December 05, 2022

HDFC Securities Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based/non-fund based bank lines	-	300.0	[ICRA]AAA (Stable); reaffirmed
Commercial paper programme	6,000.00	6,000.00	[ICRA]A1+; reaffirmed
Bank line facilities^	300.0	0	-
Total	**6,300.0**	**6,300.0**	

**Instrument details are provided in Annexure I; ^ Clubbed under long-term fund-based/non-fund based bank lines*

Rationale

The ratings continue to factor in the strong parentage of HDFC Securities Limited (HSL) by virtue of being a subsidiary of HDFC Bank Limited (HDFC Bank; 95.8% stake in HSL), its strong linkages with the parent and the shared brand name. HSL's importance to the parent is evident from the support received by it in the form of senior management deputations/transfers, customer sourcing and cross-selling, and access to the bank's retail clientele and branch network. The strong parentage and shared brand name strengthen ICRA's assumption that HSL will receive timely and adequate support (financial as well as operational) from HDFC Bank, if needed. HSL also derives significant financial flexibility in fund raising due to its parentage. The ratings also consider HSL's strong retail franchise, supported by its position as a bank brokerage house, and its healthy financial profile with strong profitability and adequate capitalisation.

While reaffirming the ratings, ICRA has taken note of the significant ramp-up in the company's debt-funded e-margin (margin trading facility; MTF) business in the recent past. This, coupled with the high dividend payouts, has resulted in an increase in the company's financial leverage level. HSL's gearing increased to 2.6 times as on September 30, 2022 from 0.6 times as on March 31, 2020. Moreover, the incremental growth in the business will be primarily supported by outside borrowings; thus, a further increase in the gearing cannot be ruled out. The ratings also take into account the credit and market risk associated with the e-margin business, given the nature of the underlying assets, the risks associated with capital market related businesses and the intense competition in the retail broking space.

Key rating drivers and their description

Credit strengths

Strong parentage by virtue of being a subsidiary of HDFC Bank – HSL is a subsidiary of HDFC Bank, which holds a stake of ~96% in the company. HSL helps augment the services 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) has been deputed from the bank to HSL. 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 due to its parentage and the same is evident from the wide investor base and the competitive cost of its money market borrowings.

Established track record in retail broking – HSL, a full-service securities brokerage house, is primarily a retail broking player (~98% of the total broking volumes for H1 FY2023 was sourced from the retail segment). The company has a strong retail franchise, supported by its position as a subsidiary of HDFC Bank. It plans to ramp up its institutional broking business and it has augmented its institutional broking team in the recent past. However, the share of the institutional segment is expected to remain small over the near to medium term, while retail broking will remain the primary operating segment. HSL registered a ~101% increase in its average daily turnover (ADTO) in the futures & options (F&O) segment in H1 FY2023 while the cash ADTO degrew by 25%. In H1 FY2023, HSL enjoyed a 3.6% market share[1] in the cash segment and a 0.8% market share in the F&O segment.

Healthy financial profile with strong profitability and adequate capitalisation – HSL reported a strong growth in its net operating income (NOI) in FY2022, supported by the performance of the capital markets. The company's NOI increased to Rs. 1,813 crore in FY2022 from Rs. 1,337 crore in FY2021 and Rs. 816 crore in FY2020. The resultant increase in the scale brought operating leverage into play and facilitated an improvement in the company's profit margins. HSL's cost-to-income ratio improved to 28.0% in FY2022 from 29.4% in FY2021 and 39.6% in FY2020, while the net profitability (profit after tax (PAT)/NOI) improved to 54.3% from 52.6% and 47.1%, respectively, during the same period. HSL reported an all-time high annual PAT of Rs. 984 crore in FY2022 (Rs. 703 crore in FY2021 and Rs. 384 crore in FY2020) with a return on net worth (RoNW) of 62.7% (FY2021: 51.6% and FY2020: 31.5%). In H1 FY2023, the company reported a PAT of Rs. 380 crore on NOI of Rs. 763 crore due to the moderation in capital market activity, given the weakening macroeconomic conditions and geopolitical tensions. Nonetheless, the profitability remained strong with PAT/NOI of 49.8% and RoNW of 45.0% in H1 FY2023.

Despite the strong profitability, the sizeable dividend payouts limit the accretion to reserves. Nonetheless, HSL is adequately capitalised with a net worth of Rs. 1,719 crore and a gearing of 2.6 times as on September 30, 2022. Going forward, the leverage is expected to increase to support the envisaged ramp-up in the MTF book as well as for maintaining a margin buffer at the exchanges.

Credit challenges

Exposed to risks inherent in capital market related businesses; operations exposed to credit and market risks arising out of MTF funding business – HSL's revenues remain dependent on capital markets, which are inherently volatile in nature. Furthermore, it remains exposed to credit and market risks on account of the MTF lending book, given the nature of the underlying assets, as any adverse event in the capital markets could erode the value of the underlying collateral stocks. HSL forayed into the MTF business in FY2019 and it ramped up its MTF book to Rs. 3,099 crore as on September 30, 2022 from Rs. 226 crore as on March 31, 2019. Its ability to maintain adequate asset quality while ramping up the lending book would remain a monitorable.

Intense competition in capital markets – With increasing competition in equity broking and the growing popularity of the discount brokerage houses, HSL's market share in term of NSE active clients contracted to 3.1% as on September 30, 2022 from 6.7% in March 2020. With the competitive intensity in this cyclical industry expected to remain high, pressure on profitability cannot be ruled out, especially during downturns. 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 funding requirement is primarily for placing margins at the exchanges and the MTF book. Its margin utilisation ranged between 35% and 65% (basis month-end data) during October 2021 to June 2022, with the average margin placed on exchanges aggregating Rs. 2,400 crore during this period. Out of the outstanding borrowings of ~Rs. 4,670 crore as of September 30, 2022, ~Rs. 4,570 crore is due during the course of the next three months while the company had an unencumbered cash and bank balance of Rs. 405 crore and drawable but unutilised lines of Rs. 788 crore as of September 30, 2022. Additionally, the company's short-term loan assets, which can be liquidated at short notice to generate liquidity, if

[1] *Market share excluding proprietary trades*

required, stood at ~Rs. 3,100 crore. HSL also enjoys financial flexibility, being a subsidiary of HDFC Bank, and the same is evident from the regular CP issuances, large investor base and competitive borrowing cost.

Rating sensitivities

Positive factors – Not applicable

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

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Entities in Brokerage Industry Rating Approach: Implicit Parent or Group Support
Parent/Group support	Parent: HDFC Bank 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 (financial as well as operational) from HDFC Bank, if required. The company also enjoys significant financial flexibility by virtue of being a subsidiary of HDFC Bank. It draws the advantage of strong operational linkages with the bank as demonstrated by the senior management deputations/transfers from the bank along with customer sourcing and cross-selling support.
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, 2022, HDFC Bank's stake stood at 95.8%.

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 209 branches. As of September 30, 2022, the company is estimated to have a 3.4% market share of the trading volumes in the cash segment and a 0.8% share of the trading volumes in the derivatives segment. The company report a PAT of Rs. 984 crore in FY2022 on NOI of Rs. 1,813 crore compared to Rs. 703 crore and Rs. 1,337 crore, respectively, in FY2021. In H1 FY2023, HSL reported a PAT of Rs. 380 crore on NOI of Rs. 763 crore.

Key financial indicators (audited)

	FY2021	FY2022	H1 FY2022*	H1 FY2023*
Brokerage income	1,015	1,155	617	425
Fee income (other than broking)	131	269	89	160
Net interest income	158	372	161	168
Other non-interest income	33	17	9	10
Net operating income (NOI)	1,337	1,813	876	763
Total operating expenses	394	508	221	265
Profit before tax	946	1,320	657	511
Profit after tax (PAT)	703	984	491	380
Net worth	1,480	1,658	1,606	1,719
Borrowings	2,040	4,619	3,532	4,458
Gearing (times)	1.38	2.79	2.2	2.59
Cost-to-income ratio	29.4%	28.0%	25.2%	34.7%
Return on average net worth	51.6%	62.7%	63.6%	45.0%
PAT/NOI	52.6%	54.3%	56.0%	49.8%

*Source: Company, ICRA Research; * Limited review; All ratios as per ICRA's calculations; Amount in Rs. crore*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 30, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021			Date & rating in FY2020	
					Dec 05, 2022	Dec 14, 2021	Mar 16, 2021	Jan 22, 2021	Jul 23, 2020	Jan 23, 2020	Nov 29, 2019
1	Fund-based/non-fund-based bank lines	Long term	300.0	300.0	[ICRA]AAA (Stable)	-	-	-	-	-	-
2	CP programme	Short term	6,000.0	4,290.0	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Bank line facilities^	Long term	-	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
4	Long-term/short-term unallocated bank lines	Long term / short term	-	-	-	[ICRA]AAA (Stable)/ [ICRA]A1+; withdrawn	[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+
5	Short-term non-fund based bank lines	Short term	-	-	-	-	-	-	-	-	[ICRA]A1+; withdrawn

^Clubbed under fund-based/non-fund based bank lines

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based/non-fund based bank lines	Simple
Commercial paper	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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate (%)	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	LT fund-based/non-fund based bank lines – Others	-	NA	-	300.0	[ICRA]AAA (Stable)
INE700G14AZ4	Commercial paper	Feb-03, 2022	5.30	Feb-02, 2023	100	[CRA]A1+
INE700G14CK2	Commercial paper	Jul-22, 2022	5.86	Oct-21, 2022	225	[CRA]A1+
INE700G14CK2	Commercial paper	Jul-25, 2022	5.90	Oct-21, 2022	100	[CRA]A1+
INE700G14CM8	Commercial paper	Jul-25, 2022	5.90	Oct-19, 2022	25	[CRA]A1+
INE700G14CN6	Commercial paper	Jul-26, 2022	5.90	Oct-28, 2022	50	[CRA]A1+
INE700G14CO4	Commercial paper	Jul-26, 2022	5.79	Oct-13, 2022	50	[CRA]A1+
INE700G14CP1	Commercial paper	Jul-27, 2022	5.93	Oct-10, 2022	200	[CRA]A1+
INE700G14CQ9	Commercial paper	Jul-29, 2022	5.93	Oct-07, 2022	300	[CRA]A1+
INE700G14CR7	Commercial paper	Aug-12, 2022	6.19	Nov-11, 2022	250	[CRA]A1+
INE700G14CT3	Commercial paper	Aug-17, 2022	6.19	Nov-16, 2022	150	[CRA]A1+
INE700G14CS5	Commercial paper	Aug-18, 2022	6.19	Nov-17, 2022	100	[CRA]A1+
INE700G14CV9	Commercial paper	Aug-22, 2022	6.17	Nov-07, 2022	400	[CRA]A1+
INE700G14CU1	Commercial paper	Aug-25, 2022	6.17	Nov-18, 2022	300	[CRA]A1+
INE700G14CW7	Commercial paper	Aug-26, 2022	6.17	Nov-22, 2022	150	[CRA]A1+
INE700G14CO4	Commercial paper	Aug-26, 2022	6.04	Oct-13, 2022	150	[CRA]A1+
INE700G14CX5	Commercial paper	Aug-26, 2022	6.17	Nov-25, 2022	140	[CRA]A1+
INE700G14DA1	Commercial paper	Sep-05, 2022	6.30	Nov-30, 2022	300	[CRA]A1+
INE700G14CY3	Commercial paper	Sep-05, 2022	6.31	Dec-02, 2022	200	[CRA]A1+
INE700G14CZ0	Commercial paper	Sep-06, 2022	6.31	Dec-05, 2022	100	[CRA]A1+
INE700G14DB9	Commercial paper	Sep-09, 2022	6.10	Oct-31, 2022	125	[CRA]A1+
INE700G14DD5	Commercial paper	Sep-12, 2022	6.24	Dec-12, 2022	400	[CRA]A1+
INE700G14DC7	Commercial paper	Sep-13, 2022	6.24	Dec-13, 2022	100	[CRA]A1+
INE700G14DB9	Commercial paper	Sep-13, 2022	6.10	Oct-31, 2022	75	[CRA]A1+
INE700G14DD5	Commercial paper	Sep-19, 2022	6.40	Dec-12, 2022	300	[CRA]A1+
NA	Commercial paper (yet to be placed)	-	-	30-365 days	1,710	[CRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Not applicable

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About ICRA Limited:

ICRA 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. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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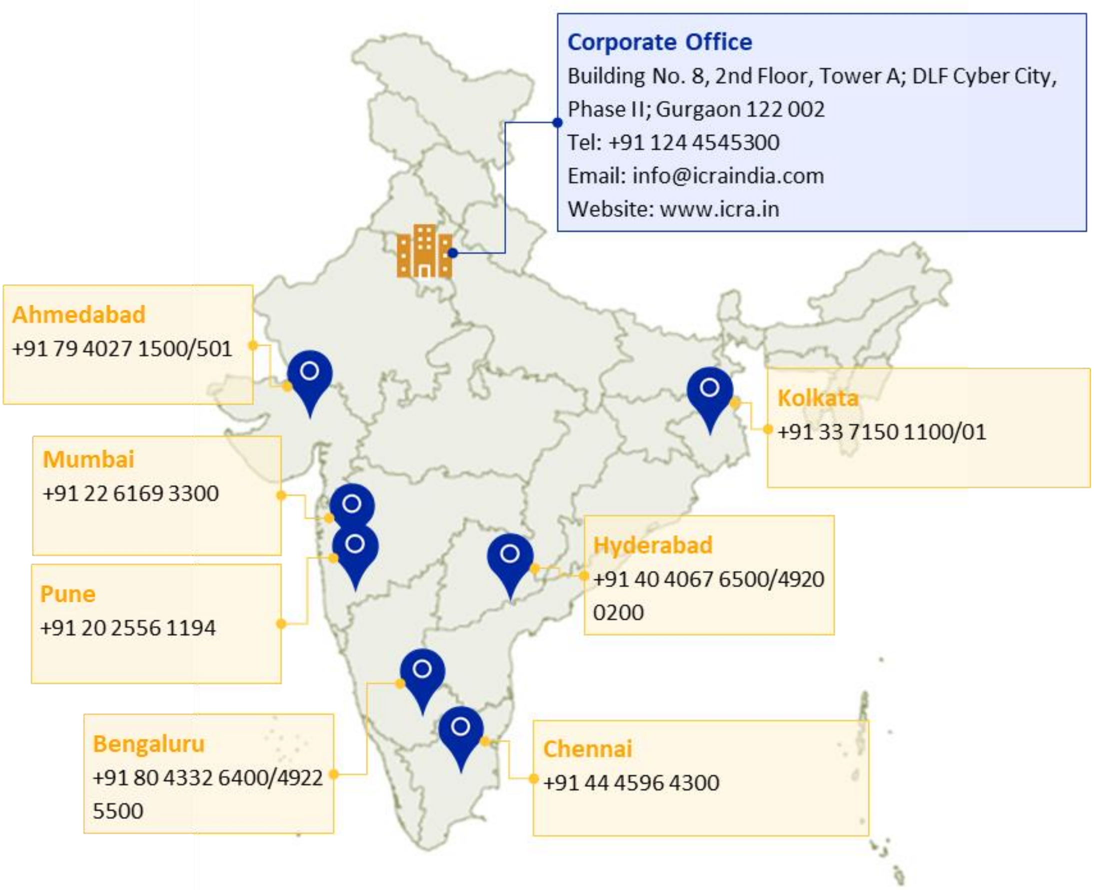

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