Volume No. I Issue No. 115

CRISIL Ltd.

Apr. 07, 2017

BSE Code: 500092 | **NSE Code: CRISIL** | **Reuters Code: CRSL:NS** | **Bloomberg Code: CRISIL:IN**

Play on quality with consistency

CRISIL is a global analytical company and India's foremost provider of ratings, data and research, analytics and solutions, with a strong track record of growth and innovation. It was incorporated in 1987 as India's first credit rating agency. Presently, it is majorly owned by Standard and Poor's (S&P), the world's leading provider of independent credit risk research and benchmarks, and a part of McGraw Hill Financial (formerly The McGraw-Hill Companies). S&P currently owns 67.1% stake in the company.

Investment Rationale

- **Strong Rating Credibility and Brand Presence:** Credibility plays a vital role in the rating business. Brand CRISIL enjoys a high level of rating credibility in the industry which is evident from the fact that one out of every two companies rated in India has a CRISIL rating.

- **Diversified revenue streams to tide over cyclical revenue growth:** From being a credit rating agency, CRISIL successfully diversified its revenue base into three different business segments (research, rating and advisory) over the last few years to mitigate the risk arising from high dependence on any one business. Superior business model with diverse revenue streams will continue to support CRISIL to mitigate the current phase of systemic slowdown. Hence, we expect CRISIL to register a healthy CAGR of 13.9% in revenue over CY16-18E.

- **Superior return ratios with strong balance sheet:** CRISIL has consistently maintained its RoE and RoCE above 30% and 45%, respectively over CY12-16 helped by asset-light business model and debt free status. CRISIL enjoys one of the best RoE in the industry. The company has also judiciously rewarded its shareholders with dividend payout in excess of 50% over the last five years. Overall, we expect return ratios to improve owing to better revenue traction and higher dividend payout (RoE and RoCE to touch 38.1% and 52.8%, respectively in CY18E).

- **Organic as well as inorganic growth to continue:** While healthy cash flow will continue to provide inorganic growth opportunities, CRISIL's consolidated revenue is expected to grow at 13.9% CAGR organically over CY16-18E driven by research and rating businesses. While revival in global economy to support growth momentum in research business, the recent measures announced by the RBI to deepen the corporate bond market are expected to give a boost to the rating division.

Valuation: CRISIL remains the preferred bet for its consistent track record in terms of revenue & profitability coupled with strong balance sheet & leadership position. Hence, we expect CRISIL to trade at a premium valuation to its peers. Currently, the stock is available at 31.6x CY18E EPS, which is at the lower end of its historical range of 22.1–51.2x one-year forward EPS. Hence, we recommend BUY rating on the stock with a target price of Rs2,375 valuing it at its three-year mean of 38.0x CY18E EPS.

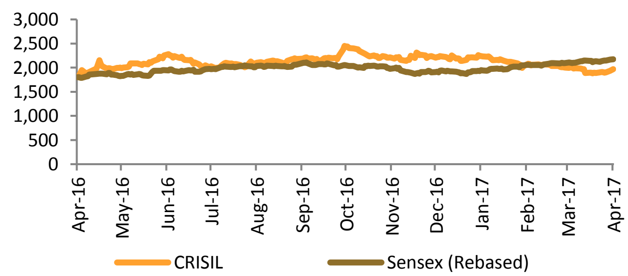
Market Data

Rating	**BUY**
CMP (Rs.)	1970
Target (Rs.)	2,375
Potential Upside	~21%
Duration	Long Term
Face Value (Rs.)	1.0
52 week H/L (Rs.)	2,490/1,840
Adj. all time High (Rs.)	2,490
Decline from 52WH (%)	20.9
Rise from 52WL (%)	7.0
Beta	0.1
Mkt. Cap (Rs.Cr)	14,025

Fiscal Year Ended

Y/E	CY15	CY16	CY17E	CY18E
Net sales (Rs.Cr)	1,380	1,547	1,758	2,011
Net profit (Rs.Cr)	285	326	379	445
EPS (Rs.)	40.0	45.8	53.3	62.4
P/E (x)	49.2	43.0	37.0	31.5
EV/EBITDA (x)	34.7	30.1	26.1	22.5
ROE (%)	33.5	35.8	36.9	38.1

One year Price Chart



Shareholding Pattern	Dec-16	Sep-16	Chg.
Promoters (%)	67.1	67.1	-
Public (%)	32.9	32.9	-

Company Overview

CRISIL is a global analytical company and India's foremost provider of ratings, data and research, analytics and solutions, with a strong track record of growth and innovation. It was incorporated in 1987 as India's first credit rating agency. Presently, it is majorly owned by Standard and Poor's (S&P), the world's leading provider of independent credit risk research and benchmarks, and a part of McGraw Hill Financial (formerly The McGraw-Hill Companies). S&P currently owns 67.1% stake in the company.

Over the years, the company has evolved to become the industry leader with a market share of greater than 60% in ratings (Source: SIDBI) and has diversified into research and infrastructure risk and policy advisory services. The company is currently one of the largest research houses in the country, providing research to over 65 industries and 150 corporates in India. The company also provides high-end offshore research and analytical services mainly to top financial institutions (including world's top 15 investment banks), insurance companies and asset management firms.

CRISIL has a more diversified business model with three segments - research, rating and advisory services. Research accounted for 64.8%/68.9% of revenue/EBIT in CY16 while rating formed 30.2%/30.8%, and advisory formed 4.9%/0.3% of revenue/EBIT in the same period.

Business Structure

Ratings

- **India Ratings**
  - Bond Ratings
  - Bank Loan Ratings
  - SME Ratings
  - Other Grading Services
- **Global Analytical Centre**

Research

- **India Research**
  - Economy & Industry Research
  - Funds & Fixed Income Research
  - Equity & Company Research
- **Global Research & Analytics**
  - Financial Research
  - Risk & Analytics
  - Corporate Research
  - Coalition

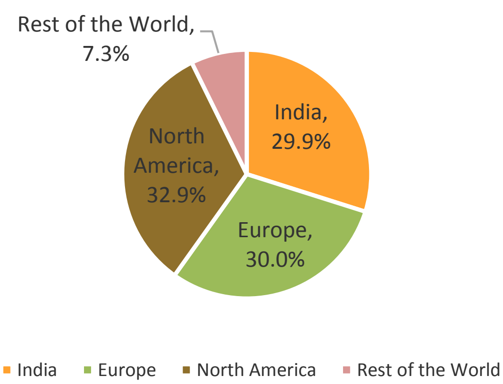
Advisory

- **Infrastructure Advisory**
- **Risk Solutions**

Source: Company, In-house research

The company has adopted a strategy of diversifying into different business segments across various geographies to mitigate the risk arising from high dependence on any one geography for revenues. While India contributed ~32% of the total consolidated revenue in CY15, North America and Europe contributed ~33% and ~30%, respectively. The company operates from 7 research centres across Argentina, China, India and Poland.

Revenue by Geography (CY16)



Source: Company, In-house research

FUNDSINDIA

.

Market leader with strong parentage

CRISIL is the largest credit rating agency (CRA) with a market share of around 60% and enjoys leadership position in the rating business including SME ratings. Besides, it is also one of the biggest research houses in India and 90% of India's commercial banks use CRISIL's industry research for credit decisions. Further, it has strong parentage of Standard and Poor's.

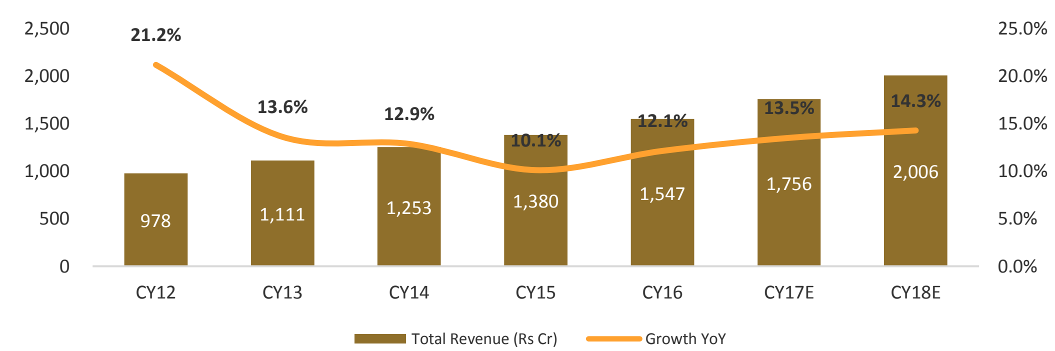
Strong rating credibility and brand presence

Credibility plays a vital role in the rating business. Brand CRISIL enjoys a high level of rating credibility in the industry which is evident from the fact that one out of every two companies rated in India has a CRISIL rating. It has robust rating process and rigorous quality control team which performs in depth reviews of all rating proposals and acts as an independent filter in the rating process. Further, CRISIL has strong brand recognition in the ratings market with over 29 years of experience in rating financial instruments.

Diversified revenue streams to tide over cyclical revenue growth

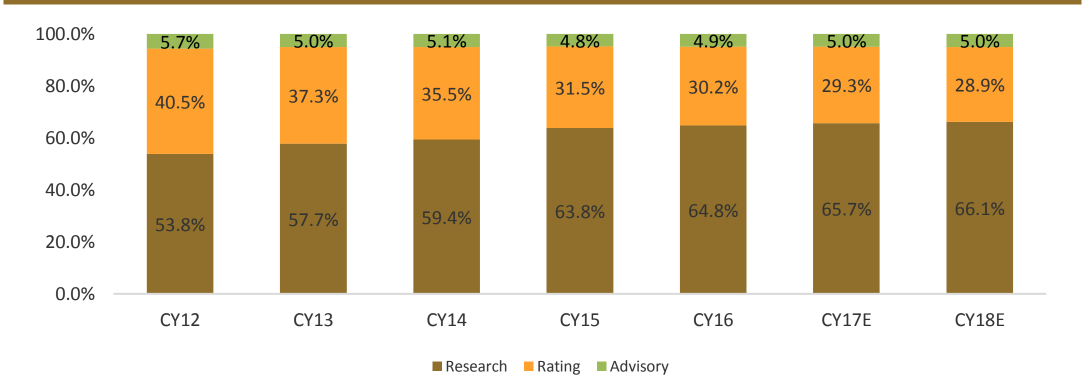
From being a credit rating agency, CRISIL successfully diversified its revenue base into three different business segments (research, rating and advisory) over the last few years to mitigate the risk arising from high dependence on any one business. Therefore, it is less exposed to concentration risk as bank loan rating (BLR) revenue would be at risk in the future if banks move to internal rating based (IRB) approach to measure credit risk. CRISIL has also diversified its business model in terms of geography. Superior business model with diverse revenue streams enabled CRISIL to mitigate the current phase of systemic slowdown. CRISIL's consolidated revenue grew at a healthy CAGR of 11.7% over CY13-16. Further, we expect CRISIL to register a CAGR of 13.9% in revenue over CY16-18E.

Revenue to grow at 13.9% CAGR over CY16-18E



Source: Company, In-house research

Research segment to contribute more than 65% of total revenue over CY16-18E



Source: Company, In-house research

GR&A to drive research revenue

CRISIL's research division posted an aggressive 18.8% CAGR over CY11-16 on the back of inorganic growth. While depressed investment cycle and weak performance of banks impacted India research business, research revenue growth was primarily driven by CRISIL GR&A's (Global Research & Analytics) risk and analytics. A series of acquisitions and their integration strengthened the research capability and widened the product portfolio of GR&A. It acquired Pipal Research (a Chicago-based leading knowledge services firm delivering high-quality financial and business research to organisations worldwide) in CY10 and Coalition (a UK-based analytics firm serving leading global investment banks) in CY12. These acquisitions strengthened its product bouquet as well as its presence in global research. As a result, the research revenue contribution has increased to 64.8% in CY16 from 46.6% in CY10. Further, GR&A won various mandates in CY16 which are expected to support future growth. Therefore, with revival in global economy, we expect its research revenues to grow at a CAGR of 15.0% over CY16-CY18E.

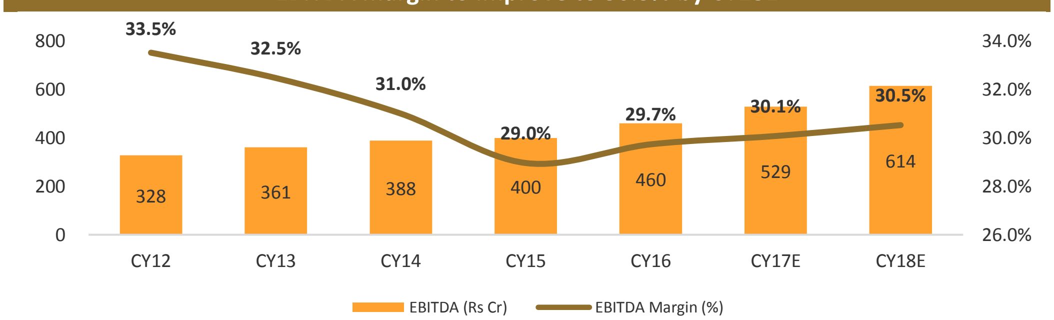
Rating revenue to show healthy traction

CRISIL derived 30.2% (CY16) of its total revenue from Indian rating business and is the market leader in the domestic rating industry. However, CRISIL's rating revenue saw modest 7.5% CAGR over CY11-16 owing to subdued investment by private sector and sluggish credit off take in the recent years. Further, SME Ratings was also impacted due to reduced budgetary support by the government. However, we expect rating revenue to show healthy traction with 11.2% CAGR over CY16-CY18E on the back of pick up in corporate bond issuances, gradual but steady improvement in bank credit demand with improving investment climate and declining interest rates.

EBITDA margin to improve to 30.5% by CY18E

CRISIL's EBITDA increased at a CAGR of 8.5% over CY13-16 as compared to 11.7% CAGR in revenue mainly due to declining EBITDA margin. EBITDA margin is largely dependent on the company's revenue mix and growth. While CRISIL successfully maintained healthy growth momentum over the past three years, it changed its revenue mix towards research business. Margins are relatively lower in research business as compared to rating business. Besides, CRISIL remained the best pay master in the industry to retain talent which resulted into higher employee cost for the company. As a result, EBITDA margin declined to 29.0% in CY15 from 33.5% in CY12. However, we expect EBITDA to grow at a CAGR of 15.5% over CY16-18E on the back of healthy revenue growth. Further, with better productivity and control over establishment costs coupled with likely improvement in high-margin corporate bond market, we estimate EBITDA margin to gradually increase to 30.1% and 30.5% in CY17E and CY18E, respectively.

EBITDA margin to improve to 30.5% by CY18E

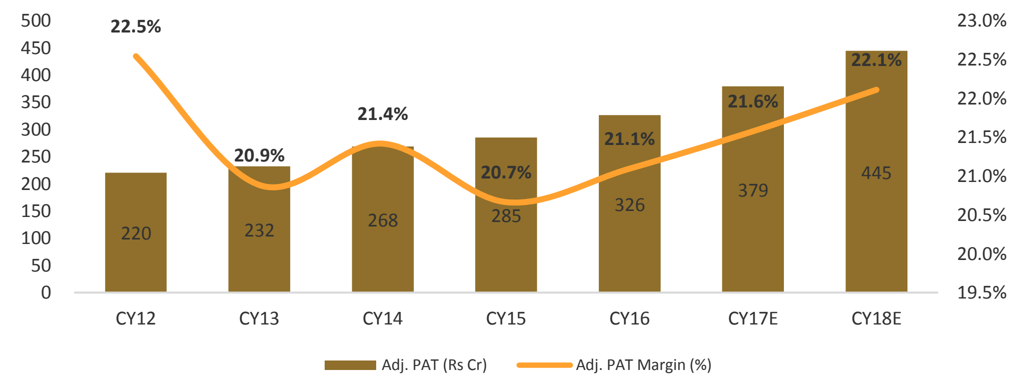


Source: Company, In-house research

Net profit margin to improve to 22.1% by CY18E

CRISIL derived a major chunk of its revenue from exports, which was tax-exempted till FY11 under the Software Technology Parks of India's (STPI) regulations. However, this exemption ended from FY12 onwards. As a result, the company's tax rate increased to 30% from CY12 as compared to 22% in CY10 and 25% in CY11. Therefore, CRISIL's net profit grew at a much slower pace of 9.6% CAGR over CY11-16. Net profit margin also declined to 20.7% in CY15 from 22.5% in CY12. However, we expect net profit to grow at 16.7% CAGR over CY16-18E led by 140 bps margin improvement led by strong topline growth and improvement in EBITDA margin.

Net profit margin to improve to 22.1% by CY18E

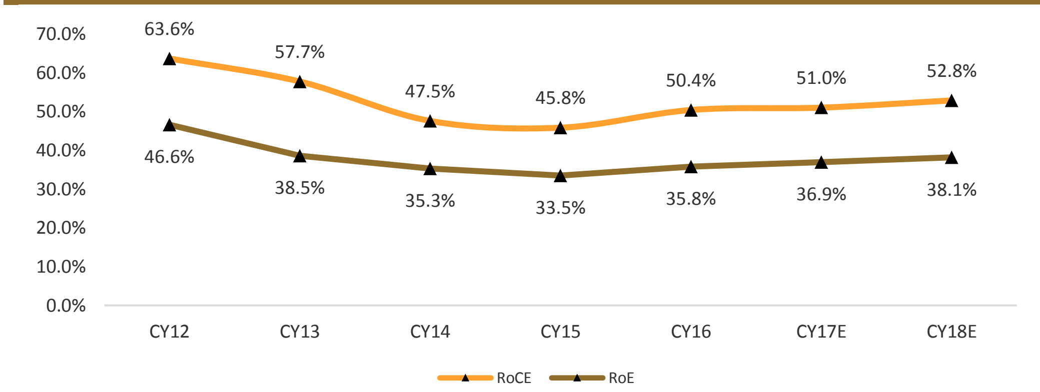


Source: Company, In-house research

Superior return ratios with strong balance sheet

CRISIL has consistently maintained its RoE and RoCE above 30% and 45%, respectively over CY12-16 helped by asset-light business model and debt free status. Further, CRISIL's RoE stood at 35.8% in CY16 which was the best in the industry – CARE (30.6%) and ICRA (16.9%). The company has also judiciously rewarded its shareholders with dividend payout in excess of 50% over the last five years. With healthy free cash flow and debt-free balance sheet, dividend payout is expected to remain healthy and above 50% over CY16-18E. Overall, we expect return ratios are set to improve owing to better revenue traction and higher dividend payout (RoE and RoCE to touch 38.1% and 52.8%, respectively in FY18E).

Return ratios set to improve further



Source: Company, In-house research

Outlook and Valuation

CRISIL has consistently maintained its RoE and RoCE above 30% and 45%, respectively over CY12-16. We continue to like CRISIL for its strong percentage, superior return ratios, free cash flow yield and healthy dividend pay-out. Moreover, the recent correction in the stock price provides a good entry point to the long-term investors. Although the stock may witness some near-term pressure due to a reduction in subsidy for SME ratings, the long-term growth story of the company remains intact. Hence, considering company's consistent track record in terms of revenue & profitability coupled with strong balance sheet & leadership position, we expect CRISIL to trade at a premium valuation to its peers. Currently, the stock is available at 31.6x CY18E EPS, which is at the lower end of its historical range of 22.1–51.2x one-year forward EPS. Hence, we recommend BUY rating on the stock with a target price of Rs2,375 valuing it at its three-year mean of 38.0x CY18E EPS.

Key Risks:

- **Foreign exchange earning risk:** CRISIL's foreign currency revenue earnings are significant and any appreciation or depreciation in the rupee can have a significant impact on revenue and profitability.
- **Introduction of internal rating-based (IRB) 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:** CRISIL enjoys the highest market share in industry. However, growing competition from players such as CARE, ICRA, Brickwork, Fitch Rating and SMERA can increase the pricing pressure which could lead to rationalization in margins enjoyed by the company.
- **Attrition risk:** Employees are the core asset for a credit rating agency and hence attrition can be a huge risk. The risk of employee movement (especially at the middle / senior management) level can expose it to grave risk.

FUNDSINDIA

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	CY15	CY16	CY17E	CY18E
Total operating Income	**1,380**	**1,547**	**1,758**	**2,011**
Raw Material cost	94	46	116	133
Employee cost	694	775	875	1,001
Other operating expenses	193	266	238	263
EBITDA	**400**	**460**	**529**	**614**
Depreciation	37	40	42	45
EBIT	**362**	**420**	**487**	**569**
Interest cost	-	-	-	-
Other Income	43	56	55	67
Profit before tax	**406**	**476**	**542**	**635**
Tax	121	150	163	191
Profit after tax	**285**	**326**	**379**	**445**
Minority Interests	-	-	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	**285**	**326**	**379**	**445**
E/o income / (Expense)	-	-	-	-
Reported PAT	**285**	**326**	**379**	**445**

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	CY15	CY16	CY17E	CY18E
Paid up capital	7	7	7	7
Reserves and Surplus	849	960	1,082	1,235
Net worth	**856**	**968**	**1,090**	**1,242**
Minority interest	-	-	-	-
Total Debt	-	-	-	-
Other non-current liabilities	32	34	36	37
Total Liabilities	**888**	**1,002**	**1,125**	**1,280**
Total fixed assets	98	85	69	49
Capital WIP	3	1	1	1
Goodwill	315	315	315	315
Investments	383	475	595	745
Net Current assets	7	43	63	86
Deferred tax assets (net)	36	36	36	36
Other non-current assets	46	46	47	47
Total Assets	**888**	**1,002**	**1,125**	**1,280**

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	CY15	CY16	CY17E	CY18E
Pretax profit	**406**	**476**	**542**	**635**
Depreciation	37	40	42	45
Chg. in Working Capital	(20)	(3)	8	(3)
Others	(22)	(56)	(55)	(67)
Tax paid	(130)	(150)	(163)	(191)
Cash flow from operating activities	**270**	**308**	**374**	**420**
Capital expenditure	(26)	(26)	(26)	(26)
Chg. in investments	11	(92)	(120)	(150)
Other investing cashflow	16	56	55	67
Cash flow from investing activities	**1**	**(61)**	**(91)**	**(109)**
Equity raised/(repaid)	38	-	-	-
Debt raised/(repaid)	-	-	-	-
Dividend paid	(197)	(215)	(257)	(292)
Other financing activities	(102)	-	-	-
Cash flow from financing activities	**(262)**	**(215)**	**(257)**	**(292)**
Net chg in cash	10	32	26	20

Key Ratios (Consolidated)

Y/E	CY15	CY16	CY17E	CY18E
Growth (%)				
Net Sales	10.1	12.1	13.7	14.3
EBITDA	2.9	15.1	15.0	16.1
Net profit	6.2	14.5	16.2	17.2
Margin (%)				
EBITDA	29.0	29.7	30.1	30.5
EBIT	26.3	27.1	27.7	28.3
NPM	20.7	21.1	21.6	22.1
Return Ratios (%)				
RoE	33.5	35.8	36.9	38.1
RoCE	47.6	52.2	52.7	54.5
Per share data (Rs.)				
EPS	40.0	45.8	53.3	62.4
DPS	23.0	25.0	30.0	34.0
Valuation(x)				
P/E	49.2	43.0	37.0	31.5
EV/EBITDA	34.7	30.1	26.1	22.5
EV/Net Sales	10.1	8.9	7.9	6.9
P/B	16.4	14.5	12.9	11.3
Turnover Ratios (x)				
Net Sales/GFA	4.6	5.0	5.3	5.6
Sales/Total Assets	1.1	1.1	1.1	1.2

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.

***** CRISIL Ltd. is a large-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.