

Wipro Limited

Apoorva Zinzuvadia (apoorva@karvy.com)

Under Performer

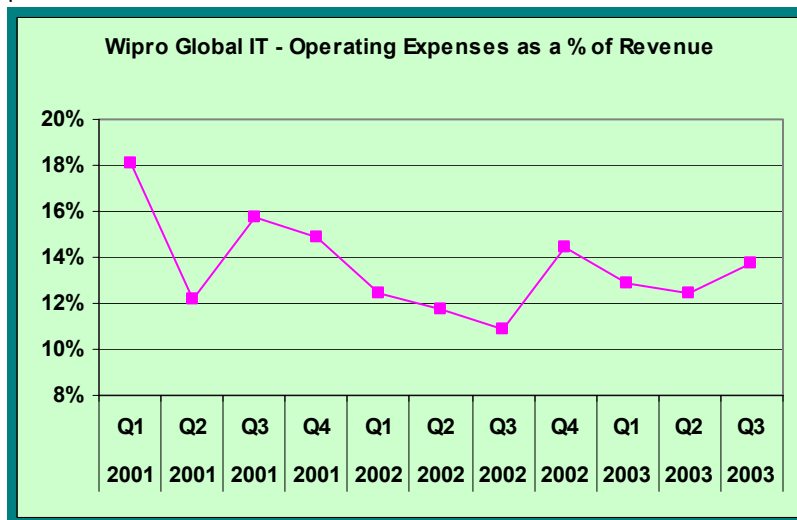
Rs1531 P/E (FY03E) - 48x

OPM slides in Global IT; growth pains in Spectramind and Healthcare

- Operating performance this quarter is not in line with expectations. The company has spent additional amounts towards beefing up its Sales and Marketing and strengthening its Sales team in its Global IT segment. Increasing Onsite work and lower utilisation on the back of recruitment of 1280 technical employees have also contributed towards the lower margins.
- Spectramind faced billing rate pressures from specific customers; ramp-up in Healthcare services was lower than expected.

Global IT Segment

- Global IT revenues for Q3FY03 stood at \$154mn (Rs7,379mn) against the company's guidance of \$152mn (Rs7,296). Our estimates stood at around \$155 (Rs7,470mn).
- Revenues from Europe registered a respectable 17% QoQ growth; N America grew slower compared to the past 2-3 quarters.
- R&D services' revenue growth was sluggish; major contributor to growth this quarter was Enterprise Solutions (especially from the Utilities and Manufacturing sector).
- Global IT's operating expenses (SG&A, R&D and amortisation) have seen wild swings, from a high of 18% of revenues in Q1 2001 to a low of 10.9% in Q3 2002. This quarter (Q3 2003), operating expenses have increased to 13.8% from 12.5% in Q2 2002.



- The company's average billing rates for the quarter have not changed much remaining almost at the same level. However, the company has indicated that there is a possibility that existing customers might re-negotiate on the billing rate contracts.
- Net addition to the Technical headcount was around 1280 in Q3 2002

Clients / Acquisitions

- Wipro has informed investors that one of its clients 186K (erstwhile a Lattice Group company) has been taken over by another company and in view of the acquisition the development / Implementation work has been frozen. 186K did not feature in the Top 10 client list of the company in Q3 2002 and the company's guidance for Q4 FY03 is after taking into account that status quo would be maintained with the 186K project in the quarter.
- On 31Dec 2002, Wipro acquired the Global Energy Practice from American Management Systems for a total consideration of \$25mn (Rs1,200mn). The practice has an existing client base from the

Energy and Utilities sectors providing specialised IT services through its team of domain experts and IT consultants. Wipro will be focusing on complex Billing and Settlement systems for these verticals. Results from this acquisition will be consolidated with Wipro Global IT segment from Q4 FY03 onwards.

- Wipro entered into a definitive agreement to purchase assets of Ericsson's Bangalore and Hyderabad and Delhi-based Research and Development Centers. Wipro has made offers to 291 employees from these centers. The transaction will be completed by January 2003. Also, Ericsson has signed an agreement of Purchase of consultancy services from Wipro for an amount of \$17mn up to calendar year 2004.

IT Enabled Services Segment (Spectramind)

- Spectramind faced billing rate pressures from specific clients. As a result, revenues for Q3 2002 stood at \$11.2mn (Rs 540mn) compared to the company's guidance of \$12.5mn
- PBT margins stood at a healthy 18%.
- Currently, the company has 9 active clients; still over 41% of its revenues continue to come from one single customer.
- Billing rate realisation dipped from \$14.1 per hour in Q2 2002 to \$13.5 in Q3 2002.
- The company added another 700 agents to its payroll and 4 in sales; attritions remained high however at a quarterly rate of 16%.
- The company diversified a bit more vertically ... in Q3 2003 Technology, Telecom and Financial Services contributed around 42%, 30% and 17% of revenues, respectively.

Healthcare Segment

- Revenues from Healthcare stood at \$5.2mn (Rs250mn) compared to the company guidance of \$3.5mn.
- The next quarter (Q4 FY03) revenue guidance for the segment in \$2.5mn as the company would ramp-down in non-core healthcare product sales business. On the other hand, the ramp-up in Services is taking time to gain momentum.
- In December 2002, the company acquired the remaining 40% stake of Wipro Healthcare IT (erstwhile GE Medical Systems IT Pvt Ltd.), making it a 100% subsidiary. Total consideration paid for the acquisition is around \$5.7mn (Rs278mn).

Other Segments

- The Indian IT segment saw services revenue contribution increase by 40% YoY.
- Consumer Care and Lighting division saw a significant reduction in operating margins ... from 15.8% in Q2 2002 to around 11.4% in Q3 2002 (in Q3 2002 OPM was around 13.5%).

View and Valuation

In view of uncertainty looming large over continuation of the 186K contract and possible billing rates pressure from existing clients, we have revised out estimates for the Global IT segment for the next quarter. Meanwhile, both Spectramind and the Healthcare IT segment have been slow in the ramp-up of their services. **We are reducing our rating on the stock to Under Performer.** We believe that sentiments for the stock would remain mildly bearish from current levels.

Important Note on Wipro's Taxation

The company has clarified that as the Global IT segment recently acquired and developed a substantial portion of land in Electronic City (Bangalore), it enjoys Income Tax Section 10A/10B benefits (90% of export income tax-free) on revenues at these premises. Also, its Sarjapur (Bangalore) facilities fall under the purview of Section 10A/10B. The company also mentioned that no major facility was expected to go out of the purview of Section 10A/10B in the next two-three years. After preliminary analysis on the effective tax rate on various segments, we have decided to reduce the effective Tax rate assumptions on the Global IT segment from the 14% to 10%.

Projections

Yearly Projections

Wipro Global IT Segment

Rs Mn

| Year Ended March 31 | 2002 | 2003 <i>Karvy Estimates</i> | Change % |
|---------------------------------------|---------------|--------------------------------|--------------|
| Revenue | 22,412 | 28,244 | 26.0% |
| Profit Before Tax | 7,609 | 8,430 | 10.8% |
| PBT per Share (Rs) | 32.86 | 36.43 | 10.9% |
| Price / PBT per Share (x) | 48 | 43 | -9.8% |
| <i>Assumed Tax Rate</i> | <i>10.0%</i> | <i>10.0%</i> | |
| PAT based on the Assumption | 6,848 | 7,587 | 10.8% |
| EPS based on Assumption (Rs) | 29.58 | 32.79 | 10.9% |
| NPM based on Assumption | 30.6% | 26.9% | |
| <i>P/E (x) (after tax assumption)</i> | <i>53</i> | <i>48</i> | |

Note: US GAAP Consolidated Results

Wipro Limited

Rs Mn

| Year Ended March 31 | 2002 <i>Actual</i> | 2003 <i>Karvy Estimates</i> | Change % |
|--|-----------------------|--------------------------------|--------------|
| Revenues | | | |
| Global IT Services and Products | 22,412 | 28,244 | 26.0% |
| Spectramind | - | 1,574 | |
| Indian IT Services and Products | 6,950 | 7,801 | 12.2% |
| Consumer Care and Lighting | 2,939 | 2,908 | -1.0% |
| Healthcare and Life Sciences | - | 814 | |
| Others | 1,680 | 972 | -42.2% |
| Total | 33,981 | 42,314 | 24.5% |
| Net Profits (before extraordinary items) | 8,330 | 9,179 | 10.2% |
| Net Profits | 8,330 | 8,438 | 1.3% |
| EPS (Rs) | 35.98 | 36.46 | 1.4% |
| P/E (x) | 44 | 43 | |

Note: US GAAP Consolidated Results

Quarterly Projections
Wipro Global IT Segment

| Year Ended March 31 | Rs Mn | | |
|-------------------------------|-----------------------------------|-------------------------|-------------------------|
| | Q3 2003 <i>Karvy Estimates</i> | Q3 2003 QoQ Growth % | Q3 2003 YoY Growth % |
| Solutions Revenues | 7,822 | 6% | 41% |
| Products Revenues | - | | |
| Total Revenues | 7,822 | 6% | 40% |
| Profit Before Tax (PBT) | 2,236 | 6% | 17% |
| PBT per Share (Rs.) | 9.66 | 6% | 17% |
| <i>Assumed Tax Rate</i> | 10% | | |
| PAT based on the Assumption | 2,013 | 6% | 17% |
| EPS based on Assumption (Rs.) | 8.70 | 6% | 17% |

Note: US GAAP Consolidated Results

Wipro Limited

| Year Ended March 31 | Rs Mn | | | | |
|---------------------------------|-----------------------------------|-------------------------|-------------------------|------------------|-----------------|
| | Q4 2003 <i>Karvy Estimates</i> | Q4 2003 QoQ Growth % | Q4 2003 YoY Growth % | Q4 2003 \$Mn | Q4 2003 RsMn |
| | | | | Company Guidance | |
| Revenue | | | | | |
| Global IT Services and Products | 7,822 | 6% | 40% | 162.0 | 7776 |
| Spectramind | 624 | 16% | 0% | 12.0 | 576 |
| Indian IT Services and Products | 2,175 | 29% | -8% | | |
| Consumer Care and Lighting | 733 | -1% | 0% | | |
| Healthcare and Life Sciences | 150 | -40% | 0% | 2.5 | 120 |
| Others | 220 | -20% | -53% | | |
| Total | 11,724 | 8% | 28% | | |
| <i>Global IT Profits</i> | 2,013 | 6% | 17% | | |
| Total PAT | 2,286 | 5% | 9% | | |
| EPS (Rs) | 9.88 | 5% | 9% | | |

Note: US GAAP Consolidated Results

Consolidated Results

Wipro Global IT segment

Rs Mn

| Year Ended March 31 | Q3 2002 | Q2 2002 | QoQ %Chg | Q3 2002 | YoY %Chg |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 7,379 | 6,738 | 9.5% | 6,052 | 21.9% |
| Services | 7,379 | 6,693 | 10.3% | 5,559 | 32.7% |
| Products | - | 45 | | 493 | |
| Cost of revenues | 4,330 | 3,932 | 10.1% | 3,425 | 26.4% |
| Services | 4,330 | 3,888 | 11.4% | 2,956 | 46.5% |
| Products | - | 44 | | 468 | |
| Gross Profit | 3,049 | 2,806 | 8.7% | 2,628 | 16.0% |
| SG&A, R&D, Amortization | 1,015 | 834 | 21.7% | 606 | 67.5% |
| OPM (%) | 2,034 | 1,971 | 3.2% | 2,022 | 0.6% |
| Exchange Rate Fluctuations | 68 | 49 | 38.2% | 32 | 112.7% |
| Interest income on funding (net) | | | | - | |
| PBT | 2,102 | 2,021 | 4.0% | 2,061 | 2.0% |
| No. of Shares | 231 | 231 | 0.0% | 231 | 0.0% |
| PBT per Share (Rs) | 9.08 | 8.73 | 4.0% | 8.91 | 2.0% |
| Gross Margin - Services | 41.3% | 41.6% | | 43.4% | |
| Gross Margin - Products | | 1.1% | | 5.0% | |
| OPM | 27.6% | 29.3% | | 33.4% | |
| PBT Margin | 28.5% | 30.0% | | 34.1% | |
| Other Income/PBT | 3.2% | 2.4% | | 1.6% | |
| <i>Assumed Tax Rate</i> | <i>10.0%</i> | <i>10.0%</i> | | <i>10.0%</i> | |
| <i>Assumed Taxes (Rs Mn)</i> | <i>210</i> | <i>202</i> | <i>4.0%</i> | <i>206</i> | <i>2.0%</i> |
| PAT based on the Assumption | 1,892 | 1,819 | 4.0% | 1,855 | 2.0% |
| EPS based on Assumption | 8.18 | 7.86 | 4.0% | 8.02 | 2.0% |
| NPM based on Assumption | 25.6% | 27.0% | | 30.6% | |

Note: US GAAP Consolidated Results

Wipro Limited

Rs Mn

| Year Ended March 31 | Q3 2002 | Q3 2002 | YoY %Chg |
|-------------------------------------|---------------|--------------|------------|
| Revenue | | | |
| Global IT Services and Products | 7,379 | 6,052 | 22% |
| Spectramind | 540 | | |
| Indian IT Services and Products | 1,689 | 1,491 | 13% |
| Consumer Care and Lighting | 739 | 738 | 0% |
| Healthcare and Life Sciences | 250 | | |
| Others | 274 | 400 | -32% |
| Total | 10,871 | 8,681 | 25% |
| Cost of revenues | 6,855 | 5,345 | 28% |
| Gross Profit | 4,016 | 3,336 | 20% |
| SG&A expenses | 1,649 | 1,130 | 46% |
| R&D expenses | 42 | 42 | 1% |
| Amortisation of Goodwill | 48 | 43 | 11% |
| Operating Income | 2,277 | 2,121 | 7% |
| Other income/(expense), net | 234 | 235 | -1% |
| Currency Fluctuations Gain / (Loss) | 81 | 6 | 1367% |
| Income Before Tax | 2,592 | 2,362 | 10% |
| Income taxes | 337 | 203 | 66% |
| Income after Tax | 2,255 | 2,159 | 4% |
| Earnings of affiliates | (48) | 84 | -157% |
| Minority interest | (18) | | |
| Discontinued Operations | (9) | | |
| Net Income | 2,181 | 2,243 | -3% |
| Number of Shares (Mn) | 231 | 231 | 0% |
| EPS (Rs) | 9.42 | 9.69 | -3% |
| GPM | 36.9% | 38.4% | |
| OPM | 20.9% | 24.4% | |
| PBT Margin | 23.8% | 27.2% | |
| NPM | 20.1% | 25.8% | |
| Tax/PBT | 13.0% | 8.6% | |
| Other Income/PBT | 9.0% | 10.0% | |

Note: US GAAP Consolidated Results

Stock Ratings Absolute Returns

| | | |
|------------------|---|----------|
| Buy | : | > 25% |
| Out Performer | : | 16 - 25% |
| Market Performer | : | 0 - 15% |
| Under Performer | : | < 0% |

Karvy Stock Broking Limited

131, Andheri Industrial Estate, Off Veera Desai Road, Andheri (W), Mumbai – 400 053. India.
Voice: (91-22) 5695 0204 - 7, 5636 7226 /9044.

Disclaimer :

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and up on sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it.

The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor any person connected with any associated companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above-mentioned companies from time to time. Every employee of Karvy and its associated companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd.