September 20, 2021

Motilal Oswal Financial Services Limited: Rating reaffirmed; PP-MLD[ICRA]AA (Stable) assigned to long-term principal protected market linked debentures

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Principal Protected Market Linked Debentures	-	100.00	PP-MLD[ICRA]AA (Stable); assigned
Non-convertible Debentures	300.00	300.00	[ICRA]AA (Stable); reaffirmed
Bank Lines – Unallocated	300.00	300.00	[ICRA]AA (Stable); reaffirmed
Total	**600.00**	**700.00**	

**Instrument details are provided in Annexure-1*

PP-MLD refers to the principal protected market linked debenture programme. According to the terms of the rated market linked debentures, the amount invested, i.e. the principal, is protected against erosion while the returns on the investment could vary as they are linked to movements in one or more variables such as equity indices, commodity prices, and/or foreign exchange rates. The assigned rating expresses ICRA's current opinion on the credit risk associated with the issuer concerned. The rating does not address the risks associated with variability in returns resulting from adverse movements in the variable(s) concerned

Rationale

ICRA has assigned rating to the Rs. 100 crore long-term principal protected market linked debentures (PP-MLD) and reaffirmed the rating on the Rs. 300 crore non-convertible debentures (NCD) and Rs. 300 crore bank lines of Motilal Oswal Financial Services Limited (MOFSL).

For arriving at the rating, ICRA has taken a consolidated view of the Motilal Oswal Group (comprising MOFSL and its subsidiaries). The rating takes into account the Motilal Oswal Group's healthy operational profile, given its track record and established position in capital market related businesses, and the increasing diversification in revenues with the scaling up of the fee-based businesses. The rating also considers MOFSL's healthy financial profile with the steady performance of the core business[1] and the comfortable capitalisation and leverage levels on a consolidated basis. MOFSL reported a profit after tax (PAT) of Rs. 1,259.46 crore (Rs. 1,197.69 crore excluding share of joint venture and associates) in FY2021, up from Rs. 189.58 crore (Rs. 215.40 crore excluding share of joint venture and associates) in FY2020, supported by the strong performance of the core business as well as the mark-to-market (MTM) gains during the year. The leverage ratio improved to 1.27 times as of March 31, 2021 from 1.48 times as of March 31, 2020. In Q1 FY2022, the Group reported a PAT of Rs. 220.10 crore and the leverage ratio stood at 1.08 times as of June 2021.

These strengths are partially offset by the inherent volatility in capital markets and the highly competitive and fragmented nature of the broking industry. This, coupled with the changing product mix (increasing share of derivatives and non-delivery cash volumes), has resulted in pressure on the broking yields. However, the increasing focus on annuity-based businesses (asset management, wealth advisory, etc) provides comfort. The Group's experience in the lending business remains limited with asset quality issues in the housing finance business (housed under Motilal Oswal Home Finance Limited; MOHFL) in the recent past. Subsequently, the Group undertook several remedial measures, including the strengthening of the systems and processes, managerial support with increased oversight, and capital infusion, thereby underscoring its commitment to the venture. This, coupled with the divestment of bad loans, resulted in a significant improvement in the asset quality (MOHFL

[1] *Core business refers to capital markets and related businesses, excluding housing finance business*

reported gross non-performing assets (GNPA) of 2.2% of advances as of March 2021 compared to 1.8% as of March 2020 and 9.2% as of March 2019). The asset quality, however, moderated in the current fiscal (GNPA of 4.7% as of June 2021) impacted by the Covid-19 pandemic, which had a bearing on collections as well as disbursements.

Going forward, the Group's ability to maintain healthy asset quality and profitability in the housing finance business, given the current challenging operating environment, would remain critical from a credit perspective. Nevertheless, ICRA draws comfort from the performance of the core business coupled with the healthy capitalisation profile, which provides adequate buffer to absorb losses and incremental credit costs over the near term. The Stable outlook reflects ICRA's expectation that MOFSL would maintain its credit profile supported by the performance of the core business.

Key rating drivers and their description

Credit strengths

Established position and demonstrated track record in capital market related businesses – The Group has a presence in diverse business segments comprising retail and institutional broking, wealth management, margin funding, commodity broking, investment banking, asset management, private equity and housing finance. MOFSL serves as the main holding company and also houses the capital market related fund-based business of the Group. MOFSL is an established player in the equity broking business holding an aggregate market share of 1.30%[2] in FY2021 (1.41% in FY2020 and 1.79% in FY2019). The Group caters to both retail and institutional clients and has significantly scaled up its presence over the years. It has an established retail franchise with more than 19.7 lakh clients across ~5,500 franchisees as on March 31, 2021, up from 14.5 lakh clients across ~3,500 franchisees as on March 31, 2020. The company reported a robust performance in FY2021, with broking volumes registering a growth of ~80% compared to a growth of 14% in FY2020. Further, the client base expanded to over 21.9 lakh clients with more than 5,700 franchisees as on June 30, 2021.

Gradual diversification in revenue profile supported by scaling up of annuity-based businesses – Over the years, the Group has increased its focus on businesses like asset and wealth management. The scaling up of these businesses has resulted in the increasing diversification of the revenue stream, which was capital market (equity broking and distribution) dominated and vulnerable to the volatilities in the stock market. Furthermore, the fee-based nature of revenues from these businesses provides stability to the revenue stream. The fee-based businesses contributed ~36% to the consolidated net operating income (NOI) in FY2021, up from 26% in FY2015. Moreover, the Group's asset and wealth management (fee-based) businesses accounted for 39% of its profitability in FY2021 while the capital market businesses contributed 54% and the housing finance business contributed 7%.

Healthy capitalisation profile – MOFSL's capitalisation levels remain healthy with a net worth of Rs. 4,432 crore as on March 31, 2021 (Rs. 3,086 crore as on March 31, 2020 and Rs. 3,053 crore as on March 31, 2019) supported by strong internal capital generation. The scaling up of the housing finance business, housed under MOHFL, led to an increase in the debt levels and the leverage on a consolidated basis. However, with limited disbursements in FY2021 owing to the pandemic, and a sizeable increase in the net worth, the consolidated gearing moderated to 1.27 times as on March 31, 2021 from 1.48 times as on March 31, 2020 and 1.67 times as on March 31, 2019. Excluding the housing finance business, the gearing would have been 0.63 times as on March 31, 2021 compared to 0.52 times as on March 31, 2020. As on June 30, 2021, the net worth stood at Rs. 4,610 crore with a gearing of 1.08 times. Going forward, the capitalisation profile is expected to remain healthy with the consolidated gearing expected to remain below 3 times over the near-to-medium term.

Healthy profitability supported by steady performance of the core business – MOFSL's core business' performance has been steady over the years. Its core operations reported a strong net profit (PAT)[3] of Rs. 1,219.23 crore (Rs. 1,157.46 crore excluding share of joint venture and associates) in FY2021 compared to Rs. 150.50 crore (Rs. 176.32 crore excluding share of joint venture

[2] *Basis gross turnover; includes prop*

[3] *Refers to consolidated MOFSL, excluding housing finance business*

and associates) in FY2020. The net profit in FY2021 was boosted by the MTM gains passed through the profit and loss account. MOHFL reported a PAT of Rs. 40 crore in FY2021 compared to Rs. 39 crore in FY2020 (after losses in FY2019). MOFSL reported a consolidated PAT of Rs. 1,259.46 crore (Rs. 1,197.69 crore excluding share of joint venture and associates) in FY2021, up from Rs. 189.58 crore (Rs. 215.40 crore excluding share of joint venture and associates) in FY2020, even though the provisions of Rs. 66.6 crore (post tax) in relation to the commodity trading settlement (pertaining to the sudden drop in crude oil prices in April 2020) impacted the consolidated profitability to some extent. The consolidated PAT stood at Rs. 220.10 crore in Q1 FY2022.

While assigning the rating, ICRA has also taken note of the Securities and Exchange Board of India's (SEBI) order regarding the Group's commodity broking and trading business in relation to the National Spot Exchange Limited (NSEL) settlement crisis in 2013. The Group has appealed against the order to the Securities Appellate Tribunal (SAT) and the matter is underway. As commodity broking forms a small share of the overall revenue stream and the Group has fully provided for its proprietary

position in commodity trading (Rs. 58.7 crore), the direct impact of the order on the business is expected to remain limited. Further, MOFSL has taken a hit of Rs. 66.6 crore (post tax) on its positions (taken on behalf of its clients) as crude oil prices witnessed a sharp drop on April 20, 2020. The company deposited this amount with the Multi Commodity Exchange of India Ltd (MCX) on April 21, 2020 to bring up the margin to the required level. MOFSL has filed a writ petition in the Bombay High Court against SEBI and MCX. It has also filed arbitration claims against the clients for the recovery of debit balances from them. ICRA will continue to monitor the outcome of any incremental developments from this event and the potential liability on the company.

Credit challenges

Exposed to volatility inherent in capital markets; gradual diversification of business profile provides comfort – The Group's traditional lines of business (broking and investment banking) remain exposed to the volatility inherent in capital markets. The capital market related businesses contributed 44% to the company's total turnover and accounted for 54% of its profit in FY2021 compared to 48% and 44%, respectively, in FY2020. Over the years, the Group has forayed into businesses such as housing finance and asset management to diversify its earnings profile. The revenues from the asset management business impart stability to the Group's earnings profile as they are linked to the assets under management (AUM). The asset and wealth management business contributed 19% to revenues (30% in FY2020) while housing finance and fund-based revenues accounted for 23% and 14%, respectively, in FY2021 (22% and 0%, respectively, in FY2020).

Intense competition in capital markets – With increasing competition in equity broking, the advent of discount brokerage houses and a significant surge in derivative volumes, the average yields for broking players have been under pressure. As MOFSL's derivatives turnover share increased to 93% in FY2021 from 88% in FY2018, its overall blended yield declined to 1.15 bps in FY2021 from 2.00 bps in FY2018. With the competitive intensity in the industry expected to remain high, the industry margin is expected to remain under pressure. However, the lower level of equity market penetration in the country indicates significant untapped potential for expansion.

Limited experience in lending business – The Group's housing finance business, which commenced under Motilal Housing Finance Limited (MOHF) in May 2014, witnessed a deterioration in the asset quality in FY2018 and FY2019. The Group undertook several remedial measures, including the strengthening of the processes and systems, managerial support, increased supervision and capital infusion, to support the venture. Supported by these endeavours and the divestment of NPAs to an asset reconstruction company (ARC), MOHFL's GNPA improved to 1.80% of advances as of March 2020 from 9.20% as of March 2019. However, the pandemic and the ensuing state-wide lockdowns/restrictions impacted operations, resulting in a dip in collections. Collections dipped in H1 FY2021 (~74% collection efficiency in July 2020), although they picked up in H2 FY2021 and increased to ~97% in March 2021. The resurgence of Covid infections, coupled with state-wide lockdowns, led to a decline in collections in Q1 FY2022 (collection efficiency dropped to ~87% in April 2021; subsequently improved to ~92% in June 2021). MOHFL's GNPAs inched up to 2.2% of advances as of March 2021 and increased further to 4.7% as of June 2021.

The performance of the core business, coupled with the healthy capitalisation profile, provides adequate buffer to absorb losses and incremental credit costs over the near term. Going forward, the Group's ability to improve its collections and consequently the asset quality, follow a measured growth strategy and maintain healthy profitability would remain critical from a credit perspective.

Liquidity position: Strong

As on June 30, 2021, MOFSL's investment book stood at ~Rs. 3,680 crore with investments in mutual funds, private equity, alternative investment funds (AIFs), equity instruments, etc. At the consolidated level, MOFSL has a comfortable liquidity position with free cash of ~Rs. 200 crore, liquid investments of ~Rs. 2,050 crore and undrawn bank lines of ~Rs. 1,660 crore as on that date. The total debt obligations, including interest payments for the period up to December 2021, stood at ~Rs. 1,700 crore. Further, the Group has adequate liquidity for placing excess margin at the exchange if required. The liquid nature of the margin funding book (~Rs. 1,700 crore as of June 2021) also provides comfort.

Rating sensitivities

Positive factors – ICRA could upgrade the rating on a substantial and sustained improvement in the Group's profitability along with a diversification in the earnings profile while maintaining healthy asset quality indicators and robust capitalisation.

Negative factors – The rating could be revised if there is a significant deterioration in the asset quality of the credit book, thereby impacting the Group's profitability and capitalisation. Further, changes in the regulatory environment, which may adversely impact the company's business operations and financial performance, would be a key rating sensitivity.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Entities in the Brokerage Industry Consolidation and Rating Approach
Parent/Group Support	Not Applicable
Consolidation/Standalone	ICRA has taken a consolidated view of MOFSL along with its subsidiaries, which are engaged in various activities such as equity broking and distribution, commodity broking, margin funding, asset, wealth and portfolio management services, investment banking and housing finance

About the company

Incorporated in 2005, MOFSL serves as the holding company of the Motilal Oswal Group, which is among India's leading providers of capital market related services. The company, through its subsidiaries, namely Motilal Oswal Private Equity Advisors (MOPEL), Motilal Oswal Asset Management Company Limited (MOAMC), Motilal Oswal Wealth Management Limited (MOWML), Motilal Oswal Home Finance Limited (MOHFL), etc, is engaged in the businesses of broking and distribution services, asset, wealth and portfolio management services, private equity and housing finance.

The company reported a consolidated net profit of Rs. 1,198 crore on net operating income (NOI) of Rs. 1,848 crore in FY2021 compared to a net profit of Rs. 215 crore on NOI of Rs. 1,554 crore in FY2020. At the consolidated level, the Group's net worth stood at Rs. 4,432 crore as on March 31, 2021.

Key financial indicators

MOFSL (consolidated)	FY2020	FY2021	Q1 FY2022*
Brokerage Income (Rs. crore)	469.52	743.64	568.94
Fee Income (other than broking; Rs. crore)	711.24	663.45	
Net Interest Income (Rs. crore)	273.40	322.78	105.79
Other Non-interest Income (Rs. crore)	100.25	118.43	14.27
Net Operating Income (NOI; Rs. crore)	1,554.41	1,848.30	689.00
Total Operating Expenses (Rs. crore)	959.84	1,066.26	466.86
Profit before Tax (Rs. crore)	285.19	1,456.74	285.73
Profit after Tax (PAT; Rs. crore)	215.40	1,197.69	220.10
PAT (including share of joint ventures and associates; Rs. crore)	189.58	1,259.46	221.22
Net Worth (Rs. crore)	3,086.30	4,432.16	4,610.00
Borrowings (Rs. crore)	4,636.27	5,705.94	5,040.00
Gearing (times)	1.48	1.27	1.08
Cost to Income Ratio (%)	61.75%	57.69%	67.76%
Return to Net Worth (%)	6.93%	31.47%	19.25%
PAT/NOI (%)	13.86%	64.80%	31.94%

Source: *Company, ICRA Research; *Unaudited numbers; All ratios as per ICRA calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)					Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2021 (Rs. crore)	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Sep 20, 2021	Aug 09, 2021	Dec 16, 2020 Aug 07, 2020	Jul 15, 2019	Sep 10, 2018 Jul 27, 2018
1	Long-term Principal Protected Market Linked Debentures	Long Term	100.0	Nil	**PP-MLD [ICRA]AA (Stable)**	-	-	-	-
2	Non-convertible Debentures	Long Term	300.0	300.0	**[ICRA]AA (Stable)**	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Bank Lines - Unallocated	Long Term	300.0	Nil	**[ICRA]AA (Stable)**	[ICRA]AA (Stable)	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Principal Protected Market Linked Debentures	Moderately Complex
Non-convertible Debentures	Very Simple
Bank Lines – Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE338I07057	Non-convertible Debentures	Nov 06, 2020	7.60%	FY2024	195.00	[ICRA]AA (Stable)
INE338I07065	Non-convertible Debentures	Feb 05, 2021	7.25%	FY2024	105.00	[ICRA]AA (Stable)
NA	Long-term Principal Protected Market Linked Debentures – Yet to be Issued	NA	NA	NA	100.00	PP-MLD[ICRA]AA (Stable)
NA	Bank Lines – Unallocated	NA	NA	NA	300.00	[ICRA]AA (Stable)

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	MOFSL Ownership (%)	Consolidation Approach
Motilal Oswal Commodities Broker Private Limited	100.00	Full Consolidation
MOPE Investment Advisors Private Limited	87.16	
Motilal Oswal Investment Advisors Limited (Formerly known as Motilal Oswal Investment Advisors Private Limited)	100.00	
MO Alternate Investment Private Limited (formerly known as Motilal Oswal Fincap Private Limited)	100.00	
Motilal Oswal Finvest Limited (Formerly known as Motilal Oswal Capital Markets Ltd)	100.00	
Motilal Oswal Wealth Management Limited	100.00	
Motilal Oswal Asset Management Company Limited	98.64	
Motilal Oswal Trustee Company Limited	100.00	
Motilal Oswal Securities International Private Limited	100.00	
Motilal Oswal Capital Markets (Singapore) Pte. Limited.	100.00	
Motilal Oswal Capital Markets (Hong Kong) Private Limited	100.00	
Motilal Oswal Home Finance Limited (formerly known as Aspire Home Finance Corporation Ltd)	97.87	
Motilal Oswal Finsec IFSC Limited	100.00	
Glide Tech Investment Advisory Private Limited	100.00	
TM Investment Technologies Pvt. Ltd	63.83	
Motilal Oswal Real Estate Investment Advisors Private Limited	87.16	
Motilal Oswal Real Estate Investment Advisors II Private Limited	78.44	
India Business Excellence Management Company	87.16	
Motilal Oswal Asset Management (Mauritius) Limited	98.64	
Motilal Oswal Capital Limited	98.64	
India Reality Excellence Fund II LLP	20.44	

Source: *MOFSL annual report FY2021*

Note: *ICRA has taken a consolidated view of the parent (MOFSL), its subsidiaries and associates while assigning the rating*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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