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Updates

Wipro: Growth acceleration around the corner. Valuations are attractive. Maintain OP

News Roundup

Corporate

- US private equity (PE) giant Blackstone is learnt to be close to picking up a 25-30% stake in Hyderabad-based nuclear and space science components company MTAR Technologies for around Rs300 crore. If the deal goes through, it will possibly be the first PE investment in the defence and nuclear space in India. (ET)
- LIC of India, the country's largest financial services firm, has finalised GE Money India, a subsidiary of the US-based financial service-to-electronics conglomerate, as one of the partners in its proposed credit card venture. (BS)
- LVMH will roll out half a dozen luxury brands in the Indian market over the next year. These include Kenzo, Marc Jacobs, Berluti, haute couture brands Givenchy, Loewe, Celine and Pucci. (BS)
- French car maker Renault SA plans to start assembling its low-cost sedan Logan in South Africa in early 2008, and, according to a person familiar with the matter, will source components from Indian manufacturers currently supplying to the company's joint venture Mahindra Renault Ltd in India that produces the care here. (BS)

Economic and political

- China ordered banks to put aside more money as reserves for the seventh time this year to cool lending and investment after inflation accelerated to a 10-year high. (ET)
- The government is planning to abolish transfer fees charged by developers from property buyers at the time of sale. (ET)
- Thanks to a late-season surge in rice sowing in the wake of an overall agriculture-friendly monsoon, the fear of shrinkage in paddy acreage this year is gradually waning. (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

EQUITY MARKETS

India	Change, %			
	6-Sep	1-day	1-mo	3-mo
Sensex	15,616	1.1	4.6	10.1
Nifty	4,519	1.0	3.7	8.1
Global/Regional indices				
Dow Jones	13,363	0.4	(1.0)	0.7
Nasdaq Composite	2,614	0.3	2.1	2.9
FTSE	6,313	0.7	0.1	(2.9)
Nikkie	16,157	(0.6)	(4.5)	(10.5)
Hang Seng	24,127	0.3	10.1	16.0
KOSPI	1,889	0.0	1.6	7.8
Value traded - India				
		Moving avg, Rs bn		
	6-Sep	1-mo	3-mo	
Cash (NSE+BSE)	144.1	153.5	154.0	
Derivatives (NSE)	409.3	375.7	403.5	
Deri. open interest	759.6	831.0	573.9	

Forex/money market

	Change, basis points			
	6-Sep	1-day	1-mo	3-mo
Rs/US\$	40.8	-	34	6
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.9	-	7	(24)

Net investment (US\$m)

	5-Sep	MTD	CYTD
FIs	101	-	8,030
MFs	17	-	461

Top movers -3mo basis

Best performers	Change, %			
	6-Sep	1-day	1-mo	3-mo
Reliance Energy	860	4.5	12.5	62.9
Chambal Fert	49	(1.0)	48.7	44.4
BHEL	1,895	0.1	13.3	41.6
Century Tex	804	2.5	13.1	38.8
Thermax	659	(0.8)	4.7	38.1
Worst performers				
Polaris	120	0.2	12.4	(27.4)
Punjab Tractors	239	(0.3)	(8.6)	(25.2)
Pfizer	684	(0.4)	(6.4)	(19.2)
Novartis India	297	(1.3)	(9.3)	(16.4)
i-Flex	2,014	(0.5)	(5.1)	(16.1)

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Technology**WIPR.BO, Rs478**

Rating	OP
Sector coverage view	Neutral
Target Price (Rs)	560
52W High -Low (Rs)	690 - 436
Market Cap (Rs bn)	693.0

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	149.4	184.8	234.7
Net Profit (Rs bn)	28.5	33.5	42.4
EPS (Rs)	19.8	23.1	29.2
EPS <i>gth</i>	39.3	16.7	26.4
P/E (x)	24.1	20.7	16.4
EV/EBITDA (x)	18.9	16.0	11.8
Div yield (%)	1.1	1.4	1.8

Shareholding, June 2007

	% of		Over/(under) weight
	Pattern	Portfolio	
Promoters	79.6	-	-
FIs	6.8	0.7	(1.7)
MFs	0.8	0.5	(1.9)
UTI	-	-	(2.4)
LIC	1.0	0.6	(1.8)

Wipro: Growth acceleration around the corner. Valuations are attractive. Maintain OP

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- **Revving up the growth engine**
- **Expect improving organic growth trajectory starting 2QFY08**
- **Maintain Outperform with a March-2009 DCF-based target price of Rs560/share**

We find the valuations of Wipro attractive and believe the stock can offer an upside of 20% over the next twelve months. We believe that there are several positives which would materialize in better company and stock performance including (1) large deal wins and ramp up in financial services and TSP verticals (2) focused approach for strategic accounts which will likely lead to better growth from Top 10 accounts, an area of concern in the past (3) strong momentum in non-ADM service offerings including infrastructure management, testing and BPO and (4) stable-to-improving margin profile in subsequent quarters. Wipro is trading at 20.7X FY2008E earnings and 16.4X FY2009E earnings, a marginal premium to Satyam and 15% discount to Infosys. Maintain Outperform with an end-March 2009 DCF-based target price of Rs560. Recession in the US economy is the key risk to our call.

Revving up the growth engine. Wipro had recently stated its target of becoming a top-10 IT services player globally in terms of revenues (the company is already among the global top-10 IT services companies in terms of net profit and employees). Wipro's breadth of service offerings is unmatched in the industry and the company has taken pro-active steps to leverage this by driving higher cross-sell, penetrating deeper into large accounts, improving its market share of large outsourcing deals and scaling up smaller verticals. We discuss some of these tenets of Wipro's growth strategy in detail:

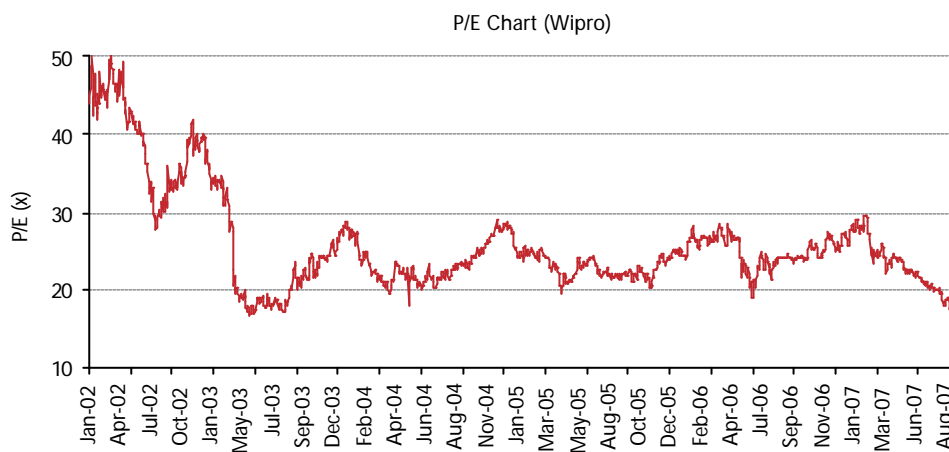
- **New structure instituted for large accounts.** Wipro launched the mega (US\$100 mn+ annual billing potential) and gama (US\$50 mn+) account initiative six months ago. The company has identified 20+ mega and 30+ gama accounts, to which the company has dedicated its best resources. These accounts are also directly managed by the executive management. We believe that this structure is critical in achieving scale and growth similar to or better than peers. Wipro indicates that this structure has enabled better success with key relationships. Results from revamping the hunting/ farming structure and scaling up the quality of its key account managers and program managers have also yielded positive results. We believe the company has the potential to exit FY2009 with more than five US\$100 mn+ relationships on a run-rate basis, from zero currently.
- **Sustaining leadership in non-ADM horizontal services.** Wipro leads the pack in testing and infrastructure management. In addition, it is a strong competitor in package implementation and BPO services. These services have grown at a COGR of 10.1% over the last four quarters as against the company average of 7.7%. Wipro is committing financial (M&A) and quality human resources to sustain high growth and leadership in these areas. The recent acquisition of Infocrossing is an obvious example of this desire.
- **Positioning for the big league.** The Infocrossing acquisition, though expensive, is a strategic fit for competing for large deals. For example, the recently announced US\$130 mn deal with a UK utility major would have been transacted at closer to US\$200 mn+ if the acquired company had had data center services and mainframe management capabilities. We believe Wipro's recent acquisition of Infocrossing, Inc. will increase its participation in large deal bids since these deals typically have a large data/applications hosting and managed services component. For large deal bids, the company has also created a separate, which include a cross-domain consultants.

Strong revenue growth in 2Q, guidance for 3Q. We believe that the above initiatives would start translating into strong revenue growth in 2Q (we model 8% growth, company has guided for 7%) and a strong guidance for Q3 (we expect 7%). Note that we are not building in any meaningful recovery in the telecom OEM segment (13% of revenues) in our model; we believe meaningful recovery would take place in FY2009. We model an organic revenue growth rate of 34% in FY2008 in Global IT services. We expect the organic revenue growth rate of Wipro to converge with peers in FY2009.

Acquisition results—a mixed bag. The performance of Wipro's acquisitions till date has been a mixed bag. While Wipro has been able to achieve financial/ strategic objectives with some of its recent acquisitions (Newlogic, Enabler, Quantech, mPower), performance of some of the others (Nervewire, Saraware, cMango) has been below expectations. Emphasis on acquisitions till date has been on skill-set enhancement, in our view. We would be happy to see Wipro make acquisitions that are game changers in nature. The Infocrossing acquisition could turn out to be one such, in our view. We expect Wipro to go slow on the acquisitions front for the next 12 months as it consolidates its recent large acquisitions.

Valuations. Wipro has underperformed the markets (BSE Sensex) by 30% over the past year. This can be attributed to weak organic revenue growth in FY2007 (32% against 46% for Infosys), concerns regarding the health of its product engineering business and recent large acquisitions, particularly Unza holdings. The stock is trading at 20.7X FY2008E, 16.4X FY2009E and 14.8X FY2010E earnings, a 15% discount to Infosys and 6% discount to TCS (on FY2009 P/E). Note that we have not built in the impact of Unza and Infocrossing acquisitions in our model. We believe the underlying improvement in business fundamentals of Wipro is yet to reflect in stock price. Maintain our Outperform rating with an end-March 2009 DCF-based target price of Rs560/ share.

Wipro is trading at its lowest 12-month roll-forward PE in the past five years



Source: Bloomberg, Kotak Institutional Equities estimates

Wipro's PE discount to Infosys at its highest in the past few years

Note: Premium/ discount on 12-month roll-forward PE multiple

Source: Bloomberg, Kotak Institutional Equities estimates

Wipro's revenue growth has been led by its new service lines (IMS, testing, PI, and BPO) over the past few quarters

Wipro's revenue break-up and qoq growth rate by service lines, 1QFY06-1QFY08

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08
Revenues (US\$ mn)									
Infrastructure management services (IMS)	30.7	34.5	40.2	43.5	51.8	58.9	71.1	79.4	80.6
Testing	31.1	37.5	45.0	51.2	57.7	65.4	70.5	76.0	81.3
Package implementation (PI)	43.8	47.8	52.5	54.3	57.7	63.6	72.4	82.2	87.1
BPO	42.6	41.3	43.1	46.6	45.3	49.5	53.2	59.4	63.9
Others (ADM, consulting)	250.3	269.6	292.6	316.6	326.9	351.6	373.4	393.7	413.2
Total	398.5	430.7	473.4	512.3	539.4	588.9	640.5	690.7	726.1
Growth qoq (%)									
IMS	7.8	12.3	16.8	8.2	18.9	13.7	20.7	11.7	1.5
Testing	15.2	20.6	20.0	13.9	12.7	13.3	7.8	7.8	7.0
IMS + Testing	11.4	16.4	18.5	11.2	15.5	13.5	13.9	9.8	4.2
PI	8.3	9.1	9.9	3.3	6.3	10.2	13.8	13.6	6.0
BPO	3.5	(3.0)	4.2	8.2	(2.8)	9.2	7.5	11.7	7.6
IMS + Testing + PI + BPO	8.1	8.7	12.3	8.2	8.6	11.7	12.5	11.2	5.4
Others (ADM, consulting)	5.3	7.7	8.5	8.2	3.2	7.6	6.2	5.4	4.9
Total	6.4	8.1	9.9	8.2	5.3	9.2	8.8	7.8	5.1

Source: Company, Kotak Institutional Equities

Wipro: Profit & Loss Statement Statement (Consolidated US GAAP Statements)- March fiscal year ends

Rs mn	2006	2007	2008E	2009E	2010E
Revenues					
<i>Global IT Services & Products</i>					
- Services	80,698	110,922	132,929	172,041	212,362
- Products	28	-	-	-	-
<i>India & AsiaPac IT Services & Products</i>					
- Services	6,097	8,369	10,706	12,576	13,582
- Products	10,380	15,520	19,025	22,666	24,026
<i>Consumer Care and Lighting</i>	5,625	7,559	9,577	11,013	12,335
<i>Others</i>	3,279	7,063	12,595	16,373	20,466
Revenues	106,107	149,431	184,831	234,669	282,771
Cost of revenues	(71,779)	(102,483)	(129,396)	(162,869)	(197,062)
Gross profit	34,328	46,949	55,436	71,800	85,709
Selling and marketing exp	(11,992)	(16,719)	(21,343)	(26,871)	(32,493)
EBIT (before amortization)	22,336	30,230	34,093	44,929	53,216
Exchange Gain/ (losses)	(288)	(0)	129	-	-
Amortization of Goodwill & Intangible Assets	(64)	(269)	(291)	(248)	-
EBIT (after amortization)	21,984	29,961	33,931	44,681	53,216
Other Income, net	1,276	2,667	3,951	3,810	4,435
PBT- before extraordinary items	23,260	32,628	37,882	48,491	57,651
Gain/(loss) on sale of stock of affiliate	-	-	-	-	-
PBT	23,260	32,628	37,882	48,491	57,651
Income Taxes	(3,264)	(4,423)	(4,811)	(6,613)	(11,515)
Income before share of equity in affiliates	19,995	28,205	33,071	41,878	46,136
Equity in earnings of affiliate	288	318	462	508	543
Minority Interest	(1)	-	-	-	-
Income from continuing operations	20,282	28,523	33,533	42,386	46,680
Discontinued operations	-	-	-	-	-
Income Tax Benefit	-	700	-	-	-
Adjustments	-	39	-	-	-
Net Profit- Reported	20,282	29,262	33,533	42,386	46,680
EPS (Rs/ share)	14.2	19.8	23.1	29.2	32.2
No of shares outstanding (mn)	1,425.8	1,439.8	1,450.0	1,450.0	1,450.0
EPS (before amortization of intangibles)	14.3	20.0	23.3	29.4	32.2
Margins (%)					
Gross Profit margin	32.4	31.4	30.0	30.6	30.3
EBITDA Margin	24.0	22.9	21.1	21.7	21.4
EBIT Margin	20.7	20.0	18.4	19.0	18.8
NPM	19.1	19.1	18.1	18.1	16.5
Growth Rates (%)					
Revenues	30.4	40.8	23.7	27.0	20.5
Gross Profit	25.7	36.8	18.1	29.5	19.4
EBIT (before amortization & exchange gains)	23.5	35.3	12.8	31.8	18.4
EBIT (after amortization & exchange gains)	23.1	36.3	13.3	31.7	19.1
Income before affiliates earnings	26.9	41.1	17.3	26.6	10.2
Income from continuing operations	28.1	40.6	17.6	26.4	10.1

Note:

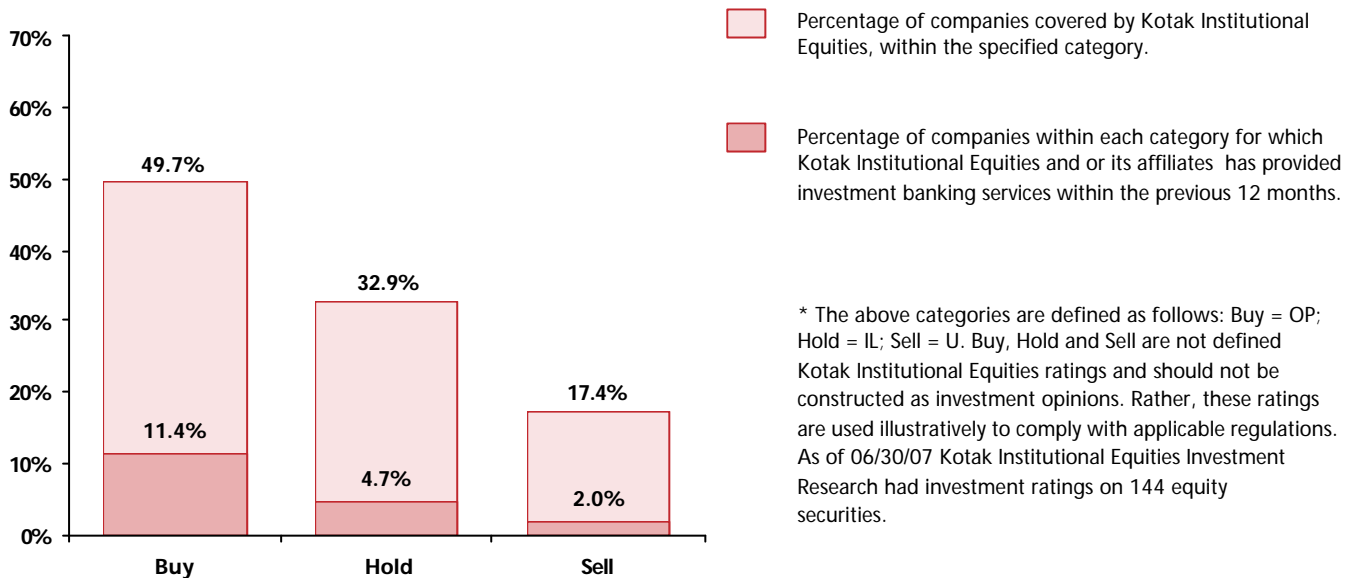
(1) Estimates do not factor in Wipro's Unza and Infocrossing acquisitions

Source: Kotak Institutional Equities estimates

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities.

As of June 30, 2007

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IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

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