FinTech Playbook: Discount Brokers

Oct 20, 2021

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Discount Brokers

'Nudging' the long tail of standalone brokers

With a pure broking revenue pool of >INR85bn, discount brokers, the "no-frills" challengers of the broking industry, are poised for a 10-percentage point (pps) increase in revenue market share (RMS) to 37% by FY25 on the back of their massive share of wallet in the increasingly relevant millennial population and rising mix of app-based trading. Given the current industry structure (low entry barriers, rising costs of compliance, and high competitive intensity), our analysis suggests that a bulk of the RMS gains would accrue from traditional brokers, especially the long tail of standalone brokers. We construct and introduce our proprietary wallet share quotient (HSIE-WSQ) to demonstrate that discount brokers have a decent 26% share of this wallet and have established a firm right-to-win (RTW) with this segment of consumers. Basis the results from our in-house survey and discussions with practitioners, we outline 13 vectors across four categories to construct our proprietary HSIE-RTW Quotient, a framework to help identify dominant franchises with an indisputable right-to-win. Finally, we outline a couple of potential endgames that are likely to shape the discount broking industry over the next 4-5 years.

- **Revenue pool to grow 2x by FY25; discount brokers slated for 37% RMS:** Amidst a doubling of the overall broking revenue pool (INR230bn), discount broking revenues (pure broking) are expected to grow 2.8x to INR85bn by FY25 on the back of rising demat penetration (FYTD monthly demat adds at 6x vs. FY20), calibrated consolidation of pricing power, continued buoyancy in capital markets and the advent of highly-convenient app-based trading. Our analysis implies a 37% RMS for discount brokers within the overall pure broking revenue pool from an estimated RMS of 27% in FY21.
- **Discount brokers dominate share of millennials' wallet:** Given the rising significance of millennials (~400mn, 34% of India's adult population and nearly 50% of working population), it is crucial for capital market firms to understand their investment habits. We estimate that millennials currently contribute ~14% of the total equity wallet. We construct and introduce our proprietary wallet share quotient (HSIE-WSQ) to demonstrate that discount brokers have a dominant 61% share of this wallet and have established a firm Right-To-Win (RTW) within this segment of consumers. However, as millennial incomes and aspirations grow over the next decade, over 10mn NTM (new to market) clients will be up for grabs for bank-led brokers.
- **Constructing the HSIE-RTW Quotient:** Basis our discussions with global as well as domestic industry practitioners and consultants and our proprietary survey results (N > 50), we list 13 vectors to construct the HSIE-RTW (right-to-win) Quotient, a framework to identify the secret sauce for a dominant discount broking franchise. These vectors are classified under four pillars: (a) user interface (UI / UX); (b) platform responsibility index; (c) quality of customer franchise; and (d) product/service breadth for potential upsell.
- **Investment implications:** Despite a work-in-progress tech interface, we identify ICICI Securities (ISEC) as the "franchise to beat" on the back of its early efforts on the open-architecture client acquisition funnel. We maintain ADD with a TP of INR975 (24x Sep'23 EPS). On the other hand, Angel Broking (NOT RATED) appears to have solved for the user interface but now needs to graduate towards building a quality customer franchise.

Company	MCap (INR bn)	CMP (INR)	Reco.	TP (INR)
ISEC	257	797	ADD	975
MOFS	131	896	REDUCE	952
ANGELBRKG	115	1,398	NR	NA

DID YOU KNOW? *Barpeta, a city in Assam, with a population of just 1.9mn (1/4th of Hyderabad, 1/5th of Ahmedabad and 1/3rd of Surat) has beaten Hyderabad, Ahmedabad and Surat in terms of new investor additions in May'21.*

DID YOU KNOW? *Discount brokers account for an estimated 27% revenue market share, despite accounting for 49% of active clients.*

DID YOU KNOW? *UPSTOX has increased its delivery fee from "Nil" to INR20.*

DID YOU KNOW? *Over 10mn new-to-market (NTM) investors are currently digital-native.*

DID YOU KNOW? *Industry interactions and walkthrough indicate that brokers have resorted to offering free ETFs to improve activation rates.*

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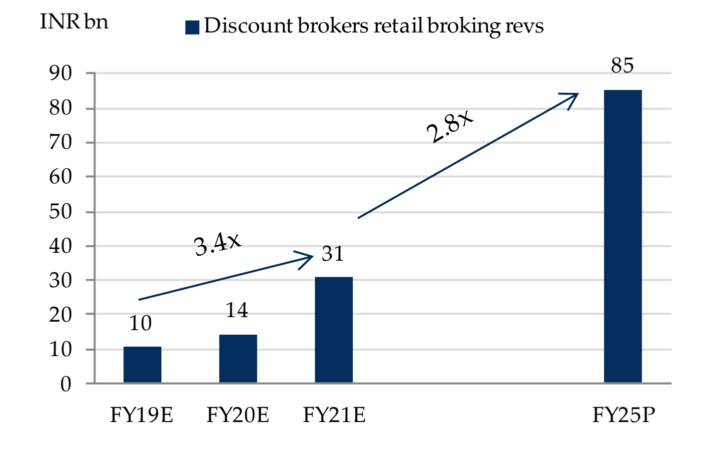
Focus charts

Exhibit 1: HSIE- RTW Quotient

	Zerodha	Upstox	ANGBRK	5Paisa	Paytm Money	Groww	ISEC	Motilal Oswal
Pillar I: UI/UX								
Clicks to trade (app)								
Clicks to trade (web)								
Clicks to IPO (on app)								
Downtime								
Service type								
Pillar II: Responsibility Index								
Nudges								
Educational platforms	✔	✔	✔	✔	✕	✔	✔	✔
Pillar III: Customer franchise								
CACs								
ARPUs								
Wallet-size								
Customer activation								
Customer additons								
Pillar IV: Cross-sell opportunity								

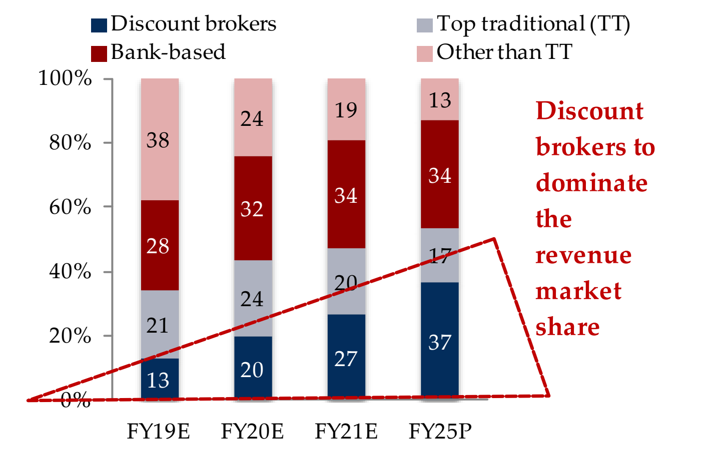
Source: Twitter, Companies, HSIE estimates, HSIE Research

Exhibit 2: Discount brokers- Pure broking revenues headed for a 2.8x jump by FY25



Note: Revenues for FY19, FY20 and FY21 involve estimates for some brokers.
Source: Companies, NSE, HSIE Research

Exhibit 3: Broking revenue market share (RMS) across broker categories



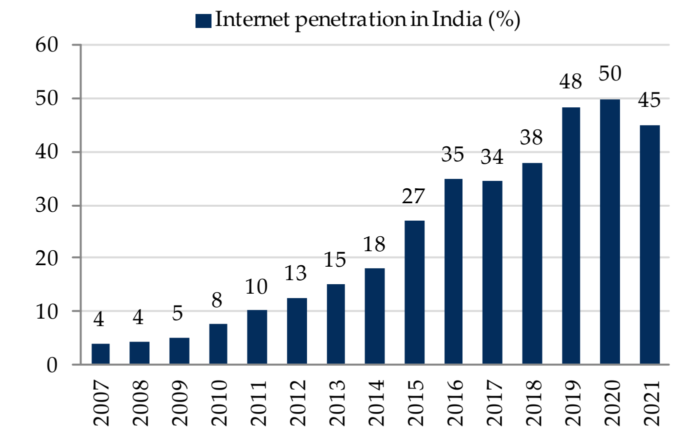
Note: Revenues represent pure broking revenues, Sample includes 17 companies from top 20 list and adjusted for estimated revenues from institutional equities business for bank-owned brokers and retail revenues of discount brokers.
Source: Companies, NSE, HSIE Research

Table of contents

Overall revenue pool headed for 2x jump by FY25

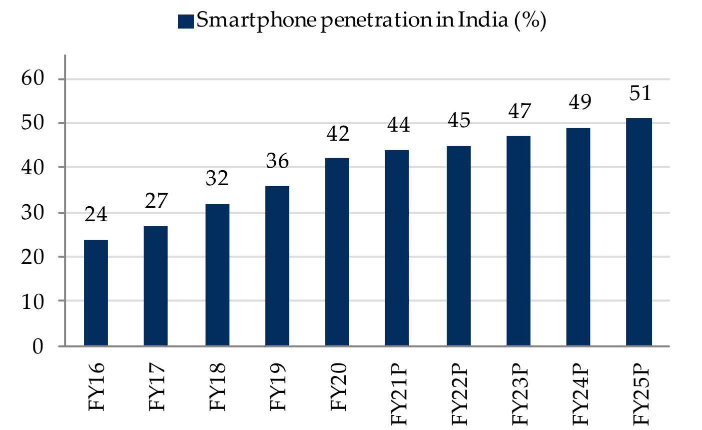
- Stock broking has undergone a radical change after digitisation (AADHAR based e-KYC led account opening by UIDAI) and demonetisation, paving the way for huge influx of population into the capital markets. The growing surge in smartphone users (driven by smartphones getting cheaper) along with increasing internet penetration has made it convenient for discount brokers to capitalise on the market opportunities and enable customers to trade online at a very low cost.
- Amongst other things such as record number of primary market issues in FY21 and FY22TD driving increased demat additions, the pandemic and low interest rates on conventional savings appear to have pushed people into exploring alternative asset classes, aside from traditional fixed income (bank deposits).

Exhibit 4: Internet penetration in India



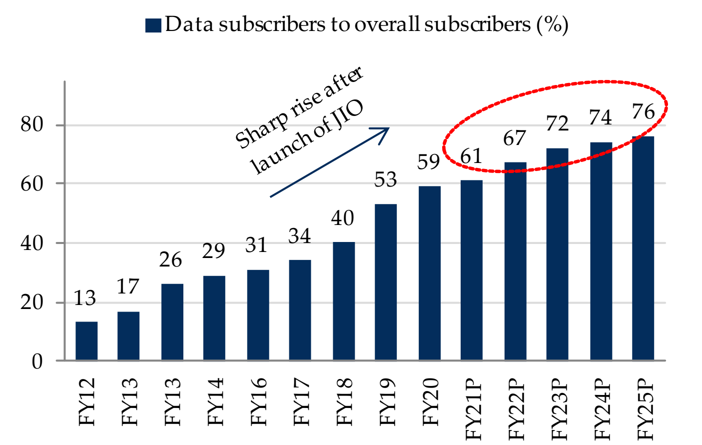
Source: Statista, HSIE Research

Exhibit 5: Rising smartphone penetration to drive DIY trading



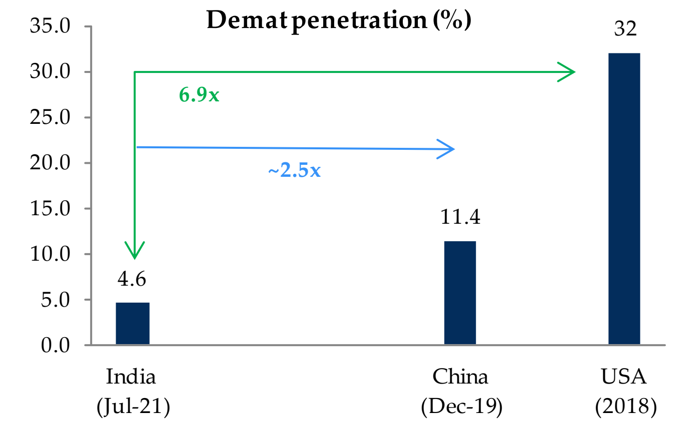
Note: For FY16 to FY20 numbers were sampled on March 20 of each financial year,
Source: Statista, HSIE Research

Exhibit 6: Cheap data plans has fuelled the data usage



Note: Numbers were sampled on March 20 of each financial year,
Source: Statista, HSIE Research

Exhibit 7: Significant opportunity in an underpenetrated market

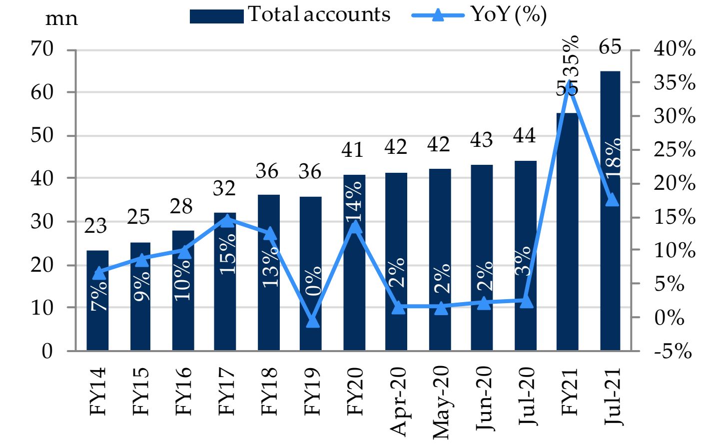


Source: Census, World Bank, CDSL, NSDL, CSDC, FINRA, NSE, **USA Data Source:** The National Financial Capability Study (NFCS) is a project of the FINRA Investor Education Foundation (FINRA Foundation), Angel Broking IP, HSIE Research

Despite record number of demat additions in the past 12-15 months (likely a secular uptick), demat penetration in India is still very low at 4.6% compared to other economies

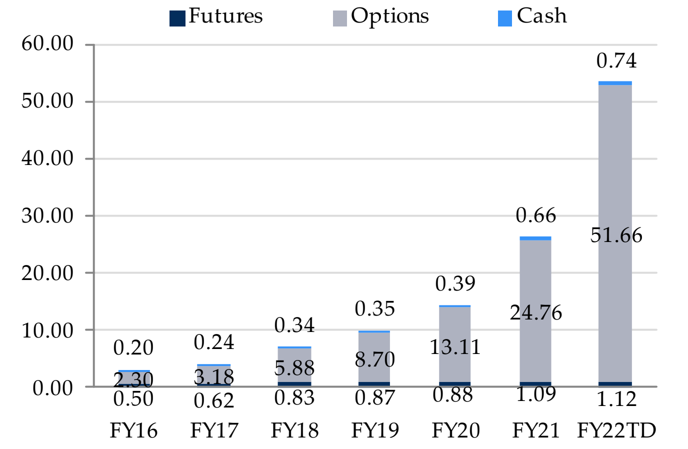
- Another key factor driving the growth of the discount brokerage industry is India's demographic profile; India has the largest working age population with millennials (those born between 1980 and 1996) accounting for 36% of the population and projected to be 50% of its workforce by 2025.
- Historically, Indians have invested their surplus in physical assets, real estate and FDs, refraining from investing in capital markets, **reflected in demat accounts as a percentage of PAN card holders at just 13%.**

Exhibit 8 : Pandemic has driven sharp uptick in demat accounts



Source: CDSL, NSDL, HSIE Research

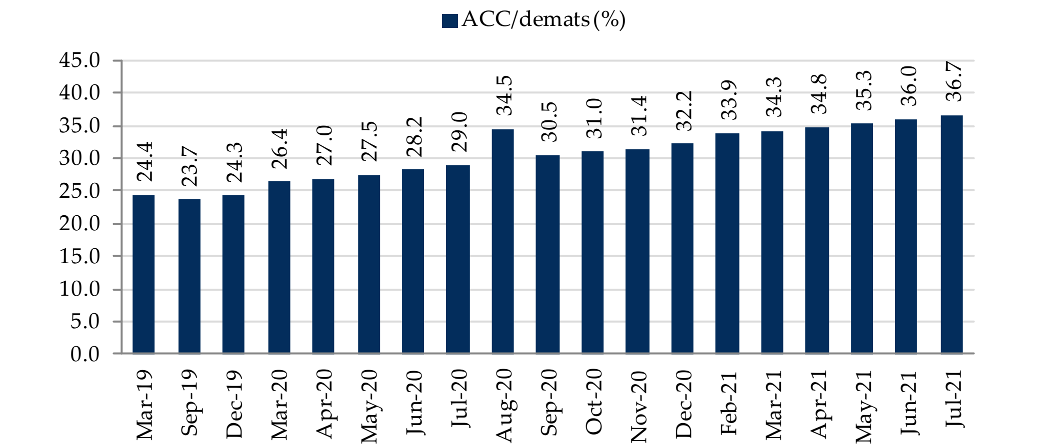
Exhibit 9: Sharp rise in industry ADTVs



Source: BSE, NSE, HSIE Research

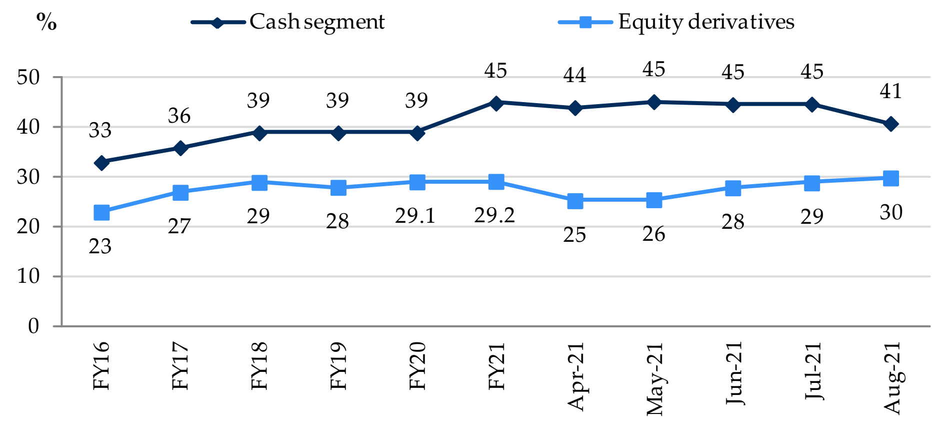
Industry interactions and walkthroughs indicate that brokers have resorted to offering free ETFs to improve activation rates

Exhibit 10: Improving NSE active clients activation rate



Source: CDSL, NSDL, NSE, HSIE Research

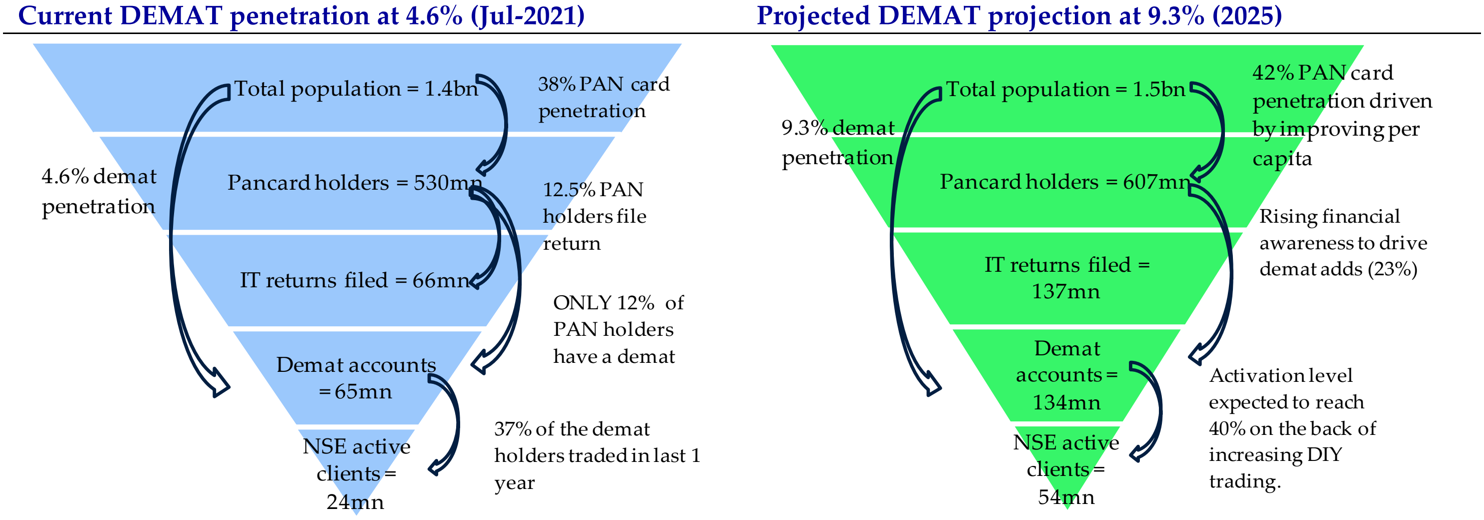
Exhibit 11: Improving individual participation in cash and derivative ADTVs



Note: This data pertains to NSE only.
Source: NSE, HSIE Research

- The medium-term Total Addressable Market (TAM) for the broking industry offers a canvas growing at its seams as total demat accounts are expected to double to 134mn by FY25 (22% CAGR over Jul-21 to FY25) on the back of rising proportion of working millennials, improving per capita GDP and disposable income, financial awareness and inclination towards alternate asset classes.

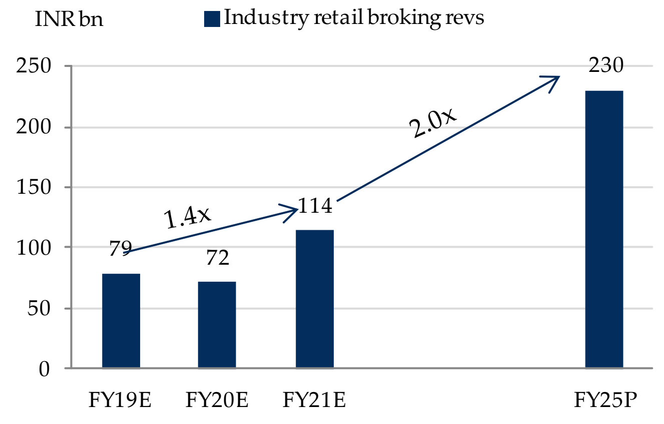
Exhibit 12: TAM: Significant growth opportunity



Source: Censusindia.gov.in, NSE, CDSL, NSDL, media reports, HSIE Research

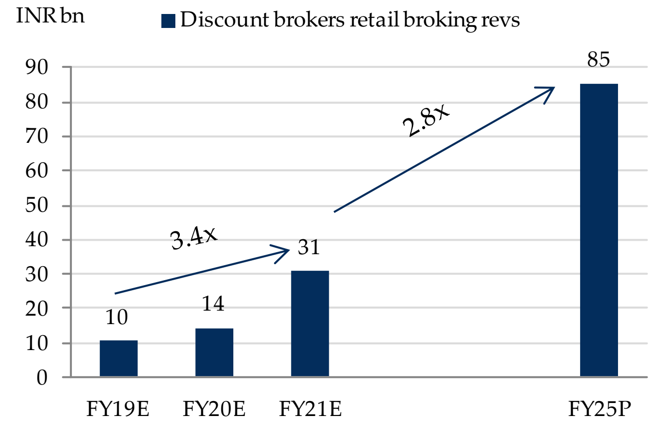
- While the demat count has exploded over the past 24m, the unit economics for the overall industry has witnessed compression, predominantly driven by pricing-led disruption by the discount brokers. However, we believe that a growing customer base, expanding wallet size, rising activation rates, and improving maturity of these N2M (new-to-market) customers will help offset the yield compression.
- **We believe that the pure broking revenue for the discount broking industry is set to grow ~2.8x over FY21-25E, albeit faster than the overall broking industry.**

Exhibit 13: Retail broking revenue to grow 2x over next 4 years



Note: Revenues for FY19, FY20 and FY21 involve estimates for some brokers. Sample involves 17 of top 20 brokers.
Source: Companies, NSE, HSIE Research

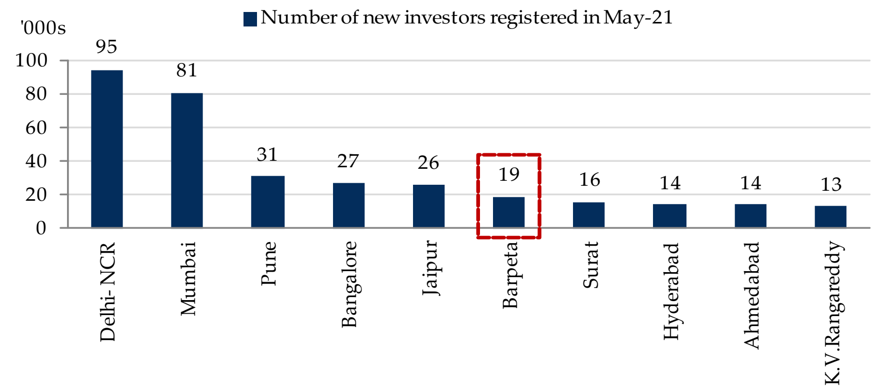
Exhibit 14: Discount brokers: Headed for a 2.8x jump by FY25



Note: Revenues for FY19, FY20 and FY21 involve estimates for some brokers.
Source: Companies, NSE, HSIE Research

Barpeta city in Assam with a population of just 1.9mn (1/4th of Hyderabad, 1/5th of Ahmedabad and 1/3rd of Surat) has beat Surat, Hyderabad and Ahmedabad in terms of new investor additions

Exhibit 15: Top 10 districts in terms of new investors



Source: NSE, HSIE Research

Changing landscape in favour of discount brokers

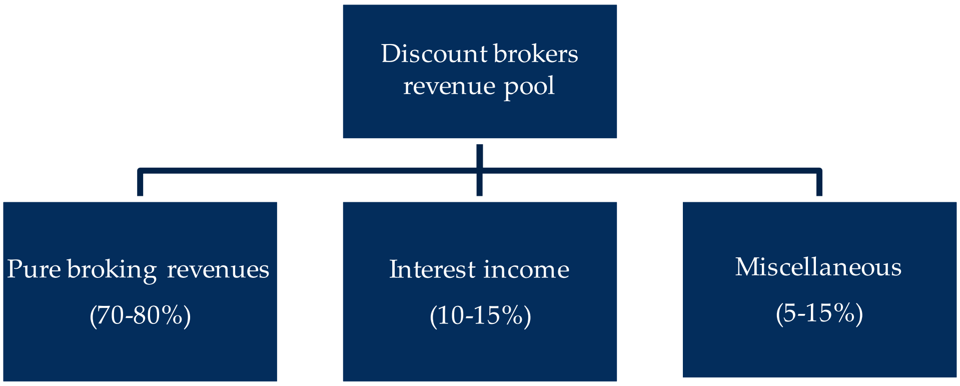
Understanding the revenue model

Full-service brokerages work on 80-20 Pareto principle, whereas discount brokers' revenues are more evenly distributed.

- Discount brokers charge an abysmally low fee on a per order basis. Broadly, brokerage charges are more or less in the same range for major discount brokers. i.e.,
  - Intra-day trades: INR10-20/order or 0.01% of trade value (WEL)
  - Delivery trades: Nil (free) for most discount brokers
- Pure broking revenue is a function of number of orders executed and broking charges (flat fee). Given that brokerage charges are flat, top line growth will be driven by increasing average volumes per active customer and customer additions.
- Despite a race to the bottom on the pricing front, the overall opportunity remains significantly under-penetrated with low entry barriers, thereby allowing sporadic bursts of deep-pocketed new challengers in this space. As a result, the predatory pricing environment is likely to sustain over the medium-term. However, a superior and seamless customer experience is a non-negotiable when it comes to driving long-term growth.

Exhibit 16: Revenue mix for a discount broker

Lifetime for a super-active customer at Zerodha is 3-6 months.



Source: HSIE Research

- The quality of pure broking APRUs for a full-service broker is significantly superior to that of discount brokers because of (i) higher customer wallet size and (ii) higher brokerage charges paid for additional value added services. However, given the pace at which the industry is adding N2M investors, the ARPU on ACC basis is sliding down due to lower ARPUs from this N2M cohort.

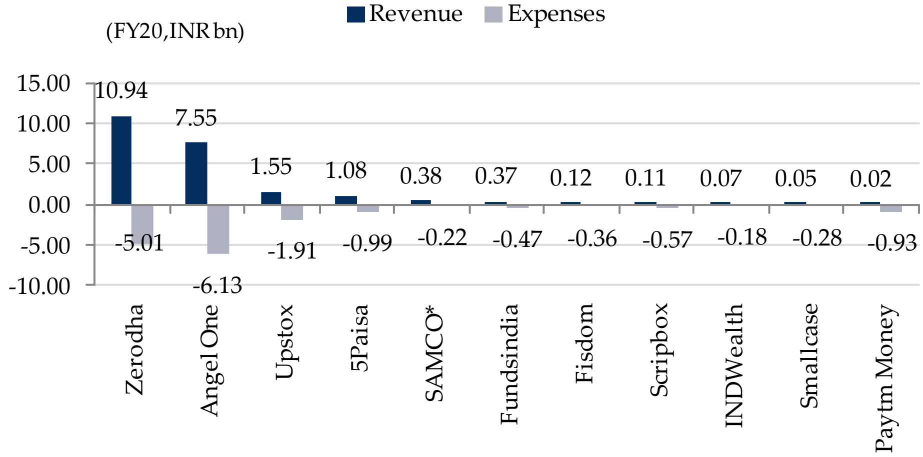
Exhibit 17: Retail broking ARPUs have been under pressure

INR/ACC	FY16	FY17	FY18	FY19	FY20	FY21
ISEC	10,832	11,351	11,491	9,660	7,581	8,510
KSEC	20,844	24,395	22,104	17,844	14,399	16,329
AXIS Sec	5,738	5,600	4,214	3,807	3,311	6,062
Angel Broking	18,392	15,613	13,157	12,146	8,742	5,814
5Paisa	NA	4,521	4,199	5,100	1,679	1,427
Geojit	9,487	11,541	12,189	11,429	10,809	13,621
IIFL Securities	NA	11,935	12,549	11,221	9,795	10,414

Note: KSEC retail revenues are adjusted for estimated institutional equities revenues
Source: Companies, HSIE Research

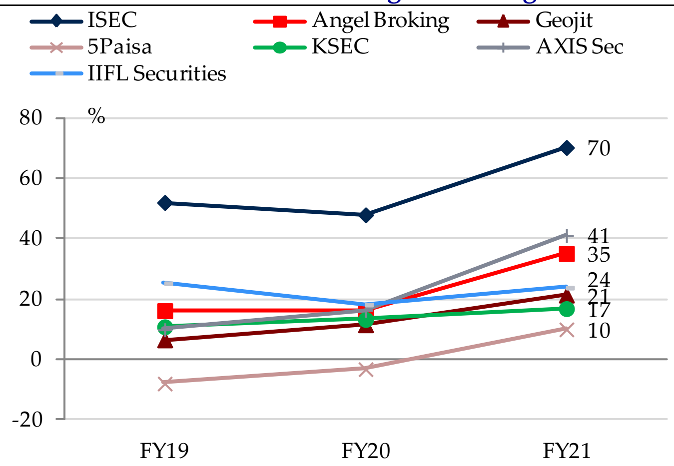
- **Interest income:** Interest income on client funding forms ~10-15% of revenues and offers an offset to the inherent lumpiness in broking income. This is a valuable proposition for brokers since they earn net yields of ~8-10% on this book.
- Almost all new-age FinTech brokers (Zerodha, Upstox, Groww, Paytm Money, etc.) offer margin only on intraday trades, whereas traditional and bank-based brokers offer margin funding for both intraday and delivery trades.
- Despite being a capital light business, high CACs (customer acquisition costs) incurred by new-age FinTech brokers have resulted in losses for most companies. We anticipate that these costs will decline as the industry reaches maturity, and that operating leverage will drive profitability.

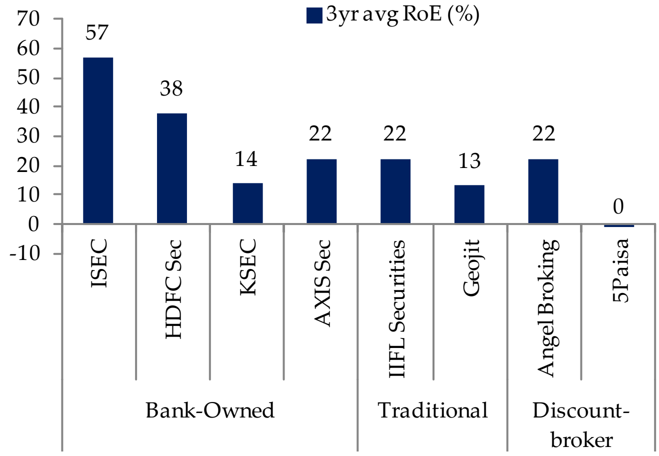
Exhibit 18: Most FinTech brokers are in cash-burn mode



Note: Data pertains to FY20 except for SAMCO (FY19). Revenue less expenses equals EBITDA.
Source: Companies, HSIE Research

Exhibit 19: Bank-owned brokers generate higher RoEs compared to discount brokers





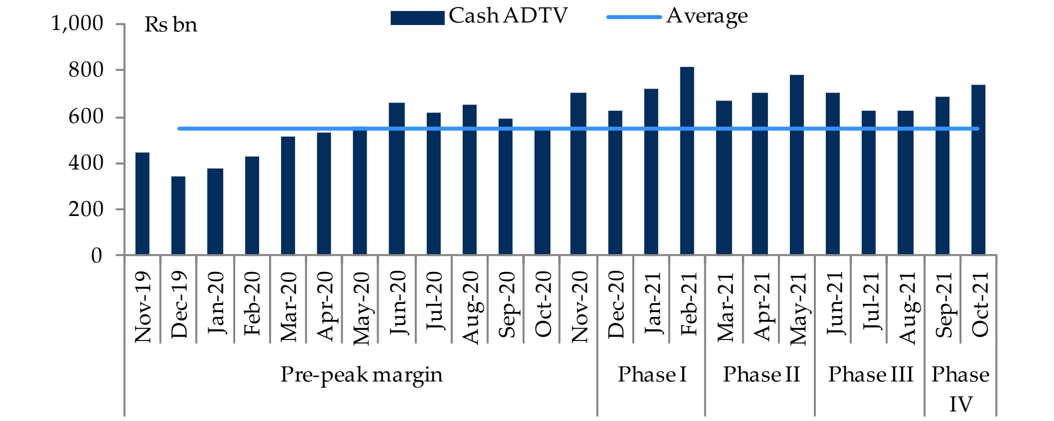
Note: HSIE Research operates under the HDFC securities legal entity
Source: Companies, HSIE Research

Discount brokers to capture 37% RMS by FY25

- The Indian broking industry is fairly fragmented with 943 registered brokers on NSE (Source: SEBI), albeit only 163 brokers have active clients. Also, of these 163 brokers, the active clients are further skewed, reflecting in the top 10 brokers accounting for 75% of the active clients.
- With new regulations that curb excess leverage, coupled with yield compression in the industry, we believe that it will be difficult for small brokers to survive and the broking industry will undergo further consolidation.

Cash volumes have remained healthy despite the implementation of peak margin norms

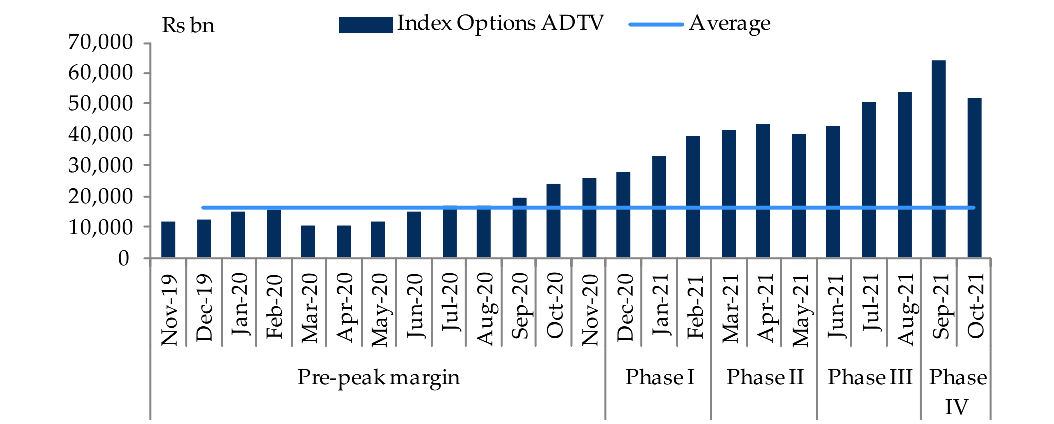
Exhibit 20: Minimal impact on Cash ADTVs



Note: Average is TTM pre implementation of peak margin, Oct-21 is till 14-10-21
Source: NSE, HSIE Research

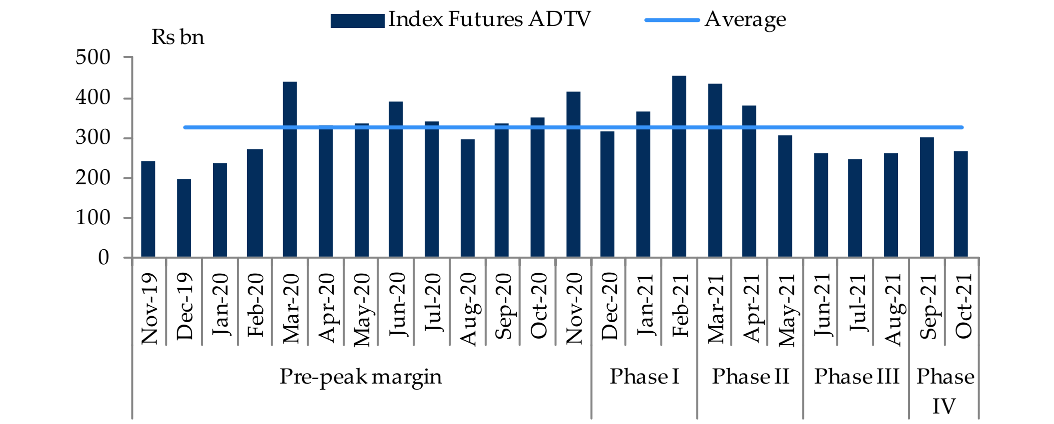
Volumes have moved from futures towards options due to lower leverage in futures and higher leverage in OTM options

Exhibit 21: Futures volume shifting towards Options



Note: Average is TTM pre implementation of peak margin, Oct-21 is till 14-10-21
Source: NSE, HSIE Research

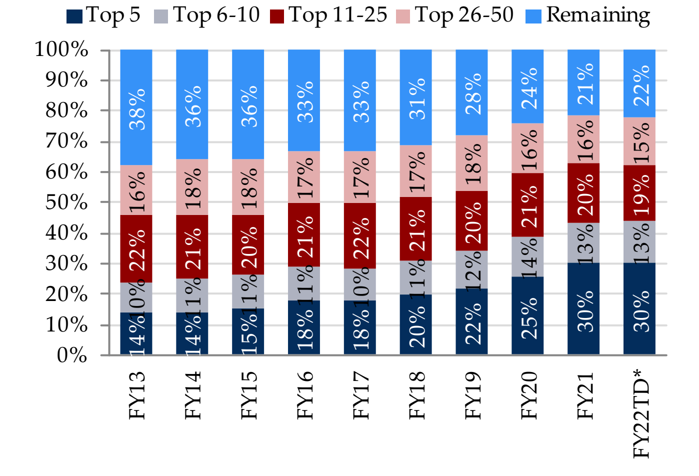
Exhibit 22: Futures volumes significantly impacted



Note: Average is TTM pre implementation of peak margin, Oct-21 is till 14-10-21
Source: NSE, HSIE Research

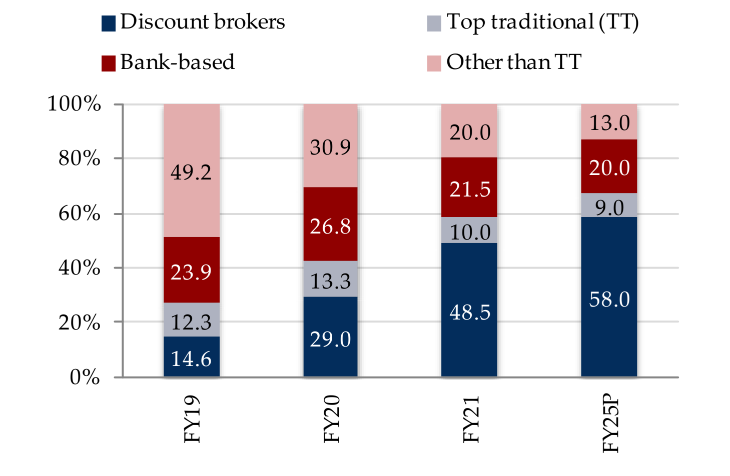
- Since FY17, broking volumes have rapidly concentrated towards the top-5 brokers, with below 25 players ceding the major market share. This is quite evident in the revenue market share movement in further charts.

Exhibit 23: ADTO market share: Top 10 players gaining market share



Source: SEBI, HSIE Research

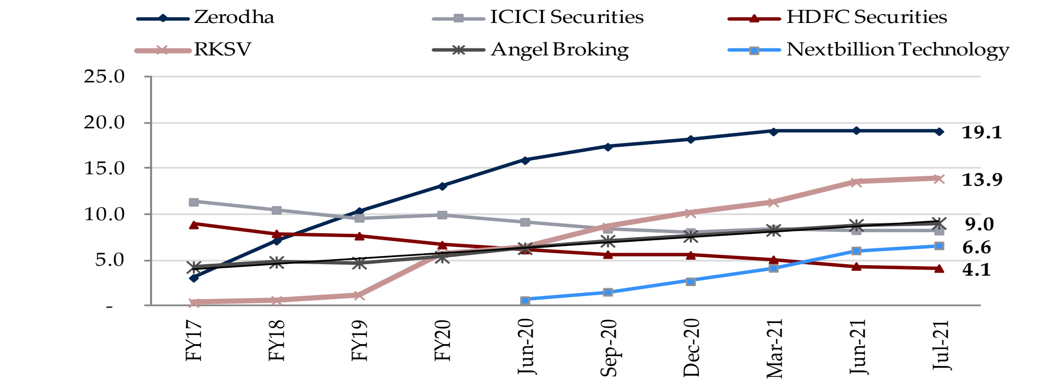
Exhibit 24: ACC market-share: Discounters expected to race ahead of traditional and bank-based brokers



Source: NSE, HSIE Research

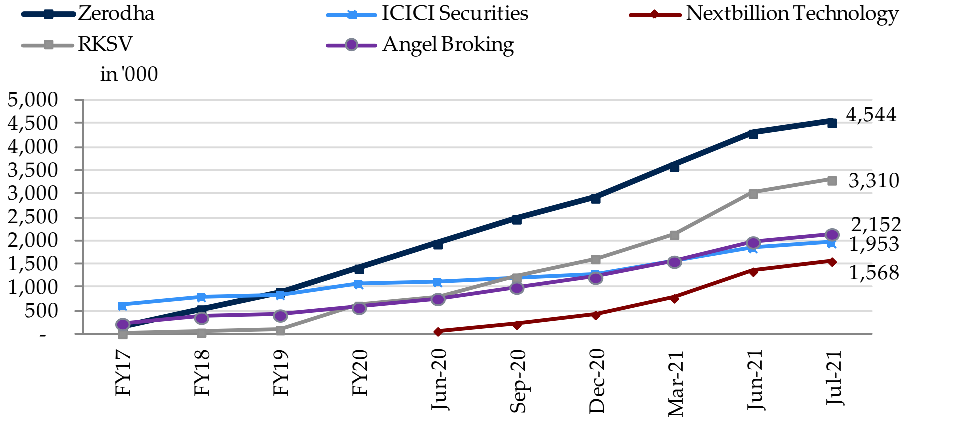
- Of the top 5 brokers in India (in terms of ACC), 4 are discount brokers and one is bank-owned (ISEC). Until FY17, ISEC commanded the highest market share (11%).
- Groww (Nextbillion Technology), one of the top 5 brokers, commenced its broking business in Jun-20 with a flat fee plan, and entered top 10 in just seven months and top 5 in just 12 months.
- In this cyclical uptick witnessed in FY21 and FY22TD, discount brokers have added ~75% of incremental customers, demonstrating the preferences of new-to-market (NTM) clients.

Exhibit 25: Active client market share of top 5 brokers in India (inc. HSL)



Note: HSIE Research operates under the HDFC securities legal entity
Source: NSE, HSIE Research

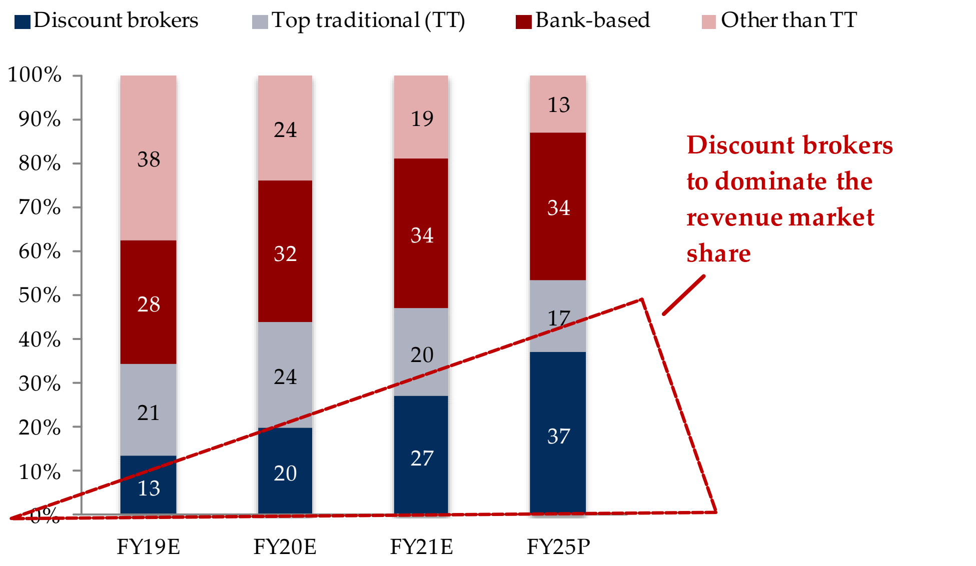
Exhibit 26: NSE active clients: 4 of the top 5 brokers are discount brokers



Source: NSE, HSIE Research

Exhibit 27: Broking revenue market share

Bank-owned and traditional brokers have been able to maintain their pricing on cash equities because of the "TRUST" factor



Note: Revenues represent pure broking revenues, Sample includes 17 companies from top 20 list and revenues from institutional equities for bank-owned brokers and retail revenues of some discount brokers is estimated

Source: Companies, NSE, HSIE Research

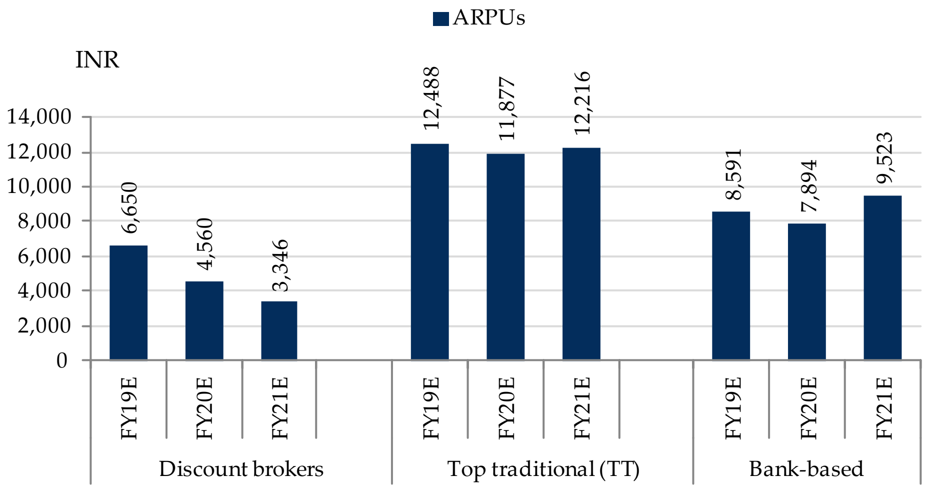
Cash equities contribute to 60-70% of the pure broking revenue for full-service brokers

- For the purpose of this exercise, we have categorised brokers into four sub-sets i.e., (1) bank-owned (AXSEC, HSL, ISEC, KSEC and SBICAP), (2) discount brokers (ANGELBRK, 5Paisa, Zerodha, Upstox, etc.), (3) top-traditional brokers (Motilal Oswal, Geojit, IIFLSEC, etc.) and (4) other standalone brokers.

- Our analysis suggests that despite discount brokers commanding a higher ACC market share of 29/49% in FY20/FY21, revenue market share (RMS) has been disproportionately lower at 20/27% respectively. This is primarily because of lower ARPUs compared to bank-owned and traditional brokers.

Despite ACC market share of discount brokers at 48%, revenue market share is at 27% in FY21E, indicating lower ARPUs for discount brokers

Exhibit 28: ARPUs across broker classes

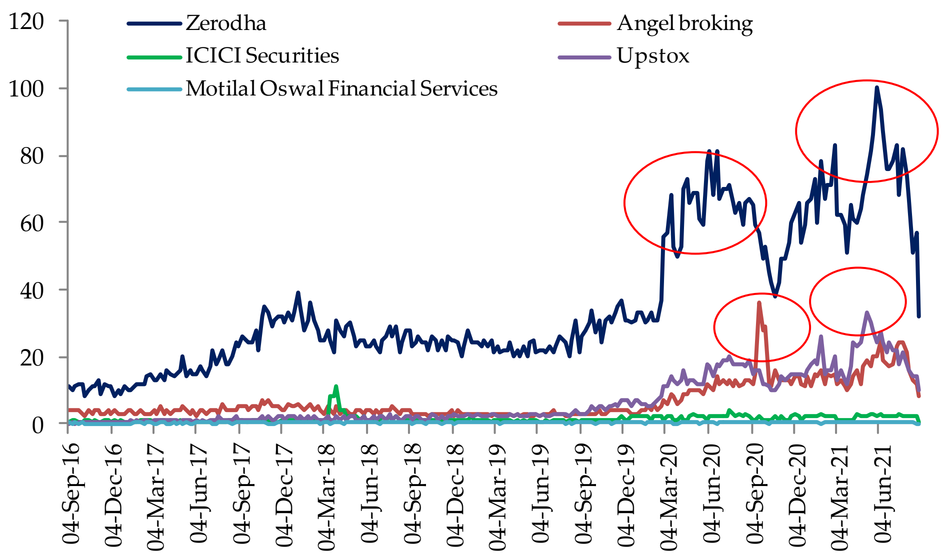


Note: APRUs based on pure retail broking revenues and NSE active clients. Sample includes 17 companies from top 20 list and revenues from institutional equities for bank-owned brokers and retail revenues of some discount brokers is estimated
Source: Companies, NSE, HSIE Research

- Revenue market share analysis suggests that discount brokers have gained market share at the cost of other standalone brokers. We expect this trend to continue on the back of growing customer preferences for digital brokers with better platforms, regulatory steps to reduce excess leverage (earlier offered by traditional brokers), and pricing pressure on full-service brokers.
- Based on current estimated revenue trends, we project that ARPUs for full-service brokers will trend lower. On the other hand, given the competitive intensity and lack of entry barriers for deep-pocketed challengers in the discount broking space, we believe medium-term ARPUs for discount brokers will continue to drift lower.
- **According to our estimates, discount brokers revenue market share will improve from 27% in FY21E to 37% by FY25, resulting in a revenue CAGR of 29% over FY21-25E.**

With the pandemic hitting the economy, interest has been skewed towards FinTech brokers

Exhibit 29: Google trends: FinTech brokers evoked maximum customer interest compared to incumbents during the pandemic

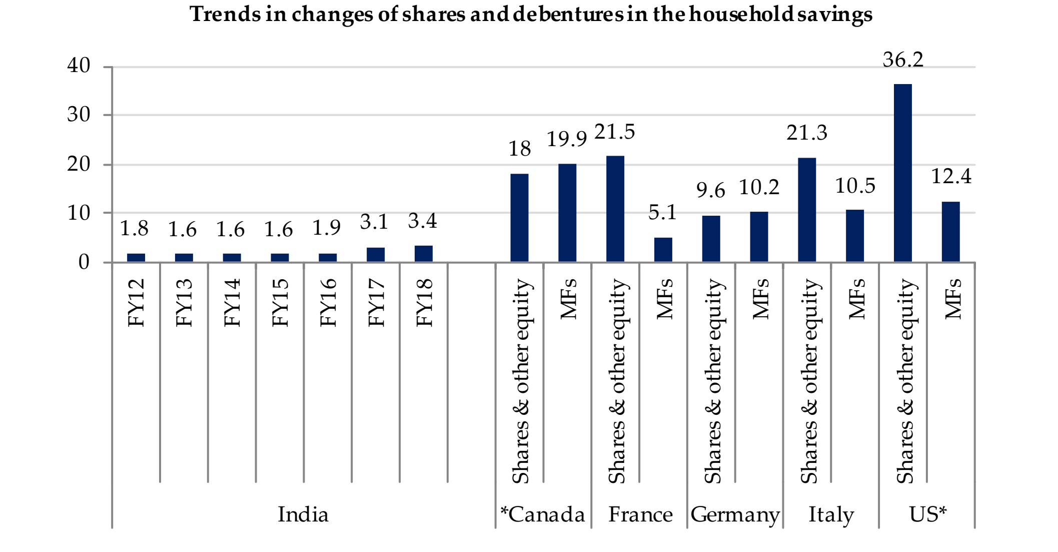


Source: Google trends, HSIE Research

Discount brokers dominate millennial wallet share

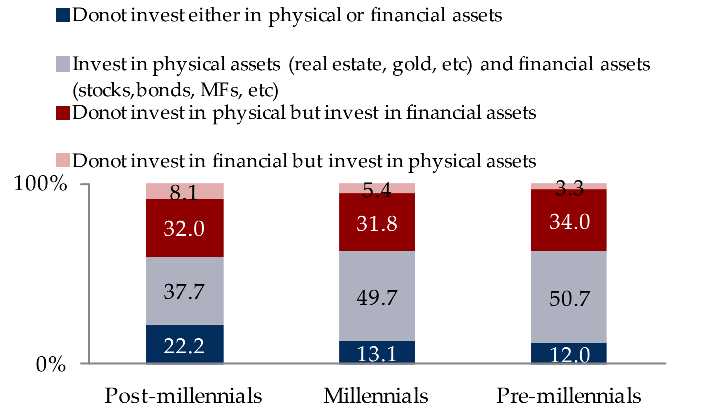
- In India, shares and debentures as a percentage of household savings constitute a meagre 4% (in FY18). This has risen over the past few years from 1.8% in FY12 to 3.4% in FY18, on the back of increasing share of working population and increasing financial awareness.
- A survey by YouGov shows that there is an inter-generational shift in attitude towards investments; with 15.7% of the millennials and 87% of the post-millennials starting to make their first investments at the age of 18-20. Millennials constituting 36% of the population and ~50% of the working population will be the major driving force for the multi-fold growth in the broking industry.

Exhibit 30: Direct equity investments remain under-penetrated in India vs. other nations



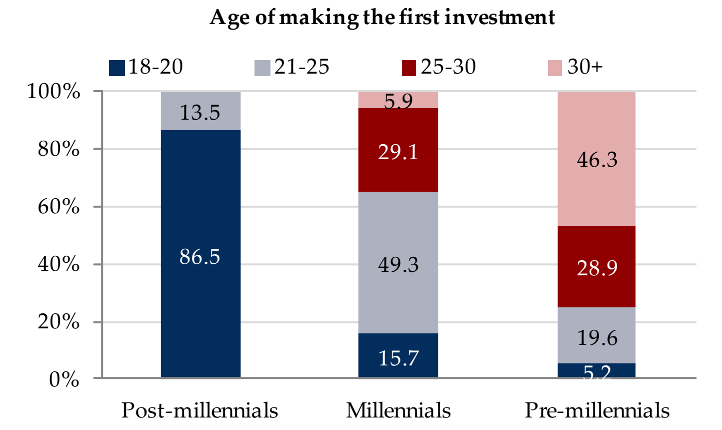
Note: Data for (*) these countries is for 2019, else 2018
Source: RBI, CRISIL Research, OECD, 2018, 2019, HSIE Research

Exhibit 31: Lower investible surpluses with millennials



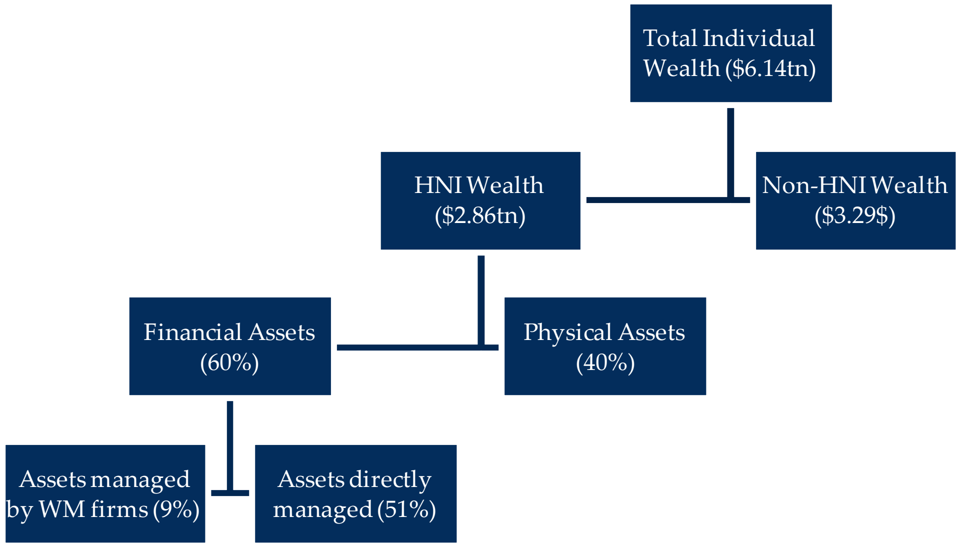
Source: YouGov Survey and HSIE Research

Exhibit 32: Millennials begin investing a lot earlier



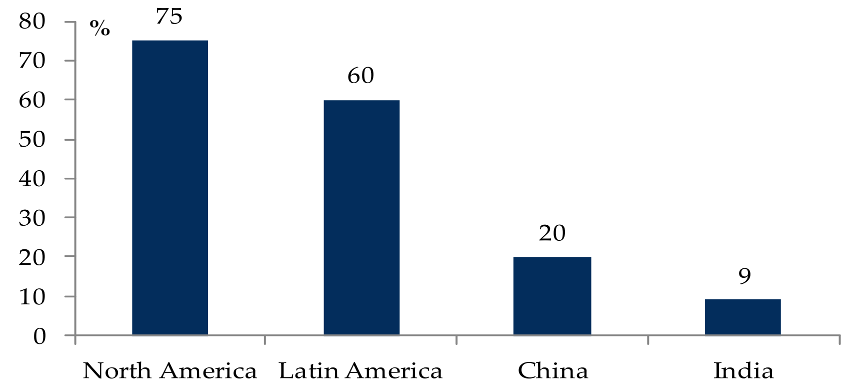
Source: YouGov Survey and HSIE Research

Exhibit 33: Wealth Managers address only 9% of the HNI wealth currently



Source: IIFLWAM, HSIE Research

Exhibit 34: Share of professionally managed UHNI wealth (% of total wealth AUM)

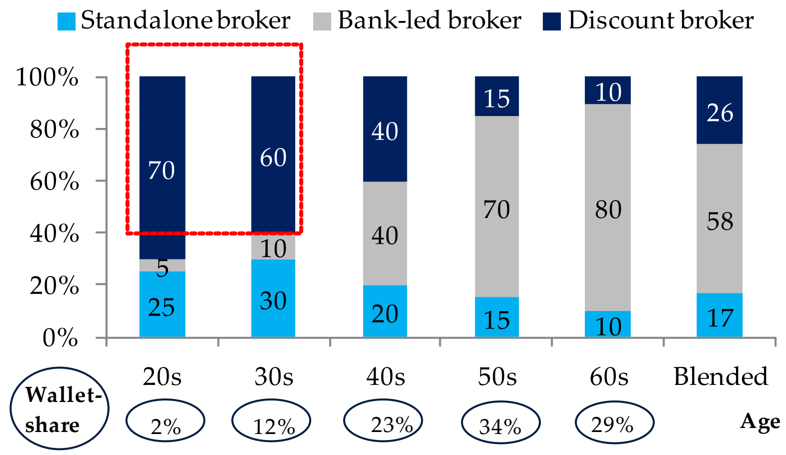


Source: IIFLWAM, HSIE Research

- We construct our proprietary HSIE-WSQ (Wallet Share Quotient) across broker classes and age cohorts. In this framework, we have made relevant assumptions around demat penetration, equity allocation and wealth distribution across broker categories. All these assumptions were then broadly validated in our conversations with industry practitioners across the wealth management ecosystem.
- Our analysis suggests that millennials account for ~14% of the overall wallet share, and discount brokers dominate this age bracket with 61% market share. This becomes a major impetus towards the growth of discount brokers.

Over the next decade, ~11mn millennial customers (highlighted in the red rectangle) could be up for grabs and in need of a wide breadth of money management services - Advantage bank-led brokers

Exhibit 35: HSIE- WSQ - Discount brokers dominate the millennials' wallet share



Source: Census 2011, NSE, CDSL, NSDL, Industry interactions, HSIE Research

- However, it is worth noting that ~57% of the equity wallet is held by the Gen-X cohorts (people in their 40s and 50s) - incidentally, these cohorts are dominated by bank-led brokers with a formidable wallet share in the range of 58%.
- In fact, as Millennials reach their peak earning capacity over the next decade, we opine that bank-led brokers stand to disproportionately benefit from increased millennial engagement in the medium-term as the Millennials search for a larger bouquet of value-added services and full-service options.
- Overall, bank-led brokers enjoy the maximum equity wallet share (58%) across the ACC universe, closely followed by discount brokers (26%).

Ingredients for a successful discount broker

- Basis our channel checks, walkthrough and discussions with industry experts, we construct an industry-first and proprietary framework "**HSIE-RTW (Right-to-Win) Quotient",** anchored on four fundamental pillars that go into establishing a formidable and sustainable discount broking franchise. As broader disclosures improve across the ecosystem, we will further tighten our HSIE-RTWQ framework. The key vectors of the HSIE-RTW framework are:
  - **Pillar I- UI/UX of execution platform:** In today's world, where every industry is undergoing a "mobile-first" shift in user journeys, even the broking industry has been faced with similar disruption from challengers. With >65% of the new additions in the past 12-15 months being N2M investors (new to capital markets), brokerages with more user-friendly and always-on reliable interface have a distinct advantage (see **here** for our analysis).
  - **Pillar II - Responsibility Index - improving customer lifecycle:** Given that NTM customers account for >65% of the additions for almost all brokers, it is absolutely critical to offer these customers the necessary handholding in order to prevent them from losing their capital. Brokers that focus on innovations to mitigate downside risks will undoubtedly be able to not only protect but also extend customer stickiness and hence, lifecycle value (detailed analysis **here**).
  - **Pillar III - Customer franchise:** Brokers are currently spending significant marketing dollars (privately funded) to acquire customers and, hence, the quality of customer franchise becomes important. A moderately higher CAC to acquire a superior quality customer (higher ARPUs and higher wallet size) is a valuable proposition.
  - **Pillar IV - Cross-sell opportunities:** Franchises with a wide bouquet of product offerings stand in a unique position to monetise the entire value eco-system. Franchises with a wider offering of financial solutions are likely to expand their ARPUs and increase customer longevity. Bank-owned and top traditional brokers are ahead of discount brokers on this parameter.

Exhibit 36: HSIE- RTW Quotient - Bank-led brokers weaker on UI / UX; massive advantage on customer franchise

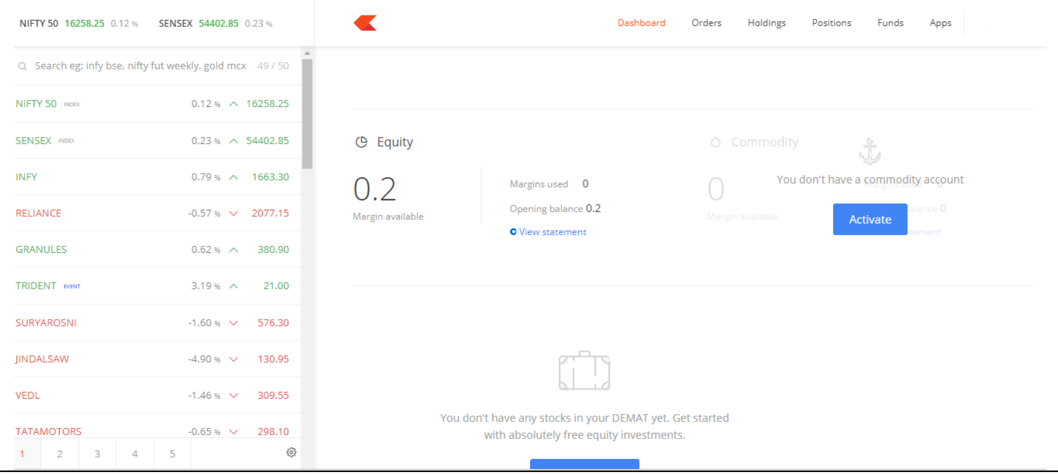
	Zerodha	Upstox	ANGBRK	5Paisa	Paytm Money	Groww	ISEC	Motilal Oswal
Pillar I: UI/UX								
Clicks to trade (app)								
Clicks to trade (web)								
Clicks to IPO (on app)								
Downtime								
Service type								
Pillar II: Responsibility Index								
Nudges								
Educational platforms	✓	✓	✓	✓	✗	✓	✓	✓
Pillar III: Customer franchise								
CACs								
ARPUs								
Wallet-size								
Customer activation								
Customer additons								
Pillar IV: Cross-sell opportunity								

Source: Twitter, Companies, HSIE estimates, HSIE Research

Pillar I: UI/UX

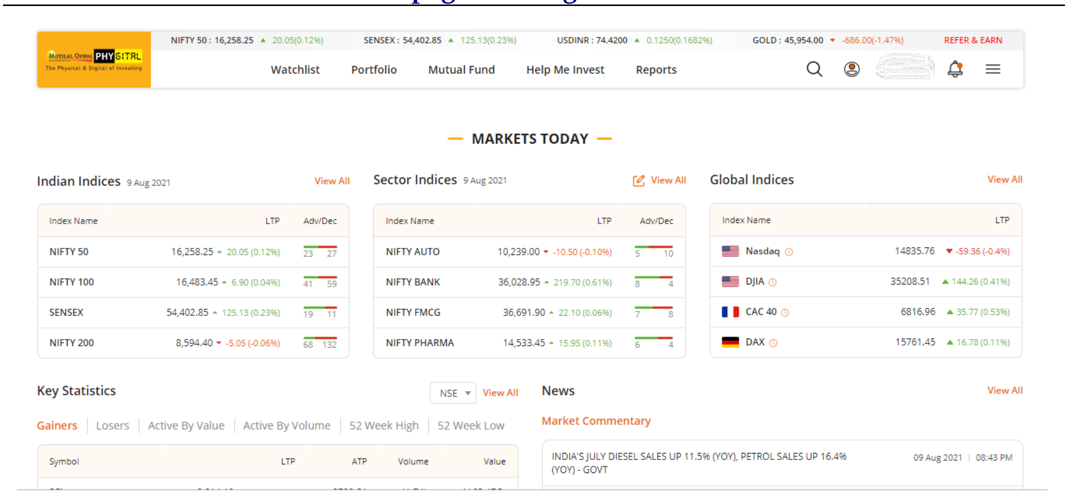
- Given the Indian economy's massive under-penetration (4%) and the recent influx of retail investors into the industry, it is worth noting that more than 60% of the new customers are new-to-market (NTM). We believe that for a novice investor, a clear and easy-to-use user interface is critical when selecting a broker (apart from pricing, trust and reliability).
- We compare and analyse the UIs of some major brokers including new-age FinTechs. The initial page after logging in on Kite-Zerodha displays only the bare minimum information for a new investor to trade, but on platforms such as Motilal Oswal and ISEC, there appears to be a significant amount of global and macro data, which we believe makes navigating a little difficult for first-time investors.

Exhibit 37: Kite by Zerodha's first page after login



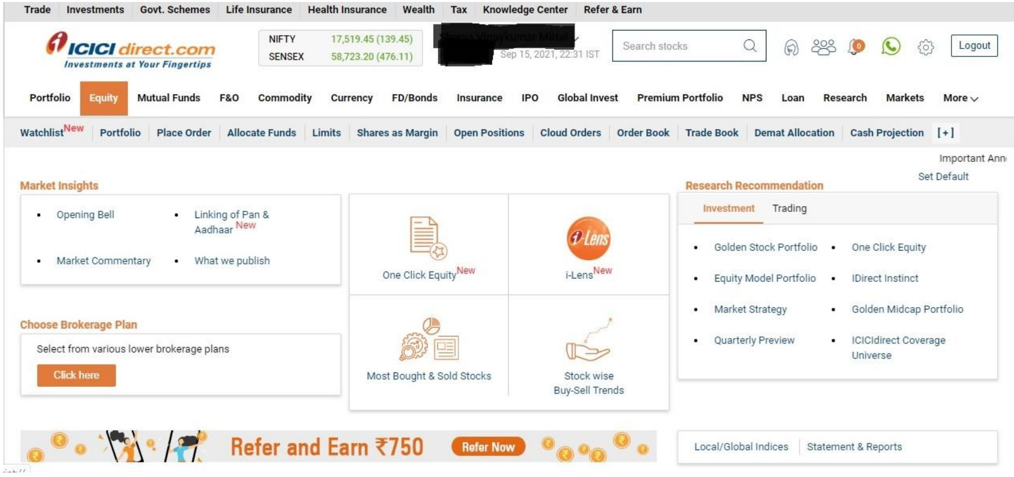
Source: www.kite.zerodha.com, HSIE Research

Exhibit 38: Motilal Oswal's first page after login



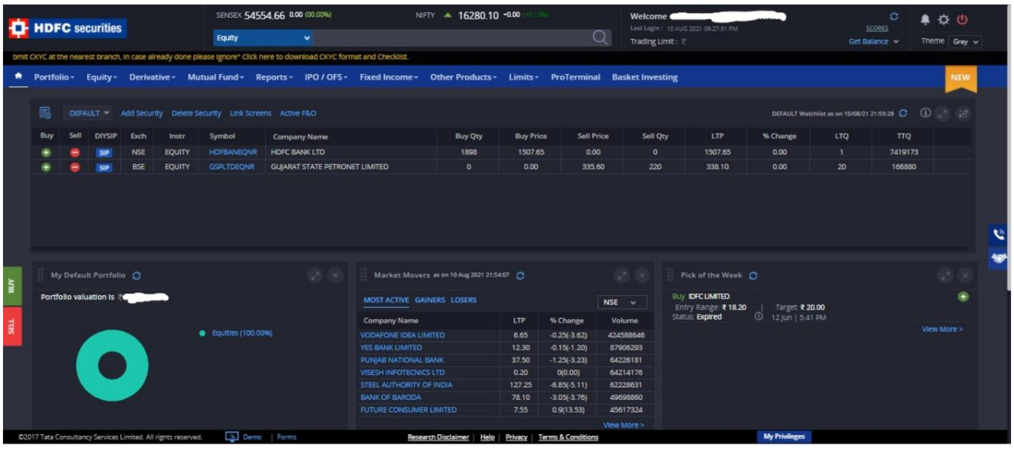
Source: www.motilaloswal.com, HSIE Research

Exhibit 39: ISEC's first page after login



Source: www.icicidirect.com, HSIE Research

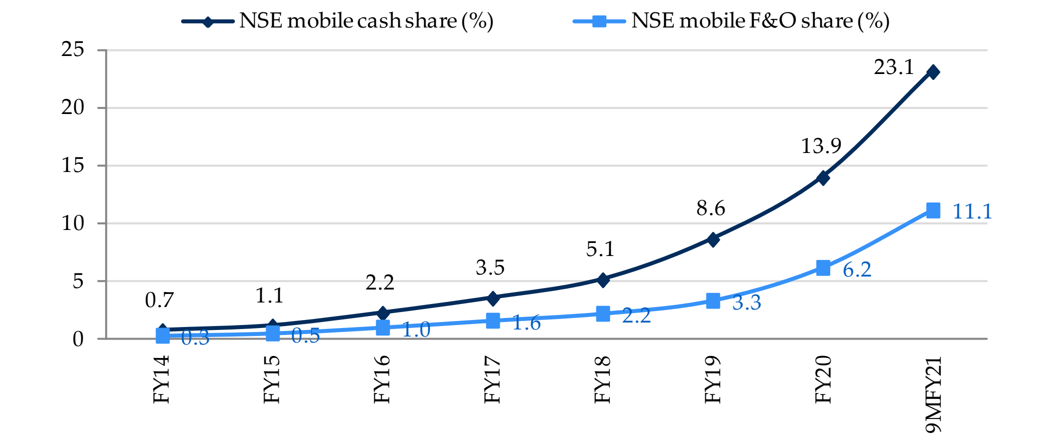
Exhibit 40: HDFC Securities first page after login



Note: HSIE Research operates under the HDFC securities legal entity
Source: www.hdfcsecurities.com, HSIE Research

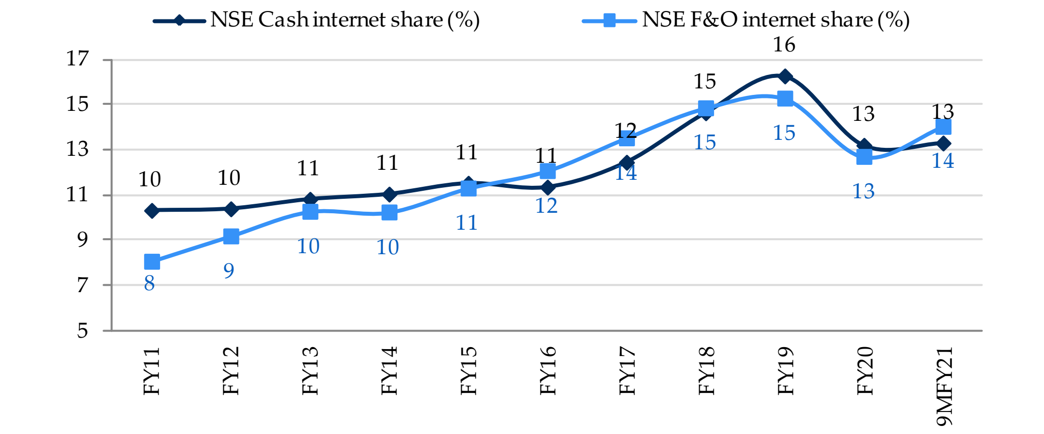
Exhibit 41: Steady increase in trading using smartphones

Steady increase in NSE mobile ADTO market share indicates shift towards app-based / DIY trading



Source: SEBI, HSIE Research

Exhibit 42: Internet share in trading volumes has remained largely stable

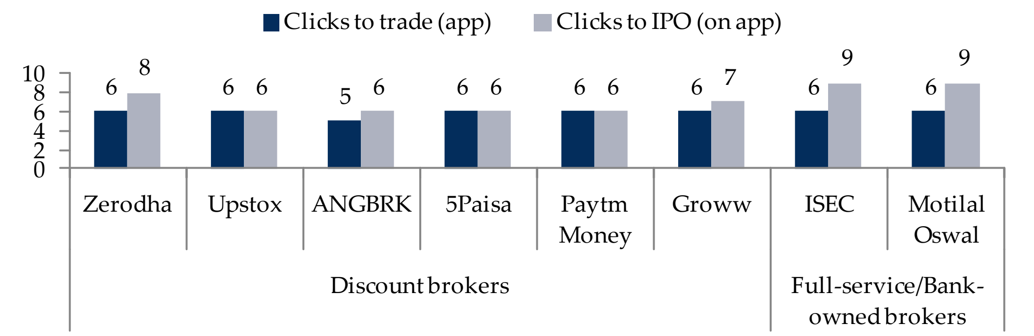


Source: SEBI, HSIE Research

- Also, we have analysed the simplicity of the platform by calculating the number of clicks to buy/sell a stock (in the table below). Lower the number of clicks makes it easier AND faster to execute trades both for retail investors as well as traders.

Clicks to trade improved for ISEC on the new IDirect Markets app

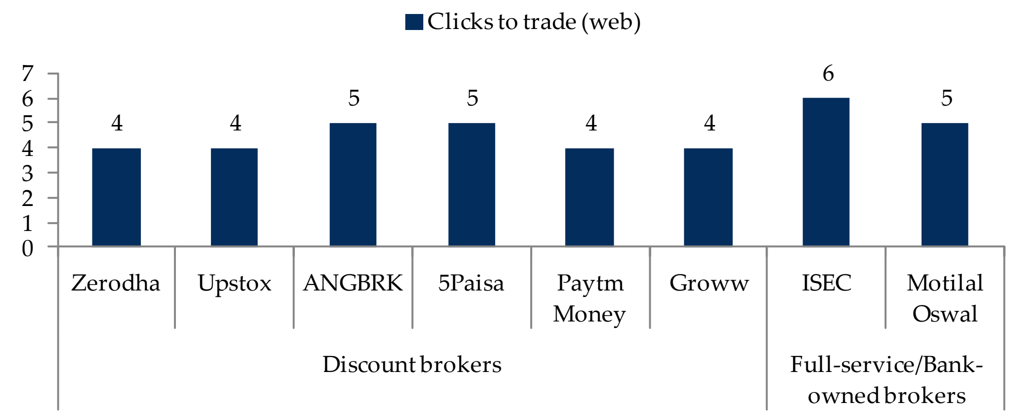
Exhibit 43: App comparison: FinTech brokers seem to do better vs. incumbents



Source: Companies, HSIE Research

Clicks to trade (web) is lower for FinTech brokers compared to standalone and bank-owned

Exhibit 44: Web comparison: Advantage FinTech brokers over incumbents



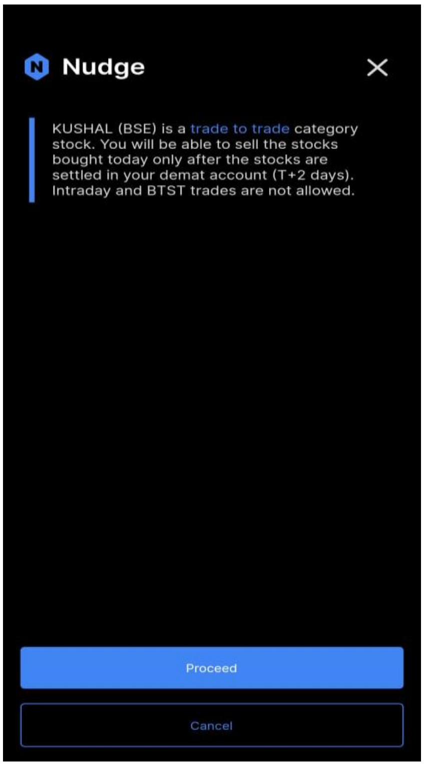
Source: Companies, HSIE Research

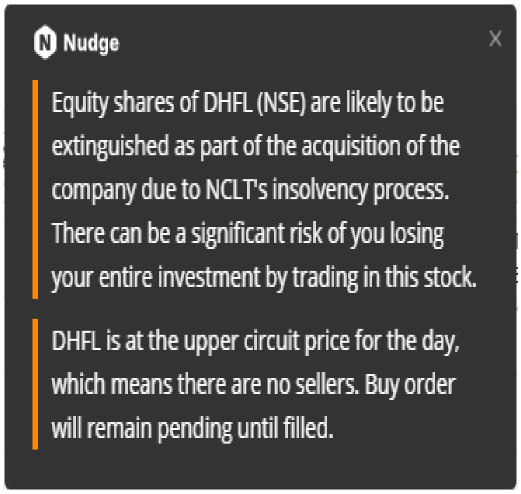
Pillar II: Responsibility Index - longer customer lifecycle

- The customer base of discount brokers is relatively young, inexperienced, and fairly new to capital markets. While developing a simplified and easy-to-use platform is the first step in getting these customers onboarded and attracted to financial investing, elongating the customer lifecycle is equally important.
- Due to lack of financial knowledge, new-to-market retail investors might end up losing money quickly. Against this backdrop, Zerodha has introduced nudges to prevent its customers from trading/investing in high risk securities, preventing customers to over-trade and burn their capital (Killswitch).
- Our walkthrough indicates that FinTech brokers such as Groww and Upstox fall short on this front, whereas bank-based players such as ISEC has made significant inroads with a feature known as "I-alerts".

These features save novice investors from breaking basic trading rules such as investing in risky illiquid securities

Exhibit 45: Illustration on how the 'Nudge' feature (Zerodha) warns the investor





Source: Kite by Zerodha app, HSIE Research

What this means for the broker:

1) *Lower revenue in short-term*
2) *Better stickiness and longer customer lifecycle resulting in higher long-term revenues*

- Another major move in this direction by discount brokers is developing an educational platform in order to better democratise finance.

Exhibit 46: Several brokers have come up with an educational platform

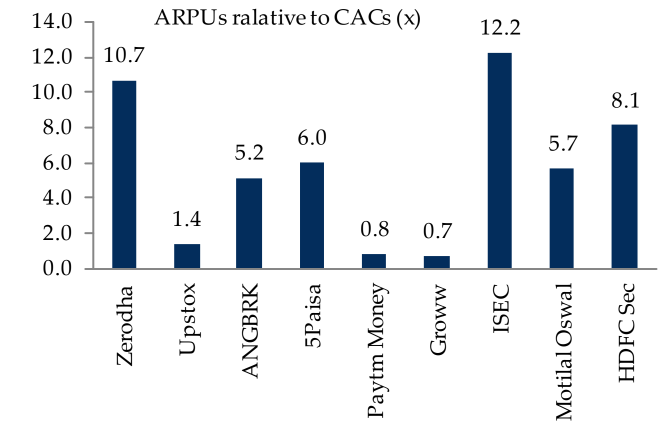
	Angel One	Zerodha	Upstox	Paytm Money	ISEC	Groww	5Paisa	MOFS
Educational platform	✔	✔	✔	✕	✔	✔	✔	✔

Source: Companies, HSIE Research

Pillar III: Customer franchise

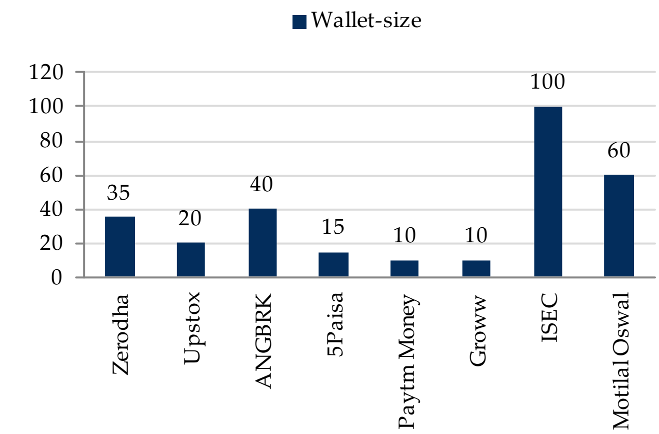
- With discount broker's commissions at trough levels, customer acquisition costs (CACs) are an extremely important driver of the P&L. Although the market leader (Zerodha) boasts of incurring no direct advertisement costs (except referrals), our workings suggest Zerodha incurs INR~611/user. However, this is the lowest CAC compared to other major FinTech discount brokers in the space.
- The advent of technology has resulted in massive cost savings for discount brokers, as need for a physical dealer is almost non-existent with most customers preferring to trade online. Hence, executing a trade for a FinTech discount broker involves almost no major variable cost.
- **Our calculations indicate that bank-led brokers and top traditional brokers have a far-superior customer franchise (higher ARPUs) vs. discount brokers. Despite higher CACs, CACs as a percentage of ARPUs are lower for these franchises. However, Zerodha is an exception among discount brokers on this parameter with CACs as percentage of ARPUs close to ISEC.**
- However, over the long-term, we believe that accelerated pace of client additions is likely to offset lower ARPUs and generate improved returns for discount brokers.

Exhibit 47: Bank-led brokers have superior ARPUs



Source: HSIE estimates, respective companies, HSIE Research

Exhibit 48: FinTech brokers low on customer wallet size



Source: HSIE Research

Pillar IV: Cross-sell opportunity

- In any financial services business, the advantage of catching clients at a younger age is the massive cross-sell and up-sell opportunity as customer incomes mature and clients graduate towards peak-earning potential. For discount brokers, the potential cross-sell opportunity is likely to reflect in a wide array of distribution choices: regular mutual funds, insurance, home loans, personal loans, bonds, research advisory, portfolio management services, NPS funds, personal finance advisory, wealth management and global investing.
- Our analysis suggests that bank-led brokers and select traditional brokers are well entrenched with the cross-sell solutioning tools to grab this pie, while discount brokers are laggards in the race.

Possible endgames

The hybrid model

Given the distinct advantages of each of the two pure-play models (tech-based brokers and conventional brokers), we see early signs of the emergence of hybrid models, which attempt to combine the best of both worlds.

- Faced with disruption from discount brokers on (a) pricing and (b) better execution platform, incumbents have had to re-think their strategy. Despite the massive yield compression, bank-led full-service brokers have launched flat fee/subscription based plans in order to compete with discount brokers on the pricing front in the derivatives segment.
- ISEC (fourth largest broker in terms of ACC) launched the Prime and NEO plans with competitive pricing in derivatives segment (see table below for pricing).

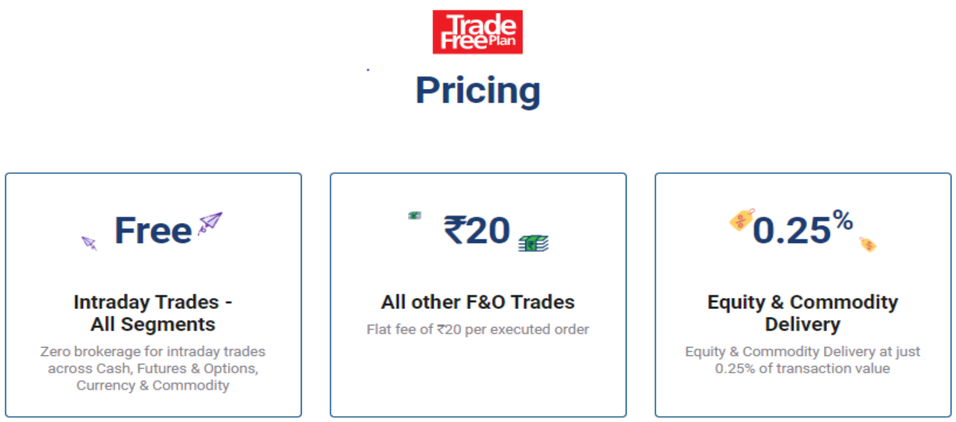
Exhibit 49: ISEC's "NEO plan"

Source: Company website, HSIE Research

KSEC added ~61% of the new acquisitions through trade-free plan

- Kotak Securities (eighth largest broker in terms of ACC) introduced a discounted "trade free plan" in Nov 20 to give neck to neck competition to discount brokers. While all self-executed intraday trades are free, equity delivery is priced at 0.25% of trade value and carried forward F&O trades at INR20/executed order.

Exhibit 50: Kotak Securities "trade free plan"



Source: Company website, HSIE Research

- Aside from pricing, full-service brokers are focussed on enhancing the UI/UX of the web platform and the mobile app. ISEC has re-launched its web platform with a new interface and is currently in the process of re-engineering its mobile app.
- On the other hand, having made serious inroads and tapped into the direct equity investments space, discount brokers are now beginning to foray into other

alternative investment products aligned to the emerging needs of the new-gen consumer segment (Millennials and Gen-Z).

- One of the next possible avenues is the **asset management space**. The recent change in regulatory guidelines from three years of profitability (of the past five years) to a minimum net worth criteria of INR1bn has meaningfully lowered the entry barriers for challengers. Discount brokers such as Zerodha (organic route) and Groww (inorganic route) have received AMC licences and are likely targeting the passive fund investing space, according to media reports.
- Passive fund investing appears to be a logical next step on account of lower entry barriers, relative white space (lack of entrenched incumbents) and scope for loss-leader pricing (cost-efficiencies).
- **Zero-sum game:** We expect to see the long-tail of standalone brokers to witness steady consolidation and mortality over the medium-term. The best-case scenario for these brokers is to self-disrupt and reposition themselves as discount brokers.

Tariff hikes: Does Upstox move trigger the bottom?

- "Upstox", India's third largest broker in terms of active clients with a market share of 13.9%, recently upped its pricing in the delivery segment from "NIL" to INR20/order. New-age FinTech brokers including Uptsox, Paytm Money and Groww have been incurring exorbitant costs on marketing and customer acquisition and have reported losses in FY20.
- This move by India's third largest broker has given soft signals around pressure on yields. While the bellwether "Zerodha" was the first to introduce free delivery trades, all the FinTech brokers have mirrored the discounted "flat-fee" pricing.
- **Possible outcomes**
  - **For brokers:** Given the significant under-penetration, sporadic entry of deep-pocketed challengers and the fact that the market leader is highly profitable on a "flat-fee" pricing model, we believe that the Upstox move on pricing may not be immediately replicated. A majority of the FinTech broking franchises are in a customer-grab phase and hence, are unlikely to raise tariffs.

Exhibit 51: Potential revenues for Zerodha, if delivery fees introduced

Particulars	2021E
Average daily delivery trades (mn)	2.9
Trading days	248
Delivery fee (INR)	20
Potential revenues (INR mn)	**14,384**

Source: HSIE Research

  - **For customers:** While our analysis in the section "Ingredients for a successful discount broker" clearly indicates customers' strong preference for selecting a better experience, we believe that customers are usually stickier (adjusting for a better platform) and are willing to pay for value-added services.

Exhibit 52: Rate chart for discount brokers

Equity	Zerodha	Upstox	ANGBRK	5Paisa	Paytm Money	Groww	ISEC	MOFS
Delivery	Nil	20	Nil	20	Nil	Nil	0.55% of TV	0.5% of TV
Intraday	INR 20/order	INR 20/order	INR 20/order	INR 20/order	INR 10/order	INR 20/order	0.275% of TV	0.05% of TV

Note: ANGBRK represents i-trade plan. TV represents trade value
Source: Companies, HSIE Research

ICICI Securities

Tech-broker under construction: a moat-worthy franchise

With early evidence of a successful pivot to an open-market sourcing architecture and focused efforts on revamping its UI for new-gen customers, ICICI Securities (ISEC) is firmly repositioning itself as "the franchise to beat". As a bank-based broker, we believe these efforts at expanding the customer acquisition funnel and enhancing the user experience are likely to reflect in sustained traction in customer addition over the medium term as millennials steadily graduate towards "peak earning capacity" and opt for full-service choices. We maintain our ADD rating with a TP of INR975 (24x Sep'23E EPS).

Our analysis of the proprietary HSIE-RTW framework suggests that ISEC's UI/UX is a work-in-progress; however, ISEC's performance on vectors such as responsiveness and downtime is relatively superior compared to discount brokers.

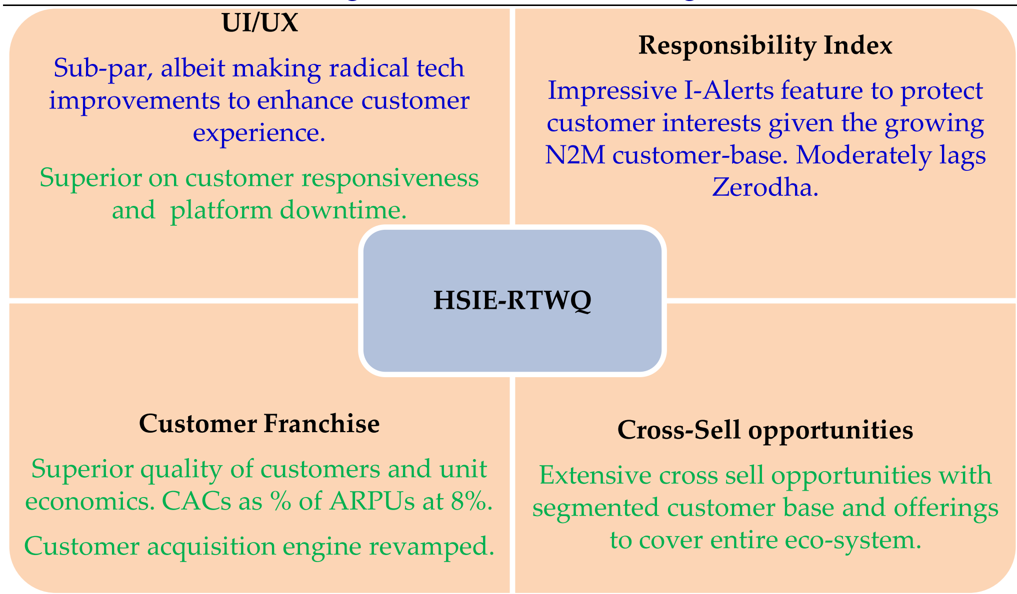
- **App re-booting:** ISEC has recently launched the apps (1) IDirect Markets and (2) IDirect Money, with a far simplified interface compared to the earlier app, focussing on improving customer experience. An additional app for millennials and Gen-Z is also in the works, which is being developed from insights taken from an Israeli company ETORO (into Social investing) and Chinese company Snowball (into bite-sized contents). ISEC claims this app will be the first-of-its-kind in the industry in India.
- **Customer segmentation:** As the path ahead lies in the growth of retail as well as HNI and UHNI assets, it has formulated different strategies for both these subsets through differentiated product offerings and cross selling personalised products.
- **Focus on customer growth:** ISEC has pivoted its acquisition-engine from being solely dependent on its parent, ICICI Bank, to an open architecture. The company tied up with HSBC during Q2FY22 and has three other banca partnerships in the pipeline. It has also tied up with FinTechs such as Flipkart, GPAY, etc., to acquire clients. We opine that ISEC is adopting the necessary bold steps to broaden its customer acquisition funnel, which should help build scale and profitability.
- **Investment in technology:** The adoption of AI and ML in the business operations has helped ISEC improve its customer acquisition rate and quality. The tech spends grew from INR150mn (1% of revenues) to INR450mn (2% of revenues) and the company estimates it would cross INR~900mn (4% of revenues) in FY22E, given that ISEC has accepted its existing gaps in its digital platform and is going hammers and tongs to build a fast and simplified one.
- **Rationalising C/I ratio:** The C/I ratio has trended downwards from 56% in Q1FY21 to 44% in Q1FY22 and variable expenses have increased from ~30% to ~44%. We believe this offers ISEC the necessary flexibility to manage expenses in a downturn.

Exhibit 53: ISEC's transformational journey

Particulars	2017	2021	2025P
Positioning	E-broker	One stop shop	Digitally integrated financial marketplace
Approach	Product focussed customer-centric lens	Customer focused lens	Customer ecosystem lens
Customer acquisition	0.42mn(8% incremental MS)	0.69mn (6% incremental MS)	>10% incremental market share
Assets	INR1.8trn	INR3.8trn	INR10trn
CI ratio	63%	45%	<40%
Diversification	Significantly dependent on equity	Texturised equity and augmented non-equity	3 or 4 categories contributing significantly to revenue streams

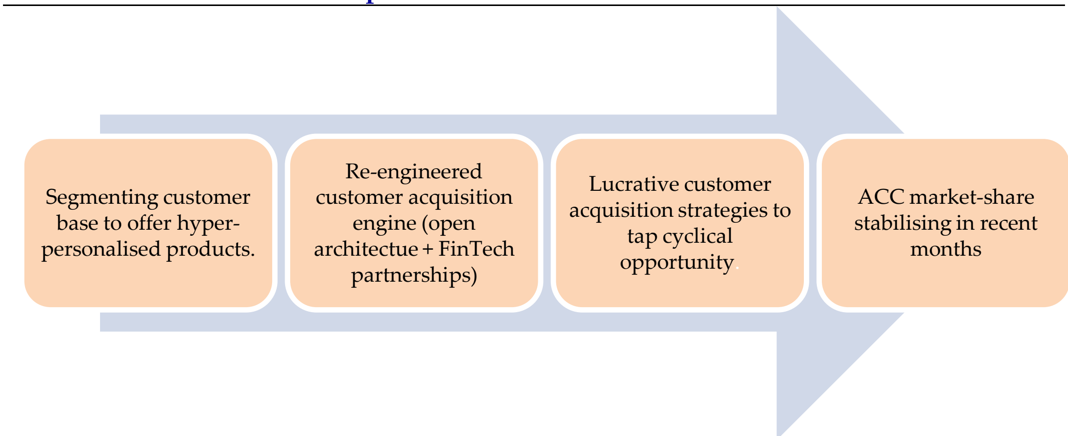
Note: MS represents market share. Source: ISEC digital day presentation, HSIE Research

Exhibit 54: HSIE-RTWQ (Right-To-Win Quotient) - Insights on ISEC



Source: HSIE Research

Exhibit 55: Growth levers in place



Source: HSIE Research

Exhibit 56: Financial summary

(INR mn)	FY20	FY21	FY22E	FY23E	FY24E
Adj. revenues	16,115	24,304	27,755	26,605	31,889
Growth (%)	-2.1	50.8	14.2	-4.1	19.9
EBITDA	7,873	14,365	16,929	15,497	19,870
EBITDA Margin (%)	48.9	59.1	61.0	58.2	62.3
APAT	5,621	10,678	12,715	11,213	14,974
Growth (%)	17.8	89.9	19.1	-11.8	33.5
AEPS	17.5	33.1	39.5	34.8	46.5
EV/EBITDA (x)	34.8	20.6	17.8	18.8	14.9
P/E (x)	45.7	24.1	20.2	22.9	17.1
ROE (%)	49.8	70.4	61.0	46.1	52.7

Source: Company, HSIE Research

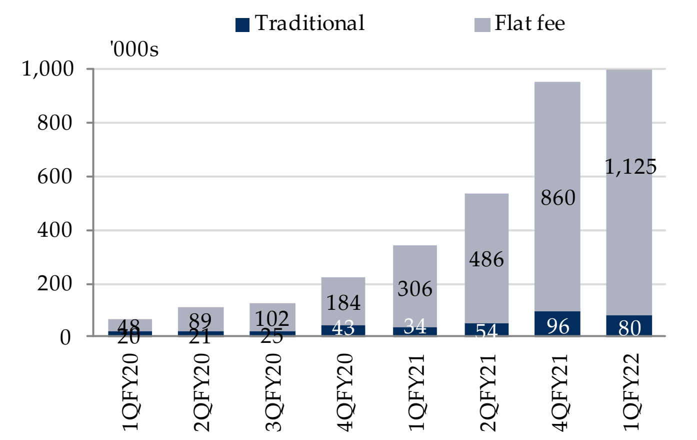
Angel Broking (NOT RATED)

Acquisition engine - check; next stop: customer franchise

Angel Broking (under a revamped brand "Angel One") has emerged as one of the fastest growing **"converted tech broker"** in India with customer base at 5.4mn (+24% CAGR over the past ~2 years) and ADTO market share at 23% (+19pps over Q1FY20) in Q1FY22. The company completely reengineered its business right from redesigning its mobile application for the new age tech savvy customers, to introducing a restructured pricing (flat pricing) and a host of products (insurance, MFs, bonds, etc) to cross-sell.

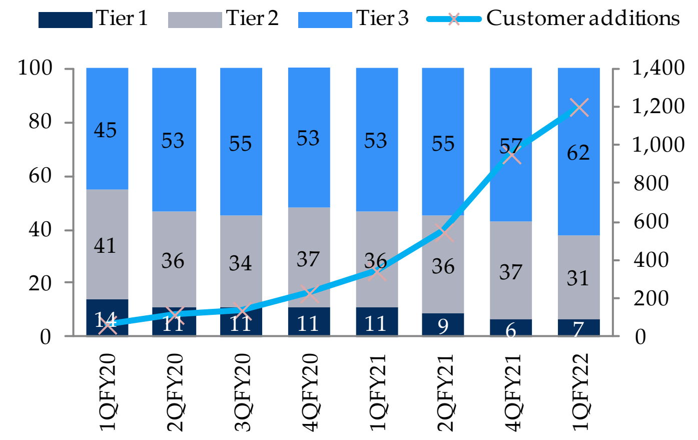
- **Laser focus on customer acquisition:** With the introduction of new pricing plan (in Q1FY20) and with its newly-launched mobile app, Angel Broking is racing ahead of its peers to grab the incremental customer market share. The company is going all-in to tap into tier-2/3 markets and capture the cyclical uptick in capital markets.
- **High marketing spends drive customer addition:** To attract the new to market millennials, the company is incurring high CACs for acquiring customers in the form of free ETFs, gift vouchers, and so on. While majority of the FinTechs brokers are incurring losses in the race to acquire new customers, Angel Broking has been able to better manage its economics and generate high margins.
- **Digitisation will be the core:** Angel Broking continues its efforts to build a superior platform for digital-natives, using AI and ML to accelerate and automate various business operations such as customer onboarding, understanding investor behaviour, and offering nudges to activate dormant customers. Furthermore, over the past two years, the company has increased its digital workforce, which now accounts for 18% of the total workforce.

Exhibit 57: Customer additions skewed towards the new "flat-fee" plan since 1QFY20



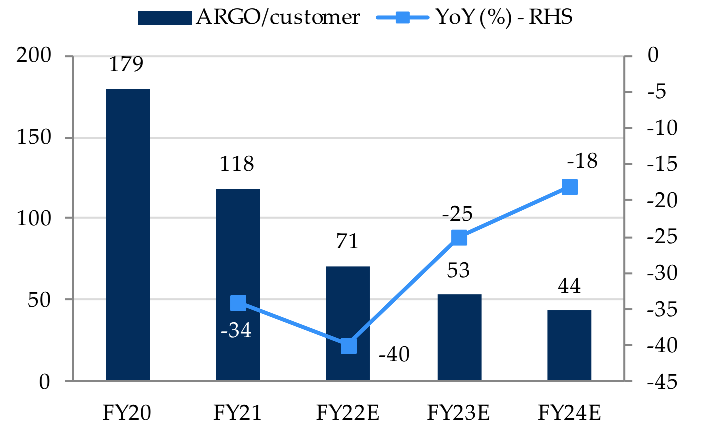
Source: Company, HSIE Research

Exhibit 58: Tier-3 and beyond cities contribute majority of additions



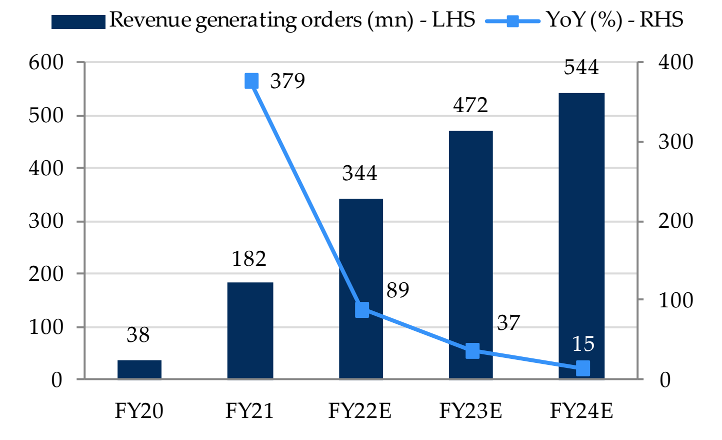
Source: Company, HSIE Research

Exhibit 59: Average orders from new customers are on a downward trajectory



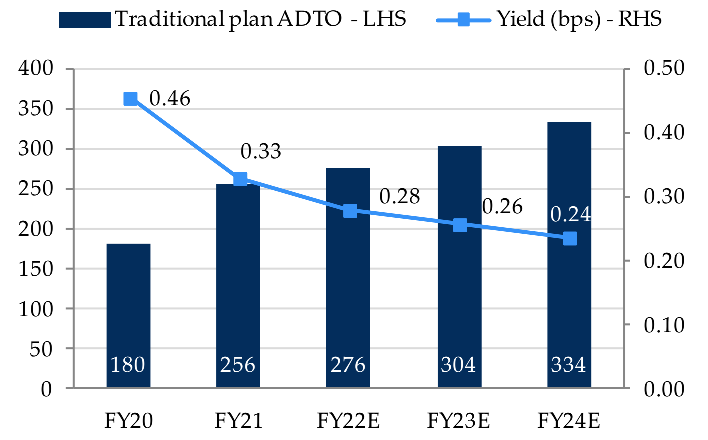
ARGO – Average revenue generating orders. Note: Estimated flat fee per order. Source: HSIE Research

Exhibit 60: Healthy growth in aggregate orders



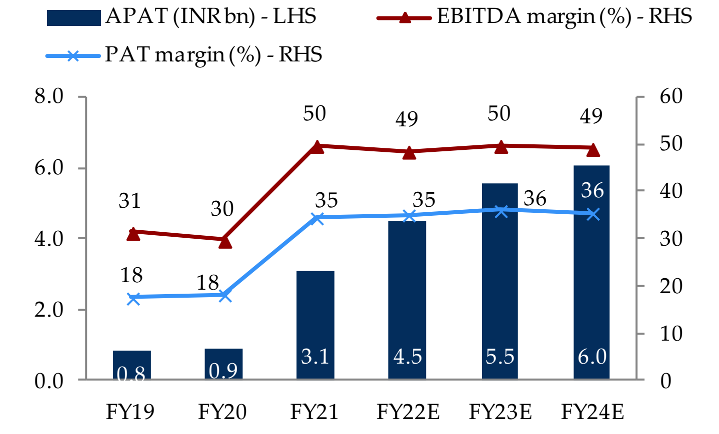
Note: Estimated flat fee per order. Source: HSIE Research

Exhibit 61: Traditional plan yields remain under pressure



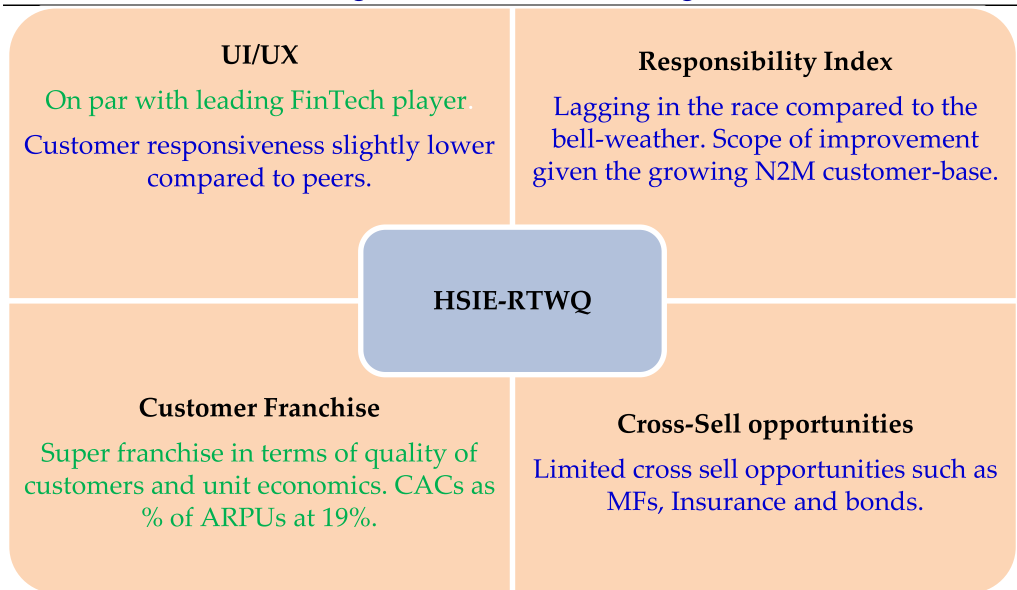
Source: Company, HSIE Research

Exhibit 62: Healthy margins to drive PAT growth



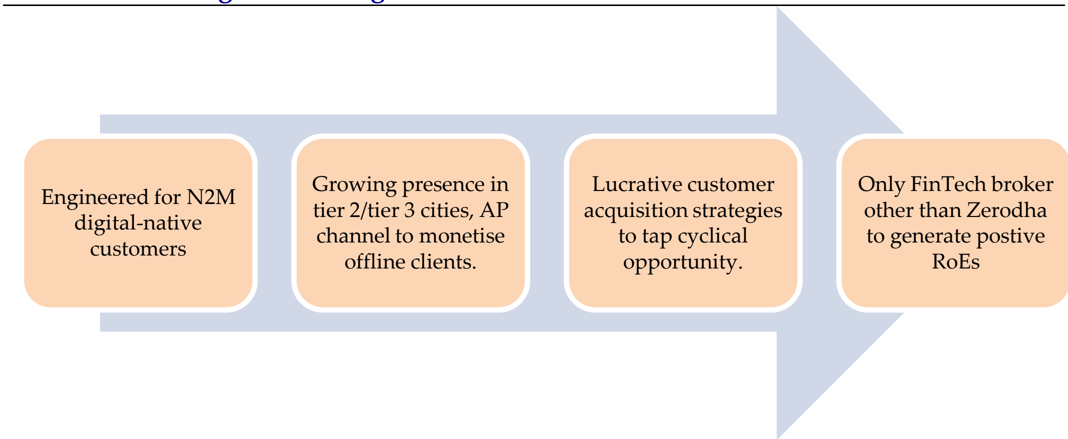
Source: Company, HSIE Research

Exhibit 63: HSIE-RTWQ (Right-to-Win Quotient) - Insights on ANGELBRKG



Source: HSIE Research

Exhibit 64: Rising and shining



Source: Company, HSIE Research

Exhibit 65: Financial summary

(INR mn)	FY20	FY21	FY22E	FY23E	FY24E
Adj. revenues	4,762	8,982	12,799	15,352	17,000
EBITDA	1,414	4,471	6,213	7,640	8,351
EBITDA Margin (%)	29.7	49.8	48.5	49.8	49.1
APAT	868	3,101	4,497	5,535	6,037
AEPS	12.1	37.9	55.0	67.6	73.8
EV/EBITDA (x)	77.3	24.5	16.1	11.3	9.3
P/E (x)	132.8	37.2	25.6	20.8	19.1
ROE (%)	15.5	36.0	35.2	34.8	31.2

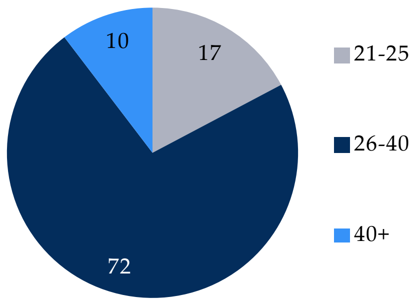
Source: Company, HSIE Research

Annexure I

HSIE proprietary broking-poll analysis

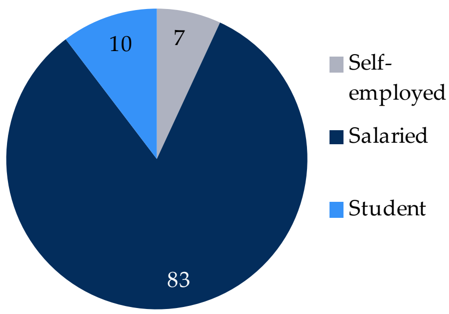
Millennials and salaried people dominated our survey.

What age group you belong to?



Source: HSIE proprietary broking poll, HSIE Research

What is your occupation?

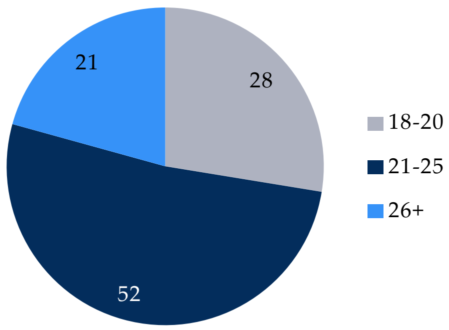


Source: HSIE proprietary broking poll, HSIE Research

28% of the participants opened their demat accounts by the age of 21 and 80% by the age of 26

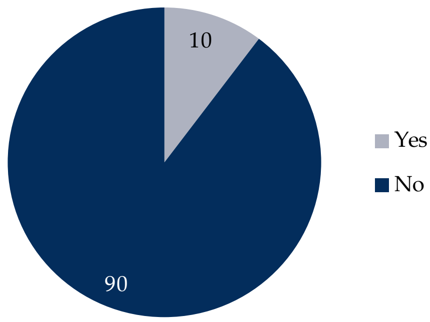
Only 10% of the survey respondents opened their account during the pandemic

At what age did you open your demat account?



Source: HSIE proprietary broking poll, HSIE Research

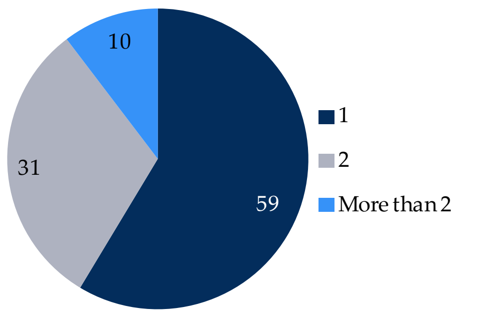
Did you open the demat account after 1/4/20 (post outbreak of Covid)?



Source: HSIE proprietary broking poll, HSIE Research

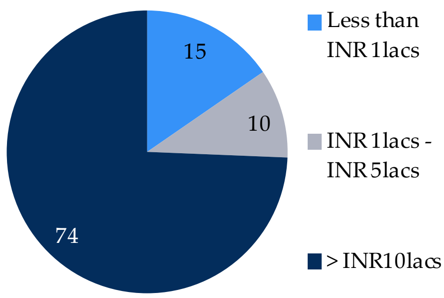
Over 40% of the respondents have 2 or more demat accounts indicating that people use different accounts for trading and investing

How many trading accounts do you have?



Source: HSIE proprietary broking poll, HSIE Research

What is your demat portfolio size?

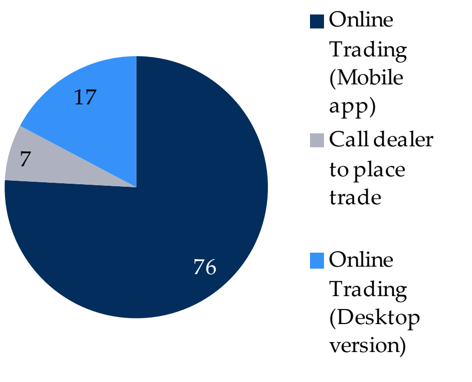


Source: HSIE proprietary broking poll, HSIE Research

76% use 'MOBILE APP" for trading, indicating the increasing relevance of superior app experience

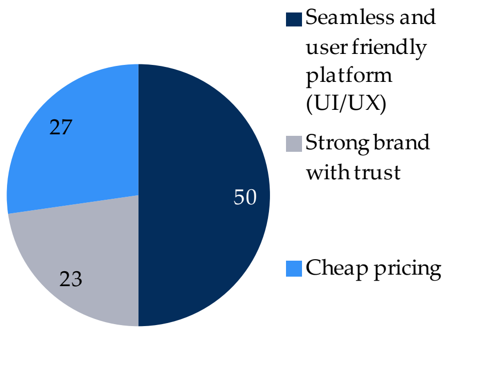
A convenient platform appears to be a non-negotiable, as 50% of the respondents demanded a seamless UI/UX

What medium do you use for trading?



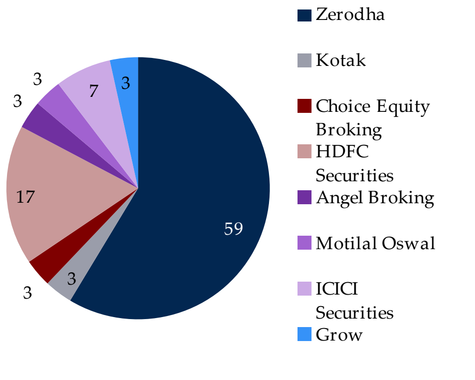
Source: HSIE proprietary broking poll, HSIE Research

What is the most important factor for you to select a broker?



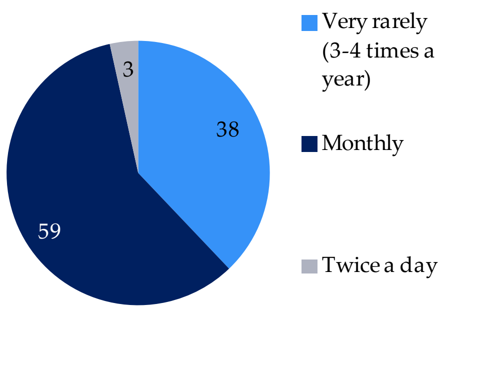
Source: HSIE proprietary broking poll, HSIE Research

Which of these is your preferred broker?



Source: HSIE proprietary broking poll, HSIE Research

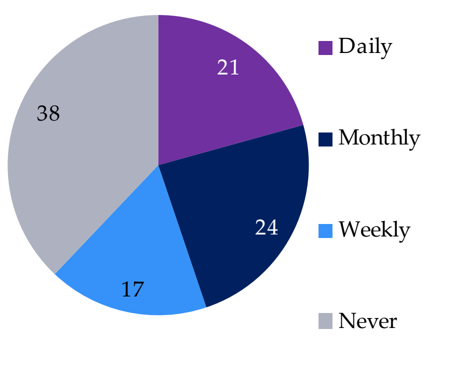
How frequently do you trade?



Source: HSIE proprietary broking poll, HSIE Research

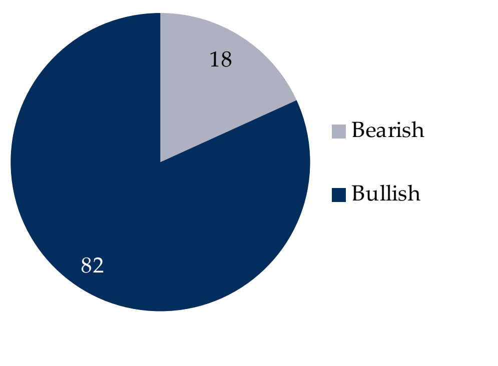
Over 80% of the respondents read financial content provided by their brokers' at least once a month, indicating the importance of reliable, high-quality advice

How often do you read the financial content provided by your brokers? E.g., How to understand a company's P&L?



Source: HSIE proprietary broking poll, HSIE Research

What is your view on the current levels of stock market?



Source: HSIE proprietary broking poll, HSIE Research

Thematic reports by HSIE

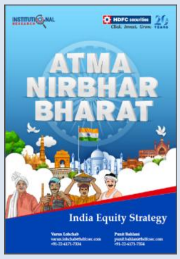
Cement: WHRS – A key cog in the flywheel

Autos: Where are we on "S" curve?

FMCG: Defensive businesses but not valuations

Autos: A changed landscape

Banks: Double whammy for some



India Equity Strategy: Atma Nirbhar Bharat

Indian IT: Demand recovery in sight

Life Insurance: Recovery may be swift with protection driving margins

Retail: Whole flywheel is broken?

Appliances: Looing beyond near-term disruption

Pharma: Chronic therapy – A portfolio prescription

Indian Gas: Looking beyond the pandemic

India Equity Strategy: Quarterly flipbook

Real Estate: Ripe for consumption

Indian IT: expanding centre of gravity

Indian Chemical: Evolution to revolution!

Life Insurance: ULIP vs. MF

Infrastructure: On the road to rerating

Cement: Spotting the sweet spot

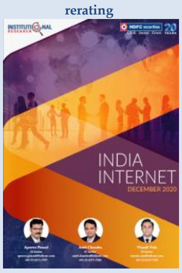
Pharma: Cardiac: the heartbeat of domestic market

Life Insurance: Comparative annual report analysis

Indian microfinance: Should you look micro as macros disappoint?

India Equity Strategy: Quarterly flipbook

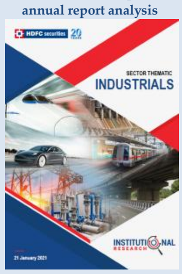
Autos: Divergent trends in PVs and 2Ws



India Internet: the stage is set

FMCG: Opportunity in adversity - A comparative scorecard

Logistics: Indian Railways - getting aggressive



Industrials: Triggering a new cycle

Indian IT: raising the bar

India Equity Strategy: Quarterly flipbook

FinTech Playbook: P2M Payments | Surging pool, dwindling yields

India Hospitals: capital discipline improving, sustenance is key

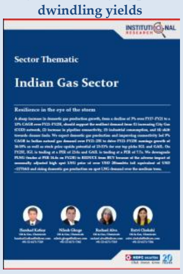
Autos: Will EVs impact the 'EV'?

Cement: Riding High

Power: Reforms essential for rennaissance

Fashion & Lifestyle: From a disruptor's lens II

India Equity Strategy: Quarterly flipbook



Indian Gas Sector: Resilience in the eye of the storm

Consumer Durables: Fans - a compounding story but underrated

Rating Criteria

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

Disclosure:
We, **Krishnan ASV, PGDM, Sahej Mittal, ACA & Deepak Shinde, PGDM** authors and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.
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