

August 08, 2023

HDFC Securities Limited: Ratings reaffirmed; Rated amount enhanced

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	300.0	[ICRA]AAA (Stable); reaffirmed
Commercial paper programme	6,000.0	10,000.0	[ICRA]A1+; reaffirmed and assigned for enhanced amount
Total	6,300.0	10,300.0	

*Instrument details are provided in Annexure I

Rationale

The ratings continue to factor in HDFC Securities Limited's (HSL) strong parentage by virtue of being a subsidiary of HDFC Bank Limited (HDFC Bank; 95.6% stake in HSL), its strong linkage 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 the company 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 the company'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. This, coupled with increasing working capital requirement amid the evolving broking sector landscape and the high dividend payouts by the company, has resulted in a rise in its financial leverage level. HSL's gearing increased to 3.3 times as on June 30, 2023 from 2.8 times as of March 31, 2022 and 0.6 times as on March 31, 2020. ICRA notes that the incremental growth in the business will primarily be 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 along with access to the bank's retail clientele and branches. HDFC Bank has a nominee director on HSL's board. 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, it 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 (~99% of the total broking volumes for Q1 FY2024 and 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 has augmented its institutional broking team in the recent past, though the same is yet to register notable traction. 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 ~150% increase in its average daily turnover (ADTO) in the futures & options (F&O) segment in FY2023 while the cash ADTO declined by 28%. Nevertheless, it registered a healthy increase in volumes and the ADTO in Q1 FY2024, higher than the industry average. HSL's ADTO increased by 68% and 14% in the F&O and cash segments, respectively, during this period. The company enjoyed a 1.9% market share¹ in the cash segment and a 0.5% market share in the F&O segment in Q1 FY2024.

Healthy financial profile with strong profitability and adequate capitalisation – HSL witnessed healthy revenue growth in FY2021 and FY2022 and reported its highest-ever profit after tax (PAT) of Rs. 984 crore in FY2022 (Rs. 703 crore in FY2021 and Rs. 384 crore in FY2020), supported by the performance of the capital markets. However, geopolitical tensions and the adverse macro-economic outlook dampened investor sentiment in FY2023, which was reflected in the moderation in capital market activity, especially in the cash segment, and the rising interest cost. Correspondingly, HSL reported a year-on-year moderation in its financial performance in FY2023 with its PAT/net operating income reducing to 50.2% in FY2023 from 54.3% in FY2022, while the return on equity (RoE) moderated to 44.9% from 62.7% during this period. Despite the YoY moderation, the overall financial profile and profitability remained strong. HSL's performance remained flat in Q1 FY2024 with PAT/NOI of 49.5% and RoE of 41.6%.

Despite the strong profitability, the sizeable dividend payouts limit the accretion to reserves. As on June 30, 2023, HSL's capitalisation profile was characterised by a net worth of Rs. 1,833 crore and a gearing of 3.3 times. Going forward, the leverage is expected to increase to aid the envisaged ramp-up in the MTF book and to support the margin requirement at the exchanges.

Credit challenges

Exposed to risks inherent in capital market related businesses as well as credit and market risks associated with 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; 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. 3,350 crore as on June 30, 2023 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 discount brokerage houses, HSL's market share² in terms of National Stock Exchange (NSE) active clients contracted to 3% as on June 30, 2023 from 7% in March 2020. With competition 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 growing the MTF book. Its margin utilisation ranged between 40% and 70% (basis month-end data) during October 2022 to June 2023, with the average cash margin placed on exchanges (including client funds) aggregating Rs. 3,300 crore during this period. As on June 30, 2023, HSL had total outstanding borrowings of ~Rs. 6,000 crore all of which was due for repayment within three months while it had an

¹Market share as per ICRA's calculation; market share excluding proprietary trades

²Market share as per ICRA's calculation

unencumbered cash and bank balance of Rs. 747 crore and drawable but unutilised lines of Rs. 336 crore. Additionally, its short-term loan, which can be liquidated at short notice to generate liquidity if required, stood at Rs. 3,350 crore. HSL also enjoys financial flexibility, being a subsidiary of HDFC Bank, and the same is evident from the regular commercial paper (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 June 30, 2023, HDFC Bank's stake stood at 95.6%.

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. As of June 30, 2023, the company is estimated to have a 1.9% market share of the trading volumes in the cash segment and a 0.5% share of the trading volumes in the derivatives segment. The company report a PAT of Rs. 777 crore in FY2023 on NOI of Rs. 1,548 crore compared to Rs. 984 crore and Rs. 1,813 crore, respectively, in FY2022. It reported a PAT of Rs. 189 crore on NOI of Rs. 383 crore in Q1 FY2024.

Key financial indicators (audited)

	FY2022	FY2023	Q1 FY2024*
Brokerage income	1,155	808	208
Distribution and depository participant fee income	254	357	86
Net interest income	372	352	78
Other non-interest income	32	31	11
Net operating income (NOI)	1,813	1,548	383
Total operating expenses	508	533	139
Profit before tax	1,320	1,042	253
Profit after tax (PAT)	984	777	189
Net worth	1,658	1,797	1,833
Borrowings	4,619	5,254	6,036
Gearing (times)	2.79	2.92	3.29
Cost-to-income ratio	28.0%	34.4%	36.4%
Return on average net worth	62.7%	44.9%	41.6%
PAT/NOI	54.3%	50.2%	49.5%

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	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years					
		Amount rated (Rs. crore)	Amount outstanding as of Jul 15, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021		
				Aug 08, 2023	Dec 05, 2022	Dec 14, 2021	Mar 16, 2021	Jan 22, 2021	Jul 23, 2020
1 Fund-based/non-fund-based bank lines	Long term	300.0	300.0	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-	-	-
2 CP programme	Short term	6,000.0	5,400.0	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 CP programme	Short term	4,000.0	0.0	[ICRA]A1+	-	-	-	-	-
4 Bank line facilities	Long term	-	-	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
5 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+
6 Short-term non-fund based bank lines	Short term	-	-	-	-	-	-	-	-

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	[ICRA]AAA (Stable)
INE700G14ET9	Commercial paper	Apr 27, 2023	7.38	Jul 27, 2023	150	[ICRA]A1+
INE700G14EU7	Commercial paper	Apr 28, 2023	7.40	Jul 28, 2023	200	[ICRA]A1+
INE700G14EW3	Commercial paper	May 04, 2023	7.32	Aug 02, 2023	250	[ICRA]A1+
INE700G14EX1	Commercial paper	May 08, 2023	7.43	Aug 07, 2023	250	[ICRA]A1+
INE700G14EY9	Commercial paper	May 09, 2023	7.43	Aug 08, 2023	250	[ICRA]A1+
INE700G14EZ6	Commercial paper	May 11, 2023	7.39	Aug 10, 2023	400	[ICRA]A1+
INE700G14FA6	Commercial paper	May 12, 2023	7.40	Aug 11, 2023	250	[ICRA]A1+
INE700G14FB4	Commercial paper	May 19, 2023	7.37	Aug 18, 2023	400	[ICRA]A1+
INE700G14FC2	Commercial paper	May 22, 2023	7.30	Aug 21, 2023	300	[ICRA]A1+
INE700G14FD0	Commercial paper	May 23, 2023	7.18	Aug 22, 2023	250	[ICRA]A1+
INE700G14FE8	Commercial paper	Jun 02, 2023	7.21	Aug 31, 2023	350	[ICRA]A1+
INE700G14FF5	Commercial paper	Jun 05, 2023	7.21	Sep 01, 2023	150	[ICRA]A1+
INE700G14FG3	Commercial paper	Jun 06, 2023	7.17	Sep 05, 2023	100	[ICRA]A1+
INE700G14FH1	Commercial paper	Jun 09, 2023	7.15	Sep 08, 2023	200	[ICRA]A1+
INE700G14FI9	Commercial paper	Jun 12, 2023	7.10	Sep 11, 2023	500	[ICRA]A1+
INE700G14FJ7	Commercial paper	Jun 14, 2023	7.21	Sep 13, 2023	200	[ICRA]A1+
INE700G14FK5	Commercial paper	Jun 19, 2023	7.17	Sep 18, 2023	250	[ICRA]A1+
INE700G14FL3	Commercial paper	Jun 22, 2023	7.15	Sep 21, 2023	200	[ICRA]A1+
INE700G14FM1	Commercial paper	Jun 23, 2023	7.10	Sep 15, 2023	250	[ICRA]A1+
INE700G14FN9	Commercial paper	Jun 30, 2023	7.20	Sep 29, 2023	350	[ICRA]A1+
INE700G14FO7	Commercial paper	Jul 06, 2023	7.10	Sep 26, 2023	150	[ICRA]A1+
NA	Commercial paper (yet to be placed)*	-	-	30-365 days	4,600	[ICRA]A1+

Source: Company; *As on July 15, 2023

[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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