BUY on Dips

January 8, 2008

Sector
Power Equipment

CMP
Rs590

Face Value
Rs2/share

Equity Capital
Rs 8.2cr

52 Week H/L
558/60

Market cap
Rs 2600cr

Valuations

	FY08E	FY09E
Or.bk	800	1,600
Sales	642	1155
Margin	25%	25%
EPS	22.78	41.11
Pex	25.4	14.1

Share Holding

	Shares 000'	% holding
Foreign	2,661	32.87
Institutions	219	2.7
Corp.	1,677	20.72
Promoters	1,627	20.1
Public	1,912	23.61
Totals	8,098	100

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ICSA India

ICSA is a one of the few technology driven domestic power Equipment Companies, which is well placed to capture the US$35bn T&D opportunity in the Indian power sector. The company has grown manifold both in terms of revenue and profit over the last three years, driven by efficiency improvement software products catering to the T&D sector. The growth trajectory is likely to continue going forward, as the company is getting into newer growth areas like oil pipelines and water distribution. We project a CAGR revenue growth of 72% and 65% profit growth over FY07-10. With the current PEx of 14.1xFY09E EPS and EV/EBIDTA 9.3x FY09E, we believe the valuations are relatively stretched on account of a recent run up of 50% in the stock price. We believe that the premium valuations for the company will sustain the high growth expectations and the enormous size of the addressable market. We are positive on the company but would be more comfortable a relatively lower valuations.

Background

ICSA – India Ltd. (formerly known as Innareddy Computer Software Associates India) manufactures niche products that are well suited in the field of Energy management, Energy audit and Control solutions to the power utilities using the GSM communication medium. ICSA is one of the early entrants in the development of these products and hence will reap the benefits of the same. Interestingly, ICSA was initially operating in the software services industry. Currently the software division including the embedded solutions for power sector contributes 66 per cent of the revenue and the power division (EPC) contributes the rest 34 per

Product profile

The company mainly provides customized technology based solutions for the T&D sector in the power sector. It also has provides solutions for oil pipelines and water distribution. The main products are

Distribution Transformer Monitoring System (DTMS)

The DTMS main object is to Monitor and control the Distribution Transformer. The features include Energy measurement, Remote data acquisition, Peak load management, Energy accounting, Transformer health monitoring, Remote switching and so on. This communicates with the load centre through DNP3 Protocol or GM/SMS technology.

Intelligent Automatic Meter Reading (IAMR)

The IAMR collects data from energy meter and other devices continuously at field and exchange this data with base station thru wire and wireless communication. It has several features like Automatic monthly billing, Detecting tamper conditions, sending alerts to control room as well as field officials, collecting instantaneous parameters. The IAMR is Compatible with various types and makes of energy meters.

Theft Detection Device (TDD)

The TDD main objective is to identify theft at LT pillars (Junction Boxes used for underground power distribution lines) under different tamper conditions. It continuously monitors energy and sends IP (instantaneous parameters) like voltages, currents, and power etc. to the base station. It also Detects tamper conditions and sends the alerts to Base station (Control Room) as well as concerned officials. In addition, it initiates the local audio alarm.

Intelligent Cathodic Protection System (iCAP)

iCAP system is an innovative field compatible, modular wireless embedded real time system.. It is an addition to the conventional Cathodic Protection system; the conventional system becomes intelligent soon after interfacing iCAP. Thereby, it automates all the operations and executes in real time. It continuously monitors the pipeline operations and notifies the abnormalities, if any, in real time. It improves the safety, productivity and life of pipeline. It eliminates the requirement of conventional measurements, surveys, tampering/pilferages/third party damages. It has several applications in Oil, Gas, Water, and so on. It is compatible to all conventional type of Cathodic Protection systems irrespective of applications.

Since these are highly technical products the company has patented the three products of DTMS, IMAR and ICAP. It is in the process of patenting the Theft Detection Device. We believe that considering the burgeoning opportunity in the energy sector especially in efficiency improvement in the power sector, these patents could be highly valuable going forward.

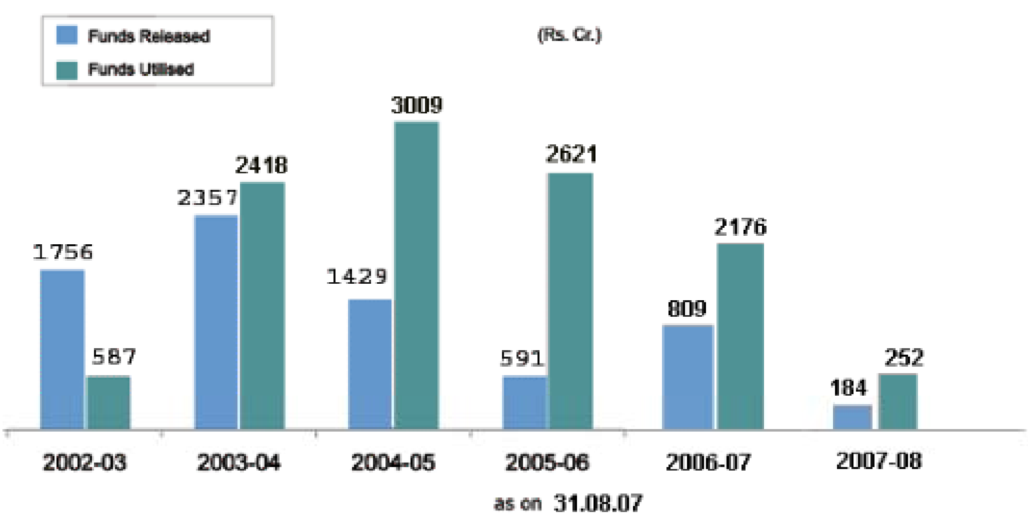
The market

Efficiency Improvement in the T&D sector

The company mainly operates in the T&D sector of the power sector. Historically the Indian T&D sector has not kept in pace with the growth in generation, which has resulted in under recovery, pilferage and huge losses in the sector. The T&D losses, which are termed as Aggregate Transmission &Cash (AT&C) losses are still in the range of 35-40%. The govt. is committed to reduce these losses and make the power sector more financially viable. In this regard the govt. has evolved a number of reform initiatives like the Accelerated Power Reform and Development Program (APRDP)
The objectives of APDRP are:

- Improving financial viability of State Power Utilities
- Reduction of AT & C losses
- Improving customer satisfaction
- Increasing reliability &quality of power supply

APRDP Performance Funds Disbursed (RS cr)



As seen in the above graph there has been a steady increase in funds disbursal for the T&D sector .The APDRP is being re-structured for implementation during 11th Plan with a view to achieve 15% AT&C loss level. It is estimated that the potential loss reduction and efficiency market could be about US$15bn

Additional capacity expansion

In order to realize the govt. lofty goal of **Electricity for all by 2011**, not only generation but T&D capacity has also augmented. The XIth 5 year plan envisages increasing transmission capacity from the current capacity of 16000MW to 36050MW by the 2011. This would entail an investment of US35bn. We believe this would present immense opportunity for equipment suppliers and contractors involved in this sector.

ICSA well placed to capture this burgeoning opportunity
ICSA with specialized products suited for the T&D sector has reaped the benefits of the increased investments in the T&D sector. The company topline has grown from Rs21cr in FY05 to Rs 332cr in FY07.The sales have been mainly driven by the embedded solutions for the power sector, viz DTMSI, IAMR. Infact, the power division's contribution to the topline from 40%in FY05 to 70% in FY07. Net profits have also grown in inline with the topline increasing from Rs3.7cr in FY05 to Rs59cr on FY07. The company expects to maintain this impressive growth rates considering the potential in the power sector as outlined earlier.

Introduction of newer products to drive growth
The company is concentrating on newer business segments like oil and gas pipelines and water distribution and developing products to cater to these industries which are also high growth sectors. The company has obtained IPR and is currently introducing the corrosion detection product called as iCAP. The management believes that this product has a potential of close of US$500mn, as the country augments its pipeline infrastructure. Apart from this the Anti Theft devise and the Automatic street light mechanism are likely to be star products going forward.

70% CAGR growth to continue through FY10
The company currently has an order book of Rs690crores, which is likely to grow to Rs800crore by March 08.It expects to grow its order book between 75-100%yoy over the next 2-3 years, driven by huge capex especially in the power sector. With an average conversion rate of 90% of the orders, we expect the revenue growth to follow orderbook growth. We expect a CAGR growth of 75% over the next 3 years.

High margins to be maintained
The company has been steadily improving its operating margins from 23% in FY05 to around 25% in FY07. The margin improvement is mainly on account of improving contribution of embedded solutions in the topline. The margins are expected to remain in the 25% range going forward with increasing share of embedded products going forward. Infact the company is getting out of low margin infrastructure business and wants to be a 100% product company.

Strengths
Management and research capabilities
The company is promoted by Mr Balareddy who is a technocrat and holds more than 20% of the equity. Other members of the top management MR N Venkata Reddy, Kodanda Ramaiah, K Somashekar Rao, Dr Srinivasulu and NVR Srinivas also have more than 2 decades of experience in the power sector, especially T&D and R&D which provides the company enough management bandwidth for product development, as well as marketing in products to the customers who are mainly state run utilities. The company has a 200 strong software development team led by the experiences business heads, which is likely to produce a robust pipeline of new products to cater to the high growth segment of energy,

Unorganized competition
The management claims that most of its competitors are in the unorganized sector which it gives it a distinct advantage in pricing, as it is the only one that has the ability to execute large orders, which is the need of the hour. Further the company has also patented its main product offerings which guard it against additional competition.

Strong shareholder base
Almost 30% of the company is held by Foreign Institutions like Goldman Sachs, Merill Lynch, Morgan Stanley, CLSA, Lloyd George etc, which are long term financial institutions. We believe their presence imbibes confidence in the company's capabilities to scale and grab the burgeoning opportunity.

Challenges
Scalability
Although the company has grown manifold over the last three years, but we believe that the real challenge lies in scaling up to the next level in order to address the US$35bn opportunity might prove it be challenge in terms managing the financials and skill requirements going forward.

Possible payment risk

The main customers of the company are state run utilities which are loss making entities albeit lower than historic levels. We believe, that this could put substantial risks payment risks on the company. In order to mitigate these risks the company currently bids for only those projects that are funded under the APRDP scheme.

Competition

Given the fact that ICSA has scaled from being a small player to reasonable size, we do not rule out any of the other players from attaining the same size, as the size o the market and the opportunities are immense. Increasing number of players could drive down margins.

Financial Performance (Rs cr)

	FY06	FY07	YOY%	H1FY06	H1FY07	YOY%
Sales	83.29	360.03	332.3%	134.28	272.81	103.2%
EBITDA	20.91	82.89	296.4%	33.37	73.63	120.6%
EBITDA Margin	25.11%	23.02%		24.85%	26.99%	
Interest	0.67	7.91	1080.6%	0.31	4.1	1222.6%
Depreciation	0.87	1.66	90.8%	0.57	0.93	63.2%
PBT	19.37	73.32	278.5%	32.49	68.6	111.1%
PAT	15.08	59.27	293.0%	27.22	52.8	94.0%

The company performance in the H1FY07 has been very impressive driven by a Rs600cr order book. Revenues have grown by 103% yoy, operating profits are up 120% to Rs73cr. Net profits are up by 94% , have grown at a lower rate than operating profits due to higher interest costs, as the company has raised FCCB of about US$36mn during the year.

Valuations and recommendations

	FY07	FY08E	FY09E	FY10E	3 yr CAGR
Order book		800	1,600	2,880	
Sales	360	642	1,155	1841	72.3%
EBITDA	82.8	164.2	288.1	405.9	69.8%
EBITDA Margin	23.0%	25.6%	24.9%	22.0%	
Net Profit	59.3	102.1	184.30	261.85	64.1%
Net Profit Margin	16.5%	15.9%	16.0%	14.2%	
EPS	13.2	22.78	41.11	58.41	64.1%
PEx	43.87	25.46	14.11	9.93	
EV/EBITDA	32.08	16.23	9.33	6.69	
Order book /sales		1.29	1.43	1.61	

We forecast a top line growth of 72% CAGR over the next 3 years, and profits are expected to grow at 64% CAGR to Rs262cr from Rs59cr. On the current market price of Rs580 the stock is trading at a PEx of 26x FY08E and 14xFY09E. We have forecasted a marginal drop in EBITDA margin, over the next three years, as we expect increasing competition in the industry. On a EV/EBITDA the stock is trading at 9.3x FY09 EBIDTA.

We believe that the current valuations are marginally stretched due to the recent run up of more than 50% in about a week's time. However, we are of the opinion that the premium valuations will sustain considering the growth expectation and the massive size of the addressable market. We also believe that one must capture the valuation of the IPR's on the products that the company has registered.

We recommend buying the stock post a correction as we are uncomfortable with the recent swift rise of 50+% in the stock price. We remain bullish and positive on the long-term fundamentals and attractiveness of the stock.

Our*Team*

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Detailed Financials

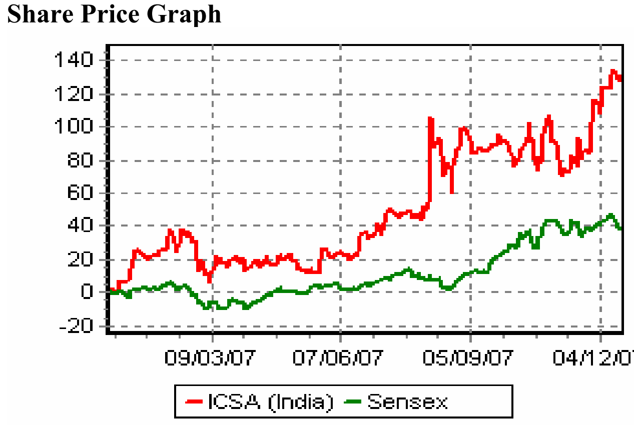
Financial Performance (Rs Cr)			
Year End	**200703**	**200603**	**200503**
Equity	6.82	6	5.4
Net worth	106.64	32.71	11.19
Enterprise Value	790.44	365.68	94.68
Capital Employed	252.69	36.47	11.61
Gross Block	13.85	7.86	4.4
Sales	332.48	81.14	21.5
Other Income	0.77	0.22	0.02
PBIDT	82.89	20.91	5.02
PBDT	74.98	20.24	4.96
PBIT	81.23	20.04	4.87
PBT	73.32	19.37	4.81
RPAT	58.51	15.08	3.73
Book Value (Rs)	31.272	10.904	4.144
EPS (Rs.)	16.974	4.934	1.344
Dividend (%)	50	30	15
Payout (%)	6.6	13.38	21.21
Ratio Analysis			
Current Ratio	1.08	0.1	0.07
Invtry Turnover	2.54	1.67	2.17
Debtors Turnover	20.68	35.05	16.6
Interest Cover	3.03	2.85	2.77
EBIDTA%	10.27	29.91	81.17
EBIT%	24.93	25.77	23.35
PAT	22.55	24.94	23.07
ROCE (%)	17.6	18.59	17.35
RONW (%)	60.75	94.89	58.6
EV/EBIDTA	83.98	68.7	44.17

Enterprise Value Calculation	**RS Mn**
Market Cap	2062
Debt	160.6
less cash/ Investments	95.9
Enterprise Value	2126
EBITDA	164.2
EV/EBITDA	**12.95**

Latest Results (Rs Cr)			
Period-Ended	**200709**	**200609**	**Var. (%)**
Sales	146.23	74.99	95
Other Income	3.6	0.03	11900
PBIDT	40.89	18.63	119.48
PBDT	38.99	18.45	111.33
PBIT	40.41	18.24	121.55
PBT	38.51	18.06	113.23
PAT	28.88	14.98	92.79

Shareholding Pattern		
(AS ON 30 Sep 2007)	Shares	(%)
Foreign	2661732	32.87
Institutions	219011	2.7
Govt. Holding	0	0
Non Promoter Corp. Hold.	1677725	20.72
Promoters	1627860	20.1
Public & Others	1912372	23.61
Totals	8098700	100

Share Price Graph



MARKET DATA (AS ON 31 Oct 2007)

Price (Rs)	408.35	52 W H/L(Rs)	425 / 162
Lat. P/E	18.6	Lat. EPS(Rs)	22.01
Mkt. Cap.(Rs Cr)	1655.86	Lat. Eqty (Rs Cr)	8.11
Lat. BV(Rs)	42.43	Div. Yield (%)	0.24