

HDFC Securities Limited

August 20, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-Term Fund-based Bank Facilities	200.00	225.00	[ICRA]AAA(Stable); Reaffirmed
Short-Term Non-fund Based Bank Facilities	100.00	40.00	[ICRA]A1+; Reaffirmed
Unallocated Bank Lines	0.00	35.00	[ICRA]AAA(Stable)/[ICRA]A1+; Reaffirmed
Total	300.00	300.00	

Rating action

ICRA has reaffirmed the rating of [ICRA]AAA (pronounced ICRA triple A) for the Rs. 225-crore (enhanced from Rs. 200 crore) long-term fund-based bank facilities of HDFC Securities Limited (HSL)¹. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 40-crore (reduced from Rs. 100 crore) non-fund based bank facilities of the company. ICRA has also reaffirmed the rating of [ICRA]AAA and [ICRA]A1+ on the Rs. 35 crore unallocated bank lines of HSL. The outlook on the long-term rating is Stable.

Rationale

The rating reaffirmation factors in the company's strong parentage by virtue of being a subsidiary of HDFC Bank Limited (HDFC Bank, which has an almost 98% stake in the company), strong operational linkages with the parent and the shared brand name. The company draws managerial and operational support from the parent, as evident from the senior management deputations (from HDFC Bank), customer-sourcing and cross-selling support, and access to the bank's retail clientele, branch network and infrastructure. The ratings also take into account HSL's adequate level of capitalisation for the current scale of operations, its comfortable liquidity position with moderate utilisation of margins placed with stock exchanges and large unutilised bank lines. The ratings also consider the robust risk management practices and healthy profitability supported by higher-than-industry average broking yields and a low cost-to-income ratio. While reaffirming the ratings, ICRA has taken note of the inherent volatility in HSL's primary business of equity broking, its high dependence on equity broking income and the intense competition in this space.

Outlook: Stable

ICRA believes that HSL will continue to benefit from the operational synergies with HDFC Group, its demonstrated track record in the capital market business and its established position in the broking business.

The outlook may be revised to Negative if there is a significant downturn in the capital markets or a change in capital market regulations, which would drastically affect the business and profitability indicators, thereby affecting its financial profile adversely. Any change in the ownership structure or the parent's credit profile will be a key rating sensitivity.

¹ For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications

Key rating drivers

Credit strengths

Strong parentage with well-demonstrated track record of operational and financial support from the parent - The company is a subsidiary of HDFC Bank, which holds a 98% stake in HSL. The strong parentage, coupled with the shared brand name, strengthens ICRA's assumption that HSL will receive timely and adequate support (financial and operational) from HDFC Bank, if needed. The company also draws the advantage of strong operational linkages with HDFC Bank as is evident from the senior management deputations (from HDFC Bank), customer-sourcing and cross-selling support received from the bank.

Strong retail broking presence - HSL is primarily a retail broking player (~94% of total broking volumes in FY2018 sourced from the retail segment) that focusses mainly on domestic and high net worth clients. During FY2018, HSL's total equity broking volumes increased ~10% YoY to Rs. 10.56 lakh crore from Rs. 9.57 lakh crore in FY2017, supported by the upswing in the capital markets. The broking turnover for FY2017 also included a large one-time promoter holding restructuring transaction. Excluding this, the YoY volume growth would have been ~65%. The company is focussed on the retail segment, with this segment contributing 94% to its turnover (~98% in FY2017, adjusting for the one-time promoter holding restructuring transaction). The company has a strong retail franchisee, strengthened by its being a subsidiary of HDFC Bank, which helps it to access the bank's retail clientele, branch network, etc. The company also benefits from lower operating costs due to shared infrastructure, etc.

Broking yields surpass industry average - With a higher proportion of volumes coming from the retail cash segment (historically in the range of 20-25%), HSL's average broking yields, in the range of 5-8 basis points (bps), are above the industry average of 3-4 bps. However, with increasing competition and a substantial increase in turnover (particularly the low-yielding futures & options (F&O) segment), HSL's blended brokerage has moderated to 5.63 bps during FY2018 from 6.54 bps (adjusting for a one-time promoter holding restructuring transaction) in FY2017. The blended yields, nevertheless, remained above the industry average.

Strong profitability supported by increasing top line and moderating cost-to-income ratio - With the increase in broking volumes, the company's top line grew by ~42% in FY2018. Over the years, the company has focussed on operational efficiencies in order to improve the cost structure. HSL's operating costs are below industry levels on account of the sharing of branch network and other infrastructure with HDFC Bank. This, coupled with increased turnover, led to an improvement in the company's cost-to-income ratio to 33.50% in FY2018 from 40.38% in FY2017. HSL's profit after tax (PAT) increased to Rs. 344.42 crore in FY2018 from Rs. 215.90 crore in FY2017 while the return on net worth increased to 34.41% in FY2018 from 26.74% in FY2017.

Comfortable liquidity position - HSL's broking business has a comfortable liquidity profile with moderate level of utilisation of the margins placed with the stock exchanges (generally in the range of 60-70%), large unutilised bank lines and ready access to client's assets (backed by share collateral) that can be monetised without a significant lag. HSL had no debt outstanding as on March 31, 2018 (no debt as on March 31, 2017). The company was not involved in margin funding till FY2018, and its capital needs were limited towards maintaining margin at the bourses. HSL forayed into margin funding in FY2019, following the introduction of the revised margin funding guidelines by the Securities and Exchange Board of India (SEBI). HSL remains adequately capitalised with a net worth of Rs. 1,000.79 crore as on March 31, 2018.

Adequate risk management systems - HSL has deployed adequate risk management systems (RMS) to monitor, evaluate and mitigate the credit, market and operational risks associated with equity broking. The Group has a centralised RMS to monitor the exposure on each client and branch on a real-time basis and necessary timely actions are taken by the RMS team to avoid a situation where margins fall below the minimum required limits.

Credit challenges

Dependence on inherently fluctuating capital markets – HSL’s revenues remain dependent on capital markets, which are inherently volatile in nature. During FY2018, HSL’s net brokerage income accounted for ~76% of the net operating income (76% in FY2017), reflecting its limited presence in the other capital market businesses. However, the company has been trying to diversify by increasing its focus on the distribution business wherein the revenues are linked to assets under management (AUM), and hence impart stability to the overall earnings profile. Although HSL’s fee income has increased over the years with its growing focus on the distribution business through cross-selling to HDFC Bank’s clients, it still accounted for a small proportion of the net operating income at ~17% during FY2018. ICRA notes that HSL’s revenues remain considerably dependent on capital markets, which are inherently volatile in nature.

Intense competition in capital markets - With increasing competition in equity broking and the advent of discount brokerage houses, average yields for broking players have been under pressure. With the competitive intensity in the industry expected to remain high, the pressure on industry margin is expected to continue. However, there is huge untapped potential for rapid expansion in the broking market over the long term given the increasing financialisation of savings, and the low share of allocation of household savings towards equity.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[ICRA’s Credit Rating Methodology for Broking Companies](#)

About the company

HDFC Securities Limited (HSL) was incorporated as a joint venture between three entities (HDFC Bank Limited, HDFC Limited and Indocean eSecurities Holdings Limited) in 2000 for offering capital market services like the broking and distribution of financial products. After the stake sale of HDFC Limited to HDFC Bank in FY2006, HSL became a subsidiary of HDFC Bank. In FY2008, HDFC Bank acquired the shares held by Indocean eSecurities Holdings Limited and increased its stake to ~90%. Since then, the bank has been actively engaged in the management of HSL. As on March 31, 2018, HDFC Bank’s stake in HSL stood at ~98%.

Currently, HSL offers online and offline broking facilities and distribution of third-party products like mutual funds, IPOs, and fixed deposits. HSL’s net worth was Rs. 1,000.79 crore as on March 31, 2018 compared to Rs. 807.41 crore as on March 31, 2017. The company reported PAT of Rs. 344.42 crore in FY2018 compared to Rs. 215.90 crore in FY2017.

Key financial indicators (Audited)

	FY2017	FY2018
Brokerage Income (Net)	421.07	596.02
Net Interest Income	52.35	53.65
Other Non-interest Income	79.78	138.57
Net Operating Income	553.20	788.24
Total Operating Expenses	223.37	264.06
Profit before Tax	329.45	524.16
Profit after Tax	215.90	344.42
Net Worth	807.41	1,000.79
Gearing (times)	0.00	0.00
Return on Net Worth	26.74%	34.41%

Amounts in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Aug-18	FY2018	FY2017	FY2016
					Sep-17	Jul-16	Jul-15
1 Long-term fund-based bank facilities	Long term	225.00	0.00	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2 Short-term non-fund based bank facilities	Short term	40.00	0.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 Unallocated bank facilities	Long term	35.00	0.00	[ICRA]AAA(Stable)/ [ICRA]A1+	-	-	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Long-term fund-based bank facilities	-	-	-	225.00	[ICRA]AAA(Stable)
-	Short-term non-fund based bank facilities	-	-	-	40.00	[ICRA]A1+
-	Unallocated bank facilities	-	-	-	35.00	[ICRA]AAA(Stable)/ [ICRA]A1+

Source – HDFC Securities 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.

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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