June 27, 2022

Master Capital Services Ltd: Rating upgraded to [ICRA]A2+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term non-fund based bank lines	100	100	[ICRA]A2+; upgraded from [ICRA]A2
Total	**100**	**100**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in rating factors in Master Capital Services Limited's (MCSL) long track record of operations, increased scale of business and improvement in MCSL's profitability metrices over the last couple of years (FY2021-FY2022) . MCSL has long track record of over 26 years in the financial services industry and its established position in the capital markets, catering to ~2.3 lakh customers through its network of 24 branches and 1,700+ franchises spread across 23 states. The rating also takes into consideration MCSL's comfortable capitalisation profile with a low gearing of 0.62 times {0.03 times after adjusting for debt in the form of deep discount bonds placed with the parent entity, Master Trust Limited (MTL)} on a net worth of Rs. 183.6 crore as on March 31, 2022. The rating also factors in the improvement in MCSL's asset quality indicators with the debtors outstanding for more than six months of the total debtors improving to 0.6% as percentage of net-worth on March 31, 2022 from 1.0% as March 31, 2021. ICRA also favourably notes the improvements in the company's profitability indicators in the past two years with the return on equity (RoE) increasing to 16.3% and 25.6% in FY2021 and FY2022, respectively, from 3.1% in FY2020, driven by the increase in both trading and broking income. The sustenance of a similar profitability trajectory would be a key monitorable going forward.

However, the rating remains constrained by the low diversification in MCSL's revenue stream with broking and trading income accounting for ~81% and ~84% of the total income in FY2021 and FY2022, respectively. Also, MCSL's market share in the equity broking segment (including cash and F&O segments) dropped to 0.79% in FY2022 from 1.18% in FY2021. This was largely because the company trailed behind the overall growth in equity broking volumes in the market, which witnessed growth of 155% compared to the 71% growth witnessed by MCSL. However, the MCSL's growth in cash segment outpaced industry growth in FY2022 resulting in increase in MCSL's market share to 2.9% in FY2022 from 1.0% in FY2021. Moreover, being a part of an intensely competitive industry, the company's broking yields are likely to remain under pressure.

With market volatility expected to taper off from the FY2021 and FY2022 levels, the profitability indicators are expected to moderate to some extent in FY2023, in line with the overall broking volumes of the market. Also, given the pressure on yields, the intense competition and the increased capital requirements for broking due to Securities and Exchange Board of India (SEBI) norms, MCSL's incremental focus will be on scaling up its proprietary operations, depending on its risk appetite, and for generating better yield on the deployed capital. From a risk appetite perspective, MCSL intends to allocate capital for the proprietary book up to a limit of 1.5 times the net worth in the near to medium term.

Key rating drivers and their description

Credit strengths

Long track record and established position in capital markets – The Master Group has a long track record of over 26 years in the financial services industry with a presence in equity, currency and commodity broking along with a focus on third-party mutual fund (MF) and insurance distribution, own portfolio management services (PMS), investment banking and wealth management services for its clients. The company caters to ~2.3 lakh customers through its network of 24 branches and 1,700+

franchises spread across 23 states with a market share of 0.79% in the equity broking segment in FY2022. In line with the industry trend, MCSL's broking volumes are driven by its derivative book, which comprises ~96% of its total volumes.

Comfortable capitalisation for current scale of operations – The company's capitalisation profile is comfortable owing to the low gearing level of 0.6 times on a standalone net worth of Rs. 183.6 crore as on March 31, 2022. Further, since most of the debt (~95% of the overall borrowing profile as on March 31, 2022) is in the form of deep discount bonds placed with the parent (MTL) and other group entities, the external gearing level was lower at 0.03 times as on March 31, 2022. As it is a brokerage entity, a significant proportion of MCSL's borrowings are in the form of non-fund based limits consisting of bank guarantees where the average monthly margin utilisation stood at ~100% in FY2022.

Improving asset quality indicators – MCSL asset quality indicators remain modest, albeit declining, with the debtors outstanding for more than six months of the total debtors, as a percentage of the net worth, improving to 0.6% as on March 31, 2022 from 1.0% as on March 31, 2021 and 2.0% as March 31, 2020. At the same time, write-offs remained negligible as a percentage of the net worth in FY2022, reflecting the company's ability to recover from these debtors. Also, MCSL remains covered on these receivables through its own provisions and deposits from sub brokers where applicable. The company's ability to maintain a low percentage of debtors and realise cashflow from these clients on a timely basis will be a rating monitorable.

Credit challenges

Low diversification of business revenues – The company's revenue profile remains exposed to the inherent volatility associated with capital markets as its key revenue drivers, i.e. trading income and broking income, are directly or indirectly linked to market performance. MCSL generated a 71% growth in equity broking volumes in FY2022 (~76% in FY2021 and 20% in FY2020) and its brokerage and trading income constituted ~84% of its total income in FY2022, making it vulnerable to cyclical downturns in the market. This risk is somewhat mitigated by the continuous acquisition of new customers, which will generate continuous inflow during periods of lower market volatility through broking income and float income.

Also, ICRA notes that the company has been focusing on diversifying its income profile towards fee-based segments like third-party product distribution (MFs, insurance, PMS, structured products, etc) and is providing its own PMS through its subsidiary, Master Portfolio Services. MCSL had assets under management (AUM) under distribution of Rs. 903 crore and AUM of Rs. 763 crore under its manufactured PMS as on March 31, 2022. This is expected to provide support to the overall income profile as it scales to appropriate levels in these segments over the medium to long term. Nevertheless, the revenue stream is expected to be concentrated towards the capital market segment in the medium term and will thus remain vulnerable to the inherent cyclicity.

Improvement in profitability, though sustainability to be seen – MCSL's profitability indicators improved in FY2021 and FY2022 with RoE of 16.3% and 25.6%, respectively, compared to 3.1% in FY2020, driven by the increase in both broking and trading income. Broking income was driven by the increasing broking volumes for MCSL during the past two years. Going forward, the volatility in the markets is expected to taper off with volumes undergoing normalisation in the near to medium term. Additionally, ICRA notes that MCSL has been steadily increasing its customer base over the years by increasing its geographical presence. Any decline in brokerage income due to reduced broking volumes could be offset by inflows from the newer customer base and will depend on MCSL's ability to tap new customer bases through diversified offerings at competitive prices.

With the yields narrowing further due to competition from discount brokerages, the broking volumes will have to increase to sustain the current level of broking income. Hence, increasing its market share in an intensely competitive industry will remain imperative for MCSL. Also, MCSL employs arbitrage strategies and its ability to identify opportunities in the capital market will remain key to sustain the current level of trading income and subsequently the profitability profile. The scaling of fee-based income to appropriate levels will further support the profitability and will be considered a credit positive. Going forward, the company's ability to increase its market presence while improving its profitability profile would be a key rating sensitivity.

Liquidity position: Adequate

MCSL's liquidity profile is adequate, supported by an unencumbered cash and bank balance of Rs. 4.0 crore as on March 31, 2022. The liquidity is further supported by the portfolio of quoted equity shares of Rs. 15.9 crore as on March 31, 2022. The company also had unutilised bank lines of Rs. 196.6 crore in the form of overdraft as on March 31, 2022, along with debt mutual investments of Rs. 2.3 crore as on March 31, 2022. MCSL's total debt stood at Rs. 113.4 crore, including external debt of Rs. 5.2 crore as on March 31, 2022. A major part of the debt (~95%) is from the parent and other group entities in the form of deep discount bonds, repayable after ~3 years.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the company is able to improve its scale of operations on a sustainable basis while maintaining a prudent capitalisation profile.

Negative factors – ICRA could downgrade the rating if there is a significant deterioration in the company's financial risk profile either due to a cyclical downturn in the market or company-specific issues or an increase in its risk profile like getting involved in positional trades without improving its capitalisation position.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's rating methodology for broking entities
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Master Capital Services Limited (MCSL) was incorporated in 1994 as a part of the Master Trust Group and is a 100% subsidiary of Master Trust Limited (MTL). MCSL is a corporate member of National Stock Exchange (NSE), Bombay Stock Exchange (BSE), Ludhiana Stock Exchange (LSE) and Over-The-Counter Exchange of India (OTCEI) and primarily offers secondary market broking services to its retail customers – both resident and non-resident Indians. The company is the stockbroking arm of the Group and provides stock & derivatives broking, currency derivatives broking, merchant banking, depository services, MF/initial public offering (IPO) distribution, investment banking and corporate advisory services. It also has an online trading platform for its customers.

In FY2022, MCSL reported a profit after tax (PAT) of Rs. 41.3 crore on a provisional basis compared to a PAT of Rs. 21.0 crore for FY2021. The company's net worth stood at Rs. 183.6 crore as on March 31, 2022 with a gearing of 0.6 times.

Key financial indicators

Master Capital Services Limited	FY2020	FY2021	FY2022
	Audited	Audited	Provisional
Brokerage Income (net; Rs. crore)	37.1	60.6	84.8
Net Interest Income (Rs. crore)	10.6	14.1	25.7
Other Non-interest Income (Rs. crore)	42.2	71.7	93.7
Net Operating Income (NOI; Rs. crore)	52.8	85.9	119.4
Total Operating Expenses (Rs. crore)	61.20	108.51	159.78
Profit before Tax (Rs. crore)	4.2	27.6	55.4
Profit after Tax (PAT; Rs. crore)	3.6	21.0	41.3
Net Worth (Rs. crore)	117.6	139.7	183.6

Master Capital Services Limited	FY2020	FY2021	FY2022
	Audited	Audited	Provisional
Borrowings (Rs. crore)	128.8	128.7	113.4
Gearing (times)	1.10	0.92	0.62
Cost-to-Income Ratio (%)	115.8%	126.4%	133.8%
Return to Net Worth (%)	3.1%	16.3%	25.6%
PAT/NOI (%)	6.8%	24.5%	34.6%

Source: *ICRA Research, MCSL; All figures and ratios as per ICRA's calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument				Current Rating (FY2023)	Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2022 (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2018
					Jun 27, 2022	Mar 19, 2021	Sep 27, 2019	Mar 26, 2018
1	Short-term non-fund based bank lines	ST	100.00	100.00	**[ICRA]A2+**	[ICRA]A2	[ICRA]A2	[ICRA]A2

ST – Short term

Complexity level of the rated instruments

Instrument	Complexity Indicator
Short-term non-fund based bank lines	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 as on March 31, 2022

ISIN	Instrument Name	Date of Issuance/ Sanction	Coupon Rate/ Yield	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Short-term non-fund based bank lines	NA	NA	NA	100	[ICRA]A2+

Source: *ICRA Research*

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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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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Branches