ICICI direct.com
On-line Share Trading

Initiating Coverage...

ICSA India Ltd (INNCOM)

Current Price	Target Price
Rs 196	Rs 241
Potential upside	**Time Frame**
23%	12 months

OUTPERFORMER

Resource saver at attractive price...

ICSA is a high growth mid-size company with various state power transmission & distribution companies and oil & gas utilities as its top clients. The company has grown by leaps and bounds with 136% CAGR over FY06-FY09. We expect ICSA to grow at a robust 37% CAGR over FY09-FY11E, on the back of strong order book and vast opportunity size. ICSA has a unique business mix of IT and infrastructure project services (IPS) with embedded solution services (ESS) and total/partial turnkey services for electrical projects as key offerings. We are initiating coverage on the stock with a target price of Rs 241 and OUTPERFORMER rating.

- **Robust order pipeline :- A guarantee to high revenue growth**

  The company currently holds a strong order book of Rs 2010 crore i.e. 1.81x FY09 revenues with an execution period of 18 months. This augurs well for ICSA's revenue visibility in FY10. The company managed to stem the slippage in orders for ESS due to delay in release of funds under RAPDRP by winning many orders in the IPS space. The company is in L1 phase for IPS orders worth Rs 700 crore. We expect the order book in ESS to pick up in Q4FY10, considering that half way into the Eleventh Plan, the power distribution utilities will flock to deploy energy metering and energy management solutions to avail the incentives guaranteed on achievement of 15% AT&C loss target. Thus, we expect the order book to scale up to Rs 2500 crore by March 2010 on the back of both IPS and ESS and bolster revenue growth in FY11 by 43% (YoY).

- **Capital light business model :-A key to high return ratios**

  The company's ESS segment is focused on high-end value services i.e. from research to pilot product deployment whereas low-end value services like product manufacturing and deployment is outsourced to third party. This form of capital light model results in superior RoE and RoCE (e.g. 29.4% and 25.7%, respectively, in FY09).

Valuations:

On the back of a robust order book, higher return ratios as compared to other mid-cap IT companies, mammoth opportunities under RAPDRP & RGGVY scheme and attractive valuations at which it is currently trading, we are initiating coverage on this stock with an **OUTPERFORMER** rating with a 12-month price target of **Rs 241** per share.

Exhibit 1: Key financials

Year to March 31	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	58.9	111.5	153.0	176.5	293.6
Shares in issue (crore)	3.4	4.4	4.7	4.7	4.7
Diluted EPS (Rs)	17.7	23.3	29.4	34.0	56.5
% Growth	264.5	31.8	26.5	15.7	65.9
P/E (x)	11.1	8.4	6.7	5.8	3.5
Price/Book (x)	6.0	2.3	1.8	1.3	1.0
EV/EBITDA	8.7	5.3	5.2	4.6	2.7
RoNW (%)	52.7	29.8	29.4	25.7	30.4
RoCE (%)	31.5	31.3	25.7	23.6	32.1

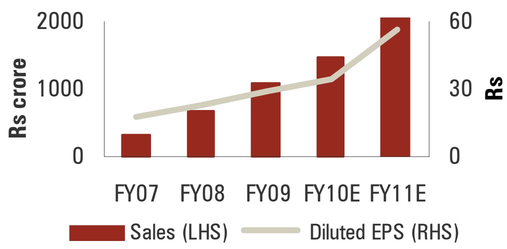
Source: ICICIdirect.com Research

Analysts' Name

Yash Gadodia
yash.gadodia@icicisecurites.com

Srishti Anand
srishti.anand@icicisecurities.com

Sales & EPS trend



Stock Metrics

Bloomberg Code	AURFI IN
Reuters Code	ICSA.BO
Face value (Rs)	2
Promoters Holding	20.6%
52 week H/L	327 / 48.35
Sensex	16177
Average volumes	478686

Comparative return metrics

stock return(%)	3M	6M	12M
ICSA	7.2	280.4	-40.3
KLG Systel	0.1	224.1	-43.8
Infotech Enterprises	62.1	291.5	21.2

Price Trend

Company background

ICSA India Ltd is a Hyderabad-based mid sized company with service offering that is a mix of embedded solution services (ESS) i.e. the IT part and infrastructure projects & services (IPS). The ESS segment (which contributed 61% to the company's FY09 revenue) has 13 products on offer of which companies hold IPR on four products i.e. IAMR, DTMS, TDD and iCAP. The company is one of the few names in India that provides embedded solutions to power distribution companies (DISCOM) in the area of energy metering to help them cut down aggregate technical & commercial (AT&C) losses. The company derives 90% of its ESS revenues from the power sector and rest from oil & gas utilities as well as water utilities. ICSA also undertakes infrastructure projects & services for the power sector on an EPC basis as well as turnkey basis (39% of FY09 revenues).

ICSA's business mix has shifted from 60:40, ESS: IPS to 40:60, ESS: IPS since Q4FY09. This was primarily due to a delay in awarding contracts in the ESS space under the APDRP scheme due to general elections 2009. A typical ESS deal is in the range of Rs 25-30 crore with an execution period of about 12 months and EBITDA of 32% plus. In contrast, a typical IPS deal is large about Rs 200-crore plus with execution period of 18 months and EBITDA of 13% plus. The company has almost 80% revenues coming in from state electricity boards (SEB) for both ESS and IPS. Due to a strong presence in the government sector the company managed to plug in slippage in ESS revenue by winning more contracts in IPS.

Shareholding pattern (June 2009)

Shareholder	% holding
Promoters	20.6
Institutional investors	41.3
Other investors	11.9
General public	26.2

Promoter & Institutional holding trend (%)

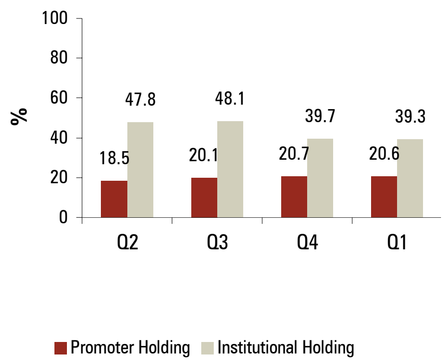
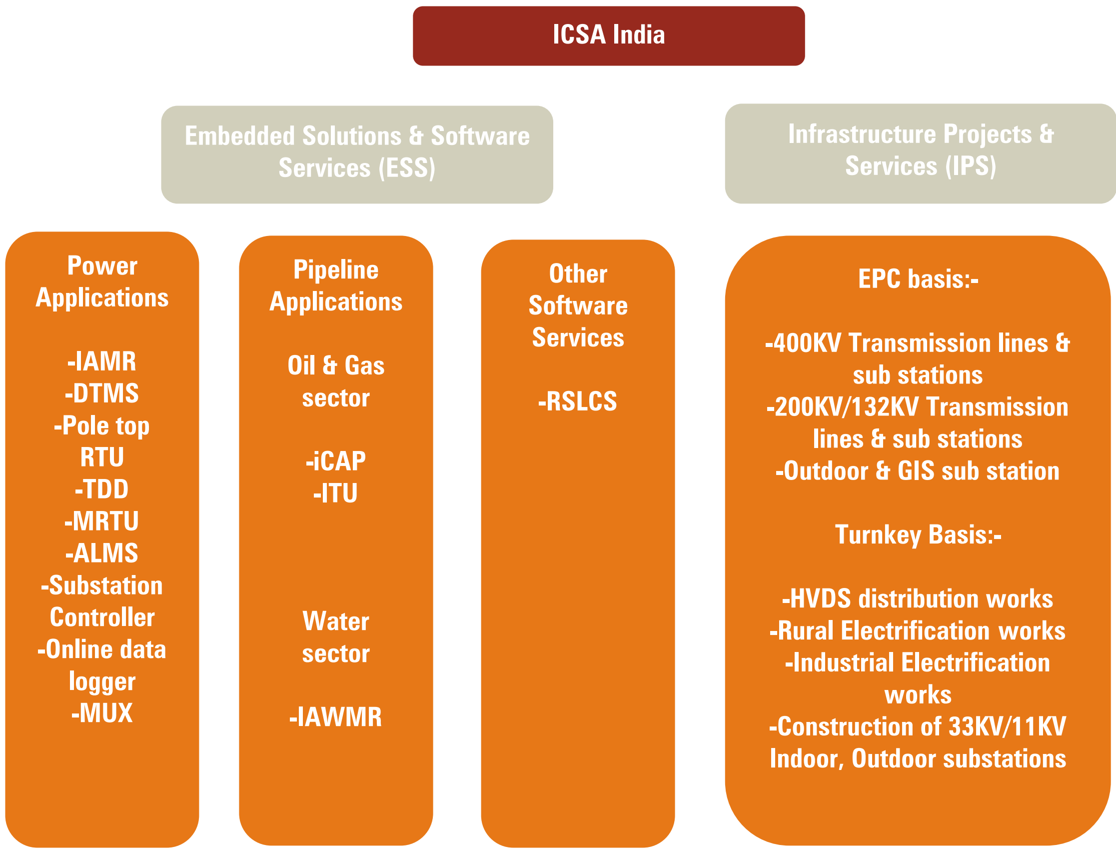


Exhibit 2: Business model



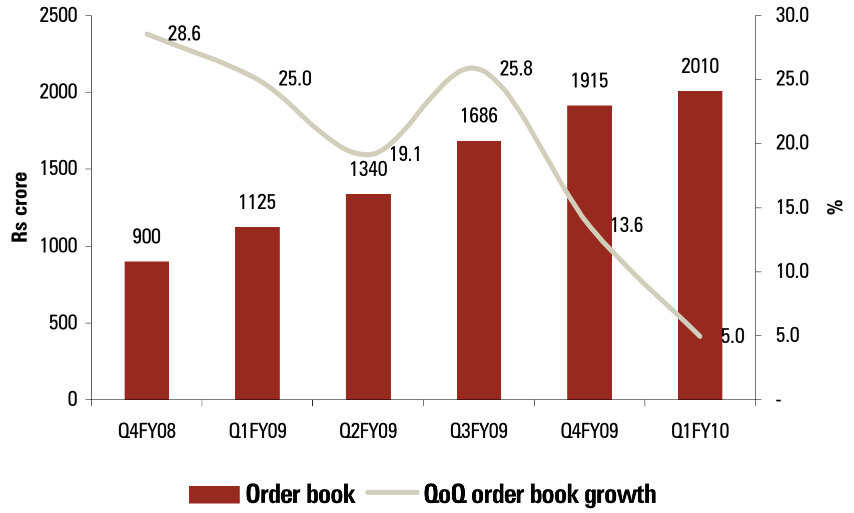
Source: Company, ICICIdirect.com Research

Investment rationale

- **Robust order book : Strong revenue visibility**

  The company currently holds an order book of Rs 2010 crore with a Rs 1413-crore order book from the IPS vertical and another Rs 597 crore from the ESS space. The execution period for the IPS order book is 18 months whereas for ESS it is 12 months. Considering the current order book status, we expect the company to clock in revenues of Rs 561crore and Rs 899 crore from ESS and IPS respectively, in FY10. At the end of FY08, ICSA had an order book of merely Rs 900 crore but managed to do sales of Rs 1111 crore in FY09. Thus, on the back of the current order book, revenue visibility for FY10 is strong with outlined revenue growth at 32% YoY.

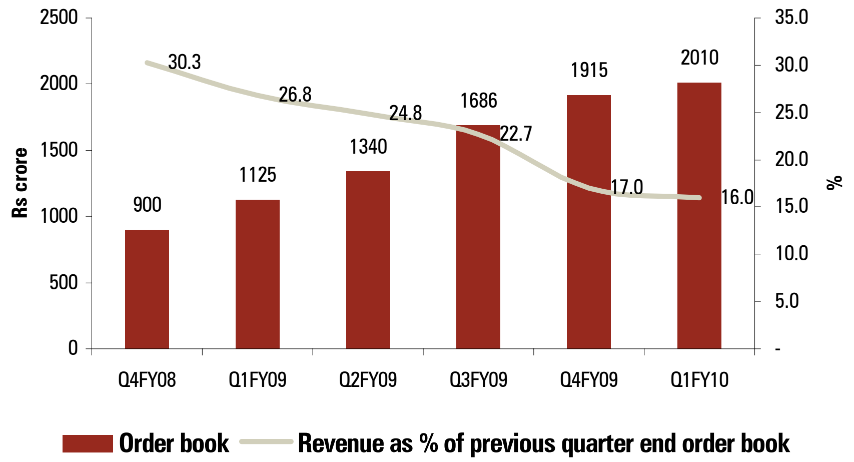
Exhibit 3: Trend in order book



Source: Company, ICICIdirect.com Research

The order book had 19% CQGR in FY09, which dipped to 5% QoQ growth in Q1FY10, on the back of a delay in release of funds under the RAPDRP scheme due to impending elections in April-May 2009

Exhibit 4: Revenue as % of previous quarter order book (RTO)



Source: Company, ICICIdirect.com Research

The RTO ratio, which was around 23% average in FY09 slumped to 17% in Q4FY09 and 16% in Q1FY09 because the order book position was skewed more towards infrastructure work as no incremental work got tender in ESS, on the back of impending general elections 2009

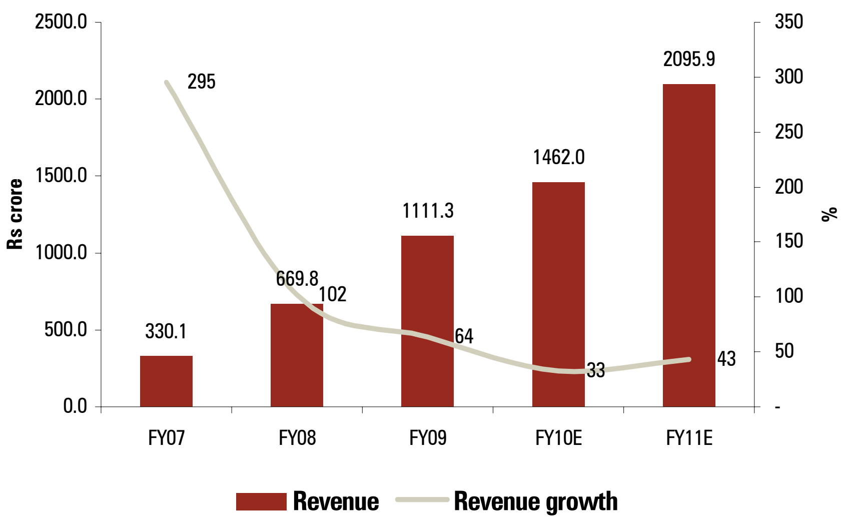
The company has demonstrated 19% CQGR in order book in FY09 but the QoQ order book growth slumped to 5% in Q1FY10. Also, the ratio of reported revenue in a quarter to outstanding order book at the end of previous quarter (RTO ratio) has been around 23% on an average in FY09. This also dipped to 16% in Q1FY10. The primary reason for the order book CQGR and RTO ratio dipping in Q1FY10 was lack of new incremental work awarded in the ESS segment under the Revised Accelerated Power Development and Reforms Programme (RAPDRP) scheme. This got delayed because of the general elections in April 2009, which resulted in nil disbursement by central government to any utility under the new scheme. Any future bids and also bids under process were put on hold. A lot of work was not allowed to be implemented and billed. The management expects growth in the ESS order book to pick up in Q3FY10.

We expect the order book position in ESS to strengthen by the start of CY10 as Discoms will start inviting tenders for deployment of power metering and management solutions to avail the grants and incentives outlined by government on reduction in AT&C losses. Thus, more than half way into the Eleventh Plan and current AT&C losses still miles away from the target of 15% (refer Exhibit 6), we assume an up tick in inflow of ESS order to kick back in Q4FY10 and execution of outstanding ESS orders to ramp up in Q3FY10.

Assuming a 6.3% CQGR in order book for FY10 and RTO of 17.5% average in the next three quarters of FY10, an annual revenue growth of 32% in FY10 looks evident. Also, once more and more orders flock in for ESS work, the execution of order book will also be faster i.e. RTO. Thus, we have built in 7% CQGR for order book in FY11 and average quarterly RTO of 19.5%. Again, this outlines strong revenue growth of 43% in FY11.

On the back of a strong order book position, we are outlining the revenue growth for FY10 at 32%. With the assumption that orders under RAPDRP will begin to flow in by Q4FY10, we expect strong revenue growth of 43% in FY11

Exhibit 5: Trend in revenue



Source: Company, ICICIdirect.com Research

- **RAPDRP and RGGVY scheme: With mammoth opportunity**

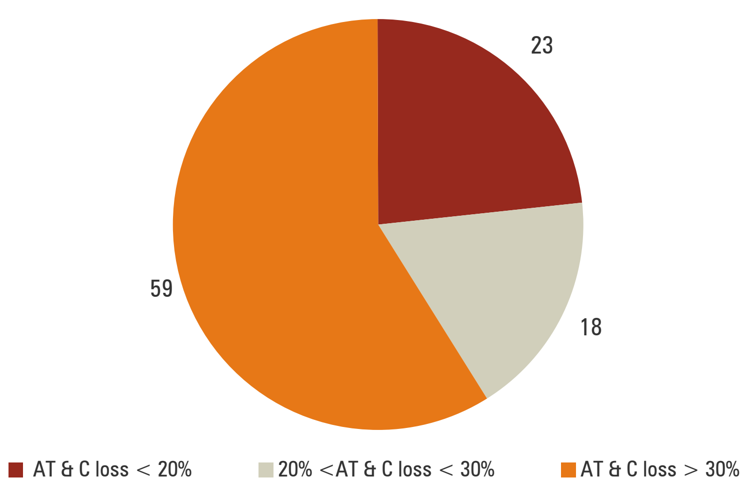
Embedded solution services: Opportunity under RAPDRP scheme

India is the sixth largest global energy consumer and generates 1,32,000 MW (according to the Tenth Plan) of power out of which more than 35% is lost in transmission and distribution i.e. 46200 MW per annum. In contrast, globally the same is around 15% on an average. Due to this, India faces a power deficit of 22000 MW, with peak hour shortage as high as 14% when nearly 50% of households are not grid-connected and thus not a part of demand calculations according to the Ministry of Power. Empirically, it is proven that the ratio of cost of generation for one unit of power to saving it is 2:1. The Ministry of Power plans to reduce AT&C losses to 15% i.e. 19800 MW annually approximately by the end of FY12. Thus, ICSA's power saving embedded solutions like IAMR, TDD, DTMS and others are positioned well to tap the huge opportunity presented under RAPDRP.

The focus of the Revised Accelerated Power Development and Reforms Programme (RAPDRP) scheme is to reduce aggregate technical and commercial (AT&C) losses, improving the quality of supply of power, increasing revenue collection and improving consumer satisfaction. Indian power distribution companies face high AT&C losses to the tune of 35%. Out of this, technical loss is in the range of 8-10% while the rest is commercial loss on the back of power theft or inefficient distribution, which can be monitored and, hence, controlled.

According to the CEA August 2009 report, out of 56 power utilities in India, only 13 have AT&C losses less than 20%, 10 have losses between 20 and 30% while 33 utilities have losses more than 30%. Thus, almost 59% of utilities have AT&C losses more than 30%, presenting a huge opportunity for ICSA's products like IAMR and TDD

Exhibit 6: Distribution of DISCOMs by amount of AT&C losses



Source: CEA, ICICIdirect.com Research

Under the RAPDRP scheme, the Ministry of Power has mandated establishment of reliable and automated systems for sustained collection of accurate base line data and adoption of information technology in the areas of energy accounting to be necessary pre-conditions before sanctioning any project.

The RAPDRP plan has two parts out of which Part-A is focused on a) setting up of base line data, b) GIS mapping, c) Asset mapping and consumer indexing, d) Automatic meter reading of distribution transformer and feeders, e) SCADA/DMS and f) IT in distribution. The government has allocated almost Rs 10000 crore for Part-A and the company has outlined that the opportunity pie for them stands at Rs 3500 crore to address opportunities related to a, d, e and f.

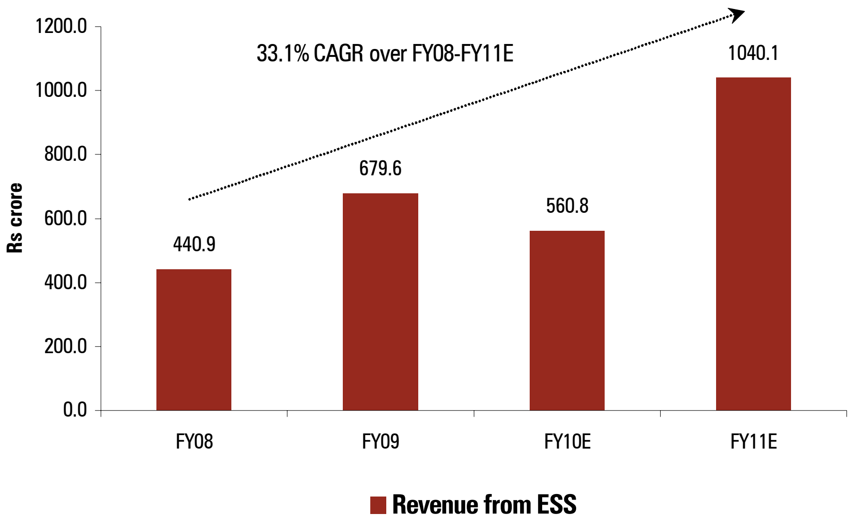
The Part B plan with improvement of projects as focus area is Rs 40000 crore in size. The government has made the plan effective by structuring it in such a way that utilities will be eligible to convert loans to grants only if they successfully achieve the mandated target level of 15% AT&C losses with the following conditions:-

1) Utilities having AT&C loss above 30% have to achieve reduction by 3% per year
2) Utilities having AT&C loss below 30% have to achieve reduction by 1.5% per year

The execution of the Eleventh Plan has not been on track since the beginning and has got further delayed due to general elections 2009. Thus, elections caused a one-time blip in terms of nil order inflows in ESS in H2FY09. This will translate into ESS revenue de-growth in FY10. Considering that we are more than half way through into the Eleventh Plan, power utilities will start inviting orders for energy metering and management solution any time soon. The management expects it to ramp up in Q3FY10 but we believe orders under ESS will flow in by the start of CY10. We expect revenues from ESS to be under pressure in the near term. However, we expect it to double in FY11 on the expectation that strong orders will flow in from the ESS segment.

ESS offering of ICSA places it in a sweet spot to tap opportunities under the RAPDRP scheme. We expect the release of funds under this scheme to begin in Q4FY10 with almost a doubling of ESS revenues in FY11

Exhibit 7: Trend in revenue from ESS



Source: Company, ICICIdirect.com Research

Established turnkey provider: Advantage point under RGGVY scheme

The Rajiv Gandhi Grameen Vidyutikaran Yojna (RGGVY) scheme aims at:-

- Electrifying all villages and habitations
- Providing access to electricity to all rural households
- Providing electricity connection to below poverty line (BPL) families free of charge

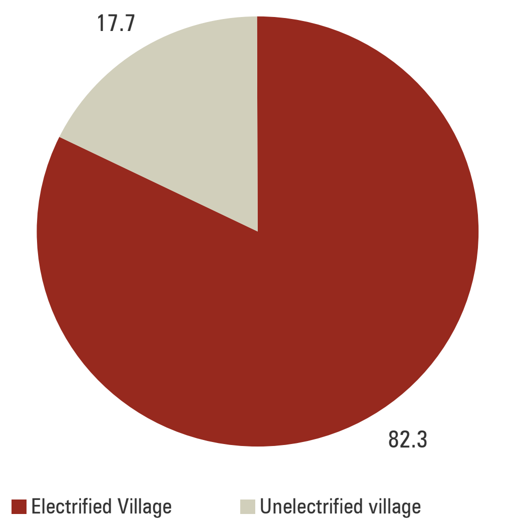
Under the scheme, projects could be financed with capital subsidy of Rs 28000 crore for provision of:

1. **Rural Electricity Distribution Backbone (REDB)**
   Provision of 33/11 KV (or 66/11 KV) sub-stations of adequate capacity and lines in blocks where these do not exist.
2. **Creation of village electrification infrastructure (VEI)**
   i) Electrification of un-electrified villages.
   ii) Electrification of un-electrified habitations with a population of above 100.
   iii) Provision of distribution transformers of appropriate capacity in electrified villages/habitation(s).

The scheme mandates that targets should be achieved by awarding the work to turnkey contractors only. ICSA has executed a lot of projects on a turnkey basis. Again, this puts ICSA in a sweet spot as it is a turnkey services provider i.e. deals in construction of 33 KV/11KV indoor, outdoor substations as well as rural electrification work.

According to the 2001 census, total number of inhabited villages is 593732. Out of this, only 82.3% i.e. 488836 were electrified as on January 31, 2009. Thus, there are almost 104896 more villages yet to be electrified

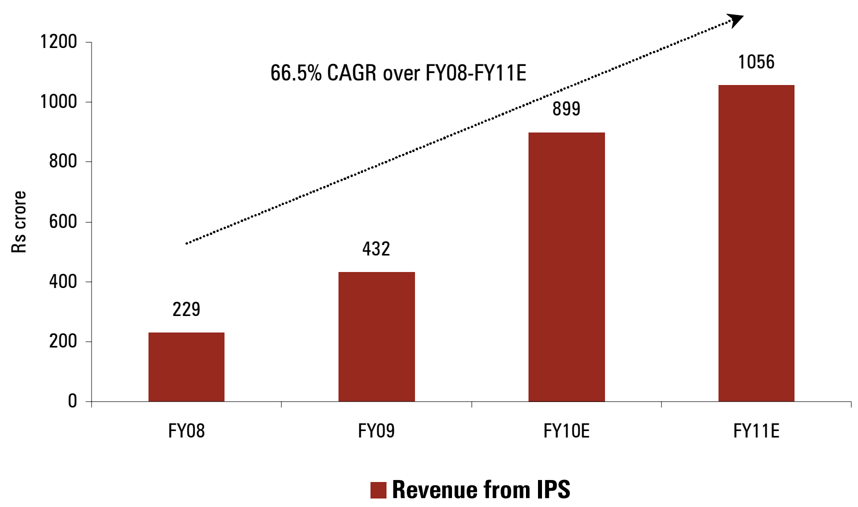
Exhibit 8: Distribution of villages on the basis of electrification



Source: Company, ICICIdirect.com Research

The IPS segment in a way has proved to be a saviour for the company by stemming slippages in order de-growth from the ESS segment. The company has undertaken many infrastructure projects on a turnkey basis. The RGGVY scheme also envisages that it will award contracts for rural electrification to turnkey contractors, which puts ICSA again in a sweet spot

Exhibit 9: Trend in revenue from IPS



Source: Company, ICICIdirect.com Research

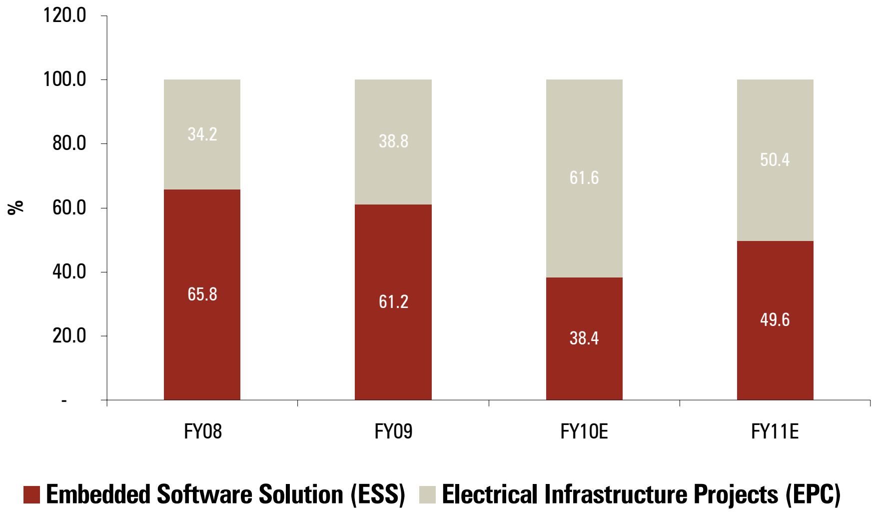
The company is in L1 phase for infrastructure contracts worth Rs 700 crore and will have almost 50% of the current infrastructure order book of Rs1413 crore flowing in FY11. Hence, we expect IPS to grow at 66.5% CAGR over FY08-FY11E period.

- **Capital light model: High return ratios**

The company has a unique business model for ESS, which revolves around in-house capabilities to address high value-added services like research, product design, product development, product testing and pilot deployment. Rest of the low value-added services like manufacturing and deployment is outsourced i.e. the company has a capital-light business model in the ESS segment. This enables the company to garner high EBIT margins of around 31% in the ESS space. Also, the research & development (R&D) team of the company is very strong. This has helped ICSA to convert a majority of its R&D investment into full fledged products with IPR for four products in its product portfolio. Thus, such a capital light model helps the company to reward its stakeholders with high returns i.e. RoE and RoCE. Thus, for an entrant to build up R&D capability and the entire value chain from procurement, designing and deployment will take time. Also, in a business involving bidding for government contracts, contractors with good implementation background becomes a must, increasing lead time for entrant further. This gives ICSA first mover advantage and acts as a major barrier for entrants.

Return ratios will drop in FY10 due to shift in business mix towards lower margin and capital intensive type of infrastructure projects and services

Exhibit 10: Trend in business mix

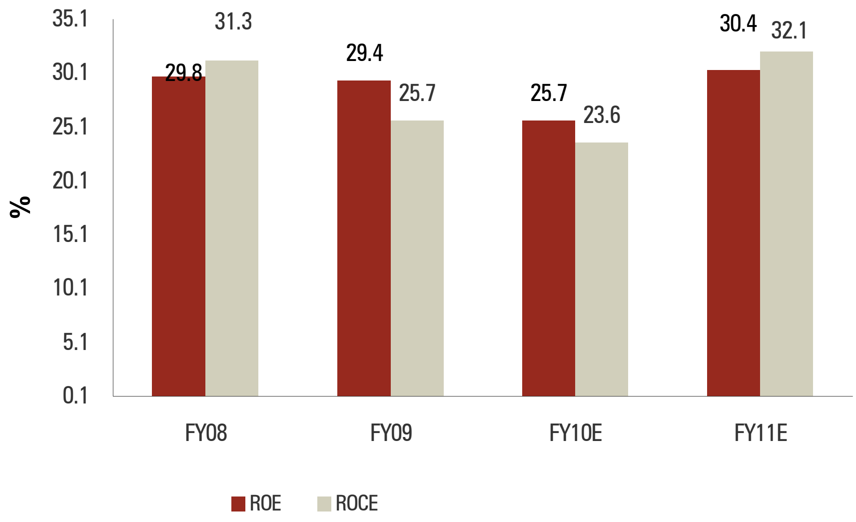


Source: Company, ICICIdirect.com Research

We expect the company to continue delivering high RoE and RoCE though both these ratios will be under pressure over the short-term, as the company has a majority of orders for infrastructure projects in the funnel that are low margin and capital intensive. Thus, due to the business mix turning diametrically opposite in FY10 i.e. 40:60 from ESS: IPS as compared to 60:40 ESS: IPS in FY09, the return ratios will dip in FY10. This will be followed by an up tick in FY11 when we expect the revenue mix to become 50:50 from ESS: IPS.

Delay in release of funds under RAPDRP has led to a shift in order book position now skewed towards more infrastructure orders. This will change the business mix completely in FY10. We expect it to move to 50:50 mix by FY11

Exhibit 11: Trend in return ratios



Source: Company, ICICIdirect.com Research

- **Skewed towards defensive vertical: Public sector**

  A majority of ICSA's clients are government sponsored power transmission and distribution utilities, which are relatively insulated from the current slowdown. Almost 80% of the company's clients are government agencies. The top four clients of the company (that contribute about 30% to revenues) are power distribution utilities.

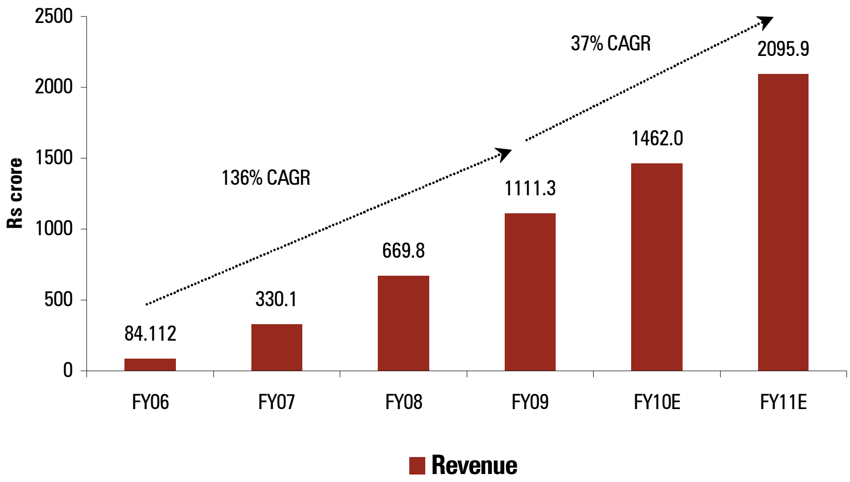
  With the government as its major contributor, the company is relatively insulated from the potential problem of order leakage due to liquidity crunch confronted by other IT companies currently due to top client specific issues. The company's strong foothold in servicing state electricity boards has been the reason behind the company managing to grow at a strong pace even in FY09 when order slippage from ESS was getting plugged in by orders from IPS.

Financials

- **Moderate revenue growth and subdued EPS growth in the near term**

The company has reported a strong revenue growth of 136% CAGR over FY06-FY09. However, we expect it to grow at a moderate pace of 37% CAGR only over FY09-FY11E. This was because of a delay in release of funds under the RAPDRP scheme for energy metering and management products by government. This handicapped the ESS segment order book growth but due to same client base for both ESS and IPS, the company managed to stem the order slippage in the ESS segment by wining more and more contracts in the IPS space. Since more and more IPS contracts occupy the order book, the execution period has also got lengthened. Therefore, we expect the revenue growth for FY10 to abate to 32%.

Exhibit 12: Trend in revenue growth



Source: Company, ICICIdirect.com Research

The company grew by leaps and bounds with 136% CAGR over FY06 to FY09. Considering the current order book status and mammoth opportunity related to ESS under the RAPDRP scheme, we have outlined the company will grow at 37% CAGR over FY09 to FY11

Change in business mix from the traditional ESS: IPS mix of 60:40 to new ESS: IPS mix of 40:60 will also impact the profitability of the company in FY10. On account of this, we expect revenue growth of merely 20.7% (YoY) in FY10. With the assumption that order book growth for ESS will revive in Q4FY10 we expect the business mix for FY11 to normalise to ESS: IPS mix of 50:50. This will pull up revenue growth to 43% (YoY) and bolster EPS growth to the tune of 66.1% in FY11. The EPS growth for FY11 looks inflated but it is purely on the back of lower EPS base in FY10 due to change in business mix. In case, funds from RAPDRP had got released on time, that is, since September 2008 and business mix had been maintained, the company would have experienced 54% growth in EPS.

Thus, the change in business mix will prove a spoilsport for the company's profitability in FY10. We have outlined the sensitivity analysis of the business mix impact on EBITDA margin and EPS as follows:-

Exhibit 13: Sensitivity analysis

FY10						
Ratio ESS:	**IPS**	**EBITDAM%**	**PATM%**	**PAT**	**EPS**	**EPS %growth**
60	40	24.4	16.2	236.1	45.4	54.4
50	50	22.6	14.4	210.3	40.4	37.6
40	60	20.8	12.6	184.5	35.5	20.7

FY11						
Ratio ESS:	**IPS**	**EBITDAM%**	**PATM%**	**PAT**	**EPS**	**EPS %growth**
60	40	24.7	16.1	337.9	65.0	91.1
50	50	22.9	14.3	299.7	57.6	69.5
40	60	21.1	12.5	261.6	50.3	47.9

Source: Company, ICICIdirect.com Research

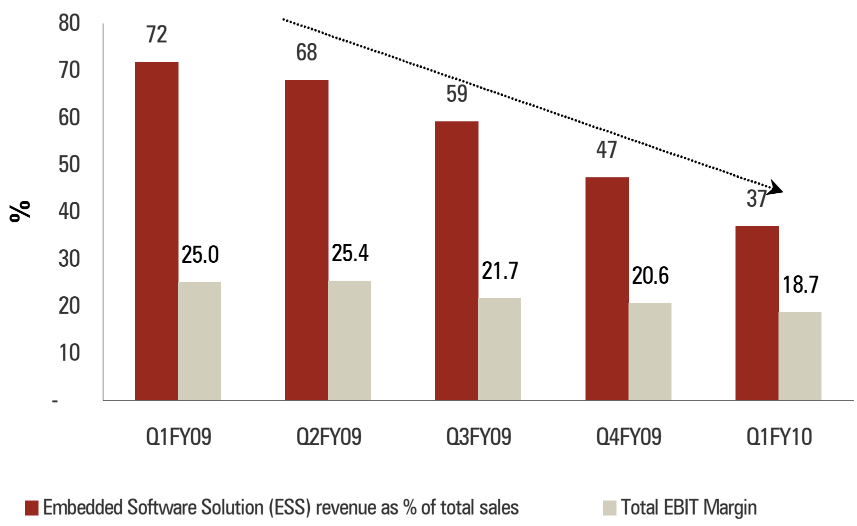
The company's profitability is a function of its business mix. On the basis of the current order book status, we have outlined the business mix for FY10 to be at 38:62 from ESS: IPS and 50:50 for FY11. Hence, we expect the EPS growth to be merely 20.7% in FY10 and 69.5% in FY11

- **Change in business mix to drag margin**

  The company had almost 61% (as on FY09 end) of its revenue coming in from the ESS segment. The embedded solution segment is very profitable as compared to the infrastructure project & services with EBIT margin of 31% whereas the IPS segment has EBIT margin of 12% only.

  The company has evolved its business model from EPC centric to ESS provider, helping ICSA to achieve scale and profitability. However, a delay in release of funds for IT products by the government under the RAPDRP scheme due to general elections 2009 has shifted the business mix towards more infrastructure projects. The company hardly has any competition in the ESS products space but competes with big infrastructure companies in the electrical procurement contracts (EPC) space. The EBIT margin for the company is largely a function of its business mix (Exhibit 14).

Exhibit 14: Historical trend in EBIT margin and ESS revenue contribution



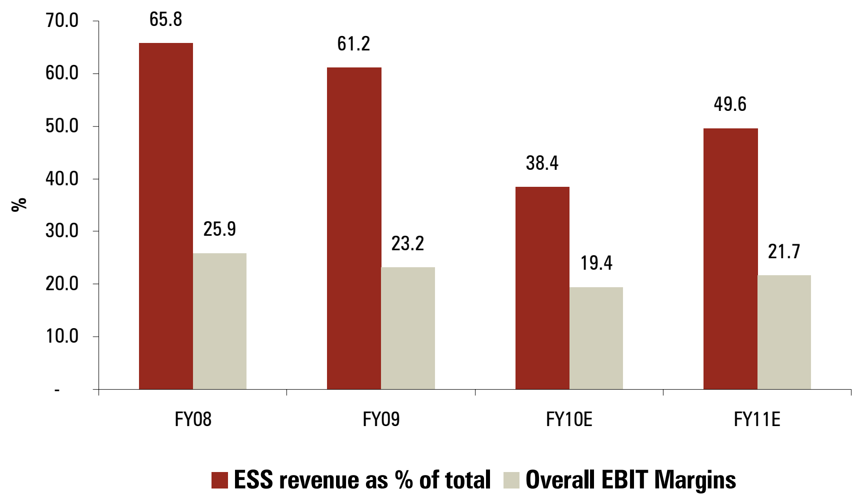
Source: Company, ICICIdirect.com Research

Revenue contribution of the ESS segment has registered a steep decline over the past one year dragging the overall EBIT margin

With almost 70% of its pending order book now from infrastructure projects, we expect the consolidated EBIT margin to be under pressure over the next two quarters and EBIT margin for FY10 to drop below the 20% mark. We expect the margins to post an up tick once the incremental work for the ESS segment sets in that is in Q4FY10. We will see the EBIT margin scaling above the 20% mark in FY11 and standing around 22% on the back of an improved business mix of ESS: IPS to 50:50.

When ESS contributed 66% to overall revenues (in FY08) overall EBIT margins were at a peak of 26%. However, now with a diametrically opposite revenue mix expected in FY10, the EBIT margin will drop below the 20% mark and rebound only in FY11 when the mix begins to normalise at 50:50 from ESS:IPS

Exhibit 15: Trend in overall EBIT margin with ESS revenue contribution

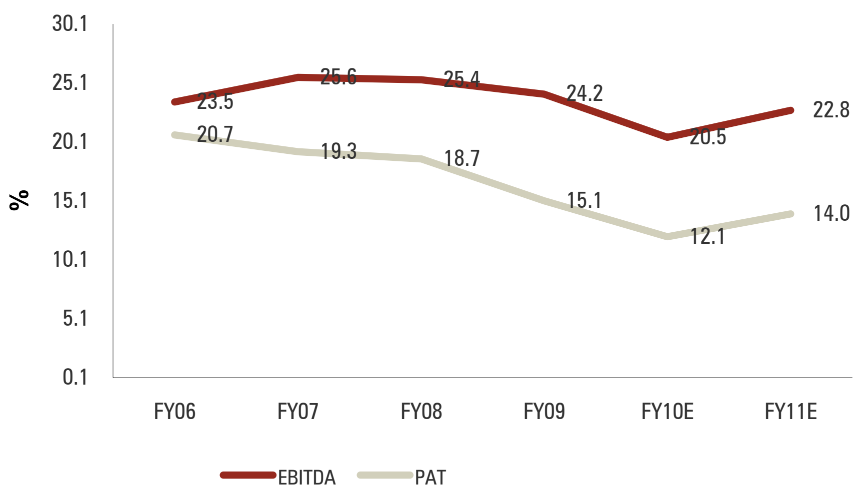


Source: Company, ICICIdirect.com Research

Thus, the margin will rebound in FY11E on the back of expectations that the company will be able to bag and execute a lot of ESS deals considering the Eleventh Plan will be coming to a closure in FY12. This will make DISCOMs expedite orders for ESS products reduce AT&C losses and receive grants from the government under the RAPDRP scheme. Thus, this will boost the operating margin in FY11.

As explained, the business mix change that is more skewed towards infrastructure projects will dent the overall EBITDA margin in FY10. Once the ESS order book begins to strengthen in Q4FY10, the business mix will start moving towards more ESS work and boost margins

Exhibit 16: Trend in margins



Source: Company, ICICIdirect.com Research

- **Return ratios under pressure**

  The company has always reported high return ratios due to its light capital intensive model. However, with its movement from embedded solution provider to turnkey contractor, the return ratios will be under pressure in the short-term (as shown in Exhibit 11) as these Infrastructure projects are low margin and capital intensive projects.

Risks & Concerns

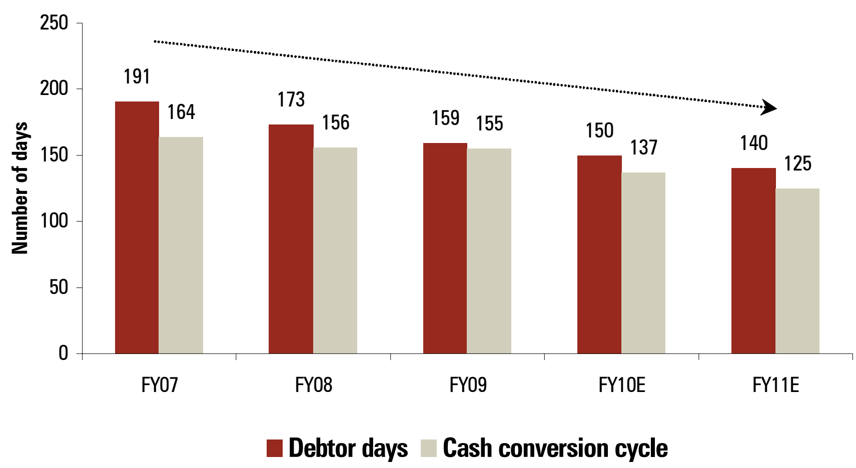
High working capital requirement

The company's business model requires high working capital on the back of high debtors of 158 days (FY09) due to 80% of its clients being government agencies as well as to finance outsourced procurement and deployment. Due to high working capital requirement, the business has always utilised free cash flows (FCF).

The company has more than 70% of its order book as infrastructure projects, which are capital intensive and with high debtor days typically 180 days. Thus, the company will continue to operate with existing term loan and working capital loan in FY10 also. We expect this number to inch up by another Rs 40 crore in FY10. Also, the interest cost that the company will have to serve for its working capital loan and long term loan of Rs 320 crore and Rs 50crore, respectively, is very high i.e. almost 12% per annum due to use of non-fund base limit.

The company has scaled down its debtor days significantly over the past three years from 192 (in FY07) to 158 days (in FY09). The debtor days stood at 152 in Q4FY09. The management has indicated that they have put up a task force to cut down debtor's day further and expect it to scale down to the level of 150 by end of FY10. This will free up cash and turn the company's free cash flow from operation positive in FY10. We expect the debtor days to scale down further to 140 in FY11 considering almost 50% of revenues will come in from ESS segment.

Exhibit 17: Cash conversion cycle



Source: Company, ICICIdirect.com Research

We expect the cash conversion cycle to improve from 155 days (FY09) to 137 days (in FY10) on the back of improved debtors days as well as inventory turnover days due to weak order book from ESS segment

If the company fails to recover the money according to outlined debtor days of 150 days, the high working capital requirement will force ICSA to avail more non fund based high interest cost loan that will impact its net profitability and, hence, our EPS estimate for FY10 as well as FY11.

The company also has US$21 million of FCCBs outstanding on its books. They are convertible at a price of Rs 189 per share and have maturity due in May 2012.

Risk of deferral in release of funds under RAPDRP scheme

The demand for most of the embedded solutions of the company comes in from public power transmission and distribution utilities due to mandatory energy metering condition and incentives associated with achievement of targets under the RAPDRP scheme. Our estimates are on the back of assumption that the company will be able to bag more and more deals in the ESS space by the start of CY10. This is considering that power distribution companies now concentrate on deployment of energy metering and energy management solution to achieve prescribed targets of AT&C losses by the end of FY12. If the government does not ramp up its spending for such solutions under the RAPDRP scheme by the expected time frame this can pose a risk to our revenue and earnings growth estimates for FY11.

Inadequate promoter holding with shares pledged

The promoter stake in the company is merely 20.7% with almost 8.2% of it pledged i.e.1.7% of total outstanding shares. In the current market conditions when credit is not available easily, the promoters of various companies are raising money by pledging their equity holding in the company. This is a point of concern and has to be monitored closely.

Valuations

ICSA has reported strong revenue CAGR of 137% over FY06-FY09. The company has a strong order book position of Rs 2010 crore that is almost 1.8x FY09A revenues, though it is skewed more towards infrastructure work. A delay in release of funds under RAPDRP scheme did hamper the growth trajectory of the ESS business but was supported by more order wins in the infrastructure segment. Going forward, we do expect the ESS segment growth to pick up by Q4FY10 and infrastructure segment to continue growing as the company is in L1 phase for more orders worth Rs 700 crore.

Peer valuations:

The company has a unique business mix of IT and infrastructure project services. Therefore, it cannot be directly valued on a PER basis, which is a de facto to value IT companies. Therefore, we have short-listed a couple of IT companies that are focused on serving the government sector. KLG Systel has its offerings like SG61 and Vidushi, which competes with ICSA's automatic meter reading solution. We have valued ICSA on an EV/EBITDA (x) basis by valuing its two segments separately.

Exhibit 18: Relative valuation

	RONW		EV/EBITDA	
	FY10E	FY11E	FY10E	FY11E
ICSA	23.8	28.7	3.4	2.1
KLG Systel	15.5	17.2	4.3	3.6
Infotech Interprises	16.6	16.3	6.9	6.0

Source: Company, ICICIdirect.com Research

One year forward EV/EBITDA(x) basis: Target price at Rs241 per share

The company had almost 61% (FY09) of its revenue coming in from the ESS segment while the rest comes from infrastructure services. The company's profitability is highly dependent on the business mix. On the basis of the current order book split of Rs 2010 crore i.e. 70% of order book from infrastructure work and rest from embedded solution, the business mix will shift diametrically opposite in FY10 as opposed to FY09.

The ESS business has EBITDA margin of 32% plus whereas in case of IPS the margins are very low i.e. in the 13% range. With a drastic shift expected in the business mix, we have valued the company's two businesses separately to derive the total firm value.

The company has a strong execution capability in government contracts leading to very high return ratio as compared to its peers. We have valued the company's capital light ESS business at a 15% premium to average EV/EBITDA(x) of 5.6x FY10E EBITDA at which other IT companies are trading i.e. at 6.4x FY10E EBITDA from the ESS segment. Considering that the infrastructure business is low margin and capital intensive with lower RoCE, we have valued it at a 25% discount to derive a target EV/EBITDA multiple for ESS business i.e. at 4.8x FY10E EBITDA from IPS business (as shown below).

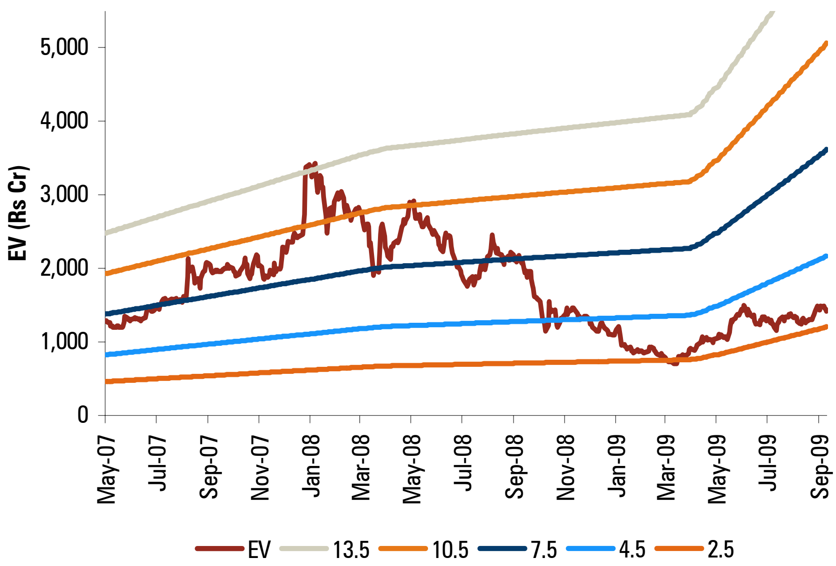
Exhibit 19: EV/EBITDA(x)

	FY10E
EBITDA in ESS (Rs crore)	176.3
EBITDA in IPS (Rs crore)	123.8
One year forward EV/EBITDA (x) for mid cap IT companies	5.6
Premium in EV/EBITDA (x) for embedded solution business	15.0
Target EV/EBITDA (x) for ESS business	6.4
Discount in EV/EBITDA(x) for Infrastructure business	25.0
Target EV/EBITDA for IPS business	4.8
Target EV (Rs crore)	1720.6
Debt (Rs crore)	500.0
Cash (Rs crore)	32.4
Target Mcap	1253.0
Derived Target price	241.0

Source: Company, ICICIdirect.com Research

Thus, this sum of the parts valuation gives us an EV, which is 5.7x FY10E EBITDA with a 12-month target price of Rs 241 per share. The company has traded at a one year forward EV/EBITDA multiple of as high as 13.5x in the later half of FY08 but delay in release of orders in the ESS space discounted it to as low as 2.5x level at the end of FY09 (Exhibit 20).

Exhibit 20: EV/EBITDA(x) chart



The company is currently trading at an EV of 4.6x and 2.7x EBITDA for FY10E and FY11E, respectively.

Source: Company, ICICIdirect.com Research

We believe the stock is trading at attractive valuations, considering its robust order book position is giving strong visibility for FY10, superior return ratios and it being the prospective prime beneficiary on release of funds under the RAPDRP scheme. Thus, we believe the EV/EBITDA (x) of 5.7x FY10E EBITDA is a reasonable multiple to value its complete business. We are initiating coverage on this stock with a 12-month price target of Rs 241per share and an **OUTPERFORMER** rating.

Exhibit 21: Profit and loss account

(In crores)	FY07	FY08	FY09	FY10E	FY11E
Sales	332.5	672.1	1100.4	1462.0	2095.9
% Growth	295.3	102.1	63.7	32.9	43.4
Total expenses	249.5	491.3	853.4	1160.9	1617.5
Operating profit	83.0	180.9	247.0	301.1	478.4
% Growth	312.5	117.9	36.6	21.9	58.9
Interest	8.0	27.1	35.3	47.2	47.5
EBDT	75.0	153.7	211.8	254.0	430.9
%Growth	274.9	105.0	37.7	19.9	69.7
Depreciation	1.7	3.5	12.1	19.6	27.3
Other Income	0.8	7.9	1.8	2.1	4.1
Profit Before Tax (PBT)	74.1	158.1	201.4	236.5	407.7
% Growth	276.4	113.4	27.4	17.4	72.4
Taxation	14.8	46.6	48.4	59.9	114.2
Tax as % of PBT	20.0	29.5	24.0	25.3	28.0
Net Profit	58.9	111.5	153.0	176.5	293.6
% Growth	237.3	89.3	37.2	15.4	66.3
Shares O/S	3.41	4.40	4.70	4.71	4.71
Diluted EPS (Rs)	17.7	23.3	29.4	34.0	56.5

Source: Company, ICICIdirect.com Research

Exhibit 22: Balance sheet

(In crores)	FY07	FY08	FY09E	FY10E	FY11E
Share capital	6.8	8.8	9.4	9.4	9.4
Reserves & surplus	104.8	365.3	511.0	678.7	957.6
Secured loans	47.6	109.9	300.0	410.0	350.0
Unsecured loans	98.5	91.5	90.0	90.0	90.0
Deferred tax liability	2.851	16.8	11.8	11.8	11.8
Total Liabilities	**260.6**	**592.3**	**922.2**	**1200.0**	**1418.8**
Net Block	10.7	91.7	201.2	297.5	390.6
Investments	0.2	2.6	0.6	0.6	0.6
Cash	87.3	58.5	18.0	32.4	46.6
Trade receivables	173.7	319.0	480.0	600.8	803.9
Loans & advances	13.0	111.1	137.6	162.2	165.9
Other current assets	19.6	47.8	75.1	137.4	106.4
Inventory	28.9	64.9	133.3	152.7	212.7
Current liabilities & provisions	90.1	136.8	180.5	269.8	423.7
Miscellaneous expense not written off	17.3	33.8	57.0	86.1	115.8
Total Assets	**260.6**	**592.3**	**922.2**	**1200.0**	**1418.8**

Source: Company, ICICIdirect.com Research

Exhibit 23: Cash flow statement

(In crores)	FY07	FY08	FY09E	FY10E	FY11E
Pre tax profit from operations	73.3	150.3	199.6	234.4	403.6
Depreciation	1.7	3.5	12.1	19.6	27.3
Expenses (deferred)/written off	-12.8	-16.5	-23.2	-29.1	-29.7
Net cash from operations	62.2	137.2	188.6	224.9	401.2
Tax	14.8	46.6	48.4	59.9	114.2
Cash profits	47.4	90.6	140.1	164.9	287.0
Increase in current liabilities	60.8	47.2	43.4	89.3	153.9
(Increase) in current assets	-172.9	-211.3	-255.0	-202.5	-232.2
(Increase) in fixed assets	-6.0	-85.1	-121.0	-115.9	-120.3
(Increase) in investments	-0.2	-0.4	0.0	0.0	0.0
(Increase) in loans & advances	-5.7	-98.0	-26.6	-24.6	-3.7
Cash flow from financing activities	162.8	214.4	183.5	103.2	-70.6
Opening cash balance	0.3	87.3	58.6	18.0	32.4
Closing cash balance	87.3	58.6	18.0	32.4	46.6

Source: Company, ICICIdirect.com Research

Exhibit 24: Key ratios

(In crores)	FY07	FY08	FY09E	FY10E	FY11E
Diluted EPS	17.7	23.3	29.4	34.0	56.5
Book value per share	32.8	85.1	110.8	146.1	205.3
Enterprise value	727.8	1006.2	1293.2	1391.7	1317.5
EV/EBITDA	8.7	5.3	5.2	4.6	2.7
Market cap/Sales	2.6	1.3	0.8	0.6	0.4
Price/Book value	6.0	2.3	1.8	1.3	1.0
Operating margin (%)	25.0	26.9	22.5	20.6	22.8
Return on Net-worth(%)	52.7	29.8	29.4	25.7	30.4
Debt/equity	1.3	0.5	0.7	0.7	0.5
Fixed assets turnover ratio	31.1	7.3	5.5	4.9	5.4
Debtors Days	190.7	173.2	159.2	150.0	140.0

Source: Company, ICICIdirect.com Research

Exhibit 25: DuPont model

	FY07	FY08	FY09E	FY10E	FY11E
PAT / PBT	79.5	70.5	76.0	74.7	72.0
PBT / EBIT	90.2	85.4	85.1	83.4	89.6
EBIT / Sales	24.7	27.6	21.5	19.4	21.7
Sales / Assets	31.1	7.3	5.5	4.9	5.4
Assets / Equity	0.1	0.2	0.4	0.4	0.4
ROE	52.7	29.8	29.4	25.7	30.4

Source: Company, ICICIdirect.com Research

ANNEXURE

Products	Function
IAMR	Intelligent automatic meter reading (IAMR) is a patented product of the company. It automates meter reading in real-time. The software solution resides beside the meter, gathers usage data and transmits it via GSM (SMS, data call, GPRS), PSTN& RF methods. The result is that the consumer's bill is ready within 24 hours of the end of the billing cycle without human intervention. It provides real-time energy audit and detects power theft, tampering and defects by generating alerts. This saves cost, time, shrinks receivable cycle for distribution companies as manual billing takes 21 days whereas using this it is reduced to 24 hours.
DTMS	Distribution transformer monitoring system (DTMS) is a patented product of the company. It facilitates monitoring the performance of distribution transformers from remote locations with respect to power load, theft and unexpected power interruptions through the GSM/radio frequency media to the base station. The system has successfully reversed the conventional paradigm of visiting the site to derive information, reducing the periodicity of checks from monthly to once in every 30 seconds. This saves cost and time as no more human intervention is required, increases the life of distribution transformer by about 30%.
Pole top RTU	It measures energy parameters of the connection at the pole. The display is kept in consumer premises to show the energy meter readings and any message from the utility. Each unit monitors 15 consumers. It regulates connection/disconnection for supply, monitors and communicates with master station via GSM network. It generates alarms in case of tampers, line disturbance, etc.
TDD	Theft detection device (TDD) is a patented product of the company. This product helps to identify power thefts at LT pillars (junction boxes used for underground power distribution lines) under different tamper conditions. It provides instantaneous parameters like voltages, currents, power to the base station. It sends alert messages to the base station as well as concerned officials through multiple communication media in case of theft detection. Also, it initiates local audio alarm.
MRTU	Micro remote terminal unit (MICRO RTU) monitors and controls sub-station feeder. It is useful in energy audit, load survey and fault analysis. It supports multiple modems like PSTN, GSM.
ALMS	Agricultural load management system (ALMS) is meant for supplying power to farmers during a specified time with assured time duration. It reduces the stress on LT lines, distribution transformers, sub-station and system in view of diversified usage. Lesser failures of distribution transformers due to diversified load and lesser interruptions, reduces the system peak demand with substantial reduction on technical losses.
Substation Controller	Total metering interface is up to 32 meters. It facilitates automatic overload tripping of feeders and remote upload of time schedules. It is equipped with alert facilities and is responsible for health monitoring of sub-station equipment.
Online data logger	It does online monitoring and data logging of load management, including data of various parameters of 11kv feeders in sub-stations, loads in MW at each stage, phase-wise voltage, current and power factor, energy, breaker status and DC auxiliary supply status. It eliminates manual interference and enhances accurate data gathering with exact time status.
MUX	It collects data from multiple meters at a single location i.e. from eight to 16 meters. It communicates with meters distributed over an area of 100 meters.
iCAP	Intelligent cathodic protection (iCAP) is a patented product of the company. It is a field-compatible, wireless embedded solution that helps measure the variation in oil pipe quality from what it used to be when laid and as it exists now. It notifies pipe behaviour across all test points in real-time, which makes it possible for maintenance professionals to know exactly what part of the pipe has corroded and needs immediate repair. It also uses acoustic emission activity to highlight probable pilferage and tampering. It is compatible with old and new pipelines. It is equipped with an in-built warning system. It possesses an integrated data transmission facility using GSM/GPRS/CDMA platforms. The conventional systems measure parameters at frequency ranging from 10 days to six months whereas iCAP does it in real-time.
ITU	Intelligent telemetric units (ITU) are standalone modules and help in conducting cost effective off PSP survey. It facilitates better GPS synchronisation and has unique feature like programmable data acquisition and data transmission to central station through GSM, CDMA, RF optical and satellite. They acquire data from sensors and transmit to the central monitoring station.
IAWR	Intelligent automatic water reading (IAWR) gets consumption data of water delivered on daily/monthly basis at the base station via GSM network. It controls delivery valve, sends SMS to consumers regarding bill amounts and payment receipts. It is also enabled with theft detection, meter bypass detection.
RSLCS	Remote street light control system (RSLCS) enables controlling any street light from central location. The ON/OFF time can be programmed and configured at central location. Individual phases can be switched ON & OFF at different times, according to the traffic movement automatically, for saving energy.

Source: Company, ICICIdirect.com Research

RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer (OP): 20% or more;
Performer (P): Between 10% and 20%;
Hold (H): ±10% return;
Underperformer (U): -10% or more;

Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICIdirect Research Desk,
ICICI Securities Limited,
7th Floor, Akruti Centre Point,
MIDC Main Road, Marol Naka,
Andheri(E),
Mumbai – 400 093
research@icicidirect.com

ANALYST CERTIFICATION

We /I, Yash Gadodia, MA and Srishti Anand, B.E, MBA (Finance) research analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that, Yash Gadodia, MA and Srishti Anand, B.E, MBA (Finance)research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its subsidiaries collectively do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that Yash Gadodia, MA and Srishti Anand, B.E, MBA (Finance) research analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction. This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.