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**20**  
YEARS

# Initiating Coverage Motilal Oswal Financial Services Limited

17-November-2020



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.582.5	Buy on dips to Rs.567-571 band and add more in the Rs.516-520 band	Rs.621	Rs.654	2 quarters

HDFC Scrip Code	MOTOSWEQNR
BSE Code	532892
NSE Code	MOTILALOF5
-Bloomberg	MOFS IN
CMP Nov 14, 2020	582.5
Equity Capital (Rsmn)	148
Face Value (Rs)	1
Equity Share O/S (mn)	148
Market Cap (Rs bn)	85.15
Book Value (Rs)	193
Avg. 52 Wk Volumes	148410
52 Week High	903.5
52 Week Low	426

Share holding Pattern % (Sep, 2020)	
Promoters	70.32
Institutions	13.96
Non Institutions	15.72
Total	100.0

## Fundamental Research Analyst

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### Our Take:

Motilal Oswal Financial Services Ltd.'s, (MOFSL) diversified business with rising fee based income along with differentiated client franchise provides potential of gains from financialisation of savings. The production and distribution of all financial products and services helps the company's advisors to attain client's financial objectives with high end service. The company has well established brand and experienced management team. Over last three decades, MOFSL has seen various markets cycles and has a strong track record in the capital market space. This gives us confidence that the company will also emerge out stronger from this pandemic led down cycle.

The AMC business is showing traction despite a challenging environment due to recovery in markets, better performance by MOFSL' funds and launch of passive funds. The broking business is expected to do well over FY21E as volumes continue to show strong traction. Scaling up of MOHL will still take some time.

### Valuations & Recommendation:

We expect (ex-Aspire) revenue to grow by 20.6% CAGR growth, operating profit by 72% (due to FY20 lower base) over FY20 to FY22E. We have estimated ~3% CAGR in broking revenues over the same time frame while wealth management revenues for the same period are expected to grow by 21% CAGR mainly driven by AUM growth of CAGR 25% which is expected to reach to Rs.245 bn in FY22E from current Rs.156 bn. Rich pipeline and constant engaging on a wide cross-section of mandated transactions across capital markets and advisory will drive 48% CAGR revenue form investment banking segment of the company. We expect, AMC business to consolidate in FY21 on account of sales likely to reset as a result of changing regulations. Going forward, we expect it to register an AUM CAGR growth of 21% FY20-22. We will monitor recovery and repair at Aspire.

We feel that investors can buy Motilal Oswal Financial Services Limited (MOFSL) on dips to Rs.567-571 band (13.7x/18.7x capital markets/AMC FY22E PAT + 0.7x FY22E market value of the treasury book+0.5x FY22E ABV of HF) and add more on dips to Rs.516-520 band for the base case target of Rs.621 (14.5x/22x capital markets/AMC FY22E PAT + 0.7x FY22E market value of the treasury book+0.5x FY22E ABV of HF) and Bull case target of Rs.654 (15.5/23.5x capital markets/AMC FY22E PAT + 0.7x FY22E market value of the treasury book+0.5x FY22E ABV of HF) over the next two quarters.

## Financial Summary: MOFS (ex- MOHL)

Particulars (Rsbn)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY19	FY20	FY21E	FY22E
Revenue	7.16	4.34	64.9	5.65	26.7	17.2	13.9	20.8	20.2
EBITDA	3.84	1.61	138.1	2.74	40.4	6.1	2.3	8.9	6.8
EBITDA Margin (%)	53.6	37.1	1648bps	48.4	523bps	35.7	16.3	42.7	33.8
APAT	2.69	1.54	74.3	2.22	20.7	4.1	1.1	7.1	5
P/E (x)						21.1	75.7	12.2	17.4
ROE (%)						15	4	23.3	14.6

(Source: Company, HDFC sec)

## Recent Developments

### **Diversification into fee based business**

The company started out as an equity broker since 1987. But since last few years the company has actively diversified into (fee-based) businesses such as asset management, wealth management, private equity, and fund-based business. The fee-based nature of these businesses also provides stability to revenue stream. Now bulk of the revenue comes from these new businesses (52% from new business in Q1FY21 compared to only 28% in FY15).

### **Scaling up of housing finance business**

Decentralized and flaunted business model with aggressive loan book growth has created delinquencies for the housing finance business. But now the top management has started revamping with a new CEO, CFO, CRO and teams for collections, legal and technical. We believe that the scaling up of MOHL will still take time and disbursements might remain muted in FY21. In Q2FY21 loan book declined to Rs 36.5bn (11th consecutive quarter decline) despite disbursements increasing (+14.8/150.8% YoY/QoQ) to Rs 0.6bn/qtr. NNPA was at Rs 1.2% (-10bps QoQ). Collection efficiency saw improving trend from 80-103% over Jul- Sep-20.

### **The AMC business is showing traction despite a challenging environment.**

AUM of the AMC business has witnessed a CAGR of 37% for the last 5 years. In this challenging environment also it is showing traction. In Q2FY21, MF AUM stood at Rs 222 bn (+13% QoQ), while PMS and AIF AUM stood at Rs 139 bn (+5% QoQ) and Rs 23 bn (+2% QoQ)

respectively. A recovery in markets resulted in an improvement in QAAUM. The AMC has added 1.4 lakh SIPs in H1FY21 vs 1.2 lakh in FY20. This has resulted in increase in new SIP count market share by 100 bps in H1FY21 to 2.4%. SIP inflow in Q2FY21 was at Rs 4.16 bn, +8% QoQ. Company's entry in passive category will help it on-boarding clients from bottom of pyramid which are typically new to equity asset class or has lower risk appetite. Moreover, this has also ensured its presence in bottom as well as top of the equity product pyramid. A recovery in markets, better performance by MOFSL' funds and launch of passive funds will result in a continued healthy inflow for the company.

Treasury reported MTM gain on investments of Rs 1.7bn. This was much higher than Rs 1.3bn in Q1FY21 and was also the result of the half-yearly revaluation of PE investment.

### Long term Triggers

#### Well diversified business

The broad range of offerings under Broking and Distribution, Institutional Equities, Asset Management, Wealth Management, Investment Banking, Private Equity and Housing Finance business helps to foresee client requirements and provide full-fledged services under single platform. The production and distribution of all financial products and services helps the company's advisors and clients to attain client's financial objectives with high end services. MOFSL's financial products and services are distributed through a pan-India network. The business has grown from a single location to a nationwide network spread across 2,500+ business locations operated by business associates or directly through own branches in 600 cities. This extensive network provides opportunities to cross sell products and services, particularly as the company diversifies into new business streams. In addition to the geographical spread, MOFSL also offers an online channel to service customers.

#### Well established brand name

Since 1987, the company has seen various capital market cycles and has a strong hold in the capital market space. The company has strong brand name and experienced management. 'Motilal Oswal' is a well-established brand among retail and institutional investors in India. The company has been able to leverage its brand awareness to grow its businesses, build relationships and attract and retain talented individuals. The promoters, Mr Motilal Oswal and Mr Raamdeo Agrawal are qualified chartered accountants with over three decades of experience each in the financial services industry. The top management team comprises qualified and experienced professionals, with a successful track record.

## **Capital market business - A strong pillar**

The capital market business has been doing exceptionally well due to rise in cash volumes. It comprises retail broking, institutional equities and investment banking business. Revenue from this segment contributes 45% in consolidated revenue while 60% in Operating Profit Mix as of H2FY21. Retail broking revenues are at all time high led by strong surge in volumes and market share gain across cash and derivative segment. In Q2FY21, Capital market segment (including wealth management) reported stellar PAT of Rs 879mn (+52.1/53.1% YoY/QoQ) led by 70.2/39.5% growth in derivative volumes, Broking ADTVs (average daily traded volumes) grew 70.8/33.3% YoY/QoQ, resulting in 110.5/29.6% YoY/QoQ growth in broking revenues. The company has also witnessed strong traction in new clients addition driven by franchisee and retail channel, total 1.17 lakh clients acquired in Q2FY21, +34% QoQ. Active clients have also registered 9% QoQ growth at 0.45 mn as of September 2020. Distribution business AUM grew by 9% QoQ at Rs 111 bn.

## **Indian Mutual Fund Industry - a multiyear growth story**

Indian Mutual Fund Industry has a multiyear growth story lying ahead of them on the back of several structural benefits. Currently Indian MF Industry is highly under penetrated- AUM to GDP ratio is mere 12.5% (vs 6.7% in FY12) compared to Global average of 62% and ~46% in other emerging countries like us. Since past few years Indian household saving is rapidly moving from physical and traditional investments to Mutual fund. More and more retail participation has been coming into mutual fund AUM via SIPs. If we compare number of tax returnees & demat account holders with Mutual fund holders and assume of them all as potential Mutual fund investors, penetration of Mutual fund investors is just 50%. This gives us the kind of potential the industry has.

## **Strong fund base book**

The company has a very strong fund base book with a market value of Rs.21.3 bn as at Sep-20. These funds have given a cumulative XIRR 13% on total investments (since inception). Fund based book includes gains/loss on sponsor commitments cum investments in equity MF, PE funds, Real estate funds, AIF and strategic equity investments. The company has also done buyback of shares. These investments have helped “seed” new businesses, which are scalable, high-RoE opportunities. They also serve as highly liquid “resources” available for future investments in business, if required.

## What could go wrong?

- Capital market has inherent risk of volatility. Market volatility (especially downward) has high correlation with fund flow into AUM and volumes growth for the broking business. So any prolonged period of negative returns from equity market can hurt company's revenues hard.
- The broking industry is currently facing significant pressures on account of increased competition from discount brokers. While the capital market cycle has been positive and volumes have compensated for declining yields, a reversal of investments into financial assets will have a significantly negative impact on both asset prices and trading volumes, which in turn will significantly impair broking revenues and earnings.
- Key risk facing Motilal Oswal Home Finance (formerly Aspire) currently is a higher than expected credit losses in its legacy book. Additionally lower rate of disbursements may impact earnings.
- Home loan business's Loan book growth is also cause of concern as it has been continuously on a declining trend. In Q2 also it declined to Rs 36.5bn (11th consecutive quarter decline) despite recovery in disbursements.
- For the broking business new regulatory changes requiring an upfront collection of margins may result in lower volumes; this remains a key risk in H2 for this segment.
- Any adverse change of regulation might impact the business growth of the company.
- Continued underperformance of its funds remains as a key investment risk. Also substantial portion of its treasury invested in equities, where returns are cyclical and unpredictable.
- There could be a spate of lumpsum redemptions in FY21 as a result of the lockdown as investors tap into their savings. We believe that even SIPs may take a small hit.
- The Indian mutual funds industry has had a spectacular run in the last few years. But FY20 was a difficult year for asset managers as equity flows deteriorated, debt crisis & series of defaults, commissions increased, and performance deteriorated. And looking at current the economic situation market conditions seems tough. Although we believe flows to mutual funds may start to improve from H2FY21 onwards.

## Company Profile:

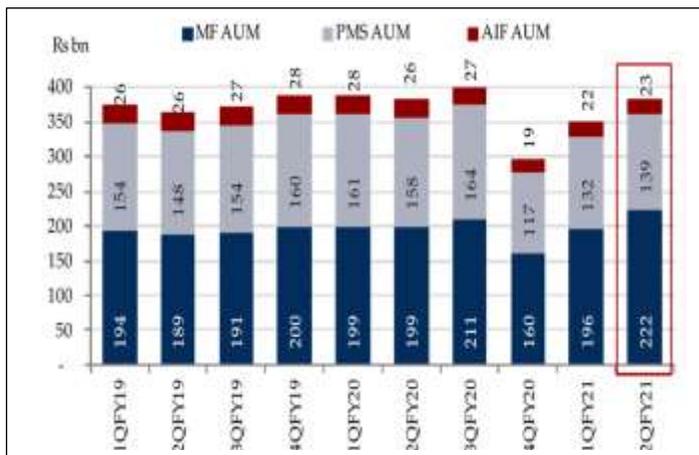
Motilal Oswal Financial Services Limited (MOFSL) is diversified financial services company with stock broking business activity. MOFSL operates in businesses such as Retail and Institutional broking, Investment banking, Asset Management, Wealth Management, Private equity and Housing finance. In each of the businesses MOFSL offers unique value proposition to its customers and creates its niche in each of the business segment and command premium position over peers. MOFSL carries its lending business by running Loan against shares book under the name of Motilal Oswal Finvest Limited and retail mortgage backed lending in affordable housing segment under the name of Motilal Oswal Home Finance Ltd (formerly known as Aspire Home Finance Corporation Ltd).

## SOTP Valuation:

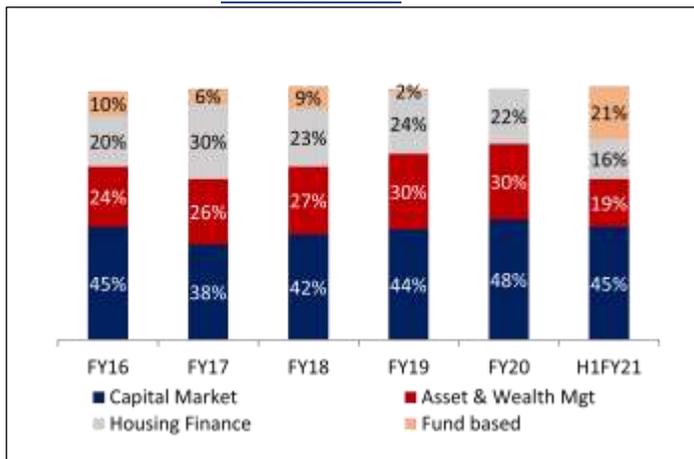
Business segments	Metric	(Rs bn)	Multiple (x)		Valuation (Rs/share)	
			Base Case	Bull Case	Base Case	Bull Case
Broking and distribution	PAT	2.32	14.5	15.5	227	243
AMC (Public and private)	PAT	1.77	22	23.5	263	281
Investments/Treasury	MTM value	25.58	0.7	0.7	121	121
Housing finance	ABV	9.9	0.5	0.5	33	33
Total					645	678
Less: intersegment		-0.16	22.5	22.5	-24	-24
<b>Total</b>					<b>621</b>	<b>654</b>

(Source: Company, HDFC sec)

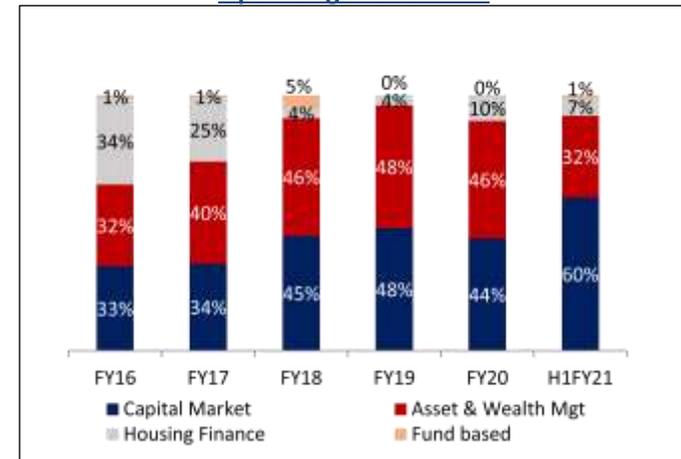
### AUM Trend



### Revenue Mix%



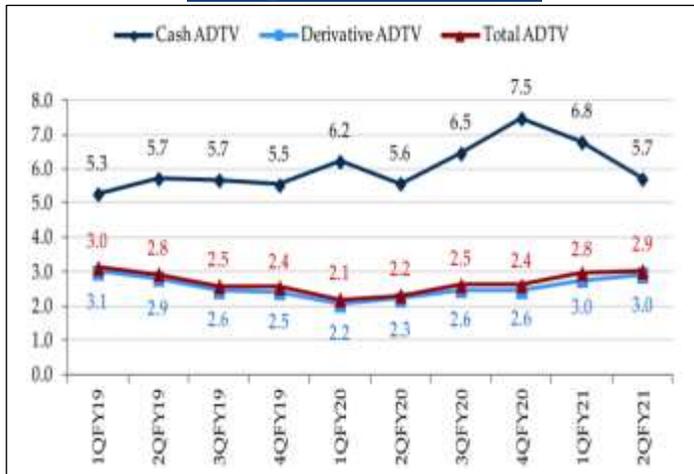
### Operating Profit Mix%



### SIP Market Share



### Broking ADTV's market share



### Investments over the years (Rs bn)



# Motilal Oswal Financial Services Ltd.

## Financials(ex- MOHL)

### Income Statement (in Mn)

	FY19	FY20	FY21E	FY22E
Net Revenues	17,186	13,943	20,847	20,184
Growth (%)	-13.4	-18.9	49.5	-3.2
Employee Benefits Expenses	4,380	4,771	5,105	5,871
Operating Expenses	6,675	6,901	6,837	7,480
EBITDA	6,131	2,271	8,904	6,832
EBITDA Margin (%)	35.7	16.3	42.7	33.8
EBIDTA Growth (%)	-21	-63	292.1	-23.3
Depreciation	195	329	395	474
EBIT	5,936	1,941	8,509	6,358
Other Income (includes treasury )	-	-	-	-
Interest & Financial Charges	-	-	-	-
PBT	5,936	1,941	8,509	6,358
Tax	1,872	480	1,093	1,053
RPAT	4,064	1,462	7,417	5,305
APAT	4,101	1,142	7,090	4,982
APAT Growth (%)	-26	-72.2	521	-29.7
AEPS	27.6	7.7	47.8	33.6
EPS Growth (%)	-26.7	-72.2	521	-29.7

### Balance Sheet (in Mn)

	FY19	FY20	FY21E	FY22E
<b>SOURCES OF FUNDS</b>				
Share Capital	146	148	148	148
Reserves	28,131	28,054	32,470	35,470
Minority Interest	408	366	422	460
Total Shareholders Funds	28,685	28,568	33,040	36,078
Total Debt	15,283	16,786	14,000	14,000
Other Financial Liabilities & Provisions	1,167	1,228	1,713	1,659
Net Deferred Tax Liability	1,007	88	93	99
<b>TOTAL SOURCES OF FUNDS</b>	<b>46,141</b>	<b>46,670</b>	<b>48,847</b>	<b>51,836</b>
<b>APPLICATION OF FUNDS</b>				
Net Block	2,528	2,828	2,641	2,369
Non current Investments	32,868	36,898	35,109	37,805
Loans & Deposits	1,899	2,534	5,711	5,530
Total Non-current Assets	37,295	42,260	43,461	45,704
Current Investments	-155	347	21	22
Debtors	15,704	7,457	9,995	10,507
Cash & Equivalent	6,065	12,618	6,221	3,179
Loans & Advances	6,858	5,586	5,711	5,530
Other Current Assets	-831	-204	-	-
Total Current Assets	27,642	25,803	21,948	19,237
Creditors	13,872	17,974	11,423	8,571
Other Current Liabilities	4,925	3,419	5,140	4,534
Total Current Liabilities	18,796	21,393	16,563	13,106
Net Current Assets	8,846	4,410	5,385	6,132
<b>TOTAL APPLICATION OF FUNDS</b>	<b>46,141</b>	<b>46,670</b>	<b>48,847</b>	<b>51,836</b>

(Source: Company, HDFC sec)

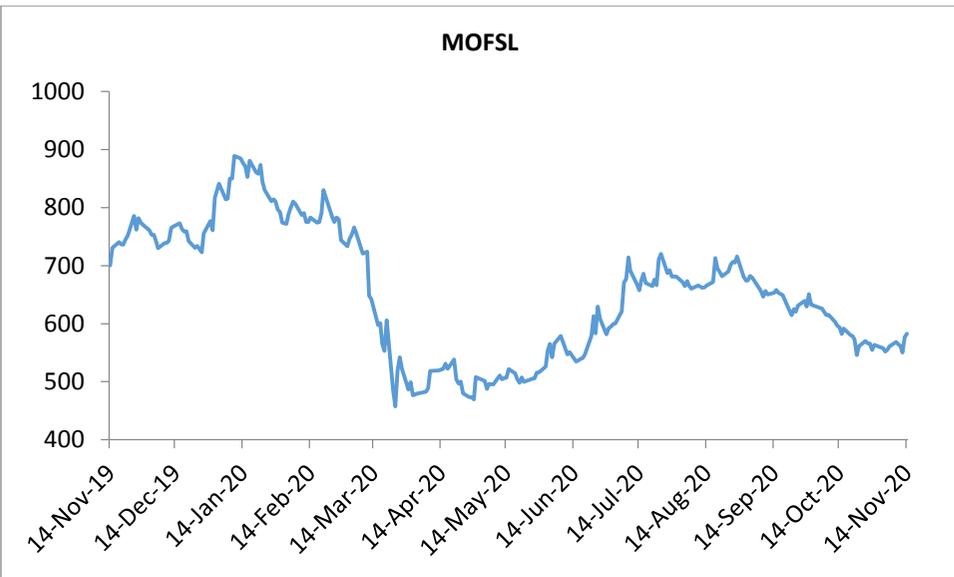
## Cash Flow Statement

	FY19	FY20	FY21E	FY22E
Reported PBT	5,936	1,941	8,509	6,358
Non-operating & EO Items	-40	-	-	-
Depreciation	195	329	395	474
Working Capital Change	-13,501	9,997	-10,384	-3,655
Tax Paid	-1,872	-480	-1,093	-1,053
<b>OPERATING CASH FLOW ( a )</b>	<b>-9,282</b>	<b>11,788</b>	<b>-2,572</b>	<b>2,124</b>
Net Capex	141	-629	-208	-202
(Purchase)/sale of net operating financial assets	660	-4,789	1,844	-2,982
Free Cash Flow (FCF)	-8,481	6,370	-937	-1,060
Non-operating Income				
<b>INVESTING CASH FLOW ( b )</b>	<b>801</b>	<b>-5,418</b>	<b>1,635</b>	<b>-3,184</b>
Debt Issuance/(Repaid)	13,283	1,503	-2,786	-
FCFE	4,802	7,873	-3,723	-1,060
Proceeds From Issue of Share Capital	183	-	-	-
Dividend	-1,524	-826	-2,987	-2,208
Others	-1,014	-495	313	225
<b>FINANCING CASH FLOW ( c )</b>	<b>10,928</b>	<b>183</b>	<b>-5,459</b>	<b>-1,982</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>2,447</b>	<b>6,553</b>	<b>-6,397</b>	<b>-3,042</b>
Opening Cash & Equivalents	3,619	6,065	12,618	6,221
Closing Cash & Equivalents	6,065	12,618	6,221	3,179

## Key Ratios

	FY19	FY20	FY21E	FY22E
<b>PROFITABILITY (%)</b>				
EBITDA Margin	35.7	16.3	42.7	33.8
EBIT Margin	34.5	13.9	40.8	31.5
APAT Margin	23.9	8.2	34.0	24.7
RoE	15.0	4.0	23.3	14.6
RoCE	14.8	5.2	24.4	15.5
<b>EFFICIENCY</b>				
Tax Rate (%)	31.5	24.7	12.8	16.6
Asset Turnover (x)	6.8	4.9	7.9	8.5
Debtors (days)	334.0	195.0	175.0	190.0
Payables (days)	295.0	471.0	200.0	155.0
Other Current Liab & Prov (days)	105.0	90.0	90.0	82.0
Working Capital (days)	-83.0	-370.0	-115.0	-47.0
Debt/EBITDA (x)	2.5	7.4	1.6	2.1
Net D/E	0.3	0.1	0.2	0.3
<b>PER SHARE DATA</b>				
AEPS (Rs/sh)	27.6	7.7	47.8	33.6
CEPS (Rs/sh)	29.7	10.2	51.7	37.7
DPS (Rs/sh)	5.7	4.1	17.1	12.7
BV (Rs/sh)	196.9	192.9	223.1	243.6
<b>VALUATION</b>				
P/E	21.1	75.7	12.2	17.4
P/BV	3.0	3.0	2.6	2.4
Dividend Yield (%)	1.0	0.7	2.9	2.2

(Source: Company, HDFC sec)



## Disclosure:

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