

SELL

TP: Rs 230 | ▼ 11%

WIPRO

| IT Services

| 18 July 2019

Another disappointing quarter

Wipro (WPRO) reported another tepid quarter as a wind-down of large projects in the retail & CPG verticals and delayed ramp-up of some contracts led to a dollar revenue decline of 1.8% QoQ. Adj. IT services EBIT margin at 17.9% was below estimates. Q2 revenue growth guidance of 0-2% QoQ was uninspiring. We tweak estimates but retain our TP at Rs 230 upon rollover to Jun'20. A muted BFSI outlook, regulatory uncertainty in healthcare, and restructuring of India & Middle East operations continue to hamper recovery prospects.

Ruchi Burde

research@bobcaps.in

Poor operating performance: WPRO reported a 1.8% QoQ drop in dollar revenues for Q1FY20 vs. our/street estimates of a 0.9%/0.2% QoQ decline. Reported IT services EBIT margins at 18.4% (-80bps QoQ) were in line, albeit aided by Rs 669mn of exceptional gains on divestment of businesses. Adjusted for this, margins at 17.9% came in lower than estimates.

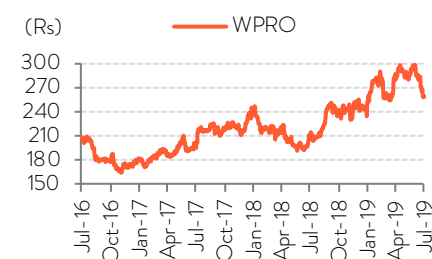
Uninspiring Sep'19 quarter guidance: Q2FY20 revenue growth guidance of 0-2% QoQ was subdued and below our estimate of 1-3% sequential growth. We highlight that the Sep'19 quarter will include inorganic revenues from consolidation of International TechneGroup (which had annual revenues of US\$ 23.2mn in FY18). The midpoint of the guided range implies moderation of WPRO's annual growth trajectory to low single-digits for FY20.

Retain SELL: We cut FY20/FY21 EPS estimates by 1.6%/2.1% as we accommodate the muted Jun'19 quarter performance. In our view, a growth recovery will continue to elude WPRO, inviting downside risks to consensus earnings estimates. We model for a 6.4% earnings CAGR over FY19-FY21 and retain SELL with an unchanged Jun'20 TP of Rs 230, valuing the stock at 13.5x one-year forward P/E.

| | |
|------------------|----------------|
| Ticker/Price | WPRO IN/Rs 260 |
| Market cap | US\$ 17.0bn |
| Shares o/s | 4,512mn |
| 3M ADV | US\$ 27.3mn |
| 52wk high/low | Rs 302/Rs 198 |
| Promoter/FPI/DII | 74%/9%/17% |

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

| Y/E 31 Mar | FY17A | FY18A | FY19A | FY20E | FY21E |
|-------------------------|--------|--------|--------|--------|--------|
| Adj. net profit (Rs mn) | 82,723 | 80,046 | 90,074 | 89,218 | 96,547 |
| Adj. EPS (Rs) | 12.8 | 13.3 | 14.9 | 15.6 | 16.9 |
| Adj. EPS growth (%) | (5.8) | 4.0 | 12.3 | 4.6 | 8.2 |
| Adj. ROAE (%) | 16.7 | 15.9 | 17.1 | 16.0 | 16.4 |
| Adj. P/E (x) | 20.3 | 19.5 | 17.4 | 16.6 | 15.3 |
| EV/EBITDA (x) | 10.6 | 12.0 | 10.0 | 9.3 | 8.7 |

Source: Company, BOBCAPS Research

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FIG 1 – JUN'19 QUARTER PERFORMANCE

| (Rs mn) | Q1FY19 | Q2FY19 | Q3FY19 | Q4FY19 | Q1FY20 | YoY (%) | QoQ (%) |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|--------------|--------------|
| US\$ revenues (IT Services excluding ISRE)* | 1,989 | 2,010 | 2,047 | 2,076 | 2,039 | 2.5 | (1.8) |
| Total revenue | 1,40,548 | 1,46,627 | 1,51,506 | 1,50,379 | 1,48,019 | 5.3 | (1.6) |
| Operating expenditure | 1,19,771 | 1,21,139 | 1,22,838 | 1,23,125 | 1,23,345 | 3.0 | 0.2 |
| Cost of revenues | 1,00,350 | 1,01,770 | 1,03,971 | 1,05,462 | 1,04,273 | 3.9 | (1.1) |
| as % of sales | 71.4 | 69.4 | 68.6 | 70.1 | 70.4 | - | - |
| SG&A expenses | 19,421 | 19,369 | 18,867 | 17,663 | 19,072 | (1.8) | 8.0 |
| as % of sales | 13.8 | 13.2 | 12.5 | 11.7 | 12.9 | - | - |
| EBIT | 20,777 | 25,488 | 28,668 | 27,254 | 24,674 | 18.8 | (9.5) |
| Other Income | 6,024 | (1,285) | 3,742 | 4,747 | 6,045 | 0.3 | 27.3 |
| PBT | 26,801 | 24,203 | 32,410 | 32,001 | 30,719 | 14.6 | (4.0) |
| Total Tax | 5,865 | 5,347 | 6,966 | 7,064 | 6,699 | 14.2 | (5.2) |
| Adjusted PAT | 20,936 | 18,856 | 25,444 | 24,937 | 24,020 | 14.7 | (3.7) |
| (Profit)/loss from JV's/Ass/MI | 270 | 33 | (341) | (104) | (147) | - | - |
| APAT after MI | 21,206 | 18,889 | 25,103 | 24,833 | 23,873 | 12.6 | (3.9) |
| Extra ordinary items | 0 | 0 | 0 | 0 | 0 | - | - |
| Reported PAT | 21,206 | 18,889 | 25,103 | 24,833 | 23,873 | 12.6 | (3.9) |
| Reported EPS | 3.5 | 3.1 | 4.2 | 4.1 | 4.0 | 12.3 | (3.9) |
| Margins (%) | | | | | | (bps) | (bps) |
| EBIT margin-IT Services (excluding ISRE) | 17.6 | 18.4 | 19.8 | 19.2 | 17.9 | 34 | (126) |
| EBIT | 14.8 | 17.4 | 18.9 | 18.1 | 16.7 | 189 | (145) |
| EBT | 19.1 | 16.5 | 21.4 | 21.3 | 20.8 | 168 | (53) |
| PAT | 15.1 | 12.9 | 16.6 | 16.5 | 16.1 | 104 | (39) |
| Effective Tax rate | 21.9 | 22.1 | 21.5 | 22.1 | 21.8 | (8) | (27) |

Source: BOBCAPS Research | *Indian State Run Enterprises.

Earnings call highlights

- Management pointed to a “stable” demand environment but cautioned about slower decision-making in pockets of BFSI, namely capital markets and European banks – commentary similar to that of TCS and Infosys.
- Management is hopeful of regaining growth momentum through the rest of FY20 aided by a strong deal pipeline.
- WPRO awaits clarity on the buyback tax in the final finance bill and remains committed to completing its plan of capital return to shareholders.
- The company has achieved 65% localisation in North America.

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. Regulatory uncertainty for the healthcare business, restructuring of India and Middle East operations, and a muted outlook for the BFSI and manufacturing verticals cloud recovery prospects. 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.

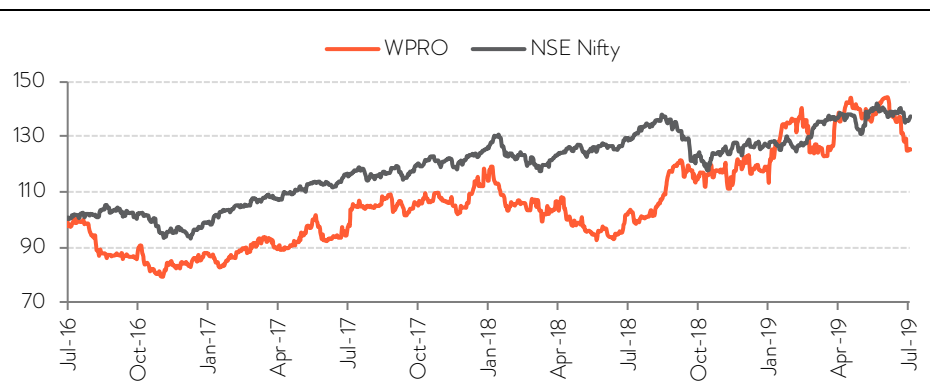
We cut FY20/FY21 EPS estimates by 1.6%/2.1% as we accommodate the muted Jun'19 quarter performance. Upon rolling valuations forward, our Jun'20 target price remains unchanged at Rs 230, set at 13.5x one-year forward P/E. Maintain SELL.

FIG 2 – REVISED ESTIMATES

| (Rs mn) | FY20E | | | FY21E | | |
|---|----------|----------|------------|----------|----------|------------|
| | Old | New | Change (%) | Old | New | Change (%) |
| IT Services revenues (excluding ISRE, in US\$ mn) | 8,488 | 8,299 | (2.2) | 9,080 | 8,857 | (2.5) |
| IT Services revenues (excluding ISRE, in US\$ mn), YoY growth (%) | 4.5 | 2.2 | - | 7.0 | 6.7 | - |
| Company-wide revenues | 6,12,162 | 5,91,012 | (3.5) | 6,55,012 | 6,35,753 | (2.9) |
| EBIT | 1,05,890 | 1,02,726 | (3.0) | 1,14,089 | 1,11,635 | (2.2) |
| EBIT margins (%) | 17.3 | 17.4 | - | 17.4 | 17.6 | - |
| Net profits | 90,569 | 89,218 | (1.5) | 98,420 | 96,547 | (1.9) |
| EPS (Rs) | 15.9 | 15.6 | (1.6) | 17.3 | 16.9 | (2.1) |

Source: BOBCAPS Research

FIG 3 – 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) | FY17A | FY18A | FY19A | FY20E | FY21E |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Total revenue | 5,54,179 | 5,46,359 | 5,89,060 | 5,91,012 | 6,35,753 |
| EBITDA | 1,12,904 | 1,05,418 | 1,27,072 | 1,19,485 | 1,35,789 |
| EBIT | 89,797 | 84,294 | 1,02,187 | 1,02,726 | 1,11,635 |
| Net interest income/(expenses) | 13,521 | 18,169 | 15,548 | 14,148 | 13,992 |
| Other income/(expenses) | 4,867 | 0 | 0 | 0 | 0 |
| Exceptional items | 0 | 0 | 0 | 0 | 0 |
| EBT | 1,08,185 | 1,02,463 | 1,15,458 | 1,16,175 | 1,25,626 |
| Income taxes | 25,214 | 22,390 | 25,242 | 26,661 | 28,879 |
| Extraordinary items | 0 | 0 | 0 | 0 | 0 |
| Min. int./Inc. from associates | 248 | 27 | 142 | 297 | 200 |
| Reported net profit | 82,723 | 80,046 | 90,074 | 89,218 | 96,547 |
| Adjustments | 0 | 0 | 0 | 0 | 0 |
| Adjusted net profit | 82,723 | 80,046 | 90,074 | 89,218 | 96,547 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY17A | FY18A | FY19A | FY20E | FY21E |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Accounts payables | 0 | 0 | 0 | 0 | 0 |
| Other current liabilities | 1,20,521 | 1,33,177 | 1,58,894 | 1,31,156 | 1,41,085 |
| Provisions | 1,274 | 799 | 640 | 1,457 | 1,568 |
| Debt funds | 1,42,412 | 1,38,259 | 99,467 | 99,467 | 99,467 |
| Other liabilities | 6,614 | 3,059 | 3,417 | 3,417 | 3,417 |
| Equity capital | 4,861 | 9,048 | 12,068 | 12,068 | 12,068 |
| Reserves & surplus | 5,17,834 | 4,76,298 | 5,58,685 | 5,32,462 | 6,17,590 |
| Shareholders' fund | 5,22,695 | 4,85,346 | 5,70,753 | 5,44,530 | 6,29,658 |
| Total liabilities and equities | 7,93,516 | 7,60,640 | 8,33,171 | 7,80,027 | 8,75,194 |
| Cash and cash eq. | 52,710 | 44,925 | 1,58,529 | 89,969 | 1,65,965 |
| Accounts receivables | 98,844 | 1,00,990 | 1,00,489 | 1,06,868 | 1,14,958 |
| Inventories | 3,915 | 3,370 | 3,951 | 4,858 | 5,225 |
| Other current assets | 1,12,296 | 1,45,107 | 1,29,457 | 1,30,346 | 1,40,214 |
| Investments | 2,99,133 | 2,59,200 | 2,33,798 | 2,33,798 | 2,33,798 |
| Net fixed assets | 69,794 | 64,443 | 70,601 | 77,842 | 78,688 |
| CWIP | 8,951 | 15,166 | 0 | 0 | 0 |
| Intangible assets | 1,41,718 | 1,35,697 | 1,30,742 | 1,30,742 | 1,30,742 |
| Deferred tax assets, net | 15,106 | 6,908 | 5,604 | 5,604 | 5,604 |
| Other assets | 0 | 0 | 0 | 0 | 0 |
| Total assets | 7,93,516 | 7,60,640 | 8,33,171 | 7,80,027 | 8,75,194 |

Source: Company, BOBCAPS Research

Cash Flows

| Y/E 31 Mar (Rs mn) | FY17A | FY18A | FY19A | FY20E | FY21E |
|-------------------------------------|-------------------|-------------------|-----------------|-------------------|-----------------|
| Net income + Depreciation | 82,803 | 73,043 | 1,15,101 | 1,06,273 | 1,20,902 |
| Interest expenses | 0 | 0 | (15,548) | (14,148) | (13,992) |
| Non-cash adjustments | 0 | 0 | 0 | 0 | 0 |
| Changes in working capital | 4,511 | (877) | 41,128 | (35,096) | (8,286) |
| Other operating cash flows | 5,459 | 12,067 | 14,424 | 0 | 0 |
| Cash flow from operations | 92,773 | 84,233 | 1,55,105 | 57,030 | 98,624 |
| Capital expenditures | (19,646) | (20,699) | (46,209) | (24,000) | (25,000) |
| Change in investments | (83,684) | 47,973 | 0 | 0 | 0 |
| Other investing cash flows | (12,373) | 8,679 | 15,548 | 14,148 | 13,992 |
| Cash flow from investing | (1,15,703) | 35,953 | (30,661) | (9,852) | (11,008) |
| Equities issued/Others | 0 | 24 | 0 | (1,05,000) | 0 |
| Debt raised/repaid | 0 | 0 | 0 | 0 | 0 |
| Interest expenses | (14,018) | (1,24,582) | 0 | 0 | 0 |
| Dividends paid | (8,734) | (5,420) | (10,840) | (10,737) | (11,619) |
| Other financing cash flows | 0 | 0 | 0 | 0 | 0 |
| Cash flow from financing | (22,752) | (1,29,978) | (10,840) | (1,15,737) | (11,619) |
| Changes in cash and cash eq. | (45,682) | (9,792) | 1,13,604 | (68,560) | 75,996 |
| Closing cash and cash eq. | 52,710 | 44,925 | 1,58,529 | 89,969 | 1,65,965 |

Per Share

| Y/E 31 Mar (Rs) | FY17A | FY18A | FY19A | FY20E | FY21E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 12.8 | 13.3 | 14.9 | 15.6 | 16.9 |
| Adjusted EPS | 12.8 | 13.3 | 14.9 | 15.6 | 16.9 |
| Dividend per share | 2.0 | 1.0 | 1.5 | 1.6 | 1.7 |
| Book value per share | 80.8 | 80.7 | 94.7 | 95.4 | 110.4 |

Valuations Ratios

| Y/E 31 Mar (x) | FY17A | FY18A | FY19A | FY20E | FY21E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 2.2 | 2.3 | 2.1 | 1.9 | 1.9 |
| EV/EBITDA | 10.6 | 12.0 | 10.0 | 9.3 | 8.7 |
| Adjusted P/E | 20.3 | 19.5 | 17.4 | 16.6 | 15.3 |
| P/BV | 3.2 | 3.2 | 2.7 | 2.7 | 2.4 |

DuPont Analysis

| Y/E 31 Mar (%) | FY17A | FY18A | FY19A | FY20E | FY21E |
|---------------------------------|-------|-------|-------|-------|-------|
| Tax burden (Net profit/PBT) | 76.5 | 78.1 | 78.0 | 76.8 | 76.9 |
| Interest burden (PBT/EBIT) | 120.5 | 121.6 | 113.0 | 113.1 | 112.5 |
| EBIT margin (EBIT/Revenue) | 16.2 | 15.4 | 17.3 | 17.4 | 17.6 |
| Asset turnover (Revenue/Avg TA) | 73.0 | 70.3 | 73.9 | 73.3 | 76.8 |
| Leverage (Avg TA/Avg Equity) | 1.5 | 1.5 | 1.5 | 1.4 | 1.4 |
| Adjusted ROAE | 16.7 | 15.9 | 17.1 | 16.0 | 16.4 |

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

Ratio Analysis

| Y/E 31 Mar | FY17A | FY18A | FY19A | FY20E | FY21E |
|--|-------|-------|-------|-------|-------|
| YoY growth (%) | | | | | |
| Revenue | 7.3 | (1.4) | 7.8 | 0.3 | 7.6 |
| EBITDA | 1.1 | (6.6) | 20.5 | (6.0) | 13.6 |
| Adjusted EPS | (5.8) | 4.0 | 12.3 | 4.6 | 8.2 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 20.4 | 19.3 | 21.6 | 20.2 | 21.4 |
| EBIT margin | 16.2 | 15.4 | 17.3 | 17.4 | 17.6 |
| Adjusted profit margin | 14.9 | 14.7 | 15.3 | 15.1 | 15.2 |
| Adjusted ROAE | 16.7 | 15.9 | 17.1 | 16.0 | 16.4 |
| ROCE | 16.0 | 14.0 | 18.6 | 19.1 | 19.8 |
| Working capital days (days) | | | | | |
| Receivables | 66 | 67 | 62 | 64 | 64 |
| Inventory | 4 | 3 | 3 | 3 | 4 |
| Payables | 96 | 100 | 109 | 108 | 95 |
| Ratios (x) | | | | | |
| Gross asset turnover | 8.2 | 8.1 | 8.7 | 8.0 | 8.1 |
| Current ratio | 2.2 | 2.2 | 2.5 | 2.5 | 3.0 |
| Net interest coverage ratio | 6.6 | 4.6 | 6.6 | 7.3 | 8.0 |
| Adjusted debt/equity | 0.2 | 0.2 | (0.1) | 0.0 | (0.1) |

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

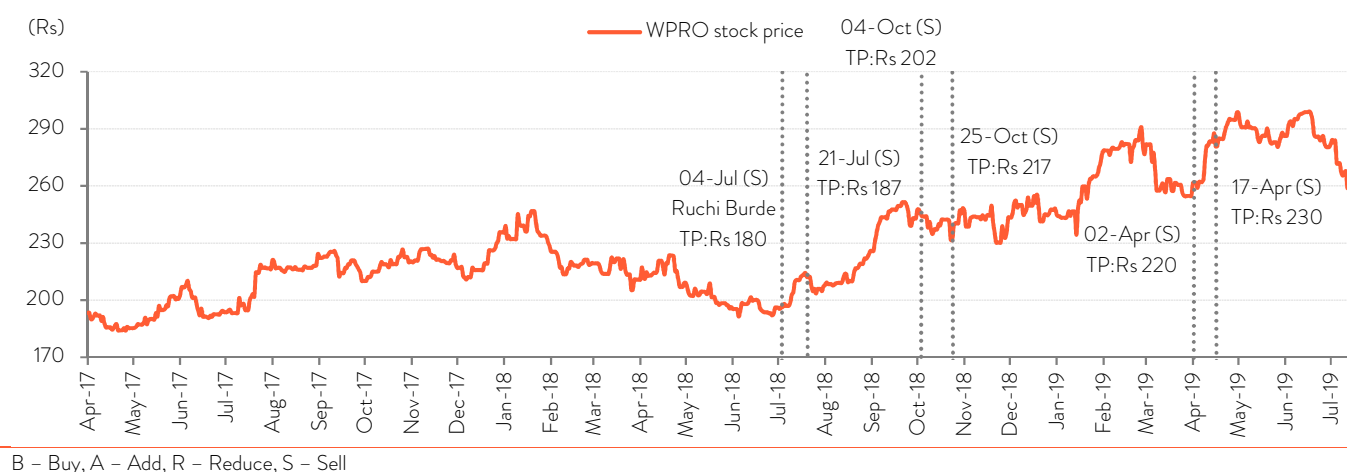
ADD – Expected return from >+5% to +15%

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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