

1 April 2011

Produced by: The Royal Bank of Scotland N.V., (India) Office

**Hold**

Target price  
Rs470.00

Price  
Rs476.05

Equity | India | Software & Services  
**Flashnote**

# Wipro

## Good fit; marginally EPS accretive

**Wipro's acquisition of SAIC's Global Oil and Gas Information Technology Services business would be marginally EPS accretive (<0.5%). However it would strengthen Wipro's positioning in Energy & Utility vertical with its contribution to IT services increasing to 12.9% from 9.9% besides other business synergies.**

### Acquisition details

- Wipro has signed an agreement to acquire the Global Oil and Gas Information Technology practice of the Commercial Business Services business unit of Science Applications International Corporation (SAIC), for an all cash consideration of approximately US\$150 million, subject to adjustments.
- Based on our interactions with the management, acquired unit generated US\$188mn revenues in last reported fiscal (Feb'10-Jan'11) with EBITDA margins of around low double digit. Based on our assumptions we expect PAT margin of mid-high single digit. This implies acquisition price of 0.8x FY11 revenues and 12-13x FY11 PAT
- Acquired unit provides Consulting, System Integration and Outsourcing Services to Global Oil majors with significant domain capabilities in the areas of Digital Oil Field, Petro-technical Data Management and Petroleum Application Services addressing the upstream segment.
- Top-10 clients of the acquired unit accounts for 90% of the revenues. Within top-10 clients, 6 clients are in Fortune-500/Global-1000 list. US account for 68% of the revenues while Europe accounts for 31% of the revenues.
- As a result of the transaction, ~1,450 employees are expected to transition to Wipro across North America, Europe, India and Middle East. Around one-third of these employees are in India.
- Based on our interaction with Wipro management, SAIC sold this business unit due to its immateriality to their total revenues (less than 2% of revenues). Acquired unit is part of the Commercial segment of SAIC which contributes around 3.4% of the SAIC's total revenues. Commercial segment had lackluster top-line growth and volatile margins. It has registered revenue decline of 17.5% in FY11 and 5.9% in FY10 with its segmental operating margins

(Continued on page 2)

### Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Rsm)	256891	271957	310243	372627	439328
EBITDA (Rsm)	51662	59771	66346	78785	90714
Reported net profit (Rsm)	38761	45934	53262	60874	68431
Normalised net profit (Rsm)	38761	45488	52621	60874	68431
Normalised EPS (Rs)	15.9	18.6	21.5	24.8	27.8
Dividend per share (Rs)	2.42	3.63	4.37	4.98	5.59
Dividend yield (%)	0.51	0.76	0.92	1.05	1.17
Normalised PE (x)	29.9	25.6	22.1	19.2	17.1
EV/EBITDA (x)	22.2	18.7	16.6	13.7	11.6
Price/book value (x)	7.88	5.94	4.88	4.06	3.42
ROIC (%)	32.4	32.0	31.4	30.0	29.7

Post-goodwill amortisation and pre-exceptional items

Accounting standard: IFRS

Source: Company data, RBS forecasts

year to Mar, fully diluted

### Analysts

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declining to 4.7% in FY11 from 7.3% in FY09.

### **Business Synergies**

- Organically Wipro gets 9.9% of its IT services revenues from Energy and Utility (E&U vertical). Within E&U, one-third of the business is coming from energy vertical. Within Energy vertical, 85% of the business is coming from downstream clients and 15% of the business is coming from upstream clients. Acquired unit would materially increase Wipro's exposure to upstream clients besides high organic presence in downstream.
- Secondly Wipro's organic energy business is largely focused on Europe while this acquired unit derives 68% of its revenues from US.
- Wipro and the acquired unit have one common client, who would contribute over US\$100mn in combined revenues post acquisition.
- This acquisition leads to addition of 5-6 Fortune 500/Global 1000 clients, helping Wipro to cross sell its other services including BPO/IMS and also increase its penetration within energy vertical.
- This acquisition will increase the revenue contribution of E&U vertical from current 9.9% to 12.9% of IT services revenues, while revenues from Energy vertical alone to increase from 3.3% to 6.5% of IT services revenues. TCS currently derives 4.4% of its revenues from E&U vertical, while Infosys derives 6.1% of its revenues from utilities.
- Outsourcing opportunities in E&U vertical are likely to improve considering lower IT/BPO services outsourcing from this vertical and higher demand to optimize operational costs.

### **Impact on Wipro's financials**

- Based on our first cut calculations, the acquired unit would add close to around US\$5-6mn incremental PAT to Wipro (post considering the loss on treasury income), which is less than 1% of the FY12E EPS.
- Over the next three years, the management expects the cost synergies to push EBIT margins of the acquired business from low-double digit levels currently to levels close to Wipro's IT services business (c.22%).
- Overall, we believe that this acquisition is marginally EPS accretive (<0.5% currently and even assuming margin improvement, it would add less than 2% to EPS at current revenue scale).

### **Good fit; marginally EPS accretive**

- We believe that this acquisition is marginally EPS accretive as explained above and therefore we do not expect any material stock price impact through this acquisition.
- However this can lead to material business synergies for Wipro within Energy vertical over medium to long term.
- Secondly we also believe that this acquisition will narrow Wipro's IT service's growth rate lag versus peers by 3-4% (despite marginal EPS accretion). Peers including Infosys and TCS are likely to outgrow Wipro by 8-11% in FY11E.

## Income statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	256891	271957	310243	372627	439328
Cost of sales	-174087	-179510	-204217	-247281	-294955
Operating costs	-31142	-32676	-39680	-46561	-53658
<b>EBITDA</b>	<b>51662</b>	<b>59771</b>	<b>66346</b>	<b>78785</b>	<b>90714</b>
DDA & Impairment (ex gw)	-6809	-7543	-8024	-9514	-11245
<b>EBITA</b>	<b>44853</b>	<b>52228</b>	<b>58322</b>	<b>69271</b>	<b>79470</b>
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
<b>EBIT</b>	<b>44853</b>	<b>52228</b>	<b>58322</b>	<b>69271</b>	<b>79470</b>
Net interest	0.00	0.00	0.00	0.00	0.00
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	-1553	-715.0	185.0	100.0	100.0
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	1233	3369	4600	6719	9050
<b>Reported PTP</b>	<b>44533</b>	<b>54882</b>	<b>63106</b>	<b>76090</b>	<b>88620</b>
Taxation	-6035	-9740	-10810	-15628	-20703
Minority interests	-99.0	-184.0	-386.0	-405.3	-425.6
Exceptionals (post-tax)	0.00	446.0	641.0	0.00	0.00
Other post-tax items	362.0	530.0	711.4	818.1	940.8
<b>Reported net profit</b>	<b>38761</b>	<b>45934</b>	<b>53262</b>	<b>60874</b>	<b>68431</b>
Normalised Items Excl. GW	0.00	446.0	641.0	0.00	0.00
<b>Normalised net profit</b>	<b>38761</b>	<b>45488</b>	<b>52621</b>	<b>60874</b>	<b>68431</b>

Source: Company data, RBS forecasts

year to Mar

## Balance sheet

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	69910	105348	120564	158516	186650
Other current assets	90865	96678	133705	174262	222183
Tangible fixed assets	49794	53458	58076	63562	69817
Intang assets (incl gw)	59636	57813	58106	58106	58106
Oth non-curr assets	13648	12435	17741	17996	25861
<b>Total assets</b>	<b>283853</b>	<b>325732</b>	<b>388191</b>	<b>472442</b>	<b>562617</b>
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Trade & oth current liab	77911	65903	83930	108352	140484
Long term debt (3)	56892	62511	64635	75342	78446
Oth non-current liab	1669	769.0	200.0	200.0	200.0
<b>Total liabilities</b>	<b>136472</b>	<b>129183</b>	<b>148765</b>	<b>183894</b>	<b>219130</b>
Total equity (incl min)	147381	196549	239427	288548	343487
<b>Total liab &amp; sh equity</b>	<b>283853</b>	<b>325732</b>	<b>388191</b>	<b>472442</b>	<b>562617</b>
Net debt	-13018	-42837	-55929	-83174	-108204

Source: Company data, RBS forecasts

year ended Mar

## Cash flow statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	51662	59771	66346	78785	90714
Change in working capital	634.5	-8051	-19000	-16135	-15789
Net interest (pd) / rec	-348.0	2611	4785	6819	9150
Taxes paid	-11238	-7151	-12388	-17530	-22919
Other oper cash items	362.0	976.0	1352	818.1	940.8
<b>Cash flow from ops (1)</b>	<b>41072</b>	<b>48156</b>	<b>41095</b>	<b>52756</b>	<b>62097</b>
Capex (2)	-25324	-9738	-12935	-15000	-17500
Disposals/(acquisitions)	358.0	397.0	0.00	0.00	0.00
Other investing cash flow	-7918	-16153	-48877	-10853	-33149
<b>Cash flow from invest (3)</b>	<b>-32884</b>	<b>-25494</b>	<b>-61812</b>	<b>-25853</b>	<b>-50649</b>
Incr / (decr) in equity	78.0	87.0	1693	2087	2095
Incr / (decr) in debt	12136	5619	2124	10707	3104
Ordinary dividend paid	-6829	-6823	-12463	-14245	-16013
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	24.0	16.0	0.00	0.00	0.00
<b>Cash flow from fin (5)</b>	<b>5409</b>	<b>-1101</b>	<b>-8647</b>	<b>-1451</b>	<b>-10814</b>
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
<b>Incl/(decr) cash (1+3+5+6)</b>	<b>13597</b>	<b>21561</b>	<b>-29364</b>	<b>25452</b>	<b>634.5</b>
Equity FCF (1+2+4)	15748	38418	28160	37756	44597

Lines in bold can be derived from the immediately preceding lines.  
Source: Company data, RBS forecasts

year to Mar

## Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For research produced by Nedbank Capital, a Buy implies upside in excess of 20%, a Sell implies an expected return less than 10%, and a Hold implies a return between 10% and 20%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research produced by Nedbank Capital and for research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

## Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

### Long term recommendations (as at 01 Apr 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	791 (8)	515 (2)
Hold	424 (5)	222 (2)
Sell	110 (1)	58 (0)
Total (IB%)	1325 (6)	795 (2)

Source: RBS

### Trading recommendations (as at 01 Apr 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (0)	1 (0)
Trading Sell	0 (0)	0 (0)
Total (IB%)	1 (0)	1 (0)

Source: RBS

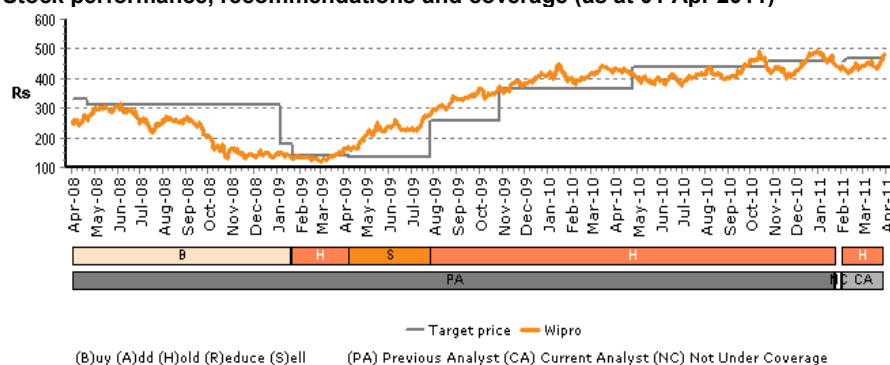
## Valuation and risks to target price

**Wipro (RIC: WIPR.BO, Rec: Hold, CP: Rs476.05, TP: Rs470.00):** Key downside risks to our PE-based TP are: 1) rupee appreciation beyond the levels that we assume and/or adverse cross-currency movement; 2) significantly lower pricing than those built into our assumptions; and 3) strong regulatory action against outsourcing in Wipro's key geographic markets.

Upside could come from: 1) rupee depreciation exceeding the level assumed in our estimates; 2) faster-than-anticipated recovery in project awards/ramp-ups for Wipro; and 3) acquisition wins not built into our model.

## Wipro coverage data (WIPR.BO, WPRO IN)

### Stock performance, recommendations and coverage (as at 01 Apr 2011)



Sandeep Shah started covering this stock on 3 Feb 11. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

### Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: RBS

### Price perf (at Close 01 Apr 2011)

	(1M)	(3M)	(12M)
Price (Rs)	443.5	491.3	432.8
Absolute (%)	7.4	-3.1	10.0
Rel market (%)	2.0	2.3	0.2
Rel sector (%)	14.4	9.0	20.9

Source: Bloomberg  
Market: Sensex  
Sector: Software

## Regulatory disclosures

None

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