

# CREDIT ANALYSIS & RESEARCH LIMITED Q2 & H1 FY14 Earnings Conference Call November 13, 2013

#### Moderator

Ladies and gentlemen good day and welcome to CARE Rating's earnings conference call. As a reminder all participants' line will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '\*' followed by '0' on your touch-tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vikram Rajput of CDR India. Thank you and over to you Sir.

# Vikram Rajput

Thank you. Good morning 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 and CEO; Mr. Rajesh Mokashi – Deputy Managing Director and other senior members of the management team.

I trust you have acquainted yourself with the highlights of the Company's Q2 and H1 FY2014 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 risk 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 will begin the call with opening remarks from Mr. Dogra who will take you through the strategic imperatives and performance of the Company during the period under review. 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

Good morning friends let me welcome you all once again. CARE Rating is poised very favorably in the credit rating space and is partaking in an exciting growth opportunity in our sector. We have continued to grow despite economic headwinds and we believe that we are hitting the right milestones at the right juncture.

It will be my endeavor over the course of the discussion to give you some perspective on the Company's role as a truly leading credit rating agency. Over the years CARE Ratings has undergone a concerted growth transformation. We had been putting our building blocks in place, and in 2008 we have marked a significant milestone of becoming the second largest credit rating agency in India based on rating income. I am happy to state that we continue to maintain this position as we grow our market share. The foundation of our model rest on highly objective opinions, growing brand equity, best in class operating model, strong financial profile and human capital.

From the time of inception, we have pursued the path of excellence in ratings and have focused on developing and upholding confidence in CARE's risk opinions. We have positioned ourselves credibly in the marketplace which has enabled us to capture several emerging prospects.

If you take a closer look at our model you will find that our business is built around close engagement with our customers. We have strengthened our human capital base and put in place both business development and analyst teams covering key geographies as well as market segments. CARE Ratings enjoys over 6,720 customer relationships, boasts of over 50+ banking customers, and most corporates who feature in the ET 500 listing. We also rate the maximum number of state governments which is required for state enterprises which receive guarantees form their state governments. We excel at forging deeper relationships with clients; and the ability of our analysts and BD team to work seamlessly with clients has improved over the years.

I would like to briefly touch upon our international strategy. We do see ourselves in a position of advantage when it comes to global forays. . The size of the global market is quite substantial and we believe that internationally rating agencies by nature are embedded in the capital markets. The Company has recently entered into a joint venture to form a new international credit rating agency 'ARC Ratings' with 4 other credit rating agencies (CRAs) from Brazil, Portugal, Malaysia and South Africa. This is part of our plan to gain toehold in the European frontier. We are also in process of setting up a credit rating agency in Mauritius. Our total investments for these ventures are quite negligible as on date given the low capex nature of our business and we are pleased with the pace of progress there. Having said that, we are cognizant of the work that we have ahead of us, in this year and subsequent years; and the opportunity to grow to a global scale still beckons us. These initiatives pave the way for CARE Ratings to grow its business and brand footprint further. We believe that CARE's global story has only just begun.

As a Company, we are always looking to introduce new services to our portfolio that add value to the marketplace we operate in. During the quarter, we launched ratings for Infrastructure Debt Funds, which are becoming progressively more vibrant in the market and grading of renewable energy companies/projects. We have also launched a grading product for renewable energy companies/projects.

Moving to the financial performance for the quarter and half year ended September 30, 2013. The growth trend in our performance has continued with very visible enhancements. We have maintained revenue growth and profitability. Our Total income in the quarter stood at Rs. 70.7 crore as compared to Rs. 66.5 crore in the previous year quarter.

Rating income delivered year-on-year growth of 4.4% in Q2FY14 driven by fresh business and ongoing surveillance of ratings and sustained momentum in volumes in both bank facilities and debt segments. The number of bank facilities rated increased to 1,863 in Q2 FY14 from 1,494 in Q2 FY13 while the number of debt instruments in Q2 FY14 was 85 as against 71 in Q2 FY13. While the number of ratings assignment increased, volumes have moderated due to slowdown in debt market activity.

SME meanwhile continues to exhibit robust operating traction in this quarter. We are steadily developing our SME vertical that leverages our brand and robust operating model. We are building scale and ability in this vertical. Although still in nascent stage, this vertical is a future growth driver.

Our EBITDA was at Rs. 53.0 crore in Q2 FY2014 as compared to Rs. 50.5 crore in Q2 FY2013. EBITDA margins stood at 75.0% in Q2 FY14. We remain focused on operating profitability and continue to maintain strong discipline and governance around capital allocation and expenditure. Our cost efficient business model driven by CARE Knowledge Centre and Ci3 has strengthened our operations and driven higher employee productivity.

Our PAT for Q2 FY2014 was at Rs. 35.1 crore as compared Rs. 33.1 crore in Q2 FY2013.

Let me read out similar financials for the H1 FY2014 period. Our financial growth for the half year on a year-on-year basis has been strong with an 18.0% increase in total income to Rs. 121.0 crore. EBITDA for the period grew at 16.9% and stood at Rs. 83.9 crore. PAT for the H1 FY2014 increased by 19.0% to Rs 59.4 crore in H1 FY2013.

We continue to maintain an exceptionally strong balance sheet. As of Sep 30 2013, we had a net worth position of Rs. 467.9 crore as against Rs. 423.9 crore as on March 31, 2013. As of Sep 30, 2013 we had cash on hand of Rs. 443.0 crore as compared to Rs. 418.8 crore as on March 31, 2013.

During H1FY14, free cash flow was at Rs. 22.4 crore as compared to Rs. 18.6 crore in H1 FY2013. We expect continued improvement on this parameter in the second half of the year. As far as the usage of cash is concerned, we are judiciously and cautiously looking at transformative and synergistic investments, organic & inorganic initiatives that will be growth and value accretive. Let me assure you it remains our objective to realize the true potential of the Company and create long term shareholder value. I am pleased to share here that the Board has declared an interim dividend of Rs. 6 per share for the quarter ended September 2013. This amounts to a total dividend of Rs. 12 per share in H1FY14, translating to a strong pay-out ratio of 68%.

To sum up I would like to say that we believe we have got the right operating model in place. Our superior business model, brand salience, human capital efficiencies, strong financial position, strong origination capabilities and business relationships have placed us on a firm footing. Our focus remains on all the three targets segments: debt, bank loans and SMEs, to remain ahead of the curve.

As we have said earlier, the debt market at 5% to GDP is severely underpenetrated. The potential is enormous, as both developed markets and other Asian markets comprise above 50% corporate debt to GDP. We do hope that the economic environment improves with the credit offtake picking and debt markets improving. We remain at the forefront to capture emerging sector prospects.

We will continue to work through economic challenges and look forward to better our performance going forward. Additionally, we are committed to sustaining a strong balance sheet ensuring that we invest cash wisely and appropriately create value for shareholders.

I would like to request the moderator now to open the forum for questions and our entire team would be glad to address any queries that you may have. Thank you very much.

Moderator

Thank you very much sir. Participants we will now begin with the question and answer session. We have the first question from the line of Hiral Desai from iAlpha Enterprises. Please go ahead.

**Hiral Desai** 

Just wanted to check before I start with the question. Could you just clarify this note number six that you have in the notes to accounts, where you have issued shares to Ascent India Fund, so just wanted to know what is the regulatory requirement?

D. R. Dogra

If you would have looked at our press release on this subject you would note that with regards to the IPO, there is an FDI guideline that says that if the NBFC (Non-Banking Financial Services Company) comes with an IPO, \$500,000 should come from the foreign investors before FIIs are allowed to put in money in the IPO. Now we have 14% FII investment in our Company but at the time of the IPO it was around 10% - 11%, somewhere in that order. The entire money had gone to our shareholders, as it was a secondary issue where through the offer for sale, even FII money, has gone to shareholders. RBI believes, and RBI has taken a stand that this was not a FDI compliant IPO, as nothing has come to the Company. So we were given some time to make this allotment to FII. And there are SEBI regulations on pricing of issue after the IPO. So that's the issue and we had to make to Ascent India to meet the RBI requirement.

**Hiral Desai** 

But after this we are compliant? So there are no further issuances likely after?

D. R. Dogra

Yes that's all we were supposed to do and this is what we have done.

#### **Hiral Desai**

The other is on the staff cost just wanted to understand if I look at the year-over-year number, staff cost in quarter two is flat and there is 23% decline versus Q1 so just wanted to check in quarter one how much of the staff expenses was related to let's say the bonus or the performance linked payout?

# D. R. Dogra

In Q1 most of the companies decide on the variable pay depending on the performance of last year. The Board considers the audited results for the year and we had a proposal to launch ESOP scheme for our employees which was subject to approval by our shareholders at the AGM. Most companies will make some provision towards annual increments and variable pay for the year.

## **Hiral Desai**

Could you give me the headcount number at the quarter end?

## D. R. Dogra

We had around 630 people on 30<sup>th</sup> September as against 578 in Q1. Since we are making this ad hoc provision we really don't know the exact numbers. But once we ultimately look at the performance related reports of all our employees we do decide the variable pay and the annual increment on the basis of their performance during the last year as well as the Company's own performance. Secondly, if you are tracking our Company, you will know that during the Annual General Meeting one of the resolutions which the members have cleared is the Employee Stock Option scheme. So part of the compensation could come through in non-cash form through ESOP scheme also. There was a consultant's report which also came in the Q1 of the year; on that basis and also on this annual ESOP scheme which we have planned now, that's the reason that provisions which were made in Q1 were little higher than what we were expected to have. So there are much lower provisions in Q2 but if you look at our H2 staff cost to H1 last year it has actually gone up. We have a number which I can share with you.

## **Hiral Desai**

It's about 14% higher on the first half basis.

# D. R. Dogra

Staff cost is one of the measures we really look at all the time. Staff cost to the operating revenue is 26.3% in H1FY13 which has gone up to 26.9% in H1FY14. This is not because we have done more number of ratings but because we are expanding into the SME space and that's why all this increase from 578 to 630 employees is happening. Though our top line has grown up only by 4.4% we have done 21% more number of ratings this time.

# Hiral Desai

Lastly, if you could talk a bit about the SME piece, what is the total team strength, how is your process/ approach different from the competitors who are also trying to scale up in the SME vertical. The other question related to this was compared to, if I look at the third largest rating agency which is also trying to scale up the SME piece, there is far more pressure in terms of the staff cost or the other expenditure on their P&L compared to what we have seen on CARE, so if you could just take us through the SME piece what is your structure and how do you plan to take it forward?

## D. R. Dogra

I can't comment on the structure which others follow but I can speak of my structure. We don't believe in outsourcing this business to outsiders. We are the only one which has an external rating committee, I am talking of the main

rating agencies in India and our rating committee as well as board is not very comfortable in outsourcing this business to franchise partners. I don't know how many others do this but certainly we don't do that. We put our own people who do due diligence at those locations and that's the reason why our staff costs are increasing and there is a slight hit on the operating margins. Last year it was like that, even this year also we will have similar impact but we are trying to maintain margins as far as possible, though it has gone down by around 1% this time. We are completely aware about that and we through our CARE Knowledge Center are putting our foot soldiers right near the SME cluster, trying to keep our cost as low as possible. Certainly our cost would be little higher than the outsourcing way of doing this business.

**Hiral Desai** 

Would you like to put a number to the team strength for the SME business?

D. R. Dogra

Yes we have around 96 in SME out of the total.

Moderator

Thank you. We have the next question from the line of Jai Mundhra from Bank of America Merrill Lynch. Please go ahead.

Jai Mundhra

This question is on your revenue. While I can see that this quarter the revenue has grown by 5% Y-o-Y mainly rating income but in the first half we have grown by around 11% and we have increased our rating assignment by somewhere around 17% Y-o-Y, so just wanted to know the full year growth which you are expecting for the full year assignment as well as in the revenue terms.

D. R. Dogra

Jai we don't give any forward-looking calls but certainly if markets are growing, the credit markets as are growing 14% - 15%, I think rating industry would also grow like that. As you have seen we would like to be ahead of the curve all the time. I think you could deduce this, we will try to keep our market share, if not grow we would try to maintain our market share.

Jai Mundhra

And if you can just throw some light on apart from the general slowdown that we see in this market but is it something specific, let's say some bank facility which has been de-grown by 23% Y-o-Y or debenture bond rated, the volume I am talking about that is also de-grown by 50% quarter-on-quarter any more color on this.

D. R. Dogra

I don't think you should directly derive our rating income on the basis of the volume that we rate because we have cap on clients. Most of these people are coming to the debt market. Our fees are capped in such cases so if somebody raises Rs. 100 crore or Rs. 1,000 crore I may end up getting even the same raise in the fee cap, may be Rs. 5,00,000 may be Rs. 10,00,000 or something like this. So, it's very difficult to relate our rating fees to the amount of debt we rate. Otherwise if you look at debt rated and you multiply with 0.1 or 0.07 which is my normal fees, you will end up getting different numbers for fees. There have not been many debt issuances in the last half year, even not in this Q2 and also in Q1 that's with the general economic environment. As we know that debt markets are growing 13% - 14% and if people don't access debt market they will certainly go to bank facility market and bank facility have grown at 13% - 14% and that is also what we rate.

#### Moderator

Thank you. We have the next question from the line of Pravin Sahay from Batlivala & Karani Securities. Please go ahead.

# **Pravin Sahay**

Just a query on the debt volume because we had seen a significant down in the debt volume this quarter and what I can see in the last year the second half volume we were down as compared on the first half last year. So I just wanted and usually for the debt rating second half is better as compared to the first half usually for debt raising activity from the corporate etc. So, like what happened in the last year our volume went down quite significantly compared to the first half last year. And if you can just give us the sense going forward like we see and the debt market rating basically?

# D. R. Dogra

I think Madan Sabnavis, our Chief Economic Advisor can take up this question much better than me.

## **Madan Sabnavis**

Hi, Madan out here. If you are talking of the debt market we have a fairly ambivalent picture as of now. On the positive side we have heard about a lot of investment clearances by the government of India - like Rs. 3.84 lakh crore of projects being cleared. There is a little bit of optimism about a lot of this really fructifying into actual output or actual implementation and that is something which is very positive. We haven't seen anything happening so far but it's quite possible that it may do so in the second half of the year. In fact we are keeping our fingers crossed that there is some movement in this particular area. On the other hand we have also seen that the Reserve Bank of India has maintained a very hawkish stance when it comes to interest rates on account of the concern on inflation. Based on all the data which we have on inflation including what came out yesterday, it does appear that inflation will continue to be at a current levels which really means that the Reserve Bank of India may not really lowering interest rates any time soon. That's going to be another major consideration for anybody who is undertaking such kind of projects which will have a direct impact on our own debt portfolio.

## **Pravin Sahay**

Just few clarification on the last year's performance like second half was lower, the Company has reported second half lower volume as compared to first half so what went wrong last year. Because we had seen some of the competitors usually given a good numbers in the second half from the debt market but we had lower volume last year?

# D. R. Dogra

As I replied to Jai in the last question, you should not relate our rating fee income to the debt we rate because most of these debt issued by to some large borrowers (Shriram Transport Finance, HDFC) are etc already capped as we have annual cap in such cases. Even if suppose borrowing goes up by a significant amount our cap goes up only by 10% - 20% or something like that depending on the absolute number of cap. But of course if the debt market is more vibrant you will have good time but everybody knows that H2 of last year was not a very good half year for us. In fact if you remember in H2 of last year all of us saying that H1 of the next year FY14 will be much better than H2 of last year. So, H2 was not a very good number if somebody has done some large HDFC Bank or ICICI Bank debt issuances their number will increase.

## **Pravin Sahav**

And just coming to as you had talked about the rating of the infra sector and some more expanding to a different ratings also the renewable energy and all. So, how is that market is performing and how the opportunity lying in that segment basically?

## D. R. Dogra

You touched two issues here, on infrastructure all of us are waiting for some clarity to come and as Madan spoke about Rs. 3.84 lakh crore worth of projects infrastructure being cleared by government especially the capital committee on investments. We are yet to see that clarity and I think if that comes it will be a big boost to the infrastructure rating space. As far as the new products which we have, we are doing that business but all these business are quite small as compared to our size of our operations, to make Rs. five crore or something it is still only 2% of our total revenue. So, they are not big business actually.

#### Moderator

Thank you. We have the next question from the line of Nishant Chandra from Temasek Holdings. Please go ahead.

## **Nishant Chandra**

Just couple of questions. One is in terms of ratings momentum what is the direction of upgrades and downgrades that you are seeing now, has it turned the corner or is it still not favorably positioned.

## D. R. Dogra

If you look at our FY13 numbers they were quite bad as far as ratio of upgrades to downgrades is concerned. In Q1 we were finding a little respite on downgrades and numbers were little better. But unfortunately Q2 again is not keeping with the same trend especially because the pain looks to be more vigorous now and the main reason is that for some last three four years we have done number of ratings for small and medium enterprises especially in the bank loan space. In any downturn all these people will get affected first and that's the reason that the spate of downgrades are still persisting. But I do not think that this kind of the pain will continue for a long time. I am not saying it has decreased but I think I am finding some solace on this side that number of downgrades are reducing now.

# **Nishant Chandra**

What has been the recovery situation from that, because you would still I am guessing pursue the clients for the revenues against the work that you have committed in terms of the ratings action?

## D. R. Dogra

Nishant I think that's a very good question. It's a matter of improving credit profile, if credit profile improves all such companies which were downgraded will certainly queue before the rating agencies for rating because banks will start asking them for rating. And when that happens they will certainly pay your old fees with the new fees. The credit profiles have not taken a big positive turn as of now, and whenever the credit profile becomes positive, certainly we will recover our money because we already spent on reviewing those ratings.

## **Nishant Chandra**

Contractually, what do the company sign up for, do they sign up for paying fee in respect to of the ratings outcome or is it only upon investment grade rating that they-

D. R. Dogra

It should, with the rating mandate the fees has to be paid. I am on call but in mandate I have a legal remedy with me.

**Nishant Chandra** 

Fair enough, I understood.

Moderator

Thank you. We have the next question from the line of Jigar Shah from Maybank KimEng Securities. Please go ahead.

Jigar Shah

I have two three questions, first of all when I see your growth in bank loan ratings and other ratings it is quite good, so in this subdued market I mean what is leading to a sort of 24% kind of growth in that market if you can elaborate a little bit on that whether it is a market share gain or whether what is it, I mean if you can throw some light on that?

D. R. Dogra

Jigar all of us are talking that no credit growth is happening and all that but rating universe still would not have covered even 50% to 60% of the bank loan market. As of now there are many unrated accounts there. Banks force their clients to go and get a rating so that they get some advantage on capital charge. Also the banks have started seeing the value of rating now that's why we do SME ratings. There is no Basel II requirement for SME to be rated, but still they come to us why because banks are asking them to go for rating and clients itself are finding the benefit of the rating because if you get a right rating you go and are able to place your facility bank loan with the right bank at a right rate. So, I think penetration is the key here., We have not penetrated the entire market that's why even in a subdued market where no credit growth is happening we are growing.

Jigar Shah

The other point was that in your initial remarks you mentioned something that debt market is only 5% of GDP, did I hear something wrong or I mean what did you mean?

D. R. Dogra

No, you understood right. Corporate debt market in many countries, let's not talk of developed markets like US or Europe; even China it is 25% of the GDP, in Brazil it's around 20 plus and India is only place where the corporate debt market is hardly 5% of the GDP. Any developed market the debt market is bigger market than equity market, we are the only the odd man. If you look at any corporate debt market report by anyone, Dr. R H Patil committee report or Rakesh Mohan Committee report on infrastructure, whatever is required for development of infra debt market, infrastructure is already in place, it's only matter of time when we sort out some of the issues. There has to be some large player who acts like a market maker, when equity market developed in India there was Unit Trust of India, now Life Insurance is almost like a market maker because they can give two way quotes to any script. Government security market, there are primary dealers but who is there for debt market, that's a big problem. And even mark-to-market principle for a capital market instrument has come into a bank loan market, is also another hindrance which is affecting the debt market. There are spate of other issues which need to be tackled. Debt markets for any player in my industry there is hardly any penetration. If the debt market develops we will have our share of the cake.

## Jigar Shah

Would you be worried at any part of time that some of these bank loan rating market can be used captively by the banks, I mean there was some such thought some time back, is that any reality or that is not practical as of now?

# D. R. Dogra

In India because there is Basel II requirement, rating is almost regulatory driven. But you look at any other market outside India where markets are large, the lenders force clients to go for a rating, it's not regulators who are forcing issuers to go for a rating and I don't think why India should be a different place. In SME, in private placements no ratings are mandatory but still no private placement happens without two ratings. SME no rating is required but still there are companies who claim that they do 10,000 ratings a year. There is NSIC scheme which is selling very well in the market. So, I think the market itself will start creating need for a credit rating and I don't think we will require regulatory support always to have demand for credit ratings.

# Jigar Shah

One last question is, what would you do with such a large cash, even after paying a decent dividend there is still a very large cash?

# D. R. Dogra

You guys should be happy that Company has large cash. Any management would like to expand their business and rating has finite proportions, you can't grow this rating business by 200% or 300% if that market develops to that extent we will do that but it's not happening. The credit growth in banking sector has been around 15% to 20% in the recent history, so no rating company can grow by big number. We grew from 2008 to 2011 by 40% - 50% but we can't grow at that rate all the time. So, if you have to grow your company you have to do many other things and for that it's not necessary that you should do everything organically, you can even go and buy out something. All companies keep on looking for right assets at right price all the time and we are no different.

## Jigar Shah

But which are your areas, I mean you have anything specific that you want to do?

# D. R. Dogra

I will let Revati, our Research head take up this question.

## Revati Kasture

We are looking at related areas, areas where we will be able to value add, we will be able to then take the business and run it. So typically areas with respect to the core business of ratings in geographies outside India or research and analytics space in terms of business research, investment research, equity research or debt analytics. So all these are the spaces that we are keenly interested in and looking at.

## **Moderator**

Thank you. We have the next question from the line of Sanjay Shah from KSA Securities. Please go ahead.

# Sanjay Shah

My majority of the question is answered but can you throw us light on our company's growing x-border that is outside India, what are the plans you talked about Mauritius. Can you throw us more light about it?

## D. R. Dogra

SanJai in the last question there was a mention of our cash which is lying with us and we are finding some use for this. As I said in my opening remarks

that our kind of business is not a very capital hungry business it doesn't require much capital. We are one of the partners in promoting an international credit agency known as 'ARC Ratings' where we own 20% of that company, that's one investment we have. Many of our clients from the emerging markets go and access international markets for international issuances. We are well equipped as compared to others because we can go to the international markets, none of our parents is an international rating agency., So we have that choice because we ourselves can go and promote someone who can do rating for our own clients for the international issuances. That's the reason why India, Brazil, Malaysia, South Africa and Portugal, five companies from these countries have joined together and promoted this company and we are part of that, that's one. Other than that I told you that we are in the process of starting operations in Mauritius. We already have operations in Maldives. We are looking at some other markets and as soon as we have something to tell you we will because it's all WIP.

# Sanjay Shah

So, how is the initial response?

## D. R. Dogra

As far as the operations are concerned we have started operations so far only in Maldives and Maldives is a very small market. Mauritius, we are yet to open. Yes we have gone to the market, surveyed the market talked to regulators and I know the market needs a credit rating agency and that's your response on that market. As for ARC Ratings there are hundreds of clients from India, there are hundreds of clients from Brazil, there are hundreds of clients from South Africa, so even if we tap our local markets for ARC Rating I think the response would be tremendous; that's what we believe because for international issuances we don't require one rating but you are required two ratings. Somebody goes to the one international established rating agency and one to our company I think we will have enough business for us for ARC Ratings.

## Moderator

Thank you. We have the next question from the line Pradeep Agarwal from Emkay Global. Please go ahead.

# **Pradeep Agarwal**

My question pertains to your earlier remark wherein you said that you have certain portion of the business wherein you have capped clients in terms of fees so would you be able to give some color as to what would be the capped fee portion and related volumes attached to those fees?

# D. R. Dogra

I don't have that number right now, but Pradeep I can ask my people to gather that information. It will not be more than 10% of the total revenues, not more than Rs. 20 crore out of the total Rs. 200 odd crore revenues we generate on rating front.

# **Pradeep Agarwal**

Okay 10%. Secondly, in terms of with this minimum fee structure coming in by RBI, do you see any change in terms of your revenues or fee structure or if you could elaborate as to what proportion of your business was below that structure which was proposed just a quarter back?

## Rajesh Mokashi

I think Pradeep we are still in the early days at this point of time. The structure has just got implemented and we have to wait and see as to how it really pans out in the market. Obviously it is not that all of the issuances have

to be at the minimum fee, as there is a ten basis point pricing for some of the bonds and other issuances. So minimum fees are kind of a threshold and obviously there are people who pay higher fees also, so it is somewhat premature and early to jump to a conclusion. But if there are instances of people going below that number in the past probably that will come to a sort of a halt and to that extent one may say that realizations could be better depending on the volume growth in the second half.

## **Pradeep Agarwal**

So, I mean the reason why I am asking this whether it will have any significant impact in terms of higher revenues because what I understand from market is with lot of competition in the market there has been undercutting on the pricing which happens and which could resulted in lower or marginal fees on those ratings.

## Rajesh Mokashi

But as I mentioned we must understand that whether everybody or what proportion of the business was really operating below the threshold is a question. We have medium and large size issuers also really who bring in the fees to the extent that it is on the fringe of border line where smaller companies were operating at that level of fee structure, to that extent it will sort of arrest that decline in realizations. But otherwise there are big players who raise big debt and big loans which really bring in the fees. So, somewhat early to judge one will know by the time we end this year.

# **Pradeep Agarwal**

And then lastly if you could give some color as to your proportion of surveillance and fresh rating revenues this quarter or H1 or BLR and non-BLR revenues. Just a trend if you could give me as to whether the surveillance proportion has increased or whether the fresh rating proportion is increasing or in terms of BLR and non-BLR what proportion is higher, just a major.

# D. R. Dogra

As a general principle Q2 and Q3 will give you maximum surveillance income because that is the time when accounts are available and analyst would be able to complete surveillance. I think Q1 and Q4 are two quarters where you don't have big state of surveillances so that's a general situation. Another hypothesis which I can give you for any mature rating agency if debt markets are not very good or are very bad it would be 50% to 60% income would come out of surveillances, that's the general rule that will apply to number one, number two or number three rating agency, I am not talking about smaller companies, largest one may have 60% the smallest one may have 50% something like that. But if debt markets are good then this situation will little bit change from 50% to 60% to around 40% to 50%. Fresh issue will be more in such scenario.

# **Pradeep Agarwal**

Why I am asking this question is because if you look at the systemic level, the default rate has increased and there has been lot of suspensions which are there in the system because of not given data by the companies so that will result in your lower surveillance income?

## D. R. Dogra

Yes that is affecting all the rating companies and we will get benefit of that when credit profiles go up. So in my one of previous questions I was telling someone that whenever credit profiles will go up all these people who are downgraded have not paid us will have to come to me only, where else they

can go because they will have to provide all information right from start to a new rating agency.

# **Pradeep Agarwal**

So, if you could give some color as to what frequency you have in terms of reviewing your ratings.

## D. R. Dogra

Actually in a normal case, we do quarterly reviews when the quarterly number comes. But that's a very, very minimal kind of review at that point of time unless there is QRN, we call it a Quarterly Review Note. Quarterly Review Note we dispose at the level of rating head, but rating head if you find needs to scale it up to the next level to internal rating committee then it goes to internal rating committee. So all cases will not go on quarterly basis even to the internal rating committee only the few ones where you find a significant reason you have to scale it up and go to the next level. But normal review happens when audited results come and we call it annual surveillance when the annual results come. But all our ratings are on day-to-day basis on a watch, if you find any corporate action report, anything which affects the credit profile of a company that company is immediately reviewed.

## Moderator

Thank you. We have the next question from the line of Ravi Mehta from Deep Financial Consultants. Please go ahead.

## Ravi Mehta

Just going by what you shared some time back in this call that bank loan rating opportunity itself is not tapped fully like probably it's half way so any color you can throw on what it could be for the SME side?

## D. R. Dogra

That's not even 5% or 10%. There are a number of reports on SME but the most conservative one says that 26 million functional SME units in India. We are very small a company as far as SME ratings go but even if you take the largest of the large agency which does SME business they have not done even 100,000. My approximation is that all the credit rating agencies would have done around 60,000 to 70,000 SME rating so far. I mean in this we have not touched even the tip of the iceberg, as this is a very big market. CARE was out of SME space for very long time and we have realized that we can't be away from this and that's why we are building both the model and the infrastructure to handle this work on our own instead of outsourcing this to outsiders.

# Ravi Mehta

And one more question was on the margins that as you scale up the SME front as you are doing it on your own so that's one of the reason why you see margins little bit declining. But apart from that reason if say the volumes grow in the second half compared to first half then probably you may able to make up the margins to an extent but overall as a strategy with a kind of cash you are sitting on and as you said you would be exploring revenues outside the India as well as in the areas outside the ratings what you do. How would the overall margin trend over a period of time as you start scaling other verticals?

## D. R. Dogra

See, though our margins have gone down, they are fairly much better than the market,. When we have those numbers which the larger or the largest rating agency in SME space are delivering, I think we will certainly catch up with the low margin for some time that's what I believe. You have to have your foot soldiers in the SME clusters and it's just like same store growth as

you appraise or value a company on retail space. The guy who is put on the SME front today will not deliver me economies of scale or even breakeven scale for one year or one-and-a-half year or so. But at least after two years or three years you will start delivering right kind of numbers and I can catch up with the margin then. But you have to keep on investing in this market. I am there only in 70 locations as of now if I have to reach each and every SME cluster in India, I need to be if not in 500 at least 300 – 400 locations. I have to keep on investing on that, and till then my margins will certainly take a hit. Certainly if I cover the entire country and if these guys establish a foothold in those markets, I think coming back to this kind of number will not be difficult for us.

Ravi Mehta

If we keep aside the other business what you scale up with the cash you have, just going by the SME scaling up margins may take a hit in near term as you expand?

D. R. Dogra

Yes they will, they have taken in last one or two years, there is certainly a reduction by 1% or 2% .

Ravi Mehta

Yes, I am talking only your historic comparison not taking the peers because they are not comparable. So going ahead what kind of probably targets you have in terms of scaling up and what kind of margins you would see meaning if it's going to take a hit a bit in near term?

D. R. Dogra

I can't give you a right number. Some rating agency does 8,000 ratings a year and I do only as of now 1,000 or 2,000 SME rating a year. I already have Care Knowledge Center and CI3 in place, now it's a matter of putting some more seats for our Care Knowledge Center that's the only thing we have to do that is not a big thing. And our rating model has worked for last two three years, last year we did around 7,000 ratings, last to last year we did 5,000 ratings so in addition to normal surveillances 12,000 new ratings had been done through CKC model. So this is a very, very robust model which has been tested for a long period so I think that's not a problem. The other problem in reaching out to SME is to have our foot soldiers right and near the SME and that's what it is taking some time and I think after we do that, there should not be problem why we should not be number one, number two in SME space; we are in LME space why we should not be number one, number two in SME space as well.

Ravi Mehta

Yes, margin is not a problem with SME.

D. R. Dogra

Margin will be a problem for some time.

Rajesh Mokashi

I think one thing you please understand that rating is not a capital guzzling business and as long as the contributions remain positive from the SME business the RONW keeps improving. This factor we all must remember because unlike a cement company or a steel company where you invest a capital, your incremental capital is practically negligible, so contributions remain positive as scaling up business. Mr. Dogra mentioned that millions of unrated SMEs exist in this country. In fact the enquiries we get from outside India also say that why don't you do something on SMEs. Each country has focused on scaling up the SME business. As long as we do it efficiently in a

technology driven manner, the time I require to do a large company let's say two or three weeks within that same two or three weeks I can churn out three or four cases. So looking at a productivity there is not such an issue so while the margins may be somewhat lower but the efficiency is that we bring in and the scaling up eventually will help us kind of be reasonably good on the margins and try and be consistent as far as our past is concerned.

Moderator

Thank you. We have the next question from the line of Shradha Sheth from Edelweiss Securities. Please go ahead.

**Shradha Sheth** 

Just wanted to understand are we going to have some stated dividend policy? Because now I see there is good pick up in the payout so are we going to have some payout policy? Because we have such a huge cash on books on an annual run rate basis?

D. R. Dogra

Shraddha I think my board and my shareholders are quite aware that we have recently come with IPO at a right price Rs.750 some time back. All shareholders would like if Company is doing well they would like to be compensated appropriately. I think board is quite aware about this and that's the reason they have taken a decision once again, we give 200% dividend for FY13 in Q1 we give 60% and Q2 also they have again decided to 60%. I think this will keep on prevailing if Company does well. I don't have a number in my hat but certainly board would be aware about this, that's what I believe.

Shradha Sheth

And just on the bank loan pricing with the one quarter back, new highlight which is BLR pricing where RBI has come in the picture, so can you throw some more color on that what is the minimum threshold they are looking at?

D. R. Dogra

Shraddha I think Mokashi has handled this question earlier and let me tell you what we believe is, it's not that some new thing has come. We were already charging some minimum fees on bank facility rating and maybe there are some people in the system who are very desperate to get a mandate and all that. But I don't think any responsible rating agency would stoop to any level, there is a threshold limit below which we can't go because we have also our cost in mind. And I don't think this has really jacked up prices, there was already a minimum fee. All our price fee disclosers on our website and we keep on charging on those rates all the time. So, I don't think there is a bit issue on that.

**Shradha Sheth** 

Minimum threshold, is there some figure that they have laid out?

D. R. Dogra

They have not, rating agencies have laid out themselves. As far as we are concerned we have said that we can go in bank facility to a minimum of four basis point against 10 basis points which was our normal rate.

Shradha Sheth

Understood, so this is including the cap, right?

D. R. Dogra

No, cap will not be four basis point because suppose you are rating someone who has a 1,000 crore bank facility limit you can't charge four basis point on 1,000 crore. So there is a separate cap which we would like to keep with ourselves.

#### Shradha Sheth

But there is nothing for the industry per se?

## D. R. Dogra

It is minimum, the four basis point is a minimum because see the issue comes when some people have only Rs. 10 crore bank limits so in such cases you can't charge even ten basis point because you have four basis point but then there has to be something minimum, so we have a minimum fees there.

#### Shradha Sheth

Lastly, just wanted to understand against last quarter also I had asked this. This minimum Rs. 5 crore and above ratings the bracket between Rs. 5 crore and Rs. 10 crore rating what is the opportunity size if it is possible to give some more color. Just want to understand structurally how much growth is doable in the bank loan ratings?

# D. R. Dogra

I will tell you this is a very dynamic figure but we will give you this figure. While RBI requires rating for Rs. 10 crore and above exposure, lots of the banks have really gone on their own and asked their clients to get rated even if their exposure is Rs. 5 crore. I will ask my people to share that number which is between Rs. 5 to Rs. 10 crore but let me tell you if my limit was Rs. 4 crore and I get enhancement of 1 crore and if my bank is insisting on Rs. 5 crore I become eligible for rating and I will ask my bank to go for a rating. So, this number is changing very fast as your credit requirements are going up. More and more people are becoming eligible for rating, actually that's also one of the reasons though credit markets grow only by 14% - 15%. But even all rating together do more than 15% that shows that there are some uncovered cases which become eligible for rating later.

## **Shradha Sheth**

And just lastly if I may ask one more, this quarter typically our run rate in terms of growth has been better than the peers but this quarter it's slightly lower than one of the peers, so we are still maintaining our market share right, so this quarter was it an anomaly or what is the reason for a lower growth?

# D. R. Dogra

I don't want to compare myself to anyone but if you look at our numbers, our bottom lines are much bigger than somebody's top line, so I don't think I should compare myself with anyone.

## **Shradha Sheth**

Market share is sustaining that's all I would want to?

## D. R. Dogra

At half year we have done much better than anyone in the system.

#### Moderator

Thank you. We have the next question from the line of Kaushal Patel from India Nivesh Securities. Please go ahead.

# **Kaushal Patel**

First question is, can you share that modified credit ratio in Q2?

## D. R. Dogra

Kaushal, Madan will get back to you.

## **Kaushal Patel**

Other expenses in expenditure. I would like to know like where exactly why, I mean what are the major expenses?

## D. R. Dogra

I think Chandresh – our CFO will give you that number. One number which I can think of is that we are now a listed company and you have to print in this quarter 55,000 annual reports so you can understand predicament so that's one cost but there are other cost actually.

### **Chandresh Shah**

We have set up new offices during this half year so there was some increases linked to the new offices. There has been addition to employees, so some travel expenses and other expenses linked to the offices have increased. And as Mr. Dogra mentioned that we had to send the annual reports so printing of annual report sof such huge number and delivery of annual reports and dividend warrants, these are the major heads.

## **Kaushal Patel**

One more question, it's related to volume and that debt rated volume. Like we have bank facilities and debentures but I would like to know the trend in commercial paper, I am not sure but I have had some data of last few years and I think the trend is like we have been less focusing on that so like I just want your view

# Rajesh Mokashi

Actually since we are the second largest rating company we practically deal with the who's who in the corporate sector today right from the big names like Tatas, the Birlas all of them are our clients. On most of these companies we have outstanding CP ratings. Utilization is a function of the money markets behavior and if the CP interest rates are higher the corporates tend to use less of this particular instrument. So our focus on the entire gamut of liabilities of a client always exist whether it is short term or long term, we are not specifically focused on a CP or a non-CP. The client gives us rating assignments for all his liabilities whether it is bank facilities or bonds or CPs. So, the data on the CP what you call markets are clearly published by the Reserve Bank of India and the extent of CP volumes. We are not in any way sort of reduced our focus anyway on the CP market. CP market continues to be an important source of rating activity and short-term money market. As such it is really a market driven by the money market behavior. The last few weeks or last few months we have seen some challenges in the money market, which has then sort of forced people to not use the CP market or the short term money market unless it is absolutely warranted. So that's the reason otherwise CP market all our clients which we rate also use CP or keep the CP rating as a backup.

#### Moderator

Thank you. We have the next question from the line of Jaymin Trivedi from ICICI Direct. Please go ahead.

# Jaymin Trivedi

Just wanted to ask how much capital we have invested in ARC Rating for 20% stake?

# D. R. Dogra

I told you it's not money guzzler business. As of now we have spent \$530,000 exactly so far.

# Jaymin Trivedi

Okay so we might spend some more.

# D. R. Dogra

What we have to do is we have to fund losses of that company for two years and I don't think that company will make huge losses, so shareholder don't have to worry on this.

## Jaymin Trivedi

And this ARC Rating would be majorly catering to clients of all countries including Brazil and Malaysia who want to raise money in European markets?

# D. R. Dogra

It's not that we will do only emerging market ratings. To start with we are best equipped to rate cases from those countries where we are present. One of our headquarters in Europe, our one of the parties is a Portuguese Rating Agency which is recognized by ESMA. We are now ESMA recognized rating agency so even European companies will certainly come to us and we will do ratings.

## Jaymin Trivedi

And as you said like it is a loss-making company, so how like we are going to see a sustainable margin profile for this company in the long term?

## D. R. Dogra

Who is loss making company? I am telling you that once you are established as an international rating agency, once you put infrastructure in place you can't generate breakeven balance in the year one or year two. So at the most we will have to fund this company for two years, after that this company will be a money maker.

## Moderator

Thank you. Participants that was the last question, I now hand over the floor to the management of CARE Ratings for closing comments. Thank you and over to you.

## 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. Ladies and gentlemen on behalf of CARE Ratings that concludes this conference call. Thank you for joining us you may now disconnect your lines.

- ENDS -

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