

April 03, 2020

Emkay Global Financial Services Limited: Rating downgraded to [ICRA]A2+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term Non-fund Based Bank Facilities	200	200	[ICRA]A2+; downgraded from [ICRA]A1
Total	200	200	

* Instrument details are provided in Annexure-1

Rationale

The rating downgrade takes into account the decline in the financial profile of Emkay Global Financial Services Limited (EGFSL) with losses at the net level in 9M FY2020, on a consolidated basis, due to the higher operational expenses and the weak performance of the newly set up wealth management segment. The rating further remains constrained by the inherent volatility in the capital markets and the highly competitive and fragmented nature of the broking industry. This, coupled with the rising share of the derivatives volumes vis-à-vis the cash turnover, has resulted in a compression in yields. The subdued capital market environment and the slower-than-expected ramp-up of the wealth management business are expected to affect the company's profitability over the near to medium term.

Nonetheless, the rating continues to consider the Group's (EGFSL, along with its wholly-owned subsidiaries) long track record, spanning over two decades in the capital market business, and its demonstrated track record in the equity broking industry and established presence in the institutional broking segment with a strong clientele comprising reputable domestic and foreign portfolio investors (FPIs). The rating also takes into account EGFSL's comfortable capitalisation and leverage levels, on a consolidated basis, for its existing scale of operations. Going forward, EGFSL's ability to diversify its earnings profile, achieve a significant and sustained improvement in its profitability levels and maintain a healthy capitalisation profile remains critical from a credit perspective.

Key rating drivers and their description

Credit strengths

Long track record in capital market related business – EGFSL, along with its wholly-owned subsidiaries, is engaged in various capital market related activities such as equity and commodity broking, margin funding, depository services, wealth and portfolio management services, distribution of financial products and investment banking operations. The company has a long track record, spanning over two decades, in equity broking and other capital market related businesses and has built a strong franchise over the years.

Established presence in broking business – EGFSL has an established presence in the equity broking business with a focus on the institutional segment. The company registered a total broking turnover of Rs. 14.83 lakh crore in 9M FY2020, accounting for about 0.58% of the industry turnover (broking turnover of Rs. 10.21 lakh crore in FY2019; 0.41% of the industry turnover). Its institutional broking business remained in line, with a turnover of Rs. 4.64 lakh crore in 9M

FY2020 against Rs. 6.87 lakh crore in FY2019. However, the retail broking business witnessed sizeable material growth with a turnover of Rs. 10.19 lakh crore in 9M FY2020 against Rs. 3.34 lakh crore in FY2019, primarily on the back of the addition of a few high net worth individuals (HNIs) and FPIs for fixed yearly revenues. EGFSL has a strong presence in the institutional broking business with ~298 clients, as on December 31, 2019, comprising a mix of domestic institutional investor (like mutual funds) and FPIs (formerly known as foreign institutional investors). The retail segment, the share of which increased to 69% of EGFSL's volumes in 9M FY2020, focuses on HNI and FPI clients with long-standing relationships.

Adequate capitalisation level for current scale of operations – The company remains well capitalised, despite reporting net losses in 9M FY2020, for its scale of operations with a net worth of Rs. 160.84 crore as on December 31, 2019. EGFSL primarily borrows for providing margin funding loans to its customers. However, in the current economic scenario, the Group's borrowings remained lower at Rs. 13.52 crore, leading to a comfortable gearing of 0.08 times as on December 31, 2019. EGFSL meets most of its margin requirements at the exchange houses through bank guarantees and overdraft facilities maintained against fixed deposits. Its net worth, unutilised bank lines and available client margins provide adequate liquidity for meeting any increased margin requirement at the exchange houses.

Credit challenges

Decline in profitability and return indicators in FY2019; net loss in 9M FY2020 – While the company reported stable revenues in FY2019 compared to FY2018, it witnessed a steep decline in profitability. EGFSL reported a net profit of Rs. 14.14 crore on a net operating income (NOI) of Rs. 124.01 crore in FY2019 (net profitability of 11.40%) compared to NOI of Rs. 131.97 crore and a net profit of Rs. 28.66 crore in FY2018 (net profitability of 21.72%). The company's financial performance declined further in FY2020 and it reported a net loss of Rs. 4.78 crore in 9M FY2020. This was on account of the higher operating expenses, coupled with the slower-than-expected ramp-up of the wealth management business. The company forayed into the wealth management business in FY2018 and put in place resources (systems, personnel, etc) for the same. This, in turn, resulted in an increase in the operating expenses with EGFSL's cost-to-income ratio increasing to 87.21% in FY2019 and further to 108.98% in 9M FY2020 from 73.82% in FY2018. The subdued capital market environment and the slower-than-expected ramp-up of the wealth management business are expected to affect the company's profitability over the near to medium term.

Exposed to risks inherent in capital market related businesses – EGFSL's revenues remain dependent on the capital markets, which are inherently volatile in nature. The company witnessed a healthy revenue growth in FY2018, driven by favourable capital market conditions. However, the revenues remained stagnant in FY2019 and moderated in 9M FY2020 owing to a slowdown in capital market activities. Equity broking income remains the primary revenue driver for EGFSL, contributing 76% to the NOI in FY2019 and 80% in 9M FY2020. Although the company offers other sources of income such as interest income (5% of NOI in 9M FY2020), investment banking (1% of NOI in 9M FY2020) and portfolio management services (9% of NOI in 9M FY2020), the contribution of the same to the overall revenue profile remains small at present.

Intense competition in capital markets – With increasing competition in equity broking, the advent of discount brokerage houses and a significant surge in derivative volumes, the average yields for broking players have been under pressure. As EGFSL's derivatives turnover share increased to 96% in 9M FY2020 from 90% in FY2019, its overall blended yield declined to 0.49 bps in 9M FY2020 from 1.03 bps in FY2019. With the competitive intensity in the industry expected to remain high, the industry margin is expected to remain under pressure.

Liquidity position: Adequate

EGFSL meets most of its margin requirements at the exchange houses through bank guarantees and overdraft facilities maintained against fixed deposits. The company has Rs. 112.30 crore in the form of fixed deposits, given as a margin to the exchange houses, and bank borrowings. At the consolidated level, EGFSL had total bank borrowings of Rs. 13.52 crore as on December 31, 2019. Further, it had an unencumbered cash and bank balance amounting to Rs. 12.36 crore and a liquid investment book of Rs. 26.23 crore, which are adequate to service the outstanding debt. The company has access to fund-based facilities of Rs. 54.25 crore, of which Rs. 46.25 crore remained unutilised as on February 29, 2020, providing additional comfort to the liquidity position.

Rating sensitivities

Positive triggers – ICRA could upgrade the rating if there is a significant and sustained improvement in the profitability with a meaningful diversification in the revenue stream while maintaining a comfortable capitalisation profile.

Negative triggers – The rating could be revised if the Group continues to report losses leading to a significant deterioration in its net worth or a deterioration in the asset quality of the lending business or liquidity position. Pressure on the rating could also arise if there is any change in the regulatory environment or in case of intense competition, which may adversely impact the company’s business operations and financial performance.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Entities in the Brokerage Industry Consolidation and Rating Approach
Parent/Group Support	Not applicable
Consolidation/Standalone	To arrive at the rating, ICRA has considered the consolidated financial profile of EGFSL, along with its subsidiaries. Details of these companies are provided in Annexure-2

About the company

EGFSL was founded in January 1995 as Emkay Share and Stock Brokers Private Limited by two first-generation entrepreneurs. The constitution of the company was changed to public limited in October 2005 and it was renamed Emkay Share and Stock Brokers Limited. In July 2008, the name was changed to Emkay Global Financial Services Limited. Currently, the company, along with its wholly-owned subsidiaries, is engaged in various activities such as equity broking, commodity broking, margin funding, depository participant, wealth/portfolio management services, distribution of financial products and investment banking operations.

On a consolidated basis, EGFSL reported a net profit of Rs. 14.14 crore on NOI of Rs. 124.01 crore in FY2019 compared to a net profit of Rs. 28.66 crore on NOI of Rs. 131.97 crore in FY2018. In 9M FY2020, EGFSL reported a net loss of Rs. 4.78 crore on NOI of Rs. 82.22 crore.

Key financial indicators of EGFSL (consolidated)

	FY2018 IGAAP	FY2019 IGAAP	9M FY2020* IND AS
Brokerage Income (Net)	96.71	94.02	65.52
Net Interest Income	5.81	8.00	4.10
Other Non-interest Income	21.15	9.00	4.63
Net Operating Income	131.97	124.01	82.22
Total Operating Expenses	97.41	108.15	89.61
Profit before Tax	36.53	17.95	(7.05)
Profit after Tax	28.66	14.14	(4.78)
PAT/Net Operating Income	21.72%	11.40%	-5.81%
Cost-income Ratio	73.82%	87.21%	108.98%
Net Worth	161.55	170.29	160.84
Gearing (times)	0.21	0.13	0.08
Return on Net Worth	19.32%	8.52%	-3.85%

Source: EGFSL and ICRA research; Amount in Rs. crore; All ratios are as per ICRA calculations

*Provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Rating (FY2021)			Chronology of Rating History for the Past 3 Years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Current Rating 3-Apr-20	FY2020	FY2019	FY2018
1 Short-term Non-fund Based Bank Facilities	Short Term	200	153*	[ICRA]A2+	-	[ICRA]A1	[ICRA]A1

*Outstanding as on February 29, 2020

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	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	NA	185	[ICRA]A2+
NA	Short-term Non-fund Based Bank Facilities - Proposed	NA	NA	NA	15	[ICRA]A2+

Source: EGFSL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership / Relationship with Rated Entity as on March 31, 2019	Consolidation Approach
Emkay Fincap Limited	100% Subsidiary	Full Consolidation
Emkay Investment Managers Limited	100% Subsidiary	Full Consolidation
Emkay Wealth Advisory Limited (Formerly Emkay Insurance Brokers Limited)	100% Subsidiary	Full Consolidation
Emkay Commotrade Limited	100% Subsidiary	Full Consolidation
EmkayGlobal Financial Services IFSC Private Limited	100% Subsidiary	Full Consolidation

Analyst Contacts

Karthik Srinivasan

+91 22 6114 3444

karthiks@icraindia.com

Samriddhi Chowdhary

+91 22 6114 3462

samriddhi.chowdhary@icraindia.com

Piyush Kherdikar

+91 22 6114 3414

piyush.kherdikar@icraindia.com

Sainath Chandrasekaran

+91 22 6114 3439

sainath.chandrasekaran@icraindia.com

Relationship Contact

L. Shivakumar

+91 22 6169 3304

shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2020 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents