April 29, 2022

Motilal Oswal Financial Services Limited: Update on entity

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Outstanding
Commercial Papers	2,500	2,500	[ICRA]A1+
Long-term Principal Protected Market Linked Debentures	100	100	PP-MLD[ICRA]AA (Stable)
Non-Convertible Debentures	300	300	[ICRA]AA (Stable)
Bank Lines - Unallocated	300	-	-
Long-term Fund-based/ Non-fund Based Bank Lines	-	300	[ICRA]AA (Stable)
Total	**3,200**	**3,200**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has taken a consolidated view of the Motilal Oswal Group (comprising Motilal Oswal Financial Services Limited (MOFSL) and its subsidiaries).

The rating takes into account the Group's healthy operational profile, given its track record and established position in capital market related businesses, and the increasing diversification in revenues with the scaling up of the annuity-based businesses. The rating also considers MOFSL's healthy financial profile with the steady performance of the core business and the comfortable capitalisation and leverage levels on a consolidated basis.

MOFSL, on a consolidated basis, witnessed a strong uptick in earnings in FY2021 with a profit after tax (PAT) of Rs. 1,259.5 crore (Rs. 1,197.7 crore excluding share of joint venture (JV) and associates), up from Rs. 189.6 crore (Rs. 215.4 crore excluding share of JV and associates) in the previous fiscal, supported by the strong performance of the core business as well as the mark-to-market (MTM) gains during the year. The performance remains strong in the current year with a PAT of Rs. 1,009.8 crore (Rs. 1,008.7 crore excluding share of JV and associates) in 9M FY2022 (Rs. 804.7 crore (excluding exceptional loss); Rs. 736.3 crore excluding share of JV and associates in 9M FY2021). The leverage ratio stood at 1.04 times as on December 31, 2021 compared to 1.3 times as on March 31, 2021 (1.5 times as of March 31, 2020).

These strengths are partially offset by the inherent volatility in capital markets and the highly competitive and fragmented nature of the broking industry. This, coupled with the changing product mix (increasing share of derivatives), has resulted in pressure on the broking yields.

The rating also factors in the Group's limited experience in the lending business with asset quality issues in the housing finance business (housed under Motilal Oswal Home Finance Limited; MOHFL) in the recent past. Subsequently, the Group undertook several remedial measures, including the strengthening of the systems and processes. It also extended greater managerial support (with increased oversight) and infused capital in MOHFL, thereby underscoring its commitment to the venture. This, coupled with the divestment of bad loans to asset reconstruction companies (ARCs), resulted in an improvement in the asset quality. MOHFL reported gross non-performing assets (GNPAs) of 2.2% of advances as of March 2021 compared to 1.8% as of March 2020 and 9.2% as of March 2019. While there was some improvement in the reported asset quality indicators in the current fiscal following the sale of stressed exposures to ARCs, the GNPAs and NNPAs increased to 3.4% and 2.3%, respectively, as of December 2021 from 2.2% and 1.4%, respectively, as of September 2021 with the implementation of the revised asset classification norms. MOFSL also remains exposed to the attendant market and credit risks associated with margin funding, given the nature of the underlying security. However, its monitoring systems and hitherto healthy performance in this business provide comfort.

The Stable outlook reflects ICRA's expectation that MOFSL would maintain its credit profile supported by the performance of the core business.

Key rating drivers and their description

Credit strengths

Established position and demonstrated track record in capital market related businesses – The Group has a presence in diverse business segments comprising retail and institutional broking, wealth management, margin funding, commodity broking, investment banking, asset management, private equity and housing finance. MOFSL serves as the main holding company and also houses the Group's capital market related fund-based business. MOFSL is an established player in the equity broking business with an aggregate market share of 1.3% in FY2021 (1.4% in FY2020 and 1.8% in FY2019).

The Group caters to both retail and institutional clients and has significantly scaled up its presence over the years. It has an established retail franchise with more than 19.7 lakh clients across ~5,500 partners as on March 31, 2021, up from 14.5 lakh clients across ~3,500 partners as on March 31, 2020. The company reported a robust performance in FY2021, with broking volumes registering a growth of ~80% compared to a growth of 14% in FY2020. Further, the client base expanded to over 26 lakh clients with more than 6,726 partners as on December 31, 2021.

Gradual diversification in revenue profile supported by scaling up of annuity-based businesses – The Group has increased its focus on businesses like asset and wealth management over the years. The scaling up of these businesses has resulted in the increasing diversification of the revenue stream, which was capital market (equity broking and distribution) dominated and vulnerable to the volatilities in the stock market. Furthermore, the fee-based nature of revenues from these businesses provides stability to the revenue stream. The annuity fee-based businesses contributed ~36% to the consolidated net operating income (NOI) in FY2021, up from 26% in FY2015. Moreover, the Group's asset and wealth management (fee based) businesses accounted for 39% of its profitability in FY2021 while the capital market businesses contributed 54% and the housing finance business contributed 7%.

Healthy capitalisation profile – MOFSL's capitalisation levels remain healthy with a net worth of Rs. 4,432.2 crore as on March 31, 2021 (Rs. 3,086.3 crore as on March 31, 2020 and Rs. 3,053.4 crore as on March 31, 2019) supported by strong internal capital generation. The scaling up of the housing finance business (housed under MOHFL) led to an increase in the debt levels and the leverage on a consolidated basis.

However, the consolidated gearing declined to 1.3 times as on March 31, 2021 from 1.5 times as on March 31, 2020 and 1.7 times as on March 31, 2019 with limited disbursements in FY2021, owing to the Covid-19 pandemic, and a sizeable increase in the net worth. Excluding the housing finance business, the gearing would have been 0.6 times as on March 31, 2021 compared to 0.5 times as on March 31, 2020. As on December 31, 2021, the net worth stood at ~Rs. 5,380 crore with a gearing of 1.0 times. Going forward, the capitalisation profile is expected to remain healthy with the consolidated gearing expected to remain below 3 times (excluding initial public offering (IPO) financing) over the near-to-medium term.

Healthy profitability supported by steady performance of core business – The performance of MOFSL's core business has been steady over the years. Excluding the impact of the MTM gains (which are routed through the profit and loss (P&L) account, in line with IndAS guidelines) and the housing finance company (HFC) business, MOFSL's core business reported a PAT of Rs. 1,219.2 crore (Rs. 1,157.5 crore excluding share of JV and associates) in FY2021 compared to Rs. 150.5 crore (Rs. 176.3 crore excluding share of JV and associates) in FY2020 and Rs. 435.2 crore (Rs. 422.1 crore excluding share of JV and associates) in

FY2019. The profitability was impacted to some extent in FY2021 by the commodity trading settlement (pertaining to the sudden drop in crude oil prices in April 2020), although it remained healthy.

MOFSL's consolidated profitability was impacted in FY2019 owing to MOHFL, which reported a net loss of Rs. 136.9 crore during the year. Since then, MOHFL witnessed an improvement in earnings and it posted a net profit in subsequent years (Rs. 39.1 crore in FY2020 and Rs. 40.2 crore FY2021). MOFSL reported a consolidated PAT of Rs. 1,259.5 crore (Rs. 1,197.7 crore excluding share of JV and associates) in FY2021, up from Rs. 189.6 crore (Rs. 215.4 crore excluding share of JV and associates) in FY2020. The consolidated PAT stood Rs. 1,009.8 crore (Rs. 1,008.7 crore excluding share of JV and associates) in 9M FY2022.

While assigning the rating, ICRA has also taken note of the Securities and Exchange Board of India's (SEBI) order regarding the Group's commodity broking and trading business in relation to the National Spot Exchange Limited (NSEL) settlement crisis in 2013. The Group has appealed against the order to the Securities Appellate Tribunal (SAT) and the matter is underway. As commodity broking forms a small share of the overall revenue stream and the Group has fully provided for its proprietary position in commodity trading (Rs. 58.7 crore), the direct impact of the order on the business is expected to remain limited.

Further, MOFSL has taken a hit of Rs. 66.6 crore (post tax) on its positions (taken on behalf of its clients) as crude oil prices witnessed a sharp drop on April 20, 2020. It had deposited this amount with the Multi Commodity Exchange of India Ltd (MCX), on April 21, 2020, to bring up the margin to the required level. MOFSL has filed a writ petition in the Bombay High Court against SEBI and MCX. It has also filed arbitration claims against the clients for the recovery of debit balances from them. ICRA 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; gradual diversification of business profile provides comfort – The Group's traditional lines of business (broking and investment banking) remain exposed to the volatility inherent in capital markets. The capital market related businesses contributed 44% to the company's total turnover and accounted for 54% of its profit in FY2021 compared to 48% and 44%, respectively, in FY2020. Over the years, the Group has forayed into businesses such as housing finance and asset management to diversify its earnings profile. The revenues from the asset management business impart stability to the Group's earnings profile as they are linked to the assets under management (AUM). The asset and wealth management business contributed 19% to revenues (30% in FY2020) while housing finance and fund-based revenues accounted for 23% and 14%, respectively, in FY2021 (22% and 0%, respectively, in FY2020).

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 MOFSL's derivatives turnover share increased to 93% in FY2021 from 88% in FY2018, its overall blended yield declined to 1.15 bps in FY2021 from 2.00 bps in FY2018. With the competitive intensity in the industry expected to remain high, the industry margin is expected to remain under pressure. However, the lower level of equity market penetration in the country indicates significant untapped potential for expansion.

Limited experience in lending business – The Group's housing finance business, which commenced under Motilal Housing Finance Limited (MOHF) in May 2014, witnessed a deterioration in the asset quality in FY2018 and FY2019. The Group undertook several remedial measures, including the strengthening of the systems and processes, and it also extended greater managerial support (with increased oversight) and infused capital in the HFC to support the venture. Supported by these endeavours and the divestment of NPAs to an ARC, MOHFL's GNPAs improved to 1.8% of advances as of March 2020 from 9.2% as of March 2019.

However, the pandemic and the ensuing state-wide lockdowns/restrictions impacted operations, resulting in a dip in collections. Collections dipped in H1 FY2021 (~74% collection efficiency in July 2020), although they picked up in H2 FY2021 and increased to ~97% in March 2021. The resurgence of Covid infections, coupled with state-wide lockdowns, led to a decline in collections in Q1 FY2022 (collection efficiency dropped to ~87% in April 2021; subsequently improved to ~92% in June 2021 and stood at ~97% in December 2021). MOHFL's GNPAs inched up to 2.2% of advances as of March 2021 and further to 4.7% as of June 2021. Subsequently, the company sold stressed assets worth ~Rs. 80 crore to ARCs in Q2 FY2022, resulting in an improvement in the reported GNPAs to 2.2% as of September 2021. The GNPAs and NNPAs increased again to 3.4% and 2.3%, respectively, in Q3 FY2022[1] primarily due to the impact of the new NPA recognition norms.

The Group has also increased its focus on capital markets-based lending[2], which stood at ~Rs. 2,100 crore as of December 2021 and September 2021, up from ~Rs. 1,500 crore as of March 2021 and ~Rs. 700 crore as of March 2020. ICRA takes note of the attendant market and credit risk associated with this product, although the company's monitoring systems and hitherto healthy performance in this business provide comfort.

The performance of the core business, coupled with the healthy capitalisation profile, provides adequate buffer to absorb losses and incremental credit costs over the near term. Going forward, the Group's ability to improve its collections and consequently the asset quality, follow a measured growth strategy and maintain healthy profitability would remain critical from a credit perspective.

Liquidity position: Strong

As of December 2021, MOFL had an unencumbered cash and bank balance of Rs. 70 crore and undrawn term loans from non-banking financial companies (NBFCs) of Rs. 300 crore against repayment obligations of Rs. 220 crore till June 2022 on a standalone basis. Additionally, the short-term contractually callable loan against shares (LAS) book and sizeable liquid investments that can be monetised without a significant lag provide comfort.

MOFSL (on a standalone) basis had an unencumbered cash and bank balance of Rs. 200 crore, unutilised bank lines of Rs. 1,744 crore and liquid investments of Rs. 400 crore. The company's repayment obligations till June 2022 stood at Rs. 2,086 crore. The on-balance sheet liquidity is sufficient to cover the near-term repayment obligations. The Group has liquidity cushion in the form of a liquid investment book of over Rs. 2,500 crore at the consolidated level. Further, the liquid nature of the margin funding book (~Rs. 2,100 crore as of December 2021) provides comfort. Thus, the liquidity position is strong.

Rating sensitivities

Positive factors – ICRA could upgrade the rating on a substantial and sustained improvement in the Group's profitability along with a diversification in the earnings profile while maintaining healthy asset quality indicators and robust capitalisation.

Negative factors – The rating could be revised if there is a significant deterioration in the asset quality of the credit book, thereby impacting the Group's profitability and capitalisation. Further, changes in the regulatory environment, which may adversely impact the company's business operations and financial performance, would be key rating sensitivities.

[1] *GNPAs and NNPAs, excluding the impact of the new NPA recognition norm, were 1.3% and 0.7%, respectively, as of December 2021*
[2] *Includes margin funding, LAS and T+5 book*

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	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, institutional equities, asset, wealth and portfolio management services, private equity, investment banking and housing finance

About the company

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

MOFSL reported a consolidated net profit of Rs. 1,198 crore on NOI of Rs. 1,848 crore in FY2021 compared to a net profit of Rs. 215 crore on NOI of Rs. 1,554 crore in FY2020. At the consolidated level, the Group's net worth stood at Rs. 4,432 crore as on March 31, 2021.

Key financial indicators

MOFSL (consolidated)	FY2020	FY2021	9M FY2022*
Brokerage Income (Rs. crore)	469.52	743.64	1,220.9
Fee Income (other than broking; Rs. crore)	711.24	663.45	
Net Interest Income (Rs. crore)	273.40	322.78	411.5
Other Non-interest Income (Rs. crore)	100.25	118.43	155.3
Net Operating Income (NOI; Rs. crore)	1,554.41	1,848.30	1,787.6
Total Operating Expenses (Rs. crore)	959.84	1,066.26	893.0
Profit before Tax (Rs. crore)	285.19	1,456.74	1,245.4
Profit after Tax (PAT; Rs. crore)	215.40	1,197.69	1,008.7
PAT (including share of JV and associates; Rs. crore)	189.58	1,259.46	1,009.8
Net Worth (Rs. crore)	3,086.30	4,432.16	~5,380
Borrowings (Rs. crore)	4,636.27	5,705.94	~5,600
Gearing (times)	1.5	1.3	1.0
Cost-to-Income Ratio (%)	61.75%	57.69%	50.0%
Return to Net Worth (%)	6.93%	31.47%	27.1%
PAT/NOI (%)	13.86%	64.80%	56.4%

Source: *Company, ICRA Research; *Unaudited numbers; All ratios as per ICRA's calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of December 31, 2021 (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022				Date & Rating in FY2021	Date & Rating in FY2020
					29-Apr-22	24-Feb-22	02-Nov-21	20-Sep-21	09-Aug-21	16-Dec-20 07-Aug-20	15-Jul-19
1	Commercial Papers	Short Term	1,500	Nil	**[ICRA]A1+**	[ICRA]A1+	-	-	-	-	-
2	Commercial Papers	Short Term	1,000	Nil	**[ICRA]A1+**	[ICRA]A1+	[ICRA]A1+	-	-	-	-
3	Long-term Principal Protected Market Linked Debentures	Long Term	100	Nil	**PP-MLD [ICRA]AA (Stable)**	PP-MLD [ICRA]AA (Stable)	PP-MLD [ICRA]AA (Stable)	PP-MLD [ICRA]AA (Stable)	-	-	-
4	Non-convertible Debentures	Long Term	300	300	**[ICRA]AA (Stable)**	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
5	Bank Lines - Unallocated	Long Term	-	-	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-	-
6	Long-term Fund-based/ Non-fund Based Bank Lines	Long Term	300	300	**[ICRA]AA (Stable)**	-	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Commercial Papers	Very Simple
Long-term Principal Protected Market Linked Debentures	Moderately Complex
Non-convertible Debentures	Very Simple
Bank Lines	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE338I07057	Non-convertible Debentures	Nov 06, 2020	7.60%	FY2024	195.00	[ICRA]AA (Stable)
INE338I07065	Non-convertible Debentures	Feb 05, 2021	7.25%	FY2024	105.00	[ICRA]AA (Stable)
INE338I07073	Long-term Principal Protected Market Linked Debentures	Sep 22, 2021	NIFTY50 Index Linked	FY2024	100.00	PP-MLD[ICRA]AA (Stable)
NA	Commercial Papers – Yet to be Issued	NA	NA	NA	2,500	[ICRA]A1+
NA	Bank Guarantee	Feb 21, 2022	NA	FY2024	300.00	[ICRA]AA (Stable)

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	MOFSL Ownership (%)	Consolidation Approach
Motilal Oswal Commodities Broker Private Limited	100.00	Full Consolidation
MOPE Investment Advisors Private Limited	87.16	
Motilal Oswal Investment Advisors Limited (formerly known as Motilal Oswal Investment Advisors Private Limited)	100.00	
MO Alternate Investment Private Limited (formerly known as Motilal Oswal Fincap Private Limited)	100.00	
Motilal Oswal Finvest Limited (formerly known as Motilal Oswal Capital Markets Ltd)	100.00	
Motilal Oswal Wealth Management Limited	100.00	
Motilal Oswal Asset Management Company Limited	98.64	
Motilal Oswal Trustee Company Limited	100.00	
Motilal Oswal Securities International Private Limited	100.00	
Motilal Oswal Capital Markets (Singapore) Pte. Limited	100.00	
Motilal Oswal Capital Markets (Hong Kong) Private Limited	100.00	
Motilal Oswal Home Finance Limited (formerly known as Aspire Home Finance Corporation Ltd)	97.87	
Motilal Oswal Finsec IFSC Limited	100.00	
Glide Tech Investment Advisory Private Limited	100.00	
TM Investment Technologies Pvt. Ltd	63.83	
Motilal Oswal Real Estate Investment Advisors Private Limited	87.16	
Motilal Oswal Real Estate Investment Advisors II Private Limited	78.44	
India Business Excellence Management Company	87.16	
Motilal Oswal Asset Management (Mauritius) Limited	98.64	
Motilal Oswal Capital Limited	98.64	
India Reality Excellence Fund II LLP	20.44	

Source: *MOFSL annual report FY2021*

Note: *ICRA has taken a consolidated view of the parent (MOFSL), its subsidiaries and associates while assigning the rating*

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