

Safal Niveshak StockTalk

Info Edge (India) Ltd.

Statutory Warning: This report may cause a reaction, and acting on it can be injurious to your wealth.

I recently talked to the management of Info Edge (India) Ltd. (IEL) to understand the company's business, what drives it, and the challenges it faces.

Here is analysis of the business for you, with the view that it would help you understand it better.



Let's start with understanding the business and its core underlying dynamics.

Info Edge's Business

IEL is India's leading **online classifieds company** with presence in the recruitment, matrimony, real estate, education and related services.

Unlike the first impression of it being an "Internet or dotcom" business, look deeper and you will see a "media" business (classifieds) that is on the Internet.

Let me briefly describe IEL's key businesses and then take them up one by one.

- **Recruitment:** This segment of IEL's business comprises online recruitment classifieds (Naukri.com, India's leading job site and Naukrigulf.com, a job site focused at the Middle East job market) and offline executive search (Quadranglesearch.com). Related sites in this business are a professional networking site (Brijj.com) and a fresher hiring site (Firstnaukri.com). This segment forms 77% of IEL's total revenues and more than 100% of its operating profits (because other businesses are smaller and in losses).

- **Matrimonial:** In this segment, IEL has presence in online matrimony classifieds (Jeevansathi.com) and 14 offline Jeevansathi match points. This segment forms 7% of IEL's total revenues.
- **Real Estate:** This comprises online real estate classifieds (99acres.com), and a real estate brokerage business (Allcheckdeals.com). This segment forms 12% of IEL's total revenues.

FIVE YEAR PERFORMANCE: BUSINESS VERTICALS							₹ MILLION
	FY2009	FY2010	FY2011	FY2012	FY2013	CAGR	
NET SALES							
RECRUITMENT	2,117	1,954	2,425	3,042	3,368	12.3%	
MATRIMONIAL	170	199	221	254	323	14%	
REAL ESTATE	139	133	228	347	516	38.8%	
VERTICAL PROFITS							
RECRUITMENT	922	803	1,098	1,550	1,658	17%	
MATRIMONIAL	(47)	(1)	(41)	(49)	(75)	NA	
REAL ESTATE	(95)	(38)	4	1	(8)	NA	

Source: Company

Let me take up each of the key businesses and describe them one by one.

1. Recruitment (Naukri)

This is by far the biggest and most profitable business for IEL, and it has been the case ever since the company started its operations in 1997.

Naukri earns a majority of its revenues by way of subscription fees paid by job seekers, who subscribe for its services like job search and resume writing. Its other revenue sources include website advertisements and resume database access to employers.

Job search, as the company mentions, is the fifth biggest activity on the Internet, after popular activities like emailing, search, and music downloads and this has benefited IEL over the past few years.

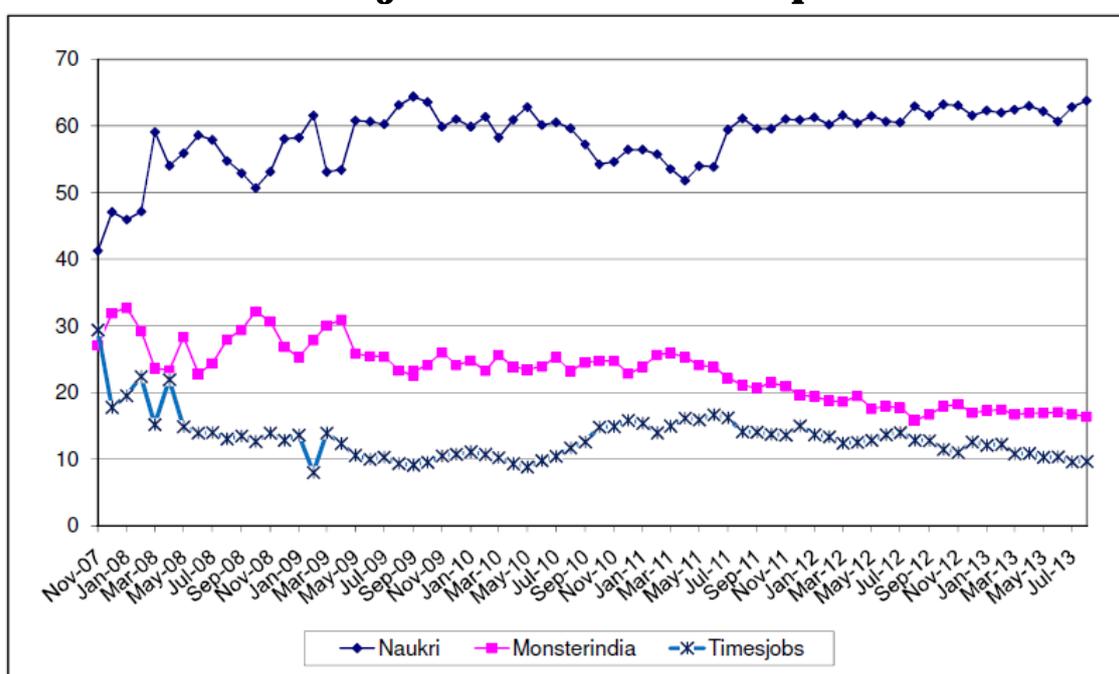
You see, there are four key factors that decide the success of an online business like that of IEL.

1. The first key determinant of an online business's success is **traffic** – number of people using the Internet.
2. The second is **traffic share** – number of people using a website as a percentage of total people using the Internet.

3. The third is the kind of **engagement** with a website that is either measured through page views (number of pages viewed by each website visitor) or through the time spent on a website.
4. The fourth and final piece of an online business’s success is how it **monetizes the engaged traffic** i.e., earns business from selling products or services to its website visitors.

Talking about traffic and traffic share, data from Comscore (an agency that measures the Internet for data like traffic and traffic share) suggests that Naukri is by far the most preferred job search website in India, with around 60% traffic share of various recruitment websites operating in India...

Traffic share of job sites in India as per Comscore



Source: Company

Here is some more comparative data I have pulled out from Alexa (an Internet analytics company), which shows the superiority that Naukri has over its competitors...

	Naukri	Monsterindia	Timesjobs
Global Rank	424	2,031	2,238
India Rank	37	150	162
Bounce Rate*	24%	30%	45%
Daily Pageviews per person	9.8	6.6	4.1
Daily time on Site (Minutes)	8.2	7.4	4.2
Site loading speed (Seconds)	2.1	3.4	3.6

Source: Alexa

A high (and rising) share of traffic has worked wonders for Naukri in the past, as seen from the rise in the number of unique customers from 27,500 in FY07 to around 50,000 as of now. Also, the average number of resumes modified daily has risen from around 25,000 in FY07 to 120,000 as of now.

The best thing about Naukri's business is this virtuous cycle that it operates in, which gives it a moat. This is something that is a product of years of brand building and offering a service/product that solves a real problem for its users in a better way than anyone else can do.



With IEL keeping its focus on this business and competition intact, the business continues to do well for the company.

Of course, there are key challenges that this business faces – weak economic environment and thus weak hiring – but the management sees Naukri to remain its best and most profitable business for years to come.

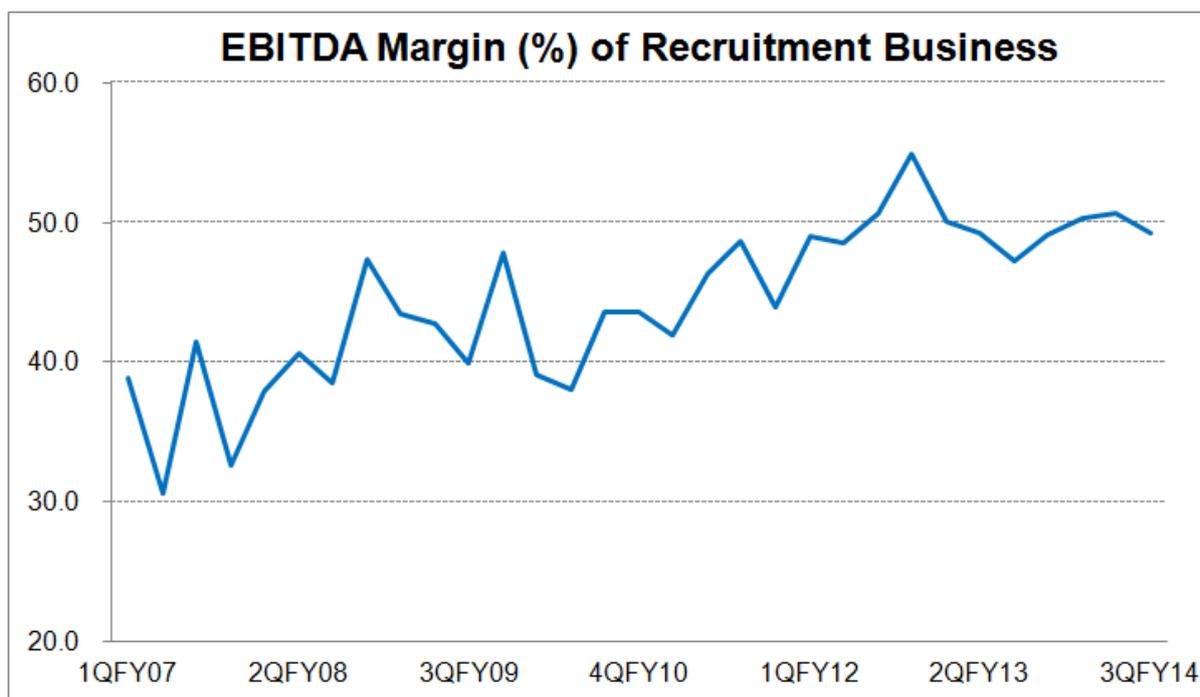
As per the management of IEL, recruitment is a well-penetrated market and much of growth for Naukri in the future would come from a shift in job classifieds from print media to online, and the ability of the company to take away a larger share of this shift away from its competitors.

Another great characteristic of an online business like Naukri is that it has great operating leverage. In simple words, operating leverage measures a company's fixed versus variable costs.

The greater proportion of fixed costs (costs that don't change much with change in the level of business), the greater the operating leverage. Like financial leverage, operating leverage magnifies results, making gains look better and losses look worse.

In case of Naukri specifically, and IEL overall, its fixed costs (employee and network costs) are much bigger than its variable costs (like advertising costs), and thus a large part of sales revenue flows straight to profits after the fixed costs are met.

This is clearly seen from IEL's recruitment business (led by Naukri) that has seen a gradual rise in its operating margins over the past seven years – from around 38% at the start of 2007, to around 53% as of now (the peak has been around 60%).



Anyways, apart from Naukri.com, the company's recruitment business also consists of brands like Quadrangle (offline placement services to middle and senior management), Firstnaukri.com (catering to hiring of fresh graduates), and Naukrigulf.com (catering to hiring in the Gulf market).

Talking about competition, while Naukri.com is extending its lead over other key job classified websites like Monster and Timesjob (as seen from Comscore data), one company that is expected to become serious competition is LinkedIn.

As per the management, IEL is investing in areas like improving search capabilities, making Naukri.com more social, and taking the site to mobile platforms to counter competition from LinkedIn.

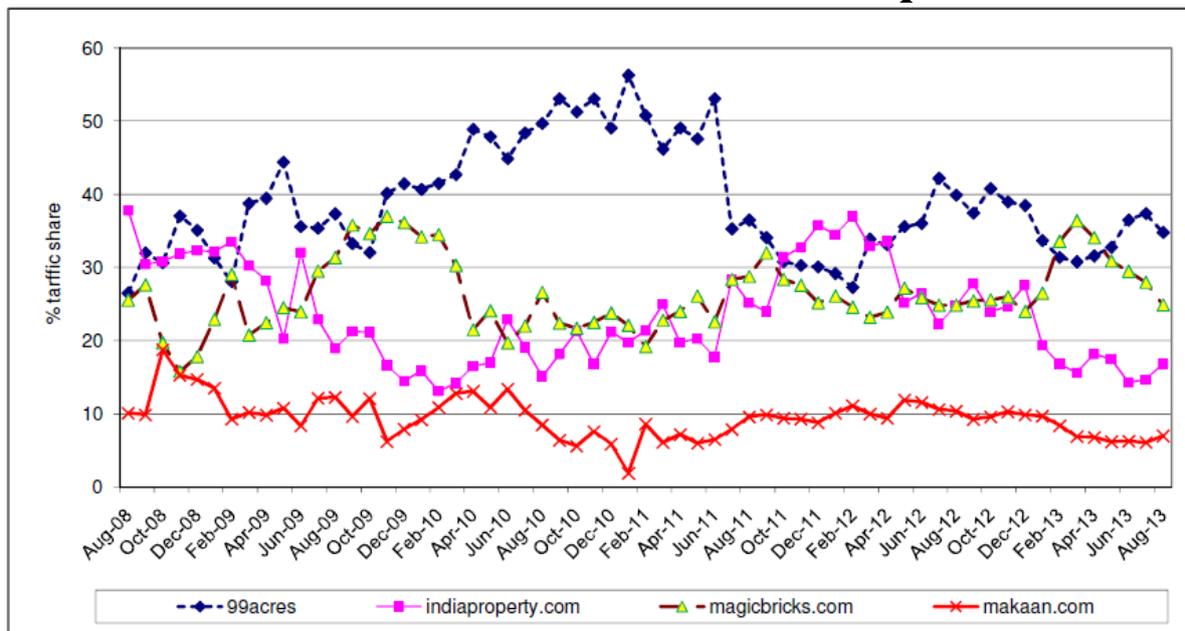
But even while companies in India are largely taking to LinkedIn to view profiles of prospective candidates, large-scale hiring is still controlled by players such as Naukri, which is a good sign for IEL. Similarly, in most geographies, job sites have withstood competition from LinkedIn e.g. Australia's leading job site Seek.com.

2. Real Estate (99acres)

Real estate classifieds is the second largest revenue generator for IEL, and its fastest growing in terms of revenue growth (at 38% CAGR over the past four years).

Here again, IEL has been a leader in traffic share against its key competitors, though the leadership position has not been as strong as that of Naukri.com...

Traffic share of real estate sites in India as per Comscore



* Change in traffic share on account of tagging of site/ change in methodology by Comscore
Source: Company

Here's some more comparative data on 99acres versus its competition, from Alexa...

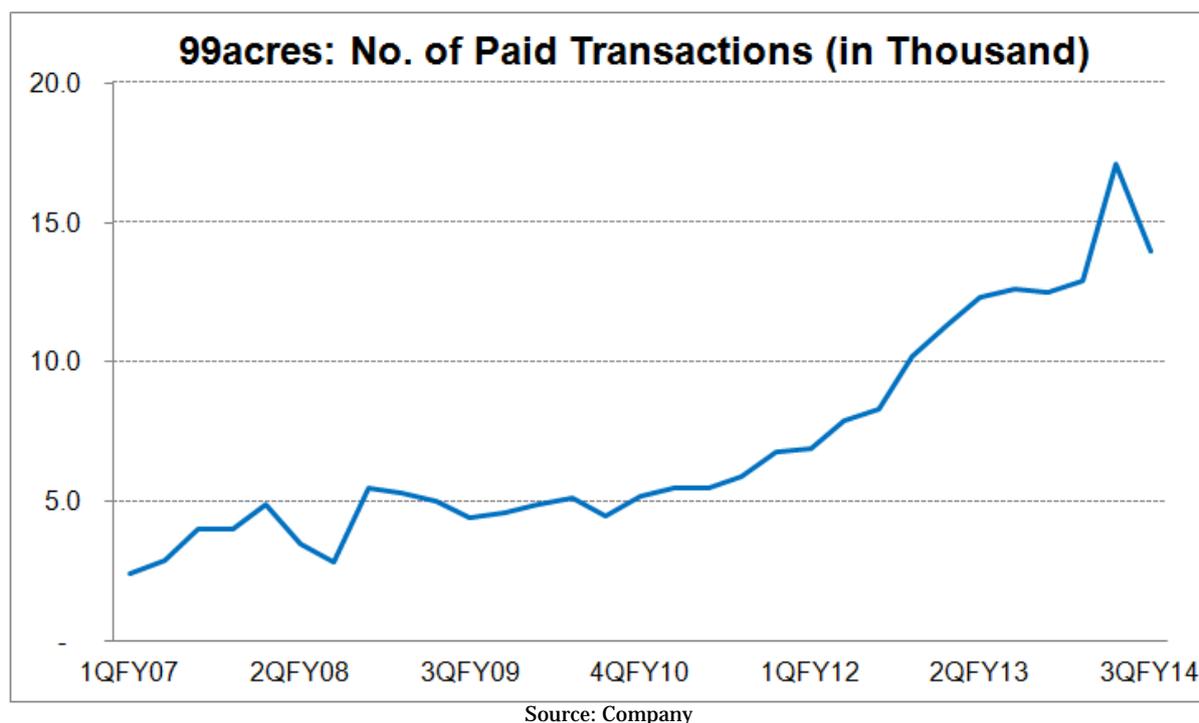
	99acres	Magicbricks	Makaan	Propertywala
Global Rank	2,056	2,783	10,074	20,067
India Rank	145	226	692	1,694
Bounce Rate	32%	38%	36%	42%
Daily Pageviews per person	6.5	5.4	5.8	6.5
Daily time on Site (Minutes)	8.5	7.4	8.3	7.3
Site loading speed (Seconds)	3.3	7.2	4.8	1.7

Source: Alexa

A large part of the revenue for 99acres comes from commissions from developers, builders, and brokers.

The management sees this business as holding a tremendous future potential simply for the reason that real estate classifieds in print media is a much bigger business (at Rs 2,000+ crore) than job classifieds, and thus a gradual shift towards online classifieds will bring a great amount of business for leading brands like 99acres.

The shift is already being seen, as 99acres continues to clock higher number of paid transactions (number of invoices issued by the business to its paying customers) with every passing quarter.



As far as profitability is concerned, 99acres earns a very miniscule profit, but the situation has been improving year after year. In my meeting with them, the management has indicated that it sees this business to be the next major growth driver for IEL as more print classified business in real estate moves online.

The management is focussing here on improving reach, investing in product and technology and features on the site all of which means hiring more people/quality people with relevant skill sets as also higher advertising spends.

Importantly, these costs are classified as operating expenses on IEL's Income Statement, while part of the same are really investments in the future which in an asset linked business would be classified as capital expenditure.

3. Matrimonial (Jeevansathi)

In a country where the dominant form of marriages continues to be "arranged", a matrimonial classified business surely has a great potential. IEL's matrimonial business, led by Jeevansathi.com, has been a key beneficiary of this continuing trend of marriages getting arranged by families.

However, unlike Naukri and 99acres, Jeevansathi is not the top website in this space in terms of traffic share. It stands at number three, lead by Shaadi.com and Bharatmatrimony.com. Plus, this market also has a lot of small, regional players.

IEL generates revenue when a website user (seeking a bride or groom) pays to get contact details of other parties. So, while a user is free to list on Jeevansathi, free to

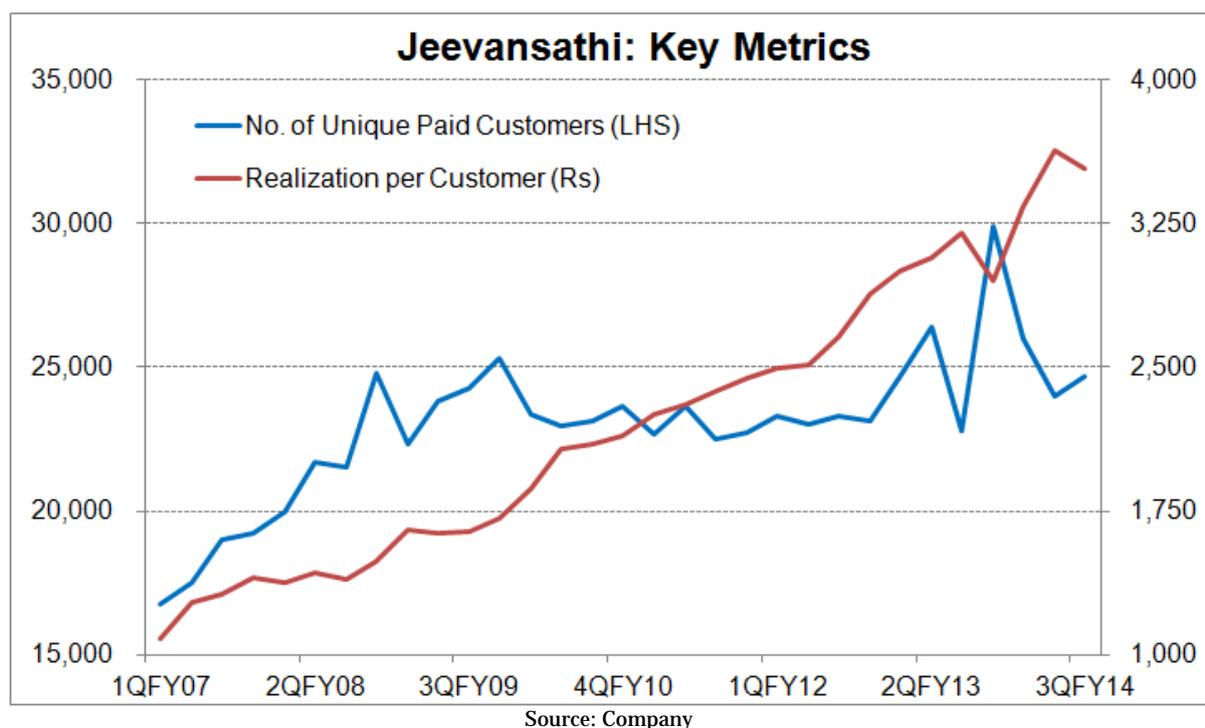
search for suitable spouse, and free to express interest, he/she has to pay a subscription fee to get the contact details of the people who match his/her profile.

Now, despite the fact that competition is strong in this field – which is show by some stagnancy in the number of unique paid customers of Jeevansathi – the company has done well to grow its revenue per customer over the years.

This says a lot about the quality of its offering and pricing power.

As per the management, improvement in pricing has also been function of the lead players (Shaadi and Bharatmatrimony) upping their pricing and IEL being a challenger following suit.

Of course, it still indicates pricing power and value the company adds to communities that it serves through Jeevansathi.



It's this consistent growth in revenue per customer that has helped the matrimonial business grow its sales at a CAGR of 14% over the past four years, despite the fact that the number of unique customers has grown at a CAGR of just 4%.

The benefit of growth in revenue has however not fallen to the bottomline of this business, as it continues to suffer losses. The reason for the continued losses is the aggressive marketing spend that the company is doing in Jeevansathi, alongwith 99acres.

In fact, as the management has indicated, IEL is spending most of its marketing and advertising money on these two businesses, as the competition is tougher here as compared to its recruitment business.

By the way, one major drawback of the matrimonial business is that, unlike recruitment and real estate, repeat business is almost zero. This is because when someone finds a life partner, he/she has no reason to visit the site again. 😊

Thus the company has to continue looking for new customers for Jeevansathi, and thus it continues to spend big money on marketing, and thus this business continues to suffer losses.

As per the management, matrimonial is one business where it lacks good clarity for the future, and is thus trying our several things to prop it up.

4. Other Businesses

Apart from the above three businesses, IEL also has presence in a few other segments of the online market, which include an online education classifieds website called Shiksha.com. It also has key investments in other growing online ventures like:

(Rs Crore)	Business	Investment by IEL	IEL's Holding	Revenue			Operating Profit	
				FY11	FY12	FY13	FY12	FY13
Subsidiaries								
Zomato	Listing of restaurant menus, review of food and dining options	142	50%	0	2	11	(7)	(10)
Meritnation	KG to Class 12 assessment based learning	72	56%	1	4	10	(5)	(21)
Associates								
Policybazaar	Financial product comparison	33	32%	26	54	87	(30)	(46)
Mydala	Discount offers and deals	27	47%					
Canvera	Digital photo storage and printing	35	23%					
Happilyunmarried	Creative fun products	5	25%					
Total		314		28	60	108	(42)	(77)
Wholly Owned Subsidiary								
Allcheckdeals	Real estate broking			16	11	14	(4)	(1)

Source: Company

Together, these businesses (except Allcheckdeals, which is a part of the real estate business) form 3% of IEL's total revenues and are in an investment phase.

The key reason the management has attributed to its faith and thus investment in these companies is their business potential and good teams managing them.

In fact, the quality of management is one of the biggest criteria that IEL looks at while deciding to invest in or avoid a new business. This is especially given that Internet is such a people-dependent business.

Of course, the quality of business and whether it solves a critical problem matters a lot. But it's the people leading the efforts who can make or mar any such business, unlike most other businesses where it's more about business economics than the quality of people leading them.

IEL has invested a total of Rs 350 crore in its various new businesses over the past three years, and 60% of the funds have been deployed in just two of them – Zomato and Meritnation.

It's worth noting that IEL had also invested in an ecommerce business named '99labels' and later wrote-off its entire investment of Rs 29 crore in the company. The management indicated this was done for two reasons –

1. 99labels required a great amount of funding than IEL's balance sheet allowed, given the former's capital intensive nature of business; and
2. E-commerce has become a very challenging business in India and its difficult to eke out any profits given the poor economics, and the fact that almost every ecommerce company has been raising more and more funds thus starving out smaller players.

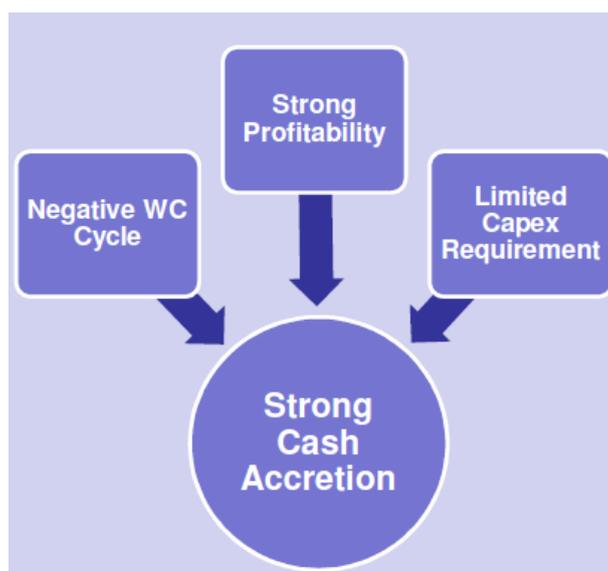
IEL's management has also mentioned that, given the lessons learnt from 99labels, it would prefer investing in businesses which have sound economics and do not require a lot of capital to grow.

Anyways, the fact that IEL wrote-off its investment in a business where it sees poor underlying economics gives me the comfort that the management is agile enough to cut off things could cause a bigger damage to its funds and reputation in the future.

Financial Analysis

Here are some facets of Info Edge's financial performance...

- During FY06 to FY13 (seven years), the company has grown its net sales at a CAGR of 28%, largely led by Naukri.com.
- IEL's gross profit margin has averaged around 60% during this period. This is despite its biggest cost – employees' salaries – rising from 34% of sales in FY06 to 42% in FY13.
- Net margins have averaged around 21% during this period.
- Return on equity (on a debt-free balance sheet) has averaged around 16%, thanks largely to Naukri, and depressed due to continued investments in new businesses.
- The company works on a negative working capital – it has no inventories and its customers pay up faster (in around 8 days) than it has to pay to its vendors (in around 40 days). This causes the balance sheet to remain clean, and without any debt.
- Free cash flow has remained positive for the past seven years, thanks largely to a consistent rise in profits, low capital expenditure, and a negative working capital.



Source: Company

Opportunities & Challenges

After discussing the specifics of IEL's key businesses and its past financial performance, let me now enumerate my understanding of the key opportunities and challenges that the company faces in the future.

Among the opportunities, the key ones are...

1. **Rising Internet penetration in India** provides the greatest opportunity to IEL. As per a [McKinsey report](#), India is likely to see the fastest growth in the world in terms of Internet user base, from 12 crore in 2012 to around 35 crore in 2015, led by downward trends in cost of Internet access and mobile devices.

Internet Impact on Young India

India is among the world's youngest nations with a median age of 26 years

- 65% of Indian population estimated to be below 35 years of age
- India will see 70 million new entrants to its workforce over the next 5 years

India currently has about 120 million internet users- third largest in the world

Likely to have 330 million to 370 million internet users in 2015- second largest and the largest in terms of incremental growth

- Declining costs of Internet access and mobile devices
- 55% of aggregate user base in 2015 expected to access internet from a mobile or tablet device

Economic contribution from Internet in India can be potentially doubled from 1.6% of GDP currently to 2.8 to 3.3% by 2015

- Internet-related economy expected to be bigger than education and as big as healthcare sector in terms of current GDP share

Internet's effect on the Indian economy goes well beyond iGDP

- Current levels of internet-related expenditure estimated to create about 6 million direct and indirect jobs
- As the direct impact of the internet on India's GDP has the potential to treble by 2015, an additional 16 million jobs could be created

2. Apart from rising number of Internet users, or possibly led by it, another key opportunity IEL has is that of **more classified advertisement shifting from print to online**, especially owing to increasing smart-phone penetration. As the company's management has indicated, it sees the real estate segment (99acres) to be one of the biggest beneficiaries of this shift, largely given that real estate classifieds is a much bigger market than job or matrimonial classifieds.
3. Naukri (recruitment) remains IEL's focus area where it plans to work towards maintaining a leadership position. The business has done decently in the past despite a weak job market. Any **improvement in the job environment**, led by an improvement in the economic environment, would benefit IEL. Also, given the business's high operating leverage, any uptick in revenues will add to the company's profitability.

Talking about concerns/risks for IEL, the key ones are...

1. **Competition** is the biggest risk IEL faces, combine with the fact that the barriers to entry are low in an online business. While IEL enjoys certain moats in the form of its brands and the virtuous cycle that I discussed above, there is no doubt that it's a "have-to-be-smart-everyday" business where the management, its insights into customers' problems, and the business's capability to provide the right solutions for these problems will play a big role.
2. IEL also faces an **investment risk**, given that it is investing a lot of money in ideas that have not been tested in the Indian markets in the past (like Zomato, Meritnation, and Canvera). There is thus a probability that its investments may not generate adequate returns and which may absorb more of the company's cash.
3. Recent **resignation of IEL's co-founder** and CFO Ambarish Raghuvanshi adds to my near-term concerns, given that IEL's is a highly people-centered business.

Valuations

Warren Buffett said this in a lecture at the University of Florida, School of Business in 1998...

"If I was teaching a class at business school, on the final exam I would pass out the information on an Internet company and ask each student to value it. Anybody that gave me an answer, I'd flunk."

Now, if I was to see IEL as an "Internet" business, I would not have bothered much about its valuations because I wouldn't have the ability to calculate any valuations at all!

But since, in reality, IEL is largely a "media" business (classifieds in the job, real estate, and matrimonial spaces) that uses Internet as its platform, I will not really shun it like I would do with ecommerce businesses.

But the question now is – how do you value a business like IEL?

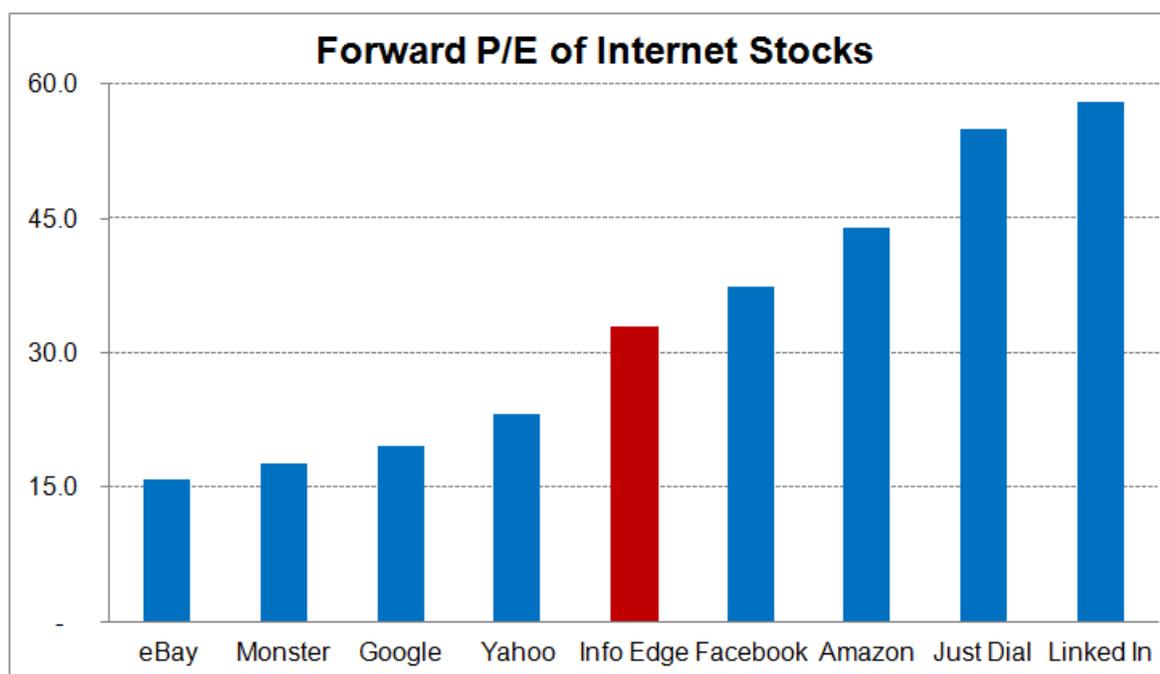
I may try and do a DCF for IEL given that it's one rare Internet company that has generated positive free cash flows year after year, but then any future cash flow projections will be like hitting the arrow in pitch dark, as it's a growing, non-established business, and thus any calculations are bound to go grossly wrong.

Analysts may also do a sum-of-the-parts (SOTP) valuation for the various business under IEL's fold (add Naukri's value to Zomato's value to 99acres's value to Jeevansathi's value, and so on). But I find issues with that, given that it would end up being SOTP of a lot of fast-moving parts which don't have an established past but have an uncertain future. (Some such calculations are available on the company's website [here](#))

Anyways, then I can look at the stock's P/E and still scratch my head asking whether it deserves a 25x P/E or 50x (the last three year's P/E range has been 25x to 50x).

Anyways, the analyst community has devised a beautiful tool called the “forward P/E” which divides the current stock price by the estimated earning of one or two year forward. This helps them turn stocks that are expensive now, cheap based on “estimated future earnings”. 😊

So if I were to take the P/E of leading Internet companies based on one-year forward earnings (as per Morningstar), here is what I get...



Again, too wide a range to assess the right P/E valuations that can be assigned to IEL's business!

Finally, I look at the market capitalization of IEL, which current stands at around Rs 5,400 crore, or US\$ 900 million at the current currency rate.

Now, in a market where loss-making Internet businesses (read Flipkart) are being valued at US\$ 1,000 million (or US\$ 1 billion), IEL's valuation of less than US\$ 1 billion looks "not-very-expensive", especially considering the quality of the latter's business – high margins, negative working capital, clean balance sheet, and positive free cash flow generation – and the huge future potential.

Of course, I cannot really compare the valuations that an unlisted business like Flipkart gets from venture capitalists with valuations of IEL which are largely market determined, but I still find some hope here.

I hope you have gauged my frustration so far in valuing IEL's business, despite it being unlike other run-of-the-mill Internet businesses and rather enjoying some moat in a market, which is seen from its high margins, return ratios, and positive free cash flows.

Anyways, if I were to believe in the Internet potential of this country, and the quality of IEL's business that is far superior to its competitors and looks like sustaining its moat in the future, one number I would keep an eye on is its P/E (especially knowing that the management is credible enough to not fudge the "E").

I may look to invest in the stock when it falls to near about 25x P/E, but only with the money that I am willing to lose for the sake of earning a high long-term return.

This kind of money, which I call as "sin money" would not form more than 5% of my total investment portfolio.

Overall, I like IEL's business given its...

- Brand leadership in online classifieds, a space that is going to grow bigger in the future given the shift from print classifieds
- Virtuous cycle of resumes and recruiters in Naukri
- Management's ability and experience in monetising a large traffic of website visitors
- Rising profits, clean balance sheet, negative working capital, and subsequently consistent FCF generation
- Clean and efficient management that has been extremely forthcoming in disclosing a lot of business information with shareholders, and cleaning up the bad lemons (like 99labels) as soon as they pop.

But I also believe that the stock requires a high margin of safety because...

- Technology disruptions that can impact IEL's business can cause me permanent loss of capital.
- Most new business IEL is investing in are untested and have an uncertain future, and thus may bring in a few surprises like 99labels.

So a final word – Unless you are a true believer in a good future of Internet in India and that IEL will be one of the key beneficiaries, do not invest your hard earned money here.

You must, as I always request, safely ignore my thoughts, assumptions, and actions, and instead do your own homework. 😊

Also Read:

- [Impact of Internet on India – McKinsey](#)
 - [Internet Trends 2013 – KPCB](#)
-

Admissions to Mastermind Course open on 5th Feb. (Wednesday) – Given the overwhelming number of requests I have received over the past few months, I am opening admissions for the 2nd batch of my Value Investing Course – **The Safal Niveshak Mastermind** – on 5th February 2014 (coming Wednesday). [Click here to read](#) more about Mastermind, its contents, and why it holds value for you.

**The Safal Niveshak
MASTERMIND**
One-Year Course in Value Investing

Admission Opens on 5th Feb. 2014

KNOW MORE

Here's what you'll get from Mastermind:

- ▶ **Premium Course in Value Investing**
50+ PDF lessons, several hours of video and audio classes, and case studies to help you become an independent, sensible, and successful investor.
- ▶ **Mini Course - Turn Your Passion into Paycheque**
Learn step-by-step method of turning your passion into an alternative source of income.
- ▶ **Special E-Books, Workbooks, and Videos**

"...one of my life changing journeys." - N. Venkateswaran
"...its price is way lower than its Intrinsic Value!" - Prakash Patel

Disclaimer: I, Vishal Khandelwal, am not invested in IEL. Please make your own decision, as blindly acting on anyone else's research and opinions can be injurious to your wealth.