

July 15, 2019

Motilal Oswal Financial Services Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debentures	350.00	350.00	[ICRA]AA(Stable); reaffirmed
Total	350.00	350.00	

Rationale

The rating reaffirmation takes into account Motilal Oswal group's (which refers to Motilal Oswal Financial Services Limited, MOFSL, along with its subsidiaries) healthy operational profile with an established market position in retail broking, its competitive cost structure with a high share of the broking business sourced through the low-cost franchisee channel and increasing diversification in revenues with scaling up of fee-based businesses. The rating also takes into account MOFSL's¹ stable financial profile with steady performance of the core business and comfortable capitalisation and leverage levels at a consolidated basis. These strengths are partially offset by the inherent volatility in capital markets and the highly competitive and fragmented nature of the broking industry, which coupled with the rising share of derivatives volumes vis-à-vis cash turnover, has resulted in a compression in yields. While reaffirming the rating ICRA has taken note of the deterioration in asset quality in the Group's housing finance business, housed under Motilal Oswal Home Finance Limited (MOHFL, erstwhile Aspire Home Finance Corporation Limited, a subsidiary of MOFSL) and the consequent impact on the consolidated financials. The strong performance of the Group's core businesses however has alleviated the impact on MOFSL's consolidated financial profile. ICRA has taken note of the remedial measures undertaken by MOHFL to strengthen its systems and processes, including overhaul of underwriting systems and setting up of adequate collections and resolution infrastructure. Going forward, asset quality of the housing finance business coupled with the capital support requirement for supporting this business would be key monitorable factors. Further, MOFSL's ability to further diversify its earnings, while improving profitability levels and maintaining healthy capitalisation, remains critical from a credit perspective.

Outlook: Stable

ICRA believes that Motilal Oswal group will continue to benefit from its diversified business profile, its demonstrated track-record and established position in capital markets related businesses and its robust risk management systems. The outlook may be revised to Positive if there is a substantial and sustained improvement in the MOFSL's profitability along with diversification in the earnings profile and significant improvement in the asset quality, particularly for the housing finance business, while maintain robust capitalisation, leading to an improvement in the financial risk profile. The outlook may be revised to Negative if there is significant deterioration in the asset quality of the home loan book with a sizeable impact on profitability and capitalisation, thereby adversely affecting its financial risk profile. Further, changes in the regulatory environment, which may adversely impact the company's business operations and financial performance, would also be key rating sensitivities.

¹ Refer to consolidated financials

Key rating drivers

Credit strengths

Established position of the Group in capital market related businesses – Motilal Oswal Financial Services Limited is one of India's leading providers of capital market related services. Motilal Oswal group which comprises of MOFSL along with its various subsidiaries such as Motilal Oswal Private Equity Advisors (MOPEL), Motilal Oswal Asset Management Co. Ltd. (MOAMC), Motilal Oswal Wealth Management Ltd. (MOWML), Motilal Oswal Home Finance Limited (MOHFL). On a consolidated basis MOFSL has a diversified portfolio, comprising retail and institutional broking, wealth management, margin funding, commodities broking, investment banking, asset management, private equity and housing finance. MOFSL serves as the main holding company which also houses the capital markets related fund-based business of the Group. The Group has also on-boarded seasoned industry professionals with strong experience in their respective fields.

Demonstrated track-record in retail broking with strong market position - MOFSL is an established player in the equity broking business holding an aggregate market share of 1.8% in FY2019 (1.9% in FY2018). The Group caters to both retail and institutional clientele and has significantly scaled up its presence over the years. The Group had an established retail franchise and caters to over 11.9 lakh clients across about 2,910 franchisees as on March 31, 2019, up from 10.5 lakh clients across 2,260 franchisees as on March 31, 2018. A franchise based business model enables the company to keep the fixed costs under control. The company reported a healthy performance in FY2019, with the broking volumes registering a year on year growth of 27%. While the share of futures and options (F&O) segment increased in FY2019, it still remains below industry average. The average blended yields, however, have reported a declining trend given the rising share of the lower yielding futures and options (F&O) segment and the competitive pressure in the industry. The share of cash segment in the total turnover for the Group, however, continues to remain higher than the industry average.

Gradual diversification in the revenue profile supported by scaling up of fee based businesses: Over the year the Group has increased its focus on businesses like asset and wealth management. The scaling up of these businesses has resulted in an increasing diversification in the revenue streams which was capital market (equity broking and distribution) dominated and vulnerable to volatilities in the stock market. Furthermore, the fee-based nature of revenues from these businesses also provides stability to revenue stream. Fee based businesses attributed to over 40% of the consolidated net operating income up from 26% in 16% in FY2015.

Healthy capitalisation profile - MOFSL's capitalisation levels remain healthy with a net worth of Rs. 3,053 crore as on March 31, 2019 (vis-à-vis Rs. 2,886 crore as on March 31, 2018) supported by strong internal capital generation. The scaling up of the housing finance business, housed under MOHFL has resulted in an increase in debt levels and consequently leverage on a consolidated basis. The gearing on a consolidated basis continues to remain moderate at 1.66 times as of March 31, 2019 (1.82 times as of March 31, 2018); Gearing excluding the housing finance business would stand at 0.45 times as on March 31, 2019. Given the agency-based nature of the core operations, the Group's capital requirement would largely be for the housing finance business. ICRA expects the MOFSL's leverage to increase, though remaining at comfortable levels in comparison with industry benchmarks.

Steady performance of the core business – MOFSL's core business performance has been steady over the years. The profitability registered a strong growth in FY2018 supported by favorable capital markets, however despite muted operating environment, the profitability ex-MOHFL remained healthy in FY2019. Profit after tax (PAT) for MOFSL excluding MOHFL stood at Rs. 427 crore in FY2019 and Rs. 524 crore in FY2018. The weak performance of MOHFL however resulted in a dilution of consolidated profitability for MOFSL to some extent. MOHFL reported a loss of Rs. 137 crore in FY2019 and a PAT of Rs. 19 crore in FY2018. While reaffirming the rating ICRA has also taken note of the recent order by SEBI on the commodity broking and trading business of the Group in relation to the National Spot Exchange Limited (NSE) settlement crisis in 2013. The Group has appealed against the order in the Securities Appellate Tribunal (SAT) and the matter is underway. Given that commodity broking forms a small share of the overall revenue stream coupled with the fact the Group has entirely provided for its proprietary position in commodity trading (~Rs 58.7 crore),

the direct impact of the order on business is expected to remain limited. ICRA, however, will continue to monitor the outcome of any incremental developments from this event and the potential liability on the company.

Credit challenges

Exposed to volatility inherent in capital markets; the gradual diversification in the business profile provides comfort –

The Group's traditional lines of business remain exposed to the volatility which is inherent in capital markets. Over the years the Group has made a foray in businesses such as housing finance and asset management in order to diversify its earnings profile. With the revenues in asset management being linked to the AUM, these revenues impart stability to the Group's earning profile. The capital market related businesses contributed 44% to the company's total turnover and accounted for 62% of its profit in FY2019, in comparison to 42% and 33%, respectively, in FY2018. The asset and wealth management business contributed 26% to revenues (21% in FY2018) while housing finance accounted for 24% of the revenues in FY2019 (23% in FY2018).

Deterioration in the asset quality of the housing finance business – MOHFL's gross non-performing assets (GNPA) and net non-performing assets (NNPA) increased to 9.3% and 7.2% (as a percentage of advances) as on March 31, 2019 respectively from 4.5% and 3.2% as on March 31, 2018 and 0.6% and 0.5% as on March 31, 2017. Adjusting for the write-off, MOHFL's GNPA increased to 16.12% as on March 31, 2019, up from 5.89% as on March 31, 2018. The deterioration in the asset quality was driven by the gradual seasoning of the portfolio and the weakening of the liquidity position of borrowers, coupled with delays in setting up of a dedicated recovery and collections infrastructure. The risks are further aggravated given the relatively unseasoned nature of loan-book coupled with risks associated with the segment and high delinquencies in softer buckets which could result in further slippages. ICRA, however, takes note of the significant remedial measures undertaken by MOHFL to strengthen its systems and processes (including managerial revamp, overhaul of underwriting systems and setting up of adequate collections and resolution infrastructure) and the group's demonstrated commitment to this venture, in terms of managerial, operational and financial support. The alignment of the name of housing finance business with Motilal Oswal group also points towards increased integration of MOHFL with the Group. Going forward, asset quality of the housing finance business coupled with capital support requirement for supporting this business would be key monitorable factors. The healthy cash accruals from core operations, however, provides comfort.

Decline in broking margins with increasing competition - With increasing competition in equity broking and the advent of discount brokerage houses, average yields for broking entities have been under pressure. MOFSL also has been facing the brunt of declining yields. However, the lower levels of equity market penetration in the country indicates significant untapped potential for expansion.

Liquidity Position

MOFSL had a total borrowing of Rs. 5,126 crore as on March 31, 2019 of which Rs. 3,724 crore is attributable to MOHFL. The balance borrowings (Rs. 1,402 crore; that is ex-MOHFL) have been used for providing margin funding to broking clients. These loans are short-term in nature and are secured against listed securities with a minimum of two times cover.

At a consolidated level MOFSL had a liquidity position of Rs. 1,776 crore as of June 30, 2019 in the form of investments and undrawn bank-lines of Rs. 620 crore. The total debt obligations for next six months stood at Rs. 2,226 crore as against the expected inflows of Rs. 1,480 crore. The group has adequate liquidity in relation to its near-term repayment obligations and placing excess margin at the exchange should there be a requirement. The liquid nature of the margin funding book also provides comfort.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Entities in the Brokerage Industry Financial consolidation and rating approach
Parent/Group Support	Not applicable
Consolidation / Standalone	ICRA has taken a consolidated view of MOFSL along with its subsidiaries which are engaged in various activities such as equity broking and distribution, commodity broking, margin funding, asset, wealth and portfolio management services, investment banking and housing finance.

About the company

Incorporated in 2005, Motilal Oswal Financial Services Limited (MOFSL) serves as the holding company of the Motilal Oswal Group which is among India's leading provider of capital market related services. The company through its subsidiaries, namely Motilal Oswal Private Equity Advisors (MOPEL), Motilal Oswal Asset Management Co. Ltd. (MOAMC), Motilal Oswal Wealth Management Ltd. (MOWML), Motilal Oswal Home Finance Limited (MOHFL), etc. offers broking and distribution services, asset, wealth and portfolio management services, private equity and housing finance.

The company reported a consolidated net profit of Rs. 290 crore on net operating income of Rs. 1,644 crore in FY2019 compared to a net profit of Rs. 623 crore on total operating income of Rs. 1,898 crore in FY2018. At a consolidated level, the Group's net worth stood at Rs. 3,053 crore as on March 31, 2019.

Key financial indicators (Consolidated)

	FY2018	FY2019
Brokerage Income (net)	423	393
Fee Income (other than broking)	687	672
Net Interest Income	272	289
Other Non-Interest Income	516	291
Net Operating Income	1,898	1,644
Total Operating Expenses	917	900
Profit Before Tax	829	384
Profit After Tax	623	290
Net Worth	2,886	3,053
Cost to Income Ratio	48.31%	54.73%
Return on Net Worth	26.32%	9.64%
PAT/NOI	32.84%	17.64%

Amounts in Rs. Crore; Source: Company & ICRA Research; All ratios as per ICRA calculations;

PAT/NOI stands for profit after tax to net operating income

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Sr. no.	Instrument	Type	Current Rating (FY2020)			Chronology of Rating History for the past 3 years			
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jul-19	FY2019	FY2018	FY2017	
						Sep-18	Jul-18	Jul-17	May-16
1	Non-Convertible Debentures	Long Term	350.00	150.00	[ICRA]AA (stable)	[ICRA]AA (stable)	[ICRA]AA (stable)	[ICRA]AA (stable)	[ICRA]AA (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.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
INE886I07030	Non-Convertible Debenture	04-Jul-17	8.53%	03-Jul-19	150	[ICRA]AA (Stable)
-	Non-Convertible Debenture (yet to be placed)	-	-	-	200	[ICRA]AA (Stable)

Source: Company

Annexure 2: List of entities considered for consolidated analysis

Company Name	Relationship with rated entity	Consolidation Approach
Motilal Oswal Investment Advisors Limited	Subsidiary	ICRA has taken a consolidated view of parent and its subsidiaries
MOPE Investment Advisors Private Limited	Subsidiary	
Motilal Oswal Commodities Broker Private Limited	Subsidiary	
Motilal Oswal Fincap Private Limited	Subsidiary	
Motilal Oswal Finvest Limited	Subsidiary	
Motilal Oswal Asset Management Company Limited	Subsidiary	
Motilal Oswal Trustee Company Limited	Subsidiary	
Motilal Oswal Wealth Management Limited	Subsidiary	
Motilal Oswal Securities International Private Limited	Subsidiary	
Motilal Oswal Home Finance Limited	Subsidiary	
Motilal Oswal Real Estate Investment Advisors Private Limited	Subsidiary	
Motilal Oswal Real Estate Investment Advisors II Private Limited	Subsidiary	
Motilal Oswal Capital Limited	Subsidiary	
Motilal Oswal Capital Markets (Hong Kong) Private Limited	Subsidiary	
Motilal Oswal Capital Markets (Singapore) Private Limited	Subsidiary	
Motilal Oswal Asset Management (Mauritius) Private Limited	Subsidiary	
Indian Business Excellence Management Company	Subsidiary	

Source: Company Annual Report 2018-19

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