

Sharekhan

by BNP PARIBAS

Sector: IT & ITES Result Update

Change

Reco: Hold	↔
CMP: Rs. 257	
Price Target: Rs. 285	↔

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 1,46,911 cr
52-week high/low:	Rs. 301 / 232
NSE volume: (No of shares)	38.5 lakh
BSE code:	507685
NSE code:	WIPRO
Sharekhan code:	WIPRO
Free float: (No of shares)	148.3 cr

Shareholding (%)

Promoters	74.0
FII	11.4
DII	7.8
Others	6.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.5	6.4	-1.6	3.6
Relative to Sensex	2.4	-3.2	-9.4	-11.8

Sharekhan Research, Bloomberg

Wipro

Mixed quarter

Wipro delivered mixed set of numbers in Q3FY2020. The company delivered in-line revenue performance, while margins performance remained marginally ahead of our expectations. Constant currency (CC) revenue grew by 1.8% q-o-q (mid-point of its guidance), driven by strong performance in consumer verticals and 0.3% revenue contribution from its ITI acquisition. EBIT margin for IT services improved 30bps q-o-q to 18.4%, led by rupee depreciation and cross-currency tailwinds. Top accounts continued to decline on q-o-q basis owing to continued softness in the BFSI and technology vertical. The management has guided revenue growth guidance of 0%-2% for Q4FY2020E, baking in deferment of renewals of certain digital projects, weakness in BFSI and macro uncertainties. As most of Wipro's top accounts are in the BFSI and technology space (witnessing macro impact), we expect Wipro to remain in the bottom quartile in terms of revenue growth among top five companies in the medium-term.

Key positives

- Strong cash conversion as free cash flow to net profit remained at 101% (vs 84% in Q2FY2020).
- Order size and deal conversion of deal funnels are higher compared to beginning of last year
- Localisation remains above 70% in the USA

Key negatives

- Top client and top 5 clients revenue declined of 4% and 2% on q-o-q basis, respectively
- Softness continues in the BFSI vertical.
- Digital growth moderated to 22.8% y-o-y versus 29% in Q2FY2020

Our Call

Valuation – Maintain Hold with a PT of Rs. 285: We have tweaked our earnings estimates for FY2020E/FY2021E factoring in continued decline in top accounts. We believe that Wipro's revenue growth would continue to remain in the bottom quartile among the top-five IT companies owing to the weakness in BFSI and technology vertical. However, the company has been reporting steady execution in margins over last the three quarters despite slower revenue growth. At CMP, the stock is trading at 15x/14x of its FY2020/FY2021 earnings estimates, which is justified due to continued underperformance in revenue growth. Wipro continues to remain our least preferred stock among the 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.

Particulars	Rs cr				
	FY17	FY18	FY19	FY20E	FY21E
Revenue	55,040.2	54,487.1	58,906.0	61,053.2	65,795.3
OPM (%)	20.6	19.7	19.5	20.5	20.9
Adjusted PAT	8,489.5	8,329.3	8,984.5	9,815.3	10,399.2
% YoY growth	-4.7	-1.9	7.9	9.2	5.9
Adjusted EPS (Rs.)	14.1	13.8	14.9	16.8	18.3
P/E (x)	18.3	18.6	17.3	15.3	14.1
P/B (x)	1.3	2.6	3.1	3.2	2.9
EV/EBITDA (x)	6.4	6.7	5.0	4.8	4.0
RoNW (%)	16.4	17.4	15.2	17.8	17.2
RoCE (%)	13.1	13.8	14.6	16.4	16.9

Source: Company, Sharekhan research

Revenue in-line, margin ahead of estimates: Wipro delivered a mixed set of numbers in Q3FY2020, with in-line revenue and EBIT margins (IT services) marginally ahead of our estimates. Constant currency (CC) revenue grew by 1.8% q-o-q (in-line with our estimates), driven by strong performance in consumer verticals and 0.3% revenue contribution from ITI acquisition. On YTD basis, CC revenue growth remained at 4.3% y-o-y. On a reported basis, USD revenue grew by 2.2% q-o-q to \$2,094.8 million against our estimates of \$2,095 million. EBIT margin for IT services improved 30bps q-o-q to 18.4%, led by rupee depreciation and cross-currency tailwinds. Net profit of Rs. 2,455.8 crore (-2.2% y-o-y, -3.8% q-o-q) was in-line with our estimates.

Soft Q4 guidance, management hopes higher funnel size to drive growth in FY2021E: Wipro's management has guided for soft revenue growth of 0% to 2% for Q4FY2020E, on the expected lines, owing to weakness in BFSI and technology vertical (that together contribute towards 43.2% of revenues), deferment of renewals of certain digital projects in financial space and macro uncertainties. Management has also indicated that there are no major changes in the demand environment. However, the order backlog as well as funnel sizes are higher compared to the beginning of last year. Further, it sees improvement in demand environment of manufacturing and traction in digital offerings especially in the consumer vertical. Further, the management expects to convert a funnel of large deals in Q4FY2020E. Therefore, we believe that FY2021E revenue growth would be better compared to FY2020E. However, Wipro is expected to lag in terms of revenue growth among large peers as its top accounts (mostly constitute of banking and technology) have been reporting sluggish performance owing to lower tech spending. On the margin front, the management highlighted that there would be a steady improvement in margins led by cost optimisation measures and anticipated higher growth.

Soft performance except consumer vertical: Though growth in financial vertical continued to remain weak owing to the macroeconomic environment, the management remains confident on new deal wins in the pipeline by leveraging its strong digital capabilities. The performance in consumer business vertical remained healthy (12.1% y-o-y on CC), driven by a ramp-up of deals won earlier. Growth in energy & utilities and communications vertical remained moderate, while recovery was witnessed in the manufacturing vertical. Healthcare vertical saw a seasonal uptick owing to HPS (opening of enrollment in the US), while the technology business vertical was impacted owing to furlough and slowdown in spends.

Key highlights from earnings call

- ◆ **Management guidance:** The management guided for IT services revenues to be in the range of \$2,095 million - \$2,137 million for the Mar 2020 quarter. This translates to a sequential growth in the range of 0-2% in CC terms.
- ◆ **Strong cash conversion:** Cash conversion remained robust as operating cash flow was 124% of net income and free cash flow was 101% of net income.
- ◆ **No of large client metrics unchanged:** The number of client providing revenue in excess of \$100 million was increased by one to 14, while the number of clients in \$75 million/\$50 million/\$20 million bracket remained at 22/41/92. Management highlighted that one client in \$75 million bucket moved to \$100 million bucket during the quarter.
- ◆ **Slowdown in large clients:** The revenues from top client, top 5 clients and top 10 clients witnessed a decline of 4%, 2% and 1% on q-o-q basis and accounted for 3%, 12.3% and 19.2% of the overall revenues as against 3.2%, 12.8% and 19.8% during Q2FY2020.
- ◆ Digital revenue grew by 22.8% y-o-y during the quarter and contributed 40% to overall revenues.
- ◆ Localisation now stands at 70% of workforce in the USA. This mitigates the risk of visa rejection and talent crunch. Attrition level has reduced to 15.7% from 17% in Q2FY2020.

Results

Particulars (IFRS)	Q3FY20	Q3FY19	Q2FY20	YoY (%)	QoQ (%)
Revenues (\$ mn)	2,094.8	2,046.5	2,048.9	2.4	2.2
Net sales	15,470.5	15,059.5	15,125.6	2.7	2.3
Direct costs	10,967.3	10,397.1	10,800.6	5.5	1.5
Gross profit	4,756.1	4,662.4	4,577.9	2.0	3.9
SG&A	1,852.6	1,886.7	1,715.6	-1.8	8.0
EBIT	2,903.5	2,775.7	2,862.3	4.6	1.4
Net other income	352.6	373.5	461.0	-5.6	-23.5
PBT	3,256.1	3,149.2	3,323.3	3.4	-2.0
Tax provision	616.4	696.6	573.1	-11.5	7.6
Net profit	2,455.8	2,510.3	2,552.6	-2.2	-3.8
EPS (Rs.)	4.3	4.2	4.3	3.6	0.5
Margin (%)				BPS	BPS
EBIT margins (Blended)	18.8	18.4	18.9	34	-16
EBIT margin (IT Services)	18.4	19.8	18.1	-147	28
NPM	15.9	16.7	16.9	-80	-100

Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y	q-o-q	y-o-y
Revenues (\$ mn)	2,095	100	2.2	2.4	1.8	3.3
Geographic mix						
Americas	1,240	59.2	1.6	6.1	1.5	7.2
Europe	496	23.7	3.1	-4.9	1.0	-4.3
APAC & others	358	17.1	3.5	0.6	4.1	2.0
Industry verticals						
BFSI	647	30.9	0.9	0.7	0.4	1.0
Consumer	354	16.9	8.0	10.9	7.0	12.1
Technology	258	12.3	-3.3	-3.2	-3.7	-1.7
Healthcare	274	13.1	3.0	2.4	3.4	4.2
Energy & utilities	270	12.9	2.2	1.6	1.2	2.6
Manufacturing	172	8.2	3.5	3.6	4.4	4.9
Communications	119	5.7	2.2	0.6	1.5	1.3
Service line						
Application services	926	44.2	0.9	-0.8	0.4	0.8
Cloud and infrastructure services	540	25.8	2.6	5.6	2.5	6.7
Digital operations and platform	321	15.3	6.4	6.5	5.7	6.4
Product engineering	157	7.5	2.2	2.4	1.8	3.1
Data, analytics and AI	151	7.2	0.8	2.4	0.1	1.9
Client's Contribution						
Top client	63	3.0	-4.1	-17.0	-	-
Top 5	258	12.3	-1.8	-3.2	-	-
Top 10	402	19.2	-0.9	-0.2	-	-

Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenues	Contribution (%)		Margin (%)	
	(\$ mn)	Q3FY19	Q3FY20	Q3FY19	Q3FY20
BFSI	647	31.4	30.9	19.8	17.7
Consumer	354	15.6	16.9	23.1	18.6
Technology	258	13.0	12.3	21.9	17.5
Healthcare	274	13.1	13.1	10.3	16.1
Energy and utilities	270	13.0	12.9	19.0	16.0
Manufacturing	172	8.1	8.2	20.0	19.2
Communications	119	5.8	5.7	18.6	16.9

Source: Company; Sharekhan Research

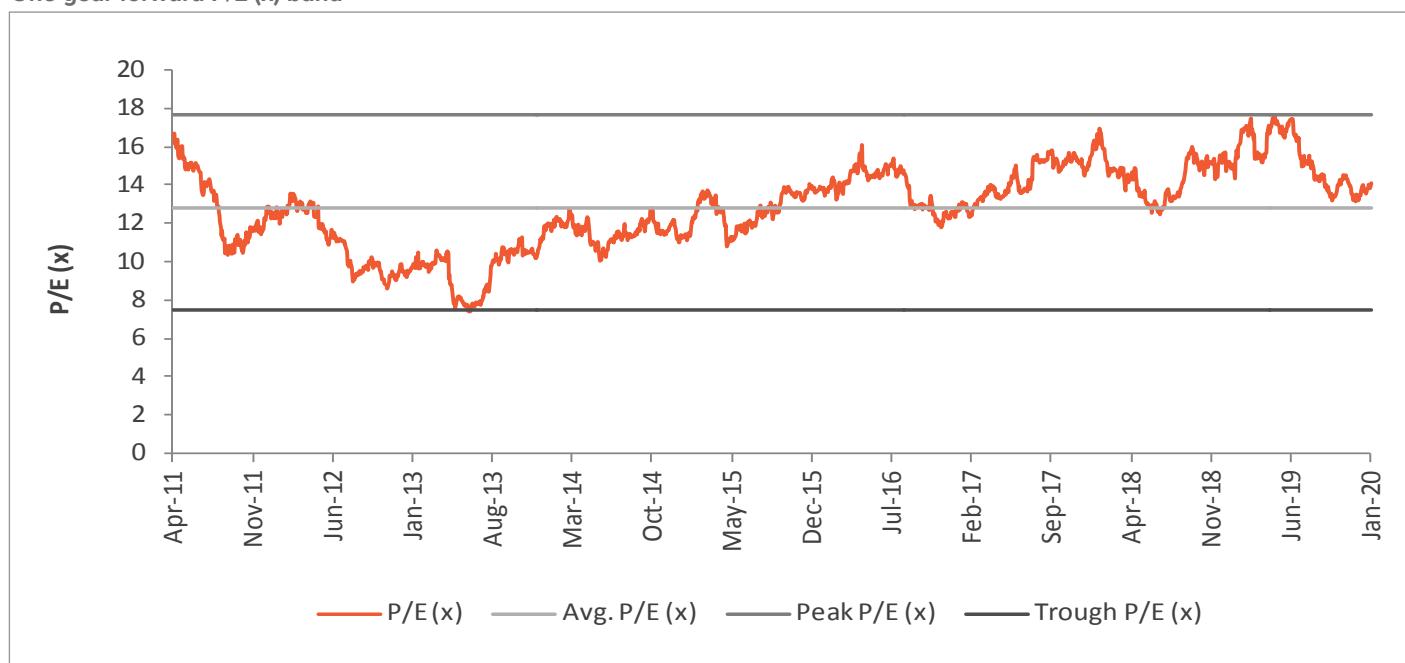
Outlook

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

We have tweaked our earnings estimates for FY2020E/FY2021E factoring in continued decline in top accounts. We believe that Wipro's revenue growth would continue to remain in the bottom quartile among the top-five IT companies owing to weakness in BFSI and technology verticals. However, the company has been reporting steady execution in margins over last three quarters despite slower revenue growth. At CMP, the stock is trading at 15x/14x of 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.

One-year forward P/E (x) band



Source: 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.85
2	Black Rock Inc	0.85
3	Vanguard Group Inc	0.59
4	Norges Bank	0.51
5	ICICI Prudential Asset Management	0.51
6	Dimensional Fund Advisors LP	0.38
7	Azim Premji Philanthropic Initiatives	0.36
8	SBI Funds Management Pvt Ltd	0.35
9	AZIM PREMJI PHILANTHROPIC	0.35
10	PineBridge Investments LP	0.24

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

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

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. KanjurMarg Railway Station, KanjurMarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.