

IPO NOTE

Issue Snapshot:

Issue period: Mar 20th,07 – Mar 23rd,07
Price band: Rs 275 - Rs 330 per share

Issue Size: Rs 70.98 cr – Rs 85.17 cr
Issue Size: 2,581,100 equity shares

Offer of sale: 2,581,100 equity shares
QIBs: 1,290,550 equity shares
HNIs: 387,165 equity shares
Retail: 903,385 equity shares

Preferential Allotment: 1,194,900 equity shares
Moody's India: 288,900 equity shares
ESOP : 906,600 equity shares

Capital Structure:

Pre Issue Equity: Rs 8.8 cr
Post issue Equity: Rs 10.0 cr

Face Value: Rs 10 each
100% book building issue
Bid Size: 20 equity shares and in multiples thereof.

Listing: BSE & NSE
Lead Managers: SBI Capital Markets, Kotak Mahindra Capital Company.

Underwriters: SBI Capital Markets, Kotak Mahindra Capital Company, Kotak Securities, SBI Cap Securities.

	Pre Issue %	Post issue %
Shareholding pattern		
Moody's Investment	29.1	28.5
IFCI	21.1	-
SBI	11.6	10.0
LIC	8.7	7.7
Undertaking of UTI	7.9	-
Punjab National Bank	6.0	5.3
GIC	5.8	5.1
Central bank of India	2.9	2.6
Allahabad Bank	1.9	1.7
Indian Bank	1.2	1.0
Canara Bank	1.0	0.9
UCO Bank	1.0	0.9
Andhra Bank	1.0	0.9
Mr Ajay Kumar Kayan	0.4	0.4
OBC	0.4	0.4
ESOS	-	9.1
Public	-	25.8
Total	100.0	100.0

ICRA Ltd

Mar 15, 2007

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Company Background:

Background: Established in 1991, ICRA is one of the four credit rating agencies in India providing a wide range of products and services. It was formed by a consortium of financial/investment institutions, commercial banks and financial services companies. The company is promoted by Moody's India (part of the Moody's Group). Moody's Investors Service (an international rating agency) provides technical services to ICRA.

Subsidiaries: ICRA has three subsidiaries namely, ImaCS, ICTEAS and ICRA Online. ICRA Management Consulting Services Ltd (ImaCS) provides management consulting services to clients based in India and abroad. ICRA Techno Analytics Ltd (ICTEAS) is engaged in the business of providing business solutions and computer aided engineering services. ICRA Online provides mutual fund based information services, outsourcing services, technology solutions targeted at distributors of third party financial products, insurance brokers and stock broking houses.

Products: ICRA is primarily engaged in providing rating services. In addition, along with its subsidiaries, ICRA provides (i) Consulting services, (ii) Information technology based services, (iii) Information services, and (iv) Outsourcing services.

Divisions: ICRA has five main business divisions namely Rating Services, Consulting Services, Information technology based services, Information Services and Outsourcing Services. The rating services are provided to four main domains – Corporate & Infrastructure, Financial Sector, Structured Finance and Public Finance. Consulting Services are provided by ImaCS, Information technology services by ICTEAS and Outsourcing Services by ICRA Online.

Objects of Issue & Investment Schedule:

The offer does not include any fresh issuance of equity shares by ICRA. However, it will make a preferential allotment of 288,900 equity shares to Moody's India and 906,00 equity shares to ESOS Welfare Trust. The object of the issue is to carry out the sale of up to 2,581,100 equity shares by selling shareholders. The listing will enhance the brand name, provide liquidity to the existing shareholders & employees who would be allotted equity shares under the ESOP Scheme and provide a public market for equity in India.

Particulars	Equity shares	Equity shares
Equity shares outstanding prior to Offer and Preferential allotment		8,805,100
Offer of sale by selling shareholders		2,581,100
<i>IFCI</i>	1,860,600	
<i>Administrator of specified undertaking of UTI</i>	700,000	
<i>State Bank of India</i>	20,500	
Preferential allotment		1,194,900
<i>Moody's India</i>	288,900	
<i>ESOS Welfare Trust</i>	906,000	
Equity shares outstanding post Offer and Preferential allotment		10,000,000

Highlights:

Presence of few players in the industry: ICRA is one amongst the four credit rating agencies in India, the other three being CRISIL, Fitch India and CARE. In FY06, it rated Rs 1,389.49 billion volume of debt and had 398 rated published issuers and for the nine months period ended Dec 06, it rated Rs. 988.64 billion volume of debt and had 399 rated published issuers. In particular, ICRA enjoys a strong market position for credit ratings in the financial sector and structured finance.

Strong in financial sector and structured finance: The contributions from these sectors have been steady. The Financial sector accounted for 60% of the total revenues of the rating business (Rs 282.06 mn) for the nine months period ended Dec'06 and 53.6% in FY06 (Rs 302.62 mn). The revenues from Structured finance accounted for 8.15% of the total revenues of the rating business (Rs 282.06 mn) for the nine months period ended Dec'06 and 12% in FY06 (Rs 302.62 mn).

Reaping benefits of consolidation and sector growth: ICRA's revenues have seen a surge of 46% in FY06 over FY05. The growth is accounted mainly because of increase in the revenues from rating & consulting services and due to consolidation of revenues of ICTEAS and ICRA Online. The company is expected to reap further benefits of the consolidation in the coming fiscals. The revenues from rating services provided by ICRA increased during fiscal 2006 primarily on account of significant growth in financial sector ratings business and increase in the number of ratings assigned by them. This growth can be primarily attributed to an increase in the issuance of subordinated debt instruments and certificate of deposits by financial institutions and banks. The revenues for the rating division from financial sector in FY06 were Rs 162.31 million as against Rs 107.48 million in fiscal 2005, an increase of 50.17%.

New product segments to drive growth: Going forward, ICRA would see significant growth in revenues on account of business generated from Information technology based services and Outsourcing Services. ICTEAS and ICRA Online, which provide Information technology based services and Outsourcing Services respectively, became subsidiaries of the company in FY06.

Information technology based services: The business solutions provided by ICTEAS include: (i) Turf View Distribution - A solution to aid large organization to manage sales through a network of distributors. (ii) Turf View Customer Care -A solution aimed to manage service franchisee operations for consumer durables (iii) Customized Solutions - Development of tailor-made software solutions for business applications that may be web-based or client server solutions. The clients of ICTEAS include BP Lubricants and Judge Technical Staffing.

The segment accounted for 15.84% and 14% of the total revenues for the 9 Mth ended Dec 06 (Rs 512.5 mn) and FY06 (Rs 559.09 mn) respectively. The growth in the revenue of ICTEAS from information technology based services was due to increased revenues from existing clients and acquisition of new clients for both business solutions as well as computer aided engineering services and that of ICRA Online was due to increase in the client base and higher value of contracts.

Revenues from Information technology based services (Amount in Rs Mn)	FY06	FY05	Growth (%)
ICTEAS	66.06	42.59	55.11
ICRA Online	12.55	9.17	36.86
Total	78.61	51.76	51.87

Outsourcing Services: This includes technology solutions, both in the form of products and services, targeted at distributors of third party financial products, insurance brokers and stock broking houses. The segment accounted for 5.3% and 2.7% of the total revenues for the 9 Mth ended Dec 06 (Rs 512.5 mn) and FY06 (Rs 559.09 mn) respectively. The revenues from outsourcing services increased mainly because of increase in the revenue from services provided to Moody's Investors Service.

Potential in the related industry: The software and outsourcing services provided by rating agencies include data analytics, research, risk assessment & management, domain knowledge, high-end knowledge and research process outsourcing. The size of the Indian IT services/software products industry is estimated at Rs 981 bn during FY06, accounting for 3.1% of GDP. The industry reported a CAGR of 28% in revenue for the period FY04-06. Within the IT industry, Software/IT services constitute the largest segment with revenues of around Rs. 772 bn.

Indian IT-ITES industry is expected to exceed US\$ 36 bn in annual revenue in FY05-06, a growth of nearly 28%. Apart from other triggers, growth is expected to be driven by the expansion of service portfolio to lower-cost, remote/virtual delivery models, thereby increasing the addressable market for service providers.

Expansion of global capabilities: For the Consulting Services, Outsourcing Services and Information technology based services, ICRA plans internal growth through formation of alliances, joint ventures outside India. The alliances and joint ventures will help ICRA to develop new markets, enhance services and increase market presence. To increase its presence in the US, ICTEAS is planning to incorporate a subsidiary in the US.

Strong parentage: ICRA benefits from a strong promoter i.e Moody's group. Moody's Corporation is the holding company for Moody's Investors Service which performs financial research and analysis on commercial and government entities. Moody's has a 40% share in the world credit rating market. ICRA provides certain outsourcing services to the Moody's Group. Moody's Investors Service tracks debt covering more than 100 countries, 11,000 company issuers, 25,000 public finance issuers and 70,000 structured finance obligations. In addition to its ratings business, the Moody's Corporation publishes credit opinions, deal research and commentary serving more than 7,300 customer accounts across the world. As of December 31, 2006, Moody's Corporation employs approximately 3,400 people in 24 offices worldwide. ICRA intends to further develop its relationship with the Moody's Group and to explore various business opportunities with them.

Industry:

Highly penetrated: The ratings over the years have achieved market penetration across various industries and companies. In 2004-05, of the total debt with tenor or put/call option of one year or above of Rs 55,384 cr that was placed privately, Rs 53,749 cr was credit rated. That is a credit rating penetration level of 97%. For 2005-06 the total privately placed debt was Rs. 79,445.82 cr, the rated amount was Rs. 76,463.32 cr, leading to a penetration level of 96.25%.

Market Size: The rating industry in India has registered a growth in the last three years. The average outstanding rated commercial paper grew by 50.56% in FY05 over FY04 and by 47.35% in FY06. Similarly rated corporated bonds grew by 15% in FY05 over FY04 and by 32% in FY06.

Recent Developments - IPO Grading: In the 'Amendments to SEBI (Disclosure and Investor Protection) DIP Guidelines, 2000' released on April 24, 2006, SEBI has included a new clause on IPO grading. As per the clause, an unlisted company making an IPO of equity shares or any other security that may be converted into or exchanged with equity shares at a later date may opt to obtain grading for such an IPO from one or more credit rating agencies. Although this is a newly introduced concept, it provides great growth opportunity for domestic ratings agencies on the back of the increasing number of IPOs in the primary market. The amount raised from IPOs has increased from Rs 178.21 bn in FY04 to Rs 214.32 bn in FY05 to Rs 236.84 bn in FY06.

Concerns:

- The volume of revenues is dependent on the volume and number of debt securities issued in the Indian capital markets. Nearly 55% of ICRA's revenues were on account of the rating services, which are primarily linked to the issuance of debt securities in the Indian capital markets.
- Any variation in interest rates and credit spreads, volatility in corporate bonds market or interest rate environment, foreign exchange fluctuations, defaults of significant issuers and other market and economic factors both domestically and globally may negatively impact the issuance of credit sensitive products and other financial services.
- The company faces increased pricing pressures from its competitors. In addition, for the consulting services business IMAcS competes with various players including investment banks and consulting organizations.
- The consulting market is large and diversified across several industries/sectors, and the market is fragmented across several consulting firms. However, the demand for consulting services tends to fluctuate and skilled resources are expensive and difficult to source.
- ICRA is over dependent on the financial sector & structured finance. Any slowdown in demand for rating services from these areas could impact its revenue growth.

Financials

Profit & Loss Account for the year ended (Rs.Mn)	9 Mths ended	Year ended		
	Dec' 06	Mar-06	Mar-05	Mar-04
Rating Services	285.18	312.94	256.16	244.88
Consulting Services	87.52	121.33	95.07	71.75
Information technology services	81.16	78.30	0.00	0.00
Information Services	14.51	15.58	14.43	10.47
Outsourcing services	27.04	15.06	5.86	1.59
Other Income	17.09	15.88	11.15	20.79
Total Income	512.50	559.09	382.67	349.48
Total Expenditure	330.01	369.75	281.39	231.54
PBIDT	182.49	189.34	101.28	117.94
Interest	0.02	1.35	0.00	0.00
Depreciation	20.38	23.12	14.25	13.74
Total Tax	48.45	56.27	31.70	37.46
EOI	-22.23	-33.49	-25.62	-43.84
PAT	135.87	142.09	80.95	110.58
OPM%	35.61	33.87	26.47	33.75
NPM%	26.51	25.41	21.15	31.64
Eqty Share Capital	88.05	88.05	88.05	88.05
Post Issue Eqty capital	100.0	100.0	100.0	100.0
EPS	15.4	16.1	9.2	12.6
EPS on fully diluted equity	13.6	14.2	8.1	11.1

Conclusion:

At a price band of Rs 275 – Rs 330, the stock is offered at 15.2x – 18.2x FY07 fully diluted EPS. Given the steady economic growth, visibility in revenues on account of consolidation and widening of services, one could see continued growth in topline and bottomline of the company. The new segments like the Information Technology services and Outsourcing services could bring in large contracts from the IT sector thus giving a thrust to margins going forward apart from diversifying revenue streams. Any move in future by Moody's to hike its stake in the company from the current 28.1% (Post issue) could be a further trigger.

Selling shareholders of ICRA are offering shares at 15.2x – 18.2x FY07 EPS (Post issue). This is cheap compared to the valuation at which its large competitor, CRISIL quotes. Although CRISIL is much larger in terms of size/services offered and S&P holds 55% of CRISIL's equity, the IPO of ICRA offers scope for gains due to expected narrowing of the valuation difference unless the valuation of CRISIL itself falls dramatically by the time ICRA's shares are listed. One could apply in this issue for listing gains.

Business Mix Comparison between CRISIL and ICRA:

Business Mix - CRISIL	Dec 06 (12) (Rs Mn)	Business Mix - ICRA	Dec 06 (9) (Rs Mn)	Mar 06 (12) (Rs Mn)
Rating Services	904.7	Rating Services	285.18	312.94
Advisory Services	893.9	Consulting Services	87.52	121.33
Research & Information Services	1,074.7	Information technology services	81.16	78.30
		Information Services	14.51	15.58
		Outsourcing services	27.04	15.06
Total	2,873.3		495.41	543.21

Financial and valuation comparison between CRISIL and ICRA:

Particulars	CRISIL - Consolidated		ICRA - Consolidated	
	(12 Mth) Dec 06	(12 Mth) Dec 06	(12 Mth) Mar 06	(9 Mth) Dec 06
Net Sales (Rs Mn)	2,873.2	543.2	495.4	
PAT (Rs Mn)	614.3	142.0	135.8	
PBIDT (Rs Mn)	880.8	189.3	182.5	
Equity (Rs Mn)	67.6	100.0	100.0	
EPS (Rs)	90.8	14.2	13.6	
Price (Rs)	2,281.6	275 - 330	275 - 330	
Market Capitalisation (Rs Mn)	15,423.9	2,750 - 3,300	2,750 - 3,300	
Networth (Rs Mn)	1,318.7	932.6	1,065.3	
Capital Employed (Rs Mn)	1,318.7	933.3	1,065.7	
RONW (%)	*46.5	15.2	12.7	
ROCE (%)	*66.8	20.2	17.1	
BV (Rs)	241.1	93.2	106.5	
PE	25.1	-	15.2 – 18.2	
OPM%	30.6	34.8	36.8	
NPM%	21.3	26.1	27.4	
Promoter	Standard & Poor	Moody's Investment	Moody's Investment	
Promoter stake (%)	55.0	29.1	28.5	

* For the yr ended Dec 05 (9 Mths)

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