

ACCUMULATE

CMP*	Rs89
Target Price	Rs98

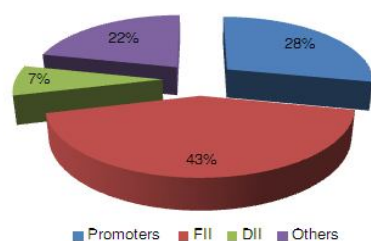
Stock Info

Sector	IT
Market Cap (Rs cr)	2,612
52 Week High/Low	130/50
Avg. Daily Volume (3m, '000)	1,888
Avg. Daily Value (3m, cr)	15.4
Dividend Yield (%)	3.4
Sensex	16,937
Nifty	5,092
BSE Code	532129
NSE Code	HEXAWARE

Stock Performance

(%)	Hexaware	Nifty
1-week	2.3	0.3
1-month	21.5	(0.9)
1-year	110.4	(14.9)

Shareholding Pattern (%)



Stock Price Chart



Note: *CMP as on October 20, 2011

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Beats expectations, maintains growth momentum

Key highlights of the result

- Strong growth in top-line:** Hexaware Technologies' (Hexaware) revenue grew 5.3% qoq in US\$ terms to US\$78.8mn in-line with our estimate of US\$78.4mn. In INR terms, top-line growth was close to double-digit (9.6% qoq) at Rs366cr reflecting sharp depreciation of INR against US dollar. The growth was driven by strong volume growth and improved pricing. Hexaware added 745 employees including 550 freshers.
- EBITDA margin boosts:** EBITDA increased 34.3% qoq to Rs69cr driven by strong growth coupled with cost containment. EBITDA margin increased to 18.7% in 3QCY2011 from 15.3% in 2QCY2011 (+340bp qoq). Hexaware contained its SG&A cost which positively impacted the margin by ~180bp. Depreciation of INR also supported margin expansion. EBITDA was higher than our estimates mainly on the account of INR depreciation and lower than anticipated SG&A expenses.
- Lower forex gains suppress bottom-line growth:** Hexaware's forex gains reduced from Rs16.3cr to Rs3.8 partially offsetting the growth witnessed at EBITDA level. Consequently, PAT grew 7.1% qoq to Rs65cr (PAT was also higher than our estimates).

Outlook and Valuation

Hexaware has reported strong growth and has sharply improved margins. Management has also raised its CY2011 top-line guidance to 32% in US\$ terms from ~30% which was provided earlier. We remain optimistic about the company's growth prospects given the large employee addition and deal pipeline, though the overhang regarding the recession in US and UK continues to remain a concern. We have raised our estimates marginally upwards to factor in the depreciation of INR. Consequently, we forecast Hexaware to report revenue CAGR of ~28% and adjusted PAT CAGR of 75% over CY2010-12E. **We initiated coverage on Hexaware with a Buy recommendation (27 September 2011). Since then the stock has appreciated more than 22% and it surpassed our target of Rs88 (12 October 2011). At the current price of Rs89, the stock is trading at 10.7x and 10x our CY2012E and CY2013E EPS respectively. Thus, based on our multiple of 11x and CY2012E EPS of Rs8.9, we arrive at a target price of Rs98 which indicates an upside of ~11% from the current levels. Therefore, we recommend an Accumulate on the stock.**

Risks to the view

- The unstable US economy and poor macroeconomic data can lead to a recession in the region which could impact the demand and growth
- INR has depreciated more than 10% over the last 3 months which is expected to have a positive impact on the company's margin in the near term. However, any appreciation of INR from here on will negatively impact the company's guidance and our estimates
- Any delay in commencement of deals or cancellation due to slowdown in US can result in deviation from our estimates

Year End	Net Revenues		EBITDA		Net income (reported)		RoaE	RoIC	EPS	Valuations (X)	
	(Rs cr)	% growth	(Rs cr)	% margin	(Rs cr)	% growth	%	%	(Rs)	P/E	EV/EBITDA
CY2009	1,039	(9.8)	202	19.5	134	127.5	17.3	47.3	4.7	19.1	8.7
CY2010	1,055	1.5	94	8.9	85	(36.5)	9.2	13.8	2.9	30.2	18.0
CY2011E	1,416	34.2	237	16.7	242	184.3	22.8	31.6	8.3	10.7	6.6
CY2012E	1,730	22.2	319	18.5	260	7.2	20.9	34.7	8.9	10.0	4.3

Revenues were driven by strong volume growth and currency movements

Exhibit 1: Quarterly Performance (Consolidated)

(Rs cr)	3QCY11	2QCY11	% qoq	3QCY10	% yoy	CY10	CY09	% yoy
Revenues	366	334	9.6	282	29.9	1,055	1,039	1.5
Direct costs	226	212	6.8	187	20.7	692	564	22.6
Gross profit	140	122	14.2	94	48.2	363	474	(23.5)
SG&A Expenses	71	71	(0.1)	70	1.3	269	272	(1.0)
EBITDA	69	51	34.3	24	185.4	94	202	(53.7)
Margin (%)	18.7	15.3		8.5		8.9	19.5	
Dep and Amort	6	6	8.8	6	9.7	24	27	(10.6)
EBIT	62	45	37.6	18	241.7	70	175	(60.3)
Other income	12	10	19.7	7	75.4	50	31	60.3
Forex loss/ (gain)	(4)	(16)	(76.7)	8	NA	25	62	NA
Exceptional items	0	0	NA	(25)	NA	(22)	0	
PBT	78	72	8.8	43	82.6	117	145	(19.1)
Tax	14	12	17.3	1	NA	9	10	(10.7)
Tax Rate (%)	17.3%	16.1%		2.0%		7.9%	7.2%	
PAT	65	60	7.1	42	54.1	108	134	(19.8)
Adjusted PAT	65	60	7.1	17	284.9	85	134	(36.5)
Margin (%)	17.7	18.1		14.9		8.1	12.9	
Adj. EPS Diluted	2.2	2.0	7.5	0.6	272.4	2.9	4.7	(36.9)

Source: Company, RSec Research

Revenue growth robust

Hexaware's 3QCY2011 revenues grew 9.6% qoq to Rs366cr driven by robust volume growth, improvement in pricing and positive impact from exchange rate movement. The company reported 9.2% qoq volume growth which was partially offset by 4.5% qoq decline in revenues due to change in effort mix. Hexaware added 745 employees including 550 freshers during 3QCY2011 which would drive the growth ahead. With these additions, the company has exceeded its annual hiring plan of 1,500 in September i.e. the company added 1,653 during the nine months. Hexaware intends to add 200 fresh graduate engineers in 4QCY2011 apart from some lateral hiring. The strong employee addition indicates the robust growth ahead. Further, onsite and offshore pricing improved 0.7% and 2.2% qoq respectively assisting top-line growth. Hexaware also added 12 new clients during the quarter.

BFSI saw the strongest growth in terms of verticals reporting a growth of 10.2% qoq. Of the 12 clients added during the last quarter, 3 clients were added in the Travel and Transportation vertical and 4 in BFSI vertical.

Double-digit qoq growth reported in BFSI vertical

Exhibit 2: Vertical wise revenue break-up

	3QCY2011 (% of total rev)	2QCY2011 (% of total rev)	% qoq
BFSI	34.4	32.9	10.2
Travel & Transportation	23.2	24.6	(0.6)
Emerging segments	42.4	42.5	5.1

Source: Company, RSec Research

APAC leads the growth in terms of geographical performance

EBITDA margin increased on account strong growth and improved cost efficiency

In terms of Geography, the growth was broad based with Asia Pacific leading the growth. Though Asia Pacific has the lowest share in revenues it is one of the growth engines for the company going forward. Of the 12 clients added in 3QCY2011, 4 customers are based in Americas, 2 in Europe and 6 in Asia Pacific region.

Exhibit 3: Geography wise revenue break-up

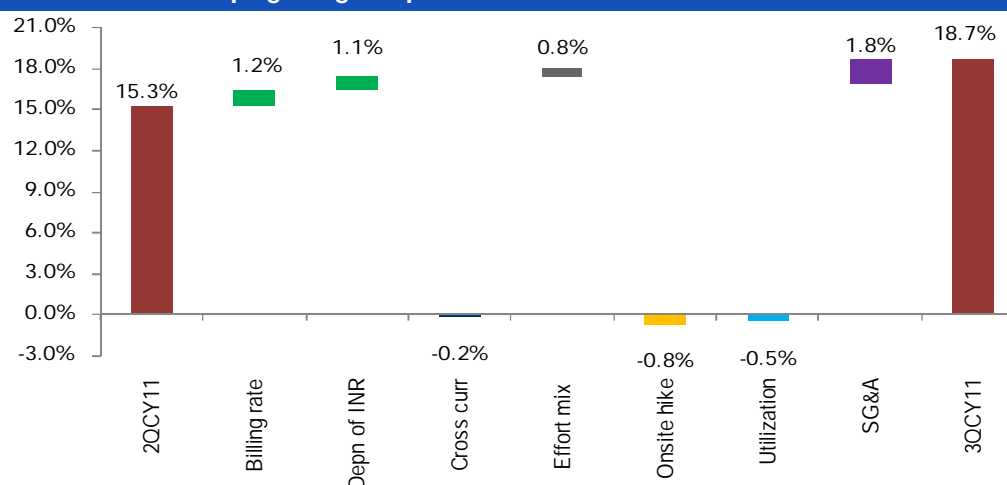
	3QCY2011 (% of total rev)	2QCY2011 (% of total rev)	% qoq
Americas	64.7	66.4	2.7
Europe	28.4	27.2	10.0
Asia Pacific	6.9	6.4	13.6

Source: Company, RSec Research

Margin gets a boost

EBITDA increased 34.3% qoq to Rs69cr driven by strong growth coupled with cost containment. EBITDA margin increased to 18.7% in 3QCY2011 from 15.3% in 2QCY2011 (+340bp qoq). Hexaware contained its SG&A cost which positively impacted the margin by ~180bp. Depreciation of INR also supported margin expansion. EBITDA was higher than our estimates mainly on the account INR depreciation and lower than anticipated SG&A expenses. The Management has utilized all the levers for margin as identified in our initiating coverage report. Hexaware changed the strategy and increased the offshoring work during the last quarter with offshore revenue mix going up by 300bp qoq to 46.3%. Hiring of freshers will improve employee pyramid which will further support margins. Going forward, management expects EBITDA margin to improve 20% in the near term. Considering the improved efficiency and continuing depreciation of INR, we have also revised our margin estimates upwards. However, we remain conservative on the margin front and anticipate that margins would improve from ~16.7% in CY2011E and ~18.5% in CY2012E.

Exhibit 4: Factors helping margin improvement



Source: Company, RSec Research

Lower forex gains suppress bottom-line growth

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Profit & Loss Statement

Y/E Dec (Rs cr)	CY2009	CY2010	CY2011E	CY2012E
Revenues	1,039	1,055	1,416	1,730
Total Expenditure	836	961	1,179	1,411
Employee expenses	564	692	881	1067
SG&A	272	269	297	344
EBITDA	202	94	237	319
% chg	68.5	(53.7)	152.8	34.7
(% of Revenues)	19.5	8.9	16.7	18.5
Depreciation& Amortisation	27	24	25	30
EBIT	175	70	212	289
% chg	91.2	(60.3)	204.3	36.7
(% of Revenues)	16.9	6.6	14.9	16.7
Other Income, net	31	50	42	45
(% of revenues)	3.0	4.7	3.0	2.6
Foreign exchange loss (gain)	62	25	(32)	0
PBT (reported)	145	94	286	334
Exceptional item	0	(22)	0	0
Tax	10	9	44	74
(% of PBT)	7.2	9.8	15.2	22.2
PAT (reported)	134	108	242	260
% chg	127.5	(19.8)	125.1	7.2
Adjusted PAT	134	85	242	260
% chg	127.5	(36.5)	184.3	7.2
(% of Revenues)	12.9	8.1	17.1	15.0
Adjusted EPS (Rs)	4.7	2.9	8.3	8.9
% chg	127.3	(36.9)	181.1	7.2

Balance Sheet

Y/E Dec (Rs cr)	CY2009	CY2010	CY2011E	CY2012E
SOURCES OF FUNDS				
Equity Share Capital	29	29	58	58
Reserves& Surplus	821	936	1,081	1,273
Shareholders Funds	850	965	1,139	1,331
Deferred Tax Liabilities	1	1	1	1
Total Loans	16	11	8	5
Total Liabilities	867	978	1,149	1,337
APPLICATION OF FUNDS				
Gross Block	450	463	546	628
Less: Acc. Depreciation	140	152	177	207
Net Block	310	311	369	421
Capital Work-in-Progress	126	97	48	24
Investments	127	40	40	40
Deferred Tax Assets	12	18	18	18
Current Assets	563	791	995	1,205
Cash	285	436	569	734
Debtors	153	192	252	284
Loans & Advances	93	98	102	108
Other CA	33	66	72	79
Current Liabilities & Provisions	271	278	322	371
Current Liabilities	200	148	178	213
Provisions	71	131	144	158
Net Current Assets	292	512	674	834
Other Non Current Assets	-	-	-	-
Total Assets	867	978	1,149	1,337

Cash Flow Statement

Y/E Dec (Rs cr)	CY2009	CY2010	CY2011E	CY2012E
Profit before tax	145	117	286	334
Depreciation	27	24	25	30
Change in Working Capital	20	(56)	(28)	5
Interest / Dividend (Net)	(22)	(25)	(42)	(45)
Direct taxes paid	(19)	(14)	(44)	(74)
Others	1	(34)	0	0
Cash Flow from Operations	151	12	197	249
(Inc.)/ Dec. in Fixed Assets	(8)	54	(35)	(58)
Interest/Divd Recd	11	27	42	45
(Inc.)/ Dec. in Investments	(125)	87	0	0
Cash Flow from Investing	(122)	168	8	(12)
Issue of Equity	0	3	0	0
Borrowings	(4)	(7)	(3)	(3)
Dividend Paid (Incl. Tax)	(18)	(23)	(68)	(68)
Cash Flow from Financing	(22)	(28)	(71)	(71)
Inc./(Dec.) in Cash	7	153	133	165
Opening Cash balances	277	283	436	569
Closing Cash balances	283	436	569	734

Key Ratios

Y/E Dec	CY2009	CY2010	CY2011E	CY2012E
Valuation Ratio (x)				
P/E (on FDEPS)	19.1	30.2	10.7	10.0
P/CEPS	15.9	23.6	9.7	8.9
P/BV	1.5	1.3	2.2	1.9
Dividend yield (%)	1.6	3.4	2.2	2.2
EV/Sales	1.7	1.6	1.1	0.8
EV/EBITDA	8.7	18.0	6.6	4.3
Per Share Data (Rs)				
EPS	4.7	3.7	8.3	8.9
EPS (fully diluted)	4.7	2.9	8.3	8.9
Cash EPS	5.6	3.8	9.2	10.0
DPS	1.4	3.0	2.0	2.0
Book Value	60.4	67.4	39.6	46.0
Returns (%)				
RoIC	47.3	13.8	31.6	34.7
RoaE	17.3	9.2	22.8	20.9

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