

Grading Rationale for CRISIL IPO Grading

eClerx Services Limited

CRISIL IPO Grade 3.0/5.0

Public Issue of 18.4 million* Equity Shares of face value Rs 10 at a targeted price of Rs 370* per share.

Bid/Offer Opens	*
Bid/Offer Closes	*
Shares Offered	*
Shares Outstanding (Post issue)	
Lead Managers	
JM Financial Consultants Ltd, Edelweiss Capital Ltd.	
Registrar to the Issue	
Karvy Computershare Private Ltd.	

eClerx Services Limited			
Past financial performance		2005-06	2006-07
Total income	Rs Million	441.2	861.2
Total expenditure	Rs Million	184.1	421.8
Net profit	Rs Million	244.6	396.7
Return on equity	Per cent	300.1	250.6
No. of equity shares	Million	1.01	1.01
Net worth	Rs Million	127.6	286.0
Earnings per share	Rs	241.6	391.8
Book value per share	Rs	126.0	282.5
Gearing	Times	0.0	0.0

Shareholding pattern	Prior to the issue		Post issue	
	No. of shares	%	No. of shares	%
Promoters	12,072,075	72.93	11,360,075	68.6
Promoter group	49,800	0.3	49,800	0.3
Others	4,430,625	26.77	4,252,625	23.1
Public	-	-	2,723,939*	14.8
Total	16,552,500	100.0	18,386,439*	100.0

* Estimated

In order to arrive at the overall grade, CRISIL considers the following broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

Overall assessment

CRISIL has assigned a CRISIL IPO Grade '3/5' (pronounced 'three on five') to the proposed initial public offer of eClerx Services Ltd (ESL). This grade indicates that the fundamentals of the issue are average, relative to other listed equity securities in India.

The grading reflects the management's ability to get contracts from large global clients in its two niche verticals – IT Hardware retailing and the post trade OTC derivative segment, and increase the size of client relationships over the last 3-4 years. The company has also benefited from the promoters' strategic focus on knowledge management as seen in its strong margins. The grading is tempered by the anticipated pressures on the company's margins from the likely increase in competition from large third party players in India, exchange rate movement and wage pressures. The grading also reflects the company's heavy client concentration, especially in the retailing vertical and the likely moderation in revenue growth rates.

Good ability to originate and grow existing client relationships

ESL has been successful in entering into and growing its relationship with large clients – most of who have been with the company for the last 3-4 years. This has enabled the company to register a revenue growth of 80 per cent during 2004-05 and 2006-07 in its two niche verticals – IT Hardware retailing and Financial Services. The company has successfully developed strategic relationships with its top 5 clients and is expected to leverage these relationships further in the years to come. This is evident from the fact that these clients have continued to increase the size of their relationship with ESL each year despite having captive units in India. The top 5 clients account for around 85-90 per cent of total revenues.

Strong focus on knowledge management

High attrition levels and continuous training of new recruits are some of the key concerns for any IT /ITeS company. The company has addressed these concerns to a large extent through its strategic focus on knowledge management. ESL has built a knowledge platform to capture and capitalize on the knowledge built in during the ongoing projects in the organization by providing structured training programs to its employees at various levels. Each line of activity carried out by the company is well documented. The knowledge management model ensures minimal loss of process knowledge when an employee leaves the company. This also ensures easy training of new recruits.

Sustainability of high margins enjoyed in the past unlikely

The company has enjoyed strong margins in the past which CRISIL believes will be difficult to sustain going forward due to the expected increase in competition from large third party players, exchange rate movements and the significantly high level of wage inflation in India.

We expect ESL to face competition from large third party players in India as these players are aggressively looking for opportunities in the data analytics space to mitigate margin pressure. This is likely to impact the future growth opportunities and also result in higher attrition leading to higher wage cost. The rising wage inflation in the Indian ITeS market (average wage inflation rate: 12-15 per cent p.a.) and the currency volatility is expected to further influence its competitive positioning and add to margin pressure. Additionally, the removal of the tax holiday post 2009-10 will further impact the company's profits, notwithstanding the mitigating effect of the company's expansion plan in the Pune SEZ.

Heavy client concentration

The client mining strategy has served the company well in past as it has been able to sustain strong revenue growth. However, this exposes the company to significantly high client concentration risk as was experienced recently by WNS Holdings, one of the large ITeS players in India. ESL has large client concentration especially in the Retail and Manufacturing vertical while only 2-3 clients' account for a substantial portion of revenues in the financial services vertical.

ESL's ability to bring in new clients across a wider spectrum of verticals will be critical to its future growth prospects. The acquisition of the Igentica group of companies is expected to expand the client base and the service line offering into the Travel and Hospitality vertical, however, any substantial reduction in client concentration in the revenue mix could take 2-3 years to materialize.

Business profile

ESL, promoted by Mr. P.D Mundhra and Mr. Anjan Malik was incorporated in the year 2000. The company provides data analytics and customized process solutions to its global clients through its 3 offshore delivery centres in Mumbai. The primary activities in the customized process solutions is to provide post trade transaction support in the OTC derivative segment through a strong awareness of the client's internal business processes and provide verification/audit of client products and websites in the Retailing segment. As of March 31, 2007, ESL had about 1,000 employees at its offshore delivery locations in Mumbai. The company has around 21 global clients out of which around 5 clients account for over 87 per cent of the company's business.

ESL has marketing offices in London, New York and Austin, Texas with around 25-30 sales people and account managers at client site. Until April 2007, the marketing function was operated through group companies viz. eClerx LLC (US) and eClerx Limited (UK). These companies were made wholly owned subsidiaries of ESL from April 1, 2007. The company has also incorporated eClerx Investments Ltd (EIL) a 100 per cent subsidiary, on June, 25 2007 for investments and acquisitions.

In July 2007, eClerx Services acquired Igentica Travel Solutions and its wholly owned subsidiaries, Igentica Limited, Electrobug Technologies Limited and Ebug Pricing Intelligence Limited in UK through EIL for an estimated purchase consideration of Rs 75 million. These companies are primarily engaged in the business of providing pricing analytics services to some of the large organizations in the travel and hospitality sector in Western Europe.

Though ESL was incorporated in 2000, the company got its first big order in 2002, a Fortune 500 client. The company's list of active clients grew from 2 in 2003-04 to 21 in 2006-07. This includes a mix of retail and manufacturing players and a few global investment banks. However, the revenue contribution of the top 5 clients continues to be significantly high at over 87 per cent in 2006-07.

ESL intends to develop clients across the verticals and has recently acquired clients through acquisition of Igentica group of companies. On the financial services side, the company plans to enter into strategic relationships (having access to the bank's confidential database) with another 7-8 banks (currently company has access to the internal systems of 3-4 investment banks) which will in turn enable the company to enhance client stickiness in the long run.

The company plans to develop new client relationships by investing in marketing and visibility and by expanding its sales force in London, New York, Austin and India offices.

ESL plans to consider acquisitions in the medium term and will primarily look at companies having a strong client base or having specific domain expertise operating in US or West Europe, where they can further reduce cost by migrating service delivery offshore.

Financial profile

For the year ended March 2007, the company's total income was Rs 861.2 million as compared to Rs 441.2 million in 2005-06. The net profit increased by 62 per cent to Rs 396.7 million in 2006-07 from Rs 244.6 million in the previous year. The ROCE and ROE for the year ended March 2007 stood at 197.5 per cent and 250.6 per cent respectively.

Profile of Management and Board

The company's operations are headed by the two founder promoters. They are supported by professionals from various backgrounds such as investment banking, retail and manufacturing, and other related disciplines. While most of the members on the operations side of the senior management team have been with the company for the last 4-5 years, many of the senior management members in the sales team have been appointed in the last 1 year.

Board Of Directors

Name of Directors	Designation	Age (years)	Qualification	Experience	Key positions held
Mr. V.K. Mundhra (Father of Mr. P.D. Mundhra)	Chairman	67	B.Com-St. Xavier's College, Calcutta	35	Director of Turner Morrison and Company Limited, Globe Motors Ltd, Luk Auto Ancillary India.
Mr. P.D. Mundhra	Executive Director	34	B.Com - St.Xavier's, Calcutta; MBA-Finance, Wharton University of Pennsylvania.	14	President of Carter Hydraulic Power Private Limited, GM of Sri Vardhman Saving Company Pvt Ltd.
Mr. Anjan Malik	Non Executive Director	37	First class honors in Physics - Imperial College of Science & Technology, London; MBA-Finance, Wharton University of Pennsylvania.	17	Accenture, Lehman Brothers (Co-Head - European Fixed Income Credit Trading Team)
Mr. Pradeep Kapoor	Independent Director	62	B.E (Mech.) - Regional Engineering College, Bhopal University	40	Chairman - Fuller Infotech Private Limited, Director - FLS Automotion India Private Limited, MD and CEO of ABG Cement Limited, MD of ABG Engineering and Constructions Limited and Director - ABG Energy Private Limited.
Mr. Anish Ghoshal	Independent Director	42	B.Com(Hons) - St.Xavier's College, Calcutta; L.L.B - University of Bombay	17	Currently a partner in AM Law, Advocates and Solicitors.
Mr. Vikram Limaye	Independent Director	40	B.Com - University of Mumbai; C.A. - Institute of Chartered Accountants of India, MBA - Wharton School, University of Pennsylvania	18	Arthur Anderson, Ernst & Young, Citibank N.A. Credit Suisse First Boston, Executive director - Infrastructure Development Finance Corporation (IDFC) Ltd.

Source: Company Prospectus

There are six directors on board, of which, three are independent directors who were all inducted in August 2007. There has not been a Board meeting after their induction and therefore, they were not involved in any decision such as the size and timing of the IPO. For the same reason, perhaps, their awareness of the company's business is limited.

Disclaimer

A CRISIL IPO grading is a one-time assessment and reflects CRISIL's current opinion on the fundamentals of the graded equity issue in relation to other listed equity securities in India. A CRISIL IPO grading is neither an audit of the issuer by CRISIL nor is it a credit rating. Every CRISIL IPO grading is based on the information provided by the issuer or obtained by CRISIL from sources it considers reliable. CRISIL does not guarantee the completeness or accuracy of the information on which the grading is based. A CRISIL IPO grading is not a recommendation to buy / sell or hold the graded instrument; it does not comment on the issue price, future market price or suitability for a particular investor.

CRISIL is not responsible for any errors and especially states that it has no financial liability whatsoever to the subscribers / users / transmitters / distributors of CRISIL IPO gradings. For information on any IPO grading assigned by CRISIL, please contact 'Client Servicing' at +91-22-66913561, or via email: clientservicing@crisil.com.

For more information on CRISIL IPO gradings, please visit <http://www.crisil.com/research/research-faqs-ipo-grading.htm>