May 14, 2019

Kotak Mahindra Investments Limited: Rating assigned to enhanced commercial paper programme and withdrawn on commercial paper programme (IPO financing)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Commercial Paper Programme (IPO Financing)	2,000	-	[ICRA]A1+; withdrawn
Commercial Paper Programme	5,500	7,000	[ICRA]A1+; assigned
Subordinated Debt Programme	200	200	[ICRA]AAA(stable); outstanding
Total	**7,700**	**7,200**	

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.

Outlook: Stable

In ICRA's opinion, KMIL will continue to report steady growth in business while maintain a comfortable capitalisation, good asset quality and healthy profitability indicators. The outlook may be revised to 'Negative' in case there is significant deterioration in the company's asset quality or solvency indicators. Any material change in expected level of support from the parent or any material ratings movement of the parent would also remain a key rating sensitivity.

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 improved to 18.94% as on March 31, 2018 from 16.84% as on March 31, 2017, while gearing reduced to 5.28 times as on March 31, 2018 from 6.36 times as on March 31, 2017. As on December 31, 2018, capital adequacy and gearing stood at 18.67% and 4.70 respectively. 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 ~0.4% (annualised) to Rs. 7,869 crore as on December 31, 2018 from that of Rs. 7,904 crore as on March 31, 2018, which registered a YoY growth of 13%. As of December 2018, promoter funding, real estate financing, margin funding and corporate loans formed 32%, 35%, 15% and 18% of the portfolio respectively as compared to 39%, 35%, 14% and 13% as of March 2018. The growth in corporate loans was largely offset by contraction of promoter funding (loan against shares) book, while margin funding and real estate financing books remained stable. The company had also seen some pre-payments in Q3 FY2019. 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 - KMIL has a stringent risk management process with a robust credit assessment mechanism. The credit risk policy and processes are the same as KMBL. KMIL asset quality improved during FY2018 on account of higher recoveries, leading to reduction in gross and net NPA levels to 0.05% and 0.01% respectively as on March 31, 2018 from 0.12% and 0.07% respectively as on March 31, 2017. However, gross and net NPA levels marginally increased to 0.58% and 0.47% respectively in December 2018, largely due to fresh slippages in real estate financing during Q3 FY2019. 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 FY2018, the company reported a net profit of Rs. 245 crore as compared to Rs. 196 crore in FY2017. With reduction in yields and growth moderation in loan book in FY2018, the net interest margin has reduced marginally to 3.97% in FY2018 from 4.67% in FY2017. However, this was partially offset by higher profit on sale of investments, lower credit costs and cost to income ratio, resulting in to profitability (net profit over average total assets) of 2.95% in FY2018 as against 2.99% in FY2017. During 9M FY2019, the company posted a net profit of Rs. 134 crore. This is attributable to muted growth in interest income, in line with its loan book growth and rise in cost of borrowings. Going forward, ability to maintain the profitability, by transferring increase in cost of borrowings to loan pricing of its customers, amid volatile interest rate scenario and competition will remain a key sensitivity for KMIL.

Credit challenges

High dependence on capital market funding - KMIL's borrowings are primarily from debt capital markets (90% as of December 31, 2018), with a diverse investor base including corporates, mutual funds, insurance, bank treasuries etc. However, robust asset liability management practices and adequate 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 (56% of total funding as of December 31, 2018), 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 21% of total portfolio as on December 31, 2018. However, the robust 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

As on March 31, 2019, KMIL has Rs.4,332 crore of debt maturing by September 2019, against which it has adequate cash balance of Rs. 249 crore, overnight mutual fund investments of Rs. 353, bank fixed deposit of Rs.2531 crore and scheduled inflows of Rs. 4,295 crore. It has further cushion available through unutilised bank lines.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies ICRA's Credit Rating Methodology for rating hybrid debt instruments issued by insurance companies
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 FY2018, KMIL reported a profit after tax (PAT) of Rs. 245 crore on an asset base of Rs. Rs. 8,832 crore, as compared to PAT of Rs. 196 crore on an asset base of Rs. 7,755 crore in FY2017. During 9M FY2019, KMIL reported PAT of Rs. 134 crore on an asset base of Rs. 8,694 crore.

Key Financial Indicators (Audited)

	FY2016	FY2017	FY2018	9M FY2019
Net Interest Income	249	306	329	201
Non-interest income	31	41	93	48
Operating expenses	37	45	49	44
Provisions	7	12	7	
Profit before tax	236	290	367	205
Profit after tax	154	196	245	134
Total portfolio	4,794	7,000	7,904	7,869
Net worth	841	1,037	1,383	1,516
Total debt	4,355	6,529	7,208	7,131
Total assets	5,367	7,755	8,179	8,754
Net interest margin (%)	5.53%	4.67%	3.97%	3.05%
Return on assets (%)	3.42%	2.99%	2.95%	2.03%
% Return on net worth	21.11%	20.91%	20.24%	12.30%
% Tier 1	16.90%	13.83%	16.20%	15.97%
% CRAR	18.20%	16.84%	18.94%	18.67%
Gearing (times)	5.25	6.36	5.28	4.70
% Gross NPAs	0.09%	0.12%	0.05%	0.58%
% Net NPAs	0.06%	0.07%	0.01%	0.47%

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)	May 2019	FY2020	FY2019	FY2018	FY2017	
						Apr 2019	Oct 2018	Oct 2017	Mar 2017	Dec 2016
1	Commercial Paper Programme (IPO Financing)	Short Term	2,000	NA	[ICRA]A1+; withdrawn	[ICRA]A1+	-	-	-	-
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 www.icra.inAnnexure-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	2,000	[ICRA]A1+
NA	Commercial Paper Programme	NA	NA	7-365 days	5,500	[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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