Financial Gatekeepers

Credit
Rating
Agencies

BUY INDIA'S BIG 3: CRISIL, ICRA, CARE

AXIS SECURITIES

22 JAN 2018

CRAs: India's Financial Gatekeepers

Buy Big Three: CRISIL, ICRA, CARE

Credit Rating Agency (CRA) business is a perfect fit for the PSPD criteria of investing – Predictable, Scalable, Profitable and De-risked. This is a debt-free business with 30-35% margin and RoCE of 30%+. We expect CRAs to increasingly benefit from reform-led improvements in debt market coupled with acceleration in corporate capex. We expect revenue to compound at 13-14% (our base case) with strong FCF (3-5% yield); this will be **distributed back to shareholders** (dividends and buybacks). Initiate coverage on the **Big Three** of India with a **BUY**: **CRISIL** (TP – Rs 2,241; **upside 16%**), **ICRA** (TP – Rs 4,500; **upside 12%),** and **CARE** (TP – Rs 1,750; **upside 26%**).

- **Comfort factors**
  - **Growth profile:** Similar to the global Big 3 CRAs (S&P, Moody's, Fitch), domestic CRAs have grown at ~1.7x nominal GDP over the last 10 years. We expect 13-14% base case revenue growth over medium term
  - **Historical returns and opportunity:** A testament to the resilience of these companies is that they have outperformed both the Bankex and PSU bank index over the last 10 years (on a risk adjusted basis as well). We believe CRAs are strong allocation candidates as they are closely linked to the banking credit growth and recovery in capex *without any regulatory provisioning requirements or jolts from deteriorating asset quality*
  - **Green shoots in corporate capex and improvements in debt market:** In last 2-3 years, CRAs have grown at a lower clip predominantly due to muted credit and GDP growth. We expect revival led by improvement in corporate capex, ongoing debt market reforms, and changing borrowing mix (in favor of Bonds and CDs). Even with moderate growth expectations, we believe CRAs are steady compounding stories which would continue to generate returns both through earnings growth and through corporate actions (buy backs)

CRAs: Predictable, Scalable, Profitable, De-risked

- CRAs have the very attributes that shareholders seek for value creation

Value creation

Predictable
- CRAs have grown at a nominal GDP multiplier of 1.7x (similar to developed countries)
- Sticky customer base with annuity revenue stream
- Extensive data base providing multiple growth opportunities

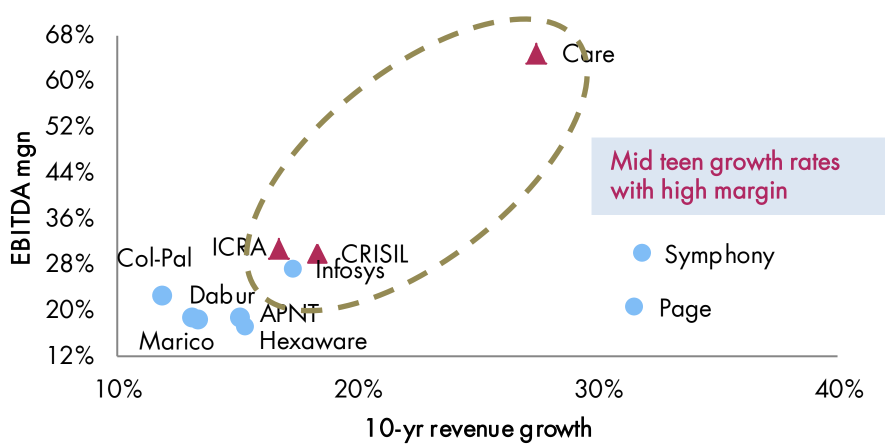
Scalable
- Improvement in revenue growth trajectory as corporate capex cycle revives
- Borrowers seeking non-traditional forms of funding – bonds, CPs and new structures eg. InvITs
- Option value: scalability of non-rating subsidiaries

Profitable
- Stable revenue growth mirroring performance of India Inc, with operating margin @30%+
- OCF: EBITDA at 100%+
- Research & Consultancy – emerging business, however structurally lower margin profile

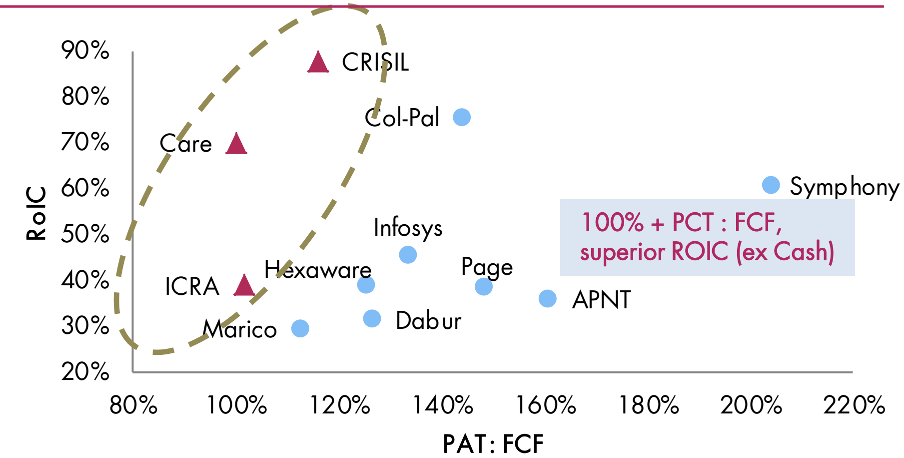
De-risked
- Moderately cyclical business with exposure across sectors
- Non-rating business (65% for Crisil and 30% for ICRA) reduce reliance on rating revenue
- Geographic diversification (predominantly South-east Asian countries)

Comparing companies with similar financial grit

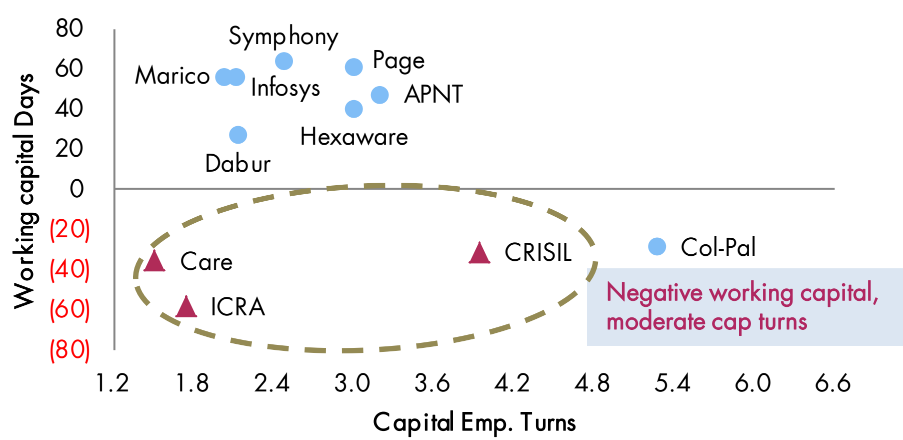
12%+ revenue growth (10-yr CAGR), 15%+ EBITDA margin



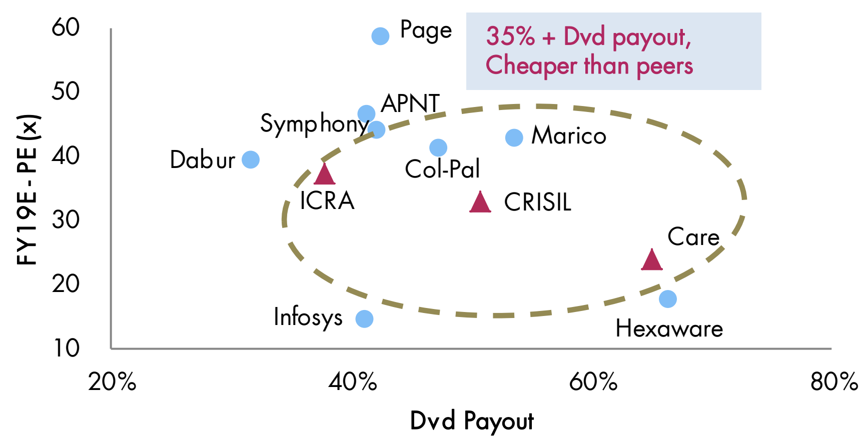
90%+ PAT: FCF, 15%+ RoIC (ex cash)



65 days working capital, 1x Cap Emp turn



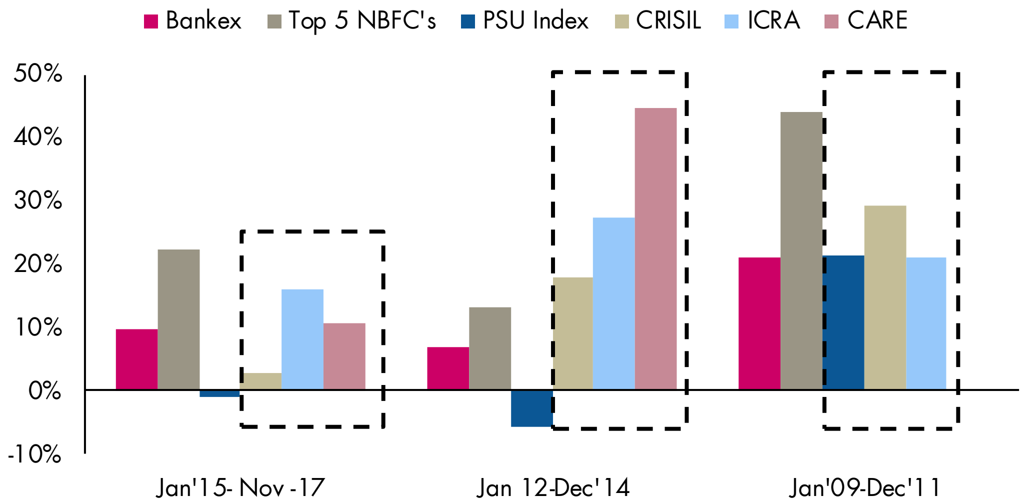
30%+ dividend payout



Source: Axis Capital

PSPD proven: CRAs generate high risk-adjusted return

Median Sharpe ratio – across cycles



Source: Axis Capital

Sharpe ratio calculates excess return (over G-Sec) per unit of risk.

https://www.investopedia.com/terms/s/sharperatio.asp

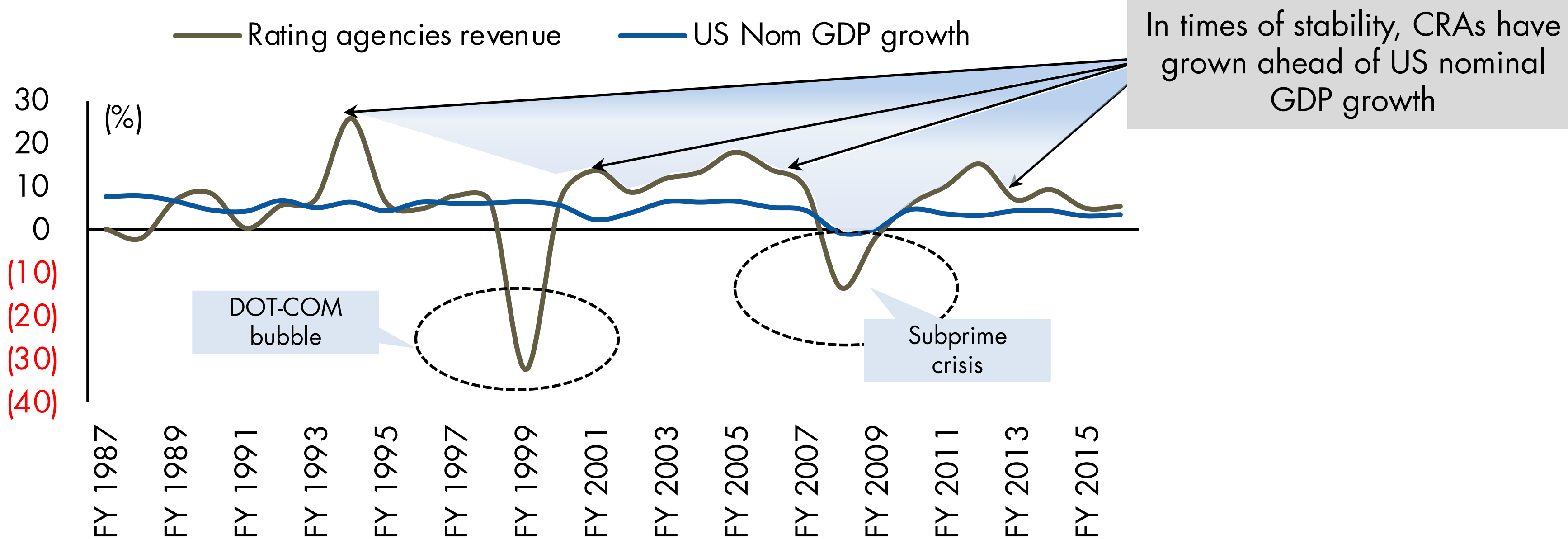
We observe CRAs have out-performed Bankex and PSU banks

- **While historical price performance justifies the allocation call, we believe, CRAs score over banks as**
  - Recovery in capex cycle will benefit CRAs as much as corporate lenders
  - CRAs are a play on falling interest rates, similar to investment gains for banks
  - No regulatory provisioning
  - No jolts from deteriorating asset quality
  - Superior RoE generation with similar or better growth profile

CRAs in US: Track record of 30 years

Excluding the 2 blips, rating agencies have broadly maintained 1.7-1.8 x multiplier to nominal GDP growth

Except 2 periods of massive unrest, CRAs have performed in line with /better than US nominal GDP growth

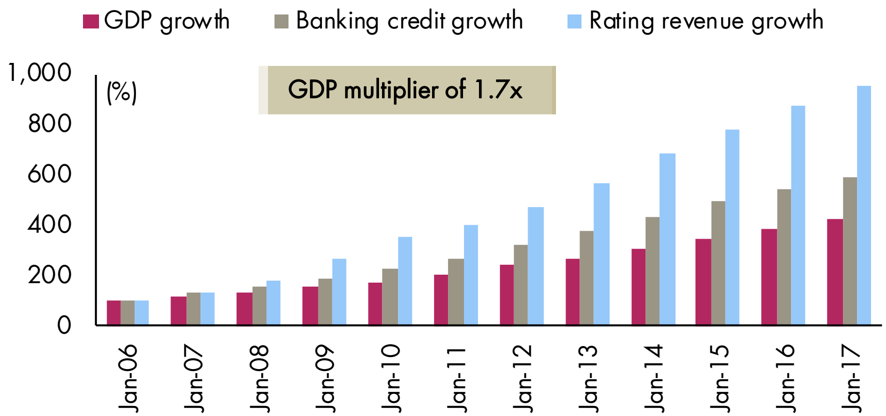


Source: Axis Capital

Indian markets (next slide) demonstrate similar traits and have outperformed nominal GDP growth

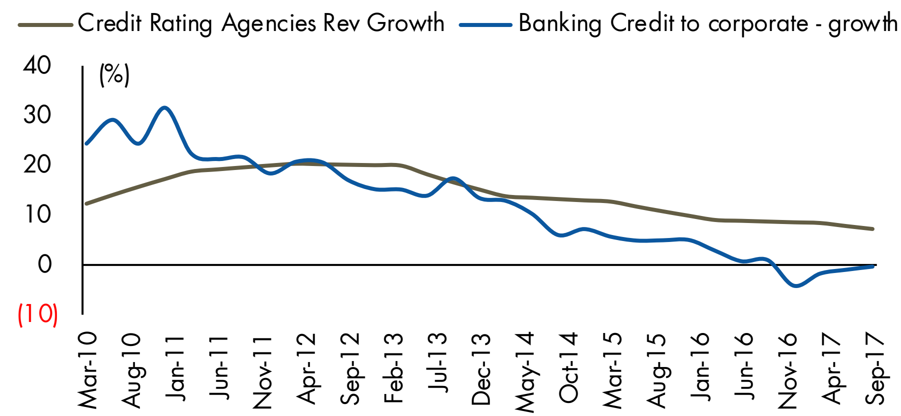
Indian CRAs: High correlation to India Inc. performance

Performance in line with or better than India GDP growth, banking credit



*Rebased to 100 from Jan'06

Revenue trajectory better than credit growth to India Inc.



Outperformed the credit growth to corporates (7 years)

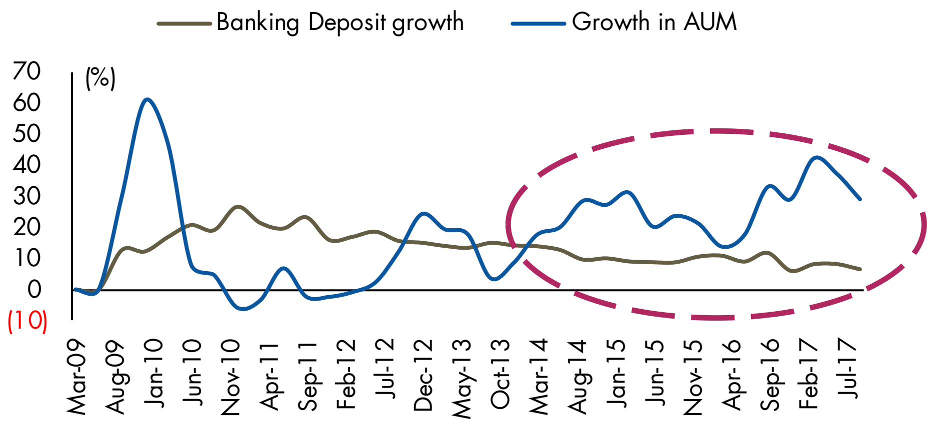
- **Why we believe the time for CRAs has come?**
  - Revival in corporate capex in the offing
  - Improvement in banking credit growth
  - Interest rates reducing over next 12 months
  - Continued ramp-up in SME (Small and Medium Enterprise) ratings
  - Improved market penetration for corporate debt rating

Axis Cap – House calls

Source: Axis Capital

Demand and supply side issues resolving for debt markets

Liquidity supply to financial institutions improving demand for corporate debt



Mutual funds' and Insurance companies' AUM has grown at >25% over past 3 years

Changing preferences of corporate borrowers (market borrowing vs. bank funding) provides supply of corporate papers

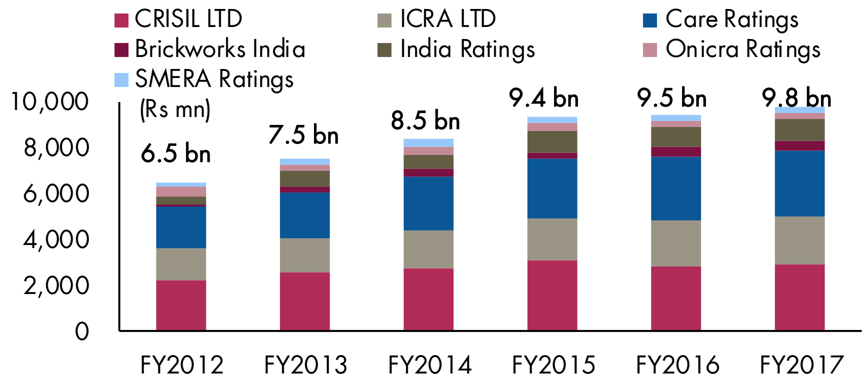
- Increasing use of bonds , CPs, and CDs by corporate borrowers
- Favorable regulatory steps to broaden bond markets
  - Framework for enhancing credit supply for large borrowers through market
  - Guidelines issued for municipal and green bonds
  - Partial credit enhancements by banks
- Ongoing innovation to help develop bond markets
  - New vehicles (INVITs, Masala Bonds) can address structural and liquidity constraints

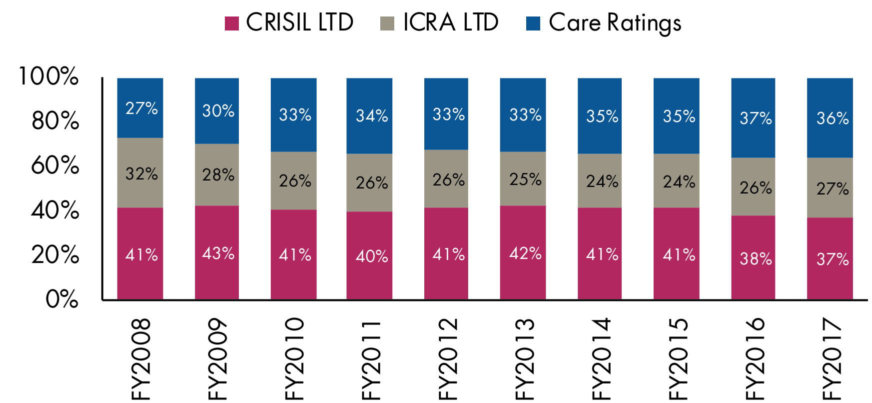
Source: Axis Capital

Comparative mapping of rating agencies

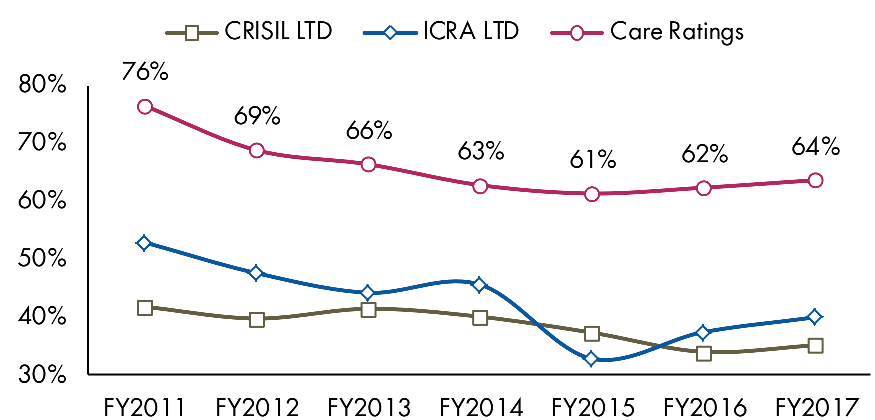
Over past 10 years, Crisil and ICRA have conceded share to CARE

Care Ratings and Brickworks (Smaller Base) have stood out in terms of revenue growth profile

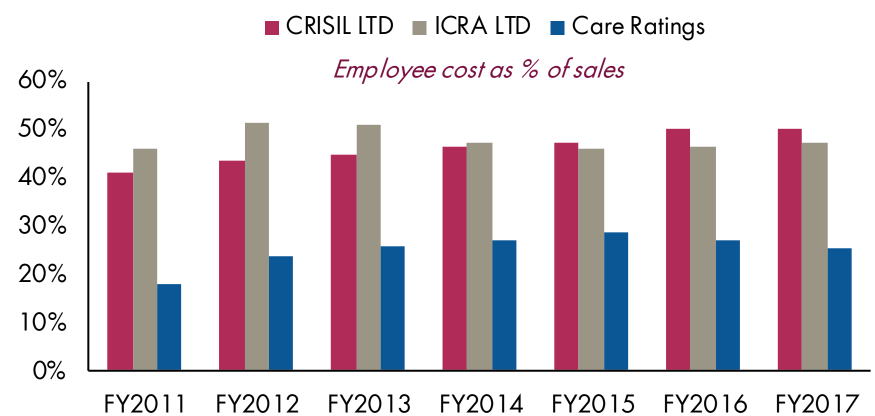




Margin profile of all players have deteriorated, reflecting high competitive intensity



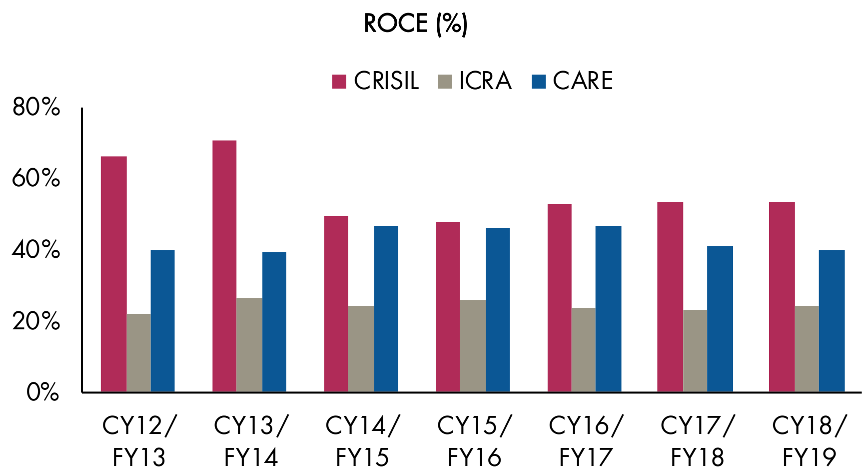
Employee cost (CARE) is half of that of peers – major reason for EBITDA margin differential



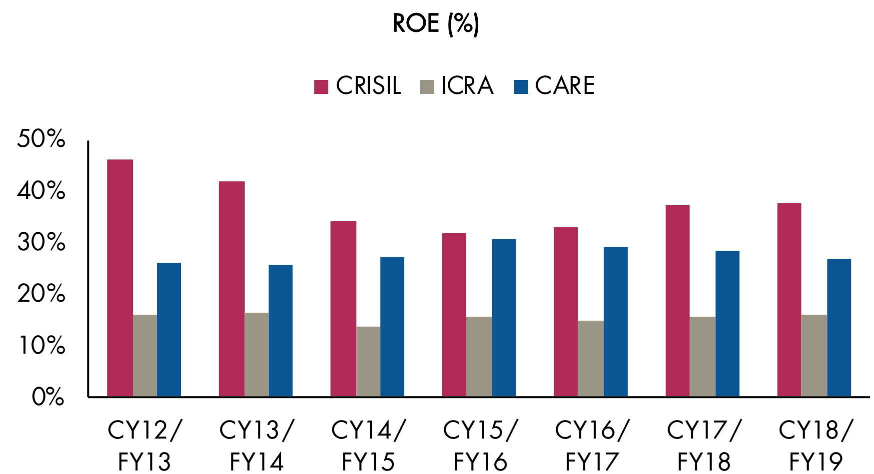
Source: Axis Capital

CARE, Crisil stand out on return profile

Superior capital allocation has been the hallmark of Crisil while CARE triumphs on cost controls



Source: Axis Capital



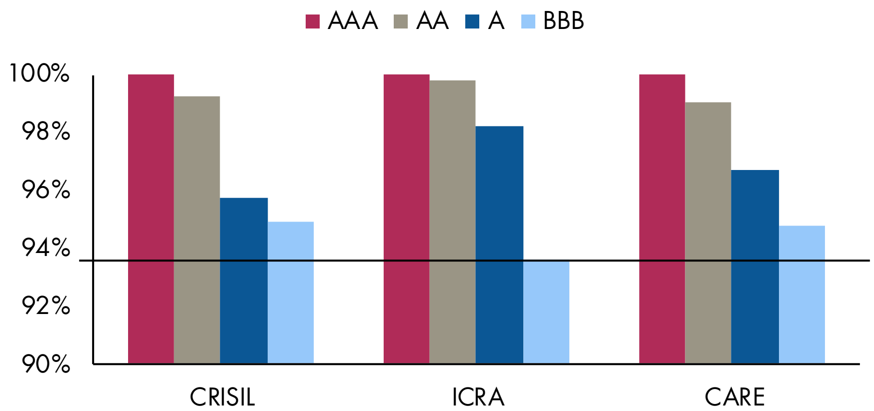
Source: Axis Capital

Net-Net

- CARE Ratings' mantra for success has been to maintain cost controls, which is reflected in its 60%+ EBITDA margin. Setting up knowledge centers in Ahmedabad and using owned office spaces (as against leased offices) are some of the changes which creates disproportionate cost savings
- Apart from being largest and most well-recognized CRA in India, Crisil has shown remarkable capital allocation by investing (successfully) in research, advisory, and consultancy ventures

Default study – analyzing one-year default rates

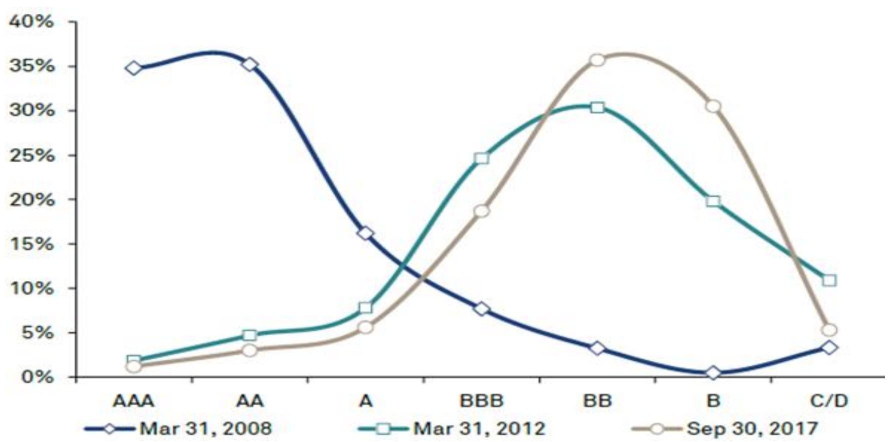
CRAs stack up well on 3-year rating default studies



Source: Axis Capital

- All three rating agencies have performed well when looked at the default studies conducted
- None of AAA rated instruments rated by any of the agencies has defaulted
- Even in BBB category, which is the lowest investment grade category, the default rate is low at 5-6%

Shift in median rating profile

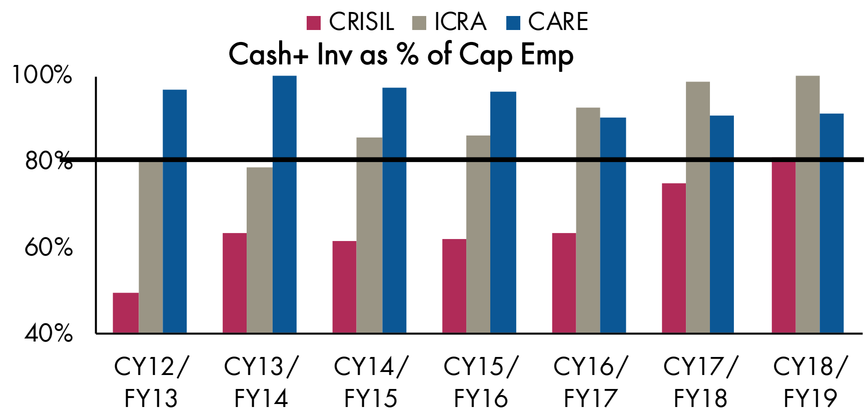


Source: Crisil , Axis Capital

- There has been a structural shift in the rating curve from a median rating of AA/A to a rating of BB/B through 2008-16
- While the chart alongside is with respect to Crisil's rating pool, this phenomenon has been broadly witnessed across the industry

Capital allocation strategy – Crisil's acquisitions more successful

High cash levels maintained by all rating agencies



Source: Axis Capital

While we discussed the RoCE profile earlier, a point to note here is that most of the capital employed is either cash or liquid investments!

While ICRA did one round of buy-back in FY17(Rs 400 mn), we believe this would be a more regular feature for most CRAs

Crisil's cherry-picked acquisition targets and their performance

(Rs mn)	Irevna	Pipal	Coalition
Year of Acquisition	CY04	CY10	CY12/13
Acquisition Cost	771	580	2500
Revenue at the time of Acquisition	331	363	1162
EV/ Sales	2.3	1.6	2.2
CY16 Revenues	8,374	307	2,840
Profit in year of acquisition	68	2.8	154
Profits in FY17	394	6.5	597

Source: Axis Capital

ICRA's capital allocation, hence acquisition strategy appears to be poorer

Particulars (Rs mn)	ICRA Mgmt Co	PT ICRA Indonesia	ICRA Online Ltd
Year	2005	2011	2005
Acquisition Cost	150	149.7	87.2
Rev in year of acquisition	121	0.7	29.5
EV/ Sales	1.2	NA	3.0
Rev in 2017	308	4	497
Profit in year of acquisition	11	(18.3)	2
Profits in FY17	(2)	(0.2)	84

Source: Axis Capital

Crisil's strategic stake in CARE – How do we read it

- **Crisil has acquired ~9% stake in CARE Ratings**
  - PURE PLAY, WELL MANAGED, ratings business
  - A segment Crisil understands

Understanding Crisil's thought process

Initial Amount (Rs mn) 4,350

Particulars	Option 1 Buy back Crisil	Option 2 Buy Care
CMP	1955	1,660
O/S Shares	71	29
Mcap as on Date	139,461	48,887
% available to be purchased/ brought back	3.1%	8.9%
# number of shares	2	3
PAT CY18/FY19	3,665	1,636
CRISIL EPS pre acquisition	51	51
Revised PAT	3,665	**3,811**
CRISIL EPS POST ACQUISITION	53.0	53.4
Benefit		**0.7%**

Source: Axis Capital

Crisil has bought a 14% IRR business

	FY18	FY19	FY20	FY28	FY29
	Year 0	Year 1	Year 2	Year 10	Year 11
Intial Investment	(4,350)				
9% of CARE's Cash and investment	536				
Initial Outflow	(3,814)				
9% FCF ogf CARE	134	148	169	450	9,458
Total investment cashflow	(3,680)				
IRR	14%				

Source: Axis Capital

Crisil 's comments on acquisition

"Crisil continuously evaluates investment options as part of its corporate strategy. The stake purchase is an investment in the excellent long-term prospects of the credit rating sector in the country. The prospects for the sector are driven by the significant demand for capital investments and infrastructure financing in India over the long term, much of which should benefit the sector"

Entry barriers – the biggest moat

All the 3 ratings agencies benefit from

- early mover advantage
- strong industry network playing a critical role
- credibility of the brand,
- quality of service, and
- wide exposure and expertise in various industries

Hence, we do not expect credible #4 or # 5 player in this space

The credit rating agencies enjoy some of the following advantages:

- **Customer stickiness and cost of new ratings:** Switching to other rating agency requires time as well as money. An existing rating agency would have a through understanding of the business along with a detailed database of the company. This would save precious time/ effort for incumbent rating agency
- **Network effect**: Established players enjoy brand recognition, provide quality service, and strong industry network which attracts new borrowers to old agencies.
- **Consistency and credibility**: Most corporate borrowers would desire consistency and comparability in credit opinions. Also investors preference for CRA's with long standing track record would ensure that newer players would take substantial time to gain investor confidence

As a result, over longer term, we expect the 3 key players to benefit disproportionately from structural and cyclical drivers of the ratings industry growth

Why only 3 rating agencies globally?

- **Comfort with investors:** Rating assigned generally defines the pricing of financial instrument. Hence, investor comfort with sanctity of the rating holds key to long-run success of rating agency
- **Cost barriers to entry:** Ratings is a volume game. Pricing competition in this segment is quite high with rating yields as low as 4-5 bps. Hence, CRAs have to generate sufficient volume to sweat the assets (analysts effectively). Therefore, high employee and operating expenses are formidable entry barriers for this business
- **Complexity:** It requires expertise to understand, evaluate and grade various financial instruments – several tranched CDO's and CMO's, Principle protected notes, Credit Default notes etc. While rating agencies merely share their "opinion", in most practical cases that in effect determines the price of the instrument

Quote from Quartz India

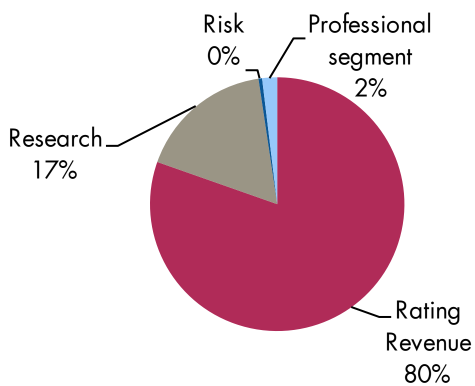
"Considering that the three major agencies control more than 90% of the business, establishing a new one wouldn't be easy. It could take years, or even decades, to gel.

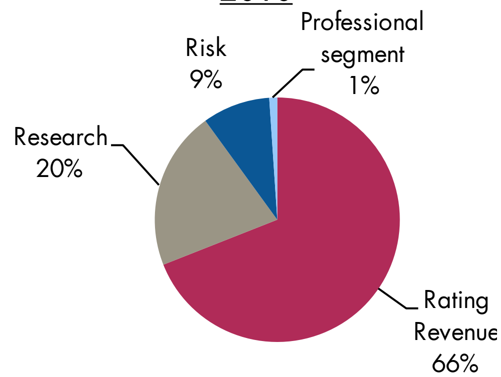
There have been previous attempts to launch new ratings agencies. All failed to take off. Examples include the Lisbon-based ARC Ratings which was launched in November 2013 as a consortium of five national ratings agencies from South Africa, Malaysia, India, Brazil, and Portugal. It is yet to release its first sovereign rating."

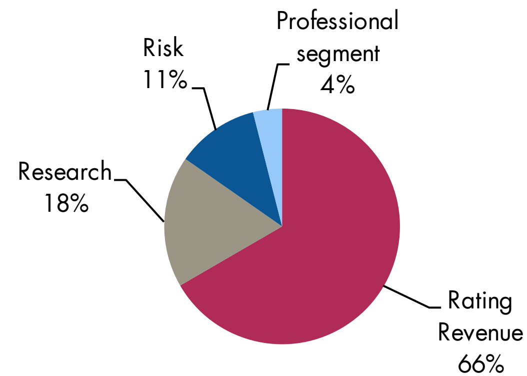
https://qz.com/905451/will-the-alternative-credit-rating-agency-planned-by-brics-work/

A brief look at Moody's Corp

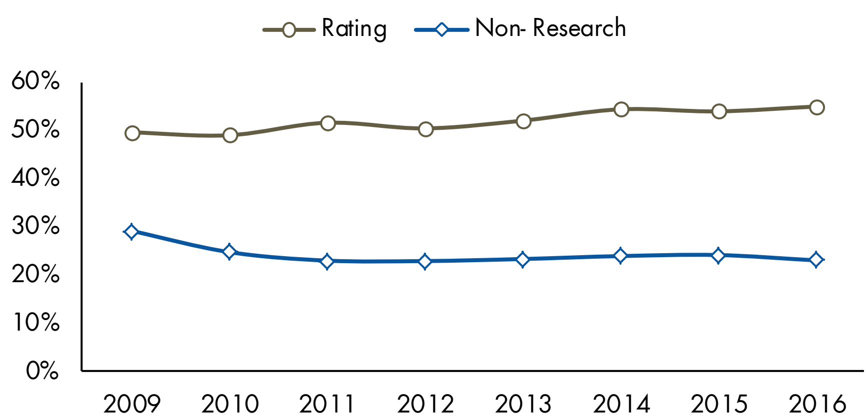
Similar to MNC CRAs in India, Moody's has diversified into research, risk, analytics, which now form 35% of its revenue







EBITDA margin in both segments similar and comparable to margin in India business



- Moody's rating revenue has grown at meager 4% CAGR over past 10 years, while non-rating revenue led by risk and advisory has grown substantially
- Moody's non-rating growth is primarily on account of 6 acquisitions (over past 10 years)
- Goodwill on the balance sheet is ~30% of capital employed (rest is cash)

 Source: Axis Capital

A peek into non-US subsidiaries of S&P, Moody's, Fitch

- Snapshot
  - Both S&P and Moody's **DO NOT** have any listed subsidiary outside of US (ex Crisil and ICRA)
  - This increases the likelihood of Crisil and ICRA being completely bought out by the parent
  - Fitch (parent) is not even listed in the US
- Both Crisil and ICRA have initiated a buyback program in recent past.
- Moody's Inc. In its investor presentation provides an annual share buy back guidance
- Over next few years, irrespective of improvement in GDP growth and capex pipeline, we believe all the CRAs will increase payouts to shareholders either through dividend or through buy-backs

	MCAP (Rs mn)	RoE (%)	Cash & Inv. (FY19)	Dividend Payout	Shareholding of Parent	FCF Yields
Crisil	137,430	32%	9,617	65%	66.8	4%
ICRA	39,150	19%	5,997	45%	50.6	3%
Care	40,600	27%	5,929	50%	NA	5%

Given ICRA's track record, we expect a higher probability of shareholder payouts from ICRA over Crisil

From a long-term (7-10 years) perspective, we expect these companies to be bought out by parent

Source: Axis Capital

22 JAN 2018 Company Report

BUY

Target Price: Rs 2,241

CMP	: Rs 1,940
Potential Upside	: 16%

MARKET DATA

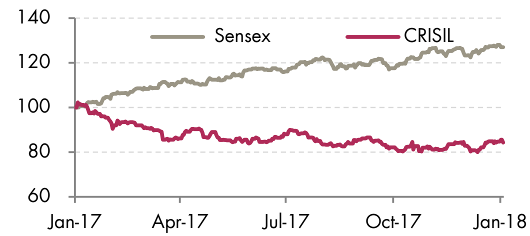
No. of Shares	: 72 mn
Market Cap	: Rs 139 bn
Free Float	: 33%
Avg. daily vol (6mth)	: 23,973 shares
52-w High / Low	: Rs 2,208 / Rs 1,752
Bloomberg	: CRISIL IB Equity
Promoter holding	: 67%
FII / DII	: 6% /11%

CRISIL

MISCELLANEOUS

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently." Warren Buffet

Price performance



Financial summary (consolidated)

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Con. EPS* (Rs)	EPS (Rs)	Change YOY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/E (x)	DPS (Rs)
CY16	15,472	3,263	-	45.7	14.2	42.4	36.2	51.4	29.8	27.0
CY17E	16,649	3,048	44.9	42.7	(6.6)	45.4	30.5	44.5	28.8	27.8
CY18E	18,718	3,600	52.4	50.5	18.1	38.4	32.3	47.2	25.3	32.8
CY19E	21,243	4,425	59.2	62.0	22.9	31.3	35.2	51.6	20.6	40.3

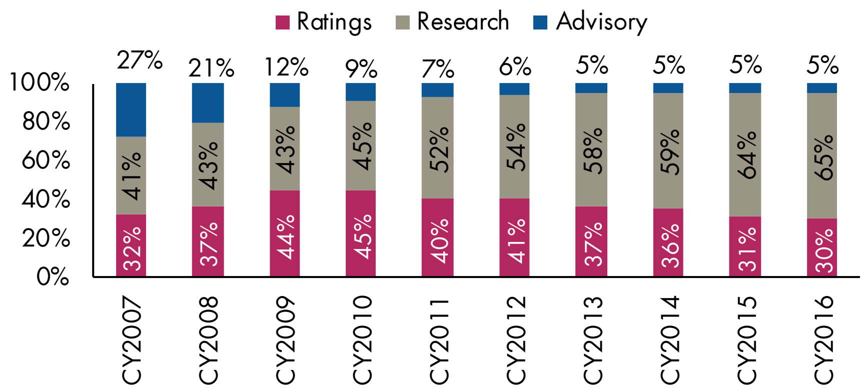
Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	CY17	CY18	CY19
Rev growth (%)	8%	12%	13%
Op. mrgn (%)	28%	28%	30%
FcF (Rs mn)	3,885	4,115	5,042
Dvd. payout (%)	65%	65%	65%

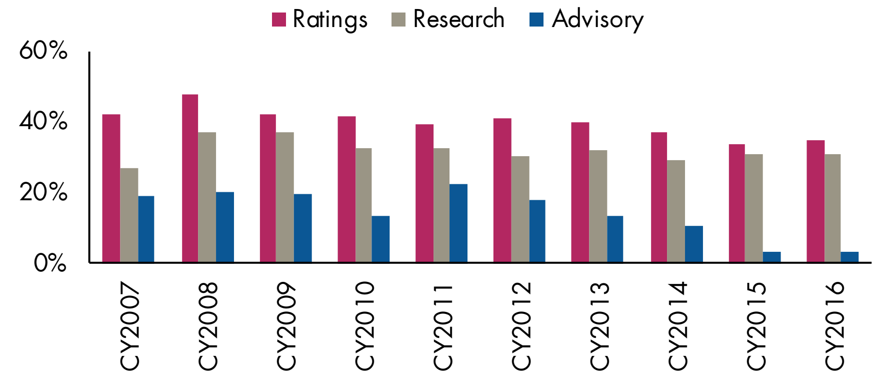
Diversified revenue profile – hedge against slowdown

Diversified revenue stream mitigates risk of slowdown in ratings business



Source: Company, Axis Capital

EBITDA concentration has also been mitigated with research, advisory and ratings contributing to the mix



Source: Company, Axis Capital

Crisil has developed a stable business model with a well-diversified revenue base. Research Services has gained prominance with its share increasing from 40% in 2007 to ~65% in CY17. Ratings segment continues to be the 2nd largest revenue contributor with 30% share.

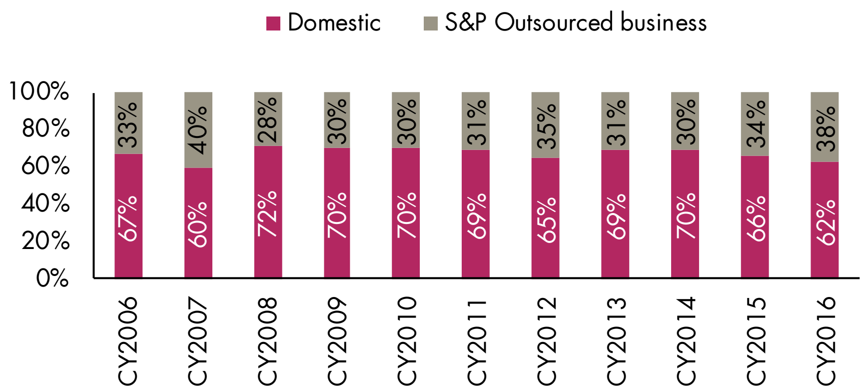
Also, these streams have been yielding profits, which is evident from distribution at operating profit level with ~34% of profits coming from rating services, 65% from research services, and <1% from advisory.

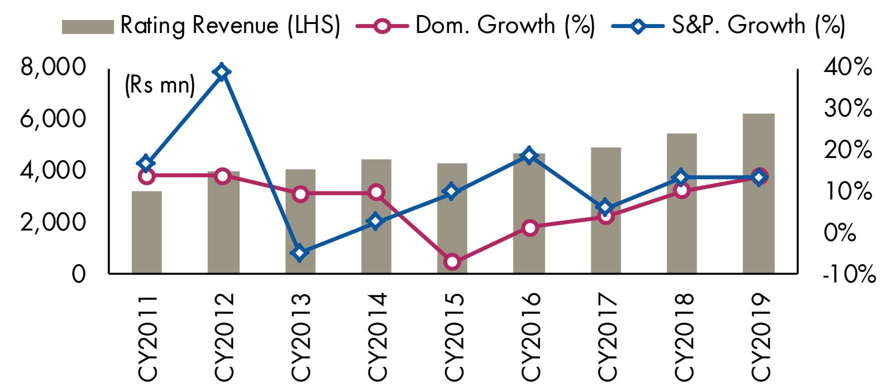
Ratings – providing a strong backbone

Crisil, the market leader, has rated over 23,000 large and mid corporates in BLRs and ~100,000 SMEs.

Its rating capabilities encompass the entire spectrum of debt instruments— bank loans, certificates of deposit, commercial papers, non-convertible debentures, bank hybrid capital instruments, asset-backed securities, mortgage-backed securities, perpetual bonds and partial guarantees.

Revenue from S&P outsourcing business brings stability to ratings revenue





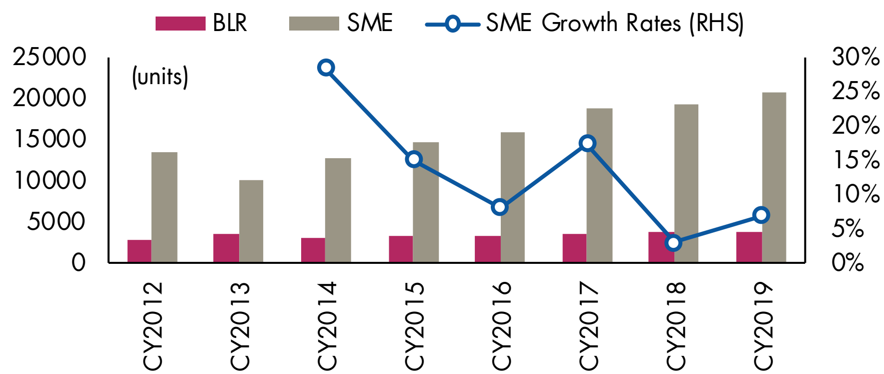
Within the ratings segment, domestic business contributes ~62% to rating revenue, while international rating business offshored by S&P contributes ~38%.

Crisil provides resources to S&P to improve workflow efficiencies, handle end-to-end analytical processes and process information.

Source: Axis Capital

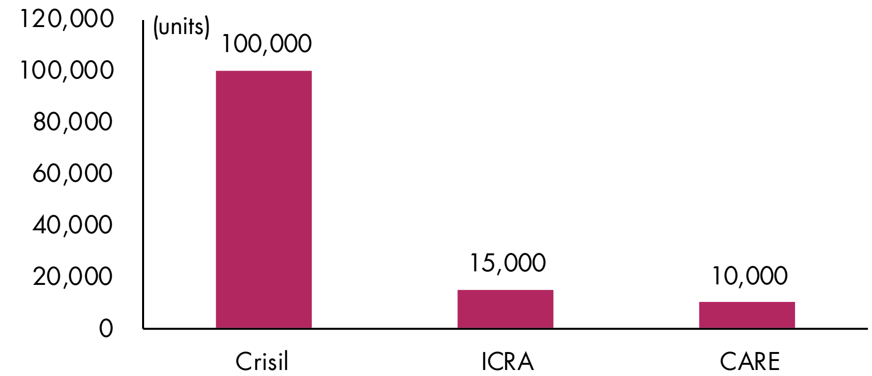
SME ratings – the growth machine

Strong growth rate in SME business



Source: Axis Capital

Crisil's SME book is 7-10x larger than peers



Source: Axis Capital

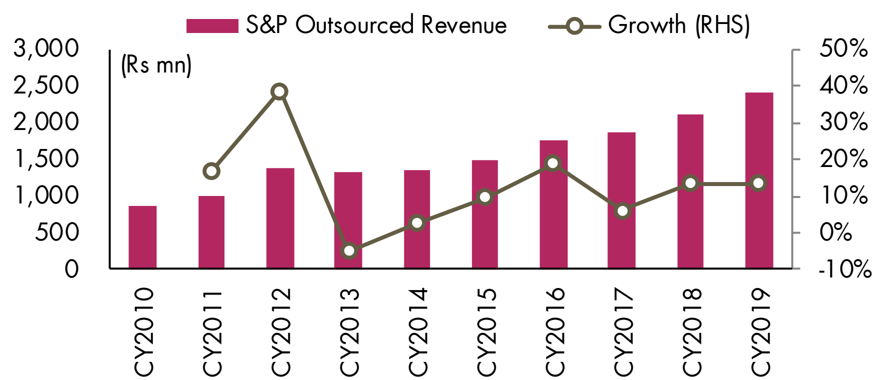
- SME ratings began in 2008, and soon witnessed an aggressive ramp-up. This led to Crisil being the market leader in SME rating, which rated ~16,000 SMEs in CY16 vs. ~2,500/4,000 for ICRA/CARE
- Crisil SME ratings designs affordable and tailor-made rating products and provides the widest range of ratings in India. It has rated and assessed 1,00,000 SMEs
- **A hallmark to the success of the SME business is that several of India's largest companies use Crisil's customized SME assessment services to evaluate their vendors, dealers, distributors, and franchisees**

With such a diversified rated pool of SMEs- the banks acceptance of Crisil SME ratings have also increased Also Crisil's intensive outreach initiatives and expansion into new markets are expected to drive demand in CY18 and beyond

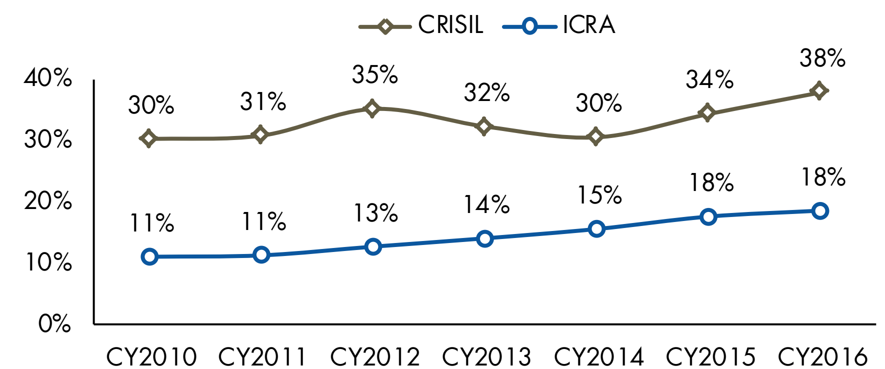
S&P's strong outsourcing provides comfort to ratings revenue growth

The GAC (Global Analytical Centre) team of Crisil works with S&P rating teams in the US, EMEA and the Asia- Pacific region providing rating support across domains.

Strong outsourcing by S&P to Crisil's GAC



KPO share in rating revenue of ICRA vs. Crisil



- **GAC support goes beyond ratings and pans across critical and emerging focus areas for S&P Global. As a global research unit, GAC allows quick and seamlessly implementation of global initiatives, and assists S&P Global in its mission to deliver essential intelligence.**
  - Enables standardization and consistency of analysis and workflows through its centralized operations
  - GAC's round-the-clock support on critical assignments enables SPGI increase coverage and improve time-to-market of analysis, insights and opinions
  - Create operating efficiencies by continuous improvement through lean management tools and process re-engineering
  - Provides a large pool of high-quality and well-trained talent to SPGI to help scale-up specialized support

Research support from S&P provides stability to the otherwise cyclical ratings revenue

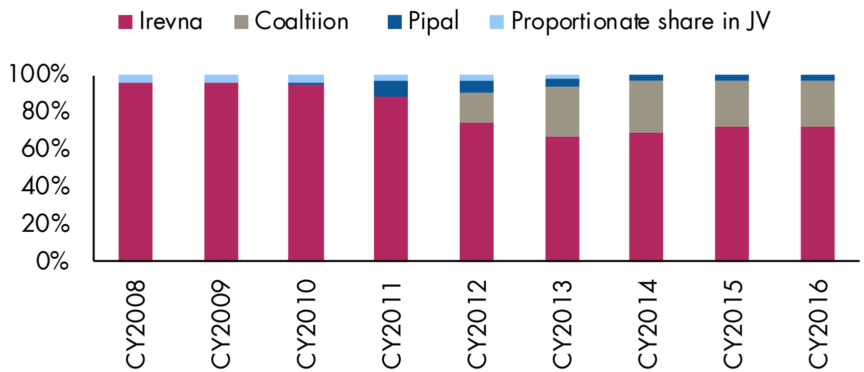
Source: Axis Capital

Research – superior capital allocation

The research segment (on the back of its acquisition-led approach) has been Crisil's growth engine. Crisil has strengthened its research business and is well set to benefit from increased outsourcing from global financial institutions.

Crisil's capital allocation has been on cue as most of the investments have generated superior returns.

Irevna – leading the research revenue for Crisil



Ability to pick targets with strong growth potential – a key strength

(Rs mn)	Irevna	Pipal	Coalition
Year of Acquisition	CY04	CY10	CY12/13
Acquisition Cost	771	580	2500
Revenue at the time of Acquisition	331	363	1162
EV/ Sales	2.3	1.6	2.2
CY16 Revenues	8,374	307	2,840
Profit in year of acquisition	68	2.8	154
Profits in FY17	394	6.5	597

- **Irevna:** Acquisition of Irevna in 2005 helped further strengthen Crisil's research platform. Irevna is a leading global equity research and analytics company providing equity and credit research services
- **Pipal Research:** Pipal Research (acquired in 2010) is an independent investment research, corporate intelligence and analytics company. CY16 revenue stood at Rs 300 mn or 2% of total revenue
- **Coalition (acquired in 2012):** Crisil acquired UK-based Coalition, a company providing high-end analytics to global investment banks. Coalition profits have increased nearly 4x since acquisition

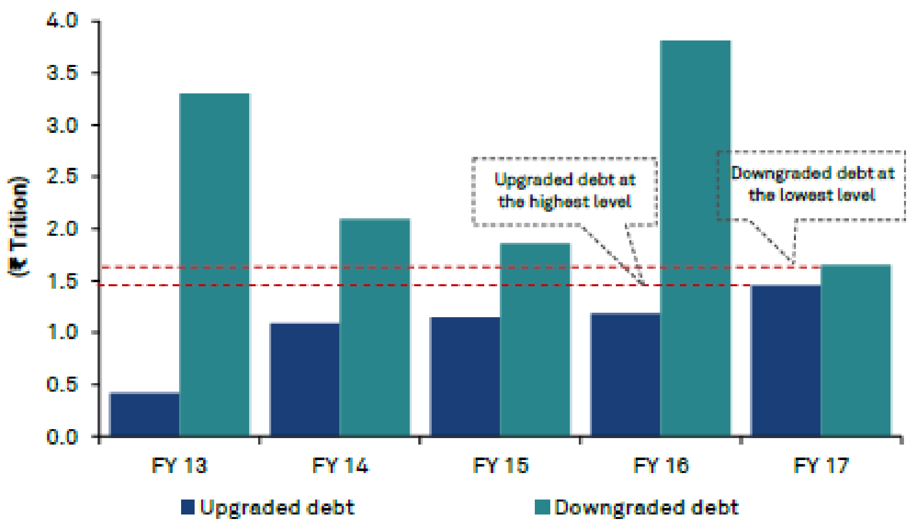
 Source: Axis Capital

Default study

Default study helps to assess the extent to which ratings have slipped into lower categories. Also the CRA's stability report measures the change in credit rating for a corporate over a particular time frame.

- **Key highlights from Crisil's stability report**
  - Long-period average default rates continue to be ordinal. Hence, higher rating categories have lower default rates
  - No long-term instrument rated 'CRISIL AAA' has defaulted
  - Overall annual default rate remained high at 4.2% in 2016, marginally higher than the previous year
  - Stability rates of long-term ratings have strengthened over the years. Stability rate across ratings are 87%+ over 1988-2016

Downgrades on a declining trajectory

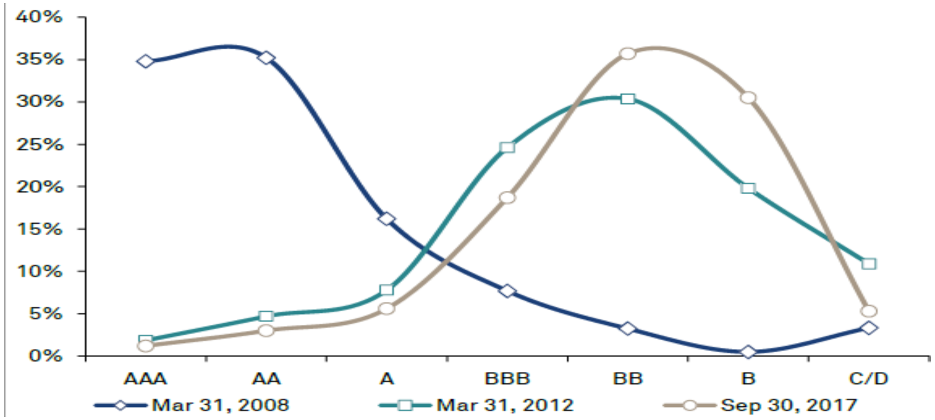


- The improvement in credit quality was driven by firm commodity prices, stable macros, impact of sustained structural reforms, improving capital structure and lower interest costs
- Though demonetization was disruptive for demand and liquidity, Crisil expects its impact to be transient

Source: Crisil, Axis Capital

Default study – quality of rated pool

Average rating pool of Crisil has deteriorated from average of A-BBB rating to BB-B



Source: Axis Capital

- Over past 3 years, Crisil's rated portfolio of outstanding ratings has stabilized – with ~14,000 ratings
- Almost three-fourths of the outstanding ratings are in the 'CRISIL BB' or lower categories
- Consequently, the median rating stayed put at 'CRISIL BB' category, lower than the 'CRISIL AA' category median as of March 31, 2008

One year stability rates over past ~28 years

Rating category	Issuer-months	CRISIL AAA	CRISIL AA	CRISIL A	CRISIL BBB	CRISIL BB	CRISIL B	CRISIL C	CRISIL D
CRISIL AAA	17815	97.37%	2.63%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
CRISIL AA	39729	1.45%	93.32%	4.49%	0.49%	0.16%	0.03%	0.02%	0.04%
CRISIL A	54216	0.00%	3.04%	88.91%	5.72%	1.48%	0.11%	0.23%	0.51%
CRISIL BBB	123326	0.00%	0.04%	2.64%	89.16%	6.53%	0.39%	0.23%	1.01%
CRISIL BB	190468	0.00%	0.01%	0.01%	3.89%	87.66%	4.04%	0.44%	3.95%
CRISIL B	171206	0.00%	0.00%	0.01%	0.05%	7.25%	84.15%	0.53%	8.02%
CRISIL C	7878	0.00%	0.00%	0.00%	0.15%	1.49%	17.99%	59.46%	20.92%
Total	604638								

More than 97% of the AAA rating assigned by Crisil since 1988 have held on to their rating during the rating period.

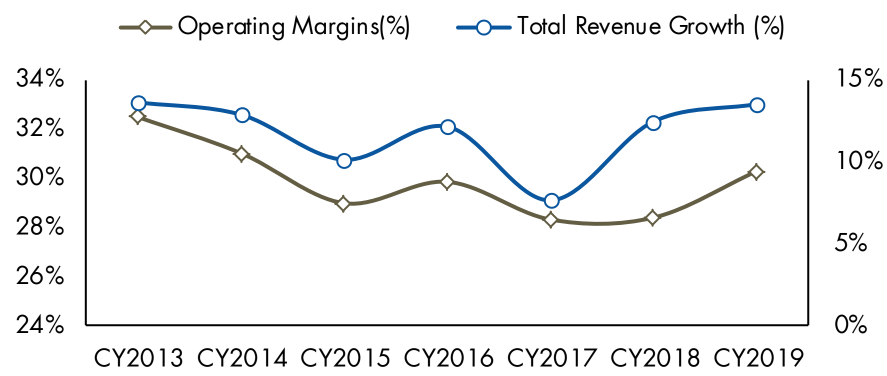
Even for BBB category (last investable grade), ~92% of the ratings assigned continue to be BBB and higher.

According to Crisil, stability report for long-term ratings over1988-2016 shows ~97% of corporates continued to be rated AAA. Even short - term ratings for Crisil A1+ rated corporates was high at 97~%

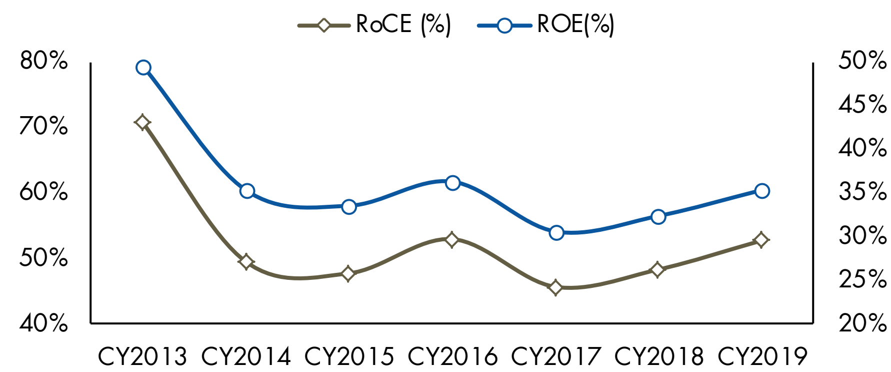
Source: Axis Capital

Profitability, FCF profile

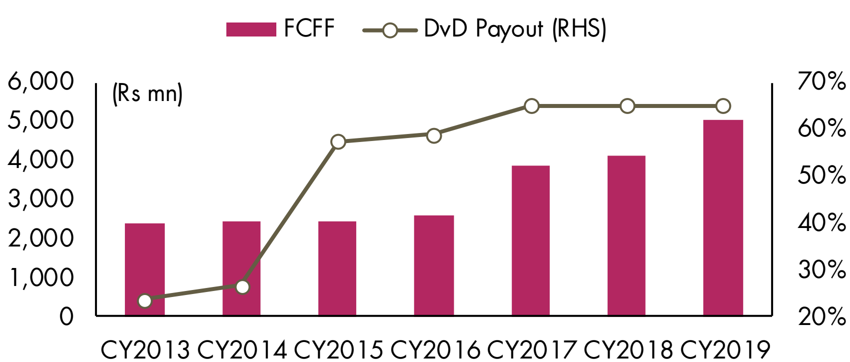
We expect revenue growth to improve to 14% with margin remaining broadly similar at 31%...



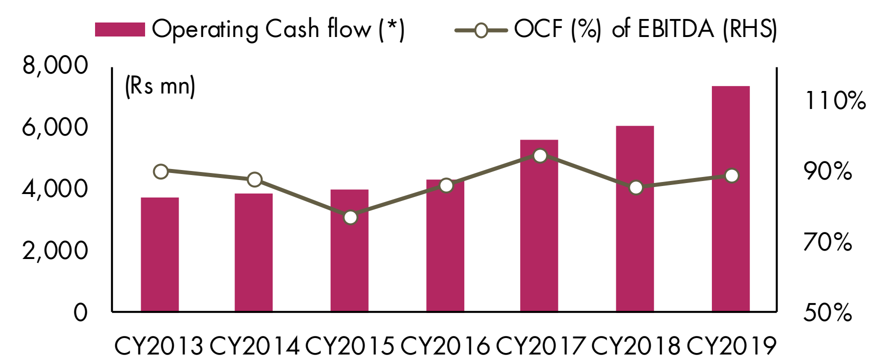
..with profitability intact, 50%+ RoCE and 37% RoE



High FCF generation, ~Rs 12 bn (10% of MCAP) expected to be paid back as dividend (CY18-21)



Consistent OCF generation with OCF: EBITDA @90%+



(*) Pretax Operating cashflow

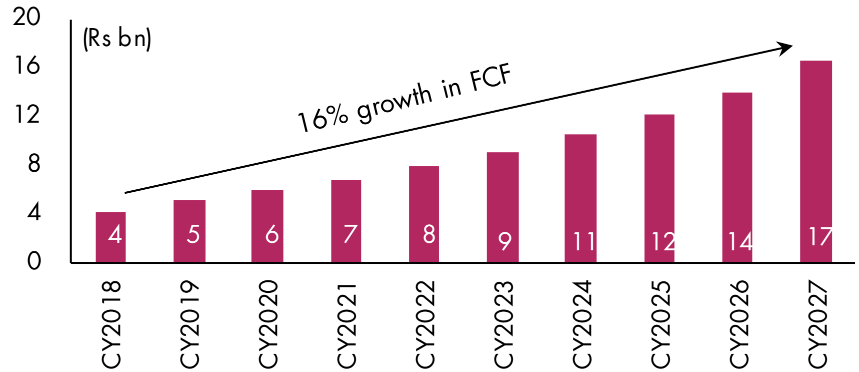
Board profile and support from S&P

Name	Designation	Accolades, experience
Mr. John L. Berisford	Chairman	Mr. Berisford is *President of S&P Global Ratings.* Mr. Berisford spent 22 successful years at PepsiCo where he led a number of important global initiatives and transformations
Mr. H. N. Sinor	Director	Mr. Sinor has spent over four decades in banking. He was Managing Director and CEO of ICICI Bank from July 1997 to March 2002.Mr. Sinor has been *appointed by the Government of India as a part-time Member of the Banks Board Bureau* with effect from April 01, 2016
Dr. Nachiket Mor	Director	He is the India Country Director for the Bill & Melinda Gates Foundation, and in his independent capacity, *a member of the Boards of Reserve Bank of India (RBI)*, National Bank for Agriculture & Rural Development (NABARD) and Micro Units Development & Refinance Agency (MUDRA). Dr. Mor has a PhD in Economics from University of Pennsylvania with a specialization in Finance from the Wharton School, a Post Graduate Diploma in Management from the Indian Institute of Management, Ahmedabad
Mr. M. Damodaran	Director	Mr. Damodaran was a member of the Indian Administrative Service (IAS), Manipur-Tripura cadre, since 1971, and had *held a number of important positions in both the Central and State Governments* and in India's financial sector, before demitting office as *Chairman, Securities and Exchange Board of India (SEBI)* in February 2008
Ms. Martina Cheung	Director	Ms. Cheung is Executive Managing Director and Head of Risk Services of S&P Global Inc.
Mr. Ewout Steenbergen	Director	Mr. Steenbergen is Executive Vice President and Chief Financial Officer (CFO) of S&P Global. He also serves *on the Board of Directors of the U.S. Fund for UNICEF*
Ms. Ashu Suyash,	Managing Director & Chief Executive Officer	Ms. Suyash has 29 years of experience in the financial services industry. Prior to CRISIL, she served as the Chief Executive Officer of L&T Investment Management Ltd and L&T Capital Markets Ltd. She led Fidelity's Indian Mutual Fund business from 2003 to 2012 as its Country Head and Managing Director

A well-diversified board

DCF-based valuation of 36x CY19 – upside of 16%

We expect 16% + growth in FCF over next 7-8 years



Source: Axis Capital

Using 12% discount rate, we expect 16% upside

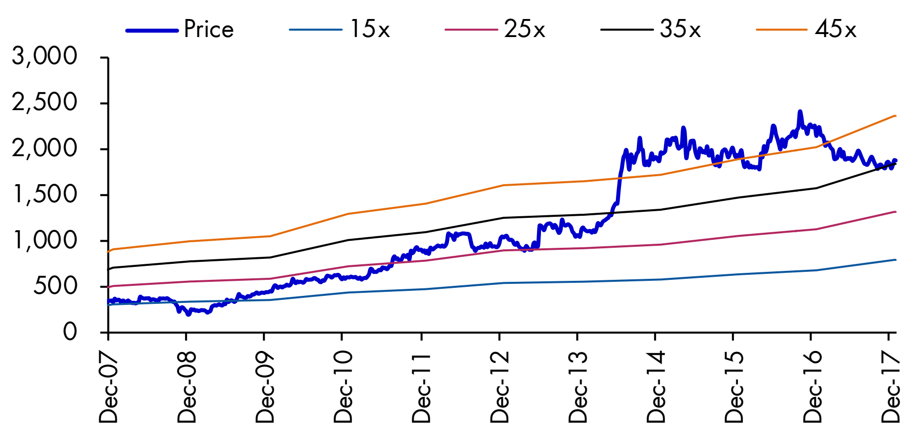
Valuation	(Rs mn)
PV of FCF	47,749
Terminal value	100,468
Value of the company	148,217
Cash and Liq. Inv	(11,623)
Equity value	**159,840**
CMP (Rs)	1,940
Per share value	2,241
Upside	**16%**

Source: Axis Capital

Key assumptions	(%)
Riskfree rate	7%
Market risk premium	5%
Beta	1.0
Discounting rate	12%
Terminal growth	5%

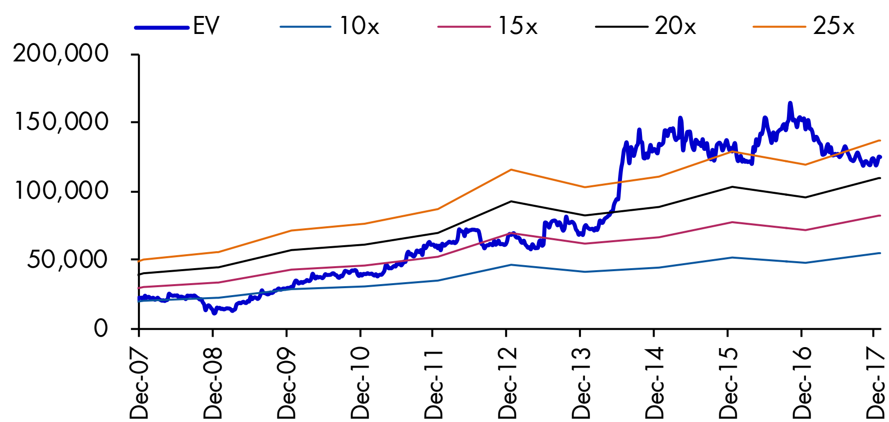
Source: Axis Capital

1 year fwd PE bands



Source: Axis Capital

1 year fwd EV/E bands



Source: Axis Capital

Key risks

- **Currency risk:** Crisil derives significant proportion of revenues from clients that are largely billed in foreign currency. While Crisil hedges a large portion of its Fx exposure the margin and profitability may be impacted by large currency swings
- **Default study** plays vital role in assessing the credibility of ratings assigned by CRAs. Ratings can also be used to determine early warning signs of worsening health of corporates. Failure to indicate early warning signal can result in *loss of trust* in rating agency as was the case with international agencies during the financial crisis of FY08-09
- **Attrition and rising cost of employees:** Rating agencies run a large attrition risk, costs incurred for acquiring and training qualified manpower is significant. Wage costs, being the key cost in this industry, poaching by competitors or even industries like research, investment banking, etc., could hit the industry. While Crisil's attrition has been around 15-20%, it has still been able to manage margin through *productivity improvement and efficiency*. The same is reflected in *revenue per employee having increased 2x at 7% CAGR over CY06-17 and operating profit/employee having increased 2.3x at 8% CAGR over CY06-17*
- **Pricing transience to fixed fee structure:** Limited bond issuance and lower bank loan rating volumes pose a threat, as many issuances have transcended to a fixed fee cap structure which can limit the upside of operating leverage in an improved market scenario. However, this is more so pronounced only in BLR market and less in CDR segment which is more profitable
- **Macro recovery failure; limited pick-up in rating markets:** Credit rating agencies reflect the pick-up in corporate investment activities. While a stable government and policy reforms have raised the prospects of a revival in economic activities, the structural nature of problems can delay the recovery process and consequently prolong the capex cycle. *While we believe our estimates are conservative, a longer-than-expected delay in corporate investment would warrant further downward revision in our estimates*

Company financials (Consolidated)

Profit & loss (Rs mn)

Y/E March	CY16	CY17E	CY18E	CY19E
Net sales	15,472	16,649	18,718	21,243
Other operating income	-	-	-	-
Total operating income	**15,472**	**16,649**	**18,718**	**21,243**
Cost of goods sold	-	-	-	-
Gross profit	15,472	16,649	18,718	21,243
Gross margin (%)	*100.0*	*100.0*	*100.0*	*100.0*
Total operating expenses	(10,857)	(11,939)	(13,408)	(14,816)
EBITDA	**4,615**	**4,711**	**5,310**	**6,427**
EBITDA margin (%)	*29.8*	*28.3*	*28.4*	*30.3*
Depreciation	(404)	(473)	(503)	(508)
EBIT	**4,212**	**4,237**	**4,807**	**5,919**
Net interest	-	-	-	-
Other income	547	311	566	686
Profit before tax	**4,759**	**4,549**	**5,373**	**6,605**
Total taxation	(1,495)	(1,501)	(1,773)	(2,180)
Tax rate (%)	*31.4*	*33.0*	*33.0*	*33.0*
Profit after tax	3,263	3,048	3,600	4,425
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	3,263	3,048	3,600	4,425
Adj. PAT margin (%)	*21.1*	*18.3*	*19.2*	*20.8*
Net non-recurring items	-	-	-	-
Reported net profit	3,263	3,048	3,600	4,425

Balance sheet (Rs mn)

Y/E March	CY16	CY17E	CY18E	CY19E
Paid-up capital	71	71	71	71
Reserves & surplus	9,382	10,449	11,709	13,258
Net worth	9,454	10,520	11,780	13,329
Borrowing	-	-	-	-
Other non-current liabilities	236	236	236	236
Total liabilities	**9,689**	**10,756**	**12,016**	**13,565**
Gross fixed assets	5,871	6,071	6,271	6,421
Less: Depreciation	(2,170)	(2,643)	(3,147)	(3,655)
Net fixed assets	3,701	3,428	3,125	2,767
Add: Capital WIP	42	42	42	42
Total fixed assets	3,743	3,470	3,167	2,809
Other Investment	4,296	4,508	4,730	4,964
Inventory	-	-	-	-
Debtors	2,101	2,164	2,433	2,761
Cash & bank	1,775	3,419	4,887	6,716
Loans & advances	1,431	1,291	1,451	1,647
Current liabilities	4,673	5,160	5,802	6,584
Net current assets	633	1,713	2,969	4,539
Other non-current assets	1,018	1,066	1,150	1,254
Total assets	**9,689**	**10,756**	**12,016**	**13,565**

Source: Company, Axis Capital

Company financials (Consolidated)

Cash flow (Rs mn)

Y/E March	CY16	CY17E	CY18E	CY19E
Profit before tax	4,759	4,549	5,373	6,605
Depreciation & Amortisation	404	473	503	508
Chg in working capital	*(400)*	*564*	*212*	*259*
Cash flow from operations	2,790	4,085	4,315	5,192
Capital expenditure	*(233)*	*(200)*	*(200)*	*(150)*
Cash flow from investing	(190)	(460)	(507)	(487)
Equity raised/ (repaid)	*133*	-	-	-
Debt raised/ (repaid)	-	-	-	-
Dividend paid	*(2,402)*	*(1,981)*	*(2,340)*	*(2,876)*
Cash flow from financing	(2,269)	(1,981)	(2,340)	(2,876)
Net chg in cash	330	1,644	1,468	1,829

Valuation ratios

Y/E March	CY16	CY17E	CY18E	CY19E
PE (x)	42.4	45.4	38.4	31.3
EV/ EBITDA (x)	29.8	28.8	25.3	20.6
EV/ Net sales (x)	8.9	8.2	7.2	6.2
PB (x)	14.6	13.2	11.7	10.4
Dividend yield (%)	1.4	1.4	1.7	2.1
Free cash flow yield (%)	0.0	0.0	0.0	0.0

Source: Company, Axis Capital

Key ratios

Y/E March	CY16	CY17E	CY18E	CY19E
OPERATIONAL				
FDEPS (Rs)	45.7	42.7	50.5	62.0
CEPS (Rs)	51.4	49.4	57.5	69.2
DPS (Rs)	27.0	27.8	32.8	40.3
Dividend payout ratio (%)	59.0	65.0	65.0	65.0
GROWTH				
Net sales (%)	12.1	7.6	12.4	13.5
EBITDA (%)	15.5	2.1	12.7	21.0
Adj net profit (%)	14.4	(6.6)	18.1	22.9
FDEPS (%)	14.2	(6.6)	18.1	22.9
PERFORMANCE				
RoE (%)	36.2	30.5	32.3	35.2
RoCE (%)	51.4	44.5	47.2	51.6
EFFICIENCY				
Asset turnover (x)	2.1	2.3	2.7	3.1
Sales/ total assets (x)	1.1	1.1	1.1	1.1
Working capital/ sales (x)	(0.1)	(0.1)	(0.1)	(0.1)
Receivable days	49.6	47.4	47.4	47.4
Inventory days	-	-	-	-
Payable days	110.0	107.4	107.5	110.4
FINANCIAL STABILITY				
Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(0.2)	(0.3)	(0.4)	(0.5)
Current ratio (x)	1.1	1.3	1.5	1.7
Interest cover (x)	-	-	-	-

AXIS DIRECT

22 JAN 2018 Company Report

BUY

Target Price: Rs 4,500

CMP	: Rs 4,010
Potential Upside	: 12%

MARKET DATA

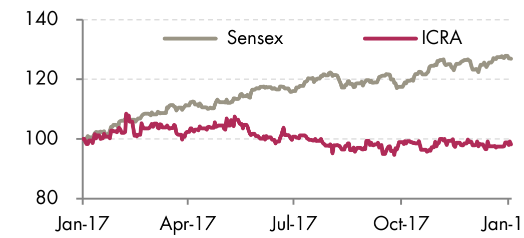
No. of Shares	: 10 mn
Market Cap	: Rs 40 bn
Free Float	: 49%
Avg. daily vol (6mth)	: 2,761 shares
52-w High / Low	: Rs 4,448 / Rs 3,726
Bloomberg	: ICRA IB Equity
Promoter holding	: 51%
FII / DII	: 11% /28%

ICRA

MISCELLANEOUS

"During the Gold Rush, most would-be miners lost money, but people who sold them picks, shovels, tents and blue-jeans (Levi Strauss) made a nice profit." Peter Lynch

Price performance



Financial summary (consolidated)

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Con. EPS* (Rs)	EPS (Rs)	Change YOY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/E (x)	DPS (Rs)
FY17	3,330	744	-	75.1	(1.7)	53.4	15.3	23.5	37.4	25.3
FY18E	3,078	1,010	92.3	102.0	35.8	39.3	19.3	27.2	34.5	51.0
FY19E	3,466	1,121	110.5	113.3	11.1	35.4	19.4	28.0	29.6	56.6
FY20E	3,909	1,275	123.2	128.8	13.7	31.1	20.0	29.3	26.1	64.4

Source: *Consensus broker estimates, Company, Axis Capital

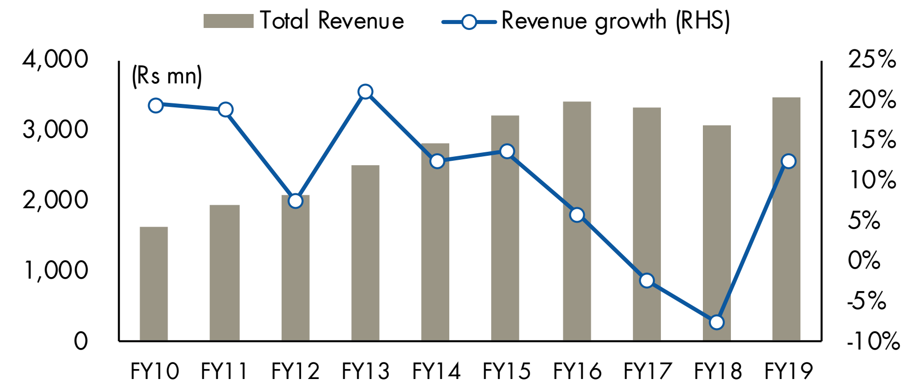
Key drivers

	FY18	FY19	FY20
Rev growth (%)	-8%	13%	13%
Op. Mrgn (%)	35%	36%	37%
FcF (Rs mn)	1,235	1,204	1,377
Dvd. Payout (%)	50%	50%	50%

ICRA's group structure

Moderate revenue growth – diversification reduces cyclicality

Revenue CAGR: 10 year at 17%; expect 13% growth FY18-20

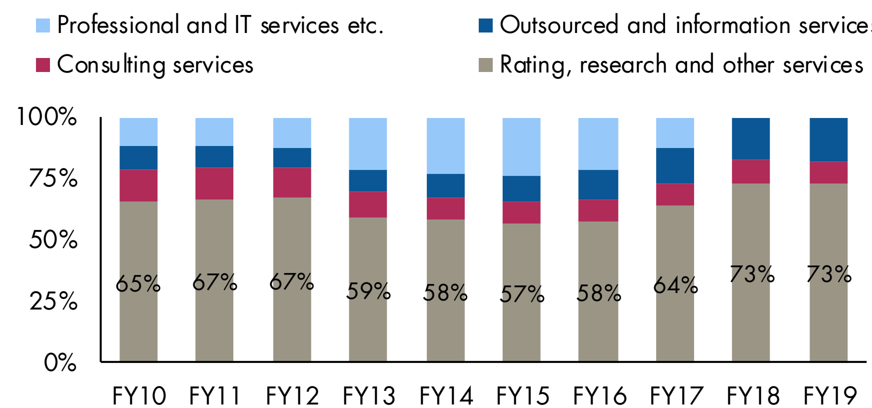


Source: Axis Capital

Overall revenue growth was supported by ratings business, which continued to grow at 8-9% despite macro slowdown, and outsourcing services from Moody's, revenue from which have tripled in 5 years.

Consulting services have dragged overall revenue growth with 3% CAGR revenue growth over past 6 years.

The core rating business continues to dominate revenue mix



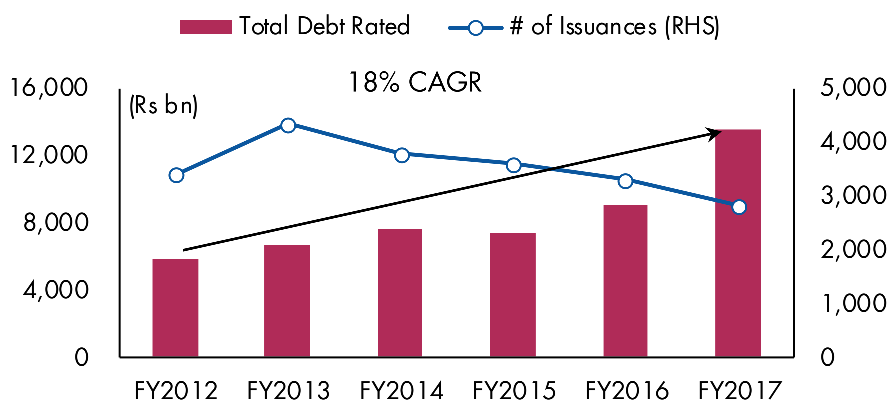
Source: Axis Capital

Ratings business continues to be the mainstay, commanding ~70% of ICRA's revenue. The share of the outsourcing business from Moody's has increased from 9% in FY10 to 18% in FY18

ICRA sold off ICTEAs which contributed ~12%, its software services arm, in FY17

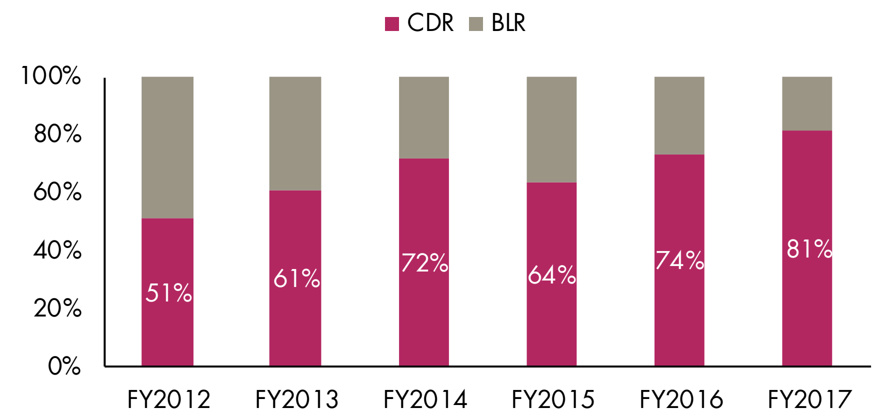
Volume growth triggers and mix improvement

Strong growth in the ICRA rated debt volume esp. in FY17



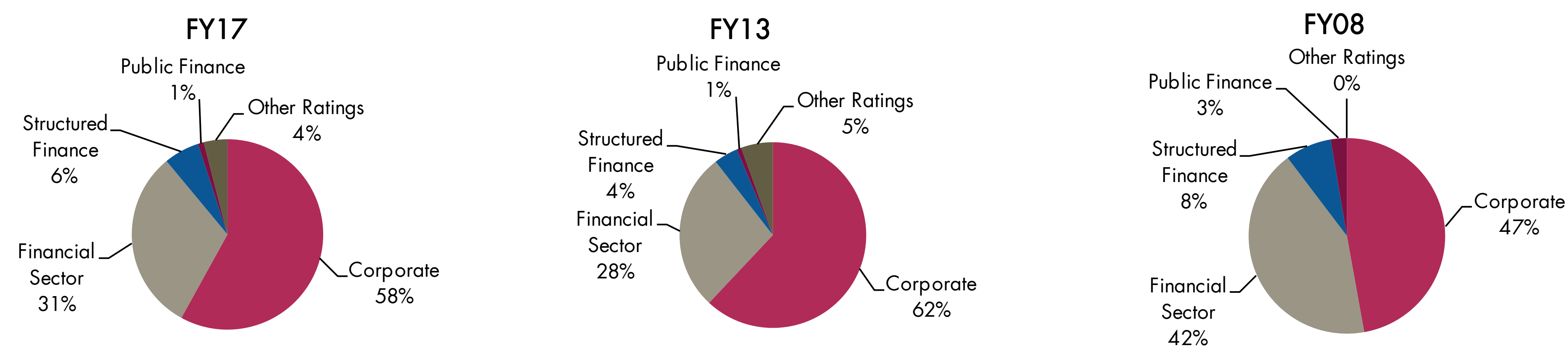
Source: Axis Capital

Mix improving towards corporate debt ratings



Source: Axis Capital

Even within rating space, revenue mix is well diversified



Source: Axis Capital

Key non-rating businesses

- **IMaCs (~10% of consolidated revenue in FY18)**
  - A wholly-owned subsidiary of ICRA, IMaCs is a multi-line management consulting firm. It has participated in 1,800+ consulting assignments across sectors. It has six practice areas – strategy, risk management, process consulting, transaction advisory, policy advisory and capacity building. Till 2005, it operated as an independent division of ICRA as "ICRA Advisory Services"
  - The segment is highly competitive, with PBT margin for the segment at low single digit. We believe improvement will be on growth-led operating leverage benefits. We believe IMaCs will gain from new opportunities due to rise in M&A and restructuring activities by corporates

- **ICRA Online Limited (ICRON, 17% of consolidated revenue)**
  - A KPO (Knowledge Process Outsourcing) division of ICRA, the segment has three lines of business – Data services, Research, and Analytics. Analytics is the emerging and high-growth division and offers services in areas of predictive and marketing analytics. The prime client for the business is Moody's (~85% of total outsourcing revenue)
  - This segment has posted ~22% CAGR over past five years with PBT margin at ~25%. However, due to a high base, such a high growth may be challenging to sustain; therefore, we conservatively build in revenue growth of 12-15% over next 3-5 years. Emergence of niche segments like Analytics will push up revenue growth over the next 3-5 years

Default study

- **Key takeaways from ICRA stability report**
  - Stability of ICRA-assigned non-structured finance ratings improved in FY17. Ratings of 93% of entities were retained in same rating category during the year (comparable number was 89% in FY16 while historical 10-year average is 89%)
  - One-year default rate for ICRA's investment grade ratings has remained below 1% for last four years. Three-year cumulative default rate of ICRA's investment grade ratings declined further to 2.4% for the cohort of ratings outstanding at the beginning of FY15 (the latest cohort having completed three years of seasoning) from 2.9% for the preceding year's cohort

One-year transition matrix of long-term ratings*: Average for last 10 years

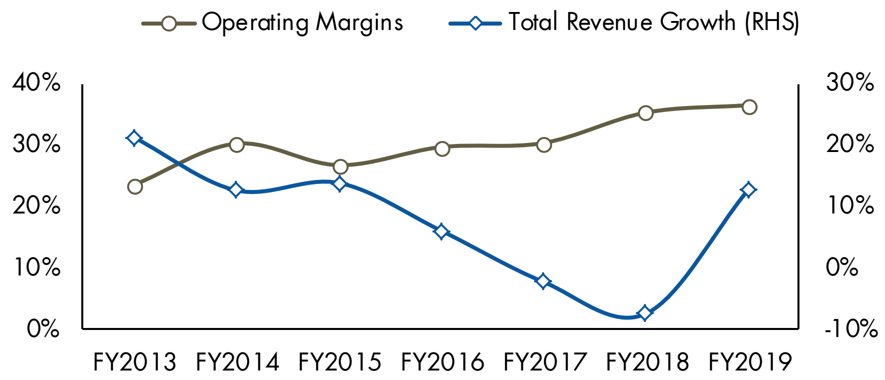
Average of 10 yrs	[ICRA]AAA	[ICRA]AA	[ICRA]A	[ICRA]BBB	[ICRA]BB	[ICRA]B and Lower
[ICRA]AAA	97.40%	2.60%	0.00%	0.00%	0.00%	0.00%
[ICRA]AA	1.40%	95.70%	2.60%	0.10%	0.00%	0.10%
[ICRA]A	0.00%	4.60%	89.30%	5.60%	0.20%	0.40%
[ICRA]BBB	0.00%	0.00%	4.20%	87.70%	5.80%	2.30%

Source: Icra, Axis Capital

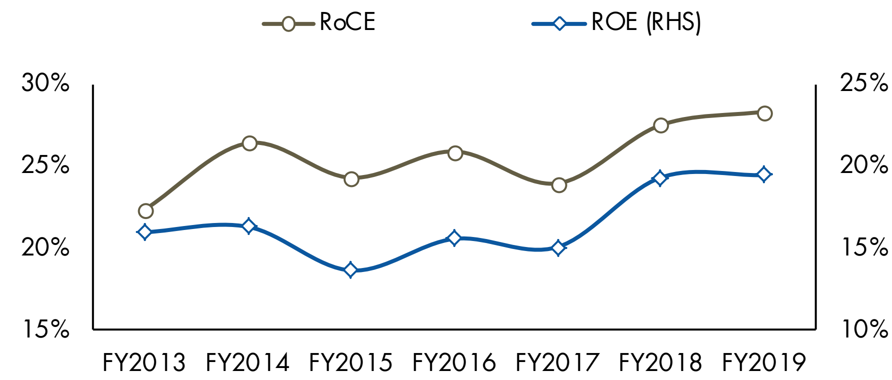
According to ICRA, stability report for long-term ratings for last 10 years shows 97.4% of corporates continue to be rated AAA

Profitability, FCF profile

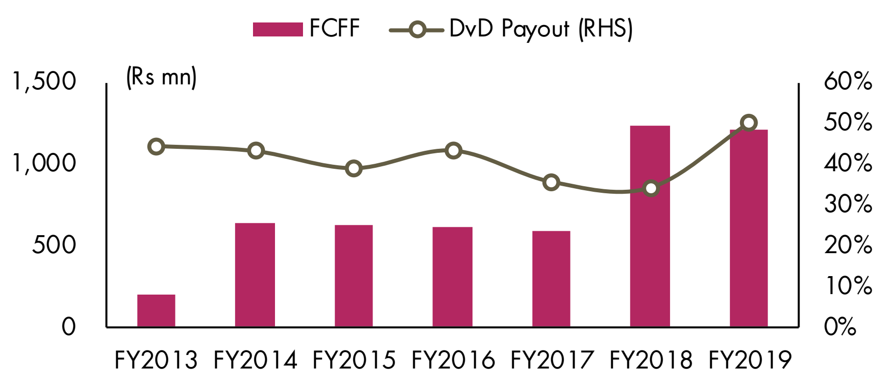
We expect revenue growth to improve to 13% with margin improvement to 35%...



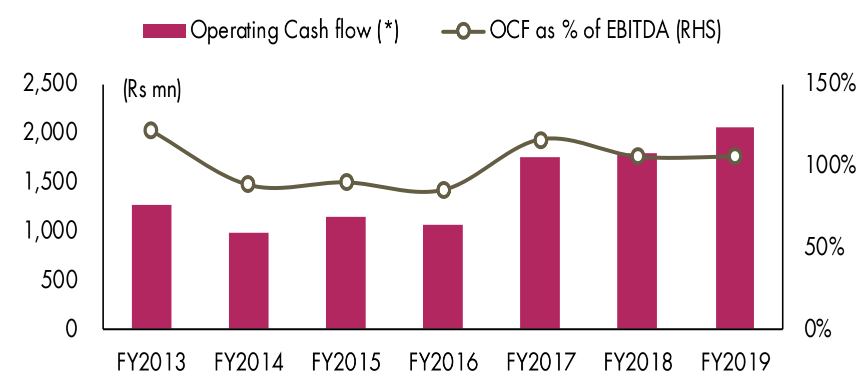
...with profitability intact, 27-30% RoCE and 19-20% RoE



High FCF generation, ~Rs 2bn (5% of MCAP) expected to be paid back as dividend (FY18-21)



Consistent OCF generation with OCF: EBITDA @100%+



(*) Pretax operating Cashflow

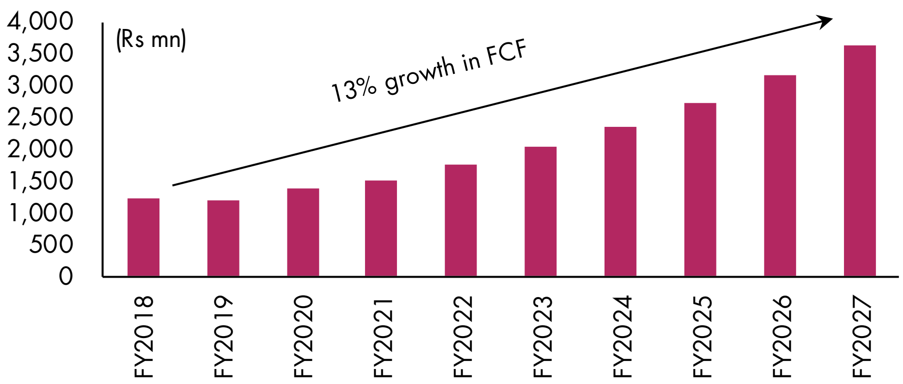
Source: Axis Capital

Board profile and support from Moody's

Mr. Arun Duggal	Mr. Arun Duggal is the *Non-Executive Chairman* and an Independent Director of ICRA Limited. He is also a Visiting Professor at the Indian Institute of Management, Ahmedabad where he teaches a course on Venture Capital, Private Equity and Business Ethics. Mr. Duggal had a *26 years career with Bank of America*, mostly in the U.S., Hong Kong and Japan. His last assignment was as Chief Executive of Bank of America in India from 1998 to 2001. He is on the Boards of ITC Limited, Info Edge, Dish TV India Limited, Dr. Lal PathLabs Limited.
Dr. Min Ye	Dr. Min Ye is a Non-Independent Director of ICRA Limited. He is the *Managing Director and the Regional Head of Moody's Asia Pacific*. Earlier, he was the Managing Director and the Country Manager for Moody's China, as well as the Chief Executive Officer of China Chengxin International Credit Rating Co. Ltd., a Moody's affiliate in China.
Mr. Simon Richard Hastilow	Mr. Simon Richard Hastilow is a Non-Independent and Non Executive Director of ICRA Limited. He is a *Managing Director and Global Head of Relationship Management at Moody's Investors Service*. He is responsible for leading the global team that grows Moody's coverage share and revenue by developing relationships with new issuers in existing markets, penetrating new markets, and strengthening and expanding relationships with existing issuers and intermediaries. Prior to joining Moody's, Mr. Hastilow spent 11 years at Thomson Reuters where he led marketing and sales teams in the corporate and wealth management sectors.
Mr. Thomas John Keller Jr	Mr. Thomas John Keller Jr. is a Non-Independent and Non-Executive Director of ICRA Limited. Mr. Keller is the *Managing Director for Sovereign Ratings and Geographic Management of Moody's Investors Service (MIS)*. In this role, Mr. Keller oversees all activities related to sovereign ratings.Prior to this role, beginning in 2007, Mr. Keller was the Managing Director for the Global Public, Project and Infrastructure Finance Group
Mr. Naresh Takkar	Mr. Naresh Takkar is the *Managing Director & Group CEO of ICRA.* Prior to holding this position he was Joint Managing Director & Chief Rating Officer of ICRA.He joined ICRA as an analyst in 1991.
Ms. Radhika Haribhakti	♦ Ms. Radhika Vijay Haribhakti is an Independent Director on the board of ICRA Limited. Ms. Haribhakti has over *30 years of experience in Commercial and Investment Banking with Bank of America, JM Morgan Stanley and DSP Merrill Lynch*. She has advised several large corporates and led their IPOs, FPOs, GDR and ADR offerings. She now heads RH Financial, a boutique Advisory Firm focused on M&A and Private Equity. ♦ She is on the Boards of Directors of Adani Ports and Special Economic Zone Limited, Mahanagar Gas Limited, EIH Associated Hotels Limited, Navin Fluorine International Limited, Rain Industries Limited and Vistaar Financial Services Private Limited.

DCF-based valuation of 35x – upside of 12%

We expect 13% growth in FCF over next 7 years



Source: Axis Capital

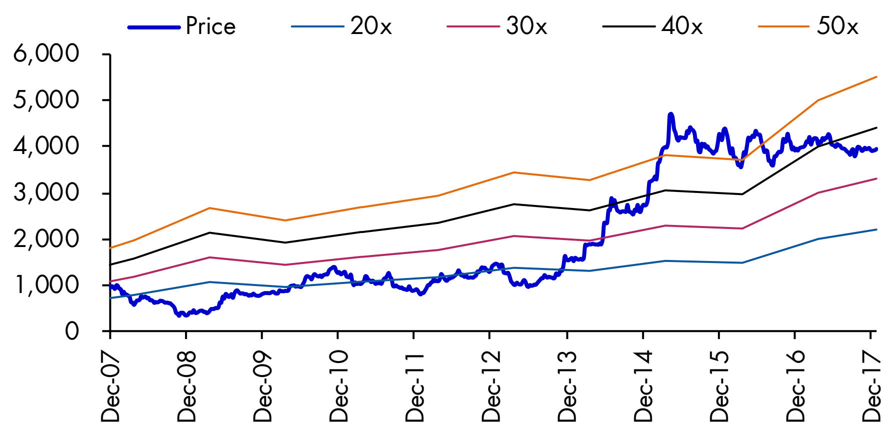
Based on12% discounting rate, we arrive at upside of 12%

Valuation	(Rs mn)
PV of FCF	12,476
Terminal value	26,075
Value of the company	38,551
Debt	(5,997)
Equity value	44,548
Market Cap	38,860
NO fo O/S shares	10
CMP (Rs)	4,010
Per share value	4,500
Upside	12%

Key assumptions	(%)
Riskfree rate	7%
Market risk premium	5%
Beta	1.0
Discounting rate	12%
Terminal growth	5%

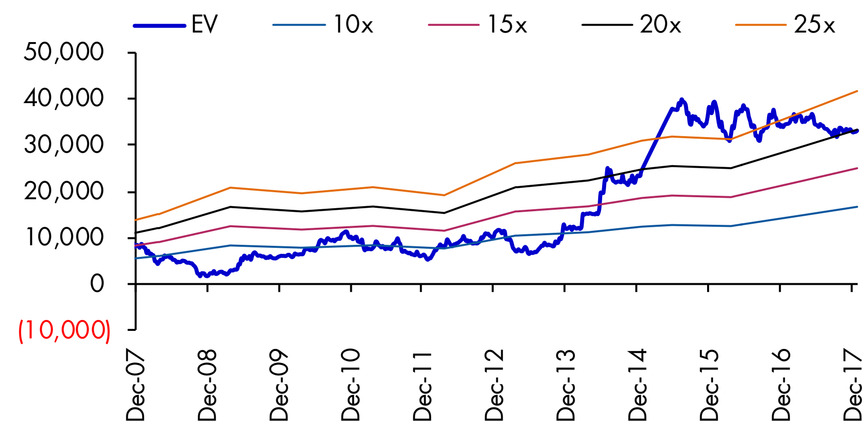
Source: Axis Capital

1 year fwd PE bands



Source: Axis Capital

1 year fwd EV/E bands



Source: Axis Capital

Company financials (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	3,330	3,078	3,466	3,909
Other operating income	-	-	-	-
Total operating income	**3,330**	**3,078**	**3,466**	**3,909**
Cost of goods sold	-	-	-	-
Gross profit	3,330	3,078	3,466	3,909
Gross margin (%)	*100.0*	*100.0*	*100.0*	*100.0*
Total operating expenses	(2,322)	(1,993)	(2,202)	(2,477)
EBITDA	**1,009**	**1,084**	**1,263**	**1,432**
EBITDA margin (%)	*30.3*	*35.2*	*36.5*	*36.6*
Depreciation	(85)	(60)	(66)	(71)
EBIT	**923**	**1,024**	**1,198**	**1,362**
Net interest	-	-	-	-
Other income	245	418	439	527
Profit before tax	**1,168**	**1,443**	**1,637**	**1,889**
Total taxation	(425)	(433)	(516)	(614)
Tax rate (%)	*36.3*	*30.0*	*31.5*	*32.5*
Profit after tax	744	1,010	1,121	1,275
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	744	1,010	1,121	1,275
Adj. PAT margin (%)	*22.3*	*32.8*	*32.4*	*32.6*
Net non-recurring items	-	-	-	-
Reported net profit	744	1,010	1,121	1,275

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	99	99	99	99
Reserves & surplus	4,891	5,396	5,957	6,594
Net worth	4,990	5,495	6,056	6,693
Borrowing	-	-	-	-
Other non-current liabilities	59	60	68	76
Total liabilities	**5,058**	**5,565**	**6,133**	**6,779**
Gross fixed assets	787	862	937	1,012
Less: Depreciation	(421)	(481)	(547)	(618)
Net fixed assets	366	381	390	394
Add: Capital WIP	7	8	9	9
Total fixed assets	373	389	399	404
Other Investment	-	-	-	-
Inventory	-	-	-	-
Debtors	340	314	353	398
Cash & bank	2,005	2,293	2,337	2,298
Loans & advances	298	253	285	321
Current liabilities	1,051	1,220	1,383	1,571
Net current assets	1,591	1,640	1,592	1,446
Other non-current assets	466	434	482	537
Total assets	**5,058**	**5,565**	**6,133**	**6,779**

Source: Company, Axis Capital

Company financials (Consolidated)

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	1,168	1,443	1,637	1,889
Depreciation & Amortisation	85	60	66	71
Chg in working capital	*(32)*	*240*	*92*	*106*
Cash flow from operations	640	1,310	1,279	1,452
Capital expenditure	*(57)*	*(75)*	*(75)*	*(75)*
Cash flow from investing	(108)	(516)	(674)	(854)
Equity raised/ (repaid)	-	-	-	-
Debt raised/ (repaid)	-	-	-	-
Dividend paid	*(250)*	*(505)*	*(561)*	*(637)*
Cash flow from financing	(705)	(505)	(561)	(637)
Net chg in cash	(173)	289	44	(40)

Valuation ratios

Y/E March	FY17	FY18E	FY19E	FY20E
PE (x)	53.4	39.3	35.4	31.1
EV/ EBITDA (x)	37.4	34.5	29.6	26.1
EV/ Net sales (x)	11.3	12.2	10.8	9.6
PB (x)	8.0	7.2	6.6	5.9
Dividend yield (%)	0.6	1.3	1.4	1.6
Free cash flow yield (%)	0.0	0.0	0.0	0.0

Source: Company, Axis Capital

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	75.1	102.0	113.3	128.8
CEPS (Rs)	83.7	108.1	119.9	135.9
DPS (Rs)	25.3	51.0	56.6	64.4
Dividend payout ratio (%)	33.6	50.0	50.0	50.0
GROWTH				
Net sales (%)	(2.4)	(7.6)	12.6	12.8
EBITDA (%)	(0.2)	7.5	16.5	13.4
Adj net profit (%)	(2.7)	35.8	11.1	13.7
FDEPS (%)	(1.7)	35.8	11.1	13.7
PERFORMANCE				
RoE (%)	15.3	19.3	19.4	20.0
RoCE (%)	23.5	27.2	28.0	29.3
EFFICIENCY				
Asset turnover (x)	1.2	1.0	1.0	1.0
Sales/ total assets (x)	0.5	0.5	0.5	0.5
Working capital/ sales (x)	(0.2)	(0.2)	(0.2)	(0.2)
Receivable days	37.2	37.2	37.2	37.2
Inventory days	-	-	-	-
Payable days	128.7	138.5	141.2	141.6
FINANCIAL STABILITY				
Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(0.4)	(0.4)	(0.4)	(0.4)
Current ratio (x)	2.5	2.3	2.2	1.9
Interest cover (x)	-	-	-	-

22 JAN 2018 Company Report

BUY

Target Price: **Rs 1,750**

CMP	: **Rs 1,385**
Potential Upside	: **26%**

MARKET DATA

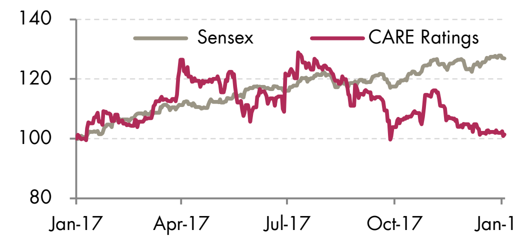
No. of Shares	: 29 mn
Market Cap	: Rs 41 bn
Free Float	: 100%
Avg. daily vol (6mth)	: 51,530 shares
52-w High / Low	: Rs 1,800 / Rs 1,293
Bloomberg	: CARE IB Equity
Promoter holding	: 0%
FII / DII	: 39% /27%

CARE Ratings

MISCELLANEOUS

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

Price performance



Financial summary (consolidated)

Y/E Mar	Sales (Rs mn)	PAT (Rs mn)	Con. EPS* (Rs)	EPS (Rs)	Change YOY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/E (x)	DPS (Rs)
FY17	2,874	1,474	-	50.0	19.0	27.7	32.6	46.4	19.9	18.0
FY18E	3,071	1,518	50.5	51.5	3.0	26.9	28.5	40.9	18.0	25.8
FY19E	3,480	1,639	57.1	55.6	7.9	24.9	26.9	39.8	15.8	29.2
FY20E	3,944	1,850	64.4	62.8	12.9	22.0	26.8	39.7	13.8	34.6

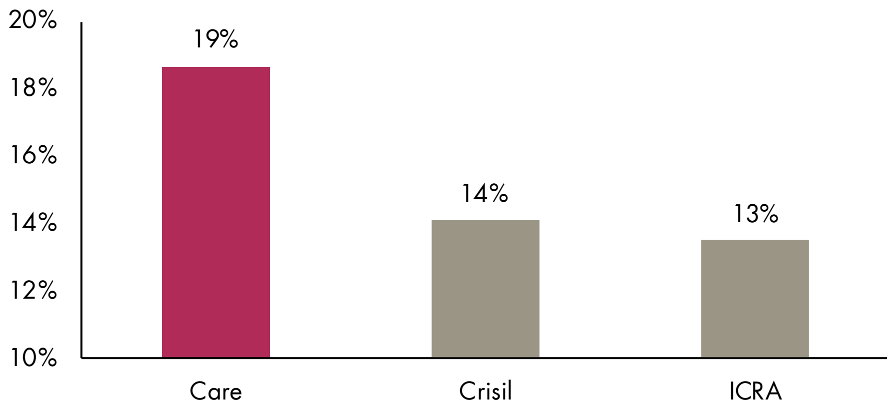
Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	FY18	FY19	FY20
Rev growth (%)	7%	13%	13%
Op. Mrgn (%)	64%	63%	63%
FcF (Rs Mn)	1,464	1,617	1,837
Dvd. Payout (%)	50%	53%	55%

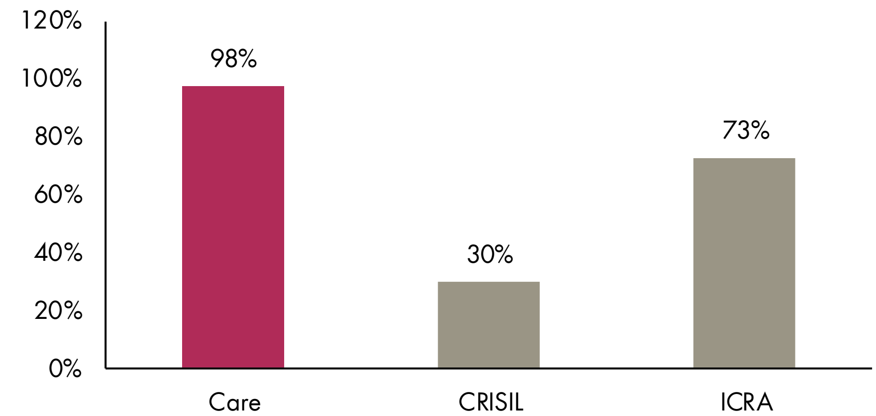
Pure play on rating business with superior returns profile

Last entrant in ratings business, but highest growth (last 5 years) profile amongst peers



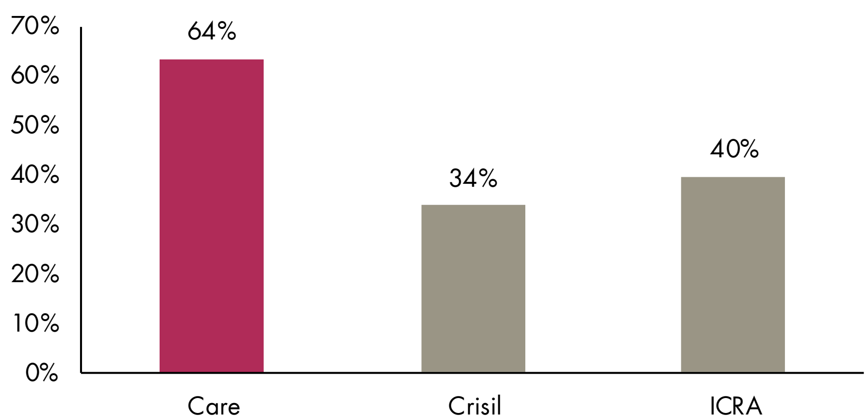
Source: Axis Capital

The only pure play on rating business



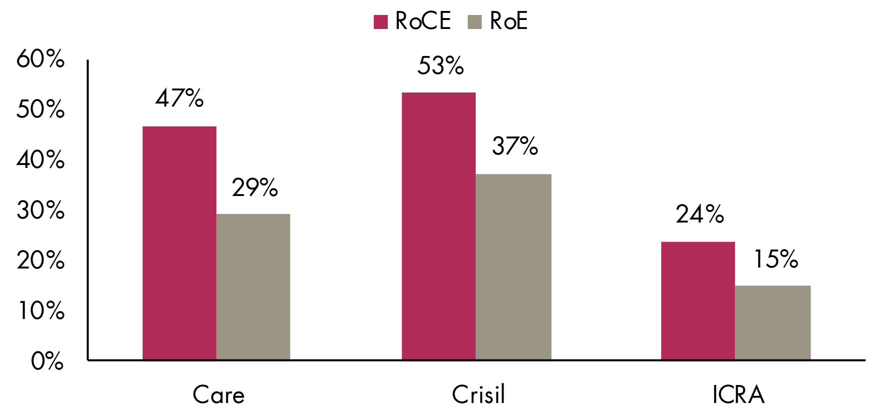
Source: Axis Capital

Best in class margin though operating efficiencies



Source: Axis Capital

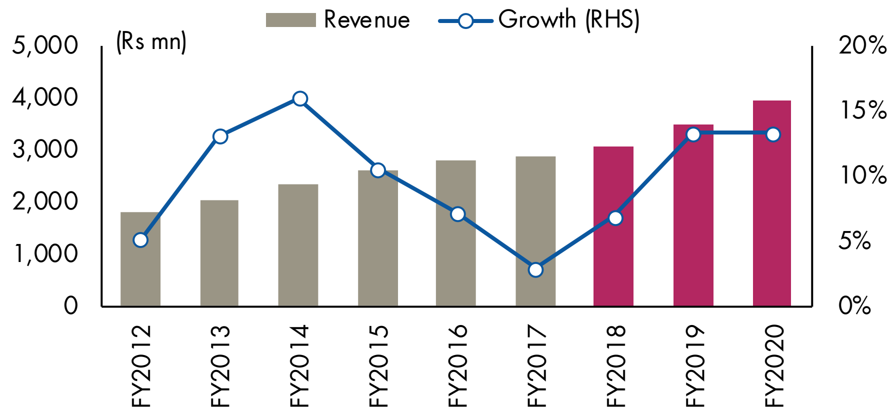
Remarkable profitability compared to peers



Source: Axis Capital

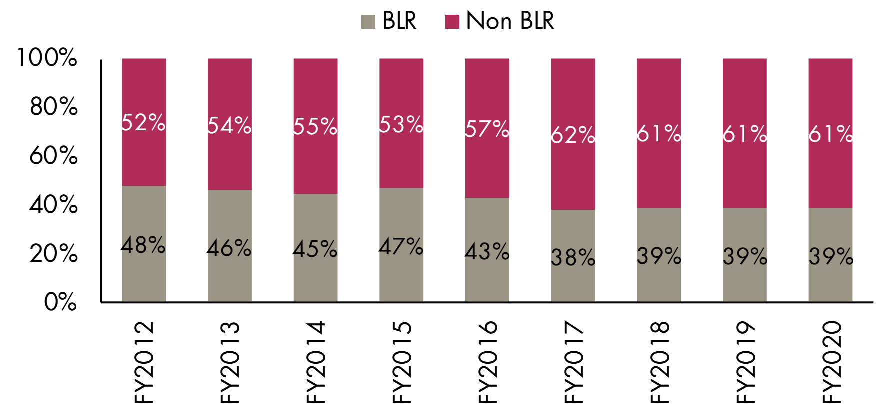
CARE – Pure play on rating business

Consistent growth profile



Source: Axis Capital

Improving share of non-BLR revenue to help margin



Source: Axis Capital

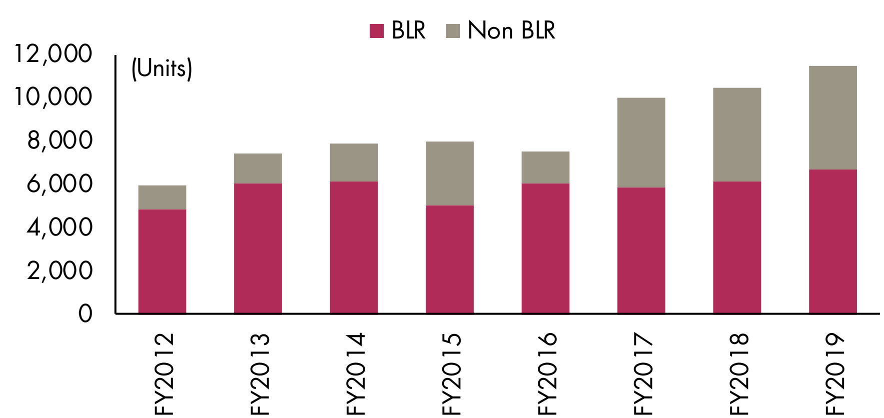
- In an endeavor to diversify its product portfolio beyond the traditional corporate bond and BLR business, CARE has been expanding its income-generating pool of products such as *SME rating, Edu-grade (education institutions grading), equi-grade (equity research of companies), real estate ratings and valuation of market-linked debentures in order to expand their pool of products.* CARE has also strengthened its position in IPO grading market and captured a significant market share.
- Continued expansion in product offerings will help CARE in maintaining market share in ratings industry

CARE was 3rd largest CRA in terms of revenue from ratings business till 2008. Basel II norms in 2008 augured well for entire rating industry especially for CARE, as it climbed to 2nd spot in terms of revenue and market share

Growth aided by both BLR and non-BLR segments

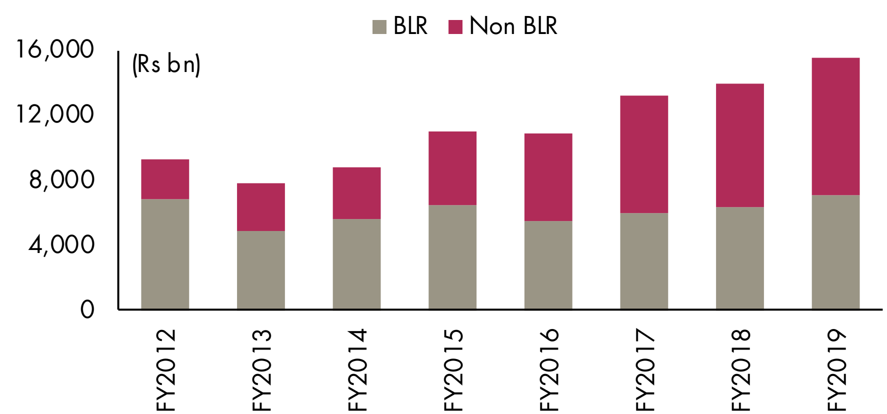
Declining volumes in BLR segment along with incremental focus on SME ratings led to higher share of non-BLR revenue

Count of instruments rated



Source: Axis Capital

Volume of instruments rated



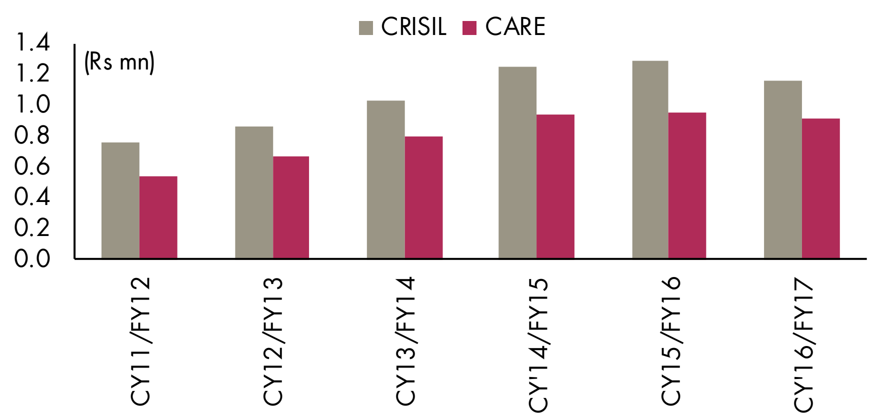
Source: Axis Capital

- Over the past 7 years (since 2010) the number of instruments rated has increased ~6x (largely in non-BLR category). However, the volume of business rated has increased only 2x, indicating lower ticket sizes
- We believe CARE could accept smaller ticket assignments largely due to overall cost competitiveness against Crisil and ICRA. This enabled CARE to demonstrate a higher revenue growth rate. However, this was not without consequence; operating margin compressed over 10% over the past 6-7 years

Highest margin due to low-cost structure

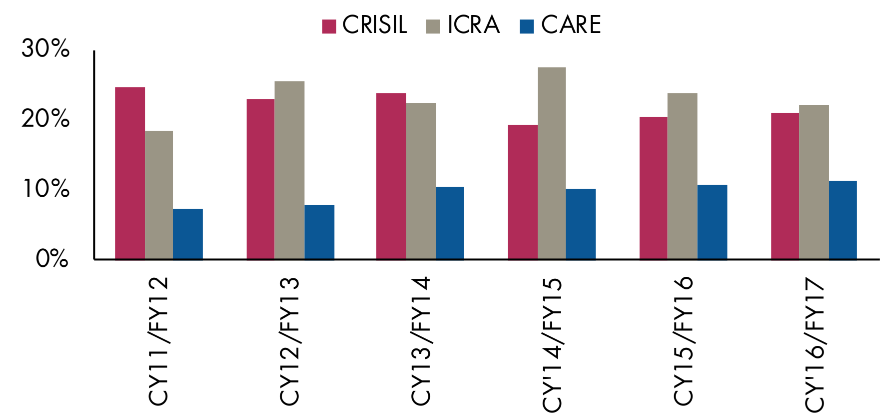
CARE enjoys the highest margin in the industry. This can be attributed to its relatively lower employee costs and owned offices (saving on lease rentals). Low-cost knowledge centre of CARE helps lead analysts save significant time and focus only on core rating assignment, leading to higher rating turnout per analyst.

Cost per employee is 30% lower vs. Crisil's



Source: Axis Capital

Opex (% of revenue) nearly half of that of ICRA and Crisil



Source: Axis Capital

While increasing contribution from SME business may pressure margin, we expect that several cost control initiatives by the management will negate the impact

Default study – ratings similar to other rating agencies

Care Ratings – Default study

	Issuer	AAA	AA	A	BBB	BB	B	C	D
AAA	477	98.08%	1.92%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
AA	1202	1.62%	93.70%	4.17%	0.17%	0.17%	0.09%	0.00%	0.09%
A	2185	0.00%	3.45%	87.82%	7.31%	0.89%	0.15%	0.05%	0.33%
BBB	6387	0.00%	0.05%	4.29%	87.86%	5.70%	0.36%	0.02%	1.72%
BB	5750	0.00%	0.03%	0.00%	6.02%	84.51%	3.48%	0.33%	5.63%
B	2688	0.00%	0.00%	0.00%	0.18%	15.84%	72.55%	0.45%	10.98%
C	171	0.00%	0.00%	0.00%	2.49%	9.36%	25.74%	31.21%	31.20%

Based on CARE's average one-year transition matrix, it can be inferred that out of all the AA rated companies at the beginning of the year,

- 93.70% have remained in the same category,
- 1.62% have been upgraded to AAA
- and 4.60% have been downgraded.

Default behavior – over one to three years

Rating Category	One year		Two Year		Three Year	
	Avg. No. of Issuers	CDR	Avg. No. of Issuers	CDR	Avg. No. of Issuers	CDR
AAA	48.0	0.00%	44.8	0.00%	42.1	0.00%
AA	122.3	0.08%	113.7	0.39%	105.8	0.95%
A	223.2	0.31%	198.7	1.57%	180.5	3.32%
BBB	668.1	1.51%	585.8	3.30%	495.4	5.22%
BB	620.6	3.93%	485.4	6.96%	336.4	10.03%
B	288.1	7.12%	213.4	12.49%	116.0	16.06%
C	19.2	22.40%	17.6	29.75%	13.0	35.58%
Total	1989.5	3.02%	1659.3	5.34%	1289.1	6.97%

There were no instances of default (in any cohort) in AAA rating category

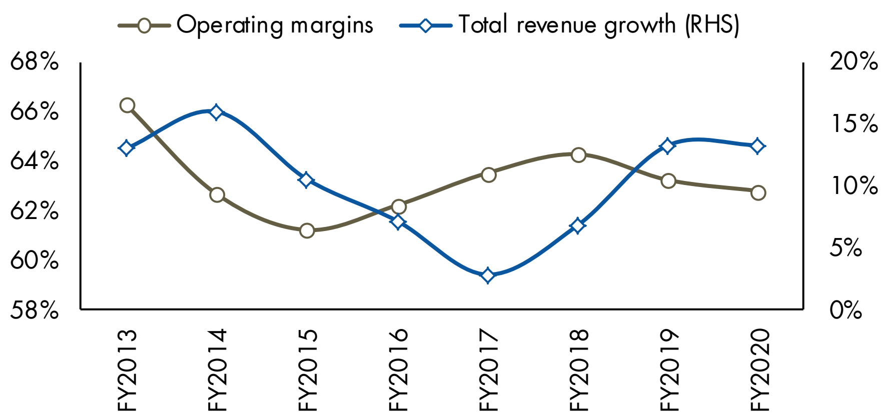
Even in the BBB category, the default rate is ~5.2% over 3 years

According to CARE, stability report for long-term ratings for FY06-16 shows 98% of corporates continued to be rated AAA

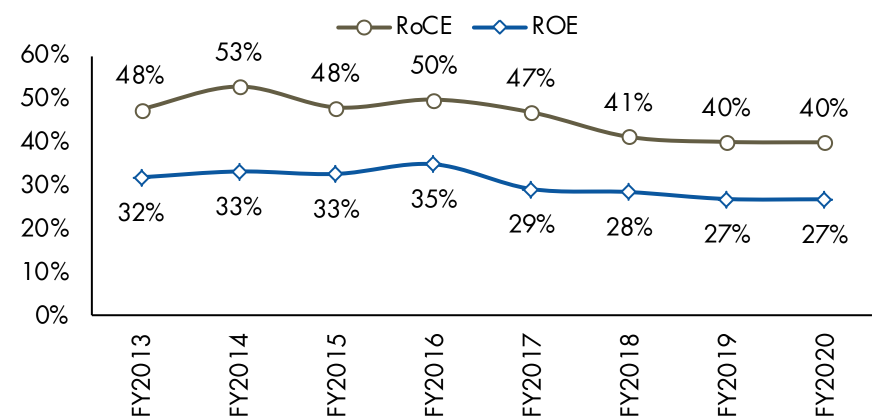
Source: Axis Capital

Spectacular profitability

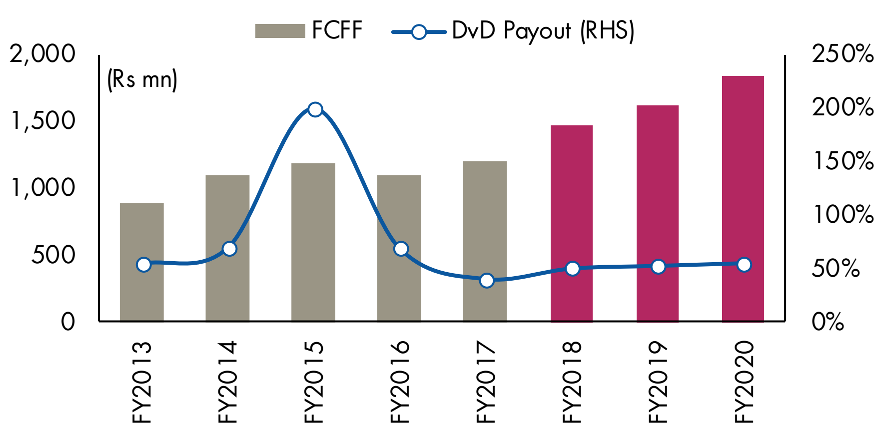
We expect revenue growth to improve to 14% with margin remaining broadly similar at 65%...



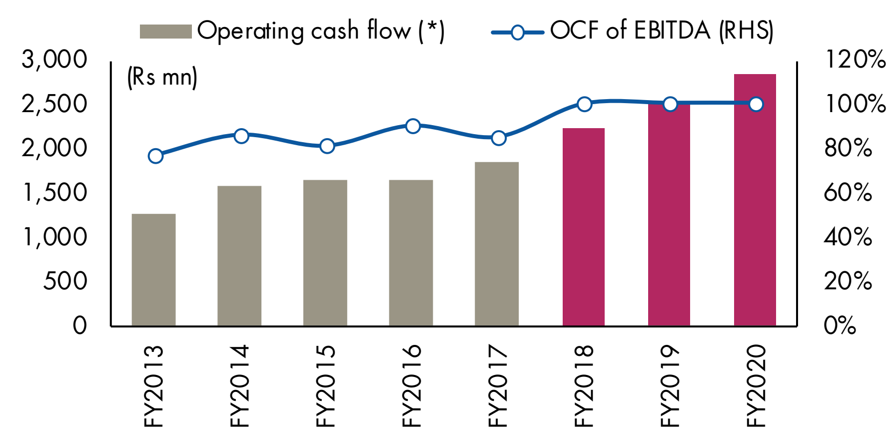
...with profitability intact, 40%+ RoCE and 27% RoE



High FCF generation, ~Rs 3 bn (7-8% of MCAP) expected to be paid back as dividend



Consistent OCF generation with OCF: EBITDA at ~90%+



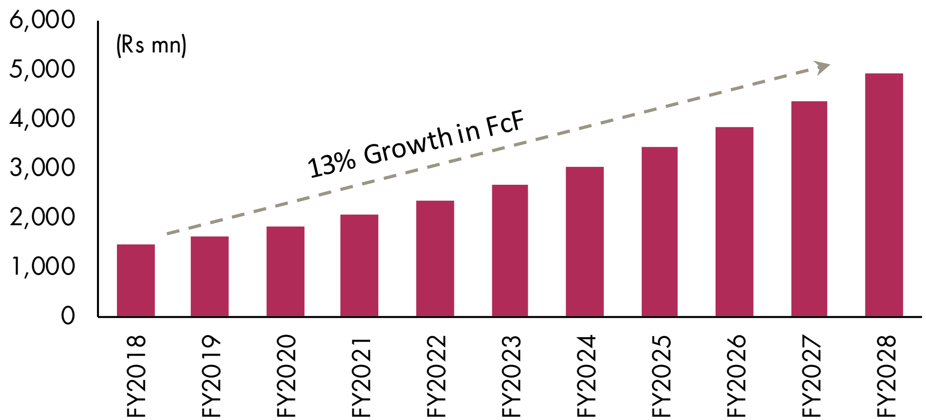
(*) Pretax Operating Cashflow

Board profile

Mr. Rajesh Mokashi	Rajesh Mokashi is the Managing Director and Chief Executive Officer. He has more than 30 years of experience in finance, commerce and credit risk sectors. He has been associated with OTIS Elevators Company (India) Limited, DSP Financial Consultants Limited and Kotak Mahindra Finance Limited in the past.
Mr. S. B. Mainak	Mr. S. B. Mainak the Non - Exec Chairman of CARE also served as the ***Managing Director of LIC till Mar'16***. He was earlier appointed by the Government of India on the Board of Satyam Computer Services Limited as an Independent Director for restructuring the company. In 2009, he was conferred the 'NDTV Profit Business Leadership Award', 'CNN-IBN Indian of the Year Award' and 'Dataquest IT Person of the Year Award'.
Mr. A.K. Bansal	Mr. A. K. Bansal is an Independent Director of our Company. He worked as ***Executive Director of Indian Overseas Bank between 2010-13***. He is also on the Board of Directors of Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited.
Dr. Ashima Goyal	She holds a doctorate in Economics and is now a Professor at Indira Gandhi Institute of Development Research, ***member of the Monetary Policy Technical Advisory Committee of the RBI,*** Vice-Chairperson and a Public Interest Director at MCX-SX, has been a member of various committees of Reserve Bank, Government of India, Governing Council of the Exchange Traded Currency Derivatives Segment (ETCD) of the Bombay Stock Exchange Ltd., and Indian Merchants Chamber, and has served on the Boards of MCX, MCX-SX Clearing Corporation, and National Institute of Bank Management

DCF-based valuation of 28x FY20 – upside of 26%

We expect FCF to grow 13% over next 7-8 years



Source: Axis Capital

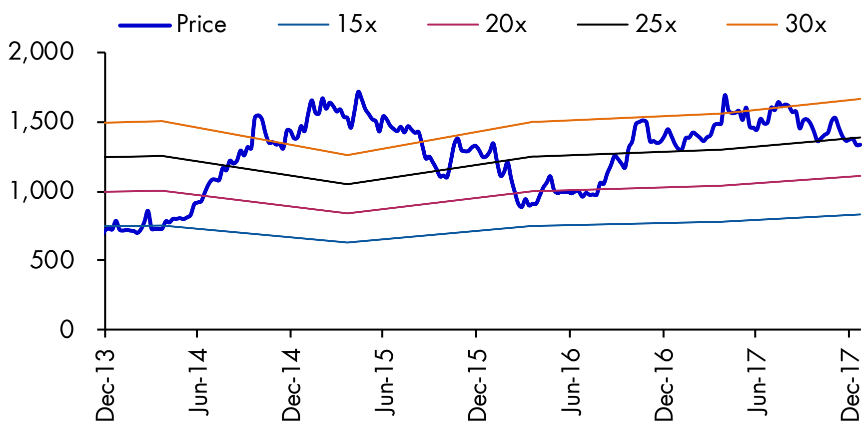
Based on 12% discounting rate, we arrive at upside of 26%

Valuation	(Rs mn)
PV of FCF	15,768
Terminal value	29,832
Value of the company	45,600
Debt	(5,929)
Equity value	51,529
Market Cap	40,788
CMP (Rs)	1,385
Per share value	1,750
Upside	**26%**

Key assumptions	(%)
Riskfree rate	7%
Market risk premium	5%
Beta	1.0
Discounting rate	12%
Terminal growth	5%

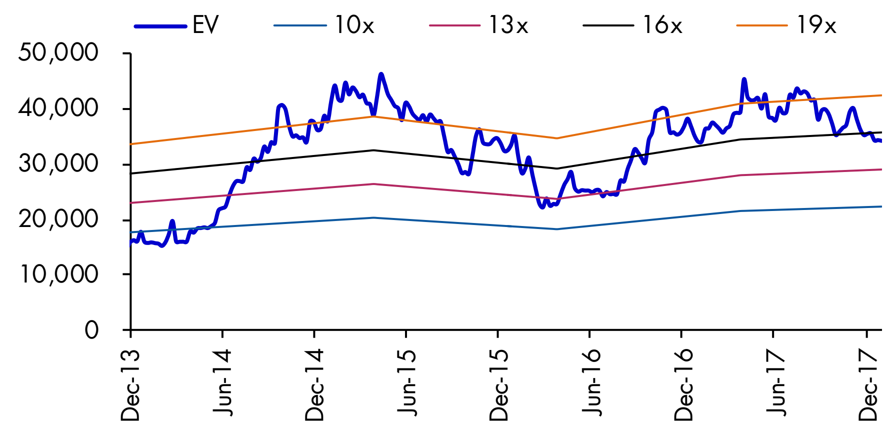
Source: Axis Capital

1 year fwd PE bands



Source: Axis Capital

1 year fwd EV/E bands



Source: Axis Capital

Key risks

- **Concentration risk**

  CARE derives 98% of its revenue from ratings business; Whereas Crisil and ICRA have more diversified revenue profile. As a result, Care is more prone to macro-economic cyclicality. However, Care has taken small steps towards diversification developing its business outside India and has entered Maldives, Nepal, Mauritius, Brazil, Portugal, Malaysia and South Africa through various routes like technical assistance to local agencies and joint ventures. Further, Care has acquired Kalypto, a risk management company in Nigeria to further de-risk

- **Ability to sustain high margin**

  CARE has one of the highest operating margin in the industry due to its cost competitiveness and technology-driven ratings methodology. However, the company's foray into newer geographies and services may impact the margin in the medium term since these initiatives will not offer same margin as in case of ratings in India. Hence we believe Care would find it challenging to maintain such high levels of margin

- **Lack of support from MNC parent**

  Of the top four rating agencies in India, three are subsidiaries with international rating agencies. Support from the MNC parent also provides Crisil ICRA and India Ratings support to wade thought cycles.

  Also support from MNC parent provides an additional outsourcing revenue opportunity for these companies. Not having any Non Compete with global rating agencies, (unlike Crisil and ICRA) has its advantage in terms of providing an opportunity to CARE to expand globally which these companies cannot, but is negative from the perspective of gaining access to global brand, processes and systems.

Company financials (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	2,874	3,071	3,480	3,944
Other operating income	-	-	-	-
Total operating income	**2,874**	**3,071**	**3,480**	**3,944**
Cost of goods sold	-	-	-	-
Gross profit	2,874	3,071	3,480	3,944
Gross margin (%)	*100.0*	*100.0*	*100.0*	*100.0*
Total operating expenses	(1,048)	(1,096)	(1,278)	(1,466)
EBITDA	**1,826**	**1,975**	**2,201**	**2,477**
EBITDA margin (%)	*63.5*	*64.3*	*63.3*	*62.8*
Depreciation	(34)	(35)	(55)	(60)
EBIT	**1,792**	**1,940**	**2,146**	**2,417**
Net interest	-	-	-	-
Other income	329	260	299	344
Profit before tax	**2,121**	**2,200**	**2,446**	**2,762**
Total taxation	(647)	(682)	(807)	(911)
Tax rate (%)	*30.5*	*31.0*	*33.0*	*33.0*
Profit after tax	1,474	1,518	1,639	1,850
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	1,474	1,518	1,639	1,850
Adj. PAT margin (%)	*51.3*	*49.4*	*47.1*	*46.9*
Net non-recurring items	-	-	-	-
Reported net profit	1,474	1,518	1,639	1,850

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	295	295	295	295
Reserves & surplus	4,658	5,417	6,195	7,028
Net worth	4,953	5,712	6,490	7,323
Borrowing	-	-	-	-
Other non-current liabilities	40	43	49	55
Total liabilities	**4,998**	**5,759**	**6,543**	**7,383**
Gross fixed assets	898	998	1,098	1,198
Less: Depreciation	(288)	(323)	(378)	(438)
Net fixed assets	610	675	720	760
Add: Capital WIP	-	-	-	-
Total fixed assets	610	675	720	760
Other Investment	-	-	-	-
Inventory	-	-	-	-
Debtors	253	270	306	347
Cash & bank	141	842	938	998
Loans & advances	78	84	95	108
Current liabilities	494	528	598	678
Net current assets	(22)	668	741	775
Other non-current assets	70	77	92	109
Total assets	**4,998**	**5,759**	**6,543**	**7,383**

Source: Company, Axis Capital

Company financials (Consolidated)

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	2,121	2,200	2,446	2,762
Depreciation & Amortisation	34	35	55	60
Chg in working capital	*30*	*11*	*23*	*26*
Cash flow from operations	1,190	1,564	1,717	1,937
Capital expenditure	*(10)*	*(100)*	*(100)*	*(100)*
Cash flow from investing	(220)	(104)	(760)	(859)
Equity raised/ (repaid)	*34*	-	-	-
Debt raised/ (repaid)	-	-	-	-
Dividend paid	*(992)*	*(759)*	*(860)*	*(1,018)*
Cash flow from financing	(958)	(759)	(860)	(1,018)
Net chg in cash	12	701	96	60

Valuation ratios

Y/E March	FY17	FY18E	FY19E	FY20E
PE (x)	27.7	26.9	24.9	22.0
EV/ EBITDA (x)	19.9	18.0	15.8	13.8
EV/ Net sales (x)	12.6	11.6	10.0	8.6
PB (x)	8.2	7.1	6.3	5.6
Dividend yield (%)	1.3	1.9	2.1	2.5
Free cash flow yield (%)	0.0	0.0	0.0	0.0

Source: Company, Axis Capital

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	50.0	51.5	55.6	62.8
CEPS (Rs)	51.2	52.7	57.5	64.9
DPS (Rs)	18.0	25.8	29.2	34.6
Dividend payout ratio (%)	36.0	50.0	52.5	55.0
GROWTH				
Net sales (%)	2.9	6.8	13.3	13.3
EBITDA (%)	5.0	8.1	11.5	12.5
Adj net profit (%)	23.2	3.0	7.9	12.9
FDEPS (%)	19.0	3.0	7.9	12.9
PERFORMANCE				
RoE (%)	32.6	28.5	26.9	26.8
RoCE (%)	46.4	40.9	39.8	39.7
EFFICIENCY				
Asset turnover (x)	9.2	6.1	6.3	6.8
Sales/ total assets (x)	0.5	0.5	0.5	0.5
Working capital/ sales (x)	(0.1)	(0.1)	(0.1)	(0.1)
Receivable days	32.1	32.1	32.1	32.1
Inventory days	-	-	-	-
Payable days	137.2	140.1	136.1	134.5
FINANCIAL STABILITY				
Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(1.0)	(1.0)	(1.0)	(1.0)
Current ratio (x)	1.0	2.3	2.2	2.1
Interest cover (x)	-	-	-	-

AXIS DIRECT

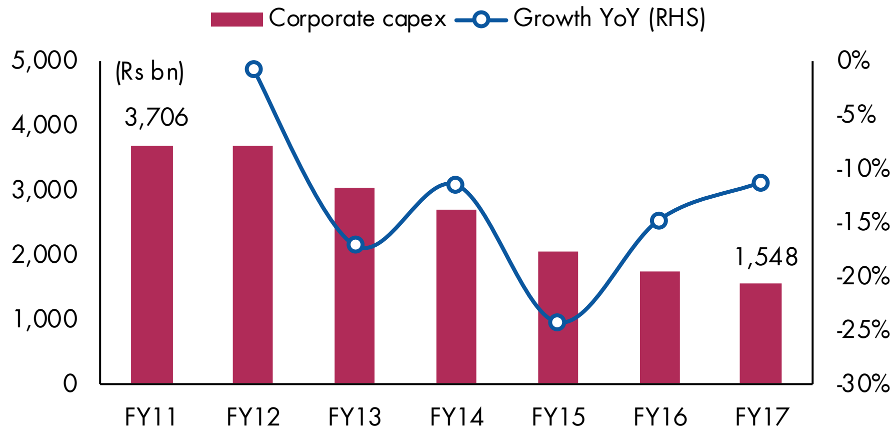
Appendix

Early signs of recovery in capex

- As we see early signs of capex bottoming out, the increase in corporate capex and the changing funding mix bode well for CRAs
- Capex bottoming out: RBI data on corporate disbursements is showing signs of capex bottoming out. Our analysis of BSE 500 companies also suggests a similar trend in capex
- Investment pipeline and bank sanctions turnaround: Most encouraging data point is over 50% rise in project pipeline and over 90% increase in corporate sanctions of banks. While we see these as green shoots of capex revival, we are not opening the champagne as yet. Despite rising 50%+ in FY17, the pipeline is still half of peak levels
- Close observation of break-up of banks' sanctions data suggests healthy trends:
  - Renewable power, Infrastructure construction, and metals have driven the incremental sanctions
  - Share of working capital in incremental credit declined to 31% in FY17 from 66% in FY15
  - Bulk of increase is from small (<Rs 5 bn) & mid-sized (Rs 5-50 bn) projects; large projects (>Rs 50 bn) bottomed out in FY16
- Other positive lead indicators that suggest corporate capex revival:
  - Improvement in India Inc's manufacturing capacity utilization (up from 71% in Sep'16 to 75% in Mar'17) and manufacturing PMIs rising above 50
  - Corporates with healthy balance sheets have now started talking about expansions: PSU refineries, steel (JSW Energy, Tata Steel), cement (Holcim, UltraTech) and fertilizer (Chambal Fertilizers)

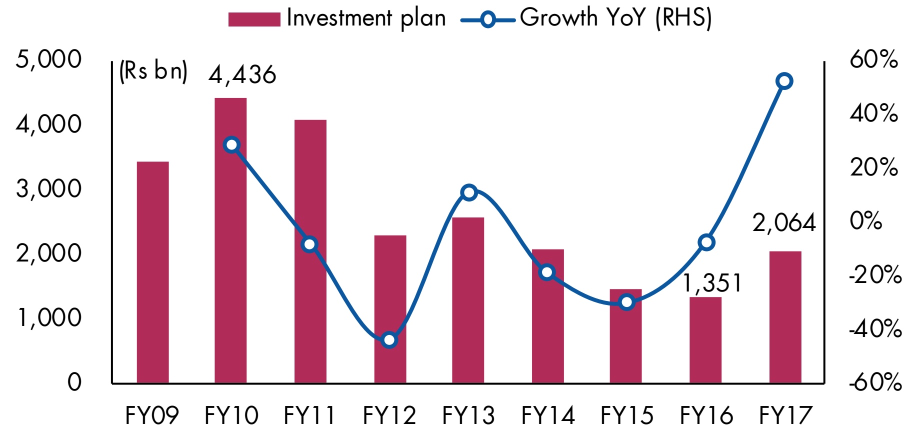
RBI data shows corporate capex bottomed out in FY17

Corporate capex bottomed out in FY17…



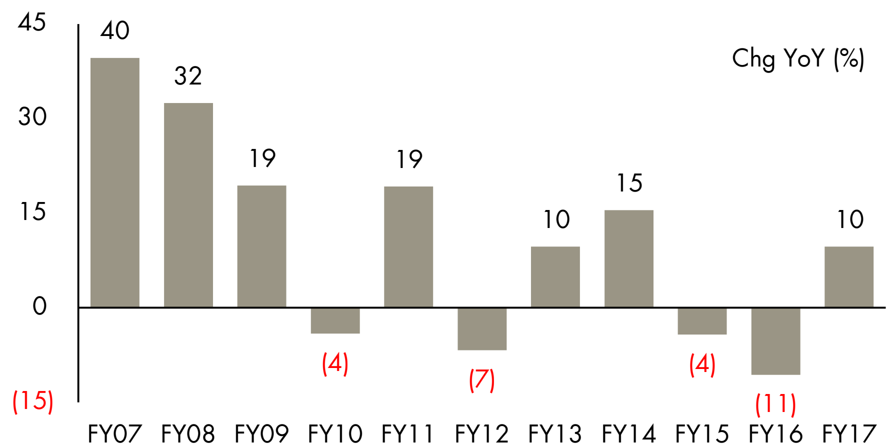
Source: RBI

…turnaround from FY18 based on 53% rise in project pipeline



Source: RBI

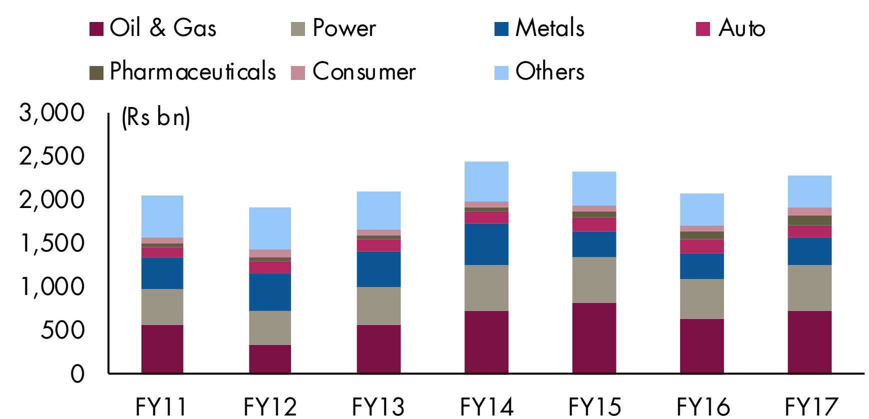
Capex bottoming out signs also visible for BSE 500*cos…



Source: C-Line, Axis Capital

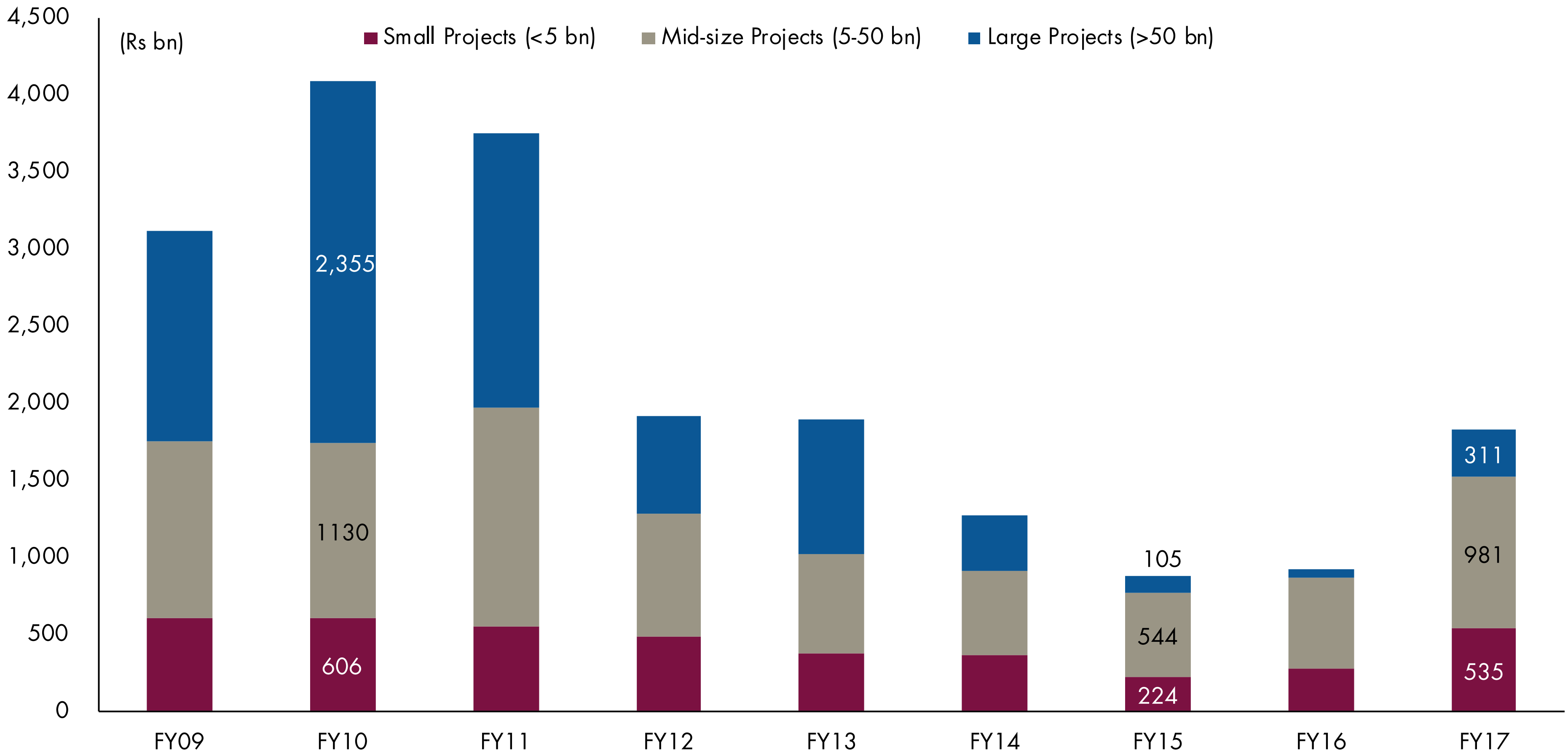
Note: *excluding telecom companies

…Oil and power PSUs, and RIL predominant drivers



Source: C-Line, Axis Capital

Recovery in capex plans is largely in small and mid-sized projects

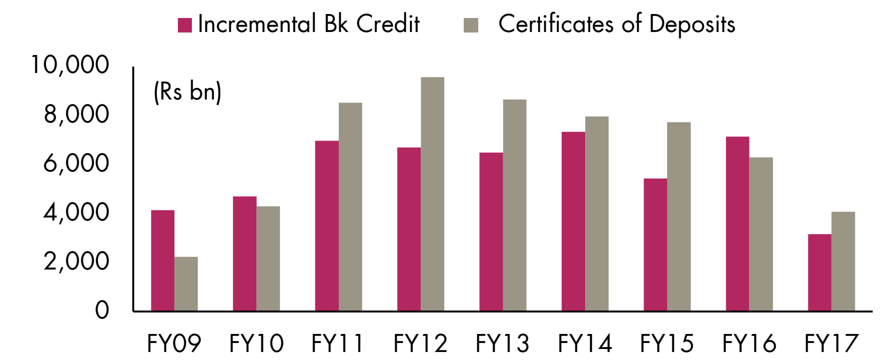


Source: RBI

Large projects touched rock-bottom levels in FY16

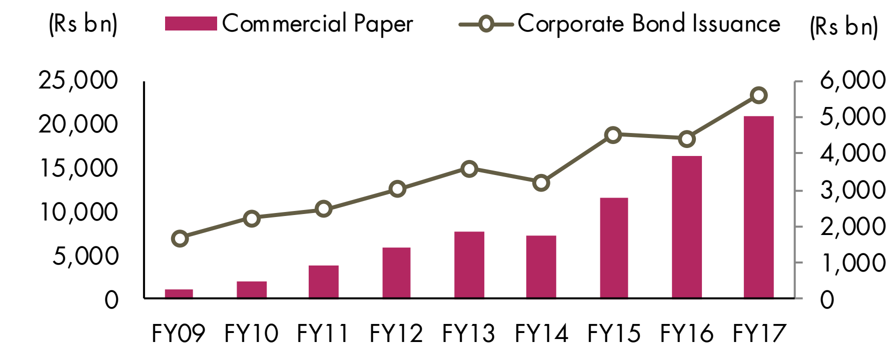
Tailwinds for deepening corporate bond market

Capital constraints for Indian banks amid higher CD issuances



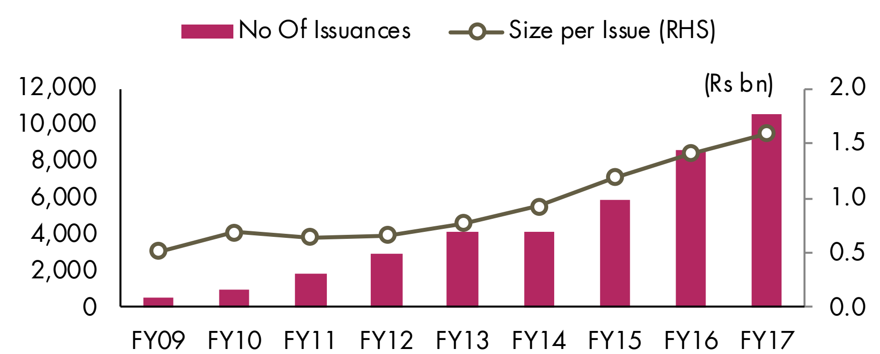
Source: Axis Capital

CP's and CD's increasing at a steady clip

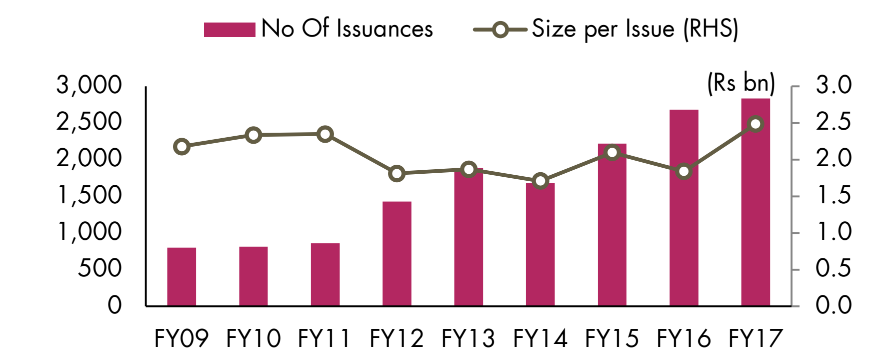


Source: Axis Capital

Growth rates of CP's and CD's aided by both volume of issuances and ticket size



Source: Axis Capital



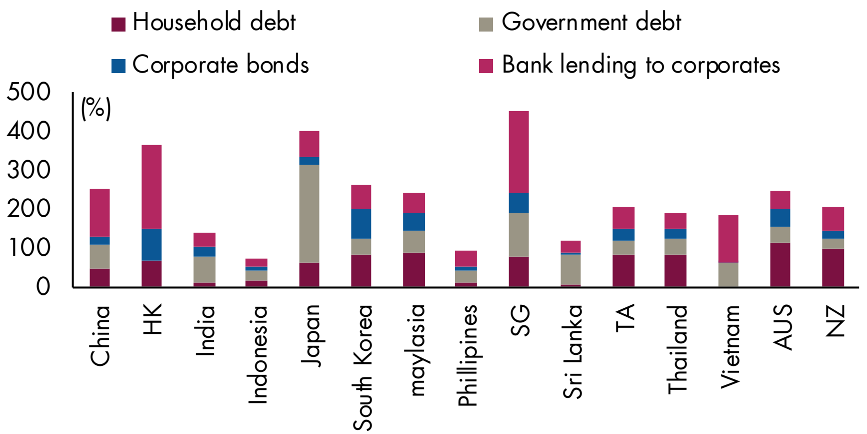
Source: Axis Capital

Capital crunch impacts credit off-take and CD issuances: Capital crunch faced by Indian banks primarily on account of NPA woes is restricting healthy growth in bank credit and CD issuances

Source: Axis Capital

Indian debt markets are under-penetrated

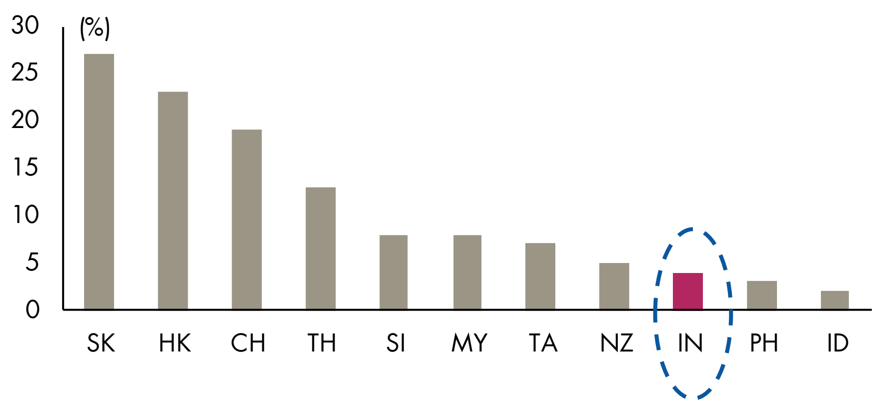
Debt as a share of GDP (%, 2016)



Source: Axis Capital

While Debt:GDP of India is strong at ~150%, the share of corporate debt is abysmally low at less than 20% of the total debt. This is not only vs. developed markets but also other BRICS countries like Brazil and China

Corporate bond change between 2008 and 2016 (ppt of GDP)



Source: Axis Capital

Most Asian countries have seen increasing proportion of corporate debt as % of GDP. However, the increase in India's context has been muted

Source: CEIC, National Authorities, ADB, Bloomberg, IMF

Challenges faced by Indian debt sector

- With respect to the development of its bond markets with regards to both the corporate and the G-secs ;India has been behind most other emerging economies . Traditionally, in India, the equity market has been more active, developed and at the centre of media and investor attention
- Historically, larger corporates have used bank finance, equity markets and external borrowings to finance their needs. Infrastructural improvements which facilitate the equity market have been conspicuously absent in debt market space
- **Development of the domestic corporate debt market in India is constrained by a number of factors. including**
  - SLR requirement of 23% requires them to put roughly a quarter of their deposits into government bonds, discouraging investments into other debt market instruments
  - High trading margin requirements
  - Trading is concentrated in a few securities, with the top five to ten traded issues accounting for bulk of total turnover
  - Illiquid securities
  - Highly-fragmented market as bulk of the debt raised is through private placements
  - SME's virtually not present in the debt market

Key positives coming through for the sector

Healthy long-term prospects for rating business in India: Despite near-term weakness, we remain positive on long-term outlook for rating agencies in the medium term due to the following reasons:

- **Dual rating of commercial paper:** RBI draft (Jan'17) on mandating dual ratings for CPs would improve the depth of the markets. With regards to the rating agencies the non BLR segment contributes ~50% of the revenue with CP contributing a meaningful chunk. We expect dual ratings would provide a fillip to the revenue growth trajectory

- **Disclosure of suspended ratings:** SEBI has asked CRAs not to suspend the rating of an instrument abruptly but continue with the rating process till the instrument's perpetuity *even if the issuer is non-cooperating*. "In case of non-cooperation by the issuer the credit rating agency shall continue to review the instrument on an ongoing basis throughout the instrument's lifetime, on the basis of best available information." Sebi said in a circular. Hence the rating of a particular instrument would be known (even if the issuer does not accept this

- **Improving penetration level:** Rating revenue in India is >1 bp of the entire credit market vs. 5-6 bps in the US (other developed countries demonstrate similar penetration levels). Improvement in penetration levels would be led by (1) increasing funding to mutual funds and other financial institutions, (II) reforms in debt markets and (III) key borrowers accessing bond markets for debt requirements

Other favorable regulatory steps taken to broaden the debt markets include

- Guidelines for large corporate borrowers

- Implementation of Bankruptcy code

- Guidelines issued for municipal and green bonds

Favorable regulatory steps to broaden bond markets

- **Draft framework for enhancing credit supply for large borrowers through market**
  - This RBI framework proposes higher risk weights and standard asset provisions for banking exposures to 'Specified large borrowers' beyond a defined limit
  - This can be a critical enabler to diversify bond market's issuer base
- **Basel III liquidity guidelines**
  - Corporate bonds and CPs can comprise up to 40% of High Quality Liquid Assets (HQLA), as against current level of ~10%. This should encourage banks to invest more in bonds and CPs
  - HQLA includes only non-financial sector corporate bonds, which should help in diversification
- **Guidelines issued for municipal and green bonds**
  - This should expand the issuer base
- **Partial credit enhancements by banks**
  - This should enable issuers and projects with moderate creditworthiness to access bond markets
- **Limiting un-hedged Foreign Currency (FC) exposures by corporates**
  - Higher capital requirements for banks towards any un-hedged FC exposures by borrowers
  - Increases the cost of ECBs and improves parity with rupee corporate bonds

Ongoing innovations can help develop bond markets

- **New structures can attract more issuers to the bond market**
  - Securitization of power transmission utility business (bond issue of East North Interconnection Co. Ltd. rated CRISIL AAA(so)/ Stable)
- **New vehicles can address structural constraints**
  - Government proposes to set up a bond guarantee fund to provide credit enhancements
  - TReDS, REITs, and InvITsare a step closer to reality
  - New Development Bank (BRICS Bank) can play a supportive role
  - 3 NBFC-IDFs have crossed combined asset size of Rs 5,000 crore by March 2016
- **New instruments can expand avenues for investors**
  - Hybrids for insurance sector (hybrid debt of ICICI Lombard General Insurance Co. Ltd. rated CRISIL AAA/Stable – the first in the insurance sector)
- **Global examples of innovative instruments should be evaluated**
  - Covered bonds, where a large global market exists, can be introduced in India (outstanding covered bonds stood at Euro 2.5 trillion at the end of 2014)
  - Project Bond Credit Enhancement (PBCE) by European Investment Bank (EIB)

New bankruptcy code can strengthen creditor rights…

Countries with strong bankruptcy resolution mechanism have better recoveries

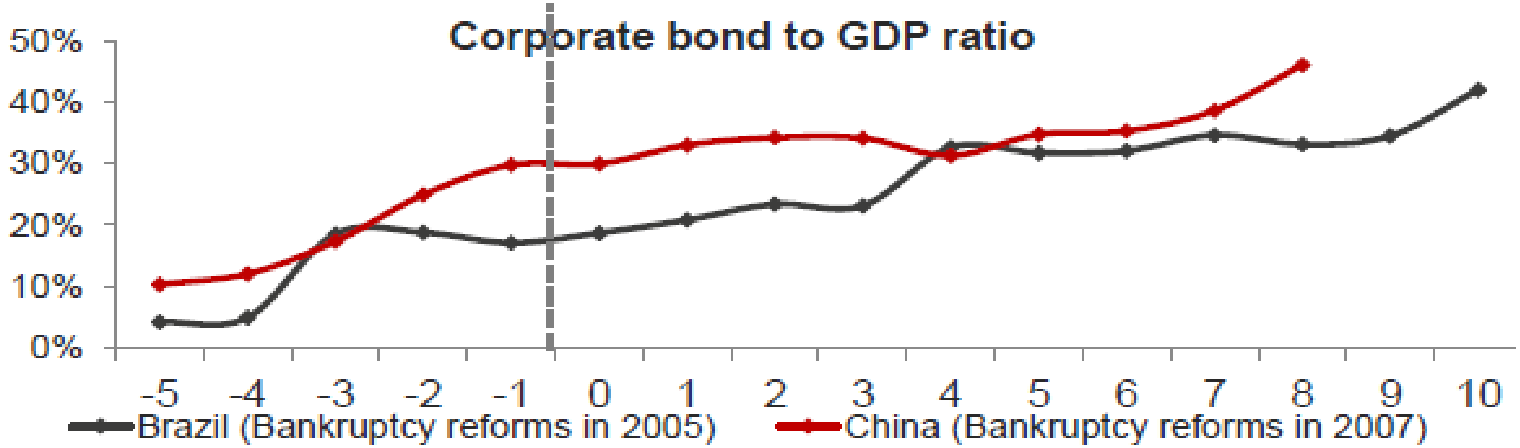
Country	Recovery rate (%)	Time (Years)	Distance to frontier *	Corporate bonds/ GDP ratio
Brazil	22.4	4	53	42%
Russia	41.7	2	58	20%
India	**25.7**	**4.3**	**33**	**17%**
China	36.2	1.7	55	46%
Japan	92.9	0.6	94	68%
UK	88.6	1	82	114%
US	80.4	1.5	90	115%

Source: World Bank's 'Doing business report'; BIS; SEBI; (*) Higher score on 'Distance to frontier' indicates stronger insolvency mechanisms

- Predictable recovery process enhances confidence of bond market investors
- Countries with better enforced creditor rights have larger domestic currency than foreign currency, bond markets: Burger & Warnock study, 2006, IMF

...and can lead to deepening of bond markets

Countries with strong bankruptcy resolution mechanism have better recoveries



Source: Crisil, Axis Capital

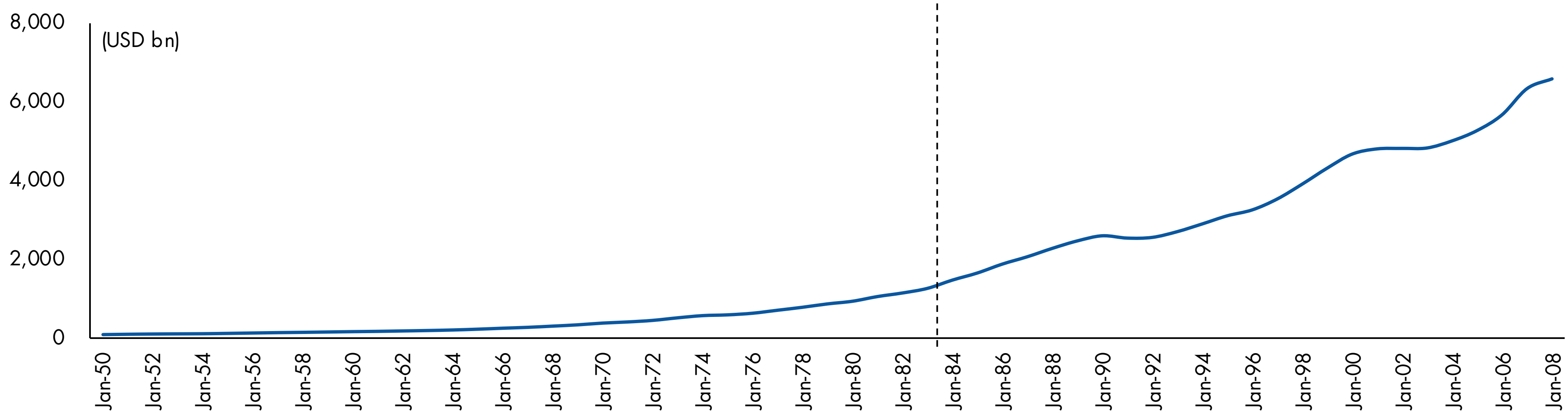
Corporate bond to GDP ratio nearly doubles 5 years after bankruptcy reforms

Country	Year of reforming the bankruptcy laws	5 year average (Pre-reforms)	5 year average (Post-reforms)
Brazil	2005	13%	26%
Russia	2009	8%	13%
India	**2016**	**18%**	**??**
China	2007	19%	33%
UK	2002	68%	107%

Source: Crisil, Axis Capital

Case study: US bond market

Rapid growth in US corporate debt issues in 1980s after decades of inactivity



Source: Bloomberg, Axis Capital

- As can be seen US corporate bond market did not grow for 25 years, after which it grew substantially
- Generally a reasonably well-developed government securities market precedes the development of the market for corporate debt securities
- So we believe, with the capital constraints faced by banks with Basel III implementation and government measures to deepen the bond penetration will lead to higher corporate bond market penetration over the longer term

Basel II and III framework led to higher credit penetration

- Bank Loan Rating (BLR) received a fillip after RBI mandated Basel II regulation for banks in 2007. The regulation mandated banks to adopt standardized approach by March, 2009
- Under BASEL II, rating assigned by external credit rating agencies acted as a measure of credit risk for banks and hence consumption of capital
- Our interactions with industry participants suggests that while credit rating is not mandatory for loans below Rs100 mn, banks have resorted to rating, as capital utilization is better for rated loans and in turn saves on risk-weighted assets especially for loans rated A and above

Capital Savings post implementation of BASEL II

	BASEL I		BASEL II		
Particulars	Risk weight	Capital required (%)	Risk weight	Capital required (%)	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	-
BB & below	100%	90	150%	135	-45
Unrated	100%	90	100%	90	-

Source: Axis Capital

BASEL II implementation led to higher credit penetration which benefited all the CRAs; CARE more so than others. BASEL III would be more onerous on capital requirement; hence, we believe that banks would be more cautious with respect to each incremental advance.

With recapitalization of PSU banks, guidelines for large corporate borrowers, and bankruptcy code being implemented, we believe, the change in borrowing mix favoring bond markets would accentuate. This would benefit rating agencies disproportionately

Disclaimer

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, author/s (Research Team) and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We (Research Analyst) also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associate does not have any material conflict of interest. I/we have not served as director / officer, etc. in the subject company.

Sr. No	Name	Designation	E-mail
1	Sunil Shah	Head of Research	sunil.shah@axissecurities.in
2	Pankaj Bobade	Research Analyst	pankaj.bobade@axissecurities.in
3	Suvarna Joshi	Research Analyst	suvarna.joshi@axissecurities.in
4	Siji Philip	Research Analyst	Siji.philip@@axissecurities.in
5	Hiren Trivedi	Research Associate	hiren.trivedi@axissecurities.in
6	Kiran Gawle	Associate	kiran.gawle@axissecurities.in
7	Rohit Chawla	Research Associate	rohit.chawla@axissecurities.in

5. ASL has not received any compensation from the subject company in the past twelve months. ASL has not been engaged in market making activity for the subject company.
6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:
   i. Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;
   ii. Managed or co-managed public offering of the securities from the subject company of this research report and / or;
   iii. Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report.

Term& Conditions:
This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

Disclaimer

DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advice necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document. The Research reports are also available & published on AxisDirect website.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Axis Securities Limited, SEBI Single Reg. No.- NSE, BSE & MSEI – INZ000161633, ARN No. 64610, CDSL-IN-DP-CDSL-693-2013, SEBI-Research Analyst Reg. No. INH 000000297, SEBI Portfolio Manager Reg. No.- INP000000654, Main/Dealing off.- Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 18002100808, Reg. off.- Axis House, 8th Floor, Wadia International Centre, Pandurang Budhkar Marg, Worli, Mumbai – 400 025.Compliance Officer: Anand Shaha, E-Mail ID: compliance.officer@axisdirect.in,Tel No: 022-42671582.