

Wipro

STOCK INFO. BLOOMBERG
BSE Sensx: 7,971 WPRO IN
REUTERS CODE
S&P CNX: 2,412 WIPR.BO

19 October 2005

Buy

Rs369

Previous Recommendation: Buy

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	1,410.9	3/05A	81,353	15,834	11.3	-21.0	32.6	9.2	30.7	35.3	6.0	24.1
52-Week Range	414/286	3/06E	105,374	19,277	13.6	20.7	27.0	6.8	29.0	33.1	4.5	19.6
1,6,12 Rel.Perf.(%)	4/-4/-27	3/07E	133,906	25,230	17.5	28.2	21.1	5.1	28.5	33.1	3.4	14.1
M.Cap. (Rs b)	520.2											
M.Cap. (US\$ b)	11.5											

- Wipro reported consolidated total revenues of Rs25b, up 9.2% QoQ and PAT of Rs4.7b, up 10% QoQ, in line with expectations. Global IT business revenue at Rs18.9b was up 9.4% QoQ, primarily driven by volume growth at 11.3% QoQ. Global IT reported revenues at US\$430.7m v/s guidance of US\$422m (in dollar terms). Spectramind revenues declined 1.4% QoQ.
- Robust business growth in the Global IT services business, with Finance Solutions & Technology Business, Technology Infrastructure and Testing Services delivering double digit QoQ growth.
- The company added 39 new customers (including 2 in BPO, 10 in Europe, and 23 in USA) during the quarter. Net employee addition at 4,575 (gross addition 5,600) indicates strong volume growth outlook going forward.
- Consolidated EBITDA margin was down 50bp QoQ against our expectation of 60bp margin expansion due to pricing decline of 2% for offshore and 0.8% for onsite business. The company reported net profit of Rs4.7b (up 10.2% QoQ), with net margin staying flat at 18.5% despite a decline in EBITDA margin, due to higher income of Rs338m.
- The company has guided for revenue of US\$463m (7.5% growth QoQ in dollar terms) in 3QFY06. We estimate that the revenue growth for the next quarter would be robust at 9.4%, while the net profit growth is likely to be muted at 2.5% due to salary hikes. On our FY07E earnings of Rs17.5, the stock trades at a P/E of 21.1x. Maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Global IT Services incl Spectramind	13,538	14,915	15,789	16,471	17,430	18,876	20,214	21,672	60,713	78,192
Other Businesses	4,158	4,882	5,112	6,487	5,435	6,090	6,910	8,747	20,639	27,182
Revenues	17,696	19,797	20,902	22,958	22,865	24,966	27,124	30,419	81,353	105,374
Q-o-Q Change (%) - Global IT	7.9	10.2	5.9	4.3	5.8	8.3	7.1	7.2	39.7	28.8
Total Expenses	13,089	14,684	15,649	17,478	17,414	19,147	20,986	23,476	60,900	81,023
EBITDA- Global IT Services	4,121	4,478	4,613	4,806	4,859	4,460	5,231	5,860	18,017	20,294
Margins (%)	30.4	30.0	29.2	29.2	27.9	23.6	25.9	27.0	29.7	26.0
EBITDA	4,607	5,113	5,253	5,480	5,451	5,819	6,138	6,943	20,452	24,351
Margins (%)	26.0	25.8	25.1	23.9	23.8	23.3	22.6	22.8	25.1	23.1
Depreciation	514	570	656	697	722	759	805	852	2,438	3,138
EBIT	4,093	4,542	4,597	4,783	4,729	5,060	5,333	6,090	18,014	21,213
Margins (%)	23.1	22.9	22.0	20.8	20.7	20.3	19.7	20.0	22.1	20.1
Other Income	-199	206	345	420	70	338	330	330	771	1,067
PBT	3,894	4,748	4,942	5,203	4,799	5,398	5,663	6,420	18,786	22,280
Provision for Tax	598	679	694	722	586	791	827	899	2,693	3,103
Rate (%)	15.4	14.3	14.0	13.9	12.2	14.7	14.6	14.0	14.3	13.9
Net Income *	3,254	3,835	4,271	4,473	4,268	4,704	4,823	5,508	15,834	19,302
Q-o-Q Change (%)	0.0	17.8	11.4	4.7	-4.6	10.2	2.5	14.2	58.5	21.9

E: MOST Estimates; * after minority interest and share in earnings from affiliates

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IT services makes up for decline in BPO

Wipro reported consolidated total revenues of Rs25b, up 9.2% QoQ and PAT of Rs4.7b, up 10% QoQ. While, Spectramind revenues for the quarter declined 1.4% QoQ as the company continues to restructure its BPO business, the Global IT services business revenue at Rs18.9b was up 9.4% QoQ, primarily driven by volume growth at 11.3% QoQ. Global IT reported revenues at US\$430.7m as against a guidance of US\$422m.

REVENUE GROWTH (RS M)

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Net Revenue	14,915	15,789	16,471	17,430	18,876
QoQ Growth (%)	10.2	5.9	4.3	5.8	8.3
IT Services	13,234	13,988	14,676	15,581	17,052
QoQ Growth (%)	8.9	5.7	4.9	6.2	9.4
Spectramind	1,681	1,801	1,795	1,849	1,824
QoQ Growth (%)	21.5	7.1	-0.3	3.0	-1.4

Source: Company/Motilal Oswal Securities

All geographies contribute to growth

The quarter saw all geographies turning in a good performance, with Europe leading with 11.3% QoQ growth. US grew by 8%, the highest since the September 2004 quarter. Japan also reported the highest growth in the last five quarters at 6.3%, up from a 1.7% decline in 1QFY06.

REVENUE BY GEOGRAPHY (RS M)

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
North America	8,810	9,211	9,382	9,836	10,627
QoQ Growth (%)	13.3	4.6	1.9	4.8	8.0
Europe	3,930	4,254	4,516	4,926	5,483
QoQ Growth (%)	19.1	8.2	6.2	9.1	11.3
Japan	588	563	583	573	609
QoQ Growth (%)	-0.2	-4.2	3.4	-1.7	6.3

Source: Company/Motilal Oswal Securities

FS, Utilities and TMTS grow in double digits

Financial services, utilities and TMTS (Technology, Media, Transportation and Services) grew by 13.6%, 13.4% and 13% respectively during the quarter, reflecting the general trend observed in the results of Wipro's peers in 2QFY06. Business momentum in these domains continues to remain

strong, and we expect that FS, Utilities and TMTS would continue to perform strongly in 2HFY06.

REVENUE BY DOMAIN (RS M)

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Financial Services	2,339	2,634	2,753	3,082	3,503
QoQ Growth (%)	16.8	12.6	4.5	11.9	13.6
Retail	1,644	1,676	1,719	1,781	1,675
QoQ Growth (%)	16.3	1.9	2.6	3.6	-6.0
Utilities	1,471	1,521	1,530	1,626	1,844
QoQ Growth (%)	-10.9	3.4	0.6	6.3	13.4
Manufacturing	1,631	1,789	1,777	1,812	1,895
QoQ Growth (%)	25.8	9.7	-0.6	2.0	4.6
TMTS	1,230	1,197	1,224	1,363	1,540
QoQ Growth (%)	18.6	-2.7	2.2	11.4	13.0

Source: Company/Motilal Oswal Securities

Spectramind declines as restructuring of BPO business continues

Spectramind continues to restructure its business to incorporate greater non-voice component into its business. However, that translates into choppy revenue growth in the near term, which is expected to continue till the transition is completed. Currently, the non-voice BPO business forms 16% of overall revenue. The company aims to bring this up to 40% over the coming quarters. In the transition phase, we expect revenue growth to fluctuate between quarters. However, the management has indicated that it has been able to achieve significant gains in profitability by increasing utilization rates and training throughput, which is likely to be sustained in the coming quarters.

Top clients growth muted

Compared to Infosys and TCS, which reported strong performance from top clients, Wipro's top client performance has been lackluster. While overall revenue growth has been strong, the growth has come mainly from non-top 10 clients, which indicates a good amount of churn in the top client composition in the quarters to come. We believe that the outcome of such a churn would be positive since it would result in faster growing, more profitable clients in the top list.

CLIENT CONCENTRATION

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Top Client	682	592	583	604	541
QoQ Growth (%)	-3.6	-13.2	-1.5	3.7	-10.4
Top 2- 5 Clients	1,818	1,761	1,836	1,874	1,929
QoQ Growth (%)	2.9	-3.2	4.3	2.1	2.9
Top 6-10 Clients	1,765	1,873	1,952	1,967	2,048
QoQ Growth (%)	7.0	6.2	4.2	0.8	4.1

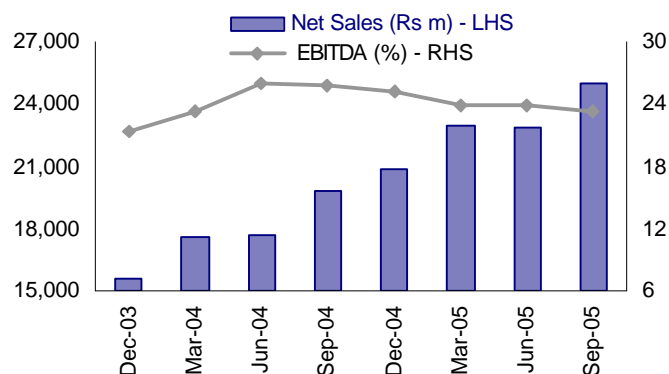
Source: Company/Motilal Oswal Securities

The company added 39 new customers (including 2 in BPO, 10 in Europe, and 23 in USA) during the quarter.

Lower SG&A expense stems fall in margins

Gross margins declined to 31.9% in 2QFY06 from 36.3% in 1QFY06, an erosion of 440bp over the quarter due to ramp up in the sales force during the quarter, combined with a pricing decline of 2% for offshore and 0.8% for the onsite business. In our interaction with the company, we learnt that the offshore price decline was an accounting effect - the company had received an extra incentive in 1QFY06 for completing a major project before time, which resulted in a spike in employee costs. However, the net erosion in EBITDA margin was lower at 50bp due to lower SG&A expenses which declined to 8.4% of sales from 12.3% in the previous quarter. Wipro will witness salary hikes in November, which are likely to pull margins down further in 3QFY06. While, margins are likely to find some respite in 4QFY06, margins for the full year would be lower at 23.1% of net sales.

EBITDA MARGIN DECLINE



Source: Company/Motilal Oswal Securities

Net margins flat at 18.5%

The company reported net profit at Rs4.7b (up 10.2% QoQ), with net margins staying flat at 18.5% despite the decline in EBITDA margins, due to higher income at Rs338m. Reported net profit at Rs4.7b was also buoyed by Rs83m income from equity investment.

Valuation and view

Net employee addition at 4,575 (gross addition 5,600) indicates strong volume growth outlook going forward. The company has guided for revenue of US\$463m (7.5% growth QoQ in dollar terms) in 3QFY06. We estimate that the revenue for the next quarter would be robust at 9.4%, while the net profit growth is likely to be muted at 2.5% due to lower margins. We expect revenue growth of 29.5% and 27.1% for FY06E and FY07E, respectively. We expect net profit to grow by 21.7% and 30.9% in FY06E and FY07E, respectively. On FY07E earnings of Rs17.5, the stock trades at a P/E of 21.1x. **Maintain Buy.**

Wipro: an investment profile

Company description

Wipro has the third largest Indian IT services operations and the largest third-party BPO operation in India. It is the largest third-party R&D services provider globally. It employs about 26,000 people in its IT services and over 15,000 people in its BPO operations. Its top clients include large telecom companies like Cisco, Nokia, Nortel, Lucent and other large companies like General Motors, Sony, Microsoft and Transco National Grid.

Key investment arguments

- ✍ Largest beneficiary of R&D services outsourcing to India
- ✍ The most comprehensive IT services company with a wide portfolio of services including R&D, Enterprise, BPO and Infrastructure management.
- ✍ Experience of integrating successfully and realizing benefits from acquisitions

Key investment risks

- ✍ Weaker Enterprise solutions practice relative to peers
- ✍ Inability to mine clients beyond a certain scale
- ✍ Lagging in package implementation segment

Recent developments

- ✍ First Indian IT vendor to be awarded Gold-level membership in the Microsoft Windows Embedded Partner (WEP) Program as a System Integrator and Independent Software Vendor.
- ✍ Mr. P R Chandrasekhar has been appointed Chief Executive of Americas and Europe.

Valuation and view

- ✍ Revenue growth of 29.5% and earnings growth of 21.7% in FY06
- ✍ Valuations at 27x FY06 earnings are expensive but at 21.1x FY07 earnings, there is still some upside.
- ✍ **Buy** with a target price of Rs437, an upside of 18.6% from current levels

Sector view

- ✍ Various CIO surveys indicate increasing share of offshore spending in IT budgets
- ✍ Indian offshore vendors gaining market share in competition with MNCs
- ✍ Prefer large companies as bulk of volumes going to them while niche players benefit due to lack of offshore competition

COMPARATIVE VALUATIONS

		WIPRO	INFOSYS	TCS
P/E (x)	FY06E	27.0	28.9	24.7
	FY07E	21.1	22.9	20.4
P/BV (x)	FY06E	6.8	10.2	11.8
	FY07E	5.1	7.8	8.1
EV/Sales (x)	FY06E	4.5	7.1	5.6
	FY07E	3.4	5.2	8.1
EV/EBITDA (x)	FY06E	19.5	21.9	19.1
	FY07E	14.0	16.0	15.3

SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	82.1	82.4	83.7
Domestic Institutions	1.4	1.4	1.8
FII's/FDIs	6.5	5.4	5.1
Others	10.1	10.9	9.5

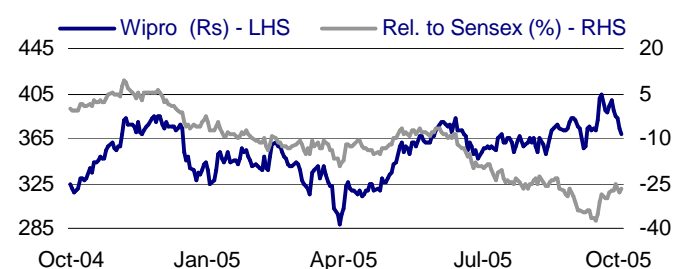
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	13.6	14.1	-3.5
FY07	17.5	17.9	-2.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
369	437	18.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Sales	43,091	58,434	81,353	105,374	133,906
Change (%)	28.7	35.6	39.2	29.5	27.1
Cost of Revenues	25,788	37,028	51,417	69,877	86,830
SG&A	6,496	8,682	9,483	11,146	14,586
			81,023		
EBITDA	10,806	12,724	20,452	24,351	32,490
% of Net Sales	25.1	21.8	25.1	23.1	24.3
Depreciation	1,715	2,280	2,578	3,184	4,143
Other Income	1,145	1,325	771	1,114	1,260
PBT	10,237	11,769	18,646	22,280	29,607
Tax	1,343	1,611	2,693	3,103	4,145
Rate (%)	13.1	13.7	14.4	13.9	14.0
PAT	8,894	10,158	15,953	19,178	25,462
Earnings of Affiliates	-356	96	-37	139	0
Minority Interest	30	56	82	40	232
Extraordinary items	-378	-206	0	0	0
Net Income	8,129	9,992	15,834	19,277	25,230
Change (%)	-2.4	22.9	58.5	21.7	30.9

BALANCE SHEET (Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	465	465	1,407	1,407	1,407
Additional Paid in Capital	6,947	7,177	10,087	10,087	10,087
Retained Earnings	28,020	38,722	45,234	64,537	89,767
Net Worth	35,432	46,364	56,729	76,031	101,263
Minority Interest	0	407	533	693	899
Loans	604	969	564	0	0
Capital Employed	36,035	47,740	57,826	76,724	102,162
Gross Block	13,785	17,705	24,317	31,317	40,317
Less : Depreciation	6,476	8,448	11,116	14,254	18,332
Net Block	7,310	9,257	13,201	17,063	21,985
Investments	2,430	20,308	24,959	24,959	24,959
Intangible Assets	5,637	5,592	5,978	5,478	4,978
Curr. Assets	27,405	22,581	27,937	47,194	72,080
Debtors	7,931	10,973	14,806	18,188	22,379
Inventories	1,449	1,439	1,769	1,869	1,969
Cash & Bank Balance	14,096	3,297	5,671	20,309	39,538
Adv., Other Current Assets	3,928	6,872	5,690	6,828	8,194
Current Liab. & Prov	6,745	9,998	14,249	17,971	21,840
Creditors	3,133	2,733	3,713	5,328	6,668
Other Liabilities	3,612	7,265	10,536	12,643	15,172
Net Current Assets	20,659	12,583	13,687	29,224	50,240
Application of Funds	36,035	47,740	57,826	76,724	102,162

E: Inquire Estimates

RATIOS					
Y/E MARCH	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS*	11.7	14.3	11.3	13.6	17.5
Cash EPS*	14.1	17.6	13.1	15.9	20.4
Book Value	25.1	32.9	40.2	53.9	71.8
DPS	10	26.3	5.0	3.4	4.4
Payout %(Incl.Div.Taxes)	8.6	184.0	44.4	25.0	25.0
Valuation (x)					
P/E		25.8	32.6	27.0	21.1
Cash P/E		21.0	28.1	23.2	18.1
EV/EBITDA		39.2	24.1	19.6	14.1
EV/Sales		8.5	6.0	4.5	3.4
Price/Book Value		11.2	9.2	6.8	5.1
Dividend Yield (%)		7.1	14	0.9	12
Profitability Ratios (%)					
RoE	25.9	24.4	30.7	29.0	28.5
RoCE	32.1	28.1	35.3	33.1	33.1
Turnover Ratios					
Debtors (Days)	67	69	66	63	61
Asset Turnover (x)	3.1	3.3	3.3	3.4	3.3
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT (Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Cash Flow from Operations	10,566	12,130	22,488	24,512	30,605
Cash for Working Capital	516	2,723	1,231	-902	-230
Net Operating CF	10,051	9,407	21,257	25,414	30,835
Net Purchase of FA	-2,950	-3,372	-7,328	-6,000	-7,461
Net Purchase of Investment	4,975	549	-5,918	841	2,079
Payment for Acquisitions	-5,192	0	0	0	0
Net Cash from Invest.	-3,166	-2,823	-13,246	-5,160	-5,382
Issue of Shares	219	637	3,979	160	208
Proceeds from LTB/STB	313	365	-405	-564	0
Dividend Payments	-697	-18,386	-9,211	-5,212	-6,596
Net CF from Financing	-166	-17,383	-5,638	-5,616	-6,388
Free Cash Flow	7,101	6,035	13,035	14,478	18,818
Net Cash Flow	6,719	-10,800	2,374	14,639	19,065
Opening Cash Balance	7,377	14,096	3,297	5,671	20,309
Add: Net Cash	6,719	-10,800	2,374	14,639	19,065
Closing Cash Balance	14,096	3,297	5,671	20,309	39,374

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3. Broking relationship with company covered	No
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