

BSE SENSEX

57,685

S&P CNX

17,167


Stock Info

Bloomberg	ISEC IN
Equity Shares (m)	322
M.Cap.(INRb)/(USD\$b)	240.9 / 3.2
52-Week Range (INR)	896 / 357
1, 6, 12 Rel. Per (%)	2/17/39
12M Avg Val (INR M)	510

Financials Snapshot (INR b)

Y/E Mar	2021	2022E	2023E
Revenues	25.9	33.4	36.9
Opex	11.6	15.0	16.9
PBT	14.3	18.4	20.0
PAT	10.7	13.7	14.9

Ratios

C/I ratio (%)	44.7	45.0	45.8
PAT margin (%)	41.3	40.9	40.3
RoE (%)	70.4	66.2	58.0
Div. Payout (%)	65.0	65.0	65.0
EPS	33.1	42.4	46.1

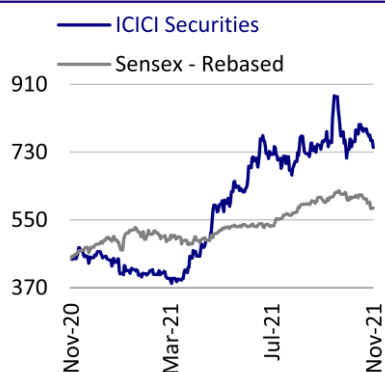
Valuations

P/E (x)	22.5	17.6	16.2
P/BV (x)	13.2	10.5	8.5
Div. Yield (%)	2.9	3.7	4.0

Shareholding pattern (%)

As On	Sep-21	Jun-21	Sep-20
Promoter	74.9	74.9	77.2
DII	7.5	7.3	10.1
FII	6.3	5.7	4.0
Others	11.3	12.1	8.7

FII Includes depository receipts

Stock performance (one-year)

CMP: INR747
TP: INR970 (+30%)
Buy
Diversification on the cards

- ISEC is under transition, whereby the company is implementing several strategic initiatives across segments to emerge as a comprehensive financial solutions provider across customer cohorts.
- The margin norms, the last leg of which was implemented from 1st Sep'21, impacted ISEC's market share. These norms are now behind and the cash volumes have started trending higher (Oct'21 cash ADTO for the industry was higher by 16% MoM).
- Momentum in client acquisition is expected to continue as ~10m individuals will get added to India's working population annually. For ISEC, 50-60% of incremental customers are in the age bracket of 18-25 years, and two-thirds are from Tier II and III towns.
- In the past six quarters, ISEC's Retail Brokerage revenue have been in the INR3-3.5b range, in spite of a strong growth in client addition. Considering allied revenue, which includes Prime subscription, Neo subscription, MTF, and other charges, the traction has been healthy, with total brokerage + allied revenue increasing to INR5b in 2QFY22 from INR3.5b in 1QFY21. We expect the momentum in Prime and Neo subscription to improve, with a targeted marketing approach. MTF revenue will have a linkage to market movement.
- Technology investments are at the core of the current transitional phase for ISEC. It is building a new app for trading, which will appeal to Gen Z and millennial customers. It is developing its Money App to enhance its product offerings in insurance, MFs, fixed income, and loans.
- The management's focus has been on growing its Distribution income, wherein the respective heads of MF, insurance, and loans are accountable for customer acquisition, revenue, and technological developments.

Valuation and view: The fintech revolution in India will continue to drive the millennial and Gen Z population towards online broking. With the management's focus on customer addition, technology development, and increasing wallet share, its revenue traction should improve going forward. We have raised our estimates for Brokerage revenue to 8% CAGR from 5% CAGR over the next three years, while increasing our cost estimates, given that the company is an investment phase, leading to no change in our PAT estimates. We expect 16%/15% revenue/PAT CAGR over FY21-24E. The stock currently trades at 14.9x FY24E P/E. We retain our **Buy** rating on the stock with a one-year TP of INR970 (21x FY23E EPS).

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

 Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Story in charts

Exhibit 1: Aspiring to build a 'neo financial market'

	2017	2021	2025
Positioning	E-broker	One stop shop	Digitally Integrated Financial Marketplace
Approach	Product focused customer centric lens	Customer focused lens	Customer ecosystem lens
Customer acquisition	0.42 mn	0.69 mn	> 10% mkt share
Assets	₹1.8 tn	₹3.8 tn	₹10 tn
Cost/ Income Ratio	63%	45%	<40%
Diversification	Significantly dependent on equity	Texturized equity and augmented non equity	3 or 4 categories contributing significantly to revenue streams

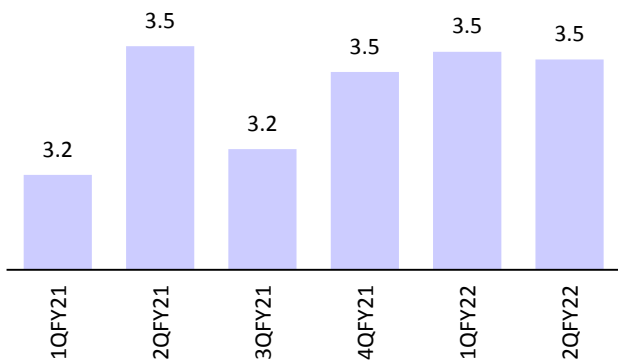
Source: MOFSL, Company

Exhibit 2: Evolving business model



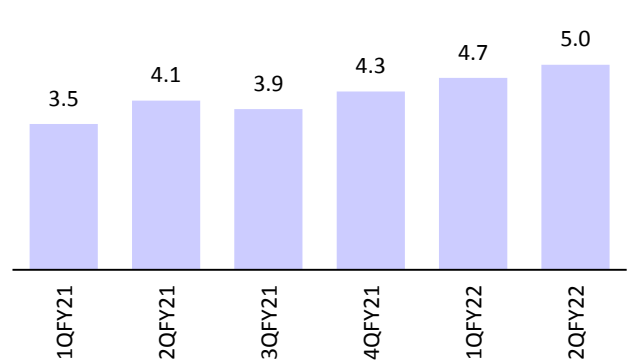
Source: MOFSL, Company

Exhibit 3: Retail Brokerage remained range-bound over the past six quarters (INR b)



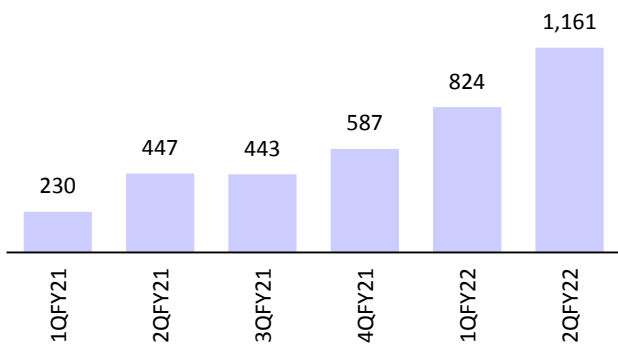
Source: MOFSL, Company

Exhibit 4: However, strong growth traction in overall Retail revenue, with ~40% growth over the period (INR b)



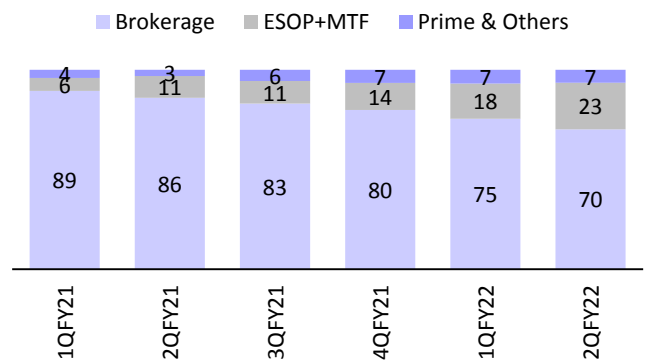
Source: MOFSL, Company

Exhibit 5: Mainly driven by allied services like MTF book, which grew 5x over the six quarters (INR m)



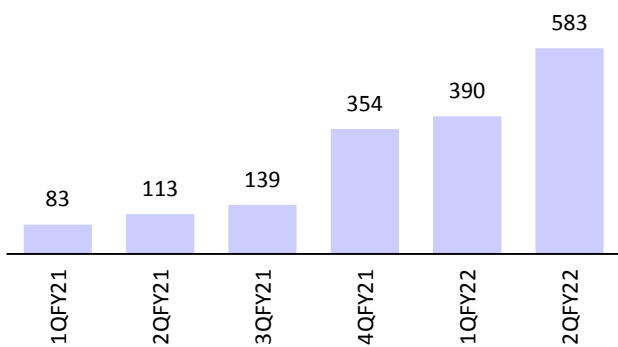
Source: MOFSL, Company

Exhibit 6: Increase in the share of ESOP + MTF revenue by 4x to 23% in total Retail revenue



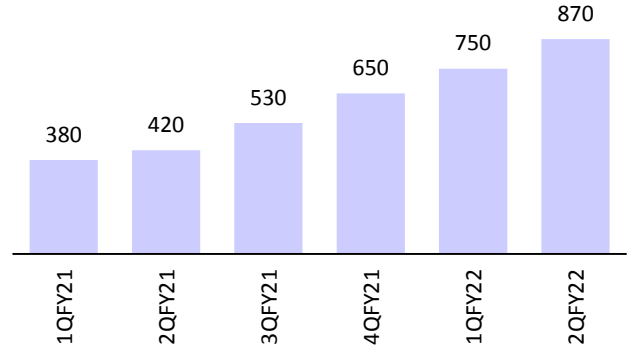
Source: MOFSL, Company

Exhibit 7: Quarterly client acquisition run-rate grew ~6x in the 10 quarter to 0.58m (In 000s)



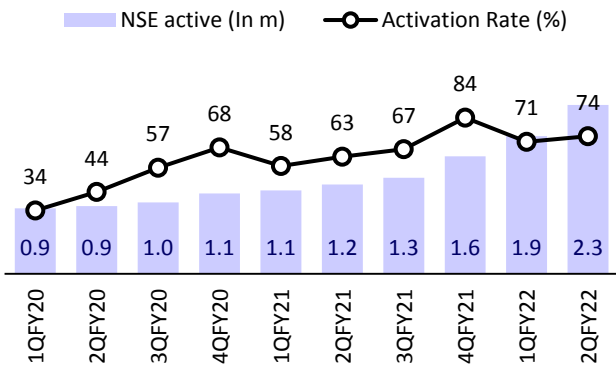
Source: MOFSL, Company

Exhibit 8: With its Prime customer base rising to 0.87m (In 000s)



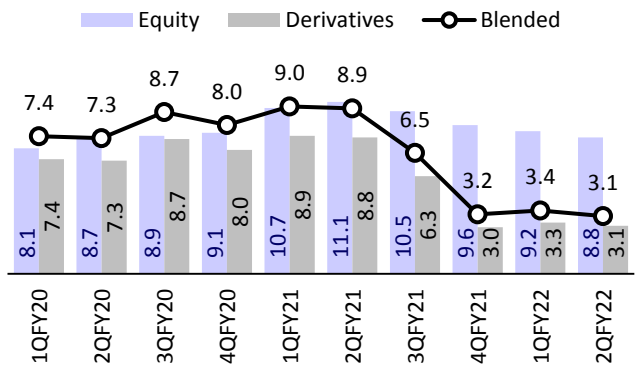
Source: MOFSL, Company

Exhibit 9: Growing number of NSE active clients, with a sharp improvement in the activation rate



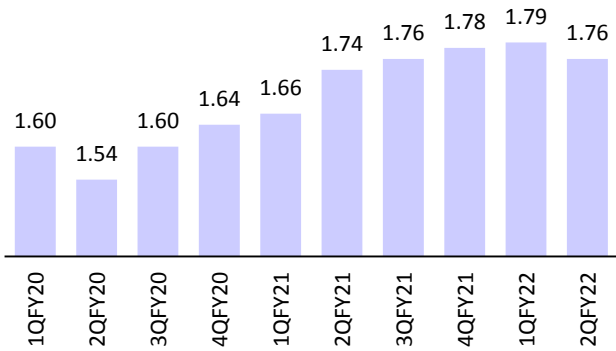
Source: MOFSL, Company

Exhibit 10: Change in margin norms led to market share loss



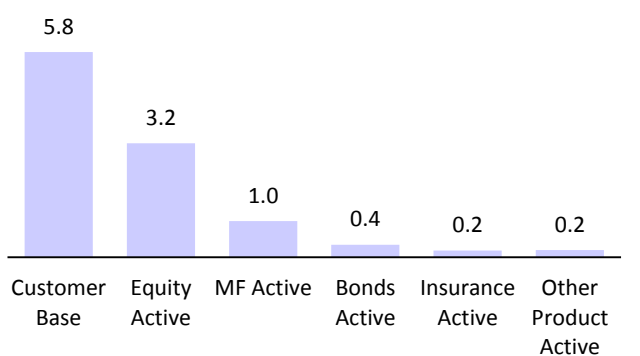
Source: MOFSL, Company

Exhibit 11: Harnessing its network by improving its cross selling ratio...



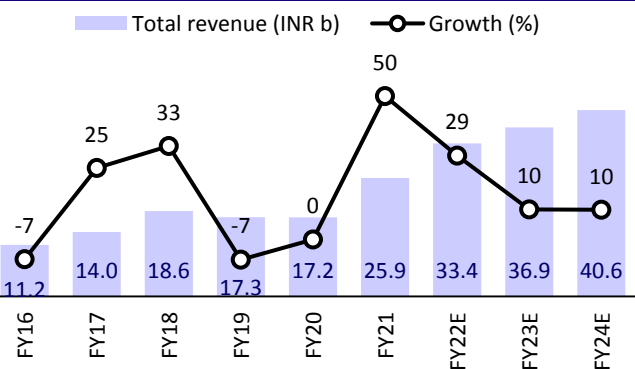
Source: MOFSL, Company

Exhibit 12: ...yet offers huge room for growth to cross-sell its products to existing ISEC clients (In m)



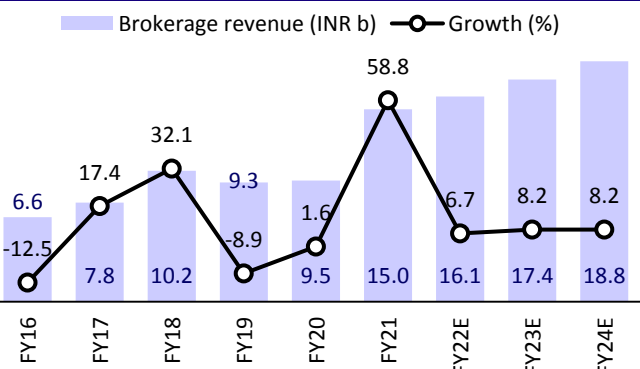
Source: MOFSL, Company

Exhibit 13: Revenue to grow at 16% CAGR over FY21-24E



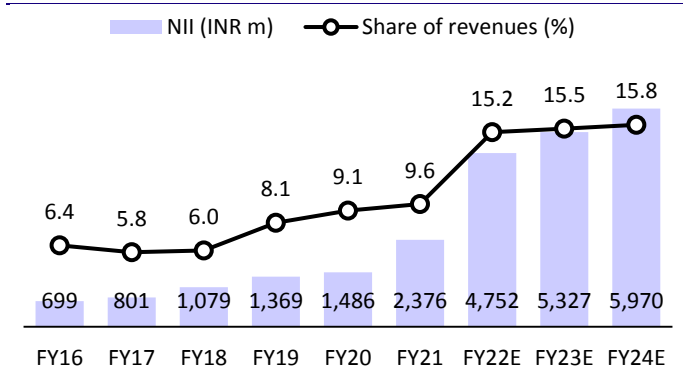
Source: MOFSL, Company

Exhibit 14: Pure brokerage revenue to see a gradual uptick



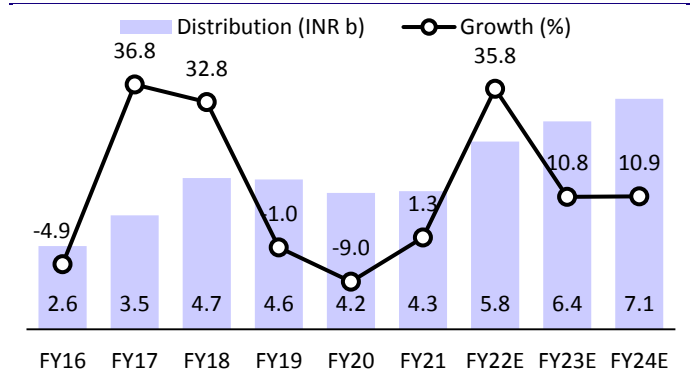
Source: MOFSL, Company

Exhibit 15: NII to grow at 36% CAGR over the next three years



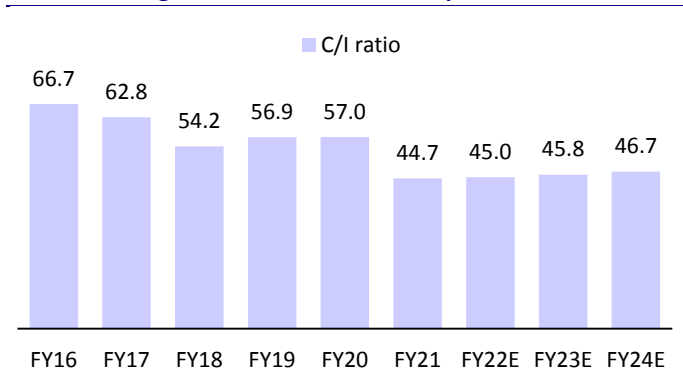
Source: MOFSL, Company

Exhibit 16: Distribution income to remain strong



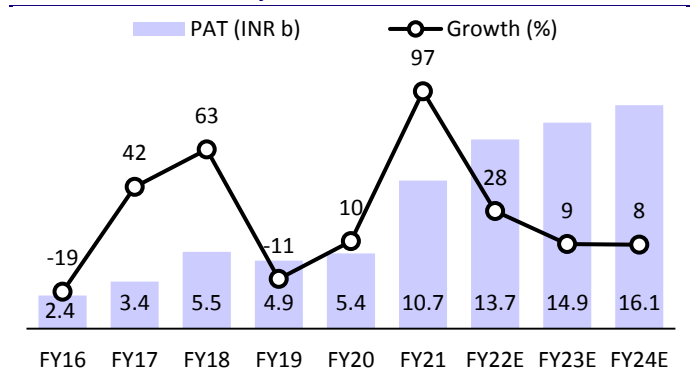
Source: MOFSL, Company

Exhibit 17: High tech investment to keep CI ratio elevated



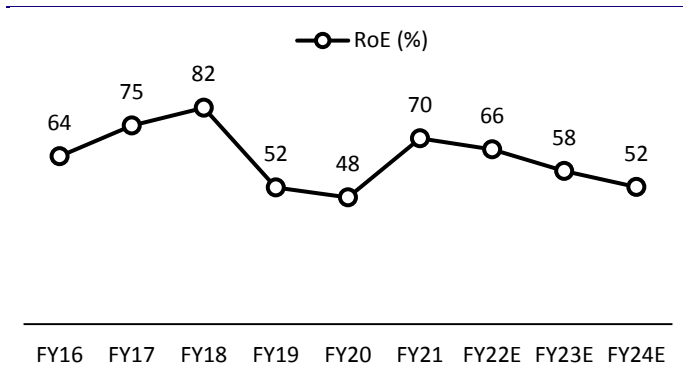
Source: MOFSL, Company

Exhibit 18: Profitability trend



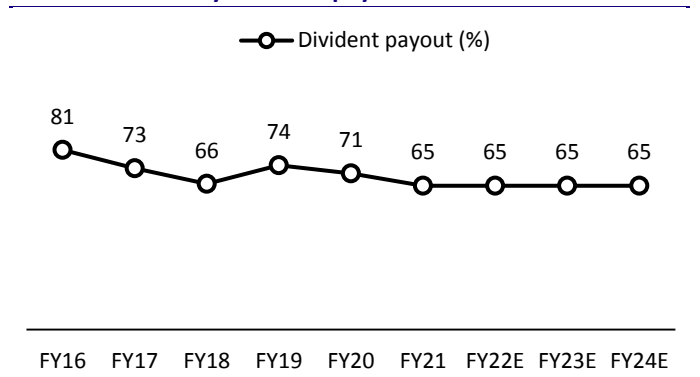
Source: MOFSL, Company

Exhibit 19: RoE to moderate



Source: MOFSL, Company

Exhibit 20: Healthy dividend payout



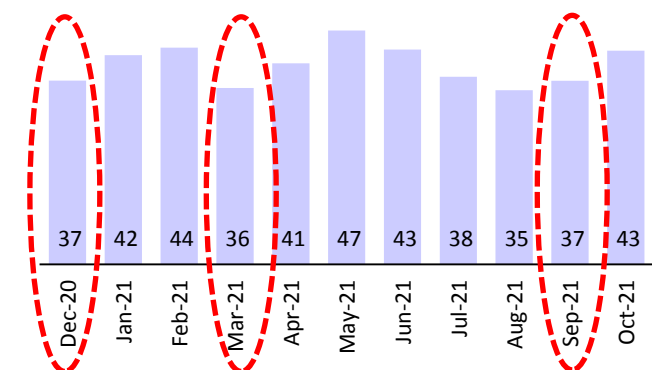
Source: MOFSL, Company

Margin norms well accepted and settled, cash ADTO back to a rising trajectory from Oct'21

- The final leg of margin norms was implemented from 1st Sep'21, wherein investors were required to meet 100% of the margin required.
- As seen in the previous legs of the margin rules, volumes in the month of implementation remained weak, but scaled up over the next couple of months. A similar trend was observed in the last leg, wherein cash ADTO for the Retail segment declined to INR37b in Sep'21 from INR47b in Apr'21, but witnessed a 16% MoM growth in Oct'21.

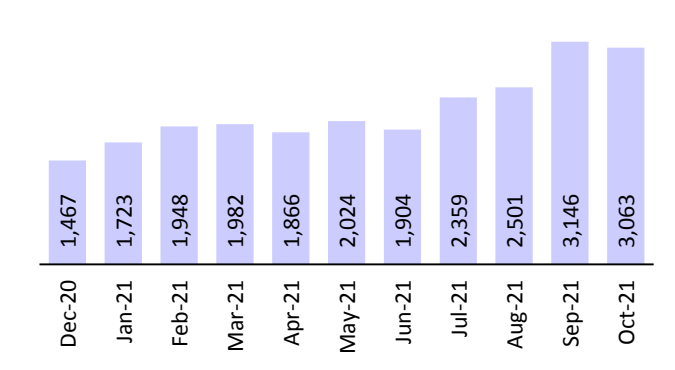
- Nov'21 saw relatively weaker trends owing to: 1) rangebound equity market in the first half of the month, 2) a large number of IPOs hitting the market, which absorbed liquidity, and 3) smaller brokers seeking additional cash margin in F&O as implementation of the clearing member and trading member margin norms as the earlier deadline of Dec'21 was nearing.
- Going forward, as individual investors get accustomed to the new margin norms, cash segment volumes will be more a function of market movement.

Exhibit 21: Retail cash ADTO impacted in the month of margin norm implementation (INR b)



Source: MOFSL, Company

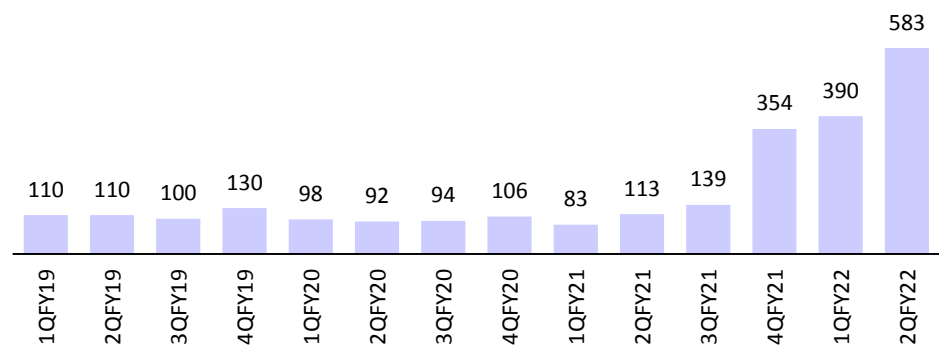
Exhibit 22: Retail F&O ADTO remains unimpacted (INR b)



Source: MOFSL, Company

Client addition trajectory should continue in the medium term, with massive changes in the customer profile

- The surge in the number of clients in terms of demat account additions and active users on the NSE has been structural in nature. New clients are primarily from Tier II and III towns and are younger millennials (born between CY90 and CY96) and Gen Z (born after CY97 – age 24 and below). These client profiles have the following features:
 - Tech savvy: These customers have been actively using apps and smartphones from a very young age. The Gen Z population is termed as tech native. These customers have tech ingrained in every aspect of their lives, and hence are more receptive to digital trading offerings.
 - Small ticket: Since these customers have just started working, their investments are significantly lower than its erstwhile customers.
 - Higher risk appetite: While these investors have a lower ticket size, their preference for riskier assets such as equities is high owing to their focus on return on investment rather than return of investment.
- The confluence of the aforementioned factors has driven broker's strategies towards customer acquisition. With expectations of almost 10m individuals being added to India's working population every fiscal, doubling the active user base over the next 3-5 years is plausible.
- The management expects the industry to add ~100m demat accounts by CY25 (current base is of 70m accounts). The risk to this growth is the behavior of these customers in a market downturn, which is an unknown.

Exhibit 23: Quarterly client acquisition run-rate inching up (in '000s)

Source: MOFSL, Company

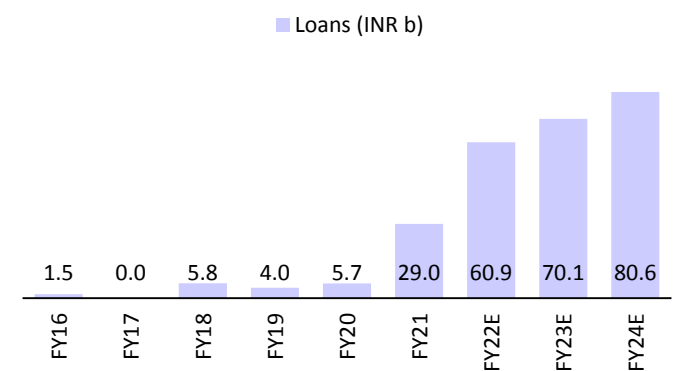
ISEC's customer acquisition strategy pivots around Tier II and III towns

- ISEC has adopted a targeted approach to customer addition, with a focus on adding young millennials who are starting their careers.
- For ISEC, 50-60% of its incremental customers are in the 18-25 age bracket as compared to 30-35 years a few years back.
- With digitization and deep mobile penetration, almost two-thirds of the recently acquired customers are from the Tier II and III towns.
- While these customers are not the highest revenue generators at present, ISEC aims to onboard them on their platform during the initial phase of their career and ensure their stickiness through right education, the right experience, and right products.

Retail and allied services to see healthy growth, driven by improving traction on Prime and Neo

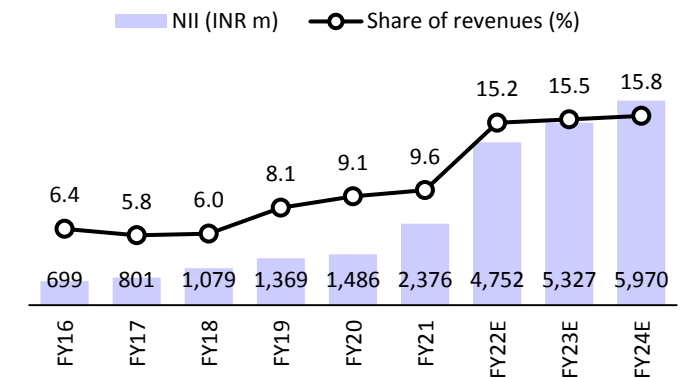
- Over the past six quarters, Retail Brokerage revenue has been flattish. Revenue from allied services such as Prime subscription, Neo subscription, MTF net interest income, and other trading related charges have seen strong traction. Retail brokerage and allied revenue has surged to INR5b in 2QFY22 from INR3.5b in 1QFY21.
- Prime as a product offers significantly lower brokerage as compared to its previous offerings. Attractive MTF offerings, at 8.9%, was a key driver for client acquisition. This also helped ISEC drive overall volumes in terms of ADTO.
- Its Neo product is targeted at the trader community, with a flat INR20/order brokerage rate similar akin to discount brokers. So far, the traction has not been as per its expectations, but with the right marketing efforts, the management expects a decent pick up.
- Currently, ISEC is generating annuity fees of INR300-400m per quarter from Prime, along with interest income of INR400-500m.

Exhibit 24: Strong MTM book...



Source: MOFSL, Company

Exhibit 25: ...to drive robust growth in NII income



Source: MOFSL, Company

Investing in technology to drive the next leg of growth

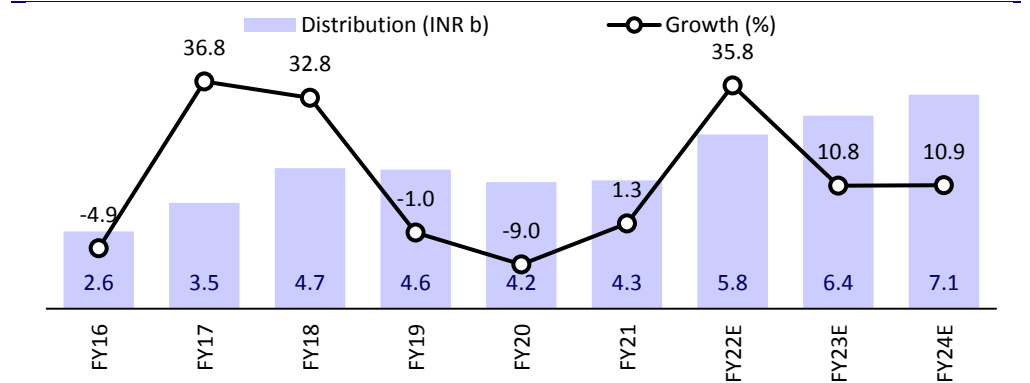
- ISEC is improving its trading application by benchmarking it with other players. The app is already in its beta stage now. Money App is an initiative to capture non-Equity clients, with only MFs offered in the initial stage. It has now added other products like insurance, bonds, FDs, etc.
- It is looking to add loans to the platform as an offering, for which it has tied up with seven partners. The large product suite is on the back of its tie-ups for: 1) insurance (ISEC has six partners and is looking to add more), 2) MFs (it has over 30 partners), and 3) fixed income (it has the widest range of bond offerings and FDs).
- With an aim to target the Gen Z population, the management is working on a completely new brand, which is in the development stage. The new brand and app will meet requirements of these customers such as integration with social networking platforms, learning tools in small video formats, gamification of the overall experience, among others.

Strong focus on the Distribution segment, to grow LI, MF, and Loans

- Share of Distribution services in ISEC's overall revenue has increased to 17.7% in 2QFY22 from 14.6% in 1QFY21. The management has been focusing on increasing the wallet share within each of its customer cohorts, for which distribution of financial products such as insurance, mutual funds, fixed income products, and loans is key.
- To enhance this further, ISEC has created a structure, wherein the heads of each of these business lines are accountable for customer acquisition, charting their own digital journey, and driving revenue.
- Over the years, it has been offering a variety of customized products in the Wealth segment to HNIs (more than INR10m in assets with ISEC). It is now trying to customize marketing for the mass segment to offer them the right products.
- This development is at an early stage, for which a significant level of data is being collated. The implementation of the same will be a key driver for garnering Distribution revenue.
- Cross selling to existing customers is another aspect that the management is laying a strong focus on. It is creating a marketplace for all financial products, and adoption of open architecture was the first step towards the same.

- This will offer transactional features and offer comparison in insurance (akin to Policy Bazaar) and loans. ISEC will offer recommendations through its own research, allowing customers to close the transaction after making comparisons.

Exhibit 26: Strong growth in Distribution income



Source: MOFSL, Company

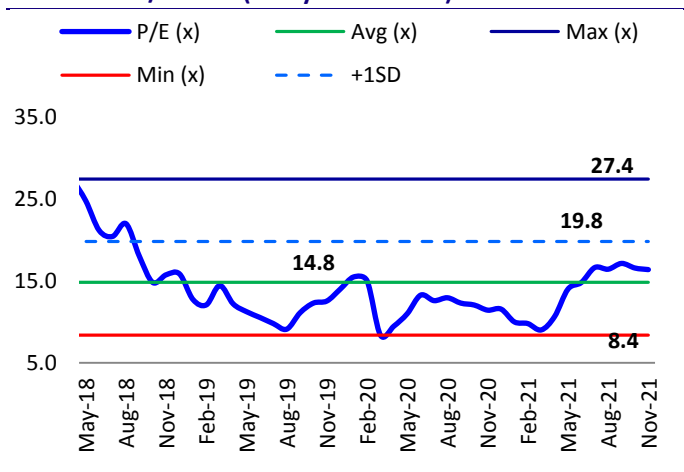
Capex to remain elevated driven by higher investments in technology

- Investments in technology till FY20 stood at INR110-150m, which increased to INR300-370m in FY21. In FY22, the company expects to double capex.
- Within Analytics, investment is towards tools and people investment.
- Marketing spend before FY20 was ~INR100m, which increased to INR400m in FY21 and is expected to increase to over INR1,000m in FY22.
- The company aspires to bring down the C/I ratio below 40% over the next few years. In the near term, costs are expected to rise owing to investments in technology, human resource, and marketing.

Valuation and view

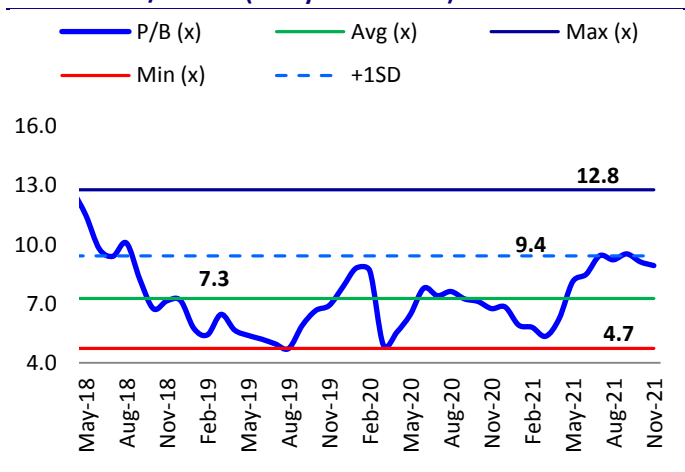
- ISEC is a classic play on the increasing financialization of savings and participation of retail investors in the equity market.
- ISEC is investing in several initiatives to make its business leaner and well-gearred for the upcycle. Initiatives such as the tie-up with ICICIBC; ‘Prime’, ‘Prepaid’, and ‘Options 20’ models, etc. have started to yield results. A new app, upgrading of the Money App, focus on distribution will drive higher wallet share.
- **With its digital client acquisition strategy, ISEC has been able to add clients from Tier II and Tier III cities. Improving activation rate should eventually translate into an improvement in market share as well. Scale up in the Neo plan will allow them to arrest the decline and later improve its market share in the Derivatives segment.**
- With initiatives such as open architecture for insurance (HDFC Life tie-up) and the launch of new loan products, traction in Distribution income is expected to remain strong.
- While we have raised our revenue estimate by 1.4%/2.7% for FY23E/FY24E, we have increased our cost estimates by 2.9%/5.8%. Our EPS estimates are largely unchanged. We maintain our Buy rating with a TP of INR970/share (21x FY23E EPS).

Exhibit 27: P/E chart (one-year forward)



Source: MOFSL, Bloomberg

Exhibit 28: P/B chart (one-year forward)



Source: MOFSL, Bloomberg

Financials and valuation

Income Statement							(INR m)
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Total Income	18,610	17,270	17,249	25,862	33,402	36,870	40,650
Change (%)	32.5	-7.2	-0.1	49.9	29.2	10.4	10.3
Brokerage Income	10,243	9,328	9,476	15,045	16,053	17,373	18,802
Income from Services	6,552	5,733	5,218	6,961	10,102	11,243	12,519
Interest Income	1,574	1,792	2,350	3,449	6,897	7,794	8,807
Other Operating Income	241	193	19	407	326	431	486
Other Income	0	225	187	0	25	30	36
Operating Expenses	10,086	9,698	9,720	11,554	15,027	16,870	18,955
Change (%)	14.3	-3.8	0.2	18.9	30.1	12.3	12.4
Employee expenses	5,504	5,545	5,338	5,880	6,762	7,573	8,482
Interest expenses	495	423	864	1,073	2,146	2,467	2,838
Depreciation	153	150	614	542	600	575	550
Others	3,935	3,580	2,905	4,060	5,520	6,254	7,085
Profit Before Tax	8,524	7,572	7,529	14,308	18,376	20,000	21,695
Change (%)	63.3	-11.2	-0.6	90.0	28.4	8.8	8.5
Tax	2,989	2,665	2,109	3,631	4,723	5,140	5,576
Tax Rate (%)	35.1	35.2	28.0	25.4	25.7	25.7	25.7
PAT	5,535	4,907	5,420	10,677	13,653	14,860	16,120
Change (%)	63.5	-11.3	10.4	97.0	27.9	8.8	8.5
Proposed Dividend	3,646	3,646	3,825	6,940	8,874	9,659	10,478

Balance Sheet							(INR m)
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Equity Share Capital	1,611	1,611	1,611	1,611	1,611	1,611	1,611
Reserves and Surplus	6,866	8,862	10,485	16,610	21,389	26,590	32,231
Net Worth	8,477	10,473	12,095	18,221	23,000	28,201	33,843
Borrowings	6,771	4,518	14,998	35,238	74,000	85,100	97,866
Other Liabilities	13,491	31,655	17,335	28,350	31,185	34,303	37,733
Total Liabilities	28,739	46,646	44,428	81,809	1,28,185	1,47,604	1,69,442
Cash and Investments	15,499	31,515	24,139	38,822	51,925	60,715	70,403
Change (%)	55.7	103.3	-23.4	60.8	33.8	16.9	16.0
Loans	5,782	4,033	5,709	29,015	60,930	70,070	80,581
Net Fixed Assets	421	476	2,061	1,688	1,857	2,043	2,247
Net Current Assets	7,037	10,623	12,520	12,285	13,472	14,777	16,211
Total Assets	28,739	46,646	44,428	81,809	1,28,185	1,47,604	1,69,442

E: MOFSL estimates

Financials and valuation

Ratios	(%)						
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
As a percentage of Revenue							
Brokerage Income	55.0	54.0	54.9	58.2	48.1	47.1	46.3
Income from Services	35.2	33.2	30.2	26.9	30.2	30.5	30.8
Interest Income	8.5	10.4	13.6	13.3	20.6	21.1	21.7
Other Income	1.3	2.4	1.2	1.6	1.0	1.2	1.3
Total cost	54.2	56.2	56.4	44.7	45.0	45.8	46.6
Employee Cost	29.6	32.1	30.9	22.7	20.2	20.5	20.9
OPEX (excl. employee) Cost	24.6	24.0	25.4	21.9	24.7	25.2	25.8
PBT	45.8	43.8	43.6	55.3	55.0	54.2	53.4
PAT	29.7	28.4	31.4	41.3	40.9	40.3	39.7
Profitability Ratios (%)							
RoE	82.0	51.8	48.0	70.4	66.2	58.0	52.0
Dividend Payout Ratio	65.9	74.3	70.6	65.0	65.0	65.0	65.0
Valuations							
BVPS (INR)	26.3	32.5	37.5	56.5	71.4	87.5	105.0
Change (%)	69.0	23.5	15.5	50.6	26.2	22.6	20.0
Price-to-BV (x)	28.3	22.9	19.9	13.2	10.5	8.5	7.1
EPS (INR)	17.2	15.2	16.8	33.1	42.4	46.1	50.0
Change (%)	63.5	-11.3	10.4	96.9	27.9	8.8	8.5
Price-to-Earnings (x)	43.4	49.0	44.3	22.5	17.6	16.2	14.9
DPS (INR)	9.4	9.4	11.0	21.5	27.5	30.0	32.5
Dividend Yield (%)	1.3	1.3	1.5	2.9	3.7	4.0	4.4

E: MOFSL estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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