CARE RATINGS

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	509
12 month price target (INR)	655
Market cap (INR bn/USD bn)	15/0.2
Free float/Foreign ownership (%)	100.0/47.6

What's Changed

Target Price	↑
Rating/Risk Rating	–

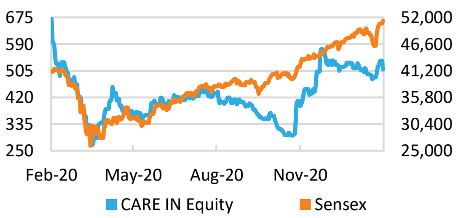
QUICK TAKE

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

FINANCIALS (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Revenue	2,436	2,295	2,549	2,841
EBITDA	813	817	915	1,001
Adjusted profit	823	800	861	928
Diluted EPS (INR)	27.9	27.2	29.2	31.5
EPS growth (%)	(40.1)	(2.7)	7.5	7.8
RoAE (%)	15.2	14.7	15.2	15.8
P/E (x)	18.2	18.7	17.4	16.2
EV/EBITDA (x)	15.7	15.3	13.4	12.0
Dividend yield (%)	3.8	3.3	3.8	3.8

PRICE PERFORMANCE



Explore:

Financial model

Podcast

Corporate access

Video

Growth on the anvil

CARE Ratings (CARE) posted in line flat consolidated revenue growth in Q3FY21. Ratings revenue fell 6% YoY amidst marginally weak credit growth in manufacturing (-0.5%) and services (0.1%) and modest growth across bond and CP issuances. Other business reported revenue growth of 42% YoY on sharpened focus on other revenue sources. With 40% decline in other expenses, EBITDA grew 4% YoY.

Under the aegis of the new management and a transformational programme underway, we anticipate improvement in CARE's market share. Meanwhile, in the wake of a gradual QoQ improvement, we revise up FY21/22/23E EPS 8%/6%/4% and target multiple to 22x Q1FY23. Maintain 'BUY' with revised TP of INR655.

In-line performance

Q3FY21 ratings revenue dipped 6% YoY (in line with estimate), from Q2FY21 (up 7% YoY) had higher revenue with spill-over of surveillance income. However, Q3FY21 saw weakness in credit growth in industries (-0.5% versus 0.7% in Q3FY20) and services (0.1% versus 0.4% growth in Q3FY20). Long-term bond issuances rose 2% YoY for the industry, with BFSI leading with 64% issuances during 9mFY21. The company's focus on de-risking business from ratings led to 42% YoY growth in the Others segment. For 9mFY21, rating sales declined 9% YoY. Despite dip in the top line, EBITDA for Q3FY21 grew in line 4% YoY as other expenses slid 40% YoY.

Better days in store

While there has been fiscal and monetary thrust, with budget impetus to improve macroeconomic environment, credit growth is expected to improve ahead. A spate of changes at the top and realigning focus on ratings market share growth is expected to yield results for CARE. With management focus on automation across businesses, margin-accretive accounts, better contributions from subsidiaries and overhauling internal processes towards stringent compliance regulations, we anticipate better days ahead. Consequently, while 9mFY21 revenue dipped 5% YoY, EBITDA fell a mere 1% YoY as other expenses plunged 38% YoY.

Outlook and valuations: Positive; maintain 'BUY'

CARE's Q3FY21 performance with improving macro environment, new management and a transformation programme underway, we are raising target multiple to 22x Q1FY21 (18x earlier) and maintain **'BUY'** with TP of INR655 (INR500 earlier) based on 18x FY22 EPS, in line with three-years' average, 40% discount to CRISIL's target P/E.

Financials

Year to March	Q3FY21	Q3FY20	% Change	Q2FY21	% Change
Net Revenue	465	498	(6.6)	714	(34.9)
EBITDA	146	157	(6.7)	434	(66.3)
Adjusted Profit	158	165	(4.0)	380	(58.4)
Diluted EPS (INR)	5.4	5.6	(4.0)	12.9	(58.4)

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Financial Statements

Income Statement (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Total operating income	2,436	2,295	2,549	2,841
COGS	0	0	0	0
Employee costs	1,093	1,153	1,226	1,329
Other expenses	530	326	408	511
EBITDA	813	817	915	1,001
Depreciation	78	83	84	85
Less: Interest expense	9	0	0	0
Add: Other income	315	336	319	325
Profit before tax	1,041	1,070	1,150	1,240
Prov for tax	206	270	290	313
Less: Other adj	0	0	0	0
Reported profit	823	800	861	928
Less: Excp.item (net)	0	0	0	0
Adjusted profit	823	800	861	928
Diluted shares o/s	29	29	29	29
Adjusted diluted EPS	27.9	27.2	29.2	31.5
DPS (INR)	19.5	16.6	19.6	19.6
Tax rate (%)	19.8	25.2	25.2	25.2

Balance Sheet (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Share capital	295	295	295	295
Reserves	5,038	5,271	5,462	5,720
Shareholders funds	5,333	5,566	5,757	6,015
Minority interest	32	32	32	32
Borrowings	0	0	0	0
Trade payables	0	0	0	0
Other liabs & prov	732	732	732	732
Total liabilities	6,181	6,414	6,605	6,862
Net block	843	780	716	651
Intangible assets	88	88	88	88
Capital WIP	5	5	5	5
Total fixed assets	936	874	809	744
Non current inv	2,261	2,261	2,261	2,261
Cash/cash equivalent	2,274	2,539	2,766	3,036
Sundry debtors	409	440	468	521
Loans & advances	146	146	146	146
Other assets	155	155	155	155
Total assets	6,181	6,414	6,605	6,862

Important Ratios (%)

Year to March	FY20A	FY21E	FY22E	FY23E
Corp Debt (% of rev)	51.6	52.4	54.9	57.3
BLR (% of rev)	48.4	47.6	45.1	42.7
Gross margin (%)	55.1	49.8	51.9	53.2
EBITDA margin (%)	33.4	35.6	35.9	35.2
Net profit margin (%)	33.8	34.9	33.8	32.7
Revenue growth (% YoY)	(23.6)	(5.8)	11.1	11.4
EBITDA growth (% YoY)	(53.4)	0.4	12.0	9.3
Adj. profit growth (%)	(40.1)	(2.7)	7.5	7.8

Free Cash Flow (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Reported profit	823	800	861	928
Add: Depreciation	78	83	84	85
Interest (net of tax)	6	0	0	0
Others	(270)	0	0	0
Less: Changes in WC	(935)	(31)	(28)	(54)
Operating cash flow	(298)	852	917	960
Less: Capex	(46)	(20)	(20)	(20)
Free cash flow	(344)	832	897	940

Assumptions (%)

Year to March	FY20A	FY21E	FY22E	FY23E
GDP (YoY %)	4.8	(6.0)	7.0	6.0
Repo rate (%)	4.4	3.5	3.5	4.0
USD/INR (average)	70.7	75.0	73.0	72.0
CD Issuances (% YoY)	10.0	18.0	14.0	14.0
Bank Credit (% YoY)	16.0	16.0	16.0	16.0
Debt Rated Vol (INR mn)	8,580.0	7,464.6	8,658.9	10,044.4
BLR Assignments	4,046.4	3,034.8	3,490.0	3,908.8
SME Nos.	1,305.6	522.2	564.0	609.1
Other costs (% of sales)	21.8	14.2	16.0	18.0

Key Ratios

Year to March	FY20A	FY21E	FY22E	FY23E
RoE (%)	15.2	14.7	15.2	15.8
RoCE (%)	19.3	19.5	20.2	21.0
Inventory days	nm	nm	nm	nm
Receivable days	66	68	65	64
Payable days	nm	nm	nm	nm
Working cap (% sales)	1.1	2.6	3.4	4.9
Gross debt/equity (x)	0	0	0	0
Net debt/equity (x)	(0.4)	(0.5)	(0.5)	(0.5)
Interest coverage (x)	79.3	0	0	0

Valuation Metrics

Year to March	FY20A	FY21E	FY22E	FY23E
Diluted P/E (x)	18.2	18.7	17.4	16.2
Price/BV (x)	2.8	2.7	2.6	2.5
EV/EBITDA (x)	15.7	15.3	13.4	12.0
Dividend yield (%)	3.8	3.3	3.8	3.8

Source: Company and Edelweiss estimates

Valuation Drivers

Year to March	FY20A	FY21E	FY22E	FY23E
EPS growth (%)	(40.1)	(2.7)	7.5	7.8
RoE (%)	15.2	14.7	15.2	15.8
EBITDA growth (%)	(53.4)	0.4	12.0	9.3
Payout ratio (%)	69.8	61.1	67.1	62.2

Exhibit 1: Quarterly financial snapshot

Year to March	Q3FY21	Q3FY20	YoY	Q2FY21	QoQ	YTDFY21	FY21E	FY22E
Revenues	556	561	(0.9)	759	(26.7)	1,689	2,295	2,549
Employee cost	301	264	13.8	286	5.3	850	1,153	1,226
Other expenses	73	121	(40.0)	54	34.7	187	326	408
Total expenditure	373	385	(3.1)	340	9.9	1,036	1,478	1,634
EBITDA	183	176	3.8	419	(56.4)	652	817	915
Depreciation	20	20	0.9	20	0.3	61	83	84
EBIT	162	156	4.2	399	(59.3)	592	734	831
Interest	2	2		2		6	0	0
Other income	81	71	13.8	80	1.5	256	336	319
Add: Exceptional items	0	0		0		0		
Profit Before Tax	242	225	7.6	477	(49.3)	842	1,070	1,150
Less: Provision for Tax	52	49	7.2	119	(55.8)	197	270	290
Less: Minority Interest	3	2		4		10		
Reported Profit	186	174	7.0	355	(47.5)	634	800	861
Adjusted Profit	186	174	7.0	355	(47.5)	634	800	861
No. of Dil. shares outstanding (mn)	29	29		29		29	29	29
Adjusted Diluted EPS	6.2	5.9	6.2	11.9	(47.8)	21.2	27.2	29.2
as % of net revenues								
Staff expenses	54.1	47.1		37.7		50.3	50.2	48.1
Other expenses	13.1	21.6		7.1		11.0	14.2	16.0
EBITDA	32.8	31.3		55.2		38.6	35.6	35.9
Net profit	33.5	31.0		46.7		37.6	34.9	33.8

Source: Company, Edelweiss Research

Exhibit 2: We upgrade our FY21/22/23E EPS by 8/6/4%

(INR mn)	Old			New			% change		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	2,239	2,478	2,748	2,295	2,549	2,841	2.5	2.9	3.4
EBITDA	753	856	965	817	915	1,001	8.5	6.9	3.7
PAT	743	811	895	800	861	928	7.7	6.1	3.7

Source: 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 10.7% EBIDTA CAGR over FY21-23E.

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
ED & Chief Ratings Officer	T.N. Arun Kumar
ED & CS	Navin Kumar Jain
Auditor	Khimji Kunverji & Co

Holdings – Top 10*

	% Holding		% Holding
Franklin Resources	4.76	Norges Bank	1.52
Bajaj Allianz Life	3.88	Bajaj Holdings	1.42
First Pacific Advisors	3.45	Norges Bank	1.52
PineBridge Invest	3.09	Bajaj Holdings	1.42
ABSL AMC	3.04	BMO Investments	1.33

**Latest public data*

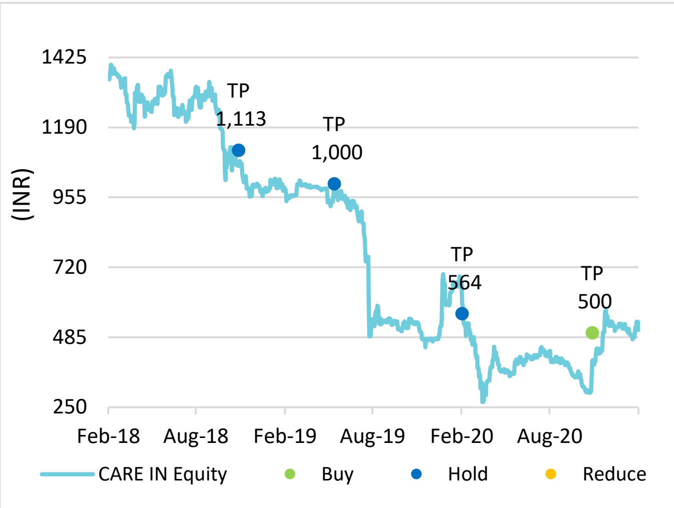
Recent Company Research

Date	Title	Price	Reco
05-Nov-20	The tide turns ; *Result Update*	404.3	Buy
11-Aug-20	CARE Ratings - Result Update Q1FY21 - Pe; *Result Update*	439	Hold
19-Jun-20	CARE Ratings - Result Update Q4FY20 -Cha; *Result Update*	405	Hold

Recent Sector Research

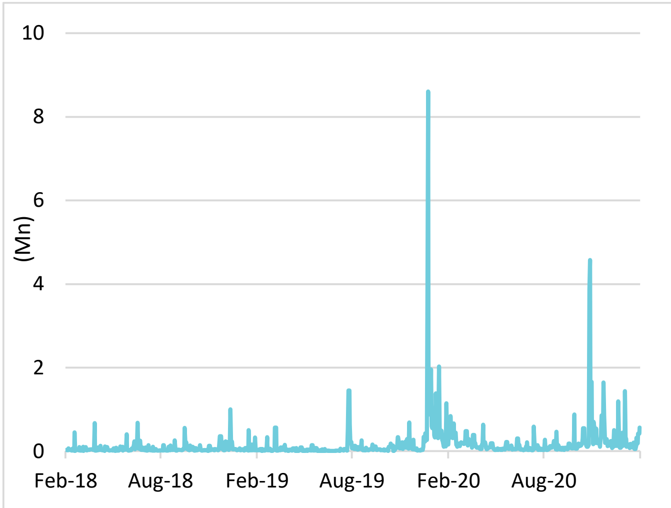
Date	Name of Co./Sector	Title
24-Oct-20	CRISIL	Ratings decline, research strong; *Result Update*
20-Oct-20	CRISIL	Ratings decline; research strong; *Oven fresh*
25-Jul-20	CRISIL	CRISIL - Result Update Q1FY21 - Consiste; *Result Update*

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	163	65	14	242
	>50bn	**>10bn and <50bn**	**<10bn**	**Total**
Market Cap (INR)	194	53	4	251

* *stocks under review*

Rating Rationale

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

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