



## Patni Computer Systems

|                    |              |
|--------------------|--------------|
| STOCK INFO.        | BLOOMBERG    |
| BSE SENSEX: 17,287 | PATNI IN     |
| S&P CNX: 5,166     | REUTERS CODE |
|                    | PTNI.BO      |

30 April 2008

Neutral

Previous Recommendation: Neutral

Rs266

|                       |            |
|-----------------------|------------|
| Equity Shares (m)     | 138.9      |
| 52-Week Range         | 599/170    |
| 1,6,12 Rel. Perf. (%) | 10/-25/-69 |
| M.Cap. (Rs b)         | 36.9       |
| M.Cap. (US\$ b)       | 0.9        |

| YEAR   | NET SALES | * PAT  | EPS  | EPS        | P/E  | P/BV | ROE  | ROCE | EV/   | EV/    |
|--------|-----------|--------|------|------------|------|------|------|------|-------|--------|
| END    | (RS M)    | (RS M) | (RS) | GROWTH (%) | (X)  | (X)  | (%)  | (%)  | SALES | EBITDA |
| 12/06A | 26,112    | 3,572  | 24.9 | 14.6       | 10.3 | 1.6  | 16.8 | 21.2 | 0.9   | 4.8    |
| 12/07A | 26,950    | 4,643  | 32.4 | 30.0       | 7.9  | 1.4  | 19.0 | 22.7 | 0.9   | 4.8    |
| 12/08E | 29,669    | 3,854  | 26.6 | -17.8      | 9.7  | 1.3  | 13.8 | 16.2 | 0.7   | 4.3    |
| 12/09E | 35,163    | 5,320  | 34.7 | 30.2       | 7.4  | 1.2  | 16.7 | 19.8 | 0.6   | 3.2    |

\* Reflects adjusted PAT

- **Revenue in line, profit below expectation:** Patni reported revenues of Rs7.06b in 1QCY08 (March 2008) as against our estimates of Rs7.1b, growth of 5% YoY (2.9% QoQ). In US\$ terms, revenue grew 13.1% YoY (1.3% QoQ). Operating profit was Rs1.1b versus our estimate of Rs1.2b with 155bp (QoQ) margin decline on account of increased immigration cost and decline in manpower utilization
- Net profit was lower than our estimates at Rs0.73b versus Rs1.1b, registering sales decline of 40% YoY (27% QoQ). The revaluation and MTM foreign exchange losses for the quarter were US\$2.2m (Rs89m) compared with forex gain of US\$4.7m (Rs.85.0m) in 4QCY07.
- **Weaker guidance:** Revenue guidance of US\$180m-US\$181m for 2QCY08 implies growth of 2.6% QoQ and 16% YoY, with assumption of rupee/US\$ parity at Rs40/US\$. Net income is expected to be US\$22m-US\$23m, a growth of 27% QoQ and negative growth of 17% YoY.
- **Buyback — short term trigger:** Management has reiterated its share buyback plans up to Rs325/ share; we could see this happening in 2QCY08, subject to clearances.
- **Valuations fair:** At CMP of Rs266, the stock trades at 9.7x CY08E and 7.4x CY09E. We believe this is a fair valuation with share buyback action as a short-term trigger. We maintain our **Neutral** recommendation.

### QUARTERLY PERFORMANCE (US GAAP)

(Rs Million)

| Y/E DECEMBER                          | CY07         |              |              |              | CY08         |              |              |              | CY07          | CY08E         |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
|                                       | 1Q           | 2Q           | 3Q           | 4Q           | 1Q           | 2QE          | 3QE          | 4QE          |               |               |
| <b>Revenues</b>                       | <b>6,724</b> | <b>6,628</b> | <b>6,736</b> | <b>6,862</b> | <b>7,061</b> | <b>7,245</b> | <b>7,514</b> | <b>7,848</b> | <b>26,950</b> | <b>29,669</b> |
| Q-o-Q Change (%)                      | -1.2         | -1.4         | 1.6          | 1.9          | 2.9          | 2.6          | 3.7          | 4.4          | 3.2           | 10.1          |
| Direct Expenses                       | 4,204        | 4,303        | 4,470        | 4,594        | 4,843        | 4,991        | 5,122        | 5,297        | 17,570        | 20,253        |
| Sales, General & Admin. Expenses      | 1,094        | 1,108        | 1,149        | 1,130        | 1,157        | 1,208        | 1,229        | 1,282        | 4,480         | 4,876         |
| <b>Operating Profit</b>               | <b>1,427</b> | <b>1,217</b> | <b>1,117</b> | <b>1,138</b> | <b>1,061</b> | <b>1,046</b> | <b>1,164</b> | <b>1,269</b> | <b>4,899</b>  | <b>4,539</b>  |
| Margins (%)                           | 21.2         | 18.4         | 16.6         | 16.6         | 15.0         | 14.4         | 15.5         | 16.2         | 18.2          | 15.3          |
| Other Income                          | 268          | 635          | 441          | 295          | 59           | 310          | 376          | 391          | 1,638         | 1,136         |
| Depreciation                          | 234          | 252          | 262          | 257          | 279          | 283          | 286          | 290          | 1,004         | 1,137         |
| <b>PBT bef. Extra-ordinary</b>        | <b>1,460</b> | <b>1,600</b> | <b>1,296</b> | <b>1,176</b> | <b>842</b>   | <b>1,073</b> | <b>1,254</b> | <b>1,369</b> | <b>5,533</b>  | <b>4,538</b>  |
| Provision for Tax                     | 260          | 253          | 198          | 179          | 117          | 166          | 194          | 205          | 890           | 683           |
| Rate (%)                              | 17.8         | 15.8         | 15.3         | 15.2         | 13.9         | 15.5         | 15.5         | 15.0         | 16.1          | 15.1          |
| <b>Net Income bef. Extra-ordinary</b> | <b>1,200</b> | <b>1,348</b> | <b>1,098</b> | <b>997</b>   | <b>725</b>   | <b>907</b>   | <b>1,060</b> | <b>1,164</b> | <b>4,643</b>  | <b>3,855</b>  |
| Q-o-Q Change (%)                      | 5.8          | 12.3         | -18.5        | -9.2         | -27.3        | 25.2         | 16.9         | 9.8          | 30.0          | -17.0         |
| <b>Net Income aft. Extra-ordinary</b> | <b>1,200</b> | <b>1,348</b> | <b>1,098</b> | <b>997</b>   | <b>725</b>   | <b>907</b>   | <b>1,060</b> | <b>1,164</b> | <b>4,643</b>  | <b>3,855</b>  |
| Q-o-Q Change (%)                      | 5.8          | 12.3         | -18.5        | -9.2         | -27.3        | 25.2         | 16.9         | 9.8          | 74.9          | -17.0         |

E: M0St Estimates

### Revenue growth in line but profitability below expectation

Patni reported revenues of Rs7.06b in 1QCY08 (March 2008) as against our estimate of Rs7.1b, registering YoY growth of 5% (2.9% QoQ) In US\$ terms, revenue grew 13.1% YoY (1.3% QoQ) Operating profit was at Rs1.1b against our estimates of Rs1.2b with 155bp (QoQ) margin decline on account of increased immigration cost towards H1B visas (-130bp) and decline in manpower utilization (impact of -50bp).

Net profit was lower than our estimates at Rs0.73b against Rs.1.1b, registering sales decline of 40% YoY (27% QoQ). The revaluation and MTM forex losses for the quarter were US\$2.2m (Rs89m) compared with forex gain of US\$4.7m (Rs85m) in 4QCY07. The forex hedges outstanding as of 31 March 2008 is up to US\$337.5m, contracted in the range of Rs39.77-Rs43.50, the average realized rate being Rs42.78.

Stock-based expenses in 1QCY08 were at US\$1.1m compared with US\$1.3m in 4QCY07; an additional hit of up to US\$2m is expected to come in 2QCY08 on account of ESOPs.

Overall cash and cash equivalents were at US\$326.1m. Receivables at the end of 1QCY08 were at US\$136.8m with days outstanding for 1QCY08 at 72 days compared with 73 days in 4QCY07.

### Weaker metrics

Top clients declined by 8.5% in the quarter, with top 2-5 clients registering flat growth. Top 6-10 clients showed healthy growth of 5.4%. As expected, Financial Services declined by 4% and marginal growth was witnessed in insurance and banking. Telecom grew by 6.9% in 1QCY08. Attrition though, was lower at 23% versus 25.1% in 4QCY07, is still above the average of 14-18% among leading peers. Utilization was considerably lower at 70% in 1QCY08 compared with 73.4% in 4QCY07. Manpower addition was lower at 207 employees compared with 655 in

4QCY07, taking total employee strength above 15,152 as at March 2008.

### Management committed towards buyback up to Rs325/share

Management has reiterated its share buyback plans up to Rs325/share. We could see this happen in 2QCY08, subject to clearances. Company could utilize its cash of around US\$60m, of the US\$326.1m (~18%) earmarked, to buy back shares up to Rs325/share. At the current market price (Rs26/share), Patni can buy back ~ 6.4% of its equity (5.3% @ 325/ share, which is upper limit)

### Continued weaker growth projected - outlook for 2QCY08

Revenue guidance of US\$180m-US\$181m for 2QCY08 implies growth of 2.6% QoQ and 16% YoY, with assumption of rupee/US\$ parity at Rs40/US\$. Net income is expected to be US\$22m-US\$23m, a growth of 27% QoQ and negative growth of 17% YoY. Management foresees a tougher pricing environment for itself and growth likely coming via volumes.

### Valuation and view

Relative weaker revenue growth QoQ and YoY, higher dependence on US markets, high client concentration with weaker pricing bargaining power, coupled with weakening business, higher attrition and lower business visibility is compelling us to project a weaker EPS (diluted) for CY08E and CY09E at Rs26.6 and Rs34.7 respectively. We believe the company would be able to show better traction in CY09 once the US subprime crisis fades and IT spend globally picks up. Patni as a long-established player in offshoring, would reap above-average benefits in case of stronger growth in CY09. Hence we have better projections in spite of weaker CY08 numbers.

At CMP of Rs266 the stock trades at 9.7x CY08 and 7.4x CY09, which we believe is a fair valuation with share buyback action as short-term triggers. We maintain our **Neutral** recommendation.

## Patni Computer Systems: an investment profile

### Company description

Patni Computer Systems Ltd. is one of the Top 10 Information Technology services and business solutions company in India with over 15,152 professionals, servicing clients across diverse industries, from 21 sales offices across the Americas, Europe and Asia-Pacific, and 19 Global Delivery Centers in strategic locations across the world.

### Key investment arguments

- One of earliest established Indian IT company which could benefit from IT offshoring.
- Experience of integrating successfully and realizing benefits from acquisitions.

### Key investment risks

- Reduced global IT spend due to economic slowdown in the US.
- Sharper appreciation of Indian rupee against major currencies like US\$, GBP and Euro.
- Relatively weaker business model.

### Recent developments

- Won prestigious NASSCOM Award for the “100 IT Innovators” for 2007.
- Won a US\$200m strategic deal with UK-based The Car phone Warehouse.

### Valuation and view

- Revenue CAGR of 14.3% and earnings CAGR of 3.5% over CY07-CY09E.
- Valuations at 9.7x CY08E and 7.4x CY09E earnings, with limited room for upside.
- Maintain **Neutral**.

### Sector view

- Indian offshoring has been vindicated with the global clients and service providers making India their base for IT-enabled solutions. India still has less than 5% share in the global IT market. We are positive on the sector from a long term perspective.
- Economic slowdown in the US, subprime crisis and sharper currency appreciation remain key concerns.
- We believe frontline Indian IT companies would be better placed to sail through the near term adversities mentioned above.

#### COMPARATIVE VALUATIONS

|               |       | PATNI | HCL TECH | SATYAM |
|---------------|-------|-------|----------|--------|
| P/E (x)       | CY08E | 9.7   | 11.0     | 29.4   |
|               | CY09E | 7.4   | 9.4      | 31.3   |
| P/BV (x)      | CY08E | 1.3   | 2.6      | 16.3   |
|               | CY09E | 1.2   | 2.6      | 6.7    |
| EV/Sales (x)  | CY08E | 0.7   | 1.5      | 24.4   |
|               | CY09E | 0.6   | 1.1      | 21.3   |
| EV/EBITDA (x) | CY08E | 4.3   | 6.8      | 28.1   |
|               | CY09E | 3.2   | 5.3      | 27.7   |

#### SHAREHOLDING PATTERN (%)

|               | MAR-08 | DEC-07 | MAR-07 |
|---------------|--------|--------|--------|
| Promoter      | 43.9   | 43.9   | 44.0   |
| Domestic Inst | 4.5    | 4.1    | 2.1    |
| Foreign       | 45.6   | 45.6   | 51.7   |
| Others        | 6.0    | 6.4    | 2.3    |

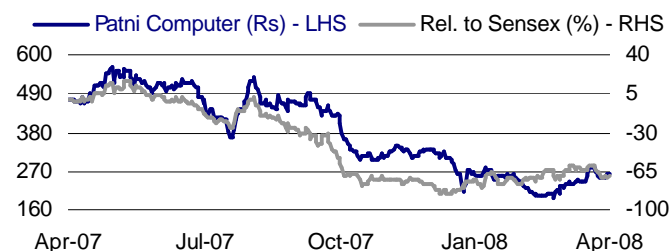
#### EPS: MOST FORECAST VS CONSENSUS (RS)

|      | MOST FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|---------------|--------------------|---------------|
| CY08 | 27.5          | 30.7               | -10.5         |
| CY09 | 35.8          | 31.3               | 14.3          |

#### TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO.   |
|--------------------|-------------------|------------|---------|
| 266                | -                 | -          | Neutral |

#### STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT    |               |               |               |               |               |
|---------------------|---------------|---------------|---------------|---------------|---------------|
| (Rs Million)        |               |               |               |               |               |
| Y/E DECEMBER        | 2005          | 2006          | 2007          | 2008E         | 2009E         |
| <b>Sales</b>        | <b>20,242</b> | <b>26,112</b> | <b>26,950</b> | <b>29,669</b> | <b>35,163</b> |
| Change (%)          | 38.9          | 29.0          | 3.2           | 10.1          | 18.5          |
| Cost of Goods Sold  | 12,499        | 16,424        | 17,570        | 20,253        | 23,732        |
| <b>Gross Profit</b> | <b>7,743</b>  | <b>9,688</b>  | <b>9,379</b>  | <b>9,416</b>  | <b>11,431</b> |
| SG&A Expenses       | 3,818         | 4,796         | 4,480         | 4,877         | 5,402         |
| <b>EBITDA</b>       | <b>3,925</b>  | <b>4,893</b>  | <b>4,899</b>  | <b>4,539</b>  | <b>6,029</b>  |
| % of Net Sales      | 19.4          | 18.7          | 18.2          | 15.3          | 17.1          |
| Depreciation        | 684           | 839           | 1,004         | 1,137         | 1,317         |
| Other Income        | 15            | 446           | 1,638         | 1,136         | 1,616         |
| Interest expense    | 0             | 0             | 0             | 0             | 0             |
| <b>PBT</b>          | <b>3,356</b>  | <b>4,500</b>  | <b>5,533</b>  | <b>4,538</b>  | <b>6,329</b>  |
| Tax                 | 620           | 928           | 890           | 683           | 1,009         |
| Rate (%)            | 18.5          | 20.6          | 16.1          | 15.1          | 15.9          |
| <b>PAT</b>          | <b>2,736</b>  | <b>3,572</b>  | <b>4,643</b>  | <b>3,854</b>  | <b>5,320</b>  |
| Change (%)          | 4.7           | 30.6          | 30.0          | -17.0         | 38.0          |
| Extr-ord Items      | 0.0           | 917.4         | 0.0           | 0.0           | 0.0           |
| <b>Net Income</b>   | <b>2,736</b>  | <b>2,654</b>  | <b>4,643</b>  | <b>3,854</b>  | <b>5,320</b>  |
| Change (%)          | 6.5           | -3.0          | 74.9          | -17.0         | 38.0          |

| BALANCE SHEET                   |               |               |               |               |               |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| (Rs Million)                    |               |               |               |               |               |
| Y/E DECEMBER                    | 2005          | 2006          | 2007          | 2008E         | 2009E         |
| Share Capital                   | 269           | 270           | 276           | 280           | 297           |
| Share Premium                   | 13,206        | 13,455        | 13,455        | 13,455        | 13,455        |
| Other Reserves                  | 6,572         | 8,709         | 12,655        | 15,932        | 20,454        |
| <b>Net Worth</b>                | <b>20,047</b> | <b>22,434</b> | <b>26,387</b> | <b>29,667</b> | <b>34,205</b> |
| Loans                           | 31            | 17            | 15            | 13            | 10            |
| <b>Capital Employed</b>         | <b>20,078</b> | <b>22,451</b> | <b>26,402</b> | <b>29,679</b> | <b>34,215</b> |
| Gross Block                     | 6,342         | 8,668         | 10,865        | 13,040        | 15,554        |
| Less : Depreciation             | 2,281         | 3,120         | 4,125         | 5,262         | 5,582         |
| <b>Net Block</b>                | <b>4,061</b>  | <b>5,547</b>  | <b>6,740</b>  | <b>7,778</b>  | <b>9,973</b>  |
| Other assets                    | 1,946         | 2,619         | 5,477         | 3,804         | 3,754         |
| Investments                     | 6,256         | 10,717        | 11,300        | 13,277        | 15,985        |
| <b>Curr. Assets</b>             | <b>11,425</b> | <b>9,046</b>  | <b>9,239</b>  | <b>12,566</b> | <b>14,203</b> |
| Debtors                         | 3,284         | 5,100         | 5,680         | 6,187         | 7,878         |
| Cash & Bank Balance             | 6,568         | 2,409         | 1,808         | 4,569         | 3,914         |
| Loans & Advances                | 0             | 0             | 0             | 0             | 0             |
| Other Current Assets            | 1,573         | 1,537         | 1,751         | 1,809         | 2,410         |
| <b>Current Liab. &amp; Prov</b> | <b>4,067</b>  | <b>5,655</b>  | <b>6,589</b>  | <b>8,226</b>  | <b>10,458</b> |
| Creditors                       | 242           | 486           | 267           | 513           | 412           |
| Other liabilities               | 3,612         | 4,101         | 4,258         | 4,741         | 5,809         |
| Provisions                      | 213           | 1,068         | 2,064         | 2,972         | 4,237         |
| <b>Net Current Assets</b>       | <b>7,358</b>  | <b>3,392</b>  | <b>2,650</b>  | <b>4,340</b>  | <b>3,745</b>  |
| Deferred Tax                    | 456           | 176           | 235           | 481           | 759           |
| <b>Application of Funds</b>     | <b>20,077</b> | <b>22,451</b> | <b>26,402</b> | <b>29,679</b> | <b>34,215</b> |

E: M0St Estimates

| RATIOS                          |             |             |             |             |             |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|
| Y/E DECEMBER                    | 2005        | 2006E       | 2007        | 2008E       | 2009E       |
| <b>Basic (Rs)</b>               |             |             |             |             |             |
| <b>EPS</b>                      | <b>21.8</b> | <b>25.8</b> | <b>33.6</b> | <b>27.5</b> | <b>35.8</b> |
| EPS - Diluted                   | -           | 24.9        | 32.4        | 26.6        | 34.7        |
| Cash EPS                        | 39.9        | 48.4        | 63.5        | 65.1        | 73.4        |
| Book Value                      | 159.5       | 162.4       | 191.0       | 211.8       | 230.4       |
| <b>Valuation (x)</b>            |             |             |             |             |             |
| P/E                             |             | 10.3        | 7.9         | 9.7         | 7.4         |
| Cash P/E                        |             | 5.5         | 4.2         | 4.1         | 3.6         |
| EV/EBITDA                       |             | 4.8         | 4.8         | 4.3         | 3.2         |
| EV/Sales                        |             | 0.9         | 0.9         | 0.7         | 0.6         |
| Price/Book Value                |             | 1.6         | 1.4         | 1.3         | 1.2         |
| <b>Profitability Ratios (%)</b> |             |             |             |             |             |
| RoE                             | 16.8        | 16.8        | 19.0        | 13.8        | 16.7        |
| RoCE                            | 20.6        | 21.2        | 22.7        | 16.2        | 19.8        |
| <b>Turnover Ratios</b>          |             |             |             |             |             |
| Debtors (Days)                  | 59          | 71          | 77          | 76          | 82          |
| Asset Turnover (x)              | 3.2         | 3.0         | 2.5         | 2.3         | 2.3         |
| <b>Leverage Ratio</b>           |             |             |             |             |             |
| Debt/Equity (x)                 | 0.0         | 0.0         | 0.0         | 0.0         | 0.0         |

| CASH FLOW STATEMENT          |               |               |               |               |               |
|------------------------------|---------------|---------------|---------------|---------------|---------------|
| (Rs Million)                 |               |               |               |               |               |
| Y/E DECEMBER                 | 2005          | 2006          | 2007          | 2008E         | 2009E         |
| CF from Operations           | 3,102         | 3,891         | 3,902         | 4,079         | 5,275         |
| Cash for Working Capital     | -214          | 1,121         | 1,258         | -3,142        | -663          |
| <b>Net Operating CF</b>      | <b>3,317</b>  | <b>2,770</b>  | <b>2,644</b>  | <b>7,220</b>  | <b>5,938</b>  |
| Net Purchase of FA           | -2,499        | -2,326        | -2,197        | -1,690        | -3,899        |
| Net Purchase of Invest.      | -2,526        | -4,461        | -582          | -1,977        | -2,708        |
| <b>Net Cash from Invest.</b> | <b>-5,025</b> | <b>-6,787</b> | <b>-2,780</b> | <b>-3,667</b> | <b>-6,607</b> |
| Proceeds from Equity Rais    | 5,240         | 250           | 6             | 4             | 17            |
| Proceeds from LTB/STB        | -15           | -14           | -2            | -3            | -3            |
| Dividend Payments            | -288          | -378          | -470          | -794          | 0             |
| <b>Cash Flow from Fin.</b>   | <b>4,937</b>  | <b>-142</b>   | <b>-466</b>   | <b>-793</b>   | <b>14</b>     |
| Free Cash Flow               | 818           | 444           | 447           | 5,531         | 2,040         |
| <b>Net Cash Flow</b>         | <b>3,229</b>  | <b>-4,158</b> | <b>-602</b>   | <b>2,761</b>  | <b>-654</b>   |
| <b>Opening Cash Balance</b>  | <b>3,338</b>  | <b>6,568</b>  | <b>2,409</b>  | <b>1,808</b>  | <b>4,569</b>  |
| Add: Net Cash                | 3,229         | -4,158        | -602          | 2,761         | -654          |
| <b>Closing Cash Balance</b>  | <b>6,567</b>  | <b>2,409</b>  | <b>1,808</b>  | <b>4,569</b>  | <b>3,915</b>  |

**N O T E S**



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

**Patni Computer Systems**

|                                                         |    |
|---------------------------------------------------------|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.