

CMP: ₹ 1400

Target: ₹ 1640 (17%)

Target Period: 12 months

November 12, 2022

BUY

Expects strong double digit growth in FY23; announces buyback at ₹ 1900/share

About the stock: eClerx Services (eClerx) provides business process management, automation and analytics services.

- It caters to financial services, communications, retail, media, manufacturing, travel and technology companies
- OCF to EBITDA of >80%, debt free and RoCE of >20%

Q2FY23 Results: eClerx reported strong Q2FY23 results.

- Revenues increased 4.6% QoQ in CC terms
- EBITDA margin increased ~92 bps QoQ to 30.1%
- The company announced buyback at ₹ 1900 per share

What should investors do? eClerx' share price has grown by ~1.6x (adjusted bonus) over the past five years (from ~₹ 857 in November 2017 to ~₹ 1400 levels in August 2022).

- We maintain **BUY** rating on the stock

Target Price and Valuation: We value eClerx at ₹ 1,640 i.e. 14x P/E on FY25E EPS.

Key triggers for future price performance:

- Traction in customer care, RPA, analytics & content development, cross sell and up sell to Personiv clients to drive growth
- Lower roll-offs, improving deal wins and revival in growth are expected to drive revenues
- Expect dollar revenues to grow at 12.9% CAGR in FY22-25E

Alternate Stock Idea: Apart from eClerx, in our IT coverage we also like Persistent.

- Key beneficiary of growth in digital technologies and exposure to growth segments like healthcare & BFSI
- BUY with a target price of ₹ 4,370

eClerx

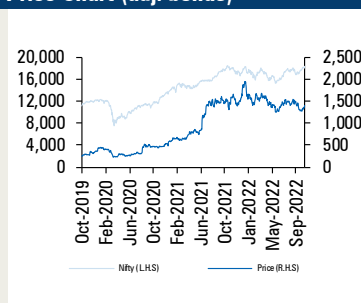
Particulars

Particular	Amount
Market Cap (₹ Crore)	6,953
Total Debt (₹ Crore)	0
Cash & Investments (₹ Crore)	688
EV (₹ Crore)	6,266
52 week H/L	1980/ 1223
Equity capital	49.6
Face value	10.0

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	53	53	53	53
FII	15	14	13	12
DII	18	19	20	20
Public	14	13	13	14

Price Chart (adj. bonus)



Recent event & key risks

- Company announced buyback at ₹1,900 per share
- Key Risk:** (i) Lower-than expected revenues, (ii) Lower than expected margins

Research Analyst

Sameer Pardikar
 sameer.pardikar@icicisecurities.com
 Sujay Chavan
 sujay.chavan@icicisecurities.com

Key Financial Summary

Key Financials	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net sales	1,564	2,160	10.2%	2,654	2,952	3,238	14.4%
EBITDA	465	697	8.3%	748	850	950	10.9%
EBITDA Margin (%)	29.7	32.3		28.2	28.8	29.3	
Net Profit	283	417	3.3%	492	523	585	11.9%
EPS (₹)	81.3	121.6		99.1	105.3	117.7	
P/E	17.2	11.5		14.1	13.3	11.9	
RoNW (%)	18.8	26.6		28.0	26.7	26.8	
RoCE (%)	23.3	34.9		36.0	34.7	35.0	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

- Revenue in US\$ term grew 3.7% QoQ to US\$82.5 million (mn) while in rupee terms, revenue grew 5.3% QoQ to ₹ 650.3 crore. In CC terms, the company reported growth of 4.6% QoQ
- The company reported that its offshore revenue (80% of mix) increased 5.5% QoQ while onshore revenue (20% of mix) declined 3.1% QoQ. eClerx indicated that decline in onshore revenue could be due to its revenue from CLX Europe being impacted by cross currency effect. BPaas (managed services) revenue (26% of mix) declined 0.2% QoQ. The company indicated that it expects BPaas to perform strongly in H2 as usually growth picks in Q3 and Q4 (FY21 was an exception due to Personiv acquisition) on account of pending work transactions. As per management it also requires some time to convince clients to move from FTE based pricing to managed services pricing and hence growth generally comes with a lag
- Geography wise North America (72% of mix) led revenue growth by 6.6% QoQ while RoW (8% of mix) grew 4.5%. Europe region (20% of mix) declined 5.5% QoQ. The company indicated that Europe region (CLX Europe) was impacted due to cross currency impact
- EBITDA margin increased ~92 bps QoQ to 30.1%. The company indicated that margins increased due to higher dollar revenue, operating efficiency & currency gains
- Other income of the company remains high consecutively for the second quarter due high revaluation income due to US\$INR currency depreciation. The company reported other income of ₹ 20.9 crore including revaluation income of ₹ 15.3 crore
- eClerx indicated that its pipeline remains strong but it is witnessing some slowdown in decision making on the client side due to macroeconomic headwinds it is facing. The company mentioned that it (i.e. slower decision making) is largely factored in the current growth rate of 3-4% quarterly which has come down from 5-6% quarterly growth rate in FY22. eClerx also indicated that it does not expect growth to come down materially from this level i.e. 3-4% quarterly, unless major roll offs which is not in the vicinity (clients terminate contracts with 30-60 days of buffer). The company indicated strong double digit growth for FY23 mentioned that the outlook for FY24 will become clear in Q4 when clients discuss their budgets for CY23
- The company indicated that 70-75% of its business is in the non-discretionary space (annuity) while rest 25-30% is discretionary in nature. eClerx also mentioned that large part of its business is skillset based wherein it provides expertise on various subject matters. Hence, customer stickiness is also higher as 80%, 60% of its revenue comes from the firms, which are their clients for over five to 10 years
- The company indicated that Personiv growth in the quarter was similar to company's growth and it forms just over 10% of its business as on Q2FY23. On the CLX Europe operations, the company indicated that it expects strong demand in luxury brand but is witnessing some slowdown in small retailers & industrial clients. However, the company indicated that it forms small part of its business
- On the BFS front the company indicated that it expects growth momentum to continue as it works in regulatory & compliance related services and trade lifecycle which is driven by volatility & complexity. The company further indicated that most of its works are in the critical segment and it does not expect any slowdown in the BFS segment. The company further indicated that none of its clients in the banking sector are under financial stress barring few small clients
- In the call centre/customer care business the company indicated that it foresees good demand in the short-medium term despite the business evolving to its next phase of text & email based model
- On the margins front the company had guided for EBITDA margin (including other income) at the lower band of 28-32% and the company continue to maintain its EBITDA margin guidance for FY23. The company further indicated that cooling of attrition from Q3 onwards, increase in utilisation, easing of return to work in SEZ will be tailwinds for achieving the guided EBITDA margin with possible headwind in form of INR/USD appreciation

- Top five (42% revenue contribution) & Top 10 (61% revenue contribution) customers reported growth of 11.9% & 20.2% on a YoY basis, respectively. The company also indicated that its emerging client's revenue grew by 17.1% YoY. The company had earlier indicated that it wanted its emerging client's revenue to grow faster pace than its top clients to reduce the client concentration & it indicated that its efforts are bearing fruits
- The company during the quarter added five clients to US\$1-3 mn revenue bucket list. eClerx indicated that it is easier for it to scale up the revenue from clients in the lower bucket list compared to US\$3mn+ bucket list. The company also indicated it expects the top client growth to remain steady
- The company's net addition during the quarter was weak with net addition of 98 taking the total headcount to 16,269 due to front loading Q2 addition in Q1. eClerx indicated that the additions were lower as it was carrying high bench strength due to aggressive hiring in last fiscal year in anticipation of demand & high attrition it was facing. The company further indicated that it expects attrition to taper off from Q3 onwards and it will focus on improving its utilisation due to which the hiring was low. eClerx also mentioned that in case of increased demand it can do elevated hiring as it has certain flexibility in its business model depending on demand
- The company's attrition during the quarter increased 750 bps QoQ to 37.1%. However, eClerx indicated that it is witnessing attrition moderating from Q3 onwards. The company's utilisation level improved marginally by 50 bps QoQ to 74.9%. eClerx indicated its utilisation level can be further improved as its bench strength gets billable. It is focusing on improving the utilisation level to its comfort level of 77-78%
- The company indicated that it had formulated an internal policy wherein it will payout 50% of the profits back to the shareholders in form of dividend & buybacks. eClerx indicated that this policy was formulated as it does not want to keep cash idle in the books apart from its acquisitions, capex & opex requirements. In lines of the same policy the company announced a buyback of 15,78,947 shares at the price of ₹ 1,900 per share for a total buyback value of ₹ 300 crore through tender route
- The company also said it is actively looking for inorganic opportunities and is seeing more opportunities now. eClerx indicated that it is exploring acquisitions in the areas of financial services- buy side services, digital analytics, product marketing, customer operations, services to telecoms. However, it mentioned that since opportunities that it is exploring are still not at its desired valuations level it will wait for some more time

Exhibit 1: P&L

	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	650.3	523.3	24.3	617.8	5.3	Revenue grew by 4.6% QoQ in CC terms, driven by top 10 clients strong growth
Employee expenses	349.4	260.1	34.3	334.1	4.6	
Gross Profit	300.9	263.1	14.3	283.7	6.0	
Gross margin (%)	46.3	50.3	-402 bps	45.9	34 bps	
SG&A expenses	119.4	98.3	21.5	118.7	0.6	
EBITDA	202.3	166.6	21.4	187.0	8.2	Margin improved due to operating leverage
EBITDA Margin (%)	30.1	31.7	-159 bps	29.2	92 bps	
Depreciation & amortisation	27.4	25.2	8.9	24.9	10.1	
EBIT	174.9	141.4	23.7	162.1	7.9	
EBIT Margin (%)	26.9	27.0	-13 bps	26.2	66 bps	
Other income (less interest)	20.9	1.7		21.9	(4.8)	Other income lower QoQ due to lower revaluation income on FX assets
PBT	170	157	8.2	135	25.5	
Tax paid	43.8	34.6	26.6	36.0	21.7	
PAT	125.9	101	25.0	121	4.4	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY23E			FY24E			FY25E	Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	2,632	2,654	0.8	3,044	2,952	(3.0)	3,238	We are trimming FY24 numbers marginally on slower decision making at some of their clients
EBITDA	732	748	2.2	856	850	(0.7)	950	
EBITDA Margin (%)	27.8	28.2	37 bps	28.1	28.8	68 bps	29.3	We are baking in moderation of employee expenses, which are currently high due to elevated attrition
PAT	446	492	10.4	524	523	(0.2)	585	
EPS (₹)	89.7	99.1	10.4	105.5	105.3	(0.2)	117.7	

Source: Company, ICICI Direct Research

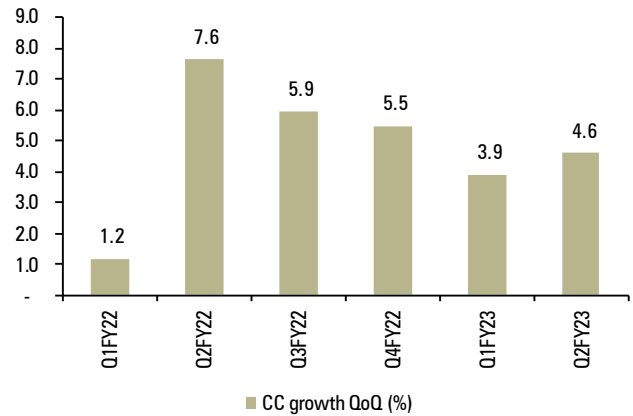
Key Metrics

Exhibit 3: Revenue grow 3.7% QoQ



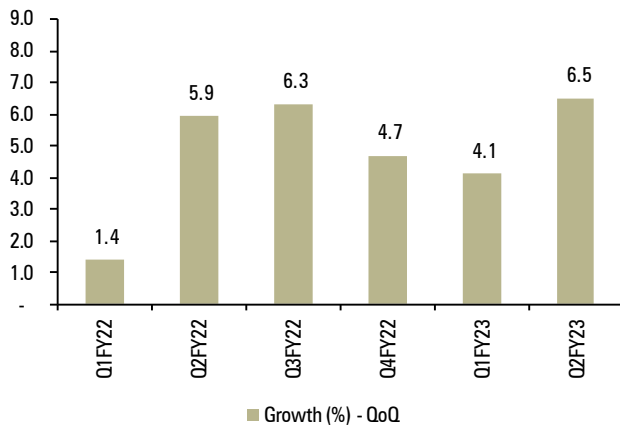
Source: Company, ICICI Direct Research

Exhibit 4: While CC growth was 4.6% QoQ



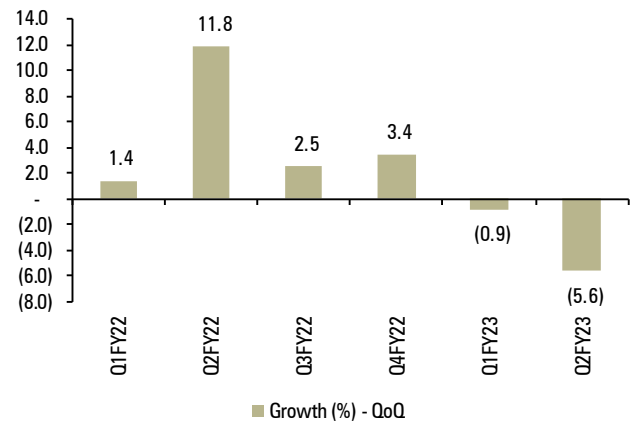
Source: Company, ICICI Direct Research

Exhibit 5: US region growth remains strong



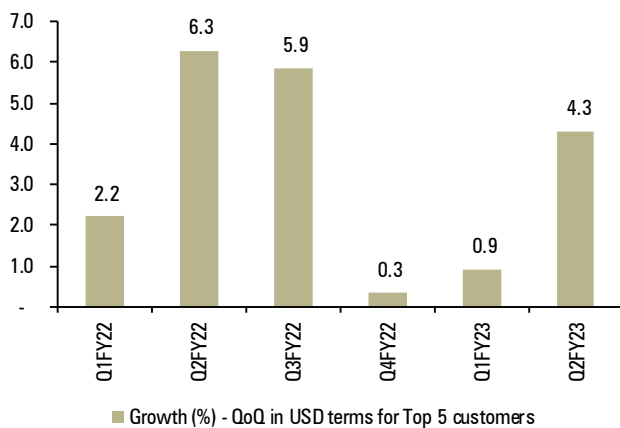
Source: Company, ICICI Direct Research

Exhibit 6: While Europe impacted by currency



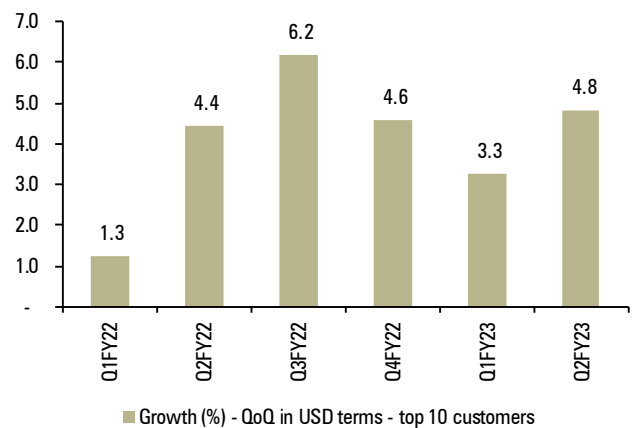
Source: Company, ICICI Direct Research

Exhibit 7: Top 5 customer's growth picking up (42% mix)



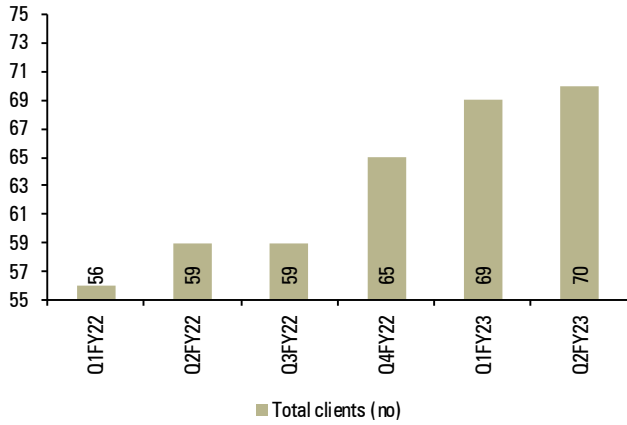
Source: Company, ICICI Direct Research

Exhibit 8: Ditto for Top 10 customers (61% of mix)



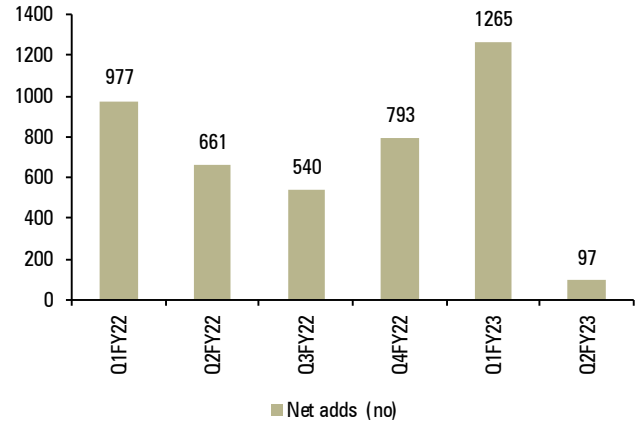
Source: Company, ICICI Direct Research

Exhibit 9: Number of clients trend



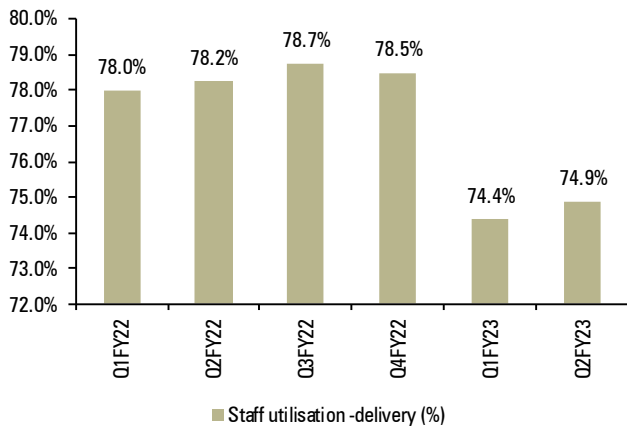
Source: Company, ICICI Direct Research

Exhibit 10: Lower net adds for Q2, front loaded in Q1



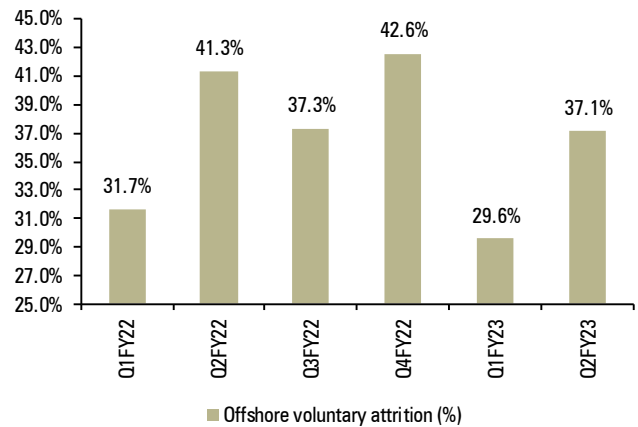
Source: Company, ICICI Direct Research

Exhibit 11: Staff utilisation picking up



Source: Company, ICICI Direct Research

Exhibit 12: Offshore voluntary attrition still elevated



Source: Company, ICICI Direct Research, * From Q1FY23 attrition in the bottom quartile is excluded, so previous numbers are not comparable

Financial summary

Exhibit 13: Profit and loss statement					₹ crore
	FY22	FY23E	FY24E	FY25E	
Total Revenues	2,160	2,654	2,952	3,238	
Growth (%)	38.1	22.9	11.2	9.7	
Employee expenses	1,079	1,359	1,484	1,615	
Other Expenditure	409	481	576	633	
EBITDA	697	748	850	950	
Growth (%)	50.0	7.4	13.6	11.8	
Depreciation	103	109	143	157	
Other Income	24	66	41	40	
Interest expense	22	22	22	22	
PBT before Exceptional Items	560	684	727	812	
Growth (%)	47.2	22.1	6.3	11.7	
Tax	143	192	204	227	
PAT before Exceptional Items	418	493	523	585	
Exceptional items	-	-	-	-	
PAT before MI	418	493	523	585	
Minority Int & Pft. from associates	0	0	0	-	
PAT	417	492	523	585	
Growth (%)	47.6	17.9	6.3	11.7	
EPS	121.6	99.1	105.3	117.7	
EPS (Growth %)	49.6	(18.5)	6.3	11.7	

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement					₹ crore
	FY22	FY23E	FY24E	FY25E	
Net profit before Tax	560	684	727	812	
Depreciation	103	109	143	157	
(inc)/dec in Current Assets	(51)	557	242	(168)	
(inc)/dec in current Liabilities	(164)	(192)	(204)	(227)	
CF from operations	448	1,158	908	573	
Other Investments	108	-	-	-	
Other income	4	66	41	40	
(Purchase)/Sale of Fixed Assets	(61)	(60)	(67)	(74)	
CF from investing Activities	38	7	(26)	(34)	
Inc / (Dec) in Equity Capital	(355)	(0)	(0)	-	
Dividend & Dividend tax	(3)	(303)	(322)	(359)	
Interest Paid on Loans	(58)	(0)	-	-	
CF from Financial Activities	(416)	(343)	(362)	(399)	
Exchange rate differences	1	-	-	-	
Opening cash balance	491	562	1,384	1,903	
Other adjustments	-	-	-	-	
Closing cash	562	1,384	1,903	2,043	

Source: Company, ICICI Direct Research;

Exhibit 15: Balance sheet					₹ crore
	FY22	FY23E	FY24E	FY25E	
Equity	33	50	50	50	
Reserves & Surplus	1,534	1,707	1,909	2,134	
Networth	1,568	1,757	1,958	2,184	
Minority Interest	1	1	1	1	
Loans	0	0	0	0	
Other liabilities	199	199	199	199	
Source of funds	1,768	1,958	2,159	2,384	
Gross Block	531	630	737	844	
Acc.dep	319	428	570	727	
Net Block	212	202	167	117	
CWIP	2	2	2	2	
Other Intangible assets	126	126	126	126	
Other non current assets	45	134	148	160	
Investments	194	194	194	194	
Goodwill	375	375	375	375	
Debtors	329	591	444	693	
Cash & Cash equivalents	494	1,384	1,903	2,043	
Loans and advances	-	-	-	-	
Other current assets	293	624	675	720	
Trade payables	17	89	100	110	
Current liabilities	156	832	936	1,029	
Provisions	129	685	771	847	
Application of funds	1,768	1,957	2,158	2,384	

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios					₹ crore
	FY22	FY23E	FY24E	FY25E	
Per share data (₹)					
EPS	121.6	99.1	105.3	117.7	
Cash EPS	151.6	121.0	134.0	149.2	
BV	456.6	353.8	394.3	439.6	
DPS	1.0	60.9	64.8	72.4	
Cash Per Share	143.8	278.6	383.2	411.4	
Operating Ratios (%)					
EBITDA Margin	32.3	28.2	28.8	29.3	
PBT Margin	25.9	25.8	24.6	25.1	
PAT Margin	19.3	18.5	17.7	18.1	
Debtor days	56	81	55	78	
Creditor days	3	12	12	12	
Return Ratios (%)					
RoE	26.6	28.0	26.7	26.8	
RoCE	34.9	36.0	34.7	35.0	
RoIC	55.0	143.3	553.0	384.4	
Valuation Ratios (x)					
P/E	11.5	14.1	13.3	11.9	
EV / EBITDA	9.0	7.2	5.7	5.0	
EV / Net Sales	2.9	2.0	1.6	1.5	
Market Cap / Sales	3.2	2.6	2.4	2.1	
Price to Book Value	3.1	4.0	3.5	3.2	
Solvency Ratios					
Debt/EBITDA	0.0	0.0	0.0	0.0	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	2.1	0.8	0.6	0.7	
Quick Ratio	2.1	0.8	0.6	0.7	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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