

Wipro

 STOCK INFO. BLOOMBERG
 BSE Sensex: 9,238 WPRO IN
 REUTERS CODE
 S&P CNX: 2,809 WIPR.BO

18 January 2006

Buy
Previous Recommendation: Buy
Rs461

Equity Shares (m)	1,410.9
52-Week Range	483/286
1,6,12 Rel.Perf.(%)	3/4/-15
M.Cap. (Rs b)	650.6
M.Cap. (US\$ b)	14.7

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	81,353	15,834	11.3	-21.0	40.8	11.5	30.7	35.3	7.7	30.4
3/06E	105,719	20,307	14.3	27.0	32.1	8.1	29.7	33.7	5.7	23.5
3/07E	140,996	27,704	19.3	34.2	23.9	5.6	28.1	32.6	4.1	16.4

Global IT services reported Rs21.5b in revenue, 14% higher QoQ v/s expectations of Rs21.3b, on the back of 12.7% QoQ volume growth. Both Technology Services and Enterprise Solutions grew robustly at 15.7% and 14.2% QoQ respectively. BPO grew slower at 6% QoQ. Other businesses were slower at 1.9% QoQ to Rs6.2b v/s expectation of Rs6.9b.

Healthy operational performance: 61 new clients were added — highest ever in a single quarter, including 20 in product engineering services and one in BPO. Total employee addition was at 5,189 — 3,770 were in IT services and 1,419 in BPO.

EBITDA margin at 25% grew 200bp as gross margins benefited from an increased composition of freshers in the employee mix. Consequently, net profit at Rs5.3b was higher, up 13.2% QoQ v/s expectation of Rs4.9b.

The company has given guidance for a robust March quarter, with 7.8% growth in Global IT services revenue to US\$510m v/s US\$473m in 3QFY06. We believe the strong guidance indicates strong growth momentum and order pipeline for Wipro. Consequently, we are upgrading our EPS estimates to Rs14.3 and Rs19.3 from Rs13.9 and Rs18.7 for FY06E and FY07E respectively. The stock is currently trading at 23.9x FY07 EPS estimates. We maintain **Buy**.

QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Global IT Services incl Spectramind	13,538	14,915	15,789	16,471	17,430	18,876	21,528	23,439	60,713	81,273
Other Businesses	4,158	4,882	5,112	6,487	5,435	6,090	6,206	6,716	20,639	24,447
Revenues	17,696	19,797	20,902	22,958	22,865	24,966	27,734	30,155	81,353	105,719
Q-o-Q Change (%) - Global IT	7.9	10.2	5.9	4.3	5.8	8.3	14.0	8.9	39.7	33.9
Total Expenses	13,089	14,684	15,649	17,478	17,414	19,146	20,712	22,810	60,900	80,081
EBITDA- Global IT Services	4,121	4,478	4,613	4,806	4,859	4,460	5,520	5,737	18,017	20,463
Margins (%)	30.4	30.0	29.2	29.2	27.9	23.6	25.6	24.5	29.7	25.2
EBITDA	4,607	5,113	5,253	5,480	5,451	5,819	7,022	7,345	20,452	25,638
Margins (%)	26.0	25.8	25.1	23.9	23.8	23.3	25.3	24.4	25.1	24.3
Depreciation	514	570	656	697	723	760	766	797	2,438	3,046
EBIT	4,093	4,542	4,597	4,783	4,728	5,060	6,256	6,548	18,014	22,592
Margins (%)	23.1	22.9	22.0	20.8	20.7	20.3	22.6	21.7	22.1	21.4
Other Income	-199	206	345	420	70	338	-51	410	771	767
PBT	3,894	4,748	4,942	5,203	4,798	5,398	6,205	6,958	18,786	23,359
Provision for Tax	598	679	694	722	586	791	990	1,044	2,693	3,411
Rate (%)	15.4	14.3	14.0	13.9	12.2	14.7	16.0	15.0	14.3	14.6
Net Income *	3,254	3,835	4,271	4,473	4,267	4,704	5,323	6,013	15,834	20,307
Q-o-Q Change (%)	0.0	17.8	11.4	4.7	-4.6	10.3	13.2	13.0	58.5	28.2

E: MOST Estimates; * after minority interest and share in earnings from affiliates

Revenue up 11% driven by 14% growth in Global IT services

Wipro reported 11% QoQ revenue growth, driven by strong 12.6% volume growth in Global IT services. Both Technology Services and Enterprise Solutions grew at a healthy 15.7% and 14.2% QoQ respectively. In the technology services space, product engineering grew 13.2% QoQ, while telecom service providers grew 29.3% QoQ, albeit on a smaller base.

TECHNOLOGY SERVICES REVENUE (RS M)

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Product Engineering	4,437	4,677	4,895	5,263	5,959
% Change QoQ	5.0	5.4	4.7	7.5	13.2
Telecom Serv. Provid.	662	656	697	931	1,203
% Change QoQ	-4.8	-1.0	6.3	33.5	29.3

Source: Company/Motilal Oswal Securities

Enterprise Solutions grew 14.2% QoQ, driven by 16.9% growth in Financial Services, 17.9% growth in Utilities and 8.9% growth in Retail.

ENTERPRISE SOLUTIONS

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Financial Services	2,634	2,753	3,082	3,503	4,096
% Change QoQ	12.6	4.5	11.9	13.6	16.9
Retail	1,676	1,719	1,781	1,675	1,825
% Change QoQ	1.9	2.6	3.6	-6.0	8.9
Utilities	1,521	1,530	1,626	1,844	2,174
% Change QoQ	3.4	0.6	6.3	13.4	17.9
Manufacturing	1,789	1,777	1,812	1,895	2,019
% Change QoQ	9.7	-0.6	2.0	4.6	6.5
TMTS	1,197	1,224	1,363	1,540	1,825
% Change QoQ	-2.7	2.2	11.4	13.0	18.5
Total	8,873	9,237	9,898	10,728	12,248
% Change QoQ	5.0	4.1	7.2	8.4	14.2

Source: Company/Motilal Oswal Securities

BPO up 6%, boosted by greater revenue per seat

After three quarters of sluggish growth, the BPO business revived during the quarter to post 6% QoQ revenue growth.

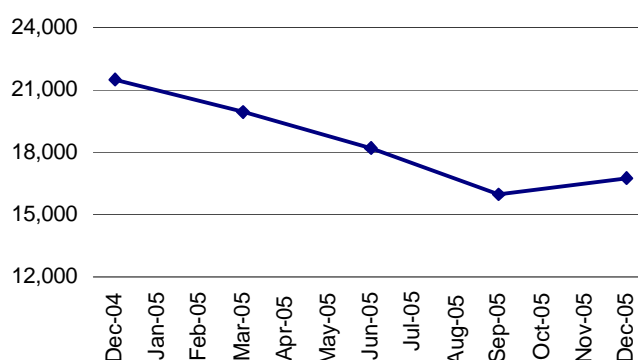
BPO REVENUE (RS M)

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
BPO Revenue	1,801	1,795	1,849	1,824	1,933
% Change QoQ	7.1	-0.3	3.0	-1.4	6.0

Source: Company/Motilal Oswal Securities

Revenue per seat, which had declined continuously for the past few quarters, grew 4.8% QoQ, even as the company is trying to increase the composition of non-commodity, non-voice businesses.

BPO -REVENUE PER SEAT



Source: Company/Motilal Oswal Securities

The quarter also saw net addition of 1,484 employees in the BPO segment after two quarters of net decline in employee base, indicating a robust growth pipeline for the BPO business. Going forward, we expect the BPO business to perform strongly, with significant deal in higher margin businesses.

EMPLOYEE ADDITION (NOS)

	DEC-04	MAR-05	JUN-05	SEP-05	DEC-05
Number of Employees	14,726	16,064	14,034	13,397	14,881
Net Addition	1,361	1,338	-2,030	-637	1,484

Source: Company/Motilal Oswal Securities

Wipro's consumer care and other businesses grew 7.5% and 5.8% respectively. However, revenue from Wipro Infotech, the domestic IT services subsidiary, declined 0.9% QoQ, which muted overall growth in other businesses to 1.9% QoQ at Rs6.2b.

The company's top five clients grew faster than the company average for the quarter, with the top client growing at 25.5% and top 2-5 clients growing at 16.7% QoQ. This is line with peer companies, which have also seen top clients picking up speed after 2-3 quarters of slow growth. The non-top clients also grew strongly at 14.2% QoQ.

CLIENT CONCENTRATION (RS M)

	3Q FY06	% CHG. QOQ	%CHG. YOY	2Q FY06	3Q FY05
Contribution					
Top Client	679	25.5	14.8	541	592
Top 2-5 Clients	2,252	16.7	27.9	1,929	1,761
Bottom 5 in Top 10 Clients	2,310	12.8	23.3	2,048	1,873
Revenues from non-Top 10 Clients	14,170	14.2	43.7	12,403	9,859

Source: Company / Motilal Oswal Securities

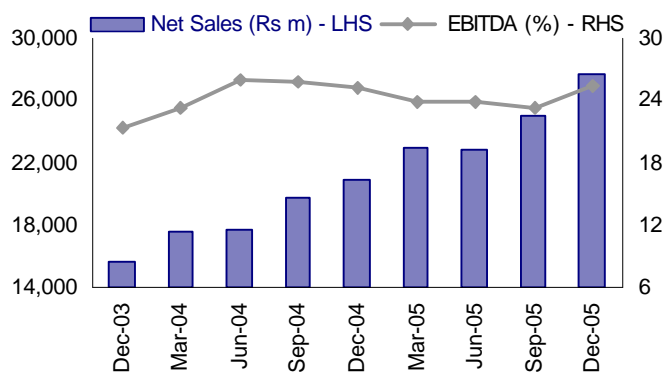
Client addition touches record high at 61

Wipro added 61 clients during the quarter, the highest ever in a single quarter. Of this, 20 were added in the product engineering space, six in the telecom service provider space and one in the BPO segment. The active client base, thereby went up to 485 at the end of the quarter. However, it appears, the company still has trouble transitioning clients to revenue buckets greater than US\$10m even as it has successfully transitioned several clients to the US\$3m-US\$10m range. Growing a greater number of mature clients will continue to be a challenge as its area core expertise R&D services remains among the highest penetrated service offerings in the IT services universe.

EBITDA margins rises by 200bp due to flattening of employee pyramid

EBITDA margin at 25% grew 200bp as gross margins benefited from an increased composition of freshers in the employee mix. The proportion of employees with experience of less than three years stood at 42% by the end of 3QFY06 compared with 35% in 1QFY06. This effectively mitigated a 120bp impact on gross margins due to salary hikes in the month of October. BPO margins also improved by 350bp during the quarter, due to higher revenue realization per seat and lower training costs on account of lower attrition. The company had an exchange loss of Rs407m, which negative other income of Rs51m. Consequent to the improvement in margins, net profit at Rs5.3b was higher than the expected Rs4.9b, up 13.2% QoQ.

SALES AND EBITDA MARGIN



Source: Company / Motilal Oswal Securities

4QFY06 guidance robust at 7.8% sequential growth

The company has given guidance for a robust March quarter, with 7.8% growth in Global IT services revenue to US\$510m v/s US\$473m in 3QFY06. Considering that approximately US\$10m would arise from the company's recent acquisitions, the guidance implies 5.7% QoQ organic growth, which is healthy. Employee addition during the quarter at 5,189 — 3,770 in IT services, 1,419 in BPO space — indicates that management expects growth momentum to be sustained. Consequently, we estimate 8.9% growth in Global IT services revenue in 4QFY06.

Outlook and view

Growth in 3QFY06 has been robust, with strong growth in volumes and stable pricing. Employee addition during the quarter at 5,189 — 3,770 in IT Services and 1,419 in BPO — also indicates that management expects growth momentum to be sustained. Client addition has been robust, with top clients growing faster than the company's average. The company has also won significant deals during the quarter, including a multi-year, multi-million dollar banking deal in Europe. We believe that the strong guidance indicates the strong growth momentum and visibility of order pipeline. Consequently, we are upgrading our EPS estimates to Rs14.4 and Rs19.3 from Rs13.9 and Rs18.7 in FY06E and FY07E respectively. The stock is currently trading at 23.9x FY07 EPS estimates. We maintain **Buy**.

Wipro: an investment profile

Company description

Wipro has the third largest Indian IT services operations and the largest third-party BPO operation in India. It is the largest third-party R&D services provider globally. It employs about 26,000 people in its IT services and over 15,000 people in its BPO operations. Its top clients include large telecom companies like Cisco, Nokia, Nortel, Lucent and other large companies like General Motors, Sony, Microsoft and Transco National Grid.

Key investment arguments

- ✍ Largest beneficiary of R&D services outsourcing to India
- ✍ The most comprehensive IT services company with a wide portfolio of services including R&D, Enterprise, BPO and Infrastructure management.
- ✍ Experience of integrating successfully and realizing benefits from acquisitions

Key investment risks

- ✍ Weaker Enterprise solutions practice relative to peers
- ✍ Inability to mine clients beyond a certain scale
- ✍ Lagging in package implementation segment

Recent developments

- ✍ First Indian IT vendor to be awarded Gold-level membership in the Microsoft Windows Embedded Partner (WEP) Program as a System Integrator and Independent Software Vendor.
- ✍ Mr. P R Chandrasekhar has been appointed Chief Executive of Americas and Europe.

Valuation and view

- ✍ Revenue growth of 30% and earnings growth of 28.2% in FY06
- ✍ Valuations at 23.9x FY07E earnings still have room for upside
- ✍ We maintain **Buy**

Sector view

- ✍ Various CIO surveys indicate increasing share of offshore spending in IT budgets
- ✍ Indian offshore vendors gaining market share in competition with MNCs
- ✍ Prefer large companies as bulk of volumes going to them while niche players benefit due to lack of offshore competition

COMPARATIVE VALUATIONS

		WIPRO	INFOSYS	TCS
P/E (x)	FY06E	32.1	29.7	27.5
	FY07E	23.9	23.0	21.6
P/BV (x)	FY06E	8.1	10.5	13.3
	FY07E	5.6	7.8	8.9
EV/Sales (x)	FY06E	5.7	7.3	6.2
	FY07E	4.1	5.4	4.6
EV/EBITDA (x)	FY06E	23.5	22.3	21.2
	FY07E	16.4	16.7	16.3

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	81.7	82.1	83.3
Domestic Institutions	1.3	1.4	1.7
FII's/FDIs	7.2	6.5	5.9
Others	9.8	10.1	9.

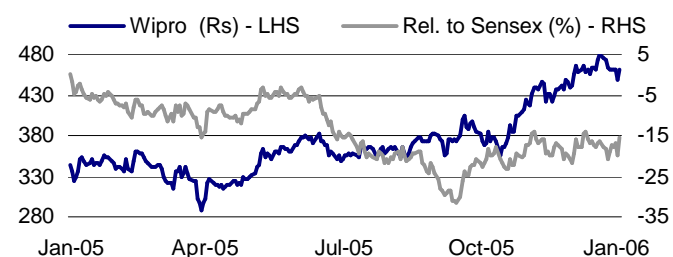
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	14.3	13.7	4.4
FY07	19.3	18.7	3.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
461	470	1.9	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Sales	58,434	81,353	105,719	140,996	174,980
Change (%)	35.6	39.2	30.0	33.4	24.1
Cost of Revenues	37,028	51,417	70,004	94,411	118,262
SG&A	8,682	9,483	10,078	11,616	12,752
			80,081		
EBITDA	12,724	20,452	25,638	34,969	43,966
% of Net Sales	21.8	25.1	24.3	24.8	25.1
Depreciation	2,280	2,578	3,093	4,294	5,200
Other Income	1,325	771	814	1,665	1,171
PBT	11,769	18,646	23,359	32,339	39,937
Tax	1,611	2,693	3,411	4,851	5,991
Rate (%)	13.7	14.4	14.6	15.0	15.0
PAT	10,158	15,953	19,948	27,489	33,947
Income from equity investee	96	-37	332	216	254
Minority Interest	56	82	1	0	0
Extraordinary items	-206	0	14	0	0
Net Income	9,992	15,834	20,307	27,704	34,201
Change (%)	22.9	58.5	28.2	36.4	23.5

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	465	1,407	1,415	1,439	1,460
Additional Paid in Capital	7,177	10,087	13,130	22,334	21,045
Retained Earnings	38,722	45,234	65,541	93,245	127,446
Net Worth	46,364	56,729	80,086	117,020	149,952
Minority Interest	407	533	693	899	1,171
Loans	969	564	0	0	0
Capital Employed	47,740	57,826	80,779	117,919	151,123
Gross Block	17,705	24,317	31,317	40,317	50,317
Less : Depreciation	8,448	11,116	14,162	18,391	23,526
Net Block	9,257	13,201	17,155	21,926	26,791
Investments	20,308	24,959	24,959	24,959	24,959
Intangible Assets	5,592	5,978	5,478	4,978	4,478
Curr. Assets	22,581	27,937	51,096	88,199	121,715
Debtors	10,973	14,806	18,247	23,564	28,764
Inventories	1,439	1,769	1,869	1,969	2,069
Cash & Bank Balance	3,297	5,671	24,151	54,473	81,050
Adv., Other Current Assets	6,872	5,690	6,828	8,194	9,833
Current Liab. & Prov	9,998	14,249	17,909	22,143	26,821
Creditors	2,733	3,713	5,266	6,972	8,615
Other Liabilities	7,265	10,536	12,643	15,172	18,206
Net Current Assets	12,583	13,687	33,187	66,056	94,895
Application of Funds	47,740	57,826	80,779	117,919	151,123

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS*	14.3	11.3	14.3	19.3	23.4
Cash EPS*	17.6	13.1	16.5	22.2	27.0
Book Value	32.9	40.2	56.8	82.9	106.3
DPS	26.3	5.0	5.0	6.7	9.4
Payout %(Incl.Div.Taxes)	184.0	44.4	35.0	35.0	40.0
Valuation (x)					
P/E		40.8	32.1	23.9	19.7
Cash P/E		35.1	27.9	20.7	17.1
EV/EBITDA		30.4	23.5	16.4	12.4
EV/Sales		7.7	5.7	4.1	3.1
Price/Book Value		11.5	8.1	5.6	4.3
Dividend Yield (%)		11	1.1	1.5	2.0
Profitability Ratios (%)					
RoE	24.4	30.7	29.7	28.1	25.6
RoCE	28.1	35.3	33.7	32.6	29.7
Turnover Ratios					
Debtors (Days)	69	66	63	61	60
Asset Turnover (x)	3.3	3.3	3.4	3.5	3.5
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Cash Flow from Operations	12,130	22,488	23,056	31,783	39,147
Cash for Working Capital	2,723	1,231	1,020	2,547	2,262
Net Operating CF	9,407	21,257	22,036	29,235	36,885
Net Purchase of FA	-3,372	-7,328	-7,000	-9,000	-10,000
Net Purchase of Investment	549	-5,918	8,793	11,559	14,764
Payment for Acquisitions	0	0	0	0	0
Net Cash from Invest.	-2,823	-13,246	1,793	2,559	4,764
Issue of Shares	637	3,979	3,210	9,436	-997
Proceeds from LTB/STB	365	-405	-564	0	0
Dividend Payments	-18,386	-9,211	-7,996	-10,908	-14,890
Net CF from Financing	-17,383	-5,638	-5,349	-1,472	-15,888
Free Cash Flow	6,035	13,035	15,036	20,235	26,885
Net Cash Flow	-10,800	2,374	18,480	30,322	25,761
Opening Cash Balance	14,096	3,297	5,671	24,151	54,473
Add: Net Cash	-10,800	2,374	18,480	30,322	25,761
Closing Cash Balance	3,297	5,671	24,151	54,473	80,234



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	Wipro
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

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