

July 11, 2024

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	3,500.00	[ICRA]AAA (Stable); reaffirmed/assigned for enhanced amount
Long-term non-fund based	1,500.00	1,500.00	[ICRA]AAA (Stable); reaffirmed
Commercial paper	10,000.00	17,500.00	[ICRA]A1+; reaffirmed/assigned for enhanced amount
Total	13,600.00	22,600.00	

*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 robust financial profile with healthy profitability and strong capitalisation. The ratings also consider the company's strong parentage as it is a subsidiary of Kotak Mahindra Bank Limited (KMBL¹), 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 the company 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 debt-funded margin trade funding (MTF) business. With the expected growth in the MTF loan book dependent on market buoyancy and the associated funding requirements through commercial paper (CP) borrowings, the gearing is likely to increase. Further, the higher working capital requirement in the broking business to fund incremental growth will primarily be supported by outside borrowings. ICRA, however, expects the company's capitalisation profile to remain strong, providing headroom for growth.

The ratings also take into account the credit and market risk associated with the margin funding exposures, given the nature of the underlying assets, the risks associated with capital market related businesses, the intense competition in the retail broking space and the evolving operating and regulatory environment. 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 healthy 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 expectation that KSL will receive timely and adequate support (financially as well as operationally) from the Group, as and when required. The company helps augment KMBL's services portfolio and enjoys customer sourcing opportunities along with access to the bank's retail clientele and branches. KMBL has a nominee director on KSL's board. It also draws the advantage of enhanced financial flexibility as it is a subsidiary of KMBL.

Established presence in broking space – KSL, a full-service securities brokerage house (98% of the total broking volumes in FY2024 was from the retail segment), has been operating in the broking space for almost three decades. As a brokerage entity within the Group, it draws franchise recognition from its association with KMBL. As of March 31, 2024, KSL had a National Stock Exchange (NSE) active client base of 12.8 lakh customers, translating to a market share of 3%, through 165 standalone branches and 1,031 franchisees. Moreover, its market share in the MTF segment stood at ~14% as of March 31, 2024, given its competitive funding profile to fund this book. KSL also has a strong presence in the institutional broking segment with institutional broking contributing 41% to its overall broking revenue in FY2024.

Given its focus on the high-yielding cash segment, coupled with the increase in its leverage position in this segment through the MTF facility, KSL registered a 35.5% growth in its average daily turnover (ADTO) in the cash segment in FY2024, though it trailed the industry average. Additionally, it witnessed a healthy increase in futures & options (F&O) volumes with a 237.8% YoY rise in its ADTO in FY2024, surpassing the industry average. A major portion of the same was contributed by the trade free product, which offers free intra-day trading. The company had a 4.6% market share² in the cash segment and a 4.7% market share in the F&O segment in FY2024.

Healthy profitability and strong capitalisation – KSL's profitability remained healthy with profit after tax (PAT)/net operating income³ (NOI) of 48.6% and a return on net worth (RoNW) of 16.8% in FY2024 compared to 41.7% and 12.4%, respectively, in FY2023. The cost-to-income ratio improved to 47.0% in FY2024 from 53.2% in FY2023, supported by higher revenues. The company reported its highest-ever PAT of Rs. 1,311.7 crore in FY2024 compared to Rs. 839.3 crore in FY2023. KSL's strong performance in FY2024 was supported by the resurgence in market performance and retail investor participation after the moderation in FY2023. ICRA also notes that a sizeable share of the F&O volumes through the NEO platform is currently not subject to any broking charges, continuing to represent upside potential to profitability. The recent Securities and Exchange Board of India (SEBI) circular on the levying of uniform charges by market infrastructure institutions is likely to impact the profitability of the broking industry, including KSL, unless offset by a hike in broking rates, especially in the F&O segment. This remains a monitorable.

KSL's capitalisation remains strong and its net worth is one of the highest among domestic broking companies at Rs. 8,419.7 crore, leading to a low gearing of 0.78 times as on March 31, 2024 (0.46 times as on March 31, 2023). Its capital needs are mainly for meeting the margin requirements at the bourses and for the MTF business. While the company's gearing could increase with the likely scale-up of the MTF loan book and associated funding requirements through CP borrowings, it would remain strong. Further, the increased working capital requirement in the broking business to fund incremental growth will primarily be supported by outside borrowings. The growth in the MTF loan book would, however, depend on market conditions and can be volatile.

² Market share as per ICRA's calculations; market share excluding proprietary trades

³ Net operating income = Net broking revenue + NII + Fee income + Other operating income

Credit challenges

Exposure to risks associated with capital market related businesses; evolving operating and regulatory environment – The trading volumes and revenues of securities broking companies are susceptible to the inherently volatile capital markets, which are cyclical in nature. As broking revenues continue to account for a sizeable portion of its NOI, KSL's profitability remains susceptible to market performance to a certain extent. Nonetheless, the improving diversification with sizeable revenue flow from the ramp-up of the MTF book, and the scale-up of the distribution business, wherein the revenues are linked to the assets under management (AUM), provide some stability to the overall earnings profile. Net broking income accounted for ~52% of the NOI in FY2024 (~52% in FY2023), followed by NII (FY2024 and FY2023: 39% each) and fee-based revenues, such as distribution, etc., (FY2024: 8%; FY2023: 7%). KSL is also exposed to credit and market risks on account of the MTF lending book, given the nature of the underlying assets and funding risks due to the nature of its borrowings. Its ability to maintain adequate asset quality while ramping up the lending book would remain a monitorable.

Securities broking companies also rely heavily on technology. Thus, any technical failure or disruption can pose operational and reputation risk. Moreover, the ability of brokerage entities to ensure compliance with the evolving regulatory landscape remains crucial.

Intense competition in capital markets – With the increasing competition in equity broking and the growing popularity of discount brokerage houses, pressure on market share and profitability cannot be ruled out. Competition in this cyclical industry is expected to remain high, especially during the slowdown in capital markets. However, the increasing financialisation of savings and the low share of wallet of the equity segment in household savings indicate huge untapped potential for expansion in the brokerage industry 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 25% (basis month-end data) during October 2023 to March 2024, with the average cash margin placed on exchanges (including client funds) aggregating ~Rs. 8,500 crore during this period. As on May 31, 2024, KSL had total borrowings of ~Rs. 9,265 crore, of which Rs. 8,065 crore falls due in the next six months (till November 2024). Against this, it had an unencumbered cash and bank balance and liquid investments of Rs. 390 crore and drawable but unutilised lines of Rs. 1,727 crore. Additionally, the MTF book, which is callable on short notice, stood at Rs. 9,586 crore while the proprietary investment book stood at Rs. 1,724 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 – A deterioration in KMBL's credit profile or a change in KSL's strategic importance to the parent or a decline in the linkages with the parent would be negative factors.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Stockbroking & Allied Services Rating Approach: Implicit Support from Parent or Group
Parent/Group support	Parent: Kotak Mahindra Bank Limited KSL is a subsidiary of KMBL, which holds a 75% stake in the company. The strong parentage and shared brand name strengthen ICRA's assumption that KSL will receive timely and adequate operational support from KMBL, if needed. The company also enjoys significant financial flexibility by virtue of being a subsidiary of KMBL. It draws the advantage of strong operational linkages with the bank as demonstrated by the senior management depositions from the bank along with customer sourcing and cross-selling support.
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, and 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). Moreover, it acts as a corporate agent of Kotak Mahindra Life Insurance Company Limited. Depending on market opportunities, the company maintains a proprietary trading book as well.

KSL's net worth stood at Rs. 8,419.7 crore as on March 31, 2024 compared to Rs. 7,156.7 crore as on March 31, 2023. It reported a PAT of Rs. 1,311.7 crore in FY2024 compared to Rs. 839.3 crore in FY2023.

Key financial indicators (audited)

Kotak Securities Limited	FY2023	FY2024
Net operating income	2,013.6	2,699.0
Profit after tax	839.3	1,311.7
Net worth	7,156.7	8,419.7
Total assets	16,246.5	24,646.6
Gearing (times)	0.46	0.78
Return on average net worth	12.4%	16.8%

Source: Company, ICRA Research; 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 (FY2025)			Chronology of rating history for the past 3 years				
	Type	Amount rated (Rs. crore)	Date & Rating in FY2025	Date & rating in FY2024	Date & Rating in FY2023	Date & rating in FY2022		
			Jul 11, 2024	Oct 31, 2023	Oct 12, 2022	Nov 24, 2021	May 27, 2021	
1 Non-convertible debentures	Long term	100.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2 Long-term fund based	Long term	3,500.00	[ICRA]AAA (Stable)	[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	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
4 Commercial paper programme	Short term	17,500.00	[ICRA]A1+	[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
INE028E14OF8	Commercial paper programme	Jun-14-2024	7.85%	Sep-13-2024	650.00	[ICRA]A1+
INE028E14ND5		Feb-12-2024	8.58%	Nov-15-2024	150.00	[ICRA]A1+
INE028E14NG8		Feb-23-2024	8.52%	Feb-21-2025	350.00	[ICRA]A1+
INE028E14NQ7		Apr-16-2024	7.64%	Jul-16-2024	240.00	[ICRA]A1+
INE028E14NR5		Apr-22-2024	7.59%	Jul-22-2024	300.00	[ICRA]A1+
INE028E14NS3		Apr-25-2024	7.72%	Jul-25-2024	500.00	[ICRA]A1+
INE028E14NT1		Apr-26-2024	7.71%	Jul-26-2024	250.00	[ICRA]A1+
INE028E14NU9		May-07-2024	7.90%	Sep-25-2024	100.00	[ICRA]A1+
INE028E14NU9		Jun-27-2024	7.90%	Sep-25-2024	350.00	[ICRA]A1+
INE028E14NV7		May-07-2024	7.80%	Aug-06-2024	50.00	[ICRA]A1+
INE028E14NV7		May-08-2024	7.92%	Aug-06-2024	400.00	[ICRA]A1+
INE028E14NW5		May-07-2024	7.94%	Oct-28-2024	200.00	[ICRA]A1+
INE028E14NX3		May-10-2024	7.92%	Aug-09-2024	500.00	[ICRA]A1+
INE028E14NY1		May-16-2024	8.00%	Aug-14-2024	525.00	[ICRA]A1+
INE028E14NZ8		May-22-2024	7.97%	Aug-21-2024	500.00	[ICRA]A1+
INE028E14OA9		May-24-2024	7.96%	Aug-23-2024	250.00	[ICRA]A1+
INE028E14OB7		May-28-2024	7.86%	Aug-27-2024	650.00	[ICRA]A1+
INE028E14OC5		May-30-2024	7.86%	Aug-29-2024	550.00	[ICRA]A1+
INE028E14OD3		May-31-2024	8.15%	Feb-28-2025	500.00	[ICRA]A1+
INE028E14OE1		Jun-05-2024	7.85%	Sep-04-2024	600.00	[ICRA]A1+
INE028E14OG6		Jun-18-2024	7.85%	Sep-17-2024	600.00	[ICRA]A1+
INE028E14OH4		Jun-19-2024	7.83%	Sep-18-2024	200.00	[ICRA]A1+
INE028E14OI2		Jun-21-2024	7.82%	Sep-20-2024	900.00	[ICRA]A1+
Not yet placed		7-365 days	NA	NA	8,185.00	[ICRA]A1+
NA	Long-term non-fund based	NA	NA	NA	1,500.00	[ICRA]AAA (Stable)
NA	Long-term fund based	NA	NA	NA	3,500.00	[ICRA]AAA (Stable)
Not placed	Non-convertible debenture programme	NA	NA	NA	100.00	[ICRA]AAA (Stable)

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Annexure II: List of entities considered for consolidated analysis

Not applicable

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