

Sector: IT & ITES
Results update

| | Change |
|------------------------------|--------|
| Reco: Hold | ↔ |
| CMP: Rs. 244 | |
| Price Target: Rs. 285 | ↔ |

↑ Upgrade ↔ No change ↓ Downgrade

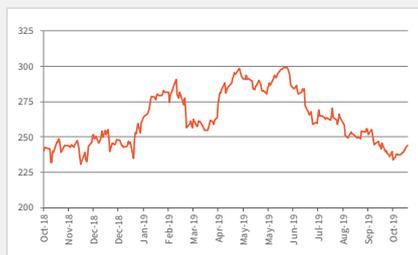
Company details

| | |
|----------------------------|-----------------|
| Market cap: | Rs. 1,39,224 cr |
| 52-week high/low: | Rs. 302 / 221 |
| NSE volume: (No of shares) | 57.5 lakh |
| BSE code: | 507685 |
| NSE code: | WIPRO |
| Sharekhan code: | WIPRO |
| Free float: (No of shares) | 148.3 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 74.0 |
| FII | 10.8 |
| DII | 7.0 |
| Others | 8.2 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|------|------|-------|------|
| Absolute | -0.8 | -6.0 | -14.1 | 2.9 |
| Relative to Sensex | -2.9 | -5.1 | -13.6 | -7.6 |

Sharekhan Research, Bloomberg

Wipro delivered mixed set of numbers in Q2FY2020. The company delivered in-line revenue performance, while margins performance remained above our modest expectations considering salary revision and decline in utilizations. Constant currency (CC) revenue grew by 1.1% q-o-q, driven by strong performance in consumer and manufacturing vertical on a q-o-q basis. However, BFSI growth continued to remain muted owing to weakness in European banking and overall capital market. EBIT margin for IT services declined 30bps q-o-q to 18.1%, ahead of our estimates. Net profit of Rs. 2,553 crore grew 35.1% y-o-y (6.9% q-o-q), ahead of our estimate; aided by better-than-expected profitability and lower tax rate. Digital growth has moderated to 29% y-o-y on CC basis, due to softness in BFSI. Top account also declined 13% q-o-q owing to closure of couple of projects and delay in renewal of certain digital projects. Management guided revenue growth guidance of 0.8%-2.8% (including inorganic initiatives) for Q3FY2020E, above our expectation. However, organic revenue growth guidance stands at 0.2-2.2% q-o-q CC for Q3FY2020E, marginally higher-than-expectations. As about half of Wipro's top accounts are in BFSI space (witnessing macro impact), we expect that Wipro would remain at the bottom quartile in terms of revenue growth among top five companies in FY2020E.

Key positives

- ◆ EBIT IT margin remained at 18.1%, above our modest expectations
- ◆ Strong cash conversion as free cash flow to net profit remained at 84%.
- ◆ Guided revenue growth guidance of 0.8%-2.8% for Q3FY2020E, above our expectation, led by strong deal signings.

Key negatives

- ◆ Top client and top 5 clients revenue declined of 13.1% and 6.8% on q-o-q basis, respectively
- ◆ Softness continues in the BFSI and manufacturing verticals.

Our Call

Valuation – Maintain Hold with a PT of Rs. 285: We have tweaked our earnings estimates for FY2020E/FY2021E, on account of profitability beat in Q2FY2020 and continued weakness in certain industry pockets. With continued weakness in BFSI vertical, we believe that Wipro's revenue growth would continue to remain in the bottom quartile among the top-five IT companies. At the CMP, the stock is trading at 14.5x/13.2x its FY2020/FY2021 earnings estimates, which is justified due to continued underperformance in revenue growth. Wipro continues to remain our least preferred stock among top-tier companies. Hence, we maintain Hold with a PT of Rs. 285.

Key Risks

Rupee appreciation and/or adverse cross-currency movements; constraint in local talent supply in the U.S.; and stringent visa regime to adversely impact earnings.

| Valuation | Rs cr | | | | |
|--------------------|----------|----------|----------|----------|----------|
| Particulars | FY17 | FY18 | FY19 | FY20E | FY21E |
| Revenue | 55,040.2 | 54,487.1 | 58,906.0 | 61,881.8 | 66,825.6 |
| OPM (%) | 20.6 | 19.7 | 19.5 | 20.7 | 21.3 |
| Adjusted PAT | 8,489.5 | 8,329.3 | 8,984.5 | 9,826.6 | 10,542.3 |
| % YoY growth | -4.7 | -1.9 | 7.9 | 9.4 | 7.3 |
| Adjusted EPS (Rs.) | 14.1 | 13.8 | 14.9 | 16.8 | 18.5 |
| P/E (x) | 17.3 | 17.7 | 16.4 | 14.5 | 13.2 |
| P/B (x) | 1.2 | 2.5 | 2.9 | 3.0 | 2.7 |
| EV/EBITDA (x) | 13.1 | 13.7 | 11.6 | 10.6 | 9.2 |
| RoNW (%) | 16.4 | 17.4 | 15.2 | 17.8 | 17.4 |
| RoCE (%) | 13.1 | 13.8 | 14.6 | 16.8 | 17.7 |

Source: Company; Sharekhan research

Revenue in-line, margin ahead of estimates

Wipro delivered mixed set of numbers in Q2FY2020, with in-line revenue and EBIT margins marginally ahead of our estimates despite a wage revision. Constant currency (CC) revenue grew by 1.1% q-o-q (in-line with our estimates), driven by strong performance in consumer and manufacturing verticals. On a reported basis, USD revenue grew by 0.5% q-o-q to \$2,048.9 million. EBIT margin for IT services contracted 30bps q-o-q to 18.1%, better than our estimates considering the wage revision and drop in the utilization. The sequential decline in EBIT margins, attributed to absence of other operating gains (-50 BPS) and investment in people (-110 BPS), partially offset by cost optimisation (+120 BPS). Net profit of Rs. 2,552.6 crore (+35.1% y-o-y, +6.9% q-o-q) was 11.5% ahead of our estimate, aided by higher-than-expected profitability and lower tax rate (18.3% in Q2FY2020 versus 21.8% in Q1FY2020).

Q3 guidance remains above expectations, but softness in BFSI likely to impact overall growth in FY2020E

Wipro's management has guided for revenue growth of 0.8% to 2.8% for Q3FY2020E, above our estimates, including the inorganic component. The management stated that the recent acquisition would contribute around 0.3% to the Q3FY2020E revenue. Organic revenue growth guidance for Q2FY2020E is expected at around 0.2-2.2%, slightly better than our expectations. However, we expect the revenue growth in FY2020E would be similar to the underlying revenue growth in FY2019, owing to continued softness in BFSI vertical (31% of total revenues), manufacturing and communication vertical. Further, top-account, which was the principal driver of its growth in last few quarters, has declined significantly on a q-o-q basis owing to closure of couple of projects and delay in renewal of certain digital projects. The management highlighted that clarity on top-account growth revival would emerge once its next year IT budget gets finalised. On the margin front, the management highlighted that there would be a steady improvement in margins owing to higher investments in building digital capabilities and localisation in major markets.

Key result highlights from earnings call

- ◆ **Management guidance:** The management guided for IT services revenues to be in the range of \$2,065 million - \$2,106 million for the Dec 2019 quarter. This translates to sequential growth in the range of 0.8-2.8% in constant currency terms. The revenue growth guidance includes revenue from inorganic acquisitions previously made; hence organic revenue growth guidance seems to be in the range of 0.2-2.2% Q-o-Q in CC basis.
- ◆ **Continued investments to maintain growth momentum:** Management highlighted that to maintain the growth momentum; it is making big bets to build digital capabilities to capture the opportunities underway.
- ◆ **Buyback and cash usage:** A cash outflow of Rs 10,500 crores has been incurred during the quarter, as the company concluded its share buyback program of 323.1 million equity shares.
- ◆ **Strong cash conversion:** Operating cash flow stood at 106.8% of net income whereas free cash flow stood at 84.0% of net income.
- ◆ **No of large client metrics unchanged:** The number of client providing revenue in excess of \$100 million/\$75 million/\$50 million/\$20 million remained stable at 13/23/41/92 clients respectively on sequential basis. However client generating revenue in excess of \$10 million reduced by 1 to 165 clients, whereas clients generating revenue in excess of \$5 million/\$3 million/\$1 million increased by 2/1/5 to 261/341/569 clients respectively.
- ◆ **Slowdown in large clients:** The revenues from top client, top 5 clients and top 10 clients witnessed a decline of 13.1%, 6.8% and 3.9% on Q-o-Q basis and accounted for 3.2%, 12.8% and 19.8% of the overall revenues as against 3.7%, 13.8% and 20.7% during Q1FY2020.
- ◆ **Digital revenue contribution increases, however growth rate moderates:** The digital revenue contribution increased to 39.6% as compared to 37.4% of overall revenues during Q1FY2020. However the digital revenue growth pace witnessed a moderation as revenue in this space grew by 29.0% Y-o-Y as against 34.6% Y-o-Y in Q1FY2020. The moderation in growth rates has been largely due to slowdown in economic environment, specially the BFSI space (interest rate uncertainty and piling up of stressed assets) and large base. This has resulted into deferment of digital spends as its being considered as discretionary spent and might see a reversal once the economic growth rate trend improves.

Results

| Particulars | Rs cr | | | | |
|---------------------------|-----------------|-----------------|-----------------|-------------|------------|
| | Q2FY20 | Q2FY19 | Q1FY20 | YoY (%) | QoQ (%) |
| Revenues (\$ mn) | 2,048.9 | 2,041.2 | 2,038.8 | 0.4 | 0.5 |
| Net sales | 15,125.6 | 14,662.7 | 14,716.1 | 3.2 | 2.8 |
| Direct costs | 10,800.6 | 10,177.0 | 10,427.3 | 6.1 | 3.6 |
| Gross profit | 4,577.9 | 4,485.7 | 4,541.7 | 2.1 | 0.8 |
| SG&A | 1,715.6 | 2,451.0 | 1,907.2 | -30.0 | -10.0 |
| EBIT | 2,862.3 | 2,034.7 | 2,634.5 | 40.7 | 8.6 |
| Net other income | 461.0 | 356.7 | 536.3 | 29.2 | -14.0 |
| PBT | 3,323.3 | 2,391.4 | 3,170.8 | 39.0 | 4.8 |
| Tax provision | 573.1 | 534.7 | 669.9 | 7.2 | -14.4 |
| Net profit | 2,552.6 | 1,888.9 | 2,387.4 | 35.1 | 6.9 |
| EPS (Rs.) | 4.3 | 3.1 | 4.0 | 37.0 | 8.3 |
| Margin (%) | | | | BPS | BPS |
| EBIT margins (Blended) | 18.9 | 13.9 | 17.9 | 505 | 102 |
| EBIT margin (IT Services) | 18.1 | 15.0 | 18.4 | 305 | -31 |
| NPM | 16.9 | 12.9 | 16.2 | 399 | 65 |

Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals and other operating metrics

| Particulars | Revenues (\$ mn) | Contribution (%) | \$ Growth (%) | | CC growth (%) | |
|-----------------------------------|---------------------|---------------------|---------------|-------|---------------|-------|
| | | | q-o-q | y-o-y | q-o-q | y-o-y |
| Revenues (\$ mn) | 2,049 | 100 | 0.5 | 0.4 | 1.1 | 3.8 |
| Geographic mix | | | | | | |
| Americas | 1,221 | 59.6 | 2.0 | 8.4 | 2.1 | 9.4 |
| Europe | 481 | 23.5 | -4.0 | -6.8 | -1.9 | -2.7 |
| APAC & others | 346 | 16.9 | 1.7 | -6.8 | 2.1 | -4.1 |
| Industry verticals | | | | | | |
| BFSI | 641 | 31.3 | -0.5 | 2.3 | -0.1 | 5.9 |
| Consumer | 328 | 16.0 | 3.1 | -1.5 | 4.1 | 6.1 |
| Technology | 266 | 13.0 | 0.5 | -4.8 | 1.3 | -2.5 |
| Healthcare | 266 | 13.0 | -1.0 | 1.9 | -0.6 | 3.0 |
| Energy & utilities | 264 | 12.9 | 1.3 | 2.8 | 2.3 | 6.3 |
| Manufacturing | 166 | 8.1 | 3.0 | -0.8 | 3.3 | 0.9 |
| Communications | 117 | 5.7 | -2.9 | 0.4 | -2.4 | 2.4 |
| Service line | | | | | | |
| Application services | 918 | 44.8 | 0.9 | -1.6 | 1.3 | 1.4 |
| Cloud and infrastructure services | 527 | 25.7 | 0.5 | -2.7 | 1.1 | 3.7 |
| Digital operations and platform | 301 | 14.7 | 0.5 | 14.4 | 1.2 | 16.8 |
| Product engineering | 154 | 7.5 | -0.8 | -2.2 | 0.4 | -0.9 |
| Data, analytics and AI | 150 | 7.3 | -0.9 | -2.3 | -0.2 | 1.1 |
| Client's Contribution | | | | | | |
| Top client | 66 | 3.2 | -13.1 | -10.8 | - | - |
| Top 5 | 262 | 12.8 | -6.8 | 6.2 | - | - |
| Top 10 | 406 | 19.8 | -3.9 | 5.7 | - | - |

Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals and other operating metrics

| Particulars | Revenues (\$ mn) | Contribution (%) | | Margin (%) | |
|----------------------|---------------------|------------------|--------|------------|--------|
| | | Q2FY19 | Q2FY20 | Q2FY19 | Q2FY20 |
| BFSI | 641 | 30.7 | 31.3 | 17.5 | 18.4 |
| Consumer | 328 | 16.3 | 16.0 | 17.7 | 16.8 |
| Technology | 266 | 13.7 | 13.0 | 23.7 | 18.9 |
| Healthcare | 266 | 12.8 | 13.0 | 14.5 | 15.1 |
| Energy and utilities | 264 | 12.6 | 12.9 | -11.4 | 16.3 |
| Manufacturing | 166 | 8.2 | 8.1 | 19.2 | 20.5 |
| Communications | 117 | 5.7 | 5.7 | 13.0 | 12.5 |

Source: Company; Sharekhan Research

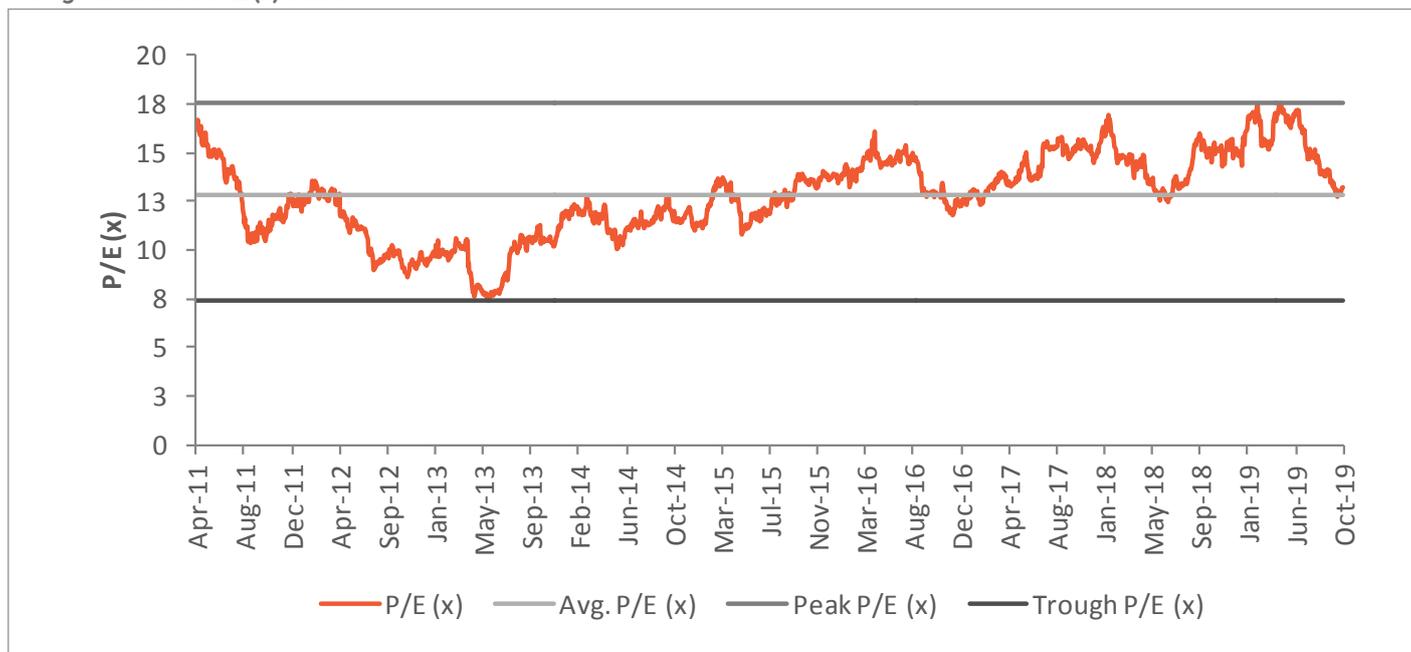
Outlook

Growth for Indian IT is expected to accelerate from 6-7% currently as demand for digital services is growing rapidly. India will continue to remain the preferred destination for talent supply and would create a gradual shift of digital business from onsite. Wipro's CEO, Mr. Abidali has laid out six strategic themes to drive business growth, with investments in creating digital capabilities, training and incentivising employees and acquiring businesses. Though the long track record of underperformance implies execution issues, the company has been focusing on higher client mining and increasing deal wins momentum to catch up the industry's average growth rate. The company aims to maintain its margin performance going ahead, with improved revenue growth rate.

Valuation

Wipro continues to remain our least preferred stock among top-tier companies. With continued weakness in BFSI vertical, we believe that Wipro's revenue growth would continue to remain in the bottom quartile among the top-five IT companies. We have tweaked our earnings estimates for FY2020E/FY2021E, on account of profitability beat in Q2FY2020 and continued weakness in certain industry pockets. At the CMP, the stock is trading at 14.5x/13.2x its FY2020/FY2021 earnings estimates, which is justified due to continued underperformance in revenue growth. Hence, we maintain Hold with a PT of Rs. 285.

One year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

| Particulars | CMP (Rs / Share) | O/S Shares (Cr) | MCAP (Rs Cr) | P/E (x) | | EV/EBIDTA (x) | | P/BV (x) | | RoCE (%) | |
|-------------|------------------|-----------------|--------------|---------|-------|---------------|-------|----------|-------|----------|-------|
| | | | | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E |
| HCL Tech | 1,084 | 136 | 1,47,383 | 14.5 | 13.1 | 9.1 | 8.3 | 3.2 | 2.8 | 23.0 | 22.8 |
| Infosys | 768 | 426 | 3,26,961 | 20.0 | 17.9 | 13.5 | 12.1 | 2.7 | 2.7 | 25.5 | 28.5 |
| TCS | 2,037 | 375 | 7,64,511 | 23.4 | 21.2 | 17.3 | 15.5 | 7.7 | 7.0 | 34.7 | 34.7 |
| Tech M | 720 | 96 | 69,443 | 15.0 | 12.8 | 9.6 | 7.8 | 3.1 | 2.7 | 19.3 | 19.8 |
| Wipro | 244 | 571 | 1,39,224 | 14.5 | 13.2 | 10.6 | 9.2 | 3.0 | 2.7 | 17.8 | 17.4 |

Source: Company, Sharekhan Research

About company

Wipro is the leading global IT services company with business interests in export of IT, consulting and BPO services. The company offers the widest range of IT and ITeS services, including digital strategy advisory, client-centric design, technology consulting, IT consulting, systems integration, software application development and maintenance, package implementation, and R&D services. Wipro develops and integrates innovative solutions that enable its clients to leverage IT to achieve their business objectives at competitive costs. The company generates revenue from the BFSI, manufacturing, retail, utilities and telecom verticals. Wipro has more than 1.6 lakh employees.

Investment theme

With six strategic themes and higher client-mining strategy, Wipro has been focusing on driving business growth. Though Wipro has been active on the investment front, including building digital capabilities, training and incentivising employees and acquiring businesses, it has been underperforming the large peers in terms of overall growth owing to execution challenges and account-specific issues. The company hopes that its growth trajectory would catch up with the industry's average growth rates, led by increasing deal wins, continued growth momentum in BFSI, receding of concerns in certain industry pockets and higher growth in the digital business. Higher revenue growth would help the company to report margin improvement going ahead.

Key Risks

1) Any hostile regulatory visa norms could impact employee expenses; 2) prolonged weakness in healthcare/manufacturing verticals; 3) rupee appreciation and/or adverse cross-currency movements; 4) softness in top accounts; 5) any further client-related/portfolio-related issues impacting sales/margins; and 6) any major macro issues in developed markets, especially in the U.S. and Europe.

Additional Data

Key management personnel

| | |
|---------------------|---|
| Abidali Neemuchwala | CEO |
| Bhanumurthy B. M. | President & Chief Operating Officer |
| Jatin Dalal | Chief Financial Officer |
| Anand Padmanabhan | President, energy, utilities & construction |
| Ankur Prakash | Senior Vice President, Communications |

Source: Company Annual Report

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|---------------------------------------|-------------|
| 1 | Premji Azim Hasham | 73.6 |
| 2 | Life Insurance Corp of India | 4.9 |
| 3 | Black Rock Inc | 0.9 |
| 4 | Vanguard Group Inc | 0.6 |
| 5 | Norges Bank | 0.5 |
| 6 | ICICI Prudential Asset Management | 0.5 |
| 7 | Dimensional Fund Advisors LP | 0.4 |
| 8 | Azim Premji Philanthropic Initiatives | 0.4 |
| 9 | Azim Premji Philanthropic | 0.4 |
| 10 | SBI Funds Management Pvt Ltd | 0.3 |

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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