CREDIT ANALYSIS & RESEARCH Ltd (CARE) IPO note – "SUBSCRIBE" 6th Dec,2012

Issue at a Glance

Issue Summary	
Total Issue of Shares (Lk)	71.99
QIB Investors (Lk)	35.99
Non -Institutional Investors (Lk)	10.80
Retail Investors (Lk)	25.20
Issue opens on	7th Dec,2012
Issue closes on	11th Dec,2012
Price Band (Rs.)	700-750
Lot size (No. of shares) and multiple	20
Face Value (Rs)	10
Issue Size (Rs in Cr.)	503.98-539.98
Equity Shares outstanding prior to the Issue (Cr)	2.85
Equity Shares outstanding after the Issue (Cr)	2.85

Shareholding Pattern

	Pre-Issue (%)	Post- Issue (%)
Promoters/FII	100	74.78
Public	-	25.22
Total Share Capital	100	100

IPO RATINGS

CARE, being a credit rating agency, **is exempted** by SEBI from obtaining the IPO grading for its Initial Public Offer. None of the rating companies including CRISIL, FITCH or ICRA graded CARE IPO.

OBJECTS

To carry out sale of 7,199,700 equity shares by the selling shareholders and to achieve benefits of listing on stock exchanges.

CARE IPO HIGHLIGHTS

- Credit Analysis & Research Ltd (CARE) is the **second** largest full-service credit rating company in India was incorporated in year 1993.

- CARE offers rating and grading services across a **diverse range of instruments and industries** including IPO grading, equity grading, and grading of various types of enterprises, including shipyards, maritime training institutes, construction companies and rating of real estate projects, among others. They also provide general and customized industry research reports.

- CARE's **existing shareholders include domestic banks and financial institutions, such as IDBI Bank, Canara Bank, SBI and IL&FS etc**. Company's list of clients includes banks and other financial institutions, private sector companies, central public sector undertakings, sub-sovereign entities, small and medium enterprises and micro-finance institutions.

- They are **the leading credit rating agency** in India for IPO grading having graded **the largest number of IPO**s since the introduction of IPO grading in India. **CARE Ratings has completed over 19069 rating assignments having aggregate value of about Rs. 44051 bn (as of September 30, 2012), since its inception in April 1993.**

- CARE’s primary focus has been to provide credit rating services in India. Its list of clients includes banks and other financial institutions, private sector companies, central public sector undertakings, sub-sovereign entities, small and medium enterprises (“SMEs”) and micro-finance institutions, among others. They well equipped to rate most kinds of short, medium and long-term debt instruments, such as commercial paper, bonds, debentures, preference shares and structured debt instruments; bank loans and facilities, both fund-based and non fund-based; and deposit obligations, such as inter-corporate deposits, fixed deposits and certificates of deposit. It also provides issuer ratings and corporate governance ratings and has rated innovative debt instruments, such as perpetual bonds.

- It **is India's 1st rating agency to receive ISO 9001:2008 quality management certifications** for its head office in Mumbai and six branch offices for the credit rating of debt instruments and facilities, for research services at its head office in Mumbai and for data processing at the CARE Knowledge Centre in Ahmedabad

Investment Rationale

- **Established presence in rating debt instruments and bank loans and facilities**

CARE has 19 years of experience in rating debt instruments and related obligations covering a wide range of sectors, and as of September 30, 2012,and had rating relationships with 4,644 clients. The experience and knowledge that it has gained over the years, along with its planning and execution strategies, enable them to retain their current client base and explore new opportunities that emerge in the industry.

Its main rating product is rating of debt instruments and bank loans and facilities, which provides them with higher volumes than other products. It has a significant rating coverage of Indian banks and financial institutions.

The total number of debt instruments it has rated increased from 3,934 as of March 31, 2008 to 14,524 as of March 31, 2012, at a CAGR of 38.6% during such period. The total number of debt instruments it rated as of September 30, 2012 was 17,237. The volume of debt rated by them increased from Rs. 4,325.84 billion as of March 31, 2008 to Rs. 9,268.61 billion as of March 31, 2012, at a CAGR of 21.0% during such period. The volume of debt rated by them as of September 30, 2012 was Rs. 3,571.20 billion and facilities.

- **Domain experience across a range of sectors**

CARE rated debt instruments covering a diverse range of sectors, such as manufacturing, services, banks and infrastructure. It also has experience in providing debt and issuer ratings to many types of enterprises, including corporates, banks, financial institutions, public sector undertakings, state government undertakings, sub-sovereign entities, NBFCs, SMEs and micro-finance institutions

➢ Strong rating credibility and brand presence

CARE brand represents a high level of rating credibility, as their ratings display high ordinality. In order for ratings to be used as a reliable indicator of credit risk, CARE believes that it is critical for a rating agency to demonstrate, over a period of time, strong correlation between the actual performance of the rating it assigns and what the rating itself conveys. Since 2007, it has published default and transition studies evaluating the performance of their ratings, with its most recent default and transition study published in 2012 covering the nine year period from March 31, 2003 to March 31, 2012. The ratings assigned by CARE show that a higher category of rating demonstrates a relatively lower likelihood of default and a higher degree of stability

➢ Strong origination capabilities and relationship management

The Company has a strong and widespread business development team across multiple cities in India. CARE's list of clients includes banks and other financial institutions, private sector companies, central public sector undertakings, sub-sovereign entities, SMEs and micro-finance institutions, among others. It had ratings relationships with 4,644 clients as of September 30, 2012. Its origination capabilities are further supported by its business development teams, which collate the ideas and views of various market participants, regulators and policy makers and pass them on to the product development team for further study and implementation. It believes that it has a stable and esteemed core client base representing most of the major Indian industrial groups, banks and conglomerates. Further, CARE believes that its strong brand and 19 years of experience in the ratings business enables them not only to obtain repeat business from its existing clients, but to source new business as well.

➢ CARE has increased its international presence through joint venture with local credit rating agency

In last few years, the company has increased its international presence through joint venture with local credit rating agency. Currently CARE ratings offers rating services in Maldives. Now the company wants to increase its footprint in other countries including Nepal and Mauritius. CARE ratings has entered into a non binding memorandum of understanding with four credit rating agencies each located in Brazil, Portugal, Malaysia and South Africa. The company is exploring opportunities to provide risk management solution and training in risk management practices to banks and financial institutions in Nigeria. In November 2011, CARE ratings acquired a 75.1% equity interest in Kalypto, a firm providing risk management software solutions

- **Higher private sector debt demand & vibrant bond market driving rating business in long term:**

  The Planning commission has estimated Rs40 lacs crore infrastructures spending in 12th five year plan, out of that 50% would come from private sector. This will create huge demand for debt capital to support infrastructure funding which in turn require rating services. We believe CARE Rating business is well positioned to reaping benefits from long term business opportunity from bond market development and increasing private sector debt capital requirement in infrastructure sector.

SNAPSHOT OF CARE BUSINESS

Exhibit 1: Value of debt rated, average rating ticket size and Rating income

Volume of Debt (Rs in crs)	FY09	FY10	FY11	FY12	1HFY13
Bank Facilities (Basel II)	388948	354657	519862	678821	201198
Fixed Deposits	1000	3052	1242	0	0
Commercial Paper	90435	148983	88801	52522	9785
Debentures/ Bonds	110683	146008	196973	195518	146137
Others	0	0	0	0	0
Total	591066	652700	806878	926861	357120
No of assignments	793184	950743	1093894	1174901	513042
Ticket size (Rs in crs)	374	361	369	155	110
Rating income	93	136	165	188	90

Source: DRHP

Shareholding Position of Major Shareholders Pre & Post Share Issue

S No.	(as % of Equity outstanding)	Pre Offer	Post offer
1	IDBI Bank	25.8	17.2
2	Canara Bank	22.8	15.2
3	State Bank of India	9.6	6.4
4	IL&FS Financial Services	9.0	6.0
5	Federal Bank	6.2	4.2
6	Bajaj Holdings and Investment	6.0	6.0
7	Aditya Birla Private Equity	4.3	4.3
8	IL&FS Trust Company	4.0	3.8
9	ING Vysya Bank	2.2	2.0
10	Russell Investments	1.9	1.9
11	Tata Investment	1.4	1.1
12	Poonawalla Investment	1.4	1.4
13	Money Matters Financial Services	1.3	1.3
14	Kalimati Investment Company	1.2	1.2
15	Serum Institute of India	1.2	1.2
16	Others	1.7	27.0
		100.0	100.0

Source: Co

IDBI Bank, Canara Bank, SBI, IL&FS, Federal Bank, IL&FS Trust (Equity shares held on behalf of Milestone Fund), Milestone Trusteeship (Equity Shares held on behalf of Milestone Army Trust), ING Vysya and Tata Investment are the selling shareholders in the offer for sale.

Risks & Concerns

- CARE’s business and revenues are impacted by changes in the volume of debt instruments issued and bank loans and facilities provided in the Indian debt market. Any reduction in such volumes may adversely affect its business, results of operations and financial performance.

- If the current global economic downturn reduces the volume of debt instruments issued or bank loans and facilities provided in the Indian debt market, its business and results of operations could be adversely affected

- Any damage to the trust and confidence that CARE’s clients have in them which is largely dependent on its brand recognition and reputation, may adversely affect its business, financial performance and results of operations.

- Material changes in the regulations that govern company’s business could adversely affect their results of operations.

- Profit margins could be under stress as company may focus on volume business with low margins (SME rating, in which CARE plans to increase its focus, is a relatively low margin business.)

- CARE Ratings is primarily engaged in the rating business which is largely contributing to top line. The company plans to diversify geographies and product portfolio to de-risk earning and business. Failure in diversifying business may result into lower growth and margins in medium term

Financials...

Consolidated Summary Statement of CARE

	(Rs. in Mn)	
	FY2012	HI FY2013
Income		
Income from operations	1904.79	912.14
Other Income	283.16	127.60
TOTAL	**2187.95**	**1039.74**
Expenditure		
Employee cost	416.40	243.17
Administration & other exp	133.31	78.66
Depreciation	21.43	19.13
TOTAL EXPENDITURE	**571.14**	**340.96**
Profit before tax	**1616.81**	**698.78**
Current Tax	452.21	193.43
Deferred Tax (net)	6.69	8.51
Total Tax Exp	**458.90**	**201.94**
Minority Int	0.22	**(0.91)**
Adjusted Profit	**1157.69**	**497.75**

Consolidated Summary Statement of Balance Sheet CARE

Particulars (Rs. in Mn)	**FY2012**	**H1 FY2013**
A) Total Non Current Assets	1644.45	1738.72
B) Total Current Assets	2651.63	3205.68
C) Total Non Current Liabilities	57.78	80.16
D) Minority Interest	5.89	4.98
E) Current Liabilities	464.03	593.13
Net worth (A+B-C-D-E)	**3768.38**	**4266.13**
F) Share Capital	285.53	285.53
G) Reserve & Surplus	3482.85	3980.60
Net worth (F+G))	**3768.38**	**4266.13**

Peer Comparison

Sr. No.	Name of the company	Standalone/ Consolidated	Revenue (from operations and other income) (Rs. million)	Face value (Rs. per Share)	EPS (Rs.)	P/E Ratio	RoNW (%)	Book value per share (Rs.)
1.	Credit Analysis and Research Limited	Consolidated(1)	2,187.95	10.00	40.55	[•]	30.72%	131.98
Peers								
2.	CRISIL (2)	Consolidated	8,497.75	1.00	28.98	32.39(4)	49.9%	59.00
3.	ICRA (3)	Consolidated	2,287.91	10.00	54.01	25.09(4)	17.9%	301.61

(1) Based on restated audited consolidated financial statements for the year ended March 31, 2012
(2) Source: Annual report of CRISIL for the year ended December 31, 2011
(3) Source: Annual report of ICRA for the year ended March 31, 2012
(4) P/E ratio based on closing market price as on October 30, 2012, available on www.nseindia.com.

Strong Financials

CARE total income and profit after tax have also continued to grow. Its unconsolidated total income has increased from Rs. 549.11 million for the financial year 2008 to Rs. 2,171.93 million for the financial year 2012, at a CAGR of 41.0% during such period.

CARE's consolidated total income was Rs. 2,187.95 million and Rs. 1,039.74 million, respectively, for the financial year 2012 and the six months ended September 30, 2012.

Their unconsolidated profit after tax has increased from Rs. 266.85 million for the financial year 2008 to Rs. 1,157.02 million for the financial year 2012, at a CAGR of 44.3% during such period, and their consolidated profit after tax was Rs. 1,157.69 million and Rs. 497.75 million, respectively, for the financial year 2012 and the six months ended September 30, 2012.

For the financial years 2010, 2011 and 2012, their unconsolidated profit after tax margin was 56.4%, 51.1% and 53.3%, respectively; and for the financial year 2012 and the six months ended September 30, 2012, its consolidated profit after tax margin was 52.9% and 47.9%, respectively.

Their unconsolidated earnings (including other income) before interest, taxes, depreciation and amortization ("EBITDA") margin on unconsolidated total revenue was 81.3%, 76.4% and 75.3%, respectively, for the financial years 2010, 2011 and 2012;

The EBITDA margin on consolidated total revenue was 74.9% and 69.0%, respectively, for the financial year 2012 and the six months ended September 30, 2012. Their unconsolidated return on equity was 40.1%, 29.9% and 30.7%, respectively, for the financial years 2010, 2011 and 2012; and its consolidated return on equity was 30.7% and 11.7% (not annualized), respectively, for the financial year 2012 and the six months ended September 30, 2012.

CARE has maintained a highly liquid, strong net worth position, with no debt on a consolidated basis as of September 30, 2012. Their unconsolidated total net worth has steadily increased from Rs. 832.64 million as of March 31, 2008 to Rs. 3,767.70 million as of March 31, 2012.

CARE has paid dividends each year since its first full year of operations.

Key Future Growth Drivers

- Initiatives by the Government to develop corporate bond market like increasing the FII limit in corporate bonds, etc
- Greater market penetration by players such as insurance companies and pension funds,
- Sustenance of economic growth - leading to increase in overall resource mobilization in the economy,
- Expansion of bank credit,
- Continued implementation of Basel II norms,
- Mandatory grading of IPOs

Recommendations & Valuations...

- CARE is a debt free company.
- CARE has Treasury as on H1FY13 stood at Rs365 Cr, which is ~ Rs 128/share.
- The company has consistently maintained a dividend payout since inception
- Care Ratings has recently started operations in Nigeria, Maldives and South America has plans to expand footprints globally.
- CARE is the second largest rating agency in the country which has seen 40% growth in profits and revenue in the last few years. &it is the only domestic rating agency with no foreign holding. Meanwhile, rival rating agencies Crisil and ICRA are both listed and are under foreign firm's control.
- At the upper price band of Rs 750 and lower price band of Rs 700, the issue is attractively priced at ~18.5x and ~17.2x its FY12 EPS of Rs 40.6.
- The issue is priced at a discount to the company’s peer group and we believe the offer price is attractive considering the company’s better margin profile and robust business growth in comparison to the peer group.
- The company has a book Value of Rs 132and P/BV of 5.68x at upper end of the price band as of FY12

We Recommend Investors to “Subscribe” to the CARE IPO & “Long Term Investors” can invest and reap the benefits of Wealth Creation.

Disclaimer:

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions. This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients and Associates of arm research. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither arm research, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. 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. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without arm research's prior written consent.

Contact us at: pr@armresearch.in