

Margin headwinds ahead, retain REDUCE

July 23, 2010

REDUCE

Price Rs 412	Target Price Rs 420
Sensex	18,131

Price Performance

(%)	1M	3M	6M	12M
Absolute	2	(2)	(2)	51
Rel. to Sensex	(0)	(5)	(9)	26

Source: Bloomberg

Stock Details

Sector	IT Services
Reuters	WIPR.BO
Bloomberg	WPRO@IN
Equity Capital (Rs mn)	4899
Face Value(Rs)	2
No of shares o/s (mn)	2449
52 Week H/L	452/270
Market Cap (Rs bn/USD mn)	1,009/21,489
Daily Avg Volume (No of sh)	1767548
Daily Avg Turnover (US\$m)	15.1

Shareholding Pattern (%)

	Jun-10	Mar-10	Dec-09
Promoters	79.5	79.5	79.6
FII/NRI	8.6	9.8	9.7
Institutions	2.6	1.7	2.0
Private Corp	3.0	2.8	2.6
Public	6.3	6.2	6.2

Source: Capitaline

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- Rev. at US\$ 1,204 mn (+3.3% QoQ) , mgnly below exp. IT Svcs EBIT Mgn expand by ~30 bps QoQ to 24.5%. Profits best est. driven by better margins and lower taxes
- Co wide vol up 4.7% QoQ led by increase in onsite vols (+16% QoQ). Growth remains broad based with fin svcs (+6.4% QoQ), TMT (+3.6% QoQ) and Manufacturing (+5.3% QoQ)
- Sep'10 QoQ revenue growth guidance of +4.1-6.1% reaffirms the +ive demand momentum. However see margin headwinds getting stronger for Wipro ahead
- Marginal change in FY11E/12E EPS to Rs 21.6/23.4 (V/s Rs 21.5/23.3 earlier) driven by exchange reset to Rs 46/\$ (V/s Rs 45 earlier). Maintain REDUCE with a March'11 TP of Rs 420.

In line revenues, margin performance remains credible

Revenues at US\$ 1,204 mn (+3.3% QoQ), were marginally below Emkay exp. of US\$ 1,210 mn. IT Svcs EBIT mgns improved by ~30 bps QoQ to 24.5%, highest ever in the co's history (co wide EBIT mgns +40bps QoQ to 19.5%) despite strong net employee addition of ~4,800 and significant onsite ramp ups during the quarter (onsite vols up by ~16% QoQ while offshore volumes up by a mere 0.6% QoQ) helped by favorable currency. Profits at Rs 13.2 bn (+9% QoQ, +31%YoY) beat estimates driven by higher margins and lower taxes. Growth was broad based for Wipro with revenues from fin services/TMT/Manufacturing up by ~6.4%/3.6%/5.3% QoQ respectively. While revenues from US were up by ~4.3% QoQ, European revenues were flat QoQ despite cross currency headwinds. Attrition jumped up by ~370 bps QoQ to 15.8% annualized attrition moving by ~600 bps QoQ to 23% .

Operating metrics performance good

Wipro's IT svcs vols were up by ~4.7% QoQ, however led primarily by increase in onsite volumes at ~16% QoQ. Onsite/Offshore pricing declined by ~5%/1.1%QoQ in reported currency terms. Co added ~4,800 on a net basis to take the total employee count to ~1, 13,000. Top client revenues were up by~ 20% sequentially.

Sep'10 Guidance reaffirms the positive demand momentum

Wipro's Sep'10 revenue growth guidance at 4.1-6.1% clearly reaffirms the positive demand momentum across the sector (V/s Infy's revenue growth guidance of ~4.1-5.1%). **However Wipro continues to be the least preferred bet for us as we believe that Infosys and TCS would continue to lead Wipro on revenue growth (refer chart below) as well faces significant margin headwinds from (1) promotion linked wage increments for ~15-20% of staff effective from Sep'10 quarter, (2) RSU charges as company attempts to address the increasing employee churn, equivalent to a 2nd round of wage increments for FY11**

Tweak FY11E/12E earnings marginally, retain REDUCE

We tweak our FY11/12 US\$ revenue estimates marginally, reset US\$/INR exchange rate to Rs 46/\$ (V/s Rs 45/\$ earlier) driving a marginal change in our FY11E/12E earnings to Rs 21.6/Rs 23.4. Maintain REDUCE with an unchanged March'11 price target of Rs 420.

Yr. end Mar (in Rs mn)	Net Sales	EBIT	EBIT %	PAT	EPS (Rs)	ROE %	P/E(x) (x)	EV/EBITDA (x)	P/B (x)
FY09	255,337	43,802	17.2	37,710	15.5	27.2	25.2	19.0	6.4
FY10	271,957	52,228	19.2	45,935	18.7	26.7	20.9	16.0	4.9
FY11E	316,967	61,109	19.3	52,948	21.6	26.1	18.1	13.3	4.6
FY12E	364,202	68,264	18.7	57,373	23.4	24.1	16.7	11.3	3.6

Key Financials - Quarterly

Rs mn	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
Revenue	63,868	68,937	69,380	69,772	71,906	12.6	3.1
Operating Expenditure	51,038	55,988	56,238	56,465	57,872	13.4	2.5
Cost of revenues	43,247	47,522	47,766	47,764	48,647	12.5	1.8
as % of sales	67.7	68.9	68.8	68.5	67.7		
SG&A expenses	7,791	8,466	8,472	8,701	9,225	18.4	6.0
as % of sales	12.2	12.3	12.2	12.5	12.8		
EBIT	12,830	12,949	13,142	13,307	14,034	9.4	5.5
Other Income	(1,051)	921	1,115	1,669	1,570	n.a	(5.9)
PBT	11,779	13,870	14,257	14,976	15,604	32.5	4.2
Total Tax	1,740	2,217	2,321	3,015	2,345	34.8	(22.2)
Adjusted PAT	10,039	11,653	11,936	11,961	13,259	32.1	10.9
(Profit)/loss from JV's/Ass/MI	114	112	128	176	157		
APAT after MI	10,153	11,765	12,064	12,137	13,416	32.1	10.5
Extra ordinary items	0	0	0	0	0		
Reported PAT	10,104	11,707	12,033	12,091	13,192	30.6	9.1
Reported EPS	4.2	4.8	4.9	4.9	5.4	29.3	9.1

Margins (%)						(bps)	(bps)
EBIT	20.1	18.8	18.9	19.1	19.5	(57)	45
EBT	18.4	20.1	20.5	21.5	21.7	326	24
PAT	15.8	17.0	17.3	17.3	18.3	253	102
Effective Tax rate	14.8	16.0	16.3	20.1	15.0	26	(510)

Source: Company, Emkay Research

Revenue growth (QoQ %)	Marc'09	June'09	Sept'09	Dec'09	March'10	June'10
Infosys	-4.3%	0.1%	2.9%	6.8%	5.2%	4.8%
TCS	-3.4%	3.3%	3.9%	6.3%	3.1%	6.4%
Wipro	-4.9%	-1.3%	3.2%	5.8%	3.5%	3.2%
EBIT margins						
Infosys	29.5	30.1	30.5	31.5	30.3	28.3
TCS	23.7	24.8	26.3	27.3	27.5	27.1
Wipro	21.6	22.2	23.6	23.6	24.2	24.5

Source: Companies, Emkay Research

(All fig in Rs mn except EPS)	FY11E			FY12E		
	Old	New	% change	Old	New	% change
Revenues(US\$ mn)	5,210	5,224	0.3	6,103	6,149	0.7
Revenues	313,335	316,967	1.2	362,397	364,202	0.5
EBIT	60,175	61,109	1.6	68,015	68,264	0.4
Net profits	52,675	52,948	0.5	57,192	57,373	0.3
EPS	21.5	21.6	0.5	23.3	23.4	0.3

Source: Emkay Research

Wipro continues to lag peers on revenue growth, however Wipro's margin performance in the past few quarters remains credible.

We tweak our FY11E/FY12E earnings marginally to Rs 21.6/Rs 23.4.

Key Financials

Income Statement

Y/E, Mar (Rs. m)	FY09	FY10	FY11E	FY12E
Net Sales	255,337	271,957	316,967	364,202
Growth (%)		7	17	15
Total Expenditure	(211,535)	(219,729)	(255,858)	(295,938)
Growth (%)		4	16	16
EBIDTA	43,802	52,228	61,109	68,264
Growth (%)		19	17	12
EBIDTA %	17.2	19.2	19.3	18.7
Other Income	42	3,824	5,524	8,119
Depreciation	-	-	-	-
EBIT	43,802	52,228	61,109	68,264
Interest				
EBT	43,844	56,052	66,633	76,383
Tax	(6,035)	(9,293)	(11,796)	(17,197)
EAT	37,809	46,759	54,837	59,185
Growth (%)		24	17	8
EAT (%)	14.8	17.2	17.3	16.3
Minority Interest	-	-	-	-
Net Profit after MI	37,710	45,935	52,948	57,373

Balance Sheet

Y/E, Mar (Rs. m)	FY09	FY10	FY11E	FY12E
Equity share capital	2,930	2,936	2,936	2,936
Reserves & surplus	144,214	193,176	237,254	295,332
Minority Interest	237	437	437	437
Networth	147,381	196,549	240,627	298,705
Secured Loans	19,681	18,107	18,107	18,107
Unsecured Loans	37,210	44,403	44,404	44,404
Loan Funds	56,891	62,510	62,511	62,511
Deferred Tax Liability	474	380	380	380
Total Liabilities	204,746	259,440	303,518	361,596
Goodwill	59636	57813	57813	57813
Gross Block	63,837	89,583	104,583	120,583
Less: Depreciation	(28,501)	(36,125)	(43,973)	(52,574)
Net block	35,336	53,458	60,610	68,009
Capital WIP	14,458	-	-	-
Investment	18,213	32,765	32,765	32,765
Current Assets	142,488	174,146	227,424	298,029
Inventories	7,587	7,926	9,552	10,976
Sundry debtors	62,760	67,636	75,551	86,810
Cash & bank balance	49,117	64,878	101,072	150,352
Loans & advances	8,083	9,112	10,855	12,972
Other current assets	14,941	24,594	30,394	36,919
Current Liab & Prov	79,580	70,488	86,840	106,766
Current liabilities	72,009	63,171	78,156	94,792
Provisions	7,571	7,317	8,684	11,974
Deferred Tax Assets	14,196	11,746	11,746	11,746
Net current assets	62,908	103,658	140,584	191,263
Total Assets	204,747	259,440	303,519	361,596

Cash Flow	FY09	FY10	FY11E	FY12E
Net Profit before Tax	43,844	55,412	65,021	74,771
Add : Depreciation	6,942	7,624	7,848	8,601
Add : Misc exp w/off				
Net changes in WC	3,849	(40,750)	(36,926)	(50,679)
Operational Cash Flows	34,648	51,997	60,341	64,777
Capital expenditure	(24,183)	(33,600)	(14,953)	(16,117)
Investments	-	-	-	-
Investing Cash Flows	(24,183)	(33,600)	(14,953)	(16,117)
Borrowings	4,753	(1,574)	-	-
dividend paid	(6,856)	(17,230)	(12,389)	(13,424)
Issue of shares	(7,790)	10,367	(28,809)	704
Share Premium	27,280	1,908	-	-
Financing Cash Flows	17,387	(6,529)	(41,198)	(12,720)
changes in cash	27,853	11,868	4,190	35,939
Opening balance	39,270	49,117	64,878	101,072
Closing balance	49,117	64,878	101,072	150,352

Key Ratios	FY09	FY10	FY11E	FY12E
EPS (Rs)	15.5	18.7	21.6	23.4
CEPS (Rs)	18.4	21.8	24.8	26.9
Book Value Per Share (Rs)	60.6	80.3	85.1	108.7
Dividend Per Share (Rs)	2.4	6.0	4.3	4.7
Valuations Ratios (x)				
PER	25.2	20.9	18.1	16.7
P/CEPS	24.5	20.6	18.2	16.7
P/BV	6.4	4.9	4.6	3.6
EV/EBIDTA	19.0	16.0	13.3	11.3
EV/Sales	3.8	3.5	2.9	2.4
M-Cap/sales	3.8	3.5	3.0	2.6
Profitability Ratios (%)				
RoCE	27.9	27.3	27.6	26.6
RoNW	27.2	26.7	26.1	24.1
EBITA Margin	17.2	19.2	19.3	18.7
EBIT Margins	17.2	19.2	19.3	18.7
Net Profit Margin	14.8	16.9	16.7	15.8

Recommendation History: Wipro Limited – WPRO IN

Date	Reports	Reco	CMP	Target
23.04.2010	Wipro Q4FY10 Result Update	Reduce	693	700
20.01.2010	Wipro Q3FY10 Result Update	Reduce	725	700
27.10.2009	Wipro Q2FY10 Result Update	Reduce	605	580
23.07.2009	Wipro Q1FY10 Result Update	Reduce	451	420

Recent Research Reports

Date	Reports	Reco	CMP	Target
22.07.2010	NIIT Q1FY11 Result Update	Accumulate	71	80
16.07.2010	Tata Consultancy Services Q1FY11 Result Update	Accumulate	780	890
13.07.2010	Infosys Q1FY11 Result Update	Accumulate	2,795	3,200
07.06.2010	eClerx Company Update	Buy	558	640

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