

February 03, 2023

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	2,500.0	3,500.0	[ICRA]A1+; assigned and reaffirmed
Total	2,500.0	3,500.0	

*Instrument details are provided in Annexure I

Rationale

ICRA has taken a consolidated view of Sharekhan Limited (SKL) and its subsidiaries, including Sharekhan BNP Paribas Financial Services Limited (SBPFSL), hereafter referred to as the Sharekhan Group or the Group.

The rating continues to factor 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 takes into account in SKL's considerable track record in the equity broking business, its well-established position in the retail broking and capital market related lending activities, and its adequate financial profile with comfortable capitalisation.

While assigning and reaffirming the rating, ICRA takes note of 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 leverage 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 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 September 30, 2022, SKL's consolidated net worth was estimated at Rs. 1,650 crore and the consolidated gearing was estimated at 1.4 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 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.

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. It has significant representation on SKL's board of directors; as of January 2023, the company had a nine-member board with five 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. 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. SKL registered a ~33% increase in its average daily turnover (ADTO) in the futures & options (F&O) segment in H1 FY2023, though the cash ADTO declined by 25%. 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; however, NIMs under pressure due to rising borrowing cost – The 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 macro-economic outlook dampened investor sentiments in the current fiscal and this was reflected in the moderation in capital market activity, especially in the cash segment, and the rising interest cost. Correspondingly, SKL reported a moderation in its financial performance in H1 FY2023 with its PAT/net operating income ratio declining to 16.9% in H1 FY2023 from 21.5% in FY2022, while the return on equity (RoE) is estimated to have moderated to 11.4% in H1 FY2023 from 17.7% in FY2022 (13.6% in FY2021). Nonetheless, as of September 30, 2022, SKL's consolidated capitalisation profile remained comfortable with an estimated net worth of Rs. 1,650 crore and a gearing of 1.4 times. ICRA notes that incremental growth in the business will be debt-funded. This, coupled with rising working capital requirements, is expected to lead to an increase in the leverage.

Credit challenges

High dependence on equity broking for revenue – The equity broking segment remains the Group's primary revenue driver, accounting for 60-70% 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 FY2021 and FY2022 (amid favourable domestic capital market activity, notwithstanding intermittent declines) with the consolidated loan book increasing to ~Rs. 2,000 crore as of March 31, 2022 from Rs. 700-800 crore prior to FY2021. The consolidated loan book has, thereafter, remained tepid in the current fiscal. 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's liquidity position remains adequate, supported by on-balance sheet liquidity and undrawn bank lines. As of December 31, 2022, compared to consolidated borrowings of about Rs. 2,350 crore, SKL (standalone level) had unencumbered cash & equivalents of Rs. 502 crore and unutilised fund-based bank lines of Rs. 153 crore, while SBPFSL had unencumbered cash & equivalents of Rs. 174 crore. The fund-based bank lines remained largely unutilised towards the end of the month. Additionally, the company's short-term loan assets, which can be liquidated at short notice to generate liquidity if required, stood at ~Rs. 1,850 crore [MTF book of ~Rs. 1,050 crore (under SKL) and LAS book of ~Rs. 700 crore (housed under SBPFSL)]. The Group also enjoys financial flexibility, given the parentage, and the same is evident from the demonstrated track record of raising funds from money markets and the competitive borrowing cost.

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 December 31, 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 September 30, 2022, SKL's active client base was 7.8 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
Brokerage income and other distribution fees	789	949
Net interest income	209	272
Net operating income (NOI)	1,044	1,231
Total operating expenses	752	874
Profit before tax	288	357
Profit after tax (PAT)	214	264
Net worth	1,383	1,601
Borrowings	633	1,803
Gearing (times)	0.5	1.1
Cost-to-income ratio	72.0%	71.0%

SKL – Consolidated	FY2021	FY2022
Return on net worth	13.6%	17.7%
PAT/NOI	20.5%	21.5%

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

SKL – Standalone	FY2021	FY2022	H1 FY2023 [^]
Brokerage income and other distribution fees	789	916	413
Net interest income	138	186	99
Net operating income (NOI)	1,130	1,111	545*
Total operating expenses	694	808	413
Profit before tax	433	303	131
Profit after tax (PAT)	370	225	101
Net worth	1,322	1,501	1,552
Borrowings	398	1,127	1,73
Gearing (times)	0.3	0.8	1.1
Cost-to-income ratio	61.4%	72.7%	75.8%
Return on net worth	25.8%	16.0%	13.2%
PAT/NOI	32.8%	20.3%	1.5%

Source: Company, ICRA Research; [^]Provisional; *Includes dividend from subsidiary of Rs. 25 crore; 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 Jan 24, 2023 (Rs. crore)	Current Rating	Previous Rating		Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
						Feb 3, 2023	Sep 22, 2022	Apr 26, 2022	Jan 13, 2022		
1	CP programme	Short term	1,000.00	1,000.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	CP programme	Short term	500.00	500.0	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-	-
3	CP programme	Short term	1,000.00	998.0	[ICRA]A1+	[ICRA]A1+	-	-	-	-	-
4	CP programme	Short term	1,000.00	0.0	[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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate (%)	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE211H14419	Commercial paper	Aug 24, 2022	6.65	Mar 07, 2023	3	[ICRA]A1+
INE211H14450	Commercial paper	Nov 15, 2022	7.47	Feb 14, 2023	150	[ICRA]A1+
INE211H14468	Commercial paper	Nov 30, 2022	7.39	Mar 01, 2023	400	[ICRA]A1+
INE211H14476	Commercial paper	Dec 02, 2022	7.30	Mar 03, 2023	25	[ICRA]A1+
INE211H14484	Commercial paper	Dec 12, 2022	8.57	Dec 12, 2023	175	[ICRA]A1+
INE211H14492	Commercial paper	Dec 13, 2022	7.39	Feb 28, 2023	400	[ICRA]A1+
INE211H14500	Commercial paper	Dec 14, 2022	8.57	Dec 14, 2023	50	[ICRA]A1+
INE211H14518	Commercial paper	Jan 05, 2023	7.95	Jun 12, 2023	175	[ICRA]A1+
INE211H14526	Commercial paper	Jan 05, 2023	7.95	Jun 13, 2023	175	[ICRA]A1+
INE211H14534	Commercial paper	Jan 16, 2023	8.75	Jan 16, 2024	500	[ICRA]A1+
INE211H14559	Commercial paper	Jan 18, 2023	7.87	Apr 19, 2023	250	[ICRA]A1+
INE211H14542	Commercial paper	Jan 18, 2023	8.75	Jan 18, 2024	50	[ICRA]A1+
INE211H14567	Commercial paper	Jan 19, 2023	7.87	Apr 20, 2023	145	[ICRA]A1+
NA	Commercial paper*	-	-	7-365 days	1,002	[ICRA]A1+

Source: Company; *Yet to be placed

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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