July 25, 2023

Master Capital Services Ltd: Rating reaffirmed

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+; reaffirmed
Total	**100**	**100**	

**Instrument details are provided in Annexure I*

Rationale

The rating factors in Master Capital Services Ltd's (MCSL) long track record of almost three decades in the financial services industry and its established position in the capital markets, catering to ~2.5 lakh customers through its network of 38 branches and 1,800+ franchises spread across 23 states as on March 31, 2023. The rating also takes into consideration MCSL's comfortable capitalisation profile with a low gearing of 0.8 times {0.3 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. 240 crore as on March 31, 2023. MCSL's gearing on a net basis is nil as the external gearing of 0.3 times as on March 31,2023 is in form of bank overdraft against fixed deposits. The rating also factors in the company's comfortable asset quality indicators and good profitability metrics with a return on net worth (RoNW) of 26.2% in FY2023 (25.6% in FY2022), supported by the improvement in trading income and net interest income.

The rating is, however, constrained by the low diversification in MCSL's revenue stream with high dependence on capital markets. Its net brokerage[1] and trading income accounted for ~79% of total income in FY2023 and ~89% in FY2022 while its market share is modest. Moreover, as it is a part of an intensely competitive industry, MSCL's ability to scale up its capital market segment operations from the current level, while keeping the profitability intact, would be a monitorable. With market volatility expected to taper off from the FY2023 level, MCSL's ability to maintain its profitability indicators will be contingent to its ability to maintain its net interest margins (NIMs), which could be impacted owing to the regulatory changes. Also, higher capital deployment would be needed for the broking operations compared with the proprietary operations due to the pressure on yields, intense competition and increased working capital requirements for broking operations, post the regulatory changes by the Securities and Exchange Board of India (SEBI). Overall, the company's ability to maintain a similar profitability trajectory would be a key monitorable, going forward.

Key rating drivers and their description

Credit strengths

Long track record and established position in capital markets – The Master Group has a long-standing presence of over two decades 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. MSCL caters to 2.5 lakh customers through its network of 38 branches and 1,800+ franchises with a market share of 0.52% in the equity broking segment in FY2023. In line with the industry trend, MCSL's broking volumes are driven by its derivative book, which comprised ~99% of its total broking volumes of 200.21 lakh crore.

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[1] *Gross brokerage adjusted for sub brokerage*

Comfortable capitalisation profile for current scale of operations – The company's capitalisation profile is comfortable with a low gearing of 0.8 times on a standalone net worth of Rs. 240 crore as on March 31, 2023. The majority of the debt (~60% of the overall borrowing profile as on March 31, 2023) is in the form of deep discount bonds placed with the parent and other Group entities. MCSL's gearing on a net basis is nil as the external gearing of 0.3 times as on March 31,2023 is in form of bank overdraft against fixed deposits.

As it is a brokerage entity, a significant proportion of MCSL's borrowings is in the form of non-fund based limits consisting of bank guarantees where the average monthly margin utilisation stood at ~100% in FY2023. However the average margin utilisation at exchanges has been much lower at 31%, indicating adequate liquidity. Going forward, the leverage could increase to some extent, given the higher working capital requirements for brokers. Nevertheless, the company is expected to maintain prudent capitalisation levels.

Improving asset quality indicators – MCSL's asset quality indicators remain comfortable with debtors outstanding for more than six months of the total debtors, as a percentage of the net worth, being 0.7% as on March 31, 2023 and 0.6% as on March 31, 2022. At the same time, write-offs remained negligible as a percentage of the net worth in FY2023, 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.

Credit challenges

Low diversification of revenues with significant share of income dependent on capital markets – 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 43% growth in equity broking volumes in FY2023 (~71% in FY2022 and 76% in FY2021) and its net brokerage and trading income constituted ~79% of its total income in FY2023 (~84% in FY2022 and ~81% in FY2021). Therefore, there is vulnerability to cyclical downturns in the market, albeit reducing. At the same time, ICRA notes that the company has been able to continuously acquire new customers, which will generate continuous inflow through broking income and float income.

ICRA also 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. 874 crore and AUM of Rs. 567 crore under its manufactured PMS as on March 31, 2023. 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 profile, though sustainability remains to be seen – MCSL's profitability indicators remained good with RoNW of 26.2% in FY2023 (25.6% in FY2022 and 16.3% in FY2021), supported by higher income from broking as well as trading operations. Within the broking segment, the net interest income increased to Rs. 38 crore in FY2023 from Rs. 26 crore in FY2022, leading to an increase in the net interest margin (NIM) to 3.7% in FY2023 from 3.2% in FY2022. This was due to the increase in the client float on account of the higher cash margin from clients and the interest income earned by MCSL on the margin funding book. Additionally, ICRA notes that MCSL has been steadily growing its customer base over the years by increasing its geographical presence. Any decline in brokerage income due to lower 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.

Incrementally, 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 the intensely competitive industry will remain imperative for MCSL. Further, high working capital requirements could lead to some moderation in the NIM. Also, MCSL employs arbitrage strategies and its ability to identify opportunities in the capital market will remain key for sustaining the current level of trading income and subsequently the profitability profile. The scaling up of fee-based income to an appropriate level 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 requirement is primarily for placing margins at the exchanges and managing its working capital requirements. During April 2022 to March 2023, the average margin placed at the exchanges (basis month-end data, including client margin) stood at Rs. 986 crore with average utilisation of 31%. MCSL's liquidity profile is adequate, supported by an unencumbered cash and bank balance of Rs. 4.61 crore as on March 31, 2023. The liquidity is further supported by the portfolio of quoted equity shares of Rs. 4.16 crore as on March 31, 2023. The company also had unutilised bank lines of Rs. 101 crore in the form of an overdraft along with debt mutual fund investments of Rs. 1 crore as on March 31, 2023. As on March 31, 2023, MCSL's total debt stood at Rs. 189 crore, comprising deep discount bonds of Rs. 113 crore from the parent and other Group entities and external debt of Rs. 76 crore.

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 Ltd (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), Multi Commodity Exchange (MCX) and National Commodity and Derivatives Exchange (NCDEX) 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 FY2023, MCSL reported a profit after tax (PAT) of Rs. 55.4 crore compared to a PAT of Rs. 41.3 crore in FY2022. Its net worth stood at Rs. 240 crore as on March 31, 2023 with a gearing of 0.8 times.

Key financial indicators (audited)

Master Capital Services Ltd	FY2021	FY2022	FY2023
	Audited	Audited	Audited
Brokerage income (net)	60.6	84.8	77.3
Net interest income	14.1	25.7	37.9
Other non-interest income	71.7	93.7	87.1
Net operating income (NOI)*	85.9	119.4	125.0
Trading Income	51	95	106
Total operating expenses	108.5	159.8	159.2
Profit before tax	27.6	55.4	73.6
Profit after tax (PAT)	21.0	41.3	55.4
Net worth	139.7	183.6	240.1
Borrowings	128.7	113.4	188.7
Gearing (times)	0.92	0.62	0.79
Cost-to-income ratio	126%	134%	127%
Adjusted Cost Income Ratio^	79%	75%	69%
Return on net worth	16%	26%	26%
PAT/NOI	24%	35%	44%

Source: Company, ICRA Research
Amount in Rs. crore; All ratios as per ICRA's calculations
*Note: *does not include trading income; ^adjusted for trading income*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount o/s as on Jul 25, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Jul 25, 2023	Jun 27, 2022	-	Mar 19, 2021
1	Non-fund based bank lines	Short term	100	100	[ICRA]A2+	[ICRA]A2+	-	[ICRA]A2

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: Click Here

Annexure I: Instrument details as of July 25, 2023

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**	Sep-08-2022	NA	NA	100	[ICRA]A2+

Source: Company

Annexure II: 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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