August 07, 2020

Motilal Oswal Financial Services Limited: Rating reaffirmed for Rs. 200-crore NCD programme; rating reaffirmed and withdrawn for matured instrument

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture	200.00	200.00	[ICRA]AA(Stable); Reaffirmed
Non-convertible Debenture	150.00	-	[ICRA]AA(Stable); Reaffirmed and withdrawn
Total	**350.00**	**200.00**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has reaffirmed and withdrawn the rating assigned to the Rs. 150-crore non-convertible debenture (NCD) programme of Motilal Oswal Financial Services Limited (MOFSL) as there is no amount outstanding against the rated instrument. The rating has been withdrawn at the request of the company and as per ICRA's policy on the withdrawal and suspension of credit ratings.

The rating reaffirmation takes into account the Motilal Oswal Group's (which refers to MOFSL and its subsidiaries) healthy operational profile, given its track record in capital market related businesses, established market position in retail broking and increasing diversification in revenues with the scaling up of the fee-based businesses. The rating also takes into account MOFSL's stable financial profile with the steady performance of the core business and comfortable capitalisation and leverage levels on a consolidated basis. ICRA has taken note of the improved asset quality and financial performance of the subsidiary, Motilal Oswal Home Finance Limited (MOHFL), in FY2020, which further enhanced the Group's consolidated performance.

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 product mix (increasing share of derivatives and non-delivery cash volumes), has resulted in pressure on the broking yields. Going forward, the Group's ability to maintain a healthy asset quality once the moratorium offered to the customers (as per the Reserve Bank of India's (RBI) COVID-19 Regulatory Package) ends will be critical from a credit perspective, given the currently challenging operating environment for the real estate sector. Further, MOFSL's ability to diversify its earnings, while improving its profitability levels and maintaining healthy capitalisation, remains critical from a credit perspective.

The Stable outlook on the [ICRA]AA rating reflects ICRA's opinion that the Group will continue to benefit from its diversified business profile, its demonstrated track record and established position in capital market related businesses and its robust risk management systems.

Key rating drivers and their description

Credit strengths

Established position of the Group in capital market related businesses – The Motilal Oswal Group, one of India's leading providers of capital market related services, comprises MOFSL and its subsidiaries such as MOPE Investment Advisors Private Limited (MOPE), Motilal Oswal Asset Management Co. Ltd. (MOAMC), Motilal Oswal Wealth Management Ltd. (MOWML), and MOHFL. 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. The Group has also on-boarded seasoned industry professionals with strong experience in their respective fields.

Demonstrated track record in retail broking with strong market position – MOFSL is an established player in the equity broking business holding an aggregate market share of 1.41% in FY2020 (1.79% in FY2019). The Group caters to both retail and institutional clients and has significantly scaled up its presence over the years. The Group has an established retail franchise and caters to over 14.5 lakh clients across ~3,500 franchisees as on March 31, 2020, up from 11.9 lakh clients across about 2,910 franchisees as on March 31, 2019. The company reported a healthy performance in FY2020, with the broking volumes registering a YoY growth of 14%. The average blended yield remained stable at 1.32 bps in FY2020 compared to 1.29 bps in FY2019, despite the increasing competitive pressure in the industry.

Gradual diversification in revenue profile supported by scaling up of fee-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 an increasing diversification in 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 ~46% to the consolidated net operating income (NOI) in FY2020, up from 26% in FY2015. Further, the Group's asset and wealth management (fee-based) businesses accounted for 46% of its profitability in FY2020, followed by the capital market businesses (44%) and the housing finance business (10%).

Healthy capitalisation profile – MOFSL's capitalisation levels remain healthy with a net worth of Rs. 3,086 crore as on March 31, 2020 (vis-à-vis 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, resulted in an increase in the debt levels and the leverage on a consolidated basis. However, with a reduction in MOHFL's loan book as on March 31, 2020, the consolidated debt levels also witnessed a reduction, leading to a moderate gearing of 1.48 times as on March 31, 2020 on a consolidated basis (1.67 times as of March 31, 2019). Excluding the housing finance business, the gearing would be 0.52 times as on March 31, 2020. Further, the capitalisation profile is expected to remain healthy with the consolidated gearing expected to remain below 1.5 times over the near-to-medium term.

Steady performance of the core business; improved performance of the housing finance business – MOFSL's core business performance has been steady over the years. Its core operations reported a strong net profit (profit after tax; PAT) of Rs. 422.13 crore in FY2019 though it declined to Rs. 176.32 crore in FY2020 primarily due to mark-to-market (MTM) losses (passed through the P&L account) as of March 31, 2020. However, if adjusted for the MTM losses, MOFSL's PAT was ~Rs. 390 crore in FY2020. The improved performance of MOHFL with a net profit of ~Rs. 39 crore in FY2020, after a loss of ~Rs. 132 crore in FY2019 on account of credit costs, resulted in an enhanced performance at the consolidated level.

While reaffirming the rating, ICRA has also taken note of SEBI's order on 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 also appealed in the Bombay High Court against the MCX. 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 48% to the company's total turnover and accounted for 44% of its profit in FY2020 compared to 44% and 33%, respectively, in FY2019. Over the years, the Group has forayed into businesses such as housing finance and asset management to diversify its earnings profile. As the revenues in asset management are linked to the assets under management (AUM), these revenues impart stability to the Group's earnings profile. The asset and wealth management business contributed 30% to revenues (30% in FY2019) while housing finance accounted for 22% in FY2020 (24% in FY2019).

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 92% in FY2020 from 88% in FY2018, its overall blended yield declined to 1.32 bps in FY2020 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.

Liquidity position: Strong

As on March 31, 2020, MOFSL's investment book stood at ~Rs. 3,089 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 and liquid investments of Rs. 606 crore and undrawn bank lines of Rs. 1,493 crore as on May 31, 2020. The total debt obligations during June 2020 to November 2020 are ~Rs. 1,902 crore (Rs. 512 of MOHFL and Rs. 1,390 crore for MOFSL ex-MOHFL). The Group has strong liquidity in relation to its near-term repayment obligations and for placing excess margin at the exchange if needed. The liquid nature of the margin funding book also provides comfort.

Rating sensitivities

Positive triggers – 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 triggers – 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 Co. Ltd. (MOAMC), Motilal Oswal Wealth Management Ltd. (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. 215 crore on net operating income (NOI) of Rs. 1,554 crore in FY2020 compared to a net profit of Rs. 285 crore on NOI of Rs. 1,566 crore in FY2019. At the consolidated level, the Group's net worth stood at Rs. 3,086 crore as on March 31, 2020.

Key financial indicators (audited & consolidated – MOFSL)

	FY2019	FY2020
Brokerage Income	381.98	469.52
Fee Income (other than broking)	774.03	711.24
Net Interest Income	301.65	273.40
Other Non-interest Income	108.69	100.25
Net Operating Income (NOI)	1,566.35	1,554.41
Total Operating Expenses	901.82	959.84
Profit before Tax	377.90	285.19
Profit after Tax (PAT)	285.25	215.40
Net Worth	3,053.44	3,086.30
Cost-to-Income Ratio (%)	57.57%	61.75%
Return on Net Worth (%)	9.48%	6.93%
PAT/NOI (%)	18.21%	13.86%

Amounts in Rs. crore; Source: Company & ICRA research: All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Current Rating	FY2020	FY2019		FY2018
					7-Aug-2020	15-Jul-2019	10-Sep-2018	27-Jul-2018	3-Jul-2017
1	NCD	Long Term	200	0	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)

Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	NCD - Yet to be placed	NA	NA	NA	200.00	[ICRA]AA(Stable)

Source: MOFSL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership / Relationship with Rated Entity	Consolidation Approach
Motilal Oswal Financial Services Limited	Parent	ICRA has taken a consolidated view of the parent and its subsidiaries
MOPE Investment Advisors Private Limited	Subsidiary	
Motilal Oswal Commodities Broker Private Limited	Subsidiary	
Motilal Oswal Fincap Private Limited	Subsidiary	
Motilal Oswal Finvest Limited	Subsidiary	
Motilal Oswal Asset Management Co. Ltd.	Subsidiary	
Motilal Oswal Trustee Company Limited	Subsidiary	
Motilal Oswal Wealth Management Ltd.	Subsidiary	
Motilal Oswal Securities International Private Limited	Subsidiary	
Motilal Oswal Home Finance Limited	Subsidiary	
Motilal Oswal Real Estate Investment Advisors Private Limited	Subsidiary	
Motilal Oswal Real Estate Investment Advisors II Private Limited	Subsidiary	
Motilal Oswal Capital Limited	Subsidiary	
Motilal Oswal Capital Markets (Hong Kong) Private Limited	Subsidiary	
Motilal Oswal Capital Markets (Singapore) Pte Limited	Subsidiary	
Motilal Oswal Asset Management (Mauritius) Private Limited	Subsidiary	
Indian Business Excellence Management Company	Subsidiary	
Passionate Investment Management Private Limited	Subsidiary	
Motilal Oswal Investment Advisors Limited	Subsidiary	
Motilal Oswal Finsec IFSC Limited	Subsidiary	
Gilde Tech Investment Advisory Private Limited	Subsidiary	

Source: MOFSL's audit report FY2020

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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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