

Hexaware delivered strong performance in the quarter with revenues and net profit growing 10.1% and 4.3% respectively on sequential basis. The respective qoq Dollar growth rates of 11.8% and 5.7% were marginally ahead of company's guidance. Contrary to our expectations, OPM level of previous quarter was maintained aided by higher utilization and material price hikes both onsite and offshore. Sequentially lower other income and higher tax rate depressed the net profit growth. Management has guided for 6.5-8.1% qoq revenue growth and significant 10.2-12.7% net profit de-growth in Q2 CY07 in Dollar terms.

**Key highlights of the quarter**

**Financials**

Period	03/07	12/06	Growth (%)	03/06	Growth (%)
(Rs mn)	(3)	(3)	qoq	(3)	yoy
Sales	2,644	2,402	10.1	1,762	50.1
Operating profit	395	357	10.7	294	34.6
OPM (%)	15.0	14.9	-	16.7	-
APAT	352	338	4.3	260	35.2
NPM (%)	13.3	14.1	-	14.8	-
EPS (Rs) Annualized	10.6	10.2	-	8.7	-
P/E @ Rs174	16.5	-	-	-	-

- ✓ Company recorded revenues of Rs2.64bn in Q1 CY07 representing 10.1% qoq growth and 50.1% yoy growth. In US\$ terms, revenues stood at US\$60.1mn reflecting robust 11.8% growth on sequential basis, ahead of guided range of 9.7-11.6%. The Rupee growth was impacted by the sharp Rupee appreciation. Rupee rate realized in Q1 CY07 was Rs43.98/\$, 1.6% lower than Q4 CY06.
- ✓ Apart from strong volume growth, material improvement in price realization both onsite at 0.6% and offshore at 1.5% contributed to the robust qoq growth. FocusFrame, a testing company acquired towards the end of the last year, was integrated for full period in Q1 CY07 against for one month in Q4 CY06 thereby pushing sequential revenue growth to some extent.
- ✓ Order bookings during the quarter stood at highest-ever US\$61mn, higher 51.7% qoq. Quarter ending order book was at ~US\$260mn to be executable over the next 2-3 years. At the start of CY07, orders worth ~US\$170mn were executable in the year.
- ✓ On integrated operating matrix ie after combining FocusFrame, Travel & Transportation grew by 20.1% qoq while the testing practice shows a jump of 111.6% qoq. Offshore revenues grew at a lower rate of 8.6% qoq resulting in decline of offshore revenue component by 50 bps to 37.9%.
- ✓ The growth in the quarter was led by large existing clients with the Top, Top 5 and Top 10 client brackets growing above the company rate at 12.7%, 13.1% and 11.0% respectively on sequential basis. The Repeat business grew 10.4% on qoq basis.
- ✓ OPM improved by negligible 10bps qoq to 15%, contrary to our expectation. Company overcame the impact of Rupee appreciation, FocusFrame integration and one-time integration cost of ~US1mn through significant improvement in utilization (about 250 bps) and material price improvements.
- ✓ Other Income was lower 14% qoq and tax rate was higher at 13.5% against 12% in previous quarter. As a result, net profit growth was lower at 4.3% qoq. The profit figure of US\$8mn was at the higher end of the guided range of US\$7.8-8mn.
- ✓ Company added highest-ever 20 new clients; 8 in Testing, 4 in ERP, 2 in BI/BA, 3 in Application Management, 2 in BPO and 1 in product engineering space. There was planned reduction in employee count by 78 over previous quarter to improve utilization. Attrition increased from to 16.1% from 15% qoq. Forex cover stood in excess of US\$60mn (covering ~65-70% of India inflow) taken at an average rate of Rs44.73.

- ✓ In Q2 CY07, company expects revenues between US\$64-65mn representing sequential growth of 6.5-8.1% and net profit between US\$7-7.2mn representing significant sequential de-growth of 10.2-12.7%. Operating margin is expected to be deeply impacted by the planned salary hikes of 14-15% offshore and 3-5% onsite, Rupee appreciation (company has assumed Rs42/\$) and high visa costs.
- ✓ For CY07, company expects to record higher than industry growth rate ie >32-33% yoy mainly driven by the Top 40 accounts and cross-selling & joint-selling synergies with FocusFrame. Company remains confident about doubling its revenues and profits over the next 8-10 quarters. The expectations are based on the existing solid order book and strong business environment. It expects to end CY07 with combined testing revenues of US\$50mn, which is expected to reach US\$100mn in CY09. Despite guiding a sharp OPM dip in Q2 CY07, company expects 100-150 bps yoy improvement in it for the year.
- ✓ To support the anticipated growth, company plans to add about 630 people (mainly freshers) at the start of Q3 CY07 and about 500 people in the next quarter taking the annual addition to ~1,400 employees.

### **Outlook**

Based on our broad calculations, company is likely to post 39.4% growth in revenues and 25.1% growth in earnings. We anticipate that company would have difficulty in even maintaining OPM on yoy basis. We are Neutral on the stock with a 12-month price target of Rs187 based on 16x CY07E EPS of Rs11.7.

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