

19th February 2007**BUY**

Price	Target Price
Rs174	Rs226

Sensex - 14,356**Price Performance**

(%)	1M	3M	6M	12M
Absolute	(5)	0	8	30
Rel. to Sensex	(7)	(6)	(14)	(8)

Source: Capitaline

Stock Details

Sector	IT Services
Reuters	HEXT.BO
Bloomberg	HEXW@IN
Equity Capital (Rs mn)	264
Mkt. Cap (Rs bn)	23
FV/Share	2
52 Week H/L	Rs 205/110
Daily Avg Volume (No of shares)	359920
Daily Avg Turnover (US\$ mn)	1.5

Shareholding Pattern (%)

Promoters	25.7
FII's /NRI's	55.7
Institutions	7.1
Private Corp	1.2
Public	10.3

Source: BSE, 31.12.2006

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Hexaware Technologies LtdResult
Update**Results below expectations, but bright future outlook****Sequential Results Review**

Hexaware posted sequential revenue growth of 6.8% to Rs 2.4 bn; slightly below our expectations of Rs 2.49 bn. Organic revenue growth in rupee term was subdued at 3% qoq. Balance being contributed by consolidation of FocusFrame with effect from 28th Nov'06 to the tune of Rs 90 mn. EBITDA margins fell by 110 bps to 14.9% driven by rupee appreciation, higher SGA expenses and one-time expenses to the tune of US\$0.25 mn on account of consolidation of FocusFrame. EBITDA was down by 1% qoq to Rs 357 mn, below our expectations of Rs 399 mn. PAT was down by 2.7% qoq to Rs 337 mn, below company's guidance of around Rs 357 mn as well as our expectations of Rs 378 mn.

The above would translate to annual revenues of Rs 8.48 bn (25% growth yoy), EBITDA of Rs 1.32 bn (21% growth yoy) and net profits of Rs 1.24 bn (36% growth yoy). FDEPS works out to Rs 9.1 for CY06, below our expectations of Rs 9.3.

Healthy clients' additions and strong order book position

12 new clients were added in Q4CY06, taking total active clients to 129. For CY06, 49 new clients were added. 41 clients belong to Fortune 500 corporations. US\$ 1 mn clients increased to 41 in CY06, up from 30 in CY05. Less than US\$ 5 mn increased to 32 in CY06, up from 22 in CY05. There are 4 clients with annual revenue runrate of more than US\$ 10 mn. We believe average deal size has increased in recent times. Fresh order intake of US\$40 mn in Q4CY06, taking total order book position to US\$240 mn. Orders executable over one year stood at US\$ 170 mn, reflecting strong visibility of future revenue stream.

Stable pricing with upward bias

Onsite billing rate stood at US\$66.1/hr; while offshore billing rate at US\$22.92/hr. The management expects 3-5% price hike in newer contracts, while stable pricing for existing contracts. Repeat business accounted for 89% of total revenues.

Focus on newer services

We believe newer services such as testing, asset management solutions, SAP-HR IT, etc would be the growth drivers of the company, besides ERP (PeopleSoft) and traditional ADM. These newer services are expected to contribute better margins compared to traditional ADM.

Appointment of a management consultant

Hexaware has recently appointed a management consultancy to assist company in re-designing/ aligning business structure, deepening existing competency and delivering value proposition to its clients. The company is expected to take a hit of US\$ 0.85 mn in Q1CY07 on account of consultancy fee. We believe benefits of consultancy would start reflecting in current year itself.

Human Resource additions

Hexaware added net 342 employees in Q4CY06, taking employee strength to 5,829 as of Dec'06. Technical work force constitutes 89.6% of the total work force. Utilisation fell to 68.2% in Q4CY06 from 72% in Q3CY06 mainly due to large intake of freshers in Q3CY06. Attrition rose to 15% from 14.2% in Q3CY06.

Margin Levers

The management of Hexaware is optimistic of improving margins by 100 bps during CY07 driven by better productivity, increased utilizations, increased offshoring (38.8% for CY06) and more hiring of freshers. However, we believe most of the improvements in margins would be offset by annual wage inflation (offshore 15%+ and onsite 3-5%), higher SGA expenses, integration costs of FocusFrame, consultancy cost and higher taxation.

Guidance for Q1CY07

The Company has provided the following guidance for Q1CY07

- Consolidated Revenue is expected to be in the range of \$ 59 – 60 mn, which would imply organic revenue growth of 3% qoq and US\$ 6 mn from FocusFrame for full quarter
- Consolidated Profit after Tax is expected to be between \$ 7.8 - 8 mn, which would translate into growth of 3.2%-5.9% qoq at an exchange rate assumption of 1 US\$ = Rs 44.00

Cutting our estimates for CY07E

Based on subdued results for current quarter and muted guidance for H1CY07E (Q2CY07E would have impact of wage hikes), we have revised/ reduce our estimates for CY07E. We now expect Hexaware to post 33% CAGR in revenues (earlier 37%) and 35% CAGR in profits (earlier 42%) for CY05-07E. We now expect FDEPS of Rs 11.5 (earlier Rs 13.1) for CY07E. At CMP of Rs 174, the stock is trading at P/E of 15.1x and EV/EBITDA of 11.4x CY07E. However, due to strong visibility of growth, scope for margin improvements and net cash of Rs 25/share, we maintain BUY with revised one year price target of Rs 226 (earlier Rs 249).

Estimates (Rs mn)	Old	CY07E	
		Revised	% Change
Revenues	12,648	11,958	-5%
EBITDA	2,051	1,791	-13%
PAT	1,838	1,663	-10%
FDEPS	13.1	11.5	-12%

Source: Emkay Research

Q4CY06 Results Analysis**Consolidated Income Statement (Rs mn)**

Particulars	Q3CY06	Q4CY06	% qoq
Revenues	2,250	2,402	6.8%
Direct costs	1,412	1,501	6.3%
Gross Profit	837	901	7.6%
Gross Margin	37.2%	37.5%	
SG&A	477	544	14.0%
EBITDA	361	357	-0.9%
EBITDA Margin	16.0%	14.9%	
Dep & Amort	55	53	-4.8%
Operating Profit	305	304	-0.2%
Other Income (net)	80	79	-1.2%
PBT	385	384	-0.5%
Tax	39	46	19.5%
PAT	347	338	-2.7%

Source : Company

Profit & Loss Statement

Dec ending (Rs mn)	CY04	CY05	CY06	CY07E
Revenues	5,459	6,787	8,482	11,958
% growth	61	24	25	41
Direct costs	3,392	4,175	5,318	7,438
Gross Profit	2,067	2,611	3,164	4,520
Gross Margin (%)	37.9	38.5	37.3	37.8
SG&A	1,280	1,526	1,842	2,729
as a % of revenue	23.4	22.5	21.7	22.8
EBITDA	787	1,085	1,322	1,791
% growth	153	38	22	35
EBITDA Margin(%)	14.4	16.0	15.6	15.0
Dep & Amort	161	221	200	308
Other Income (net)	98	148	241	398
PBT	724	1,012	1,363	1,880
Tax	86	97	120	217
as a % of PBT	11.9	9.6	8.8	11.6
PAT	637	915	1,242	1,663
% growth	271	44	36	34
Preference Dividend	-	-	-	44
Earnings to Equity shareholders	637	915	1,242	1,618
% growth	191	44	36	30
Net Margin (%)	11.5	13.2	14.2	13.5
EPS (basic)	5.5	7.8	9.6	12.5
EPS (diluted)	5.0	7.5	9.1	11.5
% growth	84	50	21	27

Source : Company, Emkay Research

Balance Sheet

Dec ending (Rs mn)	CY04	CY05	CY06	CY07E
Liabilities				
Equity Share Capital	239	240	268	268
Convertible Preference Shares			1,500	1,500
Share Premium	1,719	1,750	3,231	3,231
Reserves	720	1,564	2,501	4,003
Net Worth	2,678	3,554	7,500	9,002
Borrowings	52	62	0	-
Total Liabilities	2,730	3,616	7,500	9,002
Assets				
Goodwill	-	-	1,000	1,000
Gross Block	1,511	1,554	2,296	3,021
Less : Depreciation	541	621	795	1,103
Net Fixed Assets	970	933	1,501	1,918
Current Assets				
Cash & Cash equivalents	775	1,178	3,414	3,978
Debtors	1,361	1,852	2,063	2,640
Others	581	805	1,234	1,604
Total Current Assets	2,716	3,835	6,711	8,222
Total Current Liabilities	1,023	1,182	1,708	2,135
Working Capital	1,693	2,653	5,002	6,087
Deffered Tax	67	30	(3)	(3)
Total Assets	2,730	3,616	7,500	9,002

Source : Company, Emkay Research

Cash Flow

Dec ending (Rs mn)	CY04	CY05	CY06	CY07E
PAT	637	915	1,242	1,663
Depreciation	122	80	174	308
Changes in working capital	(251)	(417)	(80)	(521)
Cash Flow from Operations	508	578	1,336	1,450
Net capital expenditures	(346)	(43)	(1,742)	(725)
Net Borrowings	26	10	1,439	(0)
Free Cash Flow to Equity	189	545	1,033	725
Dividend	(131)	(174)	(305)	(161)
Issue of Equity	10	32	1,509	0
Cash at the beginning	707	775	1,178	3,414
Cash at the end	775	1,178	3,414	3,978

Source : Company, Emkay Research

Ratios

Dec ending	CY04	CY05	CY06	CY07E
Per Share Data (Rs)				
Basic EPS	5.5	7.8	9.6	12.5
Diluted EPS	5.0	7.5	9.1	11.5
CEPS	6.7	9.5	10.3	13.7
BVPS	22.4	29.8	53.4	64.1
DPS	1.0	1.2	1.2	1.2
Valuation Ratios (x)				
P/E	34.6	23.1	19.1	15.1
P/CEPS	26.0	18.3	16.9	12.7
EV/EBITDA	25.5	18.1	15.9	11.4
EV/Revenues	3.7	2.9	2.5	1.7
P/BV	7.8	5.8	3.3	2.7
PEG	4.1	0.5	0.9	0.6
Dividend yield (%)	0.6	0.7	0.7	0.7
Growth Ratios				
Revenues	61.0	24.3	25.0	41.0
EBITDA	153.3	37.9	21.8	35.4
PAT	271.4	43.6	35.8	33.8
EPS	8.4	49.5	20.8	26.8
Margins (%)				
Gross Margin	37.9	38.5	37.3	37.8
EBITDA Margin	14.4	16.0	15.6	15.0
PAT Margin	11.5	13.2	14.2	13.5
Return Ratios (%)				
ROE	23.8	25.7	16.6	19.6
ROCE	23.3	25.3	22.4	19.6

Source : Company, Emkay Research

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