

Sector: IT

Target Price	Rs222
Market cap	Rs25.2 bn/US\$612.7 mn
52-week range	Rs205/110
Shares in issue (mn)	144.8
6-mon avg daily vol (no of shares)	342,102
6-mon avg daily vol (mn)	Rs59.5/US\$1.4
Bloomberg	HEXW IN
Reuters	HEXT.BO
BSE Sensex	14137
Website	www.hexaware.com

Shareholding Pattern (%)

Promoters	25.5
FIIIs	52.2
MFs/FIs/Banks	7.3
Others	15.0

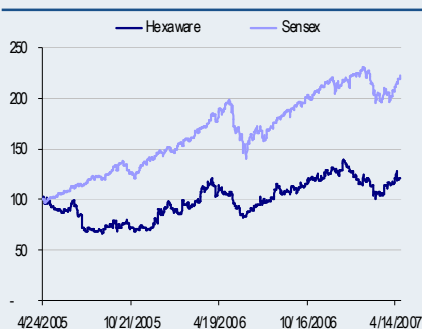
(As of 31 March 2007)

Price Performance (%)

	1M	3M	12M
Absolute	6.3	(1.0)	7.8
Relative*	(0.1)	(1.2)	(10.8)

*To the BSE Sensex

Relative Performance



(As of 24 April 2007)

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In line quarter, positive outlook

Hexaware announced 1Q CY06 results in line with our expectations. Revenues at Rs2.64 bn (our expectation Rs2.69 bn) grew by 10.1% QoQ while PAT at Rs352 mn (our expectation Rs349 mn) increased by 4.3% QoQ. Hexaware had the highest amount of order bookings this quarter (US\$61 mn) and the order book now stands at US\$260 mn. The management has guided for a topline of US\$64-65 mn (+8.1% QoQ at higher end) and profit of US\$7.0-7.2 mn (-10.2% QoQ at higher end) for 2Q CY07. The PAT guidance factors in wage hikes of 14-15% for offshore employees and 4-5% for the onsite employees as also the visa costs.

We are revising our CY07E EPS marginally downwards to Rs11.1 (-2.8%) and CY08E EPS to Rs13.9 (-3.0%) mainly due to change in exchange rate assumptions. Consequently, we are revising our one-year target price marginally downwards to Rs222 (16x CY08E earnings) from the earlier target price of Rs229. Revenue visibility continues to be good (US\$260 mn order book) and the company has quite a few margin levers (offshore shift, employee pyramid flattening, SG&A leverage, etc) going forward. We reiterate our Buy rating on the stock.

Highlights

- **Strong order booking of US\$61 mn:** The integration of FocusFrame for the complete quarter aided revenue growth while rupee appreciation of 1.6% affected it negatively. Hexaware has also managed decent billing rate hikes this quarter (onsite +0.61% QoQ; offshore +1.48% QoQ). The active client base has gone up to 151 from 129 in 4Q CY06 (including clients of FocusFrame). The company has added 20 new clients, which is among the highest addition during any quarter. The company had the highest quarterly order intake of US\$61 mn. The current order book stands at about US\$260 mn giving good visibility in the medium term.

Exhibit 1: Key financials

(Rs mn)

Y/E December	CY04	CY05	CY06	CY07E	CY08E
Net Sales	5,459	6,787	8,482	11,610	14,700
EBITDA	787	1,087	1,322	1,904	2,455
EBITDA (%)	14.4	16.0	15.6	16.4	16.7
Net Profit	637	870	1,242	1,611	2,030
Fully diluted EPS (Rs)	5.6	7.5	9.0	11.1	13.9
EPS Growth (%)	91.6	32.6	20.3	23.3	25.1
ROCE (%)	25.5	27.3	20.2	20.1	22.0
ROE (%)	26.4	28.0	22.5	19.8	21.1
PE (x)	30.9	23.3	19.4	15.7	12.5
Price/Book Value (x)	7.6	5.9	4.2	3.5	2.9
EV/EBITDA (x)	31.1	22.2	16.5	11.5	8.6

Source: Company, ASK Raymond James. Note: Valuations as of 24 April 2007.

- **Travel & transportation and enterprise application (ERP) perform well:** Among verticals, growth in travel and transportation (+20.1% QoQ) was very strong. Enterprise application (ERP), the company's niche, grew by 11.4% QoQ while testing services (with the FocusFrame acquisition) has attained a critical mass (17.5% of revenues in 1Q CY07 as compared to 3.1% in 1Q CY06). Geography wise, Europe has been the front-runner with a 19.1% QoQ growth while US grew only by 6.9% QoQ.
- **Margins remain flat at 15.0%:** Margins stayed flat during the quarter at 15.0% despite rupee appreciation, non-capitalized expense of US\$0.15 mn relating to FocusFrame integration and one-time expense of US\$0.85 mn (on account of fees for a corporate restructuring exercise). Utilization during the quarter has improved significantly by 250 bps as the company has introduced multi-skill training programs, which in turn helped them make optimum use of the available bench. Going forward for CY07-08E, we expect margins to improve by about 110 bps by using levers such as offshore shift, employee pyramid flattening, SG&A leverage and utilization improvement.
- **Outlook and valuations:** We are revising our CY07E EPS marginally downwards to Rs11.1 (-2.8%) and CY08E EPS to Rs13.9 (-3.0%) mainly due to change in exchange rate assumptions. Consequently, we are revising our one-year target price marginally downwards to Rs222 (16x CY08E earnings) from the earlier target price of Rs229. Revenue visibility continues to be good (US\$260 mn order book) and the company has quite a few margin levers (offshore shift, employee pyramid flattening, SG&A leverage, etc) going forward. We reiterate our Buy rating on the stock.

Exhibit 2: Quarter results**(Rs mn)**

Y/E December	1Q CY07	4Q CY06	QoQ (%)	1Q CY06	YoY (%)
Sales	2,644	2,402	10.1	1,762	50.1
Direct costs	1,603	1,501	6.8	1,080	48.4
Gross profits	1,040	901	15.5	681	52.7
Revenue (%)	39.4	37.5	1.9	38.7	0.7
SG&A	645	544	18.7	388	66.4
Revenue (%)	24.4	22.6	1.8	22.0	2.4
EBITDA	395	357	10.7	294	34.6
Revenue (%)	15.0	14.9	0.1	16.7	(1.7)
Depreciation	56	53	6.8	46	22.6
EBIT	339	304	11.3	248	36.8
Revenue (%)	12.8	12.7	0.1	14.1	(1.2)
Other Income	68	79	(14.2)	35	96.5
PBT	407	384	6.1	282	44.1
Tax	55	46	19.1	22	148.8
PAT	352	338	4.3	260	35.2
Minority Interest	-	-	-	-	-
PAT (Adjusted)	352	338	4.3	260	35.2
No of shares (mn)	144.8	144.9	(0.0)	122.5	18.2
EPS (Rs)	2.4	2.3	4.3	2.1	14.4

Source: Company data.

Exhibit 3: Key operating metrics

	1Q CY06	2Q CY06	3Q CY06	4Q CY06	1Q CY07
Revenue split (%)					
BFSI	41.1	41.6	41.0	40.6	39.5
Travel and transportation	19.4	19.3	17.5	16.5	18.0
Capital mkt / Asset mgmt	6.0	5.9	6.1	6.5	6.3
Others (largely ERP)	33.5	33.2	35.4	36.4	36.2
Onsite/Offshore (%)					
Onsite	61.6	60.4	61.1	61.6	62.1
Offshore	38.4	39.6	38.9	38.4	37.9
Client metrics					
>1mn US\$ clients (Nos)	31	36	40	41	46
Top 10 revenue concentration (%)	47.4	45.8	47.1	47.7	48.1
Billing rates (US\$/Hr)					
Onsite	65.7	65.8	66.0	66.1	66.5
Offshore	22.7	22.8	23.0	22.9	23.3
Employees (Nos)					
Net addition (Nos)	478	606	757	342	(78)
Utilisation (%)	71.0	71.5	72.0	68.2	70.7
Attrition rate (%)	16.5	14.0	14.2	15.0	16.1

Source: Company data.

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