

SIFY LIMITED and Subsidiaries

CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share data and as stated otherwise)

1. Description of business

Sify Limited ("Sify") together with its subsidiaries (the "Company") and its affiliates is engaged in providing various services, such as corporate network and data services, internet access services, online portal and content offerings, and selling products related to such services.

2. Summary of significant accounting policies

a. Basis of preparation of financial statements

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP) in Indian Rupees (Rs.), the national currency of India. Solely for the convenience of the reader, the financial statements as of and for the quarter ended June 30, 2006 have been translated into United States dollars at the noon buying rate in New York City on June 30, 2006 for cable transfers in Indian rupees, as certified for customs purposes by the Federal Reserve Bank of New York of US\$1 = Rs.45.87. No representation is made that the Indian rupee amounts have been, could have been or could be converted into United States dollars at such a rate or at any other rate on June 30, 2006 or at any other date.

b. Interim Information

Interim information presented in the condensed consolidated financial statements has been prepared by the management without audit and, in the opinion of management, includes all adjustments of a normal recurring nature that are necessary for the fair presentation of the financial position, results of operations, and cash flows for the periods shown, is in accordance with US GAAP. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's annual report on Form 20-F for the fiscal year ended March 31, 2006.

c. Business combinations

Business combinations have been accounted using the purchase method under the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations. Cash and amounts of consideration that are determinable at the date of acquisition are included in determining the cost of the acquired business.

3. Acquisition of Globe Travel Business

During the quarter ended June 30, 2006, the Company acquired Globe Travels which operates an online travel agency. The management believes this acquisition marks Sify's entry into the fast growing online travel business, particularly e-ticketing, the category with highest revenues and fastest growth in online e-commerce today. The management also believes that the addition of a travel portal is in line with the Company's strategy of providing end-to-end services to Sify users. The results of Globe Travels operations have been consolidated in the financial statements effective May 10, 2006, the date of acquisition. The purchase price in respect of the business acquisition comprises the following:

Cash Price	Rs.112,220 (USD 2,500)
Stock Options (No.of options)	140,000
Earn Out Payments	USD 500

The Cash price of USD 2,500 includes an amount of USD 500 as holdback amount payable upon the Airlines Reporting Corporation ("ARC") approval of the Company's application for change of ownership of the travel portal. The said holdback amount has been included and accounted as purchase consideration since the management, based on advice, believes that the resolution of the contingency (i.e approval of ARC) is beyond reasonable doubt.

The Stock Options have been treated as compensation cost in accordance with the provisions of EITF 95-8 Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination. Further, as the Earn Out Payment is contingent upon continuing employment and achievement of specified earning levels the same will be treated as compensation cost in accordance with the provisions of EITF 95-8.

As the cost of Stock Options and Contingency Earn out payments are treated as compensation cost, the cost of acquisition comprises of only cash price of Rs.112,220 and other incidental direct acquisition cost of Rs.3,999.

The Cash Price has been allocated to the estimated fair value of the assets, properties including rights at the date of purchase of business.

The following table summarizes the preliminary allocation of estimated fair value of the assets, properties including rights at the date of purchase of the business. The allocation of the purchase price is subject to obtaining third party valuation of certain intangibles.

Property and Equipment	Rs. 1,246
Intangible Assets	88,052
Goodwill	26,921
Total	116,219

The acquired intangible assets, in the opinion of the management, have a weighted average useful life of five years. The intangible assets are as follows:

Customer and Contract related intangibles	Rs. 85,797
Software	2,255

4. IP / VPN License

In December 2004, as per the Government of India (“GOI”) guidelines regarding Virtual Private Network (“IP-VPN”) services by Internet Service Providers (“ISPs”), the Company paid Rs.100,000 as an entry fee for a 15 year license and submitted a financial bank guarantee of Rs.10,000 . In addition, the ISP licensees were required to pay an annual fee of 8% of the adjusted gross revenues generated under the ISP license for IP-VPN services.

On November 10, 2005, the GOI issued guidelines for obtaining National Long Distance (“NLD”) and International Long Distance (“ILD”) licenses including the terms and conditions for the licenses. These guidelines eliminated the IP-VPN license, entitling the Company to a full refund of the Rs.100,000 entry fee, and permitting existing IP-VPN license holders to migrate to the NLD and ILD service licenses effective January 1, 2006. The Company has applied for these licenses. The Company discontinued amortization of the IP-VPN license effective November 10, 2005 and reversed the amortization of the license fee

As per the ILD and NLD license guidelines, the Company will be required to pay Rs. 50,000 as an entry fee for the ILD and NLD licenses when approval is obtained and submit a bank guarantee of Rs. 25,000 for the ILD license and Rs. 20,000 for the NLD license.. This entry fee will be evenly amortized over the license period of 20 years. In addition to the entry fee, the Company has to pay an annual license fee of 6% on the Adjusted Gross Revenue generated (AGR) as defined under the ILD and NLD licenses for IP-VPN services.

5. Sale of 26% holding in Sify Communications Limited

The new guidelines issued by the GOI for ILD/NLD licenses limit foreign direct investment (“FDI”) for the telecom sector to 74% of the equity shares outstanding. As the foreign shareholding in Sify is more than the threshold limit, Sify would not be eligible for the NLD/ILD licenses. Accordingly, the Company determined to provide the IP-VPN services through Sify Communications Limited (formerly Safescrypt Limited), a subsidiary of Sify. On December 19, 2005 Sify contributed Rs.700,000 as additional equity in Sify Communications Limited to make the net worth of the Sify Communications positive. On December 20, 2005, the Company entered into an agreement to divest 26% of its holding in Sify Communications Limited, or 4,680,000 shares, to M/s Infinity Satcom Universal (P) Ltd, a related party,

for a sale consideration of Rs.139,810. M/s Infinity Satcom Universal (P) Ltd is owned by Anand Raju, who is the brother of Raju Vegesna. Raju Vegesna is the Chairman of Sify's Board of Directors and the principal of Infinity Capital Ventures, LP ("Infinity Capital"). Infinity Capital owns approximately 32% of Sify's outstanding equity shares. Sify Communications Limited has applied for the ILD/NLD license to provide IP-VPN services.

The Company will be transferring the IP VPN business from Sify Limited to Sify Communications Limited upon the latter receiving the ILD / NLD license. Pending transfer of business as at June 30, 2006, the amount received against the sale proceeds is included under other liabilities. Further, Sify will carry on the business of IP VPN Services, until the business is transferred to Sify Communications Limited.

6. Cash and cash equivalents

Cash and cash equivalents as at June 30, 2006 amounted to Rs.2,534,318 (Rs.2,822,501 as at March 31, 2006). This excludes restricted cash included in current assets of Rs.Nil (Rs.Nil. as on March 31, 2006) and restricted cash included in non- current assets of Rs. 1,000 (Rs.1,000 as at March 31, 2006) representing deposits held under lien against bank guarantees given by the Company towards future performance obligations and letters of credit given to suppliers of the Company against purchase obligations.

7. Goodwill and intangibles

At June 30, 2006, the Company's goodwill and other intangible assets amounted to Rs.41,516 and Rs.121,904 respectively (Rs.14,596 and Rs.47,840, as at March 31, 2006 respectively). The following are the details of other intangible assets:

	Weighted average life	As at March 31, 2006		Weighted average life	As at June 30, 2006	
		Gross carrying amount	Accumulated amortization		Gross carrying amount	Accumulated amortization
Technical know how fees	5.00	Rs. 82,753	Rs. 79,240	5.00	Rs. 82,753	Rs. 82,753
Portals and web content	4.91	52,730	50,065	4.91	52,730	52,650
Customer and Contracts related intangibles	4.04	56,084	39,119	4.64	141,883	43,018
Software	2.90	222,119	197,422	2.89	226,881	203,922
Total		Rs 413,686	Rs. 365,846		Rs. 504,247	Rs. 382,343

The aggregate amortization expense for the quarters ended June 30, 2005 and 2006 was Rs 22,038 and Rs 16,497 respectively.

Estimated amortization expense

For the year ended March 31,

2007	Rs. 47,307
2008	29,929
2009	24,033
2010	17,628
2011	17,610
2012	1,894

In accordance with SFAS No. 142, “*Goodwill and Other Intangible Assets*”, the Company does not amortise goodwill but tests it for impairment on an annual basis. The Company has not recognized any impairment of goodwill during the year ended March 31, 2006 and for the quarter June 30, 2006.

8. Employee Stock Options

Prior to March 31, 2006, the Company applied the intrinsic value based method of accounting prescribed by the Accounting Principles Board (APB) Opinion (APB) Opinion No. 25, “Accounting for Stock Issued to Employees”, and related interpretations including FASB Interpretation No. 44, “Accounting for Certain Transactions involving Stock Compensation an interpretation of APB Opinion No. 25”, issued in March 2000 to account for fixed Stock Option Plans. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price.

SFAS 123, “Accounting for Stock Based Compensation”, established accounting and disclosure requirements using a fair value based method of accounting for stock based employee compensation plans. As allowed by SFAS 123, the Company elected to continue to apply the intrinsic value based method of accounting described above, and adopted the disclosure requirements of SFAS 148, “Accounting for Stock Based Compensation – Transition and Disclosure”, and amendment of FASB Statement 123. All stock options issued to date have been accounted as fixed stock option plan.

The following table illustrates the effect on net income and earnings per share if the Company has applied the fair value recognition provisions of SFAS No. 123, “Accounting for Stock Based Compensation”, to account for stock based employee compensation.

Quarter ended June 30,	
2005	
Net income/(loss) – as reported	Rs. (98,149)
Add: Stock based compensation expense included in reported net loss	1,157
Less: Stock based compensation expense determined under fair value method	(13,398)
Pro forma net income/(loss)	<u>Rs. (110,390)</u>
Earnings/(Loss) per share:	
Basic and diluted – reported	Rs. (2.77)
Basic and diluted– proforma	Rs. (3.12)

On April 1, 2006, the Company adopted FASB Statement No.123 (revised 2004),Share-Based Payment using the modified prospective approach. The Company recorded amortization of stock compensation expense of Rs.35,943 for the quarter ended June 30, 2006.

During the quarter ended June 30, 2006, the Company issued 239,600 shares under Associate stock option plan 2005, which has been accounted under SFAS 123R.

The fair value of each option is estimated on the date of grant using the Black-Scholes model with the following assumptions:

	Quarter ended June 30,	
	2005	2006
Dividend yield	-	-

Assumed volatility	103.4% - 116.6%	58.1% - 108.5%
Risk-free interest rate	4.90%	4.5%
Expected term	12-36 months	18-40 months

9. Gratuity

The Company provides for gratuity, a defined benefit retirement plan (the “Gratuity Plan”) covering all employees. The Gratuity Plan commenced on April 1, 1997. The plan provides a lump sum payment to vested employees at retirement or termination of employment, an amount based on the respective employee’s salary and the years of employment with the Company. The Company provides the gratuity benefit through annual contributions to a fund managed by the Life Insurance Corporation of India (“LIC”). Under this scheme, the settlement obligation remains with the Company, although the LIC administers the scheme and determines the contribution premium required to be paid by the Company. The Gratuity Plan is accounted for in accordance with SFAS No. 87, *Employers’ Accounting for Pensions*.

The following table sets out the funded status of the Gratuity Plan and the amounts recognized in the Company’s financial statements.

The components of net gratuity costs are reflected below:

	Quarter ended June 30, 2005	Quarter ended June 30, 2006
Service cost	Rs. 1,702	1,904
Interest cost	348	416
Expected returns on plan assets	(135)	(40)
Amortization	-	-
Recognized net actuarial (gain)/ loss	(122)	(117)
Net gratuity costs	Rs. 1,793	Rs. 2,163

The company estimates the long-term return on plan assets at 7.5% based on the average long-term rate of return expected to prevail over the next 15 to 20 years on the types of investments held with LIC.

The employer’s best estimate of contributions expected to be paid to the plan during the year 2006–2007 amounts to Rs.2,500. Further, the benefits expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter are as follows:

For the year ending	
March 31,	
2007	Rs. 1,512
2008	1,904
2009	2,619
2010	3,965
2011	6,134
2012-2016	36,879

10. Deferred revenue:

Deferred revenue includes the following amounts of unearned income:

- for the Company's corporate network / data services division, revenue relating to the connectivity / hosting charges and from provision of digital certificates;
- for the Company's Internet access services and online portal services divisions, revenue relating to the internet access charges and the advertisement charges respectively; and
- for the Company's other service division, revenue relating to development of e- learning software.

The components of deferred revenue for these segments are:

	As at March 31, 2006	As at June 30, 2006
Corporate network / data services	Rs. 305,028	Rs. 326,755
Internet access services	133,613	115,565
Online portal services	623	202
Other services	5,069	14,002
Total	Rs. 444,333	Rs. 456,524

11. Advertising costs

Advertising costs incurred during the quarter have been expensed. The total amount of advertising costs expensed during the quarters ended June 30, 2005 and 2006 was Rs.7,183 and Rs.14,259 respectively.

12. Products and services

Break-up of revenues and cost of revenues against products and services are as follows:

	Quarter ended June 30, 2005	Quarter ended June 30, 2006
<i>Revenue</i>		
Services revenue	Rs. 865,221	Rs.1,161,890
Initial franchisee fee	22,713	16,000
Installation services revenue	62,660	20,446
	950,594	1,198,336
Products revenue	70,681	120,045
	Rs. 1,021,275	Rs.1,318,381
<i>Cost of revenues (excluding depreciation and amortization)</i>		
Products	Rs. 61,881	Rs.101,349
Services	513,741	568,054
Annual fee on VPN revenue	6,353	25,913
	Rs. 581,975	Rs.695,316

13. Segment reporting

SFAS No 131, "Disclosures about Segments of an Enterprise and Related Information," establishes standards for the way that public business enterprises report information about operating segments and related disclosures about products and services, geographic areas and major customers. The Company's operations predominantly relate to connectivity to enterprises and providing Internet access to retail subscribers (both home access and public access). The Company also operates portals, "Sify.com," "Samachar.com" and "SifyMax.in," that provide a variety of India-related content to audiences both in India and abroad, and which generates revenue from advertisements and other value added services.

The primary operating segments of the Company are:

- Corporate network/data services, which provides private network services, messaging services and web hosting to businesses;
- Internet access services;
- Online portals services and content offerings; and
- Other services such as development of e-learning software.

The Chief Operating Decision Maker (“CODM”) evaluates the Company’s performance and allocates resources to various strategic business units that are identified based on the products and services that they offer and on the basis of the market served. The measure of loss reviewed by the CODM was “Earnings/loss before interest, taxes, depreciation and amortization.”

Revenue in relation to segments is categorized based on items that are individually identifiable to that segment. Bandwidth costs, which form a significant part of the total expenses, are allocated primarily between the corporate network/data services and Internet access services businesses as described below:

International bandwidth refers to bandwidth that is required for access to sites and offices outside the country. For all these businesses, bandwidth is allocated based on actual utilization captured by monitoring traffic per IP pool assigned at the egress points. The Company has packet shapers in the main locations to monitor bandwidth use by each of the above categories of users. This information is used in determining norms like bandwidth per port and bandwidth per PC. The actual utilization is cross validated against assumptions / norms for each business.

National bandwidth refers to the inter-city link bandwidth implemented within the country. Inter-city link bandwidth was allocated based on the number of subscribers or iway cyber cafés at “non gateway” points and the bandwidth sold to and used by business enterprises (determined using packet shapers). However, in order to strengthen its corporate business, the Company enhanced its national backbone to carry Internet traffic to the international fibre gateways, shifting from hybrid satellite and fibre gateways to fibre only gateways for international bandwidth. National bandwidth costs are now allocated based on international bandwidth allocation ratios because most of the traffic carried on the national backbone is directed towards the international gateways. The Company believes that the resulting allocations are reasonable.

Last mile costs related to dial-up access (E1/R2 costs) and spectrum fees for wireless connectivity that can be directly identified to businesses are allocated directly. Certain expenses, such as depreciation, technology and administrative overheads, which form a significant component of total expenses, are not allocable to specific segments as the underlying services are used interchangeably. Management believes that it is not practical to provide segment disclosure of these expenses and, accordingly, they are separately disclosed as “unallocated” and adjusted only against the total income of the Company

A significant part of the fixed assets used in the Company’s business are not identifiable to any of the reportable segments and can be used interchangeably between segments. Management believes that it is not practicable to provide segment disclosures relating to total assets since a meaningful segregation of the available data is onerous. The Company’s operating segment information for the quarters ended June 30, 2005 and 2006 is presented below:

	Quarter ended June 30, 2005				
	Corporate Network / Data Services	Internet Access Services	Online Portal Services	Other Services	Total
Revenues	Rs. 550,639	Rs. 413,337	Rs. 33,603	Rs. 23,696	Rs. 1,021,275
Allocated expenses	(335,863)	(428,480)	(38,237)	(32,773)	(835,353)
Equity in losses of affiliates			10,882		10,882
Minority interest					
Segment operating income / (loss)	Rs. 214,776	Rs. (15,143)	Rs. 6,248	Rs. (9,077)	Rs. 196,804
Unallocated corporate expenses					(187,913)
Foreign exchange gain / (loss)					(220)
Other income / (expense), net					3,161
Depreciation and amortization					(123,007)
Interest income, net					13,026
Net loss					Rs. (98,149)

Quarter ended June 30, 2006

	Corporate Network / Data Services	Internet Access Services	Online Portal Services	Other Services	Total
Revenues	Rs. 752,921	Rs.465,523	Rs. 65,913	Rs. 34,024	Rs. 1,318,381
Allocated expenses	(424,355)	(453,567)	(62,603)	(33,961)	(974,486)
Equity in profits of affiliates			15,788		15,788
Minority interest	-	-	-	-	-
Segment operating income / (loss)	Rs. 328,566	Rs. 11,956	Rs. 19,098	Rs. 63	Rs. 359,683
Unallocated corporate expenses					(228,165)
Foreign exchange gain / (loss), net					44,037
Other income / (expense), net					346
Depreciation and amortization					(147,476)
Interest income, net					33,998
Net Profit					Rs. 62,423

14. Leases

The Company's leasing arrangement consist of leasing various types of routers, modems and other equipment for setting up virtual private network and providing bandwidth to its customers in corporate connectivity business. The leases are classified as Sales-Type Leases and expire after a period of three years.

The following lists the components of the net investment in sales-type leases as of June 30, 2006:

Minimum lease payments receivable	23,498
Less: Unearned income	1,371
Net investment in sales-type leases	Rs. 22,127

The minimum lease payments for each of the fiscal years are as follows:

For the year ending March 31,	
2007	Rs.9,653
2008	11,917
2009	1,395
2010	533

15. Commitments and contingencies

a) The Company had received a notice from the Income-Tax Department of India for the financial years 2002 and 2003 for a sum of Rs.77,700 stating that no withholding tax has been deducted in respect of international bandwidth and leased line payments made by the Company to international bandwidth / lease line service providers.

Based on an opinion of counsel, withholding taxes need not be deducted if the service provider did not have any permanent establishment in India and has not installed any equipment at the Company's premises. The Company is able to demonstrate that international service providers has neither had a permanent establishment in India nor has installed any equipment at the Company's premises. Accordingly, the likelihood of the loss contingency is remote and no provision for the loss contingency is considered necessary.

b) The Company has outstanding financial and performance guarantees for various statutory purposes and letters of credit totalling Rs.247.4 million and Rs.261.9 million as of June 30, 2005 and 2006, respectively. These guarantees are generally provided to governmental agencies.

c) Provident Fund contribution not provided for on leave encashment in respect of periods prior to April 1, 2005 is estimated at Rs.4,326.

16. Legal proceedings

The Company and certain of its officers and directors are named as defendants in a securities class action lawsuit filed in the United States District Court for the Southern District of New York. This action, which is captioned *In re Satyam Infoway Ltd. Initial Public Offering Securities Litigation*, also names several of the underwriters involved in Sify's initial public offering of American Depositary Shares as defendants. This class action is brought on behalf of a purported class of purchasers of Sify's ADSs from the time of Sify's Initial Public Offering ("IPO") in October 1999 through December 2000. The central allegation in this action is that the underwriters in Sify's IPO solicited and received undisclosed commissions from, and entered into undisclosed arrangements with, certain investors who purchased Sify's ADSs in the IPO and the aftermarket. The complaint also alleges that Sify violated the United States federal securities laws by failing to disclose in the IPO prospectus that the underwriters had engaged in these allegedly undisclosed arrangements. More than 300 issuers have been named in similar lawsuits.

July 2002, an omnibus motion to dismiss all complaints against issuers and individual defendants affiliated with issuers was filed by the entire group of issuer defendants in these similar actions. In October 2002, the cases against the Company's executive officers who were named as defendants in this action were dismissed without prejudice. In February 2003, the court in this action issued its decision on defendants' omnibus motion to dismiss. This decision denied the motion to dismiss the Section 11 claim as to the Company and virtually all of the other issuer defendants. The decision also denied the motion to dismiss the Section 10(b) claim as to numerous issuer defendants, including the Company. On June 26, 2003, the plaintiffs in the consolidated IPO class action lawsuits currently pending against Sify and over 300 other issuers who went public between 1998 and 2000, announced a proposed settlement with Sify and the other issuer defendants. The proposed settlement provides that the insurers of all settling issuers will guarantee that the plaintiffs recover \$1 billion from non-settling defendants, including the investment banks who acted as underwriters in those offerings. In the event that the plaintiffs do not recover \$1 billion, the insurers for the settling issuers will make up the difference.

The Company believes that it has sufficient insurance coverage to cover the maximum amount that it may be responsible for under the proposed settlement. Although the Federal District Court has preliminarily approved the settlement, it is possible that the Federal District Court may not finally approve the settlement in whole or part. The Company believes the maximum exposure under this settlement, in the event that the plaintiffs recover nothing from the non-settling defendants, is approximately U.S. \$3.9 million, an amount which the Company believes is fully recoverable from the Company's insurer.

The Company is party to additional legal actions arising in the ordinary course of business. Based on the available information, as of June 30, 2006 Sify believes that it has adequate legal defenses for these actions and that the ultimate outcome of these actions will not have a material adverse effect on Sify.

17. Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation