February 24, 2010

India Infoline Limited (INDINF)

Rs 111

Next delta missing for steep growth…

India Infoline (IIFL) has diversified its core business of equity broking to a widespread bunch of financial services. Broking revenues contribute ~55-60% to the total topline, financing income ~22-23% while insurance distribution & online media contribute 10% to the total income. IIFL commands ~3.7% market share of total market volumes clocking Rs 3700 crore daily volume and generates higher-than-industry average yields of ~8 bps due to higher share from the retail segment (~60% of total turnover). We expect IIFL to maintain a stable market share. This will lead to revenue CAGR of 14% (FY12E Rs 1431 crore) and PAT CAGR of 19% (FY12E-Rs 246 crore).

Higher broking yields to help 17% CAGR in broking income

IIFL has a market share of ~3.7%. With the anticipated average daily market turnover rising from current levels of Rs 90,000-95,000 crore to Rs 1,20,000-1,25,000 crore by FY12E, we believe yields will stabilise around 8 bps (comparatively higher than peers). This should help it to generate brokerage income at 17% CAGR over FY09-FY12E to Rs 844 crore.

Financing business to be driven by margin funding, LAS

We expect the financing book to grow from the current Rs 1200 crore to Rs 1480 crore by FY11E and Rs 1710 crore by FY12E implying 21% CAGR over FY09-FY12E. Margin funding, which constitutes ~40% of the funding book will allow yields to be maintained at 15-16%. This will enable 13% CAGR in NII to Rs 333 crore by FY12E.

Higher operating leverage leads to lower than peers EBIDTA margins

EBIDTA margin fell from 33% and 39% in FY07 and FY08, respectively, to 30% in FY09. The margins are lower compared to listed peers on account of higher proportion of owned branches resulting in higher operating ratio of approximately 18%. The company has lately shifted to the blended model, which will improve its EBIDTA margin to 32% by FY12E.

Valuations

At the CMP of Rs 111, the stock is ruling at 13.3x and 12.8x its FY11E and FY12E EPS, respectively. The stock has historically traded at a premium to market multiples due to its diversified revenue stream and higher than industry blended yields of ~8 bps. RoEs are expected to stay in the range of 13-14% in the next two years. Since we do not expect steep rise in bottomline till FY12E, we have not ascribed any premium to the market multiple (15x FY11E EPS) thereby valuing the stock at Rs 121/share.

Exhibit 1: Key Financials

	FY08	FY09	FY10E	FY11E	FY12E
Total Revenue	1023.6	963.1	1183.9	1247.6	1431.0
PAT	159.9	144.8	229.3	236.0	245.7
EPS	6.6	5.1	8.1	8.3	8.7
PE (x)	16.8	21.7	13.7	13.3	12.8
PBV (x)	2.1	2.0	1.8	1.7	1.5
RoCE	28.2	13.5	22.8	20.0	18.8
RoNW	21.3	10.4	15.1	13.9	13.2

Source: Company, ICICIdirect.com Research

Rating Matrix

Rating	:	**Add**
Target	:	Rs 121
Target Period	:	12-15 months
Potential Upside	:	9%

YoY Growth (%)

	FY09	FY10E	FY11E	FY12E
Total Revenue	-5.9	22.9	5.4	14.7
EBITDA	-27.3	48.4	0.1	5.8
Net Profit	-17.7	66.7	2.9	4.1

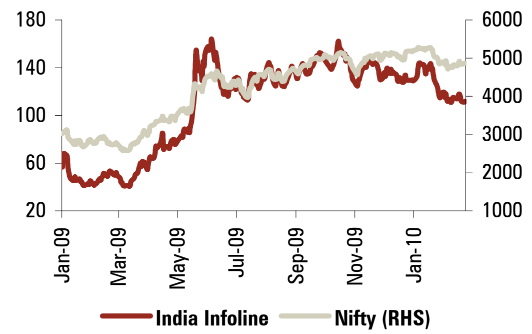
Stock Data

Bloomberg Code	IIFL.IN
Reuters Code	IIFL.BO
Face value (Rs)	2
Promoters Holding	34%
Market Cap (Rs cr)	3181
52 week H/L	173 / 40
Sensex	16100
Average volumes	188000

Comparative return matrix (%)

Stock return (%)	1m	3m	6m	12m
India Infoline	-16	-23	-12	110
Edelweiss	-12	-15	-3	59
MOSL	-11	-3	8	169
Religare	-4	2	0	21

Price movement (Stock vs. Nifty)



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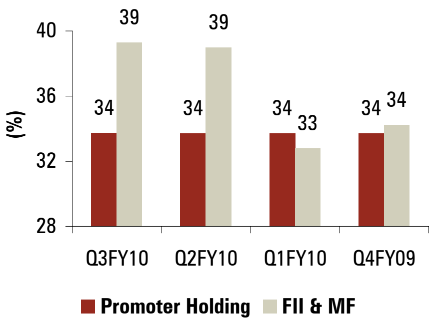
Shareholding pattern (Q3FY10)

Shareholder	Holding (%)
Promoters	33.8
Institutional investors	39.3
Other investors	27.0

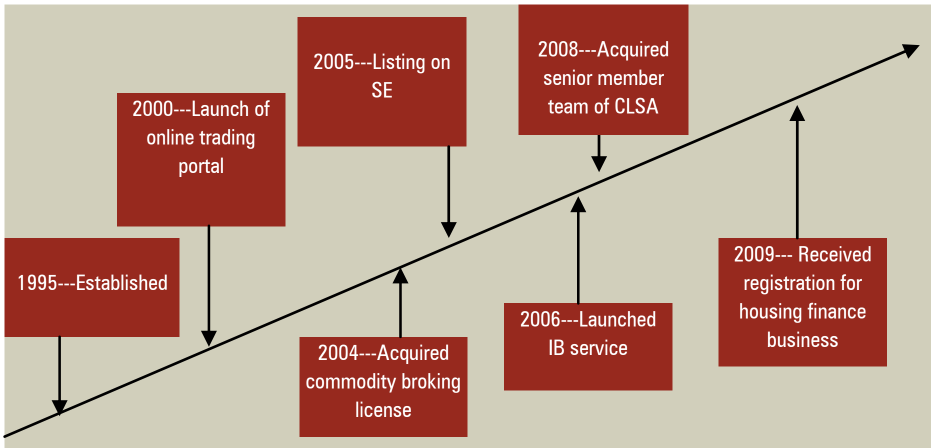
Promoter & Institutional holding trend (%)



Company background

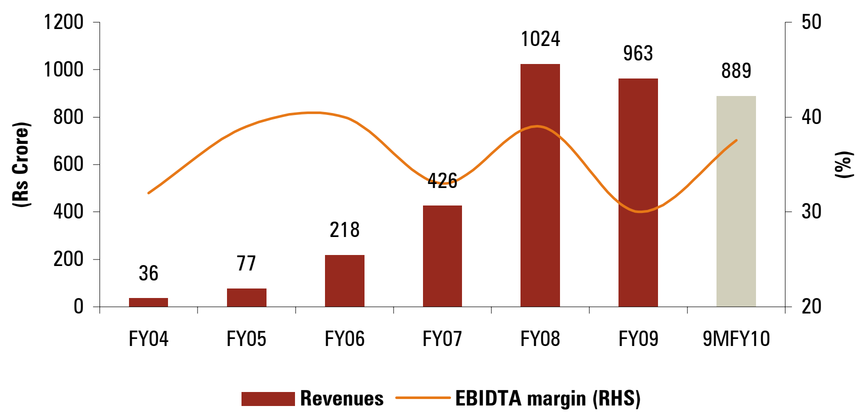
The India Infoline group, comprising the holding company, India Infoline Ltd and its wholly-owned subsidiaries, straddles the entire financial services space with offerings ranging from equity research, equities & derivatives trading, commodities trading, PMS, mutual funds, life insurance, FD, GoI bonds and other small savings instruments to loan products and investment banking. India Infoline also owns and manages the websites www.indiainfoline.com and www.5paisa.com. The company has a network of 1,814 business locations (branches and sub-brokers) spread across 365 cities and towns. It has more than 7.5 lakh customers.

Exhibit 2: Evolution of IIFL



Source: Company, ICICIdirect.com Research

Exhibit 3: Financial performance



Source: Company, ICICIdirect.com Research

Investment Rationale

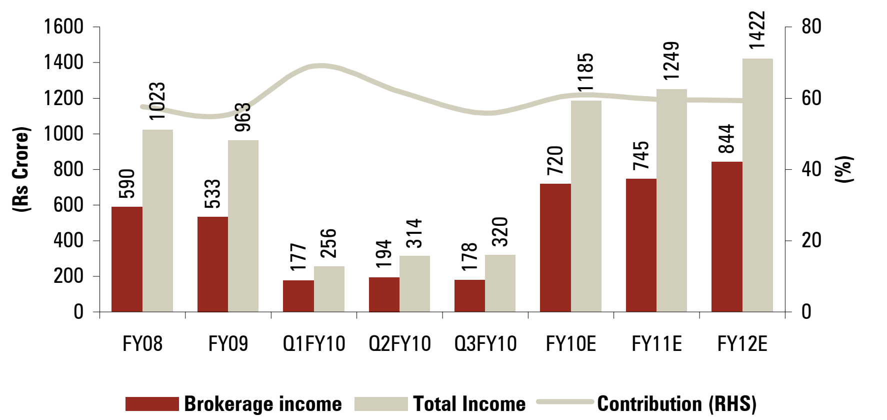
India Infoline has a diversified revenue stream. The enhanced distribution platform (spread over 2,100 locations) helps the company to generate higher retail volumes (~60% of total average daily volumes) as a result of larger retail customer base (7.5 lakh). Even on growing market volumes, we expect IIFL to maintain its market share of ~3.7% and protect yields @8 bps, which will enable 17% CAGR in broking revenues over FY09-FY12E to Rs 844 crore. Despite higher-than-industry yields, the company has a comparatively lower EBIDTA margin of 30% (FY09) on account of higher proportion of owned branches resulting in higher employee cost of 26% and operating expenditure of 29% of total income. The shift towards the blended model (own branches and franchise) will enable the company to improve its EBIDTA margin to 32% by FY12E. On account of the above factors, we expect 19% CAGR in PAT over FY09-FY12E to Rs 246 crore.

Higher yields, stable market share to enable 17% CAGR in broking income

We anticipate a stable market share for IIFL till FY12E @ 3.7%

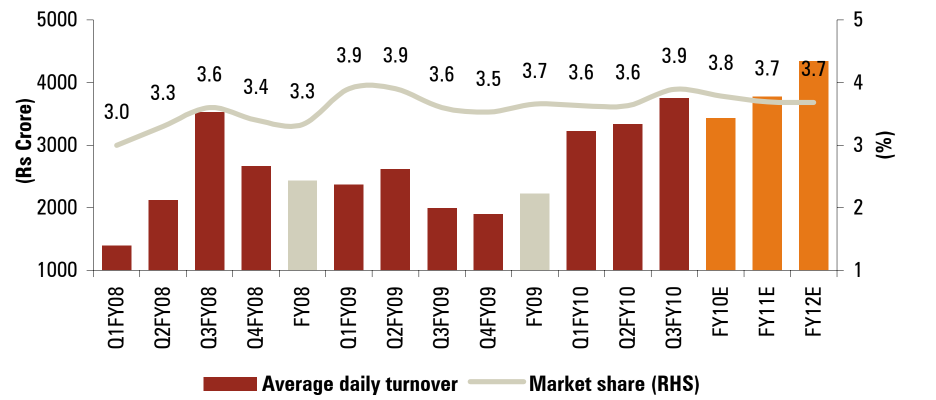
Brokerage income contributed 57% and 55% in FY08 and FY09, respectively, to the total income of the company. We expect this share to inch up ~60% by FY12E on the following supposition. We expect the total daily market turnover to increase from current levels of Rs 90,000-95,000 crore to Rs 1,20,000-1,25,000 crore by FY12E (Refer Annexure 1). We anticipate that IIFL will maintain its market share of ~3.7% and protect yields @8 bps. Hence, we expect 17% CAGR over FY09-FY12E in brokerage income to Rs 844 crore. Broking volumes are dominated by retail segment volumes for IIFL.

Exhibit 4: Contribution of brokerage income to total income still high despite diversification



Source: Company, ICICIdirect.com Research

Exhibit 5: Market share likely to consolidate at current levels



Source: Company, ICICIdirect.com Research

Market dynamics and IIFL's focus area of operation

Overall market volumes have tilted more towards the derivative segment

The retail segment has contributed over 50% to overall market volumes in the past couple of years. The share of retail participation did fall from over 57% in FY08 ~53% in FY09. This was on account of volatile market conditions. The share has again picked up in the current year to 57%. We expect this share to gradually move up to 58-59% in the coming period. IIFL has been successful in generating more than half of its volumes from the retail segment (~60%), which provide higher than industry yields. The multiple delivery channel of IIFL facilitates in acquiring retail clientele.

Exhibit 6: Retail segment contributes more than half of overall market turnover

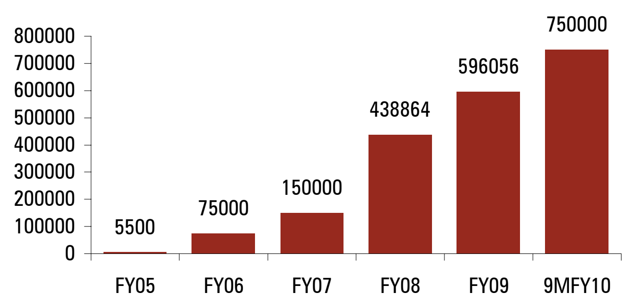
(%)	FII	DII	Prop	Retail
FY08	16	6	23	55
FY09	15	6	26	53
YTDFY10	11	5	27	57

Source: Company, ICICIdirect.com Research

Emergent retail client base

IIFL had adopted a very aggressive branch expansion strategy during FY06. This helped the company to expand its retail reach, which rose multifold during that period from 5,500 in FY05 to 75,000 in FY06 and 7,50,000 by December 2009.

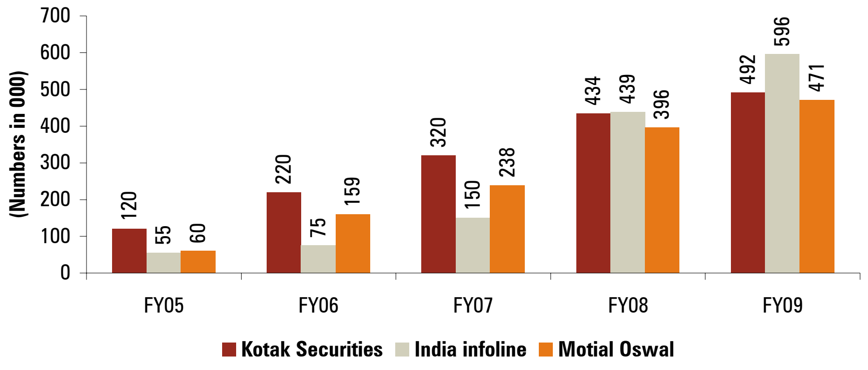
Exhibit 7: Retail client base expanding rapidly



Source: Company, ICICIdirect.com Research

Retail participation in overall market volumes is more than 50% and yields from the retail segment are comparatively higher compared to the institutional segment.

Exhibit 8: Industry dynamics for client base



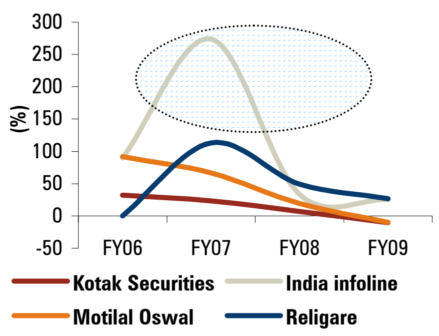
Source: Company, ICICIdirect.com Research

Multiple delivery channels help in acquiring more retail clients

Offline and online portal helps to generate more retail volumes

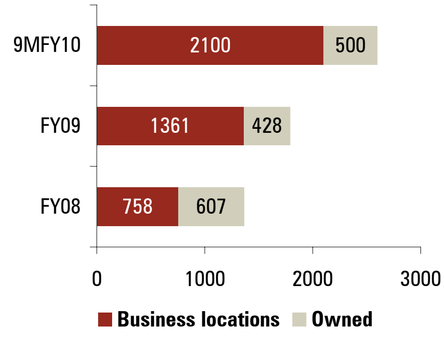
One of the major reasons for such an invigorating spreading out of retail clients (7.5 lakh) is the growth in the offline platform. IIFL doubled its distribution platform in FY06 and followed it up with over 200% growth in FY07. The company was more inclined towards the owned branch model, which led to higher operating cost and lower PAT margin. This weighed heavily on the company during the downturn of FY09 where the EBIDTA margin came down from 39% in FY08 to 30% in FY09. IIFL has lately shifted to the blended model of branch expansion. During the downturn of FY09 IIFL expanded its reach to 1,361 business locations but rationalised owned branches from 607 to 428. This shows its inclination towards the blended model. The company is currently spread over 2,100 business locations with 500 owned branches.

Exhibit 9: Branch additions



Source: Company, ICICIdirect.com Research

Exhibit 10: Shifting towards the blended model



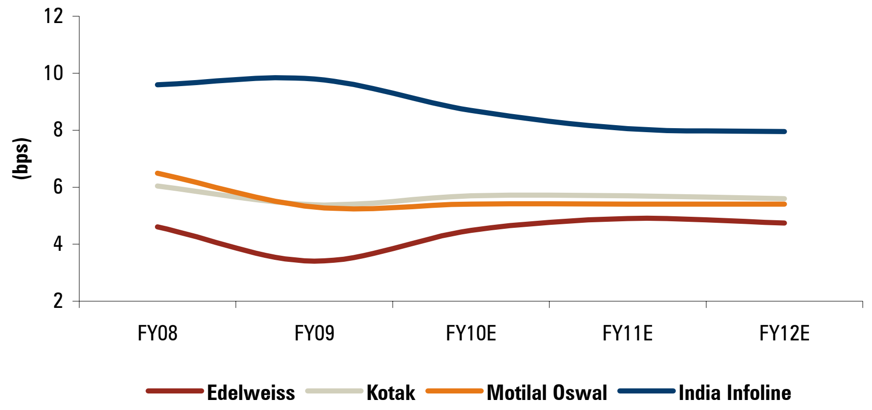
Source: Company, ICICIdirect.com Research

The brokerage income also includes processing fees, which results in higher yields for the company

Higher retail volumes lead to better yields

The company manages to generate Rs 3700 crore of average daily turnover (ADT), of which ~60% is contributed by retail participants (as indicated by management). The focus area of the company has always been the retail segment, which enables the company to maintain higher-than-industry yields (blended) of around 8 bps. Another reason for higher blended yields is the inclusion of processing fees in brokerage revenues. Going forward, we expect yields for IIFL to stabilise around 8 bps till FY12E.

Exhibit 11: Higher-than-industry yields



Calculated yields

Source: Company, ICICIdirect.com Research

On account of higher retail volumes, IIFL manages to report above industry blended yields of ~8 bps. The yields for other players like Motilal Oswal and Kotak Securities ranges around 5-6 bps while for Edelweiss it is a little lower at 4 bps.

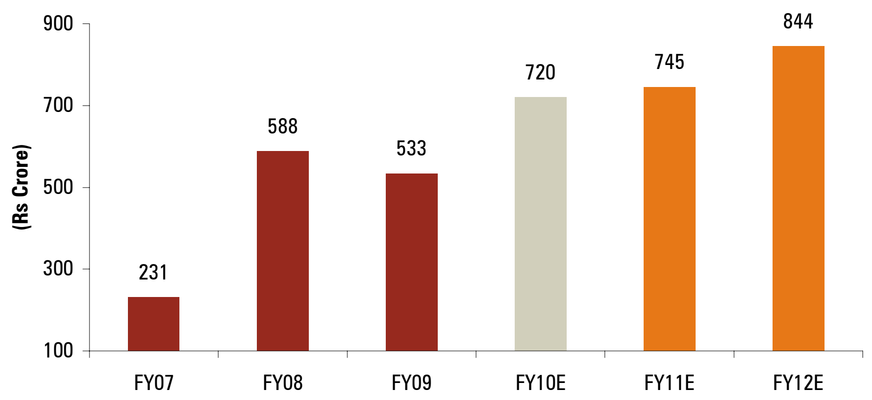
The market share of the company was lingering around 1.9% in March 2006. It started to gain traction from Q1FY08 after acquiring CLSA's senior member team and is currently at 3.7%

The company had taken a strategic decision in FY08 by inducting the four-member senior management team of CLSA to strengthen its presence on the institutional side also. This boosted the sales, market share and reach of the company. We have assumed that the institutional segment of IIFL will contribute nearly 38-40% of the total turnover.

The management is looking to consolidate its position in the market at current levels

Our recent interaction with the management indicated that the company will consolidate its position in the industry to maintain its market share at current levels of ~3.7%. This indicates that the company is not looking to aggressively expand its operations. We expect its market share to stay at current levels since it has already expanded well in most segments like online, offline, institutional vertical, etc. Therefore, we have modelled in 25% CAGR in volumes to Rs 4300 crore leading to 17% CAGR in brokerage revenues over FY09-FY12E to Rs 844 crore.

Exhibit 12: Trend in broking revenues

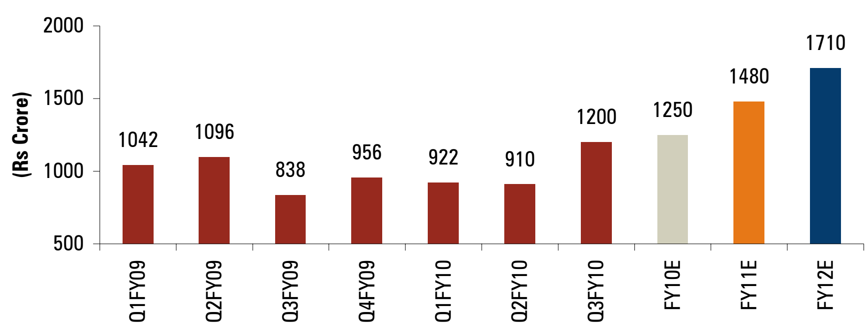


Source: Company, ICICIdirect.com Research

Financing business to be driven by margin funding business

The loan book of IIFL, which was more tilted towards mortgage and personal loans, has been shifting focus towards margin funding in the past five to six quarters. The growth in lending book from Rs 956 crore in FY09 to Rs 1200 crore by December 2009 can be attributed totally to margin funding that grew from Rs 120 crore to Rs 384 crore. In contrast, whereas other avenues like mortgage loans grew from Rs 516 crore to Rs 564 crore, personal loans are consistently sloping down while loan against shares (LAS) is steady at Rs 132 crore. We expect the funding book to grow at 21% CAGR over FY09-FY12E to Rs 1710 crore. The yield from the funding book was ~15-16% due to higher proportion of margin funding (~40% of total funding book). We expect yields to stay at these levels till FY12E with an upward bias as we enter a higher interest rate scenario. We expect 13% CAGR in NII to Rs 333 crore over FY09-FY12E.

Exhibit 13: Traction in funding book

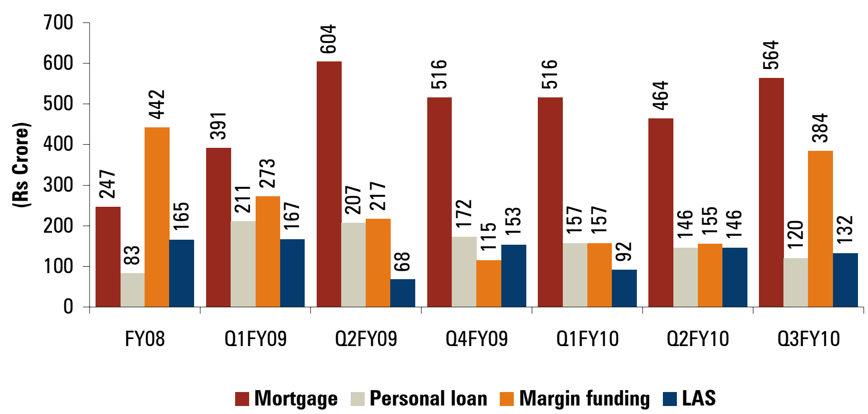


Source: Company, ICICIdirect.com Research

The company launched its consumer finance business in FY07 where it started focusing on retail loans to add to its mortgage funding business, which was already doing well. The disbursement of personal loans was stopped in August 2008 just after a couple of quarters of its inception to control asset quality. This helped to keep a check on asset quality, with NPA below 1% of loan book currently. The loan book size currently is Rs 1200 crore. We expect the book size to rise to Rs 1480 crore by FY11E and Rs 1710 crore by FY12E implying 21% CAGR over FY09-FY12E.

The margin funding business does well under stable market conditions and when the IPO pipe line is strong, which is the case currently

Exhibit 14: Break-up of funding book



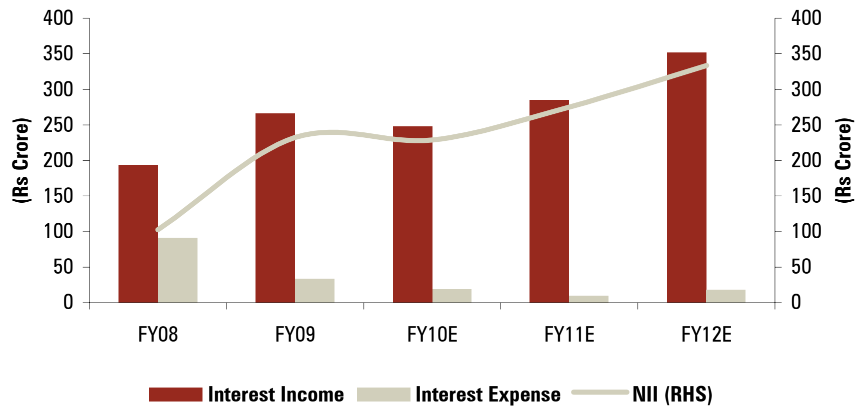
Source: Company, ICICIdirect.com Research

Growing funding book, stable yields to support NII growth

The yield on the funding book is hovering around 15-16% due to larger share of capital market related lending. We expect this to stay stable in the coming period. The interest expense is likely to move up marginally from the current zero levels owing to growth in debt levels. Growing funding book and stable yields will enable 13% CAGR in NII over FY09-FY12E to Rs 333 crore.

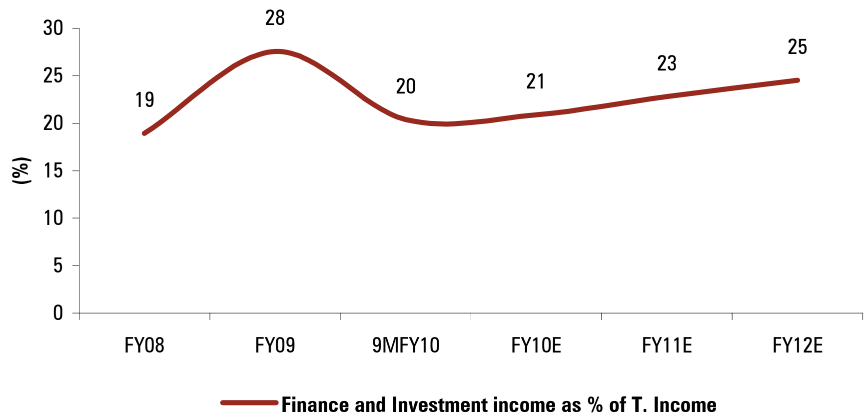
We believe the loan book provides yields of 15-16%. On the other hand, high net worth and low debt leads to lower interest outgo for IIFL keeping spreads high

Exhibit 15: Trend in net interest income



Source: Company, ICICIdirect.com Research

Exhibit 16: Contribution of financing income to total income

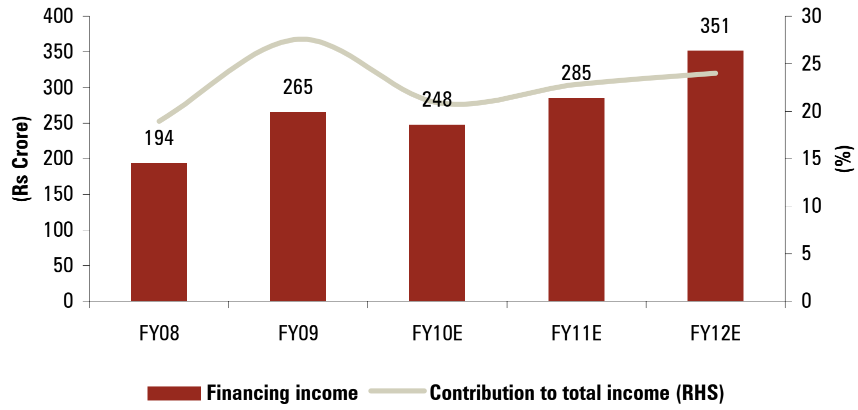


Source: Company, ICICIdirect.com Research

Contribution of interest income to total income is expected to improve owning to growth in funding book and stable yields

Despite insignificant growth in the funding book in FY09, NII for IIFL grew over 127% from Rs 103 crore to Rs 232 crore. This was on account of larger interest income (liquidity crunch in FY09 allowed the company to lend at higher rates ~ 22-24%) and since it has got IPO money to lend with no debt. The interest cost reduced drastically from Q3FY09 since the company repaid loans, which were outstanding on the books. This led to a drastic fall in the interest expense cost from Rs 91 crore in FY08 to Rs 33 crore in FY09. Currently, interest expenditure is near zero levels on account of very negligible debt on books. However, we expect debt levels to rise gradually. Hence, we expect NII growth@ 13% CAGR to Rs 333 crore.

Exhibit 17: Contribution of financing income to total income to moderate slightly



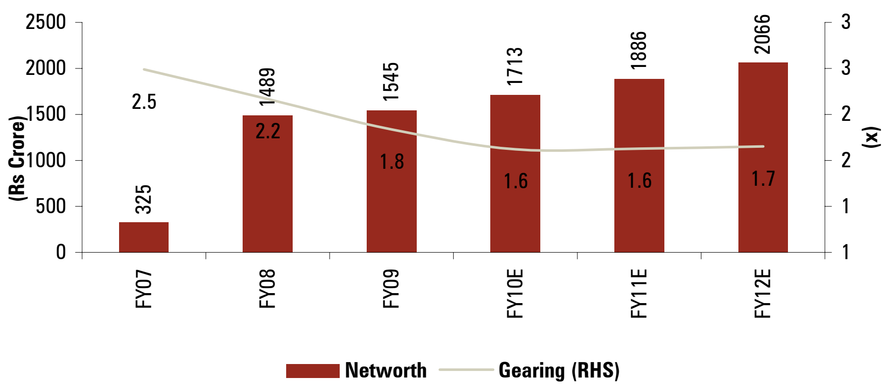
Source: Company, ICICIdirect.com Research

There is an opportunity for rapid expansion of the funding book in a conducive market environment

Low gearing: Room for expanding lending business rapidly

The net worth of IIFL is expected to rise from Rs 1545 crore in FY09 to Rs 2072 crore by FY12E. The company currently operates at very low gearing ratio of 1.2x, which shows the conservative approach of the management. Thus, there is more scope to expand its funding business during stable market conditions.

Exhibit 18: Low gearing: Scope for expanding asset base further



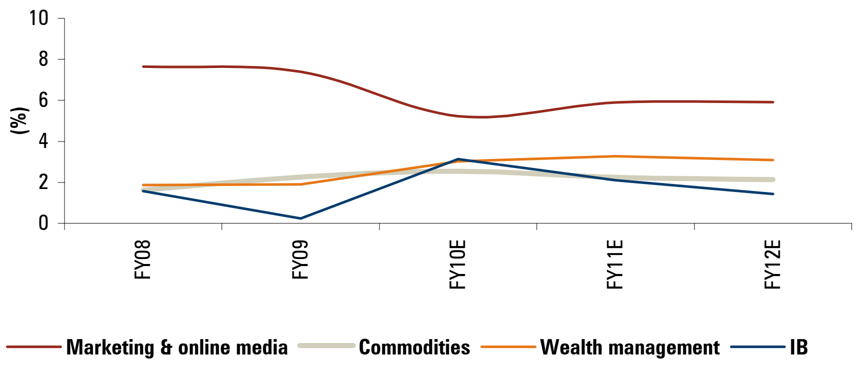
Gearing: Total assets/ Net worth

Source: Company, ICICIdirect.com Research

Other business areas likely to grow steadily

Share of online media, asset management, commodity broking and investment banking to total income drifted down from over 22% in FY07 to just over 11% in FY09. IIFL was sole manager for Cox & Kings in Q3FY10, which led to growth in IB fees in Q3FY10 to Rs 29 crore. We expect a marginal improvement in performance from these segments and expect them to contribute ~13% to total revenues by FY12E.

Exhibit 19: Contribution to total income

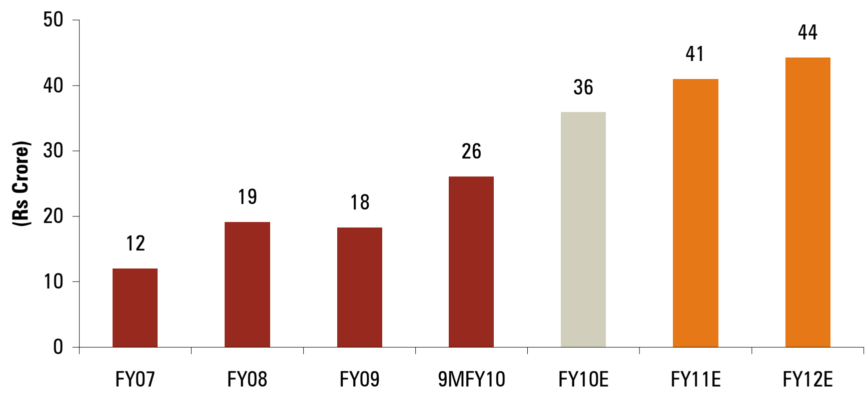


Source: Company, ICICIdirect.com Research

Asset/wealth management

Assets under management have now crossed Rs 5000 crore spanning over 1,400 family accounts. Recently, the company successfully sold IPO applications specifically in the non-institutional segment for NHPC and Oil India and Cox and Kings in FY10. We expect asset management fees to grow gradually from Rs 20 crore in FY08 to Rs 44 crore in FY12E implying 34% CAGR over FY08-FY12E.

Exhibit 20: Growth in asset management fees



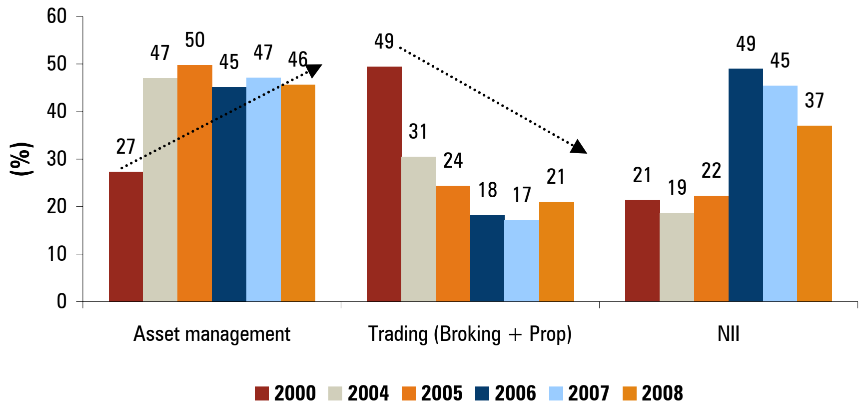
Source: Company, ICICIdirect.com Research

Developed countries have moved towards asset management model

We expect a strategic shift of gear towards wealth management as is the case in most developed countries. However, these business lines will take time to contribute significantly to the total revenues in the Indian context.

Are we moving in the same direction?
Let us examine the case of Charles Schwab in this context.

Exhibit 21: Charles Schwab revenue contribution shifting towards asset management fees



Source: Company, ICICIdirect.com Research

Asset management fees could rise exponentially though not in our investment horizon

As depicted above for Charles Schwab, revenue contribution from trading declined from 50% of total income to 21% over a period of nine years while that of the AMC rose from 21% to 46%.

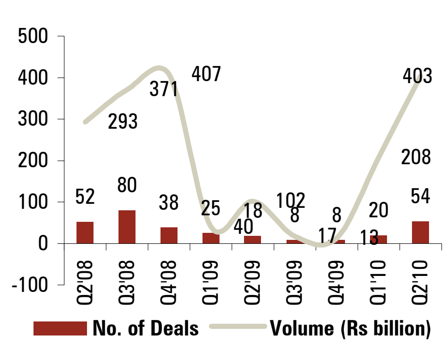
If this is the model that can evolve in our markets then we can expect a higher contribution from asset management fees though not in our investment horizon. However, this could possibly be the next potential growth driver.

Investment banking

IB fees increased from Rs 3 crore in FY07 to Rs 16 crore in FY08 and further to Rs 33 crore in 9MFY10. We expect 107% CAGR in IB fees to Rs 21 crore by FY12E.
The increase in PE deals lately and improvement in M&A activity has enabled IIFL to gradually grow its IB fees. We expect the M&A market can grow at 20-25% next year to $600 –$700 million. The recent peak was in 2007 when we saw a pool of close to $800 million. The fee in this business varies from 1% to 3%. WE see this as an opportunity to grow IB fees for IIFL.

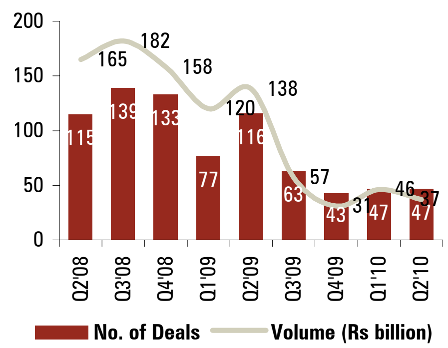
IB fees are lumpy in nature and hence income from this segment could rise steeply.

Exhibit 22: Public equity deals



Source: Company, ICICIdirect.com Research

Exhibit 23: Private equity deals



Source: Company, ICICIdirect.com Research

Recent Investment banking deals

- QIPs of Gammon India and KSK Energy Ventures
- Sole BRLM for the Cox & Kings IPO
- Sole management of Cox & Kings
- BRLM for the Infinite Solutions IPO

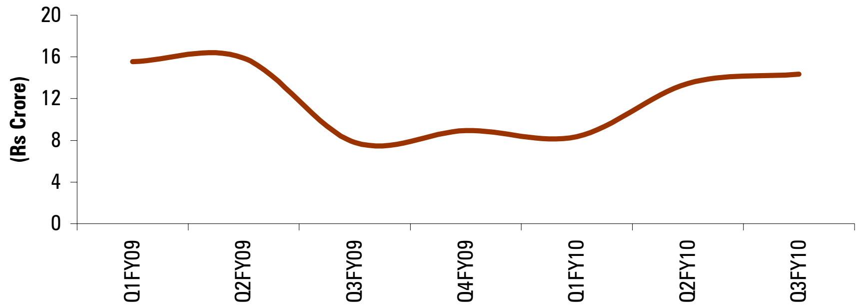
Life insurance distribution: losing ground

IIFL was a corporate agent of ICICI Prudential. The company has recently received an insurance broking license, which enables it to distribute products for multiple players. IIFL has already tied up with Max life, Met Life, Reliance Life, Kotak OM life and ICICI Prudential Life for distribution of insurance products.

We have considered 16% CAGR in amount mobilised over the next couple of years to Rs 425 crore by FY12E. We expect stable market conditions and tie-up with other players to enable the company to deliver better growth from FY11E. We expect the amount mobilised by the company to grow by over 50% YoY to Rs 330 crore in FY11E and further to Rs 425 crore in FY12E. Distribution commissions will moderate down from current 15-16% to 12-13% by FY12E on account of pressure on agency commissions. We expect distribution fees to grow at a moderate 5% CAGR over FY09-FY12E to Rs 55 crore on higher volume growth.

Distribution commission (%) is likely to fall further. Volume growth will drive revenues from this segment

Exhibit 24: Commission income for insurance premium mobilised

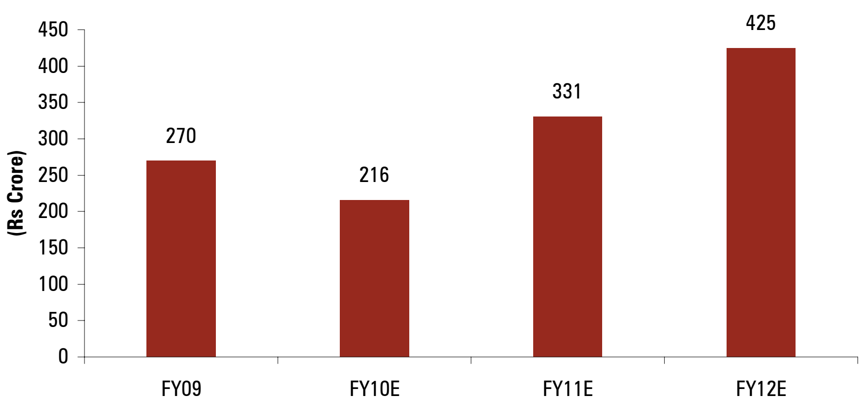


Source: Company, ICICIdirect.com Research

The management has indicated that most of the employees in the insurance business are on variable pay except the top management

The performance from the insurance business is a little subdued since the company is consistently losing its market share, which was over 2.8% in Q1FY09 to below 1.4% by the end of Q3FY10. Despite its increasing reach and growing retail base to nearly 7.5 lakh customers the company was unable to gain traction in insurance distribution income.

Exhibit 25: Amount of insurance mobilisation to grow well from FY11E



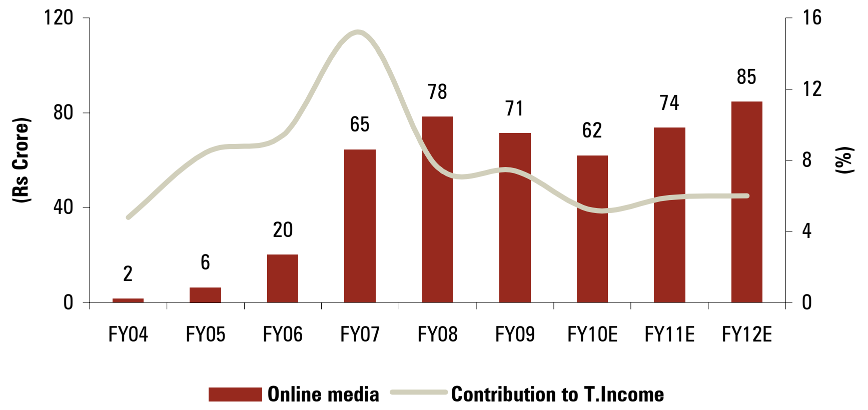
Source: Company, ICICIdirect.com Research

Marketing and online media

The growth in this segment is very encouraging but one also needs to understand the low base effect. This segment grew at 112% CAGR over FY04-FY09 from Rs 2 crore to Rs 71 crore. We expect it to grow at 6% CAGR over FY09-FY12E to Rs 85 crore and contribute 6% to the topline.

We expect steady growth from the online media segment

Exhibit 26: Online media income growing well



Source: Company, ICICIdirect.com Research

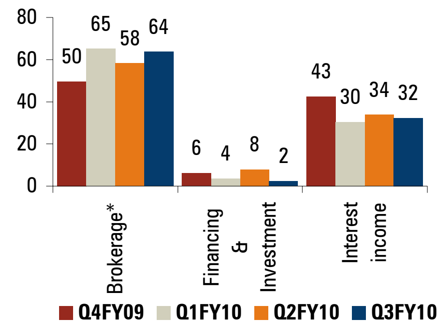
Income in this segment is generated from the sale of space on proprietary website, www.indiainfoline.com and related marketing and promotional activities undertaken through the distribution network. This also includes revenues generated by way of sponsorship and sale of research reports and customised assignments.

Diversification arrests steep decline in topline

Brokerage income, which contributes ~ 54-55% to the total topline of IIFL, is comparatively lower compared to its listed peers like Edelweiss and Motilal Oswal where the share ranges between 65% and 70%. Diversification into related business streams like commodity broking, investment banking, PMS, wealth management, etc, helped IIFL to arrest the fall in total topline during volatile market conditions.

Unlike Edelweiss that has higher dependence on treasury income, IIFL has a much diversified revenue stream

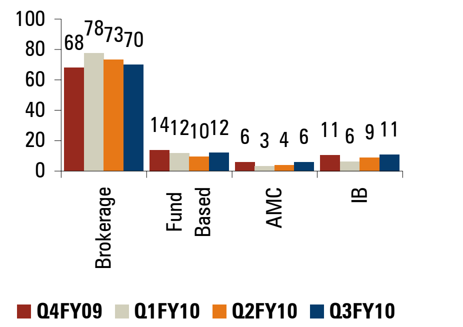
Exhibit 27: Edelweiss topline break-up (%)



*Brokerage includes treasury income

Source: Company, ICICIdirect.com Research

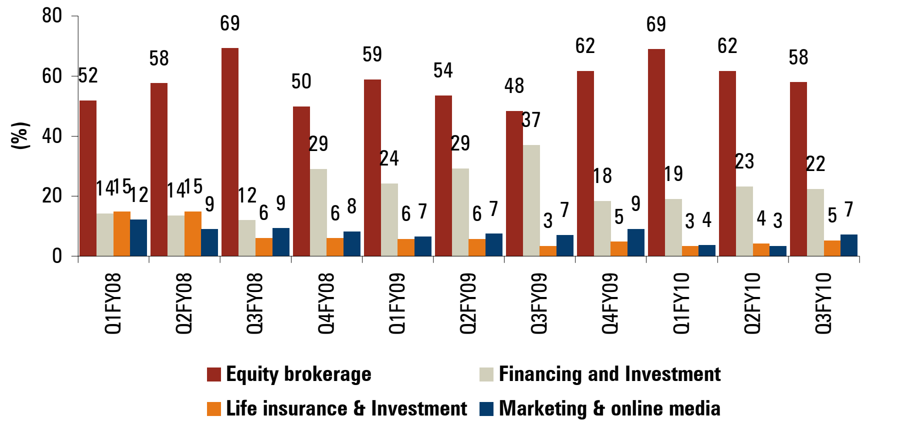
Exhibit 28: Motilal Oswal topline break-up (%)



Source: Company, ICICIdirect.com Research

Contribution from other sources is likely to remain stable

Exhibit 29: Contribution to topline for IIFL



Source: Company, ICICIdirect.com Research

Topline sustained during volatile period

IIFL managed to sustain its market share of ~3.7% when most other brokerages lost their market share in the past two years. Hence, the broking income of IIFL saw a marginal decline from Rs 590 crore to Rs 533 crore in FY09. Financing and investment income came to the rescue during that period. It grew from Rs 194 crore to Rs 265 crore in FY09. Other avenues like commodity brokerage, online media and wealth management, etc showed a very stable performance keeping a check on the fall in topline.

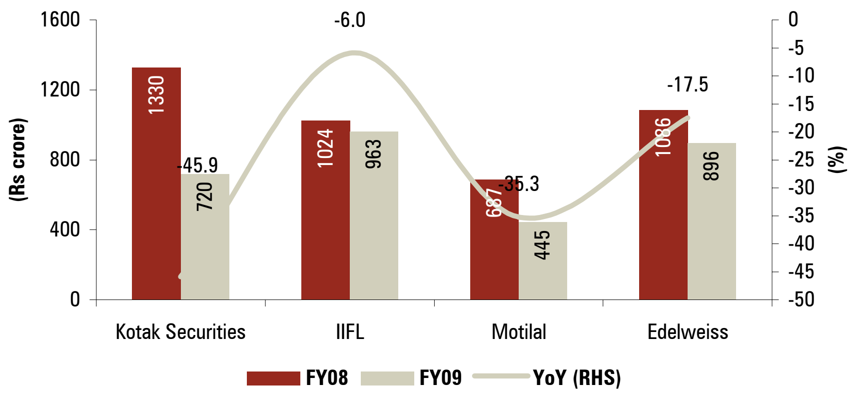
Only IIFL was able to maintain its market share in the past eight quarters whereas all other players have lost considerably

Exhibit 30: Market share maintained by IIFL

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Edelweiss	7.4	6.8	5.6	5.1	4.7	4.3	4.8
India Infoline	3.8	3.8	3.4	3.4	3.5	3.6	3.9
Motilal Oswal	4.6	4.5	3.9	3.8	3.7	3.4	2.9
Kotak Securities	6.3	5.6	4.8	4.7	4.5	4.4	3.9
Reliance money	3.6	3.2	3.9	2.7	1.7	1.6	1.6

Source: Company, ICICIdirect.com Research

Exhibit 31: Topline resilient during volatile times



Source: Company, ICICIdirect.com Research

There is no visible avenue, which can bring runaway growth from these levels

Major arena already explored: new delta missing

IIFL has explored all major business lines. Hence, we expect the company to grow along with market volumes, which will enable it to maintain its market share of ~3.7% and generate volumes of Rs 4400-4500 crore by FY12E. Total income of the company has grown at 50% CAGR over FY07-FY09. However, we expect consolidation at current levels. Hence, we have modelled in 14% CAGR over FY09-FY12E to Rs 1421 crore.

Risk and Concerns

Greater volumes from derivatives segment to hurt yields

IIFL enjoys higher-than-industry yields because of its share of cash market volumes. Currently, the average cash: derivatives ratio lies around 30:70. However, a higher derivative share will impact IIFL to that extent. We expect the share of the derivatives segment to inch up from current levels. Hence, we have factored in falling yields for the company to that extent. Still, any further dip in yield will impact the profitability to that extent.

Lull in capital market volumes

Lately, capital market volumes have picked up and stabilised around Rs 90,000-95,000 crore. We expect a steady rise in volumes over the next couple of years in our markets. If the volumes dry up in our markets, they will impact the company to that extent since brokerage income will be directly impacted negatively.

Increasing competition in online & institutional space

We have factored in falling yields for the company in the wake of falling cash segment volumes and growing competition in the online and institutional space. The management is not aggressively expanding its operations currently. Hence, higher pressure on account of competition from unorganised players may result in a faster drop in market share and, thereby, profitability.

Rapid expansion of distribution platform to hurt margin

The company is currently rationalising its distribution platform, which is keeping a check on the fall in EBIDTA margin and, hence, the PAT margin. This was a reaction to the downturn of FY09. However, since markets have stabilised now rapid expansion to capture a larger pie of the growing market turnover could impact the EBIDTA margin and our estimate, to that extent.

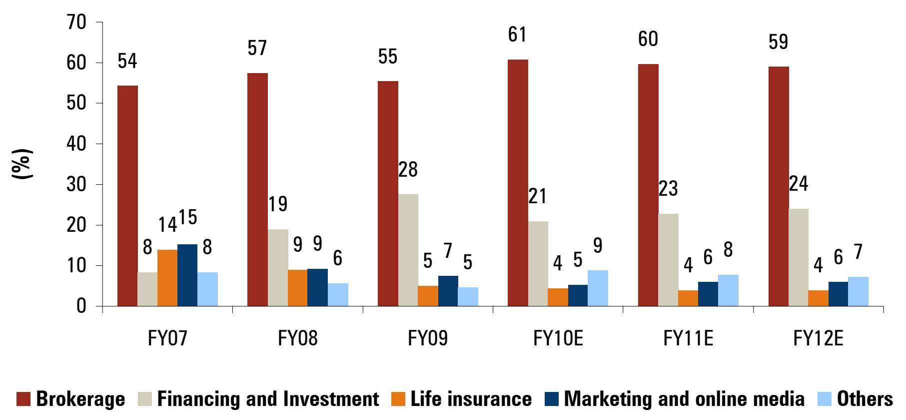
Financials

Diversified topline

The total revenue growth for IIFL has been steady even during uncertain market conditions. The total income grew at 50% CAGR over FY07-FY09 from Rs 426 crore to Rs 963 crore. We expect 14% CAGR over FY09-FY12E to Rs 1421 crore. Traditionally, brokerage income has contributed 54-55% to total income. We do not see a substantial change in the revenue mix, which becomes largely dependent on consumer finance and insurance distribution income in a single year. Since most areas have already been explored, we do not expect a drastic shift in the revenue stream from current levels.

No major shift in revenue mix expected till FY12E

Exhibit 32: Topline distribution for IIFL



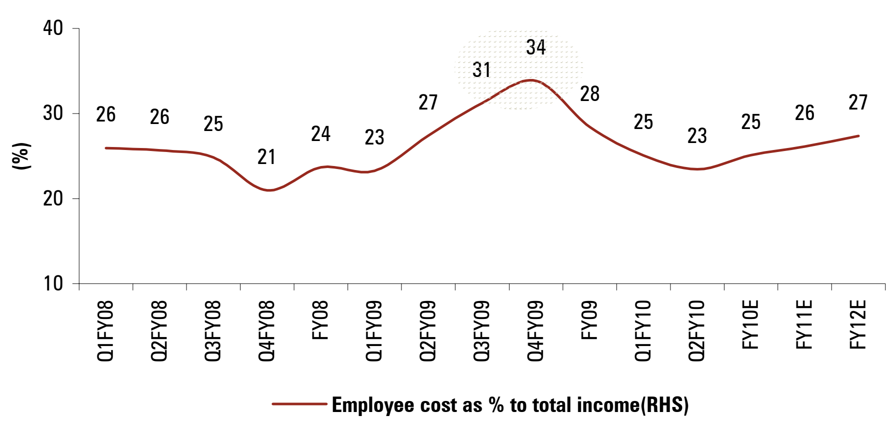
Source: Company, ICICIdirect.com Research

Higher operating leverage leads to lower EBIDTA margin

Currently, employee cost is hovering around 26% of the total income, which is higher than peers that range between 16%-17%. At the same time, the operating expense is at 29%, which is also higher than others. This higher expense ratio is due to the aggressive branch expansion done by IIFL. The company has lately shifted to a blended model, which bodes well and would enable it to contain its employee cost around 27% of the total income, which spiked up to 34% during the volatile period of Q4FY09.

The employee strength is not expected to grow rapidly from current levels, which will enable IIFL to control employee cost

Exhibit 33: Employee cost as % of total income is likely to inch up going forward



Source: Company, ICICIdirect.com Research

EBIDTA margin lower than peers

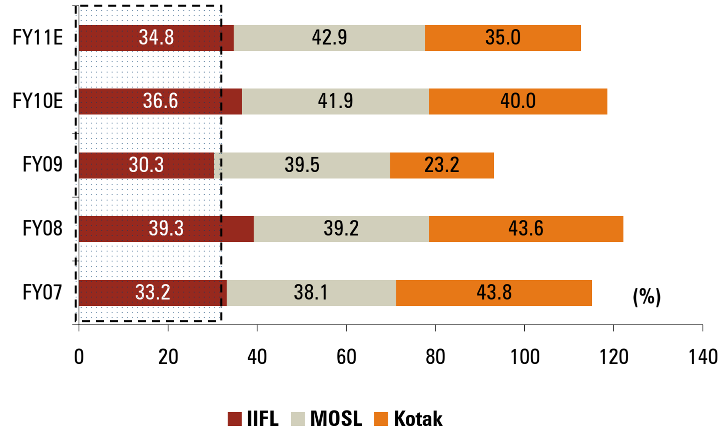
The EBIDTA margin fell from 33% and 39% in FY07 and FY08, respectively, to 30% in FY09.

Other listed players like Motilal Oswal and Kotak enjoy a higher EBIDTA margin compared to IIFL. The major reason for lower margins is the higher cost structure of IIFL. Employee expense to total income ranges between 27% and 28%. The shift towards a blended model will improve the EBIDTA margin to 32-33% by FY12E.

Shift towards a blended model will help in containing cost and improving the EBIDTA margin

The EBIDTA margin is showing early signs of improvement in the past three quarters

Exhibit 34: Comparative study of EBIDTA margin

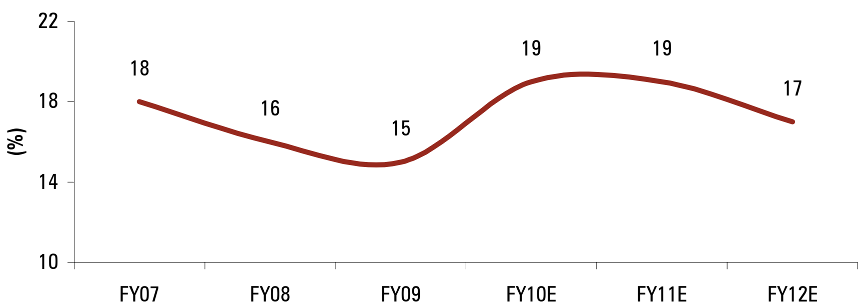


Source: Company, ICICIdirect.com Research

PAT margin maintained at higher teens

The PAT margin, which slipped from 18% during FY07 to 15% in FY09, is likely to stabilise around 17-18% by FY12E. We expect PAT to grow at 19% CAGR over FY09-FY12E to Rs 245 crore.

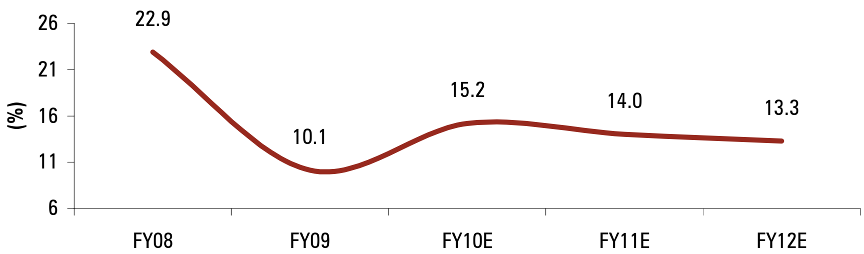
Exhibit 35: Bottomline margin to improve with improving EBIDTA



Source: Company, ICICIdirect.com Research

RoE could get dragged down if convertible warrants issued by the company get exercised

Exhibit 36: RoE to stabilise around 14%



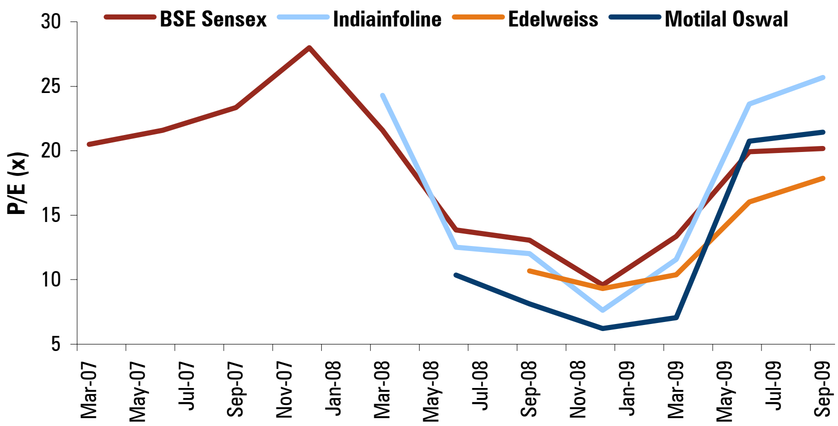
Source: Company, ICICIdirect.com Research

The BSE Sensex is trading at 15x its FY11E EPS

Valuation

At the CMP of Rs 111, the stock is ruling at 13.3x and 12.8x its FY11E and FY12E EPS, respectively. The stock has historically traded at a premium to market multiples due to its diversified revenue stream and higher than industry blended yields of ~8 bps. RoEs are expected to stay in the range of 13-14% in the next two years. Since we do not expect steep rise in bottomline till FY12E, we have not ascribed any premium to the market multiple (15x FY11E EPS) thereby valuing the stock at Rs 121/share.

Exhibit 37: Brokerages do tend to move in sync with broader market multiples



Source: Company, ICICIdirect.com Research

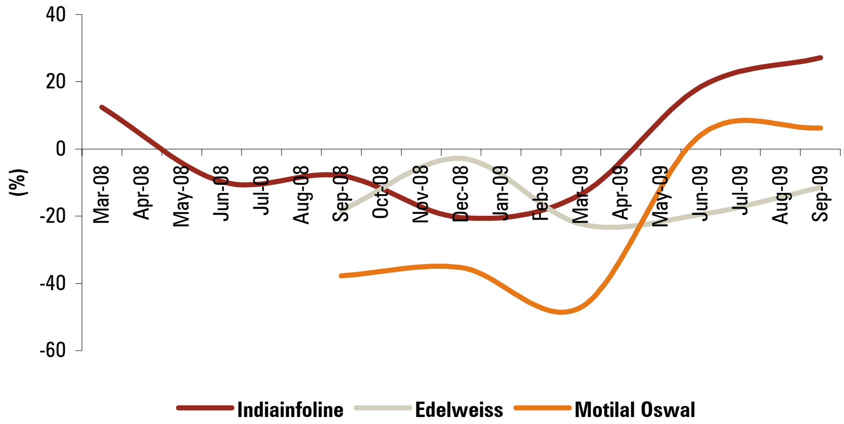
Exhibit 38: P/E band (1 year forward)

	(Disc)/Prem to Sensex	Target P/E
Edel	-15%	13
IIFL	0%	15
Motilal	-10%	13
Kotak	15%	17

Source: Company, ICICIdirect.com Research

The company has nearly 6 crore outstanding convertible warrants as on FY09. The option, if exercised, can drag down the EPS of the company from Rs 8.3 to Rs 6.9 in FY11E and our fair value, to that extent will be impacted negatively. We have not considered any such dilution in our target price.

Exhibit 39: Premium/ (Discount) to Sensex



Source: Company, ICICIdirect.com Research

Exhibit 40: Valuation ratios

	FY08	FY09	FY10E	FY11E	FY12E
EPS	6.6	5.1	8.1	8.3	8.7
Diluted EPS	3.2	4.3	6.7	6.9	7.2
DPS	1.2	2.8	1.8	1.9	2.0
CEPS	7.7	6.9	10.4	10.8	11.2
Cash per Share	12.5	22.1	9.3	4.8	0.8
BV	51.9	54.5	60.4	66.5	72.9
PE (x)	16.8	21.7	13.7	13.3	12.8
PBV (x)	2.1	2.0	1.8	1.7	1.5

Source: Company, ICICIdirect.com Research

Exhibit 41: Margin picture

(%)	FY08	FY09	FY10E	FY11E	FY12E
EBITDA / Total Income	39.3	30.3	36.6	34.8	32.1
EBIT / Total Income	36.5	26.2	32.4	30.4	28.1
PBT /T Income	27.6	22.8	30.9	29.8	27.0
PAT / T Income	18.9	16.3	20.7	20.1	18.3
RoCE	28.2	13.5	22.8	20.0	18.8
RoNW	21.3	10.4	15.1	13.9	13.2

Source: Company, ICICIdirect.com Research

Exhibit 42: Profit and Loss Account

Rs Crore	FY08	FY09	FY10E	FY11E	FY12E
Brokerage Income	589.7	533.4	719.9	745.4	844.3
Financing and Investment	193.8	265.4	247.6	284.9	351.4
Life insurance & Investment	106.6	48.2	51.4	48.6	55.3
Marketing & online media	78.3	71.3	61.9	73.6	84.7
Othrer Income	55.3	44.9	103.1	95.2	95.4
Total Revenue	**1023.6**	**963.1**	**1183.9**	**1247.6**	**1431.0**
Direct cost	217.0	206.8	257.5	271.9	315.0
Employee Expense	242.6	273.7	297.6	326.3	392.1
Admin & General expense	161.8	190.4	195.1	215.5	265.1
Total Expenditure	621.4	670.8	750.1	813.8	972.2
EBIDTA	**402.2**	**292.3**	**433.8**	**433.9**	**458.8**
EBIDTA margin (%)	39.3	30.3	36.6	34.8	32.1
Amortization/ Depreciation	28.2	39.6	50.4	54.1	56.1
EBIT	374.0	252.7	383.4	379.7	402.7
Interest	91.3	33.2	18.4	9.6	17.4
PBT	282.8	219.5	366.0	371.6	386.9
Total Tax	89.8	62.2	120.7	120.6	125.5
PAT	**159.9**	**144.8**	**229.3**	**236.0**	**245.7**
Growth (%)	111.4	-9.4	58.4	2.9	4.1

Source: Company, ICICIdirect.com Research

Exhibit 43: Balance sheet

	FY08	FY09	FY10E	FY11E	FY12E
Fixed Asset	97.3	277.0	256.6	208.5	166.3
Investments	990.9	315.0	346.5	381.1	419.2
Loans & Advances	1271.3	1361.8	1697.5	2102.0	2524.0
Cash	356.5	626.9	262.9	137.0	22.0
Other current Assets	386.8	247.9	204.6	233.8	279.3
Total Assets	3224.1	2835.7	2775.1	3069.6	3418.0
Equity Capital	57.1	56.7	56.7	56.7	56.7
Prefrence Capital	59.8	11.4	11.4	11.4	11.4
Reserves & Surplus	1372.3	1476.7	1644.7	1817.9	1998.3
Total Networth	1489.2	1544.7	1712.7	1886.0	2066.4
Loans & Borrowing (Debt)	665.0	51.8	60.8	129.8	200.1
Secured loan	100.0	1.7	1.7	1.7	1.7
Unsecured loans	565.0	50.1	59.1	128.1	198.4
Other Current Liabilities	793.4	939.8	686.3	723.5	805.6
Total Liabilities	3224.1	2835.7	2775.1	3069.6	3418.0

Source: Company, ICICIdirect.com Research

Exhibit 44: Cash flow statement

	FY08	FY09	FY10E	FY11E	FY12E
Cash flow from Operating activities					
Net Profit	239	219	366	372	387
Add: Depreciation	28	40	50	54	56
Add: Other Non Cash expense	9	9	-	-	-
Less: Direct taxes paid	100	65	121	121	126
Add: Increase in other liabilities & provisions	448	118	(254)	37	82
Less: Increase in advances*	853	29	336	405	422
Less: Increase in Other current assets	202	(139)	(43)	29	46
Add/(Less): Loans & borrowing/(Repayment)*	495	(613)	9	69	70
Net Cash flow from Operating activities	64	(182)	(241)	(22)	2
Cash flow from Investing activities					
Add/(Less): Sale/(Purchase) of Fixed Assets	(186)	(106)	(30)	(6)	(14)
Add/(Less) Investments in Subsidiaries	(964)	676	(31)	(35)	(38)
Net Cash flow from Investing activities	(1,150)	570	(61)	(41)	(52)
Cash flow from Financing activities					
Add: Proceeds from issue of Share Capital	1,256	10	-	-	-
Add: Proceeds from issue of Preference Share	60	(128)	-	-	-
Less: Dividend paid including tax		-	61	63	65
Net Cash flow from Financing activities	1,316	(118)	(61)	(63)	(65)
Net Increase / (Decrease) in Cash & Cash equivalen	230	270	(364)	(126)	(115)
Add: C&CE at the beginning of the year	127	356	627	263	137
(Increase) / Decrease in Net Current Assets	356	627	263	137	22

*We have coinsidered advances and borrowings as part of operating activites

Source: Company, ICICIdirect.com Research

Annexure

Market turnover expected to rise from hereon…..

The turnover in the stock markets has grown at a healthy CAGR (cash volumes have grown at a CAGR of 19% while the derivative segment has grown at a CAGR of 74% over FY03-FY09). We believe this surge is a function of a host of variables like trend in nominal GDP growth, other macro variables, FII participation, increased participation of local money directly or via the MF route, vibrancy of primary markets, product innovation and regulation and policy framework.

We forecast a 29% CAGR for the stock market turnover over FY09-FY11E. We expect the average daily turnover to inch up to Rs 91,294 crore and Rs 1,03,728 crore in FY10E and FY11E, respectively. Our modelling assumptions are based on the following variables:

Nominal GDP growth: We expect the nominal GDP growth to be at 14% and 14.5% in FY11E and FY12E, respectively. We believe this indicator is a reasonable proxy for FII flows, which highly influence stock market turnover.

Financial savings/GDP ratio: Financial savings, historically, have been skewed towards bank deposits. We now believe this will be favourable for the equity asset class. We have modelled in a ratio of 20% and 20.5% in FY11E and FY12E, respectively. There is a growing trend of more local money getting into equities as is evident from the rise in retail equity clients for all listed brokerages and growth in demat accounts with NSDL and CDSL.

Equity savings/GDP: We believe under-penetration/under ownership of equities in India (5.8% of total financial savings in FY08 and FY09) will be a big driver for increase in market volumes. We are modelling in that 6% and 6.1% of financial savings will be directed into equity directly/indirectly, respectively. This will lead to a rise in market volumes.

Turnover velocity: The above positive factors coupled with buoyancy in the primary market will surely inch up the turnover velocity for the markets. We expect the turnover velocity to be at 1.6% and 1.62% in FY11E and FY12E, respectively.

Exhibit 45: Modelling market turnover

(Rs Crore)	2008	2009	2010E	2011E	2012E
Nominal GDP	4320892	4933183	5549831	6326807	7244194
Growth (%)	13.8	10.7	12.5	14	14.5
Savings/GDP (%)	31.5	33.5	37	36	36
Savings	1361081	1652616	2053437	2277651	2607910
Fiancial Savings/GDP	19.0	19.5	19.5	20.0	20.5
Financial Savings	820969	961971	1082217	1265361	1485060
Equity Savings	47616	55794	64933	75922	90589
Equity Savings/Financial Savings (%)	5.8	5.8	6.0	6.0	6.1
Equity Savings/Total Savings (%)	3.5	3.4	3.2	3.5	3.7
Total annual turnover	18222565	14862809	22001903	25413344	29751832
Indian Retail	10022411	7877289	12012609	14425120	17664787
Others incl prop & FII	8200154	6985520	9989294.1	10988223	12087046
No of trading days	251	243	241	245	245
Average daily turnover	**72600**	**61164**	**91294**	**103728**	**121436**
Growth (%)	70.7	-15.8	49.3	13.6	17.1
Implied turnover velocity (%)	1.7	1.2	1.6	1.6	1.7

Source: Company, ICICIdirect.com Research

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