March 29, 2023

Revenue diversification remains in focus…

The Indian brokerage industry has undergone rapid changes in its business environment in last three fiscals, starting with a surge in customer accretion (client base rising from ~2.1 crore in FY20 to 8.1 crore in February 2023), business volume (~15.8 lakh crore in FY20 to ~163 lakh crore in Q3FY23), pick-up in flat brokerage model to rising proportion of derivatives volumes. In recent quarters, brokerages seemed to undergo a structural shift from aggressive client addition to maintaining profitability amid rising compliance cost, through improvement in unit economics.

The broking segment, especially retail broking, has become increasingly dynamic. Entry of new players, digitisation & disruption, regulations have changed the way business has been shaping up. Brokers are now restructuring their business strategy to diversify revenue streams. Value added services, including wealth management, research, advisory, AMC and financial planning has been the focus to ensure maximum customer's engagement and enrich wealth creation journey of clients. Fund based activity, including margin funding and loan against shares, is expected to enable sustained contribution to earnings. Thus, while brokerages have witnessed an increase in topline, share of pure broking income has been sliding in the overall pie. Further, as per CareEdge, revenue growth for the broking industry is expected to moderate to 10% growth in FY23 to ₹ 28000–30000 crore and be flattish in FY24E with consolidation in industry benefiting some traditional brokers.

Post Covid, the broking industry witnessed a substantial surge in client accretion competitive pricing, increased marketing and digital offerings. Active clients increased from 1 crore in FY20 to 1.8 crore in FY21 and ~3.5 crore in FY22. There was substantial participation from new to market customers from tier-II/III and beyond. However, after reaching a peak of ~3.66 crore in June 2022, active clients have declined and reached ~3.35 crore in January 2023, owing to a large number of clients onboarded earlier being inactive.

Exhibit 1: ADTO trajectory in Indian market

Total daily exchange turnover (₹ lakh crore)	FY21	FY22	Apr'22	Jun'22	Jul'22	Aug'22	Sep'22	Oct'22	Nov'22	Dec'22	Jan'23	Feb'23
Cash total (I)	**0.66**	**0.72**	**0.73**	**0.47**	**0.50**	**0.64**	**0.67**	**0.52**	**0.62**	**0.57**	**0.52**	**0.54**
YoY growth (%)	50.6	9.3		-38.6	-26.9	-6.6	-10.4	-40.4	-12.9	0.0	-25.4	-14.9
Futures	1.1	1.2	1.3	1.1	1.1	1.2	1.3	1.2	1.1	1.0	1.1	
Options	26.2	69.8	104.6	111.1	110.6	135.5	150.7	143.7	146.5	190.7	201.1	
F&O total (II)	**27.3**	**71.0**	**106.0**	**112.2**	**111.7**	**136.7**	**152.0**	**144.9**	**147.6**	**191.7**	**202.2**	**208.2**
YoY growth (%)	77	17		128	96	126	116	100	95	145	119	103
Total (I+II)	**28**	**72**	**107**	**113**	**112**	**137**	**153**	**145**	**148**	**192**	**203**	**209**

Source: NSE, BSE, SEBI, ICICI Direct Research

Sebi has been undertaking tightening of regulations amid increase in derivative volume, which is likely to increase compliance cost for intermediaries and may eventually also lead to a rise in brokerage rates, though timing and extent of price revision of the same is difficult to guess.

Recently, government hiked STT on sale of futures and options to an extent of ~25%. This rise will result in higher cost for participants and, thus, could impact robust momentum seen in volumes over last three fiscals. However, rolling back of ~6% hike in transaction charges (undertaken last year) by NSE is seen partially offsetting the increase in cost for participants. Further, withdrawal of 'Do Not Exercise' facility for trading in stock options is seen to have a limited impact as majority of volumes are undertaken in index options wherein 'Do Not Exercise' facility will be available.

At an aggregate level, moderation in client accretion, tightening of regulations and higher compliance cost are seen leading to a gradual consolidation in the industry. Such anticipated consolidation in the industry is seen as beneficial for existing players, especially incumbents. They are well placed with diversified source of revenue streams.

Sector Update

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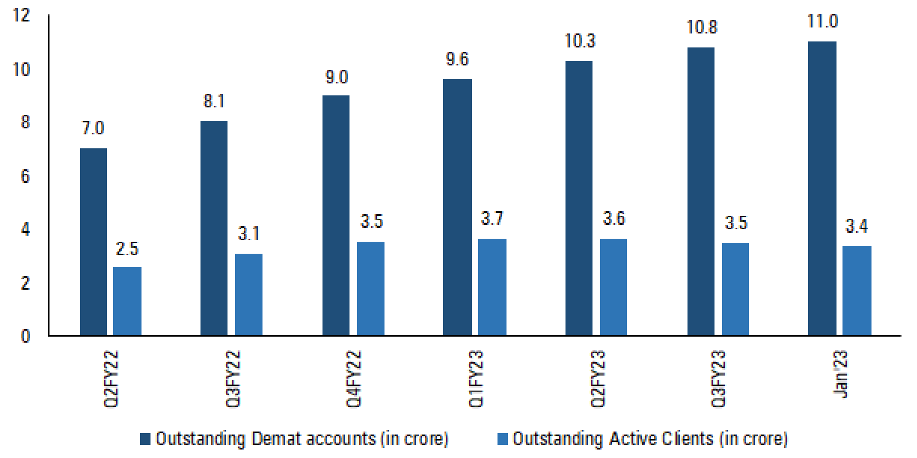
Industry Trend

Moderation in client accretion; active clients peak out

After robust client accretion for nearly 24 months, the industry witnessed a deceleration in the pace of client accretion. In 11 months of FY23, client addition was at ~2.3 crore compared to ~3.46 crore in FY22. In addition, active clients (i.e. clients with at least one trade in the last 12 months) have peaked out and started to decline in recent months. After reaching a peak of ~3.66 crore in June 2022, active clients have declined and reached ~3.35 crore in January 2023, owing to a large number of clients onboarded earlier being inactive.

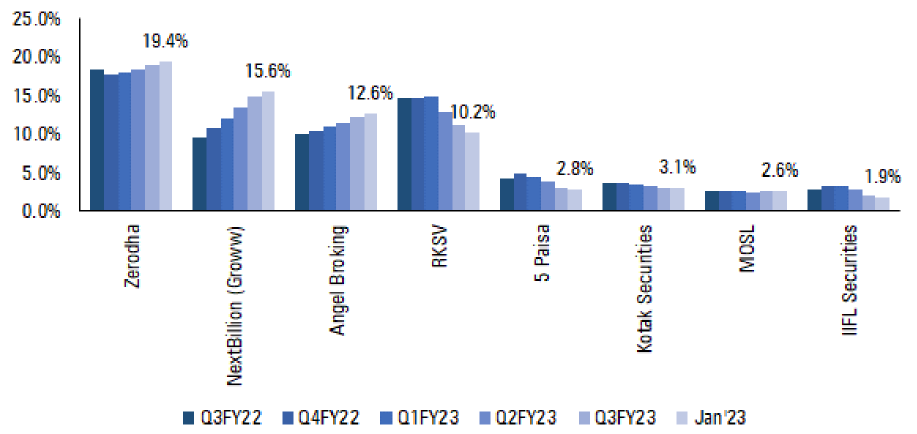
Exhibit 2: Pace of client accretion slows; active clients peak in Q1FY23



Source: CDSL, NSDL, NSE, Sebi, ICICI Direct Research

In 10 months of FY23, the industry witnessed a decline in active clients with varied experience across players. While majority of peers have witnessed a decline in the number of active clients, Zerodha, Groww and Angel continued with positive accretion though the pace has moderated. In terms of market share, incumbents and new players like RKSV and 5Paisa witnessed a moderation in market share. Zerodha, Angel and Groww remain exceptions, among peers, with continued expansion in market share.

Exhibit 3: Player-wise market share in terms of active clients



Source: NSE, ICICI Direct Research

Exhibit 4: Groww surging while RKSV moderating, others steadily growing

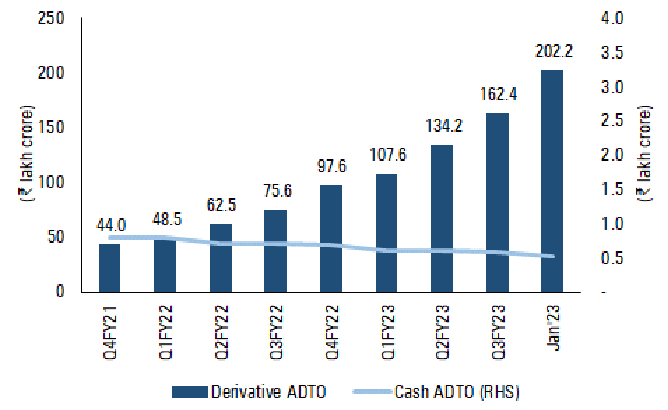
Active Clients (in lakh)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Zerodha	49.5	56.9	62.8	65.8	66.8	65.9
NextBillion Technology (Groww)	20.1	29.6	38.5	44.2	48.9	51.7
Angel Broking	24.6	30.6	36.6	40.3	41.9	42.4
RKSV Securities	38.1	45.5	52.2	54.6	47.1	38.6
HDFC Securities	10.1	10.6	11.4	11.7	11.7	11.3
5 Paisa Capital Ltd	11.6	14.6	17.5	16.5	14.3	10.8
Kotak Securities	9.7	11.1	12.6	12.7	11.5	10.6
Motilal Oswal	7.2	7.9	9.0	9.3	9.1	9.0

Source: NSE, Media sources, Company report, ICICI Direct Research

ADTO continues to surge; volumes skewed towards options

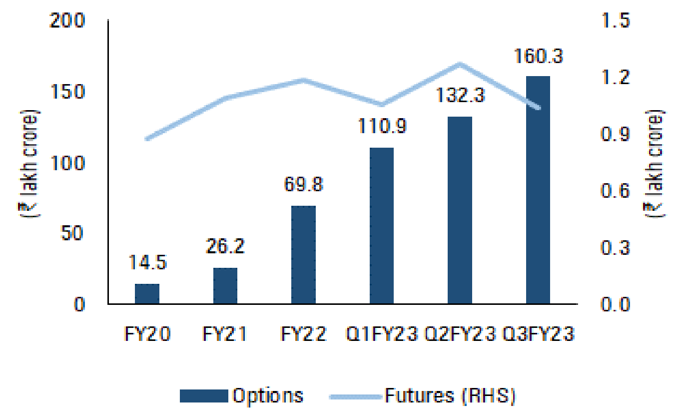
Average daily turnover (ADTO) has been increasing, in line with rising client accretion since March 2020, on the back of buoyant markets and increasing retail participation. The cash segment witnessed an increase in ADTO from ₹ 43889 crore in Q4FY20 to ₹ 79182 crore in Q4FY21. However, the trend peaked out as higher margin requirement kicked in leading to moderation in ADTO to ₹ 57047 crore in Q3FY23. Derivatives, on the other hand, have been witnessing continued increase with more than 10x increase in ADTO from ₹ 15.36 lakh crore in Q4FY20 to ~₹ 44 lakh crore in Q4FY21 and further at ₹ 162 lakh crore in Q3FY23 (₹ 208 lakh crore in February 2023).

Exhibit 5: Derivatives volumes on continuous rise……



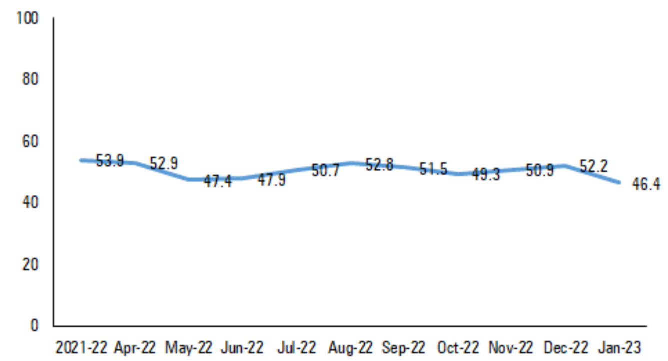
Source: Sebi, ICICI Direct Research

Exhibit 6: …primarily contributed by options



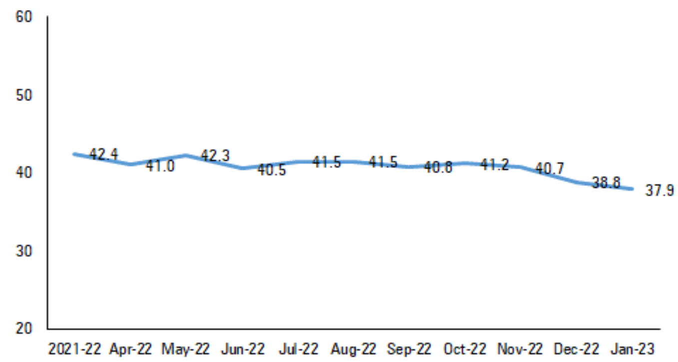
Source: Sebi, ICICI Direct Research

Exhibit 7: Moderation in share of retail in NSE cash turnover



*source: SEBI, ICICI Direct Research *Data pertaining to NSE*

Exhibit 8: Rise in prop trading impact retail share in NSE F&O



*Source: SEBI, ICICI Direct Research *Data pertaining to NSE*

Options primarily contributed to a surge in derivative ADTO in the past few fiscals. ADTO of futures segment has remained broadly steady at ~₹ 1 lakh crore while options witnessed a multifold increase in volume from ~₹ 14.5 lakh crore in FY20 to ~₹ 26 lakh crore in FY21, ~₹ 70 lakh crore in FY22 and ~₹ 200 lakh crore in January 2023. Thus, the proportion of the futures segment has declined from ~5.7% in FY20 to less than 1% in January 2023. Players-wise, derivatives constitute relatively larger share of turnover when compared to incumbents. Sebi also seems to be concerned about a continued rise in derivatives volumes, especially increase in retail participation. Thus, Sebi, with the goal of ensuring safety of retail segment, has been undertaking tightening of rules in the last fiscals. However, options volume continues to remain elevated, though any impact of recent regulations needs to be seen.

Exhibit 9: Player wise ADTO market share (Total)

Brokers	Q4FY22	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Kotak Securities	1.1%	1.2%	1.2%	1.5%	1.8%	2.1%	2.4%	2.8%
MOSL	1.3%	1.2%	1.2%	1.3%	1.3%	1.4%	1.6%	1.8%
IIFL Securities	1.0%	1.1%	1.1%	1.1%	1.1%	1.2%	1.0%	1.0%
Angel Broking	8.4%	9.2%	9.2%	9.1%	8.8%	8.7%	9.0%	8.9%
5 Paisa	1.2%	1.2%	1.3%	1.3%	1.2%	1.3%	1.3%	1.3%

Source: Company, NSE, Sebi, ICICI Direct Research

Exhibit 10: Player wise ADTO (in ₹ crore)

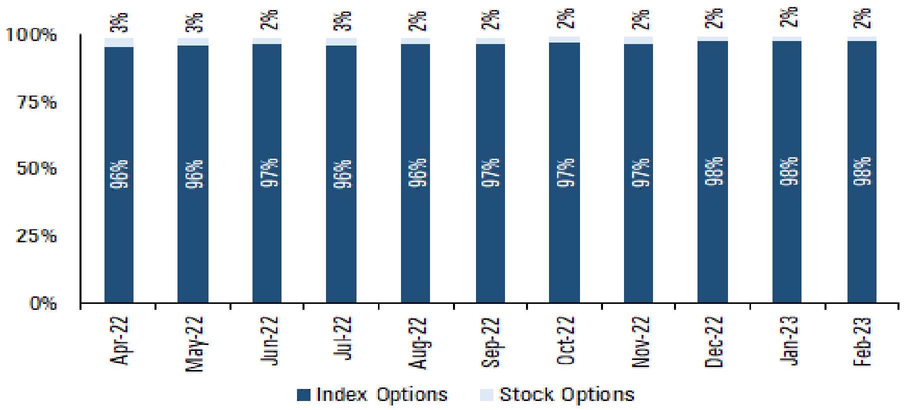
Brokers	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Kotak Securities	49,256	56,836	75,491	1,14,798	1,74,108	2,22,470	3,27,622	4,48,916
MOSL	59,800	57,900	74,300	95,600	1,23,100	1,52,400	2,21,200	2,92,000
IIFL Securities	44,120	52,710	67,530	83,500	1,11,500	1,26,700	1,35,500	1,56,700
Angel Broking	3,75,300	4,54,700	5,79,000	6,94,600	8,62,700	9,39,800	12,20,000	14,47,800
5 Paisa	52,649	57,730	80,878	98,374	1,20,598	1,36,022	1,69,903	2,05,904

Source: Company, NSE, Sebi, ICICI Direct Research

In Finance bill passed in March 2023, government hiked STT (Securities Transactions Tax) on the sale of futures and options. For sale of futures, STT rate has been increased from 0.01% to 0.0125%, which translates to an increase of 25%. Likewise, STT on sale of options has been increased from 0.05% to 0.0625%. Such rise in STT will result in higher cost for participants, especially high frequency traders, which could impact robust momentum seen in volumes over last 3 fiscals. However, rolling back of ~6% hike in transaction charges (undertaken last year) is seen to partially offset the increase in cost for participants. Overall, negative impact of STT hike should be seen, though the same is to be halved by reduction of transaction charges by NSE.

In another move, NSE has announced withdrawal of 'Do Not Exercise' facility for investors trading in stock options from 30 March 2023. The 'Do Not Exercise' facility allows a trader to instruct the broker if they do not wish to exercise the right to give or receive deliveries. Earlier 'Do Not Exercise' facility allowed traders an auto square off of positions with residual amount to be paid. However, with withdrawal of this facility, all stock option contracts that expires in the money will have to be compulsory settled through physical delivery if they have not squared off on expiry date. Thus, this will entail higher margins and thus increase cost for traders. However, **'Do Not Exercise' facility will be available for index options, which forms majority of volumes undertaken on the exchange. Thus, the said withdrawal is seen to have limited impact on volumes ahead.**

Exhibit 11: Index options forms majority of volumes on NSE (No of contracts in %)

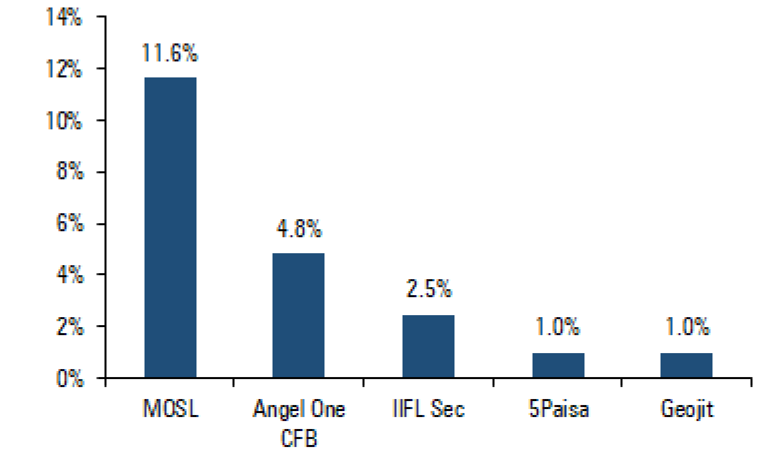


Source: Company, NSE, Sebi, ICICI Direct Research

Steady MTF book to enable sustained diversification in revenue

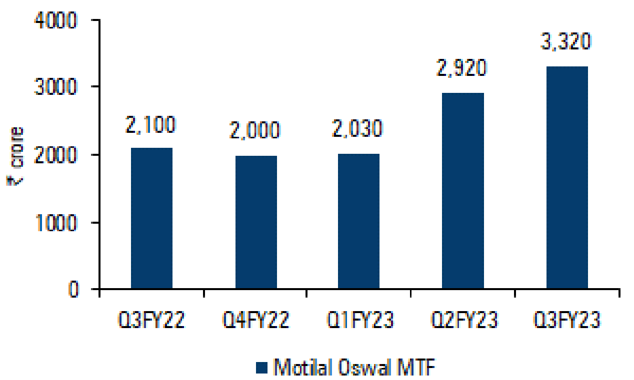
Margin funding i.e. providing funding in lieu of securities held by client in his account, is one of the avenues to generate interest based income for Indian brokers. In the last two fiscals, the margin funding book witnessed healthy growth amid increasing volume and participation. Going ahead, the performance of the lending book would remain sensitive to capital market trend. We expect margin funding book of the brokerage industry, especially larger peers, to remain steady and continue to contribute significantly to revenue.

Exhibit 12: Player-wise market share in MTF (Q3FY23)



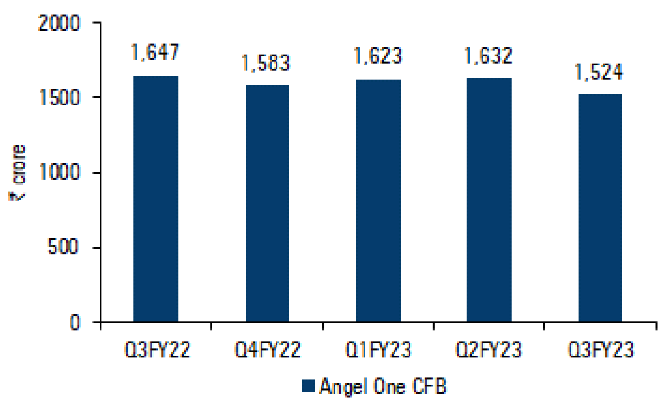
Source: NSE, BSE, SEBI, Company, ICICI Direct Research

Exhibit 13: MOSL MTF book trend



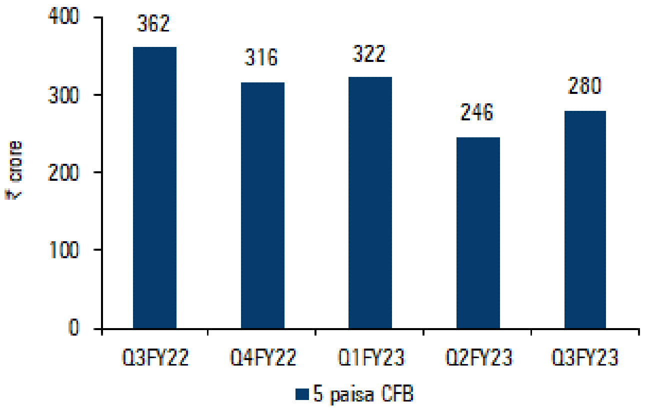
Source: Company, ICICI Direct Research

Exhibit 14: Angel One MTF book trend



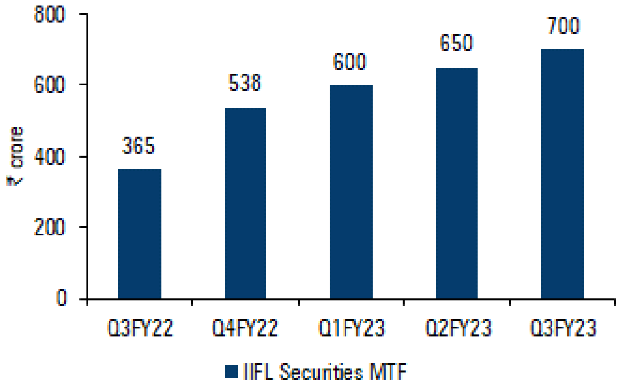
Source: Company, ICICI Direct Research

Exhibit 15: 5Paisa MTF book trend



Source: Company, ICICI Direct Research

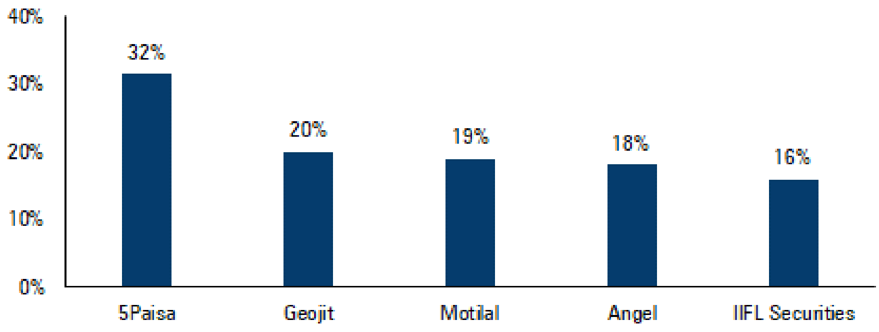
Exhibit 16: IIFL Sec MTF book trend



Source: Company, ICICI Direct Research

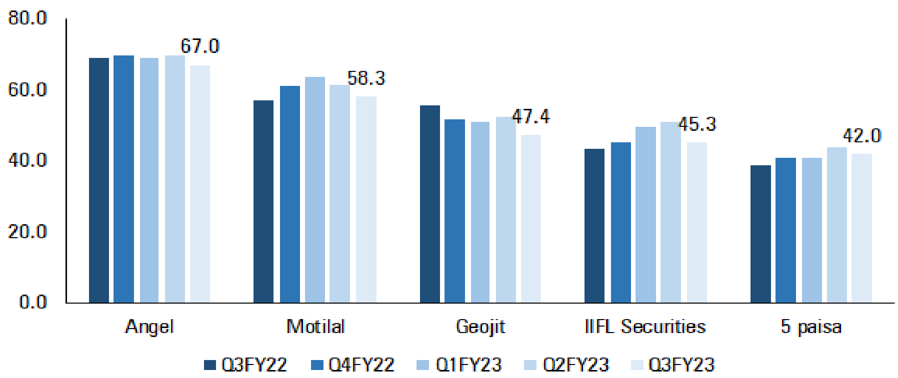
Brokers are focusing on value added services including wealth management, research, advisory, AMC and financial planning has been the focus to ensure maximum customer engagement. Services are offered to enrich wealth creation journey of clients. Fund based activity, including margin funding and loan against shares, is expected to enable sustained contribution to earnings. Thus, while brokerages have witnessed an increase in top-line, share of pure broking income has been sliding in the overall pie.

Exhibit 17: Interest contribution in overall revenue significant and rising (Q3FY23)



Source: Company, ICICI Direct Research

Exhibit 18: Share of pure broking income (as % of revenue) moderating (Q3FY23)



Source: Company, ICICI Direct Research

Increasing compliance may trigger consolidation

The Indian brokerage industry is a market with a large number of intermediaries (1277 BSE registered) with nearly half of turnover contributed by top 10 players (~79% of active clients). Large established brokers, with a strong digital presence, have been able to fare well in terms of business growth and market share in the past.

Sebi seems to be concerned about a continued rise in derivatives volumes, especially increase in retail participation. Thus, Sebi, with the goal of ensuring safety of retail segment, has been undertaking tightening of rules in the last fiscals. 100% margin in cash intraday and F&O new margin rules are fully implemented now. Such tightening in regulations is likely to increase compliance cost for intermediaries, which is likely leading to continued consolidation in the industry. Given increasing regulatory compliance and associated cost, larger brokerages are expected to gradually garner market share while consolidation is expected to continue with the alignment of small brokers with larger established player. Further, higher compliance expense could trigger upward revision in brokerage rates, though timing and extent of price revision of the same is difficult to guess.

Sebi discussion paper - ASBA for stock payment

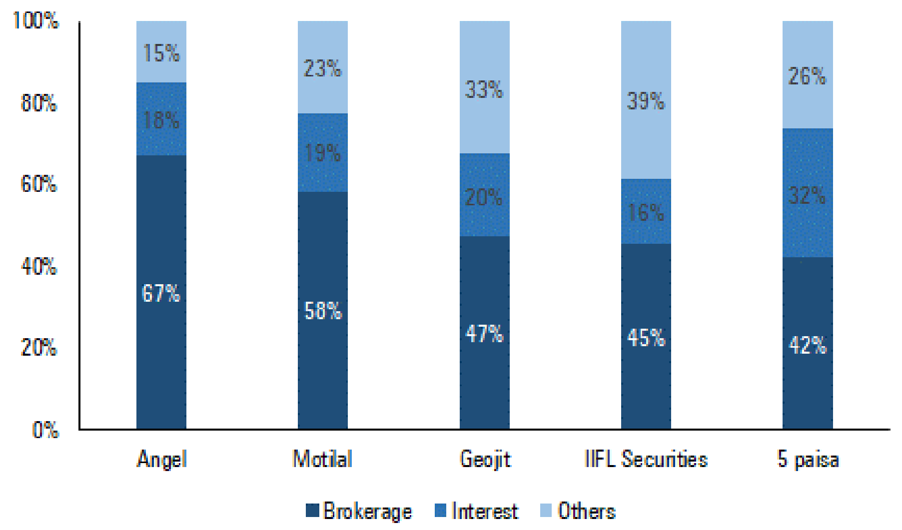
Sebi has proposed a new mechanism – Application Supported by Blocked Amount (ASBA) – wherein a direct channel of fund flow is to be created between the client and the clearing corporation particularly for UPI mode. As per the proposal, funds shall remain in the account of the client but will be blocked in favour of the clearing corporation till the expiry date of the block mandate or till the block is released. This move is to curb any malpractice in handling of client money by brokers and also enable clients to keep earning interest when funds are blocked for trading. This move could impact brokers as it would reduce float money with intermediaries, which have been utilised to avail bank guarantees and deposit with exchanges for position limits. Basically working capital needs will also surge. It may impact new age brokers too as float income as proportion of revenue may be higher than diversified large brokers and share of UPI payments likely to be higher with them.

Traditional players placed well with business model offering diverse streams of product, services over the longer term

Brokerage being the core revenue stream, still accounts for a substantial proportion of revenue for the industry. While new age brokers have been focusing on lower fixed brokerage, large incumbents are gradually attempting to diversify their portfolio offering with rising focus on value added services including advisory & research, financial planning, wealth management and margin trading facility. Thus, the proportion of pure broking income has undergone a gradual decline over the years for a majority of the players. In our view, large established full-service incumbents, with diverse product and services act as one stop for all financial needs of customers and, thus, are well placed to cater to customers as they progress on their wealth creation journey.

In the past few years, the cost structure and operational efficiency of brokerages has improved amid higher utilisation of technology. Further, players are now focussed on quality of customer and payback period to ensure improvement in unit economics. Thus, acquisition of quality revenue-generating customers and providing strong value-added services will remain key to sustainable earnings growth ahead.

Exhibit 19: Revenue break-up player wise (Q3FY23)



Source: Company report, Management talks in media, ICICI Direct Research

Exhibit 20: Earnings summary of players

₹ crore	Angel One		MOSL		IIFL Sec		5Paisa		Zerodha	RKSV	Groww
	FY22	9MFY23	FY22	9MFY23	FY22	9MFY23	FY22	9MFY23	FY22	FY22	FY22
Broking & Fee income	1,574	1,499	1,812	1,422	1,232	950	249	204	4,129	705	324
Interest & Others	724	691	725	647	84	15	49	45	835	72	45
Revenue	**2,297**	**2,190**	**2,537**	**2,069**	**1,316**	**965**	**298**	**248**	**4,964**	**776**	**369**
Expense	1,460	1,360	1,587	1,586	914	743	280	209	2,164	1,221	359
PBT	837	830	650	483	402	222	19	39	2,800	-445	9
PAT	**625**	**623**	**490**	**359**	**306**	**163**	**14**	**29**	**2,094**	**-445**	**7**

Source: Company, ICICI Direct Research, Non listed from MCA

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