

# Initiating Coverage ICICI Securities Ltd.

01-December-2020



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Capital Mkt intermediary	Rs.448.5	Buy at LTP and add on dips to Rs.401-405 band	Rs.495	Rs.540	2 quarters

HDFC Scrip Code	ICSECEQNR
BSE Code	541179
NSE Code	ISEC
Bloomberg	ISEC IN
CMP Nov 27, 2020	448.5
Equity Capital (Rsmn)	1,611
Face Value (Rs)	5
Equity Share O/S (mn)	322
Market Cap (Rs bn)	144.5
Book Value (Rs)	37.5
Avg. 52 Wk Volumes	605090
52 Week High	568.75
52 Week Low	203.60

Share holding Pattern % (Sep, 2020)	
Promoters	77.22
Institutions	14.04
Non Institutions	8.74
Total	100.0

## Fundamental Research Analyst

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### Our Take:

ICICI Securities is one of the pioneers in online trading in India with the launch of its online portal "icidirect.com" almost 2 decades back. Given the strong brand backed by its parentage, leadership and industry tailwinds, we remain optimistic on the future growth of ICICI Securities Limited (ISEC). The company has well established brand and experienced management team. Over last 2 decades, it has seen various markets cycles and has a strong track record in the capital market space. We expect, New Client Acquisition along with firm Activation Rates and strong albeit cyclical trading volumes to drive the core broking revenue growth in the near term. Company's focus on digital capabilities and cost efficiency can result in realisation of operating leverage. Discount brokers acquiring a higher client share remains a concern.

### Valuations & Recommendation:

Despite a difficult environment, ISEC delivered decent growth in H1FY21. Cash market share was strong and active client base growth was also healthy. Driven by higher volumes, ISEC is expected to report a strong FY21E; however, we remain watchful of changing regulations and believe earnings may be peaking out for the near term. ISEC has been constantly reducing its dependence on the cyclical brokerage income and has been focusing on cross selling products which provides more linear and sustainable growth. As on Q2FY21, on the distribution side it has a mutual fund AUM of Rs.34.5bn with sizeable presence in the insurance segment as well. In the wealth business AUM stood at Rs.115.3bn while margin funding and ESOP funding book stood at Rs.1.87 bn as on Sept 2020. Apart from this it has also established itself as a leading player in investment banking and advisory business.

We have envisaged 7.3% CAGR for revenue and 15% CAGR for Adjusted Net Profit over FY20-22E. EBITDA Margin is estimated to improve 670 bps. The company has strong cash balance and it has been giving healthy dividend pay-out to its investors. We expect dividend yield to improve to 3.7% in FY22E from current 2.3%. ISEC has shown agility in changing dynamics by focusing on technology, pricing, customer sourcing, diversification of income streams and cost rationalisation to maintain profitability.

We feel that investors can buy ICICI Securities Limited (ISec) at the LTP and add on dips to Rs.401-405 band. We expect the Base case fair value of Rs.495 (21.5x FY22E EPS) and the Bull case fair value of Rs.540 (23.5x FY22E EPS) over the next 2 quarters.

## Financial Summary

Particulars (Rsmn)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY19	FY20	FY21E	FY22E
Revenues	6,399	4,001	59.9	5,134	24.7	16,456	16,116	20,614	18,542
EBITDA	3,733	1,985	88.1	2,627	42.1	7,358	7,873	11,411	10,307
EBITDA Margin (%)	58.3	49.6	872bps	51.2	717bps	44.7	48.9	55.4	55.6
APAT	2,781	1,377	102	1,931	44	4,773	5,622	8,305	7,415
AEPS	8.6	4.3	102	6	44	14.8	17.5	25.8	23
P/E (x)						30.3	25.6	17.4	19.5
ROE (%)						50.4	49.8	58.2	42.9

(Source: Company, HDFC sec)

## Recent Developments

### Q2FY21 highlights:

Strong total broking revenues at Rs 4.8bn (+82.0%/16.2% YoY/QoQ) was led by sharp growth in cash ADTV (+119.7/7.4% YoY/QoQ) and derivatives ADTV (+55.7/30.8% YoY/QoQ). Cash market share was strong at 11.1% (+240/40bps YoY/QoQ). The active clients' base growth was healthy at 17.3% YoY, but sub-par compared to that shown by discount brokers. Management expects new client addition to strengthen as it has improved its digital client on-boarding infrastructure. ISEC has also launched new PRIME plan packs which seem to be attracting customers as adoption continued to increase. The MF distribution revenue was at Rs 571mn (+2.7/15.6% YoY/QoQ) as AAUM recovered 10.7% sequentially. Driven by 24 deals, IB's revenues grew (+92.9/179.4% YoY/QoQ) to Rs623mn.

Higher employee expenses (+34.1/3.9% YoY/QoQ), despite 1.6% QoQ lower headcount, drove total expenses higher by 32.3/6.4% YoY/QoQ. Management stated that it has rolled out increments to all front level employees and provided for higher variable pay. APAT for Q2 was up 102.0/44.1% YoY/QoQ to Rs 2.78bn.

### New product initiatives driving fee income and client retention:

With a focus on client retention and activation; ISEC has introduced various products like Global Investment Platform, new plans for ICICIdirect Prime which is a concessional brokerage plan with annual upfront fee income, Insta Account and expansion of loan product

portfolio along with addition of various other research products. ICICIdirect Prime generated annuity nature fee income of about Rs.200 million for FY20 and Rs.233 million for H1FY21 which shows the increasing reach of the product. Further, products like eATM (instant credit on selling the securities at no extra cost) and a diverse array of personalized customer solutions are contributing to client stickiness and deepening of the client relationship also manifested from the fact that ISEC saw an 11% increase YoY in the number of clients having two or more products.

Some other products which were launch recently were EIP which comprises a multi-asset basket of exchange-traded funds, SIP PROTECT- it is a free term life insurance on mutual fund SIPs and PMS and Quant Research Products. ICICIdirect aims to provide a one stop solution- a digital super market with a full suite of products and services catering to every requirement related to managing and growing financial assets.

### **New Client Acquisition along with firm Activation Rates and strong albeit cyclical trading volumes to drive the core broking revenue growth:**

ISEC reported pure broking revenue growth of 81.6% YoY and 10.2% QoQ primarily backed by new client acquisitions (up 23% YoY) and increase in daily trading activity driven by large movements in the equity markets which was also manifested by about 31.9% YoY growth in NSE active clients to 1.2 million. The activation rates i.e. % of New client acquisition (NCA) who have traded during the quarter rose to 63% as against 44% in Q2FY20 and 58% in Q1FY21. As on Q2FY21, ICICI direct had overall operational client base of 4.96Mn clients with total asset under holding of 2.9lk Cr. Out of the total client base ~1/3<sup>rd</sup> clients ie- 1.56Mn are active clients.

ISEC reported an increase of 119% in equity Average Daily Turnover (ADTO) to Rs.52 bn and a 55% increase in derivative ADTO to Rs.1,066 bn for Q2FY20. It outperformed the overall market growth on both these metrics which resulted in market share gain by 160 bps YoY to 8.9% for Q2FY20.

### **Industry tailwind**

Because of COVID-19, there has been a wild swing in the market and that has brought a large volume into the Indian stock market. Rising trading volumes has been supported by the growing participation of retail investors. Investors opened 3.4 million new demat accounts in the September quarter, according to SEBI data. In June quarter also, 2.4 million demat accounts were opened. This is unprecedented. This trend shows that many young investors are getting attracted by the volatility and looking to trade/invest. In fact, India has a favourable

demographic such as low penetration, rising household saving, increasing financial literacy etc. This shows that a multiyear growth story lying ahead of them.

Owing to the fragmented nature of this industry, large players have consistently gained market share in the cash equities segment. Also after recent circular of SEBI which announced new norms on bringing margin for cash buy/sell order, the larger players will gain even more share at the cost of small brokers.

### Long term Triggers

#### **Well established brand name**

Since 1995, the company has seen various capital market cycles and has a strong hold in the capital market space. 'ICICI Securities' is a well-established brand among retail and institutional investors in India. The company has been able to leverage its brand awareness to grow its businesses, build relationships and attract and retain talented individuals. The top management team comprises qualified and experienced professionals, with a successful track record.

Besides this the company is a subsidiary of ICICI Bank which holds a 77% stake in the company. This gives access to the bank's retail clientele, its branch network and the physical presence. It has also entered into unique arrangement with ICICI Bank to facilitate higher activation rate and improve the quality of customers, acquiring from more affluent and relevant segments. The bank helps company in targeting NRI customers by sharing digital leads with overseas branches of the banks and leveraging 20-minute tab-based instant account opening process for pre-existing bank customers. Strong synergy benefits with the parent provides extensive reach through 4500+ ICICI Bank branches spread across 2300+ cities and towns.

#### **Well diversified business**

The broad range of offerings under Broking, Institutional Equities, Wealth Management, Corporate Finance Advisory and various product distribution businesses help to foresee client requirements and provide full-fledged services under single platform. The production and distribution of all financial products and services helps the company's advisors and clients to attain client's financial objectives with high end services. ISEC's financial products and services are distributed through a pan-India network. This extensive network provides opportunities to cross sell products and services, particularly as the company diversifies into new business streams. The Company expects the MTF and ESOP funding book to grow which is in sync with its strategy of diversifying sources of revenue and increasing the scale of

active clients. Apart from this the company has made available its full array of loan products comprising home loan, two wheeler loans, auto loans, personal loans, loan against property, gold loans, lease rent discounting, credit/travel cards etc. on its platform.

### **Creating granular revenue streams along with focus on improved sourcing quality to build a base for a resilient business model**

ISEC is focused on broad basing the business model with expansion of its retail product basket with a view to smoothen the revenue trajectory and achieving granularity in revenue stream. ISEC has also gradually built a multi-channel open architecture with an emphasis on digital sourcing and creating partnerships with ecosystem players resulting in diversification of the sourcing mix. The number of business partners has now crossed 13,600 from about 8,000 during Q2FY20. It has been constantly focusing on scaling up its partner network, which grew by 32% in FY20 to reach over 9,400 IFAs (Independent Financial Associates), IA (Independent Associates), sub brokers and APs (Authorised Persons). This resulted in a run rate of clients sourced through partners growing by over 70% in FY20.

### **Focus on digital capabilities and cost efficiency driving realisation of operating leverage**

As a part of its long term strategy, ISEC has built a robust technology platform which can handle large concurrent volumes on heavy trading days. The platform was able to handle a peak volume about 4 m+ orders on a single day while handling 95k+ concurrent users. Further, ISEC is also focused on open architecture to on-board fintech partners in a bid to provide customer centric solutions.

With a growing and already strong online presence, ISEC is aiming for cost efficiency with a judicious reduction in the number of physical branches and reduction in overall headcount with an emphasis on nurturing a high quality talent pool. The number of branches reduced from 187 in Q2FY20 to 156 in Q2FY21 with the overall headcount declining to 3,669 in Q2FY21 from 4,077 in Q2FY20.

### **Five-Pronged Approach to strengthen the core for long term value creation**

The management has charted out a five pronged approach towards building a stronger core by: 1. ramping up scale and value by exploiting existing and newer channels 2. Increasing wallet share and stickiness with clients while broad basing revenue streams 3. Provide a unique customer experience by partnering with fintechs to offer customer centric solutions and seamless digital experiences 4. Focus on building a robust technology platform able to handle huge volumes during peak cycles 5. Focus on reducing CTI through cost efficiencies.



## What could go wrong?

- Capital market has inherent risk of volatility. Market volatility (especially downward) has high correlation with volumes growth for the broking business. So any prolonged period of negative returns from equity market can hurt company's revenues hard.
- The broking industry is currently facing significant pressures on account of increased competition from discount brokers. While the capital market cycle has been positive and volumes have compensated for declining yields, a reversal of investments into financial assets will have a significantly negative impact on both asset prices and trading volumes, which in turn will significantly impair broking revenues and earnings.
- For the broking business new regulatory changes requiring an upfront collection of margins may result in lower volumes; this remains a key risk in H2 for this segment. With the implementation of peak margin compliance norms (in a phased manner from Dec'20 to Aug'21), volumes in the market could moderate.

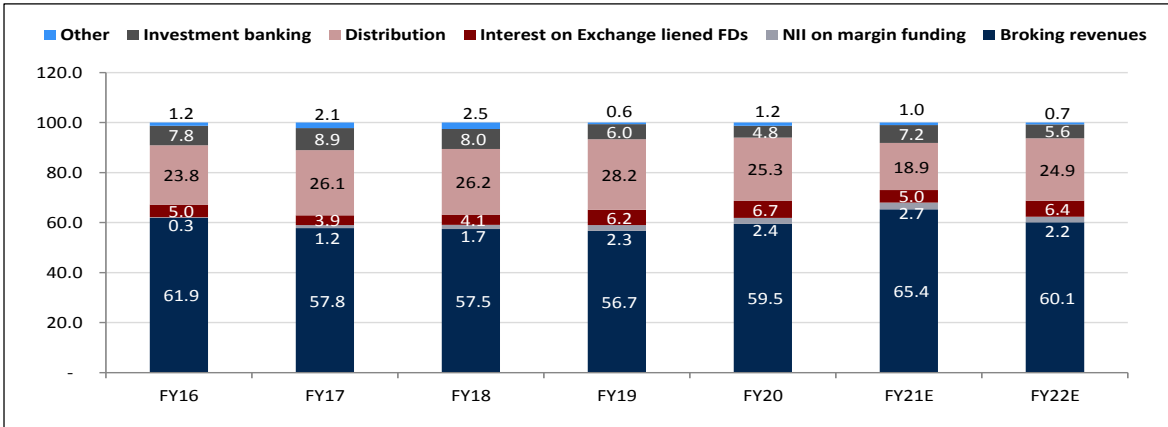
- Conversion of existing customers/onboarding of new customers in the 'Prime' plan can keep revenue realization under pressure.
- The distribution segment is facing some challenges as manifested by the decline in mutual fund commissions and static life insurance revenues. The overall distribution revenues declined by 9% for FY20 to Rs.4,229 mn and saw a 12.61% dip for H1FY21 at Rs.1,746 mn. The recovery in distribution revenues shall be watched closely.
- The recent rise in trading volume and higher market share is, we believe, a cyclical trend, and as the volatility and retail participation reduce, we expect ISEC's market share may normalise.
- Any adverse change of regulation might impact the business growth of the company.
- As per SEBI norms, promoter- ICICI Bank needs to trim down its stake by 2.22% to 75% within a stipulated period to meet the minimum public float requirement of 25%. Equity dilution by ICICI Bank can have a temporary overhang on the stock price.

### Company Profile:

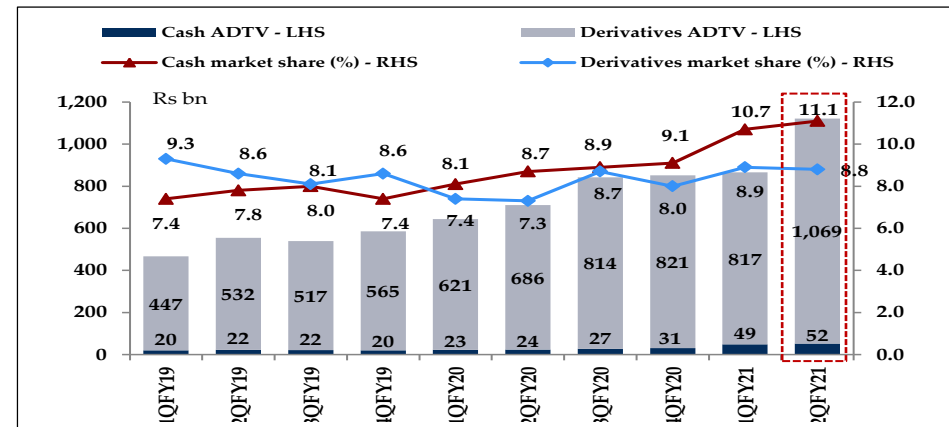
ICICI Securities Limited (ISec), incorporated in 1995, is the equity securities arm of the ICICI Group having one of the largest equity franchise in the country with a client base of 4.96 million and overall active client base at 1.56 million as at Q2FY21. It majorly offers broking services to institutional and retail clients in the equity, commodity and currency markets. Apart from this, it also has financial products distribution, private wealth management, institutional equities and financial advisory businesses. Apart from its considerable online presence, it had a network of 156 branches as on September 30, 2020. ICICI Bank holds 77.22% according to September 2020 share holding pattern.



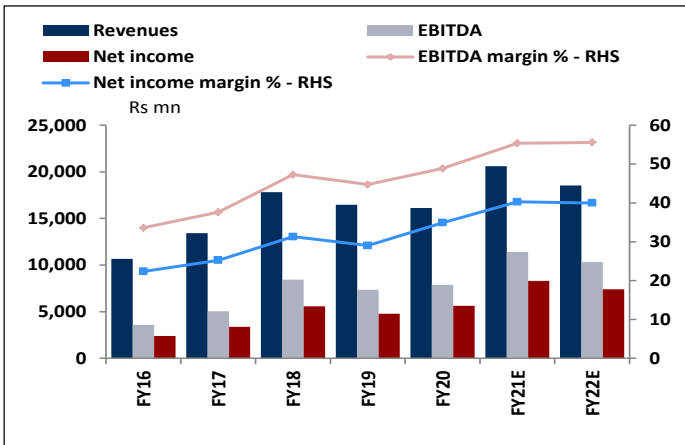
## Revenue Mix%



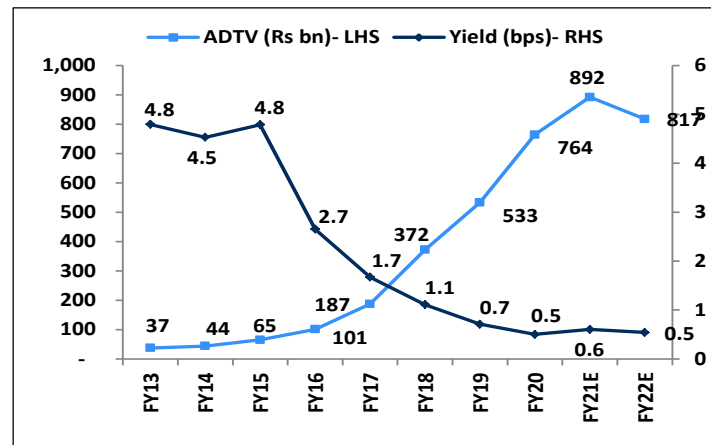
## ISEC's ADTV and rising market share



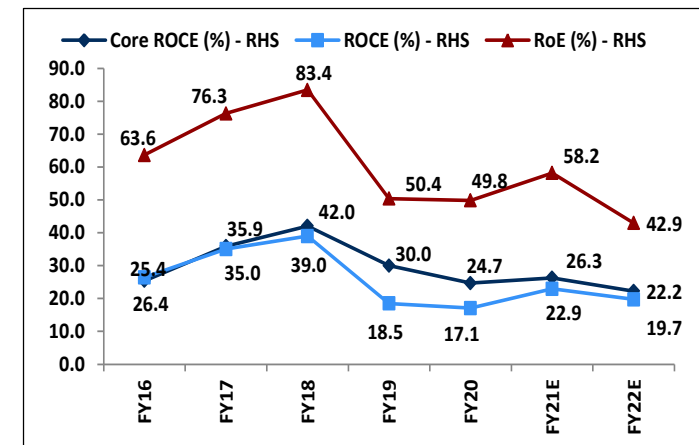
## Financial Snapshot



## ADTV & Declining Yield



## Return Ratios



(Source: Company, HDFC sec)

## Financials

### INCOME STATEMENT

(Rs mn)	FY19	FY20	FY21E	FY22E
<b>Net Revenues</b>	<b>16456</b>	<b>16116</b>	<b>20614</b>	<b>18542</b>
Growth (%)	-8%	-2%	28%	-10%
Employee benefits expenses	5545	5338	6206	5361
Operating expenses	1226	1024	1361	1205
Other expenses	2327	1881	1636	1669
<b>EBITDA</b>	<b>7358</b>	<b>7873</b>	<b>11411</b>	<b>10307</b>
<b>EBITDA Margin (%)</b>	<b>45</b>	<b>49</b>	<b>55</b>	<b>56</b>
EBITDA Growth (%)	-13%	7%	45%	-10%
Depreciation	150	614	608	634
<b>EBIT</b>	<b>7208</b>	<b>7259</b>	<b>10803</b>	<b>9673</b>
Other Income (includes treasury )	183	546	473	410
Interest & Financial Charges	27	276	173	169
<b>PBT</b>	<b>7365</b>	<b>7529</b>	<b>11103</b>	<b>9913</b>
Tax	2592	1908	2798	2498
<b>APAT</b>	<b>4773</b>	<b>5622</b>	<b>8305</b>	<b>7415</b>
APAT Growth (%)	-14%	18%	48%	-11%
RPAT	4908	5420	8305	7415
RPAT Growth (%)	-12%	10%	53%	-11%
<b>AEPS</b>	<b>15</b>	<b>17</b>	<b>26</b>	<b>23</b>
<b>EPS Growth (%)</b>	<b>-14%</b>	<b>18%</b>	<b>48%</b>	<b>-11%</b>

### BALANCE SHEET

(Rs mn)	FY19	FY20	FY21E	FY22E
<b>SOURCES OF FUNDS</b>				
Share Capital	1611	1611	1611	1611
Reserves	8862	10485	14855	16456
<b>Total Shareholders Funds</b>	<b>10473</b>	<b>12095</b>	<b>16465</b>	<b>18067</b>
<b>Total Debt</b>	<b>4473</b>	<b>16550</b>	<b>15273</b>	<b>13436</b>
Other Financial Liabilities & Provisions	705	829	887	949
Other Non Current Liabilities	5286	5311	5205	5101
Net Deferred Tax Liability	-738	-596	-607	-620
<b>TOTAL SOURCES OF FUNDS</b>	<b>20199</b>	<b>34189</b>	<b>37223</b>	<b>36933</b>
<b>APPLICATION OF FUNDS</b>				
Net Block	436	1980	2256	2414
CWIP	40	81	81	81
Loans & Deposits	1246	1183	1194	1206
<b>Total Non-current Assets</b>	<b>1722</b>	<b>3244</b>	<b>3532</b>	<b>3702</b>
FDs (ST + LT)	12645	18694	17796	19502
Debtors	4770	888	1130	1016
Cash & Equivalents	18841	5420	6699	4696
Loans & Advances	4061	5709	12990	12192
Other Current Assets	3870	9879	4694	4584
<b>Total Current Assets</b>	<b>44187</b>	<b>40589</b>	<b>43308</b>	<b>41990</b>
Creditors	23362	6926	8292	7064
Other Current Liabilities	2347	2717	1325	1694
<b>Total Current Liabilities</b>	<b>25709</b>	<b>9643</b>	<b>9617</b>	<b>8759</b>
<b>Net Current Assets</b>	<b>18478</b>	<b>30946</b>	<b>33691</b>	<b>33231</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>20199</b>	<b>34189</b>	<b>37223</b>	<b>36933</b>

## CASH FLOW STATEMENT

(Rs mn)	FY19	FY20	FY21E	FY22E
Reported PBT	7,572	7,529	11,103	9,913
Non-operating & EO Items	130	196	0	0
Interest Expenses	413	707	173	169
Depreciation	150	614	608	634
Working Capital Change	19,738	-19,991	-7,663	-2,345
Tax Paid	-2,925	-2,051	-2,798	-2,498
<b>OPERATING CASH FLOW ( a )</b>	<b>25,077</b>	<b>-12,995</b>	<b>1,424</b>	<b>5,873</b>
Net Capex	-208	-226	-412	-334
Free Cash Flow (FCF)	24,869	-13,222	1,011	5,540
Investments	-2,183	-5,788	5,351	-60
<b>INVESTING CASH FLOW ( b )</b>	<b>-2,391</b>	<b>-6,014</b>	<b>4,939</b>	<b>-394</b>
Debt Issuance/(Repaid)	-2,264	10,079	-975	-1,500
Interest Expenses	-400	-626	-173	-169
FCFE	22,205	-3,769	-137	3,871
Dividend	-2,951	-3,865	-3,935	-5,813
<b>FINANCING CASH FLOW ( c )</b>	<b>-5,615</b>	<b>5,588</b>	<b>-5,084</b>	<b>-7,483</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>17,071</b>	<b>-13,421</b>	<b>1,279</b>	<b>-2,003</b>
Opening Cash & Equivalents	1,770	18,841	5,420	6,699
<b>Closing Cash &amp; Equivalents</b>	<b>18,841</b>	<b>5,420</b>	<b>6,699</b>	<b>4,696</b>

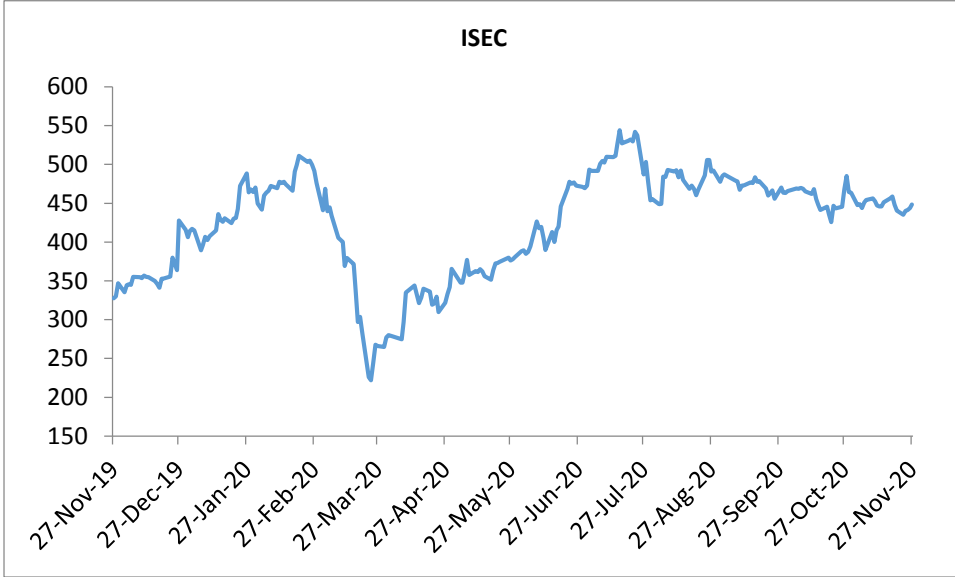
## KEY RATIOS

	FY19	FY20	FY21E	FY22E
<b>PROFITABILITY (%)</b>				
EBITDA Margin	44.7	48.9	55.4	55.6
EBIT Margin	43.8	45.0	52.4	52.2
APAT Margin	29.8	33.6	40.3	40.0
RoE	50.4	49.8	58.2	42.9
Core RoCE	30.0	24.7	26.3	22.2
RoCE	18.5	17.1	22.9	19.7
Debtors (days)	105.8	20.1	20.0	20.0
Other Current Assets (days)	387.8	570.8	562.2	639.6
Payables (days)	795.2	227.3	200.0	200.0
Other Current Liab & Prov (days)	53.0	61.5	30.0	30.0
Working Capital (days)	-354.6	302.1	352.2	429.6
Debt/EBITDA (x)	0.6	2.1	1.3	1.3
Net D/E	-1.4	0.9	0.5	0.5
Interest Coverage	271.7	26.3	62.4	57.2
<b>PER SHARE DATA</b>				
AEPS (Rs/sh)	14.8	17.5	25.8	23.0
CEPS (Rs/sh)	15.3	19.4	27.7	25.0
DPS (Rs/sh)	9.4	11.0	12.2	18.0
BV (Rs/sh)	32.5	37.5	51.1	56.1
<b>VALUATION</b>				
P/E	30.3	25.6	17.4	19.5
P/BV	13.8	12.0	8.8	8.0
Dividend Yield (%)	2.1	2.5	2.7	4.0

(Source: Company, HDFC sec Research )



One Year Price Chart



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