

**ADD**  
TP: Rs 410 | ▲ 12%

**HEXWARE  
TECHNOLOGIES**

| IT Services

| 24 October 2019

### In-line operating show; near-term outlook cloudy

**Hexaware (HEXW) reported in-line dollar revenue growth of 11.7% QoQ and EBIT margins of 13.9% in Q3CY19. Inorganic revenues boosted the topline, offsetting revenue headwinds (200bps) from a top client. BFSI commentary turned cautious, and management expects more pronounced furloughs in the Dec'19 quarter. CY19 revenue guidance has been pruned and now implies a wide 1.6-8% QoQ growth band for Q4, highlighting the uncertain outlook. We broadly retain estimates and restate ADD, rolling to a Sep'20 TP of 410 (from Rs 390).**

Ruchi Burde

research@bobcaps.in

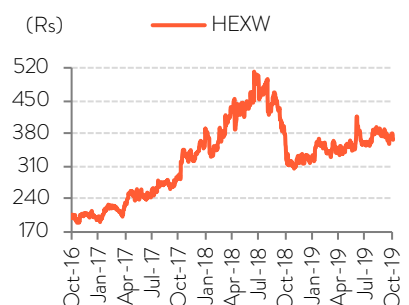
**Operating performance meets estimates:** HEXW reported 11.7% QoQ dollar revenue growth and 13.9% EBIT margins (-80bps QoQ) in the Sep'19 quarter. Revenue growth was boosted by the consolidation of Mobiquity – though management did not disclose inorganic revenues, per our estimate these yielded growth tailwinds of ~750bps. Net profit at Rs 1.8bn (+21.5% QoQ, +6.6% YoY) was ahead of estimates on higher forex gains and lower taxes.

Ticker/Price	HEXW IN/Rs 366
Market cap	US\$ 1.6bn
Shares o/s	302mn
3M ADV	US\$ 4.9mn
52wk high/low	Rs 456/Rs 294
Promoter/FPI/DII	71%/15%/14%

Source: NSE

**CY19 outlook cut for second consecutive quarter:** Management lowered its CY19 revenue growth guidance to 17-18% YoY from 19% earlier to factor in bigger challenges than estimated at a large secondary-mortgage industry client and also a deeper impact from furloughs. We highlight that the revised guidance implies a wide range of sequential growth at 1.6-8% for the Dec'19 quarter, underscoring the uncertain outlook.

### STOCK PERFORMANCE



Source: NSE

**BFSI commentary turns negative:** Management cautioned that broad-based weakness in the BFSI vertical is weighing on the performance of HEXW as well as Mobiquity – this marks yet another downshift in commentary from an optimistic view last quarter.

### KEY FINANCIALS

Y/E 31 Dec	CY17A	CY18A	CY19E	CY20E	CY21E
Total revenue (Rs mn)	39,419	46,477	55,640	64,043	71,496
EBITDA (Rs mn)	6,553	7,335	8,722	9,741	11,064
Adj. net profit (Rs mn)	4,993	5,833	6,755	7,126	8,079
Adj. EPS (Rs)	16.6	19.3	22.3	23.6	26.7
Adj. EPS growth (%)	21.1	16.6	15.5	5.5	13.4
Adj. ROAE (%)	26.9	26.5	25.7	22.9	22.2
Adj. P/E (x)	22.1	18.9	16.4	15.5	13.7
EV/EBITDA (x)	16.2	14.4	11.8	10.1	8.5

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

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**FIG 1 – SEP'19 QUARTER PERFORMANCE**

(Rs mn)	Q1CY18	Q2CY18	Q3CY18	Q4CY18	Q1CY19	Q2CY19	Q3CY19	YoY (%)	QoQ (%)	9MCY18	9MCY19	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>162</b>	<b>168</b>	<b>171</b>	<b>176</b>	<b>180</b>	<b>189</b>	<b>211</b>	<b>23.0</b>	<b>11.7</b>	<b>502</b>	<b>579</b>	<b>15.4</b>
<b>Revenue</b>	<b>10,490</b>	<b>11,367</b>	<b>12,096</b>	<b>12,524</b>	<b>12,640</b>	<b>13,083</b>	<b>14,813</b>	<b>22.5</b>	<b>13.2</b>	<b>33,953</b>	<b>40,536</b>	<b>19.4</b>
Operating expenditure	8,864	9,594	10,073	10,611	10,753	10,966	12,436	23.5	13.4	28,531	34,155	19.7
Cost of revenues	6,949	7,659	8,038	8,476	8,781	8,808	9,750	21.3	10.7	22,646	27,339	20.7
as % of sales	66.2	67.4	66.5	67.7	69.5	67.3	65.8	-	-	66.7	67.4	-
SG&A expenses	1,915	1,935	2,035	2,135	1,972	2,158	2,686	32.0	24.5	5,885	6,816	15.8
as % of sales	18.3	17.0	16.8	17.0	15.6	16.5	18.1	-	-	17.3	16.8	-
<b>EBITDA</b>	<b>1,626</b>	<b>1,773</b>	<b>2,023</b>	<b>1,913</b>	<b>1,887</b>	<b>2,117</b>	<b>2,377</b>	<b>17.5</b>	<b>12.3</b>	<b>5,422</b>	<b>6,381</b>	<b>17.7</b>
Depreciation	151	182	159	158	148	205	324	-	-	492	677	37.7
<b>EBIT</b>	<b>1,475</b>	<b>1,591</b>	<b>1,864</b>	<b>1,755</b>	<b>1,739</b>	<b>1,912</b>	<b>2,053</b>	<b>10.1</b>	<b>7.4</b>	<b>4,930</b>	<b>5,704</b>	<b>15.7</b>
Other Income	204	327	264	(215)	(42)	99	171	-	-	795	228	(71.4)
<b>PBT</b>	<b>1,679</b>	<b>1,918</b>	<b>2,128</b>	<b>1,540</b>	<b>1,697</b>	<b>2,011</b>	<b>2,223</b>	<b>4.5</b>	<b>10.6</b>	<b>5,725</b>	<b>5,931</b>	<b>3.6</b>
Total Tax	336	384	406	306	312	329	387	-	-	1,126	1,028	(8.7)
Adjusted PAT	1,343	1,534	1,722	1,234	1,385	1,682	1,836	6.6	9.2	4,599	4,903	6.6
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0	0	0	-	-	0	0	-
APAT after MI	1,343	1,534	1,722	1,234	1,385	1,682	1,836	6.6	9.2	4,599	4,903	6.6
Extraordinary items	0	0	0	0	0	(170)	0	-	-	0	(170)	-
<b>Reported PAT</b>	<b>1,343</b>	<b>1,534</b>	<b>1,722</b>	<b>1,234</b>	<b>1,385</b>	<b>1,512</b>	<b>1,836</b>	<b>6.6</b>	<b>21.5</b>	<b>4,599</b>	<b>4,733</b>	<b>2.9</b>
Reported EPS	4.5	5.1	5.7	4.1	4.6	4.4	6.1	6.2	36.8	15	15	(1.2)
<b>Margins (%)</b>								<b>(bps)</b>	<b>(bps)</b>			<b>(bps)</b>
EBITDA	15.5	15.6	16.7	15.3	14.9	16.2	16.0	(70)	(10)	16.0	15.7	(23)
EBIT	14.1	14.0	15.4	14.0	13.8	14.6	13.9	(160)	(80)	14.5	14.1	(45)
EBT	16.0	16.9	17.6	12.3	13.4	15.4	15.0	(260)	(40)	16.9	14.6	(223)
PAT	12.8	13.5	14.2	9.9	11.0	12.9	12.4	(180)	(50)	13.5	12.1	(145)
Effective Tax Rate	20.0	20.0	19.1	19.9	18.4	16.4	17.4	(370)	(200)	19.7	17.3	(234)

Source: Company, BOBCAPS Research

**FIG 2 – SEP'19 QUARTER OPERATING METRICS**

Particulars	Q3CY19 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Vertical</b>			
BFSI	38.6	8.3	11.7
TTHL	10.1	11.7	18.3
Healthcare and Insurance	19.3	12.3	26.3
Manufacturing and Consumers	17.1	19.3	41.2
Professional Services	14.9	11.7	37.8
<b>Revenue by Service Line</b>			
ADM	41.8	26.2	42.8
EAS	9.2	9.3	16.7
Digital Assurance	15.7	(0.9)	9.1
Business Intelligence & Analytics	10.9	(1.0)	(7.5)
BPO	8.2	14.5	36.3
IMS	14.2	1.6	18.8

Particulars	Q3CY19 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Geography</b>			
US	75.4	9.6	19.8
Europe	16.6	32.4	53.6
ROW	8.0	(2.9)	5.8
<b>Onsite-Offshore Revenue Mix</b>			
Onsite	62.7	10.9	17.8
Offshore	37.3	12.3	29.6
<b>Client Concentration</b>			
Top 5 clients	35.2	5.4	2.9
Top 10 clients	44.4	6.9	4.6
Non-Top 10 clients	55.6	15.8	43.1
Total Headcount (nos.)	19,062	4	19

Source: Company, BOBCAPS Research

## Valuation methodology

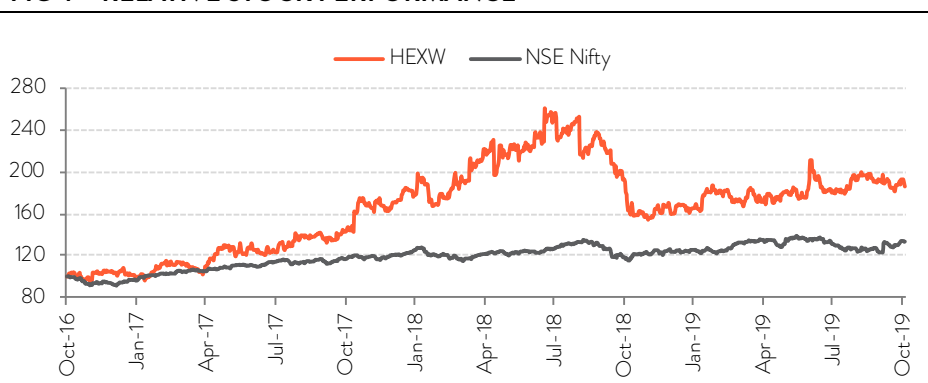
We raise CY19 earnings estimates by 3.6% on higher forex gains and lower taxes. Our CY20/CY21 EPS estimates remain largely unchanged. On rolling valuations forward, we move to a revised Sep'20 target price of Rs 410 (from Rs 390), based on an unchanged one-year forward P/E of 15.5x. Retain ADD. We see a risk of single-digit organic growth in CY20 if client-specific challenges were to amplify. We prefer L&T Infotech, NIIT Tech and Mphasis in the mid-cap IT services space.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	CY19E			CY20E			CY21E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	800	795	(0.6)	907	915	0.9	1011	1021	1.0
YoY growth (%)	18.0	17.3	-	13.4	15.1	-	11.5	11.6	-
Revenues	55,486	55,640	0.3	63,470	64,043	0.9	70,772	71,496	1.0
EBITDA	8,465	8,722	3.0	9,803	9,741	(0.6)	11,114	11,064	(0.4)
EBITDA margins (%)	15.3	15.7	-	15.4	15.2	-	15.7	15.5	-
Net profits	6,521	6,755	3.6	7,160	7,126	(0.5)	8,079	8,079	0.0
EPS (Rs)	21.6	22.3	3.6	23.7	23.6	(0.5)	26.7	26.7	0.0

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Downside risks to our estimates include:

- sharp adverse currency movements, and
- an inability to replicate success in newly launched services.

## FINANCIALS

### Income Statement

Y/E 31 Dec (Rs mn)	CY17A	CY18A	CY19E	CY20E	CY21E
<b>Total revenue</b>	<b>39,419</b>	<b>46,477</b>	<b>55,640</b>	<b>64,043</b>	<b>71,496</b>
EBITDA	6,553	7,335	8,722	9,741	11,064
Depreciation	633	650	1,020	1,477	1,607
EBIT	5,920	6,685	7,702	8,264	9,458
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	484	580	331	426	395
Exceptional items	0	0	(170)	0	0
EBT	6,404	7,265	8,203	8,690	9,852
Income taxes	1,411	1,432	1,448	1,564	1,774
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>4,993</b>	<b>5,833</b>	<b>6,755</b>	<b>7,126</b>	<b>8,079</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>4,993</b>	<b>5,833</b>	<b>6,755</b>	<b>7,126</b>	<b>8,079</b>

### Balance Sheet

Y/E 31 Dec (Rs mn)	CY17A	CY18A	CY19E	CY20E	CY21E
Accounts payables	0	0	0	0	0
Other current liabilities	4,463	6,425	6,098	7,018	7,835
Provisions	887	916	3,811	4,387	4,897
Debt funds	0	0	0	0	0
Other liabilities	31	76	76	76	76
Equity capital	594	595	595	595	595
Reserves & surplus	19,479	23,324	28,052	33,040	38,696
Shareholders' fund	20,074	23,919	28,647	33,635	39,290
<b>Total liabilities and equities</b>	<b>25,454</b>	<b>31,335</b>	<b>38,631</b>	<b>45,116</b>	<b>52,098</b>
Cash and cash eq.	5,298	8,205	12,706	17,071	22,323
Accounts receivables	5,360	8,031	7,317	8,422	9,402
Inventories	0	0	0	0	0
Other current assets	5,269	5,201	7,927	9,124	10,186
Investments	213	127	127	127	127
Net fixed assets	7,977	7,986	8,226	8,044	7,733
CWIP	2,563	2,244	2,244	2,244	2,244
Intangible assets	1,656	1,809	1,809	1,809	1,809
Deferred tax assets, net	1,336	1,784	1,784	1,784	1,784
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>25,453</b>	<b>31,335</b>	<b>38,088</b>	<b>44,572</b>	<b>51,555</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Dec (Rs mn)	CY17A	CY18A	CY19E	CY20E	CY21E
Net income + Depreciation	5,291	6,483	7,775	8,603	9,686
Interest expenses	(8)	(580)	(331)	(426)	(395)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(901)	(612)	557	(806)	(715)
Other operating cash flows	380	0	0	0	0
<b>Cash flow from operations</b>	<b>4,763</b>	<b>5,292</b>	<b>8,001</b>	<b>7,371</b>	<b>8,576</b>
Capital expenditures	(957)	(652)	(1,260)	(1,295)	(1,295)
Change in investments	(1)	0	0	0	0
Other investing cash flows	12	580	331	426	395
<b>Cash flow from investing</b>	<b>(946)</b>	<b>(72)</b>	<b>(930)</b>	<b>(869)</b>	<b>(900)</b>
Equities issued/Others	12	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(1,380)	0	0	0	0
Dividends paid	(1,428)	(2,855)	(2,026)	(2,138)	(2,424)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(2,796)</b>	<b>(2,855)</b>	<b>(2,026)</b>	<b>(2,138)</b>	<b>(2,424)</b>
<b>Changes in cash and cash eq.</b>	<b>1,021</b>	<b>2,364</b>	<b>5,045</b>	<b>4,364</b>	<b>5,252</b>
<b>Closing cash and cash eq.</b>	<b>5,297</b>	<b>7,662</b>	<b>12,706</b>	<b>17,071</b>	<b>22,323</b>

### Per Share

Y/E 31 Dec (Rs)	CY17A	CY18A	CY19E	CY20E	CY21E
Reported EPS	16.6	19.3	22.3	23.6	26.7
Adjusted EPS	16.6	19.3	22.3	23.6	26.7
Dividend per share	3.9	8.0	5.6	5.9	6.7
Book value per share	66.6	79.3	94.7	111.2	129.9

### Valuations Ratios

Y/E 31 Dec (x)	CY17A	CY18A	CY19E	CY20E	CY21E
EV/Sales	2.7	2.3	1.9	1.5	1.3
EV/EBITDA	16.2	14.4	11.8	10.1	8.5
Adjusted P/E	22.1	18.9	16.4	15.5	13.7
P/BV	5.5	4.6	3.9	3.3	2.8

### DuPont Analysis

Y/E 31 Dec (%)	CY17A	CY18A	CY19E	CY20E	CY21E
Tax burden (Net profit/PBT)	78.0	80.3	82.3	82.0	82.0
Interest burden (PBT/EBIT)	108.2	108.7	106.5	105.2	104.2
EBIT margin (EBIT/Revenue)	15.0	14.4	13.8	12.9	13.2
Asset turnover (Revenue/Avg TA)	161.3	163.7	160.3	155.0	148.8
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.3	1.3
Adjusted ROAE	26.9	26.5	25.7	22.9	22.2

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Dec	CY17A	CY18A	CY19E	CY20E	CY21E
<b>YoY growth (%)</b>					
Revenue	11.5	17.9	19.7	15.1	11.6
EBITDA	14.0	11.9	18.9	11.7	13.6
Adjusted EPS	21.1	16.6	15.5	5.5	13.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.6	15.8	15.7	15.2	15.5
EBIT margin	15.0	14.4	13.8	12.9	13.2
Adjusted profit margin	12.7	12.6	12.1	11.1	11.3
Adjusted ROAE	26.9	26.5	25.7	22.9	22.2
ROCE	33.4	35.1	39.9	41.5	46.0
<b>Working capital days (days)</b>					
Receivables	45	53	50	45	45
Inventory	0	0	0	0	0
Payables	50	51	49	44	45
<b>Ratios (x)</b>					
Gross asset turnover	4.8	5.8	6.9	7.9	9.1
Current ratio	3.0	2.9	2.8	3.0	3.3
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.3)	(0.4)	(0.5)	(0.6)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

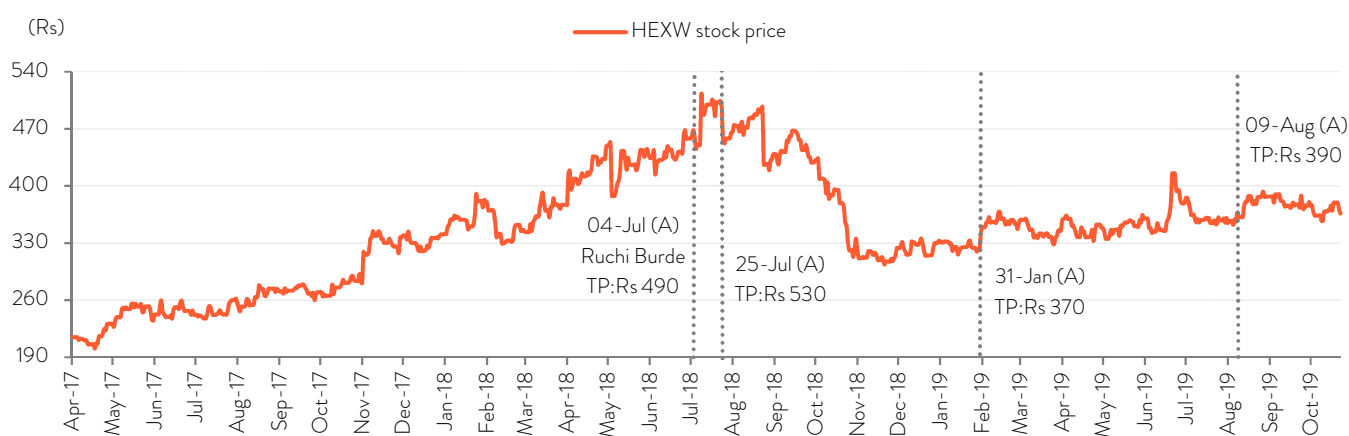
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### HISTORICAL RATINGS AND TARGET PRICE: HEXAWARE TECHNOLOGIES (HEXW IN)



B – Buy, A – Add, R – Reduce, S – Sell

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