

Infosys Technologies Limited and subsidiaries

Consolidated balance sheets

	<i>(Unaudited)</i>	
	March 31, 2003 (1)	December 31, 2003
ASSETS		
<i>Current Assets</i>		
Cash and cash equivalents	\$ 354,362,918	\$ 421,302,898
Investments in liquid mutual fund units	-	133,011,380
Trade accounts receivable, net of allowances	109,119,856	153,010,094
Deferred tax assets	288,541	472,095
Prepaid expenses and other current assets	24,384,316	35,637,535
Unbilled revenue	19,702,186	20,420,935
<i>Total current assets</i>	<u>507,857,817</u>	<u>763,854,937</u>
Property, plant and equipment, net	157,194,190	182,131,622
Intangible assets, net	6,471,236	-
Deferred tax assets	7,264,885	6,509,330
Investments	4,613,833	1,925,167
Prepaid income taxes	4,452,678	169,688
Other assets	16,454,328	14,651,560
TOTAL ASSETS	<u>\$ 704,308,967</u>	<u>\$ 969,242,304</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
<i>Current Liabilities</i>		
Accounts payable	\$ 426,611	\$ 342,644
Client deposits	3,208,295	21,203,634
Other accrued liabilities	46,249,269	78,656,396
Income taxes payable	-	14,321,236
Unearned revenue	13,202,115	18,510,857
<i>Total current liabilities</i>	<u>63,086,290</u>	<u>133,034,767</u>
<i>Non-current liabilities</i>		
Preferred stock of subsidiary		
0.0005% Cumulative Convertible Preference Shares,		
par value \$ 2 each, 4,375,000 preference shares		
Authorized, issued and outstanding – 4,375,000		
preference shares as of March 31, 2003 and December 31, 2003	10,000,000	10,757,408
Other non-current liabilities	5,217,758	4,427,000
<i>Stockholders' Equity</i>		
Common stock, \$ 0.16 par value;		
100,000,000 equity shares authorized,		
Issued and outstanding –66,243,078 and 66,455,992 as of March 31, 2003 and		
December 31, 2003 respectively	8,602,909	8,626,207
Additional paid-in capital	127,042,751	144,070,027
Retained earnings	524,621,160	670,884,201
Deferred stock compensation	(2,817,066)	-
Accumulated other comprehensive income	(31,444,835)	(2,557,306)
Total stockholders' equity	<u>626,004,919</u>	<u>821,023,129</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 704,308,967</u>	<u>\$ 969,242,304</u>

(1) March 31, 2003 balances were obtained from audited financial statements

See accompanying notes to the unaudited consolidated financial statements

Infosys Technologies Limited and subsidiaries

Unaudited consolidated statements of income

	Three months ended December 31,		Nine months ended December 31,	
	2002	2003	2002	2003
Revenues	\$ 200,014,166	\$ 275,886,678	\$ 537,775,974	\$ 759,911,290
Cost of revenues (including amortization of stock compensation expenses of \$ 729,994 and \$ 395,344 for the three months ended December 31, 2002 and 2003 and \$ 2,189,981 and \$ 1,653,156 for the nine months ended December 31, 2002 and 2003)	110,928,922	155,856,199	294,226,283	429,501,225
Gross profit	89,085,244	120,030,479	243,549,691	330,410,065
Operating Expenses:				
Selling and marketing expenses	14,952,660	20,827,551	40,734,946	56,243,853
General and administrative expenses	15,422,086	20,586,131	40,383,534	58,747,502
Amortization of stock compensation expense	513,954	278,343	1,541,863	1,163,910
Amortization of intangible assets	924,249	2,647,778	1,744,274	6,719,351
Total operating expenses	31,812,949	44,339,803	84,404,617	122,874,616
Operating income	57,272,295	75,690,676	159,145,074	207,535,449
Other income, net	6,907,692	8,842,133	12,538,464	24,385,839
Income before income taxes	64,179,987	84,532,809	171,683,538	231,921,288
Provision for income taxes	11,926,841	13,987,449	29,885,621	38,391,629
Net income	\$ 52,253,146	\$ 70,545,360	\$ 141,797,917	\$193,529,659
Earnings per equity share				
Basic	\$ 0.80	\$ 1.07	\$ 2.16	\$ 2.95
Diluted	\$ 0.78	\$ 1.05	\$ 2.13	\$ 2.91
Weighted equity shares used in computing earnings per equity share				
Basic	65,569,377	65,709,862	65,567,814	65,628,199
Diluted	66,667,561	67,181,796	66,405,932	66,557,167

See accompanying notes to the unaudited consolidated financial statements

Infosys Technologies Limited and subsidiaries

Unaudited consolidated statements of stockholders' equity and comprehensive income

	Common stock		Additional paid-in capital	Comprehensive income	Accumulated other comprehensive income	Deferred stock compensation	Retained earnings	Total stockholders' equity
	Shares	Par value						
Balance as of March 31, 2002	66,186,130	\$ 8,597,001	\$ 123,079,948		\$ (45,441,148)	\$ (7,620,600)	\$ 363,764,165	\$ 442,379,366
Common stock issued	43,359	4,480	2,191,234		-	-	-	2,195,714
Cash dividends	-	-	-		-	-	(34,013,046)	(34,013,046)
Income tax benefit arising on exercise of stock options	-	-	804,695		-	-	-	804,695
Amortization of compensation related to stock option grants	-	-	-		-	3,731,844	-	3,731,844
Comprehensive income								
Net income	-	-	-	\$ 141,797,917	-	-	141,797,917	141,797,917
Other comprehensive income								
Translation adjustment	-	-	-	8,232,075	8,232,075	-	-	8,232,075
Comprehensive income				\$ 150,029,992				
Balance as of December 31, 2002	66,229,489	\$ 8,601,481	\$ 126,075,877		\$ (37,209,073)	\$ (3,888,756)	\$ 471,549,036	\$ 565,128,565
Balance as of March 31, 2003	66,243,078	\$ 8,602,909	\$ 127,042,751		\$ (31,444,835)	\$(2,817,066)	\$ 524,621,160	\$626,004,919
Common stock issued	212,914	23,298	14,560,748		-	-	-	14,584,046
Cash dividends	-	-	-		-	-	(47,266,618)	(47,266,618)
Income tax benefit arising on exercise of stock options	-	-	2,466,528		-	-	-	2,466,528
Amortization of compensation related to stock option grants	-	-	-		-	2,817,066	-	2,817,066
Comprehensive income								
Net income	-	-	-	\$ 193,529,659	-	-	193,529,659	193,529,659
Other comprehensive income								
Unrealized gain on investments, net of taxes	-	-	-	89,130	89,130	-	-	89,130
Translation adjustment	-	-	-	28,798,399	28,798,399	-	-	28,798,399
Comprehensive income				\$ 222,417,188				
Balance as of December 31, 2003	66,455,992	\$ 8,626,207	\$ 144,070,027		\$(2,557,306)	-	\$670,884,201	\$ 821,023,129

See accompanying notes to the unaudited consolidated financial statements

Infosys Technologies Limited and subsidiaries

Unaudited consolidated statements of cash flows

	Nine months ended December 31,	
	2002	2003
OPERATING ACTIVITIES:		
Net income	\$ 141,797,917	\$ 193,529,659
Adjustments to reconcile net income to net cash provided by operating activities		
Loss on sale of property, plant and equipment	8,437	-
Depreciation	26,466,706	30,717,514
Amortization of intangible assets	1,744,274	6,719,351
Provision for investments	3,219,030	1,922,070
Deferred taxes	(2,228,025)	853,268
Amortization of deferred stock compensation expense	3,731,844	2,817,066
Changes in assets and liabilities		
Trade accounts receivable	(31,876,890)	(38,665,222)
Prepaid expenses and other current assets	(3,401,291)	(154,127)
Unbilled revenue	(11,183,030)	135,986
Income taxes	(3,159,384)	20,305,900
Accounts payable	126,497	(101,250)
Client deposits	3,776,724	17,636,155
Unearned revenue	8,014,837	4,676,599
Other accrued liabilities	14,275,082	29,409,213
Net cash provided by operating activities	151,312,728	269,802,182
INVESTING ACTIVITIES:		
Expenditure on property, plant and equipment	(26,796,968)	(48,630,139)
Expenditure on intangible asset	(4,078,363)	-
Proceeds from sale of property, plant and equipment	53,222	56,378
Loans to employees	(4,973,581)	3,714,929
Investments in liquid mutual fund units	-	(130,818,049)
Cash advanced for contemplated business combination	-	(11,141,603)
Net cash used in investing activities	(35,795,690)	(186,818,484)
FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	2,195,714	14,584,046
Proceeds from issuance of preferred stock by subsidiary	10,000,000	-
Payment of dividends	(34,013,046)	(47,153,536)
Net cash used in financing activities	(21,817,332)	(32,569,490)
Effect of exchange rate changes on cash	4,373,092	16,525,772
Net increase in cash and cash equivalents during the period	98,072,798	66,939,980
Cash and cash equivalents at the beginning of the period	210,485,940	354,362,918
Cash and cash equivalents at the end of the period	\$ 308,558,738	\$ 421,302,898
Supplementary information:		
Cash paid towards taxes	\$ 33,014,206	\$ 17,204,767
Non cash transaction (see Note 2.2)	\$ 5,000,000	-

See accompanying notes to the unaudited consolidated financial statements

Infosys Technologies Limited and subsidiaries

Notes to the unaudited consolidated financial statements

1 Company overview and significant accounting policies

1.1 Company overview

Infosys Technologies Limited (“Infosys” or “the Company”) along with its majority owned and controlled subsidiaries, Progeon Limited (“Progeon”) and Infosys Technologies (Shanghai) Co. Limited is a leading global information technology, or IT, services company. The Company provides end-to-end business solutions that leverage technology thus enabling its clients to enhance business performance. The Company provides solutions that span the entire software life cycle encompassing consulting, design, development, re-engineering, maintenance, systems integration and package evaluation and implementation. In addition, the Company offers software products for the banking industry and business process management services.

1.2 Basis of preparation of financial statements

The accompanying consolidated financial statements are prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”). Inter-company balances and transactions are eliminated on consolidation. All amounts are stated in U.S. dollars, except as otherwise specified.

Interim information presented in the 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, and is in accordance with 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, 2003.

1.3 Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities on the date of the financial statements, and the reported amounts of revenues and expenses during the period. Examples of estimates include accounting for contract costs expected to be incurred to complete software development, allowance for uncollectible accounts receivable, future obligations under employee benefit plans, provisions for post-sales customer support and the useful lives of property, plant and equipment and intangible assets. Actual results could differ from those estimates.

1.4 Revenue recognition

The company derives revenues primarily from software development and related services, licensing of software products and from business process management services. Arrangements with customers for software development and related services are either on a fixed price, fixed timeframe or on a time and material basis.

Revenue on time-and-material contracts is recognized as the related services are performed. Revenue from the end of the last billing to the balance sheet date is recognized as unbilled revenues. Revenue from fixed-price, fixed-time frame contracts is recognized as per the percentage-of-completion method. Guidance has been drawn from paragraph 95 of Statement of Position (SOP) 97-2 to account for revenue from fixed price arrangements for software development and related services in conformity with SOP 81-1. The input (efforts expended) method has been used to measure progress towards completion as there is a direct relationship between input and productivity. Provisions for estimated losses, if any, on uncompleted contracts are recorded in the period in which such losses become probable based on the current contract estimates. Costs and earnings in excess of billings are classified as unbilled revenue while billings in excess of costs and earnings are classified as unearned revenue. Maintenance revenue is recognized ratably over the term of the underlying maintenance agreement.

The company provides its clients with a fixed-period warranty for corrections of errors and telephone support on all its fixed-price, fixed-time frame contracts. Costs associated with such support services are accrued at the time related revenues are recorded and included in cost of revenues. The company estimates such costs based on historical experience and estimates are reviewed on a periodic basis for any material changes in assumptions and likelihood of occurrence.

In accordance with SOP 97-2, Software Revenue Recognition, license fee revenues are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the license fee is fixed and determinable, and the collection of the fee is probable. Arrangements to deliver our software products generally have three elements: license, implementation and Annual Technical Services (“ATS”). The company has applied the principles in SOP 97-2 to account for revenue from these multiple element arrangements. Vendor specific objective evidence of fair value (“VSOE”) has been established for ATS. VSOE is the price charged when the element is sold separately. When other services are provided in conjunction with the licensing arrangement, the revenue from such contracts are allocated to each component of the contract using the residual method, whereby revenue is deferred for the undelivered services and the residual amounts are recognized as revenue for delivered elements. In the absence of an established VSOE for implementation, the entire arrangement fee for license and implementation is recognized as the implementation is performed. Revenue from client training, support and other services arising due to the sale of software products is recognized as the services are performed. ATS revenue is recognized ratably over the period in which the services are rendered.

Revenues from business process management and other services are recognized on both, the time-and-material and fixed-price, fixed-time frame bases. Revenue on time-and-material contracts is recognized as the related services are rendered. Revenue from fixed-price, fixed-time frame contracts is recognized as per the proportional performance method using an output measure of performance.

When the company receives advances for services and products, such amounts are reported as client deposits until all conditions for revenue recognition are met.

1.5 Cash and cash equivalents

The company considers all highly liquid investments with a remaining maturity at the date of purchase / investment of three months or less to be cash equivalents. Cash and cash equivalents comprise cash, cash on deposit with banks, and deposits with corporations.

1.6 Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation. The company depreciates property, plant and equipment over their estimated useful lives using the straight-line method. The estimated useful lives of assets are as follows:

Buildings	15 years	Plant and equipment	5 years
Furniture and fixtures	5 years	Vehicles	5 years
Computer equipment	2-5 years		

The cost of software purchased for internal use is accounted under SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Deposits paid towards the acquisition of property, plant and equipment outstanding at each balance sheet date and the cost of property, plant and equipment not put to use before such date are disclosed under “*Capital work-in-progress*”.

1.7 Intangible assets

Intangible assets are amortized over their respective individual estimated useful lives on a straight-line basis, commencing from the date the asset is available to the company for its use. Management estimates the useful lives of acquired rights in software applications to range between one through two years.

1.8 Impairment of long-lived assets

The company evaluates the recoverability of its long-lived assets and certain identifiable intangibles, if any, whenever events or changes in circumstances indicate that their carrying amounts 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 undiscounted net 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 value of the assets exceeds the fair value of the assets. Assets to be disposed are reported at the lower of the carrying value or the fair value less the cost to sell.

1.9 Research and development

Research and development costs are expensed as incurred. Software product development costs are expensed as incurred until technological feasibility is achieved.

1.10 Foreign currency translation

The accompanying financial statements are reported in U.S. dollars. The functional currency of the company is the Indian rupee (“Rs.”). The translation of Rs. to U.S. dollars is performed for balance sheet accounts using the exchange rate in effect at the balance sheet date and for revenue and expense accounts using a monthly average exchange rate for the respective periods. The gains or losses resulting from such translation are reported as “*Other comprehensive income*”, a separate component of stockholders’ equity. The method for translating expenses of overseas operations depends upon the funds used. If the payment is made from a rupee denominated bank account, the exchange rate prevailing on the date of the payment would apply. If the payment is made from a foreign currency, i.e., non-rupee denominated account, the translation into rupees is performed at the average monthly exchange rate.

1.11 Earnings per share

In accordance with Statement of Financial Accounting Standards (“SFAS”) 128, *Earnings Per Share*, basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period, using the treasury stock method for options and warrants, except where the result would be anti-dilutive. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the if-converted method.

1.12 Income taxes

Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases and operating loss carry-forwards. 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 of changes in tax rates on deferred tax assets and liabilities is recognized as income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits of which future realization is uncertain. The income tax provision for the interim period is based on the best estimate of the effective tax rate expected to be applicable for the full fiscal year.

1.13 Fair value of financial instruments

The carrying amounts reflected in the balance sheets for cash, cash equivalents, accounts receivable and accounts payable approximate their respective fair values due to the short maturities of these instruments.

1.14 Concentration of risk

Financial instruments that potentially subject the company to concentrations of credit risk consist principally of cash equivalents, trade accounts receivable, investment securities and hedging instruments. By nature, all such financial instruments involve risk, including the credit risk of non-performance by counterparties. In management’s opinion, as of March 31, 2003 and December 31, 2003, there was no significant

risk of loss in the event of non-performance of the counterparties to these financial instruments, other than the amounts already provided for in the financial statements, if any. Exposure to credit risk is managed through credit approvals, establishing credit limits and monitoring procedures. The company's cash resources are invested with corporations, financial institutions and banks with high investment grade credit ratings. Limitations are established by the company as to the maximum amount of cash that may be invested with any such single entity.

1.15 Retirement benefits to employees

1.15.1 Gratuity

In accordance with the Payment of Gratuity Act, 1972, Infosys provides for gratuity, a defined benefit retirement plan (the "Gratuity Plan") covering eligible employees. The Gratuity Plan provides a lump sum payment to vested employees at retirement, death, incapacitation or termination of employment, of an amount based on the respective employee's salary and the tenure of employment.

Liabilities with regard to the Gratuity Plan are determined by actuarial valuation and as per gratuity regulations for the company and Progeon respectively. The company fully contributes all ascertained liabilities to the Infosys Technologies Limited Employees' Gratuity Fund Trust (the "Trust"). Trustees administer contributions made to the Trust and contributions are invested in specific designated instruments as permitted by law and investments are also made in mutual funds that invest in the specific designated instruments.

1.15.2 Superannuation

Certain employees of Infosys are also participants of a defined contribution plan. The company makes monthly contributions under the superannuation plan (the "Plan") to the Infosys Technologies Limited Employees Superannuation Fund Trust based on a specified percentage of each covered employee's salary. The company has no further obligations to the Plan beyond its monthly contributions. Certain employees of Progeon are also eligible for superannuation benefit. Progeon makes monthly provisions under the superannuation plan based on a specified percentage of each covered employee's salary. Infosys has no further obligations to the superannuation plan beyond its monthly provisions.

1.15.3 Provident fund

Eligible employees receive benefits from a provident fund, which is a defined contribution plan. Both the employee and the company make monthly contributions to the provident fund plan equal to a specified percentage of the covered employee's salary. The company contributes a part of the contributions to the Infosys Technologies Limited Employees' Provident Fund Trust. The remainders of the contributions are made to Government administered provident fund. The company has no further obligations under the provident fund plan beyond its monthly contributions.

In respect of Progeon, eligible employees receive benefits from a provident fund, which is a defined contribution plan. Both the employee and Progeon make monthly contributions to this provident fund plan equal to a specified percentage of the covered employee's salary. Amounts collected under the provident fund plan are deposited in a government administered provident fund. Progeon has no further obligations under the provident fund plan beyond its monthly contributions.

1.16 Investments

The company accounts by the equity method for investments between 20% and 50% or where it is otherwise able to exercise significant influence over the operating and financial policies of the investee. Non-readily marketable equity securities for which there are no readily determinable fair values are recorded at cost. Declines in value judged to be other than temporary are included in earnings. Realized gains and losses and unrealized holding gains and losses for trading securities are included in earnings. Investment securities designated as "available for sale" are carried at their fair value. Fair value is based on quoted market prices. Temporary unrealized gains and losses, net of the related tax effect are reported as a separate component of stockholder's equity until realized. Realized gains and losses and declines in value judged to be other than temporary on available for sale securities are included in earnings. The cost of securities sold is based on the specific identification method. Interest and dividend income are recognized when earned.

1.17 Stock-based compensation

The company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation an interpretation of APB Opinion No. 25* to account for its fixed stock option plans. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS 148, *Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of FASB Statement No. 123*. All stock options issued to date have been accounted as a fixed stock option plan.

The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of SFAS Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	Nine months ended December 31,	
	2002	2003
Net income, as reported	\$ 141,797,917	\$ 193,529,659
Add: Stock-based employee compensation expense included in reported net income	3,731,844	2,817,066
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(43,311,902)	(41,222,826)
Pro forma net income	\$ 102,217,859	\$ 155,123,899
Earnings per share:		
Basic – as reported	\$ 2.16	\$ 2.95
Basic – pro forma	\$ 1.56	\$ 2.36
Diluted – as reported	\$ 2.13	\$ 2.91
Diluted – pro forma	\$ 1.56	\$ 2.34

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

	Nine months ended December 31,	
	2002	2003
Dividend yield	0.2%	0.2%
Expected life	1-5 years	1-5 years
Risk free interest rate	6%	5.1%-5.7%
Volatility	60-75%	60-75%

1.18 Dividends

Dividend on common stock are recorded as a liability on the date of declaration by the stockholders.

1.19 Derivative financial instruments

The company adopted SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* as amended, when the rules became effective. The company enters into foreign exchange forward contracts where the counter party is generally a bank. The company purchases foreign exchange forward contracts to mitigate the risk of changes in foreign exchange rates on accounts receivable and forecasted cash flows denominated in certain foreign currencies. Although these contracts are effective as hedges from an economic perspective, they do not qualify for hedge accounting under SFAS 133, as amended. Any derivative that is either not designated hedge, or is so designated but is ineffective per SFAS 133, is marked to market and recognized in earnings immediately.

1.20 Reclassifications

Certain reclassifications have been made to conform prior period data to the current presentations. These reclassifications had no effect on reported earnings.

2 Notes to the unaudited consolidated financial statements

2.1 Trade accounts receivable

Trade accounts receivable as of March 31, 2003 and December 31, 2003, net of allowance for doubtful accounts of \$3,010,568 and \$ 4,743,201 respectively, amounted to \$109,119,856 and \$ 153,010,094. The age profile of trade accounts receivable, net of allowances is given below.

Period (in days)	In %	
	As of	
	March 31, 2003	December 31, 2003
0 – 30	65.8	64.5
31 – 60	29.0	23.9
61 – 90	3.9	6.9
More than 90	1.3	4.7
	<u>100.0</u>	<u>100.0</u>

2.2 Intangible assets

During fiscal 2003, the company acquired the intellectual property rights of Trade IQ product from IQ Financial Systems Inc., USA for its banking business unit. The consideration paid amounted to US\$ 3.47 million and was recorded as an intangible asset and amortized over two years being management's initial estimate of the useful life. In the same fiscal year, the company also entered into an agreement for transferring the intellectual property rights in a commercial software application product used in the design of high performance structural systems. The company is required to pay the committed consideration of US\$ 5 million within ten years of the contract date. The ownership of intellectual property in the product transfers to the company on remittance of the consideration. The committed consideration of US\$ 5 million was recorded as an intangible asset and was being amortized over management's estimate of the useful life, which was initially 5 years. During the nine months ended December 31, 2003, management revised its estimates of the remaining useful life of these intangible assets. The additional amortization for the nine months ended December 31, 2003 due to the revisions in the estimates of remaining useful life was \$ 4.4 million. The recorded values of the intangible assets have been completely amortized as of December 31, 2003.

2.3 Related parties

The company grants loans to employees for acquiring assets such as property and cars. Such loans are repayable over fixed periods ranging from 1 to 100 months. The annual rates of interest at which the loans have been made to employees vary between 0% through 4%. No loans have been made to employees in connection with equity issues.

The required repayments of loans by employees are as detailed below.

Year ending March/December	As of	
	March 31, 2003	December 31, 2003
2004	\$12,252,004	\$11,541,388
2005	4,298,780	3,899,488
2006	3,206,683	2,811,554
2007	2,416,202	2,114,012
2008	2,099,781	1,962,762
Thereafter	4,432,882	3,863,744
	<u>\$28,706,332</u>	<u>\$26,192,948</u>

The estimated fair values of related party receivables amounted to \$24,422,419 and \$ 22,666,488 as of March 31, 2003 and December 31, 2003 respectively. These amounts have been determined using available market information and valuation methodologies. Considerable judgment is required to develop these estimates of fair value. Consequently, these estimates are not necessarily indicative of the amounts that the company could realize in the market.

2.4 Share capital of Progeon

In April 2002, Progeon issued 12,250,000 equity shares of par value \$0.20 per share to its holding company, Infosys, in exchange for an aggregate consideration of \$2,500,000 ("First Tranche subscription"). In terms of the stock subscription agreement between Infosys, Citicorp International Finance Corporation ("CIFIC") and Progeon, Infosys is also required to subscribe to an additional 12,250,000 equity shares in Progeon.

On June 14, 2002, Progeon issued 4,375,000 0.0005% cumulative convertible preference shares to CIFIC at an issue price of \$2.28 (equivalent to Rs. 112) per share, in exchange for an aggregate consideration of \$10,000,000. Unless earlier converted, pursuant to an agreement between the company and CIFIC, these cumulative convertible preference shares shall automatically be converted into equity shares, (i) one year prior to the Initial Public Offering ("IPO") date or (ii) September 30, 2005 or (iii) at the holder's option, immediately upon the occurrence of any Liquidity Event; whichever is earlier. The term "Liquidity Event" includes any of a decision of the Board of Directors of the company to make an IPO, merger, reconstruction, capital reorganization or other event which, in the sole opinion of the holder of the convertible preference shares, amounts to an alteration in the capital structure of the company. Each preference share is convertible into one equity share, par value \$0.20 each. The dividend on the preference shares for the period ended December 31, 2003 is payable.

Each holder of these cumulative convertible preference shares is entitled to receive notice of, and to attend, any shareholders' meeting and shall be entitled to vote together with holders of equity shares on any matters that affect their rights as preference shareholders including any resolution for winding up the company or for the repayment or reduction of the company's share capital.

In the event of any liquidation, dissolution or winding up of the company, either voluntary or involuntary, each holder of the preference shares will be paid a dollar equivalent of Rs. 112 per preference share, as adjusted for stock dividends, combinations, splits, recapitalizations and the like, in preference to any distribution of any assets of the company to the holders of equity shares. Indian law requires redemption of preference shares within a period of 20 years.

Upon the completion of the distribution described above, the remaining assets and funds of the company available for distribution to shareholders shall be distributed among all holders of preference shares and equity shares based on the number of equity shares held by each of them (assuming a full conversion of all the preference shares). CIFIC is also required to subscribe to an additional 4,375,000 cumulative convertible preference shares in Progeon.

2.5 Other income, net

Other income, net, consists of the following:

	Nine months ended December 31,	
	2002	2003
Interest income	\$ 11,728,239	\$ 14,066,607
Income from mutual fund investments	-	1,937,136
Exchange gains	3,528,637	10,174,551
Provision for investments	(3,219,030)	(1,922,070)
Others	500,618	129,615
	<u>\$ 12,538,464</u>	<u>\$ 24,385,839</u>

The provision for investments during the nine months ended December 31, 2002 included approximately \$ 1.5 million for Asia Net Media BVI Limited, \$0.2 million for JASDIC Park Company, \$1.5 million for Workadia Inc and other miscellaneous investments. The provisions during the nine months ended December 31, 2003 include write-downs to investments in CiDRA Corporation (\$1.5 million) and Stratify Inc (\$0.4 million). These write-downs were required due to the non-temporary impact of adverse market conditions on these entities' business models and contemporary transactions on the securities of the entities which have been indicative of their current fair value.

2.6 Income taxes

The provision for income taxes comprises:

	Nine months ended December 31,	
	2002	2003
Current taxes:		
Domestic taxes	\$ 13,553,644	\$ 10,178,571
Foreign taxes	18,560,002	27,359,790
	<u>32,113,646</u>	<u>37,538,361</u>
Deferred taxes:		
Domestic taxes	(1,296,511)	1,212,292
Foreign taxes	(931,514)	(359,024)
	<u>(2,228,025)</u>	<u>853,268</u>
Aggregate taxes	<u>\$ 29,885,621</u>	<u>\$ 38,391,629</u>

The tax effects of significant temporary differences that resulted in deferred tax assets and liabilities, and a description of the financial statement items that created these differences are as follows:

	As of	
	March 31, 2003	December 31, 2003
Deferred tax assets:		
Property, plant and equipment	\$4,719,124	\$ 5,060,373
Provision for doubtful debts	1,093,701	1,170,696
Investments	2,545,761	3,059,683
	8,358,586	9,290,752
<i>Less:</i> Valuation allowance	(614,004)	(2,078,897)
	7,744,582	7,211,855
Deferred tax liability on foreign exchange gains	(191,156)	(180,566)
Deferred tax liability on unrealized gain on investments	-	(49,864)
Net deferred tax assets	\$7,553,426	\$ 6,981,425

In assessing the realizability 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 scheduled reversal of 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 income 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 the existing valuation allowance at December 31, 2003. The valuation allowance relate to provision for doubtful debts and investments. 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.

All deferred tax expenses / (benefits) are allocated to the continuing operations of the company.

The provision for foreign taxes is due to income taxes payable overseas, principally in the United States of America. The company benefits from certain significant tax incentives provided to software firms under Indian tax laws. These incentives presently include: (i) an exemption from payment of Indian corporate income taxes for a period of ten consecutive years of operation of software development facilities designated as "Software Technology Parks" (the "STP Tax Holiday"); and (ii) a tax deduction for profits derived from exporting computer software (the "Export Deduction"). All but one of the company's software development facilities are located in designated Software Technology Parks ("STP"). The Government of India has recently amended the tax incentives available to companies set up in designated STPs. The period of the STP Tax Holiday available to such companies is restricted to ten consecutive years, beginning from the financial year when the unit started producing computer software or April 1, 1999, whichever is earlier. The Finance Act 2002 provided that the exempt income from an export oriented undertaking, for fiscal 2003 be restricted to 90% of its export income. However, this restriction is not applicable from fiscal 2004. Additionally, the Export Deduction is being phased out equally over a period of five years starting from fiscal 2000.

The company is subject to a 15% Branch Profit Tax (BPT) in the U.S. to the extent its U.S. branch's net profit during the year is greater than the increase in the net assets of the company's U.S. branch during the fiscal year, computed in accordance with the Internal Revenue Code. The company has not triggered the BPT and intends to maintain the current level of its net assets in the U.S., as it is consistent with its business plan. Accordingly, a BPT provision has not been recorded.

2.7 Earnings per share

The following is a reconciliation of the equity shares used in the computation of basic and diluted earnings per equity share:

	Nine months ended December 31,	
	2002	2003
Basic earnings per equity share – weighted average number of common shares outstanding excluding unallocated shares of ESOP	65,567,814	65,628,199
Effect of dilutive common equivalent shares– stock options outstanding`	838,118	928,968
Diluted earnings per equity share – weighted average number of common shares and common equivalent shares outstanding	66,405,932	66,557,167

Options to purchase 702,902 shares under the 1998 Plan and 2,840,392 shares under the 1999 Plan were not considered for calculating diluted earnings per share for the nine months ended December 31, 2003 as their effect was anti-dilutive.

2.8 Derivative financial instruments

The Company enters into foreign exchange forward contracts where the counter party is generally a bank. The Company considers the risks of non-performance by the counter party as non-material. Infosys held foreign exchange forward contracts of \$88,000,000 and \$ 113,750,000 as of March 31, 2003 and December 31, 2003, respectively. The foreign exchange forward contracts mature between one to six months.

2.9 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 providing IT solutions, delivered to customers located globally, across various industry segments. The Chief Operating Decision Maker evaluates the company's performance and allocates resources based on an analysis of various performance indicators by industry classes and geographic segmentation of customers. Accordingly, revenues represented along industry classes comprise the principal basis of segmental information set out in these financial statements. Secondary segmental reporting is performed on the basis of the geographical location of customers. The accounting principles consistently used in the preparation of the financial statements are consistently applied to record revenue and expenditure in individual segments, and are as set out in the summary of significant accounting policies.

Industry segments for the company are primarily *financial services* comprising enterprises providing banking, finance and insurance services, *manufacturing* enterprises, enterprises in the *telecommunications* ("telecom") and *retail* industries, and *others* such as utilities, transportation and logistics companies.

Geographic segmentation is based on business sourced from that geographic region and delivered from both on-site and off-shore. *North America* comprises the United States of America, Canada and Mexico; *Europe* includes continental Europe (both the east and the west), Ireland and the United Kingdom; and the *Rest of the World* comprising all other places except those mentioned above and *India*.

Revenue in relation to segments is categorized based on items that are individually identifiable to that segment, while expenditure is categorized in relation to the associated turnover of the segment. Allocated expenses of the geographic segments include expenses incurred for rendering services from the company's offshore software development centres and on-site expenses. Certain expenses such as depreciation, which form a significant component of total expenses, are not specifically allocable to specific segments as the underlying services are used interchangeably. Management believes that it is not practical to provide segment disclosures relating to those costs and expenses, and accordingly these expenses are separately disclosed as "unallocated" and adjusted only against the total income of the company.

Fixed assets used in the company's business are not identified to any of the reportable segments, as these are used interchangeably between segments. Management believes that it is currently not practicable to provide segment disclosures relating to total assets and liabilities since a meaningful segregation of the available data is onerous.

Geographical information on revenue and industry revenue information is collated based on individual customers invoiced or in relation to which the revenue is otherwise recognized.

2.9.1 Industry segments

Nine months ended December 31, 2002

	Financial services	Manufacturing	Telecom	Retail	Others	Total
Revenues	\$ 203,419,872	\$ 91,154,337	\$ 79,168,194	\$ 61,946,100	\$ 102,087,471	\$ 537,775,974
Identifiable operating expenses	81,664,228	37,057,023	26,678,891	19,558,427	38,673,125	203,631,694
Allocated expenses	56,445,056	23,557,385	20,530,951	16,009,339	26,513,650	143,056,381
Segmental operating income	65,310,588	30,539,929	31,958,352	26,378,334	36,900,696	191,087,899
Unallocable expenses						31,942,825
Operating income						159,145,074
Other income, net						12,538,464
Income before income taxes						171,683,538
Provision for income taxes						29,885,621
Net income						<u>\$ 141,797,917</u>

Nine months ended December 31, 2003

	Financial services	Manufacturing	Telecom	Retail	Others	Total
Revenues	\$ 288,816,091	\$ 113,256,436	\$ 114,172,149	\$ 89,754,981	\$ 153,911,633	\$ 759,911,290
Identifiable operating expenses	120,933,319	49,464,341	46,200,260	33,436,345	63,491,710	313,525,975
Allocated expenses	77,123,675	28,841,657	30,594,784	22,845,631	39,190,186	198,595,933
Segmental operating income	90,759,097	34,950,438	37,377,105	33,473,005	51,229,737	247,789,382
Unallocable expenses						40,253,933
Operating income						207,535,449
Other income, net						24,385,839
Income before income taxes						231,921,288
Provision for income taxes						38,391,629
Net income						<u>\$ 193,529,659</u>

2.9.2 Geographic segments

Nine months ended December 31, 2002

	North America	Europe	India	Rest of the World	Total
Revenues	\$ 395,272,736	\$ 92,863,563	\$ 10,108,669	\$ 39,531,006	\$ 537,775,974
Identifiable operating expenses	156,416,246	31,914,376	3,536,136	11,764,936	203,631,694
Allocated expenses	104,085,331	24,259,358	3,495,073	11,216,619	143,056,381
Segmental operating income	134,771,159	36,689,829	3,077,460	16,549,451	191,087,899
Unallocable expenses					31,942,825
Operating income					159,145,074
Other income, net					12,538,464
Income before income taxes					171,683,538
Provision for income taxes					29,885,621
Net income					\$ 141,797,917

Nine months ended December 31, 2003

	North America	Europe	India	Rest of the World	Total
Revenues	\$ 558,606,344	\$ 142,899,787	\$ 10,784,260	\$ 47,620,899	\$ 759,911,290
Identifiable operating expenses	234,609,087	56,909,000	3,369,253	18,638,635	313,525,975
Allocated expenses	146,450,161	37,260,912	2,756,062	12,128,798	198,595,933
Segmental operating income	177,547,096	48,729,875	4,658,945	16,853,466	247,789,382
Unallocable expenses					40,253,933
Operating income					207,535,449
Other income, net					24,385,839
Income before income taxes					231,921,288
Provision for income taxes					38,391,629
Net income					\$ 193,529,659

2.10 Litigation

The company is subject to legal proceedings and claims, which have arisen, in the ordinary course of its business. Legal actions, when ultimately concluded and determined, will not, in the opinion of management, have a material effect on the results of operations or the financial position of the company.

Ms. Jennifer Griffith, a former employee, has filed a lawsuit against the company and its former director, Mr. Phaneesh Murthy. The lawsuit has been served on the company. Management is reviewing the allegations. Based on its present knowledge of facts, management estimates that the lawsuit will not have material impact on the result of operation or financial position of the company.