

Central Depository Services Ltd

High entry barriers provide bright future

Central Depository Services Ltd (CDSL) is one of the two depositories operating in India, which facilitate the holding of securities in electronic form and enable securities to be processed by book entry. It was originally promoted by BSE, which subsequently divested part of its stake to leading banks as its sponsors.

Depository services – Duopoly market with high entry barriers: The Indian depositories market is shared by two players i.e. CDSL and NSDL promoted by BSE and NSE. The business is highly regulated with entry barriers in place, and hence, the market is likely to remain duopoly in nature. With little threat of new entrants coming in the incremental business is to be shared by both CDSL & NSDL and this makes the business model quite interesting.

CDSL has wide base of revenue sources: CDSL has wide source of revenues, 35% from the annual issuer charges (which is recurring in nature) and 21% from transactions having some correlation with volumes in the markets. Another 13% comes from online data charges. As the capital markets have remained buoyant, there has been an increasing trend of new listings, and thus, CDSL has generated 11% of its revenues from the IPO/ Corporate action charges. Hence, broadly speaking, the revenue base of CDSL is quite diversified.

Decent growth in number of demat accounts: The number of demat accounts of CDSL has grown at a CAGR of 8.6% over FY2011-17 to 12.3 mn, compared to 5.1% for NSDL over the same period to 15.6 mn. While CDSL has an overall market share of 43% in the cumulative demat accounts, on the incremental accounts opened, it had a market share of 59% in FY2017. With capital markets remaining buoyant, the growth in demat accounts is likely to remain strong.

Revenue/PAT CAGR of 10%/12% over FY13-17, likely to sustain: Charges levied by CDSL to its clients like DPs are regulated by SEBI. However, a decent growth in number of accounts has ensured revenue/PAT CAGR of 10%/ 12% over FY13-17. With markets remaining buoyant and increasing share of financial savings in India, we expect the growth momentum to sustain going ahead as well.

Outlook & Valuation: CDSL has a unique business model with high entry barriers coupled with decent growth prospects. The average ROE for the last six years has been ~17%, which we believe will sustain going ahead as well. The incremental capital required for doing business in this space is very minimal and this makes it an interesting business model. **At the issue price band of ₹145-149, the stock is offered at 17.7x-18.2x its FY2017 EPS, which we believe is reasonably priced, and hence, recommend SUBSCRIBE to the issue.**

Key Financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015	FY2016	FY2017
Operating Income	90.7	88.9	105.3	122.9	146.0
% chg	(6)	(2)	18	17	19
Net profit	49.9	49.4	57.7	90.9	85.8
% chg	(10)	(1)	17	58	(6)
EPS (₹)	4.8	4.7	5.5	8.7	8.2
Book Value (₹)	31.4	33.8	35.3	39.4	51.0
P/E	31.2	31.6	27.0	17.1	18.2
P/BV (x)	4.7	4.4	4.2	3.8	2.9
RoE (%)					

SUBSCRIBE

Issue Open: June 19, 2017
 Issue Close: June 21, 2017

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹104.5cr

Offer for Sale: 3.52cr Shares

Fresh issue: ₹ 0cr

Post Eq. Paid up Capital: ₹104.5cr

Issue size (amount): *₹510cr - **524cr

Price Band: ₹145-149

Lot Size: 100 shares and in multiple thereafter

Post-issue implied mkt. cap: *₹1,515cr - **₹1,557cr

Promoters holding Pre-Issue: 50.05%

Promoters holding Post-Issue: 24%

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Pattern

Promoters	24%
Others	76%

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Company background

Central Depository Services (India) Limited (CDSL) commenced depository business in 1999. The depository system in India is ₹240cr market (FY2016) comprising of two depositories CDSL & NSDL. As a security depository, CDSL facilitates holding of securities in electronic form and enables security transactions, including off market transfer and pledge to be processed by book entry. CDSL was initially promoted by the BSE, which subsequently divested part of its stake to leading Indian banks. As on 30th April, 2017 CDSL had 589 registered DPs as its clients and 12.4 million investor accounts. It had a 59% market share of incremental BO (Beneficiary Owners) accounts in FY2017 and the net BO accounts grew by 13.68% in FY2017. CDSL has connectivity with all the leading stock exchange of India viz. BSE, NSE and Metropolitan Stock Exchange.

It offers services to a range of clients

- (1) **Depository participants (DP) and other capital market intermediaries:** offers dematerialization for a wide range of securities.
- (2) **Corporates:** Offers facilities to issuers to credit securities to shareholders or applicant's demat account to give effect to a range of non cash corporate events.
- (3) **Capital market intermediaries:** Offers KYC services in respect of investors in Indian capital markets to capital market intermediaries including mutual funds.
- (4) **Insurance Companies:** Offers facilities to allow holding of insurance policies in electronic form to the policy holders of several insurance companies.
- (5) **Others:** Offers other online services such as e-voting, e-locker, National Academy Depository, etc.

Scope and functions of a depository like CDSL

- A depository facilitates holding of securities in the electronic form and enables securities to be processed by book entry.
- The Depository Participants (DP), who acts as an agent of the depository offers depository services to investors.
- According to SEBI guidelines, financial institutions, banks, custodians, stock brokers are eligible to act as DPs.
- The investor who is known as Beneficiary Owner (BO) has to open a demat account through any DP for dematerialization of his holdings and transferring securities.
- The balances in the investor accounts recorded and maintained with CDSL can be obtained through the DP.
- The DP is required to provide the investors, at regular intervals, a statement of account, which gives the details of the securities holdings and transactions.

Issue details

CDSL is offering 3.52cr equity shares of ₹10 each via book building route in price band of ₹145-149/share, entirely comprising offer for sale by current BSE limited.

Exhibit 1: Pre and Post-IPO shareholding pattern

	No. of shares (Pre-issue)	(%)	No. of shares (Post-issue)	(%)
Promoters	5,22,97,850	50.0%	2,50,80,000	24.0%
Others	5,22,02,150	50.0%	7,94,20,000	76.0%
Total	10,45,00,000		10,45,00,000	

Source: RHP

Exhibit 2: Top 10 share holders (%)

BSE Ltd	50.1
State Bank Of India	9.6
HDFC Bank Ltd	7.2
Standard Chartered Bank Ltd	7.2
Canara Bank	6.5
Bank Of India	5.6
Bank Of Baroda	5.1
LIC	4.2
Union Bank Of India	1.9
Bank Of Maharashtra	1.9

Source: Company, Angel Research

Objects of the offer

- The objects of the offer are to achieve the benefits of listing the Equity Shares on NSE and for the sale of Equity Shares by the Selling Shareholders.
- The Company expects that listing of the Equity Shares will enhance its visibility and brand image and provide liquidity to its existing Shareholders.

Investment rationale

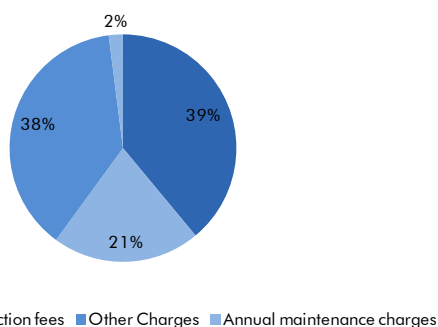
Wide source of revenues: CDSL has wide source of revenues at its privilege. Nearly 39% of the revenues come from the annual listing fees, which are steady in nature. Further, 21% of the revenues come from the transaction charges, which it levies on the DPs. While the transaction charges has co-relation with the markets and can be volatile based on volume of transactions, the annual charges fees insulates the company from any major volatility. On comparative basis, NSDL derives only 7% of its revenues from the annual fees and 51% of the revenues from the transaction charges. This lends higher revenue visibility for CDSL compared to NSDL.

Exhibit 3: Revenue Bifurcation of CDSL

Sources of revenues (₹ cr)	FY15	FY16	FY17
Annual Issuer Charges	36	48	52
Transaction Charges	28	26	31
Online data charges	15	15	19
IPO/ Corp action charges	6	11	17
ECAS Charges		2	8
Document storage charges	5	5	5
E-Voting charges	5	5	4
Others	11	11	11
Total	105.2	122.8	146.0
Annual Issuer Charges	34%	39%	35%
Transaction Charges	27%	21%	21%
Online data charges	14%	13%	13%
IPO/ Corp action charges	6%	9%	11%
ECAS Charges	0%	2%	5%
Document storage charges	5%	4%	4%
E-Voting charges	5%	4%	3%
Others	10%	9%	7%
Total	100%	100%	100%

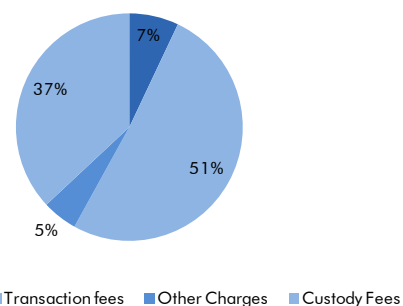
Source: RHP

Exhibit 4: Sources of revenue CDSL



Source: RHP

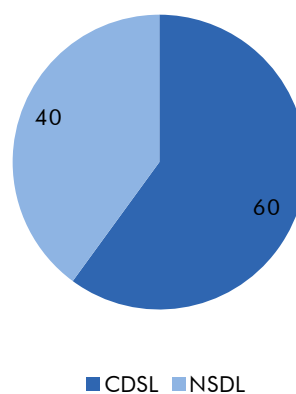
Exhibit 5: Sources of revenue NSDL



Source: RHP

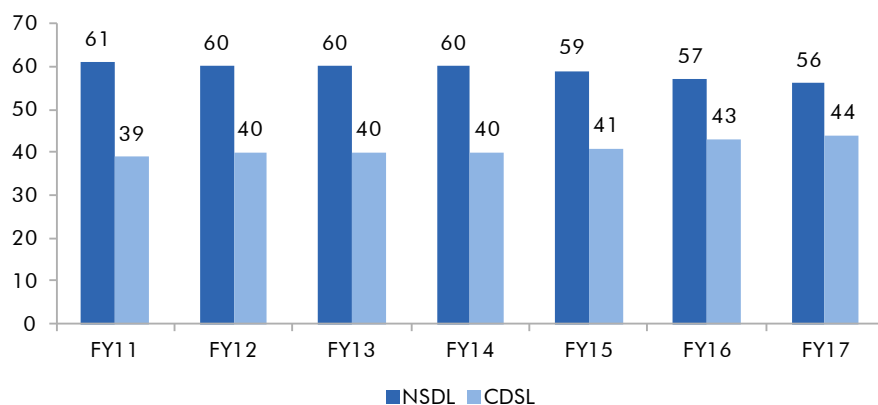
Depository services is a duopoly market with high entry barrier: In India there are two depositories i.e. CDSL and NSDL promoted by the two leading stock exchanges BSE and NSE, the operations of these depositories is highly regulated. With strong entry barriers in place, the market is likely to remain duopoly in nature, and hence, all the incremental business is to be shared by both CDSL & NSDL. This makes the business model quite interesting. While CDSL has an overall market share of 43% in the cumulative demat accounts, on the incremental demat accounts opened, it had a market share of 59% in FY2017.

Exhibit 6: Incremental market share (%)



Source: RHP

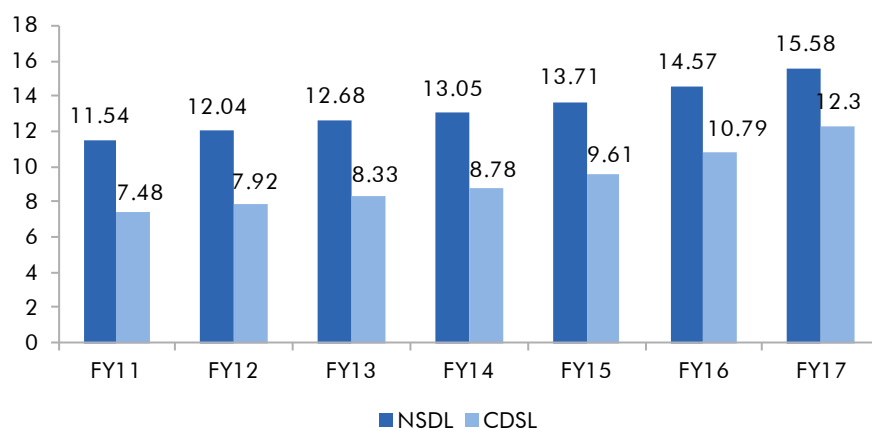
Exhibit 7: Market share trend (%) of CDSL & NSDL



Source: RHP

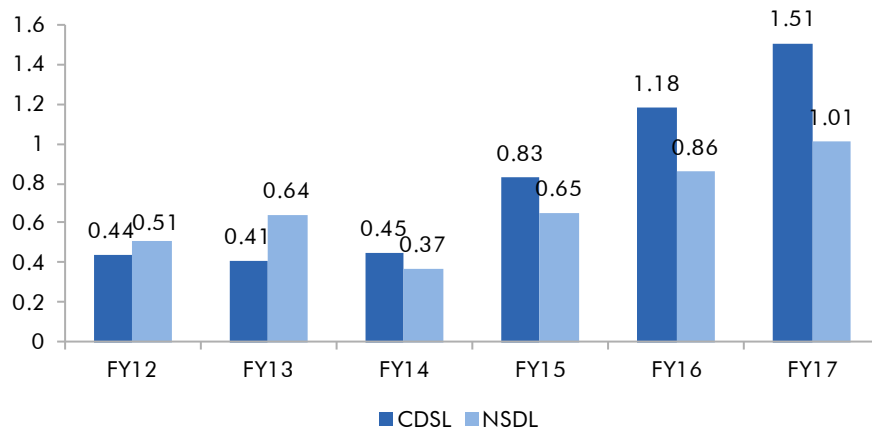
Decent growth in number of demat accounts: CDSL's number of demat accounts has grown at a CAGR of 8.6% over FY2011-17 to 12.3 mn, compared to 5.1% for NSDL over the same period to 15.6 million. While CDSL has an overall market share of 43% in the cumulative demat accounts, on the incremental demat accounts opened, it had a market share of 59% in FY2017. The table below shows that in the last four out of six years, CDSL had generated higher incremental accounts compared to its competitors NSDL. With capital markets remaining buoyant the growth in demat accounts is likely to remain strong going ahead.

Exhibit 8: Demat account growth trend (millions)



Source: RHP

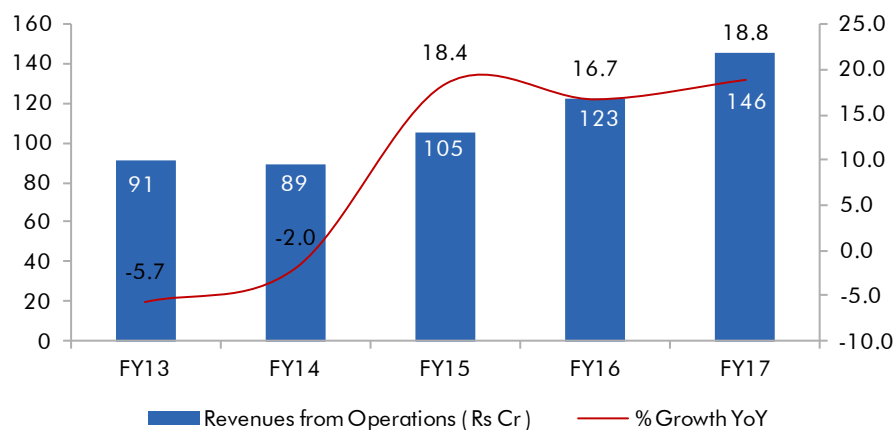
Exhibit 9: Incremental demat accounts opened (millions)



Source: RHP

Revenue/PAT CAGR of 10%/12% over FY2013-17, likely to sustain over next few years: The charges levied by CDSL to its clients like DPs are regulated by SEBI. However, a decent growth in number of accounts has ensured revenue growth of 10% and PAT growth of 12% over FY2013-17. With markets remaining buoyant, we expect the growth momentum to sustain going ahead as well

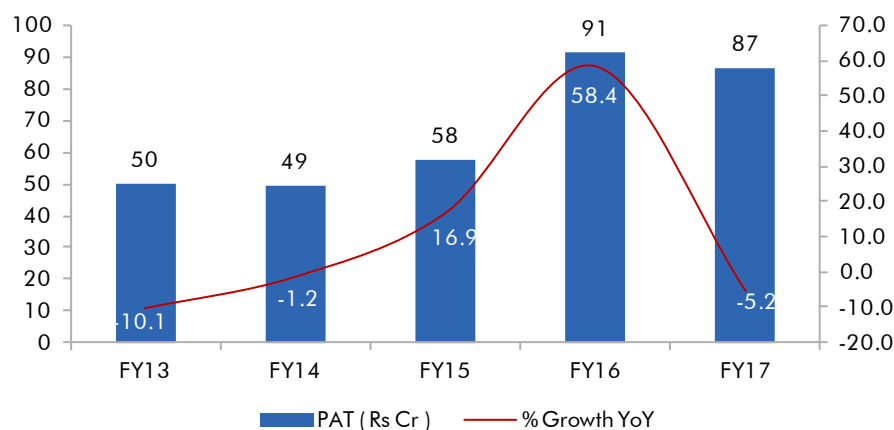
Exhibit 10: Revenue growth trend (₹ cr)



Source: Company, Angel Research

While ~21% of the company's revenues is derived from the transaction charges which is linked to market based trading volumes, a fairly large part i.e. 35% of the revenues is derived from the annual issuer charges and 13% from the online data charges, and hence, we believe that in addition to a decent growth in the revenue, the company will be able to maintain stable margins.

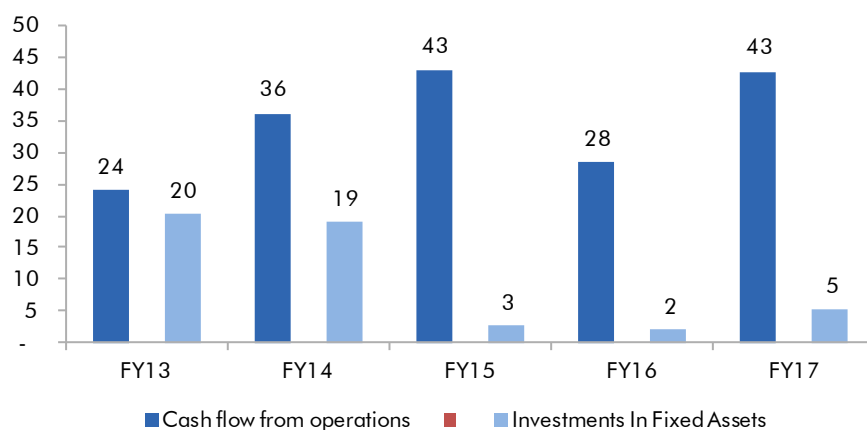
Exhibit 11: PAT growth trend (₹ cr)



Source: RHP

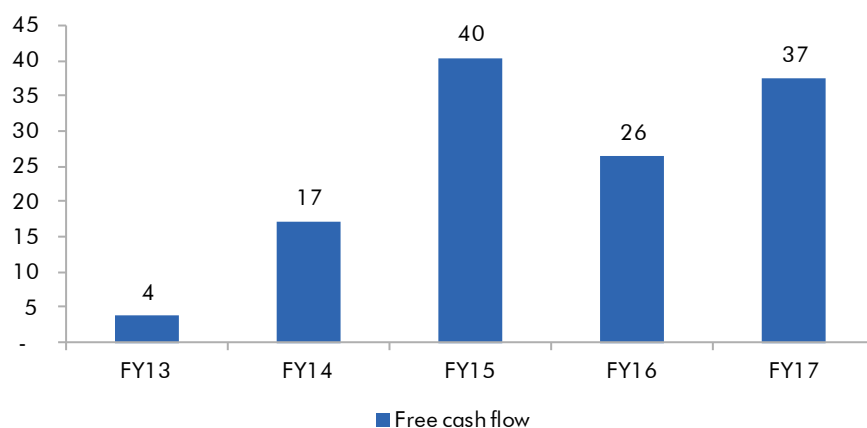
Strong free cash flow generation can be used for higher dividend payouts: The working capital requirements are very minimal in case of CDSL due to its nature of business, and hence, the cash flow operations have been healthy on a continuous basis. Over FY2013-17 the cumulative cash flow from operations for CDSL was ₹174 cr, while the investments in fixed assets were to the tune of ₹49 cr only. This resulted in strong cumulative fresh cash flows of ₹125 cr over the last five years. The average dividend payout of CDSL for the last five years is ~38% and with low capital investment requirements going ahead, the company can very much maintain the current dividend payout ratio.

Exhibit 12: Cash flow and Investments in fixed assets (₹ Cr)



Source: RHP

Exhibit 13: Free Cash Flow Generations (₹ Cr)



Source: RHP

Outlook & Valuation

CDSL has a unique business model with high entry barriers coupled with decent growth prospects. The average ROE for the last six years has been ~17%, which we believe will sustain going ahead as well. The incremental capital required for doing business in this space is very minimal and this makes it an interesting business model. **At the issue price band of ₹145-149, the stock is offered at 17.7x-18.2x its FY2017 Earnings, which we believe is reasonably priced, and hence, recommend SUBSCRIBE to the issue.**

Key Concerns:

- CDSL operates in a highly regulated industry. The various charges levied by CDSL to its users and clients are regulated by the market regulator SEBI. Inability to increase the pricing when cost goes up can impact the profitability.
- A large proportion of the business is transaction related and dependent on trading volume. Further, the business of the organization has direct correlation with the level of delivery based volumes and price levels on major stock exchanges. Hence, any declines in trading volume and market liquidity could adversely affect the operations of the company.

Exhibit 14: Income Statement

Income Statement (₹ cr)	FY13	FY14	FY15	FY16	FY17
Revenues from Operations	90.7	88.9	105.3	122.9	146.0
- YoY Growth (%)	(6)	(2)	18	17	19
Employee Expenses	17.2	17.5	19.2	21.5	24.9
- YoY Growth (%)	38	2	10	12	16
Other Expenses	37.9	38.8	39.8	36.3	41.5
- YoY Growth (%)	64	2	3	(9)	14
Total Expenses	55.0	56.2	59.0	57.8	66.4
- YoY Growth (%)	55	2	5	(2)	15
EBITDA	35.7	32.7	45.2	63.9	79.4
- YoY Growth (%)	(41)	(8)	38	41	24
Depreciation	2.6	5.0	6.2	4.2	3.7
- YoY Growth (%)	(35)	90	26	(33)	(12)
Other Income	33.3	33.9	40.2	38.5	40.8
- YoY Growth (%)	36	2	19	(4)	6
Profit Before Tax	66.4	61.6	79.1	98.2	116.6
- YoY Growth (%)	(18)	(7)	28	24	19
Exceptional Items	0.0	0.0	1.7	33.1	0.0
PBT After Exceptional Item	66.4	61.6	80.8	131.3	116.6
Prov. for Taxation	15.4	12.7	23.3	40.2	30.0
- as a % of PBT	23.2	20.5	28.9	30.6	25.7
PAT	49.9	49.4	57.7	91.3	86.6
- YoY Growth (%)	(10)	(1)	17	58	(5)

Source: RHP

Exhibit 15: Balance Sheet

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17
Share Capital	105	105	105	105	105
Reserve & Surplus	224	249	312	375	429
Net Worth	329	353	416	479	533
Minority Interest	12.4	13.6	14.6	14.7	15.5
Other Long Term Liabilities	21.6	21.8	22.9	22.9	23.2
Total Current Liabilities	54.2	67.0	56.6	32.6	33.9
Total Non Current Liabilities	0.0	0.0	1.4	3.4	1.4
Total Liabilities	417	456	511	553	607
Total Fixed Assets	9.8	9.8	6.7	3.7	5.5
Total Non Current Assets	42	62	259	240	298
Investments	316	331	191	247	230
Trade Receivables, Loans & advances & other CA	13.4	11.9	8.8	15.2	15.8
Cash & Cash equivalents	35.3	41.0	43.1	40.4	48.3
Other Current Assets	0.0	0.0	3.3	6.5	9.7
Total Assets	417	456	511	553	607

Source: RHP

Exhibit 16: Key Ratios

	FY13	FY14	FY15	FY16	FY17
Per Share Data (₹)					
EPS	4.8	4.7	5.5	8.7	8.2
BVPS	31.4	33.8	35.3	39.4	51.0
DPS	2.0	2.0	2.2	2.5	3.0
Valuation Ratios					
P/E	31.2	31.6	27.0	17.1	18.2
P/BV	4.7	4.4	4.2	3.8	2.9
EV/ EBITDA	33.7	36.2	29.1	20.1	16.1
EV/Sales	13.3	13.3	12.5	10.5	8.8
Dividend Yield (%)	1.3	1.3	1.5	1.7	2.0
Profitability Ratios					
ROE %	15.2	14.0	15.6	22.1	16.1
ROIC %	0.0	0.0	19.8	28.9	28.0
EBITDA %	39.4	36.8	42.9	52.0	54.4
PAT %	55.0	55.5	54.8	74.0	58.8

Source: RHP

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