

HEXAWARE TECHNOLOGIES

Mixed performance

India Equity Research | IT

Hexaware Technologies' (Hexaware) Q1CY18 revenue at USD162.2mn (up 3.9% in USD, 3.3% in CC), surpassed Street's 2.9% estimate. EBITDA margin fell 40bps QoQ to 15.5%, below Street's 16.2% estimate, due to higher investment in sales & marketing (S&M). The company is eyeing market share gains and focusing on maximising revenue growth. We do not foresee margin expansion due to absence of margin levers and reinvestment of growth in ramping up S&M efforts. Considering strong start to CY18 and robust traction in its automation-led IMS & BPS services, we expect Hexaware to breach upper end of its revenue growth guidance of 10-12% and clock USD revenue CAGR of 13.4% over CY17-19E. Despite strong revenue growth, margin is likely to remain flat resulting in PAT CAGR of 16.2% over CY17-19E. However, at CMP, we believe the stock is fairly valued. Maintain 'HOLD' with INR359 TP (16x CY19E EPS).

Focus on maximising revenue momentum

Hexaware has a strong deal pipeline and is also focusing on ramping up its current offerings. Considering robust traction in IMS & BPS services, modest growth in ADM and turnaround in enterprise services, we expect the company to clock higher-than-industry growth and even breach upper-end of its CY18 revenue guidance. We estimate USD revenue CAGR of 13.4% over CY17-19.

Margin expansion unlikely

Despite strong revenue growth, EBITDA margin declined 40bps QoQ in Q1CY18 on account of higher investment in S&M. With visa costs & wage hikes slated for ensuing quarters and normalisation of record-high utilization, margin expansion looks unlikely. Also, management is focusing on higher revenue growth, rather than improving profitability. Accordingly, we believe EPS growth will track revenue momentum.

Outlook and valuations: Fairly valued; maintain 'HOLD'

Automation-driven IMS & BPS service offerings and better-than-industry growth in ADM will help Hexaware post superior growth than most peers. However, due to lack of visible margin levers, PAT growth will mirror revenue growth. At CMP, the stock is trading at 17.3x CY19E EPS, which we believe is reasonable for PAT CAGR of 16.2% over CY17-19E. Hence, we maintain 'HOLD/SP' with TP of INR359 (16x CY19E EPS).

Financials

(INR mn)

Year to December	Q1CY18	Q4CY17	% Chg	Q1CY17	% Chg	CY17	CY18E	CY19E
Net revenues	10,490	10,048	4.4	9,605	9.2	39,420	45,200	51,547
EBITDA	1,626	1,599	1.7	1,623	0.2	6,554	7,419	8,549
Adjusted Profit	1,343	1,210	11.0	1,139	17.9	4,994	5,821	6,741
Diluted EPS (INR)	4.5	4.0	10.9	3.8	18.3	16.6	19.4	22.4
Diluted P/E (x)						23.3	20.0	17.3
EV/EBITDA (x)						16.6	14.5	12.3
EV/Revenues (x)						2.8	2.4	2.0

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 388
Target Price	: INR 359
52-week range (INR)	: 458 / 228
Share in issue (mn)	: 296.8
M cap (INR bn/USD mn)	: 115 / 2,020
Avg. Daily Vol.BSE/NSE('000)	: 183.5

SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	71.2	71.2	71.2
MF's, FI's & BK's	7.4	7.4	8.5
FII's	13.4	13.4	11.6
Others	8.1	8.1	8.6
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	8.3	4.2	7.9
3 months	22.6	(0.8)	5.6
12 months	93.1	14.7	34.5

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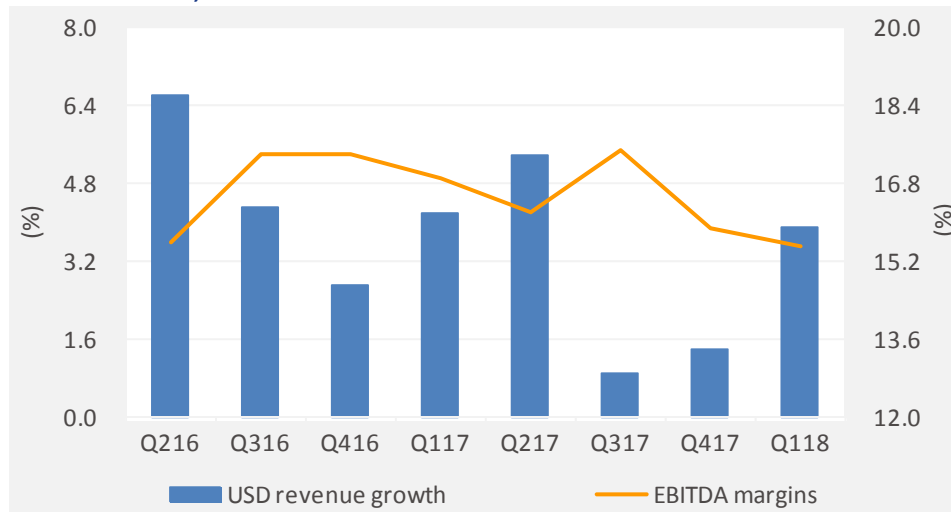
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Key highlights

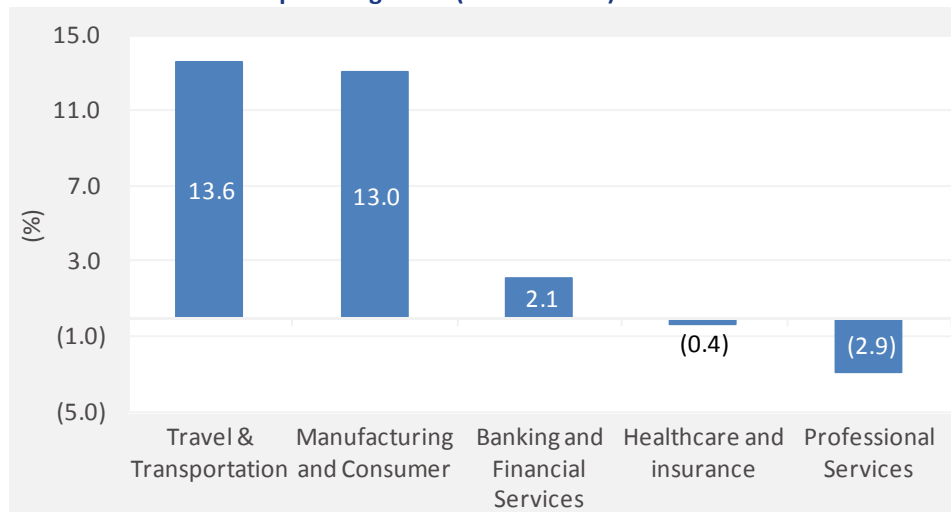
- **Revenue**, at USD162.2mn, grew 3.9% QoQ versus Street's 2.9% growth estimate. In INR/CC terms, revenue grew 4.4%/3.3% QoQ to INR10.5bn.
- **Gross profit** rose 4.5% QoQ to INR3.54bn, while gross margin jumped 10bps QoQ to 33.8%. EBITDA (net of ESOP cost), at INR1.6bn, rose 1.7% QoQ. EBITDA margin fell 40bps QoQ to 15.5%.

Chart 1: Revenue, EBITDA trend



- **Net profit**, at INR1,343mn, was marginally below Street's INR1,332mn estimate. Net profit margin rose 80bps to 12.8%.
- **Client addition**: Hexaware added five new clients during the quarter (eight in Q4CY17 as well). Active clientele stood at 224 (221 in Q4CY17).
- Among verticals, growth was seen in Travel & Transportation, Manufacturing & Consumer and Banking & Financial Services, which grew 13.6%, 13.0% and 2.1% QoQ, respectively. Healthcare & Insurance and Professional Services declined 0.4% and 2.9% QoQ, respectively.

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



Source: Company, Edelweiss research

- **Client metrics:** Top five clients constituted 42.1% of revenue (42.8% in Q4CY17) and top 10 contributed 52.8% to total revenue (52.9% in Q4CY17).

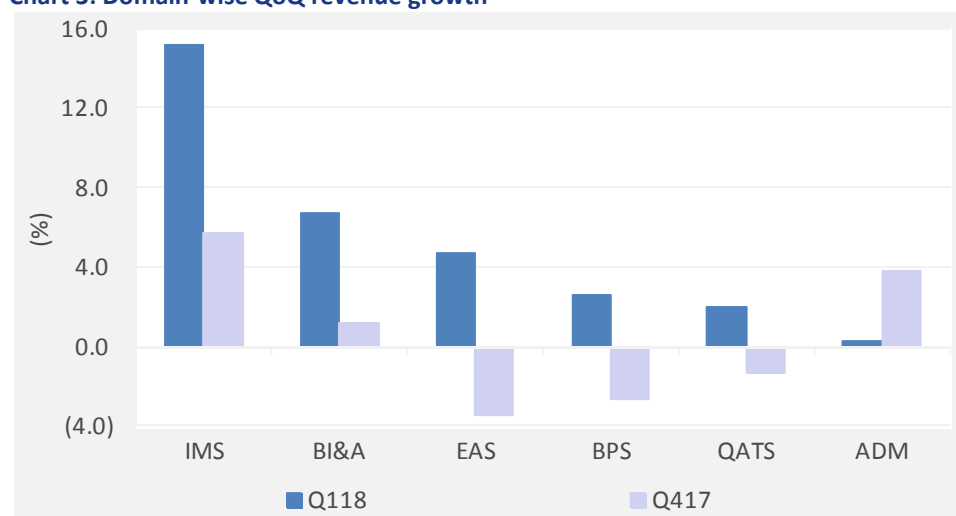
Table 1: Per client realisation - Quarterly trend

Realization per customer (USD mn)	Q216	Q316	Q416	Q117	Q217	Q317	Q417	Q118
Top 5 clients	11.2	12.7	12.9	13.2	14.1	13.4	13.4	13.7
Top 6-10 clients	3.1	3.1	3.1	3.2	3.2	3.5	3.2	3.5
Beyond 10	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4

Source: Company, Edelweiss research

- **IMS-led growth:** IMS, BI&A and Enterprise Solutions posted robust growth of 15.2%, 6.7% and 4.7% QoQ, respectively. Testing/digital assurance, BPS and ADM grew 2.0%, 2.6% and 0.3% QoQ, respectively.

Chart 3: Domain-wise QoQ revenue growth



Source: Company, Edelweiss research

- **Hiring:** Net employees increased by 914. Total employee count stands at 14,619.
- **Utilisation:** Jumped by 40bps QoQ to 81.3%.
- **Attrition:** Annualised attrition rose 30bps QoQ to 13.4% (13.1% in Q4CY17).
- **Geo split:** While Asia-Pacific and Europe posted robust growth of 24.6% and 7.3% QoQ, respectively, Americas grew 0.7% QoQ.
- **Hedging:** Hexaware has hedges worth USD177.8mn (at average rate of INR70.0), EUR6.6mn (at average rate of INR84.5) and GBP11.6mn (at average rate of INR94.2).
- **DSO:** Stood at 74 days, up by three days from previous quarter.
- **Current cash and equivalents:** Stood at INR6.1bn, translating into INR20.4/share (~5.2% of current market price).

Financial snapshot

(INR mn)

Year to December	Q1CY18	Q4CY17	% Change	Q1CY17	% Change	CY17	CY18E	CY19E
Net revenues	10,490	10,048	4.4	9,605	9.2	39,420	45,200	51,547
Direct costs	6,949	6,658	4.4	6,280	10.7	25,700	29,480	33,461
Gross profit	3,541	3,390	4.5	3,325	6.5	13,720	15,721	18,085
SG&A	1,915	1,791	6.9	1,702	12.5	7,166	8,302	9,536
EBITDA	1,626	1,599	1.7	1,623	0.2	6,554	7,419	8,549
Depreciation	151	159	(5.0)	157	(3.8)	633	632	672
EBIT	1,475	1,440	2.4	1,466	0.6	5,921	6,787	7,878
Other income	203	131	55.0	28	625.0	484	514	601
Add: Exceptional items								
Profit before tax	1,678	1,571	6.8	1,494	12.3	6,405	7,301	8,479
Tax	336	361	(6.9)	355	(5.4)	1,411	1,479	1,738
Reported net profit	1,343	1,210	11.0	1,139	17.9	4,994	5,821	6,741
Adjusted Profit	1,343	1,210	11.0	1,139	17.9	4,994	5,821	6,741
Diluted EPS (INR)	4.5	4.0	10.9	3.8	18.3	16.6	19.4	22.4
Diluted P/E (x)						23.3	20.0	17.3
EV/EBITDA (x)						16.6	14.5	12.3
EV/Revenues (x)						2.8	2.4	2.0
As % of net revenues								
Direct costs	66.2	66.3		65.4		65.2	65.2	64.9
Gross profit	33.8	33.7		34.6		34.8	34.8	35.1
SG&A	18.3	17.8		17.7		18.2	18.4	18.5
EBITDA	15.5	15.9		16.9		16.6	16.4	16.6
EBIT	14.1	14.3		15.3		15.0	15.0	15.3
Reported net profit	12.8	12.0		11.9		12.7	12.9	13.1
Tax rate	20.0	23.0		23.8		22.0	20.3	20.5

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 INR40.3bn (USD625mn) and it employees 14,619 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	CY17	CY18E	CY19E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
Company				
USD revenue growth	8	16	13	14
Net additions	740	1,590	1,581	950
Cost of rev. (% of rev.)	64.8	65.2	65.2	64.9
SGA cost (% of revenue)	19.0	18.2	18.4	18.5
Tax rate as % of PBT	25.2	22.0	20.3	20.5
Capex (INR mn)	2,221	974	1,051	1,056
Cash conversion cycle	27	23	22	22
Depreciation	6.5	6.3	5.1	4.8
Cash yield (%)	8.3	8.5	7.0	5.2
Debtor days	45	42	40	40
Payable days	18	19	18	19

Income statement

(INR mn)

Year to December	CY16	CY17	CY18E	CY19E
Net revenue	35,349	39,420	45,200	51,547
Cost of revenues	22,891	25,700	29,480	33,461
Gross profit	12,458	13,720	15,721	18,085
Total SG&A expenses	6,704	7,166	8,302	9,536
EBITDA	5,754	6,554	7,419	8,549
Depreciation	556	633	632	672
EBIT	5,198	5,921	6,787	7,878
Add: Other income	394.00	484.00	513.94	600.96
Profit Before Tax	5,592	6,405	7,301	8,479
Less: Provision for Tax	1,410	1,411	1,479	1,738
Reported Profit	4,182	4,994	5,821	6,741
Adjusted Profit	4,182	4,994	5,821	6,741
Shares o /s (mn)	300	297	297	297
Adjusted Basic EPS	13.9	16.8	19.6	22.7
Diluted shares o/s (mn)	302	300	300	300
Adjusted Diluted EPS	13.8	16.6	19.4	22.4
Adjusted Cash EPS	15.8	19.0	21.8	25.0
Dividend per share (DPS)	6.0	6.0	8.0	8.0
Dividend Payout Ratio(%)	50.1	41.4	47.4	40.9

Common size metrics

Year to December	CY16	CY17	CY18E	CY19E
Cost of revenues	64.8	65.2	65.2	64.9
Gross margin	35.2	34.8	34.8	35.1
SG&A expenses	19.0	18.2	18.4	18.5
EBITDA margins	16.3	16.6	16.4	16.6
EBIT margins	14.7	15.0	15.0	15.3
Net Profit margins	11.8	12.7	12.9	13.1

Growth ratios (%)

Year to December	CY16	CY17	CY18E	CY19E
Revenues	13.2	11.5	14.7	14.0
EBITDA	7.5	13.9	13.2	15.2
PBT	10.8	14.5	14.0	16.1
Adjusted Profit	6.4	19.4	16.6	15.8
EPS	6.4	20.1	16.6	15.8

Balance sheet		(INR mn)			
As on 31st December	CY16	CY17	CY18E	CY19E	
Share capital	604	593	593	593	
Reserves & Surplus	16,507	19,433	22,497	26,480	
Shareholders' funds	17,111	20,026	23,090	27,073	
Def. Tax Liability (net)	(376)	(376)	(376)	(376)	
Sources of funds	16,735	19,650	22,714	26,698	
Gross Block	8,811	11,401	13,260	14,720	
Net Block	3,026	5,520	6,747	7,536	
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	9,317	9,701	
Non current investments	22	22	22	22	
Cash and Equivalents	4,315	6,215	7,643	9,623	
Sundry Debtors	4,376	4,644	5,325	6,073	
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	11,142	12,858	15,033	
Trade payable	1,291	1,398	1,587	1,811	
Other Current Liab	4,980	5,229	5,538	5,870	
Total Current Liab	6,272	6,627	7,126	7,681	
Net Curr Assets-ex cash	3,842	4,515	5,733	7,352	
Uses of funds	16,735	19,650	22,714	26,698	
BVPS (INR)	56.6	66.7	76.9	90.1	

Free cash flow		(INR mn)			
Year to December	CY16	CY17	CY18E	CY19E	
Reported Profit	4,182	4,994	5,821	6,741	
Add: Depreciation	556	633	632	672	
Others	598	(484)	(514)	(601)	
Less: Changes in WC	533	673	1,217	1,619	
Operating cash flow	4,803	4,470	4,722	5,192	
Less: Capex	2,221	974	1,051	1,056	
Free Cash Flow	2,583	3,496	3,671	4,136	

Cash flow metrics		CY16	CY17	CY18E	CY19E
Year to December					
Operating cash flow		4,803	4,470	4,722	5,192
Investing cash flow		(1,999)	(490)	(537)	(455)
Financing cash flow		(2,469)	(2,079)	(2,757)	(2,757)
Net cash Flow		335	1,901	1,428	1,979
Capex		(2,221)	(974)	(1,051)	(1,056)
Dividend paid		(2,506)	(2,068)	(2,757)	(2,757)

Profitability and efficiency ratios		CY16	CY17	CY18E	CY19E
Year to December					
ROAE (%)		26.6	26.9	27.0	26.9
ROACE (%)		35.6	34.5	33.9	33.8
Debtors Days		45	42	40	40
Payable Days		18	19	18	19
Cash Conversion Cycle		27	23	22	22
Current Ratio		2.3	2.6	2.9	3.2

Operating ratios		CY16	CY17	CY18E	CY19E
Year to December					
Total Asset Turnover		2.3	2.2	2.1	2.1
Fixed Asset Turnover		6.6	6.3	5.7	5.8
Equity Turnover		2.2	2.1	2.1	2.1

Valuation parameters		CY16	CY17	CY18E	CY19E
Year to December					
Adj. Diluted EPS (INR)		13.8	16.6	19.4	22.4
Y-o-Y growth (%)		6.4	20.1	16.6	15.8
Adjusted Cash EPS (INR)		15.8	19.0	21.8	25.0
Diluted P/E (x)		28.0	23.3	20.0	17.3
P/B (x)		6.8	5.8	5.0	4.3
EV / Sales (x)		3.2	2.8	2.4	2.0
EV / EBITDA (x)		19.5	16.6	14.5	12.3
Dividend Yield (%)		1.5	1.5	2.1	2.1

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		CY18E	CY19E	CY18E	CY19E	CY18E	CY19E
Hexaware Technologies	2,020	20.0	17.3	14.5	12.3	27.0	26.9
Cyient	1,394	19.1	16.5	12.7	10.9	18.9	19.4
ECLERX SERVICES	767	16.6	13.8	9.8	7.4	21.1	21.9
HCL Technologies	19,334	13.4	12.1	9.6	8.5	24.9	24.7
Infosys	38,746	16.5	14.9	11.3	9.9	24.4	26.4
Persistent Systems	936	15.4	13.0	9.0	7.2	17.7	18.4
Tata Consultancy Services	99,988	23.4	21.0	16.8	14.9	30.6	30.4
Tech Mahindra	9,598	15.4	13.4	10.3	8.7	18.6	19.1
Wipro	18,422	14.5	13.1	11.2	10.4	16.8	17.5
Median	-	16.5	13.8	11.2	9.9	21.1	21.9
AVERAGE	-	17.2	15.0	11.7	10.0	22.2	22.7

Source: Edelweiss research

Additional Data

Directors Data

Mr. P. R. Chandrasekar	Vice Chairman	Mr. Atul K. Nishar	Chairman
Mr. Bharat Shah	Independant 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	6.36	T Rowe Price Group	2.25
Dimensional Fund Advisors	1.13	Vanguard	1.13
Aviva Group	0.75	Blackrock	0.55
Grantham Mayo Van Otterloo	0.52	SEB	0.40
SBI Funds Mgmt	0.36	Caisse De Depot Et Placement	0.30

**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
No Data Available			

**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	HOLD	SU	M	L&T Infotech Ltd	BUY	SO	M
L&T Technology Services Ltd	BUY	SO	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, L&T Infotech Ltd, L&T Technology Services Ltd, Persistent Systems, Tata Consultancy Services, Tech Mahindra, Wipro

Recent Research

Date	Company	Title	Price (INR)	Recos
02-May-18	HCL Technologies	Weak revenue outlook shadows margin stability; <i>Result Update</i>	1000	Buy
26-Apr-18	Tejas Network	Weak quarter; better outlook; <i>Result Update</i>	336	Buy
26-Apr-18	Sterlite Technologies	Tracking strong growth momentum; <i>Result Update</i>	342	Buy

Distribution of Ratings / Market Cap

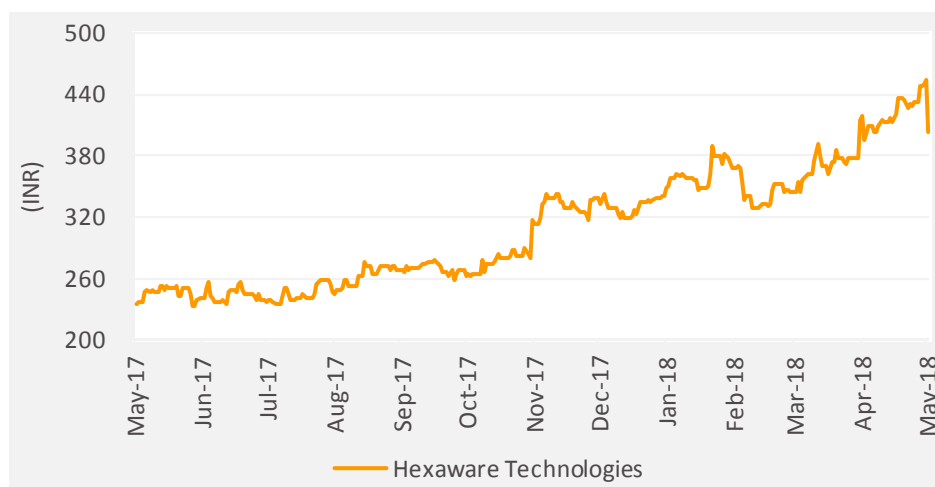
Edelweiss Research Coverage Universe

	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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