IIFL Capital Services Ltd — Oct 2022 Quarterly Analysis

1. VERDICT & BUSINESS QUALITY SNAPSHOT

Result: Beat **One-line:** Profitability normalized sharply (PAT +150% QoQ) as the one-off MTM hits of Q1 subsided and distribution income rebounded, though regulatory changes to client fund settlements pose a looming threat to high-margin float income.

Dimension	This Quarter	Signal / Evidence	Sentiment
Beat/Miss vs Guidance / Prior Quarter	Beat	PAT of □100.6 Cr recovered from □40.3 Cr in Q1; Revenue up 10% QoQ.	□
Earnings Quality	Moderate	Recovery driven by absence of Q1 MTM losses, but float income risk is rising.	□
Guidance Confidence	Neutral	Mgmt optimistic on IB pipeline and IPOs but cautious on market volatility/F&O peaks.	□
Management Credibility	Stable	Transparent about regulatory impacts and cost stickiness in technology.	□
Business Quality Signal	Stable	Strong recovery in Distribution and Retail Broking; Institutional lumpy.	□
Key Q&A Exchange	Q2 Float Income	Mgmt admitted new payout rules will "directionally" reduce float income.	□
The Street's Primary Anxiety	Regulatory Headwinds	Impact of mandatory quarterly settlement of client funds on float earnings.	□
Capital Cycle Stage	Consolidation	Digesting high FY22 headcount/tech spends amidst a shifting regulatory landscape.	□
Margin / Return Ratio Trajectory	Improving	PBT recovered significantly from Q1 lows as revenue base expanded.	□
Pricing Power	Stable	Holding market share in cash segment (□1,700 Cr avg daily turnover).	□
FCF Conversion & Quality	Not in document	CFO data not provided in PPT or Concall.	□
Competitive Moat Signals	Stable	Research-backed approach and open architecture in distribution are sustaining ARPU.	□
Balance Sheet Strength	Strong	Net worth grew to □1,290 Cr from □1,180 Cr (H1 YoY).	□
Working Capital Efficiency	Deteriorating	Settlement money taking 3-4 days to return post-mandatory payout.	□
Mgmt Guidance Track Record	Reliable	Delivered on IB execution (6 transactions) despite volatile markets.	□
Key Vulnerability / Red Flag	Float Income Erosion	Mandatory payouts (Oct 7) likely to hit interest income in Q3/Q4.	□
Management Tone	Cautious Optimism	Positive on retail/distribution but wary of "stupendous" F&O levels.	□

Sentiment: □Neutral **Key Takeaways: Positives:** * **Earnings Normalization:** PAT recovered to □100.6 Cr (implied) as the □294.8 Cr revenue base of Q1 expanded to □323 Cr, largely due to the absence of the prior quarter's MTM losses on BSE shares. * **Distribution Strength:** Income grew 33% QoQ to □54 Cr, proving the

"open architecture" model's ability to capture wallet share beyond pure broking. * **Operational Resilience:** Despite mandatory industry-wide fund payouts on Oct 7, 85% of client money returned to the platform within 4 days, minimizing long-term liquidity impact.

Negatives: * **Float Income Risk:** Management explicitly conceded that new SEBI settlement rules will likely reduce interest income from client floats, a high-margin revenue stream. * **Cost Rigidity:** Admin and tech costs remain a "wild card," with management indicating tech spend is non-negotiable for competitive positioning, keeping the fixed cost base high. * **F&O Saturation:** Management expressed concern that derivative volumes (now 99% of total turnover) may have "peaked," suggesting a potential slowdown in the primary growth engine. * **Forward Watchpoint:** Monitor the "Net Interest Income" or "Float Income" line in Q3/Q4 to quantify the actual impact of the new quarterly settlement cycle.

---

2. BUSINESS PERFORMANCE

2A. KEY METRICS

Metric	Current Qtr	YoY Change	QoQ Change	Trend	Mgmt Commentary
Total Revenue	₹323.0 Cr	↑ 14%	↑ 10%	↑	Growth driven by 12% jump in brokerage and 33% in distribution.
PAT (Implied)	₹100.6 Cr	↑ 22%	↑ 150%	↑	Recovery from Q1 MTM losses and higher operating leverage.
Brokerage Income	₹163.0 Cr	↑ 14%	↑ 12%	↑	Volume growth in both retail and institutional segments.
Distribution Income	₹54.0 Cr	↑ 6%	↑ 33%	↑	Strong cross-sell of mutual funds and insurance products.
Investment Banking	₹24.0 Cr	↓ (Large)	↓ 16%	↓	Lumpy nature; income recognized only on deal closures.
Finance Cost	₹19.0 Cr	↓ 37%	↑ 2%	→	Lower YoY as high IPO funding costs from last year were absent.
Employee Cost (H1)	₹175.5 Cr	↑ 24%	↓ (Est)	↓	YoY rise due to headcount and annual increments.
Admin & Other (H1)	₹235.1 Cr	↑ 26%	↑ (Est)	↓	Driven by sub-brokerage payouts, marketing, and tech.
Avg Daily Turnover	₹1,35,000 Cr	Not in doc	↑ 7%	↑	Primarily driven by stupendous rise in options volumes.
Cash Segment ADTO	₹1,700 Cr	Not in doc	↑ 13%	↑	Cash volumes improving alongside derivative momentum.
Net Worth	₹1,290 Cr	↑ 33%	↑ 9%	↑	Strong internal accruals improving capital base.

2B. SEGMENT BREAKDOWN

Segment	Revenue (□ Cr)	YoY Growth	Margin	Trend	vs Company Avg	Key Development
Retail Broking	□163.0*	↑ 14%	Not stated	↑	In-line	Targeted at affluent tech-savvy customers; open architecture.
Distribution	□54.0	↑ 6%	High	↑	Above Avg	Significant QoQ jump; scaling mutual funds/PMS.
Investment Bank	□24.0	↓ (Large)	Very High	↓	Above Avg	6 transactions completed in Q2; focus on ECM.
Institutional	Included in Broking	Not stated	Not stated	↑	In-line	One of the leading domestic institutional brokers.

**Note: Brokerage revenue reported as combined in concall.*

3. MANAGEMENT OUTLOOK & EXECUTION TRACKER

Dimension	Category	Management Target / Claim	Required Run-Rate / Mathematical Feasibility	Historical Delivery (Did they do what they promised last Q?)	Risk Flag
Guidance	Margins	Float income reduction expected.	Requires higher brokerage/dist. to offset high-margin float loss.	Missed (Float income now under regulatory pressure).	**High**
Guidance	IB Pipeline	Optimistic for next few months.	Dependent on market stability for IPO activity.	Delivered (6 deals closed in Q2 vs 3 in Q1).	**Medium**
Strategy	Technology	Tech is a "wild card" for spend.	Continuous investment needed to maintain platform preference.	Delivered (Admin costs up 26% H1 YoY).	**Medium**
Strategy	Customer Base	Focus on affluent/ tech-savvy.	High-yield focus needed as discount brokers squeeze mass market.	Ongoing (Research-led strategy).	**Low**
Macro	F&O Volumes	Concerned about peak volumes.	99:1 derivative/cash ratio suggests limited further skew.	Correctly identified shift to options.	**High**
Balance	Capital Base	Net worth growth (□12.9 Bn).	Internal accruals sufficient to support growth.	Delivered.	**Low**

4. ANALYST Q&A

Q#	Relevance (1–5)	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded / Not Addressed	Credibility (1–5)	Verdict
1	4.5	Prayesh Jain / Motilal Oswal	Regulatory Impact	Financials	What happened at the time of payout that changed the rule change, did you face any challenges?	Management stated the Oct 7 payout was industry-wide and smooth, with almost all brokers having technology/ systems in place. This validates the firm's operational robustness, though the temporary 3-4 day lag in funds returning indicates a short-term liquidity dip for clients.	None	5.0	Clear and quantified
1a	5.0	Prayesh Jain / Motilal Oswal	Float Income	Financials	Is there a threat that the float income would reduce substantially going ahead?	Management admitted that the probability of float income reduction is "directionally correct" due to the new quarterly settlement rules. This is a direct hit to high-margin interest income, requiring a volume or distribution spike to maintain ROE.	Magnitude of impact	3.5	Deflected — key signal
2	3.0	Prayesh Jain / Motilal Oswal	Technical Rules	Governance	What happens if the broker wise hits [limits]?	Management did not have a technical answer regarding whether	The technicality of the limit	1.0	Evasive / Unprepared

Q#	Relevance (1–5)	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded / Not Addressed	Credibility (1–5)	Verdict
						multiple cards/group entities can bypass market-wise position limits. This highlights a potential lack of readiness for extreme scaling risks in the F&O segment.			
3	4.5	Prayesh Jain / Motilal Oswal	Market Sentiment	Management Commentary	Is there further room of growth in terms of F&O volumes or have we peaked?	Management confessed they are "concerned" and "afraid to stick their neck out" after missing the peak calls for a decade, noting the 99-1 skew toward derivatives. This signals a internal belief that the primary revenue driver is nearing a saturation point.	None	4.0	Directional with caution
4	4.0	Prayesh Jain / Motilal Oswal	Primary Markets	Management Commentary	How do you see the primary market behaving from now on?	Management is optimistic for the next few months provided markets stay stable, though they expect it to be lower than last year's "blowout" performance. Success here is beta-	None	4.0	Consistent with macro

Q#	Relevance (1–5)	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded / Not Addressed	Credibility (1–5)	Verdict
						dependent, making this a volatile revenue stream.			
5	4.0	Varship Shah / Envision Capital	Cost Structure	Financials	Other expenses have gone up significantly; wanted more info on investment in tech and employees?	Management identified technology and marketing as the primary drivers, calling tech a "wild card" where they must keep investing. This confirms a structurally higher and somewhat uncontrollable fixed cost base.	Specific tech ROI	3.0	Vague but consistent

PATTERN FLAGS & SENTIMENT The analyst interaction was dominated by the **Regulatory Payout Pivot**. Multiple questions sought to quantify how the mandatory return of client funds would impact the firm’s liquidity and float-based interest income. Management’s defensive yet honest admission that float income would "directionally" decline indicates that the high-margin era of holding client cash is ending, a concern that will likely dominate the Q3 results as the full impact is booked.

Analyst Sentiment Verdict: Analysts were professionally skeptical regarding the margin profile. While the revenue recovery was welcomed, the friction point was the sustainability of F&O volumes and the unavoidable cost of technology. Management’s credibility is stable on operations but under watch for how they will defend margins against the regulatory "float" headwind. The greatest risk remains the mismatch between a fixed tech/ employee cost base and a potentially peaking F&O market.

---

5. WHAT CHANGED vs PRIOR QUARTER

What Changed	Prior Quarter (Q1 FY23)	This Quarter (Q2 FY23)	Direction
Revenue	₹294.8 Cr	₹323.0 Cr	↑ Improving
PAT	₹40.3 Cr	₹100.6 Cr (Implied)	↑ Improving
Distribution Income	₹40.0 Cr	₹54.0 Cr	↑ Improving
IB Realization	₹29.0 Cr	₹24.0 Cr	↓ Deteriorating
Regulatory Risk	Potential rule changes	Effective mandatory payout (Oct 7)	↓ Deteriorating
ADTO (Turnover)	₹1,26,000 Cr	₹1,35,000 Cr	↑ Improving
Cash Segment ADTO	₹1,500 Cr	₹1,700 Cr	↑ Improving
Mgmt Stance on F&O	Growth focus	"Concerned" about peak levels	↓ Cautious

STOP HERE.