KEYNOTE

ICICI Securities Ltd.

Surrounded by Dynamism, Paying its Way To Higher Heights

18th May 2023

ICICI Securities Ltd. (ISEC) started as an investment banking and institutional brokerage business in 1995 but has since grown into a leading wealth-tech and financial services company in India by 2023. ISEC has four business segments: broking (equity, derivative, etc.), distribution of financial products (loans, insurance, PMS, etc.), investment banking, and Private Wealth Management (PWM), which provide a varied revenue mix. To stabilize its brokerage revenue, ISEC has successfully implemented subscription models. Additionally, the growth of its Margin Trading Facility (MTF) business has reduced its reliance on brokerage revenue, which now makes up only 37% of the overall revenue mix in FY23 compared to 55% in FY20. The company's wealth business has also grown remarkably at 59% CAGR over FY20-23. With its strong growth prospects and diversified business portfolio, we recommend a BUY rating for ISEC and a target price of Rs. 588.

Priority Segments to Drive Future Growth

ISEC has four focused segments: PWM, loan distribution, insurance distribution, and derivative brokerage. The Asset Under Management (AUM) and revenue of the PWM increased at ~48% and 57% CAGR, respectively, from FY20 and FY23. While PWM client contribution to total clients has marginally increased from 70 bps in FY20 to 86 bps in FY23, its revenue contribution to the Company's revenue increased from 15% in FY20 to ~30% in FY23. This indicates that the company is effective in acquiring and retaining clients who continue to use multiple products over time.

Agile and Innovative in Dynamic and Competitive Industry

The Company is flexible in changing according to the evolving times and inventing and innovating products to protect from competition. ISEC has not only digitized segments that operate physically in the industry to a great extent, but it has also introduced many first-in-industry products in brokerage and financial distribution. From operating only physically to building a digital infrastructure within two months of the pandemic and establishing a massive digital content library, the Company has shown signs of quick and logical responsiveness.

A Stable Dividend Yield

Only 64 companies in the Indian stock market consistently provided a dividend yield of 2% or more each year between FY18 and FY22. In comparison, ISEC had an average dividend yield of around 4% during the same period, which has increased to about 5% in the past two years. This provides a sense of security to investors, assuring them of a 5% return on their investment annually. As a heavily cash-generating business, there is potential for the pay-out ratio to increase further. ISEC's strong fundamentals and diversified revenue stream make it an attractive investment opportunity.

View & Valuation

We anticipate the broking revenue to remain stable in FY24, while we expect strong growth of 21% in the distribution business and 23% in interest income, led by strong growth in the MTF book. Based on our estimates, the cost-to-income ratio will fall from 45% in FY23 to 40% in FY24, leading to a rise in PAT by 31% YoY in FY24. Using a 13x PE ratio, we expect the target price to be Rs. 588, indicating a potential upside of 20%.

BUY

CMP Rs. 490

TARGET Rs. 588 (+20%)

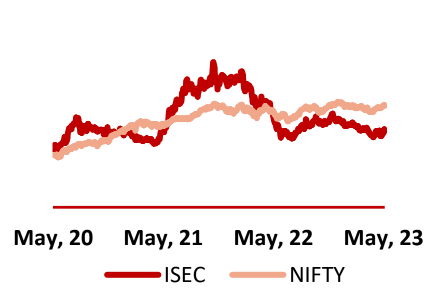
Company Data

MCAP (Rs. Mn)	1,51,673
O/S Shares (Mn)	323
52w High/Low	578/408
Face Value (in Rs.)	5
Liquidity (3M) (Rs. Mn)	98

Shareholding Pattern %

	Mar-23	Dec-22	Sep-22
Promoters	74.85	74.85	74.86
FIIs	8.75	7.77	7.43
DIIs	5.06	5.82	6.24
Non-Institutional	11.35	11.57	11.47

ISEC vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY23	FY24E	FY25E
Revenue	34	38	43
PBT	15	19	23
Net Profit	11	15	17
Total Assets	156	187	228
ROE (%)	43%	43%	42%

Source: Company, Keynote Capitals Ltd.

Chirag Maroo, *Research Analyst*
Chirag@keynotecapitals.net

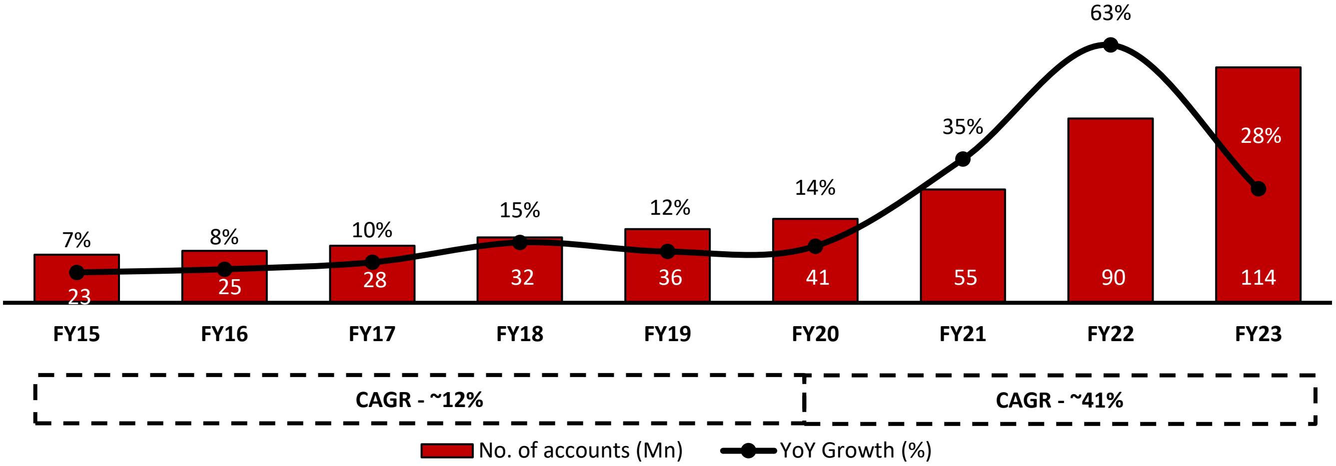
KEYNOTE

Overview of Indian Capital Markets

Broking industry

A brokerage firm acts as an intermediary between a securities exchange and an investor. The broking industry has undergone substantial transformation in the last decade, primarily driven by the disruption caused by discount brokers, resulting in a substantial increase in clients. The outbreak of COVID-19 proved to be a turning point for the broking industry, as the industry experienced significant growth due to the rapid adoption of technology and the ability to onboard clients digitally. The industry has consistently experienced growth in the number of Demat accounts, with a CAGR of 11.7% from FY15 to FY20. The trend has been further accelerated since the outbreak of COVID-19, with the number of Demat accounts growing at a notable CAGR of 41% from FY20 to FY23.

Demat accounts are growing at an accentuated pace post COVID



Source: NSDL & CDSL, Industry, Keynote Capitals Ltd.

In FY23, the mainboard IPO market witnessed a significant decline of 50% in the funds raised compared to FY22, resulting in weaker mobilization through the primary market. The amount of funds raised via 37 mainboard IPOs in FY23 was approximately Rs. 0.52 Trn, whereas Rs. 1.1 Trn was raised through 53 IPOs in FY22. However, the situation was different on the SME side, with a total of 125 SMEs conducting an IPO in FY23, raising around Rs. 22.3 Bn, which was substantially higher than the Rs. 9.7 Bn raised through 70 SME IPOs in FY22. This indicates that investor interest in SMEs was much greater in FY23 than in FY22.

Industry trends

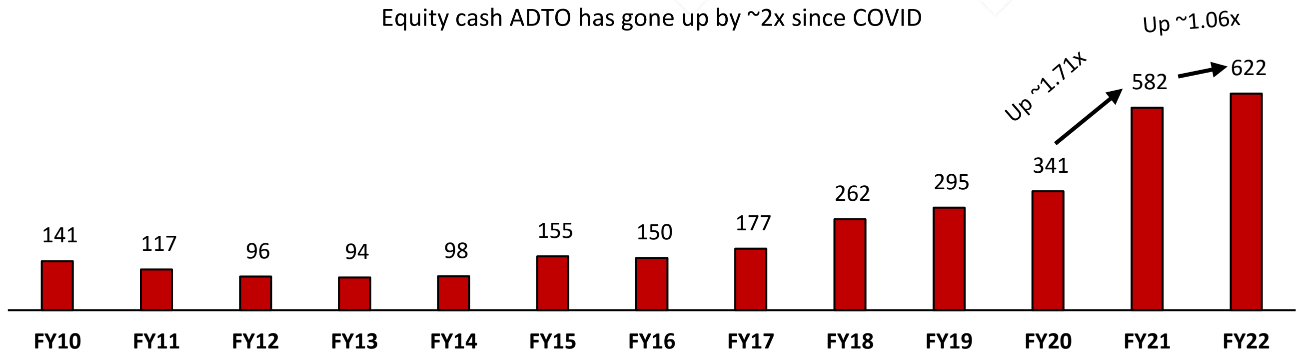
1. Digital brokers gaining at the expense of traditional brokers – The financial industry has experienced a shift in client preferences, moving away from traditional brokers, which constituted around 81% of active industry clients in FY19. This has decreased to 34% in FY23. Discount brokers, on the other hand, witnessed a remarkable growth in their market share, with around 19% of the active industry clients in FY19 increasing to approximately 65% in FY23. This transformation can be attributed to significant technological investments made by discount brokers, which gave them an edge over traditional brokers, resulting in faster growth, especially during the pandemic. In response to the loss of market share, traditional brokers have introduced hybrid plans, incorporating both discount brokerage and traditional services, in an attempt to attract clients.

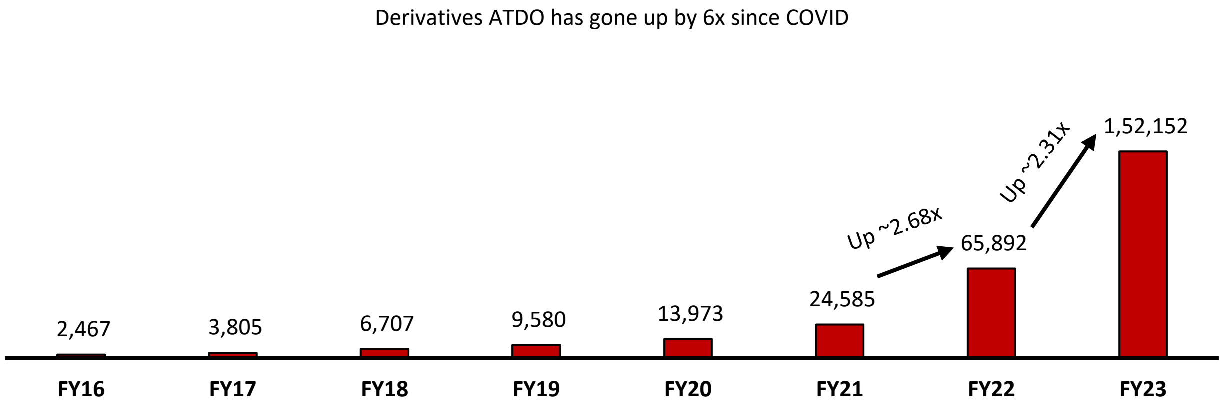
Many traditional brokers were unable to onboard clients during the pandemic, which hampered their growth.

2. Consolidation in the industry – The broking industry in India has experienced a high degree of concentration, with the top 5 players consistently increasing their market share from 38% in FY16 to approximately 67% in FY23. Furthermore, the top 10 players held around 80% of the market share in FY23, compared to 57% in FY16.

3. The surge in Average Daily Turnover (ADTO) post-COVID and derivatives market ADTO growing at the expense of equity cash after peak margin introduction

The ADTO, both in cash equity and derivatives, has grown quite strongly. Out of these two, the ADTO for the derivatives market has grown at the cost of equity cash market after the peak margin norms' introduction in December'20.





Source: NSE & BSE, Industry, Keynote Capitals Ltd.

There are indications that SEBI may intervene with regulatory measures if the current trend continues, according to their study of F&O traders in India. The study found some concerning results,

a. **Rise in Unique Traders –** The total number of unique individual traders in the equity F&O segment rose at an 85% CAGR from FY19 to FY22. Of these traders, 88% were active. The number of traders increased from 0.7 Mn in FY19 to 4.5 Mn in FY22.

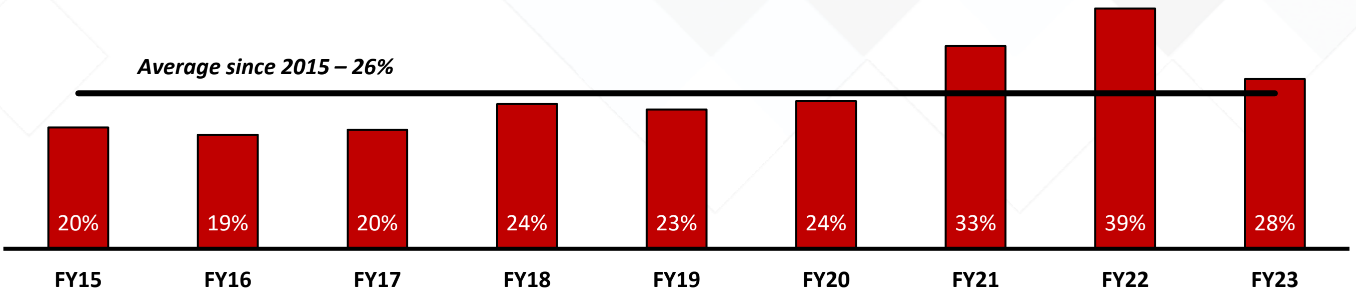
b. **Rise in Young Traders –** Participation of young traders (Age - 20-30) went up from 11% in FY19 to 36% in FY22. Individuals less than 40 years contribute 75% to the overall trading.

c. **90% Traders Make Losses –** The total loss in the equity F&O segment in FY22 amounted to Rs. 442 Bn. with an average loss per trader of Rs. 0.11 Mn.

d. **Concentration of Profits** – The top 1% of active traders account for 51% of the total net profit of the segment. The same number for the top 5% of active traders is 75%.

4. NSE activation rates which spiked post-COVID, are now normalizing

Normalization in NSE activation rates (%)



Note: Activation rate represents clients acquired in the quarter that started trading in the same quarter

Source: NSE, Industry, Keynote Capitals Ltd.

The average activation rate in the industry since FY15 stands at 26%. This rate increased to 33% and 39% in FY21 and FY22, respectively, on account of increased equity participation. Given the market's lacklustre performance in FY23, the activation rates are now returning to normalcy. Continued normalization can negatively impact the industry in the short run.

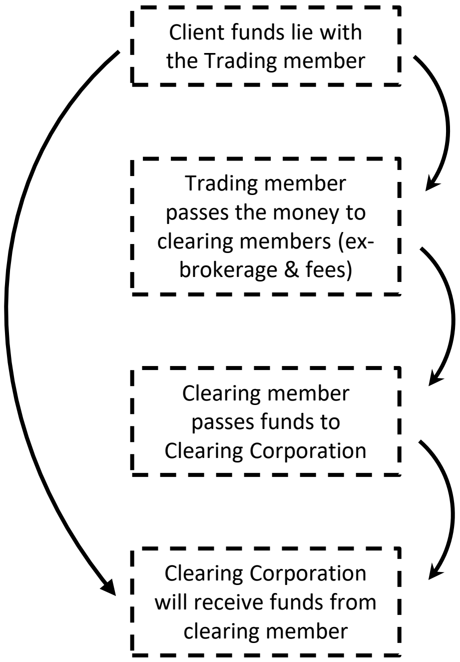
5. Brokers will now be unable to enjoy float income, unlike before

As per SEBI norms, brokers will now have to upstream unused clients' funds to the Clearing Corporation.

NOW

Brokers and clearing members now must compulsorily upstream all investor funds to the clearing corporation daily which will be parked in highly liquid and low-risk overnight money market instruments.

This move by SEBI is to prevent the misuse of investors' money by a broker.



THEN

Before this regulation by the SEBI, the broker could use unused client funds to create an FD and put the same as collateral with banks to avail Bank Guarantees which were utilized to meet the working capital needs of the broker.

Also, the broker used to earn interest on FDs which was not passed on to the client.

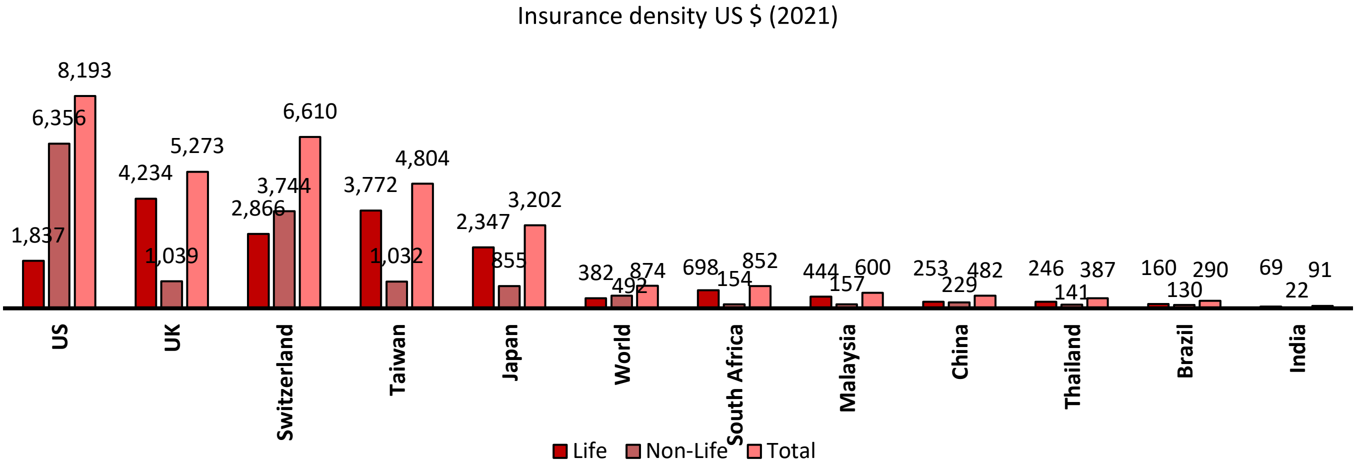
Distribution Industry

The financial services industry heavily relies on distribution to provide customers with access to financial products and services. An effective distribution system can significantly contribute to the success of these products and services, as well as support the growth and stability of the industry.

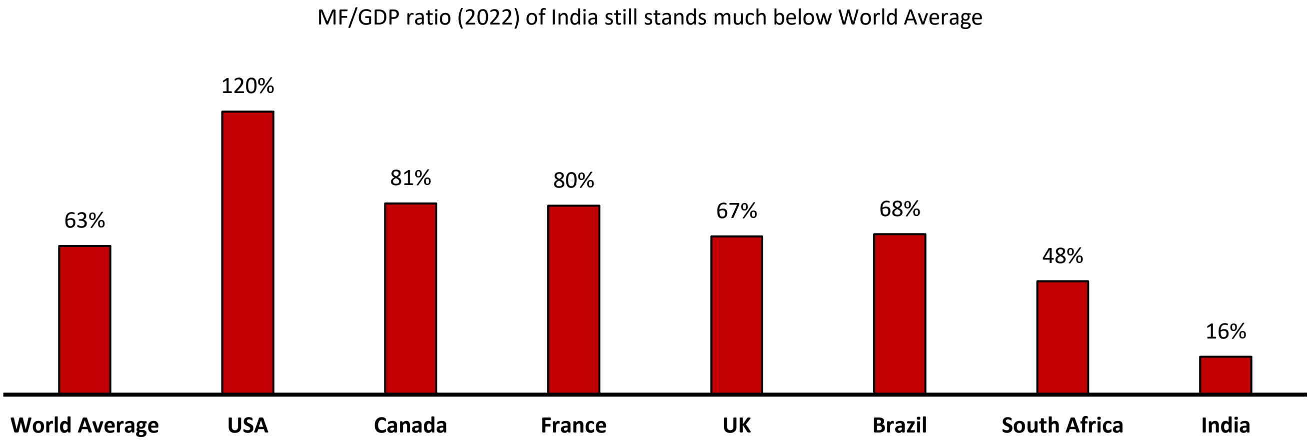
Investor participation through distributors has been a driving force in the industry's expansion, and the distribution segment is expected to continue growing due to factors such as increasing wealth, financial literacy, government initiatives, and technological advancements.

While mutual funds are the most widely distributed product, other financial products such as insurance, fixed deposits, PMS, AIFs, and bonds are also experiencing growth due to strong distribution strategies.

Potential for Insurance & Mutual Funds in India



Source: IRDAI, Industry, Keynote Capitals Ltd.



Source: AMFI, MOSPI, Industry, Keynote Capitals Ltd.

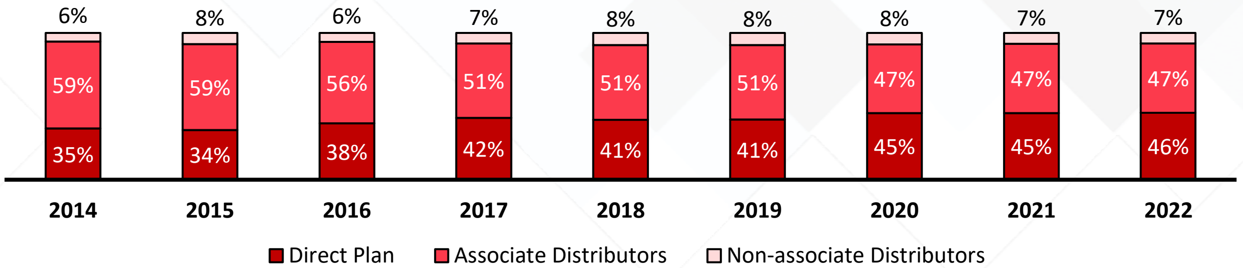
India's potential in the insurance and mutual fund industries remains largely unexplored in comparison to global standards. The country's insurance density, calculated as premium underwritten per total population, is a mere $91, while the global average is $874, revealing a significant 10-fold gap.

Additionally, the mutual fund AUM/GDP ratio in India is only 16%, despite a notable increase in mutual fund usage following COVID-19, while the world average stands at 63%. These statistics highlight the enormous opportunity that India offers in these sectors.

The Distributors' Interest

Despite the direct channel gaining traction, both these industries still heavily rely on distribution for business.

Mutual Fund Distribution Mix (%)

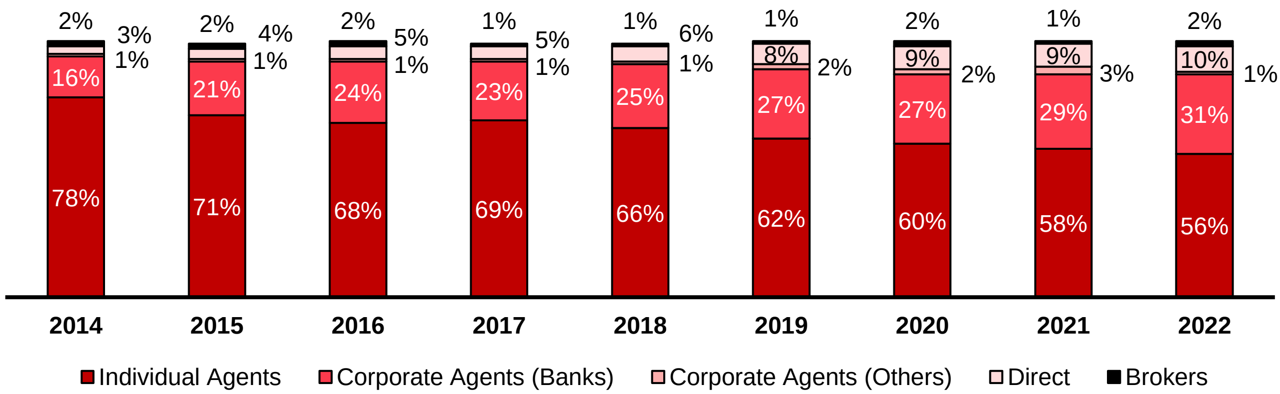


Source: AMFI, MOSPI, Industry, Keynote Capitals Ltd.

Reliance on distribution channel to bring business in high-commission equity mutual funds is even higher

Distributors account for more than 75% of the AUM garnered by equity mutual funds in 2022

Life Insurance Distribution Mix (By Premium) (%)



Source: IRDAI, Industry, Keynote Capitals Ltd.

The increasing share of the direct channel will continue to challenge distributors. Share of the direct channel is expected to grow with the rise in investor awareness.

Other financial products like PMS, AIFs, FDs, Bonds, and Structured Products also rely significantly on distributors (especially large ones) because of the following reasons.

1. Well-established Pan-India branch infrastructure or sub-distribution chain
2. Distributors possess a team of well-trained, qualified, and experienced wealth managers
3. Focused only on distribution

Industry growth to continue in double digits

Segment	CAGR 2017-22	CAGR 2022-27E	2022 AUM (Tn)	2027E AUM (Tn)
MF	16%	19%	36.5	87
Alternative Investment Fund (AIF)	50%	32%	6.4	26
PMS	19%	18%	4.4	10
Life Insurance	13%	14%	52.5	102

Source: CRISIL report, Keynote Capitals Ltd.

Regulation will only be more stringent, which will be another challenge that distributors will continue to face.

The implementation of various regulations, such as the reduction of expense ratios for mutual fund schemes by the Securities and Exchange Board of India (SEBI), the option provided by the government to forgo tax benefits under the new tax regime that reduces the attractiveness of Equity-Linked Saving Schemes (ELSS) and high-ticket insurance, have contributed to a more stringent financial landscape.

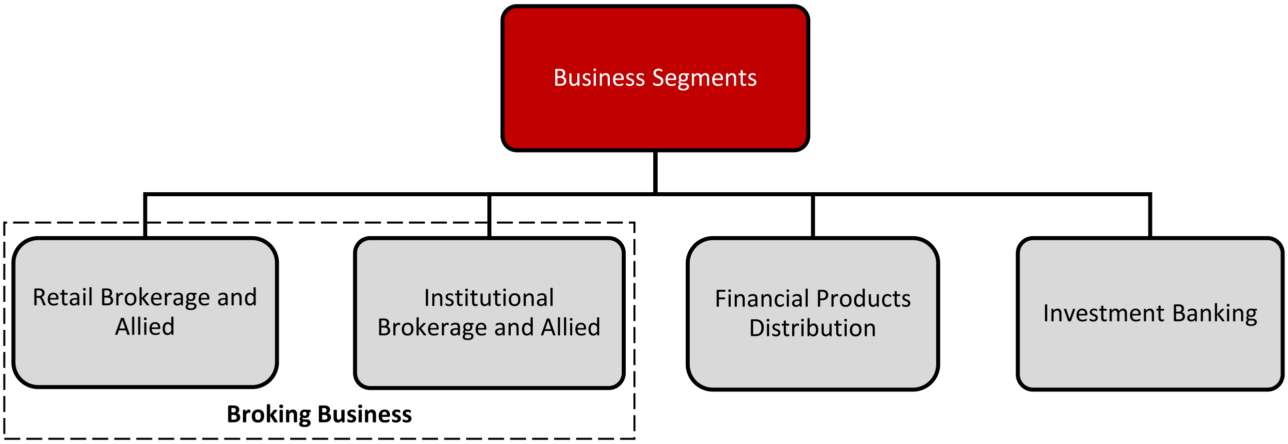
Moreover, SEBI has imposed more rigorous standards, including the elimination of upfront commissions and the introduction of direct plans on high-commission products such as Alternative Investment Funds (AIFs). These changes present a significant challenge for distributors who will have to continue navigating the increasingly complex regulatory environment.

About Company

ICICI Securities Limited (ISEC), a subsidiary of ICICI Bank Ltd, has been in operation since May 1995, initially focusing on corporate finance and institutional broking. Over the past twenty years, ISEC has diversified into four businesses, including broking, wealth management, distribution of financial products, and investment banking. These four areas address clients' needs for investment, protection, and borrowing, serving a wide range of customers such as retail and institutional investors, corporates, high net-worth individuals, and government entities. ISEC has built a strong presence throughout the customer lifecycle, with a client base of 9 million people, over 140 branches, and more than 33,000 business partners as of FY23.

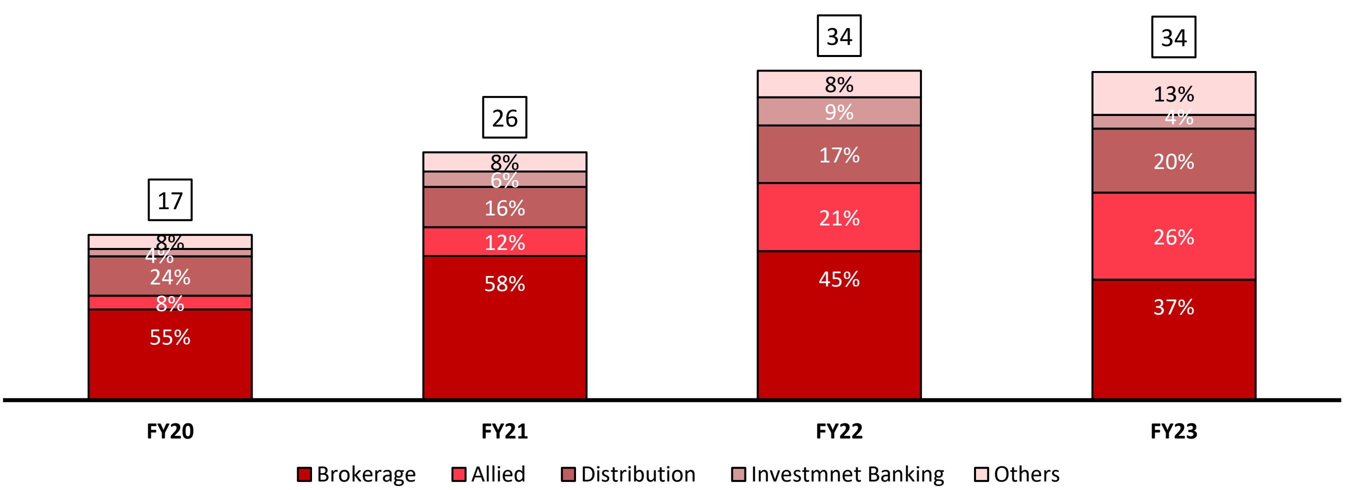
With the adaptive and innovative attributes of the ICICI franchise, ISEC has transformed from a product-focused approach to a customer-centric 360-degree approach, reducing its reliance on retail and institutional equity, increasing its product offerings, and reducing the impact of market cycles. The Company has adopted technology, analytics, digital acquisitions, and online processes. It has diversified its customer sourcing and optimized its physical process and onboarding experience. Their hyper-personalization approach ensures that customers receive excellent experiences. ISEC has achieved improved cost efficiencies, reducing their cost-to-income ratio from ~53% in FY20 to 45% in FY23.

Hyper-personalization refers to tailoring unique experiences for customers by utilizing advanced analytics, artificial intelligence, and machine learning to analyze their transaction history, investment preferences, and risk profile.



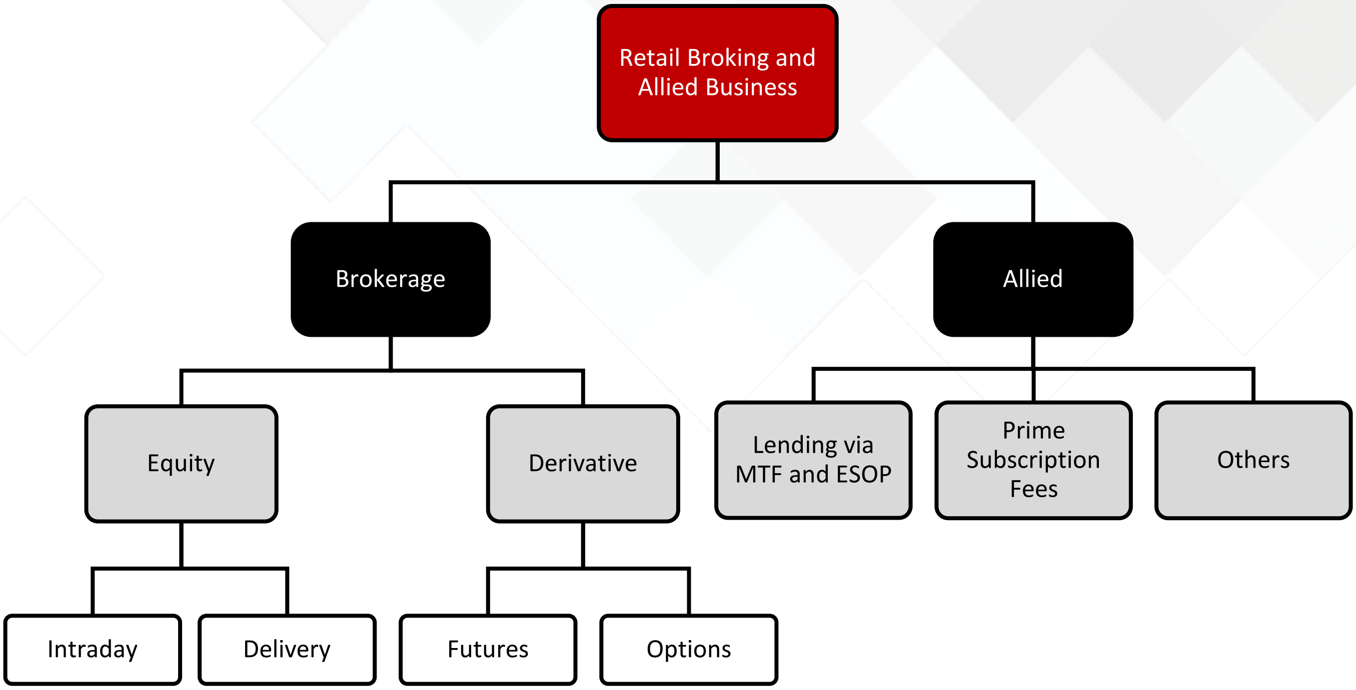
Source: Company, Keynote Capitals Ltd.

Revenue Mix (%)



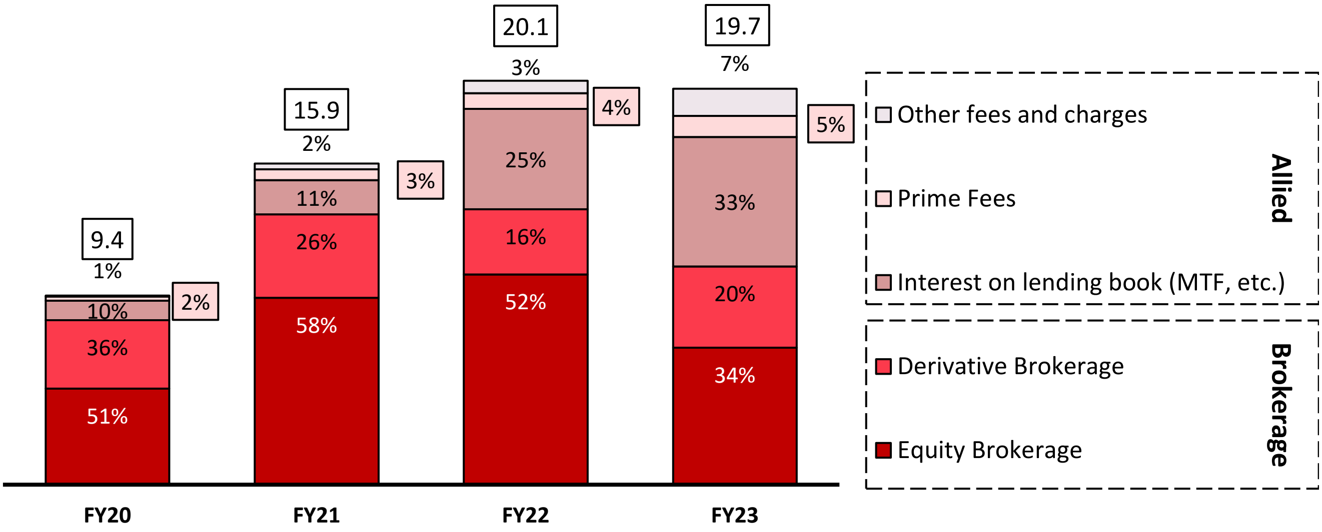
Source: Company, Keynote Capitals Ltd.

Retail Broking and Allied Services



Source: Company, Keynote Capitals Ltd.

Retail Brokerage and Allied Revenue (Rs. Bn)



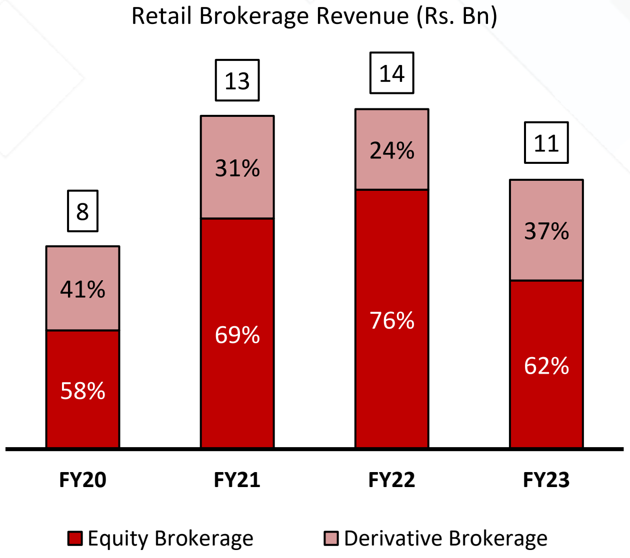
Source: Company, Keynote Capitals Ltd.

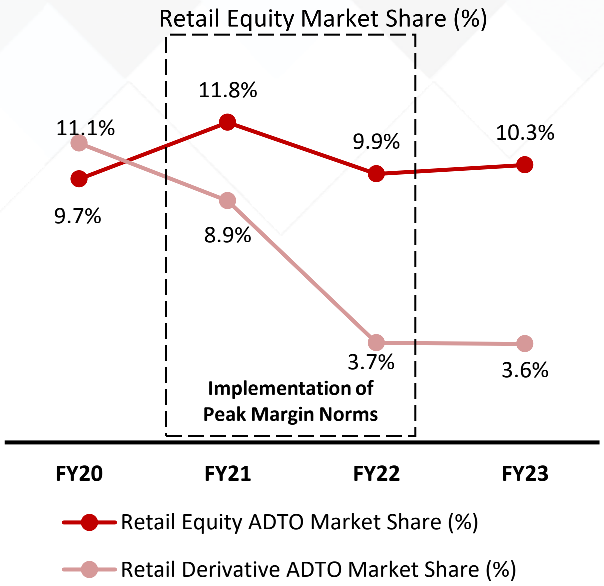
Retail Brokerage

Despite achieving a CAGR of 10% in revenue from retail brokerage between FY20-23, the Company experienced a 20% decline in brokerage revenue in FY23 compared to FY22. This was due to regulatory changes in the upfront margin, leading to reduced delivery volume and a decline in yields, mainly caused by the emergence of discount brokers. Moving forward, the Company will focus on the F&O segment to expand its market share and ADTO growth.

The contribution of the allied revenue segment has significantly risen from 7% in FY20 to 26% in FY23, with a remarkable CAGR of 93% over FY20-23. The Company has been consistently increasing its market share in the MTF book within the allied segment, which has now reached 22.6% in FY23, up from 8.4% in FY20.

Understanding Brokerage Segments





Source: Company, Keynote Capitals Ltd.

Because ISEC provided relatively more leverage on derivative products compared to the equity segment, its derivative ADTO was affected more severely. However, due to providing less leverage for the equity segment and increasing support of products like MTF, it held the market share.

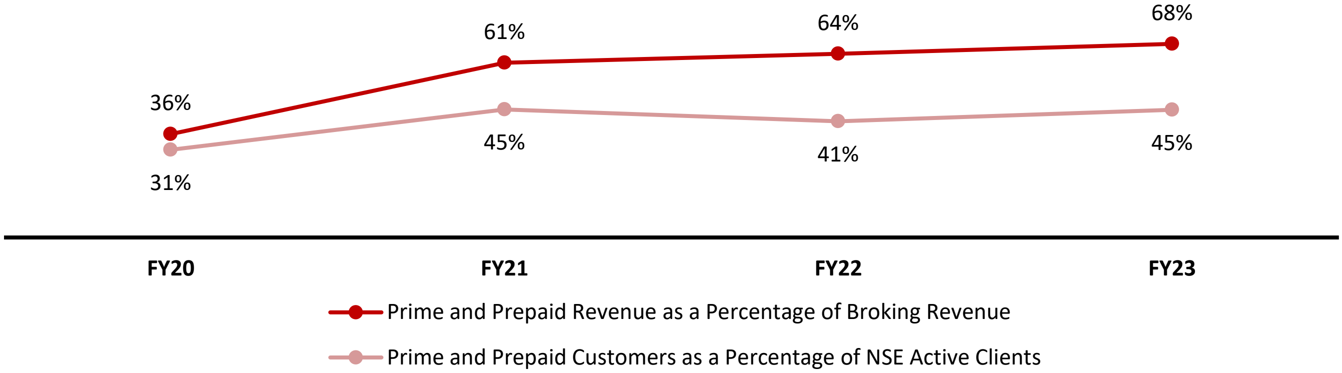
Understanding Brokerage Plans and their Customers

The Company offers brokerage services under 4 plans for Indians: Prime, Prepaid, Neo, and I-Secure. Keeping in view the different needs and concerns of traders and investors, the Company designed these plans at competitive prices. While the subscription or upfront fees are accounted in allied revenue, the brokerage earned under all the plans is reported under the brokerage tab.

Plan	Target	Type	Price (Rs.)	Cash Brokerage (%)	Futures Brokerage (%)	Options Brokerage Per Lot (Rs.)	e-ATM (Rs. Mn)	MTF Interest Rates (% per annum)
Prime	Equity Investors	S/U	299-4,999	0.1-0.27	0.01-0.027	10-40	0.2-100	9.25-18
Prepaid	Equity Investors	U	2,500-1,00,000	0.07-0.25	0.007-0.025	7-35	1-100	9.25-18
Neo	Intraday and F&O Traders	U	300	20 *(intraday, Rs./order)*	0	20 *(Rs./order)*	-	-
I-Secure	P	P	-	0.23-0.55	0.05	Rs. 95/lot	-	-

S- Subscription, U- Upfront one-time payment, P-Pay Per Use. The shaded cells represent the targeted value proposition in the respective plan
Source: Company, Keynote Capitals Ltd.

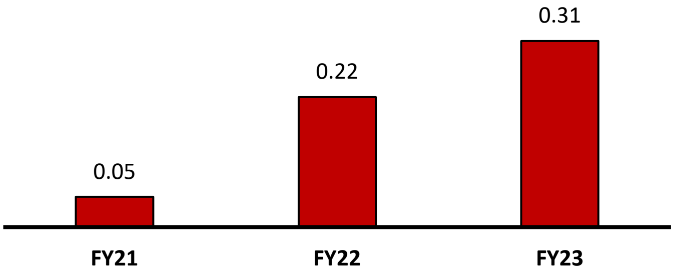
The Company's **Prime and Prepaid Plans** are the most popular options, responsible for 68% of broking revenue and constituting 45% of the Company's NSE active clients. The Prime plan was introduced in FY20 as a subscription service with the aim of providing liquidity, research, and competitive brokerage. However, by the end of FY22, the Company decided to keep one subscription variant at a low cost of Rs. 299 annually, with all other variants requiring a lifetime fee and upfront payment at higher costs (Rs. 999- 4,999). In Q1 FY23, around 90% of subscribers opted for the lower variant, but this figure reduced to around 70% in Q3 FY23, indicating a rapid movement towards higher value variants with higher ticket sizes. These high-variant adopters contribute to around 75-80% of the Prime Plan revenue, as the nature of the high-variant requires a one-time fee, implying that new customers are high-ticket clients.



Source: Company, Keynote Capitals Ltd.

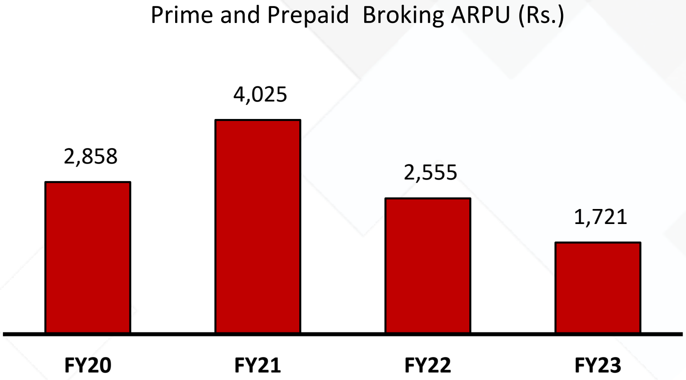
Going forward, the Company plans to maintain a similar product mix by expanding its customer base for higher-value variants while retaining subscribers for lower-variant products, which have an impressive renewal rate of over 85%. The Prime Fees constitute only a small portion of the overall ARPU that the company receives from Prime customers, with gradual wallet share growth achieved through cross-selling. The majority of revenue generated by this plan comes from equity, with only a minor percentage from derivative brokerage.

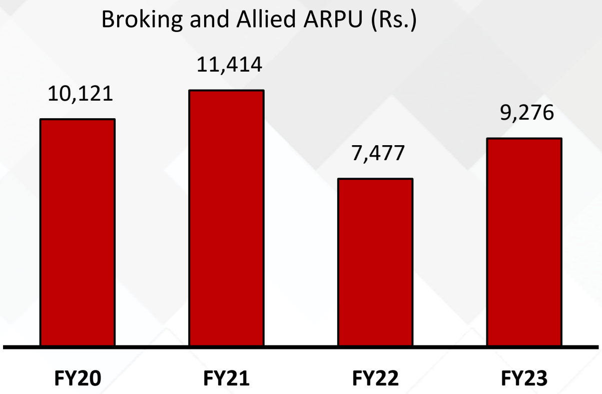
In FY21, the Company launched **Neo,** a specialized service for traders of intraday, futures, and options. Approximately 25-30% of the clients overlap between Prime and Neo, while Neo's trading ADTO share constitutes 65-70% of the company's overall share. In just two years, the Neo client base has grown six-fold.



Source: Company, Keynote Capitals Ltd.

The company has announced its plans to launch a new plan in CY23, with a stronger focused on catering to the needs of the youth in the country.





Source: Company, Keynote Capitals Ltd.

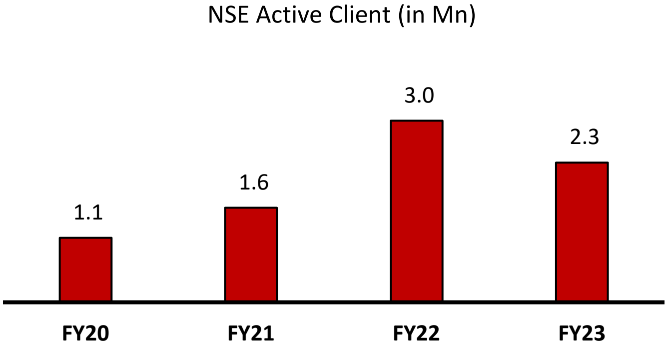
Understanding Brokerage Channels for Customer Acquisition

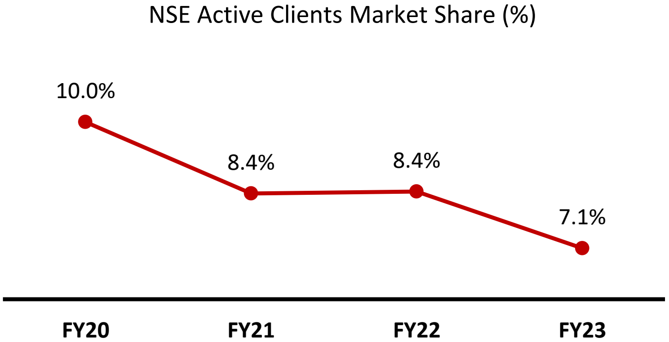
In a span of 3-4 years, the Company has witnessed a significant change in its channel mix. Previously, the Company relied heavily on physical mediums and partnerships with ICICI Bank and other business partners for customer acquisition. However, partnering with ICICI Bank proved to be highly advantageous as it not only became the Company's primary source of customer acquisition but also resulted in a notable improvement in the quality and level of revenue accretion from customers.

When the pandemic hit in March’20, the Company was paralyzed in acquiring any customers, as it had no digital infrastructure for opening an account. By FY21, the Company was fully able to source its customer digitally. However, the Company lagged behind the digitally-advanced fintech and discount brokers. The Company endeavored to increase its data online on different platforms, which would help the Company create organic traffic for its portal.

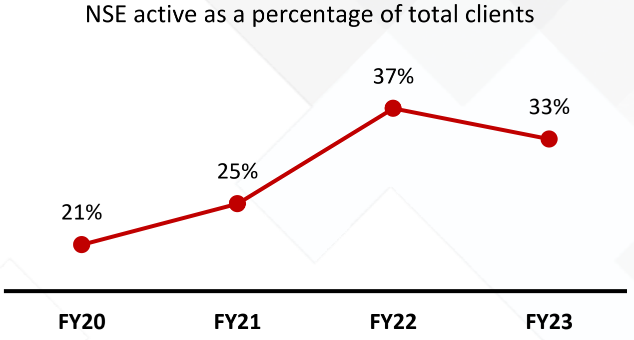
The Company has been stringent with its partners and alliances for the quality and level of customers that it provides. At the beginning of the digital phase, the Company had around 7-8 microchannels, which fell to 4-5 by FY23. The Company believes in acquiring customers with a high propensity to spend for its products over a lifetime.

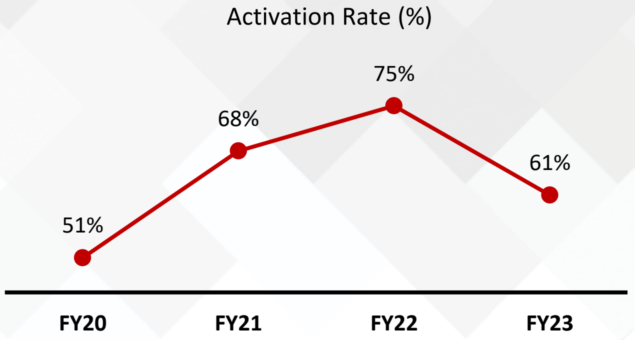
Besides ICICI Bank, the Company has partnered with HSBC, IDFC First, and Federal Bank. The Company is embedded digitally on its platforms so as to take leverage of its traffic.





Source: Company, Keynote Capitals Ltd.



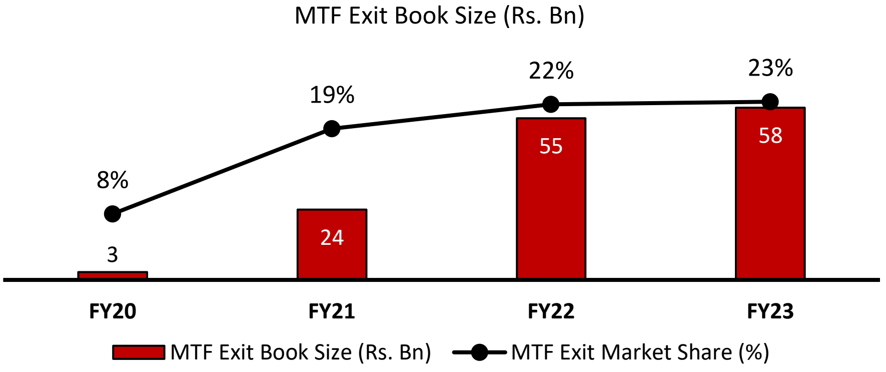


Source: Company, Keynote Capitals Ltd.

Retail Allied Services

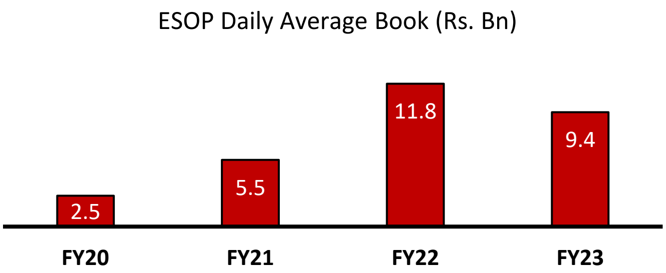
MTF and ESOP funding are two supplementary products to the brokerage business. While MTF is equally cyclical as a brokerage business, ESOP is only a little influenced by the markets. The two sources' revenue (interest income) has expanded at ~88% CAGR from ~ Rs. 1 Bn in FY20 to ~Rs. 6 Bn in FY23.

The MTF business is run to support the equity brokerage business. Presently, the book stands at ~ Rs. 58 Bn with a further approved limit of Rs. 150 Bn. During the year ending FY23, the number of customers for the business was ~ 90,000. These customers have shown a high propensity to purchase multiple products from the company.



Source: Company, Keynote Capitals Ltd.

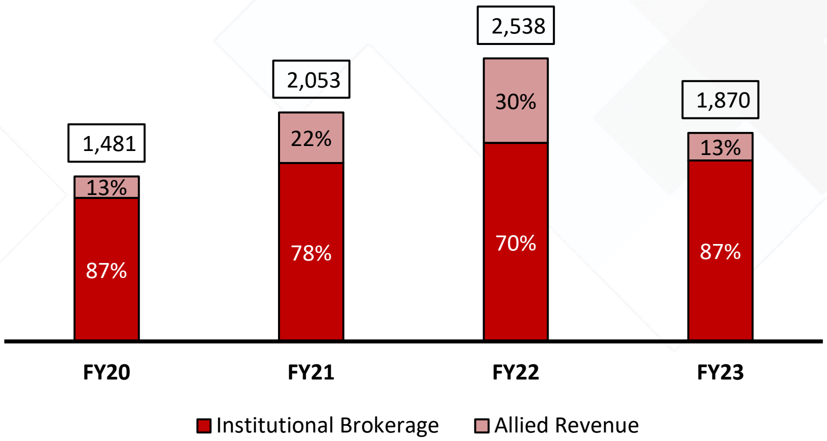
In FY23, the Company entered into a partnership with Cholamandalam Investment and Finance Company Ltd. (CIFCL) to source customers for ESOP funding exceeding Rs. 2 Mn. This agreement helps ISEC retain its customers by transferring them to CIFCL while earning revenue for managing and sourcing these customers. Within just six months of entering into the arrangement, the ESOP book funded by CIFCL has already exceeded Rs. 1 Bn.



Source: Company, Keynote Capitals Ltd.

Institutional Broking

Institutional Broking and Allied Revenue (Rs. Mn)

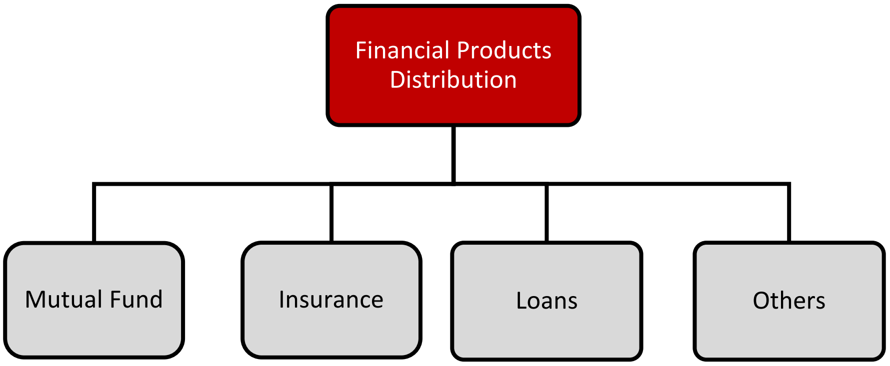


The four- year average contribution of the segment to total revenue is ~7%.

Source: Company, Keynote Capitals Ltd.

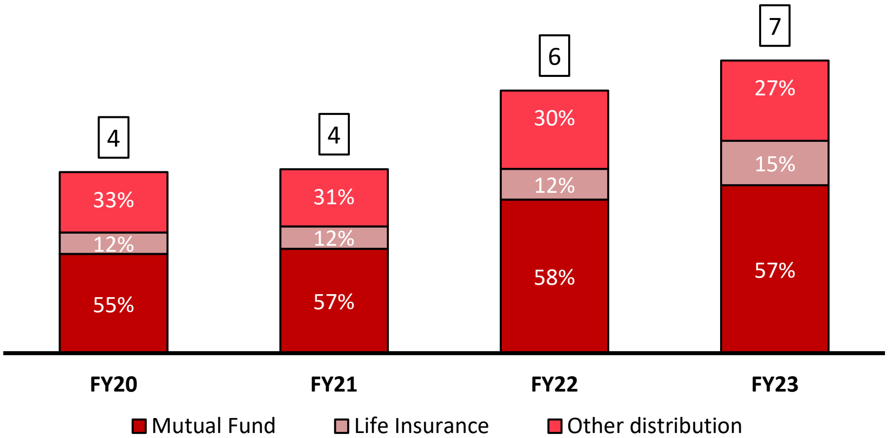
Financial Products Distribution

ISEC is a financial distributor of categories like mutual funds, insurance (life, general, health), loans, and other asset classes like fixed income, PMS, and NPS. The Company distributes these products to existing clients and new acquired from various channels.



Source: Company, Keynote Capitals Ltd.

Financial Product Distribution Revenue (Rs. Bn)



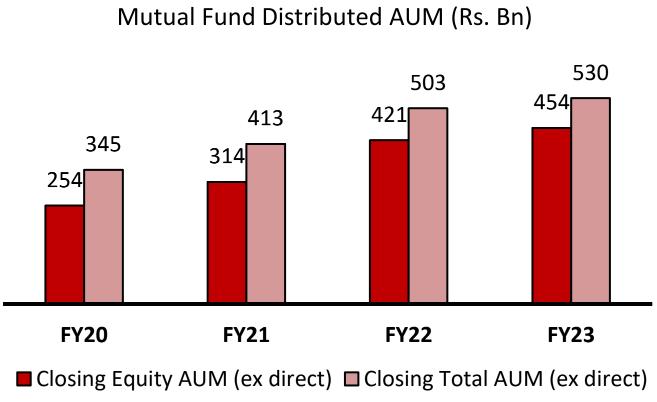
Source: Company, Keynote Capitals Ltd.

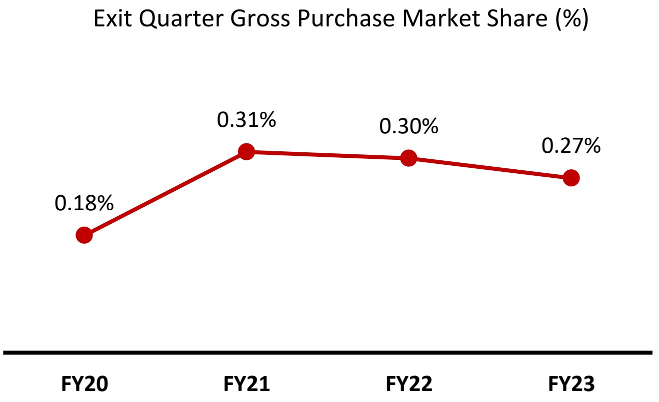
Mutual Fund Distribution

ISEC's total mutual fund AUM has grown at ~11% CAGR in the past 4 years, whereas its equity mutual funds AUM has expanded at ~16%. As a result, the share of equity mutual fund AUM increased from ~74% in FY20 to 85% in FY23. However, the market share of distributed gross inflow and distributed AUM is maintained at ~13% and ~16%, respectively, between FY19-FY22. This shows the competition intensity of the industry, which had ~1,500 mutual fund distributors in FY22. The Company's gross commission market share has been stable at ~4% between FY18 to FY22.

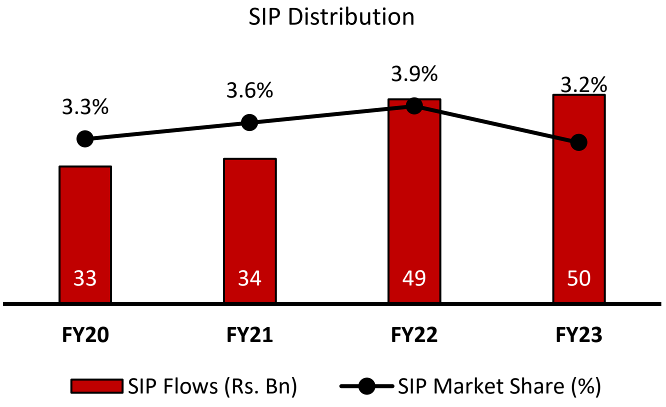
The Company grew the number of live SIPs from ~0.7 Bn (FY20) to ~1 Bn (FY23) at a CAGR of 11%.

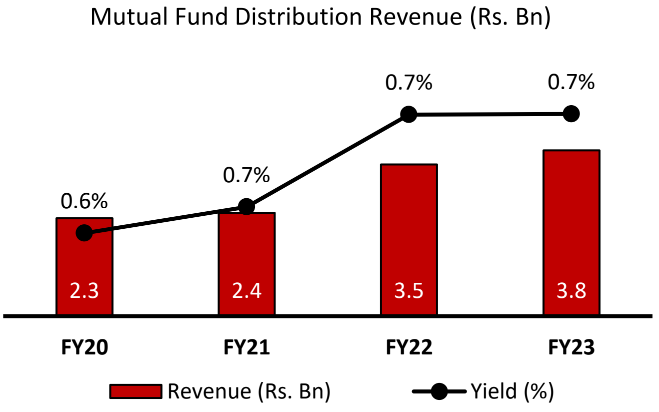
A trend that started in the industry in the past few years is the adoption of mutual fund schemes via direct plans. The fintech players in the industry have accelerated the trend with lower ticket size plans, consequently increasing the volume of such folios. To combat the ramification, ISEC innovated the value proposition of direct mutual funds. It added a service of e-ATM that provided instant liquidity to investors at a pay-when-use model. Secondly, it equipped direct plans with research. Thirdly, it enabled instant loan approvals against mutual funds from its partnered banks. Lastly, it embarked to promote passive funds, which are cheaper than direct funds, in combination with active funds, making a unique offering.





Source: Company, Keynote Capitals Ltd.





Source: Company, Keynote Capitals Ltd.

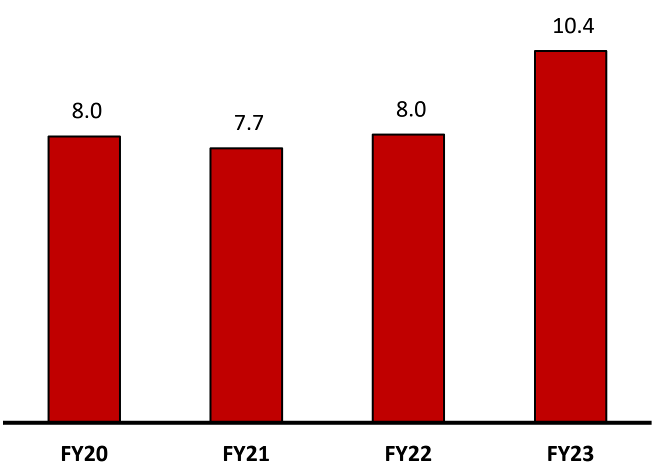
Insurance Distribution

Under the insurance umbrella, the Company distributes life, health, and general insurance. Between life and general insurance, the number of policies is sold equally, whereas life insurance takes a prominent portion of the premiums as it is a longstanding business for the Company.

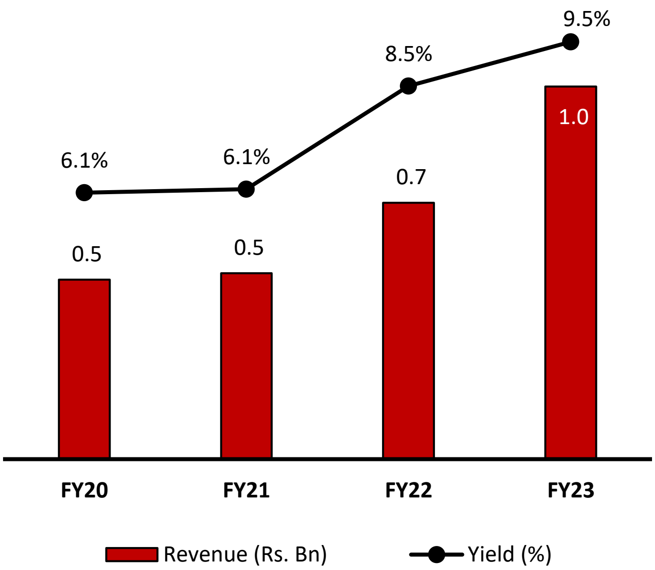
In terms of revenue, the Company earns ~20% yield on new business, whereas it earns relatively lower in renewals. Within the new business, ~60-70% of the products are unit-linked insurance plans (ULIP), whereas ~30% are non-ULIP. In FY23, the revenue for the segment surpassed Rs. 1 Bn for the first time with a ~45% YoY growth rate.

Depending on the nature of the business and the varied suitability of potential customers, the Company sources insurance policies via three methods. One is relationship managers that are on-ground and count to ~1,300 members. The advantage of having them on the sales side is that they have deep engagement with customers, and insurance is a fundamental part of their portfolio offering. The second is for general and health insurance, where the Company operates fully digitally with the help of a tech partner. In FY23, the Company partnered with Cover Stack for the same purpose. The third is the low-touch model, where the Company analytically filters potential customers that have a high propensity of buying the insurance products and channelizes them to low-touch relationship managers over call, which further converts them into a digital purchase. The Company has a base of ~8 Mn such potential customers who have been sourced via the low-touch model.

Life Insurance Premium (Rs. Bn)



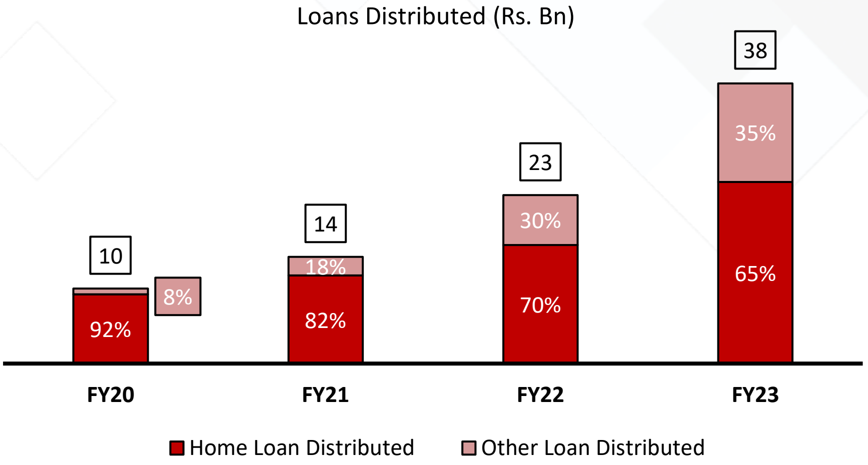
Life Insurance Distribution Revenue (Rs. Bn)



Source: Company, Keynote Capitals Ltd.

Loans Distribution

With an intention to delink the company's revenues from equity market cycles, ISEC ventured into loan distribution with broadly three stacks of loans – mortgage, business, and newly introduced personal loans. With a strategic mix of these loans, the Company has expanded the distributed book at ~40% CAGR.



Source: Company, Keynote Capitals Ltd.

Mortgage loans are home loans and loans against property because they are safer and account for ~65% of the Company's distributed loan book, the blended yield comes out to be ~0.65%. However, depending on the type of loan, the yield falls between 0.75% to 1.5%.

Business loans and loans against securities and mutual funds are also in the Company's product portfolio of loans. This group of loans accounts for 35% of the total loans. The Company has recently ventured into personal loans, on which it is expecting to earn higher commissions and thereby improve blended yield. In FY23, the Company went live with Tata Capital to sell its personal loans and Bajaj Finance to sell its loan against securities products The Company aspires to maintain a market share of ~10% in loan distribution.

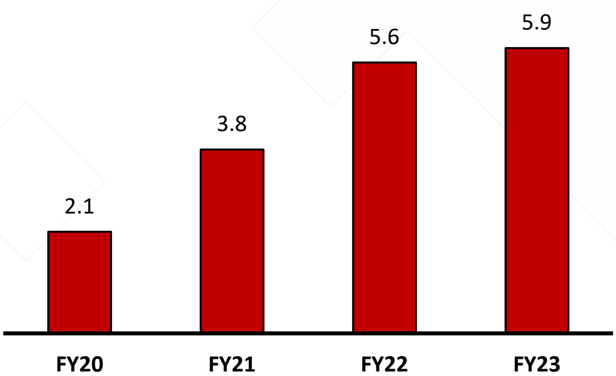
Other Product Distribution

Among several other products distributed by ISEC, there are Alternative Investment Funds (Category II and III), PMS (third party and own), Fixed Income products, ETFs, Sovereign Gold Bonds, NPS, etc.

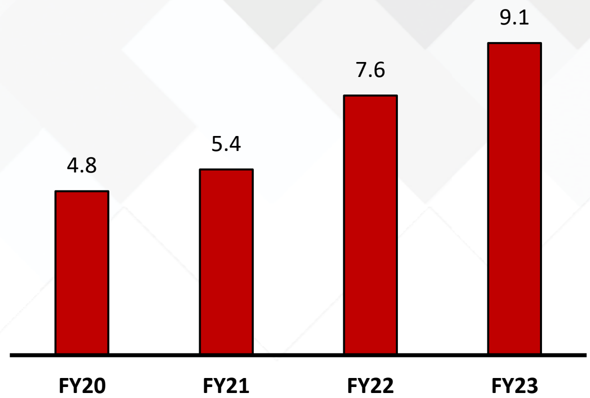
The Company's own PMS has grown at a stupendous 88% CAGR in the past four years to reach Rs. 14 Bn in FY23.

Wholistic Overview

Total Client Assets (Rs. Tn)

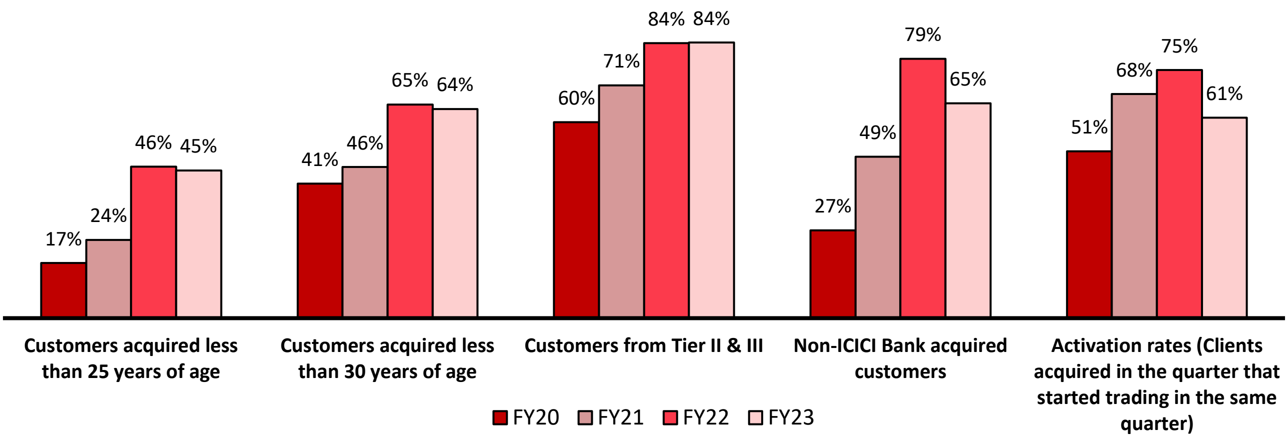


ISEC Client Base (in Mn)



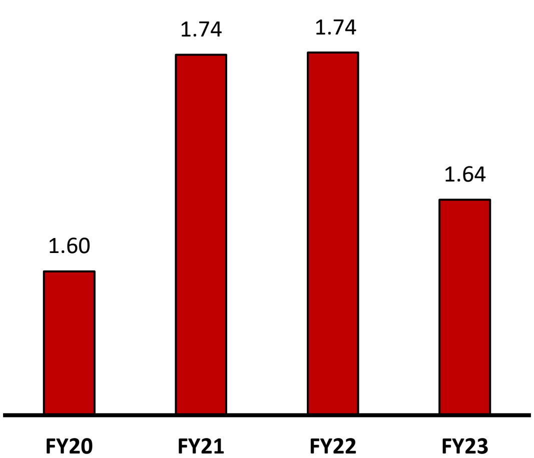
Source: Company, Keynote Capitals Ltd.

Features of New Customers Acquired

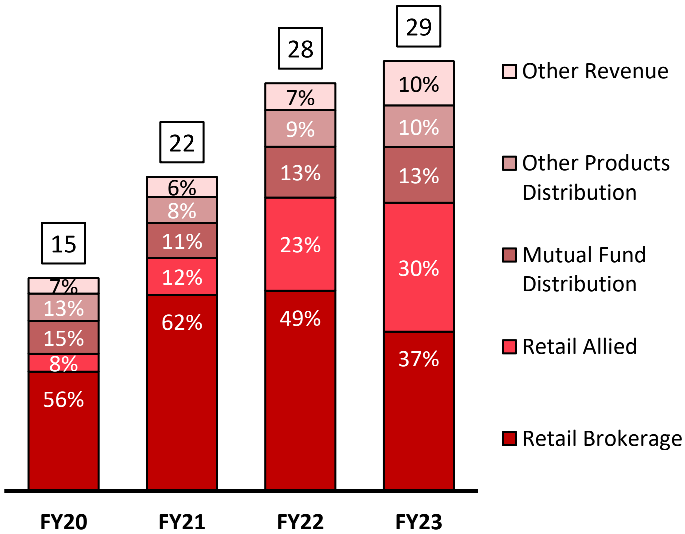


Source: Company, Keynote Capitals Ltd.

Cross Sell Ratio*



Retail Revenue (Rs. Bn)



* *Average* number of product(s) per active client
Source: Company, Keynote Capitals Ltd.

Private Wealth Management

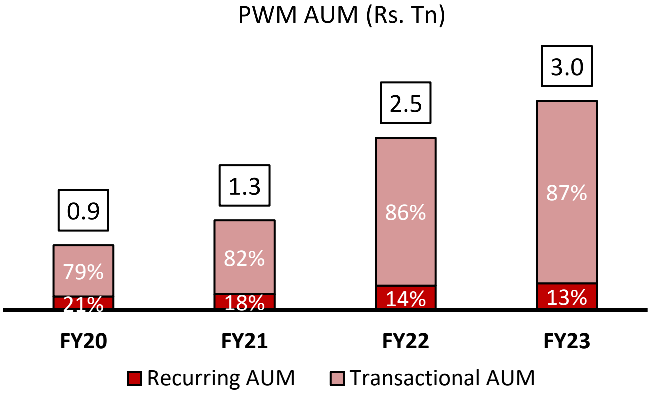
While PWM is not a different business segment, it offers the same services, like brokerage, MTF, ESOP financing, mutual funds, fixed income, PMS, AIF, loans, etc., specifically to high-net-worth individuals (HNI) who have assets of more than Rs. 10 Mn, usually between Rs. 50 Mn to Rs. 250 Mn.

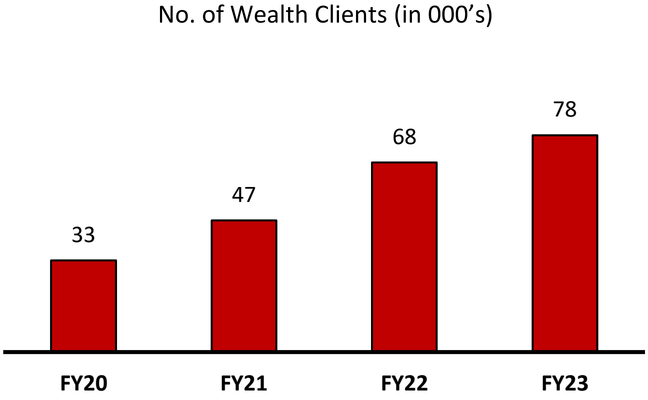
These clients become revenue/AUM/ARPU accretive as they mature. Additionally, the cross-selling ratio increases for them. The following is the outcome of data that was analyzed for the period from 2015 to 2022:

- The average retention rate at the end of the year is 98%.
- The average AUM persistency is 120%.
- The average revenue persistence is 111%.

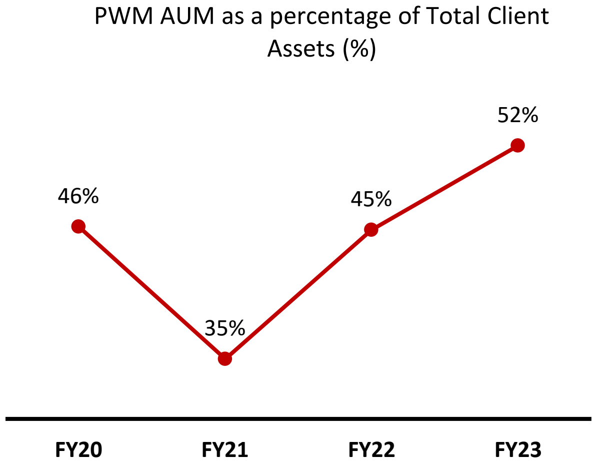
The Company focuses on High Net Worth Individuals (HNIs) in India who exhibit a strong likelihood of becoming Private Wealth Management (PWM) clients. Currently, there are 800,000 individuals in India with a net worth exceeding $1 Mn.

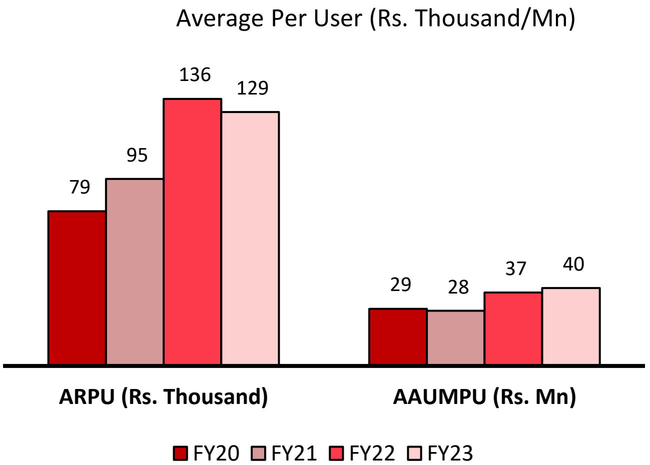
The Company is able to acquire 1,100-1,500 new customers for the wealth segment in a year and upgrade around 10,000 to 11,000 customers from the existing pool of customers who earlier have assets less than Rs. 10 Mn.





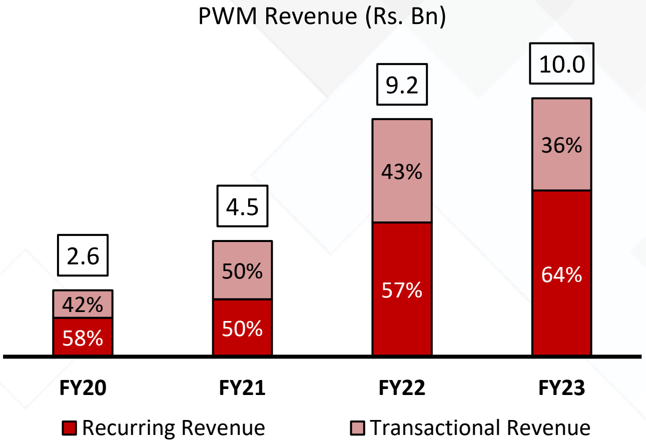
Source: Company, Keynote Capitals Ltd.

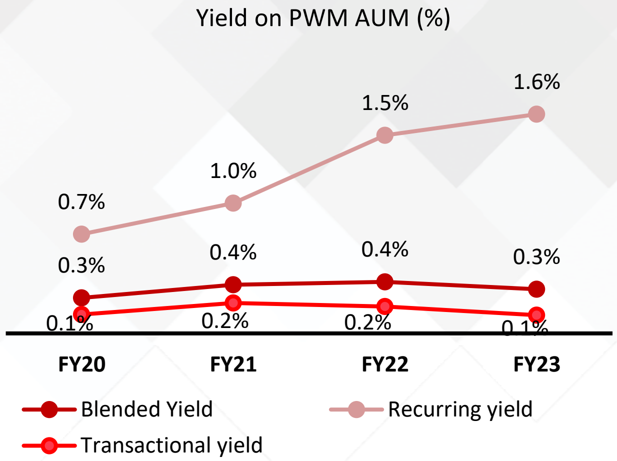




Source: Company, Keynote Capitals Ltd.

ARPU is Average Revenue Per User, AAUMPU is Average Assets Under Management Per User





Source: Company, Keynote Capitals Ltd.

The segment's revenue is classified into recurring and transactional streams. Recurring revenue includes products with trail commissions like mutual funds, AIF, PMS, etc., whereas transactional revenue includes income from equity broking, which forms a large part of transactional AUM.

Issuer Services and Advisory

This is an investment banking arm of the Company that provides Equity Capital Market (ECM) and financial advisory services to its clients. This segment accounts for ~6% of the Company's revenue. There are broadly two divisions of the segment – one is institutional flow (40%), which is granular, regular, and repeatable, and the second is IPO-like activities (60%), which are irregular in nature and not necessarily cyclical.

The Company has developed two strategies to bring more predictability and regularity to the segment's revenue.

One is on the issuer services side. The Company has planned to increase the predictable component of the irregular part of the business, which is QIPs. The Company found a sweet spot in the BFSI sector, where the companies raise capital at least once in three years. The Company has planned to increase its presence there, thereby inducing sustainability in the segmental revenue.

The second is on the advisory side, where the Company plans to grow its franchise. The Company sees a growing opportunity there and has increased and augmented people with relevant technological skills.

Between FY21 and FY23, the Company underwent the following transactions:

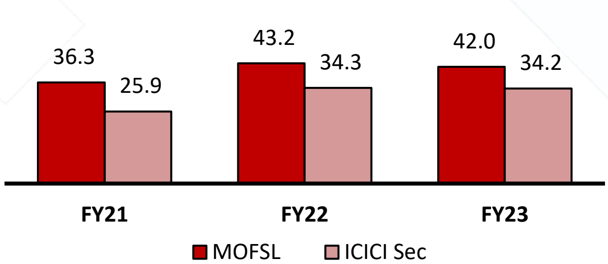
Transaction	Total Number	Deal Size (Rs. Bn)	Average Deal Size Per Transaction (Rs. Bn)
IPO/FPO/REIT/InVIT	54	1,817	34
M&A Private Equity	10	307	31
Rights Issue and Structured Finance	15	840	56
QIPs/OFS/Pref.	34	993	29
Open Offer/ Buyback/ Delisting	13	387	30
Block Transactions	7	87	12

Source: Company, Keynote Capitals Ltd.

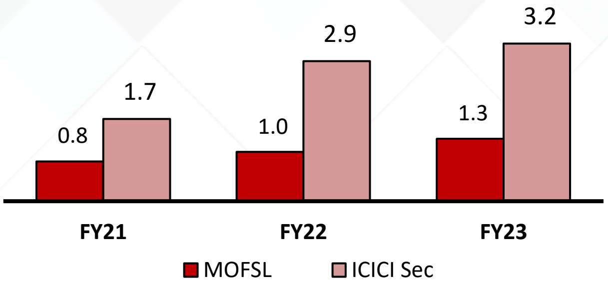
Peer Analysis

ICICI Securities can be compared to Motilal Oswal Financial Services Limited (MOFSL), as the business operations are similar. MOFSL is engaged in broking (institutional and retail), distribution, merchant banking, private equity, and investment banking services.

Revenue (Rs. Bn)
5Yr CAGR - MOFSL 9%, ISEC 13%

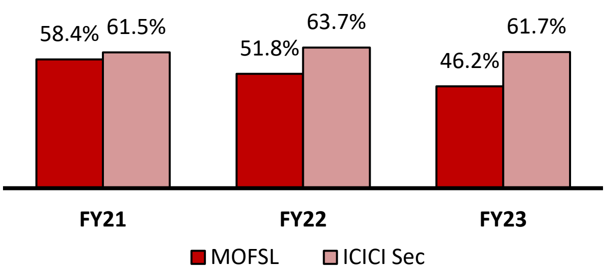


AUM (Rs. Tn)
YoY Growth - MOFSL 27%, ISEC 13%

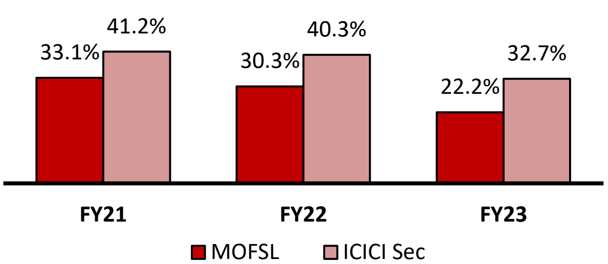


Note: MOFSL AUM constitutes AUM of Asset and Wealth Management and Distribution Assets

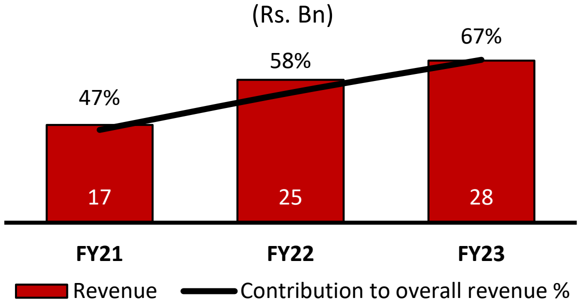
EBITDA Margin (%)



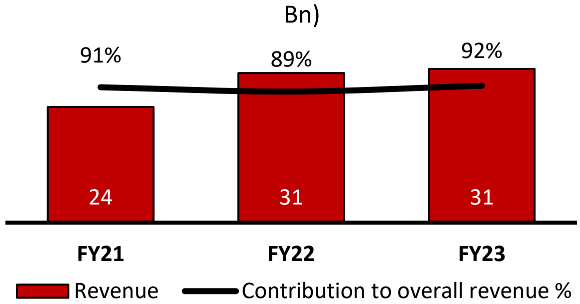
PAT Margin (%)



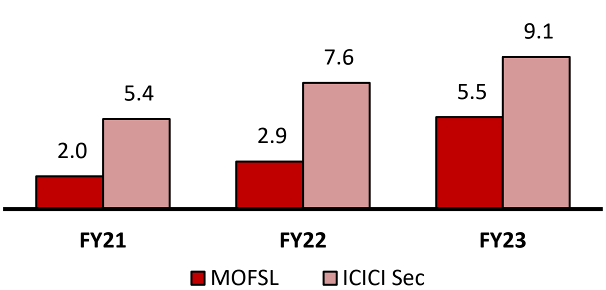
MOFSL Broking and Distribution Revenue (Rs. Bn)



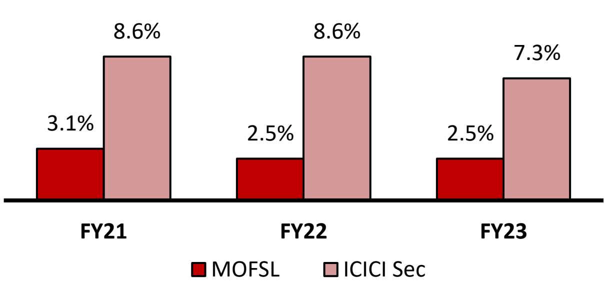
ISEC Broking and Distribution Revenue (Rs. Bn)



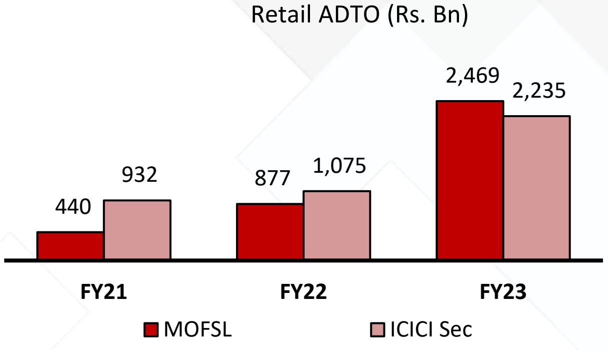
Overall Client Base (Mn)

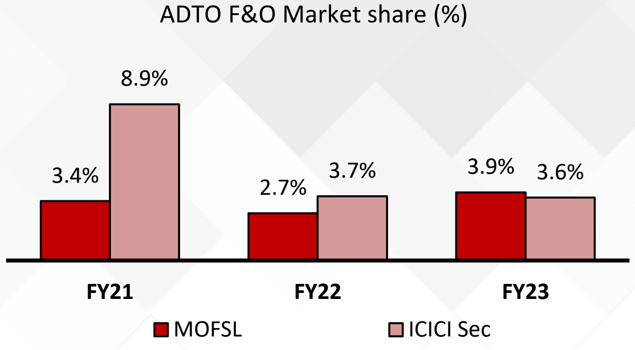


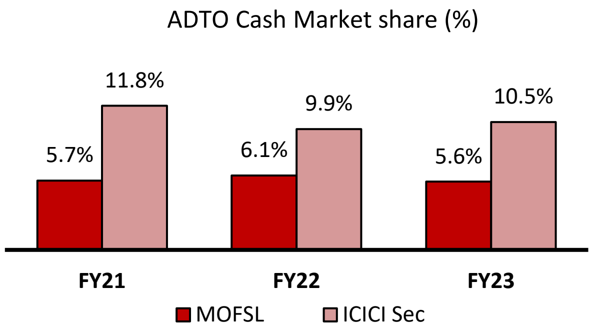
NSE Active Clients Market Share (%)

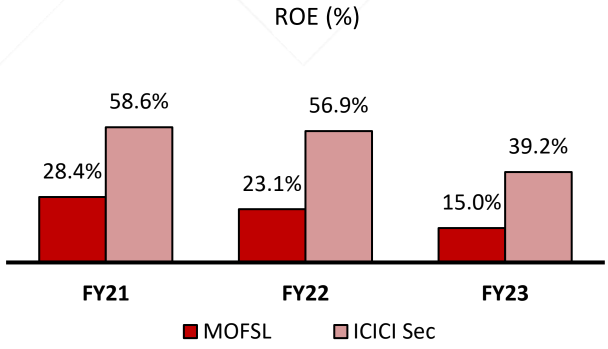


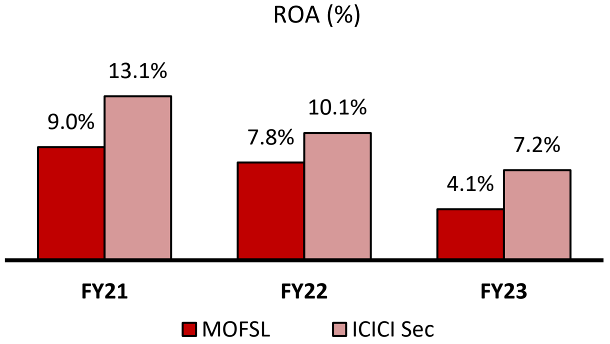
Source: Company, Keynote Capitals Ltd.

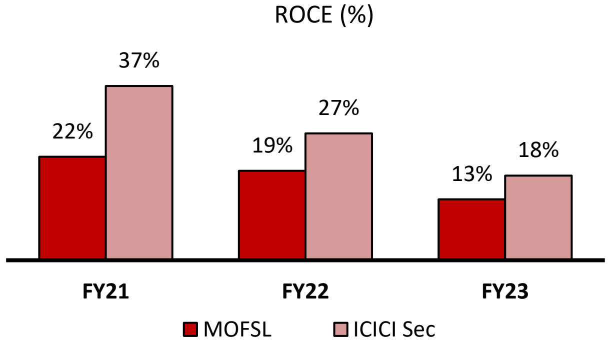


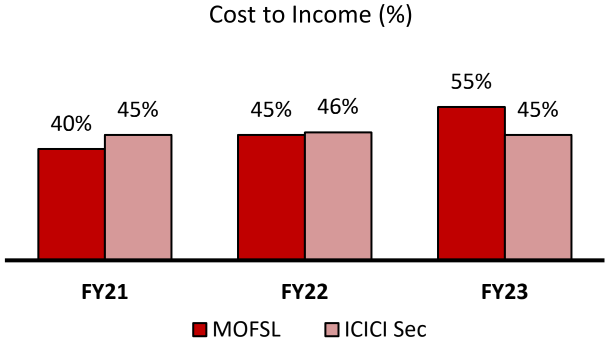












Source: Company, Keynote Capitals Ltd.

Management Analysis

The Management team of ISEC consists of industry veterans who bring immense expertise and relevant experience of working with large entities.

Name	Designation	Previous Associations	Experience with ISEC (Yrs.)
Vijay Chandok	MD, CEO	Executive Director at ICICI Bank	4 years
Harvinder Jaspal	CFO	Top management at ICICI Prudential Life Insurance Company Ltd., and Manager at Unilever	6 years
Ajay Saraf	Head investment Banking and Institutional Equities	Senior General Manger, ICICI Bank Director at American Express	12 years
Anupam Guha	Head, Private Wealth Management	Manager at ICICI Bank and ICICI Capital Services Market Ltd.	17 years

Source: Company, Keynote Capitals Ltd.

Shareholder and Composition

Particulars	FY20	FY21	FY22	Q3 FY23
% Promoter Holding		75%	74.89%	74.85%
MD's salary (Rs Mn)	49	68	59	-
As a % of PAT	0.9%	0.6%	0.4%	-

Source: Company, Keynote Capitals Ltd.

Shareholders holding > 1% combined are currently holding ~1% of ISEC

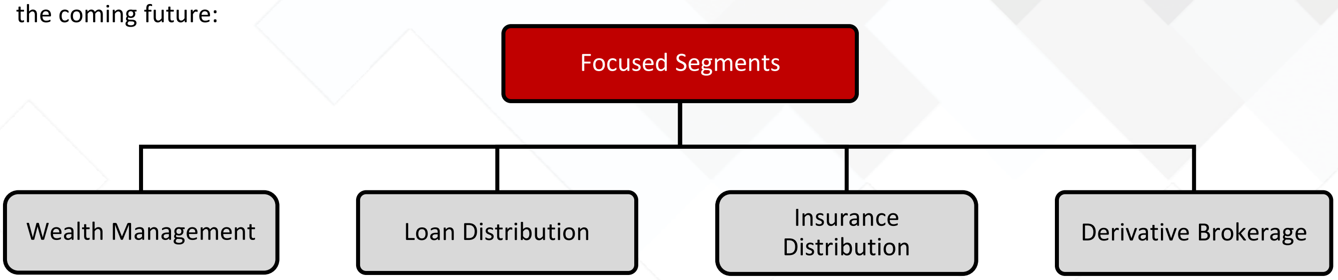
Stakeholders	FY20	FY21	FY22	FY23
Government Pension Fund Global	-	-	1.05%	3.12%
Life Insurance Corporation of India	-	-	2.32%	2.58%
HDFC Life Insurance Company Ltd.	-	1.01%	-	-
I CICI Prudential Mutual Fund	2.93%	2.03%	-	-
IDFC Mutual Fund	2.32%	1.24%	-	-
L&T Mutual Fund	2.13%	-	-	-
Smallcap World Fund Inc.	-	-	1.02%	-
Total 1% and above holding	**7.38%**	**4.28%**	**4.39%**	**5.70%**

Source: Company, Keynote Capitals Ltd.

Opportunities

Priority Segments to Drive Future Growth

The Company has defined the following segments that will remain in focus for the coming future:



Source: Company, Keynote Capitals Ltd.

Wealth Management: The Company has transformed from an e-broker to a wealth-tech platform. In India, two different customer segments are evolving with different characteristics. One is Young Indians, and the other is the Wealth and Affluent class of the population. Catering to both segments, ISEC has emerged as the largest independent wealth manager in the country.

While 90% of the wealth clients are the ones that have upgraded from the existing client base, the Company is extensively refining its client acquisition strategy. During the initial period of digital transformation of FY20, the Company had ~7-8 digital microchannels. By FY23, only a few digital microchannels (4-5) were partnering with the company for customer acquisition. The Company decided to terminate these partnerships because the acquired customers did not meet the Company's desired criteria. The Company's target customers have a longer conversion time, are more loyal, and have higher spending potential. Therefore, the Company is open to acquiring customers at a relatively higher cost as their lifetime value would exceed the acquisition cost. PWM assets have increasingly accounted for a significant portion of total client assets. In FY23, the figure increased to ~52% from 46% in FY20. While PWM client contribution to total clients has risen marginally from 70 bps (Q4 FY20) to 86 bps (Q4 FY23), its revenue contribution to the Company's revenue increased from 15% in FY20 to ~30% in FY23. This depicts Company's control and stringency in acquiring clients, contributing to multiple products over time.

Loans distribution has increased at ~40% CAGR for the past 3 years ending FY23. The Company has increased its bouquet of loan offerings from just home loans in FY20 to other loans like loan against securities/property, business loans, etc.

In FY23, the Company went live with Tata Capital to sell its personal loans and Bajaj Finance to sell its loan against securities products. During the year, the Company also commenced credit card distribution. During FY23, the Company distributed an all-time high amount worth Rs. 38 Bn. With personal loans becoming part of the bouquet, the Company's average yield is expected to increase from the current 65 bps. The Company estimates immense opportunity in this business as a single large private bank pays out around Rs. 10 Bn to its distributors in a year.

Insurance distribution is another growth leg chosen by the Company. Within insurance, life insurance revenue has grown at ~20% CAGR between FY20-23. Additionally, the Company is expanding general and health insurance. The Company has digitized these products, which are still operated physically in the industry to a great extent. With the advent of analytics, the Company has a huge base of ~8 Mn potential customers that they aim to convert.

Despite a decline in blended market share (retail and institutional) from approximately 8% in FY20 to around 3% in FY23 due to changes in new margin norms, the company is focusing on derivative brokerage as a growth driver. ISEC launched new products like Algos, APIs, OptionPlus, Flash Trade, etc to attract traction.

Agile and Innovative in Dynamic and Competitive Industry

The Company is prompt and adaptive to changes and evolving needs of the time to sustain itself as a prominent player in the industry. Over the past few years, the Company has shown such qualities on several occasions.

Before COVID-19 hit India, the Company was fully reliant on the physical form of customer acquisition. The occurrence of the pandemic slashed the Company down with no customer acquisition for the beginning of Q1 FY21. The Company designed, built, got regulatory approvals, tested, and launched a digital infrastructure for the same within 2-2.5 months. By the end of 9M FY21, the Company was opening 80% accounts digitally. During this time, the Company was 3-4 years behind the new-age brokers and had to accelerate its learning curve, for which it launched relevant plans and introduced changes at a remarkable pace. For example, for a certain change or a plan, they would run a campaign during market hours, post which they iterated accordingly and launched the revised version the next day.

To increase organic traffic to its portal, the Company aimed to increase digital properties and content. The Company broadcasted markets news during the market hours on its website. It added educational content to increase traction. The management took these actions with a motive to reduce the cost of acquisition with an aim to increase organic traffic.

The Company has been vigilant about all its products. In the mutual fund distribution business, when the Company felt an increase in competition intensity from direct mutual funds, the Company decided to add value propositions around the same direct mutual fund and build a source of revenue from it. They introduced unique propositions like providing research and instant liquidity (e-ATM service).

There are several other events which were a show of ability and logical responsiveness of ISEC in different products.

Apart from being agile, the Company is an innovator and inventor of products and tools in its industry. The following table enlists the launches made by the Company from FY20-23.

Sr. No.	Brokerage	Financial Products Distribution
FY20		
1	Prime Plan	Loan Distribution
2	Online Account Opening	One-Click Investment
3	API Architecture	Digital Insurance (integrated with multiple players)
4	Option 20	Proprietary PMS
FY21		
5	Insta iDirect Accounts	Money App
6	Global Investment Platform with Interactive Brokers Inc. USA	Loan Against Mutual Fund
7	Neo Plan	Direct2U Subscription Plan
FY22		
8	Masters of the Street	Multi-Asset PMS
9	Markets App	
10	One-Click Derivative Platform	
11	Breeze API	
12	Pay Later	
FY23		
13	Commodity Trading	Credit Card Distribution
14	Flash Trade	Personal Loan Distribution
15	OptionPlus	LIFEY
16	Super App	iLearn

Source: Company, Keynote Capitals Ltd.

The Company is spending massively on technology for cloud migration, new digital properties, and additional layers of digital infrastructure. The net block of intangible assets has increased at ~34% CAGR from Rs. 150 Mn in FY20 to Rs. 370 Mn in FY23.

A Stable Dividend Yield

The Indian national stock markets have only 64 companies that have consistently given a dividend yield of at least 2% every year between FY18 and FY22. In comparison, ISEC has had an average dividend yield of ~4% during the same period. In the past two years, FY22 and FY23, the Company's dividend yield has increased to around 5%, which provides a sense of security to investors as it assures them of a 5% return on their investment annually. The Company has a six-year (FY18-23) average dividend pay-out ratio of ~58%. The Company has expanded its shareholder equity at an impressive CAGR of ~27% during this period. Furthermore, given that the business is heavily cash-generating, there is potential for the pay-out ratio to increase even further in the long run. Presently, the Company’s dividend distribution policy implies to pay-out of at least 50% of the standalone profit every year. ISEC's strong fundamentals and diversified revenue stream underpin the aforementioned rationales, making it an attractive investment opportunity.

Challenges

Highly Competitive Market

One of the main challenges faced by the Company is fierce competition in all the business segments it operates in. With over 1,200 (Mar '23) equity and derivative brokers, 1,500 (Mar '22) mutual fund distributors, 570 (Aug '22) corporate insurance agents, and 839 (Jan '23) investment banks in India, the market is highly competitive. Despite the Company's advantage of its franchise and brand, it must continue to innovate and resist the competition. The industry demands constant evolution, and the Company must keep up to survive.

Highly Regulated Industry

Another challenge is the highly regulated nature of the industry. Regulatory bodies like SEBI and IRDAI intervene to protect customers' interests, leading to setbacks for intermediaries such as brokers and distributors. For instance, SEBI's implementation of peak margin norms in 2020 restricted the margin amount that brokers could extend to their clients, resulting in a noticeable reduction in trading volumes and leverage for traders. The Company saw a decline in equity and derivatives trading volumes as a result. Similarly, the recent regulation that brokers must transfer unused client funds to the Clearing Corporation has impacted brokers' income derived from client float.

Dependence on the Cycles of the Market

The Company's broking segment accounts for approximately 37% of the total revenue as of FY23, a decrease from 55% in FY20. This revenue is directly linked to the stock market's cycles, making it dependent on market fluctuations. Despite the challenges, the Company must continue to adapt and innovate to stay competitive in the market.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Revenue from Operations	34,350	34,157	37,586	42,765	48,545
Other income	35	97	105	110	120
Total income	**34,385**	**34,255**	**37,691**	**42,875**	**48,665**
Growth %		0%	10%	14%	14%
Finance Cost	2,737	5,358	3,468	3,945	4,866
Fees and commission expense	1,666	1,750	1,960	2,272	2,628
Impairment on financial instruments	-69	33	38	43	49
Employee benefits expense	6,644	6,864	7,161	7,718	7,786
Depreciation and amortization expense	625	751	829	986	1,168
Other expenses	4,255	4,514	4,749	5,359	5,937
Total expenses	15,857	19,270	18,205	20,323	22,434
PBT	**18,528**	**14,985**	**19,486**	**22,552**	**26,230**
Tax	4,702	3,837	4,872	5,638	6,558
PAT	**13,826**	**11,148**	**14,615**	**16,914**	**19,673**
Shares (Mn)	323	323	323	323	323
EPS	42.8	34.5	45.3	52.4	60.9

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	56,166	67,908	64,487	67,923	71,385
Securities for trade	2,430	9,163	10,806	12,708	14,920
Investments	107	77	101	119	139
Debtors	3,848	7,734	9,121	10,727	12,593
Loans	68,567	64,199	94,192	1,26,593	1,62,560
Other financial assets	1,137	1,197	1,682	1,978	2,322
Property, plant and equipment	627	1,238	1,460	1,717	2,016
Current tax assets (net)	1,247	1,365	1,610	1,893	2,223
Deferred tax assets (net)	424	374	440	518	608
Other Intangible assets	342	486	574	674	792
Other non-financial assets	1,567	1,947	2,296	2,700	3,170
Total Assets	**1,36,462**	**1,55,688**	**1,86,770**	**2,27,550**	**2,72,729**
Creditors	10,776	9,148	10,092	11,077	12,076
Debt Securities	77,392	87,887	1,07,648	1,34,505	1,62,560
Borrowings	-	5,039	5,046	5,934	6,967
Deposits	44	74	67	79	93
Lease liabilities	1,019	1,083	1,346	1,582	1,858
Other financial liabilities	16,522	18,240	22,875	28,483	36,228
Provisions	151	177	336	396	464
Other non-financial liablities	6,253	5,515	5,719	5,934	6,038
Share Capital	1,613	1,614	1,614	1,614	1,614
Other Equity	22,692	26,911	32,026	37,946	44,832
Total Equity & Liabilities	**1,36,462**	**1,55,688**	**1,86,770**	**2,27,550**	**2,72,729**

Segmental Data

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Brokerage Revenue					
NSE active client market share (%)	8.6%	7.3%	7.0%	6.8%	6.8%
NSE active client (Mn)	3.0	2.3	2.6	2.8	3.1
Retail Equity and Institutional brokerage revenue (Rs. Mn)	16,284	12,810	12,854	13,896	15,389
MTF & ESOP Revenue					
MTF & ESOP book (Rs. Mn)	56,532	69,690	88,230	1,08,299	1,28,393
Revenue (Mn)	4,980	6,436	7,941	9,747	11,555
Yield %	8.8%	9.2%	9.0%	9.0%	9.0%
Distribution Revenue					
MF AUM (Bn)	482	520	598	688	791
Revenue (Mn)	3,505	3,832	4,485	5,157	5,931
Yield %	0.73%	0.74%	0.75%	0.75%	0.75%
Life insurance AUM (Mn)	2,008	2,589	2,900	3,248	3,638
Revenue (Mn)	701	1,018	1,015	1,137	1,273
Yield %	34.90%	39.33%	35.00%	35.00%	35.00%
Cost-to-income ratio					
Cost (Mn)	11,455	12,162	12,777	14,106	14,940
Net income (Mn)	29,982	27,147	32,264	36,658	41,170
Cost-to-income ratio (%)	38.2%	44.8%	39.6%	38.5%	36.3%

Valuation Ratios

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	42.8	34.5	45.3	52.4	60.9
Growth %		-19%	31%	16%	16%
Book Value Per Share	75	88	104	123	144
Return Ratios					
Return on Assets (%)	10%	7%	8%	7%	7%
Return on Equity (%)	57%	39%	43%	43%	42%
Return on Capital Employed (%)	57%	33%	38%	37%	37%
Valuation					
PE (x)		14	10	9	8
Price to Book (x)		5.3	4.5	3.8	3.3

Source: Company, Keynote Capitals Ltd. estimates

ISEC's valuation

Valuation	
(in Rs. Mn, otherwise stated)	**FY24E**
Revenue	37,586
PAT	14,615
PE(x)	13
Market Capitalization	1,89,995
Target Price (Rs.)	**588**
Current Market Price (Rs.)	490
% Upside/(Downside)	**+20%**

Source: Company, Keynote Capitals Ltd. estimates

We anticipate the broking revenue to remain stable in FY24, while we expect strong growth of 21% in the distribution business and 23% in interest income, led by strong growth in the MTF book. Based on our estimates, the cost-to-income ratio will fall from 45% in FY23 to 40% in FY24, leading to a rise in PAT by 31% YoY in FY24. Using a 13x PE ratio, we expect the target price to be Rs. 588, indicating a potential upside of 20%.

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Our Recent Reports


IEX Ltd | Initiating Coverage Report
KEYNOTE
Indian Energy Exchange Limited
9th May 2023
BUY

Indian Energy Exchange Ltd.


Federal Bank Ltd. | Initiating Coverage Report
KEYNOTE
Federal Bank Ltd.
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BUY

Federal Bank Ltd.


Laurus Labs Ltd | Initiating Coverage Report
KEYNOTE
Laurus Labs Limited
31st Mar 2023
BUY

Laurus Labs Ltd.

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Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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Keynote Capitals Limited (CIN: U67120MH1995PLC088172)

Compliance Officer: Mr. Jairaj Nair; Tel: 022-68266000; email id: jairaj@keynoteindia.net

Registered Office: 9th Floor, The Ruby, Senapati Bapat Marg, Dadar West, Mumbai – 400028, Maharashtra. Tel: 022 – 68266000.

SEBI Regn. Nos.: BSE / NSE (CASH / F&O / CD): INZ000241530; DP: CDSL- IN-DP-238-2016; Research Analyst: INH000007997

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