

ICRA

Good numbers in a challenging quarter

India Equity Research | Credit Rating

ICRA's Q2FY14 top line of INR584mn (up 12%) was 5% higher than Street estimate driven by 7% YoY growth in ratings (outperforming peers), 25% YoY surge in outsourcing and 22% YoY spurt in IT. Adjusted EBITDA (ESOP amortisation) jumped 21% YoY to INR190mn, leading to operating margin expanding 200bps to 28%. Pressure on operating profit due to slowdown in corporate bond issuances was offset by robust margin expansion in outsourced services and IT segment. As a result, PAT grew 16% YoY to INR156mn, ~8% higher than Street's expectation, despite a higher tax rate (up 2570bps) of 31%. Maintain 'BUY' with a revised target of INR1,442 (INR1,328 earlier).

Ratings, outsourcing, IT drive sales spurt

ICRA reported healthy revenue growth of 12% YoY in Q2FY14 led by 7% YoY rise in ratings, much higher than peers—CRISIL (including outsourced rating revenue) grew 1% YoY, CARE grew 4.4%. Ratings growth was driven by structured finance ratings and SME ratings. Outsourcing segment continued to see good demand from Moody's, growing 25% YoY, coupled with favorable currency impact. Client additions and currency movements (12%) led to strong growth of 22% YoY in the IT segment.

Robust margin expansion in outsourcing, IT

Adjusted overall operating profit was up 21% and margin was higher 200bps YoY at 28%. Ratings segment's EBIT margin fell 419bps YoY to 39.7% led by slowdown in bond issuances. EBIT grew in outsourced services by 82% YoY, with 850bps YoY expansion in margin to 27.4% on back of favourable currency movements. The biggest positive was the 726% YoY jump in IT EBIT to INR35mn, leading to massive 1680bps increase in margin to 19.7% led by client wins and positive currency movements.

Outlook and valuations: Positive; maintain 'BUY'

We are revising up FY14E and FY15E earnings by 9% and 10%, respectively, due to better-than-expected earnings trajectory in outsourced and IT segments with margins at 23% and 17%, respectively, for H1FY14 compared to our earlier expectation of 18% and negative margin respectively for FY14E. With expected sales and PBT CAGR of 14% and 28%, respectively, over FY13-15E we maintain 'BUY' valuing ICRA at P/E of 18x FY15E giving a target of INR1,442 (INR1,328 earlier).

Financials

Year to March	Q2FY14	Q2FY13	Growth %	Q1FY14	Growth %	FY13	FY14E	FY15E
Revenue (INR mn)	700	625	12.1	584	19.8	2,514	2,843	3,279
EBITDA (INR mn)	190	147	29.4	122	55.7	599	759	947
Net profit (INR mn)	160	135	18.5	174	(8.1)	585	656	801
Diluted EPS (INR)	16.0	13.7		17.4		59.4	65.6	80.1
Diluted P/E (x)						22.4	20.3	16.6
EV/EBITDA (x)						17.6	13.7	10.4
ROAE (%)						18.7	18.8	20.3

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	None

MARKET DATA (R: ICRA.BO, B: ICRA IN)

CMP	: INR 1,319
Target Price	: INR 1,442
52-week range (INR)	: 1,583 / 926
Share in issue (mn)	: 10.0
M cap (INR bn/USD mn)	: 13 / 208
Avg. Daily Vol. BSE/NSE ('000)	: 16.7

SHARE HOLDING PATTERN (%)

	Current	Q1FY14	Q4FY13
Promoters *	28.5	28.5	28.5
MF's, FI's & BKs	36.2	37.5	42.8
FII's	15.3	13.4	9.9
Others	20.0	20.6	18.8
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	6.9	7.5	0.6
3 months	1.8	9.4	7.6
12 months	(9.8)	(10.8)	(1.0)

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Table 1: Segment-wise performance

INR mn	Q2FY14	Q2FY13	% YoY	Q1FY14	%QoQ	FY13
Segment revenue						
Rating Services	389	363	7.1	324	19.8	1,496
Consulting Services	65	60	8.2	52	24.1	257
Outsourced and Information services	67	54	25.4	61	10.5	216
Professional and I.T services	180	148	21.5	147	22.2	545
Total Sales	700	624		584		2,514
Segment EBIT						
Rating Services	154	159	(3.1)	127	21.9	659
Consulting Services	(1)	(3)	-	(7)		12
Outsourced and Information services	18	10	81.7	11	71.2	35
Professional and I.T services	35	4	725.6	19	84.4	(20)
Total EBIT	207	171		149		686
Segment EBIT margin (%)						
Rating Services	39.7	43.9	(4.19)	39.0	0.68	44
Consulting Services	(1.4)	(5.0)	3.67	(14.2)	12.84	5
Outsourced and Information services	27.4	18.9	8.50	17.7	9.73	16
Professional and I.T services	19.7	2.9	16.80	13.1	6.65	(4)

Source: Company

Strong cash provides diversification opportunities

ICRA has maintained a highly liquid, strong net worth position, with no debt on a consolidated basis. The company has strong cash on books of INR2.82bn (INR282/share) on a balance sheet size of INR4.1bn which implies that the core ROCE is ~70%. It intends to use this cash to grow its research business and expand into other segments like IT, consulting and other international geographies. Judicious deployment of cash reserves could lead to even further improvement in overall ratios.

Outlook and valuations

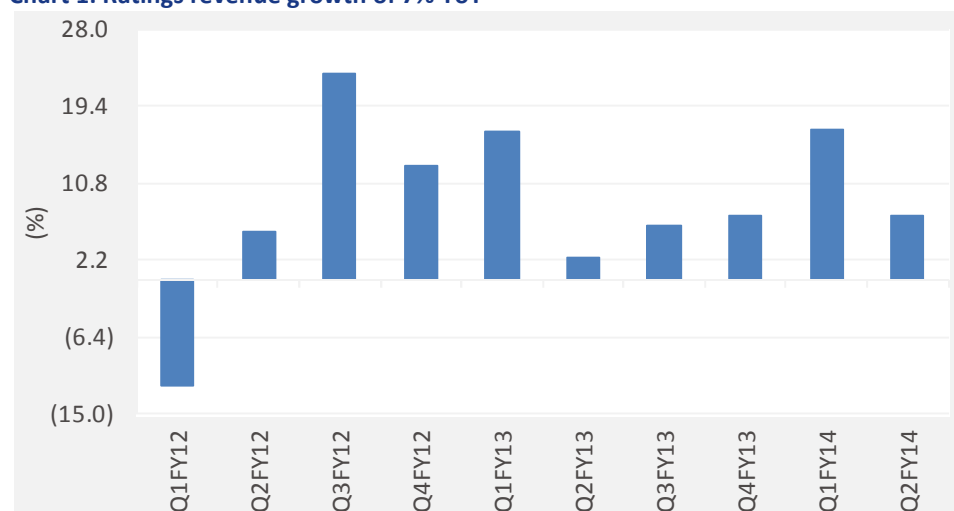
ICRA's ratings segment outperformed the industry having grown 7% YoY in Q2FY14 compared to 1% YoY growth reported by the leader CRISIL (including the outsourced rating revenues) and 4.4% YoY growth reported by CARE. This was led by selective structured finance ratings and healthy SME ratings growth reported by ICRA. This is in light of the short term bond yields having inched up strongly to 11% plus in Q2FY14 due to RBI's corrective measures which dampened the corporate debt market sentiment in the near term. However, things have improved sequentially with yields having cooled off and marginal uptick in corporate bond markets. We are also enthused by government initiatives to deepen the corporate debt market penetration, which will have a positive impact over the long term. ICRA being a strong player in this highly profitable segment would be a key beneficiary of the same trend.

We are upgrading revenues by 2.0% and 2.5% in FY14E and FY15E, respectively, due to 11% YoY growth in ratings in H1FY14 compared to our earlier full year expectation of 10% YoY. As a result we have upgraded ratings growth to 12% for FY14. We are upgrading earnings estimates by 9% and 10% for FY14 and FY15, respectively, due to better-than-expected earnings trajectory in outsourced and IT segment with EBIT margins at 23% and 17%, respectively, for H1FY14 compared to earlier full year expectation of 18% and negative

margin, respectively. With revised consolidated EBITDA margins of 26.7% and 28.9% for FY14E and FY15E, compared to 24.9% and 26.5% earlier, we expect sales and PBT CAGR of 14% and 28%, respectively, over FY13-15E compared to earlier expectation of 13% and 22% CAGR.

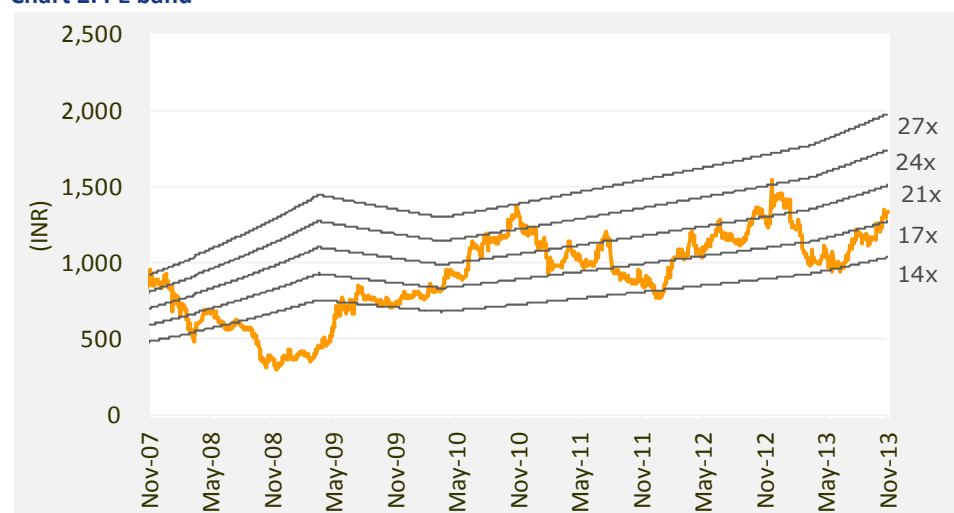
Hence, we maintain **'BUY'** recommendation, valuing ICRA at P/E of 18x FY15E (average since listing in past five years) which gives a target price of INR1,442 (INR1,328 earlier). Company is currently trading at a 35% discount to CRISIL's valuation.

Chart 1: Ratings revenue growth of 7% YoY



Source: Company

Chart 2: PE band



Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q2FY14	Q2FY13	% change	Q1FY14	% change	YTD14	FY14E	FY15E
Net revenues	700	625	12.1	584	19.8	1,285	2,843	3,279
Staff costs	334	327	2.1	309	8.2	642	1,389	1,574
Other expenses	176	151	17.0	154	14.7	330	695	758
Total expenditure	510	478	6.8	462	10.4	972	2,085	2,333
EBITDA	190	147	29.4	122	55.7	312	759	947
Depreciation	12	12	6.7	11	10.0	24	43	47
Other income	50	8	525.8	108	(53.7)	158	264	291
Profit before tax	227	143	58.9	219	4.1	446	979	1,191
Tax	70	7	881.1	46	52.0	116	318	387
Core profit	158	136	16.0	173	(8.7)	330	661	804
Extraordinary items								
PAT	158	136	16.0	173	(8.7)	330	661	804
Minority interest	(2)	(1)	NA	(1)	NA	(3)	(5)	(3)
Net profit	160	135	18.5	174	(8.1)	334	656	801
Equity capital (FV INR 1)	100	100		10		100	100	100
No. of shares (mn)	10	10		10		10	10	10
Diluted EPS (INR)	16.0	13.7	16.3	17.4	(8.1)	33.4	65.6	80.1
Market cap / rev. (x)	-	-		-		-	4.7	4.1
As % of net revenues								
Employee cost	47.7	52.4		52.8		0.5	48.9	48.0
Other expenses	25.2	24.1		26.3		0.3	24.5	23.1
EBITDA	27.1	23.5		20.9		0.2	26.7	28.9
Reported net profit	22.5	21.8		29.5		0.3	23.1	24.4

Change in estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net revenue	2,843	2,800	1.6	3,279	3,200	2.5	Due to better than expected growth in ratings, IT and outsourced revenues
EBITDA	758	698	8.7	947	849	11.5	Due to better than expected growth in IT and outsourced segments
EBITDA margin	26.7	24.9		28.9	26.5		
Core profit	656	600	9.2	801	728	10.1	Due to better than expected EBIT in IT and outsourced segments
PAT margin	23.2	21.4		24.5	22.7		
Capex	53	53	0.0	53	53	0.0	

Company Description

ICRA, an associate company of Moody's Investors Service (28.5% holding), is the second originating credit rating agency in India set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies. The company has rated 2,552 corporate debt instruments and 12,052 bank loan instruments over FY08-13, driving revenue CAGR of 39% in the BLR segment and 12% CAGR in the CDR segment over FY08-13. Being the third largest player by rating revenue market share, the company is well poised to gain from cyclical and structural uptick in domestic ratings segment. Apart from credit rating business, which is the major contributor to the bottom line (contributes 67% to consolidated revenue and 91% to profit), ICRA has three other businesses—consulting services, outsourced and information services and professional & IT services. While outsourced services grew 20% CAGR over FY08-13, off shoring opportunity will continue to drive this segment. ICRA acquired a company called BPA Tech, a California-based global business consulting and software services company, in FY13, as a result of which, IT segment now contributes 22% to top line. The company has also made its foray into the international market through subsidiaries in Indonesia and Sri Lanka that offer rating services.

Investment Theme

ICRA, has a strong competitive advantage, being the second largest credit rating agency in India by volume of corporate debt rated, third largest by rating revenue market share and a strong parentage (Moody's) world's second leading credit rating agency by market share. Being the third largest player, ICRA's domestic ratings are expected to grow at a 14% CAGR over FY13-15E. The off shoring services to parent Moody's are at 1/7th the revenues of CRISIL's off shoring arm. There is strong scope of outsourcing revenue led by double digit growth at parent's end. Also, the next leg of growth will come from ICRA's increasing focus to grow the SME ratings segment, which currently is at 1/10th the rating of CRISIL. Its international foray in Indonesia provides huge potential being an under penetrated debt market. Operating at a historic low operating margin of 24% in FY13, we expect a cyclical and structural turnaround to lead to 26% EBITDA margins over FY14-15.

Key Risks

Lower debt volumes

In India, banks and financial institutions dominate the financial market. Continued reliance on bank credit by domestic borrowers could negatively impact issuance in the domestic debt market. Further, investors' preference in the domestic debt market is skewed towards higher-category ratings. This may continue to constrain the volume of issuance in the Indian debt market.

Migration to internal ratings based approach by banks

If banks whose clients avail credit rating services under the Basel II framework migrate to the internal rating based approach for credit risk (the IRB Approach), it could have an adverse effect on ICRA's rating business.

Risk of defaults

Any rating default by a client would hamper the credibility of the rating agency. However, SEBI's mandatory disclosures of default rates would keep the rating agency under control of the watch guard.

Financial Statements

Key assumptions

	FY12	FY13	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.2	5.0	4.8	6.0
Inflation (Avg)	8.9	7.4	6.0	6.0
Repo rate (exit rate)	8.5	7.5	8.3	7.3
USD/INR (Avg)	48.0	54.5	62.0	60.0
Industry growth				
Corporate debt market issuances growth (%)	46.0	30.7	27.5	29.2
Banking credit growth (%)	17.0	14.7	15.0	16.0
ICRA				
Corporate Debt ratings				
Volume of debt rated (INR bn)	3,008	4,086	4,929	6,054
Bank Loan ratings				
Number of new assignments	3,054	3,533	3,745	4,344
SME				
Nos		1,250	1,563	1,953
Segment revenues (INR mn)				
Rating revenues	1,394	1,496	1,668	1,935
Corp. debt ratings inc. (INR mn)	725	838	934	1089
Bank loan ratings inc. (INR mn)	669	627	665	729
SME ratings income (INR mn)		31	69	117
Consulting revenues	252	257	270	297
Outsourced & Information Serv.	176	216	259	311
Professional and IT services	246	539	646	736
% of total Revenues				
Rating revenues	67.2	59.6	58.7	59.0
Consulting revenues	12.1	10.3	9.5	9.1
Outsourced & information	8.5	8.6	9.1	9.5
Professional and IT services	11.9	21.5	22.7	22.5

Income statement

(INR mn)

Year to March	FY12	FY13	FY14E	FY15E
Net revenue	2,075	2,514	2,843	3,279
Employee costs	1,067	1,279	1,389	1,574
Other Expenses	384	637	695	758
EBITDA	623	599	759	947
Depreciation & Amortization	47	48	43	47
EBIT	577	551	715	900
Other income	213	179	264	291
Interest expenses	-	-	-	-
Profit before tax	790	730	979	1,191
Provision for tax	253	132	318	387
Net profit	537	598	661	804
Extraordinary income/ (loss)	-	9	-	-
Profit After Tax after minority	535	585	656	801
Diluted EPS (INR)	53.5	59.4	65.6	80.1
CEPS (INR)	58.5	64.9	70.9	85.4
Dividend per share (INR)	20.0	22.0	23.0	28.7

Common size metrics

Year to March	FY12	FY13	FY14E	FY15E
Operating expenses	70.0	76.2	73.3	71.1
Depreciation	2.2	1.9	1.5	1.4
Interest expenditure	-	-	-	-
EBITDA margins	30.0	23.8	26.7	28.9
Net profit margins	25.9	23.8	23.2	24.5

Growth ratios (%)

Year to March	FY12	FY13	FY14E	FY15E
Revenues	7.5	21.2	13.1	15.3
EBITDA	(5.1)	(3.9)	26.6	24.8
PBT	6.8	(7.6)	34.1	21.7
Net profit	11.6	11.3	10.6	21.7
EPS	11.3	11.0	10.4	22.2

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13	FY14E	FY15E	
Equity capital	100	100	100	100	
Reserves & surplus	2,916	3,292	3,684	4,152	
Shareholders funds	3,016	3,392	3,784	4,252	
Minority interest (BS)	(1)	45	45	45	
Deferred tax liability	(26)	(22)	(22)	(22)	
Sources of funds	2,989	3,416	3,808	4,276	
Tangible assets	217	207	217	223	
Intangible assets	118	441	441	441	
CWIP (incl. intangible)	5	11	11	11	
Total net fixed assets	339	659	669	675	
Non current investments	1,921	1,987	1,987	1,987	
Cash and equivalents	410	474	637	1,137	
Sundry debtors	370	472	545	584	
Loans and advances	317	471	471	471	
Other current assets	20	19	19	19	
Total current assets (ex cash)	707	963	1,035	1,074	
Trade payable	26	41	69	78	
Others current liabilities	802	930	757	824	
Total current liabilities &	828	971	826	902	
Net current assets (ex cash)	(122)	(8)	210	173	
Uses of funds	2,989	3,416	3,808	4,276	
Book value per share (INR)	301.6	339.2	378.4	425.2	

Free cash flow		(INR mn)			
Year to March	FY12	FY13	FY14E	FY15E	
Net profit	537	589	661	804	
Depreciation	47	48	43	47	
Others	(237)	(534)	(436)	74	
Gross cash flow	347	103	268	925	
Less: Changes in WC	(43)	(211)	(218)	37	
Operating cash flow	390	314	486	888	
Less: Capex	49	53	53	53	
Free cash flow	341	261	433	835	

Cash flow metrics		FY12	FY13	FY14E	FY15E
Year to March					
Operating cash flow	390	314	486	888	
Investing cash flow	(243)	259	(53)	(53)	
Financing cash flow	(159)	(158)	(269)	(336)	
Net cash flow	(12)	415	164	499	
Capex	(49)	(53)	(53)	(53)	
Dividends paid	(202)	(232)	(269)	(336)	

Profitability & efficiency ratios		FY12	FY13	FY14E	FY15E
Year to March					
ROAE (%)	19.3	18.7	18.8	20.3	
ROACE (%)	132.7	81.2	69.7	77.2	
ROA	19.4	18.7	18.3	19.9	
Interest coverage	12,272.4	2,514.1	-	-	
Total debt / Capital employed (%)	26.8	27.8	21.1	20.6	

Operating ratios		FY12	FY13	FY14E	FY15E
Year to March					
Total asset turnover	0.7	0.8	0.8	0.8	
Fixed asset turnover	6.1	5.0	4.3	4.9	
Equity turnover	0.7	0.8	0.8	0.8	

Valuation parameters		FY12	FY13	FY14E	FY15E
Year to March					
Diluted EPS (INR)	53.5	59.4	65.6	80.1	
Y-o-Y growth (%)	11.3	11.0	10.4	22.2	
CEPS (INR)	58.5	64.9	70.9	85.4	
Diluted PE (x)	24.6	22.2	20.1	16.5	
Price/BV (x)	4.4	3.9	3.5	3.1	
EV/Sales (x)	5.1	4.2	3.7	3.0	
EV/EBITDA (x)	20.5	21.3	16.6	12.8	
Dividend yield (%)	1.5	1.7	1.7	2.2	
Market Capitalisation	13,190	13,190	13,190	13,190	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted PE (X)		EV/EBITDA (X)		ROAE (%)	
		FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
ICRA	208	20.1	16.5	16.6	12.8	18.8	20.3
Credit Analysis and Research	312	15.9	13.3	11.1	8.7	26.4	26.6
Crisil	1,209	30.4	25.4	19.8	16.3	42.5	42.6
Median	-	20.1	16.5	16.6	12.8	26.4	26.6
AVERAGE	-	22.1	18.4	15.8	12.6	29.2	29.8

Source: Edelweiss research

Additional Data

Directors Data

Pranab Choudhary	Chairman & Group CEO	Naresh Takkar	Managing Director & CEO
Uddesh Kohli	Independent – Non – Executive Director	Amal Ganguli	Independent - Non-Executive Director
Deepak Nayyar	Independent - Non-Executive Director	Dr. Min Ye	Non-Independent - Non-Executive Director
Piyush Mankad	Independent - Non-Executive Director	Simon Hastilow	Non-Independent - Non-Executive Director

Auditors - M/s. Vipin Aggarwal & Associates

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Moodys investment co	28.51	Life insurance corp	6.69
Templeton asset mgmt	5.38	General insurance co	5.23
Punjab national bank	5.01	Birla sun life asset	4.43
Birla sun life asset	4.03	Retail empl superann	3.62
Icra employee welfar	3.34	M3 investment privat	2.92

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Credit Rating

Credit Analysis and Research, Crisil, ICRA

Recent Research

Date	Company	Title	Price (INR)	Recos
23-Oct-13	CRISIL	Ratings growth muted; <i>Result Update</i>	1177	Hold
02-Aug-13	ICRA	Strong ratings growth; IT uptick in margins; <i>Result Update</i>	1,155	Buy
22-Jul-13	CRISIL	Results inline; Research drives up tick; <i>Result Update</i>	1,187	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	127	44	8	180
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	112	54	14	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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