

15 October 2010

MF Global Quarterly Report

Infosys Technologies

| Firing on all cylinders...

IT SERVICES

INFO IN: **BUY**

RS 3076

Infosys' double digit revenue growth after three years came as a positive surprise. Infosys has upgraded its FY11 revenue guidance since last two quarters by ~US\$350m with revenue growth revision of ~750bp. We have revised our FY12 EPS by 3% to Rs153 due to expectations of better volume growth. Rupee remains the biggest downward risk to our estimates.

Revenues up 10.2%, guidance revised to 24-25%

- » Infosys' Q2FY11 US\$ revenues grew by 10.2% QoQ at US\$ 1496mn against our expectations of US\$ 1455mn and guidance of US\$ 1413-1427mn (4-5.1%). In constant currency, US\$ revenues grew by 9.3% QoQ.
- » Rupee revenues at Rs 69.5bn grew by 12.1% QoQ. The EBITDA margin was at 33.3% vs. 31.7% in 1QFY11. Profit after tax was at Rs 17.4bn, up by 17% QoQ.
- » Infosys has revised its FY11 US\$ revenue growth guidance from 19-21% to 24- 25%. FY11 expected EPS stands revised from Rs 112.2-Rs 116.7 to Rs 115.1- Rs 117.1.
- » For Q3FY11, Infosys expects US\$ revenues to grow at 3.4-4.4% QoQ. Q3FY11 EPS is expected at Rs 29.4-Rs 29.9.
- » Volumes were up by 7.2% QoQ and reported blended pricing was up by 3.2%. Constant currency pricing grew 2.5% QoQ.

Valuation: At the CMP of Rs3076, the stock trades at 20x FY12E EPS. We raise our target price to Rs3555 at 23x FY12 EPS on better demand visibility, increase in hiring target and large deal traction. Maintain Buy.

VALUATION SUMMARY

Y/E MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
NET SALES	166,920	216,930	227,420	278,989	346,405
GROWTH, %	20.1	30.0	4.8	22.7	24.2
EBIDTA	52,380	71,950	78,970	91,830	114,059
EBIDTA MARGINS, %	31.4	33.2	34.7	32.9	32.9
CORE EBIDTA	52,380	71,950	78,970	91,830	114,059
NET PROFIT	45,380	58,820	62,450	70,003	88,369
NET PROFIT MARGIN, %	27.2	27.1	27.5	25.1	25.5
EPS, RS	79.2	102.6	109.3	122.5	154.7
EPS GROWTH, %	20.2	29.6	6.6	12.1	26.2
PER, X	38.9	30.0	28.1	25.1	19.9
EV/EBIDTA, X	32.3	23.1	20.9	17.9	14.0
EV/NET SALES, X	10.1	7.7	7.3	5.9	4.6
PRICE/BOOK VALUE, X	12.8	9.7	7.6	7.0	5.6
ROE, %	36.2	36.7	30.2	29.0	31.2
DIVIDEND YIELD, %	1.1	0.8	0.8	2.3	1.3

Source: Company, MF Global India Research Estimates

TARGET RS 3555 (+16%)

SECTOR RATING

OW	N	UW

STOCK RATING

BUY	NEUTRAL	SELL
> 15%	-15% TO +15%	< -15%

COMPANY DATA

O/S SHARES :	574MN
MARKET CAP (RS) :	1766BN
MARKET CAP (USD) :	40BN
52 - WK HI/LO (RS) :	3249 / 2127
AVG. DAILY VOL. (3MTH) :	0.9MN
FACE VALUE (RS) :	5

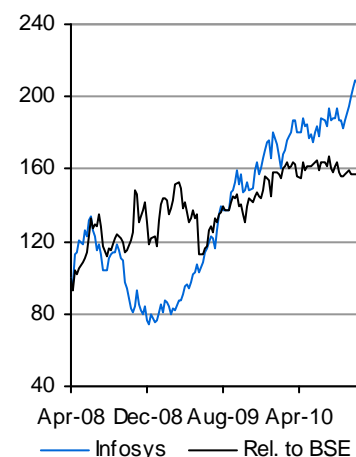
SHARE HOLDING PATTERN, %

PROMOTERS :	16.1
FII / NRI :	55.3
FI / MF :	8.2
NON-PROMOTER CORP. HOLDINGS :	6.0
PUBLIC & OTHERS :	14.5

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	0.9	11.5	38.8
REL TO BSE	-2.3	-0.9	21.8

PRICE VS. SENSEX



Source: Bloomberg, MF Global India Research

QUARTERLY RESULTS

RS MN	Q2FY11	Q1FY11	QOQ(%)	Q2FY10	YOY (%)
NET SALES	69,470	61,980	12.1%	55,850	24.4%
TOTAL INCOME	69,470	61,980		55,850	
OPERATING EXPENSES	46,340	42,360		34,160	
EBITDA	23,130	19,620	17.9%	21,690	6.6%
MARGINS (%)	33.3%	31.7%		38.8%	
DEPRECIATION	2,150	2,070		2,320	
EBIT	20,980	17,550	19.5%	19,370	8.3%
MARGINS (%)	30.2%	28.3%		34.7%	
PRE-TAX PROFIT	23,650	19,940	18.6%	19,370	22.1%
TAX PROVIDED	6,280	5,060		3,970	
PROFIT AFTER TAX	17,370	14,880	16.7%	15,400	12.8%
MF NET PROFIT	17,370	14,880	16.7%	15,400	12.8%
EPS, RS	30.4	26.1		26.9	

Source: Company, MF Global India Research

Record revenue growth, EBITDA margin up 160bp QoQ

Infosys' 2QFY11 US\$ revenues grew 10.2% QoQ at US\$1496m against our expectations of a 7.1% QoQ growth and guidance of US\$1413-1427m (4.1-5.1% QoQ growth). In constant currency, US\$ revenues grew by 9.3% QoQ. Rupee revenues at Rs69.5b grew by 12.1% QoQ. EBITDA margin stood at 33.3% vs 31.7% in 1QFY11, below estimates on higher onsite efforts. Profit after tax at Rs17.4b was up 16.7% QoQ. Volumes were up by 7.2% QoQ and reported blended pricing was up by 3.2%. Constant currency pricing grew by 2.5% QoQ.

FY11 revenue guidance revised to 24-25%, EPS revision muted due to rupee appreciation

Infosys revised its FY11 US\$ revenue guidance from US\$5.7-5.8b to US\$5.95-6b implying a revision in revenue growth rate from 19-21% to 24-25%. The rupee revenue growth revision was more muted from 16.2-18.2% to 18.5-19.4% owing to currency appreciation. The assumed INR/US\$ rate was revised by 4.3% from 46.5 to 44.5. In INR terms, EPS was revised from 112.2-116.7 to 115-117. US\$ revenue growth guidance has been revised by 700-800bp after it was initially given in 4QFY10. During the period, expected FY11 US\$ revenues have been raised by ~US\$350m. For 3QFY11 Infosys has guided for US\$ revenues growth at 3.4-4.4% QoQ. The implied 4QFY11 QoQ revenue growth comes to 0.1-1.4%. We believe that the 24-25% revenue growth assumption has room for further upward revision as seen by the muted revenue growth assumed in 4QFY11.

IMPLIED 4QFY11 GUIDANCE

	1QFY11	2QFY11	3QFY11	4QFY11	FY11
LOWER END					
US\$ REVENUE	1,358	1,496	1,547	1,549	5,950
QOQ GROWTH	4.8%	10.2%	3.4%	0.1%	24.0%
HIGHER END					
US\$ REVENUE	1,358	1,496	1,562	1,584	6,000
QOQ GROWTH	4.8%	10.2%	4.4%	1.4%	25.1%

Source: Company, MF Global India Research

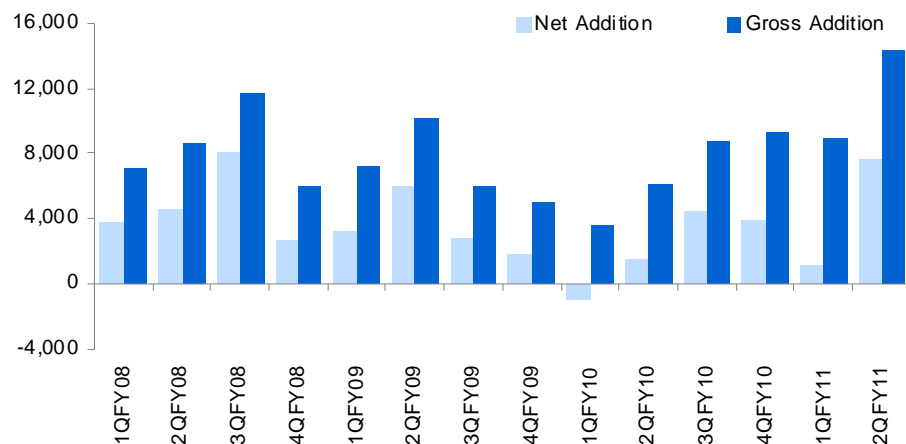
Margin expansion lower due to higher offshore efforts

Infosys' EBITDA margins expanded by 160bp QoQ to 33.3%, lower than our expectation of 33.9%. The margin expansion happened due to rupee appreciation, onsite pricing increase, utilization improvement and wage hikes given last quarter. However, margins were hurt on account of higher onsite revenue growth. The onsite-offshore effort mix tilted in favour of onsite by 160bp QoQ with onsite contributing 24.5% of the total billed efforts during the quarter. Despite hefty employee additions, utilization including trainees improved by 130bp QoQ to 74.3%. We believe that offshore leverage will prove to be a significant lever going forward while utilizations and exchange rates could hurt margins.

Hiring to be ahead of guidance, FY11 target raised to 40,000

Infosys has increased its headcount addition target for FY11 from 36,000 to 40,000. The management has indicated that they would create capacity ahead of their forecast while their outlook remains cautious in an uncertain environment. We believe that the management's inclination to hire ahead of their outlook indicates demand optimism. While it could also mean that utilizations could be under pressure if demand slows down, the management seems to be inclined towards erring on utilizations rather than growth expectations. Infosys has increased its headcount addition target for the second consecutive quarter. In 1QFY11, the company had revised its headcount addition target from 30,000 to 36,000. Over two quarters, this translates to 33% increase in headcount addition for FY11. The company added 14,264 employees on a gross basis and 7,646 employees on a net basis.

EMPLOYEE ADDITION



Gross headcount addition at 14264, FY11 hiring guidance revised to 40000

Source: Company, MF Global India Research

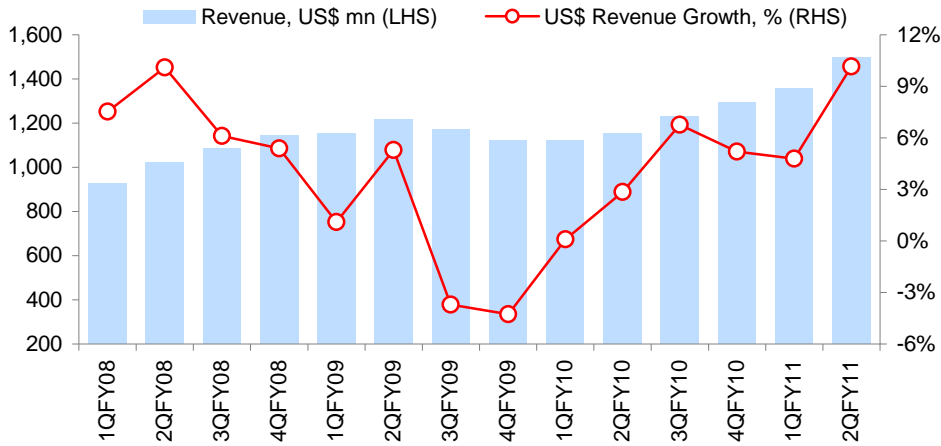
Broad based growth across services lines and verticals

Infosys saw revenue growth across service lines and verticals indicating broad basing of growth. Traction in BFSI as well as retail was particularly visible with QoQ growth rates at 8% and 20% respectively. Emerging service lines like System Integration, Engineering services, and Testing also saw double digit growth rates. In terms of geographical growth rates, Europe surprised positively with 16% constant currency growth on the back of muted growth in past few quarters.

Valuations

Infosys' double digit revenue growth after three years came as a positive surprise. Incremental revenues at US\$138m were the highest in the company's history. The company has upgraded its FY11 revenue since last two quarters by ~US\$350m with revenue growth being upgraded by ~750bp. Although the INR EPS guidance revision is muted in the current quarter, the EPS upgrade from 4QFY10 has been in line with the US\$ revenue upgrade since rupee has climbed back to earlier levels after a dip in 1QFY11. We have revised our FY12 EPS by 3% to Rs153 due to expectations of better volume growth. Our rupee assumption for FY11 and FY12 is at Rs45 and Rs44.5 respectively. We believe that rupee remains the biggest downward risk to our estimates. We raise our target price to Rs3,555 at 23x FY12 EPS (22x earlier) on better demand visibility, increase in hiring target and large deal traction. Maintain Buy.

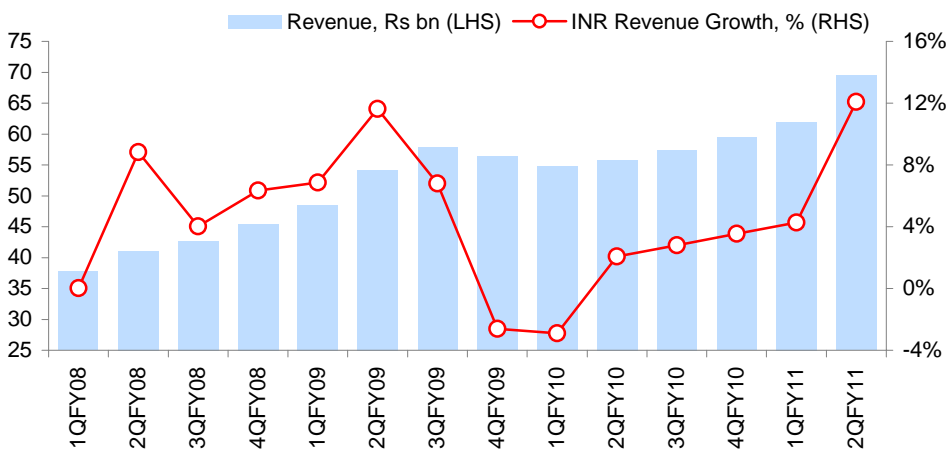
US\$ REVENUES AND QOQ GROWTH



US\$ revenue grew by 10.2% QoQ to US\$ 1496mn

Source: Company, MF Global India Research

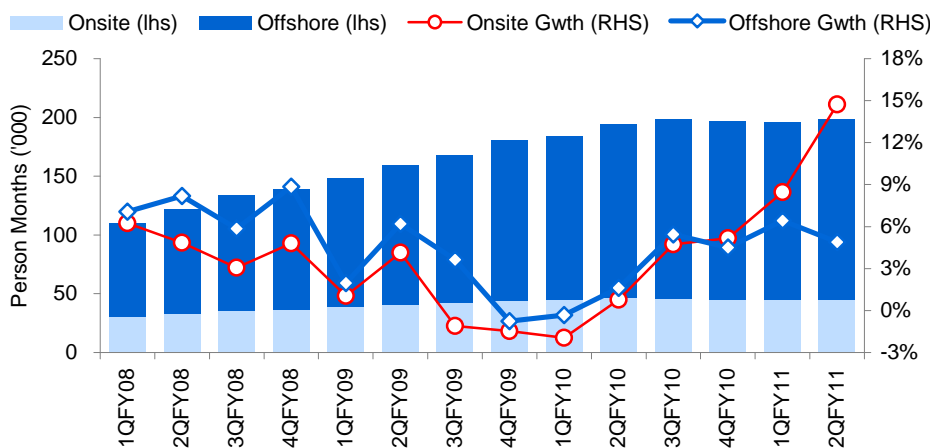
INR REVENUES AND QOQ GROWTH



INR revenues were up 12.1% QoQ to Rs 69.5bn

Source: Company, MF Global India Research

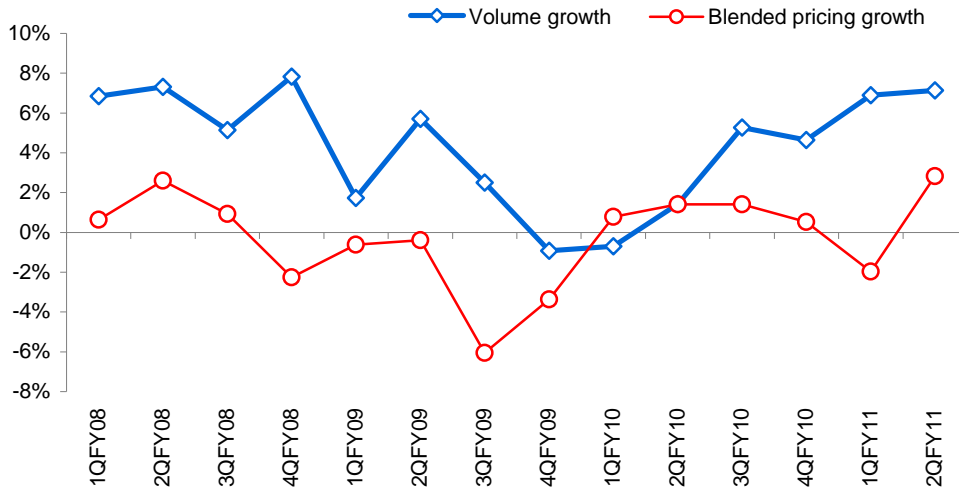
IT SERVICES VOLUMES



IT Services volumes were up 7.1% QoQ, onsite up by 14.7% while offshore grew by 4.9%.

Source: Company, MF Global India Research

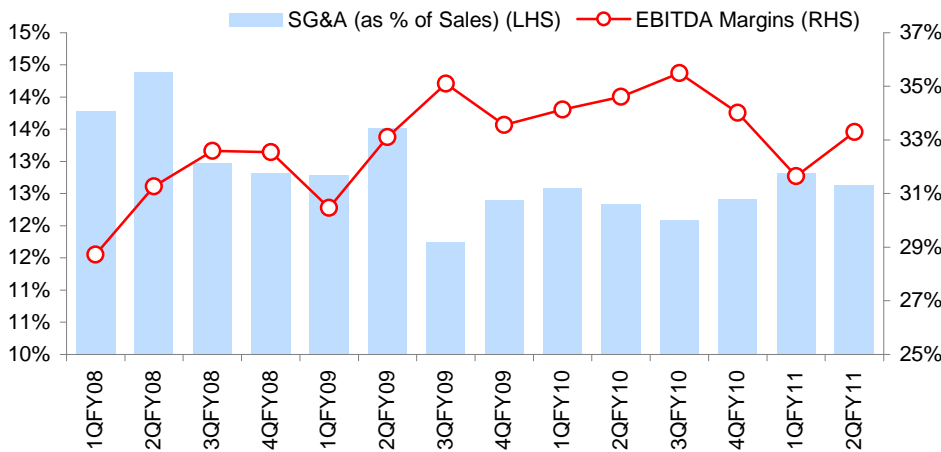
VOLUME AND PRICING GROWTH (REPORTED)



Volumes grew by 7.1% QoQ and reported pricing by 2.8% for IT services

Source: Company, MF Global India Research

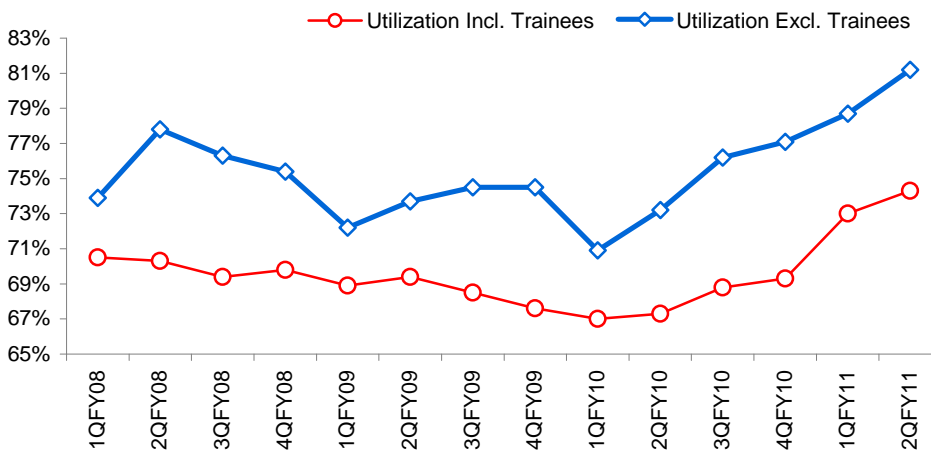
SG&A AND EBITDA MARGINS



EBITDA margin grew by 160bps QoQ to 33.3%.

Source: Company, MF Global India Research

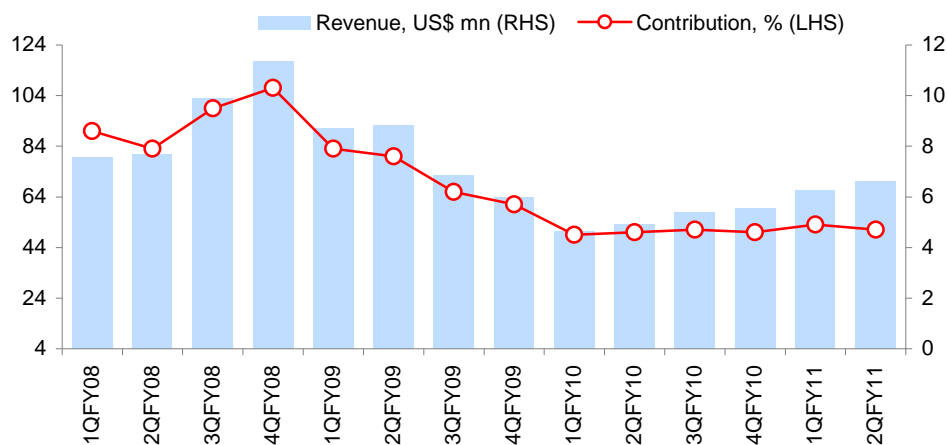
UTILIZATION



Utilisations climbed despite high employee addition on impressive volume growth

Source: Company, MF Global India Research

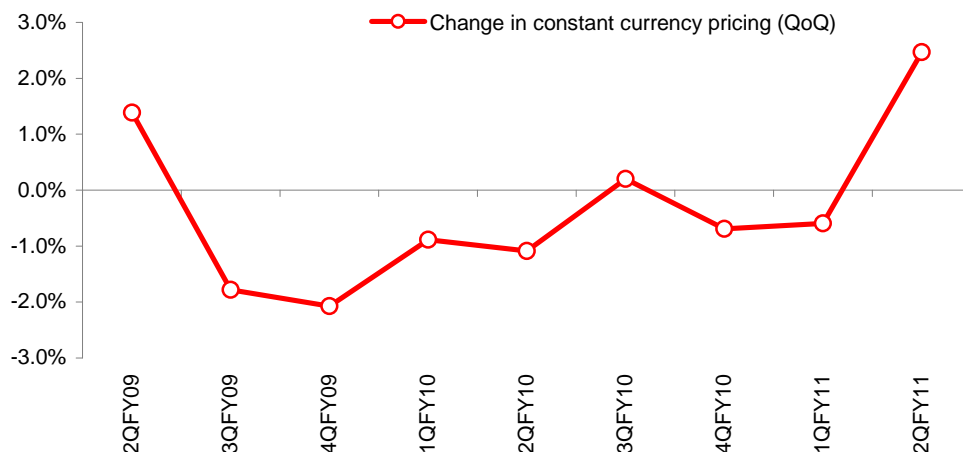
TOP CLIENT REVENUES



Revenues from top clients grew by 6% QoQ

Source: Company, MF Global India Research

QOQ CHANGE IN CONSTANT CURRENCY PRICING



Constant currency pricing grew by 2.5% on mix change

Source: Company, MF Global India Research

RECOMMENDATION HISTORY

RECOMMENDATION	TARGET, RS	CMP, RS	DATE
BUY	3555	3076	15 OCT 2010
BUY	3265	2781	9 JULY 2010

OPERATING METRICS

QOQ GROWTH	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11
VERTICALS						
BANKING AND FINANCIAL SERVICES	0%	4%	10%	6%	9%	8%
ENERGY & UTILITIES	-3%	6%	10%	0%	8%	16%
INSURANCE	-3%	7%	23%	-5%	14%	11%
MANUFACTURING	-1%	-3%	7%	10%	1%	7%
OTHERS	8%	7%	8%	9%	7%	17%
RETAILING	-2%	10%	-1%	4%	6%	20%
TELECOM	1%	-1%	7%	-1%	-3%	4%
TRANSPORTATION	0%	3%	-16%	5%	5%	10%
SERVICE LINES						
DEVELOPMENT	1%	-4%	5%	-1%	5%	2%
MAINTAINENCE	7%	1%	15%	-2%	10%	8%
INFRASTRUCTURE MANAGEMENT	-6%	22%	-3%	7%	0%	-1%
SYSTEM INTEGRATION	3%	19%	-1%	15%	-2%	50%
CONSULTING & PACKAGE IMPLEMENTATION	-4%	0%	5%	17%	0%	14%
TESTING	-1%	3%	12%	7%	16%	15%
ENGG SERVICES	-8%	-1%	11%	-21%	22%	31%
BUSINESS PROCESS MANAGEMENT	2%	5%	2%	11%	-4%	8%
OTHERS	-2%	13%	9%	-28%	15%	7%
PRODUCTS	0%	5%	2%	35%	-2%	-2%
GEOGRAPHY						
NORTH AMERICA	0%	5%	8%	4%	7%	8%
EUROPE	2%	-3%	1%	8%	-5%	18%
INDIA	-44%	37%	7%	23%	27%	36%
ROW	2%	3%	13%	2%	12%	6%
CLIENTS						
REVENUES FROM TOP CLIENT	-21%	5%	9%	3%	12%	6%
REVENUES FROM TOP 5 CLIENTS	-5%	4%	14%	-6%	2%	13%
REVENUES FROM TOP 10 CLIENTS	-4%	4%	12%	-1%	6%	13%
REVENUES FROM NON-TOP 10 CLIENTS	1%	2%	5%	8%	4%	9%
REVENUES FROM 2-5 CLIENT	3%	4%	16%	-9%	-2%	16%
REVENUES FROM 6-10 CLIENTS	-1%	5%	9%	6%	12%	12%

Source: Company, MF Global India Research Estimates

FINANCIALS

INCOME STATEMENT

Y/E MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
NET SALES	166,920	216,930	227,420	278,989	346,405
<i>GROWTH, %</i>	<i>20</i>	<i>30</i>	<i>5</i>	<i>23</i>	<i>24</i>
TOTAL INCOME	166,920	216,930	227,420	278,989	346,405
OPERATING EXPENSES	-114,540	-144,980	-148,450	-187,159	-232,346
EBITDA (CORE)	52,380	71,950	78,970	91,830	114,059
<i>GROWTH, %</i>	<i>19.3</i>	<i>37.4</i>	<i>9.8</i>	<i>16.3</i>	<i>24.2</i>
<i>MARGIN, %</i>	<i>31.4</i>	<i>33.2</i>	<i>34.7</i>	<i>32.9</i>	<i>32.9</i>
DEPRECIATION	-5,980	-7,610	-9,050	-8,760	-9,302
EBIT	46,400	64,340	69,920	83,070	104,757
<i>GROWTH, %</i>	<i>19.3</i>	<i>37.4</i>	<i>9.8</i>	<i>16.3</i>	<i>24.2</i>
<i>MARGIN, %</i>	<i>31.4</i>	<i>33.2</i>	<i>34.7</i>	<i>32.9</i>	<i>32.9</i>
OTHER NON-OPERATING INCOME	6,920	9,140	9,040	11,008	13,010
PRE-TAX PROFIT	53,440	69,090	79,260	93,928	117,825
TAX PROVIDED	-8,060	-10,270	-16,810	-23,925	-29,456
PROFIT AFTER TAX	45,380	58,820	62,450	70,003	88,369
NET PROFIT	45,380	58,820	62,450	70,003	88,369
MF NET PROFIT	45,380	58,820	62,450	70,003	88,369
<i>GROWTH, %</i>	<i>21.0</i>	<i>29.6</i>	<i>6.2</i>	<i>12.1</i>	<i>26.2</i>
NET PROFIT (ADJUSTED)	45,380	58,820	62,450	70,003	88,369
EXTRAORDINARY ITEMS: GAINS/(LOSSES)	1,210	1,080	480	0	0
UNADJ. SHARES (M)	572	572	571	571	571
WTD AVG SHARES (M)	573	573	571	571	571

CASH FLOW

Y/E MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
PRE-TAX PROFIT	53,440	69,090	79,260	93,928	117,825
DEPRECIATION	5,980	7,610	9,050	8,760	9,302
CHG IN WORKING CAPITAL	-3,770	-12,020	-1,470	-1,097	-4,068
TOTAL TAX PAID	-8,330	-10,340	-17,550	-24,785	-29,456
CASH FLOW FROM OPERATING ACTIVITIES	47,320	54,340	69,290	76,806	93,603
CAPITAL EXPENDITURE	-16,040	-13,380	-9,060	-9,370	-11,200
CHG IN INVESTMENTS	-470	720	-37,120	-15,610	0
CASH FLOW FROM INVESTING ACTIVITIES	-16,510	-12,660	-46,180	-24,980	-11,200
FREE CASH FLOW	30,810	41,680	23,110	51,826	82,403
EQUITY RAISED/(REPAID)	2,260	1,500	2,224	-255	0
DIVIDEND (INCL. TAX)	-22,240	-15,730	-16,724	-47,442	-26,728
CASH FLOW FROM FINANCING ACTIVITIES	-20,020	-14,230	-14,500	-47,697	-26,728
NET CHG IN CASH	10,790	27,450	8,610	4,129	55,676

BALANCE SHEET

AS AT 31ST MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
CASH & BANK	69,500	96,950	105,560	109,689	165,365
DEBTORS	32,970	36,720	34,940	41,899	52,023
LOANS & ADVANCES	27,710	32,790	41,870	40,447	48,738
TOTAL CURRENT ASSETS	130,180	166,460	182,370	192,035	266,126
INVESTMENTS	720	0	37,120	52,730	52,730
GROSS FIXED ASSETS	54,390	70,930	78,390	91,750	102,950
LESS: DEPRECIATION	-19,860	-24,160	-28,930	-41,680	-50,982
ADD: CAPITAL WIP	13,240	6,770	4,090	4,090	4,090
NET FIXED ASSETS	47,770	53,540	53,550	54,160	56,058
TOTAL ASSETS	179,860	221,260	275,040	301,785	377,773
CURRENT LIABILITIES	19,120	20,040	23,430	30,944	38,416
PROVISIONS	22,790	18,680	21,120	18,045	24,920
TOTAL CURRENT LIABILITIES	41,910	38,720	44,550	48,989	63,337
TOTAL LIABILITIES	41,910	38,720	44,550	48,989	63,337
PAID-UP CAPITAL	2,860	2,860	2,860	2,860	2,860
RESERVES & SURPLUS	135,090	179,680	227,630	249,935	311,577
SHAREHOLDERS' EQUITY	137,950	182,540	230,490	252,795	314,437
TOTAL EQUITY & LIABILITIES	179,860	221,260	275,040	301,785	377,773

PER-SHARE DATA

	FY2008	FY2009	FY2010	FY2011E	FY2012E
MF EPS (INR)	79.2	102.6	109.3	122.5	154.7
GROWTH, %	20.2	29.6	6.6	12.1	26.2
BOOK NAV/SHARE (INR)	240.6	318.3	403.5	442.5	550.3
FDEPS (INR)	79.2	102.6	109.3	122.5	154.7
CEPS (INR)	89.6	115.8	125.2	137.9	170.9
CFPS (INR)	70.5	78.8	105.5	115.2	141.1
DPS (INR)	33.2	23.5	25.0	71.0	40.0

FINANCIAL STRUCTURE

	FY2008	FY2009	FY2010	FY2011E	FY2012E
TOTAL DEBT/EQUITY (%)	-	-	-	-	-
NET DEBT/EQUITY (%)	(50.4)	(53.1)	(45.8)	(43.4)	(52.6)

PROFITABILITY, PRODUCTIVITY, LIQUIDITY AND VALUATION RATIOS

	FY2008	FY2009	FY2010	FY2011E	FY2012E
RETURN ON ASSETS (%)	28.9	29.3	25.2	24.3	26.0
RETURN ON EQUITY (%)	36.2	36.7	30.2	29.0	31.2
RETURN ON INVESTED CAPITAL (%)	59.8	63.7	59.3	64.4	76.4
ROIC/COST OF CAPITAL (X)	7.6	8.1	7.5	8.1	9.7
ROIC - COST OF CAPITAL (%)	51.9	55.8	51.4	56.5	68.5
RETURN ON CAPITAL EMPLOYED (%)	32.4	32.5	27.6	26.8	29.0
COST OF CAPITAL (%)	7.9	7.9	7.9	7.9	7.9
ROCE - COST OF CAPITAL (%)	24.5	24.6	19.7	18.9	21.1
ASSET TURNOVER (X)	2.2	2.3	2.2	2.6	3.1
SALES/TOTAL ASSETS (X)	1.1	1.1	0.9	1.0	1.0
SALES/NET FA (X)	3.9	4.3	4.2	5.2	6.3
WORKING CAPITAL/SALES (X)	0.2	0.2	0.2	0.2	0.2
FIXED CAPITAL/SALES (X)	-	-	-	-	-
RECEIVABLE DAYS	72.1	61.8	56.1	54.8	54.8
INVENTORY DAYS	-	-	-	-	-
PAYABLE DAYS	60.9	50.5	57.6	60.3	60.3
CURRENT RATIO (X)	6.8	8.3	7.8	6.2	6.9
QUICK RATIO (X)	6.8	8.3	7.8	6.2	6.9
INTEREST COVER (X)					
DIVIDEND COVER (X)	2.4	4.4	4.4	1.7	3.9
PER (X)	38.9	30.0	28.1	25.1	19.9
PEG (X) - Y-O-Y GROWTH	1.9	1.0	4.3	2.1	0.8
PRICE/BOOK (X)	12.8	9.7	7.6	7.0	5.6
YIELD (%)	1.1	0.8	0.8	2.3	1.3
EV/NET SALES (X)	10.1	7.7	7.3	5.9	4.6
EV/EBITDA (X)	32.3	23.1	20.9	17.9	14.0
EV/EBIT (X)	32.3	23.1	20.9	17.9	14.0
EV/NOPLAT (X)	38.1	27.0	26.5	24.3	18.8
EV/CE	10.5	8.3	6.6	6.1	4.7
EV/IC (X)	22.7	17.3	15.7	15.5	14.2

Source: Company, MF Global India Research Estimates

VINEET BHATNAGAR	MANAGING DIRECTOR	91-22-2300 2999	VBHATNAGAR@MFGLOBAL.COM
SAJID KHALID	HEAD – INSTITUTIONAL EQUITIES	91-22-6667 9972	SAKHALID@MFGLOBAL.COM
JIGNESH SHAH	HEAD – EQUITY DERIVATIVES	91-22-6667 9735	JSHAH@MFGLOBAL.COM

Equity Research

AMBRISH MISHRA	VP - AUTOMOBILES, AUTO COMPONENT	91-22-6667 9758	AMISHRA@MFGLOBAL.COM
MANISH AGARWALLA	VP - BANKING	91-22-6667 9962	MAGARWALLA@MFGLOBAL.COM
ABHISHEK RANGANATHAN, CFA	RETAIL, REAL ESTATE	91-22-6667 9952	ABHISHEKR@MFGLOBAL.COM
ALOK DALAL	PHARMACEUTICALS	91-22-6667 9950	ALDALAL@MFGLOBAL.COM
ANJALI VERMA	ECONOMIST	91-22-6667 9969	ANVERMA@MFGLOBAL.COM
DHAWAL DOSHI	METALS, POWER	91-22-6667 9769	DDOSHI@MFGLOBAL.COM
DIPESH SOHANI	REAL ESTATE	91-22-6667 9756	DSOHANI@MFGLOBAL.COM
GAURI ANAND	OIL & GAS, FERTILISER	91-22-6667 9943	GANAND@MFGLOBAL.COM
KAPIL BAGARIA	MIDCAP, SUGAR	91-22-6667 9965	KBAGARIA@MFGLOBAL.COM
NAVEEN KULKARNI, FRM	TELECOM, FMCG, MEDIA	91-22-6667 9947	NKULKARNI@MFGLOBAL.COM
VIHANG NAIK	IT SERVICES & MIDCAPS	91-22-6667 9768	VNAIK@MFGLOBAL.COM
ENNETTE FERNANDES	RESEARCH ASSOCIATE	91-22-6667 9764	EFERNANDES@MFGLOBAL.COM
JISHAR THOOMBATH	RESEARCH ASSOCIATE	91-22-6667 9986	JTHOOMBATH@MFGLOBAL.COM
NEHA GARG	RESEARCH ASSOCIATE	91-22-6667 9992	NGARG@MFGLOBAL.COM
SAPNA SHAH	RESEARCH ASSOCIATE	91-22-6667 9996	SAPSHAH@MFGLOBAL.COM
SAURABH RATHI	RESEARCH ASSOCIATE	91-22-6667 9951	SRATHI@MFGLOBAL.COM
SHUBHANGI AGRAWAL	RESEARCH ASSOCIATE	91-22-6667 9964	SAGRAWAL@MFGLOBAL.COM
VARUN VIJAYAN	RESEARCH ASSOCIATE	91-22-6667 9974	VVIJAYAN@MFGLOBAL.COM
GANESH DEORUKHKAR	PRODUCTION	91-22-6667 9966	GDEORUKHKAR@MFGLOBAL.COM
ROSHNI KALLOOR	RESEARCH COMPLIANCE OFFICER	91-22-6667 9762	RKALLOOR@MFGLOBAL.COM

Technical & Quant Research

NEPPOLIAN PILLAI	CHIEF TECHNICAL STRATEGIST	91-22-6667 9989	PNEPPOLIAN@MFGLOBAL.COM
SHIKHA KHURANA	QUANT ANALYST	91-22-6667 9948	SKHURANA@MFGLOBAL.COM

Institutional Cash Equity Sales

SUDHIR PADDIYAR	VP - EQUITY SALES (ASIAPAC)	91-22-6667 9991	SPADIYAR@MFGLOBAL.COM
KARTIK BROKER	EQUITY SALES	91-22-6667 9934	KBROKER@MFGLOBAL.COM
KINSHUK TIWARI	EQUITY SALES	91-22-6667 9946	KTIWARI@MFGLOBAL.COM
NASIR MOHAMED	EQUITY SALES (UAE)	91-22-6667 9973	NMOHAMED@MFGLOBAL.COM
SHEETAL GANDHI	EQUITY SALES (US)	91-22-6667 9944	SGANDHI@MFGLOBAL.COM
PAYAL PANCHAL	ASSOCIATE SALES (DMA)	91-22-6667 9949	PPANCHAL@MFGLOBAL.COM
ROSIE FERNS	SR. EXEC. – EQUITIES SALES SUPPORT	91-22-6667 9971	RFERNS@MFGLOBAL.COM

Institutional Cash Equity Sales Trading

SUNIL KAMATH	VP - SALES TRADER	91-22-6667 9747	SKAMATH@MFGLOBAL.COM
CHETAN SAVLA	SALES TRADER	91-22-6667 9749	CSAVLA@MFGLOBAL.COM
RAJESH ASHAR	SALES TRADER	91-22-6667 9746	RASHAR@MFGLOBAL.COM

Institutional Cash Equity Dealing

CHETAN BABARIA	DEALER	91-22-6667 9945	CBABARIA@MFGLOBAL.COM
MAYUR SHAH	DEALER	91-22-6677 9945	M SHAH@MFGLOBAL.COM

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MF Global Sify Securities India Pvt. Limited, 2nd Floor, C-Block, Modern Centre, Mahalaxmi, Mumbai-400 011

**MF Global Sify Securities
India Pvt. Limited**
2nd Floor, C-Block, Modern Centre
Mahalaxmi, Mumbai
400 011

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