

Subsidiaries continue to add to the margin pressure

November 02, 2012

Rating	Previous Reco
Hold	Hold
CMP	Target Price
Rs1,368	Rs1,300
EPS Chg FY13E/FY14E (%)	-11/-12
Target Price change (%)	NA
Nifty	5,698
Sensex	18,755

Price Performance

(%)	1M	3M	6M	12M
Absolute	6	16	21	38
Rel. to Nifty	7	6	12	29

Source: Bloomberg

Relative price chart



Source: Bloomberg

Stock Details

Sector	Non Banking Financial Company
Bloomberg	ICRA IB
Equity Capital (Rs mn)	100
Face Value(Rs)	10
No of shares o/s (mn)	10
52 Week H/L	1,417/ 793
Market Cap (Rs bn/USD mn)	14/ 254
Daily Avg Volume (No of sh)	6,896
Daily Avg Turnover (US\$m)	0.2

Shareholding Pattern (%)

	Sep12	Jun12	Mar12
Promoters	28.5	28.5	28.5
FII/NRI	8.3	8.0	7.4
Institutions	43.3	43.2	43.0
Private Corp	4.0	4.0	4.1
Public	16.0	16.3	17.1

Source: Capitaline

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- ICRA's Q2FY13 op. revenue broadly inline with exp at Rs624mn, however with lower other income and higher opex, adj. net profit came in significantly below exp at Rs110mn
- Rating revenue grew by 2.5%yoy as expected, as poor credit offtake and sluggish bond market activity continue impact business
- Slower revenue growth with sharp rise in opex in subsidiary companies taking toll on margins. Blended EBIDTA margin fell to 26% from 37% in Q2FY13
- Cut FY13/14 earnings estimates by 11%/12% to factor in lower other income and higher opex. Maintain HOLD with price target of Rs1,300

Results below exp; cost pressures in subsidiaries pull down earnings

ICRA's Q2FY13 operating revenues were broadly inline with expectation at Rs624mn, even as with lower other income (Rs8mn) and higher opex (up 42% qoq), net profit (adjusted for tax write back of Rs45.6mn and esop exp of Rs15.8mn) came in significantly below expectation at Rs110mn. **Revenue for the quarter also includes Rs90mn revenue from BPA technologies which was acquired in May 2012. Adjusted for the same the revenue growth for the quarter was just 2.9%yoy.**

We are quite surprised with sharp 15%qoq increase in subsidiaries opex, due to which consolidated EBIDTA margins came down from 37.3% in Q2FY12 to 26% in Q2FY13. ICRA has shifted almost its entire investment book to Fixed Maturity Plans/short term debt funds of 12-18 months maturity in earlier quarters, which had resulted in lower other income.

Exhibit 1: Income from operations

Revenues	Q4FY12	Q4FY12	Q4FY12	Q1FY13	Q2FY13	YoY (%)	QoQ (%)
Rating Services	353	369	433	278	362	2.5	30.2
Consulting	57	63	74	60	60	4.7	-0.2
KPO/BPO Serv	46	44	47	52	54	17.5	4.4
Professional Serv	62	65	72	119	148	138.0	24.9
Total revenues	519	542	626	508	624	20.3	22.8
BPA Tech	-	-	-	59	90		
Revenue ex BPA	519	542	626	450	534	2.9	-99

Source: Company, Emkay Research

Low corporate borrowings keep rating revenues under pressure

Muted credit growth at ~16%yoy and 11%yoy decline in fresh bond issuances resulted in just 2.5%yoy growth in rating revenues. We do not foresee any significant turn around in the activity levels over the next two quarters given higher interest rates and lower investment activity.

Financial Snapshot (Consolidated)

(Rsmn)

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/EBITDA	EV/P/BV
Mar										
FY11A	1,930	734	38.0	515	51.5	25.4	22.4	26.2	15.8	5.5
FY12A	2,075	755	36.4	523	52.3	1.6	19.4	25.8	14.7	4.6
FY13E	2,613	748	28.6	606	60.6	15.8	20.1	22.3	14.8	4.3
FY14E	3,099	909	29.3	684	68.4	12.8	20.9	19.7	12.2	3.9

Exhibit 2: Key financials – Quarterly

	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	YoY (%)	QoQ (%)	YTD'13	YTD'12	YoY (%)
Revenue	519	542	626	508	624	20.3	22.8	1,133	906	25.0
Expenditure	325	331	371	411	462	42.0	12.3	873	618	41.2
as % of sales	62.7	61.0	59.2	80.9	74.0			77.1	68.2	
Employee Cost	230	238	261	278	311	35.4	11.9	589	438	34.6
as % of sales	44.3	44.0	41.8	54.7	49.8			52.0	48.3	
Selling & Administrative Expenses	39	42	42	51	50	29.7	-1.4	101	75	34.5
as % of sales	7.4	7.8	6.7	10.0	8.0			8.9	8.3	
Other Expenses	56.9	50.4	67.0	82.6	100.7	77.1	22.0	183	106	73.4
as % of sales	11.0	9.3	10.7	16.2	16.1			16.2	11.7	
EBITDA	194	211	256	97	162	-16.1	67.2	259	288	-9.9
Depreciation	11	12	13	11	12	2.8	9.4	22	22	1.1
EBIT	182	200	243	86	151	-17.3	74.4	237	266	-10.8
Other Income	28	49	95	54	7.9	-71.3	-85.3	62	62	-0.8
Interest	0	0	0	0	0			0	0	
PBT	210	249	338	140	159	-24.4	13.0	299	328	-8.9
Total Tax	69	71	80	38	49	-29.4	29.6	87	102	-15.0
Adjusted PAT	140	178	259	102	110	-21.8	6.9	212	226	-5.9
(Profit)/loss from JV's/Ass/MI	0	1	0	0	0			0	0	
APAT after MI	140	177	259	102	110	-22.0	6.9	212	226	-6.1
Extra ordinary items	-54	-3	-16	-16	26			10	-104	
Reported PAT	86	174	242	87	136	56.9	56.2	223	122	82.0
Reported EPS	8.6	17.4	24.2	8.7	13.6	56.9	56.2	22	12	82.0

Margins (%)

EBIDTA	37.3	39.0	40.8	19.1	26.0	-1130	692	22.9	31.8	-885
EBIT	35.1	36.8	38.8	17.0	24.1	-1098	714	20.9	29.3	-839
EBT	40.5	45.9	54.0	27.6	25.4	-1505	-218	26.4	36.2	-981
PAT	27.0	32.8	41.4	20.2	17.6	-946	-260	18.7	24.9	-616
Effective Tax rate	44.5	29.1	24.7	30.3	26.5	-1801	-379	28.1	45.5	-1746

Source: Company, Emkay Research

High opex in subsidiaries weigh on margins

Consolidated Opex increased by 12.3%qoq to Rs462mn led by higher cost in subsidiaries. Opex in subs. increased by 15%qoq in Q2FY13, even as the increase was as high as 30% in last quarter also. Rise in opex could partially be attributed to BPA technologies, which has a net margin of just 5.2% for H1FY13, as against ~20% net margin for ex BPA business. Resultantly blended margins in conso business came down to 26% from 37.3% in Q2FY12.

Exhibit 3: Expense ratio in subsidiaries on the rise

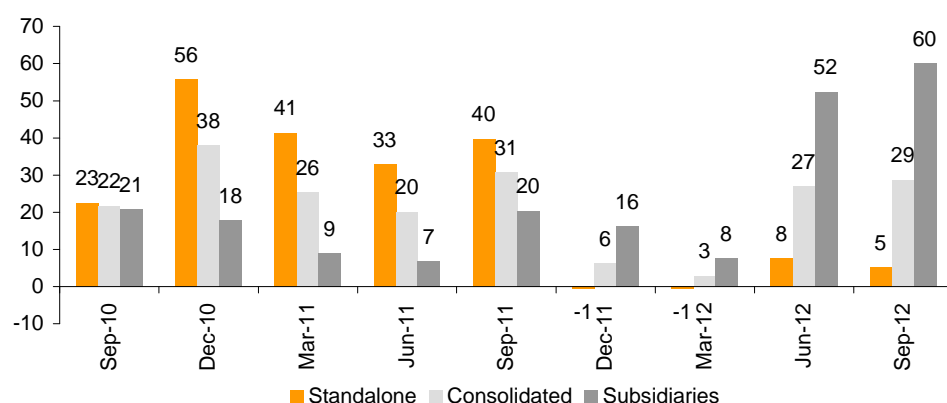
	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	YoY	QoQ
Standalone							
Revenues	353	370	433	277	361	2.4	30.5
Expenses	211	199	214	206	223	5.3	8.1
Expense ratio	60	54	49	74	62		
Consolidated							
Revenues	519	542	626	509	624	20.3	22.8
Expenses	371	355	386	427	478	28.8	11.9
Expense ratio	71	66	62	84	77		
Subsidiaries							
Revenues	166	173	193	232	263	58.4	13.5
Expenses	160	157	173	221	255	60.0	15.4
Expense ratio	96	91	89	96	97		

Source: Company, Emkay Research

Exhibit 4: Segmental results (Adjusted for ESOP expenses)

EBIT (Rs)	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	YoY (%)	QoQ (%)
Rating Services Fees	215	215	256	102	160	-25.6	56.2
Consulting Fees	-5	4	18	0	-3	-39.7	1521.3
KPO/BPO Services Fees	10	3	4	7	10	3.6	-42.5
Professional Services Fees	7	14	3	8	4	-34.0	43.7
Total	226	237	281	117	171	-24.3	46.0
EBIDTA margins (%)							
Rating Services Fees	60.8	58.2	59.0	36.8	44.1	-1665	734
Consulting Fees	-8.9	6.9	24.6	0.4	-5.1	378	-549
KPO/BPO Services Fees	21.2	7.3	7.7	13.7	18.7	-251	499
Professional Services Fees	10.5	21.4	4.3	6.4	2.9	-756	-353
Total	43.5	43.6	44.8	23.0	27.4	-1,613	436

Source: Company, Emkay Research

Exhibit 5: Expenses growth (% yoy)

Source: Company, Emkay Research

BPA technologies performance below par

BPA technologies reported revenue of USD10mn for FY12, which at 45/USD comes at Rs450mn. With rupee depreciating to now 53-54/ USD the quarterly run rate should have been about Rs130-140mn, as against the reported Rs90.5mn for the quarter. As the acquisition deal was based on performance, we believe the deal value could also come down from earlier decided USD8mn for the residual stake of 50%, if the performance continues to remain on similar lines. Moreover the net margins in BPA are barely 4-6% as against 20% for ex BPA business.

Exhibit 6: BPA Technologies

	FY12	Q1FY13	Q2FY13
Revenue	450	58.8	90.5
PAT	NA	2.2	5.7
PAT Margin	NA	3.7	6.3

Source: Company, Emkay Research Note: FY12 revenue was at USD10mn

Tax write back mitigated some of the impact on earnings

The Company reversed Income Tax provision of Rs41.9mn on FY12 ESOP expenses, thereby providing some cushion to earnings. Resultantly reported net profit grew by 56.9%yoy to Rs136mn also helped by low base. However adjusted for ESOP expenses of Rs15.8mn and tax write back, net profit declined by 21.8%yoy to Rs110mn.

Valuation and view

While poor investment activity continues to reflect in lower revenue growth, rising cost pressures in subsidiaries, which are further accentuated by recent acquisition of BPA Technologies, are eating away consolidated margins. Therefore taking above factors into consideration, we have reduced our margin assumptions from 31.8%/32.6% earlier for FY13/14 to 28.6%/ 29.3% for FY13/14 respectively. Resultantly we have cut earnings estimates by 11%/12% for FY13/14. However pick up in debt market activity and higher credit growth remains key risk (on the upside) to our earning estimates.

At CMP the stock trades at 22.3x/19.7x FY13E/14E EPS of Rs60 and Rs66. Maintain HOLD with price target maintained at Rs1300.

Key Financials (Consolidated)

Income Statement

Y/E Mar (Rsmn)	FY11A	FY12A	FY13E	FY14E
Net Sales	1,930	2,075	2,613	3,099
<i>Growth (%)</i>	42.1	7.5	25.9	18.6
Expenditure	1,197	1,319	1,865	2,190
Employee Cost	810	938	1,252	1,463
Administrative expenses	139	159	221	262
Other Exp	248	222	392	465
EBITDA	734	755	748	909
<i>Growth (%)</i>	31.2	3.0	-1.0	21.6
EBITDA margin (%)	38.0	36.4	28.6	29.3
Depreciation	45	47	55	72
EBIT	793	769	830	991
EBIT margin (%)	41.1	37.1	31.8	32.0
Other Income	105	60	138	154
Interest expenses	0	0	0	0
PBT	740	792	851	980
Tax	259	253	230	304
<i>Effective tax rate (%)</i>	35.0	31.9	27.0	31.0
Adjusted PAT	515	523	606	684
<i>Growth (%)</i>	25.4	1.6	15.8	12.8
Net Margin (%)	26.7	25.2	23.2	22.1
(Profit)/loss from JVs/Ass/MI	-	-	-	-
Adjusted PAT After	515	523	606	684
E/O items	-53	23	21	-11
Reported PAT	481	539	621	676
<i>Growth (%)</i>	23.2	12.2	15.2	8.8

Cash Flow

Y/E Mar (Rsmn)	FY11A	FY12A	FY13E	FY14E
PBT (Ex-Other income)	635	731	713	826
Depreciation	45	47	55	72
Interest Provided	-75	-32	0	0
Other Non-Cash items	-41	-156	275	74
Chg in working cap	-28	-43	-105	-106
Tax paid	-241	-303	-230	-304
Operating Cashflow	475	390	904	734
Capital expenditure	-47	-41	-248	-156
Free Cash Flow	428	349	655	578
Other income	276	158	-62	54
Investments	-1145	-308	-4	0
Investing Cashflow	-1022	-243	-452	-256
Equity Capital Raised	-	-	-	-
Loans Taken / (Repaid)	-	-	-	1.00
Interest Paid	(0.01)	(0.05)	-	-
Dividend paid (incl tax)	-198	-202	-278	-278
Income from investments	-	-	-	-
Others	0	43	0	0
Financing Cashflow	-198	-159	-278	-278
Net chg in cash	-744	-12	173	200
Opening cash position	1165	420	409	582
Closing cash position	420	409	582	783

Balance Sheet

Y/E Mar (Rsmn)	FY11A	FY12A	FY13E	FY14E
Equity share capital	100	100	100	100
Reserves & surplus	2,375	2,813	3,013	3,329
Net worth	2,475	2,913	3,113	3,429
Minority Interest				
Secured Loans	0	0	0	0
Unsecured Loans	0	0	0	0
Loan Funds				
Net deferred tax liability	-21	-26	-26	-26
Total Liabilities	2,455	2,886	3,086	3,402
Gross Block	521	547	795	951
Less: Depreciation	278	311	366	438
Net block	243	236	429	512
Capital work in progress	-	-	-	-
Investment	1,912	2,362	2,366	2,366
Current Assets	1,305	1,115	1,408	1,723
Inventories	-	-	-	-
Sundry debtors	324	370	466	553
Cash & bank balance	420	408	582	783
Loans & advances	504	283	301	321
Other current assets	56	53	59	66
Current lia & Prov	1,005	827	1,116	1,198
Current liabilities	465	357	371	380
Provisions	541	469	745	819
Net current assets	299	288	292	525
Misc. exp	0	0	0	0
Total Assets	2,455	2,886	3,086	3,402

Key Ratios

Y/E Mar	FY11A	FY12A	FY13E	FY14E
Profitability (%)				
EBITDA Margin	38.0	36.4	28.6	29.3
Net Margin	26.7	25.2	23.2	22.1
ROCE	34.7	28.8	27.8	30.5
ROE	22.4	19.4	20.1	20.9
RoIC	85%	94%	72%	57%
Per Share Data (Rs)				
EPS	51.5	52.3	60.6	68.4
CEPS	56.5	56.0	65.6	74.5
BVPS	247.5	291.3	311.3	342.9
DPS	17.4	20.0	24.0	24.0
Valuations (x)				
PER	26.2	25.8	22.3	19.7
P/CEPS	24	24	21	18
P/BV	5.5	4.6	4.3	3.9
EV / Sales	7.8	6.0	5.4	4.2
EV / EBITDA	15.8	14.7	14.8	12.2
Dividend Yield (%)	1.3	1.5	1.8	1.8
Gearing Ratio (x)				
Net Debt/ Equity	-	-	-	-
Net Debt/EBITDA	-	-	-	-
Working Cap Cycle (days)	-	-	-	-

Recommendation History: ICRA – ICRA IN

Date	Reports	Reco	CMP	Target
06/08/2012	ICRA Q1FY13 Result Update	Hold	1,221	1,250
14/05/2012	ICRA Q4FY12 Result Update	Accumulate	1,145	1,250
07/02/2012	ICRA Q3FY12 Result Update	Accumulate	946	1,100
02/11/2011	ICRA Q2FY12 Result Update	Reduce	990	900

Recent Research Reports

Date	Reports	Reco	CMP	Target
31/10/2012	LIC Housing Finance Q2FY13 Result Update	Accumulate	243	280
29/10/2012	Bank of India Q2FY13 Result Update	Reduce	279	240
26/10/2012	Punjab National Bank Q2FY13 Result Update	Reduce	749	610
26/10/2012	ICICI Bank Q2FY13 Results Update	Hold	1078	1100

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