

HEXAWARE TECHNOLOGIES

Operationally strong quarter

India Equity Research | IT

Hexaware Technologies' (Hexaware) Q3CY17 revenue, at USD154.0mn, grew 0.9% QoQ (up 0.4% CC), in line with Street's 0.8% forecast. EBITDA margin rose 120bps QoQ to 17.5%, much above Street's 16.1% estimate due to cost rationalisation. Key highlights: 1) management expects CY17 revenue to grow at upper-end of 14-15% guidance; 2) EBITDA growth guidance revised up to 16.5-17.5% from 14-15%; and 3) apart from headwinds in 2 top-5 clients, growth was broad-based across business. Considering strong revenue spurt and EBITDA guidance revision despite headwinds, we raise our target multiple to 14x (from 13x), in line with other mid-cap peers. While Hexaware is leveraging its automation-led IMS & BPS offerings leading to better-than-peers' revenue momentum, we believe the stock is fairly valued (13.1x CY19E EPS) and does not warrant recommendation upgrade. Maintain 'HOLD' with revised TP of INR300 as we raise target multiple and roll forward to CY19E.

Positive revenue momentum despite headwinds

USD revenue grew 0.9% despite partial impact of revenue loss from top clients. Excluding impact of ramp down in 2 top-5 clients, growth was broad based led by IMS (up 3.4% QoQ), BPS (2.5%), Healthcare & Insurance (7.4%) and APAC geography (20.0%). While Q3CY17 will bear full impact of ramp down in 2 top clients, management is confident of close to double digit YoY growth, leading to CY17 growth at upper-end of guidance.

EBITDA guidance revised up on operational efficiencies

Management raised CY17 EBITDA growth guidance to 16.5-17.5% from 14.0-15% earlier following strong operating performance in Q3CY17, despite headwinds. While utilisation is completely stretched, we believe cost rationalisation in SG&A, automation and better onsite mix will drive margin.

Outlook and valuations: Fairly valued; maintain 'HOLD'

Along with superior growth than peers anchored by enhanced service offerings, Hexaware also demonstrated strong operational efficiencies, leading to margin expansion despite headwinds. We estimate revenue/EPS CAGR of 12.2%/15.5% over CY16-19 and accordingly revise up target multiple to 14x. However, at CMP, the stock is fairly valued, leaving limited upside. We maintain 'HOLD/SP' with revised TP of INR300 (INR227 earlier) as we revise up margin estimate and roll forward to CY19 estimates.

Financials

(INR mn)

Year to December	Q3CY17	Q2CY17	% Chg	Q3CY16	% Chg	CY17E	CY18E	CY19E
Net revenues	9,931	9,836	1.0	9,041	9.8	39,282	43,753	49,004
EBITDA	1,734	1,598	8.5	1,576	10.0	6,705	7,419	8,648
Adjusted Profit	1,420	1,224	16.0	1,114	27.4	5,074	5,514	6,443
Diluted EPS (INR)	4.7	4.1	16.2	3.7	28.7	16.8	18.3	21.4
Diluted P/E (x)						16.7	15.4	13.1
EV/EBITDA (x)		1.2				11.8	10.6	9.0
EV/Revenues (x)						2.0	1.8	1.6

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 281
Target Price	: INR 300
52-week range (INR)	: 303 / 185
Share in issue (mn)	: 302.4
M cap (INR bn/USD mn)	: 85 / 1,318
Avg. Daily Vol.BSE/NSE('000)	: 1,137.2

SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	71.2	71.2	71.3
MF's, FI's & BK's	8.5	8.7	9.7
FII's	11.6	10.9	8.7
Others	8.6	9.2	10.3
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	4.2	6.7	4.1
3 months	9.6	3.2	(0.8)
12 months	37.5	21.0	4.5

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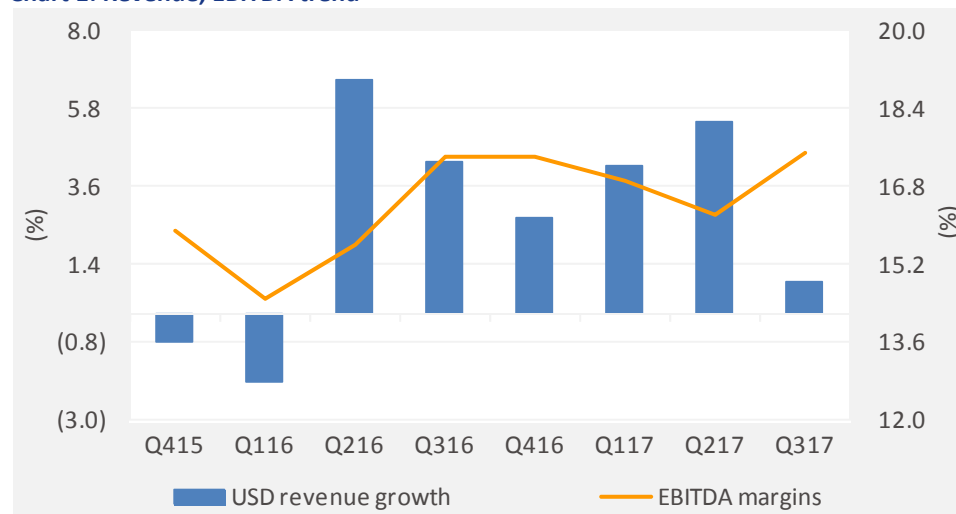
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November 1, 2017

Key highlights

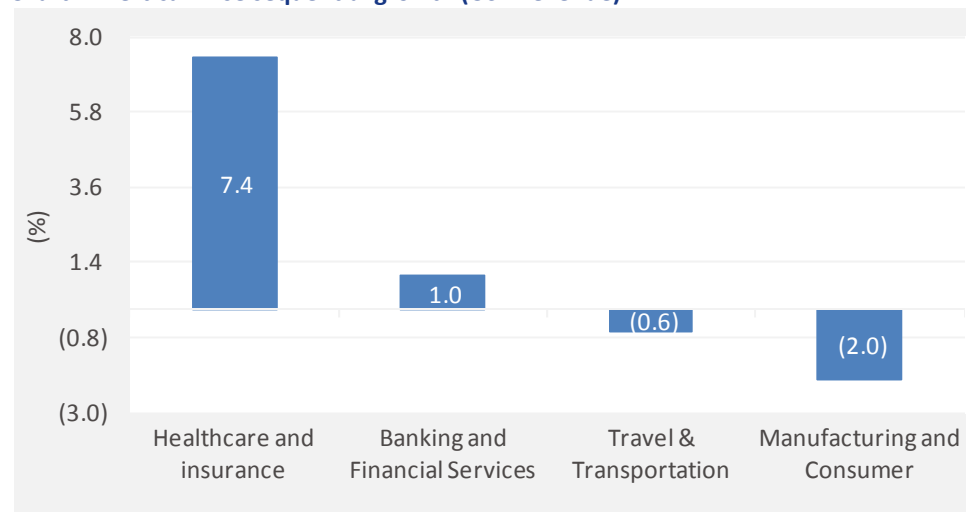
- **Revenue**, at USD154.0mn (up 0.9% QoQ), versus Street's 0.8% growth estimate. INR revenue rose 1.0% QoQ to INR9.9bn. In CC terms, revenue grew 0.4% QoQ.
- **Gross profit** grew 4.1% QoQ to INR3.57bn, while gross margin jumped 110bps QoQ to 36.0%. EBITDA (net of ESOP cost), at INR1.7bn, rose 8.5% QoQ. EBITDA margin rose by 120bps QoQ to 17.5%.

Chart 1: Revenue, EBITDA trend



- **Net profit**, at INR1,420mn, was higher than Street's INR1,224mn estimate. Net profit margin jumped 190bps to 14.3%.
- **Client addition**: Hexaware added 8 new clients during the quarter (9 in Q2CY17). Active clientele stood at 218 (220 in Q2CY17).
- Among verticals, growth was led by healthcare & insurance and BFS, which grew 7.4% and 1.0% QoQ, respectively. Travel & transportation and manufacturing & consumer segments declined 0.6% and 2.0% QoQ, respectively,

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



Source: Company, Edelweiss research

- **Client metric:** Top-5 clients constituted 43.5% of revenue (46.1% in Q2CY17) and top-10 clients contributed 54.8% to total revenue (56.5% in Q2CY17).

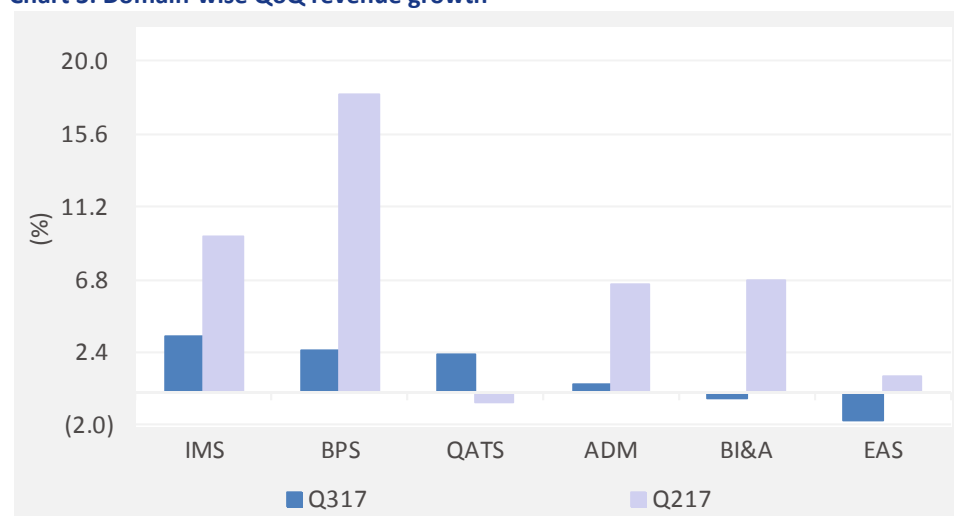
Table 1: Per client realisation - Quarterly trend

Realization per customer (USD mn)	Q415	Q116	Q216	Q316	Q416	Q117	Q217	Q317
Top 5 clients	10.5	10.4	11.2	12.7	12.9	13.2	14.1	13.4
Top 6-10 clients	3.1	3.0	3.1	3.1	3.1	3.2	3.2	3.5
Beyond 10	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3

Source: Company, Edelweiss research

- **IMS-led growth:** IMS, BPS, testing & digital assurance and ADM posted decent growth of 3.4%, 2.5%, 2.3% and 0.5% QoQ, respectively. Business intelligence & analytics and enterprise solutions declined 0.4% and 1.7% QoQ, respectively.

Chart 3: Domain-wise QoQ revenue growth



Source: Company, Edelweiss research

- **Hiring:** Net employee increased by 390. Total employee count stands at 13,488.
- **Utilisation:** Declined by 110bps QoQ to 79.7%.
- **Attrition:** Annualised attrition fell 10bps QoQ to 13.7% (13.8% in Q2CY17).
- **Geo split:** While Asia Pacific posted robust growth of 20.0% QoQ, Europe rose 2.5% QoQ and North America declined 1.2% QoQ.
- **Hedging:** Hexaware has hedges worth USD152.9mn (at average rate of INR71.4), EUR3.9mn (at average rate of INR81.6) and GBP7.5mn (at average rate of INR91.8).
- **DSO:** Stood at 72 days, up by 2 days from previous quarter.
- **Current cash and equivalents:** Stood at INR4.6bn, translating into INR15.6/share (~5.5% of current market price).

Financial snapshot

(INR mn)

Year to December	Q3CY17	Q2CY17	% Change	Q3CY16	% Change	YTD CY17	CY18E	CY19E
Net revenues	9,931	9,836	1.0	9,041	9.8	29,372	43,753	49,004
Direct costs	6,358	6,404	(0.7)	5,766	10.3	19,042	28,239	31,388
Gross profit	3,573	3,432	4.1	3,275	9.1	10,330	15,514	17,616
SG&A	1,839	1,834	0.3	1,699	8.2	5,375	8,094	8,968
EBITDA	1,734	1,598	8.5	1,576	10.0	4,955	7,419	8,648
Depreciation	160	157	1.9	142	12.7	474	678	749
EBIT	1,574	1,441	9.2	1,434	9.8	4,481	6,741	7,900
Other income	177	146	21.2	67	164.2	351	420	468
Add: Exceptional items								
Profit before tax	1,751	1,587	10.3	1,501	16.7	3,338	7,161	8,367
Tax	332	363	(8.5)	387	(14.2)	1,050	1,647	1,925
Reported net profit	1,420	1,224	16.0	1,114	27.4	3,782	5,514	6,443
Adjusted Profit	1,420	1,224	16.0	1,114	27.4	3,782	5,514	6,443
Diluted EPS (INR)	4.7	4.1	16.2	3.7	28.7	12.6	18.3	21.4
Diluted P/E (x)							15.4	13.1
EV/EBITDA (x)							10.6	9.0
EV/Revenues (x)							1.8	1.6
As % of net revenues								
Direct costs	64.0	65.1		63.8		64.8	64.5	64.1
Gross profit	36.0	34.9		36.2		35.2	35.5	35.9
SG&A	18.5	18.6		18.8		18.3	18.5	18.3
EBITDA	17.5	16.2		17.4		16.9	17.0	17.6
EBIT	15.8	14.7		15.9		15.3	15.4	16.1
Reported net profit	14.3	12.4		12.3		16.5	12.6	13.1
Tax rate	19.0	22.9		25.8		0.0	23.0	23.0

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 INR38.8bn (USD590mn) and it employees 13,488 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	CY16	CY17E	CY18E	CY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
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)	65.5	67.1	65.0	66.0
Company				
USD revenue growth	8	15	10	12
Net additions	740	1,014	527	813
Cost of rev. (% of rev.)	64.8	64.7	64.5	64.1
SGA cost (% of revenue)	19.0	18.3	18.5	18.3
Depreciation	6.5	6.3	5.5	5.3
Cash yield (%)	8.3	8.9	5.4	5.5
Tax rate as % of PBT	25.2	22.2	23.0	23.0
Capex (INR mn)	2,221	976	1,056	1,056
Debtor days	45	42	41	41
Payable days	18	19	19	19
Cash conversion cycle	27	23	22	22

Income statement

(INR mn)

Year to December	CY16	CY17E	CY18E	CY19E
Net revenue	35,349	39,282	43,753	49,004
Cost of revenues	22,891	25,398	28,239	31,388
Gross profit	12,458	13,884	15,514	17,616
Total SG&A expenses	6,704	7,179	8,094	8,968
EBITDA	5,754	6,705	7,419	8,648
Depreciation	556	636	678	749
EBIT	5,198	6,070	6,741	7,900
Add: Other income	394.00	450.44	420.06	467.86
Profit Before Tax	5,592	6,520	7,161	8,367
Less: Provision for Tax	1,410	1,446	1,647	1,925
Reported Profit	4,182	5,074	5,514	6,443
Adjusted Profit	4,182	5,074	5,514	6,443
Shares o /s (mn)	300	298	298	298
Adjusted Basic EPS	13.9	17.0	18.5	21.6
Diluted shares o/s (mn)	302	301	301	301
Adjusted Diluted EPS	13.8	16.8	18.3	21.4
Adjusted Cash EPS	15.8	19.2	20.8	24.1
Dividend per share (DPS)	10.0	10.0	11.0	12.0
Dividend Payout Ratio(%)	83.5	68.3	69.1	64.5

Common size metrics

Year to December	CY16	CY17E	CY18E	CY19E
Cost of revenues	64.8	64.7	64.5	64.1
Gross margin	35.2	35.3	35.5	35.9
SG&A expenses	19.0	18.3	18.5	18.3
EBITDA margins	16.3	17.1	17.0	17.6
EBIT margins	14.7	15.5	15.4	16.1
Net Profit margins	11.8	12.9	12.6	13.1

Growth ratios (%)

Year to December	CY16	CY17E	CY18E	CY19E
Revenues	13.2	11.1	11.4	12.0
EBITDA	7.5	16.5	10.7	16.6
PBT	10.8	16.6	9.8	16.8
Adjusted Profit	6.4	21.3	8.7	16.8
EPS	6.4	21.7	8.7	16.8

Balance sheet		(INR mn)			
As on 31st December	CY16	CY17E	CY18E	CY19E	
Share capital	604	596	596	596	
Reserves & Surplus	16,507	18,117	19,821	22,107	
Shareholders' funds	17,111	18,713	20,417	22,703	
Def. Tax Liability (net)	(376)	(376)	(376)	(376)	
Sources of funds	16,735	18,337	20,041	22,328	
Gross Block	8,811	11,404	13,268	14,728	
Net Block	3,026	5,520	6,706	7,417	
Capital work in progress	3,233	1,617	808	404	
Intangible Assets	2,298	1,761	1,761	1,761	
Total Fixed Assets	8,557	8,898	9,275	9,582	
Non current investments	22	22	22	22	
Cash and Equivalents	4,315	4,910	5,138	5,576	
Sundry Debtors	4,376	4,628	5,154	5,773	
Loans & Advances	2,572	3,332	4,368	5,795	
Other Current Assets	3,166	3,166	3,166	3,166	
Current Assets (ex cash)	10,114	11,126	12,688	14,734	
Trade payable	1,291	1,389	1,543	1,715	
Other Current Liab	4,980	5,229	5,538	5,870	
Total Current Liab	6,272	6,618	7,081	7,586	
Net Curr Assets-ex cash	3,842	4,508	5,607	7,148	
Uses of funds	16,735	18,337	20,041	22,328	
BVPS (INR)	56.6	62.1	67.8	75.4	

Free cash flow		(INR mn)			
Year to December	CY16	CY17E	CY18E	CY19E	
Reported Profit	4,182	5,074	5,514	6,443	
Add: Depreciation	556	636	678	749	
Others	598	(450)	(420)	(468)	
Less: Changes in WC	533	666	1,099	1,541	
Operating cash flow	4,803	4,593	4,674	5,183	
Less: Capex	2,221	976	1,056	1,056	
Free Cash Flow	2,583	3,617	3,618	4,127	

Cash flow metrics		CY16	CY17E	CY18E	CY19E
Year to December					
Operating cash flow		4,803	4,593	4,674	5,183
Investing cash flow		(1,999)	(526)	(636)	(588)
Financing cash flow		(2,469)	(3,472)	(3,810)	(4,156)
Net cash Flow		335	595	228	438
Capex		(2,221)	(976)	(1,056)	(1,056)
Dividend paid		(2,506)	(3,464)	(3,810)	(4,156)

Profitability and efficiency ratios		CY16	CY17E	CY18E	CY19E
Year to December					
ROAE (%)		26.6	28.3	28.2	29.9
ROACE (%)		35.6	36.4	36.6	38.8
Debtors Days		45	42	41	41
Payable Days		18	19	19	19
Cash Conversion Cycle		27	23	22	22
Current Ratio		2.3	2.4	2.5	2.7

Operating ratios		CY16	CY17E	CY18E	CY19E
Year to December					
Total Asset Turnover		2.3	2.2	2.3	2.3
Fixed Asset Turnover		6.6	6.2	5.6	5.6
Equity Turnover		2.2	2.2	2.2	2.3

Valuation parameters		CY16	CY17E	CY18E	CY19E
Year to December					
Adj. Diluted EPS (INR)		13.8	16.8	18.3	21.4
Y-o-Y growth (%)		6.4	21.7	8.7	16.8
Adjusted Cash EPS (INR)		15.8	19.2	20.8	24.1
Diluted P/E (x)		20.3	16.7	15.4	13.1
P/B (x)		5.0	4.5	4.1	3.7
EV / Sales (x)		2.3	2.0	1.8	1.6
EV / EBITDA (x)		13.9	11.8	10.6	9.0
Dividend Yield (%)		3.6	3.6	3.9	4.3

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		CY17E	CY18E	CY17E	CY18E	CY17E	CY18E
Hexaware Technologies	1,318	16.7	15.4	11.8	10.6	28.3	28.2
Cyient	946	14.5	12.9	9.3	7.5	18.4	18.2
ECLERX SERVICES	792	14.4	12.9	8.7	7.2	26.5	24.8
HCL Technologies	18,592	13.3	12.1	10.4	9.2	25.7	25.8
Infosys	33,003	14.2	12.8	9.5	8.1	22.5	25.1
Persistent Systems	816	15.0	12.7	9.1	7.1	17.3	17.9
Tata Consultancy Services	79,487	19.7	18.0	14.4	12.6	29.7	30.6
Tech Mahindra	7,388	13.9	12.5	9.8	7.8	17.5	17.4
Wipro	22,141	16.3	14.7	13.2	11.7	17.4	18.7
Median	-	14.5	12.9	9.8	8.1	22.5	24.8
AVERAGE	-	15.3	13.8	10.7	9.1	22.6	23.0

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	6.20	T Rowe Price Group	2.21
Vanguard	1.69	Dimensional Fund Advisors	1.06
SBI Funds Mgmt	0.95	Templeton Asset Mgmt	0.69
Aviva Group	0.62	Grantham Mayo Van Otterloo	0.50
Blackrock	0.48	SEB	0.38

**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	HOLD	SP	L
Just Dial	REDUCE	SU	M	Persistent Systems	BUY	SP	L
Tata Consultancy Services	HOLD	SP	L	Tech Mahindra	BUY	SP	M
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): 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
02-Nov-17	Cognizant	Digital steers quarter growth; <i>Result Update</i>		
02-Nov-17	Tech Mahindra	Margins continue to perk up; <i>Result Update</i>	488	Buy
31-Oct-17	Info Edge	Huge value-unlocking potential; <i>Result Update</i>	1,137	Buy

Distribution of Ratings / Market Cap

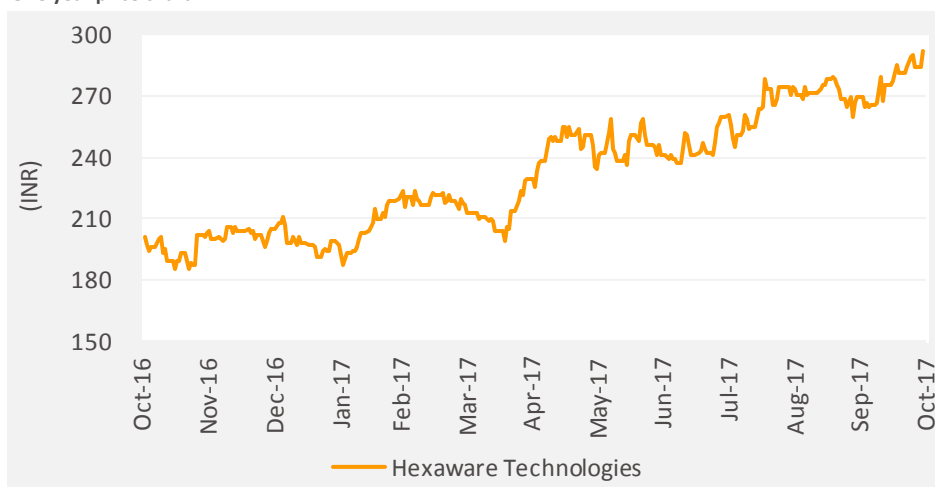
Edelweiss Research Coverage Universe

	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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