SMC Global Securities Limited

March 2, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Commercial Paper	25 **(Rupees Twenty Five Crore Only)**	CARE A1+ (A One Plus)	Reaffirmed

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the rating of SMC Global Securities Ltd and its subsidiaries (together called the SMC Group) based on the combined view of its parent entity SMC Global Securities Ltd (SMC) and subsidiaries of SMC (together called the SMC Group).

The rating assigned to SMC Global Securities Limited (SMC) takes into consideration the experienced promoters and management team, long track record of operations of SMC group in the financial services industry with established brand and market position, wide franchisee network and large client base and diversified product profile leading to diversified earnings of the group. The rating also derives strength from risk management systems in place, adequate capital structure of the group and comfortable liquidity position at parent entity level supported by arbitrage book which can be liquidated in case of need, low gearing levels and healthy level of margin utilization with exchanges.

These rating strengths are, however, off-set to some extent by the volatility in earnings and thin broking margins associated with capital markets however dependence has reduced over the years with increasing revenue and profitability in lending business (NBFC) and other avenues which are less susceptible to capital market conditions. The rating is also constrained on account of market risk owing to significant proprietary trading book, however, most trades are hedged and algo-based and there is established track record of consistent stable profits in arbitrage book. Also, the group's profitability remains moderate with profitability largely driven by arbitrage and lending business and moderate profitability in the broking and distribution business and losses in the advisory domain. The profitability of SMC which saw improvement in FY19, has however moderated in 9MFY20 owing to impact on many of the business segments including broking, lending, distribution and advisory businesses. Also, given recent origination of most of the SME lending portfolio in the NBFC and evolving product mix, the loan book is yet to season fully, though asset quality indicators remain under control so far.

Going forward, the ability of the group to profitably grow its operations while maintaining adequate risk management systems, thereby limiting credit losses in broking, trading and lending businesses, maintaining a comfortable capital structure and liquidity position would be the key rating sensitivities.

Rating Sensitivities

Positive Factors

- Scale up of operations and improvement in profitability indicators across segments with RONW being > 12% on a sustained basis
- Raise funding from diverse sources for the lending business at competitive costs
- Further diversification of the income and profitability profile with reduction in reliance on the capital markets

Negative Factors

- Decline in cash surplus and liquidity buffers which could impact the risk absorption ability
- Deterioration in asset quality at NBFC level or credit losses in the broking segment thereby impacting the profitability and capitalization levels
- Increase in adjusted net gearing levels beyond 4 times

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and management team

The group is promoted by first generation entrepreneurs, Mr. Subhash C. Aggarwal (Chairman and MD) and Mr. Mahesh C. Gupta (Vice-Chairman and MD). Both the promoters are Chartered Accountant by qualification and have more than 35 years of diverse experience in financial services and securities market. SMC has a strong and experienced Board of 12

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

members, including 7 Independent Directors. SMC group is well supported by a strong management team having rich experience in their respective fields to support the various businesses.

Long track record of operations with established brand
SMC Group was incorporated in December 1994 and has more than two decades of track record of operations in the equity broking business. The group diversified into commodity broking in 2003, insurance broking in 2006 and NBFC business in 2008. The company also has international presence through its subsidiary in Dubai (for commodity trading on DGCX). Over the years, the group has established its brand, in the broking, advisory and financial product distribution businesses. Given its track record and established brand, the company has been able to enter into various strategic partnerships including being the preferred insurance broker for Honda cars under Honda Assure, for Kia cars with KIA Motors and preferred broker for PNB providing trading facilities and demat services etc.

Wide branch network with large franchisee network and client base
SMC has a strong pan India presence through its network of around 95 branches, 2500+ sub-brokers and authorized persons and 13000+ Independent distributors as on December 31, 2019. SMC has a client base of around 18 lakhs which includes largely retail customers and few institutional customers with most of the brokerage income (equity, commodity and currency) coming from retail customers. SMC leverages its wide network for distribution of various financial products (Mutual Funds, Insurance, Debt, etc.).

Diversified product profile
The group has presence in broking, depositary services, proprietary trading, distribution of financial products (Mutual Funds, Insurance, Debt instruments, IPO, etc.), lending operations, PMS & Wealth management, real estate broking and advisory services and investment banking. Furthermore, within broking, the company has a well-diversified product profile with presence in equity, derivatives, currency and commodity.

During FY19 and 9MFY20, the income from broking (net) accounted for 26-27% of the net income, proprietary trading (25-28%), income from distribution of financial products (13-17%), Treasury income (5-7%), interest on delayed payment/ margin funding facility (5-9%), income from lending operations (16-17%), Management & advisory services and depository services.

Adequate Risk Management systems
SMC has well documented risk management framework to handle the risk in the broking, proprietary trading and lending business. There is Risk Management Committee of the Board which is responsible for identifying the risk and setting up processes to mitigate the risk. SMC has separate risk management teams which constantly evaluate the various risk, viz. market risk, credit risk, operational risk, and puts necessary mitigation measures in place on near real time basis for both broking and arbitrage operations. SMC has further tightened its risk management practice by implementing technology enabled system for automatic equity square off of positions at day end, thereby further reducing the manual intervention risks.

On the back of adequate risk management systems, the company has been able to control credit losses / write-offs with provisions and write-offs being 0.35-0.38% of the average total assets during FY19 and 9MFY20. However, there was a one-time adjustment impact of Rs.28 crore taken through Net-worth as on Mar-17 upon transition to INDAS towards expected credit loss which pertained largely to legacy transactions.

Comfortable capital structure
The capital structure of SMC Group is comfortable with overall gearing of SMC consolidated being 0.63x as on Dec-19 given the Tangible Networth of Rs.653 crore and on-book debt of Rs.412 crore as on December 31, 2019. The overall gearing had earlier increased from 0.91x as on Mar-18 to 1.19x as on Mar-19 owing to higher on-book debt to fund the increased margin funding as on Mar-19. Besides the on-book debt, SMC also avails bank guarantees for trading on the exchanges. Bank Guarantees (at consolidated level) to the exchange stood at Rs.756 crore as on December 31, 2019.

The capital structure of Moneywise also is comfortable with Tier-I CRAR of 58.54% as on December 31, 2019 and gearing of 0.63x as on Dec-19. The gearing has reduced from 1.23x as on Mar-19 upon equity infusion of Rs.50 crore from SMC and accrual of profits in Moneywise.

Key Weaknesses
Dependency on capital markets which has inherent volatility; albeit track record of profitable operations
Capital market led activities which include broking, arbitrage operations, margin lending, portfolio management and depository services contribute over 60% share in SMC's net revenue. The revenue from capital markets remains susceptible to market volatility. Also over the recent times there has been a trend of lower margins in broking business

seen owing to heightened competition which exposes the company to the risk of volatility in income and profitability. Also, income earned as delayed payment charges / margin trade funding (MTF) tends to be volatile as also seen in significant reduction during 9MFY20 due to regulatory changes restricting the number of days for which MTF can be allowed. The group's arbitrage book also remains susceptible to capital market conditions, however, most trades are hedged and algo-based and there is established track record of consistent stable profits in arbitrage book.

There had been a reducing trend of dependency on the capital markets over the period FY16-FY18 with increasing income from distribution segment (cross selling) and lending business as seen by reduction in share of capital market segments from 69% in FY16 to 61% in FY18, which has however since remained stable at the same levels since. However, the same has been impacted upon tightening of liquidity seen since Sept-18 and impact on the NBFC's including Moneywise which has seen decline in income and de-growth in loan book since. Also, the distribution segment has been impacted with significant reduction in IPOs, NCD issuances over the last 1-2 years although insurance segment has continued to grow.

The ability of the group to further diversify the income profile by increasing the share of lending business, distribution of various financial products and other segments thereby reducing the reliance on capital markets would be crucial to its credit profile.

Moderate Profitability with moderation across most segments seen in 9MFY20
SMC on a consolidated level reported net profit of Rs.74.8 crore in FY19 on a net income of Rs.562.4 crore in FY19 as against PAT of Rs.51.7 crore on net income of Rs.527.0 crore in FY18 (growth in net revenue by 7% and PAT by 45%). SMC reported Adj. PBILDT and PAT margin of 29.36% and 13.30% in FY19 as against 28.30% and 9.81% respectively in FY18. RONW although improved to 12.33% in FY19, the same has largely remained moderate in the range of 10-12% over the years. The profitability is largely driven by arbitrage, insurance broking and lending operations of the group and profitability of broking and advisory business remains moderate.

SMC, however, on a consolidated level reported PAT of Rs.18.4 crore in 9MFY20 as against Rs.48.3 crore in 9MFY19 (decline by 62% over the previous period) owing to moderation in profitability across most segments viz. broking, distribution, lending and higher losses in the advisory segment). In the broking space, there was a substantial reduction in delayed payment charges due to limits placed by the regulator on Margin Trade Funding. The brokerages have also been on a secular decline with increasing share of F&O transactions entailing lower brokerages and intense competition in the industry with the advent of discount brokers. SMC has also launched its own discount broking platform 'STOXKART' in order to compete with the discount brokers as also cater to the large segment who prefer online trading.

Distribution segment profit has also declined with lower IPOs, NCD issuances although insurance broking segment has seen better profitability in 9MFY20 as compared to FY19. The losses in the advisory segment, particularly real estate advisory have also impacted the bottom-line significantly. Consequently, RONW has also declined substantially to 3.81% in 9MFY20.

Lending book yet to season fully with some borrower concentration risk **as well**
SMC Group commenced lending business in 2008, however, there has been a significant change in product mix during the last 2 years. Thus, the asset quality trend is evolving given the loan book is under first credit cycle for many loan products. Also, given a moderate book size, nearly 45% of the portfolio entails loans of ticket size more than Rs.5 crore. The Top 10 borrowers constituted 27% of the loan book as on Dec-19 (as against 33% of the loan book as on June-18) and hence the borrower concentration continues to be high, though declining trend is seen. However most of these are secured loans (secured by immovable property, liquid securities, receivable, etc). Also, the concentration is expected to reduce further with company's focus on retail loans as well as loan run-off. The ability of Moneywise to maintain asset quality in the new segments and reduce the share of larger ticket size loans (ticket size > Rs.5 crore) lending segment would be crucial.

<u>Liquidity:</u> Strong
The liquidity profile of SMC is strong supported by arbitrage book of Rs.150-200 crore which can be liquidated in case of need, comfortable capital structure and healthy level of margin utilization with exchanges. The company had free cash and bank balances of Rs.123 crore as on Dec-19. SMC had un-encumbered proprietary / arbitrage book of Rs.140 crore as on Dec-19. Furthermore, the company maintains adequate margin with stock exchanges (Average utilization of 61% over the period Jan-19 to Dec-19) and the unutilized margin offers liquidity cushion to SMC in the case of eventuality. The liquidity profile of Moneywise also remains adequate owing to largely capital funded loan book and support from group in terms of inter-corporate loans.

Analytical approach: CARE has based its assessment on the combined view of SMC Global Securities Limited including all its subsidiaries based on consolidated financials of SMC Global Securities Limited.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology: Consolidation and Factoring Linkages in Ratings
CARE Methodology for Non-Banking Finance Companies
Financial Sector Ratios

About the Company
SMC Global Securities Limited (SMC), a Delhi based stock Broking Company which was incorporated on December 19, 1994 and is the flagship company of the SMC group. The group is one of the old integrated capital market intermediaries in the financial sector engaged in the business of broking, arbitrage trading, financial product distribution (Mutual Funds, Debt Products and Insurance), depository services, portfolio management services (PMS) and lending operations. SMC has pan-India branch and franchisee presence and is present in over 550 Cities and has a network of 95 branches, 4100+ employees, 2500+ Sub-brokers, 13,000+ Independent Distributors, client base: 18+ Lakh as on Dec-19. SMC on a consolidated basis reported total income of Rs.583.65 crore and PAT of Rs.18.41 crore during 9MFY20. AUM of Moneywise (NBFC) stood at Rs.538 crore as on Dec-19.

Brief Financials (Rs. Crore)	FY18(A)	FY18(A)	FY19(A)
SMC (Consolidated)	IGAAP	INDAS	INDAS
Total income	657.81	655.36	759.47
Net revenue (adjusted for commission to sub-brokers)	529.16	527.04	562.35
PBT	90.68	79.40	90.88
PAT	50.91	51.68	74.78
Interest coverage (times)	3.15	3.23	2.63
Overall Gearing	0.85	0.91	1.19
Total Assets	1,804.69	1772.65	2302.21
RONW (%)	8.52	8.96	12.33
Moneywise (Standalone)			
Loan Portfolio	567.09	567.09	589.22
NNPA (%)	0.71	0.71	1.70

A: Audited
#Note: Total Assets is calculated after excluding intangible assets and deferred tax assets

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Commercial Paper Issue (Proposed)	-	-	-	25.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Commercial Paper	ST	25.00	CARE A1+	-	1)CARE A1+ (03-Sep-18)	-	-

Annexure 3: List of subsidiaries getting consolidated at SMC level as on March 31, 2019

S.No.	Company Name	Shareholding of SMC Global
	Indian Subsidiaries	
1.	Moneywise Financial Services Pvt Ltd	100.00%
2.	SMC Comtrade Limited	100.00%
3.	SMC Capitals Limited	100.00%
4.	SMC Investments & Advisors Limited	100.00%
5.	Moneywise Finvest Limited	100.00%
6.	SMC Insurance Brokers Pvt Limited	97.58%
7.	SMC Global IFSC Pvt Limited	100.00%
8.	SMC Real Estate Advisors Pvt Limited	100.00%
	Foreign Subsidiaries	
9.	SMC Comex International DMCC	100.00%
10.	SMC Global USA Inc.	50.00%
	Joint Ventures	
11.	SMC and IM Capital Investment Manager LLP	50.00%

***** JV of SMC Investments & Advisors Limited which holds 50% stake in the company

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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