

Geometric Software

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,069	GMSS IN
	REUTERS CODE
S&P CNX: 2,444	GEOM.BO

21 October 2005

Neutral

Previous Recommendation: Buy

Rs86

Equity Shares (m)	57.1
52-Week Range (Rs)	132/60
1,6,12 Rel. Perf. (%)	-24/-43/-1
M.Cap. (Rs b)	4.9
M.Cap. (US\$ b)	0.1

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	1,682	275	4.9	28.1	17.6	4.0	24.6	34.6	2.7	9.8
3/06E	2,257	319	5.6	13.8	15.5	3.3	22.9	32.5	1.9	8.0
3/07E	2,930	416	7.1	26.6	12.2	2.8	24.1	33.3	1.4	5.8

Geometric Software reported consolidated revenue of Rs508m, up 5% QoQ as against our expectation of Rs522m for 2QFY06. Net profit was down 57% QoQ at Rs38m as against our expectation of Rs40m.

The products business grew 8.3% QoQ with only Teksoft reporting flat revenues. CAD-PDM launch continues to be delayed. Engineering services grew slower at 4.5%. However, offshore growth was greater at 6.2%.

The company has initiated a new service offering called Application Maintenance Services (AMS), which is designed to give an annuity component to the revenue stream.

Gross margins were up 270bp due to improvement in utilization in products business and greater offshore growth in the engineering services business. EBITDA margin went up 200bp due to lower G&A expenses.

Net profit was down 56.7% due to low other income (other income was high at Rs70m in 1QFY06 due to adjustment in the accounting policy for investments).

The company maintains that the demand in the PLM market continues to be strong. The company has refrained from giving guidance for the full year, but has indicated that it would be unable to meet its earlier guidance. While the growth in the second half of the year promises to be more robust, any further setback would negatively impact stock price. The stock currently trades at a PE of 12.2x FY07E earnings. Maintain **Neutral**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY05				FY06E				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenues	349	399	435	499	486	510	592	668	1,682	2,257
Q-o-Q Change (%)	13.0	14.1	9.1	14.7	-2.6	5.0	16.1	12.8	58.6	34.2
Direct Expenses	226	239	246	292	298	299	324	349	1,003	1,270
Sales, General & Admin. Expenses	42	49	46	76	105	114	114	123	213	455
Operating Profit	81	111	143	131	83	98	155	196	466	532
Margins (%)	23.3	27.8	33.0	26.2	17.2	19.1	26.1	29.4	27.7	23.6
Other Income	21	10	-5	26	71	-2	10	20	51	99
Depreciation	29	30	32	37	37	41	46	52	128	176
PBT bef. Extra-ordinary	73	90	106	120	118	55	118	164	389	455
Provision for Tax	13	17	17	25	20	8	20	28	70	76
Rate (%)	17.2	18.3	15.7	20.6	17.4	14.2	17.0	17.0	18.1	16.8
Minority interest	9	11	10	14	19	13	14	14	44	61
Net Income bef. Extra-ordinary	51	63	80	82	78	34	85	122	275	319
Q-o-Q Change (%)	-5.4	24.0	25.7	2.6	-4.3	-56.5	148.5	44.3	31.5	15.9

E: MOST Estimates

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Revenue growth slower at 5%

In line with Geometric's earnings warning stating that it would report mid-single digit growth in revenue for 2QFY06 as against the previously expected double-digit growth, the company has reported consolidated revenue of Rs508m, up 5% QoQ as against our expectation of Rs522m for 2QFY06. The reasons for the slower growth included:

- ✍ Delay in commencement of certain projects that were supposed to start in the beginning or middle of the second quarter; these projects commenced in September.
- ✍ Delay in commencement of large engineering services project from one of the company's business partners; the projects commenced in the last week of September as opposed to expected commencement in the beginning of the quarter.
- ✍ Delay in the launch of the CAD-PDM product due to delay in alignment with its channel partners.

Product business up 8.3% QoQ

The products business grew 8.3% QoQ with Teksoft reporting flat revenues, while all other products grew during the quarter. The company launched new versions of Feature Recognition, Nestlib, GeomCaliper and 3DSearch IT product suites during the quarter, which added to the growth momentum. The company also won three new deals for e-Drawings. CAD-PDM launch was delayed due to channel partner issues.

PRODUCT REVENUE (RS M)

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Products	30	39	76	69	75
QoQ growth %	-5.8	31.4	95.3	-8.7	8.3

Source: Company/Motilal Oswal Securities

Engineering services up 4.5% due to offshore momentum

While onsite growth in engineering services was flat at 0.5% QoQ, offshore revenue grew 6.2% sequentially during the quarter. Consequently, the total revenue from engineering services was up 4.5% QoQ. The sales cycles

have become longer due to increase in deal sizes, which contributed to the delay in project starts. Of the delayed projects from business partners, several started during the current quarter, except for one partner that was acquired, leading to cancellation of projects. The company has announced that it would not be able to meet its US\$5m revenue guidance for the full year.

ENGINEERING SERVICES REVENUE (RS M)

	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Onsite	94	113	123	130	131
QoQ growth %	21.6	19.8	9.0	5.8	0.5
Offshore	275	283	300	287	304
QoQ growth %	14.4	3.0	6.0	-4.5	6.2
Total	369	396	423	417	435
QoQ growth %	16.1	7.3	6.8	-1.5	4.5

Source: Company/Motilal Oswal Securities

AMS to add annuity component to revenue stream

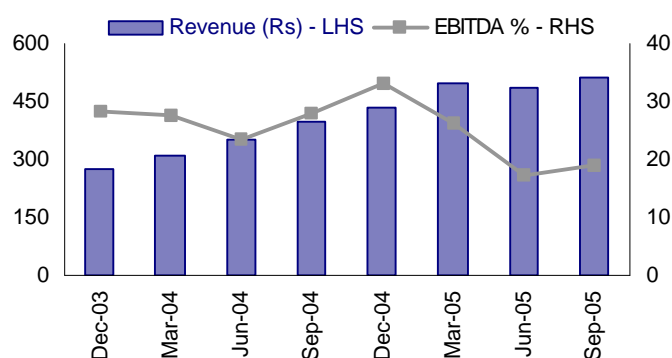
The company has initiated a new service offering called Application Maintenance Services (AMS), which is designed to give an annuity component to the revenue stream. The company plans to offshore routine maintenance work through this practice, which it believes holds immense potential as maintenance offshoring is minimal at present. The move is a part of the company's strategy to smoothen out the fluctuations in its PLM revenues by offering a wider basket of services. The company has started discussion with two of its customers for AMS work, which it expects to start after a few quarters.

The company is also trying to reduce dependence on the automotive industry (currently at 18-20% of revenue) by approaching new sectors such as machine tools and equipment manufacturing. Some of the company's customers in the automotive industry (especially the German customers) have been facing declining revenue coupled with escalating costs, which has prompted the company to look for new sectors where it can vend its expertise. While it is early to comment on specifics in this business, we believe that this is a step in the right direction.

EBITDA margin rises by 200bp

The gross margin in 2QFY06 was up 270bp due to improvement in utilization in products business and greater offshore growth in the engineering services business. While overall utilization including trainees dropped to 76% from 80% in 1QFY06, the drop in utilization excluding trainees was lower at 2% (85% in 2QFY06 as against 87% in 1QFY06). Our interaction with the company revealed that the utilization in the products business was higher during the quarter, which improved gross margins. Additionally, higher offshore growth in the engineering business (6.2%) also boosted margins for the quarter. EBITDA margin was up 200bp due to 50bp increase G&A expenses.

MARGIN IMPROVEMENT



Source: Company/Motilal Oswal Securities

Net profit plunges by 57%

The net profit for the quarter was down 56.7% due to the impact of slower revenue growth and negative other income. The last quarter saw a spike in other income at Rs70m due to a change in the method of valuation of the company's forward contracts wherein it moved to mark-to-market valuation of outstanding forward contract, which resulted in an incremental forex gain of Rs40m and boosted net margins by 820bp for the quarter. The absence of this spike caused net margin to plummet to 9.2% from 20% in the previous quarter.

Outlook and view

The company maintains that the demand in the PLM market continues to be strong. The company has refrained for giving guidance for the full year, but has indicated that it would be unable to meet its earlier guidance. While we believe that the company would report revenue growth of 34.2% for the full year ending March 2006, profit growth is expected to be muted at 15.9%. The stock has corrected sharply since the company announced an earnings warning. While the growth in the second half of the year promises to be more robust, any further setback would negatively impact stock price. The stock currently trades at a PE of 12.2x FY07E earnings. **Maintain Neutral.**

Geometric Software: an investment profile

Company description

Geometric Software is a niche player offering PLM software and services employing more than 1,000 engineers. It has relationship with eight of the top 11 software OEMs in the PLM segment and set up a JV with Dassault Systems, the largest PLM software company globally. Its key clients include Dassault Systems, UGS PLM, Matrix One and other leaders in the PLM software segment. Its vision is to grow revenues to US\$100m by FY07 from US\$38m in FY05.

Key investment arguments

- ✍ Largest beneficiary of increased spending by PLM Software OEMs due to established relationships
- ✍ Partnerships with IBM Global, EDS and HP enabling involvement in bidding for projects with large clients
- ✍ Offshore growth to accelerate as partnerships mature

Key investment risks

- ✍ Dependent on partners for business and initiating client relationship
- ✍ Realisation from industrial clients could be lower due to revenue sharing with partners
- ✍ Rupee-based billing could increase if relationship with partners is transferred to their India centres

Recent developments

- ✍ New Application Maintenance Service launched to generate annuity billing
- ✍ IBM entered the top-10 client category

Valuation and view

- ✍ Revenue growth of 34.2% and earnings growth of 16% in FY06
- ✍ Valuations at 15.4x FY06E earnings are expensive given the muted growth prospects for the year.
- ✍ Maintain **Neutral** with a target price of Rs92.

Sector view

- ✍ Various CIO surveys indicate increasing share of offshore spending in IT budgets
- ✍ Indian offshore vendors gaining market share in competition with MNCs
- ✍ Prefer large companies as bulk of volumes going to them while niche players benefit due to lack of offshore competition

COMPARATIVE VALUATIONS

		GEOMETRIC	HEXAWARE	DATAMATICS
P/E	FY06E	15.4	14.7	12.6
	FY07E	12.2	13.7	7.5
P/BV	FY06E	3.3	3.9	2.0
	FY07E	2.8	3.0	1.8
EV/Sales (x)	FY06E	1.9	1.9	1.3
	FY07E	1.4	1.5	0.8
EV/EBITDA (x)	FY06E	8.0	11.3	7.9
	FY07E	5.7	9.4	4.1

SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	30.8	31.0	31.6
Domestic Institutions	16.6	20.2	19.5
FII's/FDIs	19.3	16.1	13.0
Others	33.3	32.7	35.9

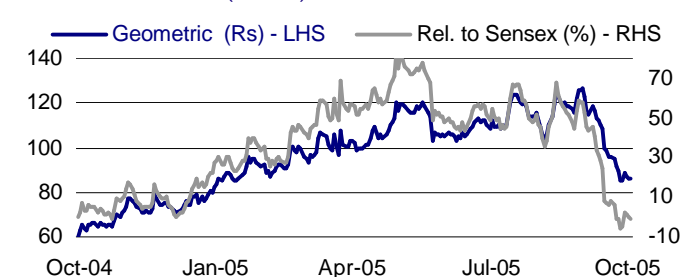
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VIATION (%)
FY06	5.6	5.9	-4.3
FY07	7.1	8.8	-19.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
86	92	7.0	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2003	2004	2005	2006 E	2007 E
Sales	841	1,060	1,682	2,257	2,930
Change (%)	34.6	26.0	58.6	34.2	29.8
Employee Costs	434	569	923	1,270	1,668
Travelling & Conveyance	33	53	80	87	111
Other Operating Expenses	141	149	213	368	440
EBITDA	233	289	466	532	710
% of Net Sales	27.7	27.3	27.7	23.6	24.2
Depreciation	61	82	128	176	217
Other Income	36	64	51	99	80
PBT	208	271	390	455	574
Tax	18	29	70	76	86
Rate (%)	8.8	10.5	18.1	16.8	15.0
PAT	190	242	319	379	487
Minority Interest	19	34	44	61	73
Extraordinary	1	0	1	0	0
Net Income	171	208	275	319	416
Change (%)	32.7	22.3	31.8	15.9	30.5

BALANCE SHEET (Rs Million)					
Y/E MARCH	2003	2004	2005	2006 E	2007 E
Share Capital	53	54	112	112	112
Share Premium	112	134	101	101	101
Reserves	603	773	990	1,269	1,622
Net Worth	768	962	1,203	1,481	1,835
Minority Interest	18	31	43	61	73
Loans	30	0	15	0	0
Capital Employed	816	993	1,261	1,542	1,907
Gross Block	474	780	1,111	1,321	1,561
Less : Depreciation	150	230	357	533	750
Net Block	325	550	754	788	811
CWIP	32	50	88	10	10
Investments	146	178	135	95	95
Curr. Assets	480	505	747	1,109	1,566
Debtors	132	200	366	445	562
Cash & Bank Balance	286	228	176	573	898
Loans & Advances	49	63	191	77	90
Other Current Assets	13	14	13	15	16
Current Liab. & Prov	167	290	462	460	574
Creditors	5	18	48	24	30
Other Liabilities	113	184	253	320	395
Provisions	50	88	161	116	149
Net Current Assets	313	215	285	649	991
Application of Funds	816	993	1,261	1,542	1,907

E: MOST Estimates

RATIOS					
Y/E MARCH	2003	2004	2005	2006 E	2007 E
Basic (Rs)					
EPS	3.3	3.8	4.9	5.6	7.1
Cash EPS	4.4	5.3	7.2	8.7	10.7
Book Value	14.6	17.6	21.5	25.9	31.2
DPS	0.4	0.5	0.6	0.7	1.1
Payout %(Incl.Div.Taxes)	12.4	12.5	12.5	12.5	15.0
Valuation (x)					
P/E		22.6	17.6	15.5	12.2
Cash P/E		16.2	12.0	10.0	8.0
EV/EBITDA		15.0	9.8	8.0	5.8
EV/Sales		4.1	2.7	1.9	1.4
Price/Book Value		4.9	4.0	3.3	2.8
Dividend Yield (%)		0.6	0.7	0.8	1.2
Profitability Ratios (%)					
RoE	24.0	23.4	24.6	22.9	24.1
RoCE	28.7	29.9	34.6	32.5	33.3
Turnover Ratios					
Debtors (Days)	57	69	75	72	70
Fixed Asset Turnover (x)	18	14	15	17	19
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT (Rs Million)					
Y/E MARCH	2003	2004	2005	2006 E	2007 E
CF from Operations	251	329	454	553	710
Cash for Working Capital	11	-35	129	-34	22
Net Operating CF	240	364	325	587	688
Net Purchase of FA	-78	-323	-369	-132	-240
Net Purchase of Invest.	58	-67	3	-18	-61
Net Cash from Invest.	-19	-390	-366	-151	-301
Proceeds from Pvt. Place.	6	24	24	0	0
Proceeds from LTB/STB	30	-30	0	0	0
Dividend Payments	-24	-26	-34	-40	-62
Cash Flow from Fin.	12	-32	-11	-40	-62
Free Cash Flow	162	41	-44	455	448
Net Cash Flow	233	-58	-52	397	325
Opening Cash Balance	53	286	228	176	573
Add: Net Cash	233	-58	-52	397	325
Closing Cash Balance	286	228	176	573	898

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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