VISIT NOTE

CARE RATINGS
New growth avenues

India Equity Research| Credit Rating

We met Mr. Rajesh Mokashi, CEO & MD, CARE Ratings (CARE), to get an insight into the company's growth strategy as well as industry dynamics. Mr. Mokashi is optimistic on recent reforms—IBC, dual ratings for commercial papers (CPs)—and perceives them as additional growth levers. Further, CARE envisages strong potential in non-rating avenues, which it is planning to tap via investment in subsidiary CARE Advisory Research and Training (CART). CARE has set revenue target of INR5bn in 4 years, implying 15% CAGR. Management reiterated maintaining integrity and strong customer relationships as top priorities to enhance branding. On anticipated uptick in the corporate bond market, improving macro-economic outlook and government initiatives (eg. high exposure framework) boost, we forecast 12% sales CAGR over FY17-19. Maintain 'BUY' with DCF-based TP of INR1,722.

Regulatory initiatives, diversification: Potent growth levers

Management stated that while credit growth has been subdued, corporate debt & CP markets remain strong. This got a further boost from recent regulation mandating dual ratings for large CP issuers. Moreover, insolvency & bankruptcy proceedings in JLF and cases referred to NCLT require dual ratings, which CARE perceives as potent growth opportunities. Management is also looking to diversify beyond the ratings segment into advisory, training and research, which it plans to do via investments in CART. Anchored by these structural opportunities and diversification, management has guided for 15% sales CAGR to INR5bn in 4 years.

Improving operational efficiencies and branding

Management, with an eye on ensuring efficiencies and improving outreach & branding, is revamping operations: a) a dedicated team has been set up to deepen relations with large corporates, enhance transparency & win confidence; b) fee caps are being renegotiated with a few clients; and c) increasing focus on credit recovery, which has pruned debtors by INR200mn.

Outlook and valuations: Gaining momentum; maintain 'BUY'

On improving macroeconomic and credit environment we estimate CARE to clock 12% sales CAGR over FY17-19. We maintain **'BUY'** with DCF-based TP of INR1,722. The stock is currently trading at 24x FY19E P/E versus 37x for ICRA and 30x for CRISIL.

Financials

Year to March	FY16	FY17	FY18E	FY19E
Revenues (INR mn)	2,794	2,874	3,164	3,592
EBITDA (INR mn)	1,739	1,826	2,035	2,329
Adjusted Profit (INR mn)	1,196	1,474	1,499	1,715
Adjusted Diluted EPS (INR)	40.7	50.0	50.9	58.2
Diluted P/E (x)	34.4	27.9	27.5	24.0
EV/EBITDA (x)	22.6	20.5	18.2	15.7
ROAE (%)	31.2	32.6	29.1	30.5

EDELWEISS RATINGS

Absolute Rating	**BUY**
Investment Characteristics	Growth

MARKET DATA *(R: CREI BO, B: CARE IN)*

CMP	: INR 1,398
Target Price	: INR 1,722
52-week range (INR)	: 1,800 / 1,188
Share in issue (mn)	: 29.5
M cap (INR bn/USD mn)	: 41 / 632
Avg. Daily Vol. BSE/NSE ('000)	: 67.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	-	-	-
MF's, FI's & BKs	28.7	38.2	40.1
FII's	39.0	37.8	36.0
Others	32.4	24.0	23.9
** Promoters pledged shares (% of share in issue)*		:	*NIL*

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(0.4)	(8.3)	(7.9)
3 months	4.8	(12.8)	(17.6)
12 months	14.7	(4.5)	(19.1)

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Key Takeaways

Industry

- Due to high NPAs in the current environment, credit growth and hence ratings growth has been slow.
- The CPs market is growing strongly. Further, issuances of greater than INR10bn by an organisation in a year require dual rating. This will further boost ratings growth from CPs.
- Due to recent reforms such as RERA and Insolvency and Bankruptcy Code (IBC), the environment will take some time to stabilise. However, they will be beneficial in the long run.
- CARE has held on to its market share despite the tough environment.

Additional revenue opportunities

- Not only insolvency & bankruptcy cases referred to NCLT, but also cases not yet referred but still in Joint Lenders Forum (JLF) need dual ratings.
- Post the resolution of a case, the balance debt has to be rated. This rating has to be BBB- or better to be considered to be sustainable debt and avoid being referred to NCLT. Hence, such companies will provide another source of revenue to credit rating agencies.
- Management perceives additional growth of ~2-3% due to new NCLT norms and dual ratings for CPs.

Bringing in operational efficiencies

- CARE has sharpened focus on credit recovery from debtors. This has led to reduction of debtors by ~INR200mn.
- A dedicated team has been set up to serve large corporates to ensure quality services to important clients. This has led to improved relations with large corporates.
- Corporates are the most lucrative clients (better than PSUs), particularly in the financial sector.
- <u>Negotiations are underway with a few client to enhance fees cap. These have been productive in some cases, leading to higher fees.</u>

Revenue trend

- Q1 is generally slower since companies' annual reports are not prepared. It was further delayed in FY17 due to implementation of IND-AS.
- Management is targeting revenue of INR5bn in 4 years, implying 15% CAGR.
- Operations in Nepal and Mauritius are envisaged to scale up strongly.

Diversification outside core with seeding new businesses through CART

- CARE is looking to deploy its cash through CART. This subsidiary will be utilised to diversify into advisory, training and research. This may be through expansion into smaller, but new businesses.
- Potential segments to expand into are bond valuation, sustainability ratings, etc.
- Management perceives CART as a strong asset which robust revenue potential.

Investing in employees

- CARE is investing in its leadership team. It is sending employees to renowned universities such as Harvard Business School and IIMs for short-term courses.
- Management is consciously moving to a more employee friendly culture through festival celebrations and events. Further, grievances, monetary or non-monetary, are being addressed more directly.
- NSIC subsidy for SME ratings has been exhausted already. However, CARE has invested in a better team through which it can push Basel II ratings to SMEs.
- Management is countering the cut in NSIC subsidy by investing further in SME team rather than downsizing it, like competitors. This enables a stronger and more adaptable team to offer diverse products.
- <u>ESOPs of 0.5mn shares have been issued to employees. This is the second lot to be issued.</u>

Push to improve branding

- Management has reiterated integrity as being first priority. It is reassessing current ratings and cleaning them up. This is part of CARE's strategy to improve branding.
- CARE is trying to enhance outreach and transparency. Senior management is going out and meeting mutual funds to share knowledge and win confidence about the company's processes and products.

Company Description

Credit Analysis & Research Ltd (CARE) is primarily engaged in rating services which accounts for around 97% of the total revenue of the company (as of FY17). CARE is the second largest rating company in India in terms of rating turnover. CARE has achieved a steady growth in its ratings business having rating relationships with 15,098, increase in number of assignments to 10,027 and cumulatively rated INR13.19lac crs of debt in FY17.

In the last few years, the company has begun expanding internationally and is providing technical assistance services to countries like Maldives, Hongkong, Nepal and Mauritius. In addition, CARE entered into collaboration with four credit rating agencies from emerging markets like in Brazil, Portugal, Malaysia, and South Africa each to provide ratings in those countries, set up ARC ratings in those countries. CARE also provides research services and it has been expanding its product portfolio to include newer services. The company is exploring opportunities to provide risk management solutions and acquired 75.1% stake in Kalypto, a firm providing risk management software solutions in Nigeria in Nov 2011.

Investment Theme

With majority of revenue coming from ratings as compared to diversified profile of other companies, the company is well placed to leverage the cyclical and structural uptick in the bank loan and corporate debt ratings. Being the second largest rating agency in India by revenue market share, CARE is well-positioned to take advantage of India's cyclical recovery in the CDR and BLR ratings leading to 12%CAGR over FY17-19E. With operating leverage, we expect a cyclical and structural turnaround to lead to 13% EBITDA CAGR over FY17-19E and average of 64% OPM.

Key Risks

Risk of defaults

Any rating default by a client would hamper the credibility of the rating agency. However SEBI's mandatory disclosures of default rates would keep the rating agency under control of the watch guard.

Concentration risk

CARE's business is concentrated on rating revenues which account for 97% of consolidated revenues as compared to CRISIL and ICRA which are more diversified in revenue profile. As a result macroeconomic concern would impact the growth of the company. However, the company has taken small steps towards diversification with the acquisition of Kalypto, a risk management company in Nigeria. Also the company is developing its business outside India having entered Maldives, Nepal, Mauritius, Brazil, Portugal, Malaysia and South Africa through various route like technical assistance to local agencies and JV route.

High margin sustenance

CARE has one of the highest operating margins in the industry due to its cost competitiveness and technology-driven ratings methodology. The company's foray into newer geographies and services may potentially impact margins in the medium term. However management is comfortable sustaining operating margins at ~63% and plus.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
Sector				
Corp debt iss. growth(%)	5.0	19.6	20.0	18.0
Banking cr. growth (%)	14.0	9.0	12.0	14.0
Company				
Corporate Debt ratings				
Vol of debt rated(INRbn)	5,400	7,250	6,889	8,073
Bank Loan Ratings				
Number of new assigments	6,038	5,828	6,318	6,949
SME				
Nos	1,072	1,179	1,356	1,654
Rating revenues (INR mn)				
CDR inc(INR mn)	1,150	1,305	1,447	1,695
BLR inc(INR mn)	1,321	1,297	1,381	1,526
SME	181	207	236	271

Income statement (INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	2,794	2,874	3,164	3,592
Gross profit	2,037	2,149	2,383	2,703
Employee costs	756	726	781	889
Other Expenses	299	322	348	374
EBITDA	1,739	1,826	2,035	2,329
Depreciation	42	34	41	42
EBIT	1,697	1,792	1,994	2,287
Add: Other income	86.9	328.55	243.46	271.69
Profit Before Tax	1,784	2,121	2,238	2,559
Less: Provision for Tax	588	647	738	844
Reported Profit	1,196	1,474	1,499	1,715
Adjusted Profit	1,196	1,474	1,499	1,715
Shares o /s (mn)	29	29	29	29
Adjusted Basic EPS	40.7	50.0	50.9	58.2
Diluted shares o/s (mn)	29	29	29	29
Adjusted Diluted EPS	40.7	50.0	50.9	58.2
Adjusted Cash EPS	41.9	51.6	52.3	59.6
Dividend per share (DPS)	28.0	28.0	32.0	35.5
Dividend Payout Ratio(%)	79.8	64.9	72.9	70.7

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	37.8	36.5	35.7	35.2
Depreciation	1.5	1.2	1.3	1.2
EBITDA margins	62.2	63.5	64.3	64.8
Net Profit margins	42.8	51.3	47.4	47.7

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	7.2	2.9	10.1	13.5
EBITDA	9.0	5.0	11.4	14.5
PBT	(9.4)	18.9	5.5	14.4
Adjusted Profit	(13.2)	23.2	1.7	14.4
EPS	(14.4)	23.0	1.7	14.4

Balance sheet (INR mn)

As on 31st March	FY16	FY17	FY18E	FY19E
Share capital	294	295	295	295
Reserves & Surplus	3,793	4,658	5,064	5,566
Shareholders' funds	4,087	4,952	5,358	5,860
Minority Interest	-	5	5	5
Long Term Liabilities	57	40	40	40
Def. Tax Liability (net)	22	35	35	35
Sources of funds	**4,165**	**5,032**	**5,438**	**5,940**
Net Block	553	526	506	484
Capital work in progress	-	1	1	1
Intangible Assets	82	83	83	83
Total Fixed Assets	635	610	589	567
Non current investments	2,206	793	793	793
Cash and Equivalents	1,729	3,688	4,090	4,576
Sundry Debtors	236	253	277	315
Loans & Advances	143	146	146	146
Other Current Assets	73	36	36	36
Current Assets (ex cash)	452	436	460	497
Other Current Liab	857	494	494	494
Total Current Liab	(405)	(59)	(34)	3
Uses of funds	**4,165**	**5,032**	**5,438**	**5,940**
BVPS (INR)	139.0	168.2	181.9	199.0

Free cash flow (INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Reported Profit	1,196	1,474	1,499	1,715
Add: Depreciation	42	34	41	42
Interest (Net of Tax)	19	8	-	-
Others	(361)	(295)	(49)	(75)
Less: Changes in WC	(169)	30	(24)	(38)
Operating cash flow	1,064	1,190	1,516	1,719
Less: Capex	29	10	20	20
Free Cash Flow	**1,035**	**1,180**	**1,496**	**1,699**

Cash flow metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating cash flow	1,064	1,190	1,516	1,719
Investing cash flow	(409)	(220)	(20)	(20)
Financing cash flow	(662)	(958)	(1,093)	(1,213)
Net cash Flow	(7)	12	403	486
Capex	(29)	(10)	(20)	(20)
Dividend paid	(910)	(992)	(1,093)	(1,213)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	31.2	32.6	29.1	30.5
ROACE (%)	46.5	46.9	43.4	45.6
ROA	30.5	32.0	28.6	30.1
Debt / Cap employed (%)	21.1	10.5	9.7	8.9

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	0.7	0.6	0.6	0.6
Fixed Asset Turnover	4.4	4.6	5.3	6.2
Equity Turnover	0.7	0.6	0.6	0.6

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	40.7	50.0	50.9	58.2
Y-o-Y growth (%)	*(14.4)*	*23.0*	*1.7*	*14.4*
Adjusted Cash EPS (INR)	41.9	51.6	52.3	59.6
Diluted P/E (x)	34.4	27.9	27.5	24.0
P/B (x)	10.1	8.3	7.7	7.0
EV / Sales (x)	14.1	13.0	11.7	10.2
EV / EBITDA (x)	22.6	20.5	18.2	15.7
Dividend Yield (%)	2.0	2.0	2.3	2.5

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		P/B (X)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
CARE Ratings Limited	632	27.5	24.0	18.2	15.7	7.7	7.0
Crisil	1,974	35.8	29.9	23.8	20.2	12.0	10.7
ICRA	604	45.3	36.6	31.9	25.3	7.2	6.5
Median	-	35.8	29.9	23.8	20.2	7.7	7.0
AVERAGE	-	36.2	30.2	24.6	20.4	9.0	8.0

Source: Edelweiss research

Additional Data

Directors Data

Mr. S. B. Mainak	Chairman	Mr. Rajesh Mokashi	Managing Director & CEO
Mr. A.K. Bansal	Independent Director	Dr. Ashima Goyal	Independent Director
Mr. Milind Sarwate	Independent Director	Ms. Sadhana Dhamane	Additional Director (Non - Executive)

Auditors - Khimji Kunverji & Co

**as per last available data*

Holding Top -10

	Perc. Holding		Perc. Holding
Franklin Resources	11.88	Goldman Sachs Group	3.52
Life Insurance Corporation of India	9.79	Reliance Capital	3.51
HDFC Bank	9.56	Norges Bank	3.18
CRISIL	8.90	Government Pension Fund	3.17
Templeton Asset Management	4.88	UTI Asset Management	2.78

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Credit Rating

CARE Ratings Limited, Crisil, ICRA

Recent Research

Date	Company	Title	Price (INR)	Recos
23-Aug-17	**Credit Analysis and Research**	Decent quarter; improving prospects; *Result Update*		Buy
07-Aug-17	**CRISIL**	Beneficiary of regulatory reforms; *Visit Note*		Hold
07-Aug-17	**ICRA**	Focus on core; debt leadership boosts margin expansion;		Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

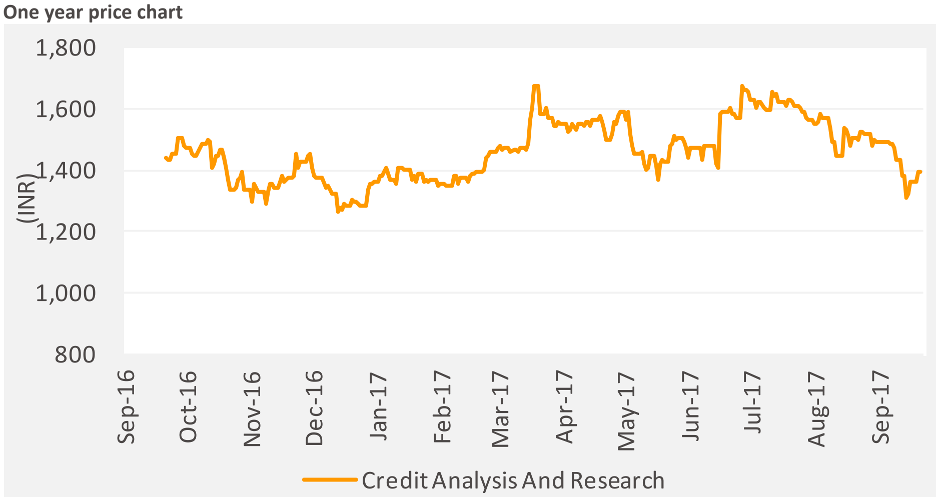
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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