

HEXAWARE TECHNOLOGIES

Guidance upgrade brightens outlook

India Equity Research | IT

Hexaware Technologies' (Hexaware) Q2CY17 revenue, at USD152.6mn, grew 5.4% QoQ (up 4.9% CC) and surpassed Street's 3.7% growth forecast. EBITDA margin (net of ESOP costs) fell 70bps QoQ to 16.2% and was below Street's 16.6% estimate. Post a robust Q2CY17, Hexaware increased CY17 revenue and EBITDA growth guidance to 14-15% (from 10-12%), despite anticipated ramp down due to in-sourcing and loss of a portion of business from a Top-5 client. The company is certainly demonstrating significantly better-than-peers revenue growth momentum drawing on its automation-led IMS and BPS offerings, but the stock is trading expensive (15x CY18E EPS). Maintain 'HOLD'.

Broad based growth

USD revenue grew 5.4% to USD152.6mn on 6.4% volume spurt, though partly offset by 1.0% realisation dip. Growth was led by BPS (up 18.0% QoQ), IMS (9.4%), Business Intelligence & Analytics (6.8%) and ADM (6.5%) amongst service lines, and BFS (7.1%) and healthcare (5.0%) amongst verticals. Americas, Europe and Asia Pacific grew 4.3%, 7.0% and 15.1% QoQ, respectively. EBITDA margin fell by 70bps QoQ majorly on lower bill rate and higher visa charges.

Guidance upgrade on strong pipeline

Management increased its revenue and EBITDA growth guidance to 14-15% from 10-12% earlier following strong growth in H1CY17 and good traction across IMS and BPS verticals, leveraging automation. Importantly, the guidance has been increased despite customer related issues and INR appreciation. With higher confidence in growth and change in USD rate to INR66 (from INR67 earlier), we are increasing our FY18/19E revenue and earnings by 0.8/1.0% and 4.9/7.4%, respectively.

Outlook and valuations: Strong growth; maintain 'HOLD'

Hexaware has clocked robust growth with improved utilisation and lower attrition in Q2CY17. With increase in guidance, we estimate 12.4% USD revenue CAGR and 12.5% earnings CAGR over CY16-18. We believe current valuations, at 15.0x CY18E EPS, leaves limited upside. Hence, we maintain 'HOLD/SP' with a revised target price of INR227 (INR212 earlier) based on 13x CY18E EPS.

Financials

(INR mn)

Year to December	Q2CY17	Q1CY17	% Chg	Q2CY16	% Chg	CY16	CY17E	CY18E
Net revenues	9,836	9,605	2.4	8,697	13.1	35,349	39,622	43,783
EBITDA	1,598	1,623	(1.5)	1,353	18.1	5,754	6,473	7,073
Adjusted Profit	1,225	1,139	7.5	999	22.6	4,182	4,870	5,290
Diluted EPS (INR)	4.1	3.8	8.2	3.3	23.5	13.8	16.0	17.4
Diluted P/E (x)						18.9	16.3	15.0
EV/EBITDA (x)						12.9	11.4	10.4
EV/Revenues (x)						2.1	1.9	1.7

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: HEXT.BO, B: HEXW IN)

CMP	: INR 262
Target Price	: INR 227
52-week range (INR)	: 268 / 178
Share in issue (mn)	: 302.4
M cap (INR bn/USD mn)	: 79 / 1,234
Avg. Daily Vol.BSE/NSE('000)	: 1,122.6

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	71.2	71.3	71.2
MF's, FI's & BK's	8.7	9.7	10.9
FII's	10.9	8.7	5.7
Others	9.2	10.3	12.2
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	8.1	5.8	6.1
3 months	13.4	8.3	8.5
12 months	18.6	16.7	(3.5)

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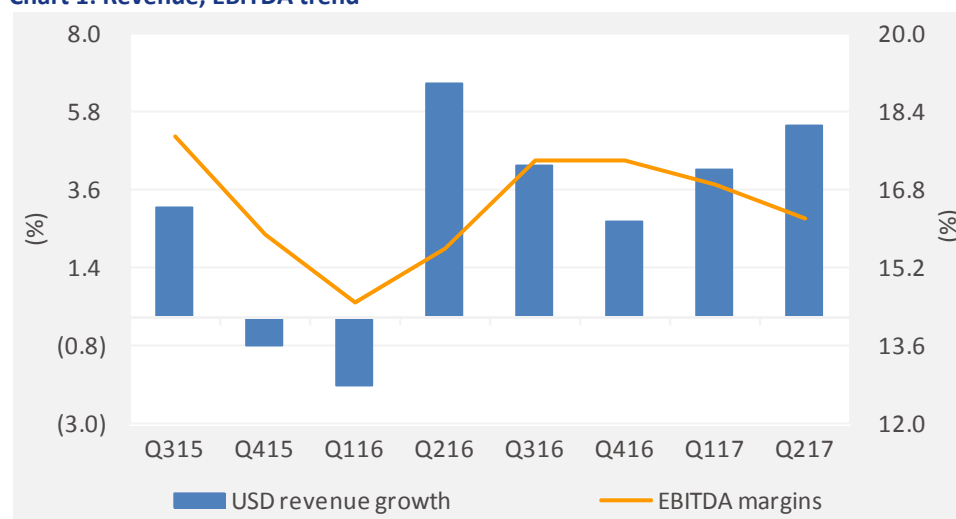
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Key highlights

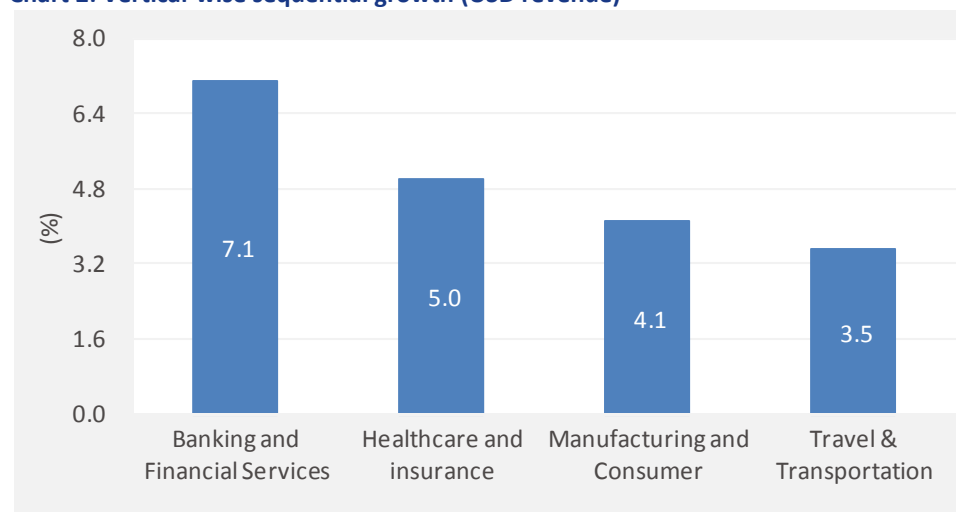
- **Revenue**, at USD152.6mn (up 5.4% QoQ), was higher than Street's estimate of 3.7% growth. INR revenue jumped 2.4% QoQ to INR9.8bn. In CC terms, revenue grew 4.9% QoQ.
- **Gross profit** grew 3.2% QoQ to INR3.43bn, while gross margin rose 30bps QoQ to 34.9%. EBITDA (net of ESOP cost), at INR1.6bn, fell 1.5% QoQ. EBITDA margin declined by 70bps QoQ to 16.2%.

Chart 1: Revenue, EBITDA trend



- **Net profit**, at INR1,224mn, was higher than Street's estimate of INR1,189mn. Net profit margin rose by 50bps to 12.4%.
- **Client addition**: Hexaware added 9 new clients during the quarter (6 in Q1CY17). Active clientele stood at 220 (222 in Q1CY17).
- **Broad-based growth** was clocked with BFS, Healthcare & Insurance, Manufacturing & Consumer segments and Travel & Transportation growing 7.1%, 5.0%, 4.1% and 3.5% QoQ, respectively.

Chart 2: Vertical-wise sequential growth (USD revenue)



Source: Company, Edelweiss research

- **Client metric:** Top-5 clients constituted 46.1% of revenue (45.6% in Q1CY17) and Top-10 clients contributed 56.5% to total revenue (56.7% in Q1CY17).

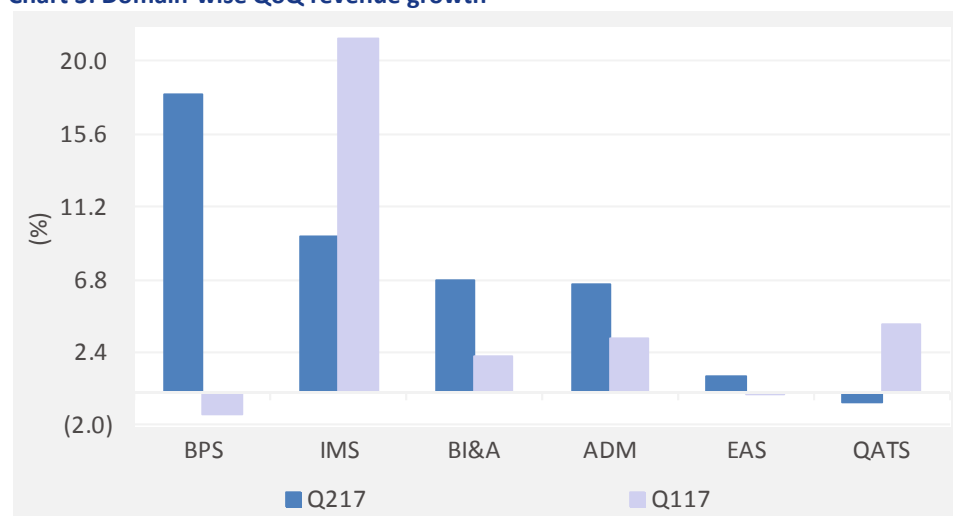
Table 1: Per client realisation - Quarterly trend

Realization per customer (USD mn)	Q315	Q415	Q116	Q216	Q316	Q416	Q117	Q217
Top 5 clients	10.7	10.5	10.4	11.2	12.7	12.9	13.2	14.1
Top 6-10 clients	2.9	3.1	3.0	3.1	3.1	3.1	3.2	3.2
Beyond 10	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.3

Source: Company, Edelweiss research

- **BPS-led growth:** BPS, IMS, Business Intelligence & Analytics and ADM posted robust growth of 18.0%, 9.4%, 6.8% and 6.5% QoQ, respectively. While Enterprise Solutions grew 1.0% QoQ, Testing & Digital Assurance declined by 0.6%.

Chart 3: Domain-wise QoQ revenue growth



Source: Company, Edelweiss research

- **Hiring:** Net employee increased by 364. Total employee count stands at 13,098.
- **Utilisation:** Improved by 190bps QoQ to 80.8%.
- **Attrition:** Annualised attrition fell to 14.9% (16.1% in Q4CY16).
- **Geo split:** Broad-based growth with Asia Pacific posting spurt of 15.1%. Europe and Americas jumped 7.0% and 4.3%, respectively.
- **Hedging:** Hexaware has hedges worth USD141.7mn (at average rate of INR72.4), EUR3.9mn (at average rate of INR81.2) and GBP4.2mn (at average rate of INR96.7).
- **DSO:** Stood at 70 days, down by 4 days from previous quarter.
- **Current cash and equivalents:** Stood at INR4.3bn, translating into INR14.5/share (~5.5% of current market price).

Financial snapshot

(INR mn)

Year to December	Q2CY17	Q1CY17	% Change	Q2CY16	% Change	YTD17	CY17E	CY18E
Net revenues	9,836	9,605	2.4	8,697	13.1	19,441	39,622	43,783
Direct costs	6,404	6,280	2.0	5,645	13.4	12,684	25,859	28,479
Gross profit	3,432	3,325	3.2	3,052	12.5	6,757	13,763	15,305
SG&A	1,834	1,702	7.8	1,699	8.0	3,536	7,290	8,231
EBITDA	1,598	1,623	(1.5)	1,353	18.1	3,221	6,473	7,073
Depreciation	157	157	0.0	139	12.9	314	602	648
EBIT	1,441	1,466	(1.7)	1,214	18.7	2,907	5,871	6,425
Other income	146	28	421.4	132	10.6	174	466	445
Add: Exceptional items								
Profit before tax	1,587	1,494	6.2	1,346	17.9	3,081	6,337	6,870
Tax	363	355	2.3	347	4.6	718	1,467	1,580
Reported net profit	1,225	1,139	7.5	999	22.6	2,364	4,870	5,290
Adjusted Profit	1,225	1,139	7.5	999	22.6	2,364	4,870	5,290
Diluted EPS (INR)	4.1	3.8	8.2	3.3	23.5	7.8	16.0	17.4
Diluted P/E (x)	-	-	-	-	-	-	16.3	15.0
EV/EBITDA (x)	-	-	-	-	-	-	11.4	10.4
EV/Revenues (x)	-	-	-	-	-	-	1.9	1.7
As % of net revenues								
	(1)	-	-	-	-	(1)	2	2
Direct costs	65.1	65.4	-	64.9	-	130.5	65.3	65.0
Gross profit	34.9	34.6	-	35.1	-	69.5	34.7	35.0
SG&A	18.6	17.7	-	19.5	-	36.4	18.4	18.8
EBITDA	16.2	16.9	-	15.6	-	33.1	16.3	16.2
EBIT	14.7	15.3	-	14.0	-	29.9	14.8	14.7
Reported net profit	12.4	11.9	-	11.5	-	24.3	12.3	12.1
Tax rate	22.9	23.8	-	25.8	-	46.6	23.1	23.0

Change in Estimates

	New	CY17E Old	% change	New	CY18E Old	% change	Comments
Net Revenue	39,622	39,321	0.8	43,783	43,352	1.0	
EBITDA	6,473	6,463	0.2	7,073	7,018	0.8	
EBITDA Margin	16.3	16.4	-	16.2	16.2	-	
Adjusted Profit After Tax	4,870	4,641	4.9	5,290	4,926	7.4	
Net Profit Margin	12.3	11.8	-	12.1	11.4	-	

Company Description

Hexaware Technologies (Hexaware) is an IT-services company, specialised in offering enterprise solutions, application management, and embedded system. The company provides software services to banking and financial services, insurance, travel & transportation, emerging segments (manufacturing and healthcare) verticals. Hexaware has a dominant PeopleSoft practice and is amongst the Top 20 software and services exporter from India. The company's last twelve month revenues stood at INR37.9bn (USD571mn) and it employees 13,098 people.

Investment Theme

Over the past one year Hexaware has focused on improving operational efficiencies and re-aligned itself vertically from earlier horizontal sales-based approach. Further, strengthening of the sales force with new recruits and new deal wins reported in the past six months are likely to result in improving revenue traction going forward. In addition, high US and BFSI exposure should aid growth in an improving macro environment. We see Hexaware fundamentally strengthened with the recent initiatives and with a healthy cash position it is well poised to explore inorganic growth opportunities as well.

Key Risks

- Double dip recession in its major market US and prolonged slowdown in Europe.
- Appreciation of INR against USD, EUR, and GBP.
- Inadequate availability of manpower.

Financial Statements

Key Assumptions

Year to December	CY15	CY16	CY17E	CY18E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
Company				
USD revenue growth	15	8	15	10
Net additions	1,359	740	587	646
Cost of rev. (% of rev.)	64.2	64.8	65.3	65.0
SGA cost (% of revenue)	18.6	19.0	18.4	18.8
Depreciation	6.0	6.5	6.0	5.2
Cash yield (%)	4.7	8.3	9.6	5.2
Tax rate as % of PBT	22.1	25.2	23.1	23.0
Capex (INR mn)	1,364	2,221	990	1,277
Debtor days	47	45	42	41
Payable days	15	18	19	19
Cash conversion cycle	32	27	23	22

Income statement

(INR mn)

Year to December	CY15	CY16	CY17E	CY18E
Net revenue	31,235	35,349	39,622	43,783
Cost of revenues	20,062	22,891	25,859	28,479
Gross profit	11,173	12,458	13,763	15,305
Total SG&A expenses	5,818	6,704	7,290	8,231
EBITDA	5,355	5,754	6,473	7,073
Depreciation	482	556	602	648
EBIT	4,873	5,198	5,871	6,425
Add: Other income	173.00	394.00	465.76	444.56
Profit Before Tax	5,046	5,592	6,337	6,870
Less: Provision for Tax	1,114	1,410	1,467	1,580
Reported Profit	3,932	4,182	4,870	5,290
Adjusted Profit	3,932	4,182	4,870	5,290
Shares o /s (mn)	300	300	300	300
Adjusted Basic EPS	13.1	13.9	16.2	17.6
Diluted shares o/s (mn)	302	302	304	304
Adjusted Diluted EPS	13.0	13.8	16.0	17.4
Adjusted Cash EPS	14.7	15.8	18.2	19.8
Dividend per share (DPS)	8.7	10.0	10.0	10.0
Dividend Payout Ratio(%)	77.3	83.5	71.6	65.9

Common size metrics

Year to December	CY15	CY16	CY17E	CY18E
Cost of revenues	64.2	64.8	65.3	65.0
Gross margin	35.8	35.2	34.7	35.0
SG&A expenses	18.6	19.0	18.4	18.8
EBITDA margins	17.1	16.3	16.3	16.2
EBIT margins	15.6	14.7	14.8	14.7
Net Profit margins	12.6	11.8	12.3	12.1

Growth ratios (%)

Year to December	CY15	CY16	CY17E	CY18E
Revenues	21.0	13.2	12.1	10.5
EBITDA	12.1	7.5	12.5	9.3
PBT	18.8	10.8	13.3	8.4
Adjusted Profit	22.8	6.4	16.5	8.6
EPS	22.8	6.4	15.9	8.6

Balance sheet		(INR mn)			
As on 31st December	CY15	CY16	CY17E	CY18E	
Share capital	603	604	600	600	
Reserves & Surplus	13,729	16,507	17,891	19,695	
Shareholders' funds	14,332	17,111	18,491	20,295	
Def. Tax Liability (net)	(256)	(376)	(376)	(376)	
Sources of funds	14,076	16,735	18,115	19,919	
Gross Block	8,325	8,811	11,417	13,503	
Net Block	3,160	3,026	5,567	7,004	
Capital work in progress	1,160	3,233	1,617	808	
Intangible Assets	2,168	2,298	1,761	1,761	
Total Fixed Assets	6,489	8,557	8,945	9,574	
Non current investments	5	22	22	22	
Cash and Equivalents	4,274	4,315	4,614	4,734	
Sundry Debtors	4,406	4,376	4,668	5,158	
Loans & Advances	2,583	2,572	3,332	4,368	
Other Current Assets	2,195	3,166	3,166	3,166	
Current Assets (ex cash)	9,183	10,114	11,166	12,692	
Trade payable	982	1,291	1,402	1,563	
Other Current Liab	4,892	4,980	5,229	5,538	
Total Current Liab	5,874	6,272	6,631	7,102	
Net Curr Assets-ex cash	3,309	3,842	4,535	5,590	
Uses of funds	14,076	16,735	18,115	19,919	
BVPS (INR)	47.4	56.6	60.9	66.8	

Free cash flow		(INR mn)			
Year to December	CY15	CY16	CY17E	CY18E	
Reported Profit	3,932	4,182	4,870	5,290	
Add: Depreciation	482	556	602	648	
Others	306	598	(466)	(445)	
Less: Changes in WC	788	533	693	1,055	
Operating cash flow	3,932	4,803	4,314	4,438	
Less: Capex	1,364	2,221	990	1,277	
Free Cash Flow	2,568	2,583	3,324	3,161	

Cash flow metrics		CY15	CY16	CY17E	CY18E
Year to December					
Operating cash flow		3,932	4,803	4,314	4,438
Investing cash flow		142	(1,999)	(524)	(832)
Financing cash flow		(3,069)	(2,469)	(3,490)	(3,486)
Net cash Flow		1,005	335	299	120
Capex		(1,364)	(2,221)	(990)	(1,277)
Dividend paid		(3,172)	(2,506)	(3,486)	(3,486)

Profitability and efficiency ratios		CY15	CY16	CY17E	CY18E
Year to December					
ROAE (%)		28.9	26.6	27.4	27.3
ROACE (%)		37.1	35.6	35.6	35.4
Debtors Days		47	45	42	41
Payable Days		15	18	19	19
Cash Conversion Cycle		32	27	23	22
Current Ratio		2.3	2.3	2.4	2.5

Operating ratios		CY15	CY16	CY17E	CY18E
Year to December					
Total Asset Turnover		2.3	2.3	2.3	2.3
Fixed Asset Turnover		6.0	6.6	6.3	5.4
Equity Turnover		2.3	2.2	2.2	2.3

Valuation parameters		CY15	CY16	CY17E	CY18E
Year to December					
Adj. Diluted EPS (INR)		13.0	13.8	16.0	17.4
Y-o-Y growth (%)		22.8	6.4	15.9	8.6
Adjusted Cash EPS (INR)		14.7	15.8	18.2	19.8
EV / Sales (x)		2.4	2.1	1.9	1.7
EV / EBITDA (x)		(0.8)	(0.7)	(0.7)	(0.7)

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		CY17E	CY18E	CY17E	CY18E	CY17E	CY18E
Hexaware Technologies	1,234	-	-	(0.7)	(0.7)	27.4	27.3
Cyient	920	14.1	12.5	8.8	7.2	18.5	18.4
ECLERX SERVICES	807	14.5	12.8	8.5	7.3	27.8	27.8
HCL Technologies	19,845	13.9	12.7	10.9	9.7	25.2	24.3
Infosys	36,175	15.3	14.0	9.9	8.8	21.8	22.8
Persistent Systems	803	14.7	12.5	8.5	6.8	17.4	18.0
Tata Consultancy Services	76,471	18.6	17.2	13.5	12.2	30.0	30.5
Tech Mahindra	5,854	11.3	9.9	7.3	5.8	17.2	17.6
Wipro	21,863	15.9	13.9	12.5	10.8	16.9	17.2
Median	-	14.5	12.7	8.8	7.3	21.8	22.8
AVERAGE	-	13.2	11.7	8.8	7.5	22.5	22.7

Source: Edelweiss research

Additional Data

Directors Data

Mr. P. R. Chandrasekar	Vice Chairman	Mr. Atul K. Nishar	Chairman
Mr. Bharat Shah	Independent Director	Basab Pradhan	Independent Director
Kosmas Kalliarekos	Director	R. Srikrishna	CEO & Executive Director
Jack Hennessy	Director	Jimmy Mahtani	Jimmy Mahtani,
Dileep C. Choksi	Independent Director	Dr. Punita Kumar-Sinha	Independent Director
Mr. Christian Oecking	Director		

Auditors - Deloitte Haskins and Sells, Chartered Accountants

**as per last annual report*

Holding - Top10

	Perc. Holding		Perc. Holding
HDFC Asset Management	5.75	T Rowe Price Group	2.21
Templeton Asset Mgmt	1.36	Vanguard	1.14
Dimensional Fund Advisors	1.06	Commonwealth Bank of Australia	0.98
SBI Funds Mgmt	0.62	Aviva Group	0.50
Grantham Mayo Van Otterloo	0.49	Blackrock	0.45

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
07 Apr 2017	Amrinder Singh	Buy	69500.00
07 Apr 2017	Rajesh Kanani	Sell	16000.00
06 Apr 2017	Rajesh Kanani	Sell	16000.00
06 Apr 2017	Amrinder Singh	Buy	69500.00
05 Apr 2017	Rajesh Kanani	Sell	16000.00

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Cyient	BUY	SP	H	ECLERX SERVICES	HOLD	SP	M
HCL Technologies	BUY	SP	H	Hexaware Technologies	HOLD	SP	M
Info Edge	BUY	SP	M	Infosys	BUY	SO	L
Just Dial	REDUCE	SU	M	Persistent Systems	BUY	SP	L
Tata Consultancy Services	HOLD	SP	L	Tech Mahindra	BUY	SP	M
Wipro	BUY	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): IT

Cyient, ECLERX SERVICES, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Just Dial, Persistent Systems, Tata Consultancy Services, Tech Mahindra, Wipro

Recent Research

Date	Company	Title	Price (INR)	Recos
27-Jul-17	HCL Technologies	Maintaining guidance bolsters confidence; <i>Result Update</i>	890	Buy
25-Jul-17	Just Dial	Good show, long haul ahead; <i>Result Update</i>	383	Reduce
24-Jul-17	Info Edge	Temporary hiccups, structural growth ahead; <i>Result Update</i>	986	Buy

Distribution of Ratings / Market Cap

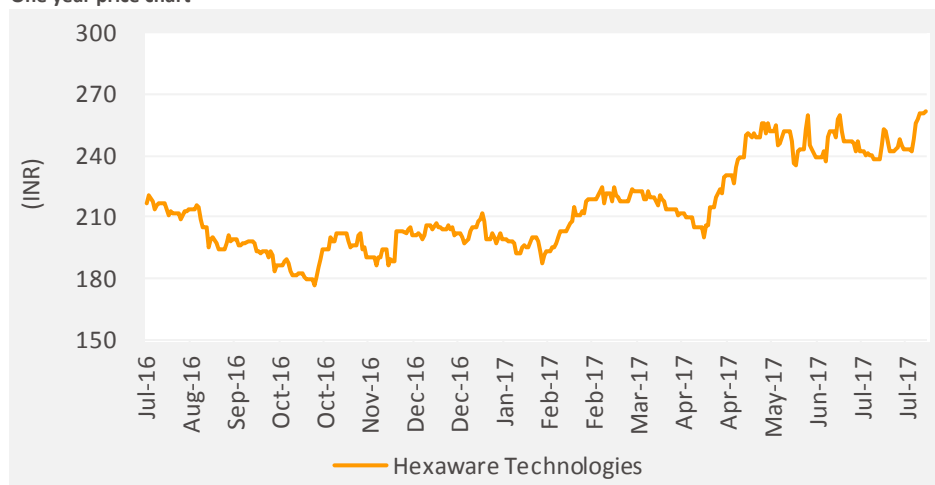
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	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

One year price chart



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