JM JainMatrix Investments	A quality report by JainMatrix Investments
ICICI Securities IPO – A Direct Purchase	• **Large Cap: Rs. 16,750 cr. Mkt cap** • **Industry – Stock Broking**
• **Date 24th Mar; IPO Opens 22-26th Mar at Rs. 519-520** • **Valuations: P/E 34.6 times TTM** • **Advice: SUBSCRIBE**	ICICI Securities

- **Overview:** ICICI Securities is a technology-based securities firm that offers a wide range of services including brokerage, financial products distribution and investment banking. They have been the largest equity broker in India since FY14 by revenue and active customers in equities. ISec FY17 revenue, EBITDA and PAT were Rs. 1,404 cr., Rs. 580 cr. and Rs. 338 cr. resp. ISec revenues, EBITDA and PAT grew at 19%, 36% and 47% CAGR in 5 years.
- ISec has a good brand, a top 5 market position, good synergy with ICICI Bank, a nationwide infra for supporting and growing its customer base and an excellent last 5 years and 9M FY18 financial performance where it has emerged as one of the leaders.
- At a P/E of 34.6 times, the valuations of the IPO appear to be high. However earnings growth is likely to continue at a high rate. Superior RoE, high and improving margins, scalable business model, and sectoral tailwinds make this issue attractive.
- **Key Risks:** 1) Cyclical industry 2) High and rising competition 3) No discount offering 4) Poor image
- **Opinion:** Investors can SUBSCRIBE to this IPO with a 2 year perspective.

Here is a note on ICICI Securities (ISec) IPO.

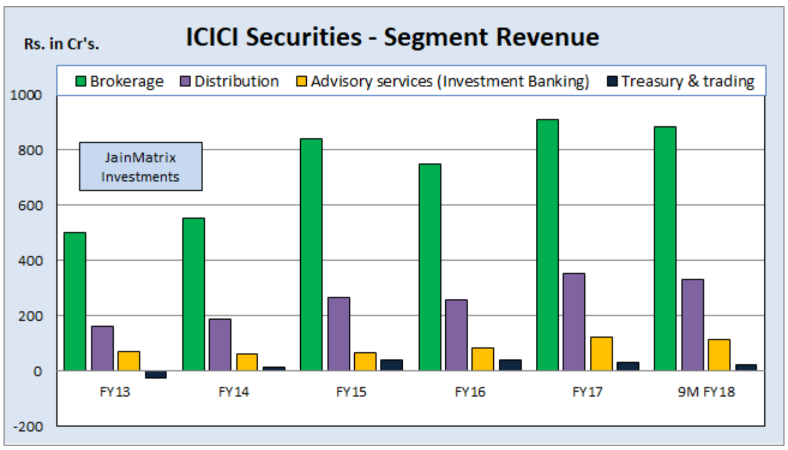
IPO highlights

- The IPO opens: 22-26th Mar 2018 with the Price band: Rs. 519-520 per share.
- Shares offered to public number 7.72 cr. The FV of each is Rs. 5 and market lot is 28.
- The IPO will raise Rs. 4,017 cr. while selling 24% of post IPO equity. The offer will be an Offer for Sale (OFS) of Rs. 4017 cr. and there is no fresh issue of shares.
- The promoter (ICICI Bank) owns 100% of ISec which will fall to 76% post-IPO.
- ICICI Bank is the selling shareholder as it is the sole owner of the entire company. Out of the 7.72 cr. shares offered for sale, 38 lakh shares have been reserved for existing ICICI Bank shareholders. The IPO quotas for QIB, Non Institutional Buyer (NIB) and Retail are in ratio of 75:15:10, quite unusual.
- The unofficial/ grey market premium for this IPO is Rs. 10-15/share. This is a positive.

Introduction

- ISec is a technology-based securities firm in India that offers a wide range of financial services including brokerage, financial product distribution and investment banking for both retail and institutional clients. They have been the largest equity broker in India since FY14 by brokerage revenue and active customers in equities on the NSE.
- ISec's FY17 revenue, EBITDA and PAT were Rs. 1,404 cr., Rs. 580 cr. and Rs. 338 cr. resp.

- ISec is a full service brokerage that offers its retail customers a range of products and services in equities, derivatives and research. Advisory services include financial planning, equity portfolio advisory, alternate investments, retirement planning and estate planning. They also distribute third-party products like mutual funds, insurance, FDs, loans, tax services and pension products.
- The retail brokerage and distribution business is supported by a nationwide network 200 own branches, 2,600 ICICI Bank branches through which ISec is marketed and over 4,600 sub-brokers, authorized persons, independent financial associates and independent associates.
- ISec provides domestic and foreign institutional investors with brokerage services, corporate access and equity research. ISec has a large cross-section of institutional clients, including FIIs who are serviced through dedicated sales teams. ISec investment banking business offers equity capital markets and financial advisory services to corporate clients, the govt. and financial sponsors. The equity capital markets services include management of IPO/FPOs, share buybacks, tender offers and equity private placements, domestic and cross-border M&A, private placements, and restructuring.
- ICICI Direct (ISec's electronic brokerage platform) currently has 39 lakh operational accounts of which 8 lakh had traded on NSE in the last 12 months. Since inception, they acquired a total of 46 lakh customers through this platform.
- ISec's brokerage and commissions business accounted for 89.5% of the total revenue. See Fig 1.



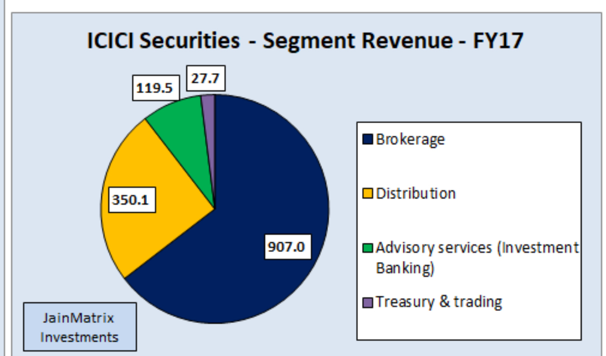


Fig 1- ISec FY17 Segment Revenue/ Fig 2 – ISec Segment Revenue Growth

- ISec was one of the pioneers in the e-brokerage business in India, and started offering online, real-time execution of trades on the NSE and BSE in FY 2000 through ICICI direct, their proprietary electronic brokerage platform. In FY17, over 95% of brokerage transactions by value, and over 90% of MF transactions by number, were performed by customers online.
- Leaders are Shilpa Kumar MD/CEO, Chanda Kochar Chairperson, Ajay Saraf ED, Harvinder Jaspal CFO

Promoter ICICI Bank – Snapshot and Financials

- ICICI Bank is the #1 private sector universal bank providing a range of services like commercial & retail banking, project & corporate finance, insurance, VC/PE, IBanking, broking & treasury services.
- Income and PAT has grown at 11.1% and 1.5% CAGR resp. over 5 years, see Fig 3.
- There was a weakening in the balance sheets of banks witnessed since FY11-15. During the year 2014-16, ICICI Bank saw asset quality concerns rising and higher NPAs. Some of this was RBI driven, and the policy focus was to clean the books of all banks.

- ICICI Bank share gained 8.7% CAGR over 5 years and CMP is Rs. 289.6. Dividend yield is around 1%.

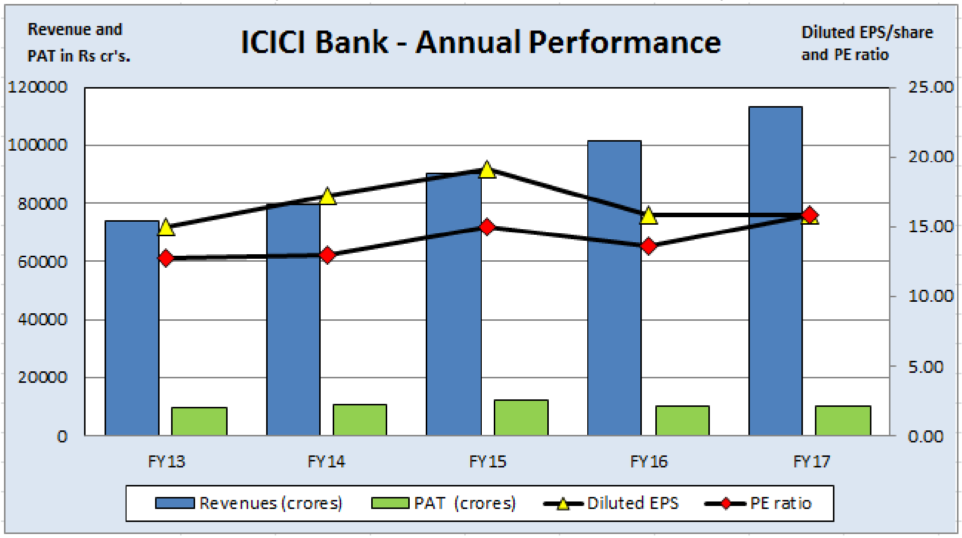


Fig 3 – ICICI Bank Financials

- However we are positive that private banks will grow faster at over 20% and gain market share over PSB's. ICICI bank too is expected to recover rapidly from the 2015-16 asset clean up. Private banks are currently well placed to lead credit growth supported by strong capitalization.
- From this short note we conclude that ICICI Bank has a fair reputation, and has somewhat rewarded shareholders over the past few years.

News, Business Model and Strategies of ISec

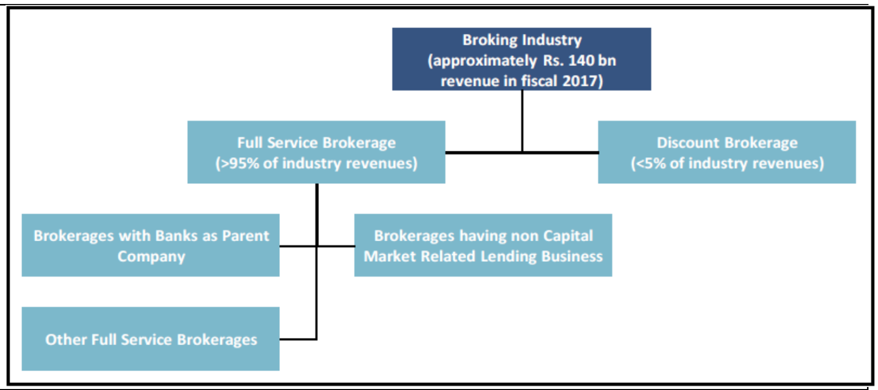
- ISec's business strategies are:
  - ➢ To strengthen their leadership position in the brokerage business.
  - ➢ Continue investing in technology and innovation.
  - ➢ Strategically expand their financial product distribution business through cross-selling.
- Business Model: ISec has a technology based business model which is scalable and asset light. So costs are controlled and cost to income ratio decreased from 84.6% in FY13 to 62.8% in FY17.
- ISec raised Rs. 1,717 cr. from 58 anchor investors. ISec will allot shares at a price of Rs 520/share to anchor investors, including Temasek, Nomura, Fidelity, Blackrock and Fairfax. IDFC Premier Equity Fund, L&T Mutual Fund Trustee, L&T Prudence Fund Pioneer Investment Fund, Reliance Strategic Investments Ltd and SBI Magnum Balanced Fund were also among the anchor investors.
- As per ISec, their distribution business is growing at a faster pace than brokerage business. ISec aims to continue leveraging the brokerage customer base for cross-selling. In Mar 2018, ISec commenced robo advisory, which is a goal-based advisory without manual intervention and based on algorithms.
- In Dec 2017, ISec requested SEBI permission to manage its own IPO.
- ISec had approached the NCLT in Sep 2017 against the Deccan Chronicle to recover dues. They claimed Rs. 125 cr. dues from DC, as they had indicated their inability to repay the entire amount and offered Rs. 45 cr. of non-convertible debentures. DC partly refunded Rs. 80 cr. but failed to deliver debentures worth Rs 45 cr. Over the last 5 years few banks and financial institutions have been trying to recover loans extended to DC after the publishing house plunged into financial crisis.
- ISec would be the 3rd subsidiary of ICICI bank which to be listed; ICICI Lombard General Insurance listed in Sep 2017 and ICICI Prudential Life Insurance listed in Sep 2016.

- ISec aims to increase market share in institutional brokerage business by leveraging their strong position among domestic institutional investors and by increasing their focus on FIIs.

Broking and Distribution Industry Outlook in India

- The Indian equity brokerage industry, which includes cash equities and equity derivatives brokerage, recorded revenues of Rs. 14,000 cr. in FY17, representing a 20% YoY growth. Industry revenues grew at 14% CAGR between FY12-17 due to rising trading turnover and growing retail participation.
- Market Share: The top 25 brokers accounted for 51% of trading turnover in the NSE cash equities market in H1 FY18. ISec had a market share of 7.8% in the broking business and 3.5% market share in the distribution business in FY17.
- The Indian brokerage sector can be classified in terms of type of brokerage service, nature of parent company and business diversification. The following chart sets forth the market structure:

Fig 4 – Indian Broking Industry Structure



- The equity ADTO (average daily turnover) has increased from Rs. 1,68,400 cr. in FY13 to Rs. 6,21,000 cr. in H1 FY18, a CAGR of 33.6%. Equity derivatives account for a major portion of the volumes, representing 95.1% of the total equity turnover in H1 FY18. Further, the equity ADTO from the equity derivatives segment has grown at a CAGR of 34.5% from FY13 to H1 FY18, as compared to a CAGR of 20.6% in the cash equities segment, primarily on account of higher index levels, reduced STT on equity futures from 0.017% to 0.01% and an increasing share of high frequency and algorithmic trading, especially in the derivatives market.
- As per CRISIL Research estimates, the Indian equity brokerage industry revenues are projected to increase at 15-18% CAGR in the next 5 years and reach Rs. 30,000 cr. by FY22, driven mainly by the continued uptick in trading volumes and increasing retail investor participation. (Source: ISec RHP)
- As per AMFI, the commissions paid by MFs to distributors grew from Rs. 2,400 cr. in FY13 to Rs. 5,000 cr. in FY17, a CAGR of 20.1%. Increased financial savings, superior returns from MFs, greater reliance on distributors and govt. policies acted as key catalysts in driving the distribution revenue growth. In addition, as per a SEBI directive in Sep 2012, AMCs were permitted to pay higher commissions to distributors in B15 cities to increased investments from under-penetrated regions.
- According to CRISIL Research, the AUM of AMCs is projected to grow at a CAGR of 21% from FY17 to reach Rs. 44 lakh cr. in FY22. Improvement in economic growth, low MF penetration, higher disposable income coupled with increased financial savings, rising retail participation, expanding geographic reach, higher digitisation and supportive govt. policies focusing on increasing awareness and ease of investing are expected to be the growth catalysts. (Source: ISec RHP).
- There was a growth in number of demat accounts (30% CAGR FY13- H1FY18).

Financials of ISec

- ISec's revenues, EBITDA and PAT grew at 18.7%, 35.8% and 47.3% CAGR in 5 years, **see Fig 5**.

- The 9M FY18 financials look excellent. The 9M FY18 PAT is 17.6% higher than the entire FY17 PAT.

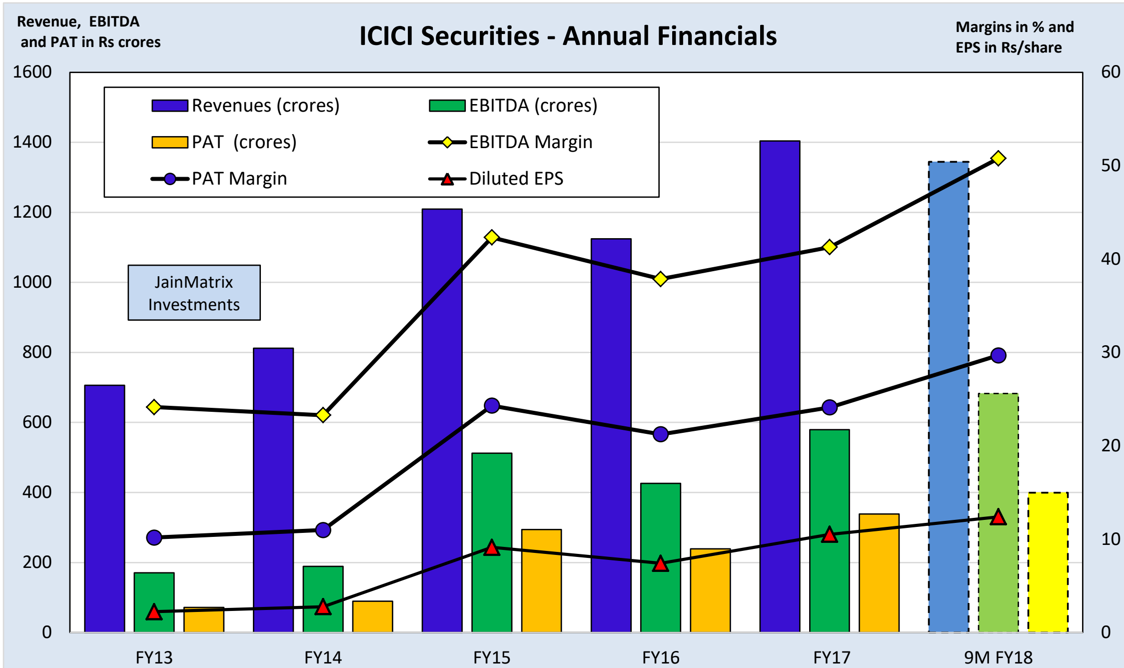


Fig 5 - Financials

- The margins are high and have improved sharply over 5 years of FY12-17. PAT margin has risen from 10.1% (FY13) to 24.1% (FY17), and to 29.6% in 9M FY18. This is a positive.

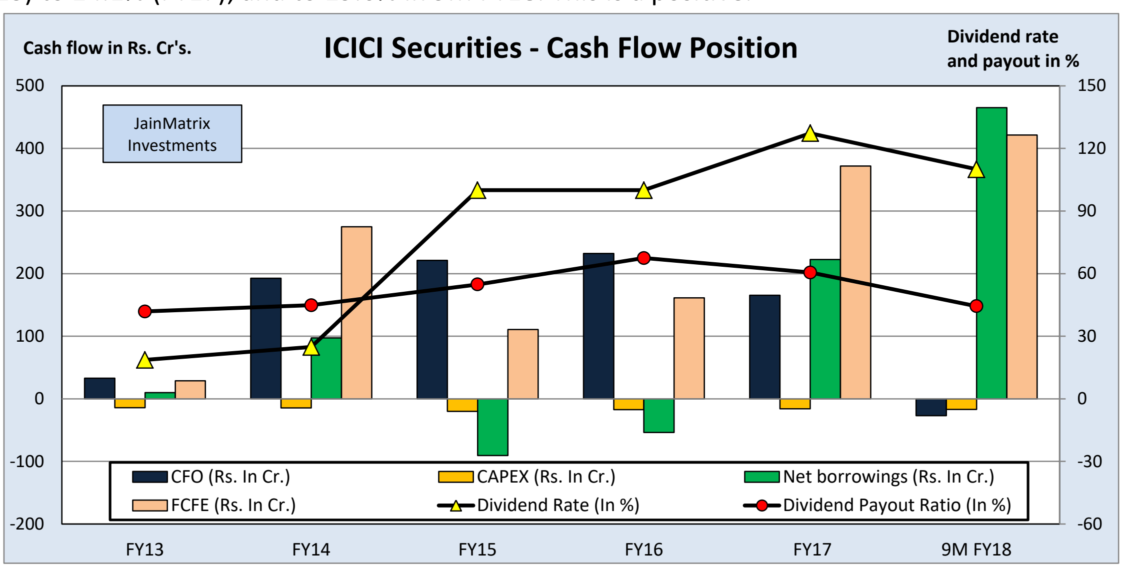


Fig 6 – ISec Cash Flow

- ISec has been Operational Cash flow positive in the last 5 years FY13-FY17. This is a positive. In 9M FY18, this CFO is slightly negative; however the trend was the same for 9M FY17 after which for the full year CFO was large and positive. See Fig 6.
- FCFE here is Free Cash Flow to Equity, which is the sum of CFO, Capex and Net Borrowings.
- ISec had a RoE of 77.5% in FY17 while the 3 year average RoE stood at 76.9% (FY15-17). The RoCE stands at 90.8%. These return ratios are high and excellent.
- The current D/E ratio is 1.27:1 which is moderate. The debt completely pertains to short term debt where money has been raised using commercial paper repayable within one year.

- The dividend payout ratio has improved from 41.8% to 60.5% (FY13-17). This is a positive.
- ISec's business is asset light and requires minimum CAPEX and hence the company has throughout generated positive FCFE and a high return on equity. The trend is likely to be the same going ahead.

Benchmarking

We benchmark ISec against other listed companies providing similar services. **See Exhibit 7.**

Particulars	ICICI Securities	Edelweiss Financial Services	IIFL Holdings	JM Financial	Motilal Oswal Financial Services
Revenues (Rs. in cr's.) (FY17)	1,404	6,592	4,912	2,357	1,726
EBITDA (Rs. in cr's.) (FY17)	580	3,859	3,373	1,777	919
Profits (Rs. in cr's.) (FY17)	339	609	686	470	360
Market Cap (Rs. in cr's.)	16,751	22,491	22,100	10,478	15,556
PE TTM (x)	34.60	27.69	26.02	17.66	32.17
Price to Book Value (x)	25.07	4.25	3.92	2.36	8.57
3 Yr CAGR Sales (%)	20.02	37.54	20.30	32.99	55.76
3 Yr CAGR Profit (%)	56.00	40.38	35.13	30.92	108.86
Debt to equity ratio (x)	1.27	6.66	5.02	3.24	2.60
EBITDA Margin (%)	41.27	58.54	68.65	75.38	53.27
Net Profit Margin (%)	24.11	9.24	13.97	19.95	20.85
Return on Equity (%)	77.47	14.08	15.65	14.10	20.15
Return on Capital Employed (%)	90.88	2.57	3.68	5.42	6.44
Dividend Yield (%)	1.22	0.53	0.65	1.20	0.23

Exhibit 7 – Benchmarking

Note1 - ISec P/B has been calculated basis Book Value as on 9M FY18. For other companies P/B has been calculated basis closing price as on 22.03.18.

Note2 - While these firms are the closest peers, ISec is mostly a stock broker. EFS, IIFL and JMF have substantial NBFC activities. EFS, IIFL and MOFS are also asset managers with PMS and MF activities.

- The PE post IPO is high/expensive, so pricing appears aggressive, this is a negative. On the P/B front as well, ISec is expensive. The 3 year sales growth of ISec is the lowest in the industry, however the 3 year PAT growth is excellent due to improving margins and cost controls.
- The RoE at 77.5% is massive and excellent, the best in the industry. This is a positive. The RoE is likely to remain high in the future as well due to the nature of their business.
- ISec had the lowest EBITDA margin, however the highest PAT margin in the industry indicating a great cost control and efficiencies in operations. The dividend yield at 1.22% is the highest.
- We can understand that ISec is a pure stock broker, and has group companies handling other asset management and NBFC activities. It thus has good focus on this business. It is able to keep operating costs low. With this, it is able to provide high profit margins and leading returns and is a high dividend firm. Thus we feel that the high valuations are justified.

Positives for ISec and the IPO

- ISec is powered by a solid proprietary technology platform called ICICI Direct. It is backed by robust infrastructure and has processed at peak over 19 lakh orders and trades in a day.
- ISec has a strong and growing distribution business with an "open-source" distribution model.
- ISec is a beneficiary of a transformation in the Indian savings environment, of household savings shifting from physical to financial assets. The share of financial savings as a proportion of household

savings has increased from 31.1% (FY12) to 41.5% (FY16). The share is likely to rise further, as physical savings such as gold and real estate are providing lower investment returns.
- ISec is a strategic component of the icici ecosystem and have mutually beneficial agreements with companies in the Group. The customers of ICICI Bank are allowed to trade in equity securities using a "3-in-1 account" facility with seamless integration providing great convenience.
- Strong financial performance with significant operating efficiency.
- As a full service stock broker, ISec provides good enough services for new and small investors.
- Unlike other IPOs, ISec has a good brand thanks to ICICI Bank, so visibility is not an issue.

Risks and Negatives for ISec and the IPO

- The valuations appear on the higher side among peers as P/E is 34.6 times.
- Stock broking industry is cyclical. It does very well in positive investment climates. However if there is a slowdown, a global trade war or adverse economic situation, and investors turn defensive, brokerage revenues dry up rapidly and return ratios can turn negative. The RHP financial data of ISec is for a 5 year period and does not display the financial effects of a negative climate on ISec.
- The entry and success of discount brokers like Zerodha, 5Paisa and RKSV is already attracting away HNI and advanced trading customers with low costs, better user experiences, etc. We do feel that so as to not lose customers ISec may be soon forced to add a discount broking platform.
- The brokerage industry is highly competitive and fragmented with close to 500 brokers in operation. Many of ISec's peers added business like financial services, loans and asset management as brokerage rates got squeezed over the last 10 years from 2-3% to a maximum of 0.75%. Consolidation is happening. However as a top 5 player, ISec can hope to benefit from consolidation.
- ISec is subject to extensive statutory and regulatory requirements and supervision from SEBI, and any adverse policy changes or punitive action in future can have material influence on ISec.
- ISec relies heavily on its relationship with ICICI Bank for many aspects of their business. Any changes in this relationship, or even a policy change that forces ICICI Bank to allow customers to have "3-in-1" accounts with other stock brokers can affect ISec business.
- The stock broking industry has an image problem. Pushy sales persons often force new accounts on unsuspecting prospects. Aggressive wealth managers and "advisers" call customers and "churn" their portfolio. Higher brokerage revenues and growing the wealth of customers are clashing objectives which customers may not understand until too late. Managing of equity portfolios of value below Rs 25 lakhs is a common (grey area) activity by stock broking employees and affiliates with uneven results for customers. Stock broking equity research reports target 10-15% gains from stocks (and quick exits) while simultaneous reports from RIAs or Research Analysts on the same stocks may target 100-150% gains (over 1-3 years), which may have better wealth outcomes.
- We feel ISec has a fuddy duddy image and may need to undergo UI and design transformation changes to appeal to millennials.
- The Indian broking industry has a long way to go in terms of customer friendly initiatives such as tracking and shadowing of professional portfolios, providing trading access to professionals, portability of trading accounts and investments, etc.

Overall Opinion and Recommendation

- The Indian equity markets are growing deeper and wider year after year.
- The shift towards financial assets over physical assets has grown brokerage and financial products distribution businesses, supported by demonetization, improved financial markets awareness, financial inclusion and ramp up in digital infrastructure. The retail participation is nowhere near the peak and likely to grow even stronger in the years to come.
- ISec has a good brand, a top 5 market position, good synergy with ICICI Bank, a nationwide infra for supporting and growing its customer base and an excellent last 5 years and 9M FY18 financial performance where it has emerged as one of the leaders.
- At a P/E of 34.6 times, the valuations of the IPO appear to be high. However earnings growth is likely to continue at a high rate. Superior RoE, high and improving margins, scalable business model, and sectoral tailwinds make this issue attractive.
- Key risks are 1) Cyclical industry 2) High and rising competition 3) No discount offering 4) Poor image
- Opinion: Investors can **SUBSCRIBE** to this IPO with a 2 year perspective.

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