

Underperformance vs large-cap peers continues

A disappointing quarter overall; turnaround post CEO change should take at least 3-4 quarters

Wipro posted disappointing 3QFY11 results with 5.6% qoq US\$ revenue growth, 30bps sequential EBIT margin decline and modest earnings growth of 3% qoq. Lower-than-expected utilization at 79.9% (250bps decline sequentially) and LTM attrition at a relatively high 21.6% were key reasons for the weak margins, in our view. Besides this, the key announcement accompanying the results was the news of CEO structure change: incumbents Girish Paranjpe and Suresh Vaswani have stepped down and TK Kurien (formerly head of the EcoEnergy business and BPO business, during varying times in his tenure) will take over as the new CEO. While Kurien has a solid reputation behind him, we believe it will take at least 3-4 quarters for Wipro's underperformance vs large-cap peers to subside. Meanwhile, the issues associated with Wipro's defensive-oriented revenue mix vs peers should continue to be a drag in a robust environment for outsourcing. Retain our Underperform rating on the stock.

Highlights of the quarter's performance

- **Revenue growth muted on the volume front:** Wipro saw volume growth of 4% for onsite and a muted 0.5% for offshore, partly offset by price realization increasing 0.6% qoq for onsite and 3.7% for offshore. The key reason we see is Wipro's revenue composition: only ~27% financial services exposure which means limited benefit from the upswing in BFSI spend; ~21% exposure to RIM and ~9-10% BPO where competitors have been aggressive in taking share. On the positive side, Wipro won 36 deals in 3Q vs 29 and 22 in Q2 and Q1 respectively, with management also alluding to a healthy sales pipeline.
- **Observations on the management change:** Wipro's joint CEO structure will be replaced by a single CEO in TK Kurien, earlier the head of the EcoEnergy business. Kurien has a solid track record in Wipro with the turnaround of the BPO business in particular being a key highlight. However, we believe it will take at least 3-4 quarters for any significant changes to begin addressing the issue of Wipro's underperformance vis-à-vis Infosys and TCS.
- **Retain cautious stance:** We continue to remain cautious on Wipro: we believe the issues of revenue mix and sales approach (with account management considered to be weaker than large-cap peers) are not likely to be reversed in the near-term. **Retain our ADD/UPF rating with a Rs 485 target price based on 19x Jun-12E EPS.**

Financial summary

Year	Revenues (Rs. bn)	EBITDA (Rs. bn)	PAT (Rs. bn)	EPS (Rs.)	P/E(x)	EV/EBITDA(x)
FY10	271.6	59.9	45.9	18.9	23.2	16.5
FY11E	311.8	66.9	53.0	21.7	20.2	14.8
FY12E	376.4	81.3	61.3	25.1	17.5	12.1

3QFY11 Update

Date Jan 27, 2010

Market Data

SENSEX	18684
Nifty	5604
Bloomberg	WPRO IN
Shares o/s	2447mn
Market Cap Rs.	1,063bn
52-wk High-Low	Rs 500-321
3m Avg. Daily Vol	Rs. 814mn
Index member	SENSEX

Latest shareholding (%)

Promoters	81
Institutions	9
Public	10

Stock performance (%)

	1m	3m	12m
Wipro	-10	2	11
CNXIT	-3	6	23
Nifty	-6	-7	13

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Wipro

Quarterly Financial Results

CMP	Rs. 438	Absolute	Add
Target	Rs. 485	Relative	Underperform

Quarterly financial results

Rs. mn\Period	31-Dec-10	31-Dec-09	yoy Growth	30-Sep-10	qoq Growth	FY10	FY11E	yoy Growth
Revenues	78,293	69,380	12.8%	77,719	0.7%	271,595	311,777	14.8%
Cost of revenues	53,530	47,766	12.1%	53,270	0.5%	186,130	212,616	14.2%
Gross profit	24,763	21,614	14.6%	24,449	1.3%	85,465	99,161	16.0%
Sales & Marketing expense	5,486	4,817	13.9%	5,751	-4.6%	18,607	22,292	19.8%
G&A expense	4,920	3,655	34.6%	4,251	15.7%	14,823	17,989	21.4%
EBITA	14,357	13,142	9.2%	14,447	-0.6%	52,035	58,881	13.2%
Amortisation	-	-				-	-	-
Forex Gain	0	394		-414		-715	44	-106.2%
Operating profit	14,357	13,536	6.1%	14,033	2.3%	52,932	58,870	11.2%
Interest expense	427	0		467		640	1,613	152.0%
Other income	1,751	721	142.9%	1,422		2,397	6,039	151.9%
Equity in affiliate earnings	160	128	25.0%	192	-16.7%	530	509	-4.0%
Taxes	2,582	2,321	11.2%	2,183	18.3%	9,293	10,547	13.5%
Net Income	13,188	12,064	9.3%	12,849	2.6%	46,172	53,038	14.9%
Diluted EPS	5.4	4.9	9.4%	5.3	2.6%	18.9	21.7	14.9%
Gross margin	31.6%	31.2%		31.5%		31.5%	31.8%	
Operating margin	22.2%	23.6%		22.2%		23.4%	23.1%	
PAT margin	16.8%	17.4%		16.5%		17.0%	17.0%	
Tax rate	16.3%	16.1%		14.4%		16.8%	16.5%	
Cash and equivalents	26,162	82,418		37,844		64,878	38,577	

Wipro

Business Overview

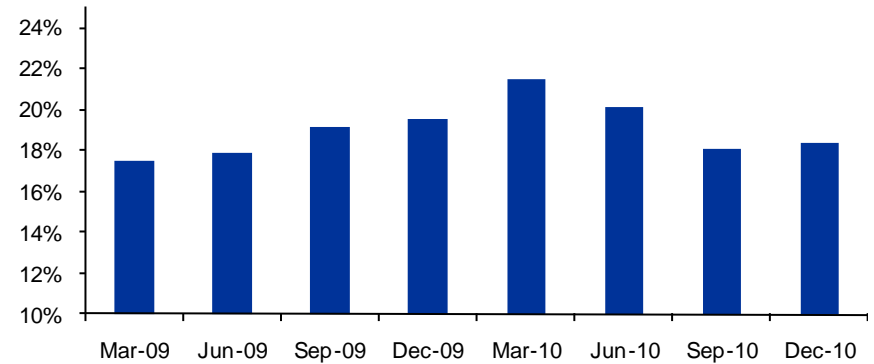
CMP	Rs. 438	Absolute	Add
Target	Rs. 485	Relative	Underperform

Key estimate revision

	FY11E			FY12E		
	New	Old	Change	New	Old	Change
IT Srvs Revs (US\$ Mn)	5,236	5,232	0%	6,318	6,361	1%
Revenue	316,552	311,777	-2%	378,381	376,403	-1%
USD/INR rate	45	45	-1%	45	45	0%
EBITDA	62,865	58,881	-6%	76,509	71,800	-6%
Margin %	19.9%	18.9%	-97bps	20.2%	19.1%	-114bps
EPS	22.6	21.7	-4%	26.4	25.1	-5%

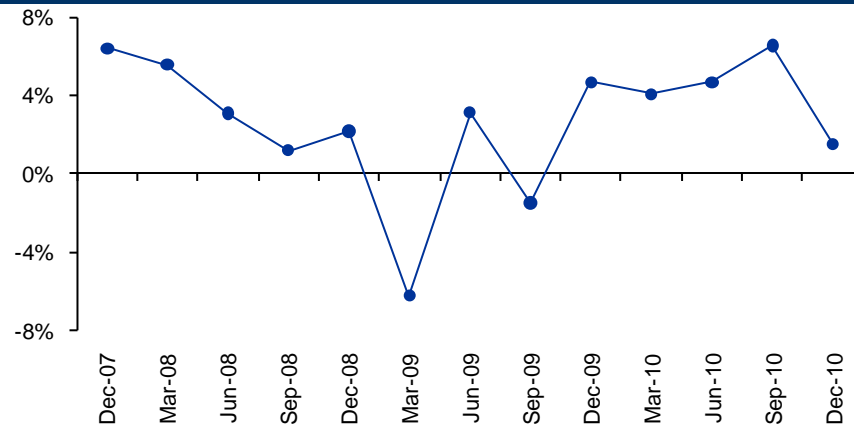
All figures in Rs. mn, except EPS, which is in Rs.

EBIT margin progression



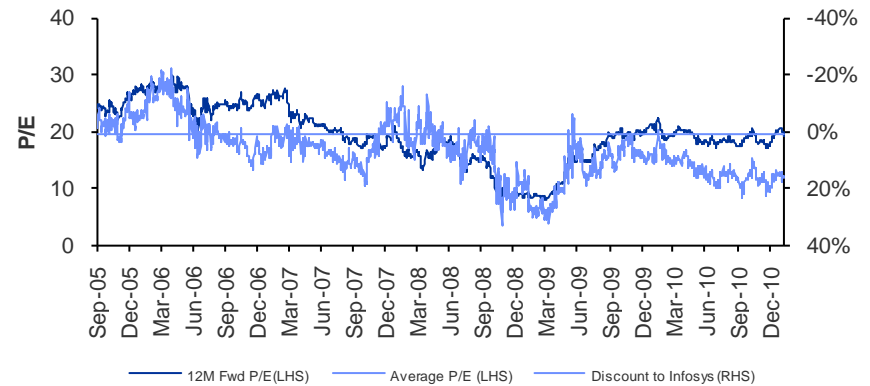
Source: Company data, Spark Capital

qoq volume growth



Source: Company data, Spark Capital

Wipro 12-m forward P/E



Source: Bloomberg, Spark Capital

Wipro

Financial Summary

CMP	Rs. 438	Absolute	Add
Target	Rs. 485	Relative	Underperform

Abridged Financial Statements				
Rs. mn	FY10	FY11E	FY12E	FY13E
Profit & Loss				
Revenues	271,595	311,777	376,403	446,131
Cost of revenues	186,130	212,616	256,682	312,761
Gross Profit	85,465	99,161	119,721	133,370
S&M expenses	18,607	22,292	25,021	28,104
G&A expenses	14,823	17,989	22,900	27,158
EBITDA	52,035	58,881	71,800	78,109
Amortisation	0	55	212	200
Forex gain	-715	44	0	0
Operating profit	52,932	58,870	71,588	77,909
PBT	55,219	63,804	77,623	85,500
PAT	46,172	53,038	61,322	67,545
Diluted EPS	18.9	21.7	25.1	27.6
Balance Sheet				
Share capital	2,936	4,907	4,907	4,907
Reserves and Surplus	193,176	232,847	271,597	316,570
Minority Interest	437	644	644	644
Long-term debt	18,107	25,273	25,273	25,273
Other non-current liabilities	9,683	8,915	8,915	8,915
Total liabilities	224,719	272,907	311,657	356,630
Net Fixed assets	41,100	49,484	56,351	62,895
Goodwill	53,802	54,437	54,437	54,437
Inventories	7,926	13,933	16,828	20,189
Sundry debtors	50,928	55,906	67,770	80,075
Cash and bank balances	64,878	38,577	61,040	91,380
Current liabilities and provisions	105,209	105,974	121,221	139,093
Net current assets	95,968	134,726	166,821	205,449
Total assets	224,719	272,907	311,657	356,630

Key metrics				
	FY10	FY11E	FY12E	FY13E
Cash flow				
Operations	51,149	57,184	55,370	62,712
Investing	-35,257	-40,337	-9,071	-8,537
Financing	-601	-24,462	-23,836	-23,836
Free cash flow	38,170	42,789	39,000	0
Total cash flow	15,291	-7,614	22,463	30,339
Margins				
Gross	31.5%	31.8%	31.8%	29.9%
EBITDA	22.0%	21.5%	21.6%	17.5%
EBIT	19.2%	18.9%	19.0%	17.5%
PAT	16.9%	17.0%	16.3%	15.1%
Growth				
Revenues	7.5%	14.8%	20.7%	18.5%
EBITDA	14.7%	16.0%	20.7%	11.4%
PAT	7.5%	19.8%	12.2%	12.3%
Diluted EPS	25.5%	15.6%	15.6%	10.1%
Return Ratios				
ROE	26.5%	24.4%	23.8%	22.6%
ROCE	23.6%	21.8%	21.4%	20.5%
ROA	27.4%	22.8%	22.1%	21.2%
Valuation				
Fully diluted shares (mn)	2,447	2,447	2,447	2,447
Market cap (Rs. mn)	1,063,514	1,063,514	1,063,514	1,063,514
EV (Rs.mn)	987,811	987,811	987,811	987,811
EV/Sales (x)	3.6	3.2	2.6	2.2
EV/EBITDA (x)	16.5	14.8	12.1	12.6
P/E (x)	23.2	20.2	17.5	15.9
EPS(E) / Current market price	4.3%	4.9%	5.7%	6.3%

Absolute Rating Interpretation	
BUY	Stock expected to provide positive returns of > 15% over a 1-year horizon
ADD	Stock expected to provide positive returns of <=15% over a 1-year horizon
REDUCE	Stock expected to fall <=15% over a 1-year horizon
SELL	Stock expected to fall >15% over a 1-year horizon
Relative Rating Interpretation	
OUTPERFORM	Stock expected to outperform sector index /sector peers in our coverage
UNDERPERFORM	Stock expected to underperform sector index/ sector peers in our coverage

Recommendation History				
Date	CMP	Target price	Absolute Rating	Relative Rating
10-Jan-11	483	485	ADD	UPF
20-Dec-10	479	485	ADD	UPF
25-Oct-10	430	485	ADD	OPF
11-Oct-10	462	485	ADD	OPF
29-Jul-10	415	485	BUY	OPF

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