Volume No. I Issue No. 88

Credit Analysis and Research Ltd. (CARE Ratings)

Sep. 9, 2016

BSE Code: 534804 | NSE Code: CARERATING | Reuters Code: CREI:NS | Bloomberg Code: CARE:IN

Poised to grow from cyclical recovery

Credit Analysis & Research Limited (CARE Ratings), incorporated in 1993, is the second largest full service rating company in India in terms of rating income (as of FY16). CARE Ratings is promoted by major banks and financial institutions in India. The company has 13 offices in India and 1 office in Male in the Republic of Malidves. CARE offers a wide range of rating and grading services across a diverse range of instruments and has over 23 years of experience in the rating of debt instruments and related obligations covering almost all range of sectors.

Investment Rationale

Debt rating volume to show healthy traction: CARE Ratings' total volume of debt rated securities increased at a moderate pace of 6.1% CAGR over FY11-16 largely due to subdued credit environment over the last two years. However, we believe that bank credit offtake has bottomed out and we expect revival in next few quarters. Besides, various steps have been taken in recent past by the RBI, SEBI and the government which will result in the deepening of the corporate bond market in India. Therefore, we expect debt rating volume to increase at a healthy CAGR of 16.6% over FY16-18E.

Revenue to grow at a CAGR of 15.7% over FY16-18E: Slowdown of investment cycle and credit offtake in the economy saw system wide moderation in the rating business. As a result, operating revenue of CARE Ratings grew at a modest 9.2% CAGR over FY11-16. However, with the company's aggressive expansion strategy in SME and MSME segments coupled with revival in investment cycle, we expect operating revenue to grow at a CAGR of 15.7% over FY16-18E.

Superior Profitability Margins: CARE Ratings has consistently maintained its EBITDA and net profit margin above 60% and 40%, respectively over the last five years. With a likely improvement in corporate debt market coupled with improving efficiency, we expect EBITDA and net profit margin to improve to 66.5% and 45.0%, respectively in FY18E.

Strong return ratios: In general, rating agencies enjoy healthy return ratios on account of higher margins and limited capital requirement. CARE Ratings has consistently maintained its RoE and RoCE above 25% and 30%, respectively over the last five years. We further expect return ratios to improve owing to better revenue traction and higher dividend payout (RoE and RoCE to touch 36.3% and 48.4%, respectively in FY18E).

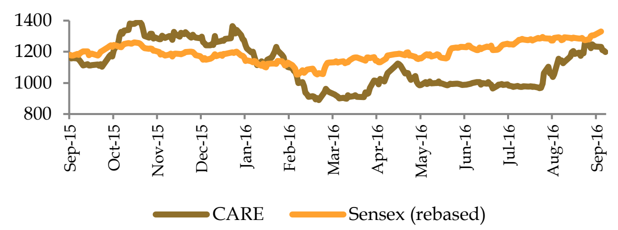
Valuation: With industry leading growth rate, highest margins among listed peers and superior return profile, CARE Ratings is best placed to benefit from cyclical recovery in corporate capex and bank credit growth. It is our preferred pick among the listed credit rating agencies. At CMP of Rs. 1,199, the stock is trading at P/E of 25.0x/20.7x for FY17E/FY18E. We assign BUY rating on the stock with target price of Rs. 1,451 based on 25x FY18E P/E.

Market Data	
Rating	**BUY**
CMP (Rs.)	1,199
Target (Rs.)	1,451
Potential Upside	21%
Duration	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	1,412/885
Adj. all time High (Rs.)	1,739
Decline from 52WH (%)	15.1
Rise from 52WL (%)	35.5
Beta	0.2
Mkt. Cap (Rs.Cr)	3,527

Fiscal Year Ended

Y/E	FY15	FY16	FY17E	FY18E
Net sales (Rs.Cr)	257	265	302	354
Adj. profit (Rs.Cr)	140	118	141	171
EPS (Rs.)	48.4	40.0	48.0	58.1
P/E (x)	27.1	30.0	25.0	20.7
P/BV (x)	10.6	8.6	8.0	7.1
ROE (%)	33.2	30.6	33.2	36.3

One year Price Chart



Shareholding Pattern	Jun-16	Mar-15	Chg.
Promoters (%)	0.0	0.0	-
Public (%)	100.0	100.0	-

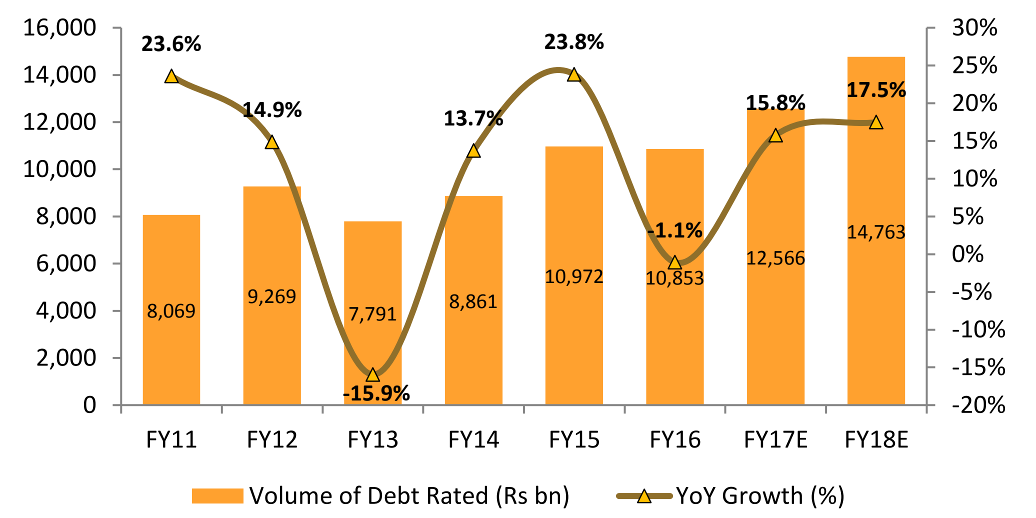
Company Overview

Credit Analysis & Research Limited (CARE Ratings), incorporated in 1993, is the second largest full service rating company in India in terms of rating income (as of FY16). CARE Ratings is promoted by major banks and financial institutions in India. The company has 13 offices in India and 1 office in Male in the Republic of Malidves. CARE offers a wide range of rating and grading services across a diverse range of instruments and has over 23 years of experience in the rating of debt instruments and related obligations covering almost all range of sectors.

Debt rating volume to show healthy traction

CARE Rating is primarily engaged in rating services and enjoys a strong market position with respect to undertaking ratings of most types of debt instruments and bank loan facilities. The total volume of debt rated securities increased at a moderate pace of 6.1% CAGR over FY11-16 largely due to subdued credit environment over the last two years. However, the company continued to enjoy the second position in terms of market share of rating revenue over the last five years. We believe that bank credit offtake has bottomed out and we expect revival in next few quarters. Besides, various steps have been taken in recent past by the RBI, SEBI and the government which will result in the deepening of the corporate bond market in India. Additionally, the SME segment is also expected to witness improvement in FY17E as the government has increased budgetary allocation towards subsidizing rating fees of SMEs to Rs 200 cr from Rs 45 Cr in FY16. Therefore, we expect debt rating volume to increase at a healthy CAGR of 16.6% over FY16-18E.

Rating volume to grow at a CAGR of 16.6% over FY16-18E



Source: Company, In-house research

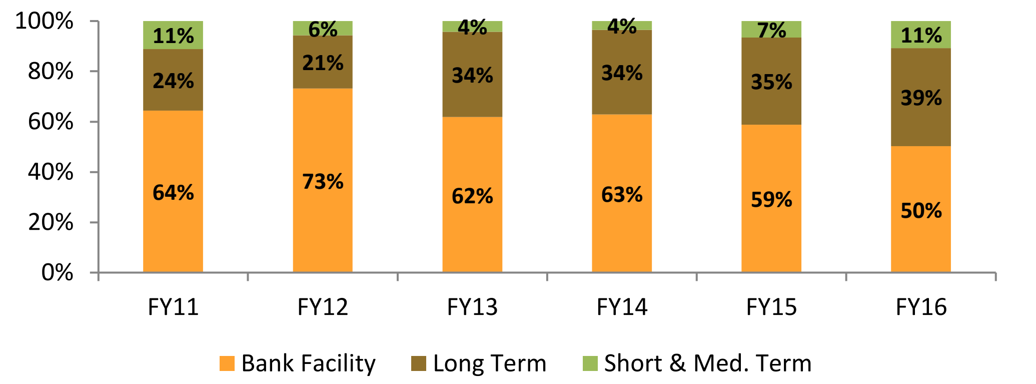
Rating volume growth across different segments

Rs bn	FY11	FY12	FY13	FY14	FY15	FY16	CAGR FY11-16
Bank Facility	5,199	6,788	4,818	5,566	6,450	5,452	*1.0%*
YoY Growth (%)		*30.6*	*-29.0*	*15.5*	*15.9*	*-15.5*	
Long Term	1,970	1,955	2,644	2,983	3,798	4,234	*16.5%*
YoY Growth (%)		*-0.7*	*35.2*	*12.8*	*27.3*	*11.5*	
Short & Med. Term	900	525	329	312	724	1,167	*5.3%*
YoY Growth (%)		*-41.7*	*-37.3*	*-5.3*	*132.4*	*61.1*	
Total	8,069	9,269	7,791	8,861	10,972	10,853	*6.1%*

Source: Company, In-house research

Long term debt instruments and bank loans are two main rating products of the company which contribute ~90% of the total rating business volumes.

More than ~90% of total rating volumes comes from Long term debt and bank loans

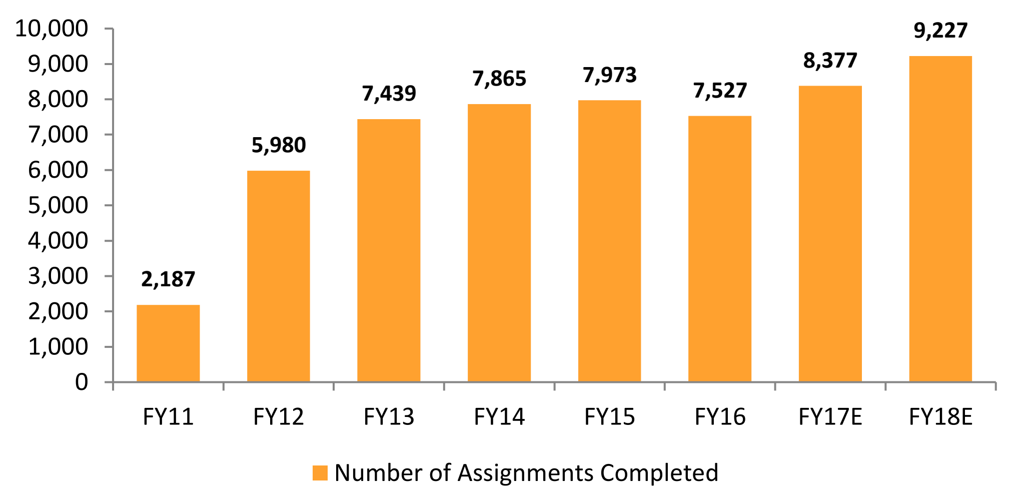


Source: Company, In-house research

Rapid growth in number of rating assignments

The total number of rating assignments increased at much faster pace of 28% CAGR over FY11-16 and touched 7,527 in FY16 from 2,187 in FY11. CARE Ratings emerged as a leader in terms of the number of ratings of private placement issues in FY16 and rated ~32% of total privately placed issues. However, there was a decline in number of rating assignments completed in FY16 over FY15 on the back of lower rating assignments in SME segment. However, we believe that we may see uptick in SME rating assignments due to higher subsidy allocation for subsidised ratings in FY17. We expect total number of rating assignment to increase at a CAGR of 10.7% over FY16-18E.

Number of assignments to increase at a CAGR of 10.7% over FY16-18E

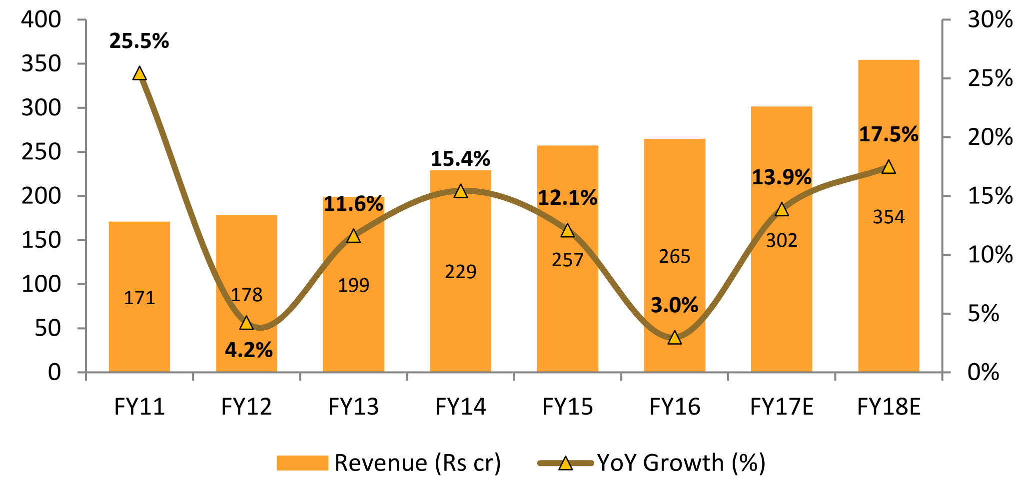


Source: Company, In-house research

Revenue to grow at a CAGR of 15.7% over FY16-18E

Slowdown of investment cycle and credit offtake in the economy saw system wide moderation in the rating business. As a result, operating revenue of CARE Ratings grew at a modest 9.2% CAGR over FY11-16. However, the company is planning to increase its market share through aggressive expansion in SME and MSME segments. As a part of its efforts, the company has launched income generating pool of products such as SME rating, MSE rating, Edu-grade, Equi-grade, Real Estate and Market Linked Debenture Valuation. We expect operating revenue to grow at a CAGR of 15.7% over FY16-18E.

Revenue to grow at 15.7% CAGR over FY16-18E

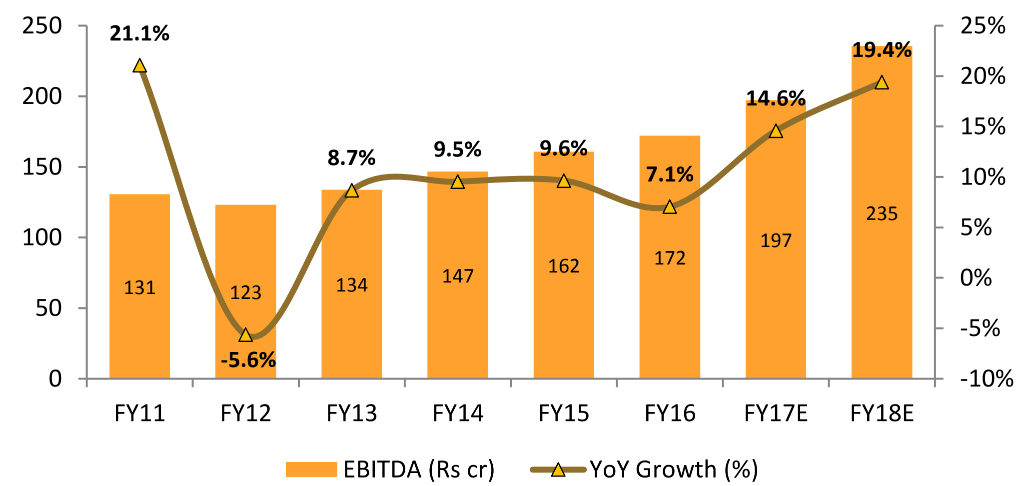


Source: Company, In-house research

Superior Profitability Margins

CARE Rating's EBITDA and net profit increased at a CAGR of 5.7% and 5.3%, respectively over FY11-16 on the back of slower operating revenue growth. However, the company has consistently maintained its EBITDA margin and net profit margin above 60% and 40%, respectively over the last five years. Although EBITDA margin and net profit margin of CARE Ratings reported declining trend over the last five years, it still remained one of the best among listed credit rating players due to its lower operating costs. The company's operational efficiency is the result of (1) increased use of technology and (2) Centralized office in Ahmedabad for all the back office work

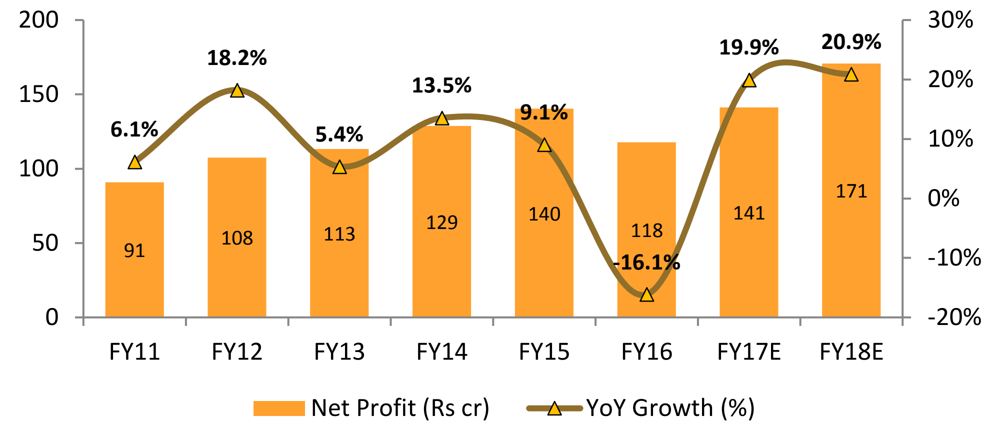
EBITDA to grow at a CAGR of 17.0% over FY16-18E



Source: Company, In-house research

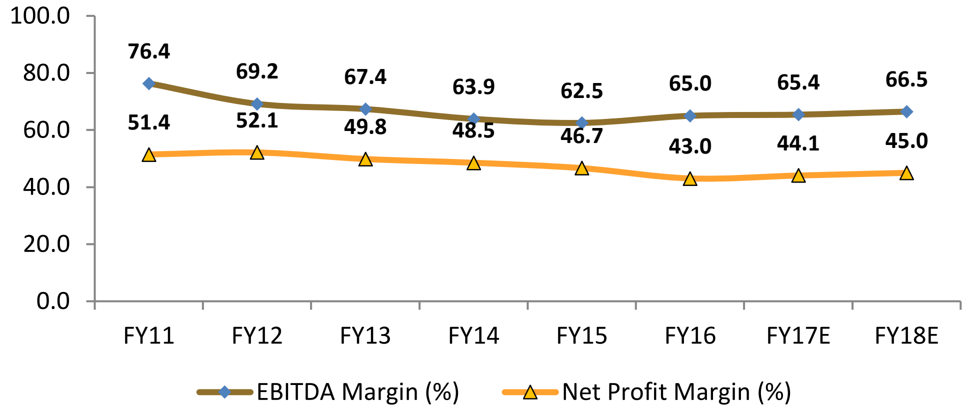
With a likely improvement in corporate debt market coupled with improving efficiency, we expect EBITDA and net profit to grow at a healthy pace of 17.0% and 20.4% CAGR, respectively over FY16-18E. As a result, EBITDA and net profit margin to improve to 66.5% and 45.0%, respectively in FY18E.

Net profit to grow at a CAGR of 20.4% over FY16-18E



Source: Company, In-house research

EBITDA & PAT margin to improve further

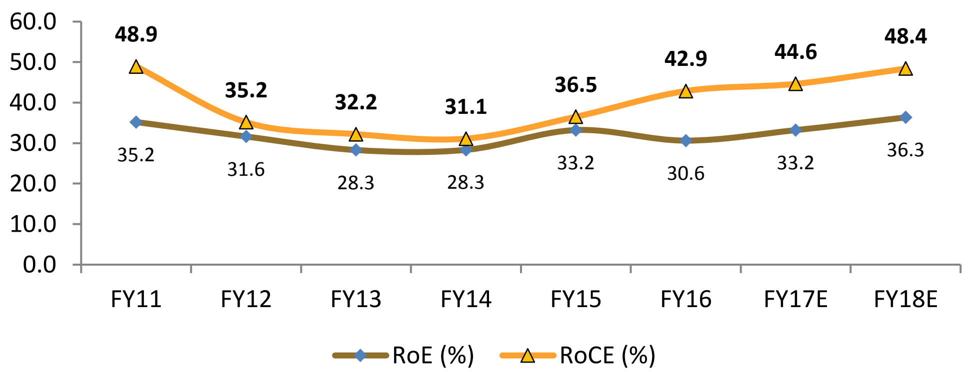


Source: Company, In-house research

Strong return ratios

In general, rating agencies enjoy healthy return ratios on account of higher margins and limited capital requirement. CARE Ratings has consistently maintained its RoE and RoCE above 25% and 30%, respectively over the last five years. We further expect return ratios to improve owing to better revenue traction and higher dividend payout (RoE and RoCE to touch 36.3% and 48.4%, respectively in FY18E).

Strong return ratios

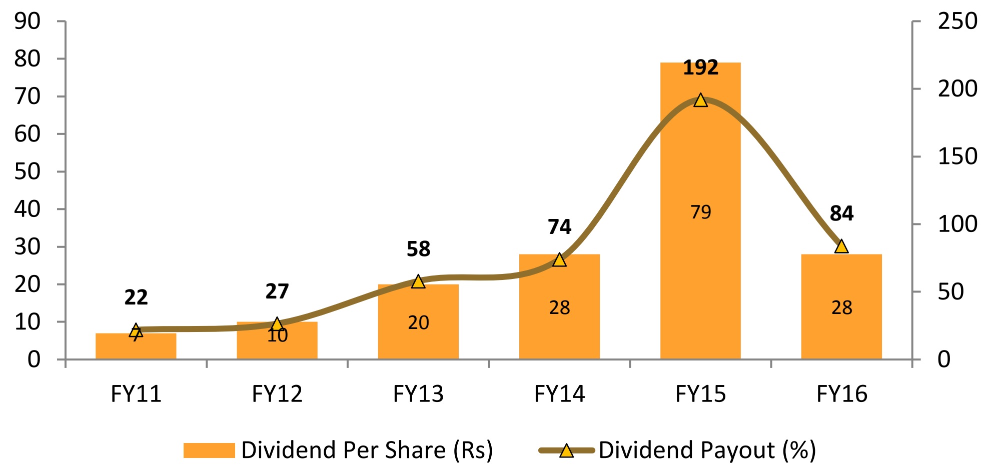


Source: Company, In-house research

Healthy dividend payout

The dividend payout ratio of CARE Ratings has improved from 22% FY11 to 84% in FY16. Additionally, the company also declared a special dividend of Rs. 65/- per equity share of Rs. 10/- each in FY15. The company has healthy cash position of Rs. 378 crore as of FY16. Besides, given the company's debt-free status and a healthy free cash flow, we believe that the company would continue to reward shareholders handsomely in the future.

Strong return ratios



Source: Company, In-house research

Outlook and Valuation

CARE Ratings has emerged as one of the fastest growing rating company in the industry with increasing market share in debt and bank loan ratings. Despite near term headwinds, we are positive on the huge long term opportunities for the credit rating sector on the back of development in debt market which is currently at a nascent stage in India. We are impressed by its above industry leading growth rate, highest margins among listed peers and superior return profile among listed peers. Besides, it is an established brand and has a well experienced management. Overall, CARE Ratings is best placed to benefit from cyclical recovery in corporate capex and bank credit growth. Therefore, it is our preferred pick among the listed credit rating agencies. At CMP of Rs. 1,199, the stock is trading at P/E of 25.0x and 20.7x for FY17E and FY18E, respectively. We assign BUY rating on the stock with target price of Rs. 1,451 based on 25x FY18E P/E.

Key Risks:

- **Revival in investment cycle**: Historically, growth in volume of debt instruments issued has been linked to investment cycle in India. As a result, CARE Rating's performance is largely dependent on capital investments in various sectors, such as manufacturing and infrastructure. So, slower than expected pick up in the capex cycle can have adverse impact on CARE Rating's revenue.
- **Migration to internal rating-based approach:** Under Basel III, banks are allowed to use internal rating of credit risk (known as the IRB approach)-Migration towards IRB may negatively impact the ratings revenue of the company.
- **Pricing Pressure:** There is likely to be an increase in the pricing pressure due to increasing competition which could lead to rationalization in margins enjoyed by the company.

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Total operating Income	**257**	**265**	**302**	**354**
Raw Material cost	-	-	-	-
Employee cost	71	70	78	89
Other operating expenses	24	23	26	30
EBITDA	**162**	**172**	**197**	**235**
Depreciation	5	4	4	4
EBIT	**157**	**168**	**193**	**231**
Interest cost	1	-	-	-
Other Income	44	9	19	25
Profit before tax	**199**	**177**	**212**	**256**
Tax	59	59	71	86
Profit after tax	**140**	**118**	**141**	**171**
Minority Interests	-	-	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	**140**	**118**	**141**	**171**
E/o income / (Expense)	-	-	-	-
Reported PAT	**140**	**118**	**141**	**171**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Paid up capital	29	29	29	29
Reserves and Surplus	331	379	412	468
Net worth	**360**	**408**	**442**	**498**
Minority interest	-	-	-	-
Total Debt	-	-	-	-
Other non-current liabilities	5	5	5	6
Total Liabilities	**366**	**414**	**447**	**504**
Total fixed assets	56	55	57	59
Capital WIP	-	-	-	-
Goodwill	-	-	-	-
Investments	346	392	424	478
Net Current assets	(44)	(39)	(45)	(45)
Deferred tax assets (net)	(3)	(3)	(3)	(3)
Other non-current assets	11	8	14	15
Total Assets	**366**	**414**	**447**	**504**

Cash Flow Statement (Standalone)

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Pretax profit	**199**	**177**	**212**	**256**
Depreciation	5	4	4	4
Chg. in Working Capital	(9)	(14)	10	2
Others	(31)	(1)	(19)	(24)
Tax paid	(58)	(58)	(71)	(86)
Cash flow from operating activities	**107**	**108**	**136**	**153**
Capital expenditure	(11)	(3)	(2)	(2)
Chg. in investments	132	(46)	(41)	(59)
Other investing cashflow	35	8	19	25
Cash flow from investing activities	**157**	**(41)**	**(24)**	**(36)**
Equity raised/(repaid)	-	25	-	-
Debt raised/(repaid)	-	-	-	-
Dividend paid	(275)	(91)	(108)	(115)
Other financing activities	(1)	-	-	-
Cash flow from financing activities	**(276)**	**(66)**	**(108)**	**(115)**
Net chg in cash	(13)	1	4	2

Key Ratios (Standalone)

Y/E	FY15	FY16	FY17E	FY18E
Growth (%)				
Net Sales	12.1	3.0	13.9	17.5
EBITDA	10.5	6.2	14.6	19.4
Net profit	9.1	-16.1	19.9	20.9
Margin (%)				
EBITDA	63.0	65.0	65.4	66.5
EBIT	61.1	63.5	64.1	65.3
NPM	46.7	43.0	44.1	45.0
Return Ratios (%)				
RoE	33.2	30.6	33.2	36.3
RoCE	36.5	42.9	44.6	48.4
Per share data (Rs.)				
EPS	48.4	40.0	48.0	58.1
DPS	79.0	28.0	30.0	32.0
Valuation(x)				
P/E	27.1	30.0	25.0	20.7
EV/EBITDA	21.6	20.4	17.8	14.9
EV/Net Sales	13.5	13.3	11.6	9.9
P/B	10.6	8.6	8.0	7.1
Turnover Ratios (x)				
Net Sales/GFA	4.2	4.1	4.0	4.6
Sales/Total Assets	0.7	0.6	0.7	0.7

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

***** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

***** CARE Ratings is a small-cap company.

Disclaimer:

The SEBI registration number is INH200000394.

The analyst for this report certifies that all the views expressed in this report accurately reflect his / her personal views about the subject company or companies, and its / their securities. No part of his / her compensation was / is / will be, directly / indirectly related to specific recommendations or views expressed in this report.

This material is for the personal information of the authorized recipient, and no action is solicited on the basis of this. It is not to be construed as an offer to sell, or the solicitation of an offer to buy any security, in any jurisdiction, where such an offer or solicitation would be illegal.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable, though its accuracy or completeness cannot be guaranteed. Neither Wealth India Financial Services Pvt. Ltd., nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance.

We and our affiliates, officers, directors, and employees worldwide:

1. Do not have any financial interest in the subject company / companies in this report;
2. Do not have any actual / beneficial ownership of one per cent or more in the company / companies mentioned in this document, or in its securities at the end of the month immediately preceding the date of publication of the research report, or the date of public appearance;
3. Do not have any other material conflict of interest at the time of publication of the research report, or at the time of public appearance;
4. Have not received any compensation from the subject company / companies in the past 12 months;
5. Have not managed or co-managed the public offering of securities for the subject company / companies in the past 12 months;
6. Have not received any compensation for investment banking, or merchant banking, or brokerage services from the subject company / companies in the past 12 months;
7. Have not served as an officer, director, or employee of the subject company;
8. Have not been engaged in market making activity for the subject company;

This document is not for public distribution. It has been furnished to you solely for your information, and must not be reproduced or redistributed to any other person.

Contact Us:

Funds India
Uttam Building, Third Floor|
No. 38 & 39| Whites Road|
Royapettah|Chennai – 600014|
T: +91 7667 166 166
Email: contact@fundsindia.com

Dion's Disclosure and Disclaimer

I, Kaushal Patel, employee of Dion Global Solutions Limited (Dion) is engaged in preparation of this report and hereby certify that all the views expressed in this research report (report) reflect my personal views about any or all of the subject issuer or securities.

Disclaimer

This report has been prepared by Dion and the report & its contents are the exclusive property of the Dion and the client cannot tamper with the report or its contents in any manner and the said report, shall in no case, be further distributed to any third party for commercial use, with or without consideration.
Recipient shall not further distribute the report to a third party for a commercial consideration as this report is being furnished to the recipient solely for the purpose of information.

Dion has taken steps to ensure that facts in this report are based on reliable information but cannot testify, nor make any representation or warranty, express or implied, to the accuracy, contents or data contained within this report. It is hereby confirmed that wherever Dion has employed a rating system in this report, the rating system has been clearly defined including the time horizon and benchmarks on which the rating is based.

Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this report is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. Dion has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. This report is not to be relied upon in substitution for the exercise of independent judgment. Opinions or estimates expressed are current opinions as of the original publication date appearing on this report and the information, including the opinions and estimates contained herein, are subject to change without notice. Dion is under no duty to update this report from time to time.

Dion or its associates including employees engaged in preparation of this report and its directors do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of securities, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

The investments or services contained or referred to in this report may not be suitable for all equally and it is recommended that an independent investment advisor be consulted. In addition, nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to individual circumstances or otherwise constitutes a personal recommendation of Dion.

REGULATORY DISCLOSURES:
Dion is engaged in the business of developing software solutions for the global financial services industry across the entire transaction lifecycle and inter-alia provides research and information services essential for business intelligence to global companies and financial institutions. Dion is listed on BSE Limited (BSE) and is also registered under the SEBI (Research Analyst) Regulations, 2014 (SEBI Regulations) as a Research Analyst vide Registration No. INH100002771. Dion's activities were neither suspended nor has it defaulted with requirements under the Listing Agreement and / or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 with the BSE in the last five years. Dion has not been debarred from doing business by BSE / SEBI or any other authority.

In the context of the SEBI Regulations, we affirm that we are a SEBI registered Research Analyst and in the course of our business, we issue research reports /research analysis etc that are prepared by our Research Analysts. We also affirm and undertake that no disciplinary action has been taken against us or our Analysts in connection with our business activities.
In compliance with the above mentioned SEBI Regulations, the following additional disclosures are also provided which may be considered by the reader before making an investment decision:

1. Disclosures regarding Ownership

Dion *confirms that:*

(i) Dion/its associates have no financial interest or any other material conflict in relation to the subject company (ies) covered herein at the time of publication of this report.

(ii) It/its associates have no actual / beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

Further, the Research Analyst confirms that:

(i) He, his associates and his relatives have no financial interest in the subject company (ies) covered herein, and they have no other material conflict in the subject company at the time of publication of this report.

(ii) he, his associates and his relatives have no actual/beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

2. Disclosures regarding Compensation:

During the past 12 months, Dion or its Associates:

(a) Have not managed or co-managed public offering of securities for the subject company (b) Have not received any compensation for investment banking or merchant banking or brokerage services from the subject company (c) Have not received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject. (d) Have not received any compensation or other benefits from the subject company or third party in connection with this report

3. Disclosure regarding the Research Analyst's connection with the subject company:

It is affirmed that I, Kaushal Patel, employed as Research Analyst by Dion and engaged in the preparation of this report have not served as an officer, director or employee of the subject company

4. Disclosure regarding Market Making activity:

Neither Dion /its Research Analysts have engaged in market making activities for the subject company.