

Wipro

STOCK INFO. BLOOMBERG
BSE Sensex: 9,257 WPRO IN
REUTERS CODE
S&P CNX: 2,805 WIPR.BO

23 December 2005

Buy

Rs465

Previous Recommendation: Buy

Equity Shares (m)	1,410.9
52-Week Range	469/286
1,6,12 Rel.Perf.(%)	0/-6/-20
M.Cap. (Rs b)	656.2
M.Cap. (US\$ b)	14.6

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	41.2	11.6	30.7	35.3	7.7	30.7
3/06E	107,603	19,671	13.9	23.2	33.4	8.3	28.9	33.0	5.7	24.0
3/07E	139,317	26,979	18.7	34.4	24.9	5.6	27.4	31.6	4.2	16.8

Wipro has recently acquired mPower Inc and MPACT Technology Services, and NewLogic. While the acquisition of mPower and MPACT Technology Services brings MasterCard into Wipro's fold, the acquisition of NewLogic would help expand Wipro's offerings in wireless technology. The impact of the acquisitions on Wipro's financials would, however, be minimal in FY06 and FY07. We expect Wipro to record profit growth of 24% in FY06 and 37% in FY07. We maintain our **Buy** recommendation on the stock.

mPower /MPACT bring MasterCard into Wipro's fold

Wipro has recently acquired mPower Inc and MPACT Technology Services, the only offshore vendors for MasterCard International, in an all cash deal worth US\$28m. mPower, which has an annualized revenue run rate of US\$18m, has developed the core payment processing applications for MasterCard through MPACT, its 51% JV with MasterCard. Wipro has acquired 100% stake in MPACT, and has entered into a strategic agreement with MasterCard to provide IT services to MasterCard and its clients.

Greater outsourcing from MasterCard likely to be a tall order

Currently, MPACT provides core Application Development and Maintenance (ADM) services to MasterCard, which is growing at 20% CAGR. Wipro hopes to be able to provide MasterCard with other value added services such as Infrastructure Management, Package Implementation,

Testing and BPO, which would enable it to capture a bigger chunk of MasterCard's IT budget, which is estimated at over US\$200m per annum. However, MasterCard has a sizeable IT department of its own and prides itself on being rated one of the "Best Places to work for in Information Technology" by Compuworld in 2004. To that extent, we believe that the potential for greater outsourcing/offshoring from the current levels is likely to be low.

Wipro would take over 300 employees from MPACT in Chennai and mPower in the US and Chennai. Margins are currently more or less in line with Wipro's average, at 25% at the EBIT level and around 20% at the net level, but are expected to improve upon integration. The transaction would be effective 1 December 2005, adding around US\$2m in 3QFY06. The first few quarters would be loss-making due to write-off of intangibles.

NewLogic to expand Wipro's offerings in wireless technology

NewLogic is an Austrian company specializing in wireless IP and Bluetooth, with estimated revenues of US\$16.8m in 2005. NewLogic mainly caters to the French and German markets, which are two of the top markets for embedded technology services (the other two are US and Japan). NewLogic has about 20 customers including Agere, Infineon, Philips, Yamaha and IBM, some of whom are existing Wipro customers as well. However, the management has confirmed that the bulk of NewLogic's revenue accrues from non-Wipro customers.

NewLogic has been rated the number 1 in Wireless IP and Bluetooth technologies by Gartner in 2005. The company also has 25 patent filings in Europe. Currently, around 40% of its business comes from IP related work, which the rest is from IT design services. The company has reported 20% CAGR in revenues over the last five years, and enjoys higher billing rates for its IT services.

The acquisition, which is likely to be completed over the next one month, is worth US\$56m in cash, which includes an up-front payment of US\$25m, while the rest would be paid out over the next three years based on certain performance criteria. NewLogic would add 120 employees to the Wipro fold, about 50% engaged in R&D/creation of IPR.

Presence in France and Germany to be strengthened

The acquisition strengthens Wipro's presence in France and Germany, two of the top four markets for embedded technology including US and Japan. NewLogic would also generate considerable downstream revenue in the embedded space for Wipro's embedded services business. Wipro hopes that the IP related business of NewLogic would help Wipro in its bid to achieve non-linear growth. However, at US\$6.7m, the impact of the same on Wipro's overall IT services business is expected to be marginal.

Impact of acquisition to be minimal

The acquisition, which is likely to be completed within a month, would result in marginal negative impact on profits for the first two quarters after integration due to losses in NewLogic on account of amortization of intangibles. Profitability is expected to improve thereafter, with the margins expected to be better than Wipro's IT services average over the long term.

Wipro plans to combine its global semiconductor IP portfolio, the analog/mixed signal services and the European SoC design services with NewLogic and create a new business unit under the Product Engineering Solutions group, with Hans-Peter Metzler, CEO of NewLogic as the head of the new business unit. However, unless Wipro is successful in accelerating non-linear growth in the IP business to achieve much faster growth in NewLogic than the current 20% CAGR, the contribution to overall revenue and impact on profitability is likely to be marginal.

Outlook and view

The impact of the acquisitions of NewLogic, mPower and MPACT is likely to be minimal in FY06 and FY07. We expect Wipro to record revenue growth of 32% and 29.5%, with profit growth of 24% and 37% in FY06 and FY07, respectively. On an estimated EPS of Rs18.7 for FY07, the stock trades at a P/E of 25x. We maintain **Buy**.

WIPRO'S ACQUISITIONS – A SNAPSHOT

TARGET	REVENUE RUN RATE (US\$M)	CONSIDERATION (US\$M)	AREA OF EXPERTISE	EXPECTED BENEFITS	LIKELY BENEFITS	EBITDA MARGIN	IMPACT IN FY06/07
NewLogic	16.8	56	SoC design, Wireless IP and Bluetooth tech.	Stronger presence in France & Germany, Non-linear growth from IP related work, downstream revenue in embedded services	Stronger presence in France & Germany, expansion of service offerings in the R&D domain	In-line with Wipro's IT services, higher billing rates	Marginal
mPower Inc and MPACT Technology Services	18	28	Credit card payment processing	Dominance in payment processing, greater outsourcing from MasterCard	Addition of MasterCard to clientele, strengthening of offerings in BFSI	In-line with Wipro's IT services	Marginal

Source: Motilal Oswal Securities

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

- ✍ Acquisition of mPower and MPACT Technology Services for US\$28m; signing of agreement with MasterCard to provide IT services
- ✍ Acquisition of Austrian semiconductor design firm NewLogic for US\$56m

Valuation and view

- ✍ Revenue growth of 32% and earnings growth of 24% in FY06
- ✍ Valuations at 25x FY07 earnings are rich compared to other Tier-I IT vedors
- ✍ 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	33.4	31.8	28.0
	FY07E	24.9	24.7	22.8
P/BV (x)	FY06E	8.3	11.3	13.7
	FY07E	5.6	8.4	9.3
EV/Sales (x)	FY06E	5.7	7.9	6.4
	FY07E	4.2	5.8	4.8
EV/EBITDA (x)	FY06E	24.0	24.3	21.7
	FY07E	16.8	17.9	17.1

SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	82.1	82.4	83.7
Domestic Institutions	1.4	1.4	1.8
FII/FDIs	6.5	5.4	5.1
Others	10.0	10.8	9.4

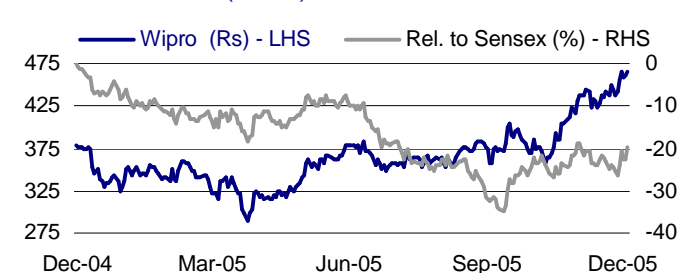
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	13.9	14.1	-1.1
FY07	18.7	18.1	3.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
465	470	1.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Sales	58,434	81,353	107,603	139,317	172,134
Change (%)	35.6	39.2	32.3	29.5	23.6
Cost of Revenues	37,028	51,417	70,810	89,792	112,200
SG&A	8,682	9,483	11,348	15,111	17,877
			82,158		
EBITDA	12,724	20,452	25,445	34,414	42,056
% of Net Sales	21.8	25.1	23.6	24.7	24.4
Depreciation	2,280	2,578	3,228	4,324	5,236
Other Income	1,325	771	523	1,198	1,171
PBT	11,769	18,646	22,739	31,288	37,992
Tax	1,611	2,693	3,168	4,380	5,319
Rate (%)	13.7	14.4	13.9	14.0	14.0
PAT	10,158	15,953	19,571	26,907	32,673
Earnings of Affiliates	96	-37	139	152	0
Minority Interest	56	82	40	80	72
Extraordinary items	-206	0	0	0	0
Net Income	9,992	15,834	19,671	26,979	32,601
Change (%)	22.9	58.5	24.2	37.2	20.8

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	465	1,407	1,415	1,443	1,465
Additional Paid in Capital	7,177	10,087	13,130	23,835	21,068
Retained Earnings	38,722	45,234	64,931	91,910	124,670
Net Worth	46,364	56,729	79,476	117,190	147,202
Minority Interest	407	533	693	899	1,171
Loans	969	564	0	0	0
Capital Employed	47,740	57,826	80,169	118,089	148,374
Gross Block	17,705	24,317	31,317	40,317	50,317
Less : Depreciation	8,448	11,116	14,298	18,558	23,729
Net Block	9,257	13,201	17,019	21,760	26,589
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	50,758	88,461	119,107
Debtors	10,973	14,806	18,573	23,283	28,296
Inventories	1,439	1,769	1,869	1,969	2,069
Cash & Bank Balance	3,297	5,671	23,488	55,015	78,909
Adv., Other Current Assets	6,872	5,690	6,828	8,194	9,833
Current Liab. & Prov	9,998	14,249	18,045	22,069	26,759
Creditors	2,733	3,713	5,402	6,898	8,553
Other Liabilities	7,265	10,536	12,643	15,172	18,206
Net Current Assets	12,583	13,687	32,712	66,392	92,348
Application of Funds	47,740	57,826	80,169	118,089	148,374

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS*	14.3	11.3	13.9	18.7	22.4
Cash EPS*	17.6	13.1	16.2	21.7	25.8
Book Value	32.9	40.2	56.3	83.1	104.3
DPS	26.3	5.0	4.9	6.5	8.9
Payout %(Incl.Div.Taxes)	184.0	44.4	35.0	35.0	40.0
Valuation (x)					
P/E	32.5	41.2	33.4	24.9	20.8
Cash P/E	26.5	35.4	28.7	21.4	18.0
EV/EBITDA	49.9	30.7	24.0	16.8	13.2
EV/Sales	10.9	7.7	5.7	4.2	3.2
Price/Book Value	14.2	11.6	8.3	5.6	4.5
Dividend Yield (%)	5.7	1.1	1.0	1.4	1.9
Profitability Ratios (%)					
RoE	24.4	30.7	28.9	27.4	24.7
RoCE	28.1	35.3	33.0	31.6	28.5
Turnover Ratios					
Debtors (Days)	69	66	63	61	60
Asset Turnover (x)	3.3	3.3	3.4	3.5	3.4
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	22,814	31,232	37,909
Cash for Working Capital	2,723	1,231	1,208	2,152	2,062
Net Operating CF	9,407	21,257	21,606	29,080	35,847
Net Purchase of FA	-3,372	-7,328	-7,000	-9,000	-10,000
Net Purchase of Investment	549	-5,918	8,320	11,130	14,764
Payment for Acquisitions	0	0	0	0	0
Net Cash from Invest.	-2,823	-13,246	1,320	2,130	4,764
Issue of Shares	637	3,979	3,210	10,941	-2,475
Proceeds from LTB/STB	365	-405	-564	0	0
Dividend Payments	-18,386	-9,211	-7,755	-10,623	-14,242
Net CF from Financing	-17,383	-5,638	-5,109	318	-16,718
Free Cash Flow	6,035	13,035	14,606	20,080	25,847
Net Cash Flow	-10,800	2,374	17,817	31,527	23,893
Opening Cash Balance	14,096	3,297	5,671	23,488	55,015
Add: Net Cash	-10,800	2,374	17,817	31,527	23,893
Closing Cash Balance	3,297	5,671	23,488	55,015	78,909

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

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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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