ICRA

Indian Brokerage Industry December 2019

Sectoral challenges to continue to have a bearing on revenue growth and profitability over the near-term

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Samriddhi Chowdhary
+91 22 6114 3462
samriddhi.chowdhary@icrain

Sainath Chandrasekaran
+91 22 6114 3439
sainath.chandrasekaran@icrai

Contents

Executive Summary

Highlights

- Markets recover in September 2019, following the withdrawal of the FPI surcharge, reduction in corporate tax and other measures announced by the Government. The market rally, however, has not been broad based and is largely limited to the large cap segment, as reflected by the performance of the leading indices while the small and medium cap segments remain subdued

- Healthy growth in turnover in H1 FY2020 supported by derivatives volumes, particularly the index option, while the cash segment remained subdued

- Tightening of regulatory framework and monitoring / reporting guidelines for broking industry

- Broking industry turnover estimated at 19,500 crore in FY2019, a marginal growth of ~3% over ~Rs. 18,800 in FY2018 (YoY growth of over 30% in FY2018 and FY2017). ICRA estimates the industry growth rate to remain muted at around 2-5%, with a revenue projection of Rs. 19,900-20,500 crore for FY2020.

- Competitive pricing, contracting yield, changing product mix and increased investment in processes and systems to result in moderation of profitability level; other businesses like margin funding and distribution of financial products to provide some comfort

- Consolidation expected over the medium to long-term

OVERVIEW

Healthy growth in volumes driven by derivatives segment, particularly index options

Equity markets continued to remain volatile with a downward slide in Q1 FY2020 owing to the slowdown in the economy, escalating trade wars, brief surge in crude prices and FII taxation in budget during July 2019. While there has been a recovery since in the benchmark indices September 2019, following the withdrawal of the FPI surcharge, reduction in corporate tax and other measures announced by the Government, the market rally has not been broad based and is largely limited to the large cap segment. Given the correction in valuations coupled with the high volatility, the cash segment has remained largely muted while the trading turnover was supported by the growth in index options. The equity markets reported an aggregate turnover of Rs. 1,663 lakh crore in H1 FY2020, up from Rs. 1,191 lakh crore in H1 FY2019, registering a year on year (YoY) growth of 43%. The ADTO increased to Rs. 13.62 lakh crore in H1 FY2020 as compared to Rs. 9.53 lakh crore in H1 FY2019 and Rs. 9.93 lakh crore in FY2019. The average daily turnover (ADTO) for the derivatives segment increased to Rs. 13.63 lakh crore in H1 FY2020 (turnover of Rs. 1,663 lakh crore), up from Rs. 9.53 lakh crore (turnover of Rs. 1,191 lakh crore) in a H1 FY2020 (YoY growth of 38%) and Rs. 9.90 lakh crore in FY2019. Performance of the cash segment remained muted with ADTO of Rs. 0.36 lakh crore in H1 FY2019, as against Rs. 0.35 lakh crore in H1 FY2019 (ADTO of Rs. 0.36 lakh crore in FY2019). Further, there has been a decline in the delivery volumes in the cash segment to 25% in H1 FY2020 (27% in H1 FY2019) as compared to 26% in FY2019 and 30% in FY2018, pointing towards a decline in investment-oriented transactions as opposed to daily trading. The share of the cash, futures and options segment in the total turnover stood at 3%, 6% and 91% respectively in H1 FY2020 as compared to 4%, 9% and 88% in FY2019 (5%, 12% and 83% in FY2018).

Pickup in IPOs after a lull in FY2019

After a robust performance in FY2018, resource mobilisation in the equity markets, through public issuances and qualified institutional placements (QIPs) significantly slowed down in FY2019, given the muted market environment. The overall resource mobilisation in the equity segment, however, was supported by preferential allotment which witnessed record volumes in the past fiscal. Resource mobilisation registered an uptick in the current year with Rs. 1.58 lakh crore through 191 issuances raised in H1 FY2020; preferential placements continued to form a large share of the total resource mobilisation during this period. There has been a gradual recovery in the IPO issuances flow in the current fiscal, though the market remains muted in relation to that witnessed in FY2017 and FY2018. Furthermore, there is also an improvement in the performance of IPOs in the current fiscal with an improvement in listing gains as well as increased investor participation. Driven by the gradual inflow of IPOs coupled with the healthy performance of issuances, the IPO financing market is also gaining traction after a lull in H2 FY2019. Buoyed by the IPO rally over the FY2017-FY2018, several issuers from a diverse range of industries were looking to tap the capital markets and had filed for approval for the same. However, the volatility in the markets, coupled with the correction in valuation, led to the deferment of fund-raising plans by corporates. Going forward, a meaningful recovery in the capital markets and improvement in investor sentiment would be critical for a traction in issuances

Regulatory Overhaul of the Industry

Over the past few years SEBI has taken steps to strengthen the regulatory framework for the broking entities to enhance monitoring of stock-brokers, protect investor interest, and also increase discipline in the brokerage industry. Ensuring compliance with the enhanced monitoring and reporting guidelines would require investment and upgradation of systems and infrastructure by broking companies and thus would result in a higher operating expenditure. Furthermore, stricter norms pertaining to use of client securities are expected to result in an increase in funding requirement for brokers. This coupled with the standardisation of cash segment margin is expected to limit the brokers' ability to offer additional value proposition, like a flexible payment terms, credit, to its clients. Brokers having own assets (hard assets or securities) and larger own balance sheet would be at an advantage while trying to raise debt funding. Over the near term, this is expected to have a moderating impact on broking turnover as well as profitability level. The increased regulatory oversight coupled with the cost of implementing the processes may also act as a deterrent for smaller broking entities and is expected to result in consolidation in the industry. However, over the long-term, these provisions are expected to improve strengthen industry structure and improve financial discipline which is critical given the fiduciary duty of broking entities. Given the recent violations in use of client securities coming to light in the recent past, stricter terms for brokerage houses would also help strengthen investor confidence and thus augur well for the industry.

Outlook for domestic broking industries - Stable to Negative

The outlook for the broking industry remains Stable to Negative over the near term. While the performance of the benchmark indices would continue to remain steady, improvement in small and mid-cap segments is expected to remain limited over the near term. This in-turn would have a bearing on the product and investor profile in the industry. The volatility in the markets is expected to encourage trading turnover, however the recent corrections in valuations, coupled with the cautious investor stance, would have a bearing on industry turnover and product mix. ICRA estimates the broking industry revenue growth rate to remain muted at around 2-5% (YoY growth of 3% in FY2019 and 30% in FY2018), with an estimated revenue projection of Rs. 19,900-20,500 crore for FY2020. Given the expected volatility in the markets and concerns regarding economic outlook, we expect retail investor participation to remain tepid. However, considering that the large untapped market in this segment would help cushion the impact to some extent, the long-term potential remains healthy. In addition to the pricing pressures and contracting yields, the enhanced monitoring and reporting requirement would also require investment and upgradation of processes, systems and infrastructure and thus would also result in pressure on profitability levels of broking entities. The increase in interest income, through margin funding, provided the credit cost remain under check, and distribution of financial products would help offset the impact on profitability to some extent. Over the medium term some consolidation is expected in the industry which would help support profitability levels.

ICRA

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in