Stock Update

Care Ratings Ltd.

August 21, 2023

RETAILRESEARCH

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Care Ratings Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Credit Rating	Rs 760	Buy in Rs 755-770 band & add more on dips in Rs 660-675 band	Rs 835	Rs 915	2-3 quarters

HDFC Scrip Code	CARRATEQNR
BSE Code	534804
NSE Code	CARERATING
Bloomberg	CARE IN
CMP Aug 18, 2023	759.8
Equity Capital (Rs cr)	29.7
Face Value (Rs)	10
Equity Share O/S (cr)	3.0
Market Cap (Rs cr)	2259
Book Value (Rs)	232.3
Avg. 52 Wk Volumes	128,600
52 Week High (Rs)	794.0
52 Week Low (Rs)	467.3

Share holding Pattern % (Jun, 2023)	
Promoters	0.0
Institutions	43.4
Non Institutions	56.6
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

The rating industry saw good traction in FY23 after muted growth in the past two years, backed by good growth in bank credit. CARE continues to maintain its leadership position in rating the Financial and Infrastructure sector which are witnessing strong growth. The company has taken significant steps to expand its reach and broaden presence in new markets. Regulatory bodies like RBI, SEBI and other bodies like NCLT have mandated ratings for new products/borrowers, bringing in new sources of income for credit rating agencies (CRA). Investments by the Government and incentives provided to expand manufacturing is likely to keep the demand for credit elevated. The requirement for credit rating is likely to grow along with the economy. Given that bank credit is expected to double in the next five years, the long-term value proposition of CRAs seems intact.

On January 13, 2023, we had initiated coverage on the company (Link) with a recommendation to 'Buy in Rs 635-650 band & add on dips in Rs 560-575 band' for base case fair value of Rs 708 and bull case fair value of Rs 748 over the next 2 quarters. Our base case target was achieved on May 16.

Valuation & Recommendation:

CARE has been on a transformational journey in the past two years with a focus on four pillars – Group Impetus, Technology, People, and Re-branding. These efforts have started yielding results. The company has seen changes in its top management since 2020 and now there is some stability, which could beneficially impact its growth in op and bottomline going ahead. We expect CARE's Revenue/EBITDA/PAT to grow at 15/20/21% CAGR over FY23-FY25E, led by increase in volume of debt rated and operating efficiencies. We believe investors can buy the stock in the band of Rs 755-770 and add on dips in Rs 660-675 band (16x FY25E EPS) for a base case fair value of Rs 835 (20x FY25E EPS) and bull case fair value of Rs 915 (22x FY25E EPS) over the next 2-3 quarters.

Financial Summary

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY22	FY23	FY24E	FY25E
Revenues	66.4	54.6	21.7	77.5	-14.3	247.6	279.0	325.4	368.7
EBITDA	17.8	16.1	10.6	27.3	-34.7	79.6	99.3	123.0	144.2
APAT	17.8	13.7	30.3	19.6	-9.2	75.1	83.5	107.0	123.8
Diluted EPS (Rs)	6.0	4.6	30.1	6.6	-9.2	25.3	28.1	36.0	41.7
RoE (%)						12.2	12.7	15.3	16.3
P/E (x)						30.0	27.0	21.1	18.2
EV/EBITDA (x)						21.8	17.0	13.4	10.9

(Source: Company, HDFC sec)

Q1FY24 Result Update

Revenues of the company grew by 22% YoY in Q1FY24 to Rs 66cr as rating and related services segment revenue increased 16% to Rs 60cr. Non rating revenues increased from Rs 2.8cr in Q1FY23 to Rs 6.5cr in the current quarter. During this quarter, volume of bond issuances more than doubled to Rs 3 lakh crore and CP issuances grew ~9% to Rs 3.8 lakh crore. Employee expenses grew by 33% YoY and other expenses were up 7% resulting in 11% YoY growth in EBITDA to Rs 18cr and 270bps YoY contraction in EBITDA margin to 26.9%. PAT increased by 30% YoY to Rs 18cr and PAT margin expanded 180bps to 26.8% on account of higher other income and lower tax rate.

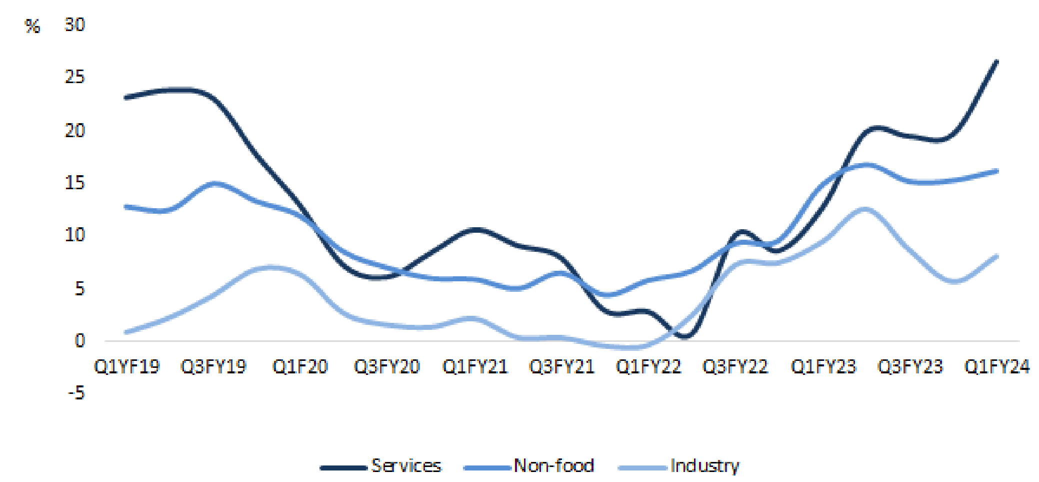
Issuance of Commercial Papers (CP) and Corporate Bond issuances picked up pace in Q1FY24. Fund-raising by businesses could improve further on expectations of likely improvement in private investment in the economy.

Key triggers

Credit growth momentum remains strong

Despite the 250bps hike implement by the RBI in FY23, credit growth has remained strong propelled by robust demand. Credit growth to services sector accelerated to 26.7% YoY in June 2023 from 12.8% a year ago, primarily due to the improved credit offtake to 'non-banking financial companies (NBFCs)' and 'trade'. Credit growth to industries, which was witnessing a slowdown in the past 2 quarters, has once again started to pick up driven by MSME.

Credit growth trend



(Source: RBI, HDFC sec)

The economy's total credit demand is expected to hold at 12-14% in FY2024, following a 15% rise in FY2023. This moderation may relate to a high comparison base and a GDP growth slowdown from 7.2% in FY2023 to 6-6.5% in FY2024. Retail loans, led by housing and vehicle loans, are predicted to continue their upward trajectory. Services sector credit growth, with contributions from NBFCs, tourism, aviation, and retail trade, should remain steady.

Favorable regulations for ratings business

SEBI has made it mandatory for large corporates (defined as one with borrowings of more than Rs 100 crore) to raise not less than 25% of their incremental borrowings from the debt capital markets, provided they have a long-term rating of AA or above. In line with the RBI's requirement of rating of bank loans for arriving at the computation of capital adequacy, the National Housing Bank also requires that the financing extended by them to Housing Finance Companies be rated.

SEBI has also mandated that monitoring of the end use of proceeds of equity issues above Rs 100 crore – whether the Initial Public Offer or the follow-on public offer or the rights issue – are to be done only by credit rating agencies and not banks as was the requirement earlier. This has been expanded now to include preferential and Qualified Institutional Placements also. SEBI has also proposed a regulatory framework for Environment Social Governance (ESG) ratings, the details of which are expected shortly.

These are favorable regulations for credit rating companies and likely to drive their ratings business.

Record high bond issuance by Indian corporates likely in FY24

Indian corporates could raise record funds through bond issuances this year as they take advantage of attractive interest rates. Indian companies raised 8.17 trillion rupees in FY23, an increase of 29% over FY22 and according to industry experts, issuance could cross 9 trillion rupees in the current year, with major focus remaining on fundraising via shorter duration bonds. In the months of April to July, firms raised 3.51 trillion rupees via bonds.

Risk & Concern

Rate hikes by RBI could result in slow-down in borrowings which would be unfavourable for CARE

Interest rates have moved up and could rise further if RBI does not stop hiking repo rates. A rate hike always remains a concern, as investors' sentiments to borrow diminishes.

Competition from new players could hurt growth in revenues

There are already three established players in this industry. Thus, as it is a boon it is also a threat, as in this form of market structure, companies normally tend to be price takers, and have to take the bite of severe competition. CRISIL is the market leader. Although, very small, but, to aggravate the situation there are four other companies (India Ratings, Brickworks, Acuite & Infomerics).

Economic slowdown could reduce business volumes

Credit rating volumes are directly linked with the economic growth of a country. In times of slowdown the overall volumes could take a hit reducing the scope of earnings for the company.

Increased shift of borrowers from banks to MFs

The dramatic growth in resources flowing to mutual funds (MFs) suggests that there is a discernible shift in the pattern of deployment of financial savings in India. This gives plenty of scope for potential movement of borrowers away from banks to mutual funds.

Proportion of non-rating business to total income is still low in CARE compared to the other two large players.

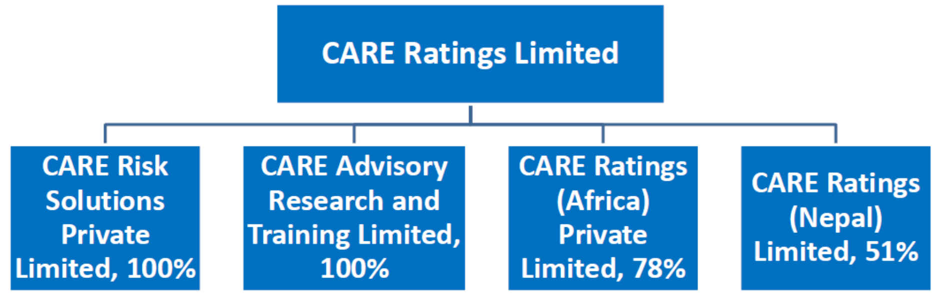
Company Background:

Credit Analysis & Research Ltd (CARE) is full service rating company that offers a wide range of rating and grading services across sectors. CARE has commenced operations in April 1993 (promoted by several banks and financial institutions) it has a credible track record of rating companies across multiple sectors and has played a pivotal role in developing the corporate debt market in India. CARE Ratings has also emerged as the leading agency for covering many rating segments like that for banks, sub-sovereigns and IPO grading. The company's main source of revenue include Bank Loan ratings, Bond ratings & SME ratings.

The company's rating services include corporate rating services, such as corporate debt, bank loan, issuer, corporate governance, and recovery rating services; financial sector rating services, which cover banks, mutual funds, capital protection oriented schemes, insurance, NBFCs, securitization, and housing finance companies; and public finance rating services that cover ratings of state government entities and urban local bodies, as well as project finance, infrastructure sector, and small and medium enterprises rating services. It also offers grading services for educational institutes, IPOs, industrial training institutes, construction companies, shipyard companies, maritime training institutes, renewable energy service companies and system integrators, micro finance institutions, and energy service companies, as well as provides equity research and grading services, and real estate project star and REIT rating services.

Besides its registered office at Mumbai CARE has regional offices at Ahmedabad, Bangalore, Chennai, Hyderabad, Jaipur, Kolkata, New Delhi, Pune, Coimbatore and international operation in Male in the Republic of Maldives. To enhance its scope of business CARE Ratings has been nurturing global opportunities and made forays in different forms.

Corporate Structure



(Source: Company, HDFC sec)

Peer comparision

(FY23)	CMP (Rs)	Mcap (Rs cr)	EPS (Rs)	OPM (%)	PATM (%)	RoE (%)	D/E (x)	P/E (x)	P/BV (x)
CRISIL (CY22)	3816	27896	75.9	26.4	20.0	31.0	0.0	50.3	15.6
ICRA	6149	5935	140.1	35.4	33.5	14.2	0.0	43.9	6.2
CARE Ratings	760	2259	28.1	35.6	29.9	12.7	0.0	27.0	3.4

Financials

Income Statement

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**248.5**	**247.6**	**279.0**	**325.4**	**368.7**
Growth (%)	***2.0***	***-0.3***	***12.7***	***16.6***	***13.3***
Operating Expenses	152.7	168.0	179.7	202.4	224.5
EBITDA	**95.8**	**79.6**	**99.3**	**123.0**	**144.2**
Growth (%)	***17.8***	***-16.9***	***24.8***	***23.8***	***17.2***
EBITDA Margin (%)	***38.6***	***32.1***	***35.6***	***37.8***	***39.1***
Depreciation	7.8	7.7	10.5	11.8	12.9
Other Income	31.3	27.2	37.9	39.7	42.4
EBIT	**119.3**	**99.1**	**126.7**	**150.9**	**173.7**
Interest expenses	0.6	0.5	1.0	1.2	1.4
PBT	**118.7**	**98.6**	**125.7**	**149.7**	**172.3**
Tax	27.7	21.8	40.3	40.6	46.2
PAT	**91.0**	**76.8**	**85.5**	**109.1**	**126.1**
Share of Asso./Minority Int.	-1.4	-1.7	-1.9	-2.1	-2.3
Adj. PAT	**89.5**	**75.1**	**83.5**	**107.0**	**123.8**
Growth (%)	***8.7***	***-16.1***	***11.2***	***28.1***	***15.7***
EPS	30.4	25.3	28.1	36.0	41.7

Balance Sheet

As at March (Rs cr)	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	29.5	29.6	29.7	29.7	29.7
Reserves & Surplus	559.4	617.8	642.5	696.0	760.4
Shareholders' Funds	**588.8**	**647.5**	**672.2**	**725.7**	**790.1**
Minority Interest	4.2	5.3	6.8	9.0	11.3
Total Debt	0.0	0.0	0.0	0.0	0.0
Net Deferred Taxes	9.3	3.7	4.9	4.9	4.9
Total Source of Funds	**602.3**	**656.5**	**684.0**	**739.6**	**806.3**
APPLICATION OF FUNDS					
Net Block & Goodwill	85.1	95.6	107.3	102.0	96.6
CWIP	3.2	8.2	4.2	4.2	4.2
Investments	238.9	44.0	43.9	118.9	193.9
Other Non-Current Assets	1.4	13.3	12.4	11.2	16.3
Total Non-Current Assets	**328.4**	**161.1**	**167.8**	**236.3**	**311.0**
Trade Receivables	21.4	16.6	21.5	26.7	28.3
Cash & Equivalents	283.1	523.6	564.8	533.0	534.0
Other Current Assets	37.7	23.7	16.9	25.0	23.2
Total Current Assets	**342.1**	**564.0**	**603.2**	**584.7**	**585.5**
Trade Payables	2.8	5.1	10.0	5.3	5.1
Current Liab & Prov.	65.5	63.4	77.1	76.0	85.2
Total Current Liabilities	**68.2**	**68.5**	**87.1**	**81.4**	**90.2**
Net Current Assets	**273.9**	**495.4**	**516.2**	**503.3**	**495.3**
Total Application of Funds	**602.3**	**656.5**	**684.0**	**739.6**	**806.3**

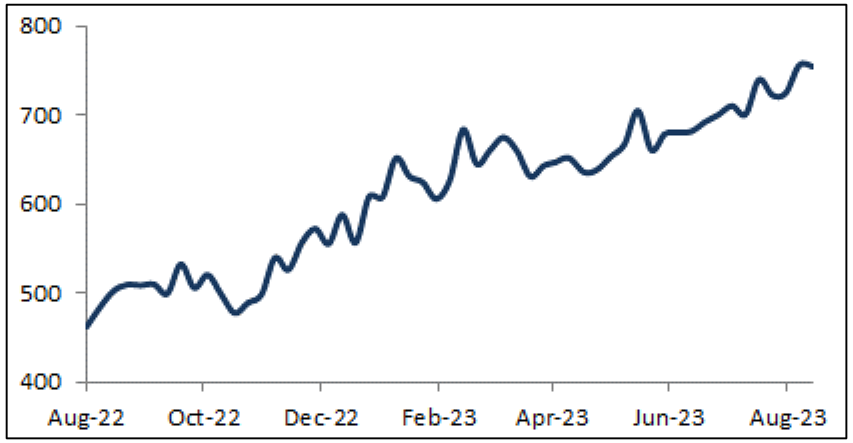
Cash Flow Statement

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	118.7	98.6	125.7	149.7	172.3
Non-operating & EO items	-31.0	-13.2	-27.4	-7.6	-4.2
Interest Expenses	0.6	0.5	1.0	1.2	1.4
Depreciation	8.0	7.7	10.5	11.8	12.9
Working Capital Change	12.9	3.7	4.1	-10.2	8.1
Tax Paid	-23.0	-29.3	-31.7	-40.6	-46.2
OPERATING CASH FLOW (a)	**86.2**	**68.0**	**82.2**	**104.4**	**144.3**
Capex	-4.2	-18.8	-11.5	-6.5	-7.5
Free Cash Flow	82.0	49.2	70.8	97.9	136.8
Investments	113.1	205.6	0.6	-75.0	-75.0
Non-operating income	-146.9	-214.2	23.8	0.0	0.0
INVESTING CASH FLOW (b)	**-38.0**	**-27.3**	**12.9**	**-81.5**	**-82.5**
Debt Issuance / (Repaid)	0.0	0.0	0.0	0.0	0.0
Interest Expenses	-0.6	-0.5	-1.0	-1.2	-1.4
FCFE	47.5	40.2	94.1	21.7	60.4
Share Capital Issuance	0.0	0.0	-0.2	0.0	0.0
Dividend	-39.8	-38.3	-59.8	-53.5	-59.4
FINANCING CASH FLOW (c)	**-40.4**	**-38.8**	**-61.0**	**-54.7**	**-60.8**
NET CASH FLOW (a+b+c)	**7.8**	**1.9**	**34.1**	**-31.8**	**1.0**

Key Ratios

	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	38.6	32.1	35.6	37.8	39.1
EBIT Margin	48.0	40.0	45.4	46.4	47.1
APAT Margin	36.0	30.3	29.9	32.9	33.6
RoE	16.0	12.2	12.7	15.3	16.3
RoCE	21.3	16.0	19.2	21.6	22.9
Solvency Ratio (x)					
Net Debt/EBITDA	-3.0	-6.6	-5.7	-4.3	-3.7
Net D/E	-0.5	-0.8	-0.8	-0.7	-0.7
Per Share Data (Rs)					
EPS	30.4	25.3	28.1	36.0	41.7
CEPS	33.0	27.9	31.7	40.0	46.0
BV	199.9	218.4	226.3	244.4	266.0
Dividend	17.0	10.0	15.0	18.0	20.0
Turnover Ratios (days)					
Debtor	45.7	28.0	25.0	27.1	27.2
Creditor	3.2	5.8	9.9	8.6	5.1
VALUATION (x)					
P/E	25.0	30.0	27.0	21.1	18.2
P/BV	3.8	3.5	3.4	3.1	2.9
EV/EBITDA	18.5	21.8	17.0	13.4	10.9
EV / Revenues	7.1	7.0	6.1	5.1	4.3
Dividend Yield (%)	2.2	1.3	2.0	2.4	2.6
Dividend Payout (%)	55.9	39.5	53.3	50.0	48.0

Price chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

ATUL JAGDISH KARWA

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Disclosure:

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Any holding in stock – No

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