# 5 MINUTE STOCK IDEA

## BY SMART SYNC INVESTMENT ADVISORY SERVICES

# CARE RATINGS LTD

## WHAT WE LIKE

**OLIGOPOLY INDUSTRY WITH BARRIERS TO ENTRY**
Credit Analysis and Research (CARE) Ltd is one of the top 3 credit rating company in India with a market share of around **29%**. Rating business license needs strict government approvals. That creates a barrier for entry of new players. Hence, there are **only 5 rating agencies registered with the SEBI**. The top 3 rating agencies (CRISIL, ICRA & CARE) make more than **95%** of the market.

**HIGH OPERATING LEVERAGE**
Employee base is the most important factor in the business. It remains the same irrespective of the business volumes (employee cost is fixed in nature). A large increase in business volume does not need a proportionate increase in cost. Hence, when volumes increase there is a disproportionate increase in profits.

**GEOGRAPHICAL DIVERSIFICATION**
Rating business still contributes **90%** to the total revenue. **Geographical diversification into places like Nepal, Mauritius & Africa will add cushion to the concentration risk of rating business in India.**

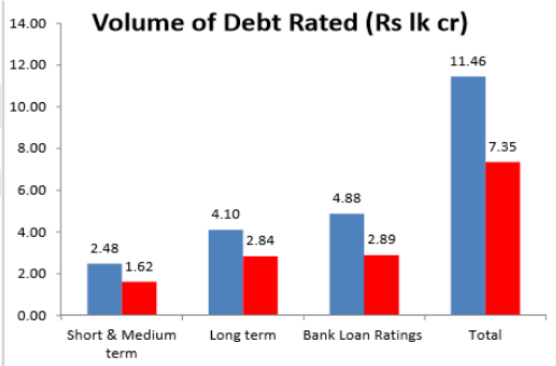
**CASH RICH, DEBT FREE & LOW CAPEX BUSINESS**
-ROE of last five years **28%**
-**Debt Free** Balance Sheet
-High Cash Generation from Operations
-Negligible Capex required compared to cash generation.

**AVAILABLE AT ALL TIME LOW VALUATION**
Ever since its IPO in 2012, CARE had traded at a premium valuation given the inherent strengths in the business model, lack of competition in the sector and Balance Sheet strengths. **Since August 2019, due to a corporate governance issue, it is trading at a record low valuation of less than 12 times earnings. In March, 2020 it even went to as low as 8 times TTM earnings.** However, the earnings are also on a downward trajectory for over 4 quarters now so re-rating of the stock may take some more time.

## WHAT WE DON'T LIKE

**CONSIDERABLE SLOWDOWN IN GROWTH**
Indian economy is going through one of its toughest periods. **Figures of the GDP growth rate has been to record lows in the last 3-4 quarters.** And with the spread of the Novel Corona Virus across the world, we are in for a sustained period of low economic activity. **In such a period, ratings agencies would have considerably lower volumes.**

**SHARP DIP IN PERFORMANCE & VOLUMES**
The company has seen **revenues and operating profit for 9MFY20 fall 22% & 51% YoY.**




**MAJOR CRA METRICS SUGGEST A SUSTAINED DROP IN NEAR FUTURE**
Three things which CRAs track in terms of macro environment:
o Growth in corporate Bond Market
o Bank Credit Growth
o Revival of the Capex Cycle
**None of the above metric shows a recovery in the near future. Thereby, earnings momentum is expected to continue to be downward.**

**WHISTLEBLOWER HIGHLIGHTS A MAJOR CORPORATE GOVERNANCE ISSUE**
A whistleblower complaint highlighting management interference in ratings of certain companies, **including that of cash-strapped IL&FS and DHFL,** led to regulatory scrutiny of the company. In July, 2019, CARE sent the CEO & MD on leave until the completion of probe into the anonymous complaint. The MD later resigned in December 2019. As advised by SEBI, board has initiated an inquiry into the matter. **Reputation of the company has suffered a lot due to this and loss of business due to this event can be experienced for a very long period of time.**