HCL TECHNOLOGIES LIMITED

CONSOLIDATED FINANCIAL STATEMENTS – AS OF JUNE 30, 2000 AND 2001 AND FOR THE THREE YEARS ENDED JUNE 30, 2001 TOGETHER WITH REPORT OF INDEPENDENT AUDITORS

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders

HCL Technologies Limited

We have audited the accompanying consolidated balance sheets of HCL Technologies Limited and subsidiaries as of June 30, 2000 and 2001, and the related consolidated statements of income, stockholder' equity and comprehensive income, and cash flows for each of the years in the three-year period ended June 30, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HCL Technologies Limited and subsidiaries as of June 30, 200 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

KPMG

New Delhi, India

August 2, 2001

HCL TECHNOLOGIES LIMITED
CONSOLIDATED BALANCE SHEETS
(In thousands)

	As of June 30,	
	2000	2001
ASSETS		
Current assets:		
Cash and cash equivalents	$39,392	$91,007
Restricted cash	415	376
Accounts receivable, net of allowances	41,214	53,591
Investment securities, available for sale	168,943	183,567
Due from related parties	427	292
Inventories	2,147	3,268
Short-term loans	323	5,309
Employee receivables	2,132	2,426
Deferred income taxes	2,285	2,403
Other current assets	5,520	13,001
Total current assets	262,798	355,240
Property and equipment, net	17,684	32,182
Intangible assets, net	9,663	7,195
Investments in equity investees	16,925	27,022
Other investments	10,076	13,553
Employee receivables	608	135
Deferred income taxes	1,392	5,378
Other assets	871	1,816
Total assets	$320,017	$442,521

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED
CONSOLIDATED BALANCE SHEETS
(In thousands, except number of shares)

	As of June 30,	
	2000	2001
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of capital lease obligations	$171	$97
Accounts payable	4,475	6,647
Due to related parties	1,333	828
Accrued employee costs	7,616	9,858
Deferred revenue	3,690	4,650
Deferred income taxes	179	662
Taxes payable	4,670	10,415
Other current liabilities	15,694	19,940
Total current liabilities	37,828	53,097
Capital lease obligations	149	72
Deferred income taxes	9	-
Other liabilities	281	25
Total liabilities	38,267	53,194
Minority interest	9	14
Stockholders' equity		
Equity shares, 350,000,000 shares authorized, Issued and outstanding - 279,527,062 and 284,919,708 as of 2000 and 2001 respectively	15,449	15,680
Additional paid-in capital	190,383	212,161
Share application money pending allotment	440	579
Deferred stock compensation	(126)	(17)
Retained earnings	85,831	187,038
Accumulated other comprehensive income	(10,236)	(26,128)
Total stockholders' equity	281,741	389,313
Total liabilities and stockholders' equity	$320,017	$442,521

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except number of shares and per share data)

	Years ended June 30,		
	1999	2000	2001
Revenues	$166,326	$206,833	$298,385
Less: Stock based sales incentive	-	2,266	1,733
Net revenues	166,326	204,567	296,652
Cost of revenues (exclusive of depreciation shown separately below)	100,330	106,637	151,304
Sales and marketing expenses	13,538	14,960	17,684
General and administrative expenses	26,638	35,402	38,137
Depreciation and amortization	6,907	6,937	8,944
Foreign exchange gains, net	549	1,447	2,573
Income from operations	19,462	42,078	83,156
Other income (expense), net	(694)	9,818	17,418
Income before income taxes, share of income of equity investees and minority interest	18,768	51,896	100,574
Income tax expense	647	5,885	8,250
Income before share of income of equity investees and minority interest	18,121	46,011	92,324
Share of income of equity investees	3,775	6,151	9,628
Minority interest	222	(52)	(5)
Net income	$22,118	$52,110	$101,947
Earnings per equity share			
Basic	$0.09	$0.20	$0.36
Diluted	$0.08	$0.19	$0.34
Weighted average number of equity shares used in computing earnings per equity share			
Basic	248,960,636	264,438,108	282,409,797
Diluted	263,426,312	280,954,110	296,688,505

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(In thousands, except number of shares)

	Equity shares		Additional paid-in Capital	Shares subscribed pending allotment	Deferred Stock compensation	Retained earnings	Comprehensive income	Accumulated other Comprehensive income	Total stockholders' equity
	Shares	Amount							
Balances as of June 30, 1998	248,960,636	$10,240	$1,724	$-	$-	$16,944		$(3,684)	$25,224
Share of net income of a subsidiary for the three months ended June 30, 1998 due to change in fiscal year end	-	-	-	-	-	(821)		-	(821)
Gain on dilution of interest in a subsidiary	-	-	-	-	-	251		-	251
Distribution to principal shareholder	-	-	(1,316)	-	-	-		-	(1,316)
Cash dividend	-	-	-	-	-	(427)		-	(427)
Comprehensive income									
Net income	-	-	-	-	-	22,118	$22,118	-	22,118
Other comprehensive income									
Unrealized loss on available for sale securities, net	-	-	-	-	-	-	(104)	-	-
Translation adjustments	-	-	-	-	-	-	(688)	-	-
Total other comprehensive income	-	-	-	-	-	-	(792)	(792)	(792)
Total comprehensive income	-	-	-	-	-	-	$21,326	-	-
Balances as of June 30, 1999	248,960,636	$10,240	$408	$-	$-	$38,065		$(4,476)	$44,237

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(In thousands, except number of shares)

	Equity shares		Additional paid-in Capital	Shares subscribed pending allotment	Deferred Stock compensation	Retained earnings	Comprehensive income	Accumulated other Comprehensive income	Total stockholders' equity
	Shares	Amount							
Balances as of June 30, 1999	248,960,636	$10,240	$408	$-	$-	$38,065		$(4,476)	$44,237
Issuance of equity shares, net	28,400,000	1,301	181,641	-	-	-		-	182,942
Issuance of equity shares on exercise of options	2,166,426	99	5,761	-	-	-		-	5,860
Stock dividend	-	3,809	-	-	-	(3,809)		-	-
Shares subscribed	-	-	-	440	-	-		-	440
Repurchase of shares by a subsidiary	-	-	-	-	-	(116)		-	(116)
Fair value of stock options granted for acquisition of minority interest	-	-	150	-	-	-		-	150
Compensation related to stock option grants	-	-	301	-	(301)	-		-	-
Amortization of compensation related to stock option grants	-	-	-	-	175	-		-	175
Contribution from principal shareholder in the form of stock based sales incentive	-	-	2,266	-	-	-		-	2,266
Capital transactions of equity investee	-	-	305	-	-	-		-	305
Income tax benefit on exercise of stock options of subsidiaries	-	-	668	-	-	-		-	668
Distribution to principal shareholder, net	-	-	(1,117)	-	-	-		-	(1,117)
Cash dividend	-	-	-	-	-	(419)		-	(419)
Comprehensive income									
Net income	-	-	-	-	-	52,110	$52,110	-	52,110
Other comprehensive income									
Unrealized gain on available for sale securities, net	-	-	-	-	-	-	1,959	-	-
Translation adjustments	-	-	-	-	-	-	(7,719)	-	-
Total other comprehensive income	-	-	-	-	-	-	(5,760)	(5,760)	(5,760)
Total comprehensive income	-	-	-	-	-	-	$46,350	-	-
Balances as of June 30, 2000	279,527,062	$15,449	$190,383	$440	$(126)	$85,831		$(10,236)	$281,741

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
(In thousands, except number of shares)

	Equity shares		Additional paid-in Capital	Shares subscribed pending allotment	Deferred Stock compensation	Retained earnings	Comprehensive income	Accumulated other Comprehensive income	Total stockholders' equity
	Shares	Amount							
Balances as of June 30, 2000	279,527,062	$15,449	$190,383	$440	$(126)	$85,831		$(10,236)	$281,741
Issuance of equity shares on exercise of options	5,392,646	231	15,206	139	-	-		-	15,576
Amortization of compensation related to stock option grants	-	-	-	-	109	-		-	109
Contribution from principal shareholder in the form of stock based sales incentive	-	-	1,733	-	-	-		-	1,733
Capital transactions of equity investee	-	-	798	-	-	-		-	798
Income tax benefit on exercise of stock options of subsidiaries	-	-	4,041	-	-	-		-	4,041
Cash dividend	-	-	-	-	-	(740)		-	(740)
Comprehensive income									
Net income	-	-	-	-	-	101,947	$101,947	-	101,947
Other comprehensive income									
Unrealized loss on available for sale securities, net	-	-	-	-	-	-	(813)	-	-
Translation adjustments	-	-	-	-	-	-	(15,079)	-	-
Total other comprehensive income	-	-	-	-	-	-	(15,892)	(15,892)	(15,892)
Total comprehensive income	-	-	-	-	-	-	$ 86,055	-	-
Balances as of June 30, 2001	284,919,708	$15,680	$212,161	$579	$ (17)	$ 187,038		$(26,128)	$389,313

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years ended June 30,		
	1999	2000	2001
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$22,118	$52,110	$101,947
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	6,907	6,937	8,944
Deferred income taxes	(425)	(158)	97
(Gain) loss on sale of property and equipment	(3)	5	30
Stock based sales incentive	-	2,266	1,733
Amortization of deferred stock compensation expense and other non cash charges	-	175	704
(Profit) loss on sale of investment securities	-	7,061	(7,130)
Write-down of marketable securities, available for sale	228	40	-
Share of income of equity investees	(3,775)	(6,151)	(9,628)
Minority interest	(222)	52	5
Changes in assets and liabilities, net			
Accounts receivable	(1,768)	(6,804)	(13,629)
Other assets	4,464	(4,886)	(21,186)
Accounts payable	62	(1,216)	2,157
Accrued employee costs	2,583	(2,085)	2,358
Other liabilities	1,801	11,151	11,214
Net cash provided by operating activities	31,970	58,497	77,616
CASH FLOWS FROM INVESTING ACTIVITIES			
Restricted cash	(771)	554	39
Purchase of property and equipment	(5,679)	(11,723)	(22,273)
Proceeds from sale of property and equipment	62	109	158
Purchase of investments	(463)	(241,162)	(184,373)
Proceeds from sale of investments	-	47,671	172,131
Investment in equity investees	-	(750)	(3,069)
Payment for business acquisition, net of cash acquired	(2,754)	(7,000)	-
Loans extended to related parties	(7,060)	-	-
Loans repaid by related parties	11,258	21	-
Net cash used in investing activities	(5,407)	(212,280)	(37,387)
CASH FLOWS FROM FINANCING ACTIVITIES			
Payments of capital lease obligations	(106)	(340)	(104)
Net proceeds from (repayment of) bank line of credit	(6,873)	(7)	-
Repayment of short term borrowings	(3,682)	(973)	-
Repayment of long term debt	(5,532)	(1,944)	-
Proceeds from issuance of equity shares, net	-	188,802	14,840
Proceeds from subscription of shares pending allotment	-	440	139
Proceeds from issuance of equity shares of subsidiary to minority	352	11	-
Repurchase of equity shares of a subsidiary	-	(469)	-
Liability to principal shareholder	1,469	(5,151)	-
Capital distribution to principal shareholder	(1,316)	(1,117)	-
Payment of dividends	(427)	(419)	(740)
Net cash provided by (used in) financing activities	(16,115)	178,833	14,135
Effect of exchange rate on cash and cash equivalents	(1,230)	(2,576)	(2,749)
NET INCREASE IN CASH AND CASH EQUIVALENTS	$9,218	$22,474	$51,615
CASH AND CASH EQUIVALENTS			
Beginning of the year	$7,840	$16,918	$39,392
Net cash activity of subsidiary for three months ended June 30, 1998	(140)		
End of the year	$16,918	$39,392	$91,007

HCL TECHNOLOGIES LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years ended June 30,		
	1999	2000	2001
SUPPLEMENTARY CASH FLOW INFORMATION			
Cash paid during the year for interest	$1,982	$3,339	$1,563
Cash paid during the year for income taxes	$528	$3,106	$4,523
Non-cash investing activities			
Property and equipment acquired under capital lease obligation	$335	$-	$29
Details of acquisitions:			
Fair value of assets acquired	$11,339	$8,040	$-
Fair value of liabilities assumed	$1,339	$3,818	$-

See accompanying notes to the consolidated financial statements.

HCL TECHNOLOGIES LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unless otherwise specified, all amounts are stated in United States Dollars)

1. ORGANIZATION AND NATURE OF OPERATIONS

a) *Incorporation and history*

HCL Technologies Limited (HCL or the Company) was incorporated in India in November 1991. The Company is primarily engaged in providing a range of information technology services targeted at technology vendors, software product companies and medium to large end user organizations.

b) *Reorganization and basis of presentation of financial statements*

Mr. Nadar, the Company's principal shareholder, had a controlling/ significant interest in, inter alia, the following entities during the periods presented:

(i) HCL, consisting primarily of software development centers, its subsidiaries and its equity investees:

- In January 1995, HCL acquired HCL Technologies America, Inc. (HCL America), for cash from a company in which Mr. Nadar held less than a controlling interest. HCL America was a company organized under the laws of California, USA in November 1988. This acquisition was accounted for under the purchase method;
- Intelicent, Inc., a 60% owned company organized under the laws of Virginia, USA in March 1996; and
- Far East Computers Private Limited (FEC), a 43% equity investee organized under the laws of Singapore in January 1980.

(ii) HCL Technologies Bermuda Limited (HCL Bermuda), a 100% owned company organized in December 1997 under the laws of Bermuda. HCL Bermuda has 100% owned subsidiaries in Europe and Asia Pacific.

(iii) HCL Holdings GmbH, Vienna (HCLH), a 100% owned company, organized in December 1996 under the laws of Austria. In August 1997, HCLH purchased a 44% interest in HCL Perot Systems NV (HPS), a company organized under the laws of The Netherlands in March 1996. This transaction was accounted for under the purchase method.

(iv) HCL Comnet Systems and Services Limited (COMNET), a majority owned company, organized in December 1994 under the laws of India.

A reorganization of the above-mentioned controlled entities was completed through a series of transactions. The following transactions occurred during fiscal 1999:

1. HCL's sale of its investment in FEC to another company controlled by Mr. Nadar, for cash;
2. HCL's acquisition of HCL Bermuda from an investment company owned by Mr. Nadar for cash;
3. The transfer by HCL of its 100% ownership of HCL America and its 60% ownership of Intelicent to HCL Bermuda in exchange for shares in HCL Bermuda;
4. HCL Bermuda's acquisition of HCLH, a company controlled by Mr. Nadar for cash; and
5. HCL's acquisition of a majority interest in COMNET from Mr. Nadar.

Since all of the businesses acquired in the reorganization were under the control of Mr. Nadar, the accompanying consolidated financial statements retroactively reflect the accounts of the transferred businesses at their historical costs. The amounts related to the equity method investment in FEC have been retroactively excluded as this company has been separately financed and autonomously managed separately from the other entities in the Company and will continue to be so subsequent to the reorganization.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States to reflect the financial position and results of operations of the Company along with its subsidiaries (hereinafter collectively referred to as the Company).

(b) Principles of consolidation

The consolidated financial statements present the accounts of the Company and all of its subsidiaries, which are more than 50% owned and controlled.

In 1999, COMNET changed its fiscal year-end from March 31 to June 30. The results of operations for the period from April 1, 1998 to June 30, 1998 were added to retained earnings for the year ended June 30, 1999 in order to report only 12 months of operating results.

Intelicent has been consolidated from March 1, 1999 upon acquisition of the 40% minority interest from the previous minority shareholder who had significant participating rights that precluded consolidation prior to the acquisition. Previously, Intelicent was accounted for by the equity method.

The Company accounts for investments by the equity method where its investment in the voting stock gives it the ability to exercise significant influence over the investee. In the case of investments in Limited Liability Partnerships (LLPs), significant influence is presumed to exist where the Company has more than a 5% partnership interest. The financial statements of Diamondhead Ventures LLP used for equity method accounting in 2001 are as of March 31, 2001.

All material inter-company accounts and transactions are eliminated on consolidation.

(c) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the results of operations during the reporting periods. Although these estimates are based upon management's best knowledge of current events and actions, actual results could differ from those estimates.

(d) Exchange rate translation

The consolidated financial statements are reported in United States Dollars (US Dollars). The functional currency of each entity in the Company is its respective local currency. The translation of the functional currency into US dollars is performed for balance sheet accounts using the exchange rates in effect at the balance sheet date and for revenue and expense accounts using an appropriate monthly weighted average exchange rate for the respective periods. The gains or losses resulting from such translation are reported as a separate component of stockholders' equity.

Monetary assets and liabilities in foreign currencies are translated into the functional currency at the rates of exchange prevailing at the balance sheet date. Transactions in foreign currencies are translated into the functional currency at the rates of exchange prevailing at the date of the transaction. The gains or losses resulting from foreign currency transactions are included in the statement of income.

(e) Revenue recognition

Revenue on time-and-material contracts is recognized as related services are performed. Revenues from fixed price contracts are recognized using the percentage of completion method of accounting, under which sales value of performance, including earnings thereon is determined by relating the actual man hours of work performed to date, to the estimated total man hours for each contract. Provisions for estimated losses on contracts in progress are recorded in the period in which such losses become probable based on current contract estimates.

Revenue from sale of goods is recognized when the following criteria are met:

- Persuasive evidence of an arrangement exists;
- The price to the buyer is fixed and determinable;
- Risks and rewards in respect of ownership of the products are transferred to the customer; and
- Collectibility of the sales price is reasonably assured.

Revenue from sale of goods is shown net of sales tax and applicable discounts and allowances.

Installation fees are recognized when the related services have been performed and the installation is complete. The installation services generally span over a very short period of time.

Revenue from providing network access and maintenance services is deferred and recognized systematically over the term of the agreement.

Warranty costs on sale of goods and services are accrued based on management estimates and historical data at the time related revenues are recorded.

(f) Inventory

Inventory consists of goods that are held for sale in the normal course of business and are stated at the lower of cost and net realizable value. Cost is determined using the weighted-average method and comprises the purchase price and attributable direct costs, less trade discounts.

(g) Property and equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Assets under capital leases are stated at the present value of minimum lease payments. The Company depreciates property and equipment over the estimated useful life using the straight-line method. Leasehold improvements are amortized on a straight-line basis over the shorter of the primary lease period or estimated useful life of the asset. Assets under capital leases are amortized over their estimated useful life or the lease term, as appropriate. The cost of software obtained for internal use is capitalized and amortized over the estimated useful life of the software. The estimated useful lives of assets are as follows:

Buildings	20 years
Computer equipment	3 to 4 years
Software	3 to 3.5 years
Mainframe computer system	6 years
Office furniture and equipment	4 years
Vehicles	5 years

Advances paid towards the acquisition of property and equipment outstanding at each balance sheet date and the cost of property and equipment not put to use before such date are disclosed under capital work-in-progress.

(h) Intangible assets

Intangible assets represent goodwill and identified intangible assets such as employee workforce and customer relationships, which arise or have been acquired in business combinations.

Values have been assigned to the identified intangible assets based on an evaluation by management. The intangible assets are amortized on the straight-line method over the periods during which the benefits are expected to accrue from these assets. The estimated useful lives of intangible assets are as follows:

Goodwill	5 to 7 years
Employee workforce	4 to 5 years
Customer relationships	10 years
Intellectual property rights	4 years

(i) Impairment of long-lived assets

Statement of Financial Accounting Standards (SFAS) No.121, Accounting for the Impairment of Long Lived Assets and for Long-Lived Assets to be Disposed Of, requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever an event or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

(j) Start-up-costs

Cost of start-up activities including organization costs are expensed as incurred.

(k) Investments in equity investees

The Company's share of profits/ losses of equity investees is included in the consolidated statements of income, and the Company's share of net assets of equity investees is included in the consolidated balance sheets. A transaction of an equity investee of a capital nature, which affects the investor's share of stockholders' equity of the investee, is accounted for as if the investee were a consolidated subsidiary.

(l) Investment securities

Investment securities consist of available-for-sale debt and equity securities. Available-for-sale securities are carried at fair value as determined by reference to prevailing market prices. Unrealized gains and losses, net of taxes are excluded from earnings and are reported as a separate component of other comprehensive income. Declines in fair value below original cost are recorded through the statement of income when they are considered to be other than temporary. The cost of securities sold is based on the specific identification method for computing realized gain or loss. However, in cases where specific identification method is not possible, first-in-first-out method is used. Dividend and interest income are recognized when earned.

(m) Other investments

Equity and preferred securities, which do not have a readily determinable fair value, are reported at cost, subject to other than temporary diminution, if any.

(n) Research and development

Revenue expenditure on research and development is expensed as incurred. Capital expenditure incurred on equipment and facilities acquired or constructed for research and development activities and having alternative future uses, is capitalized as property and equipment.

(o) Software product development

Software product development costs are expensed as incurred until technological feasibility is achieved. Software product development cost incurred subsequent to the achievement of technological feasibility have not been significant and have been expensed as incurred.

(p) Cash, cash equivalents and restricted cash

Cash equivalents represent highly liquid investments with an original maturity of ninety days or less. Restricted cash represents margin money deposits against guarantees and letters of credit. Restrictions on such deposits are released on the expiry of the terms of guarantees and letters of credit.

(q) Income taxes

Income taxes are accounted for using the asset and liability method. The current charge for income taxes is calculated in accordance with the relevant tax regulations applicable to each entity in the Company. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance of any tax benefits of which future realization is uncertain.

(r) Earnings per share

Basic earnings per share is computed using the weighted average number of equity shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of equity and dilutive equity equivalent shares outstanding during the period, using the treasury stock method for options and warrants, except where results would be anti-dilutive.

(s) Stock based compensation

The Company uses the intrinsic value based method of Accounting Principles Board (APB) Opinion No.25 to account for its employee stock-based compensation plan. The Company has therefore adopted the pro forma disclosure provisions of SFAS No.123, Accounting for Stock-Based Compensation.

(t) Retirement benefits to employees

Contributions to defined contribution plans are charged to income in the period in which they accrue. Current service costs for defined benefit plans are accrued in the period to which they relate. Prior service costs, if any, resulting from amendments to the plans are recognized and amortized over the remaining period of service of the employees.

(u) Issue of shares by subsidiary/ equity method investee

An issuance of shares by a subsidiary/ equity method investee to third parties reduces the proportionate ownership interest of the Company in the investee. A change in the carrying value of the investment in such subsidiary or equity method investee due to a direct sale of unissued equity shares is accounted for as a capital transaction and is recognized in the stockholders' equity when the transaction occurs.

(v) Dividend

Dividends are recognized upon approval by the shareholders.

(w) Derivative and hedge accounting

On July 1, 2000, HCL adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities as amended, when the rules became effective for companies with fiscal year ending June 30.

The Company enters into forward foreign exchange contracts where the counterparty is generally a bank. The Company purchases forward foreign exchange contracts to mitigate the risk of changes in foreign exchange rates on accounts payable and forecasted cash flows denominated in foreign currencies. Although these contracts are effective as hedges from an economic perspective, they do not qualify for hedge accounting under SFAS No. 133, as amended. Any derivative that is either not designated hedge, or is so designated but is ineffective as per SFAS No.133, is marked to market and recognized in earnings immediately. No transition adjustments were required to adopt SFAS No. 133.

(x) Recent accounting pronouncements

In July 2001, the FASB issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 as well as all purchase method business combinations completed after June 30, 2001. SFAS No. 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS No. 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142.

SFAS No. 142 will also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 121.

The Company will adopt the provisions of SFAS No. 141 immediately and SFAS No. 142 effective July 1, 2001.

SFAS No. 141 will require upon adoption of SFAS No. 142, that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and to make any necessary reclassifications in order to conform with the new criteria in SFAS No. 141 for recognition apart from goodwill. Upon adoption of SFAS No. 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired in purchase business combinations, and make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an intangible asset is identified as having an indefinite useful life, the Company will be required to test the intangible asset for impairment in accordance with the provisions of SFAS No. 142 within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period.

In connection with the transitional goodwill impairment evaluation, SFAS No. 142 will require the Company to perform an assessment of whether there is an indication that goodwill and equity-method goodwill is impaired as of the date of adoption. To accomplish this the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company will then have up to six months from the date of adoption to determine the fair value of each reporting unit and compare it to the reporting unit's carrying amount. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired and the Company must perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of it assets (recognized and unrecognized) and liabilities in a manner similar to a purchase price allocation in accordance with SFAS No. 141, to its carrying amount, both of which would be measured as of the date of adoption. This second step is required to be completed as soon as possible, but no later than the end of the year of adoption. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle in the Company's statement of income.

As of the date of adoption, the Company expects to have unamortized goodwill and identifiable intangible assets of $7,195,000, all of which will be subject to the transition provisions of SFAS No. 141 and 142. Amortization expense related to goodwill and intangible assets was $2,322,000 for the year ended June 30, 2001. Because of the extensive effort needed to comply with adopting SFAS No. 141 and 142, it is not currently practicable to reasonably estimate the impact of adopting these Statements on the Company's financial statements, including whether any transitional impairment losses will be required to be recognized as the cumulative effect of a change in accounting principle.

(y) Reclassification

Certain reclassifications have been made in the financial statements of prior years to conform to classifications used in the current year.

3. FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash equivalents, trade receivables, debt and equity securities and short-term loans. The cash resources of the Company are invested with mutual funds, banks, financial institutions and corporations after an evaluation of the credit risk. By their nature, all such financial instruments involve risk including the credit risk of non-performance by counter parties. In management's opinion, as of June 30, 2000 and 2001, there was no significant risk of loss in the event of non-performance of the counter parties to these financial instruments, other than the amounts already provided for in the financial statements.

The customers of the Company are primarily corporations based in the United States and accordingly, trade receivables are concentrated in the United States. Trade receivables aggregating $1,800,000 are collateralized by a license to a proprietary software of a customer. Other trade receivables are not collateralized. To reduce credit risk, the Company performs ongoing credit evaluation of customers. No single customer accounted for 10% or more of the accounts receivables as of June 30, 2000 and 2001.

4. CASH AND CASH EQUIVALENTS

The cost and fair values for cash and cash equivalents as of June 30, 2000 and 2001 are as follows (in thousands):

	2000	2001
Term deposits with banks	$18,014	$65,996
Other cash and bank balances	21,378	25,011
Cash and cash equivalents	$39,392	$91,007

5. PROPERTY AND EQUIPMENT

As of June 30, 2000 and 2001 property and equipment comprise the following (in thousands):

	2000	2001
Land	$1,487	$3,960
Buildings	3,769	5,683
Computer equipment	17,532	25,027
Software	5,451	6,311
Mainframe computer system	1,152	915
Office furniture and equipment	3,982	7,596
Vehicles	1,114	1,092
Capital work-in-progress	2,641	6,566
	37,128	57,150
Accumulated depreciation and amortization	(19,444)	(24,968)
Property and equipment, net	$17,684	$32,182

Depreciation expense was $5,315,000, $3,919,000 and $5,912,000 for the years ended June 30, 1999, 2000 and 2001 respectively. Accumulated depreciation and amortization includes accumulated amortization for software of $4,311,000 and $ 4,896,000 as of June 30, 2000 and 2001 respectively. Amortization expense for software for the years ended June 30, 1999, 2000 and 2001 was $487,000, $547,000 and $710,000 respectively.

Land and building includes certain assets costing $500,000 acquired in an earlier year from a related party. The Company is in the process of obtaining the necessary regulatory transfer approvals. The bankers of the related party have a lien on the land for working capital facilities provided to that entity.

As of June 30, 2000 and 2001 property and equipment includes assets held under capital leases, which comprise (in thousands):

	2000	2001
Computer equipment	$516	$132
Vehicles	624	561
Office furniture and equipment	21	50
	1,161	743
Accumulated depreciation	(904)	(597)
	$257	$146

6. LEASES

The Company leases computer equipment, vehicles and office furniture and equipment under capital leases. Future minimum lease payments under capital leases as of June 30, 2001 are as follows (in thousands):

Year ending June 30	$115
2003	46
2004	26
2005	9
Total minimum payments	196
Less: Amount representing future interest	27
Present value of minimum payments	169
Less: Current portion	97
Long term capital lease obligation	$72

Additionally, the Company leases office facilities under non-cancelable operating lease agreements that are renewable on a periodic basis at the option of the lessee.

Rental expense under those leases is $2,526,000, $2,650,000 and $4,015,000 for the years ended June 30, 1999, 2000 and 2001 respectively. Future minimum lease payments as of June 30, 2001 for such non-cancelable operating leases are as follows (in thousands):

Year ending June 30,	
2002	$4,311
2003	4,011
2004	3,032
2005	2,739
2006	2,445
Thereafter	1,760
Total minimum payments	$18,298

7. LEASE RENTAL RECEIVABLES

A subsidiary has leased out networking equipment under sales-type leases. Future minimum lease payment receivables under non-cancelable leasing arrangements as of June 30, 2001 are as follows (in thousands):

Year ending June 30,	
2002	$103
2003	45
2004	-
Thereafter	-
Net minimum future lease receipts	148
Less: Unearned income	31
Net investment in sales-type leases included in other assets	$117

8. INTANGIBLE ASSETS

As of June 30, 2000 and 2001 intangible assets comprise the following (in thousands):

	2000	2001
Goodwill	$10,475	$10,357
Employee workforce	3,235	3,119
Customer relationships	424	424
Intellectual property rights	350	350
	14,484	14,250
Accumulated amortization	(4,821)	(7,055)
Intangible assets, net	$9,663	$7,195

Amortization expense for the years ended June 30, 1999, 2000 and 2001 is $1,105,000, $2,471,000 and $2,322,000 respectively.

In February 1999, the Company acquired a 40% interest in Intelicent from James Martin Inc., the minority shareholder, for a cash consideration of $10,000,000. This acquisition has been accounted for under the purchase method and the difference between the purchase consideration and the fair value of the net assets taken over has been attributed to employee workforce aggregating $880,000 and the remaining amount aggregating $8,089,000 has been reflected as goodwill.

During the year ended June 30, 2000 the Company acquired a 48% interest in COMNET for a consideration of $4,222,000. This acquisition has been accounted for under the purchase method and resulted in goodwill of $2,001,000.

9. INVESTMENTS IN EQUITY INVESTEES

Equity investee

The following interests have been accounted for under the equity method:

• *60% interest in Intelicent*

Intelicent was not consolidated till February 1999 as the minority shareholder James Martin Inc. had certain significant participating rights, which provided for its effective involvement in significant decisions in the ordinary course of business. In February 1999, the Company acquired the remaining 40% shareholding from James Martin Inc. Accordingly, the entity has been consolidated from the period March 1, 1999 to June 30, 1999 and the periods thereafter.

During fiscal 2001, the operations of Intelicent were legally re-organized and merged into HCL America, subsequent to which Intelicent ceased to be a separate legal entity.

The statement of income for fiscal 1999 includes an amount of $367,000 being share of loss of Intelicent accounted for by the equity method.

The summarized income statements of Intelicent for the period ended February 28, 1999 is as follows (in thousands):

	Period ended February 28, 1999
Revenues	$11,338
Income (loss) from operations	(300)
Income (loss) before income taxes	(300)
Net income (loss)	$(612)

• *50% interest in HPS*

The Company acquired a 44% interest in HPS in August 1997 from a significant interest entity. Subsequently, in September 1998, the Company acquired a further 6% interest from the same significant interest entity. The Company has accounted for its interest in HPS by the equity method.

An analysis of the carrying amount of investments, the earnings of HPS included in net income and summarized financial information are as follows (in thousands):

	As of June 30,	
	2000	2001
Carrying value	$16,175	$23,676
Share of income of equity investee included in net income	$6,151	$10,105

The summarized balance sheet of HPS as of June 30, 2000 and 2001 and summarized income statement for the year ended June 30, 1999, 2000 and 2001 are as follows (in thousands):

	As of June 30,	
	2000	2001
Balance sheet		
Current assets	$36,478	$42,200
Non-current assets	14,256	21,660
Total assets	$50,734	$63,860
Current liabilities	$16,707	$14,006
Non-current liabilities	2,277	3,153
Stockholders' equity	31,750	46,701
Total liabilities and stockholders' equity	$50,734	$63,860

	Years ended June 30,		
	1999	2000	2001
Income statement			
Revenues	$49,860	$56,743	$106,661
Income from operations	$8,482	$11,661	$20,547
Income before income taxes	$8,981	$12,674	$20,214
Net income	$8,679	$12,449	$20,339

As of June 30, 2000 and 2001, HPS holds 631,700 and 801,700 equity shares of the parent company at a cost of $4,094,000 and $5,154,000 respectively. The balance sheet of HPS, summarized above, includes these shares at their fair values with the unrealized gain of $3,676,000 as of June 30, 2000 and unrealized loss of $163,000 as of June 30, 2001 being reflected as a component of stockholders' equity. The unrealized gain/loss recorded by HPS in relation to shares of the parent company has been eliminated in the consolidated financial statements.

The Company's share of reported earnings in HPS will change to 43.97% in the event that contingent issuances of equity shares arising from stock options granted by HPS are exercised in future. The aggregate impact of these contingent issuances is not material based on the share of earnings for the year ended June 30, 1999, 2000 and 2001.

- *11.1% interest in Diamondhead Ventures LLP*

As of June 30, 2001, the Company held a 11.1% interest in Diamondhead Ventures LLP, a technology venture fund. The carrying value of the investment in this LLP is $750,000 and $2,693,000 as of June 30, 2000 and 2001 respectively. The Company's equity in the loss of Diamondhead Ventures LLP for the years ended June 30, 2000 and 2001 are $Nil and $307,000 respectively.

- *46.7% interest in Net India Private Limited*

In February 2001, the Company invested $215,000 in Net India Private Limited for a 46.7% equity interest. The carrying value of the investment in Net India Private Limited is $160,000 as of June 30, 2001. The Company's equity in the loss of Net India Private Limited for the year ended June 30, 2001 is $56,000.

- *51.0% interest in Shipara Technologies Limited*

In February 2001, the Company invested $604,000 in Shipara Technologies Limited. The Company holds a 51.0% equity interest in this joint venture as of June 30, 2001. Shipara Technologies Limited has not been consolidated as the minority shareholder Rao Insulating Company Limited has certain significant participating rights, which provide for its effective involvement in significant decisions in the ordinary course of business. The carrying value of the investment in Shipara Technologies Limited is $493,000 as of June 30, 2001. The Company's equity in the loss of Shipara Technologies Limited for the year ended June 30, 2001 is $114,000.

- *Undistributed earnings of equity investees*

As of June 30, 2000 and 2001, the Company's share in the undistributed earnings of equity investees aggregated $9,854,000 and $19,482,000 respectively.

10. INVESTMENT SECURITIES

Investment securities, available for sale consist of the following:

As of June 30, 2000 (in thousands):

	Carrying Value	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Equity securities	$22	$-	$-	$22
Mutual fund units	168,726	200	(5)	168,921
Total	$168,748	$200	$(5)	$168,943

As of June 30, 2001 (in thousands):

	Carrying Value	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Debt securities	$101,950	$1,215	$(94)	$103,071
Mutual fund units	79,928	607	(39)	80,496
Total	$181,878	$1,822	$(133)	$183,567

Proceeds from the sale of securities, available for sale, were $47,671,000 and $172,131,000 during the year ended June 30, 2000 and 2001, respectively. Interest and dividend income earned from these investments during the years ended June 30, 1999, 2000 and 2001 was $Nil, $10,649,000, and $7,592,000 respectively.

11. OTHER INVESTMENTS

The Company holds cost method investments in LLP technology venture funds and in preferred stock of an unlisted company. The investments as of June 30, 2000 and 2001 in LLP technology venture funds aggregated $8,076,000 and $11,553,000 respectively. The Company's interest in these funds range between 0.7% to 4.7%.

In June 2000, the Company purchased 1,538,462 convertible preferred shares of an unlisted company at a cost of $2,000,000. Each preferred share is convertible to one common share at the option of the holder. Alternatively, the holders can seek redemption on or after January 1, 2003 at a price of $1.56 per share. The redemption option can be exercised only after obtaining the approval of 75% of the preferred stock holders. The preferred shares carry a non-cumulative right to receive dividends of $0.104 per share or such higher amount of dividend as may be declared on the common stock. In the event of an Initial Public Offering (IPO) by the investee, the preferred share will be converted to common shares.

12. DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into forward foreign exchange contracts where the counterparty is generally a bank. The Company considers the risk of non-performance by the counterparty as non-material. The following table presents the aggregate contracted principal amounts of the Company's derivative financial instruments outstanding as of June 30, 2000 and 2001:

	2000	2001
Forward contracts	-	$501,000 (buy)

The forward foreign exchange contracts mature between one to six months.

13. OTHER CURRENT ASSETS

As of June 30, 2000 and 2001, other current assets comprise the following (in thousands):

	2000	2001
Prepaid expenses	$1,168	$2,851
Interest receivable	54	2,798
Prepaid/ advance taxes	2,743	6,027
Deposits	401	493
Others	1,154	832
	$5,520	$13,001

14. ALLOWANCES FOR ACCOUNTS RECEIVABLE

The Company maintains an allowance for uncollectible receivables based on the trade receivables at the end of the year. Factors utilized by management in determining the adequacy of the allowance include the present and prospective financial condition of the debtor and the aging of the trade receivables. Allowance for uncollectible receivables aggregated $1,077,000 and $3,423,000 as of June 30, 2000 and 2001 respectively. The charge to the statement of income with respect to uncollectible receivables was $743,000, $839,000 and $2,935,000 for the years ended June 30, 1999, 2000 and 2001 respectively.

15. ACQUISITION OF MINORITY INTERESTS

During the year ended June 30, 1999 the Company acquired a 20% interest in HCLH from the minority shareholders for a cash consideration of $373,000.

In February 1999, the Company acquired a 40% interest in Intelicent from James Martin Inc., the minority shareholder, for a cash consideration of $10,000,000.

During the year ended June 30, 2000, the Company acquired a 13% interest in COMNET from its employees and other minority shareholders for a total consideration of $715,000, of which $150,000 was in the form of stock options.

These acquisitions have been accounted for under the purchase method.

16. TRANSACTIONS WITH PRINCIPAL SHAREHOLDER

During the year ended June 30, 2000, the Company purchased an additional 35% interest in COMNET from the principal shareholder of HCL for cash consideration of $1,724,000 contemporaneous with his acquisition of this interest from the former minority shareholders of COMNET. The difference between the cost to the principal shareholder and the consideration paid has been reflected as either capital contributions/ capital distributions.

17. BANK LINE OF CREDIT

The Company has a credit facility in India in the amount of $2,761,000 for discounting accounts receivables and availing of cash credits relating to software exports and facilities for guarantees and letters of credit of $2,442,000. The credit facilities bear interest at the rate set by the bank, which ranged from 10.0% to 13.8% per annum. As of June 30, 2000 and June 30, 2001, there were no outstanding balances against fund-based facilities. These facilities are secured by a lien on certain business assets of the Company's India operations.

A subsidiary has a credit facility of $2,336,000 and facilities for guarantees and letters of credits of $12,211,000. The effective rate of interest ranged from 14.0% to 16.5% per annum as of June 30, 2001. As of June 30, 2000 and 2001, there were no outstanding balances against these lines of credit. These facilities are secured by lien on business assets of the subsidiary and personal guarantees of the principal shareholder.

18. OTHER CURRENT LIABILITIES

As of June 30, 2000 and 2001, other current liabilities comprise the following (in thousands):

	2000	2001
Advances from customers	$2,661	$2,041
Sales tax and witholding taxes payable	1,277	2,028
Accrued liabilities and expenses	9,803	13,924
Others	1,953	1,947
	$15,694	$19,940

19. EQUITY SHARES

The Company has only one class of capital stock referred to herein as equity shares. Par value of each equity share outstanding as of June 30, 2001 is $0.04.

Voting

Each holder of equity shares is entitled to one vote per share.

Dividends

Should the Company declare and pay dividends, such dividends will be paid in Indian Rupees and will be paid for the full year irrespective of the period of holding of the shares.

Indian law mandates that any dividend, exceeding 10% of the common stock, can be declared out of distributable profits only after the transfer of upto 10% of net income computed in accordance with current regulations, to a general reserve. Further, Indian law on foreign exchange governs the remittance of dividends outside India. Such dividend payments are also subject to applicable taxes. The Company declared a cash dividend of $427,000, $419,000 and $740,000 during the years ended June 30, 1999, 2000 and 2001 respectively. The dividend per share was $0.002 during the years ended June 30, 1999, 2000 and 2001.

Liquidation

In the event of liquidation of the Company, the holders of equity shares shall be entitled to receive all of the remaining assets of the Company, after distribution of all preferential amounts, if any. Such amounts will be in proportion to the number of shares of equity shares held by the stockholders.

Stock options

There are no voting, dividends or liquidation rights to the option holders, under the Company's stock option plan.

Stock split

The Company changed its capital structure, through a 2.5-for-1 stock split in September 1999, and a 1-for-2 stock dividend in October 1999. In line with legal requirements, retained earnings were capitalized at par value of the shares issued as stock dividend. The Company further changed its capital structure through a 2-for-1 stock split in December 2000. The changes in capital structure have been given retroactive effect in the financial statements.

IPO

In December 1999, the Company issued 28,400,000 equity shares in an IPO at a price of $6.64 per share. The proceeds amounted to $182,942,000, net of issue expenses of $5,698,000.

20. OTHER INCOME, NET

For the years ended June 30, 1999, 2000 and 2001, interest and other income comprises the following (in thousands):

	1999	2000	2001
Interest and other finance costs	$(2,198)	$(757)	$(2,041)
Interest income	1,015	4,384	11,282
Dividend income from investment securities -	-	10,649	399
Profit (loss) on sale of investment securities, net	-	(7,061)	7,130
Miscellaneous income	489	2,603	648
Total	$(694)	$9,818	$17,418

21. INCOME TAXES

The individual entities within the Company file individual tax returns as per regulations existing in their respective countries of domicile.

Total income taxes for the years ended June 30, 1999, 2000 and 2001 were allocated as follows (in thousands):

	1999	2000	2001
Income from continuing operations	$647	$5,885	$8,250
Stockholders' equity for-			
- tax benefits received on exercise of employee stock options reflected as part of additional paid in capital	-	-	(3,713)
- unrealized holding gains on available for sale investment securities	(73)	75	596
Others (net)	584	73	(610)
Total taxes	$1,158	$6,033	$4,523

Income tax expense attributable to income from continuing operations consists of (in thousands):

	1999	2000	2001
Current -			
US taxes	$813	$673	$705
Others	259	5,370	7,448
Total	$1,072	$6,043	$8,153
Deferred -			
US taxes	$210	$(456)	$208
Others	(635)	298	(111)
Total	$(425)	$(158)	$97
Total taxes	$647	$5,885	$8,250

The reconciliation between the provision for income tax of the Company and amounts computed by applying the Indian statutory income tax rate is as follows (in thousands):

	1999	2000	2001
Income before taxes, share of income of equity investees and minority interest	$18,768	$51,896	$100,574
Average enacted tax rate in India	38.5%	38.5%	38.59%
Expected tax expense	7,226	19,980	38,812
Differences between Indian and foreign tax rates	238	(258)	818
Non-taxable export income	(8,261)	(16,122)	(32,232)
Non-taxable other income	-	(4,099)	(577)
Increase (decrease) in valuation allowance	885	3,639	(1,608)
Other	559	2,745	3,037
Total taxes	$647	$5,885	$8,250

A substantial portion of the profits of the Company's India operations are exempt from Indian income taxes being profits attributable to export operations and profits from undertakings situated in Software Technology Parks. Under the tax holiday, the taxpayer can utilize an exemption from income tax for a period of any ten consecutive years subject to certain conditions and stipulations. The Company has opted for this exemption for the years ended March 31, 1997 to March 31, 2006 for the existing undertakings situated in Software Technology Parks (STP). During the year ended June 30, 2000, the Company set-up new undertakings in Software Technology Parks for which exemption is available till March 2009. The aggregate dollar and per share effects of the tax holiday are $8,261,000 and $0.03 per share for the year ended June 30, 1999, $15,657,000 and $0.06 per share for the year ended June 30, 2000 and $31,743,000 and $0.11 per share for the year ended June 30, 2001 respectively.

The components of the deferred tax balances as of June 30, 2000 and 2001 are as follows (in thousands):

	2000	2001
Deferred tax assets:		
Business losses	$3,134	$6,143
Capital losses	3,439	853
Allowance for accounts receivable	316	1,165
Accrued employee costs	801	1,234
Pre-operative expenses	553	-
Property and equipment	629	1,370
Stock based sales incentive	330	330
Other temporary differences	99	126
	9,301	11,221
Less: Valuation allowance	(5,624)	(3,440)
Total deferred tax assets	$3,677	$7,781
Deferred tax liabilities:		
Unrealized gains on investment securities	$75	$596
Others	113	66
Total deferred tax liabilities	$188	$662

In assessing the realizibility of deferred tax assets, management considers whether it is more likely than not, that some portion, or all, of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. Management considers the projected future taxable income and tax planning strategies in making this assessment. Based on the level of historical taxable income and projections for future taxable incomes over the periods in which the deferred tax assets are deductible, management believes that it is more likely than not, the Company will realize the benefits of those deductible differences, net of existing valuation allowances. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

As of June 30, 2001, the US based subsidiary of the Company has a deferred tax asset for business losses of $4,233,000 of which $3,391,000 and $842,000 can be carried forward until 2006 and 2016 respectively. Additionally, this subsidiary has a deferred tax asset for capital loss carry forward of $853,000. The federal capital loss will expire, if not utilized, by the fiscal year ending 2004, while the state capital loss can be carried forward indefinitely until utilized. US tax laws impose substantial restrictions on the utilization of net operating losses and tax credits in the event of an "ownership change" of a corporation. Accordingly, the ability of the Company to utilize business losses and credit carry forward may be limited as a result of such an "ownership change" as defined in the Internal Revenue Code. The remaining deferred tax assets in respect of business losses carry forward relate to the other subsidiaries of the Company and can be carried forward for a period upto five years.

During the years ended June 30, 2000 and 2001, the US based subsidiary of the Company has received tax benefit aggregating $621,000 and $4,041,000 respectively upon exercise of employee stock options. These tax benefits have been reflected as part of additional paid in capital.

Management does not believe that it is more likely than not that certain subsidiaries of the Company would be in a position to realize the tax benefits associated with business loss carry forward, capital loss carry forward and stock based sales incentives. Given the uncertainties, these tax benefits have been fully reserved.

The components of valuation allowance of June 30, 2000 and 2001 are as follows (in thousands):

	2000	2001
Business losses	$2,067	$1,910
Capital losses	3,439	853
Stock based sales incentive	-	330
Others	118	347
Total	$5,624	$3,440

As per Indian tax laws, a taxpayer is allowed a deduction (being 100% for the first 5 years and 30% thereafter for a further period of 5 years) from the profits and gains from a newly formed industrial undertaking provided certain stipulated conditions are fulfilled. These tax benefits are optional and can be availed by the taxpayer at any time within a block of 15 years for a period of 10 years. During the current period, COMNET has elected to avail these tax benefits in respect of the eligible business income with effect from April 1, 2000, being the beginning of its tax year. Accordingly, tax provisions made for the period April to June 2000 by COMNET aggregating $312,000 have been written-back as a credit to the current tax expense during the year ended June 30, 2001.

22. EARNINGS PER EQUITY SHARE (EPS)

The following is the reconciliation of the weighted average number of equity shares used in the computation of basic and diluted EPS for the years ended June 30, 1999, 2000 and 2001:

	1999	2000	2001
Weighted average number of equity shares outstanding used in computing basic EPS	248,960,636	264,438,108	282,409,797
Dilutive effect of stock options outstanding	14,465,676	16,516,002	14,278,708
Weighted average number of equity shares and equity equivalent shares outstanding used in computing diluted EPS	263,426,312	280,954,110	296,688,505

Options issued within a one-year period prior to the initial filing of the prospectus relating to the IPO have been treated as outstanding for all reported periods in computing diluted EPS.

Options to purchase 235,300 and 2,510,689 equity shares during the years ended June 30, 2000 and 2001 respectively were not included in the computation of diluted EPS as these options were anti-dilutive.

23. STOCK OPTION PLAN

1999 STOCK OPTION PLAN

In September 1999, the Company instituted the 1999 Stock Option Plan (1999 Plan) to provide equity-based incentives to all eligible employees of the Company and its subsidiaries. The 1999 Plan is administered by a Committee consisting of a majority of independent directors of the Company (Compensation Committee) and provides for the issuance of a maximum of 40,000,000 underlying shares at the option price determined by the Compensation Committee on the date the option is granted.

Each option granted under the 1999 Plan, entitles the holder to two equity shares of the Company. The equity shares covered under these options vest over a maximum period of 110 months from the date of the grant. The options are to be exercised within a period of five years from its date of vesting.

The Company has adopted the intrinsic value method of APB 25 to account for options granted to employees under the 1999 Plan. The excess of the fair value of the underlying shares at the grant date over the exercise price of the options amounting to $301,000 has been recognized as deferred compensation during the year ended June 30, 2000, to be amortized over the vesting period of the options.

The movement in the options granted to employees during the year ended June 30, 2000 and 2001 under the 1999 Plan is set out below:

	Shares arising out of options		Weighted average exercise price	
	Year ended June 30, 2000	Year ended June 30, 2001	Year ended June 30, 2000	Year ended June 30, 2001
Outstanding at beginning of the year	-	35,679,212	-	$4.88
Granted	41,779,024	3,142,052	$4.68	$11.42
Forfeited	(3,855,432)	(4,318,692)	$3.96	$6.61
Expired	(59,412)	(212,918)	$2.06	$2.94
Exercised	(2,184,968)	(5,568,030)	$2.81	$2.72
Outstanding at the end of the year	35,679,212	28,721,624	$4.88	$5.47
Exercisable at the end of the year	2,608,014	4,593,616	$2.87	$2.92
Weighted-average grant date fair value of grants during the year			$4.69	$11.42

As of June 30, 2000 and 2001, of the total options exercised, options for 18,542 and 191,140 shares were pending allotment, respectively.

The weighted-average grant-date fair value of options granted during the year ended June 30, 2000 under the 1999 Plan is as set out below:

Options granted during the year	Shares arising out of options	Weighted average grant date fair value	Weighted average exercise price
At grant date fair value	41,571,074	$4.70	$4.70
Below grant date fair value	207,950	$2.85	$0.08

During the year ended June 30, 2001, all the options under this plan have been granted at their fair values as of the grant date.

The following table summarizes information about stock options outstanding under the 1999 plan as of June 30, 2000:

	Outstanding			Exercisable	
Range of exercise price	Number of shares arising out of options	Weighted average remaining contractual life	Weighted average exercise price	Number of shares arising out of options	Weighted average exercise price
$0.08	157,488	5.25 years	$0.08	-	$-
$2.85 - $6.48	29,591,338	6.73 years	$3.61	2,608,014	$2.87
$11.01 - $27.31	5,930,386	10.64years	$11.33	-	$-

The following table summarizes information about stock options outstanding under the 1999 plan as of June 30, 2001:

	Outstanding			Exercisable	
Range of exercise price	Number of shares arising out of options	Weighted average remaining contractual life	Weighted average exercise price	Number of shares arising out of options	Weighted average exercise price
$0.08	56,246	5.19 years	$0.07	3,742	$0.07
$2.71 - $6.16	20,835,412	5.99 years	$3.44	4,579,974	$2.88
$10.46 - $25.95	7,829,966	9.16 years	$10.89	9,900	$21.53

2000 STOCK OPTION PLAN

In October 2000, the Company instituted the 2000 Stock Option Plan (2000 Plan) to provide equity-based incentives to all eligible employees of the Company and its subsidiaries. The 2000 Plan is also administered by the Compensation Committee consisting of a majority of independent directors of the Company. The 2000 Plan provides for the issuance of a maximum of 30,000,000 underlying shares at the option price determined by the Committee on the date the option is granted.

Each option granted under the 2000 Plan, entitles the holder to two equity shares of the Company. The equity shares covered under these options vest over a maximum period of 104 months from the date of the grant. The options are to be exercised within a period of five years from its date of vesting.

The Company has adopted the intrinsic value method of APB 25 to account for options granted to employees under the 2000 Plan. Since no option has been awarded at an exercise price below the market price of the underlying shares at the grant date, no compensation cost has been recognized.

The movement in the options granted to employees during the year ended June 30, 2001 under the 2000 Plan is as set out below:

	Shares arising out of options	Weighted average exercise price
Granted	12,372,758	$7.72
Forfeited	(407,550)	$9.94
Expired	-	-
Exercised	-	-
Outstanding as of June 30,	11,965,208	$7.65
Exercisable as of June 30,	-	-
Weighted-average grant date fair value of grants During the year		$7.71

The following table summarizes information about stock options outstanding under the 2000 Plan as of June 30, 2001:

	Outstanding			Exercisable	
Exercise price	Number of shares arising out of options	Weighted average remaining contractual life	Weighted average exercise price	Number of shares arising out of options	Weighted average exercise price
$4.99 - $9.26	7,428,054	7.06 years	$5.18	-	$ -
$10.78 - $13.96	4,537,154	7.62 years	$11.68	-	$ -

The Company has adopted the pro forma disclosure provisions of SFAS No. 123. For options granted prior to the Company's IPO in December 1999, volatility of the stock price was omitted from the pricing model. Had compensation cost for the Company's stock-based compensation plan been determined in a manner consistent with the fair value approach described in SFAS No. 123, the Company's net income and basic and diluted EPS as reported would have been reduced to the pro forma amounts indicated below:

		Years ended June 30,		
		1999	2000	2001
Net income				
As reported		$22,118,000	$52,110,000	$101,947,000
Adjusted pro forma		$22,118,000	$43,744,000	$79,481,000
EPS				
As reported	- Basic	$0.09	$0.20	$0.36
	- Diluted	$0.08	$0.19	$0.34
Adjusted pro forma	- Basic	$0.09	$0.17	$0.27
	- Diluted	$0.08	$0.16	$0.27

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

	2000	2001
Dividend yield %	0.10%	0.10%
Expected life	upto 110 months	upto 110 months
Risk free interest rates	10.0%	10.0%
Volatility	53.0%	53.0%

24. EMPLOYEE BENEFIT PLANS

India operations

The Company has employee benefit plans in the form of certain statutory and welfare schemes covering substantially all of its employees.

Gratuity

In accordance with Indian law, the Company provides for gratuity, a defined benefit retirement plan (the Gratuity Plan) covering all employees. The Gratuity Plan provides a lump sum payment to vested employees at retirement or termination of employment at an amount based on the respective employee's salary and the years of employment with the Company. The Company estimates its liability as of each balance sheet date based on an actuarial valuation. The gratuity plan is not funded.

The following table sets forth the funded status of the plan and the amounts recognized in the Company's balance sheet as of June 30, 2000 and 2001 (in thousands):

	2000	2001
Change in benefit obligation		
Projected Benefit Obligation (PBO) at the beginning of the year	$353	$552
Service cost	122	165
Interest cost	41	62
Benefits paid	(19)	(16)
Actuarial (gain) loss	75	102
Effect of exchange rates changes	(20)	(31)
PBO at the end of the year	$552	$834
Change in plan assets		
Fair value of plan assets at the beginning of the year	$-	$-
Employer contributions	19	16
Benefits paid	(19)	(16)
Plan assets at the end of the year	$-	$-
Funded status	$(552)	$(834)
Unrecognized actuarial loss	100	191
Unrecognized transitional obligation	44	35
Effect of exchange rates changes	(2)	(2)
Net amount recognized	$(410)	$(610)
Amounts recognized in the statement of financial position consist of:		
Accrued benefit cost	$(410)	$(610)

Net gratuity cost for the years ended June 30, 1999, 2000 and 2001 comprise of the following components (in thousands):

	1999	2000	2001
Service cost	$105	$122	$165
Interest cost	32	41	62
Amortization	12	7	7
Net gratuity cost	$149	$170	$234

The actuarial assumptions used in accounting for the gratuity plan as of June 30, 2000 and 2001 are given below:

	2000	2001
Discount rate	12%	11%
Expected rate of increase in salaries		
-for the next five years	12%	11%
-thereafter	10%	9%

The mortality rates used are as published by one of the leading life insurance companies in India.

Superannuation

The superannuation plan is a defined contribution pension plan for senior employees of the Company. The Company contributes to an employees' superannuation fund established with a government owned insurance corporation at 15% of the employee's base compensation. The contributions made are recorded in the statement of income on an accrual basis. Total contributions made in respect of this plan for years ended June 30, 1999, 2000 and 2001 are $208,000 $176,000 and $236,540 respectively.

Provident fund

In accordance with Indian law, all employees receive benefits from a provident fund, which is a defined contribution retirement plan. Under this plan, the employer and employee make monthly contributions to a fund managed by certain employees of the Company. The employees contribute 12% of their base compensation, which is matched by an equal contribution by the employer.

The Company has no further obligations under the plan beyond its monthly contributions. The funds contributed to the fund are invested in specific securities as mandated by law and generally consist of federal and state government bonds and the debt instruments of government-owned corporations.

Total contributions made by the Company in respect of this plan for the years ended June 30, 1999, 2000 and 2001 are $333,000, $507,000 and $863,290 respectively.

Subsidiary in the US

The Company has a Savings and Investment Plan under Section 401 (k) of the Internal Revenue Code. This is a defined contribution plan where employees above the age of 21 years, having completed one year of service may choose to contribute up to 15% of their compensation or $10,500, whichever is lower. The Company makes a contribution equal to 50% of the employee's contribution, up to a maximum of 5% of the employee's annual compensation. Total contributions made to the plan by Company, for years ended June 30, 1999, 2000 and 2001 are $815,000, $704,000 and $557,000 respectively.

Subsidiary in Australia

As per local laws of Australia, employers must provide a minimum level of superannuation for most employees or incur a non-tax deductible superannuation guarantee charge including interest and penalties. The required level of employer superannuation contribution is a percentage of the employee's earnings base. The Company contributes to a fund approved by the Government of Australia. Total contributions made to the plan by Company, for years ended June 30, 1999, 2000 and 2001 are $96,520, $163,000 and $123,000 respectively.

Subsidiaries in Europe

The Company has established pension plans for its employees of the subsidiaries in United Kingdom, Sweden and Netherlands. The plans operating in United Kingdom and Sweden provide for contributions upto 5% of the basic salary by the employer and the employee. Total contributions made to the plan by the Company for the years ended June 30, 1999, 2000 and 2001 were $Nil, $45,000 and $46,000 respectively.

25. STOCK BASED SALES INCENTIVE

During the year ended June 30, 2000, the Company entered into various software consulting and engineering service agreements with its customers pursuant to which stock options are issued in exchange for customer commitments. Shares for the option plan are currently provided through the principal shareholder.

The rights to acquire shares are normally exercisable in increments at a price either being agreed in advance or to be determined as a future date, after a specified minimum volume of services has been availed by the customer. These rights vest over a period ranging from 1 to 5 years and are exercisable within 10 years from the date of vesting.

The Company accounts for these options in accordance with the Emerging Issues Task Force Abstract No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services (EITF 96-18). Pursuant to EITF 96-18, the Company has valued the rights using the Black-Scholes option-pricing model. The cost is being amortized ratably over the applicable service period. Costs associated with stock based sales incentive aggregating $2,266,000 and $1,733,000 have been recorded as a contribution from the principal shareholder during the year ended June 30, 2000 and 2001 respectively.

26. RELATED PARTY TRANSACTIONS

The Company has entered into transactions with the following related parties:

a) Companies in which Mr. Nadar, a principal shareholder, has a significant ownership interest, controlling interest or over which he exercises significant influence (significant interest entities);

b) Equity investees of the Company, and their subsidiaries (equity investees); and

c) Employees of the Company.

The related party transactions can be categorized as follows:

Revenues

The Company provides software development and other services to related parties. The related parties to whom these services were provided and the corresponding amounts of revenues earned are as follows (in thousands):

	Years ended June 30,		
	1999	2000	2001
Significant interest entities	$6,386	$1,162	$2,600
Equity investees	1,582	176	103
Total	$7,968	$1,338	$2,703

Cost of revenues

The Company outsources certain contracts to related parties and also procures personnel from them for software development. These costs are recorded as consulting charges and included as part of cost of revenues. The related parties to whom such consulting charges were paid and the corresponding amounts are as follows (in thousands):

	Years ended June 30,		
	1999	2000	2001
Significant interest entities	$11,447	$4,559	$7,112
Equity investees	184	95	465
Total	$11,631	$4,654	$7,577

Interest expense

The Company paid interest to significant interest entities amounting to $32,000, $25,000 and $Nil for the years ended June 30 1999, 2000 and 2001 respectively.

Computer equipment and software purchases

The Company purchases computer equipment and software from certain significant interest entities. These purchases during the years ended June 30, 1999, 2000 and 2001 amount to, $682,000, $1,778,000 and $2,219,000 respectively.

Purchase of land and building

During the year ended June 30, 2000, the Company purchased land and building amounting to $953,000 from a significant interest entity.

Subleasing of facilities

A significant interest entity has subleased a portion of their facilities to the Company. Total amounts charged for the years ended June 30, 1999, 2000 and 2001 were $Nil, $189,000 and $127,000 respectively.

Loans to employees

The Company has advanced general purpose and housing loans to its employees at rates ranging from 2% to 16% per annum. The repayment periods for these loans are fixed with the tenure of these loans extending upto six years.

The balances receivable from and payable to related parties are summarized as follows:

As of June 30, 2000 (in thousands):

	Significant interest entities	Equity investees	Total
Due from related parties			
Accounts receivable	$298	$15	$313
Other receivables	114	-	114
	$412	$15	$427
Dues to related parties			
Accounts payable	$952	$6	$958
Deferred revenue	177	8	185
Other payables	175	15	190
	$1,304	$29	$1,333

As of June 30, 2000 (in thousands):

	Significant interest entities	Equity investees	Total
Due from related parties			
Accounts receivable	$44	$11	$55
Other receivables	151	86	237
	$195	$97	$292
Dues to related parties			
Accounts payable	$544	$8	$552
Short term borrowings	31	-	31
Deferred revenue	214	5	219
Other payables	21	5	26
	$810	$18	$828

27. COMMITMENTS

Capital commitments

As of June 30, 2001, the Company had committed to spend $6,208,000 under agreements to purchase property and equipment. This amount is net of capital advances paid in respect of these purchases.

Other commitments

The Company's software development centers in India are 100% Export Oriented (EOU)/ STP units under the STP guidelines issued by the Government of India. These units are exempted from customs and central excise duties and levies on imported and indigenous capital goods and stores and spares. The Company has executed legal undertakings to pay customs duty, central excise duty, levies and liquidated damages payable, if any, in respect of imported and indigenous capital goods and stores and spares consumed duty free, in the event that certain terms and conditions are not fulfilled.

28. SEGMENT REPORTING

The Company provides software services to customers in various geographies. Further, one of the subsidiaries is also engaged in the business of rendering networking services and sales of networking equipment and software to customers in India. The Company views the geographic divisions of its business as operating segments. The following is the information about the Company's revenue and overheads (comprising sales and marketing expenses, general and administrative expenses and depreciation and amortization) by geographic segments (in thousands):

	Years ended June 30,		
	1999	2000	2001
Revenues			
United States	$114,301	$146,363	$222,801
India	22,967	25,945	32,653
Europe	15,113	13,679	20,850
Others	13,945	20,846	22,081
Total revenues	$166,326	$206,833	$298,385

	Years ended June 30,		
	1999	2000	2001
Overheads			
United States	$20,055	$28,197	$25,132
India	9,948	12,804	20,573
Europe	4,852	5,493	6,154
Others	12,344	10,878	12,906
Total overheads	$47,199	$57,372	$64,765

No single customer accounted for more than 10% of the revenues of the Company during the years ended June 30, 1999, 2000 and 2001.

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires that an enterprise report a measure of profit or loss and total assets for each reportable segment. Revenues are allocated to geographic segments based on the location of the customer. The contracts are executed either at customer locations or at offshore development facilities in India. Accordingly, cost of revenues are recorded based on the location where the contract is executed. For internal reporting purposes, the Company does not allocate costs to geographies where revenues are recorded. Accordingly, management believes that it is not reasonable to provide segment disclosure relating to profit and loss. Most of the fixed assets used in the Company's business are based offshore where the work gets executed. It is not possible to allocate them to the geographic segments. The management therefore believes that it is not reasonable to provide segment disclosure relating to total assets.

29. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the Company's current assets and current liabilities approximate their carrying values because of their short-term maturity. Such financial instruments are classified as current and are expected to be liquidated within the next twelve months