

# Wipro Ltd.

No cuts till now but accepts some weakness in financial sector

We hosted Wipro for a set of investor meetings over the last week. While management reiterated confidence in demand strength, there was acceptance of some budget cuts in financial sector. However, Wipro is seeing strong traction in non-US geographies and industry verticals outside financial services. In conclusion, we believe that continued slowdown in US would be negative for fundamentals of Indian IT sector and Wipro. However, sharp fall in share prices has led to attractive valuations in our view leading to our recent sector upgrade. We continue to watch the US situation closely.

- **Mixed demand scenario:** Wipro continues to see good demand environment with no project delays, cancellations or price cuts. While demand from non-BFSI customers remains strong, customer budgets in the BFSI sector are flat to 15% down. Wipro expects to get further clarity on demand by end Feb-early March.
- **Diversified business mix helping:** Wipro continues to see good demand in non-US regions especially India and Middle East. Wipro Infotech should be able to deliver 40+% organic growth in FY09 as per company offsetting some of possible US weakness. Further, utilities, healthcare and retail are showing good traction.
- **Worst case:** Wipro expects at least 20% US\$ revenue growth in FY09 in case of significant slowdown in US. This could mean a mid-to-low-teens EPS growth in our view providing for the bear-case on Indian IT sector. While it would be premature to start building this in estimates, we continue to watch US economy and datapoints closely as of now.

Table 1: Reuters: WIPR.BO/WIPR.US, Bloomberg: WPRO IN/WIT US

RsB (Year-end: Mar)	FY07A	FY08E	FY09E	FY10E	RsB	FY07A	FY08E	FY09E	FY10E	52-Week range	Rs425.0-690.0
Sales	149.4	197.6	251.8	314.8	ROE (%)	32.5	30.1	32.2	30.8	Shares Outstg	1,460Mn
Operating Profit	30.1	33.8	41.7	51.7	ROIC (%)	47.7	34.6	31.8	33.3	Avg daily volume	0.3Mn
Net profit	29.3	32.9	39.0	45.7		1Q	2Q	3Q	4Q	Free float	18%
EPS (Rs)	20.4	22.5	26.7	31.3	EPS (FY08)	4.9	5.6	5.7	6.1	Avg daily value \$M	4.0 Mn
P/E (x)	22.4	20.2	17.0	14.6	EPS (FY09) E	6.3	6.3	6.8	7.3	Mkt Cap (US\$ bn)	US\$ 16.9 Bn
P/BV (x)	6.5	5.7	5.3	3.9	EPS (FY10) E	7.2	7.5	8.0	8.6	PT (12/2008)	Rs 510

Source: JPMorgan estimates, Company data.

## Overweight

**Rs437.30**

01 February 2008  
Price Target: Rs510.00

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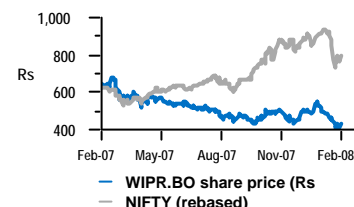
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### Price Performance



	YTD	-1M	-3M	-12M
Absolute	-15.2%	-15.2%	-12.4%	-29.7%
Relative	-1.7%	-1.7%	-3.0%	-56.8%

Source: RIMES, Reuters.

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## Demand environment

### No cut till now

Wipro indicated that they are not seeing any projects cuts, delays or price pressure. Wipro continues to win deals and see 3-5% increase in prices during renewals even from BFSI customers.

### Strong demand from certain geographies and sectors

Wipro indicated strong demand from Europe, India and Middle East regions. Wipro remains confident that their India and APAC business should see organic 40+% growth rates similar to FY08. They indicated the growing maturity and size of the India IT market as evinced in the fact that Wipro won their largest deal ever from Indian telecom operator Aircel. Wipro is one of the market leaders in India – key competition mainly consists of IBM and HP.

They are strong demand from energy and utilities, healthcare and non US retail sectors.

### However mixed demand scenario in BFSI

Wipro indicated that BFSI customer budgets were flat to 15% down. However, allocation between services, software and hardware are undecided. Further clarity would emerge by end Feb-middle March. Wipro indicated that budgets for large transformational programs could decrease.

### Worst case could be tough

Wipro indicated that under their worst case demand scenario, they would still see at least 20% volume growth in FY09. Wipro indicated that discretionary spends account for only ~30% of their revenues and hence impact of cut backs should be lesser than during the previous slowdown.

## Margin levers

Key margin levers for Wipro are:

- 1) **Pricing:** In addition to absolute price increases, Wipro indicated that higher fixed price contracts with better productivity should also improve the realizations.
- 2) **Offshore:** Wipro indicated that the offshore-onsite mix could improve especially for enterprise business.
- 3) **Employee mix:** Wipro sees another 5-8 percentage point improvement in freshers to lateral mix from current level of 47% in 0-3 years category.
- 4) **Non linearity:** Wipro has seen strong non-linear growth in BPO (HC grew 10% YTD with 40+% US\$ revenue growth. They are driving similar growth through their Infocrossing (IFOX) acquisition.

## Other issues

### Supply side issues

Wipro indicated that current IT services attrition is above their preferred range and they are driving measures within the organization to bring it down. On salary hikes,

Wipro was hopeful of moderate 10% average salary increase during FY09 as against 12-15% for past three years.

Wipro has made 14,000 campus offers for engineers and further 3,500 for graduates to join in FY09. This presents a 25%+ increase over FY08 offers.

### **Infocrossing (IFOX)**

Wipro expects the integration process to take 2-3 quarters. They expect revenues to pick up led by demand from Wipro existing clients. Further, margins should improve led by 1) higher offshore 2) better capacity utilization through more deals and 3) rationalization of costs.

### **Tax rates**

Wipro indicated that tax rates would increase by ~400 bps to 17-18% in FY10, post expiry of the STPI benefits. Wipro currently has 9 operational SEZs

### **Hedges**

Wipro has ~US\$ 2.5 billion of hedges covering them for 4-6 quarters. Further, they are following a policy of fully hedging any long-term contract inflows.

## **Valuation**

### **Dec-08 target price of Rs 510/share**

Our Dec-08 target price is Rs 510/share. We have continued to look at a combination of P/E multiples and DCF fair values to derive our target price.

### **Risks to our price target**

Macro slowdown in IT spending environment, higher-than-expected wage hikes and appreciation of the Rupee against the US dollar are key risks to our price target.

### **P/E multiples**

Our target price assumes a 1-year forward P/E multiple of 17x and trailing multiple of 20x. This assumes 3-5% discount to Infosys target multiples. With growth lagging Infosys, we expect gap in P/Es to continue.

Table 2: Target price comparison to P/E multiples

	1 year forward	1 year Trailing
Dec EPS (Rs.)	30.0	25.5
Average P/E multiple over past 1 year	22.1	25.1
Multiple used in Target price (x)	17.0	20.0

Source: JPMorgan estimates, Company data.

### **DCF valuation**

We maintain our DCF based Dec-08 fair value of Rs 510/share based on assumptions of 1) 10 year revenue CAGR of 22% 2) long-term EBIT margins of 21% 3) long-term ROIC of 32% and 4) WACC of 12.8%.

Table 3: Wipro P&L

<i>Rs m, Year-end March</i>	2008E				2009E				2005	2006	2007	2008E	2009E	2010E
	1Q	2Q	3Q	4QE	1QE	2QE	3QE	4QE						
Revenue	41,832	47,281	52,361	56,159	56,832	60,645	65,021	69,293	81,353	106,107	149,431	197,633	251,791	314,784
Gross Profit	12,736	14,272	15,241	16,117	16,943	17,185	18,400	19,590	27,498	34,460	47,265	58,366	72,117	89,142
EBIT	7,171	8,345	8,922	9,402	9,922	9,876	10,582	11,350	18,072	22,163	30,069	33,840	41,729	51,700
EBITDA	8,330	9,887	10,010	10,906	11,465	11,513	12,356	13,209	20,461	25,233	33,984	39,133	48,544	60,265
Net Other Income	991	743	455	556	446	561	670	815	592	1,276	2,706	2,745	2,492	3,766
Pre Tax Profit	8,162	9,088	9,377	9,959	10,368	10,438	11,252	12,165	18,664	23,439	32,775	36,586	44,222	55,466
Tax	839	865	1,074	1,124	1,239	1,272	1,385	1,517	2,693	3,265	3,723	3,902	5,413	10,032
<b>Net Profit</b>	<b>7,104</b>	<b>8,121</b>	<b>8,260</b>	<b>8,895</b>	<b>9,189</b>	<b>9,226</b>	<b>9,927</b>	<b>10,707</b>	<b>15,974</b>	<b>20,461</b>	<b>29,331</b>	<b>32,893</b>	<b>39,049</b>	<b>45,674</b>
EPS (Rs)	4.9	5.6	5.7	6.1	6.3	6.3	6.8	7.3	11.4	14.4	20.4	22.5	26.7	31.3
<b>Margins (%)</b>														
Gross Margin	30.4	30.2	29.1	28.7	29.8	28.3	28.3	28.3	33.8	32.5	31.6	29.5	28.6	28.3
Operating Margin	17.1	17.6	17.0	16.7	17.5	16.3	16.3	16.4	22.2	20.9	20.1	17.1	16.6	16.4
EBITDA Margin	19.9	20.9	19.1	19.4	20.2	19.0	19.0	19.1	25.2	23.8	22.7	19.8	19.3	19.1
Net Margin	17.0	17.2	15.8	15.8	16.2	15.2	15.3	15.5	19.6	19.3	19.6	16.6	15.5	14.5
<b>Sequential Growth (%)</b>														
Revenue	(3.5)	13.0	10.7	7.3	1.2	6.7	7.2	6.6	39.2	30.4	40.8	32.3	27.4	25.0
Gross Profit	(5.9)	12.1	6.8	5.7	5.1	1.4	7.1	6.5	41.5	25.3	37.2	23.5	23.6	23.6
EBIT	(13.6)	16.4	6.9	5.4	5.5	(0.5)	7.1	7.3	61.2	22.6	35.7	12.5	23.3	23.9
EBITDA	(11.1)	18.7	1.2	8.9	5.1	0.4	7.3	6.9	55.2	23.3	34.7	15.1	24.0	24.1
Net Profit	(17.5)	14.3	1.7	7.7	3.3	0.4	7.6	7.9	52.6	28.1	43.4	12.1	18.7	17.0
EPS	(17.5)	14.3	1.6	7.7	3.3	0.4	7.6	7.9	51.5	26.6	41.0	10.7	18.7	17.0

Source: JPMorgan estimates, Company data.

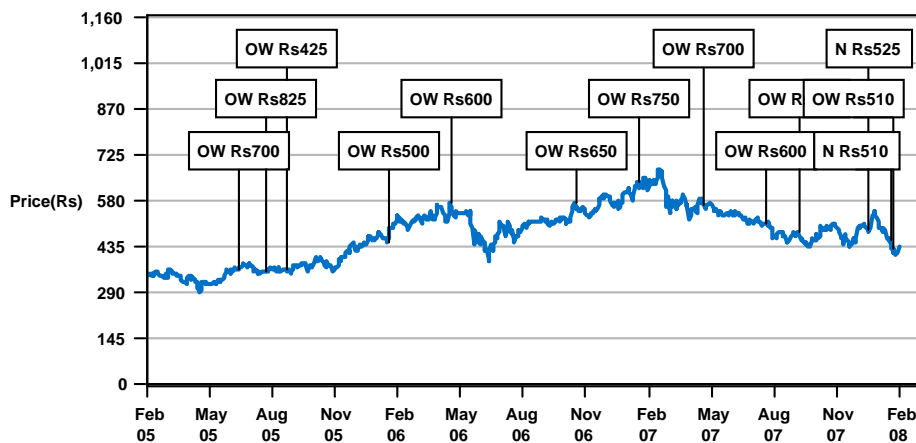
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**Wipro Ltd. (WIPR.BO) Price Chart**



Date	Rating	Share Price (Rs)	Price Target (Rs)
14-Jun-05	OW	361.00	700.00
25-Jul-05	OW	356.55	825.00
22-Aug-05	OW	365.15	425.00
18-Jan-06	OW	449.25	500.00
19-Apr-06	OW	570.15	600.00
18-Oct-06	OW	574.70	650.00
17-Jan-07	OW	636.85	750.00
23-Apr-07	OW	567.00	700.00
22-Jul-07	OW	507.80	600.00
10-Sep-07	OW	478.40	575.00
17-Dec-07	N	484.60	525.00
21-Jan-08	N	455.35	510.00
23-Jan-08	OW	428.85	510.00

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.  
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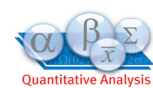
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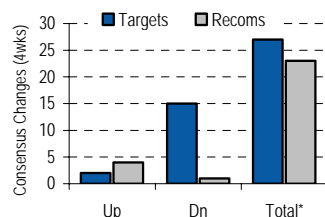
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All Data As Of 04-Feb-08

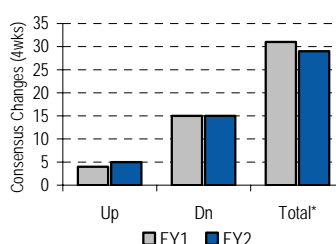
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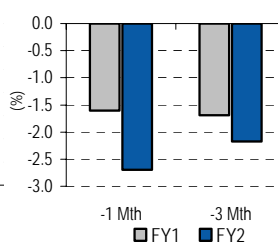
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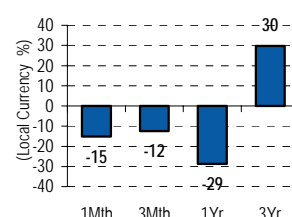
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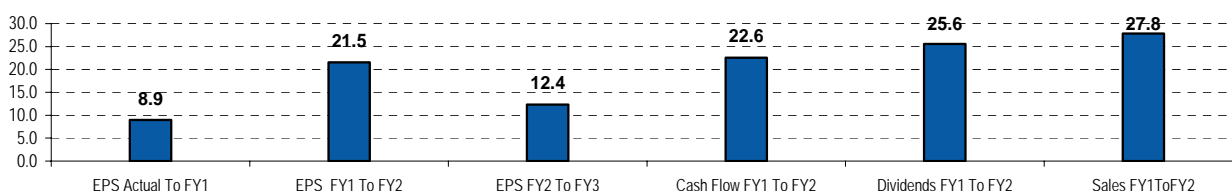
### EPS Momentum (%)



### Historical Total Return (%)



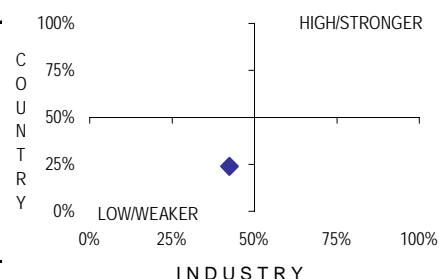
### Consensus Growth Outlook (%)



### Quant Return Drivers (A Score >50% indicates company ranks 'above average')

Score 0% (worst) to 100% (best)	vs Country Peers	vs (regional) IBES Industry Peers
Valuations: P/E Vs Market (12mth fwd EPS)	41%	51%
Valuations: P/E Vs Sector (12mth fwd EPS)	61%	76%
Valuations: EPS Growth (forecast)	23%	26%
Momentum: 12 Month Price Momentum	10%	33%
Momentum: 1 Month Price Reversion	33%	56%
Quality: Return On Equity (forecast)	75%	81%
Quality: Earnings Risk (Variation in Consensus)	91%	75%
Earnings&Sentiment: Earnings Momentum	24%	29%
Earnings&Sentiment: Change in Recoms	55%	73%
Earnings&Sentiment: Net Revisions Fy2 EPS	27%	27%

### JPMorgan Composite Q-Score



### COMPOSITE Q-SCORE\*\* (0% To 100%)

Code	Name	Country	USD MCAP	ADV	PE FY1	Q-Score**
19-HK	Swire Pacific Ltd.	Hong Kong	51,891	62.51	17.0	7%
13-HK	Hutchison Whampoa Ltd.	Hong Kong	42,049	150.09	9.9	1%
8031-JP	Mitsui & Co. Ltd.	Japan	35,859	311.66	8.8	74%
<b>507685-IN</b>	<b>Wipro Ltd.</b>	<b>India</b>	<b>16,229</b>	<b>3.02</b>	<b>19.5</b>	<b>42%</b>
J37-SG	Jardine Strategic Holdings Ltd.	Hong Kong	15,588	3.00	13.8	63%
700-HK	Tencent Holdings Ltd.	China	10,848	30.87	55.7	61%
023530-KR	Lotte Shopping Co. Ltd.	South Korea	9,950	28.56	12.6	20%
9831-JP	Yamada Denki Co. Ltd.	Japan	9,794	52.64	19.6	67%
493-HK	GOME Electrical Appliances Holding Ltd.	Hong Kong	7,273	20.82	39.0	84%
512599-IN	Adani Enterprises Ltd.	India	5,410	6.07	66.7	65%
4817-JP	Jupiter Telecommunications Co. Ltd.	Japan	5,310	3.86	21.5	30%

### Country Peers (Closest by Size, Consensus. ADV = average daily value traded in US\$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score**
500113-IN	Steel Authority of India Ltd.	Steel	23,709	13.81	12.3	88%
500209-IN	Infosys Technologies Ltd.	Information Technology Services	23,108	13.26	19.7	24%
532540-IN	Tata Consultancy Services Ltd.	Information Technology Services	23,107	6.46	17.8	39%
500010-IN	Housing Development Finance Corp. Ltd.	Finance/Rental/Leasing	20,688	14.31	39.5	44%
500875-IN	ITC Ltd.	Tobacco	19,583	6.91	24.4	43%
<b>507685-IN</b>	<b>Wipro Ltd.</b>	<b>Information Technology Services</b>	<b>16,229</b>	<b>3.02</b>	<b>19.5</b>	<b>24%</b>
507878-IN	Unitech Ltd.	Engineering & Construction	15,378	11.47	35.8	68%
500900-IN	Sterlite Industries (India) Ltd.	Miscellaneous Manufacturing	14,681	10.57	13.1	16%
530965-IN	Indian Oil Corp. Ltd.	Oil Refining/Marketing	14,611	4.11	8.7	18%
500180-IN	HDFC Bank Ltd.	Regional Banks	13,810	3.88	35.4	31%
500470-IN	Tata Steel Ltd.	Steel	12,943	15.18	7.5	93%

Source: Factset, Thomson and JPMorgan Quantitative Research. For an explanation of the Q-Snapshot, please visit <http://jpmorgan.hk.acrobat.com/qsnapshot/>  
 Q-Snapshots are a product of JPMorgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score.'

Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the JPMorgan analysts' recommendation.

\* Total number of target prices, recommendations or EPS forecasts that make up consensus. \*\* The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe.



## Wipro: Summary of Financials

Income statement						Ratio Analysis					
INR in millions, year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E	% , year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E
Revenues	106,107	149,431	197,633	251,791	314,784	Gross Margin	32.5	31.6	29.5	28.6	28.3
Cost of Goods Sold	71,647	102,166	139,268	179,674	225,642	EBITDA margin	23.8	22.7	19.8	19.3	19.1
Gross Profit	34,460	47,265	58,366	72,117	89,142	Operating Margin	20.9	20.1	17.1	16.6	16.4
SG&A Expenses	12,297	17,196	24,526	30,388	37,442	Net Margin	19.3	19.6	16.6	15.5	14.5
Operating Profit (EBIT)	22,163	30,069	33,840	41,729	51,700	SG&A/Sales	11.6	11.5	12.4	12.1	11.9
EBITDA	25,233	33,984	39,133	48,544	60,265	Sales growth	30.4	40.8	32.3	27.4	25.0
Other Income	1,276	2,706	2,745	2,492	3,766	Operating Profit Growth	22.6	35.7	12.5	23.3	23.9
Earnings before tax	23,439	32,775	36,586	44,222	55,466	Net profit growth	28.1	43.4	12.1	18.7	17.0
Tax	-3,265	-3,723	-3,902	-5,413	-10,032	EPS (Reported) growth	26.6	41.0	10.7	18.7	17.0
Net Income (Reported)	20,461	29,331	32,893	39,049	45,674	Interest coverage (x)	n.m	n.m	n.m	n.m	n.m
INR						Net debt to total capital	n.m.	n.m.	n.m.	n.m.	n.m.
EPS (Reported)	14.4	20.4	22.5	26.7	31.3	Net debt to equity	n.m.	n.m.	n.m.	n.m.	n.m.
BPS	55.3	69.6	79.9	86.2	116.7	Asset Turnover	105.8	102.3	103.6	126.1	112.0
DPS	5.0	6.0	8.0	9.0	0.0	ROE	30.1	32.5	30.1	32.2	30.8
Shares Outstanding (bn)	1425	1459	1460	1460	1460	ROIC	45.3	47.7	34.6	31.8	33.3
						ROCE	28.3	29.9	27.3	29.3	28.1

Balance sheet						Cash flow statement					
INR in millions, year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E	INR in millions, year-end Mar	FY06A	FY07A	FY08E	FY09E	FY10E
Cash and cash equivalents	39,186	52,060	27,439	34,545	67,433	Net Income	20,461	29,331	32,893	39,049	45,674
Accounts receivable	20,593	28,467	37,296	37,742	57,820	Depr. & Amortisation	3,070	3,915	5,293	6,814	8,565
Inventories	2,065	4,150	6,770	6,851	10,496	Change in working capital	-3,723	5,029	1,023	-66	-2,956
Others	9,993	16,421	29,483	29,836	45,708	Other	0	0	0	0	0
Current assets	71,837	101,098	100,988	108,974	181,457	Cash flow from operations	19,808	38,275	39,209	45,798	51,282
LT investments	1,244	1,446	1,243	1,243	1,243	Capex	-7,646	-12,679	-14,227	-7,832	-17,348
Net fixed assets	17,777	26,541	35,476	36,493	45,276	Disposal/ (purchase)	-2,915	-7,810	-35,763	0	0
Others	9,408	17,016	52,982	52,982	52,982	Cash flow from investing	-10,561	-20,489	-49,990	-7,832	-17,348
Total assets	100,266	146,102	190,689	199,692	280,958	Free cash flow	12,162	25,596	24,982	37,966	33,935
Liabilities						Equity raised/ (repaid)	7,880	3,059	-679	-14,646	14,166
ST loans	0	0	0	0	0	Debt raised/ (repaid)	0	859	141	-1,000	0
Payables	0	0	0	0	0	Other	555	1,136	3,849	240	240
Others	21,107	42,523	68,057	68,872	105,511	Dividends paid	-7,127	-9,965	-17,151	-15,453	-15,453
Total current liabilities	21,107	42,523	68,057	68,872	105,511	Cash flow from financing	1,309	-4,911	-13,841	-30,860	-1,047
Long term debt	0	859	1,000	0	0	Net change in cash	10,556	12,874	-24,621	7,106	32,888
Other liabilities	395	1,252	5,018	5,018	5,018	Beginning cash	28,628	39,186	52,060	27,439	34,545
Total liabilities	21,502	44,634	74,075	73,890	110,529	Ending cash	39,185	52,060	27,439	34,545	67,433
Shareholders' equity	78,764	101,468	116,613	125,802	170,430						

Source: Company reports, JP Morgan estimates