March 12, 2020

Kotak Mahindra Investments Limited: [ICRA]A1+ assigned to commercial paper programme (IPO financing)

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper Programme (IPO Financing)	-	1,000	[ICRA]A1+; assigned
Commercial Paper Programme	7,000	7,000	[ICRA]A1+; outstanding
Subordinated Debt Programme	200	200	[ICRA]AAA(stable); outstanding
Total	**7,200**	**8,200**	

Rationale

The rating factors in the company's strong parentage in the form of Kotak Mahindra Bank Limited (KMBL, rated [ICRA]AAA(stable)), its operational synergies with other group companies, and the Group's proven experience in capital market related activities. The rating positively takes into account the high level of financial flexibility enjoyed by Kotak Mahindra Investments Limited (KMIL) by virtue of it being a wholly owned subsidiary of KMBL. The company has consistently received capital support from the parent. The rating also takes into account KMIL's strong asset quality and sound risk management systems. The rating nevertheless takes note of the cyclical nature of KMIL's business which is vulnerable to capital market movements and its exposure to real estate financing. ICRA derives comfort from the Group's longstanding experience in real estate financing with strict underwriting norms and strong risk mitigants. Going forward, KMIL's rating would be sensitive to its ability to maintain and improve its profitability and maintain superior asset quality. KMIL's rating would also be sensitive to its parent KMBL's rating given the strong business and operational linkages among the Kotak Group companies.

While the gearing of the company remains comfortable, ICRA takes note of the likely increase in gearing for ~one to two weeks when the company would utilise Commercial Paper for IPO financing. ICRA also notes that the funds will be utilised for proprietary application for an upcoming IPO.

Key rating drivers

Credit strengths

Strong parentage of KMBL - KMIL is a 100% subsidiary of KMBL. KMIL enjoys strong financial and operational support from the Kotak Group, which in the past has included access to capital, management and systems, and supervision by a strong board. KMIL also benefits from its operational synergies with other group companies and the Group's proven experience in capital market related activities. Capital adequacy and gearing levels of KMIL improved during FY2018 with equity infusion of Rs. 100 crore by KMBL coupled with its consistent profitability. CRAR stood at 18.25% as on March 31, 2019 as compared with 18.94% as on March 31, 2018, while gearing has inched up to 5.51 as on March 31, 2019 from 5.28 times as on March 31, 2018. As on September 30, 2019, capital adequacy and gearing stood at 20.91% and 4.20 respectively, the improvement in ratios is attributable to the decline in loan book. By virtue of being a part of the Kotak Group, KMIL enjoys considerable financial flexibility to raise long term funding at competitive rates. ICRA also expects the parent to support the company, as and when a need arises.

Established player in the capital markets and real estate lending space – The total loan book contracted by 14% to Rs. 8,030 crore as on September 30, 2019 from that of Rs. 9,376 crore as on March 31, 2019, The decline in portfolio in September 2019 is due to higher repayments than disbursements across segments, barring real estate. As of September 2019, promoter funding, real estate financing, margin funding and corporate loans formed 28%, 48%, 12% and 12% of the portfolio respectively as compared to 36%, 36%, 13% and 16% as of March 2019. The company has decided to reduce the focus on capital markets business, going forward. Company's underwriting is based on proven track record of borrowers and quality of collateral. It also has put/call options at 3-6 months durations on its promoter funding and corporate loans, which gives it the option for early exits.

Good asset quality indicators supported by stringent risk management systems, but shows signs of deterioration - KMIL has a stringent risk management process with a robust credit assessment mechanism. The credit risk policy and processes are the same as KMBL. Gross and net NPA levels increased to 1.16% and 0.85% respectively in September 2019 from 0.46% and 0.25% in March 2019. The deterioration in asset quality is largely due to fresh slippages in real estate segment, which has been on the rise since December 2018. While ICRA takes into account KMIL's robust credit assessment process and the adequate structural mechanisms in terms of security cover, exclusive charge over the underlying asset, and escrow accounts to trap project cash flows, it notes that the real estate financing book would remain susceptible to economic downturns.

Strong financial performance with negligible credit costs and strong returns – In FY2019, the company reported a net profit of Rs. 201 crore as compared with a net profit of Rs. 245 crore in FY2018. The decline in profits during FY2019 is attributable to lower investment income and increase in credit costs, coupled with contraction of net interest margin. Higher borrowings to fund growth and increase in cost of borrowings, reduced the net interest margins, even though the yields have remained stable. With low bad debt levels in FY2018, the credit costs during the year was quite low. But with worsening on asset quality, overall credit costs rose during FY2019. Hence the overall profitability (return on average assets, RoA) declined to 2.1% in FY2019 from 3.0% in FY2018. In H1 FY2020, the profitability has improved with RoA of 2.8%, driven by improved NIMs, controlled operating and credit costs. Further, lower tax rates also boosted the profitability. However, credit costs are expected to increase from current levels with increase in bad debt levels. KMIL's ability to sustain profitability in the event of continued weakness in the operating environment remains to be seen.

Credit challenges

High dependence on capital market funding - KMIL's borrowings are primarily from debt capital markets, with a diverse investor base including corporates, mutual funds, insurance, bank treasuries etc. However, adequate asset liability management practices and unutilised bank lines mitigate these concerns. The company also benefits from Kotak group's support. ICRA does not expect any funding concerns for the company given the Group's extensive banking relationships and access to funds. ICRA also notes that the reliance on commercial paper funding remains high (38% of total funding as of September 30, 2019), however this is predominantly due to higher share of shorter tenor advances on its portfolio (margin funding book and short tenor corporate advances). The durations of these instruments are matched with the maturities of loan assets.

Concentrated exposure to the relatively risky real estate and capital market segments - The company's real estate portfolio remains exposed to concentration risks owing to the large ticket size and the high inherent risks associated with these loans. Moreover, recoveries in this segment take longer and are less likely than in case of retail loans. The company's capital market portfolio remains exposed to the inherent volatility in the securities markets, led by factors including changes in yields, spreads and prices. Top 10 exposures formed 20% of total portfolio as on September 30, 2019. However, the strong risk credit underwriting process followed by the company and the adequate structural mechanisms in terms of security cover and exclusive charge on the underlying assets provides comfort.

Liquidity Position: Adequate

As on January 31, 2020, KMIL has Rs. 3,272 crore of debt maturing by July 2020, against which it has adequate cash balance of Rs. 23 crore, overnight mutual fund investments of Rs. 295, bank fixed deposit of Rs.261 crore, investment in TREPS of Rs. 145 crore and scheduled inflows of Rs. 3,114 crore. It has further cushion available through unutilised bank lines.

Rating Sensitivities

Negative triggers – Material change in the expected level of support from the parent or material deterioration on credit risk profile of parent could warrant a rating downgrade. Negative pressure could arise if, there is a deterioration in asset quality with Gross NPA remaining above 5% or deterioration in tier I capital ratio on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	Parent: Kotak Mahindra Bank (rated [ICRA]AAA(Stable) KMIL is a wholly owned subsidiary of KMBL. The company enjoys strong financial and operational support from the Kotak Group, which in the past has included access to capital, management and systems, and supervision by a strong board.
Consolidation / Standalone	The ratings are based on the standalone financial statements of the issuer

About the company:

Kotak Mahindra Investments Limited (KMIL) is a wholly owned subsidiary of Kotak Mahindra Bank Limited (KMBL). The company is primarily engaged in capital market related activities, such as loans and overdrafts against shares and mutual funds. The company forayed into real estate loans, corporates loans, and structured products in FY2014.

During FY2019, KMIL reported a net profit of Rs. 201 crore on an asset base of Rs. 10,299 crore as on March 31, 2019 as compared with a net profit of Rs. 245 crore in FY2018 on an asset base of Rs. Rs. 8,794 crore as on March 31, 2018. In H1 FY2020, the company posted a net profit of Rs. 134.5 crore on an asset base of Rs. 8,946 crore as on September 30, 2020.

Key Financial Indicators (Audited)

	FY2017	FY2018	FY2019	H1 FY2020
Net Interest Income	306	324	346	210
Non-interest income	41	94	46	29
Operating expenses	45	49	58	32
Provisions	12	1	26	16
Profit before tax	290	367	308	191
Profit after tax	196	245	201	135
Total portfolio	7,000	7,904	9,376	8,030
Net worth	1,037	1,378	1,575	1,709
Total debt	6,529	7,379	8,678	7,184
Total assets	7,755	8,821	10,353	8,946
Net interest margin (%)	4.67%	3.91%	3.61%	4.34%
Return on assets (%)	2.99%	2.96%	2.09%	2.79%
% Return on net worth	20.91%	20.29%	13.59%	16.39%
% Tier 1	13.83%	15.86%	15.78%	18.24%
% CRAR	16.84%	18.60%	18.25%	20.91%
Gearing (times)	6.36	5.36	5.51	4.20
% Gross NPAs	0.44%	0.13%	0.46%	1.16%
% Net NPAs	0.41%	0.11%	0.25%	0.85%

Amount is Rs. crore

Source: Company Data; ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	12-Mar-20	14-May-19	FY2019	FY2018	FY2017	
							12-Oct-18	04-Oct-17	31-Mar-17	31-Dec-16
1	Commercial Paper Programme (IPO Financing)	Short Term	1,000	NA	[ICRA] A1+; assigned	-	-	-	-	-
2	Commercial Paper Programme	Short Term	7,000	NA	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	-	-
3	Subordinated Debt Programme	Long Term	200	200	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website click here

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper Programme (IPO financing)	NA	NA	7-30 days	1,000	[ICRA]A1+
NA	Commercial Paper Programme	NA	NA	7-365 days	7,000	[ICRA]A1+
INE975F08CR9	Subordinated Debt Programme	31-12-2015	9.00%	31-12-2025	50.00	[ICRA]AAA(stable)
INE975F08CS7	Subordinated Debt Programme	20-12-2016	8.35%	18-12-2026	50.00	[ICRA]AAA(stable)
INE975F08CT5	Subordinated Debt Programme	24-03-2017	8.55%	24-03-2027	100.00	[ICRA]AAA(stable)

Source: Company Data

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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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