

**REDUCE**

TP: Rs 240 | ▼ 1%

**WIPRO**

| IT Services

| 16 October 2019

## Puzzling margin beat; unlikely to hold up

Wipro (WPRO) reported in-line revenue growth of 1.1% QoQ CC, but a surprising beat on operating margins (18.1%, +10bps QoQ vs. -60bps est.) that materialised despite the impact of compensation revision. As per management, cost credits/reversals shored up margins and are unlikely to accrue going ahead. Q3 revenue growth guidance at 0.8-2.8% was better than expected. We raise FY20/FY21 EPS by 3% each and roll over to a Sep'20 TP of Rs 240 (vs. Rs 230); post the recent stock correction, we up our rating a notch to **REDUCE** (vs. **SELL**).

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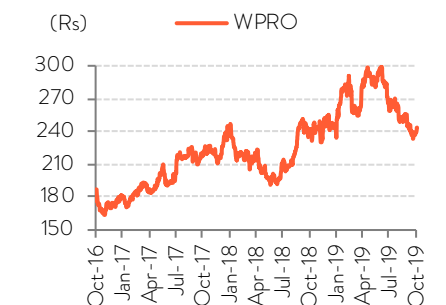
**Revenue growth lacks consistency:** WPRO posted in-line Q2 revenue growth of 1.1% QoQ CC, backed by the retail, manufacturing, energy and technology verticals. We note that performance trends remain volatile as only two of the four verticals had consecutive growth quarters. BFSI revenues dipped 0.1% QoQ CC. Revenue from the top client and top 5 clients declined by 13.1% and 6.8% QoQ (in US\$ terms) respectively.

Ticker/Price	WPRO IN/Rs 244
Market cap	US\$ 20.3bn
Shares o/s	5,950mn
3M ADV	US\$ 16.6mn
52wk high/low	Rs 302/Rs 222
Promoter/FPI/DII	74%/9%/17%

Source: NSE

**Operating margins stage a puzzling beat:** IT services EBIT margins clocked in at 18.1%, up 10bps QoQ vs. our estimate of a 60bps decline. We find the margin beat perplexing considering (1) headwinds from two months of wage revision, (2) moderation in gross utilisation by 250bps QoQ to 71.4%, and (3) contraction in offshore revenue mix by 100bps QoQ to 46.7%. The energy and utility verticals reported a surprising 440bps QoQ EBIT margin upswing and accounted for ~140% of incremental operating profits.

## STOCK PERFORMANCE



Source: NSE

**Dec'19 quarter guidance healthy:** WPRO has guided for revenue growth in the range of 0.8-2.8% QoQ in Q3FY20, ahead of our/street estimates of 0-2% QoQ growth and comparable with the 1-3% QoQ guidance for the Dec'18 quarter. The growth outlook includes 0.3% inorganic revenue contribution.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	5,46,359	5,89,060	5,98,179	6,39,994	6,85,737
EBITDA (Rs mn)	1,05,418	1,21,661	1,24,784	1,33,329	1,42,937
Adj. net profit (Rs mn)	80,046	90,074	91,910	99,258	1,07,739
Adj. EPS (Rs)	13.3	14.9	15.4	16.7	18.1
Adj. EPS growth (%)	4.0	12.3	3.4	8.0	8.5
Adj. ROAE (%)	15.9	17.1	16.4	16.8	15.8
Adj. P/E (x)	18.3	16.3	15.8	14.6	13.5
EV/EBITDA (x)	14.6	12.7	11.1	10.9	9.7

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



## Conference call takeaways

- **Vertical commentary:**
  - **BFSI:** As with peers, WPRO reiterated a soft BFSI outlook led by weakness in capital markets and large European banks. In addition to a broader slowdown in BFSI, the completion of digital projects led to a 0.5% QoQ decline in BFSI revenues in Q2FY20. Management expects weakness in this vertical to accelerate in the Dec'19 quarter owing to furloughs.
  - **Communications:** Management is optimistic about growth in the communications vertical given healthy traction in international markets. Domestic revenues here were net growth dilutive in Q2FY20.
  - **Consumer/Retail:** While WPRO refrained from putting out a medium-to-long-term outlook, it is confident of near-term growth prospects in the consumer and retail segments.
  - **Energy:** The company is watchful of macro developments in energy.
  - **Healthcare:** Management shared an optimistic outlook for healthcare, excluding the HPS business.
  - **Manufacturing:** WPRO expects growth to turn around only after a couple of quarters as the manufacturing business undergoes restructuring.
- **Deal pipeline:** Management indicated that the deal pipeline is robust. During Q2FY20, the company signed deals that were delayed in Q1.
- **Top client:** Revenues from the top client and top 5 clients declined by 13.1% and 6.8% QoQ (in US\$ terms) respectively, largely due to BFSI weakness and project completion. Management expects uncertainty to prevail in the top client account during the Dec'19 quarter.
- **Operating margins:** Management indicated that cost optimisation, the absence of marketing event costs, reversal of certain cost items and lower provisioning for bad debt supported operating margins and helped neutralise the impact of two months of wage revision as well as capability buildup (cumulative ~110bps impact). WPRO indicated that these cost reversals or credits may not hold up going ahead.

**FIG 1 – SEP'19 QUARTER PERFORMANCE**

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	YoY (%)	QoQ (%)	H1FY20	H1FY19	YoY (%)
<b>US\$ revenues (IT Services)</b>	<b>1,989</b>	<b>2,010</b>	<b>2,047</b>	<b>2,076</b>	<b>2,039</b>	<b>2,049</b>	<b>2.0</b>	<b>0.5</b>	<b>4,088</b>	<b>3,998</b>	<b>2.2</b>
<b>Total Revenue</b>	<b>1,40,548</b>	<b>1,46,627</b>	<b>1,51,506</b>	<b>1,50,379</b>	<b>1,48,019</b>	<b>1,51,847</b>	<b>3.6</b>	<b>2.6</b>	<b>2,99,866</b>	<b>2,87,175</b>	<b>4.4</b>
Operating Expenditure	1,19,771	1,21,139	1,22,838	1,23,125	1,23,345	1,25,162	3.3	1.5	2,48,507	2,40,910	3.2
Cost of revenues	1,00,350	1,01,770	1,03,971	1,05,462	1,04,273	1,08,006	6.1	3.6	2,12,279	2,02,120	5.0
as % of sales	71.4	69.4	68.6	70.1	70.4	71.1	-	-	70.8	70.4	-
SG&A expenses	19,421	19,369	18,867	17,663	19,072	17,156	(11.4)	(10.0)	36,228	38,790	(6.6)
as % of sales	13.8	13.2	12.5	11.7	12.9	11.3	-	-	12.1	13.5	-
<b>EBIT</b>	<b>20,777</b>	<b>25,488</b>	<b>28,668</b>	<b>27,254</b>	<b>24,674</b>	<b>26,685</b>	<b>4.7</b>	<b>8.2</b>	<b>51,359</b>	<b>46,265</b>	<b>11.0</b>
Other Income	6,024	(1,285)	3,742	4,747	6,045	4,658	(462.5)	(22.9)	10,703	4,739	125.8
PBT	26,801	24,203	32,410	32,001	30,719	31,343	29.5	2.0	62,062	51,004	21.7
Total Tax	5,865	5,347	6,966	7,064	6,699	5,731	7.2	(14.4)	12,430	11,212	10.9
<b>Adjusted PAT</b>	<b>20,936</b>	<b>18,856</b>	<b>25,444</b>	<b>24,937</b>	<b>24,020</b>	<b>25,612</b>	<b>35.8</b>	<b>6.6</b>	<b>49,632</b>	<b>39,792</b>	<b>24.7</b>
(Profit)/loss from JV's/Ass/MI	270	33	(341)	(104)	(147)	(86)	-	-	(233)	303	-
APAT after MI	21,206	18,889	25,103	24,833	23,873	25,526	35.1	6.9	49,399	40,095	23.2
Extra ordinary items	0	0	0	0	0	0	-	-	0	0	-
<b>Reported PAT</b>	<b>21,206</b>	<b>18,889</b>	<b>25,103</b>	<b>24,833</b>	<b>23,873</b>	<b>25,526</b>	<b>35.1</b>	<b>6.9</b>	<b>49,399</b>	<b>40,095</b>	<b>23.2</b>
Reported EPS	3.5	3.1	4.2	4.1	4.0	4.3	36.6	8.3	8	7	23.8
<b>Margins (%)</b>							<b>(bps)</b>	<b>(bps)</b>			<b>(bps)</b>
EBIT margin-IT Services (excluding ISRE)	17.6	18.4	19.8	19.2	18.0	18.1	(40)	10	18.8	17.4	140
EBIT	14.8	17.4	18.9	18.1	16.7	17.6	20	90	17.1	16.1	100
EBT	19.1	16.5	21.4	21.3	20.8	20.6	410	(10)	20.7	17.8	290
PAT	15.1	12.9	16.6	16.5	16.1	16.8	390	70	16.5	14.0	250
Effective Tax rate	21.9	22.1	21.5	22.1	21.8	18.3	(380)	(350)	20.0	22.0	(200)

Source: Company, BOBCAPS Research

**FIG 2 – SEP'19 QUARTER OPERATING METRICS**

	Q2FY20	Growth	
	(% Contr. to Revenue)	QoQ (%)	YoY (%)
Digital Revenues	39.6	6.3	28.4
<b>Revenue by Services</b>			
Technology Infrastructure Services	25.7	0.4	2.2
Analytics	7.3	(0.9)	(0.9)
BPO	14.7	0.4	16.0
Product Engg and Mobility	7.5	(0.9)	(0.8)
Application Services	44.8	0.9	(1.5)
<b>Revenue by Vertical</b>			
Global Media & Telecom	5.7	(2.9)	0.2
Finance Solutions	31.3	(0.5)	4.6
Manufacturing & Hitech	8.1	3.0	(0.5)
Healthcare, Life Sciences & Services	13.0	(1.0)	2.0
Retail & Transportation	16.0	3.1	3.9
Energy & Utilities	12.9	1.3	2.8
Technology	13.0	0.5	(4.6)

**Only technology and energy & utility verticals had consecutive growth quarters**

	Q2FY20 (% Contr. to Revenue)	Growth	
		QoQ (%)	YoY (%)
<b>Revenue by Geography</b>			
US	59.6	2.0	8.3
Europe	23.5	(4.0)	(6.8)
ROW	16.9	1.7	(5.3)
<b>Customer concentration</b>			
Top customer	3.2	(13.1)	(11.8)
Top 5 customers	12.8	(6.8)	7.0
Top 10 customers	19.8	(3.9)	5.7
Non-Top 10	80.2	1.6	1.1
(%)	Q2FY20	Q1FY20	Q2FY19
<b>Utilisation</b>			
Global IT services ex IFOX-Gross	71.4	73.9	74.4
Global IT services ex IFOX-Net	79.9	82.8	83.2
Global IT services ex IFOX-Net ex trainees	82.1	85.0	85.5
<b>Attrition</b>			
Voluntary Attrition TTM	17.0	17.6	17.5
Global IT services-Voluntary	16.0	17.9	18.5

Source: Company, BOBCAPS Research

## Valuation methodology

Despite several strategic interventions, WPRO has underperformed its tier-I IT service peers in terms of revenues and earnings over the past seven years. While we acknowledge that the company's strategic moves are steps in the right direction, we believe patchy, inconsistent execution will remain a drag on growth. Restructuring of India & Middle East operations and a muted outlook for the BFSI & manufacturing verticals cloud recovery prospects.

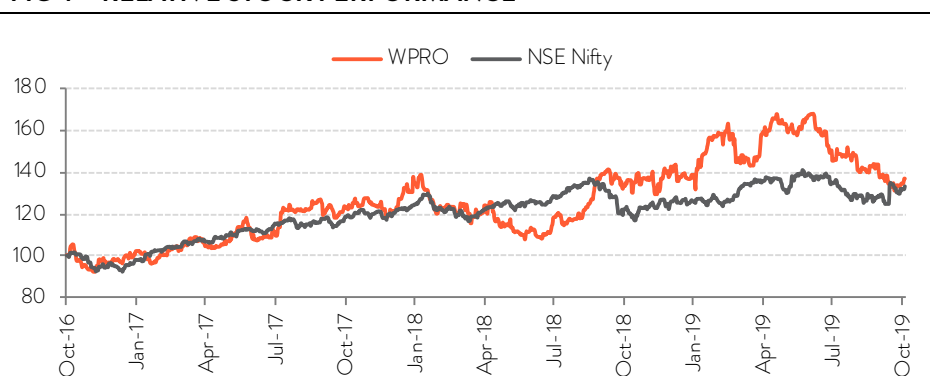
We raise our FY20/FY21 EPS estimates by 3% each as we accommodate the Sep'19 quarter operating beat, while introducing FY22 EPS at Rs 18.1. We revise our recommendation up a notch from SELL to REDUCE as the stock has corrected 15%+ since Jun'19 (post buyback). On rollover, we have a new Sep'20 target price of Rs 240 (vs. Rs 230 earlier), based on an unchanged one-year forward P/E multiple of 13.5x.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Change (%)	Old	New	Change (%)	New
IT Services revenues (excluding ISRE*, in US\$ mn)	8,299	8,309	0.1	8,857	8,900	0.5	9,548
IT Services revenues (excluding ISRE, in US\$ mn), YoY growth (%)	2.2	2.3	-	6.7	7.1	-	7.3
Company Wide Revenues	5,91,012	5,98,179	1.2	6,35,753	6,39,994	0.7	6,85,737
EBIT	1,02,726	1,05,291	2.5	1,11,635	1,12,209	0.5	1,20,308
EBIT mgns (%)	17.4	17.6	-	17.6	17.5	-	17.5
Net profits	89,218	91,910	3.0	96,547	99,258	2.8	1,07,739
EPS (Rs)	15.0	15.4	3.0	16.2	16.7	2.8	18.1

Source: BOBCAPS Research. | \*Note: ISRE refers to India State Run Enterprises.

**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)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>5,46,359</b>	<b>5,89,060</b>	<b>5,98,179</b>	<b>6,39,994</b>	<b>6,85,737</b>
EBITDA	1,05,418	1,21,661	1,24,784	1,33,329	1,42,937
Depreciation	21,124	19,474	19,493	21,120	22,629
EBIT	84,294	1,02,187	1,05,291	1,12,209	1,20,308
Net interest income/(expenses)	18,169	15,548	13,301	13,685	18,073
Other income/(expenses)	0	0	0	0	0
Exceptional items	0	0	0	0	0
EBT	1,02,463	1,15,458	1,17,842	1,25,894	1,38,381
Income taxes	22,390	25,242	25,599	26,436	30,442
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	27	142	333	200	200
<b>Reported net profit</b>	<b>80,046</b>	<b>90,074</b>	<b>91,910</b>	<b>99,258</b>	<b>1,07,739</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>80,046</b>	<b>90,074</b>	<b>91,910</b>	<b>99,258</b>	<b>1,07,739</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	1,33,177	1,58,894	1,32,747	1,42,026	1,52,177
Provisions	799	640	1,475	1,578	1,691
Debt funds	1,38,259	99,467	99,467	99,467	99,467
Other liabilities	3,059	3,417	3,417	3,417	3,417
Equity capital	9,048	12,068	12,068	12,068	12,068
Reserves & surplus	4,76,298	5,58,685	5,34,867	6,22,379	7,17,352
Shareholders' fund	4,85,346	5,70,753	5,46,935	6,34,447	7,29,420
<b>Total liabilities and equities</b>	<b>7,60,640</b>	<b>8,33,171</b>	<b>7,84,040</b>	<b>8,80,936</b>	<b>9,86,172</b>
Cash and cash eq.	44,925	1,58,529	93,781	1,69,669	2,53,799
Accounts receivables	1,00,990	1,00,489	1,08,164	1,15,725	1,23,996
Inventories	3,370	3,951	4,917	5,260	5,636
Other current assets	1,45,107	1,29,457	1,31,927	1,41,149	1,51,238
Investments	2,59,200	2,33,798	2,33,798	2,33,798	2,33,798
Net fixed assets	64,443	70,601	75,108	78,988	81,359
CWIP	15,166	0	0	0	0
Intangible assets	1,35,697	1,30,742	1,30,742	1,30,742	1,30,742
Deferred tax assets, net	6,908	5,604	5,604	5,604	5,604
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>7,60,640</b>	<b>8,33,171</b>	<b>7,84,040</b>	<b>8,80,935</b>	<b>9,86,171</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	73,043	1,09,690	1,11,737	1,20,578	1,30,568
Interest expenses	0	(15,548)	(13,301)	(13,685)	(18,073)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(877)	41,128	(36,423)	(7,744)	(8,472)
Other operating cash flows	12,067	14,424	0	0	0
<b>Cash flow from operations</b>	<b>84,233</b>	<b>1,49,694</b>	<b>62,013</b>	<b>99,148</b>	<b>1,04,023</b>
Capital expenditures	(20,699)	(40,798)	(24,000)	(25,000)	(25,000)
Change in investments	47,973	0	0	0	0
Other investing cash flows	8,679	15,548	13,301	13,685	18,073
<b>Cash flow from investing</b>	<b>35,953</b>	<b>(25,250)</b>	<b>(10,699)</b>	<b>(11,315)</b>	<b>(6,927)</b>
Equities issued/Others	24	0	(1,05,000)	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(1,24,582)	0	0	0	0
Dividends paid	(5,420)	(10,840)	(11,061)	(11,946)	(12,966)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(1,29,978)</b>	<b>(10,840)</b>	<b>(1,16,061)</b>	<b>(11,946)</b>	<b>(12,966)</b>
<b>Changes in cash and cash eq.</b>	<b>(9,792)</b>	<b>1,13,604</b>	<b>(64,748)</b>	<b>75,888</b>	<b>84,130</b>
<b>Closing cash and cash eq.</b>	<b>44,925</b>	<b>1,58,529</b>	<b>93,781</b>	<b>1,69,669</b>	<b>2,53,799</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	13.3	14.9	15.4	16.7	18.1
Adjusted EPS	13.3	14.9	15.4	16.7	18.1
Dividend per share	1.0	1.5	1.5	1.7	1.8
Book value per share	80.7	94.7	91.9	106.6	122.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.8	2.6	2.3	2.3	2.0
EV/EBITDA	14.6	12.7	11.1	10.9	9.7
Adjusted P/E	18.3	16.3	15.8	14.6	13.5
P/BV	3.0	2.6	2.7	2.3	2.0

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	78.1	78.0	78.0	78.8	77.9
Interest burden (PBT/EBIT)	121.6	113.0	111.9	112.2	115.0
EBIT margin (EBIT/Revenue)	15.4	17.3	17.6	17.5	17.5
Asset turnover (Revenue/Avg TA)	70.3	73.9	74.0	76.9	73.5
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.4	1.4	1.4
Adjusted ROAE	15.9	17.1	16.4	16.8	15.8

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



**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	(1.4)	7.8	1.5	7.0	7.1
EBITDA	(6.6)	15.4	2.6	6.8	7.2
Adjusted EPS	4.0	12.3	3.4	8.0	8.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	19.3	20.7	20.9	20.8	20.8
EBIT margin	15.4	17.3	17.6	17.5	17.5
Adjusted profit margin	14.7	15.3	15.4	15.5	15.7
Adjusted ROAE	15.9	17.1	16.4	16.8	15.8
ROCE	14.0	18.6	19.6	19.9	20.9
<b>Working capital days (days)</b>					
Receivables	67	62	64	64	64
Inventory	3	3	3	4	4
Payables	100	109	108	95	95
<b>Ratios (x)</b>					
Gross asset turnover	8.1	8.7	8.2	8.3	8.6
Current ratio	2.2	2.5	2.5	3.0	3.5
Net interest coverage ratio	4.6	6.6	7.9	8.2	6.7
Adjusted debt/equity	0.2	(0.1)	0.0	(0.1)	(0.2)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

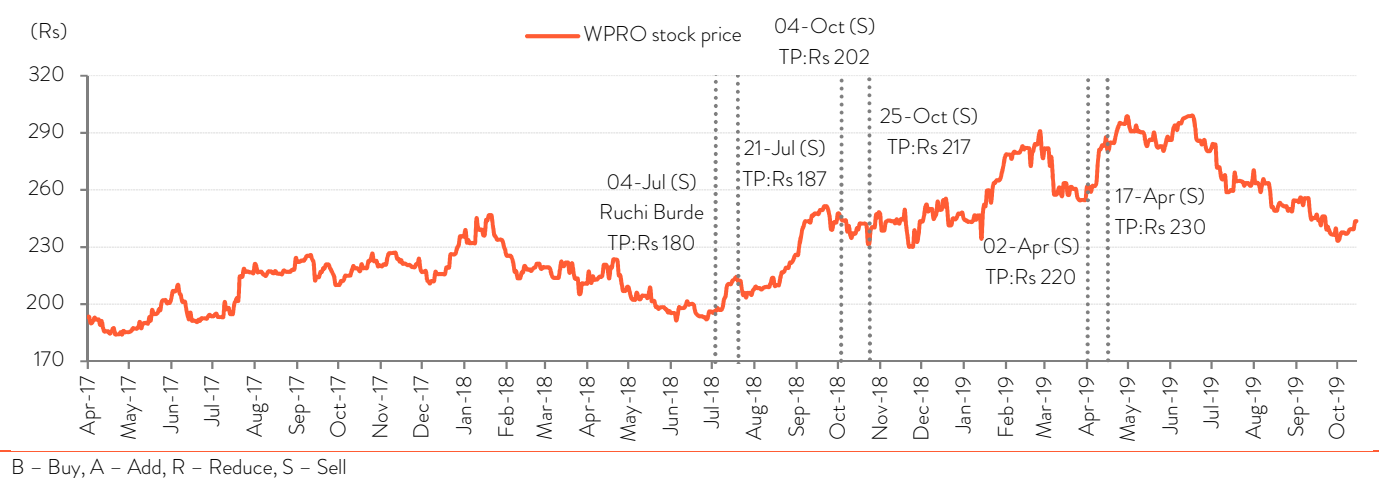
**ADD** – Expected return from >+5% to +15%

**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)



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