May 27, 2021

Kotak Securities Limited: Rating reaffirmed for NCD programme and long-term fund-based bank lines; ratings assigned/reaffirmed for enhanced long-term non-fund based bank lines and CP programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debentures	50	50	[ICRA]AAA(Stable); reaffirmed
Long-term Fund-based Bank Lines	1,500	1,500	[ICRA]AAA(Stable); reaffirmed
Long-term Non-fund Based Bank Lines	600	1,250	[ICRA]AAA(Stable); assigned/reaffirmed
Commercial Paper	4,000	5,000	[ICRA]A1+; assigned/reaffirmed
Total	**6,150**	**7,800**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has assigned a rating of [ICRA]AAA(Stable) (pronounced as ICRA triple A) for the long-term instruments and a rating of [ICRA] A1+ (pronounced as [ICRA] A one plus) for the commercial paper (CP) programme of Kotak Securities Limited (KSL). The outlook on the rating remains Stable. The ratings factor in the strong parentage of KSL, which is a subsidiary of Kotak Mahindra Bank Limited (KMBL; 75% stake in KSL with remaining 25% held by KMBL's subsidiary – Kotak Mahindra Capital Company Limited), its strong linkages with the parent and the shared brand name, which strengthens ICRA's assumption that KSL will receive timely and adequate financial and operational support from the parent. The ratings also factor in KSL's strong presence in the broking space, robust capital levels and strong profitability metrics with a low gearing. While the company does not need additional capital for its operations in the near term, ICRA expects KMBL to provide capital infusion, if and when required.

While assigning/reaffirming the ratings, ICRA has also factored in the company's plans to grow its e-margin (margin trading facility; MTF) book. KSL's gearing is expected to increase as ICRA expects the growth in the MTF book to be predominantly debt funded. The company's healthy capitalisation profile at present (gearing of 0.60 times as of March 31, 2021) provides adequate headroom to grow the MTF business over the near term. The ratings also take into account the limited diversification in KSL's business profile, the risks associated with capital markets related businesses, and the intense competition in the retail broking space. KSL's ability to scale up the broking volumes and the MTF book while maintaining adequate capitalisation as well as asset quality (in the MTF book) will remain a key monitorable.

Key rating drivers and their description

Credit strengths

Strong parentage by virtue of being a part of the Kotak Group – The company is a part of the Kotak Group with KMBL holding a majority stake. The strong parentage, coupled with the shared brand name, strengthens ICRA's assumption that KSL will receive timely and adequate support (both financially as well as operationally) from the Group, if required. The company also benefits from the shared Kotak management philosophy and prudence. As a brokerage entity, KSL draws franchise advantage from its association with KMBL. KSL's ratings would be sensitive to its parent's rating, given the strong franchise support of the Kotak Group.

Strong presence in retail broking space – KSL is primarily a retail broking player (82% of the total broking volumes in FY2021 belongs to retail broking business). As a brokerage entity, the company draws franchise advantage from its association with KMBL. The company also services its customer base of 9.96 lakh through 154 standalone branches and 1,296 franchisees as on March 31, 2021. KSL registered a healthy uptick in its trading volumes in the current fiscal with its average daily turnover (ADTO) increasing to Rs. 36,126 crore in FY2021 (total volume of Rs. 89.95 lakh crore) from Rs. 24,249 crore in FY2020 (total volume of Rs. 59.90 lakh crore), registering a YoY growth of 49% (ADTO was Rs. 26,213 crore in FY2019) supported by the upswing in the capital markets. The retail segment accounted for 82% of the broking volumes, up from 73% in FY2020. The increase was on account of the trade free product with free intra-day trading launched for retail broking. KSL had a share of 1.29% in the broking market in FY2021 compared to 1.69% in FY2020.

Healthy profitability, albeit lower broking yields; comfortable capitalisation – With the industry-wide contraction in yields owing to competitive pressure as well as the changing product mix (reducing share of high-yield delivery volumes), there has been a moderation in the profitability across players. However, KSL continues to maintain a healthy financial profile. KSL reported a profit after tax (PAT) of Rs. 793 crore in FY2021, registering a healthy YoY growth of 48%. In FY2021, the cost-to-income ratio moderated to 48% from 58% in FY2020 primarily due to the growth in the operating income. The net operating income (NOI) grew ~25% YoY to Rs. 1,941 crore in FY2021 from Rs. 1,555 crore in FY2020 owing to the strong growth in the broking volumes (offset by a marginal decline in average yields of 1.36 bps in FY2021 compared to 1.41 bps in FY2020). The interest income increased to Rs. 589 crore in FY2021 from Rs. 550 crore in FY2020 (YoY growth of 7%) on account of the increase in the MTF book while the finance costs reduced by 47% YoY due to the lower average CP borrowing rates of 3.74% in FY2021 compared to 6.20% in FY2020. This resulted in higher net interest income.

The company's ability to maintain its margins and healthy asset quality in case of volatilities in the capital market would remain important. KSL has a comfortable capitalisation profile with a net worth of Rs. 5,321 crore and a gearing of 0.60 times as on March 31, 2021 (net worth of Rs. 4,554 crore and gearing of 0.22 times as on March 31, 2020). Going forward, the gearing is expected to increase on account of higher borrowings to support the ramp-up in the MTF as well as the higher margin requirements at the exchanges.

Credit challenges

Rapid increase in margin funding book involving credit risk – The company's margin funding book increased substantially by 3 times YoY to Rs. 2,184 crore in FY2021 from Rs. 455 crore in FY2020. Also, it has recently ventured into the ESOP (Employee Stock Option Plan) loan book of Rs. 117 crore in FY2021. While net interest income (29% of total NOI) supports the diversification of revenues with sustained growth (25% YoY in FY2021), KSL's earnings are exposed to the credit risks involved in the MTF book. Due to the revolving nature of the book, the margin funding debtors outstanding for more than 90 days comprised 14% of the total margin funding book as on March 31, 2021 (down from 28% as of March 31, 2020). KSL has adequate underwriting and risk mitigation processes, though operational risk and subsequently credit risk would remain key monitorables with the increasing volume.

Exposed to risks inherent in capital markets related businesses – KSL's revenues remain dependent on capital markets, which are inherently volatile in nature. Approximately 54% of the company's revenues were through brokerage in FY2021, reflecting its limited presence in other capital market businesses. However, KSL has been intending to diversify by further increasing its focus on the lending business in the form of the MTF and the distribution business wherein the revenues are linked to the assets under management (AUM), thereby imparting stability to the overall earnings profile. KSL's fee income has increased over the years with its increased focus on the distribution business. However, it continued to account for a small proportion of the NOI at ~10-15%.

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. With the competitive intensity in the industry expected to remain high, the pressure on the industry margin is expected to continue. However, the increasing financialisation of savings and the low share of wallet of the equity segment in household savings indicate huge untapped potential for rapid expansion in the broking market over the longer term.

Liquidity position: Strong

KSL's liquidity requirement is primarily for placing margins at the exchanges and growing the margin funding book. It has a strong liquidity profile with a cushion of cash and cash equivalents of Rs. 39 crore, liquid investments of Rs. 849 crore and drawable unutilised fund-based bank lines of Rs. 1,020 crore against near-term debt maturities of Rs. 2,950 crore (due by June 2021) as on April 30, 2021. KSL had deployed Rs. 5,428 crore of margins at the exchanges as on April 30, 2021. The margin utilisation ranged between 55% and 75% during the past 12 months and 55% as on April 30, 2021. KSL had unutilised margins placed with the exchanges of Rs. 2,395 crore and a proprietary book of Rs. 874 crore, along with balance sheet liquidity and undrawn bank lines. These are sufficient to cover its short-term debt obligations.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Any dilution in the actual or perceived support from the parent (KMBL) or a change in KMBL's rating or outlook could lead to a rating downgrade. Pressure on the ratings could arise if regulatory changes or intense competition lead to a significant deterioration in the company's business and profitability indicators, thereby affecting its financial profile.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Rating Methodology for Entities in Broking Industry Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	ICRA expects KMBL to provide capital, managerial and operational support, if required, given the shared brand name and KMBL's ownership of 75%
Consolidation/Standalone	Standalone

About the company

Kotak Securities Limited (KSL) is one of the leading equity broking companies in the country with a strong presence in the retail as well as institutional broking segments. Its main business activity includes share broking (offline, online and institutional brokerage), portfolio management services and distribution of third-party products such as initial public offerings (IPOs), mutual funds, fixed deposits, etc. Depending on the market opportunity, the company also maintains a proprietary trading book. Moreover, it provides educational self-learning platforms on financial topics, which are also used for marketing activities.

KSL's net worth stood at Rs. 5,321 crore as on March 31, 2021 compared to Rs. 4,554 crore as on March 31, 2020. The company reported a profit after tax (PAT) of Rs. 793 crore in FY2021 compared to Rs. 535 crore in FY2020.

Key financial indicators (audited)

Kotak Securities Limited	FY2019	FY2020	FY2021*
Net Brokerage Income (Rs. crore)	700	752	1,049
Fee Income (other than broking; Rs. crore)	200	204	206
Net Interest Income (Rs. crore)	414	415	518
Other Non-interest Income (Rs. crore)	118	183	167
Net Operating Income (NOI; Rs. crore)	1,432	1,555	1,941
Total Operating Expenses (Rs. crore)	784	823	870
Profit before Tax (Rs. crore)	632	726	1,057
Profit after Tax (PAT; Rs. crore)	408	535	793
Net Worth (Rs. crore)	3,999	4,554	5,321
Borrowings (Rs. crore)	1,363	992	3,181
Gearing (times)	0.34	0.22	0.60
Cost-to-Income Ratio (%)	59%	58%	48%
Return on Net Worth (%)	11%	13%	16%
PAT/NOI (%)	30%	38%	44%

Source: *Company, ICRA research; * Provisional 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 May 27, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					May 27, 2021	May 08, 2020	May 21, 2019	Oct 15, 2018
1	Non-convertible Debentures	Long Term	50	-	[ICRA]AAA (Stable); reaffirmed	[ICRA]AAA (Stable)	-	-
2	Long-term Fund-based Bank Lines	Long Term	1,500	-	[ICRA]AAA (Stable); reaffirmed	[ICRA]AAA(Stable)	[ICRA]AAA(Stable)	-
3	Long-term Non-fund Based Bank Lines	Long Term	1,250	200.25	[ICRA]AAA(Stable); assigned/reaffirmed	[ICRA]AAA(Stable)	[ICRA]AAA(Stable)	-
4	Commercial Paper Programme	Short Term	5,000	NA	[ICRA]A1+; assigned/reaffirmed	[ICRA]A1+	[ICRA]A1+	[ICRA] A1+

Complexity level of the rated instrument

Instrument	Complexity Indicator
Non-convertible Debentures	Very Simple
Long-term Fund-based Bank Lines	Simple

Long-term Non-fund Based Bank Lines	Very Simple
Commercial Paper	Very Simple

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE028E14HR7	Commercial Paper Programme	18-Jan-21	16-Apr-21	7-365 days	300	[ICRA]A1+; assigned/ reaffirmed
INE028E14HS5	Commercial Paper Programme	21-Jan-21	22-Apr-21	7-365 days	50	[ICRA]A1+; assigned/ reaffirmed
INE028E14HU1	Commercial Paper Programme	16-Feb-21	10-May-21	7-365 days	250	[ICRA]A1+; assigned/ reaffirmed
INE028E14HV9	Commercial Paper Programme	16-Feb-21	18-May-21	7-365 days	300	[ICRA]A1+; assigned/ reaffirmed
INE028E14HW7	Commercial Paper Programme	22-Feb-21	21-May-21	7-365 days	250	[ICRA]A1+; assigned/ reaffirmed
INE028E14HX5	Commercial Paper Programme	26-Feb-21	28-May-21	7-365 days	450	[ICRA]A1+; assigned/ reaffirmed
INE028E14HY3	Commercial Paper Programme	2-Mar-21	31-May-21	7-365 days	350	[ICRA]A1+; assigned/ reaffirmed
INE028E14HZ0	Commercial Paper Programme	15-Mar-21	14-Jun-21	7-365 days	300	[ICRA]A1+; assigned/ reaffirmed
INE028E14IA1	Commercial Paper Programme	19-Mar-21	18-Jun-21	7-365 days	400	[ICRA]A1+; assigned/ reaffirmed
INE028E14IB9	Commercial Paper Programme	22-Mar-21	21-Jun-21	7-365 days	300	[ICRA]A1+; assigned/ reaffirmed
INE028E14IC7	Commercial Paper Programme	24-Mar-21	23-Jun-21	7-365 days	250	[ICRA]A1+; assigned/ reaffirmed
NA	Commercial Paper Programme	NA	NA	7-365 days	1,800	[ICRA]A1+; assigned/ reaffirmed
NA	Long-term Fund-based Bank Lines	NA	NA	NA	1,500	[ICRA]AAA(Stable); reaffirmed
NA	Long-term Non-fund Based Bank Lines	NA	NA	NA	1,250	[ICRA]AAA(Stable); assigned/reaffirmed
Not Placed	Non-convertible Debenture Programme	NA	NA	NA	50	[ICRA]AAA(Stable)

Source: *Company*

**as of March 31, 2021*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NA	NA	NA

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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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