# Stock Update

# ICRA Ltd.

March 2, 2023


RETAILRESEARCH

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# ICRA Ltd.

| Industry | LTP | Recommendation | Base case fair value | Bull case fair value | Time Horizon |
|---|---|---|---|---|---|
| Credit Rating | Rs 4446 | Buy in Rs 4420-4500 band & add more on dips in Rs 3930-3970 band | Rs 4890 | Rs 5230 | 2-3 quarters |

| | |
|---|---|
| HDFC Scrip Code | ICRLTDEQNR |
| BSE Code | 532835 |
| NSE Code | ICRA |
| Bloomberg | ICRA IN |
| CMP March 1, 2023 | 4445.6 |
| Equity Capital (Rs cr) | 9.7 |
| Face Value (Rs) | 10 |
| Equity Share O/S (cr) | 1.0 |
| Market Cap (Rs cr) | 4291 |
| Book Value (Rs) | 905.1 |
| Avg. 52 Wk Volumes | 7350 |
| 52 Week High (Rs) | 5455.6 |
| 52 Week Low (Rs) | 3650.0 |

| Share holding Pattern % (Dec, 2022) | |
|---|---|
| Promoters | 51.9 |
| Institutions | 33.0 |
| Non Institutions | 15.1 |
| Total | 100.0 |

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings


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## Our Take:

Recovery from the Covid pandemic has been robust and credit growth has been increasing across sectors of the economy. The improving credit growth scenario would drive higher revenues for the ratings business. Over the longer term, credit market outlook remains optimistic as support from government and regulatory authorities could enable depth in the markets which is positive for ratings business. Additionally, the share of revenue from its high margin outsourcing business is increasing and accounted for 35% of revenue in FY22. This augurs well for the company and could result in margin expansion in the coming quarters.

ICRA has expanded its offerings portfolio across all its non-ratings business segments, along with higher outreach activities leading to increase in business from existing clients along with addition of new clients. Increasing preference of sound borrowers towards bank loan alternatives has opened additional source of revenues. The long-term outlook for the ratings business remains positive, given the large funding requirements which would have to be raised through a combination of bank loans and bonds. ICRA is aiming to gain wallet share in focused large and mid-sized clients by being the preferred rating agency from lender's perspective.

On March 7, 2022, we had released a stock update report on the company (Link) with a recommendation to 'Buy in Rs 3720-3750 band & add more on dips to Rs 3350-3380 band' for fair value of Rs 4195. The stock achieved our target on March 31, 2022.

## Valuation & Recommendation:

ICRA is well placed to benefit from the revival in credit growth. We expect ICRA's revenue/PAT to grow at 15% CAGR over FY22-FY25E, led by demand revival in credit growth and strong uptick in outsourced business. ICRA has healthy cash and cash equivalents/investments on books equivalent to ~8/12% of its market cap. We believe investors can buy the stock in the band of Rs 4420-4500 and add on dips in Rs 3930-3970 band (23x Dec'24E EPS) for a base case fair value of Rs 4890 (28.5x Dec'24E EPS) and bull case fair value of Rs 5230 (30.5x Dec'24E EPS) over the next 2-3 quarters.

## Financial Summary

| Particulars (Rs cr) | Q3FY23 | Q3FY22 | YoY (%) | Q2FY23 | QoQ (%) | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | 103.0 | 86.6 | 19.0 | 98.6 | 4.5 | 342.8 | 403.7 | 462.1 | 521.2 |
| EBITDA | 36.2 | 34.6 | 4.7 | 35.5 | 2.1 | 120.6 | 141.3 | 162.7 | 182.9 |
| APAT | 38.9 | 30.9 | 25.9 | 36.7 | 5.9 | 112.3 | 132.6 | 151.8 | 170.1 |
| Diluted EPS (Rs) | 40.3 | 32.0 | 25.9 | 38.1 | 5.9 | 116.4 | 137.4 | 157.3 | 176.3 |
| RoE (%) | | | | | | 14.0 | 14.9 | 15.2 | 15.2 |
| P/E (x) | | | | | | 38.2 | 32.4 | 28.3 | 25.2 |
| EV/EBITDA (x) | | | | | | 32.5 | 27.3 | 23.1 | 19.9 |

(Source: Company, HDFC sec)

## Q3FY23 Result Update

Consolidated operating income of the company increased 19% YoY in Q3FY23 to Rs 103cr driven by traction in the ratings business and knowledge services segments. Ratings revenue increased 17.8% YoY to Rs 60cr while knowledge services segment revenue grew 25.9% to Rs 38cr. The growth in revenue was driven by 63.3% YoY increase in bond issuances across various segments such as banks, Non-Banking Finance

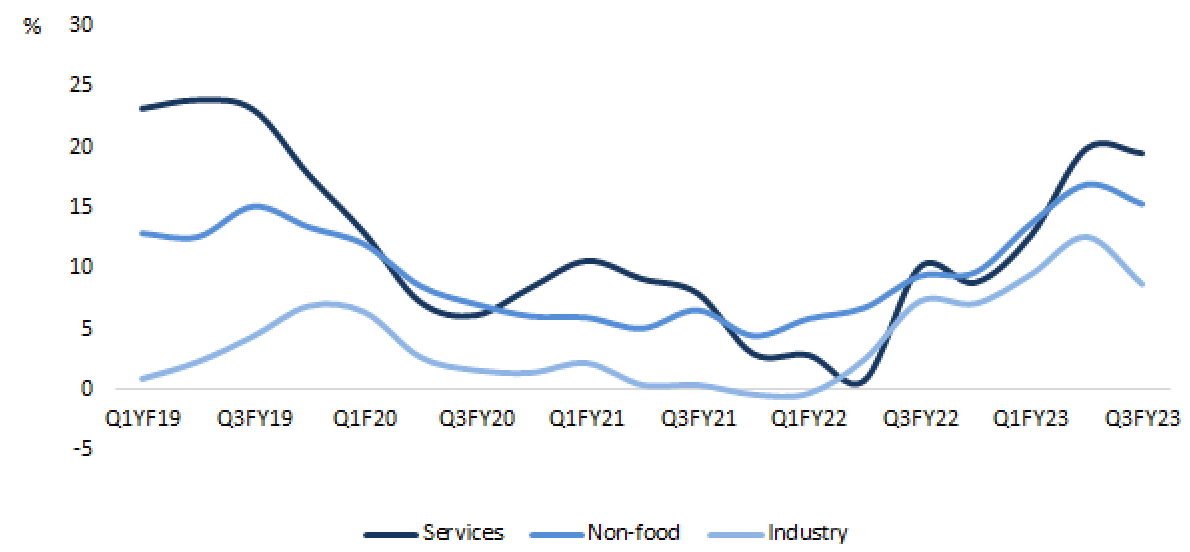
Companies (NBFCs) and corporates. Structured Finance volumes continued to grow on expected lines, driven by growth in Asset Under Management (AUMs) of NBFCs, recovering from the pandemic-led stagnation. Employee/Other expenses expanded by 26.4%/38.3% YoY. Consolidated EBITDA increased 4.7% YoY to Rs 36.2cr while margins compressed 482bps to 35.2%. PAT increased by 25.9% YoY to Rs 39cr and PAT margin expanded from 35.7% to 37.7% due to higher other income and lower tax rates.

## Key Triggers

**Credit growth expected to improve aided by Govt's push on public spending**

Bank credit offtake is expected to pick up following normalisation of economic activities aided by the government thrust on public expenditure in current fiscal year. As the Indian economy has navigated the pandemic-induced shocks, the bank credit growth by scheduled commercial banks (SCBs) improved post-August 2021 to reach a nine year high of 17.9% in late Oct'22. Apart from retail, the major driver of this growth has been the wholesale credit, which reported double-digit growth after witnessing a significant slowdown last year. Credit growth has remained strong over the last three quarters, indicating a more sustained pick-up in demand. Amid a spike in credit offtake by the industry, non-food bank credit saw 16.7% YoY growth in Jan'23, much above the 8.3% level a year ago, as per latest RBI data. The RBI said credit growth to industry accelerated to 8.7% in Jan'23 from 5.9% in the same month last year.

*Credit growth has started to pick up across sectors*




*(Source: RBI, HDFC sec)*

**Standardisation of rating scale**

To bring in uniformity, capital markets regulator SEBI, in Apr'22, came out with a standardised framework for the classification of industry, which will be used by credit rating agencies for the purpose of rating exercise and research activities. The industry classification will be applicable to credit rating agencies (CRAs) with effect from October 1, 2022. The standardised framework will help bring about uniformity in the classifications being used across sectors and in securities market. Rating agencies will have to align their rating scales with the scales prescribed under the guidelines of respective financial sector regulator or authority in terms of CRA Regulations, or in absence of the same, follow rating scales prescribed by SEBI.

**RBI's new guidance on bank loan ratings**

The central bank has said ratings given on loans to a company cannot be notched up on the basis of "diluted and non-prudent support structures" such as letter of comfort, letter of support or undertaking, and other covers like pledge of shares. Such support from the parent or promoters enables companies to reduce the cost of borrowings - as higher the rating, lower the interest charge on debt. Even for apparently more enforceable support such as corporate guarantees (as distinct from letter of comfort), RBI said such structures can be used to enhance rating only if there is a strict timeline on invocation of guarantee by lenders.

Due to the RBI's guidance, there would be situations where the same issuer has a higher rating for non-convertible debentures (NCDs) and a lower one on loan. While the RBI directive endorsed the use of corporate guarantees for 'credit enhancement' (CE) - the parlance for rating improvement - it has laid down that banks have to formally agree to a timeframe within which they would invoke a guarantee following a loan default, while the corporate guarantor has to commit to a deadline to pay up once the invocation by lenders happens.

**Revamped credit guarantee scheme to drive higher lending to MSME**

FM Nirmala Sitharaman in the Budget speech for FY24 announced launch of a revamped credit guarantee scheme worth Rs 9,000 crore for MSMEs. Sitharaman said this would enable collateral-free credit of Rs 2 lakh crore loans to the small businesses. The scheme, which will take effect from April 1, 2023, offers a helping hand to several small firms that were hurt badly when the Covid outbreak started. The infusion of Rs 9,000 crore for a credit guarantee fund means that an additional ~Rs 2 lakh crore of collateral-free funds can now flow to MSMEs, because there will be a guarantee. The Economic Survey 2022-23 revealed that the YoY growth in credit since the January-March quarter of 2022 has moved into double digits. The credit growth to the MSME sector has been remarkably high, over 30.5% on an average, during Jan-Nov 2022, supported by the extended ECLG scheme. Increased credit to the MSME sector would entail higher business for rating agencies.

**Knowledge services business growing well**

Knowledge service business has been growing well with a 29.7% revenue growth in 9MFY23 compared to overall growth of 18%. Also its EBIT margins are better at 52.5% in this period vs 33.2% for overall company. This faster growth with high margins would enable ICRA to reduce its reliance on cyclical ratings business.

## Risks & Concerns

**Rate hikes by RBI could result on slow-down in borrowings which would be unfavourable for rating agencies including ICRA**

Higher consumer inflation could drive the regulator towards a rate hike in the next few quarters. A rate hike always remains a concern, as investor’s sentiments to borrow diminishes.

**Competition from new players could hurt growth in revenues**

There are already three established players in this industry. Thus, as it is a boon it is also a threat, as in this form of market structure, companies normally tend to be price takers, and have to take the bite of severe competition. Although, very small, but, to aggravate the situation there are four more new entries (India Ratings, SMERA, Infomerics & Brickworks).

**Economic slowdown could reduce business volumes**

Credit rating volumes are directly linked with the economic growth of a country. In times of slowdown the overall volumes could take a hit reducing the scope of earnings for the company.

**Increased shift of borrowers from banks to MFs**

The dramatic growth in resources flowing to mutual funds (MFs) suggests that there is a discernible shift in the pattern of deployment of financial savings in India. This gives plenty of scope for potential movement of borrowers away from banks to mutual funds.

**Regulatory risks**

Credit rating agencies (CRAs) have come under regulatory scrutiny in the wake of loan defaults by leading corporates. To enhance CRAs' rating process and quality of disclosures, SEBI keeps prescribing higher disclosure of data by CRAs. This apart CRAs come under scrutiny of regulators and are fined for lapses that may not be fully attributable to them. SEBI also has issues on credit rating companies carrying out non-rating businesses to prevent them from assigning aggressive ratings

**Competition in non-ratings business**

In the non-ratings business i.e. Outsourced information and consulting, ICRA faces competition from other rating agencies and also from global and local consultancy firms.

**Rating standards and quality**

Rating reports are used by lenders to determine the financial viability of the entity. Failure by the company to maintain the quality of rating could result in loss of trust and impact growth.

**IRB based approach by banks**

If Banks whose clients avail Credit Rating Services under the Basel II framework migrate to the internal rating based (IRB) approach for Credit risk, it could have an adverse effect on the company's revenue and profits.

**Retention of employees, a challenge**

Employees are the core asset for a credit rating agency and hence retaining them is crucial. While ICRA remains a good paymaster, the risk of employee movement can expose it to risks of attrition, retraining and reskilling.

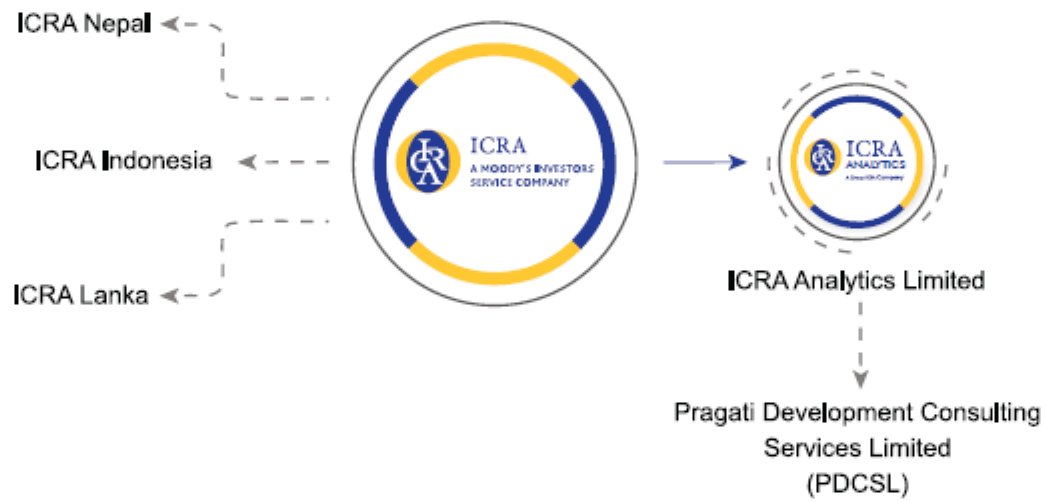
## Company Background:

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional Investment Information and Credit Rating Agency. Today, ICRA, a full-service Credit Rating Agency and has a presence in Indonesia, Sri Lanka and Nepal. ICRA is majority-held by Moody's Group, which has 51.86% equity ownership stake in the Company.

US based Moody's provides high value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India.

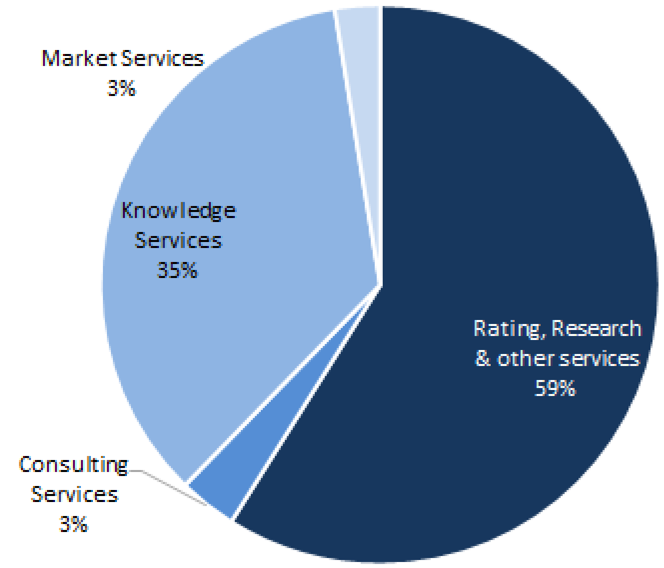
ICRA has five subsidiaries:
ICRA Management Consulting Services Ltd. (IMaCS); ICRA Online Ltd. (ICRON); PT ICRA Indonesia (ICRA Indo); ICRA Lanka Ltd. (ICRA Lanka), and ICRA Nepal Ltd. (ICRA Nepal).

*Corporate Structure*




*(Source: Company, HDFC sec)*

*Revenue breakup (FY22)*




*(Source: Company, HDFC sec)*

## Peer comparision

| (FY22) | CMP (Rs) | Mcap (Rs cr) | Net Sales (Rs cr) | OPM (%) | PATM (%) | EPS (Rs) | RoE (%) | D/E (x) | P/E (x) | P/BV (x) |
|---|---|---|---|---|---|---|---|---|---|---|
| CRISIL (CY21) | 3427 | 25025 | 2301 | 26.3 | 20.2 | 63.8 | 29.5 | 0.0 | 53.7 | 15.9 |
| ICRA | 4446 | 4291 | 343 | 35.2 | 32.8 | 116.4 | 14.0 | 0.0 | 38.2 | 5.1 |
| CARE Ratings | 650 | 1926 | 248 | 32.1 | 30.3 | 25.3 | 11.6 | 0.0 | 25.6 | 3.0 |

## Financials

### Income Statement

| (Rs cr) | FY21 | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|---|
| **Net Revenues** | **301.1** | **342.8** | **403.7** | **462.1** | **521.2** |
| ***Growth (%)*** | ***-6.2*** | ***13.9*** | ***17.8*** | ***14.5*** | ***12.8*** |
| Employee Expenses | 171.7 | 179.2 | 209.9 | 238.0 | 268.4 |
| Other Operating Expenses | 48.2 | 43.0 | 52.5 | 61.5 | 69.8 |
| **EBITDA** | **81.1** | **120.6** | **141.3** | **162.7** | **182.9** |
| ***Growth (%)*** | ***-15.3*** | ***48.6*** | ***17.2*** | ***15.1*** | ***12.5*** |
| ***EBITDA Margin (%)*** | ***26.9*** | ***35.2*** | ***35.0*** | ***35.2*** | ***35.1*** |
| Depreciation | 9.9 | 7.8 | 9.9 | 11.2 | 12.5 |
| Other Income | 42.8 | 40.9 | 48.4 | 54.5 | 60.5 |
| **EBIT** | **114.1** | **153.7** | **179.8** | **206.0** | **230.9** |
| Interest expenses | 2.1 | 1.6 | 1.7 | 1.9 | 2.1 |
| **PBT** | **112.0** | **152.1** | **178.1** | **204.1** | **228.9** |
| Tax | 29.3 | 38.6 | 44.2 | 50.8 | 57.2 |
| **PAT** | **82.7** | **113.5** | **133.9** | **153.3** | **171.6** |
| **Adj. PAT** | **81.7** | **112.3** | **132.6** | **151.8** | **170.1** |
| ***Growth (%)*** | ***-15.1*** | ***37.5*** | ***18.1*** | ***14.5*** | ***12.1*** |
| EPS | 84.6 | 116.4 | 137.4 | 157.3 | 176.3 |

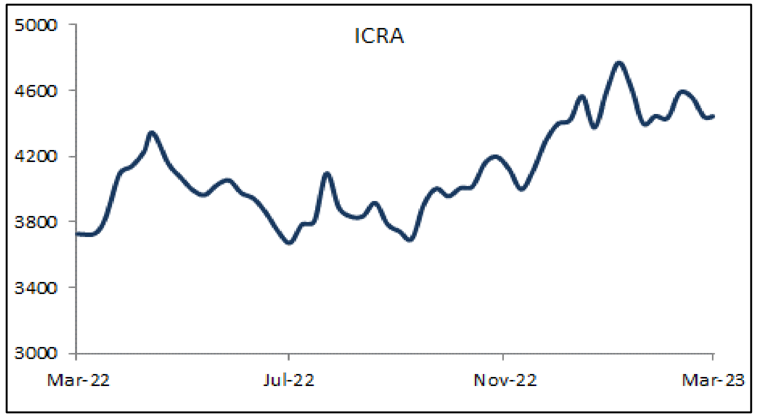
### Balance Sheet

| As at March (Rs cr) | FY21 | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|---|
| **SOURCE OF FUNDS** | | | | | |
| Share Capital | 9.7 | 9.7 | 9.7 | 9.7 | 9.7 |
| Reserves | 748.1 | 834.0 | 932.8 | 1046.0 | 1170.8 |
| **Shareholders' Funds** | **757.7** | **843.6** | **942.4** | **1055.7** | **1180.4** |
| Minority Interest | 3.3 | 4.1 | 5.4 | 6.9 | 8.4 |
| Total Debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Deferred Taxes | -5.8 | -4.6 | -4.6 | -4.6 | -4.6 |
| **Total Source of Funds** | **755.3** | **843.1** | **943.2** | **1057.9** | **1184.2** |
| **APPLICATION OF FUNDS** | | | | | |
| Net Block | 46.4 | 45.6 | 45.7 | 46.5 | 46.0 |
| CWIP | 3.4 | 1.6 | 1.6 | 1.6 | 1.6 |
| Investments | 176.8 | 453.8 | 578.8 | 703.8 | 828.8 |
| **Total Non Current Assets** | **226.6** | **501.0** | **626.0** | **751.9** | **876.4** |
| Cash & Equivalents | 399.5 | 310.1 | 245.7 | 220.6 | 214.3 |
| Inventories | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debtors | 47.5 | 26.5 | 33.2 | 38.0 | 42.8 |
| Other Current Assets | 216.7 | 136.3 | 201.6 | 236.6 | 257.9 |
| **Total Current Assets** | **663.6** | **472.9** | **480.5** | **495.1** | **515.0** |
| Creditors | 7.8 | 9.2 | 14.4 | 15.2 | 15.7 |
| Other Current Liab & Provisions | 127.2 | 121.5 | 148.9 | 173.9 | 191.4 |
| **Total Current Liabilities** | **135.0** | **130.8** | **163.2** | **189.0** | **207.1** |
| Net Current Assets | 528.6 | 342.1 | 317.2 | 306.1 | 307.8 |
| **Total Application of Funds** | **755.3** | **843.1** | **943.2** | **1057.9** | **1184.2** |

**Cash Flow Statement**

| (Rs cr) | FY21 | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|---|
| Reported PBT | 112.0 | 152.1 | 178.1 | 204.1 | 228.9 |
| Non-operating & EO items | -36.5 | -39.5 | -59.2 | -24.8 | -10.4 |
| Interest Expenses | 0.7 | 1.7 | 1.7 | 1.9 | 2.1 |
| Depreciation | 9.9 | 7.8 | 9.9 | 11.2 | 12.5 |
| Working Capital Change | 20.4 | 16.7 | 19.7 | 10.8 | 2.4 |
| Tax Paid | -30.1 | -41.5 | -44.2 | -50.8 | -57.2 |
| **OPERATING CASH FLOW ( a )** | **76.4** | **97.4** | **106.1** | **152.3** | **178.1** |
| Capex | -2.3 | -5.2 | -10.0 | -12.0 | -12.0 |
| Free Cash Flow | 74.1 | 92.2 | 96.1 | 140.3 | 166.1 |
| Investments | -130.0 | -123.5 | -125.0 | -125.0 | -125.0 |
| Non-operating income | 100.2 | 56.8 | 0.0 | 0.0 | 0.0 |
| **INVESTING CASH FLOW ( b )** | **-32.1** | **-71.9** | **-135.0** | **-137.0** | **-137.0** |
| Debt Issuance / (Repaid) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest Expenses | 0.0 | 0.0 | -1.7 | -1.9 | -2.1 |
| FCFE | 44.3 | 25.5 | -30.6 | 13.4 | 39.1 |
| Share Capital Issuance | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividend | -26.3 | -26.5 | -33.8 | -38.6 | -45.4 |
| **FINANCING CASH FLOW ( c )** | **-26.3** | **-26.5** | **-35.5** | **-40.5** | **-47.4** |
| **NET CASH FLOW (a+b+c)** | **18.0** | **-0.9** | **-64.4** | **-25.2** | **-6.3** |

**Price chart**




**Key Ratios**

| | FY21 | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|---|
| **Profitability Ratios (%)** | | | | | |
| EBITDA Margin | 26.9 | 35.2 | 35.0 | 35.2 | 35.1 |
| EBIT Margin | 37.9 | 44.8 | 44.5 | 44.6 | 44.3 |
| APAT Margin | 27.1 | 32.8 | 32.9 | 32.9 | 32.6 |
| RoE | 11.2 | 14.0 | 14.9 | 15.2 | 15.2 |
| RoCE | 15.6 | 19.2 | 20.1 | 20.6 | 20.7 |
| **Solvency Ratio (x)** | | | | | |
| Net Debt/EBITDA | -4.9 | -2.6 | -1.7 | -1.4 | -1.2 |
| Net D/E | -0.5 | -0.4 | -0.3 | -0.2 | -0.2 |
| **PER SHARE DATA (Rs)** | | | | | |
| EPS | 84.6 | 116.4 | 137.4 | 157.3 | 176.3 |
| CEPS | 94.9 | 124.4 | 147.7 | 168.8 | 189.2 |
| BV | 785.1 | 874.1 | 976.5 | 1093.8 | 1223.1 |
| Dividend | 27.0 | 28.0 | 35.0 | 40.0 | 47.0 |
| **Turnover Ratios (days)** | | | | | |
| Debtor days | 63 | 39 | 27 | 28 | 28 |
| Creditors days | 14 | 9 | 11 | 12 | 11 |
| **VALUATION (x)** | | | | | |
| P/E | 52.5 | 38.2 | 32.4 | 28.3 | 25.2 |
| P/BV | 5.7 | 5.1 | 4.6 | 4.1 | 3.6 |
| EV/EBITDA | 47.7 | 32.5 | 27.3 | 23.1 | 19.9 |
| EV/Revenues | 12.9 | 11.4 | 9.6 | 8.1 | 7.0 |
| Dividend Yield (%) | 0.6 | 0.6 | 0.8 | 0.9 | 1.1 |
| Dividend Payout (%) | 31.9 | 24.1 | 26.0 | 26.0 | 27.0 |

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## HDFC Sec Retail Research Rating description

### Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

### Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

### Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.



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