

Wipro Ltd

Recent acquisitions to payback

Wipro seems confident that a payback from its inorganic initiatives is imminent. We understand it is seeing traction in large deal wins due to capabilities it added in infrastructure management services. We raise our earnings estimates by 8% for FY10 and 11% for FY11 due to the surprise recovery and, hence, our target price from Rs 476 to Rs 600. However, at 18.4x FY11E P/E, a 10% premium to TCS, we prefer TCS over Wipro.

■ Seeing traction across services

Wipro is signing more multi-service deals, including application and package maintenance, BPO, infrastructure management and testing services. With 80 of Wipro's top 100 clients using it for at least four different services, the company is using this fact as a reference to win new multi-service deals.

■ Inorganic initiatives set to give returns

Over the past two years, Wipro has pursued an aggressive inorganic growth and utilised over US\$1 billion in cash. While its market share has remained unchanged, its margins have been diluted and, hence, lower earnings growth than peers. Wipro expects to demonstrate the benefits of its inorganic strategy in the imminent future.

■ Raising earnings by 8% for FY10E and 11% for FY11E

Wipro is currently trading at 18.4x FY11E earnings, a 10% premium to TCS. The company was ahead of its peers in reading the change in environment. Thus, the Street seems to be expecting superior growth for Wipro relative to peers. As the company's track record doesn't inspire confidence for us to assume outperformance, we would like to see at least one quarter of better relative growth before turning optimistic. Maintain **Neutral**.

Figure 1: Key financials

Rs million or as indicated, year-end March				
	FY08	FY09	FY10E	FY11E
Sales	197,428	254,564	265,845	306,638
Sales growth YoY (%)	32.1	28.9	4.4	15.3
EBITDA margin (%)	19.7	19.9	21.3	20.4
Net profit	32,240	34,415	41,250	43,944
EPS (Rs)	22.2	23.6	28.3	30.2
P/E (x)	25.1	23.5	19.6	18.4
EV/EBITDA (x)	20.5	15.8	13.8	12.1
FCF yield	(3.4)	1.6	4.3	4.3
ROE (%)	27.9	24.6	25.2	22.9

Source: Company data, Reliance Equities estimates. Note: Priced at COB 16 September 2009.

Neutral

Rs 555

Target price: Rs 600

IT services

Ganesh Duvvuri

ganeshh.duvvuri@relianceada.com
+9122 3954 1557

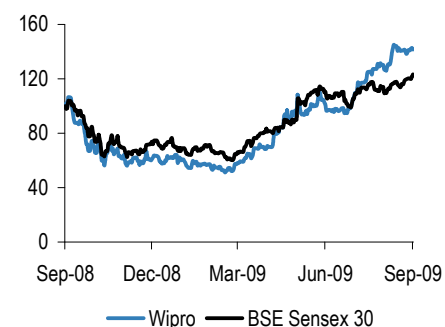
Bloomberg code	WPRO IN
Reuters code	WIPR.BO
3m avg. traded value (Rs m)	741.2
52-wk H/L (Rs)	573.9/181.7
Sensex	16677.1
Mcap (US\$ m/Rs bn)	16,864.7/813.6

Shareholding (%)		
	Jun-09	Mar-09
Promoters	79.2	79.3
MFs, Fls, banks	2.2	2.0
FII	8.9	8.6
Others	9.7	10.1

Stock performance (%)			
	1m	6m	1yr
Absolute	8.8	143.1	41.6
BSE 30 index	8.2	86.5	23.4

Share price performance

Base = 100



Source: Bloomberg, Capitaline.

Activity picking up across the board

Wipro is experiencing more engagements with clients including some discretionary spending activity. The recovery in spending is more dominant in retail and manufacturing, healthcare and other services. The company is signing multi-service deals including IT infrastructure management, BPO and testing services. Wipro claims that 80 of its top 100 clients procure at least four of its services. Surprisingly, the company is witnessing larger deals from Europe while deals from the US geography are smaller but more in number. Wipro seems optimistic in bagging government projects not only in India but also outside.

Inorganic initiatives set to payback

Wipro has been aggressive in pursuing acquisitions with its 'string of pearls' strategy and utilised US\$1 billion in cash. Despite this, it has not reported superior growth rates compared to its peers. The company seems quite confident that returns will be reflected in its performance imminently. Wipro remains optimistic on its Infocrossing acquisition (data centre operations), because of which it is able to win IT infrastructure management services deals. It is also optimistic on the Citi Tech services acquisition, which it believes would lead to mining of the Citigroup account.

Raising earnings estimates by 8% for FY10 and 11% for FY11

Wipro surprised the Street in April 2009 with its positive commentary on the environment despite its peers remaining cautious. However, reported performance in 1Q FY10 was below par relative to peers. Our channel checks lead us to believe that Wipro is winning more large deals than before and is also benefiting due to vendor consolidation. We are thus raising our earnings forecast by 8% for FY10. Wipro seems to be confident of keeping margins at current levels in FY11 despite its plan to honour 8,000 campus offers in 2Q FY10 and 3Q FY10 and another 7,500 offers starting January 2010. However, given our exchange rate assumption of Rs 45/US\$ as against Rs 47.3 in FY10, we believe margins will decline by 60bps in FY11. We are raising FY11E earnings by 11%.

Figure 2: Estimates revisions

Units as indicated						
	FY10E			FY11E		
	Old	New	Revision	Old	New	Revision
Volumes (man mths)	529,052	534,933	1.1%	620,535	637,154	2.7%
Blended pricing (US\$/man mth)	6,199	6,264	1.1%	6,074	6,257	3.0%
Revenues (US\$ m)	4,308	4,406	2.3%	4,939	5,283	7.0%
EBITDA margin	24.8%	25.0%		23.4%	24.4%	
EPS (Rs)	26.3	28.3	7.9%	27.4	30.4	11.0%

Source: Reliance Equities estimates. Note: EPS is as per US GAAP and the rest of the data is for the IT services business only.

Maintain Neutral as expectations are high

Wipro has followed a strategy that's different compared to its peers, like pursuing inorganic growth opportunities aggressively and deferring the joining dates of about 15,000 campus hires even as TCS and Infosys continued to honour their commitments. While sell-side analysts have been cautious (until recently there were few 'buy' recommendations), investors have remained optimistic on Wipro due to expectations that its differentiated strategy would

result in superior performance. However, so far the trends Wipro has demonstrated are similar to those of its peers. The company was ahead of its peers in identifying that the environment was improving. This has raised investor expectations that Wipro would report superior performance going forward, given its ability to predict market trends early on. At 18.4x FY11E earnings, Wipro is trading at a premium of 10% to TCS. We would like to see at least one quarter of superior growth before turning optimistic on Wipro. We are raising our target price to Rs 600, based on 20x FY11E earnings, i.e., a 10% discount to Infosys. Maintain **Neutral**.

Figure 3: Summary financials

Rs million or as indicated, year-end March				
Income statement	FY08	FY09	FY10E	FY11E
Sales	197,428	254,564	265,845	306,638
R&D expenses	(405)	-	-	-
Employee expenses	(133,488)	(171,473)	(175,996)	(205,100)
SG&A exp	(24,627)	(32,458)	(33,271)	(38,907)
Other operating exp	-	-	-	-
Other op. income	-	-	-	-
EBITDA	38,908	50,633	56,579	62,631
Depn and amort.	(5,960)	(8,191)	(8,802)	(9,676)
EBIT	32,948	42,442	47,777	52,955
Net int. income/exp.	-	-	-	-
Inc./loss from assoc.	-	-	-	-
Other non-op inc./exp.	2,167	(1,816)	4,725	(1,249)
PBT	36,137	39,936	48,010	52,405
Provision for taxes	(3,873)	(5,422)	(6,561)	(8,261)
Minority interest	(24)	(99)	(199)	(200)
Preference dividend	-	-	-	-
Reported net profit	32,240	34,415	41,250	43,944
REIPL net income	32,240	34,415	41,250	43,944
Wtd avg # of shares	1,455.4	1,455.5	1,455.5	1,455.5
EPS (basic, rep) (Rs)	22.2	23.6	28.3	30.2
EPS (dil., rep.) (Rs)	22.2	23.6	28.3	30.2
EPS (dil., adj.) (Rs)	22.2	23.6	28.3	30.2
DPS (Rs)	6.0	7.1	8.5	9.1
Divid payout ratio (%)	27.1	30.0	30.0	30.0
Balance sheet	FY08	FY09	FY10E	FY11E
Cash and equiv.	39,270	49,117	51,899	42,661
A/c.s receivable	38,908	46,217	46,614	52,087
Loans and adv.	-	-	-	1
Inventory	7,172	8,686	10,423	12,508
Other current assets	28,183	40,883	49,060	58,872
Total curr. assets	128,696	161,421	174,514	182,646
Accounts payable	15,218	21,144	22,933	26,741
Short-term debt	30,234	37,211	20,197	10,099
Other curr. liab.	31,786	54,213	61,080	71,109
Total curr. liab.	77,238	112,568	104,210	107,948
Net curr. assets	51,458	48,853	70,304	74,698
Net fixed assets	39,822	49,862	50,766	51,726
Net intangibles	51,436	67,106	71,106	75,106
Investments	-	-	-	-
Other long-term assets	3,345	12,159	12,159	12,678
Total assets	223,299	290,548	308,545	322,156
Total loans	14,522	19,595	19,043	-
Other long-term liab.	2,058	7,968	7,968	7,968
Shareholders' funds	129,367	150,182	177,324	206,241
Pref. shrs/other equity	-	-	-	-
Minority interest	114	235	-	-
Total liab. and equity	223,299	290,548	308,545	322,156
BVPS (Rs)	89.0	103.3	121.8	141.7
DuPont analysis	FY08	FY09	FY10E	FY11E
Margin (%)	16.3	13.5	15.5	14.3
Asset turnover (x)	1.1	1.0	0.9	1.0
Leverage (x)	1.6	1.8	1.8	1.6
ROE (%)	27.9	24.6	25.2	22.9
Cash Flow Statement	FY08	FY09	FY10E	FY11E
PBT	36,137	39,936	48,010	52,405
D&A add back	(5,343)	(6,703)	(7,096)	(8,040)
Taxes paid	(3,873)	(5,422)	(6,561)	(8,261)
(Inc)/dec in w. cap	34,643	61,078	21,749	21,968
Other op. cash flow	(70,310)	(59,090)	(13,212)	(13,941)
Cash flow from op. (A)	(8,746)	29,800	42,890	44,131
Cap exp. (B)	(18,624)	(16,743)	(8,000)	(9,000)
Acquisitions (C)	-	-	-	-
Divestitures (D)	-	-	-	-
Others (E)	17,504	(1,682)	-	-
Cash flow from investing	(1,120)	(18,425)	(8,000)	(9,000)
FCF (A+B+C+D+E)	(27,370)	13,057	34,890	35,131
Divids pd (com. and pref.)	(9,955)	(11,770)	(14,107)	(15,029)
Inc. in equity	1,938	2,591	-	-
Inc./dec. in debt	40,975	12,050	(17,566)	(29,142)
Other financing cash flows	3,766	(4,399)	(434)	(200)
Cash flow from financing	36,724	(1,528)	(32,107)	(44,370)
Total cash flow	26,858	9,847	2,782	(9,240)
Capital management	FY08	FY09	FY10E	FY11E
Inventory days	10.5	11.4	13.1	13.6
Receivable days	62.3	61.0	63.7	58.7
Growth and margins (%)	FY08	FY09	FY10E	FY11E
Sales growth	32.1	28.9	4.4	15.3
EBITDA growth	14.2	30.1	11.7	10.7
EPS growth	13.7	6.7	19.9	6.5
EBITDA margin	19.7	19.9	21.3	20.4
EBIT margin	16.7	16.7	18.0	17.3
Net margin	16.3	13.5	15.5	14.3
Rev. growth – peers	24.1	27.5	4.6	12.9
EBITDA growth – peers	17.3	29.4	7.0	9.9
EBITDA margin – peers	24.8	25.1	25.7	25.0
EPS growth – peers	15.6	13.1	8.2	12.6
Noplat	29,417	36,680	41,248	44,608
Invested capital	224,386	270,138	283,480	286,735
ROIC (%)	17.1	14.8	14.9	15.6
ROIC/WACC (x)	1.4	1.2	1.3	1.3
ROIC – peers (%)	27.3	26.3	22.8	22.0
Valuations	FY08	FY09	FY10E	FY11E
P/E (x)	25.1	23.5	19.6	18.4
P/E (peers) (x)	24.2	21.4	19.8	17.5
EV/sales (x)	4.0	3.1	2.9	2.5
EV/sales – peers (x)	4.9	3.8	3.5	3.0
EV/EBITDA (x)	20.5	15.8	13.8	12.1
EV/EBITDA (peer group)	19.3	14.9	13.5	11.8
P/B (x)	6.2	5.4	4.6	3.9
P/B peer group (x)	7.8	7.0	5.6	4.6
Div yield (%)	1.1	1.3	1.5	1.6
Free cash flow yield (%)	(3.4)	1.6	4.3	4.3
Quality of earnings	FY08	FY09	FY10E	FY11E
Op. cash flow/net income (x)	(0.3)	0.9	1.0	1.0
Capex/Depn (x)	3.5	2.5	1.1	1.1
Tax charge/pre-tax income (x)	10.7	13.6	13.7	15.8
Net debt/equity (%)	(0.1)	(0.1)	(0.2)	(0.2)
Interest cover (x)	-	-	-	-

Source: Company data, Reliance Equities estimates.

Reliance Equities International: Contact sheet

Name	Sector	Mobile	Direct No.	E-mail
Keshav Sanghi	CEO	+91 93219 25703	+91 22 3954 1515	keshav.sanghi@relianceada.com
Shirin Mehta	Head – CRM	+91 93243 12119	+91 22 3954 1575	shirin.mehta@relianceada.com
Nina Nariman	Head – Events & Marketing	+91 93219 25715	+91 22 3954 1565	nina.nariman@relianceada.com
Research				
Ajay Mathrani	Head of Research & Emerging Companies	+91 93239 57546	+91 22 3954 1571	ajay.mathrani@relianceada.com
Atsi Sheth	Economics	+91 93226 55261	+91 22 3954 1551	atsi.sheth@relianceada.com
Ketaki Sharma		+91 93224 44680	+91 22 3954 1572	ketaki.sharma@relianceada.com
Arun Baid	Emerging Companies	+91 93246 27929	+91 22 3954 1559	arun.baid@relianceada.com
Nilesh Parikh	Financial Services	+91 93246 27907	+91 22 3954 1552	nilesh.parikh@relianceada.com
Anand Mour	FMCG & Retail	+91 93243 12116	+91 22 3954 1553	anand.mour@relianceada.com
Mihir P. Shah		+91 93209 81116	+91 22 3954 1554	mihir.p.shah@relianceada.com
Urmik Chhaya	Infrastructure	+91 93249 15136	+91 22 3954 1558	urmik.chhaya@relianceada.com
Harish Bihani	Power Utilities & Capital Goods	+91 93224 43416	+91 22 3954 1578	harish.bihani@relianceada.com
Naveen Jain	Construction	+91 93242 67096	+91 22 3954 1579	naveen.h.jain@relianceada.com
Ganesh Duvvuri	IT & Media	+91 93243 12202	+91 22 3954 1557	ganesh.duvvuri@relianceada.com
Amresh Kumar	Metals & Mining	+91 93243 12156	+91 22 3954 1563	amresh.g.kumar@relianceada.com
Varatharajan Sivasankaran	Oil & Gas	+91 93246 27970	+91 22 3954 1561	varatharajan.sivasankaran@relianceada.com
Avishek Datta		+91 93246 27967	+91 22 3954 1562	avishek.datta@relianceada.com
Jai Bala	Technicals	+91 93243 12113	+91 22 3954 1502	jai.bala@relianceada.com
Gaurav Jaitly	Telecom	+91 93243 12086	+91 22 3954 1574	gaurav.jaitly@relianceada.com
Abhishek Gupta		+91 93228 35577	+91 22 3954 1556	abhishek.x.gupta@relianceada.com
Dharmendra Sahu	Database	+91 93224 44656	+91 22 3954 1569	dharmendra.sahu@relianceada.com
Mrinalini Bhosle	Co-ordinator	+91 93224 43382	+91 22 3954 1568	mrinalini.bhosle@relianceada.com
Sales				
Sudhanshu Bhuwalka	Co-head	+91 93219 51903	+91 22 3954 1511	sudhanshu.bhuwalka@relianceada.com
Varun Pardiwalla	Co-head	+91 93219 51902	+91 22 3954 1522	varun.pardiwalla@relianceada.com
Nirbhay Singh		+91 93224 44631	+91 22 3954 1507	nirbhay.singh@relianceada.com
Nityanand Singh		+91 93246 27932	+91 22 3954 1503	nityanand.singh@relianceada.com
Salestrading				
S. Chandra Sekaran	Head	+91 93246 27447	+91 22 3954 1525	chandra.s.sekaran@relianceada.com
Jaykrishna Gandhi		+91 93234 31359	+91 22 3954 1512	jaykrishna.gandhi@relianceada.com
Sanjay Kulkarni		+91 93243 12234	+91 22 3954 1513	sanjay.kulkarni@relianceada.com
Trading				
Manish Bhatia	Head	+91 93246 27469	+91 22 3954 1505	manish.j.bhatia@relianceada.com
P. Guruprasad Iyer		+91 93209 81125	+91 22 3954 1516	guruprasad.iyer@relianceada.com
Paras Shah		+91 93207 68338	+91 22 3954 1509	paras.j.shah@relianceada.com
Rajesh Menon		+91 93239 03529	+91 22 3954 1508	rajesh.menon@relianceada.com

Key to REIPL recommendations

Outperform = Expected total return is more than the hurdle rate.

Neutral = Expected total return is less than the hurdle rate but more than zero.

Underperform = Expected total return is negative.

Expected total return is defined as expected price appreciation over the next 12 months plus our dividend yield forecast for the stock.

Hurdle rate is defined as the ten-year government securities yield + our market risk premium assumption.

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