Geometric buy will help HCL strengthen its engineering R&D segment

ANALYSIS

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With HCL Technologies buying out Geometric's IT Services business, shareholders of both the companies stand to benefit and the former strengthens its automotive and engineering business verticals.

Ultimately, it was the story of a mid-size company struggling to scale and one of India's largest exporter outlining its ambition of having differentiated services in a marketplace of 'me too' providers. Last week, after 18 months of negotiations, HCL Technologies decided to buy 74 per cent of Mumbai-based Geometric, which was set up as a unit of Godrej and Boyce before being spun off as an IT services company for $186 million.

Further, both the companies agreed to a share-swap deal as per which, Geometric's shareholders will get 10 HCL shares for every 43 shares they hold in Geometric, company executives said. For the transaction, HCL will issue 15.64 million shares.

In a separate transaction, Geometric has also agreed to sell off 58 per cent stake in 3DPLM (a Joint Venture with France-based Dassault Systemes) for which Geometric shareholders will receive one preference share in 3DPLM worth ₹68 for every Geometric share, valuing the joint venture stake at about $66 million. JM Financial Singapore was the exclusive finance advisor to Geometric and JSA was the legal advisor, it said in a statement. The deal was announced after market hours on Friday.

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A stronger foothold

The deal gives HCL a stronger foothold in the Engineering R&D segment, which contributed 18.6 per cent of its business in the December-ended quarter. "This business globally is a $10-12 billion in size and is growing as companies are adopting to new technologies," said an analyst, who did not wish to be named. He added that the deal is complimentary for both firms. "HCL is weak in segments like automotive, where Geometric is strong but Geometric is weak in sales and account management, where HCL has strengths," the analyst said.

Others like Peter Schumacher, CEO of Value Leadership, a Germany-based consulting firm point out that aside from new customers, HCL will gain additional value from both cost and revenue synergies.

For Geometric, the story has been one that of an inability to scale their business, a theme that seems to resonate amongst most of the other mid-tier IT companies. Industry watchers point to deals such as iGATE getting acquired by Capgemini and Hexaware being controlled by Baring Private Equity Asia as examples of companies struggling to scale up.

"With this deal, Geometric can improve its business and HCL's profitability can be healthier as it has access to the 2,000 odd product engineering talent," said Sarabjit Kaur Nangra, IT analyst at Angel Broking. She, however, added that it is too early to gauge the extent of profitabiity for HCL.

IT analysts tracking HCL believe that the company could have used cash in its books for this acquisition. "It would overshadow HCL's core business, would have a negative impact on margins, with only a small growth benefit," said Urmil Shah, IT Analyst at IDBI Capital.

Why share swap?

However, two people who were part of the team that worked closely on this deal said that it was structured in this way for a reason. "Assume that an investor gets ₹100 out of this deal. Once it goes through, around 45 per cent is shaved off through different kinds of taxes, which leaves slightly more than 50 per cent to investors," said one of them.

Industry sources said this share swap idea was the brainchild of HCL founder Shiv Nadar, who along with automotive head Bijoy Ghosh and Engineering Services Head GH Rao hammered out the deal.

There was no unnecessary to and fro, with regard to valuation or bidding price and the Godrej family was very clear that this should help shareholders and also ensured that high levels of transparency maintained.