

### Disappointing numbers; Downgrade earnings

February 3, 2011

<b>Reco</b>	<b>Changed from</b>
Accumulate	Accumulate
<b>CMP</b>	<b>Target Price</b>
Rs1,142	Rs1,370

EPS change FY11E/12E (%)	-4/-6
Target Price change (%)	-12
Nifty	5,432
Sensex	18,091

#### Price Performance

(%)	1M	3M	6M	12M
Absolute	(10)	(17)	(7)	38
Rel. to Nifty	2	(7)	(7)	23

Source: Bloomberg

#### Relative Price Chart



Source: Bloomberg

#### Stock Details

Sector	Financial Services
Bloomberg	ICRA@IN
Equity Capital (Rs mn)	100
Face Value(Rs)	10
No of shares o/s (mn)	10
52 Week H/L	1,480/807
Market Cap (Rs bn/USD mn)	11/241
Daily Avg Volume (No of sh)	10902
Daily Avg Turnover (US\$mn)	0.3

#### Shareholding Pattern (%)

	D'10	S'10	J'10
Promoters	28.5	28.5	28.5
FII/NRI	7.8	7.0	6.5
Institutions	44.3	44.6	44.4
Private Corp	2.9	3.1	3.2
Public	16.6	16.8	17.4

Source: Capitaline

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- **ICRA's Q3FY11 results were below expectations led by slower growth in rating business coupled with higher employee expenditure**
- **The rating business grew by a lower 9.7%yoy to Rs300mn led by sluggish debt market issuance and decline in structured finance volumes during the quarter**
- **The adjusted operating margin declined by 390bps to 38.5% during the quarter led by substantial fall in margins in rating business**
- **Downgrade earnings for FY11/12/13 by 4-8% to factor in slower growth in revenues. Maintain ACCUMULATE with TP of Rs1370**

#### Revenues growth below expectations

ICRA's revenues for the quarter grew by 12.2% yoy to Rs472mn below our expectation led by slower growth in rating business. The rating business grew by a lower 9.7%yoy to Rs300mn led by sluggish debt market issuance and decline in structured finance volumes during the quarter.

#### Income from operations

Income from operations	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)
Rating Services Fees	274	331	271	335	300	9.7	-
Consulting Fees	62	78	51	57	68	10.6	19.8
Information Services Fees	10	15	7	6	9	-9.8	51.4
KPO/BPO Services Fees	24	49	31	30	34	38.9	12.8
Professional Services Fees	52	34	50	56	61	18.8	8.8
Total operating revenues	421	507	410	484	472	12.2	-2.5

Source: Company, Emkay Research

#### Pick up in rating revenues expected in coming quarters

The growth in the rating revenues was partly also due to bunching up of some revenues to the fag end of Q2FY11. The revenue growth for M9FY11 in the rating business was still at 24%. We believe that two things will still help ICRA to bounce back on revenue growth – (1) the bank loan volumes have picked up over last quarter and (2) commercial paper and bond issuances which were lower in Q3FY11 would pick up if the interest rates stabilise in Q1FY12.

In our numbers we have taken a growth of ~20% in the rating business for FY11E implying 11% yoy growth in rating revenues for Q4FY11.

#### Valuation table

YE- Mar	Net Sales	EBITDA			EPS	EPS	RoE	P/E	EV/ EBITDA	P/BV
		(Core)	(%)	APAT	(Rs)	% chg	(%)	(x)	(x)	(x)
FY09	1,358	559	41.2	411	41.1	52.4	24.2	28.8	18.7	6.5
FY10	1,623	614	37.8	477	47.7	16.0	24.2	24.8	16.3	5.6
FY11E	1,948	736	37.8	557	55.7	16.8	24.5	21.3	13.4	4.9
FY12E	2,337	934	39.9	694	69.4	24.6	26.7	17.1	10.4	4.3
FY13E	2,805	1,121	40.0	824	82.4	18.7	27.6	14.4	8.6	3.7

Source: Company, Emkay Research

**Key financials – Quarterly**

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
<b>Revenue</b>	<b>421</b>	<b>507</b>	<b>410</b>	<b>484</b>	<b>472</b>	<b>12.2</b>	<b>-2.5</b>	<b>1,367</b>	<b>1,116</b>	<b>22.4</b>
<b>Expenditure</b>	<b>242</b>	<b>299</b>	<b>280</b>	<b>284</b>	<b>335</b>	<b>38.3</b>	<b>17.9</b>	<b>899</b>	<b>717</b>	<b>25.5</b>
as % of sales	57.6	59.0	68.1	58.8	71.0			65.8	64.2	
Employee Cost	160	205	190	199	226	40.8	13.2	615	480	28.2
as % of sales	38.1	40.4	46.4	41.1	47.8			45.0	43.0	
Selling & Administrative Expenses	29	30	32	35	37	26.0	5.6	104	95	9.2
as % of sales	7.0	5.9	7.7	7.2	7.8			7.6	8.5	
Other Expenses	53	64	58	50	73	37.8	45.2	180	142	27.1
as % of sales	12.5	12.7	14.0	10.4	15.4			13.2	12.7	
<b>EBITDA</b>	<b>178</b>	<b>208</b>	<b>131</b>	<b>200</b>	<b>137</b>	<b>-23.4</b>	<b>-31.5</b>	<b>467</b>	<b>399</b>	<b>17.0</b>
Depreciation	10	12	10	12	11	7.8	-2.9	33	29	11.7
<b>EBIT</b>	<b>168</b>	<b>196</b>	<b>121</b>	<b>188</b>	<b>125</b>	<b>-25.3</b>	<b>-33.3</b>	<b>434</b>	<b>370</b>	<b>17.4</b>
Other Income	34	34	34	23	44	30.6	94.1	101	107	-5.9
Interest	0	0	0	0	0			0	0	
<b>PBT</b>	<b>202</b>	<b>230</b>	<b>155</b>	<b>211</b>	<b>170</b>	<b>-15.9</b>	<b>-19.5</b>	<b>536</b>	<b>477</b>	<b>12.2</b>
Total Tax	59	67	51	70	57	-3.9	-18.2	178	190	-6.5
<b>Adjusted PAT</b>	<b>144</b>	<b>162</b>	<b>104</b>	<b>141</b>	<b>113</b>	<b>-21.4</b>	<b>-20.1</b>	<b>358</b>	<b>318</b>	<b>12.6</b>
(Profit)/loss from JV's/Ass/MI	0	1	2	3	4			9	0	
<b>APAT after MI</b>	<b>144</b>	<b>161</b>	<b>102</b>	<b>138</b>	<b>109</b>	<b>-24.2</b>	<b>-21.3</b>	<b>349</b>	<b>318</b>	<b>9.7</b>
Extra ordinary items	2	-3	2	3	0			5	58	
Reported PAT	146	159	106	144	113	-22.6	-21.7	363	376	-3.5
Reported EPS	14.6	15.9	10.6	14.4	11.3	-22.6	-21.7	36.3	37.6	-3.5

**Margins (%)**

EBIDTA	42.4	41.0	31.9	41.2	29.0	-1343	-1228	34.2	35.8	-159
EBIT	39.9	38.7	29.5	38.8	26.6	-1334	-1227	31.8	33.1	-135
EBT	48.0	45.4	37.8	43.6	35.9	-1202	-761	39.2	42.8	-359
PAT	34.1	31.9	25.4	29.2	23.9	-1022	-529	26.2	28.5	-230
Effective Tax rate	28.9	29.9	32.6	32.6	33.5	464	97	32.9	33.6	-71

Source: Company, Emkay Research

**Traction in other businesses continues**

The traction in ICRA's other businesses continued well as the revenues grew by 15.4% qoq and 16.8% yoy.

Rs mn	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
Consulting Fees	62	78	51	57	68	10.6	19.8	176	138	27.1
Information Services Fees	10	15	7	6	9	-9.8	51.4	22	26	-17.5
KPO/BPO Services Fees	24	49	31	30	34	38.9	12.8	95	77	22.7
Professional Services Fees	52	34	50	56	61	18.8	8.8	168	144	16.5
<b>Total</b>	<b>147</b>	<b>176</b>	<b>140</b>	<b>149</b>	<b>172</b>	<b>16.8</b>	<b>15.4</b>	<b>460</b>	<b>386</b>	<b>19.3</b>

Source: Company, Emkay Research

**Lower revenue growth and amortisation of ESOP hit operating profit**

A slower revenue growth at 12.4% and amortisation of ESOP expenses have hit margins harder and the EBIDTA margins were down by ~1350bps yoy.

ICRA has started amortising ESOP expenditure i.e Rs28mn/quarter from Q3FY11 onwards and will continue to do so for next 11 quarters. ICRA has also paid Rs16-17mn of consultancy charges during the quarter which are of one time nature. Adjusted for these two, the EBIDTA margins would have declined by ~390bps yoy and 275bps qoq to 38.5%.

**Segmental results (reported)**

	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11	YoY (%)	QoQ (%)	YTD'11	YTD'10	YoY (%)
<b>EBIT (Rs mn)</b>										
Rating Services	159	214	150	216	145	-8.6	-32.8	511	423	20.9
Consulting	17	17	0	10	19			30	4	
Information Services	7	3	-3	-4	-2			-8	2	
KPO/BPO Services	11	16	6	3	5			14	28	
Professional Services	0	-14	-2	3	12			12	-5	
<b>Total</b>	<b>194</b>	<b>235</b>	<b>151</b>	<b>228</b>	<b>179</b>	<b>-7.7</b>	<b>-21.6</b>	<b>558</b>	<b>452</b>	<b>23.5</b>
<b>EBIT margins (%)</b>										
Rating Services	58.0	64.5	55.3	64.4	48.3	-969	-1,613	56.4	57.9	-152
Consulting	28.0	22.2	0.4	18.1	28.2			16.9	2.6	
Information Services	72.1	21.6	-36.7	-64.1	-19.7			-37.2	7.3	
KPO/BPO Services	44.7	31.6	19.2	10.4	14.9			14.9	36.8	
Professional Services	0.1	-42.7	-4.9	4.6	18.8			6.9	-3.3	
<b>Total</b>	<b>46.1</b>	<b>46.4</b>	<b>36.7</b>	<b>47.2</b>	<b>37.9</b>	<b>-816</b>	<b>-924</b>	<b>40.8</b>	<b>40.5</b>	<b>36</b>

Source: Company, Emkay Research

**One off hits net profit hard as well**

Driven by lower operating profit the net profit declined by 21.4% yoy to Rs113mn. However adjusted for the amortisation expenses net profit would have declined by a lower 1.9% to Rs141mn.

**Valuation and view**

We are downgrading our adjusted earnings for FY11/12/13 by 4-8% to take into account slower than expected revenue growth. We retain our ACCUMULATE rating on the stock with revised TP of Rs1,370. We have revised our TP by 12% in line with 8% downward revision in earnings and lower cash per share.

## Key Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
<b>Net Sales</b>	<b>1,623</b>	<b>1,948</b>	<b>2,337</b>	<b>2,805</b>
<i>Growth (%)</i>	<i>19.5</i>	<i>20.0</i>	<i>20.0</i>	<i>20.0</i>
<b>Expenditure</b>	<b>1,009</b>	<b>1,212</b>	<b>1,404</b>	<b>1,684</b>
Employee Cost	685	822	986	1,182
Employee Cost	125	150	175	210
Other Exp	200	240	243	291
<b>EBITDA</b>	<b>614</b>	<b>736</b>	<b>934</b>	<b>1,121</b>
<i>Growth (%)</i>	<i>9.8</i>	<i>19.8</i>	<i>26.9</i>	<i>20.1</i>
<b>EBITDA margin (%)</b>	<b>37.8</b>	<b>37.8</b>	<b>39.9</b>	<b>40.0</b>
Depreciation	41	45	50	56
<b>EBIT</b>	<b>706</b>	<b>825</b>	<b>1,028</b>	<b>1,221</b>
<b>EBIT margin (%)</b>	<b>43.5</b>	<b>42.4</b>	<b>44.0</b>	<b>43.5</b>
Other Income	134	134	145	155
Interest expenses	0	0	0	0
<b>PBT</b>	<b>793</b>	<b>767</b>	<b>916</b>	<b>1,109</b>
<b>Tax</b>	<b>258</b>	<b>250</b>	<b>298</b>	<b>361</b>
<i>Effective tax rate (%)</i>	<i>32.5</i>	<i>32.5</i>	<i>32.5</i>	<i>32.5</i>
<b>Adjusted PAT</b>	<b>477</b>	<b>557</b>	<b>694</b>	<b>824</b>
<i>Growth (%)</i>	<i>16.0</i>	<i>16.8</i>	<i>24.6</i>	<i>18.7</i>
<b>Net Margin (%)</b>	<b>29.4</b>	<b>28.6</b>	<b>29.7</b>	<b>29.4</b>
(Profit)/loss from JVs/Ass/MI	-	-	-	1.00
<b>Adjusted PAT After JVs/Ass/MI</b>	<b>477</b>	<b>557</b>	<b>694</b>	<b>824</b>
E/O items	86	-58	-112	-112
<b>Reported PAT</b>	<b>535</b>	<b>517</b>	<b>618</b>	<b>748</b>
<i>Growth (%)</i>	<i>37.1</i>	<i>-3.2</i>	<i>19.4</i>	<i>21.0</i>

## Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
<b>PBT (Ex-Other income)</b>	<b>659</b>	<b>691</b>	<b>884</b>	<b>1065</b>
Depreciation	41	45	50	56
Interest Provided	-92	0	0	0
Other Non-Cash items	-115	28	119	98
Chg in working cap	49	-291	-429	-446
Tax paid	-258	-250	-298	-361
<b>Operating Cashflow</b>	<b>418</b>	<b>358</b>	<b>470</b>	<b>567</b>
Capital expenditure	-66	-41	-45	-50
<b>Free Cash Flow</b>	<b>353</b>	<b>316</b>	<b>425</b>	<b>517</b>
Other income	322	134	145	155
Investments	-355	-37	0	0
<b>Investing Cashflow</b>	<b>-238</b>	<b>-78</b>	<b>-45</b>	<b>-50</b>
Equity Capital Raised	-	-	-	-
Loans Taken / (Repaid)	-	-	-	1.00
Interest Paid	(0.05)	-	-	-
Dividend paid (incl tax)	-141	-149	-199	-224
Income from investments				
Others	0	0	0	0
<b>Financing Cashflow</b>	<b>-141</b>	<b>-149</b>	<b>-199</b>	<b>-224</b>
<b>Net chg in cash</b>	<b>40</b>	<b>130</b>	<b>226</b>	<b>293</b>
Opening cash position	69	109	239	465
<b>Closing cash position</b>	<b>109</b>	<b>239</b>	<b>465</b>	<b>758</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11E	FY12E	FY13E
Equity share capital	100	100	100	100
Reserves & surplus	2,022	2,328	2,666	3,098
<b>Net worth</b>	<b>2,122</b>	<b>2,428</b>	<b>2,766</b>	<b>3,198</b>
<b>Minority Interest</b>				
Secured Loans	0	0	0	0
Unsecured Loans	0	0	0	0
<b>Loan Funds</b>				
Net deferred tax liability	-10	-10	-10	-10
<b>Total Liabilities</b>	<b>2,112</b>	<b>2,419</b>	<b>2,756</b>	<b>3,188</b>
Gross Block	473	515	560	610
Less: Depreciation	232	277	327	383
<b>Net block</b>	<b>242</b>	<b>238</b>	<b>233</b>	<b>227</b>
Capital work in progress	-	-	-	-
<b>Investment</b>	<b>746</b>	<b>783</b>	<b>783</b>	<b>783</b>
<b>Current Assets</b>	<b>2,154</b>	<b>2,462</b>	<b>2,931</b>	<b>3,477</b>
Inventories	-	-	-	-
Sundry debtors	366	439	527	633
Cash & bank balance	109	239	465	758
Loans & advances	557	572	589	610
Other current assets	1,122	1,212	1,349	1,476
<b>Current lia &amp; Prov</b>	<b>1,029</b>	<b>1,065</b>	<b>1,191</b>	<b>1,298</b>
Current liabilities	538	545	552	562
Provisions	492	520	639	736
<b>Net current assets</b>	<b>1,124</b>	<b>1,397</b>	<b>1,740</b>	<b>2,178</b>
Misc. exp	0	0	0	0
<b>Total Assets</b>	<b>2,112</b>	<b>2,419</b>	<b>2,756</b>	<b>3,188</b>

## Key Ratios

Y/E, Mar	FY10	FY11E	FY12E	FY13E
<b>Profitability (%)</b>				
EBITDA Margin	37.8	37.8	39.9	40.0
Net Margin	29.4	28.6	29.7	29.4
ROCE	36.2	36.4	39.7	41.1
ROE	24.2	24.5	26.7	27.6
RoIC				
<b>Per Share Data (Rs)</b>				
EPS	47.7	55.7	69.4	82.4
CEPS	52.6	61.3	75.1	89.0
BVPS	212.2	242.8	276.6	319.8
DPS	1.5	1.8	2.4	2.7
<b>Valuations (x)</b>				
PER	24.8	21.3	17.1	14.4
P/CEPS	23	19	16	13
P/BV	5.6	4.9	4.3	3.7
EV / Sales	6.2	5.1	4.2	3.4
EV / EBITDA	16.3	13.4	10.4	8.6
Dividend Yield (%)	1.3	1.5	2.0	2.3
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	-	-	-	-
Net Debt/EBITDA	-	-	-	-
Working Cap Cycle	-	-	-	-

**Recommendation History: ICRA – ICRA IN**

Date	Reports	Reco	CMP	Target
09/11/2010	<a href="#"><u>ICRA Q2FY11 Result Update</u></a>	Accumulate	1,420	1,550
13/08/2010	<a href="#"><u>ICRA Q1FY11 Result Update</u></a>	Reduce	1,219	1,200
19/05/2010	<a href="#"><u>ICRA Q4FY10 Result Update</u></a>	Reduce	967	800
21/01/2010	<a href="#"><u>ICRA Q3FY10 Result Update</u></a>	Reduce	851	800

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
02/02/2011	<a href="#"><u>Andhra Bank Q3FY11 Result Update</u></a>	Buy	137	165
31/01/2011	<a href="#"><u>Canara Bank Q3FY11 Result Update</u></a>	Hold	602	640
28/01/2011	<a href="#"><u>Bank of Baroda Q3FY11 Result Update</u></a>	Buy	835	1,160
28/01/2011	<a href="#"><u>Allahabad Bank Q3FY11 Result Update</u></a>	Buy	202	250

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