MOTILAL OSWAL

Geometric Software

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,934	GMSS IN
	REUTERS CODE
S&P CNX: 4,117	GEOM.BO

Equity Shares (m)	61.3
52-Week Range (Rs)	145/73
1,6,12 Rel. Perf. (%)	11/-5/-9
M.Cap. (Rs b)	7.3
M.Cap. (US$ b)	0.2

4 May 2007

Buy

Previous Recommendation: Buy

Rs120

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS* (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
*3/07E	3,831	374	6.1	53.4	19.6	3.4	20.9	16.2	2.1	12.6
*3/08E	6,216	539	8.8	44.0	13.6	2.8	22.7	16.4	1.3	8.0
*3/09E	8,469	830	13.5	54.0	8.8	2.2	28.3	22.3	0.9	5.5

** Financial estimates are with Modern Engineering*

- **4Q largely in line with estimates, loss in Modern Engineering is a negative surprise:** Geometric reported consolidated revenue of Rs1.24, up 16.4% QoQ. Consolidated EBITDA margins declined due to slower growth, higher rupee appreciation, lower offshore revenue and reported loss in Modern Engineering. Net profit declined 4.3% QoQ to Rs101m due to margin erosion and higher tax rates during the quarter.
- **FY08 guidance builds in conservatism due to slower ramp up in Detroit:** FY08 guidance was lower than expectation at 50%YoY revenue growth and profit growth of 30-35%. The guidance factors in slower growth in Detroit based auto manufacturers, which would lower revenue visibility for Modern Engineering over the near term.
- **Demand scenario in engineering design, PLM remains robust:** The demand scenario in Geometrics focus businesses continues to remain robust with both industry forecasting strong growth in both engineering design and extended PLM services. Mergers and acquisitions such as the Siemens acquisition of UGS would help create a wider market for extended PLM services.
- **Outlook and view:** Considering (i) the lower than expected guidance that reflects the slower near term growth in Modern Engineering, (ii) lower than expected profitability in Modern Engineering, (iii) higher tax rates and (iv) higher rupee appreciation, we are cutting our EPS estimates for FY08 and FY09 by 12.6% and 13.3% respectively. Current valuations are attractive at 14x FY08E and 9.1x FY09E diluted EPS estimates. We maintain **Buy** with a revised price target of 170 (13x diluted FY09E EPS), an upside of 42% from current levels.

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY06				FY07				FY06	*FY07
	1Q	2Q	3Q	4Q	1Q	2Q	*3Q	*4Q		
Revenues	**486**	**510**	**599**	**639**	**721**	**800**	**1,067**	**1,243**	**2,234**	**3,831**
Q-o-Q Change (%)	*-2.6*	*5.0*	*17.4*	*6.7*	*12.8*	*10.9*	*33.5*	*16.4*	*32.9*	*71.4*
Total Operating Exps	403	413	448	478	558	649	897	1,077	1,741	3,181
Operating Profit	**83**	**98**	**151**	**162**	**163**	**151**	**170**	**166**	**493**	**650**
Margins (%)	*17.2*	*19.1*	*25.2*	*25.3*	*22.6*	*18.8*	*15.9*	*13.4*	*22.1*	*17.0*
Other Income	31	-2	-40	39	-29	29	49	43	28	92
Interest	0	0	0	0	0	0	16	15	0	31
Depreciation	37	41	46	49	49	50	57	47	172	203
PBT bef. Extra-ordinary	**78**	**55**	**65**	**152**	**85**	**130**	**146**	**146**	**350**	**507**
Provision for Tax	14	8	12	27	10	14	22	26	61	68
Rate (%)	*17.4*	*14.3*	*19.1*	*17.9*	*11.8*	*10.6*	*15.0*	*17.9*	*17.5*	*13.5*
Minority Interest	19	13	13	18	11	15	19	19	64	64
Net Income bef. Extra-ordinary	**45**	**34**	**39**	**107**	**63**	**101**	**105**	**101**	**225**	**374**
Q-o-Q Change (%)	*-45.1*	*-24.5*	*16.0*	*172.2*	*-40.6*	*59.0*	*4.5*	*-4.3*	*-18.2*	*66.5*

*E: MOSt Estimates; * Including Modern Engg.*

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4Q largely in line with estimates, loss in Modern Engineering is a negative surprise

Geometric reported consolidated revenue of Rs1.24, up 16.4% QoQ, in line with our estimates. Stand-alone revenue grew 1.3%, marginally lower than estimate of 2.6%. In dollar terms, stand-alone higher grew 2.8% QoQ v/s estimate of 1.6% QoQ. Revenue from Modern Engineering was higher at US$9.4m due to the effect of full quarter integration.

However, Modern reported a net loss of US$0.1m during the quarter due to slower client ramp ups, which resulted in the delay of two projects during the quarter. Consolidated EBITDA margins declined 260bp (v/s estimate of 150 bp) due to slower growth in stand-alone revenue, higher rupee appreciation, lower offshore revenue and reported loss in Modern Engineering. Net profit declined 4.3% QoQ to Rs101m due to margin erosion and higher tax rates (on account of Modern integration) during the quarter.

FY08 guidance builds in conservatism due to likely slower ramp up in Detroit-based clients

FY08 guidance was lower than expectation at 50%YoY revenue growth and profit growth of 30-35% in FY08. The dollar guidance stands at 57%YoY in revenue and 36.2-41.5% in profit (underlying rupee-dollar rate of 43). This implies that the company’s target revenue CAGR of 47-50% with operating profit (PBT before other income) CAGR of 68-70% over FY07-FY10 would have to be back-ended in terms of profitability improvement. The lower guidance factors in slower growth in Detroit based auto manufacturers, which would lower revenue visibility for Modern Engineering over the near term. However, the management is confident of being able to gain traction in Modern Engineering over the longer term given its expertise in the engineering design space. Location diversification through its centers in Romania and China is also expected to help drive revenue growth over the longer term. In addition, Geometric expects to offshore the incremental growth within Engineering Services. The management hopes to increase offshore contribution from Modern from 5% at present to 15-17% by the end of 4QFY08. We believe that this can be achieved given Modern’s strong relationships with several auto OEMs, construction OEMs as well as the expected high demand for offshore engineering services.

Demand scenario in engineering design, PLM remains robust

The demand scenario in Geometrics focus businesses continues to remain robust with both industry forecasting strong growth in both engineering design and extended PLM services. The PLM industry is undergoing consolidation with the more traditional mechanical design (CAD/CAM) design business, which would also help increase the market for PLM based services. Mergers and acquisitions such as the recent acquisition of UGS by Siemens would also help create a focused market for extended PLM services.

Direct business is on the rise, with reduced dependence on partners

Recently, Geometric has started reaching the end-user directly, in order to achieve greater visibility and higher predictability of revenues. Geometric has already demonstrated its capability of strong ramp in its direct clientele. Revenue contribution from direct customers grew to 54% from 44% in 3QFY07 due to Modern integration as well as higher contribution from stand-alone revenue. Revenue from business partners consequently to 16% from 22% in the previous quarter.

Strengthening of management team to help increase business focus

Geometric has been investing in strengthening the management team and has hired several key executives to head various business lines over the last few months. . It has already set up a global delivery unit to improve project execution headed by an experienced executive who has joined in from a Tier I Indian IT company. Geometric is also looking to strengthen its sales and marketing team by recruiting experienced personnel for US and Europe marketing. Through Modern Engineering the sales and marketing strength of Geometric has already increased by 7-8, who are experienced employees. This is being done with a view to improve focus on individual business lines, streamline business processes and increase accountability in the system. Given the expansion in scale that would be required (800-1,000 adds planned in FY08 itself), the increase in management bandwidth would be essential to manage process and delivery efficiencies.

Near-term margins likely under pressure

Management has indicated that in the coming quarters, margins are likely to be under pressure due to expected investment in strengthening the global delivery processes, sales and marketing and investment in bench. Salary hikes of 3-5% onsite and 13-15% offshore are also likely to impact margins. Though these investmentscould have an adverse impact on PAT growth, we believe it will strengthen the delivery execution, improve sales visibility and client mining in the future.

Outlook and view

We are disappointed by the lower guidance of 50% revenue and 30-35% profit growth in FY08. Considering (i) the lower than expected guidance that reflects the slower near term growth in Modern Engineering, (ii) lower than expected profitability in Modern Engineering, (iii) higher tax rates and (iv) higher rupee appreciation, we are cutting our EPS estimates for FY08 and FY09 by 12.6% and 13.3% respectively. We believe that near term upsides could be limited due to the lower revenue visibility in Modern Engineering. However, we continue to remain positive on growth in the PLM and engineering services spaces for Geometric over the longer term. Current valuations are attractive at 14x FY08E and 9.1x FY09E (diluted) EPS estimates. We maintain **Buy** with a revised price target of 170 (13x diluted FY09E EPS), an upside of 42% from current levels.

Geometric Software: an investment profile

Company description

Geometric Software is a niche player offering PLM software and services employing more than 2,000 engineers. It has relationships 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$300m by FY2010 from US$50m in FY06.

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

- G. Ravishankar appointed Chief Financial Officer in February 2007..
- GeomCaliper Version 2.0 was released for use with Dassault Systemes' CATIA V5®

Valuation and view

- Revenue CAGR of 48.7% and earnings growth of 48.9% over FY07- FY09E.
- Valuations at 9.1x FY09E (diluted) earnings are attractive
- Maintain **Buy** with a target price of Rs170, upside of 42%.

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	INFOTECH	KPIT CUMM.
P/E (x)	FY08E	14.0	15.6	15.5
	FY09E	9.3	12.2	11.3
P/BV (x)	FY08E	2.8	4.1	3.6
	FY09E	2.2	3.1	2.8
EV/Sales (x)	FY08E	1.3	2.0	1.7
	FY09E	0.9	1.4	1.2
EV/EBITDA (x)	FY08E	8.0	9.7	10.5
	FY09E	5.6	7.2	7.6

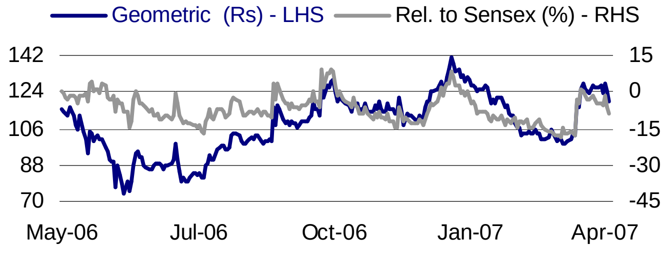
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	8.5	10.3	-17.2
FY09	13.2	14.2	-6.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
120	170	42.3	Buy

STOCK PERFORMANCE (1 YEAR)



SHAREHOLDING PATTERN (%)

	MAR-07	DEC-06	MAR-06
Promoter	27.9	28.2	30.6
Domestic Inst	15.6	14.6	11.1
Foreign	24.0	23.2	24.0
Others	32.5	34.0	34.3

INCOME STATEMENT					(Rs Million)
Y/E MARCH	2005	2006	2007	2008E	2009E
Sales	**1,682**	**2,234**	**3,831**	**6,216**	**8,469**
Change (%)	*58.6*	*32.8*	*71.4*	*62.3*	*36.2*
Total Operating Expenses	1,216	1,740	3,181	5,215	7,038
EBITDA	**466**	**494**	**650**	**1,000**	**1,431**
% of Net Sales	*27.7*	*22.1*	*17.0*	*16.1*	*16.9*
Depreciation	128	172	203	245	321
Interest	0	0	31	53	41
Other Income	51	28	92	48	62
PBT	**389**	**350**	**507**	**751**	**1,131**
Tax	70	61	68	135	209
Rate (%)	*18.1*	*17.4*	*13.5*	*17.9*	*18.5*
PAT	**319**	**289**	**439**	**616**	**922**
Minority Interest	44	64	64	77	92
Extraordinary	1	-33	0	0	0
Net Income	**275**	**259**	**374**	**539**	**830**
Change (%)	*31.8*	*-5.8*	*44.7*	*44.0*	*54.0*

BALANCE SHEET					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	112	113	123	123	123
Share Premium	100	127	567	567	567
Reserves	990	1,184	1,474	1,903	2,590
Net Worth	**1,203**	**1,424**	**2,164**	**2,592**	**3,279**
Minority Interest	43	65	77	89	101
Loans	15	0	900	740	635
Capital Employed	**1,261**	**1,490**	**3,141**	**3,422**	**4,016**
Gross Block	1,111	1,538	2,188	2,688	3,138
Less : Depreciation	357	516	894	1,139	1,459
Net Block	**754**	**1,022**	**1,294**	**1,549**	**1,678**
Goodwill	0	0	1,013	1,013	1,013
CWIP	88	46	50	50	50
Investments	135	214	314	214	364
Curr. Assets	**747**	**799**	**1,619**	**2,162**	**3,122**
Debtors	366	423	983	1,231	1,739
Cash & Bank Balance	91	57	144	256	342
Loans & Advances	276	318	493	675	1,041
Other Current Assets	13	0	0	0	0
Current Liab. & Prov	**430**	**555**	**1,112**	**1,528**	**2,169**
Creditors	44	61	130	180	243
Other Liabilites	226	281	631	820	1,140
Provisions	161	212	351	527	787
Net Current Assets	**316**	**244**	**507**	**634**	**953**
Deferred tax liability	-31	-36	-36	-37	-41
Application of Funds	**1,261**	**1,490**	**3,141**	**3,422**	**4,016**

E: MOSt Estimates; including Modern Engineering

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	**4.9**	**4.0**	**6.1**	**8.8**	**13.5**
Likely Diluted EPS			**5.9**	**8.5**	**13.2**
Cash EPS	7.2	7.0	9.4	12.8	18.8
Book Value	21.6	25.1	35.3	42.3	53.5
DPS	0.8	0.8	1.2	1.5	2.0
Payout %(Incl.Div.Taxes)	16.2	17.5	19.6	17.5	14.8
Valuation (x)					
P/E		30.0	19.6	13.6	8.8
Likely Diluted P/E			20.1	14.0	9.1
Cash P/E		17.0	12.7	9.3	6.4
EV/EBITDA		13.7	12.6	8.0	5.5
EV/Sales		3.0	2.1	1.3	0.9
Price/Book Value		4.8	3.4	2.8	2.2
Dividend Yield (%)		0.7	1.0	1.3	1.7
Profitability Ratios (%)					
RoE	25.5	17.2	20.9	22.7	28.3
RoCE	24.4	16.4	16.2	16.4	22.3
Turnover Ratios					
Debtors (Days)	61	64	67	65	64
Fixed Asset Turnover (x)	2.6	2.5	3.3	4.4	5.2
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.0	0.4	0.3	0.2

CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
CF from Operations	427	490	546	771	1,124
Cash for Working Capital	-142	-51	-209	-42	-266
Net Operating CF	**286**	**439**	**337**	**729**	**858**
Net Purchase of FA	-273	-395	-479	-500	-450
Net Purchase of Invest.	53	15	-1,050	167	-78
Net Cash from Invest.	**-220**	**-381**	**-1528**	**-333**	**-528**
Proceeds from Pvt. Place	24	28	461	12	12
Proceeds from LTB/STB	15	-15	900	-160	-105
Dividend Payments	-66	-105	-83	-137	-151
Cash Flow from Fin.	**-28**	**-92**	**1278**	**-285**	**-244**
Free Cash Flow	13	43	-142	229	408
Net Cash Flow	**38**	**-34**	**86**	**112**	**86**
Opening Cash Balance	**53**	**91**	**57**	**144**	**256**
Add: Net Cash	38	-34	86	112	86
Closing Cash Balance	**91**	**57**	**144**	**256**	**342**

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Disclosure of Interest Statement	Geometric Software
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No