# CREDIT ANALYSIS & RESEARCH LIMITED
# Q3 & 9M FY14 Earnings Conference Call
# January 20, 2014

**Moderator** Ladies and gentlemen, good day and welcome to the CARE Ratings Q3FY14 Earnings Conference Call. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode, there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference please signal an operator by pressing '*'and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vikram Rajput from CDR India. Thank you. And over to you sir.

**Vikram Rajput** Thank you. Good evening everybody and thank you for joining us on Credit Analysis & Research Limited's conference call. We are joined today by Mr. D.R. Dogra, Managing Director & CEO; Mr. Rajesh Mokashi, Deputy Managing Director and Other senior members of the management team

I trust you would have acquainted yourself with the highlights of the Company's Q3 & 9M FY14 results as shared in the presentation.

Before we get started, I would like to point out that certain statements made or discussed on the conference call today may be forward-looking in nature and must be viewed in conjunction with the risks and uncertainties we face. The Company does not undertake to update them. A statement in this regard is available for reference in the presentation.

We propose to begin the call with opening remarks from Mr. Dogra who will take you through the strategic imperatives and performance of the Company during the review period. We will then have the forum open for an interactive question and answer session.

Now, I would like to invite Mr. Dogra to share his views.

**D.R. Dogra** Thank you, Vikram. Good evening, everyone and welcome to CARE's Q3 and 9M FY14 Earnings Conference Call. I am happy to state that we have achieved notable growth in our nine months performance where our financial and operational parameters continue to remain fairly strong.

Coming to the operational highlights, for the period under review, it has been an eventful year for the Company where we are moving with an unfaltering pace towards the path of long-term success. The focal point remains in building an ever-growing brand equity and strengthened financial structure.

Overall, the consistent top line growth along with the strong focus on cost efficiency resulted in expansion of operating income and earnings per share. Our sheer determination in building a trusted brand with a strong business development team and robust and efficient quality of ratings has made it possible to post healthy results in an otherwise challenging period for the economy.

We continue to work through the prevalent economic challenges where the companies in manufacturing and infrastructure space have slowed down new investment decisions which can result in reduced scope of services with us. Underpinning our strategy to enable growth is the consistent investment in maintaining confidence in our risk opinions, creating a cost efficient scalable operating model and proactive business development initiatives. If you look at the number of assignments and clients coming to CARE Ratings there has been a considerable step up in recent years. These new relationships once establish are very sticky which enlarges the foundation on which further business is constructed. We are focused on increasing value by consistently engaging with clients and updating our opinions based on the changing market conditions. Our deep association and meticulous examination of every assignment has enabled us to deliver value, not only to the clients but also to other market participants.

Our SME silo continues to grow steadily. We are nurturing this business and putting more feet on the street right near the SME cluster to widen the parameter of SME fold. There is slow but definite shift with clients realizing the benefits from CARE rating which helps them source capital at the competitive rates. We are building both the model and the reputed infrastructure to handle these volumes keeping in mind our profitability and return profile. Also, as the ratings become more embedded in the market infrastructure in India we would have increasing value add opportunities that we would be in a position to leverage.

I would also like to call attention to our Research Vertical. CARE Ratings is gaining increased recognition for being knowledge-based company and has continued to work towards deepening the base. Research vertical increases our brand visibility and positioning in the marketplace. You may have noticed the progressive coverage of these research views in the media.

We have been alluding to our international initiatives and I am happy to report the implementation of our programme is on track. CARE Ratings has already made global forays by having its operations in the Republic of Maldives. CARE has also entered into arrangements with other organizations in countries like Mauritius, Nigeria and Ecuador for provision of technical expertise, risk management solutions as well as expanding rating activity in new territories. A significant development recently was the launch of ARC Ratings. CARE has along with four partners from Malaysia, Brazil, Portugal and South Africa, launched an international credit rating agency named ARC Ratings, SA, in London on January 16, 2014. This is a significant milestone towards growing our business and brand footprint in the global arena. ARC aims to rebuild trust and enhance reliability and transparency in the international credit rating industry. ARC offers a more comprehensive and pragmatic view on credit risk; and is registered with ESMA (European Securities and Markets Authority), thus adhering with stringent regulation standards.

That said, let me now shift to our financial performance for the quarter ended and nine months ended December 31, 2013, narrating some of the critical highlights.

Firstly, looking at nine months, our results are strong; once again effectively balancing growth and profitability. Year-to-date results are a better reflection of steady state operational performance of our business. Our financial growth for the nine-month period has been notable with 16.4% increase in total income to Rs.181.6 crore, EBITDA of nine months FY14 increased by 11.3% to Rs.123.2 crore; PAT for the period grew by 12.4% to Rs.87.4 crore in 9M FY14. Diluted EPS in 9M FY14 grew 11.8% to Rs.30.43.

Expenses for 9M FY14 over 9M FY13 has been higher resulting from employee additions, increased provisions for variable pay for employees and commencement of new offices at four locations. Higher growth in expenditure as a percentage of total income in 9M FY14 impacted EBITDA margins. While there is minimal blip on the margin front, our operating metrics continues to be market-leading, with 9M FY14 EBITDA margins at 68%. We remain focused on operating profitability and continue to maintain strong discipline and governance around capital allocation and expenditure. Our cost-efficient business model supported by CARE Knowledge Center and Ci3 ensures operations run in an technology driven manner enabling optimal productivity.

To list down Q3 FY14 financial highlights, our total income grew by 13.3% to Rs.60.6 crore compared with Rs.53.5 crore in the previous year quarter. Rating income showed YoY improvement of 17% in Q3 FY14 enabled by ongoing surveillance operating and acquisition of fresh rating assignments. Performance also benefited from strong momentum in volumes in both bank facilities and debt segments. A number of bank facilities rated expanded from 1,348 in Q3 FY14 from 1,263 in Q3 FY13 while the number of debt instrument in Q3 FY14 was 70 against 66 in Q3 FY13. Volumes have grown despite slowdown in debt market, mainly due to the concerted business development team efforts to capture fresh business.

EBITDA for the quarter stood at Rs.39 crore, EBITDA margins at 65% in Q3 FY14, our PAT for Q3 FY14 was stable at Rs.28 crore, diluted EPS in Q3 FY14 amounted to Rs.9.66.

Our balance sheet remains very strong. As on December 31, 2013, we had a net worth position of Rs. 495.6 crore as against Rs. 467.9 crore as on September 30, 2013. As on December 31, 2013 we had a cash or cash equivalent of Rs.441 crore.

We are cognizant of the high cash figure in our books. As mentioned earlier, we plan to invest in growth when we identify the right opportunity at the right price. Given the continuous generation of healthy free cash flows, this would be the fifth consecutive quarter where the Board has declared an interim dividend. Distributing value to our shareholders is part of our corporate philosophy. The Rs. 6 per share dividend declared in Q3 FY14 adds to a total dividend of Rs. 18 per share for 9M FY14, amounting to a strong payout ratio of 69.5%.

In the coming quarters, we expect possible subdued macros impacting industrial activity and the credit rating sector resultantly. However, on a long-term basis structural drivers for our business remain intact. We continue to be comfortable about the future as we have built foundation for a strong and lasting company that brings a distinctive approach to the credit rating sector. We are well poised to navigate through the economic headwinds and capitalize on the anticipated tailwinds.

As I have said on earlier calls, the foundation of our model rests on highly objective opinions, growing brand equity, best-in-class operating model, strong financial profile and human capital. As we move forward, we are confident that successful execution in our strategic imperatives will continue to promote operating efficiency; sustainable growth in revenue, free cash flow and earnings; and drive return of capital to shareholders.

With that I conclude my remarks. We would now be very happy to give you our perspective on specific questions you have. I would request the operator on this call to open for questions and answers. Thank you.

**Moderator** Thank you very much sir. We will now begin the question-and-answer session. The first question is from the line of Praveen Sahay from B&K Securities. Please go ahead.

**Praveen Sahay** We are seeing an improvement in upgrade numbers w.r.t default rates from some of the sectors. Is this somewhere benefiting the rating companies as well, have they started paying the rating company, somewhere are we seeing it?

**D.R. Dogra** Incidentally, we are about to release a research on this, on Cumulative Default Rate (CDR) numbers. Let me tell you that mid-year numbers are not a correct reflection of real CDR, because it depends on which companies you have covered under review and which are not covered so far. But we are certainly going to give our views and in fact, our research agrees with what you are saying, that there has been some improvement in the modified credit ratio during the nine months period ended December ’13 as compared to December ’12. More or less we are also very happy to see modified credit ratio overall, almost equal to nine months ended December ’11, because we went back and tried to test our figures with numbers in ’12 and ’11, and we found that whatever we had in ’11 that was in ’13 and ’12 was a much worse number then in ‘11 and ‘13. So that shows that credit profile is up now.

Certainly, I fully agree with you that if credit profiles go up, it helps the rating industry, many people start thinking of expanding. Hopefully, the interest rates go down because inflation numbers are down, that is an early signal, I am not jumping to that but I think inflation keeps on coming down. There are chances that interest rates will start falling and investment will start happening. Also, on the government front, the Cabinet Committee of Investments have taken some decisions to accelerate some of the large projects of Rs.1,000 crore and above. I think they already announced more than Rs.300,000 crore worth of projects that have been cleared by the Cabinet Committee on Investments. I think some activity would start in those projects. I think that will also enable some light for the rating industry. So all in all, I think there is a positive sign for the industry but I think we will have to watch the situation quite cautiously and carefully.

**Praveen Sahay** Second question is like in one of the slides you have mentioned the issuers are liable to pay Rating Fee regardless of whether they accept the CARE ratings or not. Is this for all kind of a rating?

**D.R. Dogra** Yes, yes, this is a general practice in the rating industry. Initial Rating fees are collected in advance before the process starts. But there is a problem as far as Surveillance goes, because we cannot insist on a client whose rating has been reviewed to pay the fees before we start doing the review. Because once the rating is accepted it is continuously under review. We do not wait for fees to be paid before we downgrade/upgrade.

**Praveen Sahay** Is there any recovery mechanism, like any recovery rate or something regarding the Surveillance?

**D.R. Dogra** If you look back at our annual reports, we presented the figure that is written off. You will find that in last 20 years it is a very marginal figure which we have written off.

**Praveen Sahay** And one more thing, looking at your Bank Loan rating numbers and the size, it seems your ticket size has increased for the BLR, is this correct what I am calculating…?

**D.R. Dogra** There is not a direct correlation between the size I rate and money I generate. Most of the big ticket enhancements are in respect to some of the clients who are already fixed on annual fee cap. Suppose, Company A is having Rs.10,000 crore enhancement and I have a cap of Rs. X, it does not give me anything because I am capped up to 31st March of 2014. So I do not get anything there. You cannot directly relate it. Most of the new assignments which we get are of lower size. So, that is the reason why my margins have come down little bit.

**Praveen Sahay** Last question was on employee expenses. This time also we are seeing that on the higher side, like in the last quarter you had told like there is some adjustment for the first quarter, that is why our number is Rs.11.7 crore. So this time again it is an increase. Is there a number of employees increased or some bonus …?

**D.R. Dogra** In Q1 we made some provisions which in Q2 we felt that these provisions are enough to take care of Q2 also, so we did not provide for additional such provisions in Q2. But, the provisions made in Q1 was enough only for Q1 and Q2, you need to provide for Q3. That is what we have done again. In fact, if you have to look at my employee cost numbers, you should look at my nine month numbers which shows around Rs.14 crore per quarter because we have done Rs.42 crore expense on staff matters in nine months which comes to around Rs.14 crore which is my basic number. But, let me tell you this Q3 we had little more spend, we are now not a small company, we are a company of over 600 employees. You have to have great strong middle level people. Though the number of people have not increased during this quarter but we have some additions and deletions; additions at a higher cost and deletions for a lower cost.

**Praveen Sahay** Currently, what is the strength?

**D.R. Dogra** This world is very volatile, so I cannot tell you what figure we have currently, but we were 611 on 31st December 2013.

**Moderator** Thank you. The next question is from the line of Chellappa Sivaguru from Pari Washington Company Advisory Pvt. Ltd. Please go ahead.

**Chellappa S** Just wanted to know if you could give me some idea of how CARE Kalypto is doing?

**D.R. Dogra** Whatever you are expecting it has done better than that, we are on a positive path there. In fact, we have taken another step there, we have housed an Advisory Division in that company. Hopefully, you will have some more news in the time to come though there is some gestation period. I think our advisory teams are doing a lot of work and in fact, IT Services division has also done better than was done last year. We are not reporting consolidated numbers, but they have done better than what they have been doing earlier.

**Chellappa S** ARC rating which launched in London, initially I think it will take some time for them to get new business. So what will be the overheads on an annual basis for this?

**D.R. Dogra** As a shareholder though my prime income would be dividend from that but I would not wait for that. The real focus of a company to be promoted by emerging market credit rating agencies is that we believe in the emerging market story so we also believe in hypothesis that most of the issuances in future will happen through the corporates in the emerging world. We will have to tap these clients. And if they happen to be in India, we will happen to be the referral agent for them, and we have referral fees for that. And we are looking at that as one of I can't say sizable but as a reasonable source of revenue for us.

**Moderator** Thank you. The next question is from the line of Jai Mundhra from Bank of America. Please go ahead.

**Jai Mundhra** A couple of questions; first is a follow up, you said there were some provisions in employee cost, I just wanted to know what was the nature of these provisions, are they related to bonus?

**D.R. Dogra** CTC composes of fixed pay and variable pay, fixed pay is paid on a monthly basis. Variable pay for the marketing staff is paid quarterly. Business Development staff is paid on quarterly basis because they have little higher variable pay component, whereas the other than the business development guys are paid only once a year. And that payment mostly we try to hurry it up but it happens only after the audited results are adopted by the Board, and that takes some time. So if you are not able to adopt your audited results by 30th of June, you have to provide increment numbers in Q1. So that is why you make a hunt somewhere in the month of May-June, have a figure and then ultimately decide in July or August that you will not pay this much, you will pay that much. That was the problem this time.

And there were some increments also. This year we had a HR consultant's report and we were to implement recommendations from that report. Though the report had come to us much before, we wanted to implement that only after our results were adopted and we had a clear view of who is to be given what variable pay for last year. Also there was another head where we call it 'Annual Increments' and readjustment of some salary structure for some key people in the Company. That was one big reason why there was a big change between Q1 and Q2 on those numbers. Salaries are payable on monthly basis, there cannot be any change. But these issues like variable pay, increment and all that, or if you recruit some people, some disruption happens.

**Jai Mundhra** And then if I look at the value of debt rated or the volume of debt rated that we have done for this quarter in bank facilities, which is somewhere around 1.7 trillion its around tripled if I look at YoY, just wanted to know if there is some lumpy fee or volume that has been rated this quarter or was the last year last quarter was exceptionally low, how to read this kind of growth?

**D.R. Dogra** As I replied to Praveen earlier, I do not think you should read much in these numbers. Because what happens that most of the bigger issuers of debt are my clients which are on cap. If they raise Rs.10,000 crore or Rs.20,000 crore, I do not earn anything because I already have an arrangement with him for one full year.

**Jai Mundhra** Not from the fee point of view, sir, just the volume or the value of the debt that has been rated, was last quarter wherein you rated some 500 billion of debt which has increased to 1.7 trillion of debt this quarter. So is this kind of the growth only in the value terms not in fees terms, is it more abnormal or how is it like?

**D.R. Dogra** I do not think there was any big issuer this time or such big issue didn't come last time.

**Jai Mundhra** And some one or two data points. What was the employee strength in second quarter and last year December quarter?

**D.R. Dogra** As on 30th September, we were 630 and on 31st December we were 611. But don't jump to any conclusions on our staff expenses. If people join us on 29th September, then they will be part of our count, but will not cost anything in the quarter. So you cannot jump to any conclusion that 630 were paid less than what 611 were paid.

**Jai Mundhra** Do you have a number for the December quarter last year?

**D.R. Dogra** We were 546.

**Jai Mundhra** You said there is some improvement in the modified CDR ratio. Can you quantify that number?

**D.R. Dogra** We announced that, 1.04 now, for every one downgrade plus retention there is 1.04 upgrade plus retention.

**Jai Mundhra** Can you just tell me what was this number last quarter, should be lower than this, right?

**D.R. Dogra** No, Q2 was 1.05, almost same, Q1 was 0.88, which was very bad.

**Moderator** Thank you. The next question is from the line of Pradeep Agarwal from Emkay Global. Please go ahead.

**Pradeep Agarwal** My question pertains to the employee cost. On a nine months basis, the employee cost has increased by 20%. So, looking at the trend, should we assume that this kind of growth will continue even in FY15?

**D.R. Dogra** Our number of staff has grown more than 20%; 546 became 611. I have to give some increments also. And especially, one thing which cannot be factored by these number of staff, if suppose people at lower level leave you and if you take people at a middle level. I do not think we have a very top, heavy induction, but certainly, the Company is growing bigger and bigger, you need a lot of group heads and all that, which are middle level people and you cannot buy them at Rs.10 lakhs or Rs.8 lakhs you have to pay right price. So that is also one of the reasons. FY14 we will have around Rs.14 crore per quarter, that is the run rate now.

**Pradeep Agarwal** The employee cost ratio is about 27% on the operating revenue line item which was an increase of 1.5% over last year. So, what will be the sustainable kind of ratio in terms of employee cost?

**D.R. Dogra** While we are much below the market but we take the same people which go to my competitors. The audience is same. So I cannot be very different but certainly our efficiencies are much better than the system. We like to keep this as low as possible.

**Pradeep Agarwal** My worry is whether this ratio will see any significant hike?

**D.R. Dogra** No, no, we do not expect that. It has not happened and we will not allow this to happen. But our margins have come down to around 68% in operating margin. PBIT margin if you see we are at around 68% down from around 70%. Maybe 68% goes to 67%, that is what we believe.

**Rajesh Mokashi** One more thing, it is also a function of your revenue. Suppose the revenues improve, realizations improve because if the market picks up in the fourth quarter, then again there is correction taking place because then it can overcome the increase in cost. Economy is to eventually pick up if not this year, next year, and things like that.

**Pradeep Agarwal** My second question pertains to this revenue growth which we had of about 18%. Is there any price element in this? Because there has been minimum fee cap which has been put up in others. So has that led to any increase in terms of revenue?

**D.R. Dogra** I wish there is something. My number of ratings have grown year-over-year by 14%. Rating fees have also grown by around 12.9% for nine months. I will take nine months figure as it is most representative than this 18% growth in the quarter because a quarter could be lumpy if you do a lot of Surveillance in one quarter, a quarter looks like a very good quarter. But in a real sense it is not a good quarter because what you are supposed to do in next quarter or earlier quarter you have done in that quarter. So you have to appraise me on nine months basis and nine months my top line grew by 13% and number of ratings grew by 14%. But yes, what has really happened is a good thing because now there is some cap, below which no company can go.

**Pradeep Agarwal** Will there be any ballpark number which says that what is the volume growth and what is the pricing growth if you can bifurcate that, will that be possible?

**D.R. Dogra** No, in our business it is impossible to do, because most of our big assignments which generate a lot of money are capped and their Surveillance income, fresh fees, capital market instruments, everything is all clubbed together under one piece. So even to the Board we are not able to tell how much is Surveillance, it's really difficult. For us there is only one income that is Rating fees.

**Pradeep Agarwal** Though you have mentioned earlier also that it is difficult to bifurcate Surveillance and Initial Rating fee, but just to give a sense, this growth of 18% this quarter is largely driven by Surveillance or Initial Rating Ffee this quarter or that ratio has changed dramatically over previous quarter which was 50:50?

**D.R. Dogra** I think that we have started getting a lot of new issuances so far. From capital market instruments which we rated we have rated 69-70 NCDs this time, so I do not think there is big change in this number. More or less it would be same.

**Moderator** Thank you. The next question is from the line of Rohit Shimpi from SBI Mutual Fund. Please go ahead.

**Rohit Shimpi** If I look at your number of assignments in Slide #10 of Presentation, just to understand is the total number of say 5,444 which is there for nine months FY14, that number would be including the Surveillance, how does that work?

**D.R. Dogra** No, no, we do not include Surveillance there. These are fresh ratings; these are the numbers pertaining to initial rating assignments. If I do a Bank Loan rating, if I do a CP rating, if I do a NCD rating, for a same company I will count that rating thrice.

**Moderator** Thank you. The next question is from the line of Mangesh Kulkarni from Almondz Global Securities. Please go ahead.

**Mangesh Kulkarni** My question is relating to our employee addition plans for the remaining part of the quarter as well as for the FY15. Is there any rethink on the employee addition because of the slow-down witnessed in the economy?

**D.R. Dogra** I wish the slowdown is a past thing. We are all hoping that second half year of this calendar year would be better half year for us. If we expect our revenues to grow between 15-20%, certainly, we will have to match this with proper staff, and I think our staff should also grow by if not 15-20%, by 10-15%.

**Mangesh Kulkarni** My second question is the last year December we came out with IPO and the Investor lock-in is now over. In your slide also, you have mentioned about you are looking for organic as well as inorganic growth opportunities. So, are there any plans for inducting a strategic investor in the Company through sale of the existing investors?

**D.R. Dogra** Management will have a very low take on this. It is between the buyer and the seller, and company is nowhere in between. With shareholders, we are certainly in discussion, I am not saying that we do not talk at all on this, but that is if they seek our advice. It is not certain that all my shareholders would sell. They are eligible to sell now. If required they may sell a part of it that. If there is no need, this kind of investment any person would like to keep. For example, if I have the share, I will keep it for my kids. I hope this kind of premise is also with my institutional shareholders.

**Mangesh Kulkarni** But you mentioned that some kind of investors are in touch with you. Can you just tell me whether it will be from the rating agency or it will be from the other field?

**Rajesh Mokashi** Actually, these are all kind of hypothetical questions because various options remain with the Company at any point of time. It is only now that from roughly December onwards that the remaining shareholders shares are now free to trade. So the Company obviously receives enquiries from many investors who earlier inhibited from investing because the liquidity of free float was much smaller, now the float is much larger. We now believe that these kinds of shares are within their kind of approved, internal limits and things like that. So there are various kind of investors who in a routine manner keep on talking to us, wanting to know more about the Company. As an investor relation service we have a duty to kind of explain to them. So there are various kind of people who are coming in and wanting to talk to us. The options for strategic or other options, these are always open. It is a matter of as to when certain things happen, but these options are always open to the Company as such.

**Moderator** Thank you. The next question is from the line of Sapna Laha from Bajaj Finserv. Please go ahead.

**Sapna Laha** I just want to know about ARC Rating. How you will recognize the income in your P&L account?

**D.R. Dogra** There will be one or two types of incomes from that business. One, which will come eventually. I do not know when, since we own 20% of that company, 20% of the dividend will come to us. That will come only when that company starts making profit and starts distributing profit to shareholders. But immediate revenue which we see is that if we are able to convince some of the corporates in India accessing the international market to go to ARC, then we get referral fees, and we will recognize 100% referral fees which we get from them.

**Sapna Laha** What will be the percentage of that?

**D.R. Dogra** We will not be able to tell you that, we are not sharing that information yet.

**Moderator** Thank you. The next question is from the line of Arun Kejriwal from Kejriwal Research. Please go ahead.

**Arun Kejriwal** After this rating has become mandatory for SME, what is the change in the environment that we are seeing, what kind of revenues are coming from say per user, and how can this pan out in the future with SME being a focus in the country as well?

**D.R. Dogra** 100% right, it is a big universe. If we go into any literature on SME the most conservative estimate says that there are 29 million functional SME units in India and I do not think even 100,000 of them have been rated. We are not a rating agency which was in SME earlier; we have just entered in the last two years. We have the infrastructure in place to do all this work now. We have created our own logistics. We do not depend on franchisees to do this kind of business.

You opened your question by saying this is compulsory, I wish it is compulsory, so far it is not compulsory. But I am fully with you that it is a very great service for the SME community as well as lenders. Instead of lenders going out and looking at 100s of SMEs and then financing two or three of them, instead if we go to the market and rate suppose 100 SMEs and find 10 of them are investment grade then at least banks can spend their time only on 10, not on 100. We could be a gatekeeper for banks. I think that is a service for banks to use and I think they have started using this service.

**Arun Kejriwal** I agree that it has not yet been mandatory, but the better lenders are now insisting on a credit rating. And indirect sort of compulsion that if it is not rated you pay higher rate of interest and you are subject to more checks and balances which get reduced in case you are rated?

**D.R. Dogra** Yes, you are 100% right, in fact, we have MoUs signed with some banks where if you are rated 1, 2 and 3, you will get 25 basis points reduction in rate of interest which is a very good both for the bank as well as for the SME. If you look at any SME study report, the foremost reason for failure of SMEs in India is inadequate capital, funding at right time at the right price. If we are able to provide capital to these SMEs at a right price I think unemployment problem will get solved. Some of the countries like Germany, the SME contributes around 40% of the GDP whereas in India we are nowhere; we are at 8-9% number, which is a very bad number. I think we need to look at this, which can really do much better for the Indian economy.

**Arun Kejriwal** Sir, going a little bit forward, speculating or star gazing, two years down the line, can we say that a big market would be the SME rating?

**D.R. Dogra** Yes, in the industry there are one or two players who are quite strong on SME. We are number one in many areas where we operate and there is no reason why you should not turn out to become number one or number two in SMEs. So that is the reason why we have created our own infrastructure in place to cater to this kind of market which is a very big market as compared to LME.

**Moderator** Thank you. The next question is from the line of Narayanan Ravindranathan from Cholamandalam Securities. Please go ahead.

**N Ravindranathan** Last quarter you were talking about some of the state government business. Wanted to know what is the size of this business for your top line and what will be your market share in the state government segment?

**D.R. Dogra** I will ask Madan who heads this business to speak on this.

**Madan Sabnavis** As of now, we rate 9 state governments and we would tend to be the market leader if you look at a total number of states which are rated and how many states have been rated by different rating agency, we would be having a size of 9 states.

**N Ravindranathan** But in terms of contribution to your revenues how much that be in terms of percentage?

**Madan Sabnavis** I do not think that would be very significant, if they are just talking of around maybe 12-13 entities within these nine states which are being rated.

**D.R. Dogra** Actually, the state does not mandate us to do a rating, corporations get a guarantee from state government and these companies like Irrigation Corporation of Maharashtra, State Electricity Board in some of the states approach us for a rating which the state government guarantee, where we have to look at the credit profile of the state government. As Madan said, as of now there are 11 states in India which are rated. We had rating in all the 11 states, but 9 are outstanding ratings as of now, because if a PSU pays the money back, then we do not keep the state rating under review because there is nothing outstanding. State PSUs are in bad shape, they are not able to raise money and those who are good they do not need ratings. By number wise we are the market leader but by share of revenues it is not significant share of revenues.

**Madan Sabnavis** In this financial year we have gotten a new mandate from Ministry of Urban Development to rate municipal corporations. But this is a part of the JnNURM rating which was done in 2008-2009, subsequently it was disbanded. Now, it is a one year extra surveillance the rating agencies have been given. But then this is going to be a one-time affair.

**N Ravindranathan** Will there be for the substantial size for your revenues?

**Madan Sabnavis** It would not be very substantial compared to overall ratings but yes, there would be some revenue coming from this.

**Rajesh Mokashi** Worldwide if you see public finance is a very important activity in terms of capital markets and our belief is that as the capital markets in India develop, as money scarcity sort of hits the public finance raising, obviously, these options become more important. More and more such corporations will be encouraged by the governments to directly raise money because the governments themselves will have scarcity of capital. If you draw an analogy with the America, other developed markets, yes there is plenty of scope for developing this line of activity.

**N Ravindranathan** But it is as of now it is still small?

**Rajesh Mokashi** As of now it is still small, but like Madan mentioned the JNNURM project, the intention behind the JNNURM project is to encourage these municipal corporations to taste the process of actually getting a rating exercise, know where they stand, see how they can improve and things like that. Eventually make them stand on your own feet. That is the kind of whole approach.

**Moderator** Thank you. The next question is from the line of Shraddha Sheth from Edelweiss. Please go ahead.

**Shraddha Sheth** Just wanted to understand our market share trajectory in the last 2-3 years. Clearly, we are outperforming the industry. So if you can just give us the trajectory how it is?

**D.R. Dogra** We do not track the industry, but certainly we track CARE, and you guys are best one to do this. You know that industry has been growing at around 10% and we have always done better than the industry. Industry used to grow at around 20% and in FY12 when we came with our equity issue we have reported in DRHP itself that we grew 40% compounded for the last 5 years. Industry has grown at 20-25%. We have been beating the industry rates for quite some time. I think that should speak. We used to be #3 rating for quite long time. We are now clear #2 rating. Market is also increasing and we are also taking away some share from the industry.

**Shraddha Sheth** Sir, particularly in these nine months, it looks more pronounced that we have been gaining even further as compared to the historic, so is it a fair conclusion?

**D.R. Dogra** I am not very much with you on this, I think I am also flowing with the wind now, there is hardly anything coming in.

**Shraddha Sheth** Because if we look at the number of the market leader, it has been a very …

**D.R. Dogra** I would not like to speculate.

**Shraddha Sheth** You would say, you are in line with the industry, is what you would say, right?

**D.R. Dogra** Yes.

**Shraddha Sheth** Just wanted to understand our cash deployment strategy. What are the areas we are looking at, and what are our internal parameters which should be met before we close down an acquisition?

**Rajesh Mokashi** I think we have always said this in the past that we need to understand that CARE is in the core analytics business and we would like to, if at all, look at such options of inorganic growth, stick to that core competency and look at opportunities in these kinds of areas. Growth has to be in such a manner that we overall grow into the analytics piece, like for example, we are right now dealing with domestic customers, do we have international customers? If you look at ARC that is the way of reaching out to them from the rating space. But there could be many other analytical opportunities which would come in, if we relate to the core competency. So that is a philosophy that we keep in mind when we look at international opportunities or growth opportunities. But we need to be careful because we need to look at the viability, the profitability, its impact on the aggregate numbers of CARE and things like that. So all these parameters are kept in mind when we sort of look at opportunities for growth.

**Shraddha Sheth** So, certain internal IRR returns that we are …?

**Rajesh Mokashi** Any business has to be, for example, EPS accretive, IRR is not necessarily the only way of looking at certain things because our presence can actually make the business grow much faster. So IRR is also there definitely but ultimately the profitability and other strategic parameters also need to be looked at.

**Shraddha Sheth** Wanted to understand our payout because we are the most cash rich company in the entire industry. So I understand that 65% is a very good payout, but definitely we can go even in line with FMCG companies. Can it be even better than that?

**D.R. Dogra** As you know, this is a decision which the board and shareholder have to take. I wish management has the final say into this, but as a professional management, a company which is sitting on some Rs.440 crore of cash and also generating around Rs.110-120 crore cash every year, I think you have to have a very reasonable dividend distribution policy and I think we are attending to that for quite a long time; for consistent five quarters we have been declaring interim quarterly dividends and you know last year we declared 200%, Rs 20 per share. In these FY14 quarters we have already decided to pay Rs 18, so you can understand the direction in which our dividend distribution is traveling. Now we are not at 65%, we are at 69.5%; we are almost at 70% dividend payout distribution position.

**Shraddha Sheth** Lastly, Sir, if you can just layout, all of us are aware about the structural growth drivers of the business, but when do we see an inflection point where we will start seeing linearity with the debt market growth, because debt market barring aside this year, has grown at 30% in the past, but we do not see that proportionate growth for the revenues of the rating agencies. Do you think it can be doable over a 3-year or a 5-year period?

**D.R. Dogra** I will ask Madan to give you the outlook on this thing.

**Madan Sabnavis** Lot will be depending upon when exactly the Indian economy takes off, and I think the two main drivers for it will be both private sector investment as well as government expenditure on capital projects. And in the current financial year we have seen there is limited leg room for the government to bring about any kind of spending in infrastructure space, so therefore the onus is more on the private sector. And as Mr. Dogra has been talking earlier about a number of projects which have been cleared there is some hope that something could be happening in the last quarter. But then we also know that the elections are coming up in May, which really means that from Q2 of next financial year is the time when we could really see certain affirmative policies being announced by the government to revive the economy. We could see a kick start in overall investment which in turn will get fed into debt market.

**Shraddha Sheth** You see a positive rub off of BASEL III on the debt ratings in the short term?

**Rajesh Mokashi** BASEL III basically has unique instruments of capital raising for the banks. So we today have what you call as upper tier-II and perpetual bonds. So those are more or less similar, but the fact that banks will require enhanced capital means that there is going to be increased capital raising by the banks which is under the ratable universe. So that is the reality.

**Moderator** Thank you, the next question is from the line of Jignesh Kamani from Nirmal Bang Securities, please go ahead.

**Jignesh Kamani** Just want to know about, what is growth in SME rating for us in terms of volume and revenue?

**D.R. Dogra** SME, we are growing, and I think we have grown almost at the same rate. But this is slow, we could have grown faster, but we would like to be a little careful in this business because we do everything in-house. We have to be a little careful while doing all this, but we are growing, the overall growth in the number of assignments is 14%, and in SMEs also we are not much different from that growth.

**Jignesh Kamani** But industry is growing at a faster pace. So are we seeing a loss in the marketplace to the competitors?

**D.R. Dogra** I told you that we are steady but slow.

**Jignesh Kamani** So when will you see the aggression coming in, maybe it will take a little more time?

**D.R. Dogra** We have entered this field only for the last two years. As you have seen our aggression in LME you will see it one day in SME as well.

**Moderator** Thank you. The next question is from the line of Chellappa Sivaguru from Pari Washington Company Advisory Pvt. Ltd., please go ahead.

**Chellappa S** What will be your investment commitment in ARC?

**D.R. Dogra** It is not a big number. Incidentally, the credit rating business is not a money guzzler. Of course, this is not an Indian domestic rating agency, this is international rating agency, and major expense of a rating agency is manpower. And you have to buy manpower not in India but in London or Europe, so it cannot be in Indian rates, so certainly you will have to shell out little higher there. But looking at wherewithal, companies like us who are the partners, it is nothing. I do not know whether I can give you that figure, but it is nothing worthwhile.

**Moderator** Thank you. The next question is from the line of Jai Mundhra from Bank of America, please go ahead.

**Jai Mundhra** Just on debt thing, bank facilities that you have rated which has grown by a substantial amount, it has almost tripled, so can we say that either we have captured the market share here or it is mainly due to the SME, but in the last question you mentioned the SME growth is also more or less with the assignment, overall growth which is around 14-15%,?

**D.R. Dogra** I cannot say whether we have captured, but certainly we have been alive in bank loan market as we are in public debt market. I think if you have a look at the press releases which all companies are giving, of course, that will not be 100% right number because we only release that rating which is accepted, so I also do some other rating where I book income but I do not disclose to the world. So anybody jumping on market share on the basis of published number will not be correct. I wish I can add something to your answer, but I think you are on the right lines.

**Moderator** Thank you. The next question is from the line of Pradeep Agarwal from Emkay Global, please go ahead.

**Pradeep Agarwal** My question pertains to ESOP. So if you can specify what will be the P&L impact of the same?

**D.R. Dogra** A few days back we finally decided on this, so we have to get some more clarity on this. There are some processes which have to be adopted before we announce this. I think we will be announcing that very soon. It will depend on the market value, Black Scholes value and all that, for which you have to engage the investment merchant banker, we are in that process now.

**Pradeep Agarwal** But any ballpark range, which you think would be there?

**D.R. Dogra** We will have to look at the Black Scholes value and then accordingly all those numbers will come. I think we will have to even go to the shareholders on that. So we will certainly be very, very transparent on this, but let that figure come to us.

**Pradeep Agarwal** And secondly, as you said in the presentation, that we have opened four offices during the year, which have resulted in higher OPEX. So, is there any other offices planned to be opened in this year or maybe in the near future?

**D.R. Dogra** We have been looking at, for example wherever SME clusters, we get good business, we like to go and open a office there, because we would like to be locally available to most of our clients if possible. I think that process will remain, but as of now we do not have a clear spot located, where we will go. But certainly wherever we get a good number of cases, we will go and open there. So I cannot say that we will not open, but as of now we wanted to open in Coimbatore, we have opened. We wanted to open in Chandigarh, we have opened. We have one or two more locations in our mind, but no clear visibility when it could happen. But we cannot go and have offices on mass scale; we are not like banks who can open 50 branches in one-go.

**Pradeep Agarwal** And what would be the size of these facilities, I mean, these are all buy out or?

**D.R. Dogra** Very small, to start with, we have around 500 to 700 square feet area, and start with 2-3 people basically.

**Pradeep Agarwal** These four offices which we have opened, so these are all on lease or we have bought out those places?

**D.R. Dogra** All four are on lease.

**Pradeep Agarwal** Will it be fair to assume that this 90% jump we have seen in this quarter will not be repeating in subsequent quarters at least for the next one or two quarters?

**D.R. Dogra** No, no, the Company can celebrate 20th year only in 20th year, not in 21st year. We have completed 20 years and you have seen spate of brand building exercises we have done to celebrate 20 years. The Company is also becoming big, so we also did some of the staff training, staff motivation activities and all that. All those things were one-time costs. Suppose, we decide to celebrate our 25th year, yes, you can expect these kind of expenses 5 years from now.

**Moderator** Thank you. Participants that was the last question. I now hand the floor back to the management for closing comments.

**D.R. Dogra** Thank you. I hope we have been able to answer all your questions. If you have any further questions or would like to know more about the

Company, we would be happy to be of assistance. We hope to have your valuable support on a continued basis as we move ahead. On behalf of the management, I once again thank you for taking the time to join us on this call.

**Moderator** Thank you. On behalf of CARE Ratings, that concludes this conference. Thank you for joining us and you may now disconnect your lines.

*- ENDS -*

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*This is a transcription and may contain transcription errors. The transcript has been edited for clarity. The Company takes no responsibility of such errors, although an effort has been made to ensure high level of accuracy.*