

**SELL**

TP: Rs 600 | ▼ 16%

**ECLERX SERVICES**

| IT Services

| 05 November 2020

## Strong growth driven by sharp CLX recovery

eClerx (ECLX) reported a surprising growth and margin beat in Q2FY21 backed by CLX recovery and aggressive cost cuts. Dollar revenue grew 8.3% QoQ, ahead of our estimate led by higher utilisation. Management expects H2FY21 revenue to better H1. In our view, long-term demand visibility thereafter is bleak and margins do not look sustainable. We raise FY22-FY23 EPS by 4-10% to factor in the H2 outlook. On rollover, we have a new Sep'21 TP of Rs 600 (vs. Rs 580). Valuations at 11x FY22E P/E are cheap but lack catalysts. **SELL.**

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**Growth outperforms:** Dollar revenue at US\$ 48.5mn (US\$ 45.4mn est.) increased 8.3% QoQ and 4% CC. Demand recovery has been faster than management expected, driven by (1) improvement in CLX and managed services business, and (2) increased utilisation (+620bps QoQ to 79.1%) post stabilisation in the 'work-from-home' environment. EBIT margin at 24.5% (vs. 20.1% est.) was up 490bps QoQ, contributed by improvement across all cost efficiency levers. Wage hike has been carried out partially in Q1 and hike for upper management will be done from Q3FY21. Management expects margin levels to reverse back to pre-covids level over the long term.

**CLX weakness subsides:** CLX business has recovered sharply following a 20-30% QoQ dip in Q1. Management does not expect current restrictions in Europe to affect operations as these are mostly for discretionary activities. But we remain wary of the volatile nature of the CLX business.

**Upbeat H2 outlook:** Post a stellar second quarter, management expects H2FY21 dollar revenue to be better than H1, partly helped by the extremely weak base of Q1. However, the elevated utilisation level is expected to normalise. This will lead to margins declining from current levels as well.

Ticker/Price	ECLX IN/Rs 714
Market cap	US\$ 362.8mn
Shares o/s	38mn
3M ADV	US\$ 1.5mn
52wk high/low	Rs 812/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	14,474	17,092	18,993
EBITDA (Rs mn)	3,092	3,249	3,743	4,090	4,530
Adj. net profit (Rs mn)	2,283	2,087	2,231	2,542	2,795
Adj. EPS (Rs)	60.1	55.5	64.3	73.2	80.5
Adj. EPS growth (%)	(19.4)	(7.7)	16.0	13.9	10.0
Adj. ROAE (%)	20.2	17.5	16.2	17.2	17.7
Adj. P/E (x)	11.9	12.9	11.1	9.7	8.9
EV/EBITDA (x)	7.4	7.4	6.4	5.4	4.6

Source: Company, BOBCAPS Research

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## Other highlights

- Q1FY21 was the most challenging quarter for the BPO business due to delayed approvals. The sharp uptick in Q2 revenues was partially because supply-side issues were resolved. Clients are looking to move more work offshore, particularly to India. Given pricing pressure post Covid-19, ECLX aims to reduce costs through automation and offshoring.
- CLX (Italy-based business) saw a steep 20-30% QoQ drop in Q1FY21 leading to a 17% decline in Europe revenues. In Q2, recovery in CLX has been much better than expected, causing Europe to grow 32%, USD. Managed services saw a 40% QoQ uptick due to recovery in CLX.
- ECLX's digital business consists of creative production, digital operations (i.e. SEO, ERP, e-commerce website management) and analytics. This forms ~40% of revenue and has seen some demand recovery. BFSI and technology services have been relatively resilient. Emerging clients (i.e. non-top 10) which were the worst affected by the Covid crisis have bounced back with 19% QoQ growth.
- DSOs improved to 74 days in Q2 from 83 in Q1.

**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
<b>Revenues (US\$ mn)</b>	<b>48.5</b>	<b>50.1</b>	<b>(3.2)</b>	<b>44.8</b>	<b>8.3</b>
Revenue	3,608	3,565	1.2	3,365	7.2
Operating Expenditure	2,527	2,785	(9.3)	2,531	(0.2)
Cost of revenues	1,793	1,910	(6.1)	1,809	(0.9)
as % of sales	49.7	53.6	-	53.8	-
SG&A expenses	734	875	(16.1)	722	1.7
as % of sales	20.3	24.5	-	21.5	-
EBITDA	1,081	780	38.6	834	29.6
Depreciation	196	177	10.8	173	13.4
<b>EBIT</b>	<b>885</b>	<b>603</b>	<b>46.8</b>	<b>661</b>	<b>33.8</b>
Other Income	(4)	87	-	115	-
<b>Interest</b>	<b>49</b>	<b>48</b>	<b>-</b>	<b>49</b>	<b>-</b>
PBT	832	642	29.6	727	14.4
Total Tax	217	206	5.5	209	4.0
<b>Adjusted PAT</b>	<b>615</b>	<b>436</b>	<b>41.0</b>	<b>518</b>	<b>18.5</b>
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-
APAT after MI	615	436	41.0	518	18.5
Extra ordinary items	0	0		0	
Reported PAT	615	436	41.0	518	18.5
Reported EPS	17.7	11.6	52.7	14.3	23.5

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>
EBITDA	30.0	21.9	810	24.8	520
EBIT	24.5	16.9	760	19.6	490
EBT	23.0	18.0	510	21.6	140
PAT	17.0	12.2	480	15.4	160
Effective Tax rate	26.1	32.1	(600)	28.7	(260)

Source: BOBCAPS Research

**FIG 2 – OPERATING METRICS**

(in US\$ terms)	Q2FY21	Growth (%)	
		QoQ	YoY
<b>Revenue by Geography (%)</b>			
North America	66.0	0.6	(4.6)
Europe	28.0	31.8	0.4
ROW	6.0	8.3	(3.2)
<b>Client Contribution to Revenue</b>			
Top 10	67.0	3.5	0.3
Non-Top 10 client revenues	33.0	19.1	4.5
Total Employees	8,502	(1)	(0.6)
<b>Billing Mix</b>			
FTE	69.0	(1.7)	(2.6)
Managed Services Revenues	31.0	39.8	7.2
<b>Onsite-Offshore Mix</b>			
Onsite Revenues	23.0	18.6	(10.9)
Offshore Revenues	77.0	5.5	(0.6)
<b>Currency Concentration</b>			
USD	81.0	3.2	0.4
Euro	13.0	56.4	10.2
GBP	5.0	35.3	1.7

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. However, the company has demonstrated efficient cost management, helped by increased utilisation (at a four-year high of 79%), offshoring and reduced attrition.

We raise FY21/FY22/FY23 EPS estimates by 11%/6%/4% factoring in the above-expected Q2 performance, higher operational efficiency and upbeat H2FY21 outlook. Rolling valuations forward, we have a revised Sep'21 target price of Rs 600 (Rs 580 earlier), set at an unchanged 8x one-year forward P/E.

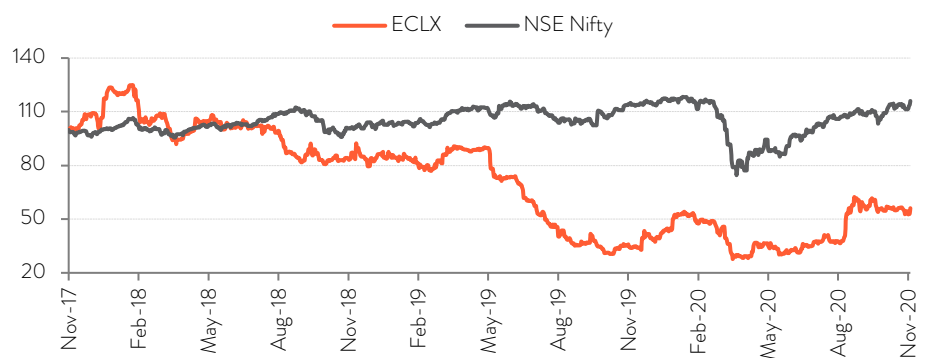
We believe that lower revenue productivity and an increasing mix of non-annuity business render ECLX comparable to BPO rather than IT services players. Despite a good Q2 performance, we remain wary of low long-term revenue visibility and unsustainable margins. ECLX's subdued growth of 0.6% from US is not encouraging. Valuations at 12.7x/10.9x FY21E/FY22E P/E are inexpensive but lack catalysts. Reiterate SELL.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	185.7	192.8	3.8	212.5	219.2	3.1	236.3	243.4	3.0
YoY growth (%)	(7.4)	(3.9)	-	14.5	13.7	-	11.2	11.0	-
Revenues	14,018	14,474	3.3	16,573	17,092	3.1	18,437	18,993	3.0
EBIT	2,542	2,989	17.6	2,973	3,218	8.2	3,320	3,540	6.6
EBITDA margins (%)	18.1	20.7	-	17.9	18.8	-	18.0	18.6	-
Net profits	1,981	2,231	12.6	2,363	2,542	7.6	2,632	2,795	6.2
EPS (Rs)	58.2	64.3	10.6	69.4	73.2	5.6	77.3	80.5	4.3

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

### Key risks

- Sharper recovery in demand, especially for the offshore business
- Stronger revival in CLX business
- Above-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>14,474</b>	<b>17,092</b>	<b>18,993</b>
EBITDA	3,092	3,249	3,743	4,090	4,530
Depreciation	447	710	754	872	990
EBIT	2,645	2,539	2,989	3,218	3,540
Net interest income/(expenses)	0	(188)	(199)	(200)	(220)
Other income/(expenses)	469	452	294	464	509
Exceptional items	0	0	0	0	0
EBT	3,114	2,803	3,084	3,482	3,829
Income taxes	832	715	853	940	1,034
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>2,231</b>	<b>2,542</b>	<b>2,795</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,283</b>	<b>2,087</b>	<b>2,231</b>	<b>2,542</b>	<b>2,795</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	1,983	2,341	2,602
Provisions	78	79	79	94	104
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	13,860	14,872	15,985
Shareholders' fund	10,505	13,355	14,244	15,256	16,369
<b>Total liabilities and equities</b>	<b>12,758</b>	<b>15,619</b>	<b>16,522</b>	<b>17,907</b>	<b>19,291</b>
Cash and cash eq.	1,256	4,357	5,516	6,330	7,444
Accounts receivables	2,352	2,363	2,379	2,810	3,122
Inventories	0	0	0	0	0
Other current assets	2,547	2,560	2,578	3,044	3,382
Investments	2,916	2,916	2,916	2,916	2,916
Net fixed assets	1,346	1,082	792	467	85
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>16,522</b>	<b>17,907</b>	<b>19,291</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	2,985	3,413	3,784
Interest expenses	(257)	(264)	(95)	(264)	(289)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(300)	(14)	(20)	(524)	(380)
Other operating cash flows	(943)	809	0	0	0
<b>Cash flow from operations</b>	<b>2,062</b>	<b>3,328</b>	<b>2,870</b>	<b>2,626</b>	<b>3,116</b>
Capital expenditures	(520)	(446)	(463)	(547)	(608)
Change in investments	(1,210)	0	0	0	0
Other investing cash flows	(567)	264	95	264	289
<b>Cash flow from investing</b>	<b>(2,297)</b>	<b>(182)</b>	<b>(368)</b>	<b>(283)</b>	<b>(319)</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)	(1,343)	(1,529)	(1,682)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(539)</b>	<b>(45)</b>	<b>(1,343)</b>	<b>(1,529)</b>	<b>(1,682)</b>
<b>Changes in cash and cash eq.</b>	<b>(774)</b>	<b>3,101</b>	<b>1,159</b>	<b>813</b>	<b>1,115</b>
<b>Closing cash and cash eq.</b>	<b>1,256</b>	<b>4,357</b>	<b>5,516</b>	<b>6,330</b>	<b>7,444</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	60.1	55.5	64.3	73.2	80.5
Adjusted EPS	60.1	55.5	64.3	73.2	80.5
Dividend per share	1.0	1.0	32.2	36.7	40.3
Book value per share	279.1	354.8	378.4	405.3	434.9

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	1.6	1.7	1.7	1.3	1.1
EV/EBITDA	7.4	7.4	6.4	5.4	4.6
Adjusted P/E	11.9	12.9	11.1	9.7	8.9
P/BV	2.6	2.0	1.9	1.8	1.6

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	73.3	74.5	72.3	73.0	73.0
Interest burden (PBT/EBIT)	117.7	110.4	103.2	108.2	108.1
EBIT margin (EBIT/Revenue)	18.5	17.7	20.7	18.8	18.6
Asset turnover (Revenue/Avg TA)	105.7	101.3	90.1	99.3	102.1
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	20.2	17.5	16.2	17.2	17.7

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	0.7	18.1	11.1
EBITDA	(15.7)	5.1	15.2	9.3	10.8
Adjusted EPS	(19.4)	(7.7)	16.0	13.9	10.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	21.6	22.6	25.9	23.9	23.8
EBIT margin	18.5	17.7	20.7	18.8	18.6
Adjusted profit margin	16.0	14.5	15.4	14.9	14.7
Adjusted ROAE	20.2	17.5	16.2	17.2	17.7
ROCE	30.4	27.1	32.8	35.5	38.6
<b>Working capital days (days)</b>					
Receivables	60	60	60	55	57
Inventory	0	0	0	0	0
Payables	64	64	67	61	62
<b>Ratios (x)</b>					
Gross asset turnover	11.2	11.8	15.5	27.2	68.9
Current ratio	3.0	4.5	5.1	5.0	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



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

**BUY** – Expected return >+15%

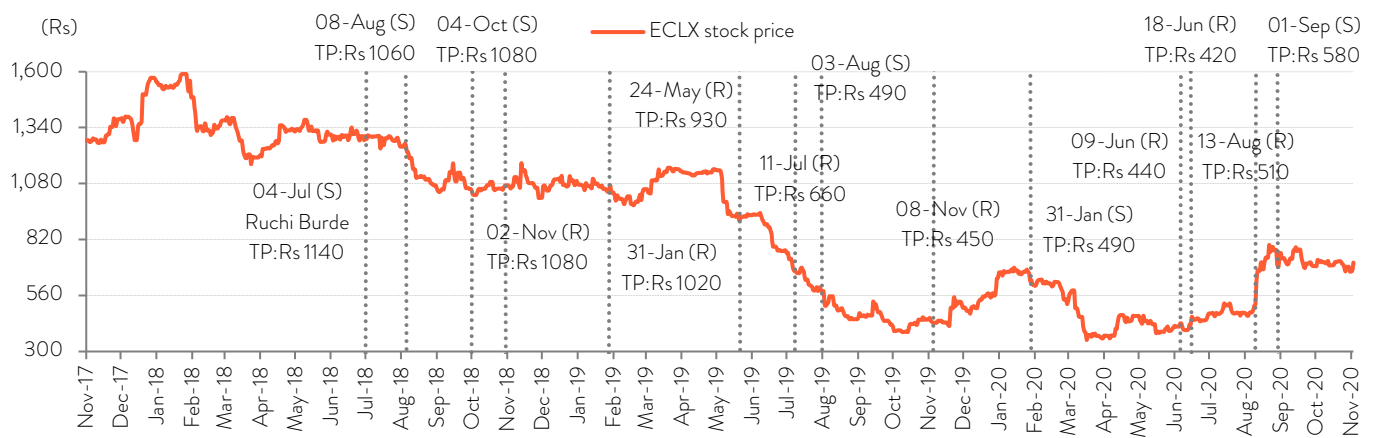
**ADD** – Expected return from >+5% to +15%

**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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