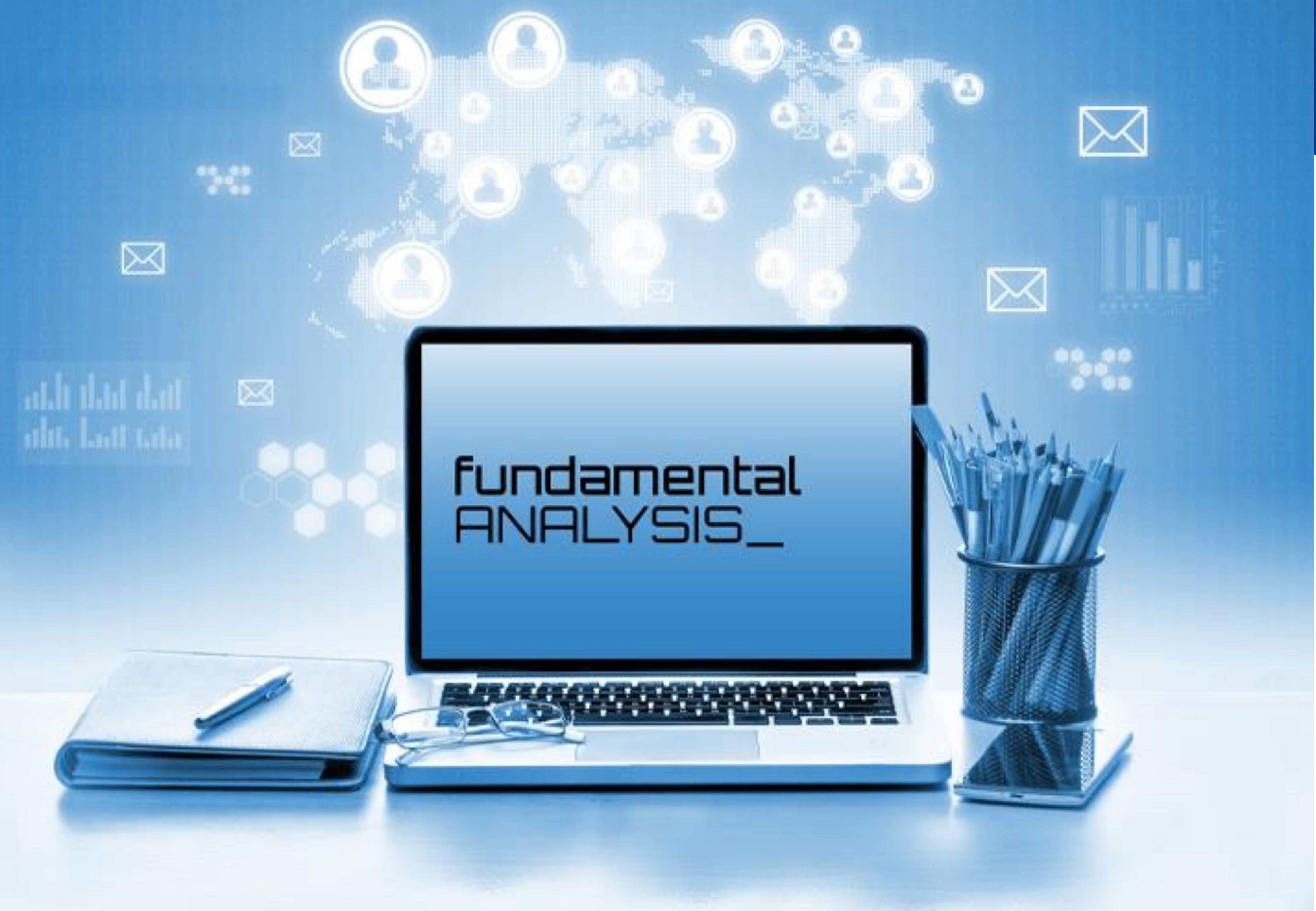
Stock Update

IIFL Securities Ltd.

October 9, 2023



RETAILRESEARCH

IIFL Securities Ltd.

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Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Broking	Rs 89	Buy in Rs 88-90 band and add on dips in Rs 79-81 band	Rs 97	Rs 108	2-3 quarters

HDFC Scrip Code	IIFLSECEQNR
BSE Code	542773
NSE Code	IIFLSEC
Bloomberg	IIFLSEC IN
CMP Oct 6, 2023	88.7
Equity Capital (Rs cr)	61.1
Face Value (Rs)	2
Equity Share O/S (cr)	30.6
Market Cap (Rs cr)	2712
Book Value (Rs)	46.6
Avg. 52 Wk Volumes	678,000
52 Week High (Rs)	92.0
52 Week Low (Rs)	48.2

Share holding Pattern % (Jun, 2023)	
Promoters	31.1
Institutions	19.6
Non Institutions	49.3
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst

Our Take:

IIFL Securities Ltd (IIFLSEC) is one of the key capital market players in the Indian financial services space. The company provides a full suite of products and services. It offers equities (both cash and derivatives), commodities, and currency broking for both retail and institutional clients. Its financial products distribution (FPD) division offers a wide range of products like mutual funds, insurance, IPOs, bonds, AIF, and others, targeting retail & HNI clients. It also has an investment banking (IB) division. The company is also constantly investing in technology and launching new innovative products to remain competitive with discount brokerages. The buoyant equity markets have resulted in strong growth in Investment Banking and financial products distribution revenue. Sale of its real estate assets could bring in further capital to invest in the financial services business. We believe the equity markets are likely to remain strong in the near term driving higher revenues and profitability for IIFLSEC.

Valuation & Recommendation:

We remain bullish about the near to mid-term prospects of the company owing to strong tailwinds across all capital market businesses. The stock is trading at a lower valuation as compared to its peers which we expect to narrow. We have envisaged 13% CAGR in topline and 18% in bottomline over FY23-FY25E. We believe investors can buy the stock in the band of Rs 88-90 and add on dips in Rs 79-81 band (7x FY25E EPS) for a base case fair value of Rs 97 (8.5x FY25E EPS) and bull case fair value of Rs 108 (9.5x FY25E EPS) over the next 2-3 quarters.

Financial Summary

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY22	FY23	FY24E	FY25E
Revenues	409	292	40.3	402	1.8	1,232	1,352	1,549	1,714
EBITDA	138	93	47.8	152	-9.2	483	465	527	590
APAT	75	44	71.3	86	-13.4	306	250	295	348
Diluted EPS (Rs)	2.4	1.4	70.4	2.8	-13.5	10.1	8.2	9.6	11.4
RoE (%)						28.5	19.8	20.4	21.0
P/E (x)						8.8	10.8	9.2	7.8
EV/EBITDA (x)						-0.9	0.8	0.0	-0.5

(Source: Company, HDFC sec)

Q1FY24 Result Update

Consolidated revenue of the company increased 40% YoY and 2% QoQ to Rs 409cr driven by sharp jump in retail broking and financial products distribution income. Retail broking revenue increased by 16% YoY to Rs 126cr on account of increased cash and F&O turnover. Distribution income more than doubled to Rs 85cr resulting from increased sale of AIF, PMS and insurance products. Investment banking division reported revenue of Rs 55cr, a growth of 84% YoY as it completed nine deals during the quarter across capital markets, debt and private equity. Employee cost was virtually unchanged QoQ and has increased 4% on a YoY basis. Finance cost has gone up 8% QoQ and 12% YoY basically because of increase in the overall borrowing cost. Net profit for the quarter stood at Rs 75cr, up 71% YoY and down 13% QoQ.

AUM and custody assets increased to 1.47 lakh crore as compared to Rs 1.12 lakh crore in Q1FY23. Average daily turnover for the first quarter was Rs 2.31 lakh crore, which consisted of Rs 1,655cr in cash and Rs 2.3 lakh crore in derivative segment. The company filed 2 DRHPs with SEBI over the quarter and has expanded the product offerings beyond capital markets.

Key Triggers

New demat openings indicate higher turnover

According to data from the two depositories, CDSL and NSDL, a record number of 3 million new demat accounts were opened in July 2023 and 3.1 million new accounts were opened in August 2023, indicating the growing retail participation in the stock market. The total number of demat accounts now stands at a new high of 126.60 million. The overall sentiment in equity markets continues to remain buoyant driven by economic growth, renewed infrastructure and real estate development, younger population, and more awareness about benefits of investing for long-term growth. As new investors start investing in equities, cash and derivatives turnover is expected to increase, resulting in higher revenue from brokerage and later higher income from financial products distribution.

Buoyant markets to drive higher IB revenue

We have seen in the past that in time of bullish markets, the number of IPOs and M&A deals increase. Indian markets witnessed a total of 37 IPOs in FY23 raising around Rs 520 billion. In the first half of 2023–24, 31 Indian corporates raised Rs.263 billion through main board IPOs. The Indian market had a record high Mergers & Acquisitions (M&A) deal value as nearly 20 deals totaling USD 152 billion were completed in 2022. IIFL completed 29 transactions, comprising 12 Initial Public Offers, 3 Qualified Institutional Placements, 6 debt transactions and number of advisory transactions, buybacks, offer for sale and open offers during FY23. The strong momentum in equity markets is likely to result in surge of IPOs, buybacks and PE deals in the coming years driving higher investment banking revenue for the company.

Focus on affluent customers

IIFLSEC is diversifying revenues with a greater focus on the distribution business, building an AUM-led model and acquiring more clients (particularly in the HNI/affluent segment). The Company has revised its strategy to concentrate on affluent customers in accordance with the re-organisation plan approved by its Board of Directors. Under the reorganising scheme, the Board of Directors approved the transfer of IIFL Securities' Online Retail Trading Business to 5paisa Capital Limited. Going ahead, clients that need help of RMs or retail clients operating through sub brokers will remain in IIFLSEC while the rest could go to 5Paisa.

The demerger is expected to be completed over the next 4-6 months. As per the Scheme of Arrangement, shareholders would receive 1 share of 5paisa Capital for every 50 shares held in IIFL Securities. The transfer would impact ~5% of revenue and ~15 lakh customers. The company does not intend to get into market share race and would focus on optimizing revenue and profitability.

This arrangement could take another 4-6 months to fructify.

Real Estate sale could provide boost to profits

IIFLSEC is in the market to sell some of its large properties it owns in cities like Chennai, Hyderabad and Pune. Other properties in Mumbai and Delhi could be sold later. The combined book value of the properties is ~Rs 230cr while the estimated market value is ~Rs 650cr. Sale of these properties could provide a strong boost to profits of the company.

SEBI order stayed by SAT

In Jun'23, SEBI had prohibited the company from on-boarding new clients for two years as a stockbroker. This is pertaining to inspections carried out for different periods from April 2011 to 2017. However, the company appealed against the ruling and Securities Appellate Tribunal (SAT) has stayed this order. SEBI has not found anything wrong subsequent to the enhanced supervision circulation becoming effective in 2017. The management believes that the order would be taken back and would not affect the working of the company.

Indian Broking Industry

Low retail penetration

Indian stock exchange has witnessed exponential growth in the past decade. However, it is still underpenetrated compared to the rest of the world. As of FY23, only 123mn (NSDL+ CDSL) Indians have demat accounts, which is around 4% of the country's population. In comparison, over 50% of Americans own stocks. Even in China, 7% of the population are equity investors (still higher than India's 4%). This indicates there is plenty of room for the stock market to penetrate further.

ADTO has increased in recent times

According to the capital markets regulator SEBI, close to 25 mn new demat accounts were opened in FY23 compared to 35 mn in FY22. The average daily turnover (ADTO) in the cash market in shot up to ~Rs 66,800cr in FY22 before moderating to ~Rs 53,500 in FY23. The average daily turnover in the derivative market increased by 10% YoY to Rs 1.61 lakh crore. Robust client addition and market volatility are key factors for surging volumes in the derivative segment.

With increase in financial literacy, mobile penetration, growing awareness and opening up of Jan Dhan bank accounts, demand for financial products has increased in smaller cities. Financial services are available across India with technology upgradation, which not only increases awareness for these products but also reduces the cost to companies for reaching out to smaller markets.

Risk & Concerns

Market volatility

Capital market has an inherent risk of volatility. Market volatility (especially downward) has high correlation with volume growth for the broking business. Hence, any prolonged period of negative returns from equity market can hit the company's revenues hard.

Competition

The broking industry is increasingly becoming competitive and technology-driven, with new format players giving rise to technology and pricing-based disruptions. It is currently facing significant pressure 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 in 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. IIFL SEC got limited benefits of client rise and volume rise in Covid times unlike its peers.

Adverse regulatory change

For the broking business, new regulatory changes could result in lower volumes in the short to medium term. Further, any adverse change of regulation or non-compliance of rules might impact the company's growth.

Market share loss

IIFLSEC has witnessed a decline in the overall market share from 2% in FY19 to 1.1% in FY23, due to high volatility, sharp rise in passive flows, competition from discount brokers and underwritten blocks. If the trend continues, there could be a negative impact on the company's stock price. Hiving off of retail online clients could result in further loss of share (especially in active customers). However the company has decided not to focus on market share but on enhancing revenues and profitability.

Company Background:

IIFL Securities Ltd (IIFLSEC) is one of the key capital market players in the Indian financial services space. Along with its subsidiaries, IIFLSEC offers advisory and broking services, financial products distribution, institutional research, and investment banking services. The company caters to over 3 mn customers through a network that is present at 2,500 points, covering branches and business partners across 500+ locations through own and franchisee offices. On the institutional side, it has over 850 foreign and domestic customers as of 31 March 2023. It has ~0.5mn active retail clients and total 2.5mn clients. IIFLSEC has ~450 RMs.

IIFLSEC, the erstwhile flagship company of the India Infoline group, was set up as Probity Research and Services in October 1995; its name was changed to India Infoline Ltd in March 2000. The company is a trading member of the BSE and NSE. IIFL Finance (erstwhile IIFL Holdings Ltd) was the holding company for the entire IIFL group. As a part of corporate restructuring, the securities and wealth businesses of IIFL Holdings Ltd were demerged into IIFL Securities Ltd and IIFL Wealth Management Ltd respectively. In September 2019, IIFL Securities was listed on the stock exchanges.

IIFLSEC completed buyback of 1.7cr shares through open market at an average price of ~Rs 51 per share in Feb’21. The company emerged a successful bidder for demat accounts of Karvy Stock Broking with NSDL and CDSL in Feb’21 and nearly 1.1 mn demat accounts from Karvy were acquired in a formal bidding process organised by stock exchanges and depositories. The company has an average SIP transactions of ~1.5 lakh transactions per month with total SIP AUM of ~Rs 2100cr. Promoters own 31.1% stake in the company, Fairfax has 27.7% stake and other institutions hold 19.6%.

Peer Comparison:

	CMP	Mcap (Rs Cr)	FY23				EPS			P/E		
			Sales	NP	Margin	RoE	FY23	FY24E	FY25E	FY23	FY24E	FY25E
ICICI Securities	628	20,303	3,416	1,118	32.7	42.3	34.5	38.2	43.9	18.2	16.4	14.3
IIFL Securities	89	2,711	1352	250	18.5	19.8	8.2	9.6	11.4	10.8	9.2	7.8
Angel Broking	1978	16,591	3,021	890	29.5	47.5	105.1	117.6	134.5	18.8	16.8	14.7

Financials

Income Statement

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**791**	**1232**	**1352**	**1549**	**1714**
Growth (%)	***9.2***	***55.8***	***9.7***	***14.5***	***10.7***
Operating Expenses	488	749	887	1022	1124
EBITDA	**303**	**483**	**465**	**527**	**590**
Growth (%)	***4.2***	***59.2***	***-3.7***	***13.2***	***12.0***
EBITDA Margin (%)	***38.4***	***39.2***	***34.4***	***34.0***	***34.4***
Depreciation	46	63	67	64	62
Other Income	77	84	18	19	22
EBIT	**334**	**503**	**416**	**481**	**550**
Interest expenses	50	102	76	82	79
PBT	**285**	**402**	**341**	**399**	**471**
Tax	64	96	91	105	123
PAT	**220**	**306**	**250**	**294**	**348**
Share of Asso./Minority Int.	0	0	0	0	0
Adj. PAT	**220**	**306**	**250**	**295**	**348**
Growth (%)	***66.5***	***38.9***	***-18.2***	***17.8***	***18.3***
EPS	7.3	10.1	8.2	9.6	11.4

Balance Sheet

As at March (Rs cr)	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	61	61	61	61	61
Reserves	907	1121	1289	1483	1715
Shareholders' Funds	**968**	**1182**	**1350**	**1544**	**1776**
Minority Interest	0	0	-1	-1	-1
Total Debt	292	607	486	476	456
Net Deferred Taxes	-21	-24	-30	-30	-30
Other Non-curr. Liab.	0	0	0	0	0
Total Sources of Funds	**1238**	**1765**	**1805**	**1989**	**2201**
APPLICATION OF FUNDS					
Net Block & Goodwill	394	406	363	313	267
CWIP	47	3	1	1	0
Investments	168	304	167	267	367
Other Non-Curr. Assets	1085	1463	1719	1968	2178
Total Non Current Assets	**1694**	**2175**	**2249**	**2550**	**2812**
Inventories	0	0	0	0	0
Debtors	34	28	22	43	38
Cash & Equivalents	1678	3740	2837	3093	3237
Other Current Assets	117	74	99	145	130
Total Current Assets	**1829**	**3842**	**2958**	**3281**	**3405**
Creditors	4	2	3	4	3
Other Current Liab & Provisions	2281	4251	3399	3837	4013
Total Current Liabilities	**2285**	**4252**	**3402**	**3842**	**4017**
Net Current Assets	-456	-410	-444	-561	-612
Total Application of Funds	**1238**	**1765**	**1805**	**1989**	**2201**

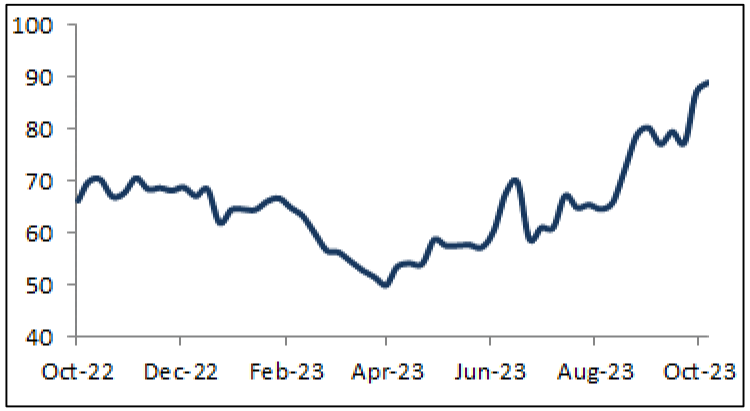
Cash Flow Statement

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	285	402	341	399	471
Non-operating & EO items	3	43	90	-250	-210
Interest Expenses	33	85	73	82	79
Depreciation	46	63	67	64	62
Working Capital Change	-157	283	-1,266	373	195
Tax Paid	-58	-82	-98	-105	-123
OPERATING CASH FLOW (a)	**152**	**795**	**-793**	**564**	**474**
Capex	-63	27	-5	-15	-15
Free Cash Flow	89	822	-798	549	459
Investments	190	-102	143	-100	-100
Non-operating income	21	-11	26	0	0
INVESTING CASH FLOW (b)	**148**	**-86**	**163**	**-115**	**-115**
Debt Issuance / (Repaid)	-167	315	-121	-10	-20
Interest Expenses	-48	-98	-73	-82	-79
FCFE	84	926	-824	357	260
Share Capital Issuance	1	4	6	0	0
Dividend	-30	-91	-91	-101	-116
Others	-117	-21	-16	0	0
FINANCING CASH FLOW (c)	**-244**	**129**	**-280**	**-193**	**-215**
NET CASH FLOW (a+b+c)	**55**	**838**	**-910**	**256**	**144**

Key Ratios

	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	38.4	39.2	34.4	34.0	34.4
EBIT Margin	42.3	40.9	30.8	31.1	32.1
APAT Margin	27.8	24.8	18.5	19.0	20.3
RoE	23.8	28.5	19.8	20.4	21.0
RoCE	25.7	33.0	23.0	24.9	25.9
Solvency Ratio (x)					
Net Debt/EBITDA	-4.6	-6.5	-5.1	-5.0	-4.7
Net D/E	-1.4	-2.7	-1.7	-1.7	-1.6
Per Share Data (Rs)					
EPS	7.3	10.1	8.2	9.6	11.4
CEPS	8.8	12.2	10.4	11.7	13.4
BV	31.9	38.9	44.2	50.5	58.1
Dividend	1.0	3.0	3.0	3.3	3.8
Turnover Ratios (days)					
Debtor days	15	9	7	8	9
Creditors days	2	1	1	1	1
Valuation (x)					
P/E	12.2	8.8	10.8	9.2	7.8
P/BV	2.8	2.3	2.0	1.8	1.5
EV/EBITDA	4.4	-0.9	0.8	0.0	-0.5
EV/Revenues	1.7	-0.3	0.3	0.0	-0.2
Dividend Yield (%)	1.1	3.4	3.4	3.7	4.3
Dividend Payout (%)	13.8	29.8	36.6	34.2	33.3

Price chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

ATUL JAGDISH KARWA

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