October 12, 2022

Kotak Securities Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	-	50	[ICRA]AAA (Stable); assigned
Non-convertible debentures	50	50	[ICRA]AAA (Stable); reaffirmed
Long-term fund-based	1,500	2,000	[ICRA]AAA (Stable); assigned and reaffirmed
Long-term non-fund-based	1,250	1,500	[ICRA]AAA (Stable); assigned and reaffirmed
Commercial paper	7,500	10,000	[ICRA]A1+; assigned and reaffirmed
Total	**10,300**	**13,600**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in the strong parentage of Kotak Securities Limited (KSL), which is a subsidiary of Kotak Mahindra Bank Limited (KMBL[1]; 75% stake in KSL with balance 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, as and when required. The ratings also factor in KSL's solid presence in the broking space, comfortable capital levels and healthy profitability metrics with a low gearing.

ICRA notes that the company's margin trading funding (MTF) business has increased (Rs. 4,711 crore as on March 31, 2022, up from Rs. 2,184 crore as on March 31, 2021), which has led to an improvement in its earnings. However, the gearing also increased to 0.74 times as of March 31, 2022 from 0.59 times as of March 31, 2021. ICRA expects that the MTF book could increase further in the medium term, though the strong net worth buffer, internal accruals and risk controls/margining policies provide mitigation against any credit or market risk. The gearing is expected to increase further in the near term but is likely to remain below 1 times.

The ratings also consider the limited diversification in KSL's business profile, exposure to risks associated with capital market related businesses, and the intense competition in the retail broking space. The scale of the MTF book and the margins also remain exposed to capital market volatility and increasing interest rates. KSL's ability to scale up the broking revenues, improve the net interest income (NII) in the MTF book and maintain the asset quality (in the MTF book) will be a key driver of its profitability.

The Stable outlook indicates ICRA's expectation that the company would continue to have a strong retail franchise and market position, supported by its position as a bank brokerage house, and steady profitability levels.

[1] *Rated [ICRA]AAA (Stable) for infrastructure bond programme*

Key rating drivers and their description

Credit strengths

Strong parentage by virtue of being a part of 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. The bank has a representative on KSL's board. 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.

Established presence in retail broking space – KSL is primarily a retail broking player (95% of the total broking volumes in Q1 FY2023 was from the retail segment). It has a presence of almost 28 years in the retail broking space. As a brokerage entity, the company draws franchise recognition from its association with KMBL. KSL services its active customer base of 19.21 lakh (up from 17.74 lakh, post the launch of a new retail-focused platform and introduction of trade-free schemes) through 173 standalone branches and 1,306 franchisees as on June 30, 2022. It is among the top 10 brokers in the country in terms of active customers. KSL registered a healthy increase in its trading volumes in FY2022 with its average daily turnover (ADTO) increasing to Rs. 1.1 lakh crore in FY2022 (+202% YoY compared to a 157% increase for the industry).

Healthy profitability; comfortable capitalisation – KSL continues to maintain a healthy financial profile with a profit after tax (PAT) of Rs. 1,049 crore in FY2022 compared to Rs. 784 crore in FY2021, up 34% YoY. The net operating income increased by 23% YoY in FY2022 on account of higher revenues from the broking and MTF segments. The company's operating expenses increased by 12% YoY in FY2022 due to higher employee and administrative expenses. The cost-to-income ratio however decreased to 45% in FY2022 from 49% in FY2021.

Net broking income increased to Rs. 1,267 crore in FY2022 from Rs. 1,029 crore in FY2021 (growth of 23%), aided by the strong performance of the equity capital markets. Broking income declined slightly in Q1 FY2023 due to the volatile capital markets, resulting in lower trading volumes. The company reported a return on average total assets (RoA) and a return on net worth (RoE) of 6.4% and 17.9%, respectively, in FY2022 compared to 6.63% and 15.8%, respectively, in FY2021.

KSL has a strong net worth base of Rs. 6,462 crore and a gearing of 0.61 times as on June 30, 2022 (0.52 times as on June 30, 2021). Going forward, the gearing is expected to increase on account of higher borrowings to support the ramp-up in the MTF book as well as the higher margin requirements at the exchanges.

Credit challenges

Rapid increase in margin funding book involving credit and market risk – The company's margin funding book increased substantially by 116% YoY to Rs. 4,711 crore in FY2022 from Rs. 2,184 crore in FY2021 (Rs. 4,046 crore in Q1 FY2023). While the NII (34% of total net operating income (NOI) as of June 30, 2022) supports the diversification of revenues with sustained growth (42% YoY in FY2022 and 15% YoY in Q1 FY2023), KSL remains exposed to credit and market risks, given the nature of the underlying assets. Any adverse event in the capital markets could erode the value of the underlying collateral stocks.

Due to the revolving nature of the book, the margin funding debtors outstanding for more than 90 days comprised 23% of the total margin funding book as on March 31, 2022 (up from 14% as of March 31, 2021). ICRA takes comfort from the strong internal processes of maintaining and calling for margins against these borrowings (average cover was 2 times as of March 2022). KSL has strong 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 market related businesses – KSL's revenues remain dependent on capital markets, which are inherently volatile in nature. Approximately 53% of the company's NOI was through brokerage income in FY2022, reflecting its limited presence in other capital market businesses. However, with the ramp-up in the MTF book, the NII increased by 42% to Rs. 731 crore in FY2022. ICRA notes that the growth in the MTF book is linked to the performance of the equity capital markets and the interest rate scenario. KSL has been intending to diversify by further increasing its focus on depository participant (DP) service income, advisory/research income and the lending business in the form of MTF, to impart stability to its overall earnings profile. KSL's fee income has increased over the years with its growing focus on the distribution business. However, it continued to account for a small proportion of the NOI at ~6-10%. With the company's broking revenues being linked to the inherently volatile capital markets, its revenue profile and profitability remain vulnerable to market performance. ICRA notes that any downturn in the capital markets may impact the company's financial performance.

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. This, coupled with a change in the volume mix (moderation in the share of cash volumes), resulted in a moderation in KSL's blended yields to 0.55 basis points (bps) in FY2022 from 1.36 bps in FY2021 and further to 0.24 bps in Q1 FY2023. However, it managed to increase its market share to 1.52% in FY2022 and further to 2.12% in Q1 FY2023 from 1.29% in FY2021.

Continued pressure on the industry margin is expected with competitive intensity in the industry expected to remain high. 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 funding requirement is primarily for placing margins at the exchanges and the MTF book. Its margin utilisation ranged between 30% and 60% during the past 12 months. As on August 31, 2022, KSL had deployed Rs. 8,004.11 crore of margins at the exchanges, of which 60% was unutilised. This apart, it had a proprietary investment book of Rs. 551 crore as of August 31, 2022. As on August 31, 2022, KSL had debt repayment obligations of Rs. 4,450 crore till February 2023, largely driven by commercial paper (CP) borrowings to fund the short-tenor MTF book. If required, the MTF book can be run down to generate liquidity. KSL had cash and cash equivalents of Rs. 179 crore and drawable unutilised fund-based bank lines of Rs. 1,605 crore as of August 31, 2022.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The ratings can be downgraded on a dilution in the actual or perceived support from the parent, viz. KMBL, or a change in the rating or outlook of KMBL. Pressure on the ratings could also 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 Rating Approach – Implicit Parent or Group Support
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 offering (IPOs), mutual funds, fixed deposits, etc. Depending on the market opportunities, the company maintains a proprietary trading book. It also provides an educational self-learning platform on financial topics, which is used for marketing activities as well.

KSL's net worth stood at Rs. 6,385 crore as on March 31, 2022 compared to Rs. 5,371 crore as of March 2021. It stood at Rs. 6,462 crore in Q1 FY2023. The company reported a PAT of Rs. 1,049 crore in FY2022 compared to Rs. 784 crore in FY2021. The PAT was Rs. 219 crore in Q1 FY2023.

Key financial indicators (audited)

Kotak Securities Limited	FY2021	FY2022	Q1 FY2023*
Brokerage income	1,029	1,267	271
Fee income (other than broking)	232	155	31
Net interest income	514	731	183
Other non-interest income	176	252	52
Net operating income (NOI)	1,951	2,406	536
Total operating expenses	883	985	269
Profit before tax	1,046	1,403	291
Profit after tax (PAT)	784	1,049	219
Net worth	5,371	6,385	6,462
Borrowings	3,181	4,709	3,921
Gearing (times)	0.59	0.74	0.61
Cost-to-income ratio	49%	45%	54%
Return to net worth	16%	18%	14%
PAT/NOI	43%	48%	44%

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*

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 September 30, 2022 (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					Oct 12, 2022	Nov 24, 2021	May 27, 2021	May 08, 2020	May 21, 2019
1	Non-convertible debentures	Long term	50	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-
2	Non-convertible debentures	Long term	50	-	[ICRA]AAA (Stable)	-	-	-	-
3	Long-term fund-based	Long term	2,000	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
4	Long-term non-fund based	Long term	1,500	1,155.27	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
5	Commercial paper programme	Short term	10,000	4,250	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debentures	Very Simple^
Long-term fund-based	Simple
Long-term non-fund-based	Very Simple
Commercial paper	Very Simple

^Subject to change once the terms are finalised

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 I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE028E14KL4	Commercial paper programme	July 20, 2022	5.68%	October 3, 2022	500	[ICRA]A1+
INE028E14KM2	Commercial paper programme	July 29, 2022	5.94%	October 10, 2022	500	[ICRA]A1+
INE028E14KN0	Commercial paper programme	August 1, 2022	6.26%	October 28, 2022	500	[ICRA]A1+
INE028E14KO8	Commercial paper programme	August 12, 2022	6.18%	November 4, 2022	500	[ICRA]A1+
INE028E14KP5	Commercial paper programme	August 17, 2022	6.60%	February 14, 2023	100	[ICRA]A1+
INE028E14KQ3	Commercial paper programme	August 26, 2022	6.22%	November 15, 2022	400	[ICRA]A1+
INE028E14KQ3	Commercial Paper Programme	August 29, 2022	6.22%	November 15, 2022	150	[ICRA]A1+
INE028E14KR1	Commercial Paper Programme	September 6, 2022	6.26%	November 29, 2022	300	[ICRA]A1+
INE028E14KS9	Commercial Paper Programme	September 15, 2022	6.20%	October 21, 2022	400	[ICRA]A1+
INE028E14KT7	Commercial Paper Programme	September 21, 2022	6.44%	November 22, 2022	400	[ICRA]A1+
INE028E14KU5	Commercial Paper Programme	September 29, 2022	6.90%	December 1, 2022	500	[ICRA]A1+
Not Yet Placed	Commercial Paper Programme	NA	NA	7-365 days	5,750	[ICRA]A1+
NA	Long-term Non-fund Based	NA	NA	NA	1,500	[ICRA]AAA(Stable)
NA	Long-term Fund Based	NA	NA	NA	2,000	[ICRA]AAA(Stable)
Not Placed	Non-convertible Debenture Programme	NA	NA	NA	100	[ICRA]AAA(Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA]

Annexure II: 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.

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