

Karvy Stock Broking Limited

March 08, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Bank Lines	250.00	250.00	[ICRA]A (Negative); downgraded from [ICRA]A+(Stable)
Short-term Debt Programme	125.00	125.00	[ICRA]A1+(SO)**; reaffirmed
Commercial Paper Programme	300.00	300.00	[ICRA]A1; downgraded from [ICRA]A1+
Total	675.00	675.00	

**Instrument details are provided in Annexure-1

Rationale

Karvy Stock Broking Limited (KSBL) has significant experience in the retail equity broking business and has maintained its market share over the years. While the ratings factor in the Karvy Group's adequate risk management systems, they are constrained by the cyclical nature of the Group's primary business, which is dependent on the domestic capital market. The ratings are also constrained by the high gearing on a standalone basis, and the financing and corporate guarantees provided to the Group's relatively new businesses. ICRA notes that Cash inflows from Karvy Data Management Services Limited (KDMSL) are critical for fulfilling KSBL's debt obligations in the short term.

Outlook: Negative

KSBL's gearing is high, on a standalone level, and the company is financing KDMSL, which has witnessed a deterioration in its cash flow position. KSBL's near-term debt repayment obligations are largely dependent on cash inflows from KDMSL. The outlook may be revised to Stable if KSBL reduces its exposure, in terms of debt/ICDs/corporate guarantee, to its subsidiaries. The outlook may be revised to Positive on the healthy scaling up of operations along with lower debt levels and greater diversification in the revenue stream.

Key rating drivers

Credit strengths

Diversified revenue profile including businesses not linked to volatile capital markets – Incorporated in 1983 to conduct the registrar and transfer agency business, the Karvy Group has a diversified business profile within the capital market space. KSBL and its wholly-owned subsidiaries are engaged in business operations including equity broking, commodity broking, retail lending and data management services. Some businesses like data management services have a relatively more stable income profile with no direct linkage to the performance of capital markets. ICRA notes that the sale of the company's registrar and transfer agency business and its SME lending assets has reduced the stable revenue stream.

Long-standing presence in retail broking space – KSBL is a broking player with a focus on domestic and high net worth clients. Over the years, the company has been able to maintain its market share. Following the industry trend and supported by the upswing in the capital markets, KSBL’s total equity broking volumes increased by ~65% in FY2018, with growth in the cash as well as the futures and options (F&O) segments. As the company’s growth was lower than the industry growth of ~73%, its market share declined to 0.61% in FY2018 from 0.64% in FY2017. As on September 30, 2018, the company had its own network of over 270 branches and 1,210 franchisees to provide services to its customer base of over 10 lakh.

Credit challenges

High leverage to support subsidiaries – The company’s gearing, at 2.19 times (as on September 30, 2018), is high at a standalone level on account of the high borrowings to support KDMSL and its subsidiaries as most of KSBL’s subsidiaries are in early stages of operations. In addition, KSBL has provided guarantees of Rs. 506.73 crore, which would increase the gearing to 4.13 times if triggered. ICRA notes the reduction in Karvy Financial Services Limited (KFSL) debt (Rs. ~164 crore, as of September 30, 2018 vs Rs. ~1,464 crore in March 2017), as it sold off its MSME and SME loan book to Small Business Fincredit. As on September 30, 2018, the gearing on a consolidated basis was 2.63 times. We also note that inflows from KDMSL are critical for fulfilling KSBL’s debt obligations. Consequently, non-payment by KDMSL will affect KSBL’s liquidity negatively. ICRA also notes that despite an improvement in KDMSL’s revenues, cash flows were still low as of September 30, 2018, corresponding to debtor days of ~237.

Intense competition in capital markets – KSBL is engaged in the equity broking business. With increasing competition in equity broking and the advent of discount brokerage houses, average yields for broking players have been under pressure. However, the low level of equity market penetration in the country (number of demat accounts in India is about 2% of the country’s population) indicates significant untapped potential for expansion.

Low profitability – KSBL reported a profit after tax (PAT) of Rs. 7.56 crore (compared to PAT of Rs. 20.26 crore in March 2018). The primary reason for the reduction in profitability was the increase in operating expenses and higher finance costs. This resulted in a decline in RoE to 2.42% as of September 30, 2018 compared to 5.02% as of March 31, 2018. The profitability indicators are lower than peer brokers of a similar size. In addition, ICRA notes the importance of KSBL’s subsidiaries to upstream cash flow so that it can repay the principal outstanding on its debt.

Liquidity position

The company’s liquidity position is moderate considering its debt repayment obligations at the standalone as well as consolidated level. As of January 31, 2019, KSBL had a cash & liquid assets balance of Rs. 213 crore, while debt repayments till March 31, 2019 are Rs. 266 crore. The reliance on the upstreaming of cash inflows from KDMSL is critical for timely debt repayment.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Brokerage Houses
Parent/Group Support	NA
Consolidation/Standalone	The ratings are based on the standalone financial statements of the company

About the company

The Karvy Group is a well-diversified business group that spans the entire financial services spectrum as well as data processing and managing segments. It caters to over 70 million individual investors in various capacities and provides investor services to over 600 corporate houses, comprising the best of Corporate India.

Karvy Stock Broking Limited is the broking arm of the Karvy Group. It provides broking and wealth management services to its clients. KSBL provides a combined account facility that caters to all investment opportunities such as equities, derivatives, currency, IPOs, mutual funds and NCDs.

KSBL's net worth stood at Rs. 413.48 crore as on March 31, 2018 compared with Rs. 393.22 crore as on March 31, 2017. It reported PAT of Rs. 20.26 crore in FY2018 compared with Rs. 16.80 crore in FY2017. As on September 30, 2018, KSBL's net worth was Rs. 421.05 crore and PAT was Rs. 7.56 crore.

On a consolidated basis, the company's net worth as on September 30, 2018 was Rs. 651 crore and total debt was Rs. 1,710.26 crore.

Key financial indicators (standalone)

Parameter	FY2017	FY2018	H1 FY2019 (Provisional)
Brokerage Income (net)	126.35	174.54	85.76
Fee Income (other than broking)	170.60	233.19	124.16
Net Interest Income	-85.03	-95.91	-51.03
Other Non-interest Income	8.45	3.53	1.48
Net Operating Income (NOI)	220.37	315.35	160.38
Total Operating Expenses	221.99	289.43	153.80
Profit before Tax (PBT)	16.80	25.92	7.56
Adjusted Profit after Tax (PAT)	16.80	20.26	7.56
Cost-to-Income Ratio	100.74%	91.78%	95.90%
PBT/NOI	7.63%	8.22%	4.72%
Adjusted PAT/NOI	7.63%	6.43%	4.72%
Return on Net Worth	4.37%	5.02%	2.42%
Net Worth	393.22	413.48	421.05
Total Debt	637.73	658.47	922.40
Gearing	1.62	1.59	2.19

Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years				
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Mar-19	FY2018		FY2017		FY2016
					Feb-18	Dec-17	Nov-16	Jun-15	
1 Long-term Bank Lines	Long term	250.00	43.03	[ICRA]A (Negative)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	
2 Short-term Debt*	Short term	125.00	NA	[ICRA]A1+ (SO)*	[ICRA]A1+ (SO)	[ICRA]A1+ (SO)	[ICRA]A1+ (SO)	[ICRA]A1+ (SO)	
3 Commercial Paper	Short term	300.00	157.00	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	

*Instrument details are provided in Annexure-1

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	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper Programme	-	-	7-365 days	300.00	[ICRA]A1
NA	Short-term Debt*	-	-	7-365 days	125.00	[ICRA]A1+(SO)
NA	Long-term Bank Lines	-	-	-	250.00	[ICRA]A (Negative)

*The structured obligation (SO) rating is backed by a standby facility from HDFC Bank
Source: Karvy Stock Broking Limited

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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