

SELL

TP: Rs 180 | ▼ 20%

WIPRO

| IT Services

| 15 July 2020

Strong operational performance despite all odds

Despite a sharp US dollar revenue decline of 7.3% QoQ, Wipro (WPRO) delivered a strong Q1 operational performance with EBIT margins rising 150bps QoQ. The revenue impact stemmed from lower volumes, pricing discounts and reduced realisation on fixed-price projects. Given Covid uncertainty and CEO transition, we remain skeptical about mid-term growth. We increase FY21/FY22 EPS by ~9%/2% to bake in stronger margins – reiterate SELL as we roll forward to a Jun'21 TP of Rs 180 (Rs 170 earlier).

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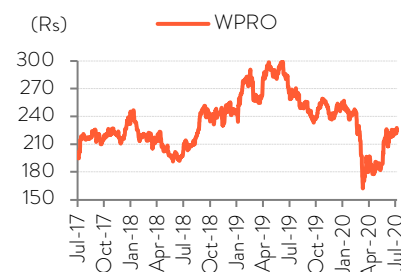
Aggressive cost control: WPRO underperformed our estimates on the revenue front with a 4.7% QoQ decline (including ISRE). IT services revenue fell 7.3% QoQ in US dollar terms (-7.5% CC) vs. our estimate of a 6.1% drop. In a positive surprise, segmental EBIT margin in IT services increased 150bps QoQ to 19% vs. our forecast of 150bps QoQ contraction. Cost of revenues contracted 260bps QoQ, showcasing good operational efficiency. Traditional levers such as variable workforce cost reduction, automation, better utilisation and higher offshore realisation were used to the fullest.

Ticker/Price	WPRO IN/Rs 225
Market cap	US\$ 17.1bn
Shares o/s	5,715mn
3M ADV	US\$ 22.9mn
52wk high/low	Rs 276/Rs 159
Promoter/FPI/DII	74%/9%/17%

Source: NSE

Pipeline expected to improve in H2FY21: The current deal pipeline is robust, with a YoY increase in order book. While slower decision-making remains a concern, deal wins are gaining momentum in IMS, cloud, digital, and engineering and security services.

STOCK PERFORMANCE



Source: NSE

3Cs to drive demand: With a new CEO at the helm, WPRO's key focus is on profitable growth and tight control over operations. Operating margins are expected to hold within a narrow band around 19% in Q2FY21. Stability is returning in the consumer business, technology services and communications. Company expects the 3Cs – Cloud, Collaboration and Cybersecurity – to fuel demand going forward.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	5,89,060	6,13,401	5,96,647	6,32,299	6,79,365
EBITDA (Rs mn)	1,21,661	1,24,867	1,17,460	1,24,983	1,38,503
Adj. net profit (Rs mn)	90,074	95,295	87,207	91,316	1,03,522
Adj. EPS (Rs)	14.9	16.7	14.8	15.5	17.6
Adj. EPS growth (%)	12.3	11.6	(10.9)	4.7	13.4
Adj. ROAE (%)	17.1	16.9	14.6	13.5	13.6
Adj. P/E (x)	15.1	13.5	15.2	14.5	12.8
EV/EBITDA (x)	11.3	10.4	10.4	9.7	8.4

Source: Company, BOBCAPS Research

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Other key highlights

- The acquisition of specialised IT services provider IVIA Servicos de Informatica gives WPRO access to Brazil and complements its financial services, retail and manufacturing verticals.
- WPRO's new CEO Thierry Delaporte is targeting profitable growth.
- The demand environment has changed drastically amid Covid-19, especially for verticals that have borne the initial brunt of the worldwide lockdown, i.e. retail, oil and gas, and manufacturing (automobiles in particular). BFSI is also suffering due to the possibility of negative interest rates.
- The company's financial services vertical declined by 6.4% QoQ (USD terms) due to low/negative interest rates. Banks are curtailing IT spend owing to higher provisioning for potential delinquencies. Manufacturing & hi-tech verticals declined by 8.5% while life sciences fell 7.3% QoQ.
- Europe revenues dropped the most-by 8.9% QoQ, followed by a 7.5% decline in the US.
- Voluntary attrition declined 170bps QoQ.
- The lack of a buyback announcement for Q2 and beyond was disappointing.

FIG 1 – JUN'20 QUARTER PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
US\$ revenues (IT Services)	1,922	2,039	(5.7)	2,074	(7.3)
Total Revenue	150,336	148,019	1.6	158,103	(4.9)
Operating Expenditure	123,495	123,345	0.1	132,109	(6.5)
Cost of revenues	104,625	104,273	0.3	114,133	(8.3)
as % of sales	69.6	70.4	-	72.2	-
SG&A expenses	18,870	19,072	(1.1)	17,976	5.0
as % of sales	12.6	12.9	-	11.4	-
EBIT	26,841	24,674	8.8	25,994	3.3
Other Income	4,110	6,045	(32.0)	3,267	25.8
PBT	30,951	30,719	0.8	29,261	5.8
Total Tax	6,838	6,699	2.1	6,205	10.2
Adjusted PAT	24,113	24,020	0.4	23,056	4.6
(Profit)/loss from JV's/Ass/MI	(211)	(147)	-	(191)	-
APAT after MI	23,902	23,873	0.1	22,865	4.5
Extra ordinary items	0	0	-	0	-
Reported PAT	23,902	23,873	0.1	23,260	2.8
Reported EPS	4.1	4.0	2.8	4.1	-
Margins (%)					
EBIT margin-IT Services	19.1	19.2	(10)	17.6	150
EBIT	17.9	18.1	(30)	16.4	140
EBT	20.6	21.3	(70)	18.5	210
PAT	15.9	16.5	(60)	14.7	120
Effective Tax rate	22.1	22.1	-	21.2	90

Source: Company, BOBCAPS Research

FIG 2 – JUN'20 QUARTER OPERATING METRICS

	Q1FY21 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
Revenue by Practice			
Technology Infrastructure Services	25.9	(7.0)	(5.1)
Analytics	7.2	(7.4)	(8.3)
BPO	14.8	(6.1)	(5.1)
Product Engg and Mobility	7.7	(7.4)	(4.5)
Application Services	44.4	(8.0)	(6.2)
Revenue by Vertical			
Global Media & Telecom	5.1	(14.1)	(18.5)
Finance Solutions	30.7	(6.4)	(8.4)
Manufacturing & Hitech	8.1	(8.5)	(3.4)
Healthcare, Life Sciences & Services	13.5	(7.3)	(3.6)
Retail & Transportation	15.9	(12.3)	(3.9)
Energy & Utilities	13.2	(4.4)	(2.8)
Technology	13.5	(2.3)	(2.1)
Revenue by Geography			
US	59.0	(7.5)	(5.3)
Europe	23.7	(8.9)	(9.2)
Client Concentration			
Top customer	3.2	(1.2)	(18.5)
Top 5 customers	12.3	(6.6)	(16.0)
Top 10 customers	20.3	(2.5)	(7.6)
Non-Top 10	79.7	(8.5)	(5.3)
Utilisation			
	Q1FY21	Q4FY20	Q1FY20
Global IT services ex IFOX -Gross	75.0	73.4	73.9
Global IT services ex IFOX-Net	84.5	82.4	82.8
Global IT services ex IFOX-Net ex trainees	84.5	82.6	85.0
Attrition			
Voluntary Attrition TTM	13.0	14.7	17.6
Global IT services-Voluntary	10.7	12.6	17.9

Source: Company, BOBCAPS Research

Valuation methodology

We increase our FY21/FY22 EPS estimates by 9%/2% as we factor in WPRO's strong operating margin performance in the Jun'20 quarter while remaining cautious on revenue growth assumptions due to the Covid-19 crisis. We also introduce FY23 EPS at Rs 17.6 and estimate 6.9% US dollar revenue growth with 17.1% EBIT margins.

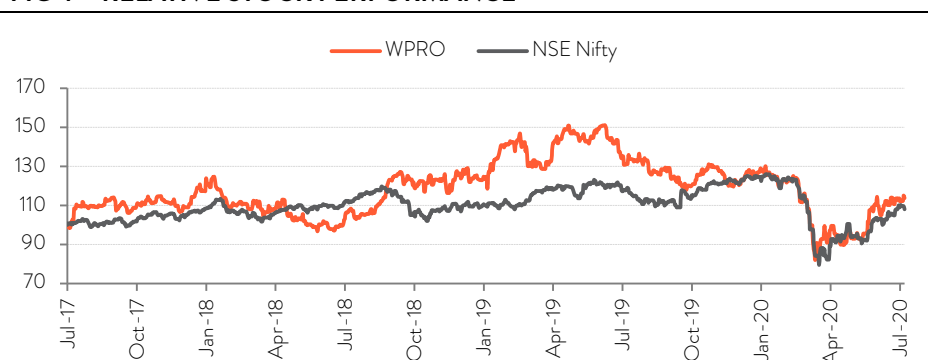
Given a patchy track record of strategy execution and a laggardly performance amongst peers, we stay apprehensive about the company's resilience in the current challenging environment. We reiterate SELL and roll forward to a revised Jun'21 target price of Rs 180 (Rs 170 earlier), set at unchanged one-year forward P/E multiple of 11x.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Change (%)	Old	New	Change (%)	New
IT Services revenues (in US\$ mn)	7,752	7,561	(2.5)	8,059	7,861	(2.5)	8,401
IT Services revenues (in US\$ mn), YoY growth (%)	(6.1)	(8.4)	-	4.0	4.0	-	6.9
Company Wide Revenues	6,12,508	5,96,647	(2.6)	6,48,129	6,32,299	(2.4)	6,79,365
EBIT	90,192	97,771	8.4	1,04,852	1,04,117	(0.7)	1,16,084
EBIT margins (%)	14.7	16.4	-	16.2	16.5	-	17.1
Net profits	81,142	87,207	7.5	91,127	91,316	0.2	1,03,522
EPS (Rs)	13.6	14.8	8.9	15.3	15.5	1.5	17.6

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates include:

- a sharper recovery in demand than expected
- stronger-than-estimated large deal wins, and
- sharp, favourable currency movements.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	5,89,060	6,13,401	5,96,647	6,32,299	6,79,365
EBITDA	1,21,661	1,24,867	1,17,460	1,24,983	1,38,503
Depreciation	19,474	20,281	19,689	20,866	22,419
EBIT	1,02,187	1,04,586	97,771	1,04,117	1,16,084
Net interest income/(expenses)	15,548	16,752	13,317	13,246	16,928
Other income/(expenses)	0	0	0	0	0
Exceptional items	0	0	0	0	0
EBT	1,15,458	1,20,589	1,11,087	1,17,363	1,33,012
Income taxes	25,242	24,799	23,519	25,847	29,290
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	142	495	361	200	200
Reported net profit	90,074	95,295	87,207	91,316	1,03,522
Adjustments	0	0	0	0	0
Adjusted net profit	90,074	95,295	87,207	91,316	1,03,522

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	0	0	0	0	0
Other current liabilities	1,58,894	1,56,761	1,32,407	1,40,319	1,50,763
Provisions	640	612	1,471	1,559	1,675
Debt funds	99,467	78,042	78,042	78,042	78,042
Other liabilities	3,417	2,825	2,825	2,825	2,825
Equity capital	12,068	11,427	11,427	11,427	11,427
Reserves & surplus	5,58,685	5,47,906	6,24,979	7,05,505	7,96,768
Shareholders' fund	5,70,753	5,59,333	6,36,406	7,16,932	8,08,195
Total liabilities and equities	8,33,171	7,97,573	8,51,151	9,39,677	10,41,500
Cash and cash eq.	1,58,529	1,44,499	1,57,078	2,32,405	3,09,371
Accounts receivables	1,00,489	1,04,474	1,22,599	1,14,334	1,22,844
Inventories	3,951	1,865	4,904	5,197	5,584
Other current assets	1,29,457	1,08,891	1,23,416	1,39,452	1,49,832
Investments	2,33,798	2,03,345	2,03,345	2,03,345	2,03,345
Net fixed assets	70,601	81,120	86,431	91,565	97,146
CWIP	0	0	0	0	0
Intangible assets	1,30,742	1,47,374	1,47,374	1,47,374	1,47,374
Deferred tax assets, net	5,604	6,005	6,005	6,005	6,005
Other assets	0	0	0	0	0
Total assets	8,33,171	7,97,573	8,51,151	9,39,677	10,41,500

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	1,09,690	1,16,071	1,07,258	1,12,382	1,26,141
Interest expenses	(15,548)	(16,752)	(13,317)	(13,246)	(16,928)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	41,128	16,506	(59,184)	(64)	(8,717)
Other operating cash flows	14,424	14,919	0	0	0
Cash flow from operations	1,49,694	1,30,744	34,757	99,071	1,00,496
Capital expenditures	(40,798)	(45,057)	(25,000)	(26,000)	(28,000)
Change in investments	0	0	0	0	0
Other investing cash flows	15,548	16,752	13,317	13,246	16,928
Cash flow from investing	(25,250)	(28,305)	(11,683)	(12,754)	(11,072)
Equities issued/Others	0	(1,05,000)	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(10,840)	(11,469)	(10,495)	(10,990)	(12,459)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(10,840)	(1,16,469)	(10,495)	(10,990)	(12,459)
Changes in cash and cash eq.	1,13,604	(14,029)	12,579	75,327	76,965
Closing cash and cash eq.	1,58,529	1,44,499	1,57,078	2,32,405	3,09,371

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	14.9	16.7	14.8	15.5	17.6
Adjusted EPS	14.9	16.7	14.8	15.5	17.6
Dividend per share	1.5	1.7	1.5	1.6	1.8
Book value per share	94.7	97.9	108.4	122.1	137.6

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.3	2.1	2.0	1.9	1.7
EV/EBITDA	11.3	10.4	10.4	9.7	8.4
Adjusted P/E	15.1	13.5	15.2	14.5	12.8
P/BV	2.4	2.3	2.1	1.8	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	78.0	79.0	78.5	77.8	77.8
Interest burden (PBT/EBIT)	113.0	115.3	113.6	112.7	114.6
EBIT margin (EBIT/Revenue)	17.3	17.1	16.4	16.5	17.1
Asset turnover (Revenue/Avg TA)	73.9	75.2	72.4	70.6	68.6
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.4	1.3	1.3
Adjusted ROAE	17.1	16.9	14.6	13.5	13.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	7.8	4.1	(2.7)	6.0	7.4
EBITDA	15.4	2.6	(5.9)	6.4	10.8
Adjusted EPS	12.3	11.6	(10.9)	4.7	13.4
Profitability & Return ratios (%)					
EBITDA margin	20.7	20.4	19.7	19.8	20.4
EBIT margin	17.3	17.1	16.4	16.5	17.1
Adjusted profit margin	15.3	15.5	14.6	14.4	15.2
Adjusted ROAE	17.1	16.9	14.6	13.5	13.6
ROCE	18.6	20.7	18.5	18.5	20.2
Working capital days (days)					
Receivables	62	61	69	68	64
Inventory	3	2	2	3	3
Payables	109	113	106	94	94
Ratios (x)					
Gross asset turnover	8.7	8.1	7.1	7.1	7.2
Current ratio	2.5	2.3	3.0	3.5	3.9
Net interest coverage ratio	6.6	6.2	7.3	7.9	6.9
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

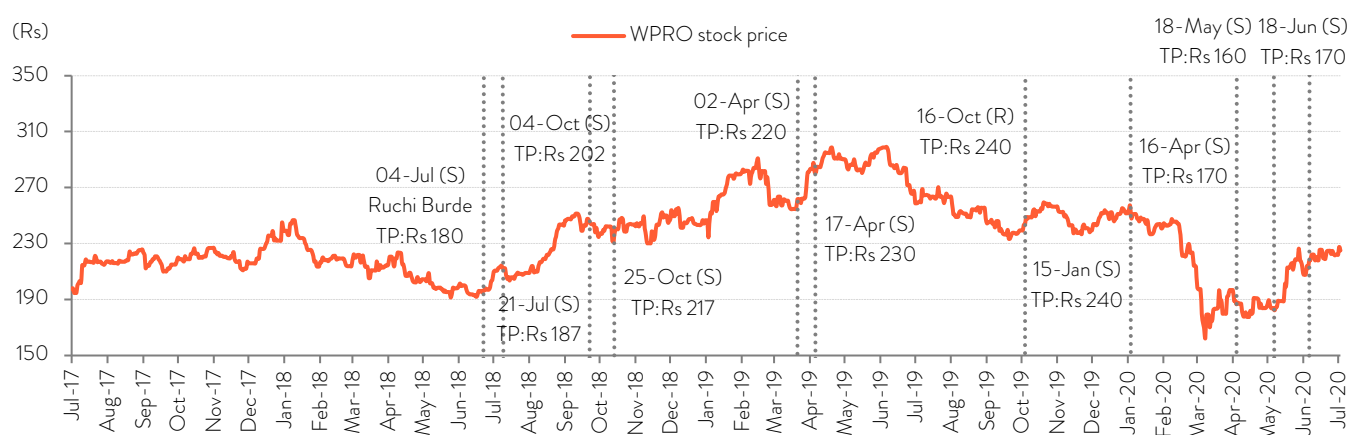
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: WIPRO (WPRO IN)



B – Buy, A – Add, R – Reduce, S – Sell

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