

CARE Ratings

Professional Risk Opinion



"DECISIONS MADE SIMPLER"

Company Snapshot (As on Jan'14)

- **Current Market Price – INR 720**
- **Target – INR 1200**
- **Time Frame - 6 months**
- **Expected Return-**
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- BSE Code – 534804.
- Market Capitalization – Rs. 2090 Cr.
- Face Value – Rs.10.00.
- Total Equity Shares – 2.89Cr.
- 52 Week High/Low – Rs.826/462.

Financial Snapshot

Particulars (in cr.)	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13
Income from operations	51.97	94.17	136.2	170.87	178.08	198.76
Operating Profit	37.47	73.00	107.84	130.55	123.18	133.88
Operating Profit margin (%)	72.10%	77.52%	79.18%	76.40%	69.17%	67.36%
Other Income	2.94	5.76	15.82	5.76	28.21	28.63
Depreciation	0.60	0.99	1.40	2.21	1.88	2.63
Profit Before tax	39.81	77.77	122.26	134.10	149.51	159.88
Tax expense	13.13	25.37	36.57	43.14	41.97	46.55
Net Profit	26.68	52.40	85.69	90.96	107.54	113.33
Cash flows from operations	30.79	50.48	74.78	88.89	97.95	89.4
Return on Avg. equity		48.36%	49.40%	35.24%	31.64%	28.30%

CARE – Credit Analysis & Research

CARE is a Credit Rating, Research and Information Services company promoted in 1993 by major banks/financial institutions (FIs) in India. The three largest shareholders of CARE are IDBI Bank, Canara Bank and State Bank of India.

CARE's operations can be divided into two divisions: **Credit Rating** and **Research & Information Services**. It offers a wide range of rating and grading services across a diverse range of instruments and industries and also provides general and customized industry research reports on subscription basis; however CARE's rating business accounts for more than 98% of its revenue and profits.

CARE has now over 20 years of experience in rating debt instruments and related obligations covering a wide range of sectors, such as manufacturing, services, banks and infrastructure. Its list of clients includes banks and other financial institutions, private sector companies, central public sector undertakings, sub-sovereign entities, small and medium enterprises ("SMEs") and micro-finance institutions, among others.



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It rates all kinds of short, medium and long-term debt instruments such as commercial papers, bonds, debentures, preference shares and structured debt instruments; bank loans and facilities, both fund-based and non fund-based; and deposit obligations, such as inter-corporate deposits, fixed deposits and certificates of deposit. It also provides issuer ratings, corporate governance ratings and has rated innovative debt instruments, such as perpetual bonds.



Corporate debentures/bonds and bank loan facilities account for ~85% of the number of rating assignments carried out by the company.

Despite starting four years after ICRA, CARE is now the second largest credit rating agency in India in terms of revenue.

Let's look at some of the stats such as number of clients, number of instruments and the volume of debt rated by the company in the last few years and the growth experienced therein.



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International Operations

International operations – Besides India, the company has done a few rating assignments in Maldives and is recognized by the Capital Markets Development Authority, Republic of Maldives to carry out ratings of debt instruments and bank loans facilities in respect of Maldivian companies.

CARE will also be one of the partners in an international rating agency – **ARC Ratings**. ARC Ratings will be formed as a joint venture between five international rating agencies, including CARE Ratings and shall provide international scale ratings to assist local issuers in mobilizing resources from international financial markets. The five partners would each hold 20% stake in ARC Ratings.



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What is Credit Rating?

What is Credit rating? – Credit rating is basically an *opinion* on the relative degree of risk associated with timely payment of interest and principal on a debt instrument (bonds/debenture/bank loans/commercial papers, etc). It is an informed indication of the likelihood of default of an issuer on a debt instrument, relative to the respective likelihoods of default of other issuers in the market. It is therefore an independent, easy-to-use measure of relative credit risk.



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CARE – Performance Snapshot

The financial metrics of the Credit rating industry are strong with high return ratios and high free cash flow generation and the performance of CARE has also been on the same lines.

Particulars (in cr.)	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	TTM
Income from Operations	51.97	94.17	136.2	170.87	178.08	198.76	205.91
Employee benefit expense	10.66	15.26	21.57	30.51	42.24	50.65	53.86
employee expense/Income	20.51%	16.20%	15.84%	17.86%	23.72%	25.48%	26.16%
Other expenses	3.84	5.91	6.79	9.81	12.66	14.23	15.68
Total Operating expenses	14.5	21.17	28.36	40.32	54.9	64.88	69.54
Operating Profit	37.47	73.00	107.84	130.55	123.18	133.88	136.37
Operating Profit margin (%)	72.10%	77.52%	79.18%	76.40%	69.17%	67.36%	66.23%
Other Income	2.94	5.76	15.82	5.76	28.21	28.63	35.79
Depreciation	0.6	0.99	1.4	2.21	1.88	2.63	2.70
Profit Before Tax	39.81	77.77	122.26	134.1	149.51	159.88	169.46
Tax expense	13.13	25.37	36.57	43.14	41.97	46.55	48.64
Profit after tax	26.68	52.4	85.69	90.96	107.54	113.33	120.82
Cash Flows from operations	30.79	50.48	74.78	88.89	97.95	89.4	
ROAE		48.36%	49.40%	35.24%	31.64%	28.30%	

As can be observed from the above illustration, the company has reported good all-round performance in the last 6 years. Besides good growth, the company has also done well on other metrics such as cash flow generation, return on equity, etc. Excluding the impact of other income, the cash flows from operations have been higher than the reported profits on account of advance payments received by the company for the rating it assigns at a later stage.

The return on average equity has been coming down as the company is sitting over 400 crores in cash surplus on which the yield is 7-8%. While the cash flow generation is very strong, there's no major capital expenditure requirement. It's actually a problem of plenty which every company would willingly accept, though there are only few such businesses.



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Major Shareholders

Name of the shareholder	% stake in CARE
IDBI Bank	17.19%
Canara Bank	15.21%
State Bank of India	6.41%
IL&FS Financial Services	5.99%
Bajaj Holdings and Investment	5.98%
The Federal Bank	4.15%
IL&FS Trust Company	3.49%
Aditya Birla Pvt. Equity Trust	2.87%
ING Vysya Bank	1.99%
Franklin Templeton	1.99%
Russell Investments	1.86%
The Wellington Trust	1.77%
Poonawalla Investment	1.39%
Tata Investment Corporation	1.08%
Goldman Sachs Funds	1.04%

Valuations

In the above sections we observed that Credit Rating business has witnessed significant developments in the last two decades and the long term prospects seem promising. Further, as the financial metrics of the industry are strong with high return ratios and high free cash flow generation, we believe, from an investors perspective Credit Rating companies are good long term investment avenues if picked at good valuations.

As already observed in the above sections, CARE's performance has been good over the years and has grown above industry rate which has helped it secure 2nd spot in the credit rating industry.



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In FY 13 the company delivered pre-tax operating profit of Rs 131.2 crores while the stock is currently available at an enterprise value of Rs 1100 crores (market cap + debt – surplus cash). At present pre-tax AAA bond yields are 9% p.a. If CARE's business was AAA bond and it paid Rs 131.2 crores a year in perpetuity, then the value of this non-growing perpetuity at present rates would be 1460 crores against the enterprise value of Rs 1,100 crores.

In other words, at current value the market is taking a negative view and assuming the company to de-grow over the longer term, though; to us it seems that CARE will continue to grow at 12-15% or even more in the longer run.



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Contact us



Decisions Made Simpler

#303, 3rd Floor,
Kedia Arcade, Infantry Road,
Bangalore – 560001.

Ph : 080-40918467

Email: sales@itipsadvisory.com

www.itipsadvisory.com