

GEOMETRIC SOFTWARE SOLUTIONS

INR 117

*Modern's consolidation dampens profits***ACCUMULATE**

Geometric Software's Q4FY07 results were ahead of expectations in terms of revenues, but net profits fell short of expectations. Revenues, at INR 1.2 bn, were up 16.4% Q-o-Q, and the net profit, at INR 105 mn, was flat Q-o-Q. For FY07, the company comfortably surpassed its guidance of 35% growth in revenues and net profits, achieving 40% growth in revenues and 45% growth in net profits on an organic basis. During the quarter, Geometric completed the integration of Modern Engineering (Modern), and on a five month basis Modern has broken-even.

EBITDA margins during the quarter fell sharply to 12.6% from 16.1% in the previous quarter, on account of loss incurred at Modern in Q4 (due to revenue shortfalls). The company's strategy of focusing on direct industrial customers has met with some success with better acceptance resulting in higher traction and improving revenue contribution. Completion of Modern's integration, ongoing initiatives with regards to the go-to-market strategy, and expected turnaround of Modern in the current fiscal augur well for Geometric. reinforcing confidence in improved profitability in the coming quarters.

At CMP of INR 117, the stock trades at a P/E of 13.5x and 10.0x and EV/EBITDA of 7.4x and 5.3x on our FY08E and FY09E, respectively. We maintain our 'ACCUMULATE' recommendation on the stock.

Key Highlights

- Revenues for the quarter stood at INR 1.2 bn, up 16.4% Q-o-Q and 94.5% Y-o-Y. Net profit, at INR 105 mn, was flat Q-o-Q and declined 2% Y-o-Y.
- Gross profits stood at INR 447 mn, up 9.0% Q-o-Q and 61.0% Y-o-Y.
- EBITDA stood at INR 157 mn, down 8.8% Q-o-Q and 3.0% Y-o-Y. EBITDA margins declined by 350bps and stood at 12.6%. The reasons for margin decline were: (a) impact of consolidation of Modern Engineering, which is a low profit business (1.9% impact); (b) investment in management resources; and (c) higher expense on account of leased facility.
- Decline in EBITDA impacted profits. Also, the interest paid on loan to fund Modern acquisition impacted net profit margin and restricted net profit at INR 105 mn (flat Q-o-Q).
- Utilisation, excluding trainees, dropped to 87% from 91% in the previous quarter. Inclusive of trainees, the utilisation rate marginally increased to 86% from 85%.

Financials

Year to March	Q4FY07	Q3FY07	Growth %	Q4FY06	Growth %	FY08E	FY09E
Revenue (INR mn)	1243	1067	16.4	639	94.5	6001	7922
Gross profit (INR mn)	447	410	9.0	278	61.0	2267	3027
EBITDA (INR mn)	157	172	(8.8)	162	(3.0)	1012	1371
Net profit (INR mn)	105	105	(0.8)	107	(1.9)	533	726
EPS basic (INR)	1.7	1.7	(0.8)	1.9	(9.5)	8.7	11.7
P/E (x)						13.5	10.0
EV/EBITDA (x)						7.4	5.3
Market cap/Revenues (x)						1.2	0.9

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Market Data

52-week range (INR) : 145 / 73
Share in issue (mn) : 61.9
M cap (INR bn/USD mn) : 7.2 / 750.2
Avg. Daily Vol. BSE/NSE ('000) : 636.1

Share Holding Pattern (%)

Promoters : 27.9
MFs, FIs & Banks : 15.6
FIs : 14.7
Others : 41.8

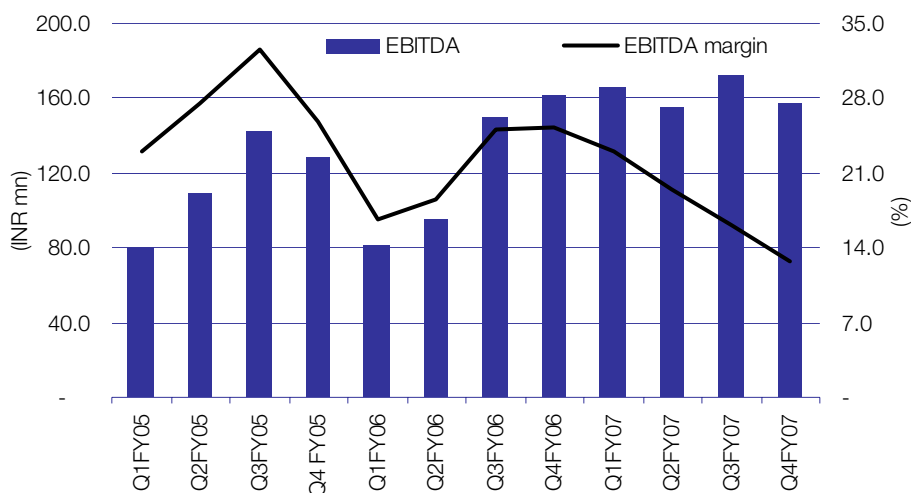
- ◆ The company’s total headcount now stands at 2,512, compared to 1,931 in the previous quarter. Of the 581 net additions, 511 employees were added from Modern Engineering. Excluding that, the net addition was low, which was a planned move to focus on bench and competency based rationalization.
- ◆ The company’s attrition rate stood at 18.6%. It has been successful in bringing its attrition down sequentially over the past three quarters.
- ◆ During the current quarter, the company also disclosed the client dependency for FY07. Revenue contribution from the top client was at 28%, top 5 clients was at 54%, and top 10 clients was at 68% of total FY07 revenues.
- ◆ **Guidance:** Geometric has guided for revenue growth of 50% and net profit growth of 30-35% for FY08.

*** FY07 guidance surpassed, but margins dwindle**

Geometric had, at the start of FY07, guided to 35% growth in revenues and net profits for FY07. The company, on an organic basis, seamlessly outperformed its guidance achieving 40% growth in revenues and 45% growth in net profits. However, on account of consolidation of less profitable revenues of Modern, net profit growth was restricted to 45.2% even though revenues grew by 71.5% over FY06.

Geometric’s EBITDA margins have been declining over the past four quarters and currently stand at 12.6%. We understand that for the past two quarters (Q3 and Q4FY07) the margin decline was attributed to consolidation of low margin Modern revenues. We believe lower-than-expected growth in product revenues was also a factor leading to the decrease in margins. Operating margins (EBITDA) for FY07 on an organic basis declined from 21.8% to 20.0%, mainly due to increase in employee related direct costs. The management has assured that margins are expected to stabilize at the FY07 level and will not decline further. Expected turnaround in Modern will also aid better profitability going forward.

Chart1: EBITDA margin analysis for past three years



Source: Company, Edelweiss research

*** Integration of new growth engine completed**

Geometric, with its USD 25 mn acquisition of Modern Engineering, has added high-end engineering services such as CAE, simulation, digital manufacturing solutions, and electronic systems to its existing offerings. We understand that this will enable Geometric target OEMs and other tier 1 vendors in the automotive, aerospace, industrial products, and hi-tech sectors. The acquisition also gives Geometric presence in China and Romania.

* Demand surge in extended PLM solutions

Geometric is uniquely positioned among India-based engineering firms with strength in extended Product Lifecycle Management (PLM) solutions. With offshore capabilities, strong alliance with other leading PLM vendors, and multi-platform PLM expertise, we expect Geometric to accelerate its growth trajectory capitalizing on the strong industry momentum. Currently, PLM related solutions (software services) contribute ~ 53% to total revenues. This is expected to grow in-line with traditional IT services, in our view.

* Valuations

Our EPS estimate for FY08E and FY09E stand at INR 8.7 and INR 11.7, respectively. At a CMP of INR 117, the stock trades at a P/E of 13.5x and 10.0x and EV/EBITDA of 7.4x and 5.3x on our FY08E and FY09E, respectively. We maintain our **'ACCUMULATE'** recommendation on the stock.

Financials Snapshot								(INR mn)
Year to March	Q4FY07	Q3FY07	Growth %	Q4FY06	Growth %	FY07	FY08E	FY09E
Total revenues	1,243	1067	16.4	639	94.5	3,831	6,001	7,922
Direct cost	796	657	21.1	362	120.2	2,347	3,735	4,895
Gross profit	447	410	9.0	278	61.0	1,484	2,267	3,027
SG & A expenses	290	238	21.8	116	150.6	834	1254	1656
EBITDA	157	172	(8.8)	162	(3.0)	650	1012	1371
Depreciation & ammortization	54	54	0.4	44	23.0	203	260	350
EBIT	103	118	(12.9)	118	(12.7)	447	752	1021
Other income	58	44	32.7	35	67.9	92	45	55
Interest	15	16	(6.0)	0		31	65	55
PBT	146	146	0.0	153	(4.3)	507	732	1021
Tax	22	22	1.6	28	(20.9)	68	101	161
Adjusted net profit	124	124	(0.3)	125	(0.6)	439	631	860
Minority interest	19	19	2.5	18	7.5	64	98	134
Reported net profit	105	105	(0.8)	107	(1.9)	374	533	726
Adjusted EPS basic	1.7	1.7	(0.8)	1.9	(9.5)	6.2	8.7	11.7
as % of net revenues								
Gross profit	36.0	38.4		43.4		38.7	37.8	38.2
SG & A expenses	23.3	22.3		18.1		21.8	20.9	20.9
EBITDA	12.6	16.1		25.3		17.0	16.9	17.3
Reported net profit	8.4	9.9		16.7		9.8	8.9	9.2
Tax rate	15.2	15.0		18.4		13.5	13.8	15.8

Company Description

Geometric Software Solutions caters to the fast-growing engineering services and PLM segments. It is a CMMI Level 5 company with over 20 years of experience in CAD/CAM/CAE, PDM, and MPM. Partnerships with major PLM vendors such as Dassault Systèmes, UGS PLM Solutions, and MatrixOne offer it an unique advantage of providing cost effective services on leading PLM platforms. Geometric offers services based on SolidWorks, CA TIA, ENOVIA, DELMIA, eMatrix, Teamcenter Enterprise Metaphase), Windchill, and other leading CAD/CAM/CAE/PDM software platforms. TekSoft, Inc., a subsidiary of Geometric, is a leading developer and supplier of innovative, automated CAD/CAM software solutions for the manufacturing industry.

Investment Theme

Geometric has a unique positioning among the India based engineering firms with its strengths in extended Product Lifecycle Management (PLM) solutions. It also has, with its USD 25mn acquisition of Modern engineering added high-end engineering services, which we expect will allow Geometric to target the OEMs and other tier 1 vendors. We believe that Geometric is now poised to change its positioning from a mere offshore IT services player to global PLM and engineering solutions and services provider, with specific action plans laid out and initiatives underway.

Key Risks

Key risks to our investment theme include: (a) availability of skilled manpower; (b) slowdown in engineering spending; and (c) significant appreciation of the rupee against USD, Euro, and GBP

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INDIA RESEARCH

SECTOR

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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