Research Report on CDSL, JAN 2022 STATUS : BUY

Central Depository Services (India) Limited

Convenient * Dependable * Secure

Central Depository Services (India) Limited (CDSL) is one of the two securities depositories operating in India and the only listed Depository. The company offers dematerialization services for different types of securities. It received the certificate of commencement of business from the Securities and Exchange Board of India (SEBI) in February 1999 and was initially promoted by the BSE Ltd, which thereafter divested its stake to leading private and public sector banks. It facilitates holding and transacting in securities in the electronic form and facilitates settlement of trades executed on stock exchanges. These securities include equities, debentures, bonds, Exchange Traded Funds (ETFs), units of mutual funds, units of Alternate Investment Funds (AIFs), Certificates of deposit (CDs), commercial papers (CPs), Government Securities (G-Secs), Treasury Bills (TBills), etc.

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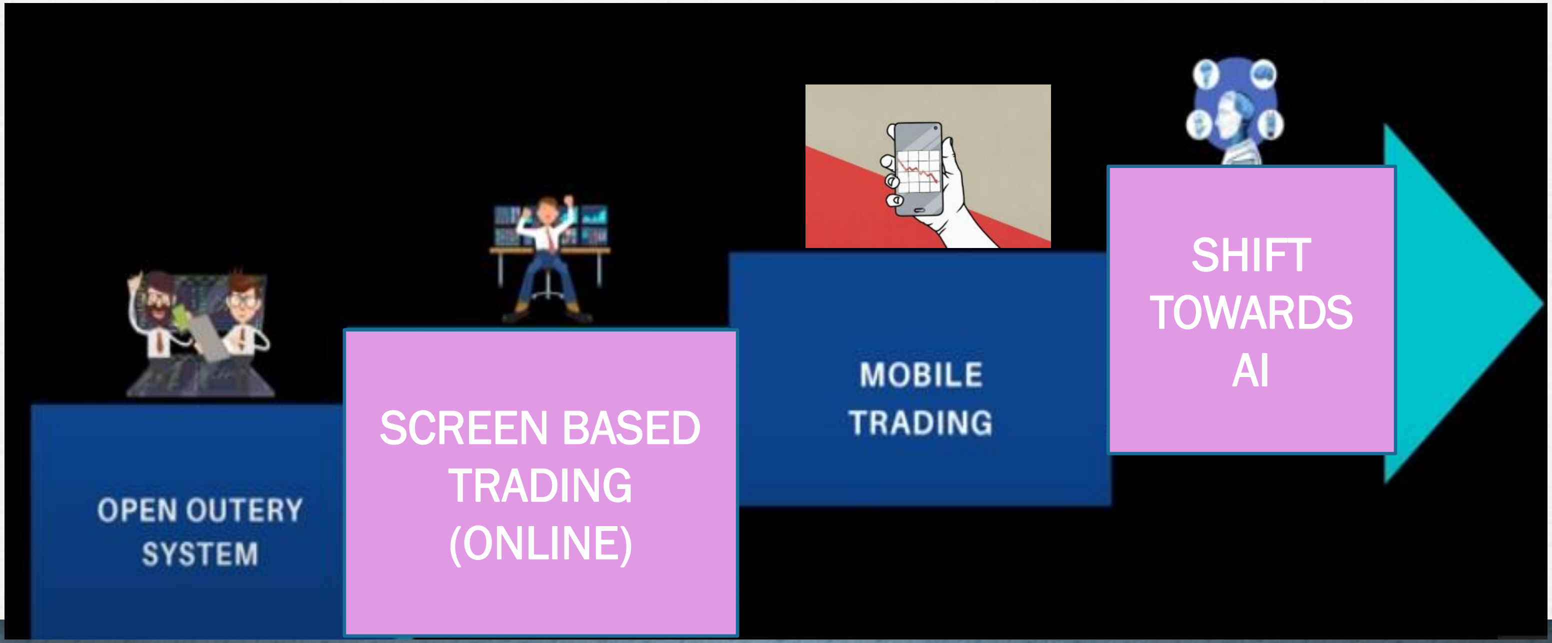
Need for establishment of Depositories in India

With growth in Indian capital market, it became difficult to handle the growing volume of paper. This caused problems like delay in transfers, long settlement period, high levels of failed trade and bad deliveries, high risk exposure etc. To remove these bottlenecks the Depositories Act was legislated in August 1996. Subsequently three years later in 1999, CDSL was established following the implementation of compulsory trading in dematerialized securities for all investors.

Ever wondered what happened if there were no depositories.

Evolution of Indian Broking Industry

To overcome the problem of paper based trading, online trading system established. After the screen based trading system, now mobile trading has also been introduced for the convenience of investors and traders. CDSL was listed on June 30, 2017 on the National Stock Exchange (NSE) through Initial Public Offer (IPO) and thereafter became the first and the only depository to get listed in Asia-Pacific region and second in the World



What does a Depository do?

Depository is a type of institution that holds securities (Shares, bonds, debentures etc.) in an electronic form (in financial terms, it is known as dematerialized form or Demat Account). The work of a depository is similar to a bank. Just as a bank holds money on behalf of its depositors, a depository holds shares and other securities on behalf of its investors. However, unlike bank accounts, an investor cannot open his Demat account directly with the Depository; rather, he needs to go through an intermediary known as depository participants.

Depository Participants (DPs): More popularly known as stockbrokers, DPs are an intermediary between the Depository and the investors. So an investor is a member or client of a Depository participant (when they open a Demat account), whereas a Depository participant is a member of a Depository. Basically, brokers offer a platform for the transaction, but securities are held by Depository in Demat form.


DEPOSITORY
DEPOSITORY PARTICPANT
BENEFICIARY OWNERS
CDSL
NSDL
PEE AAR SECURITIES LTD.
Retail Investors

Revenue Sources

Annual issuer charges:- Every issuer (Listed securities) is required to pay an annual fee to the depositor, which is decided by the market regulator, SEBI and remains the same for both depositories. Currently, it is levied at the rate of Rs. 11 per folio (ISIN position) subject to the Nominal Value of Securities admitted (Paid-up capital).

Transaction Charges:- As mentioned earlier, investors' holdings are kept by the Depository, but the transaction is carried through the broker/DP. For any transaction done by an investor, the broker has to pay a fixed amount to CDSL for the transaction settlement.

Online data charges:- The company is also engaged in KYC services through its subsidiary CDSL Ventures Ltd (CVL). CVL is the largest KYC Registration Agency (KRA) in India, with 60% of the market. The primary revenue in the segment includes one time charges for KYC creation and additional charges for data fetching

IPO & corporate action charges:- The company also facilitates crediting of securities for initial public offerings and other corporate actions, such as share splits and consolidation, as well as payment of dividends. For these services, CDSL charges a fixed amount to the issuer company based on the number of folios.

Other segments:- Besides the above category, the company also earns through account maintenance charges, E-voting charges, ECAS charges and other operating revenues.

The major part of the revenue, around 34%, comes from Annual issuer charges, which is a kind of stable revenue stream. The transactional charges, which are the 2nd biggest contributor, is quite cyclical in nature as the income on this dependent on the transactional volume.

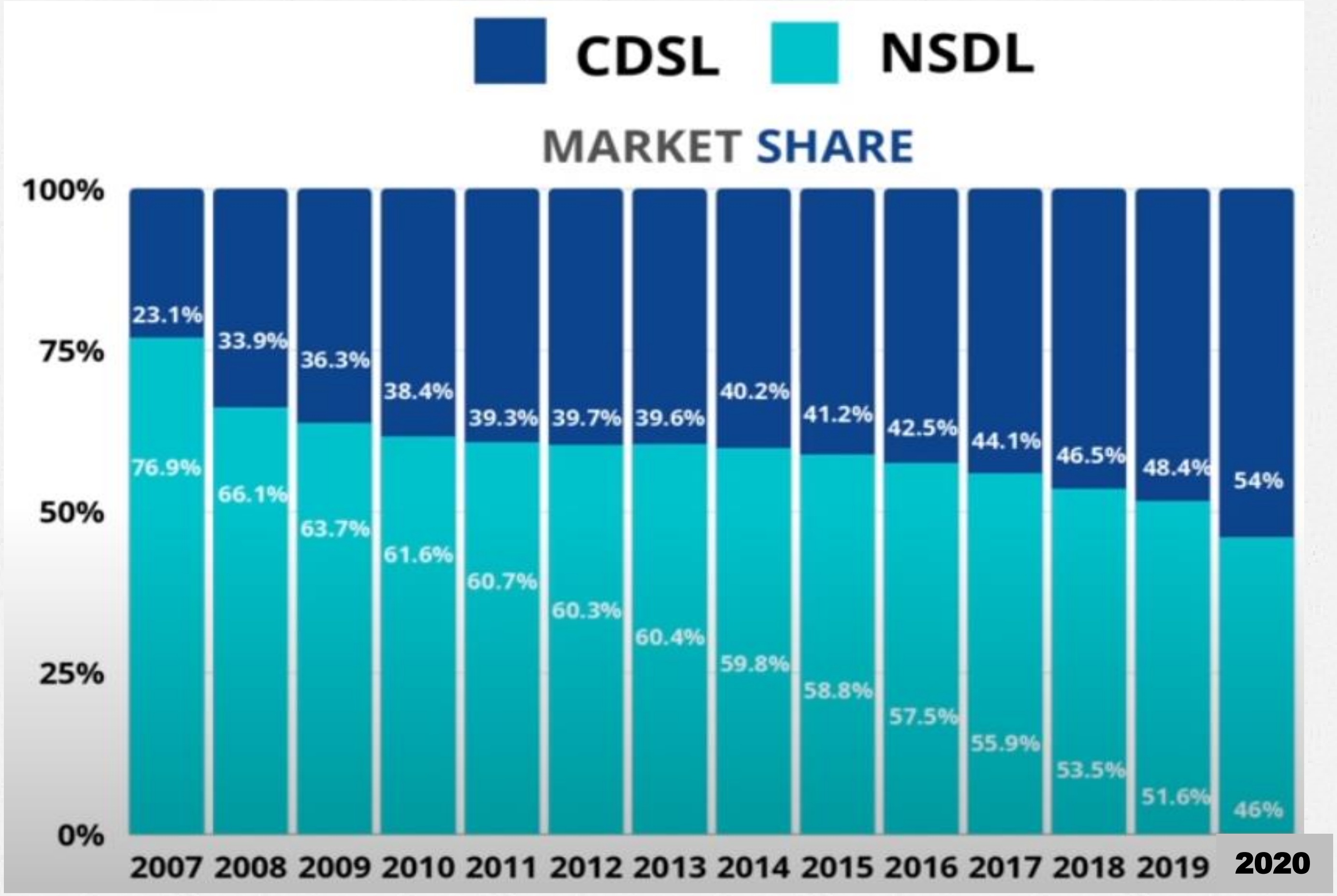
CDSL Subsidiaries

- **CDSL Ventures Limited (CVL) :** CVL is registered with Securities Exchange Board of India, UIDAI and Goods and Services Tax Network. It is the first KYC registration agency registered with SEBI as a Registrar and transfer agent to provide various services to corporates. CVL is registered as GST Suvidha Provider with GSTN.
- **CDSL Insurance Repository Limited (CIRL) :** CIRL is regulated by insurance Regulatory and Development Authority of India and is in the business of enabling policy holders to hold life policies, motor policies, health policies and all other types of general (non-life) policies. The subsidiaries has arrangements with several life insurance companies, health insurance companies and general insurance companies for holding policies in electronic form. The arrangement enables policy holders to hold, centrally manage the e-insurance account and monitor insurance policies with ease.

- **CDSL Commodity Repository Limited (CCRL) :** CCRL is regulated by the Warehousing Development and Regulatory Authority(WDRA) and is in the business of holding and transacting in electronic negotiable warehouse receipts (eNWR). The arrangement enables farmers, Farmer Producer Organizations (FPOs), etc. to hold commodities in eNWR form as against holding it in the form of a physical storage receipts. This also allows Banks/ Non-Banking Financial Institutions (NBFs) to pledge, depledge or invoke eNWRs and control the eNWRs more effectively, cut down their risk of funding against duplicate/fake warehouse receipts and thereby realize their income at a lesser risk due to clearer title on the eWNRs.

Peer Comparison

CDSL vs. NSDL



Reasons for increasing market share of CDSL

- CDSL has a centralized server model that requires no upfront investment vs setting up on-premise servers to connect to NSDL.
- CDSL focuses on retail DPs, particularly discounted brokers
- Deposit requirement for CDSL is 50 lakhs, half of NSDL's requirement of Rs 1 crore.
- The minimum net requirement for starting a DP account with CDSL is Rs. 2 crores vs Rs 3 crores for NSDL. The cost of setting up a
- DP account with CDSL is more attractive than that with NSDL.
- CDSL offers a tariff based on slab system vs Fixed rate structure for NSDL.

Competitive Advantages

- **Operates in a duopoly market:-** Depository business in India operates under a duopoly structure with 2 leading players NSDL and CDSL. CDSL enjoys a market-leading position with a 58% market share. Additionally, the business operates in a highly regulated environment with a strong entry barrier coupled with decent growth prospects.
- **License Cost :-** As per the regulations of SEBI, a company needs to have net worth of 100 crores to obtain a license to open depository. This acts as an entry barrier for a new company to enter the market.
- **Network effect:-** Another great moat that discourages new players to enter the industry is the Network effect. The company has 589 registered DPs across India and 289.34 lakhs investor account as of Q3 2021. Due to the higher switching charges, DPs prefer to stay with the Depository for a long period, and this offers a stable revenue stream for the depository company and makes it difficult for a new entrant to compete with the existing players.

- **Diversified Revenue stream:-** CDSL, along with its subsidiaries, offers a variety of services to several financial players such as mutual fund houses, securities market, insurance companies. This helps the company earn from multiple sources and remain less vulnerable to market cycles.
- **Asset Light business model:-** The company has an asset-light business model with minimal fixed cost requirement. Due to this, CDSL enjoys a significant degree of **operating leverage** and an excellent operating margin. Thus any rise in income will directly expand the net profit and ROE.
- **Exit Barriers :-** Though SEBI has removed the regulation of entry barriers, any new depository is allowed to be opened on fulfilling the necessary requirements. But no new depository enter because of exit barriers involved.

Increasing Retail Participation

The active participation of retail investors was demonstrated with the increase in the turnover of shares traded in BSE rising from 5.21 lakh crores in FY 2014 to 6.61 lakh crores in FY 2020 at CAGR of 4.05%, while trading on NSE increased from 28.08 lakh crores in FY 2014 to 89.99 lakh crores in FY 2020 at CAGR of 21.42%.

Moreover the share of client participation in capital market at NSE has risen to 45% in year 2021 as compared to 33% in 2016. This acts as a structual growth in Indian capital markets.

Why we like CDSL share

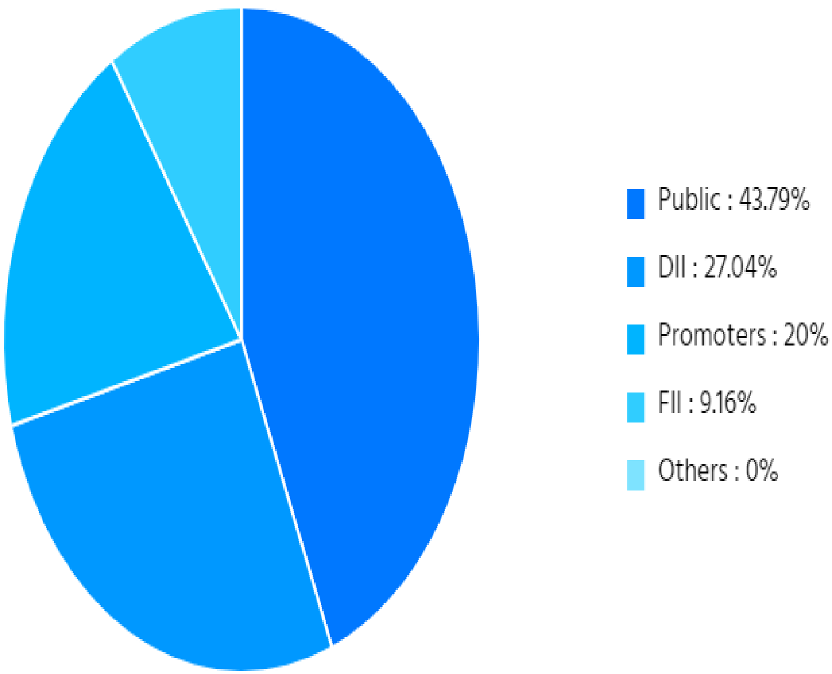
Steady growth & Room for growth: - The company's total active BO (Beneficial Owner) accounts have grown at a CAGR of 19% from 1.08 crore in FY 2015-16 to 2.12 crore in FY 2019-20. Though the industry has grown tremendously in the last few years, the Indian capital market is still highly underpenetrated in terms of equity participation, and there is significant room for growth.

Business execution:- Despite being a late entrant in the depository market, CDSL has outgrown its competitor NSDL with its unique business strategy. CDSL focuses on retail DPs, particularly discounted brokers, and with its relatively low fee structure and relaxed registration requirements, it has become India's largest Depository in terms of DP accounts.

Risks involved

- **Cyclical revenue streams:-** Transactional charges and IPO charges which together contribute 29% to the revenue, are market-linked in nature. These income are dependent on stock market performance, and the downfall in market level may bring volatility in the total revenue.
- **Regulatory hurdles:-** The charges for some of the services like annual issuer charges are controlled by SEBI, and thus the company does not enjoy any pricing power on the same. The e-KYC segment is also exposed to the risk of changes in government policies.
- **Competition from NSDL:-** CDSL needs to maintain its current market share. It can even expand the market share further. It can attract more depositary participants and should keep an eye on the competitor i.e. NSDL.

Share Holding Pattern



Promoter Pledging %

DATE	PROMOTER %
Dec 2021	20
Sep 2021	20
Jun 2021	20
Mar 2021	20
Dec 2020	20

PARTICULARS	DEC 2020 %	MAR 2021 %	JUN 2021 %	SEP 2021 %	DEC 2021 %
Promoters	**20.00**	**20.00**	**20.00**	**20.00**	**20.00**
Bse Limited	20.00	20.00	20.00	20.00	20.00

CONSOLIDATED BALANCE SHEET AS AT MARCH 31, 2021

(₹ in Lakh)

Particulars	Note No.	As at 31.03.2021	As at 31.03.2020
ASSETS			
1 Non-current assets			
a. Property, plant and equipment	3	6,808.60	7,114.25
b. Capital work in progress	3	1,005.63	-
c. Intangible assets	3	508.33	283.33
d. Intangible asset under development	3	1,272.67	-
e. Right-of-use assets	3	26.31	37.39
f. Financial Assets			
i. Investments	4	16,652.18	27,337.71
ii. Loans	5	5.46	12.20
iii. Other financial assets	6	339.24	1,990.54
g. Deferred tax assets (net)	7	2.29	99.62
h. Non current tax assets	8	1,058.93	924.66
i. Other assets	9	177.87	158.15
Total Non-Current Assets		**27,857.51**	**37,957.85**
2 Current assets			
a. Financial Assets			
i. Investments	4	54,290.26	39,120.97
ii. Trade receivables	10	2,374.35	2,602.62
iii. Cash and cash equivalents	11	4,188.78	371.73
iv. Bank balances other than (iii) above	11	16,579.59	4,998.15
v. Loans	5	7.71	11.03
vi. Other financial assets	6	1,840.88	479.15
b. Other assets	9	1,260.82	790.75
Total Current Assets		**80,542.39**	**48,374.40**
Total Assets (1+2)		**108,399.90**	**86,332.25**

EQUITY AND LIABILITIES			
1 Equity			
a. Equity Share capital	12	10,450.00	10,450.00
b. Other Equity	13	77,272.11	61,949.46
Equity attributable to owners of the Company		**87,722.11**	**72,399.46**
Non-controlling Interests		4,278.34	4,185.23
Total Equity		**92,000.45**	**76,584.69**
LIABILITIES			
2 Non-current liabilities			
a. Financial Liabilities			
Other financial liabilities	14	153.63	116.88
b. Deferred tax liabilities (Net)	7	228.61	204.10
c. Other liabilities	17	-	0.09
d. Provisions	16	103.63	272.68
Total Non-Current Liabilities		**485.87**	**593.75**
3 Current liabilities			
a. Financial Liabilities			
i. Trade payables	15		
Total outstanding dues of micro enterprises and small enterprises		-	55.65
Total outstanding dues of creditors other than micro enterprises and small enterprises		1,269.89	1,150.55
ii. Other financial liabilities	14	10,071.12	4,466.30
b. Provisions	17	1,546.98	1,627.76
c. Current tax liabilities	8	296.57	261.91
d. Other liabilities	16	2,729.02	1,591.64
Total Current Liabilities		**15,913.58**	**9,153.81**
Total Equity and Liabilities (1+2+3)		**108,399.90**	**86,332.25**

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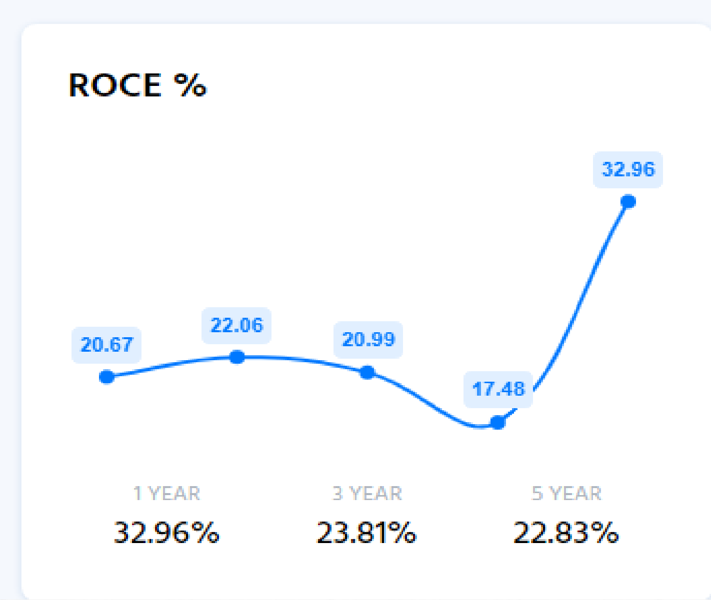
Balance sheet analysis



Though the return ratios of the company are volatile in comparison to the other NBFC, it appears to be quite high. The hefty cash and investments in the books have weighed down the return ratios, but due to regulatory requirements, CDSL is required to carry these liquid assets.

The Company is almost debt free and has good cash reserves.

CONSOLIDATED STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDED MARCH 31, 2021

(₹ in Lakh)

	Particulars	Note No.	For the year ended 31.03.2021	For the year ended 31.03.2020
1	**Revenue From Operations**	18	34,371.71	22,510.53
2	**Other Income**	19	5,691.58	5,914.58
3	**Total Income (1+2)**		**40,063.29**	**28,425.11**
4	**Expenses**			
	Employee benefits expense	20	4,133.33	4,729.34
	Depreciation and amortisation expense	21	920.05	1,173.24
	Finance Cost	25	2.30	2.94
	Impairment loss on financial assets	22	967.88	749.65
	Other expenses	23	8,087.39	7,069.07
	Settlement of Service Tax Matter	30	-	1,056.09
	Total expenses		**14,110.95**	**14,780.33**
5	**Profit before tax (3-4)**		**25,952.34**	**13,644.78**
6	**Tax expense:**	23.2		
	Current tax		5,693.30	2,709.00
	Prior period tax adjustment		-	-62.70
	Deferred tax		132.31	326.66
	Tax expense		**5,825.61**	**2,972.96**

7	**Profit for the year (5-6)**		**20,126.73**	**10,671.82**
	Attributable to			
	Owners of the Company		20,034.05	10,615.53
	Non-controlling Interests		92.68	56.29
8	**Other Comprehensive Income**			
	Items that will not be reclassified to profit or loss			
	i. Remeasurements of the defined benefit plans;		-11.89	11.94
	ii. Income tax relating to items that will not be reclassified to profit or loss		2.99	-2.97
	Total other comprehensive income / (loss) (net of tax) (i+ii)		**-8.90**	**8.97**
9	**Total Comprehensive Income for the year (7+8)**		**20,117.83**	**10,680.79**
	Attributable to			
	Owners of the Company		20,024.72	10,624.69
	Non-controlling Interests		93.11	56.10
10	**Earnings per equity share (EPS) :**			
	Basic and Diluted EPS (₹)	24	19.17	10.16
	Face value of share (₹)		10.00	10.00
	Weighted average number of shares		10,45,00,000	10,45,00,000

Profit & Loss analysis

Compounded Sales Growth	
10 Years:	14%
5 Years:	23%
3 Years:	22%
TTM:	69%

Compounded Profit Growth	
10 Years:	15%
5 Years:	24%
3 Years:	25%
TTM:	77%

Stock Price CAGR	
10 Years:	%
5 Years:	%
3 Years:	90%
1 Year:	211%

Return on Equity	
10 Years:	17%
5 Years:	19%
3 Years:	20%
Last Year:	25%

CDSL has been consistently growing both in terms of revenue and profit. The revenue has grown at a CAGR of 22% and 23% in the last 3 and 5 Years period. The company requires low incremental Capital expense and low Operating expense, thus the bottom line grew at a higher rate on the back of increasing operating leverage.

Cash Flow Statement

(₹ in Lakh)

PARTICULARS	For the year ended 31.03.2021	For the year ended 31.03.2020
A. CASH FLOW FROM OPERATING ACTIVITIES		
Profit before tax	**25,952.34**	**13,644.78**
Adjustments for		
Depreciation and Amortisation expense	920.05	1,173.24
Gain on sale / disposal of Property, plant and equipment and Intangible assets (Net)	-	(15.28)
Provision for gratuity and compensated absences	(400.23)	497.28
Amortisation of premium on Bonds	18.17	16.99
Interest cost	2.30	2.94
Interest income recognised on fixed deposit and bonds in profit or loss	(1,705.85)	(1,388.43)
Net gain arising on financial assets measured at FVTPL	(3,821.77)	(4,177.37)
Impairment loss on financial assets	967.88	749.65
Operating cash flow before working capital changes	**21,932.89**	**10,503.80**
Movements in working capital		
(Increase) / Decrease in trade receivables	(741.28)	(1,438.63)
(Increase) / Decrease in loans and other financial assets	(480.48)	(142.53)
(Increase) / Decrease in other assets	(1,362.69)	(8.81)
Increase / (Decrease) in trade payables	63.69	857.39
Increase / (Decrease) in provisions	150.40	434.31
(Decrease) / Increase in other financial liabilities and other liabilities	5,486.79	412.57
Cash Generated from operations	**25,049.32**	**10,618.10**
Direct taxes paid (net of refunds)	(5,792.91)	(2,400.96)
Net Cash generated from operating Activities	**19,256.41**	**8,217.14**

B.	**CASH FLOW FROM INVESTING ACTIVITIES**		
	Purchase of property, plant and equipment and capital advances	(919.11)	(582.59)
	Purchase of intangible assets	(888.74)	(423.88)
	Proceeds from sale of property, plant and equipment	5.69	80.77
	Proceeds from sale of intangible assets	-	-
	Purchase of investments	(34,791.33)	(15,124.29)
	Proceeds from sale of investments	34,112.07	12,151.18
	Investments in fixed deposits with banks	(13,325.11)	(5,617.36)
	Proceeds from maturity of fixed deposits with banks	3,867.76	4,917.14
	Interest received	1,215.86	1,333.45
	Net cash generated from investing activities	**(10,722.91)**	**(3,265.58)**
C.	**CASH FLOW FROM FINANCING ACTIVITIES**		
	Dividend and taxes paid thereon	(4,702.50)	(5,039.35)
	Payment of lease rental	(13.95)	(14.42)
	Net cash used in financing activities	**(4,716.45)**	**(5,053.77)**
	Net increase in cash and cash equivalents (A+B+C)	**3,817.05**	**(102.21)**
	Cash and cash equivalents at the beginning of the year	371.73	473.94
	Cash and cash equivalents at the end of the period	**4,188.78**	**371.73**
	Cash and cash equivalents at the end of the year comprises		
	i) Cash on hand	-	0.71
	ii) Balances with banks		
	- In unpaid dividend account (Refer note 2 below)	34.26	16.42
	- In current account (Earmarked against liability) (Refer note 2 below)	538.09	33.27
	- In Current Accounts	3,616.43	321.33

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KEY RATIO ANALYSIS

- **Profitability ratios:** Profit margin (PAT margin) of the company shows how well a company controls its cost. It is one of the important indicators to show the financial health of the company. Net profit of the company is Rs **200** Cr and the compounded growth of profit in the past 3 years is **25** %.
- **EPS growth:** Investors should ensure the EPS figure is growing faster than revenue numbers because it indicates company management is increasing the efficiency with which it runs the company. In Central Dep. Service , the EPS **is Rs. 19.17** which is growing at a good rate.
- **Return on capital employed:** The Company has a **healthy** ROE track record. The ROCE of CDSL is at **32 %** for the latest year.
- **Return on Equity (ROE):** The Company has a **healthy** ROE track record. The ROE of CDSL is at **25** % for the latest year.

- **P/E Ratio:** Relative valuation metrics like the P/E ratio can be used to see if the stock of Central Dep. Service is worth at the current levels at Rs **1,498.80**. The stock is trading at a current P/E ratio of **61.4**
- **Debtor days** Debtor days have improved from 35.03 to 25.21 days.
- **Dividend payout** Company has been maintaining a healthy dividend payout of 42.69%
- **Cash Conversion Cycle** The company's cash conversion cycle has reduced from 44 days to 25 days which is a good sign.

Conclusion

- The equity investment in India has a very low penetration of 2-3%, whereas, in developed nations such as the USA, the ratio stands at 45%. With the growing financial literacy and the relative outperformance of Equity instruments over other asset classes, the share of equity investments as proportions to total household savings & investments is expected to rise.
- One more growth trigger for the company is the recent MCA guidelines which makes it compulsory for the unlisted companies to dematerialize their shares before any transfer or corporate action. Out of 80,000 unlisted companies, around 11,000 have been admitted for dematerialization till now. The company's duopoly business structure, repeat business in several offerings, and robust financials makes it a no brainer stock. However, regulatory factors and competition from the equally strong player, NSDL, may create a risk to the company's future growth.

Therefore we recommend to buy CDSL share now and hold for long term