

BUY

TP: Rs 2,880 | ▲ 23%

ECLERX SERVICES

Technology & Internet

03 November 2021

Stellar Q2FY22 performance; upbeat demand environment

- Q2 revenue grew 7.1% QoQ USD, delivering a strong beat. EBIT margin missed our estimate but outperformed consensus expectations
- Absence of significant project roll-offs plus supportive medium-term demand climate boosts growth visibility beyond FY22
- Talent crunch in client markets and higher acceptance of offshore delivery serving as structural demand catalysts; retain BUY and TP of Rs 2,880

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Stellar growth: ECLX reported Q2FY22 revenue growth of 7.1% QoQ in dollar terms, outperforming our estimate of 5.1%. Growth was led by emerging clients (non-top 10 accounts) which grew 11.3% QoQ USD while revenue from the top 10 clients increased 4.5%. Revenue growth was well balanced between onsite and offshore locations, resulting in a static offshore mix (flat sequentially at 80% of revenue). The company performed well across verticals and saw an uptick in onsite consulting business as well as its evolving service portfolio.

Supply challenges limit margin expansion: EBIT margin stood at 26.7%, below our estimate of 30.3% but above consensus (25.6%). Despite stellar revenue growth, EBIT margin expansion was limited to 110bps QoQ to 26.7% due to supply pressure. Attrition rose 960bps QoQ to 41.3%, back to pre-Covid levels. ECLX's net headcount increased to 13,572 (up 662 people QoQ or 5% QoQ), driving up employee cost. About 85% of the headcount addition was in the offshore base. Management attributed the increased staffing to high attrition and buoyant demand. FY22 EBITDA margin guidance remains at 28-32%.

Supportive demand environment: Management expects a supportive demand climate over the short-to-medium term. This drives visibility and confidence on double-digit topline growth for FY23. Moreover, talent shortage in client markets, higher acceptability of offshore delivery and suboptimal operations of captives have structurally boosted demand. ECLX is also gaining from the absence of significant project roll-offs (the prime reason for its stagnant revenues over FY16-FY20). Per management, the company has not experienced any material unplanned project roll-offs over the last 18 months and does not foresee any in the near term.

Reiterate BUY: We keep our above-consensus FY23/FY24 EPS estimates largely unchanged and reiterate BUY with an unchanged Sep'22 TP of Rs 2,880. We continue to value the stock at 19.5x one-year forward P/E, ~50% discount to our target multiple for mid-sized IT companies under our coverage.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ECLX IN/Rs 2,343
Market cap	US\$ 1.2bn
Free float	45%
3M ADV	US\$ 1.7mn
52wk high/low	Rs 2,470/Rs 671
Promoter/FPI/DII	54%/20%/26%

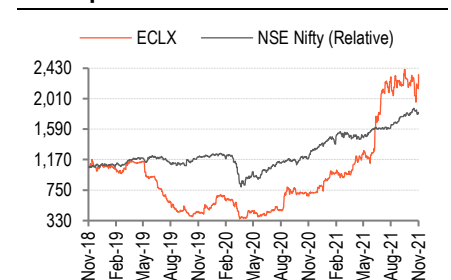
Source: NSE | Price as of 3 Nov 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	15,644	21,074	24,369
EBITDA (Rs mn)	4,642	6,637	7,653
Adj. net profit (Rs mn)	2,828	4,203	4,873
Adj. EPS (Rs)	82.8	123.8	143.6
Consensus EPS (Rs)	82.8	108.0	120.0
Adj. ROAE (%)	20.1	27.0	28.4
Adj. P/E (x)	28.3	18.9	16.3
EV/EBITDA (x)	18.2	12.7	11.0
Adj. EPS growth (%)	49.4	49.5	15.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenues (US\$ mn)	69.3	48.5	42.9	64.7	7.1	134	93	43.6
Revenue	5,233	3,608	45.0	4,864	7.6	10,097	6,973	44.8
Operating Expenditure	3,584	2,527	41.8	3,382	6.0	6,966	5,058	37.7
Cost of revenues	2,601	1,793	45.1	2,454	6.0	5,055	3,602	40.3
as % of sales	49.7	49.7	-	50.5	-	50	52	-
SG&A expenses	983	734	33.9	928	5.9	1,911	1,456	31.3
as % of sales	18.8	20.3	-	19.1	-	19	21	-
EBITDA	1,649	1,081	52.6	1,482	11.3	3,131	1,915	63.5
Depreciation	252	196	28.4	237	6.4	489	369	32.4
EBIT	1,397	885	57.9	1,245	12.2	2,642	1,546	70.9
Other Income	18	(4)	-	82	-	99	112	-
Interest	55	49	-	54	-	110	99	-
Non-recurring items	-	-	-	(57)	-	(57)	0	-
PBT	1,359	832	63.5	1,215	11.8	2,575	1,559	65.2
Total Tax	346	217	59.2	295	17.1	641	426	50.5
Adjusted PAT	1,014	615	65.0	920	10.1	1,934	1,133	70.7
(Profit)/loss from JV's/Ass/MI	0	-	-	7	-	8	0	-
APAT after MI	1,013	615	64.9	913	11.0	1,926	1,133	70.0
Extra ordinary items	0	0	-	(57)	-	(57)	0	-
Reported PAT	1,013	615	64.9	856	18.3	1,870	1,133	65.0
Reported EPS	29.0	17.7	64.0	26.6	9.4	56	32	73.5
Margins (%)			(bps)		(bps)			(bps)
EBITDA	31.5	30.0	160	30.5	100	31.0	27.5	350
EBIT	26.7	24.5	220	25.6	110	26.2	22.2	400
EBT	26.0	23.0	290	25.0	100	25.5	22.4	310
PAT	19.4	17.0	230	18.8	60	19.1	16.2	280
Effective Tax rate	25.4	26.1	(70)	24.3	110	24.9	27.3	(240)

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

(in USD terms)	Q2FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Geography			
North America	69.0	5.6	49.4
Europe	24.0	11.8	22.5
ROW	7.0	7.1	66.7
Client Concentration			
Top 10	60.3	4.5	22.9
Non-Top 10	39.7	11.3	42.5
Total Employees	13,572	5.0	5.1
Billing Mix			
FTE	76.0	8.5	8.5
Managed Services Revenues	24.0	2.8	10.6
Revenue by Location			
Onsite Revenues	20.0	7.1	24.2
Offshore Revenues	80.0	7.1	48.5
Currency Concentration			
USD	80.0	7.1	7.1
Euro	10.0	(10.7)	(10.7)
GBP	5.0	33.9	33.9

Source: Company, BOBCAPS Research

Valuation methodology

Talent shortage in client markets, enhanced acceptance of offshore delivery and suboptimal execution by captive business units have structurally boosted outsourcing demand and set in motion a structural growth turnaround at ECLX. We keep our above-consensus FY23/FY24 EPS estimates largely unchanged and reiterate BUY with an unchanged Sep'22 TP of Rs 2,880. We continue to value the stock at 19.5x one-year forward P/E, ~50% discount to our target multiple for mid-sized IT companies under our coverage.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	278.4	318.0	349.8	272.9	304.9	335.7	2.0	4.3	4.2
YoY growth (%)	32.3	14.2	10.0	29.69	11.75	10.08	-	-	-
Revenues	21,074	24,369	26,621	20,754	23,831	26,189	1.5	2.3	1.6
EBIT	5,638	6,474	6,967	5,553	6,532	7,093	1.5	(0.9)	(1.8)
EBIT margins (%)	26.8	26.6	26.2	26.8	27.4	27.1	-	-	-
Net Profits	4,203	4,873	5,300	4,169	4,939	5,406	0.8	(1.3)	(2.0)
EPS (Rs)	125.5	143.6	156.1	122.3	143.6	157.2	2.6	0.0	(0.7)

Source: BOBCAPS Research

Fig 4 – Peer comparison

Ticker	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		P/E (x)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
TCS IN	BUY	4,630	13.8	103.4	119.7	39.4	37.4	33.8	29.2
INFO IN	BUY	2,000	14.4	53.9	59.5	29.6	30.7	31.6	28.6
WPRO IN	BUY	840	18.4	23.4	26.9	21.2	21.6	27.8	24.2
HCLT IN	BUY	1,440	10.7	49.1	55.2	20.3	20.5	24.0	21.3
TECHM IN	BUY	1,890	15.3	65.2	80.0	21.4	23.3	23.0	18.7
LTI IN	BUY	7,980	21.1	134.5	161.8	29.5	29.9	50.1	41.6
MPHL IN	HOLD	3,510	16.1	76.5	92.6	21.0	23.6	43.1	35.6
MTCL IN	SELL	3,390	21.0	94.1	100.2	33.0	29.8	49.2	46.2
PSYS IN	HOLD	4,170	24.7	78.5	92.4	21.0	21.5	51.1	43.4
COFORGE IN	BUY	6,680	27.1	125.6	172.0	28.4	32.8	40.3	29.4
ECLX IN	BUY	2,880	22.9	125.5	143.6	27.0	28.4	18.7	16.4

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- volatility in top 10 accounts,
- high attrition, and
- inability to unlock M&A synergies.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Affle (India)	AFFLE IN	0.4	1,059	1,240	BUY
Coforge	COFORGE IN	4.2	5,065	6,680	BUY
eClerx Services	ECLX IN	1.2	2,343	2,880	BUY
HCL Technologies	HCLT IN	42.9	1,176	1,440	BUY
IndiaMart InterMesh	INMART IN	3.0	7,331	8,430	HOLD
Info Edge	INFOE IN	10.4	6,049	6,530	BUY
Infosys	INFO IN	97.3	1,703	2,000	BUY
Just Dial	JUST IN	0.6	776	1,190	BUY
L&T Infotech	LTI IN	15.9	6,736	7,980	BUY
Mindtree	MTCL IN	10.2	4,628	3,390	SELL
Mphasis	MPHL IN	8.2	3,299	3,510	HOLD
Persistent Systems	PSYS IN	4.3	4,003	4,170	HOLD
Tata Consultancy Services	TCS IN	176.0	3,492	4,630	BUY
Tech Mahindra	TECHM IN	17.6	1,499	1,890	BUY
Wipro	WPRO IN	48.4	653	840	BUY

Source: BOBCAPS Research, NSE | Price as of 3 Nov 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	14,376	15,644	21,074	24,369	26,621
EBITDA	3,249	4,642	6,637	7,653	8,312
Depreciation	710	816	999	1,179	1,345
EBIT	2,539	3,826	5,638	6,474	6,967
Net interest inc./(exp.)	(188)	(203)	(210)	(200)	(200)
Other inc./(exp.)	452	182	279	311	395
Exceptional items	0	0	(57)	0	0
EBT	2,803	3,806	5,651	6,585	7,162
Income taxes	715	978	1,440	1,712	1,862
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	8	0	0
Reported net profit	2,087	2,828	4,203	4,873	5,300
Adjustments	0	0	0	0	0
Adjusted net profit	2,087	2,828	4,203	4,873	5,300

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	0	0	0	0	0
Other current liabilities	2,058	2,874	2,887	3,338	3,647
Provisions	197	238	115	134	146
Debt funds	63	63	63	63	63
Other liabilities	129	175	175	175	175
Equity capital	358	346	346	346	346
Reserves & surplus	12,706	14,674	15,814	17,755	19,865
Shareholders' fund	13,065	15,019	16,160	18,100	20,211
Total liab. and equities	15,513	18,370	19,400	21,810	24,242
Cash and cash eq.	3,345	4,909	3,927	5,608	7,761
Accounts receivables	2,378	2,930	3,464	4,006	4,376
Inventories	0	0	0	0	0
Other current assets	1,520	1,950	3,753	4,340	4,741
Investments	4,368	2,286	2,286	2,286	2,286
Net fixed assets	1,246	2,229	1,904	1,505	1,012
CWIP	2	2	2	2	2
Intangible assets	2,272	3,726	3,726	3,726	3,726
Deferred tax assets, net	384	340	340	340	340
Other assets	0	0	0	0	0
Total assets	15,513	18,370	19,401	21,811	24,243

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	3,338	3,646	2,694	5,282	6,000
Capital expenditures	(335)	(387)	(674)	(780)	(852)
Change in investments	(1,371)	2,236	0	0	0
Other investing cash flows	1,889	(1,894)	69	111	195
Cash flow from investing	183	(45)	(605)	(669)	(657)
Equities issued/Others	6	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(3,053)	(1,849)	0	0	0
Dividends paid	(36)	(34)	(3,070)	(2,932)	(3,189)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(3,082)	(1,883)	(3,070)	(2,932)	(3,189)
Chg in cash & cash eq.	439	1,717	(982)	1,680	2,153
Closing cash & cash eq.	3,345	4,909	3,927	5,608	7,761

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	55.5	82.8	123.8	143.6	156.1
Adjusted EPS	55.5	82.8	123.8	143.6	156.1
Dividend per share	1.0	41.8	1.0	72.9	79.3
Book value per share	347.1	399.0	429.3	480.9	536.9

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	5.8	5.4	4.0	3.4	3.1
EV/EBITDA	25.8	18.2	12.7	11.0	10.0
Adjusted P/E	42.2	28.3	18.9	16.3	15.0
P/BV	6.7	5.9	5.5	4.9	4.4

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	74.5	74.3	74.4	74.0	74.0
Interest burden (PBT/EBIT)	110.4	99.5	100.2	101.7	102.8
EBIT margin (EBIT/Revenue)	17.7	24.5	26.8	26.6	26.2
Asset turnover (Rev./Avg TA)	91.2	92.3	111.6	118.3	115.6
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	15.5	20.1	27.0	28.4	27.7

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	0.5	8.8	34.7	15.6	9.2
EBITDA	5.1	42.9	43.0	15.3	8.6
Adjusted EPS	(7.7)	49.4	49.5	15.9	8.8
Profitability & Return ratios (%)					
EBITDA margin	22.6	29.7	31.5	31.4	31.2
EBIT margin	17.7	24.5	26.8	26.6	26.2
Adjusted profit margin	14.5	18.1	19.9	20.0	19.9
Adjusted ROAE	15.5	20.1	27.0	28.4	27.7
ROCE	26.1	37.7	49.3	51.2	54.7
Working capital days (days)					
Receivables	61	62	55	56	57
Inventory	0	0	0	0	0
Payables	66	82	73	68	70
Ratios (x)					
Gross asset turnover	11.3	9.0	10.2	14.3	21.1
Current ratio	3.2	3.1	3.7	4.0	4.5
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.3)	(0.2)	(0.3)	(0.4)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

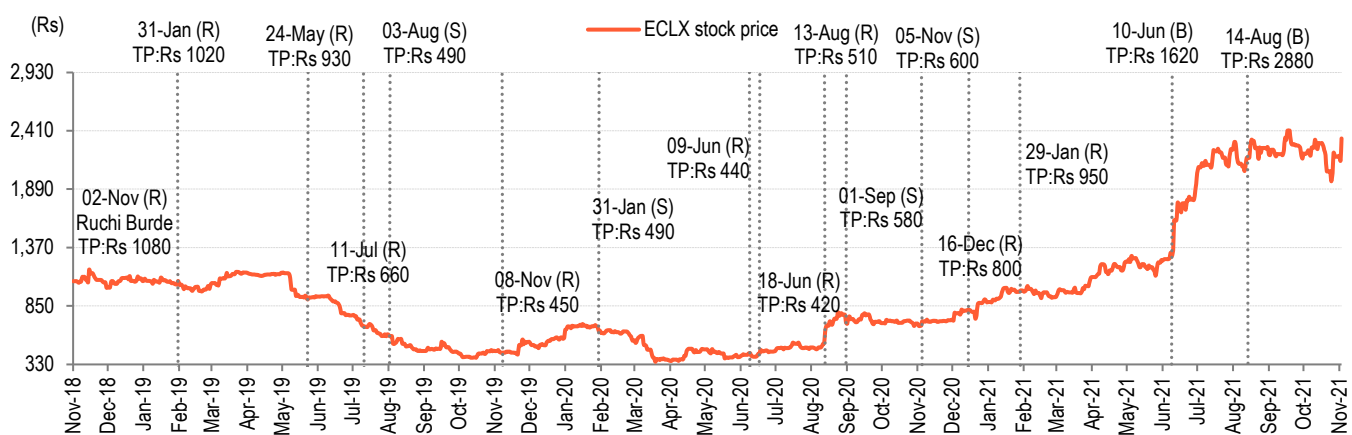
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): ECLERX SERVICES (ECLX IN)



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

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