

BUY

TP: Rs 440 | ▲ 17%

**HEXWARE
TECHNOLOGIES**

| IT Services

| 11 February 2020

Client-specific challenges receding; upgrade to BUY

An above-expected furlough impact and challenges at a large secondary-mortgage client marred revenue performance in Q4CY19. Dollar revenue growth at 1.8% QoQ fell short of our estimate of 3.1%, though EBITDA margins at 15.7% were a shade higher. Management expects client-specific challenges to abate, underpinning guidance for 15-17% YoY growth in CY20. We raise CY20/CY21 EPS slightly and roll forward to a Mar'21 TP of Rs 440 (vs. Rs 410). Upgrade to BUY (from ADD) on receding client overhang.

Ruchi Burde

research@bobcaps.in

Revenue miss but slight beat on margins: The dual impact of above-expected furloughs and sharp revenue decline in a large BFSI account led to subdued dollar revenue growth of 1.8% QoQ for HEXW vs. 3.1% expected in Q3. Notably, dollar revenue from the top 6-10 and non-top 10 clients increased by 10.7% and 3.6% QoQ respectively. EBITDA margins at 15.7% were slightly better than estimates on higher ESOP cost reversal (adjustment as RSU 2014 programme came to an end).

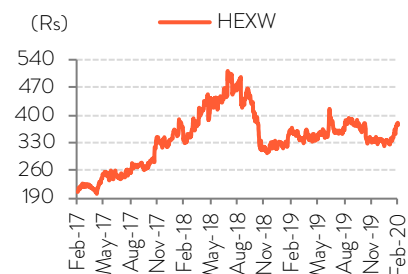
Guidance upbeat as client headwinds expected to abate: Management has guided for 15-17% YoY revenue growth in CY20 despite lingering revenue headwinds (~300bps) from its large BFSI client. HEXW expects this account to stabilise or improve, aiding a strong growth rebound for the company from Q2CY20.

Upgrade to BUY: We upgrade our rating from ADD to BUY on strong growth momentum outside the top 5 clients and management guidance of easing client-specific challenges. On raising CY20/CY21 EPS estimates marginally and rolling valuations over, we move to a new Mar'21 TP of Rs 440 (from Rs 410), set at an unchanged target P/E of 15.5x.

Ticker/Price	HEXW IN/Rs 375
Market cap	US\$ 1.6bn
Shares o/s	302mn
3M ADV	US\$ 2.3mn
52wk high/low	Rs 456/Rs 320
Promoter/FPI/DII	71%/15%/14%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Dec	CY18A	CY19E	CY20E	CY21E	CY22E
Total revenue (Rs mn)	46,477	55,825	64,484	72,754	81,763
EBITDA (Rs mn)	7,335	8,778	9,811	11,259	12,650
Adj. net profit (Rs mn)	5,833	6,748	7,136	8,214	8,815
Adj. EPS (Rs)	19.3	22.3	23.6	27.2	29.1
Adj. EPS growth (%)	16.6	15.4	5.7	15.1	7.3
Adj. ROAE (%)	26.5	25.7	22.9	22.5	20.8
Adj. P/E (x)	19.4	16.8	15.9	13.8	12.9
EV/EBITDA (x)	14.8	12.2	10.5	8.7	7.4

Source: Company, BOBCAPS Research

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FIG 1 – DEC'19 QUARTER PERFORMANCE

(Rs mn)	Q4CY19	Q4CY18	YoY (%)	Q3CY19	QoQ (%)	CY19	CY18	YoY (%)
Revenues (US\$ mn)	214	176	21.7	211	1.8	793	678	17.1
Revenue	15,288	12,524	22.1	14,813	3.2	55,825	46,477	20.1
Operating Expenditure	12,891	10,611	21.5	12,436	3.7	47,047	39,142	20.2
Cost of revenues	10,234	8,476	20.7	9,750	5.0	37,572	31,122	20.7
as % of sales	66.9	67.7	-	65.8	-	67.3	67.0	-
SG&A expenses	2,658	2,135	24.5	2,686	(1.1)	9,474	8,020	18.1
as % of sales	17.4	17.0	-	18.1	-	17.0	17.3	-
EBITDA	2,397	1,913	25.3	2,377	0.8	8,778	7,335	19.7
Depreciation	356	158	-	324	-	1,033	650	58.9
EBIT	2,041	1,755	16.3	2,053	(0.6)	7,745	6,685	15.9
Other Income	(16)	(215)	-	171	-	212	580	(63.5)
PBT	2,026	1,540	31.5	2,223	(8.9)	7,957	7,265	9.5
Total Tax	351	306	-	387	-	1,379	1,432	(3.7)
Adjusted PAT	1,675	1,234	35.7	1,836	(8.8)	6,578	5,833	12.8
(Profit)/loss from JV's/Ass/MI	0	0	-	0	-	0	0	-
APAT after MI	1,675	1,234	35.7	1,836	(8.8)	6,578	5,833	12.8
Extra ordinary items	0	0	-	0	-	(170)	0	-
Reported PAT	1,675	1,234	35.7	1,836	(8.8)	6,408	5,833	9.9
Reported EPS	5.5	4.1	35.6	6.1	(8.7)	21	19	6.6
Margins (%)			(bps)		(bps)			(bps)
EBITDA	15.7	15.3	40	16.0	(40)	15.7	15.8	(10)
EBIT	13.4	14.0	(70)	13.9	(50)	13.9	14.4	(50)
EBT	13.2	12.3	100	15.0	(180)	14.3	15.6	(140)
PAT	11.0	9.9	110	12.4	(140)	11.8	12.6	(80)
Effective Tax rate	17.3	19.9	(260)	17.4	(10)	17.3	19.7	(240)

Source: Company, BOBCAPS Research

FIG 2 – DEC'19 QUARTER OPERATING METRICS

(In dollar terms)	Q4CY19 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Net new deal wins (US\$ mn)	30	7.1	(7.4)
Revenue by Vertical			
BFSI	35.5	(6.4)	2.6
TTHL	10.3	3.8	26.6
Healthcare and Insurance	21.0	10.8	33.8
Manufacturing and Consumers	18.2	8.4	45.7
Professional Services	15.0	2.5	32.3
Revenue by Service Line			
ADM	40.4	(1.6)	40.1
EAS	9.2	1.8	17.8
Digital Assurance	15.6	1.2	8.5
Business Intelligence & Analytics	10.6	(1.0)	(1.5)
BPO	8.4	4.3	40.0
IMS	15.8	13.3	9.9
Revenue by Geography			
US	74.4	0.5	17.7
Europe	17.5	7.3	63.8
ROW	8.1	3.1	(2.4)
Revenue Mix - Onsite-Offshore			
Onsite	60.4	(2.1)	13.7
Offshore	39.6	7.8	31.9
Client Concentration			
Top 5 clients	33.4	(3.4)	(3.2)
Top 10 clients	43.4	(0.5)	2.4
Non-Top 10 client revenues	56.6	3.6	42.3
Total Headcount	19,999	5	23

Source: Company, BOBCAPS Research

Management commented that CY19 deal wins reported healthy growth (ex-US\$ 100mn deal won in Q4CY18 but called off in Q2CY19)

Loss of revenue from large BFSI account has silver lining in terms of improved onsite-offshore mix, reduced client concentration and gradual margin improvement

Performance outside top 5 clients was healthy. Dollar revenue from top 6-10/ non-top 10 clients increased by 10.7%/3.6% QoQ

Valuation methodology

We upgrade our rating on HEXW from ADD to BUY considering strong growth momentum outside the top 5 clients (dollar revenue from the top 6-10 and non-top 10 clients increased by 10.7% and 3.6% QoQ respectively in Q4CY19) and management guidance of easing client-specific challenges.

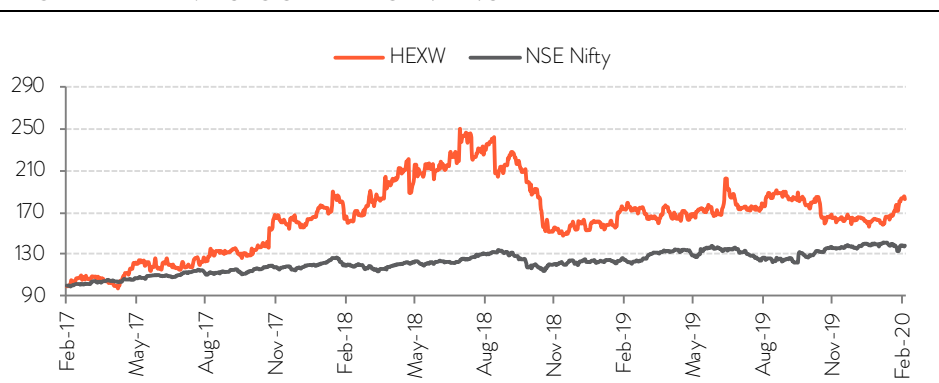
On raising CY20/CY21 EPS estimates slightly and rolling valuations forward, we arrive at a new Mar'21 target price of Rs 440 (from Rs 410), set at an unchanged target P/E of 15.5x. We further introduce CY22 EPS at Rs 29.1, baking in 12.4% dollar revenue growth and 15.5% EBITDA margins.

FIG 3 – REVISED ESTIMATES

(Rs mn)	CY20E			CY21E			CY22E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	915	921	0.7	1,021	1,039	1.8	1,168
YoY growth (%)	15.1	16.1	-	11.6	12.8	-	12.4
Revenues	64,043	64,484	0.7	71,496	72,754	1.8	81,763
EBITDA	9,741	9,811	0.7	11,064	11,259	1.8	12,650
EBITDA margins (%)	15.2	15.2	-	15.5	15.5	-	15.5
Net profits	7,126	7,136	0.1	8,079	8,214	1.7	8,815
EPS (Rs)	23.6	23.6	0.1	26.7	27.2	1.7	29.1

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates include:

- sharp adverse currency movements,
- loss of revenue due to the coronavirus outbreak, and
- an inability to replicate success in newly launched services.

FINANCIALS

Income Statement

Y/E 31 Dec (Rs mn)	CY18A	CY19E	CY20E	CY21E	CY22E
Total revenue	46,477	55,825	64,484	72,754	81,763
EBITDA	7,335	8,778	9,811	11,259	12,650
Depreciation	650	1,033	1,478	1,607	1,737
EBIT	6,685	7,745	8,333	9,652	10,913
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	580	212	531	552	37
Exceptional items	0	(170)	0	0	0
EBT	7,265	8,127	8,864	10,203	10,950
Income taxes	1,432	1,379	1,729	1,990	2,135
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	5,833	6,748	7,136	8,214	8,815
Adjustments	0	0	0	0	0
Adjusted net profit	5,833	6,748	7,136	8,214	8,815

Balance Sheet

Y/E 31 Dec (Rs mn)	CY18A	CY19E	CY20E	CY21E	CY22E
Accounts payables	0	0	0	0	0
Other current liabilities	6,425	6,118	7,067	7,973	8,960
Provisions	916	3,824	4,417	4,983	5,600
Debt funds	0	0	0	0	0
Other liabilities	76	76	76	76	76
Equity capital	595	595	595	595	595
Reserves & surplus	23,324	28,048	33,043	38,792	44,963
Shareholders' fund	23,919	28,643	33,637	39,387	45,557
Total liabilities and equities	31,335	38,660	45,196	52,419	60,194
Cash and cash eq.	8,205	13,234	17,581	22,850	28,598
Accounts receivables	8,031	7,341	8,480	9,568	10,752
Inventories	0	0	0	0	0
Other current assets	5,201	7,953	9,187	10,365	11,648
Investments	127	127	127	127	127
Net fixed assets	7,986	8,220	8,037	7,725	7,283
CWIP	2,244	2,244	2,244	2,244	2,244
Intangible assets	1,809	1,809	1,809	1,809	1,809
Deferred tax assets, net	1,784	1,784	1,784	1,784	1,784
Other assets	0	0	0	0	0
Total assets	31,335	38,659	45,196	52,418	60,193

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Dec (Rs mn)	CY18A	CY19E	CY20E	CY21E	CY22E
Net income + Depreciation	6,325	7,781	8,613	9,821	10,552
Interest expenses	(53)	(212)	(531)	(552)	(37)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,166)	539	(830)	(793)	(864)
Other operating cash flows	382	0	0	0	0
Cash flow from operations	5,487	8,109	7,252	8,476	9,651
Capital expenditures	(606)	(1,267)	(1,295)	(1,295)	(1,295)
Change in investments	88	0	0	0	0
Other investing cash flows	590	212	531	552	37
Cash flow from investing	72	(1,055)	(764)	(743)	(1,258)
Equities issued/Others	4	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(2,506)	(2,025)	(2,141)	(2,464)	(2,645)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,502)	(2,025)	(2,141)	(2,464)	(2,645)
Changes in cash and cash eq.	3,057	5,029	4,347	5,269	5,748
Closing cash and cash eq.	8,205	13,234	17,581	22,850	28,598

Per Share

Y/E 31 Dec (Rs)	CY18A	CY19E	CY20E	CY21E	CY22E
Reported EPS	19.3	22.3	23.6	27.2	29.1
Adjusted EPS	19.3	22.3	23.6	27.2	29.1
Dividend per share	8.0	5.6	5.9	6.8	7.3
Book value per share	79.3	94.7	111.2	130.2	150.6

Valuations Ratios

Y/E 31 Dec (x)	CY18A	CY19E	CY20E	CY21E	CY22E
EV/Sales	2.3	1.9	1.6	1.3	1.1
EV/EBITDA	14.8	12.2	10.5	8.7	7.4
Adjusted P/E	19.4	16.8	15.9	13.8	12.9
P/BV	4.7	4.0	3.4	2.9	2.5

DuPont Analysis

Y/E 31 Dec (%)	CY18A	CY19E	CY20E	CY21E	CY22E
Tax burden (Net profit/PBT)	80.3	83.0	80.5	80.5	80.5
Interest burden (PBT/EBIT)	108.7	104.9	106.4	105.7	100.3
EBIT margin (EBIT/Revenue)	14.4	13.9	12.9	13.3	13.3
Asset turnover (Revenue/Avg TA)	163.7	159.5	153.8	149.1	145.2
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.3	1.3
Adjusted ROAE	26.5	25.7	22.9	22.5	20.8

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

Ratio Analysis

Y/E 31 Dec	CY18A	CY19E	CY20E	CY21E	CY22E
YoY growth (%)					
Revenue	17.9	20.1	15.5	12.8	12.4
EBITDA	11.9	19.7	11.8	14.8	12.4
Adjusted EPS	16.6	15.4	5.7	15.1	7.3
Profitability & Return ratios (%)					
EBITDA margin	15.8	15.7	15.2	15.5	15.5
EBIT margin	14.4	13.9	12.9	13.3	13.3
Adjusted profit margin	12.6	12.1	11.1	11.3	10.8
Adjusted ROAE	26.5	25.7	22.9	22.5	20.8
ROCE	35.1	41.1	42.4	47.5	52.2
Working capital days (days)					
Receivables	53	50	45	45	45
Inventory	0	0	0	0	0
Payables	51	49	44	45	45
Ratios (x)					
Gross asset turnover	5.8	6.9	7.9	9.2	10.9
Current ratio	2.9	2.9	3.1	3.3	3.5
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.5)	(0.5)	(0.6)	(0.6)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

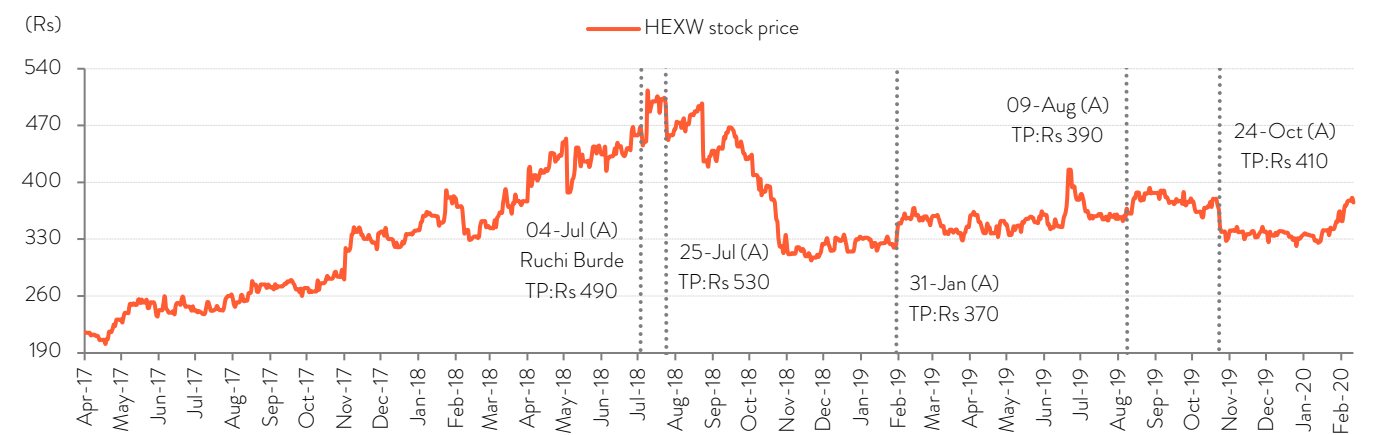
ADD – Expected return from >+5% to +15%

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: HEXWARE TECHNOLOGIES (HEXW IN)



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

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