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Kulwinder Rajpal
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Investment Report – eClerx Services

Summary:

Industry – ITeS (Information Technology enabled Services)

Valuation - Moderately Undervalued (47%)

Certainty - High

Sensitivity - Low

About:

eClerx Services is an India based Process Management (Business and Knowledge) and Data Analytics company. It provides critical business operations services to over fifty global Fortune 500 clients, including some of the world's leading companies across financial services, cable & telecom, retail, fashion, media & entertainment, manufacturing, travel & leisure, software and high-tech. Incorporated in 2000, it was the first Knowledge Process Outsourcing firm to get listed and is today traded on recognised Stock exchanges of India, which are BSE and NSE. eClerx employs more than 9,500 people across its global sites in the US, UK, India, Italy, Germany, Singapore, Thailand. It has 4 subsidiaries, 4 step-down subsidiaries, 1 associate company and 1 R&D centre.

Lines of Business:

eClerx's service offerings can be further broken down into three service lines

1. **Customer Operations:**
   - Focuses on improving customer experience and operational efficiencies with the help of deep domain knowledge, advanced automation and data analytics
   - Leaders in quality monitoring and insights, digital care services, and advanced technical operations
   - Customer operations can be further broken down into five sub service lines namely, Operations Support, Technology Solutions, Data Analytics and Reporting, Customer Experience, and Consulting Services
2. **Digital:**
   - Aims at improving profitability for digital businesses through creative production, e-commerce/web operations, and analytics and insights services
   - Sub service lines include Data Management, Analytics & Insights, Digital Marketing Operations and Creative Services
3. **Financial Markets:**
   - Offerings include consulting, technological innovation, and process management expertise
   - Delivers holistic solutions across the entire trade life cycle, change management, data analytics, compliance, cash securities operations, document digitisation and generation, and outreach

Market:

- Indian IT and BPO industry grew at about 8% in FY 2019, exports grew at about 9%
- According to NASSCOM industry growth is expected to remain mild because of global uncertainties
- Considering the impact COVID-19 the industry growth may take more time to pick up

Investment Thesis:

- Successfully going through the transition in its business model
  - Company is in transition from being just a KPO/BPO to being a Process Management and Data Analytics company which impacts profitability and growth in the medium term
  - Transition aimed at providing more differentiated and specialised service offerings
  - Growth to be better as transition nears completion in about 3-5 quarters
- Well defined strategy with a strong follow-up
  - Accurate assessment of engines of growth going forward leading to a pivot in the business
  - Focus on Onshore, Analytics and Technology for long-term value
  - Customer Operations and Digital service lines to provide growth going forward with Financial Markets expected to offer low or flat growth
  - Two opportunistic acquisitions and integrations (CLX in 2015 and 24 consulting in 2018) aimed at bringing the strategy to fruition
  - Delivery centre utilisation rates to remain flat, Canada onshore centre expected to turn net income positive
- Robust balance sheet, strong free cash flow generation and Intellectual Property
  - Debt to equity ratio at 9%, Current ratio at 7.8
  - Consistent free cash flow generation over the past 10 years
  - Addition of Intellectual Property through acquisitions, Goodwill to Equity ratio at 15.8%
- Candid and shareholder oriented management
  - Professional management with experience in their respective domain(s)
  - Shareholder oriented board committed to creating long-term value
  - Third consecutive share buyback in FY 2018-19
- Good Institutional and Promoter holding (See Exhibits)
  - Mutual fund holding increased from by more than 4% in FY 2019-20
  - Promoter holding at 50.76% (Shareholding Report Q4 FY 2019-20)
  - Foreign institutions hold 17.56%
- COVID impact
  - Impact on the company is low to moderate in terms of business risk
  - No or very little liquidity risk

Financials (See Exhibits):

- Strong current financial profile, close to zero debt and more than satisfactory current ratio
- Margins under pressure as company undergoes transition
- Similar impact on return ratios
- Healthy free cash flow generation in the last 10 years
- Revenue growth expected to be flat in FY 2019-20

Risks:

- Geographical concentration risk as about 94% of revenues come from US and EU regions
- Customer concentration risk as 57% of revenues come from top 5 customers and about 67% of revenues come from top 10
- Currency risk as 81% of revenues are in USD, 10% in EUR and 9% in GBP
- Competition from bigger peers as well relevant industry peers, however, company has a superior profile when compared to the latter

Valuation:

Under conservative assumptions and based on various methods the intrinsic value per share comes out to be between **₹700 - ₹810** whereas, the weighted average value is around **₹737** suggesting an undervaluation of about **47%** from the price of **₹392.20** as of 22/05/2020.

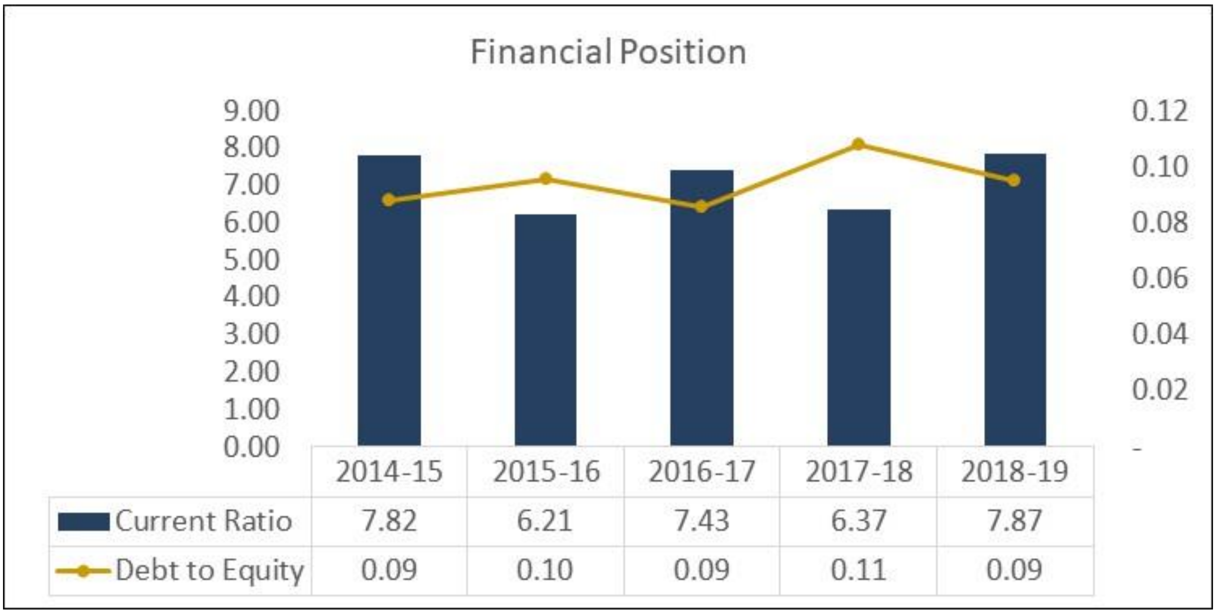
If we look at the valuation from the perspective of ratios the company has a **Price/Book** ratio of **1.1**, **Price/Earnings** ratio of **8.2** and **Price/FCF** ratio of **10** (all ratios based on FY 2018-19).

Viewpoint:

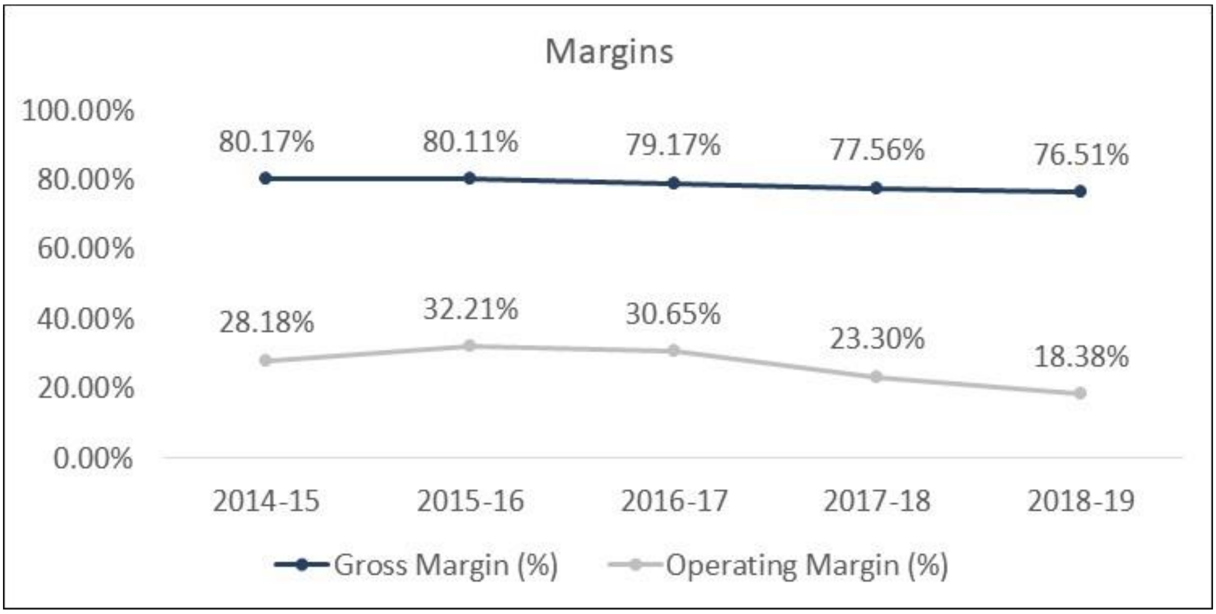
eClerx Services appears to be a company with a good profile lead by a candid and shareholder oriented management. While, currently undergoing transition the short term outlook appears timid. However, the company is taking the right steps to implement its strategy and is clearly focused on the long-term. These factors combined with a liquid balance sheet and consistent free cash flow generation augur well for the company. Thus, considering the above valuation it may be a good time to build a long position or hold any existing positions entered into at lower levels.

Exhibits:

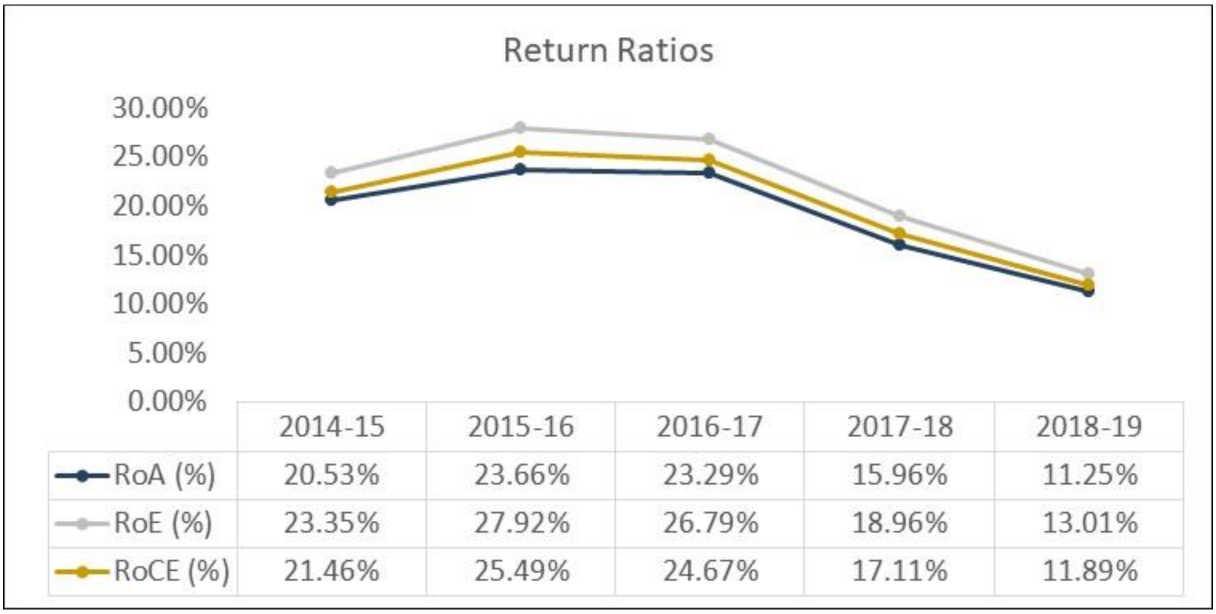
1. Financial Position



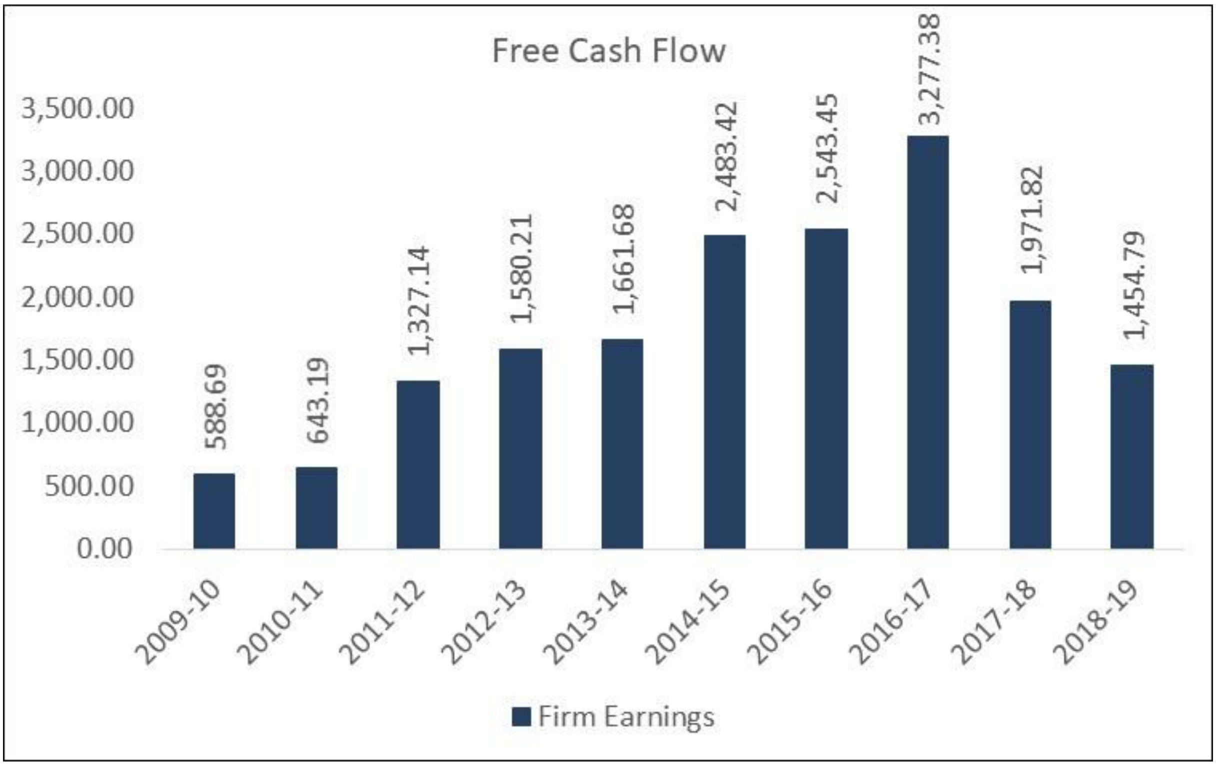
2. Margins



3. Return Ratios



4. Free Cash Flow (in ₹million)



5. Shareholding