

BUY

TP: Rs 3,790 | ▲ 52%

ECLERX SERVICES

Technology & Internet

02 February 2022

All-round outperformance; maintain BUY

- Q3 revenue growth at 5.9% QoQ USD beat our estimate led by a sharp increase in offshoring
- EBIT margin at 27.1% also stood above our estimate of 25.9% aided by operating leverage and a higher offshore mix
- We raise FY23/FY24 EPS by 5%/4% and increase our TP to Rs 3,790 (vs. Rs 3,690); retain BUY

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Stellar growth: ECLX reported Q3FY22 revenue growth of 5.9% QoQ USD, outperforming our estimate of 2.6%. The top 10 accounts contributed a bulk of the growth, rising 6.5% QoQ USD, while revenue from the non-top 10 clients increased 5.1%. Revenue growth was skewed towards offshore locations, which saw an impressive uptick of 7.2% QoQ, raising the offshore mix by 100bps QoQ. The company performed well across verticals. Personiv too has been doing well and its above-expected performance in FY21 has led ECLX to raise earnouts beyond earlier estimates.

Supply-side challenges retreating: EBIT margin stood at 27.1%, above our estimate of 25.9% and up 40bps QoQ. Attrition was at 37.3%, down from a high of 41.3% in Q2FY22. ECLX's net headcount increased to 14,112 (up 540 people QoQ or 4.1% QoQ), driving up employee cost. About 86% 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%, biased toward the upper end of the range.

Positive outlook: Management sees a positive demand environment largely driven by customer support and analytics in the digital business. ECLX expects to maintain growth momentum, with Q4FY22 to be better than Q3 due to seasonality. Of the four business pillars – BPO, onshore, consulting and tech – it is tech that has been growing the fastest over the last few years and management believes it will continue to do so. However, some margin impact could be seen in Q1FY23 as another round of salary hikes is due (higher than that in FY22), but this should be mitigated by higher growth and better utilisation. Also, the company expects fewer roll-offs ahead.

Maintain BUY: Post Q3FY22, we raise FY23/FY24 EPS estimates by 5%/4% and reiterate BUY with a revised TP of Rs 3,790 (vs. Rs 3,690 earlier). We continue to value the stock at 24x Dec'23E EPS, ~50% discount to our target multiple for mid-sized IT companies under our coverage.

Key changes

Target	Rating
▲	◀ ▶

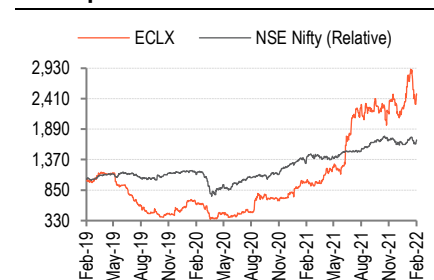
Ticker/Price	ECLX IN/Rs 2,492
Market cap	US\$ 1.3bn
Free float	45%
3M ADV	US\$ 3.6mn
52wk high/low	Rs 2,970/Rs 915
Promoter/FPI/DII	54%/20%/26%

Source: NSE | Price as of 2 Feb 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	15,644	21,458	25,244
EBITDA (Rs mn)	4,642	6,773	7,949
Adj. net profit (Rs mn)	2,828	4,217	5,086
Adj. EPS (Rs)	82.8	122.4	147.6
Consensus EPS (Rs)	82.8	108.0	120.0
Adj. ROAE (%)	20.1	27.0	29.6
Adj. P/E (x)	30.1	20.4	16.9
EV/EBITDA (x)	19.4	13.2	11.3
Adj. EPS growth (%)	49.4	47.7	20.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance

Source: NSE



Other highlights

- Chairman Pradeep Kapoor has resigned for age-related reasons and the board has appointed Anish Ghoshal as the new chairman. CFO Rohitash Gupta has also decided to take a sabbatical and step down. New CFO Srinivas Nadadur has been with ECLX for 10+ years, including 6-7 years as delivery head.
- Capex is expected to rise in Q4FY22 and Q1FY23 towards the cost of office refurbishment (as employees start returning to work).
- Seat count remained at 11,039 vs. Q2FY22.
- DSO in Q3FY22 was similar to last quarter at 66 days.

Fig 1 – Quarterly performance

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenues (US\$ mn)	73.4	53.3	37.7	69.3	5.9	207	147	41.5
Revenue	5,592	3,943	41.8	5,233	6.9	15,689	10,916	43.7
Operating Expenditure	3,813	2,767	37.8	3,584	6.4	10,779	7,825	37.8
Cost of revenues	2,738	1,950	40.4	2,601	5.3	7,793	5,552	40.4
as % of sales	49.0	49.5	-	49.7	-	49.7	50.9	-
SG&A expenses	1,075	817	31.6	983	9.4	2,986	2,273	31.4
as % of sales	19.2	20.7	-	18.8	-	19.0	20.8	-
EBITDA	1,779	1,176	51.3	1,649	7.9	4,910	3,091	58.8
Depreciation	264	202	30.7	252	4.8	753	571	31.8
EBIT	1,515	974	55.5	1,397	8.4	4,157	2,520	65.0
Other Income	45	33	-	18	-	144	145	-
Interest	54	48	-	55	-	163	147	-
Non-recurring items	(50)	-	-	-	-	(106)	0	-
PBT	1,457	959	52.0	1,359	7.2	4,031	2,517	60.1
Total Tax	384	247	55.1	346	11.0	1,024	673	52.2
Adjusted PAT	1,073	711	50.9	1,014	5.9	3,007	1,844	63.0
(Profit)/loss from JV's/Ass/MI	-	-	-	0	-	8	0	-
APAT after MI	1,073	711	50.9	1,013	5.9	3,000	1,844	62.6
Extra ordinary items	(50)	0	-	0	-	(50)	0	-
Reported PAT	1,024	711	43.9	1,013	1.0	2,950	1,844	60.0
Reported EPS	31.1	20.8	49.8	29.0	7.2	87	53	64.1
Margins (%)			(bps)		(bps)			(bps)
EBITDA	31.8	29.8	200	31.5	30	31.3	28.3	300
EBIT	27.1	24.7	240	26.7	40	26.5	23.1	340
EBT	26.0	24.3	170	26.0	10	25.7	23.1	260
PAT	19.2	18.0	110	19.4	(20)	19.1	16.9	220
Effective Tax Rate	26.3	25.8	50	25.4	90	25.4	26.7	(130)

Source: Company, BOBCAPS Research

Fig 2 – Operating metrics

(in USD terms)	Q3FY22 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Geography			
North America	70.0	7.5	46.1
Europe	23.0	1.5	13.1
ROW	7.0	5.9	60.7
Client Concentration			
Top 10	60.6	6.5	30.9
Non-Top 10	39.4	5.1	49.7
Total Employees	14,112	4.0	22.9
Billing Mix			
FTE	74.0	3.1	45.6
Managed Services Revenues	26.0	14.7	19.3
Onsite-Offsite Mix			
Onsite Revenues	19.0	0.6	13.8
Offshore Revenues	81.0	7.2	44.9
Currency Concentration			
USD	80.0	5.9	36.0
Euro	11.0	16.5	16.5
GBP	4.0	(15.3)	37.7

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. The company has seen a consensus EPS upgrade of over 35% for FY22 and FY23TD. With the current level of demand and growth traction, we see the possibility of another round of earnings upgrades.

We raise our FY23/FY24 EPS estimates by 5%/4% and reiterate BUY with a revised TP of Rs 3,790 (vs. Rs 3,690). We continue to value the stock at 24x Dec'23E EPS, ~50% discount to our target multiple for mid-sized IT companies under coverage. Maintain BUY.

Fig 3 – Revised estimates

(Rs mn)	New			Old			% change		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues (US\$ mn)	283	329	361	278	318	350	1.7	3.4	3.1
YoY growth (%)	34.6	16.1	9.7	32.3	14.2	10.0	-	-	-
Revenues	21,458	25,244	27,499	21,074	24,369	26,621	1.8	3.6	3.3
EBIT	5,762	6,765	7,254	5,638	6,474	6,967	2.2	4.5	4.1
EBIT margins (%)	26.9	26.8	26.4	26.8	26.6	26.2	-	-	-
Net Profits	4,224	5,086	5,508	4,210.4	4,873	5,300	0.3	4.4	3.9
EPS (Rs)	124.7	150.4	162.9	125.8	143.6	156.1	(0.9)	4.7	4.3

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Revenues (US\$ mn)	210.4	283.2	328.8	360.7
YoY growth (%)	4.9	34.6	16.1	9.7
EBIT margin (%)	24.5	26.9	26.8	26.4

Source: Company, BOBCAPS Research

Fig 5 – 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	4,770	14.1	104.0	120.3	39.6	37.5	37.1	32.0
INFO IN	BUY	2,250	17.1	54.4	62.3	29.8	32.0	32.9	28.7
WPRO IN	BUY	850	18.2	22.6	26.9	20.5	21.6	26.0	21.9
HCLT IN	BUY	1,610	12.6	49.0	56.2	20.3	20.9	23.9	20.8
TECHM IN	BUY	1,940	16.2	62.6	74.7	20.6	21.9	23.7	19.9
LTI IN	BUY	8,490	23.2	131.1	166.8	28.9	30.9	48.8	38.4
MPHL IN	HOLD	3,470	19.1	75.7	90.1	20.9	23.1	41.3	34.7
MTCL IN	BUY	5,610	23.9	97.9	105.3	34.2	31.0	41.5	38.6
PSYS IN	HOLD	4,580	27.9	82.3	98.3	22.0	22.7	53.9	45.1
COFORGE IN	BUY	7,080	27.8	125.1	174.2	28.3	33.2	38.5	27.7
ECLX IN	BUY	3,790	25.0	124.7	150.4	27.0	29.6	20.0	16.6

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- high attrition, and
- inability to unlock M&A synergies.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Coforge	COFORGE IN	4.0	4,823	7,080	BUY
eClerx Services	ECLX IN	1.3	2,492	3,790	BUY
HCL Technologies	HCLT IN	42.5	1,171	1,610	BUY
Infosys	INFO IN	101.8	1,787	2,250	BUY
L&T Infotech	LTI IN	15.0	6,397	8,490	BUY
Mindtree	MTCL IN	9.0	4,066	5,610	BUY
Mphasis	MPHL IN	7.8	3,128	3,470	HOLD
Persistent Systems	PSYS IN	4.7	4,436	4,580	HOLD
Tata Consultancy Services	TCS IN	193.6	3,856	4,770	BUY
Tech Mahindra	TECHM IN	17.3	1,483	1,940	BUY
Wipro	WPRO IN	43.5	588	850	BUY

Source: BOBCAPS Research, NSE | Price as of 2 Feb 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	14,376	15,644	21,458	25,244	27,499
EBITDA	3,249	4,642	6,773	7,949	8,610
Depreciation	710	816	1,011	1,184	1,356
EBIT	2,539	3,826	5,762	6,765	7,254
Net interest inc./(exp.)	(188)	(203)	(213)	(200)	(200)
Other inc./(exp.)	452	182	234	307	390
Exceptional items	0	0	(106)	0	0
EBT	2,803	3,806	5,676	6,872	7,443
Income taxes	715	978	1,452	1,787	1,935
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	8	0	0
Reported net profit	2,087	2,828	4,217	5,086	5,508
Adjustments	0	0	0	0	0
Adjusted net profit	2,087	2,828	4,217	5,086	5,508

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	2,939	3,458	3,767
Provisions	197	238	118	138	151
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	15,828	17,853	20,047
Shareholders' fund	13,065	15,019	16,173	18,198	20,392
Total liab. and equities	15,513	18,370	19,468	22,033	24,548
Cash and cash eq.	3,345	4,909	3,864	5,508	7,727
Accounts receivables	2,378	2,930	3,527	4,150	4,520
Inventories	0	0	0	0	0
Other current assets	1,520	1,950	3,821	4,496	4,897
Investments	4,368	2,286	2,286	2,286	2,286
Net fixed assets	1,246	2,229	1,905	1,529	1,052
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	19,469	22,034	24,549

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	3,338	3,646	2,692	5,405	6,224
Capital expenditures	(335)	(387)	(687)	(808)	(880)
Change in investments	(1,371)	2,236	0	0	0
Other investing cash flows	1,889	(1,894)	21	107	190
Cash flow from investing	183	(45)	(666)	(700)	(690)
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)	(3,071)	(3,060)	(3,314)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(3,082)	(1,883)	(3,071)	(3,060)	(3,314)
Chg in cash & cash eq.	439	1,717	(1,045)	1,644	2,219
Closing cash & cash eq.	3,345	4,909	3,864	5,508	7,727

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	55.5	82.8	122.4	147.6	159.8
Adjusted EPS	55.5	82.8	122.4	147.6	159.8
Dividend per share	1.0	41.8	1.0	75.2	81.4
Book value per share	347.1	399.0	429.7	483.5	541.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	6.2	5.7	4.2	3.5	3.2
EV/EBITDA	27.5	19.4	13.2	11.3	10.4
Adjusted P/E	44.9	30.1	20.4	16.9	15.6
P/BV	7.2	6.2	5.8	5.2	4.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	74.5	74.3	74.3	74.0	74.0
Interest burden (PBT/EBIT)	110.4	99.5	98.5	101.6	102.6
EBIT margin (EBIT/Revenue)	17.7	24.5	26.9	26.8	26.4
Asset turnover (Rev./Avg TA)	91.2	92.3	113.4	121.6	118.1
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	15.5	20.1	27.0	29.6	28.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	0.5	8.8	37.2	17.6	8.9
EBITDA	5.1	42.9	45.9	17.4	8.3
Adjusted EPS	(7.7)	49.4	47.7	20.6	8.3
Profitability & Return ratios (%)					
EBITDA margin	22.6	29.7	31.6	31.5	31.3
EBIT margin	17.7	24.5	26.9	26.8	26.4
Adjusted profit margin	14.5	18.1	19.7	20.1	20.0
Adjusted ROAE	15.5	20.1	27.0	29.6	28.5
ROCE	26.1	37.7	50.2	53.0	56.0
Working capital days (days)					
Receivables	61	62	55	56	58
Inventory	0	0	0	0	0
Payables	66	82	72	68	70
Ratios (x)					
Gross asset turnover	11.3	9.0	10.4	14.7	21.3
Current ratio	3.2	3.1	3.7	3.9	4.4
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%

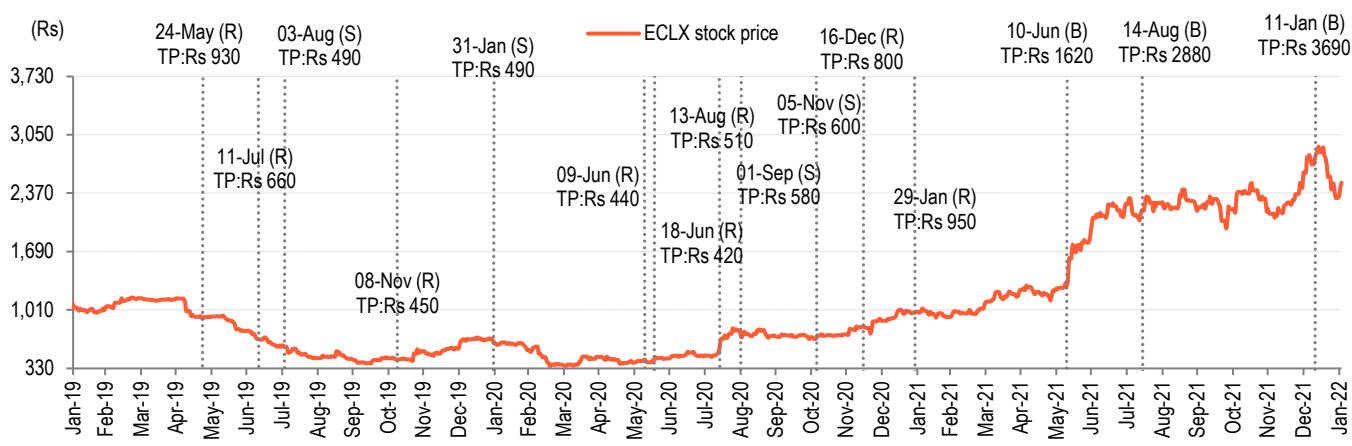
HOLD – Expected return from -6% to +15%

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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