November 09, 2023

IIFL Securities Limited: Rating reaffirmed; removed from Watch with Developing Implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Short-term (ST) fund-based bank lines	200	200	[ICRA]A1+; reaffirmed and removed from watch with developing implications
Commercial paper	1,050	1,050	[ICRA]A1+; reaffirmed and removed from watch with developing implications
Total	**1,250**	**1,250**	

**Instrument details are provided in Annexure I*

Rationale

The rating action takes into account the healthy performance trajectory of IIFL Securities Limited (IIFL Sec) with no visible adverse impact on the operational or financial performance following the Securities and Exchange Board of India (SEBI) order of June 19, 2023. The company's profits stood at an all-time high in Q2 FY2024, surpassing the previous high of Q4 FY2023, supported by industry tailwinds. IIFL Sec had earlier obtained a stay from the Securities Appellate Tribunal (SAT) in respect of the order passed by SEBI. The said order had prohibited IIFL Sec from onboarding new clients for two years in respect of its business as a stockbroker.

In June 2023, ICRA placed the company's rating on watch with developing implications following the SEBI order of June 19, 2023, pending the outcome of the SAT appeal. Further, the impact of the order on the company's business in the near term was monitorable. The order followed multiple inspections carried out by SEBI for different periods between April 2011 and January 2017. The prohibition pertained to non-compliance by the company with certain requirements of the 'Enhanced Supervision Circular' dated September 26, 2016, which became effective from July 1, 2017. Lapses were found with respect to intermingling of client funds with own funds, misuse of clients' credit balances and incorrect designation of client bank accounts during FY2011-2014. The company had informed the stock exchanges that the said order pertained to inspections carried out for periods before the issuance of the 'Enhanced Supervision Circular' in July 2017. The company further mentioned that the circular was applied retrospectively while the order mentioned that there was no instance of non-compliance, after the implementation of the order with effect from (w.e.f.) July 1, 2017.

The rating factors in IIFL Sec's 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 rating also factors in the company's comfortable capitalisation and track record of profitable operations. IIFL Sec reported a consolidated return on equity (RoE) of 19.7% in FY2023 with a profit after tax (PAT) of Rs. 250 crore compared to 28.5% and Rs. 306 crore, respectively, in FY2022. The profitability improved in H1 FY2024 supported by industry tailwinds, with RoE and PAT of 25.3%[1] and Rs. 182 crore, respectively. The consolidated net worth stood at Rs. 1,535 crore as on September 30, 2023, with a total debt/net worth of 0.6 times.

The above strengths are, however, partially offset by the inherent volatility in the capital market businesses, intense competition in the retail equity broking space and the risks owing to the evolving regulatory landscape in recent years. Nonetheless, the presence of fee-based revenues from financial product distribution helps offset the cyclicality 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

[1] *Annualised; as per ICRA calculations*

brand name. The margin trade funding (MTF) book expanded significantly in H1 FY2024 (Rs. 895 crore as of September 2023 from Rs. 671 crore in September 2022) owing to increased demand and in line with industry trends. Accordingly, the financial leverage inched up, although the gearing continues to remain less than 1 times. IIFL Sec also remains exposed to credit and market risks on account of the MTF loan book, given the nature of the underlying assets.

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 out 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 less than 5% of the consolidated revenues.

Key rating drivers and their description

Credit strengths

Established presence in broking and IB segments – IIFL Sec has an established presence of over two decades in capital market related businesses and a pan-India presence. It draws on the advantage of an established franchise and brand name, i.e. IIFL, and an experienced management team. It is an independent full-service brokerage house offering both retail and institutional broking services. It is ranked 13th in terms of National Stock Exchange (NSE) active clients as of September 2023. It is also a leading player in the institutional segment with over 860 domestic and foreign clients with research covering over 267 stocks as of September 2023. It has an established presence in the retail as well as the institutional broking segments with an overall market share[2] (excluding proprietary volumes; ex-prop) of ~1.0% in H1 FY2024 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 healthy market 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. The IB revenues had moderated to Rs. 129 crore in FY2023 from Rs. 150 crore in FY2022 due to muted primary market issuances. However, healthy deal activity in terms of primary issuances in H1 FY2024 improved the IB revenues to Rs. 93 crore compared to Rs. 55 crore in H1 FY2023.

Comfortable capitalisation and track record of profitable operations – IIFL Sec's capitalisation remains comfortable with a consolidated net worth of Rs. 1,535 crore as on September 30, 2023, 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 MTF book, while the fee-based businesses are less capital intensive in nature. The MTF book witnessed an uptick in H1 FY2024 and stood at Rs. 895 crore in September 2023 compared to Rs. 671 crore as of September 2022. Correspondingly, the consolidated borrowings increased to Rs. 901 crore as of September 2023 from Rs. 708 crore as of September 2022. The financial leverage, however, remains modest with a gearing of 0.6 times as of September 30, 2023.

Following record profitability in FY2022 owing to buoyant domestic capital markets and increased retail investor participation, the company's profitability was impacted in FY2023 due to muted industry performance in H1 FY2023. Notwithstanding the recovery in H2 FY2023, the profitability moderated with the company reporting a consolidated PAT of Rs. 250 crore on net operating income (NOI) of Rs. 1,030 crore (PAT/NOI – 24.3%; RoE – 19.7%) compared to Rs. 306 crore and Rs. 1,043 crore, respectively (PAT/NOI – 29.3%; RoE – 28.5%), in FY2022. However, profitability improved in H1 FY2024 with an improvement in market sentiment in H1 FY2024 and renewed retail investor interest. The company's profits stood at an all-time high in Q2 FY2024, surpassing the previous high of Q4 FY2023, supported by industry tailwinds. Overall, the company reported a consolidated PAT of Rs. 182 crore in H1 FY2024 on NOI of Rs. 663 crore (PAT/NOI – 27.5%; RoE – 25.3%).

[2] Based on broking volumes; as per ICRA calculations

Credit challenges

Exposure to inherent volatility in capital markets – IIFL Sec's revenues are susceptible to the inherent volatility in 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 ~40-50% of the NOI in recent years due to increase in other revenue streams, the same remains sizeable. Further, in the IB segment (accounting for 10-14% of the NOI), the company's presence is primarily in the ECM segment, which is more episodic in nature compared to the mergers and acquisitions or debt transactions segments, resulting in volatility 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 18-24% of NOI during FY2021-H1 FY2024) helps offset the cyclicality of the other businesses to a certain extent. IIFL Sec also remains exposed to credit and market risks on account of the MTF loan book, given the nature of the underlying assets.

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 13th position, in terms of NSE active clients, as of September 2023. 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 such as IIFL Sec. ICRA also takes note of the SEBI order of June 19, 2023 against the company, for which an appeal is pending with SAT. The company has received a stay from SAT against the SEBI order and there is no visible adverse impact due to the order on the company's operational and financial performance thus far. However, any unfavourable outcome from SAT would be a credit negative.

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, though ICRA notes that the SEBI order of June 19, 2023 prohibited the company from onboarding new clients for two years due to lapses observed with respect to intermingling of client funds with its own funds, misuse of clients' credit balances and incorrect designation of client bank accounts during FY2011-FY2014. The company has obtained a stay from SAT and the outcome of the appeal remains a monitorable. 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 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 55% (basis month-end data) during April 2023 to September 2023. The average margin (cash and non-cash collateral) placed on exchanges stood at ~Rs. 7,400 crore between April and September 2023. Borrowings falling due till March 2024 stood at Rs. 465 crore, against which the company had an unencumbered cash and bank balance of Rs. 289 crore, liquid investments of Rs. 49 crore and unutilised bank lines of Rs. 70 crore. Additionally, it has short-term MTF loan assets of Rs. 895 crore (gross), which can be liquidated at short notice if required.

Rating sensitivities

Positive factors – Not applicable.

Negative factors – The rating could witness pressure if there is a sustained deterioration in the profitability and/or capitalisation. Further, any 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 and 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 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. 250 crore on NOI of Rs. 1,030 crore in FY2023 (PAT/NOI – 24.3%) compared to Rs. 306 crore and Rs. 1,043 crore, respectively, in FY2022 (PAT/NOI – 29.3%). In H1 FY2024, the PAT and NOI stood at Rs. 182 crore and Rs. 663 crore, respectively (PAT/NOI – 27.5%). The net worth was Rs. 1,535 crore as on September 30, 2023 with a gearing of 0.6 times as on that date.

Key financial indicators

IIFL Sec (consolidated)	FY2022	FY2023	H1 FY2024*
Brokerage income (gross)	675	760	511
Investment banking income	150	129	93
Other fee income^	212	244	170
Net interest income	95	129	83
Other non-interest income@	53	20	37
Net operating income (NOI)	1,043	1,030	663
Fee and commission expense	142	251	231
Other operating expenses	665	694	421
Profit before tax	402	341	242
Profit after tax (PAT)	306	250	182
Loan book (net)	473	491	769
Net worth	1,182	1,350	1,535
Borrowings	607	486	901
Gearing (times)	0.5	0.4	0.6
Cost-to-income ratio	63.7%	67.4%	63.5%
Return on net worth	28.5%	19.7%	25.3%

PAT/NOI	29.3%	24.3%	27.5%

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	Current Rating (FY2024)					Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating in FY2024		Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Nov 09, 2023	Jun 26, 2023	Mar 08, 2023		
1	ST fund-based bank lines	ST	200	150	[ICRA]A1+	[ICRA]A1+; Rating Watch with Developing Implications	[ICRA]A1+	-	-
2	Commercial paper	ST	1,050	Nil	[ICRA]A1+	[ICRA]A1+; Rating Watch with Developing Implications	[ICRA]A1+	-	-

**November 08, 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	Holding Company	Full Consolidation
IIFL Facilities Services Limited	100%	Full Consolidation
IIFL Management Services Limited	100%	Full Consolidation
Livlong Insurance Brokers Limited[3]	100%	Full Consolidation
IIFL Commodities Limited	100%	Full Consolidation
Livlong Protection and Wellness Solutions Ltd[4]	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
India Infoline Foundation (Section 8 Company)	100%	Full Consolidation

Source: IIFL Sec annual report FY2023

[3] *Formerly known as IIFL Insurance Brokers Limited*
[4] *Formerly known as IIFL Corporate Services Limited (formerly known as IIFL Asset Reconstruction Limited)*

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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.

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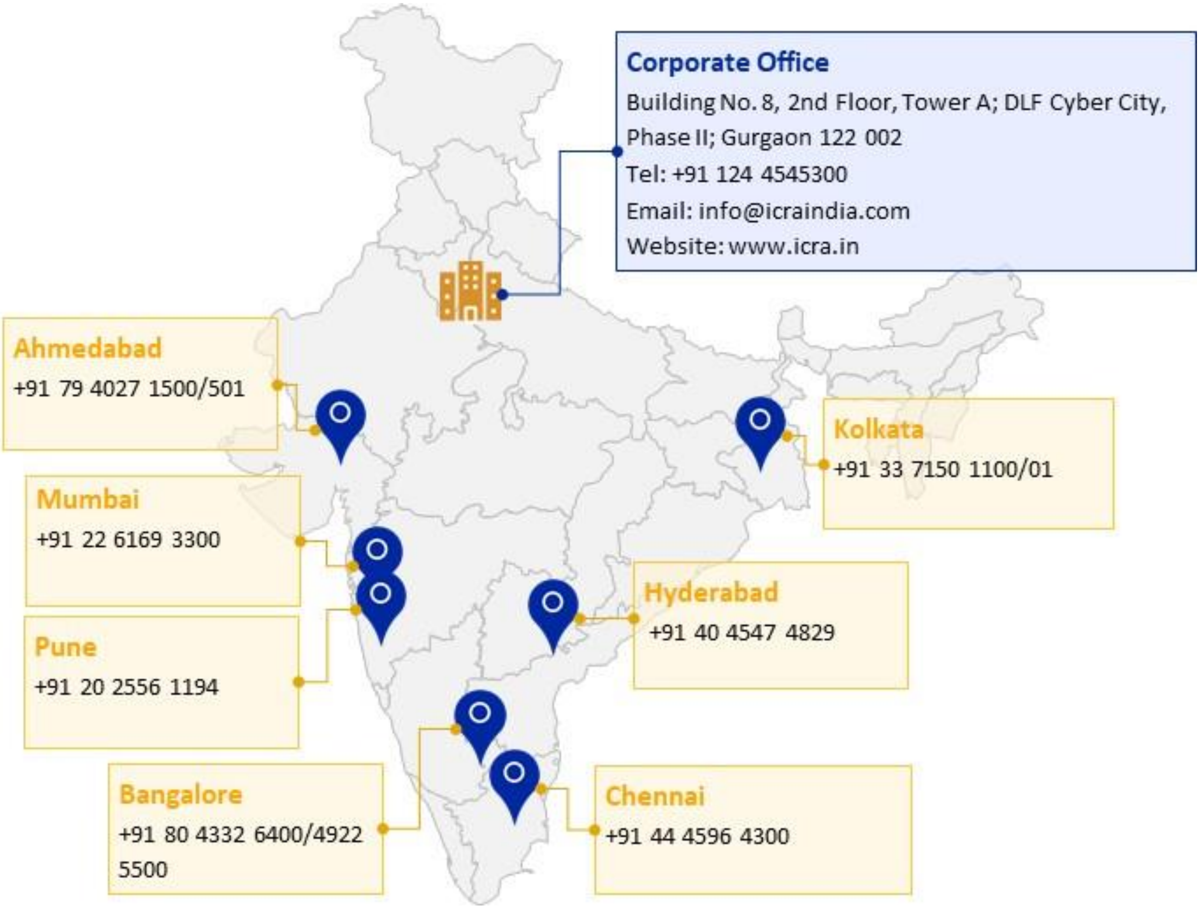

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