December 14, 2021 (Revised)

HDFC Securities Limited: Ratings reaffirmed; Rated amount enhanced for CP programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper Programme	5,000.00	6,000.00	[ICRA]A1+; assigned/reaffirmed
Bank Line Facilities	200.00	300.00	[ICRA]AAA (Stable); reaffirmed
Long term/Short term Unallocated Bank Limits	100.00	0.00	[ICRA]AAA(Stable)/[ICRA]A1+ reaffirmed and withdrawn
Total	**5,300.00**	**6,300.00**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned/reaffirmed ratings factor in the strong parentage of HDFC Securities Limited (HSL), which is a subsidiary of HDFC Bank Limited (HDFC Bank; 96.2% stake in HSL), its strong linkages with the parent and the shared brand name. HSL's importance to the parent is evident from the managerial and operational support received by it, including senior management deputations/transfers, customer sourcing and cross-selling support, and access to the bank's retail clientele and branch network. The ratings also consider HSL's strong retail franchise, supported by its position as a bank brokerage house, and its healthy financial profile characterised by its strong profitability and adequate capitalisation. Further, HSL derives significant financial flexibility in fund raising due to its shared brand name.

The ratings also factor in the significant ramp-up in the company's e-margin (margin trading facility; MTF) business in the recent past, which has resulted in a moderation in the company's gearing level. HSL's gearing increased to 2.2 times as on September 30, 2021 from 0.6 times as on March 31, 2020. With the enhanced facility being deployed towards the further scaling up of this business, the gearing is expected to increase. The ratings also take into account the credit and market risk associated with the e-margin business, given the nature of the underlying assets, limited diversification in HSL's business profile, the risks associated with capital markets related businesses and the intense competition in the retail broking space.

The Stable outlook reflects ICRA's expectation that the company would maintain its earnings profile supported by its strong retail franchise and its position as a bank brokerage house.

Key rating drivers and their description

Credit strengths

Strong parentage with well-demonstrated track record of support from the parent – HSL is a subsidiary of HDFC Bank, which holds a stake of ~96% in the company. HSL helps augment the service portfolio of HDFC Bank and enjoys customer-sourcing and cross-selling support and access to the bank's retail clientele and branches. HSL's Managing Director and Chief Executive Officer (MD & CEO) had been on deputation from the bank for the last seven years and was recently transferred from the bank to HSL. The company has a seven-member board, which includes three independent directors (of which one is on the board of HDFC Bank while the Chairperson was a former senior executive at the bank). The strong parentage and shared brand name strengthen ICRA's assumption that HSL will receive timely and adequate support (both financial and operational) from HDFC Bank, if required. Further, HSL derives significant financial flexibility in fund raising due to its shared brand name.

Strong retail broking presence – HSL, a full-service brokerage house, is primarily a retail broking player (~97% of the total broking volumes for H1 FY2022 were sourced from the retail segment) that focuses mainly on domestic and high net worth clients. The company has a strong retail franchise, supported by its position as a subsidiary of HDFC Bank. HSL plans to ramp up its institutional broking business and it augmented its institutional broking team in FY2020. However, the share of the institutional segment is expected to remain small over the near to medium term, with retail broking to remain the primary operating segment. HSL registered a 59% increase in its average daily turnover (ADTO) in FY2021 and a 65% increase in the ADTO in H1 FY2022, leading to a market share[1] of 0.32% as on September 30, 2021 (0.40% as on March 31, 2021).

Healthy profitability and adequate capitalisation – The cost-to-income ratio improved steadily over the past two fiscals, supported by the increasing economies of scale. The net operating income (NOI) grew ~64% YoY to Rs. 1,337.3 crore in FY2021 from Rs. 816.1 crore in FY2020 owing to the strong growth in the broking volumes. The NOI was Rs. 875.9 crore in H1 FY2022. While HSL had traditionally reported a more efficient cost structure compared to peers, supported by the shared resources with the bank, the same improved further in the past two fiscal supported by the increasing economies of scale (cost-to-income ratio of 25.2% in H1 FY2022 compared to 29.4% in FY2021). HSL reported a profit after tax (PAT) or net profit of Rs. 703.2 crore (net profitability or PAT/NOI of 52.6%) in FY2021 compared to Rs. 384.2 crore (PAT/NOI of 47.1%) in FY2020. It reported a PAT of Rs. 490.7 crore (PAT/NOI of 56.0%) in H1 FY2022.

The company's ability to maintain the margins and healthy asset quality, considering the volatilities in the capital market, would remain important. ICRA notes that despite the healthy profitability, regular dividend payouts limit the accretion to reserves. Currently, HSL has an adequate capitalisation profile with a net worth of Rs. 1,605.5 crore as on September 30, 2021. The company's ability to maintain the leverage over the medium term, given the debt-funded nature of the MTF book and regular dividend payouts, will be a key monitorable.

Credit challenges

Exposed to credit and market risks arising out of MTF funding business – HSL forayed into the MTF business in FY2019 and had ramped up its MTF book to Rs. 3,005 crore as on September 30, 2021 from Rs. 226 crore as on March 31, 2019. As the MTF book is largely debt funded, the ramp-up of this business resulted in a moderation in the company's gearing to 2.2 times as on September 30, 2021 from Nil as on March 31, 2019. HSL remains exposed to credit and market risks, given the nature of the underlying assets, as any adverse event in the capital markets could erode the value of the underlying collateral stocks. However, the company's monitoring and risk management processes and the adequate performance of this business provide comfort.

Exposed to risks inherent in capital markets related businesses – HSL's revenues remain dependent on capital markets, which are inherently volatile in nature. Further, its sizeable MTF book poses asset quality risk in case of a sharp correction in the market. HSL's net brokerage income accounted for ~70-80% of the NOI, reflecting its limited presence in other capital market businesses. However, the company has been trying to diversify by increasing its focus on the distribution business and other fee-based businesses, like portfolio management services (PMS), to impart stability to the overall earnings profile. HSL has increased its focus on the distribution business through cross-selling to HDFC Bank's clients, though such fee-based income continued to account for a small proportion of the NOI at ~10-20%.

Intense competition in capital markets – With increasing competition in equity broking, the advent of discount brokerage houses and a significant surge in derivative volumes, the average yields for broking players have been under pressure. This, coupled with a change in the volume mix (moderation in the share of cash volumes), resulted in a moderation in HSL's blended yields to 2.7 basis points (bps) in H1 FY2022 from 3.7 bps in FY2021. HSL's blended yields, however, remain relatively higher than peers supported by the higher share of the cash segment in its volume mix vis-à-vis peers. With the competitive intensity

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[1] *Market share in terms of broking volumes reported on NSE and BSE*

in the industry expected to remain high, the pressure on the industry margin is expected to continue. However, the increasing financialisation of savings and the low share of wallet of the equity segment in household savings indicate huge untapped potential for rapid expansion in the broking market over the longer term.

Liquidity position: Strong

HSL's liquidity requirement is mainly for meeting the additional margin requirements at the exchange and supporting the MTF book. As on October 31, 2021, the company's total debt was Rs. 4,662.0 crore, of which commercial papers (CPs) accounted for Rs. 4,525.0 crore. HSL had an unencumbered cash and bank balance of ~Rs. 1,329 crore and Rs. 588 crore of sanctioned and unutilised fund-based bank lines as on October 31, 2021. Further, it had an MTF book of ~Rs. 3,629 crore outstanding as on October 31, 2021, which is secured against liquid securities, with the company having ready access to the client's assets that can be monetised without a significant lag.

Rating sensitivities

Positive factors – Nil

Negative factors – Pressure on HSL's ratings could arise if there is a deterioration in the credit profile of the parent, a significant change in the company's shareholding or a decline in the linkages with the parent.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Brokerage Industry Rating Approach-Implicit parent or group support Policy on withdrawal of credit rating
Parent/Group Support	HSL is a subsidiary of HDFC Bank, which holds a ~96% stake in the company. The strong parentage and shared brand name strengthen ICRA's assumption that HSL will receive timely and adequate support (financially as well as operationally) from HDFC Bank, if required.
Consolidation/Standalone	Standalone

About the company

HDFC Securities Limited (HSL), a subsidiary of HDFC Bank, is engaged in securities broking. The company was incorporated in 2000 as a joint venture among between HDFC Bank Limited, HDFC Limited and Indocean eSecurities Holdings Limited for offering capital market services like broking and distribution of financial products. HSL became a subsidiary of HDFC Bank in FY2006 following the acquisition of HDFC Limited's stake by the bank. Subsequently in FY2014, HDFC Bank acquired the shares held by Indocean eSecurities Holdings Limited and increased its stake in HSL to ~89% and further to ~98% in FY2015. Since then, the bank has been actively engaged in the management of HSL. As on September 30, 2021, HDFC Bank's stake stood at 96.19%.

Currently, HSL offers online and offline broking facilities, margin trade facilities and distribution of third-party products like mutual funds and insurance products through a network of 218 branches.

Key financial indicators (audited)

HSL	FY2020	FY2021	H1 FY2022*
Brokerage Income (Rs. crore)	565.4	1,014.8	617.1
Fee Income (other than broking; Rs. crore)	122.4	125.2	81.0
Net Interest Income (Rs. crore)	117.7	158.0	161.1
Other Non-interest Income (Rs. crore)	10.7	39.0	16.6
Net Operating Income (NOI; Rs. crore)	816.1	1,337.3	875.9
Total Operating Expenses (Rs. crore)	323.2	393.7	220.9
Profit before Tax (Rs. crore)	509.0	945.6	657.0
Profit after Tax (PAT; Rs. crore)	384.2	703.2	490.7
Net Worth (Rs. crore)	1,247.6	1,480.3	1,605.5
Borrowings (Rs. crore)	690.9	2,040.4	3,531.8
Gearing (times)	0.6	1.4	2.2
Cost-to-Income Ratio (%)	39.7%	29.4%	25.2%
Return to Net Worth (%)	31.5%	51.6%	63.6%
PAT/NOI (%)	47.1%	52.6%	56.0%

Source: *Company, ICRA Research; * Provisional numbers; All ratios as per ICRA calculations*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Oct 31, 2021 (Rs. crore)	Date & Rating	Date & Rating in FY2021			Date & Rating in FY2020		Date & Rating in FY2019
					Dec XX, 2021	Mar 16, 2021	Jan 22, 2021	Jul 23, 2020	Jan 23, 2020	Nov 29, 2019	Aug 20, 2018
1	Bank line facilities	Long term	200.00	Nil	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Bank line facilities	Long term	100.00	Nil	[ICRA]AAA (Stable)	-	-	-	-	-	-
3	CP programme	Short term	5,000.00	4,525.00	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	CP programme	Short term	1.000.00	Nil	[ICRA] A1+	-	-	-	-	-	-
5	Long-term/short-term unallocated bank lines	Long term / short term	-	-	-	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+
6	Short-term non-fund based bank lines	Short term	-	-	-	-	-	-	-	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Bank Line Facilities	Simple
CP Programme	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
HDFC Bank	Overdraft/Cash Credit Facilities	Sep-01-2021	-	-	200.00	[ICRA]AAA (Stable)
IndusInd Bank	Overdraft/Cash Credit Facilities	May-29-2021	-	-	100.00	[ICRA]AAA (Stable)
INE700G14736	CP Programme	Aug-10-2021	3.98%	Nov-08-2021	75.00	[ICRA]A1+
INE700G14744	CP Programme	Aug-11-2021	3.92%	Nov-09-2021	125.00	[ICRA]A1+
INE700G14751	CP Programme	Aug-13-2021	3.81%	Nov-11-2021	100.00	[ICRA]A1+
INE700G14769	CP Programme	Aug-17-2021	3.78%	Nov-16-2021	200.00	[ICRA]A1+
INE700G14777	CP Programme	Aug-23-2021	3.61%	Nov-22-2021	100.00	[ICRA]A1+
INE700G14785	CP Programme	Aug-26-2021	3.64%	Nov-24-2021	100.00	[ICRA]A1+
INE700G14793	CP Programme	Aug-30-2021	3.63%	Nov-29-2021	200.00	[ICRA]A1+
INE700G14801	CP Programme	Aug-30-2021	3.58%	Nov-01-2021	100.00	[ICRA]A1+
INE700G14801	CP Programme	Aug-31-2021	3.58%	Nov-01-2021	100.00	[ICRA]A1+
INE700G14827	CP Programme	Sep-01-2021	3.62%	Nov-30-2021	200.00	[ICRA]A1+
INE700G14843	CP Programme	Sep-09-2021	3.65%	Dec-09-2021	300.00	[ICRA]A1+
INE700G14868	CP Programme	Sep-14-2021	3.65%	Dec-14-2021	200.00	[ICRA]A1+
INE700G14876	CP Programme	Sep-17-2021	3.68%	Dec-16-2021	100.00	[ICRA]A1+
INE700G14884	CP Programme	Sep-20-2021	3.68%	Dec-20-2021	200.00	[ICRA]A1+
INE700G14892	CP Programme	Sep-21-2021	3.68%	Dec-21-2021	400.00	[ICRA]A1+
INE700G14900	CP Programme	Sep-27-2021	3.78%	Dec-27-2021	100.00	[ICRA]A1+
INE700G14918	CP Programme	Oct-04-2021	3.98%	Jan-03-2022	100.00	[ICRA]A1+
INE700G14926	CP Programme	Oct-05-2021	4.35%	Apr-26-2022	100.00	[ICRA]A1+
INE700G14934	CP Programme	Oct-08-2021	3.92%	Jan-07-2022	150.00	[ICRA]A1+
INE700G14942	CP Programme	Oct-13-2021	3.74%	Jan-12-2022	300.00	[ICRA]A1+
INE700G14959	CP Programme	Oct-18-2021	3.55%	Dec-24-2021	150.00	[ICRA]A1+
INE700G14967	CP Programme	Oct-20-2021	3.60%	Dec-06-2021	200.00	[ICRA]A1+
INE700G14983	CP Programme	Oct-21-2021	3.90%	Jan-20-2022	275.00	[ICRA]A1+
INE700G14975	CP Programme	Oct-22-2021	3.74%	Jan-21-2022	100.00	[ICRA]A1+
INE700G14AA7	CP Programme	Oct-22-2021	4.50%	Apr-21-2022	50.00	[ICRA]A1+
INE700G14991	CP Programme	Oct-25-2021	3.98%	Jan-24-2022	100.00	[ICRA]A1+
INE700G14AC3	CP Programme	Oct-28-2021	4.40%	Jan-27-2022	250.00	[ICRA]A1+
INE700G14AB5	CP Programme	Oct-29-2021	4.40%	Jan-28-2022	150.00	[ICRA]A1+
-	CP Programme (to be placed)	-	-	7-365 days	1,475.00	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Not applicable

Corrigendum:

Rationale dated December 14, 2021, has been revised with the following changes:

In Credit Strengths - Strong retail broking presence section, on page no. 2, the growth in average daily turnover (ADTO) for FY2021 inadvertently captured as 13% has been corrected to 59% and the growth in ADTO in H1 FY2022 captured as 132% is corrected to 65% while the market share as on March 31, 2021 captured as 0.28% has been corrected to 0.40%.

Further in credit challenges – Intense competition in capital market section, on page no. 2, the blended yield for FY2021 inadvertently captured as 5.2 basis points (bps) has been corrected to 3.7 bps.

The link to ICRA's policy for withdrawal of credit rating is included on page no. 3

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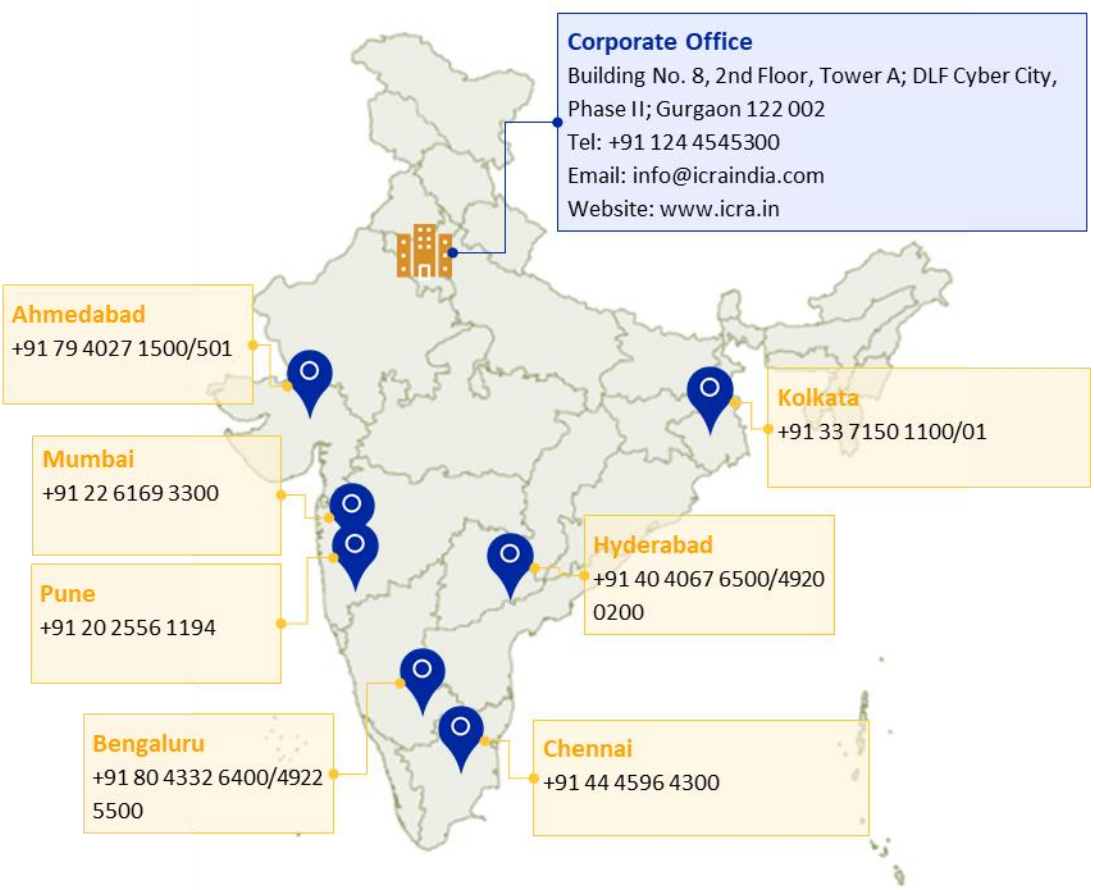

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