Motilal Oswal Financial Services Limited

July 27, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	150.00	150.00	[ICRA]AA (Stable); reaffirmed
Total	**150.00**	**150.00**	

**Instrument details are provided in Annexure-1*

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) with a Stable outlook for the Rs. 150-crore non-convertible debenture (NCD) programme of Motilal Oswal Financial Services Limited (MOFSL).

Rationale

The rating reaffirmation takes into account Motilal Oswal Group's healthy operational profile with a strong market position in retail broking, robust risk management systems, and its competitive cost structure with a high share of the broking business sourced through the low-cost franchisee channel. MOFSL serves as the holding company of Motilal Oswal Group, which provides a diverse range of financial services. The rating also factors MOFSL's favourable financial profile with healthy profitability, comfortable capitalisation and low leverage levels. While reaffirming the rating, ICRA has taken note of the highly competitive and fragmented nature of the broking industry, which, coupled with the rising share of derivatives volumes vis-à-vis cash turnover, has resulted in a compression in the yields and, the Group's dependence on capital markets, which are inherently volatile in nature. The gradual diversification in the Group's revenues, supported by the growing fee-based businesses, such as asset management, provides comfort.

The strong performance of the Group's core businesses is expected to support its consolidated financial profile despite the deterioration in the asset quality of its step-down subsidiary, Aspire Home Finance Corporation Limited (Aspire, rated [ICRA]A+(Stable]/[ICRA]A1+), and the consequent impact on the consolidated financials. Moreover, Aspire has strengthened its processes and systems and has adequate collections and resolution infrastructure, which provides comfort. While reaffirming the rating, ICRA has also taken note of the Group-level restructuring with the upcoming merger of Motilal Oswal Securities Limited (MOSL) with MOFSL. Following the merger, the non-banking finance company (NBFC) business housed under MOFSL would be moved to Motilal Oswal Capital Markets Private Limited, which is a 100% subsidiary of MOSL. ICRA has taken a consolidated view of Motilal Oswal Group, and thus the proposed restructuring is not expected to have a material impact on the Group's credit profile.

Going forward, the company's ability to further diversify its earnings, while improving profitability levels and maintaining healthy capitalisation, remains critical. Further, the improvement in the asset quality and consequent financial profile of the housing finance business would be other monitorable factors.

Outlook: Stable

ICRA believes that Motilal Oswal Group will continue to benefit from its diversified business profile, its demonstrated track record and established position in capital markets related businesses and its robust risk management systems.

The outlook may be revised to Positive if there is a substantial and sustained improvement in the Group's profitability along with diversification in the earnings profile, material improvement in the asset quality, particularly for the housing finance business, while robust capitalisation is maintained, leading to an improvement in the financial risk profile. The outlook may be revised to Negative if there is significant deterioration in the asset quality of the home loan book with a sizeable impact on profitability and capitalisation, thereby adversely affecting its financial risk profile. Further, changes in the regulatory environment, which may adversely impact the company's business operations and financial performance, would also be key rating sensitivities.

Key rating drivers

Credit strengths

Strong promoter group with demonstrated financial and operational commitment to the venture – MOFSL is one of India's leading providers of capital market related services. Motilal Oswal group has been engaged in equity broking since 1987 and has a long track record in the capital markets. The group has a diversified portfolio, comprising retail and institutional broking, wealth management, margin funding, commodities broking, investment banking, asset management, private equity and housing finance. MOFSL serves as the main holding company which also houses the capital markets related fund-based business of the group.

Strong and experienced top management team - The group has on-boarded seasoned industry professionals with strong experience in their respective fields. ICRA draws comfort from the experienced management personnel who have successfully scaled up the investment banking and asset management businesses leading to diversification in the revenue streams which was capital market (equity broking and distribution) dominated and vulnerable to volatilities in the stock market.

Strong market position in equity broking – Motilal Oswal group is a leading player in the equity broking business holding an aggregate market share of 2.00% (2.10% in FY2017). The group caters to both retail and institutional clientele and has significantly scaled up its presence over the years. The group had a retail network of over 9.71 lakh clients across about 3,788 franchisees as on March 31, 2018, up from 8.51 lakh clients across 3,077 franchisees as on March 31, 2018. While retain broking remains the group's forte, it has an established presence in the institutional segment with empanelment from 676 entities. The company reported a healthy performance in FY2018, with the broking volumes increasing to Rs. 34.61 lakh crore in FY2018 from Rs. 21.06 lakh crore in FY2017, registering a year on year growth of 64%. The average blended yields, however, have reported a declining trend given the rising share of the lower yielding futures and options (F&O) segment and the competitive pressure in the industry. The share of cash segment in the total turnover for the group, however, continues to remain higher than the industry average.

Healthy scaling up of asset management businesses - Over the year the group has been increased its focus on asset management business to diversify its offering portfolio while increasing the presence in fee-based businesses. The asset management vertical comprises services such as mutual funds, portfolio management service and alternative investment funds. Supported by the healthy inflows coupled with favourable capital markets, the AUM under the asset management business (includes Mutual Funds, Portfolio Management Services and Alternative Investment Funds) has seen a 77% rise in FY2018 (35,640 crore as on March 31, 2018 from Rs. 20,179 crore as on March 31, 2017).

Adequate capitalisation levels for current scale of operations and comfortable gearing levels - The Group's capitalisation levels remain healthy with a net worth of Rs. 2,248 crore as on March 31, 2018 (vis-à-vis Rs. 1,786 crore as on March 31, 2017) supported by strong internal capital generation. On a consolidated basis, the company had a gearing of 2.34 times as on March 31, 2018. The scaling up of the housing finance business, under Aspire, resulted in an increase in debt levels, and consequently leverage on a consolidated basis. ICRA expects MOFSL to remain well poised to meet the capital requirements of its step-down subsidiary, Aspire, as well as its other fund-based businesses, supported by the strong accruals from its core businesses. With the housing finance business expected to scale up further in the next few years, ICRA expects the Group's leverage to increase, though it should remain at comfortable levels compared to industry benchmarks.

Healthy financial performance - With robust performances in the capital market and the asset management businesses, the Group's total revenues grew 44% to Rs. 2,784 crore in FY2018 from Rs. 1,933 crore in FY2017. With the increase in the scale of operations, coupled with operational efficiencies, MOFSL's net operating profit/ ATA(Average Total Assets) improved to 8.02% in FY2018 from 6.88% in FY2017. The Group's return on assets improved marginally to 5.91% in FY2018 from 5.39% in FY2017 while the return on equity improved to 23.67% in FY2018 from 20.09% in FY2017. However, Aspire's profitability indicators deteriorated in FY2018 with the return on assets (profit after tax/average total assets) and return on equity (profit after tax/average net worth) falling to 0.65% and 4.40%, respectively, compared to 2.35% and 16.72%, respectively, in FY2017. Excluding Aspire, the Group's PAT increased by 81% in FY2018 to Rs. 510 crore.

Adequate risk management and operational systems employed by the company - The Group has an independent risk management team. The purpose of this team is to design and implement business operations strategy, plans and procedures. It takes care of the company's risk-taking strategy and ensures adherence to its policies across businesses.

Credit challenges

Exposed to volatility inherent in capital markets; gradual diversification in business profile provides comfort – The Group's traditional lines of business remain exposed to the volatility inherent in capital markets. Over the years, the Group forayed into businesses such as housing finance and asset management to diversify its earnings profile. With revenues in asset management being linked to the AUM, they impart stability to the Group's earnings profile. The capital market related businesses contributed 38% to the company's total turnover and accounted for 32% of its profit in FY2018, in comparison to 37% and 30%, respectively, in FY2017. The asset and wealth management business contributed 30% to revenues (24% in FY2017) while housing finance accounted for 24% of the revenues in FY2018 (31% in FY2017). The Group also has fund-based businesses, which accounted for 7% of the revenues in FY2018 (6% in FY2017).

Needs to provide additional support to housing finance subsidiary given the asset quality pressures - Aspire's gross NPA (GNPA) and net NPA (NNPA) increased to 4.5% and 3.3%, respectively, as on March 31, 2018, from 0.58% and 0.47%, respectively, as on March 31, 2017. Adjusting for write-offs and repossessed stock, Aspire's GNPA/advances increased to 6.33% as on March 31, 2018 from 4.60% as on December 31, 2017. The deterioration in the asset quality was driven by the gradual seasoning of the portfolio and the weakening of the liquidity position of borrowers. Delays in the setting up of a dedicated recovery and collections infrastructure aggravated the situation. The loan book remains relatively unseasoned. This, coupled with the higher risks associated with the segment and the limited ability of the borrowers to absorb income shocks, could result in further deterioration in the asset quality indicators (especially delinquencies in the softer buckets). ICRA, however, takes note of the company's effort to focus on collections and to strengthen its systems and processes to keep delinquencies within reasonable levels. Though the strong performance of the Group's core businesses is expected to more than offset the impact of the Group's consolidated financial profile, the company's ability to improve the asset quality while ramping up the loan book, and as the portfolio seasons, would be a key rating sensitivity going forward.

Decline in broking margins with increasing competition - With increasing competition in equity broking and the advent of discount brokerage houses, average yields for broking entities have been under pressure. The Group has also been facing the brunt of declining yields. However, the lower levels of equity market penetration in the country indicate significant untapped potential for expansion.

Analytical approach: For arriving at the ratings, ICRA has taken a consolidated view for Motilal Oswal Financial Services Limited along with its subsidiaries as they have operational linkages and common senior management.

Links to applicable criteria:
ICRA's Credit Rating Methodology for Non-Banking Finance Companies
ICRA's Credit Rating Methodology for brokerage houses

About the company

Incorporated in 2005, Motilal Oswal Financial Services Limited (MOFSL) is a non-deposit-taking NBFC, providing margin financing services to the Group's retail broking clients. MOFSL also serves as the holding company of the Group. The Motilal Oswal Group is India's leading provider of capital market related services, including retail and institutional broking, wealth management, loan against shares, margin financing, commodities broking, investment banking, and venture capital management. The Group consists of MOFSL and its subsidiaries, namely Motilal Oswal Securities Limited, Aspire Home Finance Limited, Motilal Oswal Commodities Brokers Pvt Ltd, Motilal Oswal Private Equity Advisors Pvt Ltd, Motilal Oswal Investment Advisors Pvt Ltd, Motilal Oswal Capital Markets Pvt Ltd, Motilal Asset Management Company Ltd, and Antop Trader Pvt Ltd.

The company reported a consolidated net profit of Rs. 541 crore on total operating income of Rs. 2,001 crore in FY2018 compared to a net profit of Rs. 360 crore on total operating income of Rs. 1,462 crore in FY2017. At a consolidated level, the Group's net worth stood at Rs. 2,248 crore as on March 31, 2018.

Key financial indicators of MOFSL (consolidated)

	FY2017	FY2018
Total Operating Income	1,462	2,001
Profit after tax (PAT)	360	541
Tangible Net worth	1,786	2,248
Minority Interest	29	35
Total Loan Book	4,619	5,680
Total Assets	8,439	9865
Return on average assets	5.4%	5.9%
PAT/ Average Net worth (ROE)	20.09%	23.67%
Gearing (times)	2.79	2.34

Source: Motilal Oswal Financial Services Limited and ICRA research
Amounts in Rs. crore; All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Sr. no.	Instrument	Type	Current Rating (FY2019) Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Chronology of Rating History for the past 3 years FY2018 Jul-17	FY2017 May-16	FY2016 Jan-15
1	Non-Convertible Debentures	Long Term	150.00	50.00	[ICRA]AA (stable)	[ICRA]AA (stable)	[ICRA]AA (stable)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE338I07040	Non-Convertible Debentures	27-Nov-2014	10.05 %	27-Nov-2017	50.00	[ICRA]AA(stable)
-	Non-Convertible Debentures-Yet to be issued	NA	NA	NA	100.00	[ICRA]AA(stable)

Source: Motilal Oswal Financial Services Limited

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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.

For more information, visit www.icra.in

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