ICICI Securities

SELL

Loan assets drive earnings upgrade

Higher core broking revenues and strong growth in funding book drive profits, while distribution and IB remain soft. Cost decline is lower than our expectation.

HIGHLIGHTS OF THE QUARTER

- **Adj. revenues** printed Rs 3.85bn (-2.3/-3.9% YoY/QoQ, (4.3% below est.), while **APAT** was at Rs 1.37bn (+35.7/-2.3% YoY/QoQ, 6.4% below est.).
- **Broking revs at Rs 2.24bn (-1.0%/-+4.1 YoY/QoQ)** were ahead of est. led by sharp improvement in market share (8.7%, +70/140bps YoY/QoQ).
- **MTF+ESOP book size jumped to Rs 11.5bn (+69.6% QoQ).** Management aspires to further increase this book significantly over the coming quarters. Management through postal ballot has asked for shareholder approval to increase in advances to upto Rs 35.0bn (currently at Rs 15bn). We have increased our avg. loan book size est. for FY21/22E to Rs 19.6/23.5bn.
- Active clients base (0.96mn, +13.6/5.5% YoY/QoQ) continued to grow at a brisk pace with increasing share of clients (35% of active client base) opting for prime/prepaid brokerage plans.
- **Distribution revenues at Rs 1.08bn grew +0.8/1.6% YoY/QoQ.** While revs were below estimates, we are hopeful of recovery in 4QFY20, as AUM growth is expected to be healthy (led by M2M gains) and 4Q is a seasonally strong quarter for insurance.
- **MF Revs** were at Rs 576mn (-3.8/+3.6% YoY/QoQ), while AUM at Rs 375bn (+9.3/+4.7% YoY/QoQ). Yields were stable QoQ.
- **Total cost** at Rs 2.0bn (-14.3/+1.4% YoY/QoQ) were higher than est. ISEC has reduced headcount to 3,955 (-7.0/-3.0% YoY/QoQ) and branches (178 in Dec-19 vs. 187 in Sep-19). We expect significant lower costs in FY21/22E.

Outlook: Stock may continue to trade at high levels.

STANCE

While volumes increase deteriorating mix is expected to keep yields under check. Distribution revenues have bottomed out. ISEC is rapidly building loan assets which will drive earnings in the near term. All the above, along with cost control will drive earnings at FY20-22E CAGR of 17.9%. We increase FY20E/21E/22E APAT estimates by 0.6/4.8/5.1%, and continue to rate ISEC a SELL with a TP of Rs 376 (16x Dec-21E EPS). We believe 16x is a fair multiple for the stock given market linked nature of its business lines. A rally in equity markets coupled with increased retail participation remains a key risk.

FINANCIAL SUMMARY

(Rs mn)	3QFY20	3QFY19	YoY(%)	2QFY20	QoQ(%)	FY18	FY19	FY20E	FY21E	FY22E
Adj. revenues	3,847	3,936	-2.3	4,001	-3.9	17,824	16,456	15,767	17,207	18,386
EBITDA	2,008	2,343	15.4	2,021	-9.0	8,427	7,358	7,892	9,389	10,481
EBITDA Margin (%)	47.8	40.5	733bps	50.5	-272bps	47.3	44.7	50.1	54.6	57.0
APAT	1,372	1,012	35.7	1,404	-2.3	5,577	4,773	5,596	6,894	7,785
AEPS	4.3	3.1	35.7	4.4	-2.3	17.3	14.8	17.4	21.4	24.2
EV/EBITDA (x)						16.7	16.5	17.8	15.6	14.1
P/E (x)						24.4	28.5	24.3	19.7	17.5
ROE (%)						83.4	50.4	48.5	49.2	46.2

Source: Company, HDFC sec Inst Research estimates

INDUSTRY	**RETAIL BROKING**
CMP *(as on 20 Jan 2020)*	**Rs 424**
Target Price	**Rs 376**
Nifty	12,225
Sensex	41,529

KEY STOCK DATA

Bloomberg	ISEC IN
No. of Shares (mn)	322
MCap (Rs bn) / ($ mn)	137/1,920
6m avg traded value (Rs mn)	139

STOCK PERFORMANCE (%)

52 Week high / low			Rs 452/188
	3M	6M	12M
Absolute (%)	48.5	88.4	85.4
Relative (%)	42.8	80.1	71.2

SHAREHOLDING PATTERN (%)

	Sep-19	Dec-19
Promoters	79.2	79.2
FIs & Local MFs	12.0	11.9
FPIs	2.7	2.7
Public & Others	6.1	6.2
Pledged Shares	Nil	Nil

Source : BSE

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Adj. revenues declined 2.3% YoY, largely led by decline in IB revs (-31.3% YoY).

Employee expenses declined 6.2% YoY led by decline in headcount. Employee count declined 7.0/3.0% YoY/QoQ to 3,955 as of Dec-19.

Branch count has reduced from 187 as of Sep-19 to 178 as of Dec-19.

ISEC Results Summary: 3QFY20

(Rs mn)	3QFY20	3QFY19	YoY (%)	2QFY20	QoQ (%)
Revenues (see note below)	**3,847**	**3,936**	***-2.3***	**4,001**	***-3.9***
Employee expenses	1,328	1,416	*-6.2*	1,339	*-0.8*
Operating expenses	157	354	*-55.7*	151	*3.6*
Other expenses	523	573	*-8.7*	490	*6.9*
Total expenses	**2,008**	**2,343**	***-14.3***	**1,980**	***1.4***
EBITDA	**1,839**	**1,593**	***15.4***	**2,021**	***-9.0***
Depreciation	148	39	*283.5*	147	*1.1*
EBIT	**1,690**	**1,554**	***8.8***	**1,875**	***-9.8***
Finance expenses	19	0	*NM*	59	*-67.3*
Other income	180	27	*577.1*	61	*196.2*
PBT	**1,851**	**1,581**	***17.1***	**1,877**	***-1.4***
Tax expenses	479	569	*-15.9*	473	*1.3*
APAT	**1,372**	**1,012**	***35.7***	**1,404**	***-2.3***
Adjustment	**-**	**0**	***NM***	**-53**	***NM***
RPAT	**1,372**	**1,012**	***35.7***	**1,351**	***1.6***
AEPS (Rs)	**4.3**	**3.1**	***35.7***	**4.4**	***(2.3)***
Margins (%)					
EBITDA	48.7	40.5	*826*	50.5	*(179)*
EBIT	44.9	39.5	*546*	46.9	*(191)*
PBT	47.3	40.2	*710*	46.9	*36*
APAT	35.0	25.7	*934*	35.1	*(5)*
Tax rate (%)	25.2	36.0	*(1,080)*	25.2	*2*
C/I ratio (%)	47.6	57.9	*(1,034)*	47.5	*8*

Note: Revenues netted of for estimated interest cost on margin funding and ESOP funding book; treasury income re-classified as other income.
Source: Company, HDFC sec Inst Research

ADTV growth continues to remain robust (+59.6/19.0% YoY/QoQ) led by increase in industry volumes and improvement in ISEC's market share (+70/140bps YoY/QoQ).

Market share improved across both cash & derivative segments.

Improvement in market share was led by increase in active clients, traction building in prime and prepaid brokerage plans.

ESOP + MTF book size jumped 69.6% QoQ to Rs 11.5bn.

Operating metrics

(Rs mn)	3QFY20	3QFY19	YoY(%)	2QFY20	QoQ(%)
Total broking revenues	2,246	2,269	*(1.0)*	2,158	*4.1*
I-sec ADTV	846	530	*59.6*	711	*19.0*
Total market ADTO (ex-prop)	9,648	6,625	*45.6*	9,660	*(0.1)*
Reported market share (Blended)	8.7	8.0	*70bps*	7.3	*140bps*
Reported market share (Cash)	8.9	8.0	*90bps*	8.7	*20bps*
Reported market share (Derivatives)	8.7	8.1	*60bps*	7.3	*140bps*
Yield (bps)	0.44	0.70	*(37.5)*	0.49	*(11.1)*
Active clients - NSE (mn)	0.96	0.85	*13.6*	0.91	*5.5*
Distribution					
MF revenue (Rs mn)	576	599	*(3.8)*	556	*3.6*
MF AAUM (Rs bn) - RHS	375	343	*9.3*	358	*4.7*
MF Equity AAUM (Rs bn)	279	254	*9.8*	263	*6.1*
Blended Yield (%)	0.61	0.70	*-10bps*	0.62	*0bps*
Insurance dist. Revenue (Rs mn.)	120	104	*15.4*	123	*(2.4)*
Insurance Premium (Rs mn)	1,865	1,994	*(6.5)*	1,982	*(5.9)*
Yield (%)	6.4	5.2	*122bps*	6.2	*23bps*
Other dist. Revenue	383	367	*4.4*	383	*0.0*
Investment banking revenues	176	256	*(31.3)*	323	*(45.5)*

Source: Company, HDFC sec Inst Research

Broking revenues were higher than estimates led by sharp improvement in market share to 8.7% (+70/140bps YoY/QoQ).

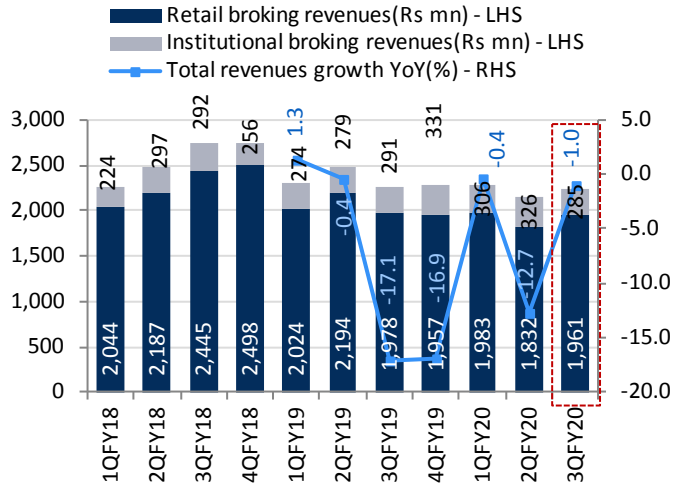
Contrary to the trend seen earlier, retail broking declined only 0.9% YoY while institution broking declined 2.1% YoY.

Life insurance distribution: Yields continue to expand as the distributor continues to focus on protection sales.

Distribution yields have improved meaningfully to 6.4% in 3QFY20 from 5.1/6.2% in 1QFY20/2QFY20.

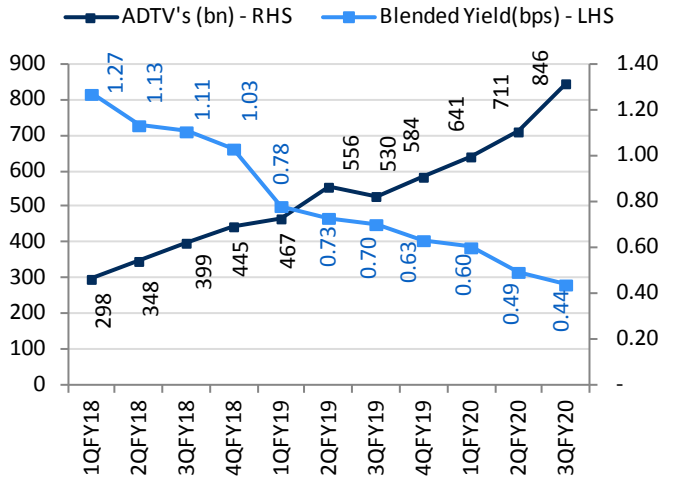
IB revenues were significantly below estimates dragged operating performance.

Broking revenue split and growth



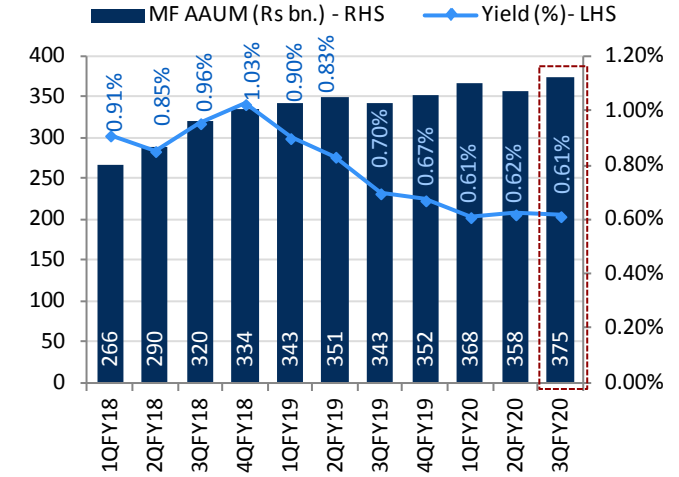
Source: Company, HDFC sec Inst Research

Broking: ADTV and yields



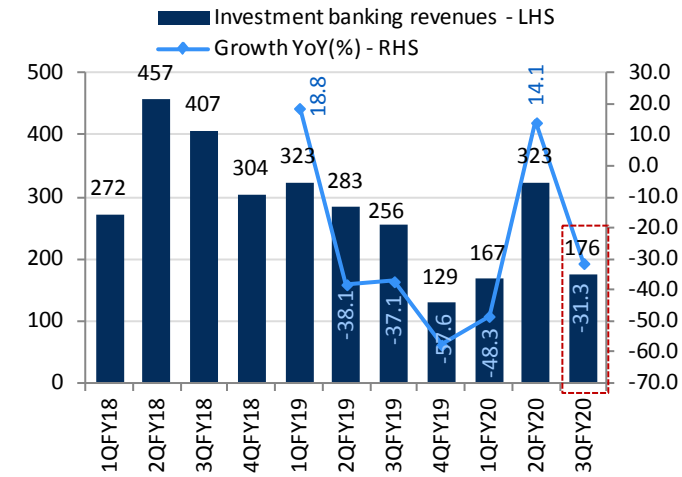
Source: Company, HDFC sec Inst Research

MF AAUMs and yields



Source: Company, HDFC sec Inst Research

Advisory revenues (Rs mn) and growth (%)



Source: Company, HDFC sec Inst Research

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

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

We have fine tuned our insurance distribution revenues factoring in higher distribution yields as evidenced in 3QFY20.

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

Assumptions

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Broking income					
Total broking revenues	**11,269**	**10,723**	**10,451**	**11,006**	**11,344**
Growth (%)	*33.4*	*(4.8)*	*(2.5)*	*5.3*	*3.1*
Broking Revenues	**10,243**	**9,328**	**9,049**	**9,109**	**9,332**
Growth (%)	*32.0*	*(8.9)*	*(3.0)*	*0.7*	*2.5*
I-sec ADTO	372	533	739	875	1,018
Growth (%)	*98.6*	*43.3*	*38.6*	*18.4*	*16.4*
Total market ADTO (ex-prop)	4,184	6,271	9,719	11,663	13,763
Calculated market share	8.9%	8.5%	7.6%	7.5%	7.4%
Yield (bps)	1.11	0.71	0.50	0.42	0.37
Growth (%)	*(33.5)*	*(36.2)*	*(30.0)*	*(15.0)*	*(12.0)*
NII on margin funding book	**297**	**373**	**378**	**785**	**895**
Avg. loan book (Rs mn.)	5,184	5,285	8,720	19,620	23,544
Growth (%)	*56.0*	*2.0*	*65.0*	*125.0*	*20.0*
Interest on liened FD	**729**	**1,022**	**1,023**	**1,112**	**1,117**
Assumed interest rate	7.5%	9.1%	8.8%	8.5%	8.0%
Lien with exchanges	11,759	10,604	12,646	13,531	14,383
Growth (%)	*53.4*	*(9.8)*	*19.3*	*7.0*	*6.3*
Distribution					
Total distribution revenues	4,675	4,635	4,340	5,128	5,861
Growth (%)	*33.5*	*(0.9)*	*(6.4)*	*18.2*	*14.3*
MF revenue (Rs mn.)	**2,847**	**2,695**	**2,314**	**2,874**	**3,380**
Growth (%)	*71.8*	*(5.3)*	*(14.1)*	*24.2*	*17.6*
MF AAUM (Rs bn.)	305	347	368	423	474
Growth (%)	*43.9*	*13.8*	*6.0*	*15.0*	*12.0*
Yield (%)	0.93%	0.78%	0.63%	0.68%	0.71%
Insurance dist. Revenue (Rs mn.)	**460**	**474**	**516**	**623**	**720**
Growth (%)	*(35.5)*	*3.0*	*8.9*	*20.8*	*15.6*
Insurance Premium (Rs mn.)	9,038	8,869	8,603	9,893	11,081
Growth (%)	*7.7*	*(1.9)*	*(3.0)*	*15.0*	*12.0*
Yield (%)	5.1%	5.3%	6.0%	6.3%	6.5%
Other Dist. Revenue	**1,368**	**1,466**	**1,510**	**1,631**	**1,761**
Growth (%)	*21.0*	*7.2*	*3.0*	*8.0*	*8.0*
Investment Banking					
Investment banking revenues	1,430	991	912	1,003	1,103
Growth (%)	*19.7*	*(30.7)*	*(8.0)*	*10.0*	*10.0*
Other revenues	451	107	64	70	78
Growth (%)	*56.4*	*(76.3)*	*(40.0)*	*10.0*	*10.0*

Source: Company, HDFC sec Inst Research

Change in estimates lead to increase in PAT by 4.8/5.1% for FY21/22E.

Change in estimates

(Rs mn.)	FY20E			FY21E			FY22E		
	Revised	Old	*Change (%)*	Revised	Old	*Change (%)*	Revised	Old	*Change (%)*
Revenues	15,767	16,058	*-1.8*	17,207	17,094	*0.7*	18,386	18,128	*1.4*
EBITDA	7,892	8,270	*-4.6*	9,389	9,361	*0.3*	10,481	10,327	*1.5*
EBITDA margin (%)	50.1	51.5	*-145bps*	54.6	54.8	*-20bps*	57.0	57.0	*4bps*
PAT	5,596	5,560	*0.6*	6,894	6,578	*4.8*	7,785	7,407	*5.1*
EPS	17.4	17.3	*0.6*	21.4	20.4	*4.8*	24.2	23.0	*5.1*
RoE (%)	48.5	48.3	*24bps*	49.2	47.5	*164bps*	46.2	45.0	*118bps*

Source: Company, HDFC sec Inst Research

Income statement

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues	**17,824**	**16,456**	**15,767**	**17,207**	**18,386**
Growth (%)	***32.7%***	***-7.7%***	***-4.2%***	***9.1%***	***6.8%***
Employee benefits expenses	5,453	5,545	5,312	5,260	5,242
Operating expenses	1,683	1,226	631	723	791
Other expenses	2,260	2,327	1,932	1,835	1,872
EBITDA	**8,427**	**7,358**	**7,892**	**9,389**	**10,481**
EBITDA Margin (%)	***47.3***	***44.7***	***50.1***	***54.6***	***57.0***
EBIDTA Growth (%)	***66.9%***	***-12.7%***	***7.3%***	***19.0%***	***11.6%***
Depreciation	153	150	599	517	522
EBIT	**8,274**	**7,208**	**7,293**	**8,872**	**9,959**
Other Income (includes treasury)	289	183	467	611	782
Interest & Financial Charges	14	27	249	168	221
PBT	**8,549**	**7,365**	**7,511**	**9,316**	**10,520**
Tax	2,971	2,592	1,915	2,422	2,735
APAT	**5,577**	**4,773**	**5,596**	**6,894**	**7,785**
APAT Growth (%)	***64.7%***	***-14.4%***	***17.2%***	***23.2%***	***12.9%***
RPAT	**5,577**	**4,908**	**5,571**	**6,894**	**7,785**
RPAT Growth (%)	***64.7%***	***-12.0%***	***13.5%***	***23.8%***	***12.9%***
AEPS	**17.3**	**14.8**	**17.4**	**21.4**	**24.2**
EPS Growth (%)	***64.7%***	***-14.4%***	***17.2%***	***23.2%***	***12.9%***

Source: Company, HDFC sec Inst Research

Balance sheet

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital	1,611	1,611	1,611	1,611	1,611
Reserves	6,866	8,862	10,986	13,839	16,645
Total Shareholders' Funds	**8,477**	**10,473**	**12,597**	**15,449**	**18,256**
Long-term Debt	-	-	1,672	1,312	952
Short-term Debt	6,724	4,473	15,000	22,000	25,000
Total Debt	**6,724**	**4,473**	**16,672**	**23,312**	**25,952**
Other Financial Liabilities & Provisions	535	705	820	889	978
Other Non Current Liabilities	5,210	5,286	5,814	6,396	7,036
Net Deferred Tax Liability	(666)	(738)	(752)	(767)	(783)
TOTAL SOURCES OF FUNDS	**20,279**	**20,199**	**35,151**	**45,279**	**51,438**
APPLICATION OF FUNDS					
Net Block	**382**	**436**	**2,061**	**2,086**	**2,101**
CWIP	39	40	-	-	-
Loans & Deposits	1,828	1,246	1,258	1,271	1,284
Other Non Current Assets	-	-	-	-	-
Total Non-current Assets	**2,249**	**1,722**	**3,319**	**3,357**	**3,385**
Liened FDs (ST + LT)	13,689	12,645	16,818	18,836	20,871
Debtors	3,101	4,770	3,888	3,536	3,526
Cash & Equivalents	1,770	18,841	12,135	12,324	13,744
Loans & Advances	5,822	4,061	6,701	15,076	18,092
Other Current Assets	1,442	3,870	1,552	1,676	1,778
Total Current Assets	**25,824**	**44,187**	**41,093**	**51,448**	**58,010**
Creditors	6,117	23,362	6,872	7,237	7,459
Other Current Liabilities	1,677	2,347	2,389	2,289	2,499
Total Current Liabilities	**7,794**	**25,709**	**9,261**	**9,526**	**9,957**
Net Current Assets	**18,031**	**18,478**	**31,832**	**41,922**	**48,053**
TOTAL APPLICATION OF FUNDS	**20,279**	**20,199**	**35,151**	**45,279**	**51,438**

Source: Company, HDFC sec Inst Research

Cash Flow

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	**8,524**	**7,572**	**7,511**	**9,316**	**10,520**
Non-operating & EO Items	164	130	(25)	-	-
Interest Expenses	483	413	249	168	221
Depreciation	153	150	599	517	522
Working Capital Change	(5,324)	19,738	(22,074)	(9,986)	(4,719)
Tax Paid	(3,221)	(2,925)	(1,915)	(2,422)	(2,735)
OPERATING CASH FLOW (a)	**780**	**25,077**	**(15,655)**	**(2,407)**	**3,808**
Net Capex	(216)	(208)	(189)	(189)	(184)
(Purchase)/sale of net operating financial assets	6	-	-	-	-
Free Cash Flow (FCF)	*569*	*24,869*	*(15,844)*	*(2,597)*	*3,625*
Investments	(69)	(2,183)	2,307	(5)	(5)
Non-operating Income					
INVESTING CASH FLOW (b)	**(279)**	**(2,391)**	**2,118**	**(194)**	**(189)**
Debt Issuance/(Repaid)	2,754	(2,264)	10,527	7,000	3,000
Interest Expenses	(466)	(400)	(249)	(168)	(221)
FCFE	*2,857*	*22,205*	*(5,567)*	*4,236*	*6,403*
Proceeds From Issue of Share Capital					
Dividend	(2,224)	(2,951)	(3,447)	(4,041)	(4,978)
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**64**	**(5,615)**	**6,831**	**2,791**	**(2,200)**
NET CASH FLOW (a+b+c)	**564**	**17,071**	**(6,707)**	**190**	**1,420**
Opening Cash & Equivalents	1,206	1,770	18,841	12,135	12,324
Closing Cash & Equivalents	**1,770**	**18,841**	**12,135**	**12,324**	**13,744**

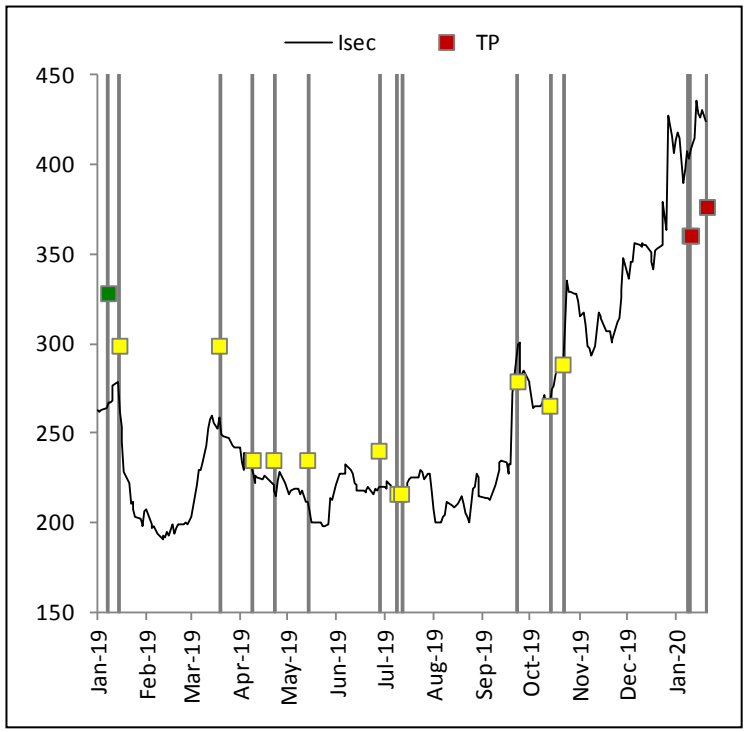
Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
EBITDA Margin	47.3	44.7	50.1	54.6	57.0
EBIT Margin	46.4	43.8	46.3	51.6	54.2
APAT Margin	31.3	29.8	35.3	40.1	42.3
RoE	83.4	50.4	48.5	49.2	46.2
Core RoCE	51.2	98.0	82.1	30.1	25.9
RoCE	46.5	31.8	26.2	20.6	19.2
EFFICIENCY					
Tax Rate (%)	34.8	35.2	25.5	26.0	26.0
Asset Turnover (x)	48.9	40.2	12.6	8.3	8.8
Inventory (days)					
Debtors (days)	*64*	*106*	*90*	*75*	*70*
Other Current Assets (days)	*421*	*400*	*574*	*749*	*804*
Payables (days)	*198*	*795*	*240*	*240*	*240*
Other Current Liab & Prov (days)	*34*	*54*	*55*	*55*	*55*
Working Capital (days)	252	-344	369	529	579
Debt/EBITDA (x)	0.80	0.61	2.11	2.48	2.48
Net D/E	0.6	(1.4)	0.4	0.7	0.7
Interest Coverage	574.1	271.7	29.2	52.9	45.0
PER SHARE DATA					
AEPS (Rs/sh)	17.3	14.8	17.4	21.4	24.2
CEPS (Rs/sh)	17.8	15.3	19.2	23.0	25.8
DPS (Rs/sh)	5.5	9.4	8.9	10.4	12.8
BV (Rs/sh)	26.3	32.5	39.1	48.0	56.7
VALUATION					
P/E	24.4	28.5	24.3	19.7	17.5
P/BV	16.0	13.0	10.8	8.8	7.4
EV/EBITDA	16.7	16.5	17.8	15.6	14.1
OCF/EV (%)	0.4	20.5	(11.4)	(1.9)	2.2
FCF/EV (%)	0.4	20.5	(11.3)	(1.8)	2.4
FCFE/MCAP (%)	2.1	16.3	(4.1)	3.1	4.7
Dividend Yield (%)	1.3	2.2	2.1	2.5	3.0

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
8-Jan-19	263	BUY	328
15-Jan-19	279	NEU	298
19-Mar-19	258	NEU	298
9-Apr-19	232	NEU	235
24-Apr-19	218	NEU	235
14-May-19	211	NEU	235
28-Jun-19	218	NEU	240
9-Jul-19	216	NEU	216
13-Jul-19	219	NEU	216
22-Sep-19	273	NEU	279
14-Oct-19	266	NEU	265
23-Oct-19	287	NEU	288
9-Jan-20	403	SELL	360
11-Jan-20	408	SELL	360
21-Jan-20	424	SELL	376

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period

NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period

SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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