



EQUITY BROKERAGE INDUSTRY UPDATE

Profitability declines in Q3FY10 on sequential basis; nevertheless better than Q3FY09

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Industry Outlook: Neutral

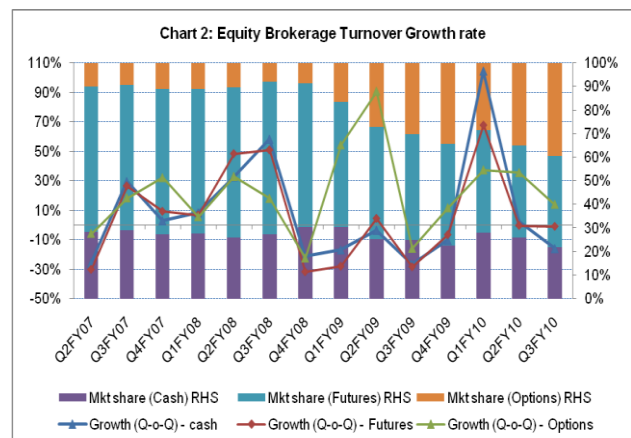
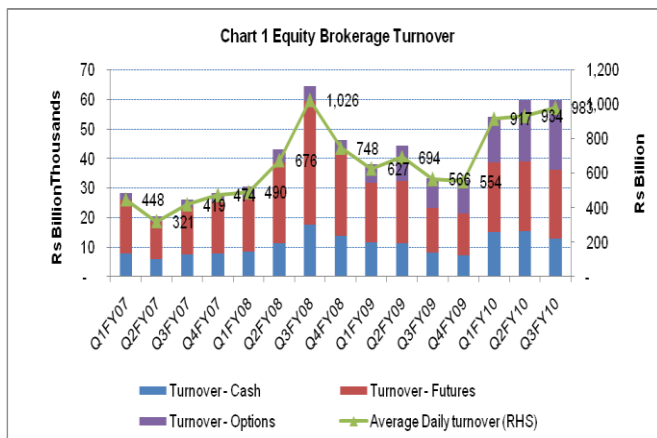
- ICRA continues to maintain a neutral outlook on domestic brokerage houses on account of inherent volatility in the capital markets and also on account of uncertainty on the outcome of various impending structural changes in the industry which could have mixed implications for brokerage houses.
- ICRA has noted the profitability indicators during Q3F10 for most players in the segment, which has shown some moderation over the previous sequential quarter. Nevertheless, the profitability indicators remained comfortable compared to the Q3FY09.

Industry Update: Q3FY09-10

- Operating environment remains comfortable in third quarter of FY10; though profitability declines on a sequential basis.
- Equity broking turnover at National Stock Exchange (NSE) and Bombay Stock Exchange (BSE), combined, remained flat on sequential quarter on quarter basis but reported a 79% rise on year on year basis.
- Market proportion further shifts more in favour of Option trading; cash market trading proportion continues to decline.
- Overall average equity brokerage yields may have declined with larger proportion of option trading volumes; yields likely to remain intact for respective segments namely cash, futures and options.
- Capital market remained conducive for initial public offerings (IPO) though not many IPOs during the period.
- No major opportunity for IPO funding during the quarter under review. Lending against securities also remained subdued.

Website:
www.icra.in

Equity brokerage turnover remained flat during the quarter; proportion changes more in favor of option trading...



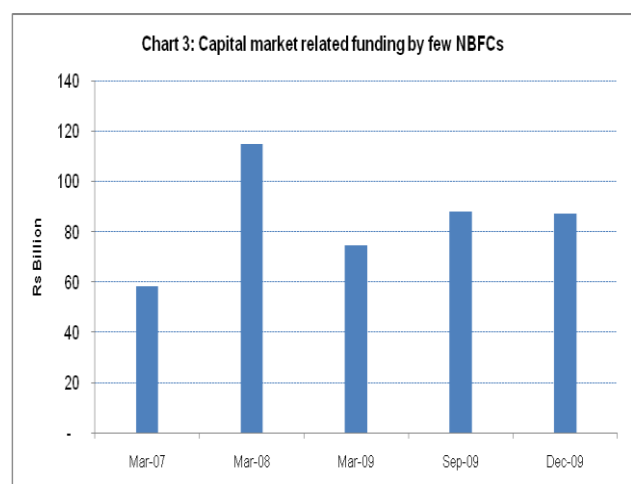
Source: NSE, BSE Website

During Q3FY10, equity broking turnover remained flat on sequential quarter basis, while it reported a 79% rise on year on year basis albeit on low base in Q3FY09. Nevertheless, average daily turnover increased to Rs 983 billion in Q3FY10 from Rs 934 billion in Q2FY10 with lesser number of trading days (61) during the quarter. While the trading volume in cash segment declined by 16% during the quarter on q-o-q basis, trading volume in option segment grew by 14% during the quarter on q-o-q basis. On the other hand, trading volume in the future segment reported a marginal decline during the quarter. In-fact, trading volumes in the Options segment has been on an increasing trend since FY09 and the option trading volumes accounted for 40% of the total trading volumes on the Exchange houses in Q3FY10 compared to less than 10% proportion during FY08. The proportion of trading in future segment remained steady at 39% during Q3FY10 while the proportion of trading in the cash segment declined considerably to 22% from 26% in Q2FY10.

While the equity broking volumes have remained stable during the Q3FY09-10, a similar growth is not reflected in the equity broking revenues of the brokerage houses on account of lower average brokerage yields on option trades. On an average, yield on trading in options is 1 – 2 basis points while it is 3 – 4 basis points in the future segment and as high as 10 – 12 basis points in the cash segment. Accordingly, ICRA believes the overall average brokerage yield to have declined in Q3FY09-10, however, average yields in the respective segment may not have declined significantly during the quarter.

Lending portfolio¹ remained almost flat...

While the H1FY10 had seen a significant pick up in the lending activities buoyed by increasing trend in the equity prices and improving operating environment, Q3FY10 saw almost no growth in the lending portfolio of margin funding & loan against shares. During Q3FY10, stock prices remained relatively range bound leading to lesser demand of margin funding / loan against shares. While the credit book remained almost flat during the quarter under review, average book in Q3FY10 was higher than that in H1FY10 on account of lower book size as on Mar-09. Going forward, in ICRA’s view, loan against securities activity may pick up at a quicker pace on account of lower incremental concerns on economy.

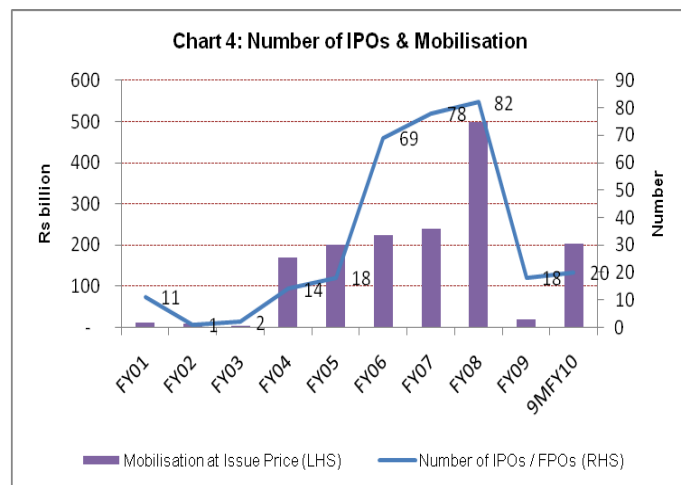


Source: Company, ICRA database

¹ Data compiled for Aditya Birla Finance Ltd, ECL Finance Ltd, Emkay Global Finance Ltd, IDFC, IL&FS Financial Services Ltd, India Infoline Investment Services Ltd, Investsmart Financial Services Ltd, Kotak Mahindra Investments Ltd, Kotak Mahindra Prime Ltd, Motilal Oswal Financial Services Ltd, Rathi Global Finance Ltd and Religare Finvest Ltd.

No major IPO funding during the quarter...

During FY10, many large ticket IPOs hit the capital market. Domestic capital market has already seen 20 IPOs in the current financial year (till December 2009) with an overall mobilization of ~Rs 204 billion as compared with Rs 20 billion mobilized by 18 IPOs in the entire FY09. While the addition of new stocks adds to brokerage volumes, new IPOs also help the brokerage houses in earning distribution income and advisory fees. In addition, they also provide a quick revenue source for the NBFCs in terms of the IPO funding. However unlike H1FY10, IPO funding remained subdued during Q3FY10 against the backdrop of lower than expected IPO listing gains on few big IPOs in H1FY10. During Q3FY10, big IPOs like JSW Energy Ltd (~Rs 38.2 billion) and Indiabulls Power Ltd (~Rs 15.3 billion) saw lackluster response in the HNI segment. Although few of the smaller IPOs like DB Crop Ltd (~Rs 3.8 billion) and Cox & Kings India Ltd (Rs 6.1 billion) got high subscription level in the HNI segment, in ICRA estimates, IPO funding during Q3FY10 would have been much lower at Rs 23 billion as against Rs 335 billion in H1FY10.

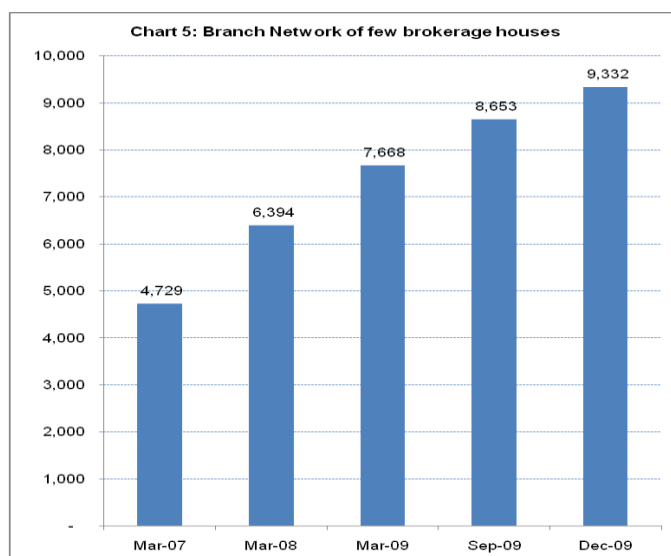


Source: NSE Website

For IPO funding, NBFCs raise 15 – 20 days money from the mutual funds through the issuance of short term Non Convertible Debentures (NCD). However, with RBI proposing to ban NCD of less than 90 days maturity², going forward, NBFCs may have to tap alternate sources of funds thereby impacting their spread. In ICRA's view, while the new proposal of RBI, if implemented, could increase the cost of funds for the brokerage houses, they would still continue with their IPO funding programme on account of favorable risk-adjusted returns. ICRA expects that Gol's plans of diluting its stakes in various un-listed public sector companies could also add to the IPO funding business.

Broking network³ continues to grow at a rapid pace; led by the franchisee route...

Brokerage houses have rapidly scaled up their branch network in 9MFY10, as compared with the FY09, buoyed by the improvement in market sentiments in the FY10. During Q3FY10, ICRA's sampled brokerage houses added 679 branches / franchisee (1,664 YTD & 1,274 in FY08-09) large part of which was in the form of franchisee as the brokerage houses continue to remain cautious on adding company owned branches in order to keep costs low. Over past few years most of the brokerage houses have been expanding their branch network through franchisee route in order to gain market share while keeping a flexible cost structure. Going forward also, brokerage houses have chalked out aggressive expansion plans and ICRA expects higher proportion of the franchisee network. Earlier in H2FY09, most of the brokerage houses had put their expansion plans on hold with few of them also consolidating the branch network.



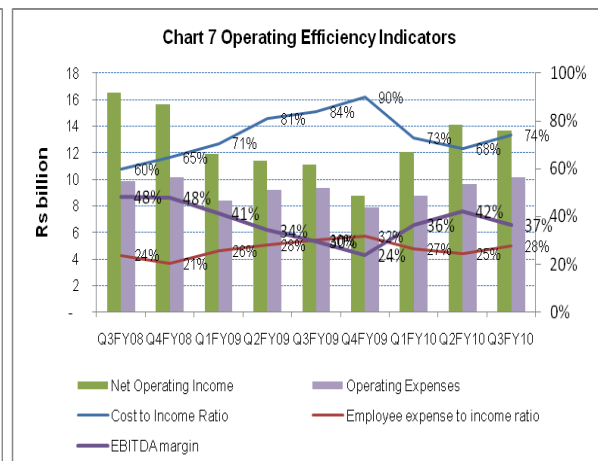
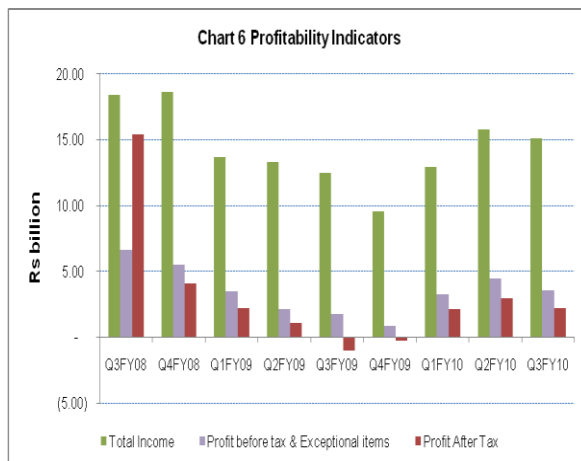
Source: Company, ICRA database

² Made in the Credit Policy of October 2009

³ Data compiled for seven brokerage houses namely Anand Rathi Financial Services Ltd, Edelweiss Capital Ltd, Emkay Global Financial Services Ltd, India Infoline Ltd, Kotak Securities Ltd, Motilal Oswal Financial Services Ltd, Religare Enterprise Ltd, and Sharekhan Ltd.

Profitability⁴ declines in Q3FY10 on sequential quarter basis; robust growth on y-o-y basis...

Financial profitability of the eight listed brokerage houses⁴ declined marginally during Q3FY10 from the previous quarter. Brokerage houses' total income declined by 4% during Q3FY10 on sequential quarter basis on account of lesser contribution from the equity broking business, though non-broking operations & fund based operations provided some support. In ICRA's view, equity brokerage income of the listed brokerage houses got impacted in Q3FY10 despite flat industry brokerage volumes on account of high proportion of trading turnover in low yielding option segment. Nonetheless, their total income grew by 21% on year on year basis albeit on a low base. Brokerage houses' operating expenses grew marginally by 5% on sequential quarter basis (9% on year on year basis) as they again become active on branch expansion and recruitment. Accordingly, Brokerage houses' profit before tax and exceptional items declined by 21% on sequential quarter basis while it grew by 96% on year on year basis.



Source: BSE website. ICRA database⁴

Brokerage houses operating efficiency indicators also moderated, though marginally, during the Q3FY10. Operating cost to Operating income ratio increased to 74% in Q3FY10 from 68% in Q2FY10 (84% in Q3FY09) largely led by the rise in employee expense which stood at 28% of the total income in Q3FY10 as against 25% in Q2FY10 (30% in Q3FY09). While the brokerage houses have again started scaling up their branch network, focus is more on maintaining high proportion of franchisee so as to keep the operating expenses flexible. While brokerage houses do not disclose the credit provisioning on quarterly basis, in ICRA's view, Q3FY10 would have seen lower incremental credit provisioning.

Conclusion

ICRA continues to maintain a neutral outlook on domestic brokerage houses. While ICRA has noted a marginal decline in the profitability indicators during Q3FY10 for most players in the segment and inherent volatility in the capital markets, it expects brokerage houses' short term profitability to remain comfortable assuming no further negative surprises in the global & domestic market, easing of liquidity & credit concerns and improving of market sentiments. In the short term, the actual budget announcement would be a key driver for setting a trend in equity trading volumes. Over the medium term, the outcome of various impending structural changes in the industry could have crucial bearing on brokerage houses' profitability.

February 2010

⁴ Data compiled for eight listed brokerage houses namely Edelweiss Capital Ltd, Emkay Global Financial Services Ltd, Geojit BNP Paribas Financial Services Ltd, HSBC Investdirect (India) Ltd, India Infoline Ltd, Indiabulls Securities Services Ltd, Motilal Oswal Financial Services Ltd, and Religare Enterprise Ltd.

Annexure 1: ICRA rated entities engaged in capital market related business operations

Sr. No	Company	Rating as on February 23, 2010
1	Anand Rathi Commodities Limited	A2+ (SO)
2	Anand Rathi Financial Securities Limited	LA-/ A2+
3	Anand Rathi Stock & Shares Brokers Limited	LA-/ A2+
4	Aditya Birla Finance Limited (Erstwhile Birla Global Finance Company Limited)	A1+
5	Bonanza Commodity Limited	A2
6	Bonanza Portfolio Limited	A2
7	CD Integrated Services Limited	A3+
8	Crosseas Capital Services Private Limited	A4+
9	Dalmia Securities Private Limited	A1
10	Dimensional Securities Private Limited	LBBB- / A3
11	ECL Finance Limited	LAA-pp(SO) stable / A1+
12	Edelweiss Capital Limited	LAA-pp / LAA-pn / LAA- stable
13	Emkay Global Financial Services Limited	A2+
14	Enam Securities Private Limited	A1+
15	Enam Finance Private Limited	A1+(SO)
16	Gupta Equities Private Limited	LBB+/ A4+
17	IDFC-SSKI Securities Private Limited	A1+
18	IL&FS Financial Services Limited	A1+
19	India Infoline Investment Services Limited	LA+ stable / LAA-pp(SO) stable / A1+
20	India Infoline Limited	LAA-/ A1+
21	Infinity.com Financial Securities Limited	A3
22	Intime Spectrum Securities Limited	LBBB-/ A3
23	Inventure Growth & Securities Ltd	A3+
24	Investsmart Financial Services Limited	A1+
25	Joindre Capital Services Limited	LBBB- / A3
26	KIFS Securities Private Limited	A2+
27	Kotak Mahindra Investments Limited	LAA -/ LAA-pp / A1+
28	Kotak Securities Limited	LAA / LAA pp / A1+
29	Karvy Consultants Limited	LA-
30	Karvy Stock Broking Limited	LA-
31	Money Logix Securities Private Limited	A4
32	Nirmal Bang Securities Private Limited	LBBB/ A2
33	Pashupati Capital Services Private Limited	LBBB- / A3
34	Pioneer Investcorp Limited	LBBB- / A3
35	Prabhudas Lilladher Financial Services Private Limited	A1
36	Progressive Share Brokers Private Limited	LBB+ / A4+
37	Reliance Securities Limited	A1+ (SO)
38	Religare Securities Limited	A1+
39	Religare Finvest Limited	LA+ / A1+
40	Sharekhan Limited	A1+
41	Shilpa Stock Brokers Limited	LBB+/ A4+
42	Standard Chartered - STCI Capital Markets Limited (formerly UTI Securities)	A1+
43	Sushil Financial Services Private Limited	A4+
44	Sykes & Ray Equities (India) Limited	A3
45	Systematix Shares & Stocks (India) Limited	LBBB-/A3
46	TransGlobal Securities Limited	LBBB- / A3



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