

IPO Note
Motilal Oswal Financial Services Ltd. (MOFSL)
August 18, 2007
Aggressively priced, but could provide returns for patient investors

Summary: MOFSL is a Non Banking Financial Company (NBFC), which offers a foray of financial products and services like Retail Wealth Management, Portfolio Management Services (PMS), Institutional Broking, Venture Capital (VC) Management and Investment Banking (IB) services. MOFSL's diverse portfolio reduces dependence on any particular product, service or customer and allows them to exploit synergies across its businesses. MOFSL has witnessed rapid organic growth due to favorable market conditions as well as efforts put in by them. FY05 and FY06 saw MOFSL grow inorganically through acquisition of three significant regional broking firms from Karnataka, Kerala and UP. Over a period of time many more regional broking firms may be acquired to gain solid footing in various regions of India. MOFSL has also established a base in UAE to address the needs of the overseas audience. MOFSL plans to increase its market share in retail business, institutional brokerage and growth of fee-based revenues.

Issue Snapshot:

Issue opens: 20th August 2007
 Issue closes: 23rd August 2007
 Price Band: Rs. 725 - 825
 Issue Size: Rs. 216.25 cr – 246.07 cr

Issue Size: 2,982,710 equity shares
 QIB: 1,704,240
 Non-institutional: 284,040
 Retail: 852,120
 Employees: 142,310

Face Value: Rs. 5
 Book value (31/03/2007): Rs. 131.05
 Bid size: 8 shares and in multiples of 8 thereof

100% Book Building Process

Capital Structure:

Pre Issue Equity: Rs. 12.71 crs
 Post issue Equity: Rs. 14.20 crs

Listing: BSE & NSE
 Lead Managers: Citigroup Global Markets India Pvt. Ltd.

Shareholding Pattern:

Shareholding pattern	Pre Issue %	Post Issue%
Promoters & Group	78.67	70.41
Non-Promoters	21.33	29.59*
Total	100	100

* - Break up not disclosed in RHP

Background:

MOFSL is a well-diversified financial services firm offering a range of financial products and services such as retail wealth management (including securities and commodities broking), portfolio management services, institutional broking, venture capital management and investment banking services. As a leading Indian domestic brokerage house, they have a diversified client base that includes retail customers (including high net worth individuals), mutual funds, foreign institutional investors, financial institutions and corporate clients. MOFSL has placed 9.48% with two leading private equity investors - New Vernon Private Equity Limited and Bessemer Venture Partners at post money company valuation of Rs. 1345 crore (Rs. 13.45 billion) last year.

MOFSL is the holding company and also provides financing for retail broking customers and it operate through its following four subsidiaries:

- Motilal Oswal Securities Ltd. (MOSL) – MOFSL holding 99.95%
- Motilal Oswal Commodities Brokers Pvt. Ltd. (MOCB) – MOFSL holding 97.55%
- Motilal Oswal Venture Capital Advisors Pvt. Ltd. (MOVC) – MOFSL holding 100%
- Motilal Oswal Investment Advisors Pvt. Ltd. (MOIA) –MOFSL holding 75%

Motilal Oswal Securities Ltd. was founded in 1987 as a small sub-broking unit, with just two people running the show. It was promoted by Mr. Motilal Oswal and Mr. Raamdeo Agrawal, who have been instrumental in growth of MOFSL from Stock Broking to various avenues like commodity broking, Private Equity and Investment Banking. A brief introduction about them is as under:

- Mr. Motilal Oswal has been the director of MOFSL since its incorporation and is currently the Chairman and Managing Director of MOFSL. A Chartered Accountant (CA) by academics, he has served on various committees of BSE, NSE, CDSL and SEBI. He was also awarded the "Rashtriya Samman Patra" by Central Board of Direct Taxes (CBDT) for a period of 5 years commencing FY95-99.
- Mr. Raamdeo Agrawal is the co-promoter of MOFSL. He is also a CA by academics and he specializes in equity research. He is a member of the National Committee on Capital Markets of the Confederation of Indian Industry. He is the man behind the strong research capability at MOFSL. He was awarded the "Rashtriya Samman Patra" by CBDT for a period of 5 years commencing FY95-FY99.

Objects of issue:

No	Object	Funds required (Rs. mn)
1	Augmenting Long term working capital	400
2	Financing activity	1,100
3	Purchase/lease of new office space and general corporate purpose for business expansion	*
4	Technology	102
5	Issue Expenses	*

Source: RHP

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Means of Finance:

The entire requirement of funds is proposed to be funded through the proceeds of the Issue. In case of shortfall, if any, the same shall be met out of internal accruals. Excess money, if any, will be utilised for general corporate purpose, including acquisitions. The objects for which the funds are being raised have not been appraised by any external agencies and as such all the fund requirements are based on management estimates.

Schedule for Deployment of Funds:

(Rs. in millions)

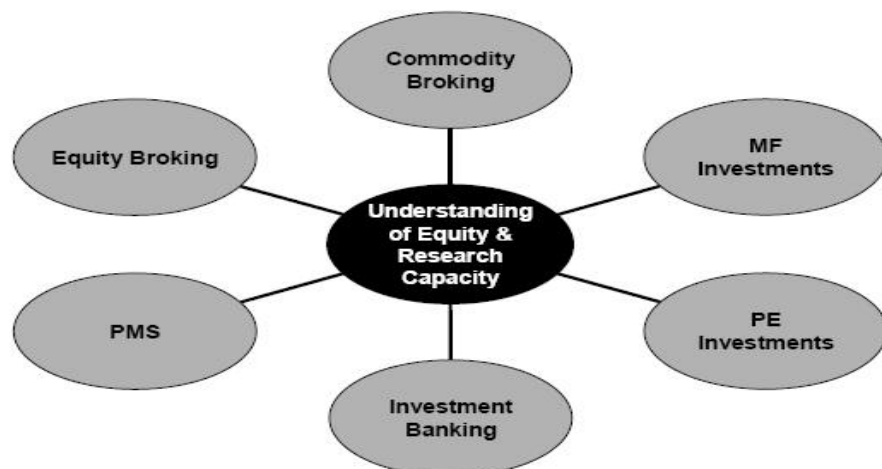
Particulars	FY 2008	FY 2009	Total
Augmenting Long term working capital	400	-	400
Financing activity	900	200	1,100
Purchase/lease of new office space and general corporate purpose for business expansion	*	*	*
Technology	102	-	102

Products & Services:

Since inception, MOFSL's business has primarily focused on retail wealth management and institutional broking. In 2006, it diversified into investment banking and venture capital management. Its principal business activities include:

- **Retail wealth management (RWM):** RWM provides broking and financing services to retail customers as well as investment advisory, financial planning and portfolio management services. As on March 31, 2007, it had 238,421 registered retail equity broking clients and 4,718 registered commodity broking clients whom we classify into three segments, being "mass retail", "mid-tier millionaire" and "private client group (PCG)". It offers retail clients investment products across major asset classes including equities, derivatives, commodities and distribution of third-party products such as mutual fund schemes and primary equity offerings.
- **Institutional broking:** Institutional broking business offers equity broking services in cash and derivative segments to institutional clients in India and abroad. As on March 31, 2007, it was empanelled with 251 institutional clients including 165 FIIs.
- **Investment banking (IB):** IB business offers financial advisory, capital raising and other investment banking services to corporate clients, financial sponsors and other institutions. Financial advisory includes advisory assignments with respect to mergers and acquisitions (domestic and cross-border), divestitures, restructurings and spin-offs. Capital raising and other investment banking services include management of public offerings, rights issues, share buybacks, open offers/delistings, private placements (including qualified institutional placements) and syndication of debt and equity.
- **Venture capital management and advisory:** In 2006, Motilal Oswal Venture Capital (MOVC), the recently incorporated venture capital advisory subsidiary, was appointed as the Investment Manager and Advisor of a private equity fund: the India Business Excellence Fund (the "Fund"), which was launched with a target of raising US\$100 million. The Fund is aimed at providing growth capital to small and medium enterprises in India, with investments typically in the range of US\$3 million to US\$7 million. MOVC will manage and advise the Fund and other private equity funds which may be raised in the future.

A diagrammatical representation of its wide range of financial products and services is as under:



RWM and institutional broking businesses comprised 89.92% of revenues on March 31, 2007. Rs. 382.12 mn (US\$ 8.87 mn) was contributed by the newly established investment banking business, which commenced operations in May 2006. The newly established venture capital management business has now started contributing to the revenue stream.

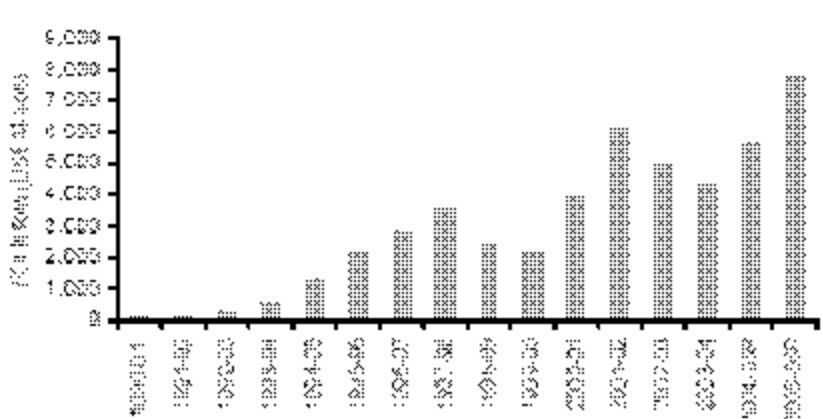
MOFSL faces competition in all the main business lines. Its primary competitors differ in each respective business and include both domestic and foreign institutions such as Kotak Securities, ICICI Securities, HDFC Securities, SSKI, Sharekhan, Enam, IndiaInfoline, Indiabulls, IL&FS Investsmart, Edelweiss, Religare, Geojit, Citigroup, HSBC, ABN Amro, Deutsche Bank, JM Financial, DSP Merrill Lynch, JP Morgan and Standard Chartered.

Key Positives:

- **MOFSL enjoys a large and diverse distribution network:** 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 1,200 Business Locations and Business Associates in 377 cities and towns. In addition to geographical spread, MOFSL also offers an online channel to service its customers. MOFSL have recently entered into a strategic alliance with State Bank of India (SBI), the largest bank in India, to offer online brokerage services to SBI's retail banking clients.
- **Proficient Research Team & Aggressive Sales Team:** It is believed that MOFSL's understanding of equity as an asset class and business fundamentals drives the quality of research and differentiates it from its competitors. Their research team is focused on cash equities, equity derivatives and commodities. As on March 31, 2007, they had 25 equity research analysts covering 221 companies in 26 sectors and 9 analysts covering 26 commodities. The *Asia money* brokers' poll has consistently recognized and rewarded MOFSL in various categories. The research is complemented by a strong sales and dealing team. The experience of the sales team enables to effectively market ideas generated by research team to its client base and to build stronger client relationships.
- **Very Well reputed brand:** Motilal Oswal is a well-established brand among retail and institutional investors in India. MOFSL's brand is associated with high quality research and advice as well as corporate values, like integrity and excellence in execution. It has been able to leverage the brand awareness to grow its businesses, build relationships and attract and retain talented individuals, which is important in the financial services industry.

Industry Overview:

In recent years, India has become a global preferred destination for FDI, owing to its large consumer market and efforts by government to position it as one of the front-runners of rapidly growing Asia Pacific region. Overall, India attracted FDI of around US\$ 35.07 billion between Fiscal 2000 and Fiscal 2006, which is as represented below:



Source: RBI Annual Report 2005-06

The Indian financial services industry has experienced significant growth in the last few years. There has been a considerable broadening and deepening of the Indian financial markets due to various financial market reforms undertaken by the regulators, the introduction of innovative financial instruments in the recent years and the entry of sophisticated domestic and international players. Sectors such as banking, asset management and brokerage have been liberalised to allow private sector involvement, which has contributed to the development and modernisation of the financial services sector. This is particularly evident in the non-banking financial services sector, such as equities, derivatives and commodities brokerage, residential mortgage and insurance services, where new products and expanding delivery channels have helped these sectors achieve high growth rates.

Capital Market

There were 4,842 companies listed on the Bombay Stock Exchange as on June 30, 2007. Establishment of SEBI, market-determined prices and allocation of resources, screen-based nation-wide trading, T+2 settlement, scripless settlement and electronic transfer of securities, rolling settlement and derivatives trading have greatly improved both the regulatory framework and efficiency of trading and

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settlement. There are 23 recognised stock exchanges in India, including the Over-The-Counter Exchange of India (“OTCEI”) for small and new companies and NSE, which was set up as a model exchange to provide nationwide services to investors. In 2003, NCDEX and MCX were set up for trading of futures in various commodities.

[Primary & Secondary Market](#)

The primary segment of capital markets in India has been witnessing a surge in activities driven by strong fundamentals of India economy, improved corporate results, a buoyant secondary market, revival of structural reforms by Government, etc. The number of primary equity market issuances in India for FY06 has been at Rs. 211.54 bn for Domestic Offerings and US\$ 2,552 mn for ADRs/GDRs. The Indian equity markets have been witnessing a strong rally since 2003 with the benchmark BSE Sensex crossing 15,000 mark in July 2007 from 5,200 in September 2004 and 6,600 in January 2005 setting a new historical high. The average daily turnover at NSE has increased from approximately Rs. 54 bn on FY01 to approximately Rs. 78 bn at the end of FY07.

[Equity Brokerage](#)

Indian capital markets are undergoing rapid consolidation driven by increased trading volumes, increased regulation, customer sophistication, availability of better technology and increased back-office requirements. Changes in regulatory framework and settlement mechanics have resulted in smaller operating players losing market share, leading to consolidation in industry. The market share of top five brokers on NSE has increased from 12% in FY04 to about 15% in FY07. Similarly market share of top ten brokers on the NSE has grown from approximately 17% in FY04 to 24% in FY07 indicating a long-term consolidation process in a highly fragmented securities brokerage industry, with hundreds of smaller players exiting the market and larger brokers gaining market shares.

[Mutual Funds](#)

The mutual fund industry has also experienced considerable activity over last few years with the total assets under management growing from Rs 1,396,160 mn as of March 31, 2004 to Rs 3,263,880 mn as of March 31, 2007. The fixed income asset class, which comprises income, liquid, gilt and money market schemes, comprises a major share of total funds under management. The other two asset classes – equity and balanced schemes – have experienced significant growth from 2004 due to the buoyant stock market.

[Commodity Exchanges](#)

Commodities trading in India have experienced exponential growth since Indian government issued its notification on April 1, 2003 permitting futures trading in commodities. The total value of commodities traded in India in 2005-2006 was Rs. 21,344,765 mn, representing a growth of 3,108% over the value of commodities in 2002-2003 (Rs. 665,307 mn). The emergence of three nationwide exchanges (MCX, NCDEX and NMCE) has increased the awareness of commodities trading. Some of the commodities where trading takes place are gold, silver, copper, castor seed, gram (chana), soya oil, sugar, rubber etc.

[Investment Banking](#)

The pursuit of value creation is leading Indian companies to constantly evaluate alternatives, which help meet strategic objectives; be it restructuring of group companies to unlock shareholder value or acquiring/divesting businesses, various strategic options are being exercised by Indian companies. Corporate assets (businesses, brands, companies) changing hands is now a regular phenomenon for Indian corporates. The volume of M&A activity has increased significantly from US\$ 8,097 mn in 2002 to US\$ 53,632 mn in 2007, with the number of deals increasing from 326 to 581 during the same period.

[Private Equity](#)

Although investors have recently been active in private equity investing in India, the pace of private equity activity has accelerated over the past few years. As private equity investing in India has continued to develop, the size and nature of investments has also evolved, increasingly moving from smaller start-up and early stage funding to larger-scale, later stage growth capital investments.

There have been some key developments in the financial sector over the past few years:

Consolidation: The Indian broking industry has consolidated gradually, with the top 25 Indian brokerage houses having increased market share to 43% in Fiscal 2007 from less than 29 % in Fiscal 1996 according to NSE.

Technology: New technologies such as screen-based trading, electronic matching, and paperless securities have made the process of trading more convenient and streamlined. Better telecom connectivity and lower costs have made it possible to have large interconnected operations across multiple locations for centralised operations and effective risk management and control.

E-Broking: E-broking offers the dual benefit of better service and convenience levels for retail investors and lower cost of operations and lower risk for brokers. The share of e-broking is expected to rise steadily in India due to widening retail investor participation, growing Internet usage, faster telecom connectivity and increasing comfort levels with transacting on the Internet.

Growth in Retail Segment: The retail segment is currently very fragmented and relatively under-serviced. It is expected that retail industry will experience a period of high growth due to more investor friendly regulatory reforms in financial markets, diversified asset instruments, change from traditional investment avenues to capital market products, falling real interest rates, etc.

Concerns:

- MOSL and equity broking business forms a significant portion of MOFSL's revenues:** MOSL contributed 99.99% and 88.50% of total consolidated revenues for FY06 and FY07 respectively. In addition, MOFSL is dependent on equity brokerage business, which contributed 87.42% and 79.91% of total consolidated revenues for FY06 and FY07. In spite of foray into other avenues like IB and Private Equity, brokerage business will continue to constitute a major portion of revenues and any decline in brokerage business will adversely affect the financial condition and operating results.
- Downturns in securities markets could reduce transaction volumes:** MOFSL's revenues, level of operations and profitability are dependent on favourable capital market conditions, a conducive regulatory and political environment, investor sentiment, price levels of securities, etc. that affect volume of stock trading in India and level of interest in Indian business developments. When trading volume is low, profitability will be adversely affected because revenues will be reduced and some operating costs are fixed.
- Consolidation in the industry could lead to cut throat competition:** The financial services industry, both domestically and internationally, is undergoing change that has resulted in increasing consolidation. This consolidation among our competitors could put MOFSL at a competitive disadvantage, which could cause them to lose customers, revenue and market share. It could force to expend greater resources to meet new or additional competitive threats, which could affect the overall financial condition.

Consolidated Financials:

Rs. In mn.	FY07	FY06	% Chg
Income from Operating Activities	3587.49	2576.5	39.24
Other Income	203.75	148.68	37.04
Total Income	3791.24	2725.18	39.12
Expenditure			
Operating Expenses	947.95	788.37	20.24
Staff Costs	1012.97	635.26	59.46
Administrative Expenses	462.87	307.07	50.74
Total Expenditure	2423.79	1730.7	40.05
PBIDT	1367.45	994.48	37.50
Interest	39.38	31.76	23.99
Depreciation	109.98	55.48	98.23
Exceptional Items	42.64	5.13	731.19
PBT	1175.45	902.11	30.30
Tax	410.44	298.21	37.63
PAT	765.01	603.9	26.68
Extraordinary Items	41.97	-	-
Reported PAT	723.04	603.9	19.73
Equity	127.11	56.18	126.25
Face Value	5	5	
EPS	28.44	53.75	-47.08
EPS on Fully diluted equity	25.46	-	-
OPM%	38.12	38.60	-
NPM%	20.15	23.44	-

Conclusion & Recommendation:

There is little doubt on the scope and potential for growth in the financial services space in India. Companies with reputation, history, spread and scale like MOFSL could do well going forward. MOFSL could get one of the highest valuations among its peers going forward. In terms of valuation, the issue has been priced (at the higher end of the price band) based on bull market valuations as is apparent from the peer group comparison given below. Apart from the initial post listing euphoria, this space would need to remain in limelight for MOFSL to show continuing gains. However for patient investors, the issue could provide 30-50% returns in a year's time assuming the space quotes at or close to historical 52 week high P/E's at least once in the forthcoming year.

Company Name	FY07		CMP as on 17/08/07 (Rs)	P/E	52 week high	P/E based on 52 week high	OPM %	NPM %	FV (Rs.)	BV (Rs.)	Q1 FY08	
	Sales (Rs. cr)	EPS (Rs.)									Sales (Rs. cr)	EPS (Rs.)
India Infoline	416.09	15.07	568.3	37.71	848	56.27	34	18	10	55.8	129.71	0
IL&FS Investmart	235.09	5.72	186.35	32.58	253	44.23	34	17	10	99	65.8	1.28
Emkay Shares	56.62	4.28	103.75	24.24	124	28.97	34	18	10	46.9	23.82	2.2
Geojit Fin. Services	132.41	1.21	40	33.06	50	41.32	33	19	1	9.7	39.67	0.59
MOFSL	358.75	28.44	-	At 725- 25.49 At 825- 29.01	-	-	38.12	20.15	5	-	-	-

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