

Reliance Securities Limited

March 29, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term non-fund based bank facilities	400.00	400.00	[ICRA]A2@ downgraded from [ICRA]A1@; Continues to be on Watch with Negative Implications
Commercial Paper programme	200.00	200.00	[ICRA]A2@ downgraded from [ICRA]A1@; Continues to be on Watch with Negative Implications
Total	600.00	600.00	

* Instrument details are provided in Annexure-1

@On rating Watch with Negative Implications

Rationale

ICRA has downgraded the short term rating for various instruments of Reliance Capital Limited (RCL) and its subsidiaries to [ICRA]A2@ (pronounced ICRA A two) from [ICRA] A1@ (pronounced ICRA A one). The ratings continue to be on Watch with Negative Implications. The ratings' downgrade reflects the increasing refinancing risks as the company has a large amount of short-term debt maturing over the next three months. The rating downgrade also reflects the slow pace of monetisation of RCL's non-core investments (non-financial services businesses).

The downgrade is driven by no material improvement on the liquidity profile as compared to earlier expectations. With weakening financial flexibility amidst large quantum of short term borrowings due for repayment in the near term, the timeliness of receipt of funds from divestments of some of its potentially core and non-core investments remains critical. At the same time, while the management remains confident, they have not provided clarity on the timely recoverability of funds extended to certain groups by RCFL and RHFL, and also the funds extended to the Reliance group by RCL, which now is critical to ensure timely repayment of debt obligations.

ICRA notes that while RCFL and RHFL have been able to raise funds in the securitisation market in the past six months, their respective current on-balance sheet liquidity is modest in relation to the size of borrowings. RCL's key NBFC subsidiaries, RCFL and RHFL, have witnessed an increase in exposure towards higher ticket-size loans to some companies. The exposures are concentrated, and the top 10 exposures for RCFL contribute to ~21% of total AUM as of December 31, 2018. The top 10 exposures for RHFL contribute to 11% of total AUM as of December 31, 2018. ICRA also notes that Reliance Communications Limited (rated ICRA [D]) has filed for bankruptcy proceedings in the National Company Law Tribunal (NCLT) and overall, Reliance ADAG group companies have been under financial stress.

The rating continues to factor in RCL's status as a holding company for its financial services businesses, which have a presence across various verticals like asset management, life insurance, general insurance, commercial and home finance, broking and distribution of financial products and proprietary investments. The rating also takes into consideration RCL's experienced management profile with varied experience across financial services segments. ICRA notes that RCL has substantial exposure towards the ADAG group's various non-financial companies in the media, entertainment and infrastructure businesses. RCL has been making efforts to divest some of its core and non-core investments to reduce its debt. The divestment schedule was affected in CY2018 by the adverse capital market movements and the liquidity crunch faced by the NBFC sector post September 2018.

ICRA takes note of RCL's moderate profitability indicators. Going forward, RCL's ability to successfully and timely monetise some of its investment exposures in its media and entertainment businesses and shore up its liquidity profile would continue to be a key rating monitorable. RCL's lending business entities, RCFL & RHFL reported a significant decline in its disbursements in Q3 FY2019 amid tightening liquidity for the company and significant debt repayments during September 2018 to February 2019. The liquidity position continues to be moderate going forward, given significant debt repayments due over the course of next six months, at standalone RCL level, as well at RCFL's & RHFL's standalone level. ICRA, however, notes that the company has been regular in meeting all its debt obligations and has raised funds through sizeable securitisation and assignment of loan assets ~Rs.6200 crore since September 2018.

The ratings are on Rating Watch with Negative Implications due to the longer time frame taken to monetise non-core investments at RCL and reduction in financial flexibility at RCL and its lending subsidiaries. ICRA will closely monitor the progress in terms of divesting its core and non-core assets to improve upon its liquidity profile.

Outlook: Not Applicable

Credit strengths

Important broking subsidiary of Reliance Capital Limited – RSL is a 100% subsidiary of RCL, the financial services arm of the Reliance ADA Group. Primarily a retail broker, RSL also has small presence in the institutional broking segment. It operated from 110 branches, with 1,289 active franchisees and an active client base of 8,70,417 as on September 30, 2018. With an uptick in domestic capital markets during H1FY2019 (till August 31, 2018) and RSL's focus on expanding its trading client base, RSL's equity broking volumes were Rs. 6.44 lakh crore in H1FY2019 as compared to Rs. 10.62 lakh crore in FY2018 registering a growth of 21% yoy. However, with the growth being lower than the industry growth of ~35%, its market share declined to 0.54% in H1FY2019 from 0.61% in FY2018. Going forward, the rating will remain sensitive to the stake of RCL in RSL.

Improvement in profitability –With the increase in broking volumes, RSL's net brokerage income¹ increased by 43% to Rs. 149.81 crore from Rs. 104.46 crore in FY2017. Its net interest income and other income remained stable during the year. Overall, the company's net operating income (excluding trading income and net of interest expenses) increased by 35% during FY2017 to Rs. 141.93 crore from Rs. 105.43 crore in FY2016. During FY2018, the operating expenses declined and cost to income ratio was reported at ~98% in FY2018 (116% in FY2017). With an increase in net operating income and trading income and an improvement in operating efficiency, RSL's reported a net profit of Rs. 8.62 crore in FY2018 as compared to a net loss of Rs. 0.20 crore in FY2017. During H1FY2019, with increase in brokerage income and support from trading income, RSL reported a net profit of Rs. 9.78 crore (RONW of 8.12%).

Adequate capitalisation and liquidity profile – RSL's capitalisation and liquidity profile is adequate for its current scale of operations with a net worth of Rs. 120 crore as on September 30, 2018 (Rs. 110 crore as on March 31, 2018), including Rs. 25 crore of preference shares (CCD) from RCL. RSL's funding requirement is mainly for meeting margin requirement at the exchange houses. RSL has a liquid assets cover of ~2.08 crore of its short term borrowings as on September 30, 2018 which provides comfort. RSL's gearing stood at 2.37 times as on September 30, 2018 (2.65 times as on March 31, 2018 and 1.73 times as on March 31, 2017). These borrowings are largely deposits by clients for margin requirements.

¹ Net of referral fees/sub-brokerage commission

Credit challenges

Low average broking yields – During FY2018 and H1 FY2019, the proportion of lower yielding F&O volumes increased in total broking volumes resulting in decline in blended average yields. While cash yields remained stable during FY2018 and H1 FY2019, yields in F&O segment declined due to company's aggressive pricing for trader community. Consequently, average broking yields were reported at 0.78 bps and 0.91 bps during FY2018 and H1 FY2019 as compared to 0.95 bps in FY2017 & 1.55 bps during FY2016, and remain lower than industry average of 2-3 bps.

Elevated cost structure – In ICRA's view, RSL's cost structure remains elevated when compared to many other ICRA-rated brokerage houses, with the cost to income ratio of the company being reported at 103% during H1FY2019.

Liquidity Position:

RSL's funding requirement is mainly for meeting margin requirement at the exchange houses. RSL has a liquid assets cover of ~2.08 crore of its short term borrowings as on September 30, 2018 which provides comfort.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Brokerage Houses
Parent/Group Support	Parent / Investor: Not Applicable
Consolidation / Standalone	While arriving at the rating for RSL, ICRA has considered the consolidated performance of Reliance Capital Limited and its subsidiaries carrying businesses as finance companies (namely Reliance Commercial Finance Limited, Reliance Home Finance Limited, Reliance Financial Limited, Reliance Asset Reconstruction Company Limited, Reliance Commodities Limited & Reliance Securities Limited, collectively referred to RCL group) given the strong operational and financial synergies between the companies.

About the company

Reliance Securities Limited

Reliance Securities Limited (RSL) is a wholly owned subsidiary of Reliance Capital Limited (RCL), and is engaged in retail and institutional securities broking. As on September 30, 2017, the company had a net worth of Rs. 141.85 crore, including redeemable preference shares of Rs. 175 crore from the parent. During FY2018, the company reported a net profit of Rs. 8.62 crore on a net operating income of Rs. 187.48 crore as compared with a net loss of Rs. 0.20 crore on a net operating income of Rs. 141.93 crore during FY2017. During H1FY2019, the company reported a net profit of Rs. 9.78 crore on a total operating income of Rs. 111.32 crore.

Key Financial Indicators

	FY2017	FY2018	H1 FY2019*
Brokerage Income (net)	104.46	149.81	90.60
Net Interest Income	32.19	37.52	19.72
Other Non-Interest Income	5.27	0.31	1.08
Net Operating Income	141.93	187.48	111.32
Trading Income	28.09	23.42	16.08
Total Operating Expenses	165.02	184.80	115.07
Profit After Tax	-0.20	8.62	9.78
Net Worth	131.51	110.86	120.50
Cost to Income Ratio	116.27%	98.57%	103.37%
PAT /Average Total Assets	-0.04%	1.21%	2.56%
Return on Net Worth	-0.15%	7.78%	8.12%
Total Debt / Net worth (times)	1.44	2.65	2.37

Amounts in Rs. Crore, ratios as per ICRA calculations

*Annualised

Reliance Capital Limited

Reliance Capital Limited (RCL) is a part of the Reliance group. RCL's subsidiaries have a significant presence across various financial services businesses like Asset Management, Life Insurance, General Insurance, Commercial & Home Finance, Broking & Distribution of financial products and Proprietary Investments. RCL is a Core Investment Company with investments in group as well as non-group entities.

RCL's reported a consolidated PAT of Rs. 246 crore in Q3FY2019, as against Rs. 309 crore in Q2FY2019, and Rs 37 crore in Q3FY2018. For 9MFY2019, PAT stood at Rs. 850 crore, as against a loss of Rs. 478 crore (Rs. 881 crore profit as per iGAAP) due to impact of ECL provisioning and fair valuation of investments as per Ind-AS.

Key Financial Indicators

RCL (Standalone)	FY2017	FY2018	H1FY2019
Net Operating Income	202	467.00	308.00
Profit on sale on investments	253	774.00	-
Profit after tax	419	828.00	308.00
Networth	13,701	14,168	13,289
Investment Book	18,834	21,108	23,272
Total assets	33,266	36,352	36,697
Return on assets	1.20%	2.37%	1.69%
Return on equity	3.11%	5.94%	4.49%
Capital adequacy ratio	38.0%	47.00%	31.69%(Dec-18)
Gearing ²	1.41	1.52	1.75

Amounts in Rs. Crore, ratios as per ICRA calculations

*Annualised

² Including minority interest

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	Mar-19	FY2018		FY2017			FY2016
							Jan-18	Sep-17	Feb-17	Dec-16	Apr-16	Jul-15
1	Short-term non-fund based bank facilities	Short Term	400.00	400.00	[ICRA]A2 @; downgraded from [ICRA]A1 @	[ICRA]A1 @	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+
2	Commercial paper	Short Term	200.00	200.00	[ICRA]A2 @; downgraded from [ICRA]A1 @	[ICRA]A1 @	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+	[ICRA]A 1+

@ On rating Watch with Negative Implications

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	Short-term non fund-based bank facilities	NA	NA	<1year	400.00	[ICRA]A2@
NA	Commercial paper programme	NA	NA	7-365 days	200.00	[ICRA]A2@

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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