a very high level of attrition, right? So, these two factors have put a dent on our margins and continues to pressure, And how are we responding?

Last year, we gave one of the biggest wage hikes in the history of the company. This year, similar levels of wage hikes, And then, in addition to the wage hikes, we've had to make including in the last quarter, periodic interventions to basically prevent our people from leaving, So, attrition is a huge, huge area of focus for us in terms of reducing attrition. And I think, you know, steadily,

the kind of measures we have taken and also with slight cool off, slight, slight, cool off that we see happening, right, I think our attrition numbers should start improving,

The second factor is, you know, what are the levers we have used in the past for fixing this issue, right? So, one is that the whole fresher program was not available to us five quarters back. We did not have one. We put one in place, and it's accelerating with each passing quarter. Each passing quarter, we bring in more freshers. We learn new stuff of how to enable deployment, how to accelerate deployment.

So, it's something that we are doing consistently quarter-on-quarter, And it's not just the fresher. It's also how we manage our pyramid. You know, we just are so focused on fixing that starting with the freshers program, is something that will gradually and steadily bring us back to our mid-teens goal, just that we now feel that we are two quarters delayed.

Outside of this, we are working on shore mix. We are working to improve utilization. We are working aggressively to fix any leakages that may be there. We are also working on commercial levers. You know, we are having selective commercial discussions with our clients around rates, etc. We are also focused on high-margin service lines. So, I did speak about how advanced engineering data and platforms are the strongest growth service line for us. And in this also, you know, we see some margin differentials. So, our investment also is obviously in areas where we see higher demand. And fortunately, it's areas where there is better margin.

And we'll continue to also drive OpEx levers. For example, support cost, cost of talent acquisition, etc. So, there's a bunch, a 360 approach we are taking towards fixing margins. And that is why we feel we are delayed, because I think the impact this quarter was quite high, and we have got a coming quarter with wage hikes, etc. So, delayed a couple of quarters, but the interventions we are taking, we are confident that we will fix it. We will bring it back to mid-teens.

Mukul Garg:

And also, just one, small one on growth. Again, like, you know, the last few quarters have been characterized by a supply constraint, which has kind of impacted our ability to grow. Now with a couple of our verticals, especially larger clients showing some sort of slowdown, will that open up supply to target new clients and use that as a lever to compensate for the growth impact, which will happen at other accounts?

Ajay S. Bhutoria:

So, yes and yes.

Moderator:

Thank you. The next question is from the line of Mihir Manohar from Carnelian Asset Management. Please go ahead.

Mihir Manohar:

Ajay, you mentioned about some of the clients are indicating a reduction in the spend. Have you spoke about the verticals specifically? And also, the service areas where we are seeing this

reduction in the spend? If you could throw some more light, you know, what kind of reduction, what quantum of reduction, is there on the talks?

And second thing was on the attrition and wage hikes. I mean, we are seeing, you know, one of the largest, we are giving one of the largest wage hikes in the history of the company, but however, despite that, the attrition is not coming down. So, I just wanted to understand, you know, how should we read this? I mean, you mentioned steps about what are you taking, but just wanted to understand that.

Ajay S. Bhutoria:

So, two questions here. So, let me attempt at answering both. So, first of all is the quantum of reduction, Mihir. I can't give you specific instances, but I will tell you that the quantum of reduction is material. Material enough that consumer services this quarter, constant currency reduced by 0.4%. You know, after having blistering four quarters of growth, this quarter, it reduced by 0.4%. And HTM barely, barely flat. You know, it grew 0.5% constant currency, but just about, right? So, the quantum of reduction is material enough to make impact on revenues. So, that's the answer to the first question.

Answer to the second question is, Mihir, last year for us was a little bit of catch-up. This year, what I can share with you is that we've given one of the best hikes and the initial response from the associates has been very positive.

Vivek, if I may request you to chime in, as to what you see with the hikes and the response, and additional points that you'd like to mention. Vivek is our CHRO.

Vivek Ranjan:

Thanks a lot, Ajay, and thanks, Mihir, for the question. Yes, Ajay, as you have mentioned, there have been multiple interventions we have taken and wage hike has been done this quarter. So, while we see that our attrition has increased slightly on LTM basis, which is very similar to industry, but we do see moderating of attrition this quarter as an outcome of these interventions we have taken. And the interventions are not only related to compensation.

Obviously, we have given increased rewards and recognition, which is towards the higher side of market, but we have extensively focused on other levers. We know that this is a hybrid workplace situation and we have focused towards ensuring that there is a high level of engagement and connectedness.

And one important area which had led to attrition in the industry as a whole was providing growth opportunities. So, we have taken initiatives like quarterly promotions, etc., and significant investment in learning to ensure that we provide growth and learning opportunities. And all of these and more has led to us seeing that attrition is getting stabilized. And what we think is that it will reduce in coming few months.

Mihir Manohar: And just an extension to the earlier one. And how should we see this weakness? I mean, I understand it is difficult, but for what long period of time will this weakness continue in your opinion?

Ajay S. Bhutoria: So, in my opinion, Mihir, I think it is a two to three quarter affair until we hit the new baseline, I think what Fed is trying to do is to really, really work to control inflation, and with the measures that are being taken and the general state of the economy with inflation, etc., you know, it's a very strange setup. It's a big dichotomy. I think it is two to three quarters is what we anticipate and let's revisit this next quarter to see whether it's two to three quarters, less or more. Right now, my prognosis is two to three quarters.

Moderator: Thank you. The next question is from the line of Manik Taneja from JM Financial. Please go ahead.

Manik Taneja: So, Ajay, just basically, just wanted to get your thoughts. If our struggle essentially is also a function of the portfolio mix for us as compared to some of other tier-two players because you had been speaking about catching up with peers on growth in FY23 but now you're highlighting certain concerns there, while the commentary from peers remains mixed. So, is it a function of our portfolio mix that's impairing growth for us?

Ajay S. Bhutoria: So, Manik, hi, again. And look, I can't comment on the peer group and their portfolios, but I can share insights into our portfolio and our business. So, the data points that I shared with you, Manik, is, pertains to our portfolio, our business and our verticals, I would say, And our verticals are Hi-Tech Manufacturing, Consumer Services and Banking Financial Services and Insurance. And then the services we provide across our five service lines and three geographies. So, I can give you insights and all the points that I discussed through the course of this call is, again, with respect to our portfolio, Manik. I can't really comment on how the competitors are doing with their respective portfolios.

Manik Taneja: And just a technical question. While on margins, you guys are now saying that we'll get back to mid-teens EBITDA margin by second half or second quarter of FY24. How about catch-up on growth to peers? Does that also gets pushed off?

Ajay S. Bhutoria: So, you know, two different tracks, margin and growth. Somewhat related, but we are tracking the two on two clearly different tracks. Growth for us is also a function of what we see with the economy, So, we are seeing a blip in a couple of our verticals, and we'll have to see how that pans out in the next couple of quarters, However, we are confident we are sanguine that the long-term secular demand is going to continue to remain strong, positive and stable,

So, short term, we will see some blips, but the kind of investments we put in, the kind of momentum we have generated, the kind of teams we have brought to bear, the kind of service lines that we are driving and how well some of them are doing, I think, you know, long-term

prognosis, I'm absolutely confident. And margin, you heard the whole thing, you know, I'll not repeat again. You heard what we are trying to do to get back to mid-teens by Q2 FY24.

Manik Taneja: No, sir. Ajay, the reason why I requested for that clarification, when you came on board last year, and between January and May, when you unveiled the strategic roadmap, you had suggested a timeline of about four to six quarters for catch-up. Now we're almost 15 months from that strategic plan rollout. And thereby, that's the reason why I was asking. Is there any timeline that you guys are suggesting with regards to the growth catch-up?

Ajay S. Bhutoria: So, Manik, just to repeat some data points, if you look at our last five quarters of growth, right? So, it's exactly after we published our strategy and we got on the growth trajectory, right? At that point in time, I had mentioned, it will take 4 to 8 quarters for us to get into predictable, sustainable, profitable growth.

Now if you see what we have achieved in the last 5 quarters, So, we, in constant currency, the growth, respectively, has been 4.8%, 12.3% or 6.3% plus 6%, which was inorganic, 4.7%, 4.2%, 3.1% constant currency this quarter, Last quarter was 4.2%. So, if you see, we have moved above the median.

Now, having said that, you know, we do see some softness because of economic situations impacting two of our verticals, right, and at least one service line. So, you know, I think we are executing very strongly. And bottom line to that is our focus continues to create growth resilience, to create that headroom for future growth, and while we work on getting back to mid-teens by second quarter of FY24.

So, I think we are well on the path of execution. You know, from the time we published the strategy to now, we've added, in constant currency, 26.3% revenues quarterly. So, I think we are strongly on the execution path, Manik. We feel quite good about the execution thus far.

Moderator: Thank you. The next question is from the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: Very sorry to ask on the margin again. But we are currently at an EBITDA margin of 11.2%, and we have headwinds that you pointed out. There will be two rounds of wage hikes. And in the third quarter, we will have furloughs. And also, almost 50% of your verticals portfolio you believe there could be a slowdown in the next two to three quarters. So, are we again optimistic to assume that by second quarter of next financial year, we will reach 15% because that looks again slightly stretched looking at these values and the headwinds both on revenue and margin, which you're calling out?

Ajay S. Bhutoria: Yes. So, Sandeep, again. And if I heard your question right, just to respond, I think previously, the same question was asked. So, I'll just kind of reiterate the response. Growth and margins, we are tracking on two different, they are related, somewhat related, but we are focused on tracking

these on two different channels, two different tracks, right? Two different swim lanes. So, margin, we are laser focused on fixing margins without impacting our thrust on growth, right? So, that is on one track.

And then on the growth track, we have short-term headwinds of growth related to macroeconomic conditions, tracking that very carefully. And we will see how it plays out in the next two to three quarters. So, I can't give you guidance into the future, but we are tracking macroeconomic difficulties and seasonal ups and downs.

Sandeep Shah: Just a follow-up. So, in terms of second quarter, if you look at the wage hikes and last year, we called out in the second quarter, the total impact of wage hikes and the delivery cost being as big as 530 bips. So, in that scenario, to achieve our guidance, are we also aspiring to a flattish kind of a margin in the second quarter or there will be a down tick because of the wage hike in the second quarter and then there we will a pull off in the second half of this financial year?

Ajay S. Bhutoria: Yes. So, Sandeep, I'll request Sachin to take that question. Sachin, if you will, please.

Sachin Zute: Thanks, Ajay. So, Sandeep, given that wage hikes for us are effective from 1st of July, we will have some impact on the margins in second quarter. But given the various steps, various programs, which are linked to optimization of cost of delivery and linked to OpEx, we believe that part of that, we may be able to offset. But we will have impact of salaries, yes, in a similar range of what we saw last year, this quarter as well.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to Mr. Ajay Bhutoria for closing comments.

Ajay S. Bhutoria: So, thank you, and thank you, everyone, for joining our quarterly earnings call. Really deeply appreciate and look forward to talking to you in the next quarter and if not, in the interim. Thank you, very much, and good morning, good evening, good night.

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