

Patni Computer**Rs433**
UNDERPERFORMER

RESULT NOTE

Mkt Cap: Rs61bn; US\$1.5bn

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Result: Q1CY07

Comment: Muted growth story continues, poor hiring hazes visibility

Last report: 04 April 2007 (Price Rs390; Recommendation: Underperformer)

Key financials

| Year end 31 Dec (Rs m) | Net sales (Rs m) | % Change yoy | Net profit (Rs m) | EPS (Rs) | % Change yoy | PE (x) |
|------------------------|------------------|--------------|-------------------|----------|--------------|--------|
| 2005 | 20,242 | 43.2 | 2,736 | 21.9 | 6.8 | 19.8 |
| 2006 | 26,112 | 29.0 | 3,568 | 25.6 | 16.8 | 16.9 |
| 2007E | 28,398 | 8.8 | 4,360 | 31.0 | 21.0 | 14.0 |
| 2008E | 33,424 | 17.7 | 4,987 | 35.1 | 13.3 | 12.3 |

Patni Computer's (Patni) revenue declined 1.2% qoq in rupee terms to Rs6.72bn (+1.1% qoq \$ terms growth) – lower than our revenue forecast of Rs6.97bn. The muted growth was primarily on account of vendor rationalization undertaken by large telecom client. However, decline in EBIT margin of 30bp was lower than our expectations of 77bp decline. The adverse impact of rupee appreciation, lower utilization and higher SG&A was partly offset by better billing rate and offshorization. Net income increased 5.8% qoq despite a 2.9% qoq decline in EBIT on account of higher other income (Rs268m against Rs192m in last quarter) and lower tax rate. For the next quarter, Patni has guided for 4.5% sequential growth (at \$163m). The PAT guidance at \$22.5-23m (-8.6% qoq excluding impact of forex gain) primarily builds in salary hike (4-4.5% onsite and 18-20% offshore) and rupee appreciation. We have downgraded CY07 and CY08 revenue estimates by 7.3% and 10.9% respectively, to account rupee appreciation and slower employee addition - company added 292 employees (net) during Q1CY07 against guidance of 500 additions and employee base is up just 7.8% yoy. However, we have raised earning estimates for CY07 by 2.7% to account for higher than expected other income, while leaving CY08 estimates unchanged. We believe there is a limited scope for significant margin expansion going ahead, given the fact that utilization has already reached 72.8% and the attrition is high at 29.1%. Expect 13% revenue CAGR and 17% earnings CAGR over CY06-08E. The stock trades at 14x CY07E and 12.3x CY08E – maintain Underperformer.

KEY HIGHLIGHTS**❑ Revenue declined 1.2% qoq**

Patni's revenue declined 1.2% qoq in rupee terms to Rs6.72bn (+1.1% in \$ terms to \$156m), which was lower than our revenue expectation of Rs6.97bn. Billing rate increased during the quarter by about 1% during contract renewal in strategic customers in Insurance vertical.

Revenues from GE account declined 18.8% sequentially and contributed to 11.1% of revenues (as against 13.5% in the previous quarter) primarily due to reclassification of GE group companies. Revenue from client #2-5 remained flat. Revenues from client #6-10 declined 10.2% sequentially.

Telecom vertical witnessed 25.1% sequential decline in rupee terms on account of vendor rationalization undertaken by a large telecom client. Manufacturing and financial services verticals continue to witness sequential decline - 2.5% and 3.3%, respectively, during the quarter under review. Product engineering vertical witnessed a strong growth of 16.1% qoq contributing 16.8% to total revenues. In terms of geographies, Europe declined (-7% qoq) contributing 14.2% of revenues, while revenues from USA remained broadly flat.

□ EBIT margins down 30bp qoq against our expectations of 77bp qoq decline

Gross margin improved 20bp to 38.3% despite rupee appreciation (-40bp impact), lower utilization (decline from 73.7% in last quarter to 72.8%), primarily driven by billing rate increase and offshoring (offshore efforts increased +40bp to 68.3%). EBIT margins declined 30bp to 17.7% on account of higher SG&A and provisions. EBIT declined 2.9%qoq to Rs1.19bn.

□ Net profit increased 5.8% qoq on account of lower tax and higher other income.

Net profit increased 5.8% qoq to Rs1.2bn (we expected net profit of Rs1.06bn) against 2.9% qoq growth in EBIT due to lower tax rate (17.8% v/s 18.9% in last quarter) and higher other income. Other income was high at Rs268m against Rs172m in last quarter due to foreign exchange gain of Rs113m (\$2.6m), which include one time gain of \$1.1m from revaluation of foreign tax liability.

□ Expects 4.5% qoq growth in topline and 8.6% qoq decline in net profit in Q2CY07

The company guided for revenue of \$163m in Q2CY07 (+4.5% qoq) and plans to add 1,200 employees during next quarter. Company had guided for 500 (net) additions during Q1CY06 and ended up hiring 292 employees. It has given 1,200 campus offers.

During Q2CY07 the company expects net income of \$22.5-23.0m (-8.6% qoq excluding impact of forex gain). PAT is expected to decline in Q2CY07 on account of salary hike (300-320bp impact), rupee appreciation (@ Rs42.5/\$ impact is estimated at 80bp). The impact of which is expected to get partly offset by higher other income (+120bp) booked normally during Q2 and other cost savings (+50bp).

OTHER KEY POINTS

- Attrition increased to 29.1% (excl-BPO LTM) as against 27.4% in the previous quarter.
- Number of million dollar remained flat at 74.
- Employee base increased by 292 taking the headcount to 13,096 at the end of the quarter.
- GE now contributes to 11.1% of revenues against 13.5% in the last quarter. Contribution from top 5 and top 10 clients declined from 38% and 52.2% in the last quarter to 35.9% and 48.8%, respectively, during the current quarter.
- ADM businesses contributed to 65.6% of revenues as against 70.1% in the previous quarter. Enterprise applications and embedded technology services increased to 13.5% and 11.5% of revenues as against 13.2% and 9.1%, respectively, in the previous quarter.
- Utilization decreased ~90bp sequentially to 72.8%.
- Offshore proportion of efforts increased to 68.3% (+40bp qoq).
- Debtor days increased to 72 from 71 in last quarter.
- Cash increased to \$295.1m (~20% of market cap) from \$289.5m at the end of Q4CY06.
- Added 26 clients – client base is 252.

□ Valuations

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Quarterly results

| (Rs m) | Q1CY06 | Q2CY06 | Q3CY06 | Q4CY06 | Q1CY07 | CY06 | CY07E |
|------------------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| Revenue | 5,776 | 6,561 | 6,971 | 6,805 | 6,724 | 26,112 | 28,398 |
| CORS | 3,593 | 4,273 | 4,343 | 4,215 | 4,152 | 16,424 | 18,027 |
| SG&A | 1,160 | 1,298 | 1,206 | 1,123 | 1,151 | 4,787 | 4,937 |
| EBITDA | 1,022 | 990 | 1,422 | 1,467 | 1,421 | 4,901 | 5,434 |
| Other income | 11 | 182 | 77 | 172 | 268 | 442 | 845 |
| Depreciation | 193 | 205 | 211 | 239 | 229 | 848 | 966 |
| PBT | 840 | 967 | 1,288 | 1,400 | 1,460 | 4,495 | 5,314 |
| Provision for taxation | 197 | 201 | 264 | 265 | 260 | 927 | 954 |
| PAT | 642 | 766 | 1,024 | 1,135 | 1,200 | 3,568 | 4,360 |
| yoy growth (%) | | | | | | | |
| Revenues | 33.2 | 38.7 | 34.1 | 22.2 | 16.4 | 29.0 | 8.8 |
| EBIDTA | 4.7 | 19.3 | 52.0 | 32.7 | 39.0 | 24.8 | 10.9 |
| Profits | (5.8) | 23.3 | 43.5 | 71.7 | 86.8 | 30.4 | 22.2 |
| qoq growth (%) | | | | | | | |
| Revenues | 3.7 | 13.6 | 6.3 | (2.4) | (1.2) | | |
| EBIDTA | (7.6) | (3.1) | 43.6 | 3.2 | (3.1) | | |
| Profits | (2.8) | 19.3 | 33.6 | 10.9 | 5.8 | | |
| Margins (%) | | | | | | | |
| EBITDA margin | 17.7 | 15.1 | 20.4 | 21.6 | 21.1 | 18.8 | 19.1 |
| Net margin | 11.1 | 11.7 | 14.7 | 16.7 | 17.9 | 13.7 | 15.4 |

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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