

**REDUCE**

TP: Rs 510 | ▼ 2%

**ECLERX SERVICES**

| IT Services

| 13 August 2020

**Aggressive cost management saves the day**

eClerx (ECLX) reported a surprising operating margin beat in Q1FY21 backed by aggressive cost cuts. Dollar revenue declined 6.1% QoQ, in line with our estimate, led by a slowdown in retail, travel and CLX business. While management expects sequential revenue growth in Q2, demand visibility thereafter is bleak. We raise FY21/FY22 EPS by 36%/18% to factor in the margin beat and share buyback. On rollover, we have a new Sep'21 TP of Rs 510 (vs. Rs 420). Valuations at 7.5x FY22E P/E are inexpensive but lack catalysts. Reiterate **REDUCE**.

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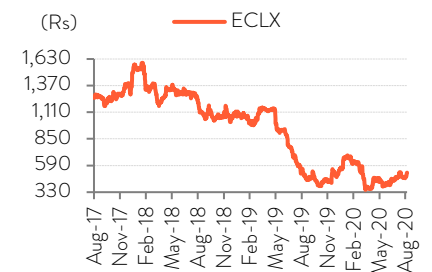
**Tight cost control drives margin beat:** Q1 dollar revenue declined 6.1% QoQ, as expected. EBIT margins outperformed estimates, rising 280bps QoQ to 19.6% vs. ~300bps QoQ contraction expected. Margin expansion was aided by tight cost control (operating costs down 7.4% QoQ against a 4.1% QoQ rupee revenue decline) and rupee depreciation.

**Modest deal wins:** Management indicated that the company won several deals in Q1FY21, though contract sizes were modest. ECLX signed a new deal with a Nordic bank and also improved its relationships with Fortune 500 clients. The deal pipeline has improved from Q4FY20 levels, but management is cautious on pipeline conversion potential.

**Outlook cautious:** ECLX expects Q1FY21 to be the trough quarter, with recovery from Q2 onwards. Retail is likely to bounce back faster than the travel vertical. The CLX business has been badly affected and will take time to recover. Operating margins are expected to be volatile due to wage hikes in Q2 and Q3 along with return-to-office costs. Management stated that it remains open to any lucrative acquisitions (worth US\$ 10mn-15mn).

Ticker/Price	ECLX IN/Rs 519
Market cap	US\$ 261.3mn
Shares o/s	38mn
3M ADV	US\$ 1.4mn
52wk high/low	Rs 710/Rs 320
Promoter/FPI/DII	50%/25%/25%

Source: NSE

**STOCK PERFORMANCE**

Source: NSE

**KEY FINANCIALS**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	14,305	14,376	14,018	16,573	18,437
EBITDA (Rs mn)	3,092	3,249	3,287	3,840	4,301
Adj. net profit (Rs mn)	2,283	2,087	1,981	2,363	2,632
Adj. EPS (Rs)	60.1	55.5	58.2	69.4	77.3
Adj. EPS growth (%)	(19.4)	(7.7)	4.9	19.3	11.4
Adj. ROAE (%)	20.2	17.5	14.4	16.2	16.9
Adj. P/E (x)	8.6	9.4	8.9	7.5	6.7
EV/EBITDA (x)	5.0	5.2	5.1	3.8	3.2

Source: Company, BOBCAPS Research

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## Other highlights

- Q1FY21 was the most challenging quarter for the BPO business due to delayed approvals. Clients are looking to move more work offshore, particularly to India.
- Emerging clients (i.e. non-top 10) have been the worst affected by Covid-19 crisis as they comprise travel and luxury digital clients. ECLX's digital business consists of creative production, digital operations (i.e. SEO, ERP and clients' e-commerce website management) and analytics. This forms ~40% of revenues and has been hit due to demand slowdown. BFSI and technology services have been relatively resilient.
- CLX (Italy-based business) saw a steep 20-30% QoQ drop in Q1 revenue, leading to a 17% decline in Europe revenues. Recovery in CLX is expected to be slow.
- The company will roll out wage revision (except for the top leadership) in two stages, effective from Jul'20 and Oct'20.
- Currently, most employees are working from home but management expects this percentage to come down due to approval restrictions.
- Rental assets – essentially computing assets – have been converted to bought-out assets, aiding some reduction in costs.
- DSOs improved from 88 days in Q4FY20 to 83 in Q1FY21, though the company expects to see some negative impact in Q2.
- The ~Rs 1.1bn buyback concluded in Jul'20 wherein 5.7% of shares were extinguished (~2.09mn shares repurchased at an average price of Rs 523). Cash balance is at Rs 7bn post buyback.
- Net OCF/PAT remains above 100%.

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**Hiring target not set for FY21  
as utilisation remains low**

**FIG 1 – QUARTERLY PERFORMANCE**

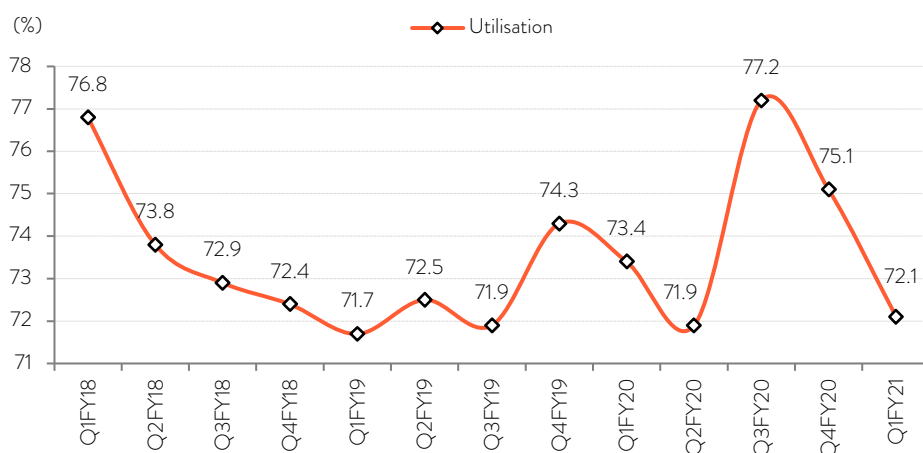
(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
<b>Revenues (US\$ mn)</b>	<b>44.8</b>	<b>50.9</b>	<b>(12.0)</b>	<b>47.7</b>	<b>(6.1)</b>
<b>Revenue</b>	<b>3,365</b>	<b>3,547</b>	<b>(5.1)</b>	<b>3,509</b>	<b>(4.1)</b>
Operating Expenditure	2,531	2,886	(12.3)	2,733	(7.4)
Cost of revenues	1,809	1,923	(5.9)	1,889	(4.2)
as % of sales	53.8	54.2	-	53.8	-
SG&A expenses	722	963	(25.0)	844	(14.5)
as % of sales	21.5	27.1	-	24.1	-
<b>EBITDA</b>	<b>834</b>	<b>661</b>	<b>26.2</b>	<b>776</b>	<b>7.4</b>
Depreciation	173	172	0.8	185	(6.5)
<b>EBIT</b>	<b>661</b>	<b>489</b>	<b>35.1</b>	<b>591</b>	<b>11.8</b>
Other Income	115	82		168	
<b>PBT</b>	<b>776</b>	<b>572</b>	<b>35.8</b>	<b>759</b>	<b>2.3</b>
Total Tax	209	131	59.2	157	33.0
Adjusted PAT	568	441	28.8	602	(5.7)
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-
APAT after MI	568	441	28.8	602	(5.7)
Extra ordinary items	0	0	-	0	-
<b>Reported PAT</b>	<b>568</b>	<b>441</b>	<b>28.8</b>	<b>602</b>	<b>(5.7)</b>
Reported EPS	14.3	10.6	35.8	14.7	(2.4)
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>
EBITDA	24.8	18.6	610	22.1	270
EBIT	19.6	13.8	580	16.8	280
EBT	23.1	16.1	700	21.6	140
PAT	16.9	12.4	440	17.2	(30)
Effective Tax rate	26.9	22.9	400	20.7	620

Source: BOBCAPS Research

**FIG 2 – OPERATING METRICS**

(in US\$ terms)	Q1FY21	Growth (%)	
		QoQ	YoY
<b>Revenue by Geography (%)</b>			
North America	71.0	(1.9)	(6.7)
Europe	23.0	(16.9)	(25.0)
ROW	6.0	(6.1)	(12.0)
<b>Client contribution to revenue</b>			
Top 10, %	69.6	(3.1)	(7.1)
Non-Top 10 client revenues	30.4	(12.3)	(21.4)
Total Employees	8,595	1	(8.3)
<b>Billing Mix</b>			
FTE	76.0	(0.9)	(7.1)
Managed Services Revenues	24.0	(19.5)	(24.6)
Onsite Revenues	21.0	(14.2)	(19.6)
Offshore Revenues	79.0	(3.6)	(9.7)
<b>Currency Concentration</b>			
USD	85.0	(2.6)	(6.5)
Euro	9.0	(29.6)	(20.8)
GBP	4.0	(24.9)	(49.7)

Source: BOBCAPS Research

**FIG 3 – UTILISATION DROP DUE TO COVID LED DEMAND HIT**

Source: BOBCAPS Research

## Valuation methodology

Over the last three years, ECLX has witnessed a structural downward reset to operating margins led by a changing business mix in favour of onsite revenues. Growth and margin recovery hopes have been pushed back further due to the Covid-19 crisis. However, management has shown efficient cost management, thus helping arrest any sharp decline in margins in a very challenging quarter.

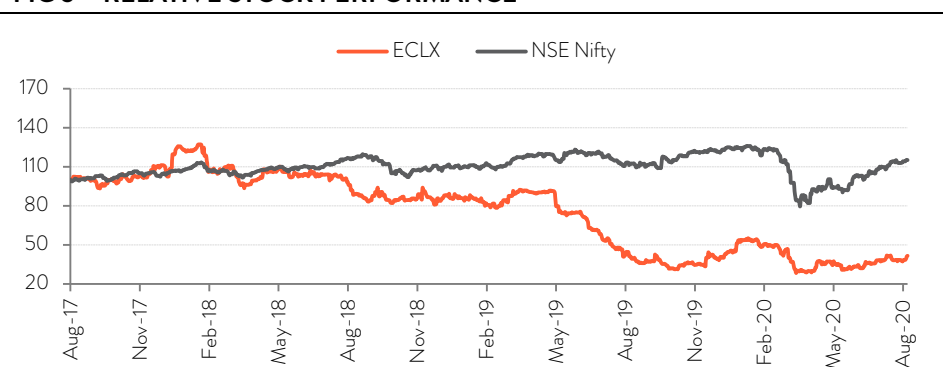
We raise FY21/FY22 EPS estimates by 36%/18% factoring in higher operational efficiency (drives 23%/7% earnings upgrade) and a lower number of shares post buyback (drives 13%/11% upgrade). Rolling valuations forward, we have a revised Jun'21 target price of Rs 510 (Rs 420 earlier), set at an unchanged 7.2x target P/E. We believe that lower revenue productivity, weaker margins, dimmer growth visibility and an increasing mix of non-annuity business render ECLX comparable to BPO rather than IT services players. Valuations at 9x/7.5x FY21E/FY22E P/E are inexpensive but lack catalysts. Reiterate REDUCE.

**FIG 4 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenue (US\$ mn)	182.7	185.7	1.6	209.8	212.5	1.3	236.3
YoY growth (%)	(8.9)	(7.4)	-	14.8	14.5	-	11.2
Revenues	13,797	14,018	1.6	16,326	16,573	1.5	18,437
EBIT	2,010	2,542	26.4	2,778	2,973	7.0	3,320
EBIT margins (%)	14.6	18.1	-	17.0	17.9	-	18.0
Net Profits	1,614	1,981	22.8	2,220	2,363	6.4	2,632
EPS (Rs)	42.9	58.2	35.6	59.0	69.4	17.6	77.3

Source: BOBCAPS Research

**FIG 5 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- Sharper recovery in demand, especially for the offshore business
- Sharper recovery in CLX business
- Stronger-than-expected traction in large accounts

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>14,305</b>	<b>14,376</b>	<b>14,018</b>	<b>16,573</b>	<b>18,437</b>
EBITDA	3,092	3,249	3,287	3,840	4,301
Depreciation	447	710	745	867	981
EBIT	2,645	2,539	2,542	2,973	3,320
Net interest income/(expenses)	0	(188)	(199)	(200)	(220)
Other income/(expenses)	469	452	388	464	506
Exceptional items	0	0	0	0	0
EBT	3,114	2,803	2,731	3,237	3,605
Income taxes	832	715	750	874	973
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>2,283</b>	<b>2,087</b>	<b>1,981</b>	<b>2,363</b>	<b>2,632</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,283</b>	<b>2,087</b>	<b>1,981</b>	<b>2,363</b>	<b>2,632</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	1,960	1,969	1,920	2,270	2,526
Provisions	78	79	77	91	101
Debt funds	63	63	63	63	63
Other liabilities	152	152	152	152	152
Equity capital	384	384	384	384	384
Reserves & surplus	10,120	12,971	13,760	14,701	15,749
Shareholders' fund	10,505	13,355	14,144	15,085	16,134
<b>Total liabilities and equities</b>	<b>12,758</b>	<b>15,619</b>	<b>16,357</b>	<b>17,662</b>	<b>18,976</b>
Cash and cash eq.	1,256	4,357	5,514	6,280	7,347
Accounts receivables	2,352	2,363	2,304	2,724	3,031
Inventories	0	0	0	0	0
Other current assets	2,547	2,560	2,496	2,951	3,283
Investments	2,916	2,916	2,916	2,916	2,916
Net fixed assets	1,346	1,082	786	449	58
CWIP	150	150	150	150	150
Intangible assets	2,220	2,220	2,220	2,220	2,220
Deferred tax assets, net	121	121	121	121	121
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>12,758</b>	<b>15,619</b>	<b>16,357</b>	<b>17,662</b>	<b>18,976</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	3,562	2,797	2,726	3,230	3,613
Interest expenses	(257)	(264)	(189)	(264)	(286)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(300)	(14)	72	(511)	(373)
Other operating cash flows	(943)	809	0	0	0
<b>Cash flow from operations</b>	<b>2,062</b>	<b>3,328</b>	<b>2,608</b>	<b>2,455</b>	<b>2,955</b>
Capital expenditures	(520)	(446)	(449)	(530)	(590)
Change in investments	(1,210)	0	0	0	0
Other investing cash flows	(567)	264	189	264	286
<b>Cash flow from investing</b>	<b>(2,297)</b>	<b>(182)</b>	<b>(260)</b>	<b>(267)</b>	<b>(304)</b>
Equities issued/Others	53	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(554)	0	0	0	0
Dividends paid	(38)	(45)	(1,192)	(1,422)	(1,584)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(539)</b>	<b>(45)</b>	<b>(1,192)</b>	<b>(1,422)</b>	<b>(1,584)</b>
<b>Changes in cash and cash eq.</b>	<b>(774)</b>	<b>3,101</b>	<b>1,157</b>	<b>767</b>	<b>1,067</b>
<b>Closing cash and cash eq.</b>	<b>1,256</b>	<b>4,357</b>	<b>5,514</b>	<b>6,280</b>	<b>7,347</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	60.1	55.5	58.2	69.4	77.3
Adjusted EPS	60.1	55.5	58.2	69.4	77.3
Dividend per share	1.0	1.0	29.1	34.7	38.6
Book value per share	279.1	354.8	375.8	400.8	428.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	1.1	1.2	1.2	0.9	0.7
EV/EBITDA	5.0	5.2	5.1	3.8	3.2
Adjusted P/E	8.6	9.4	8.9	7.5	6.7
P/BV	1.9	1.5	1.4	1.3	1.2

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	73.3	74.5	72.5	73.0	73.0
Interest burden (PBT/EBIT)	117.7	110.4	107.4	108.9	108.6
EBIT margin (EBIT/Revenue)	18.5	17.7	18.1	17.9	18.0
Asset turnover (Revenue/Avg TA)	105.7	101.3	87.7	97.4	100.6
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	20.2	17.5	14.4	16.2	16.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	4.8	0.5	(2.5)	18.2	11.2
EBITDA	(15.7)	5.1	1.2	16.8	12.0
Adjusted EPS	(19.4)	(7.7)	4.9	19.3	11.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	21.6	22.6	23.4	23.2	23.3
EBIT margin	18.5	17.7	18.1	17.9	18.0
Adjusted profit margin	16.0	14.5	14.1	14.3	14.3
Adjusted ROAE	20.2	17.5	14.4	16.2	16.9
ROCE	30.4	27.1	28.1	33.2	36.7
<b>Working capital days (days)</b>					
Receivables	60	60	61	55	57
Inventory	0	0	0	0	0
Payables	64	64	66	60	62
<b>Ratios (x)</b>					
Gross asset turnover	11.2	11.8	15.0	26.8	72.8
Current ratio	3.0	4.5	5.2	5.1	5.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.3)	(0.4)	(0.4)	(0.5)

Source: Company, BOBCAPS Research



## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

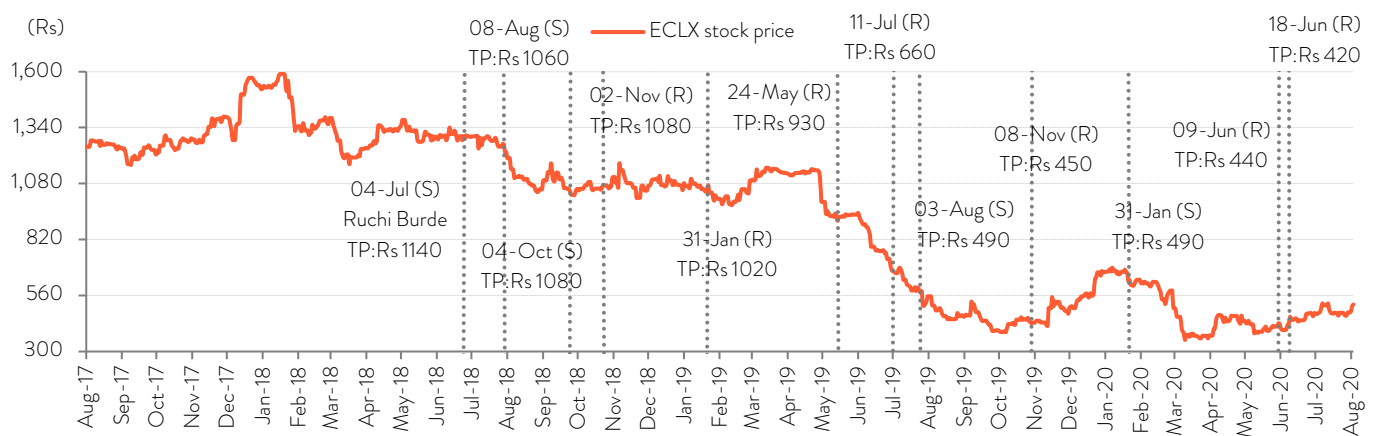
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): ECLERX SERVICES (ECLX IN)



B – Buy, A – Add, R – Reduce, S – Sell

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