

March 08, 2023

IIFL Securities Limited: Ratings assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Short-term (ST) fund-based bank lines	200	[ICRA]A1+; assigned
Commercial paper	1,050	[ICRA]A1+; assigned
Total	1,250	

*Instrument details are provided in Annexure I

Rationale

The ratings factor in IIFL Securities Limited's (IIFL Sec) long-standing presence of over two decades in capital market businesses with an established market position in the broking (retail as well as institutional) and investment banking (IB) segments. The ratings also factor in the company's comfortable capitalisation and track record of profitable operations. IIFL Sec reported a consolidated return on equity (RoE) of 28.5% in FY2022 with a profit after tax (PAT) of Rs. 305.8 crore compared to 23.9% and Rs. 220.3 crore, respectively, in FY2021, supported by buoyant domestic capital markets and increased retail investor participation. Notwithstanding the moderation in 9M FY2023 owing to muted capital market activity, the profitability remains healthy with an RoE of 16.8% and a PAT of Rs. 163.4 crore. The consolidated net worth stood at Rs. 1,354 crore as on December 31, 2022 with total debt/net worth of 0.4 times.

However, the ratings remain constrained by the inherent volatility in the capital market businesses, intense competition in the retail equity broking space and the risks emanating from the evolving regulatory landscape in recent years. Nonetheless, the presence of fee-based revenues from financial product distribution helps offset the cyclicity to a certain extent. IIFL Sec's borrowing profile remains modest, though this is on account of the limited borrowing avenues given the nature of the operations. The company, nevertheless, enjoys financial flexibility on account of its association with the IIFL brand name.

ICRA takes cognisance of the proposed scheme of arrangement, whereby IIFL Sec's online retail trading (OLRT) business would be hived off to 5Paisa Capital Limited (5Paisa Capital), subject to regulatory and statutory approvals. As per the scheme, ~15 lakh of IIFL Sec's ~30 lakh customers are expected to move to 5Paisa Capital. However, the impact on revenues is expected to be marginal as the OLRT business accounted for only 4.5% of IIFL Sec's overall revenues in FY2022.

Going forward, IIFL Sec's ability to profitably scale up its businesses while improving revenue diversification would remain critical from a credit perspective.

Key rating drivers and their description

Credit strengths

Established presence in broking and IB segments – IIFL Sec has a long-standing presence of over two decades in capital market related businesses and a pan-India presence across 500+ locations with a client base of ~30 lakh customers as of December 31, 2022. It draws on the advantage of an established franchise and brand name, i.e. IIFL, and an experienced management team.

IIFL Sec is an independent full-service brokerage house offering both retail and institutional broking services. It is the 11th largest broker in terms of National Stock Exchange (NSE) active clients as of December 2022 and a leading player in the institutional segment with over 800 domestic and foreign clients with research covering over 255 stocks as of December 2022.

It has an established presence in the retail as well as the institutional broking segments with an overall market share¹ (excluding proprietary volumes; ex-prop) of 2.2% each in FY2022 and H1 FY2023. The company's market share (ex-prop) stood at 3.7% and 2.2%, respectively, in the cash and futures & options (F&O) segments in FY2022 and H1 FY2023. While the proposed transfer of the OLRT business to 5Paisa Capital will moderate its market share, it is still expected to maintain a leading position in the brokerage industry.

The company also has an established presence in the equity capital market (ECM) segment in the IB space, particularly in the initial public offering (IPO)/follow-on public offer (FPO) vertical. IB revenues surged in FY2022 to Rs. 150.4 crore from Rs. 73.6 crore in FY2021 on the back of the record number of IPOs in FY2022. Subsequently, IB revenues moderated to Rs. 96.4 crore in 9M FY2023 owing to muted primary market issuances during this period.

Comfortable capitalisation and track record of profitable operations – IIFL Sec's capitalisation remains comfortable with a consolidated net worth of Rs. 1,353.9 crore as on December 31, 2022, augmented over the years by its track record of profitability, notwithstanding consistent dividend payouts of ~30%. The company requires funds primarily for placing margin buffers at the exchange and for financing the margin trade funding (MTF) book, while the fee-based businesses are less capital intensive in nature. The MTF book and aggregate borrowings stood at Rs. 556.5 crore and Rs. 591.1 crore, respectively, as on December 31, 2022, leading to a modest gearing of 0.4 times.

Supported by the buoyant domestic capital markets and increased retail investor participation in the last two years, the company reported a PAT of Rs. 305.8 crore on net operating income (NOI)² of Rs. 1,042.9 crore (PAT/NOI – 29.3%; RoE – 28.5%) compared to Rs. 220.3 crore and Rs. 664.4 crore, respectively (PAT/NOI – 33.2%; RoE – 23.9%), in FY2021. In 9M FY2023, the PAT stood at Rs. 163.4 crore on NOI of Rs. 775.4 crore (PAT/NOI – 21.1%; RoE – 16.8%). Notwithstanding the moderation in capital markets in 9M FY2023, the profitability remains healthy.

Credit challenges

Exposure to inherent volatility in capital markets – IIFL Sec's revenues are susceptible to the inherent volatility in the capital market businesses. Notwithstanding the reduction in the share of broking income over the years from over 80% of NOI between FY2014 and FY2017 to ~50-60% of the NOI in recent years, the same remains sizeable. Further, in the IB segment (accounting for 10-12% of the NOI), the company's presence is primarily in the ECM segment, which is more episodic in nature compared to the mergers & acquisitions or debt transactions segments, resulting in cyclicity in revenues. Additionally, the revenues in this segment are milestone based and tend to be lumpy in nature. Nonetheless, the presence of certain fee-based revenues from financial product distribution (accounting for 18-20% of NOI during FY2021-9M FY23) help offset the cyclicity of the other businesses to a certain extent.

Intense competition and risks from evolving regulatory landscape – Capital market businesses may be characterised by intense competition and pricing pressures across segments, further exacerbated by the growing dominance of discount brokers. IIFL Sec too ceded market share to competition and dropped to the 11th position, in terms of NSE active clients, as of December 2022 from the 9th position as of March 2022. Further, a series of regulatory changes in the last couple of years have increased the compliance cost for all brokers, thereby exerting pressure on margins besides increasing the working capital requirements. Nonetheless, the under-penetration of capital markets in India provides headroom for growth for established players like IIFL Sec.

¹ As per ICRA calculations

² NOI is defined as total operating income minus interest expense

Environmental and social risks

While financial institutions do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. Nonetheless, such risk is not material for IIFL Sec as its lending operations are primarily focused on capital market related lending and it also benefits from adequate portfolio diversification. Further, the business activities are typically short-to-medium term in nature, which will allow it to adapt if required.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for financial institutions as any material lapses could be detrimental to their reputation and invite regulatory censure. IIFL Sec has not faced such lapses in recent years. Additionally, it is noted that customer preferences are increasingly shifting towards the digital mode of transacting, a phenomenon that necessitates the adoption of technological advancements, besides providing an opportunity to reduce the operating costs. IIFL Sec has been making investments to enhance its digital interface with its customers.

Liquidity position: Adequate

IIFL Sec's funding requirement is primarily for placing margin buffers at the exchanges and for financing the margin funding book. Its margin utilisation ranged between 40% and 54% (basis month-end data) during October 2021 to September 2022, with the average margin (comprising cash, fixed deposits and bank guarantees) placed on exchanges aggregating ~Rs. 2,828 crore during this period. As of January 31, 2023, the margin placed at exchanges aggregated ~Rs. 2,925 crore. Borrowings falling due in the next six months between February and July 2023 stood at Rs. 239.7 crore, against which the company had an unencumbered cash and bank balance of Rs. 156.8³, liquid investments of Rs. 32.8 crore and unutilised bank lines of Rs. 145.2 crore. Additionally, it has short-term MTF loan assets of Rs. 548.1 crore, which can be liquidated at short notice to generate liquidity, if required.

Rating sensitivities

Positive factors – Not applicable.

Negative factors – The ratings could witness pressure if there is a sustained deterioration in the profitability and/or capitalisation. Further, changes in the regulatory environment, which may adversely impact the company's business operations and financial performance, would be a key rating sensitivity.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Entities in the Brokerage Industry Consolidation and Rating Approach
Parent/Group support	Not applicable
Consolidation/Standalone	Consolidation

About the company

Incorporated in March 1996, IIFL Securities Limited (IIFL Sec; formerly India Infoline Limited) is a full-service securities broking company offering capital market services such as equity, commodity & currency broking, depository participant services, merchant banking and distribution of financial products. The company's clientele includes corporates, institutional investors, foreign portfolio investors (FPIs), mutual funds, insurance companies, alternative investment funds (AIFs), trusts, high-net-worth individuals (HNIs) and retail clients. The company also has investments in subsidiaries that offer facilities and ancillary services such as real estate broking/advisory services and insurance broking. IIFL Sec was promoted by first-generation

³ Rs. 72.6 crore in own accounts and the balance is excess own funds in client bank accounts.

entrepreneurs – Mr. Nirmal Jain and Mr. R. Venkataraman. The company was listed in September 2019 pursuant to the composite scheme of arrangement of the promoter group entities.

The company reported a PAT of Rs. 305.8 crore on NOI of Rs. 1,042.9 crore in FY2022 (PAT/NOI – 29.3%) compared to Rs. 220.3 crore and Rs. 664.4 crore, respectively, in FY2021 (PAT/NOI – 33.2%). In 9M FY2023, the PAT and NOI stood at Rs. 163.4 crore and Rs. 775.4 crore, respectively (PAT/NOI – 21.1%). The net worth was Rs. 1,353.9 crore as on December 31, 2022 with a gearing of 0.4 times as on that date.

Key financial indicators

IIFL Sec (consolidated)	FY2021	FY2022	9M FY2023*
Brokerage income (gross)	499.1	674.7	545.5
Investment banking income	73.6	150.4	96.4
Other fee income^	122.3	211.9	148.3
Net interest income	43.0	95.1	94.2
Other non-interest income@	21.9	53.1	24.7
Net operating income (NOI)	664.4	1,042.9	775.4
Fee and commission expense	95.5	142.2	133.7
Other operating expenses	432.9	664.7	553.6
Profit before tax	284.7	402.1	221.8
Profit after tax (PAT)	220.3	305.8	163.4
Loan book (net)	98.0	473.3	556.5
Net worth	967.7	1,182.0	1,353.9
Borrowings	291.6	607.0	591.1
Gearing (times)	0.3	0.5	0.4
Cost-to-income ratio	65.2%	63.7%	71.4%
Return on net worth	23.9%	28.5%	16.8%
PAT/NOI	33.2%	29.3%	21.1%

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

* Unaudited numbers; ^Includes income from financial product distribution and insurance broking; @Includes rental income, fair value gains/(loss)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2023)			Chronology of Rating History for the Past 3 Years		
		Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
				Mar 08, 2023			Feb 04, 2020
1 ST fund-based bank lines	ST	200	200	[ICRA]A1+	-	-	[ICRA]A1+; reaffirmed and withdrawn
2 Commercial paper	ST	1,050	Nil	[ICRA]A1+	-	-	[ICRA]A1+; reaffirmed and withdrawn
3 PP-MLD programme	LT	-	-	-	-	-	PP-MLD[ICRA]AA- (stable); downgraded from PP-MLD [ICRA]AA (stable); and withdrawn

*February 24, 2023; ST – Short term; LT – Long term; PP-MLD – Principal protected market linked debenture

Complexity level of the rated instruments

Instrument	Complexity Indicator
ST fund-based bank lines	Very 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/Banker Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	ST fund-based bank lines	NA	NA	NA	200	[ICRA]A1+
NA	Commercial paper [^]	NA [^]	NA	NA	1,050	[ICRA]A1+

Source: Company; [^] Yet to be placed

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Company Name	IIFL Sec Ownership	Consolidation Approach
IIFL Securities Limited	NA	NA
IIFL Facilities Services Limited	100%	Full Consolidation
IIFL Management Services Limited	100%	Full Consolidation
Livlong Insurance Brokers Limited ⁴	100%	Full Consolidation
IIFL Commodities Limited	100%	Full Consolidation
Livlong Protection and Wellness Solutions Ltd ⁵	95%	Full Consolidation
IIFL Securities Services IFSC Limited	100%	Full Consolidation
IIFL Wealth (UK) Limited	100%	Full Consolidation
IIFL Capital Inc	100%	Full Consolidation
Shreyans Foundations LLP	99%	Full Consolidation
Meenakshi Towers LLP	100%	Full Consolidation

Source: IIFL Sec annual report FY2022

⁴ Formerly known as IIFL Insurance Brokers Limited

⁵ Formerly known as IIFL Corporate Services Limited (formerly known as IIFL Asset Reconstruction Limited)

ANALYST CONTACTS

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

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Deep Inder Singh
+91 124 4545 830
deep.singh@icraindia.com

Komal M Mody
+91 22 6114 3424
komal.mody@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

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

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45



Branches



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