

Stock Update eClerx Services Ltd.

Nov 13, 2023





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
IT Outsourcing- BPO/KPO	Rs. 2203.35	Buy in the Rs. 2181-2225 band & add more on dips to Rs. 1977-2017 band	Rs. 2423	Rs. 2619	2-3 quarters

HDFC Scrip Code	ECLSER
BSE Code	532927
NSE Code	ECLERX
Bloomberg	ECLX IN
CMP Nov 12, 2023	2203.35
Equity Capital (Rs Cr)	48.2
Face Value (Rs)	10.0
Equity Share O/S (Cr)	4.8
Market Cap (Rs Cr)	10,619.7
Book Value (Rs)	409.6
Avg. 52 Wk Volumes	91887
52 Week High	2248.4
52 Week Low	1260.3

Share holding Pattern % (Sept, 2023)	
Promoters	53.6
Institutions	33.4
Non Institutions	12.6
Total	100.0



**HDFCsec Retail research
stock rating meter**

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

eClerx Services Ltd. (eClerx) is one of India's leading process management and data analytics companies. eClerx provides business process management, automation and analytics services to the financial services, communications, retail, fashion, media & entertainment, manufacturing, travel & leisure, and technology companies. The company employs 16,000+ people across Australia, Canada, Germany, India, Italy, Netherlands, Philippines, Singapore, Thailand, UK, and the USA. eClerx has built a strong position in specific high opportunity segments such as data analytics & management and process improvement solutions. Its multi-year annuity contracts facilitated by ongoing engagements, has helped the company forge a predictable revenue stream and attractive profitability.

eClerx digital business consists of creative production, digital operations like SEO, ERP, e-commerce website management and analytics. This contributes ~40% of revenue and digital has seen some demand recovery. Also the company's core focus continues to have a constant client engagement resulting in higher proportion of long gestation annuity based contracts which provides good visibility of earnings growth. Apart from this, the global digital transformation is expected to expand at a compound annual growth rate (CAGR) of 22.5% from 2020 to 2027. We expect more client acquisition from digital side going forward.

eClerx's demand trends have improved in Q1 and Q2 supported by financial market on compliance and KYC side. However, some clients have specific challenges, which continue to persist. eClerx is cautiously optimistic on demand side and confident to report better revenue as well as profitability growth in Q3FY24.

Valuation & Recommendation:

eClerx performance over the past five quarter reflects rising demand for and stickiness of the company's services. Revenue of eClerx was impacted due to client-specific issues in FY17 leading to flat revenue in FY18, FY19 and FY20. After reporting flattish revenue for the past three-four years, eClerx has finally shown signs of revival and reported 8.8%, 38.1% and 22.6% revenue growth in FY21, FY22 and FY23, respectively. eClerx's new appointed CEO Mr Kapil Jain has world-class experience in sales, consulting, product development, and technology transformation, and has overseen substantial scale in the BPM business. Mr Kapil's experience will help on driving growth, improving operational management, and investing in capability development to serve the company's key strategic initiatives.

Investors can buy in the Rs. 2181-2225 band and add further on dips in the Rs 1977-2017 band (15.25x Sep'25E EPS). We believe the base case fair value of the stock is Rs 2423 (18.5x Sep'25E EPS) and the bull case fair value of the stock is Rs 2619 (20x Sep'25E EPS) over the next two to three quarters. At the LTP of Rs 2203.35, the stock is trading at 16.8x Sep'25E EPS.



Financial Summary (Consolidated)

Particulars (Rs cr)	Q2FY24	Q2FY23	YoY-%	Q1FY24	QoQ-%	FY22	FY23	FY24E	FY25E	FY26E
Total Operating Income	722	650	11.0	684	5.4	2,160	2,648	2,912	3,188	3,468
EBITDA	205	181	12.9	167	22.4	661	722	783	867	950
Depreciation	30	27	10.5	28	6.5	103	114	119	118	118
Other Income	14	21	-32.6	8	83.8	25	66	63	75	82
Interest Cost	6	5	20.9	6	4.1	22	21	24	22	20
Tax	46	44	5.9	34	36.4	143	164	179	205	228
APAT	136	126	8.0	107	27.6	418	489	523	598	666
Diluted EPS (Rs)	28.2	26.1	8.0	22.1	27.6	82.5	98.8	108.5	123.9	138.0
RoE-%						27.3	29.8	26.5	23.6	21.1
P/E (x)						25.4	21.7	20.3	17.8	16.0
EV/EBITDA (x)						15.3	14.0	12.5	10.7	9.1

(Source: Company, HDFC sec)

Q2FY24 Result Update

- eClerx reported strong performance in Q2FY24, with 5.4% QoQ and 11% YoY revenue growth to Rs 722 crore in Rupee terms and in US\$ terms, revenue grew by 4.4% QoQ and 6.2% YoY to US\$ 87.6 mn. Revenue growth in CC terms was at 4.4% QoQ and 5.4% YoY. Growth was led by emerging clients (top 10 accounts) which grew 5.3% QoQ in US\$ terms.
- EBIT grew by 25.7% QoQ and 13.4% YoY to Rs 174.5 crore in Q2FY24, supported by higher revenue growth and lower sub-contracting cost in the quarter. Net profit was up by 27.6% QoQ and 8% YoY to Rs 136 crore in Q2FY24.
- eClerx total delivery headcount as of Sept 30, 2023 stands at 16,215 – an increase of 0.3% YoY.

Key Updates

eClerx's expertise with AI and Machine Learning technologies to bring momentum in client addition

eClerx is focused on solving clients' problem by implementing artificial intelligence/machine learning (AI/ML) technologies around text mining, image processing, speech and video processing as well as executing use cases around predictive analytics. Most of eClerx's services are based around data, AI/ML solutions. The text analytics use cases include text mining, natural language processing and intelligent document digitization. With the advent of Generative AI, eClerx is focused on solving use cases around content generation, summarization and semantic search. Besides, the company's image processing tools use deep learning to solve use cases around image classification, adjustment and tagging and its speech to text conversion tools has been an integral part of Customer Experience offering where these models run both on private and public datasets for training.



The company has seen new trends in two areas: cable & telecom and financial services industries. Within the cable & telecom industry, the rise of streaming services has made it more important for cable companies to provide personalized content for their customers. AI and ML make it easier for these companies to cater to their audience. AI and ML can help cable companies provide better customer service by automatically detecting customers' needs based on behaviour patterns or context clues, such as location-based information gathered from connected devices like smartphones or smart TVs. AI and ML give cable companies the ability to predict when customers may be dissatisfied.

Using machine-learning algorithms, companies can identify patterns in customer interactions, demand of products across the financial industry. Banks and financial institutions use AI and ML to identify the demand of customers, risk management, and resolve the customer's queries and trade settlement. ML technology is often used in the finance industry to predict stock prices and influence trading decisions. It works by using large historical data sets to make predictions about the future. Asset managers employ the use of ML and AI to value and manage assets, including stocks and bonds. Data-driven decision-making helps eliminate human error caused by confirmation bias or loss aversion.

eClerx has completed 55 active discussions and setting up domain specific IP for Gen AI with investing in team building and training programs. In addition, by analyzing each customer's data profile and behavior patterns over time, the company is able to offer personalized recommendations based on their unique interests as well as targeted ads across different devices.

Growth trajectory to continue led by stability in the top 10 clients and focus on new-gen technologies and BPaaS

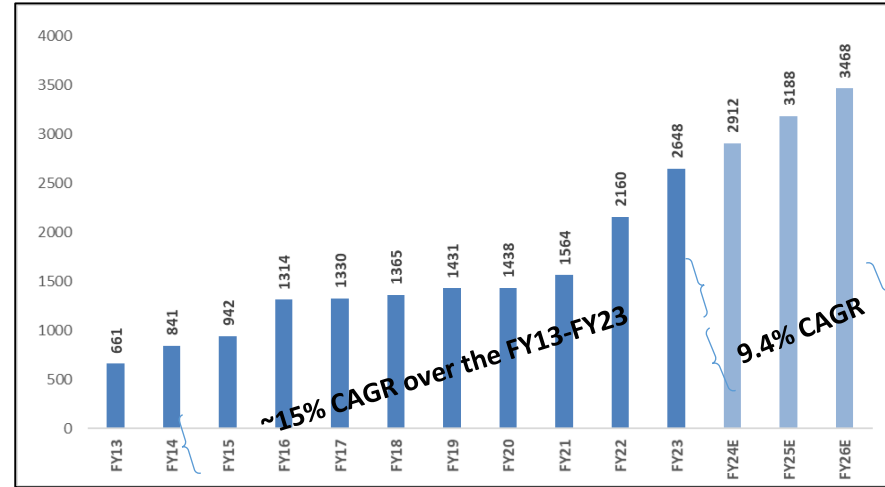
eClerx has seen modest growth trend in the recent past, and the company is likely to witness a gradual recovery in growth on account of stable deal momentum, no client roll-offs and expanding delivery base to boost the overall deal pipeline. Besides, its acquired company Personiv's integration, increased offshoring and higher revenue visibility in the managed services segment could help to generate incremental revenue going forward. Also, stability in the top-10 clients which contributed 59% to the revenue in Q2FY24, growth in emerging clients, cross-selling and on account of acquisition of digital capabilities amid strong industry tailwinds could bring large opportunity to intake deals going forward and the company could maintain its revenue growth trajectory.

On Business Process as a Service (BPaaS) or managed services side, eClerx is focused on productised services including Creative, Content & Commerce, Trade Lifecycle (TLC), Customer Experience (CX), Client Lifecycle (CLC), Field Tech Operations (FTO) and Finance and Accounting Operations (FAO) to midmarket clients, with power sales efforts by providing resonant "arrow-heads" to acquire new client relationships. The company added new logos and increased footprints at established clients. Its deep domain, execution experience, technology platforms and industry partnerships to deliver value-added, high return on investment services could help to increase its share of Business Process as a Service (BPaaS). These services continued to help to create longer-term stickier relationships. Besides, Automation and Analytics – a key focus area for the company – grew to \$71mn in revenue in FY23. In automation, reported growth across low-code/no-code, intelligent automation and in its platforms such as Compliance Manager, DocIntel, M360, Merchandiser+, Workforce Manager, and Fluid4.

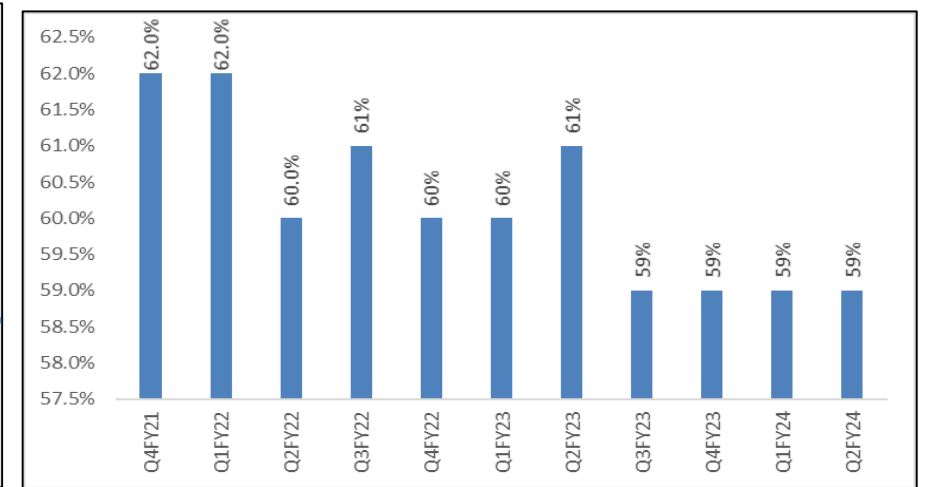


The company is increasing its adoption and traction in the Digital and Customer Operations segments, followed by Financial Markets. However, despite some cannibalization of existing revenue due to technology interventions, medium-to-long-term implications could be positive for the company. We expect that the company could report 9.2% revenue CAGR over the FY23 to FY26E.

Revenue (Rs, Cr)



Client Contribution (Top-10)-%



(Source: Company, HDFC sec)

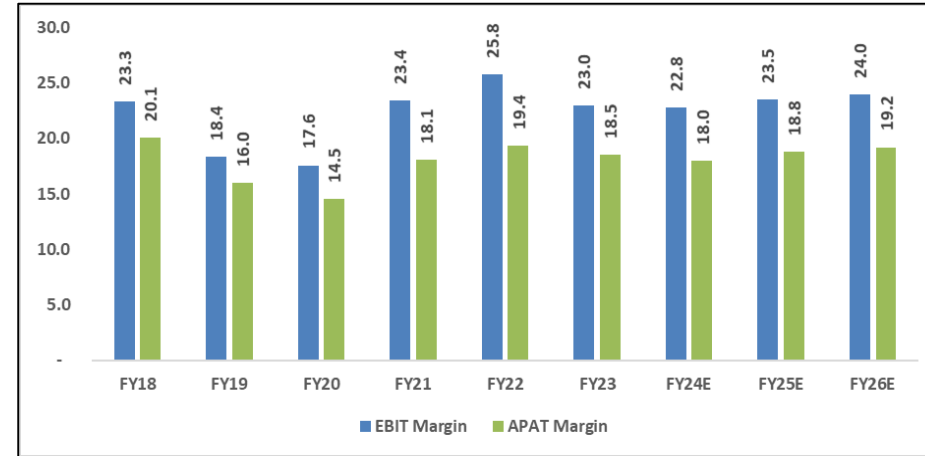
Expectation of margin stability led by operational efficiencies

eClerx faces challenges like wage hike, higher S&M expenses and non-recurring expenses etc. However, margins are expected to remain steady through the rest of FY24, inline or marginally better with the past trend. We expect stronger margins recovery is expected in Q3FY24 and Q4FY24.

We expect EBIT margin in the range of 22.5-24% over the FY24E to FY25E and the company could maintain PAT margins at 18-19.5% levels over the FY24E to FY26E, supported by cost rationalisation and higher share of offshore business.



Margins-%



Increasing focus on digital transformation could increase demand in KPO industry, it is positive for eClerx

Over the past year, technology industry has witnessed an increasing focus on the digital transformation of businesses and also the expansion of digital-driven services. The initial investments were in front-end consumer facing applications to provide better user experience and are expected to continue. Now, investments are moving to the back-end which are likely to be large scale digital transformation programs intending to modernize /replace core legacy systems and size of the budgets is also expected to grow significantly. The company has a 3000+ full-time digital delivery employees at its five production hubs in Mumbai, Pune, Chandigarh, Verona, and Phuket which apply deep digital expertise to effectively support the most demanding global clients utilizing a follow the sun delivery model.

Taking into the consideration of healthy growth outlook of IT-BPM sector, eClerx could report healthy growth going forward. We expect. eClerx could report 10%/9.5%/8.8% revenue growth in FY24E/FY25E/FY26E, respectively.

Strong fundamentals led by healthy debt protection metrics and liquidity

- eClerx’s financial profile remains healthy marked by stable earnings, sizeable network, and strong liquidity with large cash reserves, healthy capital structure and coverage metrics.
- The company has achieved substantial and sustained growth in revenue and profit, revenue CAGR of 15% and 11% of PAT CAGR over the last one decade. We expect, the company could report revenue and PAT CAGR at 9.4% and 10.8% over FY23 to FY26E.
- eClerx's financial profile looks strong supported by healthy cash accruals, almost debt free balance sheet and robust liquidity. Total Cash and cash equivalents stood at Rs 911 crore as on Sept 30, 2023 vs. Rs 690 crore as on March 31, 2023.



- We expect the FCF could remain positive going forward, even after factoring in annual capex. The company is looking synergistic opportunity with attractive valuation and allocate its capital.
- Because of cost rationalization efforts, the company could see growth in profitability as well as better return ratios in the future. We expect return ratios to remain healthy on account of a sustained improvement in operating performance and healthy payouts.
- Capital spending is expected to remain moderate; this and incremental working capital needs are likely to be funded through cash accruals.
- eClerx has always been declaring low dividends but conducting large share buybacks. The company has initiated buyback offers five times over the last six years and has recommended total dividend of Rs 1 per share in FY23 followed by buy back offers. The company is looking M&A activity going forward and we expect another buy back offer, if M&A activity does not happen soon. eClerx had last conducted buyback @ Rs 1,750/per equity share for 1,714,285 equity shares representing 3.4 % of the total number of equity shares in the total paid up equity share capital of the company between Feb 03 to 16, 2023 spending Rs.300 cr.
- We expect company could recommend more buyback offers in FY24E, due to sufficient balance of liquidity going forward. The promoters raised their stake in the company from 53.38% as on Dec 31, 2022 to 53.6% as on Sept 30, 2023.
- The net working capital cycle marginally increased by 5 days YoY to 58 days in FY23 due to increase by receivables days.

What could go wrong?

- INR appreciation against the USD, pricing pressure, retention of the skilled headcount, strict immigration norms and rise in visa costs are key concerns.
- The Indian IT as well as BPM industry continues to face geopolitical uncertainties such as proposed legislations on restricting outsourcing or immigration in its key markets, which may have an adverse impact on the current business model of the industry.
- eClerx derived 59% of its revenue from the top-10 clients in Q2FY24. The company's revenue growth trajectory could be materially impacted due to loss of any of these clients. Most of the contracts with existing clients are on long-term-basis. Any non-renewal of contracts or changes in their terms can impact the sustainability and scalability from such clients.
- The company derived over 92% of its revenue in Q2FY24 from US and Western Europe. Challenging business and economic conditions and protectionist policies in these regions and continued policy changes could enhance cost pressure on clients and thus may affect the company.
- Privacy and protection of personal data is an area of increasing concern globally. Legislations like GDPR (General Data Protection Regulation) in Europe carry severe consequences for non-compliance or breach. Any violation or security breach, observed non-compliance or inadequacy of privacy policies and procedures could have an adverse impact.
- Process automation or any large any large technological disruption and inability of the company to adopt change can impact the traditional cost arbitrage led KPO model of the company.



- eClerx attrition increased from 21% on LTM basis in Q1FY24 to 23.8% in Q2FY24. Higher attrition could hit its profitability due to cost of recruiting and training new employees.
- Gen AI could bring challenges to the company as demand for its services may get affected in case adoption of Gen AI is fast and robust. However, Gen AI also provides an opportunity to the company as help would be required from the vendors in terms of creating a large language model, doing data engineering, data testing etc.

Operating Metrics

Geographic Concentration

(% of revenue)	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
North America	66	70	70	69	70	69	70	72	71	71	72	73
Europe	28	23	23	24	23	23	22	20	20	20	20	19
ROW	6	7	7	7	7	8	8	8	9	9	8	8

Client Concentration

(% of revenue)	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Top 10 contribution	62	62	60	61	60	60	61	59	59	59	59

Client Concentration- US\$ Mn

\$ Mn	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Strategic (top 10 Clients)-mm	44.4	46.4	48.0	50.3	50.0	50.4	49.2	51.8
Emerging (\$ 0.5 mm)	23.1	24.5	25.5	25.3	28.1	28.1	27.0	27.9
Emerging (\$ others)	5.8	6.2	5.6	7.6	20.0	13.5	27.2	7.8

Client Contribution (based on 12 month accrued revenue)

No's	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
US\$ 500k-1mm Clients	23	18	25	32	27	31	32	39	39
US\$ 1mm-3mm Clients	20	25	23	21	26	24	27	24	22
US\$ 3mm +	16	16	16	16	16	17	18	18	18
DSO	65	66	75	72	75	82	80	75	76



Billing Mix

(% of revenue)	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Onshore Revenue	20	19	20	21	20	19	18	18	19
BPaaS	24	26	27	25	24	25	26	25	24

Employee Metrics

No's	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Delivery and Support Staff	12,910	13,309	14,112	14,910	16,171	16,269	16,804	16,127	15,726	16,333
India Attrition -%	31.7	41.3#	37.3	42.6	29.0	37.0	32.0	30.0	21.0	23.8
Staff utilization (Delivery)-%	81.0	78.2	78.7	78.5	73.1	73.5	74.4	74.5	74.7	75.4

#Attrition includes PH & Thailand (in addition to India) from Q2

Subsidiaries

Company	Year End	Holding -%	Sales Turnover	Profit After Tax	Country
eClerx BV	202303	100	5.11	-0.07	Netherlands
eClerx LLC	202303	100	534.93	38.99	U.S.
eClerx Pvt Ltd	202303	100	52.89	7.04	Singapore
eClerx Canada Ltd	202303	100	5.56	0.8	Canada
eClerx Investments Ltd	202303	100	0	0	India
AGR Operations Manila Inc.	202303	99.99	124.14	7.48	U.S.
AG Resources India Pvt Ltd	202303	100	36.14	4.61	India
CLX Europe S.P.A	202303	100	191.02	9.77	Italy
CLX Europe Media Solution Ltd	202303	100	24.08	0.03	U.K.
CLX Europe Media Solution GMBH	202303	100	29.49	2.76	Germany
ASEC Group LLC	202303	100	236.97	20.43	U.S.
Eclipse Global Holdings LLC	202303	100	0	0.03	U.S.
eclerx Ltd	202303	100	84.04	2.85	U.K.
eclerx Investments (UK) Ltd	202303	100	0	3.4	India
Personic Contact Centers LLC	202303	100	76.34	-1.86	U.S.
Personiv Contact Centers India Pvt Ltd	202303	99.85	94.46	18.99	India

(Source: Company, HDFC sec)



Financials (Consolidated)

Income Statement

(Rs Cr)	FY22	FY23	FY24E	FY25E	FY26E
Net Revenues	2160	2648	2912	3188	3468
Growth (%)	38.1	22.6	10.0	9.5	8.8
Operating Expenses	1500	1926	2128	2321	2518
EBITDA	661	722	783	867	950
Growth (%)	47.4	9.3	8.4	10.7	9.6
EBITDA Margin (%)	30.6	27.3	26.9	27.2	27.4
Depreciation	103	114	119	118	118
EBIT	557	608	664	750	832
Other Income	25	66	63	75	82
Interest expenses	22	21	24	22	20
PBT	560	653	703	802	893
Tax	143	164	179	205	228
RPAT	418	489	523	598	666
Growth (%)	48.0	17.1	7.0	14.2	11.4
EPS	82.5	98.8	108.5	123.9	138.0

Balance Sheet

As at March, Rs Cr	FY22	FY23	FY24E	FY25E	FY26E
SOURCE OF FUNDS					
Share Capital	33	48	48	48	48
Reserves	1534	1667	2185	2778	3437
Shareholders' Funds	1568	1715	2233	2826	3485
Long Term Debt	127	151	161	150	140
Net Deferred Taxes	-23	-40	-42	-44	-47
Long Term Provisions & Others	58	56	51	46	41
Minority Interest	1	2	2	2	3
Total Source of Funds	1730	1883	2405	2980	3622
APPLICATION OF FUNDS					
Net Block & Goodwill	715	793	810	765	745
CWIP	0	0	0	0	0
Other Non-Current Assets	47	69	72	76	80
Total Non Current Assets	762	862	882	841	825
Current Investments	0	0	0	0	0
Inventories	1	0	1	1	1
Trade Receivables	329	440	487	533	580
Cash & Equivalents	688	690	1051	1556	2109
Other Current Assets	253	240	264	304	350
Total Current Assets	1270	1371	1803	2394	3039
Short-Term Borrowings	37	43	48	43	38
Trade Payables	17	18	16	17	19
Other Current Liab & Provisions	249	290	217	195	186
Total Current Liabilities	302	350	281	256	242
Net Current Assets	968	1021	1522	2138	2797
Total Application of Funds	1730	1883	2405	2980	3622

(Source: Company, HDFC sec)



Cash Flow Statement

(Rs Cr)	FY22	FY23	FY24E	FY25E	FY26E
Reported PBT	560	653	703	802	893
Non-operating & EO items	0	-21	-63	-75	-82
Interest Expenses	15	12	24	22	20
Depreciation	103	114	119	118	118
Working Capital Change	-70	-87	-156	-117	-111
Tax Paid	-164	-178	-179	-205	-228
OPERATING CASH FLOW (a)	444	493	448	546	611
Capex	-61	-90	-108	-118	-129
Free Cash Flow	383	403	340	427	482
Investments	39	-64	-1	-1	-1
Non-operating income	59	70	63	75	82
INVESTING CASH FLOW (b)	38	-84	-46	-44	-48
Debt Issuance / (Repaid)	-73	-77	-12	30	15
Interest Expenses	-22	-21	-24	-22	-20
FCFE	289	304	304	436	477
Share Capital Issuance	28	22	0	0	0
Dividend	-3	-3	-5	-5	-5
Others	-347	-360	0	0	0
FINANCING CASH FLOW (c)	-70	-80	-40	3	-10
NET CASH FLOW (a+b+c)	66	-32	361	505	553

Key Ratios

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Profitability Ratio (%)					
EBITDA Margin	30.6	27.3	26.9	27.2	27.4
EBIT Margin	25.8	23.0	22.8	23.5	24.0
APAT Margin	19.4	18.5	18.0	18.8	19.2
RoE	27.3	29.8	26.5	23.6	21.1
RoCE	18.3	20.2	17.9	16.3	14.9
Solvency Ratio (x)					
Net Debt/EBITDA	0.2	0.3	0.3	0.2	0.2
Net D/E	0.1	0.1	0.1	0.1	0.1
Per Share Data (Rs)					
EPS	86.6	101.4	108.5	123.9	138.0
CEPS	108.0	125.1	133.2	148.3	162.5
BV	325.2	355.8	463.4	586.3	723.0
Dividend	1.0	1.0	1.0	1.0	1.0
Turnover Ratios (days)					
Debtor days	55.6	60.7	61.0	61.0	61.0
Inventory days	0.1	0.1	0.1	0.1	0.1
Creditors days	2.8	2.5	2.0	2.0	2.0
Valuation (x)					
P/E	25.4	21.7	20.3	17.8	16.0
P/BV	6.8	6.2	4.8	3.8	3.0
EV/EBITDA	15.3	14.0	12.5	10.7	9.1
EV / Revenues	4.7	3.8	3.4	2.9	2.5
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

(Source: Company, HDFC sec)



One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclical of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.



Disclosure:

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Any holding in stock – No

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