

Institutional Equity Research

Hexaware Technologies

IT | India

4QCY17 Result Update | February 08, 2018

CMP* (Rs)	355
Upside/ (Downside) (%)	(12)
Bloomberg Ticker	HEXW IN
Market Cap. (Rs bn)	105
Free Float (%)	29
Shares O/S (mn)	297

REDUCE 

Target Price: Rs313

Weak Performance; Valuations Prohibitive

Marred by the extended impact of client-specific issues, Hexaware Technologies (Hexaware) delivered a weak performance in 4QCY17. Its USD revenue grew by 1.3% QoQ (same in CC terms) to US\$156.1mn, while volume rose by 1.1% QoQ. From vertical perspective, Travel & Transportation witnessed steep pressure with segmental USD revenue declining by 7.5% QoQ. On a positive note, USD revenue from the key BFS vertical grew by a decent 3.9% QoQ, while USD revenue from Insurance & Healthcare and MFG & Consumer rose by 2.2% QoQ and 1.1% QoQ, respectively. However, owing to wage hike and investments made for acquiring new clients, EBIT margin declined by a steep 151bps QoQ to 14.3%, which along with lower other income led to 14.8% QoQ decline in net profit. Factoring in the continued impact of loss of business from clients, the Management expects CC revenue and EPS to grow by 10-12% YoY each in CY18E, with operating margin expected to remain flat. The revenue guidance factors in the client-specific issues, which will have 2.5-3% impact on revenue growth. Thus, we expect CY18E revenue growth to be weaker than that of CY17, as the client-specific issue is expected to extrapolate into 1HCY18 as well.

Key Operating Metrics – IMS & Europe Drive Growth

Though the Management expects revenue to accelerate from 2QCY18 onwards, we expect CY18E revenue growth to be weaker than that of CY17, as the client-specific is likely to have 2.5-3% impact on revenue growth in 1HCY18E. From service line perspective, continuing to witness healthy growth for last several quarters, revenue from RIMS grew by 4.9% QoQ, while revenue from ADM grew by a decent 3.9% QoQ. On the other hand, revenue from Enterprise Solutions and BPO declined by 3.1% QoQ and 2.8% QoQ, respectively. Geographically, while revenue from the Americas region remained flattish, revenue from Europe and APAC region surged by 8.5% QoQ and 7.7% QoQ, respectively.

Outlook & Valuation

Notwithstanding Hexaware's differentiated business strategy, we believe its near-term growth will be a challenge owing to client-specific issues. Notably, the stock has substantially outperformed the broader market over the past year and in light of expected slower growth, current valuations at 19.6x/17.0x CY18E/CY19E EPS seem to be prohibitive, in our view. **Thus, rolling over our estimates to CY19E EPS, we downgrade our recommendation on the stock to REDUCE from HOLD with a revised Target Price of Rs313 (from Rs285 earlier).**

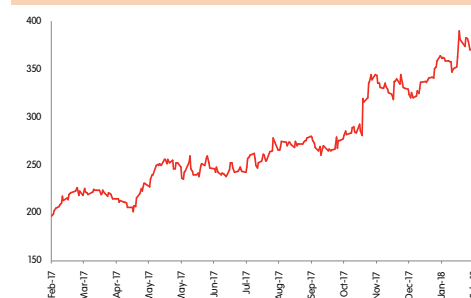
Key Financials (Rs mn)	CY16	CY17	CY18E	CY19E
Net Sales	35,349	39,420	43,966	49,369
EBIT ex-ESOP costs	5,436	5,919	6,627	7,786
APAT	4,171	4,995	5,532	6,366
Diluted EPS (Rs)	13.7	16.4	18.2	20.9
P/E (x)	25.9	21.7	19.6	17.0
EV / EBITDA (x)	17.2	15.6	13.6	11.4
RoE (%)	26.3	26.7	25.4	25.1
Dividend Yield (%)	1.5	1.4	1.7	2.0

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	(2.0)	5.4	79.5
Relative to Nifty	(0.7)	3.7	60.0

Shareholding Pattern (%)	Sep'17	Dec'17
Promoter	71.3	71.2
Public	28.8	28.8

1 Year Stock Price Performance



Note: * CMP as on February 07, 2018

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Risks to the view

- ▶ Better-than-expected revenue growth, which would lead to margin and EPS coming above our estimates.
- ▶ Strong client additions, which would drive revenue traction.
- ▶ Capital return measures including a share buy-back.

Exhibit 1: Consolidated Financial Results

(Rs mn)	4QCY17	3QCY17	QoQ (%)	4QCY16	YoY (%)
Net Revenues (US\$ mn)	156.1	154.0	1.3	138.9	12.3
Net Revenues	10,048	9,931	1.2	9,409	6.8
Employee Expenses	5,592	5,330	4.9	5,160	8.4
SG&A and Other Operating Expenses	2,858	2,867	(0.3)	2,612	9.4
EBITDA	1,598	1,733	(7.8)	1,637	(2.4)
Depreciation	159	160	(0.9)	138	14.9
EBIT	1,440	1,573	(8.5)	1,499	(4.0)
Interest Costs	0	0	(42.1)	0	214.3
Other Income	131	179	(26.5)	139	(5.7)
PBT	1,571	1,751	(10.3)	1,638	(4.1)
Tax	361	332	8.9	408	(11.5)
APAT	1,210	1,419	(14.8)	1,230	(1.7)
E/o (adj for tax)	0	0	-	0	-
RPAT	1,210	1,419	(14.8)	1,230	(1.7)

Source: Company RSec Research

Exhibit 2: Margin Break Up

Particulars (%)	4QCY17	3QCY17	QoQ (bps)	4QCY16	YoY (bps)
Employee Expenses % Net Sales	55.7	53.7	198	54.8	81
SG&A and Other Expenses % Net Sales	28.4	28.9	(43)	27.8	68
EBITDA Margin	15.9	17.4	(154)	17.4	(149)
EBIT Margin	14.3	15.8	(151)	15.9	(160)
Tax Rate	23.0	18.9	405	24.9	(192)
APAT Margin	12.0	14.3	(225)	13.1	(104)
APAT Margin	14.3	12.4	184	12.6	165

Source: Company, RSec Research

Exhibit 3: Key Assumptions

Particulars	CY16	CY17	CY18E	CY19E
Onsite USD revenue growth (%)	11.0	20.3	12.4	13.3
Offshore USD revenue growth (%)	4.0	7.8	9.4	10.3
Total USD revenue growth (%)	8.3	15.6	11.3	12.3
USD/INR rate	67.26	64.89	65.00	65.00
EBIT margin (%)	15.4	15.0	15.1	15.8

Source: Company, RSec Research

Exhibit 4: Vertical break-up

(% of revenue)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Travel & Transportation	14.5	14.5	13.2	13.6	13.4	13.2	12.0
Banking and Financial Services	40.0	41.6	42.1	42.7	43.3	43.4	44.4
Insurance and Healthcare	17.1	16.0	16.5	15.7	15.6	16.6	16.7
MFG, Consumer and Others	28.5	27.9	28.2	28.0	27.7	26.9	26.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

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Exhibit 5: Vertical growth

(QoQ, %)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Travel & Transportation	0.5	4.5	(6.4)	7.5	3.5	(0.6)	(7.5)
Banking and Financial Services	8.6	8.6	3.9	5.6	7.1	1.0	3.9
Insurance and Healthcare	3.8	(1.9)	5.5	(0.9)	5.0	7.4	2.2
MFG, Consumer and Others	8.8	1.9	4.1	3.3	4.1	(2.0)	1.1
Total	6.6	4.3	2.7	4.2	5.4	0.9	1.3

Source: Company, RSec Research

Exhibit 6: Service line break-up

(% of revenue)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
ADM	36.5	36.0	36.4	36.1	36.5	36.3	37.2
Enterprise Solutions	13.3	13.0	12.7	12.1	11.6	11.3	10.8
Quality Assurance and Testing Services	20.1	20.3	20.9	20.9	19.7	20.0	19.5
Business Intelligence & Analytics	15.6	15.2	14.1	13.8	14.0	13.8	13.8
BPO	6.5	6.8	6.8	6.4	7.2	7.3	7.0
RIMS	8.0	8.7	9.1	10.7	11.0	11.3	11.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 7: Service line growth

(QoQ, %)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
ADM	3.2	2.9	3.9	3.3	6.6	0.4	3.9
Enterprise Solutions	3.5	1.9	0.4	(0.7)	1.1	(1.7)	(3.1)
Quality Assurance and Testing Services	5.5	5.3	5.8	4.2	(0.6)	2.5	(1.2)
Business Intelligence & Analytics	9.4	1.6	(4.7)	2.0	7.0	(0.5)	1.3
BPO	19.4	9.1	2.7	(2.0)	18.6	2.3	(2.8)
RIMS	16.8	13.4	7.5	22.5	8.4	3.7	4.9
Total	6.6	4.3	2.7	4.2	5.4	0.9	1.3

Source: Company, RSec Research

Exhibit 8: Geographic revenue break-up

(% of revenue)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Americas	82.2	82.9	83.6	81.6	80.8	79.1	77.7
Europe	12.2	11.3	10.9	11.0	11.2	11.3	12.1
Asia-Pacific	5.6	5.7	5.5	7.4	8.0	9.6	10.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 9: Geographical revenue growth

(QoQ, %)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Americas	5.9	5.2	3.6	1.7	4.4	(1.2)	(0.4)
Europe	11.0	(3.2)	(1.3)	5.3	7.3	1.8	8.5
Asia-Pacific	6.4	6.7	(1.8)	40.3	14.0	21.1	7.7
Total	6.6	4.3	2.7	4.2	5.4	0.9	1.3

Source: Company, RSec Research

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Exhibit 10: Delivery-wise contribution

(% of revenue)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Onsite revenue	61.4	63.2	61.9	64.5	64.7	65.4	65.1
Offshore revenue	38.6	36.8	38.1	35.5	35.3	34.6	34.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 11: Delivery-wise growth

(QoQ, %)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Onsite revenue	3.7	7.3	0.6	8.5	5.8	2.0	0.9
Offshore revenue	11.5	(0.6)	6.4	(2.9)	4.8	(1.1)	2.2
Total	6.6	4.3	2.7	4.2	5.4	0.9	1.3

Source: Company, RSec Research

Exhibit 12: Headcount, utilisation data

(Nos.)	2QCY16	3QCY16	4QCY16	1QCY17	2QCY17	3QCY17	4QCY17
Total headcount	11,875	11,859	12,155	12,734	13,098	13,488	13,705
Technical employees	10,830	10,851	11,147	11,702	12,063	12,409	12,638
Marketing	451	415	401	407	432	445	452
General Management/Support	594	593	607	625	603	634	615
Net Employee Addition	276	(16)	296	579	364	390	217
Utilisation including trainees (%)	70.0	74.1	78.6	78.9	80.8	79.7	80.9

Source: Company, RSec Research

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Profit and Loss Statement

Y/E March (Rs mn)	CY16	CY17	CY18E	CY19E
Net Revenues (\$mn)	525.6	607.5	676.4	759.5
Growth (%)	8.3	15.6	11.3	12.3
Net Sales	35,349	39,420	43,966	49,369
Growth (%)	13.2	11.5	11.5	12.3
Employee Expenses	19,705	21,687	24,402	27,294
SG&A and Other Operating Expenses	9,650	11,182	12,255	13,575
EBITDA	5,994	6,552	7,310	8,500
EBITDA (%)	17.0	16.6	16.6	17.2
EBITDA Growth (%)	7.6	9.3	11.6	16.3
Depreciation	558	633	683	714
EBIT	5,436	5,919	6,627	7,786
EBIT (%)	15.4	15.0	15.1	15.8
EBIT Growth (%)	6.9	8.9	12.0	17.5
ESOP Compensation Cost	247	0	0	0
Other Income	394	485	466	469
Interest	1	1	1	1
PBT	5,582	6,403	7,092	8,254
Tax (incl deferred)	1,411	1,411	1,560	1,888
Extraordinary Items	0	0	0	0
RPAT	4,171	4,993	5,532	6,366
RPAT Growth (%)	6.1	19.7	10.8	15.1
EPS (Rs)	13.7	16.4	18.2	20.9
EPS Growth (%)	6.1	19.8	10.7	15.1

Balance Sheet

Y/E March (Rs mn)	CY16	CY17	CY18E	CY19E
SOURCES OF FUNDS				
Share Capital - Equity	604	594	594	594
Reserves	16,805	19,479	22,819	26,627
Total Shareholders' Funds	17,409	20,073	23,412	27,221
Long Term Provisions & Others	299	211	211	211
Creditors	1,959	2,204	2,458	2,741
Other Current Liabilities & Provns	3,443	2,966	3,046	3,136
Total Current Liabilities	5,401	5,170	5,505	5,877
TOTAL SOURCES	23,110	25,453	29,127	33,308
APPLICATION OF FUNDS				
Net Block	2,791	3,580	3,997	4,270
CWIP	3,233	2,563	2,563	2,563
Goodwill and Other Intangibles	1,996	1,833	1,833	1,833
Investments	22	24	24	24
LT Loans & Advances	1,483	1,582	1,582	1,582
Deferred Tax Assets	1,252	1,336	1,336	1,336
Total Non Current Assets	10,777	10,918	11,335	11,608
Debtors	4,376	5,360	6,023	6,763
Cash & Bank	4,126	5,147	7,374	10,103
Liquid Investments	189	189	189	189
Other Current Assets	3,642	3,838	4,207	4,645
Total Current Assets	12,333	14,535	17,793	21,700
TOTAL APPLICATION	23,110	25,453	29,127	33,308

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Cash Flow Statement

Y/E March (Rs mn)	CY16	CY17	CY18E	CY19E
PAT	4,171	4,995	5,532	6,366
Depreciation	558	633	683	714
Working Capital Change	(755)	(1,413)	(696)	(806)
OPERATING CASH FLOW (a)	3,975	4,215	5,518	6,274
Capex	(1,364)	(752)	(1,099)	(987)
Investments	1,505	(1)	0	0
INVESTING CASH FLOW (b)	142	(753)	(1,099)	(987)
Debt Issuance	(1)	0	0	0
Share capital Issuance	31	(1,366)	0	0
Dividend	(3,172)	(1,827)	(2,192)	(2,557)
FINANCING CASH FLOW (c)	(3,142)	(3,193)	(2,192)	(2,557)
NET CASH FLOW (a+b+c)	974	270	2,227	2,729
Non-operating and EO items	(712)	751	0	0
Closing Cash & Equivalents	4,126	5,147	7,374	10,103
Free Cash Flow	2,611	3,463	4,419	5,286

Key Ratios

Y/E March (Rs mn)	CY16	CY17	CY18E	CY19E
Valuation Ratio (x)				
Profitability (%)				
EBITDA Margin	17.0	16.6	16.6	17.2
APAT Margin	11.8	12.7	12.6	12.9
RoE	26.3	26.7	25.4	25.1
RoIC or Core RoCE	23.5	24.9	25.9	28.0
RoCE	25.6	24.6	23.8	23.7
Efficiency				
Tax Rate (%)	25.3	22.0	22.0	22.9
Fixed Asset Turnover (x)	5.9	5.3	5.2	5.2
Debtors (days)	45	50	50	50
Payables (days)	24	24	24	24
Cash Conversion Cycle (days)	21	25	26	26
Net Debt/EBITDA (x)	(0.7)	(0.8)	(1.0)	(1.2)
Net Debt/Equity (x)	(0.2)	(0.3)	(0.3)	(0.4)
Interest Coverage (x)	3,866	4,974	7,531	8,848
Per Share Data (Rs)				
EPS	13.7	16.4	18.2	20.9
CEPS	15.7	18.6	20.6	23.5
DPS	5.5	5.0	6.1	7.1
BV	57.7	66.5	77.6	90.2
Valuation (x)				
P/E	25.9	21.7	19.6	17.0
P/BV	6.2	5.3	4.6	3.9
EV/EBITDA	17.2	15.6	13.6	11.4
OCF/EV (%)	3.9	4.1	5.5	6.5
FCF/EV (%)	2.5	3.4	4.4	5.5
FCFE/mkt cap (%)	3.7	3.9	5.2	5.9
Dividend Yield (%)	1.5	1.4	1.7	2.0

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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