

July 26, 2011

| Reco | Previous Reco |
|--------------------------|---------------|
| Not Rated | Not Rated |
| CMP | Target Price |
| Rs322 | N. A. |
| EPS change FY12E/13E (%) | (18)/(12) |
| Target Price change (%) | NA |
| Nifty | 5,680 |
| Sensex | 18,871 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---------------|-----|------|------|------|
| Absolute | (3) | (33) | (31) | (38) |
| Rel. to Nifty | (7) | (30) | (30) | (40) |

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

| | |
|-----------------------------|-------------|
| Sector | IT Services |
| Bloomberg | PATNI@IN |
| Equity Capital (Rs mn) | 268 |
| Face Value(Rs) | 2 |
| No of shares o/s (mn) | 134 |
| 52 Week H/L | 510/306 |
| Market Cap (Rs bn/USD mn) | 43/969 |
| Daily Avg Volume (No of sh) | 158393 |
| Daily Avg Turnover (US\$m) | 1.3 |

Shareholding Pattern (%)

| | Jun-11 | Mar-11 | Dec-10 |
|--------------|--------|--------|--------|
| Promoters | 67.1 | 45.0 | 45.7 |
| FII/NRI | 27.5 | 44.7 | 44.1 |
| Institutions | 1.7 | 3.1 | 4.5 |
| Private Corp | 0.8 | 2.3 | 2.1 |
| Public | 2.9 | 4.9 | 3.6 |

Source: Capitaline

Manik Taneja

manik.taneja@emkayglobal.com
+91 22 6612 1253

Priya Gajwani

priya.gajwani@emkayglobal.com
+91 22 6612 1385

- June'11 rev fell short of est with a 3.4% QoQ decline to ~US\$ 184 mn. Mgns declined ~ 640 bps QoQ to 11.4% driven by lower top line, wage increments and higher SG&A expenses
- Metrics performance poor with the only bright spot being growth within top 5/10 clients at ~2.6/2.3% with performance weak across verticals and outside top 10 clients (-8.2% QoQ)
- Cut our 'lower than street' CY11/12E EPS by ~18%/12% to Rs 25/30.4 as we incorporate lower op performance, higher amortization and taxes. Expect sharper cuts from street
- Valuations at ~10x CY12E EPS are modest (after a 30%+ fall in past 3M's), upsides hinged on potential delisting and op improvement(more likely a late CY12/early CY13 case)

Watershed as expected

Patni reported rev at US\$ 184 mn (-3.4% QoQ), lower than est. (US\$ 188 mn) impacted by ~1% sequential vol decline and absence of milestone payments QoQ While top client s performance was good as co. consolidated business with top5/10 clients growing by ~2.6%/2.3% sequentially, non top 10 client revenues fell sharply by ~8% QoQ. Growth metrics across major verticals / geographies was poor as co reported decline in revenues across all geographies/ major verticals (Manufacturing an exception with a +1% QoQ). Margins (adjusted for severance expenses) were down sharply by ~640 bps QoQ driven by lower top line, wage increments (co increased offshore salaries by 9-10% and onsite wages by 2.4%). Reported profits came in at ~Rs 111 mn (- 90% QoQ) lower than expected (Rs 300 mn), impacted by lower operating performance and higher severance expenses of US\$ 17.5 mn(V/s est of US\$ 15mn). LTM attrition continued to be high at ~23%, but was down by ~170 bps QoQ in a seasonally high turnover quarter

Expect operating performance in CY12

After the watershed in CY11(expect a single digit US\$ rev growth with mgns slipping by ~530 bps YoY to 14.2%), we expect an improvement in op performance for Patni as (1) rev growth picks up benefiting from a common and possibly aggressive front end (mgmt indicated that integration nearly complete and expects to see follow up to new client wins within Fortune 100s space ahead), and (2) improvement in mgns (driven by rev growth leverage, improvement in bulge mix as co hires more freshers ahead, SG&A leverage and cost synergy gains for the combine). We thereby build in 14.4% US\$ rev growth for CY12 and ~ 220 bps YoY expansion in mgns (note that this still remains below management's target of taking margins to ~20% by H2CY12)

Cut our CY11/12E EPS by 18/12%, valuations modest on normalized earnings

We cut our CY11/12E earnings by ~18%/12% to Rs 25/30.4 as we incorporate lower operating performance, higher amortization and tax expenses (28% V/s 26% earlier). Valuations are modest on CY12 normalized earnings after a 30%+ correction in past 3 months and provide downside support, however meaningful upsides hinge on a potential delisting by parent iGate(more of a medium term possibility) and improvement in operating performance (more likely a late CY12 opportunity at the earliest).

Financials

| Y/E Dec | Net Sales | EBITDA | EBITDA % | PAT | EPS (Rs) | ROE % | P/E(x) | EV/EBITDA (x) | P/B (x) |
|---------|-----------|--------|----------|-------|----------|-------|--------|---------------|---------|
| FY10 | 31,620 | 6,442 | 20.4 | 5,723 | 43.6 | 18.3 | 7.4 | 3.3 | 1.2 |
| FY11 | 31,689 | 6,194 | 19.5 | 6,020 | 44.9 | 18.2 | 7.2 | 4.4 | 1.4 |
| FY12E | 34,136 | 4,847 | 14.2 | 2,612 | 19.3 | 8.2 | 16.7 | 5.2 | 1.4 |
| FY13E | 39,206 | 6,448 | 16.4 | 4,119 | 30.4 | 12.2 | 10.6 | 3.5 | 1.2 |

Quarterly performance

| Rs mn | Q1CY10 | Q2CY10 | Q3CY10 | Q4CY10 | Q1CY11 | Q2CY11 | YoY (%) | QoQ (%) | YTD 11 | YTD 10 | YoY (%) |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 7,745 | 7,776 | 7,967 | 8,200 | 8,477 | 8,221 | 5.7 | (3.0) | 16,698 | 15,522 | 7.6 |
| Operating Expenditure | 6,052 | 6,186 | 6,461 | 6,796 | 6,968 | 7,281 | 17.7 | 4.5 | 14,250 | 12,238 | 16.4 |
| Cost of revenues | 4,596 | 4,689 | 5,071 | 5,293 | 5,351 | 5,506 | 17.4 | 2.9 | 10,857 | 9,284 | 16.9 |
| as % of sales | 59.3 | 60.3 | 63.6 | 64.5 | 63.1 | 67.0 | | | 65.0 | 59.8 | |
| SG&A expenses | 1,457 | 1,497 | 1,391 | 1,503 | 1,618 | 1,775 | 18.6 | 9.8 | 3,393 | 2,954 | 14.9 |
| as % of sales | 18.8 | 19.2 | 17.5 | 18.3 | 19.1 | 21.6 | | | 20.3 | 19.0 | |
| EBITDA | 1,693 | 1,590 | 1,505 | 1,405 | 1,508 | 940 | (40.9) | (37.7) | 2,448 | 3,284 | (25.4) |
| Depreciation | 280 | 327 | 285 | 281 | 324 | 458 | 40.3 | 41.7 | 782 | 607 | |
| EBIT | 1,413 | 1,264 | 1,220 | 1,124 | 1,185 | 482 | (61.9) | (59.4) | 1,667 | 2,676 | (37.7) |
| Other Income | 413 | 520 | 329 | 616 | 456 | 496 | (4.6) | 8.8 | 952 | 932 | 2.1 |
| PBT | 1,825 | 1,783 | 1,549 | 1,739 | 1,641 | 977 | (45.2) | (40.4) | 2,618 | 3,609 | (27.4) |
| Total Tax | 328 | 311 | 268 | (30) | 461 | 89 | (71.4) | (80.7) | 550 | 639 | |
| Adjusted PAT | 1,497 | 1,473 | 1,281 | 1,769 | 1,180 | 889 | (39.7) | (24.7) | 2,068 | 2,970 | (30.4) |
| (Profit)/loss from JV's/Ass/MI | 0 | 0 | 0 | 0 | 0 | 0 | | | 0 | 0 | |
| APAT after MI | 1,497 | 1,473 | 1,281 | 1,769 | 1,180 | 889 | (39.7) | (24.7) | 2,068 | 2,970 | (30.4) |
| Extra ordinary items | 0 | 0 | 0 | 0 | 0 | -781 | | | -781 | 0 | |
| Emkay PAT | 1,497 | 1,473 | 1,281 | 1,769 | 1,180 | 108 | (92.7) | (90.8) | 2,849 | 2,970 | (4.1) |
| Reported EPS | 11.7 | 11.4 | 9.9 | 13.7 | 8.9 | 0.8 | (92.8) | (90.8) | 10 | 23 | (57.7) |

| Margins (%) | | | | | (bps) | | (bps) | | | | (bps) | |
|--------------------|------|------|------|-------|-------|------|---------|-----------|------|------|-------|--|
| EBIDTA | 21.9 | 20.5 | 18.9 | 17.1 | 17.8 | 11.4 | (902) | (636) | 14.7 | 21.2 | (649) | |
| EBIT | 18.2 | 16.3 | 15.3 | 13.7 | 14.0 | 5.9 | (1,039) | (812) | 10.0 | 17.2 | (726) | |
| EBT | 23.6 | 22.9 | 19.4 | 21.2 | 19.4 | 11.9 | (1,105) | (747) | 15.7 | 23.2 | (757) | |
| PAT | 19.3 | 18.9 | 16.1 | 21.6 | 13.9 | 1.3 | (1,763) | (1,260) | 17.1 | 19.1 | (207) | |
| Effective Tax rate | 18.0 | 17.4 | 17.3 | (1.7) | 28.1 | 9.1 | (832.6) | (1,901.5) | 21.0 | 17.7 | 330 | |

Source: Company, Emkay Research

Sharp cuts in earnings estimates as we scale down revenue assumptions as well as build in lower margins in CY11

| All fig in Rs mn except EPS and %) | CY11E | | | CY12 E | | |
|---------------------------------------|-------|-------|----------|--------|-------|----------|
| | Old | New | % change | Old | New | % change |
| Revenues(US\$ mn) | 787 | 762 | -3.2% | 911 | 871 | -4.4% |
| Revenues | 34606 | 34136 | -1.4% | 40097 | 39206 | -2.2% |
| EBITDA | 5668 | 4847 | -14.5% | 6428 | 6448 | 0.3% |
| EBITDA mgns, % | 16.4 | 14.2 | (217.8) | 16.0 | 16.4 | 41.6 |
| Net profits | 4116 | 3393 | -17.6% | 4623 | 4118 | -10.9% |
| EPS | 30.7 | 25.0 | -18.5% | 34.5 | 30.4 | -12.0% |

Operating Metrics at Glance

| | Q2 CY11 | Growth | |
|---|---------|------------|------------|
| | | % QoQ | % YoY |
| Revenue by Geographical Segments (%) | | | |
| Americas | 79.3% | -1.8% | 7.4% |
| EMEA | 13.1% | -13.3% | 19.7% |
| APAC | 7.5% | -3.4% | 17.5% |
| Revenue by Industry Verticals (%) | | | |
| Insurance Healthcare | 38.9% | -3.2% | 8.0% |
| Manufacturing, retail, distribution and logistics | 37.1% | 0.9% | 17.6% |
| Banking & Financial Services | 11.7% | -2.6% | 14.6% |
| Communications, Energy & utilities | 9.1% | -19.4% | -13.2% |
| Media Entertainment leisure and travel | 1.5% | -2.5% | -2.5% |
| public sector | 1.7% | 10.5% | 25.2% |
| Client- Revenue Metrics (%) | | | |
| Top client | 12.1% | 11.3% | 18.5% |
| Top 5 Clients | 35.8% | 2.6% | 10.6% |
| Top 10 Clients | 48.4% | 2.3% | 9.2% |
| Non Top 10 client revenues | 51.6% | -8.2% | 10.1% |
| Total Employees | 18,372 | -1.0% | 16.9% |
| | | bps | bps |
| Utilization (%) | 75.7% | 140 | -440 |
| Revenue by Project Type (%) | | | |
| Time and Material | 54.2% | -60 | -270 |
| Fixed Price (including Fixed Price SLA) | 45.8% | 60 | 270 |

Revenue declines across all geographies and major verticals

Non top 10 client revenues declined by ~8.2% sequentially driving the overall co wide decline

Financials

Income Statement

| Y/E, Dec. (Rs. m) | CY09 | CY10 | CY11E | CY12E |
|--------------------------|--------------|--------------|--------------|--------------|
| Net Sales | 31,620 | 31,689 | 34,136 | 39,206 |
| Growth (%) | | 0 | 8 | 15 |
| Total Expenditure | (25,178) | (25,495) | (29,289) | (32,757) |
| Growth (%) | | 1 | 15 | 12 |
| EBIDTA | 6,442 | 6,194 | 4,847 | 6,448 |
| Growth (%) | | (4) | (22) | 33 |
| EBIDTA % | 20.4 | 19.5 | 14.2 | 16.4 |
| Other Income | - | - | - | - |
| Depreciation | (1,169) | (1,173) | (1,832) | (1,989) |
| EBIT | 5,273 | 5,020 | 3,016 | 4,460 |
| Interest | - | - | - | - |
| EBT | 6,795 | 6,897 | 3,677 | 5,720 |
| Tax | (1,072) | (877) | (1,065) | (1,601) |
| EAT | 5,723 | 6,020 | 2,612 | 4,119 |
| Growth (%) | | 5 | (57) | 58 |
| EAT (%) | 18.1 | 19.0 | 7.7 | 10.5 |

Cash Flow

| Y/E, Dec. (Rs. m) | CY09E | CY10 | CY11E | CY12E |
|-------------------------------|----------------|-----------------|----------------|----------------|
| Net Profit after Tax | 5,723 | 6,020 | 2,612 | 4,119 |
| Add : Depreciation | 1,169 | 1,173 | 1,832 | 1,989 |
| Add : Misc exp w/off | | | | |
| Net changes in WC | (2,179) | 2,617 | (1,595) | (2,212) |
| Operational Cash Flows | 6,125 | 5,521 | 4,909 | 6,167 |
| Capital expenditure | (316) | (874) | (311) | (1,125) |
| Investments | (5,578) | 5,098 | - | - |
| Investing Cash Flows | (5,895) | 4,224 | (311) | (1,125) |
| Borrowings | - | - | - | - |
| dividend paid | (461) | (10,588) | (397) | (482) |
| Issue of shares | 2,615 | 1,198 | - | - |
| Share Premium | - | - | - | - |
| Financing Cash Flows | (208) | (11,011) | (1,797) | (2,228) |
| changes in cash | 23 | (1,266) | 2,801 | 2,815 |
| Opening balance | 2,922 | 2,944 | 3,527 | 5,816 |
| Closing balance | 2,944 | 3,527 | 5,816 | 8,695 |

Balance Sheet

| Y/E, Dec. (Rs. m) | CY09 | CY10 | CY11E | CY12E |
|--------------------------------|---------------|---------------|---------------|---------------|
| Equity share capital | 265 | 261 | 271 | 271 |
| Reserves & surplus | 34,397 | 31,092 | 65,629 | 68,710 |
| Minority Interest | - | - | - | - |
| Networth | 34,662 | 31,353 | 65,900 | 68,980 |
| Secured Loans | - | - | - | - |
| Unsecured Loans | - | - | - | - |
| Loan Funds | - | - | - | - |
| Deferred Tax Liability | 1,048 | 44 | - | - |
| Total Liabilities | 35,711 | 31,397 | 65,900 | 68,980 |
| Goodwill | - | - | - | - |
| Gross Block | 16,797 | 16,873 | 50,808 | 51,933 |
| Less: Depreciation | (5,830) | (6,205) | (8,037) | (10,026) |
| Net block | 10,967 | 10,668 | 42,771 | 41,907 |
| Capital WIP | - | - | - | - |
| Investment | 17,827 | 12,729 | 12,729 | 12,729 |
| Current Assets | 10,815 | 13,367 | 17,974 | 22,444 |
| Inventories | - | - | - | - |
| Sundry debtors | 5,077 | 6,825 | 7,108 | 8,163 |
| Cash & bank balance | 2,944 | 3,527 | 5,816 | 8,695 |
| Loans & advances | 775 | 1,836 | 1,683 | 1,719 |
| Other current assets | 2,019 | 1,178 | 3,367 | 3,867 |
| Current Liab & Prov | 6,104 | 7,699 | 9,911 | 10,437 |
| Current liabilities | 6,104 | 7,699 | 8,976 | 9,900 |
| Provisions | - | - | 935 | 537 |
| Net current assets | 4,711 | 5,668 | 8,063 | 12,007 |
| Misc exps | - | - | - | - |
| Deferred Tax | 2,205 | 2,337 | 2,337 | 2,337 |
| Total Assets | 35,711 | 31,397 | 65,900 | 68,980 |

Key ratios

| Y/E, Dec. | CY09 | CY10 | CY11E | CY12E |
|---------------------------------|-------|-------|-------|-------|
| EPS (Rs) | 43.6 | 44.9 | 19.3 | 30.4 |
| CEPS (Rs) | 52.5 | 53.6 | 32.8 | 45.0 |
| Book Value Per Share (Rs) | 264.0 | 233.8 | 238.0 | 260.7 |
| Dividend Per Share (Rs) | 3.0 | 67.5 | 2.5 | 3.0 |
| Valuations Ratios (x) | | | | |
| PER | 7.4 | 7.2 | 16.7 | 10.6 |
| P/CEPS | 7.5 | 9.0 | 13.4 | 10.5 |
| P/BV | 1.2 | 1.4 | 1.4 | 1.2 |
| EV/EBIDTA | 3.3 | 4.4 | 5.2 | 3.5 |
| EV/Sales | 0.7 | 0.9 | 0.7 | 0.6 |
| M-Cap/sales | 1.3 | 1.3 | 1.2 | 1.1 |
| Profitability Ratios (%) | | | | |
| RoCE | 16.6 | 15.0 | 9.5 | 13.2 |
| RoNW | 18.3 | 18.2 | 8.2 | 12.2 |
| EBITDA Margin | 20.4 | 19.5 | 14.2 | 16.4 |
| EBIT Margins | 16.7 | 15.8 | 8.8 | 11.4 |
| Net Profit Margin | 18.1 | 19.0 | 7.7 | 10.5 |

Recommendation History: Patni Computers – PATNI IN

| Date | Reports | Reco | CMP | Target |
|------------|---|-----------|-----|--------|
| 27/04/2011 | Patni Computer Q1CY11 Result Update | Not Rated | 459 | N.A. |
| 09/02/2011 | Patni Computer Q4CY10 Result Update | Not Rated | 464 | N.A. |
| 11/01/2011 | Patni Computers Event Update | Not Rated | 646 | N.A. |
| 27/10/2010 | Patni Q3CY10 Result Update | Not Rated | 465 | N.A. |

Recent Research Reports

| Date | Reports | Reco | CMP | Target |
|------------|---|------------|-----|--------|
| 20/07/2011 | Wipro Q1FY12 Result Update | Reduce | 399 | 420 |
| 20/07/2011 | NIIT Tech Q1FY12 Result Update | Accumulate | 203 | 250 |
| 19/07/2011 | Persistent Q1FY12 Result Update | Accumulate | 373 | 430 |
| 18/07/2011 | NIIT Technologies Initiating Coverage | Accumulate | 209 | 250 |

Emkay Global Financial Services Ltd.

Paragon Center, H -13 -16, 1st Floor, Pandurang Budhkar Marg, Worli, Mumbai – 400 013. Tel No. 6612 1212. Fax: 6624 2410

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