

**ADD**  
TP: Rs 410 | ▲ 9%

**HEXWARE  
TECHNOLOGIES**

| IT Services

| 28 July 2020

## Results outperform of estimates

Hexaware (HEXW) reported a resilient Q2CY20 with a dollar revenue decline of just 1.4% QoQ. Traction in the BFSI and healthcare verticals offset the drop in travel and hospitality. EBIT margin at 13.2% was up 140bps QoQ due to higher gross margins and a 330bps rise in utilisation. TCV was healthy at US\$ 46mn, rising 28% YoY. We raise CY21/CY22 EPS by ~11% each and roll over to a Jun'21 TP of Rs 410 (from Rs 350), based on an unchanged 15x P/E. Near-term stock movement hinges on the delisting outcome. Retain ADD.

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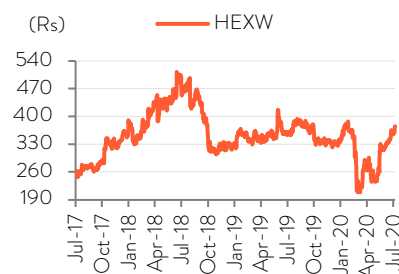
**Resilient performance:** Dollar revenue declined 1.4% QoQ, far better than the 6.7% drop estimated. Higher volumes partially mitigated headwinds from lower billing rates, supply challenges, adverse currency movement and onsite/offshore mix change. BFSI's strong performance continued from Q1CY20. EBIT margin at 13.2% was well above our (10.5%) and street estimates, expanding 140bps QoQ, supported largely by gross margin expansion (+220bps QoQ).

Ticker/Price	HEXW IN/Rs 375
Market cap	US\$ 1.5bn
Shares o/s	302mn
3M ADV	US\$ 4.8mn
52wk high/low	Rs 399/Rs 202
Promoter/FPI/DII	71%/15%/14%

Source: NSE

**Healthy deal wins – trend similar to peers:** As with other IT peers, deal win TCV was a positive surprise at US\$ 46mn (+28% YoY), albeit down 33% sequentially. Management stated that the contract wins represented market share gains from other significant players as technology budget hikes were rare in the pandemic-hit Jun'20 quarter. Customer service transformation and cloud migration are emerging areas of demand.

## STOCK PERFORMANCE



Source: NSE

**Recovery in sight in H2CY20:** Management believes Q2 marks a bottom in the current pandemic crisis and expects flat-to-positive volume growth going into Q3CY20. In addition, HEXW expects sequential growth in one of its top 3 clients where revenues have been soft for the past three quarters. Near-term EBIT margins are guided to be in the narrow range of 12.2-12.6%, close to H1CY20 margins of 12.5%.

## KEY FINANCIALS

Y/E 31 Dec	CY18A	CY19A	CY20E	CY21E	CY22E
Total revenue (Rs mn)	46,477	55,825	63,412	71,233	79,775
EBITDA (Rs mn)	7,335	8,778	10,540	11,946	13,379
Adj. net profit (Rs mn)	5,833	6,748	6,762	7,387	8,528
Adj. EPS (Rs)	19.3	22.3	22.4	24.4	28.2
Adj. EPS growth (%)	16.6	15.4	0.2	9.2	15.4
Adj. ROAE (%)	26.5	26.2	22.5	21.1	21.0
Adj. P/E (x)	19.4	16.8	16.8	15.4	13.3
EV/EBITDA (x)	14.8	12.2	10.3	9.1	7.7

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



## Other highlights

- The travel, transportation and hospitality vertical declined sharply by 27% QoQ, USD, in Q2CY20. Manufacturing was weak too. BFSI/health & insurance grew 3.1%/3.5% QoQ.
- Among services, business intelligence and analytics grew by a stellar 9% QoQ. ADM saw a 5.8% decline as discretionary spends dried up. Weakness in BPO persisted with a sequential decline of 10.7%, primarily due to supply-side issues.
- Headcount dropped by 1,173 employees QoQ, largely in the BPO segment. On-boarding of new batches was also halted. Utilisation increased 330bps QoQ as new deals ramped up and employee headcount declined. Management stated that hiring has resumed in Q3CY20.
- Top-5 and Top-10 clients grew 7.5% and 3.8% QoQ respectively.
- 'Amaze', a product to facilitate cloud migration, was launched in Q2CY20. HEXW expects to leverage this product to take advantage of current demand.
- DSO stood at 77 days, improving by 5 days on account of increased focus on cash balance.
- The voting process regarding delisting is currently underway.
- Interim dividend of Rs 1.5 was declared during the quarter.

### FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2CY20	Q2CY19	YoY (%)	Q1CY20	QoQ (%)	H1CY20	H1CY19	YoY (%)
<b>Revenues (US\$ mn)</b>	<b>208</b>	<b>189</b>	<b>10.3</b>	<b>211</b>	<b>(1.4)</b>	<b>419</b>	<b>377</b>	<b>11.1</b>
<b>Revenue</b>	<b>15,691</b>	<b>13,083</b>	<b>19.9</b>	<b>15,418</b>	<b>1.8</b>	<b>31,109</b>	<b>26,166</b>	<b>18.9</b>
Operating Expenditure	12,978	10,966	18.3	13,082	(0.8)	26,060	21,932	18.8
Cost of revenues	10,259	8,808	16.5	10,415	(1.5)	20,674	17,616	17.4
as % of sales	65.4	67.3	-	67.6	-	66.5	67.3	-
SG&A expenses	2,720	2,158	26.0	2,667	2.0	5,386	4,316	24.8
as % of sales	17.3	16.5	-	17.3	-	26.1	24.5	-
<b>EBITDA</b>	<b>2,713</b>	<b>2,117</b>	<b>28.2</b>	<b>2,336</b>	<b>16.1</b>	<b>5,049</b>	<b>4,234</b>	<b>19.2</b>
Depreciation	637	205	-	518	-	1,154	410	181.6
<b>EBIT</b>	<b>2,076</b>	<b>1,912</b>	<b>8.6</b>	<b>1,818</b>	<b>14.2</b>	<b>3,895</b>	<b>3,824</b>	<b>1.8</b>
Other Income	(193)	(71)	-	328	-	135	198	(32.1)
<b>PBT</b>	<b>1,883</b>	<b>1,841</b>	<b>2.3</b>	<b>2,146</b>	<b>(12.3)</b>	<b>4,029</b>	<b>4,022</b>	<b>0.2</b>
Total Tax	361	329	-	397	-	758	658	15.1
Adjusted PAT	1,522	1,512	0.7	1,749	(13.0)	3,272	3,364	(2.7)
(Profit)/loss from JV's/Ass/MI	0	0	-	0	-	0	0	-
APAT after MI	1,522	1,512	0.7	1,749	(13.0)	3,272	3,364	(2.7)
Extra ordinary items	0	0	-	0	-	0	(170)	-
<b>Reported PAT</b>	<b>1,522</b>	<b>1,512</b>	<b>0.7</b>	<b>1,749</b>	<b>(13.0)</b>	<b>3,272</b>	<b>3,194</b>	<b>2.4</b>
Reported EPS	5.0	4.4	13.4	5.8	(13.0)	11	9	21.9

(Rs mn)	Q2CY20	Q2CY19	YoY (%)	Q1CY20	QoQ (%)	H1CY20	H1CY19	YoY (%)
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	17.3	16.2	110	15.2	210	16.2	16.2	-
EBIT	13.2	14.6	(140)	11.8	140	12.5	14.6	(210)
EBT	12.0	14.1	(210)	13.9	(190)	13.0	15.4	(240)
PAT	9.7	11.6	(190)	11.3	(160)	10.5	12.9	(230)
Effective Tax rate	19.2	17.9	130	18.5	70	18.8	16.4	240

Source: BOBCAPS Research

**FIG 2 – OPERATING METRICS**

	Q2CY20 (% Contr. to Revenue)	Growth (%)	
		QoQ	YoY
Net new deal wins (US\$ mn)	46	(33.3)	28
<b>Revenue by Vertical</b>			
BFSI	38.5	3.1	6.7
TTHL	7.3	(27.3)	(20.2)
Healthcare and Insurance	21.1	3.5	21.3
Manufacturing and Consumers	16.9	(4.8)	16.6
Professional Services	16.2	1.7	20.0
<b>Revenue by Service Line</b>			
ADM	40.6	(5.8)	21.1
EAS	8.7	3.3	2.1
Digital Assurance	16.4	1.7	2.2
Business Intelligence & Analytics	12.6	9.0	13.0
BPO	7.7	(10.7)	6.2
IMS	14.0	3.0	(1.0)
<b>Revenue by Geography</b>			
US	75.3	0.0	8.2
Europe	17.4	(3.6)	37.1
ROW	7.3	(10.0)	(12.4)
<b>Onsite-Offshore Revenue Mix</b>			
Onsite	61.0	(1.5)	7.2
Offshore	39.0	1.0	16.7
<b>Client Concentration</b>			
Top 5 clients	37.4	7.5	10.6
Top 10 clients	47.5	3.8	13.0
Non-Top 10 client revenues	52.5	(5.7)	8.1
Total Headcount	18,825	(6)	3

Source: BOBCAPS Research

### Valuation methodology

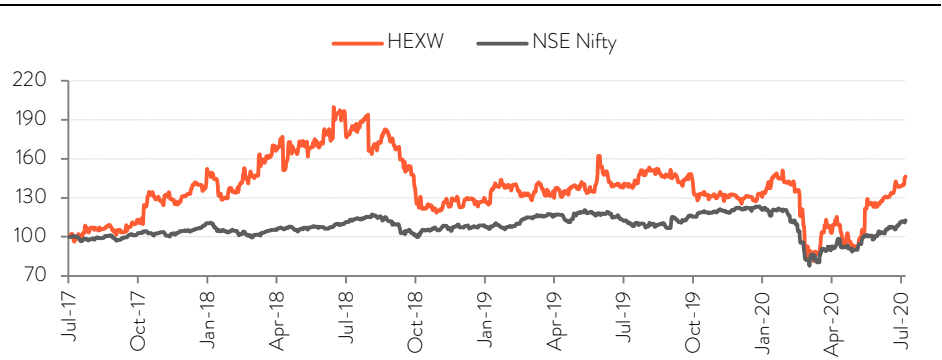
We increase CY20/CY21/CY22 EPS estimates by 13%/11%/11% as we bake in the better-than-expected Jun'20 quarter and management's positive growth/margin outlook despite the current pandemic. Rolling valuations forward by a quarter, we arrive at a revised Jun'21 target price of Rs 410 (Rs 350 earlier), based on an unchanged one-year forward P/E multiple of 15x. Retain ADD. In our view, near-term stock price movement hinges on the outcome of the ongoing delisting process.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	CY20E			CY21E			CY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	819	841	2.8	880	913	3.7	986	1023	3.7
YoY growth (%)	3.2	6.0	-	7.5	8.6	-	12.0	12.0	-
Revenues	61,902	63,412	2.4	68,669	71,233	3.7	76,904	79,775	3.7
EBITDA	9,201	10,540	14.6	10,625	11,946	12.4	11,898	13,379	12.4
EBITDA margins (%)	14.9	16.6	-	15.5	16.8	-	15.5	16.8	-
EBIT	7,131.4	8,115	13.8	8,486.2	9,224	8.7	9,568	10,556	10.3
EBIT margins (%)	11.5	12.8	-	12.4	12.9	-	12.4	13.2	-
Net profits	6,002	6,762	12.7	6,671	7,387	10.7	7,685	8,528	11.0
EPS (Rs)	19.8	22.4	12.7	22.1	24.4	10.7	25.4	28.2	11.0

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

### Key risks

Downside risks to our estimates include:

- sharp adverse currency movements,
- above-expected 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	CY19A	CY20E	CY21E	CY22E
<b>Total revenue</b>	<b>46,477</b>	<b>55,825</b>	<b>63,412</b>	<b>71,233</b>	<b>79,775</b>
EBITDA	7,335	8,778	10,540	11,946	13,379
Depreciation	650	1,033	2,426	2,722	2,823
EBIT	6,685	7,745	8,115	9,224	10,556
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	580	212	250	(48)	37
Exceptional items	0	(170)	0	0	0
EBT	7,265	8,127	8,365	9,176	10,593
Income taxes	1,432	1,379	1,603	1,789	2,066
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>5,833</b>	<b>6,748</b>	<b>6,762</b>	<b>7,387</b>	<b>8,528</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>5,833</b>	<b>6,748</b>	<b>6,762</b>	<b>7,387</b>	<b>8,528</b>

### Balance Sheet

Y/E 31 Dec (Rs mn)	CY18A	CY19A	CY20E	CY21E	CY22E
Accounts payables	0	0	0	0	0
Other current liabilities	6,425	11,304	12,161	13,661	15,299
Provisions	916	1,253	1,390	1,561	1,748
Debt funds	0	0	0	0	0
Other liabilities	76	45	45	45	45
Equity capital	595	597	597	597	597
Reserves & surplus	23,324	27,058	31,791	36,962	42,931
Shareholders' fund	23,919	27,655	32,388	37,559	43,528
<b>Total liabilities and equities</b>	<b>31,335</b>	<b>40,257</b>	<b>45,984</b>	<b>52,826</b>	<b>60,621</b>
Cash and cash eq.	8,205	2,466	6,210	13,926	20,760
Accounts receivables	8,031	9,796	12,161	11,709	13,114
Inventories	0	0	0	0	0
Other current assets	5,201	6,301	6,949	7,806	8,742
Investments	127	30	30	30	30
Net fixed assets	7,986	21,238	20,207	18,929	17,549
CWIP	2,244	863	863	863	863
Intangible assets	1,809	11,761	11,761	11,761	11,761
Deferred tax assets, net	1,784	1,437	1,437	1,437	1,437
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>31,335</b>	<b>41,268</b>	<b>46,995</b>	<b>53,837</b>	<b>61,632</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Dec (Rs mn)	CY18A	CY19A	CY20E	CY21E	CY22E
Net income + Depreciation	6,325	7,781	9,187	10,109	11,351
Interest expenses	(53)	(212)	(250)	48	(37)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,166)	2,353	(2,020)	1,266	(515)
Other operating cash flows	382	(8,147)	0	0	0
<b>Cash flow from operations</b>	<b>5,487</b>	<b>1,775</b>	<b>6,918</b>	<b>11,422</b>	<b>10,798</b>
Capital expenditures	(606)	(5,701)	(1,394)	(1,443)	(1,443)
Change in investments	88	0	0	0	0
Other investing cash flows	590	212	250	(48)	37
<b>Cash flow from investing</b>	<b>72</b>	<b>(5,490)</b>	<b>(1,145)</b>	<b>(1,491)</b>	<b>(1,406)</b>
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)	(2,029)	(2,216)	(2,558)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(2,502)</b>	<b>(2,025)</b>	<b>(2,029)</b>	<b>(2,216)</b>	<b>(2,558)</b>
<b>Changes in cash and cash eq.</b>	<b>3,057</b>	<b>(5,739)</b>	<b>3,745</b>	<b>7,715</b>	<b>6,834</b>
<b>Closing cash and cash eq.</b>	<b>8,205</b>	<b>2,466</b>	<b>6,210</b>	<b>13,926</b>	<b>20,760</b>

### Per Share

Y/E 31 Dec (Rs)	CY18A	CY19A	CY20E	CY21E	CY22E
Reported EPS	19.3	22.3	22.4	24.4	28.2
Adjusted EPS	19.3	22.3	22.4	24.4	28.2
Dividend per share	8.0	5.6	5.6	6.1	7.0
Book value per share	79.3	91.4	107.1	124.2	143.9

### Valuations Ratios

Y/E 31 Dec (x)	CY18A	CY19A	CY20E	CY21E	CY22E
EV/Sales	2.3	1.9	1.7	1.5	1.3
EV/EBITDA	14.8	12.2	10.3	9.1	7.7
Adjusted P/E	19.4	16.8	16.8	15.4	13.3
P/BV	4.7	4.1	3.5	3.0	2.6

### DuPont Analysis

Y/E 31 Dec (%)	CY18A	CY19A	CY20E	CY21E	CY22E
Tax burden (Net profit/PBT)	80.3	83.0	80.8	80.5	80.5
Interest burden (PBT/EBIT)	108.7	104.9	103.1	99.5	100.4
EBIT margin (EBIT/Revenue)	14.4	13.9	12.8	12.9	13.2
Asset turnover (Revenue/Avg TA)	163.7	153.8	143.7	141.3	138.2
Leverage (Avg TA/Avg Equity)	1.3	1.4	1.5	1.4	1.4
Adjusted ROAE	26.5	26.2	22.5	21.1	21.0

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

**Ratio Analysis**

Y/E 31 Dec	CY18A	CY19A	CY20E	CY21E	CY22E
<b>YoY growth (%)</b>					
Revenue	17.9	20.1	13.6	12.3	12.0
EBITDA	11.9	19.7	20.1	13.3	12.0
Adjusted EPS	16.6	15.4	0.2	9.2	15.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.8	15.7	16.6	16.8	16.8
EBIT margin	14.4	13.9	12.8	12.9	13.2
Adjusted profit margin	12.6	12.1	10.7	10.4	10.7
Adjusted ROAE	26.5	26.2	22.5	21.1	21.0
ROCE	35.1	31.4	25.5	29.8	36.6
<b>Working capital days (days)</b>					
Receivables	53	58	63	61	57
Inventory	0	0	0	0	0
Payables	51	69	81	79	80
<b>Ratios (x)</b>					
Gross asset turnover	5.8	3.8	3.1	3.6	4.4
Current ratio	2.9	1.5	1.9	2.2	2.5
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.3)	(0.1)	(0.2)	(0.4)	(0.5)

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

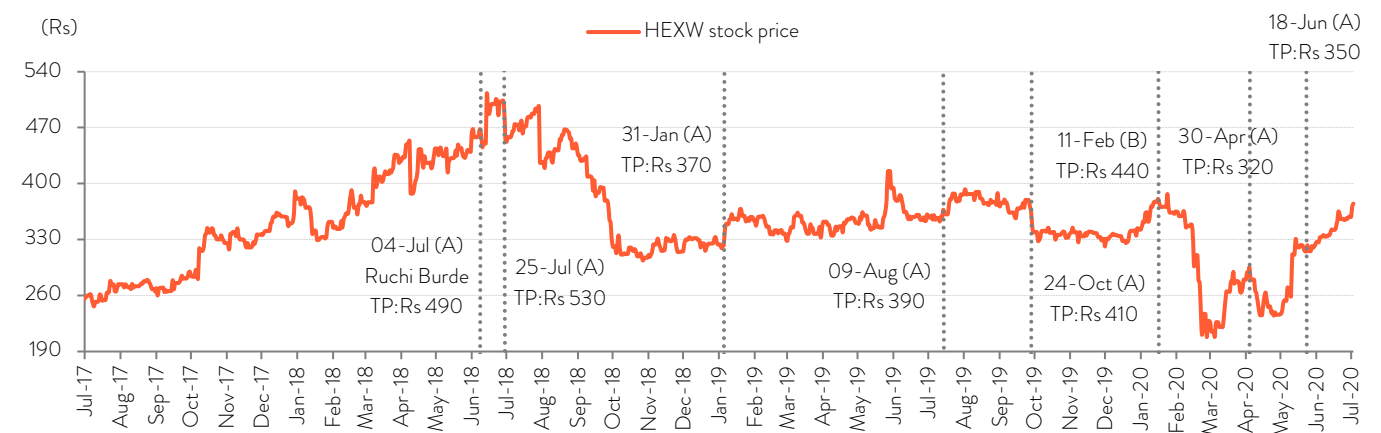
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): HEXAWARE TECHNOLOGIES (HEXW IN)



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

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