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India Ratings Assigns Motilal Oswal Financial Services' Additional CPs 'IND A1+'; Affirms Existing Ratings

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India Ratings and Research (Ind-Ra) has taken the following rating actions on Motilal Oswal Financial Services Limited's (MOFSL) debt instruments:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating Assigned along with Outlook/ Watch	Rating Action
Commercial papers	-	-	7 to 365 days	INR7,500	IND A1+	Assigned
Commercial papers	-	-	7 to 365 days	INR50,000	IND A1+	Affirmed
Non-convertible debentures*	-	-	-	INR8,000	IND AA/Stable	Affirmed
Non-convertible debentures [$]	-	-	-	INR3,000	IND AA/Stable	Affirmed
Principal protected market-linked debentures [$,#]	-	-	-	INR3,000	IND PP-MLD AA/Stable	Affirmed
Bank loans	-	-	-	INR4,000	IND AA/Stable	Affirmed

#details in annexure
$interchangeable with principal protected market-linked debentures (PP-MLDs) and applicable rating of 'IND PP-MLD AA'/Stable
*unutilised

The rating of MLDs is an ordinal assessment of the underlying credit risk of the instrument and does not factor in the market risk that investors in such instruments will assume. This market risk stems from the fact that coupon payment on these instruments will be based on the performance of a reference index (to be detailed in the information memorandum of the issue).

PP-MLD refers to full principal protection wherein the issuer is obligated to pay the full principal upon maturity.

Analytical Approach

Ind-Ra continues to take a consolidated view of MOFSL and its group companies while arriving at the ratings, on account of the strong financial, managerial and operational linkages among them.

Ind-Ra opines the group restructuring proposal by MOFSL is a credit neutral event for all the rated group companies.

Detailed Rationale of the Rating Action

The ratings reflect MOFSL's established franchise in the capital market business, along with consistent cash flow generation from its broking and asset management business. The ratings also factor in MOFSL's adequate capitalisation and liquidity, as well as the fungibility of the liquidity across group entities if required in an unfavourable scenario. However, lack of diversification of the income stream, modest scale of operations of the housing subsidiary and its asset quality seasoning are the rating constraints.

List of Key Rating Drivers

Strengths

Established franchisee in capital market business
Broking and asset management business - consistent revenue contributors
Adequate capitalisation

Weakness

MOHFL's modest scale of operations
Low housing segment growth, non-housing driving growth
MOHFL's weak asset quality

Detailed Description of Key Rating Drivers

Established Franchisee in Capital Market Business: The Motilal Oswal Group is a well-established brand in the capital markets, having an equity broking business since 1987. The group has witnessed multiple market cycles and idiosyncratic risk events. With a client base of around 4.03 million at 3QFY24, the group caters to both retail and institutional clients through its 9,397 outlets (franchisees and other partners), taking the pan-India pin code coverage to 98.0%.

Also, despite the broking business being fairly fragmented, MOFSL is among the top players in the full-service capital market space and had a market share (retail cash average daily turnover) of 7.5% in terms of retail cash turnover at 3QFY24. MOFSL has expanded into different verticals of the capital markets to provide a wide range of products, such as mutual funds, alternative investment funds, equity and derivatives broking, private equity, wealth management, margin funding and investment banking. Moreover, its research and advisory support to broking clients can lead to client stickiness across market cycles, despite stiff competition from discount brokers. The group has a high profitability in its broking business segment as it operates on the advisory mode while a large part of its managed assets remains equity, offering higher spread margin in terms of revenue across the different lines of business operations.

With an increasing retail participation in the past three years across discount brokerages, there could be a gradual migration of clients towards full service providers, benefitting the broking franchise. Given volatility in the capital market business, such as wealth, asset management and broking, its volume could see a certain moderation. However, the benefit of a widening of participation in the equity markets would stand to accrue on a recurring basis and operating leverage benefits of an established franchise would play out for MOFSL.

Broking and Asset Management Business - Consistent Revenue Contributors: Over FY20-FY23, MOFSL's consolidated revenue expanded at a CAGR of 24% to INR40.5 billion; during 9MFY24, the revenue growth remained healthy at 32% yoy. Notably, the contribution from the capital market segment remained fairly stable above 60% in FY23 and the balance mix was well-supported by the assets and wealth management, housing finance and fund-based income. During FY20-FY23, the company's revenue from broking and distribution rose at a 32% CAGR, led by a 29% CAGR in active clients and a 119% CAGR in average daily turnover. About 45% of the broking revenue was contributed by franchisees having more than five years' vintage, leading to a lower proportionate fixed cost in the company's books. Over the medium term, the group plans to expand its asset management business more on alternative investment funding as it offers higher yields, while the company has created a product basket in the passive category. The wealth management business's group strategy focuses on relationship manager-led expansion in its assets under management (AUM), supported by newer customised technology platforms. In retail broking, the group has witnessed an increasing demand for margin financing, along with debtor financing from its retail clients since the regulatory change requiring a 50% upfront cash margin. Consequently, margin trade financing + loan against shares + debtor funding book almost grew three times to INR72.62 billion in 9MFY24 (FY23: INR39.1 billion) compared to FY22 levels of INR20.4 billion, thereby earning healthy spreads on the deployed book. The margins are prescribed by the exchanges in the margin trade financing business; furthermore, as a policy, the company follows three stocks per client to manage the market risk arising from any adverse movements in stock prices.

The group's consolidated return on equity stood at 36.8% in 9MFY24 (FY23: 18.0%; FY22: 30%; FY21: 38%) in tandem with the capital market performance. Given the volatile nature of capital markets (as reflected by mark-to-market gain/loss (9MFY24: INR10.4 billion; FY23: INR1.4 billion; FY22: INR5.0 billion; FY21: INR8.6 billion; FY20: loss of INR2.2 billion)), the cyclicality in the return profile is likely to continue.

Adequate Capitalisation: The consolidated leverage (debt to equity) was conservative at 1.5x in 9MFY24 (FY23: 1.6x; FY22: 1.1x; FY21: 1.3x). MOHFL's capital adequacy ratio stood at 48% in 9MFY24 (FY23: 52%; FY22: 52%; FY21: 50%). The company is not planning any further capital infusion in the near term. As per the company's board policy, the gross leverage is unlikely to exceed 2x in the medium term. The gross leverage (ex-housing) stood at 1.40x and the net leverage (ex-housing) stood at 1.18x at 9MFY24. Ind-Ra expects the group's cash generating businesses - brokerage, distribution, asset and wealth management - to supplement any further capital requirement of MOHFL, thus limiting any incremental borrowing requirement. Furthermore, MOFSL is adequately capitalised with the group's fund-based book (equity investment including alternate funds), which housed the group's investments of INR58.7 billion at end-9MFY24. The company may raise short-term debt for working capital needs, if required.

MOHFL's Modest Scale of Operations: MOHFL's housing business prior to 2018 had a high AUM concentration at specific branches, leading to a build-up of credit risk. With a course correction in underwriting filters, incrementally some of these older branches, based on the new set rules, seem to be saturated for further growth in the informal segment. Thus, MOHFL's growth needs to be driven by the new geographies where new teams have been established. The company's attrition rate has been high at the sales level; however, with the newer set of employees coming in, the scaling up of franchise while maintaining the asset quality remains a key rating monitorable.

For building a self-construction and resale-led housing book, MOHFL plans expansion in tier 3 and tier 4 cities which could require revamping the branch expansion strategy. The operating leverage remains low as the branch disbursement compared with the team size remains low, thus providing scope for expansion in the long term. MOHFL's operating expense is likely to remain elevated over the next 12 months as it plans to expand its sales team for driving higher disbursements. Also, for builder finance, MOHFL is using the group expertise in the real estate segment for sourcing and underwriting, whereas operations are managed by its inhouse team. However, the exposure here is capped at 20% of overall loan book (stands at 15% in the overall book).

Low Housing Segment Growth, Non-housing Driving Growth: MOHFL has realigned its strategy by focusing on builder financing in FY23, where its share in overall loan book increased to 13% at 9MFY24. The company looks to equally focus on affordable housing/ loan against property (LAP) and developer financing for driving loan book growth. The lending is capped up to INR5 million ticket size properties in the affordable category. Its target customers remain low-income group borrowers, along with maintaining moderate funding towards the economically weaker section borrower profile. The customer segment is mixed, with self-employed segment constituting around 50% and the rest being salaried; however, the company looks to focus on the self-employed segment. The book has historically been largely dominated in Maharashtra, Gujarat and Madhya Pradesh. However, MOHFL is focusing on diversifying its presence in pan India, particularly in the southern states. The sourcing channel comprises broking franchise owners, connectors and internal sales team with minimal reliance on direct sourcing agents' network. The company has established its information technology system and the underwriting standard operating procedures; nevertheless, its efficiency needs to be tested with the scalability and seasoning of the new book. MOHFL has a four-layer credit approval structure with loan sanctioning authority defined at different levels with no authority of sanctioning at the branch level.

Since FY19, there was an overhaul in the management team and a gradual conversion to a vertical-based model from a branch-based model. The new team has a fairly diversified organisational mix; however, aligning the new team to the group strategy and retaining the senior management will be a rating monitorable in the medium term. MOHFL has built its senior management team and plans to calibrate the growth trajectory with this new team. The emphasis has been made on establishing the verticalisation of business channels such as sales, collection and underwriting credit with minimal overlap. The company has formed a collection team of around 448 employees. The management believes the disbursements made after FY18 and the revamp of credit policies, improved control on branch sales and collection team, revamped monthly information systems, and the restructuring of systems and processes should provide the company better control on credit costs. This is partly evident from the controlled slippages with gross non-performing assets (GNPA) in the new book at 0.9% as against 2.1% on its overall book, where the new book forms 52% of the loan book at 9MFY24. However, this book has yet to witness a complete seasoning cycle; therefore, establishing credit cost remains a challenge. Ind-Ra will closely monitor the developments on this front and its impact on the company's financial profile.

MOHFL's Weak Asset Quality: In its erstwhile model, under the Aspire brand, MOHFL's housing finance business faced asset quality pressure in the book originated till March 2018, due to the aggressive loan growth, lack of a dedicated collection vertical, branch-level delegation of authority, and products catering to under-construction segment. However, MOHFL has now completely stopped providing plot and composite loans.

MOHFL has undertaken substantial write-offs, along with the sale to an asset reconstruction company to clean up the delinquent book originated before April 2018. With increased oversight from MOFSL and the change in the management, a collection team has been set up and each borrower has been mapped with internal information technology systems. At end-9MFY24, MOHFL's book sold to the asset reconstruction company and the written-off loan book stood at INR11.1 billion, largely to clean up the stress emanating from the older book. Its GNPA increased to 2.1% at end-9MFY24 (FY23: 1.1%). The standard restructured book remains a key monitorable as an incremental slippage would emanate from this book, which stood at INR2.1 billion (5.5% of the loan book) in 9MFY24 (9MFY24: 6.8%), largely due to classifying portfolio outstanding against top-up loans as restructured. The written-off loan pool in MOHFL stood at INR3.6 billion at end-December 2023, comprising one large account where recovery remains moderate. Also, at end-December 2023, Motilal Oswal Finvest Limited's ('IND AA'/Stable) investment in security receipts stood at INR1.44 billion of MOHFL where the recovery could be substantial compared to net book value. The collection efficiency has improved to 97.1% of current billing, excluding the overdue monthly payment and prepayments, as of December 2023. The restructured book collection efficiency remained at 84.2% excluding prepayments and overdue monthly payment as of December 2023.

The company could see slippages from the restructured book, which could keep credit cost elevated and needs monitoring. Nevertheless, the new book (52% of the overall AUM) originated post March 2018 has been better with reasonable early delinquencies, largely due to improved oversight on underwriting through systems with a process-driven approach, the build-up of a monitoring team at the head office and third-party audits. MOHFL built 2.2% of the expected credit loss provision on the entire AUM, providing cover of

40.2% in 9MFY24 (1HFY23: 26.1%) on the overall monitored book (GNPA+ restructured book) which stood at 7.6% in 9MFY24 (9MFY23: 8.7%) of AUM. However, its lower loan-to-value ratio and the substantial equity of borrower in residential property purchased would act as deterrents against willful delays.

Liquidity

Adequate: The group had sanctioned unutilised bank lines of INR42.2 billion for contingencies, and unencumbered cash and bank balance, and liquid investment of INR2.5 billion at end-February 2024. The liquidity position is adequate to meet debt repayment obligations over March-April 2024. The group's liquidity pool is fungible for the liquidity requirements of the group companies. The consolidated debt stood at INR125.6 billion at end-9MFY24. Of this, INR28 billion was attributable to MOHFL, while the balance was mainly used to extend loans, which are sufficiently secured (maximum loan to value of 50%) and short term in nature, such as margin financing and debtors book funding in the broking business and loan against shares in non-baking finance companies.

Rating Sensitivities

Positive: A significant scaling up of the group franchise with a substantial market share in its business lines, along with diversifying revenue streams and the leadership in core business, along with a sizeable scaling up of the lending franchise could be positive for the ratings.

Negative: Following factors could, individually or collectively, lead to a negative rating action:

- sharp deterioration in the market share and competitive positioning of any of the group's large businesses, which could lead to a significant weakening of the group's profitability and/or capital buffers

- signs of sharp deterioration in MOFSL's liquidity and/or access to funding due to unexpected market-wide shocks

- the consolidated gross leverage (ex-housing) exceeding 2.0x on a sustained basis

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on MOFSL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

About the Company

MOFSL is the ultimate holding company of the broker-turned-diversified financial services Motilal Oswal group. The group is present in several businesses such as retail and institutional broking, asset management, private equity, wealth management, loan against shares, margin financing, commodities broking, investment banking, venture capital management and housing finance. Since 1986, the company has seen various capital market cycles and has a strong hold in the capital market space.

FINANCIAL SUMMARY (MOFSL, CONSOLIDATED)

Particulars	9MFY24	FY23	FY22
Total tangible assets (INR million)	3,14,245	2,29,100	1,68,268
Total tangible equity (INR million)	81,688	61,523	55,778
Profit after tax (INR million)	17,179	9,328	13,107
Return on average tangible assets (%)	8.4	4.7	9.6
Tangible equity/ tangible assets (%)	26.0	26.9	33.1
Source: Company, Ind-Ra			

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook							
	Rating Type	Rated Limits (million)	Rating	29 January 2024	18 September 2023	21 July 2023	11 May 2023	20 October 2022	14 February 2022	25 October 2021	7 October 2021
Commercial papers	Short-term	INR57,500	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+
Non-convertible debentures	Long-term	INR11,000	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable
Principal protected market-linked debentures	Long-term	INR3,000	IND PP-MLD AA/Stable	IND PP-MLD AA/Stable	IND PP-MLD AA/Stable	IND PP-MLD AA/Stable	IND PP-MLD AA/Stable	IND PP-MLD AAemr/Stable	IND PP-MLD AAemr/Stable	IND PP-MLD AAemr/Stable	IND PP-MLD AAemr/Stable
Bank loans	Long-term	INR4,000	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	-	-	-

Bank wise Facilities Details

Click here to see the details

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Commercial papers	Low
Non-convertible debentures	Low
Principal protected market-linked debentures	High*
Bank loans	Low

* Instrument characterised by underlying market risk

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity indicators.

Annexure

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook
Principal protected market-linked debentures	INE338I07081	13 May 2022	NIFTY50 LINKED	07 February 2025	INR284	IND PP-MLD AA/Stable
Unutilised					INR2,716	
Total limit					INR3,000	
Source: NSDL, MOFSL						

APPLICABLE CRITERIA

Rating FI Subsidiaries and Holding Companies

Non-Bank Finance Companies Criteria

Securities Firms Criteria

Evaluating Corporate Governance

The Rating Process

Financial Institutions Rating Criteria

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

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