



Geometric Software

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,110	GMSS IN
	REUTERS CODE
S&P CNX: 4,090	GEOM.BO

24 January 2007

Buy

Rs131

Previous Recommendation: Buy

Equity Shares (m)	61.3
52-Week Range (Rs)	145/73
1,6,12 Rel. Perf. (%)	15/26/-22
M.Cap. (Rs b)	8.1
M.Cap. (US\$ b)	0.2

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	225	4.0	-18.9	33.0	5.2	17.2	16.4	3.3	15.1
*3/07E	3,887	374	6.1	53.4	21.5	3.7	20.9	16.1	2.3	13.0
*3/08E	6,675	618	10.1	65.2	13.0	3.0	25.6	18.6	1.3	7.6

* Financial estimates are with Modern Engineering

- ✎ **Extended PLM services and Engineering Services to be focus areas for growth:** Geometric Software' new business strategies target to achieve the high growth areas of extended PLM services (objective: integrating PLM services with shop floor management services) and engineering services. Geometric aims to achieve revenue CAGR of 47-50% with operating profit (PBT before other income) CAGR of 68-70% over FY07E-FY10.
- ✎ **Margins to benefit from better pricing, higher offshoring in engineering services:** Management expects operating margins (PBT before other income) to increase from 12-14% in FY07E to 18-20% in FY09E. The primary lever for margin expansion would be the higher billing rates that Geometric can command by targeting clients directly in PLM services and diversifying within engineering services. Higher offshoring in engineering design services (via reduction in onsite composition of Modern Engineering), superior volume growth both in PLM and Engineering services resulting in G&A cost leverage, are also likely to result in higher margins.
- ✎ **Outlook and view:** Considering the investments in senior management at various levels to strengthen the various processes and marketing, we have downgraded our FY08E PAT (including Modern) estimates by 4%. Considering the lower-than-expected 3QFY07 results as well as continuing investments in the near term, we have downgraded our FY07 PAT by 8.4% (including Modern). However considering the increasing earnings visibility through new business strategies we have significantly upgraded our FY09 PAT estimates by 16.7%. At revised estimates, the stock is trading at 13.6x FY08E and 8.8x FY09E diluted earnings. We maintain **Buy** on our revised price target of Rs200 (based on 14x likely diluted FY09 EPS) and continue to consider Geometric to be one of the better mid-cap niche stocks with high visibility.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY06				FY07				FY06	*FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	*3Q	*4QE		
Revenues	486	510	599	639	721	800	1,067	1,299	2,234	3,887
Q-o-Q Change (%)	-2.6	5.0	17.4	6.7	12.8	10.9	33.5	21.7	32.9	74.0
Total Operating Exps	403	413	448	478	558	649	897	1,096	1,741	3,200
Operating Profit	83	98	151	162	163	151	170	203	493	686
Margins (%)	17.2	19.1	25.2	25.3	22.6	18.8	15.9	15.6	22.1	17.7
Other Income	31	-2	-40	39	-29	29	49	27	28	76
Interest	0	0	0	0	0	0	16	20	0	36
Depreciation	37	41	46	49	49	50	57	61	172	216
PBT bef. Extra-ordinary	78	55	65	152	85	130	146	149	350	510
Provision for Tax	14	8	12	27	10	14	22	22	61	67
Rate (%)	17.4	14.3	19.1	17.9	11.8	10.6	15.0	14.4	17.5	13.2
Minority Interest	19	13	13	18	11	15	19	23	64	68
Net Income bef. Extra-ordinary	45	34	39	107	63	101	105	104	225	374
Q-o-Q Change (%)	-45.1	-24.5	16.0	172.2	-40.6	59.0	4.5	-0.9	-18.2	66.4

E: MOST Estimates; * Including Modern Engg.

Extended PLM services and Engineering Services to be focus areas for growth

Geometrics' new business strategies aim at targeting high growth areas of extended PLM services (which aims to integrate PLM services with shop floor management services) and engineering services. Products would serve as an entry point for deals wherein technical expertise needs to be showcased rather than as a major revenue driver.

The following new strategies expect to drive growth and ensure visibility:

- ✍ Within PLM services, Geometric had always tapped the potential through global system integrators and PLM software OEMs. However, the new management is considering reaching the end-user directly, this will result in greater visibility in revenues from the same client as well as higher predictability of revenues. Geometric expects to continue with the software OEMs for PLM services as it has very strong traction with some of the leading PLM software OEMs in R&D.

Recently, the company significantly reduced its share of revenues from global system integrators and has started developing relationships with industrial customers directly. In a couple of leading auto OEMs, Geometric has already demonstrated its capability of strong ramp up by serving the clients directly.

- ✍ New management is also looking at increasing the onsite composition within PLM services to increase relationships as well as further mine clients on an ongoing basis versus its earlier status of being merely a third party offshore partner for the global system integrator.
- ✍ Within Modern Engineering, the company is not considering laying off any of the onsite staff (around 450 employees in the US), as it believes that these employees, being domain experts, will help to mine the quality clients of Modern as well as create a robust pipeline both for PLM and Engineering Services. It expects to offshore the incremental growth within Engineering Services, which we believe will be robust

considering the quality clients of Modern, the latter's strong brand image with several auto OEMs, construction OEMs as well as the expected high demand for offshore engineering services.

- ✍ Management is also looking to strengthen its various processes by investing in senior management personnel. 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 staff, who are experienced employees.
- ✍ The company is also looking to invest in the bench, to improve its resource management to tap the high demand for PLM and Engineering Services. This will lead to a decline in utilization rates in the short term; however it will also lead to higher volume growth.
- ✍ Within Engineering Services, management is also looking to diversify into industrial automation, Embedded Systems (Auto Electronics) and Aero Space. The company is also open to tap potential inorganic opportunities considering its expectation of further mining within the existing clients as well as moving up the value chain.

Vision 2010 (Organic) with new strategies:

Geometric is targeting revenue CAGR of 47-50% with operating profit (PBT before other income) CAGR of 68-70% over FY07E-FY10. Within PLM services, management expects to increase onsite composition of revenue to mine clients better. In Engineering Services, Geometric expects to increase the offshore composition by driving larger offshoring from Modern Engineering's customers. Within engineering, management is targeting around 20% of revenue to come from new verticals - electronics and industrial automation, indicating revenues of around US\$22-US\$24m by 2010.

VISION: US\$300M BY 2010 (US\$M)

	FY07E	FY10E	CAGR (%)	COMMENTS
Products	8.7	20.1	32.3	Management has not counted significant growth in products considering its lumpy nature, however we believe Enterprise products has high potential, which could improve the profitability significantly
<i>Contribution (%)</i>	<i>10.0</i>	<i>7.0</i>		
PLM	56.6	152.4	39.2	Management expects onsite efforts to increase by 5-7% over 3 years
<i>Contribution (%)</i>	<i>65.0</i>	<i>53.0</i>		
Eng Ser	21.8	115.0	74.2	Expects Electronics and Industrial Automation to contribute 20% of segment revenues by 2010
<i>Contribution (%)</i>	<i>25.0</i>	<i>40.0</i>		
Total Revenues	87.0	287.5	48.9	Expects revenues of US\$275-300m by 2010 from FY07E US\$86-88m
Employees	2,500	6,000	33.9	Considering niche offerings and with high attrition it will be challenge for Geometric to scale up the employee size.
OPBT Margins (%)	12-14	18-20		Various levers being considered, significant will be billing rate increase and offshoring of Engineering services

Source: Company/ Motilal Oswal Securities

New strategies to drive margins significantly

The company is looking at increasing the expected operating margin (PBT before other income) of 12-14% in FY07E to 18-20% in FY09E. The primary levers for margin expansion would be:

- ✎ Improvement in billing rates in Geometric (standalone) through renegotiation as well as higher billing rates from customers targeted directly instead of through global system integrators.
- ✎ Higher billing rates that Geometric can command through Modern Engineering for its Engineering Services growth.
- ✎ Anticipated 20% contribution from Electronics and Industrial Automation verticals by 2010 will aid margin improvement since they are high competency based areas where billing rates are higher.
- ✎ Higher offshoring in Engineering Design Services (including reduction in onsite composition of Modern Engineering).
- ✎ Better resource planning as well as project execution coupled with higher volume growth in Engineering as well as in PLM services through direct marketing and the resulting G&A cost leverage, are also likely to lead to higher margins.
- ✎ Pick up in enterprise products from 2HFY08 is also likely to result in additional margins.

We have not considered the margin improvement in line with company. We believe that attrition at +20% is likely to

have continuing pressure on wage inflation, however any billing rate increase higher than our estimates would lead to an upside in our PAT estimates.

3QFY07 results below expectation

Geometric Software registered revenue growth of 2.8% QoQ (excluding Modern) v/s our expectation of 6.7% growth. Product revenues remained flat during the quarter (expectation of 25% growth) due to lower sales in one of the desktop products. Higher offshore services composition (excluding Modern) at 68.7%, against our expectation of 67.3%, also contributed to lower revenue growth.

REVENUE MIX (RS M)

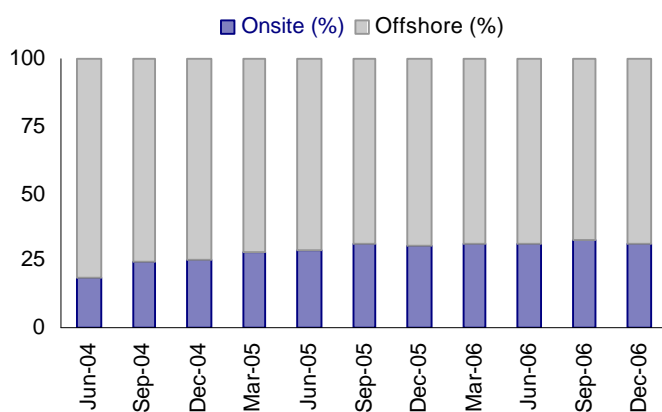
	SEP-05	DEC-05	MAR-06	JUN-06	SEP-06	DEC-06
Software OEM & Others	231	247	270	296	320	329
<i>% Change QoQ</i>	<i>(6.2)</i>	<i>7.0</i>	<i>9.0</i>	<i>9.6</i>	<i>8.2</i>	<i>2.8</i>
Products	75	106	95	102	106	105
<i>% Change QoQ</i>	<i>8.0</i>	<i>41.4</i>	<i>10.8</i>	<i>7.4</i>	<i>3.8</i>	<i>0.7</i>
Indust. Cust. (Inc Eng Ser)	204	246	275	324	376	386
<i>% Change QoQ</i>	<i>20.0</i>	<i>20.3</i>	<i>11.9</i>	<i>18.0</i>	<i>15.9</i>	<i>2.8</i>

Source: Company/ Motilal Oswal Securities

EBITDA margins (excluding Modern) were higher than our expectation at 19.6% (estimated 19.2%) due to higher-than-expected offshore services revenue growth. PAT growth (excluding Modern) was also lower than expected at 0.5% QoQ versus estimate of 5% growth due to lower product growth and higher tax rate (15% v/s expectation of 12.4%).

Modern Engineering, consolidated w.e.f. November 2006, registered revenues of Rs245m v/s our estimate of Rs280m. Lower revenues were due to lower-than-expected working days due to the holiday season during December 2006 on account of its highly US centric business. Modern has registered PAT of Rs4m v/s estimate of Rs8m. Lower revenue booking during December 2006 led to lower operating margins, which we believe is likely to improve ahead due to higher billing days, higher offshoring and greater client mining through cross selling opportunities.

IMPROVEMENT IN OFFSHORE COMPOSITION AIDS MARGINS



Source: Company/ Motilal Oswal Securities

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. Though this could have an adverse impact on PAT growth, we believe these investments will strengthen the delivery, execution as well as higher sales visibility and client mining in future. We also believe that with Modern's presence across US, China, Romania coupled with Geometric's strong offshore presence in India, any investment in strengthening Sales/ Marketing and Global Delivery processes is likely to reap rich benefits in the long term.

Outlook and view

Considering the investments in senior management at various levels to strengthen the various processes and sales/ marketing leading to possible pressure on margins, we have downgraded our FY08E PAT estimates by 4%. Considering lower-than-expected 3QFY07 results as well as continuing investments in the near term, we have downgraded our FY07 by 8.4%. However considering the increasing earnings visibility through new business strategies, we have significantly upgraded our FY09 PAT estimates by 16.7%.

At revised estimates, the stock is trading at 13.6x FY08E and 8.8x FY09E likely diluted earnings. We expect improved revenue and earnings visibility for Geometric ahead due to significant change in business strategies, expected strengthening of execution and sales and marketing capabilities. We maintain **Buy** on our revised price target of Rs200, upside of 52.2% (based on 14x likely diluted FY09 EPS) and continue to consider Geometric to be one of the better mid-cap niche stocks with high visibility.

Geometric Software: an investment profile

Company description

Geometric Software is a niche player offering PLM software and services employing more than 1,900 engineers. It has relationships with eight of the top 11 software OEMs in the PLM segment and has set up a JV with Dassault Systems, the largest global PLM software company. 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\$275-US\$300m by FY10 from US\$50m in FY06.

Key investment arguments

- ✎ Largest beneficiary of increased spending by PLM Software OEMs due to established relationships.
- ✎ The new business strategies of tapping clients directly to reap long term benefits.
- ✎ Acquisition of Modern to add Engineering Design as another high growth potential segment.

Key investment risks

- ✎ Dependent on few clients within PLM R&D services.
- ✎ Larger R&D offshoring by PLM OEMs to captives.
- ✎ With high attrition, employee scale up would be a challenge.

Recent developments

- ✎ Acquired the Engineering Services division of Modern Engineering in October for a consideration US\$25m.
- ✎ The board has approved sale / transfer of the Engineering Services division in favor of an existing / prospective wholly-owned subsidiary.

Valuation and view

- ✎ Expect Revenue and PAT (Adjusted) CAGR of 72.8% and 65.5% respectively from FY06-FY08E.
- ✎ Valuations at 8.8x FY09E earnings are attractive.
- ✎ Maintain **Buy** with a target price of Rs200, upside of 52.2%.

Sector view

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

COMPARATIVE VALUATIONS

		GEOMETRIC	INFOTECH	KPIT CUMM.
P/E (x)	FY07E	22.5	21.5	26.1
	FY08E	13.6	15.6	19.5
P/BV (x)	FY07E	3.7	3.5	6.5
	FY08E	3.0	3.0	5.0
EV/Sales (x)	FY07E	2.3	2.6	2.9
	FY08E	1.3	2.0	2.1
EV/EBITDA (x)	FY07E	13.0	16.3	18.7
	FY08E	7.6	13.1	13.2

SHAREHOLDING PATTERN (%)

	DEC-06	SEP-06	DEC-05
Promoter	28.2	28.3	30.7
Domestic Inst	14.6	15.3	13.8
Foreign	23.2	23.5	20.6
Others	34.0	32.9	34.9

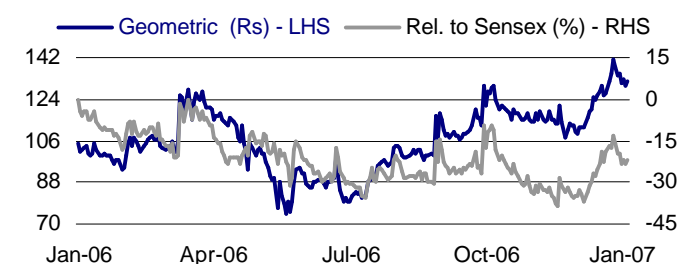
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	6.1	6.4	-4.9
FY08	10.1	9.9	2.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
131	200	52.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Sales	1,682	2,234	3,887	6,675	9,316	
Change (%)	58.6	32.8	74.0	71.7	39.6	
Total Operating Expenses	1,216	1,740	3,200	5,531	7,643	
EBITDA	466	494	686	1,143	1,673	
% of Net Sales	27.7	22.1	17.7	17.1	18.0	
Depreciation	128	172	216	298	406	
Interest	0	0	36	76	69	
Other Income	51	28	76	74	83	
PBT	389	350	510	843	1,280	
Tax	70	61	67	136	210	
Rate (%)	18.1	17.4	13.2	16.1	16.4	
PAT	319	289	442	707	1,070	
Minority Interest	44	64	68	89	113	
Extraordinary	1	-33	0	0	0	
Net Income	275	259	374	618	958	
Change (%)	31.8	-5.8	44.6	65.2	54.9	

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	1,973	2,784	
Net Worth	1,203	1,424	2,164	2,663	3,474	
Minority Interest	43	65	81	105	138	
Loans	15	0	900	740	635	
Capital Employed	1,261	1,490	3,145	3,508	4,247	
Gross Block	1,111	1,538	2,188	2,638	3,088	
Less : Depreciation	357	516	907	1,205	1,611	
Net Block	754	1,022	1,280	1,433	1,476	
Goodwill	0	0	1,013	1,013	1,013	
CWIP	88	46	50	50	50	
Investments	135	214	264	164	664	
Curr. Assets	747	799	1,698	2,535	3,384	
Debtors	366	423	961	1,416	1,851	
Cash & Bank Balance	91	57	243	410	458	
Loans & Advances	276	318	493	709	1,075	
Other Current Assets	13	0	0	0	0	
Current Liab. & Prov	430	555	1,124	1,649	2,295	
Creditors	44	61	133	201	265	
Other Liabilities	226	281	643	912	1,240	
Provisions	161	212	348	537	790	
Net Current Assets	316	244	574	887	1,089	
Deferred tax liability	-31	-36	-35	-37	-44	
Application of Funds	1,261	1,490	3,145	3,508	4,247	

E: MOf Estimates; including Modern Engineering

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	4.9	4.0	6.1	10.1	15.6	
Likely Diluted EPS			5.8	9.6	14.9	
Cash EPS	7.2	7.0	9.6	14.9	22.3	
Book Value	216	25.1	35.3	43.5	56.7	
DPS	0.8	0.8	12	17	2.1	
Payout %(Incl.Div.Taxes)	16.2	17.5	19.7	16.9	13.4	
Valuation (x)						
P/E		33.0	21.5	13.0	8.4	
Likely Diluted P/E			22.5	13.6	8.8	
Cash P/E		18.7	13.6	8.8	5.9	
EV/EBITDA		15.1	13.0	7.6	5.1	
EV/Sales		3.3	2.3	1.3	0.9	
Price/Book Value		5.2	3.7	3.0	2.3	
Dividend Yield (%)		0.6	0.9	1.3	1.6	
Profitability Ratios (%)						
RoE	25.5	17.2	20.9	25.6	31.2	
RoCE	24.4	16.4	16.1	18.6	24.7	
Turnover Ratios						
Debtors (Days)	61	64	65	65	64	
Fixed Asset Turnover (x)	2.6	2.5	3.4	4.9	6.4	
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	563	926	1,368	
Cash for Working Capital	-142	-51	-176	-181	-182	
Net Operating CF	286	439	388	745	1186	
Net Purchase of FA	-273	-395	-479	-450	-450	
Net Purchase of Invest.	53	15	-1,000	167	-428	
Net Cash from Invest.	-220	-381	-1478	-283	-878	
Proceeds from Pvt. Place	24	28	464	24	33	
Proceeds from LTB/STB	15	-15	900	-160	-105	
Dividend Payments	-66	-105	-88	-160	-188	
Cash Flow from Fin.	-28	-92	1277	-296	-260	
Free Cash Flow	13	43	-91	295	736	
Net Cash Flow	38	-34	186	167	48	
Opening Cash Balance	53	91	57	243	410	
Add: Net Cash	38	-34	186	167	48	
Closing Cash Balance	91	57	243	410	458	

N O T E S



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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 |

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