INSTITUTIONAL RESEARCH

# ICICI Securities

## Pushing the Right Levers

**ADD**

| CMP *(as on 10 June 2020)* | Rs 418 |
|---|---|
| Target Price | Rs 442 |
| NIFTY | 10,116 |

| KEY CHANGES | OLD | NEW |
|---|---|---|
| Rating | SELL | ADD |
| Price Target | Rs 316 | Rs 442 |
| EPS % | FY21E | FY22E |
| | 9.7% | 11.9% |

| KEY STOCK DATA | |
|---|---|
| Bloomberg code | ISEC IN |
| No. of Shares (mn) | 322 |
| MCap (Rs bn) / ($ mn) | 135/1,790 |
| 6m avg traded value (Rs mn) | 238 |
| 52 Week high / low | Rs 525/191 |

| STOCK PERFORMANCE (%) | 3M | 6M | 12M |
|---|---|---|---|
| Absolute (%) | 3.5 | 18.6 | 82.7 |
| Relative (%) | 7.4 | 33.5 | 96.6 |

| SHAREHOLDING PATTERN (%) | Dec-19 | Mar-20 |
|---|---|---|
| Promoters | 79.2 | 79.2 |
| FIs & Local MFs | 11.9 | 11.5 |
| FPIs | 2.7 | 3.2 |
| Public & Others | 6.2 | 6.2 |
| Pledged Shares | Nil | Nil |

*Source : BSE*

**We recently interacted with the management of ISEC and were impressed by its focus on digital initiatives. We believe C/I ratios will improve over FY20-22E to 45.9% (-520bps). Additionally, in the near term increased market volatility is expected to boost revenues and earnings. We upgrade ISEC to ADD (from SELL) with TP of Rs 442 (22.5x FY22E EPS).**

- **Digital focus to reduce costs**. ISEC remains focused on driving its business digitally. Initiatives such as insta account opening are speeding up customer acquisition while reducing manpower dependence. Branch/employee counts have reduced 13.6/6.0% YoY to 172/3,790 as of Mar-20. We expect this trend to continue and C/I to improve from 51.1% in FY20 to 45.9% in FY22E.
- **Regulatory changes to result in market share consolidation**. Increasing margin requirements for cash and derivatives segment, and new pledging mechanism will hurt profitability of smaller brokers as access to funds fot them gets restricted and they will not be able to provide leverage to clients. Top 10 brokers now account for 70% (+2,419bps over FY16) of active customers– consolidation will likely continue.
- **Lockdown results in surge in activity.** Beginning Mar-20 there has been a huge surge in trading activity as cash ADTV surged 42.7% YoY to Rs 558bn. Interest and demand for online broking accounts was at 3 yr high in Mar/Apr-20 as visible in google trends. New demat account adds averaged 689k/month over Mar to May-20 vs. 11MFY20 average of 388k. Cash ADTV's (ex-prop) for Apr/May 20 continue at higher levels- 42.3/53.9% YoY despite steep decline in stock prices. Cash is the highest yielding line for brokers.
- **Revenues to sustain despite lower stock prices (vols).** While ADTVs have been strong in Apr/May-20, we expect ADTVs to stabilize at lower levels as volatility subsides. We expect FY21E pure broking revenues at Rs 11.0bn (-1.3% YoY), given price competition and pressure on ADTVs. **Distribution revenues** are expected to be stable at Rs 3.9bn (-3.9% YoY).
- **We expect FY21E t**o be a year of consolidation for broking as lower prices imply lower ADTVs and lower MF distribution revenues. Additionally, environment for financial product sales remains challenged. Having said the above, we expect ISEC's digital focus, cost reduction initiatives, and favorable regulatory environment to benefit it over FY20-22E and we increase FY21E/22E EPS estimates by 9.7/11.9% to Rs 17.0/19.7. We are increasing our target multiple to 22.5x (from 18x) on Mar-22E EPS, implying an upgrade to ADD (from SELL) with TP of Rs 442/share. Risks include prolonged sub-dued markets, lower market share, weak environment for financial product sales, and any lower than expected reduction in costs.

### Financial Summary

| (Rs mn) | FY18 | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|
| Adj. revenues | 17,824 | 16,456 | 16,116 | 15,835 | 16,651 |
| EBITDA | 8,427 | 7,358 | 7,873 | 8,124 | 9,001 |
| EBITDA Margin (%) | 47.3 | 44.7 | 48.9 | 51.3 | 54.1 |
| APAT | 5,577 | 4,773 | 5,622 | 5,477 | 6,335 |
| AEPS | 17.3 | 14.8 | 17.5 | 17.0 | 19.7 |
| EV/EBITDA (x) | 16.9 | 18.9 | 19.3 | 18.4 | 16.6 |
| P/E (x) | 24.1 | 28.2 | 24.0 | 24.6 | 21.3 |
| ROE (%) | 83.4 | 50.4 | 49.8 | 42.6 | 42.6 |

Source: Company, HSIE Research estimates

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## Digital focus to Reduce costs

- ISEC's management has been focused on digital. We expect this to yield strong reduction in costs.
- Over the last year the company has undertaken several digital initiatives and one of the most promising one is- insta account opening. The company can now open an account completely digitally with no need for paper.
- Given ISEC's digital prowess, we believe that the company will not be adding employees over FY21E and FY22E. Natural attrition will result in employee count and costs declining. Employee count has already reduced for the company from 4,032 at end of FY19 to 3,890 at end of FY20. We expect to see this trend to continue.
- ISEC has been shutting down branches with low profitability- branch count has reduced 13.6% YoY to 172 at end of FY20.
- Management has also stated that it would look at reducing costs by using some of the learning from work from home which it has implemented during the lockdown.
- We are building a decline in employee/other expenses at a FY20-22E CAGR of 4.2/5.8%. This will result in pre-EBITDA C/I reducing from 51.1% in FY20 to 45.9% in FY22E, and EBITDA margins rising from 48.9% in FY20 to 54.1% in FY22E.

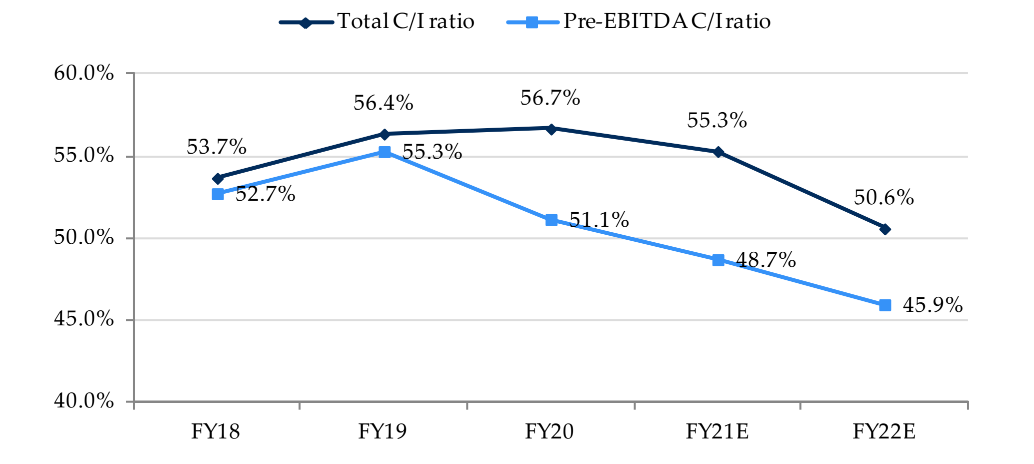
### Operating costs expected to rationalize

| Expenses (Rs mn) | FY18 | FY19 | FY20 | FY21E | FY22E | CAGR | |
|---|---|---|---|---|---|---|---|
| | | | | | | FY18-20 | FY20-22E |
| Employee benefits expenses | 5,453 | 5,545 | 5,338 | 5,030 | 4,899 | -1.1% | -4.2% |
| Operating expenses | 1,683 | 1,226 | 1,024 | 1,045 | 1,082 | -22.0% | 2.8% |
| Other expenses* | 2,260 | 2,327 | 1,881 | 1,636 | 1,669 | -8.8% | -5.8% |
| **Total** | **9,397** | **9,098** | **8,242** | **7,711** | **7,651** | **-6.3%** | **-3.7%** |

*Steep decline in FY20 is due to the implementation of Ind AS116 which results in operating lease capitalization and reclassification of lease expenses from to depreciation and interest expenses.

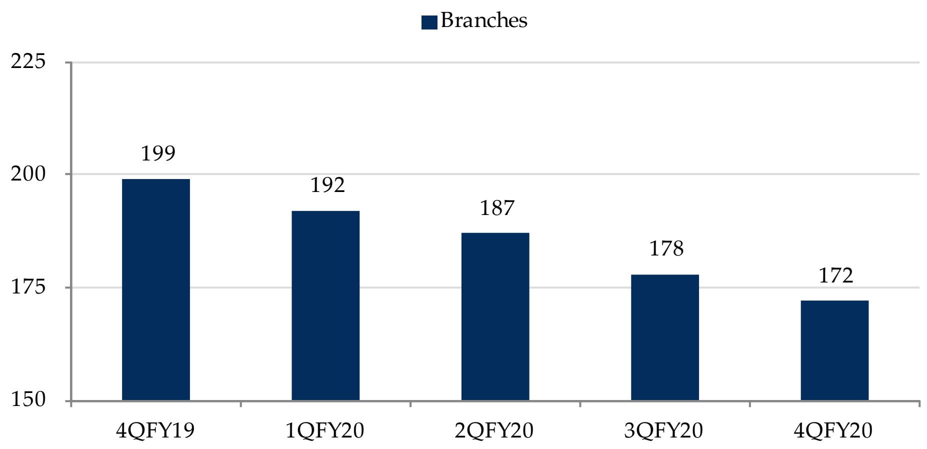
Source: Company, HSIE Research

### C/I ratio trend




Source: Company, HSIE Research
Note: FY19 and prior numbers are not comparable due to adoption of lease accounting (Ind AS 116)

**ISEC's branch count has reduced over the last 5 quarters**

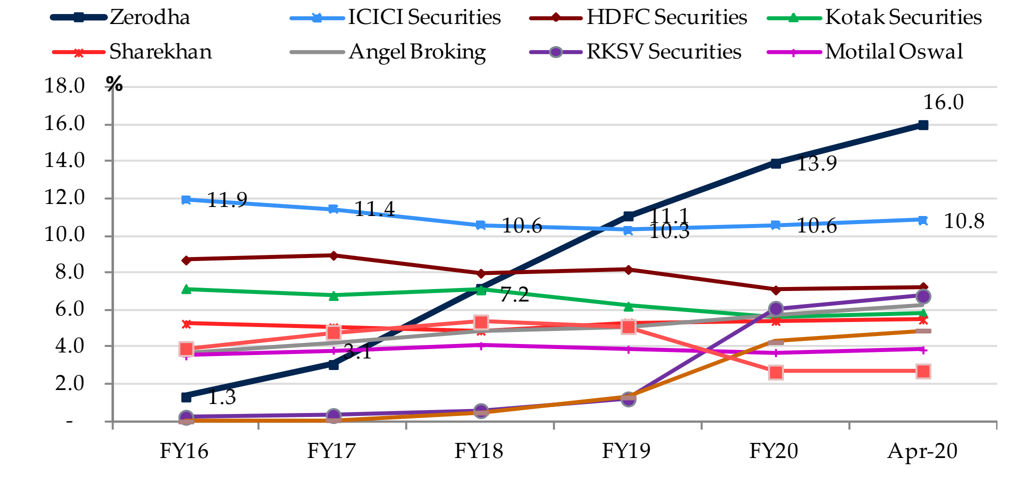



Source: Company, HSIE Research

## Regulatory Changes to Drive Consolidation

- Brokers are now expected to collect VaR and extreme loss margins upfront and at time of margin calls even for the cash segment. Several smaller brokers were extending credit even for the cash segment and implementation of this circular will reduce their competitive advantage.
- Brokers are also not allowed to offer high intra-day leverage (30-50x) on derivative trading as SEBI has proposed that clients need to provide margin towards the maximum outstanding open interest position during the day. Providing high leverage was possible as earlier this rule was checked only for the end of day open interest.
- Smaller brokers were offering higher leverage. Change in this rule will reduce attractiveness of smaller brokers This change will also have a negative impact on brokerage income as trading volumes will reduce.
- Post Karvy stock broking's bankruptcy it has become impossible for brokers to pledge client securities. Smaller brokers funded their operations using client securities. This further makes it difficult for smaller brokers to continue in this business.
- Because of the Coid-19 situation, the implementation of the above changes have been delayed, but once implemented attractiveness of smaller brokers is set to reduce.
- We expect further consolidation in the industry. As of Apr-20, top 10 brokers account for 70% of NSE active customers. We expect this number to grow further over the coming years.

**Top 10 brokers active client market share**



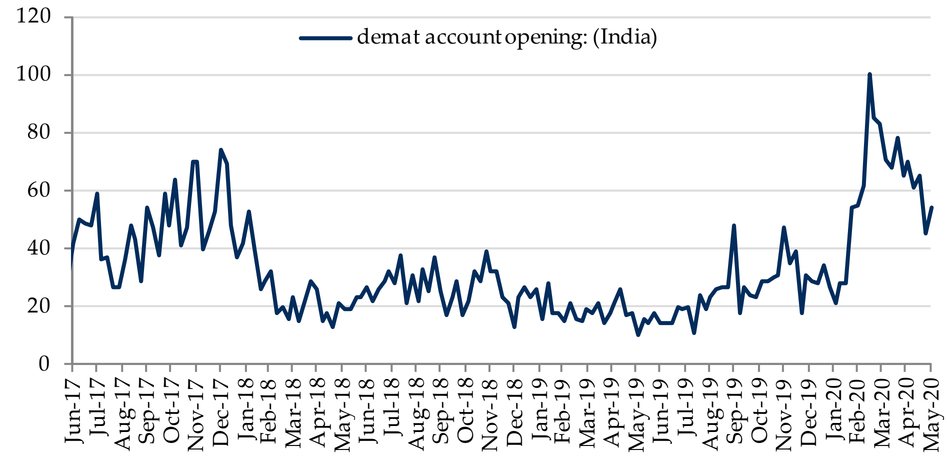

Source: NSE, HSIE research

## Lockdown results in surge in activity

- Online activity surged during the lockdown, which began 25-Mar-20 and is only now gradually being lifted.
- During this period we have seen a surge in interest for broking accounts. This is evidenced in google trends- Mar-20 to May-20 shows a strong growth in search for "online trading account opening", "demat account opening", "icici direct", and "zerodha".
- We are also seeing this phenomenon play out with demat accounts. CDSL and NSDL too have reported a strong growth in demat accounts. Net new demat accounts added have increased to 789k/680k/597k in Mar/Apr/May-20 respectively. 11MFY20 average was ~378k.
- Industry active customers have grown over last few months from 8.9mn in Dec-19 to 10.0 in Apr-20.
- FY21TD cash segment ADTV has grown 42.7% YoY to Rs 558bn. This is very profitable for brokers as this is a high yielding segment with higher rack rates.
- We are seeing that retail brokers with digital on-boarding capabilities acquiring disproportionate share of new customers. Discount brokers such as Zerodha and Upstox (RKSV) are doing extremely well. Active customer adds have improved materially even for ISEC.
- ISEC has done well in this regard as over the last year it developed capabilities to onboard customers completely digitally (insta account opening) and is now also allows non ICICI Bank account customers to open account with them.

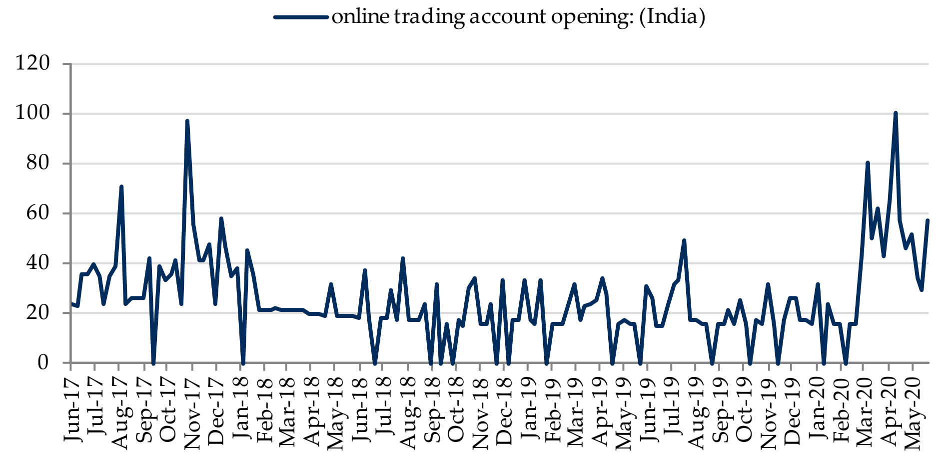
- Zerodha on a call hosted by us in Mar-20 has stated it was acquiring ~1,500 customers/day, while ISEC in its 4QFY20 earnings call reported that it is acquiring ~1,000 customers/day.
- ISEC also reported a higher activation rate (71% vs. 26% YoY) from the customers it had acquired through the ICICI Bank channel.
- Millennial are 70% of active customers with ISEC over the last three years.
- Lastly, ISEC has also disclosed:
  - 37% of active clients have been with the company for more than 14 years ago
  - >65% revenues in each of financial years (FY14 to FY20) has been contributed by customers who have been with ISEC for more than 5 years.

**Google trends: Interest for "demat account opening" peaks in Mar-20**



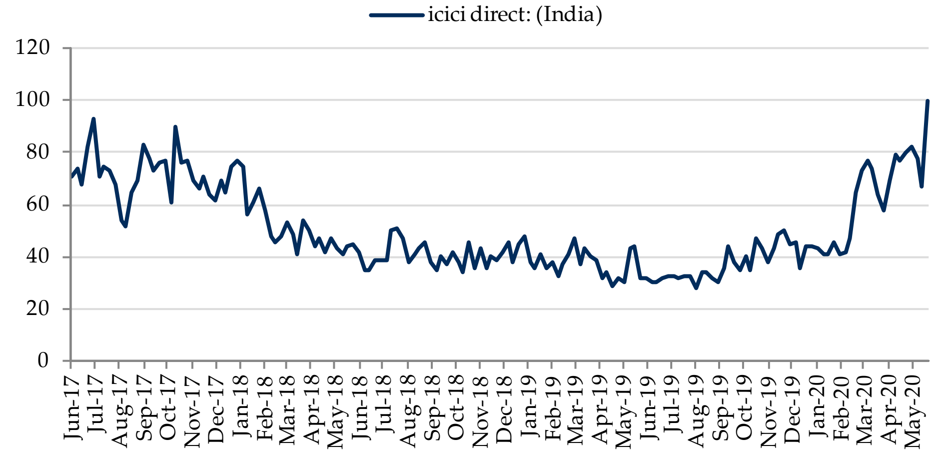

Source: Google trends, HSIE Research

**Google trends: Interest for "online trading account opening" peaks in Apr-20**



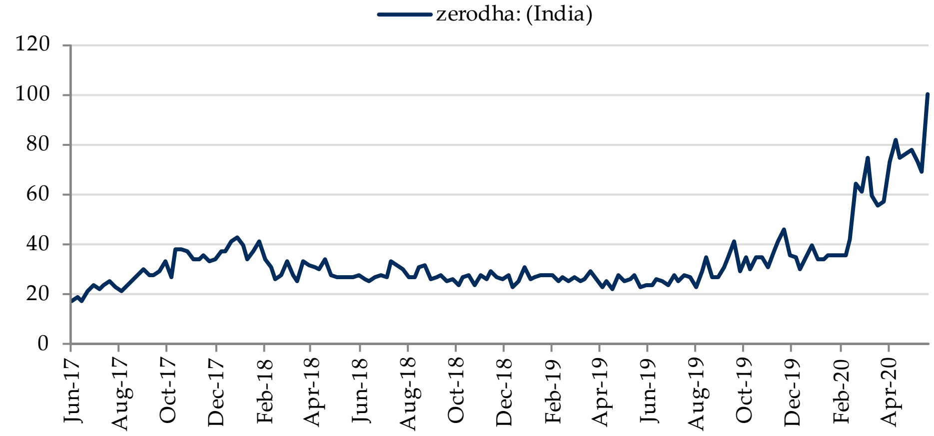

Source: Google trends, HSIE Research

## Google trends: Interest for "ICICI Direct" peaks in Mar-20



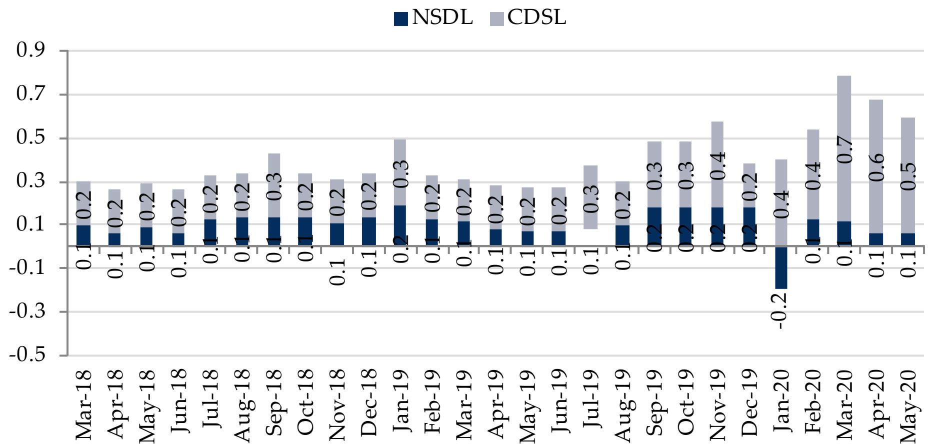

Source: Google trends, HSIE Research

## Google trends: Continued strong interest for "Zerodha" at peak in May-20




Source: Google trends, HSIE Research

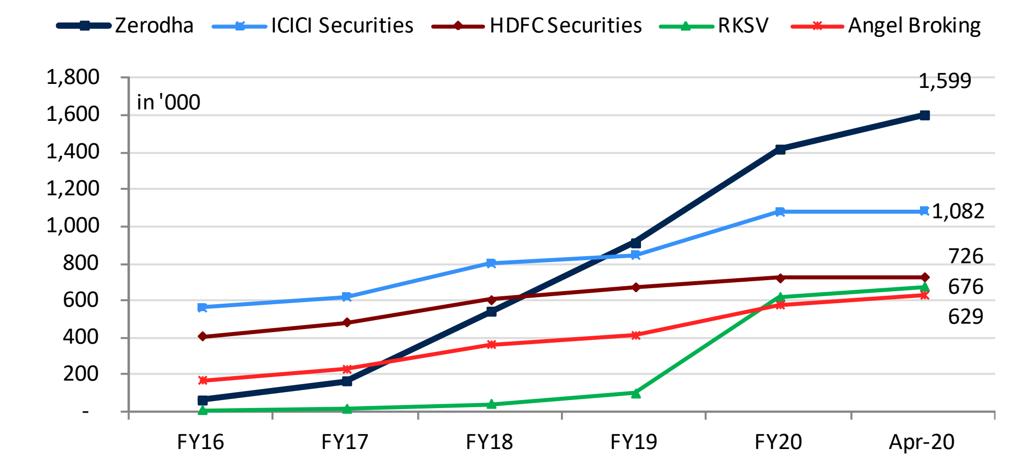
## Depositary accounts addition trend




Source: CDSL, NSDL, HSIE research

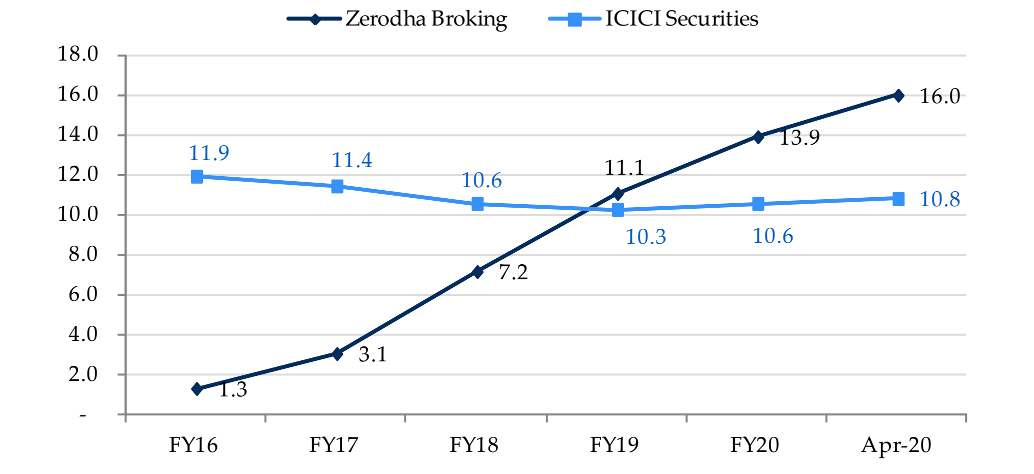
**Active customers and market share**

**Active customers: Top 5 brokers account for 47.1% of active customers**




Source: NSE, HSIE research

**Zerodha and ICICI Sec's active clients market share**



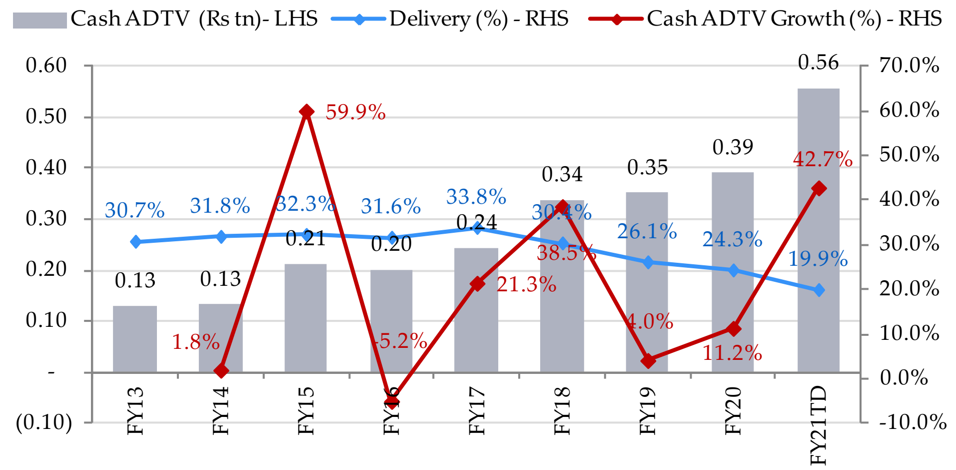

Source: NSE, HSIE research

## Revenues to Sustain Despite Pressure on ADTVs

- Lower equity prices usually means lower ADTVs; however, ADTVs in the first two months of FY21E have spiked up -1.4/+13.9% YoY to Rs 12.1/13.7bn as high activity levels compensated for lower equity prices.
- Cash ADTV has been even better- FY21TD cash segment ADTV has grown 42.7% YoY to Rs 558bn. This is very profitable for brokers as this is a high yielding segment with higher rack rates.
- Retail participation has increased from 37.9% in average in 11MFY20 to 40.5% in Mar-20. Retail participation continues to be high at 41.6% in Apr -20. This augurs well for earnings.
- We however expect a more normalized level of market activity post 1QFY21E; this should bring down ADTVs and retail participation.
- ADTVs matter more for ISEC than for other discount brokers as we estimate that ~70-75% of revenues (cash and futures trading) is value denominated. Options revenues are more volume driven as pricing is on a per lot basis.

- Pricing continues to be under pressure as Bajaj Finance launched its broking foray offering a subscription model- Rs 899 p.a. and Rs 0.99 per trade. Details are in table, although the leading discount broker has suggested that it will be looking to increase broking tariffs.
- As the penetration of prime increases in ISEC's customer base we expect yields to decline for both cash and futures. Additionally pricing will be under pressure even for the options segment as penetration of Options 20/20 plan increases.

**Cash ADTV has risen 42.7% in FY21TD while delivery vols has dipped 535 bps to 19.9%.**




Source: NSE,BSE, HSIE Research

**Market ADTVs (ex-prop)**

| ADTV (ex-prop) (Rs bn) | FY17 | FY18 | FY19 | FY20 | FY21TD |
|---|---|---|---|---|---|
| **Cash** | **199** | **270** | **269** | **292** | **418** |
| Share (%) | 8.2 | 6.5 | 4.3 | 3.0 | 4.8 |
| *Growth (%)* | | *36.0* | *(0.6)* | *8.3* | *43.1* |
| **Futures** | **457** | **615** | **653** | **670** | **690** |
| Share (%) | 18.9 | 14.7 | 10.5 | 7.0 | 7.9 |
| *Growth (%)* | | *34.6* | *6.3* | *2.7* | *2.9* |
| **Options** | **1,758** | **3,300** | **5,326** | **8,668** | **7,624** |
| Share (%) | 72.8 | 78.9 | 85.2 | 90.0 | 87.3 |
| *Growth (%)* | | *87.7* | *61.4* | *62.7* | *(12.0)* |
| **Total** | **2,413** | **4,184** | **6,248** | **9,631** | **8,732** |
| *Growth (%)* | | *73.4* | *49.3* | *93.2* | *(9.3)* |

Source: NSE, HSIE Research
Note: This is only for NSE.

**ISEC Retail Broking Revenue: Cash/Derivative segments- Estimated**

| ISEC Retail Broking Revenues (Rs bn) | FY18E | FY19E | FY20E |
|---|---|---|---|
| Cash | 5.2 | 4.5 | 4.4 |
| Futures | 1.6 | 1.2 | 1.6 |
| Options | 2.3 | 2.5 | 2.2 |
| **Total** | **9.2** | **8.2** | **8.2** |
| **Revenue mix (%)** | | | |
| Cash | 57.0 | 54.7 | 53.5 |
| Futures | 17.8 | 14.1 | 19.1 |
| Options | 25.2 | 31.1 | 27.4 |
| **Total** | **100** | **100** | **100** |

Source: Company, HSIE Research

## Comparison of brokerage rates for top brokers

| Companies | ICICI Securities | Kotak Securities | HDFC Securities | Angel Broking | Motilal Oswal | 5Paisa | Zerodha | Bajaj |
|---|---|---|---|---|---|---|---|---|
| **Equity** | Equity Intraday 0.28% & Delivery 0.55%. Discounted delivery charges reduces to 0.09% and 0.05% in intraday. | 0.06% for Intraday & 0.59% for Delivery - Reduces upto 0.05/0.18% in higher brokerage slabs | 0.5% for Delivery & 0.05% for Intraday | 0 for equity delivery & Rs 20/executed order for intraday | 0.05% for Intraday & 0.5% for Delivery - Reduces upto 0.01/0.10% if brokerage paid upfront | Rs 20 per executed order. Equity delivery fees reduces to Rs 10/nil per order on subscription based model. | 0 for equity delivery & Rs 20/executed order or 0.01% (intraday) | 0.5% for Delivery & 0.1% for Intraday. Reduces to Rs 0.99/per order in subscription based model. |
| **Equity Futures** | 0.05% of Turnover & Rs 50/lot for second leg in Intraday | 0.06% - Reduces upto 0.03% if brokerage paid upfront | 0.05% on Turnover | Rs 20/executed order | 0.05% - Reduces upto 0.01% if brokerage paid upfront | Rs 20 per executed order. reduces to Rs 10/nil per order on subscription based model. | Rs 20/executed order or 0.01% whichever is lower | 0.1% on Turnover. Reduces to Rs 5/per order in subscription based model. |
| **Equity Options** | Rs 95/lot & Rs 50/lot for second leg in Intraday. Reduces to Rs 20 per lot in prime plan. | Rs 100/lot - Reduces upto Rs 30/lot if brokerage paid upfront | ₹100 per lot or 1% of the premium (whichever is higher) | Rs 20/executed order | Rs 100/lot - Reduces upto Rs 20/lot if brokerage paid upfront | Rs 10 per executed order. reduces to Rs 2 per lot on subscription based model. | Rs 20/executed order or 0.01% whichever is lower | Rs 100 per lot. Reduces to Rs 5/per order in subscription based model. |
| **Currency Futures** | 0.05% of Turnover & Rs 10/lot for second leg in Intraday. Reduces to Rs 20 per lot in prime plan. | 0.04% - Reduces upto 0.01% if brokerage paid upfront | Rs 23/contract | Rs 20/executed order | Rs 20/lot - Reduces upto Rs 10/lot if brokerage paid upfront | Rs 20 per executed order. reduces to Rs 10/nil per order on subscription based model. | Rs 20/executed order or 0.01% whichever is lower | NA |
| **Currency Options** | Rs 25/lot & Rs 10/lot for second leg in intraday. Reduces to Rs 20 per lot in prime plan. | Rs 20/lot - Reduces upto Rs 30/lot if brokerage paid upfront | Rs 23/contract | Rs 20/executed order | Rs 20/lot - Reduces upto Rs 10/lot if brokerage paid upfront | Rs 20 per executed order. reduces to Rs 10/nil per order on subscription based model. | Rs 20/executed order or 0.01% whichever is lower | NA |
| **Commodity** | NA | 0.05% - Reduces upto 0.01% if brokerage paid upfront | 0.02% for Intraday / 0.025% for positional | Rs 20/executed order | 0.05% - Reduces upto 0.01% if brokerage paid upfront | NA | Rs 20/executed order or 0.01% whichever is lower | NA |
| **Account opening charges** | | | | | | | | |
| **Trading only** | NA | NA | NA | Free | NA | NA | Rs 300 | Rs 599 |
| **Trading & Demat** | Rs 975 for 3 in 1 Account | Rs.750 | Rs 999 | Free | Free, but with Margin Cheque | Free | Rs 200 | NA |
| **Commodity** | NA | Rs 250 | NA | Free | Free, but with Margin Cheque | NA | Rs 300 | NA |
| **Others** | | | | Broker assisted trades (Call & Trade) are charged extra ₹20 per executed order. | | | Broker assisted trades (Call & Trade) are charged extra ₹20 per executed order. | |

Source: Company, HSIE Research

### ISEC pricing plans:

#### Prime plan features and pricing

| Prime Plan (₹) | Total amount with GST (₹) | Scheme Validity (in days) | Cash % | Margin / Futures % | Options (Per Lot) (₹) | Currency Futures & Options (per lot) % | Special MTF Interest rates/LPC (% per Day) |
|---|---|---|---|---|---|---|---|
| **900.00** | 1,062.00 | 365 | 0.25 | 0.025 | 35 | 0 | 0.035 |
| **4,500.00** | 5,310.00 | 365 | 0.18 | 0.018 | 25 | 0 | 0.031 |
| **9,500.00** | 11,210.00 | 365 | 0.15 | 0.015 | 20 | 0 | 0.024 |

Source: Company

The key features include instant payout for stocks sold, reduced brokerage across all segments, research reports, zero brokerage on intraday stop loss products for trades squared off within 5 minutes, reduced interest on delayed payments/MTF carry forward positions in equity margin product.

#### Options 20-20 pricing

| | Fixed brokerage per Order (Rs) | Variable brokerage per lot (Rs) |
|---|---|---|
| Brokerage charges | 20 | 5 |

Source: Company, HSIE Research

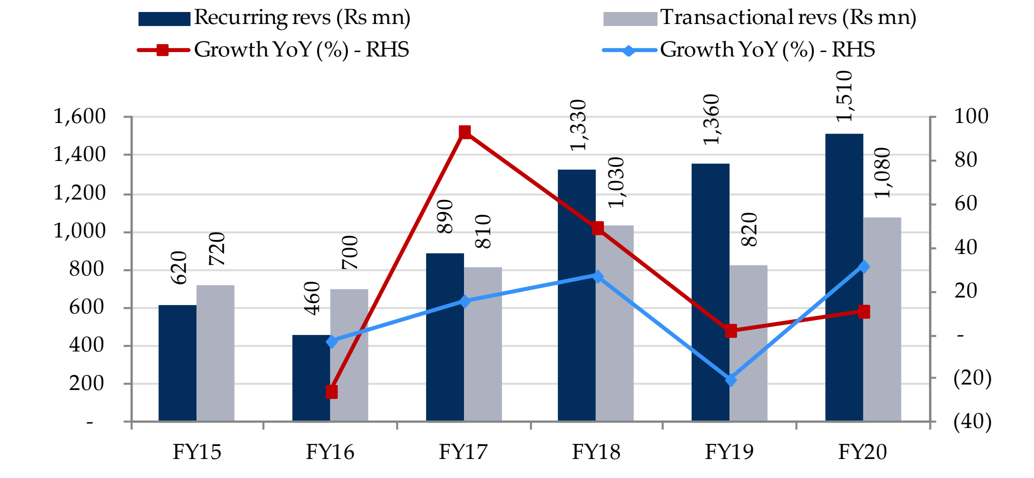
- **Distribution income likely to take a hit**
  - We are building in lower levels of AUM for mutual funds given sharp negative MTM. We expect MF revenues to decline in FY21E by 5% to Rs 2.15bn and then grow by 18.7% to Rs 2.55bn in FY22E.
  - We expect sales environment for life insurance too to be under pressure given social distancing norms and the need to sell insurance over video calls. We are concerned on premium growth and hence expect commission growth ISEC to be 7.4%pa over FY20-22E to Rs 566mn.

- **Wealth management unit to retain and grow assets**
  - ISEC at FY20 end employed ~300 RMs to service ~32k wealth clients who had ~Rs 0.83tn in assets.
  - The company employs RMs to service customers who cross Rs 10mn in assets.
  - The division generated revenues of Rs 2.6bn in FY20 (+18.8% YoY)
  - While ISEC's wealth practice is enviable, we would also like to understand the profitability of this vertical- the same has not been shared.
  - The numbers of this division are already captured in the valuation of the company.

*ISEC disclosed metrics for its private wealth management for the first time in FY20.*

*Transactional revenues displayed sharp reversal in FY20 with growth at 31.7% YoY (vs. -20.4% in FY19).*

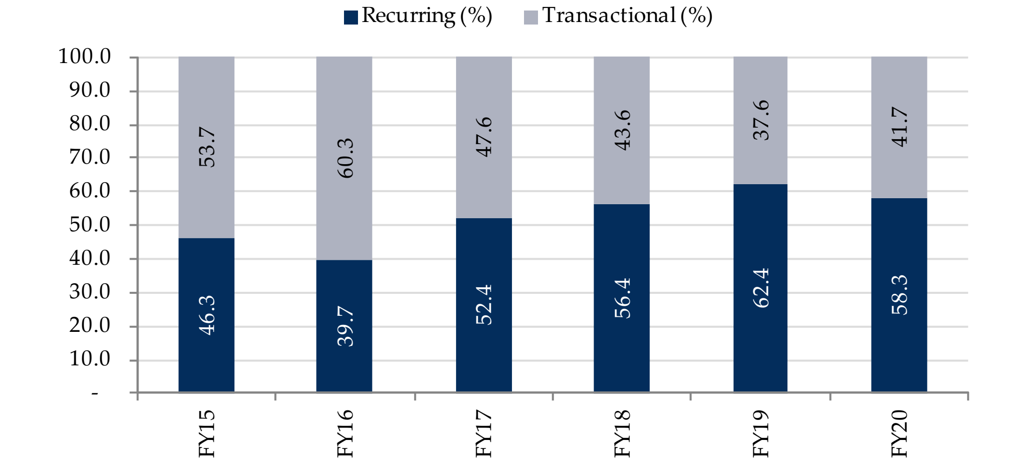
### Recurring revs grew at 19.5% CAGR over FY15-20




Source: Company, HSIE Research

*58.3% of the revenues are recurring in nature.*

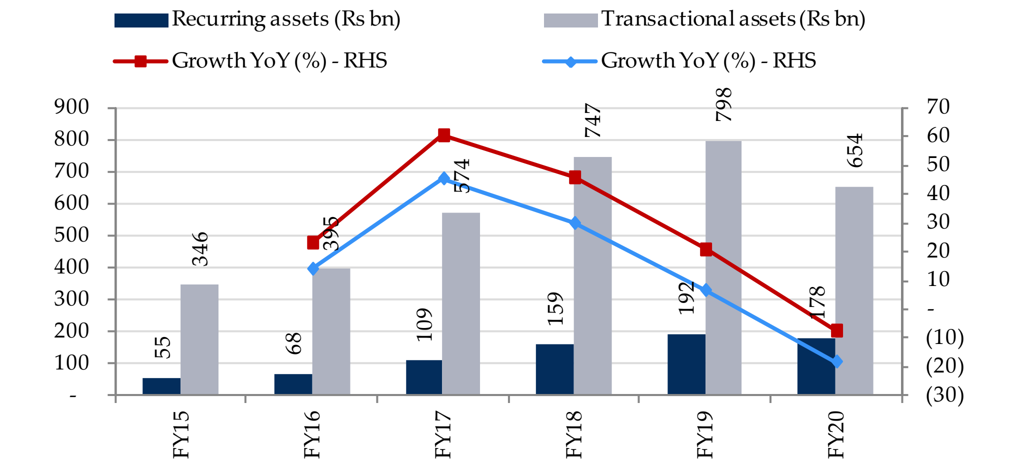
### Share of recurring revs has declined ~408bps




Source: Company, HSIE Research

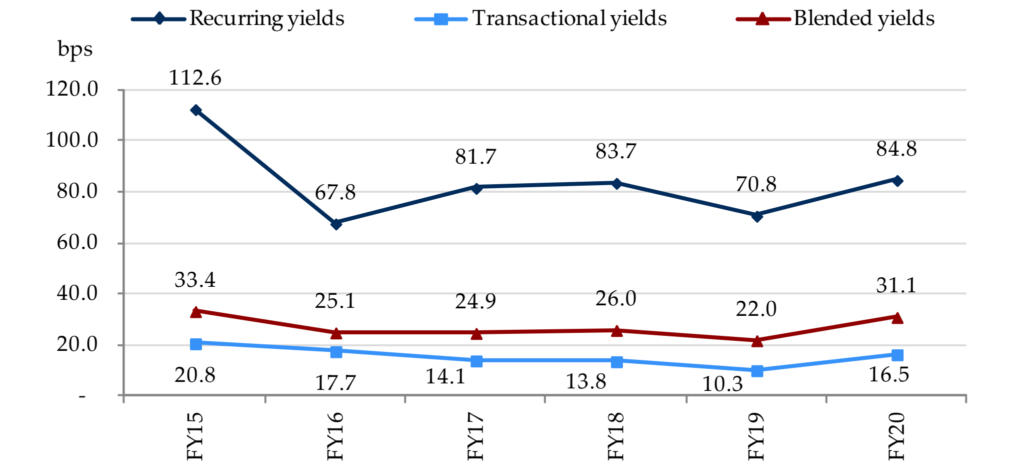
*Despite 7.3% YoY decline in recurring assets in FY20, recurring revenues grew 11.0% YoY.*

### Recurring assets grew at 19.5% CAGR over FY15-20




Source: Company, HSIE Research

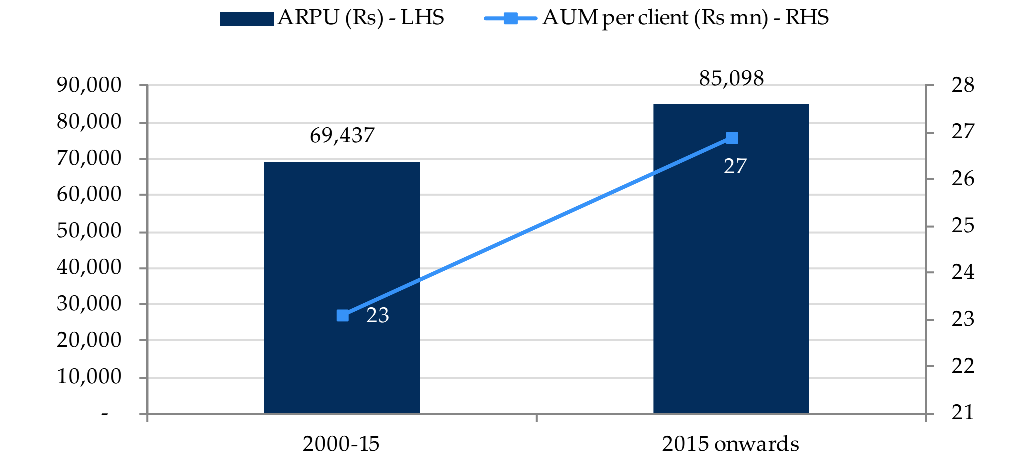
### Recurring yields increased by 14bps in FY20




Source: Company, HSIE Research

### Acquiring more profitable clients

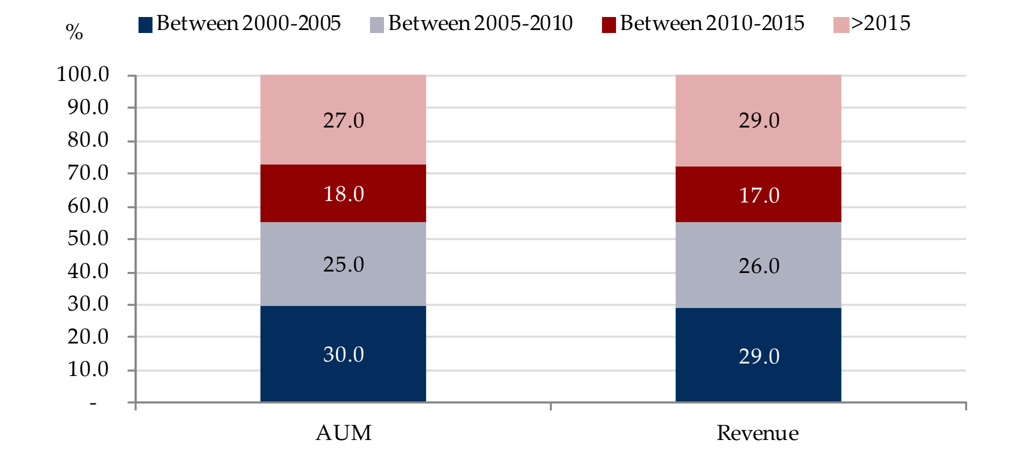
*While clients acquired after 2015 have a higher APRU and AUM per client, we believe this can be partially attributed to surge in MF inflows witnessed post FY16.*




Source: Company, HSIE Research

### Vintage split of AUM and revenue

*Vintage clients continue to contribute higher share in AUM and revenues.*




Source: Company, HSIE Research

### Estimate changes

- We have fine tuned our revenue estimates. Total FY21/22E revenues move up by 3.0/2.5% YoY.
- The biggest mover to our estimates are lower cost assumptions. Total pre-EBITDA costs decline at a FY20-22E CAGR of 3.7%, as a result FY20-22E EBITDA CAGR is 6.9%.

### Change in estimates

| (Rs mn.) | FY21E | | | FY22E | | |
|---|---|---|---|---|---|---|
| | Old | New | Change (%) | Old | New | Change (%) |
| Revenues | 15,378 | 15,835 | 3.0 | 16,246 | 16,651 | 2.5 |
| EBITDA | 7,563 | 8,124 | 7.4 | 8,298 | 9,001 | 8.5 |
| EBITDA margin (%) | 49.2 | 51.3 | 213bps | 51.1 | 54.1 | 298bps |
| APAT | 4,993 | 5,477 | 9.7 | 5,660 | 6,335 | 11.9 |
| EPS | 15.5 | 17.0 | 9.7 | 17.6 | 19.7 | 11.9 |
| RoE (%) | 39.7 | 42.6 | 283bps | 40.3 | 42.6 | 228bps |

Source: Company, HSIE Research

## Valuation and view

- ISEC has several positive changes going for it. The company has stepped up its customer acquisition (insta account opening and open architecture) and retention (wealth management, wider product suite, more competitive pricing).
- Additionally changing regulations seems to be favoring larger brokers. Over the next 4-5 years we see the industry consolidating towards larger bank owned brokers, traditional brokers and large tech oriented discount brokers.
- Lastly, ISEC is also focused on cost reduction. As detailed previously we expect the company to reduce total pre-EBITDA costs at FY20-22E CAGR of 3.7%.
- We expect an AEPS to decline 2.6% in FY21E and then grow 15.7% in FY22E to Rs 19.7.
- We are increasing the multiple (from 18x) for the company to 22.5x and upgrade the stock to ADD (from SELL) with TP of Rs 442/share.

### SoTP

- With a few assumptions we have attempted to do a SoTP valuation for ISEC.
- We assume a C/I ratio of 40% for distribution, and 75% for investment banking.
- We allocate balance costs to broking which works out to ~52%.
- We have used a tax rate of 25.2%.
- Using multiples of 35x for distribution and wealth management, 15x for IB and 17x for broking, we derive a SoTP fair value of Rs 444/share- implying a FY22E P/E of 22.6x.

| Particulars (Rs mn) | FY22E | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Revenue | Costs | PBT | Tax | PAT | Multiple (x) | Valuation | Comments |
| Distribution and WM | 4,430 | 1,772 | 2,658 | 670 | 1,988 | 35.0 | 69,589 | Higher multiple given stability, growth potential and relatively higher RoE profile. |
| Investment banking | 842 | 631 | 210 | 53 | 157 | 15.0 | 2,361 | Lower profitability with higher cyclicality. |
| Broking | 11,619 | 6,018 | 5,601 | 1,411 | 4,190 | 17.0 | 71,223 | Retail granular business, with high competition, cyclicality, and lower growth. |
| **Total** | **16,891** | **8,421** | **8,470** | **2,134** | **6,335** | **22.6** | **143,173** | |
| **SoTP fair value (Rs / share)** | | | | | | | **444** | |

Source: Company, HSIE Research

### DCF

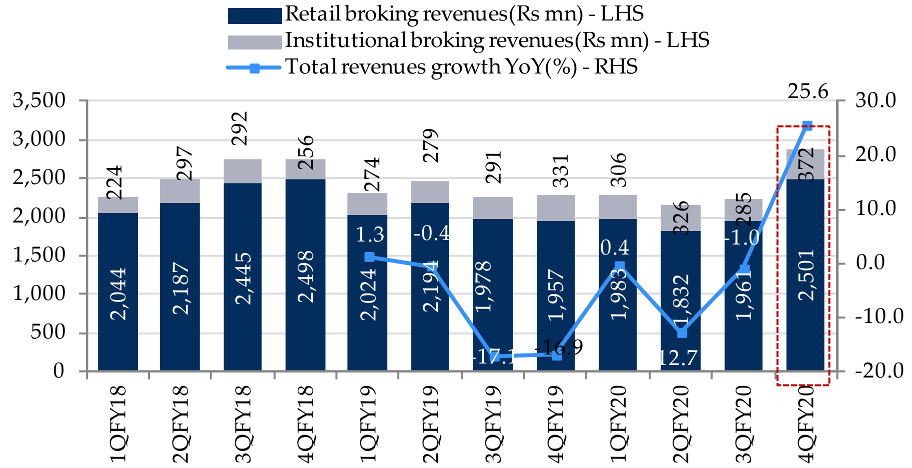
- Using a cost of equity of 12.0%, DCF value for ISEC works out to be Rs 403/share implying a FY22E P/E of 20.5x.

| DCF based valuation (Rs mn) | FY20 | FY21E | FY22E | FY23E | FY24E | FY25E | FY26E | FY27E | FY28E | FY29E | FY30E | FY31E | FY32E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **APAT** | **5,622** | **5,477** | **6,335** | **7,427** | **8,524** | **9,755** | **11,025** | **12,568** | **14,328** | **16,333** | **18,620** | **21,227** | **22,288** |
| *Growth (%)* | *17.8* | *-2.6* | *15.7* | *17.2* | *14.8* | *14.4* | *13.0* | 14.0 | 14.0 | 14.0 | 14.0 | 14.0 | 5.0 |
| Dividend payout (%) | 60.0 | 70.0 | 70.0 | 75.0 | 75.0 | 75.0 | 75.0 | 75.6 | 76.3 | 76.9 | 77.5 | 80.0 | 80.0 |
| Dividend | 3,373 | 3,834 | 4,435 | 5,571 | 6,393 | 7,316 | 8,268 | 9,505 | 10,925 | 12,556 | 14,431 | 16,982 | 17,831 |
| Discounted values | | | 3,960 | 4,441 | 4,550 | 4,650 | 4,692 | 4,815 | 4,942 | 5,071 | 5,204 | 5,468 | |
| Discounted terminal value | | | | | | | | | | | | 82,014 | |
| | | | | | | | | | | | | | |
| Explicit period cash flows | | 47,792 | 36.8% | | | | | | | | | | |
| Terminal value | | 82,014 | 63.2% | | | | | | | | | | |
| **Equity value** | | **129,806** | **100%** | | | | | | | | | | |
| **Value per share (Rs)** | | **403** | | | | | | | | | | | |
| | | | | | | | | | | | | | |
| Cost of equity (%) | | 12.0 | | | | | | | | | | | |
| Terminal RoE (%) | | 25.0 | | | | | | | | | | | |
| Terminal growth (%) | | 5.0 | | | | | | | | | | | |

Source: Company, HSIE Research

*Broking revs enjoy robust growth of 25.6% YoY.*

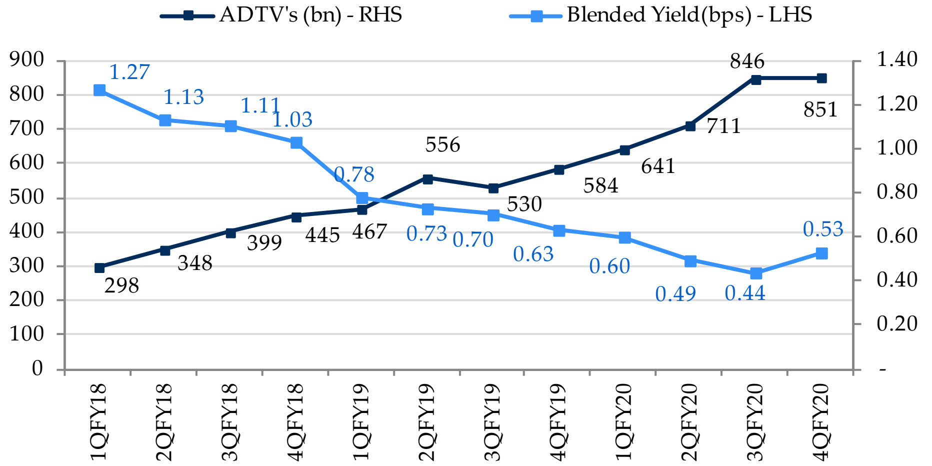
### Broking revenue split and growth




Source: Company, HSIE Research

*Broking ADTV blended yield saw sequential growth of 0.09bps in 4QFY20.*

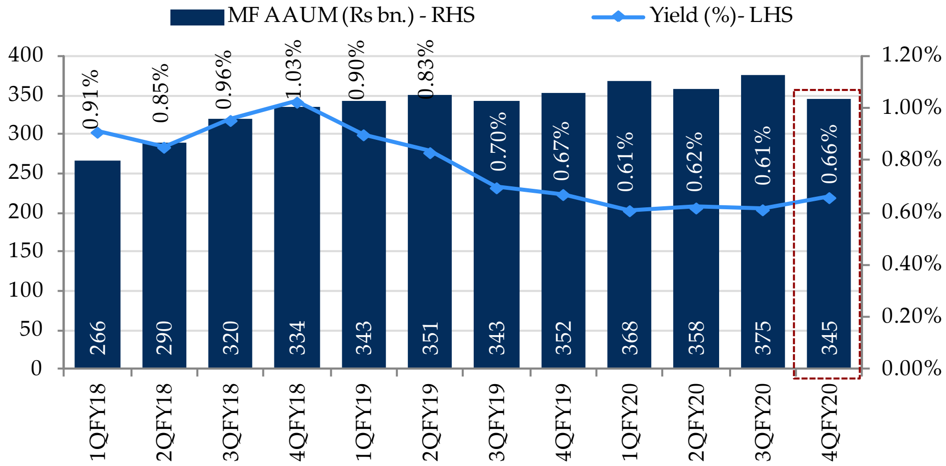
### Broking: ADTV and yields




Source: Company, HSIE Research

*Distribution yield improved in 4QFY20.*

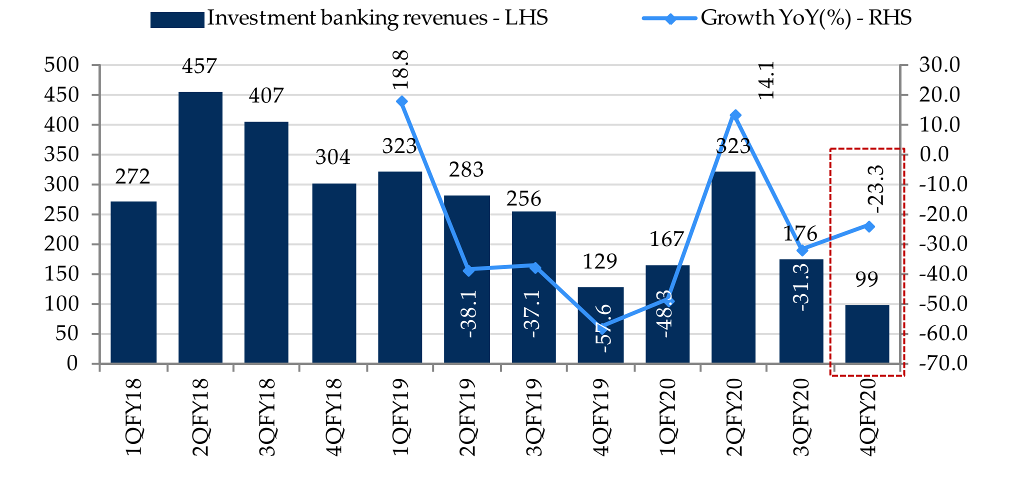
### MF AAUMs and yields




Source: Company, HSIE Research

*IB revenues were significantly below estimates.*

**Advisory revenues (Rs mn) and growth (%)**




Source: Company, HSIE Research

*We expect ISEC to seed ADTV market share, as competitive intensity continues to remain elevated, however with adoption of plans such as prime, market share decline will be limited.*

*We believe broking yields will continue to compress as more clients opt for prime/prepaid brokerage plans.*

*We have fine tuned our insurance distribution revenues factoring in higher distribution yields as evidenced in 4QFY20.*

*We believe MF distribution yields will improve as share of new flows increase within the book.*

## Assumptions

| Particulars | FY18 | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|
| Broking income | | | | | |
| **Total broking revenues** | **11,269** | **10,723** | **11,124** | **10,979** | **11,259** |
| Growth (%) | 33.4 | (4.8) | 3.7 | *(1.3)* | *2.5* |
| **Broking Revenues** | **10,243** | **9,328** | **9,476** | **9,278** | **9,294** |
| Growth (%) | 32.0 | (8.9) | 1.6 | *(2.1)* | *0.2* |
| I-sec ADTO | 372 | 533 | 764 | 779 | 877 |
| Growth (%) | 98.6 | 43.3 | 43.3 | *2.0* | *12.6* |
| Total market ADTO (ex-prop) | 4,184 | 6,271 | 9,670 | 9,863 | 11,244 |
| Calculated market share | 8.9% | 8.5% | 7.9% | 7.9% | 7.8% |
| Yield (bps) | 1.11 | 0.71 | 0.50 | 0.48 | 0.43 |
| Growth (%) | (33.5) | (36.2) | (29.1) | *(4.0)* | *(11.0)* |
| **Prime/other plan (fees)** | **NA** | **7** | **196** | **314** | **439** |
| Growth (YoY) % | NA | NA | 2,700.0 | *60.0* | *40.0* |
| **NII on margin funding book** | **297** | **373** | **382** | **294** | **313** |
| Avg. loan book (Rs mn.) | 5,184 | 5,285 | 8,001 | 8,401 | 9,493 |
| Growth (%) | 56.0 | 2.0 | 51.4 | *5.0* | *13.0* |
| **Interest on liened FD** | **729** | **1,022** | **1,070** | **1,094** | **1,212** |
| Assumed interest rate | 7.5% | 9.1% | 7.3% | 6.0% | 6.5% |
| Lien with exchanges | 11,759 | 10,604 | 18,694 | 17,759 | 19,535 |
| Growth (%) | 53.4 | (9.8) | 76.3 | *(5.0)* | *10.0* |
| **Distribution** | | | | | |
| **Total distribution revenues** | **4,675** | **4,635** | **4,031** | **3,876** | **4,430** |
| Growth (%) | 33.5 | (0.9) | (13.0) | *(3.9)* | *14.3* |
| **MF revenue (Rs mn.)** | **2,847** | **2,695** | **2,263** | **2,151** | **2,553** |
| Growth (%) | 71.8 | (5.3) | (16.0) | *(5.0)* | *18.7* |
| MF AAUM (Rs bn.) | 305 | 347 | 362 | 319 | 357 |
| Growth (%) | 43.9 | 13.8 | 4.3 | *-12.0* | *12.0* |
| Yield (%) | 0.93% | 0.78% | 0.63% | 0.68% | 0.72% |
| **Insurance dist. Revenue (Rs mn.)** | **460** | **474** | **490** | **511** | **566** |
| Growth (%) | (35.5) | 3.0 | 3.4 | *4.3* | *10.7* |
| Insurance Premium (Rs mn.) | 9,038 | 8,869 | 7,983 | 6,386 | 6,897 |
| Growth (%) | *7.7* | (1.9) | (10.0) | *(20.0)* | *8.0* |
| Yield (%) | 5.1% | 5.3% | 6.1% | 8.0% | 8.2% |
| **Other Dist. Revenue** | **1,368** | **1,466** | **1,278** | **1,214** | **1,311** |
| Growth (%) | 21.0 | 7.2 | (12.8) | *(5.0)* | *8.0* |
| **Investment Banking** | | | | | |
| Investment banking revenues | 1,430 | 991 | 764 | 779 | 842 |
| Growth (%) | 19.7 | (30.7) | (22.9) | *2.0* | *8.0* |
| **Other revenues** | **451** | **107** | **197** | **201** | **121** |
| Growth (%) | 56.4 | (76.3) | 84.5 | *2.0* | *(40.0)* |

Source: Company, HSIE Research

# Financials

## Profit and Loss Account

| (Rs mn) | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|---|---|---|
| **Net Revenues** | **11,467** | **10,672** | **13,429** | **17,824** | **16,456** | **16,116** | **15,835** | **16,651** |
| *Growth (%)* | *45.5%* | *-6.9%* | *25.8%* | *32.7%* | *-7.7%* | *-2.1%* | *-1.7%* | *5.2%* |
| Employee benefits expenses | 3,921 | 4,014 | 4,846 | 5,453 | 5,545 | 5,338 | 5,030 | 4,899 |
| Operating expenses | 1,045 | 1,015 | 1,290 | 1,683 | 1,226 | 1,024 | 1,045 | 1,082 |
| Other expenses | 2,158 | 2,058 | 2,244 | 2,260 | 2,327 | 1,881 | 1,636 | 1,669 |
| **EBITDA** | **4,343** | **3,586** | **5,049** | **8,427** | **7,358** | **7,873** | **8,124** | **9,001** |
| *EBITDA Margin (%)* | *37.9* | *33.6* | *37.6* | *47.3* | *44.7* | *48.9* | *51.3* | *54.1* |
| *EBITDA Growth (%)* | *182.4%* | *-17.4%* | *40.8%* | *66.9%* | *-12.7%* | *7.0%* | *3.2%* | *10.8%* |
| Depreciation | 163 | 160 | 155 | 153 | 150 | 614 | 604 | 624 |
| **EBIT** | **4,180** | **3,426** | **4,895** | **8,274** | **7,208** | **7,259** | **7,520** | **8,377** |
| Other Income (includes treasury ) | 386 | 372 | 277 | 289 | 183 | 546 | 243 | 240 |
| Interest & Financial Charges | 68 | 57 | (49) | 14 | 27 | 276 | 440 | 147 |
| **PBT** | **4,497** | **3,741** | **5,221** | **8,549** | **7,365** | **7,529** | **7,323** | **8,470** |
| Tax | 1,558 | 1,354 | 1,835 | 2,971 | 2,592 | 1,908 | 1,845 | 2,134 |
| **APAT** | **2,939** | **2,387** | **3,386** | **5,577** | **4,773** | **5,622** | **5,477** | **6,335** |
| *APAT Growth (%)* | *229.5%* | *-18.8%* | *41.8%* | *64.7%* | *-14.4%* | *17.8%* | *-2.6%* | *15.7%* |
| **RPAT** | **2,939** | **2,387** | **3,386** | **5,577** | **4,908** | **5,420** | **5,477** | **6,335** |
| *RPAT Growth (%)* | *229.5%* | *-18.8%* | *41.8%* | *64.7%* | *-12.0%* | *10.4%* | *1.1%* | *15.7%* |
| **AEPS** | **9.1** | **7.4** | **10.5** | **17.3** | **14.8** | **17.5** | **17.0** | **19.7** |
| *EPS Growth (%)* | *252.1%* | *-18.8%* | *41.8%* | *64.7%* | *-14.4%* | *17.8%* | *-2.6%* | *15.7%* |

## Balance Sheet

| (Rs mn) | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|---|---|---|
| SOURCES OF FUNDS | | | | | | | | |
| Share Capital | 1,611 | 1,611 | 1,611 | 1,611 | 1,611 | 1,611 | 1,611 | 1,611 |
| Reserves | 1,912 | 2,371 | 3,285 | 6,866 | 8,862 | 10,485 | 12,027 | 14,528 |
| **Total Shareholders' Funds** | **3,523** | **3,982** | **4,896** | **8,477** | **10,473** | **12,095** | **13,638** | **16,139** |
| Long-term Debt | - | - | - | - | - | 1,574 | 1,257 | 903 |
| Short-term Debt | 2,265 | 1,729 | 3,954 | 6,724 | 4,473 | 14,975 | 10,000 | 10,500 |
| **Total Debt** | **2,265** | **1,729** | **3,954** | **6,724** | **4,473** | **16,550** | **11,257** | **11,403** |
| Other Financial Liabilities & Provisions | 202 | 310 | 389 | 535 | 705 | 829 | 887 | 949 |
| Other Non Current Liabilities | 525 | 628 | 827 | 5,210 | 5,286 | 5,311 | 5,683 | 6,081 |
| Net Deferred Tax Liability | (387) | (509) | (578) | (666) | (738) | (596) | (607) | (620) |
| **TOTAL SOURCES OF FUNDS** | **6,128** | **6,139** | **9,488** | **20,279** | **20,199** | **34,189** | **30,857** | **33,952** |
| **APPLICATION OF FUNDS** | | | | | | | | |
| **Net Block** | **348** | **354** | **346** | **382** | **436** | **1,980** | **2,213** | **2,347** |
| CWIP | 37 | 24 | 28 | 39 | 40 | 81 | 33 | 33 |
| Loans & Deposits | 1,147 | 1,293 | 1,362 | 1,828 | 1,246 | 1,183 | 1,194 | 1,206 |
| Other Non Current Assets | - | - | - | - | - | - | - | - |
| **Total Non-current Assets** | **1,532** | **1,671** | **1,737** | **2,249** | **1,722** | **3,244** | **3,440** | **3,586** |
| Liened FDs (ST + LT) | 7,883 | 6,412 | 8,450 | 13,689 | 12,645 | 18,694 | 17,759 | 19,535 |
| Debtors | 1,731 | 2,933 | 7,101 | 3,101 | 4,770 | 888 | 868 | 912 |
| Cash & Equivalents | 821 | 264 | 1,206 | 1,770 | 18,841 | 5,420 | 1,850 | 2,011 |
| Loans & Advances | 310 | 254 | 359 | 5,822 | 4,061 | 5,733 | 9,978 | 10,949 |
| Other Current Assets | 963 | 1,932 | 1,045 | 1,442 | 3,870 | 9,854 | 4,302 | 4,429 |
| **Total Current Assets** | **11,709** | **11,795** | **18,160** | **25,824** | **44,187** | **40,589** | **34,757** | **37,836** |
| Creditors | 5,569 | 5,925 | 8,699 | 6,117 | 23,362 | 6,926 | 6,016 | 6,169 |
| Other Current Liabilities | 1,545 | 1,402 | 1,710 | 1,677 | 2,347 | 2,717 | 1,325 | 1,302 |
| Total Current Liabilities | **7,114** | **7,328** | **10,409** | **7,794** | **25,709** | **9,643** | **7,341** | **7,471** |
| Net Current Assets | **4,596** | **4,468** | **7,751** | **18,031** | **18,478** | **30,946** | **27,417** | **30,365** |
| **TOTAL APPLICATION OF FUNDS** | **6,128** | **6,139** | **9,488** | **20,279** | **20,199** | **34,189** | **30,857** | **33,952** |

Source: Company, HSIE Research

## Cash Flow

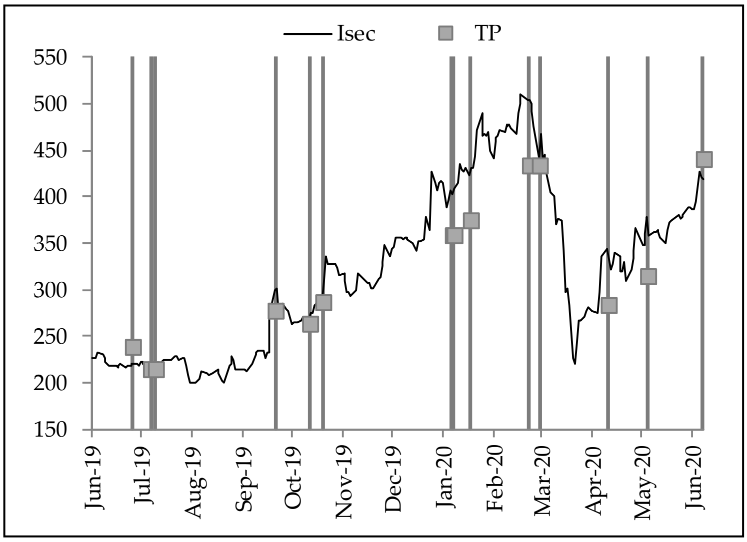
| (Rs mn) | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|---|---|---|
| **Reported PBT** | **4,497** | **3,741** | **5,220** | **8,524** | **7,572** | **7,529** | **7,323** | **8,470** |
| Non-operating & EO Items | (77) | 22 | 5 | 164 | 130 | 196 | - | - |
| Interest Expenses | 304 | 251 | 277 | 483 | 413 | 707 | 440 | 147 |
| Depreciation | 163 | 160 | 155 | 153 | 150 | 614 | 604 | 624 |
| Working Capital Change | (1,034) | 776 | (3,120) | (5,324) | 19,738 | (19,991) | (5,775) | (3,104) |
| Tax Paid | (1,579) | (1,553) | (1,986) | (3,221) | (2,925) | (2,051) | (1,845) | (2,134) |
| **OPERATING CASH FLOW ( a )** | **2,274** | **3,397** | **551** | **780** | **25,077** | **(12,995)** | **747** | **4,002** |
| Net Capex | (199) | (165) | (154) | (216) | (208) | (226) | (317) | (300) |
| (Purchase)/sale of net operating financial assets | - | - | (16) | 6 | - | - | - | - |
| Free Cash Flow (FCF) | 2,074 | 3,232 | 382 | 569 | 24,869 | (13,222) | 430 | 3,702 |
| Investments | 1,027 | (1,075) | 1,102 | (69) | (2,183) | (5,788) | 5,351 | (60) |
| Non-operating Income | | | | | | | | |
| **INVESTING CASH FLOW ( b )** | **828** | **(1,240)** | **932** | **(279)** | **(2,391)** | **(6,014)** | **5,034** | **(360)** |
| Debt Issuance/(Repaid) | (906) | (537) | 2,226 | 2,754 | (2,264) | 10,079 | (4,975) | 500 |
| Interest Expenses | (304) | (251) | (277) | (466) | (400) | (626) | (440) | (147) |
| FCFE | 865 | 2,444 | 2,331 | 2,857 | 22,205 | (3,769) | (4,986) | 4,055 |
| Proceeds From Issue of Share Capital | | | | | | | | |
| Dividend | (2,105) | (1,927) | (2,490) | (2,224) | (2,951) | (3,865) | (3,935) | (3,834) |
| Others | - | - | - | - | - | - | - | - |
| **FINANCING CASH FLOW ( c )** | **(3,315)** | **(2,715)** | **(541)** | **64** | **(5,615)** | **5,588** | **(9,351)** | **(3,481)** |
| **NET CASH FLOW (a+b+c)** | **(214)** | **(557)** | **942** | **564** | **17,071** | **(13,421)** | **(3,570)** | **161** |
| Opening Cash & Equivalents | 1,035 | 821 | 264 | 1,206 | 1,770 | 18,841 | 5,420 | 1,850 |
| **Closing Cash & Equivalents** | **821** | **264** | **1,206** | **1,770** | **18,841** | **5,420** | **1,850** | **2,011** |

## Key Ratios

| | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21E | FY22E |
|---|---|---|---|---|---|---|---|---|
| **PROFITABILITY (%)** | | | | | | | | |
| EBITDA Margin | 37.9 | 33.6 | 37.6 | 47.3 | 44.7 | 48.9 | 51.3 | 54.1 |
| EBIT Margin | 36.5 | 32.1 | 36.4 | 46.4 | 43.8 | 45.0 | 47.5 | 50.3 |
| APAT Margin | 25.6 | 22.4 | 25.2 | 31.3 | 29.8 | 33.6 | 34.6 | 38.0 |
| RoE | 97.7 | 63.6 | 76.3 | 83.4 | 50.4 | 49.8 | 42.6 | 42.6 |
| Core RoCE | 33.3 | 25.4 | 35.9 | 42.0 | 30.0 | 24.7 | 19.6 | 21.2 |
| RoCE | 32.7 | 26.4 | 35.0 | 39.0 | 18.5 | 17.1 | 17.9 | 20.5 |
| **EFFICIENCY** | | | | | | | | |
| Tax Rate (%) | 34.6 | 36.2 | 35.1 | 34.8 | 35.2 | 25.3 | 25.2 | 25.2 |
| Asset Turnover (x) | 32.9 | 30.4 | 38.3 | 48.9 | 40.2 | 13.3 | 7.6 | 7.3 |
| Inventory (days) | | | | | | | | |
| Debtors (days) | *55* | *100* | *193* | *64* | *106* | *20* | *20* | *20* |
| Other Current Assets (days) | *281* | *246* | *259* | *421* | *400* | *587* | *669* | *698* |
| Payables (days) | *251* | *302* | *376* | *198* | *795* | *227* | *200* | *200* |
| Other Current Liab & Prov (days) | *50* | *49* | *48* | *34* | *53* | *62* | *30* | *30* |
| Working Capital (days) | 34 | -5 | 29 | 252 | -343 | 319 | 459 | 488 |
| Debt/EBITDA (x) | 0.52 | 0.48 | 0.78 | 0.80 | 0.61 | 2.10 | 1.39 | 1.27 |
| Net D/E | 0.4 | 0.4 | 0.6 | 0.6 | (1.4) | 0.9 | 0.7 | 0.6 |
| Interest Coverage | 61.1 | 60.6 | (100.4) | 574.1 | 271.7 | 26.3 | 17.1 | 57.0 |
| **PER SHARE DATA** | | | | | | | | |
| AEPS (Rs/sh) | 9.1 | 7.4 | 10.5 | 17.3 | 14.8 | 17.5 | 17.0 | 19.7 |
| CEPS (Rs/sh) | 9.6 | 7.9 | 11.0 | 17.8 | 15.3 | 19.4 | 18.9 | 21.6 |
| DPS (Rs/sh) | 5.0 | 5.0 | 6.4 | 5.5 | 9.4 | 11.0 | 12.2 | 11.9 |
| BV (Rs/sh) | 10.9 | 12.4 | 15.2 | 26.3 | 32.5 | 37.5 | 42.3 | 50.1 |
| **VALUATION** | | | | | | | | |
| P/E | 45.8 | 56.4 | 39.8 | 24.1 | 28.2 | 24.0 | 24.6 | 21.3 |
| P/BV | 38.2 | 33.8 | 27.5 | 15.9 | 12.9 | 11.1 | 9.9 | 8.3 |
| EV/EBITDA | 32.2 | 38.8 | 27.5 | 16.9 | 18.9 | 19.3 | 18.4 | 16.6 |
| OCF/EV (%) | 1.4 | 2.3 | 0.3 | 0.4 | 18.0 | (8.8) | 0.4 | 2.6 |
| FCF/EV (%) | 1.5 | 2.3 | 0.3 | 0.4 | 17.9 | (8.7) | 0.3 | 2.5 |
| FCFE/MCAP (%) | 0.6 | 1.8 | 1.7 | 2.1 | 16.5 | (2.8) | (3.7) | 3.0 |
| Dividend Yield (%) | 1.2 | 1.2 | 1.5 | 1.3 | 2.2 | 2.6 | 2.9 | 2.8 |

Source: Company, HSIE Research

## RECOMMENDATION HISTORY




| Date | CMP | Reco | Target |
|---|---|---|---|
| 28-Jun-19 | 218 | NEU | 240 |
| 9-Jul-19 | 216 | NEU | 216 |
| 13-Jul-19 | 219 | NEU | 216 |
| 22-Sep-19 | 273 | NEU | 279 |
| 14-Oct-19 | 266 | NEU | 265 |
| 23-Oct-19 | 287 | NEU | 288 |
| 9-Jan-20 | 403 | SELL | 360 |
| 11-Jan-20 | 408 | SELL | 360 |
| 21-Jan-20 | 424 | SELL | 376 |
| 25-Feb-20 | 505 | SELL | 435 |
| 2-Mar-20 | 476 | SELL | 435 |
| 11-Apr-20 | 335 | SELL | 285 |
| 8-May-20 | 378 | SELL | 316 |
| 10-Jun-20 | 418 | ADD | 442 |

From 2nd March 2020, we have moved to new rating system

**Rating Criteria**

BUY: >+15% return potential
ADD: +5% to +15% return potential
REDUCE: -10% to +5% return potential
SELL: > 10% Downside return potential

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