

Rich

Motilal Oswal Financial Services LTd.

BSE: 532892 | NSE: MOTILALOFS

CMP: 656.40

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This company was always around us and familiarity breeds contempt. That was our mental state before we got into details of analyzing this company in more details. With the first detailed look the whole perception changed and this started to look like a no brainer with all cylinders firing and favorable macroeconomic triggers providing great tail wind to all its business verticals.

So, this report is also going to be straight forward and simple.

About Motilal Oswal Financial Services:

Promoted by legendary Motilal Oswal and Ramdeo Agrawal MOFSL is on its way to become a financial conglomerate from just a broking firm and we want to be there in the journey of this big transformation.

Motilal Oswal Financial Services Ltd is a well-diversified financial services company focused on wealth creation for all customers, such as institutional, corporate, HNI and retail. The company's services and product offerings include wealth management, retail broking and distribution, institutional broking, asset management, investment banking, private equity, commodity broking, Mutual funds and newly acquired Aspire Housing that focuses on affordable small ticket housing loans .

They distribute these products through 1,289 business locations spread across 548 cities and the online medium to over 541,372 registered customers.

Business Verticals: Firing from all Cylinders

Company mainly operates in the following business areas.

1. **Capital Market business (Broking and other related activities):** This is good old business of Motilal Oswal which stamped it as a brokerage house. This had been the traditional business of MOFSL which once contributed 100% revenues and profits. This is a cyclical business, where the business cycle depends on market activities. With prudent diversification, the contribution of this business, in overall revenue and profits coming down steadily and management envisages this becoming only 30% of MOFSL revenue and profits in near future and the progress towards it are very visible with changing revenue mix over the years. (Contributed 46% of overall revenue in FY16Q3 and 37% in FY17Q3)

This business has grown 18% FY17Q3 YoY and at 27% at 9 monthly basis. This is relatively slow growth and High ROE business. The ROE for this business Stands at a whooping 56%.

2. **Asset and Wealth Management Businesses (Mutual Fund and PMS):** This is basically Mutual Fund which is a new venture, allied with financial advisory service and Private Wealth Management (PMS) service. Though newly launched this service is seeing great traction among the Indian investors and as per FY17Q3 numbers, the wealth under management for this has grown by 49% YoY and market share among mutual funds has grown from just 1.2% to a healthy 3.1% this FY and MOFSL ranking has improved from No. 12 to No. 10 recently, and all this happened in a very short period of time. This is a great achievement considering the crowded mutual fund industry.

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With reducing interest rates and savings moving to financial assets from fixed assets the opportunity space for this is huge to say the least. More on this later.

- Affordable Housing Finance:** MOFSL acquired Aspire Housing a fast growing small ticket (25 lacs and below ticket size) housing finance company in FY14 and made it a 100% subsidiary of MOFSL. This relatively unknown vertical is the real growth engine of MOSFL group, from a mere 3% contributor to total revenue in FY15 this business has quickly moved up to become almost 33% contributor to overall revenue as per FY17 Q3 numbers. Income from Aspire Housing Finance has grown by an outstanding 143% in FY17Q3 on YOY basis and a 212% on 9 monthly basis YOY. This business is only present in 4 states now and hence leaves open huge size of opportunity to continue with the growth momentum that is showcased till now. We will delve in this more in later sections.
- Fund based activities:** This business is about AMC and PE funds and NBFC loan against securities. This business basically acts as reservoir of funds (kept in different financial instruments) of MOFSL as a group which is deployed to different business as per opportunity and need. This has grown by 2% FY17 Q3, YOY basis and at 15% on 9 monthly basis. This contributes to around 8% of the group's total revenue.

Just to sum up all the businesses, their contribution, growth and ROE in a simple chart we arrive at the following.

Business Vertical	Contribution	Current Growth rate (YOY)	Current ROE
Capital Market Business	38%	18%	52%
Asset and Wealth Management	21%	56%	200%
Housing Finance	33%	143%	15%
Fund based Businesses	8%	2%	6%

Key Observations:

- Great balance:** Over all the businesses are set in a way that provides great balance of healthy growth and maintenance of healthy ROE. High cash generating and high ROE, moderate growth businesses like Capital market and Fund based business is financing the top growth business of Aspire housing. Thereby creating ample cash flow for the Aspire housing business, which in turn is lifting up the growth profile of the whole group?
- Changing business structure:** Business is fast changing towards a housing finance and asset management business from its age old brokerage business. So, today MOFSL is fast shifting towards a housing finance and asset management business and the process will continue in near future. Soon it will be an affordable housing finance and asset management business who incidentally does brokerage business too. Market is probably not noticing and valuing for it yet.
- ROE focused management:** For any financial business ROE is the key measure that ensures good return for stake holders and who knows it better than legendary MOFSL management? In every communication

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management makes it clear that they are targeting for a 20% ROE and results are showing that management is walking the talk.

As of now FY17 9 monthly ROE stands at 23%. This is best in class.

But this company was always there... What are the factors that are compelling us to come up with this recommendation now?

What's special? What can be the re-rating triggers?

We are upbeat on the stock for the following reasons:

- 1. Management Pedigree**
- 2. Tailwinds from macroeconomic scenario**
- 3. Large opportunity space to tap in**
- 4. Great performance so far**

We will explain each reason one by one.

1. Management Pedigree:

MOFSL boasts of two first generation legendary entrepreneurs Mr. Motilal Oswal and Mr. Ramdeo Agrawal at the helm. The second line of management is also something to be proud of for the company. This is one company that has shown their prudence in stock market and over a period of time in entrepreneurship as well. At the end of the day it is not easy to erect a 9000 odd crores company in just a decade. Also, given their business structure and specially keeping in mind the markets love for affordable housing one can easily trust on the MOFSL duo to create unprecedented value out of all business verticals.

Also, MOFSL has a lucrative ESOP policy in place, which ensures retention of key talents in long run.

Being in stock market for decades as prudent investors, no one probably knows better than them, how to unlock value from the existing business set up. Also, what we like most is management here talks less and delivers more. As of now management has met or showing all possibilities of meeting targets that they have set for themselves.

So, broadly a transparent management, legends in investing field, enviable second line, ESOP policy for talent retention gives us great certainty about value creation through this business.

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2. Tailwinds from macroeconomic scenario

Let's take a quick look at what is happening around us. India is growing at a scorching 7% + growth rate (GDP), domestic savings are at all time high, inflations are broadly under control. Falling interest rates reducing options to grow ones savings at a decent pace, Govt. has sucked up the extra liquidity from market through demonetization and is currently flush with money, Elections are nearing and current Govt. is showing all intentions of inclusive growth. So, if we decode the above continuous process of change we get the following macro trends which we believe will continue for some time now.

These trends are visible now and will become even more prominent going forward.

- 7%+ GDP growth rate, Inflation under control → Incomes going to go up faster than expenditures, which will in turn increase domestic savings.



Rising Domestic Savings

- All time high domestic savings and falling interest rates → idle money will find alternative ways of investing. With real estate not providing the required growth and with increased financial literacy Mutual funds and equity market to see domestic inflows going up.

As per industry estimates, inflow of domestic saving in mutual funds can triple by next 5 years.

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AMC ASSETS GROW RS3.71 TN IN 2016

	AUM* (in Rs Cr)	Change (in Rs. Crore)
2008	4,21,149	1,29,010
2009	7,94,522	3,73,373
2010	6,75,683	1,18,839
2011	6,81,713	6,030
2012	7,55,683	73,971
2013	8,55,284	99,600
2014	10,80,835	2,25,551
2015	13,22,767	2,41,932
2016	16,93,875	3,71,108

*Assets under management

Source: Value Research

Growing mutual fund inflow

- Demonetization making Govt. flush with money and general elections are nearing → we are going to experience financially stronger and benevolent Govt. thriving for inclusive growth. Govt. has already announced lucrative schemes for affordable housing and we believe this effort is going to continue for sure. **As per ICRA estimates, affordable housing to grow at 18-20% rate for next few years.**

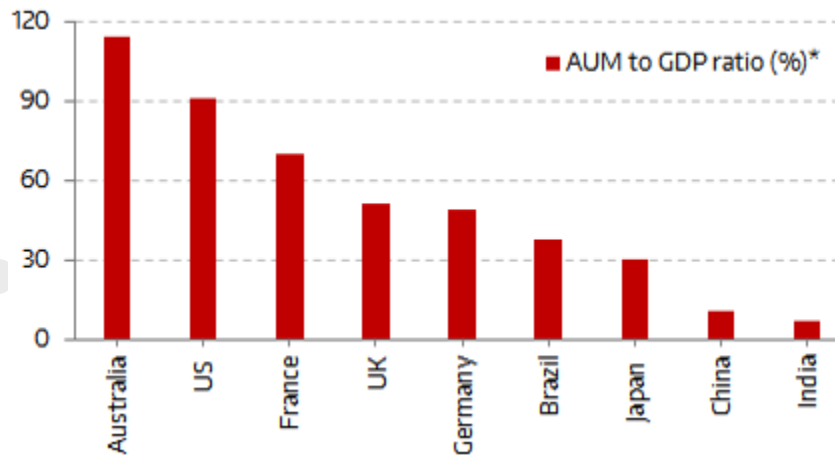
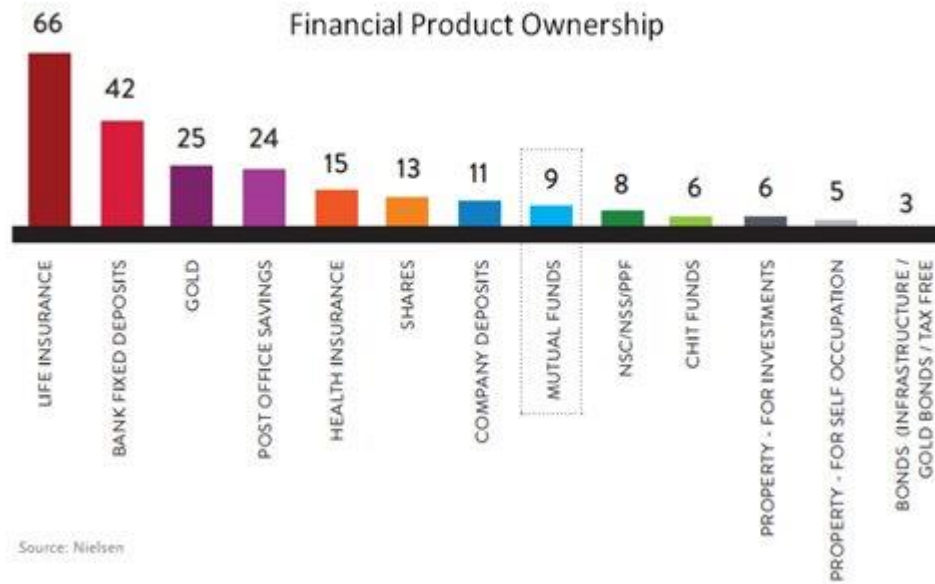
Given the scenario and the foreseeable feature we couldn't find a better fit than Motilal Oswal Financial Services (MOFLS) to take opportunities of the trends discussed above.

So, we believe the brokerage business and AMC business will register similar growth rates going forward for next few years while Aspire housing will be growing even faster with a much larger contribution to the overall pie making blended growth faster than the current growth rates.

3. Huge untapped opportunity space:

As we know Indians are conservative and they prefer physical instruments of investments like land, real estate, Gold etc for investments compared to equity markets or mutual funds. However, majority of Indian being young and with higher financial prudence the scenario is fast changing. But still there is a long way to go from here.

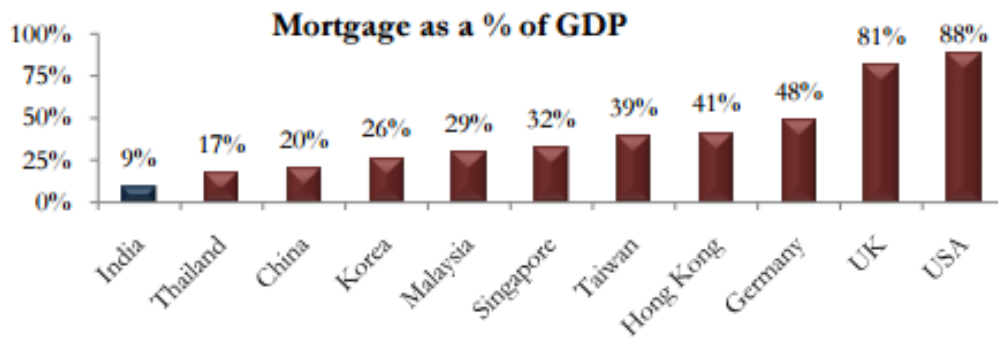
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With lowering interest, falling rates of real estate and gold FD, Gold and real estate is losing relevance fast and the growth is going towards mutual funds and equity markets. There are early signs of the lock gate being broken and we believe we are at an inflection point here and this may observe a 'j' curve of growth going forward. MOFSL with its brokerage and Mutual fund business is well placed to lap up this opportunity.

In terms of affordable housing finance again there is a long way to. We lag almost all developed and developing countries when it comes to GDP vs mortgage rate. India is a long way behind and on its way to catch up with the world.

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95% of India's housing demand is from the affordable housing segment and Aspire is just a great start up and now with solid backing from MOFSL.

Also, as of now Aspire is present in only 4 states (Maharashtra, Gujarat, Telengana. MP) leaving open, great growth potential in front of them by extending to other parts of India. Management is showing prudence here too, by not chasing unprofitable growth and consolidating their position in the mentioned 4 states. However, as a logical next step, this only leaves them with a great opportunity space to continue growing fast.

4. Great Performance So Far:

MOFSL has delivered a great performance so far with TTM sales growth of 52% and TTM profit growth of 92% on a consolidated level. Maintained good return ratios (ROCE 51% and ROIC 104%) with moderate ROE of around 12.4 % at TTM level. Promoter holding has been robust with around 71% along with decent dividend record.

But this is achieved from the old business construct which was dominated by low growth and cyclical brokerage business mainly. If one takes into consideration the changing business matrix where high growth Aspire housing and wealth management business (Currently 54% jointly) becomes the key contributor, this growth looks modest and one can safely assume that they will be growing even faster going forward or at the worse will maintain similar growth rate.

So, the past had been good and the future looks even more promising in terms of business performance.

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Views and Valuations:

MOSFL is trading at 29 PE multiple (TTM) currently and which is not cheap by any means. But given the changing business dynamics, macroeconomic tailwinds, huge size of opportunity, great management ability we see this as reasonable and if one adds the future growth projections to current valuations it looks cheap for its tomorrow and we initiate a buy coverage for the stock here at CMP.

Buy Strategy and Allocations:

We advise our clients to allocate 7-8% of portfolio value in MOFSL within the buy range of Rs 640-710.

We would like to take up our allocation in this to 12-13% eventually.

All averaging suggestions will be provided on time.

Statutory Disclosure:

SEBI Research Analyst Registration # INH300003173

1. At the time of writing this article, the analyst does not have a position in the stocks covered by this report. 2. The analyst has not traded in the recommended stock in the last 30 days 3. The research analyst does not have any material conflict of interest at the time of publication of the research report 4. The research analyst has not received any compensation from the subject company in the past twelve months 5. The research analyst or its associates has not managed or co-managed public offering of securities, has not received any compensation for investment banking or merchant banking or brokerage services nor received any third party compensation. The subject company was not a client during twelve months preceding the date of distribution of the research report. 6. The research analyst has not served as an officer, director or employee of the subject company. 7. The research analyst or research entity has not been engaged in market making activity for the subject company. 8. The research analyst or research entity or its associates or relatives does not have actual/beneficial ownership of one per cent or more in the securities of the subject company, at the end of the month immediately preceding the date of publication of the research report or date of the public appearance. 9. The analyst does not own more than 1% equity in the said company

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