

Kotak Commodity Services Private Limited

January 25, 2019

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short Term Bank Lines	250.00	250.00	[ICRA]A1+; reaffirmed
Commercial Paper Programme	200.00	200.00	[ICRA]A1+; reaffirmed
Total	450.00	450.00	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation takes into account the ownership of KCSPL by the family of promoters of Kotak group and the company's strategic importance to the Kotak family. The rating also takes into account the operational support from the Kotak Securities Limited (KSL). The rating also takes into account the company's large retail franchise, comfortable liquidity levels and capitalisation level, and strong risk management systems (which is a shared framework with KSL). The rating also takes into account the adverse operating environment with RBI's regulation on allowing banks to participate in commodity hedging for its clients, and low diversification in business revenue streams for KCSPL. However, the company's demonstrated ability to maintain its volume turnover and the gradual improvement in net profitability provide comfort.

Outlook: Not Applicable

Key rating drivers

Credit strengths

Long track record of the promoters in capital markets related businesses – The rating factors in the ownership of KCSPL by the family of promoters of the Kotak Group. Mr. Suresh Kotak, being the major shareholder and the chairman of KCSPL has rich knowledge of the commodity market.

Adequate risk management infrastructure in place – The company has strong risk management systems in place with client margins maintained as required by the exchange houses, and are collected primarily in the form of cash, bank guarantees and securities after haircut. The risk framework and policies are shared with KSL. KCSPL applies haircut on securities as per its internal risk management policy; the company continuously monitors the security cover online. The company also has an agile square-off mechanism with instant squaring-off of the client's position if the margin falls below levels prescribed in the risk management policy.

Strong asset quality indicators – The company's asset quality remained comfortable over the years. While Rs. 0.01 crore of bad debts were written off in FY2017, the amount rose marginally to Rs. 0.11 crore in FY2018. As on September 30, 2018, the debtors outstanding for more than 30 days stood at Rs. 1.35 crore.

Improvement in profitability in FY2018 – KCSPL's total income grew strongly in FY2018 to Rs. 52.70 crore from Rs. 43.77 crore in FY2017 supported by an increase in trading volumes (39.73% of total income) and income from proprietary trading (28.29% of total income). KCSPL's strong revenue growth enabled it to absorb rising costs and resulted in a significant increase in the net margins (profit after tax to operating income) to 35.44% in FY2018 from 15.98% in FY2017.

On an absolute basis, the profit after tax increased from Rs. 3.99 crore in FY2017 to Rs. 9.37 crore in FY2018, as income from proprietary trading book increased to Rs. 14.85 crore in FY2018 as compared to Rs. 5.42 crore in FY2017.

Credit challenges

Subdued operating environment – Industry volumes have been on declining spree since FY2012 following the National Spot Exchange Limited (NSEL) crisis and the introduction of commodity transaction tax (CTT). However, the industry volumes saw an uptick in H1FY2019 as it rose by ~20%(annualized) over FY2018 , while the turnover of KCSPL increased overall by 30% in H1FY2019, resulting in a improvement in its market share by 17 bps. However, with the recent guidelines allowing banks to trade in commodity derivatives for hedging purpose, the competitive environment will intensify in 2019. This has also resulted in a large scale hiring for commodity trading professional by banks, which is leading to talent shortage.

Low diversification in business revenues - KCSPL's revenue profile remains dominated by brokerage income which accounted for 51% of the total revenues in FY2018 followed by trading income and net interest income contributing 36% and 3% of total revenues respectively. During FY2018, trading income improved by 174% to Rs. 14.85 crore as the company capitalized on arbitrage opportunities in the agricultural commodities segment. Given the opportunistic nature of the proprietary trading book and the inherent volatility in the market, the trading revenues are expected to remain variable. Given the company's low profitability levels, any adverse movement in trading activities can have a bearing on the overall margins.

Liquidity Position:

The company has a liquidity cushion of around Rs. 35 crore in the form of unencumbered cash and deposits, as well as unutilised sanctioned bank lines of Rs. 76 crore as on January 20, 2019. The liquidity profile remains adequate in relation to the near-term debt maturities (commercial papers of Rs. 120 crore still due for maturity in Q4 FY2019). With the adequate liquidity profile and the company's ability to raise funds from a diverse funding base, ICRA does not foresee any liquidity risk in the near term.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Brokerage Houses
Parent/Group Support	The rating takes into account the ownership of KCSPL by the family of promoters of Kotak group and the company's strategic importance to the Kotak family. The rating also takes into account the operational support from the Kotak Securities.
Consolidation / Standalone	The ratings have factored in the standalone financial statements of the issuer.

About the company:

Kotak Commodity Services Private Limited is promoted by the Kotak family, who have a history of over 75 years in commodity trading in India. KCSPL commenced its futures broking operations in 2003, when the two national commodity exchanges (Multi Commodity Exchange of India and National Commodity and Derivatives Exchange) were licensed to start operations by the Government of India. KCSPL is a trading and clearing member of both the exchanges. KCSPL currently carries out commodity broking activities for both institutional and retail clients predominantly in the futures segment. KCSPL has 40 branches and 756 franchisees as on September 30, 2018. The company reported a net profit of Rs. 9.37 crore in FY2018 in comparison with Rs. 3.99 crore in FY2017.

Key financial indicators for KCSPL

	FY2017	FY2018
Brokerage Income (net)	20.79	20.86
Net Interest Income	1.75	1.42
Other Non-Interest Income	2.44	3.28
Operating Income	24.99	25.56
Total Revenues	41.73	52.50
Total Operating Expenses	12.91	14.14
Profit Before Tax	3.47	13.79
Profit After Tax	3.99	9.37
Net Worth	41.31	50.68
Cost to Income Ratio	102.70%	106.84%
Return on Average Net Worth	9.67%	18.49%

Source: ICRA Research, Company
Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Type	Rated Amount (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating (FY2019) Jan 19	Chronology of Rating History for the past 3 years		
					FY2018 Oct 17	FY2017 Aug 16	FY2016 Dec14
					1. Short term bank lines	Short Term	250
2. Commercial paper programme	Long Term	200	xx	[ICRA]A1+; reaffirmed	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

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 www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate (In %)	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Short Term Bank Lines	NA	NA	NA	250.00	[ICRA]A1+
NA	Commercial Paper Programme	NA	NA	NA	200.00	[ICRA]A1+

Source: Company

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