

**REDUCE**

TP: Rs 440 | ▲3%

**ECLERX SERVICES**

| IT Services

| 09 June 2020

## Valuation inexpensive but lacks catalysts

eClerx's (ECLX) Q4FY20 dollar revenue declined by a sharp 7.9% QoQ owing to onsite revenue contraction of 15%. EBIT margins at 16.8% reversed gains recouped over the last six quarters. The Q1FY21 outlook is also dim. We cut FY21/FY22 EPS by 27%/11% to factor in the Covid-19 hit and lower our Mar'21 TP to Rs 440 (vs. Rs 490 earlier). A strong cash position coupled with inexpensive valuations (7x FY22E EPS) would limit downsides. But a lack of catalysts will also cap any upsides – we recommend **REDUCE** vs. **SELL** earlier.

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**Disappointing operating performance:** Q4FY20 dollar revenue declined by 7.9% QoQ (vs. -2.1% estimated), with 590bps EBIT margin contraction (vs. -120bps est.). Management attributed the sequential decline to Covid-led supply constraints and planned roll-offs. Italian business (CLX subsidiary) and onshore consulting were affected the most.

**Dim outlook:** We expect a severe hit on the top and bottomline in Q1FY21 owing to demand headwinds in the wake of Covid-19. Work-from-home costs are expected to exceed Rs 110mn. Management believes Q1 would be the trough, after which it is hopeful of recovery. Capex and depreciation are guided to increase due to work-from-home costs. ECLX hopes to use levers such as delayed promotions, flat salary growth for top management, reduced travel costs and lower rentals to mitigate the impact on operating margins.

**Stock lacks catalysts:** Following a 30%+ correction over the last four months, valuations at 9.4x/7x FY21E/FY22E P/E are inexpensive. However, the absence of catalysts cap upsides, with the Covid-19 crisis having pushed back hopes of growth and margin recovery. We recommend **REDUCE** vs. **SELL** earlier.

Ticker/Price	ECLX IN/Rs429
Market cap	US\$ 213.5mn
Shares o/s	38mn
3M ADV	US\$0.3mn
52wk high/low	Rs 949/Rs 320
Promoter/FPI/DII	50%/25%/25%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	13,651	14,305	14,376	13,667	15,791
EBITDA (Rs mn)	3,668	3,092	3,249	2,924	3,758
Adj. net profit (Rs mn)	2,887	2,283	2,087	1,716	2,300
Adj. EPS (Rs)	74.5	60.1	55.5	45.6	61.1
Adj. EPS growth (%)	(15.7)	(19.4)	(7.7)	(17.8)	34.0
Adj. ROAE (%)	23.9	20.2	17.5	12.5	15.9
Adj. P/E (x)	5.8	7.1	7.7	9.4	7.0
EV/EBITDA (x)	3.5	3.9	4.1	4.6	3.0

Source: Company, BOBCAPS Research

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## Other highlights

- **Challenging work-from-home transition:** ECLX faced challenges in getting work-from-home approvals due to the nature of BPO services, especially in the voice segment. Voice delivery has now been partially moved to chat. New laptops and data cards had to be procured, leading to increased costs (~US\$ 2mn). About 90% of employees have been transitioned to work-from-home mode. Most banking clients were supportive of this shift.

**Demand environment severely impacted:** ECLX saw delays in project go-lives and roll-offs due to lower demand, depleting Q4FY20 revenues by US\$ 2mn. Clients have reshuffled and reallocated budgets. Top 10 client revenue contribution declined 12.2% QoQ. The impact of Covid-19 reversed gains from improved deal pricing in H2FY20, especially in the top 10 accounts.

The travel vertical (~2% of revenues) and managed services have been the worst affected. Retail (7-9% of revenues) was the second-most impacted vertical. Banking, hi-tech and telecom remained relatively resilient. FY20 USD revenue growth was flat, decreasing 0.1%. EBITDA margin for the year improved 100bps due to improved deal pricing.

- **CLX business slows:** While the analytics segment maintained growth, managed services which consists largely of travel and hospitality clients slowed down. CLX (based in Italy) was the hardest hit along with the onshore consulting business, reflecting in a 14.5% QoQ decline in Europe revenue (in dollar terms). Some recovery is being seen in the segment as Italy emerges from the pandemic.
- **Dividend:** The board recommended Re 1 as final dividend for FY20.

**FIG 1 – MAR'20 QUARTER PERFORMANCE**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>47.7</b>	<b>51.2</b>	<b>(6.8)</b>	<b>51.8</b>	<b>(7.9)</b>	<b>200.5</b>	<b>200.8</b>	<b>(0.1)</b>
<b>Revenue</b>	<b>3,509</b>	<b>3,651</b>	<b>(3.9)</b>	<b>3,755</b>	<b>(6.5)</b>	<b>14,376.0</b>	<b>14,305.0</b>	<b>0.5</b>
Operating Expenditure	2,733	2,844	(3.9)	2,723	0.4	11,127.3	11,213.0	(0.8)
Cost of revenues	1,889	1,777	6.3	1,891	(0.1)	7,613.4	7,059.0	7.9
as % of sales	53.8	48.7	-	50.4	-	53.0	49.3	-
SG&A expenses	844	1,067	(20.9)	832	1.4	3,513.9	4,154.0	(15.4)
as % of sales	24.1	29.2	-	22.2	-	24.4	29.0	-
<b>EBITDA</b>	<b>776</b>	<b>807</b>	<b>(3.8)</b>	<b>1,032</b>	<b>(24.8)</b>	<b>3,248.7</b>	<b>3,092.0</b>	<b>5.1</b>
Depreciation	185	128	44.5	176	5.1	709.7	447.4	58.6
<b>EBIT</b>	<b>591</b>	<b>679</b>	<b>(12.9)</b>	<b>856</b>	<b>(30.9)</b>	<b>2,539.0</b>	<b>2,644.6</b>	<b>(4.0)</b>
Other Income	168	96	-	115	-	451.8	469.2	-
<b>PBT</b>	<b>759</b>	<b>775</b>	<b>(2.0)</b>	<b>970</b>	<b>(21.8)</b>	<b>2,990.8</b>	<b>3,113.8</b>	<b>(4.0)</b>
Total Tax	157	183	(14.2)	222	(29.3)	715.5	831.7	(14.0)
Adjusted PAT	602	592	1.7	749	(19.6)	2,275.4	2,282.1	(0.3)
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-	0.0	(0.4)	-
APAT after MI	602	592	1.7	749	(19.6)	2,275.4	2,282.5	(0.3)
Extra ordinary items	0	0	-	0	-	0.0	0.0	-
<b>Reported PAT</b>	<b>602</b>	<b>592</b>	<b>1.7</b>	<b>749</b>	<b>(19.6)</b>	<b>2,275.4</b>	<b>2,282.5</b>	<b>(0.3)</b>
Reported EPS	14.7	15.6	(5.7)	18.6	(21.1)	55.5	59.6	(7.0)
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	22.1	22.1	-	27.5	(540)	22.6	21.6	100
EBIT	16.8	18.6	(170)	22.8	(590)	17.7	18.5	(80)
EBT	21.6	21.2	40	25.8	(420)	20.8	21.8	(100)
PAT	17.2	16.2	90	19.9	(280)	15.8	16.0	(10)
Effective Tax rate	20.7	23.6	(290)	22.9	(220)	23.9	26.7	(280)

Source: Company, 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. Growth and margin recovery hopes have been pushed back further due to the Covid-19 crisis.

We cut FY21/FY22 EPS estimates by 27%/11% and revise our Mar'21 target price to Rs 440 (set at an unchanged 7.2x FY22E P/E). We believe that lower revenue productivity, weaker margins, dimmer growth visibility and an increasing mix of non-annuity business render ECLX comparable to BPO rather than IT services players. Our target P/E multiple of 7.2x is at a 20% discount to the five-year average 12-month forward P/E of BPO peer Firstsource Solutions (FSOL: Not Rated).

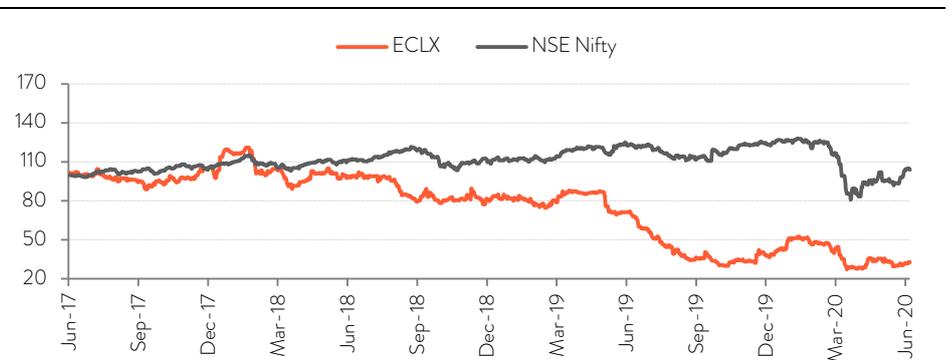
Following a 30%+ correction over the last four months, valuations at 9.4x/7x FY21E/FY22E P/E are inexpensive but the absence of catalysts cap upsides. We raise our rating a notch to REDUCE vs. SELL earlier.

**FIG 2 – REVISED EARNINGS**

(Rs mn)	FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue (US\$ mn)	223.8	182.7	(18.4)	256.9	209.8	(18.4)
YoY growth (%)	10.0	(8.9)		14.8	14.8	
Revenues	15,934	13,667	(14.2)	17,997	15,791	(12.3)
EBIT	2,883	2,151	(25.4)	3,236	2,887	(10.8)
EBIT margins (%)	18.1	15.7		18.0	18.3	
Net Profits	2,337	1,716	(26.6)	2,573	2,300	(10.6)
EPS (Rs)	62.1	45.6	(26.6)	68.3	61.1	(10.5)

Source: BOBCAPS Research

**FIG 3 – RELATIVESTOCK PERFORMANCE**



Source: NSE

## Key risks

Key upside risks to our earnings estimates include:

- a sharper recovery in demand especially for the offshore business,
- stronger-than-expected traction in large accounts, and
- sharp favourable currency movements.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
<b>Total revenue</b>	<b>13,651</b>	<b>14,305</b>	<b>14,376</b>	<b>13,667</b>	<b>15,791</b>
EBITDA	3,668	3,092	3,249	2,924	3,758
Depreciation	483	447	710	774	871
EBIT	3,185	2,645	2,539	2,151	2,887
Net interest income/(expenses)	0	0	(188)	(200)	(200)
Other income/(expenses)	390	469	452	400	464
Exceptional items	213	0	0	0	0
EBT	3,787	3,114	2,803	2,351	3,151
Income taxes	896	832	715	635	851
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	4	0	0	0	0
<b>Reported net profit</b>	<b>2,887</b>	<b>2,283</b>	<b>2,087</b>	<b>1,716</b>	<b>2,300</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,887</b>	<b>2,283</b>	<b>2,087</b>	<b>1,716</b>	<b>2,300</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	1,981	1,960	1,969	1,872	2,163
Provisions	60	78	79	75	87
Debt funds	63	63	63	63	63
Other liabilities	152	152	152	152	152
Equity capital	384	384	384	384	384
Reserves & surplus	11,669	10,120	12,971	13,655	14,571
Shareholders' fund	12,054	10,505	13,355	14,039	14,955
<b>Total liabilities and equities</b>	<b>14,311</b>	<b>12,758</b>	<b>15,619</b>	<b>16,202</b>	<b>17,420</b>
Cash and cash eq.	4,403	1,256	4,357	5,519	6,375
Accounts receivables	2,328	2,352	2,363	2,247	2,596
Inventories	0	0	0	0	0
Other current assets	2,371	2,547	2,560	2,434	2,812
Investments	1,653	2,916	2,916	2,916	2,916
Net fixed assets	1,215	1,346	1,082	746	380
CWIP	1	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>14,311</b>	<b>12,758</b>	<b>15,619</b>	<b>16,202</b>	<b>17,420</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	4,278	3,562	2,797	2,490	3,171
Interest expenses	(142)	(257)	(264)	(200)	(264)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(27)	(300)	(14)	142	(425)
Other operating cash flows	(1,058)	(943)	809	0	0
<b>Cash flow from operations</b>	<b>3,050</b>	<b>2,062</b>	<b>3,328</b>	<b>2,431</b>	<b>2,482</b>
Capital expenditures	(415)	(520)	(446)	(437)	(505)
Change in investments	861	(1,210)	0	0	0
Other investing cash flows	(183)	(567)	264	200	264
<b>Cash flow from investing</b>	<b>263</b>	<b>(2,297)</b>	<b>(182)</b>	<b>(237)</b>	<b>(241)</b>
Equities issued/Others	87	53	0	0	0
Debt raised/repaid	53	0	0	0	0
Interest expenses	(3,135)	(554)	0	0	0
Dividends paid	(40)	(38)	(45)	(1,033)	(1,384)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(3,035)</b>	<b>(539)</b>	<b>(45)</b>	<b>(1,033)</b>	<b>(1,384)</b>
<b>Changes in cash and cash eq.</b>	<b>278</b>	<b>(774)</b>	<b>3,101</b>	<b>1,162</b>	<b>857</b>
<b>Closing cash and cash eq.</b>	<b>4,403</b>	<b>1,256</b>	<b>4,357</b>	<b>5,519</b>	<b>6,375</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	74.5	60.1	55.5	45.6	61.1
Adjusted EPS	74.5	60.1	55.5	45.6	61.1
Dividend per share	1.0	1.0	1.0	22.8	30.6
Book value per share	320.2	279.1	354.8	373.0	397.3

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	0.9	0.9	0.9	1.0	0.7
EV/EBITDA	3.5	3.9	4.1	4.6	3.0
Adjusted P/E	5.8	7.1	7.7	9.4	7.0
P/BV	1.3	1.5	1.2	1.2	1.1

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	76.2	73.3	74.5	73.0	73.0
Interest burden (PBT/EBIT)	118.9	117.7	110.4	109.3	109.1
EBIT margin (EBIT/Revenue)	23.3	18.5	17.7	15.7	18.3
Asset turnover (Revenue/Avg TA)	96.5	105.7	101.3	85.9	93.9
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	23.9	20.2	17.5	12.5	15.9

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	2.6	4.8	0.5	(4.9)	15.5
EBITDA	(21.8)	(15.7)	5.1	(10.0)	28.5
Adjusted EPS	(15.7)	(19.4)	(7.7)	(17.8)	34.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	26.9	21.6	22.6	21.4	23.8
EBIT margin	23.3	18.5	17.7	15.7	18.3
Adjusted profit margin	21.2	16.0	14.5	12.6	14.6
Adjusted ROAE	23.9	20.2	17.5	12.5	15.9
ROCE	38.2	30.4	27.1	23.9	32.8
<b>Working capital days (days)</b>					
Receivables	60	60	60	62	56
Inventory	0	0	0	0	0
Payables	65	64	64	65	61
<b>Ratios (x)</b>					
Gross asset turnover	11.0	11.2	11.8	15.0	28.1
Current ratio	4.5	3.0	4.5	5.2	5.2
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.4)	(0.1)	(0.3)	(0.4)	(0.4)

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

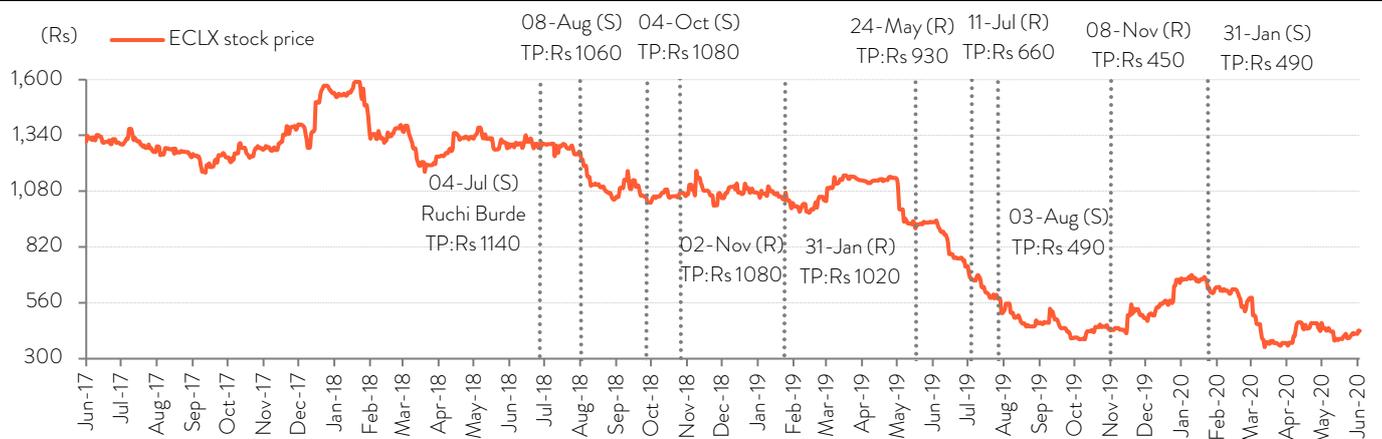
**ADD** – Expected return from >+5% to +15%

**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)

### HISTORICAL RATINGS AND TARGET PRICE: ECLERX SERVICES (ECLX IN)



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

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