

ECLERX SERVICES

Inorganic contribution, profits surprise positively

India Equity Research | IT



eClerx's Q1FY13 results were ahead of estimates as revenue of USD28.1mn was up 10.1% QoQ (incl. Agilyst) vs our estimate of USD27.7mn. On organic basis, revenue grew 1% versus our estimate of flat revenue. EBITDA margin, at 39.8%, surged 320bps due to favourable currency. Agilyst consolidation fuelled growth though expansion in the organic business came as a positive surprise as the management had earlier hinted at delays in decision making to impact growth H1FY13. Although, uncertainty in BFSI remains an overhang on revenue growth, we believe the long term story remains intact for eClerx as clients continue to focus on increased offshoring. At P/E of 10.9x/9.6x FY13E/14E, maintain 'BUY'.

Revenue growth, margin expansion surprise

eClerx posted a robust USD revenue growth of 10.2% on a consolidated basis (incl. Agilyst ~9.2%) and 1% on an organic basis (1.5% in CC). EBITDA margin saw an increase of 320bps QoQ largely owing to currency benefit. PAT at INR493mn was significantly higher than our and street estimates of INR423mn due to increased other income and lower tax rate of 17.6% (19% in Q4). North America saw a major traction as it grew 11.8% (incl. Agilyst) while Europe continued the downtrend as it declined for the fourth consecutive quarter by 4.2% in Q1FY13.

Agilyst, higher offshoring to drive growth in FY13

In Q1, Agilyst contributed revenue of USD2.3mn (two months' revenue). On a full year basis, we expect Agilyst to contribute ~15% to the revenue growth while organic business to post a YoY growth of 9% which implies a CQGR of 2% for the remaining quarters of FY13. Also, Agilyst results reduce dependence on top five clients (contribution of top five is down to 80% in Q1FY13 vs 87% in Q4FY12)

Outlook and valuations: On growth path; maintain 'BUY'

Even as the macro uncertainty, especially in BFSI, remains an overhang on revenue growth, we believe the long term story is well intact for eClerx as clients continue to focus on cost reduction, leading to increased offshoring. We are revising our FY13 USD revenue growth to 24% versus 20% earlier, leading to 2.3% upgrade in FY13 EPS estimate to INR64.5. At CMP of INR703, the stock is trading at P/E of 10.9x and 9.6x FY13E and FY14E earnings, respectively. We maintain 'BUY/SO' rating.

Financials

Year to March	Q1FY13	Q4FY12	Growth %	Q1FY12	Growth %	FY12	FY13E	FY14E
Revenue (INR mn)	1,537	1,276	20.5	996	54.3	4,729	6,463	7,300
EBITDA (INR mn)	612	468	30.8	391	56.6	1,898	2,462	2,636
Net profit (INR mn)	493	304	62.0	352	40.2	1,598	1,944	2,206
Diluted EPS (INR)	16.4	10.1	62.3	11.7	40.1	53.0	64.5	73.2
Diluted P/E (x)						13.2	10.9	9.6
EV/EBITDA (x)						9.6	7.1	6.4
EV/Revenues (x)						3.8	2.7	2.3

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: ECLE.BO, B: ECLX IN)

CMP	: INR 703
Target Price	: INR 810
52-week range (INR)	: 857 / 570
Share in issue (mn)	: 29.2
M cap (INR bn/USD mn)	: 21/ 366
Avg. Daily Vol.BSE/NSE('000)	: 25.2

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	54.5	54.8	54.8
MF's, FI's & BK's	13.0	12.4	9.5
FII's	20.3	21.7	24.5
others	12.1	11.1	11.2
* Promoters pledged share (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	(1.2)	3.0	(3.7)
3 months	(15.0)	(1.6)	2.0
12 months	(25.8)	(6.3)	9.9

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Other highlights

- Contribution from top five clients stood at 80% (87% in Q4FY12). Top five grew sequentially by 1.3%.
- North America saw a sequential growth of 11.8% in USD terms while Europe saw a decline for the fourth consecutive quarter (QoQ decline of 4.2%).
- Net addition of 1140 employees, taking the employee count to 5,545.
- Debtor days stood at 30 (29 in the previous quarter).
- Cash and cash equivalents stood at INR1,878mn.
- The company has outstanding hedges worth USD85.2mn at an average rate of INR49.5/USD.

Table 1: Key operating metric data

Currency concentration (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
USD	75.0	75.0	75.0	74.0	77.0	80.0	79.0	83.0
EURO	21.0	21.0	21.0	21.0	19.0	18.0	17.0	14.0
GBP	4.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Others	1.0	1.0	1.0	2.0	1.0	-	1.0	1.0
Geographic concentration (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
North America	60.0	58.0	61.0	61.0	65.0	70.0	70.0	71.0
Europe	33.0	34.0	32.0	31.0	26.0	24.0	23.0	20.0
ROW	6.0	8.0	7.0	8.0	9.0	6.0	7.0	9.0
Client concentration (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
Top 5	87.0	86.0	86.0	88.0	86.0	86.0	87.0	80.0
Billing mix (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
FTE	87.0	91.0	90.0	93.0	95.0	94.0	95.0	93.0
SEZ revenues	58.0	62.0	62.0	66.0	64.0	67.0	72.0	62.0
Utilisation (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
	-	-	-	67.0	71.0	72.0	72.0	68.0
Clients added (Nos.)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
	NA	NA	NA	4	5	8	10	8
Clients billed (Nos.)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
	NA	NA	NA	48	50	53	55	54

Source: Company, Edelweiss research

Financial snapshot
(INR mn)

Year to March	Q1FY13	Q4FY12	% Change	Q1FY12	% Change	FY12E	FY13E	FY14E
Net revenues	1,537	1,276	20.5	996	54.3	4,729	6,463	7,300
Software development expenses	652	575	13.4	447	46.1	2,039	2,842	3,387
Gross profit	885	701	26.3	550	61.0	2,690	3,622	3,914
SG&A	273	233	17.3	159	72.0	793	1,160	1,278
EBITDA	612	468	30.8	391	56.6	1,898	2,462	2,636
Depreciation & amortization	38	40	(5.9)	24	61.3	129	166	196
EBIT	574	427	34.2	367	56.2	1,769	2,296	2,440
Other income	46	(51)	(189.4)	73	(36.6)	223	184	370
Profit before tax	598	376	59.2	440	36.1	1,992	2,458	2,810
Tax	105	71	47.6	88	19.6	394	514	604
Exceptionals	21	-		-		-	21	-
Reported net profit	493	304	62.0	352	40.2	1,598	1,944	2,206
Adjusted net profit	493	304	62.0	352	40.2	1,598	1,944	2,206
Diluted EPS (INR)	16.4	10.1	62.3	11.7	40.1	53.0	64.5	73.2

As % of net revenues

Gross profit	57.6	54.9		55.2		56.9	56.0	53.6
SG&A	17.8	18.3		16.0		16.8	17.9	17.5
EBITDA	39.8	36.6		39.2		40.1	38.1	36.1
Adjusted net profit	32.1	23.9		35.3		33.8	30.1	30.2
Reported net profit	32.1	23.9		35.3		33.8	30.1	30.2
Tax rate	17.6	19.0		20.0		19.8	20.9	21.5

Change in Estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	6,463	5,892	9.7	7,300	7,160	2.0	Revised FY13 USD/INR assumption to 53.5 from earlier 51.5/USD and raise USD revenue growth from earlier 21% to 24%.
EBITDA	2,462	2,382	3.3	2,636	2,666	(1.1)	
EBITDA Margin	38.1	40.4		36.1	37.2		
PAT	1,944	1,902	2.2	2,206	2,214	(0.4)	Higher tax rate of 22% (earlier assumption of 20%) offsets the gain on operating profits in FY13, and leads to decline in PAT for FY14E.
PAT Margin	30.1	32.3		30.2	30.9		
Capex	290	290	0.0	350	350	0.0	

Company Description

Incorporated in 2000, eClerx is one of the first KPOs to be listed in India and provides data analytics and customized process solutions to global enterprise clients from its offshore delivery centers in India. The company provides business solutions leveraging the cost effective combination of people, process and technology. These provide clients with benefits beyond cost reduction by designing solutions that incorporate talent management, process improvements, better reporting and metrics. It currently offers services to clients in the financial services, retail and manufacturing industries. eClerx's TTM revenues stood at USD103mn and employs over 5,545 people.

Investment Theme

eClerx is a strongly differentiated play in India's burgeoning KPO space and stands out by virtue of its business model. The company has built a strong and relatively uncontested position in specific high opportunity segments such as data analytics & management and process improvement solutions thus positioning itself as an established provider of specialised services. It inks multi-year annuity contracts facilitated by ongoing engagements, which has helped the company forge a predictable revenue stream leading to attractive profitability. Strong financial track record marked by significant profitability and return ratios, strong execution and management are eClerx's distinctive factors. We expect eClerx's earnings growth at 18% CAGR over FY12-14E.

Key Risks

Supply side pressures could affect client servicing and margins.

Volatility in exchange rates could impact the company's financials meaningfully.

Process automation and adverse regulations could impact the existing business

Financial Statements

Key Assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	6.4	7.0
	Inflation (Avg)	3.6	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.3	6.8
	USD/INR (Avg)	47.5	45.5	48.4	52.3	50.0
Company -	Pricing growth* (%)	(7.3)	0.8	4.5	(6.7)	-
	USD revenue growth (%)	30.0	38.3	29.1	24.0	20.8

*calculated pricing growth

Income statement

Year to March		FY10	FY11	FY12	FY13E	FY14E
(INR mn)						
Net revenue		2,570	3,421	4,729	6,463	7,300
Cost of revenues		1,078	1,477	2,039	2,842	3,387
Gross profit		1,492	1,945	2,690	3,622	3,914
Total SG&A expenses		489	599	793	1,160	1,278
EBITDA		1,004	1,346	1,898	2,462	2,636
Depreciation & Amortization		70	91	129	166	196
EBIT		934	1,255	1,769	2,296	2,440
Other income		(106)	240	223	184	370
Exceptionals		-	103	-	21	-
Profit before tax		828	1,392	1,992	2,458	2,810
Provision for tax		93	168	394	514	604
Net profit		735	1,224	1,598	1,944	2,206
Profit After Tax		735	1,224	1,598	1,944	2,206
Profit after minority interest		735	1,224	1,598	1,944	2,206
Basic shares outstanding (mn)		28	29	29	29	29
Basic EPS (INR)		25.8	42.7	55.1	67.0	76.1
Shares outstanding (mn)		30	30	30	30	30
Diluted EPS (INR)		24.8	40.7	53.1	64.5	73.2
CEPS (INR)		28.3	45.8	59.6	72.8	82.8
Dividend per share (INR)		11.7	22.6	17.6	33.5	34.2
Dividend payout (%)		45.4	53.0	32.0	50.0	45.0

Common size metrics - as % of net revenues

Year to March		FY10	FY11	FY12	FY13E	FY14E
Cost of revenues		41.9	43.2	43.1	44.0	46.4
Gross margin		58.1	56.8	56.9	56.0	53.6
SG&A expenses		19.0	17.5	16.8	17.9	17.5
EBITDA margins		39.0	39.3	40.1	38.1	36.1
EBIT margins		36.3	36.7	37.4	35.5	33.4
Net profit margins		28.6	35.8	33.8	30.1	30.2

Growth ratios (%)

Year to March		FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)		30.3	33.1	38.2	36.7	13.0
EBITDA		23.2	34.1	41.0	29.7	7.1
EBIT		27.0	34.4	41.0	29.8	6.3
PBT		19.2	68.1	43.1	23.4	14.3
Net profit		18.9	66.5	30.5	21.6	13.5
EPS growth (%)		14.2	64.3	30.5	21.6	13.5

Balance sheet					(INR mn)
As on 31st March	FY10	FY11	FY12E	FY13E	FY14E
Equity capital	193	292	293	293	293
Share premium account	740	667	695	695	695
Reserves & surplus	1,066	1,425	2,425	3,232	4,276
Shareholders funds	1,999	2,384	3,414	4,220	5,265
Sources of funds	1,999	2,384	3,414	4,220	5,265
Gross block	446	639	889	1,169	1,479
Accumulated depreciation	246	335	463	630	826
Net block	199	305	426	540	654
Capital work in progress	22	65	50	60	100
Deferred tax asset	7	7	7	7	7
Goodwill	101	-	-	-	-
Investments	775	279	1,300	1,450	1,550
Sundry debtors	392	659	907	1,240	1,360
Cash and equivalents	472	1,515	887	1,517	2,075
Loans and advances	501	698	873	1,091	1,363
Total current assets	1,366	2,873	2,666	3,847	4,798
Sundry creditors and others	220	350	437	546	683
Provisions	251	795	598	1,137	1,161
Total current liabilities & provisions	471	1,144	1,035	1,683	1,844
Net current assets	894	1,728	1,631	2,164	2,954
Uses of funds	1,999	2,384	3,414	4,220	5,265
Book value per share (INR)	67.3	79.2	113.3	140.1	174.8

Free cash flow					(INR mn)
Year to March	FY10	FY11	FY12E	FY13E	FY14E
Net profit	735	1,224	1,598	1,944	2,206
Depreciation	70	91	129	166	196
Others	(53)	(607)	(139)	(164)	(301)
Gross cash flow	753	709	1,588	1,946	2,100
Less: Changes in WC	147	(209)	531	(97)	233
Operating cash flow	606	918	1,057	2,043	1,868
Less: Capex	84	237	235	290	350
Free cash flow	522	681	822	1,753	1,518

Cash flow metrics					
Year to March	FY10	FY11	FY12E	FY13E	FY14E
Cash flow from operations	734	1,242	1,588	1,946	2,100
Cash for working capital	(129)	(324)	(531)	97	(233)
Operating cash flow	606	918	1,057	2,043	1,868
Net purchase of fixed assets	(89)	(240)	(235)	(290)	(350)
Net purchase of investments	79	496	(1,021)	(150)	(100)
Others in Cash Flow Metrics	51	76	139	164	301
Investing cash flow	41	332	(1,117)	(276)	(149)
Dividends	(389)	(335)	(598)	(1,137)	(1,161)
Proceeds from issue of equity	5	25	30	-	-
Financing cash flow	(384)	(310)	(568)	(1,137)	(1,161)
Exchange rate differences	(2.9)	1.1	-	-	-
Net cash flow	260	941	(629)	630	558

Profitability & efficiency ratios

Year to March	FY10	FY11	FY12E	FY13E	FY14E
ROAE (%)	40.2	55.9	55.1	50.9	46.5
ROACE (%)	92.0	75.4	83.9	94.0	75.2
Debtors days	60	56	60	61	65
Payable days	32	30	30	28	31
Cash conversion cycle (days)	28	26	30	33	34
Current ratio	2.9	2.5	2.6	2.3	2.6

Operating ratios

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Total asset turnover	7.0	14.5	9.1	12.0	10.5
Fixed asset turnover	12.8	13.6	12.9	13.4	12.2
Equity turnover	1.4	1.6	1.6	1.7	1.5

Valuation parameters

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Diluted EPS (INR)	24.8	40.7	53.1	64.5	73.2
Y-o-Y growth (%)	14.2	64.3	30.5	21.6	13.5
CEPS (INR)	28.3	45.8	59.6	72.8	82.8
Diluted PE (x)	28.4	17.3	13.3	10.9	9.6
Price/BV (x)	10.4	8.9	6.2	5.0	4.0
EV/Sales (x)	7.3	5.4	3.8	2.7	2.3
EV/EBITDA (x)	18.7	13.7	9.6	7.1	6.4
EV/EBITDA (x)+1 yr forward	14.0	9.7	7.4	6.6	-
Dividend yield (%)	1.7	3.2	2.5	4.8	4.9

Peer comparison valuation

Company	CMP (INR)	Mcap (INR bn)	P/E (x)		EV/EBITDA(x)		ROAE (%)	
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
eClerx	703	21	10.9	9.6	7.1	6.4	50.9	46.5
HCL Tech	481	333	12.6	11.9	7.0	6.6	23.5	20.6
Hexaware	113	33	10.3	8.5	6.9	5.2	30.0	30.6
Info Edge	339	37	27.7	22.0	17.3	12.9	22.0	22.4
Infosys	2,169	1,245	13.1	11.7	7.9	7.0	28.1	27.0
Infotech	175	20	8.7	8.6	3.5	3.3	18.1	16.1
Mphasis	399	84	11.2	10.0	5.7	4.8	17.7	17.1
TCS	1,209	2,367	17.6	16.1	(0.5)	(0.8)	35.9	30.8
Wipro	346	851	12.7	12.5	9.0	8.8	21.6	19.0

Source: Edelweiss research

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ECLERX SERVICES	BUY	SO	M	HCL Technologies	HOLD	SP	H
Hexaware Technologies	BUY	SO	M	Info Edge	REDUCE	SU	M
Infosys	BUY	SO	L	Infotech Enterprises	BUY	SO	H
Mphasis	HOLD	SP	M	Tata Consultancy Services	HOLD	SP	L
Wipro	HOLD	SP	L				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s):

ECLERX SERVICES, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Infotech Enterprises, Mphasis, Tata Consultancy Services, Wipro

Recent Research

Date	Company	Title	Price (INR)	Recos
24-Jul-12	Wipro	Disappointing, once again; <i>Result Update</i>	356	Hold
18-Jul-12	Infotech Enterprises	Revenue disappoints, but outlook positive; <i>Result Update</i>	181	Buy
12-Jul-12	TCS	In line results with robust volume; <i>Result Update</i>	1236	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	104	60	18	183
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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