

## COMPANY UPDATE

# Patni Computer Systems Ltd. (PTNI.BO)

Sell

Equity Research

## iGATE to acquire majority stake in Patni for \$1.2bn; maintain Sell

### What's changed

iGATE (IGTE) has announced that it has entered into definitive agreement with the promoters of Patni and General Atlantic (PE firm) to acquire their 45.6%/17.4% stakes, respectively, at Rs503.50 per share (9.4% premium to Jan 7 close), amounting to a total consideration of US\$921mn. iGATE will also make an open offer to the public shareholders for 20% stake in Patni at Rs503.50. iGATE expects the transaction to be completed in 1H2011.

### Implications

Proposed deal values Patni at \$1.45bn (2.05X CY10E P/S, 11.5X CY10E P/E) and the cost of acquisition stands at \$1.2bn. Takeaways: (1) Combined entity would have 24k+ employees and revenues close to \$1bn, making it a stronger Tier II player; (2) iGATE's exposure to BFS and media verticals should compliment Patni in filling Patni's portfolio gaps; (3) No major overlap of customers (only GE), would provide an opportunity to cross-sell services to a broader client base, likely reducing the risk of client attrition. (4) No non-compete fees paid to the promoters, which values Patni at Rs503.50 per share (including the control premium); (5) Employees have not been given any accelerated stocks or retention offers, which may lead to even higher attrition in the near term (26% in 3QCY10); (6) Integration of businesses and planning joint go-to-market strategies may take 3-4 months; (7) Final structure of the combined entity has not been finalized. Both Patni/iGATE said it may result in a reverse merger of iGATE into Patni or delisting of one of the entities, with a preference for US listing. However, Patni will remain listed at least until 1H2011.

### Valuation

We reiterate our Sell rating on Patni with a 12-month Director's Cut-based TP of Rs391 (US\$17.0 on ADR), implying 16% potential downside. Stock is currently trading at 11.8X P/E on CY11E EPS of Rs39.04, in line with its 6-yr historical average.

### Key risks

Inorganic growth to fill portfolio gaps, turnaround post the deal.

### INVESTMENT LIST MEMBERSHIP

Asia Pacific Sell List

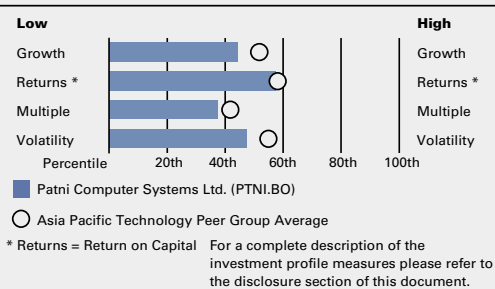
Coverage View: **Neutral**

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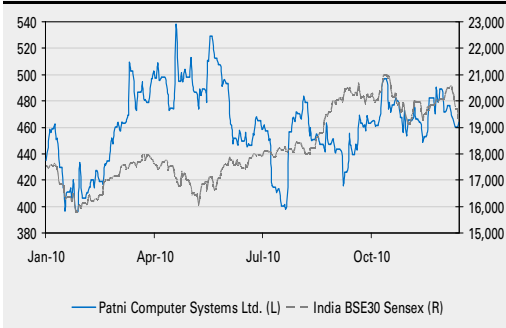
### Investment Profile



Key data	Current
Price (Rs)	463.85
12 month price target (Rs)	391.00
Market cap (Rs mn / US\$ mn)	60,250.2 / 1,327.5
Foreign ownership (%)	30.5

	12/09	12/10E	12/11E	12/12E
EPS (Rs)	45.45	42.71	39.04	42.34
EPS growth (%)	38.6	(6.0)	(8.6)	8.4
EPS (diluted) (Rs)	45.45	42.71	39.04	42.34
EPS (basic pre-ex) (Rs)	46.26	44.03	40.07	43.46
P/E (X)	10.2	10.9	11.9	11.0
P/B (X)	1.7	1.9	1.7	1.5
EV/EBITDA (X)	4.8	8.8	7.7	6.7
Dividend yield (%)	0.8	15.9	0.8	0.8
ROE (%)	18.6	17.0	15.4	14.5
CROCI (%)	18.5	19.5	18.1	17.4

### Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	5.6	3.9	6.6
Rel. to India BSE30 Sensex	11.2	(3.6)	(2.8)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 1/10/2011 close.

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# Patni Computer Systems Ltd.: Summary Financials

Profit model (Rs mn)	12/09	12/10E	12/11E	12/12E	Balance sheet (Rs mn)	12/09	12/10E	12/11E	12/12E
<b>Total revenue</b>	<b>31,461.5</b>	<b>32,126.8</b>	<b>36,106.1</b>	<b>41,196.2</b>	Cash & equivalents	2,952.6	4,460.4	4,185.2	4,111.1
Cost of goods sold	(18,357.3)	(18,965.0)	(21,255.6)	(24,198.9)	Accounts receivable	5,089.7	5,385.0	6,012.0	7,075.9
SG&A	(6,913.0)	(6,835.8)	(7,578.7)	(8,602.5)	Inventory	0.0	0.0	0.0	0.0
R&D	--	--	--	--	Other current assets	3,479.6	3,532.6	3,790.6	4,294.4
Other operating profit/(expense)	0.0	0.0	0.0	0.0	<b>Total current assets</b>	<b>11,521.9</b>	<b>13,378.0</b>	<b>13,987.9</b>	<b>15,481.4</b>
ESO expense	--	--	--	--	Net PP&E	7,731.4	8,163.9	9,357.7	10,719.7
<b>EBITDA</b>	<b>6,191.1</b>	<b>6,326.0</b>	<b>7,271.8</b>	<b>8,394.7</b>	Net intangibles	5,303.0	4,941.4	4,535.1	4,071.4
Depreciation & amortization	(1,420.8)	(1,214.2)	(1,378.9)	(1,573.3)	Total investments	17,751.9	12,251.9	16,251.9	20,251.9
<b>EBIT</b>	<b>4,770.3</b>	<b>5,111.8</b>	<b>5,892.8</b>	<b>6,821.4</b>	Other long-term assets	893.3	893.3	893.3	893.3
Interest income	173.2	177.2	267.6	251.1	<b>Total assets</b>	<b>43,201.6</b>	<b>39,628.6</b>	<b>45,025.9</b>	<b>51,417.8</b>
Interest expense	(9.8)	(0.7)	(0.7)	(0.7)	Accounts payable	282.9	349.2	448.5	590.4
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Short-term debt	0.0	0.0	0.0	0.0
Others	1,121.0	1,600.0	900.0	800.0	Other current liabilities	7,333.2	7,588.0	8,117.5	9,157.7
<b>Pretax profits</b>	<b>6,054.8</b>	<b>6,888.3</b>	<b>7,059.8</b>	<b>7,871.8</b>	<b>Total current liabilities</b>	<b>7,616.2</b>	<b>7,937.2</b>	<b>8,566.0</b>	<b>9,748.0</b>
Income tax	(121.2)	(1,168.8)	(1,833.5)	(2,204.1)	Long-term debt	9.4	9.4	9.4	9.4
Minorities	0.0	0.2	0.3	0.3	Other long-term liabilities	66.6	66.6	66.6	66.6
<b>Net income pre-preferred dividends</b>	<b>5,933.6</b>	<b>5,719.7</b>	<b>5,226.6</b>	<b>5,668.0</b>	Total long-term liabilities	76.0	76.0	76.0	76.0
Preferred dividends	0.0	0.0	0.0	0.0	<b>Total liabilities</b>	<b>7,692.2</b>	<b>8,013.3</b>	<b>8,642.0</b>	<b>9,824.1</b>
<b>Net income (pre-exceptionals)</b>	<b>5,933.6</b>	<b>5,719.7</b>	<b>5,226.6</b>	<b>5,668.0</b>	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Post-tax exceptionals	0.0	0.0	0.0	0.0	<b>Total common equity</b>	<b>35,509.4</b>	<b>31,615.3</b>	<b>36,383.8</b>	<b>41,593.7</b>
<b>Net income</b>	<b>5,933.6</b>	<b>5,719.7</b>	<b>5,226.6</b>	<b>5,668.0</b>	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, pre-exception) (Rs)	46.26	44.03	40.07	43.46	<b>Total liabilities &amp; equity</b>	<b>43,201.6</b>	<b>39,628.6</b>	<b>45,025.9</b>	<b>51,417.8</b>
EPS (basic, post-exception) (Rs)	46.26	44.03	40.07	43.46	<b>BVPS (Rs)</b>	<b>275.00</b>	<b>242.40</b>	<b>278.96</b>	<b>318.91</b>
EPS (diluted, post-exception) (Rs)	45.45	42.71	39.04	42.34					
<b>EPS excl. ESO expense (basic) (Rs)</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>					
<b>EPS excl. ESO expense (dil.) (Rs)</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>					
DPS (Rs)	3.51	73.71	3.51	3.51					
Dividend payout ratio (%)	7.6	167.4	8.8	8.1					
Free cash flow yield (%)	18.8	9.6	7.2	7.5					
<b>Growth &amp; margins (%)</b>	<b>12/09</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>	<b>Ratios</b>	<b>12/09</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Sales growth	0.9	2.1	12.4	14.1	CROCI (%)	18.5	19.5	18.1	17.4
EBITDA growth	31.7	2.2	15.0	15.4	ROE (%)	18.6	17.0	15.4	14.5
EBIT growth	34.0	7.2	15.3	15.8	ROA (%)	14.5	13.8	12.3	11.8
Net income growth	33.3	(3.6)	(8.6)	8.4	ROACE (%)	19.9	18.7	16.9	15.7
EPS growth	40.9	(4.8)	(9.0)	8.4	Inventory days	NM	NM	NM	NM
Gross margin	41.7	41.0	41.1	41.3	Receivables days	61.1	59.5	57.6	58.0
EBITDA margin	19.7	19.7	20.1	20.4	Payable days	7.1	6.1	6.8	7.8
EBIT margin	15.2	15.9	16.3	16.6	Net debt/equity (%)	(8.3)	(14.1)	(11.5)	(9.9)
					Interest cover - EBIT (X)	NM	NM	NM	NM
<b>Cash flow statement (Rs mn)</b>	<b>12/09</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>	<b>Valuation</b>	<b>12/09</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Net income pre-preferred dividends	5,933.6	5,719.7	5,226.6	5,668.0	P/E (analyst) (X)	10.2	10.9	11.9	11.0
D&A add-back	1,420.8	1,214.2	1,378.9	1,573.3	P/B (X)	1.7	1.9	1.7	1.5
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	4.8	8.8	7.7	6.7
Net (inc)/dec working capital	208.4	(229.0)	(527.8)	(921.9)	EV/GCI (X)	0.8	1.7	1.4	1.2
Other operating cash flow	(918.2)	201.8	271.5	536.3	Dividend yield (%)	0.8	15.9	0.8	0.8
<b>Cash flow from operations</b>	<b>6,644.6</b>	<b>6,906.5</b>	<b>6,349.0</b>	<b>6,855.4</b>					
Capital expenditures	(731.5)	(1,285.1)	(2,166.4)	(2,471.8)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	169.2	0.0	0.0	0.0					
Others	(5,980.6)	5,500.0	(4,000.0)	(4,000.0)					
<b>Cash flow from investments</b>	<b>(6,542.9)</b>	<b>4,214.9</b>	<b>(6,166.4)</b>	<b>(6,471.8)</b>					
Dividends paid (common & pref)	(453.2)	(9,613.6)	(457.8)	(457.8)					
Inc/(dec) in debt	(8.1)	0.0	0.0	0.0					
Common stock issuance (repurchase)	191.3	0.0	0.0	0.0					
Other financing cash flows	189.3	0.0	0.0	0.0					
<b>Cash flow from financing</b>	<b>(80.8)</b>	<b>(9,613.6)</b>	<b>(457.8)</b>	<b>(457.8)</b>					
<b>Total cash flow</b>	<b>20.9</b>	<b>1,507.8</b>	<b>(275.2)</b>	<b>(74.2)</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

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**Exhibit 1: iGATE + Patni = \$1bn revenues + 25k employees  
(last 12 months)**

<b>(US\$ mn)</b>	<b>Patni</b>	<b>iGATE</b>	<b>Combined</b>
<b>Revenues</b>	689	252	941
<b>EBIT</b>	133	45	178
<i>EBIT margin</i>	19%	18%	19%
<b>Net Income</b>	134	46	180
<b>Cash &amp; Equivalents</b>	318	121	439
<b>Employees</b>	16,556	8,278	24,834
<b>Customers</b>	282	82	364
<b>Global Delivery Centres</b>	22	7	29
<b>Locations</b>	30	16	46
<b>Geography (%)</b>			
US	80%	86%	82%
EU	14%	8%	13%
RoW	6%	6%	6%
<b>Verticals (%)</b>			
BFSI	43%	61%	48%
Media and telcos	14%	10%	13%
Manufacturing	29%	18%	26%
Others	15%	11%	14%

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Source: Company data, Goldman Sachs Research.

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**Exhibit 2: Offer price of Rs503.50 values Patni at \$1.45bn**

	<b>Shares (mn)</b>	<b>Share (%)</b>	<b>Value (Rs mn)</b>	<b>Value (\$mn)</b>
<b>Patni shareholding</b>	<b>130.98</b>	<b>100%</b>	<b>65,946</b>	<b>1,454</b>
<b>Stake acquired</b>	<b>83.01</b>	<b>63%</b>	<b>41,793</b>	<b>921</b>
<i>Promoters</i>	60.09	46%	30,256	667
<i>General Atlantic</i>	22.91	17%	11,537	254
Open offer	26.20	20%	13,189	291
<b>Overall acquisition value</b>	<b>109.20</b>	<b>83%</b>	<b>54,982</b>	<b>1,212</b>

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Source: Bombay Stock Exchange, company data, Goldman Sachs Research.

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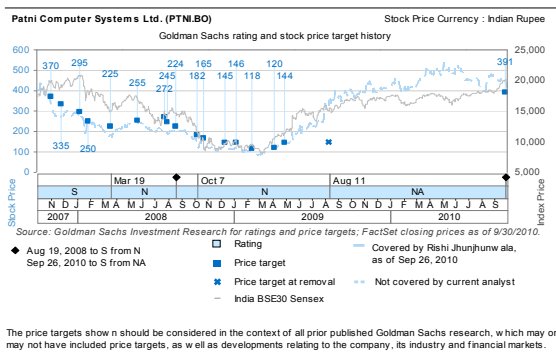
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