

CRISIL Ltd.

Estimating Growth Rates

Corporate Valuation Assignment - VI

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Key observations about CRISIL⁽¹⁾:

- CRISIL is India's largest rating agency and has rates more than 7,000 debt instruments globally
- Strategic diversification into different business in the past years

2004	2007
• <i>Ratings – 59%</i>	• <i>Ratings – 32%</i>
• <i>Advisory – 27%</i>	• <i>Research – 42%</i>
• <i>Research – 14%</i>	• <i>Advisory – 26%</i>
- Leadership across all business
 - Ratings: 70% market share in domestic debt market
 - Research: Irevna – global investment research outsourcing provider, ranked no.1 in Financial Services Industry Analytics Outsourcing for the 2nd consecutive year; CRISIL Research (caters over 600 clients including 90% of commercial banks in India); CRISIL Fund Services – Market leader in Indian funds space
 - Advisory: Strong relationship with governments, regulators, corporate providing advisory services on policy and infrastructure and also one of the leading provider of risk solutions to commercial banks in India
- In 2007, CRISIL had a robust performance driven by growth in all its business segments:
 - Ratings business grew by 44% and Research business grew by 56%
- Ratings segment has grown at a CAGR of 31% over 2004-2007 period and contributes approx 32% to the operating revenue
- Research revenue has grown at a CAGR of 125% over 2004-2007 and contributes approx. 42% to the operating revenue
- Advisory business has grown at a CAGR of 40% over 2004-2007 and contributes approx. 26% to the operating revenue

Key Growth Drivers for CRISIL⁽²⁾

- Ratings business: Development of Bank loan, SME and structured finance markets
 - Basel II opportunity – 6,500 entities to be rated by 2010
 - SME ratings are expected to grow from 1000 ratings to 5000 ratings in 2009
 - Securitization market is expected to grow over the next few years
- Research business: Growth in IPO grading, derivatives and credit outsourcing
 - Untapped credit and derivatives off-shoring sector
 - Strong performance in the research business despite the current financial turmoil
- Advisory services: Infrastructure development
 - Mandatory grading of IPOs
 - Demand for customized research services
- New Initiative: Credit Information company
 - Retail finance sector to double to INR 5.4 trillion (US\$ 138 billion) by 2011

Notes:

(1) Source: CRISIL Analyst Meet, April 2008: <http://www.crisil.com/crisil-investors/investor-analyst-meet.htm>

(2) Source: CRISIL Analyst Meet, April 2008: <http://www.crisil.com/crisil-investors/investor-analyst-meet.htm>

Industry growth ⁽³⁾:

- Credit rating business in India is set to grow because of 3 growth drivers:
 - Strong CapEx cycle in the economy to increase debt raising activity
 - Development of corporate bond market which is untapped
 - Regulatory requirements for Basel II norms
 - Growing insurance industry

I. Estimated Extraordinary Growth period for CRISIL: 4 years

- Based on the above growth factors related to CRISIL and the industry, we expect CRISIL to grow at a rate of high growth rate over the next 4 years
- This growth will slow down after 4 years due to increased competition and pricing pressures

Key challenges and issues:

- Talent management / High attrition rate – 20%-25%
- Cost pressures arising due to increased development and training costs of employees
- Increasing competition and pricing pressure

After considering the above information, we have calculated the growth using 3 methods:

- Historical/Fundamental growth
- Analyst estimates
- Return on Equity, Retention ratio and Leverage information

Key Growth Drivers for CRISIL:

- Strong prospects in the ratings, research and advisory business
- New Initiatives: Credit Information company
- Strong cash position
- No financial leverage
- High Retention ratio and low dividend payout ratio
- Increase in EPS
- Increasing ROE

II. Historical growth rates ⁽⁴⁾

a) EPS Growth (Arithmetic mean and Geometric mean)

	Dec-07	Dec-06	Dec-05	Mar-05	Mar-04
Earnings Per Share	91.68	50.29	25.44	31.26	23.41
Growth % (y-o-y)	82.32%	97.63%	-18.61%	33.58%	
Growth % (CAGR)	40.68%	29.04%	4.26%	33.58%	

Notes:

(3) Source: Analyst Report by Emkay Research dated Nov 2008

(4) Source: Company filings and Reuters knowledge

b) Growth in Sales , Operating Income and Net Income

	Dec-07	Dec-06	Dec-05	CAGR %(05-07)
Sales	2,70,88,00,207	1,56,85,30,121	84,98,49,772	78.53%
Operating Income	1,04,78,00,000	59,37,00,000	29,84,00,000	87.39%
Net Profit/Loss	70,67,00,000	37,38,00,000	18,14,00,000	97.38%

Additionally, there has been a robust growth in revenues as well as net income.

Revenues, Operating Income and Net Profit: During the year 2007, sales have increased by 73% yoy and the sales have been increasing at a CAGR of 79% from 2005-2007. The operating income (EBT) has increase at a CAGR of 87% from 2005-2007 and grew by 76% yoy. The net profit also grew by 89% in 2007 and has been increasing at a CAGR of 97% from 2005-2007.

Importance of fundamental growth rates:

We consider the historical growth drives the future growth of the company as it reflects the owner-management's ability to grow in the market, aggressiveness to venture into new business, degree of leverage, strategy to utilize resources efficiently and capitalize on every opportunity.

We consider the compounded annual growth rate in EPS of 40% as a good indicator to calculate the future growth of CRISIL. The EPS has been consistently rising from the past 5 years.

III. Analyst Estimates ⁽⁵⁾

CRISIL	Emkay Research
Net Operating Revenue (CAGR 07-09)	40%
Net Profit (CAGR 07-09)	41%
EPS (CAGR 07-09)	46%
ROE (consistent)	36%

As there are no other analyst recommendations available for CRISIL, we have considered the estimates available for the competitor as well.

ICRA	Emkay Research
Net Operating Revenue (CAGR 07-09)	36%
Net Profit (CAGR 07-09)	36%
EPS (CAGR 07-09)	36%
ROE (consistent)	24%

Importance of analyst estimates:

We consider the figures estimates by Emkay research are approximately in-line with our historical growth rates in EPS.

As there are very few analysts covering CRISIL, we have limited information on other estimates.

Notes:

(5) Source: Analyst Report by Emkay Research dated Nov 2008.

IV. Growth rates using Return on Equity ⁽⁶⁾

a) ROE* RR

	Dec-07	Dec-06	Dec-05	Mar-05	Mar-04
Dividend Per Share	18.06	10.14	6.58	7.96	6.29
Earnings Per Share	91.68	50.29	25.44	31.26	23.41
Price per share	3,627.90	2,250.00	1,549.35	683.30	480.00
Dividend Yield	0.00	0.00	0.00	0.01	0.01
ROE	24.70%	20.84%	12.90%	18.03%	15.51%
Dividend Payout Ratio	0.20	0.20	0.26	0.25	0.27
Retention Ratio (RR)	0.80	0.80	0.74	0.75	0.73
Growth (ROE*RR)	19.83%	16.64%	9.56%	13.44%	11.34%

The overall historical growth rate comes to approx 20%.

b) ROE and Leverage

As CRISIL is a debt-free company, there is no interest expense to be deducted nor are there any changes in the debt-equity ratio of the company. The company has clearly stated in its 2007 Annual report that *“CRISIL has been a debt-free company since its date of incorporation. The company followed the strategy of funding all its expansion, diversification and infrastructure related expenditure through internal accruals.”* Hence, the equity shareholders do not face any financial risk.

Given our understanding about the company, we would give equal importance to growth calculated by ROE*RR as the growth calculated using fundamentals. Reasons being:

- It takes into account the level of reinvestment which is very high in the case of CRISIL
- Reducing dividend yields
- Increase in ROE
- Increase in EPS

Moreover, this method is also a reflection of the fundamentals of the company.

V. Factors important for determining the weights for all the above methods

Fundamentals – EPS growth: Since the EPS growth is fairly consistent – 40% weight

G=ROE*Retention ratio: Since growth in ROE and RR is fairly consistent – 40% weight

Analyst estimates: Since very limited justification is available related to the estimates growth rates.

However, the estimate is in-line with the current EPS growth we have given 20% weight to the same.

VI. Conclusion

Taking into consideration, the various viewpoints related to the growth factors of CRISIL, we consider that it has huge potential to outperform. Moreover, CRISIL is in a monopoly kind of business and also has a strong business growth lined for its other divisions.

After considering the above weights assigned to each of the business, we have estimated CRISIL to grow at a rate of 32%-35% for the next 4-5 years.

(6) Source: Company financials and Reuters knowledge.