

CARE RATINGS

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	665
12 month price target (INR)	810
Market cap (INR bn/USD bn)	20/0.3
Free float/Foreign ownership (%)	100.0/47.6
What's Changed	
Target Price	↓
Rating/Risk Rating	—

QUICK TAKE

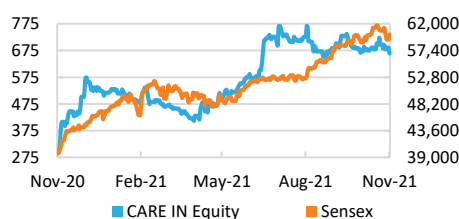
	Above	In line	Below
Profit		•	
Margins			•
Revenue Growth		•	
Overall		•	

FINANCIALS

(INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	2,484	2,648	2,972	3,343
EBITDA	958	956	1,112	1,301
Adjusted profit	895	853	955	1,112
Diluted EPS (INR)	30.4	29.0	32.4	37.8
EPS growth (%)	8.7	(4.7)	11.9	16.5
RoAE (%)	16.0	14.2	15.3	17.0
P/E (x)	21.9	22.9	20.5	17.6
EV/EBITDA (x)	15.4	15.4	13.0	10.8
Dividend yield (%)	2.6	2.9	2.9	3.3

PRICE PERFORMANCE



Explore:



Financial model



Podcast



Corporate access



Video

High base hits growth

CARE Ratings (CARE) reported flat sales growth in Q2FY22 (3% below estimates) on the back of subdued growth in ratings, in line with a broadly flat bond market. Ratings sales contracted 3% YoY. However, EBITDA slid 20% YoY, missing our estimates by 7%, owing to higher other expenses (up 104%) in the wake of raised IT, CSR and legal costs.

An internal transformation across people, processes and products is now largely complete. Management is hence focused on gradual acceleration in market share (100bps per year) in ratings and growth across subsidiaries. However, higher costs on IT and employees have prompted a cut in FY22E and FY23E EPS by 7% each. Retain 'BUY' with a TP of INR810 (INR846 earlier) at 25x FY23E EPS.

High base impacts growth

CARE's Q2FY22 overall revenues grew 1% YoY (3% below estimates) as ratings sales were muted (-3% YoY) versus 10% growth for ICRA. Bond issuances had a high base with the RBI's LTRO and TLTRO operations last year. New bond issuances were flat for the industry for Q2FY22 and down 30% in H1FY22. Credit growth recouped to 0.1% (H1FY21: -1.0%) as industry credit growth stood at -2.6% (-4.4% in H1FY21), services at -0.8% (from -1.7%). EBITDA fell 20% YoY (7% below estimates) as other expenses surged 104% YoY due to expenses incurred on upgradation of IT infrastructure and higher charges on CSR and legal fees. Besides, CARE also incurred an ESOP charge of INR20mn, causing employee costs to jump 11% in Q2FY22.

Revenue levers in place

Internal transformation on people, processes and products is now largely over and hence the focus is now on regaining lost market share in ratings (100bps per year) and new streams such as REITs and InVITs. Management continues to focus on other subsidiaries, resulting in revenues rising 35% YoY in H1FY22 and plans to derive one-third of overall revenues from these over 3–4 years. Furthermore, management sees additional revenue streams in the future, with adjacencies in analytics, data-driven assignments, research and outsourcing.

Outlook and valuation: Gradual growth uptick; retain 'BUY'

We find CARE well-placed to capitalise on an uptick in the bond market as it regains market share and the contribution other businesses increases. We build in a 14% EPS CAGR over FY22–24E. Retain 'BUY' at 25x FY23, in line with its five-year average, yielding a revised TP of INR810. The company is trading at a deep discount to peers.

Financials

Year to March	Q2FY22	Q2FY21	% Change	Q1FY22	% Change
Net Revenue	764	759	0.7	492	55.3
EBITDA	335	419	(20.0)	86	288.3
Adjusted Profit	287	355	(19.0)	110	160.0
Diluted EPS (INR)	9.7	12.0	(19.0)	3.7	160.0

Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	2,484	2,648	2,972	3,343
COGS	0	0	0	0
Employee costs	1,199	1,289	1,417	1,558
Other expenses	328	402	443	485
EBITDA	958	956	1,112	1,301
Depreciation	78	77	78	79
Less: Interest expense	6	6	6	0
Add: Other income	313	287	269	285
Profit before tax	1,186	1,160	1,296	1,506
Prov for tax	277	292	327	380
Less: Other adj	0	0	0	0
Reported profit	895	853	955	1,112
Less: Excp.item (net)	0	0	0	0
Adjusted profit	895	853	955	1,112
Diluted shares o/s	29	29	29	29
Adjusted diluted EPS	30.4	29.0	32.4	37.8
DPS (INR)	17.0	19.0	19.6	22.0
Tax rate (%)	23.3	25.2	25.2	25.2

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
Corp Debt (% of rev)	57.4	58.3	60.1	62.3
BLR (% of rev)	42.6	41.7	39.9	37.7
Gross margin (%)	51.8	51.3	52.3	53.4
EBITDA margin (%)	38.5	36.1	37.4	38.9
Net profit margin (%)	36.0	32.2	32.1	33.3
Revenue growth (% YoY)	2.0	6.6	12.2	12.5
EBITDA growth (% YoY)	17.8	(0.2)	16.3	17.0
Adj. profit growth (%)	8.7	(4.7)	11.9	16.5

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(8.0)	9.0	7.0	7.0
Repo rate (%)	4.0	4.0	4.3	5.3
USD/INR (average)	75.0	73.0	72.0	71.0
CD Issuances (% YoY)	18.0	14.0	14.0	14.0
Bank Credit (% YoY)	16.0	16.0	16.0	16.0
Debt Rated Vol (INR mn)	8,837.4	9,323.5	10,535.5	12,115.8
BLR Assignments	2,427.9	2,634.2	2,845.0	3,129.5
SME Nos.	742.6	779.7	842.1	909.4
Other costs (% of sales)	13.2	15.2	14.9	14.5

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	21.9	22.9	20.5	17.6
Price/BV (x)	3.3	3.2	3.1	2.9
EV/EBITDA (x)	15.4	15.4	13.0	10.8
Dividend yield (%)	2.6	2.9	2.9	3.3

Source: Company and Edelweiss estimates

Balance Sheet (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Share capital	295	295	295	295
Reserves	5,594	5,798	6,082	6,443
Shareholders funds	5,888	6,092	6,377	6,738
Minority interest	42	42	42	42
Borrowings	0	0	0	0
Trade payables	0	0	0	0
Other liabs & prov	666	681	695	710
Total liabilities	6,706	6,924	7,223	7,598
Net block	768	711	653	594
Intangible assets	83	83	83	83
Capital WIP	32	32	32	32
Total fixed assets	882	825	767	708
Non current inv	343	343	343	343
Cash/cash equivalent	4,876	4,879	5,177	5,543
Sundry debtors	214	486	545	614
Loans & advances	230	230	230	230
Other assets	160	160	160	160
Total assets	6,706	6,924	7,223	7,598

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	895	853	955	1,112
Add: Depreciation	78	77	78	79
Interest (net of tax)	4	4	4	0
Others	(245)	10	10	14
Less: Changes in WC	129	(272)	(59)	(68)
Operating cash flow	862	672	988	1,138
Less: Capex	(45)	(20)	(20)	(20)
Free cash flow	817	652	968	1,118

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	16.0	14.2	15.3	17.0
RoCE (%)	21.1	19.3	20.7	22.8
Inventory days	nm	nm	nm	nm
Receivable days	46	48	63	63
Payable days	nm	nm	nm	nm
Working cap (% sales)	1.2	11.4	12.2	12.9
Gross debt/equity (x)	0	0	0	0
Net debt/equity (x)	(0.8)	(0.8)	(0.8)	(0.8)
Interest coverage (x)	142.5	142.4	167.4	0

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	8.7	(4.7)	11.9	16.5
RoE (%)	16.0	14.2	15.3	17.0
EBITDA growth (%)	17.8	(0.2)	16.3	17.0
Payout ratio (%)	55.9	65.6	60.5	58.3

Q2FY22 conference call: Key highlights

Financials

- In Q2FY22, CARE's consolidated top line was flat YoY, 3% below our estimate. Ratings revenue in Q2FY22 dipped 3% YoY owing to spillover of surveillance income and RBI's TLTRO operations in the base quarter. Others segment saw a revenue growth of 9% YoY.
- **Industry:** For the industry, long-term bond issuances grew 4% YoY during Q2FY22, however, issuances dipped 30% in H1FY22 owing to a series of broad-based LTRO and TLTRO operations announced by RBI in the base.
- **CP uptick:** CP issuances jumped 50% YoY, 60% QoQ for the industry in Q2FY22 to INR6.2tn. Further, bank credit growth was up 0.1% (versus -1.0% in YTD Sep-20). This was owing to a narrowed dip across industrial credit (at -2.6% versus -4.4% in YTD Sep-21) and services credit (at -0.8% versus -1.7% in YTD Sep-21).
- EBITDA dipped 20% YoY to INR335mn (7% below estimates). This is on account of a surge in other expenses (at 104% YoY) and employee costs (at 11% YoY).
- Other expenses rose owing to higher costs for CSR (~INR10mn), IT expenses (~INR17mn) and legal and professional fees (~INR10mn). Employee expenses saw an impact of INR20mn and INR37mn in Q2FY22 and H1FY22 owing to ESOP expenses.
- PAT declined 19% YoY in Q2FY22, owing to decline in profitability.
- The Board announced an interim dividend of INR7/sh.

Operations and macroeconomic outlook

- The focus for the management is now on expanding the reach of the group and subsidiaries with people and processes in place, to improve the brand value of CARE. While market has been recognising the brand, pricing pressure remains for the company.
- The management has been upgrading technology and has upgraded the data centre and end user technology along with artificial intelligence.
- Management has put resources broadly in-place and look to cement the position in new areas of growth including outreach to clients and focus on business development. Next step is to improve productivity
- Management aims to recoup lost market share in ratings business by gaining 1% each year, from low twenties to high twenties.
- Management anticipates a pick up in the bond market owing to the PLI schemes announced by the government along with a capex cycle. Thus, wholesale credit markets should see a pick up in capex along with enhanced working capital lines owing to higher commodity prices.
- With the new management team in place, the team's focus is four-fold: 1) accentuating the group concept with ratings being the mainstay and accelerating growth from CART and CRSPL. 2) Increase use of technology to cut costs and enhance offerings, ease workflow systems and increase data focus. 3) Enhance HR as people remain the key resource, with emphasis on training. And 4) Rebrand CARE name to ensure it is associated with quality.

- Management is working on building share in the capital markets business as well, and it remains a key focus area with emphasis on profitable products like securitisation, along with REITs, InvITs, etc. Management remains focused on increasing market share in the ratings business.
- CARE Ratings has signed a Memorandum of Understanding with US based Tresata Inc., a global leader in AI & predictive analytics software, on the 8th of August, 2020 to join forces to launch predictive intelligence business solutions in India. Tresata's Analytics Operating System will power their core ratings applications which will help to revolutionize intelligence about businesses in India. In turn, this will assist in making data driven decisions - data collected and validated both from issuers and also from a variety of broader market sources over the years. With this System, the rating analysts will leverage the latest artificial intelligence & machine learning techniques to analyze client data when evaluating risk – both current and emerging. This association is expected to be monetised via Analytics and not via the ratings division.
- Management is currently building technology across ratings, risk solutions and advisory.
- CRSPL (Risk Solutions business) has seen significant opportunity to be scaled up with products for BFSI sector and CFOs and technological expertise is being built with focus on new products.
- Management plans to attain one-third of revenues from the subsidiaries over the next 3 to 3.5 years.

Exhibit 1: Quarterly financial snapshot

Year to March	Q2FY22	Q2FY21	YoY	Q1FY22	QoQ	YTD FY22	FY22E	FY23E
Revenues	764	759	0.7	492	55.3	1,256	2,648	2,972
Employee cost	318	286	11.4	326	(2.3)	644	1,289	1,417
Other expenses	110	54	104.6	80	38.3	190	402	443
Total expenditure	429	340	26.2	406	5.6	834	1,692	1,860
EBITDA	335	419	(20.0)	86	288.3	422	956	1,112
Depreciation	18	20	(9.9)	19	(1.4)	37	77	78
EBIT	317	399	(20.5)	68	367.4	385	879	1,033
Interest	1	2		1		2	6	6
Other income	80	80	0.0	73	9.2	153	287	269
Add: Exceptional items	0	0		0		0		
Profit Before Tax	396	477	(17.0)	140	183.2	536	1,160	1,296
Less: Provision for Tax	104	119	(12.1)	24	329.3	128	292	327
Less: Minority Interest	5	4		5		10		
Reported Profit	287	355	(19.0)	110	160.0	398	853	955
Adjusted Profit	287	355	(19.0)	110	160.0	398	853	955
No. of Dil. shares outstanding (mn)	29	29		29		29	29	29
Adjusted Diluted EPS	9.6	11.9	(19.4)	3.6	168.2	13.2	29.0	32.4
as % of net revenues								
Staff expenses	41.7	37.7		66.2		51.3	48.7	47.7
Other expenses	14.4	7.1		16.2		15.1	15.2	14.9
EBITDA	43.9	55.2	(11.3)	17.6	26.34	33.6	36.1	37.4
Net profit	37.6	46.7		22.4		31.7	32.2	32.1

Source: Company, Edelweiss Research

Exhibit 2: We have cut our FY22/23E PAT by 7% each

(INR mn)	Old		New		% change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	2,707	3,065	2,648	2,972	-2.2	-3.0
EBITDA	1,039	1,203	956	1,112	-8.0	-7.6
PAT	915	1,025	853	955	-6.7	-6.8

Source: Company, Edelweiss Research

Company Description

Credit Analysis & Research Ltd (CARE) is primarily engaged in rating services which accounts for around 98% of the total revenue of the company. CARE is the second largest rating company in India in terms of rating turnover. As on FY20, company has rated INR7.2trillion of debt.

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 revenues (98%) 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. Management is focusing on: i) automation across businesses and improving ratings models; ii) focus on margin-accretive accounts within capital markets; iii) improving the contributions of subsidiaries; and iv) overhauling internal processes towards stringent compliance regulations. We anticipate an improvement in CARE's market share. We have built in 14% EPS CAGR over FY22-24E.

Focus is to regain lost market share in ratings (100 bps per year) from low twenties to high twenties, and new streams like REITS and InVITs which are more profitable. Management continues to focus on other subsidiaries resulting revenues rising 35% YoY in H1FY22 and plans to derive one-third of overall revenues over 3-4 years.

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. They have further provided for the penalty laid by SEBI related to IL&FS default.

Concentration risk

CARE's business is concentrated on rating revenues, which account for 98% 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. The margins have started now normalising in line with the industry, as they have been investing in more experienced employees.

Additional Data

Management

Chairman	Najib Shah
MD & CEO	Ajay Mahajan
CFO	Jinesh Shah
Chief Ratings Officer	Sachin Gupta
Auditor	Khimji Kunverji & Co

Holdings – Top 10*

% Holding		% Holding	
LIC of India	9.85	ABSL AMC	2.21
Franklin Resour	3.58	Russell Investm	1.80
Vanguard Group	2.87	PineBridge Inve	1.53
Polar Capital	2.86	Tata Steel	1.20
Goldman Sachs G	2.45	Raiffeisen Bank	1.12

*Latest public data

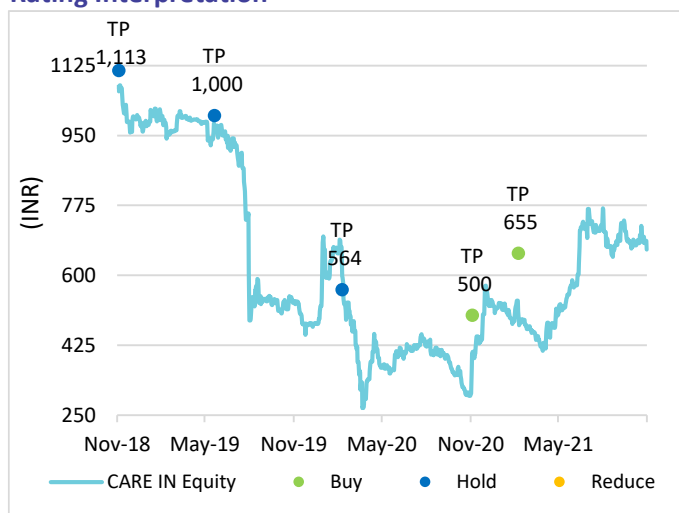
Recent Company Research

Date	Title	Price	Reco
04-Aug-21	Healthy sales across the board; <i>Result Update</i>	710.05	Buy
14-Jun-21	Structural transformation underway; <i>Result Update</i>	630.7	Buy
11-Feb-21	Transformation underway; <i>Company Update</i>	509.25	Buy

Recent Sector Research

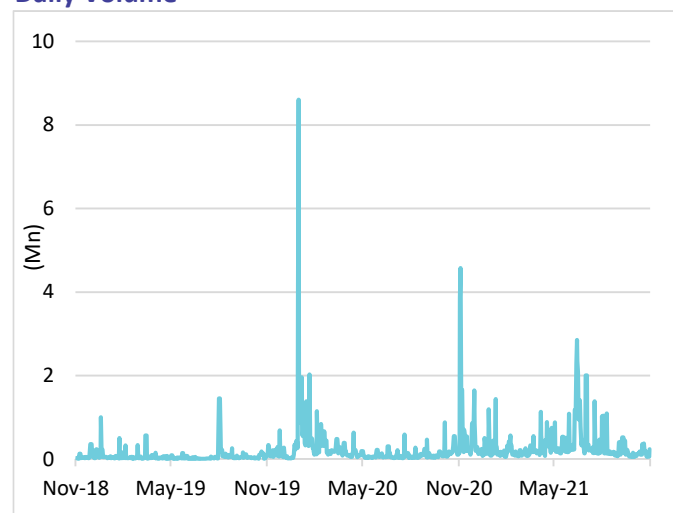
Date	Name of Co./Sector	Title
23-Jul-21	CRISIL	Ratings muted; research healthy; <i>Result Update</i>
23-Apr-21	CRISIL	Global recovering, domestic tempering; <i>Result Update</i>
15-Feb-21	CRISIL	Improved traction across the board; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	179	56	18	254
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	229	41	3	273

*1 stocks under review

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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Aditya Narain

Head of Research

Aditya.Narain@edelweissfin.com
