eClerx Services Ltd.

Initiating Note | **Regular Coverage**

Absolute : LONG
Relative : NR
17% Upside in 11 months

30%+ growth, ~33% EBIT margin and ~100% ROIC - Pricey and Promising!

IT Enabled Services

Rating Information	
Price (₹)	600
Target Price (₹)	700
Target Date	30th Sep'11
Target Set On	4th Nov'10
Implied yrs of growth (DCF)	10
Fair Value (DCF) (Sep' 11)	880
Fair Value (DDM) (Sep' 11)	508
Ind Benchmark	BSE IT
Model Portfolio Position	-

Stock Information	
Market Cap (₹ Bn)	17.2
Free Float (%)	40%
52 Wk H/L (₹)	638/240
Avg Daily Volume	79,678
Avg Daily Value (₹ Mn)	31.4
Equity Cap (₹ Mn)	287
Face Value (₹)	10
Bloomberg Code	ECLX IN

Ownership	Recent	3M %	12M %
Promoters	59.9%	-0.1%	-0.4%
DII	11.2%	3.5%	6.4%
FII	15.4%	1.3%	12.6%
Public	13.5%	-4.6%	-18.7%

Price %	1M%	3M%	12M%
Absolute	2.5	29.9	136.8
Vs Industry	2.7	18.4	94.3
FSOL	-3.5	9.4	-13.1
HGSL	-7.6	-7.1	-21.1

Consolidated Quarterly EPS forecast

₹/Share	1Q	2Q	3Q	4Q
EPS (11E)	10.3	9.7	10.1	10.9
EPS (12E)	10.8	11.8	12.7	13.7

45% revenue CAGR, ~36% EBIT margin and 100% plus ROIC over FY08-10 places eClerx among the best performing BPOs. eClerx offers a blend of BPO and KPO services to leading investment banks, a large US computer manufacturer and companies in e-commerce segment. At ~17x TTM PE the valuations don't look cheap, but we believe these multiples are sustainable and company can continue to grow at ~32% revenue CAGR over FY10-13E despite the high client concentration. We initiate with a LONG rating and Sep-11 PT of ₹ 700 at 16x Sep-11 TTM EPS.

Niche positioning between BPO and KPO earns above average billing rates which when coupled with below average Employee and SG&A costs translate into an EBIT margin (~33%), almost twice that of most large BPO players: eClerx's superior business mix (non-voice, data intensive and analytical service offerings) earns above average annual offshore billing rate of $ 30,000 per billable employee while employee costs and SG&A expenses are below average (Pg 4 Exhibit 4).

In our view, third party service providers like eClerx are more efficient and cost effective than Captive BPO units; former will continue to thrive as captives fade

High client concentration certainly poses risk but the quality of top 5 clients, scope of account mining and long term nature of existing contracts is comforting: While top 5 clients contribute ~87% to the revenues posing client concentration risk, we believe that the account mining opportunities they offer can sustain current growth momentum for a couple of years. Also, eClerx's 4-8 year long relationships with top 5 clients and long term nature (2-3 yrs duration) of ~80% of contracts provides better visibility and gives some comfort.

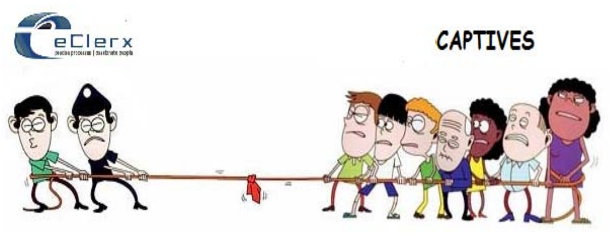
Unlike most of the mid-tier IT / BPO players who are adversely impacted by FX volatility and higher tax rates, eClerx is relatively well placed on both these fronts but higher attrition in 2Q11 is concerning: Up to 30% attrition helps eClerx manage employee pyramid but 48% annualized attrition in 2Q11 is a bit concerning even after considering seasonality. The new SEZ facility (Airoli) provides cushion against steep rise in tax and hedges will cover against near term rupee appreciation.

2Q11 results: ~6.8% QoQ revenue growth at 33% EBIT margin; PAT margin of ~34% supported by FX gains; High annualized attrition of ~44% in 1H11

Current valuations are not cheap but sustainable as company continues to deliver: In our view, at ~17x TTM PE the valuations are rich but sustainable as company continues to deliver. Our Sep-11 PT of ₹ 700 is set at 16x Sep-11 TTM EPS.

Consolidated Financials

₹ Mn YE Mar	FY10A	FY11E	FY12E	FY13E
Sales	2,570	3,377	4,485	5,937
EBITDA	1,004	1,213	1,573	2,032
Depreciation	70	84	99	120
Other Income	-106	199	114	96
Net Profit	735	1,169	1,398	1,607
Adj Net Profit	735	1,169	1,398	1,607
Total Equity	1,999	2,692	3,391	4,194
Gross Debt	0	0	0	0
Cash	1,247	1,605	2,012	2,397
₹ Per Share	**FY10A**	**FY11E**	**FY12E**	**FY13E**
Earnings (FD)	25.7	40.9	48.9	56.2
Book Value	70	94	119	147
Dividends	18	17	20.9	24.0
FCFF	20.2	29.2	38.7	41.6
P/E (x)	23.0	14.5	12.1	10.5
P/B (x)	8.4	6.3	5.0	4.0
EV/EBITDA (x)	-1.2	-1.3	-1.3	-1.2
ROE (%)	40%	50%	46%	42%
Core ROIC (%)	115%	100%	97%	89%
EBITDA Margin (%)	39%	36%	35%	34%
Net Margin (%)	29%	35%	31%	27%



Winning against the captives!

Company Snapshot

How we differ from Consensus

		Equirus	Consensus	% Diff	Comment
EPS	FY11E	40.9	38.9	5%	We are expecting higher growth than
	FY12E	48.9	47.3	3%	consensus in FY11E and FY12E.
Sales	FY11E	3,377	3,323	2%	
	FY12E	4,485	4,185	7%	
PAT	FY11E	1,169	1,145	2%	
	FY12E	1,398	1,396	0%	

Our Key Investment arguments:

- **Revenues can grow at 32% CAGR over FY10-13E:** In our view, despite high client concentration and soft new client additions, eClerx can grow at ~32% over FY10-11E.

- **EBIT margin will come off a bit from FY10's 36% on account of Rupee appreciation and wage inflation but we believe ~33% EBIT margin is sustainable:** Historically (FY08-10), eClerx's EBIT margin has been around 36-37%. While rupee appreciation and wage inflation will certainly have an impact on margins, we believe that ~33% EBIT margin in FY11E is sustainable at current exchange rate.

- **Unlike most of the mid-tier IT / BPO players who are adversely impacted by FX volatility and higher tax rates, eClerx is relatively well placed on both these fronts but higher attrition in 2Q11 is concerning:** Up to 30% attrition helps eClerx manage employee pyramid but 48% annualized attrition in 2Q11 is a bit concerning even after considering seasonality. The new SEZ facility (Airoli) provides cushion against steep rise in tax and hedges will cover against near term rupee appreciation.

Risk to Our View

Ramp down at a key client can disrupt the growth momentum for a few quarters. Dodd-Frank legislation (pg 6) can lead to loss of business in Capital Markets vertical. Sharp appreciation of rupee is a risk to margins and our EPS estimates.

Key Triggers

- Upside on fall of client concentration
- Downside on loss of any of the top 5 clients or negative implication of Dodd-Frank law or sharp appreciation of rupee

Sensitivity to Key Variables	% Change	% Impact on Operating Margin
Rupee Appreciation	1%	-70 bps

DCF Valuations & Assumptions

Rf	Ke	WACC	Term. Growth	ROIC in Terminal Yr
8%	14%	14%	4%	74%

	FY11E	FY12E	FY13E	FY10-15E	FY15-20E
Sales Growth	32%	33%	32%	30%	14%
NOPAT Margin	29%	29%	26%	27%	23%
IC Turnover	2.9	3.0	3.1	3.1	3.1
RoIC	100%	98%	89%	91%	78%
Years of strong growth	1	2	3	5	10
Valuation as on date (₹)	390	467	505	622	**782**
Valuation as of 30th Sep'11	439	525	569	701	**880**

Our Sep-11 DCF fair value ₹ 880 is derived assuming ~30% revenue CAGR over FY10-15 followed by ~14% revenue CAGR over 2015-20E followed by terminal growth rate of 4%, WACC of 14% and 23% NOPAT margin in terminal year.

Company Description:

eClerx is a mid-tier BPO player offering a blend of BPO and KPO services to leading investment banks, a leading computer and computer peripherals manufacturer and a few other Fortune 500 companies in e-retail segment and travel and tourism industry.

Comparable Valuation

			Mkt Cap	Price	Target	EPS			P/E			BPS	P/B	RoE			Div Yield	
Company	Reco.	CMP	(₹ Bn)	Target	Date	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY10	FY11E	FY12E	FY10	FY11E
eClerx	LONG	600	17	700	Sep'11	25.7	40.9	48.9	23.3	14.7	12.3	70	6.4	40.0	49.8	46.0	3%	3%
FirstSource Soln.	NR	27.8	12	NA	NA	2.4	2.8	3.8	11.4	10.1	7.4	31.4	0.8	8.2	9.1	10.7	0%	0%
Hinduja Global Soln.	NR	395	8	NA	NA	63.4	59.3	67.7	6.2	6.7	5.8	511.6	0.8	15.5	12.1	12.6	5%	3%

Investment Rationale

Revenues can grow at 32% CAGR over FY10-13E and ~33% EBIT margin is sustainable

Revenues can grow at ~32% CAGR over FY10-13 despite high client concentration and weak new client additions

eClerx has grown at 45% CAGR over FY08-10 despite recession and turmoil in global Investment Banks, a clientele that contributes ~50% to its revenues. In recent past, client concentration has gone up and new client addition has been soft. But we believe there are enough account mining opportunities to achieve ~32% growth over FY10-13E.

In our view, third party service providers like eClerx will thrive while captive BPO units fade

We believe that captive BPO unit was a preferred low cost offshoring option in past. But today, in most cases, third party service providers are more cost effective and efficient than captives. It is our view that captives will gradually fade and third party service providers will continue to thrive. We also believe that eClerx may lose out if Captives BPO units are spun off like UBS and CITI but in most cases eClerx should be beneficiary as captives fade.

Capital Markets vertical offers account mining opportunities despite some structural risks

eClerx presently has engagements with 9 out of top 14 Investment banks and overall ~15 clients in Capital Markets vertical. In our view, while this vertical is more exposed to structural risks (as discussed on pg. 6), the account mining opportunities are more promising.

Sales and Marketing Support (SMS) vertical offers promising growth opportunities albeit with limited scalability in most of the accounts

In SMS vertical, eClerx presently has a large engagement with a leading US computer and computer peripherals manufacturer and many small engagements with companies in E-commerce segment. We believe this vertical can offer promising growth opportunities as E-commerce channel is now more widely used for selling products and services over the internet. However the volume of work that each client can offer is limited in most cases.

EBIT margin will come off a bit from FY10's 36% on account of Rupee appreciation and wage inflation but we believe ~33% EBIT margin is sustainable

Historically (FY08-10), eClerx's EBIT margin has been around 36-37%. While rupee appreciation and wage inflation will certainly have an impact on margins, we believe that ~33% EBIT margin is sustainable at current exchange rate.

Effective tax rate will rise post implementation of DTC but MAT credits and SEZ benefits will have a cushioning effect

In FY11E and FY12E, eClerx's effective tax rate is expected to be ~12% as compared to ~11% that company has paid over the past 2-3 years. Withdrawal of STPI benefits will have no impact as company doesn't avail any STPI benefits. Management's prudent capacity expansion in Airoli, a SEZ facility, will ensure that most of the incremental revenues will be tax free until company grows to 4,800 employees from ~3,300 employees (presently). Post implementation of DTC, company expects effective tax rate to rise to ~20% in FY13.

FX headwinds have severely impacted company's earnings in FY09 & FY10 but presently company is better prepared to face the recent sharp appreciation of rupee

eClerx incurred FX losses to the tune of ~12% and ~17% of operating profit in FY09 and FY10 respectively. In FY11E, we expect company to report substantial FX gains (~12% of FY11E operating profit). Hence FY11E EPS growth is likely to be ~59% despite revenue growth of only 31%. Recent appreciation of rupee will certainly have some impact of company's margins but as shown in exhibit 1, company's hedges will provide some cushion against rupee appreciation in near term.

Exhibit 1: Hedge position as of 30th Sep 2010

Contract	Year	Currency	Amount	Average Rate (INR)
Forward	FY11	USD	$ 17.4 Mn	48.1
		Euro	€ 4.7 Mn	62.9
	Total FY11 -Equiv USD		**$ 23.9 Mn**	**47.3**
	FY12	USD	$ 21.8 Mn	48.1
		Euro	€ 5.1 Mn	60.3
	Total FY12 -Equiv USD		**$ 28.8 Mn**	**46.9**
Put Option	FY11	USD	$ 6.0 Mn	45.7
	FY12		$ 3.0 Mn	46.0

Source: Company; Note: EUR/USD taken at 1.39

2Q11 Results: 6.8% QoQ revenue growth at ~33% operating margin; ~34% PAT margin supported by FX gains; Annualized Attrition increased from ~39% in Q1 to ~48% in Q2

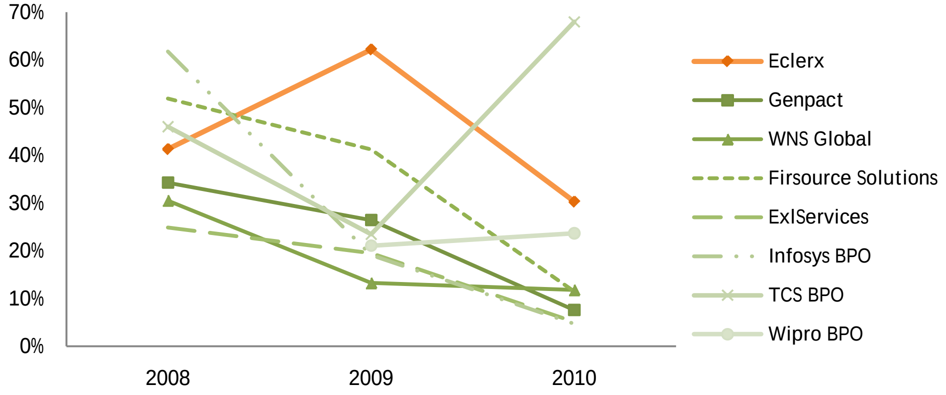
In 2Q11, eClerx reported a healthy revenue growth of 6.8%/7.1% in Rupee/USD terms. EBIT margins contracted as by 131 bps QoQ mostly as SG&A costs as % of Sales increased by 190 bps on account of higher costs of Airoli facility.

Superior growth at over double the Operating Margin as compared to leading pure play BPO players

Lucrative business mix has helped eClerx garner superior billing rates

In our view, most of the services delivered by eClerx fall under BPO umbrella except for some data intensive analytical work that can be classified as KPO. However on account of non-voice, data intensive nature of work, average revenue per employee of eClerx is significantly higher than some of the peers in BPO industry as shown in exhibit 4.

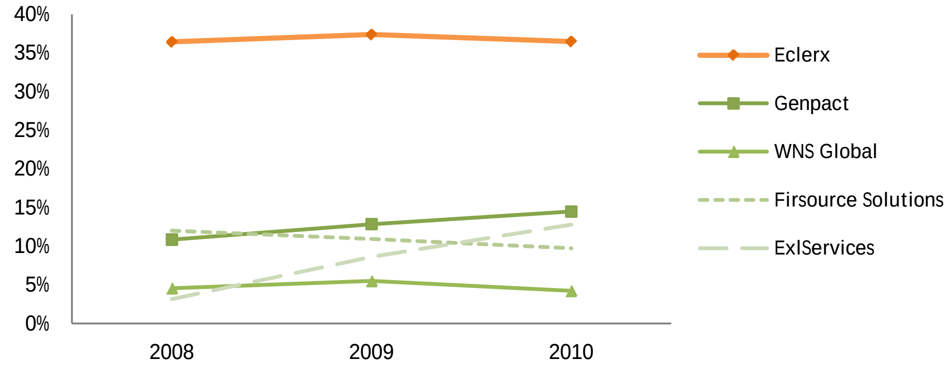
Exhibit 2: YoY Revenue growth



Source: Bloomberg, Equirus Research

- *TCS BPO's 2010 growth also includes inorganic growth (CITI Global Services acquisition)*

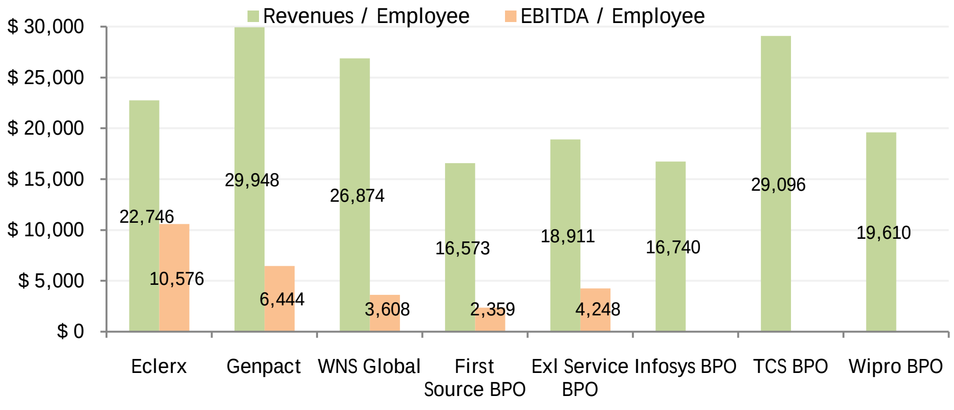
Exhibit 3: Operating Margin (EBIT Margin)



Source: Bloomberg, Equirus Research

While revenue per employee is higher, eClerx's COGS (employee expenses) is lower than peers in BPO industry and hence EBITDA per employee is higher than most of the large players

Exhibit 4: Revenue / Employee & EBITDA / Employee of peers

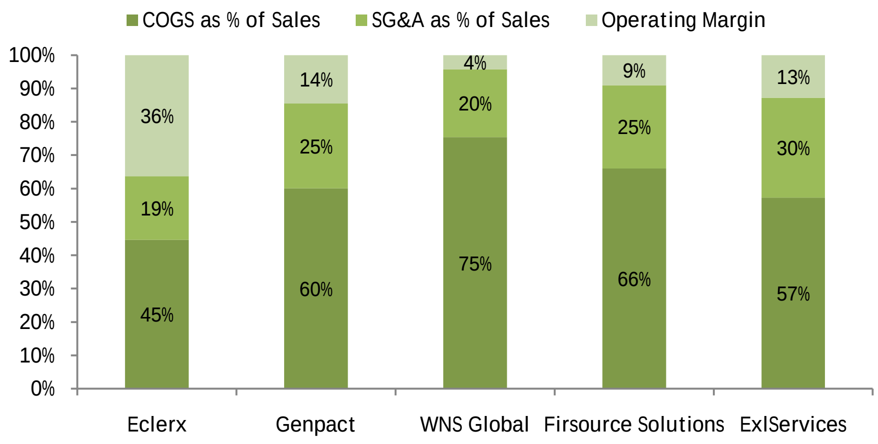


Source: Bloomberg, Equirus Research

- *TCS BPO has presence in UK hence avg. revenue per employee is bound to be higher*
- *15% of Genpact's revenues come from IT services and hence avg. revenue per employee is bound to be slightly higher; EBITDA per employee for Infosys, TCS and Wipro BPOs is not available*

Tight SG&A cost management combined with low employee expenses translates into Industry leading operating margins: In our view, due to its small size eClerx may not have benefits of economies of scale that larger players have, yet it has done a commendable job of operating business at significantly lower SG&A expenses than peers in BPO Industry. It is also our view that eClerx carefully plans capacity expansion and avoids very long term investments in capacity expansion so that margins are not impacted.

Exhibit 5: Operating Margin (EBIT Margin)



Source: Bloomberg, Equirus Research

Attrition within limit (30-35%) is desirable as it helps eClerx maintain employee pyramid without impacting delivery ability

Up to 30-35% attrition at ground level doesn't impact delivery ability but rather helps eClerx maintain margins

As per our view which is also concurred by management, 30-35% attrition at ground level doesn't impact eClerx's ability to deliver. In fact, it helps the company maintain employee pyramid and keep average cost per employee low. While attrition at ground level has been historically high, eClerx has been able to restrict attrition at managerial level and above to 10-15%.

But 48% annualized attrition in 2Q11 is significantly higher and a bit concerning even after taking into to account seasonality

Traditionally, eClerx has seen high attrition in Q2 yet 48% annualized attrition on top of 38% in 1Q11 is a bit concerning and we believe eClerx may have to raise its wage structure if attrition level doesn't drop in 2H11. We haven't built in another wage hike in FY11E in our estimates.

Supply side constraints are inconsequential and cost of training new employees is negligible

At ground level eClerx mostly hires Bcom and engineering graduates and for managerial roles MBAs from 2nd and 3rd tier Management schools. We believe there is sufficient supply of talent (Bcom and MBA graduates) that is hired by eClerx.

In many cases the new hires are billable within one week of joining and hence the cost of attrition is indirectly borne by clients

In many cases fresh graduate hires are trained for just one week and rest of the training happens on-the-job while they are billable to client. This implies that most of the cost of training a new hire is borne by the client and hence while eClerx enjoys benefits of attrition (within manageable level) the costs are borne by client albeit in many cases but not all.

Client concentration is definitely a risk but the quality of top 5 customers and maturity of eClerx's engagement with them gives comfort

eClerx's client concentration (Top 5 clients) has steadily increased from 75% to 87% in last 5 quarters suggesting that nearly entire incremental growth has come from top 5 clients

eClerx's client concentration has steadily increased over the last 5 quarters from 75% to 87%. It is certainly a risk as loss of one of the clients can disrupt the growth momentum.

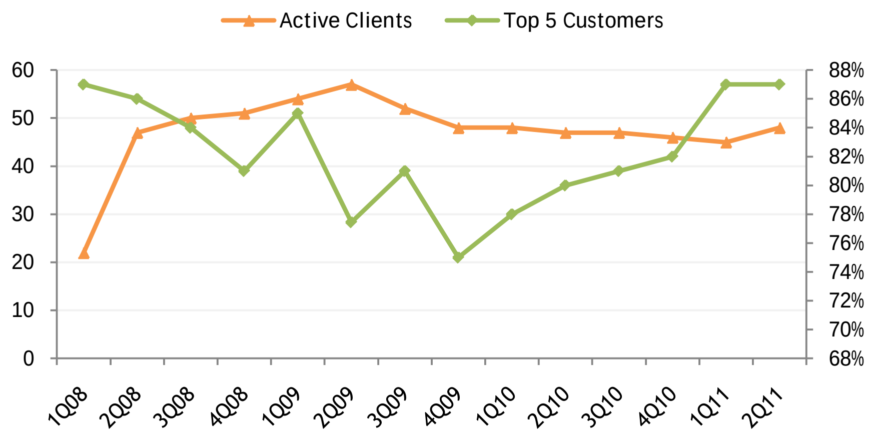
eClerx's engagement with Top 5 customers is in the range of 4-8 years suggesting that

While eClerx's dependence on top 5 customers is certainly very high, these relationships are 4-8 years old.

Long term contracts having 2-3 years duration give more visibility of business and certainty of annual revenues

In our view, long term contracts in BPO Industry are generally contracts having 3-5 years of duration or even longer. ~80% of eClerx's contracts are of 2-3 years duration which can go through a renegotiation every year. In our view, such contract terms give more visibility of business and certainty of annual revenues.

Exhibit 6: Client concentration and Active clients



Source: Bloomberg, Equirus Research

eClerx chose to drop few infeasible client engagements that it had inherited from Ingentica acquisition, hence falling number of active clients is not a serious concern

eClerx's active client count has fallen from 57 in 2Q09 to 45 in 1Q11 as company dropped few infeasible client engagements it had inherited from the acquisition of Ingentica Travel Solutions Ltd. In our view, fall in number of active clients is not much of a concern. Also, the last 5 clients acquired are Fortune 500 companies offering account mining opportunities.

Fall in number of active clients as eClerx chose to drop a few infeasible client engagements that it had inherited from Ingentica acquisition

eClerx's active clients count has fallen from 57 in 2Q09 to 45 in 1Q11 as company dropped a few infeasible client engagements it had inherited from acquisition of Ingentica Travel Solutions Ltd.

Other Key points of investor interest

Growth Strategy of eClerx

Mostly organic growth in existing verticals; Inorganic growth to expand in other verticals

Default growth strategy of eClerx continues to be organic growth in verticals where it already has exposure. However the company continues to look out for an acquisition to expand capabilities and enter into a new vertical.

Extending service offerings to Buy Side clients in Capital Markets vertical

eClerx's is presently working for 9 out of top 14 Investment Banks. Through these engagements eClerx has demonstrated domain expertise across most of the back office operations in Capital Markets domain. The company now plans to extend trade processing services like trade confirmation and settlement to Buy side clients, Hedge funds etc.

Looking at acquisition to expand in new vertical - Health care/ Supply Chain/ Legal Process outsourcing

eClerx is actively looking at acquisition opportunities to expand outside of existing verticals (CAPM and SMS). Management is looking for acquisition opportunities in verticals like Healthcare, Supply chain and Legal process outsourcing.

eClerx faces competition from captives as well as BPO arms of TCS, Wipro, Infosys, Cognizant, Accenture and Capgemini

Strong domain expertise and track record favours eClerx while inability to offer IT capabilities is a disadvantage in large integrated Business Process Management deals

In Capital Markets vertical, eClerx mostly faces competition from BPO arms of TCS, Wipro, Infosys, Cognizant and Accenture. In Sales & Marketing Support vertical, eClerx faces competition from Captive BPO and analytics arm of its Top client, while occasionally Capgemini. In our view, while its strong domain expertise and track record favours eClerx, inability to offer IT capabilities certainly limits ability to participate in large integrated outsourcing deals.

At what valuations are small BPO players or Captives acquired?

Recent acquisitions of Citi Global Services Ltd by TCS was attractively price ~1.8x revenue run rate but valuations can be much higher depending on the niche

In recent past, CITI group and UBS spun off their India Back office operations to TCS and Cognizant respectively. Valuations of both these deals are comparable from headcount perspective. However Infosys recent acquisition of McCamish looks richly valued on headcount despite the fact that McCamish was making losses. Thus niche BPO players can attract higher valuations depending on the niche and health of business operations.

Exhibit 7: Recent Acquisitions

Acquirer	Target	Revenues ($ Mn)	Headcount	Acquisition ($ Mn)	Other Benefits
TCS	CITI Global Services Ltd	~280	12,500	505	$ 2.5 Bn 9 yr contract
Cognizant	UBS India Service Centre	NA	2,000	75	$442 Mn 5 yr contract
Infosys	McCamish Systems	Less than $38 Mn	300 IT + BPO Headount	38	Infosys to pay additional $20 Mn if pre-set targets are achieved

Forecast: Key Assumptions & Sensitivity

Assumptions	FY11E	FY12E	FY13E
S,G&A expenses as a % of sales	18.2%	18.0%	17.8%
Effective Income Tax Rate	12%	12%	20%
Exchange Rate (₹/$)	45.1	44.8	45

The sensitivity of various parameters to our FY11 estimates is present in the following table.

Sensitivity to Key Variables	% Change	% Impact on Operating Margin
Rupee Appreciation	1%	-50 bps

Investment Risk & Concerns

Client Concentration risk

Contribution of Top 5 clients to revenues rose to 87% in 1Q11 - back to where it was in 1Q08; Client concentration in past 3 years has been in 75%-87% range

eClerx's client concentration has steadily increased over the last 5 quarters from 75% to 87%. The client concentration is same as it was in 1Q08. High client concentration is certainly a concern as ramp down at any of top 5 clients can disrupt the growth momentum for a few quarters.

Structural risk to the Business

eClerx stands at a disadvantage against competition in large deals due to its inability to offer Integrated Business Process Management (IT + BPO services)

In our view, not only eClerx but all pure play BPO players are at a disadvantage when competing in large deals against large IT services players like TCS, Wipro, Infosys, Cognizant, Capgemini and Accenture. We believe that Integrated Business Process management (i.e. IT and BPO services combined) will emerge over pure BPO services. Also, as seen in recent past (TCS acquisition of CITI Global Services, Cognizant's acquisition of UBS India Shared Service centre, etc.) large IT and large BPO players will continue to strengthen their complementary skills through organic and inorganic growth. Clearly, eClerx is at disadvantage and hence may be vulnerable to vendor consolidation risk.

Dodd-Frank poses a threat to the traditional Business Process Outsourcing model in financial services sector as it proposes to hold service providers supporting operations legally liable for the wrongdoings of their enterprise customers

The Dodd-Frank Wall Street Reform and Consumer Protection Act signed by President Obama on July 21, 2010, can have serious implications on the traditional outsourcing model in the financial services sector. It may lead to mutation of some current processes and in worst case discontinuation of some processes if client exits some line of business due to new regulations.

Also, the traditional outsourcing model doesn't make service providers legally responsible for wrongdoings of their enterprise customers. As per our understanding, (Based on Source: http://www.outsourcing-law.com/2010/07/dodd-frank-new-risks-for-bpo/) in order to limit the systemic financial risks, the new law proposes to hold external service providers supporting operations and processing transactions legally responsible as 'aiders and abettors' for violations of their clients. Not only that, it also encourages employees of external service providers to flag violations of clients as

In our view, this law may imply additional costs for external service providers as they try to comply to the law and mitigate their risks. In worst case, it may lead to in-house shift of some key processes from external service providers to captives. It is still unclear how this will shape up and impact eClerx's business. We will continue to track the developments and clarifications in Dodd-Frank's law and flag if it translates into a real risk for eClerx.

Risk to Margins

1% appreciation of rupee impacts eClerx's operating margins by ~50 bps

100% offshore effort implies high sensitivity to currency fluctuations in case of eClerx and most of the BPO players. 1% change in rupee impacts eClerx's operating margin by ~50 bps.

Corporate Governance

Following are key highlights of our preliminary assessment of level of corporate governance in the company from its 2009-10 Annual Report:

- **Board of Directors**
  - **Composition:** Board consists of 8 members, which includes one executive director, two non-executive directors, four independent directors and one non-executive independent director.
  - **Background:** Independent directors bring with them a good blend of strategy, legal and financial expertise.
  - **Distribution of Power:** The Company has three committees, viz. Audit committee, Shareholder's grievance committee and Remuneration committee. Chairman of all the committees are independent directors.
  - **Shareholding of Independent Directors in the company:** Total shareholding between 4 Non-executive Independent directors is less than 0.1%.
- **Disclosure norm:** As per our preliminary study, we do not find any issues on this front, company follows disclosure norms as stipulated by the listing agreement of the exchanges and is timely in coming up with quarterly results and other disclosures.
- **Auditor of eClerx:** M/s. Walker Chandiok & Company
- **Auditor's report:** No irregularities have been found by auditors in their assessment of the company.

Valuation

At current valuations of ~17x TTM PE, the stock is not cheap but we believe that the multiples can sustain; We set our PT of ₹ 700 at 16x Sep-11 TTM EPS: In our view, at ~17x TTM PE the valuations are rich, but we believe that these multiples are sustainable as company continues to deliver 30-32% revenue growth over FY11-13E. Our Sep-11 PT of ₹ 700 is set at 16x Sep-11 TTM EPS.

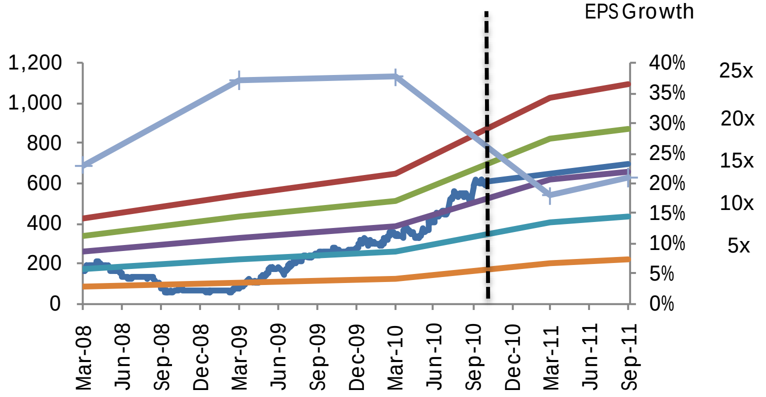
Our PT implies ~20% discount to our Sep-11 DCF Fair value of ₹ 880

Our Sep-11 DCF fair value ₹ 880 is derived assuming ~30% revenue CAGR over FY10-15 followed by ~14% revenue CAGR over 2015-20E followed by terminal growth rate of 4%, WACC of 14% and 23% NOPAT margin in terminal year.

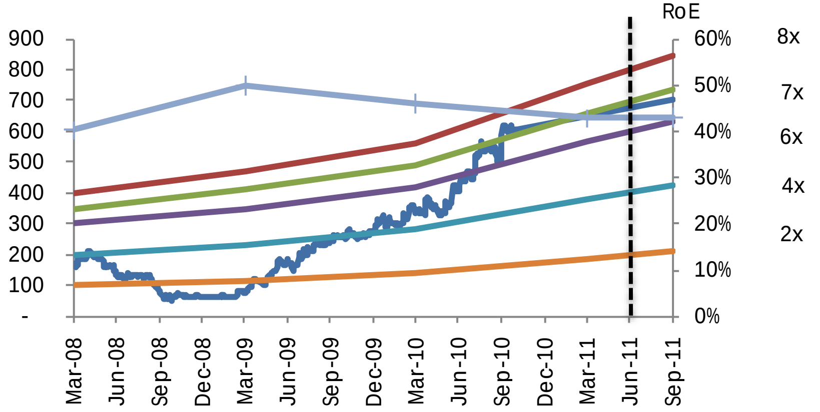
Assuming ~45% payout in growth phase and 55% payout in terminal year we arrive at Sep' 11 DDM Fair value of ₹ 511

Our DDM Fair value of ₹ 454 assumes ~45% dividend payout ratio over FY10-20E, followed by 55% in the terminal year.

TTM P/E vs. 2 year forward EPS Growth



TTM P/B vs. 2 year forward ROE

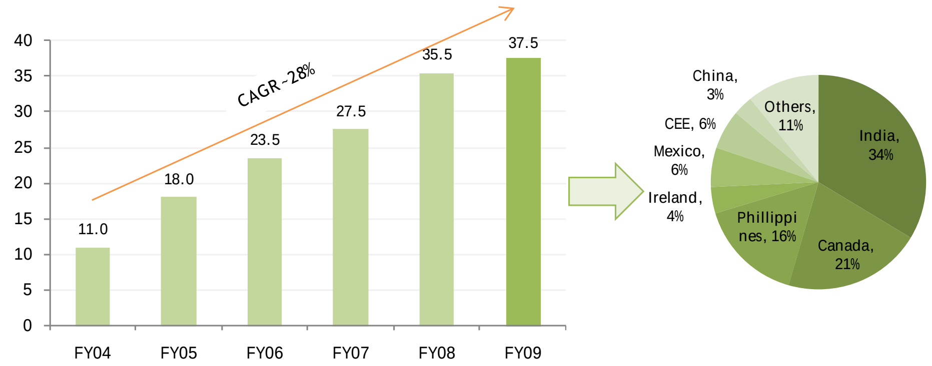


Annexure 1: Industry Overview

Global Business Process Outsourcing market has grown at 28% CAGR over 2004-09 and India's share in FY09 was 34%

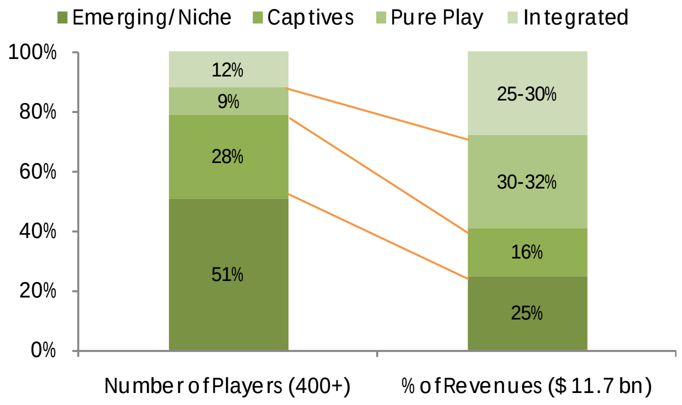
As per Nasscom research, Global BPO sourcing market grew at 28% over FY04-09. India's share in FY09 was 34%. Nasscom expects India's BPO exports to grow from USD 12 Bn to 50 Bn which implies a CAGR of ~15% over FY10-20E.

Exhibit 8: Global Sourcing Market Size & Market share percentage



Source: IDC, Nasscom, Equirus Research

Exhibit 9: FY09 India's BPO exports



Source: Nasscom, Equirus Research

Integrated Players: These are large players with ability to offer IT and BPO services. They were late entrants in BPO industry but have benefitted from their ability to handle large integrated Business process management deals (IT + BPO services).

Pure Play BPO Players: These players have ability to offer wide range of services across vertical and services lines and have set up delivery centres across globe.

Captives: Captives were first movers in BPO space. Some captives were set up in India way back in late 1996. Though in recent past we have seen monetization of some captives by parents (E.g. Citi, UBS), more and more captives continue to open up.

Emerging/Niche players: These segment comprises of small BPO players with revenues less than $ 10 mn focused on specific verticals and service lines.

Annexure 2: Company Overview

eClerx is a pure play BPO player founded in 2000. Today, the company has grown to employee strength of ~3,200. eClerx has a wide range of non-voice, data intensive and analytical service offerings that have a blend of BPO and KPO.

eClerx has carved its niche in Capital Markets domain and it manages critical back office functions as well as some middle office functions for leading investment banks. Apart from financial services, eClerx also provides Sales and Marketing support to companies in E-commerce domain. Company's both verticals contribute roughly 50% of the revenues.

Exhibit 10: eClerx's Business Verticals

Vertical	Clients	Nature of Work	Competition
Capital Market	9 out of top 14 Investment Banks	Work is data intensive and analytical in nature (Not complex statistical analysis but simple analytical skills) E.g. 1) Reconciliation of trades & data from different systems across geographies 2) Generation of daily, weekly and monthly reports	BPO arms of TCS, Infosys, Wipro, Cognizant and Accenture
Sales and Marketing Support	Leading US Computer and computer peripherals manufacturer contributes major chunk of revenues. Other clients are from travel, tourism and e-retail industry	1) Website content management, Data management 2) Supporting launch of new product campaigns, generating scorecards to monitor success of campaigns 3)Pricing analytics	BPO and analytics captive of Computer Manufacturer; Capgemini

Exhibit: Other features of eClerx Business model

IT Capabilities	eClerx has 150 people strong IT team to support the processes
Tools Used	Most of the processes use client's legacy software systems. However, eClerx has build some proprietary tools which are accepted and used in Capital Markets vertical

Billing Rates	~$ 30,000 a year per billable resource
Hiring	1) Entry level executives are mostly B.Com graduates. Entry level salary is approx. Rs 2,50,000 ($5,500) per annum 2) Managerial level hiring is fresh MBA graduates and laterals with relevant experience
Typical Team composition	E.g. 20 Member team may have 16 billable resources, 2 resources on bench, 1 manager and 1 IT resource

Financial Performance

eClerx's sustained revenue growth, debt free position and low effective tax rates has resulted in steady margins and net cash accruals over FY08-10. Despite distributing ~40-45% of profits as dividends, the company has maintained a healthy cash position.

Exhibit 8: Historic Financial performance

	FY08	FY09	FY10
Revenues	1,217	1,973	2,570
EBITDA	492	808	1,004
EBITDA (%)	40%	41%	39%
PAT	453	618	735
PATM (%)	37%	31%	29%
Debt	40	0	0
Cash	877	1,064	1,247
Sales Growth (%)	41%	62%	30%
PAT Growth (%)	12%	36%	19%
EPS Growth (%)	NA	28%	18%
RoE (%)	NA	41%	40%
RoIC (%)	NA	113%	115%

Key Management profile

PD Mundhra — Co-founder and Executive Director

Mr. PD Mundhra has over 16 years experience in the manufacturing and financial services industries, ten years in capital markets and the KPO / BPO sector. He holds a Master of Business Administration degree in finance from The Wharton School, University of Pennsylvania (USA) and a Bachelors of Commerce from St. Xavier's College, Calcutta (India).

Anjan Malik — Co-founder and Director

Mr. Anjan Malik is the co-founder and director of eClerx Services Limited and the executive director of its on-shore subsidiaries. He has over 18 years experience in investment banking, capital markets, consulting and technological solutions; nine of those in capital markets and KPO / BPO sector. Mr. Malik holds a Masters of Business Administration degree in finance from The Wharton School, University of Pennsylvania (USA) and a first class Bachelors of Science degree in Physics, with honors, from the Imperial College of Science and Technology, London (UK).

Rohitash Gupta — CFO

Rohitash Gupta, (Principal, Corporate Finance) manages the finance, secretarial, corporate development and investor relations of eClerx Services Limited. He has over 13 years of experience in the retail, manufacturing, IT and consulting industry. He has received his Bachelors of Technology degree from Indian Institute of Technology, Kanpur (India) and a Master of Management degree from the School of Management, Indian Institute of Technology, Bombay (India).

Alberto Corvo — Managing Principal, Financial Services

Alberto Corvo manages Financial services division at eClerx. HE has over 15 years of experience in Investment Banking and Banking technology and holds a MBA from Yale school of management and Masters in Electronics engg from Politecnico di Milano (Italy).

Scott Houchin — Principal, Sales & Marketing Support

Scott Houchin leads Sales and Marketing support division. He has over 15 years of experience in Fortune 500 technology companies. He holds BSc in Business management from University of South Dakota (USA).

Quarterly Consolidated Earnings Forecast & Key Drivers

Rs in Million	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	FY10	FY11E	FY12E	FY13E
Revenue	544	623	691	713	771	823	856	927	999	1,076	1,161	1,249	2,570	3,377	4,485	5,937
COGS (Excl. Depr.)	231	253	282	312	358	371	394	426	479	503	541	581	1,078	1,549	2,104	2,851
SG&A	103	116	130	140	130	154	158	171	180	194	209	225	489	614	807	1,054
EBITDA	210	254	278	261	283	298	304	329	340	379	411	443	1,004	1,213	1,573	2,032
Depreciation	15	18	18	19	15	23	23	23	23	25	25	26	70	84	99	120
EBIT	195	236	260	242	267	275	281	306	317	354	386	417	934	1,129	1,474	1,912
Interest	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Income	-59	-52	-20	-40	66	38	48	46	33	29	25	26	-106	199	114	96
PBT	136	184	240	268	334	313	329	352	350	384	411	444	828	1,328	1,588	2,008
Tax	17	23	27	25	41	37	40	42	42	46	49	53	93	159	191	402
Reported PAT	119	161	213	242	293	276	290	310	308	338	362	391	735	1,169	1,398	1,607
Extraordinary	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Adj. Net Profit	119	161	213	242	293	276	290	310	308	338	362	391	735	1,169	1,398	1,607
EPS (Rs)	4.2	5.7	7.4	8.5	10.3	9.7	10.1	10.8	10.8	11.8	12.7	13.7	25.8	40.9	48.9	56.2
Key Drivers																
COGS (Excl. Depr.) as % of Sales	42.4%	40.6%	40.8%	43.8%	46.5%	45.1%	46.0%	46.0%	48.0%	46.8%	46.6%	46.5%	41.9%	45.9%	46.9%	48.0%
S,G&A expenses as % of Sales	18.9%	18.6%	18.9%	19.6%	16.9%	18.7%	18.5%	18.5%	18.0%	18.0%	18.0%	18.0%	19.0%	18.2%	18.0%	17.8%
Sequential Growth (%)																
Revenue	0.1%	14.6%	10.8%	3.2%	8.1%	6.8%	4.1%	8.2%	7.8%	7.8%	7.9%	7.5%				
COGS (Excl. Depr.)	19.9%	9.7%	11.5%	10.7%	14.8%	3.5%	6.2%	8.2%	12.4%	4.9%	7.6%	7.3%				
EBITDA	-20.1%	20.7%	9.5%	-6.2%	8.3%	5.4%	2.1%	8.2%	3.2%	11.7%	8.4%	7.9%				
EBIT	-19.7%	21.0%	10.1%	-7.1%	10.6%	2.7%	2.3%	8.9%	3.4%	11.9%	9.0%	8.1%				
Adj. Net Profit	-22.9%	35.7%	31.8%	13.9%	21.0%	-5.8%	4.9%	7.0%	-0.8%	9.8%	7.2%	7.9%				
EPS	-22.9%	35.6%	30.7%	14.5%	20.9%	-6.0%	4.9%	7.0%	-0.8%	9.8%	7.2%	7.9%				
Yearly Growth (%)																
Revenue	28.4%	26.9%	33.9%	31.3%	41.8%	32.0%	24.0%	30.0%	29.5%	30.8%	35.6%	34.8%	30.3%	31.4%	32.8%	32.4%
EBITDA	31.3%	66.9%	19.8%	-0.9%	34.4%	17.3%	9.3%	26.0%	20.1%	27.3%	35.2%	34.8%	24.2%	20.9%	29.6%	29.2%
EBIT	35.3%	76.2%	22.2%	-0.7%	36.9%	16.2%	8.0%	26.6%	18.4%	29.0%	37.4%	36.4%	27.0%	20.9%	30.6%	29.7%
Adj. Net Profit	-26.1%	14.6%	90.0%	57.0%	146.5%	71.1%	36.1%	28.0%	4.9%	22.3%	25.0%	26.0%	19.0%	59.0%	19.6%	14.9%
EPS	-26.3%	14.4%	88.0%	56.3%	145.2%	70.0%	36.5%	27.6%	4.7%	22.3%	25.0%	26.0%	18.4%	58.5%	19.5%	14.9%
Margin (%)																
EBITDA	38.7%	40.8%	40.3%	36.6%	36.7%	36.2%	35.5%	35.5%	34.0%	35.3%	35.4%	35.5%	39.0%	35.9%	35.1%	34.2%
EBIT	35.9%	37.9%	37.7%	33.9%	34.7%	33.4%	32.8%	33.0%	31.7%	32.9%	33.2%	33.4%	36.3%	33.4%	32.9%	32.2%
PBT	25.1%	29.6%	34.8%	37.6%	43.3%	38.0%	38.4%	38.0%	35.0%	35.7%	35.4%	35.5%	32.2%	39.3%	35.4%	33.8%
PAT	21.9%	25.9%	30.8%	34.0%	38.0%	33.6%	33.8%	33.5%	30.8%	31.4%	31.2%	31.3%	28.6%	34.6%	31.2%	27.1%

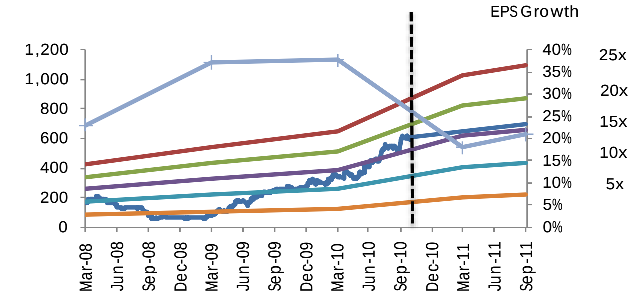
Consolidated Financials

P&L	FY10	FY11E	FY12E	FY13E
Revenue	**2,570**	**3,377**	**4,485**	**5,937**
Op. Expenditure	1,567	2,163	2,911	3,905
EBITDA	**1,004**	**1,213**	**1,573**	**2,032**
Depreciation	70	84	99	120
EBIT	934	1,129	1,474	1,912
Interest	0	0	0	0
Other Income	-106	199	114	96
PBT	828	1,328	1,588	2,008
Tax	93	159	191	402
Reported PAT	735	1,169	1,398	1,607
Adjustments	0	0	0	0
Adj. Net Profit	**735**	**1,169**	**1,398**	**1,607**
EPS (Rs)	25.7	40.9	48.9	56.2
DPS (Rs)	17.5	17.0	20.9	24.0
CEPS (Rs)	28.2	43.8	52.3	60.4
FCFF (Rs)	20.2	29.2	38.7	41.6
Sales Growth (%)	30%	31%	33%	32%
PAT Growth (%)	19%	59%	20%	15%
EPS Growth (%)	18%	59%	20%	15%
EBITDAM (%)	39%	36%	35%	34%
PATM (%)	29%	35%	31%	27%
Tax Rate (%)	11%	12%	12%	20%

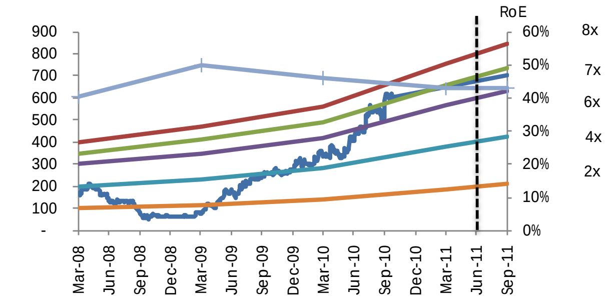
Balance Sheet	FY10	FY11E	FY12E	FY13E
Equity Capital	190	286	286	286
Reserve	1,809	2,406	3,105	3,908
Networth	**1,999**	**2,692**	**3,391**	**4,194**
Debt	0	0	0	0
Def Tax Liability	0	0	0	0
Minority Interest	0	0	0	0
Total Liabilities	**1,999**	**2,692**	**3,391**	**4,194**
Net Block	199	275	376	496
Capital WIP	22	0	0	0
Others	109	195	235	295
Net Work. Cap	**1,669**	**2,222**	**2,780**	**3,404**
Inventory	0	0	0	0
Account Receivables	392	555	737	976
Other Current Assets	501	740	912	1,211
Account Payables	220	340	432	586
Other Curr Liabi	251	338	448	594
Cash	1,247	1,605	2,012	2,397
Total Assets	**1,999**	**2,692**	**3,391**	**4,194**
Net D/E	-0.6	-0.6	-0.6	-0.6
Interest Cov	NA	NA	NA	NA
Cash Conv Cycle	60.0	66.8	62.6	61.9
WC Turnover	6.1	5.5	5.8	5.9
FA Turnover	11.6	12.3	11.9	12.0

Cash Flow	FY10	FY11E	FY12E	FY13E
PAT	735	1,169	1,398	1,607
Depreciation	70	84	99	120
Change in WC	-147	-196	-151	-238
Operating C/F	**659**	**1,058**	**1,346**	**1,488**
Capex	-82	-224	-240	-300
Change in Invest	0	0	0	0
Investing C/F	**-82**	**-224**	**-240**	**-300**
Change in Loan	0	0	0	0
Change in Eq Cap	-3	93	0	0
Others	-390	-569	-699	-803
Financing C/F	**-393**	**-476**	**-699**	**-803**
Cash Generation	183	358	407	385
RoE (%)	40%	50%	46%	42%
RoIC (%)	40%	50%	46%	42%
Core RoIC (%)	115%	100%	97%	89%
Div Payout (%)	53%	49%	50%	50%
P/E	23.0	14.5	12.1	10.5
P/BV	8.4	6.3	5.0	4.0
P/FCFF	29.3	20.3	15.3	14.2
EV/EBITDA	-1.2	-1.3	-1.3	-1.2
EV/Sales	-0.5	-0.5	-0.4	-0.4
Div Yield(%)	3%	3%	4%	4%

TTM P/E vs. 2 yr forward EPS growth



TTM P/B vs. 2 yr forward RoE



Historical Consolidated Financials

P&L	FY08	FY09	FY10
Revenue	**1,217**	**1,973**	**2,570**
Op. Expenditure	725	1,165	1,567
EBITDA	**492**	**808**	**1,004**
Depreciation	45	73	70
EBIT	447	735	934
Interest	3	0	0
Other Income	67	-40	-106
PBT	511	694	828
Tax	58	77	93
Reported PAT	453	618	735
Adjustments	0	0	0
Adj. Net Profit	**453**	**618**	**735**
EPS (Rs)	24.0	32.6	25.7
DPS (Rs)	7.7	12.5	17.5
CEPS (Rs)	18.7	24.4	28.2
FCFF (Rs)	-1.3	18.2	20.2
Sales Growth (%)	41%	62%	30%
PAT Growth (%)	12%	36%	19%
EPS Growth (%)	NA	28%	18%
EBITDAM (%)	40%	41%	39%
PATM (%)	37%	31%	29%
Tax Rate (%)	11%	11%	11%

Balance Sheet	FY08	FY09	FY10
Equity Capital	189	189	190
Reserve	1,139	1,467	1,809
Networth	**1,328**	**1,657**	**1,999**
Debt	40	0	0
Def Tax Liability	0	0	0
Minority Interest	0	0	0
Total Liabilities	**1,368**	**1,657**	**1,999**
Net Block	116	201	199
Capital WIP	69	1	22
Others	80	115	109
Net Work. Cap	**1,103**	**1,339**	**1,669**
Inventory	0	0	0
Account Receivables	256	451	392
Other Current Assets	270	307	501
Account Payables	184	231	220
Other Curr Liabi	117	251	251
Cash	877	1,064	1,247
Total Assets	**1,368**	**1,657**	**1,999**
Net D/E	-0.6	-0.6	-0.6
Interest Cov	NA	NA	NA
Cash Conv Cycle	67.7	51.0	60.0
WC Turnover	5.4	7.2	6.1
FA Turnover	6.6	9.8	11.6

Cash Flow	FY08	FY09	FY10
PAT	453	618	735
Depreciation	45	73	70
Change in WC	-226	-50	-147
Operating C/F	**272**	**641**	**659**
Capex	-309	-126	-82
Change in Invest	0	0	0
Investing C/F	**-309**	**-126**	**-82**
Change in Loan	40	-40	0
Change in Eq Cap	752	-12	-3
Others	-170	-277	-390
Financing C/F	**622**	**-329**	**-393**
Cash Generation	584	186	183
RoE (%)	56%	41%	40%
RoIC (%)	55%	41%	40%
Core RoIC (%)	149%	113%	115%
Div Payout (%)	38%	45%	53%
P/E	25.0	18.4	23.3
P/BV	8.5	6.9	8.6
P/FCFF	-452.3	33.0	29.7
EV/EBITDA	-1.7	-1.3	-1.2
EV/Sales	-0.7	-0.5	-0.5
Div Yield(%)	1%	2%	3%

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Absolute Rating

- LONG : >= 15% upside over investment horizon
- SHORT: >=5% downside over investment horizon
- NEUTRAL: Trading range of -4% to +14%

Relative Rating

- OVERWEIGHT: Likely to outperform the benchmark by at least 5% over investment horizon
- NEUTRAL: likely to perform in line with the benchmark
- UNDERWEIGHT: likely to underperform the benchmark by at least 5% over investment horizon

Target Period

Target Period of minimum 3 months to maximum 12 months with target date either on last day of September or March month for any near.

Lite vs. Regular Coverage

Our research opinions are based on set of several assumptions. The distinction between Lite and Regular coverage is provided to indicate the depth of analysis and due diligence performed to derive such assumptions. However such distinction should not be interpreted as an indication of confidence level or accuracy of forecast and recommendation.