

SIFY TECHNOLOGIES LIMITED and Subsidiaries
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share data and as stated otherwise)

1. Description of business

Sify Technologies Limited (Sify) together with its subsidiaries (India World Communications Limited, Sify Communications Limited, Sify Networks Private Limited and Sify International Inc.) (collectively referred to as the 'Company') 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 financials statements

The accompanying unaudited condensed financial statements have been prepared in accordance with U.S 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, 2007 have been translated into United States dollars at the noon buying rate in New York City on June 30, 2007 for cable transfers in Indian rupees, as certified for customs purposes by the Federal Reserve Bank of New York of U.S. \$1 = Rs. 40.58. 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 2007 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, 2007.

c. Recent accounting pronouncement

SFAS No. 157:

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines 'fair value' as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 provides guidance on determination of fair value and lays down the fair value hierarchy to classify the source of information used in fair value measurement. The Company is currently evaluating the impact of SFAS No. 157 on its financial statements and will adopt the provisions of SFAS No. 157 for the fiscal year beginning April 1, 2008.

3. Acquisition of Globe Travel Business

During the quarter ended June 2006, the Company acquired the business of Globe Travels which operates an online travel agency. Management believes that 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 purchase price paid / payable amounting to Rs. 116,219 (USD 2,571,303) in respect of the acquisition was allocated based on a preliminary allocation of estimated fair value (determined by the management) of the assets, properties and rights on the date of acquisition. During the quarter ended June 2007, the Company has finalised the purchase price allocation resulting in an increase in recorded goodwill from Rs. 26,921 to Rs. 36,200.

4. Income Taxes

Effective April 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income taxes - An interpretation of Statement of Financial Accounting Standards No.109 (FIN 48). The interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions considered or to be considered in income tax returns. Historically, the Company has not incurred any penalties or interest relating to unrecognized tax benefits. Upon adoption the Company did not have any liability for income tax relating to uncertain tax positions. The adoption of FIN 48 did not have any impact on the retained earnings or provision for taxation as of April 1, 2007.

FIN 48 also requires that changes in judgment that result in subsequent recognition, de-recognition or change in a measurement of a tax position taken in a prior annual period (including any related interest and penalties) be recognized as a discrete item in the period in which the change occurs. This change will not impact the manner in which the Company recorded income taxes on an annual basis and did not impact its recorded income tax provision in the quarter ended June 30, 2007.

A listing of open tax years is given below:

Jurisdiction	Open tax years
India	1997-98 to 2006-2007

5. Cash and cash equivalents

Cash and cash equivalents as at June 30, 2007 amounted to Rs. 1,874,377 (Rs.3,070,157 as at March 31, 2007). This excludes cash-restricted included in non-current assets of Rs.191,777 (Rs.1,000 as at March 31, 2007), representing deposits held under lien against overdraft facilities and bank guarantees given by the Company towards future performance obligations.

Cash Restricted – Non current

	As at March 31, 2007	As at June 30, 2007
Against future performance obligation	Rs.1,000	Rs. 1,000
Deposits held under lien against overdraft facilities	-	Rs.190,777
	Rs.1,000	Rs.191,777

The fair values of cash and cash equivalents approximate their carrying values.

6. Accounts receivable

Account receivable as of March 31, 2007 and June 30, 2007 are stated net of allowance for doubtful receivables. The Company maintains an allowance for doubtful receivables based on its age and collectability. Accounts receivable are not collateralised except to the extent of refundable deposits received from cybercafe's franchisees and from cable television operators.

Accounts receivables consist of:

	As at March 31, 2007	As at June 30, 2007
Due from customers	1,290,030	1,661,146
Less: Allowance for doubtful debts	101,624	144,557
Balance at the end of the year	1,188,406	1,516,589

The activity in the allowance for doubtful accounts receivable is given below:

	As at March 31, 2007	As at June 30, 2007
	Rs.	Rs.
Balance at the beginning of the year	200,047	101,624
Add : Additional provision	153,638	51,030
Less : Bad debts written off	252,061	8,097
Balance at the end of the year	101,624	144,557

7. Other current assets

Other current assets consist of:

	As at March 31, 2007	As at June 30, 2007
Vendor advances and deposits	159,785	78,121
Advances for expenses	5,025	147,244
Accrued income	73,702	9,117
Interest earned but not due	51,161	58,470
	289,673	292,952

8. Investments in affiliates

In March 2006, MF Global Overseas Limited (MFG), a company incorporated in United Kingdom acquired 70.15% of equity share capital of MF Global Sify Securities Private Limited, formerly Man Financial-Sify Securities India Private Limited ('MF Global) from Refco Group Inc., USA ('Refco'). Thereby, MFG holds 70.15% of MF Global and the balance, 29.85% of MF Global equity shares, is held by Sify Limited. MFG is a subsidiary of Man Group plc, a company incorporated in United Kingdom.

The summarised unaudited financial information as to assets, liabilities and results of operations of MF Global and its subsidiaries is presented below:

Balance Sheet	As at	As at
	March 31, 2007	June 30, 2007
	Rs.	Rs.
Current assets	4,097,993	5,174,990
Non-current assets	280,079	185,962
Total Assets	4,378,072	5,360,952
Current liabilities	3,363,146	4,270,058
Shareholders' equity	1,014,926	1,090,894
Total Liabilities and Shareholders' equity	4,378,072	5,360,952

Statement of Operations	For the quarter ended June 30,	
	2006	2007
	Rs.	Rs.
Revenues	283,213	365,950
Net Profit	52,890	75,968

9. Goodwill and other intangible assets, net

As at June 30, 2007, the Company's goodwill and other intangible assets amounted to Rs 50,797 and Rs 137,939 respectively (Rs 41,517 and Rs 150,873, as at March 31, 2007 respectively). The following are the details of other intangible assets:

	Weighted average life	As at March 31, 2007		As at June 30, 2007	
		Gross carrying Amount	Accumulated Amortization	Gross carrying Amount	Accumulated Amortization
Technical know-how fees	-	82,753	82,753	82,753	82,753
Portals and web content	-	52,730	52,711	52,730	52,730
Customer contracts and others	4.04	141,881	60,252	128,770	65,995
Systems software	2.90	239,846	219,714	250,224	223,529
ILD / NLD License fee	20.00	50,000	907	50,000	1,531
		Rs. 567,210	Rs. 416,337	564,477	426,538

Estimated amortization expense in future years for the carrying value of other intangible assets:

For the year ended March 31,

	Rs
2007-08	25,927
2008-09	23,988
2009-10	20,110
2010-11	17,601
2011-12	2,500

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company does not amortize 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, 2007 and for the quarter ended June 30, 2007.

10. Other assets

Other assets consist of:

	As at March 31, 2007	As at June 30, 2007
	Rs.	Rs.
Deposits	105,653	120,232
Staff advances recoverable	150	-
Withholding Taxes	105,734	121,220
Deposit with Department of Income Tax	12,954	32,385
	224,491	273,837

Deposit with Department of Income Tax represents tax demands paid to the authorities under protest. Refer to note 19 (a).

11. Employee stock options

Compensation cost in respect of the stock option plans is accounted under Financial Accounting Standards Board (FASB) Statement No.123 (revised 2004) "*Share Based Payment*". Accordingly, the Company has recorded stock compensation expense of Rs. 13,965 for the quarter ended June 30,2007.

During the quarter ended June 30, 2007, the Company has issued 46,000 options under its Associate stock option plan 2005. The fair value of each option was estimated on the date of grant using the Black-Scholes model with the following assumptions

	Quarter ended June 30,2007
Dividend yield	-
Assumed volatility	57.2%-95.7%
Risk free interest rate	4.5-4.8%
Expected term	18-40 months

12. Earnings per share

In accordance with SFAS No. 128, *Earnings per Share*, basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted income / (loss) is computed by considering the impact of the potential issuance of ordinary shares on the weighted average number of shares outstanding.

A reconciliation of equity shares used in the computation of basic and diluted earnings per equity share is set out below:

	Quarter ended June 30, 2006	Quarter ended June 30, 2007
Earnings		
Net Profit / (loss)	62,423	55,026
Equity shares		
Weighted average number of equity shares outstanding	42,583,948	42,803,988
Effect of dilutive equivalent shares-stock options	480,670	-
Weighted average number of equity shares and equivalent shares outstanding	43,064,618	42,803,988

As the Company was in a loss position for the quarter ended June 30, 2007, the potential ordinary shares were excluded from the calculation of diluted income/loss per share as the shares would have had an antidilutive effect. The Company's outstanding shares include shares held with a depository to represent equity shares underlying the Company's ADSs.

13. 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 of 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.

Net gratuity cost for the quarter ended June 30, 2006 and 2007 included:

	Quarter ended June 30, 2006	Quarter ended June 30, 2007
	Rs.	Rs.
Service cost	1,904	1,751
Interest cost	416	411
Expected returns on plan assets	(40)	(239)
Recognized net actuarial (gain)/ loss	(117)	-
Net gratuity costs	2,163	1,923

Principal weighted average actuarial assumptions:

	Quarter ended June 30, 2006	Quarter ended June 30, 2007
Discount rate	8%	9.55%
Long-term rate of compensation increase	6%	6%
Rate of return on plan assets	6%	7.5%

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 2007–2008 amounts to Rs. 10,000. 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:

For the year ended March 31,	
2008	1,405
2009	1,905
2010	2,892
2011	5,209
2012	7,400
2013 to 2018	43,302

14. 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, 2007	As at June 30, 2007
	Rs.	Rs.
Corporate network/data services	351,933	377,494
Internet access services	61,459	53,177
Online portal services	21	22
Other services	36,617	28,410
	450,030	459,093

15. Borrowings

The Company has short term borrowings of Rs. 171,669 as at June 30, 2007 (Rs. 800,000 as at March 31, 2007), from its bankers for working capital requirements. The borrowings are secured by fixed deposits held by the Company. The borrowings bear interest ranging from 8 to 9.75% and are repayable within one year from the balance sheet date.

16. Products and services

Breakup of revenues against products and services are as follows:

	Quarter ended June 30,	
	2006	2007
	Rs.	Rs.
<i>Revenue</i>		
Service revenue	1,161,890	1,177,130
Initial franchise fee	16,000	13,279
Installation service revenue	20,446	72,075
	1,198,336	1,262,484
Product revenue	120,045	142,617
	Rs.1,318,381	Rs.1, 405,101

17. 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 Internet, connectivity, security and consulting, hosting and managed service solutions;
- Retail Internet access services, from homes and through cybercafés;
- Online portal 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. 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 cybercafés 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 that can be directly identified to businesses are allocated directly. Spectrum charges that are paid for the license that has been provided to enable Sify to operate on the 5.7 GHz wireless spectrum are allocated based on the bandwidth that is used by the various businesses that use this spectrum. 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, 2006 and June 30, 2007 is given below:

	Quarter ended June 30, 2006				
	Corporate Network / Data Services	Internet Access Services	Online Portal Services	Other Services	Total
Revenues	Rs. 764,013	Rs.454,431	Rs.65,913	Rs34,024	Rs.1, 318,381
Allocated expenses	(432,233)	(445,689)	(62,603)	(33,961)	(974,486)
Segment operating income / (loss)	Rs.331,780	Rs.8,742	Rs 3,310	Rs.63	Rs 343,895
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
Equity in profits of affiliates					15,788
Income Taxes					-
Net Profit / (Loss)					Rs.62,423

	Quarter ended June 30, 2007				
	Corporate Network / Data Services	Internet Access Services	Online Portal Services	Other Services	Total
Revenues	888,898	413,421	44,367	58,415	1,405,101
Allocated expenses	(550,090)	(380,738)	(78,025)	(55,336)	(1,064,189)
Minority interest	(5,678)	-	-	-	(5,678)
Segment operating income / (loss)	333,130	32,683	(33,658)	3,079	335,234
Unallocated corporate expenses					(283,021)
Foreign exchange gain / (loss), net					(19,344)
Other income / (expense), net					(67)
Depreciation and amortization					(134,321)
Interest income, net					38,223
Equity in profits of affiliates					22,676
Income taxes					(14,406)
Net Profit / (Loss)					(55,026)

18. Sales-type leases

The Company's leasing arrangement consist of leasing various types of routers, modems and other equipment for establishing virtual private networks and providing bandwidth to its customers in its 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 at March 31, 2007	As at June 30, 2007
	Rs.	Rs.
Minimum lease payments receivable	30,493	25,815
Less: Unearned income	1,901	1,493
Net investment in sales-type leases	28,592	24,322

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

For the year ending March 31,

2008	13,110
2009	7,275
2010	5,430
Total	25,815

19. Commitments and contingencies

- a) During the year ended March 31, 2006, the Company received a notice from the Income-Tax Department of India for the financial years 2002 and 2003 for a sum of Rs.103,000 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. Subsequently, the demand was revised to Rs. 77,724 by the income tax authorities. Under the Income tax regulations the company is required to pay such amounts in 12 monthly installments under protest if it seeks to dispute the demand. Accordingly, the Company has paid 5 installments amounting to Rs. 32,385 till June 30, 2007 under protest and challenged such demands. The Company believes that 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 has demonstrated to the tax authorities that international service providers neither had a permanent establishment in India nor installed any equipment at the Company's premises, and hence concluded that the likelihood of the loss contingency is remote and no provision for the loss contingency is considered necessary. The amounts paid under protest are included under 'Other assets'.
- b) The Company has outstanding financial and performance guarantees for various statutory purposes and letters of credit totalling Rs. 641,115 and Rs. 613,914 as of March 31, 2007 and June 30,2007, respectively. These guarantees are generally provided to governmental agencies.
- c) Additionally, the Company is also involved in lawsuits, claims and proceedings, which arise in the ordinary course of business. There are no such items pending that the Company expects to be material in relation to its business.

20. Legal proceedings

- a) The Company and certain of its erstwhile 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.

In 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.

- b) The Company is party to additional legal actions arising in the ordinary course of business. Based on the available information, as of June 30, 2007, 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.

21. Acquisition of minority interest in Subsidiary

The Board of Directors of the Company at their meeting held on February 10, 2008 has approved the merger of Sify Communications Limited, a subsidiary Company and the Company with retrospective effect from April 1, 2007, subject to approval by the members, the Honourable High Court and other statutory authorities. The shareholders of the Company at the Extraordinary General Meeting held on March 17, 2008 have accorded their assent on the said merger. The Company has filed a petition with the Honourable High Court of Madras, India, for the proposed merger and is pending approval.

22. Reclassification

Certain prior period / year amounts have been reclassified to confirm to the current year's presentation.