Wipro

Strong growth prospects, valuations rich

IT & ITES	Sharekhan code: WIPRO	Company Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Hold**	↓
CMP: **Rs. 674**	
Price Target: **Rs. 740**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

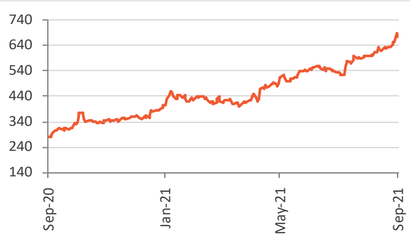
Company details

Market cap:	Rs. 3,69,442 cr
52-week high/low:	Rs. 690 / 271
NSE volume: (No of shares)	105.1 lakh
BSE code:	507685
NSE code:	WIPRO
Free float: (No of shares)	147.8 cr

Shareholding (%)

Promoters	73.0
FII	13.0
DII	6.5
Others	7.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.0	22.5	61.7	142.0
Relative to Sensex	5.9	11.0	46.2	90.3

Sharekhan Research, Bloomberg

Summary

- We downgrade our rating on Wipro to Hold from Buy with a revised PT of Rs. 740, owing to expected margin pressure and an unfavourable risk-reward ratio.
- Wipro is confident of strong revenue growth in FY2022, aided by solid deal intake, a healthy deal pipeline and strong staff additions. Synergies from the Capco acquisition will help Wipro capture opportunities in the BFS space.
- We expect sub-contracting expenses to inch up in the coming quarters, owing to strong demand, rising attrition and lower hiring of freshers.
- Margins would stay stressed in the subsequent quarters owing to wage hikes for mid- and junior staff (effective September 2021), full-quarter impact of salary revision for senior staff, impact from full-quarter consolidation and investments in building capabilities.

Wipro has shown remarkable progress in its turnaround journey even after significant changes in its leadership team, implementation of new operating models and significant hiring of external talents. After strong start of the fiscal, Wipro remains confident of sustaining strong revenue growth momentum going ahead, aided by solid deal wins, robust deal pipeline and strong employee additions. Synergy benefits of Capco acquisition will help Wipro to capture opportunities from accelerated digital investments by BFS firms.

- **Strong growth momentum to continue:** The acquisition of Capco helped Wipro to strengthen its presence in the BFSI vertical by enhancing capabilities and providing access to new large clients in the BFS space, where tech spend remains strong. Wipro's management remains confident of delivering strong revenue growth in FY2022 because of solid deal intake, healthy deal pipeline, and strong employee additions.
- **Expect subcontracting costs to increase:** We expect subcontracting expenses to inch up in the coming quarters owing to a strong demand environment, increasing attrition, and lower fresher hiring compared to large peers. Historically, Wipro had higher subcontracting costs compared to its peers.
- **Multiple margin headwinds:** Margins in the subsequent quarters would be impacted by rollout of wage hike to mid and junior staff (effective from September 2021), full-quarter impact of salary revision of senior staff in Q2, impact from full-quarter consolidation of Capco in Q2, unsustainable utilisation (86.8% in Q1FY2022), investments in frontline capabilities, and skill-based premium. Wipro has maintained its EBIT margin guidance at 17-17.5% for FY2022 compared to 20.3% in FY2021.

Our Call

Valuation – Stretched valuation, downgrade to Hold with a PT of Rs. 740: Though Wipro aspires to reach industry-leading growth rates by FY2023E, we expect Wipro's USD revenue to post a 9% CAGR organic growth over FY2022-FY2024E, which would still lag to peers. Further, there are limited margin levers to offset headwinds in the subsequent quarters. The stock price has run up around 23% over the past three months, factoring in strong progress in operating metrics, which provides limited upside from the current level. At the CMP, the stock is trading at 27x/24x its FY2023/FY2024 earnings estimates, which is at 78% premium to its five-year average. Hence, we have downgraded our rating on Wipro from Buy to Hold with a revised price target (PT) of Rs. 740.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, war for talents in major markets, constraint in local talent supply in the US, and a stringent visa regime to adversely impact earnings.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	62,242.5	78,951.5	88,529.1	97,312.8
OPM (%)	24.2	22.1	22.2	22.2
Adjusted PAT	10,794.6	12,096.6	13,658.5	15,122.5
% YoY growth	*11.0*	*12.1*	*12.9*	*10.7*
Adjusted EPS (Rs.)	19.1	22.1	24.9	27.6
P/E (x)	35.3	30.5	27.0	24.4
P/B (x)	7.3	6.5	5.8	5.1
EV/EBITDA (x)	24.1	20.5	18.0	16.1
RoNW (%)	19.5	19.6	19.9	19.8
RoCE (%)	18.2	18.9	20.4	20.8

Source: Company; Sharekhan estimates

Indian IT services industry to benefit from higher adoption of digital technology

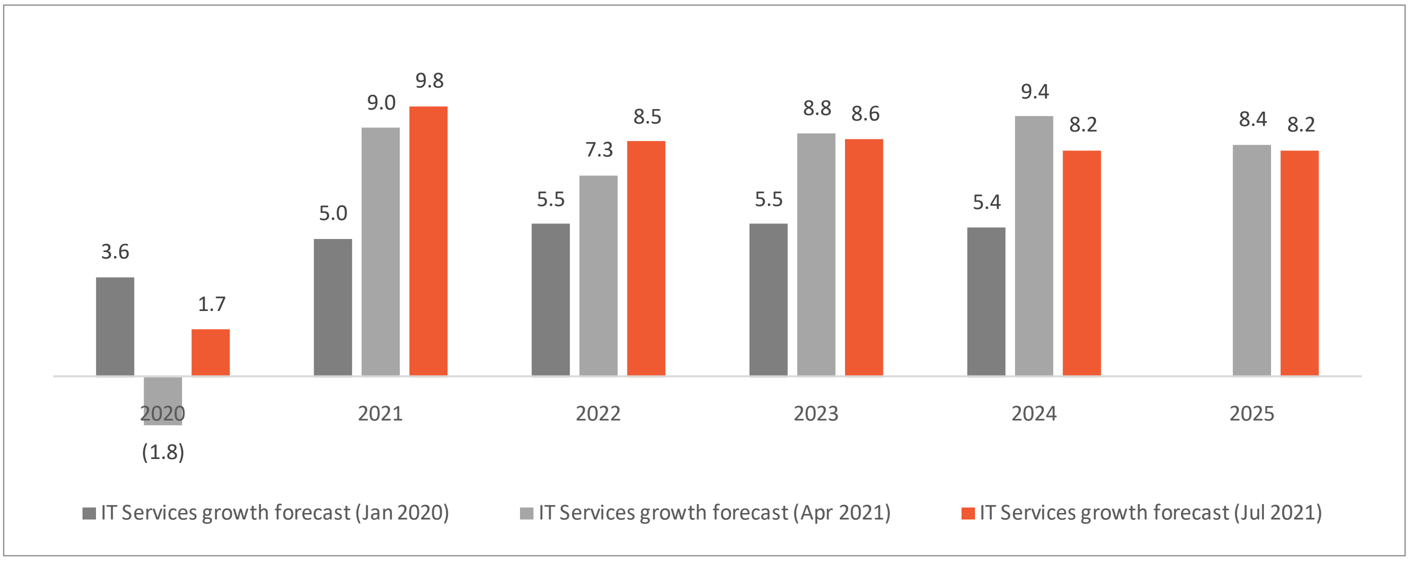
The pandemic has significantly accelerated the adoption of cloud and digital technologies among enterprises as these technologies are creating opportunities to drive operational efficiency, optimise cost structures, enhance customer experience, and generate new revenue sources. Across industries, enterprises are investing in operational efficiency programmes to reduce costs of operations, then reinvest the savings in transforming business models, and leveraging new technologies. Hence, managements of Indian IT companies consider this technology shift as the start of a multi-year technology upgradation cycle, which would open up opportunities for the industry.

Demand in industry is being driven by two big trends – (1) investment in both front-end and back-end transformation to enhance experience in digital transactions and (2) higher tech spending around cloud migration, application modernisation and data modernisation for greater resilience and agility within enterprises. Further, demand for outsourcing remains strong as enterprises are looking for their business transformations by bringing strategic technology partners with strong capabilities. We believe Indian IT services companies would benefit, given their strong global service delivery experience, competitive cost structure, infrastructure, talent availability, and innovation.

According to the latest forecast, Gartner expects worldwide IT spending to rise by 8.6% y-o-y to $4.2 trillion in 2021. Of this, Gartner forecasts IT services spends would grow by 9.8% in FY2021. Further, IT services spending is likely to report an 8.7% CAGR over FY2021-FY2025, led by strong growth in digital technology. Digital technologies (such as cloud hosting, cloud migration, ADM DevOps, consulting, IoT, etc.) would report a 15-20% CAGR over FY2021-FY2025, while next-generation technologies (5G, robotics, and Blockchain) are expected to report a CAGR of 35-45% over the same period.

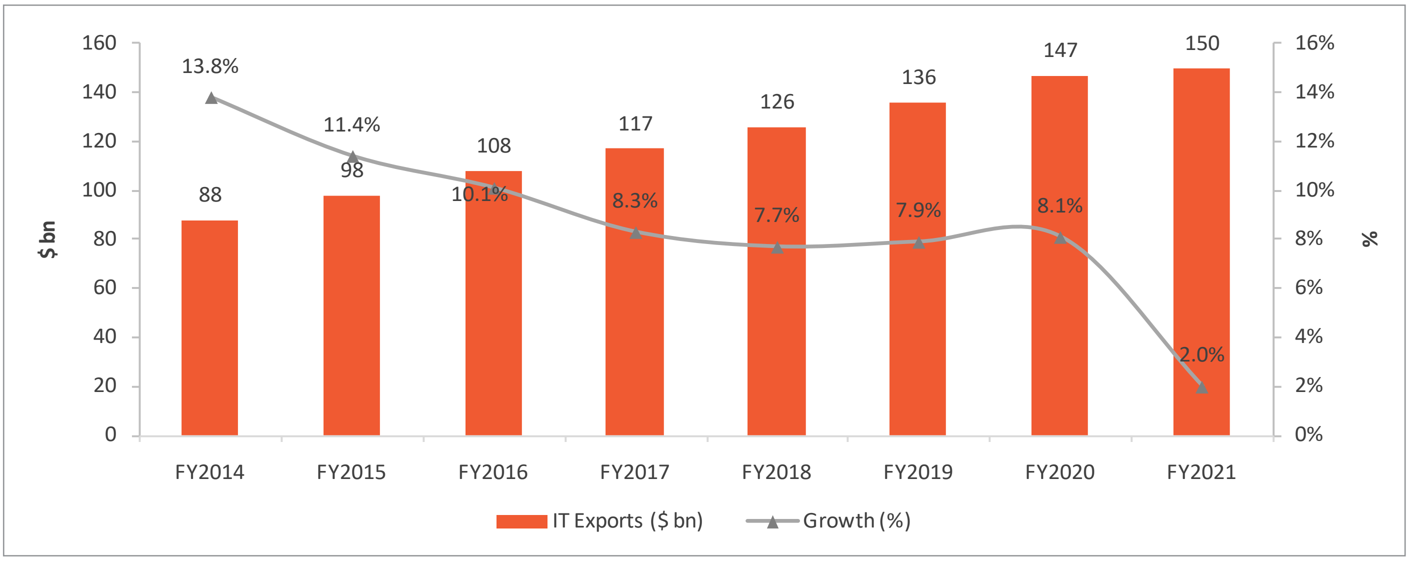
According to NASSCOM, the Indian IT industry reached a size of $194 billion in FY2021, a rise of 2.3% y-o-y. Exports from the Indian IT industry grew by 2.0% y-o-y to reach $150 billion in FY2021 and domestic revenue of the IT industry grew by 3.4% y-o-y to ~$45 billion. Growth is driven by increased demand for digital transformation and infrastructure modernisation. Digital revenue accounted for 28-30% of total industry revenue in FY2021, growing at a rapid pace. The Indian IT services industry is expected to touch $300 billion-350 billion in annual revenue in the next five years, led by higher demand in emerging technology areas such as cloud, artificial intelligence (AI), and cyber security.

Industry experts revised in IT services spending



Source: Gartner, Sharekhan Research

Indian IT industry export growth trajectory



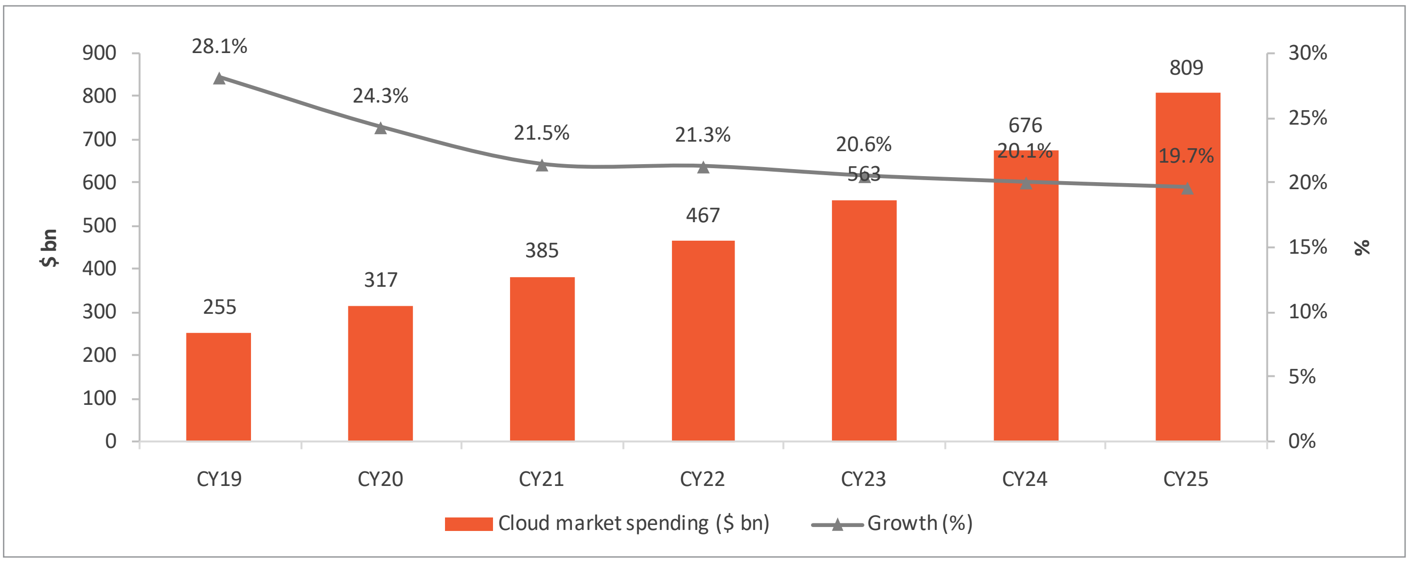
Source: Nasscom, Sharekhan Research

Differential between Indian IT exports and global outsourced IT services spending have gradually decreased and stood at around 0.5% in 2020. We believe the growth differential would accelerate in CY2021 because of higher offshoring and higher digital transformation initiatives. Further, large global enterprises would expand captive centres in India for higher access to talents.

Cloud technology remains the cornerstone of ongoing transformation

The pandemic precipitated structural changes across industries, given higher adoption of online digital channels. Hence, cloud and advanced analytics remain the prime focus areas of enterprises worldwide, as these technologies help in business scalability, reducing risk, increasing efficiencies, and improving customer experiences. Enterprises have sped up cloud investments by migrating workloads to public cloud and data modernisation. Public cloud adoption is in early stages as only 15-20% of workloads have moved to public cloud and it is expected that 60-70% of workloads would be shifted in 3-4 years. Total public cloud spending in 2020 was $317 billion, implied around 20% of total enterprise technology spending ($1.5 trillion). Given strong adaption of cloud post COVID-19 crisis, it is estimated that the spending on cloud-related technologies would grow at 21% over 2020-2025.

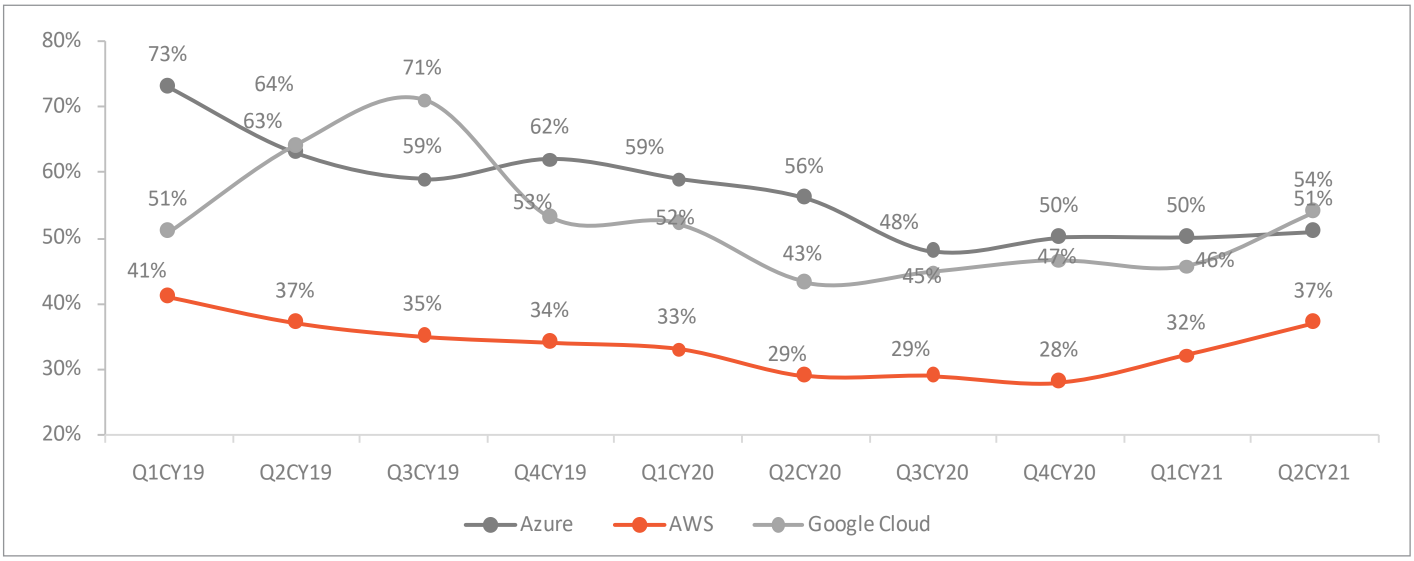
Cloud market spending is expected to grow at 21% over 2020-2025



Source: IDC; Sharekhan Research

Strong growth in revenue of cloud providers offers confidence for strong growth of Indian IT services companies. Higher spend on cloud would have an upside risk from data, analytics, and AI spend. During Q2CY2021, revenue growth for Amazon Web Services (AWS), Azure (Microsoft), and Google Cloud Platform (GCP, Alphabet) remained at 37% y-o-y, 51% y-o-y, and 54% y-o-y, respectively. This corroborates with the commentary of Indian IT companies that enterprises are investing more on cloud and digital transformation initiatives.

Could adoption continues to touch record-high

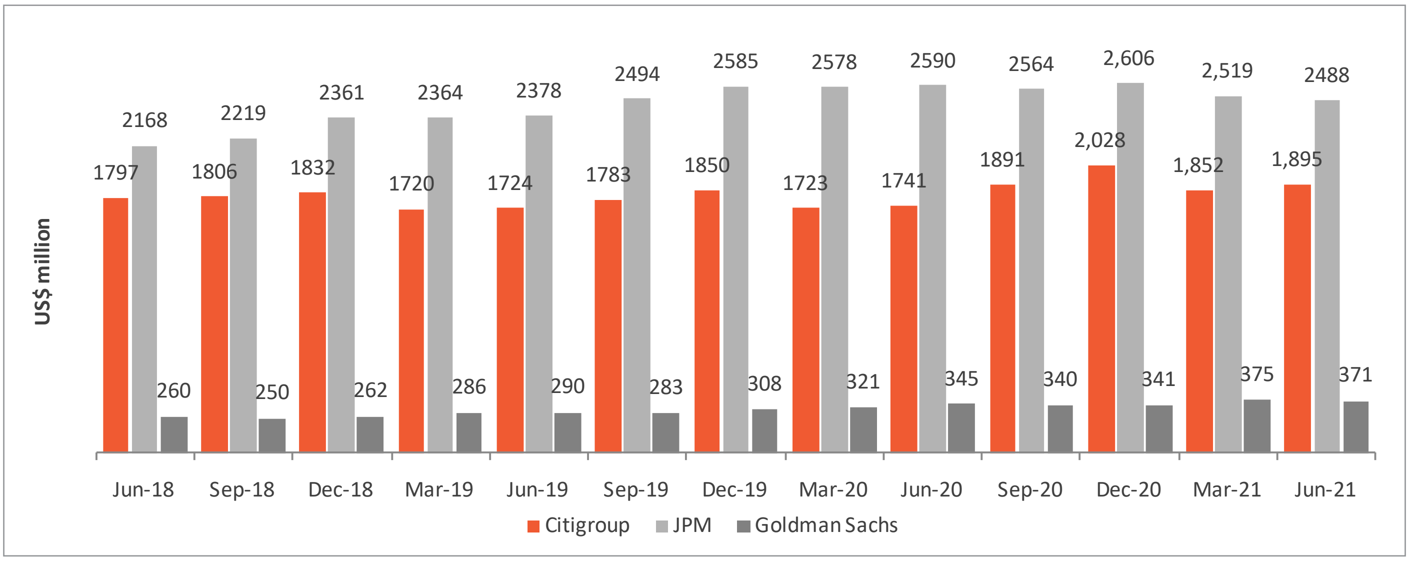


Source: Sharekhan Research

Expect strong BFS spending in CY2021; Capco's acquisition strengthens Wipro's position in BFS markets

Technology spends by major US and UK banks have accelerated after the pandemic. Adoption of online channels by end-users and rising competition from fintech companies accelerated the investments in digitalisation by BFS firms across developed markets. Banks are leveraging technology for both cost reduction, improving customer experience and gaining market shares. We believe tech spending among BFS firms would remain strong in the near-to-medium terms, given accelerated investments on IT modernisation, and cloud migration. We believe Indian IT services companies are well placed to participate in the transformation journey of global BFS firms.

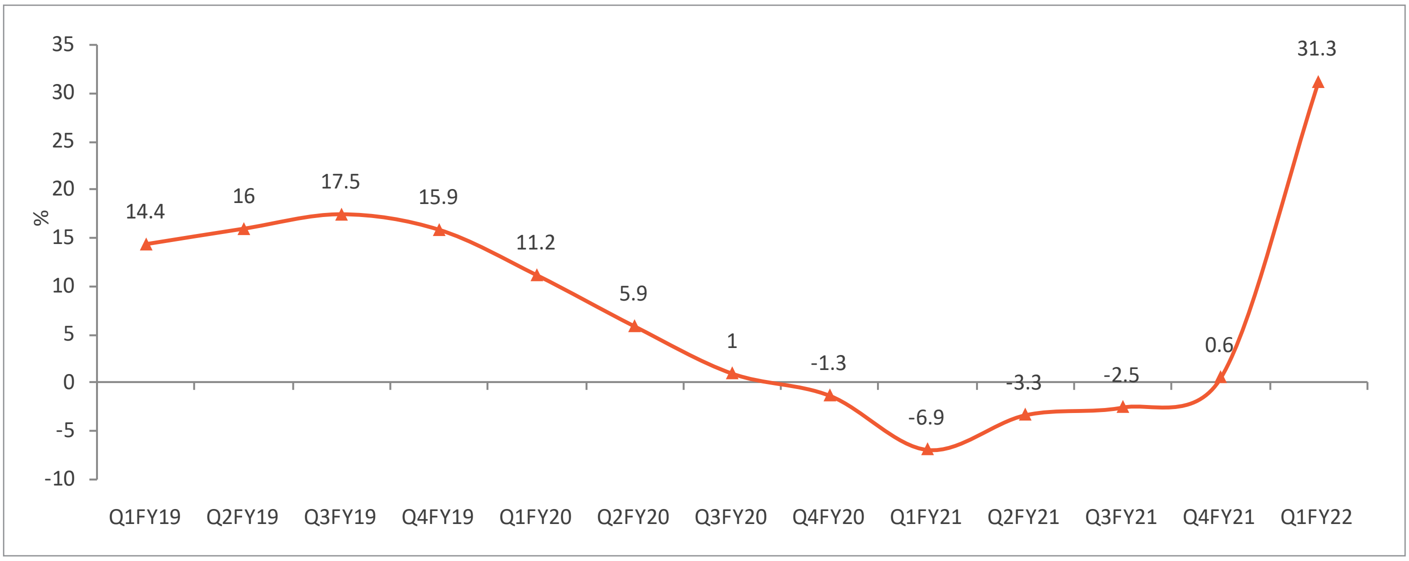
Technology spends by large US banks remained strong



Source: Sharekhan Research

Indian IT services companies reported strong sequential growth in their BFSI vertical during Q1FY2022. Wipro reported strong revenue growth of 22.4% q-o-q and 31.3% y-o-y in its BFSI vertical due to Capco's acquisition. The acquisition of Capco helped the company to strengthen its presence in the BFSI vertical, given enhancing capabilities, providing access to new large clients in the BFSI space and joint go-to-market strategies. Further, management indicated that the deal pipeline is shaping up well from the synergy benefits of Capco's acquisition. As Capco's integration is going well, we believe Wipro would continue to report strong growth in its BFSI vertical in the subsequent quarters due to a strong demand environment across all service offerings and higher cross-sell opportunities to the complementary client base in Capco.

Wipro' BFSI constant-currency revenue growth trend (% y-o-y)



Source: Sharekhan Research

Strong revenue growth momentum likely to stay

FY2021 was a transforming year for the company as it recruited an external CEO (Thierry Delaporte), shifted to a new operating model, and invested in senior talents across verticals and global account executive (GAE) model. Further, it announced Capco's acquisition to strengthen its presence in global financial markets. With better-than-expected growth performance in Q1FY2022, strong growth guidance for Q2FY2022, and improvement in the deal pipeline, it seems that Wipro is progressing well in its turnaround journey.

Management indicated that the demand environment remains strong. The company plans to hire 12,000 freshers in FY2022 (including 6,000 in Q2FY2022) and plans to on-board 22,000 freshers in FY2023, which indicates a strong underlying demand environment and anticipation of strong deal wins going ahead. On the vertical fronts, BFSI, consumer, and hi-tech would continue their growth momentum, while the healthcare vertical would bounce back strongly in Q2FY2022 due to deal closures. On strategic market units (SMUs) front, Wipro expects to maintain its revenue growth momentum in Europe, aided by strong deal wins, healthy deal pipeline, and strengthening leadership. Further, the company indicated pick-up in growth momentum in APMEA region due to improving demand environment and strong deal pipeline. Wipro's management remains confident of delivering strong revenue growth in FY2022 because of solid deal intake, healthy deal pipeline, strengthening leadership, and strong employee additions. Further, it aspires to achieve peer-matching growth on an organic basis beyond FY2022E.

Expect subcontracting cost to remain elevated

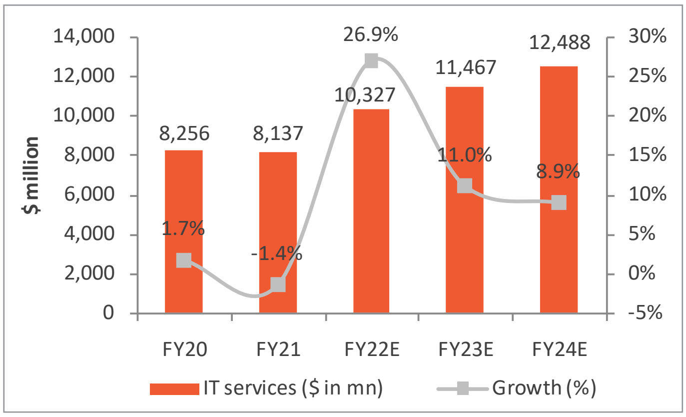
Though subcontracting costs as a percentage of total revenue have declined over the past few quarters, we expect subcontracting expenses to inch up in the coming quarters because of a strong demand environment, increasing attrition, and lower fresher hiring compared to large peers. The company has successfully brought down its subcontracting costs as a percentage of revenue to 13.4% in Q1FY2022 from 16.1%/15.3% in Q1FY2019/Q1FY2020. Given higher demand for new-gen and digital services, supply-side challenges and higher attrition, Wipro could use higher subcontractors to meet the client's requirements on time.

Margins likely to remain under pressure given multiple headwinds

Margins in the subsequent quarters would be impacted by roll-out of wage hike to mid and junior staff (effective from September 2021), full-quarter impact of salary revision of senior staff in Q2FY2022, investments in frontline capabilities, impact from full-quarter consolidation of Capco, decline in utilisation (86.8% in Q1FY2022), and skill-based premium. Further, Wipro's voluntary attrition rate inched up sharply by 340 bps q-o-q to 15.5% in Q1FY2022. However, the company expects to hire 6,000 freshers in Q2FY2022 and 12,000 freshers in FY2022, which are expected to mitigate margin pressure to some extent. Management also indicated that it would implement value-based pricing approach to ease some margin pressure. We expect margin headwinds to be partially offset by strong revenue growth, higher offshoring, and employee pyramid (fresher hiring). Wipro has maintained its EBIT margin guidance at 17-17.5% for FY2022.

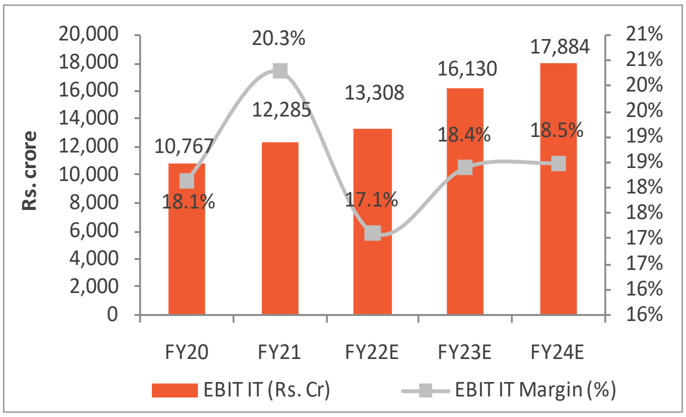
Financials in charts

IT revenue in US$ (million) and growth (%)



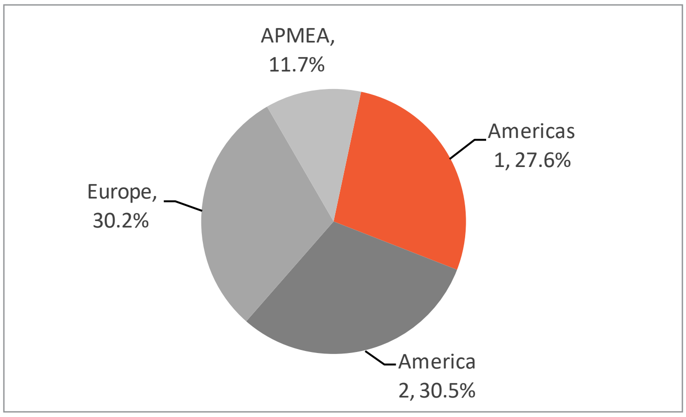
Source: Company, Sharekhan Research

IT EBIT (Rs. cr) and EBIT margin (%)



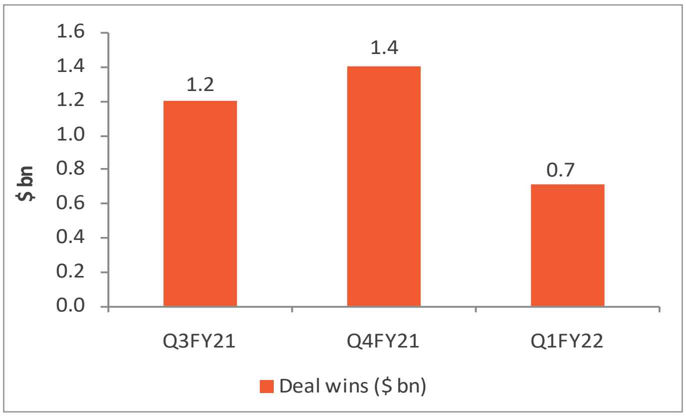
Source: Company, Sharekhan Research

Geograpghy break-up (%)



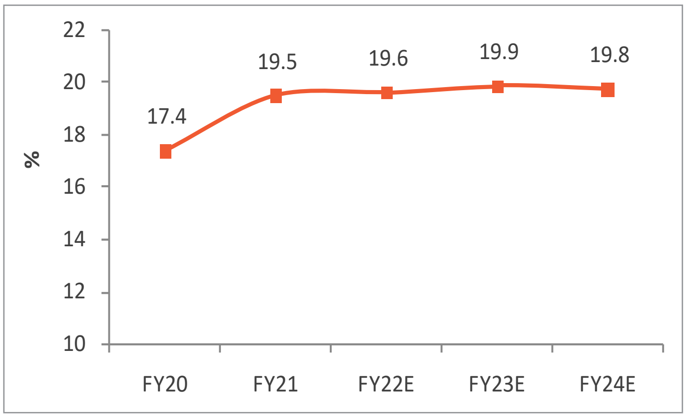
Source: Company, Sharekhan Research

TCV of deal wins ($ bn)



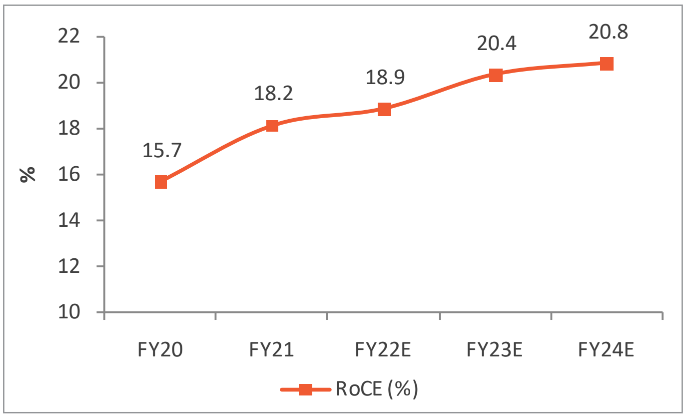
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Expect acceleration in technology spending going forward

The need for business continuity, operational resilience, and the switch to digital transactions have led to strong demand for cloud and digital technologies. Industry analysts such as Gartner estimate that IT services spending would grow by 7-9% over CY2021-CY2024E as compared to the average of 3.6% achieved over CY2010-CY2020. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals.

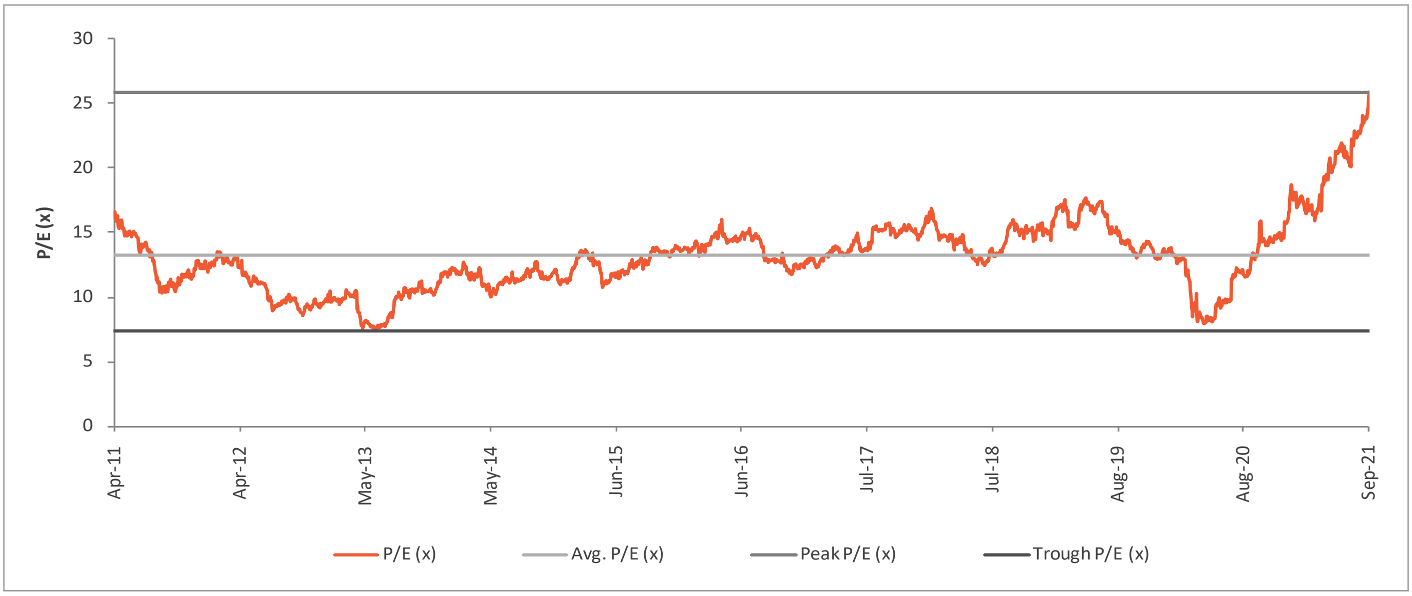
■ Company outlook - Expect to reduce the revenue growth gap with large peers

Wipro focuses on higher client mining, enhancing digital capabilities, blend of both external and internal talents, and large deal wins to drive its organic revenue growth. The recent acquisition of Capco would strengthen the company's position significantly in the global financial services market. Management remains optimistic on growth of the BFSI space as demand in this sector is strong across all service offerings.

■ Valuation - Stretched valuation, downgrade to Hold with a PT of Rs. 740

Though Wipro aspires to reach industry-leading growth rates by FY2023E, we expect Wipro's USD revenue to post a 9% CAGR organic growth over FY2022-FY2024E, which would still lag to peers. Further, there are limited margin levers to offset headwinds in the subsequent quarters. The stock price has run up around 23% over the past three months, factoring in strong progress in operating metrics, which provides limited upside from the current level. At the CMP, the stock is trading at 27x/24x its FY2023/FY2024 earnings estimates, which is at 78% premium to its five-year average. Hence, we have downgraded our rating on Wipro from Buy to Hold with a revised price target (PT) of Rs. 740.

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/EBITDA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Infosys	1,707	424	7,23,875	32.3	27.8	22.3	19.4	4.8	4.5	27.7	30.0
TCS	3,815	370	14,11,096	35.6	31.4	25.2	22.4	13.9	11.8	41.5	40.6
Wipro	674	548	3,69,442	30.5	27.0	20.5	18.0	6.5	5.8	18.9	20.4

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 research and development (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 2.1 lakh employees.

Investment theme

With the company's large-deal focus and customer-first approach, management hopes its growth trajectory would catch up with the industry's average growth rates. Wipro is expected to report strong revenue growth in the coming years, led by increasing deal wins, continued growth momentum in the BFSI, and higher adoption of digital transformation initiatives. We expect margin headwinds to be partially offset by strong revenue growth, higher offshoring revenue, WFH efficiencies, and focus on cost synergies after the acquisition.

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 US and Europe.

Additional Data

Key management personnel

Thierry Delaporte	Chief Executive Officer
Bhanumurthy B. M.	President and Chief Operating Officer
Jatin Dalal	Chief Financial Officer
Anand Padmanabhan	President, energy, utilities, and construction
Ankur Prakash	Senior Vice President, Communications

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp. of India	3.70
2	Black Rock Inc	1.03
3	Vanguard Group Inc	0.52
4	Axis Asset Management Co. Limited	0.51
5	SBI Funds Management Pvt. Limited	0.50
6	Government Pension Investment Fund	0.46
7	Dimensional Fund Advisors LP	0.34
8	Goldman Sachs Group Inc.	0.30
9	ICICI Prudential Asset Management	0.25
10	UTI Asset Management Co. Limited	0.20

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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