



11th May 2009

Patni Computer Systems Limited

CMP Rs. 163.0 | BUY

Summary	Page 3
Our take on IT	Page 4
Patni Facts	Page 5
Spud Bashing	Page 7
Investment Arguments	Page 9
Valuation	Page 10
Looking out for...	Page 11
Quarterly Financials	Page 12
Financials	Page 13-14

Patni Computer Systems Limited

CMP Rs. 163.0

Initiating Coverage

BUY

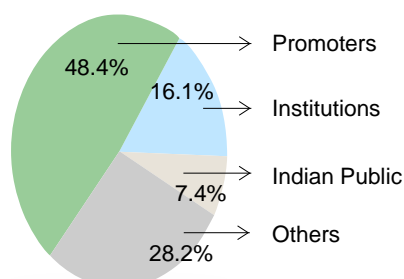
Stock Codes

Bloomberg	: PATNI.IN
Reuters	: PTNI.BO
BSE Code	: 532517
NSE Code	: PATNI
BSE Group	: B

Stock Data

Benchmark	: BSE IT
52 Week H/L	: 287.5/94.0
Float	: 66.1Mn
Mkt Cap	: Rs. 20,880 Mn
Face Value	: Rs. 2.0

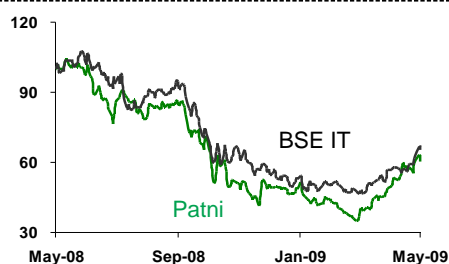
Shareholding Pattern (as on Mar '09)



Stock Returns

	1 Mth	3 Mths	6 Mths
Patni	23.46	41.32	19.80
BSEIT	15.13	31.14	3.36

Price Comparison



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Valuation

Patni is available at almost 5 times earnings which is still half the multiple which it could have received at the maximum buyback price @Rs 325 per share. Patni is available at below book at 0.7 times with cash per share of Rs.114. If we remove the cash element, the entire business is still available at a discount.

PE Interest

In the past, a few PE investors have been waiting on the fence for an opportunity to invest in Patni. So far only GA has stayed on board. But with the inclusion of any PE investor, there would be an expectation that they could put in their own management team. But every investor has to go through Mr. Narendra Patni at least till 2013, says the ADR agreement, which allows him the authority to pick the management team till then.

Management Change

Patni has just added on board their new CEO, Mr. Jeya Kumar (former CEO at MPhasis) after Mr. Narendra Patni stepping down as CEO. This looks like a move to stabilize the performance over the long run leading to steady growth in the future. Also Mr. Narendra Patni & his brothers have been known to be in the midst of a stake war owing to Mr. Narendra Patni's veto powers till 2013. This change in management seems like a good move indicating complete attention to business performance than other personal feuds of the promoters.

Comparison

Peer Comparison	P/E	Revenue (Rs. Mn)	Mcap (Rs. Mn)
Patni (CY08)	5.0	31,172.7	20,880.3
Infosys (FY08)	15.5	156,480.0	902,207.3
Wipro (FY08)	17.4	176,581.0	522,778.4
TCS (FY08)	13.2	185,365.5	616,573.3
HCLTech (Jun-07)	12.7	37,686.2	100,241.8

Summary Financials

Particulars (Rs Mn)	CY05	CY06	CY07	CY08	CY09E
Total Revenues	19,869.3	26,080.3	26,911.5	31,172.7	34,290.0
EBITDA	4,122.3	6,269.0	6,976.6	6,004.9	5,964.0
Reported PAT	1,987.7	2,447.7	4,836.2	4,380.1	3,751.5
OPM (%)	18.8%	21.9%	19.6%	15.1%	15.4%
EBITDA (%)	20.7%	24.0%	25.9%	19.3%	17.4%
EPS (Rs.)	14.4	17.7	34.8	34.2	29.3
P/E (x)	11.3	9.2	4.7	4.8	5.6
P/BV (x)	1.1	1.0	0.8	0.7	0.7
Cash per Share (Rs.)	94.6	92.3	92.1	114.8	123.1
ROCE (%)	16.1%	23.2%	21.9%	17.0%	15.0%
Dividend Payout (%)	19.9%	19.3%	10.4%	10.3%	10.2%

It's always a quasi-daunting task to explain something that is so ubiquitous. The Indian IT story has been played & replayed over the past decade ad infinitum. Recent turmoil in the global markets & many clients of our IT companies suffering overall, the story has been looking a little bleak according to the media. Having enjoyed reasonable growth in the past & still plenty of growth to be seen, why is the Indian IT story downplayed suddenly when there is a blip in the economy?

There is uncertainty at every step as we know it, but what remains a silver lining for the IT industry is that, companies, no matter how much distress they are in will need IT services. Whom would these companies partner with in these times, the formidable & reliable players who have proved to be trusted partners in the past or some new entrants with low priced services & no track record? Despite the geographical spread of the Indian IT companies, they are still looked upon cautiously.

What is implied when we look at formidable & reliable IT partners? With a good track record in service delivery & a 'full services play' as it is known in this industry, a reliable IT partner is the one who provides all this at outsourced prices. This is how it has been & the only inflection that is seen in this model is the global delivery story. Setting up development centres near the clients so that they can get round the clock services support has become a trend & in some cases a benchmark for a good IT partner.

Most of the Indian Software Services companies follow this model. But now it seems that the focus has also grown to providing specific IT services tailored for specific sectors. This demands in-depth knowledge of the sectors as well as capability to deliver related services in the near future. This, yet again is a conventional approach & now instead of spreading geographically companies also seem to focus on vertical growth. Catering to clients in market specific verticals & adding onto the knowledge base through inorganic means has become a recent trend.

Another silver lining for the Indian IT industry is the fear of job loss that roams in the market. Apart from the non-performance related lay offs, there has been a wide ranging stability in the employee count within the firms. This fear has worked for their advantage since attrition rates have dropped to historical low & good talent is retained within the firms. This does cause a momentary recruiting crunch, but this positive feedback loop has proved to be good for the firms. Firms that are capable of retaining this good talent can hope to see a jump in their average utilization rates which might translate into more revenue stability.

One such company which fits the garden variety Indian IT services framework is Patni Computer Systems Limited. One of the Top 10 IT companies in India, Patni caters to a client base of around 320 active clients across 30 countries. With over 20 Global Delivery Centres spanning across US, Europe & India, Patni also plans to setup base in China to leverage their recently acquired IT talent & infrastructure providing near shore service to its growing Asia Pacific clients.

History

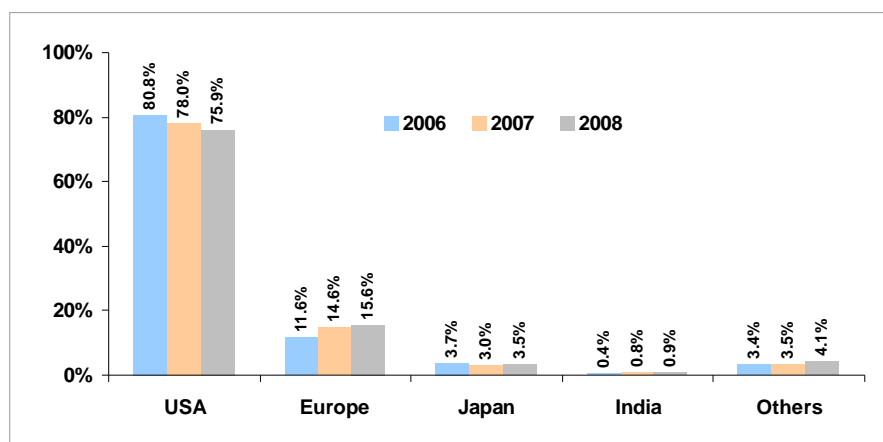
Patni is a 30 years old company, has been one of those companies which started the IT services movement in India along with giants like TCS, Infosys & many more. Back in 1972, the duo of Narendra Patni & his wife Poonam Patni, took the first steps towards setting up an offshoring business from US. Later on they set up operations in Pune with just 20 people. Now Patni is 14500 employees strong all over the globe.

Patni, during its formative years had the likes of Narayan Murthy, Nandan Nilekani & S Gopalkrishan working for it, who later went on to start Infosys. But Patni sadly, grappling in the past with its hardware & software services portfolio, had to play catch-up with its rivals which might explain the scale to which the business grew despite being in the same business at the same time. Although now, Patni has also emerged as a formidable player in the Indian IT services space & has a similar services portfolio as the rest of the top ranking Indian Software Services companies.

Geography

Geographically Patni is more dependent on its American clients. It also operates in other geographies like India, Japan, Europe, Latin America & so on. Following is a representation of its revenues coming from different geographies. The management plans to direct a portion of its investment for the year in geographical expansion.

Revenues by Geography



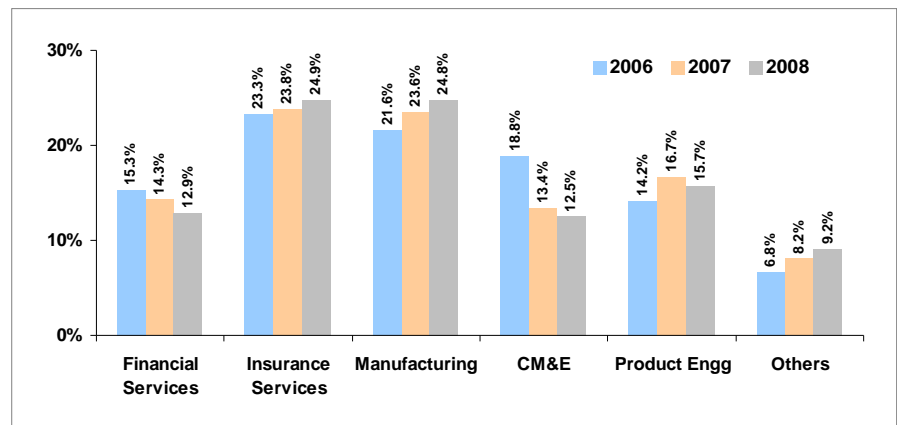
Revenues by Verticals

One of the most noticeable aspects of revenue by verticals is Patni's exposure to the financial services segment. None of Patni's clients have faced shutdowns or bankruptcy. What was thought of as a disadvantage of not having those big clients a few years back, now in hindsight looks like a wonderful move. But does it imply Patni's inability to grasp those projects or even selectively choosing not to cater to those clients? This remains unfounded.

Most of the clients are in a distressed condition which has made them demand price cuts & the company has also witnessed a slight blip in its volumes. As of Q1CY09 there has been an average 2.5% decline in pricing with some of its clients, but there has been no indication of such a declining trend. Although in the near future, depending on the economic conditions, the company might also face more volume decline along with some pricing pressure.

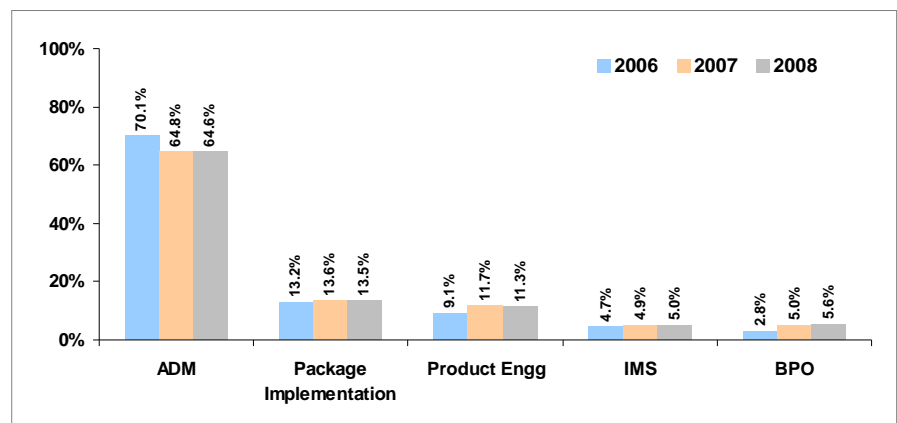
Patni is a strong player in its service offerings for the Manufacturing & Product Engineering clients.

Following represents its revenue by verticals.



Revenues by Horizontals

Patni has a very well balanced portfolio, yet the management expects more opportunities to arise in further fine tuning this balance by strategic investments directed towards it. The management expects to deploy the surplus cash on the books towards this endeavour & cultivate a well balanced services portfolio.



Economic Perspective

Pricing Pressure

Patni, as we know is facing some pricing pressure & volume decline from some of its distressed clients, but the fluctuations look more like a quarterly aberration so far. Many of the long term projects are still in execution while some contracts are on the verge of completion. This means that any pricing decline registered at this point is too premature a figure to establish as a credible trend. Also moving on, fixed price contracts are likely to increase in comparison to the time & material based contracts giving better visibility of revenues.

Volume Pressure

Patni has also faced some volume pressure from its clients, who are deferring projects & delaying commitment to new contracts. Due to an overall cut in the discretionary spending of the clients, short term demand seems to have contracted. But business from existing customers looks positive.

In order to minimize the negative impact of volume decline, the company plans to focus more on converting more contracts to fixed price type. Although 94% of the company's business is routine & annuity based, Patni's utilization rate has been slightly low at 70.3%, but looking at the overall job market, reduced attrition & change in offshore-onsite mix of revenue, a stable rate of 72% to 73% can be expected.

Patni plans to recruit about 1200 employees this year, but due to demand aberrations, has deferred the joining dates of most of these prospective employees. They plan to match the infusion of new employees in tandem with the demand for the year, so as to maintain a steady utilization rate.

To meet with the volume/pricing pressure, the company has arranged for some cost rationalization measures where in they plan to use levers like utilization, offshore-onsite mix tilted more towards offshoring, reducing bench to nil & finally cutting variable expenses by deferring salary hikes for the year. This might show an overall impact on the margins in sync with the volume pressure & operating margin might stabilize at around 14%. Patni hedges 25% of its 12 Months revenues.

Revenue as T&M and Fixed Priced contracts

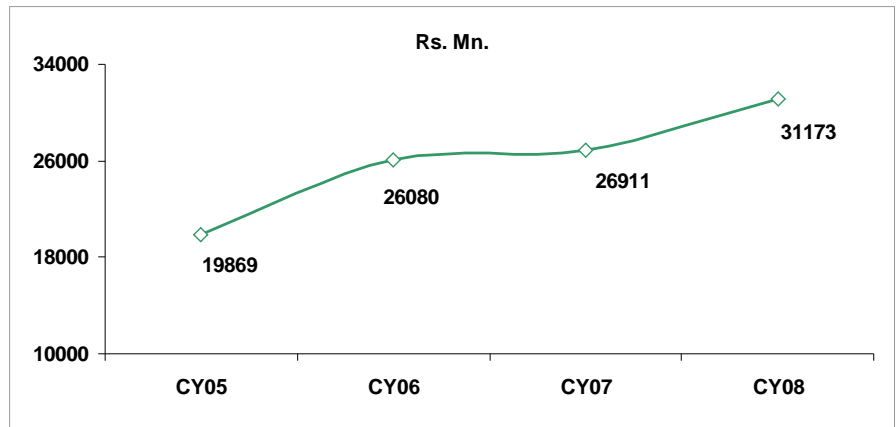
Revenue Type	2006	2007	2008
T&M	67.00%	66.00%	62.20%
Fixed Price	33.00%	34.00%	37.80%

Revenue by Clients

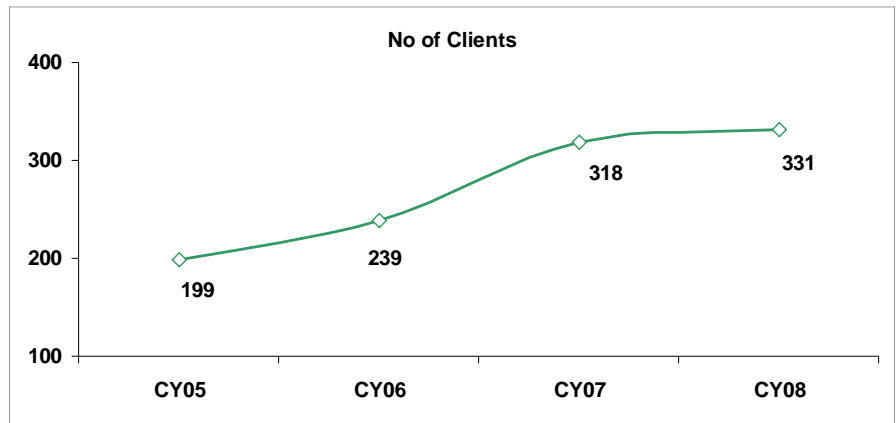
Revenue by Clients	2006	2007	2008
Top Client	13.50%	12.50%	11.00%
Top 5 Clients	38.00%	34.20%	34.60%
Repeat Business	91.00%	90.00%	94.00%

Overall growth

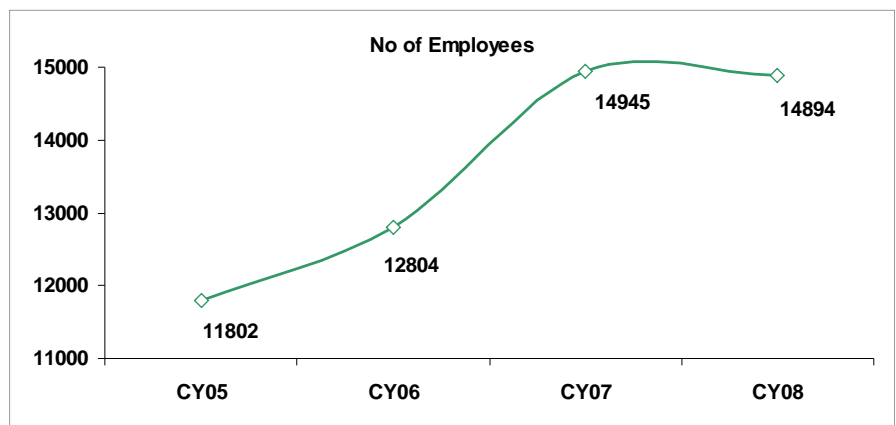
Revenues



Clients



Employees



The Tale of Patni Brothers

The Patni brothers, Narendra Patni, Gajendra Patni & Ashok Kumar Patni have been known to be part of a stake war. To sell their stake to any PE investors, the two brothers have to go through Narendra Patni due to the agreement which gives him the veto rights till 2013.

Gajendra Patni & his son Amit Patni have been involved in power projects, both of whom hold a big stake in Patni along with the rest of the family. No investor can enter without going through Narendra Patni at least till the end of the agreement tenure.

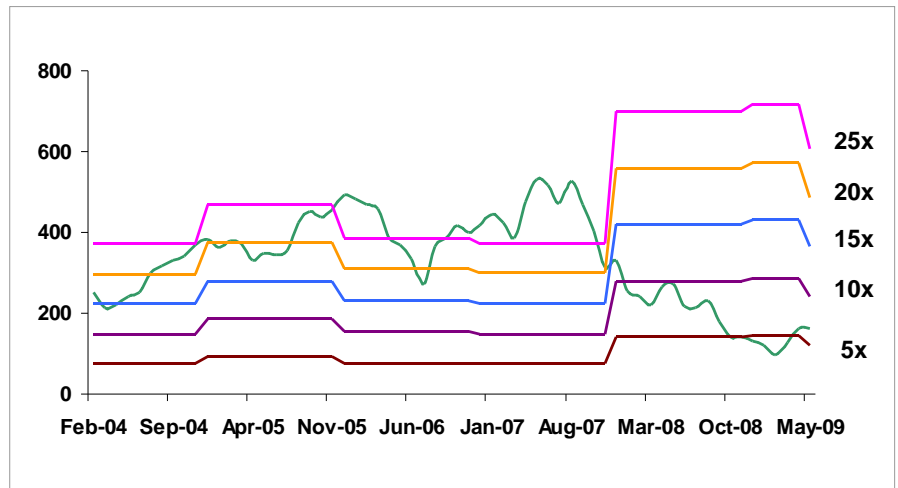
Patni right now is available at almost 5 times earnings. In 2008, Patni spent Rs 237 Crs for executing a buy back @ max price of Rs 325 / share which is 10 times today's earnings. This brings Patni's current valuation to about half the buyback valuation.

Patni is still available below book-value at 0.7 times with cash/share of about Rs. 114.

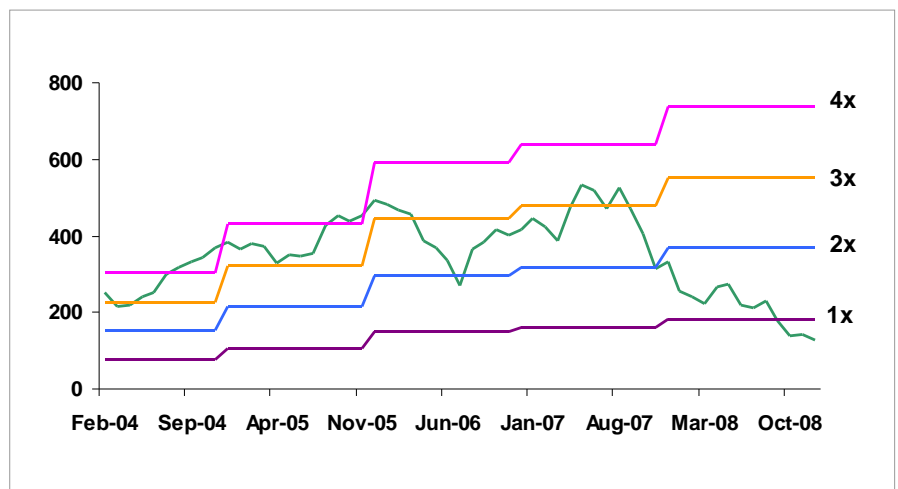
In the past, a clutch of top PE players which included Carlyle, APAX Partners, etc. had shown interest in buying a large stake in Patni. General Atlantic seems to be one of the few PE funds which has tagged along since its association 5 years ago. The play would now be to invest & gain management rights from the promoters, but for such an act to take place the investors have to go through Mr. Narendra Patni who has the veto rights till 2013. With the introduction of the new CEO Mr. Jeya Kumar (formerly CEO at Mphasis), it can be expected that this move is to place a proper management team to smoothen the company's performance leading to a possible sale in the future. When this will happen, only time can tell!

With the current valuation, a reasonable estimate for the value of the business if acquired by a PE investor might be somewhere with a 20-25% upside to the maximum buyback valuation which would be around Rs. 400 per share (P/E of 14).

PE Band



P/BV Band



As mentioned earlier, after squeezing the margin out of the end-to-end service offerings, it might now be a time for looking at specialized services for specific sectors & that's where most of the players are aiming at in building their domain expertise. Consulting, a high margin business is the next hope to compete with the MNC IT services & consulting companies who have a strong foothold in it.

One such acquisition in the field of life-sciences consulting is Taratec (US based) acquired by Patni in 2007 for \$27mn cash. This acquisition is in line with Patni's strategy to enhance its market specific services. The life sciences market overseas has been seeing good growth over the years & has a diverse set of service requirements. Patni's end-to-end capability to provide for such services & its global delivery model coupled with Taratec's consulting experience in the domain might prove to be a good combination going forward.

Quarterly Financials									
Particulars (Rs. Mn)	Mar 09	Dec 08	Sept 08	Jun 08	Mar 08	Dec 07	Sept 07	Jun 07	Mar 07
Net Revenues	7831.2	8570.0	7996.1	7673.1	6933.5	6754.1	6747.4	6587.8	6796.3
Total Expenditure									
Personnel Expenses	4679.4	5140.7	4626.5	4488.8	4072.7	3794.1	4017.3	3871.5	3706.8
SG&A	2009.8	2370.7	1857.0	2117.6	1797.2	1225.4	1561.0	1009.9	1587.8
Operating Profit	1142.0	1058.6	1512.6	1066.6	1063.6	1734.6	1169.0	1706.4	1501.7
Other Income	128.5	98.0	531.9	493.2	180.4	(363.2)	531.9	331.1	365.0
EBITDA	1270.5	1156.6	2044.5	1559.8	1244.0	1371.4	1700.9	2037.5	1866.7
Depreciation	284.1	294.4	289.2	279.8	278.1	218.0	289.2	245.1	232.5
PBIT	986.4	862.2	1755.3	1280.1	965.9	1153.4	1411.7	1792.4	1634.3
Interest	39.1	79.0	26.8	32.4	34.0	38.1	39.9	38.7	30.6
PBT	947.3	783.2	1728.5	1247.7	931.9	1115.3	1371.9	1753.7	1603.7
Tax									
<i>Current Tax</i>	233.2	342.5	28.0	165.3	166.9	311.7	300.0	358.7	272.2
<i>FringeBenefit Tax</i>	14.0	14.3	14.3	8.6	12.2	11.7	10.5	12.1	9.9
<i>Mat Credit</i>	(65.1)	(306.5)	(116.0)	(117.5)	(48.4)	(466.5)	(73.8)	(96.5)	(17.8)
PAT	765.2	732.9	1802.3	1191.2	801.2	1258.5	1135.1	1479.5	1339.3
Equity Capital	256.2	256.2	260.6	278.1	278.1	278.0	278.0	277.3	278.0
Adjusted EPS (in Rs.)	6.0	4.7	13.2	8.6	5.8	7.3	7.1	10.5	9.6
Annualised Adjusted EPS	23.8	18.8	53.0	34.2	23.0	29.3	28.4	42.2	38.4
P/E on Adj Annualised EPS	6.8	8.7	3.1	4.8	7.1	5.6	5.7	3.9	4.2
Profitability									
OPM %	14.6%	12.4%	18.9%	13.9%	15.3%	25.7%	17.3%	25.9%	22.1%
EBITDA %	16.2%	13.5%	25.6%	20.3%	17.9%	20.3%	25.2%	30.9%	27.5%
PBIT %	12.6%	10.1%	22.0%	16.7%	13.9%	17.1%	20.9%	27.2%	24.0%
PAT %	9.8%	8.6%	22.5%	15.5%	11.6%	18.6%	16.8%	22.5%	19.7%

Earnings Statement					
Particulars (Rs Mn)	CY05	CY06	CY07	CY08	CY09E
Total Revenues	19,869.3	26,080.3	26,911.5	31,172.7	34,290.0
- Growth (%)		31.3%	3.2%	15.8%	10.0%
Total Expenditure	16,129.0	20,368.0	21,625.0	26,471.2	29,016.5
Operating Profit	3,740.3	5,712.3	5,286.5	4,701.5	5,273.5
Other Income	381.9	556.7	1,690.1	1,303.4	690.6
EBITDA	4,122.3	6,269.0	6,976.6	6,004.9	5,964.0
Depreciation	678.2	842.8	984.8	1,141.5	1,187.1
EBIT	3,444.1	5,426.2	5,991.8	4,863.5	4,776.9
Interest	81.2	189.6	147.2	79.0	70.0
PBT	3,362.9	5,015.4	5,844.6	4,784.5	4,706.9
Tax	466.2	2,567.7	1,008.4	404.4	955.4
Reported PAT	1,987.7	2,447.7	4,836.2	4,380.1	3,751.5
- Growth (%)		23.1%	97.6%	-9.4%	-14.4%

Ratio Analysis					
Particulars	CY05	CY06	CY07	CY08	CY09E
OPM (%)	18.8%	21.9%	19.6%	15.1%	15.4%
EBITDA (%)	20.7%	24.0%	25.9%	19.3%	17.4%
PBIT (%)	17.3%	20.8%	22.3%	15.6%	13.9%
PAT (%)	10.0%	9.4%	18.0%	14.1%	10.9%
Interest Cover (x)	42.4	28.6	40.7	61.6	68.2
EPS (Rs.)	14.4	17.7	34.8	34.2	29.3
P/E (x)	11.3	9.2	4.7	4.8	5.6
P/BV (x)	1.1	1.0	0.8	0.7	0.7
BVPS (Rs.)	154.2	168.7	196.8	221.7	248.0
Cash per Share (Rs.)	94.6	92.3	92.1	114.8	123.1
FCF per Share (Rs.)		34.1	78.7	125.0	240.3
Market Cap (Rs. Mn.)	22,461.2	22,540.0	22,658.5	20,881.1	20,880.3
M Cap/Sales (x)	1.1	0.9	0.8	0.7	0.6
EV (Rs. Mn.)	15,785.6	20,510.0	21,396.5	8,549.8	5,541.7
EV/EBITDA (x)	3.8	3.3	3.1	1.4	0.9
EV/Sales (x)	0.8	0.8	0.8	0.3	0.2
ROCE (%)	16.1%	23.2%	21.9%	17.0%	15.0%
RONW (%)	9.4%	10.5%	17.7%	15.4%	11.8%
Debt/Equity Ratio (x)	0.0	0.0	0.0	0.0	0.0
Debtors T/o Days	58.5	70.7	71.1	63.0	86.0
Advances T/o Days	11.8	11.7	22.1	16.4	17.9
Creditors T/o Days	56.0	51.3	57.5	73.1	72.4
Working Cap T/o Days	131.8	39.6	36.1	22.4	157.5
Fixed Assets T/o (Gross)	3.7	3.8	2.6	2.7	2.7
DPS (Rs.)	2.9	3.4	3.6	3.5	3.0
Dividend Payout (%)	19.9%	19.3%	10.4%	10.3%	10.2%
Dividend Yield (%)	1.8%	2.1%	2.2%	2.2%	1.8%

Balance Sheet					
Particulars (Rs Mn)	CY05	CY06	CY07	CY08	CY09E
Equity Capital	275.6	276.6	278.0	256.2	256.2
Share Application money pending allotment	0.0	2.7	1.8	1.7	0.0
Reserves	20,971.7	23,044.9	27,081.7	28,143.2	31,512.1
Shareholders Funds	21,247.3	23,324.2	27,361.5	28,401.1	31,768.3
Borrowed Funds	31.8	30.6	23.8	17.5	15.0
Deferred Tax Liability	59.8	35.6	12.8	133.7	59.2
Total Liabilities	21,338.9	23,390.4	27,398.0	28,552.4	31,842.5
Goodwill	2,921.3	3,400.7	4,278.4	4,907.3	4,907.3
Fixed Assets	4,173.1	5,869.1	8,317.4	8,985.6	8,948.6
Investments	6,331.3	10,697.8	11,516.8	11,771.3	2,088.6
Current Assets					
Sundry Debtors	3,230.1	5,122.8	5,316.5	5,450.9	8,193.3
Loans & Advances	652.8	846.2	1,648.9	1,420.7	1,704.9
Cash & Bank Balance	6,707.3	2,060.6	1,285.9	2,931.8	13,682.8
Other Current Assets	1,176.1	1,011.3	1,277.6	1,494.8	1,614.4
Current Liabilities					
Liabilities	3,091.8	3,719.0	4,295.0	6,327.8	6,897.3
Provisions	1,400.7	2,449.5	2,532.4	3,027.5	3,300.0
Net Current Assets	7,273.8	2,872.3	2,701.4	1,942.9	14,998.0
Deferred Tax Assets	639.3	550.5	584.0	945.2	900.0
Total Assets	21,338.9	23,390.4	27,398.0	28,552.4	31,842.5

Cash Flow					
Particulars (Rs Mn)	CY05	CY06	CY07	CY08	CY09E
Opening Cash & Bank	3,364.2	6,707.3	2,060.6	1,285.9	2,931.8
Profit After Tax	1,987.7	2,447.7	4,836.2	4,380.1	3,751.5
Invnt Income	(381.9)	(556.7)	(1,690.1)	(1,303.4)	(690.6)
Interest Paid	81.2	189.6	147.2	79.0	70.0
Depreciation	678.2	842.8	984.8	1,141.5	1,187.1
Deferred Taxation	(62.5)	59.9	(63.9)	(24.6)	0.0
Others	2,660.8	2,288.3	6,873.3	13,384.0	24,516.4
Change in Working Cap	(2,053.8)	(3,036.5)	(8,419.0)	(11,897.2)	(26,849.8)
CF - Operating Activities	2,909.7	2,235.1	2,668.5	5,759.4	1,984.7
Change in Fixed Assets	(2,297.6)	(2,510.3)	(3,361.4)	(1,736.7)	(1,150.1)
Change in Investments	(2,616.5)	(4,366.5)	(818.9)	(254.6)	9,682.8
Investment Income	381.9	556.7	1,690.1	1,303.4	690.6
CF - Investing Activities	(4,532.2)	(6,320.2)	(2,490.3)	(687.8)	9,223.2
Increase in Equity	5,439.1	102.1	(297.3)	(2,890.7)	(1.7)
Changes in Borrowings	3.2	(1.2)	(6.9)	(6.2)	(2.5)
Interest Paid	(81.2)	(189.6)	(147.2)	(79.0)	(70.0)
Dividend Paid	(395.4)	(473.0)	(501.6)	(449.8)	(382.7)
CF - Financing Activities	4,965.6	(561.7)	(952.9)	(3,425.7)	(456.9)
Net Change in Cash	3,343.1	(4,646.7)	(774.7)	1,645.9	10,751.0
Closing Cash & Bank Bal	6,707.3	2,060.6	1,285.9	2,931.8	13,682.8

Disclaimer

Disclosure of Interest Statement

1. Analyst Ownership of the scrip
2. PPFAS ownership of the scrip
3. PMS ownership of the scrip

Patni Computer Systems Limited Limited

NO
NO
NO

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