CARE Ratings
Professional Risk Opinion

Credit Analysis & Research Ltd (NSE Code: CARERATING) – Alpha/Alpha + stock recommendation for Aug'13

Content Index

Company Snapshot (As on 27th Aug'13)

Current Market Price – Rs 526

Dividend yield – 3.80%

BSE Code – 534804

NSE Code – CARERATING

Market capitalization – Rs 1,500 cr.

Total Equity shares – 2.855 cr.

Face Value – Rs 10.00

52 Weeks High/Low – Rs 986.20/ Rs 415.05

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%

Credit Analysis & Research (CARE) – Basic Details

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.

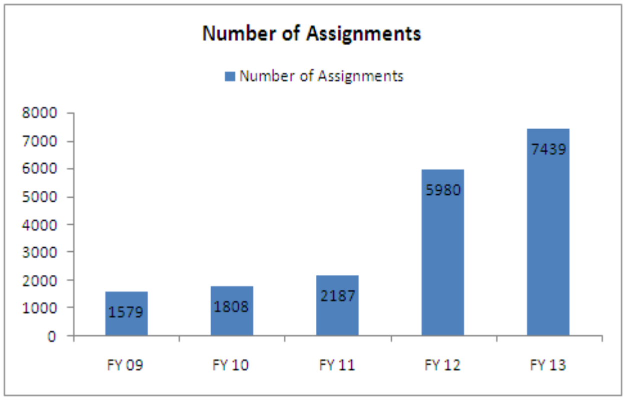
CARE has now over 20 years of experience in rating debt instruments and related obligations covering a wide range of sectors, such as manufacturing, services, banks and infrastructure. Its list of clients includes banks and other financial institutions, private sector companies, central public sector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

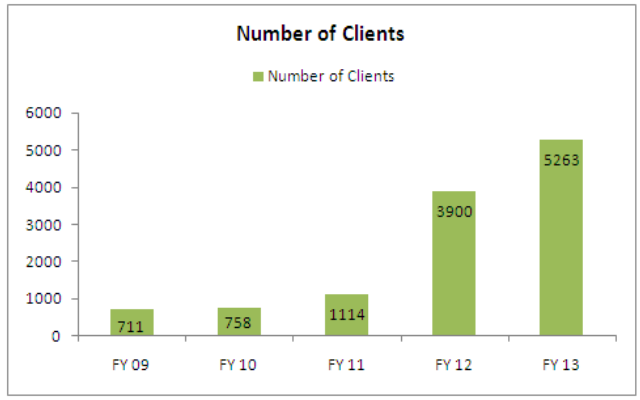
It rates all kinds of short, medium and long-term debt instruments such as commercial papers, bonds, debentures, preference shares and structured debt instruments; bank loans and facilities, both fund-based and non fund-based; and deposit obligations, such as inter-corporate deposits, fixed deposits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

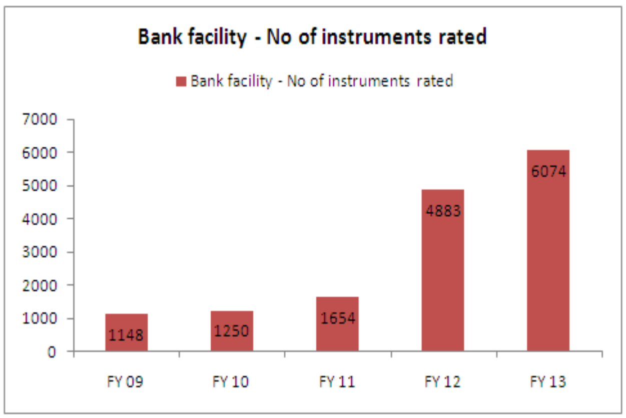
Corporate debentures/bonds and bank loan facilities account for ~85% of the number of rating assignments carried out by the company.

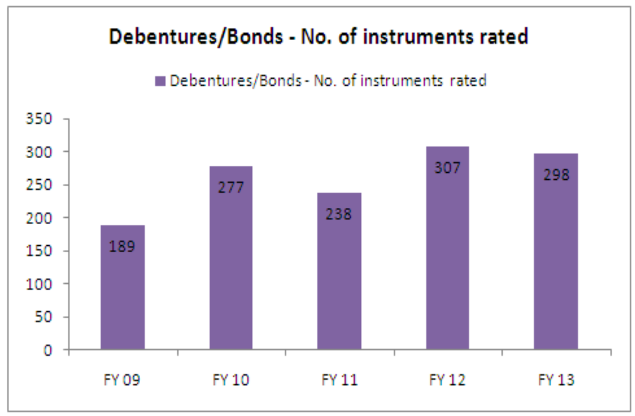
Despite starting four years after ICRA, CARE is now the second largest credit rating agency in India in terms of revenue.

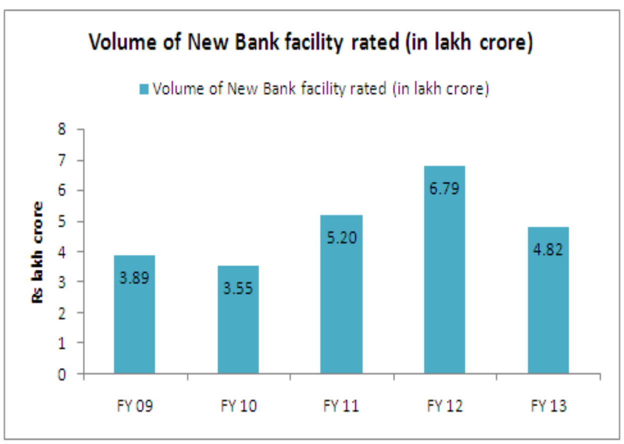
Let's look at some of the stats such as number of clients, number of instruments and the volume of debt rated by the company in the last few years and the growth experienced therein.

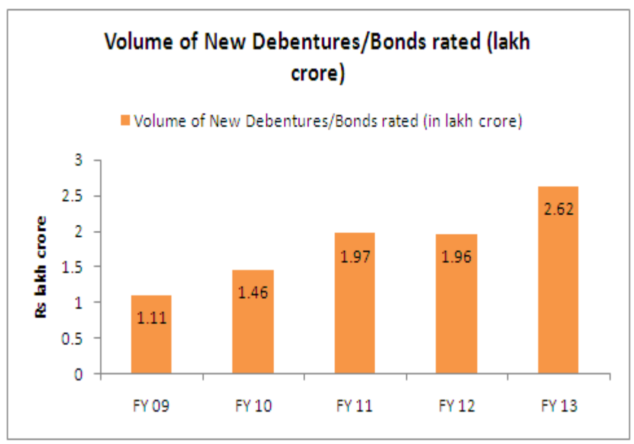












As can be observed above, the growth in the volume of **new** bank facilities and debentures/bonds has not been linear while there has still been a steady increase in the revenue and the number of clients of the company; well this is because the rating of any debt instrument or bank loan facility which is accepted and used by the client must remain under surveillance until the entire debt is repaid and this enables the company to maintain relation with clients who got their debt instruments/bank facilities rated in previous years and also enables the company to charge annual surveillance fees over the lifetime of the debt, which provides it with annuitized revenue.

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.

Grading Services – Besides Credit rating, CARE also provides specialized grading services such as IPO grading, equity grading, and grading of various types of enterprises, including ESCO, RESCO (Renewable Energy Service Company), shipyards, maritime training institutes, construction companies and rating of real estate projects. CARE is the leading credit rating agency in India for IPO grading, having graded the largest number of IPOs since the introduction of IPO grading in India.

Dynamics of the Credit rating industry

In India there are 6 credit rating agencies, the first credit rating agency, Credit Rating and Information Services of India Limited (**CRISIL**) was set up in 1987. Second rating agency, ICRA Limited (**ICRA**) was established in 1991 and the third agency, **CARE**, was established in 1993. Duff and Phelps Credit Rating India Limited which started its operations in 1996 was renamed Fitch Ratings India Private Limited in 2001 and renamed again to **India Ratings** and Research Private Limited in 2012. Brickworks Ratings India Private Limited (**Brickworks**) began its rating business in 2008. SME Rating Agency of India Limited (**SMERA**) also began its rating business in 2008.

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.

CRAs in India rate a large number of financial products:

1. Bonds/ debentures – [the main product]
2. Commercial papers
3. Structured finance products
4. Bank loans
5. Fixed deposits and bank certificate of deposits
6. Mutual fund debt schemes
7. Initial Public Offers (IPOs)

A simple alphanumeric symbol is used to convey the credit rating and the issuer company which has issued the debt instrument or has availed the bank loan gets strength and credibility with the grade of rating awarded to the credit instrument it intends to issue to the public for raising funds.

Significance of Credit rating for various stakeholders

Investors – CRAs typically opine on the credit risk of issuers of securities and their financial obligations. CRAs play a useful role in helping investors and others sift through this information, and analyze the credit risks they face when lending to a particular borrower or when purchasing an issuer‘s debt and debt like securities. CRAs also provide investors with rating reports, giving detailed information and analytical judgments on the issuer‘s business and financial risk profile. This assists investors in taking informed investment decisions, calibrated to their own risk-return preferences.

Issuers and borrowers – Issuers rely on credit ratings as an important tool to access investors and also to reach a wider investor base than they otherwise could. In most cases, successful placement of a significant bond issuance needs at least one rating from a recognized CRA; without a rating, the issue may be undersubscribed or the price offered by investors may not be appropriate. Further, they enable issuers to price their issues competitively. In financial markets, the price of debt is determined primarily by the rating of the debt issue.

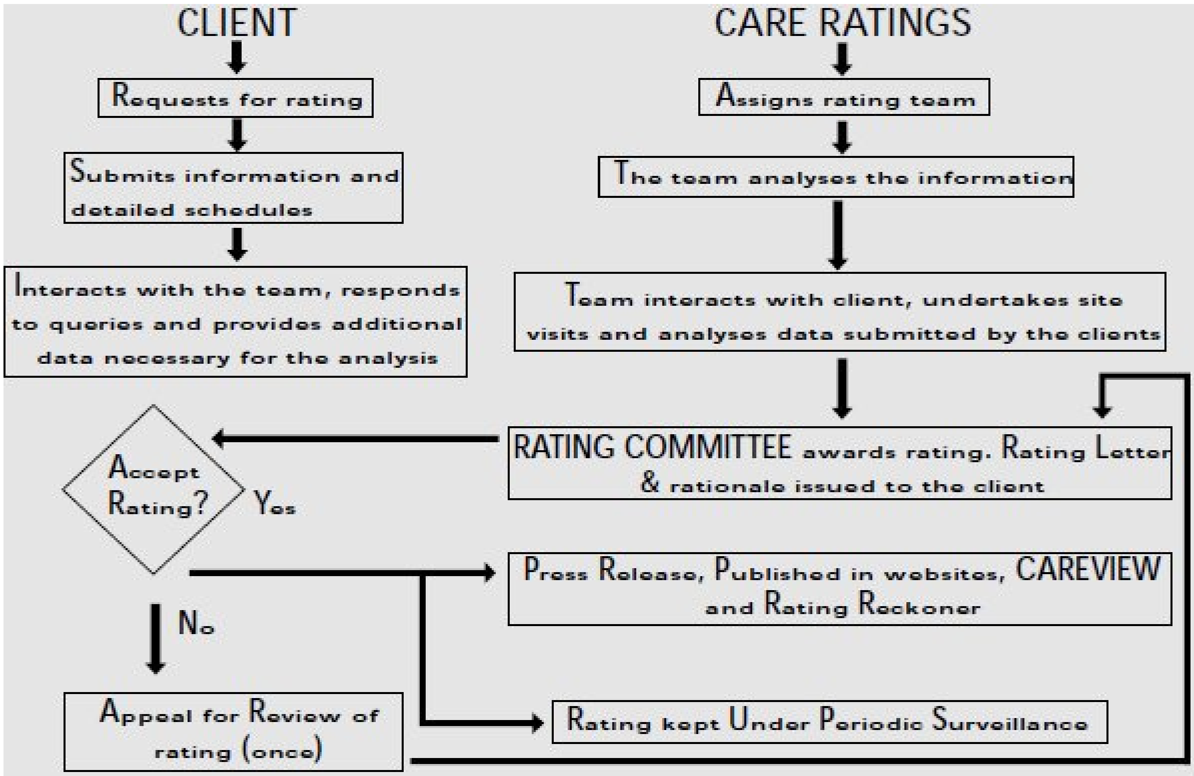
Banks and bank loan rating – From the perspective of banks, although credit rating is not mandatory under **Basel II**, however banks are likely to save capital if they lend to companies that have their loan facilities rated, else they may have to provide a risk weight of 100 per cent for credit risk on such loans. On the other hand, by getting loans rated, a bank can save capital on loans in the better rated categories, as shown in the illustration below.

Illustration of capital-saving potential by banks on a loan of Rs 1000 million

Rating	Basel I		Basel II (Standardised Approach for credit risk)		
	Risk weight	Capital required[1] (Rs. mn)	Risk weight	Capital required (Rs. mn)	Capital saved (Rs. mn)
AAA	100%	90	20%	18	72
AA	100%	90	30%	27	63
A	100%	90	50%	45	45
BBB	100%	90	100%	90	0
BB and below	100%	90	150%	135	(45)

The rating process

The process of rating starts with a rating request from the issuer, and the signing of a rating agreement. The rating agreement has important clauses like confidentiality, agreement by the issuer to share information with the CRA for the purpose of assigning the rating and thereafter on an ongoing basis when the rating is under surveillance.



The rating agency undertakes discussion with the management of the issuing entity. After discussion with the issuer's management, a report is prepared detailing the analyst team's assessment of the business risk, financial risk, and management risk associated with the issuer. The report is then presented to the rating committee.

Drawing on the knowledge and expertise of the participants, the rating committee determines the rating. On finalization of a rating at the rating committee meeting, the rating decision is communicated to the issuer. As the decision to get an initial rating is at the issuer's discretion (except in India for public issues of debt), the global best practice is to allow the issuer to decide whether to accept the rating. If the issuer disagrees with the rating, it can also appeal for a fresh look at the rating assigned. The rating committee then discusses the information submitted; it may or may not decide to modify the rating, depending on the facts of the case. If the rating is not changed and the issuer continues to disagree with the rating, it can choose not to accept the rating, which then does not get published.

Only ratings accepted by the clients are published and then monitored on a continuous basis over the life of the instrument. This also enables the rating agency to charge annual surveillance fee, besides the initial rating fee, over the life of the instrument rated.

Progress of Credit rating industry in India

In India the credit rating industry is driven largely by rating of corporate bonds, bank loans, and micro, small, and medium enterprises (MSMEs).

In the initial stages, the rating agencies faced several challenges as the corporate debt market in India was nascent, though it is still hugely underpenetrated at ~11.8% of GDP (17.2% in Emerging East Asia and 19.8% in Japan), which is very low as compared to both the developed as well as emerging markets.

Gradually, things started to look up with the introduction of mandatory rating for certain debt instruments such as below:

- In 1992, credit rating became mandatory for the issuance of debt instruments with maturity/convertibility of 18 months and above.
- Subsequently, the RBI guidelines made rating mandatory for issuance of commercial paper.
- RBI also made rating of public deposit schemes mandatory for NBFCs.
- In 2003, SEBI along with stock exchanges made ratings mandatory for debt instruments placed under private placement basis and having a maturity of one year or more, which are proposed to be listed.

With the introduction of mandatory ratings such as above, the credit rating industry has made rapid strides in terms of the number and value of instruments which have been rated.

Another development that has benefitted the ratings industry is the restriction on certain classes of investors to invest not more than a stipulated part of their portfolio in unrated bonds. The RBI in 2003 issued prudential guidelines on the management of the non-SLR investment portfolio of all scheduled commercial banks except regional rural banks and local area banks.

- These guidelines require such institutions to make fresh investment only in rated non-SLR securities.
- Similarly, non-government provident funds, superannuation funds, gratuity funds can invest in bonds issued by public financial institutions, public sector companies/banks and private sector companies only when they are dual rated (i.e. rated by at least two different credit rating agencies).
- Further, such provident funds, superannuation funds, gratuity funds can invest in shares of only those companies whose debt is rated investment grade by at least two credit rating agencies on the date of such investments.

Progress in Bank loan rating with the implementation of Basel II – The RBI introduced a phased approach to the implementation of Basel II in India. In the first stage, Indian banks were required by the RBI to adopt a 'standardized approach' for credit risk. Under the 'standardized approach', the **RBI recognized certain rating agencies as eligible credit rating agencies** and Indian banks are required to use such eligible credit rating agencies to assess their credit risk in order to determine compliance with capital adequacy requirements.

The implementation of Basel II standards by the RBI has resulted in large scale demand for credit ratings across sectors and geographies, which was previously limited to a small group of clients. A large number of Indian companies, hitherto unrated by rating agencies, have now come forward to get their bank facilities rated. This not only allows these companies to explore alternative sources of funds, but, through greater visibility, also facilitates healthy competition among fund providers.

Development of SME (Small & Medium Enterprises) Rating – Access to capital is essential to running a business—even more so for an SME. But, banks are often reluctant to loan to an SME because of the perceived risk in loaning to a small enterprise with an unproven record and limited assets.

Providing these banks with objective financial information about the SME can speed up the process and allow the SME access to much-needed capital. A credit rating from a third party removes some of the uncertainty of loaning to a small enterprise and increases transparency among other small enterprises seeking capital from some of the same sources.

To encourage enterprises to obtain the ratings, government operates a performance and credit rating scheme through various credit rating agencies via the **National Small Industries Corporation (NSIC)**. The first rating is subsidized by up to 75% by the Indian government through the **NSIC**. The rating lasts for one year. All subsequent ratings are paid for in full by the SME, and more than 40% return for another rating.

The agencies that provide rating for SMEs—CRISIL, SMERA, ICRA, CARE, Onicra, and Fitch—have tie-ups with several banks to offer preferential interest rates based on ratings. The interest rate reduction for SMEs ranges from 0.5-1.25% and around 35% of the enterprises have reported a reduction in the loan processing time. In many cases, savings from the reduced borrowing cost exceeds the rating fee.

Growth drivers for rating services

Demand for rating services is driven by overall capital mobilization in the economy particularly from the debt markets viz. corporate bonds and commercial paper (or other market linked short term instruments) issuances and the bank credit.

Economic growth fuels demand for both investment and operational related funding. In a competitive business environment many industries are also increasingly witnessing trends such as consolidation leading to demand for funding mergers and acquisitions. All these factors result in an increase in funding requirements for Indian corporate entities, which can be met through debt placement in the capital market, bank credit, cross border financing such as external commercial borrowing, foreign currency convertible bonds or equity placement.

Rating agencies provide ratings for most kinds of short, medium and long term debt instruments, such as commercial paper, 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 deposits.

The demand for ratings is influenced by choice of sources of funding which in turn depends on liquidity condition in the banking system, the condition of the capital market, prevailing interest rate and changes in currency expectations, etc.

Looking ahead, if the slight moderation in the rate of inflation currently observed were to gain traction, there is a possibility that interest rates would trend down gradually over the next few quarters. While moves on the policy front have usually been unhurried ahead of Parliamentary elections, Government announcements over the past few months do point towards measures to revive investments. If these were to actually come about and revive the investment cycle, economic growth could be better than what the prevailing environment indicates. This in turn would influence growth in the ratings business positively.

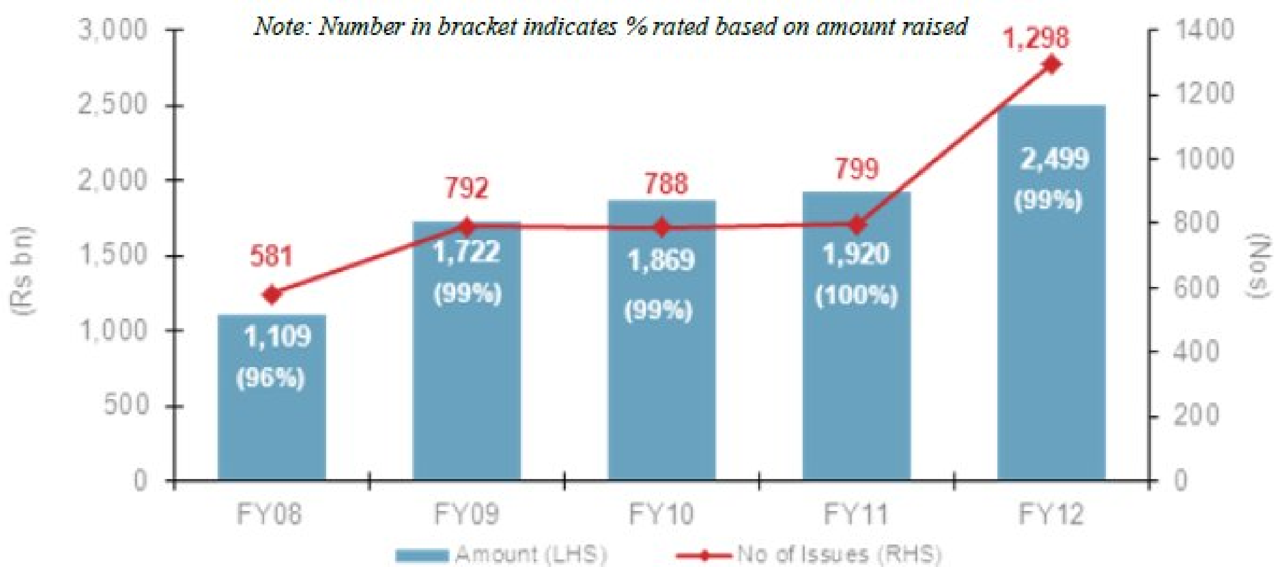
Bank loan ratings – As for bank loan ratings, this segment is expected to continue growing in volume terms as the penetration of Bank loan ratings is still very low and more number of smaller entities are expected to seek ratings under Basel II to access bank loans.

However, there is one concern specific to bank loan ratings; the RBI has allowed banks to migrate to **internal rating-based (IRB) approach** and approved banks can use their own internal estimates to determine the capital requirement for a given credit exposure against third party ratings.

If banks migrate to internal ratings, then the borrowing companies need not approach rating agencies for the ratings.

The RBI plans to have 18 months of parallel runs of the systems and plans to give final approval starting March 2014. The actual impact of IRB will be known only once the RBI starts granting approval to various banks that have the adequate systems to adopt IRB.

Bond market in India – Debt market issuances are the major source of revenue for Credit rating agencies as there's almost 100% credit rating penetration level on account of mandatory rating for almost all kinds of debt instruments.



In the short term debt issuances growth would again depend on the extent of revival in the investment cycle, but in case interest rates were to actually decline, issuers holding high-cost debt could be seen opting for refinance.

Over long-term, the under-penetrated debt market offers significant scope for growth in the revenues of credit rating agencies.

According to the RBI, the corporate bond market in India, as a per cent of GDP, was 11.8% compared to 17.2% in Emerging East Asia and 19.8% in Japan. The size of the corporate debt market as of September 2012 is just a fourth of the bank loan market. Large non-financial companies have been raising only about 4 per cent of their requirements through the debt market.

In the recent past, a number of measures have been proposed or taken by government to develop the corporate bond market in India and there are signs of stirring in India's corporate bond market, after policymakers removed some impediments. There have been two successive years of strong growth in issuance. While 2011-12 saw a 31% increase in issuance to Rs 2.51 trillion ($50.2 billion) compared to 2010-11, growth accelerated further by 39% in 2012-13 with issuance volumes reaching Rs 3.5 trillion ($70 billion). The number of issuers too increased from 182 in 2010-11 to 267 in 2012-13.

The last four months have seen several innovations. In May, L& T came out with the first inflation-indexed debentures by a corporate and state-owned United Bank of India issued India's first Basel-III bond in June. This was followed by Mahindra & Mahindra's 50-year bond issue. The Rs 5-billion debenture issue by India's first infrastructure debt fund, India Infradebt, has just been rated.

Soon, Indian mutual funds, which hold Rs 1.87 trillion of corporate bonds, will start using individual security-level valuations by independent agencies to value their corporate bond portfolios.

The investor base is also widening. Foreign investment in India's bond market increased five times, from Rs 18.95 billion in 2008-09 to Rs 283.34 billion in 2012-13. Mutual funds' investment in corporate bonds has almost doubled from Rs 1.09 trillion in March 2009 to Rs 1.87 trillion in May 2013, constituting 22% of their investment portfolio.

Regulatory changes have also been supportive of development of bond market in India. The Employees' Provident Fund Organization (EPFO), India's largest investor with an investible corpus of around Rs 5.46 trillion, has revised its investment norms, enabling it to invest in debt of 15 private sector companies, up from seven earlier.

The new investment norms for insurance companies enable them to invest a greater proportion of their investments in paper rated below AAA — they can even invest a certain amount in paper rated below A. These measures will free up an additional Rs 1 trillion, which insurers can deploy in non-AAA-rated corporate bonds.

The limit for foreign investment in corporate bonds has been increased from $40 billion in August 2011 to $51.5 billion in June 2013. Recently, withholding taxes for foreign institutional investors in debt have been reduced from 20% to 5% for instruments with three-year tenure.

SME ratings – SME ratings is expected to post healthy growth, given that many banks have begun using external ratings as an input in their lending decisions and the enhanced awareness among small and medium companies about the benefits of ratings.

Besides, only 65,000 SMEs are rated out of the 25 million MSMEs in the country, less than 1% penetration. As per Edelweiss Securities, subsidization of first year SME rating fees to the extent of 75% (maximum of Rs 40,000 in first year of rating) by the government will propel huge structural opportunity for the industry in the years ahead.

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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.

(All amounts in Rupees, unless otherwise stated)	Note	As at March 31, 2013	As at March 31, 2012
EQUITY AND LIABILITIES			
Shareholders' Funds			
Share Capital	2	285,528,120	285,528,120
Reserves and Surplus	3	3,953,437,872	3,485,599,819
Non Current Liabilities			
Deferred Tax Liability (Net)	4	39,049,751	32,714,042
Long Term Provisions	5	42,472,284	22,750,481
Current Liabilities			
Other Current Liabilities	6	510,132,418	384,045,373
Short Term Provisions	7	340,234,866	70,985,149
Total		5,170,855,311	4,281,622,984
ASSETS			
Non Current Assets			
Fixed Assets			
Tangible Assets	8	511,554,761	483,408,759
Intangible Assets	8	-	-
Capital Work in Progress	8	365,190	-
Non Current Investments	9	1,522,294,069	1,044,327,183
Long Term Loans and Advances	10	108,423,241	115,894,895
Other Non Current Assets	11	-	1,339,609
Current Assets			
Current Investments	12	2,378,300,436	1,746,943,557
Trade Receivables	13	293,009,594	156,260,289
Cash and Bank Balances	14	314,410,702	685,992,923
Short Term Loans and Advances	15	18,603,169	11,971,654
Other Current Assets	16	23,894,149	35,484,115

Cash and Cash equivalents (investments in various mutual fund schemes) and zero debt

In the last 2-3 years, because of high interest rates and the overall slowdown, the credit off-take has been impacted and thereby the growth of the credit rating industry has also been affected, however CARE's growth has been better than industry growth rate.

Important features of business operations

Credit Rating is a network driven sticky business model with recurring revenue stream, and first mover advantage. Also, there are just few rating agencies (6 in India) as licenses issued are regulated by authorities such as SEBI, RBI, etc. In India, the top four players command ~95% market share similar to global landscape where top 3 players hold 95% of the market share.

Sticky business model with first mover advantage – Once a client starts availing credit rating facility from a certain Credit Rating Agency (CRA), it is unlikely to discontinue availing the service until there's some dispute over the rating assigned or the company is financially unable to pay for the service or if the lifetime of the debt instrument or the bank loan facility has ended. Even after expiry of any debt instrument, in case of new debt instrument and bank loan facility, the client is likely to approach the same Credit rating agency from which it got rated earlier.

Network driven – The rating process commences with the request for rating received from the client and therefore networking and reach of a CRA plays a crucial role in attaining new clients, more so in the case of Small and medium enterprises where the penetration of credit rating is still very low.

Recurring revenue stream – A rating is an opinion given on the basis of information available at a particular point of time. As time goes by, many things change, affecting the debt servicing capabilities of the issuer, one way or the other. It is therefore essential that rating agencies monitor all outstanding debt issues rated by them.

While issuer ratings and SME ratings are more often than not one-time assessments of credit quality, instrument ratings (debentures, bonds, commercial papers, bank loan facilities, etc) are monitored over the life of the instrument.

As the rating of any debt instrument or bank loan facility which is accepted and used by the client must remain under surveillance until the entire debt is repaid, CRAs continue to charge surveillance fees over the lifetime of the debt, which provides them with annuitized revenue.

Fee structure – The rating fee is charged as a per cent age of the debenture/bond issue or the bank loan facility being availed by the client. So, larger the size of the issue, higher is the fees for the CRA. At the same time, rating fee is paid up-front and therefore if the client requests for rating of its bank loan facility or debt issue, it has to pay some portion of the fees regardless of whether it accepts the rating or not.

Other Current Liabilities

Amount Rs.

	As at March 31, 2013	As at March 31, 2012
Sundry Creditors for Expenses*	17,115,126	8,288,284
Unearned Revenue	252,048,250	197,892,924
Advance from Customers	160,278,350	137,898,606

Unearned revenues and advance from customers basically represent the cash which the company has received upfront and the service is yet to be delivered and the same results in very strong cash flows from operations for the credit rating agencies in general.

Shareholding pattern

	Jun'13	Mar'12	Dec'12
Promoter and Promoter Group	**0.00%**	**0.00%**	**0.00%**
India	0.00%	0.00%	0.00%
Foreign			
Public	**100.00%**	**100.00%**	**100.00%**
Institutions	62.23%	61.99%	58.05%
FII	13.59%	11.98%	8.37%
DII	48.64%	50.01%	49.68%
Non-Institutions	37.77%	38.01%	41.95%
Bodies Corporate	30.35%	30.98%	34.60%
Custodians	-	-	-
Total	**2,85,52,812**	**2,85,52,812**	**2,85,52,812**

There is no identifiable promoter of CARE as it was promoted by a group of financial institutions in 1993 and they are still the major shareholders in the company.

As on 30th Jun'13, the details of the major shareholders of the company and their stakes are as below:

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%

Dividend Policy

Dividend details		
	FY 13	FY 14
Interim Dividend	12	6
Final Dividend	8	NA
Dividend payout (%)	50.39%	NA

As CARE got listed only recently in Dec'12, there's not much data in terms of dividend payout history of the company, however one can get an idea about the company's prospective dividend policy from its dividend payout for FY 13.

For FY 13, the company has announced a total dividend of Rs 20/- per share (Rs 12/- already paid in Mar'13 and Rs 8/- shall be paid in Sep'13) which is 50.39% of the reported net profit of the company.

For FY 14, they have already paid first interim dividend of Rs 6/- per share and we expect 1-2 more interim dividends before a final dividend.

During a recent con-call, the management indicated that they are likely to continue with high dividend payout policy (we believe 40-50%) as the business isn't capital hungry, generates very good free cash flow and the company is already sitting on over 400 crores of cash surplus.

At current stock price of 525, the stock offers tax free dividend yield of 3.80%.

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.

As far as valuations are concerned, at current price of 525-530, CARE is available at a market cap of Rs 1,500 crores. We know that it's a debt free company, holding close to 400 crores as cash and cash equivalents. Besides, we know that the business model is good, being very low on capital requirement, negative working capital requirement backed by up-front payment of fees and recurring revenue stream from existing clients.

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.

Risks & Concerns

Unlike CRISIL and ICRA which are backed by global credit rating giants, S&P and Moody's respectively, CARE is not backed by any international credit rating agency and therefore there will always be some valuation discount.

Secondly, RBI has come out with its own guidelines relating to **Internal Risk Based (IRB)** approach for Bank loan ratings. The IRB Approach allows Banks, subject to the approval of RBI, to use their **own internal estimates** for some or all of the credit risk components in determining the capital requirement for a given credit exposure. This guideline is meant for the Banks which are willing and allowed by the RBI to adopt more sophisticated IRB approach.

RBI will now allow Banks to adopt IRB approach if Banks meet the requisite requirements and obtain RBI's approval for the same. The IRB approach would get implemented over a period of time and may have an impact on the Bank loan rating business of CARE in the longer run.

At the moment CARE derives more than 86% of its revenue from credit rating business and bank loan ratings account for ~40% of its credit rating business as against CRISIL and ICRA which get 20-30% revenue and therefore CARE is most susceptible to IRB related risk in comparison to CRISIL and ICRA which have more diverse revenue streams.

Katalyst Wealth – Alpha/Alpha + service

Katalyst Wealth's **Alpha/Alpha +** services are focused on sharing our philosophy of value investing and making every individual an informed investor through un-biased and in-depth research, analysis and follow up on the stocks under our coverage.

For more information on **Credit Analysis & Research Ltd (CARE)**, discuss with **Ekansh Mittal**

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