November 29, 2024

IIFL Capital Services Limited: Rating reaffirmed

Summary of rating action

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

**Instrument details are provided in Annexure I*

Rationale

The rating continues to factor in IIFL Capital Services Limited's {IIFL Cap; erstwhile IIFL Securities Limited (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 rating also considers the company's comfortable capitalisation, healthy profitability and diversified revenue profile.

Supported by industry tailwinds, IIFL Cap has witnessed a significant improvement in its profitability metrics. It reported its highest-ever annual profit with a consolidated profit after tax (PAT) of Rs. 513.3 crore on net operating income (NOI) of Rs. 1,522.8 crore (PAT/NOI of 33.7% and return on net worth (RoNW) of 32.7%) in FY2024 compared to Rs. 249.8 crore and Rs. 988.6 crore, respectively, in FY2023 (PAT/NOI of 25.3% and RoNW of 19.7%). The healthy profitability trajectory was maintained in H1 FY2025 amid continued exuberance in the domestic capital markets. The company reported PAT and NOI of Rs. 387.6 crore and Rs. 910.3 crore, respectively, in H1 FY2025 (PAT/NOI of 42.6% and RoNW of 38.7%). In this regard, ICRA takes note of the possible downside risk to revenues on account of the tightening of the regulatory framework to curb speculative trading in the derivatives segment as well as the impact of the transition to the 'true to label' charges pertaining to market infrastructure institutions. While the impact would be more prominent for discount brokers, it would be less for full services brokers like IIFL Cap with fairly diversified revenue profiles.

Supported by the healthy profitability trajectory, the capitalisation remains comfortable, characterised by a consolidated net worth of Rs. 2,222.0 crore[1] as on September 30, 2024 and low on-balance sheet gearing (total debt/net worth) of 0.5 times. This is because most of the funding requirement is met through off-balance sheet non-fund based bank guarantees for margin placement at stock exchanges. IIFL Cap's borrowing profile remains modest, though this is on account of the limited borrowing avenues due to the nature of the operations. The company, nevertheless, enjoys financial flexibility on account of its association with the IIFL brand name.

The rating also factors in the company's increasing focus on scaling up the distribution and wealth management businesses, which would augur well for revenue diversification and stability, notwithstanding the near-term impact of initial incubation costs on the profitability to a certain extent. As on September 30, 2024, fee-based revenues from distribution and IB accounted for 23% and 13% of the NOI, respectively, while net broking and net interest income accounted for 50% and 13%, respectively. On average, broking accounted for ~54% of the NOI during FY2020-H1 FY2025, although the share has been reducing.

[1] Including non-controlling interest

The above strengths are partially offset by exposure to the inherently volatile capital markets, heightened competition in equity broking amid the growing popularity of discount brokerage houses, and vulnerability to regulatory risks in light of the evolving regulations and operating environment. Nonetheless, the presence of fee-based revenues from financial product distribution helps offset the cyclicality to a certain extent. The rating also considers the credit and market risks associated with capital market-related lending businesses, given the nature of the underlying assets. Moreover, maintaining adequate asset quality, capitalisation and profitability will remain imperative along with the ability to seamlessly align with the evolving regulatory landscape.

Key rating drivers and their description

Credit strengths

Established presence in broking and IB segments – IIFL Cap 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. The company was recently renamed IIFL Capital Services Limited from the erstwhile IIFL Securities Limited with a view to better reflect its presence across multiple capital market-related businesses. It is an independent full-service brokerage house offering both retail and institutional broking services. It is ranked 16th in terms of National Stock Exchange (NSE) active clients as of October 2024, although it was among the top 10 brokers (in terms of NSE active clients) before discount brokers started dominating the space. It is also a leading player in the institutional segment with ~961 domestic and foreign clients with research covering ~281 stocks as of September 2024. 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 0.6% in FY2024. ICRA notes that the proposed scheme to transfer the online retail trading (OLRT) business to 5Paisa Capital Limited has been withdrawn due to the change in valuation amid the delay in receiving the requisite statutory/regulatory approvals. The OLRT clients continue to be serviced by IIFL Cap.

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 reached an all-time high of Rs. 224.5 crore in FY2024 (15% of NOI) and Rs. 120.0 crore (13%) in H1 FY2025 amid healthy primary market issuances. ICRA also notes IIFL Cap's increasing focus on scaling up the distribution and wealth management businesses, which would augur well for revenue diversification, notwithstanding the near-term impact of initial incubation costs on profitability to a certain extent.

Comfortable capitalisation – IIFL Cap's capitalisation remains comfortable with a consolidated net worth of Rs. 2,222.0 crore[3] as on September 30, 2024 and a low gearing of 0.5 times. The capitalisation was augmented over the years, aided by the track record of healthy profitability, notwithstanding consistent dividend payouts of ~30%. The company requires funds primarily for placing margin buffers at stock exchanges and for financing the capital-market related lending business, while the fee-based businesses are less capital intensive in nature. The margin trading facility (MTF) book has witnessed an uptick and stood at Rs. 916.4 crore as of March 2024 and Rs. 1,052.2 crore as of September 2024 compared to Rs. 490.6 crore as of March 2023. Working capital requirements also increased during this period. Correspondingly, the consolidated borrowings rose to Rs. 1,153.9 crore as of March 2024 (Rs. 1,053.1 crore as of September 2024) from Rs. 485.8 crore as of March 2023. The financial leverage, however, remains low compared to peers, with on-balance sheet gearing of 0.5 times as on September 30, 2024 (0.6 times as on March 31, 2024). Additionally, IIFL Cap uses non-fund based limits to place margins on stock exchanges, which averaged ~Rs. 1,400 crore in H1 FY2025.

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

[3] *Including non-controlling interest*

Track record of healthy profitability – Industry tailwinds have supported IIFL Cap's improving profitability metrics in recent years. The company reported its highest-ever annual profit with a consolidated PAT of Rs. 513.3 crore on NOI of Rs. 1,522.8 crore (PAT/NOI of 33.7% and RoNW of 32.7%) in FY2024 compared to Rs. 249.8 crore and Rs. 988.6 crore, respectively, in FY2023 (PAT/NOI of 25.3% and RoNW of 19.7%). The healthy profitability trajectory was maintained in H1 FY2025 amid the continued exuberance in the domestic capital markets. IIFL Cap reported PAT and NOI of Rs. 387.6 crore and Rs. 910.3 crore, respectively, in H1 FY2025 (PAT/NOI of 42.6% and RoNW of 38.7%). It reported average PAT/NOI of 35.4% and RoNW of 28.7% during FY2020-H1 FY2025. In this regard, ICRA takes note of the possible downside risk to revenues on account of the tightening of the regulatory framework to curb speculative trading in the derivatives segment as well as the impact of the transition to the 'true to label' charges pertaining to market infrastructure institutions. While the impact would be more prominent for discount brokers, it would be less for full services brokers like IIFL Cap with fairly diversified revenue profiles.

Credit challenges

Exposed to inherent volatility in capital markets as well as credit and market risks associated with MTF – IIFL Cap's revenues are susceptible to the inherent volatility in capital market businesses. Notwithstanding the reduction in the share of broking income to ~50% of the NOI in recent years from over 80% during FY2014-FY2017 due to the increase in other revenue streams, the same remains sizeable. Further, the company's presence in IB (12-16% of NOI) 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. Accordingly, the possibility of pressure on profitability, especially during market downturns, cannot be ruled out. Nonetheless, the presence of certain fee-based revenues from financial product distribution (20-25% of NOI) and the focus on increasing the share of recurring revenues from distribution as well as by scaling up the wealth management businesses would help offset the cyclicality of the other businesses to a certain extent. IIFL Cap also remains exposed to credit and market risks on account of the MTF loan book, given the nature of the underlying assets.

Elevated competition, high dependence on technology, and evolving regulatory environment – Securities broking companies rely heavily on technology for trade execution and fund management. Thus, any technical failure or disruption can pose operational and reputational risk. In this regard, IIFL Cap encountered three technical glitches in FY2024, although ICRA notes that the company is in the process of revamping its digital infrastructure with a view to offer seamless services. Going forward, its ability to offer uninterrupted services will be imperative for maintaining customer experience. Additionally, given the multiple regulatory changes in recent periods, the ability of brokerage entities to ensure compliance with the evolving regulatory landscape remains crucial. While the regulatory changes in the preceding years necessitated higher working capital requirements, recent changes, such as uniform exchange charges, are likely to impact the profitability of brokerage houses, especially discount brokers (the impact of uniform exchange charges on IIFL Cap is not likely to be material; ~5% of the consolidated revenues). Further, the regulator has proposed certain measures to curb the exuberance in the futures & options (F&O) segment. These include the rationalisation of weekly index derivatives, increase in their contract size, upfront collection of option premium from buyers, increase in margins on expiry days, removal of calendar spread benefits on expiry days, and enhancing the monitoring of position limits. The proposed measures will be introduced in a phased manner between November 2024 and April 2025. The combined effect of the aforesaid measures and the recent hike in the securities transaction tax in the F&O segment pose a risk to capital market volumes and, hence, the revenues and profitability of industry participants. However, the impact is expected to be more prominent for discount brokers while traditional brokers, like IIFL Cap, are likely to be less impacted.

The sector also remains characterised by intense competition and susceptibility to the entry of new players. In this regard, heightened competition in the equity broking segment and the growing popularity of discount brokerage houses have led to pricing pressure in recent years. However, the increasing financialisation of savings and the low share of wallet of the equity segment in household savings offer untapped potential for expansion in the broking sector over the longer term. Nevertheless, the possibility of pressure on profitability, especially during downturns, cannot be ruled out.

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 Cap 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.

Regarding social risks, data security and customer privacy are among the key sources of vulnerability for financial institutions as material lapses could be detrimental to their reputation and invite regulatory censure. IIFL Cap has not faced such lapses in recent years, though ICRA notes that the Securities and Exchange Board of India (SEBI) order of June 19, 2023 prohibited the company from onboarding new clients for two years due to lapses observed with respect to the intermingling of client funds with its own funds, misuse of clients' credit balances and incorrect designation of client bank accounts during FY2011-FY2014. The order was set aside by the Securities Appellate Tribunal (SAT). SEBI appealed against the SAT order and the outcome of the appeal remains a monitorable. Further, the company encountered three technical glitches[4] in FY2024, although it was not a material outlier compared to peers.

Going forward, its ability to offer uninterrupted services will be imperative for maintaining customer experience. Moreover, it is noted that customer preferences are increasingly shifting towards the digital mode of transacting, necessitating the adoption of technological advancements, besides providing an opportunity to reduce the operating costs. IIFL Cap has been making investments to continue enhancing its digital interface with its customers.

Liquidity position: Adequate

IIFL Cap'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 2024 to October 2024, with the average cash margin placed on exchanges aggregating Rs. 4,865 crore during this period. As on September 30, 2024, the cash margin placed at exchanges aggregated Rs. 4,576 crore, of which Rs. 1,432 crore was from the company's own fund. The borrowings falling due in the next six months till March 2025 stood at Rs. 681 crore against which IIFL Cap had an unencumbered cash and bank balance of Rs. 569 crore, liquid investments of Rs. 242 crore and unutilised bank lines of Rs. 304 crore. Additionally, it has short-term loan assets, which can be liquidated at short notice to generate liquidity, if required.

Rating sensitivities

Positive factors – Not applicable

Negative factors – A sustained decline in the scale of the broking business or a deterioration in the asset quality of the lending business, materially impacting the profitability with profit before tax (PBT)/NOI falling below 25% on a sustained basis, will be a credit negative. A deterioration in the capitalisation with the leverage exceeding 2 times and/or a weakening in the liquidity profile will also be credit negatives.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Stockbroking and allied services
Parent/Group support	Not Applicable
Consolidation/Standalone	Consolidation

[4] *Interruption impacting trading for more than five minutes*

About the company

Incorporated in March 1996, IIFL Capital Services Limited {IIFL Cap; erstwhile IIFL Securities Limited (IIFL Sec)} is a full-service securities broking company offering capital market services such as equity, commodity and currency broking, depository participant services, merchant banking, distribution of financial products and wealth management services. 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. It also has investments in subsidiaries that offer facilities and ancillary services such as real estate broking/advisory services and insurance broking. IIFL Cap 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. 513.3 crore on NOI of Rs. 1,522.8 crore in FY2023 (PAT/NOI of 33.7%) compared to Rs. 249.8 crore and Rs. 988.6 crore, respectively, in FY2023 (PAT/NOI of 25.3%). The PAT and NOI stood at Rs. 387.6 crore and Rs. 910.3 crore, respectively (PAT/NOI of 42.6%), in H1 FY2025. The net worth was Rs. 2,222.0 crore[5] as on September 30, 2024 with a gearing of 0.5 times.

Key financial indicators (audited)

IIFL Capital Services Limited	FY2023	FY2024	H1 FY2025*
Net operating income	988.6	1,522.8	910.3
Profit after tax	249.8	513.3	387.6
Net worth^	1,349.7	1,788.4	2,222.0
Total assets	5,237.4	7,874.7	9,665.1
Gearing (times)	0.4	0.6	0.5
Return on average net worth	19.7%	32.7%	38.7%

*Source: Company, ICRA Research; * Provisional numbers; ^ Including non-controlling interest; 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 (FY2025)			Chronology of rating history for the past 3 years					
	Type	Amount rated (Rs. crore)	Nov 29, 2024	FY2024		FY2023		FY2022	
				Date	Rating	Date	Rating	Date	Rating
ST fund-based bank lines	Short term	-	-	26-Jun-23	[ICRA]A1+; RWD*	08-Mar-23	[ICRA]A1+	-	-
			-	09-Nov-23	[ICRA]A1+	-	-	-	-
ST fund-based/Non-fund based bank lines – Others	Short term	200	[ICRA]A1+	-	-	-	-	-	-
			-	-	-	-	-	-	-
Commercial paper	Short term	1,050	[ICRA]A1+	26-Jun-23	[ICRA]A1+; RWD*	08-Mar-23	[ICRA]A1+	-	-
			-	09-Nov-23	[ICRA]A1+	-	-	-	-

**RWD – Rating Watch with Developing Implications*

[5] *Including non-controlling interest*

Complexity level of the rated instruments

Instrument	Complexity Indicator
ST fund-based/Non-fund based bank lines – Others	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	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	ST fund-based/non-fund based bank lines – Others	NA	NA	NA	200	[ICRA]A1+
INE489L14355	Commercial paper	4-Mar-24	9.50%	4-Mar-25	99	[ICRA]A1+
INE489L14413	Commercial paper	8-Aug-24	9.20%	7-Feb-25	25	[ICRA]A1+
INE489L14439	Commercial paper	19-Sep-24	8.30%	19-Dec-24	20	[ICRA]A1+
INE489L14447	Commercial paper	14-Nov-24	9.10%	13-Feb-25	50	[ICRA]A1+
INE489L14454	Commercial paper	27-Nov-24	7.30%	3-Jan-25	252	[ICRA]A1+
NA	Commercial paper - Proposed	NA	NA	NA	604	[ICRA]A1+

Source: Company; ISIN details as on Nov 28, 2024

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 CAP Ownership	Consolidation Approach
IIFL Capital Services Limited	Holding company (rated entity)	Full Consolidation
IIFL Facilities Services Limited	100%	Full Consolidation
IIFL Management Services Limited	100%	Full Consolidation
Livlong Insurance Brokers Limited (formerly IIFL Insurance Brokers Limited)	100%	Full Consolidation
IIFL Commodities Limited	100%	Full Consolidation
IIFL Securities IFSC Limited	100%	Full Consolidation
IIFL Wealth (UK) Limited	100%	Full Consolidation
IIFL Capital Inc.	100%	Full Consolidation
IIFL Securities Alternate Asset Management Limited	100%	Full Consolidation
Livlong Protection and Wellness Solutions Limited	80%	Full Consolidation
Shreyan Foundation LLP	99%	Full Consolidation
Meenakshi Towers LLP	100%	Full Consolidation

Source: Company

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

Subhrajyoti Mohapatra
+91 80 4332 6406
subhrajyoti.mohapatra@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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For more information, visit www.icra.in

ICRA Limited

Registered Office

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

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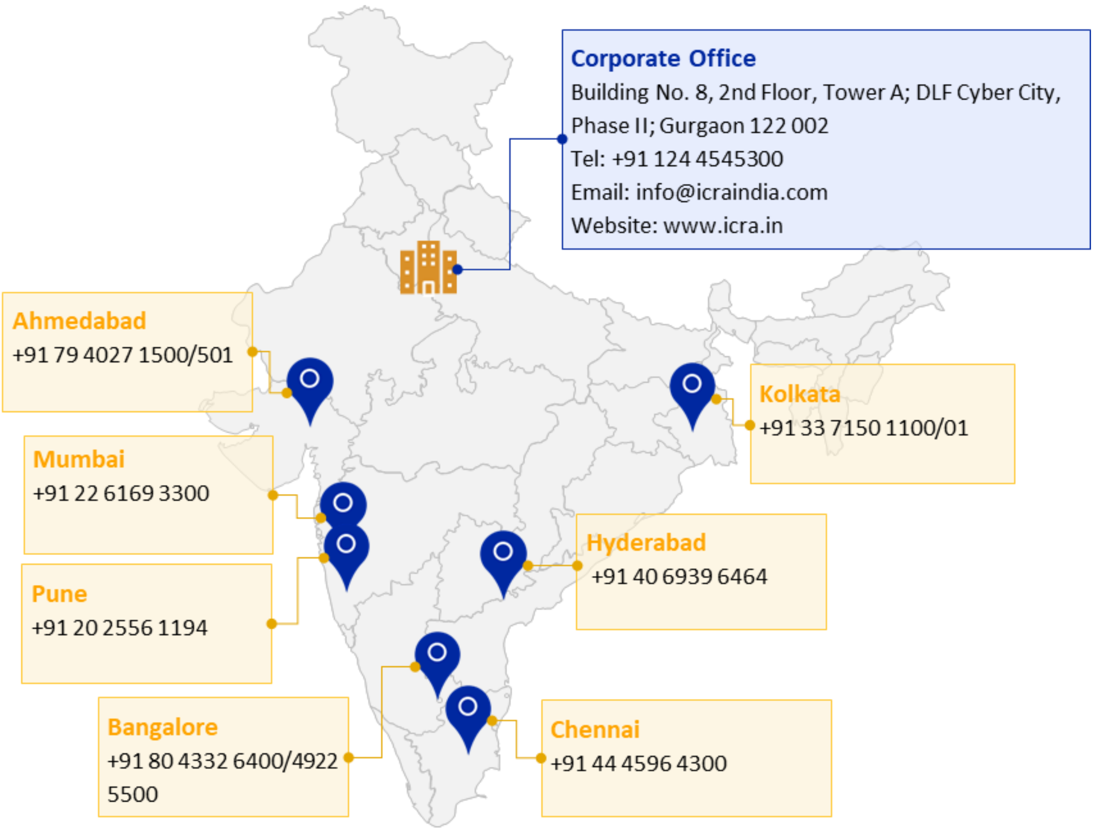

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