India Midcaps

RESULT UPDATE

CARE RATINGS

Persistently weak performance

India Equity Research| Credit Rating

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CARE Ratings (CARE) recorded yet another weak quarter with Q1FY21 standalone revenue declining 27% YoY (8% below estimates) led by weak bank credit (down 1.2% YoY) and lower CP issuances (down 40%) despite long-term bond issuances for the industry rising 25% YoY in the quarter. Volume of debt rated slid 34% YoY. EBITDA plunged 57% YoY (25% below estimates) owing to lower sales. Despite RBI's higher TLTRO operations this quarter, company continues to lose market share in the bond market, with the capped remuneration structure from AAA clients. With new management at the helm and a transformation programme underway, we await improvement in CARE's market share. Meanwhile, in light of the tepid credit environment and CARE's weak positioning, we maintain 'HOLD' with a P/E-based TP of INR465 based on 18x FY22 EPS.

Revenue and EBITDA decline continues

Q1FY21 ratings revenue dipped 27% YoY (14%below estimate) due to a 34% YoY reduction in rated volume to INR2.6tn. This was owing to a weak environment that led to a fall in bank credit (down 1.2% YoY) as well as CP issuances (down 40% YoY). While long-term bond issuances shot up 25% YoY for the industry, they were largely in the AAA-rated category wherein remuneration for CARE is capped. CRISIL's ratings revenue grew 17% YoY (ex-S&P and SME rating), indicating a sustained outperformance versus peers post-IL&FS crisis. CARE's Q1FY21 EBITDA plunged 57% YoY as employee expenses slid at a slower pace than revenues (down 13% YoY).

Changes underway; prepping for medium term

Under the aegis of Mr. Ajay Mahajan, the company is overhauling internal processes with enhanced focus on technological improvement. Management is working on automation across ratings business and improving ratings models. Management is also looking to improve the contributions of its subsidiaries. Such endeavours should yield results over medium term. In the short run, CARE remains cautious on growth, but believes the decline would taper off in 9MFY21 versus Q1FY21 as it beefs up processes.

Outlook and valuation: Awaiting improvement; maintain 'HOLD'

CARE has consistently lost market share and seen declined profitability. Considering the tepid credit environment and CARE's weak positioning thereof, we maintain **'HOLD'** with a PE-based TP of INR465 at 18x FY22E EPS.

Financials (INR mn)

Year to March	Q1FY21	Q1FY20	% Chg	Q4FY20	% Chg	FY20	FY21E	FY22E
Net revenues	330	452	*(26.9)*	577	*(42.7)*	2,436	2,103	2,318
EBITDA	49	114	*(57.1)*	129	*(62.0)*	813	606	817
Adjusted Profit	99	131	*(24.1)*	139	*(28.8)*	823	598	761
Adjusted Diluted EPS	3.4	4.4	*(24.1)*	4.7	*(28.8)*	27.9	20.3	25.8
Diluted P/E (x)						15.7	21.6	17.0
EV/EBITDA (x)						13.1	17.5	12.8
ROAE (%)						15.3	11.1	14.0

EDELWEISS RATINGS

Absolute Rating	**HOLD**
Investment Characteristics	None

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

CMP	: INR 439
Target Price	: INR 465
52-week range (INR)	: 727 / 235
Share in issue (mn)	: 29.5
M cap (INR bn/USD mn)	: 13 / 173
Avg. Daily Vol. BSE/NSE ('000)	: 230.0

SHARE HOLDING PATTERN (%)

	Current	Q4FY20	Q3FY20
Promoters *	-	-	-
MF's, FI's & BKs	23.7	24.3	19.0
FII's	29.2	29.4	40.8
Others	47.1	46.3	40.2
** Promoters pledged shares (% of share in issue)*	:		*NIL*

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	3.2	3.0	(0.3)
3 months	14.2	14.7	0.5
12 months	1.3	(13.2)	(14.4)

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Q1FY21 operational highlights

Financials

In Q1FY21, CARE's standalone top line declined 27% YoY, 15% below our estimate. This was primarily led by weak bank credit (down 1.2% YoY) and lower CP issuances (down 40%), though long-term bond issuances were up 25% for the industry led by the RBI's TLTRO operations.

All-round volumes down for CARE Ratings by 34% YoY for Q1FY21: During Q1FY21, CARE's overall debt rated volume slid 34% YoY to INR2.59tn for new clients. This was led by a 17% YoY plunge in long-term corporate bond volumes to INR1.59tn in bonds, 78% YoY reduction in short-term rated volumes to INR0.18tn, and 29% YoY cut in bank loan rated volume to INR0.83tn. The overall number of instruments rated fell 58% YoY to 517 with a plunge of 62% YoY in bank loan ratings to 351.

Industry: For the industry, long-term bond issuances grew 25% YoY during Q1FY21. Majority of this debt was raised by the financial sector (57%), of which banks/term lending was 28%, financial services/investment was 18% and housing finance was 13%. The infrastructure sector accounted for ~19% of total corporate bond issuances.

CP and wholesale credit down in FY20: CP issuances were down 40% in FY20 to INR3.72tn. Furthermore, bank credit growth has slowed to 1.2% YoY. This is led by: industry credit, down 1% YoY; services credit, down 2.6% YoY; and agriculture credit, down 0.4% YoY.

EBITDA declines, misses estimates: EBITDA declined 57% YoY to INR49mn (25% below estimate). This is on account of a slower decline in staff expenses (at 13% YoY).

PAT decreased 24% YoY in Q1FY21, lower than EBITDA contraction, owing to a 22% YoY increase in other income.

Net cash position as of end-FY20 was INR4.3bn.

Operations and macroeconomic outlook

TLTROs conducted by the RBI in February addressed part of the problem. As a result, for the industry, long-term bond issuances grew 25% YoY during Q1FY21 to INR2.09trn. However these operations favoured funding by banks to only better-rated clients, restricting broad-based ratings growth. With bond issuances restricted to AAA entities and few sectors–financials and infrastructure–revenue was muted as many of these have fixed fee caps on rating revenues. The lockdown announced in March posed a challenge in terms of completing surveillance.

New CEO Mr. Ajay Mahajan joined the company in April and has outlined three pillars of long-term strategy: i) Continue to invest in current ratings processes and diligence to make it more transparent. Invest in technology. ii) Add new product suite with products in securitization, structured credit and stressed asset ratings in order to reduce dependence on market's ability to raise fresh money. iii) Diversify revenue stream to non-ratings businesses such as research, data analytics and risk solutions. According to management, they are targeting 25% of revenues from non-rating revenues over the next three–five years.

FY21 presents a grim picture with CARE estimating GDP growth between -1.5% and -5.0% and bank credit should also remain negative, with reluctance from banks to lend beyond

AAA rated entities. Thus, the company remains cautious on growth. Though they believe the quantum of decline will come off in the next three quarters with their beefing up processes.

Over the near term, the CEO will focus on improving the brand's credibility, which had taken a hit over FY19–20, by taking short-term steps such as internal critiquing and beefing up of processes.

CARE will critically evaluate organic and inorganic expansion opportunities based on analytical capabilities and deploying capital efficiently.

The modified credit ratio (MCR) at the end of FY20 declined to 0.96, at a seven-year low as Indian corporate were pressured by the economic slowdown and tight financing. The MCR, up to 15th June, was further down to 0.78, with higher downgrades. The MCR is the credit quality of rated entities, as measured by CARE Ratings.

Financial snapshot **(INR mn)**

Year to March	Q1FY21	Q1FY20	% change	Q4FY20	% change	FY20	FY21E	FY22E
Net revenues	330	452	*(26.9)*	577	*(42.7)*	2,436	2,103	2,318
Staff costs	228	262	*(12.8)*	239	*(4.3)*	1,093	1,056	1,084
Other expenses	53	76	*(30.4)*	209	*(74.6)*	530	442	417
Total expenditure	281	338	*(16.7)*	448	*(37.1)*	1,623	1,497	1,501
EBITDA	49	114	*(57.1)*	129	*(62.0)*	813	606	817
Depreciation	18	17	*6.3*	18	*1.2*	78	85	87
EBIT	31	97	*(68.1)*	111	*(72.0)*	736	520	731
Interest	2	2	*(20.8)*	2	*(6.3)*	9	-	-
Other income	94	77	*22.0*	72	*30.8*	315	280	287
Add: Exceptional items								
Profit before tax	124	173	*(28.3)*	182	*(31.8)*	1,041	800	1,018
Provision for taxes	25	42	*(41.2)*	42	*(41.7)*	206	202	256
Minority interest								
Reported net profit	99	131	*(24.1)*	139	*(28.8)*	823	598	761
Adjusted Profit	99	131	*(24.1)*	139	*(28.8)*	823	598	761
Diluted shares (mn)	29	29		29		29	29	29
Adjusted Diluted EPS	3.4	4.4	*(24.1)*	4.7	*(28.8)*	27.9	20.3	25.8
Diluted P/E (x)	-	-		-		15.7	21.6	17.0
EV/EBITDA (x)	-	-		-		13.1	17.5	12.8
ROAE (%)	-	-		-		15.3	11.1	14.0
Market cap / rev. (x)	-	-		-		5.3	6.2	5.6
As % of net revenues								
Employee cost	69.1	57.9		41.4		44.9	50.2	46.7
Other expenses	16.1	16.9		36.3		21.8	21.0	18.0
EBITDA	14.8	25.3		22.4		33.4	28.8	35.3
Reported net profit	30.0	28.9		24.2		33.8	28.5	32.8

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. However, in the short run, CARE remains cautious on growth, but believes the decline would taper off in 9MFY21 versus Q1FY21 as it beefs up processes. We will await sales growth pick up with stabilizing margins ahead. 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. We have built in 0.2% EBIDTA CAGR over FY20-22E.

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 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.

Financial Statements

Key Assumptions

Year to March	FY19	FY20	FY21E	FY22E
Macro				
GDP(Y-o-Y %)	6.1	4.8	(4.0)	7.0
Inflation (Avg)	3.4	4.3	3.5	4.0
Repo rate (exit rate)	6.3	4.4	3.0	4.0
USD/INR (Avg)	70.0	70.7	75.0	73.0
Sector				
Corp debt iss. growth(%)	10.0	10.0	18.0	14.0
Banking cr. growth (%)	18.0	16.0	16.0	16.0
Company				
Vol of debt rated(INRbn)	11,400	7,866	6,135	7,117
Number of new assigments	8,088	4,056	3,042	3,498
Nos	1,632	1,306	261	282
CDR inc(INR mn)	1,596	1,109	865	1,004
BLR inc(INR mn)	1,304	1,041	951	998
SME	73	40	41	42

Income statement (INR mn)

Year to March	FY19	FY20	FY21E	FY22E
Net revenue	3,190	2,436	2,103	2,318
Gross profit	2,161	1,344	1,047	1,234
Employee costs	1,028	1,093	1,056	1,084
Other Expenses	415	530	442	417
EBITDA	1,746	813	606	817
Depreciation	33	78	85	87
EBIT	1,713	736	520	731
Less: Interest Expense	-	9	-	-
Add: Other income	303.92	314.68	279.77	287.02
Profit Before Tax	2,017	1,041	800	1,018
Less: Provision for Tax	637	206	202	256
Less: Minority Interest	6	12	-	-
Reported Profit	1,374	823	598	761
Adjusted Profit	1,374	823	598	761
Shares o /s (mn)	29	29	29	29
Adjusted Basic EPS	46.6	27.9	20.3	25.8
Diluted shares o/s (mn)	29	29	29	29
Adjusted Diluted EPS	46.6	27.9	20.3	25.8
Adjusted Cash EPS	48.9	31.2	23.2	28.8
Dividend per share (DPS)	30.0	19.5	16.6	19.6
Dividend Payout Ratio(%)	74.6	81.0	94.8	88.0

Common size metrics

Year to March	FY19	FY20	FY21E	FY22E
Operating expenses	45.3	66.6	71.2	64.7
Depreciation	1.0	3.2	4.1	3.7
Interest Expense	-	0.4	-	-
EBITDA margins	54.7	33.4	28.8	35.3
Net Profit margins	43.3	34.3	28.5	32.8

Growth ratios (%)

Year to March	FY19	FY20	FY21E	FY22E
Revenues	(4.1)	(23.6)	(13.7)	10.2
EBITDA	(17.2)	(53.4)	(25.5)	35.0
PBT	(13.5)	(48.4)	(23.1)	27.2
Adjusted Profit	(6.8)	(40.1)	(27.3)	27.2
EPS	(6.8)	(40.1)	(27.3)	27.2

Balance sheet (INR mn)

As on 31st March	FY19	FY20	FY21E	FY22E
Share capital	295	295	295	295
Reserves & Surplus	5,205	5,038	5,069	5,161
Shareholders' funds	5,500	5,333	5,364	5,455
Minority Interest	24	32	32	32
Long Term Liabilities	64	83	83	83
Def. Tax Liability (net)	67	51	51	51
Sources of funds	**5,655**	**5,499**	**5,531**	**5,622**
Net Block	737	843	778	711
Capital work in progress	-	5	5	5
Intangible Assets	94	88	88	88
Total Fixed Assets	831	936	871	804
Non current investments	2,495	2,261	2,261	2,261
Cash and Equivalents	2,194	2,274	2,376	2,512
Sundry Debtors	473	409	403	426
Loans & Advances	101	146	146	146
Other Current Assets	51	154	154	154
Current Assets (ex cash)	625	709	703	725
Other Current Liab	490	681	681	681
Total Current Liab	135	28	22	44
Uses of funds	**5,655**	**5,499**	**5,531**	**5,622**
BVPS (INR)	186.7	181.0	182.1	185.2

Free cash flow (INR mn)

Year to March	FY19	FY20	FY21E	FY22E
Reported Profit	1,380	835	598	761
Add: Depreciation	33	78	85	87
Others	(473)	(2,145)	11	(45)
Less: Changes in WC	(145)	(935)	6	(22)
Operating cash flow	1,086	(298)	689	826
Less: Capex	262	46	20	20
Free Cash Flow	**823**	**(344)**	**669**	**806**

Cash flow metrics

Year to March	FY19	FY20	FY21E	FY22E
Operating cash flow	1,086	(298)	689	826
Financing cash flow	(1,954)	(1,060)	(567)	(670)
Investing cash flow	827	1,239	(20)	(20)
Net cash Flow	(41)	(119)	102	136
Capex	(262)	(46)	(20)	(20)
Dividend paid	(1,953)	(1,033)	(567)	(670)

Profitability and efficiency ratios

Year to March	FY19	FY20	FY21E	FY22E
ROAE (%)	24.0	15.3	11.1	14.0
ROACE (%)	35.0	19.3	14.9	18.7
ROA	23.4	14.8	10.9	13.7
Debt / Cap employed (%)	9.8	13.3	13.2	13.0

Operating ratios

Year to March	FY19	FY20	FY21E	FY22E
Total Asset Turnover	0.5	0.4	0.4	0.4
Fixed Asset Turnover	4.5	2.8	2.3	2.8
Equity Turnover	0.6	0.4	0.4	0.4

Valuation parameters

Year to March	FY19	FY20	FY21E	FY22E
Adj. Diluted EPS (INR)	46.6	27.9	20.3	25.8
Y-o-Y growth (%)	*(6.8)*	*(40.1)*	*(27.3)*	*27.2*
Adjusted Cash EPS (INR)	48.9	31.2	23.2	28.8
Diluted P/E (x)	8.8	14.7	20.2	15.9
P/B (x)	2.2	2.3	2.3	2.2
EV / Sales (x)	3.4	4.4	5.0	4.5
EV / EBITDA (x)	5.7	12.1	16.1	11.8
Dividend Yield (%)	7.3	4.7	4.0	4.8

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		P/B (X)	
Name	**(USD mn)**	**FY21E**	**FY22E**	**FY21E**	**FY22E**	**FY21E**	**FY22E**
CARE Ratings Limited	173	20.2	15.9	16.1	11.8	2.3	2.2
Crisil	1,689	35.4	31.5	25.5	21.4	10.4	9.6
Median	-	27.8	23.7	20.8	16.6	6.3	5.9
AVERAGE	-	27.8	23.7	20.8	16.6	6.3	5.9

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 – Top10

	Perc. Holding		Perc. Holding
Life Insurance Corp of India	9.85	Kayne Anderson R Investment	5.38
CRISIL	8.90	L&T Mutual Fund	3.74
Franklin Resources Inc	6.97	India Capital Fund	3.55
Stitching Depositary APG Emerging	6.84	First Pacific Advisors LP	3.34
Aditya Birla SunLife Trustee Co	6.07	Bajaj Allianz Life Insurance Co	2.95

**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
24-Jul-20	**CRISIL**	Consistent share gains bolster conviction; *Result Update*	1,731	Buy
19-Jun-20	**CARE Ratings**	Challenges take a toll on performance ; *Result Update*	405	Hold
27-Apr-20	**CRISIL**	Robust show; sustainability key; *Result Update*	1,388	Reduce

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240

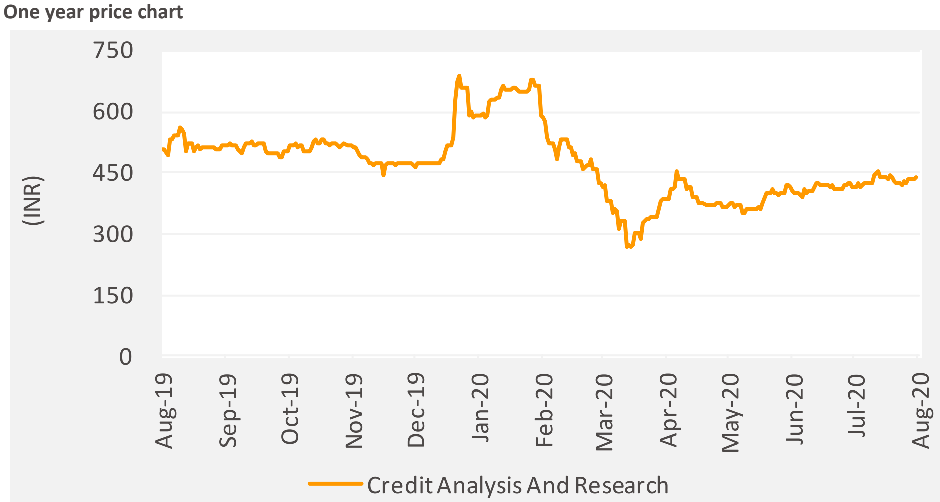
* 1stocks under review

	> 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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