

10 March 2010

Patni Computer Systems

In a brand new "avatar"; initiate at Buy

Rating: Buy

Target Price: Rs620

Share Price: Rs506

- **Buy.** We initiate coverage on Patni with a Buy rating and a target price of Rs620. We expect its strengthened management, healthy cash flow and focus on internal efficiency would result in long-term revenue traction.
- **Strengthened management.** After a hiring spree, stability in top management is yielding benefits, in our view. Growth has already started picking up. We believe Patni is increasingly participating in larger deals and is likely to close in on two large multi-year deals of around US\$100-200m each.
- **Strong cash flow to aid business.** The company has US\$440m in cash (translating to Rs158 a share). With limited capex of US\$15-20m, we expect its liquidity profile to improve further. Patni continues to seek acquisitions to fill in its weaker spots.
- **Focus on internal efficiency.** Patni has been able to increase utilization and lower overhead costs to maintain margin. We forecast a steady margin performance over 2009-11 by the flattening out of the employee pyramid, improving productivity through fixed-price projects and further cost rationalization.
- **Valuation.** Our target price of Rs620 comprises Rs515 (at a target PE of 12x 12-month forward EPS) and Rs105 (valuing the cash above the average 10% peer cash holding). Our target multiple is at a 40% discount to average large-cap FY11 PEs (20x) and in line with IT-midcaps.

Key financials

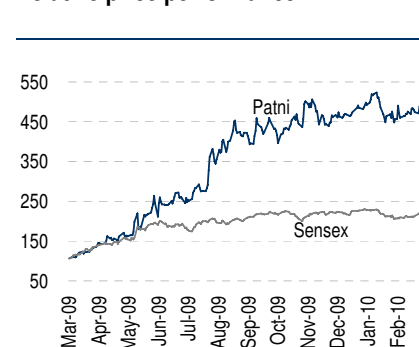
Year end 31 Dec	FY08	FY09	FY10e	FY11e	FY12e
Sales (Rsm)	31,991	31,634	33,021	38,122	43,060
Net profit (Rsm)	4,544	5,723	5,456	5,786	6,303
EPS (Rs)	33.0	44.3	41.9	44.0	47.5
Growth (%)	(1.2)	34.4	(5.5)	5.1	8.0
PE (x)	15.3	11.4	12.1	11.5	10.7
PBV (x)	2.5	1.9	1.7	1.5	1.3
RoE (%)	16.7	18.3	14.6	13.6	13.0
RoCE (%)	17.4	19.1	18.1	18.1	18.0
Dividend yield (%)	0.6	0.6	0.6	0.7	0.8
Net gearing (%)	(53.5)	(58.8)	(63.6)	(67.5)	(70.8)

Source: Company, Anand Rathi Research

Key data

Key data	PATNI IN / PTNI.BO
52-week high/low	Rs527/ Rs105
Sensex/Nifty	17098/5116
3-m average volume	US\$4.0m
Market cap	Rs65bn/US\$1.4bn
Shares outstanding	129m
Free float	53.5%
Promoters	46.5%
Foreign Institutions	40.3%
Domestic Institutions	7.0%
Public	6.2%

Relative price performance



Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rsm)

Year end 31 Dec	FY08	FY09	FY10e	FY11e	FY12e
Net sales	31,991	31,634	33,021	38,122	43,060
Sales growth (%)	18.7	(1.1)	4.4	15.4	13.0
- Op. expenses	26,942	25,545	26,382	30,510	34,482
EBIDTA	5,049	6,090	6,639	7,612	8,578
EBITDA margins (%)	15.8	19.2	20.1	20.0	19.9
- Interest	-	-	-	-	-
- Depreciation	782	782	837	875	934
+ Other income	491	657	934	987	1,111
- Tax	214	241	1,280	1,938	2,451
PAT	4,544	5,723	5,456	5,786	6,303
PAT growth (%)	(2.1)	26.0	(4.7)	6.0	8.9
Consolidated PAT	4,544	5,723	5,456	5,786	6,303
FDEPS (Rs/share)	33.0	44.3	41.9	44.0	47.5
CEPS (Rs/share)	38.7	50.4	48.3	50.6	54.5
DPS (Rs/share)	3.0	3.0	3.0	3.5	4.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rsm)

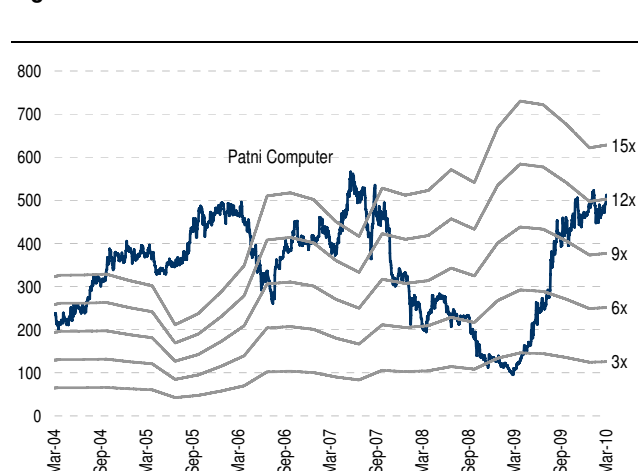
Year end 31 Dec	FY08	FY09	FY10e	FY11e	FY12e
Share capital	256	258	261	263	265
Reserves & surplus	27,481	34,404	39,643	45,131	51,053
Shareholders' fund	27,737	34,662	39,904	45,394	51,319
Debt	9	4	4	4	4
Minority interests	-	-	-	-	-
Capital employed	27,746	34,667	39,908	45,398	51,323
Fixed assets	7,332	6,850	6,926	7,183	7,549
Investments	16,416	21,557	21,557	21,557	21,557
Working capital	1,076	3,315	3,597	4,131	4,601
Cash	2,922	2,945	7,828	12,527	17,616
Capital deployed	27,746	34,667	39,908	45,398	51,323
No. of shares (m)	138	129	130	132	133
Net Debt/Equity (%)	(53.5)	(58.8)	(63.6)	(67.5)	(70.8)
W C turn (days)	12.3	38.2	39.8	39.5	39.0

Source: Company, Anand Rathi Research

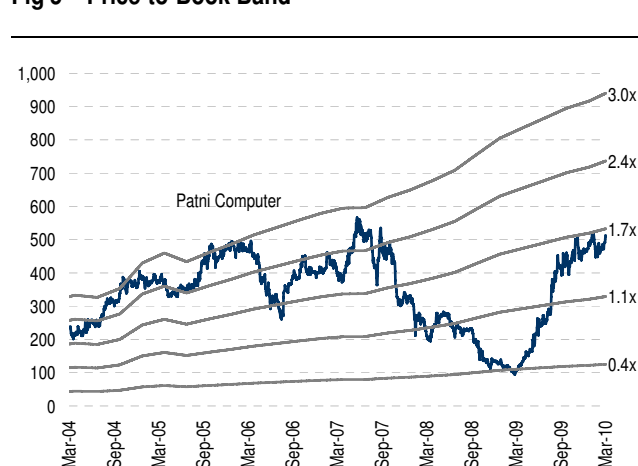
Fig 3 – Cash flow statement (Rsm)

Year end 31 Dec	FY08	FY09	FY10e	FY11e	FY12e
Consolidated PAT	4,544	5,723	5,456	5,786	6,303
+ Depreciation	782	782	837	875	934
Cash profit	5,326	6,505	6,293	6,661	7,237
- Incr/(Decr) in WC	(2,128)	2,238	282	534	470
Operating cash flow	7,454	4,267	6,011	6,127	6,767
- Capex	1,374	300	913	1,132	1,300
Free cash flow	6,080	3,967	5,098	4,995	5,467
- Dividend	450	453	457	539	621
+ Equity raised	(3,194)	1,655	243	243	243
+ Debt raised	(4)	(5)	-	-	-
- Investments	780	5,141	-	-	-
- Misc. items	-	-	-	-	-
Net cash flow	1,652	23	4,884	4,699	5,088
+ Opening cash	1,269	2,922	2,945	7,828	12,527
Closing cash	2,922	2,945	7,828	12,527	17,616

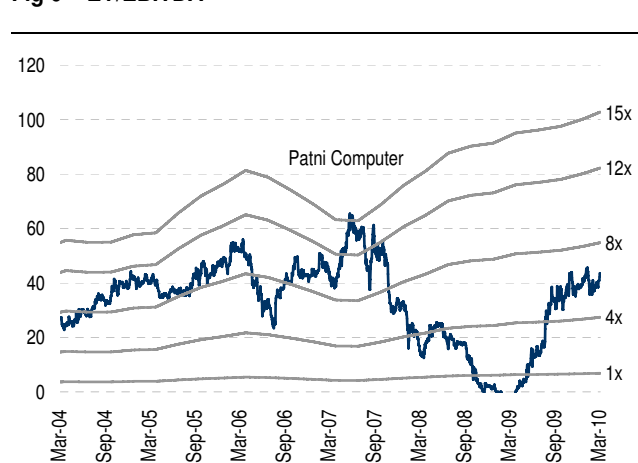
Source: Company, Anand Rathi Research

Fig 4 – PE Band


Source: Anand Rathi Research

Fig 5 – Price-to-Book Band


Source: Anand Rathi Research

Fig 6 – EV/EBITDA


Source: Anand Rathi Research

Investment Argument and Valuation

We initiate coverage on Patni with a Buy rating and a target price of Rs620. Our positive view on Patni is driven by its strong management bandwidth, healthy cash flow and focus on internal efficiency.

Management bandwidth strengthened

After a hiring spree and realigning its sales structure, stability in top management is yielding benefits. A rebounding economy, too, would reflect in better financials. The results are already starting to show: revenue (US\$ terms) was up 3.3% qoq each in 2Q and 3Q and 1.8% in 4QFY09. Management is ensuring higher and quality wins, offering revenue assurance.

We believe Patni is increasingly participating in larger deals. It is likely to close in on two large multi-year deals of around US\$100-200m each. According to the management, these deals are some of the largest in Patni's history, and should help towards the targeted growth trajectory of at least 3-4% revenue growth every quarter.

Healthy cash flow to aid business

At end-4QFY09, Patni had US\$440m in cash. This translates to Rs158 a share and 48.7% of assets. With limited capex of US\$15-20m, we expect the liquidity profile to improve further.

Patni has been actively pursuing inorganic opportunities over the past 12 months. Management indicated that it continues to look for acquisitions to fill out the gaps in its service-line portfolio (ITO, Enterprise solutions), geographical reach (Europe, in particular) and micro-verticals.

Focus on internal efficiency

In the past few quarters, even as volume growth in the sector declined, management was able to expand margins by cutting costs and running a leaner operation. Patni has reduced its G&A expenditure by 5.8% (in absolute terms) in FY09.

It has been able to use levers like utilization (utilization to as high as 77.4% in 4Q) and lowering G&A costs to maintain margins. Moreover, it plans to increase its share of revenue from fixed-price projects, by ~400bps next year, thereby aiding realizations and margin.

We forecast that it would achieve steady margin performance over 2009-11 by flattening the employee pyramid, improving productivity in fixed-price projects and through further cost rationalization.

Valuation

We assign Patni a target price of Rs620, based on a target PE of 12x 12-month forward EPS of Rs42.9 (Rs515) and adding Rs105 for its cash holding (excess cash holding over the industry average of 10% of their market-cap; see Fig 8).

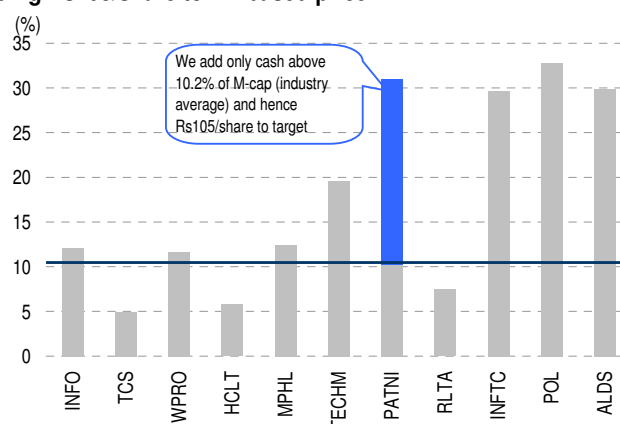
Our target multiple of 12x 12-month forward EPS is in line with the historical 40% discount it has traded to average large-cap forward PEs. Our average FY11 target PE multiple for the large-caps is 20x (Fig 7). Our target PE multiple for Patni is in line with IT mid-caps.

Fig 7 – IT companies' FY11 PEs @ target prices

IT large caps	1-year forward PE	IT mid-caps	1-year forward PE
Infosys	23.0	Infotech Enterprises	13.0
TCS	23.0	Relta India	12.0
Wipro	23.0	Polaris	12.0
HCL Tech	17.0		
Tech Mahindra	17.0		
Mphasis*	17.0		
IT Large caps	20.0	IT Mid-caps	12.3

Source: Anand Rathi Research, *average of FY10 & FY11

Fig 8 shows that the average cash holding of IT companies is 10% of their market cap (31% of Patni's market cap is in liquid investments). Hence, we add Rs105/share (vs Rs158/share cash holdings) to the PE-based price to arrive at the target price of Rs620.

Fig 8 – Adding Rs105/share to PE-based price

Source: Anand Rathi Research

We believe EV/EBITDA is a better way to value Patni, since it removes the effect of cash on the balance sheet. The respective EV/EBITDA multiples at the target prices provide the valuation at which a company's core business is being valued at.

Fig 9 – EV/EBITDA at target prices

IT large caps	1-year forward	IT mid-caps	1-year forward
Infosys	16.6	Infotech Enterprises	6.6
TCS	17.2	Relta India	6.4
Wipro	16.4	Polaris Software	8.2
HCL Tech	9.4	Allied Digital	4.6
Tech Mahindra	9.3	Patni Computer Systems	10.4
Mphasis	12.4		

Source: Anand Rathi Research

Risks to our target price

- **Client concentration risk.** Patni's revenue has traditionally been highly concentrated among a few clients. In FY09, 36.5% came from the top five, while the top ten accounted for 49.8%.
- **High dependence on ADM and the US.** Patni has high exposure to mature ADM services (65.2% for FY09) and low exposure to growth markets, such as infrastructure management services and systems integration. It received ~80% of its FY09 revenue from the US. These verticals could be causes for worry in case they slow down.

Management bandwidth strengthened

Management changes at Patni are positive, in our view. Hence, we believe the turnaround would be quicker. Patni has essentially turned from a promoter-driven company into a professionally-managed one.

Stability in top management (after a hiring spree and realigning its sales structure) is yielding benefits. An economic upswing would reflect in better financials, as is already being seen.

The company started its turnaround in earnest from end-2008, with the replacement of its promoter-run management. Jeya Kumar joined as CEO in Dec '08. Since then, about 10 top management positions have been filled with professionals from various leading global companies. The results are already starting to show in the financials; revenue (US\$ terms) was up 3.3% qoq each in 2Q and 3Q and 1.8% in 4QFY09. Top management is ensuring higher and quality wins, providing strong revenue assurance.

Fig 10 – Patni’s management team (added this past year)

Name	Designation	Date	Details of experience
Dr Anil Gupta	EVP and global head of business operations	Jan '10	Has over 28 years' experience. CEO at Aditi Technologies. Earlier was V-P for India Engineering Centre in Bangalore for Sun Microsystems
Vijay Mehra	EVP and head, business verticals	Sep '09	Global CIO of the Essar Group; has more than 20 years experience
Naresh Lakhanpal	President, Patni Americas, Inc.	Aug '09	Has over 23 years' experience in strategy formation, product development operations and sales. Was global practice director for TMT for Deloitte, CEO of Navigational Sciences
V. Mathivanan	EVP and president, Patni's APAC operations	Aug '09	Has over 30 years' experience in IT with PSA Corp, Singapore Network Services and CrimsonLogic
Manish Soman	Chief, Operations and EVP	Jun '09	Worked with Genpact; responsible for IT delivery integrated with BPO offerings across six verticals. CEO of Deloitte and MD of its India operations
Juergen Dillenberger	Senior sales manager	Feb '09	Has over 22 years' experience. V-P at T-Systems and global director for application outsourcing at HP
Georg Wagner	V-P	Feb '09	Global director for application outsourcing and offshoring at HP. Senior manager at Deloitte for large outsourcing engagements, and managed Deloitte's European support centre
Gabi Schulte-Holthaus	Sales director, SAP Alliance	Feb '09	Was with Infosys and Siemens
Amit Luthra	Senior sales manager, Life Sciences	Feb '09	Worked with Cognizant and Accenture. In Cognizant, responsibility included growing the life-sciences business in Switzerland
Mike Reynolds	V-P, BFSI in Europe, West Asia (the Mid-East) and Asia	Feb '09	Partner at Accenture; led the financial services EMEA Alliance sales division
Jeya Kumar	CEO	Dec '08	CEO of MphasiS; has over 25 years' experience. Prior to MphasiS, was senior V-P, Sun Microsystems, heading the services business, and a member of Sun's executive management group

Source: Company, Anand Rathi Research

Win rate and quality beginning to improve

We believe Patni is increasingly participating in larger deals and is likely to close in on two large multi-year deals of around US\$100-200m each. These are some of its largest, say management, and should help achieve the targeted trajectory of at least 3-4% revenue growth every quarter. Even without them, the pipeline looks healthy. Patni indicated that its new deals could have free transition and/or employee/asset takeover clauses involved.

Its micro-verticals strategy seems to be paying off, with strong pipeline growth in the banking, financial services and insurance, and communications verticals. These bring in nearly 43% of revenue. Also, after management restructuring, the focus on deals has sharpened. The company has also seen product engineering revenues pick up on the return of projects earlier put on hold, though it expects a meaningful pickup in discretionary spending only in 2HFY10.

Vijay Mehra, who comes with over 20 years of global management and consulting experience, will define and boost Patni’s micro-verticals strategy, structure, systems and skills.

Patni is building a solutions-based go-to-market strategy and is now focused on micro-verticalization, playing on its inherent strengths. It has identified key areas within verticals that have the potential to grow manifold, based on its differentiated capabilities.

Fig 11 – Micro-verticals focus

Patni’s verticals	Focus
Insurance	Property & casualty, Third-party administration
Manufacturing, Retail and Distribution	Supply chain management integration
Communications, Media and Utilities	Media & entertainment (Media), Business support systems (BSS) (Telecoms)
Project engineering services	Storage & networks

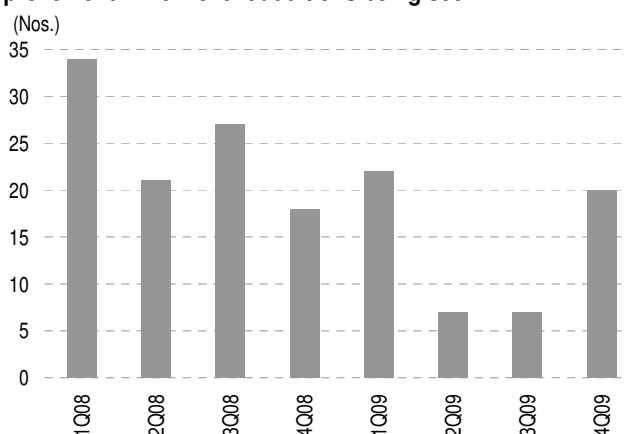
Source: Company, Anand Rathi Research

Management estimates that overall client budgets will not meaningfully increase in 2010 but Patni should benefit from increased offshoring by clients and its own greater participation in the market.

Pickup in new client adds

Twenty new clients were added in 4Q, taking gross new client additions for 2009 to 56. Strong new client additions are key for Patni to deliver growth rates in line with its peers.

Fig 12 – Improvement in new-client additions being seen

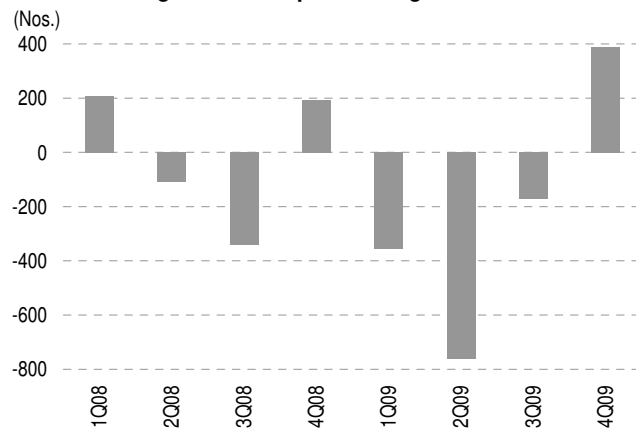


Source: Company, Anand Rathi Research

Hiring picks up momentum

Patni added 388 employees (net), after three quarters of sliding headcount. Hiring is expected to be positive through the year and tilted toward campus joiners, thus broadening the employee pyramid.

Fig 13 – Positive net hiring after three quarters augurs well for business traction



Source: Company, Anand Rathi Research

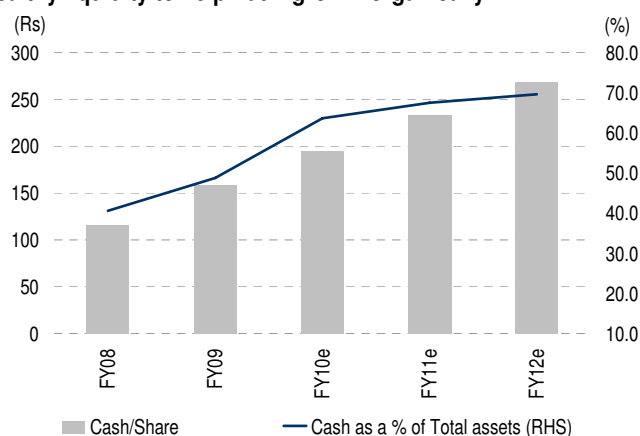
Healthy cash flow to aid business

Robust profits and relatively lower capex could ensure cash flows. This would improve liquidity, helping inorganic growth. Cash per share of Rs158 (Dec '09 end) is 31% of current share price.

At end-4QFY09, Patni had US\$440m in cash. This translates to Rs158 a share, and 48.7% of assets. With limited capex of US\$15-20m, the liquidity profile is expected to further improve. This, we expect, would help it grow inorganically and enable it to target larger companies for acquisition.

Fig 14 – Healthy liquidity to help Patni grow inorganically

We expect a 19.3% CAGR in cash over FY09-12, to Rs269 a share



Source: Company, Anand Rathi Research

Inorganic growth opportunities

In the past six years, the company has acquired a string of companies to strengthen its vertical domain expertise and broaden its geographical reach.

Fig 15 – Acquisitions

Date	Name	Value	Comment
May '03	The Reference, Inc.	US\$7.5m	US-based IT solutions provider focused on the financial services vertical
Nov '04	Cymbal Corp.	US\$68m (US\$35m upfront + US\$33m over three years based on performance)	Telecoms service provider focused on IT services. Cymbal had 500 personnel, access to 14 key communication service provider accounts
Jun '06	ZAIQ Technologies	n.a.	US-based design and verification company
Jul'07	Taratec Development Corp.	US\$27m	High-end Life Science consultancy capabilities in areas of regulatory compliance. Analytics, Drug safety. US\$20m in revenue, Gained access to Taratec's clients
Jul'07	Logan Orviss International	upfront payment + performance-linked incentive payments over three years	Had a profitable year, with revenue of €11.8m in 2006. London-based telecommunications consultant

Source: Company, Anand Rathi Research

Acquisitions likely in 2010

Over the past 12 months, Patni has been actively pursuing inorganic opportunities. With management restructuring out of the way, the company stated it is likely to close deals within the next two or three quarters. Funding is primarily expected to be based on internal accruals, with deal sizes of US\$100-200m.

One of Patni’s stated M&A criteria is for any acquisition to be GAAP EPS-accretive, which we believe could result in some delay, as valuations for IT companies worldwide have become better in the last two quarters.

The company indicated that it continues to look for acquisitions to fill out gaps in its service-line portfolio (TTO, Enterprise solutions), geographical reach (Europe in particular) and micro-verticals.

Patni had net cash of US\$440m on 31 Dec '09, against its current market capitalization of US\$1.4bn. It had already (in 2008) bought back 11m shares, for US\$53m, thus increasing the possibility of further buy-backs.

Focus on internal efficiency

Patni is moving towards higher fixed-price projects (up 460bps yoy, to 42.4% in 4Q) making it successful in managing margin pressure. It is being helped by better utilization and a changing client mix.

In the past few quarters, even as volume growth for the sector declined, management was able to expand margins by cutting costs and running a leaner operation. Performance in FY09 is as given:

In 1QFY09, notwithstanding an 11.2% qoq decline in revenue, EBITDA margin slipped only 106bps. The company was able to cut cost of revenue by 5.8% qoq, through reducing headcount, by 2.2%.

In 2QFY09, EBITDA margin expanded 330bps as utilization improved 410bps on 3.3% revenue growth and billable headcount reduction of 5.2% qoq.

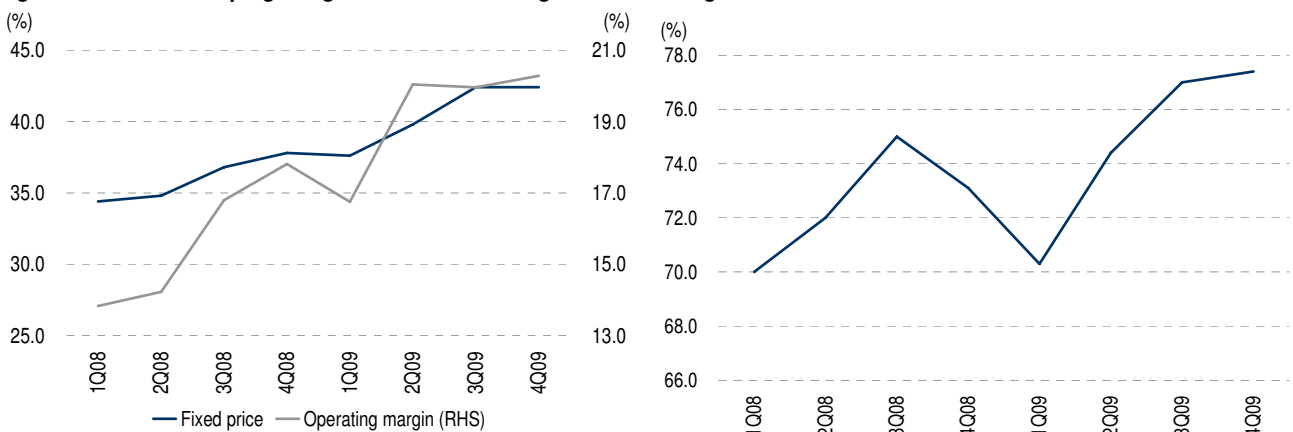
In 3QFY09, EBITDA margin was constant qoq, even after increasing SGA costs to tap better market opportunities by increasing utilization 260bps qoq to 77%, which saw US\$ revenue increase 3.3%.

In 4QFY09, EBITDA margin increased 30bps qoq, along with an 1.8% US\$ revenue increase, along with an increase in billable headcount, by 2.9% qoq, keeping SGA costs around the 3QFY09 levels.

Operational levers in place for sustainable margin improvement

Patni has reduced its G&A expenditure by 5.7% in FY09. Management believes that it would be able to maintain current G&A expenditure on an absolute basis even if the revenue base were 50% higher than at present. The company has been able to use levers like utilization and lowering G&A costs to maintain margins. Moreover, it plans to increase its share of revenue from fixed-price projects, by ~400bps next year, thereby aiding realizations and margins.

Fig 16 – FPP focus helping margins / utilization being used as a margin lever

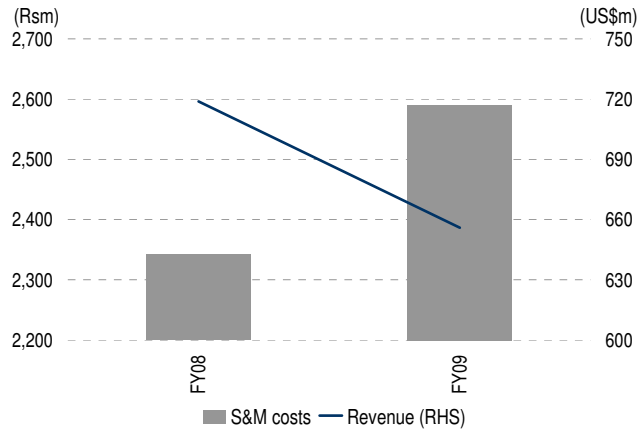


Source: Company, Anand Rathi Research

Strong investments in S&M build confidence

Patni has cut direct costs and G&A over the past four quarters. However, it has invested considerably in sales and marketing (S&M) in an effort to create scalable long-term revenue and increase clientele in under-penetrated geographical areas. S&M expenses have grown over 10.6% in FY09.

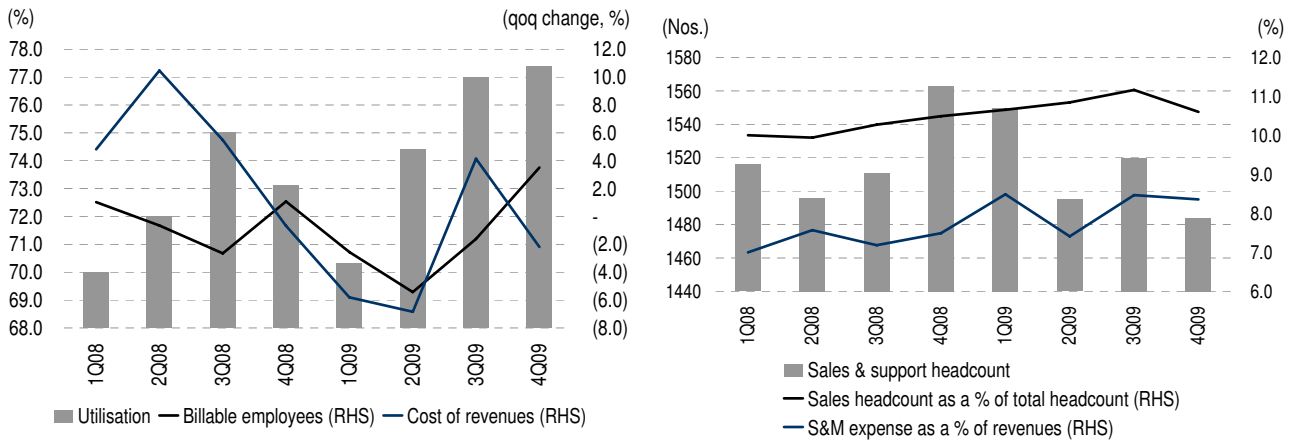
Fig 17 – S&M costs grow 10.6% while revenue dips



Source: Company, Anand Rathi Research

At the same time, management continues to focus on optimizing costs, which should help hold margins for the next two years. In 2009, Patni aggressively rationalized underperformers. It is now focusing on optimizing support costs, improving efficiency of fixed-price projects, expanding span of control to bring about sustainable productivity improvements. It has ~80% of its hedges of US\$320m for 2010 at Rs48/US\$ vs spot of Rs45.50.

Fig 18 – Margin levers being used to the optimum / S&M spends increasing



Source: Company, Anand Rathi Research

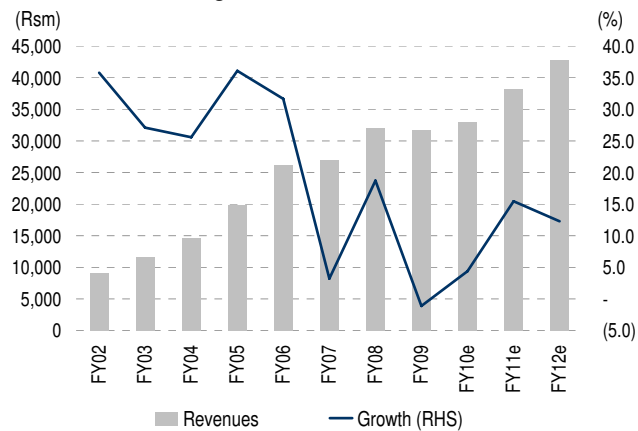
Financials

We estimate Patni would report a **14.2% CAGR in revenue over FY10-12**. The EBITDA margin is likely to expand from **19.2% in FY09 to 19.9% in FY12**, with a profit CAGR of 7.5%.

Revenue CAGR of 14.2% over FY10-12

Over FY05-09, Patni saw a 12.4% CAGR in revenue. Ahead however, over FY10-12, we expect it to post a 14.2% CAGR in revenue. This growth would arise even after rupee appreciation (we assume a Rs/US\$ conversion for FY10 at 45.1, for FY11/12 at 45, while that for FY09 was Rs48.3). We expect Patni to add 2,180 and 2,400 employees in FY10 and FY11, respectively. We assume some pricing uptick for FY10/11.

Fig 19 – Revenue and revenue growth rate

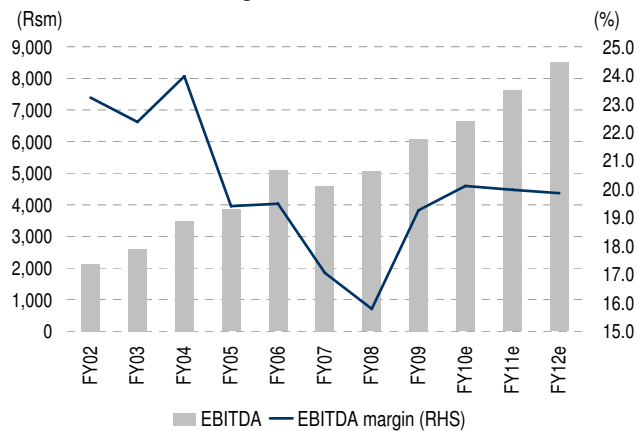


Source: Company, Anand Rathi Research

EBITDA margin to expand from 19.2% in FY09 to 19.9% in FY12

As the company moves up the value chain and optimizes costs, there would be levers like flattening the employee pyramid, increasing utilization to reduce the impact of salary hikes and rupee appreciation on the margin. We expect EBITDA margin to expand from 19.2% in FY09 to 19.9% in FY12.

Fig 20 – EBITDA and EBITDA margin



Source: Company, Anand Rathi Research

Over FY10-12, we expect a 7.5% CAGR in FDEPS (assumed average Rs/US\$ conversion: for FY10 at 45.1, FY11/12 at 45).

EPS sensitivity to currency movement

For a 1% fluctuation in currency, the impact on EPS is about 3.2%. Thus, for a 1% rupee depreciation, the EPS rises 3.2%. For Infosys, for a 1% change in currency, the impact on the EPS is about 2%.

Fig 21 – EPS forecasts (Rs)

	FY10e	FY11e	FY12e
PATNI - AR estimates	41.9	44.0	47.5
PATNI - Const. Rs/US\$*	45.3	48.8	52.5
Difference (%)	(8.2)	(10.8)	(10.7)

Source: Anand Rathi Research * Const. Rs46.4/US\$ (average for three months ending Dec '09) taken for calculations

Fig 22 – Income statement

Year end 31 Dec (Rsm)	FY08	FY09	FY10e	FY11e	FY12e
Revenues	31,991	31,634	33,021	38,122	43,060
Growth (%)	18.7	(1.1)	4.4	15.4	13.0
Avg. currency rate (Rs/US\$)	44.5	48.3	45.1	45.0	45.0
Depreciation (%)	9.3	8.5	(6.5)	(0.3)	-
Employees	14,894	13,995	16,175	18,575	20,433
Growth (%)	(0.3)	(6.0)	15.6	14.8	10.0
Software engineers	13,331	12,511	14,611	16,931	18,696
% of total employees	89.5	89.4	90.3	91.1	91.5
Revenue/software engineer (US\$ '000)	53.6	50.7	54.0	53.7	53.7
Growth (%)	1.4	(5.4)	6.4	(0.5)	-
Expenses	26,942	25,545	26,382	30,510	34,482
As % of revenue (%)	84.2	80.8	79.9	80.0	80.1
Cost of services	21,028	19,555	19,928	23,480	26,832
As % of revenue (%)	65.7	61.8	60.3	61.6	62.3
Cost / Employee (Rs '000)	1,409.4	1,353.8	1,321.0	1,354.4	1,375.7
Inflation (%)	11.6	(3.9)	(2.4)	2.3	1.8
Other costs	5,914	5,990	6,454	7,030	7,650
As % of revenue (%)	18.5	18.9	19.5	18.4	17.8
EBITDA	5,049	6,090	6,639	7,612	8,578
EBITDA margin (%)	15.8	19.2	20.1	20.0	19.9
Interest	-	-	-	-	-
Depreciation	782	782	837	875	934
Other income	491	657	934	987	1,111
PBT	4,758	5,965	6,736	7,724	8,755
Tax	214	241	1,280	1,938	2,451
Effective tax rate (%)	4.5	4.0	19.0	25.1	28.0
PAT	4,544	5,723	5,456	5,786	6,303
Minority interest	-	-	-	-	-
Consolidated PAT	4,544	5,723	5,456	5,786	6,303
Extraordinary expenses	-	-	-	-	-
Reported PAT	4,544	5,723	5,456	5,786	6,303

Source : Company, Anand Rathi Research

We expect a 13.5% CAGR in US\$ revenue over FY09-12 vs 10.8% in rupee terms

We have assumed G&A costs to be almost flat while S&M costs to be higher ahead

Tax rate to balloon from FY10

Fig 23 – Balance sheet

Year end 31 Dec (Rsm)	FY08	FY09	FY10e	FY11e	FY12e
Equity	256	258	261	263	265
Reserves	27,481	34,404	39,643	45,131	51,053
Shareholders' funds	27,737	34,662	39,904	45,394	51,319
Debt	9	4	4	4	4
Capital employed	27,746	34,667	39,908	45,398	51,323
Fixed assets	7,332	6,850	6,926	7,183	7,549
Investments	16,416	21,557	21,557	21,557	21,557
Cash	2,922	2,945	7,828	12,527	17,616
Working capital	1,076	3,315	3,597	4,131	4,601
Capital employed	27,746	34,667	39,908	45,398	51,323

Source : Company, Anand Rathi Research

A cash-rich company. Cash expected to go up from Rs158/share in CY09 to Rs269 three years on

Fig 24 – Cash flow statement

Year end 31 Dec (Rsm)	FY08	FY09	FY10e	FY11e	FY12e
PAT	4,544	5,723	5,456	5,786	6,303
+ non-cash expense	782	782	837	875	934
Cash profit	5,326	6,505	6,293	6,661	7,237
- Increase/(decrease) in working capital	(2,128)	2,238	282	534	470
Operating cash flow	7,454	4,267	6,011	6,127	6,767
- Capex	1,374	300	913	1,132	1,300
Free cash flow	6,080	3,967	5,098	4,995	5,467
+ Equity raised	(3,194)	1,655	243	243	243
+ Debt raised	(4)	(5)	-	-	-
- Investments	780	5,141	-	-	-
- Dividend paid	450	453	457	539	621
- Misc. expense	-	-	-	-	-
Net change in cash	1,652	23	4,884	4,699	5,088
Opening cash	1,269	2,922	2,945	7,828	12,527
Closing cash	2,922	2,945	7,828	12,527	17,616

Source : Company, Anand Rathi Research

Fig 25 – RoE, RoCE analysis

Year end 31 Dec	FY08	FY09	FY10e	FY11e	FY12e
EBIT / Sales (%)	14.9	18.9	20.4	20.3	20.3
Sales / Average CE (x)	1.2	1.0	0.9	0.9	0.9
EBIT / Average CE (RoCE) (%)	17.4	19.1	18.1	18.1	18.0
Average CE / Average Equity (x)	1.0	1.0	1.0	1.0	1.0
PBT / EBIT (x)	1.0	1.0	1.0	1.0	1.0
PAT / PBT (x)	1.0	1.0	0.8	0.7	0.7
Consolidated PAT / PAT (x)	1.0	1.0	1.0	1.0	1.0
PAT / Average Equity (RoE) (%)	16.7	18.3	14.6	13.6	13.0

Source : Company, Anand Rathi Research

Fig 26 – Key ratios @ Rs506

Year end 31 Dec	FY08	FY09	FY10e	FY11e	FY12e
Diluted shares (m)	138	129	130	132	133
FDEPS (Rs)	33.0	44.3	41.9	44.0	47.5
CEPS (Rs)	38.7	50.4	48.3	50.6	54.5
BV (Rs)	201.3	268.4	306.2	345.1	386.6
P/E (x)	15.3	11.4	12.1	11.5	10.7
P/C (x)	13.1	10.0	10.5	10.0	9.3
P/B (x)	2.5	1.9	1.7	1.5	1.3
EV/Sales (x)	2.0	2.0	1.7	1.4	1.1
EV/EBITDA (x)	12.4	10.2	8.7	6.9	5.6
Net gearing (%)	(53.5)	(58.8)	(63.6)	(67.5)	(70.8)
Working capital turnover (days)	12.3	38.2	39.8	39.5	39.0
DPS (Rs)	3.0	3.0	3.0	3.5	4.0
Dividend payout (%)	9.9	7.9	8.4	9.3	9.9
Dividend yield (%)	0.6	0.6	0.6	0.7	0.8

Source : Company, Anand Rathi Research

Low return ratios on account of cash-induced higher balance sheet size and the tax impact kicking in from CY10

Company Background & Management

Patni's key strengths include reasonable scale, domain focus and an ability to manage large clients. It operates in the insurance, telecoms services, product engineering and manufacturing verticals. Its key market is the US. It is focusing on broadening its client and revenue base.

Patni is a global technology services and solutions company, specializing in the insurance, telecoms services, product engineering and manufacturing sector. It has 13,995 employees and operates from 28 global locations.

On 24 Oct '00, it issued 124,500 shares of Rs10 each to GE Capital Mauritius Equity Investment, which at present holds about a 2.1% stake. Patni is GE's second-largest offshore vendor. It came out with an IPO in Jan '04 of 18.72m shares (FV: Rs2), comprising a fresh issue of 13.4m shares at Rs230 each.

Strong management

Narendra Patni, Chairman

Chairman (erstwhile CEO) Narendra Patni was one of the founders of Patni Computer Systems. His professional experience includes senior management and consulting positions with the U.S. Trust Co. of New York and Arthur D. Little, Inc.

He was also president and director of the Forrester Consulting Group. In 1972, he founded his first company, Data Conversion, Inc., which is now a US subsidiary, Patni Computer Systems, Inc.

Jeya Kumar, CEO

Managing overall business strategy and global operations is Jeya Kumar. Until recently, he was CEO, Mphasis, and has more than 25 years of global experience spanning several geographical areas.

Prior to Mphasis, he was senior vice-president, Sun Microsystems, where, as head of a \$5bn-a-year Services business, he was responsible for the business unit's financial performance, strategy, marketing, portfolio management, in-market management, product engineering, technology development, M&A and channels in more than 120 countries.

He also held various management positions with global firms including Apple Computers, Inc., and the National Semi-Conductor Corp.

Surjeet Singh, CFO

CFO since Jul '06, Surjeet Singh is responsible for overall financial strategy, financial operations and compliances, globally.

Prior to joining Patni, he was co-founder and CFO, Cymbal Corp., a services company acquired by Patni in late 2004. Prior to this, he held various senior finance and operations positions in Ranbaxy, an Indian multinational pharmaceutical company. In all, Surjeet has around two decades of multi-industry experience, holding senior management positions in finance, business planning and global supply chain functions.

SWOT Analysis

Fig 27 – SWOT Analysis

<u>Strengths</u>	<u>Weaknesses</u>
<p>Strong domain expertise in insurance, telecoms We believe that Patni has built strong domain knowledge in the insurance and telecoms services verticals. It is increasingly moving towards providing solutions for these verticals. As a result, we believe that customers would find it difficult to replace Patni, increasing revenue stickiness</p> <p>Good client relationships Patni has strong and long-lasting relationships with several large customers (GE, ABN AMRO and AT&T)</p> <p>Strong balance sheet Patni has Rs158 of cash/share. Further, we expect continued robust cash flow momentum in FY10-12.</p>	<p>Customer concentration For FY09, Patni obtained ~36.5% of revenue from its top-five and ~49.8% from its top-ten clients. Due to the high client concentration, any slowdown in spending from these large clients could have a huge impact on it</p> <p>High exposure to ADM Patni's high exposure to mature Application Development and Maintenance (ADM) services and low exposure to growth markets, such as Infrastructure Management Services and Systems Integration</p> <p>High exposure to the US Nearly 80% of its FY09 revenue came from the US. Compared with other IT large caps, Patni has less business from emerging markets</p>
<u>Opportunities</u>	<u>Threats</u>
<p>Participating and winning new deals We believe Patni is increasingly participating in large deals and is likely closing in on two large multi-year deals of around US\$100m-200m. Also, after management restructuring, deal focus has sharpened</p> <p>Scaling up with new management We believe that management changes at Patni are positive. Hence, we believe the turnaround could be faster than otherwise. It has essentially become a professionally-managed company (from a promoter-driven one)</p> <p>Acquisitions could drive further growth Patni is looking to acquire companies specializing in ITO and Enterprise solutions We believe that such acquisitions could add domain expertise and new clients with growth potential</p>	<p>Management distraction This has resulted from news of disagreements between promoters running the company and those looking to divest.</p> <p>Salary hikes Average offshore salaries for the Indian IT sector, leading to potential margin pressure</p> <p>Rupee appreciation Rupee appreciation against the US dollar is a risk to margins</p>

Source: Anand Rathi Research

Annexure – Company history

Patni has had a series of acquisitions and management changes. These have had a bearing on its prospects.

Fig 28 – Spate of events in Patni's history

Date	Event (particular)
Jan '10	Dr Anil Gupta appointed EVP and global head of business operations
Jan '10	Derek Kemp appointed president, EMEA region (previously global industry head for Communications, Media & Utilities at Patni)
Oct '09	Won a deal with Edwards, a vacuum equipment manufacturer, to provide IT and BPO services
Sep '09	Vijay Mehra appointed executive vice-president and head of business verticals
Aug '09	Naresh Lakhanpal appointed president of Patni Americas, Inc.
Aug '09	Patni's regional business structured by four geographical areas - US, EMEA, APAC and SAARC. Asia-Pacific region further divided into APAC and SAARC. APAC operations headquartered in Singapore; SAARC operations based out of India
Jul '09	Arun Maira, independent director, resigned to join as member, Planning Commission, Delhi
Jul '09	Patni was in the race for the Indian software unit of AIG, but lost to Mphasis
Jun '09	Patni opened a centre in Mexico, its first delivery centre in Latin America
Jun '09	Manish Soman appointed chief of operations and executive vice-president. Responsible for sales, technology, business continuity and resource planning
Feb '09	Jeya Kumar appointed chief executive officer. N. K. Patni ceases to be CEO but continues to act as chairman
Dec '08	Fred Cohen appointed group V-P and would head its global asset management practice
Apr '08	Peer Gribbohm appointed senior V-P, strategic market development, responsible for Patni's business across Europe
Apr '08	Derek Kemp appointed senior V-P, responsible for communications, media and entertainment sector within Europe
Apr '08	Jeremy Mackinlay appointed marketing director, responsible for Europe
Apr '08	Loek van den Boog appointed executive director
Mar '08	Robert Rando appointed new V-P, sales, product engineering services
Dec '07	John Blyzinskyj appointed new senior V-P, manufacturing services
Oct '07	Announced multi-year US\$200m deal with The Carphone Warehouse, a UK FTSE 100 co.
Sep '07	Rajesh Padmanabhan appointed EVP and global head of Human Resources
Jul '07	Acquired a 100% stake in Taratec, a consulting company in Life Sciences, for US\$27m
Jul '07	Acquired a 100% stake in Logan Orviss International, a consulting company in specialist telecommunications
Jun '07	Brian Stones appointed executive V-P, European operations
Mar '07	Dr Sanjay Savla appointed senior V-P and business unit head, infrastructure management services
Jun '06	Acquired US-based ZaiQ Technologies, adding verification and validation expertise to product engineering services
Jun '06	Surjeet Singh appointed CFO
Mar '06	Won significant multi-services telecoms deal from The Carphone Warehouse, UK's largest independent retailer of mobile communications
Dec '05	American Depository Shares listed on the NYSE
Nov '04	Patni entered telecommunications vertical by acquiring the US-based Cymbal Corp. for US\$68m
Feb '04	Patni's IPO 22x oversubscribed. Price fixed at Rs230/share (face value: Rs2)
May '03	Acquired US-based The Reference, focused on the financial services vertical
Sep '02	General Atlantic invested US\$100m, acquiring a minority stake

Source: Company, Anand Rathi Research

Patni's fact sheet

Period (Dec-end)	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09
Revenue breakup (geographical, %)						
Americas	76.7	78.6	78.9	80.0	80.8	80.5
EMEA	17.5	15.6	15.1	14.2	13.5	14.0
APAC	5.8	5.8	6.0	5.8	5.7	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0
Revenue breakup (industry verticals, %)						
Insurance	25.1	27.1	27.3	29.7	31.2	30.5
Manufacturing, Retail & Distribution	29.5	28.8	29.2	27.7	28.4	30.3
Financial Services	12.5	12.9	13.7	13.8	12.3	12.0
Communications, Media & Utilities	17.7	15.5	14.4	13.7	13.5	12.3
Product Engineering services	15.2	15.7	15.4	15.1	14.6	14.9
Total	100.0	100.0	100.0	100.0	100.0	100.0
Revenue breakup (service offerings, %)						
Application development & maintenance	64.2	64.6	65.1	64.9	65.0	65.8
Package software implementation	15.0	13.5	13.7	13.8	12.9	12.8
Product engineering services	10.8	11.3	11.4	11.3	11.1	11.2
Infrastructure management services	4.7	5.0	3.5	4.7	6.0	5.3
Business process outsourcing	5.3	5.6	6.3	5.3	5.0	4.9
Total	100.0	100.0	100.0	100.0	100.0	100.0
Revenue (project type, %)						
T&M	63.2	62.2	62.4	60.2	57.6	57.6
Fixed price projects (incl. fixed priced SLA)	36.8	37.8	37.6	39.8	42.4	42.4
Total	100.0	100.0	100.0	100.0	100.0	100.0
Client details						
Top client (%)	10.5	11.0	12.3	12.3	11.9	11.1
Top 5 clients (%)	32.9	34.6	33.7	37.2	38.3	37.0
Top 10 clients (%)	45.3	48.7	46.8	50.1	51.4	50.9
USD\$1m (Nos.)	91	92	94	90	92	92
USD\$5m (Nos.)	30	30	26	26	27	26
USD\$10m (Nos.)	20	19	20	17	16	15
USD\$50m (Nos.)	2	2	2	2	2	2
New clients (Nos.)	27	18	22	7	7	20
Active clients (Nos.)	332	331	320	294	283	272
Repeat business (%)	94.3	93.1	94.1	94.5	93.6	93.7
Revenue mix & Utilization (%)						
Efforts – onsite	28.2	28.7	28.3	27.6	26.8	26.9
Efforts – offshore	71.8	71.3	71.7	72.4	73.2	73.1
Revenue – onsite	58.0	58.6	57.8	55.5	55.1	54.9
Revenue – offshore	42.0	41.4	42.2	44.5	44.9	45.1
Utilization	75.0	73.1	70.3	74.4	77.0	77.4
Employee details						
Offshore	11,662	11,928	11,693	11,022	10,843	11,264
Onsite	3,039	2,966	2,847	2,758	2,764	2,731
Total employees	14,701	14,894	14,540	13,780	13,607	13,995
Sales & support	1,511	1,563	1,550	1,495	1,520	1,484
Net additions (technical)	(343)	193	(354)	(760)	(173)	388
Attrition (LTM) excluding BPO (%)	20.2	18.6	15.5	13.2	11.3	13.7

Source: Company Reports

Appendix 1

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The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

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	Buy	Hold	Sell
Large Caps (>US\$1bn)	>20%	5-20%	<5%
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