

CARE RATINGS

Challenges take a toll on performance

India Equity Research | Credit Rating



CARE Ratings (CARE) posted yet another weak quarter with Q4FY20 standalone revenue declining 29% YoY (8% below estimate) due to weak bank credit (down 3.7%) and lower bond (down 5%) & CP (down 26%) issuances. EBITDA plunged 55% YoY (40% below estimate) adjusted for the one-off COVID-19 provisioning owing to 56% YoY jump in other expenses. FY20 was a challenging year for CARE with sales plunging 26% YoY and overall quantum of debt rated falling 36%. According to management, the challenges will persist in FY21 as well despite measures like RBI's TLTRO as these favour funding by banks to only better-rated clients. Considering the tepid credit environment and CARE's weak positioning, we are revising down EPS 37% for FY21E and 26% for FY22E. Maintain 'HOLD' with revised DCF-based TP of INR450 (INR564 earlier).

Revenue and EBITDA take a hit

Q4FY20 rating revenue dipped 29% YoY (8% below estimate) due to 36% YoY reduction in rated volume to INR5.3tn. This was owing to weak environment with bank credit falling 3.7% (ex-agri and personal) and lower bond (down 5%) & CP (down 29%) issuances. CRISIL's rating revenue grew 15% (ex-S&P and SME rating), indicating sustained outperformance versus peers post the IL&FS crisis. Local primary bond sales were lacklustre in March, otherwise a busy month, due to COVID-19. Q4FY20 EBITDA tanked 55% YoY adjusted for the one-off COVID-19 provisioning. FY20 was a challenging year for CARE with sales falling 26% YoY and EBITDA plummeting 53% YoY.

Challenges to persist in FY21

i) Corporate bond issuances have been strong in April-May led by RBI's TLTRO. However, management is cautious and believes FY21 will be even more challenging as TLTRO operations favour funding by banks to only better-rated clients. ii) The one-off expenses in FY20 like the legal and consultancy fees for forensic analysis of INR45mn are not expected to repeat, but the lower sales leads to operating deleverage. iii) We await improvement in market share under the aegis of Mr. Ajay Mahajan, joined as MD and CEO (from 15th April 2020), a widely experienced banker.

Outlook and valuation: Neutral; maintain 'HOLD'

Considering tepid credit environment and CARE's weak positioning, we are revising down EPS 37% for FY21E and 21% for FY22E. With sustenance of a challenging environment, we maintain 'HOLD' with revised DCF-based TP of INR450.

EDELWEISS RATINGS

Absolute Rating **HOLD**Investment Characteristics **None**

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

CMP	: INR 405
Target Price	: INR 450
52-week range (INR)	: 955 / 235
Share in issue (mn)	: 29.5
M cap (INR bn/USD mn)	: 12 / 130
Avg. Daily Vol. BSE/NSE ('000)	: 230.0

SHARE HOLDING PATTERN (%)

	Current	Q3FY20	Q2FY20
Promoters *	-	-	-
MF's, FI's & BKs	24.3	19.0	19.0
FII's	29.4	40.8	47.6
Others	46.3	40.2	33.4
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(2.0)	(5.1)	(3.1)
3 months	(24.4)	(27.9)	(3.5)
12 months	(24.6)	(63.2)	(38.6)

Financials

(INR mn)

Year to March	Q4FY20	Q4FY19	% Chg	Q3FY20	% Chg	FY20	FY21E	FY22E
Net revenues	577	815	(29.2)	498	15.8	2,436	2,151	2,373
EBITDA	199	469	(57.6)	157	26.7	813	643	862
Adjusted Profit	139	346	(59.7)	165	(15.3)	823	627	797
Diluted P/E (x)						14.5	19.0	15.0
EV/EBITDA (x)						11.9	14.9	10.9
ROAE (%)						15.3	11.6	14.5

Shradha Sheth

+91 22 6623 3308

shradha.sheth@edelweissfin.com

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Q4FY20 conference call: Key highlights

Financials

In Q4FY20, CARE's standalone top line declined 29% YoY, 8% below our estimate. This was primarily led by weak bank credit (down 3.7%) and lower bond & CP issuances (down 5% and 26% each YoY).

For FY20, the consolidated top line toppled 24% YoY owing to a decline in initial rated volume and low credit offtake during the year.

All round volumes down for CARE Ratings: During Q4FY20, CARE's overall debt rated volume slid 36% YoY to INR5.39tn for new clients. This was led by 13% YoY plunge in long-term corporate bond volumes to INR3.49tn in bonds, 20% YoY reduction in short-term rated volumes to INR0.63tn, and 65% YoY cut in bank loan rated volume to INR1.27tn. The overall number of instruments rated fell 54% YoY to 1,377 with a plunge of 60% in bank loan ratings to 1,025.

For FY20, CARE's overall debt rated volume also plunged 36% to INR12.74tn. This was owing to 51%, 31% and 22% decline in bank loan rated volume, short-term rated and long-term rated debt volumes, respectively. The overall number of instruments rated declined 43% YoY to 5,343 with a plunge of 50% in bank loan ratings to 4,046.

Industry: For the industry, bond issuances grew 6% YoY during FY20. Majority of this debt was raised by the financial sector (65%), of which banks/term lending was 35%, financial services/investment was 18% and housing finance was 13%. Infrastructure sector accounted for ~20% of total corporate bond issuances with roads & highways, power generation and real estate with 8%, 6% and 5% share, respectively.

CP and wholesale credit down in FY20: Total corporate bonds raised during FY20 aggregated to INR6.9tn, 6% higher than issuances amounting to INR6.5tn during FY19. CP issuances were down 15% in FY20 to INR21.9tn. Furthermore, bank credit growth has slowed to 6.1% compared with 13.3% YoY growth in FY19. This is led by wholesale credit—with industry credit down to 0.7%, services credit fell to 7.4% and agriculture credit was down at 4.2%.

Sharp EBITDA miss: Q4FY20 reported EBITDA declined 72% YoY. Further, adjusted for INR70m bad debt provisions on receivables post COVID-19 impact assessment, EBITDA declined 55% YoY (40% below estimate) with margin contracting 2300bps YoY to 35%.

FY20 EBITDA plummeted 53% at the consolidated level as employee and other expenses grew 6% and 28%, respectively.

FY20 had one-off expenses like the legal and consultancy fees for forensic analysis of INR45mn and INR10mn for SEBI adjudication proceedings post the IL&FS fiasco.

PAT declined 60% YoY in Q4FY20, lower than EBITDA contraction, owing to a lower tax rate of 23% versus 38% in the base quarter. FY20 PAT shrunk 40% to INR823mn.

CARE announced a final dividend of INR2.5per share in Q4FY20, taking total dividend declared in FY20 to INR19.5 per share.

Net cash position as of end-FY20 was Rs4.5bn vs. Rs4.7bn as of end-FY19.

Operations and macroeconomic outlook

During FY20, the ratings business was impacted by weak GDP growth (4.2%) and muted IIP (-0.7%) and services sector growth and turmoil in the NBFC sector. As a result, lending appetite of banks reduced and NPA levels also increased. TLTROs issued by RBI in February addressed a part of the problem. However these operations favored funding by banks to only better-rated clients, restricting broad based rating 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. Further majority issuances tilted toward ECB raisings with growth of 11-12% at USD53bn hurt revenue opportunity for domestic rating agencies. The lockdown announced in March posed a challenge in terms of completing surveillance. Further the local primary bond sales were lacklustre in March, otherwise a busy month, due to COVID-19.

New CEO Mr. Ajay Mahajan joined the company in April and has outlined three pillars of long-term strategy: 1) Continue to invest in current ratings processes and diligence to make it more transparent. Invest in technology. 2) 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. 3) Diversify revenue stream to non-ratings businesses like research, data analytics and risk solutions.

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.

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

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.

Financial snapshot

(INR mn)

Year to March	Q4FY20	Q4FY19	% change	Q3FY20	% change	FY20	FY21E	FY22E
Net revenues	577	815	(29.2)	498	15.8	2,436	2,151	2,373
Staff costs	239	257	(7.1)	233	2.5	1,093	1,056	1,084
Other expenses	139	89	55.6	108	28.7	530	452	427
Total expenditure	378	346	9.1	341	10.8	1,623	1,507	1,511
EBITDA	199	469	(57.6)	157	26.7	813	643	862
Depreciation	18	9	100.3	17	1.7	78	85	87
EBIT	181	460	(60.6)	140	29.8	736	558	776
Interest	2	-		2	(5.8)	9	-	-
Other income	72	95	(23.8)	74	(3.0)	315	280	289
Profit before tax	252	555	(54.6)	212	18.6	1,041	839	1,065
Provision for taxes	42	208	(79.7)	48	(10.9)	206	211	268
Minority interest								
Reported net profit	139	346	(59.7)	165	(15.3)	823	627	797
Adjusted Profit	139	346	(59.7)	165	(15.3)	823	627	797
Diluted shares (mn)	29	29		29		29	29	29
Adjusted Diluted EPS	4.7	11.8	(59.7)	5.6	(15.3)	27.9	21.3	27.0
Diluted P/E (x)	-	-		-		14.5	19.0	15.0
EV/EBITDA (x)	-	-		-		11.9	14.9	10.9
ROAE (%)	-	-		-		15.3	11.6	14.5
Market cap / rev. (x)	-	-		-		4.9	5.5	5.0

As % of net revenues

Employee cost	41.4	31.5		46.7		44.9	49.1	45.7
Other expenses	24.1	11.0		21.7		21.8	21.0	18.0
EBITDA	34.5	57.5		31.5		33.4	29.9	36.3
Reported net profit	24.2	42.5		33.1		33.8	29.2	33.6

Change in Estimates

	New	FY21E Old	% change	New	FY22E Old	% change	Comments
Net Revenue	2,151	2,632	(18.3)	2,373	2,817	(15.8)	Revenue estimates declined on account of weak credit environment
EBITDA	644	1,102	(41.6)	862	1,191	(27.6)	Low revenue estimates led to EBITDA cut
EBITDA Margin	29.9	41.9		36.3	42.3		
Adjusted Profit After Tax	627	998	(37.2)	797	1,077	(26.0)	
Net Profit Margin	29.2	37.9		33.6	38.2		
Capex	20	20	0.0	20	20	0.0	

Company Description

Credit Analysis & Research Ltd (CARE) is primarily engaged in rating services which accounts for around 90% of the total revenue of the company (as of FY20). CARE is the second largest rating company in India in terms of rating turnover. For FY20, CARE's overall debt rated volume stood at INR12.74tn. The overall number of instruments rated stood at 5,343 with bank loan ratings at 4,046.

CARE has achieved a steady growth in its ratings business

In the last few years, the company has begun expanding internationally and is providing technical assistance services to countries like Maldives, Hong Kong, 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 (90%) 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. FY20 was a difficult year for CARE due to anemic investment cycle and market share loss, with the company registering 24%/53%/40% revenue/Ebitda/PAT decline. However 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, when growth returns. In the interim, considering tepid credit environment and CARE's weak positioning we maintain 'HOLD'.

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. Further SEBI has relaxed the default recognition framework, due to the COVID scenario.

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. However management is comfortable sustaining operating margins at ~63% and plus.

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	5.0	14.0
Banking cr. growth (%)	18.0	16.0	16.0	16.0
Company				
Vol of debt rated(INRbn)	11,400	7,866	6,371	7,391
Number of new assignments	8,088	4,056	3,042	3,498
Nos	1,632	1,306	261	282
CDR inc(INR mn)	1,596	1,109	898	1,042
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	2,151	2,373
Gross profit	2,161	1,344	1,095	1,290
Employee costs	1,028	1,093	1,056	1,084
Other Expenses	415	530	452	427
EBITDA	1,746	813	643	862
Depreciation	33	78	85	87
EBIT	1,713	736	558	776
Less: Interest Expense	-	9	-	-
Add: Other income	303.92	314.68	280.37	289.27
Profit Before Tax	2,017	1,041	839	1,065
Less: Provision for Tax	637	206	211	268
Less: Minority Interest	6	12	-	-
Reported Profit	1,374	823	627	797
Adjusted Profit	1,374	823	627	797
Shares o /s (mn)	29	29	29	29
Adjusted Basic EPS	46.6	27.9	21.3	27.0
Diluted shares o/s (mn)	29	29	29	29
Adjusted Diluted EPS	46.6	27.9	21.3	27.0
Adjusted Cash EPS	48.9	31.2	24.2	30.0
Dividend per share (DPS)	30.0	19.5	16.6	19.6
Dividend Payout Ratio(%)	74.6	81.0	90.4	84.1

Common size metrics

Year to March	FY19	FY20	FY21E	FY22E
Operating expenses	45.3	66.6	70.1	63.7
Depreciation	1.0	3.2	4.0	3.6
Interest Expense	-	0.4	-	-
EBITDA margins	54.7	33.4	29.9	36.3
Net Profit margins	43.3	34.3	29.2	33.6

Growth ratios (%)

Year to March	FY19	FY20	FY21E	FY22E
Revenues	(4.1)	(23.6)	(11.7)	10.3
EBITDA	(17.2)	(53.4)	(20.9)	34.0
PBT	(13.5)	(48.4)	(19.4)	27.0
Adjusted Profit	(6.8)	(40.1)	(23.8)	27.0
EPS	(6.8)	(40.1)	(23.8)	27.0

Balance sheet		(INR mn)			
As on 31st March	FY19	FY20	FY21E	FY22E	
Share capital	295	295	295	295	
Reserves & Surplus	5,205	5,038	5,098	5,225	
Shareholders' funds	5,500	5,333	5,393	5,520	
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	5,559	5,686	
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	2,396	2,566	
Sundry Debtors	473	409	412	436	
Loans & Advances	101	146	146	146	
Other Current Assets	51	154	154	154	
Current Assets (ex cash)	625	709	712	736	
Other Current Liab	490	681	681	681	
Total Current Liab	135	28	31	54	
Uses of funds	5,655	5,499	5,559	5,686	
BVPS (INR)	186.7	181.0	183.1	187.4	

Free cash flow		(INR mn)			
Year to March	FY19	FY20	FY21E	FY22E	
Reported Profit	1,380	835	627	797	
Add: Depreciation	33	78	85	87	
Others	(473)	(2,145)	(7)	(46)	
Less: Changes in WC	(145)	(935)	(4)	(23)	
Operating cash flow	1,086	(298)	709	860	
Less: Capex	262	46	20	20	
Free Cash Flow	823	(344)	689	840	

Cash flow metrics		FY19	FY20	FY21E	FY22E
Year to March					
Operating cash flow		1,086	(298)	709	860
Financing cash flow		(1,954)	(1,060)	(567)	(670)
Investing cash flow		827	1,239	(20)	(20)
Net cash Flow		(41)	(119)	122	170
Capex		(262)	(46)	(20)	(20)
Dividend paid		(1,953)	(1,033)	(567)	(670)

Profitability and efficiency ratios		FY19	FY20	FY21E	FY22E
Year to March					
ROAE (%)		24.0	15.3	11.6	14.5
ROACE (%)		35.0	19.3	15.5	19.4
ROA		23.4	14.8	11.3	14.2
Debt / Cap employed (%)		9.8	13.3	13.2	12.9

Operating ratios		FY19	FY20	FY21E	FY22E
Year to March					
Total Asset Turnover		0.5	0.4	0.4	0.4
Fixed Asset Turnover		4.5	2.8	2.4	2.9
Equity Turnover		0.6	0.4	0.4	0.4

Valuation parameters		FY19	FY20	FY21E	FY22E
Year to March					
Adj. Diluted EPS (INR)		46.6	27.9	21.3	27.0
Y-o-Y growth (%)		(6.8)	(40.1)	(23.8)	27.0
Adjusted Cash EPS (INR)		48.9	31.2	24.2	30.0
Diluted P/E (x)		8.7	14.5	19.0	15.0
P/B (x)		2.2	2.2	2.2	2.2
EV / Sales (x)		3.1	4.0	4.4	4.0
EV / EBITDA (x)		5.6	11.9	14.9	10.9
Dividend Yield (%)		7.4	4.8	4.1	4.8

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		P/B (X)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
CARE Ratings	157	19.0	15.0	14.9	10.9	2.2	2.2
Crisil	1,420	32.9	30.6	23.6	20.5	9.1	8.7
Median	-	26.0	22.8	19.3	15.7	5.7	5.5
AVERAGE	-	26.0	22.8	19.3	15.7	5.7	5.5

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 Co of India	9.85	Lloyd George Investment Co	2.95
CRISIL	8.90	Bajaj Allianz Life Insurance	2.95
Franklin India MF	6.97	Pinebridge Global Funds	2.82
Aditya Birla SunLife AMC	6.07	Vanguard Inc	2.43
L&T Mutual Fund	4.34	Russel Investments Ltd	1.80

**as per last available data*

Bulk Deals

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

**as per last available data*

Insider Trades

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

**as per last available data*

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.

Board: (91-22) 4009 4400, Email: research@edelweissfin.com

Aditya Narain

Head of Research

aditya.narain@edelweissfin.com

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

CARE Ratings Limited, Crisil, ICRA

Recent Research

Date	Company	Title	Price (INR)	Recos
27-Apr-20	CRISIL	Robust show; sustainability key; <i>Result Update</i>	1,388	Reduce
14-Feb-20	CRISIL	Ratings outperforms; research improves; <i>Result Update</i>	1,585	Reduce
11-Feb-20	ICRA	Tepid show; <i>Result Update</i>	2,994	Reduce

Distribution of Ratings / Market Cap

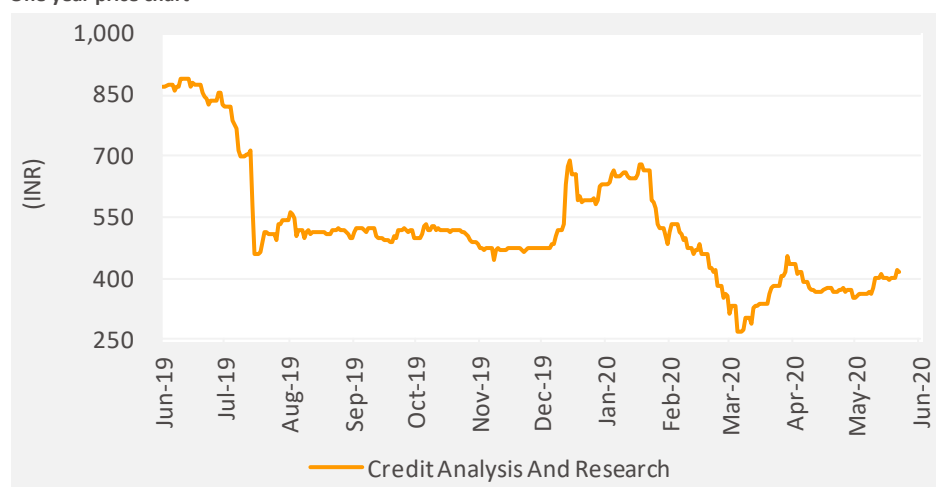
Edelweiss Research Coverage Universe

	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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