

BUY

TP: Rs 1,620 | ▲ 21%

ECLERX SERVICES

| IT Services

| 10 June 2021

Upbeat FY22 outlook; upgrade to BUY

- ECLX reported Q4FY21 revenue growth of 19.3% CC QoQ, including 6.3% organic growth and the balance from its Personiv acquisition
- EBITDA margin at 32.8% was up 300bps QoQ. We raise FY22/FY23 EPS 13%/17% and roll over to a new Mar'22 TP of Rs 1,620 (vs. Rs 950)
- Upgrade from REDUCE to BUY at a higher target P/E of 12x (vs. 8x) on upbeat Q4 results and a better FY22 growth and margin outlook.

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Growth uptick: Q4 dollar revenue at US\$ 64mn increased 19.7% QoQ USD (19.3% CC of which 6.3% CC was organic growth), below our estimate of US\$ 69mn. Demand recovery has been faster than management expected driven by the incorporation of Personiv and increased utilisation (at 83.8%) as the 'work-from-home' environment stabilised. Utilisation increased 260bps QoQ and 870bps YoY. Attrition shot up to 35.8%, similar to the company's pre-Covid levels. EBIT margin at 27.6% (27% est.) expanded 290bps QoQ as offshore revenue increased 23% QoQ.

Synergy benefits from Personiv: Q4 annualised revenue from Personiv (acquisition completed on 23 Dec 2020) crossed the US\$ 30mn run rate and the growth outlook remains positive based on revenue and cost synergies from the overlap in operating geographies. We expect the readily available talent pool and cross-selling opportunities to also aid a better performance in FY22.

Double digit organic growth outlook for FY22: On the heels of two consecutive quarters of good growth, management expects double-digit organic growth in FY22. The deal pipeline has been healthy over the last 6-12 months and the demand outlook for the digital business remains positive. In terms of margins, management is confident of preserving the ~200bps of gains seen in Q4FY21 on account of SG&A savings. However, it believes 100bps margin benefit due to office-related costs saving may reverse on return of workforce to office

Upgrade to BUY: Given the positive demand environment for digital services, double-digit organic growth outlook for FY22, EBIT margin guidance of >25% (despite wage hike due in Q1FY22) and better offshore delivery, we raise FY22/FY23 EPS 13%/17% and upgrade the stock from REDUCE to BUY. Our new TP of Rs 1,620 is set at a higher FY23E P/E of 12x (vs. 8x) given ECLX's strengthening business mix (shift towards offshore), potential synergies from Personiv and efficient use of margin levers. Nevertheless, we maintain that its business is more comparable to BPO companies than IT service players.

Key changes

Target	Rating
▲	▲

Ticker/Price	ECLX IN/Rs 1,344
Market cap	US\$ 692.6mn
Free float	45%
3M ADV	US\$ 1.1mn
52wk high/low	Rs 1,379/Rs 390
Promoter/FPI/DII	54%/20%/26%

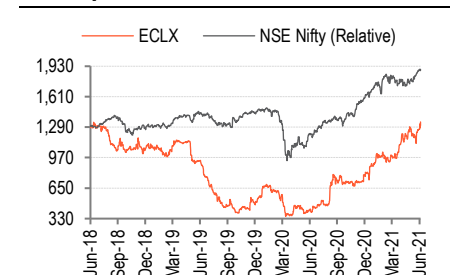
Source: NSE | Price as of 10 Jun 2021

Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	15,644	20,066	22,393
EBITDA (Rs mn)	4,642	6,416	7,052
Adj. net profit (Rs mn)	2,828	4,128	4,609
Adj. EPS (Rs)	82.8	121.0	135.0
Cons. EPS (Rs)	77.0	88.0	96.0
Adj. ROAE (%)	18.7	22.9	23.3
Adj. P/E (x)	16.2	11.1	10.0
EV/EBITDA (x)	10.1	7.2	6.6
Adj. EPS growth (%)	49.4	46.0	11.6

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenues (US\$ mn)	63.8	47.7	33.8	53.3	19.7	210	201	4.9
Revenue	4,728	3,509	34.7	3,943	19.9	15,644	14,376	8.8
Operating Expenditure	3,177	2,733	16.2	2,767	14.8	11,002	11,127	(1.1)
Cost of revenues	2,261	1,889	19.7	1,950	15.9	7,813	7,613	2.6
as % of sales	47.8	53.8	-	49.5	-	50	53	-
SG&A expenses	916	844	8.5	817	12.1	3,189	3,514	(9.2)
as % of sales	19.4	24.1	-	20.7	-	20	24	-
EBITDA	1,551	776	99.8	1,176	31.9	4,642	3,249	42.9
Depreciation	244	185	32.1	202	21.0	816	710	14.9
EBIT	1,307	591	121.0	974	34.1	3,826	2,539	50.7
Other Income	37	168	-	33	-	182	452	-
Interest	56	49	-	48	-	203	188	-
PBT	1,288	710	81.5	959	34.4	3,806	2,803	35.8
Total Tax	305	157	94.5	247	23.4	978	715	36.7
Adjusted PAT	983	553	77.8	711	38.2	2,828	2,087	35.5
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	0	0	-
APAT after MI	983	553	77.8	711	38.2	2,828	2,087	35.5
Extra ordinary items	0	0	-	0	-	0	0	-
Reported PAT	983	553	77.8	711	38.2	2,828	2,087	35.5
Reported EPS	28.8	14.7	96.1	20.8	38.6	82	55	47.2
Margins (%)			(bps)		(bps)			(bps)
EBITDA	32.8	22.1	1,070	29.8	300	29.7	22.6	710
EBIT	27.6	16.8	1,080	24.7	290	24.5	17.7	680
EBT	27.3	20.2	700	24.3	290	24.3	19.5	480
PAT	20.8	15.8	500	18.0	280	18.1	14.5	360
Effective tax rate	23.7	22.1	160	25.8	(210)	25.7	25.5	20

Source: BOBCAPS Research, Company

Fig 2 – Operating metrics

(in US\$ terms)	Q4FY21	Growth (%)	
	(% Contr. to Revenue)	QoQ	YoY
Revenue by Geography			
North America	70.0	27.0	37.7
Europe	23.0	(1.7)	18.3
ROW	7.0	39.6	56.0
Client Contribution to Revenue			
Top 10	62.0	15.9	22.0
Non-Top 10 client revenues	38.0	26.4	50.6
Total Employees	11,924	4.0	40.2
Billing Mix			
FTE	73.0	24.8	39.2
Managed Services Revenues	27.0	7.7	29.0
Onsite-Offshore Mix			
Onsite Revenues	21.0	9.3	22.1
Offshore Revenues	79.0	22.8	37.2
Currency Concentration			
USD	79.0	16.7	28.3
Euro	12.0	10.5	21.4
GBP	4.0	19.7	5.2

Source: BOBCAPS Research, Company

Valuation methodology

ECLX has demonstrated efficient cost management, helped by increased utilisation (at a four-year high of 83.8% in Q4FY21), offshoring and manageable attrition, enabling the EBIT margin to hold at ~25% for the last two quarters. We raise FY22/FY23 EPS estimates by 13%/17% factoring in the Q4 performance, higher operational efficiency, Personiv acquisition flowthrough and upbeat FY22 margin outlook. FY21 EPS was roughly in line with our estimate but ahead of consensus. In our view, FY22/FY23 consensus EPS would also see upgrades of at least 10% from current levels.

Rolling valuations forward, we have a revised Mar'22 TP of Rs 1,620 (Rs 950 earlier), set at a higher 12x one-year forward P/E (vs. 8x before), and upgrade the stock from REDUCE to BUY. In our view, higher revenue visibility, a shift in revenue mix to offshoring and a rising EBITDA margin merit the higher multiple. Despite the good performance and upbeat outlook, we maintain that ECLX is more comparable to BPO rather than IT services players and has a very high top-client concentration (top-10 clients formed ~62% of revenues in Q4). Hence, our 12x multiple is at a ~30% discount to the BPO industry multiple of 17x.

Fig 3 – Revised estimates

(Rs mn)	FY22E			FY23E		
	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	299.5	261.2	(12.8)	305.2	287.0	(6.0)
YoY growth (%)	38.7	24.1	-	1.9	9.9	-
Revenues	22,998	20,066	(12.7)	23,815	22,393	(6.0)
EBIT	4,886	5,473	12.0	5,277	6,072	15.0
EBIT margins (%)	21.2	27.3	-	22.2	27.1	-
Net Profits	3,657	4,128	12.9	3,957	4,609	16.5
EPS (Rs)	106.9	121.0	13.2	115.6	135.0	16.8

Source: BOBCAPS Research

Fig 4 – Peer comparison

Company	Rating	Target Price (Rs)	US\$ revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
TCS	BUY	3,780	17.2	118	135	44.2	40.7	28
INFO	ADD	1,540	13.1	56	59	30.4	30.3	26
HCLT	BUY	1,190	11.9	55	63	22.6	23.1	19
TECHM	BUY	1,190	15.0	64	76	21.1	22.3	16
LTI	BUY	4,710	17.5	132	155	29.1	28.8	30
MPHL	SELL	1,580	12.9	80	94	22.0	23.8	17
PSYS	SELL	1,340	15.0	63	70	17.1	16.9	19
COFORGE	BUY	4,080	23.2	132	163	25.2	26.2	25
ECLX	BUY	1,620	16.8	121	135	22.9	23.3	12

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- volatility in top-10 clients,
- Personiv acquisition synergies failing to materialise, and
- high attrition.

Fig 5 – Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Coforge	COFORGE IN	3	3,897	4,080	BUY
eClerx Services	ECLX IN	1	1,344	1,620	BUY
HCL Technologies	HCLT IN	36	969	1,190	BUY
Infosys	INFO IN	83	1,424	1,540	ADD
L&T Infotech	LTI IN	10	4,035	4,710	BUY
Mphasis	MPHL IN	5	1,964	1,580	SELL
Persistent Systems	PSYS IN	3	2,519	1,340	SELL
Tata Consultancy Services	TCS IN	165	3,217	3,780	BUY
Tech Mahindra	TECHM IN	13	1,065	1,190	BUY

Source: BOBCAPS Research, NSE | Price as of 10 Jun 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue	14,305	14,376	15,644	20,066	22,393
EBITDA	3,092	3,249	4,642	6,416	7,052
Depreciation	447	710	816	944	980
EBIT	2,645	2,539	3,826	5,473	6,072
Net interest inc./(exp.)	0	(188)	(203)	(200)	(200)
Other inc./(exp.)	469	452	182	382	442
Exceptional items	0	0	0	0	0
EBT	3,114	2,803	3,806	5,655	6,314
Income taxes	832	715	978	1,527	1,705
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	2,283	2,087	2,828	4,128	4,609
Adjustments	0	0	0	0	0
Adjusted net profit	2,283	2,087	2,828	4,128	4,609

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	1,958	2,058	2,143	2,749	3,067
Provisions	46	197	86	110	123
Debt funds	63	63	63	63	63
Other liabilities	132	129	129	129	129
Equity capital	371	358	358	358	358
Reserves & surplus	13,435	12,706	16,870	18,514	20,350
Shareholders' fund	13,807	13,065	17,228	18,873	20,708
Total liab. and equities	16,006	15,513	19,650	21,924	24,091
Cash and cash eq.	4,515	3,345	3,418	4,480	6,114
Accounts receivables	2,426	2,378	2,572	3,299	3,681
Inventories	0	0	0	0	0
Other current assets	2,519	1,520	2,786	3,573	3,988
Investments	2,863	4,368	7,139	7,139	7,139
Net fixed assets	1,299	1,246	1,079	777	514
CWIP	2	2	150	150	150
Intangible assets	2,182	2,272	2,272	2,272	2,272
Deferred tax assets, net	203	384	384	384	384
Other assets	0	0	0	0	0
Total assets	16,006	15,513	19,650	21,924	24,091

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Cash flow from operations	2,062	4,640	2,178	4,005	4,882
Capital expenditures	(520)	(135)	(501)	(642)	(717)
Change in investments	(1,210)	0	(2,516)	0	0
Other investing cash flows	(567)	264	(21)	182	242
Cash flow from investing	(2,297)	128	(3,037)	(460)	(474)
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)	(1,702)	(2,484)	(2,774)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(539)	(45)	(1,702)	(2,484)	(2,774)
Chg in cash & cash eq.	(774)	4,723	(2,561)	1,061	1,634
Closing cash & cash eq.	1,256	5,979	3,418	4,480	6,114

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	60.1	55.5	82.8	121.0	135.0
Adjusted EPS	60.1	55.5	82.8	121.0	135.0
Dividend per share	1.0	1.0	41.8	61.0	68.1
Book value per share	366.8	347.1	457.7	501.4	550.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	3.3	3.3	3.0	2.3	2.1
EV/EBITDA	15.1	14.7	10.1	7.2	6.6
Adjusted P/E	22.4	24.2	16.2	11.1	10.0
P/BV	3.7	3.9	2.9	2.7	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	73.3	74.5	74.3	73.0	73.0
Interest burden (PBT/EBIT)	117.7	110.4	99.5	103.3	104.0
EBIT margin (EBIT/Revenue)	18.5	17.7	24.5	27.3	27.1
Asset turnover (Rev./Avg TA)	94.4	91.2	89.0	96.5	97.3
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	17.7	15.5	18.7	22.9	23.3

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
YoY growth (%)					
Revenue	4.8	0.5	8.8	28.3	11.6
EBITDA	(15.7)	5.1	42.9	38.2	9.9
Adjusted EPS	(19.4)	(7.7)	49.4	46.0	11.6
Profitability & Return ratios (%)					
EBITDA margin	21.6	22.6	29.7	32.0	31.5
EBIT margin	18.5	17.7	24.5	27.3	27.1
Adjusted profit margin	16.0	14.5	18.1	20.6	20.6
Adjusted ROAE	17.7	15.5	18.7	22.9	23.3
ROCE	30.4	26.1	31.9	38.2	41.2
Working capital days (days)					
Receivables	61	61	58	53	57
Inventory	0	0	0	0	0
Payables	64	66	70	65	69
Ratios (x)					
Gross asset turnover	11.4	11.3	13.5	21.6	34.7
Current ratio	4.7	3.2	3.9	4.0	4.3
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.3)	(0.2)	(0.2)	(0.3)

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

Disclaimer

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

BUY – Expected return >+15%

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

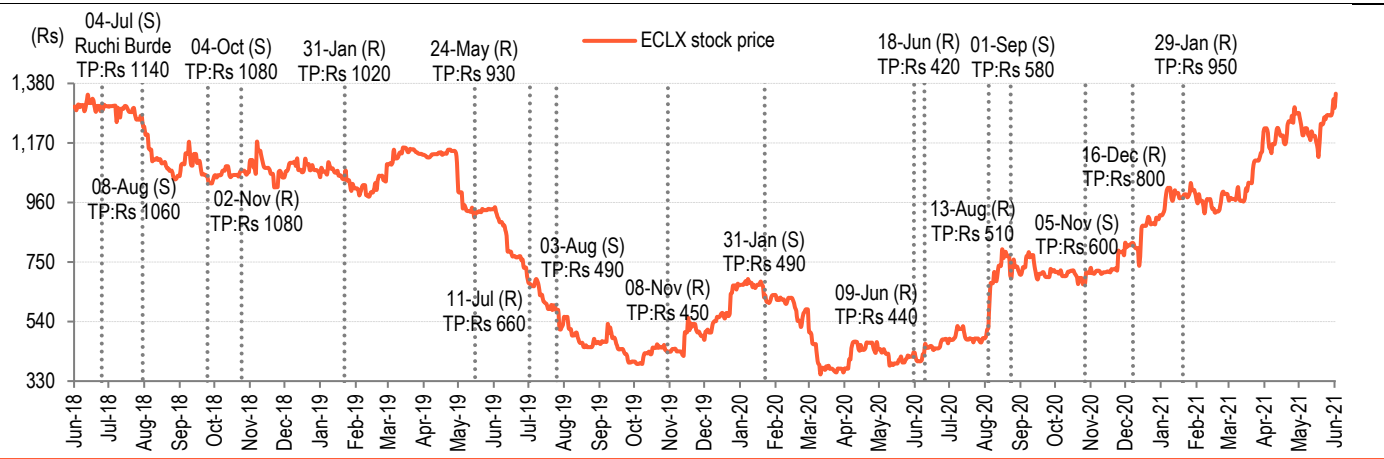
REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

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

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



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

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