

**ADD**

**Wipro**

**Target price (INR)**

**722**

**Low growth in top clients poses near-term challenge**

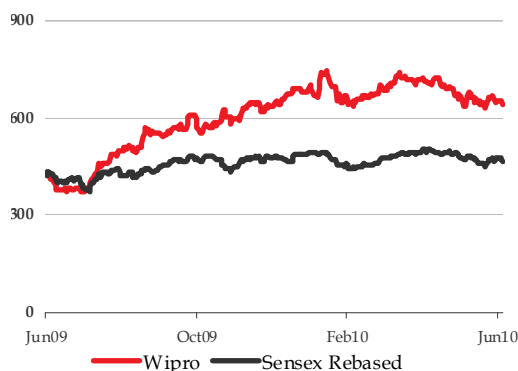
## Company Report

**Last Price (INR)** **642.4**

|                      |                |
|----------------------|----------------|
| Bloomberg code       | WPRO IN        |
| Reuters code         | WIPR.BO        |
| Avg. Vol. (3m)(mn)   | 1.10           |
| Avg. Val.(3m)(INRmn) | 758            |
| 52-wk H/L (INR)      | 756 / 362      |
| Sensex               | 16,617         |
| MCAP (INRbn/USDbn)   | 943.67 / 20.10 |

| Shareholding (%) | 12/09 | 03/10 |
|------------------|-------|-------|
| Promoters        | 79.6  | 79.5  |
| MFs, FIs, Banks  | 2.0   | 1.7   |
| FIIIs            | 7.1   | 7.2   |
| Public           | 5.5   | 5.5   |
| Others           | 5.8   | 6.1   |

### Stock Chart (Relative to Sensex)



| Stock Perfm. (%) | 1m   | 6m   | 1yr  |
|------------------|------|------|------|
| Absolute         | -1.4 | -4.0 | 48.4 |
| Rel. to Sensex   | -0.8 | -1.3 | 38.2 |

| Financials (INRmn) | 03/10   | 03/11f  | 03/12f  |
|--------------------|---------|---------|---------|
| Sales              | 271,957 | 304,123 | 354,380 |
| y-o-y (%)          | 6       | 12      | 17      |
| EBITDA (%)         | 22      | 22      | 21      |
| A.PAT              | 45,931  | 51,114  | 59,184  |
| Sh o/s (diluted)   | 1,465   | 1,470   | 1,468   |
| A.EPS (INR)        | 31.2    | 34.8    | 40.3    |
| y-o-y (%)          | 16      | 11      | 16      |
| D/E (x)            | -0.4    | -0.5    | -0.5    |
| P/E (x)            | 20.6    | 18.5    | 16.0    |
| EV/E (x)           | 14.6    | 12.7    | 10.8    |
| RoCE (%)           | 21      | 19      | 19      |
| RoE (%)            | 27      | 24      | 24      |

| Quarterly Trends | 06/09  | 09/09  | 12/09  | 03/10  |
|------------------|--------|--------|--------|--------|
| Sales (INRmn)    | 63,868 | 68,937 | 69,380 | 69,772 |
| PAT (INRmn)      | 10,104 | 11,707 | 12,033 | 12,088 |

Revenue in IT Services is likely to grow at a CAGR of c20% till FY13f, driven by a surge in volumes and stable pricing. Low growth in Top 10 clients and low contribution from the BFSI segment could lead to underperformance vis-à-vis its peers in FY11f and FY12f. EBITDA margins are forecast to decline by c50-bp in FY11 and FY12, led by salary hikes and higher attrition. We do not foresee further improvement in utilization as it is likely to hamper revenue growth during an economic upturn. The rising tax rate is likely to lower the CAGR in net profits during FY10-FY13f to 15%. We arrive at a Jun11 target of INR722. At our target price, the stock is likely to trade at c19x FY12f earnings. We initiate coverage with an Add rating.

### Forecast 20% CAGR in IT Services, led by volumes

Revenues in IT Services are forecast to report a CAGR of c20% during FY10-FY13, led by a surge in volumes. Volumes grew by 4.7% and 4.1% q-o-q in the quarters ended Dec09 and Mar10; we forecast this trend to continue in FY11 and FY12. Growth of 2.3% in Top 10 clients compared to 4.6% for other clients and low contribution from the BFSI vertical are likely to lead to WPRO underperforming its peers in FY11f and FY12f. We have witnessed strong traction in the BFSI vertical during the past two to three quarters. Our channel check suggests that the trend of outperformance by BFSI over other verticals is likely to continue in FY11f.

### EBITDA margins to decline by 50-bp in FY11f and FY12f

EBITDA margins are forecast to decline by c50-bp in FY11 and FY12, led by salary hikes, increasing attrition, and higher selling, general and administrative expenses. Also, employee utilization is at a five-year high of c80%; we do not foresee further improvement as it is likely to hamper revenue growth during an economic upturn.

### Increasing tax rate to lower CAGR in net profit to 15%

WPRO's tax rate is estimated to move up to c20% in FY11f and FY12f from c17% in FY10. The rising tax rate is likely to lower the CAGR in net profit during FY10-FY13f to 15%. Despite the rise in tax rate in FY11f and FY12f, it is likely to be lower than those of its peers.

### Initiate with an Add rating and Jun11 target of INR722

We arrive at a Jun11 target of INR722. At our target price, the stock is likely to trade at c19x FY12f earnings. WPRO's valuation discount vis-à-vis Infosys Technologies (INFO IN, Add) has narrowed during the past six months to c10%, from c20%. We estimate the company to trade at a c15% discount to INFO. We initiate coverage on WPRO with an Add rating. Lower-than-expected revenue growth and USD appreciation against the INR are the key risks to our estimates.

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## Investment Summary

Revenue in IT Service is likely to grow at a CAGR of c20% till FY13f, driven by surge in volumes and stable pricing. Volumes grew by 4.7% and 4.1% q-o-q in the quarters ended Dec09 and Mar10; we forecast this trend to continue in FY11 and FY12. Low growth in Top 10 clients compared to other clients and low contribution from BFSI could lead to underperformance vis-à-vis its peers in FY11f and FY12f. EBITDA margins are forecast to decline by c50-bp in FY11 and FY12, led by salary hikes and higher attrition. We do not foresee further improvement in utilization as it is likely to hamper revenue growth during an economic upturn. The rising tax rate is likely to lower the CAGR in net profits during FY10-FY13f to 15% compared to 17% in profit before tax. We arrive at a Jun11 target of INR722. At our target price, the stock is likely to trade at c19x FY12f earnings. WPRO has traded at a discount of 15% to 20% vis-à-vis INFO; however, the discount has narrowed during the past six months to c10%. We estimate the company to trade at c15% discount to INFO during FY11-FY12. We initiate coverage with an Add rating.

### 20% CAGR in IT Services led by volumes

Revenues in IT Services are forecast to report a CAGR of c20% during FY10-FY13.

Revenues in IT Services are forecast to report a CAGR of c20% during FY10-FY13f, led by a surge in volumes. The segment's volumes grew by 4.7% and 4.1% q-o-q in the quarters ended Dec09 and Mar10, after declining in two of the previous four quarters. We forecast this trend to continue in FY11 and FY12.

### Lower growth in Top 10 clients compared to other clients

Revenue growth has been led by clients other than the Top 10. Revenues from the Top 10 clients have reported a CQGR of 2.3% during the past 12 quarters compared to 4.6% for other clients. Client concentration for Wipro (WPRO) is comfortable compared to that for Infosys Technologies (INFO IN, Add) and Tata Consultancy Services (TCS IN, Add). The company's top client contributes 2.5% to total revenues, whereas the same stands at 4.6% for INFO and 8.2% for TCS. Though diversified clients give comfort, it also implies that the average Top-10 client size is lower than that for its peers.

### Low contribution from financial services

WPRO generates 26% of its revenues from the Banking, Financial Services and Insurance (BFSI) vertical compared to 34% for INFO and c45% for TCS. Lower contribution from BFSI could lead to the company underperforming its peers in FY11f and FY12f in the near term as the vertical has seen huge traction during the past two to three quarters. Even our channel check suggests the trend of outperformance by BFSI over other verticals is likely to continue in FY11f.

### EBITDA margins to decline by 50-bp in FY11f and FY12f

EBITDA margins may come under pressure in FY11f and FY12f.

We forecast WPRO's EBITDA margins to decline by c50-bp in FY11 and FY12, led by flat utilization, salary hikes, rising attrition levels and an increase in selling, general and administrative (SG&A) expenses. Employee utilization is at a five-year high of c80%; we do not foresee further improvement as it is likely to hamper revenue growth in an economic upturn. During the past two years, WPRO also managed to increase the revenue contribution from fixed-price projects, which helped increase gross margins. With volume growth returning to the Indian IT industry and clients discussing new projects, we do not estimate offshore revenues to outperform onsite in the near term as they did during the past 12 quarters, which helped WPRO increase its gross margins. We forecast SG&A expenses at c12% of revenues in FY11 and FY12.

### Increasing tax rate to lower net profit CAGR to 15%

We forecast WPRO's profit before tax to report a CAGR of 17% during FY10-FY13f. The tax rate is estimated to move up to c20% in FY11f and FY12f from c17% in FY10. The rising tax rate is likely to lower the CAGR in net profit during FY10-FY13f to 15%. Despite the rise in tax rate in FY11f and FY12f, it is likely to be lower than those of its peers, INFO and TCS.

## Initiate with an Add rating and Jun11 target price of INR722

Initiate coverage with an Add rating and target price of INR722.

We arrive at a Jun11 target of INR722. At our target price, the stock is likely to trade at c19x FY12f earnings. For the past 8 quarters, WPRO has traded at a discount of 15% to 20% vis-à-vis INFO; however, the discount has narrowed to c10% during the past six months. We estimate the company to trade at a 15% discount to INFO during FY11-FY12. We initiate coverage on WPRO with an Add rating. Key risks to our estimates are lower than expected revenue growth and USD appreciation against INR.

Exhibit 1: P/E chart



Source: Company, Avendus Research

Exhibit 2: Valuation summary

| (INRmn) | Net Sales | EBITDA | Net Profit | EPS (INR) | P/E (x) | EV/EBITDA (x) | EV/Sales (x) | P/B (x) |
|---------|-----------|--------|------------|-----------|---------|---------------|--------------|---------|
| Mar09   | 256,891   | 50,247 | 39,374     | 26.9      | 24.0    | 17.6          | 3.5          | 6.4     |
| Mar10f  | 271,957   | 59,342 | 45,931     | 31.2      | 20.6    | 14.6          | 3.2          | 4.8     |
| Mar11f  | 304,123   | 65,863 | 51,114     | 34.8      | 18.5    | 12.7          | 2.7          | 4.2     |
| Mar12f  | 354,380   | 76,177 | 59,184     | 40.3      | 16.0    | 10.8          | 2.3          | 3.6     |
| Mar13f  | 420,255   | 90,692 | 70,370     | 47.9      | 13.4    | 8.8           | 1.9          | 3.0     |

Source: Avendus Research

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## 20% CAGR in IT Services driven by volumes

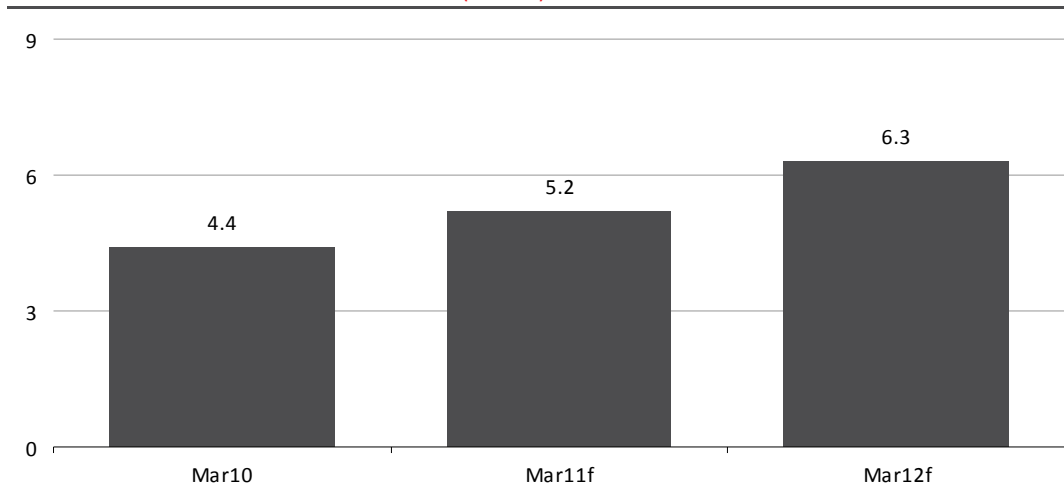
Revenues in IT Services are forecast to report a CAGR of c20% during FY10-FY12, led by a surge in volumes. The segment's volumes grew by 4.7% and 4.1% q-o-q in the quarters ended Dec09 and Mar10; we forecast this trend to continue in FY11 and FY12. During the past 12 quarters, emerging markets have outperformed other geographies such as the US, Europe and Japan. Revenue growth has been led by clients other than the Top 10 clients. The average Top-10 client size for WPRO is lower than that for its peers. Among the Top 3 IT companies, the company has the least exposure to the BFSI vertical. This is likely to lead to the company underperforming peers in the near term as the vertical has seen huge traction during the past two to three quarters. Also, our channel check suggests that the trend of outperformance by BFSI over other verticals is likely to continue in FY11f.

### Volume growth of c5% q-o-q in IT Services

**Forecast sequential volume growth of c5% in IT Services during FY11-FY13.**

Revenues in IT Services are forecast to report a CAGR of c20% during FY10-FY12, led by a surge in volumes. The segment's volumes grew by 4.7% and 4.1% q-o-q in the quarters ended Dec09 and Mar10, after declining in two of the previous four quarters. We forecast this trend to continue in FY11 and FY12.

**Exhibit 3: Revenues from Global IT Services (USDbn)**



Source: Company, Avendus Research

### Emerging markets outperforming other geographies

WPRO generates c14% of its revenues from India, the Middle East and other emerging markets. These geographies have outperformed the major markets of the US and Europe during the past 12 quarters. Revenues from emerging geographies reported a CQGR of 9.2% as against 3.0% for the US, Europe and Japan.

**Exhibit 4: Revenue mix by geography**

| (%)                  | Revenue contribution | CQGR for 12 quarters |
|----------------------|----------------------|----------------------|
| Emerging markets     | 14                   | 9.2                  |
| US, Europe and Japan | 86                   | 3.0                  |

Source: Company, Avendus Research

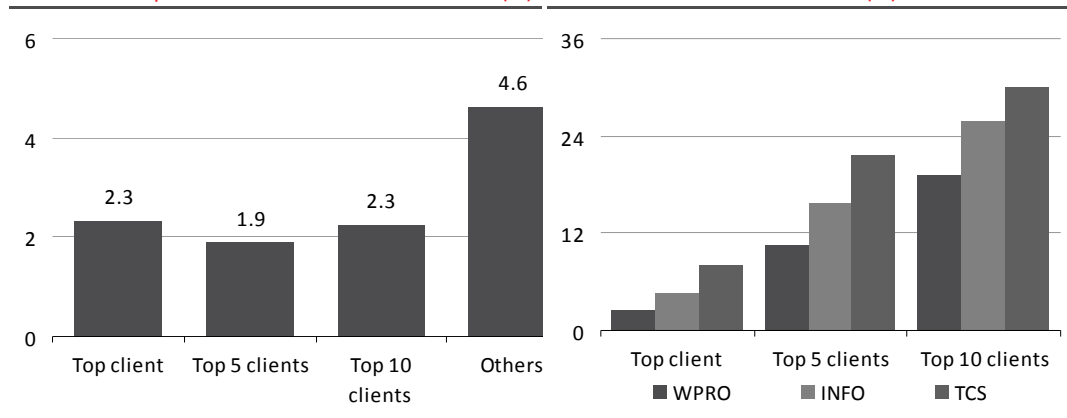
### Lower growth in Top 10 clients compared to other clients

Revenues from the Top 10 clients reported a CQGR of 2.3% during the past 12 quarters compared to 4.6% for other clients.

### Client concentration is lowest among peers

Client concentration for WPRO is comfortable compared to that for INFO and TCS. The company's top client contributes 2.5% to total revenues, whereas the same stands at 4.6% for INFO and 8.2% for TCS. Though diversified clients give comfort, it also implies that the average Top-10 client size is lower than that for its peers.

Exhibit 5: 12-quarter CQGR in clients for WPRO (%) Exhibit 6: Client concentration (%)



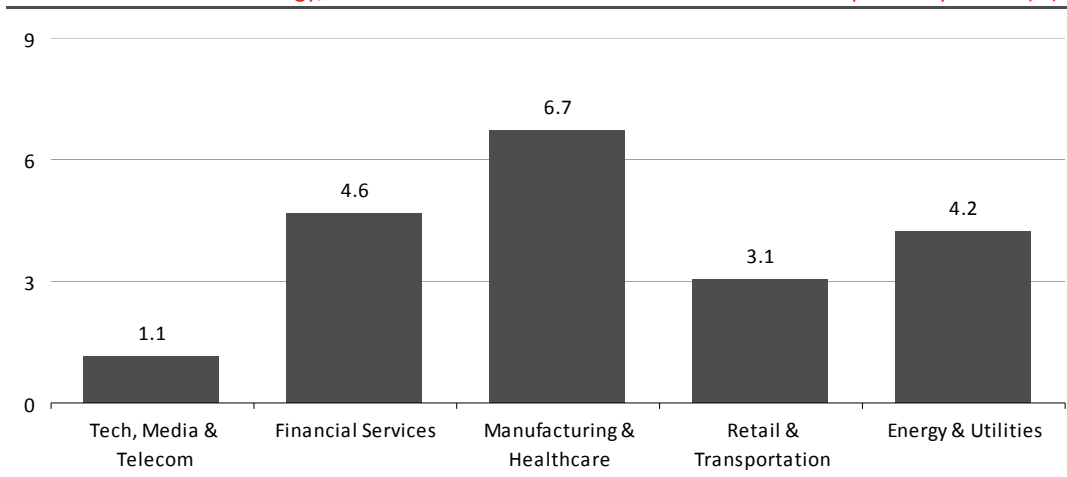
Source: Company, Avendus Research

Source: Company, Avendus Research

### Technology, media and telecom vertical has been underperforming

WPRO's technology, media and telecom vertical has been underperforming for the past 12 quarters. Revenues from other verticals reported a CQGR of 3% to 7% during the past 12 quarters compared to 1.1% for the technology, media and telecom vertical.

Exhibit 7: CQGR in technology, media and telecom vertical vis-à-vis others for the past 12 quarters (%)



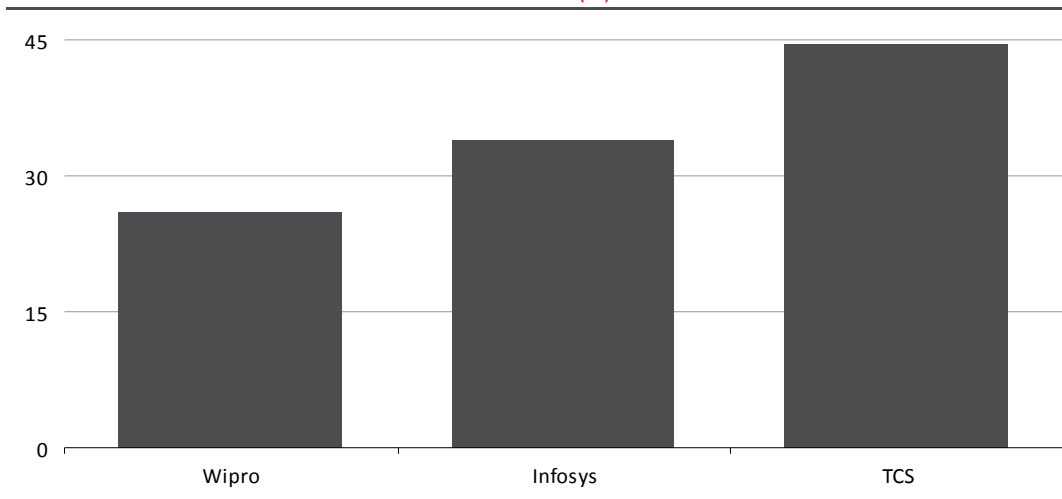
Source: Company, Avendus Research

### Lowest contribution from BFSI among peers

WPRO's generates 26% of its revenues from BFSI compared to 34% for INFO and c45% for TCS. The lower contribution could lead to the company underperforming its peers in FY11f and FY12f as the vertical has seen huge traction in during the past two to three quarters. Also, our channel check suggests that the trend of outperformance by BFSI over other verticals is likely to continue in FY11f.

The low contribution from BFSI could lead to underperformance as against peers.

Exhibit 8: Revenue contribution from financial services (%)



Source: Company, Avendus Research

### Forecast c10% growth in the consumer and product business

Forecast c10% growth in the consumer and product business in FY11 and FY12.

WPRO generates c25% of its total revenues from its consumer and product business; however, the business contributes only 5% to operating income. We estimate this business to grow by c10% in FY11f and FY12f.

Exhibit 9: Revenue forecast for consumer and product business

| (INRmn)                    | Mar10  | y-o-y (%) | Mar11f | y-o-y (%) | Mar12f | y-o-y (%) |
|----------------------------|--------|-----------|--------|-----------|--------|-----------|
| IT Products                | 38,205 | 11.5      | 42,026 | 10.0      | 46,228 | 10.0      |
| Consumer Care and Lighting | 22,584 | 17.3      | 24,842 | 10.0      | 27,327 | 10.0      |
| Others                     | 7,962  | -21.9     | 8,758  | 10.0      | 9,634  | 10.0      |
| Total                      | 68,751 | 7.9       | 75,626 | 10.0      | 83,189 | 10.0      |

Source: Avendus Research

## EBITDA margins to decline by 50-bp in FY11f and FY12f

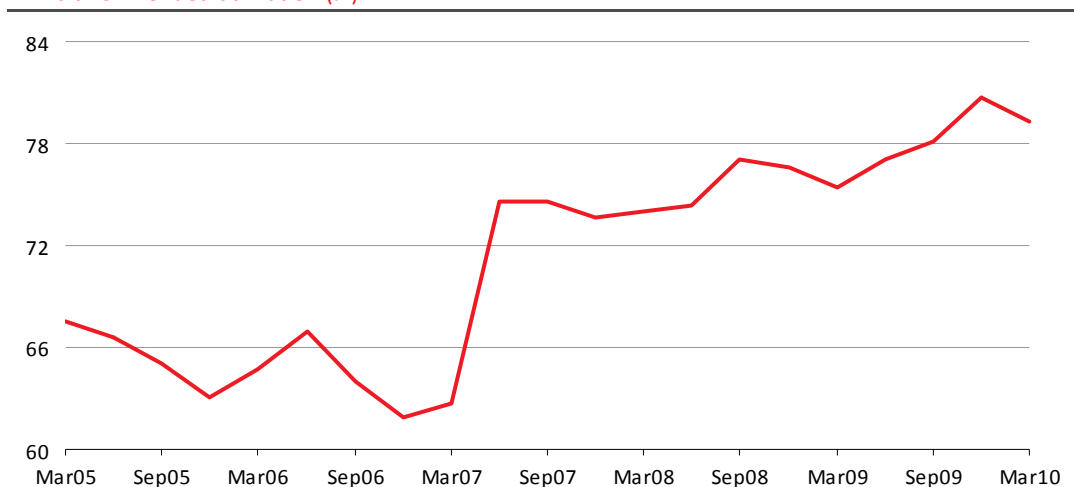
We forecast WPRO's EBITDA margins to decline by c50-bp in FY11 and FY12, led by flat utilization, salary hikes, likely rise in attrition levels and an increase in selling, general and administrative expenses. Employee utilization is at a five-year high of c80%; we do not foresee further improvement as it is likely to hamper revenue growth in an economic upturn. Intake of freshers and increasing attrition is likely to put further pressure on EBITDA margins. During the past two years, WPRO also managed to increase the revenue contribution from fixed-price projects, which helped increase gross margins. With volume growth returning to the Indian IT industry and clients discussing new projects, we do not estimate offshore revenues to outperform onsite in the near term as they did during the past 12 quarters, which helped WPRO increase its gross margins. We forecast SG&A expenses at c12% of revenues in FY11 and FY12.

### Utilization at five-year high; little scope for further improvement

**Little scope for further improvement in employee utilization.**

Employee utilization is at a five-year high of c80%. We do not foresee further improvement in utilization as it is likely to hamper revenue growth in an economic upturn. The company has targeted gross hiring of c20,000 employees in FY11f; thus, improvement in utilization seems difficult. During the economic downturn (Mar08-Mar10), WPRO managed to increase utilization by c10% on account of its focus on cost rationalization.

Exhibit 10: Blended utilization (%)



Source: Company, Avendus Research

### Salary hikes likely to impact gross margins by c50-bp in FY11f

WPRO gave its offshore employees a salary hike of 13% to 15% in the quarter ended Mar10. This is estimated to reduce gross margins in FY11f. Intake of freshers is also likely to lower blended utilization. These metrics are likely to adversely impact gross margins by c50-bp in FY11f.

Exhibit 11: EBITDA and Gross margins (%)

| (%)            | Mar10 | Mar11f | Mar12f |
|----------------|-------|--------|--------|
| Gross margins  | 34.0  | 33.5   | 33.5   |
| EBITDA margins | 22.1  | 21.7   | 21.6   |

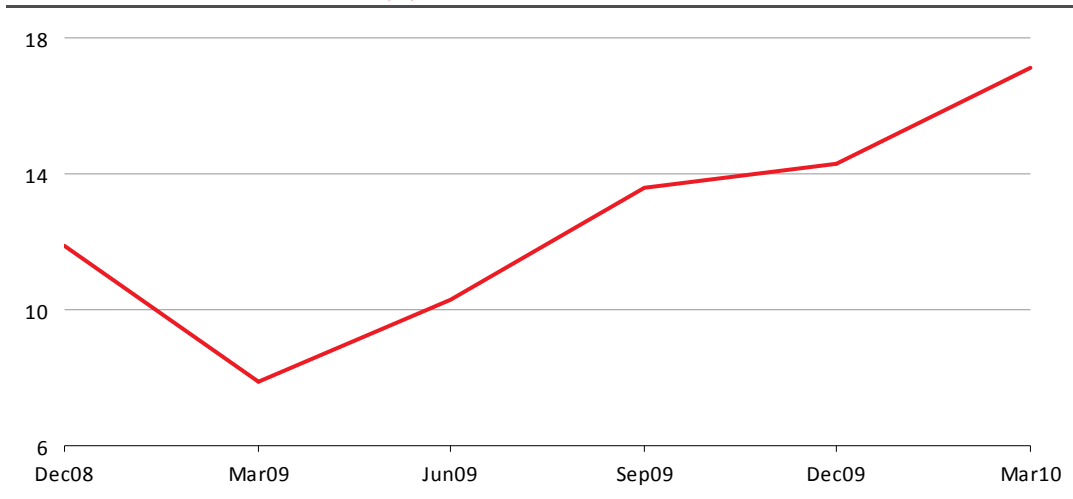
Source: Company, Avendus Research

### Sharp rise in employee attrition during the past four quarters

Employee attrition has picked up during the past four quarters on account of the improving business environment, which bettered job markets. The pick-up in attrition is likely to put pressure on EBITDA margins as it would lead to higher recruitment and training costs.



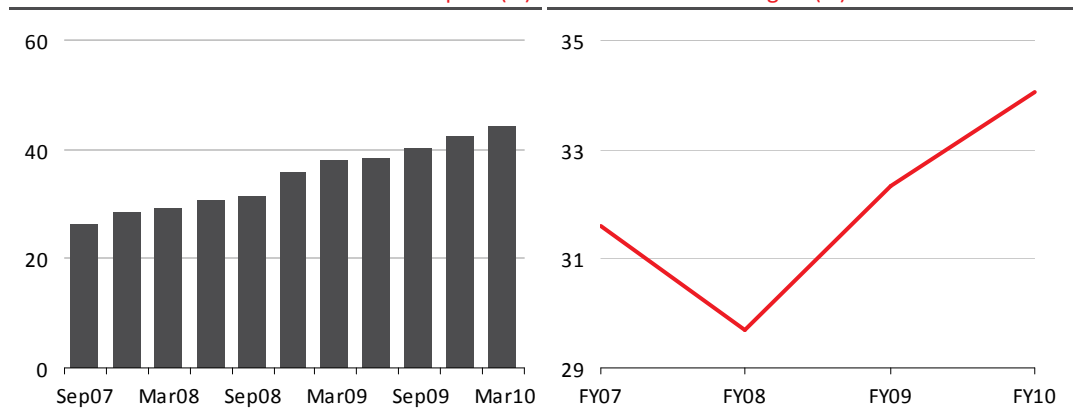
Exhibit 12: Annualized attrition rate (%)



Source: Company, Avendus Research

## Rising revenues from fixed-price projects boost gross margins

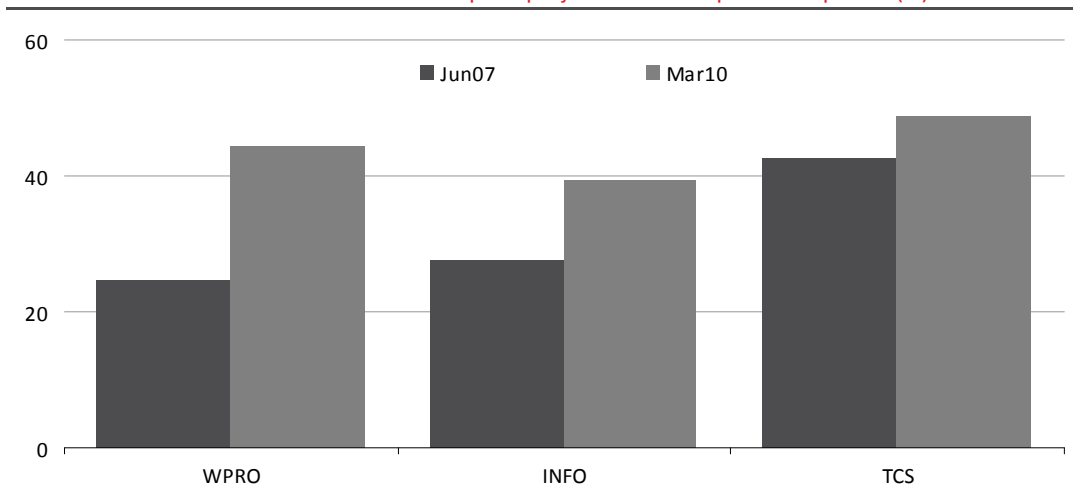
Exhibit 13: Revenue contribution from fixed-price (%) Exhibit 14: Gross margins (%)



Source: Company, Avendus Research

Source: Company, Avendus Research

Exhibit 15: Revenue contribution from fixed-price projects for the Top 3 IT companies (%)



Source: Company, Avendus Research

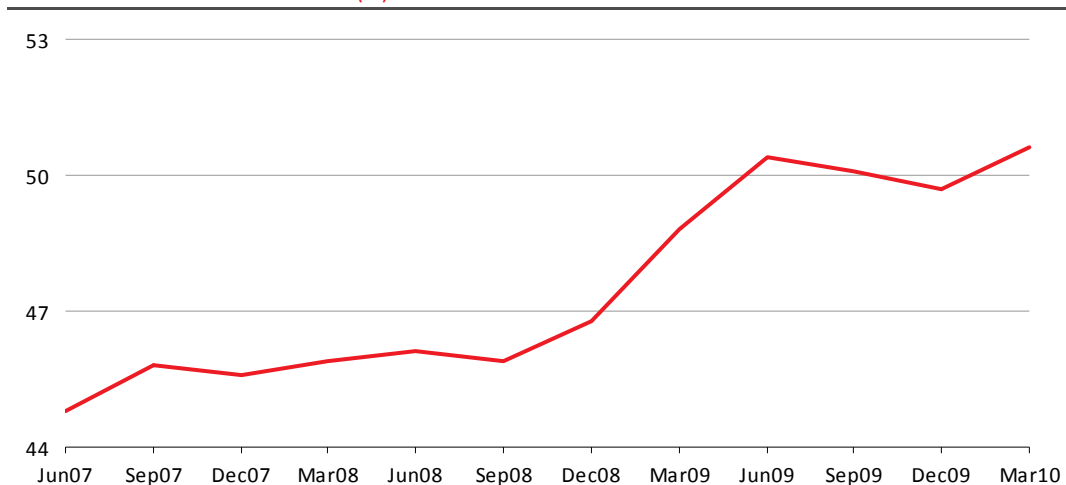
Revenue contribution for the company from fixed-price projects has always been on the lower side compared with that for other peers. In 2007, WPRO's revenue contribution from fixed-price projects

was c25% compared to c28% for INFO and c43% for TCS. However, during the economic downturn, the company focused on changing its billing model and increased the revenue contribution from fixed-price projects to c45% in the Mar10 quarter. Higher revenues from fixed-price projects provide companies with an opportunity to increase gross margins, though it also exposes them to the risk of project delay.

### Shifting work to offshore also helped increase gross margins

WPRO increased its offshore revenues at a CQGR of 4.9% during the past 12 quarters as against 2.7% for onsite revenues. This has been largely due to the shift of work from onsite to offshore to help increase gross margins. However, with volume growth returning to the Indian IT industry and clients discussing new projects, we do not estimate offshore revenues to outperform onsite in the near term.

Exhibit 16: Offshore revenue mix (%)



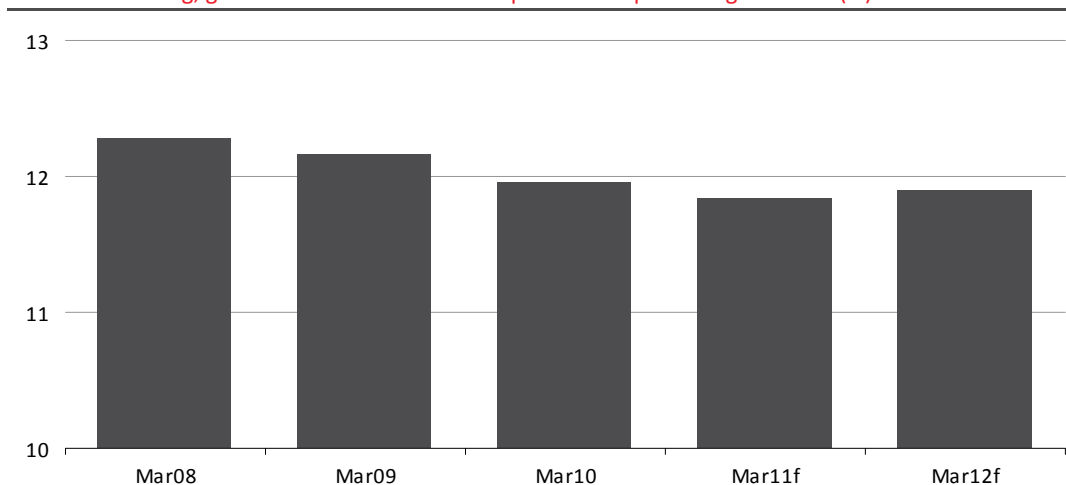
Source: Company, Avendus Research

### Estimate SG&A expenses at c12% of sales

Forecast SG&A expenses to remain at c12% of sales in FY11 and FY12f.

We forecast SG&A expenses at c12% of revenues in FY11 and FY12f. WPRO's SG&A expenses, as a percentage of sales, declined from 12.3% in FY08 to 12.0% in FY10.

Exhibit 17: Selling, general and administrative expenses as a percentage of sales (%)



Source: Company, Avendus Research

## Net profit CAGR likely to fall 200-bp to 15% during FY10-FY13f

We forecast WPRO's profit before tax to report a CAGR of 17% during FY10-FY13f. The tax rate for the company is estimated to increase by c300-bp in FY11f and FY12f from c17% in FY10. The rising tax rate is likely to lower the CAGR in net profit during FY10-FY13f to 15%. Despite the c300-bp jump in the tax rate in FY11f and FY12f, it is likely to be lower than those of its peers.

### Profit before tax to report a CAGR of 17% during FY10-FY13f

We forecast WPRO's profit before tax to report a CAGR of 17% during FY10-FY13, led by volume growth. EBITDA margins are estimated to decline by 50-bp in FY11f, which is likely to lead to lower growth in the profit before tax compared with revenue growth.

Exhibit 18: CAGR in profit before tax during FY10-FY13f (%)

| (INRmn)           | Mar10  | Mar11f | Mar12f | Mar13f | CAGR (%) |
|-------------------|--------|--------|--------|--------|----------|
| Profit before tax | 54,880 | 60,143 | 70,233 | 87,215 | 16.7     |

Source: Avendus Research

### Increasing tax rate to lower net profit CAGR to 15%

WPRO's tax rate is estimated to move up to c20% in FY11f and FY12f from c17% in FY10. The rising tax rate is likely to lower the CAGR in net profit during FY10-FY13f to 15%.

Exhibit 19: CAGR in net profits during FY10-FY13f (%)

|            | Mar10  | Mar11f | Mar12f | Mar13f | CAGR (%) |
|------------|--------|--------|--------|--------|----------|
| Net profit | 45,931 | 49,114 | 56,784 | 70,370 | 15.3     |

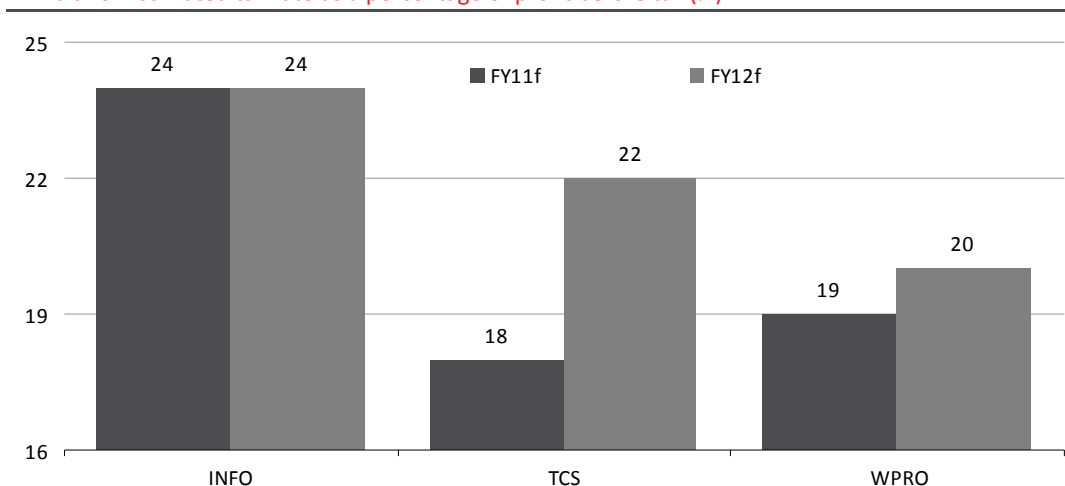
Source: Avendus Research

Rising tax rate to lower net profit CAGR to 15% during FY10-FY13f.

### Despite increase, tax rate to be lower than peers

Despite the c300-bp rise in tax rate in FY11f and FY12f, WPRO's tax rate is likely to be lower than those of its peers, INFO and TCS. The company's tax rate is estimated at c19% in FY11f and c20% in FY12f, compared with c24% (FY11f and FY12f) for INFO and 18% (FY11f) and 22% (FY12f) for TCS.

Exhibit 20: Estimated tax rate as a percentage of profit before tax (%)



Source: Company, Avendus Research

## Initiate with an Add rating and Jun11 target of INR722

We arrive at a Jun11 target of INR722. At our target price, the stock is likely to trade at c19x FY12f earnings. For the past 8 quarters, WPRO has traded at a discount of 15% to 20% vis-à-vis INFO; however, the discount has narrowed to c10% during the past six months. We estimate the company to trade at a 15% discount to INFO during FY11-FY12. We initiate coverage on WPRO with an Add rating. Key risks to our estimates are lower than expected revenue growth and USD appreciation against INR.

### Jun11 target price of INR722; to trade at 19x FY12f earnings

Initiate coverage with an Add rating and Jun11 target price of INR722.

We initiate coverage on WPRO with an Add rating and a Jun11 target of INR722. At our target price, the stock is likely to trade at c19x FY12f earnings, in line with its average valuation for the past five years.

Exhibit 21: One-year forward P/E

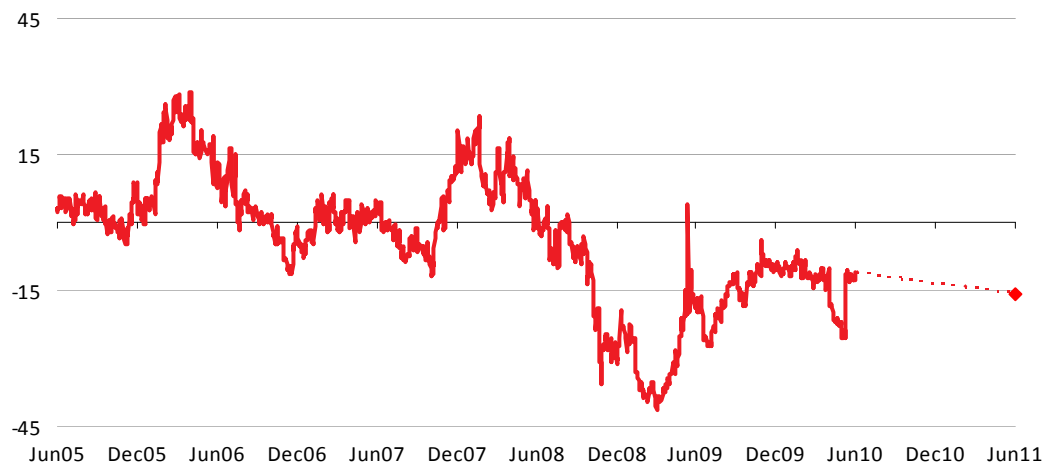


Source: Bloomberg, Avendus Research

### Estimate it to trade at c15% discount to INFO

WPRO has always traded in a narrow range to INFO's valuation. Its average discount vis-à-vis INFO has been in the range of 15% to 20% for the past 8 quarters, which declined to c10% during the past six months. We estimate WPRO to trade at a c15% discount to INFO during FY11-FY12.

Exhibit 22: P/E discount of WPRO vis-à-vis INFO



Source: Avendus Research

Exhibit 23: DCF assumptions and summary

|                    | ----- Stage-I: 3 years explicit ----- |       |       |                    |         | ----- Stage-II: 12 years ----- |       |                     |         |       | ----- Stage-III: 10 years ----- |                     |         |  |
|--------------------|---------------------------------------|-------|-------|--------------------|---------|--------------------------------|-------|---------------------|---------|-------|---------------------------------|---------------------|---------|--|
|                    | FY11f                                 | FY12f | FY13f | -- Over stage I -- |         | FY14f                          | FY25f | -- Over stage II -- |         | FY26f | FY35f                           | -- Over stage II -- |         |  |
| Sales Growth (%)   | 11.8                                  | 16.5  | 18.6  | 9.2                | CAGR    | 15.0                           | 7.6   | 12.6                | CAGR    | 7.2   | 5.0                             | 6.4                 | CAGR    |  |
| EBIT margins (%)   | 19.1                                  | 19.1  | 19.3  | 19.0               | Average | 19.3                           | 19.0  | 19.3                | Average | 19.0  | 19.0                            | 19.0                | Average |  |
| Tax Rate (%)       | 20.0                                  | 21.1  | 21.8  | 19.9               | Average | 20.0                           | 24.7  | 19.3                | Average | 25.2  | 30.0                            | 26.5                | Average |  |
| Gross Turnover (x) | 3.4                                   | 3.2   | 3.2   | 3.4                | Average | 3.6                            | 3.6   | 3.6                 | Average | 3.6   | 3.6                             | 3.6                 | Average |  |
| WCAP (days sales)  | 60                                    | 56    | 47    | 63                 | Average | 55                             | 55    | 54                  | Average | 55    | 55                              | 55                  | Average |  |
| ROIC (%)           | 31.5                                  | 32.2  | 33.5  | 32.0               | Average | 38.7                           | 36.3  | 37.4                | Average | 36.0  | 33.6                            | 35.4                | Average |  |

| DCF Value as on Jun10      |         |     | WACC Assumption (%) |      | Terminal Growth (%) | Sensitivity Analysis |      |      |      |
|----------------------------|---------|-----|---------------------|------|---------------------|----------------------|------|------|------|
| (INRmn)                    | % of EV |     |                     |      |                     | WACC (%)             |      |      |      |
|                            |         |     |                     |      |                     |                      |      |      |      |
| Explicit period cash flows | 101,881 | 11  | Risk-free rate      | 8.00 |                     |                      | 10.9 | 11.9 | 12.9 |
| Stage-II cash flows        | 465,610 | 53  | Mkt. Risk Premium   | 6.00 |                     |                      |      |      |      |
| Stage-III cash flows       | 295,502 | 33  | Beta (x)            | 0.80 |                     | 4.0                  | 812  | 719  | 643  |
| Terminal Value             | 23,850  | 3   | Cost of Equity      | 12.8 |                     | 5.0                  | 817  | 722  | 644  |
| Total EV                   | 886,843 | 100 | Cost of Debt        | 12.5 |                     | 6.0                  | 825  | 725  | 646  |
| Less: Gross Debt           | 70,033  |     | Debt/Total Capital  | 24.5 |                     |                      |      |      |      |
| Add: Investments & Cash    | 97,643  |     | WACC                | 11.9 |                     |                      |      |      |      |
| Equity Value               | 914,453 |     | Terminal Growth     | 5.0  |                     |                      |      |      |      |
| No of shares (mn)          | 1,470   |     |                     |      |                     |                      |      |      |      |
| Value/share (INR) (Jun10)  | 622     |     |                     |      |                     |                      |      |      |      |
| Value/share (INR) (Jun11)  | 722     |     |                     |      |                     |                      |      |      |      |

Source: Avendus Research

## Key risks to our estimates

- Lower-than-expected volume growth in FY11f and FY12f.
- Lower-than-expected growth rate in the consumer and product business.
- USD appreciation against the INR in FY11f and FY12f as against our assumption of USD depreciation.

## Financials and valuations

### Income statement (INRmn)

| Fiscal year ending                  | 03/09          | 03/10          | 03/11f         | 03/12f         | 03/13f         |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Gross sales                         | 256,891        | 271,957        | 304,123        | 354,380        | 420,255        |
| Less: Excise duty                   | -              | -              | -              | -              | -              |
| Net sales                           | 256,891        | 271,957        | 304,123        | 354,380        | 420,255        |
| Other operating income              | -              | -              | -              | -              | -              |
| <b>Total operating income</b>       | <b>256,891</b> | <b>271,957</b> | <b>304,123</b> | <b>354,380</b> | <b>420,255</b> |
| <b>Total operating expenses</b>     | <b>206,644</b> | <b>212,615</b> | <b>238,260</b> | <b>278,202</b> | <b>329,563</b> |
| Net materials                       | -              | -              | -              | -              | -              |
| Other direct costs                  | -              | -              | -              | -              | -              |
| Personnel                           | 173,857        | 179,382        | 202,242        | 236,066        | 279,050        |
| SG&A                                | 32,787         | 33,233         | 36,019         | 42,137         | 50,514         |
| R&D                                 | -              | -              | -              | -              | -              |
| <b>EBITDA</b>                       | <b>50,247</b>  | <b>59,342</b>  | <b>65,863</b>  | <b>76,177</b>  | <b>90,692</b>  |
| Other income                        | 3,566          | 4,601          | 5,250          | 6,250          | 7,250          |
| Depreciation                        | 6,947          | 7,831          | 7,720          | 8,544          | 9,476          |
| <b>EBIT</b>                         | <b>46,866</b>  | <b>56,112</b>  | <b>63,393</b>  | <b>73,883</b>  | <b>88,465</b>  |
| Interest                            | 2,333          | 1,232          | 1,250          | 1,250          | 1,250          |
| Recurring PBT                       | 44,533         | 54,880         | 62,143         | 72,633         | 87,215         |
| Net extra ordinary items            | -              | -              | -              | -              | -              |
| PBT (reported)                      | 44,533         | 54,880         | 62,143         | 72,633         | 87,215         |
| Total taxes                         | 5,422          | 9,294          | 11,427         | 14,047         | 17,443         |
| PAT (reported)                      | 39,111         | 45,586         | 50,716         | 58,586         | 69,772         |
| Add: Share of earnings of associate | 362            | 530            | 598            | 598            | 598            |
| Less: Minority interest             | 99             | 185            | 200            | -              | -              |
| Prior period items                  | -              | -              | -              | -              | -              |
| Net income (reported)               | 39,374         | 45,931         | 51,114         | 59,184         | 70,370         |
| <b>Avendus net income</b>           | <b>39,374</b>  | <b>45,931</b>  | <b>51,114</b>  | <b>59,184</b>  | <b>70,370</b>  |
| Dividend + Distribution tax         | 6,856          | 17,196         | 20,636         | 24,075         | 27,514         |
| Shares outstanding (mn)             | 1,465.0        | 1,468.0        | 1,468.0        | 1,468.0        | 1,468.0        |
| Avendus diluted shares (mn)         | 1,465.0        | 1,470.0        | 1,468.0        | 1,468.0        | 1,468.0        |
| <b>Avendus EPS (INR)</b>            | <b>26.9</b>    | <b>31.2</b>    | <b>34.8</b>    | <b>40.3</b>    | <b>47.9</b>    |
| <b>Growth ratios (%)</b>            |                |                |                |                |                |
| Total operating income              | 30.1           | 5.9            | 11.8           | 16.5           | 18.6           |
| EBITDA                              | 50.7           | 15.9           | 9.7            | 15.7           | 19.1           |
| EBIT                                | 32.2           | 17.4           | 11.6           | 16.5           | 19.7           |
| Recurring PBT                       | 29.6           | 20.6           | 11.8           | 16.9           | 20.1           |
| Avendus net income                  | 20.8           | 16.7           | 11.3           | 15.8           | 18.9           |
| Avendus EPS                         | 20.5           | 16.3           | 11.4           | 15.8           | 18.9           |
| <b>Operating ratios (%)</b>         |                |                |                |                |                |
| EBITDA margin                       | 20.2           | 22.1           | 21.7           | 21.5           | 21.6           |
| EBIT margin                         | 18.8           | 20.9           | 20.8           | 20.8           | 21.1           |
| Net profit margin                   | 15.1           | 16.6           | 16.5           | 16.4           | 16.5           |
| Other income/PBT                    | 7.7            | 8.3            | 8.4            | 8.6            | 8.3            |
| Effective Tax rate                  | 11.8           | 16.7           | 18.4           | 19.3           | 20.0           |

## Balance sheet (INRmn)

| Fiscal year ending             | 03/09          | 03/10          | 03/11f         | 03/12f         | 03/13f         |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| Equity capital                 | 2,930          | 2,936          | 2,936          | 2,936          | 2,936          |
| Preference capital             | -              | -              | -              | -              | -              |
| Reserves and surplus           | 144,214        | 193,176        | 224,783        | 261,144        | 308,172        |
| <b>Net worth</b>               | <b>147,144</b> | <b>196,112</b> | <b>227,719</b> | <b>264,080</b> | <b>311,108</b> |
| Minority interest              | 237            | 437            | 437            | 437            | 437            |
| Total debt                     | 70,439         | 70,033         | 70,033         | 70,033         | 70,033         |
| Deferred tax liability         | -3,895.0       | -1,306.0       | -1,306.0       | -1,306.0       | -1,306.0       |
| <b>Total liabilities</b>       | <b>213,925</b> | <b>265,276</b> | <b>296,883</b> | <b>333,244</b> | <b>380,272</b> |
| Gross block                    | 70,713         | 81,594         | 98,885         | 119,635        | 144,535        |
| less: Accumulated depreciation | 34,646         | 40,494         | 49,970         | 49,970         | 49,970         |
| Net block                      | 36,067         | 41,100         | 48,915         | 69,665         | 94,564         |
| CWIP                           | 13,727         | 12,358         | 12,358         | 12,358         | 12,358         |
| Goodwill                       | 59,636         | 57,813         | 57,813         | 57,813         | 57,813         |
| Investments                    | 1,670          | 2,345          | 2,345          | 2,345          | 2,345          |
| Cash                           | 65,660         | 95,298         | 141,464        | 152,807        | 174,936        |
| Inventories                    | 7,587          | 7,926          | 7,926          | 7,926          | 7,926          |
| Debtors                        | 48,652         | 50,928         | 60,430         | 69,330         | 84,551         |
| Loans and advances             | 32,851         | 43,766         | 39,112         | 39,112         | 39,112         |
| less: Current liabilities      | 60,131         | 56,418         | 66,931         | 71,564         | 86,784         |
| less: Provisions               | 5,902          | 6,548          | 6,548          | 6,548          | 6,548          |
| Net working capital            | 88,717         | 134,952        | 175,452        | 191,063        | 213,192        |
| <b>Total assets</b>            | <b>199,817</b> | <b>248,568</b> | <b>296,883</b> | <b>333,244</b> | <b>380,272</b> |

## Cash flow statement (INRmn)

| Fiscal year ending                 | 03/09          | 03/10          | 03/11f         | 03/12f         | 03/13f         |
|------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Net profit                         | 40,927         | 46,647         | 51,114         | 59,184         | 70,370         |
| Depreciation                       | 6,947          | 7,831          | 7,720          | 8,544          | 9,476          |
| Deferred tax                       | -799           | 0              | 0              | 0              | 0              |
| Working capital changes            | -20,663        | -5,682         | 1,012          | -4,268         | 0              |
| Less: Other income                 | 3,566          | 4,601          | 5,250          | 6,250          | 7,250          |
| <b>Cash flow from operations</b>   | <b>22,846</b>  | <b>44,195</b>  | <b>54,595</b>  | <b>57,211</b>  | <b>72,596</b>  |
| Capital expenditure                | -18,368        | -9,512         | -17,291        | -20,750        | -24,900        |
| Strategic investments purchased    | -327           | -675           | 0              | 0              | 0              |
| Marketable investments purchased   | 0              | 0              | 0              | 0              | 0              |
| Change in other loans and advances | -2,311         | -10,915        | 4,654          | 0              | 0              |
| Goodwill paid                      | -8,200         | 1,823          | -              | -              | -              |
| Other income                       | 3,566          | 4,601          | 5,250          | 6,250          | 7,250          |
| <b>Cash flow from investing</b>    | <b>-25,640</b> | <b>-14,678</b> | <b>-7,387</b>  | <b>-14,500</b> | <b>-17,650</b> |
| Equity raised                      | -              | -              | -              | -              | -              |
| Change in borrowings               | 53,158         | -406           | 0              | 0              | 0              |
| Dividends paid (incl. tax)         | -6,856         | -17,196        | -20,636        | -24,075        | -27,514        |
| Others                             | -16,666        | 20,508         | 3,086          | -7,294         | -5,304         |
| <b>Cash flow from financing</b>    | <b>29,636</b>  | <b>2,906</b>   | <b>-17,550</b> | <b>-31,368</b> | <b>-32,818</b> |
| <b>Net change in cash</b>          | <b>26,842</b>  | <b>32,423</b>  | <b>29,658</b>  | <b>11,343</b>  | <b>22,129</b>  |

## Key Ratios

| Fiscal year ending                     | 03/09 | 03/10 | 03/11f | 03/12f | 03/13f |
|--|-------|-------|--------|--------|--------|
| <b>Valuation ratios (x)</b>            |       |       |        |        |        |
| P/E (on Avendus EPS)                   | 24.0  | 20.6  | 18.5   | 16.0   | 13.4   |
| P/E (on basic, reported EPS)           | 24.0  | 20.6  | 18.5   | 16.0   | 13.4   |
| P/CEPS                                 | 20.4  | 17.6  | 16.1   | 14.0   | 11.8   |
| P/BV                                   | 6.4   | 4.8   | 4.2    | 3.6    | 3.0    |
| Dividend yield (%)                     | 0.6   | 1.6   | 1.9    | 2.2    | 2.5    |
| Market cap. / FCF                      | 41.3  | 21.4  | 17.3   | 16.5   | 13.0   |
| Market cap. / Sales                    | 3.7   | 3.5   | 3.1    | 2.7    | 2.2    |
| EV/Sales                               | 3.5   | 3.2   | 2.7    | 2.3    | 1.9    |
| EV/EBITDA                              | 17.6  | 14.6  | 12.7   | 10.8   | 8.8    |
| EV / FCF                               | 203.6 | 25.2  | 22.4   | 22.6   | 16.8   |
| EV / Total Assets                      | 4.6   | 3.5   | 2.8    | 2.5    | 2.1    |
| Net Cash / Market cap.                 | 10.4  | 14.7  | 19.1   | 20.3   | 22.6   |
| <b>Per share ratios (INR)</b>          |       |       |        |        |        |
| Avendus EPS                            | 26.9  | 31.2  | 34.8   | 40.3   | 47.9   |
| EPS (Basic, reported)                  | 28.0  | 31.8  | 34.8   | 40.3   | 47.9   |
| Cash EPS                               | 31.6  | 36.6  | 40.1   | 46.1   | 54.4   |
| Book Value                             | 100.4 | 133.6 | 155.1  | 179.9  | 211.9  |
| Dividend per share                     | 4.0   | 10.0  | 12.0   | 14.0   | 16.0   |
| <b>ROE Decomposition (%)</b>           |       |       |        |        |        |
| EBIT margin                            | 18.8  | 20.9  | 20.8   | 20.8   | 21.1   |
| Asset turnover (x)                     | 1.4   | 1.1   | 1.1    | 1.1    | 1.2    |
| Interest expense ratio                 | 1.3   | 0.5   | 0.4    | 0.4    | 0.4    |
| Tax retention ratio                    | 88.2  | 83.3  | 81.6   | 80.7   | 80.0   |
| ROA                                    | 22.7  | 20.5  | 18.7   | 18.8   | 19.7   |
| Total assets / equity (x)              | 1.3   | 1.3   | 1.3    | 1.3    | 1.2    |
| ROE                                    | 28.5  | 26.8  | 24.1   | 24.1   | 24.5   |
| <b>Return ratios (%)</b>               |       |       |        |        |        |
| EBIT / Capital Employed                | 27.9  | 25.3  | 23.2   | 23.5   | 24.8   |
| ROCE                                   | 23.9  | 20.9  | 19.1   | 19.1   | 20.0   |
| ROIC                                   | 41.7  | 35.9  | 36.7   | 38.7   | 39.5   |
| FCF / IC                               | 4.5   | 26.5  | 26.3   | 23.4   | 26.4   |
| OCF/Sales                              | 8.9   | 16.3  | 18.0   | 16.1   | 17.3   |
| FCF/Sales                              | 1.7   | 12.8  | 12.3   | 10.3   | 11.3   |
| <b>Turnover ratios (x)</b>             |       |       |        |        |        |
| Gross turnover                         | 3.6   | 3.3   | 3.1    | 3.0    | 2.9    |
| Net turnover                           | 7.1   | 6.6   | 6.2    | 5.1    | 4.4    |
| Revenue / IC                           | 2.6   | 2.1   | 2.1    | 2.3    | 2.3    |
| Inventory / Sales (days)               | 10.5  | 10.4  | 9.5    | 8.2    | 6.9    |
| Receivables (days)                     | 62.2  | 66.8  | 66.8   | 66.8   | 66.8   |
| Payables (days)                        | 109.8 | 100.4 | 94.5   | 90.9   | 87.7   |
| Working capital cycle (ex-cash) (days) | -28.6 | -9.3  | -5.5   | -3.1   | -0.7   |
| <b>Solvency ratios (x)</b>             |       |       |        |        |        |
| Gross debt to equity                   | 0.5   | 0.4   | 0.3    | 0.3    | 0.2    |
| Net debt to equity                     | -0.2  | -0.4  | -0.5   | -0.5   | -0.5   |
| Net debt to EBITDA                     | 1.4   | 1.2   | 1.1    | 0.9    | 0.8    |
| Interest Coverage (EBIT / Interest)    | 20.8  | 46.1  | 50.7   | 59.1   | 70.8   |



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