

Geometric Software

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,227	GMSS IN
	REUTERS CODE
S&P CNX: 2,944	GEOM.BO

18 July 2006

Under Review

Previous Recommendation: Neutral

Rs85

Equity Shares (m)	56.7
52-Week Range (Rs)	135/73
1,6,12 Rel. Perf. (%)	4/-30/-63
M.Cap. (Rs b)	4.8
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
3/06A	2,234	226	4.0	-19.4	21.2	3.4	17.2	16.4	2.1	9.7
3/07E	3,289	419	6.9	73.4	12.2	2.3	23.1	22.2	1.5	6.3
3/08E	4,541	600	9.9	43.1	8.6	1.9	24.6	23.5	1.1	4.6

Geometric Software reported 12.8% QoQ growth in revenues to Rs721m, higher than our expectation of Rs704m. Services grew 13.7% QoQ, faster than our expectation of 12% QoQ growth, on the back of a healthy 9% volume growth. Products grew 7.5% QoQ as against our expectation of flat product revenues.

Gross margins declined by 340bp due to salary hikes effective April 2006 and 7% increase in offshore manpower. SGA expenses declined 75bp due to lower travel costs during the quarter. EBITDA margins declined 265bp as against our expectation of a 200bp decline. PAT declined 40.6% QoQ to Rs63m but was higher than our estimate of Rs39m due to lower forex loss and lower minority interest.

The company is on the verge of an acquisition in the engineering services space for which the due diligence is on. As mentioned in our last results update, Geometric has made a preferential issue to ICICI Ventures at Rs115.66/share. This has resulted in equity dilution of 7.2%.

Considering the robust demand for PLM and engineering services, we expect Geometric to outperform. We estimate 43% CAGR in sales and 63% CAGR in PAT (before extraordinary items) over FY06-08 (without considering the probable acquisition). The stock quotes at 12.2x FY07E and 8.6x FY08E earnings. Our **Neutral** stock rating is currently **Under Review**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Revenues	486	510	599	639	721	771	867	930	2,234	3,289
Q-o-Q Change (%)	-2.6	5.0	17.4	6.7	12.8	6.9	12.4	7.4	32.9	47.2
Direct Expenses	298	299	314	340	408	436	469	508	1,251	1,820
Sales, General & Admin. Expenses	105	114	134	138	150	159	182	186	490	677
Operating Profit	83	98	151	162	163	176	216	236	494	791
Margins (%)	17.2	19.1	25.2	25.3	22.6	22.8	24.9	25.4	22.1	24.1
Other Income	31	-2	-40	39	-29	25	0	25	28	21
Depreciation	37	41	46	49	49	52	58	60	172	220
PBT bef. Extra-ordinary	78	55	65	152	85	148	158	201	350	592
Provision for Tax	14	8	12	27	10	25	27	34	61	96
Rate (%)	17.4	14.2	19.1	17.9	11.8	16.9	16.9	16.9	17.5	16.2
Minority Interest	19	13	13	18	11	17	23	26	64	77
Net Income bef. Extra-ordinary	45	34	39	107	63	106	109	141	225	419
Q-o-Q Change (%)	-44.9	-24.4	16.0	170.8	-40.6	67.6	2.2	29.6	-18.0	86.1

E: MOST Estimates

Services boost revenue growth

Geometric Software reported 12.8% QoQ growth in revenues to Rs721m, higher than our expectation of Rs704m. Services grew 13.7% QoQ, faster than our expectation of 12% QoQ growth, on the back of a healthy 9% volume growth. Software OEMs grew strongly at 9.6% QoQ while industrial customers (including engineering design services) grew 18% QoQ.

SEGMENT-WISE REVENUES (RS M)

	JUN-05	SEP-05	DEC-05	MAR-06	JUN-06
Software OEM & Others	246	231	247	270	296
% Change QoQ	-0.9	-6.2	7.0	9.0	9.6
Products	69	75	106	95	102
% Change QoQ	-8.4	8.0	41.4	-10.8	7.4
Ind. Cust. (Incl. Eng Ser)	170	204	246	275	324
% Change QoQ	-2.6	20.0	20.3	11.9	18.0

Source: Company/Motilal Oswal Securities

Product revenues grew 7.4% QoQ as against our expectation of near flat revenues from the product business. This was due to strong demand in the PLM market and the release of a new version of its *Teamcenter Engineering and Enterprise* product. The company's business partners in Europe contributed strongly to its growth. Geometric bagged its first major contract in Europe for its application management services (AMS), which were launched in 2HFY06. R&D services also continued to gain traction, with client additions in the OEM space. However, some of the existing OEM clients have not ramped up as expected.

Sales force ramped up; forced attrition pushes up attrition rate

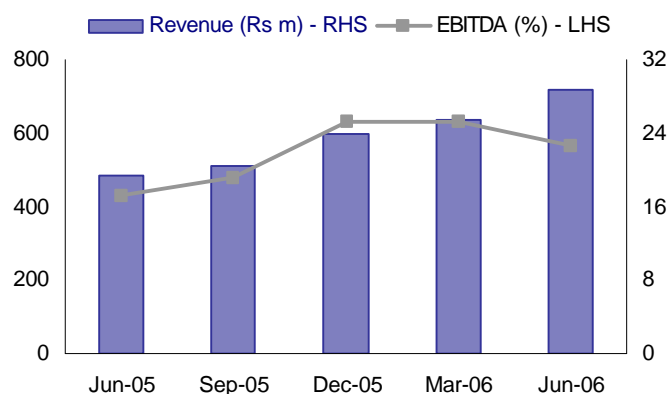
Geometric has strengthened its sales & marketing team to focus on Europe, Americas and India by adding four key sales personnel during the quarter. We expect this to result in increased client mining and client additions in these regions in the coming quarters. The company saw a net addition of just 83 employees due to high attrition of 23.8%, of which 5.67% was forced attrition.

Lower SG&A helped cushion margin impact due to salary hikes

Gross margins declined by 340bp due to salary hikes effective April 2006 and 7% increase in offshore manpower.

The company effected salary hikes of 14-15% offshore. SG&A expenses declined 75bp due to lower travel costs during the quarter. EBITDA margins declined 265bp during the quarter as against our expectation of a 200bp decline.

SALARY HIKES IMPACT MARGINS DURING THE QUARTER



Source: Company/Motilal Oswal Securities

Lower other income loss pushes up profits to Rs63m

The company suffered forex losses of Rs45.2m and reported other income of Rs16m. Net other income loss was lower than expected at Rs29m (expected loss of Rs40m). Tax rate at 11.8% was lower than our expectation of 17.3% due to greater proportion of revenue coming from tax-exempt premises. PAT declined 40.6% QoQ to Rs63m due to the steep fall in margins but was higher than our estimate of Rs39m.

Strong demand scenario, acquisitions to boost growth

The robust growth in both services and products is indicative of the strong demand scenario. The management has indicated that the demand is higher than it can fulfill, currently. Geometric is on the verge of acquiring an engineering services company, for which due diligence is on. The impending acquisition would boost growth.

As mentioned in our last results update, Geometric has made a preferential issue to ICICI Ventures at Rs115.66/share. This has resulted in equity dilution of 7.2%. Though equity dilution has come in 1QFY07, additions to sales and

PAT would be realized post 2QFY07. We expect the acquisition to strengthen Geometric's engineering designing services business by adding quality clients, expanding service offerings and domain expertise. The following table reflects the likely scenario post the acquisition.

ACQUISITION TO BOOST GROWTH (RS M)

	WITHOUT ACQUISITION		WITH ACQUISITION	
	FY07E	FY08E	FY07E	FY08E
Sales	3,288.8	4,541.0	4,215.4	6,421.2
PAT	419.3	600.0	434.6	672.9
Equity Cap	121.4	121.4	124.9	124.9
EPS (Rs)	6.9	9.9	7.0	10.8
P/E (x)	12.2	8.6	12.1	7.8

Source: Company/Motilal Oswal Securities

Assumptions:

1. We have assumed revenues of US\$32.5m for FY07, w.e.f. from mid-August 2006 from the probable target company. We have assumed 2% PAT margin, with Geometric's stake at 85% in the target company.

2. In FY08, we have assumed a debt repayment of US\$2.5m from the expected debt of US\$15m to be taken for the acquisition in FY07. This would be funded by the probable sale of property in FY08.
3. As the acquisition could help the company to achieve its US\$100m target, ESOPs of 35m equity shares could also be diluted. However, we have assumed only 50% dilution considering the non-fulfillment of the second requisite condition of PBT margins of 24-28% in FY07.

Outlook and view

Considering the robust demand for PLM and engineering services, we expect Geometric to outperform in the future. We estimate 43% CAGR in sales and 63% CAGR in PAT (before extraordinary items) over FY06-08 (without considering the probable acquisition). The stock quotes at 12.2x FY07E and 8.6x FY08E earnings. Our **Neutral** stock rating is currently **Under Review**.

Geometric Software: an investment profile

Company description

Geometric Software is a niche player offering PLM software and services employing more than 1,500 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\$100m by FY07 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.
- Realization 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

- Diluted 7.2% equity to ICICI Venture in 1QFY07 through a preferential issue at Rs115.66/share.
- The board has recently approved sale / transfer of the Engineering Services Division of the in favor of an existing / prospective wholly owned subsidiary.

Valuation and view

- Revenue CAGR of 43% and PAT CAGR of 63% over FY06-08.
- Valuations at 12.2x FY07E earnings are attractive.
- Our recommendation is under review.

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 (x)	FY07E	12.2	14.7	9.8
	FY08E	8.6	11.6	5.6
P/BV (x)	FY07E	2.3	2.4	1.5
	FY08E	1.9	2.1	0.9
EV/Sales (x)	FY07E	1.5	1.6	0.7
	FY08E	1.1	1.2	0.1
EV/EBITDA (x)	FY07E	6.3	10.5	4.9
	FY08E	4.6	7.9	0.7

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	30.6	30.7	31.2
Domestic Institutions	11.1	13.8	19.8
FII's/FDIs	24.0	20.6	15.6
Others	34.3	34.9	33.4

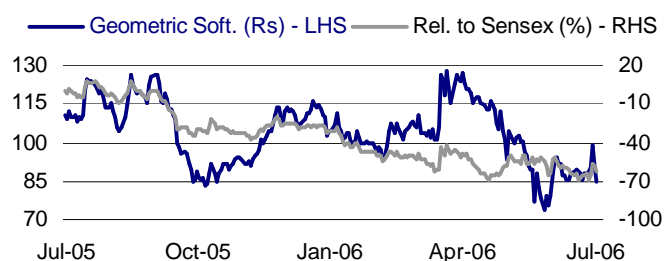
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	6.9	7.3	-4.8
FY08	9.9	9.4	5.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
85	-	-	Under Review

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Sales	1,060	1,682	2,234	3,289	4,541
Change (%)	26.0	58.6	32.8	47.2	38.1
Employee Costs	569	923	1,251	1,820	2,618
Travelling & Conveyance	53	80	119	151	194
Other Operating Expenses	149	213	370	526	660
EBITDA	289	466	494	791	1,069
% of Net Sales	27.3	27.7	22.1	24.1	23.5
Depreciation	82	128	172	220	284
Interest	0	0	0	0	0
Other Income	64	51	28	21	50
PBT	271	389	350	592	836
Tax	29	70	61	96	137
Rate (%)	10.5	18.1	17.4	16.2	16.4
PAT	242	319	289	497	699
Minority Interest	34	44	64	77	99
Extraordinary	0	1	-33	0	0
Net Income	208	275	259	419	600
Change (%)	22.2	31.8	-5.8	62.1	43.1

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	59	112	113	121	121
Share Premium	130	100	127	567	567
Reserves	773	990	1,184	1,516	1,992
Net Worth	962	1,203	1,424	2,205	2,680
Minority Interest	31	43	65	90	124
Loans	0	15	0	0	0
Capital Employed	993	1,261	1,490	2,295	2,804
Gross Block	780	1,111	1,538	1,788	2,138
Less : Depreciation	230	357	516	736	1,020
Net Block	550	754	1,022	1,052	1,118
CWIP	50	88	46	50	50
Investments	178	135	214	264	364
Curr. Assets	505	747	799	1,865	2,496
Debtors	200	366	423	694	849
Cash & Bank Balance	53	91	57	713	973
Loans & Advances	238	276	318	458	674
Other Current Assets	14	13	0	0	0
Current Liab. & Prov	266	430	555	894	1,174
Creditors	12	44	61	70	111
Other Liabilities	167	226	281	475	552
Provisions	88	161	212	349	511
Net Current Assets	239	316	244	970	1,322
Deferred tax liability	-24	-31	-36	-41	-49
Application of Funds	993	1,261	1,490	2,295	2,804

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	7.7	4.9	4.0	6.9	9.9
Cash EPS	10.7	7.2	7.0	10.5	14.6
Book Value	35.3	216	25.1	36.3	44.1
DPS	0.6	0.8	0.8	1.3	1.8
Payout % (Incl.Div.Taxes)	14.4	16.2	17.5	18.1	18.2
Valuation (x)					
P/E		17.1	21.2	12.2	8.6
Cash P/E		11.7	12.0	8.0	5.8
EV/EBITDA		10.1	9.7	6.3	4.6
EV/Sales		2.8	2.1	1.5	1.1
Price/Book Value		3.9	3.4	2.3	1.9
Dividend Yield (%)		0.9	0.9	1.5	2.1
Profitability Ratios (%)					
RoE	24.1	25.5	17.2	23.1	24.6
RoCE	23.1	24.4	16.4	22.2	23.5
Turnover Ratios					
Debtors (Days)	57	61	64	62	62
Fixed Asset Turnover (x)	2.4	2.6	2.5	3.2	4.2
Leverage Ratio					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
CF from Operations	312	427	490	644	892
Cash for Working Capital	19	-142	-51	-106	-129
Net Operating CF	331	286	439	538	763
Net Purchase of FA	-322	-273	-395	-254	-350
Net Purchase of Invest.	44	53	15	-50	-100
Net Cash from Invest.	-278	-220	-381	-304	-450
Proceeds from Pvt. Place	24	24	28	472	34
Proceeds from LTB/STB	-30	15	-15	0	0
Dividend Payments	-53	-66	-105	-52	-87
Cash Flow from Fin.	-58	-28	-92	421	-53
Free Cash Flow	9	13	43	285	413
Net Cash Flow	-6	38	-34	655	260
Opening Cash Balance	58	53	91	57	713
Add: Net Cash	-6	38	-34	655	260
Closing Cash Balance	53	91	57	713	973



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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Disclosure of Interest Statement

Geometric Software

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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 |
| 4. Investment Banking relationship with company covered | No |

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