

ICRA

Focus on core to facilitate margin expansion

India Equity Research | Credit Rating

ICRA's Q4FY17 revenue decline by 14% (to INR788mn) was primarily due to the sale of IT business (segment revenue plunged 99% YoY), though continuing segments' revenue growth stood at 9%. EBITDA growth of 3% was led by the strong 644bps margin expansion (due to exclusion of low-margin IT business) and PAT of continuing operations grew 20%. Ratings grew 9% extending its decent growth rate (CRISIL's ratings segment grew 4%), while consulting services and outsourced services grew 8% and 6%, respectively. On strong structural opportunities in domestic debt market, focus on core (ratings) business (driving 570bps EBITDA margin expansion over FY17-19E) and benefiting from strong parentage (Moody's), we estimate 22% earnings CAGR over FY17-19. We upgrade to 'HOLD' with DCF-based target price of INR4,345.

Outperformance in domestic ratings

Revenue grew 9% YoY in Q4FY17 and 8% in FY17, led by growth in corporate debt as bank loan ratings remained muted. Bank credit growth remained modest due to sluggish off-take in private sector capex cycle and higher refinancing. Going forward, management expects debt market to extend its strong growth trajectory backed by uptick in infrastructure and regulatory changes, while bank credit growth will be dependent on wider economic growth. EBIT margin surged by ~800bps to 46.5% in Q4FY17, driven by actualisation of expenses in Q3FY17.

Outsourcing services slows down

Outsourced services segment slowed down to 6% during the quarter (16% in FY17), after having grown at 20% plus for 2 years. Management stated growth was impacted by lacklustre environment and appreciation of INR. EBIT margin fell by 354bps YoY to 26.3% hit by slowdown in growth.

Outlook and valuations: Positive; upgrade to 'HOLD'

With robust structural avenues in debt market and outsourcing opportunity from Moody's, we estimate 22% earnings CAGR over FY17-19. We value ICRA using DCF valuation due to its healthy growth prospects and strong brand franchisee, taking 13% growth in the first 5 years, declining growth over next 5 years to terminal rate of 7% and discount rate of 10%. Upgrade to 'HOLD' from 'Reduce' with TP of INR4,345.

Financials

Year to March	Q4FY17	Q4FY16	Growth %	Q3FY17	Growth %	FY17	FY18E	FY19E
Revenue (INR mn)	788	920	(14.4)	755	4.4	3,330	3,281	3,766
EBITDA (INR mn)	295	285	3.4	176	67.8	1,009	1,084	1,353
Adj.Profit (INR mn)	220	193	13.6	123	78.2	732	872	1,089
Adj.Dil EPS (INR)	22.2	19.3	14.7	12.3	80.0	73.9	88.1	110.0
Diluted P/E (x)						56.8	47.7	38.2
EV/EBITDA (x)						37.7	34.3	27.1
ROAE (%)						15.0	16.7	18.8

EDELWEISS RATINGS

Absolute Rating	HOLD
Investment Characteristics	Growth

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

CMP	: INR 4,199
Target Price	: INR 4,345
52-week range (INR)	: 4,550 / 3,520
Share in issue (mn)	: 9.9
M cap (INR bn/USD mn)	: 42 / 649
Avg. Daily Vol. BSE/NSE ('000)	: 5.3

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	50.5	50.1	50.1
MF's, FI's & BKs	27.8	28.4	28.4
FII's	8.7	8.6	8.5
Others	12.9	12.9	13.1
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	4.8	0.2	(4.6)
3 months	14.0	3.5	(10.5)
12 months	34.8	(1.1)	(35.9)

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Table 1: Segment wise performance

INR mn	Q4FY17	Q4FY16	% YoY	Q3FY17	% QoQ	FY17	FY16	% YoY
Segment revenue								
Rating Services	588	538	9.3	541	8.7	2,136	1,976	8.1
Consulting Services	82	76	8.0	77	5.7	307	292	5.1
Outsourced and Information services	122	115	6.3	126	(2.9)	486	421	15.6
Professional and I.T services	1	195	(99.4)	14	(91.7)	415	734	(43.4)
Total Sales	793	923		758		3,344	3,423	
Segment EBIT								
Rating Services	274	207	32.0	198	37.9	850	736	15.5
Consulting Services	(8)	0	NA	(4)	87.7	(12)	16	(173.8)
Outsourced and Information services	32	34	(6.3)	24	35.2	125	112	11.7
Professional and I.T services	1	15	(96.3)	(23)	(102.5)	23	51	(55.5)
Total EBIT	298	257		195		986	915	
Segment EBIT margin (%)								
Rating Services	46.5	38.5		36.7		39.8	37.3	
Consulting Services	(10.2)	0.1		(5.7)		(3.9)	5.5	
Outsourced and Information services	26.3	29.8		18.8		25.7	26.6	
Professional and I.T services	49.1	7.9		(163.7)		5.4	6.9	

Source: Company

Q4FY17: Key Highlights

- **Q4FY17:** Revenue dipped 14.4% YoY impacted by the sale of IT business. Excluding the IT segment, revenue growth was 9% YoY. EBITDA margin expanded by strong ~640bps due to exclusion of the low-margin IT segment, leading to EBITDA growth of 3% YoY. PAT grew 14% YoY, while PAT from continuing operations grew 20% YoY.
- **FY17:** Revenue fell 2% for the year, dented by sale of IT business (on 7th October, 2016), excluding which revenue growth was 9%. EBITDA was flat YoY on account of margin expansion by 67bps. PAT was also flat YoY (adjusted for discontinuing operations).
- **Ratings segment** revenue grew 9% in Q4FY17 and 8% in FY17. Revenue growth was led by strong debt market growth, while bank loan ratings were subdued due to modest growth in bank credit. Slow credit growth was due to slow offtake in private sector capex cycle and higher refinancing since yield in debt market was lower. Going forward, management expects bond market to continue its strong trajectory, particularly infrastructure segment, supported by regulatory measures. Bank credit growth will be dependent on wider economic growth. ICRA has been more selective in lower ticket segment, which also impacted growth slightly. EBIT margin expanded strongly by ~800bps to 46.5% in Q4FY17.
- **Consulting services** segment revenue grew 8% in Q4FY17 and 5% in FY17. Delays in execution and slower growth in fresh business impacted business growth. Overall business environment, especially private investment cycle, remained subdued. EBIT margin in Q4FY17 was at -10%. Negative EBIT margin for the year was on account of higher provisioning for a specific project as per the company's policies.
- **Outsourced and information services** segment continued to slow down to 6% in Q4FY17 (14% in Q3FY17) after >20% growth for 2 years. Growth for the year stood at 16%. Slowing growth was due to headwinds in the segment and sluggish environment.

Slowdown was aggravated by appreciation of INR and automation may also be a challenge going forward. Management guided that though slowdown in growth is expected to continue, focus on improving cost efficiencies will partially offset the impact on earnings. EBIT margin fell by 354bps YoY to 26.3% due to slowdown in growth, change in compensated absences policy and fixed assets impairment.

- **Divestment of ICTEAS:** ICRA Techno Analytics, a wholly-owned subsidiary previously, was divested entirely for a consideration of INR687.5mn comprising cash consideration of INR320mn and 10% debentures for the balance amount to be redeemed after 1 year. The transaction was completed on October 7, 2016. Cash was partially used for the below stated buyback. Management is open to inorganic expansion going forward, though as of now there are no acquisition plans.
- **Buyback:** ICRA bought back 96,720 equity shares at an average price of INR4,135.54 per equity share. Total size of buyback was INR399.9mn.

Financial snapshot

(INR mn)

Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17	FY18E	FY19E
Net revenues	788	920	(14.4)	755	4.4	3,330	3,281	3,766
Staff costs	318	404	(21.3)	407	(21.7)	1,580	1,501	1,629
Other expenses	175	230	(24.2)	172	1.3	742	696	783
Total expenditure	493	635	(22.4)	579	(14.9)	2,322	2,197	2,412
EBITDA	295	285	3.4	176	67.8	1,009	1,084	1,353
Depreciation	20	28	(29.4)	21	(2.4)	85	85	91
EBIT	275	257	7.0	155	77.2	923	999	1,262
Other income	63	49	27.3	63	0.1	245	325	391
Interest								
Profit before tax	337	306	10.3	218	55.0	1,168	1,325	1,653
Provision for taxes	117	112	4.2	94	24.9	425	450	562
Minority interest	1	-	348.8	1	(8.2)	2	2	2
Exceptional Items								
Reported net profit	220	193	13.6	123	78.2	742	872	1,089
Adjusted Profit	220	193	13.6	123	78.2	732	872	1,089
Equity capital(FV INR 1)	10	10		10		99	99	99
Diluted shares (mn)	10	10		10		10	10	10
Adjusted Diluted EPS	22.2	19.3	14.7	12.3	80.0	74.9	88.1	110.0
Diluted P/E (x)	-	-		-		56.1	47.7	38.2
EV/EBITDA (x)	-	-		-		37.7	34.3	27.1
ROAE (%)	-	-		-		15.0	16.7	18.8
Market cap / rev. (x)	-	-		-		12.5	12.7	11.0
As % of net revenues	-	-		-				
Employee cost	40.4	44.0		53.9		47.4	45.8	43.3
Other expenses	22.2	25.0		22.8		22.3	21.2	20.8
EBITDA	37.4	31.0		23.3		30.3	33.0	35.9
Reported net profit	27.9	21.0		16.3		22.0	26.6	28.9

Company Description

ICRA, an associate company of Moody's Investors Service, 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, 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. 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 FY17-19E. 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 average of 33% EBITDA margins over FY17-19E.

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.

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	6.3
USD/INR (Avg)	65.0	67.5	67.0	67.0
Sector				
Corp debt iss. growth(%)	16.5	8.7	11.0	16.0
Banking cr. growth (%)	15.0	15.0	15.0	15.0
Company				
Prof. and IT services	21.5	12.4	0.1	0.1
Vol of debt rated(INRbn)	6,824	7,350	8,159	9,464
Number of new assignments	2,553	2,681	2,949	3,450
Nos	1,395	1,506	1,627	1,757
Rating revenues (INR mn)	1,975	2,127	2,385	2,758
CDR inc(INR mn)	1,216	1,335	1,556	1,896
BLR inc(INR mn)	729	753	781	806
SME	30	38	47	57
Consulting revenues	285	306	331	357
Outsourced & Info Serv.	419	484	561	646
Prof. and IT services	732	413	4	5
Rating revenues (%)	57.9	63.9	72.7	73.3
Consulting revenues	8.4	9.2	10.1	9.5
Outsourced & Info Serv.	12.3	14.5	17.1	17.1

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	3,412	3,330	3,281	3,766
Employee costs	1,589	1,580	1,501	1,629
Other Expenses	812	742	696	783
EBITDA	1,010	1,009	1,084	1,353
Depreciation	96	85	85	91
EBIT	915	923	999	1,262
Add: Other income	270.77	245.19	325.35	391.37
Less: Interest Expense	6	-	-	-
Profit Before Tax	1,180	1,168	1,325	1,653
Less: Provision for Tax	416	425	450	562
Less: Minority Interest	2	2	2	2
Profit- Discontinued Ops	30	10	-	-
Reported Profit	762	742	872	1,089
Adjusted Profit	732	732	872	1,089
Shares o/s (mn)	10	10	10	10
Adjusted Basic EPS	73.2	73.9	88.1	110.0
Diluted shares o/s (mn)	10	10	10	10
Adjusted Diluted EPS	73.2	73.9	88.1	110.0
Adjusted Cash EPS	80.7	82.3	96.6	119.2
Dividend per share (DPS)	25.0	27.0	32.0	40.0
Dividend Payout Ratio(%)	39.5	43.4	43.7	43.8

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	70.4	69.7	67.0	64.1
Depreciation	2.8	2.6	2.6	2.4
Interest Expense	0.2	-	-	-
EBITDA margins	29.6	30.3	33.0	35.9
Net Profit margins	21.5	22.0	26.6	29.0

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	6.0	(2.4)	(1.5)	14.8
EBITDA	2.1	(0.2)	7.5	24.9
PBT	12.8	(1.0)	13.4	24.8
Adjusted Profit	(6.8)	(0.1)	19.2	24.9
EPS	(6.8)	0.9	19.2	24.9

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	100	99	99	99	
Reserves & Surplus	4,662	4,891	5,382	5,994	
Shareholders' funds	4,762	4,990	5,481	6,093	
Minority Interest	8	9	9	9	
Long Term Liabilities	133	59	59	59	
Def. Tax Liability (net)	(61)	(54)	(54)	(54)	
Sources of funds	4,842	5,005	5,495	6,108	
Gross Block	830	807	887	937	
Net Block	437	328	323	282	
Capital work in progress	7	8	8	8	
Intangible Assets	483	38	38	38	
Total Fixed Assets	927	374	370	328	
Non current investments	1,674	1,045	1,045	1,045	
Cash and Equivalents	2,432	3,588	4,378	4,976	
Sundry Debtors	478	340	431	495	
Loans & Advances	348	320	320	320	
Other Current Assets	352	389	-	-	
Current Assets (ex cash)	1,179	1,049	751	815	
Trade payable	91	84	78	85	
Other Current Liab	1,278	968	968	968	
Total Current Liab	1,370	1,051	1,046	1,052	
Net Curr Assets-ex cash	(191)	(3)	(295)	(238)	
Uses of funds	4,842	5,005	5,495	6,108	
BVPS (INR)	476.2	503.9	553.5	615.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	762	742	872	1,089	
Add: Depreciation	96	85	85	91	
Others	(117)	(523)	586	(112)	
Less: Changes in WC	33	(263)	292	(57)	
Operating cash flow	712	567	1,251	1,125	
Less: Capex	104	104	80	50	
Free Cash Flow	608	463	1,171	1,075	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		712	567	1,251	1,125
Investing cash flow		(415)	(104)	(80)	(50)
Financing cash flow		(385)	(322)	(381)	(477)
Net cash Flow		(88)	141	789	599
Capex		(104)	(104)	(80)	(50)
Dividend paid		(289)	(322)	(381)	(477)

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)		16.2	15.0	16.7	18.8
ROACE (%)		25.9	23.9	25.3	28.5
ROA		15.7	14.9	16.6	18.8
Interest Coverage Ratio		165.9	-	-	-
Debt / Cap employed (%)		27.0	19.9	18.1	16.4

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover		0.7	0.7	0.6	0.6
Fixed Asset Turnover		3.7	5.2	9.0	11.0
Equity Turnover		0.8	0.7	0.6	0.6

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)		73.2	73.9	88.1	110.0
Y-o-Y growth (%)		(6.8)	0.9	19.2	24.9
Adjusted Cash EPS (INR)		80.7	82.3	96.6	119.2
Diluted P/E (x)		57.3	56.8	47.7	38.2
P/B (x)		8.8	8.3	7.6	6.8
EV / Sales (x)		11.6	11.4	11.3	9.7
EV / EBITDA (x)		39.2	37.7	34.3	27.1
Dividend Yield (%)		0.6	0.6	0.8	1.0

Additional Data

Directors Data

P.K. Choudhury	Chairman	Dr. Uddesh Kohli	Independent Director
Deepak Nayyar	Independent Director	Piyush Gunwantrao Mankad	Director
Amal Ganguli	Independent Director	Dr. Min Ye	Director
Simon Richard Hastilow	Director	Naresh Takkar	Director & CEO

Auditors - B.S.R & Co

**as per last available data*

Holding Top -10

	Perc. Holding		Perc. Holding
Birla Sunlife Asset Management	9.19	Capital Group	2.94
Life Insurance Corporation of India	6.75	Mondrian EM MRK SM Cap EQ	1.12
General insurance Corporation of india	5.28	HDFC Life Insurance	1.08
Punjab National Bank	4.29	PPFAS Asset Management	0.39
Franklin	3.04	Axis Bank Asset Management	0.2

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
27 Dec 2016	Ashoka Pte Ltd	Sell	177247	3875.02
27 Dec 2016	Franklin Templeton Investment Funds	Buy	157700	3875.00
18 Oct 2016	Franklin Templeton Investment Funds	Buy	104729	4100.00
18 Oct 2016	Ashoka Pte Ltd	Sell	118705	4100.01

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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
24-Apr-17	Crisil	Subdued performance further dented by external factors; <i>Result Update</i>	1,912	Hold
21-Feb-17	Crisil	Short-term hiccups likely; long-term story intact ; <i>Result Update</i>	2,056	Hold
07-Feb-17	CARE	Strong volumes, brightening prospects;	1,390	Buy

Distribution of Ratings / Market Cap

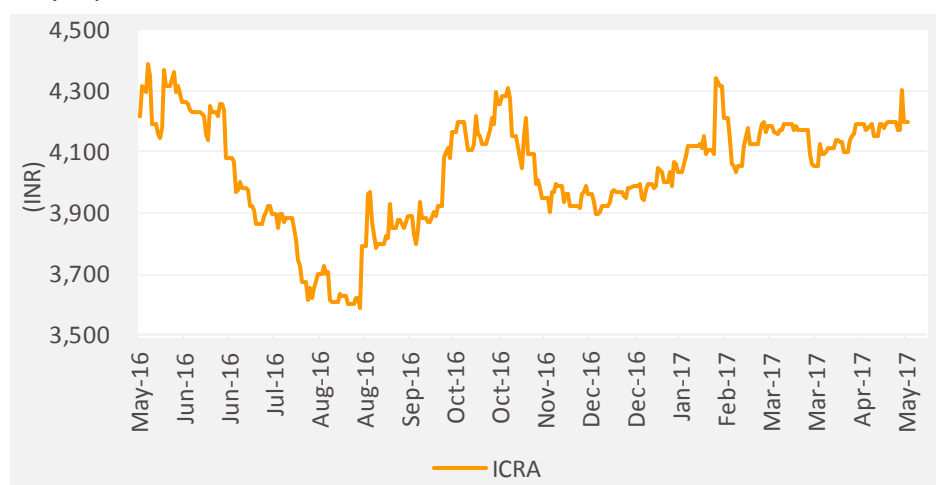
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

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

One year price chart



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