October 31, 2023

Kotak Securities Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	100.00	100.00	[ICRA]AAA (Stable); reaffirmed
Long-term fund based	2,000.00	2,000.00	[ICRA]AAA (Stable); reaffirmed
Long-term non-fund based	1,500.00	1,500.00	[ICRA]AAA (Stable); reaffirmed
Commercial paper	10,000.00	10,000.00	[ICRA]A1+; reaffirmed
Total	**13,600.00**	**13,600.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings factor in Kotak Securities Limited's (KSL) strong retail franchise, supported by its position as a bank brokerage house, and its healthy financial profile with healthy profitability and strong capitalisation with a low gearing. The ratings also consider the company's strong parentage as it is a subsidiary of Kotak Mahindra Bank Limited (KMBL[1]), which holds a 75% stake, while KMBL's subsidiary (Kotak Mahindra Capital Company Limited) holds the balance. KSL has strong linkages with the parent and the shared brand name strengthens ICRA's expectations that KSL will receive timely and adequate financial and operational support from the parent, as and when required. KSL's importance to the parent is evident from the support received by it in the form of senior management deputations, customer sourcing and cross-selling, and access to the bank's retail clientele and branch network.

To diversify its revenue profile, KSL has been increasing its secured margin trade funding (MTF) business. While the scale of the MTF loan book and associated funding requirements through commercial paper (CP) borrowings depend on market conditions and can be volatile, the increased working capital requirement in the broking business to fund the incremental growth will primarily be supported by outside borrowings. KSL also remains exposed to credit and market risks on account of the MTF loan book, given the nature of the underlying assets.

KSL's business profile remains exposed to the inherent volatility and risks associated with capital market related businesses and the intense competition in the retail equity broking space. Nonetheless, the increasing share of non-broking revenues has been aiding the diversification of the revenue profile. Going forward, KSL's ability to continue to ramp up the broking revenues and sustain the net interest income (NII), given the elevated interest rate environment, while ensuring adequate asset quality would be imperative for maintaining its profitability.

The Stable outlook indicates ICRA's expectation of continued benefit from the company's parentage, strong retail franchise and market position 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 75% directly and 25% through its wholly-owned subsidiary. The strong parentage, coupled with the shared brand name and board representation, strengthens ICRA's assumption that KSL will receive timely and adequate support (financially as well as operationally) from the Group, if required. KSL helps augment KMBL's services portfolio and enjoys customer sourcing opportunities along with access to the bank's retail clientele and branches. It also draws the advantage of enhanced financial flexibility by virtue of being a subsidiary of KMBL.

Established presence in retail broking space – KSL, a full-service securities brokerage house (98% of the total broking volumes in Q1 FY2024 was from the retail segment) has a presence of almost three decades in the broking space. As a brokerage entity within the Group, the company draws franchise recognition from its association with KMBL. KSL services its active customer base of 9.28 lakh through 175 standalone branches and 1,262 franchisees as on June 30, 2023. It is among the leading brokerage houses in the country, in terms of National Stock Exchange (NSE) active clients (~3% market share as of March 2023), and had a market share (in terms of broking volumes) of 5.16% in the cash segment and 2.75% in the derivatives segment in FY2023.

KSL registered a ~299% year-on-year (YoY) increase in its average daily turnover (ADTO) in the futures & options (F&O) segment in FY2023, majority of which was contributed by trade free product which offers free intra-day trading. This was significantly higher than the market growth of 104%. The cash segment ADTO declined by 21% in FY2023, in line with the market decline of 20%. KSL's ADTO in the F&O segment continued to increase by 267% YoY in Q1 FY2024, significantly above the market growth of 101%. The ADTO in the cash segment declined by 1.9% YoY against market volume growth of 5.3%. The company enjoyed a 4.81% market share in the cash segment and a 3.76% market share in the F&O segment in Q1 FY2024.

Healthy profitability and strong capitalisation – KSL's profitability remained healthy with profit after tax (PAT)/net operating income[2] (NOI) of 41.7% and return on equity (RoE) of 12.4% in FY2023, notwithstanding the moderation from FY2022 (47.7% and 17.9%, respectively, in FY2022). The industry tailwinds and record retail investor participation partly supported the strong performance in FY2022. However, geopolitical tensions and the adverse macro-economic outlook dampened investor sentiment in FY2023, which was reflected in the moderation in capital market activity, especially in the cash segment, and the rising funding cost of borrowings. KSL's performance remained steady in Q1 FY2024 with PAT/NOI of 41.6% and RoE of 12.1%. ICRA also notes that a sizeable share of the F&O volumes through the NEO platform is currently not subject to any broking charges and remains a potential upside to profitability.

KSL's capitalisation remains strong and it has one of the highest net worth figures among domestic broking companies at Rs. 7,279 crore, leading to a low gearing of 0.38 times as on June 30, 2023 (0.61 times as on June 30, 2022). While the scale of the MTF loan book and associated funding requirements through CP borrowings depend on market conditions and can be volatile, the increased working capital requirement in the broking business to fund the incremental growth will primarily be supported by outside borrowings.

Credit challenges

Exposed to risks inherent in capital market related businesses as well as credit and market risks associated with MTF business – KSL's revenues remain dependent on capital markets, which are inherently volatile in nature. Approximately 48% of the company's NOI was through brokerage income in FY2023. With the ramp-up in the MTF book, the share of NII increased to 36% of NOI in FY2023 from 30% in FY2022. The MTF loan book size is, however, exposed to capital market conditions and it

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[2] Net operating income is defined as Net broking revenue + Net interest income + Fee income + Other operating income

declined to Rs. 3,731 crore as of March 31, 2023 from Rs. 4,711 crore as of March 31, 2022. 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%. KSL has been intending to diversify by further increasing its focus on depository participant (DP) service income, advisory/research income, to impart stability to its overall earnings profile.

As the company's broking revenues are 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. KSL is also exposed to credit and market risks on account of the MTF loan book, given the nature of the underlying assets; any adverse event in the capital markets could erode the value of the underlying collateral stocks. Its ability to maintain adequate asset quality while ramping up the loan book would remain a monitorable.

Intense competition in capital markets – With increasing competition in equity broking and the growing popularity of discount brokerage houses, KSL's market share in terms of NSE active clients contracted to 2.8% as on March 31, 2023 from 3.4% in March 2022. With competition in this cyclical industry expected to remain high, pressure on profitability cannot be ruled out, especially during downturns. 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 growing the MTF book. Its margin utilisation ranged between 20% and 30% (basis month-end data) during September 2022 to August 2023, with the average cash margin placed on exchanges (including client funds) aggregating ~Rs. 7,700 crore during this period. As on August 31, 2023, KSL had total borrowings of ~Rs. 3,650 crore, all of which was due for repayment within three months. Against this, it had an unencumbered cash and bank balance of Rs. 295 crore and drawable but unutilised lines of Rs. 1,605 crore. Additionally, MTF book which is callable on short notice stood at Rs. 5,245 crore while the proprietary investment book stood at Rs. 637 crore, which can be liquidated at short notice to generate liquidity if required. KSL also enjoys financial flexibility, as it is a subsidiary of KMBL, and the same is evident from the regular CP issuances and competitive borrowing cost.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Pressure on KSL's ratings could arise if there is a deterioration in KMBL's credit profile, a change in KSL's strategic importance to the parent or a decline in the linkages with the parent.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Entities in Brokerage Industry Rating Approach: Implicit Support from Parent or Group
Parent/Group support	Parent: Kotak Mahindra Bank Limited The ratings factor in the high likelihood of support from KMBL, given the shareholding, shared brand name and representation on the board.
Consolidation/Standalone	Standalone

About the company

Kotak Securities Limited (KSL), a subsidiary of Kotak Mahindra Bank Limited (KMBL), was incorporated on July 20, 1994. It provides securities broking in the cash equities segment, equity, commodity and currency derivatives segment, depository services, primary and secondary market distribution services. It is also registered as a portfolio manager with the Securities and Exchange Board of India (SEBI) and as a mutual fund advisor with the Association of Mutual Funds in India (AMFI). It also acts as a corporate agent of Kotak Mahindra Life Insurance Company Limited. Depending on market opportunities, the company also maintains a proprietary trading book.

KSL's net worth stood at Rs. 7,157 crore as on March 31, 2023 compared to Rs. 6,385 crore as on March 31, 2022. It reported a PAT of Rs. 839 crore in FY2023 compared to Rs. 1,049 crore in FY2022.

Key financial indicators (audited)

Kotak Securities Limited	FY2022	FY2023	Q1 FY2023*	Q1 FY2024*
Brokerage income	1,267	1,052	266	278
Fee income (other than broking)	155	142	35	35
Net interest income	731	779	183	193
Other non-interest income	252	202	71	85
Net operating income (NOI)	2,406	2,175	555	592
Total operating expenses	985	1,071	269	293
Profit before tax	1,403	1,115	291	292
Profit after tax (PAT)	1,049	839	219	219
Net worth	6,385	7,157	6,462	7,279
Borrowings	4,709	3,308	3,921	2,767
Gearing (times)	0.74	0.46	0.61	0.38
Cost-to-income ratio	44.8%	53.2%	53.8%	55.7%
Return to net worth	17.9%	12.4%	13.6%	12.1%
PAT/NOI	47.7%	41.7%	43.8%	41.6%

*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 (FY2024)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Sep 30, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021
					Oct 31, 2023	Oct 12, 2022	Nov 24, 2021	May 27, 2021	May 08, 2020
1	**Non-convertible debentures**	Long term	100.00	-	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**
2	**Long-term fund based**	Long term	2,000.00	-	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**
3	**Long-term non-fund based**	Long term	1,500.00	150.27	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**
4	**Commercial paper programme**	Short term	10,000.00	4,450.00	**[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	Very 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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE028E14LX7	Commercial paper programme	20-Jul-2023	7.20%	Oct-19-2023	250	[ICRA]A1+
INE028E14LY5	Commercial paper programme	8-Aug-2023	7.34%	31-Oct-2023	100	[ICRA]A1+
INE028E14LZ2	Commercial paper programme	8-Aug-2023	7.34%	7-Nov-23	300	[ICRA]A1+
INE028E14MA3	Commercial paper programme	14-Aug-2023	7.40%	13-Nov-23	400	[ICRA]A1+
INE028E14MB1	Commercial paper programme	18-Aug-2023	7.40%	17-Nov-23	300	[ICRA]A1+
INE028E14MC9	Commercial paper programme	24-Aug-2023	7.40%	23-Nov-23	200	[ICRA]A1+
INE028E14MD7	Commercial paper programme	1-Sep-2023	7.41%	30-Nov-23	500	[ICRA]A1+
INE028E14ME5	Commercial paper programme	7-Sep-2023	7.37%	7-Dec-23	200	[ICRA]A1+
INE028E14MF2	Commercial paper programme	14-Sep-2023	7.45%	14-Dec-23	600	[ICRA]A1+
INE028E14MG0	Commercial paper programme	18-Sep-2023	7.45%	18-Dec-23	600	[ICRA]A1+
INE028E14MH8	Commercial paper programme	22-Sep-2023	7.43%	22-Dec-23	500	[ICRA]A1+
INE028E14MI6	Commercial paper programme	26-Sep-2023	7.42%	26-Dec-23	500	[ICRA]A1+
Not yet placed	Commercial paper programme	7-365 days	NA	NA	5,550	[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)

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

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.

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