CARE Ratings Ltd. – Q3 FY22 - EARNINGS CALL – February 2, 2022 - Transcript

Kumari Nisha – Corp Comm - CareEdge Group [0:00:00]

Good morning, ladies, and gentlemen. I am Kumari Nisha from the Corporate Communication team and on behalf of CARE Ratings Limited, I welcome you to our Q3 FY'22 Earnings Conference Call.

We wish to inform you that all participants are in a listen-only mode. And there will be a question-and-answer session once the presentation concludes. During the Q&A session, you can click on or raise your hand option, which will enable me to unmute you for posing your question. Also, please note that this conference has been recorded. Ajay Mahajan, Managing Director & CEO, CARE Ratings Limited will be interacting on this call.

Now, I would request Mr. Ajay to take over the proceedings, please.

Ajay Mahajan - Managing Director & CEO, CARE Ratings Ltd. [0:00:52]

Thank you, Nisha. Good morning, friends, and welcome to the Investor call of CARE Ratings Limited for the last quarter. While we have glided through the first month of the year, so swiftly, let me take this opportunity to wish each one of you a very happy and prosperous 2022. I hope you've had the chance to go through our results for the third quarter ended December 31, 2021 and have analyzed the same.

I am here with the Senior Management of CareEdge, to explain how the company has fared so far this year, and address questions that you may pose after my preliminary remarks. I will also briefly take you through our vision for the coming years, which will give you a perspective of the plans we have in place.

The government as you know is optimistic about India's economic prospects for the coming fiscal. The Indian economy, as announced by the finance minister yesterday, is projected to grow at 9.2% in FY23, the highest among all large economies. In our view, the finance minister has done a stupendous job, by announcing a very forward-looking budget, focused on what India needs over the next decade to return to high growth rates, infrastructure, green and sustainable development and all-inclusive welfare.

A higher-than-expected allocation of 10 trillion to CapEx in the infrastructure sector is likely to crowd in private sector investments as well. Drones in agriculture, organic farming, wasteland development with an outlay of 3 trillion will help build "Bharat" the rural economy so to say and lead to transmission of life there. The extension of ECLGS scheme by another year, with an increase in allocation to 5 trillion rupees is an excellent step to support the MSME sector that faced the brunt of the second wave of the pandemic.

It is impressive that the government is spearheading increased digitization, scaling it from rural to urban areas, planning to create portals and platforms to deliver digital services in critical areas of health and education. All this obviously will consume a large dose of capital expenditure to be precise 7.5 trillion of capex next year.

Economic growth would essentially be led by government capital spending and measures to support consumption. The Union budget announced yesterday had some announcements to this effect. The size of FY '23 budget has been raised by 5% capital expenditure for FY23 is at an all-time high, 24% over the revised estimate of FY '22. Notably, CapEx as a percentage of GDP at 2.5% is the highest in 24 year (since FY '99).

On including the CapEx to be undertaken by the public sector undertakings through their internal and external resources, approximately 4.7 lakh crores in FY23, the push to CapEx will be over 12 lakh crores in FY23, which is a good 10% increase over FY22. In our view, the union budget for 2022-23 is a super positive one. While short-term challenges may exist, the road ahead is being seen and communicated with a great deal of clarity. The focus is on making India future-ready with increased digitization or even giving the PM Gati Shakti an even stronger push to build infrastructure in the country.

Let's now look at the economic performance in the third quarter. Domestic economic activity has been gaining ground, progressively strengthening from the sharp decline in FY21. The lower severity of the COVID-19 latest infections, coupled with the higher rate of vaccination has added overall activity and mobility carrying forward the improvements seen in the second quarter to the third quarter.

The readings from the various high-frequency economic indicators attests to the improvement during the period. GST collections, E-way bills, Toll Collections, PMI Manufacturing and Services, Petroleum consumption among others have recorded further improvements in the third quarter over the second quarter of the current fiscal. Consumption demand during the quarter too received a very strong festive period boost.

Despite the advancements, the output of various segments remained below pre-pandemic levels during the third quarter of FY22. Also, the pace of improvement has been uneven across segments, with some seeing robust growth, while some seeing only modest advances. Adding to this the new variant of COVID-19 virus towards the end of the third quarter, and the resultant intermittent restrictions have been a bit of a drag on activity, underscoring the fragile nature of recovery and the persistent economic and business uncertainty.

Fund-raising by businesses, which has a direct bearing on the company's business in the quarter gone by presented a mixed picture. While fundraising from the corporate bond markets was subdued, it was strong for commercial paper. Bank credit demand by corporates, although restraint picked up pace.

Corporate bond issuances during the quarter totaled Rs 1.45 lakh crores, which was 19% less than the issuances in the preceding quarter and 15% lower than a year ago (Q3 FY21). Issuances in the first nine months of FY22 at Rs 4.14 lakh crores was also 26% lower than the same period of last year.

Commercial paper issuances in the third quarter however, were at 6.5 lakh crores which was 4% higher than the second quarter and nearly 50% more than a year ago. The issuances of these short-term securities during the first nine months of FY22 has seen a 36% increase from the corresponding period of FY21.

Bank Credit offtake has seen a notable improvement as well. The incremental bank credit growth as of end December 2021, was 6.7% as against 3.2% growth in the corresponding period of 2020. This improvement in credit demand is however driven by the retail segment. At the same time, even as the incremental credit growth to the industry and services sector continue to be in contractionary territory, the decline has been less severe. The credit growth to industry and services during April to November '21 was (-)0.5% as against the degrowth of 1.4% in the same period of last year.

There has been stability in the overall environment in the credit and debt markets during Q3 with higher levels of economic activity and mobility.

The strengthening of the economy bodes well for a revival in the investment cycle, in the near future. Moreover, with the government having maintained emphasis on public investment-led economic growth, in the budget announced yesterday, private investments are likely to gradually crowd in too. This, in turn, holds encouraging potential for the debt and credit markets. That said, we are cautious in our optimistic outlook, as we need to be watchful on how the pandemic-triggered episodic disruptions playout in the recovery. Also, with our subsidiaries businesses getting reassuring traction, our resolve and focus on diversification and developing new viable business opportunities for CareEdge Group remains strengthened.

Forced by circumstances, we adapted well to the flexible work style, which enables our employees to work from home in a seamless manner when the need arises. Even as our offices across the regions continue to operate with less than full physical attendance on all working days, we continue to complete all our mandated assignments both new and surveillances within the stipulated timeline. Given the uncertainties regarding the pandemic, we are confident of being able to work effectively and efficiently for the smooth functioning of our businesses even in the future.

Let us now give a quick overview of our financial performance for the third quarter of the ongoing financial year, which I believe most of you would have already read and analyzed.

Our total income increased from 54.83 crores to 55.45 crores for the quarter, while our expenses increased by 5.4% from approximately 33.78 crores to 35.6 crores. Employee costs and other expenses increased by 1.24 crores and 0.63 crores respectively.

Our PBT decreased from Rs.21.05 crore to Rs19.85 crore with 31% margins. PAT was at Rs.14.90 crore, with 27% margin.

As a famous saying by Steve Forbes goals, your brand is the single most important investment you can make in your business. And so, during the quarter gone by, we reinvented ourselves where Care group on-boarded a new and energized brand called CareEdge. We engaged a professional global agency to reinvent the brand and its architecture from its first principles. We are dynamic with strong values and have a vision to become a financial powerhouse. We are backed by a team led by industry experts and thought leaders to establish CareEdge as a trusted "Knowledge Purveyor".

We also further strengthened our outreach efforts. The Economics, Ratings & Industry Research teams published their views on various developments blended with the expertise of our rating and research specialists. In Q3 alone, we published 64 daily, 27 weekly, six fortnightly, 37 monthly and 49 special reports.

Moreover, CareEdge's Senior Management, economist, sector specialists, industry research teams, along with our business development teams participated in multiple knowledge-sharing forums. In Q3 alone, we conducted 22 knowledge-sharing forums. What's more, in continuation of our knowledge dissemination series, CareEdge ratings conducted eight webinars in Q3. Representations were made by industry experts, invited as guest speakers along with CareEdge senior management and sector specialists.

We continue with the initiatives to cement our transformation agenda as well. With technology being one of the key identified enablers of our transition endeavor, we have been upgrading, modifying and establishing new innovative solutions for our businesses as an ongoing process. Our focus and emphasis on our human resources has been continuous and multi-pronged. Training programs have been conducted for our staff on an ongoing basis to keep them up to date with the evolving and latest skill requirements. On the side of leadership, we have also hired some very senior professionals to assist in the transformation of the company.

We are formally on a transformative journey at CareEdge and we are pleased about the overall performance in such challenging times. Our focus firmly remains on improvement in productivity, strengthening analytical rigor in our ratings, and diversifying revenue streams going ahead.

Our journey ahead, rests on these four pillars. First, is the Group approach, to synergise multiple offerings with a singular thrust. Second, is the Technology factor, to drive digital transformation in the ratings business and enhance product quality. Third is Talent, wherein we have employee and culture-centric initiatives to drive growth and cultural transformation. And fourth is Re-branding: to create a distinguished brand worthy of a financial powerhouse.

In conclusion, we are confident that the economy would have a strong bounce back in the remainder of FY '22. Hopefully, the capital expenditure in the economy will only grow from here. The strengthening economy is bound to stimulate investment sentiments and climate albeit at a gradual pace. The budget announced yesterday, as I said, will bring more corporate interests to spend on CapEx. This will be reflected in debt and credit markets. That said, even though the economy appears to be on a strong footing, the pandemic still remains a threat and carries with it a certain amount of uncertainty.

Despite this, we believe we are better positioned to navigate these challenges due to valuable learning from the past as well as our transformative process, which is deeply underway. We shall continue on disciplined execution of our strategy to create better shareholder value in times to come.

With that, I close my speech. Thank you very much. I will be very happy to take questions.

Moderator [0:13:02]

Thank you, sir. Dear participants, we will now open the floor for the Q&A session. As announced earlier, please click on raise your hand option which will enable you to unmute yourself and pose your query. I repeat, please click on the raise your hand option Thank you.

Q&A

Kunal Shah - Carnelian Capital [0:14:25]

On the Rating business, for the nine months of the fiscal we had a growth of 6%; while some of our competitors had better growth. It’s now been some time we have done changes in the team and the rebranding exercise. What is your take on the growth for the rating business in comparison to our peers?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:15:31]

It's a good question, Kunal. It is quite a competitive market out there. I do agree with you and have had the chance to look at the results of other listed companies in our space. In the nine months, speaking of the operating revenue growth, we are broadly in-line with our competitors. That said, we obviously continue to strive to do better.

In these difficult times, while we have fixed some of the challenges we had in the company and are poised for future growth, we have to look at increasing the overall revenue basket within the constraints we have and the disruptions caused by the pandemic.

Also, while the 6% growth in our operating income is not a very large change that I would suggest, however, with the COVID provisions we made at the end of March 2020, we had a Rs.2.67 crore write back last year. Considering this, our growth is actually 7.1%.

While that doesn't change the 6% by a very vast margin, but a 7% increase in operating expenditure, considering credit offtake by the industry was negative, albeit a lower negative, is a satisfactory performance for us. That said, we are not getting complacent and remain focused on seeking high growth in the future.

Vikas - Carnelian Capital:

We made a lot of investments or are making investments in higher growth. So the question is two-fold. When do you see these investments resulting into gaining of the market share? And, secondly, with the whole capex cycle and investment cycle picking up, our growth too has by-and-large come in about the 16-18% range as per the bank's results. So how do you see our growth over the last few years?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:18:15]

Speaking of investments, we have fairly made investments in two things: in fixing the gaps in the senior and middle management structure at CARE Ratings, and imparting stability to an otherwise declining franchise over the last three years, particularly between 2018 and 2020.

So, you can see the numbers. The firm has stabilised and is poised for growth when we get the right lift-off in capital expenditure and in corporate credit. Coming to the bank balance sheets that you are referring to, as given in the credit numbers, wholesale and retail credit demand is marginally growing. If you see the growth in corporate bond volumes, in the economic backdrop, there has been a shrinkage of corporate debt issuances in the capital markets. On bank credit on a bilateral basis, there are pockets of growth opportunities, and we are seeking all of that.

Let me also highlight one very important element, which is that our initial ratings business – which is the new business for us has actually seen significant growth, and that is embedded within these numbers. Sometimes, the industry is very competitive. So, there are lots of challenges in the continued business from the previous years, which is what we normally call the surveillance basket; and within this, we are seeing challenges because of the maintenance of those accounts, especially at a time when the corporate sector financial performance has been very good. Our focus is on large and medium clients; we are not in the SME space in a substantial manner. We believe that we don’t get paid there to offset our costs appropriately. In the large and medium segment, there is a lot of deleveraging that has happened in the past two years or so, as a result of which we are seeing that a lot of clients come back and do not need the ratings anymore. Also, the industry is quite competitive. So, retaining the past accounts is a challenge. But we are well placed to deal with this challenge.

Also, like I said, the initial ratings business has grown reasonably well. And, we believe that momentum will continue in the fourth quarter and into the next year, as we have all seen the reactions of corporate India to the Budget. There is going to be a substantial tailwind. With the government investing in a lot of infrastructure projects, we see a lot of private sector crowding happening over a sustained period of time.

I refrain from making any forward-looking statements, but I am quite confident that CARE Ratings today is very well-poised to benefit from this tailwind that will be unleashed post the Budget announcements and the actual spending of the government that starts from next year.

Manvardhan Baid - Laurel Group [0:21:46]

Congrats, again, on a reasonably decent set of numbers. I was going through the YouTube page that CARE has recently activated, and there is a lot of content being created by way of webinars, etc. I want to understand your thought and focus on that particular aspect, since this is also become a new way to generate income. Anybody producing content now is a media company. So, I see CARE as a media company or a potential media company as well. Any thoughts in that direction? What is the focus? What is the outlook?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:22:33]

It's a very good question. Presently, we are just learning to open up to the market, in line with the very communicative businesses that already exist in the market. I think CARE Ratings has had a distance to cover there. While we have always printed and produced a lot of thematic research reports and sector specialised reports and shared it with the market, with the media and the press. However, going forward, I think, it requires a very concentrated effort to build firstly, the brand, and the brand that stands for all the subsidiaries as well as one group.

So, if you go back to some of the comments I made earlier, the first and foremost approach that we are changing is to have a group approach. We all exist together in the business; all our subsidiaries are now deeply integrating into our strategy. And even on the execution plane, there is a lot of conversation internally happening, as opposed to the past where subsidiaries were generally a little distanced from our core businesses.

Secondly, on the branding side, we have put in a lot of effort. Like I said in the opening remarks, CareEdge is a result of that. Dovetailed with that is a very clear transparent and a constant commitment to share content with the market and to stand up against our very able competitors, specifically also the MNC competitors – in terms of the quality of articles we write, the quality of communication, and more importantly, the quality of insights we share. And we believe that we are second to none in regard to our comprehensive understanding of multiple sectors; the ability to share and communicate is where I think we needed to work a little bit more. So, it's more about creating the right pipeline and right networks into various forms of communication, including social media, where you will see CareEdge group putting in more efforts.

And lastly, with support of this content, the ultimate objective is to generate more business. And while some investors may or may not necessarily see the results of it on a quarter-to-quarter basis, but like I have said, very firmly and consistently over the last two years, transformations don't happen by flicking your fingers and changing culture overnight. We are working painstakingly, but very consistently to become a better communicator of the skills we carry.

The focus pillars are: Knowledge, technology, and a very strong communication and brand strategy. The third pillar of marketing, communication and branding is what we have recently reworked on. The benefit of this will be derived, over a period of time, as the perception of quality takes time to embed in the marketplace. This benefit will also accrue to our subsidiary businesses – the Advisory business, the Consulting and Advisory, and the ESG businesses, that would be the focus. We will be unveiling ESG very soon, it is in fact a part of this quarter.

And likewise, in our Risk Solutions businesses – which may still be at an early stage at this moment – we are seeing a very positive outlook. I think these benefits will take a little time to be seen in the top-line and the bottom-line, but we are firmly on our path to build a very communicative brand because we believe that we have all the knowledge and skill across sectors, but we needed to work on our communication.

Manvardhan Baid - Laurel Group [0:27:08]

I want to understand that in terms of YouTube, in particular, do we have a dedicated resource? Because this is a different world. I mean there is a lot of potential and not many people from your industry have looked at it…

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:28:01]

It's a very good point to make. We are very happy to learn. We have a marketing team in the making. We already had a team, but we needed to deeply strengthen the team and create various channels of communication. So, we are focusing on multiple channels: YouTube, LinkedIn, and various other forms of communication, including Twitter.

But your question is specific to YouTube and how can content be monetised there. Very happy to seek your ideas. But for now, it is fair that we move on from this point as I have noted it down and will put my mind to it.

Sanjay Kumar - ithought [0:29:07]

I have a few questions. Firstly, as you rightly said, large and medium is deleveraging and they are not giving credit to MSME. So that is kind of forcing MSMEs to borrow, which is why we are also seeing banks posting good growth, at least in that segment. So why are we not focusing on that segment?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:29:27]

Two things. One, bank loans to companies that have Rs.50 crore of loans or lesser don't require any rating anymore. So, a lot of MSMEs are typically lower than that threshold and they don't require ratings. Secondly, in segments above the MSME going let's say up to Rs.100 crore of turnover, and I may not be exactly right on the exact thresholds, but broadly, the point is that in the SME space, again, it being an overly competitive market, seven rating agencies are at play. And so, we felt that the price-to-effort ratio of rating a company, even in SME, is not commensurate with the amount of work that we do in the large and medium space. So, while on a marginal basis we don't turn down business, but we look for specific opportunities in this space, which meet our cost hurdles and generate a return for the shareholder.

Sanjay Kumar - ithought [0:30:30]

The large banks, given the limited demand in credit, are gaining market share because of their low cost of funds. So, would you play the pricing game, not in the MSME segment, but in the large and medium segment? What would you go for? Would you go for low growth, high margins, or high growth low margins?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:30:53]

The honest answer is that unfortunately nothing in life and certainly in business life, is a formula. Having said this, I will give you the general pricing discipline we have followed for the last two years. We clearly know the amount of effort that goes into the rating process, the cost of rating analysts, the cost of technology, the cost of supervisory ranks above them, the group head, the rating head, the CGMs and the directors and senior directors of the businesses, of course, and then the senior management.

So, we have our internal thought processes and worksheets around what it takes on the margin to price our product and in what size. We have very clearly put our foot down to not play the game in this race on pricing. That said, if there is on a basis-point-basis, the cost may or may not necessarily be exactly what we think we should get from a client, but if the absolute value of the money makes sense for us, we don't say no to business. Having said this, there are internal strong pricing controls, and within those pricing controls, we try our best to win the business rather than look for any excuse to lose it.

Sanjay Kumar - ithought [0:32:30]

Everybody is talking about the capex cycle. But I have a slight contrarian view, at least from the CARE perspective. Cement, steel, textile, and even chemicals, all of them are expanding, but we are not seeing that reflected in the credit score, because it's mostly internal accruals. So, we might even see net-free textile and steel companies, which is a very rare site in India. So where will CARE’s growth come from, given this limited demand due to internal accruals like capex?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:33:10]

I agree with you. And that is the point I was making that in the past couple of years. We have seen significant deleveraging and internal accruals are very strong and past loans are being paid back by very large companies, who until a few years ago, were a matter for concern for banking. I come from a banking background. For some of the commodity companies in the cycle that hit in 2017-18, there were questions around whether those companies will be robust enough to pay back their debt, and today, we have a situation where they are almost debt-free.

I agree with the comment you are making, particularly on the commodity side, but I do believe that the metals business is on a very strong upswing, and while the absolute large players at this moment of time may have the resources to be self-sufficient on it, there is a lot of middle markets out there – which we also focus on – which will have the needs for capex, particularly since their balance sheets are quite light and their debt EBITDAs and their debt-servicing ratios are now looking very attractive to raise money. Even if interest rates were to be 100 or 150 basis points higher, the cost of money is still very nominal in India, considering the inflation levels, which exist both, globally and in India. I think the cycle will get support from the corporate sector.

A big concentration of clients in our portfolio is infrastructure, where we are very strong, and that requires money, regardless of any of the other comments made until now. So, infrastructure will need money. And as private sector crowds-in, as we set up more green energy and more hydrogen plants and facilities, as we set up more roads and highways, there will be demand across the board, including from EPC for funded and non-funded facilities. So, I remain very positive on infra.

The lower-end of BFSI and smaller NBFC's micro-finance has seen contraction and some challenges in the past couple of years, particularly driven by the second wave of COVID-19. We think some of that will alleviate over a period of time, and it will be time for NBFCs and the banks to gear up for stronger credit growth in the economy in general. So, our big bets are infra, followed by BFSI, followed by the corporate sector.

Mudit Minocha - M3 Investments [0:36:21]

I'm sure you already know that buying back something which is worth Rs.100 at Rs.50 creates instant shareholder value; not only does it create long-term wealth, it also showcases capital allocation prudence of the management, also the minority shareholder treatment. Such decision in time also leaves a trail of evidence of good governance in the company.

In the last five years, a lot of minority shareholders have lost a lot of wealth. The last two CEOs were not able to convince the Board of this simple concept of buyback. They have given some of the other reasons not to pursue the same. So, what assurance would you give to make a very strong case for a buyback, which could deal on the positive side?

We have enough money to buyback say third of the company. And I don't think there is any argument that could substantiate anything against buybacks. You yourself must be very convinced of the same. So, I would want to hear your thoughts on the same and what are your commitment towards it?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:37:41]

There are very strong regulatory issues around this, so very hard to give you a timeline or an answer that throws any clarity on the question you asked with regard to timing, etc. But as you rightly summarized, this is an important matter for us to internally deliberate on, and we are working on it in terms of deliberations. But, is the Board actively considering it at this moment of time? No is the right answer. But is the Board open to a conversation on this? That's the right answer. And I assure you of both, my commitment, and also the ability to move further on this matter with the Board.

Mudit Minocha - M3 Investments [0:38:37]

Would you be needing any help from the shareholder side in terms of giving some support on this? We are happy to share our ideas and thoughts around that…

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:38:53]

Mudit, at the right time, I could reach out or our investor cell could reach out to you. But presently, we believe that for whatever discussions and preliminary discussions we need to have, we have the materials with us. We will also be seeking help from the right players in the system, the intermediaries in the system, at the right time. I cannot show you a firm view on this right now because the matter is under discussion and only at the management level, we haven't yet taken it to the Board in a formal manner.

Mudit Minocha - M3 Investments [0:39:29]

Alright. I'm hoping that you give us some positive results this time. Thank you.

Moderator [0:39:45]

The next query is from the line of Mr. Aakash Mittal? Yes, Aakash.

Aakash Mittal – **Accenture** [0:40:27]

After reading some global trends on the rating industry, one of the trends I find very clearly prominent is the role of technology in it, right technology means automation, RPA machine learning a lot of analytics into it. When I go through your reports, and documents and compare it with competitors who have a foreign parentage, or MNCs, or some sort of linkage, like a sister concern. I don't find that sort of confidence in the technology investments and the role of technology. So, is there anything that you are doing that is not yet shared or something is different than that?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:41:14]

May I ask which document are you referring to when you say that you can't see enough technology being used?

Aakash Mittal [0:41:21]

I couldn't feel that you are leveraging enough analytics, enough of machine learning for your reporting purposes, for generating the credit reports.

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:41:36]

The honest answer to this is as follows. Any project that we embark on in technology takes a little bit of time, to first clear plan, a BRD document and FSD document and then implementation of technology code getting ready. And then finally production of that technology. These things take time and I have said on record in the past. We are working on all our technology projects, and continuously monitoring as well

As a result, sort of efflux of talent in technology from a lot of companies, including people who are working with us, both in-house and as vendors, we have seen some delays counting to one to three months in some of our technology projects. But we are firmly on the path to building a very tech-led business.

In all my comments also, I've been saying, that the four pillars of our strategy are one, the group approach, second talent, third technology, and fourth branding. So tech is a very, very important component of our evolution for the future, not just a facilitator of the business in terms of improving productivity and focusing on a proper workflow platform, and reporting and all of that, but you will see a continuous effort on technology, also for deployment in the marketplace for third party products that we are building in risk solutions, and even in our advisory business through ESG platform and so on so forth.

So, rest assured technology is center stage. If we haven't communicated that well, we will improve our communication.

Aakash Mittal [0:43:34]

Perfect, thank you. That's it.

Chetan Cholera - Prayag Equities [0:44:08]

I heard the communication word a few times during your answers, I hope the same kind of communication you keep with the shareholders by keeping regular con calls from every quarter. And you need to improve the presentation quality also as it's not that good.

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:44:36]

Okay, and do you have a specific document in mind? We take your criticism very constructively.

Chetan Cholera - Prayag Equities [0:44:46]

If you go through the quarterly presentations, I think you'll find out it's not that properly made up.

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:45:04]

Okay, thank you for that feedback, we'll work on it.

Chetan Cholera - Prayag Equities [0:45:10]

And I think you should keep the con call in every quarter after each quarterly result. Also, I don't know why you taking so much of time convincing management and then go to the Board for the buyback.

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:45:40]

We've noted your concern, I have already made my comments. I don't want to say anything more. But we've noted your comments, and we'll work on it.

Chetan Cholera - Prayag Equities [0:45:52]

We expect to restart growth, I think when you came, we had very high expectations from you, but it is taking very long.

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:46:05]

I'm sorry to have disappointed you, we are doing our best. And our teams are also doing their best both on the business development side, we've had a very strong growth of the new business. I think in the aggregate you're seeing a little less growth.

And like I said, if you're just for two provisions, we are 11% up in Q3, the top line revenue against a market where credit growth is, negative-to-flat. But if that disappoints you, I can only tell you that the team is very focused on working hard, we have no other objective. We have no other distraction. We are fully working on both improving internally, increasing our revenue and improving our analytics, technology, diversifying our businesses.

I take your comments on board. And all I can tell you is that we will make note of that and work harder.

Shalabh Agarwal - Snowball Capital [0:47:41]

Good morning, Ajay and thank you for giving me this opportunity. In one of the earlier questions, you alluded that the initial rating has grown, but it's the surveillance basket, which has kind of disappointed. Just wanted to understand is it primarily because of issuers not cooperating or as you said, because of deleveraging and the exit from the pool is higher than inflow, and which is what is leading to this degrowth?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:48:12]

There is no degrowth. I'm repeating myself that the Q3 operating revenues are up 10%, 11%, adjusting for 2,67,00,000 of provision, right back in Q3 of last year. And even otherwise, we have a 6% growth, 5% operating growth here in Q3.

But the point is right, while the new business has seen significant traction, there is a little leakage from the basket below, because of the deleveraging in the corporate sector, that's one reason. The second reason is some issuers don't cooperate, if they switch rating agencies or have any other form of other distractions, I don't know. But there is a little contribution from there as well.

So, it's a mix of deleveraging and some INC accounts both. And third is that if the debt is not replaced with fresh debts and there is more switch to shorter-term borrowings, then automatically the surveillance basket does not get benefit from that. And you can see corporate bond issuances are reducing, in other words, even if debt is sustained, but in shorter baskets, it becomes very hard to make the same amount of fee from the customer from a commercial paper issuance versus dated bonds. Also, it does not add to the surveillance basket for next year. So, it's a mix of all of these factors.

Shalabh Agarwal - Snowball Capital [0:49:49]

Sure. Having analyzed the numbers of competitors, would you believe that this issue is a little more affecting CARE compared to our competitors, or it's more of an industry phenomenon?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:50:06]

It’s very hard to get that breakup of new and surveillance rating business from competitors, it's very hard to comment. We only have the top-line numbers and one of our competitors in the listed space, it has grown in the nine months, I have the numbers in front of me, by 7%.in terms of operating revenue, I'm keeping investment income, because that will be very difficult ARPU, but operating ratings are up 7%. And ours adjusting for provision is also 7.23% up. So, we are broadly neck to neck, I wouldn't therefore, be able to derive any further insights on the surveillance basket.

Shalabh Agarwal - Snowball Capital [0:50:46]

Sure. Sir is there any seasonality in our numbers, because if I look back couple of last years the first and third quarters seem to be lower compared to the second and fourth quarters, anything that you'd like to point on?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:50:59]

This is something that we have discussed before, but it is a good sort of point in the discussion today to refresh this, our thinking and more importantly, the characteristics of our hook. The hook is such that there is a larger sort of surveillance basket due as also new ratings typically are. As you as we all know the busy season is indeed, the second half of the year. So, from a new business point of view, the business is indeed loaded in favor of the second half of the year.

Apart from that, from a surveillance standpoint, I think the way the business exists at CARE, historically, is that the quarter two and quarter four or more dominant, quarter one and quarter three, as you rightly point out, are relatively lower.

And my last comment on this is it's also got to do with accounting, like some of our competitors regardless of when the surveillance is due, they account for the revenue on an accrual basis, as in, they will count for the surveillance revenue on a one by 12 basis, every month. Whereas in our accounting policy is such that we take 90% of the revenue of the surveillance in the month that we complete the surveillance.

So historically, the cycle of surveillance is annual, and it's very little that we could do. On annual surveillance, if we did the credit in September last year, chances are when people credit again in September this year. And therefore, the quarter two and quarter four predominance in our revenue basket continues to sustain year after year.

Shalabh Agarwal - Snowball Capital [0:52:55]

Sure, that's very helpful. Sir the last question is that couple of quarters back, you had mentioned a platform that you were trying to create where all the companies, all the rating companies will come together and kind of have a representation to the regulator. I guess then only you and one smaller rating company had agreed on. So, what's the update on that?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:53:26]

So, this is one of those things that you want to do for the larger sort of market development and in that market welfare. I'm acutely aware of that, we have not been able to make as much inroads into firstly improving the membership of AIRA, that's called the All India Rating Association. I'm the chair for the first year. But unfortunately, a lot of that time was lost in setting up the organization, in just getting things to get started, as you know, now, in anything that you set up a new, it takes a little while to put that into motion.

So, in my defense, I would say that some of that was caused by it being the first-year effort. And the second is the pandemic also has sort of somewhere slowed this initiative. And the third is that we have made efforts with around two of our larger set of rating agencies, but they have had their diffidence in joining for whatever reason.

So, at this moment of time, it is work in pipeline, and until we get representation from the MNC group, it will be hard to make this market binding, sort of effort here and becoming one single mouthpiece for the rating agencies as also one single association to engage with us.

Prayesh Jain - Motilal Oswal [0:55:27]

Firstly, you spoke about a lot of tailwinds for the industry going ahead. But could you just highlight any regulatory issues such as Basel 3, how does that impact the industry going ahead?

Secondly, you alluded to competition. But you know, what's happening on the Brickworks front is in any further action out there? Thirdly, could you talk about your inorganic activities, which you had alluded earlier that you would look at, particularly on the risk analytic side, that you would look to expand your operations on that side? So, any developments happening around there?

And my last question would be your thoughts on how the margins will pan out going ahead? In this quarter, you've seen significant pressure on margins. So how do we see on a full year basis margin now and going ahead?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [0:56:27]

Basel III has been a challenge. And so far, so good. The banks have been internally challenged on the NPA front. And at this moment of time, even with the decline in their GNPA ratios, from 8.5%, across the industry to more like seven or low sevens, across the industry, it's still a big challenge for banks to be able to first build internal models, and then also convinced the regulator of the same.

And if that happens, it happens, we need to be mindful of that risk, and consistently, keep hearing our business towards fixed income and capital markets, and therefore keep reducing reliance on that business. It's not possible to do that in one year. But our objective is to consistently improve the mix towards capital markets.

On Brickworks, I would avoid speculation. And I have not heard anything about this other than that speculative report that appeared in some newspaper. So, I would think that the matter maybe at this moment of time, is on the back burner, if not dead.

Third, inorganic activity, we said so again, in one of our previous calls, that we looked at this with a very clean lens over the last one year of really hard work, as to what are the three-four areas that we should be interested, we did arrive at risk analytics, data analytics, KPO, a couple of those type of opportunities as areas where rather than build from scratch, we should look for opportunities in the inorganic space.

Having said this, it's once you determine that, the space is a good space, you must also find the right suitor the right opportunity. And while we remain very open, there is no immediate thrust within the constraints of our cash corpus. And obviously, from a diversification standpoint, we don't believe that we should use all of that in one acquisition. And considering the cash pool, the constraints of prudence on top of that cash pool and the market opportunity in the desired segments, at this moment of time, we don't have necessarily anything specific to go after, but we will remain vigilant in this space. And if we find something interesting that we can build upon at the right value, ultimately we are very mindful of the right value, having said this, we are not short of risk-taking. So don't misconstrue that, to think that we don't have the ability to take risk, but we are taking the risk on behalf of the shareholder. And therefore, we will apply the lens of prudence on valuation, as well as the future growth that business can provide to us, because you would have paid in full for what it brings to the table if not higher through goodwill, and the future growth of that business and synergy with the CARE platform will be the driver for making the acquisition in the first place. And we're very conscious of that. Considering the very strong secondary market for equities of very, very perky valuations, we believe that opportunity may or may not arise in the immediate future. I hope I answered that comprehensively.

And my last comment is that instead, we'll continue to invest in our own businesses, our risk solutions, our advisory and consulting business internationalize some of that, and make more investments there. So, in the early part of the call, a few investors have had some concerns around revenue growth, as well as on reducing back margins. The challenge always is, how much of that cash we can put to use in one year versus spread it over a longer period of time, we have been very prudent on that.

But sometimes the key lies in making the right investments, and not be guided by accounting in making those investments. And we remain very vigilant on what needs to be done to build businesses for the future, and not just be focused on quarterly performances. So that's the comprehensive answer on inorganic.

Your last question, on margins, it's a pure play on revenues. Margin in our business, in a high operating leverage business, as you can understand very well is totally a function of revenue growth. In a quarter where we can grow 20% 30% or in a year where we can grow even 12% to 15% that margins will improve significantly.

If you see our cost structures, despite the fact that CARE is still not the best paymaster, we have tried to manage our expenses very effectively. Our incremental expenses in technology are less than five crores in nine months' time. And all other headline, expense items, we are safe. Our expenses are really in manpower. And that's 75% of our expenses and technology and other expenses on the balance 25% of our expenses. And we have tried to manage that very well.

I don't think we will have significant negative surprises there. And our margins will definitely improve as our revenues improve. We remain very, positive, very optimistic but only worried about no resurgence of the epidemic further from here.

Prayesh Jain - Motilal Oswal [1:03:32]

Thank you so much. Just a follow-up on the first question that you answered with regards to Basel 3. So, is it fair to assume that in case the credit growth revives in the industry and the services segment, is it fair to assume that the growth in the ratings industry's revenue would be relatively much lesser as compared to the credit growth that we'll see in the space?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [1:04:01]

It's very hard, maybe now that you asked, we'll back test this hypothesis, and then see if we can through AI and ML, as some of my other friends on the call suggested, we'll see if there is any predictability to this that we can create. But the marketplace is a very dynamic one, it's very hard to say that at an aggregate level, there is a certain correlation or a certain factor of bank credit growth that you can translate into credit growth.

The first and foremost is how much of that credit growth is wholesale growth. And how much of that growth is retail growth. The retail growth also comes to the rating agencies through NBFCs, but very rarely through the banks, because banks as you know very well, rate only subordinated and hybrid papers. We don't rate bank deposits and we don't rate bank-related those types of assets.

So effectively when we start thinking about this, it's a very complex situation to solve. Again, the dynamics in banking are spread between public, private, and cooperative sectors very differently. Then you have the NBFC space, where you have retail NBFCs, and some of them very marginally, but some of them also do wholesale.

It's very hard to model some of this to derive the conclusion you derived. But I would say that with infra, and BFSI as our strong segments, I would believe that there would be a reasonable correlation. It's very hard to guess how much lower to the headline credit growth number you see from the BFSI space.

Keshav Garg [1:06:04]

So, I don't think there is any point in talking about the buyback because all we get are false assurances. So I'll let that pass. Sir. I wanted to understand that we have heard so much talk about the growing non-rating advisory business, but we don't see it in the results what we see is degrowth from 7 crore revenue in Q3 of last year to 5 crore revenue with a loss.

Sir so, anything you can tell the shareholders which can reassure them about the prospects of this company will be very grateful. Thank you very much.

Ajay Mahajan - Managing Director, Care Ratings Ltd. [1:06:43]

Keshavji, I understand, however, this requires a consultation and discussion with the Board and and we don't have any intent to mislead you or any other shareholder.

With regards to your question on subsidiaries, I have the numbers. I'm also a little disappointed that in one of the four subsidiaries, we had some challenges in this year, and I'll explain that to you. But let me start by saying, that in one of our subsidiaries in Africa, we have grown revenues nine months by 53%. Again, the baselines are smaller, but we are talking about 5 crore of revenue from 3.29 crores in our Africa business.

We are growing our Nepal business is flattish but not degrown, it's grown 7.24% in revenue terms. And even in back terms, both these companies are significantly higher than last year. We are also thinking about how we can use our Mauritius subsidiary to also see some contiguous geographies around Africa and see and build a growth strategy without taking any undue risks. And you will understand that Africa is still a market that most people are exploring.

So, it is very important in credit ratings businesses to not go over-board and bet your reputation online so we want to be very careful, but nevertheless, we are exploring opportunities in both these businesses.

To summarize, both our rating subsidiaries are sharply up in revenue terms, particularly Africa. Our third subsidiary is Advisory business, that business is upon revenue terms 55% in the first nine months. It made a total revenue of 5.7 crores in the first nine months as opposed to 3.68 crores in the first nine months of the last year. So, it's up 55%.

This business will obviously take a little while to meet its operating costs and start making money, but kindly note that these are not insignificant numbers, considering that they are literally built from scratch businesses. CART was a 3-crore business, March '20 ended. So, from there we have gone to 5.7 in nine months and advisory businesses in India are very hard to build. I hope you appreciate that point. And within that context, these three businesses have done reasonably well and we are quite happy with the growth we are seeing. We will continue this momentum and these numbers will become more meaningful in times to come.

The fourth subsidiary, which is our IT technology focus subsidiary, unfortunately had a difficult second quarter on the back of exodus of tech talent as also some markets outside the country which were becoming inaccessible due to even more severe pandemic conditions in those countries.

So those projects delays cost us some revenue reversals and some as a result in Care Risk Solutions we are 16% down on nine months revenue, but we hope to make that up hopefully in the not-so-distant future. So, assuring you Keshavji, that subsidiaries are not just a high-level talk, it is a very focal area for CareEdge's new management, and we are working as a larger group within the constraints of regulations to make sure that this franchise develops across the world and not just in India.

Keshav Garg [1:10:29]

Sir, also wanted to understand that ICRA in the third quarter their profits have gone up y-o-y from 12 crores to 15 crores in the ratings business vertical only. So, can you share your comments on this?

Ajay Mahajan - Managing Director, Care Ratings Ltd. [1:10:41]

These are all numbers and facts. So, I cannot disagree. All I can say is the nature of the business seems to suggest that through the year, numbers improve quarter by quarter, but I would just compare the nine-month performance, they are 7%, we are 7%. Their expenses are more controlled than ours because we are operating from a lower base and their operating profit is indeed up because of the significant increase in the revenue in Q3

So, we are as competitively driven. I can only tell you that we are doing our best. It's hard to replicate somebody else's strategy or somebody else's balance sheet, we are doing our best.

Keshav Garg [1:11:31]

Okay sir, thank you very much and best of luck.

Moderator:

Moderator [1:11:36]

Thank you, Keshav. With this I'll close this call. Dear participant, thank you for your participation. We look forward to your comments or suggestions in the feedback mail, which will be coming in your inbox no sooner this session ends.