

Company Flash

18 January 2008 | 9 pages

Wipro (WIPR.BO)

Buy: 3QFY08 Results Marginally Below Expectations

- In-line 3QFY08 results** — Wipro reported revenues of Rs.56.4b (our exp: Rs.56.6b), up ~11% QoQ and net profit of Rs.8.3b (our exp: Rs.8.4b), up ~2% QoQ. Global IT Services reported revenues of \$910m, up 14% QoQ with a ~150bp EBIT margin decline (primarily due to Infocrossing integration).
- Organic growth of 7.4% in Global IT** — Organic revenues rose 7.4% QoQ; volumes increased 6.5% while pricing was up 0.5%. Onsite realizations were up 1.3% QoQ while offshore realizations remained stable in the quarter. Better pricing realization and employee mix resulted in stable margins for organic business – despite wage hikes and rupee appreciation.
- BFSI up 10%; US grows 6.2%** — BFSI revenues increased ~10% QoQ while US revenues are up 7.1% QoQ (excluding Infocrossing) – Wipro did well in both areas where most of the investor concerns are centred.
- Negative surprise on Infocrossing margins** — As per segment results, Infocrossing gross margins were ~18% for Q3. This is materially lower than the 30% historical gross margin. We are waiting for more clarity on this.
- Guidance of 5% revenue growth** — Wipro Global IT Services revenue guidance for 4QFY08 is \$955m, an increase of ~5% - is in line with the Infosys guidance for the quarter.
- Macro concerns to weigh on sector performance** — With negative news flow on the US economy increasing, IT services stocks continue to underperform. Valuations are close to historic lows – Wipro trades at ~16x FY09E.

Buy/Low Risk	1L
Price (17 Jan 08)	Rs460.45
Target price	Rs565.00
Expected share price return	22.7%
Expected dividend yield	1.5%
Expected total return	24.2%
Market Cap	Rs672,267M
	US\$17,163M

Price Performance (RIC: WIPR.BO, BB: WPRO IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	20,270	14.08	24.3	32.7	8.3	29.9	1.1
2007A	29,130	20.18	43.3	22.8	6.5	32.3	1.3
2008E	33,171	22.76	12.8	20.2	5.4	29.5	1.5
2009E	41,101	28.20	23.9	16.3	4.4	29.8	1.7
2010E	44,482	30.52	8.2	15.1	3.7	26.5	2.2

Source: Powered by dataCentral

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Other Highlights

- Organic growth was strong across verticals. Technology and telecom business grew 8.3% QoQ while BFSI business was up 9.8% QoQ.
- Organic growth in US geography was a healthy 7.1% QoQ.
- Revenue from top clients grew 11.3% QoQ while that from top10 clients was up 12.2%
- Company had forex hedges of US\$2.45b at the end of last quarter. Forex gains during the quarter were Rs. 169m
- AsiaPac IT revenue grew 37% YoY while operating profit was up 40% YoY.
- Both non-IT businesses have also done well. Consumer business revenue was up 109% YoY while operating profits were up 89% YoY. Other businesses revenue was up 48% YoY and operating profit was up 156% YoY.

Figure 1. Wipro – Key Financials

Rs m	3Q07	2Q08	3Q08	QoQ	YoY
Revenue (US m)	885	1,151	1,319	14.6%	48.9%
Revenue	39,636	47,281	52,361	10.7%	32.1%
Cost of revenue	27,360	33,009	37,120	12.5%	35.7%
Gross profit	12,276	14,272	15,241	6.8%	24.2%
Gross margin	31.0%	30.2%	29.1%	-108bp	-186bp
Operating expenses	4,362	6,167	6,511	5.6%	49.3%
Forex gains/(losses)	-211	58	169	n.a.	n.a.
EBIT	7,703	8,163	8,899	9.0%	15.5%
EBIT margin	19.4%	17.3%	17.0%	-27bp	-244bp
Depreciation and amortization	1,096	1,325	1,633	23.2%	49.0%
EBITDA	8,799	9,488	10,532	11.0%	19.7%
EBITDA margin	22.2%	20.1%	20.1%	5bp	-209bp
Other income	705	743	455	-38.8%	-35.4%
Profit before tax	8,408	8,906	9,354	5.0%	11.3%
Income tax expense	1,080	865	1,074	24.2%	-0.5%
Income from operations	7,328	8,041	8,280	3.0%	13.0%
Affiliates/Minority	121	81	-19	-123.5%	-115.7%
Net profit	7,450	8,122	8,261	1.7%	10.9%
EPS - basic	5.21	5.60	5.69	1.7%	9.2%
EPS - fully diluted	5.14	5.57	5.68	1.9%	10.6%

Source: Company Reports

Figure 2. Global IT – Key Financials

Rs m	3Q07	2Q08	3Q08	QoQ	YoY
Revenue (US m)	641	790	910	15.2%	42.1%
Revenue	28,674	32,454	36,137	11.3%	26.0%
Cost of revenue	19,041	21,935	24,941	13.7%	31.0%
Gross profit	9,634	10,519	11,196	6.4%	16.2%
Gross margin	33.6%	32.4%	31.0%	-143bp	-262bp
Operating expenses	2,801	3,355	3,753	11.9%	34.0%
Forex gains/(losses)	-211	58	169	n.a.	n.a.
EBIT	6,833	7,164	7,443	3.9%	8.9%
EBIT margin	23.8%	22.1%	20.6%	-148bp	-323bp
Depreciation and amortization	954	1,106	1,376	24.4%	44.3%
EBITDA	7,787	8,270	8,819	6.6%	13.3%
EBITDA margin	27.2%	25.5%	24.4%	-108bp	-275bp

Source: Company Reports

Figure 3. Key HR and Execution Metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08
IT services							
Delivery employees	40,496	45,824	45,824	45,824	45,824	45,824	45,824
- net add	2,841	5,328	3,489	1,041	2,719	4,463	2,389
Support staff	2,518	2,997	3,304	4,041	4,931	5,110	5,310
Sales staff	257	294	317	340	377	391	408
Utilization (inc trainees)							
- Onsite	95.0%	95.0%	95.0%	95.0%	95.0%	95.0%	95.0%
- Offshore	64.8%	61.1%	58.4%	60.4%	67.7%	67.9%	66.8%
- blended	72.0%	69.0%	67.0%	68.0%	74.5%	74.7%	73.5%
Available effort							
Total delivery	104,918	117,920	133,591	137,162	133,847	144,172	155,488
- Onsite	24,380	27,059	29,617	31,064	33,218	34,779	36,811
- Offshore	80,538	90,861	103,974	106,098	100,629	109,393	118,677
Support	7,554	8,991	9,912	12,123	14,793	15,330	15,873
Total	112,472	126,911	143,503	149,285	148,640	159,502	171,361
Billed effort							
Onsite	23,161	25,706	28,136	29,511	31,557	33,040	34,971
Offshore	52,184	55,555	60,689	64,068	68,121	74,301	79,273
Total	75,345	81,261	88,825	93,579	99,678	107,341	114,244
Billed effort distribution							
Onsite	30.7%	31.6%	31.7%	31.5%	31.7%	30.8%	30.6%
Offshore	69.3%	68.4%	68.3%	68.5%	68.3%	69.2%	69.4%
Realization per employee (\$/person-month)							
Onsite	10,979	11,058	11,012	11,254	11,192	11,410	11,563
Offshore	4,251	4,206	4,189	4,214	4,213	4,282	4,280
BPO services							
Delivery employees	15,939	15,355	16,863	17,464	19,064	19,942	19,907
- net add	-148	-584	1,508	601	1,600	878	-35
Support staff	548	639	756	834	884	999	1,191
Utilization	66%	70%	68%	63%	62%	67%	69%

Source: Company Reports

Figure 4. Wipro – Client Metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08
Client relationship							
Total active clients	580	612	606	620	647	681	718
New clients	62	54	37	44	39	59	39
Relationship size							
\$1M+	233	243	253	262	281	307	313
\$1M-\$3M	104	104	107	117	123	135	128
\$3M-\$5M	35	37	45	37	44	54	59
\$5M-\$10M	36	37	31	35	34	41	47
\$10M-\$20M	26	30	31	33	36	34	32
\$20M+	27	27	31	32	31	34	35
Client concentration							
Top customer	3.5%	3.3%	3.2%	3.0%	3.1%	2.9%	3.0%
Top 5	15.0%	14.4%	14.3%	14.0%	13.6%	13.6%	13.5%
Top 10	25.9%	24.7%	24.5%	24.1%	24.1%	23.3%	24.3%

Source: Company Reports

Figure 5. Wipro – Revenue Mix

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08
Service Mix							
Technology InfraServices	9.6%	10.0%	11.1%	11.5%	11.1%	11.4%	11.1%
Testing	10.7%	11.1%	11.0%	11.0%	11.2%	11.7%	11.9%
Package Implementation	10.7%	10.8%	11.3%	11.9%	12.0%	11.8%	11.8%
Consulting	1.0%	1.0%	1.1%	1.1%	1.2%	1.3%	1.4%
BPO	8.4%	8.4%	8.3%	8.6%	8.8%	8.9%	9.0%
ADM	59.6%	58.7%	57.2%	55.9%	55.7%	54.9%	54.8%
Vertical Mix							
Telecom, product engg.	29.1%	28.8%	27.5%	26.5%	25.3%	24.7%	24.9%
Telecom service providers	7.0%	6.8%	6.5%	6.6%	7.5%	8.0%	8.0%
Technology Business	36.1%	35.6%	34.0%	33.1%	32.8%	32.7%	32.9%
Financial services	22.4%	22.6%	22.7%	22.9%	23.8%	24.2%	24.7%
Retail	8.4%	9.7%	9.7%	10.0%	9.7%	9.5%	9.7%
Utilities	9.1%	8.0%	9.8%	10.3%	9.4%	9.4%	9.1%
Manufacturing	9.3%	9.1%	9.0%	9.3%	9.6%	9.5%	9.4%
Corporate/govt.	11.5%	11.8%	11.6%	11.2%	11.6%	11.9%	11.5%
Others	3.2%	3.2%	3.1%	3.2%	3.1%	2.8%	2.8%
Enterprise Business	63.9%	64.4%	65.9%	66.9%	67.2%	67.3%	67.2%
Geographic Mix							
North America	64.9%	64.7%	63.9%	63.8%	65.0%	62.5%	62.2%
Europe	30.6%	30.1%	31.6%	31.1%	30.2%	31.8%	31.5%
Japan	3.2%	3.7%	3.3%	3.2%	2.8%	3.3%	3.1%
RoW	1.3%	1.5%	1.5%	1.9%	2.0%	2.4%	3.2%

Source: Company Reports

Wipro

Company description

Wipro is India's leading Indian company with business interests in IT and BPO services exports, domestic hardware, consumer lighting and consumer care. It has one of the widest ranges of services, including systems integration, IT-enabled services, package implementation, software application development and maintenance, and R&D services. Wipro is the first P CMM Level 5 and SEI

CMM Level 5 certified IT services company in the world. It has close to 700 clients spanning the BFSI, Manufacturing, Retail, Utilities and Telecom verticals. Its IT services exports team has more than 57,000 employees and BPO operation has around 20,000 employees.

Investment strategy

We rate Wipro Buy/Low Risk (1L). As one of the top three Indian IT services firms, Wipro looks well positioned to benefit from growing demand for offshore IT services. Apart from economies of scale in offshore delivery, one of Wipro's key strengths is its full-service model. This includes a strong position in the infrastructure/R&D services business, which offers significant long-term growth potential. It has strong exposure to the BPO segment, which should offer above-average growth in the long term. Wipro's management has actively pursued acquisitions to strengthen its service portfolio. We expect Wipro's global IT revenues to grow above the industry average rates over the next 2-3 years. We believe wage inflation will be largely offset by gains from improved employee mix, an improving offshore-onsite ratio and better utilization. We expect 26.7% revenue CAGR and 14.8% EPS CAGR over FY07-10E. For the global IT business, we expect 22.8% revenue CAGR.

Valuation

Our 12-month target price of Rs565 is based on 20x FY09E EPS, a ~15% discount to our target multiple for Infosys. Our target multiple is derived from a P/E-band analysis of Wipro's historical trading pattern and peer group valuations. Because of its small free float, strong exposure to R&D services and a model leveraged to large SI and IT outsourcing deals, Wipro has historically traded at a premium of 10-20% to Infosys. But now Wipro has started trading at a discount to Infosys due to Wipro's slower growth and RoIC/RoE in the recent past. We think Wipro will continue to trade at a marginal discount to Infosys given expected sub-par growth vs. Infosys in the coming years. We believe P/E is the most appropriate valuation measure given Wipro's profitability and earnings visibility.

Risks

We rate Wipro shares as Low Risk, which is consistent with our quantitative risk-rating system that tracks historical share price volatility. This is in line with our risk ratings for other large peer-group companies in our coverage universe. The key downside risks to our target price include: (1) high exposure to the telecom/tech sectors (~33% of total); (2) risks to earnings from a sharp US slowdown; (3) any significant appreciation of the rupee against the US Dollar/Euro/GBP; (4) a slowdown in the banking, financial services and insurance (BFSI) sector; (5) H1B visa quotas; and (6) acquisition-related risks.

Appendix A-1

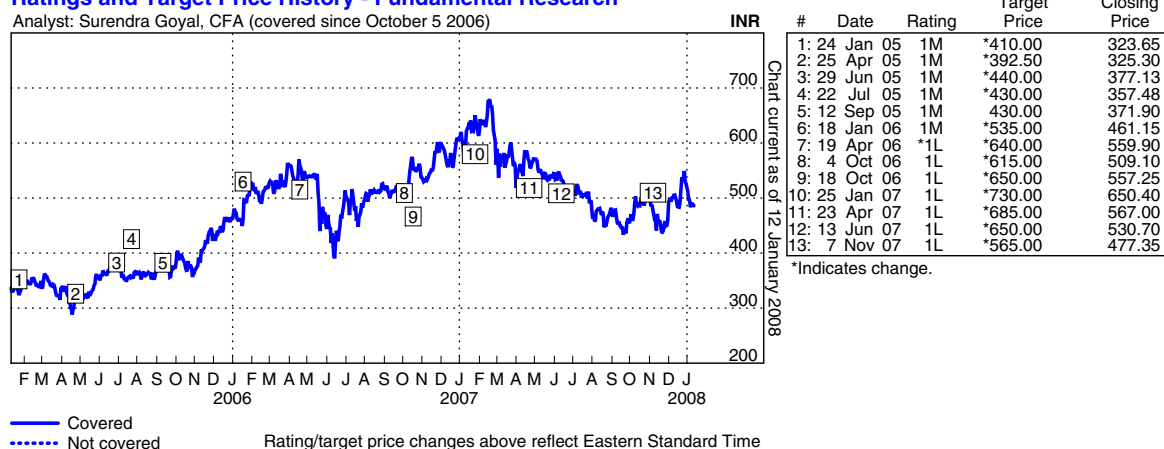
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Analyst: Surendra Goyal, CFA (covered since October 5 2006)



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