

September 22, 2022

Sharekhan Limited: Rating reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial paper programme	1,500.0	2,500.0	[ICRA]A1+; assigned and reaffirmed
Total	1,500.0	2,500.0	

*Instrument details are provided in Annexure I

Rationale

While arriving at the rating, ICRA has taken a consolidated view of Sharekhan Limited (SKL) and its subsidiaries (hereon referred to as the SKL Group). The rating factors in SKL's strong parentage by virtue of being a part of the BNP Paribas Group (BNP Paribas SA (BNPP), rated Aa3/Stable/P-1 by Moody's, is SKL's ultimate parent) and its strategic importance to the parent. The rating also considers SKL's considerable track record in the equity broking business and its well-established position in retail broking and capital market related lending activities. The rating factors in the SKL Group's adequate financial profile with comfortable capitalisation.

While assigning and reaffirming the rating, ICRA has factored in SKL's high dependence on broking income, which remains susceptible to the extent of competition in the industry and the inherent volatility associated with capital markets. The Group's consolidated gearing increased in the last two fiscals, given the focus on growing the lending business {margin trade facility (MTF) book under SKL and capital market-based lending under Sharekhan BNP Paribas Financial Services Limited (SBPFSL)} and the increase in the margin placed at the exchanges. Also, the Group made a hefty dividend payout in FY2021. Nevertheless, its capitalisation level remains comfortable. As of June 30, 2022, SKL's consolidated net worth was estimated at ~Rs. 1,650 crore and the consolidated gearing stood at 1.2 times.

The rating also considers the credit and market risks associated with the margin trading and capital market related lending businesses, given the nature of the underlying assets. Going forward, the Group's ability to scale up its lending business while maintaining adequate asset quality and capitalisation will remain imperative. Further, SKL's ability to seamlessly align with the evolving regulatory landscape, scale up the broking volume and maintain adequate profitability will be a monitorable. The rating also factors in SKL's foray into the discount broking segment, though the impact of discount broking on the consolidated financials remains nominal at present. The discount broking entity is expected to take a few years to scale up and break even.

Key rating drivers and their description

Credit strengths

Strong parentage with strategic importance to parent – SKL is a wholly-owned subsidiary of BNPP. BNPP acquired a 100% stake in the company in FY2017 with the objective of entering the retail broking and allied lending business in India. BNPP has significant representation on SKL's board of directors. As of September 2022, the company had a ten-member board with six representatives from BNPP, including two Whole-time Directors who ensure that SKL's operations are aligned with the parent's operations and policies. Moreover, certain management functions (such as risk and treasury) of SKL report directly to BNPP. The ownership structure and co-branding¹, along with BNPP's regular supervision and control over the subsidiaries' activities, strengthen ICRA's assumption that SKL and SBPFSL will receive adequate support from the parent.

¹ SKL's logo and signage include 'By BNP Paribas' while SBPFSL shares its name with the parent

Long track record in capital market related businesses and established position in retail broking – SKL has experience of over two decades in the equity broking space and is among the largest retail broking houses in the domestic broking landscape. It has a wide geographical presence with 3,420 franchisees and 137 branches as on June 30, 2022. It is a full-service stockbroking company, primarily engaged in the retail equity broking segment. In FY2022, SKL reported an average daily turnover of ~Rs. 49,400 crore (~Rs. 27,000 crore in FY2021), which improved further to ~Rs. 58,000 crore in Q1 FY2023. Its market share (in terms of broking volumes) was 0.54% in Q1 FY2023. Apart from broking, SKL along with its subsidiary, SBPFSL, is engaged in various capital market related activities such as margin financing, loan against shares (LAS), initial public offering (IPO) financing, employee stock ownership plan (ESOP) financing, commodities trading, portfolio management services and mutual fund distribution.

Adequate financial profile with comfortable capitalisation – The SKL Group registered a healthy growth in revenues in FY2021 and FY2022 and reported its highest-ever profit after tax (PAT) of Rs. 264 crore in FY2022 (Rs. 214 crore in FY2021 and Rs. 101 crore in FY2020). ICRA notes that geopolitical tensions and the adverse macroeconomic trajectory dampened investor sentiment in Q1 FY2023, especially in the high-yielding cash segment, and the Group's PAT (in absolute terms) moderated during this period. Nevertheless, the profitability remains adequate with PAT/net operating income of 18.3% in Q1 FY2023 compared to 21.5% in FY2022 and 20.5% in FY2021. As on June 30, 2022, SKL's consolidated capitalisation profile remained comfortable with an estimated net worth of ~Rs. 1,650 crore and a gearing of 1.2 times. Going forward, while the incremental growth will be debt-funded and the leverage is expected to increase further, the capitalisation profile is expected to remain comfortable.

Credit challenges

High dependence on equity broking for revenue – The equity broking segment remains the Group's primary revenue driver, accounting for ~70% of the consolidated net operating income. Furthermore, SKL is predominantly a retail broking player with a negligible presence in the institutional broking and other capital market segments. The Group started to focus actively on its lending business, which was primarily housed under SBPFSL, from FY2018 with plans of foraying into retail lending. SBPFSL subsequently realigned its strategy to focus on capital market related lending products like margin funding, LAS, IPO finance and ESOP funding. The Group's lending business witnessed growth in recent years, notwithstanding intermittent declines, with the consolidated loan book increasing to ~Rs. 1,900 crore as on June 30, 2022 from Rs. 700-800 crore prior to FY2021.

Given the focus on MTF and other lending products, net interest income is likely to grow over the medium term. However, with most of its revenues being linked to the inherently volatile capital markets, SKL's revenue profile and profitability remain vulnerable to market performance. Its ability to seamlessly align with the evolving regulatory landscape and diversify its revenue stream, thus providing stability to its profitability, will remain imperative.

Exposed to risks inherent in capital market related businesses – SKL's earnings profile remains dependent on capital markets, which are inherently volatile in nature. Further, its MTF and LAS books pose asset quality risk in case of a sharp correction in the market. SKL remains exposed to credit and market risks, given the nature of the underlying assets, as any adverse event in the capital markets could erode the value of the underlying collateral stocks. However, the company's monitoring and risk management processes and the adequate performance of this business provide comfort.

Highly fragmented and competitive industry – With the increasing competition in the broking segment, especially from the discount broking segment, SKL's market share in terms of broking volumes moderated to 0.5% in June 2022 from 1.5% in FY2018. With the competitive intensity in this cyclical industry expected to remain high, pressure on profitability cannot be ruled out, especially during downturns. Nonetheless, the lower level of equity market penetration in the country offers significant untapped potential for growth.

Liquidity position: Adequate

SKL uses non-fund based bank lines of Rs. 915 crore to place margins at the exchanges (average month-end utilisation level for last 12 months was ~81%). Further, as on July 31, 2022, at the standalone level, SKL had an unencumbered cash balance of Rs. 132 crore and unutilised fund-based bank lines of Rs. 153 crore while SBPFSL had an unencumbered cash balance of Rs. 17 crore to meet contingencies. The fund-based bank lines have remained largely unutilised towards the month end. Further, the CP borrowings are largely for the short-term and callable-on-demand nature of the MTF book of ~Rs. 900 crore (under SKL) and the LAS and MTF book of ~Rs. 800 crore (housed under SBPFSL) provides additional comfort.

Rating sensitivities

Positive factors – Not applicable

Negative factors – A material change in SKL's shareholding or in its linkage with the parent and/or a deterioration in the credit profile of the parent could lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology - Broking Rating Methodology – Non-banking Finance Companies (NBFCs) Rating Approach – Implicit Parent or Group Support Rating Approach - Consolidation
Parent/Group support	Part of BNPP Group
Consolidation/Standalone	For arriving at the rating, ICRA has considered the consolidated financials of SKL. As on June 30, 2022, the company had four subsidiaries and two stepdown subsidiaries, which are all enlisted in Annexure II.

About the company

SKL is a security broking service provider registered with the Securities and Exchange Board of India (SEBI). Its main business activity is share broking, primarily in the retail segment, with a small presence in portfolio management services and the distribution of mutual fund products. SKL became a wholly-owned subsidiary of BNPP, a leading bank in Europe, in FY2017.

SKL, which is a member of the Bombay Stock Exchange (BSE), the National Stock Exchange (NSE), the Metropolitan Stock Exchange of India Limited (MSEI) and the Multi Commodity Exchange (MCX), is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL). As on June 30, 2022 SKL's active client base was 7.7 lakh and the broking volumes were largely contributed by the franchises. As on June 30, 2022, the company had 3,420 franchisees and 137 branches.

Key financial indicators (audited)

SKL – Consolidated	FY2021	FY2022	Q1 FY2023 [^]
Brokerage income and other distribution fees	789	949	197
Net interest income	209	272	63
Net operating income (NOI)	1,044	1,231	263
Total operating expenses	752	874	198
Profit before tax	288	357	65
Profit after tax (PAT)	214	264	48
Net worth	1,383	1,601	1,649*
Borrowings	633	1,803	1,932*
Gearing (times)	0.5	1.1	1.2*

Cost-to-income ratio	72.0%	71.0%	75.3%
Return on net worth	13.6%	17.7%	11.9%*
PAT/NOI	20.5%	21.5%	18.3%*

Source: Company, ICRA Research; ^Provisional; *ICRA's estimate; All ratios as per ICRA's calculations; Amount in Rs. crore

SKL – Standalone	FY2021	FY2022	Q1 FY2023^
Brokerage income and other distribution fees	789	916	197
Net interest income	138	186	49
Net operating income (NOI)	1,130	1,111	250
Total operating expenses	694	808	197
Profit before tax	433	303	53
Profit after tax (PAT)	370	225	40
Net worth	1,322	1,501	1,541*
Borrowings	398	1,127	1,263*
Gearing (times)	0.3	0.8	0.8*
Cost-to-income ratio	61.4%	72.7%	78.8%
Return on net worth	25.8%	16.0%	10.4%*
PAT/NOI	32.8%	20.3%	15.8%*

Source: Company, ICRA Research; ^Provisional; *ICRA's estimate; All ratios as per ICRA's calculations; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)					Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Sep 19, 2022 (Rs. crore)	Date & Rating in FY2023	Previous Rating	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					Sep 22, 2022	Apr 26, 2022	Jan 13, 2022	May 20, 2021	Jul 31, 2020	Jul 03, 2019
1	CP programme	Short term	1,000.00	1,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	CP programme	Short term	500.00	278.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-	-
3	CP programme	Short term	1,000.00	0.00	[ICRA]A1+	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Commercial paper	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or

complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate (%)	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE211H14336	Commercial paper	Apr-19-22	5.40	Oct-17-22	100	[ICRA]A1+
INE211H14351	Commercial paper	Apr-28-22	5.07	Sep-22-22	50	[ICRA]A1+
INE211H14369	Commercial paper	Apr-29-22	5.30	Oct-31-22	75	[ICRA]A1+
INE211H14385	Commercial paper	Jun-24-22	5.87	Sep-23-22	250	[ICRA]A1+
INE211H14393	Commercial paper	Jul-19-22	5.88	Oct-18-22	100	[ICRA]A1+
INE211H14401	Commercial paper	Jul-22-22	5.88	Oct-21-22	150	[ICRA]A1+
INE211H14369	Commercial paper	Aug-01-22	6.42	Oct-31-22	200	[ICRA]A1+
INE211H14419	Commercial paper	Aug-24-22	6.65	Mar-07-23	3	[ICRA]A1+
INE211H14427	Commercial paper	Sep-13-22	6.45	Dec-13-22	350	[ICRA]A1+
NA	Commercial paper (yet to be placed)	-	-	7-365 days	1,222	[ICRA]A1+

Source: Company

Annexure II: List of entities considered for consolidated analysis

	SKL Ownership	Consolidation Approach
Sharekhan Limited	Rated Entity	Full Consolidation
Sharekhan BNP Paribas Financial Services Limited	100%	Full Consolidation
Sharekhan Commodities Private Limited	100%	Full Consolidation
Wealthtiger Investment Advisors Private Limited	100%	Full Consolidation
Sharekhan Consultants Private Limited	100%	Full Consolidation
Sharekhan.com India Private Limited	100%	Full Consolidation
Espresso Financial Services Private Limited	100%	Full consolidation

Source: Company

Note: ICRA has taken a consolidated view of the parent (SKL) and its subsidiaries/stepdown subsidiaries while assigning the rating

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Branches



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