

Wipro

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,007	WPRO IN
	REUTERS CODE
S&P CNX: 2,933	WIPR.BO

19 July 2006

Buy
Rs458
Previous Recommendation: Buy

Equity Shares (m)	1,425.8
52-Week Range	599/345
1,6,12 Rel.Perf.(%)	6/-14/-8
M.Cap. (Rs b)	653.4
M.Cap. (US\$ b)	14.0

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
3/06A	106,108	20,269	14.2	25.8	32.2	8.3	29.9	34.0	5.8	24.2
3/07E	142,570	27,449	19.0	33.8	24.1	6.6	31.0	35.9	4.3	17.9
3/08E	181,535	33,633	23.0	20.7	20.0	5.3	30.5	35.7	3.3	14.0

- Consolidated sales grew 2.5% to Rs31.3b, higher than our estimate of Rs30.9b. Global IT services grew 7.7% (estimate of 6%), with organic growth of 7%. BPO revenue grew by a mere 1% QoQ (estimate of 10% QoQ) due to discontinuation of low margin processes/clients.
- Growth in the global IT services business has been driven by 9.1% growth in Enterprise segment with Technology and R&D segment growing by just 4.5%. Volumes in Global IT business grew by 5.5%, lower than peers.
- Consolidated EBITDA margins improved to 24% (estimate of 24.2%) from 23.3% in 4QFY06, on the back of higher gross margin in Global IT business at 34.3% in 1QFY07 from 33.6% 4QFY06.
- Wipro recruited 2,693 new technical employees (net) which included 409 employees from acquisitions. Attrition rate in global IT Services increased to 17% from 16% in 4QFY06.
- Higher other income at Rs489m against estimate of Rs358m and lower tax rate at 14% (estimate of 15%) resulted in PAT (before extraordinary) of Rs6.1b (estimate of Rs5.95b), up 2% QoQ.
- Wipro expects Global IT revenues to increase by 7% to US\$577m in. Guided growth includes US\$10m-11m revenues from inorganic growth. We have revised our EPS estimates downward considering the RSU charge and higher than expected attrition rates which could lead to higher employee cost. We expect sales CAGR of 30.8% (up from 30.1%) and PAT CAGR of 28.8% (down from 30.2%) from FY06-FY08E. We have revised our EPS estimates down by 1.9% for FY07 to Rs19 (down from Rs19.4) and 2.3% for FY08E to Rs23 (down from Rs23.5). The stock is trading at 24.1x FY07E and 20x FY08E. We maintain **Buy** for price target of Rs575 (upside of 26.5%).

QUARTERLY PERFORMANCE

									(RS MILLION)	
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Global IT Services incl Spectramind	17,430	18,876	21,528	22,892	24,513	26,407	28,646	30,284	80,726	109,850
Other Businesses	5,435	6,090	6,206	7,651	6,800	8,499	7,782	9,639	25,382	32,719
Revenues	22,865	24,966	27,734	30,543	31,312	34,906	36,428	39,924	106,108	142,570
Q-o-Q Change (%) - Global IT	5.8	8.3	14.0	6.3	7.1	7.7	8.5	5.7	33.0	36.1
Total Expenses	17,414	19,146	20,712	23,435	23,790	26,618	27,617	30,522	80,706	108,547
EBITDA	5,451	5,819	7,022	7,108	7,523	8,288	8,810	9,402	25,401	34,022
Margins (%)	23.8	23.3	25.3	23.3	24.0	23.7	24.2	23.5	23.9	23.9
Depreciation	738	770	777	926	995	1,020	1,106	1,157	3,211	4,278
EBIT	4,714	5,049	6,245	6,205	6,551	7,268	7,704	8,245	22,190	29,745
Margins (%)	20.6	20.2	22.5	20.3	20.9	20.8	21.1	20.7	20.9	20.9
Other Income	84	349	-40	614	489	541	447	562	1,007	2,039
PBT	4,798	5,398	6,205	6,819	7,040	7,809	8,151	8,807	23,197	31,784
Provision for Tax	586	791	990	898	979	1,171	1,223	1,321	3,265	4,694
Rate (%)	12.2	14.7	16.0	13.2	13.9	15.0	15.0	15.0	14.1	14.8
Net Income *	4,267	4,704	5,323	5,976	6,142	6,729	7,032	7,546	20,269	27,449
Q-o-Q Change (%)	-4.6	10.3	13.2	12.3	2.8	9.6	4.5	7.3	28.0	35.4

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

Global IT services up 7.7% on the back of 5.5% volume growth

Global IT business grew 7.1% QoQ, driven by 7.7% QoQ growth in software services and 1% QoQ growth in Spectramind (BPO). Acquired companies contributed to 0.7% growth in global IT revenues. Global IT software services registered volume growth was 5.5% QoQ for the quarter. Rupee depreciation improved revenue realization by 1.4% during the quarter. Onsite billing rates for software services were up 0.8% QoQ while offshore rates grew 0.5% QoQ.

BILLING RATES (US\$/MANMONTH)

	MAR-05	JUN-05	SEP-05	DEC-05	MAR-06	JUN-06
Onsite	10,907	11,057	10,973	10,577	10,894	10,979
% Change QoQ		1.4	-0.8	-3.6	3.0	0.8
Offshore	4,224	4,315	4,223	4,220	4,229	4,251
% Change QoQ		2.2	-2.1	-0.1	0.2	0.5

Source: Company/ Motilal Oswal Securities

Within Global IT services, the R&D services segment grew slower this quarter at 4.5% QoQ, while the enterprise segment grew strongly at 9.1% QoQ.

SEGMENT REVENUE (RS M)

	JUN-05	SEP-05	DEC-05	MAR-06	JUN-06
R&D services	5,592	6,193	7,163	7,806	8,159
% change QoQ	4.3	10.8	15.7	9.0	4.5
Enterprise	9,898	10,728	12,248	13,066	14,255
% change QoQ	7.2	8.4	14.2	6.7	9.1

Source: Company/ Motilal Oswal Securities

The growth in the enterprise segment was driven by strong growth in financial services, which grew by 9.8% QoQ to touch 63.6% of revenue. Retail also grew strongly at 14.9%, while manufacturing and TMTS grew 8.5% and 7.4% respectively. Utilities declined 2.7% during the quarter.

REVENUE BY DOMAIN (RS M)

	JUN-05	SEP-05	DEC-05	MAR-06	JUN-06
Financial Services	3,082	3,503	4,096	4,676	5,133
QoQ Growth (%)	11.9	13.6	16.9	14.2	9.8
Retail	1,781	1,675	1,825	1,795	2,062
QoQ Growth (%)	3.6	-6.0	8.9	-1.6	14.9
Utilities	1,626	1,844	2,174	2,254	2,197
QoQ Growth (%)	6.3	13.4	17.9	3.7	-2.6
Manufacturing	1,812	1,895	2,019	2,066	2,241
QoQ Growth (%)	2.0	4.6	6.5	2.4	8.5
TMTS	1,363	1,540	1,825	1,899	2,040
QoQ Growth (%)	11.4	13.0	18.5	4.1	7.4

Source: Company/ Motilal Oswal Securities

During the quarter the company added 40 new client through acquisitions, and 60 clients through the organic route. The company added 2,841 employees for Global IT software services. BPO employees declined by 110 due to restructuring of BPO operation. Wipro recruited 2,693 new technical employees (net) which included 409 employees from acquisitions. Attrition rate in global IT Services increased to 17% in 1QFY07 from 16% in 4QFY06.

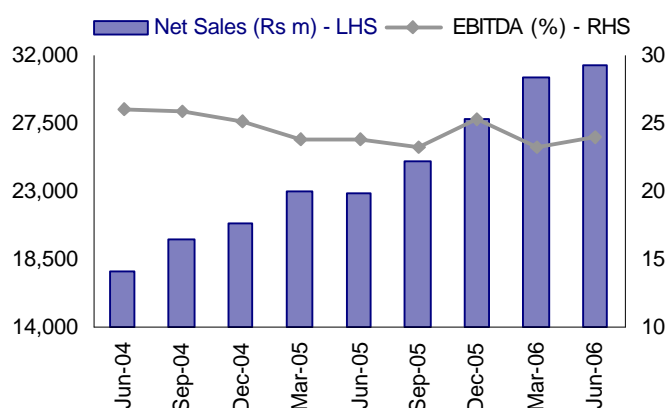
Weak season causes decline in Indian IT services

1Q is typically a weak quarter for Indian IT services, which reported sharp fall in revenue during the quarter at Rs4.6b, down 17.8% QoQ. Consumer care and lighting grew 24.8% YoY (up 11.3% QoQ) to Rs1.65b, while other business declined 0.8% QoQ during the quarter to Rs793m, which is also a seasonal phenomenon.

Higher utilization, rupee depreciation pulls up margins by 70bp

Gross margin in Global IT business was up to 34.3% from 33.6% in 4QFY06 due to higher utilization and rupee depreciation. Consolidated SG&A expenses were up to 8.2% of sales from 7.6% in 4QFY06 due to investment in sales and marketing. Consolidated EBITDA margins improved to 24% from 23.3% against estimates of 24.2%.

UTILIZATION RATES, RUPEE DEPRECIATION PUSH UP MARGINS



Source: Company/ Motilal Oswal Securities

Higher other income, lower taxes result in 2.8% profit growth

Wipro had lower than expected forex loss of Rs18.8m during the quarter, which pushed up total other income to Rs489m for the quarter as against expectation of Rs358m. Effective tax rate at 14% was lower than expectation of 15%. Consequently, the company reported consolidated PAT (before extraordinary) of Rs6.1b (estimate of Rs5.95b), up 2% QoQ.

Outlook and view

Wipro expects Global IT revenues to increase by 7% to US\$577m in 2QFY07 from US\$539m in 1QFY07. However guided growth includes US\$10m-11m revenues from inorganic growth, excluding which the revenues are expected to grow by 5.7% QoQ. Wipro expects operating margins to move in a narrow band in coming quarters.

Attrition rate in global IT Services increased to 17% in 1QFY07 from 16% in 4QFY06. In order to combat attrition, the company has decided to give offshore salary hikes starting from September 2006 instead of November. The hikes will be staggered over September-November 2006.

Wipro is also introducing Restricted Stock Units (RSU) for some of its middle level management from July 2006 (a negative surprise).

The RSUs will result in a charge of Rs3.4b to the income statement over a period of 5 years w.e.f from 1 July 2006. We expect charge of Rs0.51b in FY07 and a charge of Rs0.68b p.a. in the following years. While salary hikes and RSUs are likely to dent margins by 100-120bp in the coming quarters, margins are likely to move in narrow band due to the presence of various margin levers such as higher fresher recruitment, SG&A expense, margin upsides from the acquired companies and utilization rates.

We have revised our EPS estimates downward after considering the RSU charge and the higher than expected attrition rates which could lead to higher employee cost in coming quarters. We expect sales CAGR of 30.8% (up from 30.1%) and PAT CAGR of 28.8% (down from 30.2%) from FY06-FY08E. We have revised our EPS estimates downward by 1.9% for FY07 to Rs19 (down from Rs19.4) and 2.3% for FY08E to Rs23 (down from Rs23.5). The stock is trading at 24.1x FY07E and 20x FY08E. We maintain **Buy** for price target of Rs575 (upside of 26.5%).

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 over 40,000 people in its IT services and close to 16,000 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.

COMPARATIVE VALUATIONS

		WIPRO	INFOSYS	TCS
P/E (x)	FY07E	24.1	25.4	22.9
	FY08E	20.0	21.1	18.9
P/BV (x)	FY07E	6.6	9.3	10.0
	FY08E	5.3	6.9	7.1
EV/Sales (x)	FY07E	4.3	6.3	4.8
	FY08E	3.3	4.8	3.8
EV/EBITDA (x)	FY07E	17.9	19.7	18.0
	FY08E	14.0	15.4	14.3

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	81.1	81.4	82.4
Domestic Institutions	1.8	1.6	1.4
FII's/FDIs	7.2	7.2	5.4
Others	9.9	9.8	10.9

Recent developments

- ✎ Acquisition of Quantech Global Services, with expertise in the mechanical engineering space for US\$10m.
- ✎ Acquisition of Portuguese firm Enabler, for Euro41m to enable penetration into the Retail segment.
- ✎ Acquisition of Finnish firm Saraware for Euro25m to enhance wireless presence.

Valuation and view

- ✎ Revenue CAGR of 30.8% and earnings CAGR of 28.8% over FY06-08.
- ✎ Valuations at 20x FY08E offer potential for upside.
- ✎ We maintain **Buy** with a price target of Rs575.

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

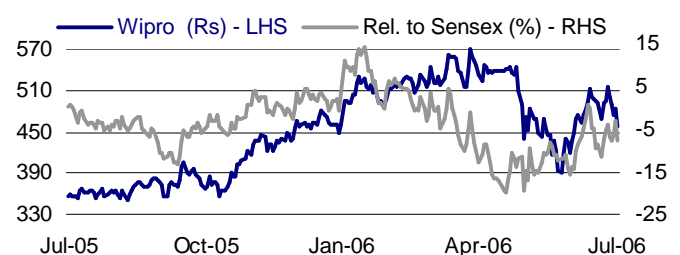
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	19.0	18.9	0.4
FY08	23.0	23.9	-3.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
458	575	26.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Sales	58,434	81,353	106,108	142,570	181,535	
Change (%)	35.6	39.2	30.4	34.4	27.3	
Cost of Revenues	37,028	51,417	70,925	96,847	124,634	
SG&A	8,682	9,483	9,782	11,700	14,408	
EBITDA	12,724	20,452	25,401	34,022	42,493	
% of Net Sales	21.8	25.1	23.9	23.9	23.4	
Depreciation	2,280	2,578	3,211	4,278	5,331	
Other Income	1,325	771	1,007	2,039	2,317	
PBT	11,769	18,646	23,197	31,784	39,479	
Tax	1,611	2,693	3,265	4,694	6,198	
Rate (%)	13.7	14.4	14.1	14.8	15.7	
PAT	10,158	15,953	19,932	27,090	33,281	
Income from equity investee	96	-37	288	321	353	
Minority Interest	56	82	1	0	0	
Extraordinary items	-206	0	0	39	0	
Net Income	9,992	15,834	20,269	27,449	33,633	
Change (%)	22.9	58.5	28.0	35.4	22.5	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Share Capital	465	1,407	2,852	2,864	2,878	
Additional Paid in Capital	7,177	10,087	16,521	19,640	23,220	
Other reserves	38,722	45,234	59,392	75,985	96,316	
Net Worth	46,364	56,729	78,764	98,491	122,414	
Minority Interest	407	533	0	0	0	
Loans	969	564	0	0	0	
Capital Employed	47,740	57,826	78,764	98,491	122,414	
Gross Block	17,705	24,317	32,041	43,041	55,541	
Less : Depreciation	8,448	11,116	14,263	18,322	23,453	
Net Block	9,257	13,201	17,777	24,718	32,088	
Investments	20,308	24,959	32,839	34,430	42,154	
Intangible Assets	5,592	5,978	8,335	13,473	13,273	
Curr. Assets	22,581	27,937	41,315	52,370	69,522	
Debtors	10,973	14,806	20,593	26,279	33,404	
Inventories	1,439	1,769	2,065	3,638	3,623	
Cash & Bank Balance	3,297	5,671	8,858	10,866	16,851	
Adv., Other Current Assets	6,872	5,690	9,799	11,586	15,644	
Current Liab. & Prov	9,998	14,249	21,502	26,503	34,622	
Creditors	2,733	3,713	4,446	6,791	7,135	
Other Liabilities	7,265	10,536	17,356	19,712	27,487	
Net Current Assets	12,583	13,687	19,813	25,867	34,900	
Application of Funds	47,740	57,826	78,764	98,491	122,414	

E: Most Estimates

RATIOS		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Basic (Rs)						
EPS*	14.6	11.3	14.2	19.0	23.0	
Cash EPS*	17.6	13.1	16.5	22.0	26.6	
Book Value	32.5	39.8	55.2	69.1	85.9	
DPS	26.3	5.0	5.0	6.7	8.0	
Payout %(Incl.Div.Taxes)	184.0	44.4	35.2	35.0	35.0	
Valuation (x)						
P/E		40.6	32.2	24.1	20.0	
Cash P/E		34.9	27.8	20.8	17.2	
EV/EBITDA		30.6	24.2	17.9	14.0	
EV/Sales		7.7	5.8	4.3	3.3	
Price/Book Value		11.5	8.3	6.6	5.3	
Dividend Yield (%)		11	1.1	1.5	1.8	
Profitability Ratios (%)						
RoE	24.4	30.7	29.9	31.0	30.5	
RoCE	28.1	35.3	34.0	35.9	35.7	
Turnover Ratios						
Debtors (Days)	69	66	71	67	67	
Asset Turnover (x)	3.3	3.3	3.3	3.3	3.3	
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	2006	2007E	2008E	
Cash Flow from Operations	12,130	22,488	23,194	31,367	38,611	
Cash for Working Capital	2,723	1,231	2,698	7,773	2,799	
Net Operating CF	9,407	21,257	20,496	23,594	35,812	
Net Purchase of FA	-3,372	-7,328	-8,678	-12,274	-12,300	
Net Purchase of Investment	549	-5,918	-7,356	-1,587	-7,820	
Payment for Acquisitions	0	0	0	0	0	
Net Cash from Invest.	-2,823	-13,246	-16,034	-13,861	-20,120	
Issue of Shares	637	3,979	7,345	3,131	3,594	
Proceeds from LTB/STB	365	-405	-564	0	0	
Dividend Payments	-18,386	-9,211	-8,056	-10,856	-13,302	
Net CF from Financing	-17,383	-5,638	-1,275	-7,725	-9,708	
Free Cash Flow	6,035	13,035	11,578	15,047	23,263	
Net Cash Flow	-10,800	2,374	3,187	2,009	5,985	
Opening Cash Balance	14,096	3,297	5,671	8,858	10,866	
Add: Net Cash	-10,800	2,374	3,187	2,009	5,985	
Closing Cash Balance	3,297	5,671	8,858	10,866	16,851	



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2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

Wipro

No
No
No
No

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